

Introduction

And I looked and behold a pale horse: and his name that sat on him was Death, and Hell followed with him. And power was given unto them over the fourth part of the earth, to kill with sword and with hunger, and with death . . .

—REVELATION 6:8

Two subjects have long obsessed me. First, stock markets on a short-term basis are random, irrational, and undecipherable, but at major inflexion points and in the long-term ebb and flow of events are they truly intuitive and wise in their judgments, or do stock prices mostly just reflect the foolish consensus of crowds?

Second, at least once in every century there has been an episode of great wealth destruction when the Four Horsemen of the Apocalypse—Pestilence, War, Famine, and Death—have ridden rough-shod. World War II was the last time that the pale horse with Death on his back and Hell following him terrorized the world.

How do you preserve wealth in times when the Four Horsemen are on the loose? We know from history that equities are *wealth enhancers* in good times, but do stocks work as true *wealth preservers* when their country, their “home” society, is facing defeat and occupation from a foreign power? If they don’t, what should a person with wealth do? How well in *real*-inflation adjusted, purchasing power terms, do public equities perform?

To be the ultimate repository of family or institutional capital, an asset class, an investment vehicle, must be able to preserve as well as enhance wealth over the long run—in bad times as well as good. The value of accumulating wealth is terribly diminished if it cannot be preserved. As you become richer, protecting your fortune against the “slings and arrows of outrageous fortune” becomes at least as important as enhancing it.

The preservation of wealth across time is not an academic matter. The world is and always has been prone to disasters that destroy great globs of wealth. In earlier centuries there were wars, natural disasters, famines, and plagues. Then in the eighteenth and nineteenth centuries came revolutions that confiscated wealth and heads. The last century, the twentieth, was perhaps the most ruinous of all time with World War I, hyperinflations, the Great Depression, and then the inter-connected climax, the worst ravager of them all, World War II. It was truly a world war, and in retrospect, it was a close call whether Western civilization as we know it was going to survive.

The Second World War has long been a fascination of mine. It offers so many lessons about life, politics, financial markets, wealth, and above all, survival. I have read and studied it for years, but as an amateur, not as a professional. World War II was unquestionably the war of the century and probably the war of the millennium because it gripped, ravaged, and tortured almost the entire world. Its effect on the conquered and then occupied countries, and later on the losers of the war was so extreme that it was the ultimate test in modern times of whether public equities or any asset could preserve the purchasing power of wealth in the face of a prolonged and total national disaster. It also was an epic struggle with first the Axis Powers and then the Allies appearing to be prevailing.

The 1930s and 1940s were an incredibly dark time for the world. Until you become really engrossed with the actual diary of events, you

don't realize how grim things were and how close the world came to a new Dark Age. Thus, I spend a lot of time in this book on the ebb and flow of the war and on the character and management styles of the leaders on both sides. I think I have found and included some unusual insights on Hitler, Churchill, Mussolini, and others. *Wealth, War, and Wisdom* focuses primarily on the events that occurred between 1938 and 1943 and not the Allies' later victories because it was the *turning points* in the struggle that mattered. Korea is included because of its significance for the Japanese market.

Investors (and for that matter, people in general) have to deal with adversity and hard times. This book relates how dire were the defeats and agonies of the late 1930s and of the early 1940s, and how the leaders—Churchill, Hitler, Stalin, MacArthur, and Yamamoto in particular—managed them, and how they dealt with people. All of us professionals have to practice and endure crisis control, and this is another reason why investors read history and biographies.

Looking back with the perfect vision and the perspective of today, we can identify the victories that were the great turning points. However, at the time, in the fog of war, it was far from clear that the tide had turned. Did equity markets with the unique wisdom of the crowd “through a glass darkly” sense these moments? I think the evidence is that they did, while the press and the so-called expert commentators and strategists mostly did not, and that we should be very respectful of the collective wisdom of stock markets. This means listening to what the market is saying by its action. (Chapter 1 provides more insight on the wisdom of markets.)

