LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

How Could Our Ancestors Have Been So Wrong?

At the end of World War II, a little more than fifty years ago, interest rates had dropped to a level where long 2¼% U. S. Treasury bonds sold above par. Closer to home, the Omaha Public Power District was formed to take over the Nebraska Power Company. The deal was financed with serial bonds and 30-year term bonds. The coupon on those terms was 2%. At times in the late 40's and early 50's interest rates dropped below this level and those 2's sold at premiums. Stocks were in such disrepute that in some states public pension funds, by law, could not buy them. But stocks were cheap. They paid 6–7% cash dividends and sold at 7–9 times earnings. Even at these price levels they were considered too risky. Consensus was another depression would soon arrive. So sincere, thoughtful, worldly trustees bought bonds, not stocks, for their charges. How could they have been so wrong?

Careful! We're talking about our fathers and grandfathers—our genetic forebearers. Still, how could they have been so wrong?

Perhaps the answer is that we give greater credence to our own experiences than we do to the dry words of history books or the ramblings of old men. We tend to believe the world is as we have seen it, and will remain so.

Those in the command seats in 1945 were born for the most part in the 1880's through the early 1900's. Their business/economic awareness was gained from 1910 on. They experienced a terrible war and saw the shattering of empires. There was a sharp post-war depression to start off the Twenties, but for the most part the Twenties were boom times. The stock market soared and caught the attention of the leaders to be. So did the 1929 Crash and the Depression that followed. The Dow Jones Index which began in 1896 at 45 reached almost 400 in 1929 and then fell to almost 40 in 1932. Wow!

But there's more. Interest rates peaked around the middle of the Twenties and continued to trend down until well into the Forties. So the person who bought quality bonds (not volatile stocks) learned two lessons: bonds continued to pay interest regularly, and bond prices rose. Stocks, on the other hand, fell in value and many cut or eliminated dividends.

The Thirties did not do much to change that lesson. Times were tough. At one point the unemployment rate rose to 25%. In steel, once a glamour industry, production fell to something less than 20% of capacity. Stocks recovered from their 1932 lows only to experience a disheartening crash in 1937. By the end of the Thirties the world was at war again. But those bonds were still paying interest.

So the generation in the command seats in the late 1940's and early 1950's *knew* bonds were best.

What does the generation now coming into the command seats know? For identification—not as a pejorative—we'll call this generation the Boomers. They *know* inflation is the enemy. They *know* the route to rich retirement is save and buy common stocks. Why? The Boomers have grown up in a relatively prosperous world. Though there have been wars and riots aplenty, there have been no world wars. The Dow Jones that was in the 40's in 1932 is now in sight of 6000. Inflation disgraced those OPPD 2% bonds of February 1, 1977. Not only did they sell at deep discounts for a long time, the 2% they paid was diluted by much higher prices for food and shelter. A fellow named Ibbotson put historical data, starting in 1926, into a computer and *proved* that if you *hold them long enough* stocks always beat bonds or treasury bills. Currently, stocks sell at 16–18 times earnings and pay 1–2% dividends. Bonds pay 6½–7½% but they are risky. Their prices fluctuate wildly and inflation will erode their value.

So all you have to do is save, buy and hold stocks, and retire rich. Is that the way it will work out or will some future generation again ask, "How could our ancestors have been so wrong?"

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