

The rise in stock prices far beyond the rise of prices in general is, therefore, partly a transitory phenomenon, resulting from a gradual adjustment in the allocation of wealth among various types of assets in response to full employment and inflation. What has happened, in essence, is that share prices have already advanced more closely to their ultimate level than the prices of other securities. Since, even now, according to the best estimates, there are no more than some 12 million shareholders in the United States, it is possible that this transition has not yet come to an end, and that the stock market boom will consequently continue. Like any major price movement, this boom is also to some extent feeding upon itself, though high margins requirements and occasional shakeouts have probably prevented the worst speculative excesses. At the same time, it appears unlikely that yields will fall much below their present, already depressed levels. Any further increase in stock prices must therefore be a result of improved earnings.

THE PATTERN OF YIELDS

IN THE LONG RUN

So far I have discussed, in very general terms, the changes in the pattern of wealth holding that are correlated with inflation. I shall now try to be a little more specific about the way in which this pattern is determined. For this purpose I shall assume, to begin with, that inflation continues at a rate of perhaps 2 percent or 3 percent per year, but does not significantly increase its pace. Furthermore it will be supposed that this rate of inflation is a matter of general knowledge, even though some people may be more concerned to protect themselves against rising prices than others. I also assume that full employment is maintained, and expected to be maintained, except possibly for occasional recessions of the kind which we have had in the postwar period. The latter assumption, as I shall explain in more detail below, is of considerable relevance to the present state of the economy.

Under those assumptions it is clear that the rise in the general price level will be more or less accurately discounted in the returns obtained from various kinds of assets. For instance, if prices are expected to rise by 3 percent per year, and people would otherwise be satisfied with a return of $2\frac{1}{2}$ percent per year on Government bonds, then the new return on Government bonds must be $5\frac{1}{2}$ percent. To take another example, if in times of constant prices the yield on good quality equities is 2 percent above the yield of good quality bonds, and prices are again expected to rise by 3 percent per year, then under the latter conditions the yield on equities will be 1 percent below that of bonds. Similar reasoning can be applied to almost any other kind of asset. In the case of cash, for instance, it follows that under inflationary conditions there will be a tendency to hold relatively less cash, for its return (apart from convenience) is zero so it becomes less attractive