

Too close to the action: Lessons from 1974

As humans, we tend to panic about bad stuff while it's happening to us. We tend to think the bad stuff will last for longer and be more destructive than is usually the case. It's a behavioural error we all make.

Later, we regain perspective and realise the bad stuff wasn't so bad after all.

The coronavirus is bad. Very bad. But we reckon it's not as disastrous as the newspapers or the financial markets think. And once it eases off and China and the world recover, probably in the next few months, people will gradually realise this. More than likely, we'll look back in a few years' time and wonder what all the fuss was about. Events such as the October 1987 stock market crash, the Asian financial crisis and the tragic events of September 2001 are all examples of this.

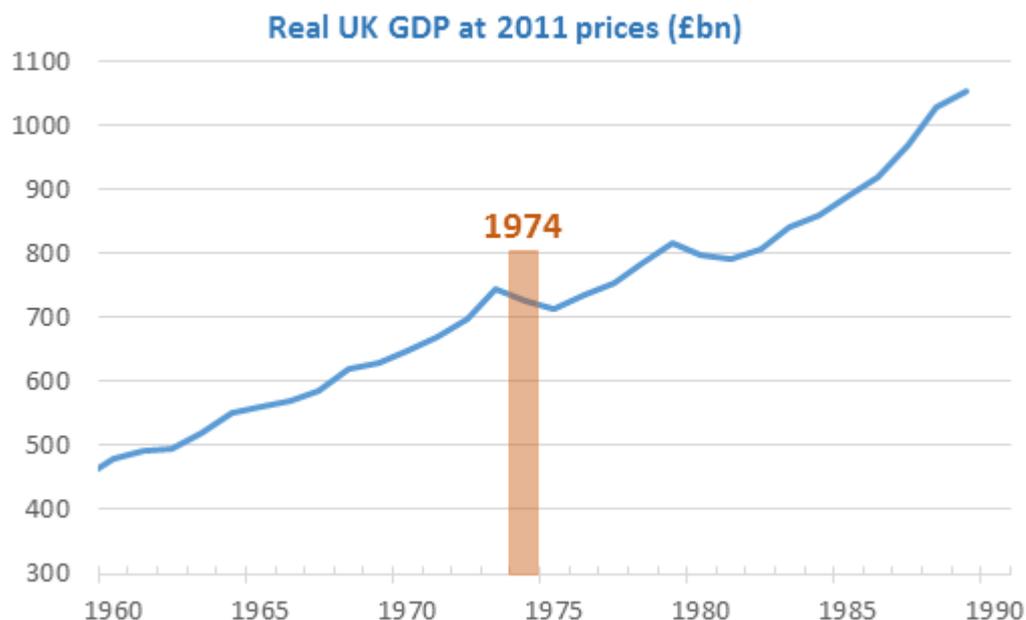
Closer to home, 1974 was another example. For many people in the UK, 1974 felt catastrophic. Just about everything went wrong.

The oil embargo of 1973 led to oil prices quadrupling from \$3 to \$12 per barrel and tipped the UK – along with much of the world – into recession. Inflation soared from 10.6% in December 1973 to a peak of 26.9% (!) in August 1975. The Three-Day Week early in 1974 meant that commercial users of electricity could only use three days of electricity each week. A huge miner's strike began in February 1974.

Politics was a shambles, with general elections in February and October leading to weak and floundering Labour governments.

Many investors thought the UK was a catastrophe. UK equities halved over the year, having already fallen by a quarter in 1973.

Looking back, though, investors were far too close to the bad news and exaggerated it hugely. The UK economy contracted by 2.5% in 1974 – which was painful, but far from disastrous. Viewed from a long-term perspective, the bad news for the UK economy was tiny, as shown in the graph. It was a downward blip in a strong long-term trend.



Investors began to realise this by year-end – and turned positive. UK equities gained 144% in 1975, their best year on record.

Likewise, sooner or later, investors will realise that coronavirus is not a catastrophe for humanity. Markets will recover. The financial world will return to normal.