INTRODUCTION

Many stories have been written about the the famous Stock Market Crash of 1929, but I am aware of none that have delved into the bull market beyond the last few months before the crash. Countless people have been fascinated with the crash and have made all sorts of false assumptions that the speculative fever was intensified by margins which are only 1O%. That statement is completely false and, in fact, many stocks were not available on margin at all. Others paint the picture that a vast portion of the population was involved, right down to shoe shine boys. Again, we will see that this was a gross exaggeration. One book, "The Day The Bubble Burst," is an excellent accounting of the social impact of those trying times. The cast of characters is unsurpassed and provides a look into the private lives of some of the people who were the biggest players.

But from an analytical perspective, the atmosphere that surrounded the market at that time is a very important area to explore. Far too often, economists and market analysts assume that such catastrophes are freaks in the marketplace and that they will never happen again. Others try to inject the famous Kondratieff cycle into the stock market and proclaim that the end is near. Some have been calling for a devastating collapse ever since 1982 and each year they crawl out from under their rocks to proclaim that this is the year that the market will collapse to 10 cents on the dollar as that infamous month of October approaches.

Other hard-money advocates beat their chests, warning that everyone must buy gold and claiming that this deflationary wave in the 1980s is only the beginning of a situation similar to that which took place in 1929. But they should go back in history and understand what took place. If they look at a simple chart they would see that the collapse from 381 to 40 points on the Dow Industrials took place in the span of three short years. Such disasters have always come without warning and the process has never dragged out over a period of four to six years. Normally the pain has always been swift and to the point and panics are just that, panics which take their toll in the course of one to three years.

It is a widely known fact that nearly 90% of money managers have been unable to beat the Dow or the S&P in performance. It is always easy for someone on the outside to look in and criticize a money manager for his performance. When it comes right down to it, most managers are damned if they do out-perform by critics who say they have been too aggressive. If they perform less than the Indexes their critics say that if they had just bought the Dow stocks they would have been ahead of the game.

Trading any market is difficult to say the very least. Judging someone's performance on the surface tells little about his system or his analysis. For example, take two managers who both made money on the stock market rally between September 1985 and April 1986. One bought the market because he felt that the economy was going to heat up and he realizes that inflation brings with it growth for many industries. The other manager bought the market because he thought there was going to be a discount rate cut. Both may have made money, but the gains were based on two totally different fundamental principles.

The difference between the two managers may eventually show up only when the fundamental long-term ideas of one trader or the other prove to be wrong. Then one will continue to make money and the other will suddenly become a net loser. The loser will chase the market, inevitably getting chopped up back and forth while the other will consistently do well if his long-term concepts remain in the proper perspective.

Therefore, we find that trading managers come and go not merely for small private accounts, but for the big institutions as well. People have a tendency to judge managers on a short-term basis and many scrutinize each and every trade, when, in fact, it is the long-term that counts the most.

The short-term trading or analysis of the stock market has always been the worst. Sure, some analysts have done quite well calling the market for short-term moves, but eventually it turns out to be periodic and lacks consistency. The long-term is something that most people vacillate over, switching their opinions on a short-term basis from bullish to bearish. How can an investor achieve consistency, or at least make sure that if he misses a short-term move, he is not caught on the wrong side of Wall Street?

If you want to know what the future holds, you need a map of the past to at least provide a guide as to what is or is not possible. Far too many people fail to look at the events of the past as a whole, but single out only an isolated period to support an unwarranted assumption to arrive at a foregone conclusion.

While some argue that 1929 is knocking at our door, others laugh insisting that such events are not possible in this day and age. Economists, in their efforts to support their biased Keynesian conclusions, attack the protectionism acts as the cause of the Great Depression. Others blame the massive collapse on the over-speculation that preceded it. In all, most accounts are totally inaccurate and others lack the details of the real events during that era because they have merely skimmed the surface.

On the contrary, the events which took place between 1921 and 1929 are very important. The fundamentals in many areas are the same as we see today and there are undoubtedly many parallels between the past and the present. However, was the blame for the Great Depression justifiably put on the stock market? In fact, is the stock market the almighty leading indicator to the economy as it was believed then and as it is still perceived today? Should we be listening to the "warnings" of impending disaster or are we on the verge of a new era where the Dow industrials will soar to 3500 or beyond? How does one get a feeling for what the future holds? Should we wait and watch for moves in the discount rate? Does the first up tick in interest rates mean disaster cannot be avoided?

One of the best ways to get a grip on the situation is to clearly define what the market has done under what conditions. Analysis is supposedly the art of taking a known relationship or a proven technical method from past performance and projecting what the future performance maybe. If this is the only means by which we can objectively take a shot at the future, then perhaps it is best to sort out those fundamental relationships and make certain that the stock market does react in the manner that "generally" accepted beliefs would have us assume.

One huge problem for most people is an understanding of just which fundamentals truly move the market. At times you find analysts cheering for deflation and lower interest rates, which, in their minds, will entice people to buy stocks. But just think about it for one minute. If deflation is the situation and the economy cools down, doesn't business in general also cool off, thereby reducing corporate income?

The generally accepted relationship of the stock market to interest rates has been higher rates mean lower stocks. The thought behind this is that higher rates increase the cost of margin. Accordingly, people will buy fewer stocks and therefore stocks must go down. The emphasis has been placed upon the speculation and not the true economic impact. During the early 1920s prior to the crash, the generally accepted fundamental relationship was that stocks rise with higher rates and decline with lower rates.

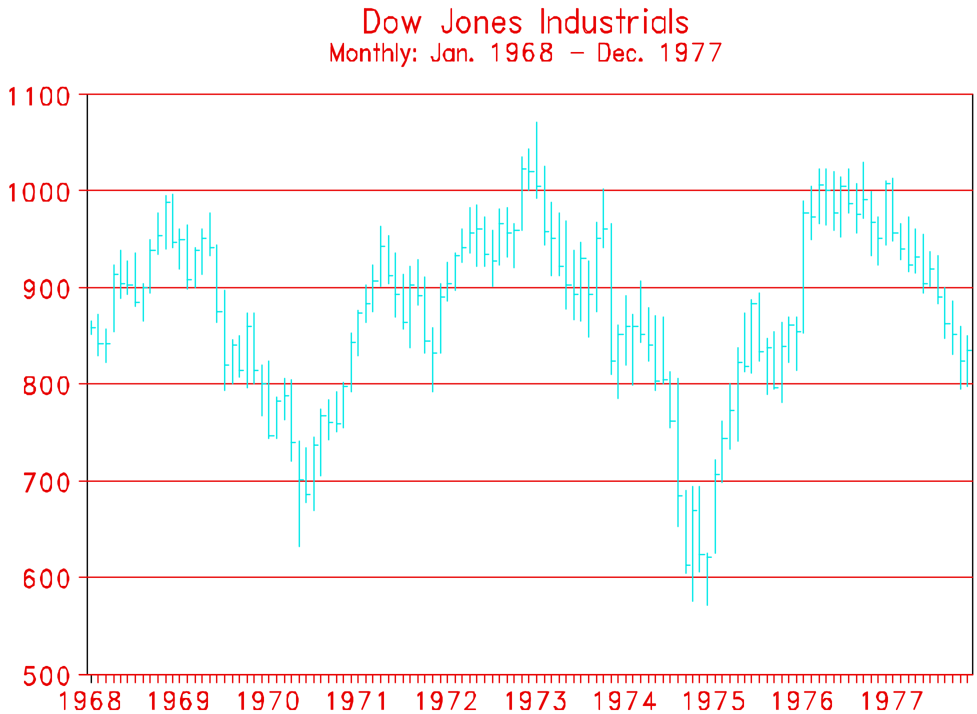
It is true that interest rates collapsed between 1929 and 1932 along with the market. Interest rates collapsed from 1919 to 1921 and so did all commodities and stocks as well. Each depression had been marked by a decline in interest rates and each bull market took place when business expanded and borrowed more to fund their expanded levels of business. It is true that interest rates bottomed in 1976 and rose into 1981 while the stock market held the 1974 low and moved up with the inflationary cycle into 1981, peaking only slightly ahead of interest rates. There was no direct relationship to the contrary.

So what is the answer? Does the market rally with lower rates all the time? Obviously not! So under what conditions will the stock market rally when higher rates exist? This is just one vital question that needs to be answered.

The past has a tremendous amount of knowledge to offer if one merely takes the time to study what took place. For example, did you realize that foreign loans were also a major concern in the 1920s? Did you also realize that the economy has always expanded only during inflationary times and never during periods of deflation? But then why do most people say that the stock market doesn't do very well against inflation if true industrial expansion takes place during inflationary periods? Is the stock market overbought because it stands at its all-time highs or is it in fact the best buy in 50 years? What about all the takeovers? Is that good or bad for the market? There was a tremendous number of takeovers and mergers between 1927 and 1929 just before the crash. Does that parallel mean it is a warning of impending disaster?

Many people are trying to forewarn of a massive collapse in the stock market. Others say it will remain bullish as long as interest rates decline. Still others have honestly projected that interest rates will continue to drop into 1989 and the Dow will reach in the "thousands." A few doom and gloom guys crawl out from under their rocks every year to proclaim that October will collapse just like 1929. Widows and orphans will be cast into the streets and suicides will become a common everyday event on your local street corner. Earthquakes will strike Wall Street itself and man will be punished for being so presumptuous as to have ever taken the Dow above 1,000 in the first place.

Well perhaps if those people (who are just outright mad at the rest of the world for



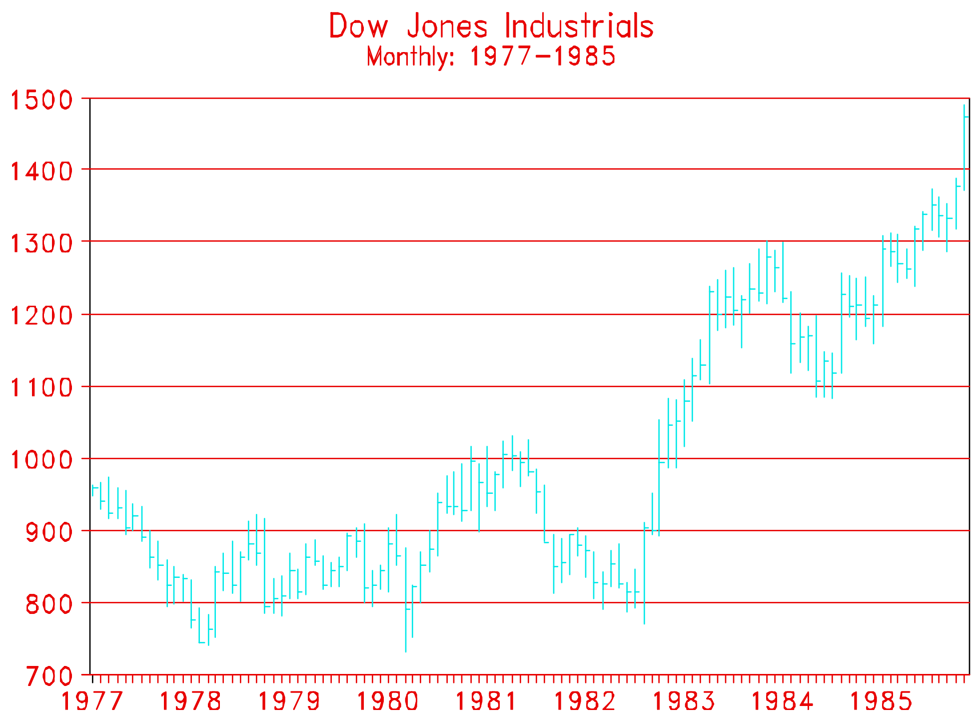
making any profits when they have been short every step of the way up) keep crawling out every year, one of these days they may be right during that fatal October. But perhaps they should go back and read the newspapers from 1869. Then it was September 24, 1869 which became known as "Black Friday." So maybe they had better hedge their bets and not let everything ride on October every year. And those people who foolishly think that interest rates will continue to ease beyond 1986 had better read each page of this report twice and commit it to memory!

Is the Dow really in lofty heights? How does one measure such territory where charts have never before dared to enter? A little exercise in comparisons might shed some light on the subject. But then again, it might not mean anything at all. Nevertheless, it's certainly worth exploring.

The Dow Jones Industrials reached a peak of 381.44 in September of 1929. The CPI stood at 51.3. In 1985, when the Dow hit a new high in July, the CPI stood at 322.8. If we adjust the 1929 high for inflation, we find that the 1929 high in 1985 terms would be 6,064. The CPI has increased 629% since 1929. Boy, talk about being a poor investment over the long haul!

Just for the hell of it, let's see how the Dow held up to the expansion in the money supply. Money supply (M1) stood at $26.5 billion in 1929 compared to $595.8 billion in 1985. That comes out to be a 2,248% increase. If the Dow had appreciated in comparison to the growth in money it should be 8,574.77! Well, so it's lagging a little, big deal.

How about a comparison of the Dow to public debt? In 1929, the public debt stood at $16.9 billion and in 1985 it has grown up quite impressively to $1.823 trillion, which works out to be a 10,787% increase. Obviously, if the Dow had kept up with government spending it should be 41,145. Boy that certainly makes 2,500 seem awfully cheap.



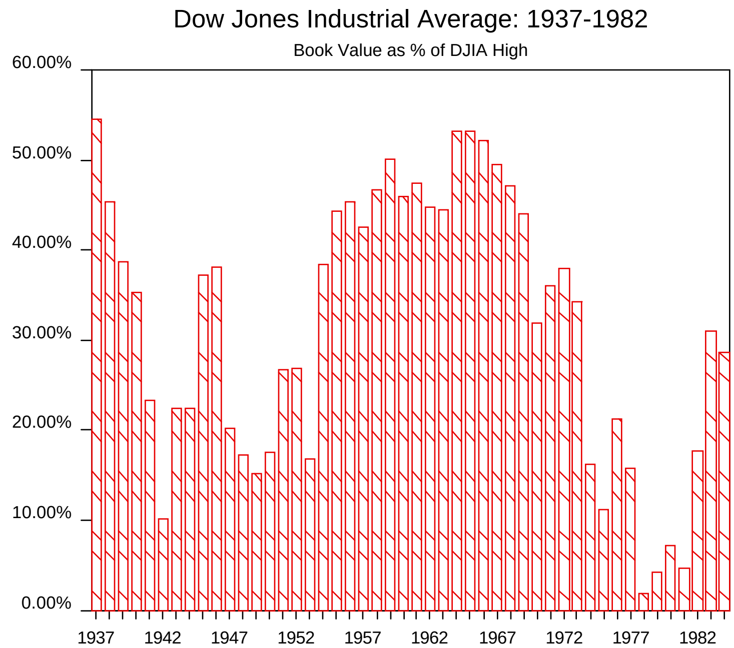
Well, these comparisons might be the revelation of a lifetime, but then again put them alongside a dollar and they just might buy you a $1 cup of coffee around Wall Street these days.

Is there something in this world which one can measure anything against to render a fair comparison of worth from one day to another? Ever since we abandoned the gold standard and moved on to this politically backed paper monetary standard, comparisons seem to be far more difficult to come up with. There is a huge imbalance from what everything used to be and where it now stands.

Since we are looking at industrial stocks, perhaps we should use the GNP to compare their performance with the production expansion to which these companies contributed. GNP, expressed in constant 1972 dollars, stood at $103 billion in 1929. In 1985, it stood at $1,671.6 billion ($3.8 trillion in current dollars). Therefore, in constant terms GNP had grown 1621% since 1929. The Dow would have to stand at 6,183 in order to maintain parity with the GNP.

Quite frankly, trying to find something against which the Dow has performed appreciably better is simply not so easy. If we compare the price of gold to the Dow, we find that in 1929 gold was $20 and in 1985 at the end of July, when the Dow had reached its new high, gold closed the month at $327.10 on spot in New York. This is a gain of 1635.5%, while the Dow from the 1929 peak to the July 1985 peak had appreciated only 361%. The truth of the matter is that the only thing I was able to find that lagged behind the Dow was the increase in the civil labor force, which stood at 49.2 million in 1929 and currently stands at 115.3 million, an increase of merely 234%.

Why has the Dow performed so miserably in comparison to just about every other indicator and to gold itself? Is there something we are missing? Is there something the Dow has to offer to vindicate itself for such a terrible long-term performance? To

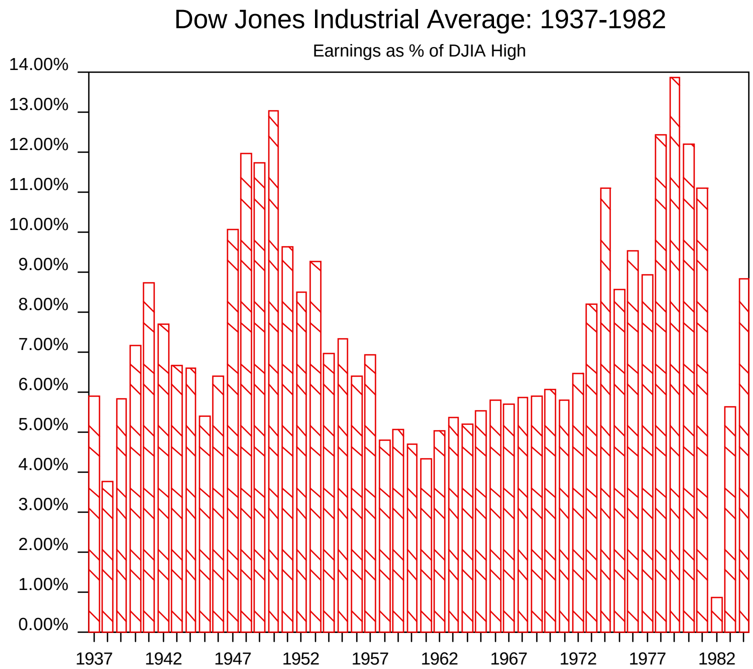


some degree the answer to that question is yes. Since 1929 the total amount of dividends paid on the Dow Industrials has been 1305.42 at the end of 1984. If one were to add this to the July 1985 high, it would be equivalent to nearly 2700.00. Although this is still a far cry from 6000.00, it is at least bringing it up a little closer.

Let us look at the Dow in comparison to the composite book value. In 1937, the book value was 88.30 while the Dow had reached a peak on March 10 at 194.40. This meant that the Dow was trading at better than double the book value. At the end of 1984, the composite book value was 916.70, while the Dow closed out the year at 1211.57. Obviously, a comparison of this rally to the rally of 1937 still shows the Dow lagging behind. On the 1973 rally when the Dow closed at 1051.70 on January 11, the book value stood at 690.23. Again, this rally was shy of the levels achieved during 1937, but the 1985 rally has still not reached the heights of the 1973 rally in comparison to book value trading ratios.

When we look at the Dow from book value, CPI, GNP or its performance against gold, it comes up shy every time. Recent rallies are not trading at the same heights as they have during the past 56 years. By such fundamental comparisons, it is extremely difficult to imagine that the Dow is overpriced and in jeopardy of a major panic collapse.

If we look once again at the chart of the Dow Industrials on a percentage basis over book value, it becomes distinctly clear that 1978 was the LOWEST point in recent history. If we look at the annual chart provided for the Dow Industrials from 1890 to date, we find that the 1978 low was substantially above that major sharp correction which took place back in 1974. Even the 1982 correction, when almost everyone was calling for an impending collapse and the Dow was unquestionably moving down to 500, it was still trading on a percentage basis over book, above the low which had been estab-

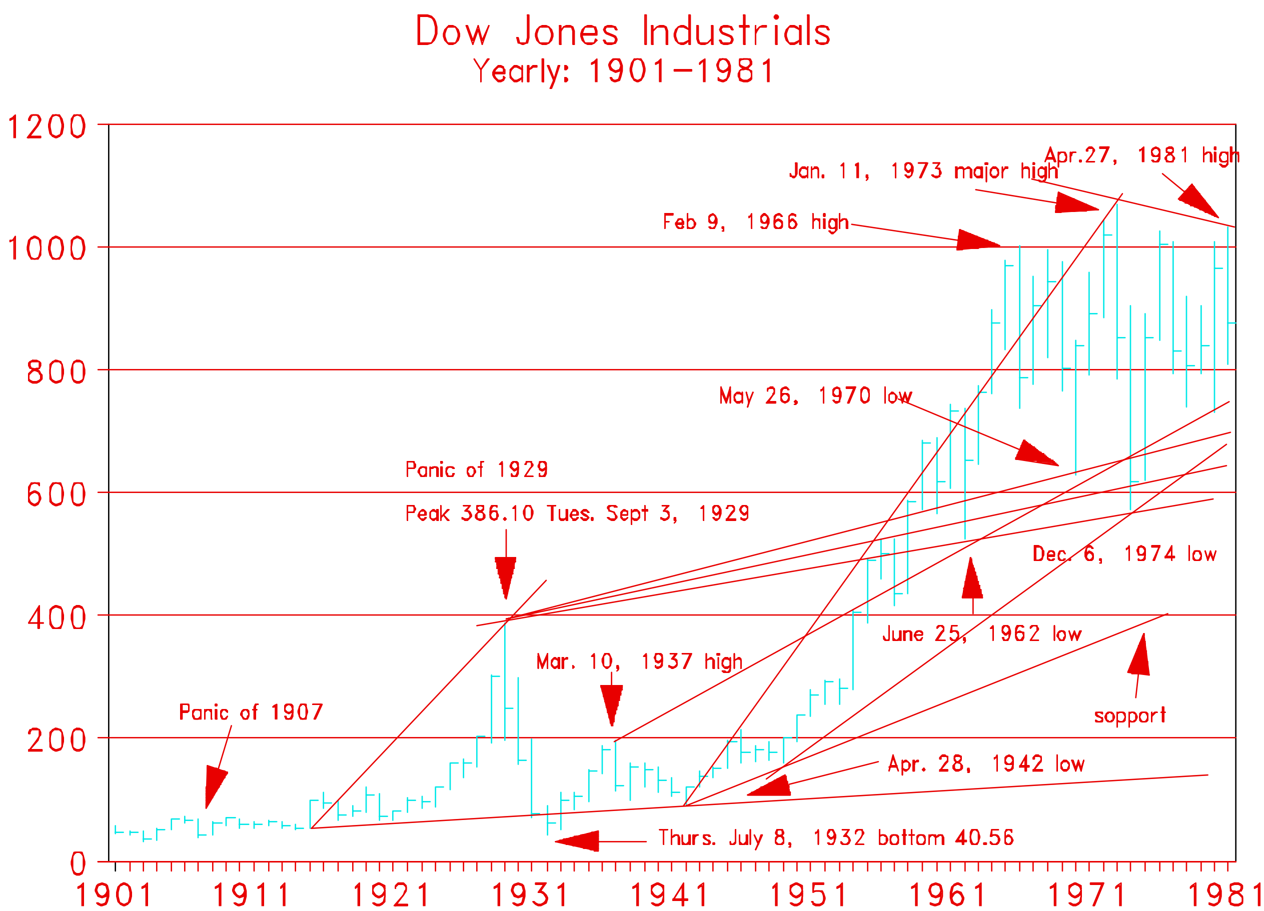


lished during 1978, as well as on the index itself.

What is this book value we speak of? It represents cash and the depreciated value of all assets, including real estate and other subsidiaries. This is what the takeover boys are looking at. They look for companies that are selling for $30 a share and they calculate that if they were to sell off all the assets they might end up with $75 a share. We all know that these situations have been numerous. So why is it a fact that so many companies are selling far below book value? Doesn't this suggest that perhaps the market is under-priced? If so, then why all the doom and gloom every time the market turns downward?

A case can undoubtedly be made for the market being overpriced or underpriced. Obviously one or the other is eventually going to be right. But which one? What does the future really hold in store for the stock market? Are we in a phase similar to 1921-1929 when prices soared and the Dow rose from 62 to 381, which was a 515% rally in seven years? Or perhaps the doom and gloom boys are correct and the Dow will drop 50% or maybe 88% as it did between 1929-1932.

There are some who argue that we are about to collapse. Others suggest that the famous Kondratieff cycle is upon us and that the market will collapse under its mighty influence. Joseph Granville became perhaps one of the most famous analysts of our time because of his strong opinions. Most other analysts envy the attention he gained back in 1982 and love to kick his name about like a football. But in his recent book entitled "The Warning," Joe admits: "Probably more than anything else, I bypassed the August 1982 upturn because of how the market looked against the template of the Kondratieff Wave...In relation to the 1982 bottom I had made a timing error, but I knew my basic analysis was right."



We will see as we explore the market's past, which to this very day remains shrouded in an obscure fog of mystifying confusion of untold proportions, that timing has always been the elusive element in analysis. Wall Street's chastisement of Joseph Granville is typical. Wall Street has always sought that infallible analyst who will descend from the mountain bringing with him the definitive rules of the game. That elusive mountain has never provided the man who possessed a record of consistency. No one beat the game in the 1920s. No matter how flawless their record, the countless analysts of the roaring 20s all lost in the end - including the bears.

And for those who were correct for long periods of time, Wall Street still bore a hatred when it was wrong and the analysts were proven right. Even the Wall Street Journal refused at one time to report the comments of Jesse Livermore despite his superb track record. Then other journalists chastised the Wall Street Journal for its pompous attitude.

Like the President of the United States, an analyst is immediately subjected to a continuous series of criticisms. The President is blamed for everything from foreign affairs to how much money it costs every time you buy a loaf of bread. It is as if the President's sole existence has caused every problem imaginable and, of course, he must carry the blame for the errors of each and every predecessor. The press will judge him based solely upon what they see, making no allowance whatsoever for any other factors. Problems of all past administrations suddenly become the track record of the man currently in office. Like the interest on the back debt, which haunts each year's administration, today there still exist serious international and shifting domestic events, which were inherited by Hoover when he took office in 1929.

The art of analysis is, in fact, taking fundamental concepts built upon the record of the past and projecting the assumption that the future will offer more of the same. If there has never been that infallible soothsayer of the marketplace, then perhaps we have drawn the wrong conclusions from the past. The press and the analysts were all bearish in 1982. They judged the market based solely upon what was lying in front of their noses. They judged the market by current events and ignored the long-term signs that were pointing to a new round of internationalism. Oddly enough, the parallels of the past were quite similar to the 1980s, if you know where to look.

We will explore the avenues of fundamentals. We all know the often told stories about the speculative frenzy which supposedly destroyed the economy and created the Great Depression. But do we really know the truth? Do we honestly know what created the most spectacular bull market in the history of the stock market? Was it uncontrolled speculation? Was there a relationship to the dollar and its postwar historical swings? Are the so-called parallels that people draw between then and now valid? Are these proposed opinions and parallels truly non-biased or have people selected only a small segment in time to suit their own foregone conclusions?

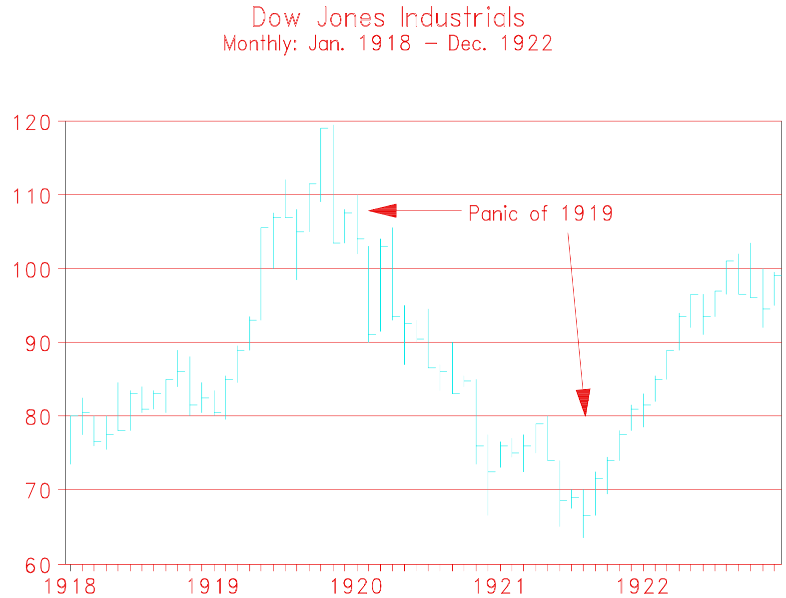
Anyone who takes it upon himself to write of the events in the past immediately subjects himself to becoming some sort of a historian. In so doing he injects his own biased viewpoint. As a result, the events he chronicles are automatically colored by his own thoughts and the accounting is still one man's opinion. This report will offer a different viewpoint of the past. The speaking will be quoted from those who commented on the events of the day and the commentary offered will be a collective interpretation of what took place.

Let me say now that I too had some preconceived ideas when I began this project. But listening to those who cried out from the past changed my own unwarranted assumptions and, in the end, I emerged with a conclusion quite different from what I had expected it to be.

Click here for PEI's Homepage

CHAPTER I

1921

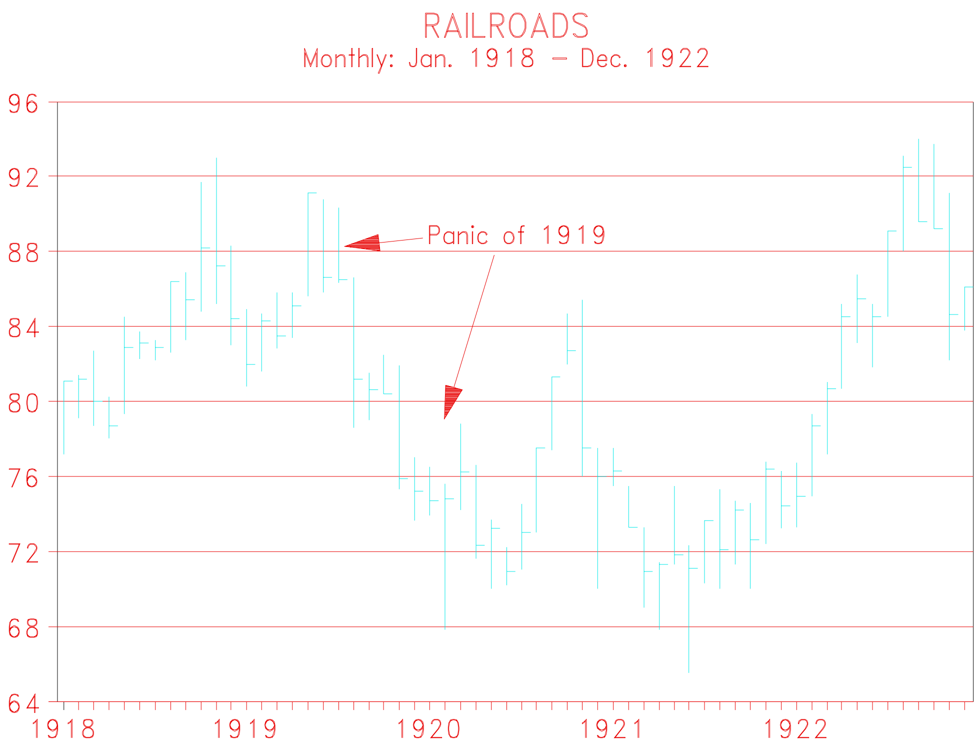


The year 1921 began on a sour note. The front page headline of the New York Times on January 8, 1921 read: "BUSINESS REVIVING, COUNTRY SANE AGAIN, SAYS W.P.G. HARDING - Governor of the Federal Reserve Board Sounds Keynote of Optimism. DEPRESSION AT AN END - EXTRAVAGANCE HAS PASSED." The article began as follows:

"All danger of a disastrous financial collapse has passed and there are signs that the widespread industrial depression is nearing its end, declared W.P.G. Harding, Governor of the Federal Reserve Board, last night at a dinner in Delmonico's tendered by officials of the Fidelity and Deposit Company of Maryland to Franklin D. Roosevelt, lately elected as Vice-President of the institution."

The article went on to say: "Now I think we can in taking an inventory of our present situation, congratulate ourselves upon two things. One is that the country generally has recovered to its normal state. We are no longer afraid. We are not indulging in the old idea of extravagance, living beyond our means. Nor are we troubled so much as we were a few weeks ago with that other extreme of over pessimism, where people get down in the tombs and they cannot see any daylight, cannot see any hope and see nothing but gloom and darkness.

"Now that situation is as bad as the other. They are both abnormal conditions of mind and we can congratulate ourselves gener-

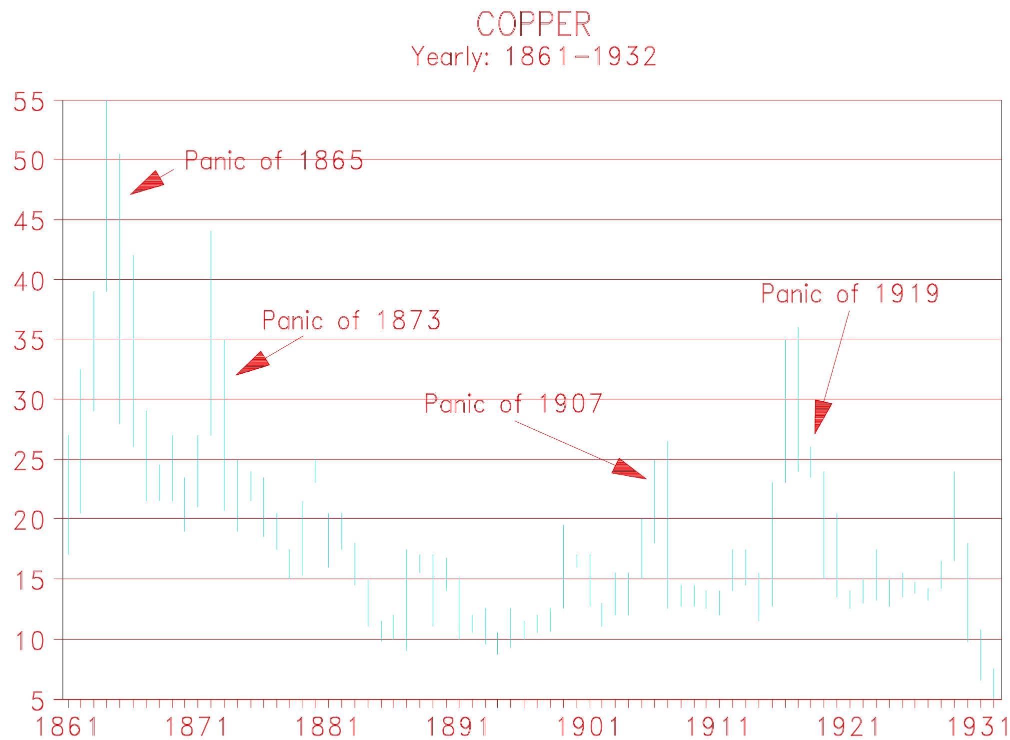


ally that the country has reached a more normal state of mind, if you please. This is not the time to try any remedies for the purpose of alleviating or deadening pain temporarily, of which the ultimate effects would be not to restore the patient to health, but to impair his strength and vitality.

"We ought to be safe and sound and calm in our judgments in living and in financing ourselves. I am thoroughly convinced that any danger which may have existed of a general collapse - and I have never thought that danger was as imminent as a great many people have thought it was - but any such danger as that has passed. I think undoubtedly that the worst is over. And while the Federal Reserve system cannot deal with individual cases, if there are individuals who have become so much over-extended that they will have to undergo process of readjustment, that, after all, is merely an individual condition which will have to be taken care of. We will have to let it take its course. The Federal Reserve deals with general conditions. It deals with the banking situation as a whole and the Reserve position. The inherent strength of the Federal Reserve Banks has so much improved that you need to have no apprehension whatever that the Federal Reserve position cannot take care of the banking situation in general. It can do so and it will do so."

The atmosphere during 1921 was far from optimistic. There was no analyst, economist, businessman or politician who held visions in his mind's eye of a future which would one day be remembered as the "Roaring 20s." There is no newsletter writer or market analyst who dared to claim that he had called the bottom, no less foreseen the ominous events.

As with most periods following wars, the ability to recover lay solely in man's desire to re-establish his economic way of life. Regaining his dignity and his sense of confidence was his only salvation. The panic



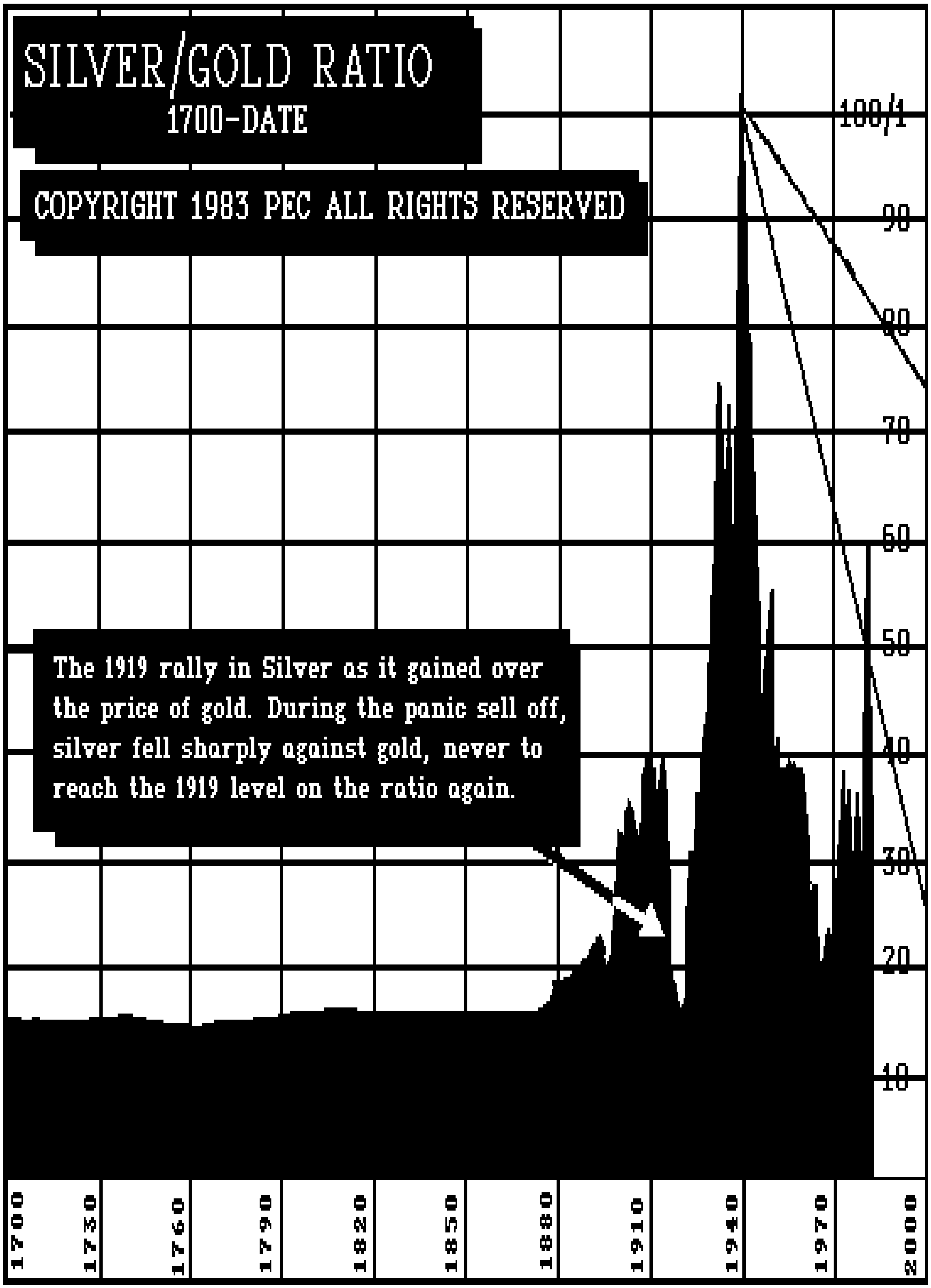
collapse of 1920 was swift, unmerciful, and devastating.

Many fortunes were lost to the boom and collapse of the postwar years. Many of the prominent individuals and their personal tragedies we will look at in due course. The panic and devastation was not merely confined to the United states. Its tentacles had stretched far and wide throughout Europe on the right and to Japan on the left.

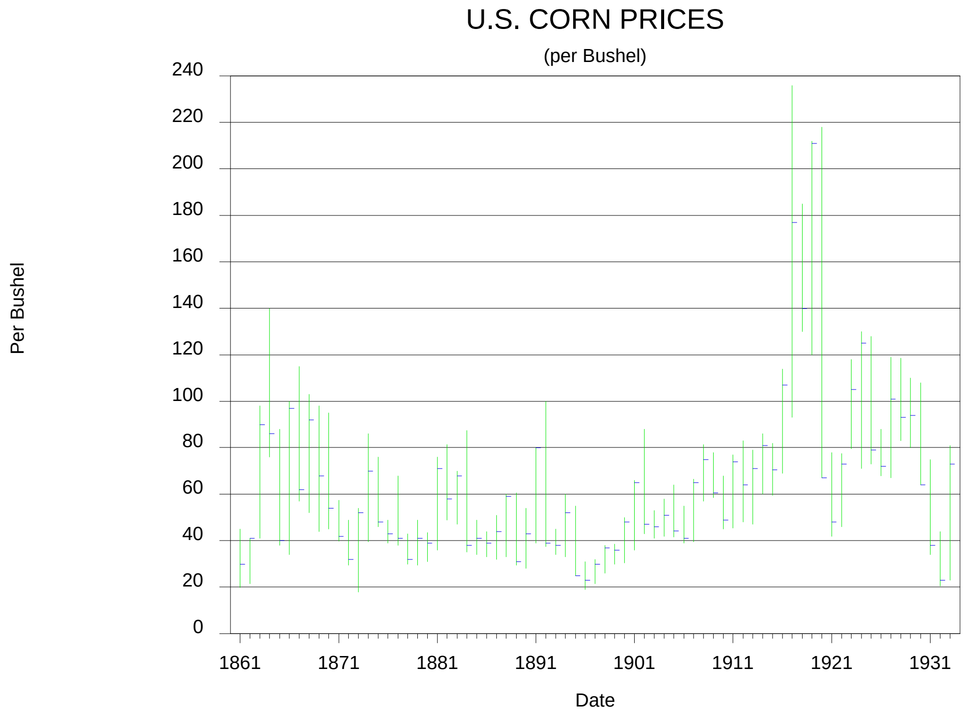
The more I immersed myself in the past to try to gain a sense of the truth, the more surprised I became at how the historians have distorted many of the events. Feelings in Europe were still very bitter and the Treaty of Versailles had essentially divided Europe between the British, French and Italians. Turmoil ensued over the League of Nations Agreement in 1919 and the press in the States was filled with cartoons of Europeans still battling among themselves for their dominant share of the spoils.

The League of Nations Agreement sought to preserve the boundaries won in the War and the French inserted what was known as Article 10. This mandated that all nations which signed would fight against any nation which infringed upon the boundaries of another. Congress refused to ratify such a clause while President Wilson supported the League without any alteration. Indeed, the popular opinion in the United States was not in favor of signing the League of Nations Agreement. Herbert Hoover wrote in his memoirs: "Two million returning soldiers were, in the majority, very anti-European. They had little experience with the peoples of Europe and regarded them as just foreigners." They generally opposed the League on the ground that they never wanted to be sent out of the United States again."

In the Fall of 1919, British lobbyists began a campaign to obtain billions of dollars in loans from the U.S. government. There were many who were opposed to this idea and others who saw that lending Federal funds to Europe would potentially return handsome profits for U.S. business.

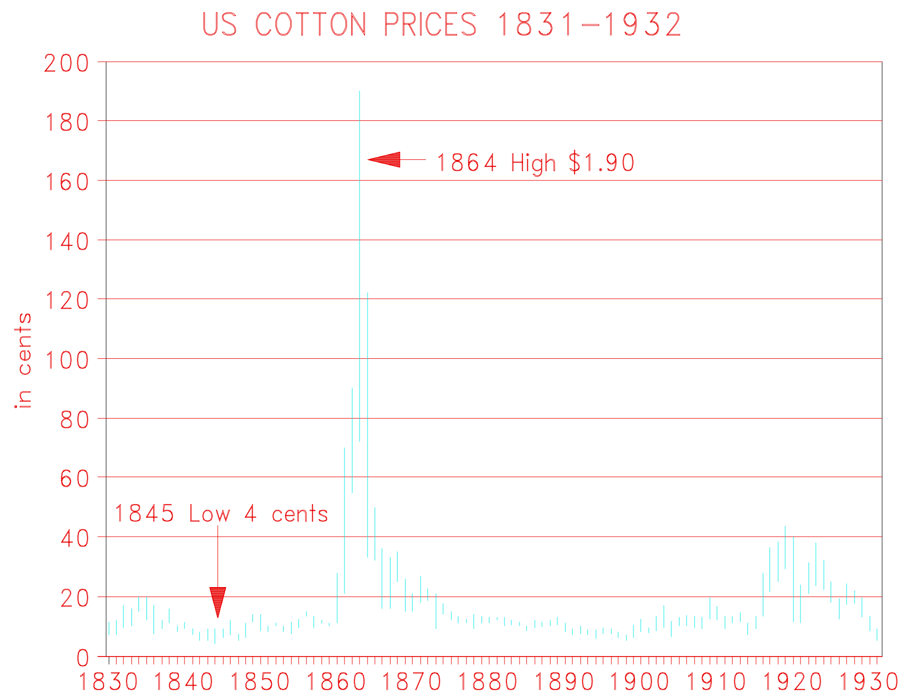


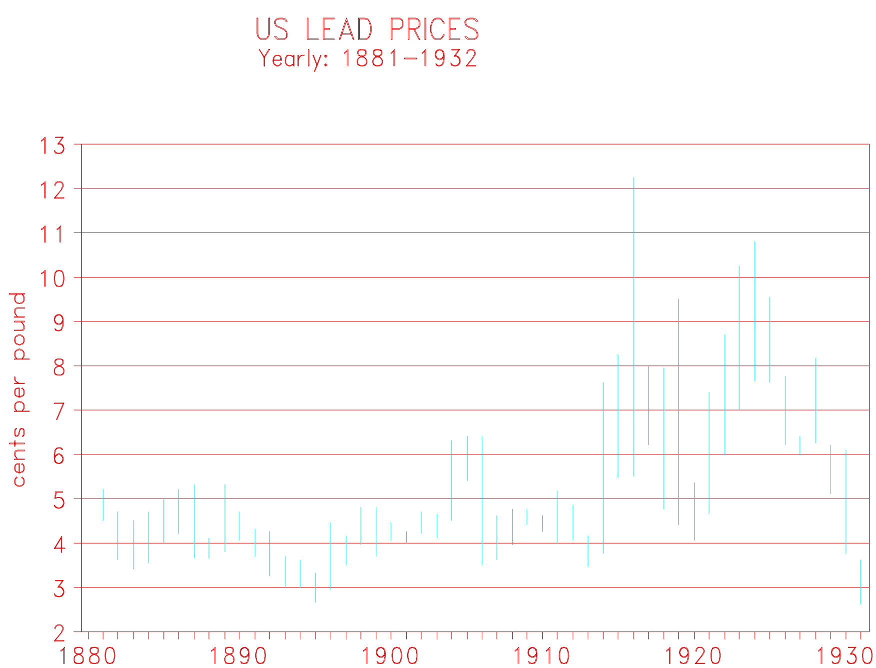
SILVER/GOLD RATIO
1700-DATE
COPYRIGHT 1983 PEC ALL RIGHTS RESERVED
100/1
90
80
70
60
50
40
30
20
10
The 1919 rally in Silver as it gained over the price of gold. During the panic sell off, silver fell sharply against gold, never to reach the 1919 level on the ratio again.
1700
1730
1760
1790
1820
1850
1880
1910
1940
1970
2000

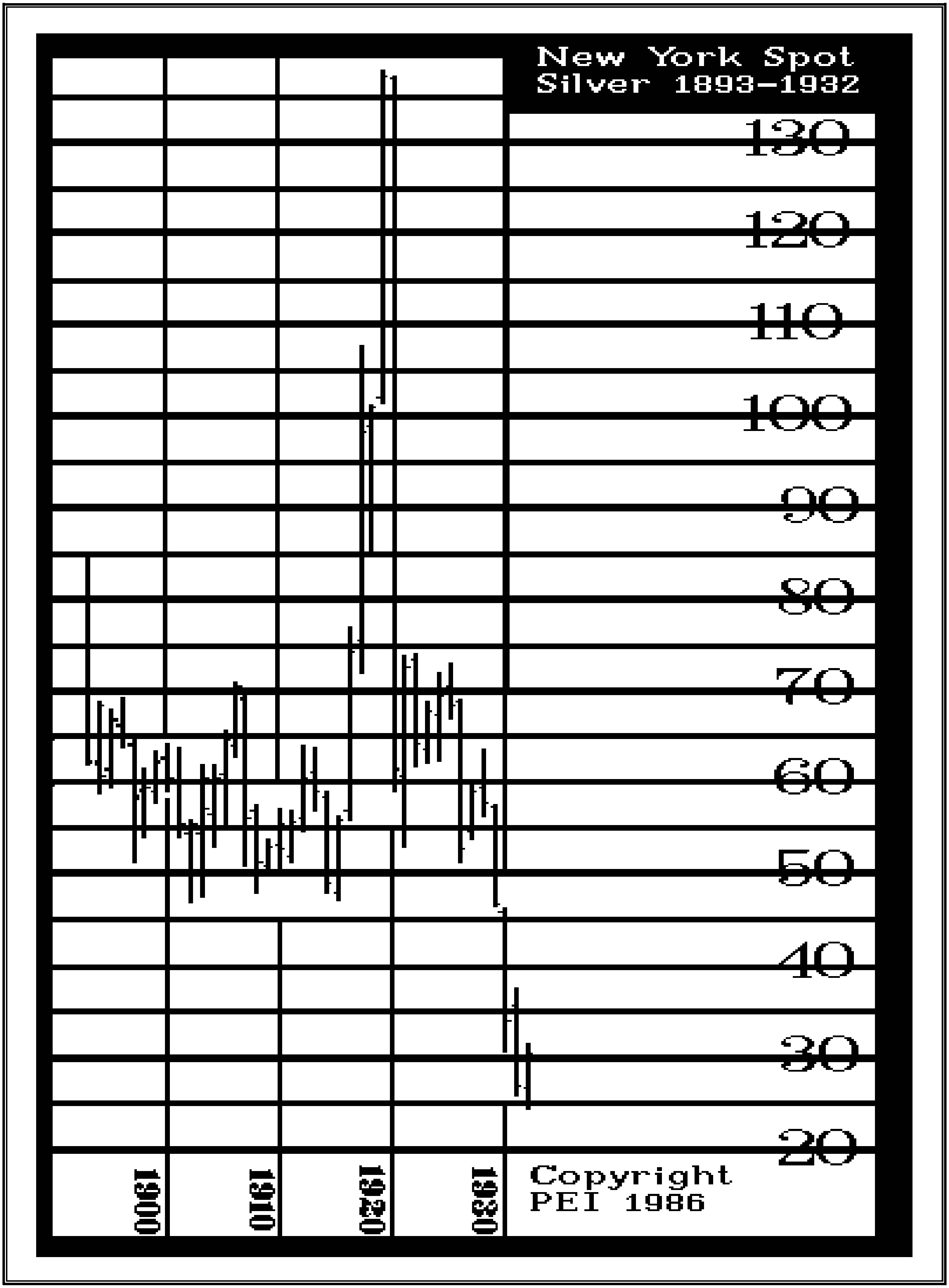


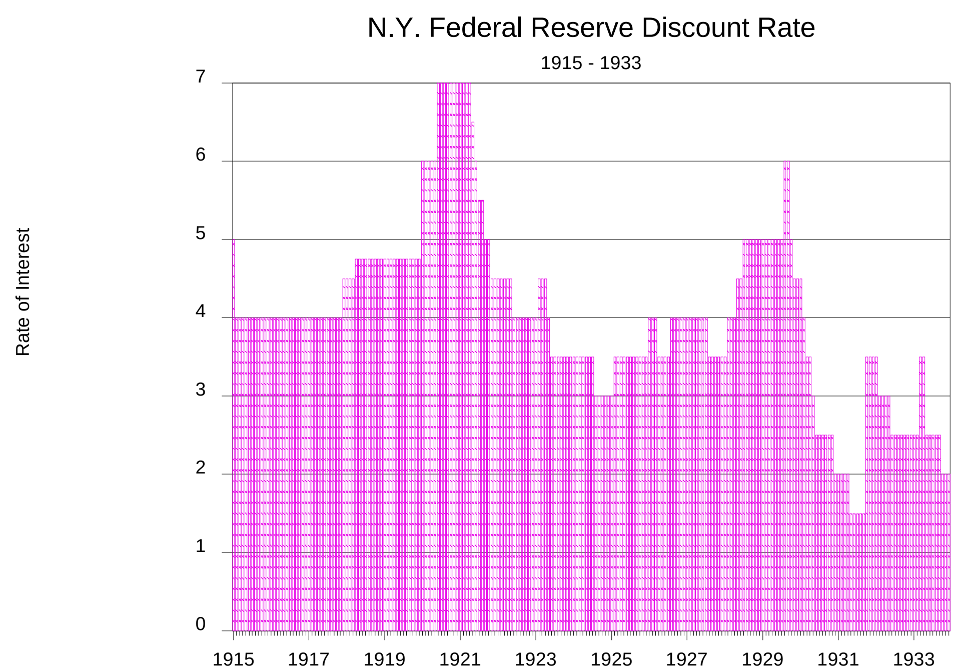
Herbert Hoover publicly denounced the proposals beginning on January 7, 1920. Hoover insisted that any loans should be made from the private sector and that government should not get involved. In December, 1920, he addressed the American Banker Association in Chicago. He stated right then and there his opinions upon an issue that later became an underlying problem, which erupted and forged the entire world into the greatest depression of the 20th century. "Our government," Hoover said, "would be subject to every political pressure that desperate foreign statesmen can invent and their groups of nationals in our borders would clamor at the hill of Congress for special favors to their mother countries. Our experience in war shows that foreign governments which are borrowing our money on easy terms cannot expend it with the economy of private individuals and it results in vast waste...The collection of a debt to our Treasury from a foreign government sets afoot propaganda against our officials, against our government. There is no court to which government can appeal for collection of debt except a battleship. The whole process is involved in inflation, in waste, and in intrigue. The only direct loans of our government should be humane loans to prevent starvation. The world must stop this orgy of expenditure on armament. European governments must cease to balance their budgets by publishing paper money if exchange is ever to be righted. The world is not alone in need for credit machinery. It is in need of economic statesmanship.

To understand the events of the bull market into 1929, and the subsequent collapse, it is also necessary to understand the period which had led to the greatest bull market in modern history. During World War I, most commodities had been fixed by the U.S. government. One such example was the Sugar Equalization Board. This establishment contracted to buy all the sugar crops from the U.S. as well as from the West Indian, Hawaiian and Philippine nations. Herbert Hoover recommended to President Wilson that the crop of 1919 should be


US COTTON PRICES 1831–1932
1864 High $1.90
1845 Low 4 cents
in cents
0
20
40
60
80
100
120
140
160
180
200
1830 1840 1850 1860 1870 1880 1890 1900 1910 1920 1930


US LEAD PRICES
Yearly: 1881–1932
cents per pound
2
3
4
5
6
7
8
9
10
11
12
13
1880 1890 1900 1910 1920 1930


New York Spot
Silver 1893-1932
130
120
110
100
90
80
70
60
50
40
30
20
1900
1910
1920
1930
Copyright
PEI 1986



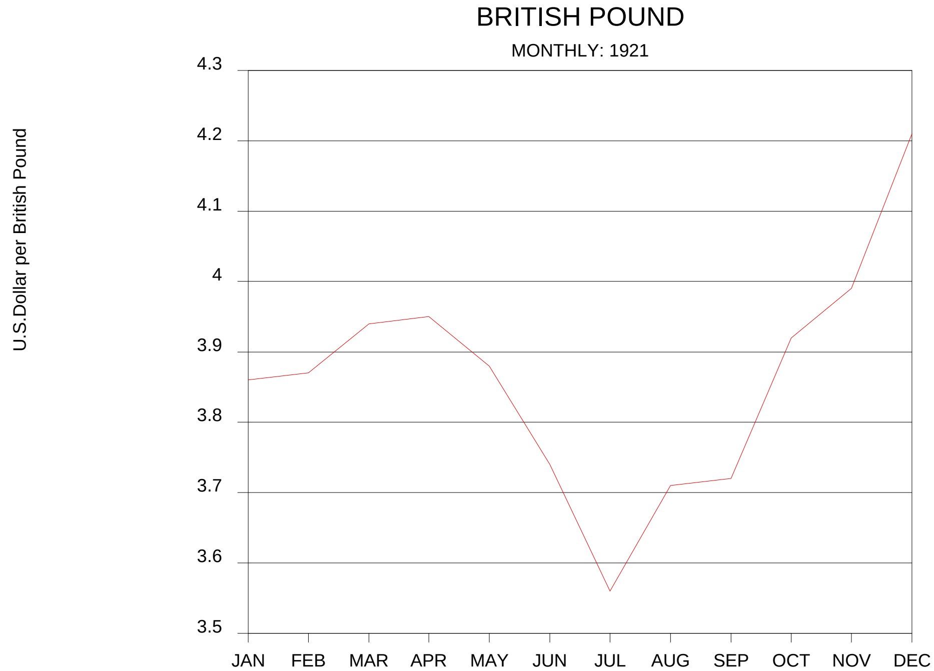
purchased until Europe could re-establish itself. But the President listened to Professor Taussig who had also sat on the Board. The controls were not renewed and the price of sugar jumped from 9 cents to 25 cents during 1919. This is merely one example of the drastic speculation in world markets during 1919 into early 1920.

Commodities had literally soared in value to their highest levels in over 20 years while many reached historic highs. Silver rallied to $1.40 after being as low as 45 cents in 1915. Corn reached a record high in 1917 at $2.50 per bushel prior to controls and fell back to $1.20. But in early 1920, it reached $2.20 compared to a 1915 price of as low as 60 cents. Cotton had soared to 43 cents compared to 7 cents in 1915.

The stock market had also followed suit. The wild speculation during 1919 to 1920 was predicated on the fact that most of the crops in various commodities had been destroyed in Europe and they were unquestionably in short supply. The stock market rallied because if commodities rose in value, so did the profits of American industry.

Clearly there was an extravagance of speculation following the War. This speculation was noted in European markets as well. It was undoubtedly a world wide event. But the world did not deal with the situation in the same manner.

In the United States, steps were taken to make money tight, and that the Federal Reserve did very nicely. The discount rate had stood at 4% during 1917. In December of 1917, the Fed began to raise the discount rate, jumping it to 4.5%. That was followed swiftly by another jump to 4.75% in March of 1918. There the rate stood throughout 1918 and 1919. The Fed waited until the fever of speculation had reached the very top. In January 1920, they raised the discount rate from 4.75% to 6% and then in June of that year it was raised again to 7%. The Fed had gone into overkill as usual, acting not in advance of a problem but in response to it after many of the markets had already peaked.



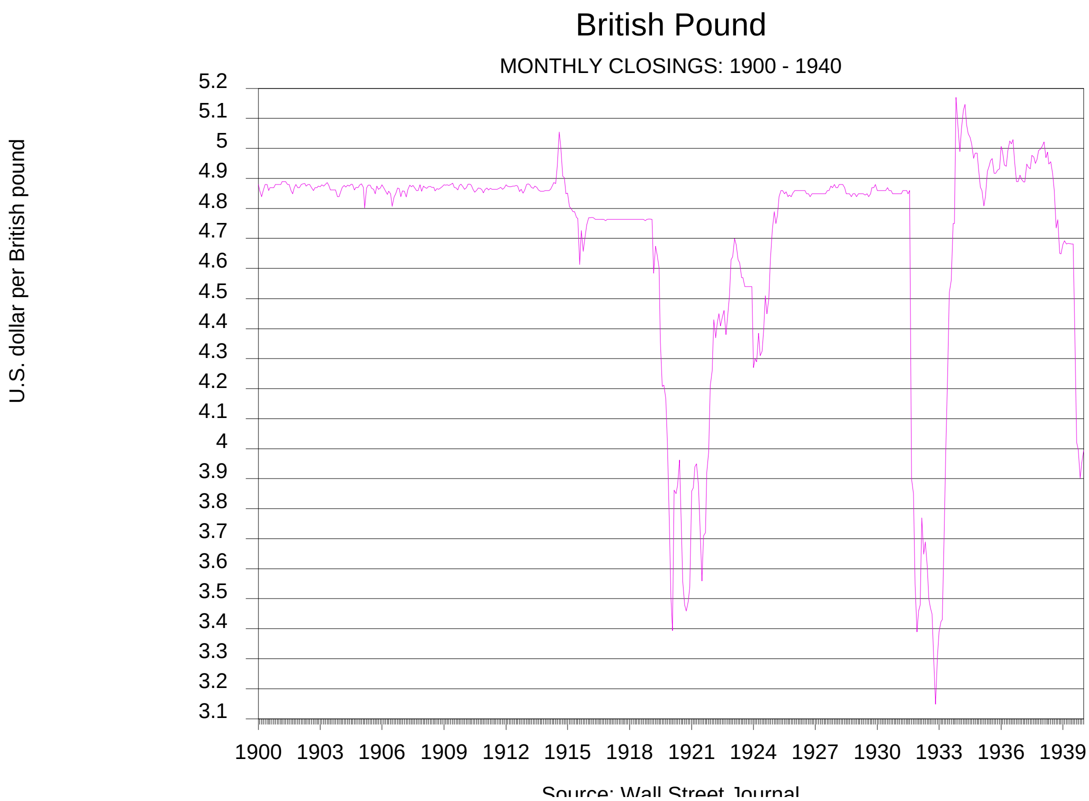
This was the U.S. solution to the inflation problem of the immediate postwar era. They chose to raise interest rates to force a deflation upon the free markets. Had they left the markets alone, the same action would have followed. As commodities began to come back into production during 1920, the markets had already sensed this was taking place and were in effect preparing in their own way to correct back in line with the newly anticipated increase in production.

In Britain, a different approach was selected to bring an end to the speculation fervor which also centered around foreign exchange. There a committee was formed consisting largely of bankers. This committee became known as the "Cunlife Committee, named after its chairman, Lord Cunlife, Governor of the Bank of England. This distinguished group of bankers had little sense of reality and the decisions that they made were the first turn of the screw which would eventually led to the greatest deflationary period in the history of that nation. As a result of the decisions of Cunlife, the economic devastation suffered in Britain between 1920 and 1922 was actually far worse than the Great Depression of the 1930s.

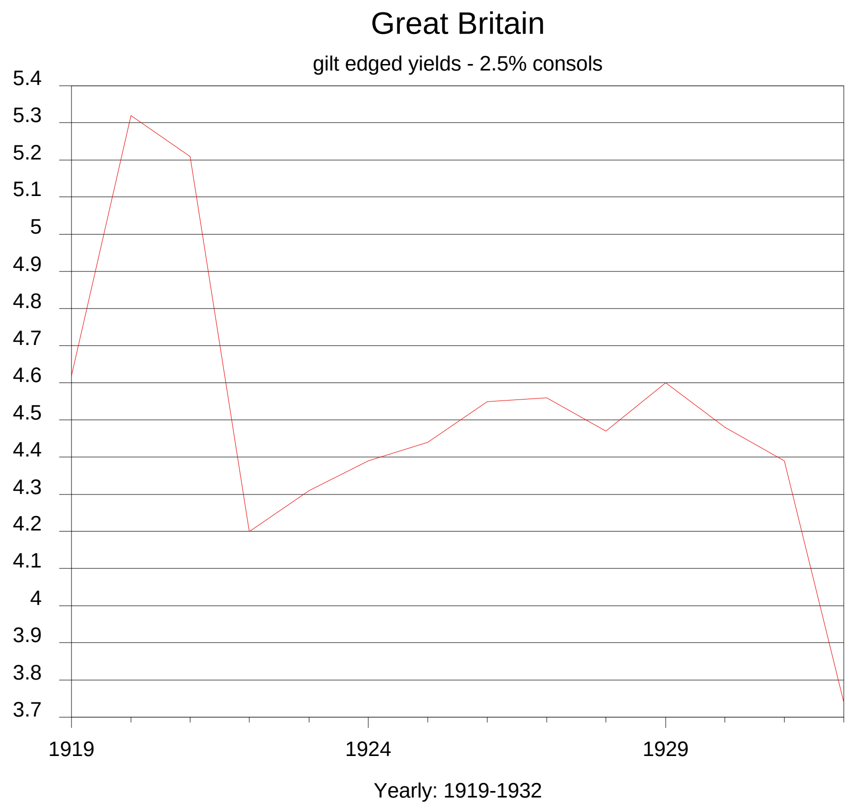
This group of bankers decided that on paper everything could be brought under control by maintaining the gold standard at the old parity of $4.86. They believed that Britain could maintain the old parity and keep the pound at prewar levels by raising taxes and reducing money supply.

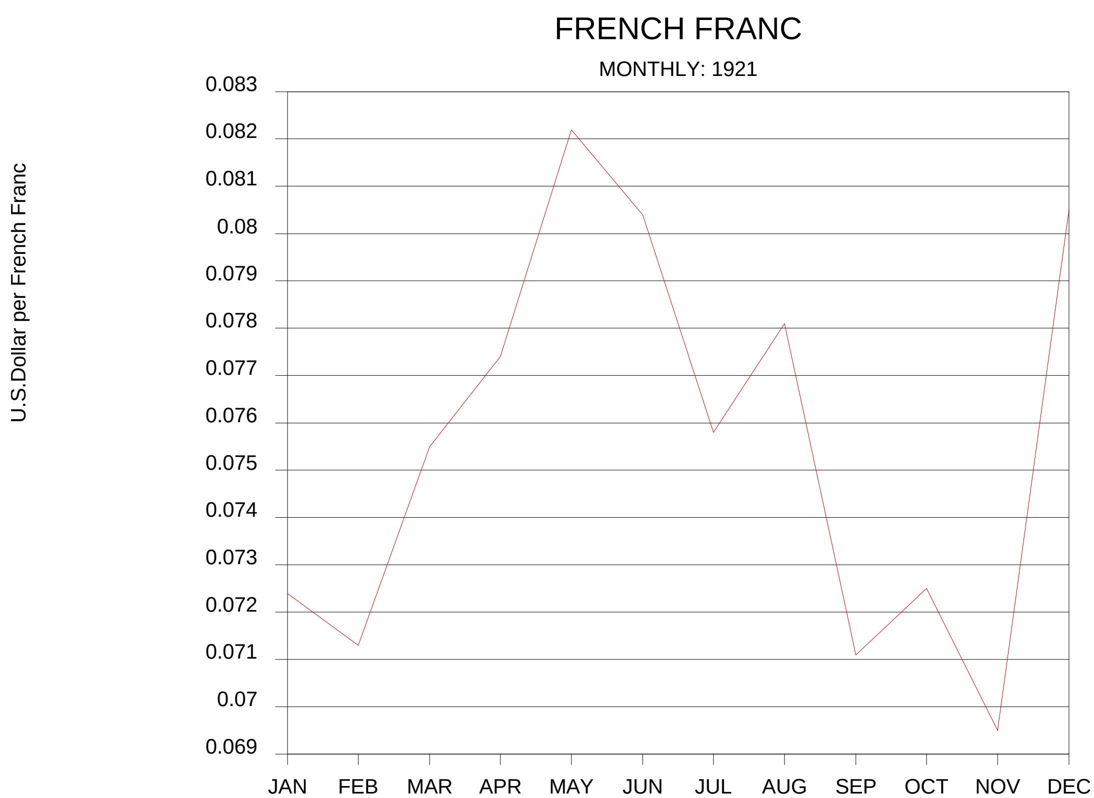
There was a great deal of speculation in Britain as to how far the pound would fall once the War was over. The Cunlife Committee seems to have had no sense of what the pound would have actually been worth in a free market and as such the gap between reality and fiction would soon become clear.

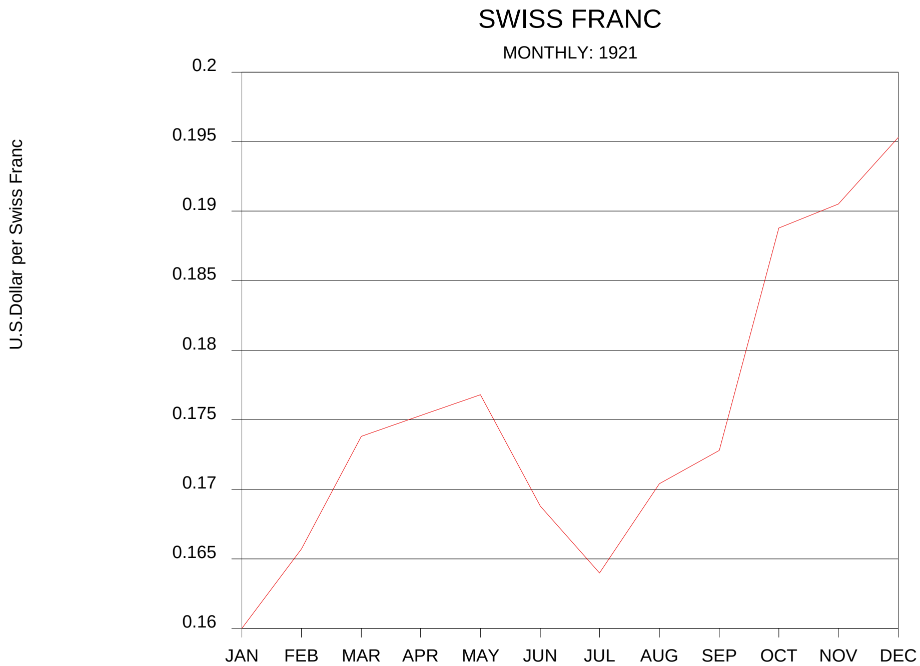
In August 1918, the Cunlife Committee published its first report. They merely


British Pound
MONTHLY CLOSINGS: 1900 - 1940
U.S. dollar per British pound
5.2
5.1
5
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
3.2
3.1
1900 1903 1906 1909 1912 1915 1918 1921 1924 1927 1930 1933 1936 1939
Source: Wall Street Journal


Great Britain
CPI - ALL ITEMS 1980=100
11
10
9
8
7
6
5
4
3
1900 1905 1910 1915 1920 1925 1930
Yearly: 1900-1932


Great Britain
gilt edged yields - 2.5% consols
5.4
5.3
5.2
5.1
5
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
1919
1924
1929
Yearly: 1919-1932


FRENCH FRANC
MONTHLY: 1921
U.S.Dollar per French Franc
0.083
0.082
0.081
0.08
0.079
0.078
0.077
0.076
0.075
0.074
0.073
0.072
0.071
0.07
0.069
JAN
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC



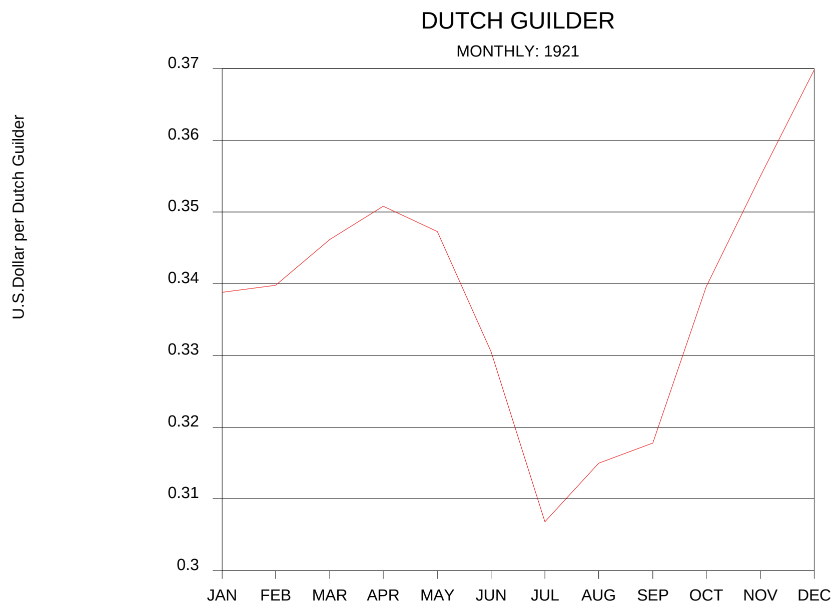
stated that Britain should live within its means and use revenue to retire most of the war bond issues held by the banks. Furthermore, much of the increase in paper money which was in circulation was also to be retired.

When the Armistice was signed on November 11, prices of goods and services initially fell for a four month period in Britain. But then in March 1919, Britain was forced to abandon the wartime fixed rate of $4.86 on the pound. Between March of 1914 and April of 1920, prices in Britain rose more dramatically than in the United States, increasing by 50%. The primary reason was the pound itself. The pound fell literally straight down to a low of $3.20, illustrating dramatically how overvalued the pound had been under the Cunlife recommendations.

To the American, the sudden dramatic rise in the dollar became noticeable only through the means of a drastically lower commodity value. In a sense, commodities declined in value, but not as dramatically on a worldwide basis. To the British, commodities began to rise because the declining value of the pound was reflected in higher prices since those base prices were in terms of dollars. Had the commodities risen in terms of dollars, the British would not have seen a rise in price levels of merely 50%, but could have experienced nearly a 100% price level increase.

Foreign exchange has been a major factor in all markets including stock prices. This, however, has seldom taken part in most analytical approaches. Yet as we pour through the wealth of price movements, we will see just how coincidentally tops and bottoms have come into play with foreign exchange movements.

The panic of 1920 was swift and severe, led by the oversupply in commodities and the drastic price movement in foreign exchange. The Dow Jones Industrials peaked during 1919 at nearly the 120 level. The year 1920 had opened at slightly above 100 and began to fall sharply after the dollar began to rise abruptly. At the end of 1920, the



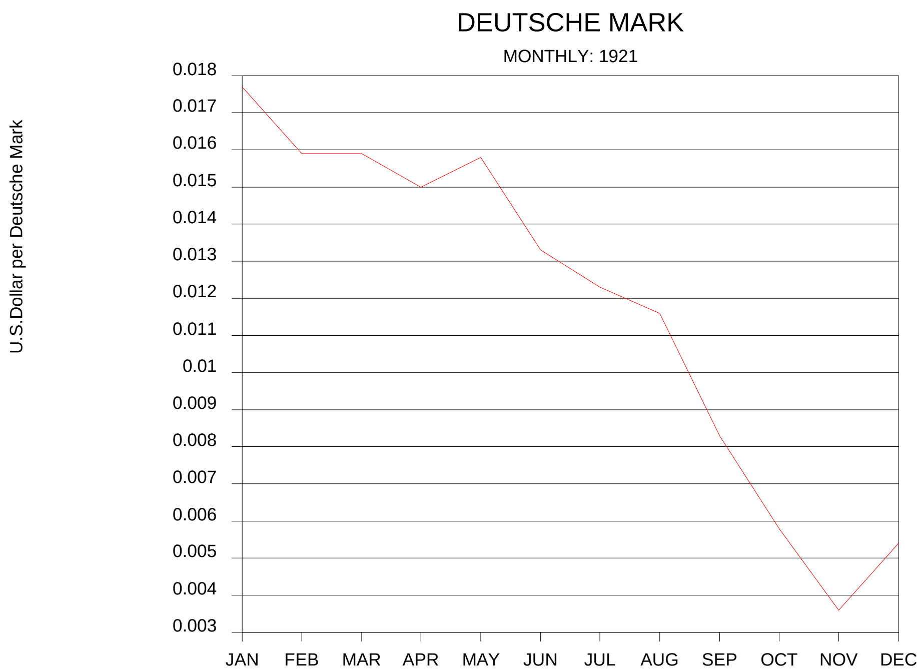
Industrials closed the year at 71, which was slightly more than a decline of 40%. The sharp decline in the stock market had equaled the rise in the dollar.

Numerous Americans had lost a fortune during that decline, yet at the same time something strange was taking place. While most were talking about the panic of 1907 and deciding that a depression was certainly at hand, foreign capital from the private overseas investor continued to flow into the United States.

One rule that we have found through the course of our research is that corrections in a market are normally 50% to 60% moves. A trend comes to an end when a decline moves beyond this percentage level as the 88% decline from the 1929 high. The fact that the panic of 1920 was severe is undenied, but the fact that the economy survived is a strong point in its favor as being merely a correction to economic conditions and not the end of an era.

Europe was still in turmoil following World War I. In Germany, the National Assembly had been established in 1919 to provide public elections for the office of the President. Paul Von Hindenburg was actually the first and last President elected by this new constitution. Although World War I was essentially over with the defeat of Germany, the world was not completely at rest. The Russian Civil War, which began June 1918 between the Soviet Communists and White Russian forces, had brought with it some international participants. British forces had landed at Murmansk in June of 1918 followed by the French at Archangel in August 1918. Japan and the United States also sent troops. By 1919 Poland invaded Russia, seeking to regain land over which it had long claimed ownership. Despite the Civil War, foreign invasion support and the Russian-Polish War, the Soviets eventually won. A treaty with Poland was signed on the 12th of October in 1920 and one month afterward the Civil War came to an end when the White Russian forces under General Wrangel were forced to evacuate the Crimea in November 1920.

In January 1921, Greece invaded Turkey. The Turkish forces eventually repelled the



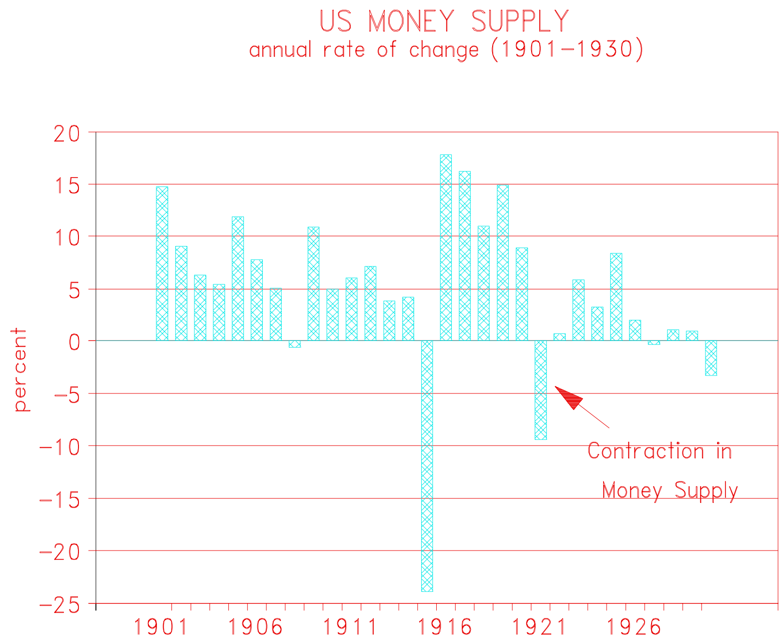
attack but the peace did not come until the signing of the Armistice of Mudanya on the 11th of October, 1922.

In Italy, a crisis in democracy had split the nation into moderate and nationalistic camps. An economic crisis spurred on by raging inflation brought the failure of the Cabinets of Giolitti in June 1920 and the succeeding Cabinet of Giolitti in June 1921. Terrorism became the battle tactic of the Fascists against the Socialists. With the country breaking apart at the seams, the King empowered Mussolini to form a Cabinet in October 1922. By November, Parliament granted unrestricted powers to Mussolini. Eventually in 1926 the final stages for the Fascist state were in place.

Europe lay in shambles and it was not merely the world economic structure that had been seriously fractured, but the very foundation of democracy itself. The side effect had been a serious curtailment of international trade. Much of the industry had turned toward armaments, which were a big business. Europe had lost much of its gold reserves and would continue to do so for the next few years. By and large, this had been caused by the establishment of industries in neutral overseas countries, such as in Latin America, to process much of its raw materials.

Another great problem for Europe, of course, was the extent of damage to productive facilities caused by World War I. In addition, the work force had taken a serious turn. Women represented a greater percentage of the work force while the men served on the front lines. Europe was also hampered in the early 1920s by the "planned" economy of the USSR, which at first was a world exporter of food. Russia would lose its exporter status in the 1930s but at point its exports hampered European agricultural production through increasing the supply which in turn depressed prices.

Chaos is a fair word to use in trying to describe the state of Europe at this point in time. In 1922, a World Economic Conference was finally held in Genoa but the United States and Turkey did not partici-



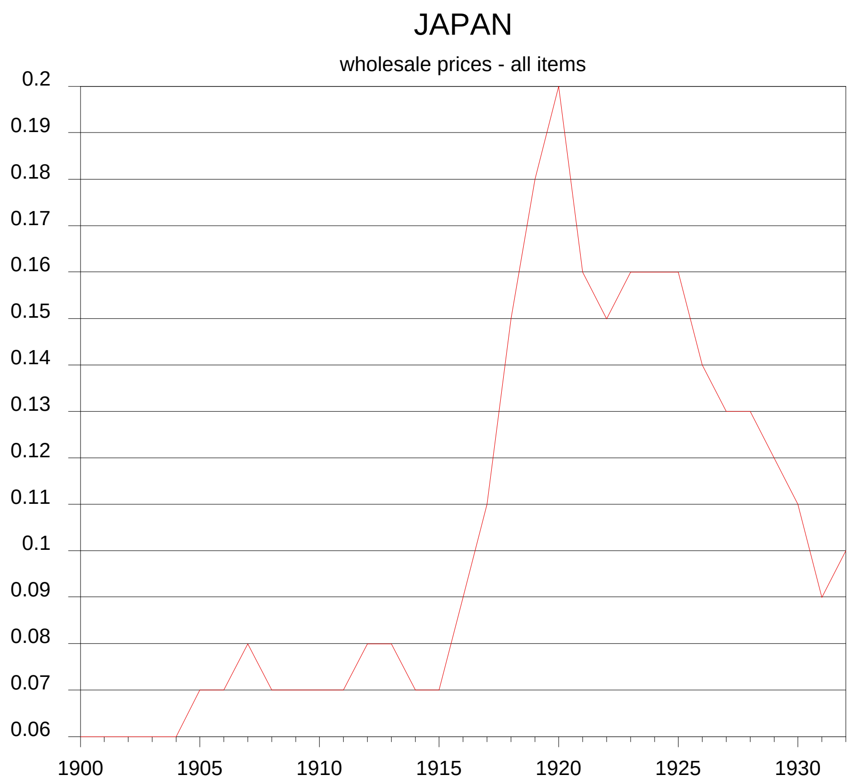
pate. This conference brought calls for the abandonment of the unchecked printing of money, and the creation of a currency unit for international exchange based on gold was proposed as a solution for the economic strife which faced the world.

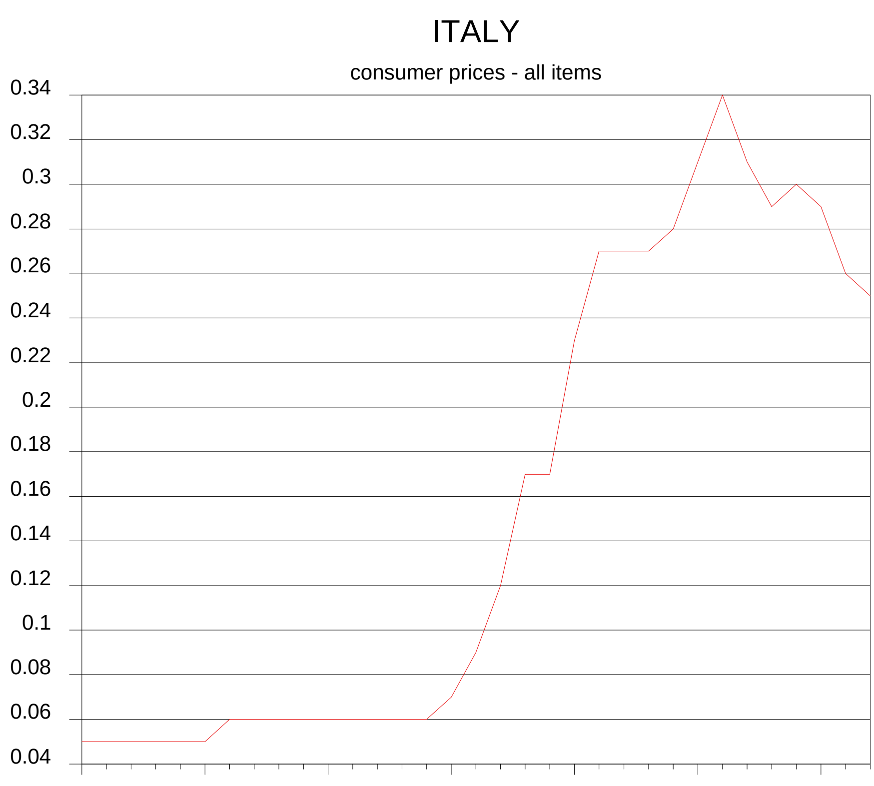
The United States had chosen to fight the inflationary pressures that had brought the 1919 rally in commodities as well as stocks by jacking the discount rate to what was then called the "7% Crisis Level." It did not raise taxes but money supply had contracted by 10%, dropping from $23.7 billion in 1920 to $21.5 billion as reflected by M1 in 1921. The flight to the dollar from the European currencies caused them to collapse, and perhaps aided the U.S. money supply which otherwise would have declined as much as 20%.

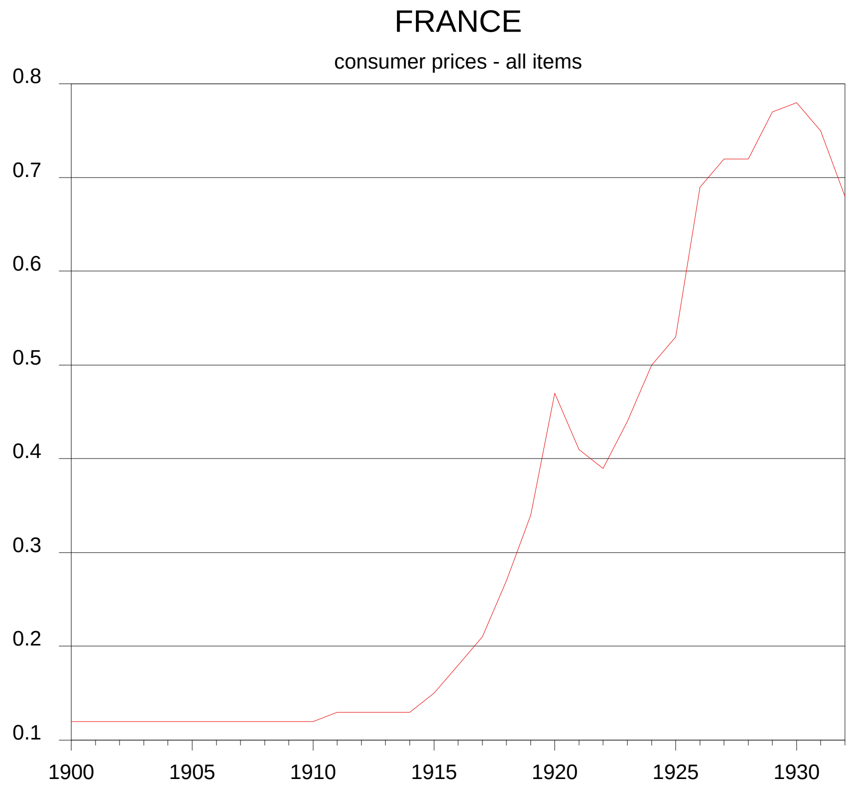
Britain, after abandoning the gold standard, attempted to fight speculation and inflation by raising taxes and contracting its money supply, forcing the pound to collapse from $4.86 to $3.20. But France, Belgium and most of the recently created central and Eastern European nations chose the inflationary road which had brought about a flood of unchecked printing of paper money. These were essentially the three courses of economic action taken by the major industrialized nations. The flight to U.S. based assets would have a major role in the years ahead.

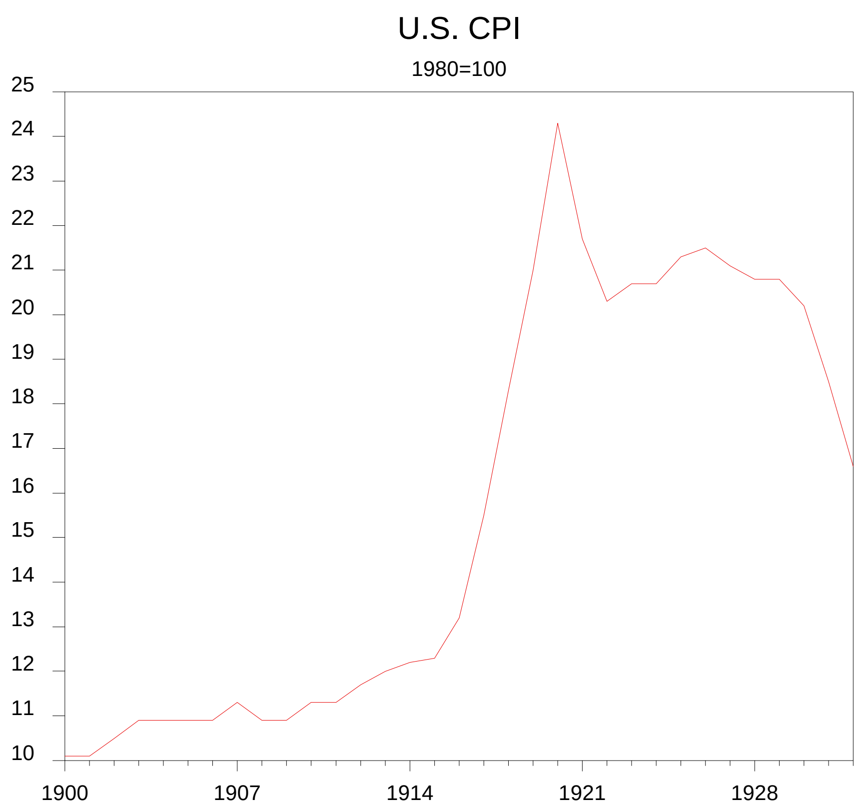
The year 1921 was marked by what had become known as the 1921 London Ultimatum. This British decree demanded the prompt fulfillment of the Peace Treaty, which called for the trial of war criminals, disarmament, and, the most important of all demands, fixed conditions of payment of the reparations by Germany. This Ultimatum had been preceded by the London Conference, which had seen the rejection of the German counter proposals.

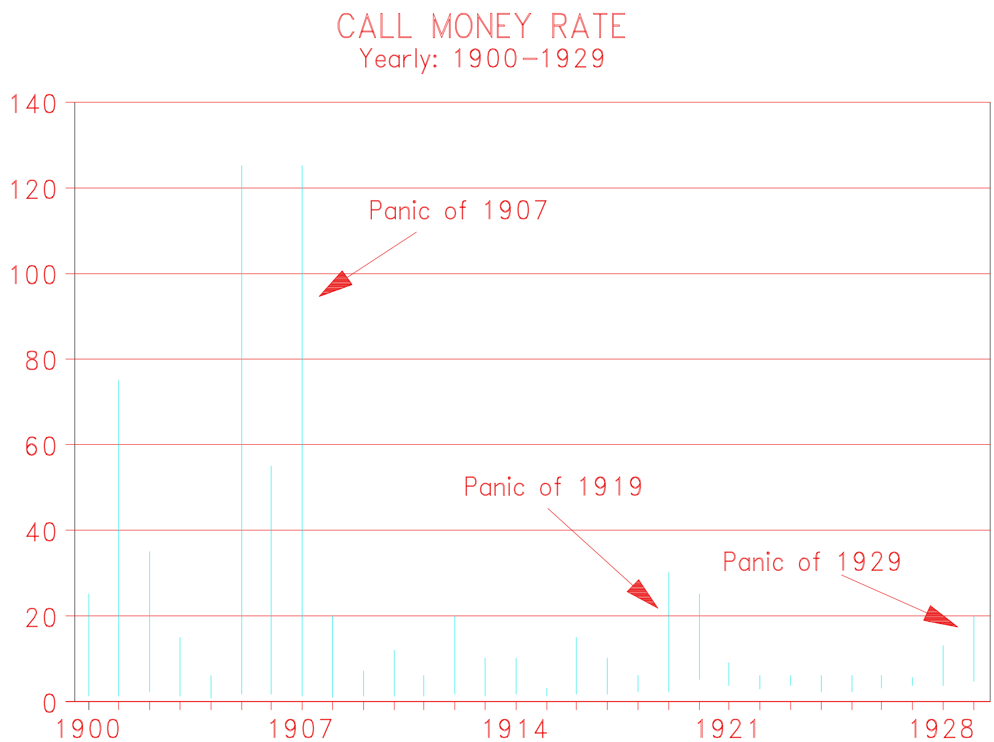
The deflationary forces in the United States, with a sharply rising dollar and an economy retaining for the most part its productive capability, began to attract much foreign capital. But perhaps the greatest attraction was the inflationary rates in


JAPAN
wholesale prices - all items
0.2
0.19
0.18
0.17
0.16
0.15
0.14
0.13
0.12
0.11
0.1
0.09
0.08
0.07
0.06
1900
1905
1910
1915
1920
1925
1930


ITALY
consumer prices - all items
0.34
0.32
0.3
0.28
0.26
0.24
0.22
0.2
0.18
0.16
0.14
0.12
0.1
0.08
0.06
0.04


FRANCE
consumer prices - all items
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
1900
1905
1910
1915
1920
1925
1930


U.S. CPI
1980=100
25
24
23
22
21
20
19
18
17
16
15
14
13
12
11
10
1900
1907
1914
1921
1928



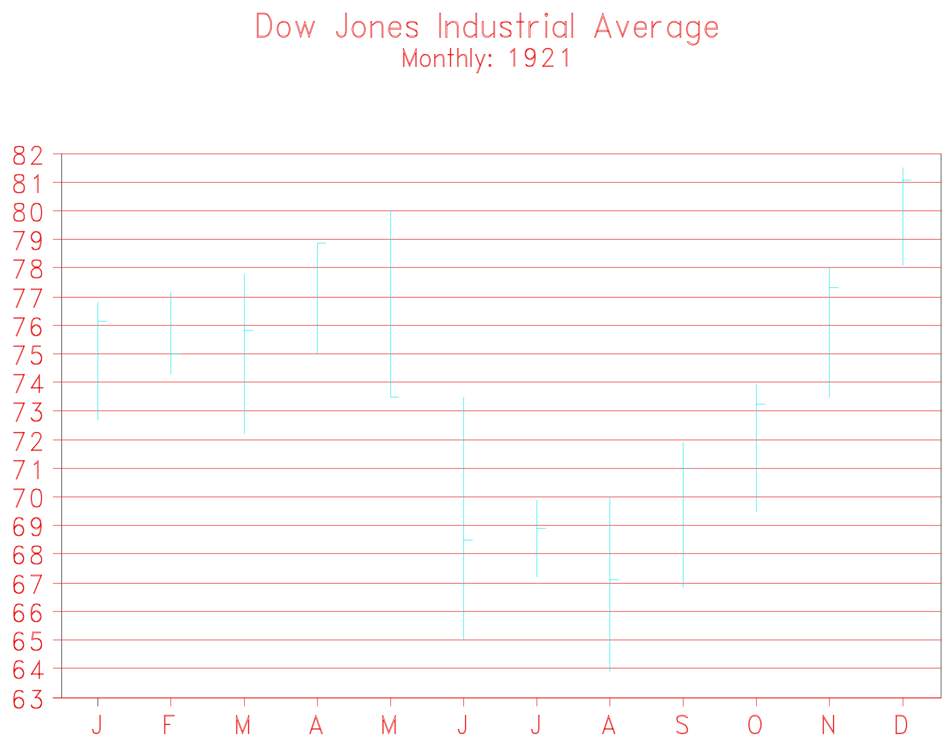
Europe between 1910 and 1921: in France, the consumer price index rose from 12 to 41; in Britain, it rose from 4.1 to 9.7; in Germany from 18.2 to 265.5; and in Italy, from .06 to .27. in Japan the wholesale prices rose from .07 to .16 between 1910 and 1921 while in the U.S., the CPI rose from 11.3 to 21.7. Although this period would later be called the deflationary years," in the U.S. the cost of living had risen sharply but perhaps at a lesser rate than the rest of the world.

Interest rates had risen sharply with call money (demand deposits) reaching a peak in 1919 of 30%. Even in 1920 call money reached a peak of 25% and by 1921 call money traded within a range of 9.25% to 3.5%. In Britain, interest rates on three month average treasury bill rates jumped from 2% in 1912 to 3.4% in 1919 but continued higher in 1920 to 6.2%, declining slightly to 4.5% in 1921.

It is understandable how depression, both in the economy as well as in the emotional state of the world population, had risen substantially. Business conditions in the U.S. had been quite brisk. When W.P.G. Harding said: "We are not indulging in the old idea of extravagance," he was referring to the shift of much European manufacture to the U.S. during the war period. Businesses were extravagant, overexpanding as if the trend would continue forever. Many were simply caught off guard by the sheer velocity of the fail, which was similar to the decline in the commodity markets between 1980 and 1982, yet far worse and in a shorter time span.

The depression of 1920 had not only seriously affected the economy within the United States, but also the lives of many individuals. One such man, who will remain in our writings throughout this period, was William C. Durant.

In 1908, Durant put together a half dozen automobile companies and called them General Motors Co. of New Jersey. In 1911, he was ousted from control and immediately formed Chevrolet Company; in May 1916, he regained control of General

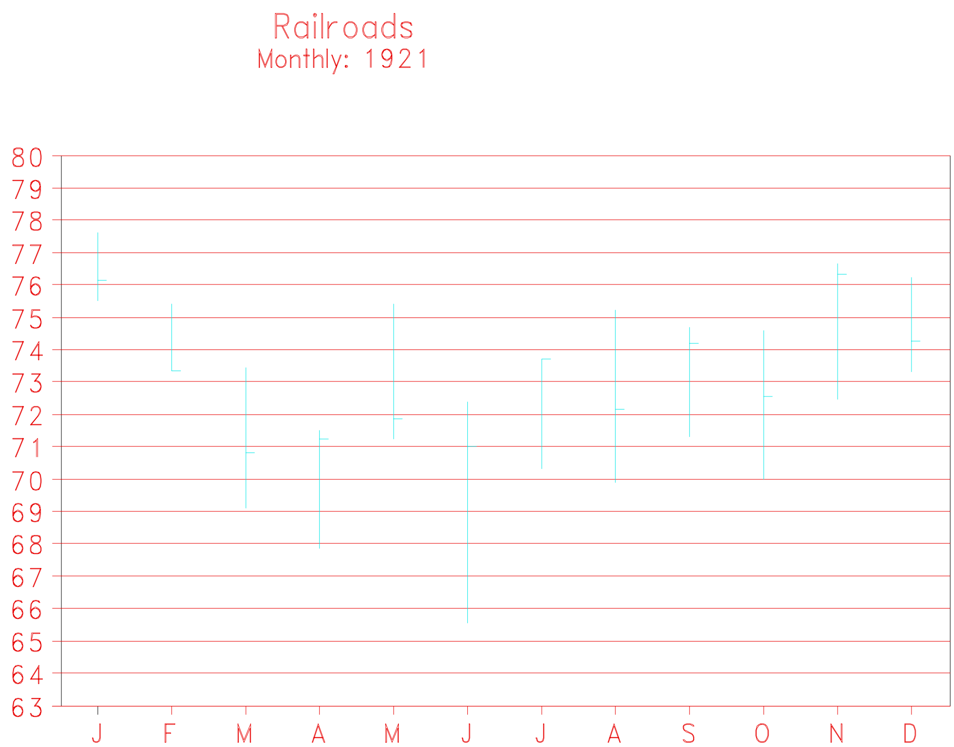


Motors. In the aftermath of the panic of 1920, Willy Durant was ousted once again but this time he would never return to his beloved General Motors. Many prominent men lost their fortunes as the worldwide economic convulsions engulfed a world and its people in a swift and sudden blow in the aftermath of World War I.

The sharp collapse in all markets between 1920 and 1921 cannot be given proper justice in words, even with the aid of hindsight. Jonathan Ogden Armour, founder of the famous meat packing company which still bears his name today, met with perhaps the most unbelievable fate of any tycoon. Armour's personal fortune had amounted to $150 million at the peak in 1919. No one suspected that a complete devastation was about to take place in all markets from commodities to stocks. Armour supplied the bulk of meat and grain supplies to the Allies during World War I. At the end of the war he found himself overstocked and overexpanded along with everyone else.

When all markets broke in a state of panic, the slide was straight down. Armour's vast fortune in today's terms, adjusted for inflation, would be $107 billion. Nonetheless, he lost $1 million dollars each day for 130 days straight without exception. He eventually died in 1927 while living in England, totally insolvent and owing a lot of money. There really are no words one can find which are capable of describing the personal tragedy that this once great supporter of freedom suffered during the panic of 1920. Swift and fast, the fortunes of many disappeared along with that of Jonathan Armour in the first 130 days of that panic. In an interview shortly before his death, he commented on his past and stated that he held the distinction in history of losing more money than anyone ever before. This was the atmosphere which surrounded the financial markets and the investment community at that time. The severity of the decline had stirred the memories of those horrifying days of the panic of 1907.

The Dow Industrials were initially steady as 1921 was ushered in. It was trading above



the 1920 low and continued in a sideways pattern rising into April. Then without notice, it began to collapse in May once again simultaneously with the rise in the dollar. Fears suddenly rose and the doom and gloomers were now predicting almost the end of civilization itself. How much more could society endure?

Despite the fact that January through March brought stable prices in the stock market, investors and traders remained very nervous. As the market rose into April, the Treasury released its report which revealed another deficit. This coupled with a labor crisis raging nearly out of control in Britain, and the end of military purchases of commodities from the Europeans, sent the stocks down that May. The downward pressures continued into June, steadied somewhat in July, and then plunged lower again into August. The pessimism continued despite the bright words or promises from the Fed. By September, 20,000 business failures had taken place and 3.5 million Americans were unemployed. Even the great mail order house of Sears Roebuck chalked up an operating loss of $16,435,468 by the end of 1921, while Montgomery Ward revealed a loss of $9,887,396. Eventually, the year 1921 would become known as the "Year of Deflation."

The world itself was in turmoil. In Britain, unemployment reached 2.5 million in July of 1921, one month before the Dow bottomed in the U.S. That was the peak in unemployment for both Britain and the United States but this would not be known for nearly two years.

Moreover, the rest of the world was still torn apart by the depression. A revolution took place in Portugal after one of the founders of the republic was assassinated. In Japan, the trend continued as Prime Minister Takashi Hara was assassinated on November 4. In Persia, there was a bloodless coup but in Morocco in July, the Spanish army was defeated by the Rifs. General Fernandez Silvestre committed suicide,

creating a political crisis in Madrid which nearly destroyed the government.

1921 was also the year when the "New Economic Policy" was announced by Nikolai Lenin in Russia. The U.S. Secretary of State, Charles E. Hughes, denied Russia's requests to resume trade relations and the cold war began as long as Communism prevailed.

But the stock market survived, and 1921 held at near the 62 point level, which was above the previous major low established in 1915 at 54 points. As the world drew nearer to its own economic destruction and desperate, hungry people began to flock toward the idealistic goals and dreams of Communism, some strange and invisible hand was making its presence felt. At the peak of pessimism and the deplorable news that couldn't possibly have been worse, the market held while short interest climbed.

In the midst of depression the American Stock Exchange had its beginnings from what had been known as the New York Curb Exchange. This exchange literally obtained its name from the location of its transactions. Clerks would position themselves on the streets signaling to traders perched in various windows along the street. But finally in 1921, they moved off the street corners and into their own building at Trinity Place. This was perhaps a subtle hint that just maybe the financial system of the marketplace would cheat death one more time.

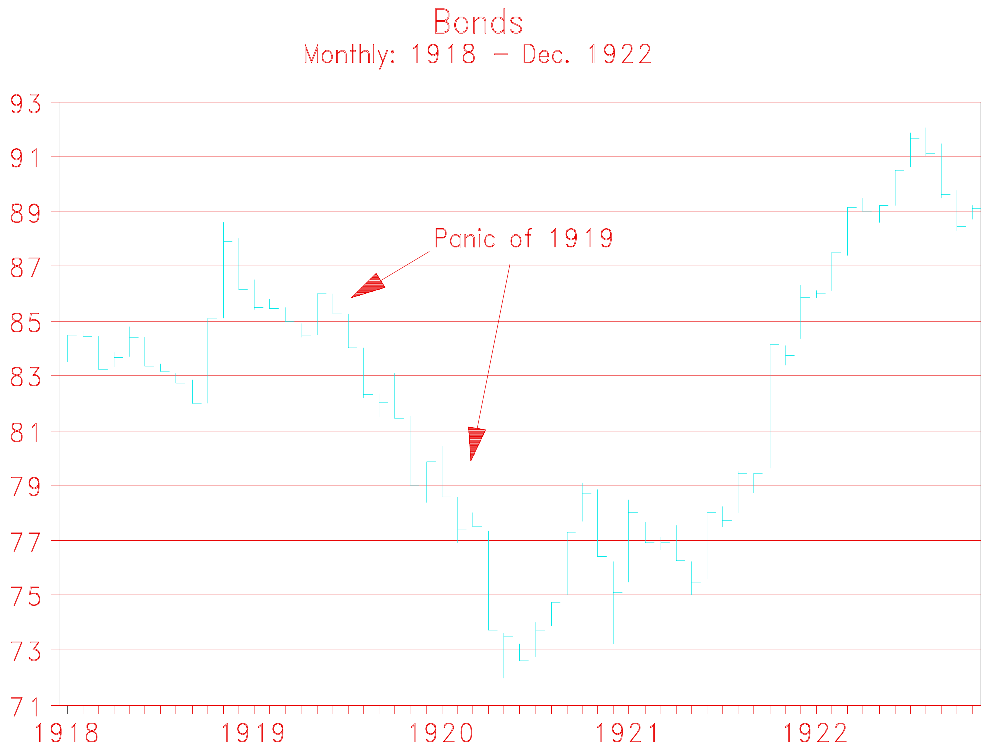
The Dow Jones Industrials had come under pressure because unemployment was high, business activity was low, and business failures were still rising into 1921 as a result of the Depression. The call money rates had subsided from the 30% high of 1919 but the Federal Reserve was not too quick to act. In the midst of the panic in 1919 the discount rate stood at 4.75%. Despite the fact that all markets were collapsing, money became tight and in January 1920, the Fed raised the rate to 6% from 4.75% in a single move. The markets literally crumbled as the Fed tried to smash the inflationary wave which had ensued.

In June of 1920, the Fed again raised the discount rate a full point to 7% trying to insure that inflation would come to an end. There the rate stood until May 1921, when only after devastating the economy did the Fed perhaps realize that it had gone into an overkill mode of operation. In May 1921, the discount rate was cut to 6.5% but obviously the economy and the emotions of the public were not impressed. Again, in June, the Fed cut the discount rate to 6% but the Dow Industrials still were not impressed and the market collapsed to 65 points. In July, the Fed cut the discount rate again to 5.5% and the market merely consolidated. In August, the Fed took no action but the markets sold off violently with the Dow Industrials reaching their final low at 64 for the entire panic of 1919 to 1921.

Despite the Federal Reserve's actions to finally lower the rates, their measures had little, if any, effect. In September, the Fed cut the discount rate to 5% but still it remained above 1919 levels. October brought no change but pessimism was still high. In November, the Fed cut the rate again to 4.5% where it remained for the balance of the year.

Germany began making payments according to the reparations agreement and gold reserves climbed to their highest point since 1917 in the United States. The railroads dropped sharply from January directly into April. There was a rally in early May but then a sudden, violent collapse into June. Perhaps it was a subtle signal that August would be the final low for the industrials and also the turning point for the economy since the railroads failed to make a new low and instead supported prior to the industrials.

Despite the fact that interest rates were easing, the bonds were performing terribly. They continued to decline directly into June as confidence was in short supply. Even the discount rate cuts didn't help the bonds as they only moved lower on that news. People became afraid of bonds as foreign governments teetered on the brink



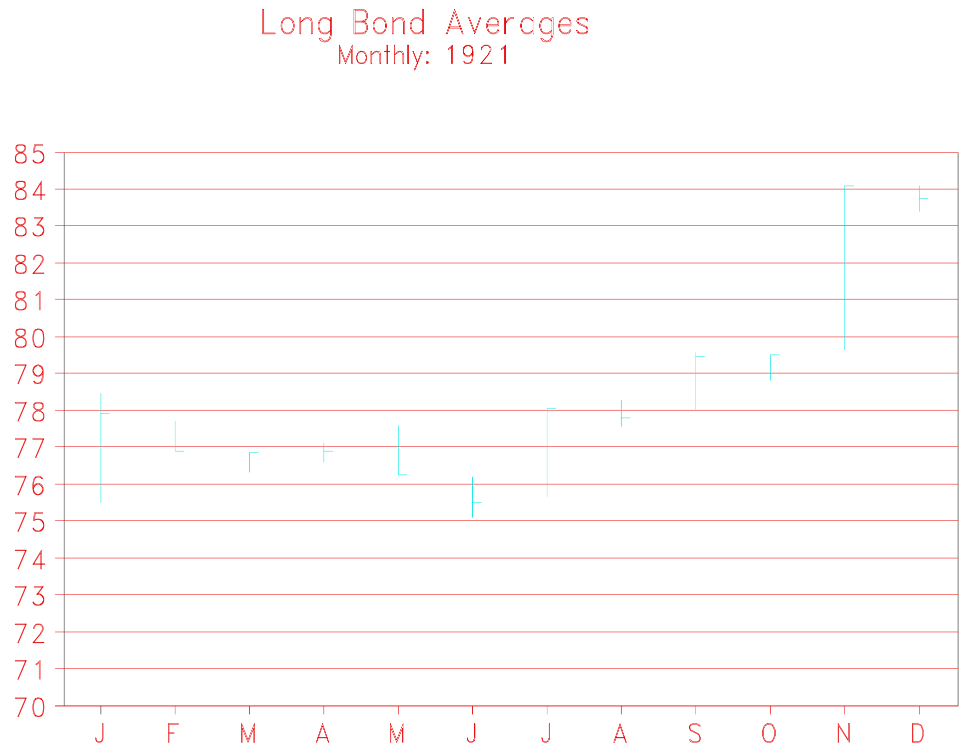
of financial ruin. Many questioned even the soundness of U.S. bond issues.

In the New York Times in July of 1921 the commentary under the Financial Column echoed the disappointed national tone:

"Looking back at the completed half year of 1921, the prevalent feeling is unmistakably one of disappointment. There was manifestly strong belief six months ago that the money market would revive, that the decline in commodity prices would end, and that mercantile trade in the spring months would reflect the stimulating influence of accumulating needs, of real consumers at the lower level of prices. None of these things has happened in accordance with the hopes of January.

"Money is not as tight as in 1920 but it is dearer and far less easy to obtain than in 1919 or in wartime. The investment bond market, after a brief recovery, has sunk back into apathy. Its present prices are not only below those of the January 'reinvestment movement' but substantially under those of last October. The pace of the fall in commodity prices slackened in early summer, but the average decline continued and, with its continuance, demand from the retail trade remained cautious and hesitant; the trade revival did not come. The stock market, meantime, continued to fall to a lower range of values after each temporary recovery, and as lately as June was governed by heavy liquidation for the account of embarrassed millionaire speculators of 1920."

As is the case today, people are moved only by that which lies before their own eyes. The fundamentalists, who cannot see beyond the next round of figures, failed then as they still fail today to foresee the subtle changes in trend and sentiment. As we continue through our accounting of the greatest bull market in the history of the United States, and the world for that matter, it will become blatantly clear that despite the sharp rise in the stock market into the late 1920s, the analysts wouldn't believe

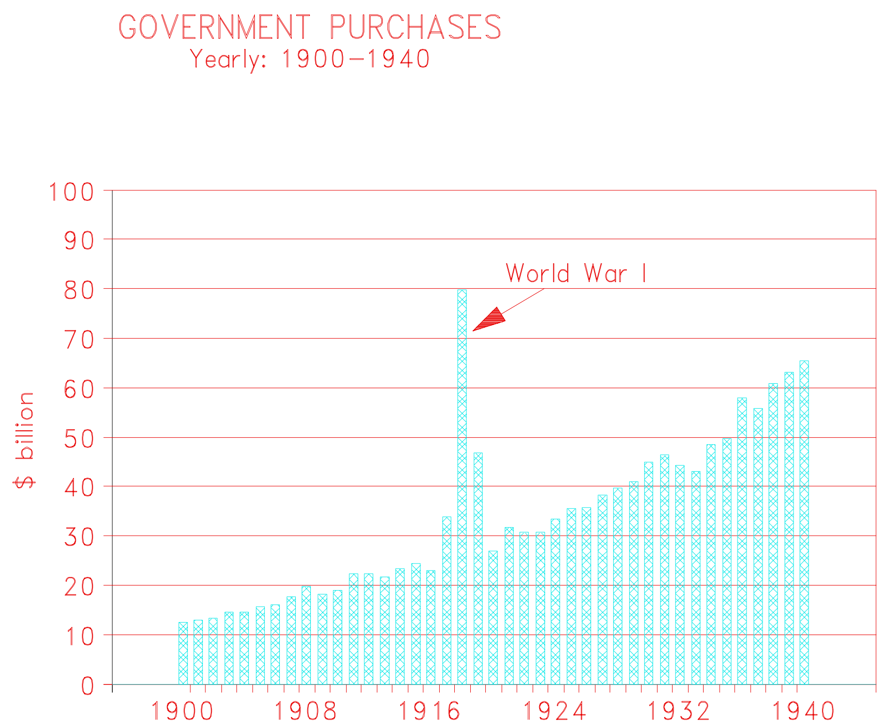


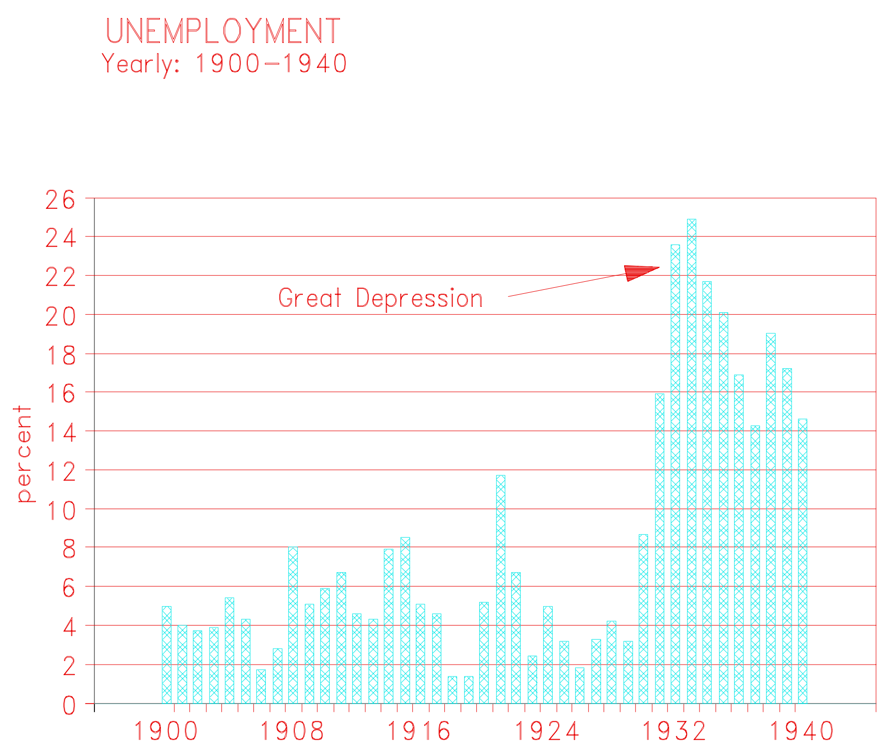
it and continued to cry depression for many years to come.

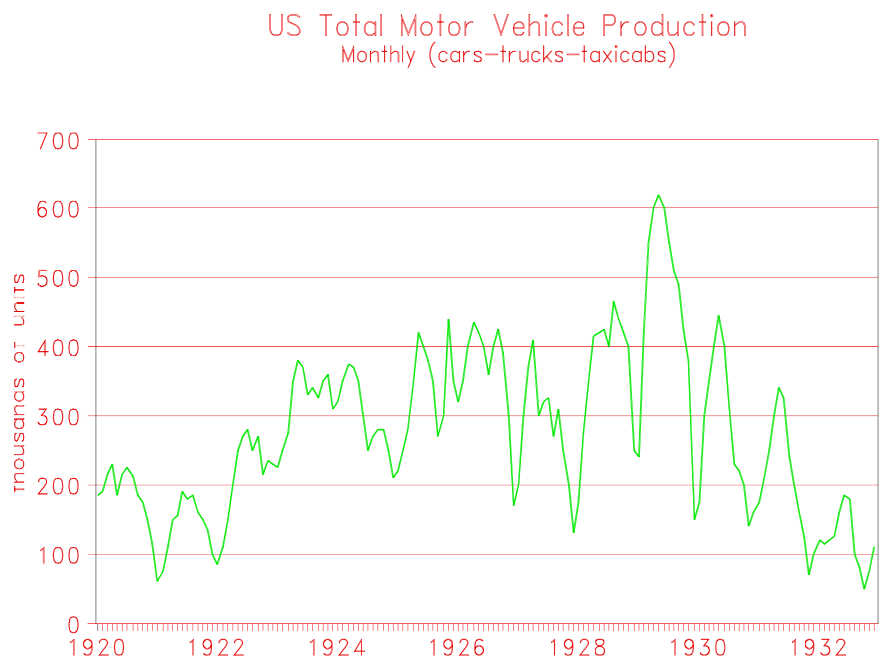
At this time, the economist Schumpeter formulated his economic theory, which has stood in direct contrast to both Keynes and Marx. Schumpeter's theory was centered around his concept of innovation. He believed that economic waves of prosperity begin because of some innovation that helps to broaden the economy. Once the prosperity peaks, the resulting collapse comes about due to the lack of some new innovation. Therefore, the over expansion results in too much competition, which reduces profits and forces the weakest out of business.

The bottom in the stock market in 1921 can be safely attributed to several reasons. The most important, a purely technical reason, was that the economy was fundamentally sound and despite the collapse in the agricultural sector, industry was expanding upon new frontiers with bright new ideas and the traditional spirit of American innovation. The first coast-to-coast airplane flights had been achieved and airmail service began to take off, so to speak, at the post office. This carried over into many other areas and helped to broaden the business connections which could be vital for future economic expansion.

