Living with scars

Coronavirus restrictions will have long-lasting effects on many national economies. Some businesses will never re-open. Growth may be permanently lower. Economists call this effect ‘scarring’. However, scarring is also personal. It affects the life chances and attitudes of individuals and households

Don’t graduate during a recession

Life is tough for those entering the workforce during a recession. They are likely to earn lower incomes than those entering at other times for at least the first ten years of their working lives. There may also be long-term effects on health. Lower-income workers seem to come off worse, but it has been suggested that even CEOs are affected. Those graduating in recession years seem more likely to run smaller, less prestigious companies.

Recessions and attitudes to risk

Past experiences can also affect people’s attitudes to risk. People who see shares perform badly in their formative years are less likely to hold them years later compared with those who grew up in better times. For example, younger households in the 1980s tended not to hold shares, even if they could afford them because the experience of the 1970s bear market heavily coloured their attitudes at the time.

Slightly older folk, who had seen the bull market of the 1950s and 1960s, were more inclined to own shares. And much older people, who experienced the 1930s depression, were less likely to hold shares.

A more extreme extension of formative years on risk attitudes was found in former US soldiers. Those who had fought in combat were much less likely to hold shares and unit trusts than those who had not.

The effect may also be seen in the jobs people take. These days, it is often suggested that millennials prefer jobs with social meaning over financial reward. However, not everyone entering the workforce has the same experiences. By looking at the income per capita in different regions of the US and comparing the jobs taken by young people, researchers found "people who experience relatively bad macroeconomic conditions between the ages of 18 and 25 give a higher priority to income for the rest of their career".

Scars and luck

It's right to be concerned that coronavirus will damage the economy for many years. The scars could be deep. But not everyone will be scarred in the same way. Different generations, people in different jobs, and on different incomes will be affected differently. It will affect people's incomes and attitudes to risk well into the future.

If one common scar that develops is an aversion to financial risk, it could have macro-economic effects. Greater risk aversion may translate into higher savings, with more going to safer instruments such as bonds and fixed-term deposits than shares. Evidence from the past suggests this is possible.

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At an individual and household level*, there is also nothing wrong with this - even if it goes against ideas of financial pundits, who often encourage people to place a large proportion of their savings into shares.

Understanding how your past can affect your attitude to risk is important. It even affects professional investors. Thinker and fund manager Morgan Housel explains how a tragic event in his youth made him especially conscious of what are known as tail-end risks – low probability, high impact events – when he invests. He writes these "are all that matters".

The extent of the disruption caused by coronavirus is likely to be large. Many will be affected but in different ways. Your perception of the financial risks you are prepared to take may change. There is no need to be ashamed of this.

*There is a macro-economic argument that claims increased saving by many people at once will have important international consequences. This issue is outside the scope of this article.