I first became fascinated with the subject of the wisdom of markets when, by chance, I discovered that the British stock market bottomed for all time in the summer of 1940 just before the Battle of Britain; that the U.S. market turned forever in late May 1942 around the epic Battle of Midway; and that the German market peaked at the high-water mark of the German attack on Russia just before the advance German patrols actually saw the spires of Moscow in early December of 1941. Those were the three great momentum changes of World War II—although at the time, no one except the stock markets recognized them as such. This, to me, confirmed the extraordinary (and unrecognized) wisdom of market crowds.

This leads to another important point. Today, almost every investor is a contrarian. Everyone knows about the dangers of groupthink and the madness of crowds. But is there a special, intuitive wisdom in the uncoordinated ebb and flow of the investor crowd? I have come to think there is. Mr. Market is a smart, canny old soul, and during World War II he often, not always but often, sensed important tipping points that at the time few of the elite grasped. The ebbs and flows of the stock market reflect the collective opinion of the investor crowd, and in this book, I maintain that markets have great wisdom. The investor ignores their message at his extreme peril.

Another major theme of the book is what happened to wealth before and during the war, and what insurance steps should a wealthy individual take to protect his or her fortune from the Black Swan-like appearance of the apocalypse. I also have studied whether stocks and bonds preserved and enhanced wealth not only in the years of extreme duress from 1930 to 1945 but also over the course of the century. I could not have come to the conclusions that I have without the massive studies of Elroy Dimson, Paul Marsh, and Mike Staunton of the London Business School. I found that equities generally did preserve wealth—over the full course of the century and particularly if you owned the right stocks in the right country (Chapters 9 and 15 especially address this topic). However, stocks (and bonds for that matter) had substantially higher returns if their country of residence was on the winning side. If your homeland lost the war and was occupied, public equities did not work during the years of war and occupation and bonds were even worse. Moreover, for the first 50 years of the twentieth century, equities in both France and Germany adjusted for inflation were a wealth-losing proposition. Government bonds were a disaster.

Asset diversification helped. Real assets such as land, property, gold, or a business were somewhat better than stocks but far from perfect. A working farm protected both your wealth and your life. The other solution was having money outside the country in a safe haven, but of course, that didn't help you keep body and soul together at the time.

As far as I know much of the market data has never been compiled in this form or published before. *Wealth, War, and Wisdom* also relates what happened to other forms of wealth such as bonds, land, gold, jewelry, and property during those years (again, primarily in Chapters 9 and 15).

Anyone with wealth has to care about all this. There is no use working yourself to death to accumulate wealth if it can't be preserved and enhanced. There are definite messages in the book as to what a person of means should do to pass on wealth to future generations in an uncertain world although I concede the next apocalypse may be different from the previous one.

I also find the history of this epic war populated as it was with such extravagant figures to be an endlessly intriguing, incredibly dramatic, and gripping event. Some may quarrel with my judgments about the inflexion points and disagree with my interpretations of the leaders, of their actions, and the moods of the times.

Investors, as opposed to traders and speculators, have to make long-term, slowly evolving judgments about the course of events in economies and the world. The more history they know and understand, the better these perspective decisions will be. An investor simply must know some history as well as be a statistician, psychologist, and a gifted intuitionist.

However I am definitely not a *real* historian. This is in no way a true history book—either of stock markets or of World War II. I have done no original research on World War II, but I have read a number of books that are listed in the bibliography. I have shamelessly borrowed from the ideas, insights, and reminiscences of the true historians and warriors who wrote the tomes listed in the bibliography. In spite of my extensive reading, however, I found no source that deals with what really happened to financial markets and wealth during the war years. There are market statistics, but very little background information. To find the social information I present in this book, I have read old newspapers and interviewed people who lived through that time. Numerous market charts with event references are included in the book. I have written an impressionistic, interpretive account of those times that I hope reverberates today.

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