The automobile industry became a rising star and by 1922, Henry Ford was proclaimed by the Associated Press to be a billionaire making $264,000 per day. The Lincoln Motor Company was started in 1921 and was bought by Ford in 1922 for $12 million. In 1922, Durant Motors come out with the "Star," priced at $348 to compete with Henry Ford's Model-T, an attempt by Willy to regain his former fame and influence. Chevrolet began to use Du Pont paints and offered cars in a variety of colors. Hudson, Deusenberg and Checker Motors Corporation also joined America's latest industrial innovation, the automobile. For despite the doom and gloom sayers, those who had money were buying cars. Perhaps still in the stages of infancy, the auto indus-


GOVERNMENT PURCHASES
Yearly: 1900–1940
World War I
$ billion
100
90
80
70
60
50
40
30
20
10
0
1900
1908
1916
1924
1932
1940


UNEMPLOYMENT
Yearly: 1900–1940
Great Depression
percent
26
24
22
20
18
16
14
12
10
8
6
4
2
0
1900
1908
1916
1924
1932
1940



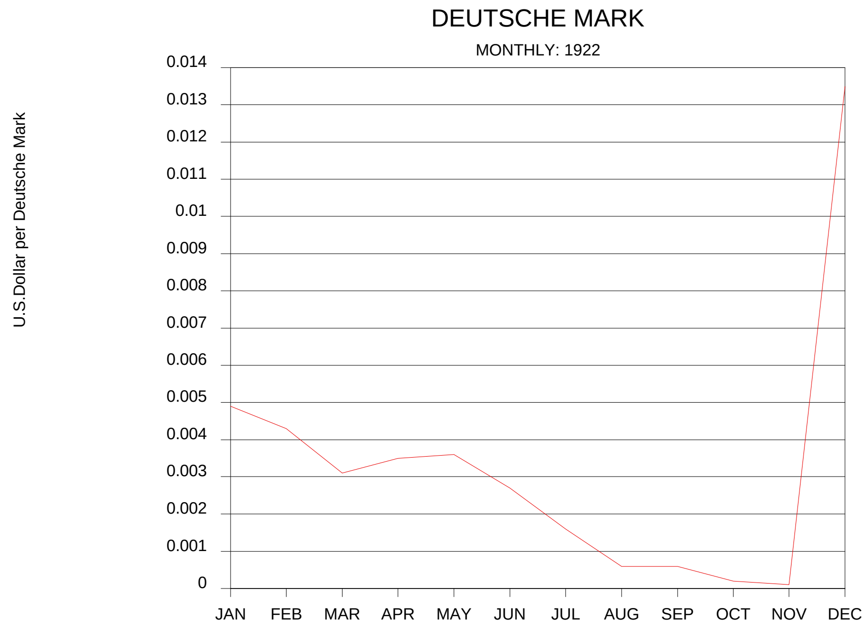
try was embarking on a new age of industrialism. It was Schumpeter's Theory of Innovation that saved the decline and fall of the U.S. financial system.

The devastation of the 1920 panic and that of early 1921 was senselessly brought about by a government which was incorrect in its assessment of the economy and its fear of inflation. The overkill tactics of the Federal Reserve were a serious mistake which would carve a cold image in the minds of many for years to come.

Click here for PEI's Homepage

CHAPTER II

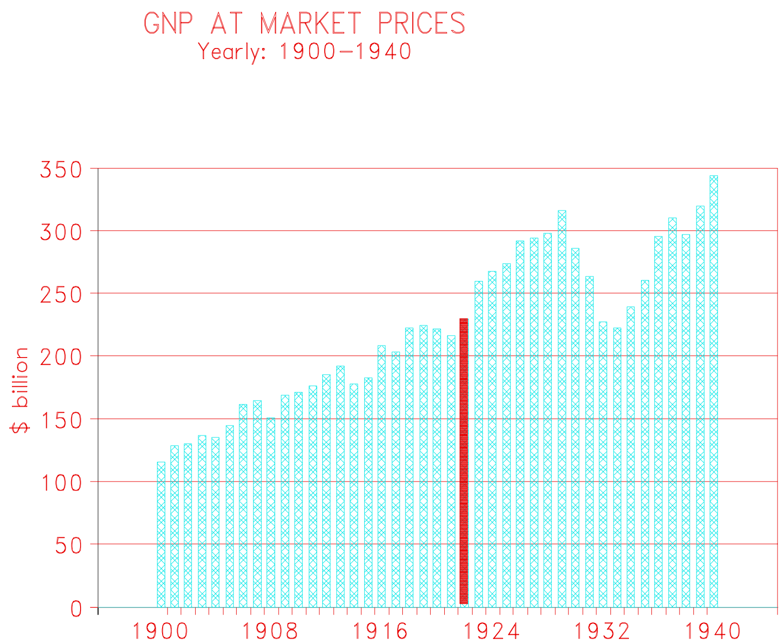
1922

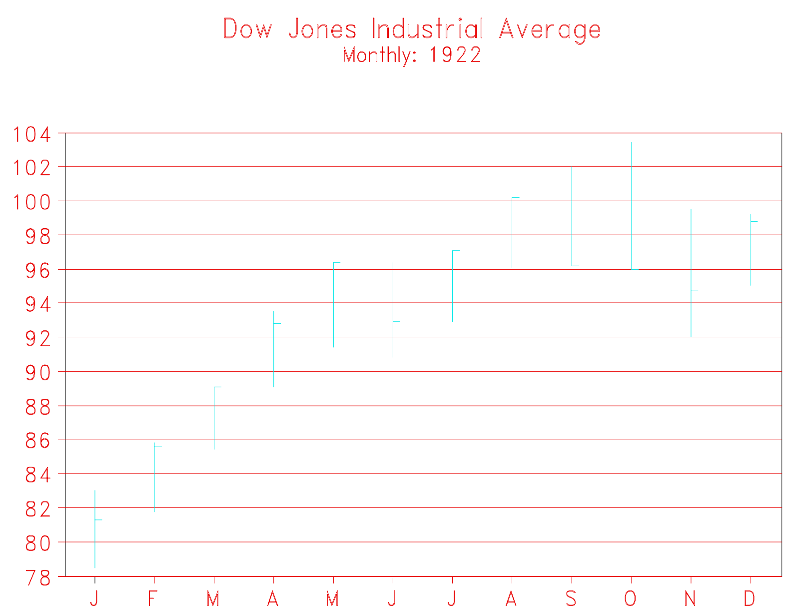


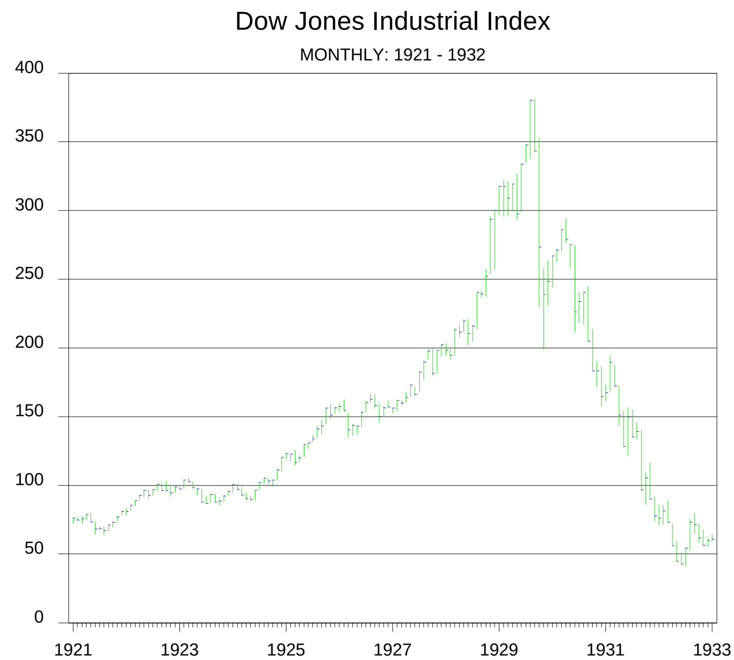
Germany had met the British Ultimatum and begun its reparation payments, but economically Germany would not be able to repay for all the damage of World War I. German coal production rose from 219.4 to 256.3 million tons between 1920 and 1922 but social unrest brought riots and a collapse in productivity. By 1923, coal production dropped to 180.4 million tons while steel production fell from 11.71 million tons in 1922 to 6.31 million tons in 1923. Exports in general had fallen 40% from their 1913 levels. Industrial disputes rose to their highest levels of 1,785 incidents, a record which still stands to this day.

The postwar era was definitely marked by inflationary pressures around the world. The United States chose the deflationary method we have discussed through actions taken on the part of the Federal Reserve. Britain chose to raise taxes, an old favorite in that political structure. But Germany chose the unchecked wholesale printing of money. Perhaps it had no choice with the demands placed upon it by the world. It was a little absurd to expect a nation that was destroyed by the War to suddenly profit from world trade to such an extent that it would be able to pay for the reconstruction of the rest of the world.

The strain was simply unbearable as reflected by the desperate condition of the mark. The German mark began to fall faster than anyone could have possibly imagined. At first it fall to 162 to the U.S. dollar, then down to 11,000 to the dollar by the end of 1922. Confidence of the German people had been destroyed. Chancellor Wilheim Writhe, who had been elected in


GNP AT MARKET PRICES
Yearly: 1900-1940
$ billion
350
300
250
200
150
100
50
0
1900
1908
1916
1924
1932
1940


Dow Jones Industrial Average
Monthly: 1922
104
102
100
98
96
94
92
90
88
86
84
82
80
78
J F M A M J J A S O N D



1921, was forced to resign over the reparations issue in 1922. He was replaced by Chancellor Wilheim Cund in 1922 but by now he could not stop the onslaught in loss of confidence.

In Britain, the producer price index declined from the 1921 level, falling from 7.9 to 6.5 in 1922. The consumer price index fell from 9.7 to 7.9 in 1922 but these gains were made at the serious expense of its population through the drastic increases in taxation and reduction in money. This would eventually prove to be a major deterrent toward recovery in the years ahead and leave Britain as a debtor nation counting on payments from Germany which would never come.

In France, their CPI fell from .41 to .39 between 1921 and 1922 while in the United States the gross national product rose from 12.7 in 1921 to 14.9 in 1922. U.S. industrial production was rising sharply between 1921 and 1922 but this was largely ignored by the analysts as a temporary situation. Raw steel production rose from 20.9 million tons to 35.3 in 1922 and passenger car production rose from 1.4 million to 2.2 million. Copper production rose from 437.5 million tons to 670.3 Obviously something was taking place which should not have been ignored.

In the United States, the Federal Reserve continued to ease as foreign capital continued to gravitate towards its economy. In June 1922, the Fed cut the discount rate from 4.5% back to 4% which is where it had stood between 1915 to 1917.

The Dow Industrials had rallied for nine months straight since the August 1921 low. By May 1922, the industrials were nearing the 100 level once again. Oddly enough, the June discount rate saw the market correct for the first time. After the June consolidation, the market resumed higher, reaching a peak in October. Many viewed the discount rate cut as bearish and as a signal that a depression would resume. November 1922 provided a sharp correction and December closed slightly below the 100 level.

The year 1922 was a strange year indeed. The boom in the economy was again highly influenced by favorable overseas investors. The British pound had rallied from its drastic decline of 1920. During 1921, the pound had rallied during the first quarter, reaching $3.95 in April but falling sharply back to $3.56 in July, bottoming one month prior to the turn in the Dow Jones Industrials. By year end, the pound had staged a comeback, closing December 1921 at $4.21. The pound continued higher in 1922 but at a slightly less aggressive pace, peaking during May at $4.45 and consolidating into September down to $4.38. But by year end, the pound resumed its uptrend, closing December 1922 at $4.63.

The stock market was moving higher from its 1921 low, once again following the opposite trend of the dollar. The economy was booming in many sectors yet by and large the press remained negative. The housing construction figures are reflective of how the consumer was apparently doing better than the professional stock traders. The following table illustrates the housing boom that was taking place:

Dwelling Units Constructed

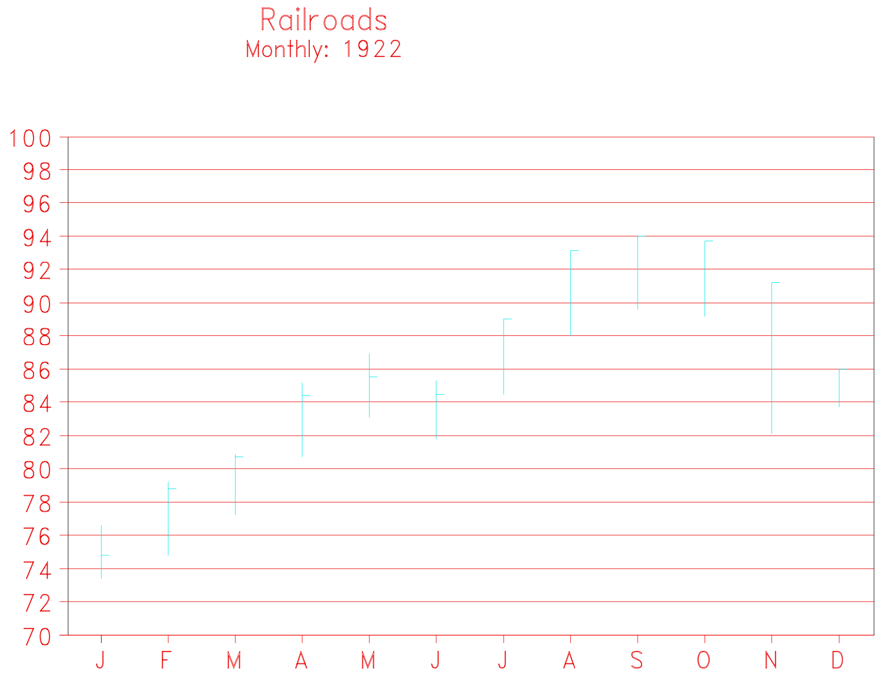
1921....449,000
1922....716,000
1923....817,000
1924....893,000
1925....937,000
1926....849,000
1927....810,000
1928....753,000
1929....509.000

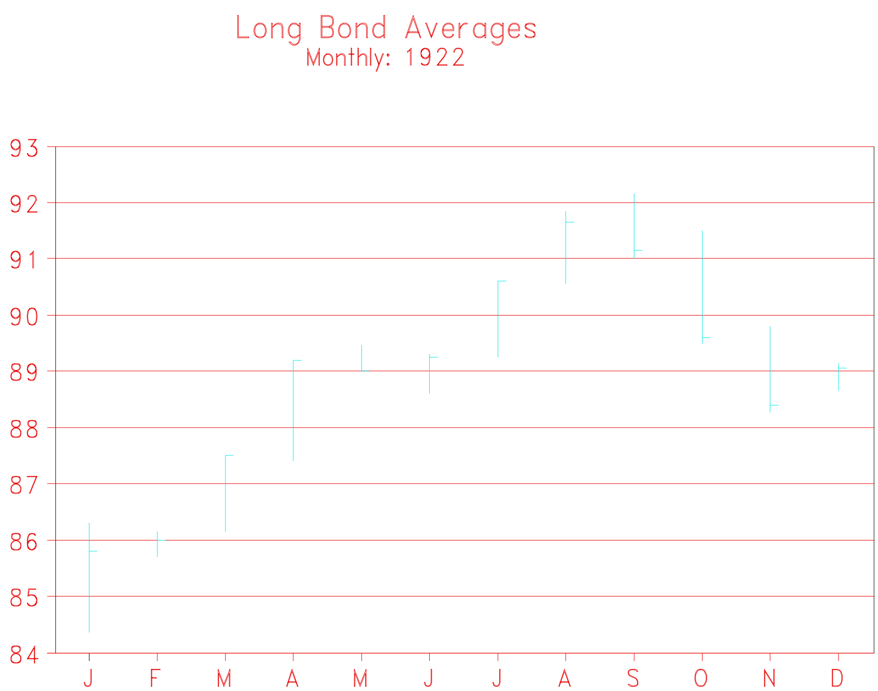
There was nearly a 35% increase in the construction industry between 1921 and 1922. This was the sharpest rise for the entire period known as the Roaring 20s. Once the peak was reached in 1925, even 1939 levels would be 20% below that which was recorded during 1922.

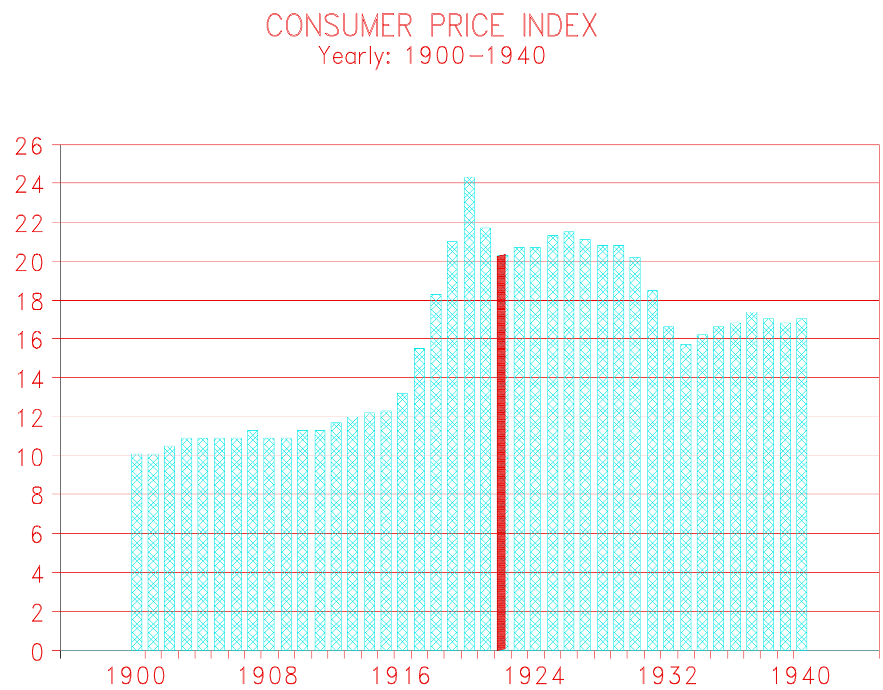
One issue that also helped the U.S. markets at that time was the severity of the foreign loan situation. In February 1922, President Harding called a conference at the White House. In attendance were Secretaries Hoover, Hughes and Mellon, along with representatives from the banking industry and the bond- issuing houses. President Harding had become alarmed at the number of foreign bond issues which were being floated in the States. Individuals from overseas, as well as representatives from foreign governments, were coming to the U.S. financial markets to raise capital. They offered rates between 5% and 8% to attract badly needed capital. As the money had flowed to the U.S. from overseas investors, Europe's cash flow was in jeopardy. Many became concerned over the security of many of those bond issues and the outflow of capital had even driven the dollar down on foreign exchange markets.

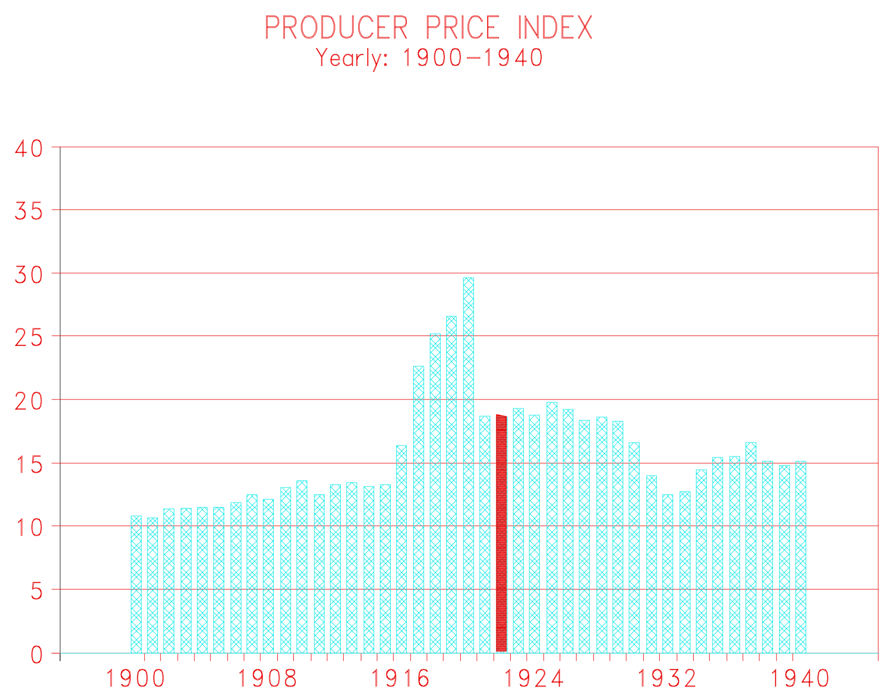
It was agreed at the White House conference in early 1922 that any foreign bond issue be submitted to the State Department for its opinion. The State Department in turn referred the submission to the departments of Commerce and the Treasury. The Commerce Department ventured their opinion as to the security and repayment ability of the intended borrower, whereas the Treasury ruled on governmental issues as to their political desirability. A public notice to that effect was eventually made on March 3, 1922.

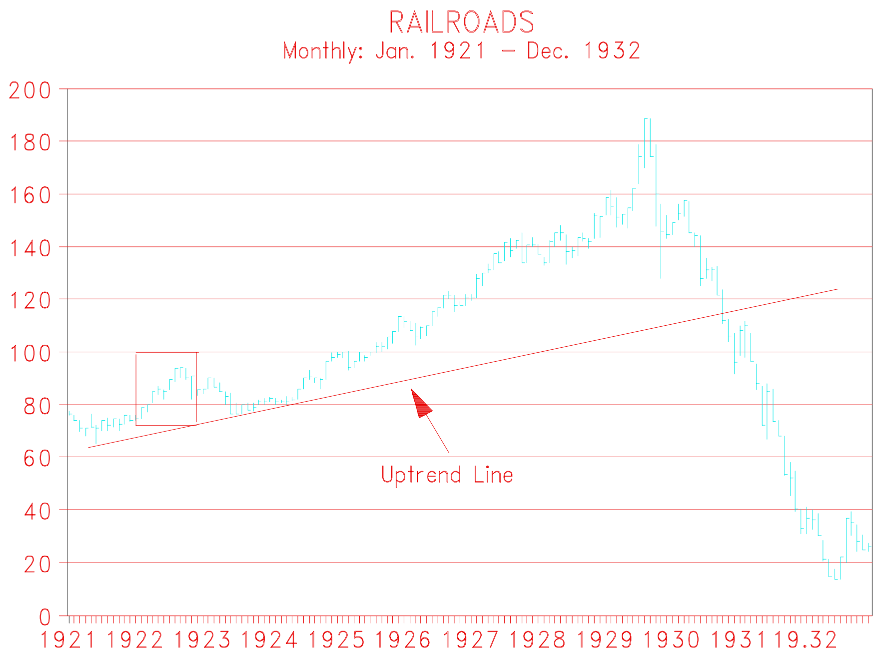
The big New York banks complained about the restrictions and, in fact, the Governor of the New York Federal Reserve, Benjamin Strong, filed a protest with the State Department in April 1922. Benjamin Strong would eventually, in my opinion, almost single-handedly create much of the damage that caused the panic of 1929. Due to Strong's attack upon this policy, Presi-

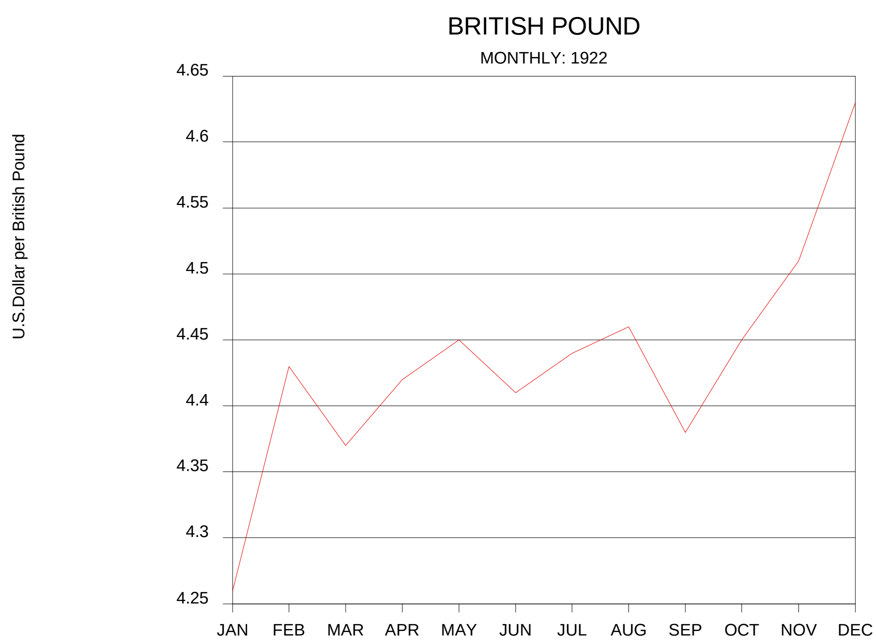

Railroads
Monthly: 1922
100
98
96
94
92
90
88
86
84
82
80
78
76
74
72
70
J F M A M J J A S O N D

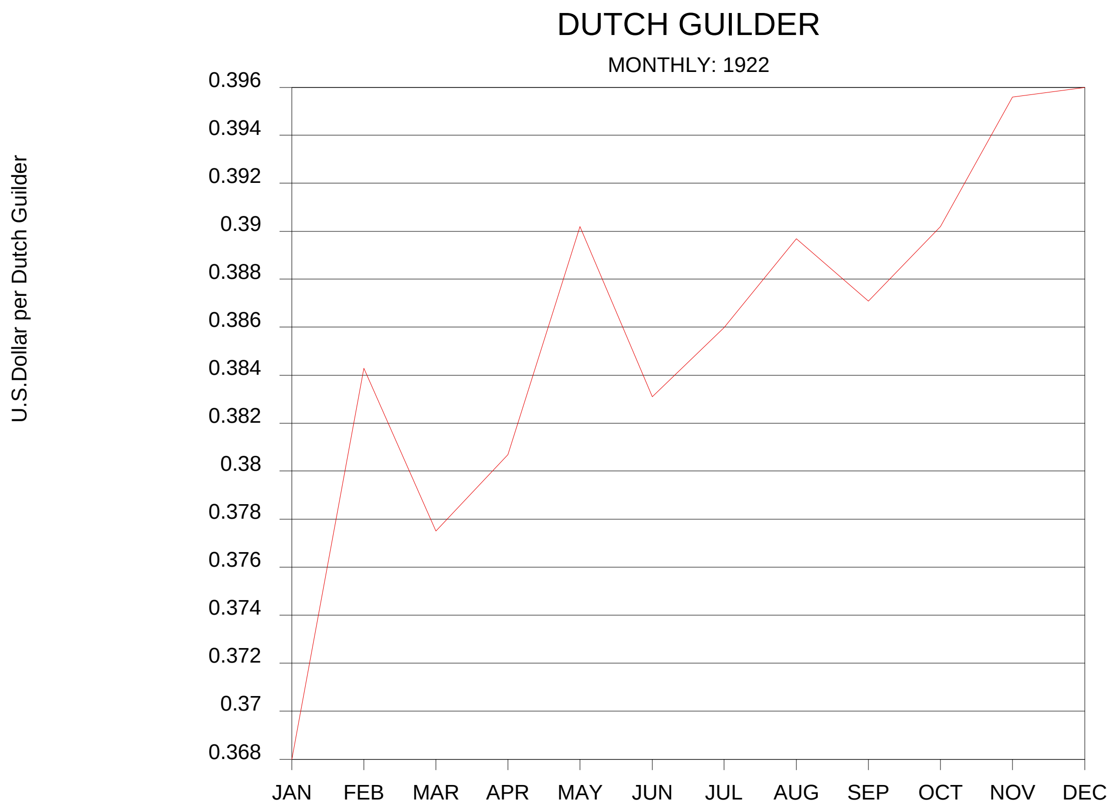

Long Bond Averages
Monthly: 1922
93
92
91
90
89
88
87
86
85
84
J F M A M J J A S O N D

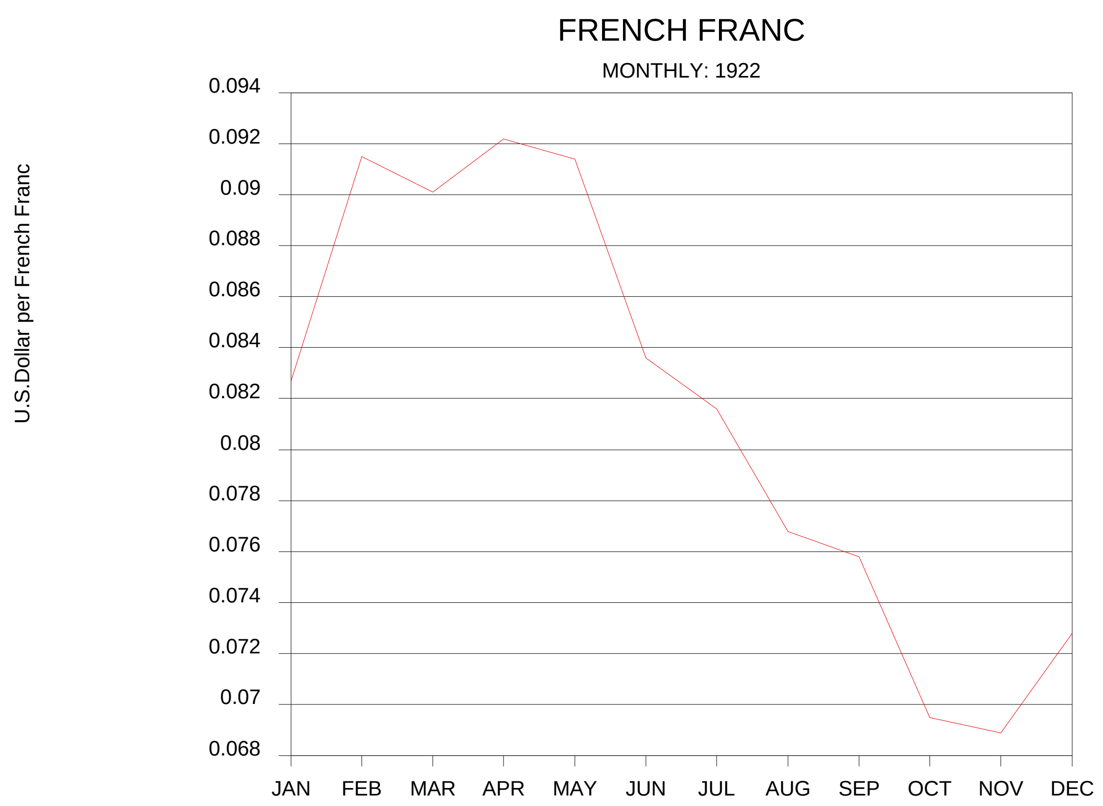

CONSUMER PRICE INDEX
Yearly: 1900-1940
26
24
22
20
18
16
14
12
10
8
6
4
2
0
1900
1908
1916
1924
1932
1940

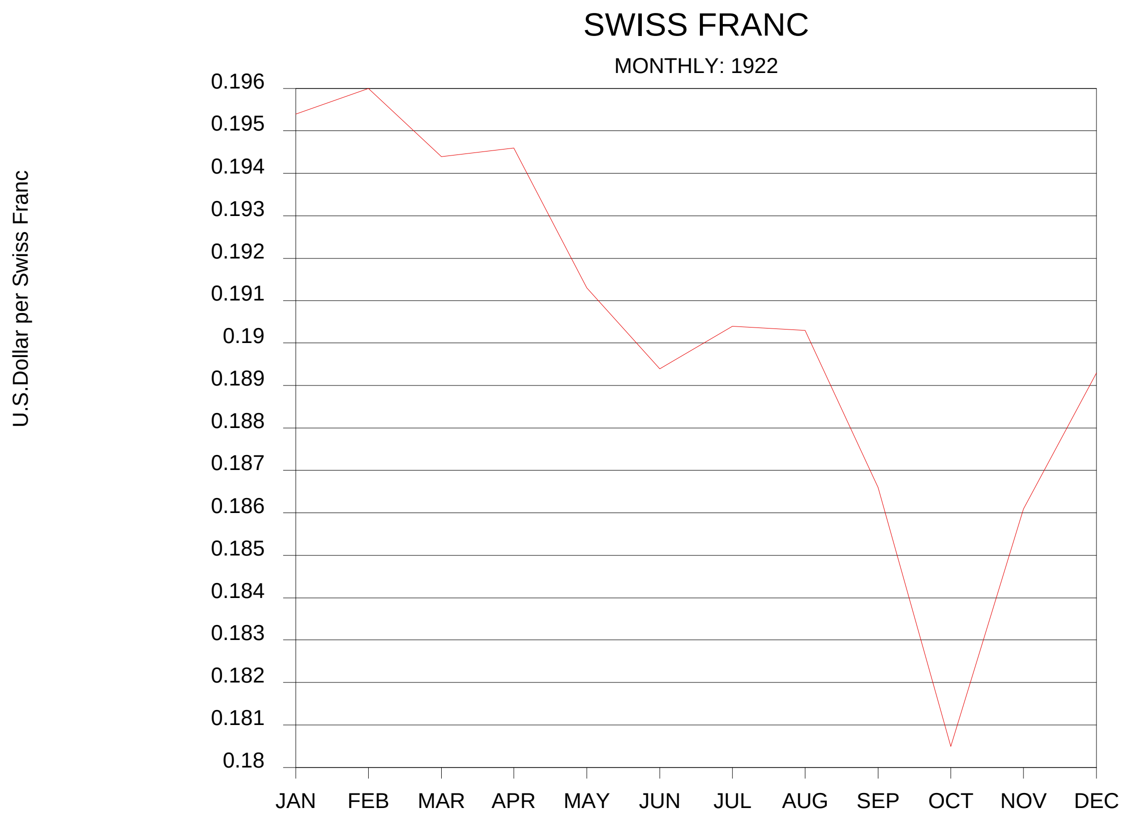

PRODUCER PRICE INDEX
Yearly: 1900-1940
40
35
30
25
20
15
10
5
0
1900
1908
1916
1924
1932
1940

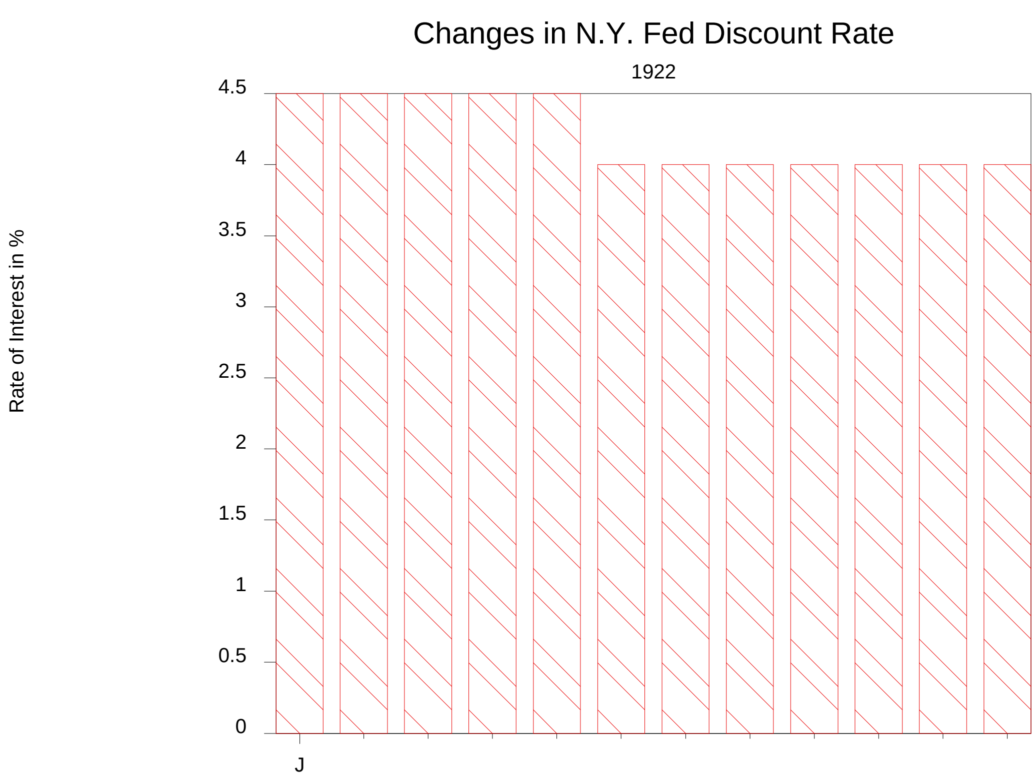

RAILROADS
Monthly: Jan. 1921 – Dec. 1932
200
180
160
140
120
100
80
60
40
20
0
Uptrend Line
1921 1922 1923 1924 1925 1926 1927 1928 1929 1930 1931 19.32


BRITISH POUND
MONTHLY: 1922
U.S.Dollar per British Pound
4.65
4.6
4.55
4.5
4.45
4.4
4.35
4.3
4.25
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC


DUTCH GUILDER
MONTHLY: 1922
U.S.Dollar per Dutch Guilder
0.396
0.394
0.392
0.39
0.388
0.386
0.384
0.382
0.38
0.378
0.376
0.374
0.372
0.37
0.368
JAN
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC


FRENCH FRANC
MONTHLY: 1922
U.S.Dollar per French Franc
0.094
0.092
0.09
0.088
0.086
0.084
0.082
0.08
0.078
0.076
0.074
0.072
0.07
0.068
JAN
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC


SWISS FRANC
MONTHLY: 1922
U.S.Dollar per Swiss Franc
0.196
0.195
0.194
0.193
0.192
0.191
0.19
0.189
0.188
0.187
0.186
0.185
0.184
0.183
0.182
0.181
0.18
JAN
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC

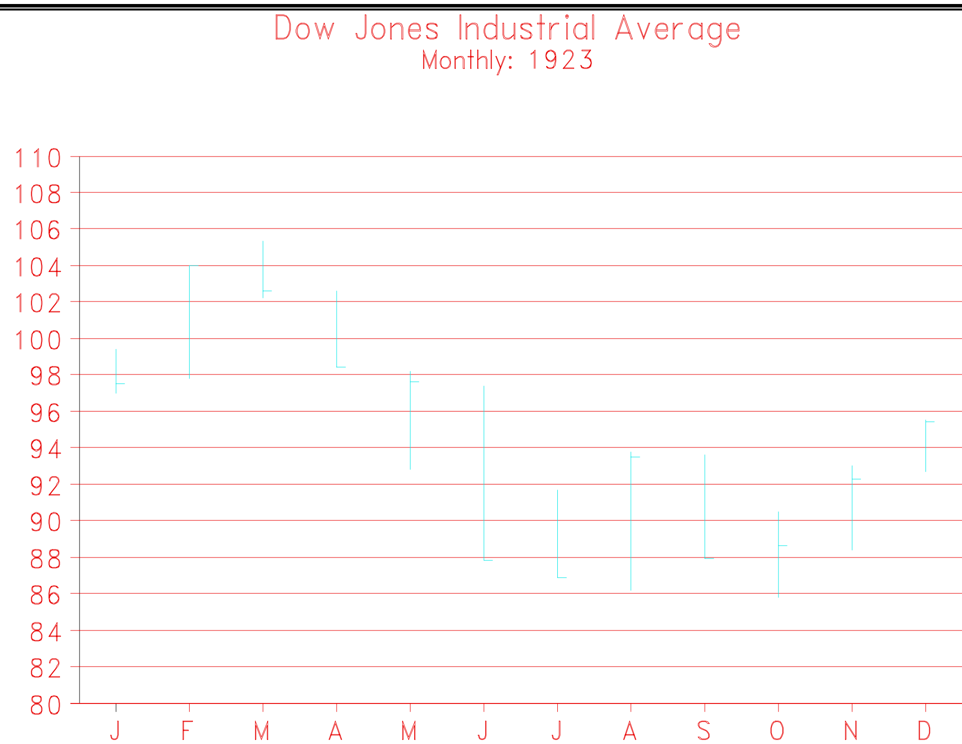

Changes in N.Y. Fed Discount Rate
1922
Rate of Interest in %
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
J

dent Harding retreated and reduced the restrictions to merely passing its opinion upon the foreign political implications of a foreign bond issue. This was a serious error that would eventually come back to haunt the stability of the entire economic structure.

The year 1922 was a year of strange prosperity. Passenger car production soared to record levels well above those of 1917 and 1920. The CPI declined from 1921, still yielding a sense of deflation that aided in the confusion for many analysts. Producer prices declined by a mere fraction while GNP rose to new record highs. Business inventories had reached a record swing from a plus $12 billion in 1920 down to a negative in 1921. Inventories rose only slightly in 1922, reflecting that many goods had actually fallen into short supply. Unemployment dropped from the 1921 record high of 11.7% in 1921 to 6.7% yet exports were beginning to decline, indicating that much of the boom was created by a buoyant domestic recovery.

All things considered, the greatest import of the United States during the 1921 period had been foreign private capital. This inflow helped support the stock market and added greatly to the recovery of 1922. But by the end of 1922, U.S. exports had declined and foreign bond issues seeking a home in the U.S. financial community had changed the trend in the dollar and set a new invisible hand at work on an international level to both create and destroy the greatest bull market in history.

Click here for PEI's Homepage

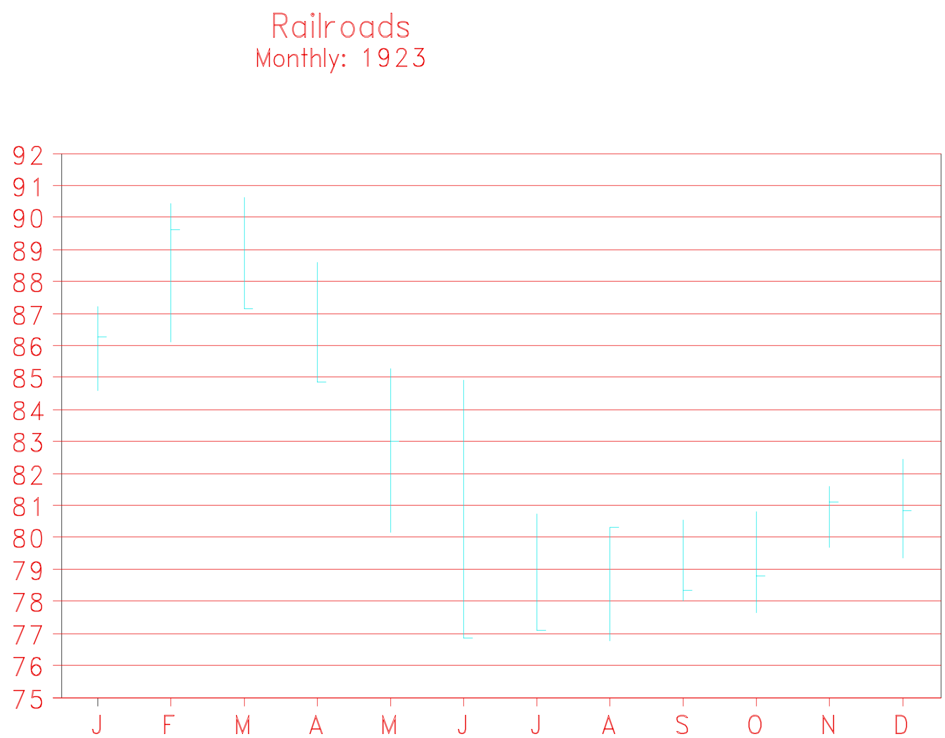


As 1923 dawned upon the annals of time, the stock market initially consolidated to very quiet trading during January, primarily on European news. But the Dow Jones Industrials had held the November 1922 low. February suddenly turned with a vengeance against the numerous professional short interests. The market stormed straight up, exceeding the 1922 highs by reaching 104 and closing near that level in February.

The Federal Reserve, in June of 1922, had lowered the discount rate to 4%, but when economic activity began to rise, the Fed became frightened of potential inflation. In February the Fed raised the discount rate abruptly back to 4.5% after the stock market rallied. But despite this factor, the market pushed higher into March nearly reaching 106. Call money had traded between 6% and 2.75% in 1922 and it was in February 1923 when call money peaked at 6%, matching the 1922 high and only gradually declining into the summer months, where it bottomed at 3.5% for 1923.

The stock market had become a barometer of the general business expectations. In the March 24, 1923 edition of Time magazine, the financial commentary had this to say:

"The financial markets reflected the current situation in general business several months ago; the 'discounting' performed by the stock market last fall is now quite clear to everyone. (Sharp decline from 1922 high.) The problem now before the securities markets consists of similarly forecasting what the situation will be next autumn. The present rate of industrial production has accelerated so swiftly that doubts are now beginning to be entertained in Wall Street as to the ability of this movement to endure. As a result, prices of shares on the Stock Exchange have proved irregular at high levels, with speculative reactions and rallies of only day to day significance. Meanwhile, gilt-edged bonds have proved sluggish and have shown an unmistakable tendency to decline under the prospect, already realized in some measure, of higher money rates. Weaker bonds, however, have

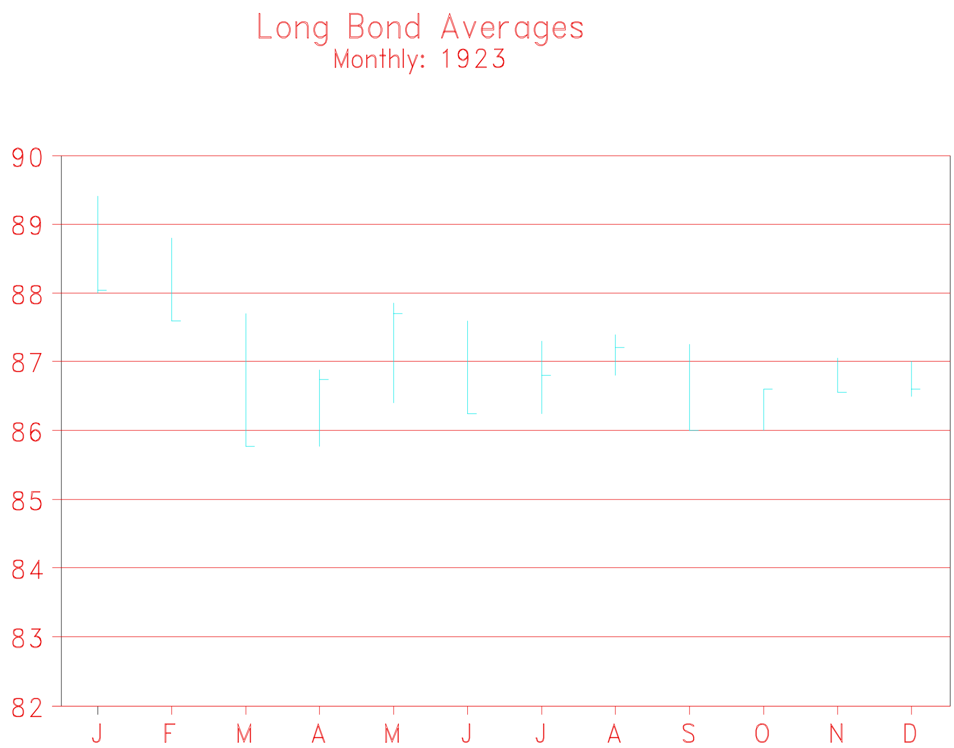


risen rather than declined in many instances, owing to their improved position following better corporate net earnings. French government dollar issues have proved strong."

Here we find that the commentary in early 1923 chose to take the decline in the stock market as a leading indicator, despite the fact that corporate earnings, industrial production, and the U.S. economy had become a slowly evolving shelter for foreign capital. Even the French government had been forced to issue bonds in U.S. dollars in order to find a marketplace. The sharply declining European economies had set-off a shift in international wealth and investment which favored the U.S. economy. Although the 1922 rally was sharp, swift and largely fueled by foreign capital flowing from Britain, Germany and France, the true underlying trend was not noticed by the analytical establishment at that time. Instead, they remained very pessimistic, perhaps influenced by the poor business conditions overseas and the reluctance of the Dow to punch through into new territory above the 106 level. After all, every time the Dow had penetrated above 100 it had always collapsed back, as in 1907 and again in 1920.

Europe remained in disarray. In Germany, Adolf Hitler was sentenced to five years imprisonment after the failure of the uprising that became known as the 1923 Beerhail Putsch in Munich. Germany had defaulted on its reparations, prompting even the United States stock market to decline to some degree. The French and Belgian troops invaded the Ruhr and occupied the Memel area near Lithuania. In Germany, Chancellor Cumo, called for passive resistance but his policy yielded little, if any, results. The attacks by extremists on the republic continued. It was after the "Cabinet of the Great Coalition" under Chancellor Gustav Stresemann when martial law was proclaimed in Germany and Hitler was jailed.

Nonetheless, it was the classic chicken or the egg dilemma for the U.S. financial mar-



kets. Was the sharp decline into 1923, from the March high of 87 points into July, an omen of what was to come or was this a consolidation phase as Europe tried to pick itself up with issuing bonds in dollars? Hindsight has graced us with the ability to note that the wave of industrial innovation and expansion was the leading factor. Second, the grave concerns that had brought capital to the States from Europe were subsiding after the massive devaluations. As the cash eased on its flow into the U.S., the stock market had proved to be a haven for international capital. The peak of the market coincided with the low in the dollar as European currencies began to decline into early 1924. The British pound had peaked at $4.70 in March 1923 and fell back once again to $4.27 by January 1924.

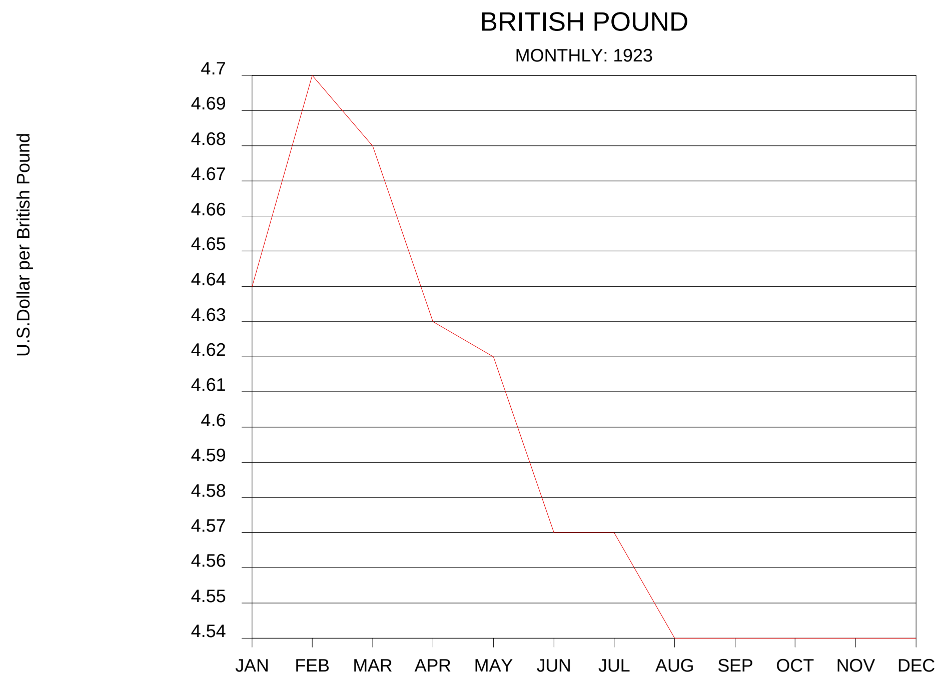
As we have taught at our seminar programs, the more any market continues to test the same number, the higher the probability of pushing through that level. This applies to support as well as resistance. In this case, the Dow had run up to the 100 level four times and failed. Instead of interpreting that as long-term bullish, it was seen as bearish. This one factor kept many people off guard for years and, as a result, they fought the market all the way up, finally turning bullish only after 1928.

1923 was a very important year. It was the year during which the markets corrected from the first bull market rally in 1922 and as such it was very reflective of the consolidation phase of 1984.

On 31 March 1923, Time magazine had this commentary to add to the sentiment which prevailed:

"A Lesson Learned?"

"That the lesson of 1920 has been remembered, if not thoroughly learned, by the average American businessman has been obvious from recent occurrences in the financial markets. The economic signs of a boom have continued, yet tempered by a spirit of caution. Not merely bankers, but

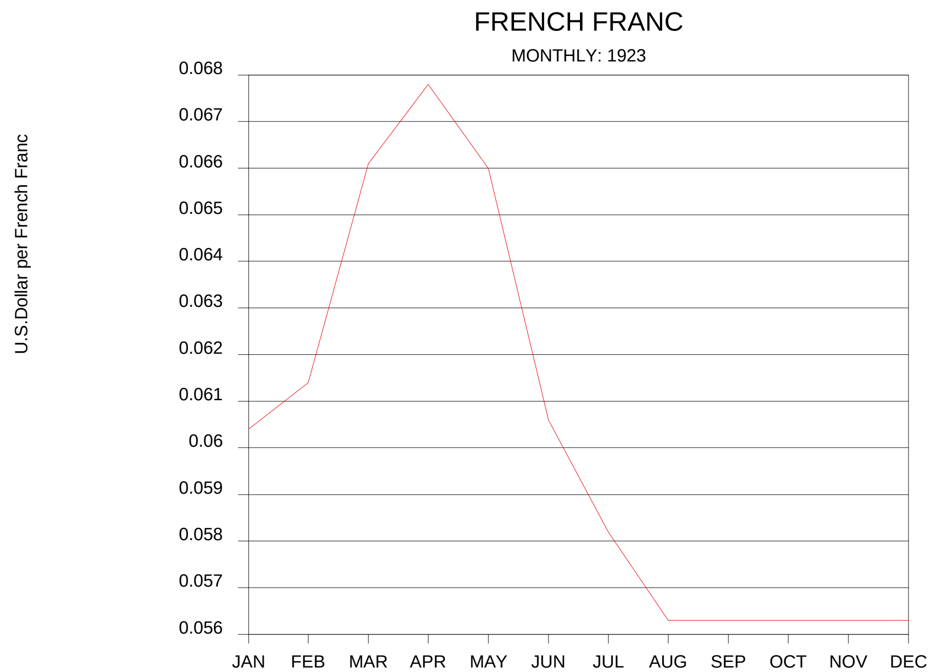


leaders in mercantile circles too are advising against recklessness. The speculating public has grown cautious in the Stock and Cotton Exchanges."

As the market began to decline in the spring, proceeding on its way into a summer low, the caution turned more toward pessimism. In the April 28, 1923 edition of Time magazine the commentary was as follows:

"A general consensus of opinion indicates that the recent expansion in production and distribution has reached its peak. Nevertheless, previous fears that this expansion would broaden into a reckless and unsound speculative movement are less keenly felt. The principal markets seem to have attained an equilibrium, and the question now is whether present industrial and mercantile activity can be maintained throughout the year. The predictions of business leaders are hardly consistent. Secretary Mellon is an out-and-out optimist who sees no evidence of inflation, no cause for alarm, and a long period of prosperity ahead. Charles M. Schwab is cheerful, but feels it necessary to caution businessmen against over-optimism. Charles R. Mitchell, President of the National City Bank, recognizes present prosperity, but warns against the dangers of rising costs produced by overswift expansion. Much the same position was taken by the U.S. Department of Commerce in a recent bulletin. In the case of the stock market, J.L. Livermore, noted operator, is more pessimistic. He points out the large amounts of undigested securities now on the market."

By May of 1923, the market was continuing lower and would not reach bottom until July when it would consolidate through a sideways trend into a near double bottom chart pattern in October. The Federal Reserve also believed that they acted prematurely by raising the discount rate in February. With the market dropping back to nearly 92 points in May, the Fed cut the discount rate back to 4%. In the May 12 edition of Time magazine the commentary reflected the atmosphere surrounding the

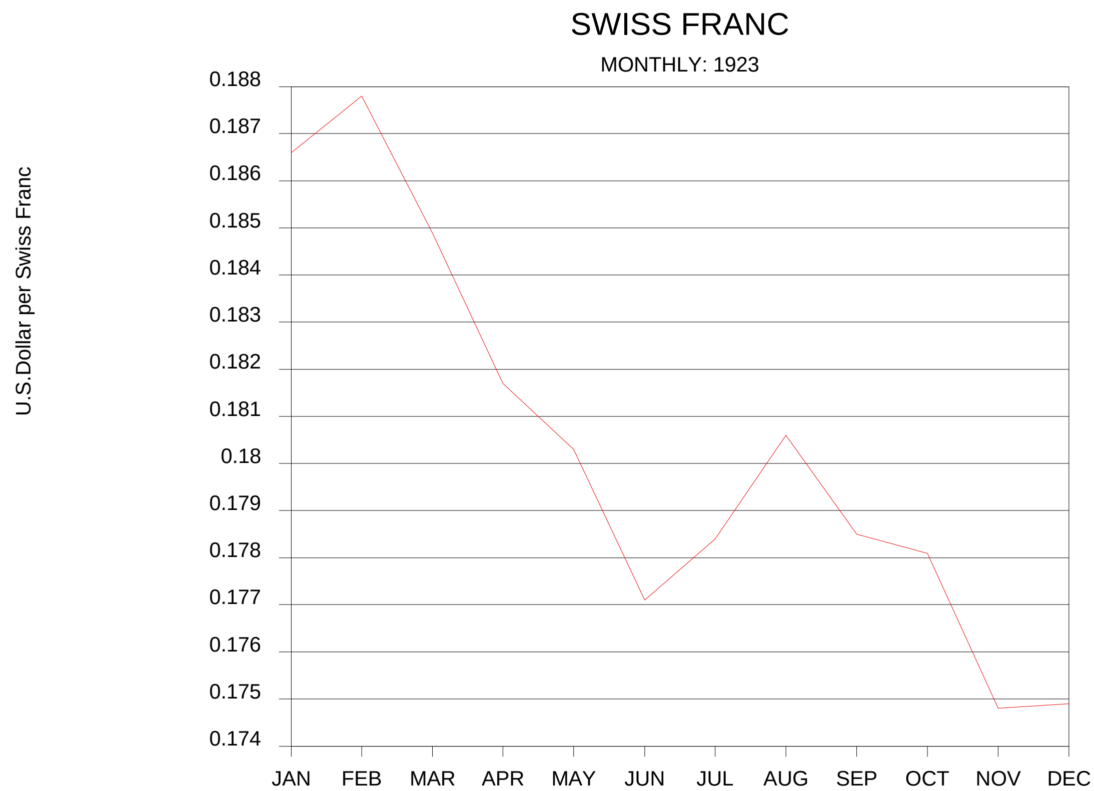


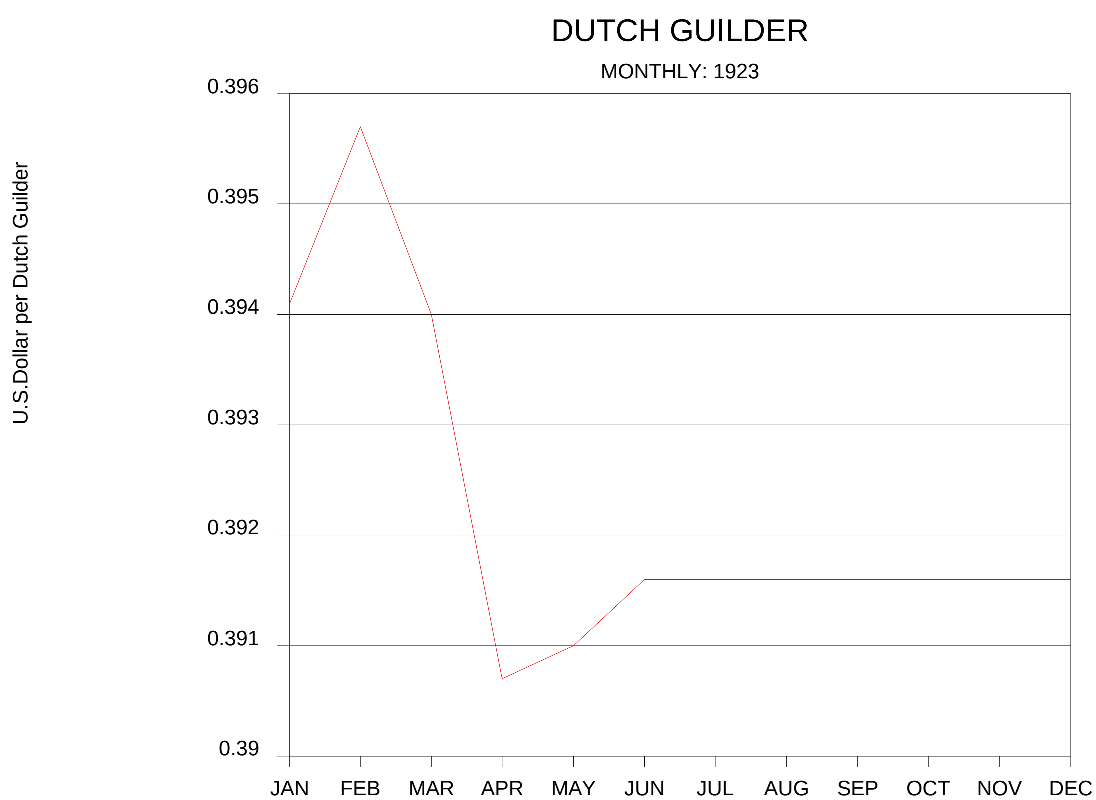
economy and the market as the trend continued lower:

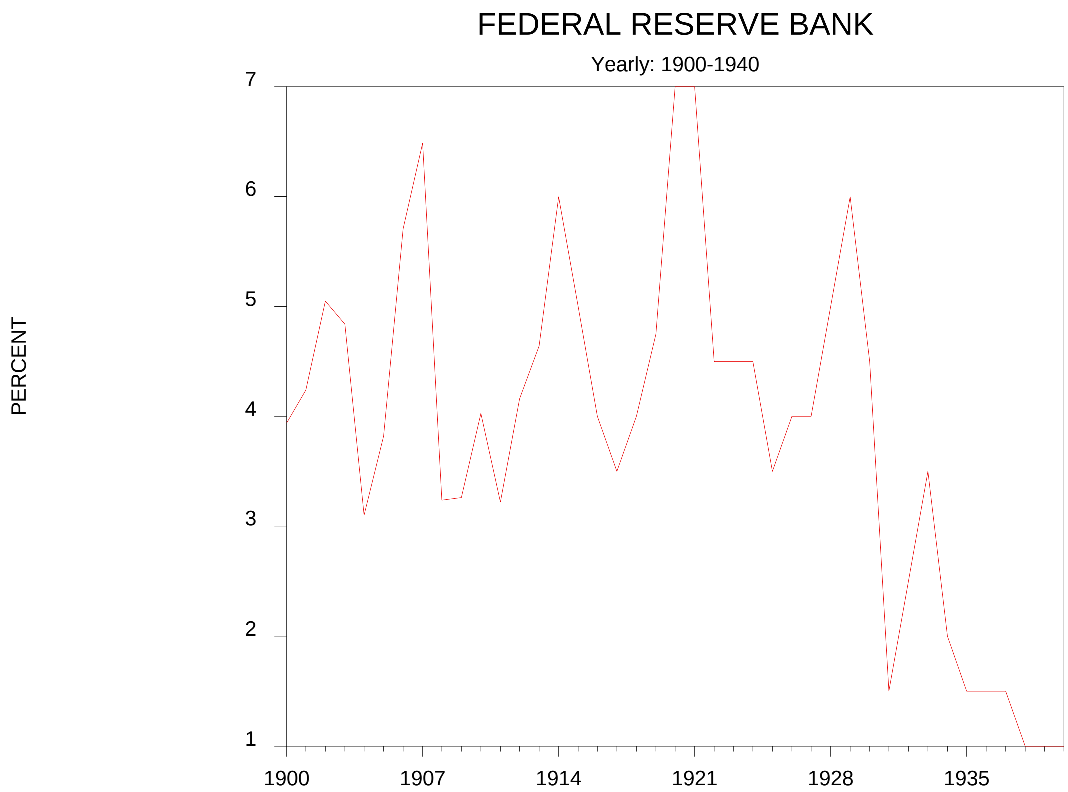
"The pronounced downward movement on the Stock Exchange has given rise to conjecture by the business world as to whether the peak in business activity has not already been reached. The well-known ability of the stock market to 'discount' future conditions has led some business leaders to anticipate the autumn situation this year with less complacency. Industrial news, containing as it did reports of price cuts in oil and weakness in cotton and sugar, tended in general to confirm such less optimistic opinions, although April pig production set another high record. The strong banking position, however, indicates that should present business activity fall off, no such tremendous speculative liquidation as that of 1920 to 1921 will be witnessed, except possibly to a limited extent in real estate. The check-rein to current expansion of trade and industry will, it is generally agreed, be afforded by the shortage of labor, and the already recognized tendency of labor to lessen productivity under higher wages, which is usually a sign that the peak of prosperity is not far away."

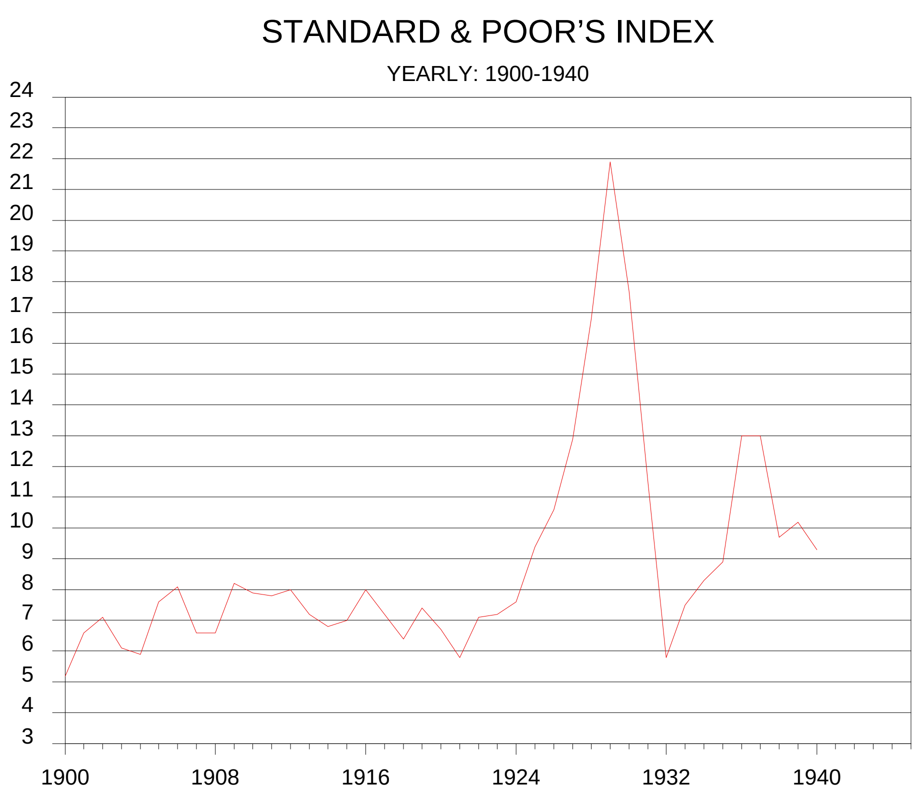
In the early 1920s, the preoccupation with commodity prices was much more pronounced than it is today concerning the analysis of the market. With only a few months distance from the strong rally in equities from the 1921 low, it is clear how analytical minds were still greatly influenced by the crash of 1920. Recovery and prosperity were words looked upon with caution, and despite the sharp rally back up to the higher 1919 levels and the influx of foreign capital fleeing an ever-eroding European situation, bullishness was seriously lacking.

Despite the apparently sound conditions of the business community and steady to rising corporate earnings, the general atmosphere was still greatly concerned that the stock market was indicating another collapse in the months ahead. People were sensitive to the prior events and feared that

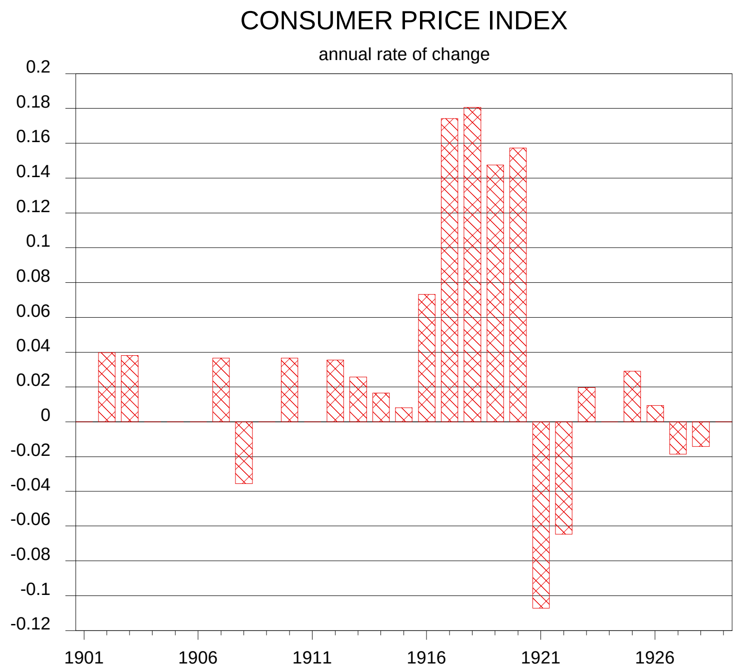

SWISS FRANC
MONTHLY: 1923
U.S.Dollar per Swiss Franc
0.188
0.187
0.186
0.185
0.184
0.183
0.182
0.181
0.18
0.179
0.178
0.177
0.176
0.175
0.174
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC


DUTCH GUILDER
MONTHLY: 1923
U.S.Dollar per Dutch Guilder
0.396
0.395
0.394
0.393
0.392
0.391
0.39
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC





Source: Economic Statistics



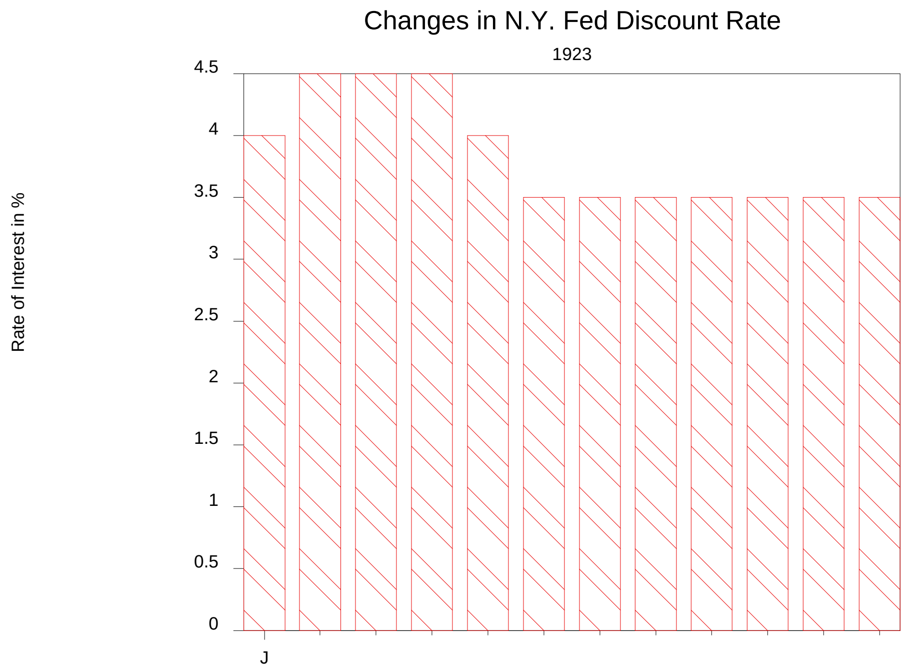
the stock market was a leading indicator forewarning of another impending disaster.

Inflation was almost nonexistent by official standards, quite similar to the 1981 to 1985 Reagan era. Yet admittedly, people were not yet accustomed to heavy taxation. The income tax had been instituted for World War I and had not been repealed. This commentary appeared in the June 4 edition of Time magazine:

"Of money, inflation today there is almost none. But inflation of land and real estate values, inflation in prices produced by inequitable and excessive taxation are obviously factors in the present situation. Sudden liquidation through a collapse in any of these is quite improbable; a gradual dying out of the present boom is more likely. Such an outcome the fitful ups and downs of the stock market today are apparently reflecting some distance in advance of the event."

Opinion began to look upon the high level of taxation as creating real inflation where government claimed none existed. This was one factor which was looked upon as a serious reason for a slow death of the short-lived prosperity during 1922 to 1923 in the minds of the analysts in those days.

This stands in contrast to the majority of thought in the analytical world today. Arthur Laffer's ideas of excessive taxation bringing prosperity to an end are nothing new; they are actually a pre-1929 concept leftover from the days when Adam Smith, rather than Keynes, was regarded as the father of economics in the post-1929 era. Today those concepts are gone and a completely opposite way of thinking exists. Most analysts now look upon tax hikes as a means to reduce inflation and therefore have cheered for such action and purchased stocks. Strangely, analysts believe that in some way it is better to prevent the private sector from making too much, for that would lead to inflation which erodes the underlying value of stocks as it does with



bonds. They somehow lost sight of the effects of a huge bureaucracy sucking up too much of the working capital within the private sector. Perhaps they never realized that economically the only difference between capitalism and communism today is that communism takes 100% whereas capitalism takes 50%. The higher the tax shelter, the closer an economy comes to destruction.

As the market approached the first low in July 1923, three stock brokerage firms went bankrupt. Most bankruptcies were caused by the sharp decline in the stock prices themselves. This had an adverse effect upon the market as it consolidated through the summer months only intensifying the fears of a renewed depression. But interest rates were not yielding to what most people had thought to be normal. Most commentary remarked specifically about the high rates, citing that if they declined it would confirm a depression through the lack of corporate demand. The discount rates at the New York Fed stood at 4% after the May cut. In June the Fed lowered the discount rate to 3.5% where it remained until August 1924. This action did not support the market, but rather intensified the fears of a depression.

On July 5, the Bank of England hit the market with a surprise by raising its discount rates to 4%; it had previously remained unchanged at 3% since June 15, 1922. The 4% rate was just a point under the U.S. rate and the financial analysts boasted that this proved that the N.Y. financial markets were the leaders in the world and that Britain, as well as all other nations, would have to realize that the U.S. markets were the dominant forces. They saw no hope for Britain until the pound returned to the then so-called par value at $4.86 with the dollar.

We can see that July continued lower and actually provided the lowest monthly close on the Dow Industrials for that year. In the July 30 edition of Time magazine, the following commentary appeared when the stock market was at its lowest point in 1923:

"The impending German collapse, the agricultural depression and the likelihood of radical and deeply harmful legislation in Washington next winter continue to heavily overhang the markets. As a sign of the times, it is reported that seashore cottages do not rent quite so readily this summer as last. Money is easy, though rates are firm."

The atmosphere was still quite depressed. People just could not possibly see the stock market rising as long as commodities themselves remained depressed. This relationship of the market to commodities had become fairly well entrenched, particularly since the stock market peaked in 1919 precisely along with the entire commodity group from metals to agriculture. The perception of declining commodity prices was viewed as lower profits in agriculture, less traffic in freight and thereby less demand, which posed an adverse effect upon the entire marketplace. This is a theory that is not even remotely used in this day and age. Interest rates were a concern, but at the same time higher interest rates were not interpreted as being very bearish. They recognized the fact that as business expanded, the demand for money also rose. For them the shocking thing was to see easy money with firm rates.

At the peak of pessimism, August provided a sharp correction back up, which was a bit of a surprise. At the same time, it was viewed as merely a reaction and of no real importance given the serious events of those times. It was reported in Time magazine on August 13, 1923 as follows:

"The comparative steadiness of prices after the unexpected death of President Harding has been all the more remarkable for coming in the midst of an obviously 'bear' stock market."

The business section had carried a few interesting articles which apparently were signs that the underlying economy was still sound, yet everyone chose to ignore them at the time.

Studebaker's profits for the quarter ending June 30, 1923, showed net sales of $49,370,091 as against $45,606,044 for the same period during the boom in 1922. Even after expenses, the second quarter of 1923 provided a $7.2 million net profit compared to 1922, which provided a $7 million profit. This is only one example of how corporate profits were continuing to grow despite the fact that the financial community was over-concerned about a potential depression.

It seems to be only natural for people to believe that once a certain set of circumstances become reality, that the same set of circumstances will continue in motion from there on out until the end of time. Here we distinctly found that the so-called experts in economic and financial analysis were all very bearish and looked upon the fall as potentially leading toward a depression. They believed that the strong economic signs were merely lagging and that the stock market was a leading indicator to future business conditions. They saw easy money yet firm rates. This they felt was not a clear sign that capital was in demand, and if it were not, then expansion must be slowing. These types of analysis on the fundamental level stand in contrast to what is normally believed today. Yet, at the same time in 1985, and back in 1982, people refused to believe that the rally in the stock market was indicative of anything at all other than a strange event which had to correct back down.

In the August 20, 1923 edition of Time magazine we found additional commentary:

"The prophets of economic disaster have so long pointed out the dangers to Germany in hopelessly inflating her paper currency that Wall Street has become blase to the impending financial collapse of Germany. News this week was obviously still-crescendo-all previous price and currency records were as usual outdone, as the long-prophesied political overturn arrived. Yet the view was taken that Germany had already ruined herself, and just how long it would take her to find it out made little difference to domestic business."

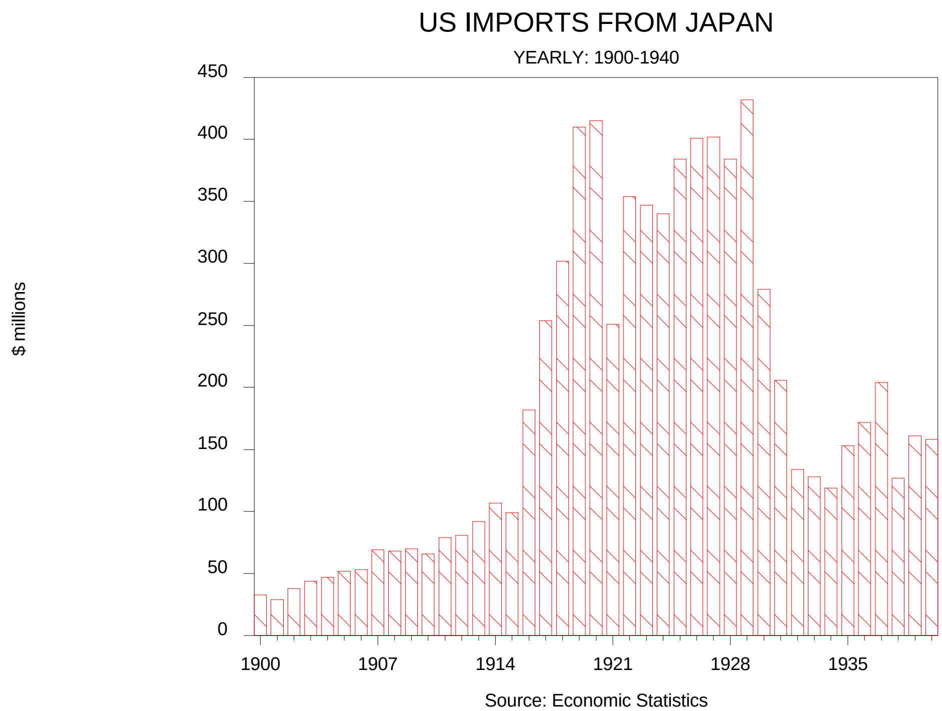
What everyone couldn't figure out was that the collapse of Germany through her hyperinflation was supposed to be an ill omen for the world. Many had asserted that the downfall of Germany would eventually cause other defaults throughout Europe, which in turn would depress the U.S. economy. Talk of this scenario had begun in early April. Therefore, the stock market had begun to decline in unison with the rise in the dollar from March 1923.

However, as this news became widely discussed in June and July and the press began its hype, it was as if the news was already discounted. The U.S. stock market bottomed in July and rallied sharply in August. September dropped back down again but held the July low. In October, the market made a new low for the year but closed above the July low. The dollar continued to strengthen into January and the stock market rallied as well. Foreign capital once again began to flow toward the U.S. market, moving directly into equities as a safe haven from European turmoil. This provided the base building during the mid-1923 session, a scenario which had not been discussed.

In addition to Harding's death and the pending collapse of Germany, the summer of 1923 presented more problems internationally. A massive earthquake had struck Japan and seriously disrupted her productivity. Again debate was two-sided but once more the doom and gloom was put forth. The stock market dropped sharply into the end of September as it prepared to make its final low in October.

On 17 September 1923, Time magazine once again reported the debate:

"The Japanese earthquake proved a gloomy influence in financial London, owing to the extensive British investments and interests throughout the Orient. In New York during the past week, its influence was practically negligible except as a subject of debate. Some American business leaders look upon it as a boom to our industries, because of the extensive purchasing of our products which it should occasion. Others consider it the forerunner of financial depression here, pointing out the effect of the Chicago fire in 1871 upon the Panic of 1873, and the San Francisco earthquake of 1906 on the Panic of 1907. Both views are extreme, and the truth lies somewhere between them. Prosperity is not created by wrecking cities, or the recent War would have created unparalleled prosperity for many years, instead of the irregular and frequently oppressive results now seen throughout Europe. On the other hand, few losses by American insurance companies are looked for, and in consequence little financial liquidation here. The principal loser will be Japan herself. More issues of Japanese securities in the near future are not unlikely. Meanwhile, a genuine curtailment in Japanese naval and military programs will be inevitable, if Japan's economic recovery is to be swift."



The logic applied by Time magazine was quite clear-cut. The Japanese earthquake did not involve any direct loss to the U.S. so the doom and gloom boys, who appear to have been seeing gloom in just about everything, were stretching things a bit too far. Nonetheless, with the added advantage of hindsight, Japanese investment in the U.S. markets was withdrawn by the sheer demand of capital in the homeland. This no doubt had a short-term effect of selling pressure in the equities which was noted during September. Yet the U.S. production seemed to benefit in the fall and corporate profits continued to rise.

The trade perspective with Japan had changed. Imports from Japan to the U.S. peaked at $354 million in 1922 and declined to $347 million in 1923, followed by a drop to $340 million in 1924. This amounted to a 4% decline from the U.S. perspective while exports to Japan rose from $222 to $253 million during the same corresponding period, which was a gain of 13.9%. Therefore in the end, the U.S. industry benefited and the ill omen of previous disasters failed to materialize.

On October 1, 1923, Time magazine made this comment as the stock market continued to decline into early October: "As the Fall season develops, there is evidence that the declining stock market last Spring forecast general conditions in trade with some accuracy. A more conservative attitude prevails in mercantile circles; some disappointment is being expressed by previous optimists concerning the Autumn outlook."

Everyone continued to keep a watchful eye upon the stock market - more so than upon the production numbers and corporate profits. Although fundamentally business was still doing well, the fear of depression and collapse still lived on in the minds of the analysts. Auto sales for the first eight months in 1923 exceeded the entire year's sales during both 1921 and 1922. This was a clear sign that the consumer was not backing off and although rates re-

mained firm due to consumer demand, money was easy to obtain. In the long run, the consumer proved to know more about the market and the economic future than the professional analysts and speculators who tried to forecast the future by every new tick in the market.

In the October 29, 1923 edition of Time magazine this note was published:

"This status quo of business can often be determined by the prophecies of various business groups. Some manufacturers are stoutly insisting in public that the stock market no longer accurately discounts the future, while privately they are trimming their sales for 1924. Most merchants, whose sales have not yet started to decline, apparently foresee limitless prosperity ahead.

"A prophet of a different sort is Leonard P. Ayres of the Cleveland Trust Co., whose predictions as to the trend of business have in recent years proved so accurate and courageous that his remarks are always worth listening to. His mouthpiece, the fortnightly bulletin of the Cleveland Trust, now expresses its opinion that 1924 will be a year of diminished prosperity, and cites the obvious decline in output in iron and steel, automobiles, tires, cotton, wool, shoes and building construction. It also declares that short-term interest charges are about to begin a long decline. That in consequence, food prices should respond by commencing a gradual rise. The bulletin very sanely concludes: 'here is good reason to believe at the present time we are not headed for any drastic period of depression, but nearly all the familiar indications point to a less active year in 1924 than that now drawing to a close. It seems probable that general business will decline to levels lower than the present ones before it will again recover to any such pitch of activity as it reached last spring.'"

The stock market was undoubtedly viewed as an important indicator for the future. But just as the well-known analysts of those days throw in the towel on the very low of the industrials that October of 1923, others were not quick to realize that something was brewing. No one stepped back far enough to realize that the market was following the dollar in the midst of a world in economic turmoil.

November saw a sharp rally in stock prices, which would eventually continue for five months as the Dow rallied from the October low at slightly below 86 back above the 100 level, testing the 1923 Spring high. On November 5, 1923, Time magazine had these comments:

"Prophets of future tendencies in business, and particularly those practical seers who attempt to cash their foreknowledge in the stock market, have been considerably bewildered at the outlook during recent weeks. On the one hand, the ordinary signs of approaching depression, such as declining iron production and falling stock prices and interest rates are apparent to all. On the other hand, business leaders talk optimistically, merchandising is very heavy and profitable, and railroads are getting some fat around their bones; worst of all, the stock market refuses to decline.

"The inconclusiveness of the stock market has led some bankers and manufacturers to declare that it is no longer a reliable barometer to future business. The same opinion, incidentally, was frequently expressed during the prophetic decline in prices which occurred in 1920.

"It may be, however, that the stock market is now, as upon former occasions, a better index to the future than the post prandial discourse of many of its critics. The largely featureless stock market of the past few weeks may prove next Spring to have reflected a period of duller but largely painless business conditions. But by that time, the public who watch stock prices will be more interested in their bearing upon the Fall of 1924 than upon their forecasting accuracy this Autumn.

"Money had been perceptibly easier. Ordinarily this fact would possess considerable significance as to next Spring's business. With our excessive gold supply, however, it is safe to assume only that declining interest rates should mean rising bond prices."

The market began to rally after a brief but sharp panic sell off after the rally in August. As we can see from the previous commentary of November 5, 1923, the pessimism persisted. The majority remained convinced that the market was a leading indicator and that interest rates simply had to decline. But at last, some clear points were revealed, which through hindsight illustrated the true trend of the economy which would set the tone into 1929. The market began to rally that November. Time magazine reported in the November 12, 1923 edition as follows:

"The center of the American business stage has been almost monopolized by the stock market during the past week. Ten days ago share prices were distinctly weak; of the speculative 'leaders,' Can declined l/4 in a day, Baldwin 7/8, Studebaker 7/8, Steel 1 1/8. Even the reliable chain stores sold off sharply. Stuart Warner dropped 3 3/4.

"Then came the turn. Late one afternoon, U.S. Steel revealed a fine quarterly statement, declared an extra dividend of 1/4. Next morning, by curious coincidence - if it was a coincidence - the redoubtable Jesse L. Livermore announced, apropos of nothing in particular, that he had turned bullish, that with agricultural recovery and a European settlement near at hand profits lay on the buying side, and that next year should be prosperous without becoming a boom. Stock prices soared. Can rose 5 5/8 that day, Baldwin 5 1/2, Studebaker 5 5/8, Steel 5 1/8, with lesser advances throughout the list even among the rails. Sales on the Stock Exchange passed the million mark each day the rest of the week and prices continued to advance, fractionally but steadily."

"These optimistic events at once split Wall Street into two schools of thought. One declared its belief that the turn had come and that pessimistic predictions regarding 1924 had been overdone. The other, bearish to begin with, continued in that frame of mind; it viewed with cynical suspicion the remarkable coincidence of the extra Steel dividend, Judge Gary's colorful prophecies, broker Livermore's equally colorful announcement, the upward rush in the price of the four present leading speculative stocks."

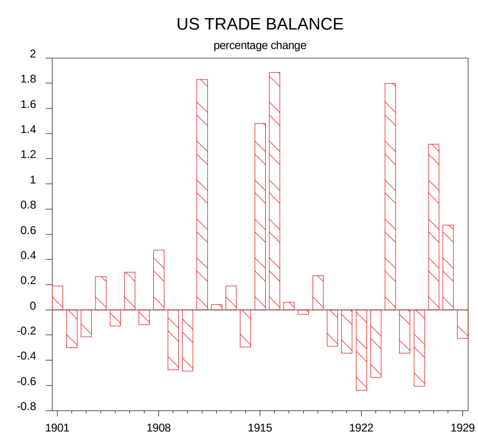
"When it came to explaining the motive behind the alleged bull manipulation of the stock market, however, differences of opinion were expressed. Some were impressed with the maneuver chiefly as a drive against 'short interest' which was believed to be large. Others pointed out that 1924 was a Presidential year, that the Party in power might show more than verbal gratitude to anyone who could prevent depression and maintain prosperity at least until after election day. A third school maintained that large interests wished to stir up a good market in order to liquidate securities likely to decline further next year. All agreed, however, that, if manipulation was responsible, it was no 'piker's game,' that substantial financial interests had seriously committed themselves to it."

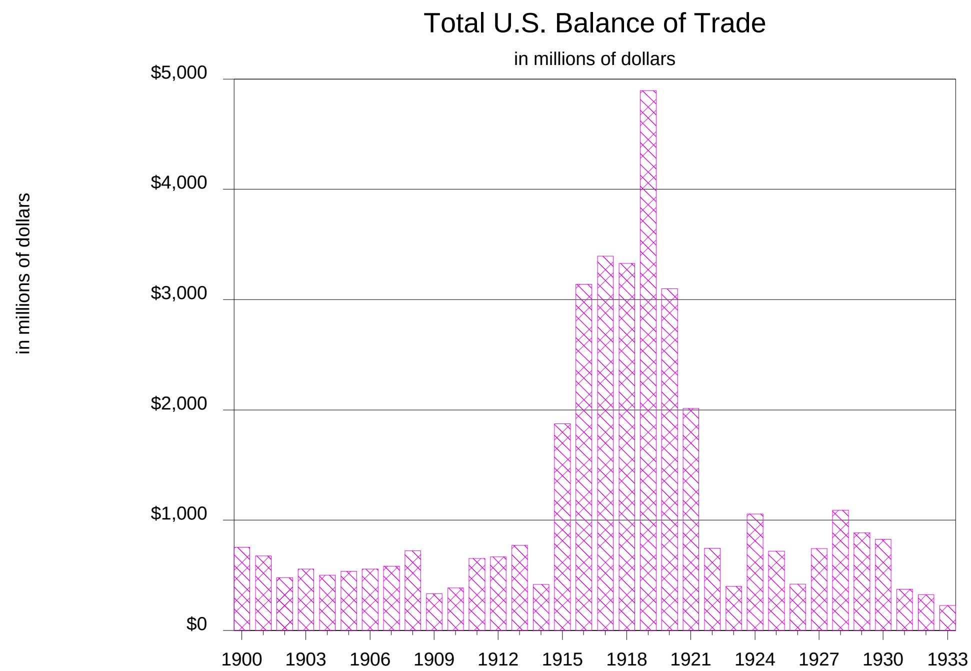
"The test of all these wildly varied views should come by the beginning of December, when Congress meets, although the reason for the price advance may not be clear even to the initiated before next Spring."

"The stock market, as is well known, usually acts as a thermometer and barometer to general business conditions. The questions now asked are: Is someone putting a lighted match under the thermometer bulb? If so, who?"

This article in Time magazine illustrates several interesting points. Those who were "bearish to begin with" refused to allow the market to guide their analysis. They were bent upon having a depression and chose to slander Livermore by suggesting that he might gain some personal favors from the President if he could make the market go up. The excuses were, quite frankly, defamatory and uncalled for.

In Germany during November 1923, the Stresemann Cabinet was forced to resign in the face of a vote of "no confidence." But, the new cabinet under Wilhelm Marx was





finally able to bring currency stabilization in December, which helped restore confidence even in terms of the U.S. market. The collapse of the mark to 4.5 trillion to the U.S. dollar in November was indeed a historic case of hyperinflation. But the worst was essentially over even though the dollar would continue its rise into January 1924.

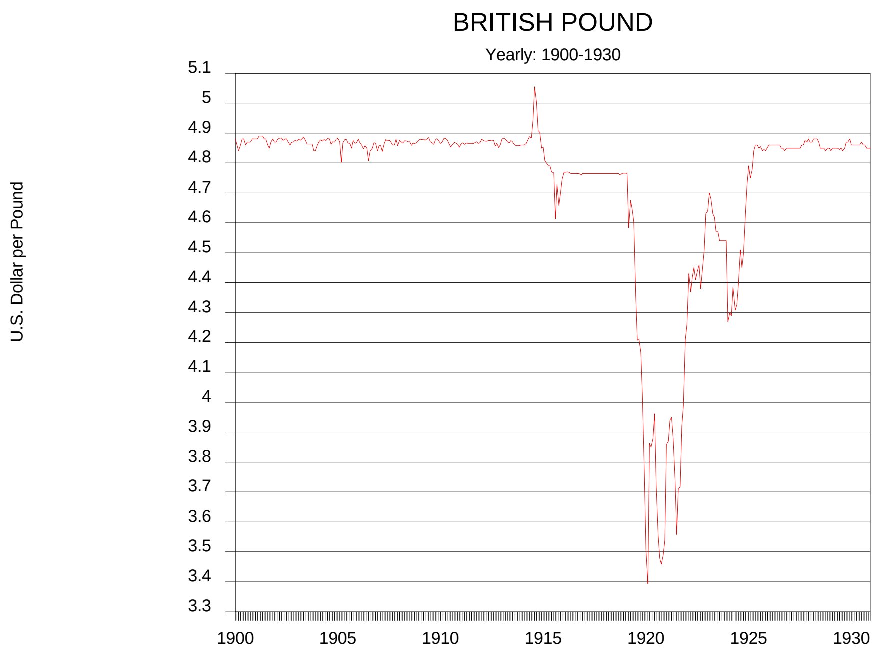
Through an international perspective and viewing the import/export numbers, it is not difficult to see why the stock market had supported during 1923. Its bottom was not created by manipulation for, indeed, it would have taken a lot more than a group of men to halt a decline as evidenced by every preceding panic. With foreign exchange in turmoil and devaluations of unprecedented order in Europe, it would have been an unwise foreign investor who was not drawn to the dollar during this period.

The American analysts clung to their theories that declining interest rates were a sign of declining demand for capital and, as such, a warning of recession or depression. Indeed, this theory had always worked before. The stock market had risen with higher rates as expansion led to higher demand for capital. The fear of inflation was largely due to government intervention as that which took place in 1920. But the analytical world failed to realize that interest rates may have declined because of the excess capital which was flowing into the U.S. in flight from European currencies. As such, they analyzed the market solely from a domestic perspective and failed to broaden their minds to conceive of the international concerns among capital.

Click here for PEI's Homepage

Chapter IV

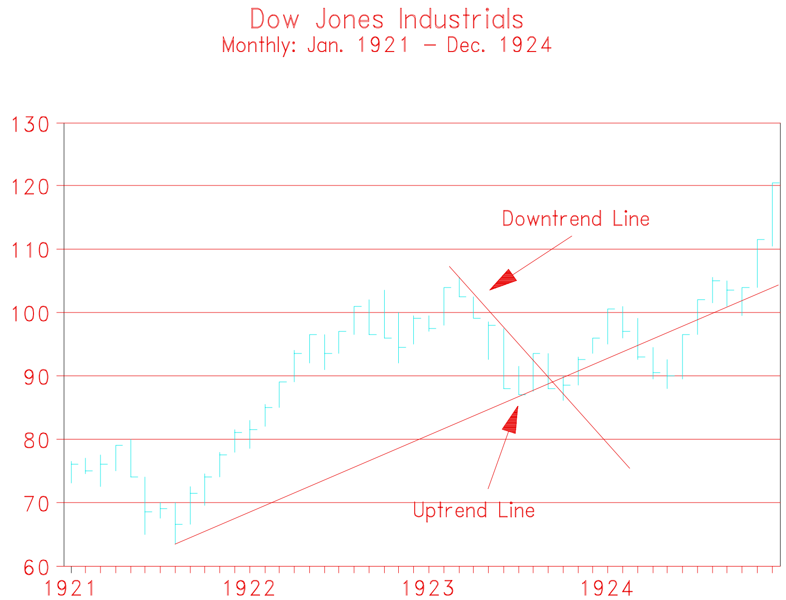
1924



The year 1924 began with the dollar continuing its rally into January. The British pound had continued to fall from its February 1923 high of \$4.70 to its January 1924 low of \$4.27. The French franc had fallen from its April 1923 high of 14.74 francs per dollar to 21.52 in January 1924. But the French franc continued lower against the dollar moving into February 1924, dropping to 23.58 to the dollar. This would eventually prove to be the high on the dollar until 1926.

The Swiss franc had proven to be the most stable of the European currencies. But here too, this currency dropped from its 1923 equivalent high in U.S. terms of 18.78 cents to 17.29 cents in January 1924. This would prove to be the low for the Swiss during 1924. The actual peak on the Swiss against the dollar had taken place during February 1922 at 19.6 cents and had steadily declined into the January 1924 low. From here, the Swiss would rally back to the 19.4 cent level but the 1922 high would not be penetrated during the balance of this decade.

The Dow Jones Industrials continued their rally which had begun from the October 1923 low amidst the bitter rumors which continued to fester over a proposed relationship between Livermore and the current administration. The railroads had also continued to rally into January along with the bonds. It was clearly a broad market rally and no one group could have possibly controlled enough capital to manipulate it.



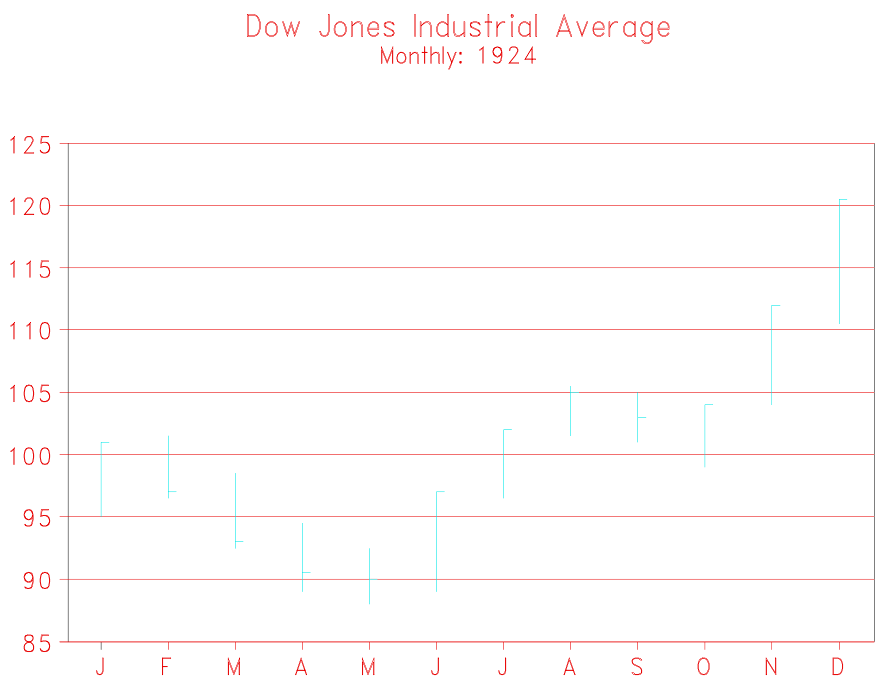
Indeed it would have been no "piker's game."

As it is today, people who are consistently wrong, or even temporarily wrong, make up rumors and stories against anyone who has been consistently right. Rumors normally run from, "Oh, he went bankrupt many years ago," implying that he will be wrong someday soon, to "I heard he was a crook so you shouldn't listen to him anyway" or "he has powerful friends and they are forcing the market to do what it would not do otherwise." These are all excuses put forth by the losers.

Jesse Livermore was one person who had been consistently correct about the market. The fact that Livermore was proved correct and that 1924 led to prosperity, "but not necessarily a boom," stands as witness to such accusations. In the years ahead, those who were the losers grew to hate Livermore, and instead of going with the trend many would fight it just to try to prove him wrong.

For those who were bearish and continued to fight the market all the way, the mere fact that U.S. Steel declared an extra dividend, based on the reality that earnings were rising, didn't matter. They remained convinced that lower interest rates indicated that a depression was due. It is amazing how differently we view the stock market today in relation to interest rates as compared to the bull market of the 1920s.

Technically, we can see that the August rally exceeded and even closed above the 1923 Downtrend Line. Although September fell back below the Downtrend Line, the market rallied back above it in October and was now ripe for an upmove. Technically there was clearly a lack of follow-through to the downside. Looking at the Uptrend Line on the yearly Chart taken from joining the 1921 and 1922 low, we can see that the 90 level was quite important. Although October 1923 exceeded the 90 level, it fell back for the monthly close. November ran up and exceeded the Uptrend Line and closed above it. Although the Industrials had not exceeded the 1919



high, they were clearly in a technical position to try one more time.

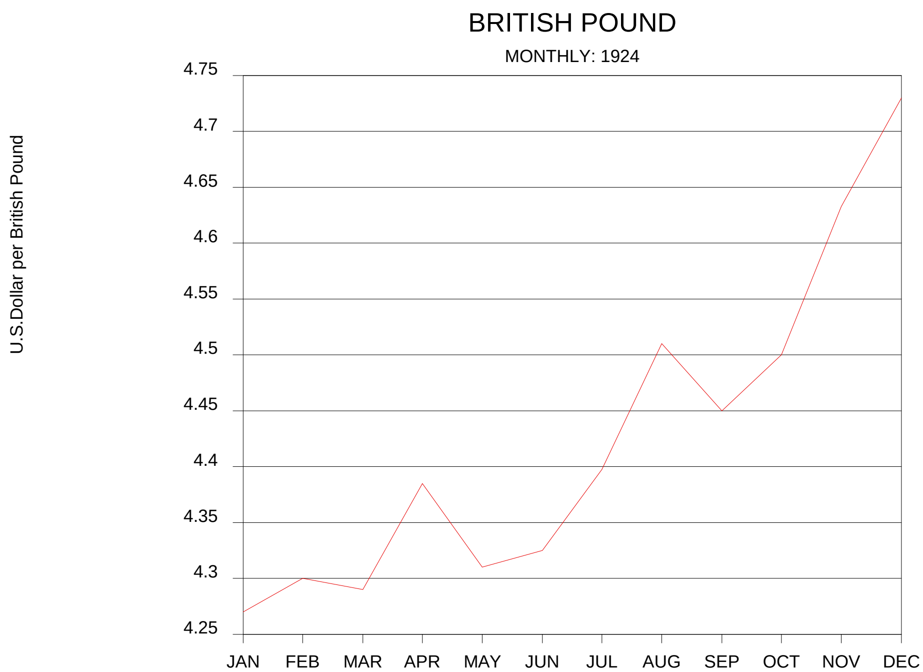
We can see from the yearly chart provided for 1924 that the market continued higher into early February and then once again corrected for a three-month reaction into May of that year. The early summer brought a substantial rally in the stock market and by August the market closed above 105 on a monthly basis. After a two-month sideways pattern going into the Presidential elections of that year, the Industrials soared as December ended and closed above 120 at record highs.

1924 brought many signs of relief, and Livermore's gut feelings proved to be correct. Germany issued the new Reichemark, which was exchanged for 1 billion old marks and was backed by 30% gold. In the United States, corporate expansion continued but, more importantly, new companies were being formed. IBM had its beginnings in 1924 along with MGM, Columbia Pictures, Dean Witter & Co., and Massachusetts Investors Trust; Kleenex was introduced and so was the first Chrysler.

There were still great arguments for both pessimism and optimism. In January 1924, the New York Times listed the issues for both sides but drew no conclusions. They were published as follows:

"The Grounds For Hopefulness
1) Our Impregnable gold, credit and banking position.
2) Large recent profits in industry.
3) Recent record freight traffic and signs of its likely continuance.
4) A conservative and economical administration in Washington.
5) Economic recovery in Europe, clearly beginning despite Germany and Russia.

The Case for the Pessimist
1) Potential of credit inflation due to our abnormal gold reserves.
2) Uncertainty as to the continuance of large industrial profits, as seen in declining commodity prices, the steel industry, etc.



3) Probability of attack, and its possibility of success, by radical Congressmen upon the Transportation Act.

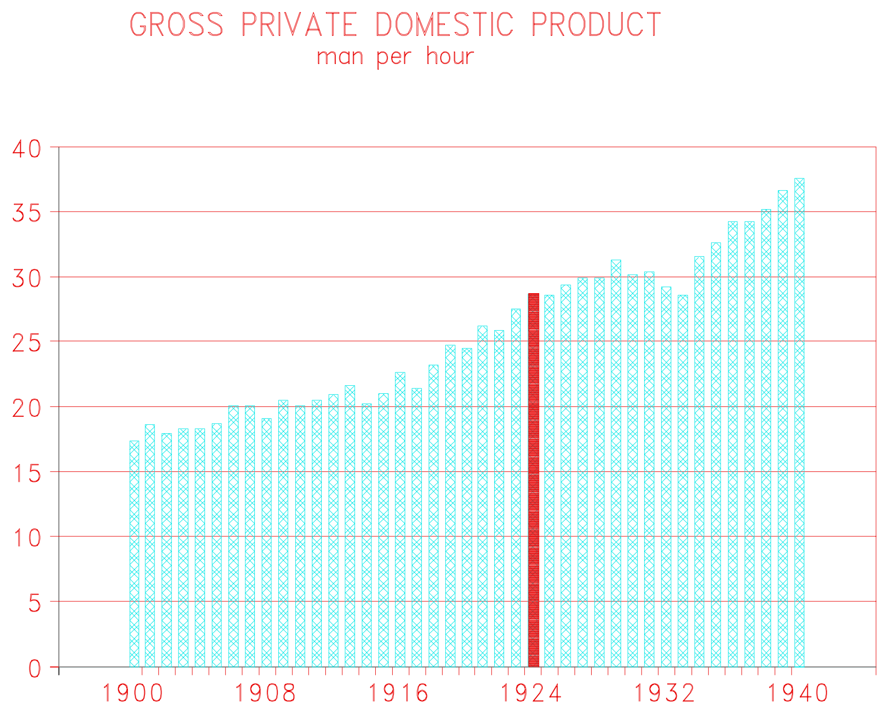
4) Unsettling influence of Presidential election, bonus agitation, possible tampering with Federal Reserve Act by farm bloc.

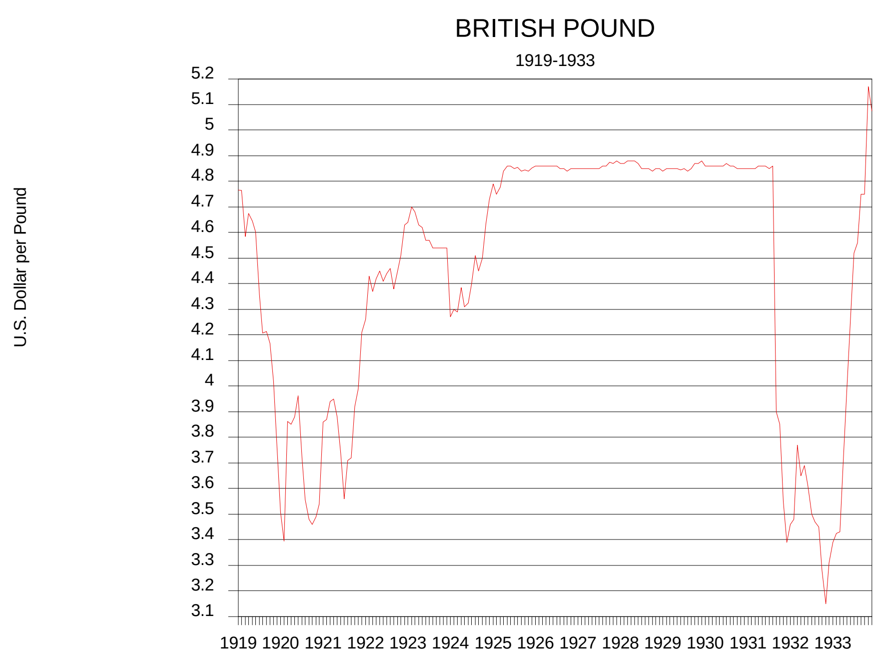
5) Germany drifting into bankruptcy, England faced with a Labor Ministry, France feeling the results of debt inflation, reparations still unsettled."

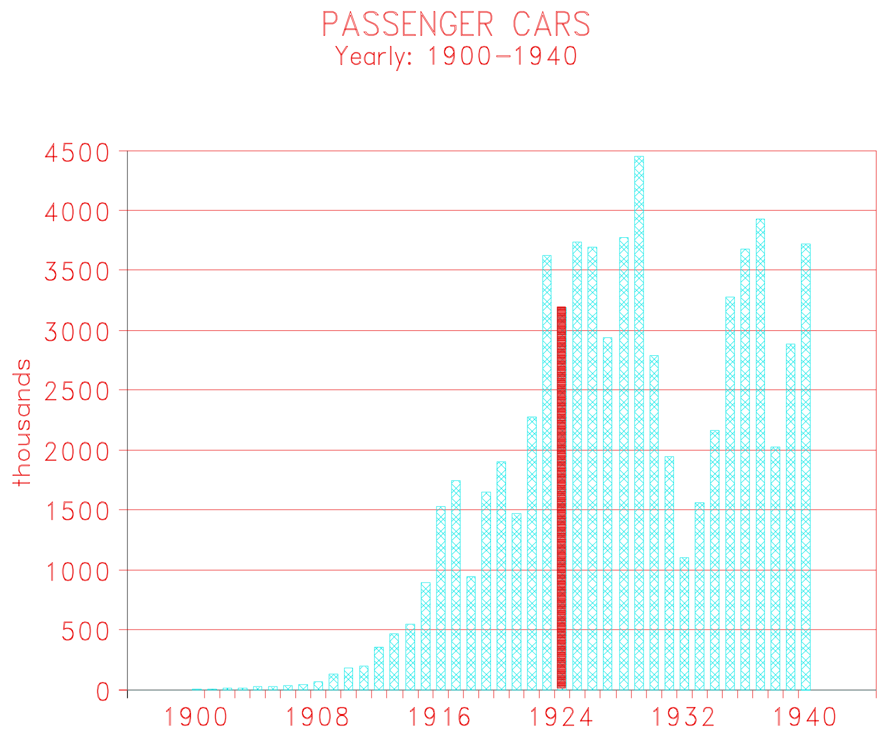
During the period of the 1920s, the so-called knowledgeable investor and analyst seemed to pounce upon every aspect of each issue and preferred to take the pessimist's view. But the bull market of this entire period was built upon the average man who came into the market and paid cash. Contrary to many false beliefs about this period, a number of the more leveraged speculators lost money on the way up as well as down.

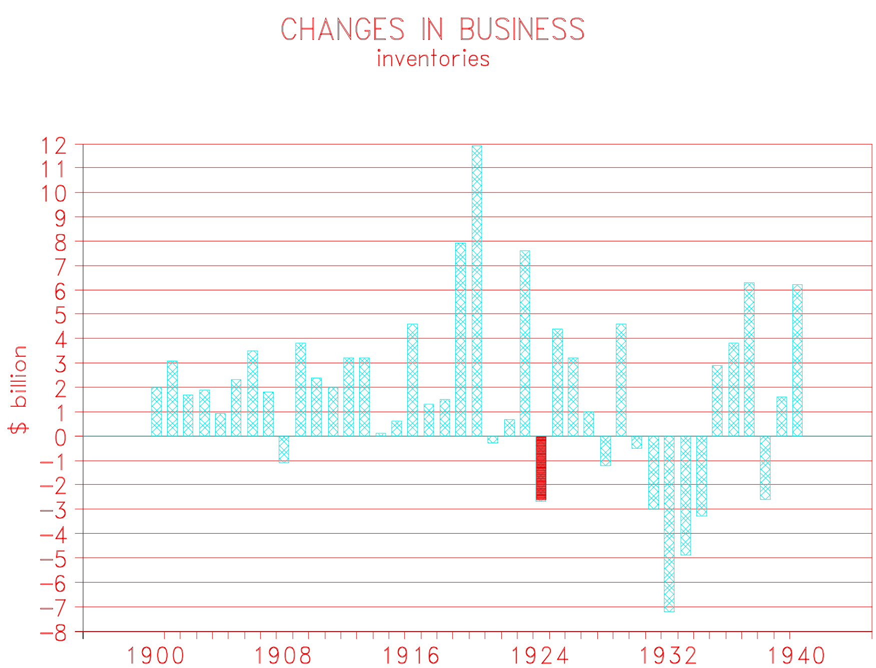
The U.S. gold reserves had reached their highest point in history with nearly half the entire world's official reserves held by the United States. Interest rates were easy, money was easy, and there was no appreciable sign of runaway inflation. Yet the soundness of the banking system was questioned; it would lead to inflation, pessimists asserted. When it came to corporate profits, the pessimist admitted that they were rising and at a record pace. But how long could this last? The U.S. would follow in Germany's footsteps, they proclaimed. This type of attitude continued for many years because these were the very traders who kept on shorting the market and who spread rumors about Livermore in an effort to discredit his accuracy and experience, both of which they lacked. Their principles had been based upon a foregone conclusion propelled by an unwarranted assumption.

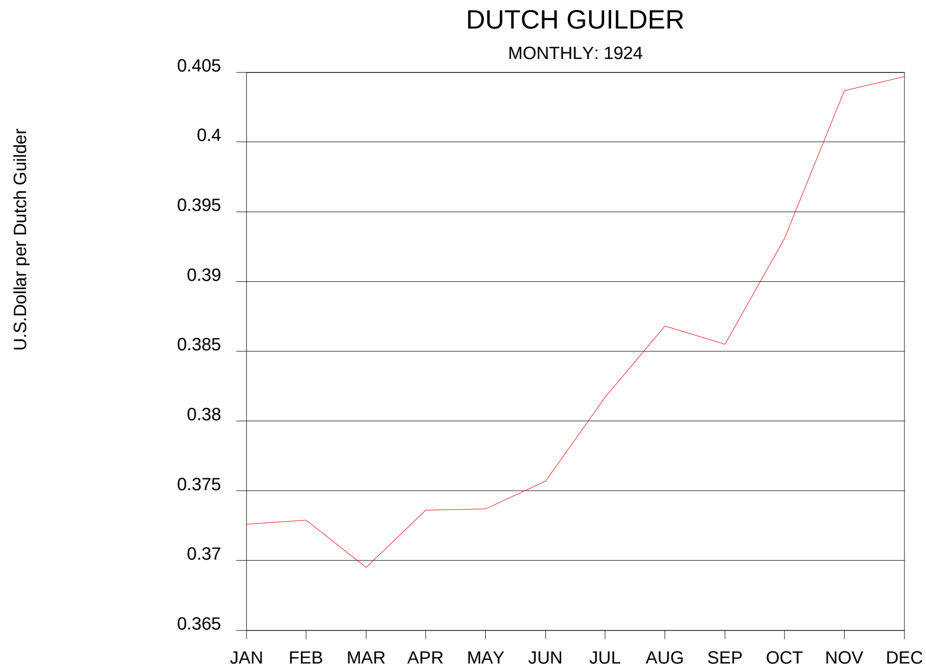
Corporate profits were up on an average of 30% along with dividends as the expanding American economy prompted many members of the general public to take stock in America. The railroads, after being hard hit in 1923, rallied sharply, still leading the industrials on the way up. The prosperity and expansion continued as America became the leader in innovation.


GROSS PRIVATE DOMESTIC PRODUCT
man per hour
40
35
30
25
20
15
10
5
0
1900
1908
1916
1924
1932
1940


BRITISH POUND
1919-1933
U.S. Dollar per Pound
5.2
5.1
5
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
3.2
3.1
1919 1920 1921 1922 1923 1924 1925 1926 1927 1928 1929 1930 1931 1932 1933


PASSENGER CARS
Yearly: 1900–1940
thousands
4500
4000
3500
3000
2500
2000
1500
1000
500
0
1900
1908
1916
1924
1932
1940


CHANGES IN BUSINESS
inventories
$ billion
12
11
10
9
8
7
6
5
4
3
2
1
0
−1
−2
−3
−4
−5
−6
−7
−8
1900
1908
1916
1924
1932
1940



The automobile industry consistently confounded all conservative judgment. Year after year it apparently reached what the pessimists projected was its saturation point. Nonetheless, auto production forged ahead to new record highs. The cost of automobiles had actually declined by 11% from 1913 to 1923. This was largely due to the assembly line method of production.

In January 1924, U.S. Steel announced another extra dividend of 25 cents, and the very favorable fourth quarter report for 1923 displayed earnings of $49.9 million, up from $47.1 million in the third quarter. This meant that the normal dividend of 6% annually had risen to 7%. In 1922 the mills were operating at 75% capacity but as 1924 began they were at 90% capacity.

As the market rallied from the fall of 1923 into early February, Jesse Livermore began to sell out his positions in favor of the short side. In the February 25, 1924 edition of Time magazine, the business and finance section carried this article:

"Mr.Jesse Livermore, young man with light hair, big back head and solemn face, knows more about stocks and such things than all others put together. So it is said. He sells or buys tens of thousands of shares at a time and thousands follow when he says, 'Buy' or 'Sell.'

"Wall Street last week gave an exhibition of mysteries second only to the oil scandal in Washington, and in fact caused by it. The stock market had advanced steadily if irregularly for many weeks, and had become over-bought and top-heavy. At such times, any incident is enough to cause an upset.

"At this stage, enters Mr. Livermore, the noted operator. His last two main prophecies on the stock market had been sufficiently fulfilled so that he had attracted considerable speculative following. From his vantage point in Miami, he sent a statement to the press which was widely published, although the Wall Street Journal refused to include it in its columns. Mr. Livermore declared that the oil scandal had undermined confidence in the stock market, and rendered doubtful the presidential nominations.' I think it is very foolish trying to be an optimist in the stock market at the present time,' he added. The effect of his pronouncement on the stock prices was electrical. In a single day, Fisher Body tell 13 points, General Electric 8 1/2, Du Pont 7 1/2, Baldwin 6, American Can 5, National Lead 8, Houston Oil 7 1/2, U.S.Steel 3 1/8, Studebaker 3 1/4; the entire list with hardly an exception declined.

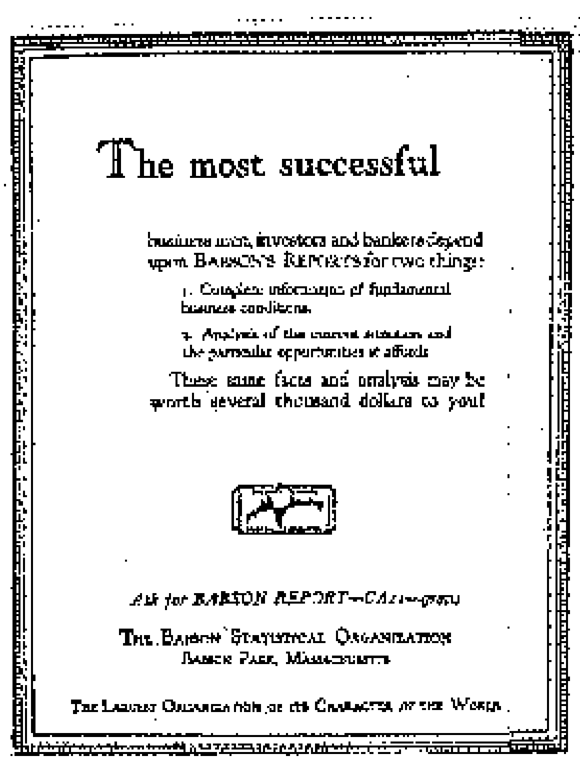
"Flattering as such results may have proved to Mr.Livermore, the real cause of the sudden decline was undoubtedly the 'technical position' of the market. After all, Mr. Livermore is a better Judge of the stock market than of national affairs. This was shown when he advocated more businessmen in our government, only to meet Senator Lenroot's retort that there had been several prominent business men rather too much mixed up in government affairs lately."

