HORIZON KINETICS

Under the Hood: What's in *Your* Index?

(An Ongoing Series)

5,000 Years of Interest Rates and Your Bond Fund(s), Part I

Here's a tired phrase: "historically low interest rates". It is used, more and more, to explain that, yes, the reason one can't earn a living yield on one's capital is that rates haven't been this low for a long, long time. Is that all? Somehow, the fuller implications, some useful insight, is missing. "Have a nice day."

Then there are those who seem to be more animated about the topic, if not agitated. Those who believe that these low rates have created both debt bubbles and valuation bubbles in all sorts of financial sectors and securities. And to such a degree that they feel it is incumbent upon advisors to try to impress upon the equivocal ear the need for liquidity and protection for some portion of one's portfolio, lest the entirety suffer grievously when the present circumstance changes.

But what makes such observers react so in the face of "historically low interest rates"? Because what *we* mean is "in the recorded history of mankind." Meaning in the last 5,000 years. Near-zero and negative long-term interest rates, which are now a near-worldwide phenomenon, *have never happened before.* That should arouse at least a moment's reflection, while putting one's capital at risk, should it not? Despite the pressing need for income, one does not want to be an accidental victim of an historical moment.

There is a marvelous book called *A History of Interest Rates*, by Sidney Homer, a former partner in the investment firm then known (in 1963) as Salomon Brothers & Hutzler. More than three decades in the making, this is a unique compilation and reference work that does indeed cover and explain the instruments and pricing of loans and debt since at least the earliest recorded coinage in 3,000 B.C. Sumeria, although other forms of credit existed far earlier. They simply took other forms, ranging from seasonal loans of crop seed payable in additional ratios of post-harvest grain, to pre-coinage silver and other metals.

But there is no substitute for seeing for oneself. Here, then, are just a few samples of interest rates for certain credit instruments from financial centers of their day. Surely, a pattern is evident from the encompassed centuries.

In 700 years of lending history in Athens, straddling both sides of the year zero, interest rates were not lower than 6%. Assuredly, the loan markets of that time were not the loan markets of today, when capital can be mobilized on a global basis, and the forms of security and the liquidity of the loan market were doubtless quite different. But, let's go on nonetheless.

Much the same for the next few hundred years, albeit in Rome, not Athens. Interest rates were as low as 4%.

Athens,

Normal loans on safe investments

6th Century B.C.	16%
5th Century B.C.	10-12%
4th Century B.C.	10-12%
3rd Century, early	7 1/7 – 12%
3rd Century, late	6-10%
2nd Century B.C.	6-9%
1st Century B.C.	6-12%
1st Century A.D.	8-9%

Source: Homer, Sidney. *A History of Interest Rates.* New Jersey: Rutgers University Press, 1963. P 43.

Filling out the remainder of the first thousand years of the common era, the Roman capital shifted to Constantinople (lately Istanbul), where for 400 years the loan rate reached as low as 6%.

There are another 1,000 years to cover, and the additional capitals of commerce and lending will remain as familiar. And while you won't find loan rates of zero, you will, just as in these first couple of thousand years, find periods when rates doubled or tripled. The impact of such increases could be devastating.

Rome	Normal Loans
1st Century B.C.	4-12%+
1st Century A.D.	4-12%
2nd Century A.D.	6-12%
3rd Century A.D.	12%+
4th Century A.D.	12.5%+
Byzantine Empire	
6th Century A.D.	6-8%
7th Century A.D.	6-8%
9th Century A.D.	$8\ ^{1/3}$–$11\ ^{1/8}$%
10th Century A.D.	$8\ ^{1/3}$–$11\ ^{1/8}$%

Ibid. P 61.

For instance, and as a preview of the next piece in this series, on the occasion of the Jacobite rebellion of 1745, 3% English Government Bond yields rose to over 4%, accompanied by a price decline from 100 to below 75. This was, according to Mr. Homer, the first "black Friday."

Next, we'll review the more recent history of interest rates and what happens to a bond fund trading near a zero yield, when rates rise just a touch.