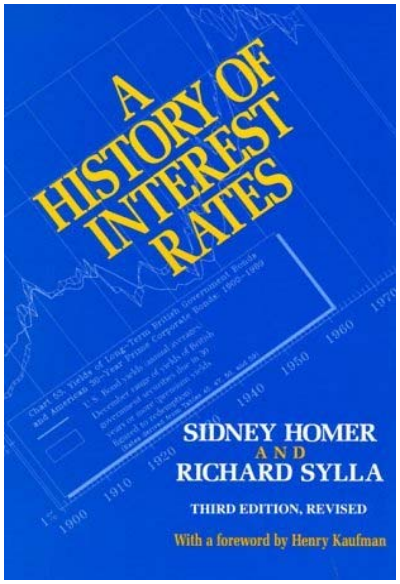

<u>A History of Interest Rates</u> Third Edition (**Revised 1996), Sidney Homer and Richard Sylla.**

While at Salomon Brothers, Sidney Homer developed one of the leading fixed income departments on Wall Street in the 1960's. Homer's research on the history of bonds starts during the Mesopotamia Era (3000 BC) and finishes in the 1970's. This work is the most extensive historical account of bonds I know of. Professor Sylla, at NYU, continued Homer's original work with data up through the mid 1990's.

While most investors will probably stay away from this work, due to its title, I assure you that traveling through this much history allows us to see patterns that shed light on today's bond markets.

There are several lessons one can glean from this book. I will list a few major points of interest that I discovered in this journey through time. First, there have been three major moves in the US bond markets since 1899.

"This pattern of the bond market during the first ninety years of the twentieth century permits it to be conveniently described in three well-distinguished segments: (a) the first bear bond market, 1899 – 1920; (b) the great bull bond market, 1920 -1946; and, in following chapter, (c) the greatest of all bear bond markets, 1946 -1981. The bull market that began in 1981 continued into the mid-1990's." *Pg.335*

Secondly, from reading many sources on the long-term trends of bond and other markets, currently (March 2005), there is a vigorous debate over whether the great bull bond market that started in 1981 has ended or is still playing out. With the historic levels of debt we see today coupled with historically low interest rates, I urge the reader towards the greatest of caution when looking at current bond market risks. While most investors see bonds as a safe investment, in comparison to stocks, history has plainly demonstrated that bonds can be exceedingly volatile and that they have, at times, lead to substantial losses. As evidence, consider the following:

Venice was among the first to offer government bonds. Through a variety of circumstances, from the year 1375 to 1381, their bond prices fell from 92.5 to a range of 19 - 43. *Pg.108.* Because of the huge cost of the war with America, in 1775, the English Consols fell almost 50%. *Pg.160* Government [US] credit sank so low that by 1787 certified interest-bearing claims against it were worth less than fifteen cents on the dollar." *Pg.278* **According to Homer, the period from 1946-1981 marked the greatest bear bond market in history. Corporate bond yields climbed from 2.46% to 15.49% [yields go up as prices go down] and the thirty-year 2½ government bond would have fallen from 101 in 1946 to 17 by 1981, or 83%**. *Pg.367*

Curious about Dr. Richard Koo's statement (see review of Balance Sheet Recession) that Japan had lowered interest rates, in 2001, to the lowest in history, I thoroughly examined Homer's charts. I found nothing that would disagree with Koo's claim. Additionally, the 1% discount rate that the United States reached in 2003, places the US as one of the nations to offer the lowest interest rates in history as well.

Doug Wakefield

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