Livermore had been proven correct not only about the market but about the economy as well. Nonetheless, few people like someone who is more correct than incorrect, particularly when money is at stake. Not only did the Wall Street Journal refuse to even mention the accuracy of his predictions in light of their own views, but many grew to fester a hatred toward the man. Perhaps it was human nature to blame manipulation on Livermore rather than admit one's own error; nonetheless, this attitude could continue to the point that his own life would be threatened because of his accuracy.

Even today, the vast majority of people who trade the stock market rely totally upon fundamental analysis. The greatest of all problems lies in the fact that fundamentals change so quickly, and that the very same fundamental is often used by both the pessimist and the optimist in their arguments to support their positions.

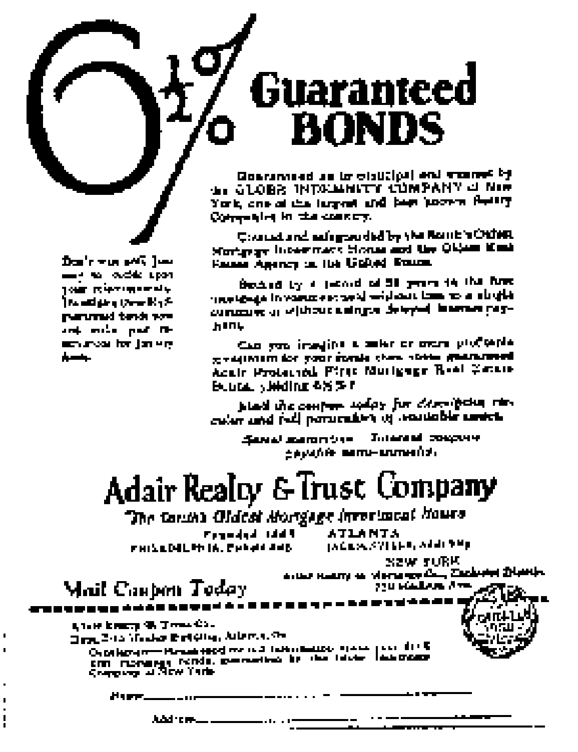
As the stock market bottomed in 1923, the height of pessimism existed. Rather than believe that the corporate strength within the economy was still moving along, indicating that the decline in the market was merely a consolidation phase, the majority chose the position that held true to their conviction that the stock market was a leading indicator, and that in itself suggested a time would come when corporate earnings would eventually drop.

With hindsight we can see clearly that that position was incorrect. There were many various fundamentals that were obviously overlooked by most analysts at that time. Foreign trade during 1923 averaged more



than $26.5 million for each working day. Exports were $13.8 million and imports averaged $12.6 million per working day. Almost two-thirds of the exports were in the manufacturing sector while the imports were primarily raw materials used in production. As 1924 began, January imports were valued at $299 million against exports which were valued at $394 million for the month.

In addition to the positive production posture of that time, the U.S. had become a creditor nation instead of a debtor nation. This did lead to serious criticism and many complaints. The complaints came largely from Argentina and Japan who claimed that the U.S. was forcing them to pay exorbitant interest rates. Of course, much was due to political reasons on the part of the party which was currently out of favor criticizing the party in favor. The truth of the matter was that foreign nations who came

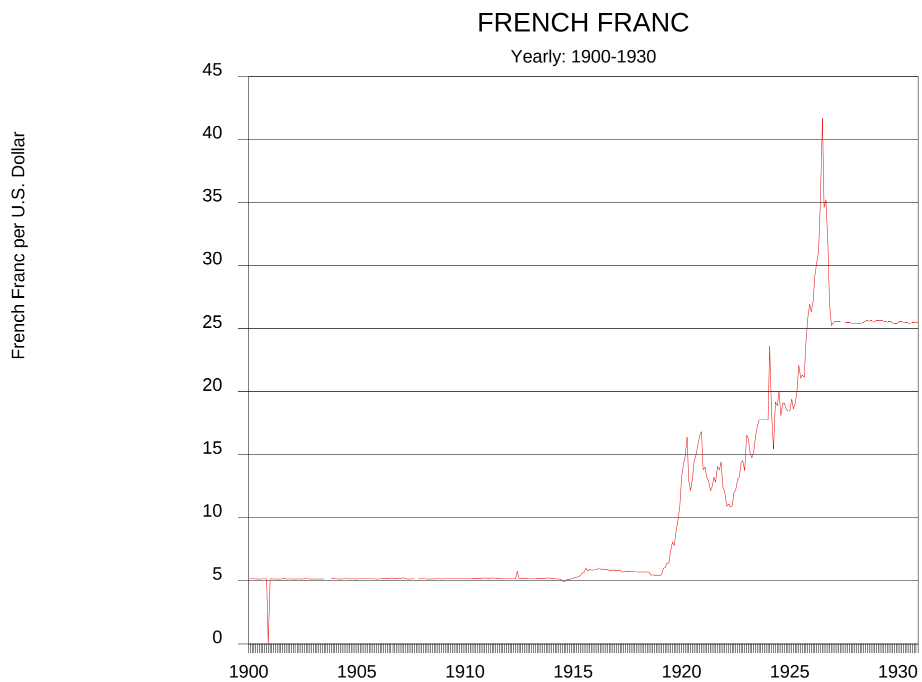


to the New York market had to compete for money against the steady demand for domestic money on the part of business and investment, which stood at several billion at that time. Therefore, to entice investors to purchase their foreign bonds, it was only natural that they would offer much higher rates of interest in order to attract_willing lenders. This was one reason why the Federal Reserve maintained the discount rate at 4.5%, which was sharply higher than call money rates.

Inflation was a concern as a result of the rising gold reserves, which stood at record levels. This was being caused by two factors. First, a strong trade surplus and second, a definitive fight in international capital to the U.S. as political and financial stability throughout Europe remained in serious question. Nonetheless, the cost of living had dropped during January by .2%. From the peak in inflation, July 1920, to January 1924 the actual cost of living had declined by 19.5% despite the rise in the gold reserves.

Time magazine reflected the sentiment in their March 10, 1924 issue by commenting on all the positive annual statements that had been pouring out for 1923 in nearly every sector. They stated: "It is, however, always important to remember that by this time annual statements for 1923 are practically ancient history. They indicate whether the given company has a strong or weak cash position, but they give little hint as to the present operations or future outlook. While sentiment is divided between optimism and pessimism, the perusal of these statements is valuable in gaining perspective; they cannot and do not furnish much of a basis for future predictions."

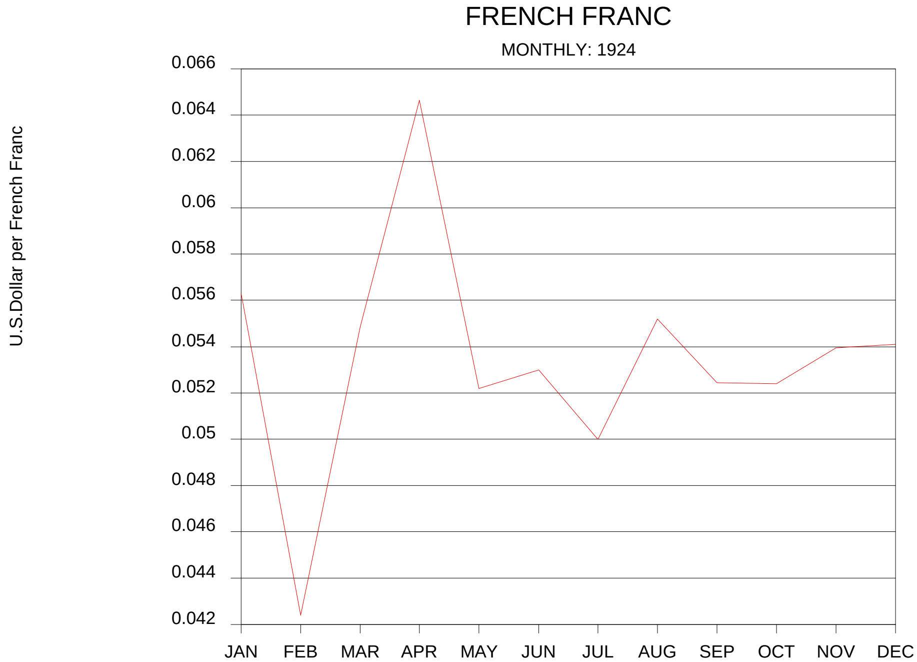
The pessimism that underscored the press commentary during March of 1924 was



quite amazing. Here the stock market had just rallied sharply, peaking during early February. Only one month of lower trending prices and everyone was right back to the good old doom and gloom scenarios, ignoring fantastic corporate earnings which should have been the basis for a solid bull market in the first place. They also ignored the fact that gold was still flowing into the States and that most of it was due to a flight of capital in favor of the U.S. economy which reigned supreme in the world at that time. The downtrend continued from February 1924 into May of that year. The foreign situation was beginning to turn during late February. Several new governments had been set up by the Treaty of Versailles and those that had been seriously battered by hyperinflation were returning to the gold standard.

France established a gold franc that was equal to 19.3 U.S. cents. However, 20 gold francs contained .1867 troy ounces of gold. Nonetheless, France did not mint any gold coins for general circulation between 1915 and 1929. Austria, with the help of Britain, discarded the krone in favor of the new schilling, which was based upon silver. The new retenmark of Germany was equal to 23.8 U.S. cents and based upon gold. Even Russia, after realizing that its rubles were worthless, issued in 1923 the new "chervonetz," which was equal to 10 gold rubles or $5.15. Hungary was forced to abandon the old krone in favor of the new "sparkrone." The European trend was not necessarily to redeem its old currencies, but instead it practically repudiated them by creating new currencies based upon gold.

The February 1923 high in the Dow had corresponded precisely with a high in the dollar on world exchange markets. As Europe regrouped, cash flow into the States began to subside and so did the buying pressure from overseas. Analysts, however, continued to view the market solely from a domestic perspective, giving no recognition to the fact that perhaps America had a monopoly upon economic stability at that time.



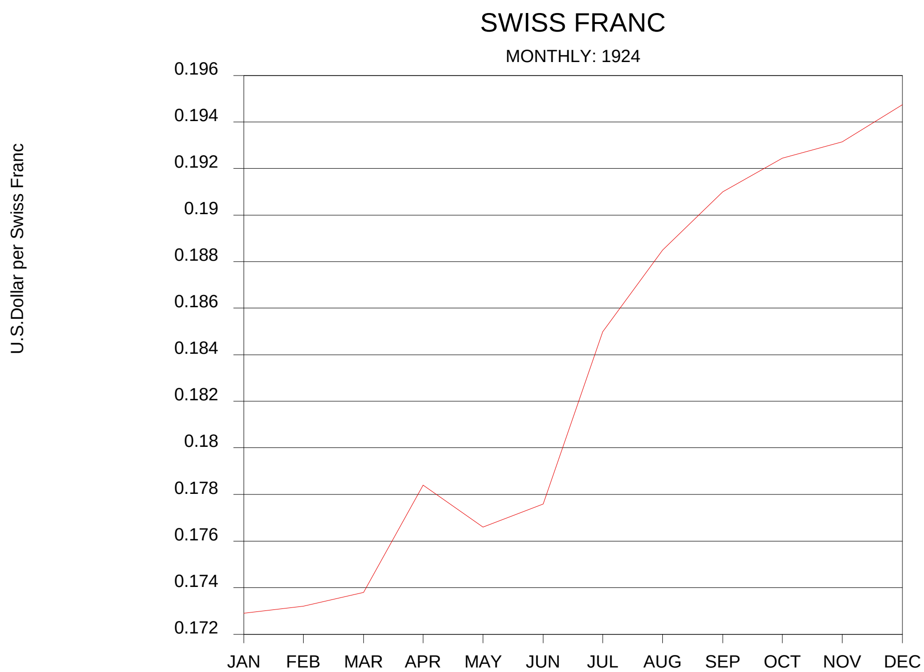
Nevertheless, as the stock market continued lower, gloom became fashionable once again. In the April 21, 1924 issue of Time magazine the opening statement under the business and finance section had this to say about the current atmosphere: "Amid the babel of conflicting opinions during the past week, on the future probabilities in business, one strong and uncompromising attitude became conspicuous. This was the bearishnsss of Wall Street."

The analysts, who preferred to choose the bearish side as usual, were pointing out that although the stock market had rallied sharply from the fall of 1923 into early 1924, many stocks remained at their lows. It was true, in fact, that many stocks did not participate in the sharp rally. Industries such as leather rubber, shipping and fertilizers had hardly moved since the February high, and neither had the automobile stocks or steel and tobacco. Others pointed out that the railroads had held up rather strongly.

The analysts were much too busy trying to find stocks that did not participate in the rally to justify why the market would continue lower, rather than explaining honestly why some sectors had risen sharply. The real reason why the rally from the 1923 low into the early 1924 high was not a broad market rally is twofold.

First, call money had remained under the discount rate and time deposits were paying 2% at best. Most foreign bond issues were forced to pay 6% to 8% in order to attract lenders. But many small investors who entered the market on full cash positions and not margin were attracted to issues which were paying an annual dividend of 5% or better. U.S. Steel is only one example. The speculators were interested primarily in price fluctuations while the capital investors were interested in return. With turmoil in Europe on the front pages during the last quarter of 1923, it was not hard to figure out, given a choice between a foreign bond paying 6% and U.S. Steel, which of the two was the safer capital investment.

The second reason why the rally into early 1924 was a selected rally lies primarily in



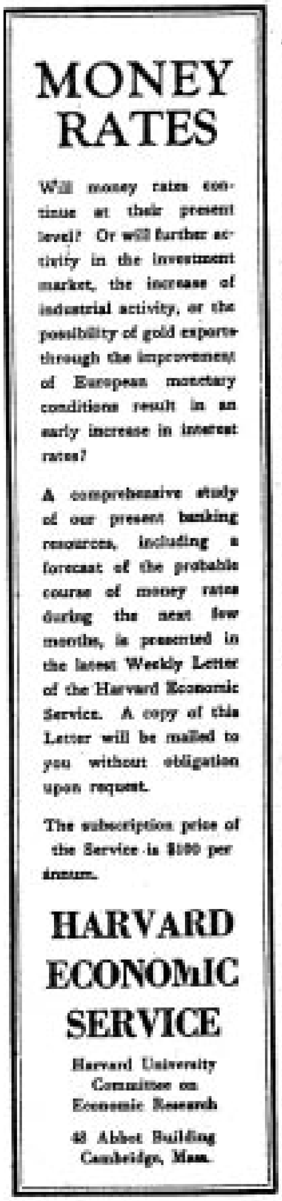
the realm of foreign exchange. Foreign investors were also attracted by the better performing companies with the best dividends. As the dollar continued its rise, the gold reserves continued to expand to record levels. The trade balance between the U.S. and Europe continued to move in favor of the U.S., reflecting a strong export economy which aided the rise in the gold reserves. However, the gold reserves grew even sharper than the exports which reflected that a net capital flow to the U.S. on a cash basis was also taking place. This was not in payment for goods but capital fleeing into the dollar.

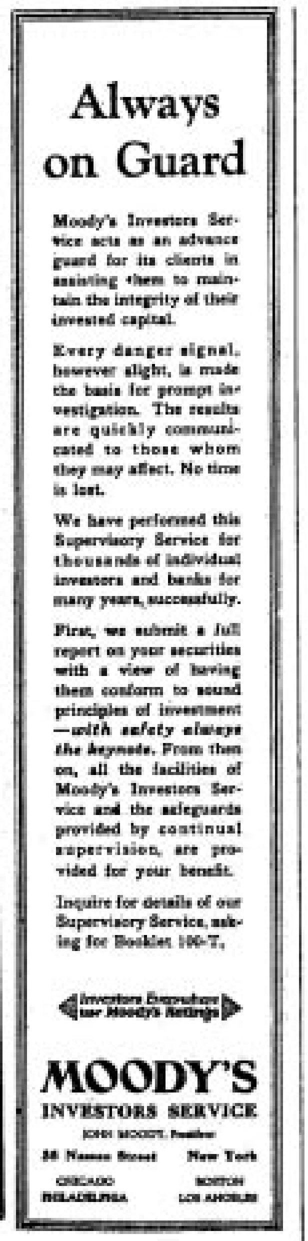
Therefore, it clearly seems plausible that the only people who didn't know why the market had risen during that period when the dollar rallied sharply were the professionals.

The small U.S. investor's motives were dividends and concern over foreign bonds. The international investor focused on the safety of the dollar and the profits brought through foreign exchange. Both forces combined to make the rally from the 1923 low a rally which was selective largely focusing upon the blue chips. In many respects this was the very same type of rally which was witnessed from the September 1985 low when the Dow Jones Industrials lead the broad market to new highs all the way.

The real estate boom, which was largely taking place in the East, was becoming a little uncertain at this point in time. Commentary again found Realtors expressing their fears that the boom was now at an end. Commodity prices continued to fall from December 1923. Yet some commodities such as livestock, oils and building materials, were advancing. Nonetheless, steel production was establishing all-time new records. Output for March had reached 4.1 million tons compared to 3.7 million tons during the previous month, 3.6 million tons in January 1924, and 4 million tons during March 1923.

The fears that were circulating were largely based upon anticipation rather than on hard-core facts. Most became skeptical





about the future of business conditions every time the stock market began a down tick. But the building boom was still intact even during March. Building expenditures during March 1924 were $318 million compared with $248 million in February, $189 million in January and $292 million during March 1923.

The Federal Trade Commission was also active during those days. They sent forth a directive to Eastman Kodak and associated firms that stated in no uncertain terms that they must cease from restraining competition in the manufacture and sale of motion picture film. It specifically singled out and barred Kodak from acquiring control of three additional laboratories. The Commission reported that Kodak had essentially a monopoly on the manufacture of positive film and a complete monopoly on negative film.

The sentiment hadn't changed, and as April continued to click on by, the April 28 commentary in Time Magazine was still quite gloomy: "Nothing is quite so easy to do, or so unfair in the doing, as throwing mud at former prophecies that haven't panned out. Hindsight, now as previously, is much simpler than foresight. All the same, there was heard last week considerable criticism of the bankers and industrial leaders who last fall predicted great prosperity this spring. The spring has come, but profits in most lines of industry are getting leaner each week; in some industries they have disappeared."

April began to see somewhat of a decline in production and this prompted everyone to proclaim that the stock market peak in February had foretold of this disaster. The declines were actually hardly worth noting, yet the press focused upon the disasters which were still centered within the leather, textile and fertilizer sectors. Time reported: "It is the basic 'assumption' now for a quiet summer and only a bit of a rally in the fall provided Coolidge is reelected."

It was during May 1924 that John Maynard Keynes' book hit the streets selling for $2.50. Perhaps no one realized at that time just how much difference that $2.50 would make in the future events of Western civilization. His book was revolved by Time on May 12, 1924 under the title of "Monetary Reform." Time commented on the book as follows:

"Mr. Keynes, famed British economist, has never before emphasized so clearly the fact that he is a fiscal Bolshevik.

"Monetary Reform analyses the function of money, shows how it affects the investing and business classes, the earner, production. It discusses inflation and its relation to taxation and capital levy. It delves into the whole theory of money and the foreign exchanges. It suggests alternative aims in monetary policy and then advocates inflation, neatly garbed.

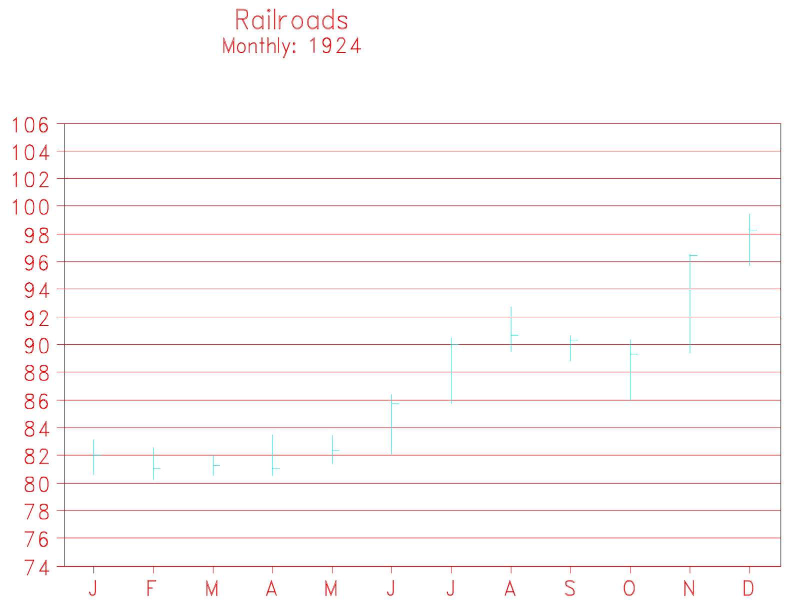
"Mr. Keynes wants a devaluation of currency, which means stabilization of money at present values. He wants internal purchasing power fixed on a commodity-value basis related to unemployment, state of trade, etc., while the external purchasing power shall be controlled by gold whenever necessary.

"Those readers who have followed Mr. Keynes' recent course will not be surprised at this attack on the present fiscal policies of most countries. Mr. Keynes would have the world embark upon great experiments. He apparently imagines that the clarity of his expression stimulates not the imagination but the common-sense of men. His contentions are a subversion of established fiscal policies in use for more than 100 years, a period in which, as Mr. Keynes agrees, the gold standard of currency became the unquestioned foundation of 'the stability and safety of a money contract.' It is inconceivable that rapid progressivism should be regarded favorably in the conservative world of money.

"The author is fortunately being ignored, because every country in the world is seeking to claim parity with the dollar and to fix its internal values to the gold value of its currency or in other words, to deflate. Furthermore, if the signs of the times be read aright, the Federal Reserve Bank has already adopted a policy of discounting European notes in large amounts, which is a policy more calculated to assist the recovery of European currencies than any yet operated."

Time's unfavorable commentary upon the publication of the Keynesian theory, which is so widely employed today, provides a good insight into the general attitudes which prevailed. Those who have attributed the great bull market of the 1920s to irresponsible speculation that swept the nation should go back and read a bit further beyond 1929. If anything, the one consistent undertone that prevailed was one of disbelief and conservatism. On the slightest down tick, pessimism soared. Perhaps rightfully so, considering the number of panics that had taken place during the previous 20 year period.

Nonetheless, as the market continued lower into May, industrial production did have a fairly sharp correction in a very abrupt fashion. Steel production, which had been at 90% capacity, fell to 60% capacity in May. Yet there were some strange signs which counteracted against the declining stock market and sharp correction in the industrial production. Money was very abundant and very cheap. As the stock market bottomed, commentary in the press by early June compared the stock market to a motionless sphinx which had entered a



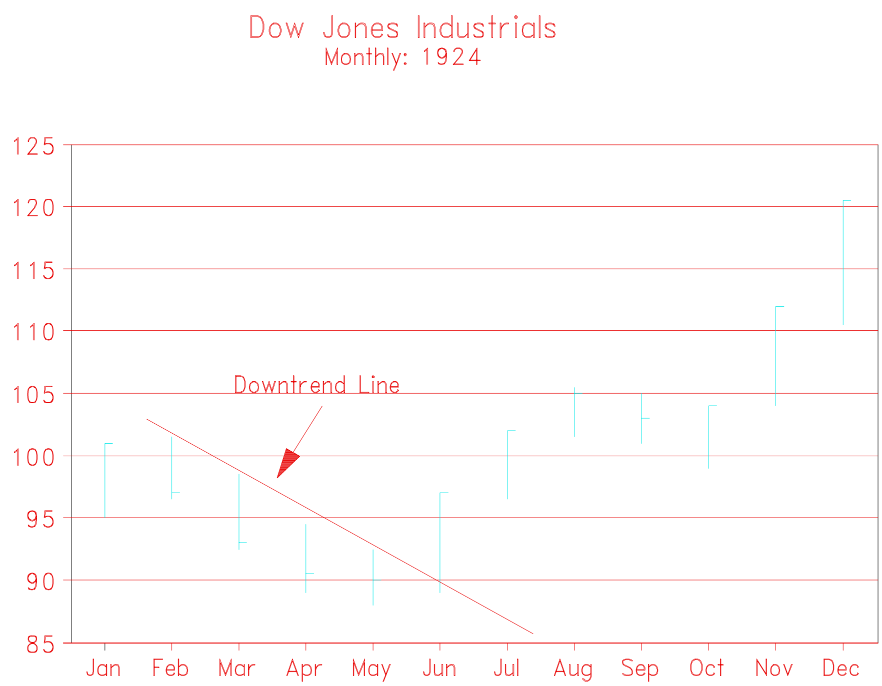
Sargasso sea where ships became entangled in a bed of seaweed.

The economy had indeed come to a pause in its robust fervor for expansion. In part, this was created by the sharp rise in the dollar. Exports to Europe had slackened during the first quarter in response to the high in the dollar and the adjustment period following the collapse of Germany.

One aspect of the foreign war debt owed to the United States had begun to rear its horns and it eventually became a leading element thrusting the U.S. into a debtor nation position decades into the future. The total war debt owed to the U.S. from World War I was roughly $11 billion. While Europe haggled with reparations demanding $33 billion in payment from Germany, the British and the French launched propaganda toward the U.S. and indeed within its own borders to forgive its war debts. By this time, the U.S. had already granted concessions to the European governments forgiving a portion of their debt. The British were given a concession of 30%, the French 40%, the Italians 70% and the Belgians approximately 60%.

One aspect of the war debts had a large part in creating the Great Depression (which eventually led to Keynes' "Bolshevik" policies being embraced out of sheer desperation), and this lay solely in the interest impact to the United States. By 1929, only $250 million in payments would be made by Europe on its war debt to the United States. That same corresponding period cost the U.S. government $450 million in interest to float that loan through its own bonds.

This effect would be a subtle yet distinct factor which would remain hidden in the economic statistics for many years. The reluctance of Europe to pay its debt then and after World War II added a fair portion to the U.S. national debt, which to this day is still being carried at interest costs in the hundreds of billions in 1985. Eventually in 1933, France repudiated its debt on the premise that it could not afford to pay its $60 million annually. The truth of the mat-



ter is that France at that very moment had $500 million on deposit in New York City from a surplus on international exchange.

The foreign trade picture began to turn equally as fast as the dollar's retreat from its January-February 1924 high. The British pound rose from its January low of $4.27 to $4.38 by March. By July this trend continued as the dollar retreated and the pound rose to $4.57. By year end, the pound closed 1924 at $4.73 near the pre-war par level. 1924 began a sharp upturn in U.S. exports to Europe and the trade surplus grew sharply, rising 44% above the 1923 surplus. This trend began to shape the future in April although the market would continue lower into May.

Technically, the market had corrected into a May low. The 1924 Downtrend Line (connecting the February and March highs) had contained the rallies during April and May. During early June, the market had begun to rally and once the 1924 Downtrend Line was exceeded. The market fell back and tested it once on a weekly basis and never looked back again. By August the market rallied to slightly above the 105 level, trying for the second time to penetrate the 1923 high and the major high of 1919. As I have discussed at our technical seminars over the years, the more a market tests the same area, the more likely it will be for penetration and eventual follow-through.

On June 9, the press admitted that perhaps the business conditions were not going to collapse entirely. Most commented upon the fact that money was easy and that the outlook indicated that it would continue to remain so.

The banking business began at this time to take on a new style or image. Prior to mid-1924, banks regarded advertising as undignified. Yet all sorts of advertisements began to appear in the papers. Steady and aggressive campaigns were launched as **a** scramble to become a billion dollar bank became the main battle cry. Up to this time, only the American Bank had surpassed that lofty goal. This change in the banking attitude also played an important

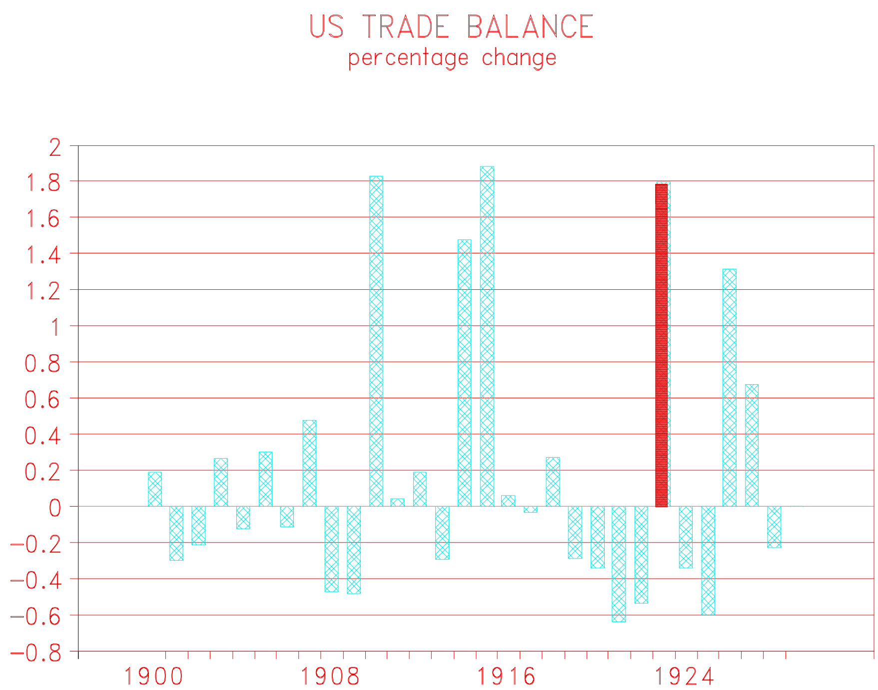
role in the mental attitude that would help create the biggest bull market in history. Numerous major corporations had been formed and the public was bombarded by new and exciting events. Banks were aggressively competing for business, which tended to increase the perception of just how sound the underlying structure actually was at that time.

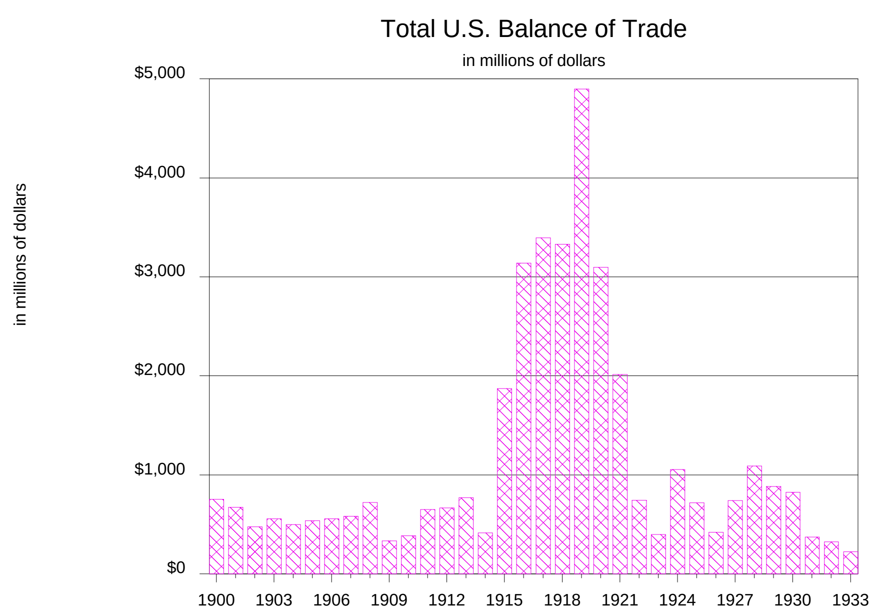
Interest rates were falling drastically. By mid-June, call money rates fell below 3%, setting a new record low; by June 20, call money fell to 2%, which was a six year low. The Federal Reserve followed suit and the discount rate was lowered from 4.5% to 3.5%. The stock market began to rally. Today such a rally would at once be attributed to a decline in rates thereby affording more capital for speculation. But once again it coincided with a rise in capital flow in favor of the U.S. created largely by the dramatically rising trade surplus. The discount rate cut came after the market had already bottomed and the gold reserves were growing abnormally once again.

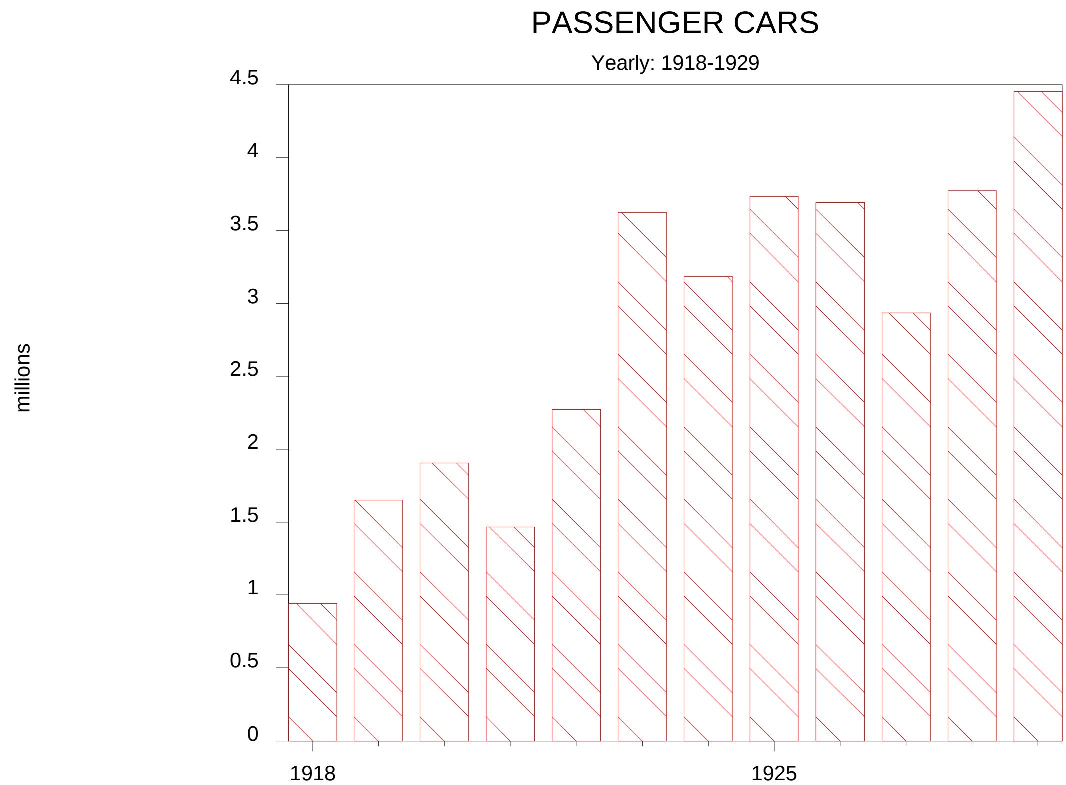
Everyone was waiting for Livermore, who back in February proclaimed his bearishness and was once again right on target. The press called upon him to see if he would give the market his blessing but he remained unchanged. However, he gave his reasons which were widely published. He basically stated that he felt that it takes a lot more than simply cheap money to make a bull market and he pointed out quite correctly that all the recent rallies in the stock market had taken place during rising periods when interest rates were substantially higher or during sustained periods of higher rates. Most of the press ended their articles much more favorably than in the past. For example, one article ended by adding: "The importance attached to Mr. Livermore's opinion in Wall Street and elsewhere is due to the large number of times he has been correct."

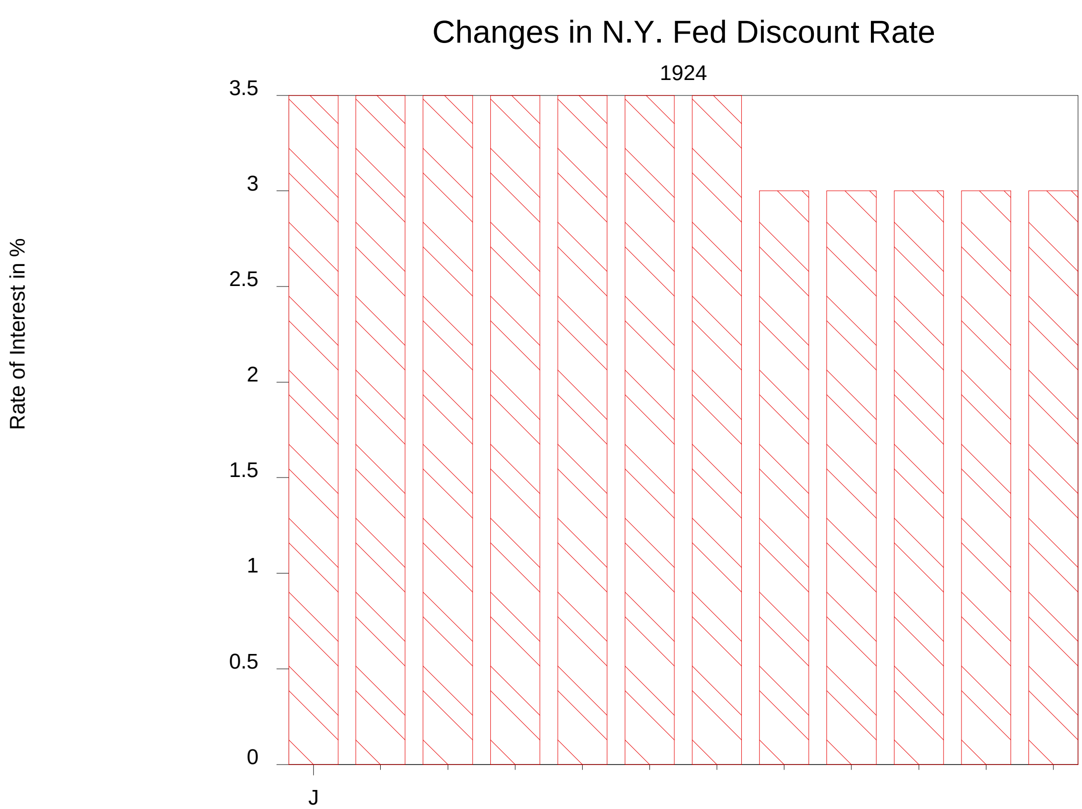
During this period there was actually an oil crisis taking place simultaneously with the stock market low. In 1923, there was an unexpectedly large oil production. Most companies had stockpiled crude because prices had dropped sharply when auto production fell to some degree. However, in those days, oil consumption depended greatly upon the weather, not for heating oil considerations, but for gasoline consumption. The winter of 1924 was exceptionally cold and the spring was wet. The automobile was largely a novelty and used primarily for excursions and this put a damper on the American motoring public's activities which included joy rides into the country for relaxation. If weather was bad, gasoline consumption fell.

But during the spring of 1924, the oil companies raised the price of crude, bringing out the wildcatters once again. This sparked further production and gasoline stockpiles rose tremendously, setting a re-


US TRADE BALANCE
percentage change
2
1.8
1.6
1.4
1.2
1
0.8
0.6
0.4
0.2
0
−0.2
−0.4
−0.6
−0.8
1900
1908
1916
1924


Total U.S. Balance of Trade
in millions of dollars
in millions of dollars
$5,000
$4,000
$3,000
$2,000
$1,000
$0
1900
1903
1906
1909
1912
1915
1918
1921
1924
1927
1930
1933


PASSENGER CARS
Yearly: 1918-1929
millions
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
1918
1925


Changes in N.Y. Fed Discount Rate
1924
Rate of Interest in %
3.5
3
2.5
2
1.5
1
0.5
0
J

cord high at the end of April of 1.6 billion gallons. Gasoline prices started to drop and undercutting took place in the Midwest as well as on the East Coast. The oil stocks became hard hit going into early June.

Up to 1924, the interest rates in the United States had, by and large, been higher. But after the Fed lowered the discount rate to 3.5% in June 1924, the U.S. emerged as the lowest interest rate market. This was interpreted much differently at that time than we would interpret such an event today. Time magazine put it very well on June 30 in their comments as follows:

"Usually London, as the former financial center of the world, has been able to maintain the lowest money rates, while New York rates have ruled far above."

In those days, the higher the rate of interest a nation paid, the less of a credit rating it maintained within the international community. Money was pouring into the United States as nervous Europeans looked upon America as the land with streets paved in gold. Industry was expanding, innovation was abundant, and from their eyes the U.S. was the place to be. As foreign capital flooded into the United States, the interest rates continued to drop to the point where call money rates reached 2%.

In 1924, foreign capital was pouring into the U.S. while the discount rate had been declining steadily since 1920. Around the world the official discount rates stood at the end of June 1924 as follows:

Austria.................. 12.0%
Belgium....................5.5%
Bulgaria....................7.0%
Czechoslovakia........6.0%
Denmark..................7.0%
England....................4.0%
France.......................6.0%
Germany.................10.0%
Greece......................7.5%
Hungary..................18.5%
India..........................7.0%
Italy...........................5.5%
Japan........................ 8.0%
Holland.................... 5.0%
Norway..................... 7.0%
Poland.................... 12.0%
Portugal....................9.0%
Rumania...................6.0%
South Africa............ 6.0%
Spain.........................5.0%
Sweden.....................5.5%
Switzerland..............4.0%
United States..........3.5%

The stock market began to rise sharply by the end of June and during July the upward trend continued. By and large, everyone remained confused and began to suggest that the rally was due to the decline in interest rates. But the true cause was the influx of a 44% rise in the U.S. trade surplus.

In the July 7, 1924 edition of Time magazine, this attitude was expressed: "Wall Street, however, after several months of an uninteresting experience with meaninglessly see-sawing prices, is now getting the old-fashioned thrill that only a sudden decline in interest rates can give. Bonds and stocks with fixed or certain dividends are making new highs daily. Yet, on the basis that it takes something more than cheap money to produce rising markets and prosperity, investors are still gun-shy of industrial stocks for the most part. The Great God Livermore has yet to declare himself convinced that the turn in the Industrials has come. But it is too much to believe that the speculative leader is unaware of the soaring investment markets, or that he has not profited somewhat thereby."

What was taking place was still the two fold play. First, foreign investment seeking dollar safety entered the market looking for higher dividend paying stocks. Many industrials were still paying a 4% to 7% dividend and with call money at 2%, they were looking at a hard-core fixed profit. This dividend play in the face of cheap money also attracted the small investor ahead of the so-called knowledgeable investor. What only hindsight would reveal was the hidden truth that the schlep on the street sometimes knows more than the man in the back seat of the limousine.

Although money was cheap, it hadn't yet broken all-time record lows which had been established at 1.55 back in 1894. Yet the 2% level matched the low which had been established prior to World War I during June 1914. Speculation then began to circulate that the Fed was going to cut the discount rate again to 3% and the buying fever continued, reaching a high during mid-August of 1924 before any setback would come.

Nonetheless, just in the midst of the early weeks of August before the high came into play, U.S. Steel once again announced a surprise extra dividend, but this time an extra 1/2 point or 50 cents. Although the earnings of U.S. Steel did decline from $50 million during the first quarter of 1924, the second quarter was still $41.3 million. This meant that U.S. Steel earnings for the first half of 1924 were $8.47 per share which was still another record.

Most analysts today perceive lower rates of interest as bullish and higher as bearish. Some would point to this June discount rate cut and assert that it was the fundamental reason why the market rallied. But this would be proven incorrect in the months and years that followed. The importance of this discount rate cut is that it was bullish only because the call money rate and long-term rates were below the dividend yields. Therefore, just as we saw money market funds burst with cash and attract money from the stock market in the early 1980s, in 1924 the stock market was paying more than an interest-bearing account and as such rallied as capital flow turned positive. Capital, even domestically, will flow to the highest bidder and in 1924 it was the stock market.

Then it came. On Thursday, August 7, the Fed cut the discount rate to 3% as money simply poured into the U.S. economy in the face of a continued expansion in the U.S. trade surplus. The rising stock market and the impressive earnings on the part of America's largest corporations lured many foreign investors. But just as the news broke following the earnings and the discount rate cut, the market peaked. After closing August above 105, the market pulled back to eventually dip below 100 moving into October, just prior to the Presidential elections.

The world had come under serious debt pressure due to World War I. The actual amount of gold in the world was far less than the outstanding debt which was owed to the United States and by mid-1924 the U.S. held more than half of the entire official world supply.

South African gold production was reaching a record level of 829,437 ounces in July of 1924 alone. Due to various laws in nations such as Britain, which prohibited the exportation of gold, and due to the premium placed upon gold itself among the debt ridden world, most of the South African new gold production was pouring into the United States. As this continued, money in the U.S. remained easy and relatively cheap. This created much confusion within the analytical sector which served for many as a misinterpreter of the economy. Everyone was used to lower rates during recessions but not during expansion.

Traditionally, it was held that declining interest rates reflected a lower demand for money and subsequently it was regarded as a sign of recession. But at the same time, interest rates which became too high were seen as inflationary, robbing industry of profits. Therefore, it was consistent under the current interpretation of interest rates within that atmosphere for Livermore to point out that the stock market had risen previously on higher rates and not with lower rates. Subsequently, even the famous Jesse Livermore became confused by the declining rate during the summer of 1924 and he indeed missed the rally along with most other professionals.

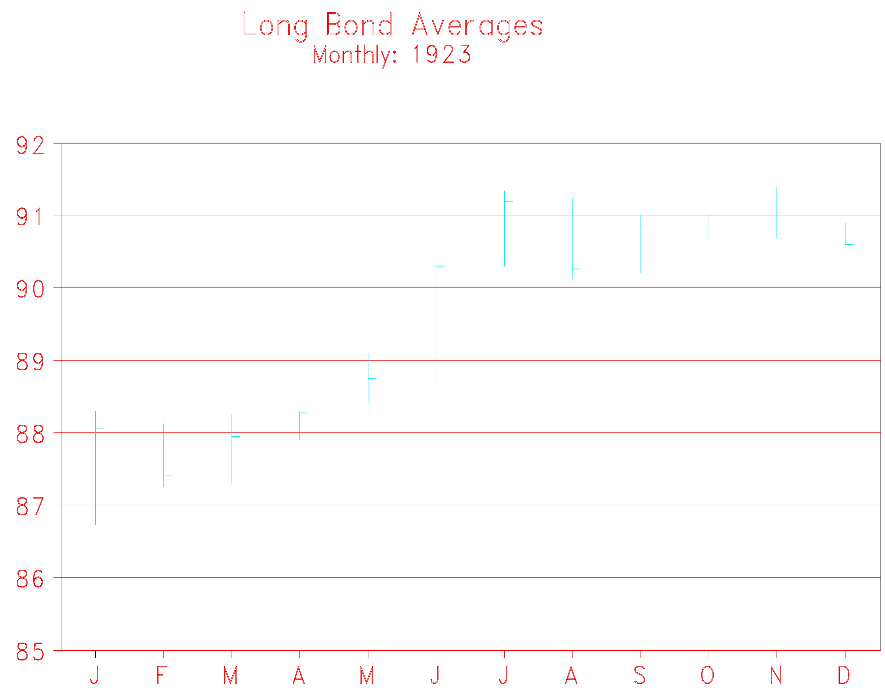
As the market came into its bottom prior to the Presidential elections, money remained easy but call money rates began to rise for the first time that year. Call money suddenly rose from 2% to 2.5%. Gold imports began to ease off sharply as India began to attract the precious metals. Yet foreign loans were increasingly being floated in New York as the world came knocking on the U.S. door for money. This was one primary factor for the rise in the call money rate during October 1924.

The winter and spring had already been fairly cold and damp. When it came to the wheat harvest in the fall the rains continued in Europe and became very destructive, forcing wheat up to $1.50 on the futures in Chicago.

After the August high, the market traded down through a consolidation phase for two months coinciding precisely with the last drop in the discount rate. But the consolidation had reached bottom, barely penetrating below the 100 level during October. In the final throws of October, the market rallied back and closed at 104. Suddenly, from the opening bell in November, traders scrambled nearly buckling under the pressure of huge volume which had not been seen since the pre-1920 years.

Then the stock market took off in one of the most straight up moves it had ever made. Immediately the press jumped on the move, interviewing everyone trying to find out what was really going on. The consensus narrowed the reasons down to three: 1) The election of President Coolidge; 2) Coolidge's lack of action against the railroads to restrain laws which would break them up; 3) Britain had come close to socialism yet in the nick of time veered away and elected a Conservative government. These were the main occurrences reported as the influencing force which encouraged the masses to buy. Although these were logical reasons to the experienced trader in an attempt to interpret the actions of the unsophisticated investor, again they missed the important aspects which made sense to the little guy. If U.S. Steel is paying 7% and the bank 3%, you had to be crazy not to buy U.S. Steel. This led the common masses into the stock market as never before in the face of declining income on time deposits at the banks.

Brokerage houses were reporting that private individuals who hadn't invested in the market since the war had suddenly decided that business conditions were sound. The rally was led by the rails with new highs for the year being scored across the board. Volume soared to near record levels trading 2 million shares a day.



It was in November that call money rates fell back to 2% again but this time some foreign capital was leaving New York in favor of Europe. The "Expert's Plan" had been adopted and everyone turned their eyes toward Europe assuming that a robust recovery was at last at hand. In anticipation of that, N.Y. banks began to lend overseas to various industries. The London stock market began to rally and sterling at last began to firm, approaching the pre-war level coming close to par. By November all the press had turned from doom and gloom and pronounced that the signs now pointed the way to prosperity moving into the spring of 1925.

Many infrequently traded stocks suddenly appeared on the ticker tape. During the week of November 10, 689 different stocks traded and in the ten post- election days 18,717,732 shares had changed hands, which was a record since 1901. The total appreciation in the value of the entire exchange was nearly $3 billion with an average advance of 5 points.

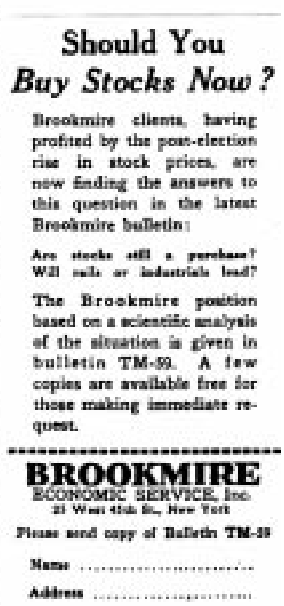
The ticker was twenty minutes behind and the press announced that it was the "public's market." By early December the market still soared; advances were simply all over the place. Time magazine had this to comment:

"The stock market has continued to prove the most active spot in business. Volume has been continuing at about an average of 2 million shares a day, with rising prices in both rails and industrials. Liberty bonds, on the other hand, have been stationary or weak- another normal sign of a good sized 'bull market.'"

Again, the commentary at that time was strikingly different from what we would expect today. Here, Time magazine clearly states that declining bonds and rising stocks were the true sign of a good bull market. As long as interest rates are relatively higher than dividends, the bias will be toward bonds. But if rates are under dividends, the bias swings toward the stock market. The strong rally into the end of 1924 was reflective of capital leaving the bond market and flooding into the equity markets. This is an important insight which has been seriously lost in recent years.

Another important insight into this market has been misinterpreted by many who have written only about the Crash of 1929. The picture that has been painted is one in which the masses were recklessly over-margined, borrowing everything they could to buy stocks. We will take a look at that period when it comes into play later during 1928. However, the initial raging bull market which took off from the October low in 1924 was strikingly different from what most of us would have expected.

Time magazine reported: "One remarkable feature of the recent market activity has been the stationary status of broker's loans. Usually, as stock prices rise, Investors sell out to speculators who buy 'on margin,' thus occasioning a rise in the amount of money borrowed by stockbrokers at the banks. No official figures on broker's loans are kept, but fairly reliable estimates indicate that recently no advance has occurred in their amounts."



The stock market was rising not on margined speculation but on solid investment. As reported by Time magazine in December: "Public investment in real estate has been on a decline." Cash was flowing from both the bond and real estate markets directly into the stock market for full cash purchases. This signaled not speculation, but massive investment due to rising confidence in the private industrial sector of the United States. The U.S. trade surplus with Europe would stand at a 44% gain over 1923 by year end.

On December 15, 1924, Time Magazine reported as follows:

"On the Stock Exchange, heavy volumes in trading continue, along with a continued although somewhat irregular advance in prices. As yet, no signs of security inflation have appeared except in a minor way. Broker's loans are stationary and purchasing is still largely for cash. Declarations of new dividends, especially among the weaker railroads, already go to show that the autumn's 'bull market' has not been a merely speculative movement, but caused by fundamental economic reasons.

"The real puzzle is with industrial securities. They have appreciated along with the rails, but more uncertainly and subject to larger reactions. Moreover, securities of different industries have behaved quite differently. Industrial news continues to become more encouraging."

Indeed, the commentary during December 1924 sounded universally bewildered by the substantial appreciation in the industrials. Normally, the railroads had been viewed as the bulwark within the overall market. Railroads had been the rage of the 1907 period but by the 1920s they had gained a more conservative perspective. The industrials had now become the speculative issues. For example, during 1921 the railroads bottomed during June at the mid-65 level. The industrials continued lower into August reaching 64 on the Index. The railroads rallied reaching 94 during September 1922, whereas the industrials continued to lag, eventually reaching 103 by December. The railroads therefore bottomed in advance and peaked in advance of the industrials. Even during 1923, when the industrials reached their lowest point during October, the rails had already bottomed during June and were in a moderate uptrend into year end. During early 1924, the industrials fell from their February high into the May low correcting by merely 14% while the rails traded sideways between 83 and 80, which was less than a 4% correction from a January high.

Between June and December 1924, the rail rallied from 82 to 99 while the industrials rallied from 89 to 121. The rails lost their leadership and from this moment on, the Dow Jones Industrial Index would begin to assert a more prominent role. The "puzzle" with which the analytical world was faced was a loss of their leading indicator.

Eventually, this change in leadership between the rails and the industrials was another milestone unto itself. It reflected the fundamental change in the perception of the American economy. At last America had entered the true industrial age where innovation, ingenuity and determination would change the course of history. In the years to come, the industrials left the realm of speculative issues and entered into the world of investments. Even in the years ahead the slow death of the rails was not easily foreseeable. Yet in 1932, the rails had fallen 95% while the industrials had declined by 88%. Perhaps not that much of a difference, but a subtle enough one that pointed to the slow death through the decades to come. The rails eventually evolved into today's Transportation Index.

The big news hit in December. Gold started to flow out of the U.S. and back to Europe. The British pound, which had reached $4.70 in February 1923, fell in January 1924 to $4.27. The pound had continued to rally and although still below par, which was $4.76 at that time, it had reached $4.73 in December of 1924. The European recovery was steaming along spurred onward by the loans extended to it by the New York banks. Suddenly, the outflow of gold from N.Y. caused many to buy even more stocks, proclaiming that fears of a gold inflationary period were over.

Indeed, the gold exports were something to write about. In one day J.P. Morgan & Co. sent $5 million in gold coin to the German Reichsbank. Although this was viewed as a means to stem potential inflation, the truth of the matter, when looked at closely, revealed that even though this single shipment was greater than all the gold payments from the U.S. to Germany in a ten year period, it was still merely a payment due them on account of their borrowings of $110 million. The gold exports received headlines and were proclaimed as a sign that a gold inflationary wave was out of the question, but they were, in fact, merely gold loans to Europe.

Strangely enough, these very words of the pessimists were turned against them. Those who had continued to point to rising gold reserves and declining rates as a warning of future depression gave rise to this burst of investment as gold began to flow out of the States. It did not matter that it was largely due to loans. No one seems to have analyzed such cash flows in a detailed posture in those days. The analysis was 100% domestically oriented. Yet, the other signs that the pessimist used in his arguments were drawn from the depressed state of the world at large. Now with the so-called "Exports Plan" to rebuild Europe, even this fundamental turned against the pessimist.

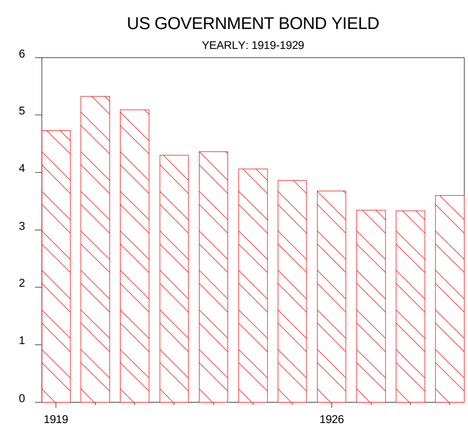
Nonetheless, the fact that on a domestic level people were pouring their cash into the stock market and not into real estate or bonds was not truly reflective of the bond offerings themselves. The following is a list of the bond offerings sold in the U.S. between 1921 and 1924:

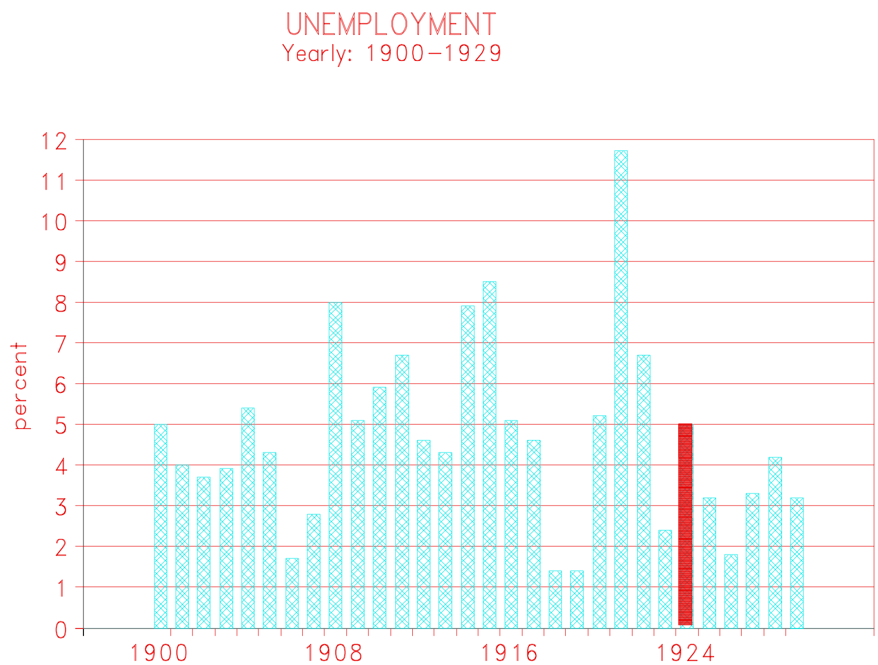
1921........ $2,145,406,132
1922........ $1,675,131,561
1923........ $1,608,595,788
1924........ $2,127,823,688

Although cash was generally leaving the bond market, 1924 was still a record year for bond issues, nearly reaching the 1921 level. But there was a noted and distinct difference in 1924 compared to the previous years. The total sales of bonds this year included state and municipals which had not been the case before. Prior years were largely federal and corporate but in 1924 the states began to borrow much more heavily as well. Foreign capital had still been absorbing much of the bond issues during this period, but with the recovery boom in Europe, this began to slacken as well. The biggest buyers of the bonds domestically were the banks and not the public.

As 1924 drew to an end, call money rates jumped from 2% to 4% in one month. Granted, this may appear to be a sudden and sharp rise, but the stock market continued higher and closed the year on the high above 120 on the Dow Jones Industrials. The disruption of the financial markets was caused by a tremendous amount of payments which came due from many places at once. The British had to make a $68.5 million interest payment and a $23 million principal payment on their war debt to the U.S. The final income tax payment for 1923 was due in December at that time and the U.S. government 4% bonds were sold to subscribers.

Even though the call money rate doubled in one month, at such times in the past it was not unheard of to see the rate swing nearly three to four times during such periods. Therefore, the mere fact that the rate had only doubled was a bullish sign for the market and illustrated that the great American Financial System was sound and capable of handling huge transactions of record proportions. Therefore, in the face of doubling the brokers loan rates in a single month, the market pushed ever higher because sales are still largely for cash. Second, higher rates reflected higher demand and, as previously stated, the analysis of that time was based on the awareness that depression and declining rates had always gone hand in hand.

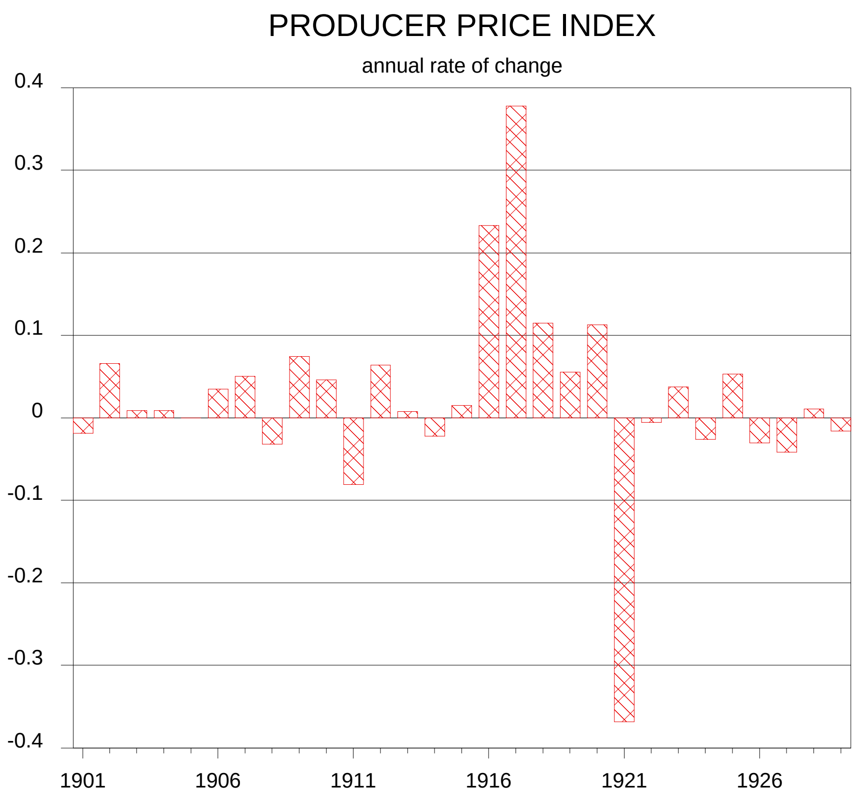


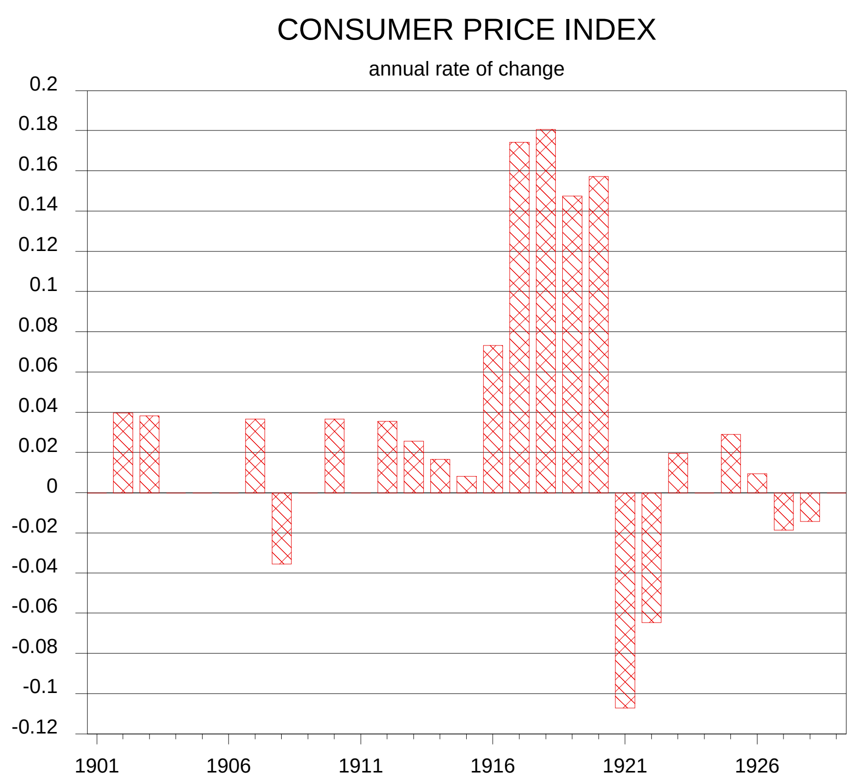


In retrospect, the bond market was neither the mirror image nor the companion of the stock market during the early 1920s. The bonds had collapsed during the depression of 1920 and bottomed as rates began to decline in 1921. But contrary to what most people would assume, again based upon the mere fact that the U.S. had never defaulted on a Federal Bond issue, the bonds were killed at the end of 1921. With huge defaults and excessive European debt coupled with large outstanding corporate issues, bonds remained plentiful.

But as the world sorted out its economic woes, U.S. federal and corporate bonds rallied sharply from 75 on the Dow Jones Index up to slightly above 92 during September 1922. From that point onward, despite declining rates, the bonds fell back, dipping below 86 by March 1923. For thirteen months the bonds traded sideways while the stocks rallied. A trading range between 88 and 86 had become well established. Finally in May 1924 the bonds rallied as call money rates began to approach 2% which proved to be a six year low. The first discount rate cut by the Fed in June caused the bonds to explode, reaching back above the 90 level. In July, the trend continued as the bonds reached above 91. But in August a clear and decisive divergence revealed something that would set the tone for the next five years. When the August 7, 1924 discount rate cut to 3% took place, the bonds were unable to rally and instead fell one full point without even exceeding the July high. While the bonds became paralyzed for the balance of the year, the stock market soared from a low in October of 99 to nearly 121 by year end. The vote was in. Capital, both large and small, was rushing into the stock market when it was clear that dividends were far greater than bond yields.

Taxation rose during 1924 as well. Forty-six states imposed what was called the "Inheritance Taxes." This would be followed by Federal government taxes the next year, in addition to state taxes. This was one of the first underlying factors which would bring inflation back as government on both federal and local levels grabbed for more


PRODUCER PRICE INDEX
annual rate of change
0.4
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
-0.4
1901
1906
1911
1916
1921
1926


CONSUMER PRICE INDEX
annual rate of change
0.2
0.18
0.16
0.14
0.12
0.1
0.08
0.06
0.04
0.02
0
-0.02
-0.04
-0.06
-0.08
-0.1
-0.12
1901
1906
1911
1916
1921
1926

money and eventually forced upon industry a higher cost in labor.

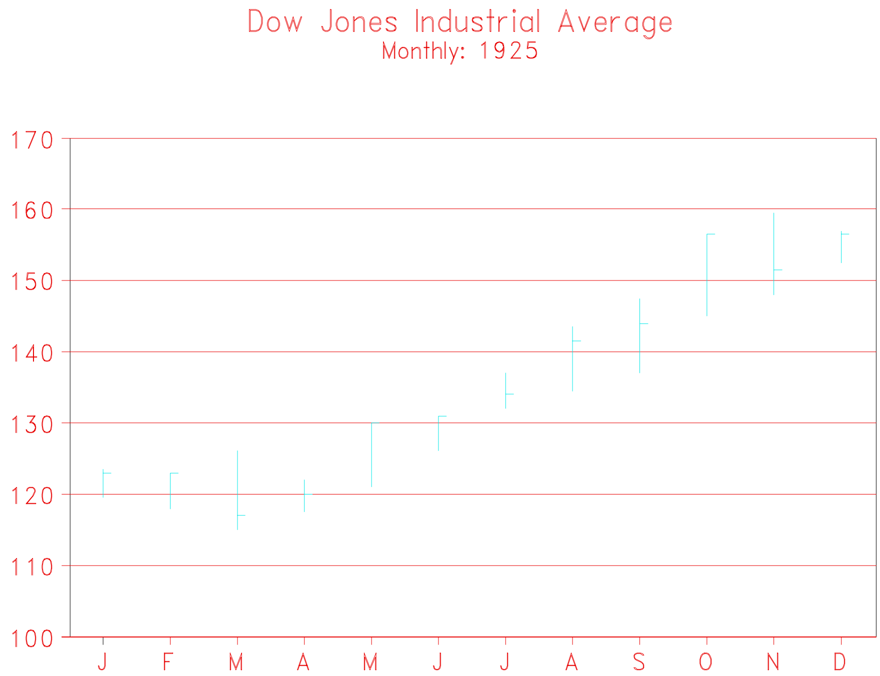
The claims made earlier against Jesse Livermore by the pessimists stated that he had manipulated not merely the summer rally, but the exorbitant rally in the price of wheat just to get Coolidge elected. Those charges were obviously proved false by the stock market's broad rally at year end. But in addition, wheat, which had touched $1.50 earlier, had now passed the $1.75 level moving into year end, and the prospects for another cold winter had the bulls calling for $2 in 1925.

The year 1924 proved to be the beginning of a broad bull market sparked by investors and not by over margined speculators. Business conditions were sound and corporate earnings as well as dividend yields stood at record levels.

Click here for PEI's Homepage

Chapter V

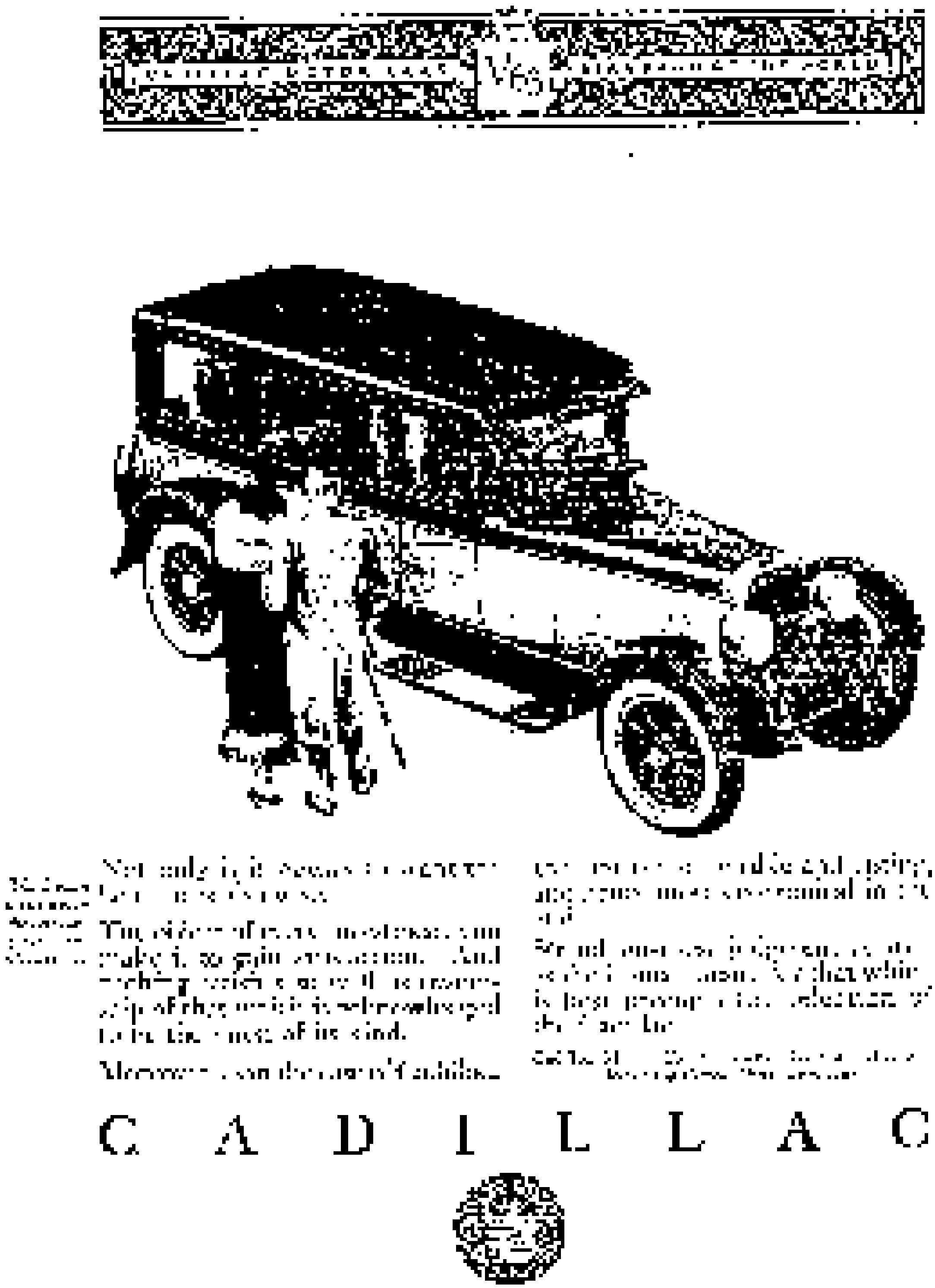
1925

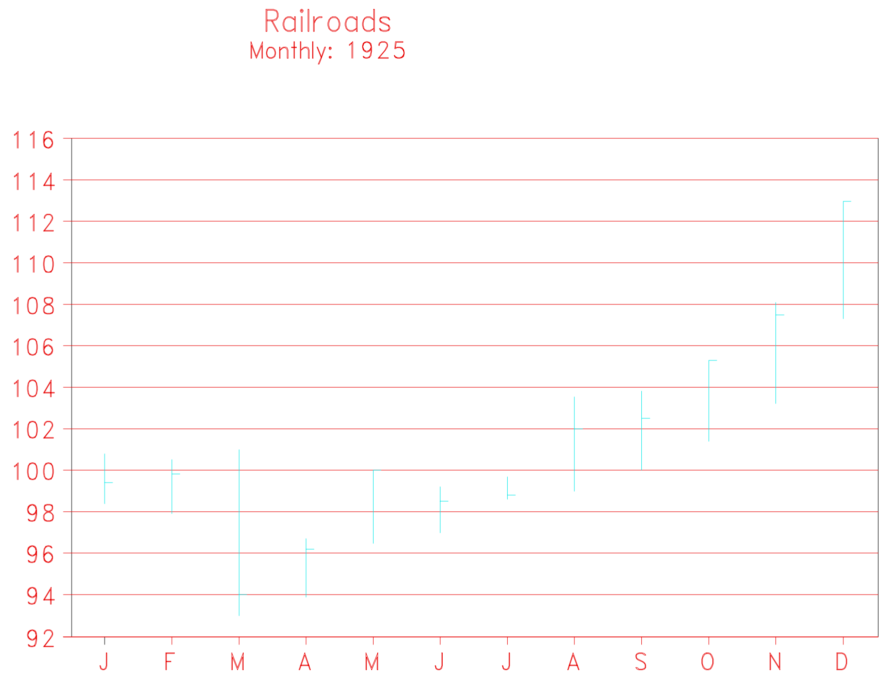


1925 was a year of good prosperity. The stock market experienced a little follow through to the upside after closing 1924 above 120 and on the high of the year. There was some topping action during January, with a modest 10% decline moving into a consolidation phase which came to an end during March. April registered some positive gains but from May onward the stock market rallied, scoring new highs from one month to the next.

While the industrials consolidated for the first six months during 1925, they continued to rally into June, reaching slightly above the 93 level and finally exceeding the 1922 high. The bonds corrected for two months during July and August as the industrials began to rally sharply into November. Once again the bonds consolidated, eventually closing December above 93 but still not surpassing the June high. The December rally in the bonds came only after the industrials began to move lower after establishing a record high the previous month.

The rails dropped sharply during March, falling nearly 8% in a single month. But April and May brought with them improvement after the panic sell off in March. June and July traded higher but still no new highs were achieved for the year. Then in August, the rails broke out almost reaching 104. September managed to push a little higher and the momentum picked up sharply in the final quarter. The rails and the industrials had both bottomed during March and we found the industrials loading during the summer and peaking in November, while


CADILLAC

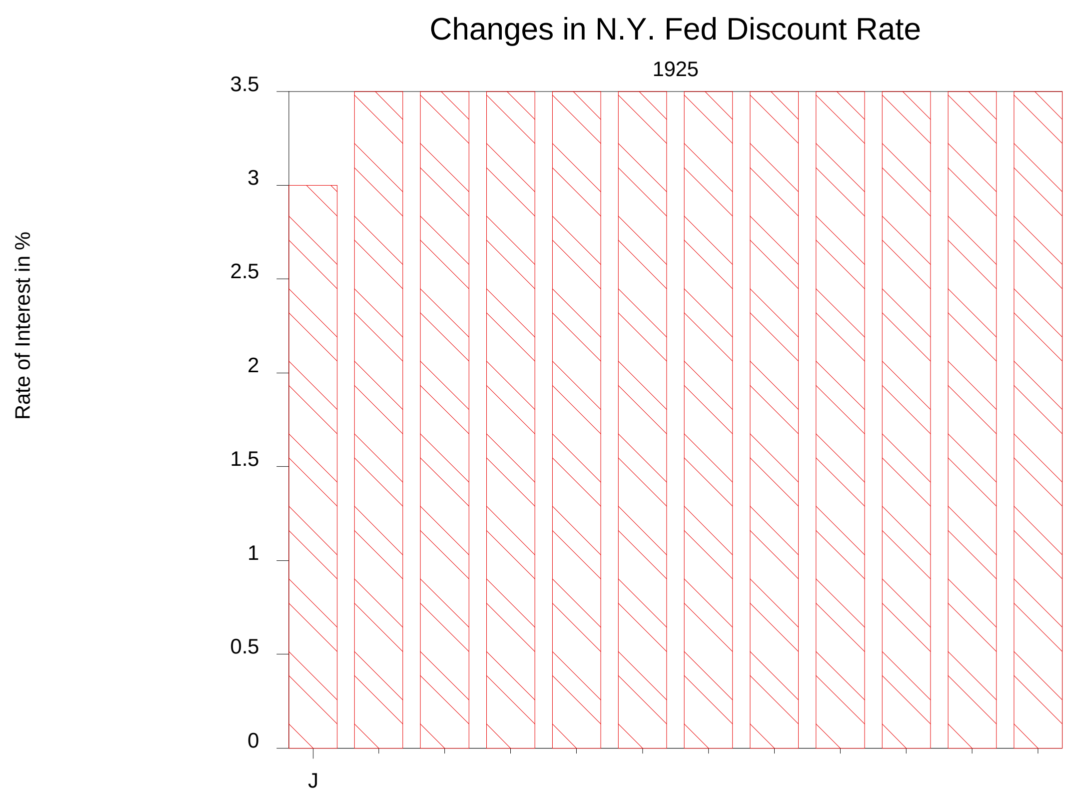


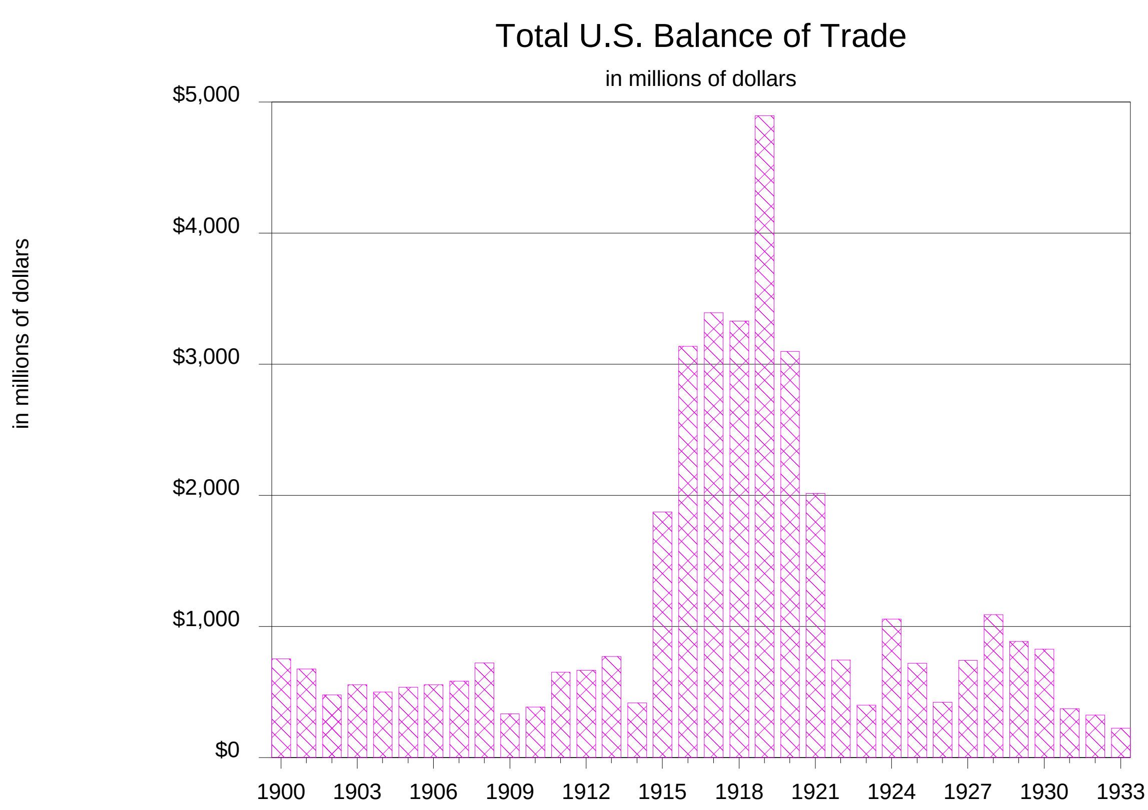
the rails experienced their largest gains in December.

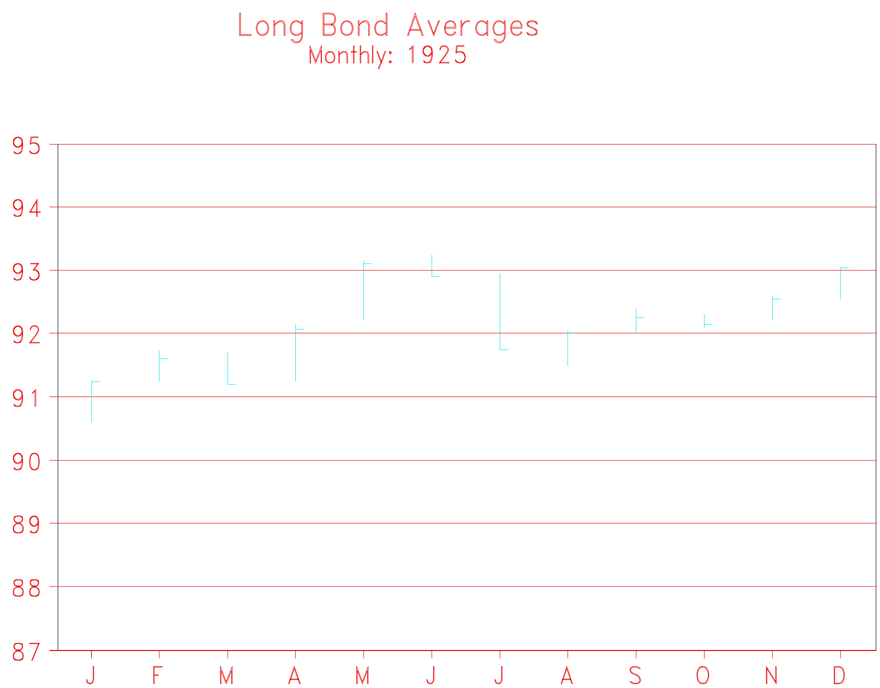
Fundamentally, January began with a positive note as President Coolidge announced: "The Business of America is Business!" This was essentially true. The railroad stocks had made an outstanding recovery after the railroad depression of some years before. Actually, 1924 proved to be a tremendous year for the expanding railroads. More new mileage came under construction during 1924 than in any other year since the war. Yet despite the added 1315 miles of new rails, taxation had been and would still be a huge obstacle to industry in general. For the railroads, taxation had risen from $112 million annually in 1912 to $350 million by 1924. Considering the gross revenues of $975 million, the dividends paid by the railroads during 1924 were $303 million. Yet at the same time, expenses during 1924 were $563 million. Much of the outlay in capital went to expansion and refurbishing of old box cars. The threat of over taxation was dismissed by the Congress and, in fact, what had been a major factor for the fall 1924 rally was the statement by Coolidge that he did not intend to increase taxes against the railroads. Still in all, heavy taxation would eventually provide one nail in the coffin in years ahead.

The stock market still attracted the so-called nonprofessional, not for leveraged speculation, but for outright cash investment. On January 12, 1925, Time magazine once again reported the situation with cunning insight:

"Wall Street professionals are learning the difficulty of being unable to see the forest for the trees. Hard-bitten by many years of experience in stock speculation, they believe that what goes up must come down and have therefore been led to sell short many of the leading speculative stocks. But the market keeps on upward, steadily and remorselessly. The paradoxical result has been that many an amateur speculator west of the Alleghenies has by continuing to buy stocks, serenely drubbed the professionals of the financial arena.


Changes in N.Y. Fed Discount Rate
1925
Rate of Interest in %
3.5
3
2.5
2
1.5
1
0.5
0
J

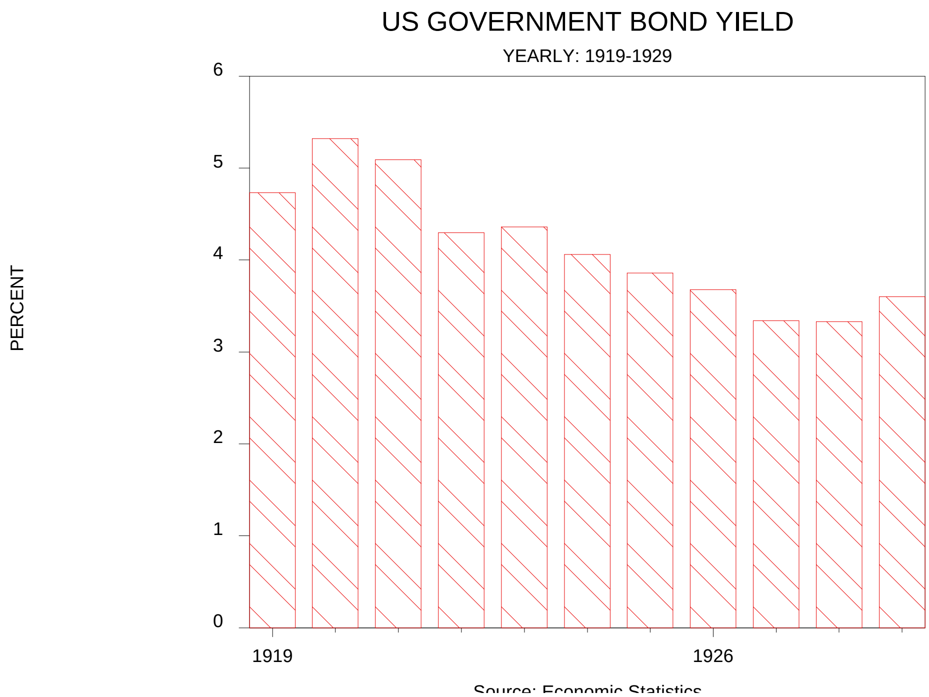

Total U.S. Balance of Trade
in millions of dollars
in millions of dollars
$5,000
$4,000
$3,000
$2,000
$1,000
$0
1900
1903
1906
1909
1912
1915
1918
1921
1924
1927
1930
1933



To the surprise of many today, the accounts of what really took place clearly illustrate that all the so-called analysts and professional traders were dead wrong. The public with capital was buying for cash and as such they did not have to sell a position on a 10% swing as did the leveraged speculators. The story we are most familiar with is that the poor fool on the street didn't start buying until the top. But that was only true of those who had little money to begin with. The massive buying that absorbed the stock market during late 1924 and throughout 1925 would be solid cash investment which provided a firm base. As such, the correction into March was minimal but the continued rally into year end was awesome.

Wheat was also very volatile. By February, the predictions that wheat would reach $2 had been fulfilled. Wheat touched $2.10 and then the so-called exports came out. Arthur Cutten and James Barnes both announced that wheat would continue higher to $2.50. Everyone remarked that they had never seen such a bull market before. Russia, which up to this time had been a grain exporter, became a grain importer. Foreign demand from Russia and Europe forced the market to nearly triple early 1924 levels. But just as the professionals declared that wheat was moving to $2.50, sure enough during the last two weeks in February, wheat began to crack. It penetrated below 2 on what was termed a speculative break.

Industry was booming. Steel was now operating at 94% capacity. Money was still reported to be easy and interest rates were low. Gold exports continued to be heavy yet this was largely caused by extending foreign loans. The U.S. trade balance was still very much a surplus in its favor. Then in early March, the N.Y. Fed raised the discount rate quite suddenly from 3% back up to 3.5%. Some argued that the N.Y. Fed had raised the rate to bring a halt to speculation. But this proved basically only wishful conjecture on the part of professionals who had been trying to sell short all the way up.

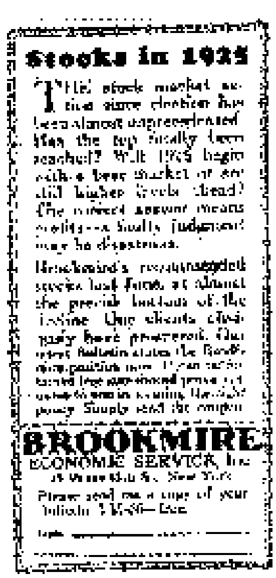


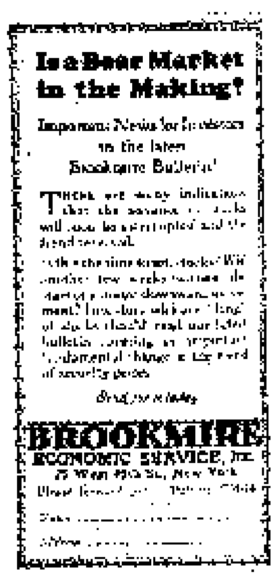
The Federal Reserve System was structured a bit differently at that time. Each reserve bank maintained its own discount rate. Of course, the N.Y. Fed was seen as the major money center. Nonetheless, the drop in the N.Y. Fed's rate to 3% during August 1924 had not been followed by the other reserve banks. Boston, Philadelphia, Cleveland and San Francisco had fixed their discount rates at 3.5%, while the remaining seven district reserve banks were maintaining 4%. This meant that the N.Y. Fed was the lowest rate in the nation. The cause of the rise in the N.Y. Fed's rate was twofold: This imbalance naturally found money leaving N.Y. for other parts of the nation. Second, it was the N.Y. Fed which maintained the gold reserves and the drain upon the gold by foreign nations was becoming exorbitant. The rise in the discount rate found the market dropping sharply during March as the pessimists warned that higher rates would force the speculation out of the market and at last a collapse would be at hand. Although the market dropped sharply with the rails taking the lead, April saw no follow through and short covering once again brought the market back up, regaining 40% of the March decline.

Nonetheless, the press chose the professional side of the matter, reporting that doom and gloom were here again. Even Time magazine quickly picked up on the matter and reported on March 23: "Although the steel barometer has failed to register a decline so far, it is still possible that somebody may be holding a match under it. Elsewhere in business, the earmarks of a new downward trend seem plainly apparent. Not only have commodity prices as a whole registered their first decline for many months, but in the speculative markets the drop has been especially severe. Even the much-heralded intention to advance steel prices has apparently been abandoned. Thus it may be that the recent advance of the New York Reserve discount rate will mark a 'turn' in business from expansion to contraction. Moreover, some lines of business such as the textiles, have been poor all along."

It seems consistent that as soon as the market fell even 8% everyone jumped all over it pouring out their doom and gloom. The speculative issues were declining more, simply because the speculators are always the weakest in the lot. The mere fact that one industry such as textiles had performed poorly all along never prevented the bull market. Such things come out only when the market stops for a moment and then everyone looks for the declining markets and assumes that they have been the leading indicators.

This we noted in 1985 moving into the November period. After the Dow had corrected from the July 1985 high, falling back to 1288 on September 17, it began to rally and made new highs far in advance of the S&P 500, transportations, utilities and Value Line. Everyone looked at all the other indicators and assumed that the Dow was merely a false move due to General Foods, much like the disbelief about the extra dividends that U.S. Steel issued during 1923 and 1924. As we saw in 1985, analysts looked around for reasons to discredit the new highs in the Dow, and in 1925 everyone looked around for reasons to proclaim a major top.

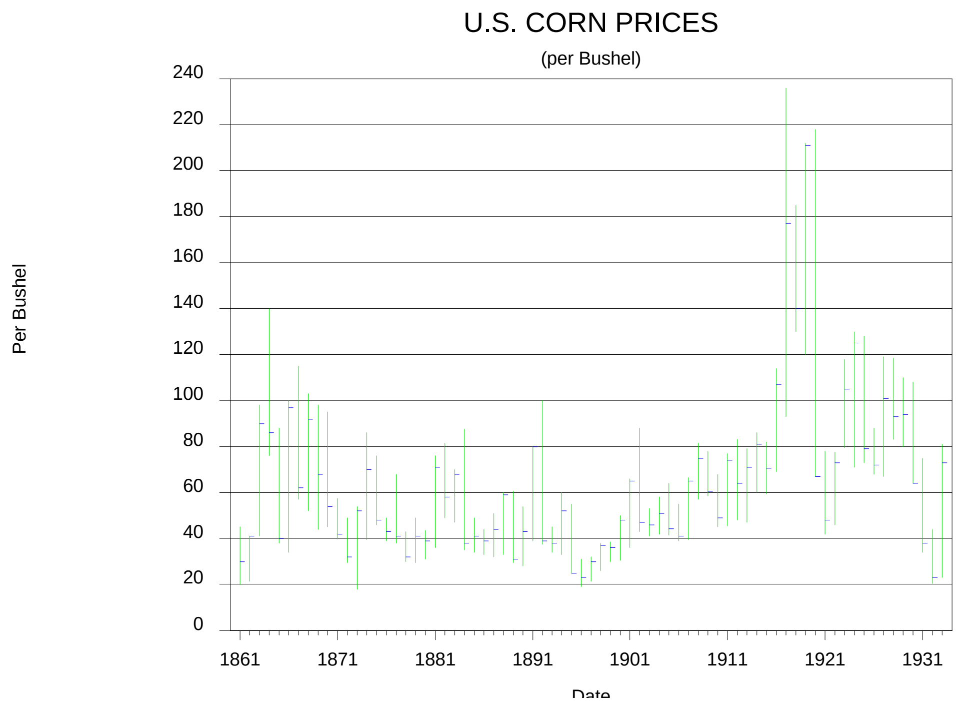




In fact, what took place was that the broad market had declined by a mere 6% while the Dow Industrials declined merely 10%. It was only the speculative issues that declined by 20% and everyone assumed that they were the leading indicators.

The wheat market was a favorite for the bears in the stock market to point to as another leading indicator. On March 3, wheat stood at $2.05 on the May futures but this market fell in what remains to this day an historic panic sell off. By March 17, the May futures on wheat reached $1.51. The rye futures during this period fell from $1.82 to $1.10. The decline was blamed on that infamous character Jesse Livermore and the gossip claimed that it was a personal attack by the "Palm Beach Crowd" (Livermore) upon Arthur Cutten. The Secretary of Agriculture conducted an investigation into the entire affair. The incident was reported as follows:

"The huge 'bull account' of Mr. Cutten provided a tempting target for the bears, whose assault was made so powerfully that the latter was compelled to sell some 8 million bushels of wheat in Winnipeg, thus helping the decline along and enabling the 'bear raiders' to cover easily. The result must have been to demolish much of Mr. Cutten's large paper profits resulting from the long advance of grain prices during 1924. Mr. Cutten himself has declared he was rid of his wheat and from his approval of Secretary Jardine's coming probe, it may be deduced that the events of the last few weeks have proved rather expensive to the great bull leader. He attributes the fall in wheat to the manipulative tactics of a 'mas-



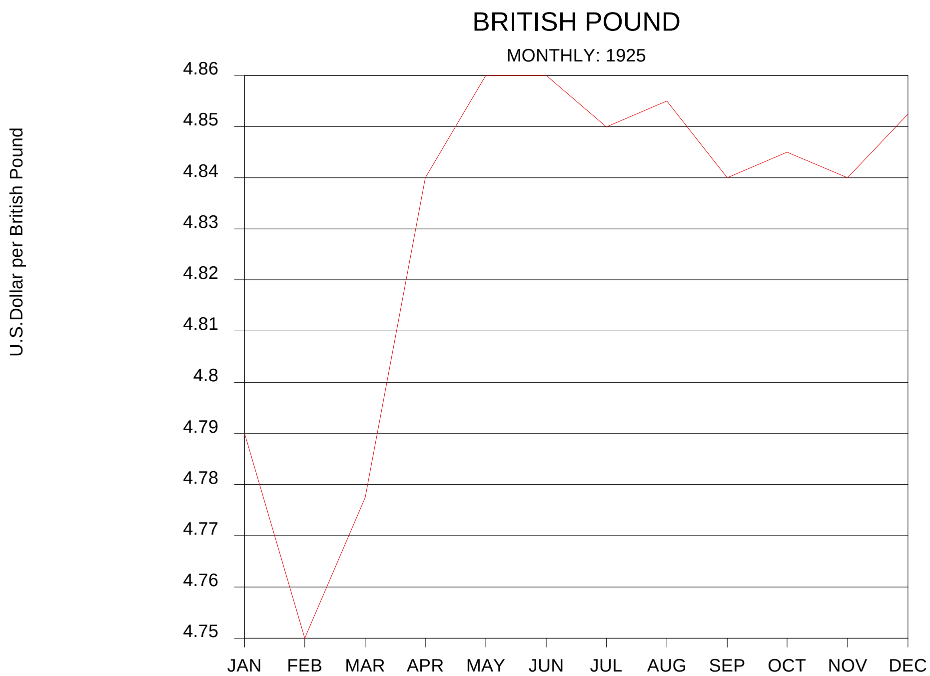
ter speculator' in Florida, supported by a powerful group of interests."

The "Wheat Scandal," as it was known, is actually quite typical. Everyone seemed to take the side of Arthur Cutten against Jesse Livermore. Yet the bull market in wheat had seriously gone beyond the limit of reason. The prices had reached an historic level in such a short time span that a correction by any normal standards was certainly in order. Had Jesse Livermore been there or not, the market would have fallen from its own lack of further upside momentum.

Jesse Livermore was a man who had a great "feel" for the market. He was no more to blame for the collapse in wheat than he was for manipulating the stock market into a rally from its 1923 October low. Livermore was short the wheat but not the rye. Yet, the rye market collapsed as well. The "Palm Beach" crowd had no positions in the rye market but there the collapse was devastating as well. In plain words, Cutten's hot air which talked the market higher simply ran out. If Livermore was guilty of manipulation on the downside, then Cutten was guilty of manipulation on the upside.

After the wheat scandal had passed, mergers began to fill the papers. Dodge Motors was bought by the investment bankers and Pan American Petroleum was bought by Standard of Indiana. While everyone laughed at Mr. Chrysler for introducing a new medium-priced car back in 1924, the general consensus was that the competition was far too great and that he would fall. But when the figures rolled in, the Maxwell Motor Corporation scored an historic record. During 1924, 32,000 Chrysler cars had been sold and the stockholders cheered to such an extent that a new corporation was formed to acquire all the assets of the Maxwell Motor Corporation. To honor the man who made it possible, it would be named the Chrysler Motors Corporation.

During mid-April, the general press began to talk about the top in a major business cycle. Many continued to argue that the



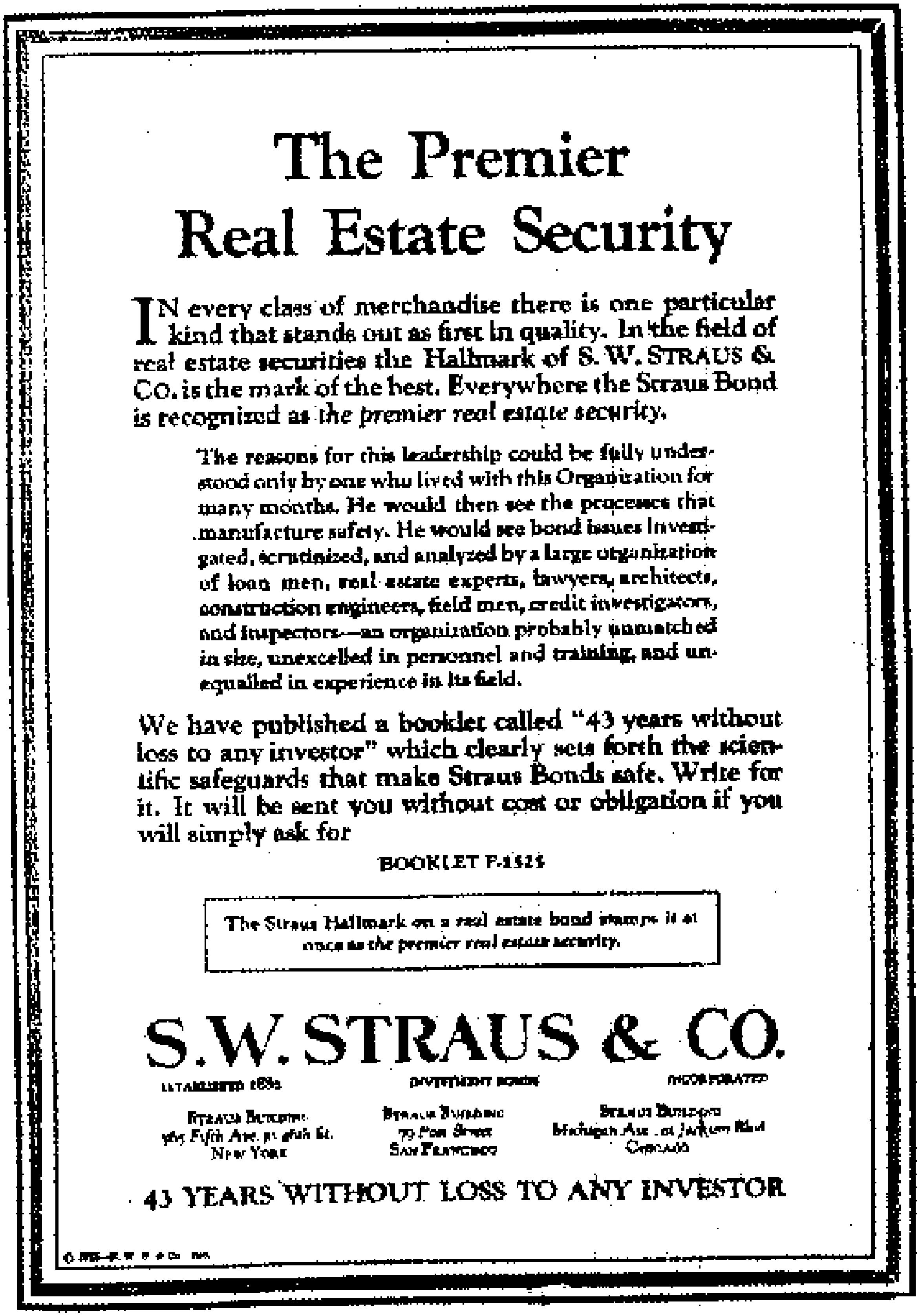
sharp drop in wheat and the speculative issues in the stock market were a warning sign. Others pointed out that good commercial paper was scarce because companies were simply not borrowing and that there were no overextended debtors among the large industrial corporations. Call money remained cheap and things seemed to be quiet for the moment. Time magazine reported that Wall Street had taken to watching and analyzing weather maps and agricultural reports as never before in search of a clue. Many continued to feel that if commodities declined, so would the profits of industry and thus the stock market.

During late April, Britain resumed the gold standard and sterling took a jump from the close of March at $4.77 to $4.84. The previous par value of sterling during prewar years was $4.86 and most felt that the small difference would not lend to a great amount of gold flowing out of Britain.

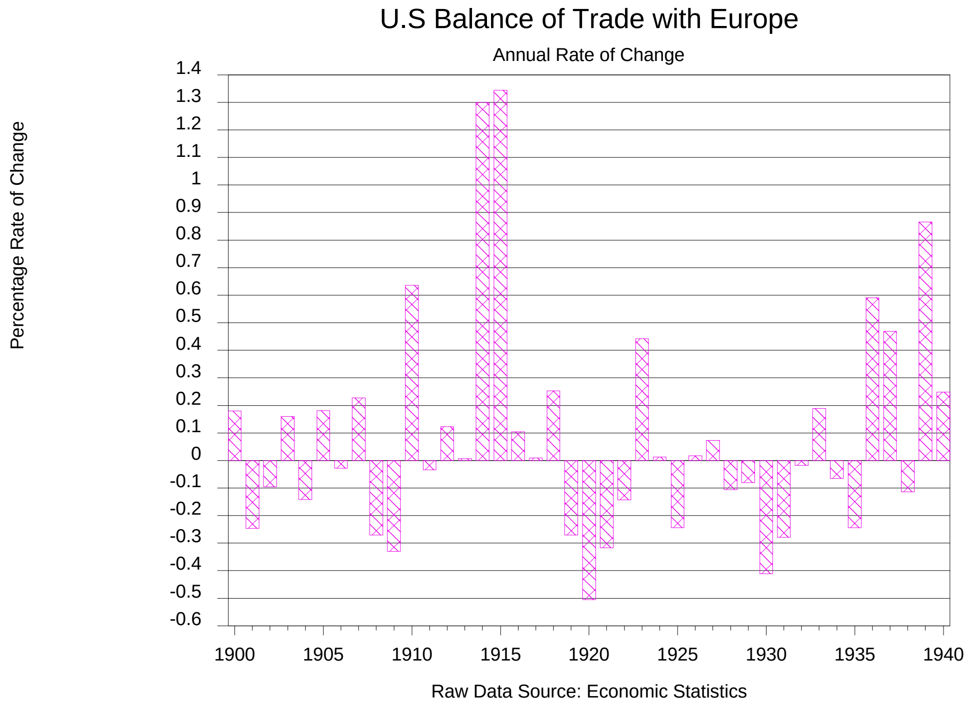
The British pound continued to rally to the par level, closing at $4.86 both during the months of May and June, but it began to slip in July, falling to $4.85. The pound continued to decline ever so gradually against the dollar after the British had returned to the gold standard. June 1925 had been the high in the pound and the decline eventually reached bottom during November 1925 at $4.84.

The Dow Jones Industrials had bottomed in March and began to trade sideways during April. May brought a sizable rally and June continued the uptrend but with less force. But curiously enough, the stock market began to rally in a more pronounced fashion in July and continued higher into a November high, when the dollar had reached its peak and the pound its low. The stock market and the foreign exchange markets continued to turn and reach temporary highs during the same periods.

The stock market began to rally in early May and the press reported that prices were stable and that perhaps prosperity was here to stay, although somewhat hampered in its momentum. After a sharp month end rally


The Premier
Real Estate Security
IN every class of merchandise there is one particular kind that stands out as first in quality. In the field of real estate securities the Hallmark of S. W. STRAUS & CO. is the mark of the best. Everywhere the Straus Bond is recognized as the premier real estate security.
The reasons for this leadership could be fully understood only by one who lived with this Organization for many months. He would then see the processes that manufacture safety. He would see bond issues investigated, scrutinized, and analyzed by a large organization of loan men, real estate experts, lawyers, architects, construction engineers, field men, credit investigators, and inspectors—an organization probably unmatched in size, unexcelled in personnel and training, and unequalled in experience in its field.
We have published a booklet called "43 years without loss to any investor" which clearly sets forth the scientific safeguards that make Straus Bonds safe. Write for it. It will be sent you without cost or obligation if you will simply ask for
BOOKLET F-1525
The Straus Hallmark on a real estate bond stamps it at once as the premier real estate security.
S. W. STRAUS & CO.
43 YEARS WITHOUT LOSS TO ANY INVESTOR


Submerged
—one of many hard tests
TELEPHONES must voice the words that people speak, and people live in ice-bound lands, under the humid heat of the tropics or where the air is desert dry.
In such corners of the earth human beings can withstand the rigors of the climate. Things of metal or of fibre may fail, but telephones must not.
That they may endure, Western Electric subjects its telephone products to tests even more exacting than those imposed by Service or Nature.
Western Electric
SINCE 1869 MAKERS OF ELECTRICAL EQUIPMENT

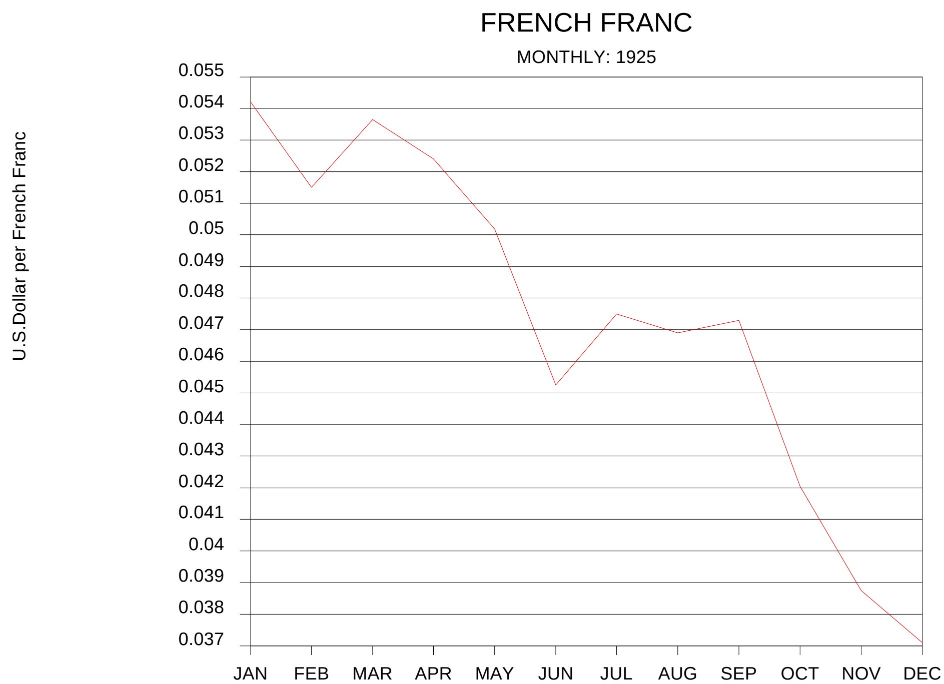


to close on the high, everyone began to look at the stock market again for some sign that hopefully could indicate what the future would hold. Others were still harping on the fact that corporate earnings were not at all-time highs when in fact the price of shares was. Taxation had taken its toll, somewhat reducing earnings. June was not at first much to speak about. Several times the market formed a double top pushing against the May highs unsuccessfully in its attempt to push higher.

Finally at the end of June, the stock market pushed higher. But once again it was not very impressive, as the Dow industrials advanced by merely 2 points. But nonetheless, it once again finished the month on the high, finally exceeding the May high. Although it was a subtle move, it definitely illustrated that the trend was still higher.

The interest rates continued to remain easy for the most part and a change in the foreign loans took place. After Britain returned to the gold standard, many nations found their credit ability rising and, as it did, the interest rates declined further. Cash remained an excess commodity in the States and bond dealers began to bid for foreign issues. The public, which had been investing in the stock market, was still paying cash, and broker loans were steady to actually declining. The optimism of improved European conditions and Britain's return to the gold standard led many to believe that they would be big buyers of U.S. exports and another boom was at hand. Record crops suddenly came pouring in from both cotton and corn producers and consumer demand continued to rise to the amazement of all the so-called professionals who were still looking for doom and gloom.

July brought with it a rise in stock prices again as the Dow moved up to new record highs. But still it remained well within an 8 point range and analysts immediately jumped on a sharp decline in steel production. At the close of May, tonnage was reported at 4.05 million and June was reported to be 3.7 million. This was cited extensively by those who had continued to



short the market in belief that each new high would prove to be the final and fatal last high.

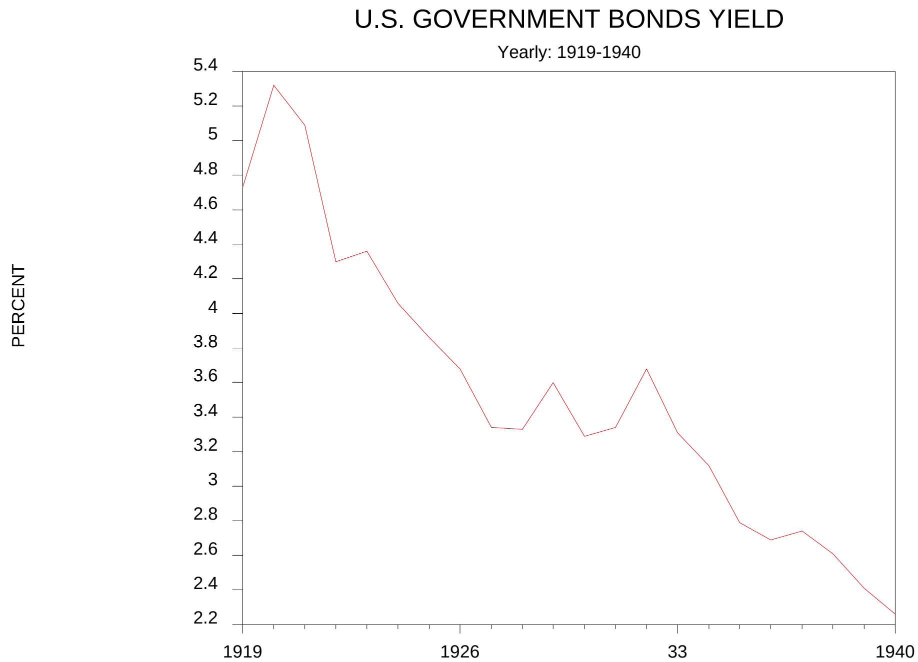
Nevertheless, they let their bias stand in the way of interpretation. That is so often the case with fundamental analysis. One is always forced to line up the negative reports and take a guess based upon the positive reports as to which will be the leading or the lagging indicators. At best, it has historically shaped up to a fifty-fifty bet. One report that was definitely on the positive note was that of the inventory conducted by the Comptroller of the Currency. This report was very positive and clearly illustrated how both resources and deposits at the banks were continuing to grow. The largest banking institution in the United States, The National City Bank, showed new record highs. The composite of resources and deposits had grown between April and June from $910 million to $1.15 billion. The trend was nationwide, a very positive indication once again that the system was not overextended.

Nonetheless, in the July 31, 1925 edition of Time magazine we find an interesting article:

'Market Decline?"

"Col. Leonard P. Ayres of Cleveland is an admirable prophet. Employing no mysteries or obscure language, he states not only what he thinks of the future, but also why. Thus the reader of his predictions can judge not only his conclusions, but also his methods of arriving at them.

"Col. Ayres believes that the long continued advance in securities prices will be brought to an end within the next few months. Pointing out that bond prices are now higher than they have been for eight years, and that average industrial stock prices are higher than ever before, the Colonel declares that this situation has resulted from easy credit rather than from high current earnings or brilliant prospects and that therefore rising interest rates this fall will call a halt to it.



"As proof of this view, Col. Ayres has charted since 1890 the average yields on 60 high-grade bonds and the current rates prevailing for 90-day ‘time money’ on security collateral, as well as the average price for industrial stocks. As a rule, he discovers that stock prices have risen during periods when time rates were lower than bond yields, and have fallen when time rates were higher than yields.

"Recently, time rates have been considerably below bond yields, but with a tendency of late months to seek a common level. Col. Ayres believes that in the fall, with heavier commercial demands for money, time rates will rise. And this, he concludes, will result in a decline in both bond and stock prices."

The relationship which is being discussed here is the short-term versus the long-term rates. When short-term remains below the long-term, prosperity and rising stock prices take place. However, when short-term rates exceed the long- term (as we noticed in 1974 and 1981), stock prices fall. The observation is essentially correct. However, Col. Ayres was stretching the point at this period in the cycle. Because the short-term rates had run up to match the long- term rates as we noticed in December 1924, he suggested that the end was near. Again, the question is not whether this observation is correct or not, because it is; the question is timing. The short-term rates had only matched the long- term rates during massive payments on foreign loans coinciding with income tax periods and government borrowings. Yet it failed to produce a sustained effect and by and large the short-term rates had remained under long-term rates. This at best was perhaps a warning of years ahead, but it was not a sign of immediate disaster. When we look at 1928 through 1929, we will clearly see just how far short-term can exceed the long-term before a major top comes into play.

The real estate market had been plugging along quite nicely up until 1924. There was considerable expansion in this sector due to the expanding economy and high employment. The housing shortage was officially

Smith Safety *and* 7%

—NO FARTHER AWAY THAN YOUR MAIL BOX

Investors in 48 States and in 30 foreign lands have bought Smith Bonds by mail

YOU may live on a remote R.F.D. route or in a big city, served by the U.S. Air Mail. Your mail may be delivered by a uniformed representative of Uncle Sam or by the postal service of a foreign land. But wherever you live, the proven safety of Smith Bonds and the profit of 7% interest are no farther away than your mail box.

In every State in the Union, and in 30 countries and territories abroad, thrifty men and women have found safety, convenience and profit in buying Smith Bonds by mail.

From far away Johannesburg, in South Africa, an investor in Smith Bonds writes:

"The purchase of a bond from you was made quite as conveniently from this distance of about ten thousand miles via the mail route as if I had been in Washington."

Smith Bonds are First Mortgage Bonds, strongly secured by improved, income-producing city property. They are protected by the system of safeguards which for 52 years has proven 100% efficient in protecting investors against loss.

You may buy these bonds for cash, or under our Investment Savings Plan, which gives you 10 months to complete your purchase of a $100, $500 or $1,000 bond, after an initial payment of 10%. You may make your payments monthly, or at irregular intervals, to suit your convenience, and every payment that you make earns the full rate of bond interest.

COMPOUND YOUR INCOME FROM SECURITIES

Use our Investment Savings Plan to compound your income from securities you now own. Apply your interest and dividends toward the purchase of Smith Bonds and invest 7% on these odd sums. Our free booklet, "How to Build an Independent Income," explains all details.

Most persons who now own Smith Bonds obtained their first intimate knowledge of these proven profitable investments by clipping and mailing a coupon similar to the one below. Why don't you mail the coupon now?

The F. H. Smith Company

Founded 1873

No Loss to Any Investor in 52 Years

SMITH BUILDING WASHINGTON, D.C.

THE F. H. SMITH COMPANY, Smith Building, Washington, D.C.

Please send me your booklets, "Fifty-two Years of Proven Safety," telling why Smith Bonds are Safe Bonds, and "How to Build an Independent Income," describing your Investment Savings Plan.

Name ______________________

Address ______________________

AUTHORIZED BY

DOBBS

SHOPS *for* MEN

From top to toe, from hat to hose, men's wearables in the new Dobbs shops provide a harmonious outfit of uniformly high grade and distinctive style

DOBBS & CO

618-620 Fifth Avenue New York

Railroad Stocks

What Action Should Investors Take Now?

THE rails have advanced, but not so strongly as industrials. What now? Is a strong rail market ahead, or is their lagging tendency a warning of lower prices?

Lower stock prices are generally considered to be forecast by the higher rediscount rate. Is this correct or will other constructive factors outweigh it?

Read the latest Brookmire Bulletin.

It contains definite advice on stock trends—a comment on the new 1½% rediscount rate—summary of railroad earnings. A copy on request [illegible] obligation.

BROOKMIRE

ECONOMIC SERVICE, Inc.

25 West 45th St., New York

A Good Start for the Day

Fortify yourself against winter germs by eating Shredded Wheat Biscuit with hot milk. Nothing so nourishing and satisfying, and nothing so easy to prepare. Supplies warmth and strength for work or play. Better than mushy porridges for children because it makes them chew. Two Biscuits with hot milk make a good, satisfying meal.

