The Future of Taxable Bond Yields

The yields of high grade long-term bonds in a free economy are the end product of thousands of separate decisions by an army of borrowers and an army of investors. These decisions are influenced by every important political and economic event the world over. For example, an elderly politician in Asia with a beard called Ho Chi Minh probably had more to do with the recent sharp rise in bond yields than any other single individual in the world; far more, for example, than Chairman Martin.

Short-term interest rates are often closely controlled by monetary or fiscal policy, but long-term yields are only influenced by policy, not controlled. Long-term yields can only be controlled by policy in wartime when controls are also extended over wages, prices, the allocation of scarce materials, and investment.

Looking back over the history of prime bond yields we find two interesting correlations which should be helpful in judging the future:

1. Since 1790 all of the great sustained periods of rising yields have roughly coincided with major wars — just before, during, or just after. One centered around the War of 1812, one centered around the Civil War, one centered around World War I, while the most recent bear bond market (still underway) was postponed by controls during World War II, but followed soon after and was accentuated by Korea and Viet Nam. In periods of real peace, yields have usually declined. They declined in the 1880's and 1890's, and in the 1920's in spite of great growth and prosperity during those decades.

2. Also since 1790 all of the great periods of commodity price inflation have coincided with the same major wars. There have been no peacetime inflations in the sense of a sustained rise in commodity prices. Therefore, the great bear bond markets have coincided roughly with the great commodity price inflations.

It has been argued from this coincidence that the destruction of major wars creates inflation and that inflation raises