Shredded Wheat

"It's All in the Shreds"

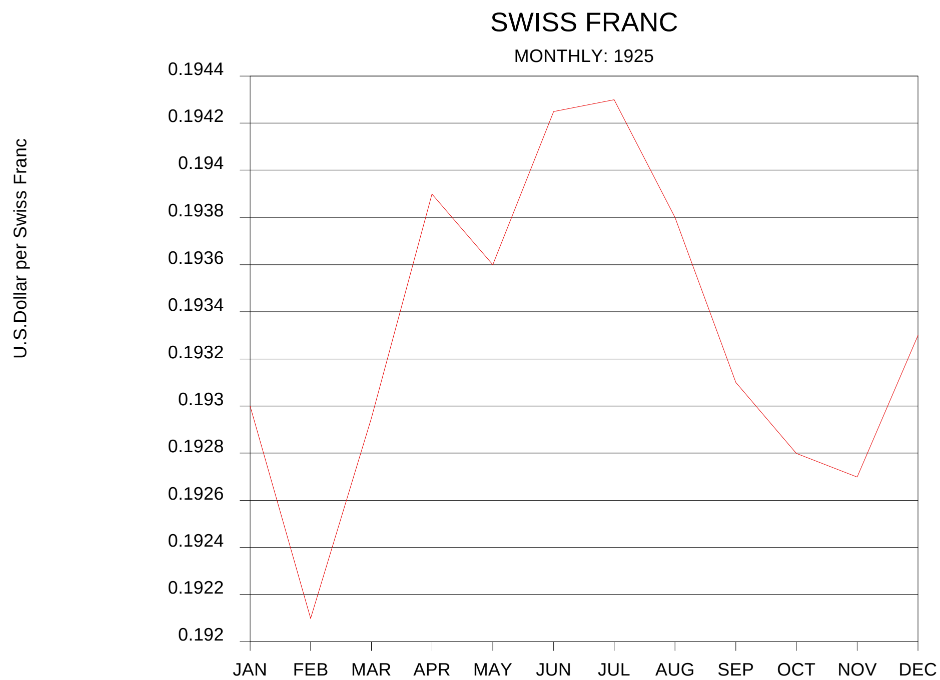
declared to be over by June 1925 and real estate began to decline in value while the stock market still raged onward for four more years.

August brought a continued but slow upward growth in the stock market as the Dow exceeded the 140 level. In early September, reports once again clearly illustrated that the economy had not peaked. The general production figures for July were released and showed a 2% gain over June but, more important, it was a 20% increase over July 1924.

On September 7, 1925, Time magazine's comments about the future were still questioning despite the strong production increases and the steady rise in the market: "There are certain clouds on the business horizon which later on may or may not blow up into stormier weather. The chief of these is the tendency of individual and institutional investors alike to place funds in fixed rather than liquid assets. This tendency accounts for much stock market activity, and for the even wider and greater speculation in land and improved real estate. So far has activity in both these fields gone, that the wiser heads in Wall Street and the more hard-bitten Realtors of Miami are now wondering where the limit is. It is not yet clearly discernible, yet many traders are definitely planning on 'cleaning up and getting out' both in shares and town-lots. Some day many of them are going to try to do it, and perhaps on short notice."

The press was still cautious and what we may have thought about this period is simply not true. The professionals clearly doubted the advances and it was the small investor who didn't margin his bets who formed the foundation of this bull market. The press was leaning more toward talking the market down rather than up and the majority of professionals remained unimpressed.

The stock market rallied again in early September reaching 148 on the Dow Industrials. Suddenly there was a one week correction and many stocks fell 10%. Immediately, the press and everyone jumped on the move. "The long prophesied 'reaction' on the Stock Exchange has come; it is yet too early to say that it has gone" reported Time magazine. Yet there was no appreciable change in the amount of money or interest rates. Stock market funds remained "abundant and cheap," reported the



New York Times. The reaction was just that.

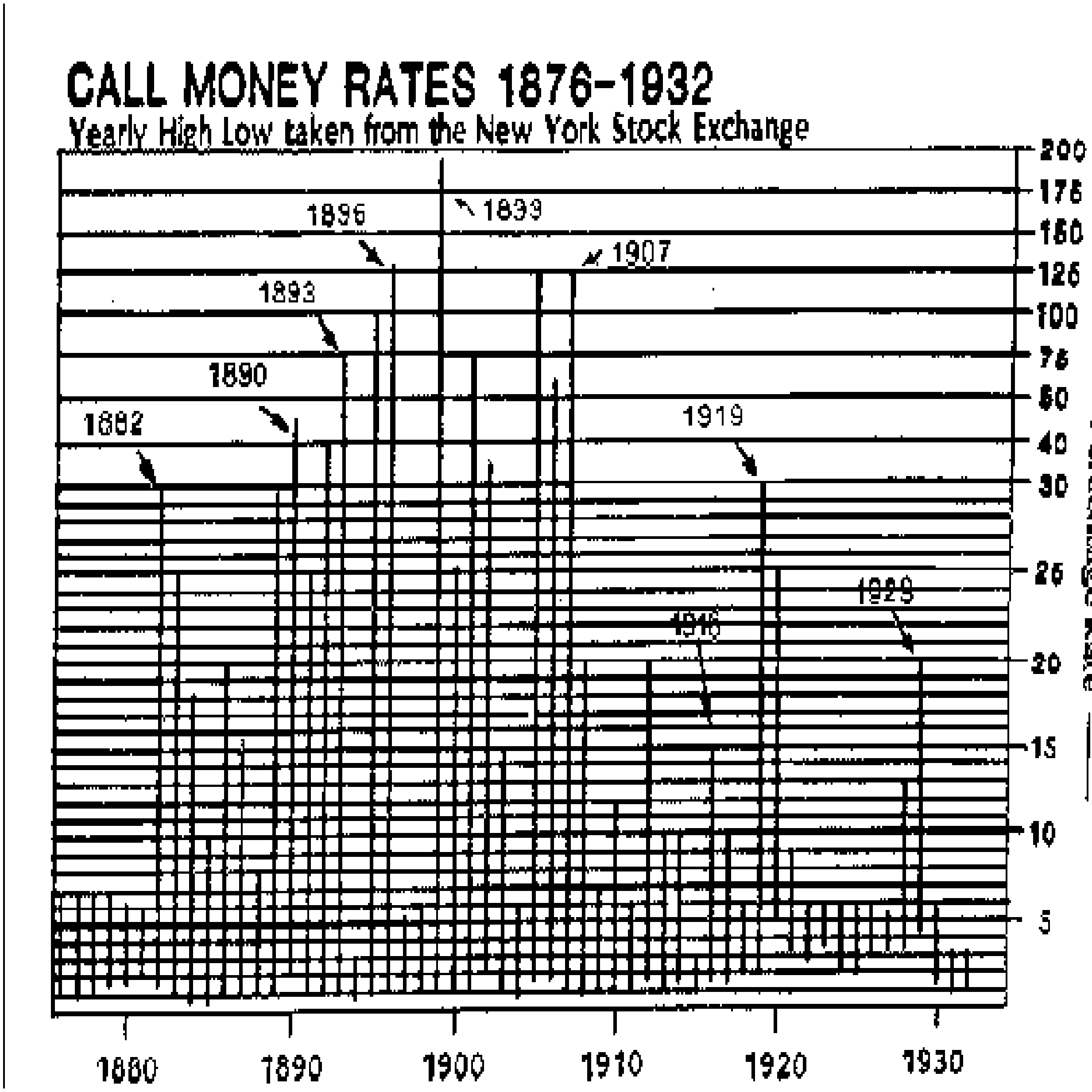
The reaction passed and instead the market thrust violently higher into October reaching almost 158, which was nearly a 20% gain from the reaction low. The Dow Industrials closed the month on the high amid those who began to spread rumors of a discount rate hike, but nothing happened. The rumors served to ease the fears of the shorts but didn't phase the urge of the bulls.

Time magazine reported in October: "Prosperous Motors - Despite direful predictions which were made a year and even six months ago, the current year will go down as the most prosperous in history for motor manufacturers. In only a very few cases will the dollar profits of every leading producer fail to be the largest on record."

The rumors spread about the discount rates hike were somewhat believable. Call money rate had jumped up to 6%. This was a seasonal event due largely to the fact that funds were sent West to pay for crops. Therefore, the call money rate at N.Y. jumped but it did not rise nationwide. The event was also somewhat pushed aside by the fact that the Bank of England cut their discount rate from 4.5% to 4%.

By November, the market continued higher and came close to penetrating 160. The big news came out that there would be a lowering in the income tax rate and business cheered. The outlook for retail sales at Christmas became a lot more rosy. The stock market pulled back to some degree but held 150 on a closing basis by the end of November, even though the volume trading hands had exceeded all previous records back to 1916. Several days reached 2.8 million shares, coming close to the all-time high which had been established on May 9, 1901 at 3.3 million shares traded.

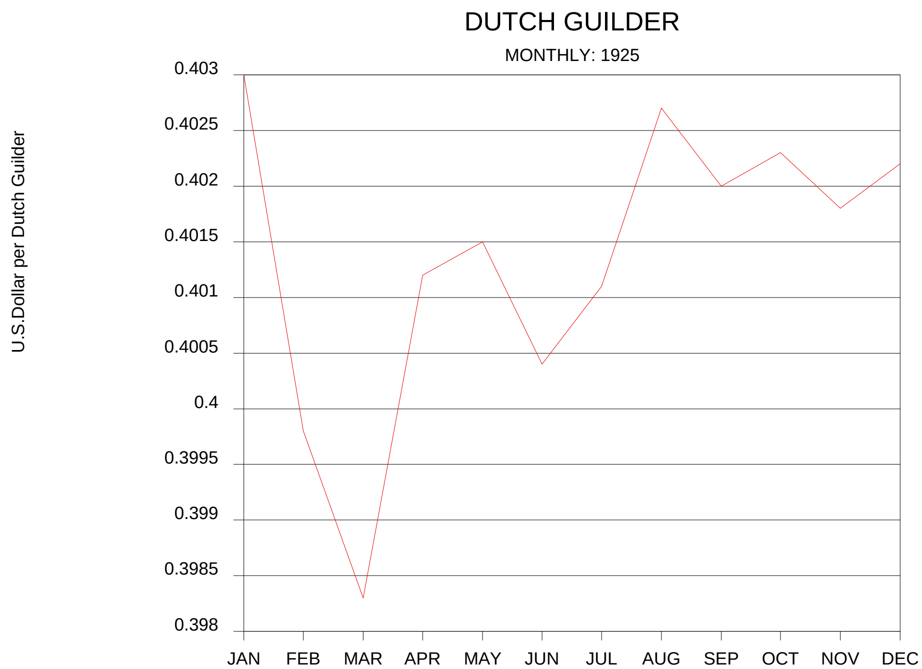
The unexpected rate hike came during late November but not from the N.Y. Fed. Instead, the Boston Reserve Bank raised its discount rate from 3.5% to 4%, which pro-



vided the decline into late November. Yet news simultaneously came out about General Motors, which had broken all previous records in both earnings and sales during the month of October. They had sold 96,000 cars on which they had earned $12.5 million in October alone.

In the December 14, 1925 edition of Time magazine, the comments on the discount rate hikes were interesting: "There is nothing wrong seemingly with most lines of business or with the credit structure which sustains them. The advance in Reserve rates has so far exerted no appreciable effect on merchant or manufacturer, except to worry and puzzle him temporarily by the unexpected manner in which they were inaugurated."

Many doom and gloomers tried their best to point to the unexpected reserve bank hikes as being a warning of the future. But the market firmed in December and rallied again, closing near the highs with the rails showing the strongest gains. Even the

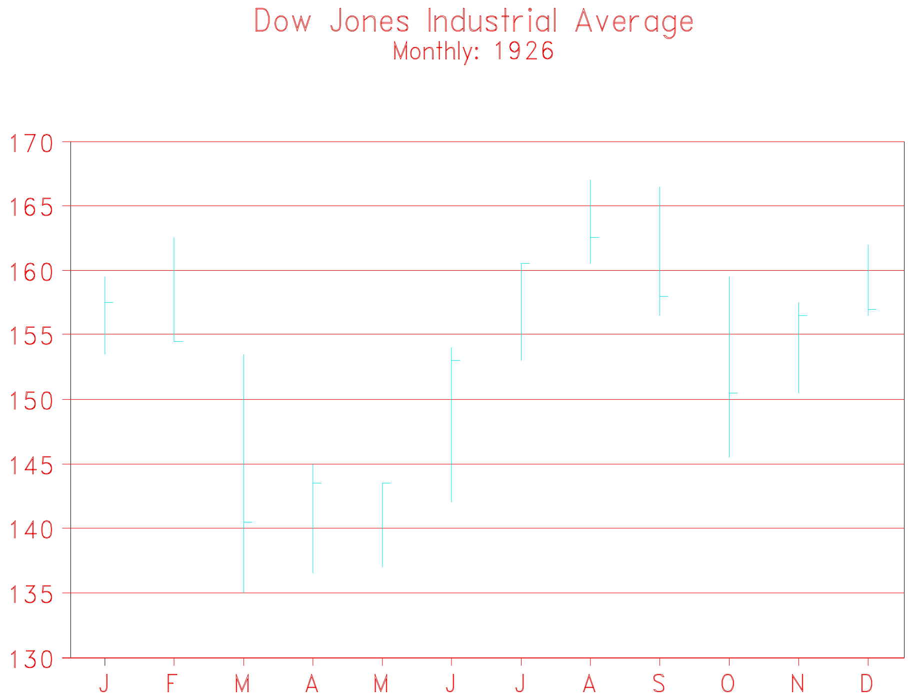


bonds rallied after the discount rate hike, an event which further confounded the analysts. The bottom line was quite simple. Long-term rates were rising but short-term still remained relatively low on a consistent basis. Earnings were high and tax cuts were on the horizon. As long as dividends outpaced interest rates, only the public was not moved to sell. In the end, the professionals continued to try to pick the top but very unsuccessfully.

In the final analysis, 1925 brought to America commercial air travel which had become the latest thing. Radio stations popped up all over the place and finally even appeared in Japan. New companies such as Caterpillar Tractor Co. continued to enter the American business scene, and buildings such as the Chicago Tribune Tower, Chicago Palmer House and the Brooklyn Museum opened their doors. Even refrigerators were registering sales of nearly 80,000 annually by 1925. Wesson oil Co. had its beginnings, the N.Y. Cocoa Exchange began trading, and everyone was eating Wise potato chips.

Chapter VI

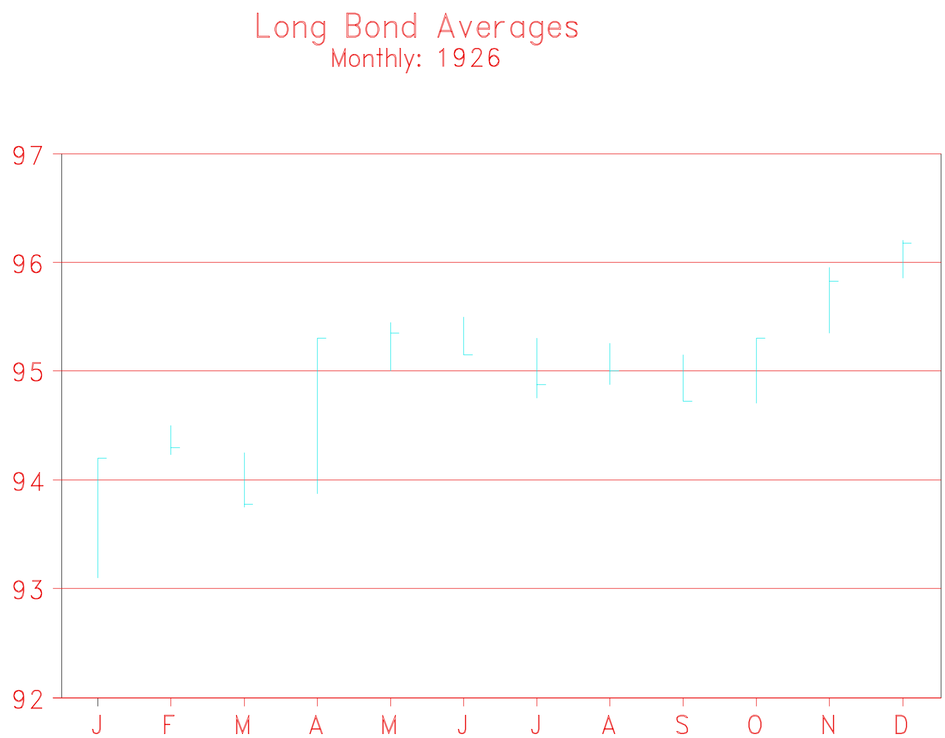
1926



With all the intrigue awaiting the curtain's rise in one of Shakespeare's plays, the year 1926 dawned upon the stage before an audience who remained quite sheltered from the ideas flourishing among the central characters at the free world nations' central banks. "Friends, Romans, Countrymen, lend me your ears. I have come to bury Caesar, not to praise him." As the cunning words of Marc Antony gained the ear of the mob and then manipulated them into following the triumvirate into a war for world dominance, 1926 had begun quite unknowingly in the shadow of such secrecy and intrigue.

It could not be found among the pages of the press for they were unaware of its existence. Nonetheless, a great triumvirate was indeed underfoot. From Britain, one arrived clad in his brilliant ideas for a new era of internationalism. His name was Montagu Norman, Governor of the Bank of England. He held the vision of an all-powerful European unity, an international system encompassing both trade and banking power. Although new to the position since his appointment in 1920, he held the view that only bankers were even remotely capable of comprehending such a vision. His ally in the States was Benjamin Strong, Governor of the New York Federal Reserve.

This elite group of bankers in many ways chose to usurp a financial power on their own, and documents later proved that discussions had taken place even prior to 1925 without the knowledge of either the British or the American government.



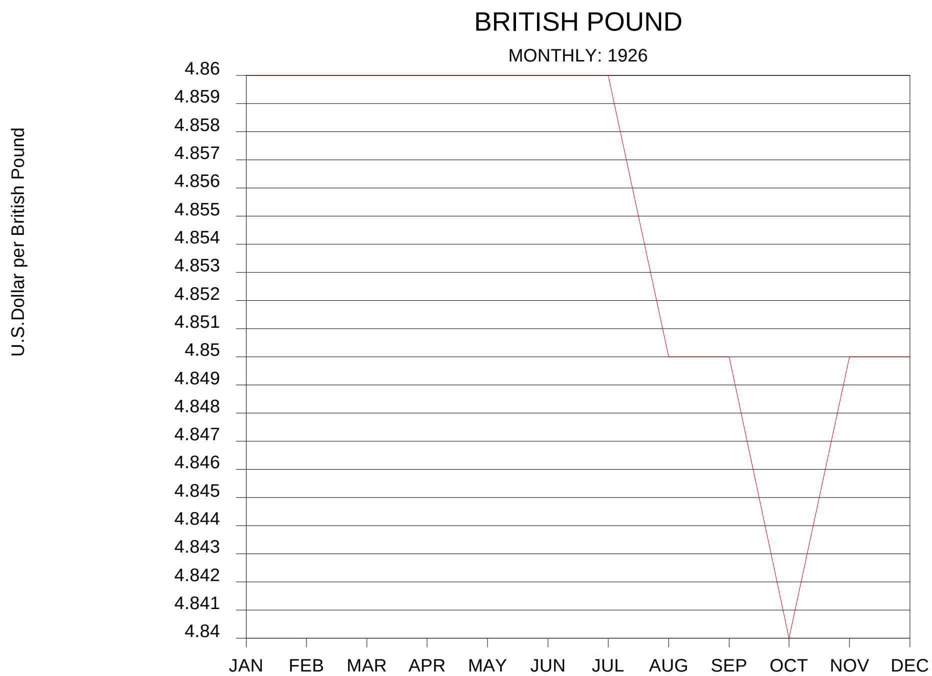
The quest for power and the idea of controlling the world economies at their will was perhaps no child's dream. But, it was a lofty goal and one which should have been thought out carefully, but was not.

The European triumvirate was composed of Montagu Norman of Britain, Hjalmar Schacht of the Reichsbank in Germany and Charles Rist of the Bank of France. It was learned that these distinguished men urged Benjamin Strong to lower the discount rate to help Europe attract much needed funds. Britain's motive was perhaps to find a means to firm the pound at the par value of $4.86 under the prewar gold standard. This was a clear overvaluation by at least 10%.

Of course, Germany and France were still both motivated by their own difficulties, which left them with unbalanced budgets unleashed by military and public works expenditures.

In his memoirs, Herbert Hoover wrote that he first learned of the pact from Adolph Miller who was a member of the Federal Reserve Board. Miller relayed to Hoover that Strong and his "European Allies" proposed still further "easy money policies" for the United States, which meant additional discount rate reductions. Miller had disagreed with Strong's proposals and felt that he was working for the interests of Europe and not the United States.

At the time, Herbert Hoover was Secretary of Commerce and upon learning of this plot from Miller, he protested to Daniel Crissinger who was Chairman of the Board of Governors. Hoover warned him that "such action would further stimulate speculation and was not the remedy for Europe's ills anyway." Hoover commented that Crissinger was a political appointee who was "utterly devoid of global economic or banking sense." Miller and Hoover could not overcome Benjamin Strong's influence. Hoover then appealed to President Coolidge but was rebuffed and told that the Fed was a separate agency and the law prohibited him from interfering with it.



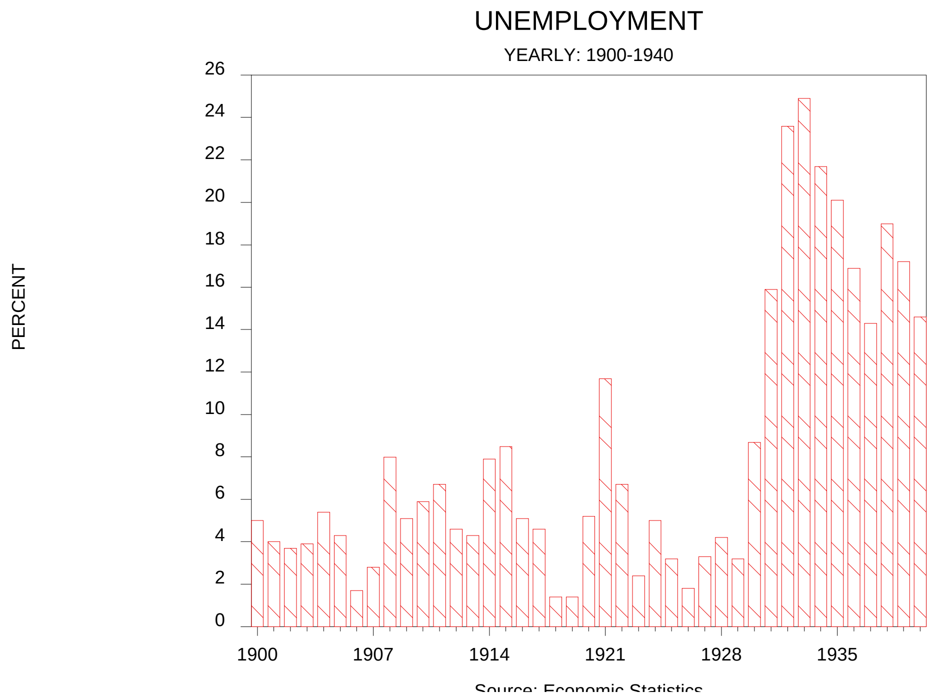
Hoover then wrote: "I was so alarmed, however, that I took up the matter with members of the Senate Banking Committee - the legislative father of the Board." Senator Irvine Lenroot wrote at length to the Board, building upon information which Hoover was supplying. In a memorandum from Hoover to Lenroot, the following passage appeared: "The effects of these policies upon the United States mean inflation with inevitable collapse which will bring the greatest calamities upon our farmers, our workers, and legitimate business."

Senator Lenroot also politely hinted to the Board that "public exposure" of the ploy would not be a desirable outcome. The end result of the efforts of Herbert Hoover, Adolph Miller and Irvine Lenroot was that the central bank conspiracy was brought to a halt, at least for a while.

Back on the surface and away from the political intrigues at the Fed, the year 1926 brought many changes in how people began to look at the market. The Dow Industrials continued the rally which had begun during 1925 but came to an abrupt halt by February. A very sharp reaction took place during March; then April and May spent a lot of time going nowhere fast. By June the market began to rally and eventually made new highs again during August before correcting sharply lower for another two month period.

The bond market pressed higher throughout most of 1926. Advertisements pushing bonds as the "safe and risk-free" investment became commonplace. The railroads, long regarded as the finest area of stock investment, followed the industrials in a very choppy trading pattern during 1926.

The tone of the market place and the economy was fairly well summed up at the beginning of the year by Time magazine: "Business prophets have spoken both optimistically and pessimistically at the year's opening, and as usual the future remains obscure to the average businessman. Current business is good; none except the anthracite miners and a few others question



that statement. This real interest in business relates to how long the present prosperity will last."

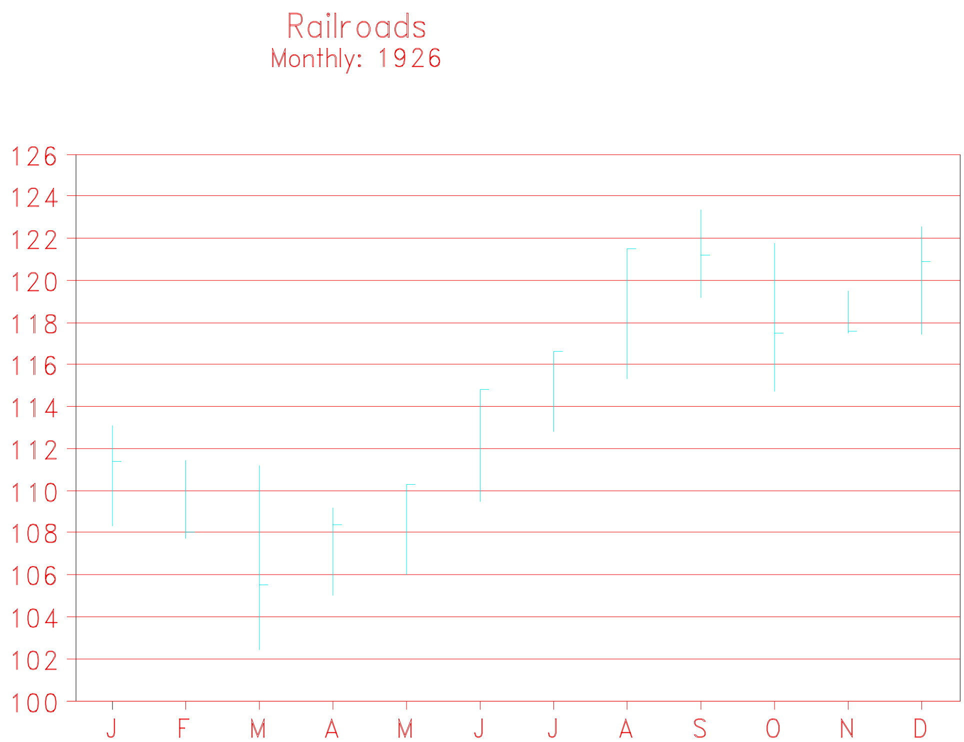
During early 1926, the general tone of the Press still sounded a little bit like a doubting Thomas. The memory of the panics and crashes, which had been numerous between 1901 and 1920, still lingered on in the minds of many. Business was good. Innovation in the United States had continued to progress and the growth in the stock listings themselves attested to the number of new business ventures. A comparison to January 1, 1925, just one year prior, showed that at the start of 1926, trading on the New York Stock Exchange had grown in both the number of issues as well as value.

It is interesting to note the trend. The number of corporate bond issues had increased by only 35, whereas the number of new issues in the stock arena was 118. Corporations began to shift their borrowings from bonds to stocks. This would be a trend that deceived many in the years ahead.

By 1926, the U.S. had emerged as the money center of the world; it was the place where foreign nations came to borrow capital. As a result, foreign bonds were listed on the N.Y. exchange. As of January 1, 1926, there were 116 separate foreign bond issues listed, of which 65 nations were the makers. This was broken down as follows:

No. Nations	No. Bond Issues
2 Asiatic nations	(3)
3 Australasia	(7)
37 Europe	(59)
5 North America(U.S.excluded)	(17)
18 South/Central America	(30)

Many businessmen at that time adhered to the old philosophy of whatever goes up must come down. They believed that the stock market was overdone and they continued to look for pessimistic news to support their contention. Other subscribed to the underlying facts. They pointed out that at no time in history had credit been so cheap and the banking business so sound, and these two elements combined to form a



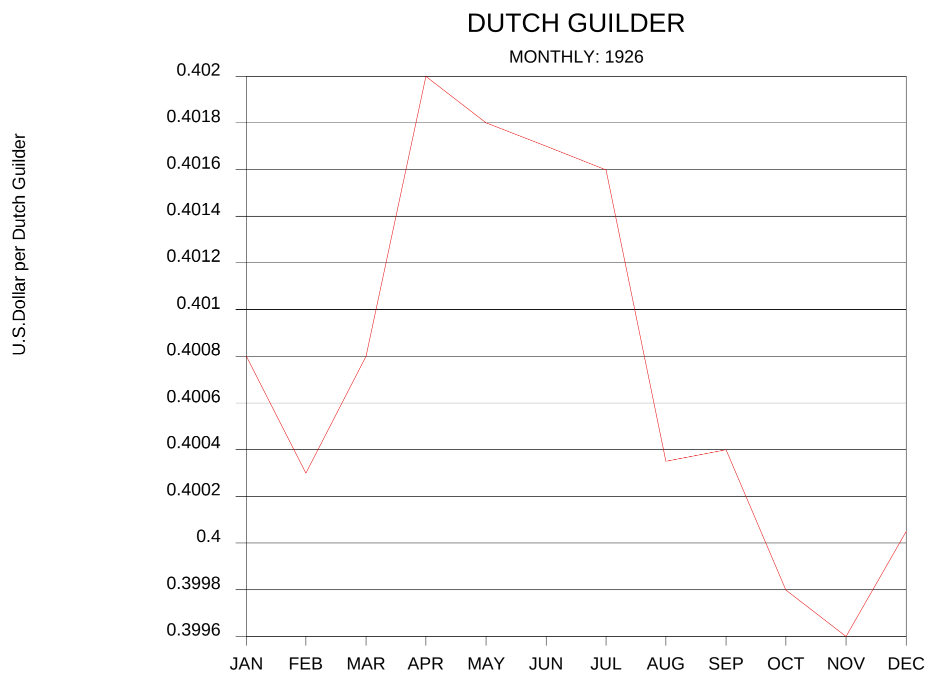
good, solid age of prosperity. These factors were true indeed. The U.S. was the world's banker in more ways than they knew. Everyone was floating their bonds on the N.Y. markets. Banking profits were quite impressive. All of the top ten banks had turned in record profits for 1925 precisely when credit and money were cheap.

Nonetheless, the market continued higher into January, reaching the 158 level on the Dow Industrial. February saw a new intra-day high testing the 163 level. But then the market began to break and February fell to close under 155. March continued to decline, as the normal correction after an 11-month bull cycle that culminated precisely during February.

Cyclically and technically, the market was due for a correction. All markets must correct even if only for one month after completing an 11-month bull cycle. Therefore, any bit of news would have been sufficient.

The news that came was Washington's rejection of a rail merger. The Van Sweringen brothers controlled the New York, Chicago, St. Louis Rail road Co., The Pere Marquette, Erie, Chesapeake & Ohio, and the Hockling Valley railroads. They wanted to merge them to create what would have been one of the largest railroads in the U.S., saving the company $6 million in expenses. But Washington stated that the railroads were voted into a merger by the majority stock holders without consideration to the minority stockholders. Strangely enough, everyone was in favour of the merger. But Washington's denial of the application was excuse enough. Wall Street was in a state of shock and the main railroad stock of the group, known as the "Nickel Plate," fell 33 points the very next day. Had Coolidge broken his promise?

As the Ides of March rolled around, the market continued to crash. It was written up as the worst panic since the Rich Man's Panic of 1901 and the dismal days of April and May 1920. Despite the new records on



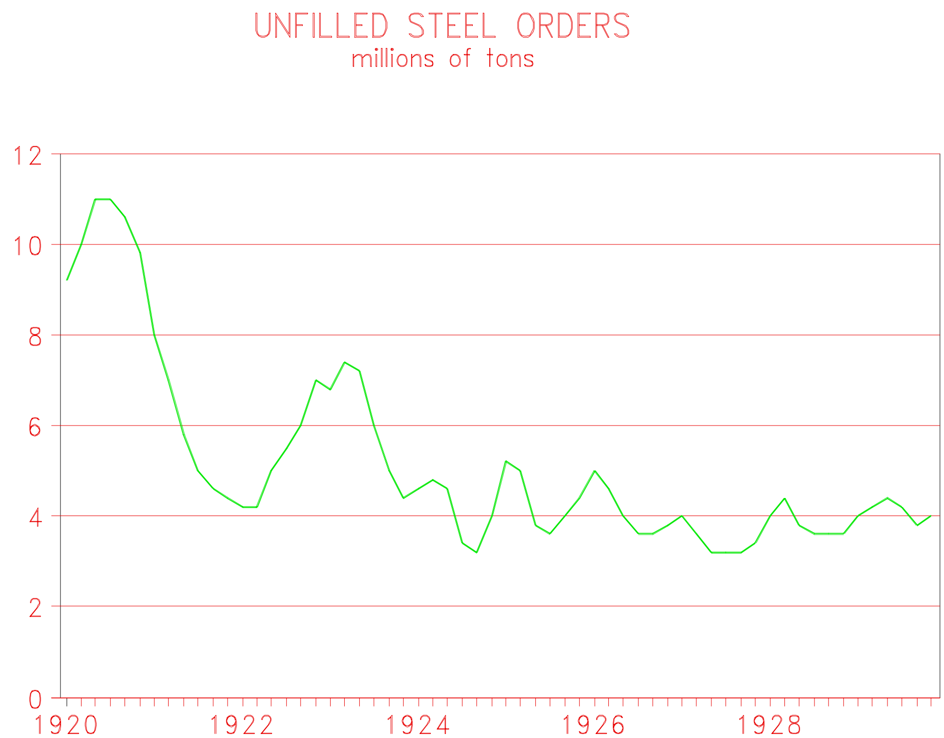
volume, which had been established on the way up during the fall of 1925, new records on the way down were established as volume reached 3.7 million shares for the day on March 3. The ticker was 52 minutes behind, which only fueled more panic. The banks rushed out to support their clients, yet during the whole affair business was not affected.

The broader market continued to decline into early April under heavy selling. Bad news seemed to pour out during March and April 1926. Although earnings were still up for 1925, many had been expecting even greater earnings for 1926, but now that seemed to be an incorrect assumption. Others pointed to rising business inventories and immediately proclaimed the end of the world was near. But steel production was still moving at 96% capacity. By the end of March, 125 issues had made new lows for the year.

Perhaps it was Senator Lenroot's polite threat to the Fed in late December 1925 that prompted an initial retreat from the scheme to artificially stimulate Europe through lowering U.S. interest rates. Whatever it was, the Fed raised the discount rate in January 1926 from 3.5% to 4%. The stock market did not interpret this hike in the discount rate to be bearish in January although it created some nervousness. The market continued to surge higher in February following the rate hike.

Again on the foreign exchange markets, the dollar dropped from a February high against everything except the French franc which continued to decline sharply into July 1926. Strangely enough the stock market had come to a halt along with the dollar.

Within the economy, several varied trends were taking place. Unfilled orders for U.S. steel had peaked at 5 million tons in December 1925. Although production itself remained high during the first quarter of 1926, it was merely catching up with the backlog of unfilled orders. That December 1925 high of 5 million tons would remain the peak until World War II.



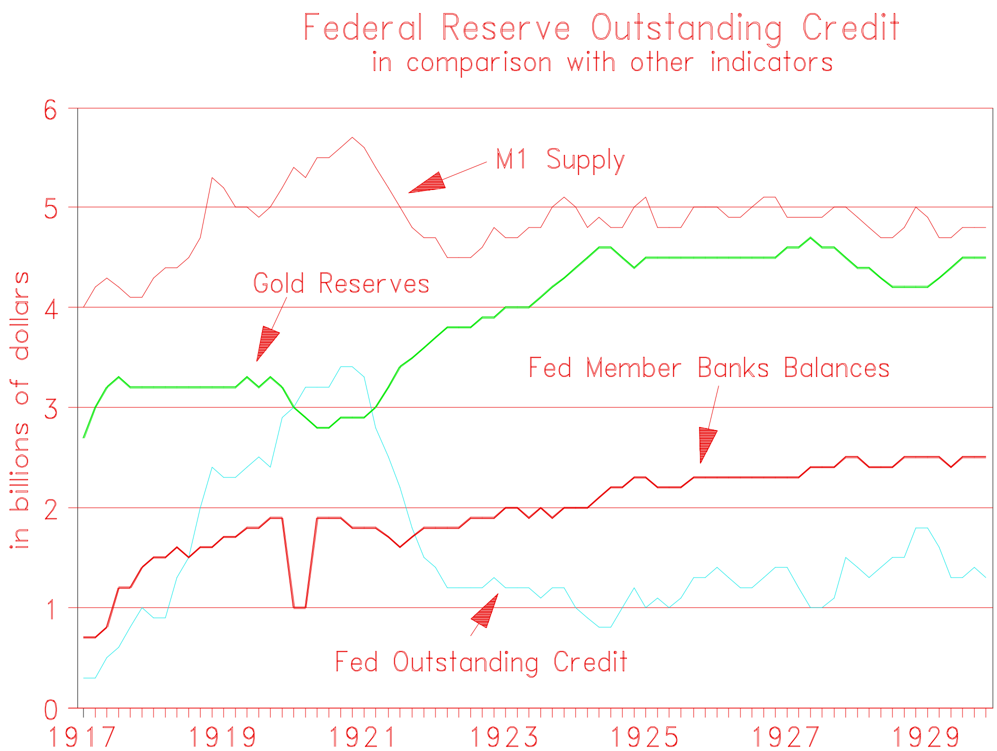
U.S. auto production, including trucks and taxicabs, had reached a temporary peak in January 1926 at nearly 440,000 units. This was the highest monthly production figure since the low of 50,000 units during January 1921.

On the banking scene, brokers' loans had reached a record high of $3.1 billion during January 1926. Total outstanding loans of reporting banks reached nearly $19.5 billion. In both cases, these were now above the corresponding record highs which had been established at the peak of speculation in 1919. Brokers' loans were then $1.5 billion and total loans of reporting banks stood at $16.5 billion.

The rate of change between brokers' loans and total loans clearly illustrated a growing sector of speculation. But as we will review in the years ahead, many corporations were shifting toward floating more stock rather than bonds. Had that not been the case, then total outstanding loans would have risen more dramatically to finance the wave of innovation and expansion which was underfoot during the Roaring 20s.

When we look at the money in circulation, reserve credit and bank balances in comparison to the gold stock and broker loans, a curious effect leaps out from the statistics. Note that total reserve credit peaked in 1920 at nearly $3.5 billion. Yet it peaked in December 1925 at $1.4 billion. Bank balances stood at record highs by January 1926, yet money in circulation remained well below its 1920 high. The expansion was not being financed by the Fed as much as from capital which was earned through the trade surplus as well as through the flight in capital to the U.S. from overseas.

The first quarter of 1926 was the only quarter during which the U.S. had moved from a trade surplus to a deficit. This deficit in trade came to a bottom with the stock market during March of 1926 and this never took place again, even through the end of 1932.



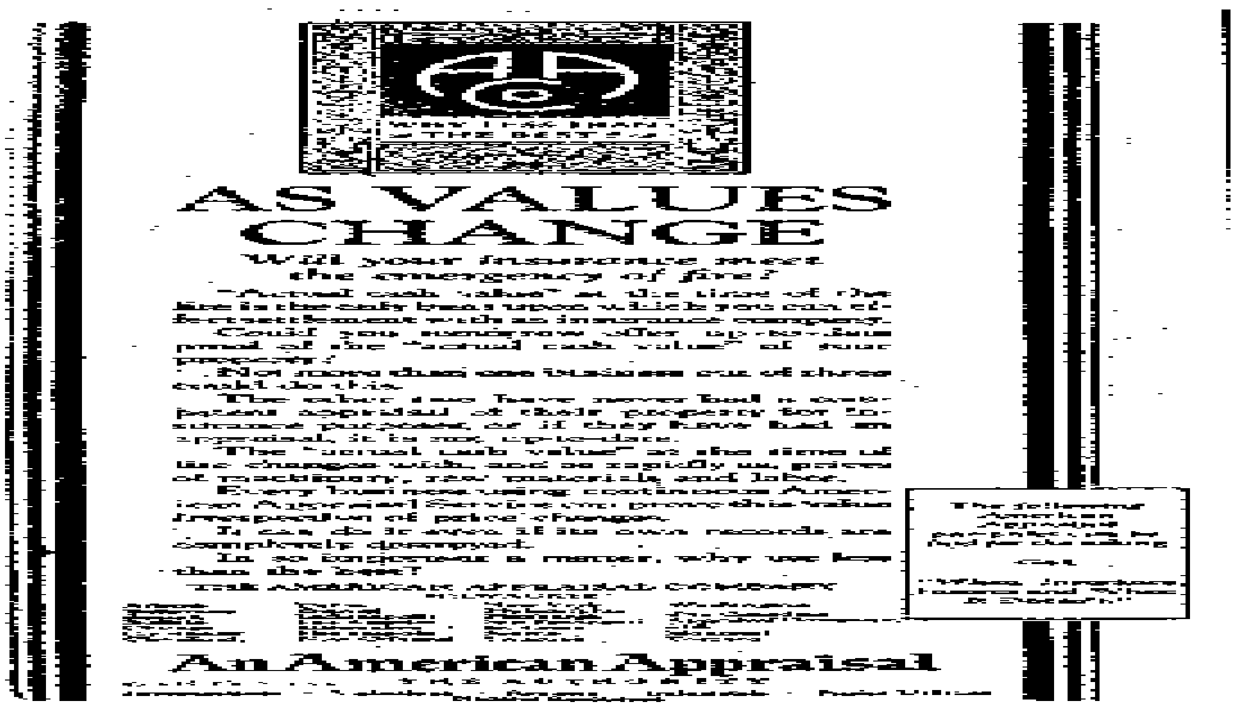
Virtually all commodities had peaked during 1925 and the first quarter in 1926 held only disaster for those markets. Silver had managed to rally back to 73 cents in late 1925. But 1926 saw a high form in January at 69 cents and a continued panic sell off brought the silver market under the low which had been established during 1921.

Around the globe, the stock markets did not respond in similar manners. In Japan, the peak came during February at about 110 on their index and this proved to be the final high. The Japanese market never exceeded its February 1926 high and continued steadily lower, eventually reaching bottom during July 1930 at 41.

In Italy, the stock market dropped into February and then rallied in March counter to the U.S. trend. Curiously enough, that March 1926 high was the final high for the Italian market which had reached 90 on their index. From there the market continued lower and a drastic low at the 60 level during June 1927. Further manipulation on the part of the central bankers in 1927 would aid this market in rebounding back to the 85 level during May 1928, but from there onward, the decline would eventually reach bottom at 39.9 during June 1932.

In Switzerland and Sweden, their stock markets rallied during the first quarter of 1926, pausing briefly when the U.S. market had supported, but their uptrends continued. Sweden witnessed a major high during 1927 while in Switzerland, the market reached its high during September 1928.

The British stock market declined throughout the first quarter of 1926, perhaps in response to the overvaluation of the pound. While the undervaluation policies of France were continuing to add a downward pressure on the franc, their market peaked briefly during February, declined into March, and then rose 30% in September 1926. The uptrend in France continued until the first quarter of 1928.



When looking at all the international aspects during the first quarter of 1926, one sees that this was the only quarter during which the trade surplus of the United States turned into a deficit and the dollar peaked during February. Therefore, the actions of the market during March seem to have taken place in conjunction with shifts in international trends, perhaps more so than with purely domestic influences.

During April 1926, the Fed at New York suddenly cut the discount rate back to 3.5%. Although there was no official comment, it seems that they perhaps took action due to the sudden swing from a trade surplus to a deficit. But during August of 1926, the Fed would raise the discount rate back to 4% where it would stand for one full year thereafter.

Government was still enjoying its power plays. The Ward Food Products Corp., a $2 billion operation, was forced to consent and surrender its corporate charter and to sever all relations that might suggest a monopoly. The anti-trust laws were being fixed more and more and this news was not looked upon very favourably by the stock market during the spring of 1926.

Taxation was also increasing. The latest invention was the gasoline tax. By 1926, all the states in the Union had imposed a tax on gasoline except New Jersey, Illinois, Massachusetts and New York. The revenues of the forty-four states which did collect the tax for 1925 added up to $146 million, which was up 83% over 1924, and up 450% over 1923 levels.

The stock market, after a swift and sharp kick in the pants, remained stagnant as stock prices hardly budged. Yet the steel and motor industries continued to rack up sales. Gillette bought two foreign companies in Germany and Austria to further push the Gillette safety razor. The N.Y. Fed suddenly lowered the discount rate from 4% to 3.5%. Call money rates fell to March 1925 levels, reaching 3%, and broker loans fell to 2.5%. Bond sales were brisk and new daily records were established while the stock market still licked its wounds.

Many had warned about massive business failures, but there were hardly any taking place, and in fact, failures were trending a bit lower than 1925 levels. By early May the New York Times reported: "In general the national industry has kept at a steady gait and seemingly will continue so. The stock market fluctuations did not truly reflect its condition."

The famous Otto H. Kahn was quoted during May 1926 and the words from such an important banker are still quite important today. He stated in May 1926:

"Episodes such as those which have marked the course of stock prices and so-called Wall Street sentiment...constitute a generally harmful nuisance. They also constitute a reflection on the steadfastness and sobriety of a portion of the community...The only circumstances under which, in a country with the resources, the resiliency and the basic elements of ours, a temporary descent into the cyclone cellar becomes warranted are - leaving aside grave foreign complications - either manifestations of stark and persistent over-production or over-trading, the advent of a major credit disturbance, or acute monetary stringency. None of these circumstances exists today or is even remotely likely to occur."

The commodities in general declined as well, though they did not stop in March but rather extended into April. Yet supplies in many sectors had dropped significantly from the previous years. During April 1925, for example, wheat was reported with visible stocks of some 50 million bushels, while in April 1926 the visible supplies had declined to 28 million. Nonetheless, most commodities from lead to rubber fell and established new lows for the year in April.

Despite the lowering of the discount rate from 4% to 3.5%, the stock market remained steady, showing little incentive to rally after the March blood bath. There was a marked flow of cash to Europe at this time through foreign loans. The French floated a huge loan and the proceeds were used in an effort to try to stabilize the French franc.

In Britain, strikes still plagued the nation. Coal miners, who throughout history seem to have struck every time they have had a chance, went on another rampage. Many in the U.S. were looking for coal exports to pick up sharply as they had in previous years, exporting nearly four million tons of coal to Britain. But this time the Brits really got out of hand. The strikers tried to effect a naval blockade. The Royal Navy was called out with trained guns ready and ordered to blow the strikers out of the water if they did not give up the effort.

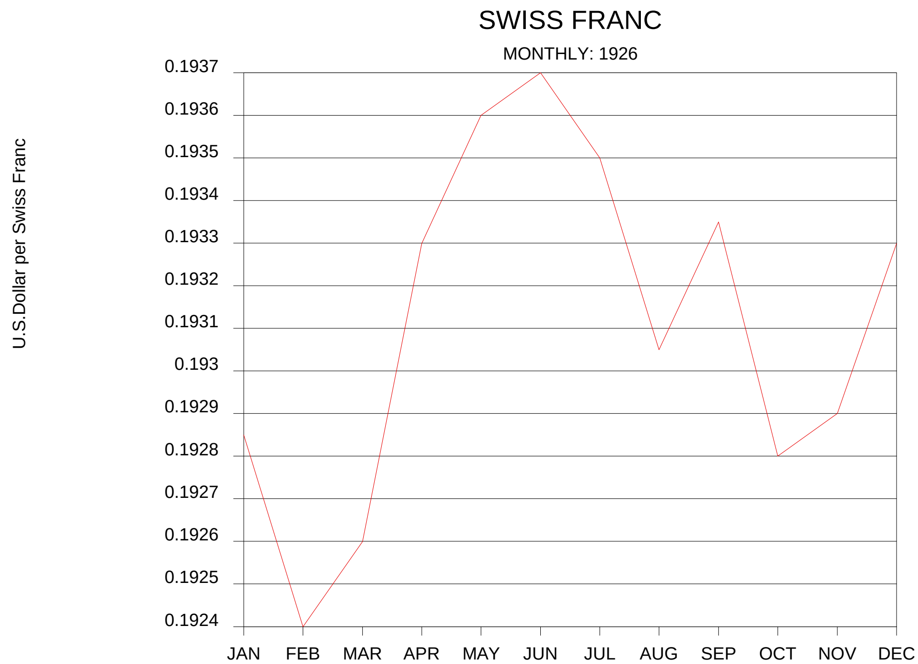
Europe’s poor showing economically began to ring a few alarms. In May 1926, the U.S. bankers quietly withdrew a $100 million loan for Italy that had been headed up by J.P. Morgan & Co., syndicating the loan through 1,000 U.S. banks. After the bankers withdrew their support for the bond issue, it fell from 94.5 to 89 virtually overnight. This did not reflect an outright distrust of the numerous European bond issues but there was a concern about expanding these already substantial loans.

In Italy, the consumer price index was soaring. It had jumped to .34 in 1926 from .17 in 1919 (1980-100). Inflation had doubled during this time span. Exports had risen from 8.04 billion lira in 1921 to 18.54 in 1926. This was a peak in Italian exports which would never be reached again until

after World War II. Imports stood at 16.91 billion lira in 1921, rising to 25.88 in 1926. Exports had risen 130% while imports rose by 53%. Despite this improvement in foreign trade, the GNP had risen only moderately by comparison in constant lira terms of 18.8%. Inflation was rampant and far outpaced economic growth, drastically distorting the situation. From 1926 onward, the situation became worse.

In Germany, inflation seemed at last to be under control, registering merely 1% for 1926. Japan was already undergoing sharp deflationary pressures as their CPI dropped by nearly 8.6% during 1926. But in France, inflation was rising due to the drastic decline in the franc itself on world exchange markets. For the year 1926, inflation rose 17.6% over that of the previous year. But from 1921 levels, inflation was up sharply by 68.2%. British economic policy was still in overkill, forcing a deflationary period upon its population. Inflation had continued to decline as the pound rose in the face of declining commodities, further reducing their CPI from 1921 to 1926 by 17.7%. In the United States, inflation was almost nonexistent. With 1980= 100 on the CPI, it stood at 21.7 in 1921 and by 1926 it remained at 21.5. Again this was largely aided by the relatively strong dollar against all other currencies except the pound and the decline in the overall commodity sector.

As June came on the scene, the stock market began to rally. Several banks had failed in Florida, which had experienced a tremendous real estate boom. In Boca Raton, Jesse Livermore, Thomas Coleman du Pont and a handful of others resigned from the directorate of architect Addison Mizer's 16,000 acre project, a deal worth approximately $40 million. People who had subscribed for lots owed $21 million and creditors pressed to force the project into bankruptcy. These events had a more positive effect on the stock market. The bad press that the Florida land boom had received made many skeptical about real estate investments and cash began to flow back toward the stock market once again. However, real estate related stocks continued to decline into July.



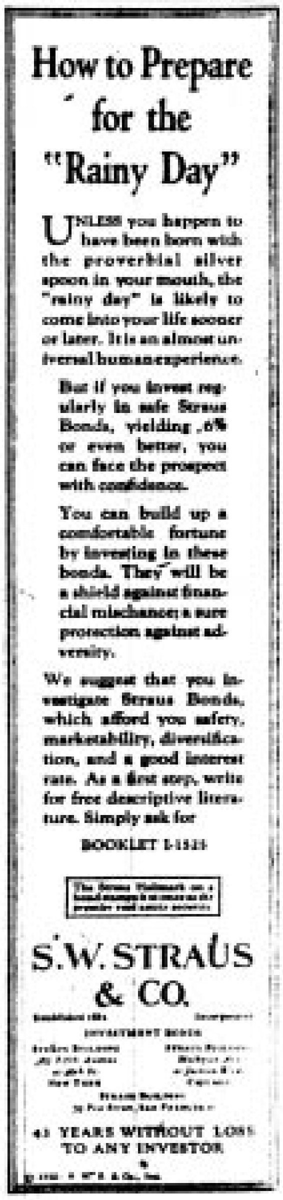
General Motors announced that it would spend $40 million, $10 million of which would be invested in a new venture that would prove to be a fantastic money maker for G.M. This new venture brought the establishment of G.M.'s Hertz Drivurself Corp. which would rent motors to the public. The news of the venture hit the streets and everyone was talking about how G.M. was going to make a fortune and at the same time become a major consumer of its own production. As the summer rally continued into August, the March low in GM. was 113 and the August high was 225.75.

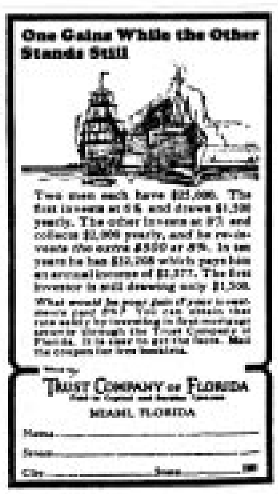
This summer rally was not just made up of G.M. Many other stocks did very well. Du Pont rallied from a spring low of 193 to 314; U.S. Steel from 117 to 156; and Hudson from 50 to 75. But Jesse Livermore was there. As a result, Time magazine, The New York Times and the Wall Street Journal all reported the rally skeptically and they doubted how much it truly reflected business conditions.

The truth of the matter was quite simple. Most companies were still showing prosperity with all-time record earnings. The velocity rate of money was up nearly 11% over 1925 levels. The money in circulation was $42.01 for every person living in the U.S. Yet steel production had backed off from the February high of 96% of capacity down to 71% capacity as unfilled orders declined.

The stock market came into a roaring high as G.M. declared an increase of 50% in dividends while the open market value of the stock had reached $1.8 billion. The Secretary of the Treasury also announced that there were 11,000 citizens who were worth more than a million and that 74 people had earned a total of $154 million in the previous year. Newspapers were filled with stories that caused many to dream about becoming millionaires.

The Dow Jones Industrials had been very choppy during the first halt of 1926. After rallying to a new record high during February, the March collapse was severe indeed,





posting a decline on the index of 17%. That panic in March was by no means the "normal" 5% correction that we hear talk of these days. The industrials had fallen from 163 to 135 and then during April they merely consolidated between 145 and 136. May posed an even narrower trading range between 144 and 137. June saw a rally from the 143.50 level up to 154 while July continued the trend, moving from 153.50 to 160.50. August then punched through to new highs for the year, reaching nearly 167, and the corrections that month all held above the July high of 160.50.

From the August 1926 high, the market began to drift sideways during early September, then suddenly dropped back to 156 during the final two weeks. October tried desperately to rally back over the 160 level but failed. Then suddenly the market went into another panic sell off, dropping back to 145.50 and barely closing October back above the 150 level. This time the market had corrected nearly 12.5% between the August high and the October low. Again, this was no mere 5% correction.

In the October 25 edition of Time magazine, the commentary on the market was as follows:

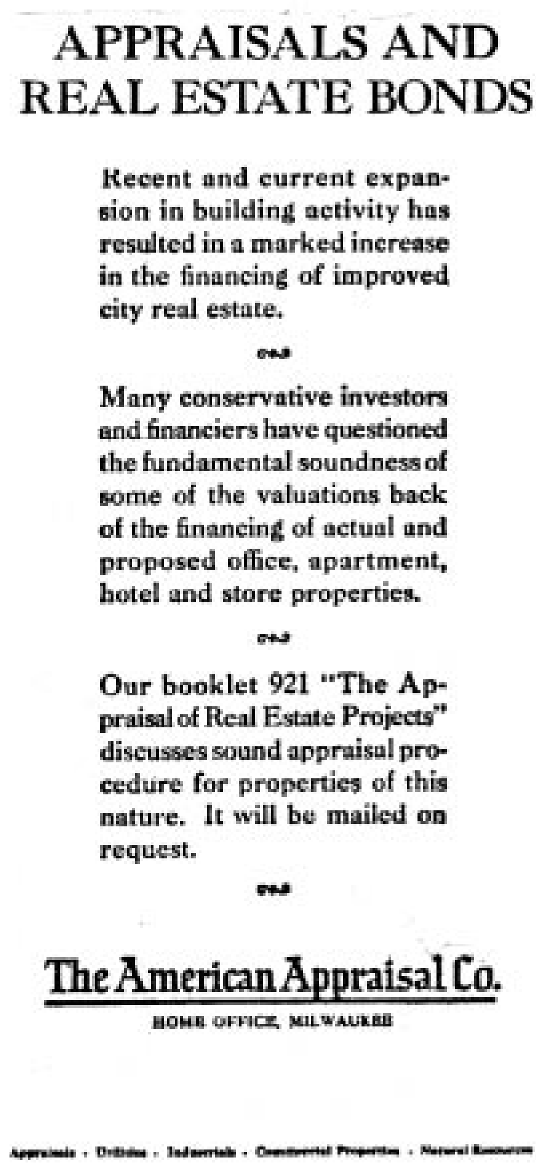
"The prices of stocks which began jiggling up and down a fortnight ago, bobbed more violently last week. There was a definite downward trend. One 'combined average' of prices estimated the general drop on the New York Stock Exchange at 2.93 points, the lowest since the 3.89 drop March 26, when many speculators were wrong. Bond prices rose in usual antithesis to stock drops. No underlying cause is yet discernible for this situation, especially since 250 leading U.S. corporations earned in aggregate $568,000,000 during the first half of this year. This, according to the American Bankers Association Journal, is 21% more than the $470,000,000 of last year's first half."

Here we find that Time magazine reflected a very important relationship which everyone accepted in those days. Note that Time clearly stated that the bonds moved up as the stocks moved down. This, they added, was a normal situation. This once again is strikingly different from how most people now view the bond market in relation to stocks. Back then, people would run into the bonds for shelter whenever the stocks became questionable. When stocks were very bullish, bonds would decline as capital left the bond market in favour of the stock market. This is a play which we strongly believe will be seen once again following 1985.

The amount of foreign debt floating upon the U.S. markets was quite large by this time. Some $11 billion dollars of debt were outstanding by the fall of 1926. Before the war, the trend in foreign investments had been for U.S. investors to place funds principally in Canada, Mexico or Cuba. But during the postwar years, Europe became the largest single debtor to the U.S. During 1913 there were only 11 foreign bond issues listed on the New York Stock Exchange. Now that number had grown to 145 issues. Some "frontier" bond issues in what is now Washington State were defaulted upon during 1926. But this by and large was overlooked by the bond investing public. Yet money continued to be cheap and abundant.

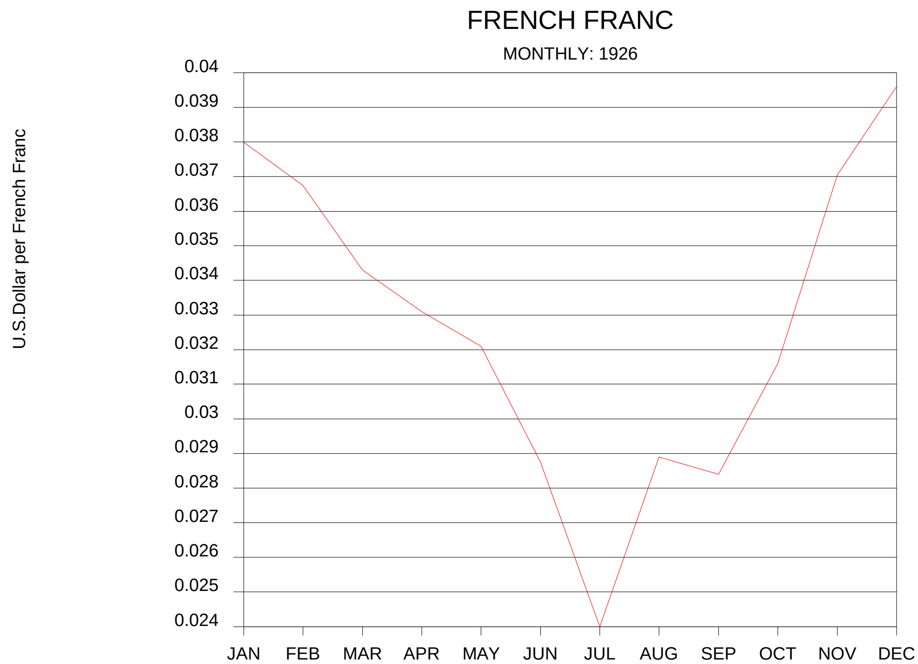
It is also important to note Time magazine’s comment on earnings. They pointed out that corporate earnings were rising and underlying economic indicators were apparently indicating prosperity, yet the stock market corrected violently by 12.5% moving into October.

Unfilled orders for steel were beginning to rise from their June low. Auto production had rallied back, sharply peaking in August but not failing under 350,000 units going into October. This was contrary to normal seasonal conditions, which had produced a greater rise in production during



that period in 1925 and 1924. This was the only excuse that the bears could find to talk about.

The French franc had dropped from its January 1925 high of 5.4 cents to 2.5 cents in July 1926. The dollar began to decline sharply against the franc between July and October 1926, dropping nearly 32% as the

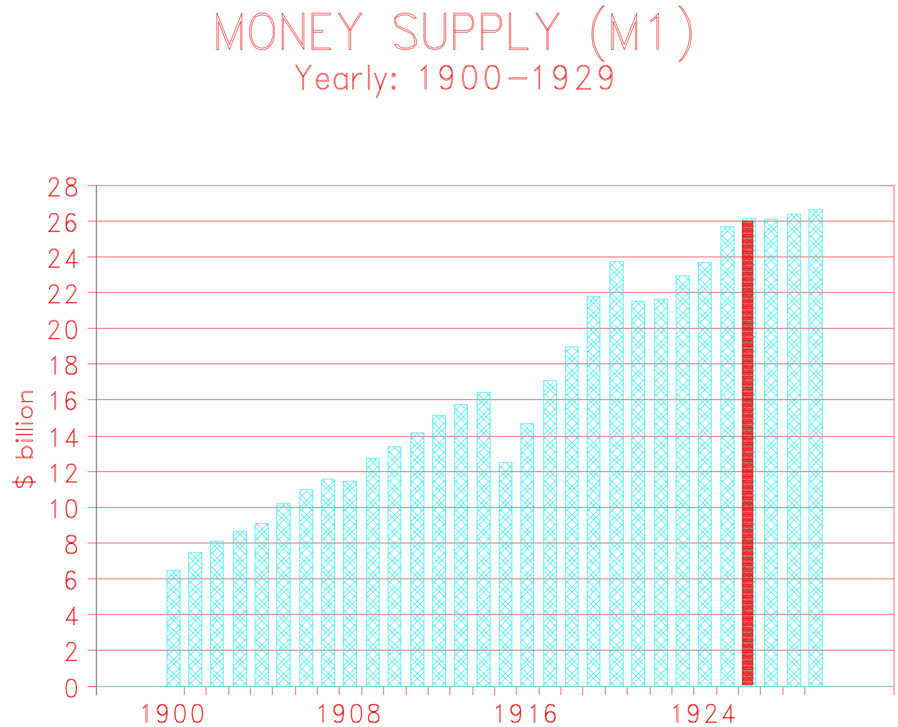


franc rallied. The Swiss franc remained steady as did the Dutch guilder but the pound actually began to decline during the fourth quarter of 1926.

Time magazine reported once again in their December 13 issue on the state of business affairs: "Investment bankers know that there is hoarded U.S. money yearning to buy safe securities, and corporations who need to borrow are learning this situation also. Borrowers are willing to pay less interest while investors are willing to accept less. Thus last week Standard Oil of New Jersey through J.P. Morgan & Co. offered $120,000,000 of debenture bonds at 5%. Morgan's merely opened their books and snapped them shut, for $500,000,000 in subscriptions tumbled in. Immediately, Standard Oil of New York offered $50,000,000 debenture bonds at 4.5% interest. Dillion Read & Co. bought them all up knowing that the bonds had a swift sale. Standard Oil of Now Jersey's yearly interest on this item will be $6,000,000. Had its bonds been sold at the 4.5% of its sister company's it would have saved $600,000 yearly in interest."

Many of the odd and unusual theories that I have developed in economics are based upon the study of events and how relationships come and go. One of those important rules concerns the creation of money. Most of the actual money created is done so in the private sector, whether it's on a gold standard or paper standard. The actual money supply was increasing during this period but the velocity in the turnover of money was rising on an average of 11% annually during this seven year period. Money was in effect creating money. The stock market value had doubled and this in effect doubled a portion of the money supply as well. People could borrow on the new higher values of those stocks and then take the borrowed funds and reinvest once again.

From the point of which we began looking at the stock market in 1921 until the end of 1926, the Dow Industrials had tripled in price. The economy was still expanding and innovation was high. Money remained

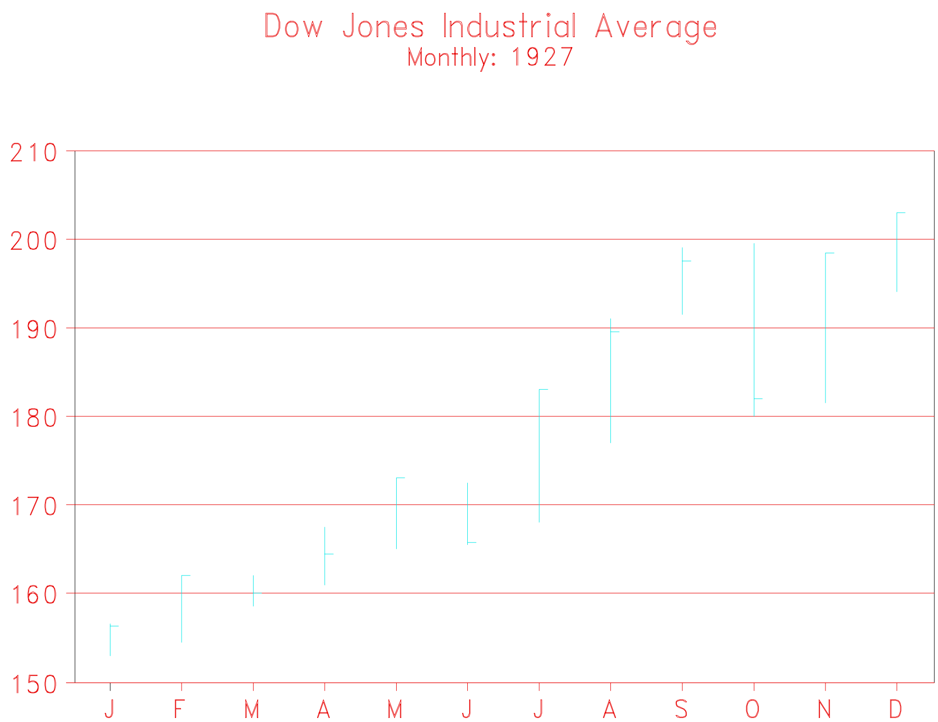


cheap despite the fact that the stock market had tripled. Foreign investment in the U.S. economy still ranked very high.

1926 had brought with it the beginning of Greyhound, G.M.'s introduction of Hertz and Pontiac, and Chrysler's launching of the Imperial. America moved more toward luxury cars, yet the Model-T was still a big seller for only $350. Broadway musicals were the rage, and this was a year of vast expansion and a rise in American pride. Although the summer rally had been blamed on good old Jesse Livermore, the bull market would still prove that it wasn't finished just yet.

Chapter VII

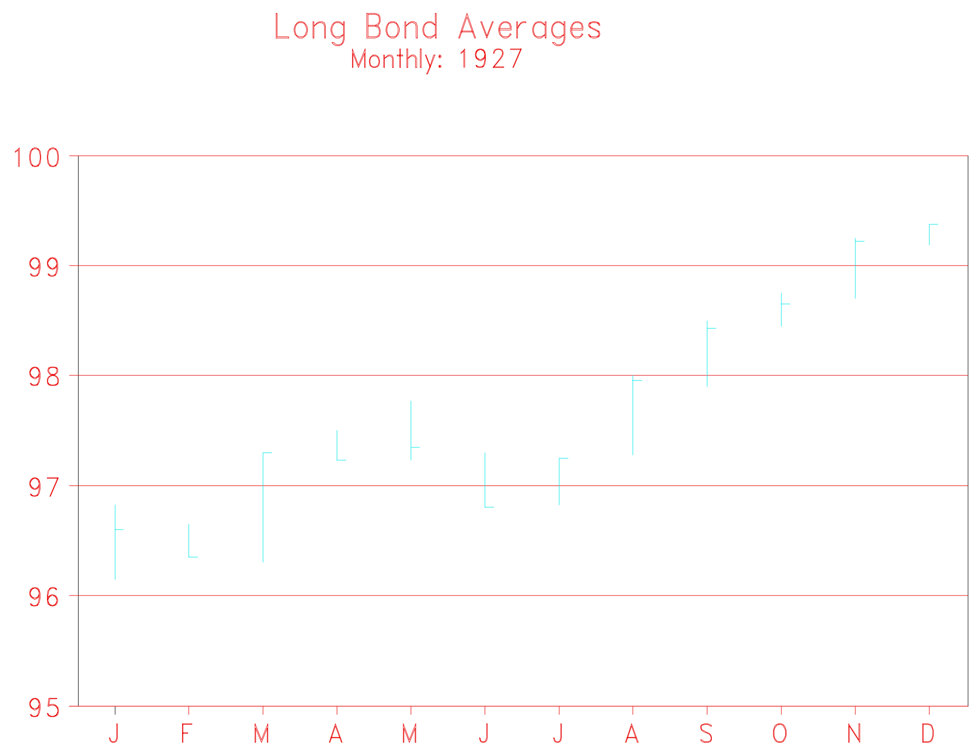
1927



1927 was a very strange year. Contrary to the standard fundamental beliefs well ingrained in the analytical section of everyone's mind, the bond market and stocks became a battleground between two schools of thought. Every time the stocks would crack, the bonds would rally. This was caused by the fact that bonds were being played up as the "safe" and "secure" way to invest money. Stocks were being touted as a much more speculative investment. This was one noted relationship that stands in direct contrast to what we find during the 1980s.

As we have just reviewed, 1926 was a choppy year for the industrials. Although the trend was basically up, two sharp corrections had taken place with quite severe declines. During 1927, the rally, which had been underway during latter part of 1926, firmed up quite nicely. Only four months during 1927 failed to exceed the previous month's high, yet only one month had violated a previous month's low. The trend essentially remained straight up during 1927, finishing on the high.

The railroads also remained in a steady uptrend through the course of 1927. suffering a correction eventually during October. The bonds were a little unstable but basically remained in a sideways to higher trend in the summer and then rallied strongly into year end. As early 1928 approached, the final and complete split between the bond market and the stock market would eventually take place.



1927 began on a note of decent optimism but surprisingly there was a lack of real interest in the stock market from the speculative side. After getting burned in 1926 many people began to turn toward the bond market, succumbing to the onslaught of bond advertisements. Nonetheless, the industrials began to rally in February, scoring major new highs once again exceeding those established during 1926. The main fundamental was, of course, the impressive list of earnings for 1926.

U.S.Steel made an impressive earnings showing. Many had regarded U.S. Steel as the bulwark of American industry. "As steel went, so did the fate of the nation," was one saying which perhaps overembellished steel's importance. In retrospect, this entire bull market began with the auto industry leading the way. Nevertheless, after new highs on the industrials were made in February, the press was filled with stories about doom and gloom in March. Although the stock market didn't collapse, it did pause for a while before new highs came into play.

It was reported in March of 1927 that in Detroit 45,000 fewer men were employed than in March 1926. This, coupled with a decline in unfilled orders in the steel industry, prompted talk about how unprosperous the winter had been. Perhaps the rise in unemployment at this time was created by a peak in U.S. exports which took place in 1925. No one knew this fact and as the market began to move higher in the months ahead, this was not understood until it was too late. As usual, the response was another factor that created additional problems through its side effects. In this case, it was the Smoot-Hawley Tariff Act of June 1930 and the age of massive protectionism.

Money, on the other hand, remained very abundant. Interest rates were still declining as reflected by the Treasury first quarter borrowings, which were $450 million in Treasury Certificates paying 3 1/8%, and a new offering of a five-year note that brought 3 1/2%.

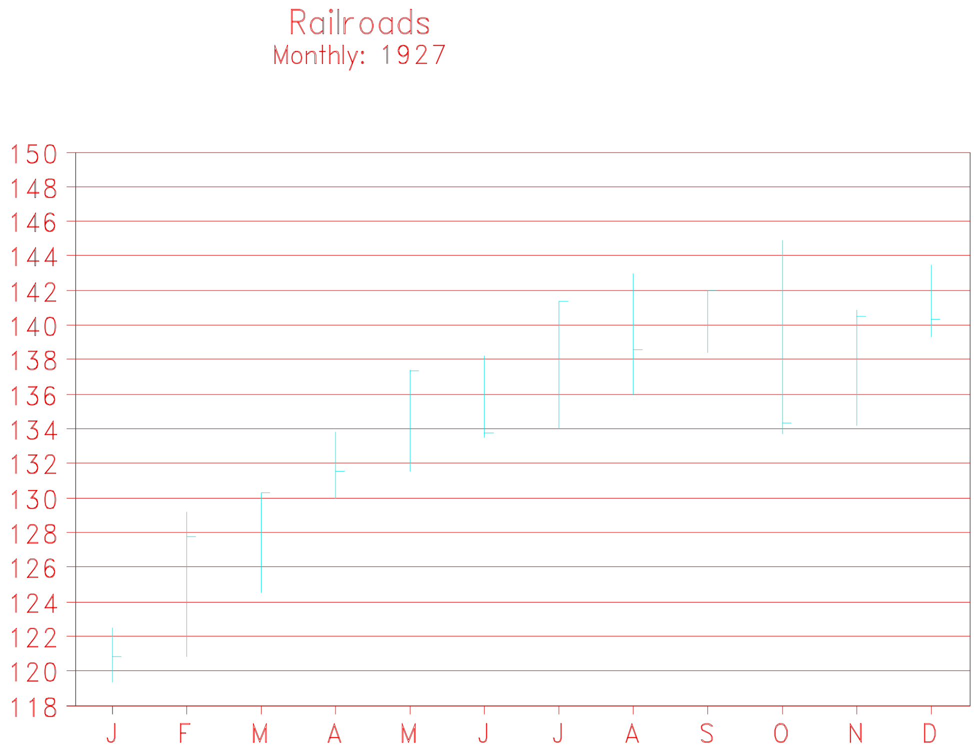
The Industrials rallied quite nicely during April, reaching new record highs once again. This was largely due to the fact that $500 million was paid out in dividends during April among 500 U.S. corporations for the first quarter of 1927. The largest of all dividend payments was noted by Time magazine, which wrote: "The largest extra dividend, $60 a share, was paid by a relatively obscure concern, Pratt & Whitney, manufacturer of aircraft."

The April rally once again established records in volume and in the number of various shares traded. There were 1100 issues listed on the New York Stock Exchange and trades took place on 651 different stocks in a single day, exceeding the previous record of 649 which had been established in March of 1926.

William C. Durant, the original founder of General Motors who lost control and was ousted twice, spent $21,000 to advertise his intention to form a new motors company to compete against General Motors. The press didn't take too kindly to the ad and neither did Wall Street. Durant Motors Inc, which traded on the Curb Exchange, firmed slightly but it failed to rally significantly.

Meanwhile, May brought with it a little more than just flowers. New highs were scored once again as the industrials approached the 175 level which now came very close to tripling the 1921 low. Seats on the exchange rose from $185,000 in January of 1927 to $200,000, which was substantially above the 1925 level of $116,000. Business was good in many industries despite exports being down. But quietly behind the scene, investment capital from Europe continued to make its way into the U.S. economy.

Perhaps it was jealousy that made government feel like it was missing out on the action. After inventing the inheritance taxes, government constantly sought new ideas for innovative taxation. The Census Bureau released its calculations for real estate taxes collected during 1925 in 247 cities. The valuations for tax purposes came up to $63.5 billion. New York was valued at $12.9 billion, Philadelphia $3.9, Chicago $1.8, Boston $1.8 and Los Angles $1.3 bil-

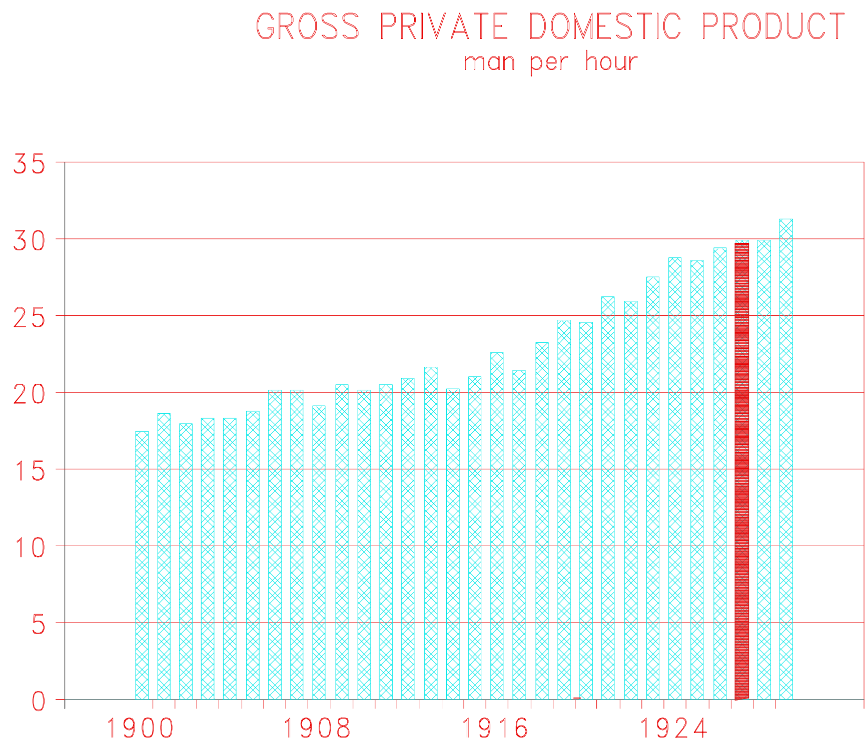


lion. The taxes levied were $2.5 billion and the national deficit on the local level was $400 million. Only 44 cities out of 247 had collected enough in taxes to meet obligations. Many local governments continued to waste money and raised necessary funds through new bond issues. Many of these issues would go into default once the Great Depression hit. The City of Detroit's bond issue would be one example of a default which was not redeemed until 1963.

Meanwhile, trading was steady and May finished on the high of the month. Another seat traded in late May, this time fetching $215,000; the next day another bought $217.000. The seats themselves were moving up even faster than the stock market.

The famous Virgil Jordan, chief economist of the National Industrial Council at the time, delivered a very profound speech at the annual meeting in 1927. He stated: "The business forecaster who attempts to predict the business outlook for the rest of this year and for 1928 is up against it, if he relies upon most of the current and fashionable methods of prognosticating. For some reason the old medicine no longer works. There may be a slight further recession in business for a short time, but it is likely to end in a real business boom rather than in a genuine depression."

Virgil was a very intelligent man. He was smart enough to recognize that the so-called normal or traditional methods of economic analysis were not making any sense. This always seems to be the case whenever you really need some answers from the economic community. Going into early 1985, we found that the U.S. dollar moved contrary to trade deficits, expansion in the money supply, and it only had strength as interest rates declined from their highs of 1981. Similarly, back in the 20s the normal economic theories were leading to much confusion. Traditionally, as we read earlier, many believed the declining interest rates illustrated a lack of demand for money and was therefore an indicator of depression. The stock market



was moving higher, yet there was no sign of tight money. This was very confusing to everyone, especially those who had constantly called for a depression on every down tick in the stock market. What they didn't realize was that the United States had not merely become a creditor nation with a huge trade surplus and half the world's gold reserves, it had become a nation of safety and security; a place where capital could reside without fear of governmental devaluations occurring overnight.

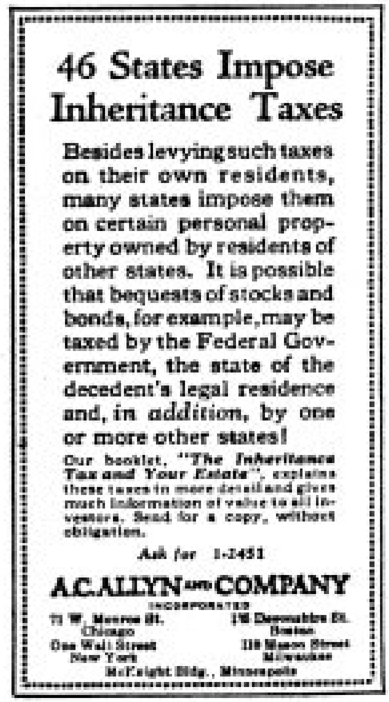
This wave, in our analytical terminology, was a wave of "private confidence." Money flowed from overseas into the U.S. stock market largely because it was a safe haven from declining or unstable currencies in Europe where an atmosphere of distrust existed toward government itself. Money rates remained cheap because of the influx of foreign capital as well as the trade surplus, which had peaked but was declining since 1925.

A few mixed signals began to develop during 1927. The stock market was rising along with corporate earnings, but government was passing hordes of laws in areas where they should never have been involved. Taxation was rising. The income tax, which had been instituted to pay for World War I, had never been repealed as was originally intended. In the movie industry. wage cuts were taking place. During June, Paramount cut wages by 10%. Others eventually followed suit in some manner or another. This was the beginning of a very subtle trend that eventually provided the hidden cause behind what would later become known as the Great Depression.

The government was slowly trying to cash in on the profits of industry but instead of being satisfied with a proportional increase, it chose to increase its share. The State of New York took the position that "good will" of a company was something for which another would be willing to pay in a takeover or merger. Therefore, it tried to tax corporations on such a basis. A small company was always the likely starting place since they had less money and obviously could not afford a long and costly court battle. The firm selected by New York was A. Breslauer, Inc., a dealer in human hair for the wig business. The owner wrote in a letter to the New York State Tax Commission: "The business has no good will of any value. The business conducted by the corporation is that of dealing in human hair goods. Since the fashion of bobbing hair came in, the business of dealing in hair has shrunk considerably and has destroyed the good will which any business of this nature may have had in prior years."

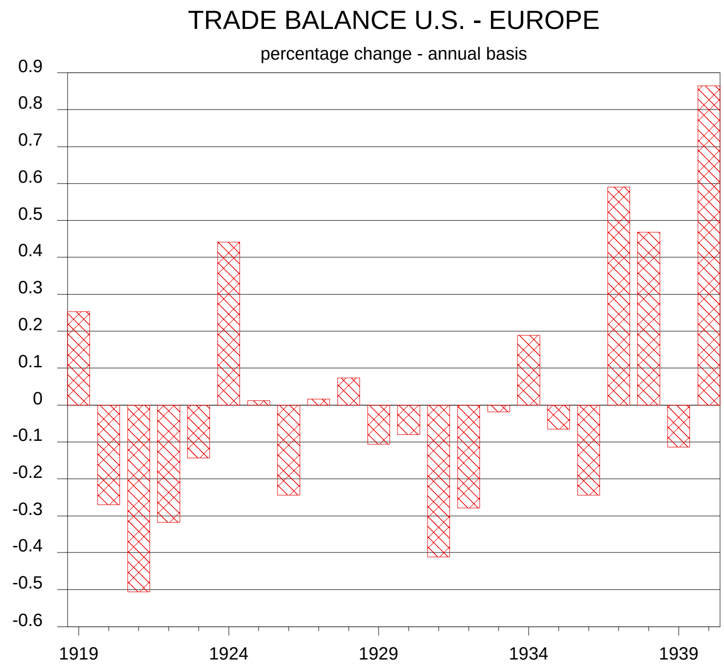
The actions of the State of New York to tax not only on current earnings, but on the future ability to make profits, is not unique. Every state as well as the Federal government has at one time or another attempted to collect taxes in an unethical manner, making a total mockery of the Constitution and the principles upon which the foundation of the United States was established. Much of the true blame for the Great Depression is due to governments' usurpation of power which undermined the structure of the economy.

Taxation has always been merely a form of official extortion. Good government does not tax its people unnecessarily nor does it conspire against its citizens on mere technicalities. Adam Smith warned that increased taxation would lead to higher inflation because it increases the cost of labour which is the largest part of the expenses for business. Thomas Jefferson also stated: "A wise and frugal government, which shall restrain men from injuring one another, which shall leave them otherwise free to regulate their own pursuits of Industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good govern-



ment, and this is necessary to close the circle of our felicities." At that same annual meeting of the National Industrial Council, a cry against this trend in government came from the Secretary, M.J. Hickey. He stated: "If our leaders of government and the people of the United States really care about the liberties for which our forefathers fought, bled and died; if they want a general restoration of our institutions of law and orderly social progress, they must promptly unite in halting the present ceaseless and unnecessary making of laws by Congress and the State Legislatures."

Nevertheless, there were some underlying signs that warned the economy was weakening in some sectors. The wage cuts and rate of unemployment were still rising in many industries. State and local bond issues continued to flood the market at an ever increasing rate. They were joined by numerous foreign government bond issues. The amount of debt on these two levels



overshadowed the Federal Government's position, which was relatively flush with cash in comparison.

On our economic models, the major top came in during October 1929. But during this wave, confidence was focused upon the private sector and trust or confidence in government was seriously declining worldwide. During 1927, we found more and more commentary of a derogatory nature toward the growing bureaucracy and this prompted the focus upon private investment. Despite the lack of speculative participation during 1927, as we pointed out in the years before, broad buying by the public had become widespread during prior years.

The import-export figures at the end of June had been favourable. This provided one of the fundamentals that started the market rallying during July. The figures illustrated a favourable trade surplus for this fiscal year ending June 30. However, the trade surplus had reached its peak during 1925 and declined steadily. Exports had peaked in 1925 while imports from Europe continued to increase, reaching their peak during 1929.

The market had paused briefly during June, but in July the market soared once again to new highs and closed on the high at the end of the month. The market continued higher into August amid headlines that seemed to have merely a different date rather than events. The Brits expelled a bunch of Russians for spying and, of course, the Russians sent the Brits packing from Moscow. Advertising was growing tremendously. There were newspapers and magazines in which you could find tons of ads for buying bonds all claiming the "safe" investment. But industry was also advertising heavily, which kept the names of the companies before the people, and this in turn helped to fuel the market by giving it a sense of success. Lucky Strikes were being promoted at the annual cost of $3.3 million in advertising. Chevrolet was spending $4.1 million annually, Dodge $3 million and Listerine $3.4 million.

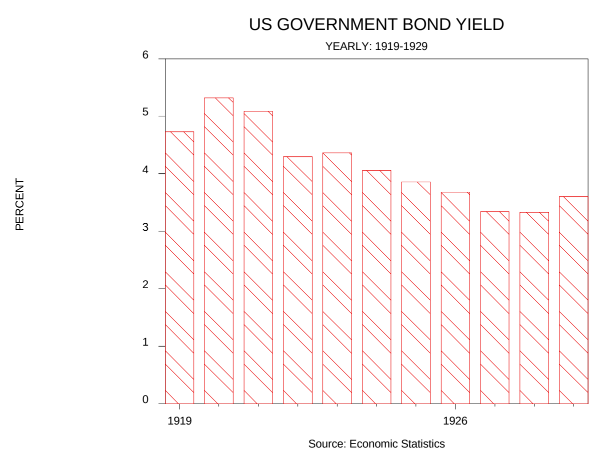
As September came rolling around, the Dow Industrials soared once again, this time nearly reaching the 200 level. The papers were filled with the raging war between America's Standard oil and Britain's Royal Dutch-Shell. The one curious power play the Russians did use against Britain for bouncing their spies out of England was the contract for Russian oil. The contract negotiation between Royal Dutch-Shell and Russia was lengthy. But the spy incident upset the Russian pride, as always, and the contract, worth hundreds of millions, was awarded to Standard oil, a decision intended to be a slap in the face to Britain. The controversy continued for several months as Britain claimed that it was unethical to buy Soviet oil. The U.S. asked that if it was unethical to buy oil from Russia, then should it not be unethical to also sell any goods to Russia as the British were doing in many other commodities.

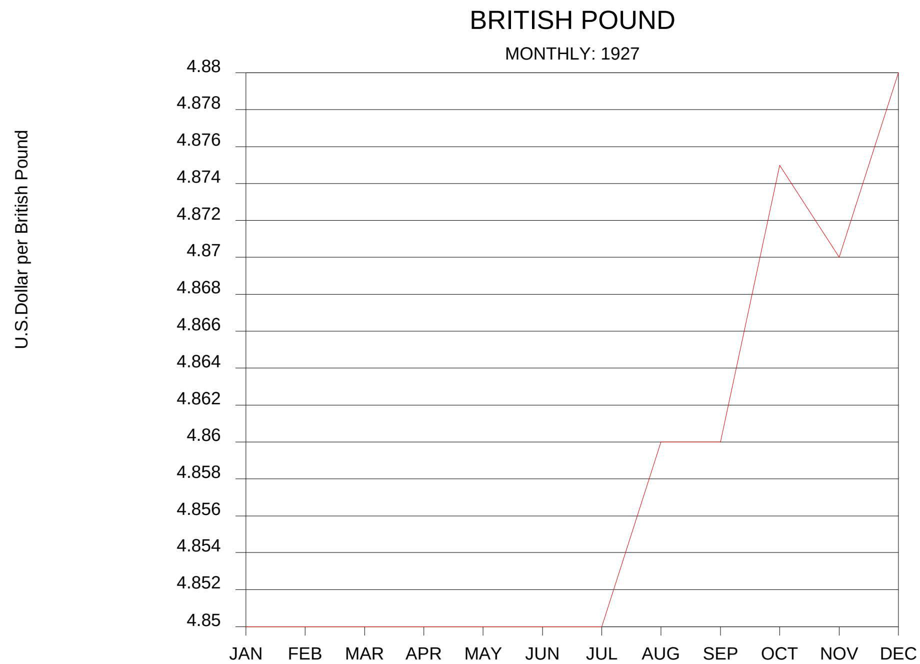
In the midst of all this, commodities were not exactly making new highs. Many farmers were suffering from low prices. In August, the Kansas City Federal Reserve Bank lowered its discount rate from 4% to 3.5%. This left the remaining 11 Federal Reserve branches all fixed at 4%. But within two weeks thereafter, the Federal Reserve Banks of New York, Boston and St Louis also reduced their discount rates from 4% to 3.5%. The real reason behind the discount rate cuts started a furious controversy in itself.

The Journal of Commerce reported that the discount rate cuts were due to what we would now call a G-4 meeting. The Governor of the N.Y. Fed, Benjamin Strong, met in Washington with the Federal Reserve Board and with Governor Norman of the Bank of England, Deputy Governor Rist of the Bank of France, and Dr.Hijalmar Schact, the head of the German Reichsbank.

The Journal of Commerce charged: "The little New York group that dominates the Federal Reserve System came to Chicago and tried to induce the directors to cut the (discount) rate and afford pretext to New York. The request was flatly and somewhat indignantly refused. Kansas City on the other hand consented and started the ball rolling. Europe and particularly England wants, and no doubt needs, a very low money market in this country so that American bank funds in large totals may be attracted to England; and to that end our discount rates are to be reduced, and probably Federal Reserve securities are to be sold, and easy credit is to be manufactured. What Europe wants, and what the present Federal Reserve manipulations are intended to provide, is an artificial expansion in our business, an increase instead of a decline in commodity prices; so that Europe may get more money for the goods she sells to us and so that we may sell so cheaply to our foreign customers in competition with Europe."

The Wall Street Journal also reported: "American banks are finding it profitable to





place surplus funds in London, owing to higher level of money rates there, and such transfers of dollars into sterling have been a leading cause of firmness in the sterling rate this week. Some American funds are also being placed in Germany to take advantage of higher rates prevailing in Berlin."

The central bank conspiracy which Adolf Miller uncovered back in 1925, had not disappeared. It had only adopted a lower profile until a credit crisis in Europe was becoming intolerable. There is no doubt that much of the cause for the Great Depression can be traced directly to the escalating taxation and the actions of the Federal Reserve Board in favour of Europe. Europe was an economic basket case and the huge amounts of foreign bond issues floating on the New York Stock Exchange will attest to that statement. Despite the fact that billions of dollars had already been lent overseas to try to rebuild Europe, there was little improvement. Strikes in Britain were continuous throughout the years, robbing that nation of valuable productive resources. The people were striking for themselves and took little consideration of the fact that the war debts and the rebuilding of Europe required a concerted effort.

The U.S. stock market rallied into September and the industrials nearly reached 200 on sound economic principles in the U.S. as far as corporate earnings were concerned. But the controversy over the "G-4 meeting" and the subsequent drop in the discount rate did not die so easily.

During the week of September 12, the Federal Reserve Board met in Washington and fixed the discount rate for all reserve banks at 3.5%. The controversy came at that time with the Federal Reserve Board overruling the Chicago, Minneapolis, Philadelphia and San Francisco reserve banks, which were opposed to the lower rate in favor of European economic stimulation.

At the time of the discussions that brought about the Federal Reserve Act of 1913, there were essentially two arguments concerning who would have the power to set the discount rates. William Jennings Bryan argued that the power should be centralized with the Federal Reserve Board in Washington and others argued that each reserve bank should have the right to establish its own rate according to local conditions. The eventual compromise was that the reserve banks would submit to the Board for approval any proposed rate changes. Thus, this action was a political power play at that time which was not looked upon favourably by the press.

Money, which might have found its way to Europe, was instead flowing to the reserve districts which had maintained the higher rate of 4%. Obviously this was counter productive to the goals of the 1927 G-4 meeting. The dollar had been super strong attracting European investors in the stock market for many years, largely due to the poor economic conditions and the instability in economic policy which had prevailed throughout Europe. So once again, Europe cried unfair and requested the U.S. to lower its interest rates so that they would attract the capital needed to pay their debts. In turn, this measure sought to lower the value of the dollar and support the European currencies on the foreign exchange markets, a tactic which was repeated in late 1985.

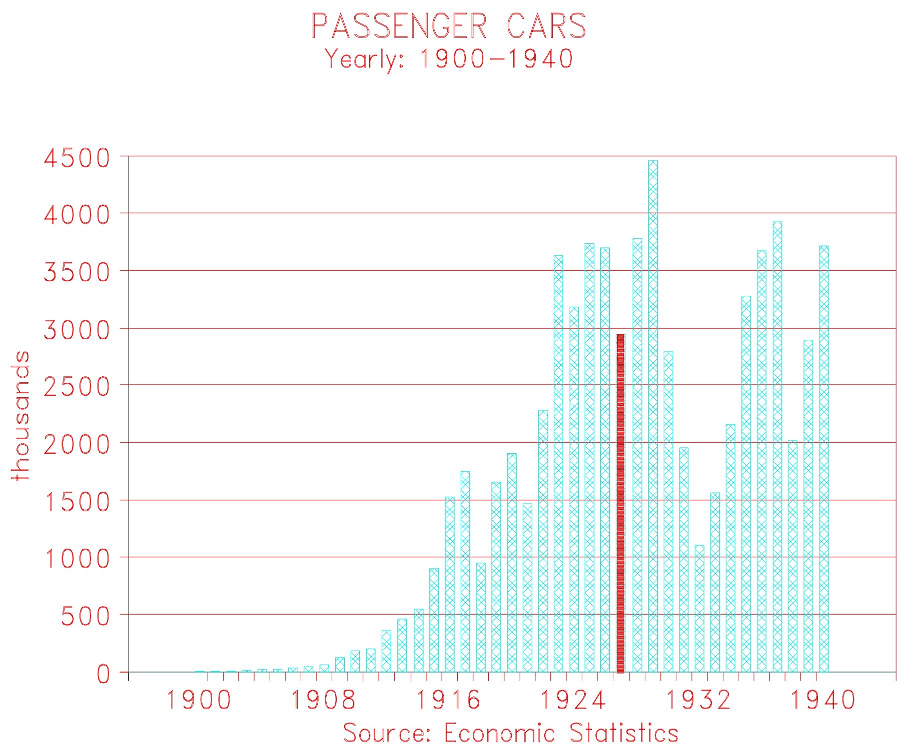
The chairman or Governor of the Federal Reserve Board in Washington was Daniel Richard Crissinger. His response to the press's allegations of what was really taking place was short and brief: "The Federal Reserve Board established the rate of 3.5% for sound reasons. That is all there is to it." The Chicago Journal of Commerce wrote: "It would be much easier than Eastern bankers know to make a political issue of the Federal Reserve System but difficult would be the defense of it if an issue were made."

One week later, Daniel Richard Crissinger, Governor of the Federal Reserve Board, tendered his resignation. He denied that the dispute had anything to do with his resignation, as all such political resignations traditionally do. The point of the matter was that he had forced the remaining member banks to lower their rates when there was no real legal grounds for doing so. Money remained substantially abundant and there was no need to lower the rate just when the Dow industrials were close to reaching 200 for the first time in history.

At the height of the stock market fury, new record levels were also attained for the seats. In September, a seat was traded at $230,000 which was now nearly double that of 1925. Even the Curb Exchange seats traded at $32,000.

October opened on a high note just as the Radio Fair at Madison Square Garden was jammed with 300 exhibits. General Electric exhibited the "photo-electric cell," which generated power through obtaining energy from sunlight. Just as innovative displays were everywhere, the market tumbled by 10% in a sharp drop of 20 points, nearly finishing October on the lows for the month.

From overseas bad news hit. In Japan a serious banking failure had taken place in the spring. Small banks were in trouble and the trouble only became worse. The public panicked and began withdrawing funds from the small banks and transferring them to the larger banks. Japan had 1300 banks but it appeared as though scarcely more than 200 would survive. These events later proved to be positive to some extent. The



larger banks ended up with large cash surpluses which aided the reconstruction efforts still going on due to the devastating earthquakes of years before and the generally poor economic conditions which prevailed.

In the U.S., automobile sales were up for some but down below 1926 levels for the industry as a whole. As business slackened off to some degree and the assembly line continued to improve production, the industry employed 40,000 less than the year before. The trend began to shift away from economy cars, such as the reasonably priced Model A and Model T lines for which Ford was known, and the touring car gained popularity. This boosted sales for G.M. and a battle between Ford and G.M. began to get a lot of press.

Ford's production for the first six months of 1927 was only 332,384 while G.M.'s production was 586,444. The shift can be noted easily by reviewing the sales records of Chevrolet and Ford. In 1924, Ford's sales were 2,083,545 and Chevrolet's 587,341 but by 1926 Ford's sales were 1,810,000 while Chevrolet's reached 1,234,850. During the first six months of 1927 it was shocking to see that Ford had fallen so far behind. But the trend was clear. Sales of the cheap cars were declining and sales of expensive cars were rising. Unemployment among the working class was beginning to rise. G.M. was on the mark with catering toward the touring car market rather than the lower-priced end of the line where money was becoming tight.

The credit for the October panic does not go solely to the subtly rising unemployment or merely to the banking crisis in Japan. Unemployment figures were not published because they were not gathered from any one source. But the true credit belongs in part to the controversy over the discount rate cut. Surprising as it might sound, the market didn't like the cut. It was viewed as potentially dangerous and certainly potentially inflationary.

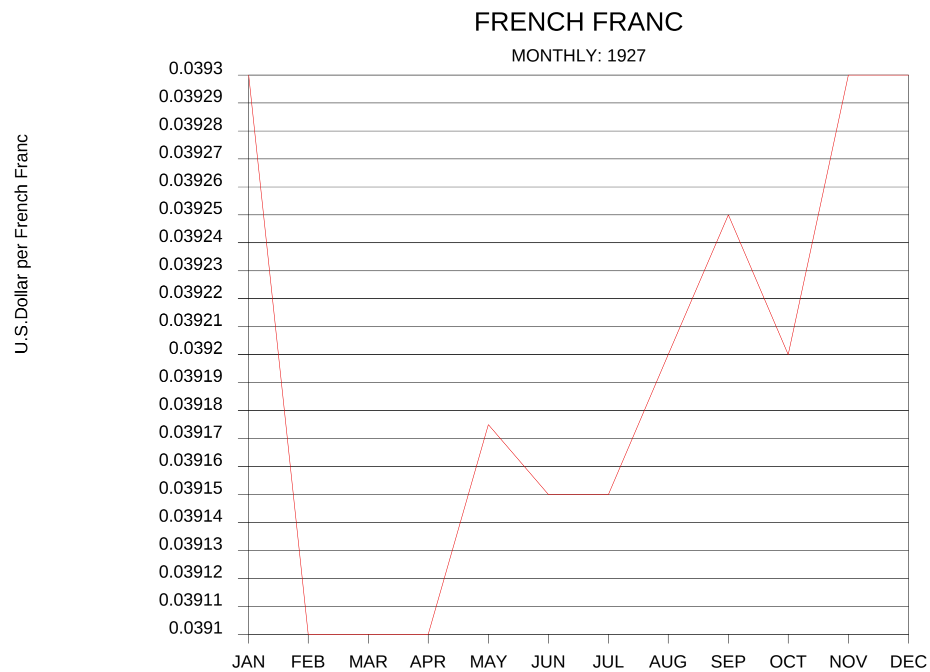
When the press turned its attention to the outstanding foreign loans, the market became nervous indeed. After all. there were 255 foreign bond issues on the New York Stock Exchange floating around with a value of $4,650,000,000. And in addition, the exchange had just approved foreign stock issues for listing on the New York Stock Exchange that month. News began to leak about the U.S. banks, which had lent $1.3 billion to foreign borrowers for the period of January to October. This was more than the entire year of 1926 and then some. Obviously, the immense demand for money from overseas was becoming unbelievable and for this the Fed lowered the rate on top of it. This brought estimates from Washington stating that outstanding foreign loans by U.S. banks would reach $12.5 billion by year end.

Where was all this money going? Germany had been advanced $262 million, which was more than half of the $508 million which flowed to Europe as a whole. Canada received $286 million, Latin America $375 million and in the Far East $122 million was loaned.

In November, Time magazine quoted Dr. Charles Herty: "Struggling to assert industrial supremacy, Europe, led by Germany, is challenging U.S. trade in world markets by the establishment of huge cartels for control of production and fixation of prices. Recent affiliations of foreign chemical and steel interests are belligerent gestures." He continued to state: "This is a foreign menace to U.S. peace and prosperity...Are our bankers simply middlemen or brokers whose only thought is the commission they want? It is reported throughout the European press that German cartel, the interessen Gemeinschaft Farbenindustrie, has, through exchange of stock, merged with the Norwegian Hydro-Electric Co. and that the latter is contemplating a great expansion of its operations for fixation of nitrogen through a loan of $20 million which it expects to get through one of the great American Banking organizations. Is it right that the savings of our people should be directed by this institution to the support of a European monopoly which will seek the destruction of the American nitrogen fixation industry, now so rapidly developing in this country?"

Many blame to this day the Smoot-Hawley protectionism act as a major cause of the depression. Yet, was it the protectionism that caused such a blow or the U.S. government's own exercise of power that prevented U.S. industry from reaching the size of European monopolies? Time magazine reported on Washington's opinions in reference to Dr. Herty's major doctrine regarding Europe's vigorous industrial attitude. "They demur at his denunciation of foreign loans. They would fight back by Europe's methods. U.S. business cannot now. They are blocked by the Sherman Anti-Trust law which forbids amalgamations likely to stifle competition. So they argued repeal the Sherman Anti-Trust law, or at least amend it to permit unification of U.S. industry to strike as a unit against similarly organized European blocs." Time magazine reported that the Administration's attitude was "sympathetic" but "no tampering with the Sherman law will be tolerated."

Had the U.S. listened to Dr. Herty closely, perhaps the protectionism would have been avoided. The administration loved the power to haul in a big company and force it to give up its charter thus breaking down the power of the private sector. This had been done with a vengeance all in the name of the people. Yet while Europe borrowed



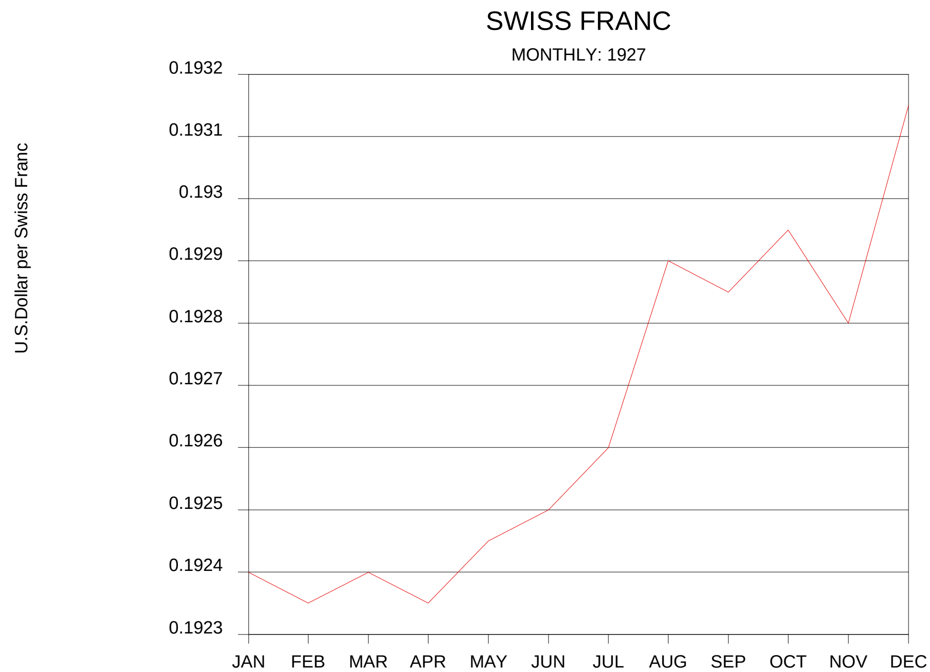
from the U.S. in ever increasing amounts to form monopolies and then fix the prices, for which any American firm would have been thrown into jail, the trade war could only be expected to become worse in the years ahead. Once again, government's lack of foresight and refusal to relinquish power once seized was a primary cause for the depression which was now only two years away.

In October, the head of the top European chemical producers met in Paris. Attending were leaders from German, French, British and Belgian industries. They reached an accord consolidating their companies to form what some would later call the "Billion Dollar Chemical Cartel." The total U.S. exports of chemicals during 1926 were $171 million. This new cartel was boasting as their goal an estimated $500 million in projected exports, largely to the U.S.

The President of the Chemical Foundation in New York, Francis P. Garvan, made a statement in response to this cartel: "Is there an American with soul so dead as not to thrill at this threat? What was our position in 1914? That position can come again and will come again unless all American people unite against this combine threatening their peace and their prosperity. Don't make the mistake of thinking this is a dye fight, or a nitrate fight, or a rayon fight or a fight for European or Asiatic markets. No, it is a fight to reassert European, in reality German supremacy in chemistry and chemical progress and that means German military supremacy. America will never join such a combine."

Ironically, the very laws which were enacted under the pretense of protecting the free enterprise system, in combination with the ever increasing taxation, and the willingness to lend money overseas undermined the U.S. industry, increased unemployment and reduced intentionally the U.S. surplus in trade.

Nevertheless, it was during the fall of 1927 when the issue of foreign loans began to catch the eye of the media. The U.S. government had passed another law forbidding

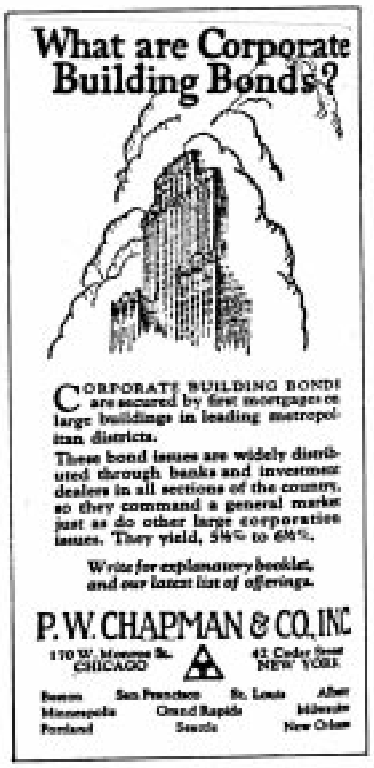


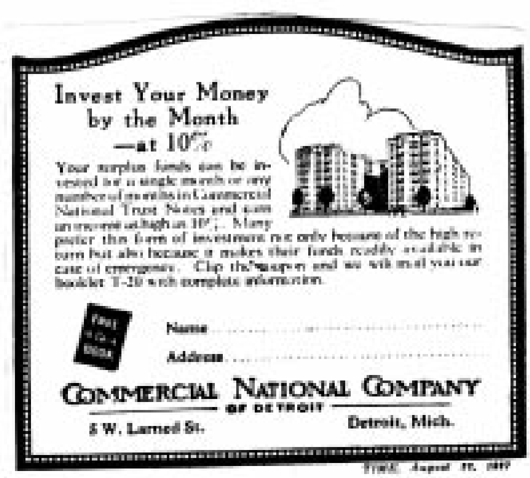
any foreign nation from selling their bonds in the U.S. unless they had reached an agreement with the U.S. government to repay any official loans outstanding from the War.

International borrowings were becoming substantial on the part of Europe. France, for example, had $70 million in outstanding bonds which had been sold in the United States. With the Fed lowering the discount rate, France sought to retire its bonds, which were paying an 8% rate but experiencing some problems over the restriction of loans due to the U.S. government. They cleverly entered into a deal with the Swedish Match Co. which bought $75 million in French bonds paying 5%. The complexity of the deal is illustrative of how foreign loans were being handled to get around U.S. laws.

The Swedish Match Co. was the largest producer in the world with net assets of $162,934,000. France gave the company access to market its products in France, which had previously been controlled by a French monopoly. Then the Swedish Match Co. owned the International Match Co., which was a U.S. corporation, and the U.S. division in turn issued $50 million of its own debentures and marketed them at 5% to U.S. citizens. This clever maneuver avoided any possible problems the French may have had with the U.S. officials.

It was also during late October when the American Banker's Association met in Houston, Texas. Senator Caraway of Arkansas addressed the assembly charging the bankers with the defeat of the farm relief bill in the House. The bankers denied it and then refused Senator Caraway permission to address the assembly any further. In the midst of this turmoil, other charges also asserted that the bankers were favouring foreign lending and neglecting domestic industries that needed help right here at home. The scheduled discussion on foreign loans was canceled from the roster on the excuse that Senator Carter Glass of Virginia was unable to attend due to personal family illness. The convention broke up, agreeing to meet in Philadelphia in 1928.



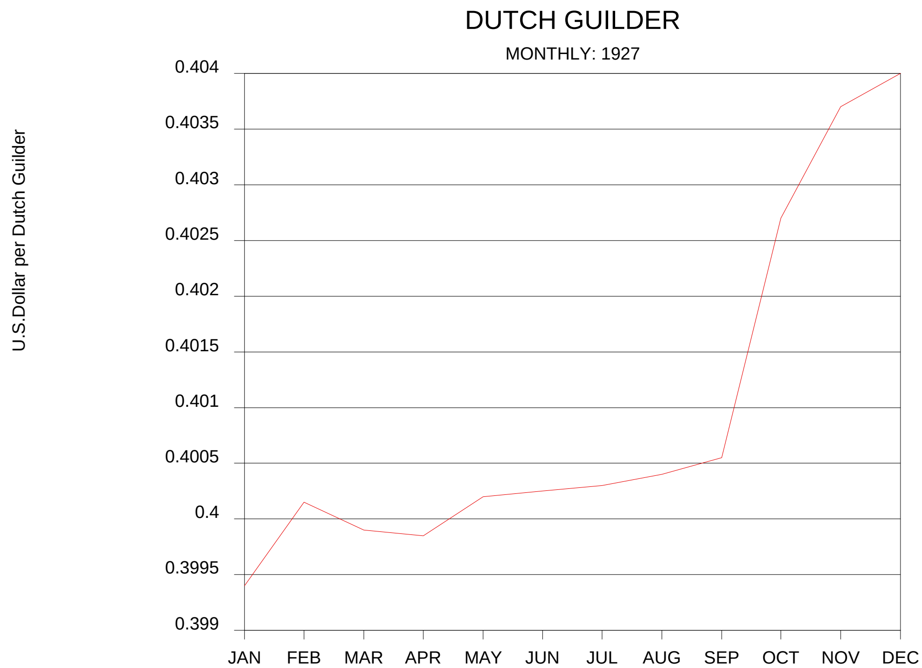


There can be no doubt that the banks were willing lenders to foreign nations as well as private companies. The primary reason was that foreign loans traditionally paid a minimum of 2% over that of domestic U.S. loans. Thus, the Central Bank intervention sought to lower the dollar and strengthen the European currencies. This in turn would make repayment of U.S. loans by a foreign nation easier than if the dollar had continued to rise.

Meanwhile, the stock market continued to be very choppy. October made a new high but it also corrected quite sharply by 10% after the discount rate cut. This was largely viewed as potentially inflationary although, oddly enough, we look at this in the opposite direction today. The bonds continued higher as people scrambled to lock in higher yields in the face of declining rates. The railroads abruptly fell from 145 to 133.5 during October as well. The general tone was one of despair blaming short interest but the "depression" was also blamed in many economic sectors, particularly the farming industry.

November saw the markets recover while the industrials actually achieved the highest monthly closing, yet they failed to exceed the October high. The railroads were not as fortunate. The bonds continued to soar and exceeded 99. The rally was largely due to the quick buck theory. The October collapse had been so sudden and so profitable for the short interests, that short-covering came in rather quickly as the market rallied back for month end.

December found the bonds rallying once again, coming close to 99.5 and finishing 1927 on the high for the entire year. The railroads rallied above the November high but failed to exceed the October high or even close above the November closing price. The industrials, however, managed to continue higher and at last broke above the 200 mark, closing the year on the high point.



The U.S. economy was still strong although foreign loans were subtly beginning to affect the soundness of the underlying economic conditions. Call money rates declined to 3.5% and the New York Times reported that although rates were exceptionally low, money was simply not finding its way into the stock market. It seems almost ironic that the Dow was at all time record highs yet speculative interest was just not there in droves. The New York Times reported that money was moving into bonds.

Yet there was some contradictory information, which was perhaps one reason why the stock market in the United States would continue higher into 1929. The Department of Commerce issued a report prior to year end revealing for the first time some interesting statistics. For 1924, the total U.S. income was estimated to be $79 billion which worked out to be $685 per person. This was compared to other nations which clearly illustrated the supremacy of the U.S. position. Great Britain's income was $430 per person, France $225, Germany $210, Canada $270, Italy $105 and Japan $45.

The foreign loans resulted in a mass exodus of gold reserves from the U.S. during the fourth quarter of 1927. More bond issues were beginning to flood the market. Poland, through Bankers Trust Co., made an offering of $47 million paying 7%. Brazil offered $41 million paying 6.5%, but simultaneously sold an additional issue amounting to a combined total of $85 million, which was the largest single offering at any one time on record. The Central Bank of Germany offered $45 million at 6% priced between 95.5 and 96.5. The Commerz und Privat Bank of Hamburg and Berlin offered $20 million at 6%. The Free State of Prussia offered $30 million paying 6%.

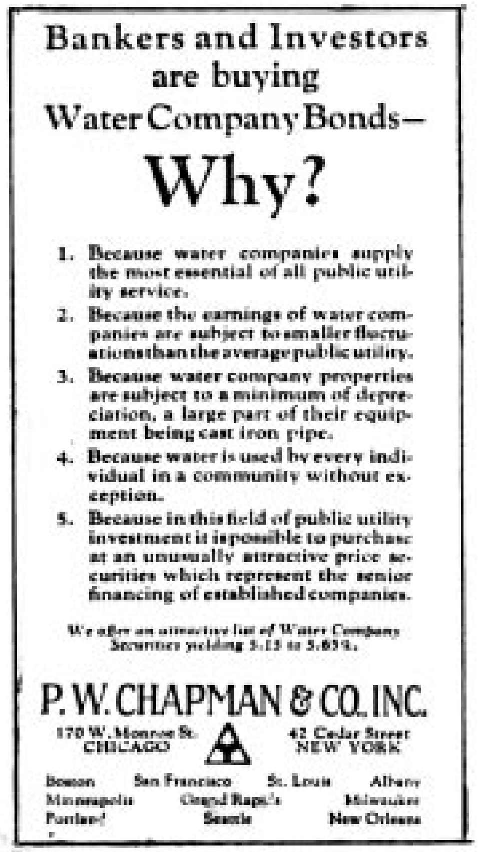
There were numerous other foreign offerings from Berlin, Hanover, Saxony, Prussia, Baden, Munich, Bresiau, Frankfurt, Hamburg, Chemnitz, Lepzig, Mannheim, Essen, Dusseldorf and Hagen, many of which would never be repaid.

Columbia offered $5 million at 6%, City of Bucharest $10 million, Hungarian Mortgage Land Bank $8 million and $5 million with the Deutsche Bank. The total amount was staggering. But once again, politicians did not respond to a major problem until it had become a crisis.

The commentary offered by Time magazine concerning the sharp October drop of 10$ in the stock market adds a little flavour to the atmosphere at that time. As published by Time magazine on October 31, 1927:

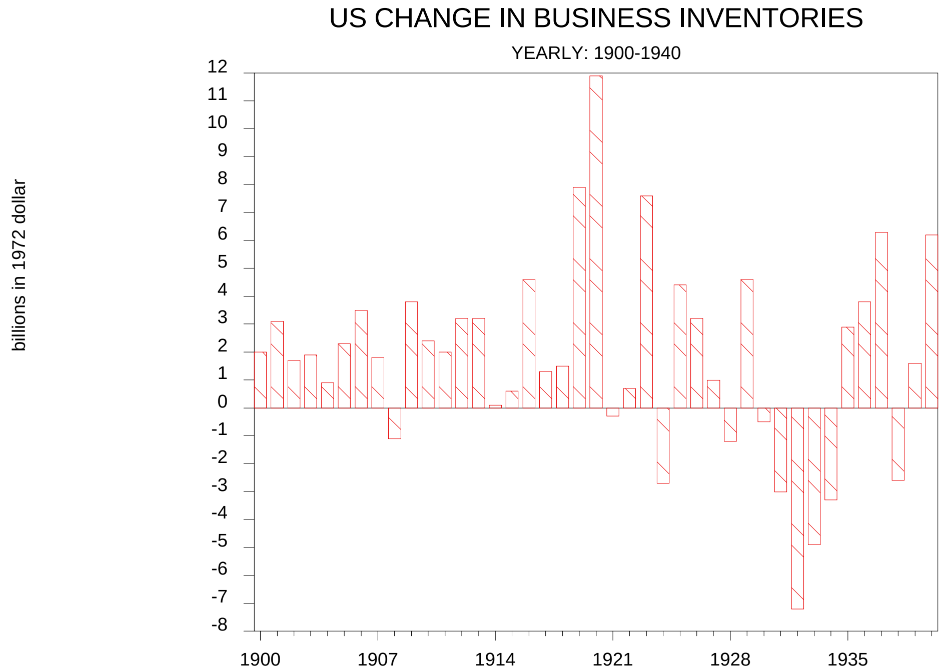
"The stock market last weak registered one of the most exciting periods in its history. Prices of time-tried shares, long leaders in what has become known as the Coolidge market were slashed unmercifully by the short interests, marking a decline on the exchange that reflected the country wide depression now being experienced in almost every avenue of trade. U.S. Steel common, General Motors, General Electric and N.Y. Central shares known as financial bellwethers and representative of industrial railway and utility activity, were unable to offer their usual resistance to the present economic disquiet and concluded at prices considerably lower than they have notched for months. The condition in the stock market in relation to money available for borrowing constituted almost a paradox in last week's trading. This 'money' represents funds that banks are willing to lend authoritative brokers in financing their transactions. There was a great deal of it available last week and the interest rate fell at one time to as low as 3.5% for this class of borrowing which is known as call money or short-term loans."

The dollar continued to decline against the foreign currencies but reached its low during early 1928. Time commented on this as well: "This to economists was a



healthy sign regarding world conditions. It means that gold will be shipped from the U.S. to other nations if their money goes above par." This attitude was based upon imports costing less because it would be cheaper to pay in gold rather than to pay a premium for the currency. But in reality the dollar was declining because of the massive borrowings which were leaving the U.S. in favour of overseas. Even foreign corporations were borrowing in the States such as the bond offerings from Girocenrale ($20 million) and United Westphalian Electric Works ($15 million) which were only two more German bound loans.

The bond offerings were coming close to the $2.5 billion level during the fourth quarter. The last week in October alone saw $263 million in bond offerings during a single week. But even this was not a record, for that distinction belonged to the week of



Source: Economic Statistics

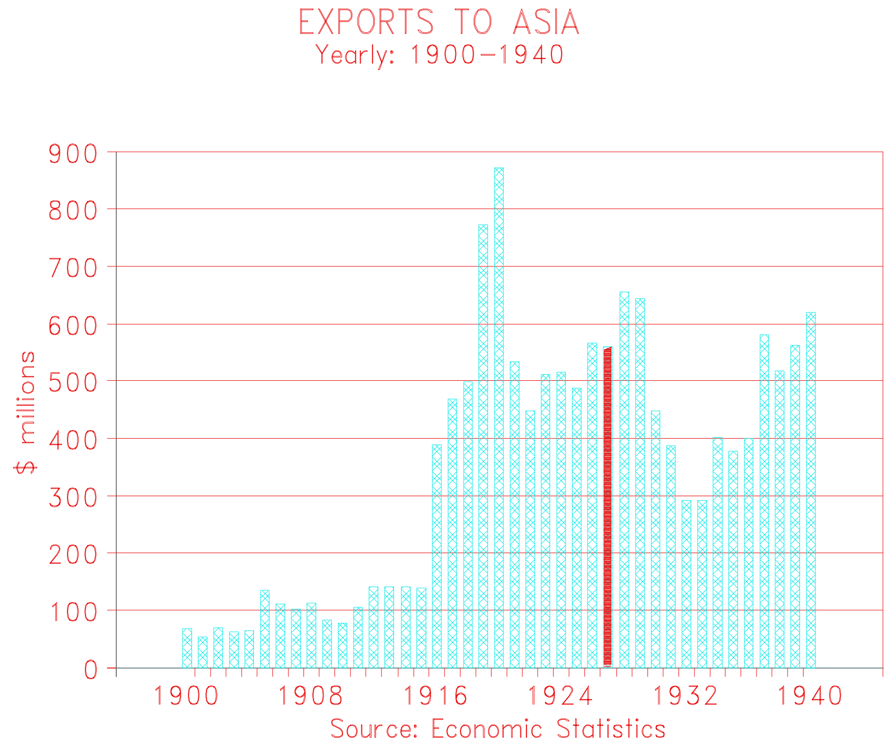
February 4 1927 which had totalled $303 million.

President Coolidge made an announcement at the end of October in which he stated that the "business and trade conditions of the U.S. were healthy and that business is better than it has ever been."

Wall Street was turning bearish at the year end. Analysts cited the 11% decline in railroad receipts and noted that freight car loadings were off by 4.5%. These factors turned everyone skeptical as to how far the market could move. Yet as we pointed out the markets basically consolidated during November and December with the industrials moving up during the later part of December. Despite this fact, lower interest rates were still a past indicator of depression because lower rates showed a lack of demand for money and subsequently less speculative interest in the stock market as well as industrial expansion.

Yet the conflicting economic indicators were almost everywhere, confusing many investors and, as usual, dividing them into two schools of thought: bullish and bearish. The retail sales were still buoyant. There were sixty-two chain stores selling everything from the 5 & 10 cent items to shoes and furniture. As of November 1, sales were reported to be collectively $943 million, which was $106.5 million above the same period for 1926. Industry activity was on the whole 14.45% greater than that reported for 1926. The famous Great Atlantic Pacific Tea Co., not commonly known today as A & P food stores, alone showed sales which exceeded $200 million. The stock was very closely held so quotes were rare and sales even rarer. Had the A & P sales been included, this would have boosted the chain store group beyond $1 billion.

During late November, following a lot of short covering that was based upon the favourable reports on national income and chain store sales. G.M. announced that it

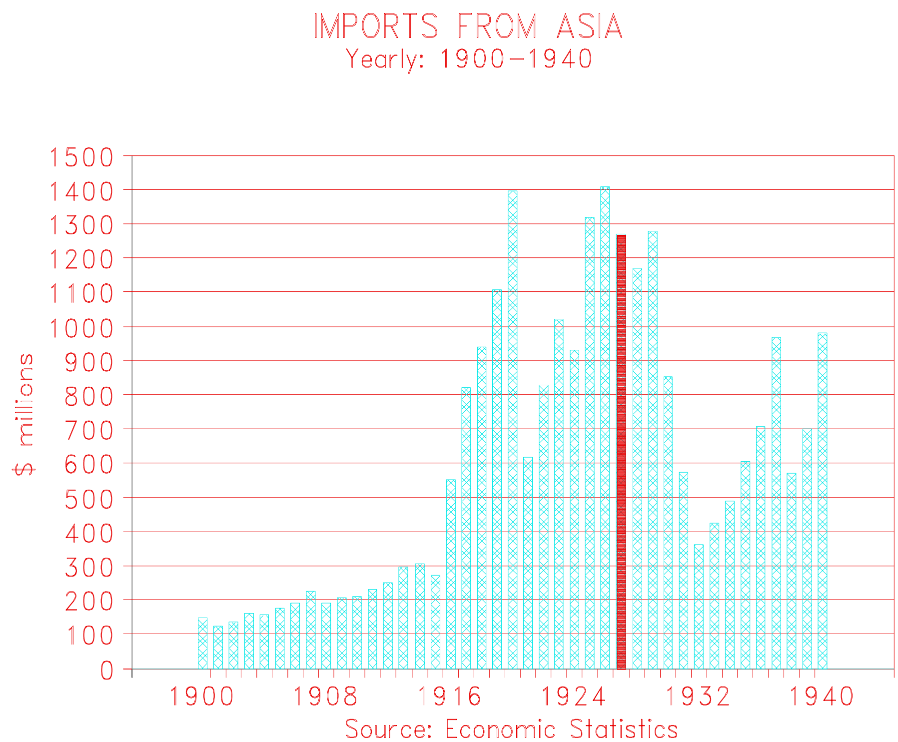


would pay a bonus dividend of $2.50 per share. This meant that on the outstanding 17.4 million shares G.M. was paying a record $62,250,000 in dividends. This set a record for the largest dividend ever paid at one time by any industrial company. G.M.'s earnings up to the end of the third quarter were $193,758,302. Yet, when one looks closely at the numbers, the auto industry was not necessarily expanding. Instead Ford's sales were declining in favour of G.M. and this prompted the bonus dividend.

The New York Stock Exchange had changed the rules to allow foreign stocks to be listed on the Big Board. Many speculated that Europeans would scramble to have their stocks listed. However, the exchange had imposed the rule that companies must pay dividends and such dividends had to be paid regularly. To the disappointment of many, by year end only one foreign stock had been listed. the Austrian Credit Anstaliz. Only one other application had even been received. The big boom that the brokerage industry had been fighting for had laid less than a golden egg. Many Europeans are selling their stock on their own exchanges and did not want to comply with the requirement to pay a regular dividend. This was another sign that Europe was interested in extracting rather than participating in the U.S. markets. A simple little subtle sign was again overlooked.

Mergers were continuing to fill the press from every sector of the business community. Banks were also scrambling to buy other banks. Chase National Bank bought Mutual Bank in Manhattan which became Chase's twenty-first branch in New York.

It was also during the fourth quarter of 1927 that a new Governor to the Federal Reserve Board was appointed. Roy Archibald Young announced that the Federal Reserve Board had decided that it would institute some reforms in foreign commerce financing. He proposed that the banker's acceptance on foreign trade should not be duplicated and that only one



acceptance should be issued for a single transaction. Normally one acceptance was issued to finance the shipment of goods to a foreign nation and a second was issued to finance the distribution of goods into the trade channels. Nearly $1 billion worth of such acceptances were in the U.S. markets and it was the Federal Reserve's decision that the second acceptance should be used to retire the first. Thereby the Fed imposed some additional constraints upon U.S. exports which would later serve as another official intervention to hampered U.S. overseas trade. The Federal Reserve Banks held less than a fourth of such acceptances. Of the outstanding $1 billion in financing required for U.S. exports the Fed's holdings combined through all branches averaged only $244 million at the end of 1927 and now it sought to make things a little more difficult once again for American business interests in favour of Europe.

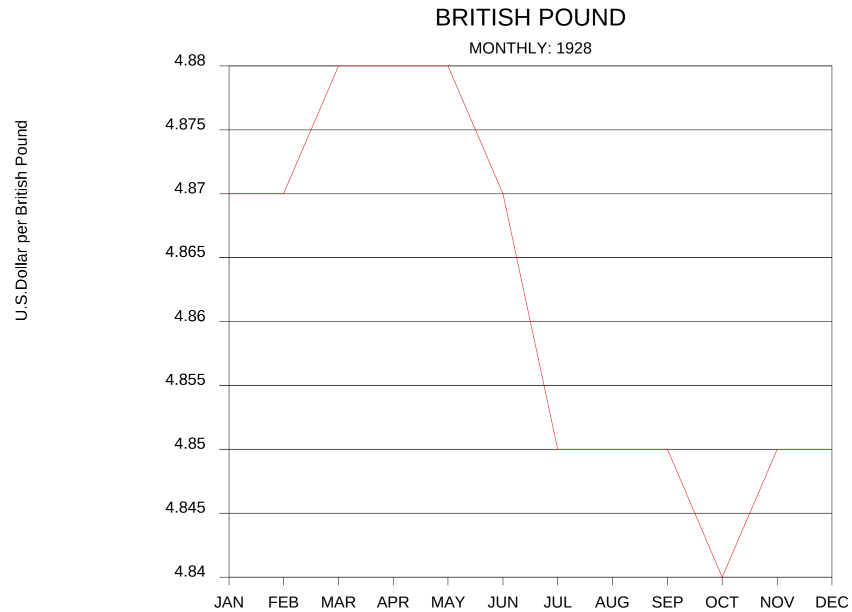
The Secretary of the Treasury's report for the fiscal year ending June 30, 1927 was released during the first week in December, and it illustrated this domestic problem. It showed that the value of crops had declined from $12.7 million to $12 million when compared to 1926. Foreign loans were up $1.8 billion over 1926. Exports were still rising through the first half of the year, gaining $4.9 billion compared to imports which were up $4.3 billion, illustrating a small gain of $600 million. However, U.S. exports on an adjusted basis had peaked during 1925, dropped 24% during 1926 and in 1927 posted merely a 1.6% gain over 1926.

In December, the dollar declined to such an extent that it was cheaper to pay for imports in gold rather than currency. The pound par value was $4.8665 and it closed the year at $4.8828. The Dutch guilder rallied to 40.45 cents, which was also above its par value of 40.20. In December alone, the first shipment in gold to the Dutch was $4 million.

Meanwhile the value of seats on the exchanges throughout the United States had continued to set records. Seats on the NYSE traded at $305,000, the N.Y. Curb

Exchange $65,000, Chicago $16,500, San Francisco $80,000; and in the commodities, a Chicago Board of Trade seat sold for $10,000.

The business sector had continued to expand throughout 1927 but primarily in the domestic retail sector. J.C.Penny opened its 500th store in 1927 and the two- millionth Eureka vacuum cleaner was sold. Lindbergh crossed the Atlantic, landed in Paris and was then welcomed home in the style of our first astronauts. Meanwhile the Holland Tunnel was opened in New York City. America had continued to prosper and its innovation was still the leading edge which brought the iron lung, transatlantic telephone service, the television and the photoelectric cell. Remington Rand was formed and Wonder Bread and homogenized milk were introduced, all during this eventful year, 1927.



The year 1928 began with a declining dollar and a rising bond market. Against the British pound, the dollar had declined by 2 cents between July 1927 and January 1928. The pound continued to press higher into March, reaching $4.88 which was now 2 cents above the gold standard par value and 3 cents above the July 1927 level. The vast majority of bond issues had been decisively of foreign origin. The dollar's decline was largely due to central bank intervention.

Many a story of shoeshine boys trading stocks is typical of the type of atmosphere we associate with the raging bull market of the 1920s. This is not, however, a fair representation of the years prior to 1928 and is at best an isolated exaggeration of the 1928 to 1929 period. As we have illustrated by pouring through the examples on month-by-month basis, the majority of press commentary was bearish on the stock market up until this point in time. Advertising campaigns had been plastered all over the place from billboards to newspapers promoting the bond market as the "safe" investment and stocks as the unsafe, "speculative" venture.

But a turning point had at last arrived. From 1928 onward, the bonds would collapse and the stock market would soar to record highs more than triple those achieved back in 1919. This dramatic event in itself is again something which would be inconceivable to the modern day analyst. Nonetheless, it was real and it stands as a definitive witness that bonds and stocks **DO NOT** always trade in the same direction. The causes would be even more perplexing and perhaps not fully understood until a similar situation eventually unfolds during 1986 to 1987.

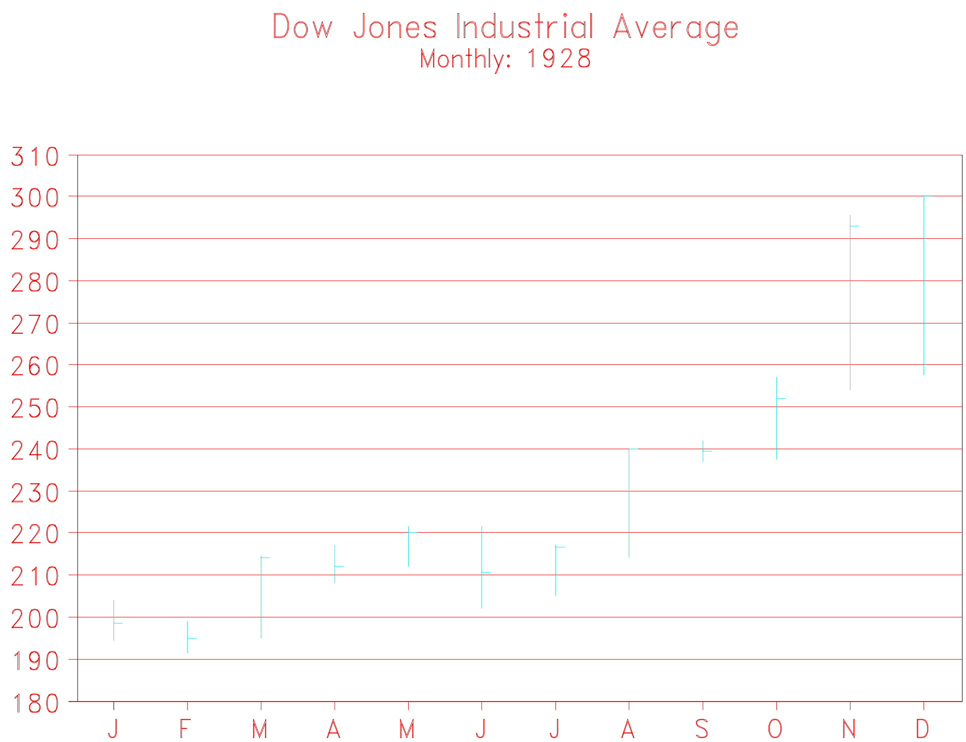
During January, the stock market pushed above the December 1927 high, but at the end of the month it finished below the 200 level. The bond market was unable to remain above the 1927 high and began to trade in a sideways pattern, yet still remained appreciably above 99. The railroads fell a bit lower closing January below 138.

Then in early February, alarmed at the cash outflow to overseas and the abrupt decline in the dollar, the various Federal Reserve branches began to raise the discount rate. No official explanation was offered by the Fed. Chicago and Richmond raised their rates from 3.5% to 4%. Suddenly, New York was forced to concede that their intervention and attempted manipulation of the dollar and interest rates had touched off a serious drain on U.S. reserves. San Francisco and Minneapolis also followed suit. in the February 13, 1928 edition of Time magazine, the commentary on the situation was as follows:

"One effect of the rate changes forecast by financial commentators was that stock market quotations would fall sharply because market operators would find money too expensive to borrow. That did not happen appreciably last week. Another prognostication was that banks would make greater efforts than in the past few months to lose money to commercial and industrial organizations. Nor did that develop noticeably last week."

Here we find that the fundamental analysts began to take on a form more commonly employed today. After the old fundamental that lower rates implied depression failed to work and the stock market rallied, those who had been bearish all along claimed that the market was going up because money was so cheap and that the big operators could afford to hold larger positions. Yet the claim that banks would in turn lend more directly into the industrial sector rather than for speculation, thereby stimulating the industrial expansion, had another side which could be interpreted as being bullish. If the future expectations of earnings would rise, this was also a positive reason why solid investors would be attracted to the market rather than purely leverage speculators who were more interest rate sensitive. It was clear that the fundamentalists were totally confused by the market, which was accurately pointed out by Time magazine. These are the very same type of analysts who have survived today, and we will see why when we reach the period of the famous crash.

Some people began to point to the few companies which were turning up losses for 1927 or at least a decline in earnings when compared to 1926. Dodge Brothers earned $14,830,475 in 1927 compared to $31,471,415 in 1926. Gabriel Snubbers turned in $960,330 for 1927 compared to $1,033,630 for 1926. The President promptly pointed out that sales were down 22% yet their earnings were off only 7%.



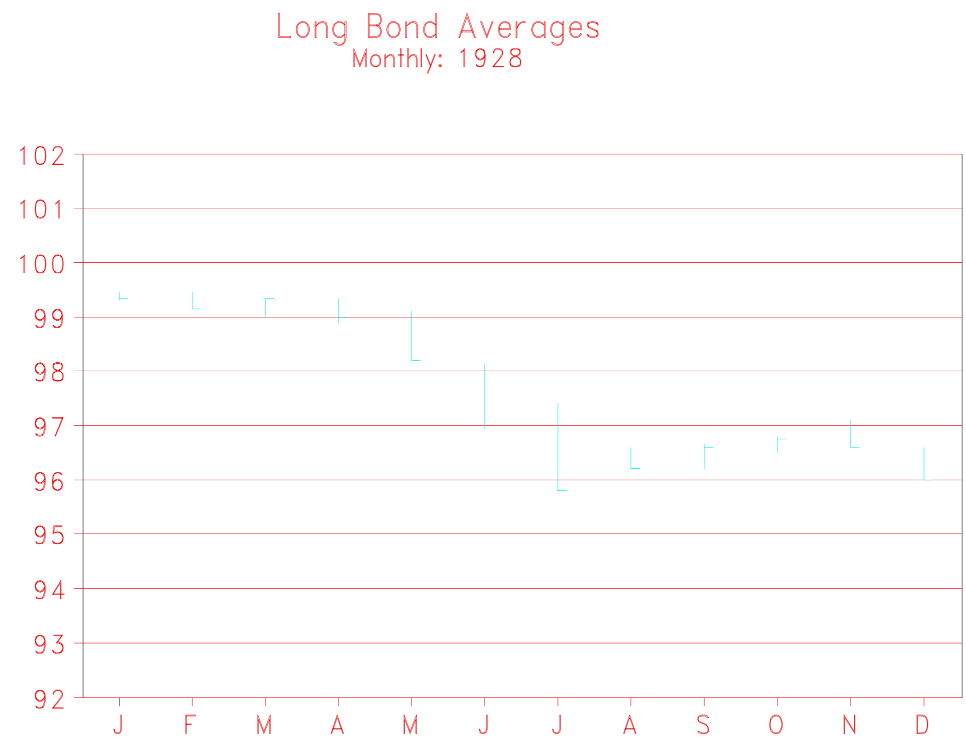
Continental Banking Corp. showed 1927 earnings of $5.5 million compared to $6.5 million for 1926. Even U.S. Steel turned in lower earnings for 1927 of $164 million compared to $199 million the previous year.

There were some definite losses due to foreign competition. Time magazine reported this little note about the textile industry: "New England has lost its monopoly of the textile industry, for factories have grown under favorable conditions in North Carolina, South Carolina and Virginia. Then too, the Yankee is perhaps less thrifty. Some of his sons and grandsons have preferred golf sticks to spindles. Others have sold the old factory to absentee owners in Manhattan."

There had been a slowly shifting process in various industries as the South began to take the lead in textiles. Foreign competition was also becoming a concern of many but, then again, concern over financial problems in France began to make many think twice about the huge offerings of foreign bonds.

The import/export figures for the United States clearly illustrated the trade surplus with Europe was still sharply lower from 1925 levels. The drastic 24.3% decline of 1926 was improved by 1.6% during 1927. The effects upon the U.S. industry were varied, showing the most serious affiliation upon textiles, chemicals and portions of raw industrial manufacture.

Toward the end of February, additional earnings reports for 1927 started to slowly come out. Coca-Cola reported sales of $8 million a day! Earnings were at record highs, reaching $19.4 million for 1927 compared to $18.4 million for 1926. Continental Can reported earnings for 1927 of $4.4 million compared to $3.7 for 1926. Canada Dry Ginger Ale, Inc. posted 1927 earnings of $2.3 million compared to only $1.7 the previous year. The consumer oriented companies were doing better, as well as the luxury industries including diamonds and furs.



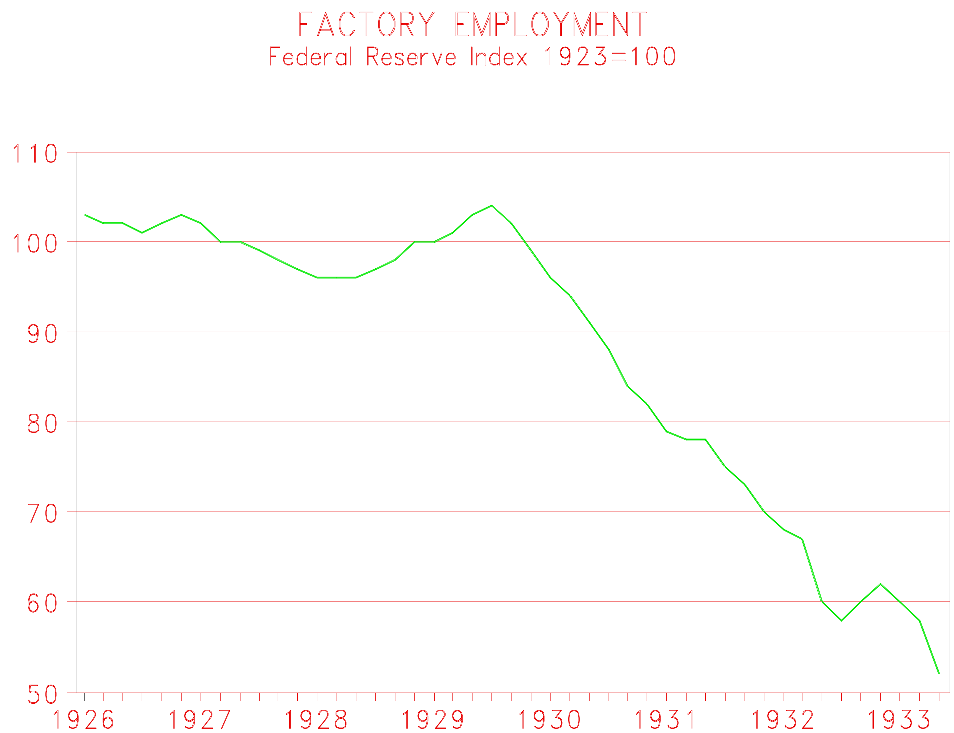
The foreign bond issues were not going away. The largest issue came again from Australia, which was estimated to be nearly $75 million. This would be the eleventh bond issue offered in the U.S. market at 5%, expecting to sell at 98.

The U.S. had lifted its ban on French Industrial bonds being offered in the U.S. In February 1928, a $10.75 million bond issue for the Paris-Orleans Railroad Co. was offered at 5.5%. Analysts had expected that the French would have to pay 6-6.5% to float a bond issue in the States. Therefore, the bankers threw everyone a curve ball by placing them out at 5.5%. This led to speculation that perhaps things were not so bad in France and that the bankers might know something that the rest of the world was still in the dark about. They also noted that this bond issue was replacement for a 7.6% issue which had been recalled. They suspected that perhaps other French bonds might be recalled and offered again at an even lower rate. The issue was bought up in less than two days. The total outstanding French bonds on the U.S. market had reached $500 million.

The dollar continued to decline into early March and, in fact, within weeks after the French bond issue, the dollar reached its lowest point after the central bank intervention. The speculation that rates might continue to drop despite the recent rise in the discount rate proved to be false, leaving the majority buying bonds right at the high.

The city of Baltimore conducted an experiment to ascertain what the rate of unemployed persons might be. They sent policemen around the city on a door-to-door campaign to calculate exactly how many unemployed lived in Baltimore. They were instructed to leave out the "tramps, beggars, gamblers and thieves." In New York State, it was reported that 20,000 persons were unemployed, the largest amount since 1921.

The Labor Bureau Inc. reported that 4 million persons were unemployed throughout the United States. Jacob S. Coxey, who



had led a march of unemployed from Ohio to Washington, claimed that 25% of the population lacked a job. The "Magazine of Business" reported in its February 1928 edition that for every 100 persons who were unemployed in 1921, when unemployment was regarded to be its highest, 122 now were seeking jobs in 1928.

There is no doubt that 1927 brought a slowdown in production in many sectors including steel. This figure of 25% perhaps sounds a bit exaggerated. However, current unemployment figures are heavily discounted for all sorts of various reasons such as minor disabilities, where in fact even a man with one arm sought some kind of employment in those days. Therefore, comparing current rates of unemployment with those that existed in the 1920s is like comparing apples and coal.

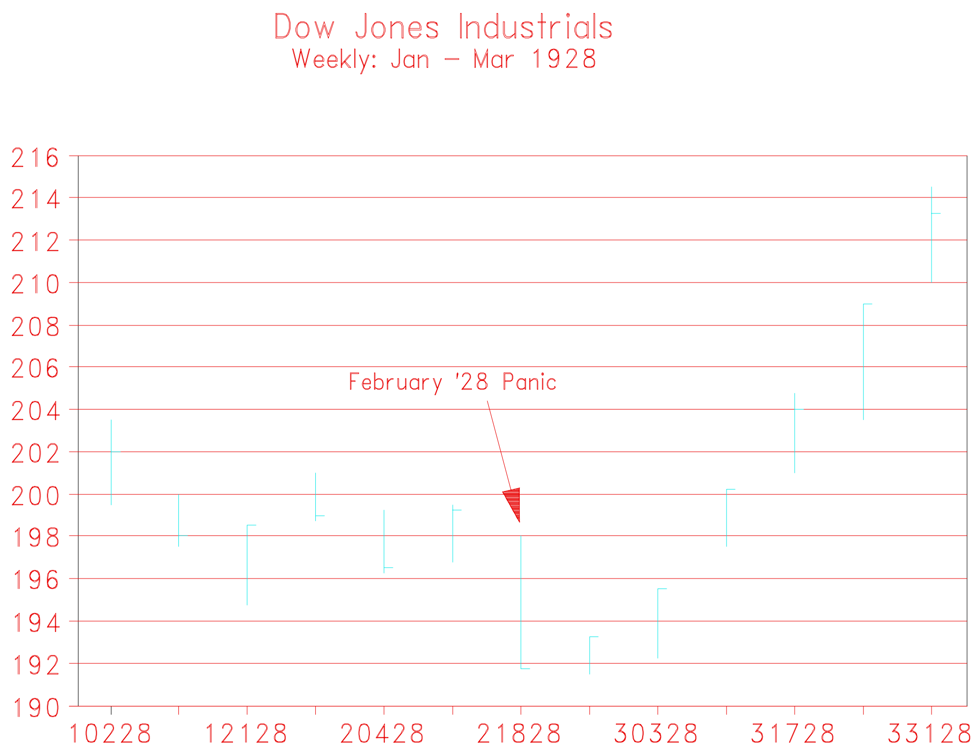
The month of February brought with it a very sharp break in the railroad stocks. After closing 1927 above 140, February fell to under 133. The bonds moved sideways but slightly to the downside, yet remained still above 99. The industrials, which had closed 1927 out above **the 200 level**, now penetrated the January low falling to 192.

The February 27, 1928 edition of Time magazine covered the event with the following commentary:

"TICKER LIGHTENING"

"Last week's violent and sudden break in prices on the New York Stock Exchange, with unprecedented volume of transactions during the last hour of the trading week, brought to speculators' memories the time honored adage: 'When a big market breaks badly on good news it is a bear market; when a big market rises sharply on bad news it is a bull market.'

"Friday's nose-dive was nothing short of shocking to the most hardened ticker-tape readers. Saturday's pace of selling was equally alarming, especially from 11 o'clock until noon. The ticker stamped out 'Good Night' at 12:35, despite use of the new abbreviated symbols which normally keep it



within one minute of the execution of orders on the floor of the Exchange. In one hour 1,100,000 shares changed hands.

"The items of good news to which the market reacted were:

1) Increased car loadings.
2) Best financial statements ever issued by the General Motors Corp., the N.Y. Central, The Pennsylvania Railroads.
3) Decrease in broker's loans.
4) First dividend in fourteen years to New Haven Railroad stockholders.
5) increased bookings of U.S. Steel Corp. orders with an operating ratio of 90% of capacity.
6) indications of a general speeding up of automotive industry to catch spring trade.

"Against these favorable influences were some unfavorable items:

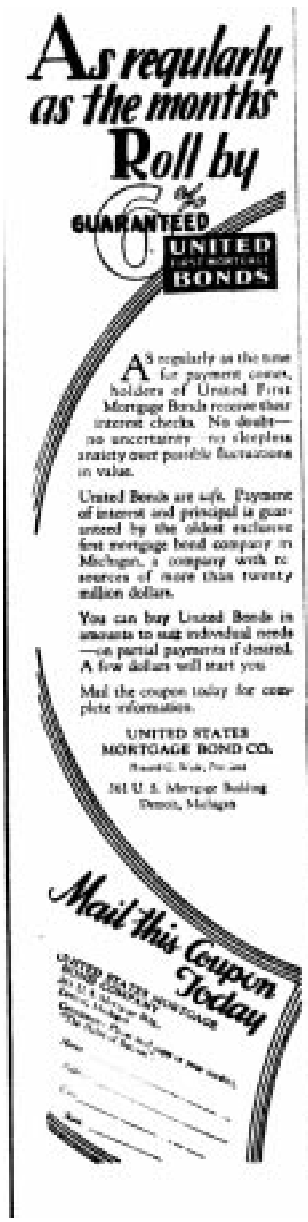
1) Spotty trade.
2) Unsatisfactory corporate reports, generally.
3) Further cut in oil prices.
4) increase of Unemployment in large centers.
5) Uncertainties in many commercial directions.

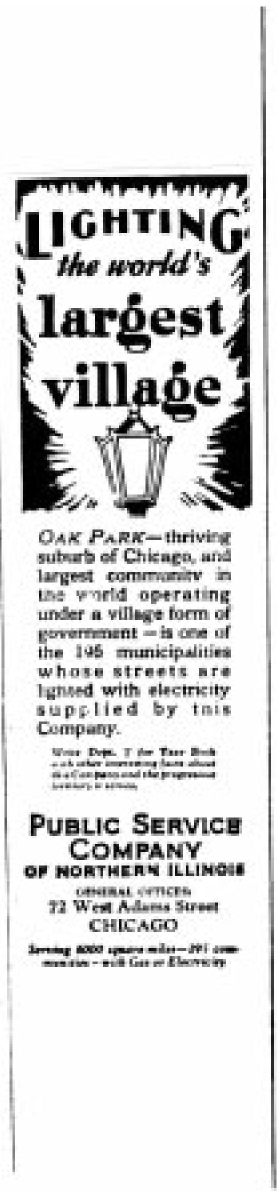
"Two classic explanations were offered for last week's break:

"First: popular speculative Wall Street has got in the habit of judging the trade situation by the stock market rather than judging the stock market by the manifest trend of trade. Hence, confusion of cause and effect, resultant consciousness of error, hasty attempt at correction.

"Second: deliberate initiation of liquidation by institutions and powerful individuals who carry their stocks through a blow if they care to but who have decided after due reflection that the level of stock prices is out of line.

"Neither explanation admits the possibility of the existence of an underlying weak-

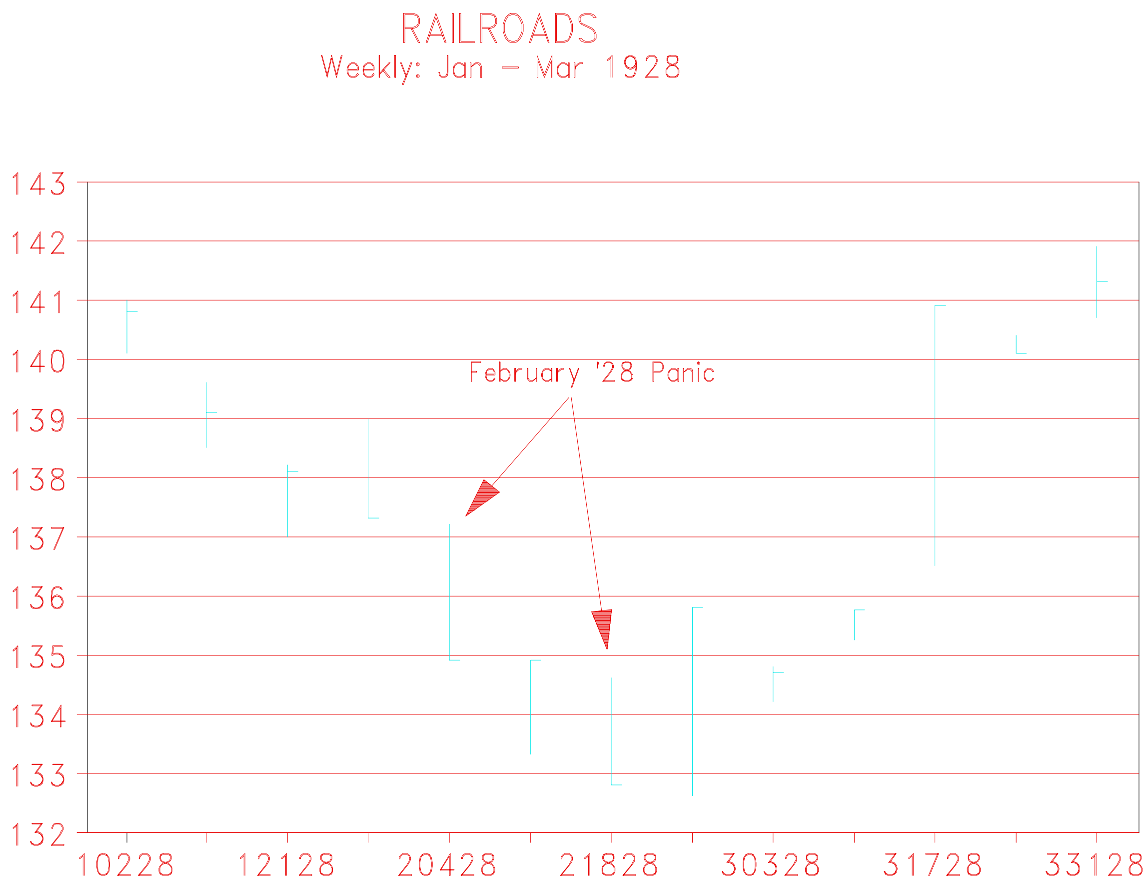


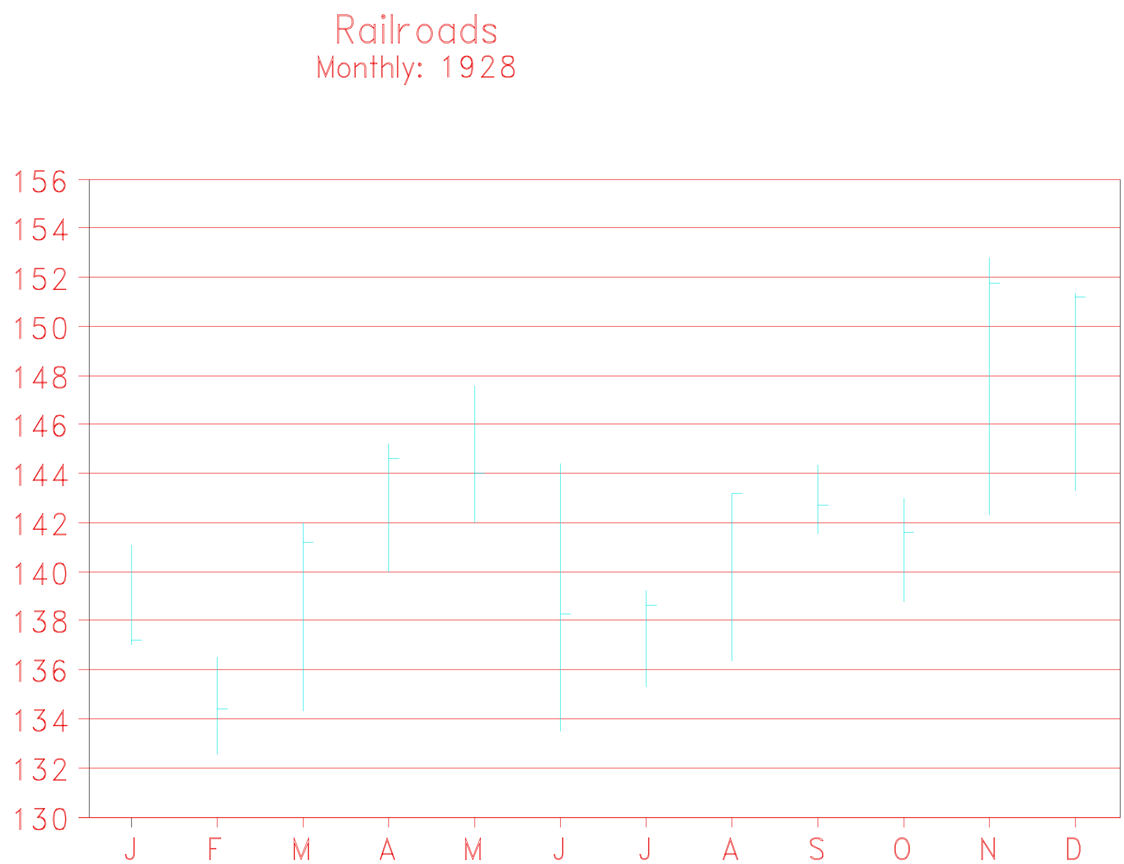


ness of any degree of gravity. Obstinate gamblers for the rise may have barked their shins. Or that undefined but still not mythical group of forces known as 'the largest interests,' the insiders of popular legend may have put the brakes on inflation. The only disquieting symptom last week was the pace at the finish. It cannot be accurately described for want of clear financial terminology. If stockbrokers had a sort of Beaufort's scale (a series of numbers from 0 to 12) such as miners use to describe wind velocity, it might be said that the week passed from the strong wind of weakness through the gale of heavy liquidation to the storm of drastic reaction. But at no moment was hurricane force recorded. Hurricane weather, in finance, is panic, of which state the ticker pulse gave not a suggestion."

The old adage, referred to by Time magazine, is quite interesting. If a market breaks on good news it must be a bear market and if a market rallies on bad news it must be a bull market. It is also interesting that just as soon as the first sign of a fast market to the downside takes place those famous words "bear market" appeared. The correction which took place during February in terms of price was not much. In total on the average for the industrials it was a mere 5%. The railroads displayed a correction of nearly 10%. This was perhaps a sign that the age of the railroads was coming to an end. It would have a life of perhaps another year, but from here on out it would take a back seat to the industrials. In the future, the railroads would become the Dow Transportation Index which eventually took a shabby second place. But the technical importance is that the corrections in the rails were always more pronounced when compared to the industrials. This is a leading indication and a significant factor which should be remembered.

The commodities were also trading a bit lower at this time. However, over at the Chicago Board of Trade, wheat jumped up from 2.75 cents to 3.375 cents on a rumour that there was a big buyer in cash wheat to the tune of 8 million bushels. The rumour suggested that the buyer was Russia. When all the dust began to settle, it turned out that it wasn't 8,000,000 bushels, but only 8,000 and it wasn't wheat but instead hops. The


RAILROADS
Weekly: Jan – Mar 1928
February '28 Panic
143
142
141
140
139
138
137
136
135
134
133
132
10228
12128
20428
21828
30328
31728
33128


Railroads
Monthly: 1928
156
154
152
150
148
146
144
142
140
138
136
134
132
130
J
F
M
A
M
J
J
A
S
O
N
D

LARGEST ORGANIZATION OF ITS CHARACTER IN THE WORLD

Babson's Reports *are used by* Leading Business Men *and* Investors

to aid them in forecasting business conditions, commodity prices, money rates and security values.

Through the Babson Statistical Organization thousands of business men enjoy the advantage of a complete statistical department. The staff of more than 200 includes economists and engineers with a thorough and special knowledge of the statistical field and with many years practical experience in the business world.

To have this organization of statisticians and economists for the exclusive use of your business would cost several hundred thousand dollars annually. The pro rata cost to any *one* client, however, is a mere fraction of a clerk's salary.

Write for Babson Report No. D-21 Gratis

BABSON STATISTICAL ORGANIZATION

BABSON PARK, MASSACHUSETTS

LARGEST ORGANIZATION OF ITS CHARACTER IN THE WORLD

ROYAL MAIL

"The Comfort Route"

EUROPE

FRANCE ENGLAND GERMANY
(Cherbourg) (Southampton) (Hamburg)

NOTHING adds more to the pleasure of your trip abroad than that complete comfort and delightful homelike atmosphere which you find on the famous "O" steamers of the Royal Mail.

BERMUDA

Sail to Summer sunshine in the Glorious Gulf Stream Playground on the S.S. ARCADIAN 19,500 ton displacement. Weekly sailing.

WEST INDIES CRUISES

By palatial S.S. ORCA 25,500 tons displacement. Jan. 19 and Feb. 20.

SOUTH AMERICA

Splendid service by the palatial steamers EBRO and ESSEQUIBO, 14,350 tons displacement, the largest ships to Peru and Chile.

New York Havana Panama
Peru Chile

The Royal Mail Steam Packet Co.
The Pacific Steam Navigation Co.

26 Broadway, New York
607 Boylston St., Boston
117 W. Washington St., Chicago
Detroit Minneapolis San Francisco
Seattle Vancouver Toronto Halifax

UNION LETTER CO.

Direct Mail Advertising

261 Broadway
NEW YORK

Phone Barclay 4525

HIGH GRADE
FAC-SIMILE
TYPEWRITTEN
LETTERS

Addressing *Printing*
Folding *Mailing*

RIDING COMFORT

Brownie Spring Oiler Saves Nerves, Temper, and Springs

MAKE LIFE EASIER

Just put in some oil every 500 miles.

Quickly Attached, Oils All Spring Leaves. Satisfaction Guaranteed.

8 BROWNIE OILERS $4
Write Us Today

Brown Spring Oiler Co.
6905 Carnegie Ave. Cleveland, O.

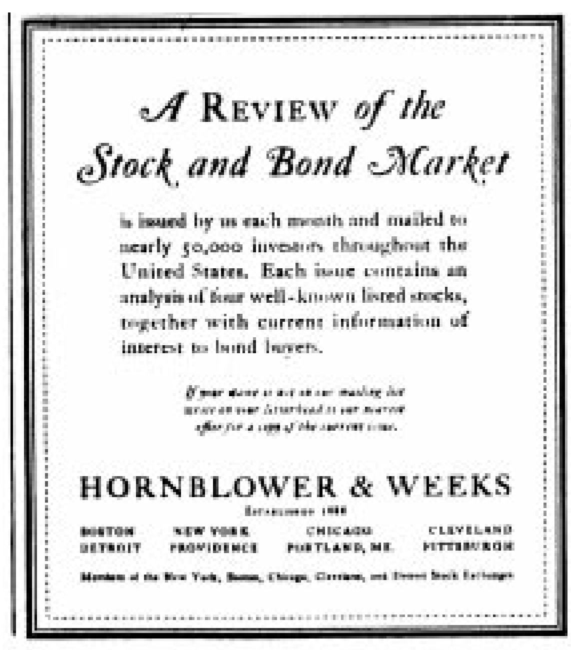
buyer wasn't Russia but Germany. Nonetheless, the wheat traders had a good time.

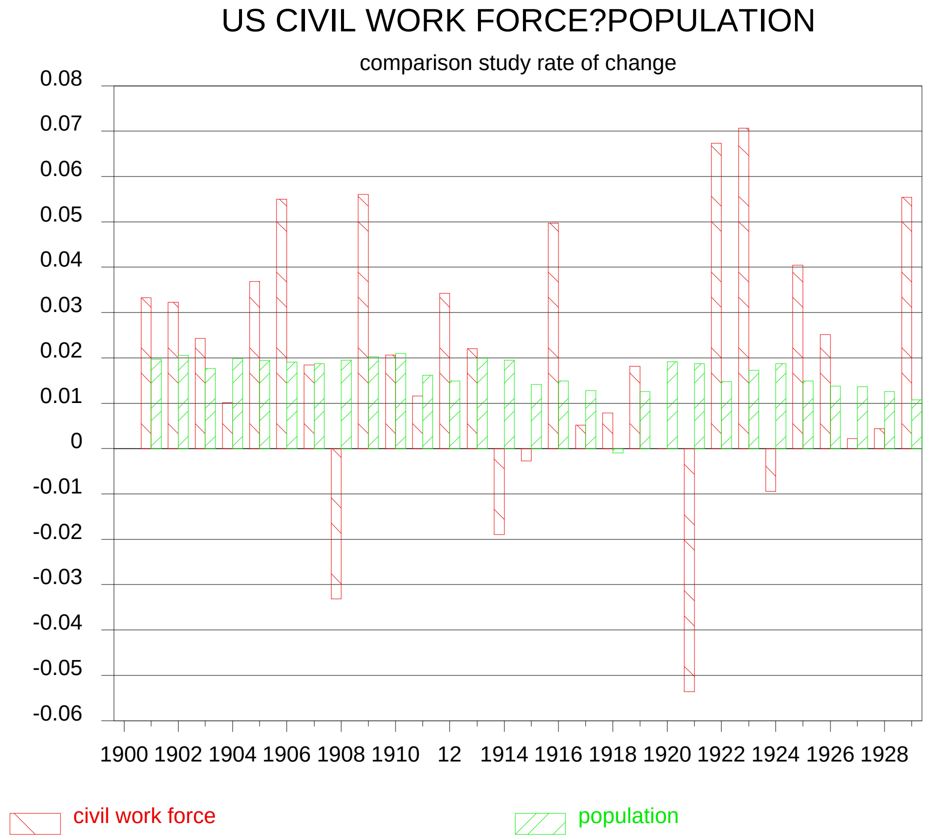
Over in the Rubber Exchange, back in Manhattan, the prices were in a state of panic. Down and dirty the price of rubber fell to an all-time low on the two-year old Exchange. The volume on the exchange had surpassed all previous records for weeks wrapped up in the course of four trading days. A telegram from London began the onslaught. The news was that the British "might" let the restricted rubber production in Ceylon, Malay States and Straits Settlements become "inoperative" after May 1st. The seats on the exchange doubled as one was sold for $6,600. The news itself had come from the then Premier Stanley Baldwin. By the time London opened the next day, the huge rubber king in Britain, Arthur A. Baumann, suffered a 7 million pound sterling loss and publicly stated: "10 Downing Street is really unfit to govern the Empire."

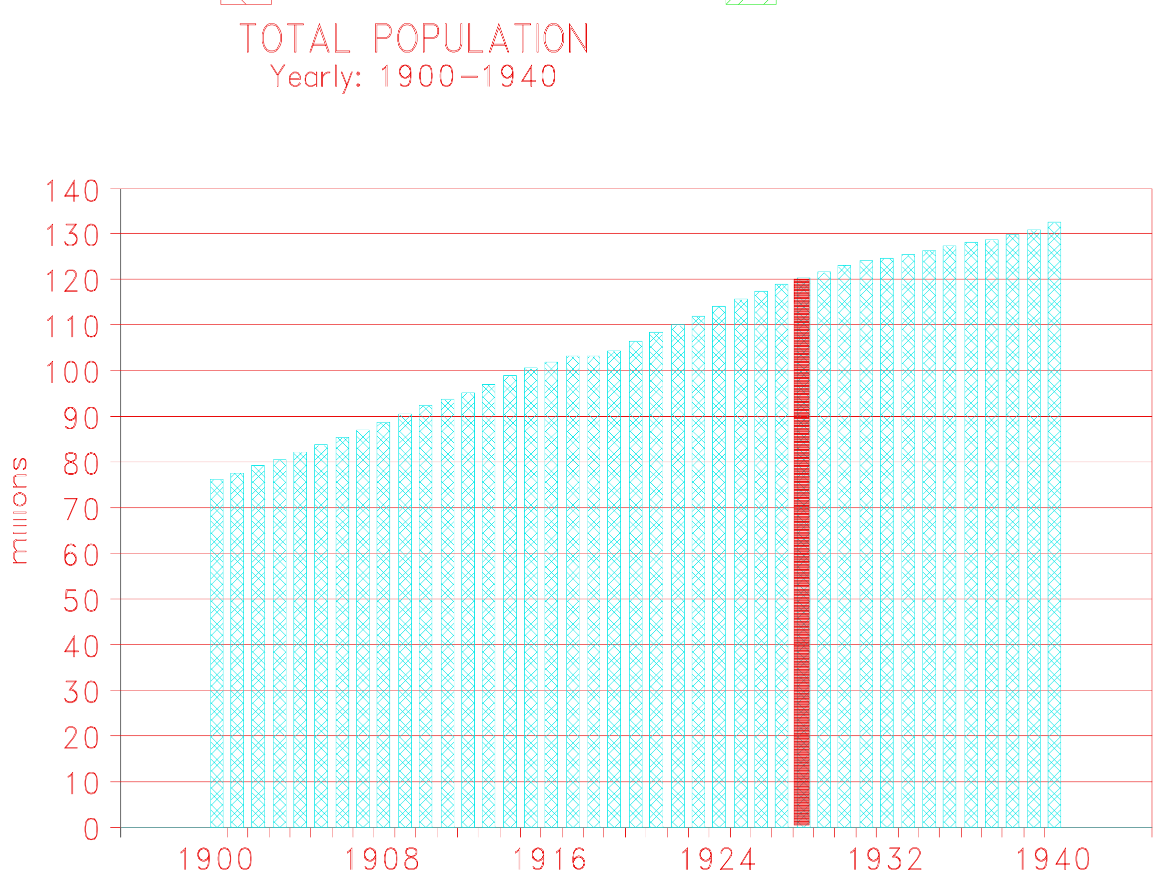
Trade with Russia was beginning to be quite impressive. At this point in time it was estimated to be $100 million annually. However, during February 1928, Russia had exported gold to the United States for the first time. It sat idle in the vaults at Chase National Bank and at the Equitable Trust Co., losing $700 a day in interest while Washington decided what to do with it. The United States had outlawed Russian gold since the Revolution. Just the previous month, the Secretary of State ruled that Chase could not cash any coupons on the Russian Soviet Railroad bond issue. But then President Coolidge ruled that Soviet gold exports to the United States were merely in payment for trade purchases and ordered that the gold be delivered to the mint and struck into coins.

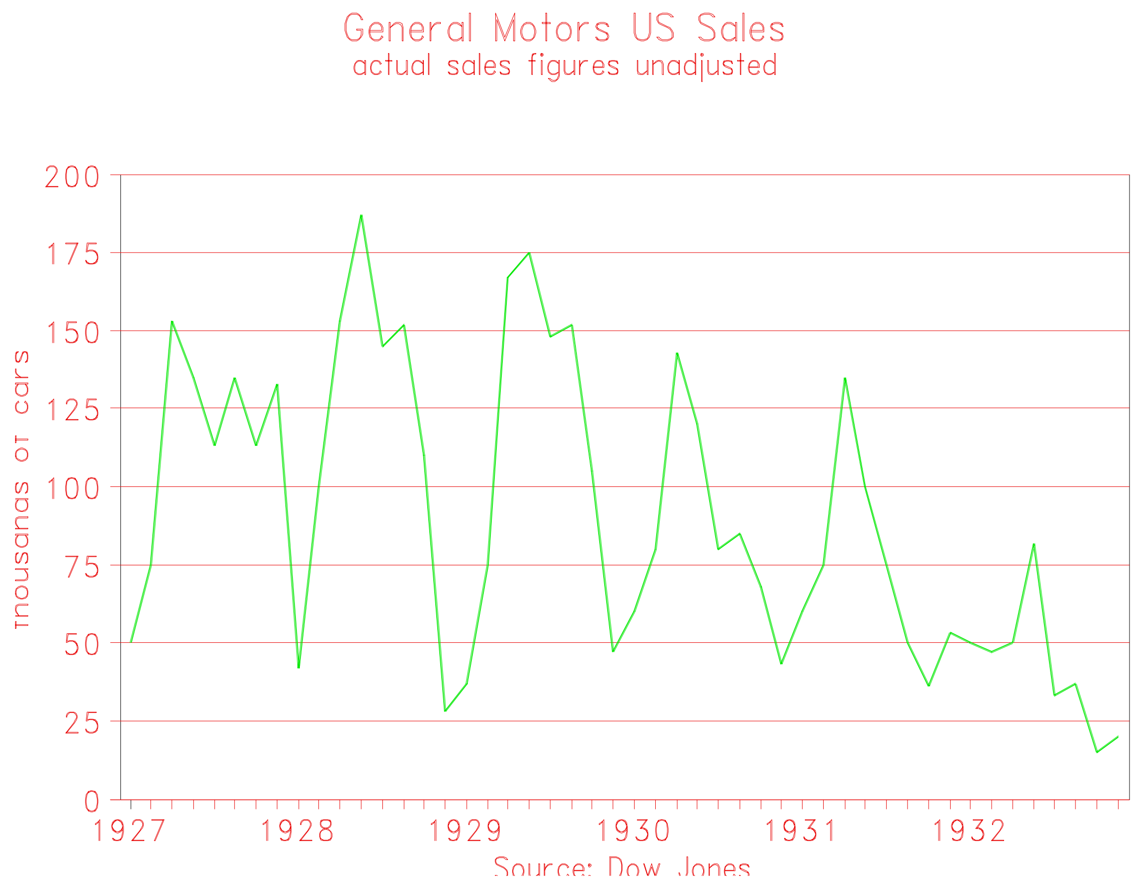
The markets began to recover during February as more earnings reports began to hit Wall Street. RCA released their 1927 statement showing an $11.7 million profit compared to $7.3 million for the previous year. Packard Motor Co. reported an estimated $10 million in earnings for the last six months compared to $7.9 million for the same period in the previous year. AT&T reported earnings of $166 million compared to $155 million the previous year. Still not all reports were profitable. National Lead Co. (Dutch Boy Paints) reported $4.9 million in earnings for 1927 compared to $9.0 million for 1926. Some industries were stagnant such as United Drug Co. (Rexall), reporting $8.3 million compared to $8.8 million for the previous year.

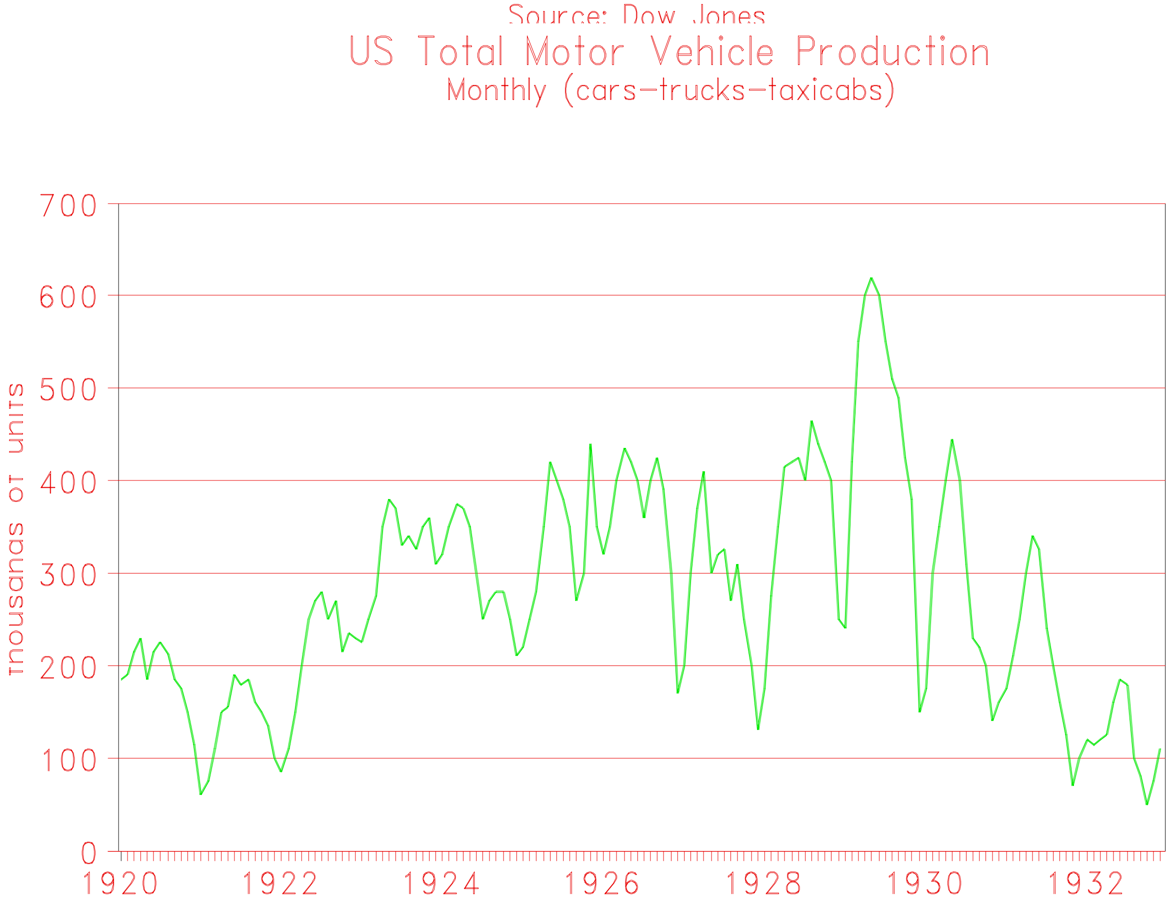
The fixation with unemployment was not over. In March it was reported that the number of jobless climbed to 5 million. Cities began to report unemployment figures.




US CIVIL WORK FORCE?POPULATION
comparison study rate of change
0.08
0.07
0.06
0.05
0.04
0.03
0.02
0.01
0
-0.01
-0.02
-0.03
-0.04
-0.05
-0.06
1900 1902 1904 1906 1908 1910 12 1914 1916 1918 1920 1922 1924 1926 1928
civil work force
population

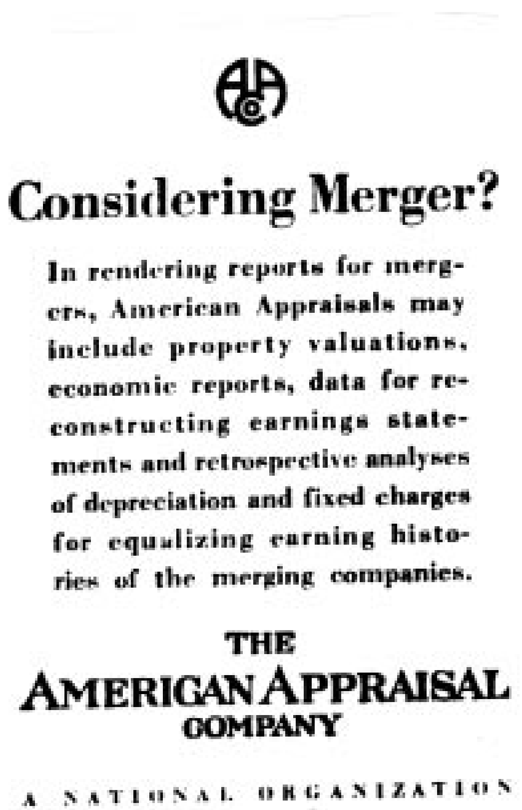

TOTAL POPULATION
Yearly: 1900–1940
millions
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
1900
1908
1916
1924
1932
1940


General Motors US Sales
actual sales figures unadjusted
thousands of cars
200
175
150
125
100
75
50
25
0
1927
1928
1929
1930
1931
1932
Source: Dow Jones


US Total Motor Vehicle Production
Monthly (cars–trucks–taxicabs)
thousands of units
700
600
500
400
300
200
100
0
1920
1922
1924
1926
1928
1930
1932

Baltimore, which had started the practice of sending police knocking on a door-to-door journey, reported 42.5% unemployed, the highest in the nation. Next in line was Cleveland, reporting 33.8%. Detroit reported 32.3%, Philadelphia 30.6%, Buffalo 26.7%, Omaha 26% and New York 24.2%. Chicago reported the lowest unemployment rate of 7.8%.

Confusion was surrounding the issue. Why were so many people unemployed? The Secretary of Labor, James Davis, stated: "You can make all the boots and shoes needed annually in America in about six months and you can blow all the window glass needed in America in seventeen days. You can dig all the coal necessary in six months with the men now in the industry. Because of our increase in population in the last eight or ten years it now should take 140 men to supply the needs of the country where 100 could do so. Instead of that and in spite of our having 20,000,000 more people, the needs of the country are fully supplied with 7% fewer workers than we needed in 1919."



There were several events which had taken place to cause such a vast unemployment problem. First, after the ravages of World War I had settled upon Europe, many people set out to start a new life on the "streets paved in gold" which were rumoured to exist in the United States. There was a huge increase in population within the United States. This factor, combined with the improvements within the assembly line methods invented by Ford, is why jobs were being displaced to some extent. If we were to take the steady population, net of immigrants, we would find that unemployment was about 7% below the peak of 1919.

The U.S. was substantially behind the times in collecting economic data. There was no regular agency that kept track of unemployment. This sudden exposure to the unemployment figures which were being collected startled the stock market in February and sparked continued concern thereafter. In early March, the U.S. Commissioner, E. Stewart, became alarmed and publicly made an announcement: "Every machine that is built to do the work of four men throws three out of work. Of course, new industries are created and production increases to absorb part of the surplus labor but sooner or later we will reach the saturation point. Whether we have reached that point now will be determined by the middle of April, and if we have reached it, there is only one solution, shorter working hours. Anything else will be suicidal." This was no light public statement. But for some strange reason, the market paused and then rallied sharply, as March closed the month on the industrials at nearly 211, well above the 1927 high.

During mid-March the rally began. In the March 19 edition of Time magazine, it was reported as follows:

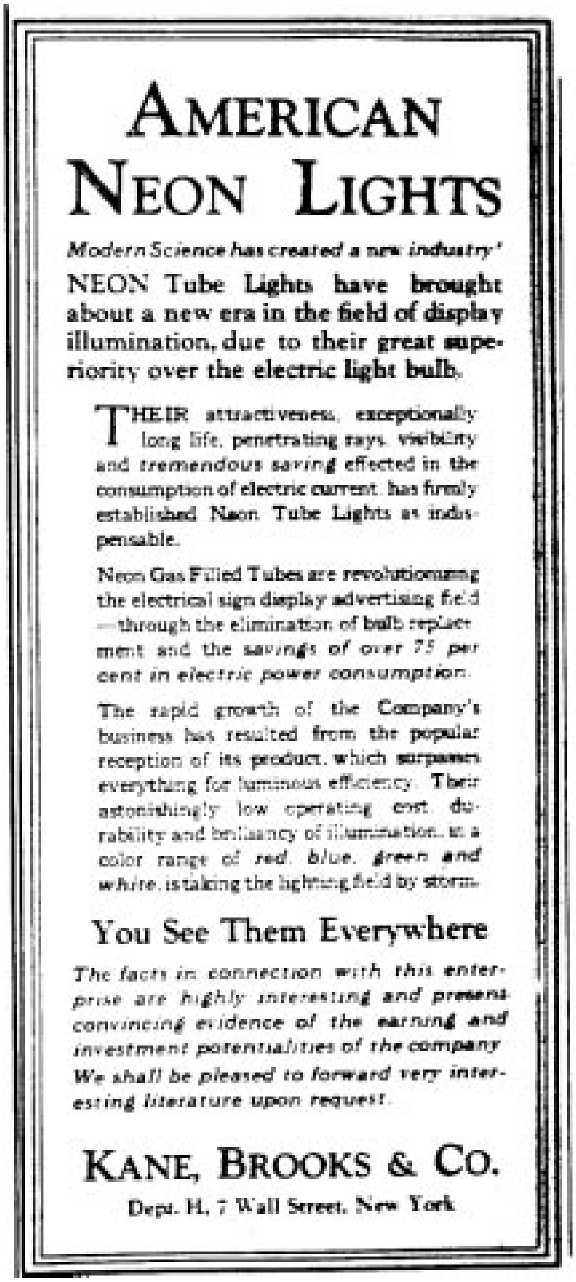
"Last week was perhaps the most remarkable speculative week in modern history of the New York Stock Exchange. Speculative, because there were no political or geological events like the declaration of War in 1914, or the San Francisco earthquake of 1906. Modern, because in older days (up to 1907), the trading was small in volume and almost entirely between professional speculators, consequently subject to more sudden and violent whims than the trading of today, which affects the fortune of perhaps 7,000,000 U.S. security owners.

"Long will it be remembered in Wall Street that last week's unparalleled bull spurt came immediately after a dull bear market, precipitated by a sudden break. Equally long will market historians discuss the reason for last week's phenomenal spurt. The principal reason was the unexpected action of the officers and directors of the General Motors Corporation in purchasing 200 000 shares of their own stock in the open market for their own account.

"The result was not only a week of record volume - 16,278,900 shares between Monday morning and Saturday noon - but a record week in the quality of the stocks that went up under the leadership of General Motors. Only the best stocks gained.

"General Motors managers acted against the pessimism of the Federal Reserve Bank. Why? Because their annual report for 1927, published last week, was far and away the most encouraging document which the financial year had so far brought forth. Assets of \$1.09 billion, an increase of \$77 million over 1926 earnings of \$235 million, the largest peace-time result ever achieved by a corporation; total business of \$1.2 billion - these figures stimulated Wall Street speculators and investors everywhere, and they bought 2,431,500 shares of General Motors stock in five and one-half days, lifting the price of the stock from \$144 3/4 to a high point of \$161. There are 17,400,000, shares of General Motors stock outstanding. Last week they increased \$282 million in value."

The market literally soared beyond the belief of what everyone had thought was even possible. In the midst of bearish statements of doom centering around the newly accounted unemployment figures and in the face of a hike in the discount rate, the market rallied more in one week than it had ever done before. The bonds fell to a new low for the year, testing the 9900 level, but managed to rally for the end of the month in March, establishing the highest monthly closing for the year 1928.



There were all sorts of rumours flying around. There was talk of bull pools but mostly of bear pools caught short. One such story was that of a huge short position in RCA. A rumour began to circulate that a corner in RCA had been established despite shorts who had run in and sold 350,000 shares. It was known that of the 1,155,400 shares of RCA, almost the entire lot was owned by General Electric, Westinghouse Electric, National Bank of Pittsburgh and the Fisher Brothers of Detroit ("Body by Fisher"). Nevertheless, the shorts had sold nearly one third of the outstanding issues on the unemployment news. In one day, they drove RCA down from the previous day's close at $121 1/4 to $85 1/4. When General Motors began buying their own shares, the whole market went nuts. RCA opened the following day at $120 1/2 and shorts went crazy. A buying stampede of unprecedented proportions unfolded. RCA exploded upward within a matter of minutes, reaching 138 1/2, which is where the market had closed the previous day. The day ended by registering 3,000,100 shares traded in total; which established an all-time record for the entire 130 years in New York Stock Exchange history. The press called the rally the "Ides of March Terror." When the final count in volume came out the following week, it revealed more than what Time magazine had originally reported. The final figure was 20.5 million odd shares included. Asset traded that week at $315,000.

Oil stocks were not doing very well. The oil prices continued to decline under high production pressure and price wars. Philips Petroleum, for example, released their annual report during March of 1928. It revealed how serious the problem had become. Their 1927 earnings were $4.9 million against $21.4 million for the previous year. The coal industry was picking up. Pittsburgh Coal reported 1927 earnings of $1.8 million against 1926 losses of $2.1 million. The airplane industry was still doing well as displayed by the March 1928 release of the Curtis Aeroplane & Motor Co., Inc. which produced 1927 earnings of $794,148 against $413,317 for 1926.

International Harvester reported 1927 earnings that March of $23.3 million against $22.6 million for 1926. Studebaker showed an 8.5% decline from 1926 earnings. Another turnaround was the American Woolen Co. with 1927 earnings of $2.5 million against a 1926 loss of $2.1 million. Quite impressive.

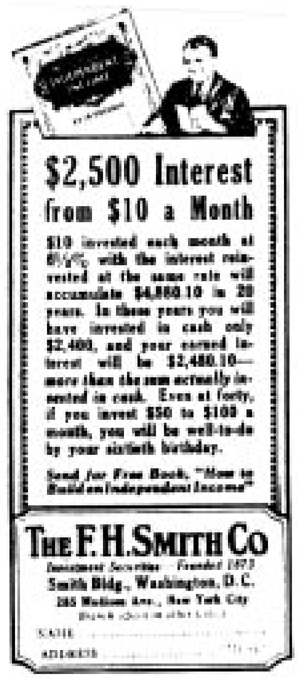
Obviously, the reports were mixed but overall the reports released during March were more turnaround surprises than disappointments. Only rubber and oil, both with huge overproduction problems, had been expected. Therefore, with G.M. showing an impressive report, wool and textile turning around and airplanes still growing, there was a lot of good news despite the depressive unemployment figures and the hike in the discount rate.

The rally literally broke all records and continued straight into the end of the month. March finally closed at all-time record highs for the industrials. The rails rallied sharply from the February low of just under the 133 level back up to 142, closing slightly above 141, but they did not exceed the 1927 high which was nearly 145. Again the industrials led the way. The bonds rallied, closing on the high as well, but it was a weak rally at that.

Perhaps the events are better described by Time magazine, which commented on the affairs in its April 2, 1928 edition.

"THE PUBLIC INVITED"

"Last week, only one member was carried from the floor of the New York Stock Exchange in a state of complete collapse. A petition circulated among members for a three day holiday, Good Friday, the intervening Saturday and Easter Monday, appeared to find more brokers fascinated by



the profits of 4,000,000 share sessions than worried by the danger of physical ruin. Every 'record' of any shape or description was broken and rebroken.

"The explanation is simple. The 'public' had finally come in, tardily, clumsily, 'at the top,' as always, with the greatest reservoir of cash of all, compared to which Wall Street's organized money force is small. It astonished nobody, because 7,000 tickers are now hypnotizing greedy eyes in 40 states, leaving scarcely a middle-sized town from Maine to California where citizens may not actually see their savings bank withdrawals dance past their giddy eyes in strange, cryptic abbreviations three minutes after passing their checks to the broker."

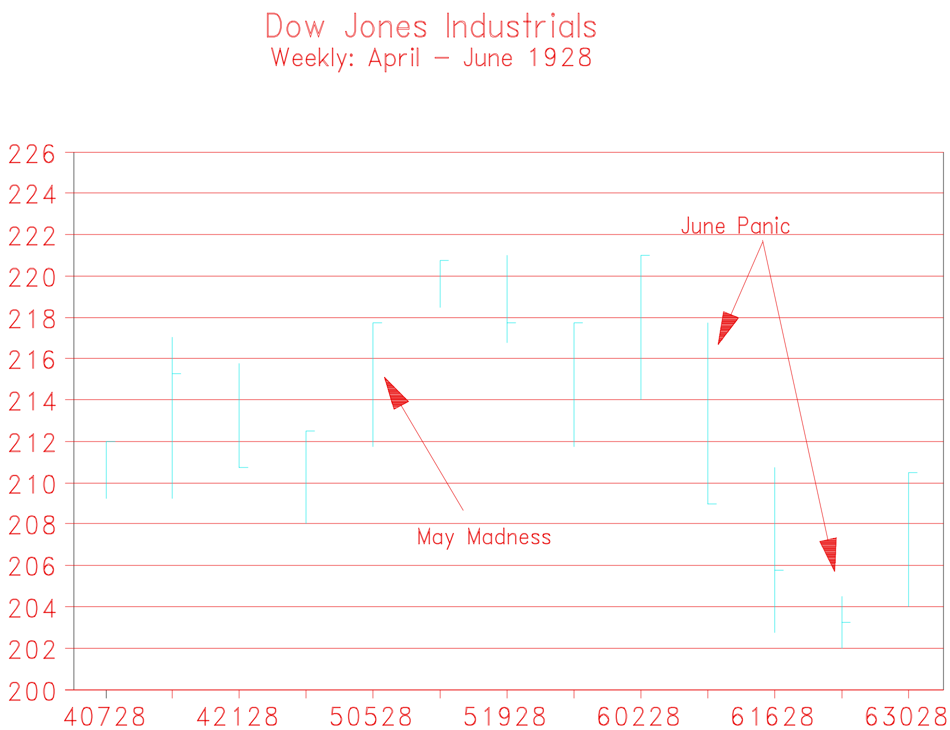
If we go back and read that article carefully, we will note a very interesting comment. It called the public tardy and clumsy and waiting to buy "at the top, as always." They assumed along with everyone else that the market had surely peaked this time.

They forgot that the public, as we reported earlier in prior years, bought huge amounts of stocks at half this level and for cash! There was never any evidence of massive public selling. The public which had bought for the most part back in 1924 was still long the market. This March high did not prove to be the top. Short interest again began to build. April made a new high, settled back a little, and did close below the March high at the end of April. Shorts were definitely foaming at the mouth and ready to take what everyone assumed was the suckers' long positions down for a ride. When all was said and done, the entire month of March had set a record with 84,987,834 shares traded. The shorts were convinced that the top was in place.

However, the March rally had taken place suddenly and coincided with the low in the dollar. The French stock market peaked in February and began to drop sharply in March. In Britain, their stock market peaked in late January and fell 12% into March. In the Netherlands, their market peaked in February and the Belgian market had also rallied back, reaching its major peak for 1928 during February as well. The U.S. stock market had responded to a shift in international investment from Europe as well as the major low in the dollar itself.

At the beginning of May, the St. Louis, Richmond and Minneapolis district branches of the Federal Reserve raised their discount rates to 4.5% from 4%. The others were now expected to follow suit shortly. Despite this event, the market held once again and a seat on the New York Stock Exchange traded at $395,000. Between March 9 and April 23, each of the 18 trading days exceeded 3,000,000 share days with the highest volume on March 30 reaching 4,759,300 shares that day alone. Seats on the other exchanges had risen dramatically as well. The New York Curb traded at $65,000, Boston at $18,000, Los Angeles at $35,000, San Francisco $125,000, Philadelphia at $11,500 and even the Chicago Board of Trade reached $9,000.

During April, while the industrials had made a new high and then retreated to finish the month below the height of the

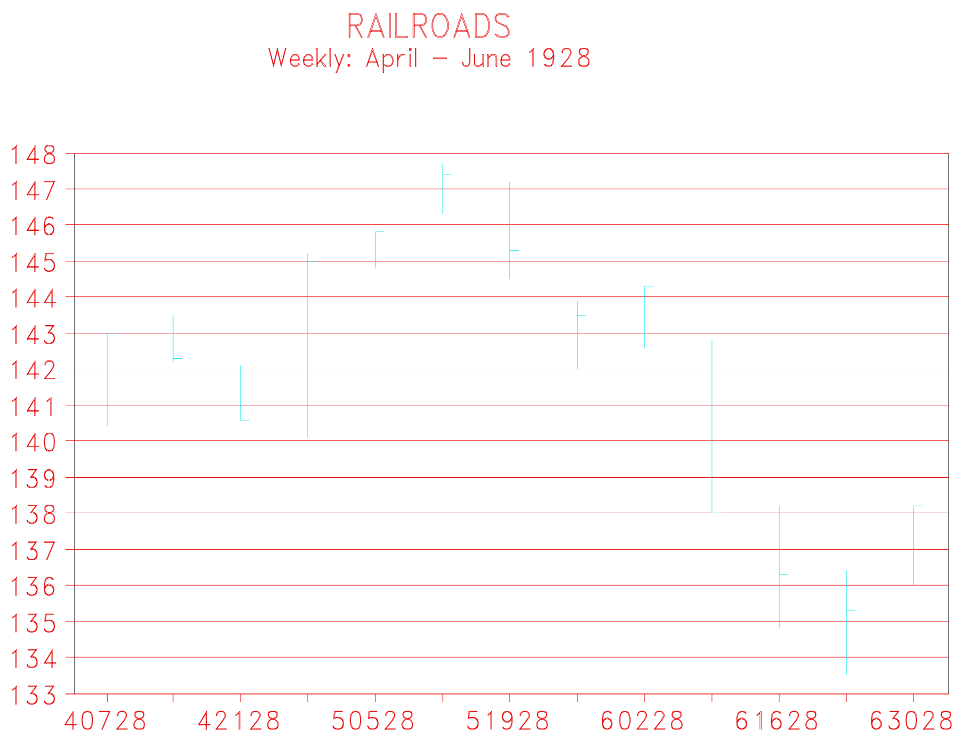


"Ides of March Terror," the rails advanced, tested the 1927 high and closed well above the high established during March. Although the April railroad high was not above that established in 1927, it was the highest monthly closing achieved. The bonds fell sharply dipping below the 99 level for the first time in 1928, barely crawling back up to settle slightly above 99 at the end of April.

It was about this time that further foreign bond offerings were flooding the market. Britain and Ireland offered another $10 million War Bond issue. Although it was taken up in the market the saturation level was obviously making its presence felt. The so-called clumsy "public" was shifting from bonds to stocks while the so-called professionals were buying the bonds and selling the stocks in anticipation of an imminent collapse in stock prices. Previously, bonds had always held up when stocks collapsed and this had been a popular "professional" spread. But now the so-called nonprofessionals were joined by foreign buyers firming the market and preparing for substantially higher levels in the future.

There was a noted and historic change in banking taking place at this precise point in time. Banks up to this period had paid interest only on a monthly, quarterly or semiannual basis. If a depositor had to withdraw his funds before the prescribed date when interest was to be paid, he forfeited all interest even if it was one day early. During the second week in May the Emigrant Industrial Savings Bank in Manhattan announced that it was the first bank that would pay interest on a daily basis. It acknowledged that on some very small accounts its bookkeeping costs might be more than its profits, but it stated that over its 77 years of history it had learned that small accounts often turned into very big accounts.

The National City Bank in Manhattan tried to counteract this competition with an announcement that it would lend between $50 and $1,000 to any individual on what it called "personal" loans provided that the

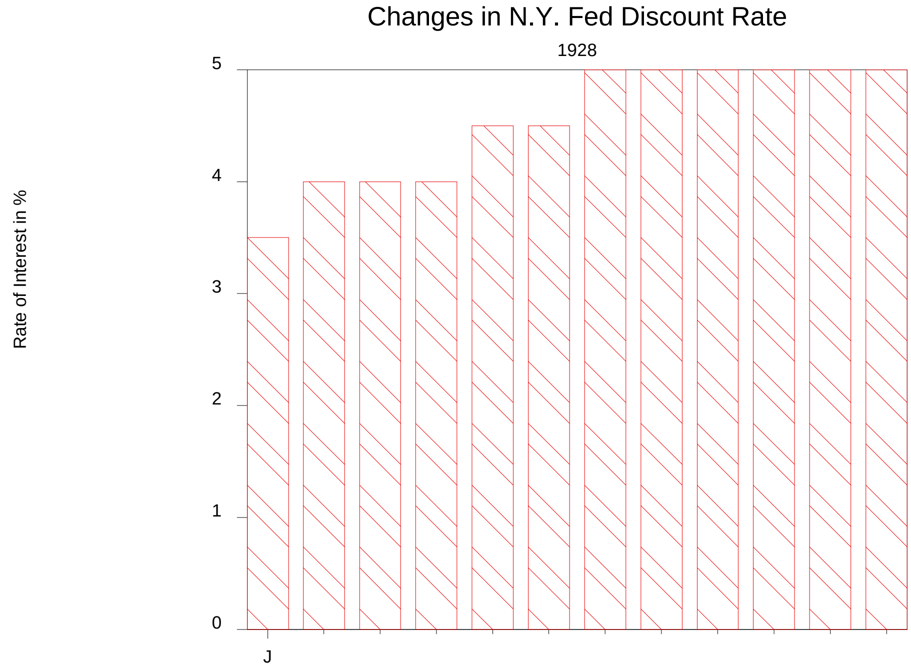


person was employed. The rate of interest to be charged was 6%. All loans were to be for one year only. The personal loans were under the stipulation that only responsible, employed persons without collateral may apply, provided the note was endorsed by two respectable friends. This was not actually a first. The first such bank to issue "personal" loans was in Norfolk, Virginia. The concept was introduced by an attorney named Arthur J. Morris. The loans were to be paid on monthly installments. Previously, the merchants were the only lenders on a personal basis but the going rate was normally $20, quite similar to the traditionally higher rates imposed by credit cards today.

In May, many reports began to hit the press with the first quarterly earnings in 1928. Again AT&T showed a gain of 8% above 1927. General Motors was among the most impressive again, displaying earnings of $69.4 million for the first quarter compared to $52.5 million for the same period in 1927. This was not necessarily reflective of the entire auto industry because G.M. continued to carve out a larger share of the marketplace. Some rails were mixed with Pennsylvania R.R. showing a decline in earnings while the Union Pacific was posting a 10% gain. Coca-Cola was posting a 10% gain; General Cigar, a 50% decline; Hudson Motors, a 5% gain; and Packard posted 1928 first quarterly earnings of $5.7 million compared to $2.0 million in 1927. Clearly, the auto industry, which had saved the economy back in 1921 and begun this age of prosperity, continued to turn in overall good results.

May brought with it a lot more than mere flowers. The bonds tanked, falling nearly a full point from above 99 to barely holding 98. The industrials soared to new record highs straight up passing the 220 mark. Even the rails at last exceeded the 1927 high by reaching above 147, but they fell back to close just above 144.

The market turned toward the motors and the aviation stocks. Suddenly airplanes came into favour. Time magazine reported



on this newly favoured industry on May 28 as follows:

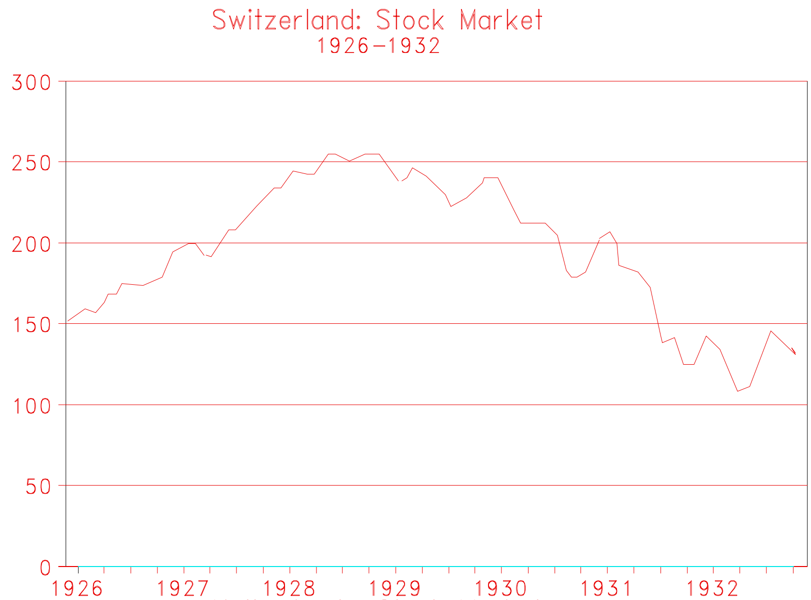
"Thousands of small speculators, who have been largely responsible for the three months hubbub in Wall Street, were last week seized with the same idea. Each of them wanted to stow away, or play with, a few shares of air stock. True enough they had played intermittently with air stocks since the Paris flight of Charles Augustus Lindbergh, but never as they did last week."

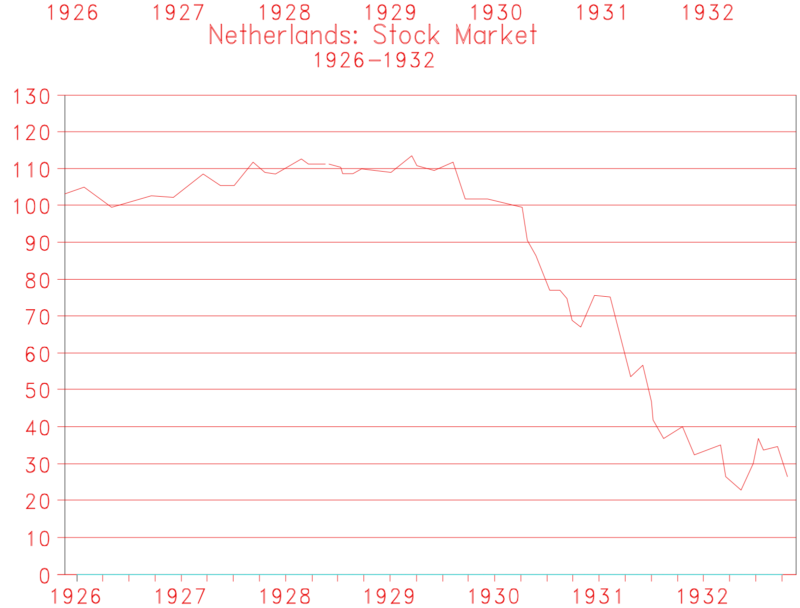
Much of this had to do with a few new issues in this industry that underwriters had placed at $12.50 but that soared on the Curb Exchange to $25 and rose even further to $30 in a single day. One of the best known was Wright (Wright Brothers). They were producing about 100 airplane motors a month and announced an extra dividend. The stock was selling at $214. They offered stockholders the right to buy one share for $100 for every five shares of stock owned. The stock jumped immediately to $245 on the news. On the day before Lindbergh crossed the Atlantic, this stock had closed at $28.50. Curtiss, famous for the Curtiss Jenny, was selling for $21.75 before the Lindbergh flight. On this air stock buying spree, Curtiss ran up to $192.75.

Time magazine commented on the floor trading activity for early May as follows:

"MADNESS. The frenzy of trading on the New York Stock Exchange last week surpassed all previous spectacles. From the floor a jubilant howling roared; brokers milled around; pages and messengers doubled around huddles of bidding brokers; brokers chanted a litany of bids and asks at each other, and sweated like the marching monks in Tannhauser."

The week set another new record with Wednesday trading 4,820,840 shares. The total for the week was 21,352,200 shares. But something strange had also taken place. Although Wednesday had set a new record, it also experienced a sharp panic sell off which was short-lived. Many stocks cracked, falling from 5 to 40 points. But some of the curious noticed that stocks like

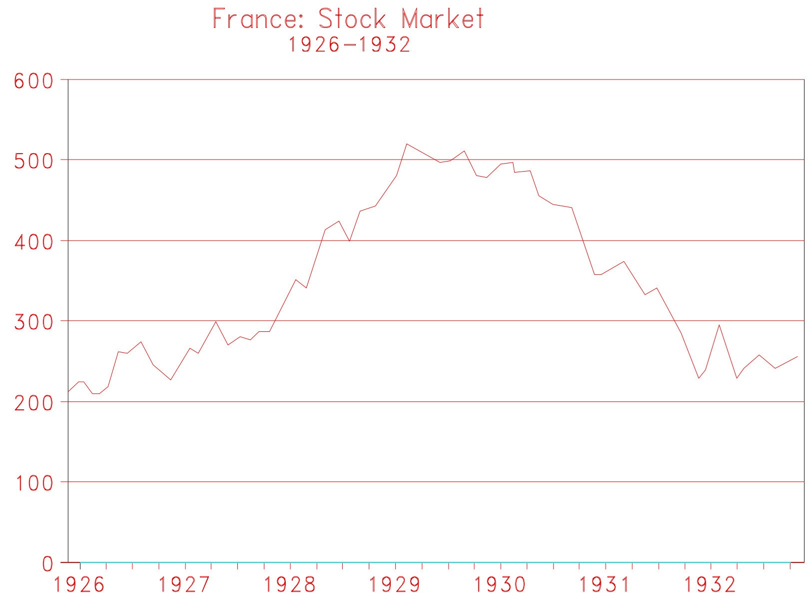


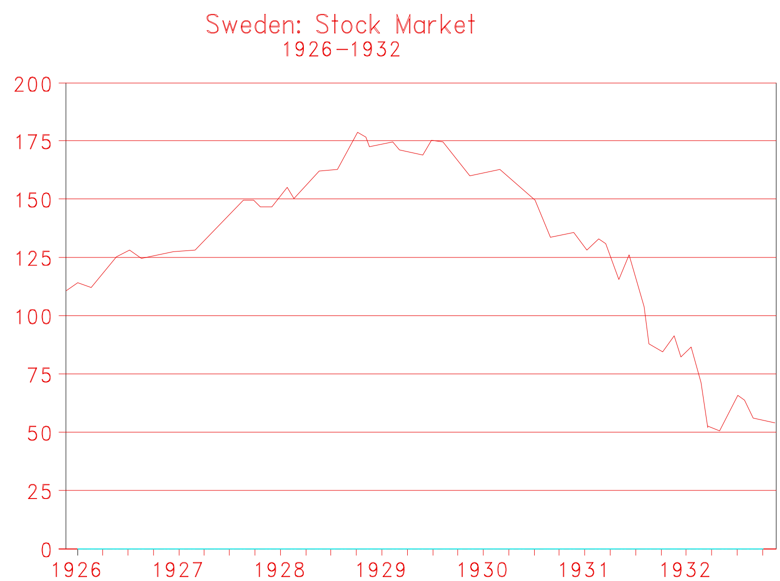


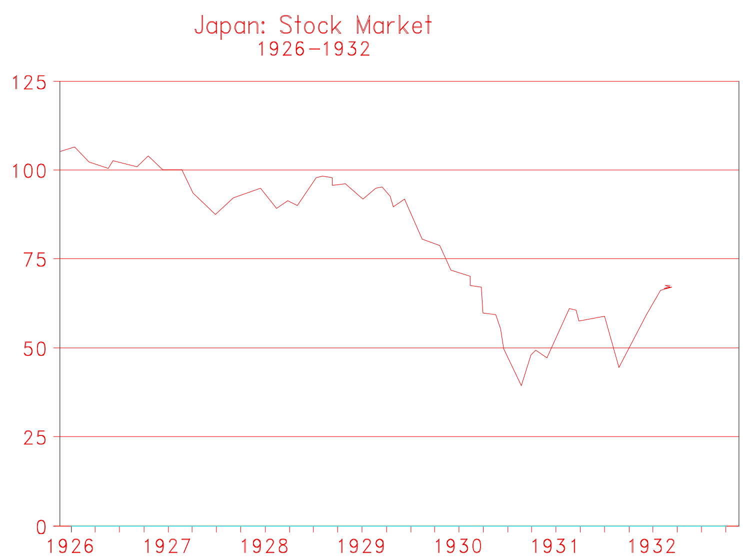
AT&T didn't decline, but instead they rallied to new highs when others were falling and looking for some sign of support.

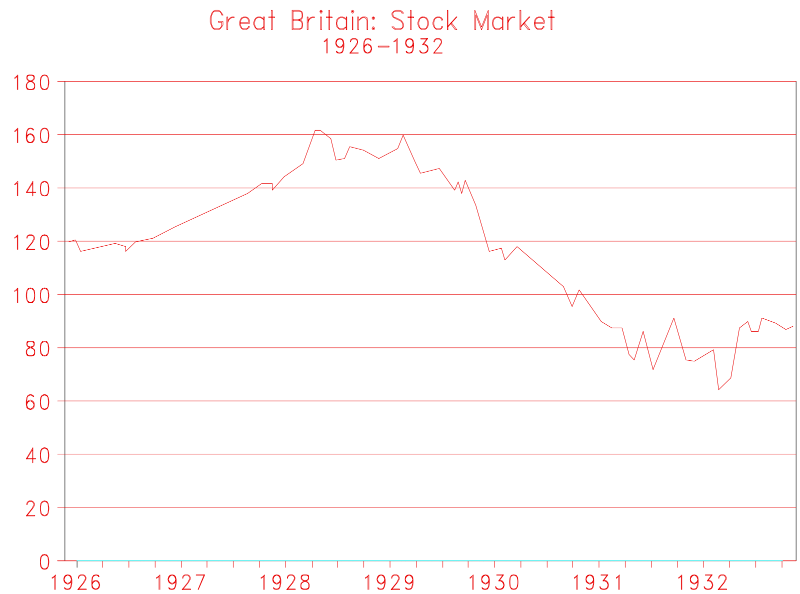
The exchange closed that Saturday and even shortened the days. Normally the market traded from 10 am to 3 pm, but it was ordered to close by the governors at 2 pm each day that week. One of the more famous seers who was often quoted in those days was the well-known economist Colonel Leonard Porter Ayres of the Cleveland Trust. He came out and made quite a serious statement which was still reflective of the "professional" trader of the day. He said:

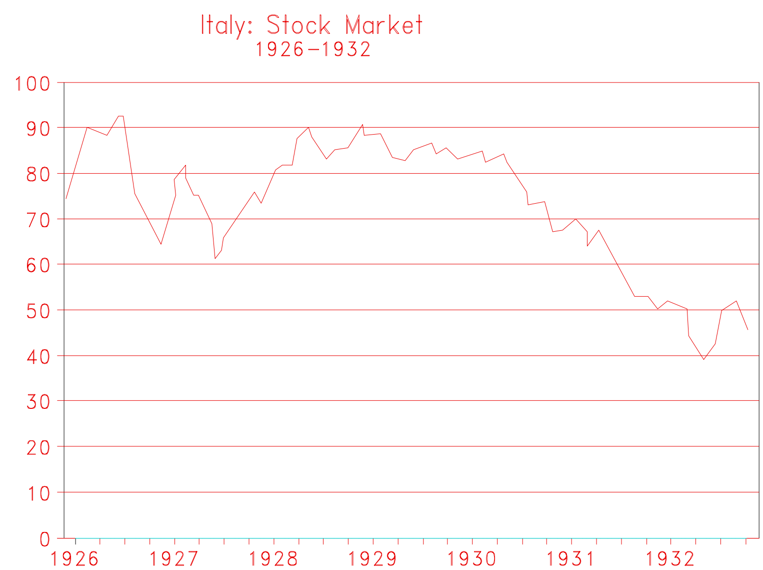
"This wave of speculation has extended to all parts of the country, and drawn in all parts of the country, and drawn in all classes of population. Increasing thousands of first-time speculators are watching their paper profits mount, and are concluding that anyone who works for a living is a boob. It is almost literally true that great waves of speculation like the present one cannot be killed off; they have to commit suicide. How much longer this market may run is as impossible to predict as was the duration of

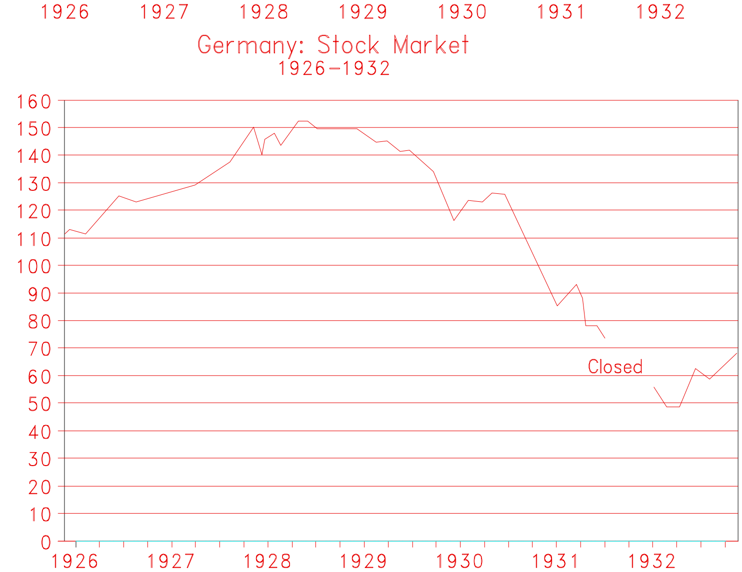

France: Stock Market
1926–1932
600
500
400
300
200
100
0
1926
1927
1928
1929
1930
1931
1932

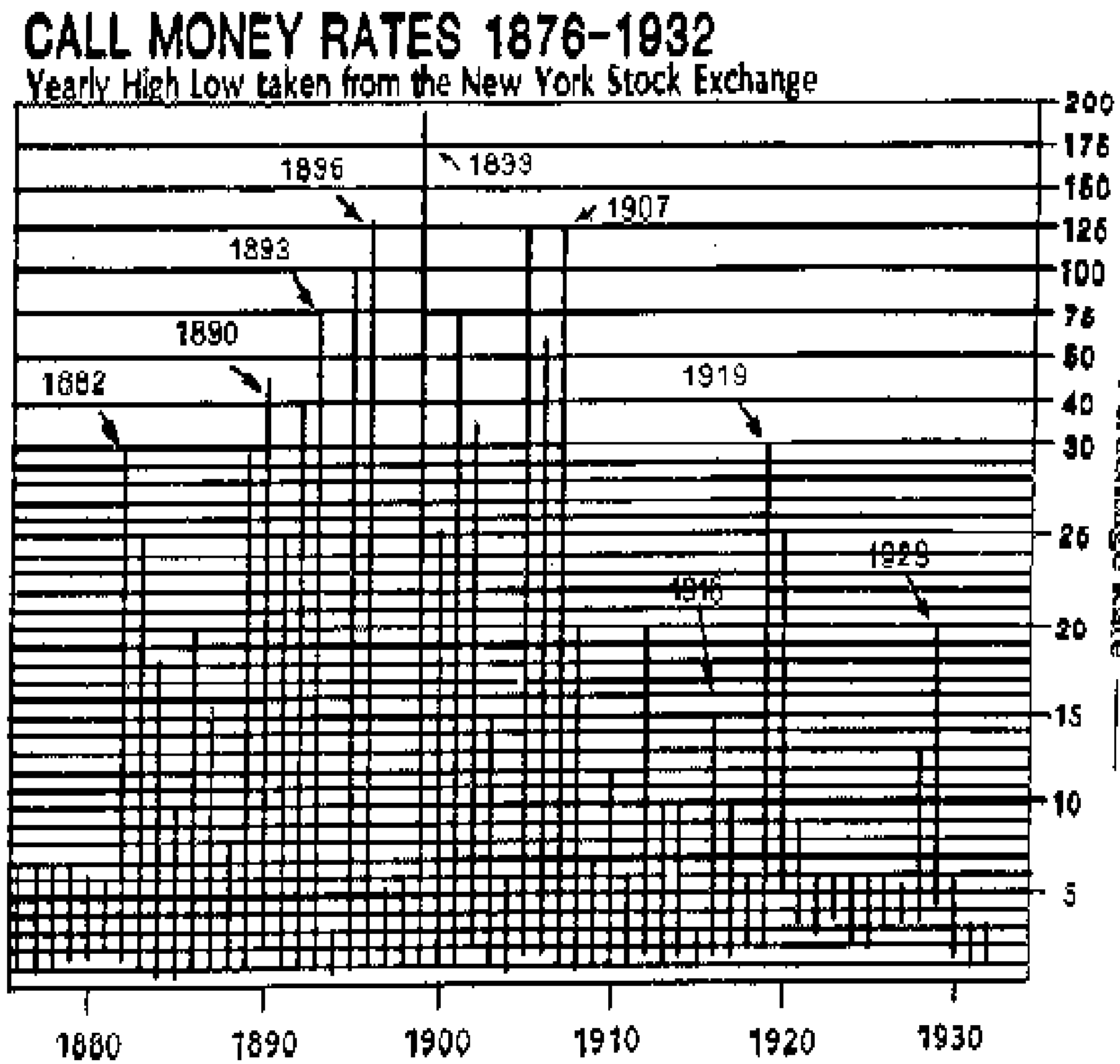

Sweden: Stock Market
1926–1932
200
175
150
125
100
75
50
25
0
1926
1927
1928
1929
1930
1931
1932


Japan: Stock Market
1926–1932
125
100
75
50
25
0
1926
1927
1928
1929
1930
1931
1932


Great Britain: Stock Market
1926–1932
180
160
140
120
100
80
60
40
20
0
1926
1927
1928
1929
1930
1931
1932

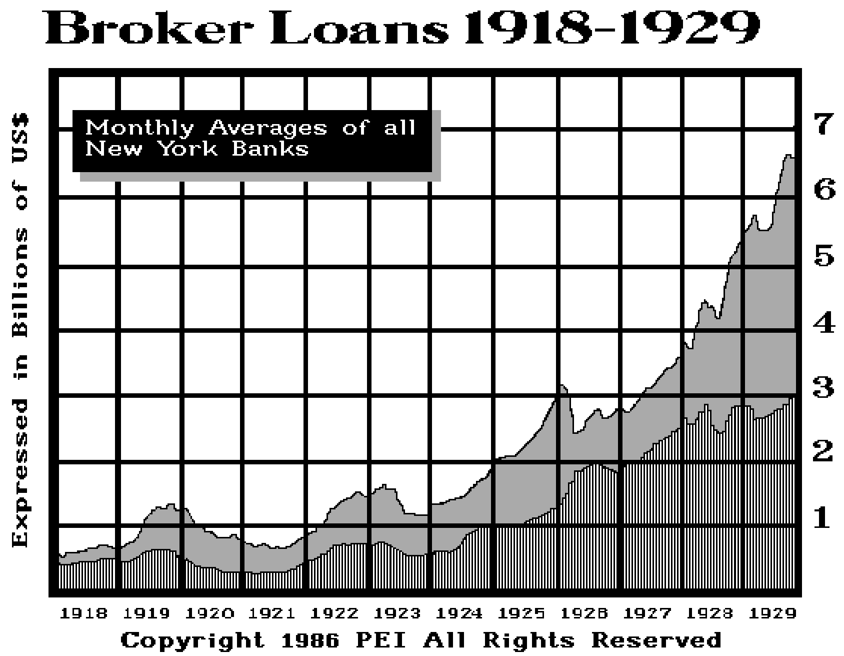

Italy: Stock Market
1926–1932
100
90
80
70
60
50
40
30
20
10
0
1926
1927
1928
1929
1930
1931
1932


Germany: Stock Market
1926–1932
160
150
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
Closed
1926
1927
1928
1929
1930
1931
1932



the Florida boom and for similar reasons. The leading stocks in this market, taken as a group, now yield in dividends about half as much as it costs to carry them on margin. Speculators think they are discounting the future earnings of the prosperous companies. In the bull markets of the past 30 years the prices of groups of stocks have repeatedly been carried up to levels quite out of relationship to their earnings or their dividends. This has happened with the express companies, the rails, the coppers, the oils, and the equipments. The records show that these extreme price advances have always turned out to be based on belated recognitions of past performances rather than on prophetic appreciation of future possibilities."

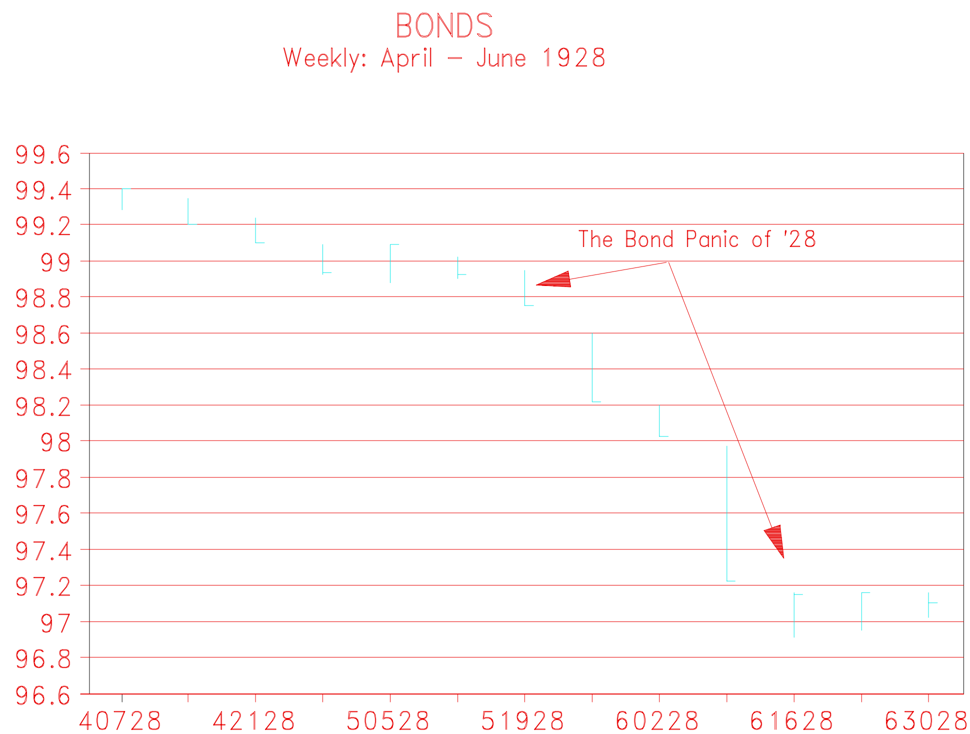
The public was not concerned so much with margin. Figures in historical studies revealed that most of the buying again was for cash which was being funded by the withdrawal from the bond markets. Concern was building over many areas. The fact that the discount rate was raised in May to 4.5% by the New York Fed did not deter the buyers in the stock market.



Why was the Fed raising the discount rate so fast after lowering so far? The Fed's helping hand to lower the discount rate so that Europe could attract more needed funds backfired. Since September 1927 gold flowed out of the U.S. reserves like water held in a bottle with a hole in the bottom. Between September and May, $494 million in gold bullion left for Europe. This was in itself an historic drain. This meant that cash for lending was tight and the Fed, after artificially lowering the discount rate to help Europe, forced a decline in the dollar which it never expected. Now the Fed had to raise the discount rate faster than they had ever done in prior years and faster than they had brought it down. During a single week in May, France drew $13 million from the U.S. reserves and as soon as that left on the boat another $12 million was set aside for their account. The total gold reserves dropped from $2,690,052,000 to $2,640,809,000 in one week. That was a decline of nearly $50 million dollars. Even the N.Y. Fed was forced to raise its rate to 4.5%.

The foreign markets were very active themselves. Curiously enough, the British stock market peaked at this time, coinciding with the low in the dollar and the high in the pound. From the April high, the London market continued to fall 15% into July, rallied back up by 5%, remained sideways until January 1929, and fell straight down from the 175 level to 120 by the end of 1929. Therefore, this upturn in the U.S. stock market began to pick up steam as the dollar rose against the pound into 1929.

The German stock market peaked during June. Sweden peaked back in 1927 at 175, fell to 140, and rallied back to 175 to create a double top during September 1928 at about 170. Italy peaked back in 1926, fell sharply, and then rallied for a test of the highs during 1928. Belgium peaked precisely during May 1928. Japan had been in a downtrend since 1925. The Netherlands moved largely sideways, finally topping



during the first quarter of 1929. Switzerland's market peaked during September 1928. All foreign stock markets that moved higher beyond the May 1928 point did so at a very slow pace. Only France soared straight up, but this was solely due to the fact that the franc was devalued substantially during this period.

By the end of May, 1928, all the Federal Reserve district branches had raised their discount rates to 4.5% with the exception of San Francisco and Kansas City. The call money rate rose to 6.5% for the first time since July, 1921. The exchanges were still very much unsettled by the huge volume of trading. Clients complained about the short hours of trading and the five-day trading week so the New York Stock Exchange resumed a six-day week and a full day going into June. The Chicago Board of Trade took a vote of 795 for and 116 against beginning to trade stocks. The Chicago Stock Exchange complained bitterly. In Los Angeles, the new Curb Exchange was scheduled to open trading in June. Time magazine reported in June that the U.S. invested $1,000 every second. They claimed that the national wealth was $320 million and the population was now 117 million. And to top matters off, the Equitable Trust Co. in Manhattan, aggressive and bent on building business, advertised in a bold and striking way. Their ad stated: "Banks don't solicit expiring accounts. Establish your banking relationship and your credit while conditions are favourable. No doctor is anxious to be called in when the patient is known to be dying. Neither can you expect a bank to want your account when you are in business trouble. Be sure to establish a profitable connection when you are prosperous and in a position to choose."

Broker loans were rising, which did indicate that some speculation had also entered the market at this time. But May brought with it a top in the railroads and moving into June, a sharp correction followed. From a record high in May nearly reaching 148, the rails fell sharply all the way back to under 134 in June. It was a one-month correction which was very sharp indeed. The bonds

also fell from above 99 in May, cracking slightly below the 97 level, a little more than 2 full points.

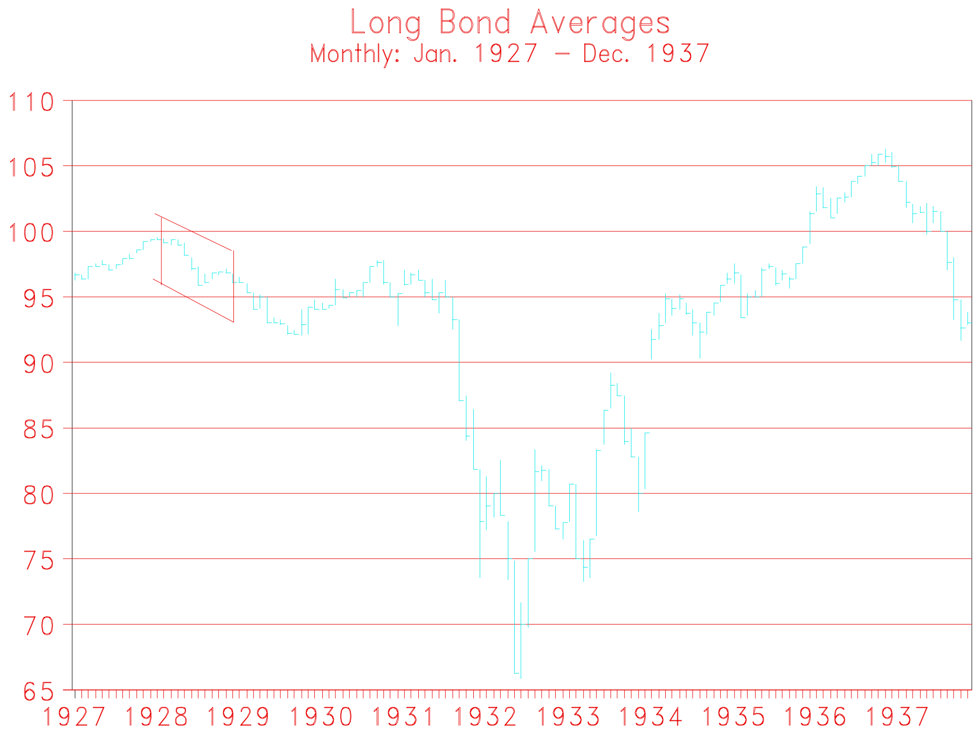
In the June 25, 1928 edition of Time magazine, the commentary on the "Stock Market Break" that month was as follows:

"Stock market prices broke last week. It was expected. Many causes can be adduced. But the chief is the fact that speculators had abandoned thought of the relation of security prices to the earnings of underlying business ventures. It is inaccurate to say that any one security issue started the break last week. But if one is to be set up as a black example, it is the Bank of Italy. On the San Francisco and Los Angeles exchanges Bank of Italy stock broke 160 points - from 284.75 to 125. Related issues acted likewise. Bancitaly dropped 86 points - 195 to 109; Bank of America 120 points - 270-150; United Security 80 points - 245 to 165. In New York the drops in these issues were as great. Millions of paper profits disappeared. On one day New York Stock Exchange brokers handled 5,052,790 shares (a record number), New York Curb Market breakers 1,329,000."

What was it that shook the market so drastically? Why was it that the banking stocks led the way down? The answer to those questions ironically was the world debt situation. The collapsing bond market cast an unsettling air about the exchange. Some people were fleeing from bonds into stocks and professional traders were selling both. The bank stocks were the centre of attraction because they were seen as perhaps the greatest risk.

In the July 23, 1928 edition of Time magazine, an excellent article appeared which summed the situation up quite nicely. It explained a few very important factors which we today would find not merely interesting but critical, considering the international debt situation in the 1980s.

"BULL. For four years, Wall Street has been noisier than ever before in its history. It has seen a stream of gold pouring in from



abroad. Between 1923 and 1928, the U.S. exported gold worth $500,000,000, but imported $1 billion. Each $1 of gold in a bank reserve means a potential $13 credit. In four years the U.S. in this way alone added $6,500,000,000 to its credit resources. It could finance a building boom, a Florida boom, vast installment selling, new highways, new factories. It had enough credit to support a continuous bull market with stocks soaring week by week. Through the twelve Federal Reserve banks it could lend money to brokers at 3.5 or 4% swelling the credit available for speculation. Money was easy. Times were good for the traders.

"Money was never so easy as last September, when the bull market was in full swing. But in Europe the central banks were in trouble. Helpfully, the Federal Reserve sought to ease up still further on credit in the U.S. with the sound idea that higher interest rates abroad would attract much needed funds. It ordered the Chicago Bank to reduce its rediscount rate from 4 to 3.5%. Chicago bankers, led by famed Melvin Alvah Traylor, head of the powerful First National Bank dissented sharply voiced grave warnings. Unheeding, the Federal Reserve forced its way, helped Europe weather its crisis.

"BEAR. Banker Traylor's warnings have been remembered in the last few months. Since September, Coolidge prosperity has suffered many a blow. One by one market operators have noted these ominous signs:

1) The stream of gold has turned away from the U.S. In the last year, exports have exceeded imports by $497,963,400, killing all the gains of the 1924 to 1927 period. In June, exports reached a record for a single month with $99,932,000.

2) Its credit resources already strained by the movement of gold abroad, the Federal Reserve stopped buying government securities, started SELLING them, withdrawing loose money from the market, reducing its credit reserves still further.

3) In spite of this reduction, borrowings from member banks, largely to finance brokers' loans, climbed to a new high point

since 1921, reaching almost to $1,200,000,000.

4) Speculation skyrocketed. Brokers' loans increased by more than $1,000,000,000 in twelve months, standing last week at $4,242,699,000.

5) The stock market became nervous, jumpy, catapulted through a 5,000,000 share day, recovered a little, remained uncertain.

"PROGRAM. Determined to stop the speculative orgy, the Federal Reserve started to bring the era of easy money to an end. Sale of government securities was the first step. Then followed a series of experiments with the rediscount rate. New York advanced from 3.5% to 4% on Feb 3, from 4 to 4.5% on May 18. Still the market held and broker's loans continued to mount.

"Last week, Chicago took the initiative, jumped the rediscount rate to 5%. Then New York, Richmond, Atlanta did the same. The market broke at once, representative stocks averaging a decline of 4.41 points, the greatest since the fateful July 30, 1914. Du Pont fell 16.5 points; General Motors 8; General Electric 6.25. Call money rose to 7%. Thanks to six months campaigning, money at last was tight. At last Banker Traylor had had his way.

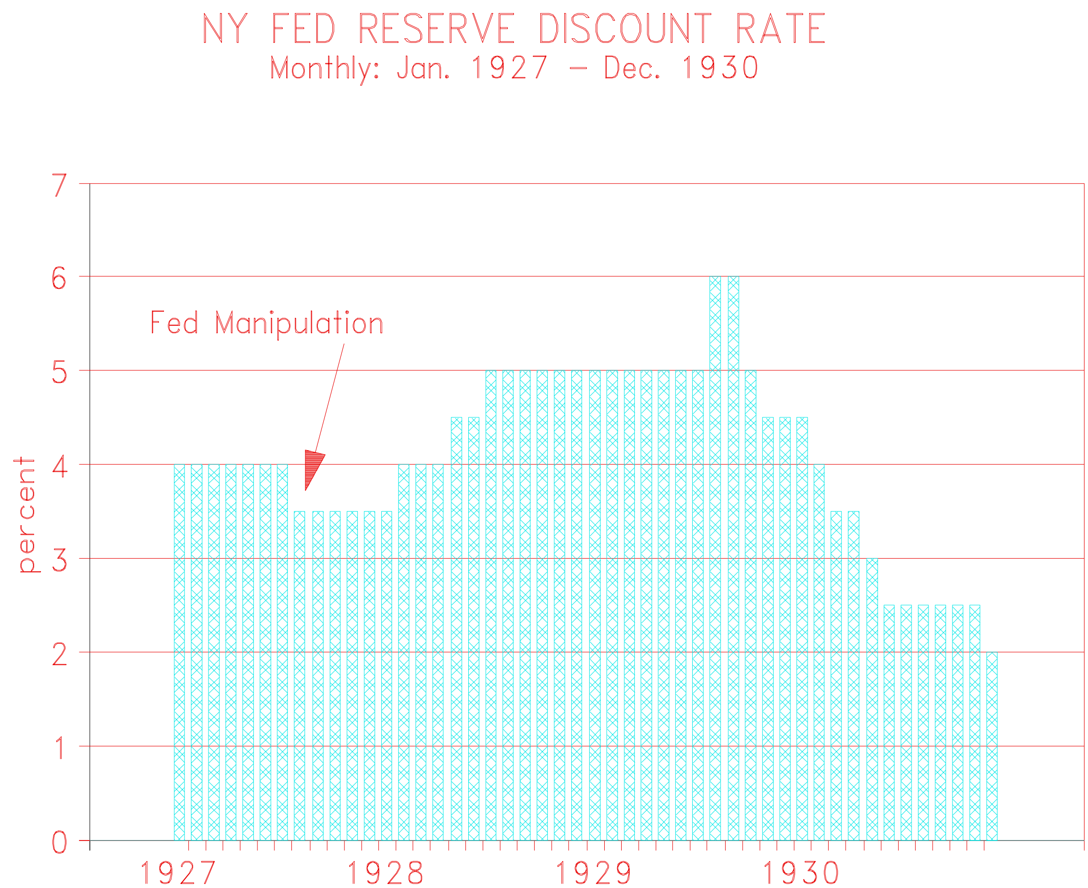
"BETS. Experts foresaw tight money throughout the summer, or until member-banks repay some of their debts to the Federal Reserve and brokers' loans show a marked drop. Col. Leonard Porter Ayres, famed economist of the Cleveland Trust Co., saw the stock market as a 'great national bet against the continuation of high rates, and since the Federal Reserve authorities can hardly reverse their present policies until the excessive use of credit for speculation has been terminated, the decision will probably be against the stock market.' He predicted 'the end of the Coolidge prosperity era of five years and a serious decline in stock prices before the end of this year.' Banker Traylor, 1927 Cassandra, ventured a snort, a prophecy: 'There is no more justification for the prices of a lot of these favorite speculative stocks than there was for $500 an acre for Iowa land in 1920. If there is not a return to sanity we will lose our position of world leadership.'

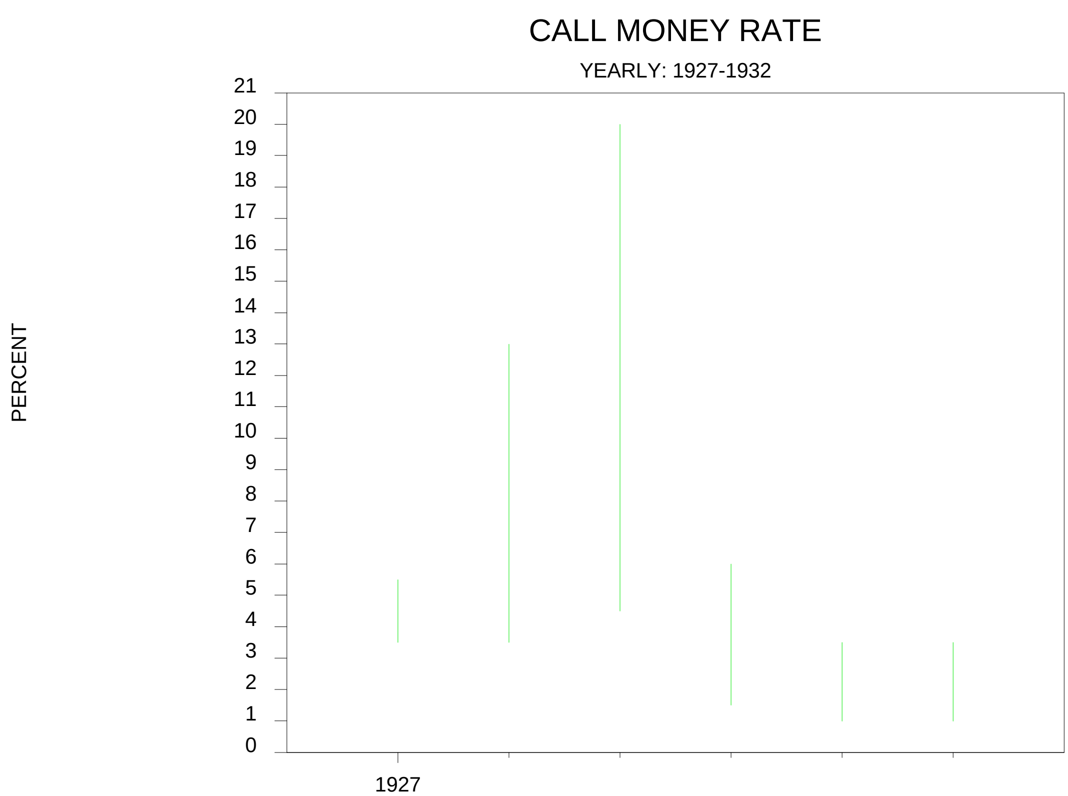
"MORBID. Stock speculation shouted 'Paternalistic!' and 'Mollycoddling!' They cried: 'What business is it of the Federal Reserve whether General Motors is at 150 or 200?' Bond houses watched a continuing weakness in their market with foreboding.

"STRONG FLAYED. From Chicago came angry demand at the Chicago Tribune for this resignation of Governor Benjamin Strong of the Federal Reserve Bank of N.Y. Declared the Tribune, in I-told-you-so spirit; 'Stock speculation grows of its own momentum, like a snowball. This snowball was started on its way with the help of Gov. Strong. It was through his influence that the Federal Reserve Bank of Chicago was forced to lower its rate against the judgment of Mr. Traylor. Gov. Strong's participation at the start makes his resignation now imperative."

The above article, recounted here word for word without deletion, sums up the atmosphere that surrounded that sharp collapse in the stock market during June 1928. Clearly the bitterness toward the artificial lowering of the domestic U.S. interest rates to help financially distressed Europe brings back memories of the G-5 boys in 1985.

Are there any lessons to be learned? Obviously, we will see from here on out that up until the G-4 meetings of Benjamin Strong, Governor of the NY Fed, interest rates had


NY FED RESERVE DISCOUNT RATE
Monthly: Jan. 1927 - Dec. 1930
Fed Manipulation
percent
7
6
5
4
3
2
1
0
1927
1928
1929
1930


CALL MONEY RATE
YEARLY: 1927-1932
PERCENT
21
20
19
18
17
16
15
14
13
12
11
10
9
8
7
6
5
4
3
2
1
0
1927

remained fairly steady. Was that pressure to drop the discount rate to aid cash flow toward Europe in the face of a strong dollar the catalyst for the stock market collapse and the entire 1929 Depression?

From this point onward, interest rates began to rise at a far greater pace than ever before. Like the snowball effect mentioned in the article in respect to the stock market, the same snowball effect took over in the interest rate markets as well. The upward velocity from this point onward neither stopped the stock market nor the depression which would eventually engulf the world.

In the July 30 edition of Time magazine, the front cover story was once again the conflict of Chicago vs. New York. The account illustrates the bad feelings throughout the nation over the huge problems set off by the G-4 boys of the 1920s.

"Brilliant is the spotlight which plays about the comings and goings, the doings and infrequent sayings of Gov. Benjamin Strong of the Federal Reserve Bank of New York. All the world knows when he speeds to Europe. All the world watches for his meeting with the Grand Viziers of international finance.

Montagu Collet Norman, witty Governor of the Bank of England;

Hjalmar Schacht, stern President of the German Reichsbank;

Emile Moreau or Charles Rist of the Bank de France.

"In Washington, a man named Roy A. Young presides day by day over the Federal Reserve Board, central authority of the twelve regional banks. In Chicago, Minneapolis, Atlanta, sit Governors with as much authority as clothes the Governor of New York's bank. But when Benjamin Strong ill receives the foreign chiefs in Manhattan, no Wall Streeter thinks of the quiet, unostentatious figure in the Treasury building's spacious offices. And certainly no Streeter thinks of such an untraveled, provincial person as a banker in Minneapolis or Atlanta or Chicago might be supposed to be.

"So compelling was the prestige of cosmopolitan Gov. Strong that it seemed almost presumptuous when Chicago bankers ventured last fall to challenge the wisdom of his international money-juggling. If wise Gov. Strong, fresh from a meeting of master minds, thought Chicago should reduce its rediscount rate from 4 to 3.5% to aid his European comrades in finance, only bad manners or sheer contrariness could explain Chicago's dissent. Gov. Strong was cast for the hero's role in the drama of U.S. money. Obviously, all that remained for Chicago was to be the juvenile or the villain.

"Last week, Gov. Strong was again in Europe. And his Manhattan supporters noted with alarm that Chicago was showing distinct signs of insubordination, was even pretending to take the lead in the intricate business of money-Juggling. Boldly, the Chicago Reserve Bank recalled its warnings of last fall, pointed to diminishing credit

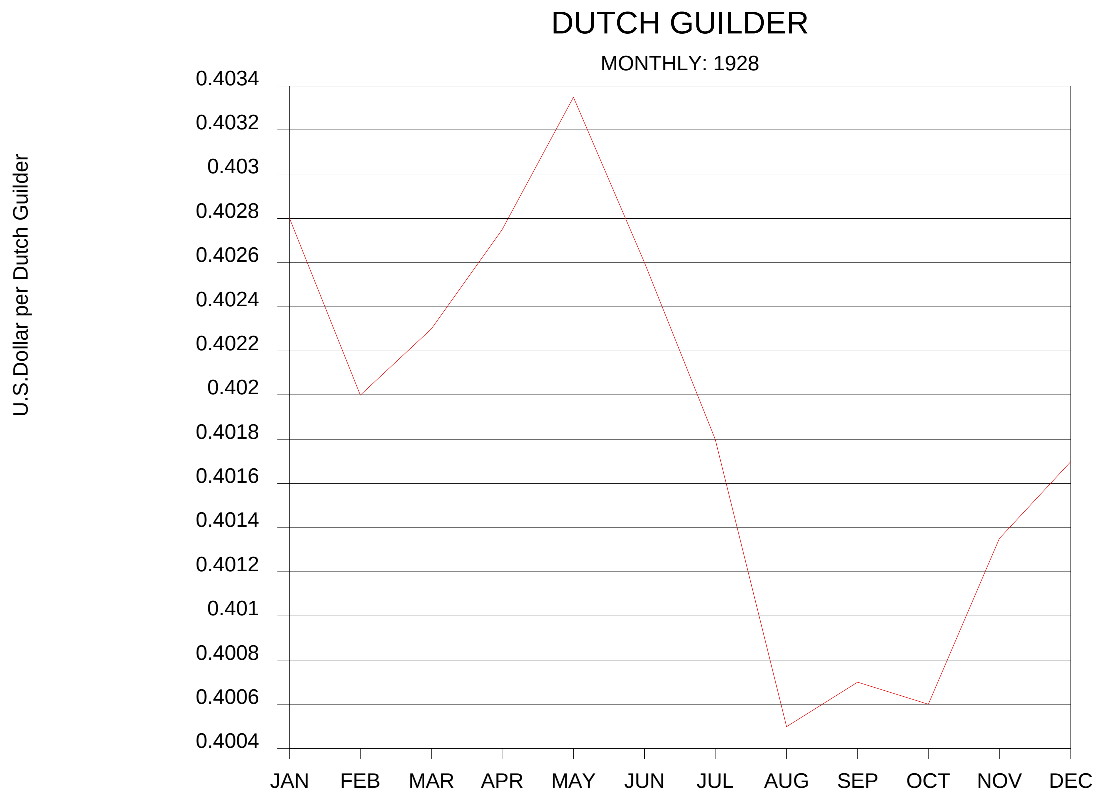
BENJAMIN STRONG

MELVIN ALVAH TRAYLOR

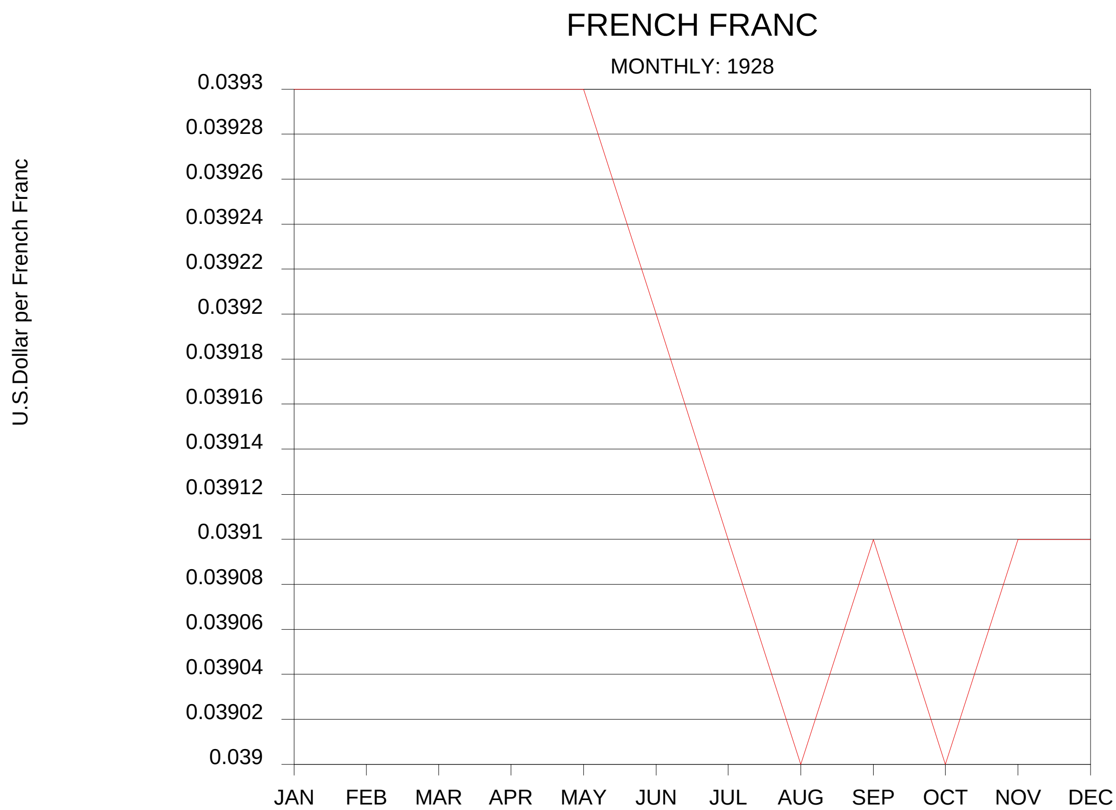
reserves and wild speculation, jumped its rediscount rate to 5%. Manhattan, accustomed to lead, was forced to follow. Chicago's press openly flayed the absent Gov. Strong; screechingly demanded his resignation.

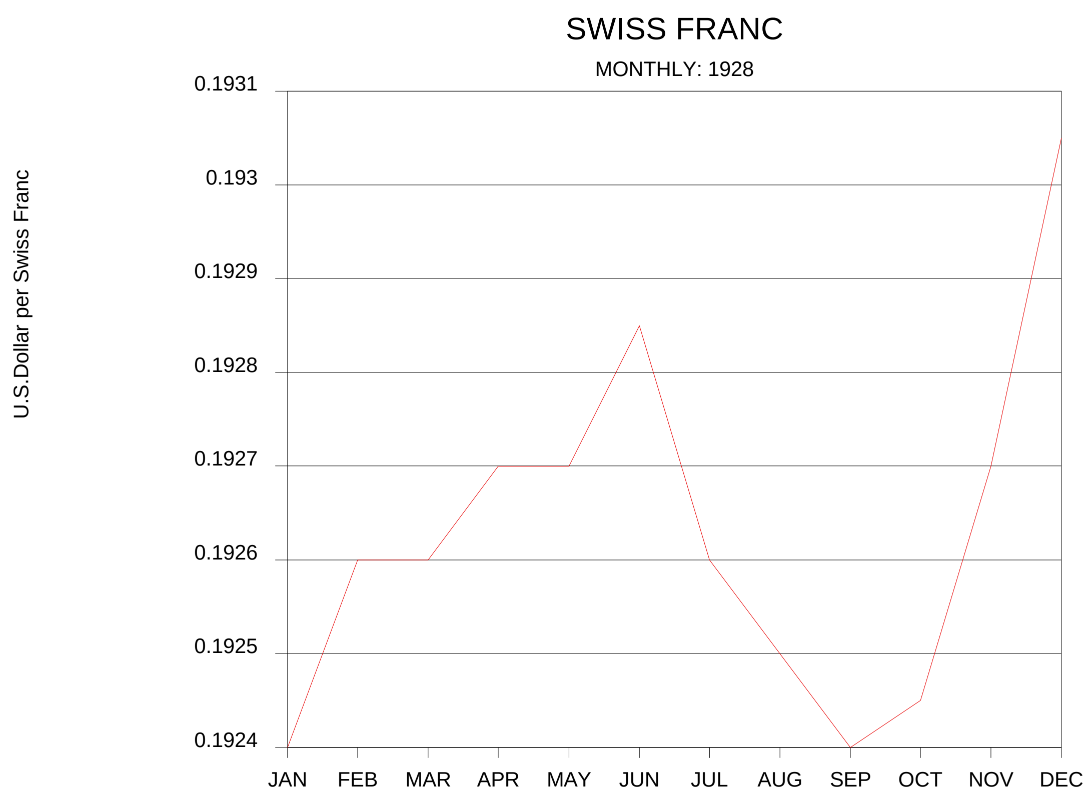
"Puzzled, irritated, New York bankers asked questions. Who gave provincial Chicago the right to criticize internationally-minded Manhattan and its Gov. Strong? In New York papers, an anonymous banker charged the regional bankers suffered 'delusions of grandeur.' And if it came to that, who were these Chicagoans, anyway?"

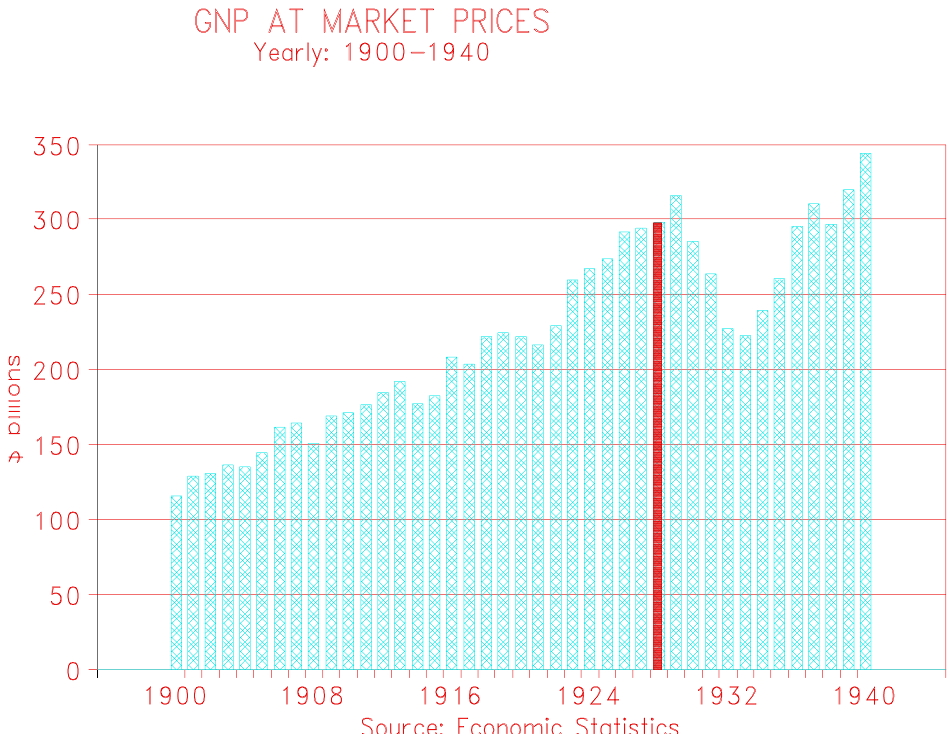
It is surprising with all this fanfare about speculation and the interest rates that the Chicago hike to 5% on the discount rate in July 1928 did not send the market to new lows. If we look at the charts, we can clearly see that the railroads rallied back from the June low of under 134, nearly reaching 140 in July and closing the month above the June close. The industrials, which had fallen from 221 to 202 in June, rallied back and closed almost on the high in July near 218. The bonds, however, fell from above


DUTCH GUILDER
MONTHLY: 1928
U.S.Dollar per Dutch Guilder
0.4034
0.4032
0.403
0.4028
0.4026
0.4024
0.4022
0.402
0.4018
0.4016
0.4014
0.4012
0.401
0.4008
0.4006
0.4004
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC


UNEMPLOYMENT
Yearly: 1900-1929
PERCENT
12
11
10
9
8
7
6
5
4
3
2
1
0
1900 1907 1914 1921 1928


FRENCH FRANC
MONTHLY: 1928
U.S.Dollar per French Franc
0.0393
0.03928
0.03926
0.03924
0.03922
0.0392
0.03918
0.03916
0.03914
0.03912
0.0391
0.03908
0.03906
0.03904
0.03902
0.039
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC


SWISS FRANC
MONTHLY: 1928
U.S.Dollar per Swiss Franc
0.1931
0.193
0.1929
0.1928
0.1927
0.1926
0.1925
0.1924
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC



9700 to reach their lowest closing for the year at the end of July under 9600.

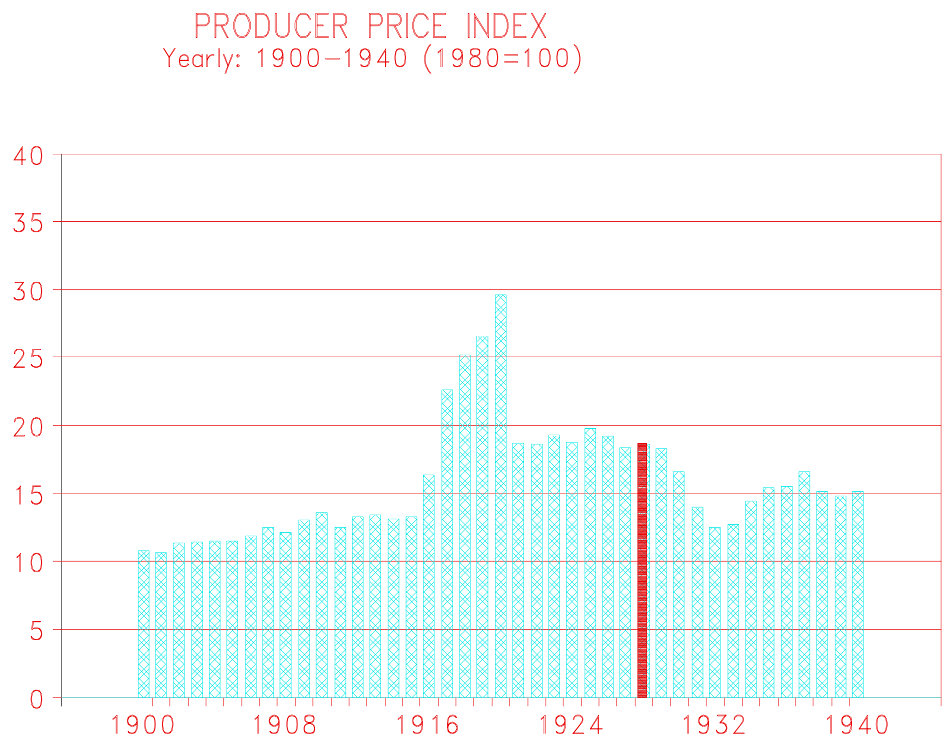
July was still marked by mergers and takeovers much like the period during the 1984-1986 era. One of the most important mergers was in the soap industry that July. The two famous firms were the Colgate Co. and the Palmolive-Peet Co. This merger would provide a combined estimated sales for 1927 of $100 million. The Colgate Co. was originally founded in 1795 and now this merger would mark a combined effort to attack the giant of the industry, which was Proctor and Gamble with 1927 sales reported at $191 million.

Another merger which has lived on in the minds of America today was the merger of the Dodge Brothers and the Chrysler Corp. Other events were noted around the nation with numerous mergers. G.M. announced record earnings once again which helped to steady the market.

In Chicago, the price of meat was rising sharply. Porterhouse steak rose from 80 cents to 90 cents a pound and sirloins to 45 cents. Meat prices were watched with alarm as they could potentially rise to the 1920 highs of the World War I era when porterhouse reached $1 a pound.

The rise of the stock market had definitely been accompanied with rising call money rates that now traded between 5-10%, which was sharply higher over the 2% low in prior years. But it is also important to note that the varying rates where money was deposited were a direct cause at that time of many side effects. For example, commercial bank deposits only paid 2%. Therefore, corporations seeking to invest their surplus cash were often lured to good securities which yielded 4% to 6% in dividends. But a growing practice at that time was similar to the money-market crisis for the banks in the 1980s.

Bonds not only fall during periods of higher rates, but their popularity declines as well. This is a normal relationship which one must keep in mind in the years that will follow 1986. The stock market of the 1920s



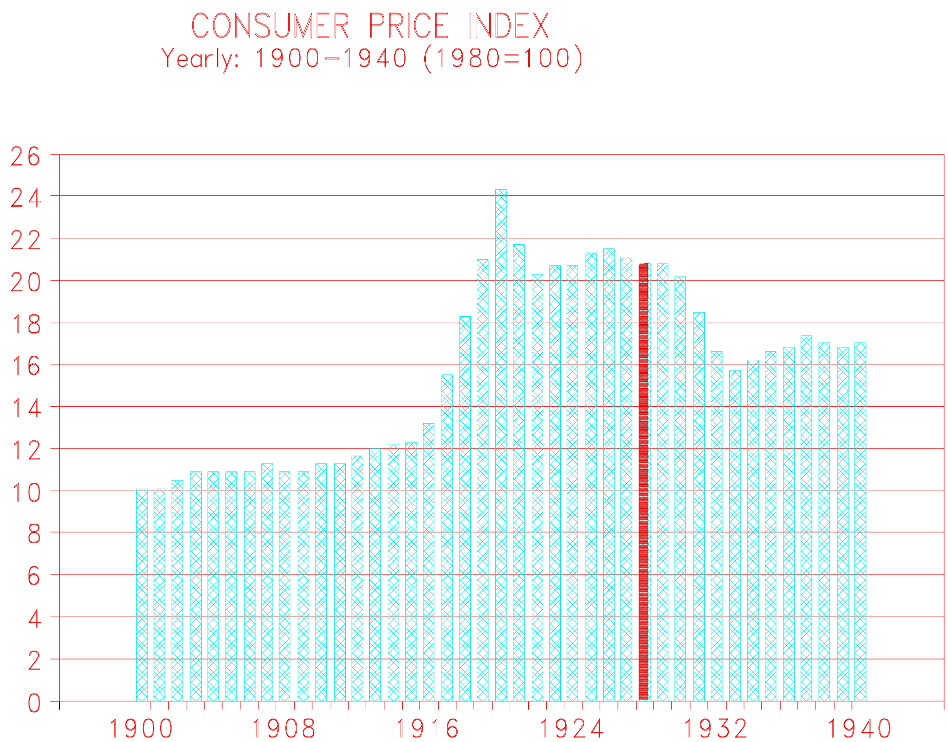
was now being fueled in an unending circle of funds. Corporations, with rising surplus cash and cash obtained through the sale of securities, were attracted to the call money market much as individuals were attracted to the money-market funds in the early 1980s.

Instead of corporate cash being deposited as a normal commercial deposit earning only 2% at the bank, corporations were distinctly lending their surplus in the call money market where they could obtain 5% to 10% on an overnight basis. Between July 1927 and 1928, the frolics of the Fed did not merely set off a cash flow drain in favour of Europe, it set off a drain from time deposits into call money deposits. Call money deposits rose from $906 million in July 1927 to $1.8 billion by July 1928.

Eventually, the Fed and Congress blamed the rise in call money upon wild speculation. Although that argument was perhaps true to some degree, it was primarily caused by the action of the Fed in the first part. By distinctly lowering its discount rate artificially to lower the dollar and help Europe, it set off a great imbalance among the varying types of interest bearing deposits. Cash not merely flowed to Europe but those who feared Europe's problems found the stock market a safe bet. Call money could be literally "called" out on a moment's notice. The risk was essentially the bank's for the bank placed the funds in the call money market upon instruction and for a commission.

Banks were becoming concerned at losing deposits to Europe and time deposits domestically as well. The banks began to warn clients that they were going to raise their commissions on call money loans. In a single week late in July, call money deposits leaped a staggering $370 million.

The President of the National City Bank in New York publicly stated: "It is a dangerous and unhealthy trend." The Vice President of Guaranty Trust commented: "This is one of the by-products of prosperity with which we have not learned to deal." The Cleveland Trust Co. stated: "Clearly a re-



form is needed in New York banking practice."

The controversy over the varying money rates continued into 1929. But for now the bonds weakened as advertisements appeared with headlines: "BACK TO BONDS They Pay In the Long Run." Corporate earnings were still rising and the reports adorned the papers day after day.

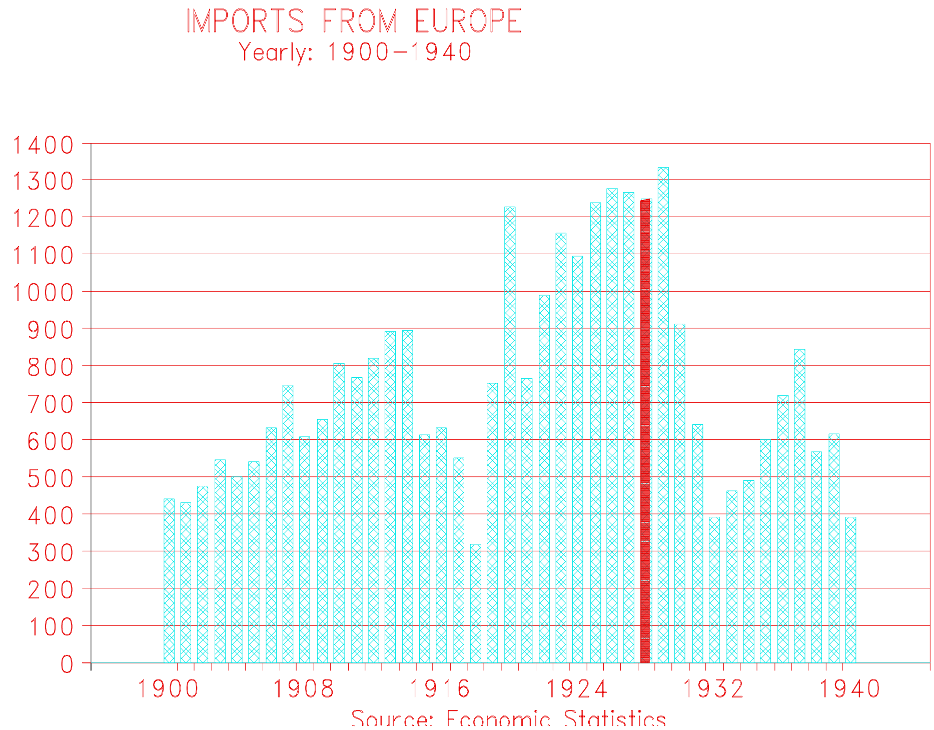
Then August came onto the scene. Suddenly the market raged onward in the face of climbing rates around the nation. The Dow Industrials soared to a new record high straight up in virtually a single breathless move closing August above 240. The rails rallied smartly but remained below the May high of nearly 148, closing barely above 143. Of course, the bonds did little more than hang around a half point range desperately trying to remain above the July low.

The surge in the stock market and the surge in call money deposits raised the blood pressure at banks around the nation as well as at the Fed. Time magazine once again reported on the issue in a very precise manner in its August 13 edition.

'STOCK MARKET"

"Week by week the total of brokers' loans mounted. Federal Reserve banks led by Chicago raised the rediscount rate to 5%. Still the member banks reported that corporations and individuals were withdrawing deposits and putting their funds on the call loan market. Last week, U.S. bankers sat down to a serious campaign to end the wholesale diversion of money for speculative purposes.

"In Chicago, Federal Reserve directors discussed radical action, a return to the early system of 'differential rediscounting' with low rates for agricultural and industrial loans, high rates for loans destined for speculation. To Manhattan came curly-haired Roy A. Young, Governor of the Federal Reserve Board, ostensibly on a tour of inspection. But bankers noted his arrival



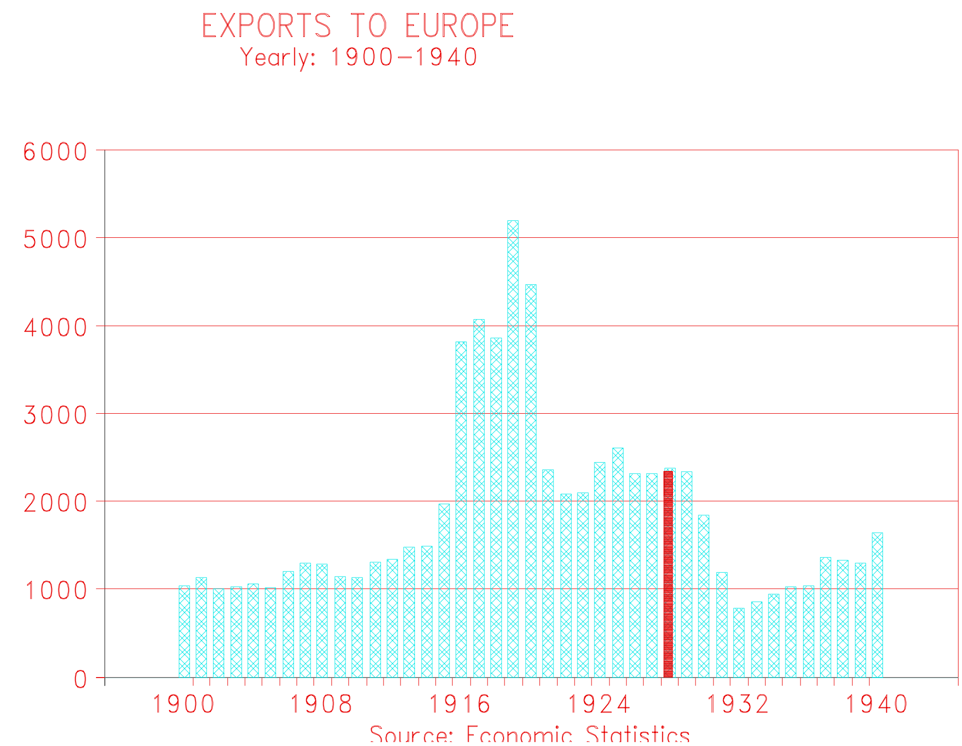
coinciding with the issuance of a serious warning by the Federal Reserve Bank of New York. Banks were 'overloaned.' The discrepancy between deposits and loans was becoming too great.

"Most promising, however, was the action of the New York Clearing House. Banks shall refuse to put the money of the corporation out on call in amounts less than $100,000. Further, they shall increase their service charge on loans made for others from 5% on the interest on the loan, to .5 of 1% of the principal. Banks anticipated protests, prepared to meet them by handing the corporations a partial recompense. Interest rates on commercial accounts were raised from 2% to 2.5% and on deposits for 30 days or more from 2.5 to 3.5%.

"But a chasm still yawned between interest rates on deposits and on call money. Opinions were divided on the possibility of curbing speculation by refusing to lend money on behalf of corporations. The corporations, for example, might lend their money directly, ignoring the banks. Or they might start a bank of their own. There seemed, last week, a number of ways by which the money market might be taken out of the control of the Federal Reserve and of its member banks."

Curiously enough, the dilemma of the time was brewing. The Fed, in its efforts to help Europe, set off a cash drain from U.S. deposits. The Fed's insistence to control the stock market and to stop the rise in equities caused its member banks to raise call money rates to try to discourage borrowing. But the drastic imbalance between the short-term and long-term became too attractive. The higher the call money rates went, the more money they attracted.

This is a very important lesson which we should learn well. The stock market from this point would rise from the June low of 202 to 386 by late 1929 at its peak. That rise was not squashed by the Fed despite rising rates. The higher the rates for brokers' loans the more money it attracted. Therefore, the age old scenario that the stock



market falls with higher interest rates is clearly NOT TRUE!

It is clear that as long as dividends were rising and equaled or bettered the call money rate, the incentive to borrow was NOT diminished but increased. If the short-term exceeds the long-term rates and dividends are not hampered, overnight markets as well as brokers' loans will attract money, not the opposite. Therefore, a rise in the discount rate alone does not mean that a bull market is over. The entire situation depends greatly upon the earnings and dividends as well as the rate of growth in the total value of the stock market itself. In addition, overseas rates may have been high but the safety of those loans was questioned. Therefore, call money was far more attractive and at least it was secured by stocks whereas foreign loans were always subject to default.

Banking in the United States was seriously threatened by this double-edged sword of losing time deposits and domestic deposits to Europe. In August 1928, in a small town in Indiana, the Citizens National Bank & Trust Co. came up with a great idea to attract deposits. It opened the first drive-in window for banking. This advantage would eventually sweep the nation as a means of attracting small time deposits.

August was filled with rumours of mergers in numerous industries. But the most noted, which came at the end of August just as the market rose to above 240, an all-time new high, was the great Chicago bank merger. During the last week of August, the stock of the largest Chicago bank, The Continental National Bank & Trust Co., rose from $545 to $676 a share in a single week. The stock of Chicago's second biggest bank, Illinois Merchants Trust Co., jumped that fateful week from $875 to $1,282 a share! This merger meant that the new Continental Illinois, the same bank which caused all the ruckus in the 1980s, would be the second largest bank in the United States. The price movements in stock on mere rumour of mergers in those days was simply astounding. The press merely had this to say as August came to a close: "Bulls rejoiced at the stock market's unexpected spurt of strength."

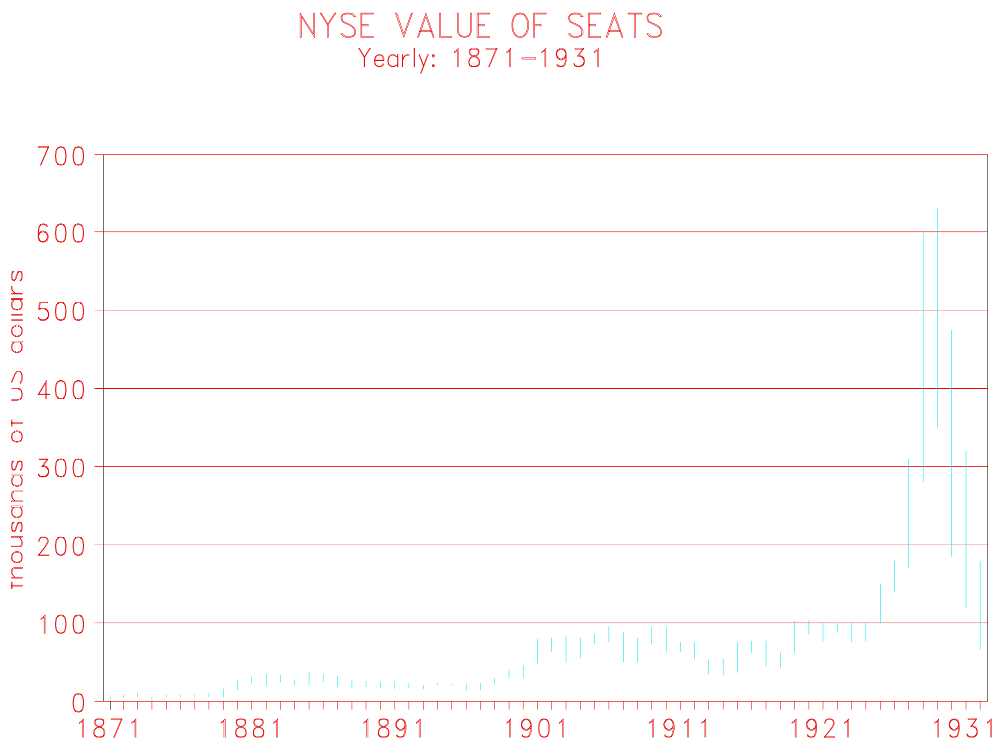
As the month of September, 1928 arrived on the heels of new highs in the industrials, the rails still failed to exceed the May high but did manage to push above the August high. Bonds regained a little during September but still traded within a half-point range. The industrials consolidated in one of the most narrow monthly ranges in history. Perhaps it was the calm before the storm. The stock market exceeded the August high but closed lower on the month. Note the chart pattern very carefully. This is a definitive technical indication of a coming major move. For the market to have held at that level in a sideways pattern trading within less than 5 points back and forth is not the sign of topping out but the clear warning of a breakout.

September brought with it little news other than rising call money rates. Perhaps the quietness of Wall Street that month was due to a heat wave in Washington and New York. The local papers reported: "The heat and humidity rose to stultifying temperatures while people died." The heat wave was so staggering that in Washington government offices were closed and in New York the Grand Central Terminal closed. Nevertheless the New York Stock Exchange was open and in New York it was joined by a completely new futures exchange in September, 1928. It was the Silk Exchange and the first trade was at $5.

In the midst of the heat wave, trading reached a new record in the middle of September, which passed the 4 million share day mark. New highs were made on many issues such as US Steel, Adams Express, Victor-Talking Machine and Montgomery Ward. Although trading was at a record level, the trading range on the industrials as a whole was the smallest in history with new price highs and record highs in volume. Obviously, many people were shorting the market and buyers were coming in simultaneously. Despite the press and the public statements by the so-called "professionals," the market failed to give ground. The balance between the two forces at record volume essentially cancelled each other out, creating an amazingly narrow trading range. This in technical terms is quite unusual. Most narrow trading ranges are accompanied by low volume as traders wait on the sidelines patiently for the market to yield some sign of breaking through one side or the other. So in many respects, September 1928 was a month of many unusual records in the history of the stock market. This pattern is something we should never forget for it preceded one of the strongest and most relentless rallies in history. And as many always say, history has a unique tendency to repeat.

September was also the month when the cocoa market in New York collapsed in panic. Cocoa fell 115 points to $200 a ton. The excuse for the collapse was pinned on women. The press commented that more and more women had taken up smoking and were eating less. Chocolate candy was one item stricken from the list as women strived for a new, slim look. Smoking was curiously enough being advertised in the press as an aid toward dieting.

The banks in New York raised the rate on 90-day loans to 7% and threatened to raise them even higher if demand remained strong. The high on 90-day time money reached a previous high which had been seen in only three out of the previous thirty years with the last high being hit in the deflation days of 1920-1921. The rise in



rates sparked much criticism. A well-known columnist in those days was Arthur Brisbane. He boldly commented on the occurrence in his column: "Borrowers should send three large gilt balls to be hung above the Federal Reserve Bank entrance, and similar ornaments to some of the big banks: This is what the law of New York State says, Section 370: 'The legal rate of interest shall not be more than $6 on $100 for one year.' Every bank charging more than 6% interest is violating the law and knows it. When men extort eight percent for loans on absolutely good security, somebody ought to go to jail, beginning with the responsible respectability in the Federal Reserve."

The amazing thing is that the market held that September and surged even higher in the following quarter. Commodities in general were still in disarray. A crisis in condiments was the next commodity to depart from the normal price affairs of the day.

Not all commodities were collapsing at this point in time. The price of salt was collapsing quite steadily. However, the price of pepper was roaring. In those days there was even a spot and futures market on pepper. The price rose dramatically from 12 cents a pound to 43 cents in the futures while the spot market was testing 40 cents. The crop from Lampong was cut in half due to severe weather conditions during 1928.

Despite the doom and gloom and the rising interest rates, neither the volume in the stock market nor the value of seats were deterred. That September a seat reached a new record high as it went for $415,000. The number of seats remained constant at 1,100 members.

There were some ominous signs from the industrial sector which the market also shrugged off during September. Car loadings (railroads) showed an increase during the week which ended September 1 of 36,108 over and above the previous week. But the bears were pointing out that it was still 412 cars shy of the same corresponding week in 1927.

The wheat crop was estimated to be slightly above that of the previous year. But Russia had previously been a net exporter of wheat and it became increasingly clear that Russia was losing its ability to produce wheat and that it would have no excess for sale that year. Wheat prices began to firm.

One side benefit of the banks raising their time money rates from 7% to 8% was the decisive shift in gold movement. During September, Britain made its first gold shipment back to the U.S. Although the U.S. had lost $500 million in gold during the past year, thanks to the Fed, the first return of gold was a small shipment of $2.5 million. It was viewed as a sign of possible easing of the cash flow problems which had been created by the Fed's willingness to help Europe at the expense of its own stability.

As October dawned upon Wall Street, call money rose to 9% but backed off to 8% and then 7.5%. The export figures for the U.S. first half of 1928 were released. They showed a $2.3 billion surplus which was more than any full year before the War, and it was $11 million above that of the same corresponding period for 1927. Buyers began to come in and the professional shorts, which had sold even more positions because call money had reached 9%, a new high, began to panic. New record volume was recorded again.

The New York Stock Exchange came out and made a statement that the month of September had broken all records for volume trading, some 99,906,718 shares which was substantial compared to 67,703,538 shares during August. The industrials rallied again, reaching a new record high and breaking right through the September highs that now had proven to be the calm before the storm. The rally took the Dow Jones industrial average from the September high of 240 to 258. Dividend reports were flooding the market and in the last few days of September, the quarterly dividends paid out on stock were an estimated $125 million. The interest paid on the corporate bond issues including governmental was an estimated $375 million. Call money lurched ahead to 10% but still the stock market didn't falter.

During October, the press was filled with reports of foreign governments seeking more loans from the U.S. markets. Germany was reported to be looking for another $100 million, Greece $75 million and Hungary $5 million. Time magazine reported that President Charles E. Mitchell of the National City Bank in New York told the German government that $150 million in German bonds remained unsold on the market already. Through hindsight, it became clear that outstanding foreign loans in the U.S. had saturated the market. This combined with the Fed's policy of helping Europe out by lowering the domestic U.S. interest rates artificially, only heightened the move from bonds to the stock market. Therefore, cash indeed became scarce because of the drain on U.S. gold reserves and the outstanding foreign bond issues, but even a new high in call money up to 10% did not deter the market from moving substantially higher.

The sentiment during that fall of 1928 was still very mixed. The bearish camp was still well entrenched with the so-called professionals and was even enlarging. It was as if many a bitter bear was either broke or turning into a bull. In the October 15, 1928 edition of Time, an article appeared concerning the annual banking conference being held in Philadelphia. The article began:

"Bulls, of whom there are many, and bears, of whom there were few, looked last week toward Philadelphia. Traders felt, and with reason, that the deliberations of 5,400 U.S. bankers gathered for the meeting of the American Banker's Association, held a more or less potent threat to the stock market. Many a banker, speaking for himself or his bank, had warned against frenzied speculation. The market had kept its strength; had soared through a record month. But traders feared the effect of a solemn and public pronouncement from the Philadelphia convention. Resolute bulls faced the 5,400 bankers with hostility."

One of the more famous long-term bulls in the stock market had been John Jacob Raskob who had recently become the Chairman of the Democratic party. His statement hit the market as a surprise, particularly since he had been such a prominent bull.

"Since I have taken this position as Democratic National Chairman, I have not purchased any stock whatever. It is my opinion that security prices have so far outrun demonstrated values, earning power and dividend returns, that a material readjustment is necessary before they will again be attractive to the prudent investor. My name has frequently been mentioned as being prominently identified with Chrysler Corp, and Radio. As a matter of fact I have never owned and do not own a single share of Chrysler Corporation stock. And the stock in Radio Corp. which I hold was purchased outright by me a long while ago and held as an investment. I am not interested directly or indirectly in any pool or stock market operations."

Mr. Raskob's statements were a shock at first but the market fell but a few points and essentially held its ground during October 1928.

Another well-known name came forward with statements on the market. He was Col. Leonard Porter Ayres of the famed Cleveland Trust Co. His statement was as follows:

"The transition to a new and sober era is not going to be easy. The American people are in a mood of invincible optimism. Three years ago they were speculating in Florida real estate and finally that bubble burst. They then speculated in urban real estate and now they have turned to the stock market where prices of the stocks of mail order houses, chain stores, motor companies and soft drink firms are selling on a basis to yield half as much as the obligations of the U.S. government. All the experience of the past points clearly to the conclusion that prices are too high and must come down. However, our concern is not about what may happen in the stock market. We may look forward to the future with confidence but the great rewards of business and banking during the next decade will probably go to the plodders rather than to the plotters, to the calculators rather than to the speculators, to the thrifty and not to the shifty."

The Representative Louis T. McFadden, chairman of the House Committee on Banking and Currency also had a few comments about the situation that month. In regard to the Federal Reserve policy of tight money, he warned that it would "produce a business slump without intending to do so." However, he also warned that easing the policy might send more cash into the speculative sector. He therefore advocated that government should assume a more authoritative role and extend to the Federal

Reserve "a commanding position...controlling all the elements in the credit situation."

The Chairman of the Federal Reserve, Roy Young, also had a few remarks at the 1928 banking conference. He stated:

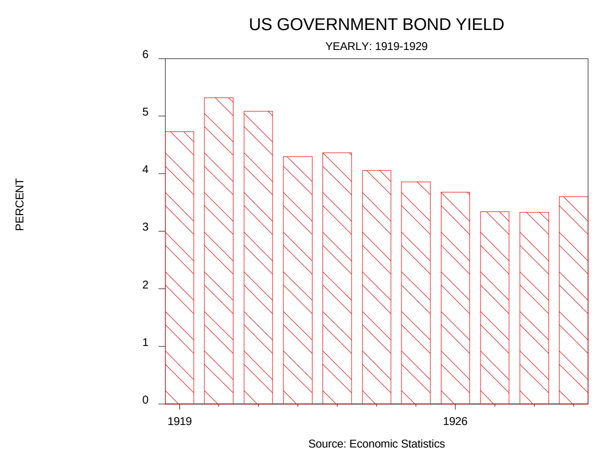
"Responsibility of banks does not end with their depositors and stockholders. Banks also have a responsibility to the community in which they are located. It is my conviction that a healthy banking situation is the best guaranty of a healthy economic development." In regard to credit he stated: "The Federal Reserve cannot earmark its credit. But it can help steer the credit ship. People must not expect the impossible."

Despite all this bad news, the market rallied. Perhaps one bit of news which was to some degree a piece of relief but merely added some confusion was the death of the New York Federal Reserve Governor Benjamin Strong. Many viewed it as hopeful that the U.S. would no longer waste its resources in defense of Europe while others interpreted it as Europe losing its last hope. Either way it was bullish for stocks coupled with the fact that Roy Young had little to really state about the speculative money in the stock market. The industrials that October rallied by 10%, but the rails declined from the September high, falling from just above 144 to slightly under 139. The bonds rallied slightly but still remained within half a point trading range.

November brought with it the elections. Wall Street remained firm and held its ground, never really giving into fears of a Democratic victory. The market rallied like a charging bull paying no attention to barriers or prominent "professional" bears which may have stood in its path. The Dow Jones Industrials gained nearly 20% in a single month. The index rallied from 254 to 296, closing at the 293 level. The bears were simply astonished and speechless. Again, despite the fact that the professionals all felt that the market had topped they became even more confused. The public clearly voted not merely for the Republican ticket but for the stock market as well. The Republican era of prosperity would continue and Europe, begging on its knees for more borrowed money, was shunned at the door.

At last even the railroads charged ahead, rising from the depths of 142, reaching for the stars and coming close to 153, a new record high. The bonds rallied prior to the elections, penetrating above 97 for the first time since the devastation of the past July. But then the bonds fell and closed below the October close. It was the final reaction rally in a collapse which would now unfold into a massive liquidation of bonds as capital shifted into common stock.

Another bullish aspect came during the first week in November. President Alfred P. Sloan of General Motors announced that the third quarter earnings for 1928 were $79



million. That brought the first nine-month period of 1928 earnings for G.M. up to $240 million. This was reported by the press as being the largest corporate profit in peace time history. What had become known as the Raskob's rule of 15X earnings meant that G.M. should have been selling for $270 a share which was $50 above the closing price during the first week in November. U.S. Steel also announced earnings of $52 million for the third quarter. That was $10 million above 1927 and the largest in two years. U.S. Steel did rise to the 15X earnings rule and closed the first week of November at $160 7/8.

Brokers' loans were on the rise. For five weeks in succession they continued to make new highs throughout October and into early November, reaching $4.9 billion compared to $3.3 billion in 1927.

There is no doubt that this was a serious event and that government was calling it a speculative frenzy. But the shift in capital from bonds to stocks was also significant. Given the total outstanding stock on the exchange, if all purchases were margined, brokers' loans would have been $150 billion. Obviously the margined position was not as far out of whack as the press and government would have us believe. The importance of this perspective is quite significant. Although brokers' loans were at record highs, in proportion to total outstanding equity holdings, it was quite small. This signified that outright cash positions far outnumbered margined positions.

The second important point of this perspective is how corporations chose to raise money and how the public preferred to participate in that debt servicing. From January 1, 1924 to November 1, 1928, total new issues of common stock placed on the market were $38 billion. The brokers' loans represented about 12.5% of those new issues. Prior to this period, it was common to find corporations that needed to borrow doing so through the bond markets. There was a decisive shift between the bonds and the stocks as a means to borrow money. The bond market continued to decline from this point onward due to the large offerings of foreign governments and the general lack of buying interest. Dividends in many cases offered comparable performance during this five year period. Where interest earned failed to meet a bond yield, the market more than compensated for the difference. The margin accounts did not care if call money rose to 10%, for the leveraged position provided healthy dividends which more than covered interest costs on margined accounts.

Therefore, from an analytical perspective, higher interest rates are obviously not a deterrent to the stock market. The conditions under which the market has fallen with rising interest rates have been solely due to the fact that rates rise faster or beyond the yields on stocks. If the yields are higher than the cost of money, rates will rise but they will not deter the market until this imbalance is equalized. As we continue to explore the market performance, we will also begin to notice that interest rates are also affected by international political conditions. Stocks have also risen ignoring earnings and in the face of rising interest rates when foreign political conditions have sparked a flight to the dollar based assets.

The buying continued throughout November and it is best to let Time magazine add the flavour of the moment. November 19, 1928:

'FOOLISH? STUBBORN?"

"Oils, coppers, utilities up 3 to 7 points as the market opens Wednesday, then churn back and forth. Kennecott copper up 12, Curtiss Aero 12.25, Wright Aero 15.5. Turnover 4,894,670 shares...More on Tuesday, 5,037,330 shares, second 'five million' day in history, only a handful less than on record-breaking June 12. Montgomery Ward closes at 366. Net gain; 17 points. Mounting, too, are Wright (6.5 points more, 22 in two days), Coty, Inc. (10.5). Where is the ticker? Over an hour behind (might as well have been a week) on Thursday, 47 minutes the day before, 46 minutes on Friday. Friday Montgomery Ward adds another 18 points, closes at 384. It was 349 on Wednesday morning. What is happening to Radio? Climbing whole points at a time, Radio soars from 234.5 to an incredible 270. Who is pushing it? No one knows?...Thus, the Hoover market. Like its predecessor, the much-loved, much-criticized Coolidge market, it is the joy of bulls, despair of bears. Will it last? Will it break? Foolish bulls or stubborn bears?"

Perhaps it was stubborn bears at this point in the game desperately trying to pick the top and send the market up even further. Oddly enough it was the very professionals being pushed around by the little guy on the street. What a day! And December offered only a small short-lived glimmer of hope for the bears. The market broke, tumbling back nearly 15% yet the industrials hadn't even penetrated the November low. It was an incredibly sharp drop. Largest in history! But did it signal despair and the end of the bulls? Not even a 15% drop could stop this bull from its divine destiny.

December rallied for year-end, and after the industrials fell to 258 and just when the pros thought they had the bull by the horns, or maybe it was the other end, it kicked up a storm and rallied straight up again, charging right through this November high reaching for that ultimate brass ring, which by now was replaced by pure gold, and closed a hair under 300. Indeed, who was the fool?

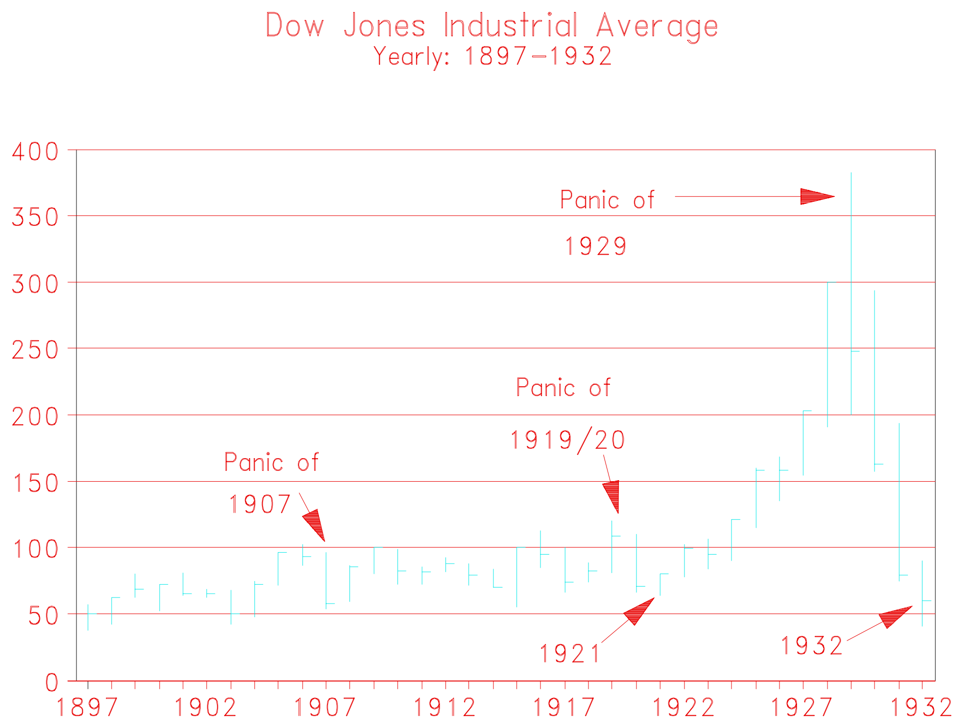
The railroads fell sharply that cold December but rallied back quite impressively for year end. Nonetheless, the rails failed to exceed the previous month's high, clearly yielding first place to the industrials. The great era of the rails had come to an end and now they were clearly reduced to a second place bet.

The bonds fell straight down from the opening bell that memorable December. They fell dropping below the previous four-month consolidation period and finished desperately clinging to 96, a level which it would see only once during 1929 and then never again for over a year.

In the final glimmer of analysis, 1928 was a year of many lessons and stories. Its complete disregard for fundamentals, its disregard for the so-called well established relationships, is a omen for the future. The words of two very famous men come to mind as we end one of the most impressive years in the history of the market. In 1901 Charles H. Dow stated: "In most bull markets there comes a time when the public controls fluctuations and the efforts of the largest operators are insufficient to check the rising tide." Those words were certainly true 27 years later as they are today. The contrast is perhaps Andrew Mellon who once said in 1926: "Gentlemen prefer bonds."

Chapter IX

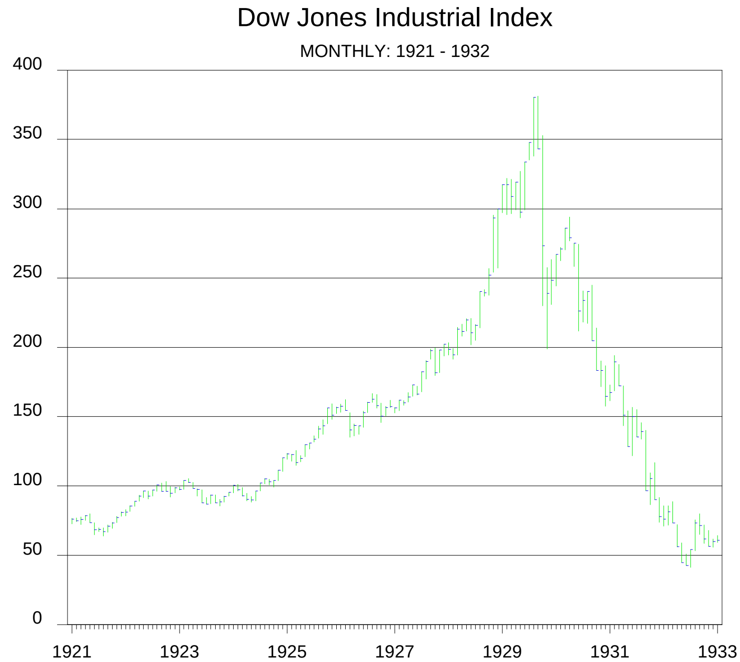
1929



The mere mention of the year 1929 sends shivers down the spine of perpetual bulls who immediately pronounce that such events could never take place ever again. Others rub their hands in pleasant contemplation of the events of 1929 and pronounce warnings every October that this is the year when 1929 will be relived. What is it that divides analysts and economists alike into two separate schools of thought that are as different as night and day? Are there justifications for worrying that a panic such as that of 1929 could possibly take place again? Or are such rumblings totally unjustified and merely a ploy to sell newsletters?

We have reached that infamous year after scrolling through the annals of time on a month-by-month basis. We have looked at and read first hand the accounts of the free press. We have seen for ourselves that the early stages were not the wild speculative madness which most would have us believe. We have also seen the fears and the dreams, the concerns and delights, along with the harsh, cold facts from the past that somehow ring a familiar bell. We have scrutinized this analysis and torn apart many supposedly infallible relationships. We have come to a better understanding of what really happened on a month-by-month basis, an analysis which has simply never been brought to light before.

We have come to realize that the pictures painted by most writers of this period have grossly misrepresented the era. They have unfairly focused upon the final year in which speculation did run far ahead of rea-

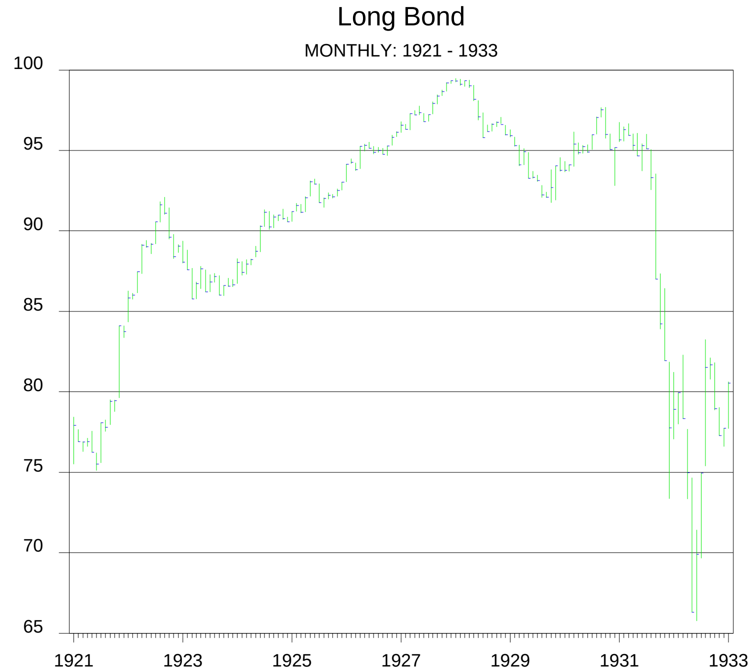


son. Yet one would also be left with a distorted idea of using the last few months of the gold and silver bubble in 1980 to describe the entire period of that bull market, which ran between 1970 and 1980. In this respect, those who have focused only upon the last few months of this bull market and the following crash have done a grave injustice. If we do not understand how this market arrived in 1929, then we would never know if a crash of this magnitude would be possible again or not.

What is the value of all these words, all these thoughts, all these interpretations? The value is immeasurable. History has an uncanny quirk about it. It loves reruns. Perhaps it is merely man's way of refusing to listen to the wisdom of his parents, much like a teenager who suddenly believes he knows all. As a result, perhaps each generation must struggle through the corridors of the same school of life where its fathers once walked. The echoes of the past can be heard if you listen clearly. The question is, can we learn from past mistakes? Were there warning signs that were definitive and clearly defined? Was it all a mere nightmare or could it honestly happen all over again?

As the year 1929 dawned upon the narrow alleyways surrounding Wall Street and its various exchanges, the Dow Jones Industrials continued to rally even further. After reaching the 300 level at the end of 1928, the industrials surged even higher, closing January on a new record high at the 318 level. The market had climbed a long way from the August 1921 low where it had once upon a time planted itself at the 64 level. The relentless upward drive was still there, gaining, but at slightly more than 10% over the December 1928 high.

The railroads continued to climb and exceeded the 1928 high at last, but merely reached 158, barely a 4% gain. The bonds, which had closed 1928 miserably trying to hold the 96.00 level, improved at first in early January. They managed to rally back to 96.14, and then fell toward the end of the month, closing below 96.00 and still clinging to the edge by their fingertips.



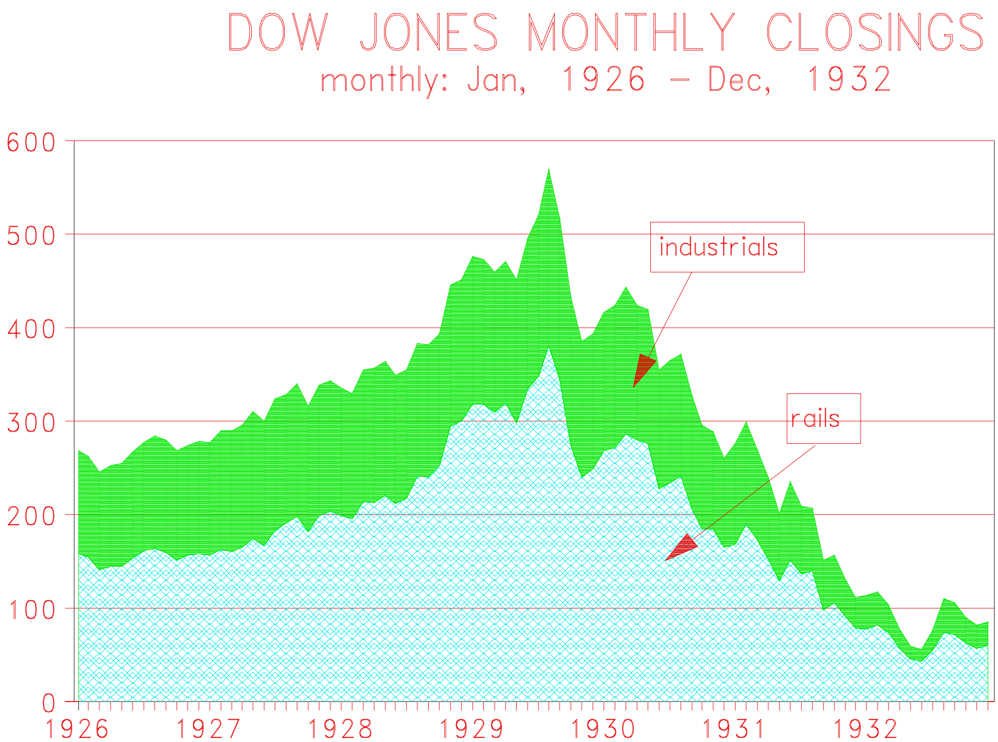
The institutional game had been growing throughout the 1928 period. Today in the 1980s we call them "institutions" or perhaps "mutual funds." In the 1920s the name commonly used was "investment trusts." By the dawn of 1929, there were 200 listed investment trusts. There were few rules or disclosures in those days. Many famous names were associated with the investment trusts, such as Walter Chrysler, Arthur Cutten, William Straus and Fred Fisher. In 1929, Time magazine defined the investment trust so succinctly that we simply couldn't do a better job. Here is Time's description:

"Perhaps the best analogy to an Investment Trust would be a hypothetical bank that had no restrictions on what it could do with the depositors' money."

According to reports, there were only 29 investment trusts in 1925. This obviously illustrates the huge growth rate in this investment sector. The trusts were not required to disclose who owned what stock and, in many cases, the collective money was used to spur onward personal wishes in the market. The investment trust would eventually prove to be one of the greatest disasters for the small, unaware investor and a primary reason for many of the SEC rules that exist today.

After the January rally, the month of February brought a continued decline for the bonds as they fell to about 95.10. This steep decline had come after a long, hard battle for the bond market since 1915. The bonds reached their highs of 96.25 during January 1917 and fell straight down into the fall of 1918, reaching 81.94. After a brief three-month rally into year end in 1918, the bonds managed to test 88.58. After that, it was virtually a free fall into 1920 where they reached a major low of 71.96.

From that moment on, the bonds made a long hard rally as we have seen in the previous chapters. 1922 brought an initial high on the corporate bonds of 92.12. After a sharp but quick correction into early 1923



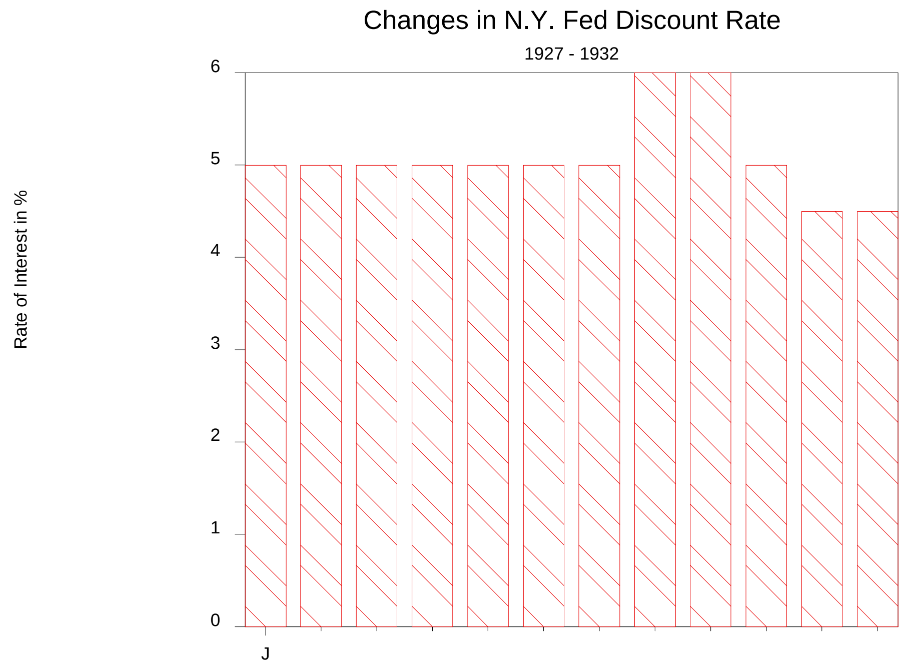
where bonds tested 85.77, the bonds began a slow but firm rally into January 1928 and reached 99.78. Therefore, the decline that took place in February 1929 was significant technically. Had the bonds been a sound investment within a long-term bull market, then they should have declined and hold the high of the previous cycle, which was established in 1917 at 96.25. After the latter part of 1928 desperately tried to hold that technical long-term support, it gave way.

The industrials dropped below the January low by 2 points and then rallied once again and exceeded the January high, closing a fraction higher. Finally, the industrials did manage to punch through the 320 level. The rails held the January low and succeeded in penetrating the January high but closed a bit lower.

With the entry of Herbert Hoover into the Presidency, the death of Benjamin Strong of the New York Fed and the resignation of Daniel Crissinger as Governor of the Federal Reserve Board, Coolidge's appointee to the post, Roy Young, adopted a different approach. Hoover stated that Young was an "able, courageous, and cooperative man." Hoover later stated in his memoirs: "Prior to my inauguration as President I conferred several times with him and found him fully alive to the situation. He agreed to use the full powers of the Board to strangle the speculative movement."

It was in on February 7 that the Federal Reserve began to make outright threats to Wall Street. Brokers' loans reached a new high of $5.6 billion and the Fed basically felt that enough was enough. Brokers' loans had stood at $3.5 billion in June 1927. The Fed came out and stated that a member Reserve Bank is "not within its reasonable claims for rediscount facilities" when Fed money is borrowed and used in "making or maintaining speculative loans." The Board also threatened to "restrain the use of Federal Reserve credit facilities in aid of the growth of speculative credit."

Simultaneously with the Fed's announcement, the Bank of England raised its discount rate from 4.5% to 5.5%. This was

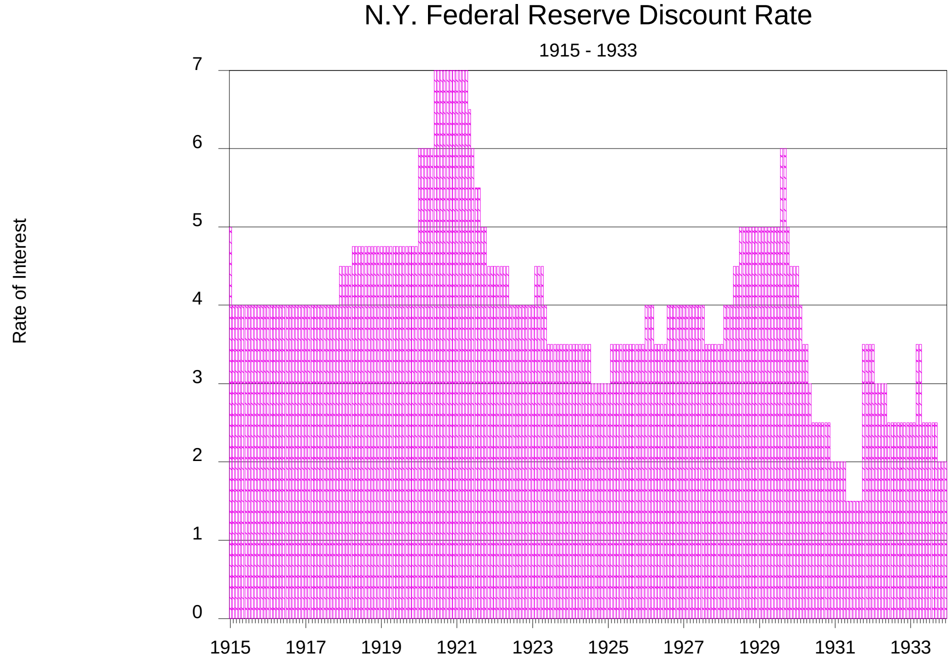


a move to decrease the flow of gold from England to the U.S. which had resumed while the New York discount rate stood at 5%. This statement in early February, combined with England's hike in the discount rate, was the cause of the early February decline. But the move did not succeed in breaking the market. In later years, some claimed that the Fed's statements were minimized by President Coolidge, who a few days before he left office, made an announcement to the press in which he assured the people that prosperity was "absolutely sound" and that stocks were "cheap at current prices."

Debate was brisk over what rights the Fed had to single out the stock market. Many felt that the entire situation had been caused by the Fed's artificial lowering of the rates to bail out a crisis in credit throughout Europe. Time magazine accurately made an observation about why the market shrugged off the finger-pointing or perhaps we should say neck squeezing:

"Speculators have long since realized that Federal Reserve authorities disapprove of their activities. The important question lies in what steps the Federal Reserve can take to translate disapproval into actual cutting off of credit. Discussions of the power of the Federal Reserve Board (as distinct from its opinions) is obscured by the popular conception of an all-powerful group of government appointees sitting in Washington and turning credit on and off like firemen playing a hose. The essential theory of the Federal Reserve System is that the member banks in each district get together, pool their resources and form a virtually inexhaustible reserve fund upon which all may freely draw. Therefore, although the Federal Reserve Board may frown upon the use of this reserve for speculative purposes, it cannot lose sight of the fact that the Federal Reserve banks are privately owned, are operating largely with private funds, and fundamentally exist for the sake of supplying money rather than withdrawing it.

"As for the discount rates, here again it is the province of the twelve Reserve banks

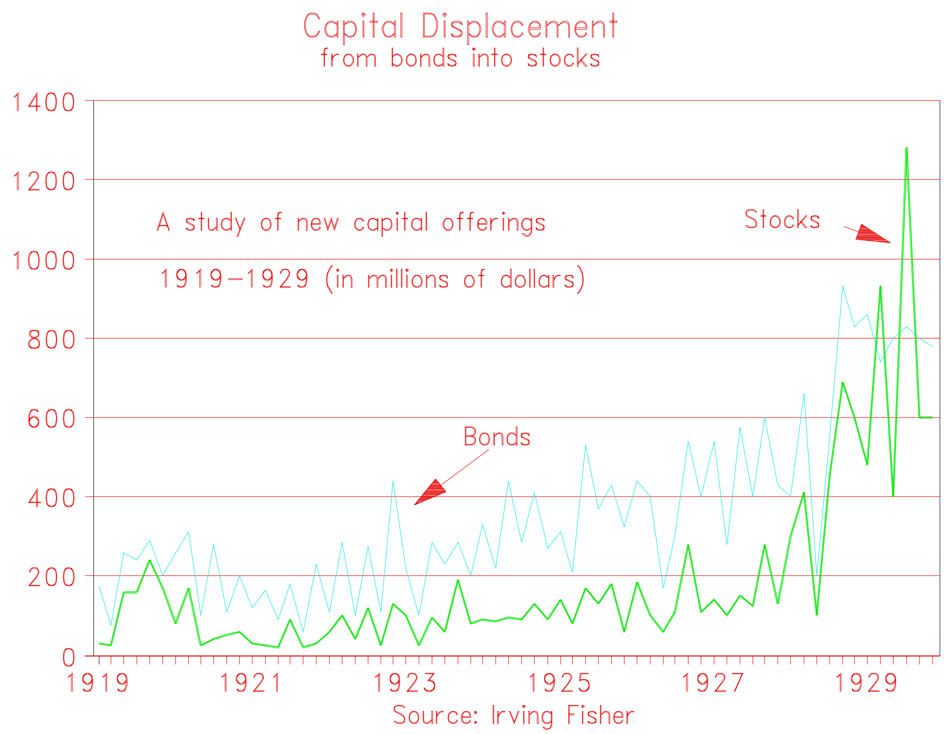


(not of the board) to initiate rate changes. Here the Reserve banks have a specific and unquestioned method of making it expensive to borrow money. But this method cannot be indiscriminately applied. In the first place, high discount rates will attract money from foreign countries (deemed to be inflationary in those days). More important, however, is the fact that the Reserve bank cannot make it harder for the speculator to borrow money without making it correspondingly harder for the businessman or the farmer to borrow money. A rise for one is a rise for all. If Wall Street pays dearly for money, so will Main Street."

This commentary sums up the attitude and the debate between the Fed and Wall Street. Was the Fed trying to blame Wall Street for its own mismanagement?

There can be no doubt that a change in Fed policy took place in February 1929 just one month prior to Hoover's inauguration. One member of the Federal Reserve Board, Adolph Miller, stated years later in a July 1935 magazine article that "after waiting for the individual reserve banks to initiate a policy of safety, the Board in February, 1929 took matters into its own hands, adopted a policy of 'direct pressure' and issued a warning to the public." It did so, said Mr. Miller, "because its anxiety over the situation had become very great." Herbert Hoover stated that the credit policy of 1927 was enacted "In hope of preventing European difficulties. But certainly, the huge budget deficits, currency inflation, vast increase in armaments, and growing military alliances (In Europe) which were at the root of the trouble were not to be cured by a poultice of inflated credit from the United States. I do not attribute the whole of the stock boom to mismanagement of the Federal Reserve System. But the policies adopted by that system must assume the greater responsibility." (His Memoirs 1952.)

There had been many bubbles burst in various commodities and the huge Florida real estate boom. No one bothered to single those markets out. The Fed had made a grave error in trying to bail out Europe. It



set off a huge series of offerings of foreign government bonds which were just lying about unsold. The people were just fed up with the foreign borrowing and decided to move cash into U.S. assets and take control in their own hands. The mere facts that the European markets peaked shortly after the time of the central bank intervention of 1927 and that the dollar itself had bottomed during March 1928, are strong evidence that foreign interests began to sense trouble in Europe and assets flowed into the U.S. stock market.

We have already discussed how much new corporate financing was taking the avenue of common share offerings. Had those offerings been in bonds, the Fed would not have had a sacrificial lamb. But as events would have it, the stock market was the Fed's whipping boy for its own mismanagement.

Also, corresponding with the hike in the English discount rate, a sizable jump of full point, news came out that Mr. Montagu Collet Norman, Governor of the Bank of England, was on his way to the States accompanying a $7.5 million gold shipment. Again, he was on his way to discuss the recent turn in cash flow and to seek a way to quickly end the flow of gold from Britain to the States. The pound had fallen sharply during his term and with the aid of the Fed's helping hand through artificial maneuvers to lower the dollar and boost the European currencies, the pound had rallied back to $4.85. But the U.S. cash shortage set off by that maneuver had cost the U.S. over $500 million in gold reserves, which had served as a base for nearly $7.5 billion in credit. Therefore, the brokers' loans singled out by the Fed were less than the credit lost by the Fed's measures to lower the dollar on exchange markets.

This is a lesson that 1929 has offered for our serious consideration today. The G-5 meetings of 1985 tampered with the free market forces to correct the effects of government's own mismanagement and to prevent a debt crisis in Europe sparked by inflated currencies and deficit spending. This may very well set off another round of higher interest rates moving into 1989 once the intervention and manipulations of 1985 break down in 1986-87. If history repeats once again, the G-5 boys of 1985 have tried nothing new. The G-4 boys of 1927 tried that same path and took a seriously wrong turn.

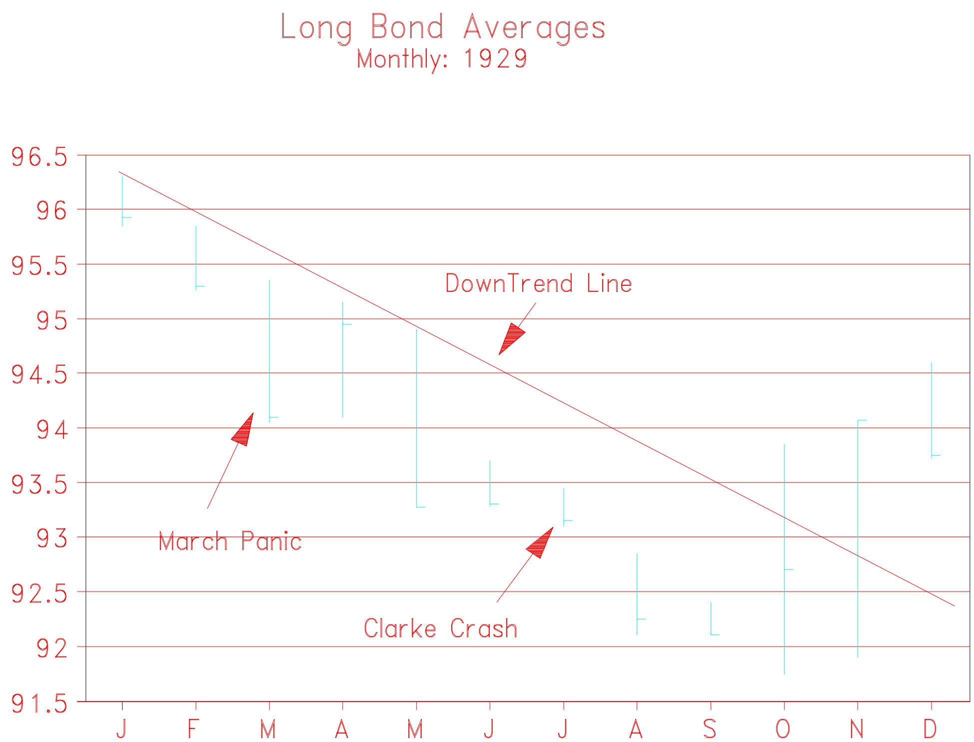
The Fed was not about to give up easily. The Fed, under a change of management and a new President, became preoccupied with bringing an end to speculation. Time magazine reported on February 25 how the Fed went crying to Congress:

"Into Congress last week overflowed the financial argument between Federal Reserve Board and Wall Street. A mingled outburst of oratory, ethics, provincialism and little economics was the result. The prevailing sentiment was strongly against the speculator. Since, however, the very Senators and Representatives who were most inclined to view Wall Street as the heart of the money octopus also regarded the Federal Reserve System as at least a tentacle of the same monster, the banker was scolded while the broker was flayed.

"The Senate passed a resolution asking the Federal Reserve Board to lay before it, such information as might be 'helpful' in securing anti-speculative legislation. It was a mildly-worded resolution, perhaps because it was edited by Senator Carter Glass of Virginia, one of the authors of the Federal Reserve Act (1913)."

The Fed, after crying on the shoulders of the Senate, perhaps realized that if it cried too much, Congress might step in and disrupt its precious authority. So the Fed used another method at its disposal. The Federal Reserve Board each week made a big deal over meetings where it purposely tried to imply that a decision would be taken to raise the discount rate. Each Thursday afternoon the market churned back and forth creating a violent and choppy trading range. But following each meeting, their comment was merely "no announcement." Week after week, the Fed employed those scare tactics trying desperately to influence the market and cause a major panic sell off. But the stock market held its ground. This was perhaps the first time in history that the Fed openly resorted to an official policy of scare tactics. This established the precedent and to this day whenever the Fed comes out and announces what it will do, 99.9% of the time it takes no such action. The Fed always acts without warning whenever it raises or lowers the rates, trying its best to make sure that no one will profit from the move. So whenever it openly proclaims what it is thinking of doing, it is unquestionably trying to manipulate the market, which is going against what its policies would like to see and what its management is incapable of accomplishing.

The Fed was not satisfied with this new tool of open verbal warfare. The Fed also began to sell government securities and bankers' acceptances, further depressing the bond market. Then member banks called in $60 million from the call money markets. Call money, which had settled back to 6.5% even with record highs in brokers' loans, jumped to 10%, a previous record high. When the dust settled, the figures came out showing why the Fed had issued its warning. The outstanding credit had increased by $250 million. But was that all due to the stock market? Could the decline in the dollar have the slightest influence? The Fed chose to blame Wall Street rather than a policy it had inflicted all by itself. Did the fact that time deposits were paying only 2% have any bearing upon the rise in call money deposits? Before the year was over, the Fed decreased its holdings of



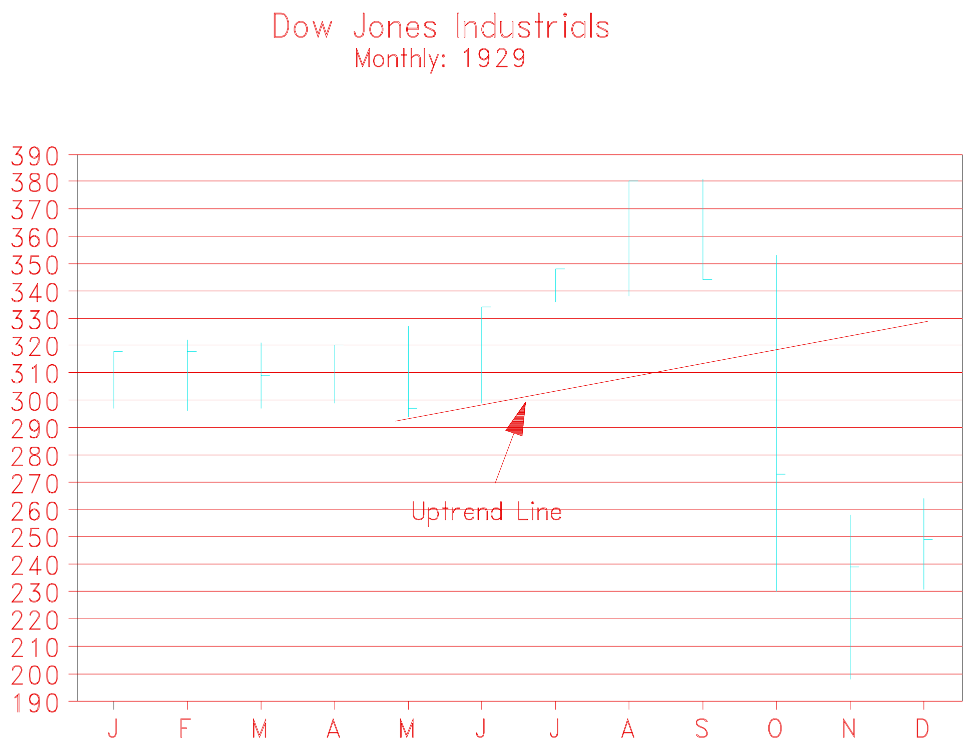
government securities by nearly 60% in its battle against the stock market.

As March came on the scene, the Dow Industrials traded sideways and remained directly within the confines of the trading range established during the previous month.

Andrew Mellon, famous for his saying that gentlemen prefer bonds, came out publicly that March with a prognostication. He basically stated that bonds, in his opinion, were very much depressed and offered an excellent buying opportunity.

Andrew Mellon was a man of honour and distinguished character and in many ways he was an outcast among the mere aggressive New York bankers. When his grandfather arrived from Northern Ireland, he had brought a small fortune which he divided into three parts. With the first part he opened a bank in Pittsburgh, Pennsylvania; with the second he bought stock in Pennsylvania Railroad; with the third he invested in real estate in St. Louis. This brought the family millions of dollars which were used for charity.

Andrew Mellon was undoubtedly a man of compassion and understanding while all the time he remained a country banker at heart. One day, an inventor came to Mr. Mellon hoping that his bank would lend him money to continue his research. The man talked at length and it was obvious that he had spent his last dime. The process he was working on would create a new industrial metal. Andrew Mellon, as the banker, told the man that his bank could only lend upon security. But Mr. Mellon then added that he personally would lend the man $10,000 on his character. The funds were expended and more was needed, which Mellon provided. When the process was perfected and a production plant was necessary, Mr. Mellon called the inventor in and told him that he would put up the several hundred thousand dollars that were needed and it was up to the inventor to say what his capital was worth. The inventor asked Mellon why he did not foreclose upon him for he had no way to repay his



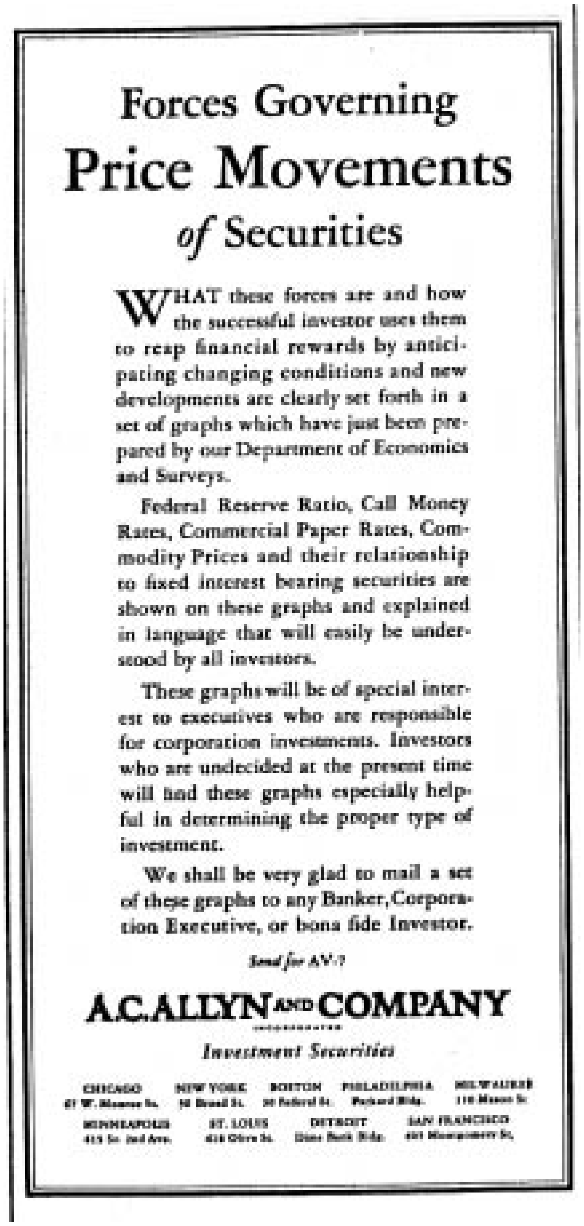
outstanding debt. Mr. Mellon simply replied, "The Mellons never did business that way." The inventor offered a 50-50 split and Andrew Mellon agreed. The American aluminum industry was born that day.

Andrew Mellon had a reputation as a conservative, and his philosophy was always to treat his fellow man with dignity and respect. This reputation did not serve well for a prophet of the bull market.

Mellon, long a bond advocate rather than a speculator, actually helped the stock market and hindered the bonds. Wall Street had never viewed his opinion to be of particular interest. However, in this case, they felt that if he was advocating buying bonds, that meant he must have thought that the Fed wasn't going to raise the discount rate. Many stocks jumped 25% as the bonds sold off.

During the last hours of March, the call money rate jumped to a new record high of 14% for the last nine-year period. The banks had withdrawn another $25 million from the call money market. The next day (March 26), call money opened back down at 12%. It rose again, establishing a new high of 15%. Some of the favorite speculative stocks were hit hard, many showing declines of 10 points or more. Call money continued to climb, reaching 20% as the casualties mounted that day and some investors were forced into liquidation which had grabbed the bull by the horns. But by the end of that eventful day, many stocks rallied sharply even with call money at 20% as shorts bailed out. Confusion among the fundamentalists continued to mount.

The shorts, made up of the "professional" traders, had been convinced that they had picked the top and the ranting of the Fed would break the market sooner or later. But as the trading approached the final hour, the stock market, as if guided by some invisible hand, rallied once again with a vengeance. Order takers were dashing around; the ticker fell far behind. Only those on the floor knew what was happen-

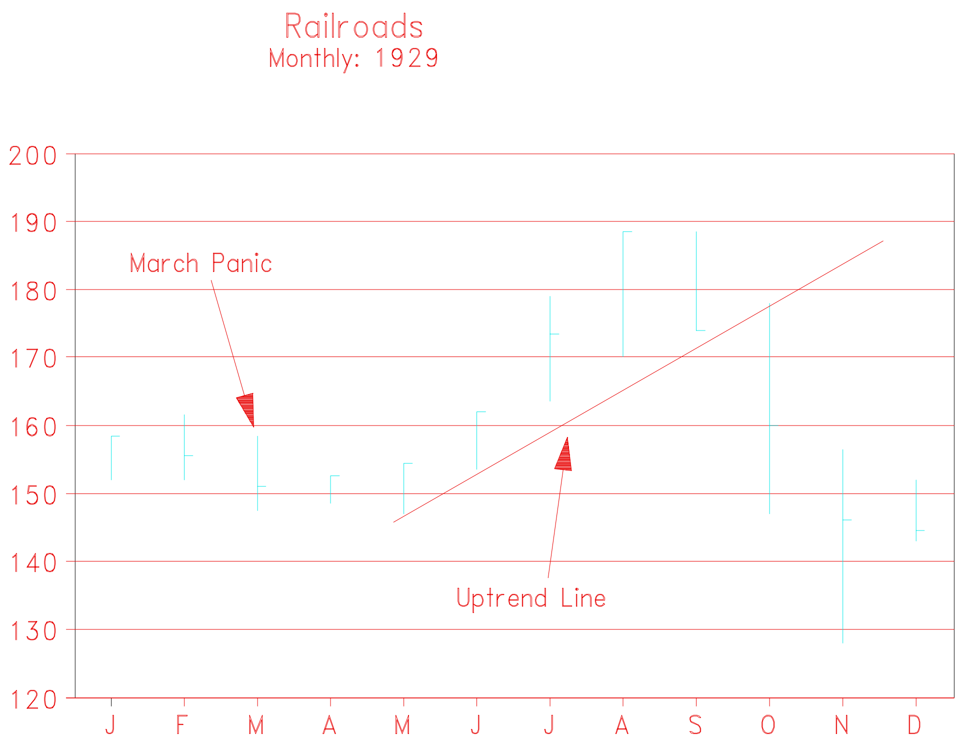


ing. Pure panic showed in the pale white faces of the professionals as they ran for cover. In the end, many stocks closed above where they had opened. The swings were violent. Some stocks had dropped 15 to 20 points from the open and closed up 6 points on the day. But many others remained fairly well depressed. Allied Chemical dropped from its 1929 high of $305.25, closing on March 26 at $260.25. Chrysler Corp. fell to $89.75 after reaching a 1929 high of $135. General Electric fell from its 1929 high of $262 3/8 to $219. Montgomery Ward fell from $156 7/8, closing at $114 5/8.

Granted, throughout the bull market many strange and new issues had come on the market. Anyone who has driven through Staten Island or along the Belt Parkway en route to John F. Kennedy airport in New York will recall the sight of thousands of mausoleums which line the highways. A new issue hit the market at about this time with units being offered at $106. It was Mausoleum Corp. of America. Even the graveyard business had taken the public route.

March was torn from the calendar pages of 1929, and April suddenly appeared on the scene. What would it reveal? Devastation or another untold rally? As call money remained high, so did the stock market. The Dow Industrials still traded sideways, consolidating in the midst of confusion while engaged in a battle to the death with the Fed. March had closed back under 310, while many speculative stocks dropped 15% or more. The market churned back and forth with debates still emotionally heated on both sides. But the Dow Industrials rallied again and reached the highest monthly closing in history, just a fraction below the 320 level. But despite the highest monthly closing, the February intra-day high had remained untouched.

March had brought a higher degree of panic to the transportations, which at that time had been called the rails. April continued to rain on their parade, keeping the rails quite depressed. Many speculators had been playing the railroads because they had always been the leading segment of the stock market. The huge bull markets of the



early 1900s were built upon the back of the steel rails that at last connected the United States from one coast to the other. But this bull market was different. Those who had thought that there would eventually be that moment in history when the rails would rally and snatch the load from the young upstarts that made up the industrial group were being slaughtered. New highs in the industrials did not mean new highs for the rails. This factor eventually vindicated Schumpeter's theory of innovation. The previous bull markets were built upon the railroad innovation. But the bull market of the 1921 to 1929 era was built upon the innovation of the automobile industry.

March had brought sheer devastation to the bond market as it collapsed from above 95 to test almost 94. As call money went higher, the bonds simply buckled. Many a trader had shorted the bonds and bought the stocks purely on his conviction that the Fed had blown the economy through its helping hand, which this time they felt had stretched out much too far. But as call money eased to some extent and stocks steadied, many were forced out of the spread and the bonds rallied in April. For one brief and shining moment, the bonds exceeded the 95 level for the last time in 1929, but closed the month of April below that magic psychological barrier.

As May appeared, the bonds collapsed violently. Bond traders literally ran for cover. It was a collapse far worse than ever before, which reminded one of the panic in the bond market back in 1917. The bonds fell from nearly 95 to 93 in a single, straight downward thrust. If there was ever a time that would have brought a tear to the eye of even the most reputed bond bull, such as Andrew Mellon, it was May of 1929.

Time magazine reported the early stages for the first week of May as follows:

"AGAIN, ZOOM"

"Possibly unchastened, but certainly cautious, the Stock Market last week edged its way back across the four million shares a day mark, succeeded in maintaining a bullish though still rather bilious, complexion. Yet only the memory of its recent crisis, plus the still large, though lately deflated loans to brokers, could have kept the Market from lowering its horns in another bull stampede. For of bullish portends there was no end."

May brought with it a procession of bigger and more lavish corporate earnings. General Electric posted a "net" profit of $13,862,298 for the first quarter of 1929. It was an all-time new record. U.S. Steel production exploded from its 1928 year-end performance of 96% capacity to the full nine yards, 100%! Even the less dominant steel producers were running at 98% capacity. News also broke that AT&T had become a $3 billion entity. Where would it all end? Were the warnings and ranting of the Federal Reserve justified? Were brokers' loans sucking up too much capital, diverting it from industry and threatening the entire stability of prosperity? Well, you couldn't support that argument looking at the earnings and production figures that were coming out. Industry was forging ahead at full steam! How could the Fed justify pointing the finger at the stock market as the root of the cash bullion withdrawals and tight money? If a true age of prosperity ever existed, was it not 1929 with U.S. Steel at 100% capacity? Let's face the facts. Fundamentally, industry was at an historic, profitable production level. If stocks should rally, it would be logical to find such a rally when industry is at its prime rather than on the last stop of depravation.

May continued with many news topics that highlighted government's participation in the entire event. In New York, a hefty gasoline tax was being imposed. The taxi drivers screamed and warned that the excessive rates would force them out of business. Fares had to be raised nearly 20% in a single move due to increased taxation. The battlefront between government and the private sector expanded to many areas, not merely the stock market. The depression would be caused in part by the excessive increases in taxation and the tight money which had flowed to Europe due to the Fed's intervention.

The Presidential committee on unemployment, which began in 1921, finally released their prognostication in May 1929. "All Is Well," they proclaimed. "No serious cyclical fluctuations have characterized the period under review." This was very well outdated and of no essential significance, although this report was welcome news for the bulls.

In June, the rails rallied and exceeded the February 1929 highs, and they managed to sustain it, closing on the highs at the end of this month. The bonds consolidated within a half a point range but remained hugging just above the devastation which created the low of May. The industrials rallied that month, taking off from just a fraction below 300 to nearly 335, which was a new record high. They managed to close June on the high tick, clearly above the previous five months of choppy sideways agony.

During early June, the bears spread rumors that the famed bull, William Durant, had been pressed for margin during May and that he was on the verge of bankruptcy. But bullish reports that U.S. exports of automobiles had reached a record for 1928 with some 515,000 cars landing at foreign ports was welcome news. The great bull market, which had been built upon the back of the auto industry, was clearly still the gleam of the bull's eye. The numbers of cars registered around the world in 1928 were as follows:

United States	**24,493,124**
Great Britain	**1,128,200**
France	**1,098,000**
Canada	**1,061,830**
Germany	**531,000**
Australia	**516,695**
Argentina	**310,895**
Italy	**177,330**
Brazil	**165,200**
New Zealand	**151,454**

The above list is reflective of world economic strength in itself. This clearly illustrates that the United States was indeed the land of opportunity and the wealthiest nation on the face of the earth.

The market continued to rally into July as news of record car loadings hit the press. In those days, car loadings at the railroad were viewed as a good indication that the economy was moving. This interpretation was based upon the fact that it was the railroads that delivered cars, wheat, corn and numerous industrial products from manufacturer to retailer.

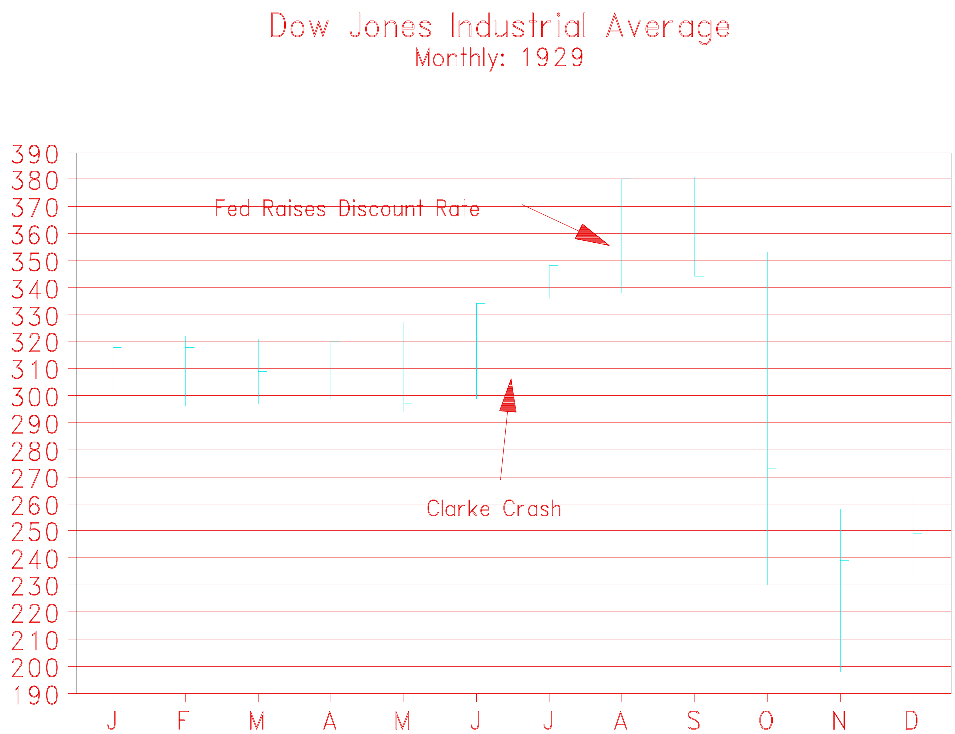
Time magazine reported the comments of Arthur Cutten, famed bull market player, on July 22. When asked about the market, his comment was: "The two things a man needs most to play on the market are nerve and vision. People say that the bull market of the last four years has caused an overvaluation of all stocks. I don't think this is true. It was true in 1922 when industry was overinventoried. But in the closely knit organization of business today, stock prices can't far overrun their real demonstrable value." The fact that stocks would eventually fall to 10 cents on the dollar by 1932 proves that Mr. Cutton's beliefs were false. When it comes to market movement, logic has never stood as an important factor in the final hour.

The market began to run up to new highs, once again for another reason. Banking! The foreign loans naturally caused some concern for the stability of the banks. This is perhaps understated for the time. But when the "Clarke Crash" took place in mid-1929, people began to think twice about leaving money in a bank altogether.

Time magazine appropriately wrote of this incident and how it affected the sentiment of the population at that point in time:

"CLARKE CRASH"

"Many a Manhattanite last week began to think that putting savings in a sock was perhaps not such a foolish idea. Just as State officials were making a final report on last February's City Trust Co.'s failure, their statements shared headlines with first in-

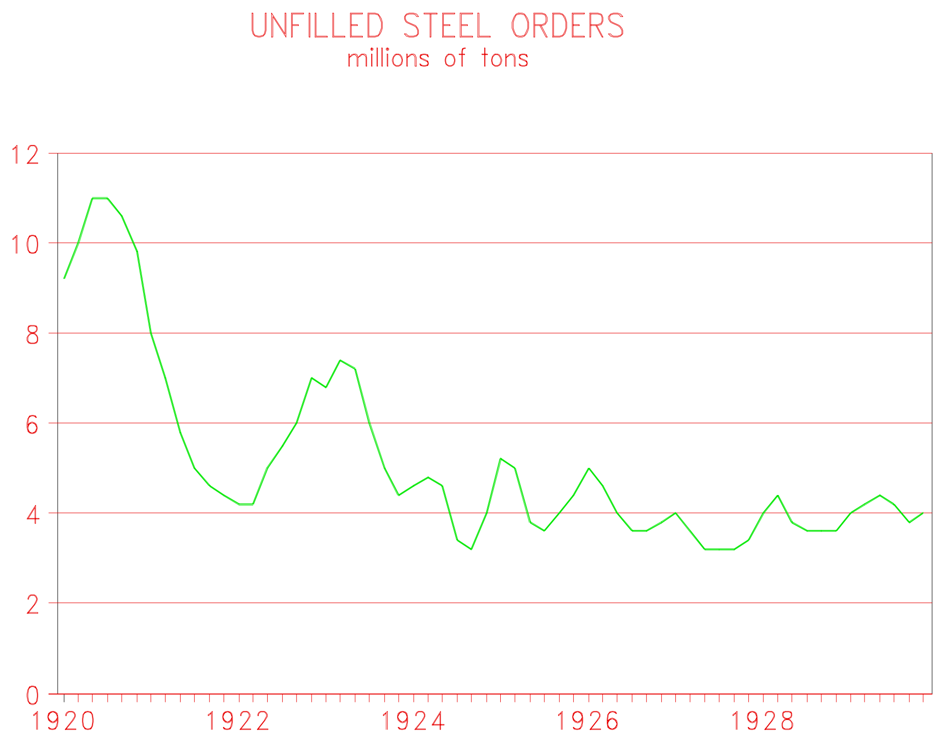


vestigation of Clarke Brothers, another Manhattan banking firm, which last fortnight closed its doors. First reports put the Clarke failure at $4 million and gave depositors hope of getting 25 cents on the dollar. Later it seemed likely that the failure was for $5 million, that 5 cents on the dollar was the probable figure.

"Clarke brothers (James, Philip, Hudson, Clarke and John F. Bouker) announced that they would do everything they could, at the same time refusing to answer many an investigating question and showing few symptoms of real cooperation. Investigators for Irving Trust Co., receivers, quickly discovered that the listed assets of the bank had little meaning. Their bad bonds, bad oil stocks, bad loans. There was a credit of $840,000 against the Now York Port Terminal Co., a company which was said not to be operating if it had ever been formed. Also the brothers had apparently borrowed $404,995 from their own bank. Thus while Clarke brothers claimed assets of $5 million the actual value of these assets was figured at a minimum of $640,000 and a maximum of $1,830,000. There are some 3,000 depositors, none of whom will receive anything for at least three months. Six depositors said their deposits had been accepted the day before the bank closed.

"Layman who think that banks are all alike, wonder how the State Banking department had permitted Clarke Brothers to get into such a dreadful condition. Explanation lay in the fact that Clarke Brothers unsupervised, belong to the class of banking institutions known as 'private bankers' which do not have to be supervised as long as they do not describe themselves as 'banks,' do not accept deposits that at anytime run under $500, do not transmit money or negotiate notes. The $500 minimum deposit regulation passed in 1914 is supposed to keep widows, orphans, and other 'small' depositors out of such banking houses. Present day prosperity permits many to save $500 without having good banking judgement.

"Because Clarke Brothers conducted a private banking business they have been



erroneously described as a 'private bank.' A private bank is really an entirely different kind of institution. It is fully supervised. It carries on a restricted specialized business. Example: R.H. Macy's Manhattan department store is a private bank because it accepts deposits, pays interest, is in the banking business, but it is primarily a department store and its depositors are its customers.

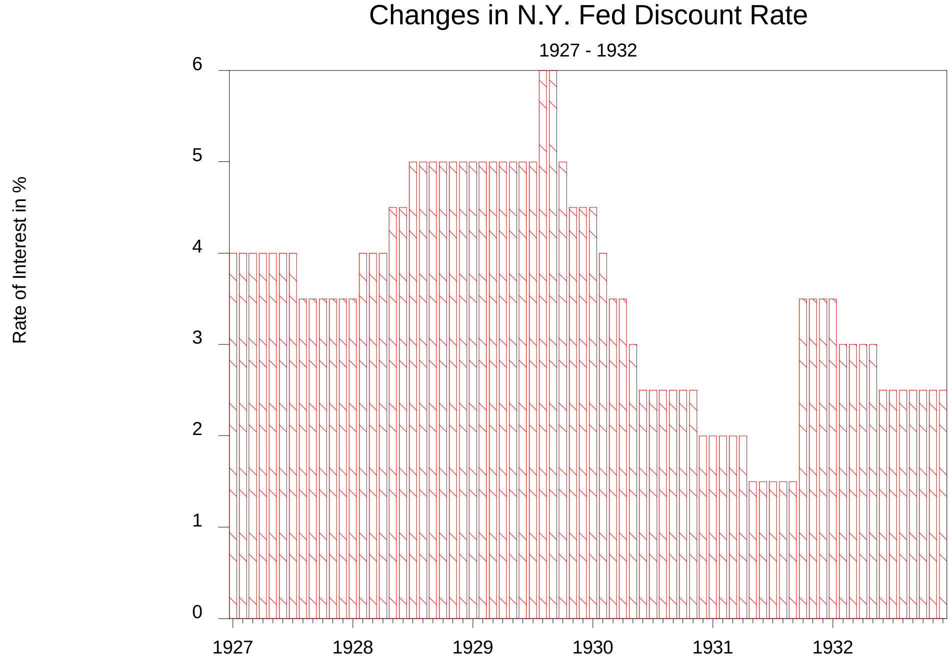
In all sectors of banking. Some began to attribute the rise in interest rates to the cash shortage originally sparked by the Fed. Others began to become concerned that may be a time bomb was ticking away. The stock market began to look even better. They knew, for example, who was making money and who was not.

In July, U.S. Steel announced that its earnings for the first half of 1929 were $94 million compared to $87 million for 1928. Still the upward trend in corporate earnings was clearly intact.

The new issues were still pouring out. In July 1929, the famed department store of Bonwit Teller & Co. went public, offering 60,000 shares of preferred at $52. While new bond issues floated around begging for takers, stock issues were sold on the mere opening of the book.

The activity in the stock market was still brisk despite the groans that could be heard from the Fed on each and every new high tick. Nonetheless, the exchange approved what was then termed "floating brokers." This new term applied not to some vagrants, but to the opening of branch offices on board the oceanliners. The stock brokerage firm of De Saint Phalle & Co. was approved to open offices on the French Line ships. Now you could trade stock on your way to Europe and back.

The real estate market was a poor investment. Those who had real estate which was deemed to be worth $50,000 were forced to take $25,000 or even $20,000 if they needed immediate cash. The easy liquidity of stocks had depressed the real estate market



as an investment, as had the high interest rates. In New York, a group of prominent Manhattan real estate brokers announced the formation of the New York Real Estate Securities Exchange. The exchange was set up to operate in an unusual manner. The Realtors would issue stocks and bonds with real estate as security. Therefore, the public could trade in the securities which represented real estate holdings.

"Neither private banks nor private bankers affect the stability of the standard normal, supervised, incorporated savings banks and trust companies which constitute the type of bank which the public recognizes as such and in which the public has many a safeguard for its money."

There were numerous banking operations in those days and the Clarke failure is perhaps an example of the instability which existed within the financial community. Banking failures were now on the rise and in Florida 25 banks failed in a single, swift blow. The Florida incident was being excused as an isolated affair. The banks reportedly failed because they were filled with uncollectable land-boom notes. The last deposits amounted to $34 million. But an additional cause of the failure was a fruit fly which destroyed the Florida crops. The devastation was terrible and the banks, already struggling with bad notes from the land-boom era, now faced failures on the part of producers.

The banking failure stories were gaining wide publicity. Many people began to be concerned that there was a potential problem.

The war between the Federal Reserve and Wall Street had persisted since February. The Fed, perhaps lacking the authority to really take any measures, continued to harass the stock market with its verbal assaults.

We must commend Time magazine for finally taking a stand and reporting the situation as it really was in the August issue.

"FEDERAL RESERVE"

"Last February the Federal Reserve Board harassed the market by convening every Thursday to discuss a raise in the rediscount rate, then reporting 'no announcement.' It formally announced that 'when it (the board) finds conditions... that obstruct Federal Reserve Banks in...so managing credit facilities as to accommodate commerce and business, it is its duty...to take measures to correct them; which in the immediate situation means to restrain the use of the growth of speculative credit.' For months no more was heard. Brokers and speculators forgot. Last week when the Federal Reserve Board went into a conference, expected to last three or four days, few noticed it and fewer guessed the purpose."

The Governor, Roy A. Young, emerged this time with an announcement: "We have considered how the resources of the Federal Reserve System might best be conserved and made available to meet autumn requirements. The problem has presented difficulties because of certain peculiar conditions." The Fed raised the discount rate from 5% to 6% in one move. Only Chicago and Philadelphia refused to raise their rates.

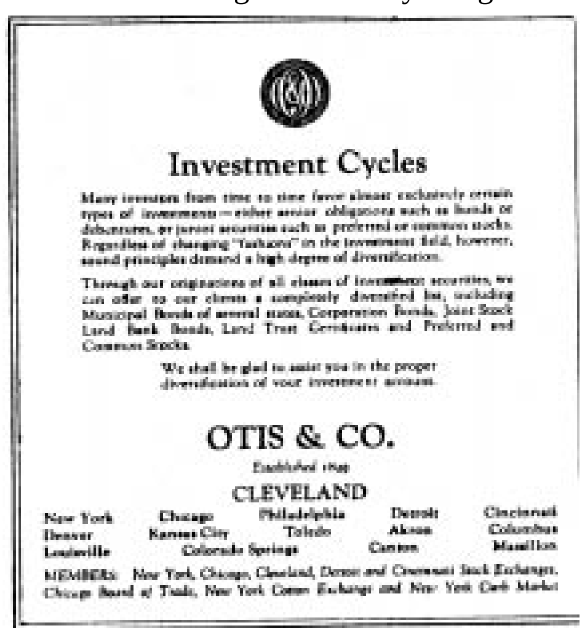
Time magazine reported on August 19th as follows:

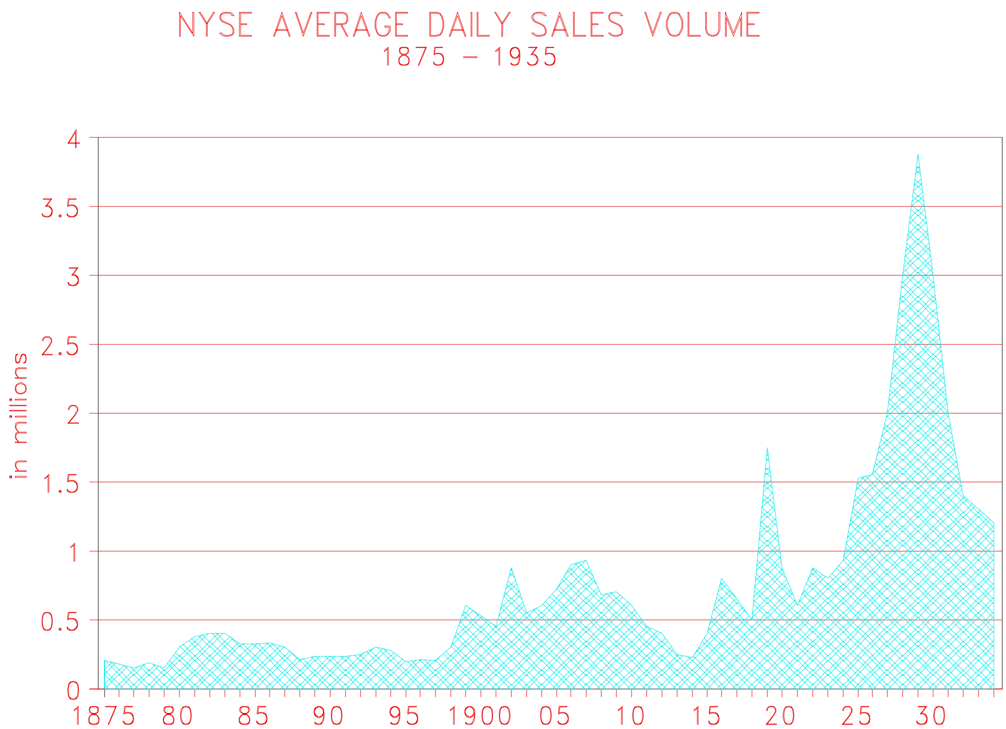
"THE MARKET"

"Commuters on their trains last Friday morning discussed and laid grim bets on how far the Market would fall. The Los Angeles and San Francisco markets, still open on the previous afternoon when the Board's announcement was made had crashed badly. Six hours ahead of New York, Friday's market in Amsterdam had opened with U.S. Steel plunging downward. To add to the threat of another Black Friday (Sept 24, 1860) was the fact that brokers' loans reached a new all time high over $6 billion. At the New York Stock Exchange, the gallery was packed with spectators by 9:30 am. Five minutes before the opening the ticker flashed. 'The floor is filled with sellers.'

"when the gong sounded, trading began with clamorous confusion. Ten thousand shares of AT&T were sold at $266, 15 points off; 1,000 of General Electric, 14 off; 11,000 American & Foreign Power, 12.25 off; 20,000 of General Motors, 3 5/8 off; 15,000 of I.T.& T., 5 5/8 off; 7,000 of Packard, 9 1/8 off.

"The New York Times averages showed a decline of $9.66 compared to the record May 22 decline of $8.12 and the December 8, 1928 break of $5.47. Through all the fury, call money ruled at a modest 8% and during the day there was a brief rally as bargain-hunters bought, shorts covered with large profits. But then the rise stopped as if some heavy hand lay upon the market, gradually driving prices back into low ground. Heavy as the hand might have been on Friday, it soon lost its strength. Saturday saw gains in





the general list. By Monday the rise, although not universal, bore up many stocks and U.S. Steel, the market leader, reached a new all-time high, $229 5/8."

The interpretation of the discount rate hike was beginning to vary. Some argued that the rise was merely an adjustment to the higher sustained levels of call money itself and that the hike was not necessarily an indication of higher future rates. Col. Leonard P. Ayres of the Cleveland Trust Co., suggested that the result might be a further expansion in credit. He pointed out that while the Fed raised the discount rate to 6%, the Reserve Banks themselves lowered the buying rate on acceptances from 5.25% to 5,125%. This actually meant that banks could profitably sell their acceptances which were normally used to finance exports and imports as well as commodity crops. This in turn would free up a lot of cash and make it available for further crop financing as well as speculation. Col. Ayres' interesting suggestion, in fact, pointed to the Fed's attempt to crack the market without actually tightening cash. Was it in fact an outright ploy for the publicity itself? On the surface that rate hike certainly appears to be precisely that, a ploy.

The month of August was actually the highest monthly closing in the eight-year bull market. Just one week from the top, we looked at the auto stocks which had led this rally from the depths of depression in 1921. The list that follows illustrates the closing prices of August 23 and the prices for which they would be selling on a 15x earnings ratio which was known as the Raskob rule:

From the high of 380.18 reached on March 26 on the Dow Jones Industrials, the market had fallen back to an intra-day low on March 28 at 370.34. But during August, going into Labor day, the industrials rallied with a vengeance once again. The industrials reached an intra-day high of 383.96 and closed the month of August at 380.33, the highest monthly closing in history. As the long weekend gave time to ponder all the scenarios of whether the Fed was tightening or not, the traders became anxious to reopen on September 3. The market fell back a little that day. reached a low point of 378.23, and then rallied to exceed the August intra-day high, reaching 386.10. Volume was again heavy, amounting to 4,439,000 shares. The next day, September 4, opened with trading becoming noticeably nervous. The market began to break, falling from 380.12 almost straight down to 376.33. Clerks were going crazy. The ticker was nearly an hour behind but again the market took a pause and rallied back to 379.61.

The following day the exchange reported the previous day's volume had reached 4,692,000 shares, the highest volume for the past two weeks. On September 5, the market rallied again, reaching 382.01 and exceeding the previous day's high. But suddenly it ran out of steam. Selling started coming from everywhere. This time the market broke fiercely and fell straight down with few up ticks in between. It was pure madness. This was surely a break far worse than most preferred to remember. The industrials fell straight down to 367.35, nearly 8% in a single daily session. If it weren't for the shorts that covered for the close, the market wouldn't have had the strength to rally by even 2 points to close at 369.77 for the day. For the next two days that week, the market held that panic low and rallied back, reaching as high as 381.44 on Saturday the 7th. It couldn't close above 380, and finally settled at 377.56.

The forces had Sunday to think the situation through. Again the Fed talked but uttered nothing significant. As Monday the 9th opened for trading, the market rallied again, reaching 380.57 in a desperate attempt to push higher. But again, nervous longs started to take profit. The market fell back to 373.49, closing near the low at 374.93.

Tuesday looked like just another day. The market opened and rallied, trying once again to push above the 380 level, but nothing doing. The high for the day stood at 379.16 and then like the dying breath of a beaten animal, the market gave up. Selling was pouring in from all over. Most people didn't know where they were filled until the next day. The market had dropped below the previous week's low, falling to 364.46. Volume was now rising but only when the market declined. The onslaught continued that week as the industrials fell to 359.70 on Friday the 13th. The market had now traded over 5 million shares for two days in a row.

The following week of September 16 to 21 saw each day trade over 4 million shares. Monday through Friday the market had held the previous week 's low, churning back and forth like a dying fish lying on the dock. The market had managed to get back up to 375.20 that Thursday but on Friday it sold off again and fell to 360.44. It was a hard battle with over 20 million shares

traded. But they did it; they held the 360 area. Perhaps tired of the struggle, that Saturday session was expected to be quiet. Indeed it was. Many traders, needing the rest, took the day off.

Saturday was only a 2 million share day. Hardly much to write about. Nonetheless, selling persisted. To the surprise of those who were there, the market cracked and fell to 359.65, which was a mere fraction below the previous week's low. Everyone excused the occurrence and said it didn't matter because it was done on little volume. How often have we heard that excuse these days. Low volume or not, the next week proved that that Saturday penetration was perhaps a ill-omen in itself, warning of what would lie ahead.

After a brief rally on Monday the 23rd of September, the market managed to work its way back up to 365.03 but fell for the close and settled at 359.00. Again each day traded over 4 million shares. By Wednesday the market had fallen to a new correction low of 344.85. The market rallied again back to 358.16 on Thursday but to no avail. It collapsed on Saturday, falling to 341.03. By the end of September the market had fallen 45 points from the 386 high on September 3.

Roger W. Babson, famed market letter analyst of the day, came out that September and stated that the market was "riding to a fall." Although after his statement the market rallied back up and people laughed, eventually he would be remembered for calling the top.

October was merely a rerun but worse. News came out that building permits for 1928 showed a 23.4% decline. Almost anything now seemed to be bearish and a reason for more selling. The Chinese started to dump silver and that shiny metal fell to a new low since the 1920 high of $1.40, this time reaching to 50.7 cents. This drop in silver broke the 1921 low and now barely held the 1915 low as silver continued to fall to 46 cents by year-end.

On the first of October, the market fell to 335.99. The market was very active and to describe the trading as nervous was definitely an understatement as October dawned upon Wall Street. October 2 brought with it a relief as the market consolidated and traders were still reluctant to give in on their battle against the Federal Reserve. But the next day, the downtrend resumed, falling to 327.71 and on October 4 the market fell to 320.45, off 23 points or nearly 8% from the close of September. The market rallied sharply on the 5th, back to 342.59 for an intra-day high on Saturday. The first week of October was not much different from the preceding weeks in September but still cries from the bulls echoed through the halls and side streets of the financial district: "Fundamentally everything is sound, nothing has changed."

The second week of October 1929 found the market reaching to 348.50 on Monday the 7th after falling to 338.86. But in general, the market hold during this second week in October, rallying back as far as 358.77 by Friday the 11th. The commentary in the general press was quite confused but definitely still more bearish rather than bullish. Yet, at the same time, the reassurance that everything was fundamentally sound remained the distinctive undertone. The Fed remained curiously silent, perhaps secretly its directors hid from the press under their typically institutional mahogany desks.

Monday of the third week, October 14, opened a little lower but the market rallied

Your Dollars

Are they Continuously and Efficiently at Work?

THE matter of putting your dollars to work for you is vitally important—just as important as the business of making and saving them.

How are you to choose between thousands of securities? Shall you select low yields for safety or take a chance on more speculative issues? Shall you depend upon your own judgment or the judgment of others? The situation is involved.

Analyze it and you face a single question. Will you invest according to custom and rule o' thumb or will you select your securities and build your income on facts and sound economic laws?

It is foolish to assume worry and possible loss of income—even loss of principal—when you can get the established facts so easily—when you can proceed with great assurance.

Thousands of today's keenest investors have already solved the problem by adopting what has come to be known as—

The Babson Continuous Working Plan

This plan was originated to help you keep your dollars efficiently employed to maximum advantage at all times,—which means changing your policy as conditions change. It is a Complete, Continuous, and Concise Working Plan. Further it is Constructive and Conservative,—providing you with "Instantaneous" recommendations on—"What to do,"—enabling you to act quickly and profitably.

71% Profit

During the past two years the complete list of "Long Growth" recommendations has made for clients a profit in excess of 71% exclusive of dividends. It is this sort of record which is offered you with Babson's Service for Investors,—a Service with more than 25 years of continuous success in earning profits for clients. The information given has consistently brought great average gains to those investors who have followed it carefully and closely.

Send for Booklet!

May we send you complimentary our booklet, "Bigger Investment Returns," which explains this proven and successful Plan.

Careful study of the plan described should enable you to keep your dollars continuously and efficiently at work. Thousands of other successful investors secure maximum profits consistent with safety thru intelligent use of it. You can too. The coupon brings a booklet descriptive of this Babson Plan without charge or obligation.

Babson's Reports

BABSON PARK, MASS.

Largest Statistical Community in America

Babson's Statistical Organization
Div. 45-11
Babson Park, Mass.

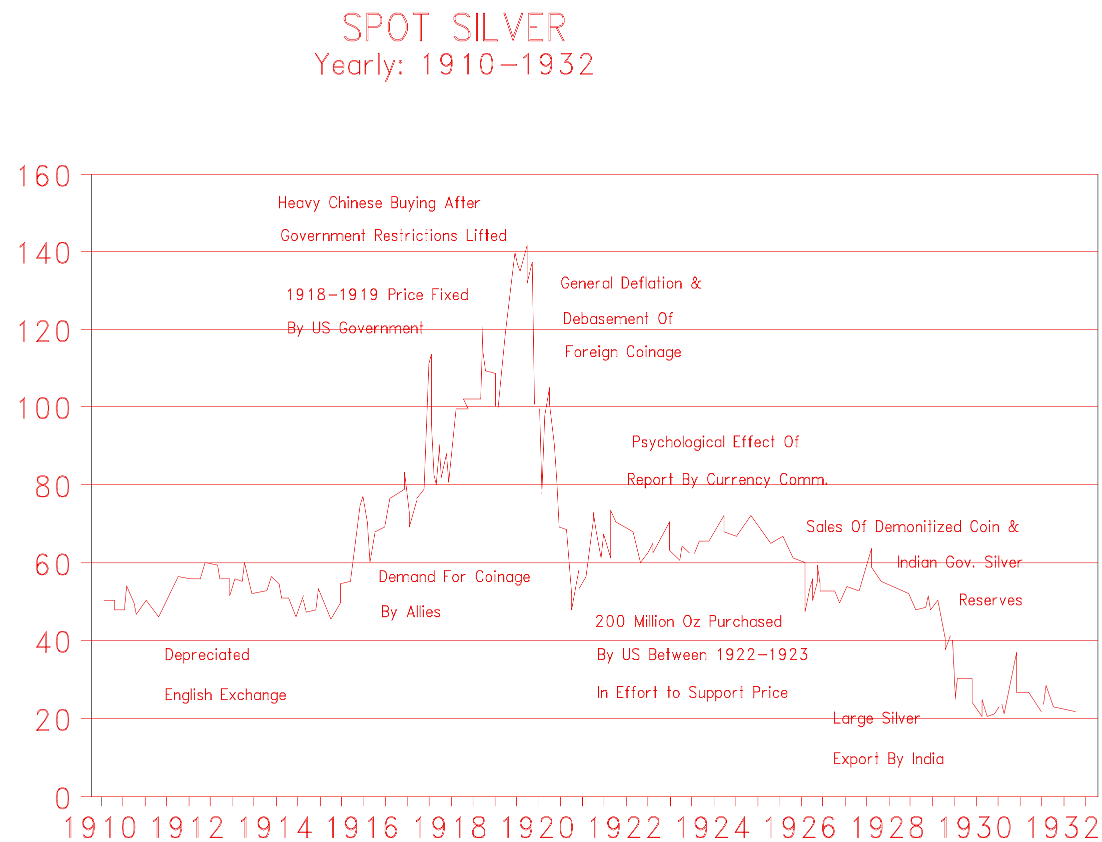
Send me free, and without obligation your Babson Plan as described in your booklet "Bigger Investment Returns."

Name ....

Street ....

City ....

State ....



back to 358.20, closing back down at 350.97, off nearly a full 8 points from the high of the day. That was the last and fatal sign of strength for the month and from Monday onward, the market fell sharply that week. Each day brought lower prices and finally by the end of trading that Saturday, the market fell to 321.71. Readers picked up their October 14 edition of Time magazine at the local newsstand and read of the shocking goings on in Chicago as margin calls were flowing in from all sectors of the nation. The story that raised more than a few eyebrows was this:

"In Chicago many gangsters, known to be heavy speculators, received margin calls, left brokers' offices muttering threats. Dynamite was thrown into the home of one Charles H. McCarthy, manager of a brokerage credit department. Stench bombs were tossed into the offices of Hornblower & Weeks, E.A. Pierce & Co., Logan & Bryan. 'A new form of wolf has invaded LaSalle Street,' said the deputy police commissioner. 'The racketeer who responds with a bomb when he is called for more margin.'" It seems as though the mob was in the market in those days and when the trend went against them, they weren't very good losers.

The Dun's Review, issued for the week of October 7, stated the following: "Nothing has occurred to indicate that widespread trade recession is under way and statistics of railroad freight traffic show week after week, that distribution of merchandise remains at a notably high level.' Indeed, the fundamentalists remained bullish. Many signs of the economy were still quite bullish. There was no real news which indicated that the economy was about to collapse. This still led many to look at the dip as a buying opportunity yet the selling continued despite the calls from the fundamentalists who claimed that everything was just fine.

Nonetheless, General Motors stock had fallen so far since its 1929 high during the second week in October, that the total value of the stock had fallen $1.2 billion. W.P. Chrysler came out just before the break and stated that he saw no reason why automobile stocks should drop given the present rate of sales and earnings. But, the market saw no logic and delivered no mercy.

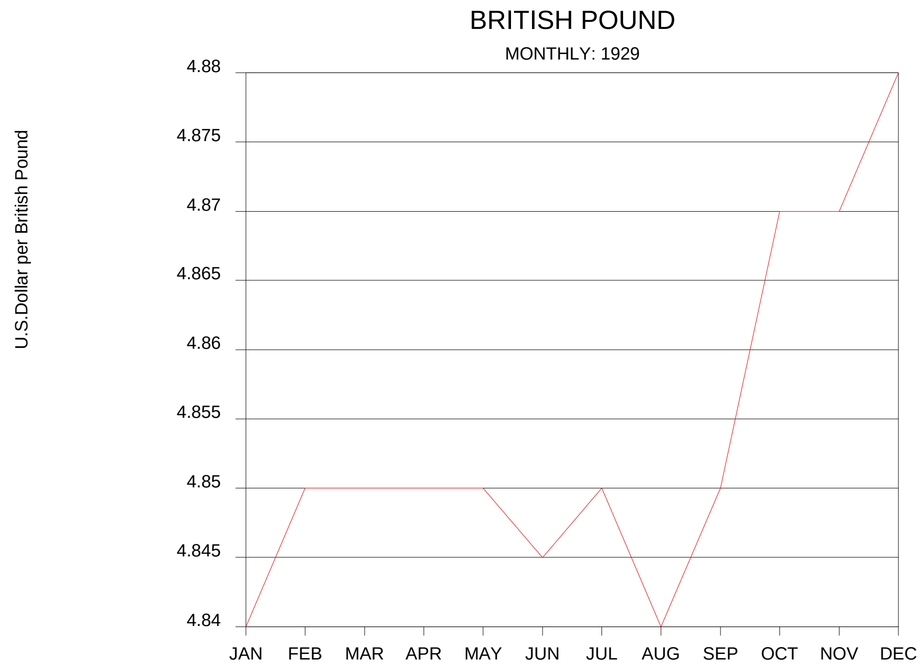
One bearish factor at this time was the speech of Philip Snowden, British Chancellor of the Exchequer, which attributed the rise in the Bank of England's discount rate to the "orgy of speculation" in the United States. Many began to wonder just how much foreign capital was taking part in the so-called American "orgy."

Some began to recall the words of Roger W. Bobson who stated that the market was riding toward a fall. Some brokers said that he was always wrong and that eventually he would be wrong again when things settled down. Commentators blamed everybody from the Fed to Bobson and everyone in between who even uttered a bearish note. But Yale University's Professor Irving Fisher uttered a few words that placed his name in history for a brief period in time. He stated: "Stock prices have reached what looks like a permanently high plateau." Colonel Leonard P. Ayres of the Cleveland Trust also came out and stated that month: "It seems probable that stocks have been passing not so much from the strong to the week, as from the smart to the dumb." The bears at last had a few more hats tossed into their side of the ring and the confidence of the bulls was beginning to crack.

Virtually everything and anything was getting hit on the slightest bit of news. One such stock was Boston's Edison Electric illuminating Co. The company wanted to split its stock and stockholders were all in favour as the stock rallied to $440 a share on the news. But the Massachusetts Department of Public Utilities unexpectedly refused to grant its blessing. Instead, it criticized the company for everything from its rates to the amount of dividends it paid, as well as the price at which the stock was trading. When the news hit the market, this stock fell to $299 a share. This was unbelievable, nearly a 40% decline based upon the remarks of an overzealous state administrator who took it upon himself to publicly state: "No one in our judgement, on the basis of its earnings, would find it to his advantage to buy it." This is the atmosphere that began to surround the market like the black cloud of death in biblical stories.

The third week of October brought no real sign of relief. On Monday, October 21, the market fell in another selling wave. The Dow Jones Industrials fell to 314.55 at one point during the day. Then news began to circulate about a big bank meeting that some hoped would stem the wide break which had taken place that morning. The ticker tape fell two hours behind and selling turned to panic as people increasingly feared what they could not see and ignored all logic and reason offered by the fundamentalists. Selling became "blind" and people would not find out where they were filled for hours on end. The bankers who met that day were called to order by the famous J.P. Morgan & Company as they gathered in their offices in Manhattan.

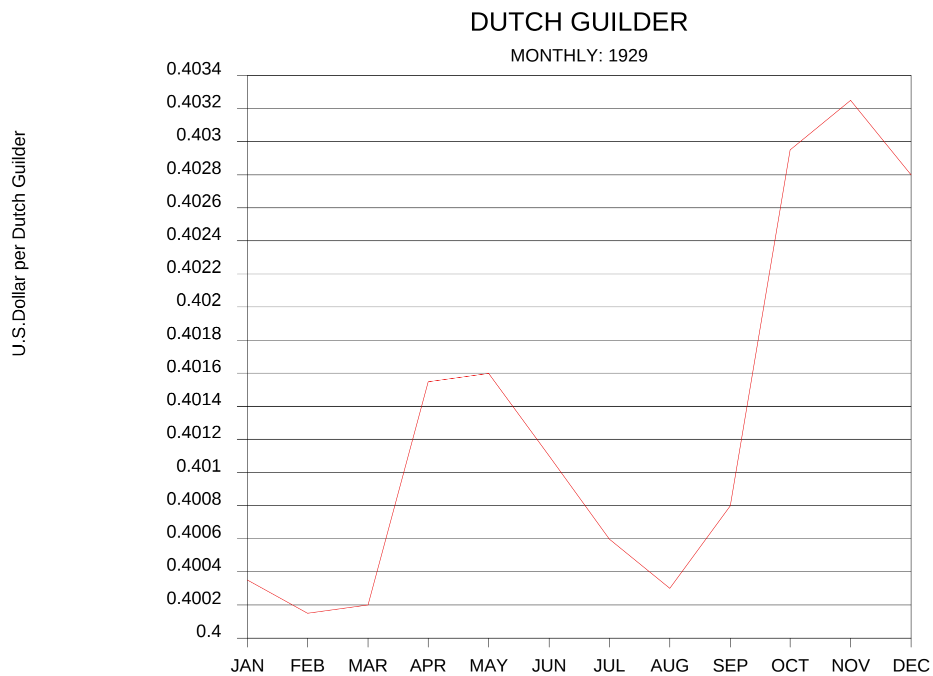
The banking meeting included the heads of four of the greatest banks in the United States with a combined asset power of $6 billion dollars in resources. Represented were the National City Bank, Chase National, Bankers' Trust, Guaranty Trust and, of course, J.P. Morgan. The market held briefly and traders hoped that the bankers were going to take decisive action. The



market traded back up, reaching as far as 329.28, a 14 point rally. Later in the day, the bankers were joined by representatives from 30 of the nation's leading stock exchange houses. Then emerged Mr. Lamont from the renowned House of Morgan and he assumed the role of spokesman for the distinguished group of financiers. The statement that was released was not one of earthshattering support and at first it was misunderstood. The bankers merely stated that the break in the market was a "technical" one and that it was not based upon anything fundamentally wrong with the market. They explained that the market was merely scared and that it had run into what they termed "air-holes" with urgent and heavy selling being met with an absence of sizable bids. But the tickers misreported what Mr. Lamont had said and it was interpreted as though the Fed would raise the discount rate again.

The market was confounded as the ticker, hours behind, only intensified the panic. No one know whether their stock was selling at the price last reported by the ticker or if it was 20% lower. The sheer fear of that unknown had intensified the selling as the blind began to load the blind. Emotionally, the lack of definitive prices made the situation far worse than it perhaps would have been. Nonetheless, the real selling that day was noted to be mostly large blocks of stock amounting to 5,000 to 20,000 shares at a clip. Many assumed it was the investment trusts bailing out. The day finally came to an end with the market closing at 320.91, about mid-ground between the high and the low of the day.

With the fourth week in October starting off with such a panic, the next day was not looked forward to by many traders at all. The headlines continued to reflect a desperate situation but the fundamentals were stressed heavily. "Serious Business Decline Unlikely" topped an article in the New York Times. This was merely one example as countless worldwide stories projected the same note of optimism. Indeed, when the next day arrived, traders were literally shaken by the previous day's action as the exchange released the volume which un-

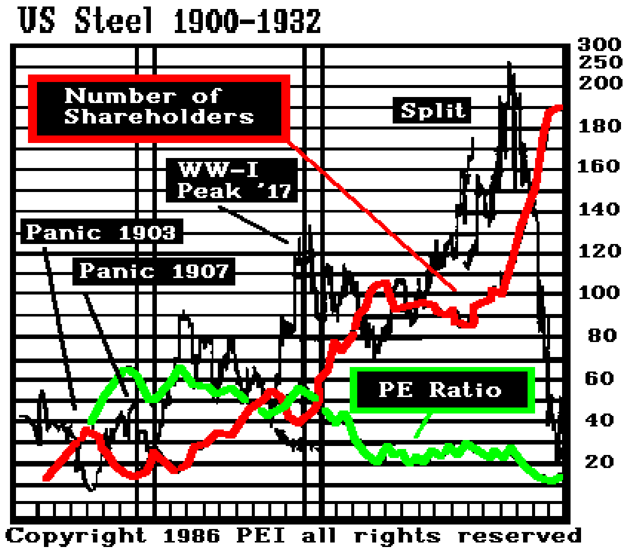


doubtedly had broken all previous records: 6,092,000 shares had changed hands.

Tuesday, October 22 brought with it a sharply higher open. The low of the day was 2 points above the previous day's closing. The market rallied straight up to 333.01 and the roar of optimism was heard loud and clear. The market found the industrials closing at 326.51 that day, off nearly 8 points from the optimistic high of the day. Wednesday, October 23 brought the exact opposite. The market managed to rally up to 329.94 but then the pressure began to build. Suddenly the market collapsed and the industrials fell drastically behind. The exchange had released the volume for the previous day, indicating that 4,130,000 shares traded hands. Obviously, the volume increased on down days and slackened off on days that rallied. This illustrated that there were still sizable long positions still holding on in the market and that further panic was not out of the question. Wednesday fulfilled that indication in style as the market closed down at 305.85 with volume once again reaching a new record of 6,369,000 shares.

Thursday, October 24 opened a bit stronger as the market rallied nearly 8 points from the previous day's close. But then again, heavy selling came into play and the market fell to 272.32 on the Dow Jones Industrial Index, off nearly 50 points from the close of the previous week. The ticker was behind as much as 3.5 hours. The devastation was indescribable. The volume was for heavier than anyone ever expected possible. The members of the exchange worked well into the night and it was after midnight when any reliable figures could be put together. The next morning the volume was released; 12,895,000 shares had changed hands. The volume clearly reflected distress selling at its height.

In the October 25 edition of the New York Times, the headlines read: "Weird Roar Surges From Exchange Floor During Trading"..."Brokers In Uproar As Market Boils"..."Senators Stirred By Market Break - King Presses His Proposal For Investiga-



tion Of Federal Reserve System." The article went on to report that the further collapse of the stock market that day caused a revival in the Senate of suggestions calling for legislative action to curb credit for speculation and for amendment of the National Banking and Federal Reserve Acts to restrict credit used in the stock market.

Along with such proposals, some of the senators advocated a detailed investigation of the Federal Reserve Banking system as proposed in the pending resolution of Senator King of Utah..."Today's activities in the market were watched with interest by senators who have been expecting developments that would create a sentiment not only in Congress, but throughout the country in favor of legislation to make it more difficult for banks to lend money for speculation and for Federal laws to heavily tax stock transfers made ostensibly for speculative purposes." Senator Glass of Virginia, one of the authors of the Federal Reserve Banking Act, found in the situation the strongest argument for pressing his bill providing for the imposition of a 5% exercise tax on sales of stock which had not been held for over sixty days. "It is his present plan to offer his bill as a 'Rider' to the pending tariff bill," the press reported.

On the same page of the New York Times on October 25, another article appeared pointing out the real winner in the midst of that panic. It was the state of New York. The state of New York earned $350,000 in tax on that day's stock sales. The taxation, which the state imposed upon the New York Stock Exchange and the Curb Exchange, was bringing them literally millions of dollars in tax revenue. Now the federal government wanted to impose taxes as well. It seems as though laws are never good enough. The government always takes the position that it is far better to raise taxes as the supposed incentive against something, rather than to actually outlaw whatever it is that they are trying to prevent. In the end, obviously government will always be the ultimate winner when it takes that sort of approach.


Brokerage Houses Are Optimistic on the Recovery of Stocks

THE NEW YORK TIMES, FRIDAY, OCTOBER 25, 1929.

Weird Roar Surges From Exchange Floor During Tradin

BROKERS IN UPROAR AS MARKET BOILS

FURIOUS PACE BEFORE GONG

CROWDS SURGE IN STREET

SCENE IN WALL STREET AS PRICES CRASHED ON EXCHANGE.

SENATORS STIRRED BY MARKET BREAK

GLASS SEES VIEWS BACKED

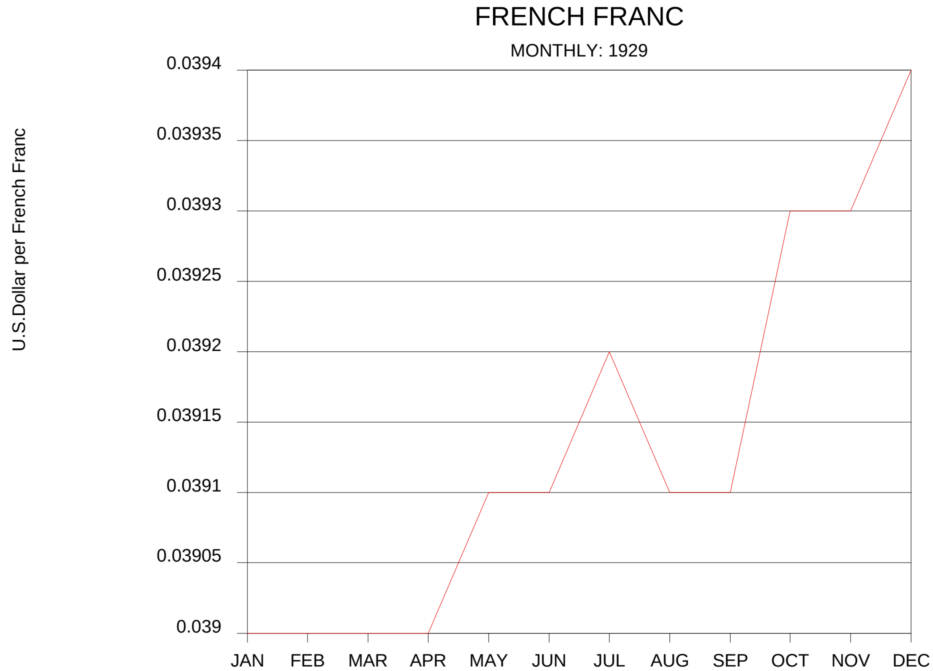
BREAKS OF THE PAST RECALLED IN STREET

On another page in the New York Times on October 25, the headline read: "Brokerage Houses Are Optimistic On The Recovery Of Stocks." Another article, entitled "Investment Trusts Buy Stocks Heavily, Pour In Their Reserves As Market Drops," went on to say:

"Investment trust purchases yesterday were reported to have been the heaviest of any day since the inception of the investment trust movement in this country. Many trusts which had placed scale buying orders extending from 10 to 50 points below yesterday's morning opening prices were said to have purchased hundreds of thousands of shares. These scale orders had been placed under the market several weeks ago in a period when many of the trusts were liquidating a part of their holdings.

"When the decline was most abrupt from 1130 to 1230, the scale orders of the investment trusts and other interests acted as a cushion for the crashing securities markets. During this interval, scale buying orders were caught by the hundreds and several trusts declared after the close of the market that they had purchased all the stocks which they cared to add to their portfolios for the time.

"The decline was so severe, however, that a few trusts complained that their scale orders had not reached down far enough and that many of their purchases were made at the higher levels prevailing before the break assumed its greatest proportions. One trust was reported to have been unusually successful in its operations making most of its purchases by keeping in constant telephone communication with its brokers on the floor of the exchange, buying in 5,000 and 10,000 share blocks at the lowest level of the day. When the stock market rallied, the trust had a paper profit on its operations

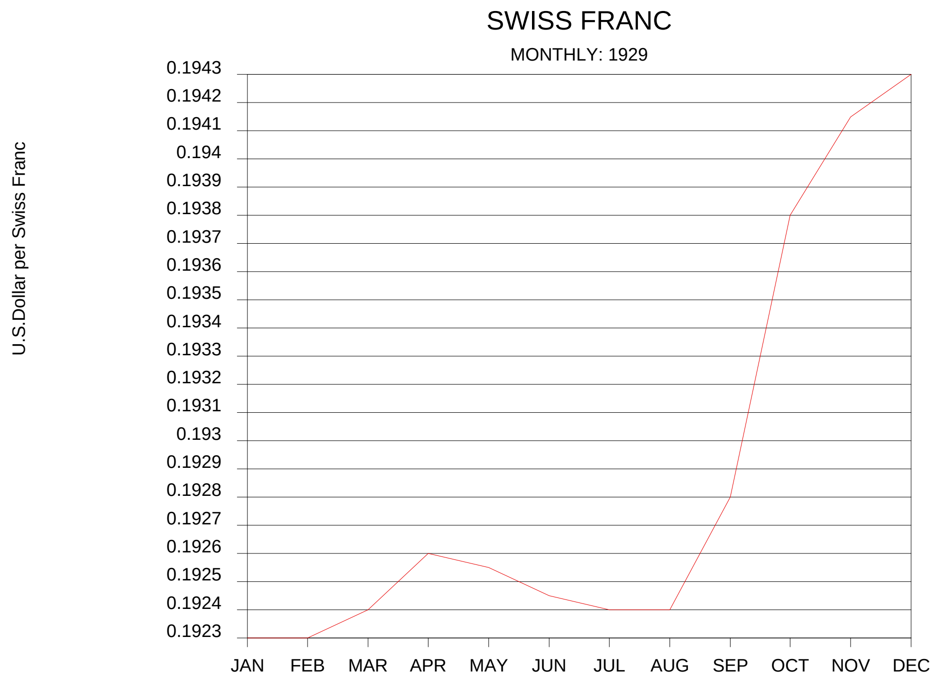


for the day of several hundred thousand dollars.

"The cash reserves of the entire group of large investment trusts before yesterday's operations was estimated at approximately $750,000,000. More than $100,000,000 of this total was reported to have been used by the trusts in the purchase of stocks yesterday. One trust, which had $30,000,000 in cash on Wednesday evening, reported that it had used only one-fifth of its total yesterday in purchasing stocks."

Obviously, the investment trusts had received sizable hoards of cash as the market had come into its high during September. Since the market began to decline, many trusts did not simply jump into the market investing their capital upon receipt. Had they done so, the break could have been seriously worse than what took place. Institutional cash was actually at record highs just prior to the October 1929 collapse.

This very same fundamental was implicated as the reason for the stock market rally in 1982, and claims were made that the institutional cash was at all-time highs. Again fundamentally we find that the institutional cash levels at the top of the market in 1929 were also at record highs and this simple factor of watching institutional cash reserves as a leading indicator for market performance does not necessarily hold a constant relationship to the market. To the contrary, institutional cash would logically be at all-time highs when a market is soaring to this extent. It is reflected by the small investor reading the bullish headlines and sending in his cash as quickly as possible. In fact, the entire investment trust phenomena was exploding between 1925 and 1929 and therefore from one month to the next, in effect, it always had established a new record high in cash during the bull phase of this period. Therefore, if one were to draw any assumptions from watching institutional cash levels, perhaps it should be marked rises and marked steady declines. It is doubtful that this indicator will afford



any loading indication but in the future perhaps it might be used as a confirmation of a change in trend following market performance.

The banking statement provided that week by the House of Morgan was at first misinterpreted by the traders in the confusion. It was actually not until later in the week that Mr. Lamont's statement became clearly understood. The New York Times explained this confusion as follows on the 25th:

"Through a misunderstanding, reports of Mr. Lamont's statement appearing on the news tickers made it seem that he had said that he expected the Federal Reserve authorities to take some action today upon the stock market situation. In a later interview, he disclaimed all such intentions pointing out that he would hardly be in a position, even if he should care to do so, to forecast the actions of the Federal Reserve Board."

The crash had shaken the securities and commodity markets worldwide. In London, the exchanges stayed open late into the night following New York time so that investors would not be left in a serious position with no way to act. Between the confusion among public statements and with the tickers falling 8.5 hours behind, it is not hard to imagine the intensity of the panic during that fourth week in October.

As Saturday arrived, volume declined to 2,098,000 shares, nearly half that of the previous Saturday session and one-sixth of the huge volume on that Thursday. The market held the previous day's low and trading was steady between 303.60 and 295.98. The total volume for the week was 37 million shares, more than half the entire volume of the previous month. On the close of Saturday the industrials were off 88 points from the high of September 3, which was about 23%. The railroads were off 24 points, nearly 12.5%, with the utilities down nearly 28%, showing clearly that they had been the hardest hit. The bonds, however, had fallen

The New York Times.

NEW YORK, FRIDAY, OCTOBER 25, 1929.

WORST STOCK CRASH STEMMED BY BANKS; 12,894,650-SHARE DAY SWAMPS MARKET; LEADERS CONFER, FIND CONDITIONS SOUND

FINANCIERS EASE TENSION

Five Wall Street Bankers Hold Two Meetings at Morgan Office.

Wall Street Optimistic After Stormy Day; Clerical Work May Force Holiday Tomorrow

LOSSES RECOVERED IN PART

Upward Trend Start With 200,000-Share Order for Steel.

BIG DROP IN WHEAT; PIT IN A TURMOIL

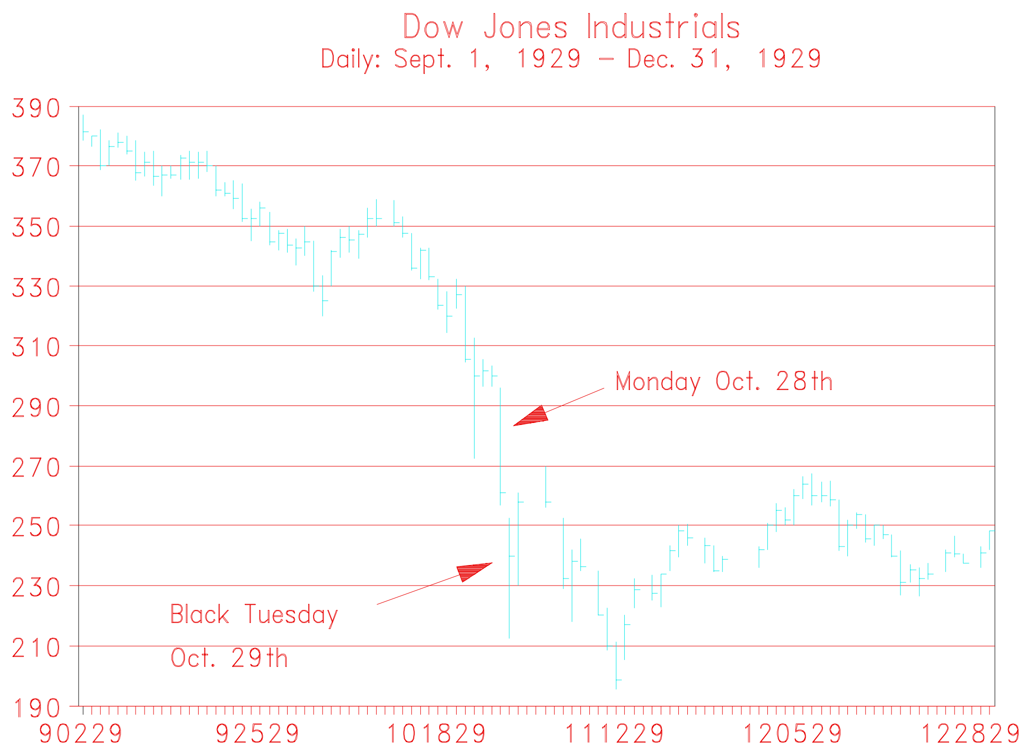
TREASURY OFFICIALS BLAME SPECULATION

HUMBERT ESCAPES ANTI-FASCISTI'S SHOT AT BRUSSELS TOMB

TESTIFIES HE HANDED $10,000 TO WARDER

to 92.10 during September and closed at 92.18, which was the lowest closing since 1928 high. October had also brought the bonds down, falling to 91.76 during the first week of October 4. By Friday, October 11, the bonds rallied sharply as the stocks declined, closing the second week at 92.39. But during this third week in October many were dumping stocks, running back into the bonds and trading according to their old familiar theory. The relationship, which was stocks down, bonds up, began to come alive again but would soon prove to be false as the depression unfolded. By the close of this week the bonds rallied steadily, posting gains each day closing at 93.71.

Sunday the 27th brought welcome relief. Traders hoped that things would settle down after the news of the bank meetings had been misreported and then denied. But the Federal Reserve had not seen enough blood just yet. After a late special meeting which lasted 2.75 hours, a spokesman for the Federal Reserve emerged from the closed door session uttering their famous statement, "No announcement." The discount rate would not be lowered. Despite the denials of Lamont, traders began to think that the Fed might tighten further in their battle against the market. Perhaps the greatest of all fears was that the selling



might now continue when Monday opened for trading.

When Monday, October 28 opened, the worst fears expressed over the weekend came to a real fruition. Monday opened at 295.18, which was slightly below the lows of both Friday and Saturday of the previous week. But worst of all, 295.18 quickly became the high of the day in a very obvious manner. The market began to plummet and now even the investment trusts began to worry. No scale buying was seen of any real size. The market had encountered Mr. Lamont's famous "air-holes" collapsing in a terrible manner. The industrials fell to 256.75 and this time there was no sharp rally for the close as the market went out with a screech so loud it was as if it had been dealt a swift and sharp fatal blow. The roar was reported to be so loud that it was audible on the streets outside the building.

The railroads fell sharply and make a new low for the month, falling to 155.07, off 20 points from the high thus far for this month alone. The utilities collapsed, falling to 86.96, down 18 points from the previous day. As a whole, the broad market dropped 155 in a single day! The bonds rallied again but, curiously enough, they closed at 93.69, slightly lower than Saturday. This perhaps reflected above all that people were getting seriously hurt and not much capital was seen on the bid side for bonds that day.

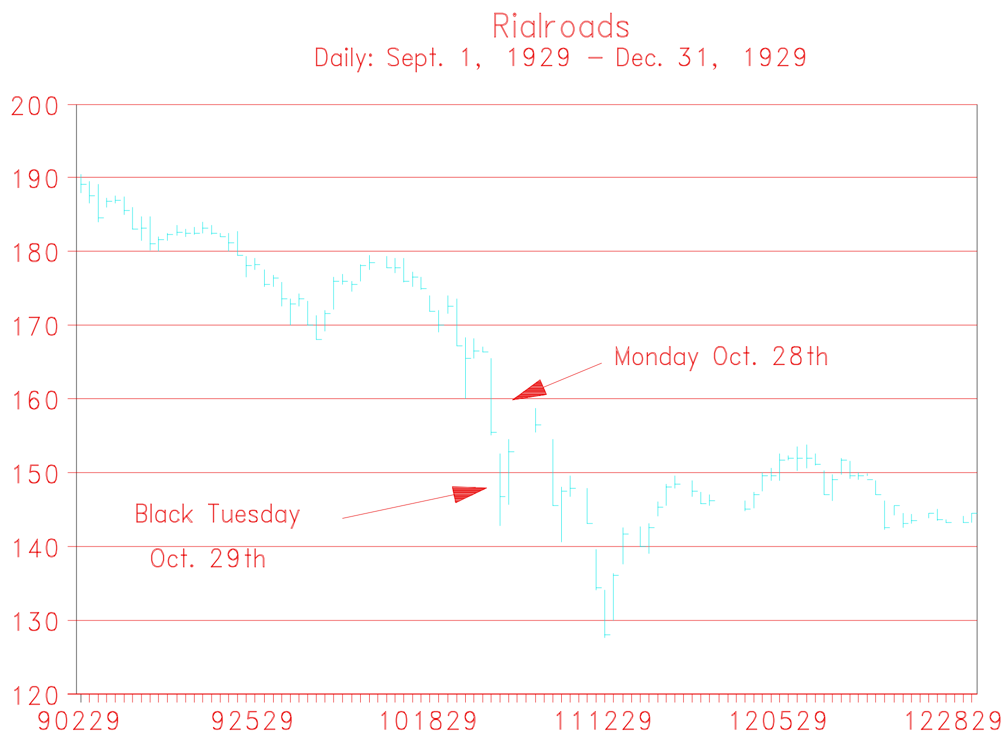
Then came what would be known as Black Tuesday, a day that would carve its memory into the minds of men who would not be born for decades to come. Monday's volume was released: 9,213,000 shares. As if Monday's devastation was not enough, Tuesday's speculation that the Fed was going to raise the discount rate loomed above the heads of the traders. People asked why, and there was little explanation that could offer consolation or reason for that matter. Everything was an assumption based on unwarranted rumor, but the Fed and its board were viewed as the assassins who were terrorizing the financial world. The market opened 8 points below the previous day's close and 4 points under its lowest point of depravation. Again it quickly become noticeable that it was again the high of the day. Selling came in from everywhere as the industrials were forced to an appalling and depressing low of 212.33. Volume for the day was 16,410,000 shares, more than four times the volume in the good old days when the market leaped ahead, rearing its horns through the stops placed by the short players.

This devastating decline was unmistakably no poor man's crash. By Monday, the previous day, G.M. had lost nearly $2 billion off the total value of its 43.5 million outstanding shares. General Electric had dropped 120 points from its 1929 high. Westinghouse Electric crashed 194 points, American and Foreign power fell nearly 112 points and even AT&T collapsed by 130 points. Everything had buckled under to the waves of mass hysteria.

But Black Tuesday had not left even some of those declines alone. On Tuesday, G.M. fell below 50 after being above 200 at one point, which was now off by 75%. Even the almighty Chrysler, which had been the leading automobile issue throughout the bull market, was now under 40, off more than 100 points from just a few weeks before. The railroads had tried to resist the depravation before this week, but even here with car loadings doing very well, the rails broke severely. The Dow Jones Rail Index, which had reached 190.50 in September, now groveled at the 142 level. Common sense, logic, reason, earnings, dividends all seemed to be fundamental excuses which could not muster a supporting consensus.

Perhaps the greatest indication of all, which clearly proved that this was no small panic and that it was not restricted to the small investor, was the collapse in the banking stocks. Traditionally, most banking issues were purchased by the wealthy and many traded over the counter as unlisted securities. Here again we can see that the Federal Reserve concern for the amount of money in the brokers' loans was perhaps not justified for the nation as a whole. The margin for bank stocks was usually none and those that were marginable were on a 50 to 80 percent basis. There was no overleveraged position in this market. Yet despite this fact, the damage which had been done seriously affected the rich as well as the middle class. The banking issues, of which many were selling at $400 or more a share, crashed. First National fell on the 28th by $500 in a single day. Bank of Manhattan fell $150 that day as well. In fact, sharp losses were expressed in the quotations for Bank of America, Chase National and even the mighty National City. Other stocks, traditionally held by the rich, were the insurance companies, trust companies and utilities. Here it became clear that the rich industrialists, who normally paid 100% cash for their bank shares, saw their portfolios cut more than in half between September 3 and October 29.

In the midst of the hysteria when people watched their fortunes disappear faster than they had been amassed, a knight in shining armour came to the rescue. He was John D. Rockefeller, American oil tycoon. Rockefeller had never been a man of much public exposure, preferring to refrain from public statements. But he was a man highly respected among businessmen as well as Wall Street. With the calm and steady voice of confidence he came forward and publicly announced: "Believing that fundamental conditions of the country are sound, my son and I have for some days been purchasing sound common stocks." At last, someone of substance offered to put his money where his mouth was, so to speak. The news hit



the floor in the later part of the session just prior to the close. The market firmed and began to rally sharply for the close, settling at 230.07, up nearly 18 points from that day's low of 212.33. On this day, selling of even investment trusts had come in but many could not be sold for there was no bid of any price. But as the news eventually began to circulate, what the bankers and the investment trusts had tried and failed at, only John D. Rockefeller seems to have been able to pull off. Here was a man of few words, devout patriotism and acknowledged business accomplishment. Despite the numerous words from Hoover to the Governor of the State of New York, Franklin D. Roosevelt, all claiming that the economy was sound, it took an acclaimed tycoon not known for speculation but for his business judgement, to provide a level of confidence once again.

The next day, the market opened higher, fell slightly to 230.98, still almost a point above the close on Tuesday, and then rallied straight up to 260.93, closing at 258.47. Shorts were covering but more apparent was real buying from bargain hunters. But most important, volume reached 10,727,000 shares, the highest volume ever recorded on a day that rallied instead of declined. The buoyant rally continued into Thursday, the 31st of October, as trading slacked off to 7,149,000 shares. The bonds had fallen back to 93.13 on Tuesday but rallied on Wednesday to 93.52, coming close to matching the previous week's high of 93.83. But as the stock market moved higher on Thursday, the bonds fell by a full point, dropping for the close back to 92.11. Clearly, cash for stocks came flooding back out of the bond market as traders continued to view the old relationship of stocks up, bonds down. The total volume for the week was nearly 44 million shares. The exchange, exhausted and drained, declared a three-day holiday, ending the week on a definite notes of optimism.

The week of October 28, 1929, had been the largest volume week in the history of the exchange. The backlog of work was incredible as October slipped into the past. November began on Friday of that week but the market was closed and remained closed for a three-day holiday and did not reopen until Monday, November 4.

The week of October 28 had caught the attention of virtually everyone in world, not merely the nation. Stories continued to dominate the press during early November of 1929. The Dow Jones Industrial Index had fallen from the 386 high in September to 212 on Tuesday, October 29. But the decline in many individual stocks was much worse than the indexes suggested.

Montgomery Ward fell from its high of $156 to $83 while Electric Bond and Share fell from $189 to $50. One story, which history has recorded but prosperity has caused us to forget, concerns a hero - at least in the public's view - from the House of Morgan and how he helped stem the decline during that dreadful week.

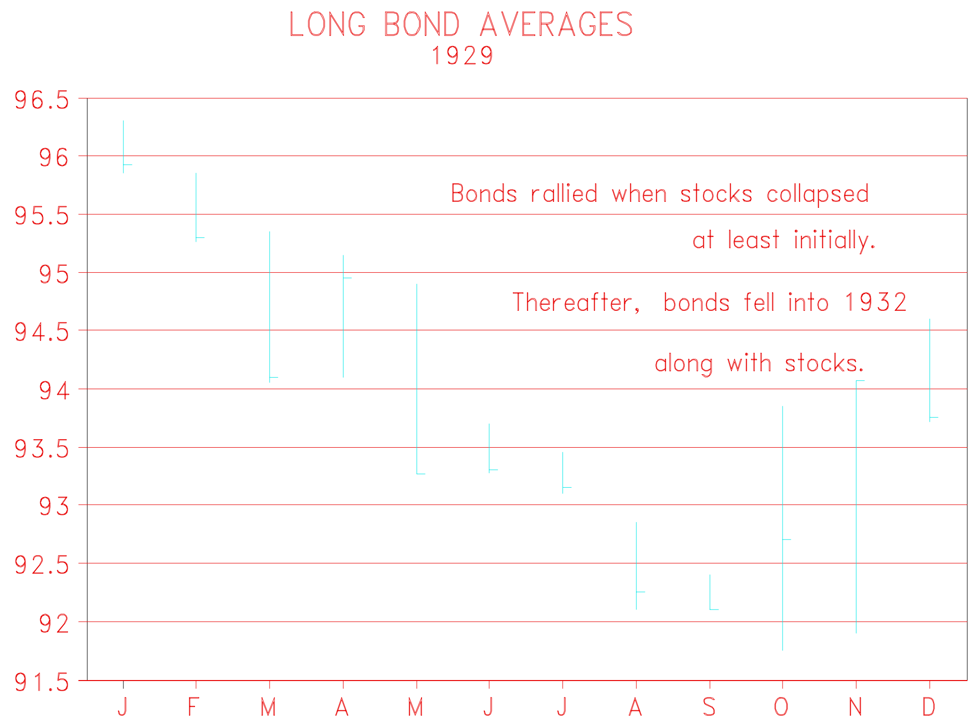
The hero was Richard Whitney, head of Richard Whitney & Company. He was well-known as the brother of George Whitney, who was a Morgan Partner. At 1:30 PM on Tuesday, Broker Whitney stepped into Post Number 2 and in a loud and confident voice announced a bid at $205 for U.S. Steel. This was 15 points above the market at that time and soon the tickers began to flash "Steel, 205 bid." Whitney was bidding for only 25,000 shares which amounted to a mere $5,000,000. But the importance of the bid lay solely in the Whitney's implied relationship with the House of Morgan.

Despite the seemingly buoyant recovery for Thursday afternoon on the 31 st, many a speculator was cut down to size that week. The speakeasies were booming as rumor after rumor depicting suicides drifted through the smoky back alley rooms. Perhaps the odd saying, "misery loves company," was born in those dark, smoke- filled rooms that very day. For misery certainly was not alone. Proud boosts of how they had survived could be heard between the gulps of imported bootleg of the finest quality. But between the lies and the exaggeration relating how they knew all along that this would be the outcome rumor and speculation spun tales of the famous who were less fortunate. The rumors and the gossip which told a dismal tale of suicides began to turn into blatant reality.

When the week was over, estimates began to pour out indicating that the number of margined positions which had been closed out ranged from 25% to 75%. The swing within the market that Thursday the 31st was awesome. The decline from Monday had cut the total value of the New York Stock Exchange issues by nearly $11.3 billion. By the close of Thursday, all but $3 billion had been recovered.

The "Banking Pool," as it was called by the end of that week, seemingly stood by ready to stem the tide should it shift toward selling once again. But the following week brought with it National City's withdrawal of its offer to buy out the Corn Exchange. This untimely event, coupled with remarks from Senator Carter Glass, who chose to blame anyone and everyone for the collapse in the market, undermined the confidence in the Banking Pool.

In the Philadelphia Record, Senator Glass, author of the Federal Reserve Act, attacked Charles Edwin Mitchell for causing the crash by making optimistic statements. Mitchell was the head of National City Bank and therefore an important member of the Banking Pool. Senator Glass's verbal assault was quoted as follows: "He, more than any fifty men, is responsible for this stock crash." The hostility of Senator Glass toward Mitchell was a long

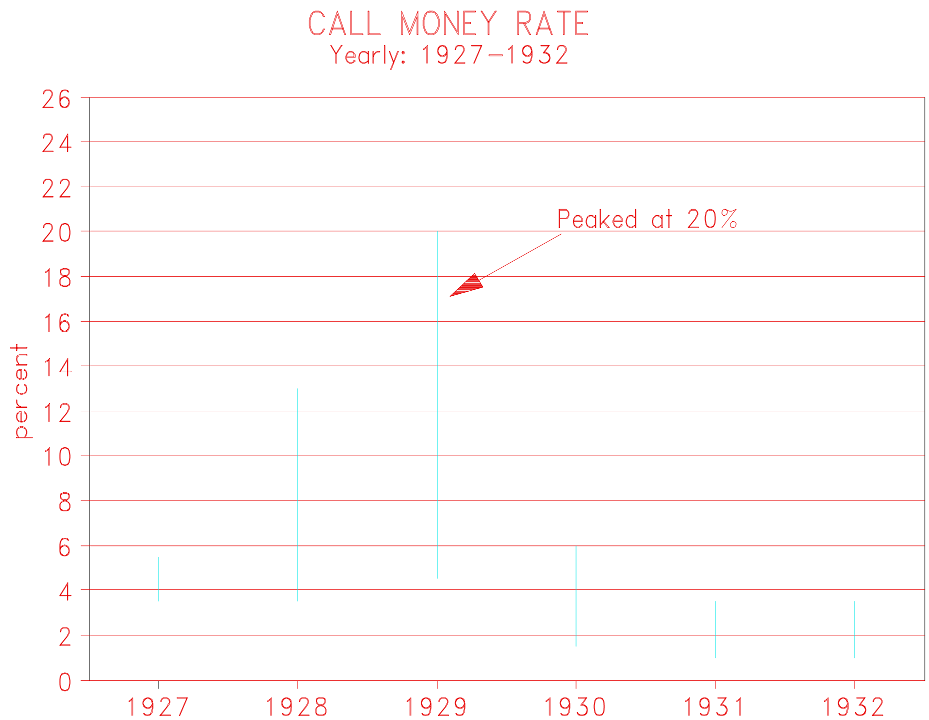


running story in itself. But nonetheless, rumor circulated to the point that Mr. Mitchell was forced to come out publicly and deny that he was going to resign.

Senator Glass had a sharp tongue and perhaps far too much pride. While the majority pointed the finger of blame at the Fed, Glass lashed out in defense of his creation. His personal pride stood before the best interests of the nation and instead of considering that his creation could possibly be wrong or at fault, he chose to condemn everyone from the President to Mitchell for making optimistic statements.

As Monday, November 4 opened, the first print was now off nearly 10 points from the close of October 31. The high of the day once again quickly formed at 269.75. The market fell as people began to question the validity of the Banking Pool. The Dow Jones industrials dropped to 255.43 and closed at 57.68 with volume running at 6,203,000 shares. The market was closed again on Tuesday, November 5 and reopened on Wednesday under the low of Monday. The high of the day formed at 252.20, more than 3 points below Monday's low. Selling continued once again as the industrials dropped to 228.35 closing at 232.13. Volume was now 5,915,000 shares. So far, the industrials, railroads and utilities still held the low of the previous week's panic.

On Thursday, November 7, the selling persisted. The market opened up slightly but rumors of Mitchell caused much nervousness. The high of the day formed quickly once again at 242.10, up nearly 10 points from the previous day's close. But then the selling began to pour in from all corners of the exchange floor. The market fell abruptly falling to 217.84 holding the previous week's low by merely 5 points. But then a rally sparked by short covering unfolded and the market rallied back and closed at 238.19 with volume reaching 7,184,000 shares. On Friday, November 8, The market calmed down with volume declining to 3,215,000 shares, which was the lightest in nearly three weeks. The indus-



trials traded between 245.28 and 234.63, closing steady at 236.53.

The market was closed down on Saturday once again hoping that time off might help allay fears of panic. But as the speculators had two days to think things over, their fears were not yet settled. As the week of November 11 began trading, the dread of panic once again gripped the market. After opening at 235, the market briefly reached 235.13 on the open and then fell like a rock. The industrials dropped to 219.34 which still managed to hold above the major low of November 7. But this time there was no rally. The industrials closed at 220.39, the lowest closing yet achieved. Volume was relatively light with merely 3.7 million shares changing hands.

As everyone had the night of Monday, November 11 to think things over, talk again began to turn toward fear. The Utilities, which had long been viewed as the rich men's investments, had indeed broken the previous low and closed at 73.91. Even the bonds had declined to a small extent. This did not speak well for what "strong" hands may have been up to. Some asked if the decline would ever come to an end.

As Tuesday, November 12 arrived, the industrials barely managed to rally up to the 222.56 level before falling once again. Volume doubled as panic filled the minds and hearts of those that remained in the market. This time the industrials fell without mercy straight down to 208.09, closing at 209.74. The rails fell to 133.68, which was also a new record low for this devastating crash. Even the bonds fell back under the 93 level for the first time in November.

As Wednesday the 13th opened, the selling continued and the industrials reached 211.92 but fell breaking the magic 200 mark testing 195.35. By the close, the industrials couldn't muster enough support to rally and closed below 200 at 198.69. Volume was again heavy, amounting to nearly 7.8 million shares that day. The bonds fell nearly half a point closing at 92.44 and the rails finished at 128.07 with the utilities down at

64.72. Would no one be able to stop this market from falling further?

At last, Washington's long silence was broken. President Hoover promised a tax reduction and an industrial conference. Other heroes began to step up. Julius Rosenwald, board chairman of Sears, offered to cover the margin accounts of all employees. Standard oil of New York announced that it would lend $43 a share against its own stock to employees who were overmargined. Other companies began to join suit such as Standard oil of New Jersey, Humble oil, U.S. Steel, Gulf oil and others.

Although the market had forgotten Rockefeller's pronouncement that he and his son were buying stocks of sound value, this time it would not forget. Rockefeller placed and order to buy 1 million shares at $50 of his own Standard oil of New Jersey. This above all would make Rockefeller one of the true historical heros of the moment.

The lists of winners and loser of the era began to fill the press. The plans to establish a Papal Bank were abandoned as the Vatican took heavy losses during this period. The State of New York was among the winners. It had raked in nearly $5 million in taxes of 2 cents per share for the month of October alone.

Many losers obviously didn't come forward publicly. But one such loser did. She was a girl of 19 named Margaret Shotwell. She told the press that she had lost more than $1 million and even named the stocks she had owned. The list was Montgomery Ward, Paramount, Cities Service and General Motors, all blue-chip companies no doubt. When she was only 12 years of age, her father had brought home a friend to listen to her play the piano. That friend was John Neal who upon his death left her $l million in stock of Reynolds Tobacco, which she diversified into other companies on margin.

Others did not take their losses so easily and the suicide lists began to grow in prominence as well as in number. That drop in November brought with it the suicide of the president of New York's County Trust Co., James J. Riordan. The president of Rochester Gas & Electric Co., Robert M. Searle, also committed suicide and was rumored to have lost nearly $1.5 million during October's panic. In New York City, 44 suicides took place between October 13 and November 15.

The first brokerage house to go under was Mandeville, Brooks & Chaffee of Providence, Rhode Island with liabilities of some $4 million. The panic had clearly cut deeply into the heart and soul of many who participated in the market game.

But it would be wrong to paint a picture entirely of doom and gloom. Many foreign visitors remarked on the somewhat cheerful atmosphere that curiously surrounded parts of the marketplace. Jokes of all sorts were heard for each new devastation. Some were clean while others were just plain sick. Actor Eddie Cantor told the press that when he heard that Rosenwald was offering to cover the margins of his employees at Sears, he immediately sent a telegram to apply for a position as office boy. Through it all there was some sipirit left and obviously not all were wiped out by this first crack in the market.

On the streets of New York, one could buy for $3 the news letter of Roger W. Babson who cashed in on his market call for a break. Although Babson had called for a break of only 60 to 80 points and the market had fallen more than 186 points, he was, nonetheless among the very few that at least called the direction correctly. That was not the case for most analysts. One such analyst, Charles Amos Dice, was a well-known bull and many followed his lead through the bull market. In October he published "New Levels In the Stock Market" in which he claimed that the market would remain at near the current levels and that the Dow would hold the 300 level on the industrials. Mr. Dice is not remembered by many in this day and age.

Between Hoover and Rockefeller, someone did step in to save the market that week. Although it was not a Friday, November 13, a Wednesday, would stand as the low for the Panic of 1929. The Dow Industrials, after closing that Wednesday below 200, opened above it on Thursday the 14th. The low of the day dug itself in at 205.61 and by the end of the day the market closed at 217.28 after reaching a high of 219.49, up nearly 10% in a single day. Friday brought more of the same as the market gapped up even higher. The low of the day was 222.50 and the market pushed upward testing the 232.77 level and falling back to 228.73 for the close. After reaching 7.8 million on the Wednesday panic, volume remained respectable but did not exceed levels of recent down days. Thursday reached 5.5 million and Friday's volume was merely 4 million shares. Curiously enough, the bonds continued lower on Thursday when the stocks began to recover. They closed at 91.93 but managed to rally back for a close on Friday at 92.03.

The market remained closed that Saturday as the exchange attempted to restrict trading to a five-day week. In part, the halt in the decline was helped by the Fed cutting the discount rate from October's cut to 5% back down to 4.5%. This level would be maintained through the balance of 1929 and no further cuts would come from the Fed until February of 1930.

On November 18, 1929, Time Magazine reported on its opinion as to the cause of the crash. It appeared as follows:

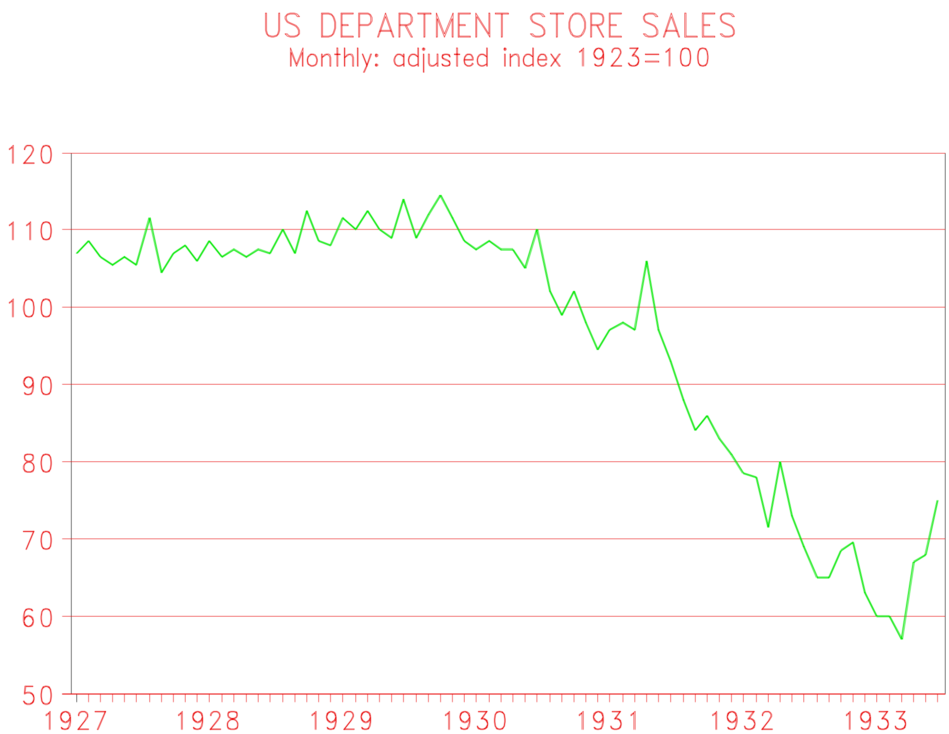
"Why the Crash come on October 23, 1929, is as mysterious (and as unimportant) as why the World War chanced to begin on August 4, 1914. If some trace the War no further than to an archducal assassination, then others might trace the Crash to a variety of such moments as that when Goldman Sachs terminated the syndicate on their Blue Ridge investment trust. Vital point is the undermining of popular confidence that ended in the Crash. Causes of undermining were:

1) Warnings from the Federal Reserve Board and other prophets of disaster warnings that scoffed at when given, nevertheless filled the Market with a conviction of sin.

2) A period of almost two months (since Babson Break early in September) in which it had taken strych-nine-injections to push quotations ahead. The September slump (currently almost ignored in favor of the peculiar theory that the Market crashed without warning) was of tremendous importance in its indication that a Market which could survive only by constant rises had reached the limits of its climb.

3) Most important of all indications of a slowing tempo in U.S.industry. The motor stocks, for example, had long since fallen from their January highs..."

While Senator Glass tried to blame the crash upon those who spoke "too optimistically" thereby inducing others to throw their



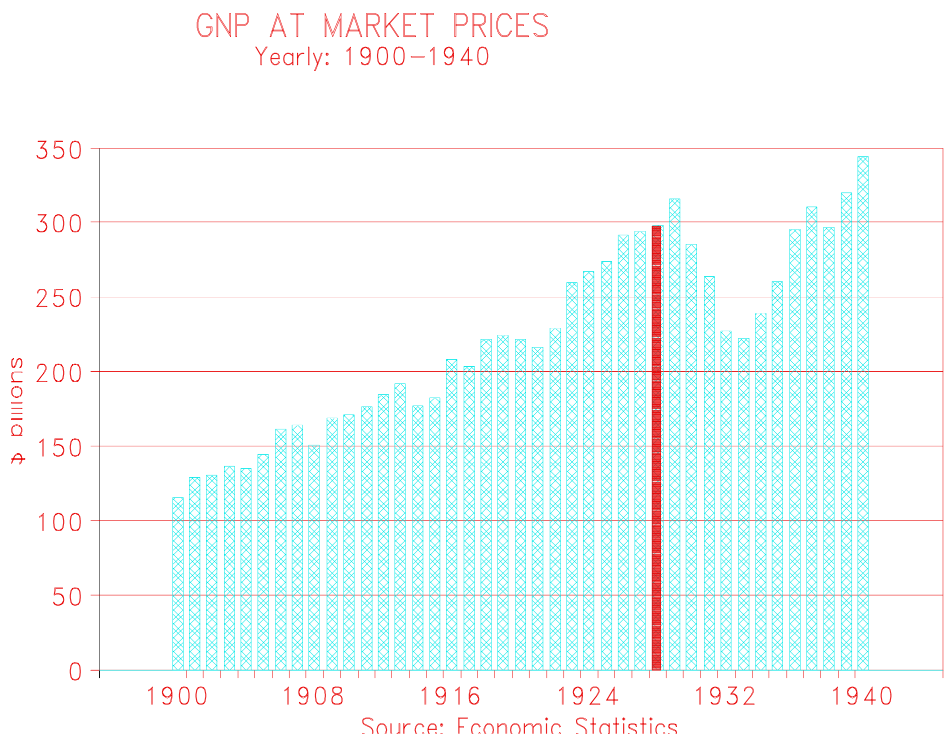
money into the market, Time has taken the opposite view. Time pointed to all the scorn and the jaw-boning of the Fed that eventually undermined the confidence within the market and the nation. Time was certainly correct in pointing out that by September there was a small indication that industry was perhaps entering a slump. Although steel production was declining, it was certainly not a major leading indicator. However, the motor stocks indeed did peak in January as Time reported. This was perhaps a better technical warning since the motor stocks were the leaders all the way up. In fact, the bull market had been built upon the innovation of the automobile industry. From our sense of the importance of technical patterns, the true key for anything tangible is the fact that the strong leaders had peaked in January. The broader market, in fact, continued higher into September. But these were the highly speculative stocks as well as the stocks that had lagged for years.

Time Magazine went on in its article of November 18 to discuss the three main thoughts at the time from the economic viewpoint. It reported at follows:

"ECONOMICS. Apart from the 'causes' of the break, many an economic point was made apropos the break. Three widely discussed points were:

1) That corporations which had loaned money 'on call' to speculators had contributed more than any other group to an unsound financial situation because many a corporation promptly called in its loan at the first sign of trouble. Five directors of one corporation threatened to resign last week if their company should call its loan. These directors took the honorable position that having once loaned its money to the stock market, the corporation should stand by the market so long as its loan was adequately protected by collateral.

2) That speculation had been encouraged by the over-conservative financial reports of corporations. There have always been dishonest concerns which rig their books to show $1 per share profit when actually there



was no profit. But suppose an ultra-conservative concern, by scaling its assets to minimum and carrying the liabilities at maximum, shows a $1 per share profit when someone else thinks they might presumably have shown $2 per share profit; then the incentive to imagination and hence speculation is great and obvious.

3) That wide-spread distributions of stock to employees have made hundreds of thousands unduly 'stock-conscious.'"

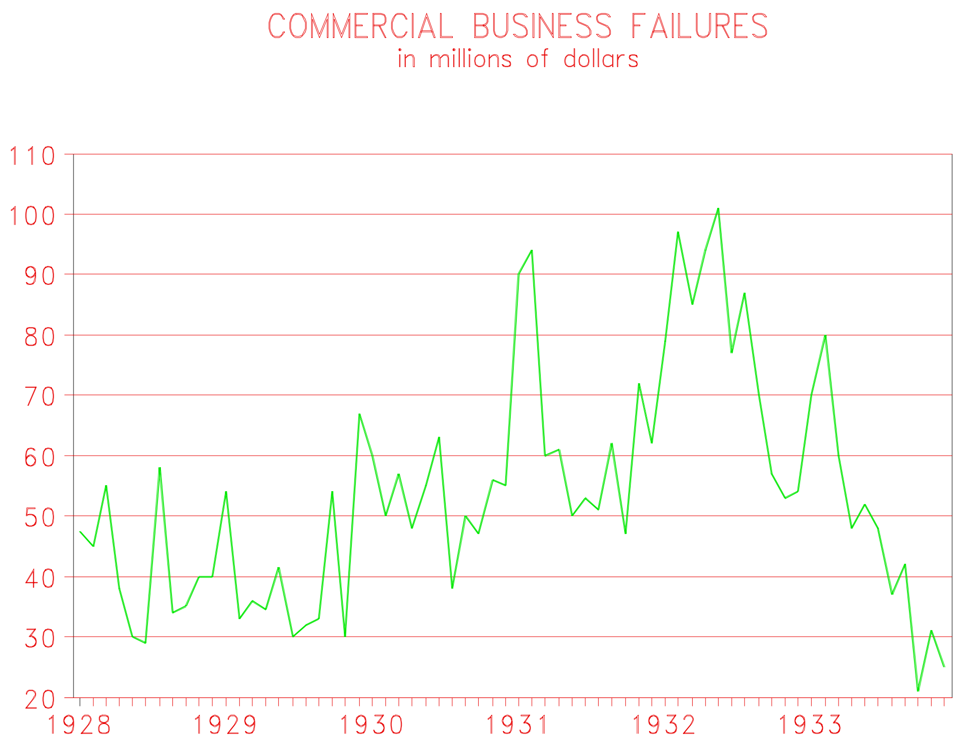
Obviously, in a serious situation like the Panic of 1929, people go around blaming everyone else but themselves. Granted the corporations dumped tons of money into the call money market where rates rose as high as 20%. But did anyone think twice about running into their money-market funds in 1981 when rates there far outpaced the time deposits at savings and loans? Well, time deposit rates were 2% at that time. Why wouldn't anyone in his right mind not move funds to the call money market when he could earn five to ten times what he could at the bank time rates? This is hardly an excuse for the crash.

Nor can one pin the blame upon corporations over or underestimating profits. The big companies were pouring out dividends like there was no tomorrow. Granted, there were undoubtedly some fraudulent practices, but this was certainly not the case for the majority and consequently would not have sparked such a rally to begin with.

Finally, trying to pin the blame on companies that provided stock plans for their employees is absurd. Virtually every major company has had a stock plan in place for the past 50 years and no major bull-fever has broken out.

The causes of this devastating collapse could not be assessed just at this point in time. By year end, most would actually begin to believe that the worst was over and that prosperity would remain intact.

As the final week in November draw the month to a close, the market began to firm.



The week of November 18-22 saw the industrials trading between 222.93 for the low, rallying back to 250.75 by Friday and closing the week at 245.74, up nearly 18% from the low established on November 13. Volume was far from heavy. Thursday the 21st was the peak on volume, reaching only 3.1 million shares. The entire week brought light volume totalling only 14.5 million. During the previous week when the low had been established, volume reached nearly 22 million shares with the market open only four days instead of five. Clearly, not much fresh buying was honestly entering the market.

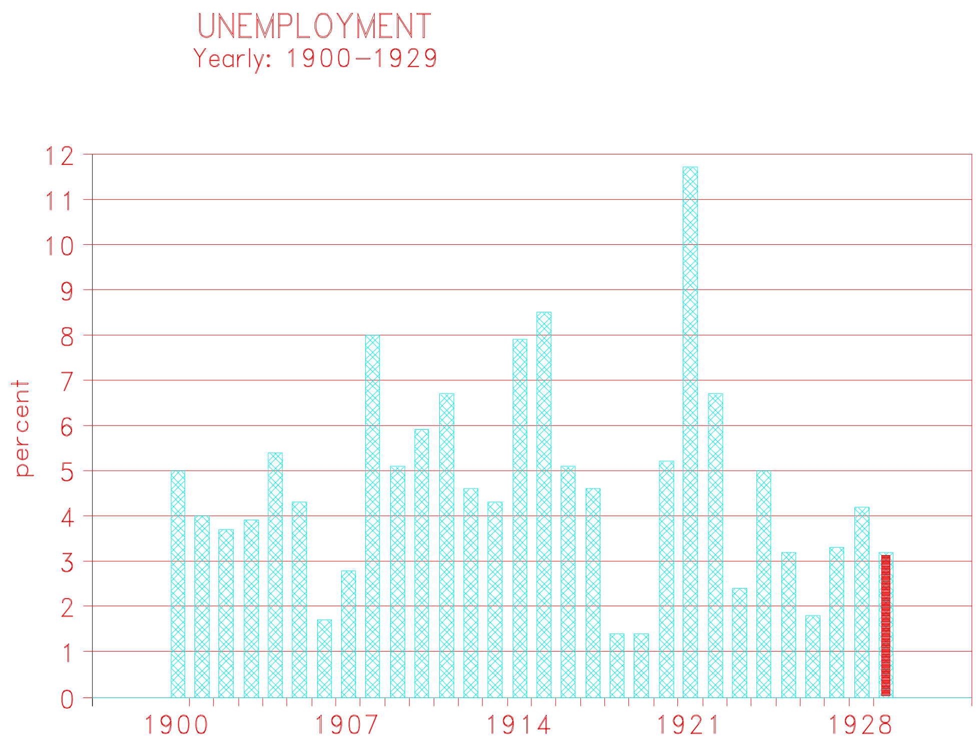
The rails managed to firm as well, rallying back to 149.48 by the end of the week. The bonds also rallied, closing back above 93 on Friday the 22nd. Although the market seemed to firm, caution was still most assuredly in the wind while dry cool jokes circulated around the floor.

The final week in November was a short trading session. The market began to dip back, falling from the previous week's high of 250.75 to 234.51 on Tuesday the 26th. The industrials managed to hold but again volume increased to 3.6 million shares that day. Clearly the signs were still indicating nervousness. The market firmed and rallied back on Wednesday, reaching 240.66 and closing November at 238.95. But volume was down to 2.4 million shares. There was undoubtedly a distinct trend that up days brought low volume while down days carried on increase of nearly double the volume. The bonds rallied and closed that week at 94.05 on news of Hoover's impending economic conference.

"I will appreciate it if you would make it convenient to attend a small conference in my office on Thursday morning at 10 o'clock to discuss matters connected with my statement of last Saturday."

Herbert Hoover

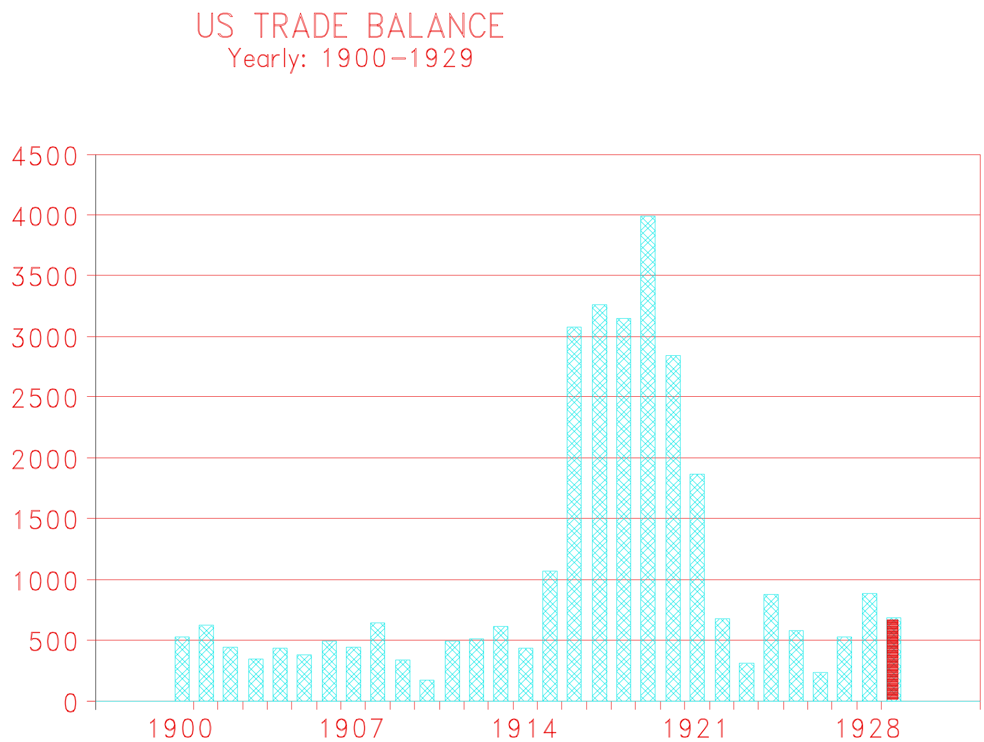
The markets were closed. The whole world waited to hear a few words of optimism and some decisive plan to stem the panic and save the nation. History chose to



place a lot of the blame upon Herbert Hoover and in the depths of depression shanty towns were eventually named "Hooverville" across the land. But the facts are clear that Herbert Hoover attempted actions and sought pledges from industry which would, under normal conditions, fundamentally provide a logical, supportive outcome. But fundamentals never predict the future and economic solutions seldom bring what they are supposed to deliver. Speculation is perhaps a mere shadow of expectation thrown forward upon the road which extends into the future. But then again, without confidence, there is no speculation.

The pledges that Herbert Hoover extracted from industry were real and fundamentally sound. Leading employers made the commitment that there would be no reduction in wages. Labor representatives pledged that there would be no strikes, no undue agitation for higher wages. The U.S.Chamber of Commerce promised to form a permanent national economic council to deal with the current emergencies. From industry and the railways, Hoover extracted promises that expenditures on improvements and expansion would go forward. Congress pledged bipartisan support for Hoover's plans to reduce taxes by some $160 million. The Treasury Department pledged to increase its public building program from $248 million to $423 million. From the Interstate Commerce Commission, Hoover demanded prompt action to allow railroad mergers in an effort to insure financial security through this consolidation that many sought. Hoover also demanded that the Subcommittee award 15 ocean mail contracts by January, which would require $200 million in new ship building. Even New York City pledged to speed up a $1 million contract for new construction. And from the Federal Reserve, Hoover demanded easy credit.

These were among the few lists of pledges that Hoover obtained during that lost week in November. But history still chooses to cast much of the blame upon this man for the Great Depression that eventually followed. Yet Hoover's actions were clean



and swift. They were positive steps toward increasing employment immediately. Yet there was something that didn't quite get to the point. There is a lot to be said for confidence. With it, the future can be molded and shaped, but without it, the future will mold and shape the events of man.

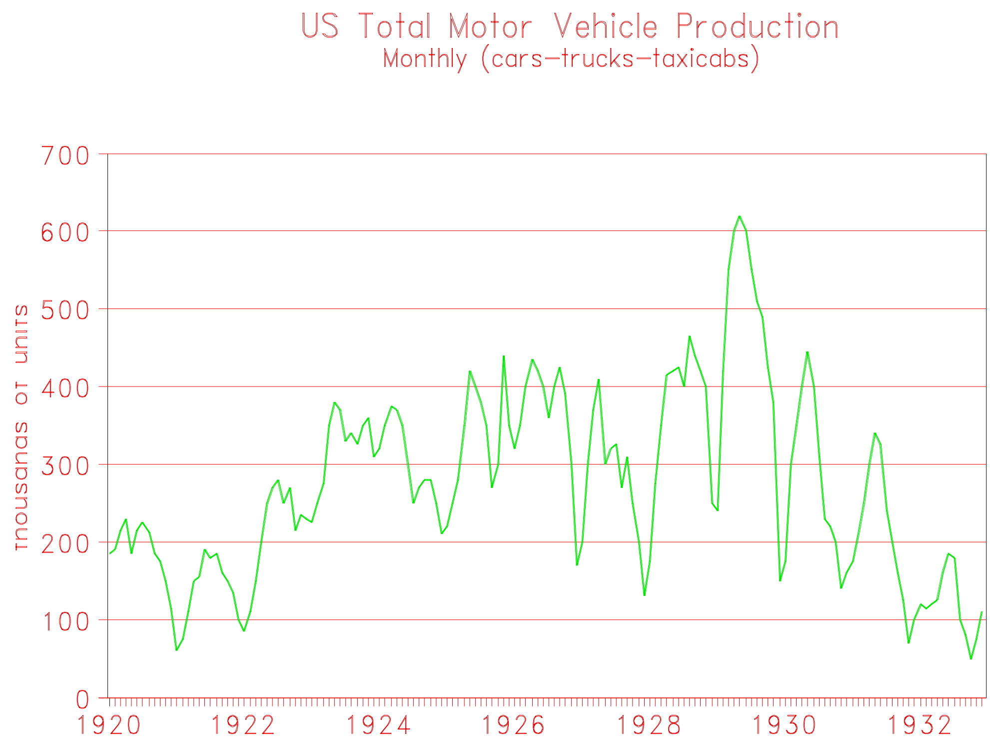
The meeting with Herbert Hoover that week was by far the most dramatic gathering in the history of American business. Friends, foes, and bitter competitors all gathered in common harmony to place their pledges upon the President's desk. There were many who naturally scoffed at the President from the ranks of the opposite party in Congress. This brought many editorials that demanded Congress to go home and leave the nation in the hands of President Hoover. Perhaps we will never know if that political bickering was the cause for the continued decline in confidence. But there are many times when politicians, who seek to strengthen their own positions, thrash out at a President with political rhetoric, which undermines not merely the President but the nation. It is a rare politician indeed who honestly thinks first of his nation and last of his own political career.

Henry Ford was one such attendee that day in Washington. When the meeting was over, Mr.Ford handed out a prepared statement giving his opinion of the situation. The market break he attributed to two causes:

1) "There was a serious withdrawal of brains from business by men who would otherwise have been working out better designs for commodities and better methods of manufacture and planning to put more value into their products.

2) "American production has come to equal and even surpass, not our people's power to consume, but their power to purchase."

Henry Ford also offered his solutions, which were as follows:



1) "Putting additional value into goods or reducing the prices to the level of actual value.

2) "Starting a movement to increase the general wage level."

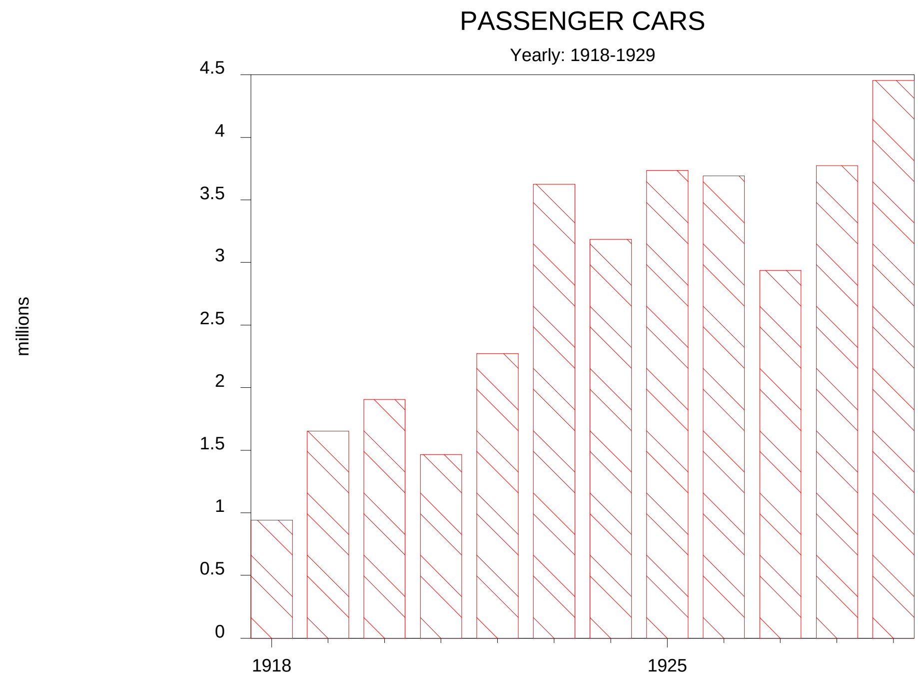
Ford's ideas did not exactly agree with those of President Hoover. The President was concerned about maintaining wages as were many business leaders. Ford sought to increase wages assuming that they would increase buying power. Ford returned and raised the wages of his employees.

Ford's ideas were a bit strange in some respects. Although there was not a serious wave of resignations from men choosing to become traders rather than work, many viewed the market as the easy road to riches. However, this could not be construed as a reason why the market crashed. But Ford was correct that production had reached levels requiring foreign markets because domestic markets could not absorb all the goods. Inflation on luxury items had risen significantly and this was true in many other areas as well. Thus, his suggestion to reduce prices to the level of actual value in a sense meant to reduce inflation.

The basic assumption at that time was that previous breaks in the stock market had normally prompted caution among the population, which in turn caused many to curtail spending out of fear for their future security. This occurrence is a natural event which Hoover clearly understood but he failed to prevent that natural sequence because it is something that belongs in the realm of human nature.

Nonetheless, his tactics are still employed in politics for both points of view. President Carter went on TV to state that he was serious about inflation yet no one listened. People often have made up their own minds and ominous or optimistic statements have little lasting effect unless the people themselves foresee the same conclusion.

When President Reagan was elected, spending in the private sector immediately declined. Expectations of future inflation

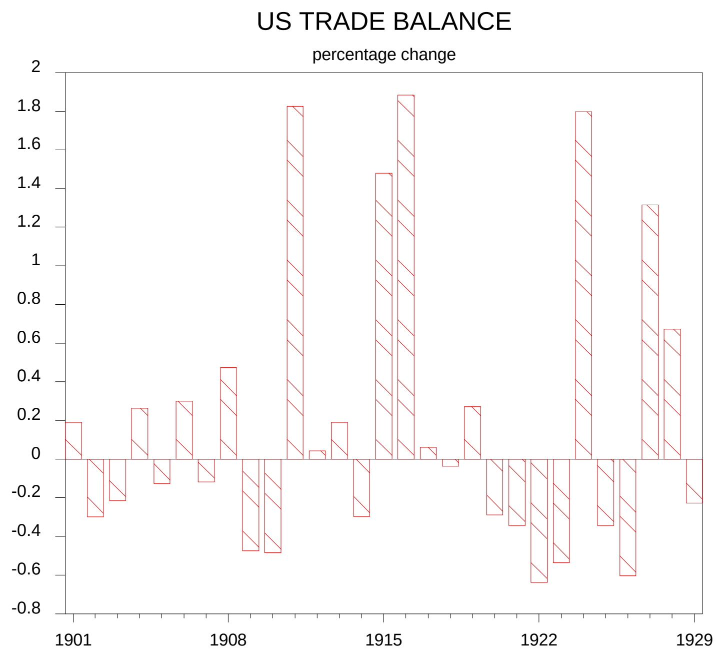


declined and savings began to rise. Much of the credit for stemming inflation does not rightfully belong to the Federal Reserve or directly to actions taken by President Reagan. The curbing of inflation took place because of the natural human instinct that dictated Reagan was serious about stopping inflation. People did not take Carter or the Federal Reserve for that matter - seriously. It was the election of a new President that shifted the anticipation factor within all Americans to expect that perhaps something different was going to take place.

This is the very same thing that Hoover was up against. He sought to get commitments from the private sector that they would not cut back out of fear but instead continue as if nothing had happened. Perhaps what President Hoover was asking from the people was something that was impossible to obtain. When it comes to money, people are very reluctant to spend their savings when they sense a change in the mood or anticipate uncertainty in the future.

For days the press reported numerous lists of cities such as Camden, New Jersey which pledged to employ 60,000 men in its city, county and federal building plan. The market during December remained cautious, yet firm. Monday, December 2 closed at 241.70, up only slightly following the Hoover conference. Yet by the end of the week, Friday, December 7. closed at 263.46. up nearly 10% on the week. The bonds continued to climb, closing that week at 94.57.

Friday, December 7, was the highest daily closing for the entire month. Monday, the 9th reached 267.56 for the highest intra-day point that month. But from then December would decline to 226.39 on Monday, December 23. After Christmas passed, the market rallied back to close that infamous year of 1929 at 248.43 on the industrials, well below the psychological 300 level, which was supposed to be lasting support.



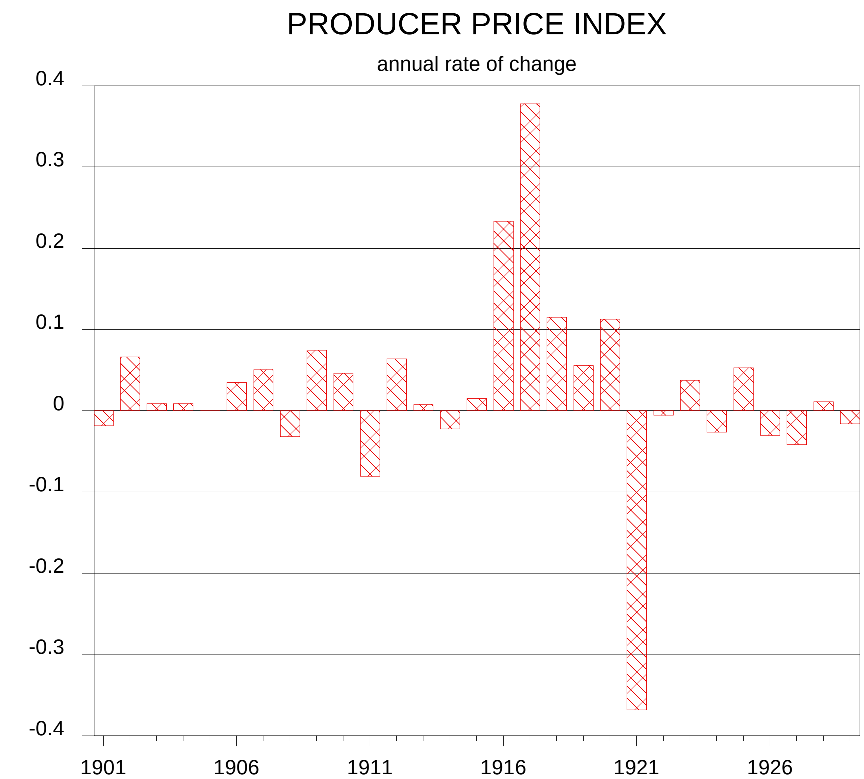
As expectations of 1930 began to take form, many viewed that it would be a quiet year for the stock market. The value of a seat on the exchange sold that December for $350,000, down $144,000 from the previously recorded sale.

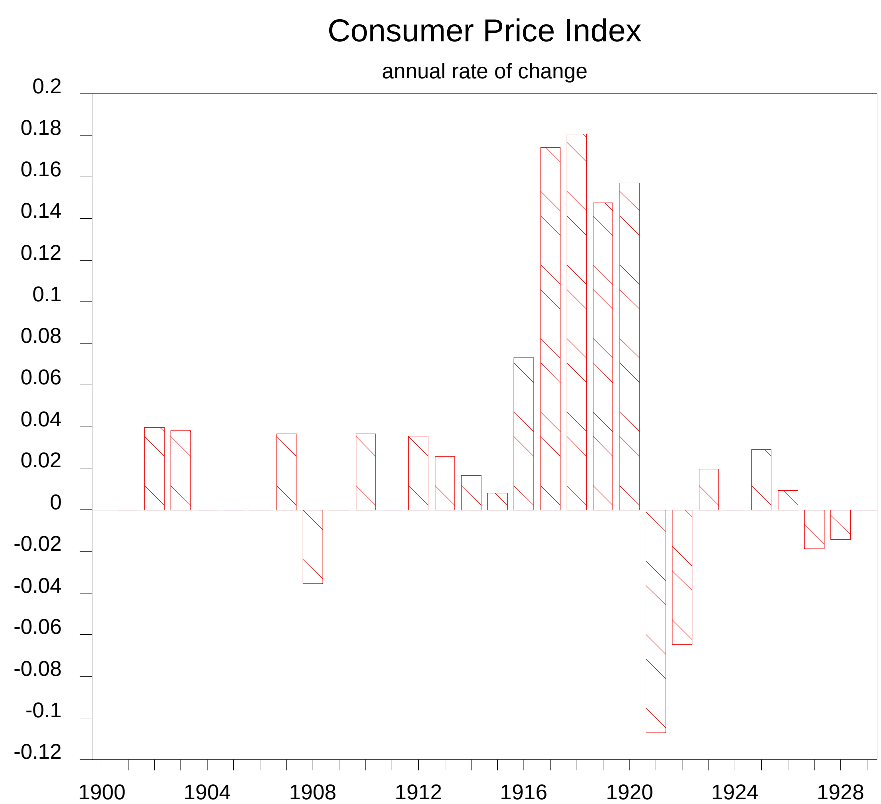
Perhaps one false investment concept that many were led to believe in 1980 was that diamonds have always hold their value. That statement on the part of merchants seeking to lure investors into their market place should be considered in light of December 1929. Then in Amsterdam, buyers literally could not be found at the famous Tulpstraat and at the Saphartistraat. The work week in this diamond cutting center was itself cut from six days to three. In Antwerp, which was the largest diamond cutting center in the world, 15,000 cutters were unemployed. All operations were closed between December 7 and 21 in London, the final source for 90% of all wholesale diamonds. Then the dealers in London suspended all sales to trade in an effort to help stabilize prices.

Diamonds, which supposedly were forever, fell in value by more than 50% following the trend of the stock markets around the world. The only difference between diamonds and stocks was the total non-liquidity. At least most stocks could be sold for the current bid. But in diamonds, there were no bids unless at destitute levels. And at times during the next two years, diamonds of investment grade, which were larger stones, fell more rapidly than even the stock market.

In the oil industry, a price war continued. The price of oil declined, threatening jobs and earnings of the top oil producers as the war between European and American producers escalated into harsh public statements from both sides of the Atlantic.

1929 would remain in the minds of men for decades if not centuries in the future. We all know now that the situation would get worse and that this break was merely the first stumble for a bull that had grown larger than any generation before it. But how and why the market would drop remains of vital

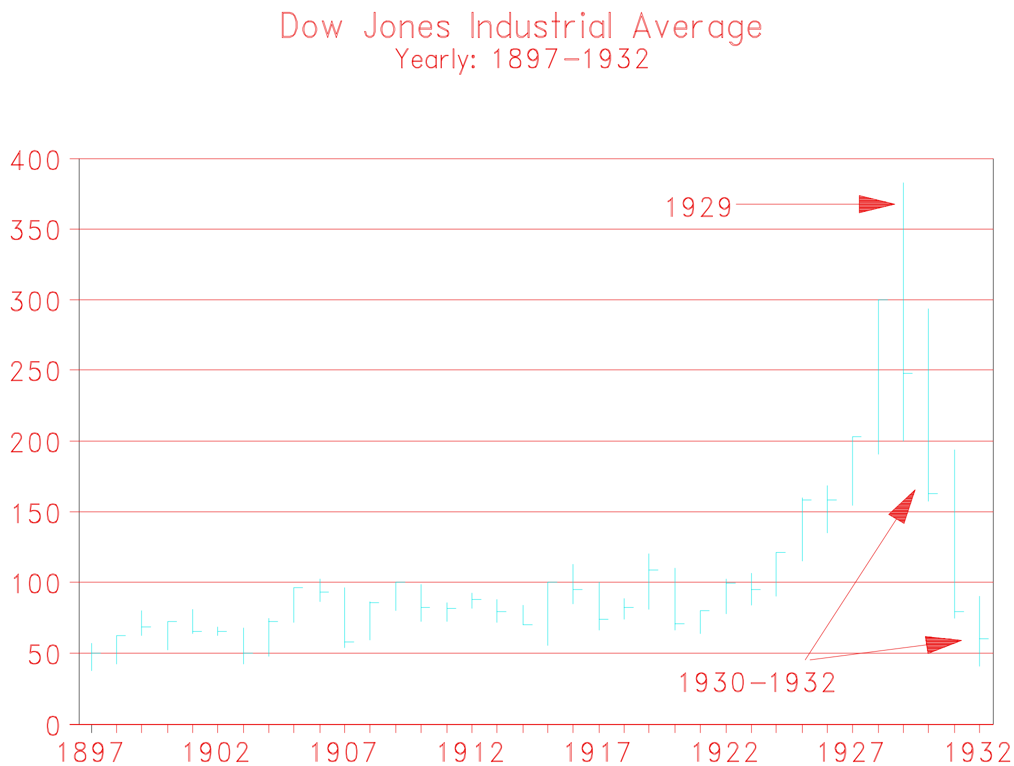

PRODUCER PRICE INDEX
annual rate of change
0.4
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
-0.4
1901
1906
1911
1916
1921
1926


Consumer Price Index
annual rate of change
0.2
0.18
0.16
0.14
0.12
0.1
0.08
0.06
0.04
0.02
0
-0.02
-0.04
-0.06
-0.08
-0.1
-0.12
1900
1904
1908
1912
1916
1920
1924
1928

importance to us in trying to understand what the future will shape as we travel our own path on that road to a meeting with destiny.

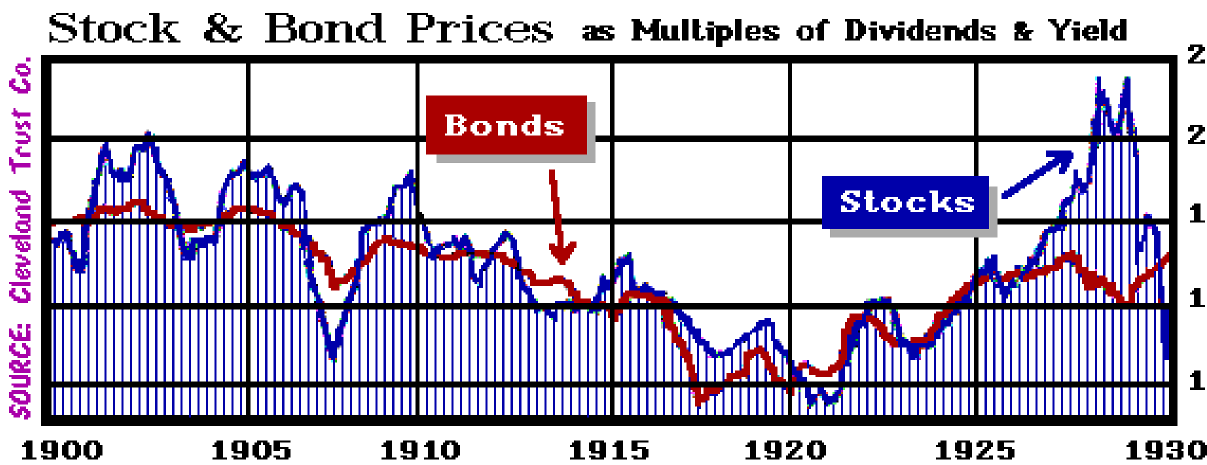
As 1929 came to a bitter end, everyone was still trying to sort out the facts from the fiction. Had the market indeed risen to heights that could not be justified? What caused the rally and was the correction into November 13 merely a pause in the long-term trend? Would the actions of men such as President Hoover, Rockefeller and Rosenwald stem the tide and restore prosperity once again? These are but a few questions that plagued the nation as well as the financial community. In addition, many worried desperately that the destruction in the stock market would spill over into the general economy. As 1930 dawned upon the chaos that man had brought down upon himself, optimism still ran high that all the prominent men of the day clenched within their fists the power to command the future.

National City Bank released a survey on business and its earnings for 1929 compared to those of 1928. Although the survey issued during the latter part of January 1930 was incomplete, it was a fair analysis of the situation, which included 806 companies from the American economy. This report demonstrated that there was an overall gain of 12.5% in corporate earnings for 1929 above the preceding year. The report was also broken down into industry groups, which are still of interest to us today. The largest benefactor during 1929 was the amusement companies, which posted a gain in earnings of 85.6%. The steel and iron industry also reported earnings up 70.7%. Next on the list was the shipping industry, which reported earnings up 67.3%.



There were definitely losers as always. Surprisingly, these included the automobile industry, which was down 10.2%. Fertilizer companies were off 21.1%, while the sugar industry reported a drastic decline. In 1928, the sugar industry posted earnings of $5.3 million but in 1929 that turned into a deficit of $1.5 million.

During 1929, a total of 38 U.S. corporations had paid out dividends in excess of $10



million. This was a sizable figure in those days and if adjusted to current dollars through the official government CPI, it works out to be in the neighborhood of $200 million+ in 1985.

The biggest dividends for both 1928 and 1929 were paid out by General Motors. In 1928, G.M. paid $165 million in dividends while in 1929 that was reduced to $155 million. Below is a partial listing of a few selected stocks **and the total amount**s of dividends paid out during 1929 compared to their previous year. The amounts expressed below are given in millions of dollars.

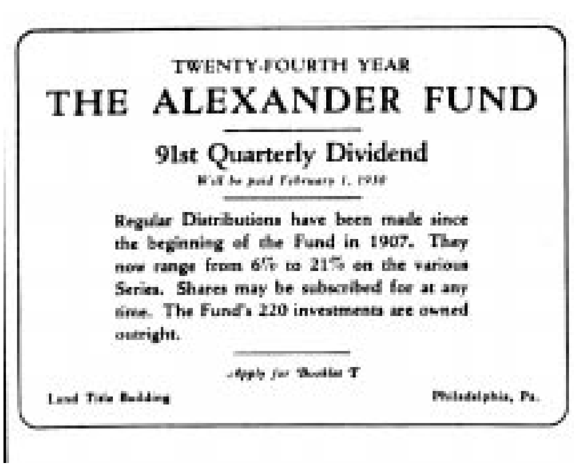
CORPORATE DIVIDENDS

Company	1929	1928
General Motors	$155.0	$165.3
AT&T	116.0	103.8
U.S. Steel	63.0	49.8
Du Pont	60.1	49.6
Stand Oil NJ	46.7	36.5
Kennecott	43.9	32.9
General Electric	43.2	42.2
Anaconda	42.7	14.4
Standard Oil Ind	40.0	32.4
Consolidated Gas	34.8	23.9

There is no doubt that 1929 was a year of spectacular economic growth. In the aftermath yet to come, many companies increased their dividends in an effort to try to support their own stocks. But logic and fundamentals did not prevail in the months that lay ahead. As a result, many companies expended cash that otherwise should have been retained. Dividends rose in many cases while earnings declined. The increase in corporate dividends was not truly warranted and they failed to provide psychological stability in the market.

The reasons for the Crash were difficult to put a finger on at this point and indeed arguments would fester for years if not decades to come. Nonetheless, during the first quarter of 1930, most believed that the Crash of 1929 was a short-lived situation. A number of well-known analysts pointed to value and earnings as reasons why the market was fundamentally sound. But perhaps the losses were too great and traders simply lacked nerve. Nonetheless, it is significant that the auto industry had built the bull market with spectacular earnings and expansion during the early to mid-1920s. Even the assembly line innovations developed by Henry Ford helped improve other industries as well. But take a look at the table above on corporate dividends. G.M. was the largest producer of dividends throughout the raging bull market, yet 1929 was a year during which G.M.'s earnings had declined and this was counter to the general overall trend of corporate America. It is also important to remember that G.M. peaked in early 1929 well in advance of the broad market. This is something we should carve into our brains. When the leaders peak yet the broad market continues to charge off into new highs, a major top is not too far away.

The Boston News Bureau chose to look upon the stock market in a very unique way at that time. The Bureau attempted to prove that the decline during the last quarter of 1929 was merely a correction and that the market remained fundamentally sound and stocks were far from actually being overvalued.



The Boston News Bureau devised a method of judging what they termed "equivalent value." For General Motors, for example, they took the 1923 high of $17.50 and followed this stock up to 1929 through various forms of analysis. G.M. went through a reverse split. One new share of G.M. was given for four old shares. This reduced the outstanding stock to one quarter. Then G.M. declared a 50% stock dividend, which was later followed by a two for one split which doubled the outstanding supply. Then this was followed by a two and one-half split. Therefore, the Bureau ventured that the 1929 low was $168.375 but the equivalent value was actually $672 in terms of the original shares of 1923. Of course, this didn't mean much to the person who bought G.M. after all the splits.

This exercise in numbers basically concluded that although the market had fallen by nearly 50%, it was still substantially above the "equivalent" values for 1923. Below is a listing of some selected stocks illustrating the 1929 low point for the Crash and the Boston News Bureau's "equivalent" value.

Stock	'29 low	BNB/eq	'23 high
Allied Chemical	197	197	112
American Can	86	516	107
AT&T	193	193	128
Anaconda	70	70	53
Atlantic Refining	30	120	160
Baltimore & Ohio	105	105	60
Du Pont	80	560	148
General Electric	168	672	202
General Motors	33	63	17
Intl Harvester	65	260	98
Kennscott	49	98	45
Montgomery Ward	49	49	26

Otis Elevator	195	390	153
Radio Corp (RCA)	26	26	4
Standard Oil NJ	4 8	48	44
Studebaker	38	95	126
Union Carbide	59	177	67
U.S. Steel	150	210	123
Woolworth	52	313	290

*fractions have been omitted from the above quotes for highs and lows.

There is no doubt that the market held above the peaks of the 1923 period. There were selected stocks that still retained their value on a long-term basis even in the depths of the Crash in late 1929. But was this significant? Did this prove that the 50% decline was merely a reaction, a pause in the long-term uptrend? Would the market in fact rebound if the Fed lowered the discount rate back to 3.5%? Was it truly that simple?

Many believed in this line of thinking. They viewed that stocks had reached a major low back in November of 1929 and that with an easing on the part of the Fed, the market was now ripe for a rally during the first quarter of 1930.

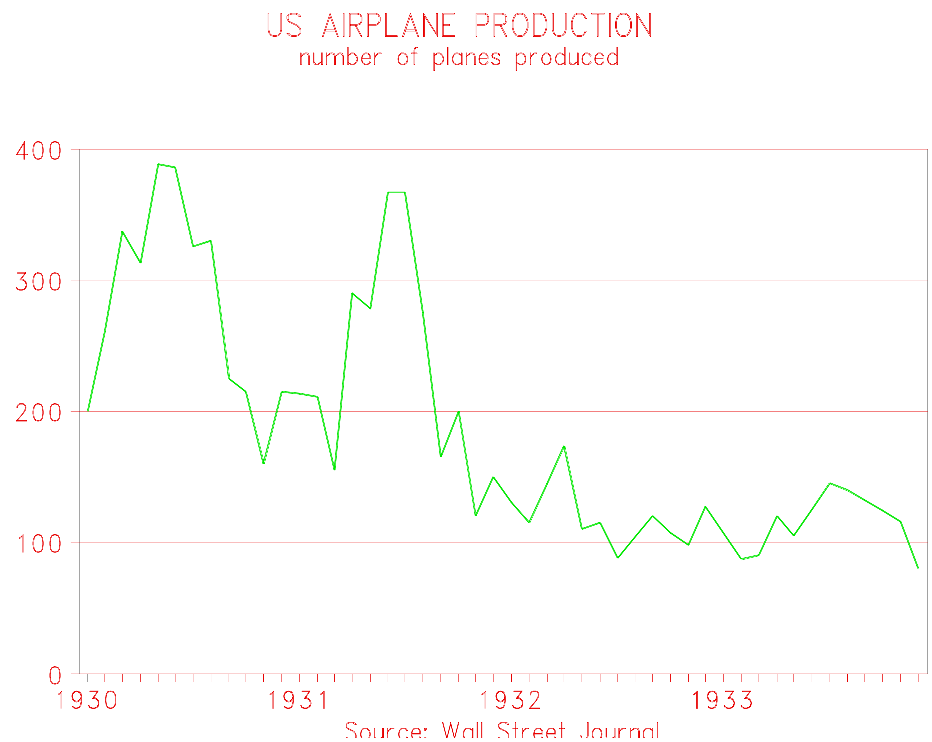
Professor Irving Fisher of Yale University stated that he believed that the market had reached a new plateau. He wrote a book entitled the "Stock Market Crash and After," which was published by Macmillan Company on December 15, 1929 and copyrighted February, 1930. The title implied that he had assumed that the decline was over. Professor Fisher's analysis was strictly fundamental and explored the various ways of looking at the market from dividends and earnings in comparison to price. He concluded that everything substantiated the fact that the market was basically sound and that reason for optimism did in fact exist. But curiously enough, Professor Fisher ended his book with these words:

Irving Fisher

"As a means of further present reassurance I trust that the book itself will be of some use, besides affording substantial reasons for practical optimism for the future.

"The only 'fly in the ointment' is the danger in a few years of gold shortage and long gradual deflation like the deflations after the Civil War and after the Napoleonic Wars. And even this danger may be averted if wise banking policies and gold control are adopted in time. For the immediate future, at least, the outlook is bright."

Perhaps Professor Fisher couldn't have been more incorrect. The immediate future was far from bright. Optimism ran fairly high during the first quarter of 1930 and most subscribed to the concept that the market remained fundamentally sound. But let us give credit where credit is due. In the end, Fisher's "fly in the ointment" seemed to bring along with it a number of friends. The long protracted deflation and a gold shortage indeed developed, which turned Fisher's optimism to cold hard pessimism.



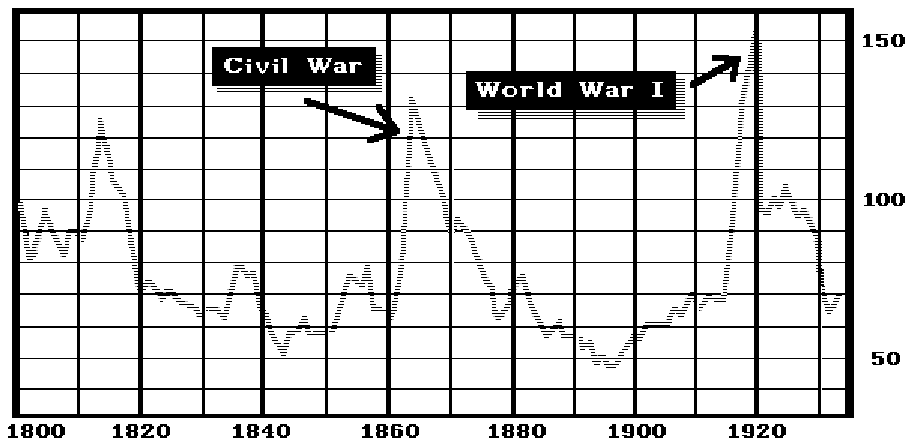
From the depths of the panic in late 1929, the market began to recover moving through the first quarter of 1930. From the November 1929 low, the railroads had managed to climb back up from under the 130 level to nearly 158 by March. The rails had fallen hard during the panic of 1929 from nearly the 190 level to slightly below 130, coming close to scoring a one-third decline. December 1929 had closed lower than November but it held above the 142 level. January and February had both closed higher than the previous month and by March, the rails had regained about half of the loss from the peak of 1929 to the November low. In technical terms, the first quarter of 1930 was clearly a 50% reaction and nothing more.

The industrials, which had peaked at 386 in 1929 and had fallen during the panic to slightly below the 200 level, came close to reaching 300 once again but stopped a little shy of that key level by March. The industrials had fallen nearly 50% during the panic of 1929 and the first quarter was clearly a rally which retraced 50% of the losses incurred during the panic of late 1929.

The bond market had moved counter to the trend in the stock market during late 1929. This was caused by the old school of thought which professed that investors buy bonds while gamblers buy stocks. Therefore, the initial urge of capital was indeed to run back to bonds from which it had fled beginning in January 1928. But despite a severe decline in interest rates, bonds eventually collapsed as public confidence gave way moving into 1932.

January and February were rather dull periods at first as the stock market tried to pick itself up from the trough of devastation. It was in March of 1930 when the call money rate had declined back to 2%, clearly displaying that the demand for money from the speculative aspect of the market had dwindled. The bonds soared in a straight and abrupt fashion during March, rising from 94 to slightly above 96. In those days, 2 point moves were still far from com-

US Wholesale Commodity Price Index
1800-1934 (1926=100)



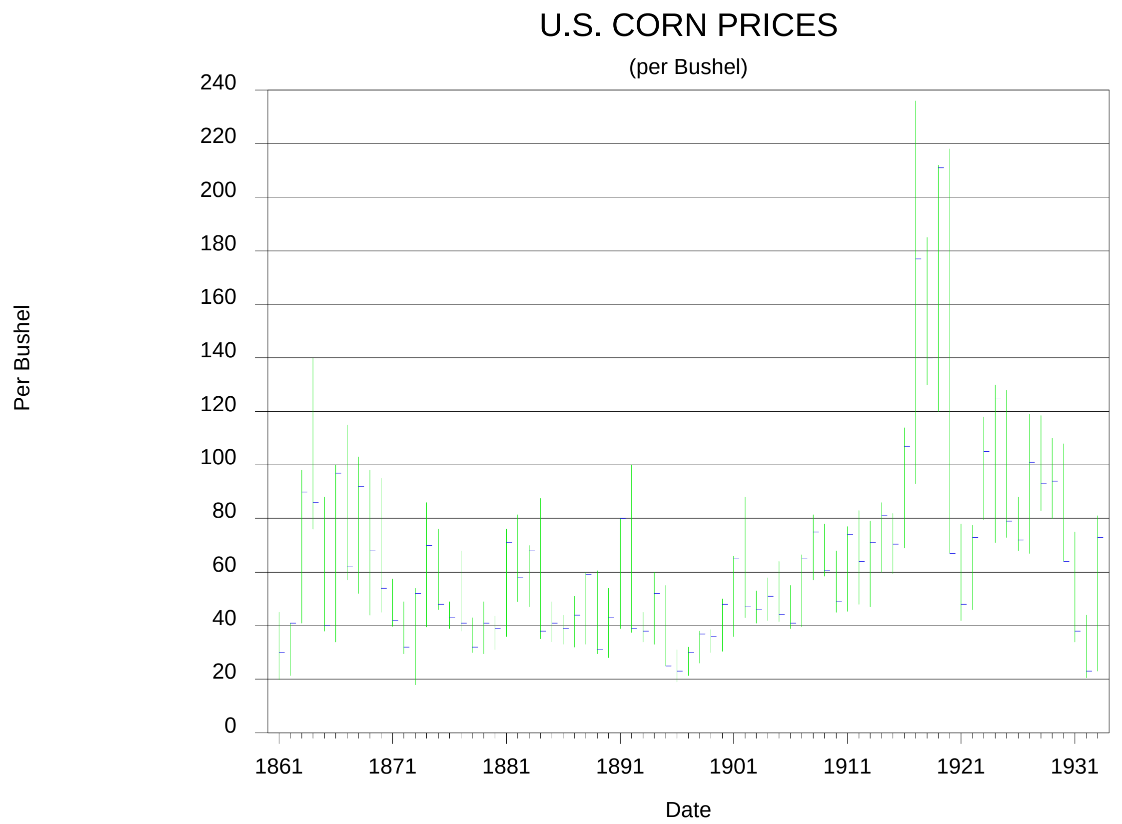
monplace during the course of a single month.

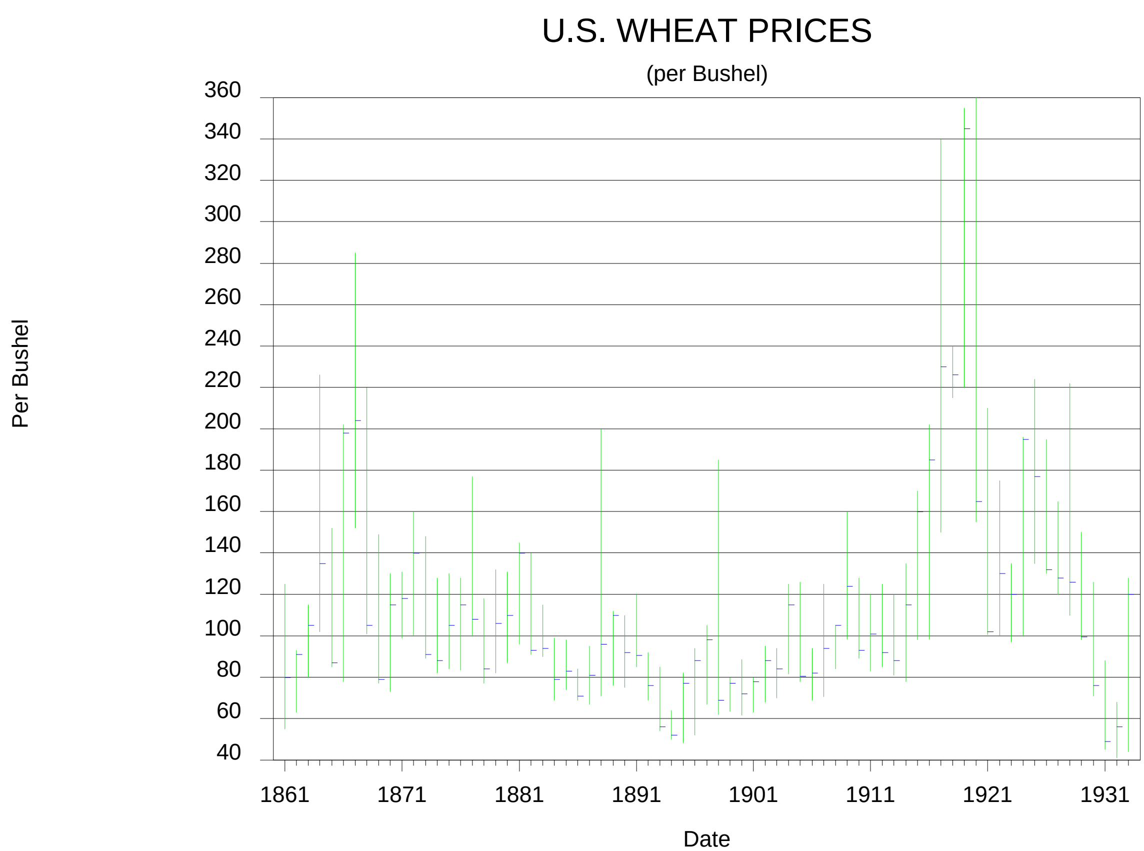
The bonds remained steady during January and February despite the Fed's cut in the discount rate during February from 4.5% to 4%. But then in March, the bonds were aided by a second cut to 3.5%. Here the Fed had cut the discount rate from 6% to 3.5% in just seven months in an attempt to halt the drastic decline in the economy. Interest rates literally plummeted straight down during the first quarter of 1930, but even this rapid retreat by the Fed did not prevent the retribution it seemed destiny demanded.

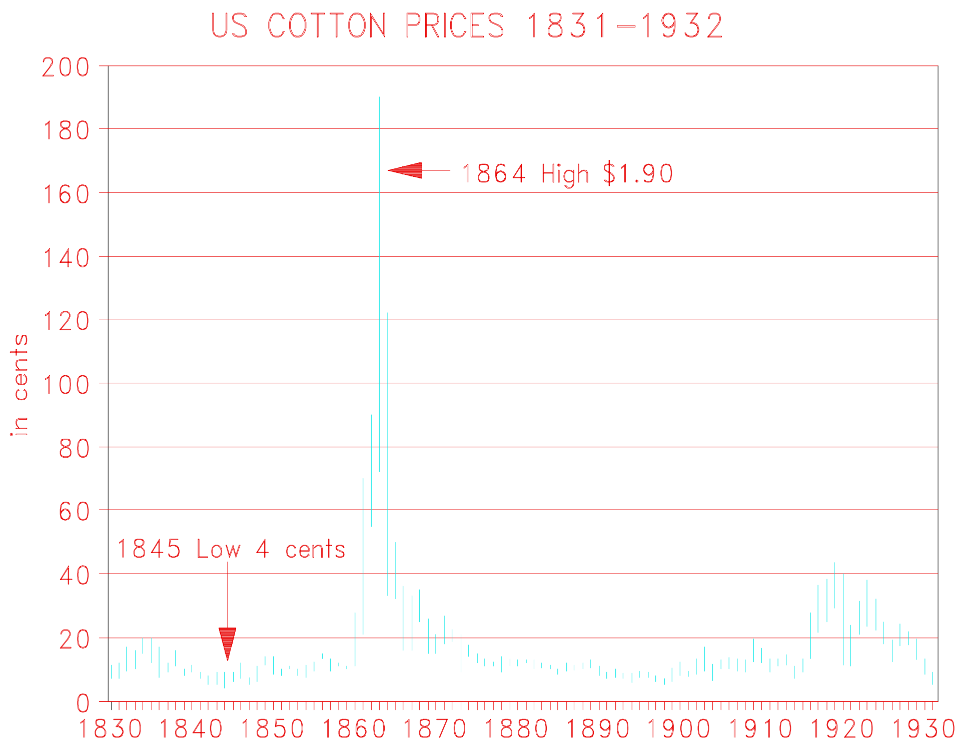
The opinions of the market were still optimistic, particularly during March. With easing on the part of the Fed and a President who was trying desperately to prevent a decline in economic activity, many felt that the November 1929 low just had to be "THE" low. But despite the fact that first quarter earnings were expected to be mixed, there was a decisive weakness that many perhaps refused to admit. That weakness could be seen in the sharply lower levels of volume.

By February 1930, the depression in the luxury industries widened. They were the very first to make the hard-hit list. Behind the diamond dealers, the fur industry suffered badly. Within three months of the September high, fur prices began to tumble. By January 1930, furs were off 35% and continued to decline. By February, wholesale prices had dropped 50%. The only furs which seemed to hold relatively unchanged were raccoons, largely due to the normal seasonal demand.

Another industry in which stocks were very hard-hit was the new and upcoming "air stocks." The airlines were not the big giants of today. This was the new, risky industry that had ridden on the tails of the automobile industry. The total combined value of the air stock group in 1929 was $1.16 billion. That was the value the market had placed upon the outstanding issues of this industry. But by January, the market which gaveth, tooketh away. As 1930 be-


U.S. CORN PRICES
(per Bushel)
Per Bushel
240
220
200
180
160
140
120
100
80
60
40
20
0
1861
1871
1881
1891
1901
1911
1921
1931
Date


U.S. WHEAT PRICES
(per Bushel)
Per Bushel
360
340
320
300
280
260
240
220
200
180
160
140
120
100
80
60
40
1861
1871
1881
1891
1901
1911
1921
1931
Date



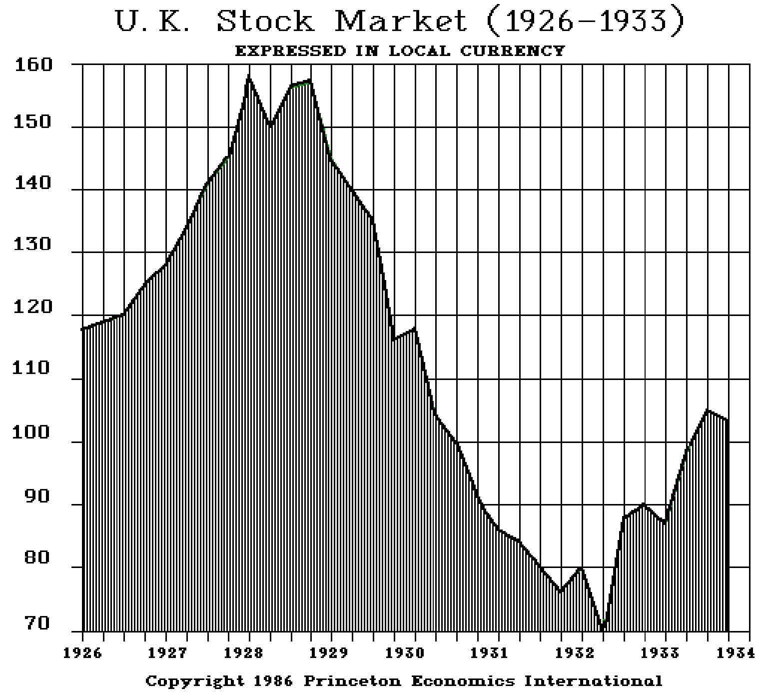
gan, this group of stocks was valued at only $284 million by the marketplace.

The air industry began to regroup during 1930. United Airlines was formed at this time by a merger of Boeing Transport with National Air Transport. TWA came forth from the merger of Transcontinental and Western Air. American Airlines was born out of a merger of Robertson Aircraft and Errett Cord, the founder of Auburn Motors and producer of the first front-wheel drive car named the Cord. This age of mergers among the airline companies helped preserve that industry by cutting costs and sharing assets, which enabled it to survive the Great Depression that followed.

In January 1930, Irving Fisher began to change his tune shortly after his book had gone to the publisher. At a meeting called by the State of New York seeking to revise its utility laws, Professor Fisher was called upon for his opinion. Fisher admitted that he had not studied the utility industry and as such was unprepared to render an opinion. But he made a little speech, which did manage to hit the press. He was quoted as stating: "The U.S. is headed toward a period of business depression, probably beginning within the next two years, which may exceed that which preceded the War...The only thing that will save us is a new gold policy or the discovery of a new process or additional gold fields. If the fall of gold production is not prevented by design or accident we shall throttle business, wringing out all profits and experiencing all the evils of deflation."

Professor Fisher's prophecy in fact came true. But whether or not increasing the money supply, which in effect was increasing gold production, would have prevented that deflationary cycle is highly unlikely.

The downward momentum of the economy was incredible. Can you imagine a period of less than two quarters in which steel production utilization dropped from 95% to 60% of capacity in such a short time span? The severity of this decline was sharp



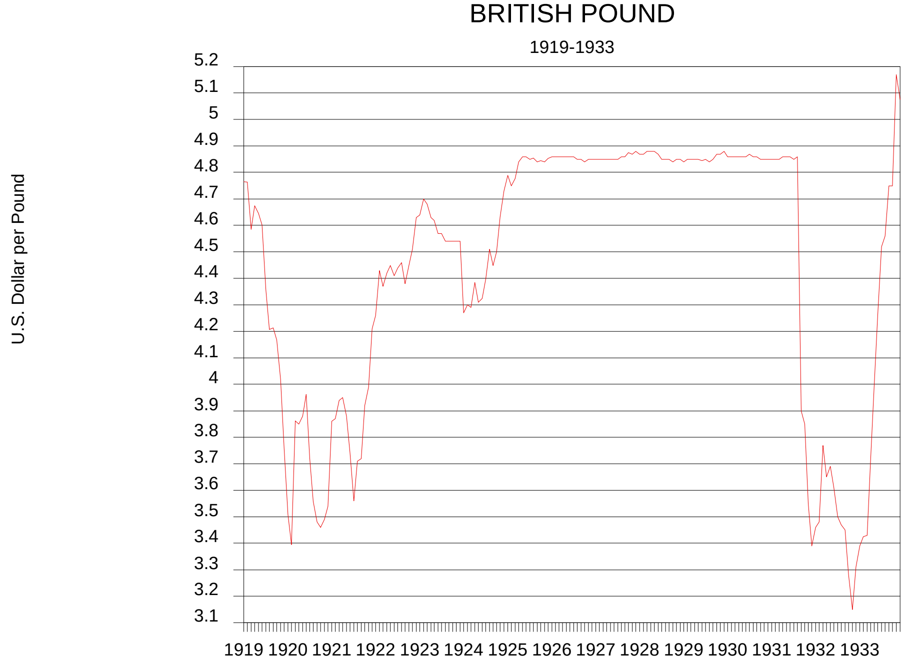
and clearly an omen of things yet to come. By January, Century Fox, the motion picture producer, went into receivership.

Commodities continued to decline in value from one end of the spectrum to the other. Magnesium, which was produced by Dow Chemical, had fallen from $5 a pound to 48 cents. Zinc fell moderately in comparison from $6.70 per ton to $5.40. Those who would have liked to blame the entire event upon the stock market and the feverish speculation of the era would have a hard time explaining the drastic decline in commodities at this early stage in the game.

Cotton, which had rallied to 44 cents during the 1919-1920 inflation period, had remained in a long depressed bear market since the major high at $1.90 during the Civil War in 1864; it had fallen sharply into early 1922, dropping to 11 cents. But during the initial stages of recovery, cotton managed to rally back to 37.5 cents in 1924. But from then on, cotton declined steadily. It reached a temporary low in 1927 and rallied briefly when the Fed cut the discount rate to 3.5%. But when that intervention clearly became temporary, cotton turned downward very sharply from its peak in 1928 at 24 cents. 1929 saw cotton fall back to 18 cents during the November panic, but the first quarter in 1930 was not much of a recovery for cotton. The high for 1930 was 19.5 cents and from April on, cotton plummeted, dropping by year end to 12.5 cents. By 1932, cotton would fall to 5 cents, barely holding the major low of 4 cents which had been established way back in 1845.

Copper was one commodity which had resisted the downtrend. While wheat was down 15%, silver off 16% and lead off by 13% from mid-1929, copper had remained steady at the 18 cent level. But during the first quarter of 1930, copper fell to 14 cents in a single move. Now even this commodity was off 22% from the mid-1929 level.

The first quarter of 1930 was filled with mixed news about U.S. industry. But in Europe, one man who would eventually leave his mark on the depression was hard at work trying to expand his monopoly. Ivar



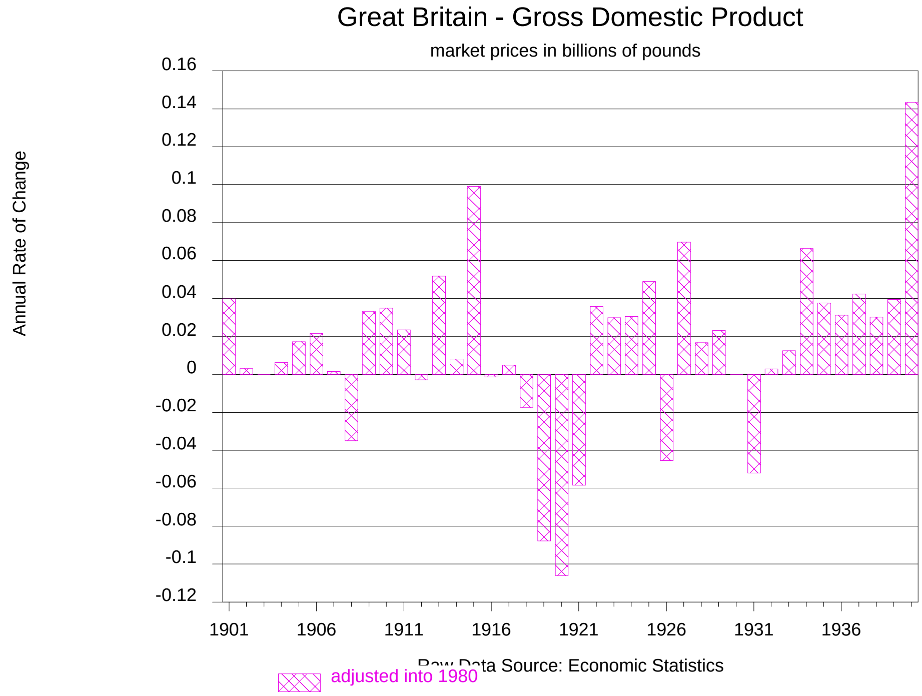
Kreuger and his Swedish Match Co. proposed to lend Germany $125 million at 6% in return for a German monopoly on matches. The proposal stirred up quite a fuss. The Finance Minister warned that if they did not accept the loan, Germany would suffer a 273 million mark deficit. The proposal was accepted on a vote of 240 to 145. Everyone believed that Kreuger was one of the richest men in the world, a fallacy that would later help the depression bring prices down even further once his schemes were finally revealed.

In London, the markets were nervous indeed. However, a well-known local broker wrote to his clients in his newsletter that shocked the British financial establishment. The broker was Oswald T. Falk, a member of the distinguished London house of Buckmaster & Moore. Falk actually advised all of his clients to sell their entire holdings of British stocks and buy those of the United States or perhaps even some colonial enterprises in Canada. His comments are still as interesting today as they were shocking to those who read them then. He stated:

"I believe that the industrial prosperity of England is much more than temporarily depressed, and that we are some way down the road of a long decline, at the end of which we shall find our relative industrial position entirely different from what it was in the 19th Century... I would sell the shares of almost all British industrial companies operating at home, particularly the shares of the older industries.

"I believe that the economic, political and climatic advantages of the U.S. and Canada during the next few decades will be so overwhelmingly great that these countries offer the most attractive field for investment. There is room for immense expansion and the desire for it. Wealth is the main objective, the pace will be hot, and the profit high.

"I think it is quite wrong to believe that the currency chaos of the last ten years will now be replaced by a long period of calm stabil-

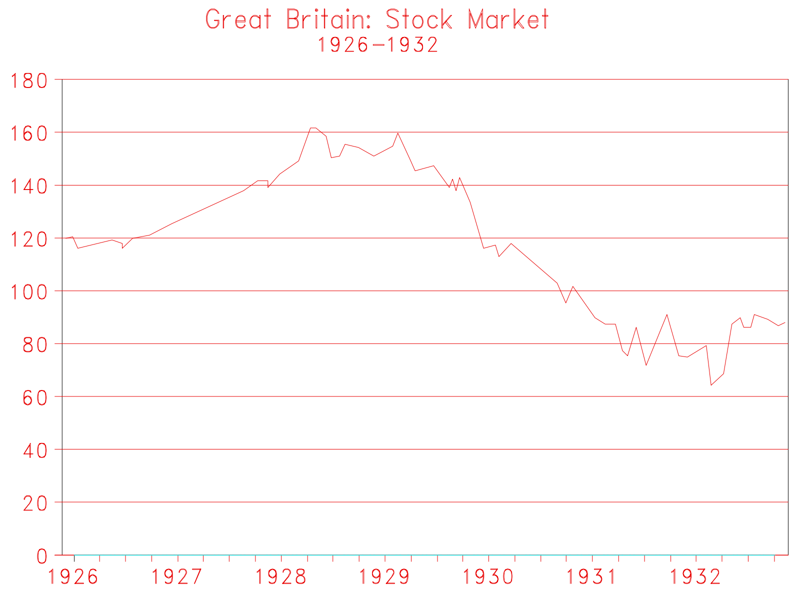


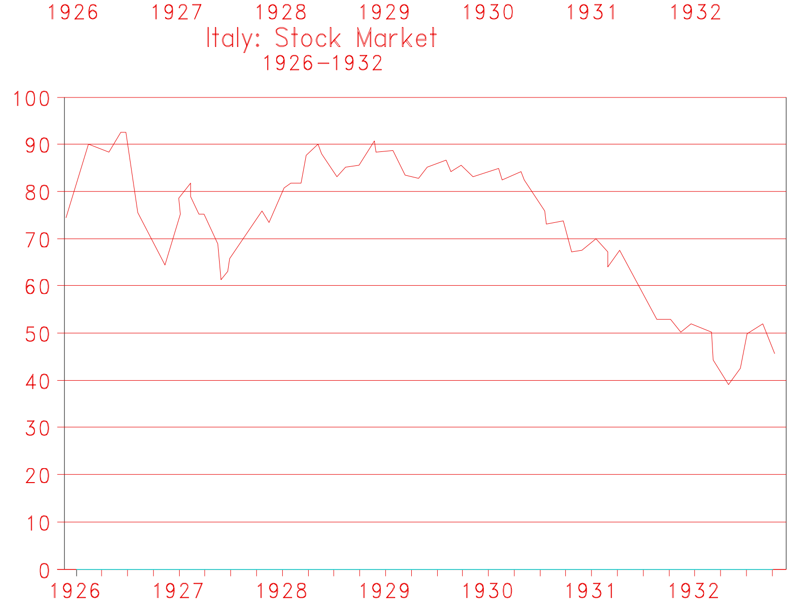
ity similar to that of the 19th Century. On the basis of this view, I would invest a large part of any fund in the strongest currency in the world, the American dollar."

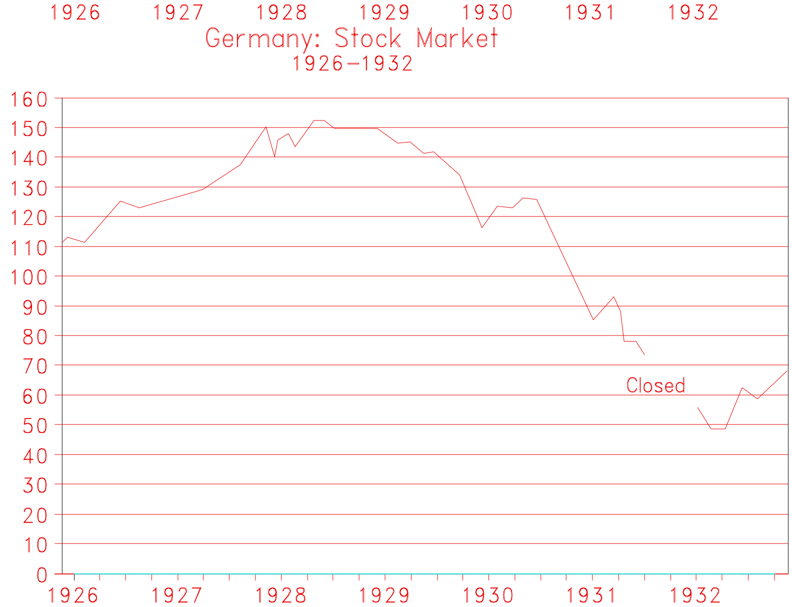
You can imagine that what Mr. Falk wrote was shocking coming from such a distinguished house. Some literally called him mad, others a traitor. But the feeling that he absorbed from the market was unique and pure. Although Britain would maintain the facade of the gold standard until August of 1931, the actions of the pound thereafter, falling from $4.86 to nearly $3.10 by November 1932, clearly support the keen observations of Mr. Falk.

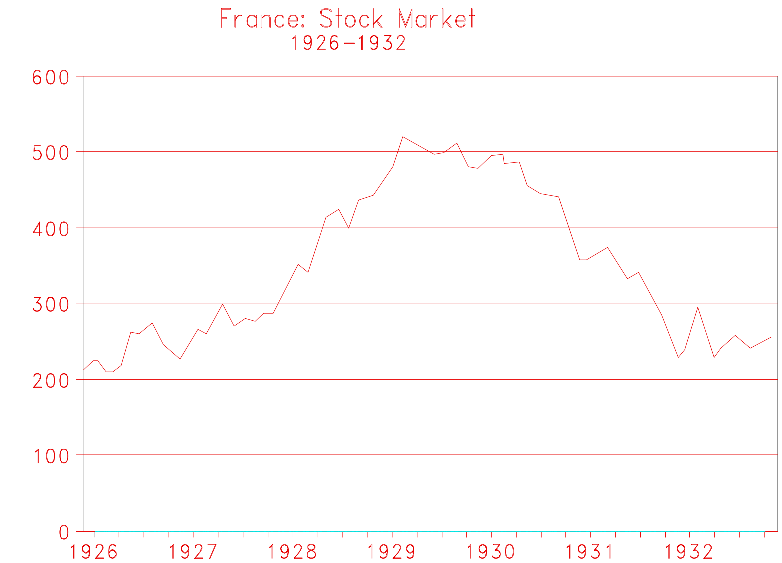
Indeed the manipulation of the central banks under the leadership of Benjamin Strong, Governor of the New York Federal Reserve, came to a bitter and devastating end. For all the intervention and manipulation could not support foreign currencies perpetually and prevent the dollar from rising once again. When that facade caved in, it did so with style and with more abruptness than if the central banks had left the free market alone in the first place. Curiously enough, although most politicians agree that protectionism was a major error which caused the Depression and must be avoided in the 1980s, they fail to see how the manipulation of foreign exchange and interest rates disrupted the marketplace and increased volatility.

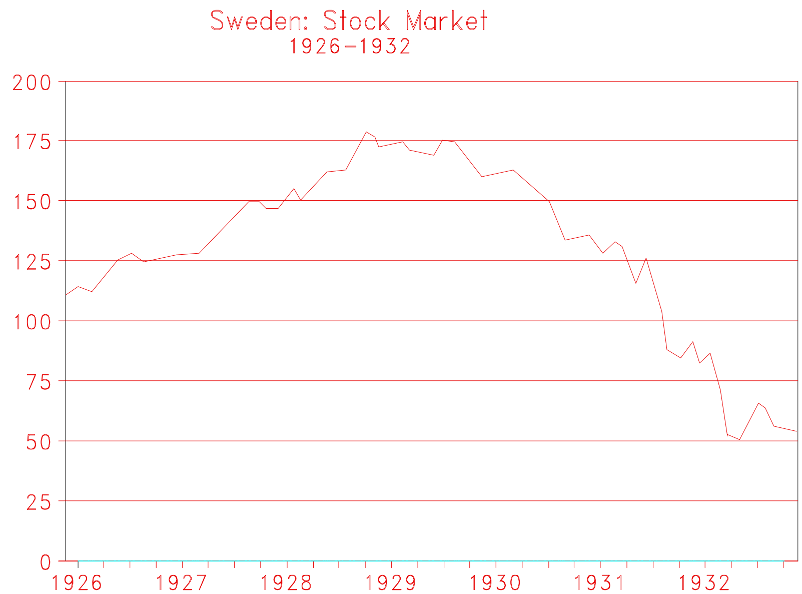
Although the U.S. stock market had declined sharply from the 1929 high, Falk's recommendation was not such a bad call. All stock markets fell sharply but as the pound fell, even declining U.S. stocks rose in terms of foreign currencies. Falk had the amazing insight into the future and his personal pride as a Brit did not stand in his way of stating what he believed would be the final result. He had the foresight to see through the artificial value of the pound, which had been achieved through central bank intervention. In his mind, it was only a question of time before the natural forces would take hold. The decline of the British industrial era began with alarming proximity to the forecasts of Oswald T. Falk.

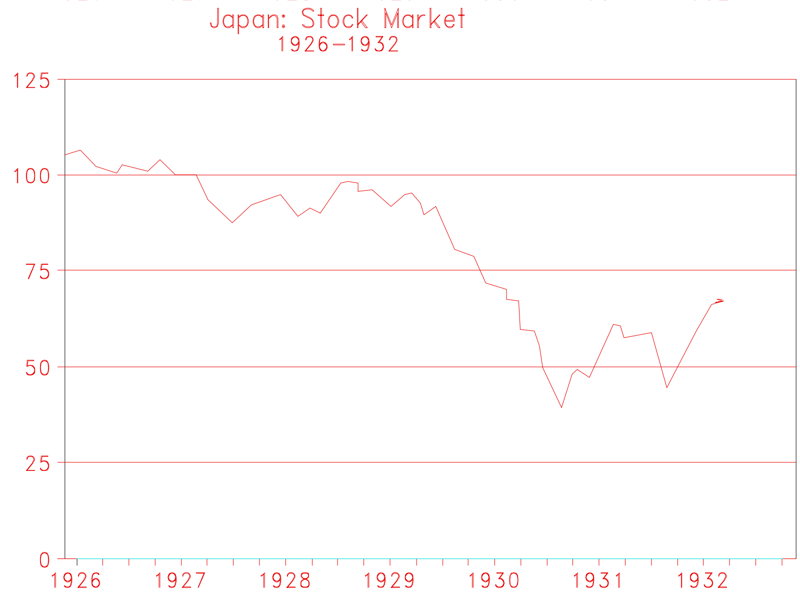

Great Britain: Stock Market
1926–1932
180
160
140
120
100
80
60
40
20
0
1926
1927
1928
1929
1930
1931
1932

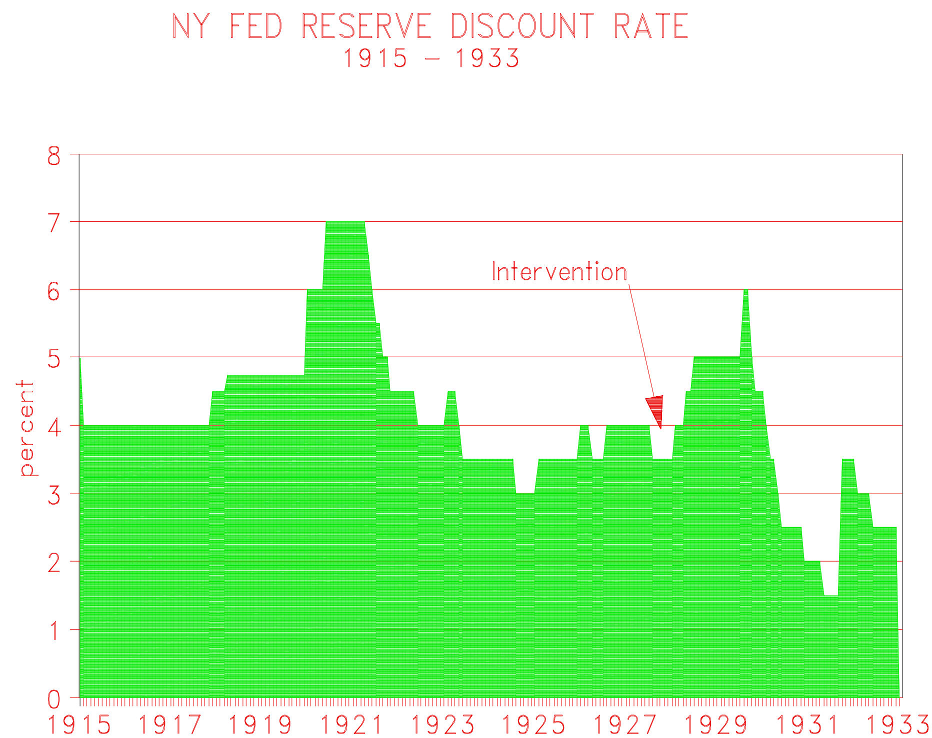

Italy: Stock Market
1926–1932
100
90
80
70
60
50
40
30
20
10
0
1926
1927
1928
1929
1930
1931
1932


Germany: Stock Market
1926–1932
160
150
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
Closed
1926
1927
1928
1929
1930
1931
1932


France: Stock Market
1926-1932
600
500
400
300
200
100
0
1926
1927
1928
1929
1930
1931
1932


Sweden: Stock Market
1926-1932
200
175
150
125
100
75
50
25
0
1926
1927
1928
1929
1930
1931
1932

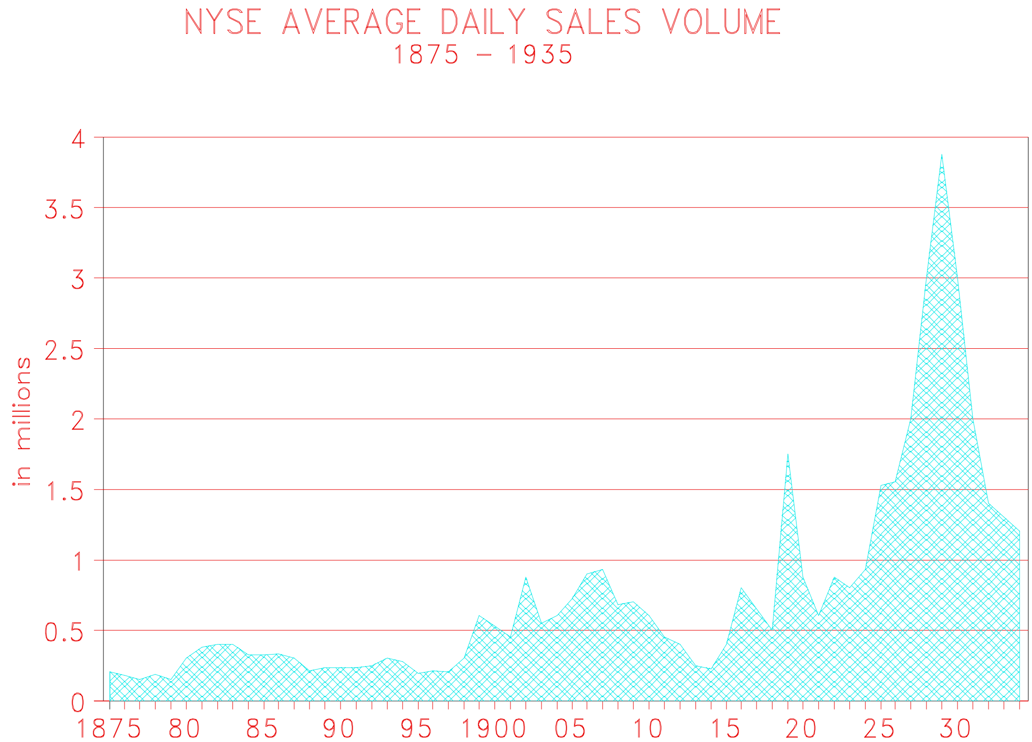

Japan: Stock Market
1926-1932
125
100
75
50
25
0
1926
1927
1928
1929
1930
1931
1932



The foreign stock markets had actually peaked shortly after the central bank intervention. In France, the stock market peaked near 550 on the index during February, 1929. By late 1929, this market fell to 475. The Swiss market peaked during September of 1929 at 250 and fell to 215 by November of 1929. In Britain, the stock market peaked during April, 1928 at 165 and by November, 1929, the market had fallen to 120. The Belgian stock market peaked during May of 1929 at 130 and by November of 1929 it had fallen to 75. Most markets had peaked within six to fifteen months of the central bank intervention. In some strange way, the foreign markets seemed to sense that their currencies were artificially overvalued.

The first quarter rally of 1930 in the U.S. was noticeably accompanied by sharply lower volume when compared to 1929. January had registered a total volume of only 62.3 million shares compared to 110.8 million shares for January of 1929. The difference narrowed during both February and March to the point that the volume during March of 1930 reached 227.5 million shares compared to 294.4 million shares during March, 1929. Some of the press during March of 1930 actually referred to the market as a "creeping bull market." As volume reached even 5 million shares on a few days during March of that year, the value of seats on the New York Stock Exchange began to rise. After trading at a low of $350,000 during late 1929, a seat traded at $425,000. Although this was a far cry from the peak of $625,000 in 1929, it illustrated that a reaction was taking place in the brokerage industry as well.

There were many who were trying to come up with ideas to stimulate business during the first quarter of 1930. One such idea became known as the "Bohannon Plan." President James A. Bohannon of Peerless, manufacturer of the Peerless Arrow, suggested that auto manufacturers should try to stimulate auto sales by encouraging those who were directly or indirectly involved in the auto industry to buy a new car. Sales were declining significantly and even the dealers were quick to support the idea.



Nonetheless, the stimulation would not even put a pause in the declining demand for automobiles. By the end of 1930, when all the sales figures were released, the decline was sharp indeed. Ford sales dropped during 1930 by 50% yet Chevrolet posted sales which were off by only 5%.

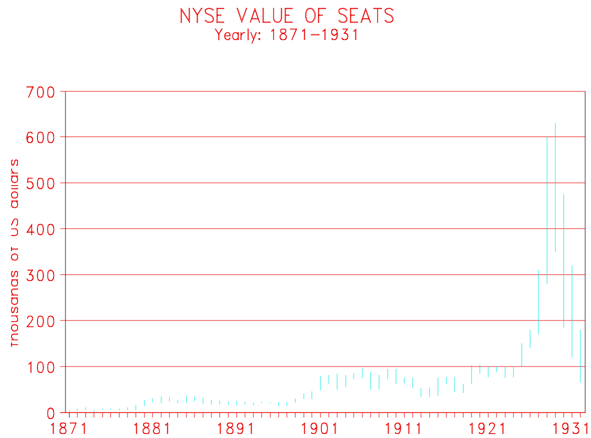
During the first quarter of 1930, earnings of many companies began to show declines. The following is a list comparing the first quarter earnings of 1930 to 1929.

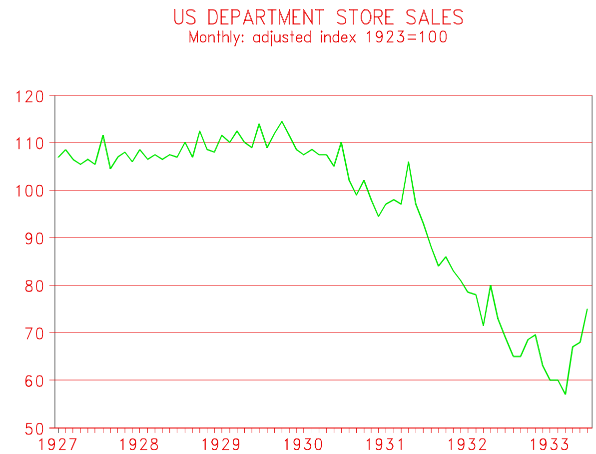
Company	1930*	1929*	%Ch
AT&T	$40,500	$40,439	.1%
Atlantic Refining	1,124	3,892	71.1%
Beech-Nut Packing	614	654	-6.1%
Chicago Yellow Cab.	532	664	-19.8%
Commonwealth Edison	5,120	4,941	3.6%
General Electric	15,042	14,505	3.7%
General Foods	5,900	5,168	14.1%
Hudson Motors	2,316	4,567	-49.2%
E.I. du Pont	15,854	23,847	-33.5%
Intl Cement	841	1,017	-17.3%
Natl Air Transport	127	120	5.8%
Otis Elevator	1,759	1,692	3.9%
S.S. Kresge	2,759	3,177	-13.1%
Western Union	1,486	3,714	-59.9%

*Expressed in thousands.

The above listing provides some perspective of the mixed earnings at this early stage in the developing depression. The industrial producers such as DuPont, the auto industry and the building industry were all hard hit. In addition, retail chain stores and department stores noted sharply lower earnings as well. The utilities and telephone companies seemed to hold their own at this point. Western Union, perhaps more utilized by business than the public, posted a first quarter decline of 59.9% in earnings, which was the most severe of the well-known corporations.

The Dow Jones Index on Department Store Sales curiously enough peaked during September 1929 at 114. By the end of the first quarter in 1930, this index fell to 108. The decline perhaps does not appear to be significant. However, this index eventually





fell to 57 during March of 1933, continuing beyond the 1932 low in the stock market.

As the first quarter of 1930 came to an end, March 31 closed virtually on the high for the month at 286.10. March 31, 1930 had reached 289.13 and the optimism began to build with the fundamentalists focusing upon tax cuts, government economic stimulation through increased spending, and, of course, the drastic decline in the discount rate on the part of the Federal Reserve. On March 31, Congress passed the Public Buildings Act, which provided for $230 million in additional spending in an effort to stimulate the economy. On April 4, an appropriation for state road building projects added another $300 million in spending to help stimulate the economy. The bullishness leading into April seemed to be well founded. By all Keynesian principles, the economy should have supported in the face of declining interest rates and increased government spending. Yet, through it all, there was something still lacking in the formula for renewed or subsidized prosperity.

As the second quarter began, April continued the uptrend as the industrials reached 290.15. Volume continued to increase, reaching a new high for the so-called recovery at 5.3 million shares that day. April 2 was active with 5.3 million shares changing hands once again. Those were the first back-to-back 5 million share days during an uptrend since the devastation of late 1929. But the Dow Jones Industrials merely matched the previous daily high of 290.15 intraday and closed 2 points lower.

On Thursday, April 3, volume declined to 4.6 million shares as did the market. That day's trading range was 288.17 to 282.29 but it at least managed to close higher than the previous day. Then on Friday, April 4, the buying began again. Volume that day reached 5.9 million shares, which would be the highest volume reached during the recovery. The industrials managed to make a new high at 291.44 but closed back under 290.

Excitement began to build. Closing above 290 would surely lead to a breakout, the consensus of opinion surmised. The sentiment seemed to be betting that 300 would be broken with ease at almost any moment and following that, who knew? After all, the Fed had lowered the discount rate back to 3.5%, which was the very place at which it had stood just prior to the breakout in early 1928. Was this not a reason in itself for the market to now blast-off to new record highs? Earnings may have been mixed, but value was certainly there. AT&T was only off .1% in earnings yet the market was still basically 25% lower than the 1929 high.

The following day the market tried to press higher but Saturday sessions were noted for their light volume. That Saturday, however, volume reached 2.5 million shares. This was almost double the volume of previous average Saturday sessions during this new recovery. Nonetheless, that day the market couldn't quite make it. It stopped dead at 291.06 and closed at 289.96.

On Sunday April 6, optimism for the following week remained high. The majority was cautious but certainly it expected the 300 level to be tested if not exceeded. Rumors that the Fed would perhaps cut the discount rate a bit further made some nervous while it assured others. Brokers' loans were certainly far from record levels. That would seem to suggest to some that there was plenty of room for a continued bull market. Still, many failed to see that even though volume was improving, the number of participants was far from overwhelming.

On Monday, April 7, the market opened steady. Buying began to increase at impressive rates. The market pushed ahead again, as most had expected, reaching 293.43. Then on the close, the industrials finished above the 290 mark. Volume registered in at 5.49 million shares for the day. The next day, some nervous profit taking and keen shorts began to hit the market. It slipped at first, but nothing drastic. The industrials fell to 285.96 but closed at 288.36. Volume was down to 4.6 million shares for the day.

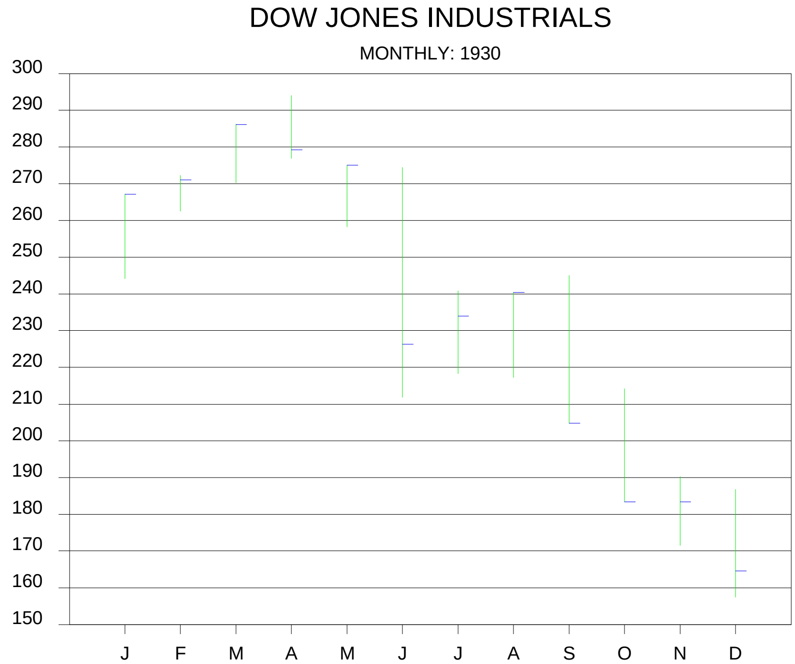
On Wednesday, April 9, the market staged a rally once again. Volume exceeded the 5 million share mark but only by a fraction. The market had charged back up to 293.36, coming close to scoring a new high but no cigar. It did close at 291.15 which was a new high closing for the recovery. This sparked further optimism and the majority was certain that 300 would be the very nearest target for the week.

Thursday brought renewed buying and the low of the day quickly formed at 289.72. The suspense continued to build as trading increased, posting volume at the 5.6 million share mark once again. The day managed to reach 295.98 and closed at 292.19, which was another new high for both an intraday and a closing level.

Friday, April 11 dipped back again as profit taking was seen during the morning session. But the market staged another rally and, sure enough, the industrials struck a new high of 296.35. It was an outside reversal, so to speak. The low of the day was 288.42, which was about a point under the previous day's low. But by the end of the day, the market had also run up and exceeded the previous day's high and closed at 292.65, another new closing high.

On Saturday, trading dropped back to 2.1 million shares, which was still pretty decent for a Saturday session. The day remained within the boundaries of the previous daily range but on the finish it closed at 293.43, another new closing high. Optimism still remained high for the following week as Easter approached. Many suspected that volume might be light due to the short trading week and the many traders who were prone to taking a holiday around this time.

Monday and Tuesday remained steady days with the industrials holding support in the mid-289 level yet failing to punch through the previous week's high. None-

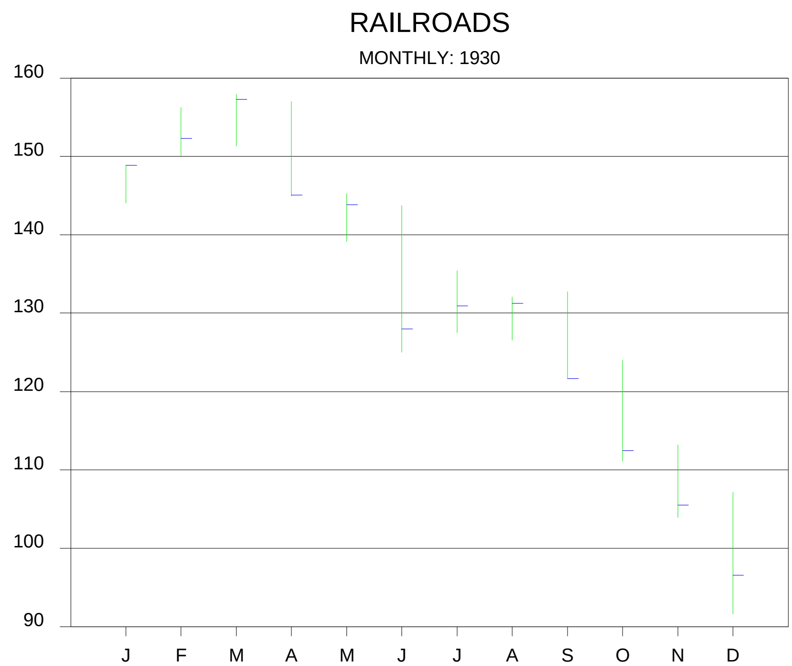


theless, both days continued to hold, closing within the 293 level. Then on Wednesday, April 16, the market staged a rally to new highs after holding the 290 level intraday. This time the industrials managed to reach 297.25 but fell back to close at 292.20. Volume was 4.3 million shares for the day. Thursday tried its best to punch through again after holding 290 intraday. The highest it could reach was 296.05, the highest closing for the year. The entire recovery was accomplished on this day. The industrials closed at 294.07 with volume registering at only 3.9 million shares. The highest volume did not coincide with price.

As the Easter holiday began, much of the news about first quarter earnings began to appear. Around the world, financial pressure continued in Europe and the keen investors began to think twice about this optimistic scenario with the Fed and interest rates. In India, a civil disobedience campaign against the British had begun under the leadership of Mahatma Gandhi. In France, talk of a workmen's insurance law was under way and, in fact, by April 30 it was passed. in the United States, calls for protectionism could be heard in the corridors of the House of Representatives.

In South America, the depression was creating problems as unemployment continued to rise and rumors of political unrest began to build. The financial press in the United States in general was not necessarily bearish. Nonetheless, if one looked closely, the news was certainly not rosy enough to suggest a raging bull market either.

After Easter, the market tried that Monday to stage a rally. However, the best it could muster was a high of 295.88. But in a trading pattern which many have noticed today, markets quite often reverse their trend after a holiday. Well, that same coincidental pattern seems to have existed then too. Easter Monday was met with profit taking and short selling. Volume was 4.4 million shares and by the end of the day the industrials fell to 287.24, closing at 288.23.



The next day, the industrials paused but only after falling in the morning to 284.28. The afternoon session saw a quick rally which was mostly short covering and little fresh buying. The industrials jumped back to 291.39, closing at 290.01. Volume was 4.5 million shares and many believed that the sell off was over and that the market would try the upside once again.

On Wednesday, April 23, the shorts became nervous. The industrials traded back up to 293.27 stopping many out. But then when all the buying was done, the profit taking seemed to come into the market with numerous odd lots. The industrials turned south and fell right back down, testing 286.25 and closing at 288.78 with volume registering 5.5 million shares. Volume began to increase on the downside at this time, a distinct shift from the pre-Easter pattern which had displayed higher volume on up days. Rumors began to circulate from booth to booth of large bear raiders.

On Thursday, April 24, the market rallied in the morning reaching 290.58. But once again the industrials just could not hold that level. By midday the market began to fall sharply as selling increased. Suddenly out of nowhere, the industrials simply fell, entering areas where no bids had shown. They managed to gain some support at 283.74 and closed at 286.18.

Both Friday and Saturday failed to reach 290 on the rally side but each managed to penetrate the previous daily low. By the end of the week, that Saturday session posted volume of 2.3 million shares, showing a decisive increase for the downside as that day closed at 285.46, the lowest for the entire week.

By now confusion began to increase. Talk of rising unemployment and demands from many sectors to raise tariffs began to reach the ears of Wall Street. Optimism soon gave way to pessimism and no one looked toward the next week with expectations of 300 over again.

The final week in April opened about unchanged and tested 286.12 that Monday.

Volume was brisk at 4.8 million shares but it was still increasing on the downside rather than on rallies which perhaps illustrated the fears which resided in the bull camp. The selling continued that day, and this time even 280 didn't prove to be support as the low of the day formed at 275.71 and the market closed near the low at 276.94. The industrials had now fallen 22 points from the high of April 16, which was a decline of nearly 7.5%. Tuesday, April 29 brought more of the same but the market held at 272.24, closing at 278.43, up only marginally from the previous daily close. But volume increased to 5.4 million shares.

As the calendar turned the pages of April into May, the selling persisted. By Friday, May 2, the market fell to 264.93, closing at 266.56. Friday's volume had now posted a new high at 5.9 million shares to exceed the highest volume record during the pre-Easter rally. That Saturday was not a day that people were prepared to take off. The selling continued again and this time the market broke severely with the industrials dropping to 256.99 and closing the week at 258.31. But that Saturday in early May posted volume at 4.8 million shares with liquidation far outnumbering the bargain hunters. Commentary at the time suggested that most of the buying came from profit taking on the part of short players.

Poor earnings reports continued and unemployment news still looked gloomy. Talk of a depression seemed to be on the tip of everyone's tongue and the cries for protectionism began to rise in pitch and tone. As the week of May 5 began, sellers continued to outnumber buyers. Now, even shorts were not anxious to cover so quickly. Monday, May 5 saw the industrials fall to 249.82. But then the market started to stage a rally and some shorts suddenly changed their mind once again. The short-cover rally brought the market back to 262.84 intraday but it closed at 259.68. The balance of the week was spent moving back up against the short positions along with some bargain hunting, and by Saturday the week's high stood at 272.20 with the week closing at 272.01.

Nevertheless, news continued to be bearish. But despite the fact that shorting the market seemed the logical thing to do, the market adopted a stubborn bullish attitude and simply refused to go down. The industrials continued to churn back and forth throughout May and actually reached their highest point intraday on May 29 at 276.66, closing the month at 275.07. Debate continued as some called to new lows under that of the panic of 1929 while the majority insisted that it would remain as the major low.

June opened at 278.86 after the three-day holiday, which fell between May 30 and June 1 that year. However, 276.86 quickly formed the high for not merely the day, but the entire month! The industrials closed that day at 274.45. That first week in June saw the market pause from its rally and drop back to 263.29 by Friday. Volume had been reduced to daily levels which averaged under 2 million shares as confusion mounted. Dull was one word which floated among the vocabulary of the traders on the floor.

Then on Saturday came news that a bill in Congress to dramatically raise tariffs would perhaps pass, and a few traders became interested enough to post volume that day at 2.2 millions shares. The market fell back, slipping below 260, testing 256.87 and closing at 257.82. Some argued that U.S. industries would rebound as long as Europe was forced to stop its dumping policies while others warned of a growing trade war in the wind. The instability within the market and the crack within the foundation of confidence proved to be the winning hand.

That Sunday there were a lot of really nervous guys in the market. When trading began on Monday, June 9, it was certainly not dull. Volume jumped back up to 4.6 million shares as the market opened at 259 and fell 10 points to 249.51, closing this time at 250.78. This was a 3.8% move in the course of one day. The next day, the Dow Jones Industrials fell to 247.62 with volume registering at 4.7 million shares. But then at the end of the day, profit taking from the outstanding short positions drove the market up 10 points to close at 257.29. But that was all she was worth. The next day the industrials tested 257.24 and said good-bye to the 260 level for what would eventually seem like years. The market fell straight down, punching through to new lows at 243.90. The balance of the week continued

"Sound Sleep is more necessary than exercise or food"—

says

GENE TUNNEY

"I envy Gene Tunney his nerve control more than his strength or agility. On the day before his contests, and on the morning thereof, he was as calm as if nothing unusual were going on," wrote William Lyon Phelps in Delineator last July. And in maintaining this nerve control Gene Tunney considers sleep an important factor.*

The retired world's champion comments on sleep

"WHEN preparing for a competition in which physical endurance and mental alertness are required, sound, undisturbed sleep is more necessary than exercise or food.

"Exercise and digestion consume nerve-energy which is the motive power of the living machine—Man. Sleep and rest are the mediums through which this destroyed nerve-energy is restored.

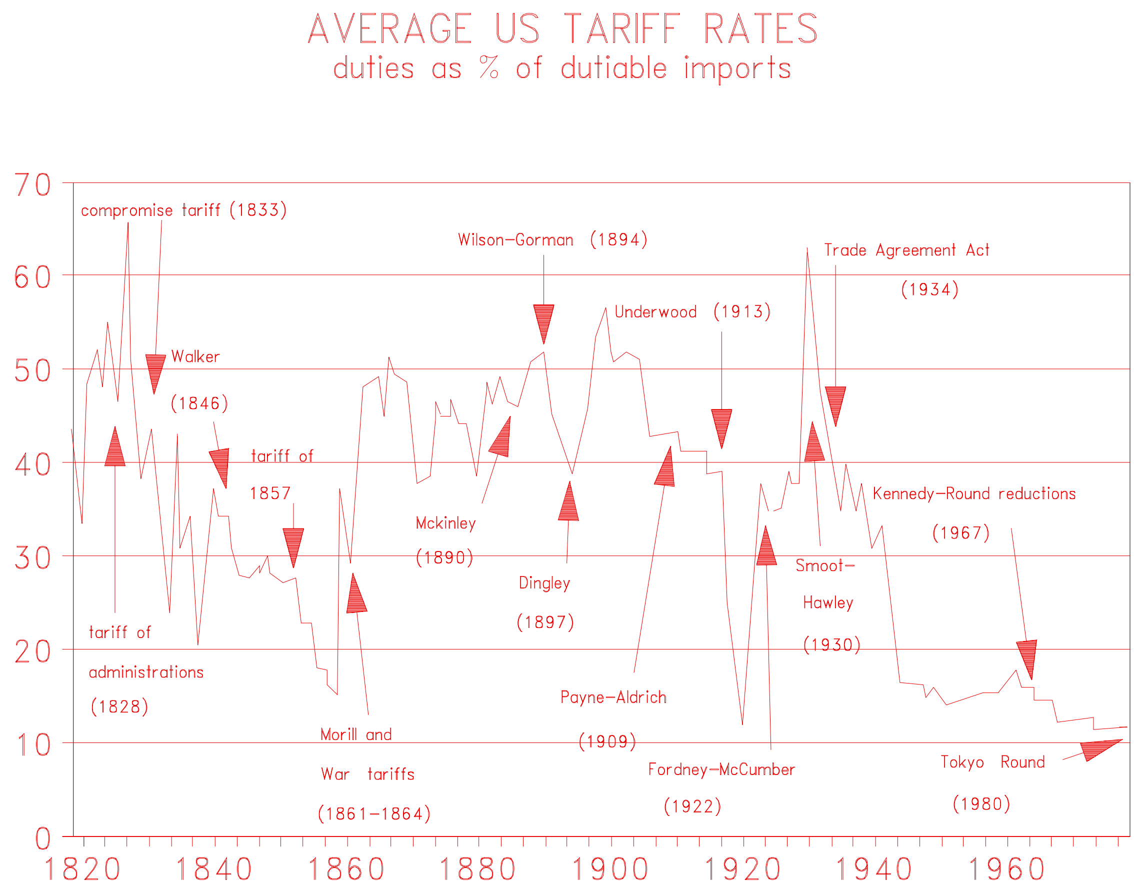
"A wise athlete when preparing for athletic competition makes it a rule to get ten hours of sleep and rest a night. This long rest after the hard daily grind will completely refresh his nerves and fit him for the next day's grind, gradually conditioning him for the great event—the contest."

**The Simmons Company, 666 Lakeshore Drive, Chicago, Ill., will send on request a reprint of this article, "Gene Tunney Shows The Way."*

SIMMONS, largest makers of beds, springs and mattresses, have developed scientifically the sleep equipment for complete relaxation and healthful sleep—in two price ranges:—Simmons Beautyrest Mattress—hundreds of sensitive coils under thick layers of upholstery, damask covers—$39.50; Ace Box Spring, $42.50; Ace Open Coil Spring, $19.75. The new Deepsleep Mattress—another inner coil mattress at a popular price, $19.95; Deepsleep Box Spring, $27.50, Slumber King Spring, $12.00. The Simmons Company, New York, Chicago, Atlanta, San Francisco.

SIMMONS

BEDS · SPRINGS · MATTRESSES and BERKEY & GAY FURNITURE



to see selling outpace the buying and the week closed at 244.25.

As the week of June 16 began, the news of what would become known as the Smoot-Hawley Tariff Act loomed over the market like a black cloud. Monday the 16th gapped down and the high of the day formed at 242.18 while the low of the day was 228.94. The selling continued as news reports indicated that the President was going to sign the bill on Tuesday. Hoover as besieged by petitions from 1,028 economists pleading with him not to sign the bill. But history was made that week when he signed his name to that piece of paper. The Dow Jones Industrials plummeted to 212.27, closing the week at 215.30. The selling pressure continued the following week as the industrials fell to 207.74, off 14.9% from the close of June 14.

The Smoot-Hawley Tariff Act was signed on June 17, 1930. This act raised tariffs to their highest levels during the 1900s, exceeding the Payne-Aldrich Act of 1909. It also embraced a most favored nations policy, which was first introduced back in 1923. Under this provision, certain nations were granted large tariff concessions under an arrangement that continued for more than 45 years.

Other nations began to raise their tariffs in response to the Smoot-Hawley Tariff Act of 1930. A general world economic depression began to set in during this second quarter in 1930 as world trade and production declined and unemployment increased. Even all the public spending programs, which had brought the market to its high in April, were now old news. With nearly $1 billion being pumped into the economy, nothing seemed to matter!

History has chosen to remember the Smoot-Hawley Tariff Act as one of the primary causes of the Great Depression. However, the United States was traditionally a high-tariff nation and contrary to general belief, the Smoot-Hawley Tariff Act did not create the highest level of tariffs in history. That distinction belongs to what was known as the "Tariff of Abominations" in 1828. At that point, tariffs rose to about 64% as a percentage of dutiable imports. (Source: U.S. Department of Commerce)

The chart on the average of collected tariffs on U.S. imports illustrates that the percent of duties indeed rose to nearly 60% as a result of the Smoot-Hawley Tariff Act. However, an economic decline had clearly begun some time before this measure was signed into law. We can see that the chart above illustrates that tariffs were also at

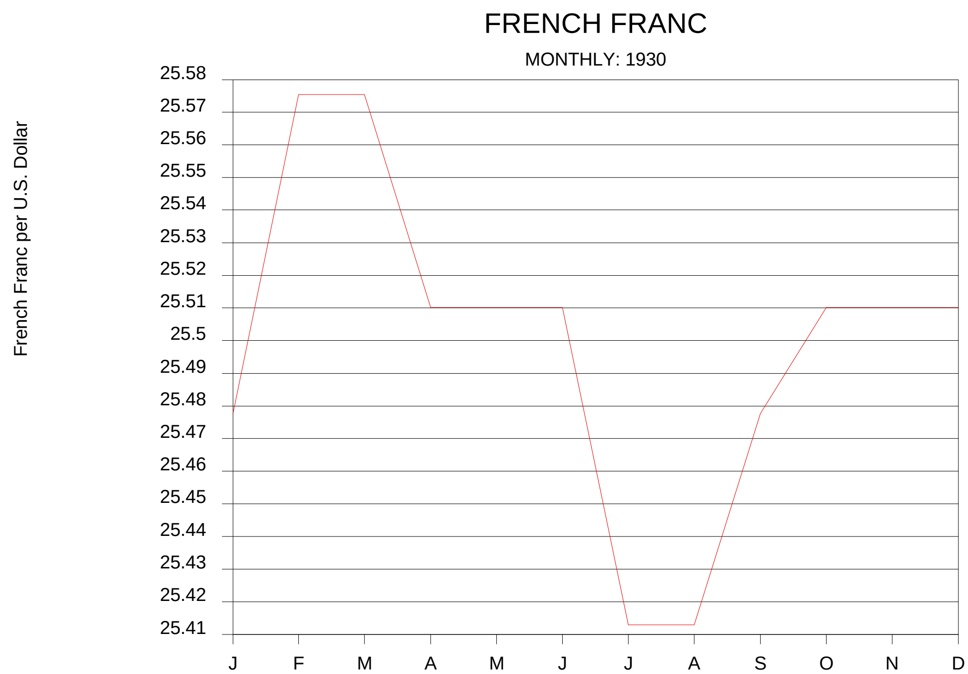
their lowest point at the end of World War I. The following table gives us a look at the import/export picture between 1919 and 1940 between the U.S. and Europe, its major trading partner at the time.

US/EUROPE TRADE BY VALUE
1919-1940 in $millions
Economic Statistics

EUROPE

Year	Exports to	Imports from	US/Surplus
1919	5,188	751	4,437
1920	4,466	1,228	3,238
1921	2,364	765	1,599
1922	2,083	991	1,092
1923	2,093	1,157	936
1924	2,445	1,096	1,349
1925	2,604	1,239	1,365
1926	2,310	1,278	1,032
1927	2,314	1,265	1,049
1928	2,375	1,249	1,126
1929	2,341	1,334	1,007
1930	1,838	911	927
1931	1,187	641	546
1932	784	390	394
1933	850	463	387
1934	950	490	460
1935	1,029	599	430
1936	1,043	718	325
1937	1,360	843	517
1938	1,326	567	759
1939	1,290	617	673
1940	1,645	390	1,255

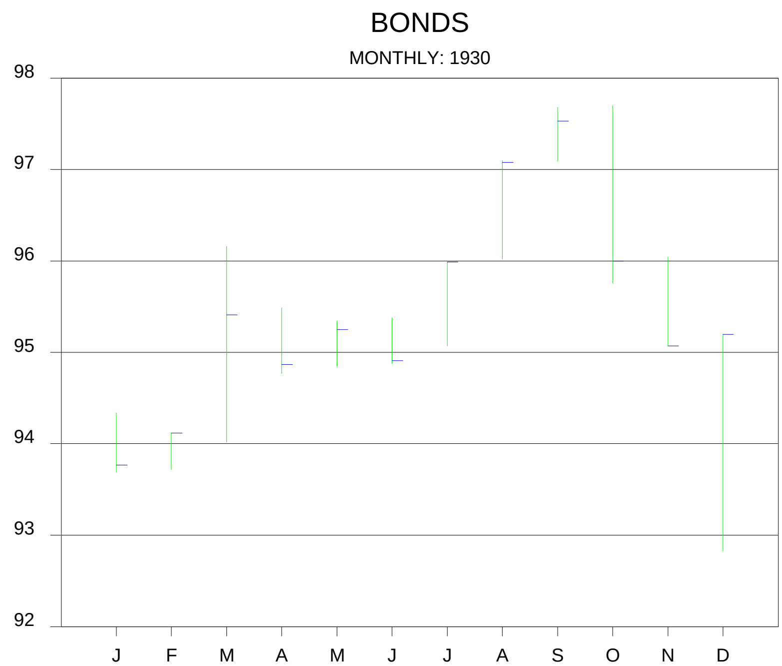
We can see clearly how World War I benefited the United States by increasing its trade surplus with Europe. When we review the period for World War II, we will see how the U.S. trade surplus expanded greatly at the expense of Europe, once again bringing U.S. official gold reserves to 76% of total official world holdings by 1950. But it would be misleading to blame the Smoot-Hawley Tariff Act for the Great Depression. U.S. exports to Europe had de-



clined to their lowest point in 1922 as did imports for the 1920s. But the peak in exports actually took place in 1925 while imports continued to rise into 1929. The trade surplus with Europe also peaked during 1925 and was declining steadily with the exception of a rise during 1928.

The Smoot-Hawley Tariff Act of 1930 was enacted during a period when the trend was already in a declining mode. Granted, the decline from the 1928 rally in the trade surplus was aided more significantly by the new tariffs and continued to decline sharply until 1933. But the decline was equally as sharp for goods produced and marketed within the domestic economy. If we look at the chart on the average U.S. tariffs collected on imports, there is no direct correlation between this and other major depressions which preceded that of the 1930s. Yet most politicians prefer to point to protectionism as the only lesson we should have drawn from our experience of the 1930s. They fail to attach any significance to exorbitant tax rates, manipulation and intervention in foreign exchange rates. Perhaps if Europe had not over valued its currencies following World War I and had accepted the free market's evaluation, then the intervention of 1927 would not have been necessary and a trade war would have been prevented. But the insistence of Montagu Norman, Governor of the Bank of England, upon returning the pound to its former par value, kept British exports high both in terms of dollars and in French francs. It was France who still festered its traditional dislike of Britain and, as such, the French purposely kept the franc undervalued in terms of gold to promote exports. As a result, France accumulated a hoard of gold which surpassed that of Britain while simultaneously imposing high restrictions on importation of foreign goods. France was by far the most aggressive in leading the protectionism trend within Europe itself.

The cries for protection from imports have always been made by various sectors of industry in every nation around the world. Whether those measures take the

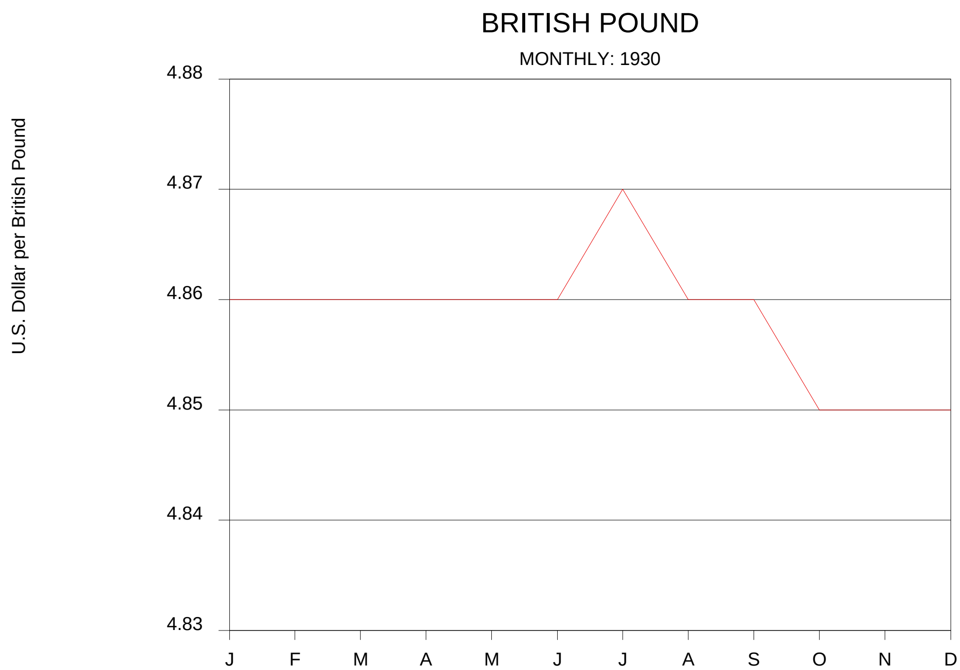


form of quotas or tariffs, the same effect upon trade will result. To think that only tariffs were the cause of the Great Depression is grossly incorrect. This economic contraction which took place worldwide was primarily created by the destruction of public confidence within the economy in addition to a debt crisis that was hidden behind all the press reports and economic statistics. But the central banks viewed the problem of a U.S. trade surplus and the U.S. creditor status as a deterrent to the reconstruction of Europe. Non-U.S. bankers argued that unless U.S. interest rates were lowered and trade was shifted back in their favor, then repayment of war loans to the U.S. would become impossible.

The true problem was that the U.S. economy had expanded through innovation and through the devastation suffered by Europe at the hands of war. But exports clearly peaked in 1925, NOT during 1929 or 1930. Europe's capacity to buy was severely hampered by its enormous debt service resulting from the war and its quest for rearmament once again. Furthermore, the steps to intervene by reducing U.S. interest rates in hopes of attracting more money to Europe should not have been taken. What should have been done was a currency devaluation in light of the reduced capability for economic growth in Europe.

Instead, Britain chose to try to return the pound to the same level at which it had once stood prior to the war. This resulted in a serious overvaluation for the pound. This kept British imports relatively high when a devaluation would have done far more to stimulate British exports by reducing their costs to the United States. Britain's depression was further widened as taxes were raised in an attempt to hold on to the gold standard. Once the pressures from this serious, major blunder became so great and the gold standard was abandoned in 1931, the pound collapsed to levels under those seen during 1920 following the war.

The U.S.-Europe trade balance expressed on an annual percentage change basis has been provided in the chart above. Here we can see that the year over year change in the

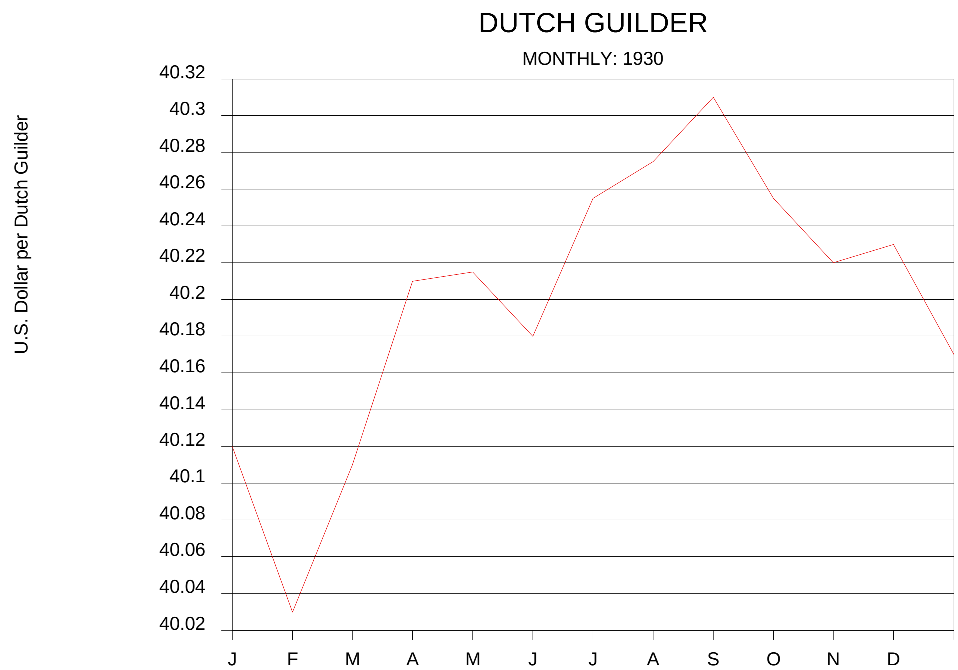


U.S. trade surplus was on a steady decline since its peak in 1920. The decline in imports from $1.3 billion to $911 million between 1929 and 1930 was not entirely caused by the Smoot-Hawley Tariff Act of 1930. By the time this Act went into force, half of the year had already expired. As a result, in comparing the exports between 1929 and 1930, a decline of 21.4% occurred. Imports declined by 31.7%. However, the decline in imports during the first half of 1930 was 26%. Obviously, the downtrend was already in motion and the second half of 1930 was not such a drastic decline in comparison to the previous year.

When viewed objectively, all the economic data point to the fact that a general decline in world trade was already in motion as of the fourth quarter of 1929. The protectionism was enacted as a response to that decline and to the European monopolies which were cutting deeply into many U.S. industries. Had a decline not been in motion, there would not have been as much support for higher tariffs as there was at the time. With this in mind, we cannot blame the depression upon the Smoot-Hawley Tariff Act entirely although the 1920-1930s was a period of unspoken war for international trade.

We still come back to the fact that diamonds were off 50% by January 1930; furs and most other raw commodities had declined from 15% to 30% by the first of the year. The decline in the European stock markets, which preceded the peak in the U.S. market, illustrated an overvaluation of foreign currencies themselves. The intervention implemented in 1927 merely attempted to artificially hold those currencies excessively high while simultaneously holding the dollar low.

Although many nations sought to return to the gold standard and set their goal at the pre-World War I levels of par (for example, $4.86 on the pound), this was far too ambitious given the actual shift in industrial capability from Europe to the U.S. This is what was obvious to Oswald T. Falk. Again, if we refer to the table of imports and exports from the U.S. perspective, we can see



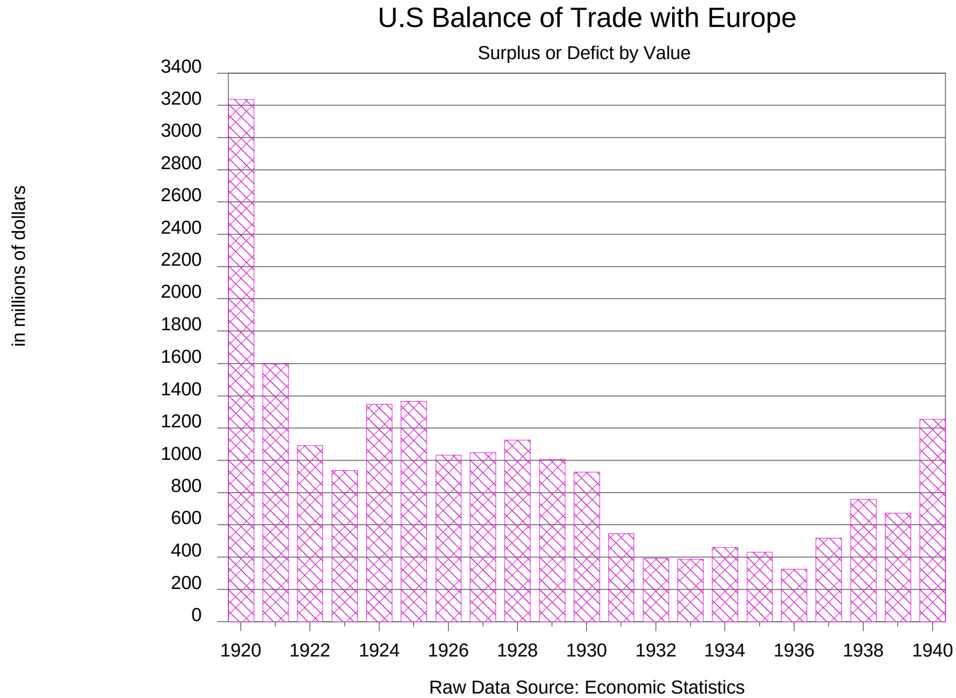
clearly that exports peaked in 1925 while imports from Europe peaked during 1929.

Europe could not afford to purchase all the production of the U.S. and, therefore, once both the European and the domestic U.S. consumers reached their capacity for purchasing goods and services, a contraction was logical. Much of the blame truly lies on the central banks and their political attempt to strengthen the European currencies at levels which were far too high in respect to the ability to participate within the world economy. The war had devastated their economic position, which was not reflected in a lower currency valuation upon the foreign exchange markets.

On the surface, one might tend to believe that if the dollar were being held down artificially between 1925 and 1931, U.S. exports should have increased as the overvalued pound would have purchased more U.S. goods. That might be the classical relationship but the policies in Britain had forced upon its own people a deflationary depression, which came to its bottom in 1922-1923 and suppressed rapid economic expansion during the period. If the people themselves were suffering from tight money policies, no matter how low the dollar goods might be priced, demand was not present. Thus, this currency valuation theory in relationship to trade is not always one of direct immediate influence.

Hence, the lower dollar did not encourage an increase in U.S. exports, which is again the case that is emerging in the aftermath of the September 1985 central bank manipulation. Indeed, this entire period offered many lessons that the fundamentalists seem to have ignored. The increase in government spending which was implemented by Hoover led eventually to actual fiscal deficits, stands in direct contrast to those claims that government has the power to prevent recession by printing more money.

To prove this point, again take note that U.S. exports to Europe peaked precisely during the same period when most nations



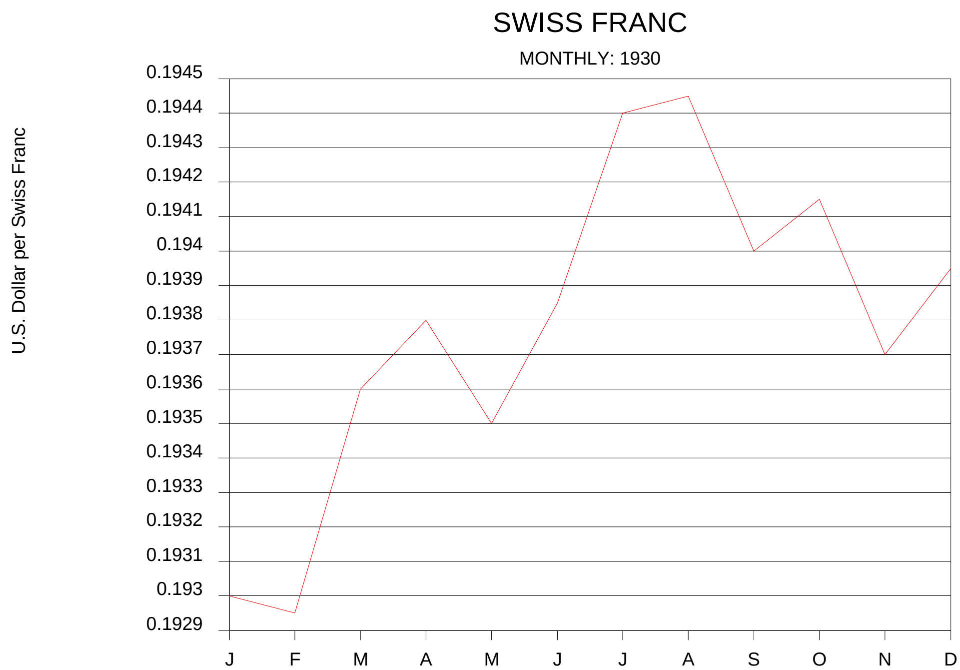
returned to the gold standard at what was then called "par" or pre-World War I levels. Thus, the U.S. trade surplus peaked near the dollar's low initially, but failed to improve thereafter. And as far as the thinking behind the fiscal deficits, we will soon see how these bullish attitudes for increased government spending later turned into ammunition for bears.

The intervention of the central banks in 1927 was needed to divert capital toward Europe in order to maintain those artificially high levels. That was one of the primary causes of the depression. That intervention resulted in the direct and immediate effect of a flight in capital from bonds into stocks. As prices were driven higher, speculators and novice investors were drawn into the market for reason of quick profit. That would not have taken place had the European currencies not been overvalued. The European stock markets peaked shortly thereafter as well, and capital from those markets also flowed into the U.S. stock market. Many smart Europeans had come to the same conclusions as Falk. Dollar investments were seriously undervalued.

The observations of Oswald T. Falk, which were discussed earlier, were correct. His reasons for advising all his clients to sell British stocks and buy U.S. stocks were based on his perception that a true economic expansion had not taken place in Europe and that the dollar was truly the strongest currency, although that could not be seen at the time due to the artificially fixed foreign exchange markets.

The stock market crash of 1929 was therefore not purely a domestic invention but an international reaction to intervention which had sought to re-establish the former glory of a world which once existed and had now changed. Falk's forecast that the U.S. economy would grow in the future at the expense of an older, decaying European economy was completely correct and obvious at that point in time.

If we look at May 1930 and compare it to May of 1929, auto production was down



31%, pig iron down 13% and railroad car loadings had declined by 9%. The only thing that had increased was business failures which were up by 9%. This clearly establishes that the decline was obviously in place prior to the Smoot-Hawley Tariff Act and that the Act merely helped to perpetuate a trend which had begun prior to Hoover's signing of the bill on June 17. If we look at U.S. exports as a percentage of G.D.P. (Gross Domestic Product) in terms of constant 1972 dollars, we find that exports made up only 5.28% whereas the British exports in 1929 were 22.9% of their G.D.P. By 1931, these percentages declined to 4.44% in the U.S. and 16.71% in Britain. If the U.S. depression was caused by a loss of U.S. exports, then the loss of only 4% to 5% of G.D.P. should not have created an 88% decline in the stock market. Obviously, other factors were involved.

In the chapter for 1927, you will recall a speech by Dr. Herty. He pleaded with Congress to either put up tariffs, to which they replied no, or repeal the Sherman Anti-Trust Laws to allow U.S. industry to band together to fight the cartels which were being organized in Europe. We have already shown how U.S. exports peaked in 1925, yet U.S. imports from Europe peaked in 1929. Had the free market system been so holy, then the U.S. administration should have at least allowed U.S. industry to compete on the same level by permitting those mergers. But the government's view of a monopoly under the Sherman Anti-Trust Act was far too narrow minded. It only considered U.S. domestic monopolies and did not take into consideration foreign monopolies. Again, had government listened to Dr. Herty in 1927, the protectionism of the Smoot-Hawley Tariff Act of 1930 may have been avoided. It appears that at the very least, much of the blame for the depression lies upon the mismanagement of government and its blunders in legislation and intervention. It was clearly not the shoe shine boy who was buying on margin as many politicians have tried to make us believe.

Many economists and politicians, particularly Franklin D. Roosevelt, placed a lot of the blame for the Great Depression upon the Smoot-Hawley Tariff Act. Posterity has chosen to distort much of this issue and in effect seek an easy mark on which to blame the depression. Others sought to blame the speculation in the stock market to further political power to control the free markets, which to this very day still plague Wall Street. But, if we are to be honest in our approach in trying to understand the events of this unfortunate era, we must also consider all the facts.

The Republican platform of 1928 had structured within it a call to reform and raise tariffs, particularly in the hard hit agricultural sector. Those who talk of trade wars and the like should also review the actions of Europe and its tendency to grant monopolies, such as those to the Swedish Match Co. on the part of France and Germany, in addition to the distinct encouragement of cartels and price fixing. These steps were all taken well in advance of the Smoot-Hawley Tariff Act and were unquestionably measures directed toward an easy road for the reconstruction of the European economy.

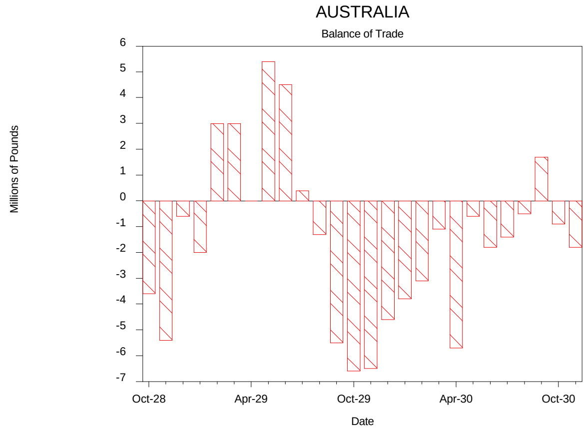
The truth of the matter is that the United States' efforts to increase tariff levels came after similar measures which had already been underway in 30 various nations. Some nations were striving to rebuild their economies while others were seeking to achieve a higher level of self-sufficiency and rearmament. The postwar era had indeed imposed upon Europe a varied effect prompted by a still more diverse political approach. In Britain, the full brunt of the depression had been suffered back in 1922 and the balance of the roaring' 20s had been largely a period of stagnation during which pride had ruled more than reason. Instead of trying to stimulate economic growth, the Bank and the Treasury had sought to grasp the opportunity to force the bitter doctrine of the Cunlife Committee and the lofty aspirations of Montagu Norman by returning the British nation to the gold standard, which seriously overvalued the pound at the expense of its own economic reality. France perhaps suffered least among European nations essentially because it had undertaken the opposite direction, which seriously undervalued the franc in terms of gold. This helped France establish a massive gold hoard which even exceeded that of Britain. But France was particularly adamant about protecting itself from imports. particularly those in the food sector.

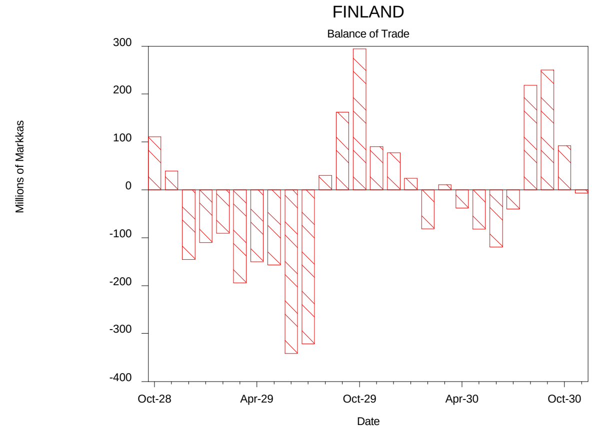
President Hoover's idea was one which he termed the "flexible tariff." This concept sought to remove from Congress the usual haggling over what products would and would not be subject to tariffs. The concept was actually quite sound given the trade war at the time. A Tariff Commission would adjust the measures on a basis whereas the cost of production of a particular product from an overseas supplier would be compared to that of the domestic producer. If there was an unfair advantage, the Tariff Commission would have the authority to raise the tariff of that particular product in an effort to equalize the competitiveness between the domestic and the overseas producer. The actions of the Commission were subject to the approval of the President.

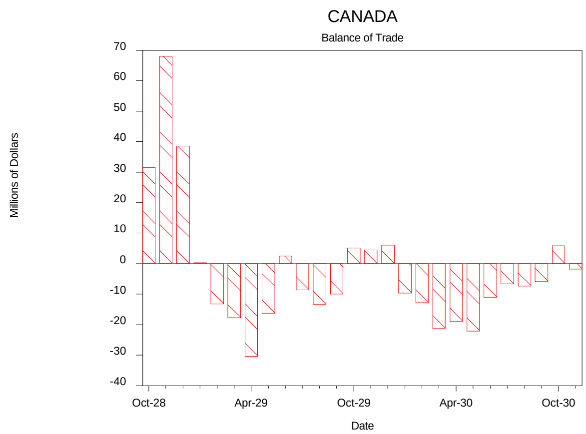
Senator Borah was originally very supportive of the "flexible tariff" concept to let a bipartisan Tariff Commission handle the affair rather than have Congress argue over every nut and bolt or green apple which was on the import list. The House actually passed its version of the Tariff Act on May 28, 1929 but in the words of Herbert Hoover, it was "not satisfactory." Senator Borah then sprung into action and turned against the bill in his traditional manner of opposing whatever administration was in power at the time. Senator Borah suddenly proclaimed that the "flexible tariff" robbed the Congress of its authority to preside over

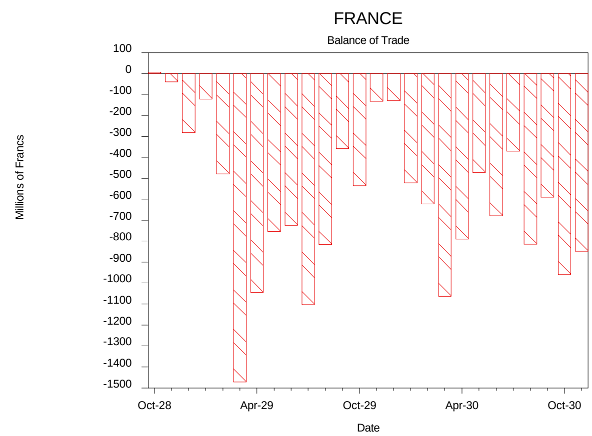
such issues and claimed that it was unconstitutional, but the Supreme Court later ruled that it was not.

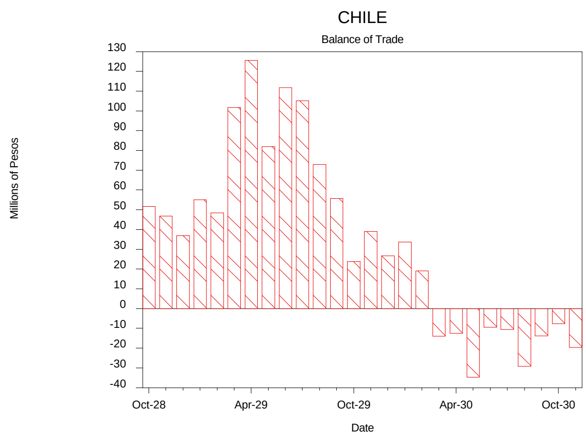
The President felt that the House bill had gone too far in raising industrial tariffs by about 8%; in his mind, the tariffs were more greatly needed in the agricultural field. On August 20, 1929, the Senate committee had reduced the industrial levy imposed by the

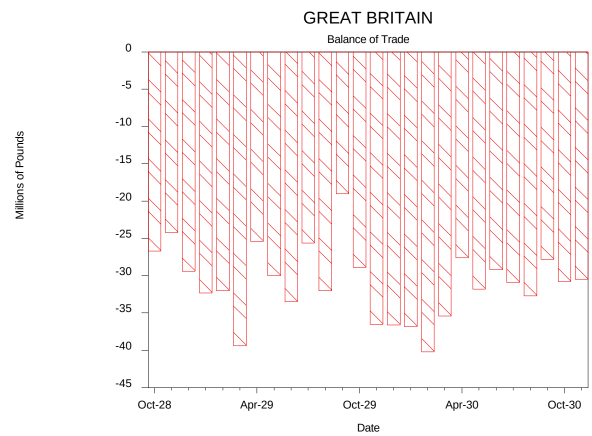

AUSTRALIA
Balance of Trade
Millions of Pounds
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
-6
-7
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date

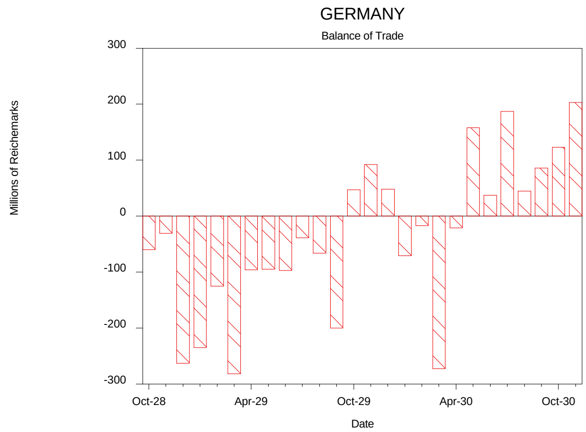

FINLAND
Balance of Trade
Millions of Markkas
300
200
100
0
-100
-200
-300
-400
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date

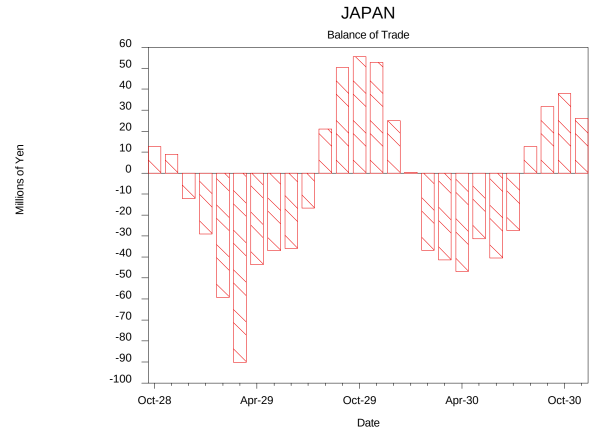

CANADA
Balance of Trade
Millions of Dollars
70
60
50
40
30
20
10
0
-10
-20
-30
-40
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date

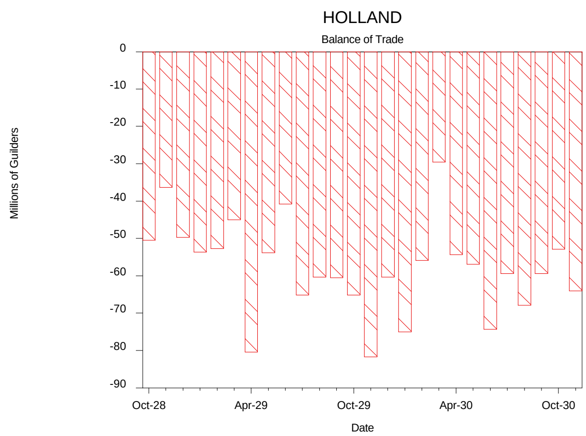

FRANCE
Balance of Trade
Millions of Francs
100
0
-100
-200
-300
-400
-500
-600
-700
-800
-900
-1000
-1100
-1200
-1300
-1400
-1500
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date

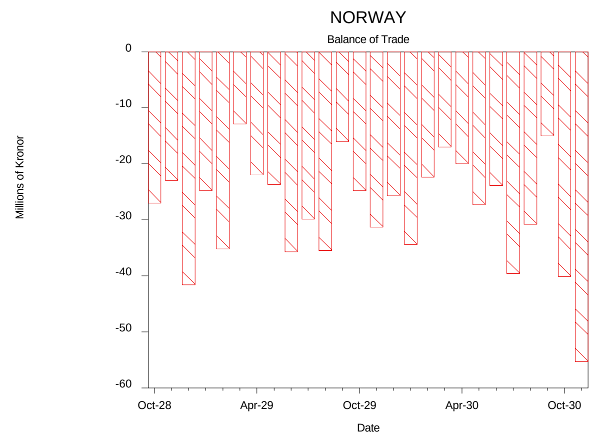

CHILE
Balance of Trade
Millions of Pesos
130
120
110
100
90
80
70
60
50
40
30
20
10
0
-10
-20
-30
-40
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date

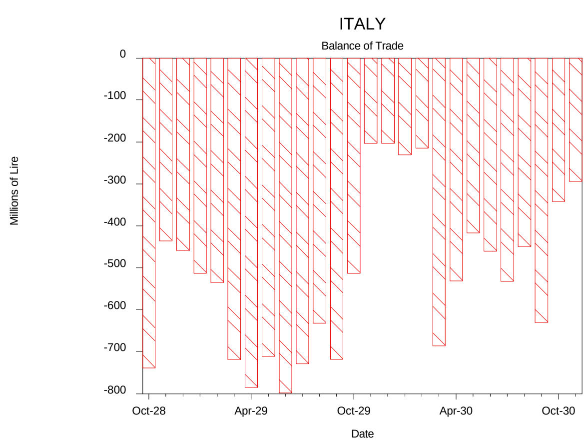

GREAT BRITAIN
Balance of Trade
Millions of Pounds
0
-5
-10
-15
-20
-25
-30
-35
-40
-45
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date

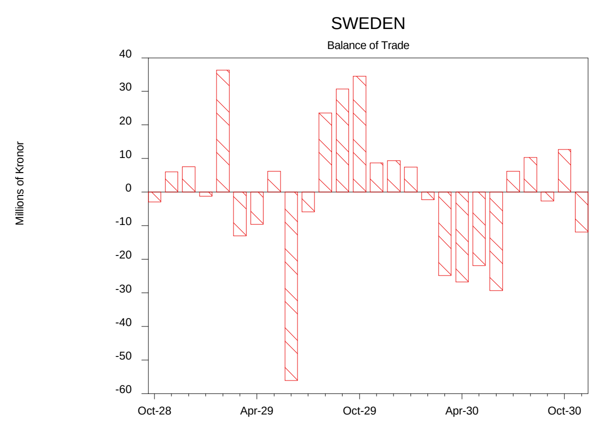

GERMANY
Balance of Trade
Millions of Reichemarks
300
200
100
0
-100
-200
-300
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date


JAPAN
Balance of Trade
Millions of Yen
60
50
40
30
20
10
0
-10
-20
-30
-40
-50
-60
-70
-80
-90
-100
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date


HOLLAND
Balance of Trade
Millions of Guilders
0
-10
-20
-30
-40
-50
-60
-70
-80
-90
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date


NORWAY
Balance of Trade
Millions of Kronor
0
-10
-20
-30
-40
-50
-60
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date


ITALY
Balance of Trade
Millions of Lire
0
-100
-200
-300
-400
-500
-600
-700
-800
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date


SWEDEN
Balance of Trade
Millions of Kronor
40
30
20
10
0
-10
-20
-30
-40
-50
-60
Oct-28
Apr-29
Oct-29
Apr-30
Oct-30
Date

House but the provisions for the "flexible tariff" had been greatly watered down.

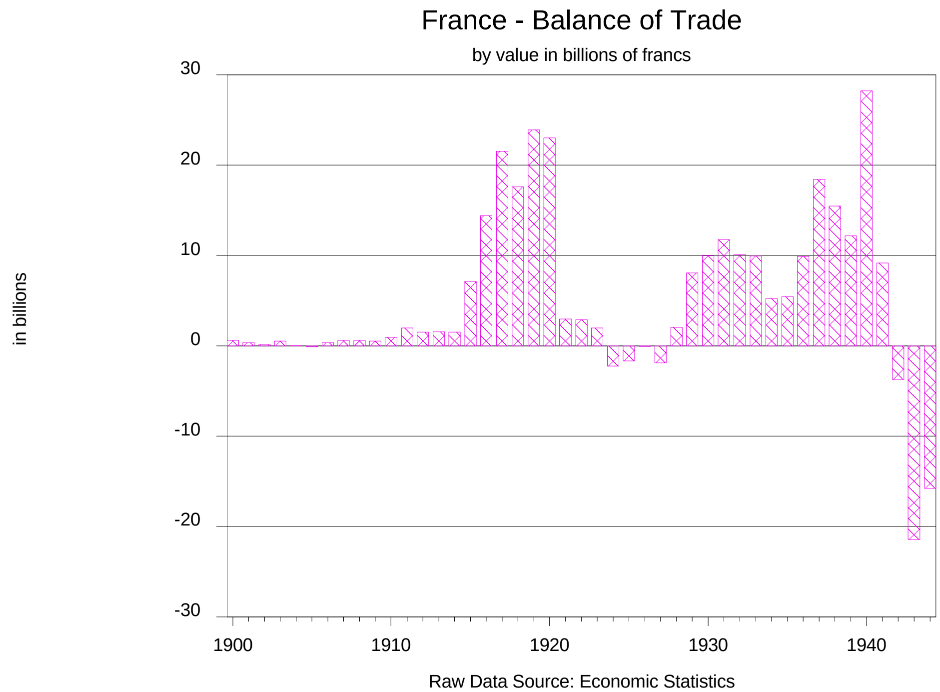
In September 1929, President Hoover appealed to the nation that the "flexible tariff" was essential. The senators, both Republican and Democrat, began to attack the President's flexible tariff. Hoover sent a memo to Senator Smoot on September 27, 1929, which stated: "No flexible tariff, no bill."

On October 2, 1929, the Senate's vote on the flexible tariff was 47 to 42 and it went down in smoke. Hoover's battle to get the tariff decisions out of Congress and into a responsible committee continued. Most of the Democrats were the very politicians who had raised industrial tariffs considerably in their bill striking Hoover's flexible provisions.

On March 24, 1930, the Senate passed a tariff bill on a vote of 53 to 31. The flexible tariff provision was again very watered down. Both Smoot and Hawley fought for the flexible provisions and in May 1930. Hoover wrote the provision that he wanted and sent it to the Hill with an ultimatum that unless his provision for a flexible tariff was incorporated, his vote would be assured.

The Democrats continued to publicly denounce the bill while behind the scenes they demanded more authority and higher tariffs on favored items. On June 7, 1930, Senator Steiwer of Oregon made a public statement in which he revealed that Democratic senators who had voted for increasing the tariff levels behind the scenes were the very ones who were publicly denouncing the bill. That helped to quiet the political statements for a while as a few Democrats appeared with egg on their face, as one would say. Finally on June 12, 1930, the Senate passed the conference report by seven Democratic votes which were needed.

The opponents of the bill began a smear tactic and the press took up the issue primarily over the levels of increases. The flexible bipartisan provisions, which Hoover had fought for so long and hard,



gained little attention. Yet in reality, the Smoot-Hawley Tariff Act was one of the most provocative reforms in the tariff process. Nonetheless, by early July, European response to the Smooth-Hawley Tariff Act was clear. Italy raised its tariffs to absurd levels, even as high as 167% on autos, which was the highest of any nation. In Britain, the bankers advocated that a tariff wall be constructed around the British Empire. France, who had been the instigator behind protectionism not merely with the U.S. but among other European nations, remarked that the new U.S. Tariff Act was "blind economy and selfish nationalism." The tariff retaliation of Europe was far more extreme than any tariffs in pre-1930 history. Ironically, the tariff issue was made up to be far worse than it was by the opponents who exaggerated the bill prompting overreaction on the part of many nations.

On June 15, 1930, President Hoover issued a detailed analysis of the Smoot-Hawley Tariff Act. In his memoirs, his detailed analysis is provided. The President stated: "A statistical estimate of the bill by the Federal Tariff Commission (bipartisan) shows that the average duties collected under the 1922 law were about 13.8 percent of the value of all imports, both free and dutiable, while if the new law had been applied it would have increased this percentage to about 16.0 percent."

The Smoot-Hawley Tariff Act concerned itself with a total of about 3300 items. Of this, 890 items were raised in respect to the amount of tariff to be collected, 235 were decreased, and 2170 remained unchanged. Therefore, the total number of items which were increased represented 27% of all dutiable items.

Over the next two years, Hoover's Tariff Commission reviewed some 250 industrial items and changed the rate of tariff on 73 of those items. The majority of those changes were steps to lower the tariff rate. Nonetheless, on a percentage basis, tariffs ended up rising, due in part to serious fluctuations in foreign exchange. The Tariff Commission was backlogged as Roosevelt suggested in the 1932 campaign. But this backlog actually began within a matter of days. The opponents of the bill immediately besieged the Tariff Commission by dumping upon its doorstep over 50 items to be reviewed before July 1930, in an effort to destroy the Commission before the President could even reorganize and set the Commission up to comply with the law. Despite this, it was a sound concept to establish a bipartisan committee to take control of the tariff issues and take them out of the Congress where special interests had a much more profound influence. Had the serious price fluctuations and the devastating foreign exchange movements in combination with the general instability and lack of confidence in the system not taken place simultaneously, the concept may have worked under more stable conditions.

In the end, the propaganda largely propelled by Roosevelt during the 1932 elections has left a mark on our perspective of the Great Depression and the events which led to its creation. Undoubtedly the trade war was one contributor but that trade war had begun long before the Smoot-Hawley Tariff Act was signed by the President. That unfortunate distortion lives on in our perception of how to manage world trade. Trade must be fair. Regardless of tariffs or quotas both measures seek the same end. But the world must realize that government subsidized industries abroad are a violation of free trade and for any nation to take steps to counter that unfair trade practice is not protectionism but self-defense which must be addressed. To sidestep such practices will in the end create another trade war when conditions reach critical levels. Free trade is precisely that. Protectionism is an act which raises tariffs or quotas to protect an uncompetitive industry. But to enact tariffs or quotas against industries which are not government subsidized in another nation so that they can undercut that industry in trade is an unethical means to remain within a proposed free trade world society.

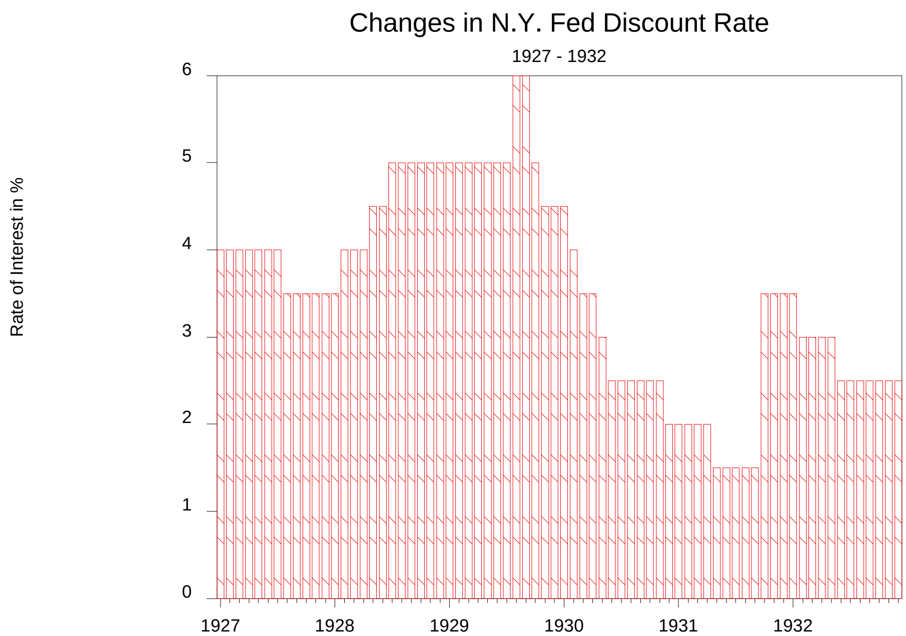
During June of 1930 rumors began to increase of massive "bear-raids." These were supposedly groups of big investors who would sell one particular stock short. These rumors were for the most part proven to be false when the Senate proceedings in later years disclosed the short interests. Nonetheless, when a market moves in one direction or another the rumors must always spread crediting some powerful individual or group for the action. The truth is always that when broad markets move it is the masses that control the trend not a selected few.

June 1930 also began to show a trend which would become one of the most serious by-products of the economic convulsion. In a single week in early June 15 banks closed their doors. The event was reported by the general press but it was certainly not front page news at this time. Here is how Time magazine reported the failures in the June 23 edition of 1930:

"Last week there were 15 less banks in the country. This shrinkage was caused by:

FAILURES. A period of economic stress and strain is always ominously punctuated by bank failures. Ten banks last week closed their doors. Some were small, their failure consequently significant only to the immediate neighborhood. Of more general importance were the following:

"CAUSE: Heavy withdrawals. EFFECT: Bank of Bay Biscayne in Miami, oldest bank in Southern Florida and three subsidiaries failed to open their doors. The four banks had aggregate deposits of over $19,000,000.



To meet possible runs on other Miami banks the Federal Reserve Bank of Atlanta rushed $2 million cash down by airplane announced that $6 million more was en route.

"CAUSE: Allegedly bad Western loans. EFFECT: closing by State Banking department 'for inquiry' of Merrimac River Savings Bank, Manchester N.H. with deposits of $11 million.

"CAUSE: Amos W. Shafer. EFFECT: closing by State Banking Department of Cincinnati's Cosmopolitan Bank & Trust Co. Mr. Shafer broke the bank single-handed. As district manager of Henry L. Doherty & Co. Cities Service specialists he used the firm's account to make away with $632,000 which was within $14,000 of the bank's capitalization."

The story was not altogether that dramatic and it was buried on page 48. But this was a trend that was becoming more noticeable and served in itself as one reason the market would fall in the years ahead as bank failures began to reach the front page. But it should be noted that the famous "banking holiday" when both the exchanges and banks were closed nationwide did not take place until Roosevelt took office in 1933. Massive bank failures were not the fundamental which began this severe decline in 1929 or from the recovery in early 1930. Banking failures began to attract news during the fourth quarter of 1930. However, the majority of those failures were still confined to the Midwest as the by-product of declining commodity values and real estate-backed loans.

During June 1930 banks were in Washington pleading their case for branch banking in front of the House Committee on Banking and Currency. Charles E. Mitchell, famed director of the National City Bank in New York made his case that the small bank was more efficient as part of a large bank, rather than as a small independent. But the House opinion still ran high that mergers meant a monopoly as Mitchell responded: "Banking is not a business which can be monopolized." The hearing would continue for years over this issue as is normally the case in Washington. Eventually numerous banks failed because of the weakness of the small independent bank. Government's concern of monopolies in this area led to hundreds of bank failures in the years that followed.

By the end of June many stocks had fallen to reach near or below the lowest levels of the panic of November 1929. Du Pont was trading at nearly 10 points under its November low of $109. Mack Truck was trading at $46 against its November low of $55. Even AT&T was trading at $201.25 which was close to the November low of $197.25. On June 30 Time magazine commented upon the market as follows:

"Lowered money rates and reduced brokers loans had no effect. It was generally felt that bear operators were ready and able to force continued lows during the present week. Basic cause of the market weakness was the continued fall in commodity prices. Nearly every basic commodity was selling at a lower price than during any other post-War year and some of the most deflated were going back to the beginning of the 20th Century."

Commodities continued to fall. At the end of June silver was selling for 33.7 cents, silk $3.25 per pound, sugar 1.27 cents per pound, rubber 11.75 cents per pound and zinc at 4.37 cents per pound. All five of these commodities were at new lows for the 20th century.

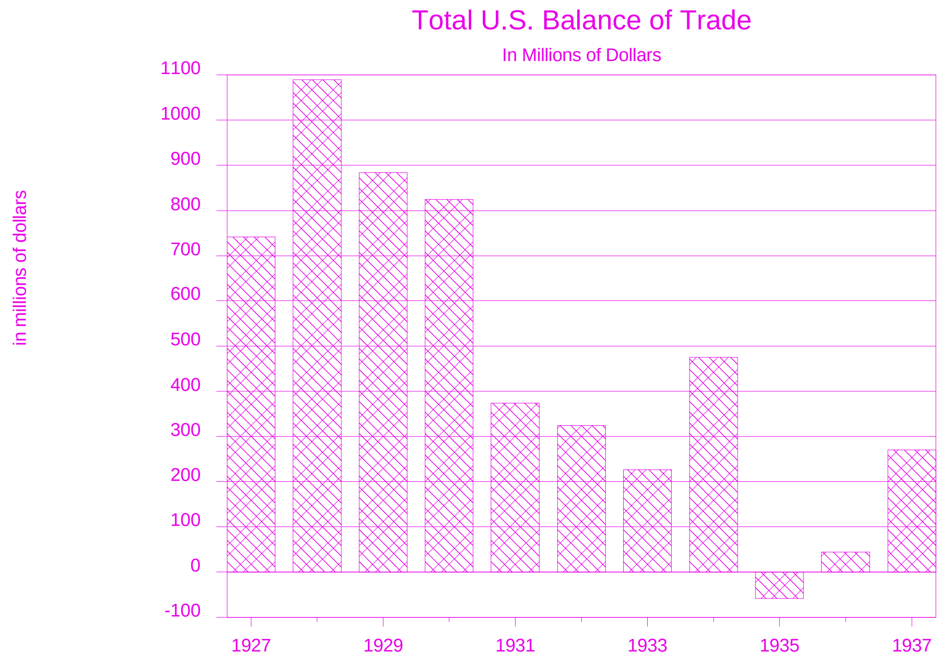
As the second quarter of 1930 came to a dreadful close the consensus of opinion remained well divided. Economists were increasingly pessimistic while many stock market analysts claimed that the November low had held on the broad market ignoring individual exceptions and that the market would turn back up. No matter whom you chose to ask the opinions that were offered were merely speculations in themselves.

As the third quarter of 1930 made its grandiose entrance the market jittery were still alive and well. Not all entrepreneurship had been lost at this point; there were still some brave souls willing to take a chance on the market as well as in business.

Around the beginning of July 1930 a purely American financed enterprise introduced a new American car. It was the Austin named after the British gentlemen Sir Herbert Austin. The car was shockingly different from those other American monstrosities. It was only ten feet long or in other words 28 inches shorter than anything else produced in the States. The Austin was produced in several European nations and over there size was traditionally maintained "small" for several reasons. First and foremost the European governments taxed automobiles upon a size and weight basis. Naturally the smaller and lighter the car the less tax you had to pay. Personal income was not nearly as high in Europe as compared to the States. Therefore European car drivers were also traditionally more economy conscious. The Austin sales were reasonable at first but far from a major threat to G.M., unlike the V.W. beetle in the 1960s.

One of the seldom known facts of the period was that the former President Calvin Coolidge began writing a syndicated daily newspaper article for the press at this time. He began his first column with this note, finally breaking a long-standing period of silence upon the events which were beginning to engulf the world:

"We need more faith in ourselves. Largely because of some decline in trade we have



set about finding fault with nearly everybody and everything. Yet our government our physical properties and our industries have changed very little from a year or two ago when people were fairly content."

Time magazine commented that Coolidge's remarks were "an understatement" as far as "some decline" in trade was concerned. Time was absolutely correct. Bank clearings for the first six months of 1930 according to Bradstreet (later known as Dun & Bradstreet), were off by 16.9% in New York City 14.9% for the nation and 15.9% in Canada. This meant that the velocity rate of money changing hands was declining noticeably. Hoarding of gold coin began to increase by late 1929 as the government stopped issuing new gold coinage of any significance.

The gold coin production in the United States began to come to a screeching halt which only served as a catalyst to further spur onward the trend of hoarding gold.

The production figures for the $20 gold piece were as follows from 1916-1928.

$20 U.S. Gold Coins Minted

1916	796,000	1923	2,268,250
1917	- 0 -	1924	10,300,500
1918	- 0 -	1925	9,546,750
1919	- 0 -	1926	3,339,250
1920	786,250	1927	6,233,750
1921	528,500	1928	8,816,000
1922	4,033,500	1929-33	Minted, not released

*Coins dated 1929-32 bring 10X to 30X pre-1929 gold coins which were in general circulation.

The above table of $20 Double Eagle gold coin production seems to correspond to various economic events as well. Notice that 1924 production was nearly a 5-fold increase above that of 1923. The U.S. trade surplus jumped up 44% in 1924 above that of the previous year which was the single greatest increase during the 1920 era. The trade surplus peaked during 1925 and gold production began to decline thereafter. The trade surplus bottomed during 1927 and then rose nearly 10% during 1928. But

from that 1928 peak in the U.S. trade surplus, it fell nearly 60% going into 1932 and gold coin production came to an abrupt halt.

Another report was released about this time which illustrated a very curious aspect which had taken place during the second quarter. The number of U.S. Steel stockholders had actually increased by 5,557 between the end of the first and the second quarters of 1930. During the bull market on June 30, 1929, U.S. Steel had a total of 105,612 stockholders. Yet at June 30 1930 U.S. Steel had 129,626 stockholders!

After reviewing many of the top companies I found that what had taken place during the recovery period and into May of 1930 was strange indeed. Much of the buying had taken place with an unusually higher proportion of odd-lots. This meant that small investors had gone along with the optimistic attitude which had dominated the beginning of 1930. The buying had actually begun to shift with many of the big players fading away after being wiped out in November 1929.

On July 14, 1930, Time magazine reported several various opinions which had been published concerning the market. They were as follows:

"Hardy indeed is the prophet who will be definite in his predictions for the immediate future. Bertle Charles Forbes who stoutly maintains things have gone far enough, last week said July income can be invested now 'with every confidence.' He predicted: 'The turn of the year will mark the turning point.'

"Guaranty Trust Co. of New York in its survey wrote: 'Recent developments do not brighten the outlook for a marked upturn in the early future...With few exceptions current reports continue to point to further

recession in industrial output and trade volume.'

"U.S. Representative Louis T. McFadden of Pennsylvania, vociferous chairman of the Banking & Currency Committee, made a dire prophecy of much lower price levels even hinted at anarchy and revolution, insinuated that vast machinations by J.P. Morgan-directed group are to blame for everything.

"The Department of Agriculture anxious to reduce wheat acreage came out with a lengthy report of which the essence was: 'While improvement is expected over the low level of prices in the past month, the present prospect is that world wheat prices during the next seven years will average appreciably lower than in the past seven years.'"

One thing that was certain was this. Earnings were declining as illustrated by G.M., which posted an estimated $100 million in earnings at this time compared to $151 million for the same six month period during 1929. Chrysler cut wages by 10% and in Flint, Michigan, tension continued to build after the State Troopers fought off striking employees at Fisher Body Division of G.M. Some wages were reportedly cut sharply, bringing the daily earnings of women employees down to $1.20 per day.

The business commitments given to Hoover at the end of 1929 were voluntary. Although this was a sound and sensible approach, the contraction in economic activity had a mind of its own. The increased Federal and local government spending had little effect. Consumer confidence was declining as gold hoarding rose. Business could not live up to its promise not to curtail spending or cut wages. The reality of a contracting economy was forcing corporations to cut wages or collapse itself.

Many technicians had recalled the various other panics which had taken place in 1907 and 1920. In both cases the decline was approximately 50% from the actual peak in the market. Here the stock market had come close to that 50% correction mark. This led many analysts to believe that the worst was over and that indeed a new base would be built during 1930. Some pointed out that the worst was over back in 1920 within 130 days of the top. The similarities which were drawn between the 1920 collapse as well as the collapse in 1907 were in fact a logical scenario. But then again people tried to compare the 1929 collapse to the mid-1970s and again to the 1982 period. They were wrong in their parallels then as they were wrong about the parallels in 1930 with those of 1907 and 1920.

In Washington hearings on the merger of Standard Oil Co. of New York and Vacuum Oil Co. were raging onward in heated debate. In defense of the merger, SOCONY (Standard Oil Co. of New York) illustrated that in 1909 it sold 92% of all oil in New York and New England. It illustrated that its share in 1929 was only 23%. Since the government broke the Standard Oil Co. of New Jersey into separate companies under anti-trust powers the government continued to reign over the oil industry with an iron fist.

The government called oil men from all over to the hearing to try to prove their case. The prosecutor was the Assistant U.S. Attorney John Harlan Amen. He put Albert C. Woodman who was president of Richfield Oil Corp. of New York on the stand. Amen questioned him asking: "Is your company influenced by the prices established by SOCONY?" Woodman replied: "We are

What is the

Key to Successful Investing?

Why Do Some Men Accumulate Wealth More Readily Than Others?

Experience covering more than a quarter of a century gives this answer:—Behind every record of successful investing you find a continuous working plan.

With the right plan success is assured!

Babson clients have been successful. Year after year clients make consistently large profits through careful adherence to our "Continuous Working Plan." It is a complete and forward looking plan, offering conservative investors a sound, constructive, profitable investment program for the future.

The future will see a changing complexion of stock market values as has the past. As in 1929 certainty and uncertainty will again compete in an attempt to dominate public opinion. Which side will you be on?

Those investors who are on the right side will capitalize the certainties, and many will accumulate large fortunes. Even the investor with moderate capital has a chance to profit handsomely.

To capitalize on these certainties you need Babson's Reports and our "Continuous Working Plan"—the key to successful investing. The sole aim of this plan, devised from an experience of more than twenty-five years of investment leadership, is to help you make money.

Send for Booklet

Send today for this plan, probably the most remarkable one ever written for investment success. It is comprehensively outlined in our booklet, "Bigger Investment Returns." The coupon will bring your acquaintance copy without cost or obligation.

"Be Right with Babson's"

The Babson Statistical Organization,
Div. 96-11
Babson Park, Mass.

Send me free, and without obligation complete information and your booklet "Bigger Investment Returns."

Name ....

Street ....

City ....

State ....

Largest Statistical Community in America

not influenced by SOCONY any more than by half a dozen other companies." Amen continued: "What company is dominant in the New York and New England field? Woodman replied again: "No one company is dominant!"

This trial would become a long one. Government was simply not willing to give in. The government called gasoline station attendants from New York to New Hampshire to testify. The defense cross-examined and questioned whether these attendants knew who was the largest oil company and most didn't really know. What was clear was that government was not about to give away its powers of anti-trust now or ever.

In California a gasoline war was raging between the Standard Oil Co. of California and the independents. The war became so heated that at times some gasoline stations were literally giving it away for free. On July 12, the Standard Oil Co. of California made a public announcement. "Effective Saturday morning July 12, at the opening of business, the Standard Oil Co. of California will restore its prices for gasoline to levels prevailing prior to the beginning of the so-called price war. The Standard Oil Co. of California announced as a policy that it will not sell its products to the dealer who cuts his prices."

In the banking industry rumors continued to spread concerning the repeal of the branch banking. Many stock players were looking for suspected mergers and take-overs from which to profit by when the repeal came. Rumors circulated that the Melbank Corp. of Pittsburgh (Mellon family) was lining up at least 50 banks to acquire. The stories told that the second largest bank, Peoples-Pittsburgh Trust Co., had lined up another 25 banks. The stocks

of banking operations were hot at this time, which accounted for helping the stock market's pause from the June low. July continued to edge higher and finally closed at 233.99 on the Dow Jones Industrials up 12.6% from the June low of 207.74.

By now the gossip over the resignation of Waddill Catchings from Goldman Sachs over the Shenandoah and Blue Ridge investment trusts had died down. Previously in June, this issue had sparked a lot of fears. The Blue Ridge fund had peaked in 1929 at 29 5/8 and fell to 3 1/2. The Shenandoah fund dropped from 39 3/8 to 6 7/8. This naturally hadn't provided a lot of good will for the firm at the time and it increased rumors of massive selling by more investment trusts. What had happened was that in the heat of speculation, investment trusts were bid up far beyond the asset value of the trusts themselves. The same thing took place during the mutual fund boom of the mid-1960s. As a result the losses of many investment trusts far exceeded those on a percentage basis of their composite stock holdings. This is an important note that investors should keep in mind. A mutual fund whose share value is based solely upon assets rather than speculative demand is the wiser investment for the mutual fund buyer.

At the end of July the press carried the interesting comments of Franklin D. Roosevelt who was Governor of the State of New York at the time. After an inspection tour of the State insane asylums he proceeded to make a public statement. It was picked up by Time magazine as follows: "Unemployment and worry over economic circumstances are helping to break down mental stability." Apparently, F.D.R. attributed the abnormal increase in the number of institutional patients to the break in the economy.

As early August approached the U.S. shipyards reported that they were at their busiest level since 1921. Their employment roles were moving counter to the economic trend. In July 1930, shipyards employed 19,812 men, which was a 21% rise over and above that of July 1929. The amount of tonnage under construction was up almost 100% over 1929 levels. But the U.S. was merely gaining some business on a worldwide basis. They were second to Britain in shipbuilding but that was only a 7.8% share. Britain held 45.5% of that market. The increased employment in shipbuilding was a direct result of Hoover's policies to increase government spending.

Second quarter reports began to emerge at this time. AT&T turned in an impressive report which showed an earnings gain of $14 million over and above the first half of 1929 with a net improved bottom line of $1.5 million. They also reported that they had added 165,000 new phones during the first half-year of 1930.

General Electric reported that sales were up $3 million from 1929, but on a $197 million sales level it was a very small percentage gain. But what made it worse was that their expenses rose, reducing their earnings from $1.07 to $1.02 per share.

One of the nice performers was American Chain Co, Inc. They reported net profits of $1.2 million for the first half of 1930 compared with $1.03 million for the same period in 1929. Earnings per share jumped up from $2.63 in 1929 to $3.30. The chain store business on a retail level was still alive and well.

The most dramatic rise was that of the Great Atlantic & Pacific Tea Co. which many know as the A&P food store chain. They had 17,000 stores in operation, which combined posted sales of $548 million for the first half of 1930. This was a rise of $41 million, an 8.13% increase over and above the first half of 1929.

Campbell Soup Co. announced that it had sold 2.3 billion more cans of its tomato soup during its fiscal year ending June 30, 1930 than during 1929.

William Wrigley Jr., Co.(Wrigley Gum) reported that its first half of 1930 posted earnings of $5.6 million, which were up $436,000 over 1929. American Chiclet Co. also reported earnings of $1,081,000 against $1,039,000 for the previous year.

It was clear from these reports coming in that the consumer had not yet stopped the pursuit of retail items. Perhaps the automobile had reached its saturation point in 1929. A viable used car market was developing as well which obviously cut into their sales following the peak of 1929. But on the whole, the average consumer was still buying the necessities such as food and clothing along with the lower priced non-luxury goods.

August remained essentially a sideways affair. During the first two weeks the market tended to press lower. News was still mixed and many felt that the June low would hold. During mid-August McGraw-Hill's "Engineering News Record" publication reported that engineering construction was off 17% nationwide. The survey was conducted on a sectional basis. The New England States showed virtually no decline whatsoever. But the Midwest particularly hard hit by the continued decline in commodities showed a 42% decline in activity. Another building industry statistician and trade publisher reported in August with their survey that in 37 states east of the Rockies a decline of 44% from July 1929 had taken place in construction.

Time magazine also reported in August that unemployment in the building industry was currently running 37% compared to 16% during 1929. Time commented on the situation as follows: "Chief reason for the decline in construction is that money, while cheaper for many purposes, has not been diverted back into mortgages as predicted. Interest rates on first mortgages are still 5.5% to 6% while seconds must yield at least 7%. Yields on 15 private building bond issues during June averaged 6.2%. Banks and building & loan societies are reported to be loaded up with property acquired through foreclosure the construction field is considered 'overbuilt' except for special buildings."

Apparently despite the decline in rates banks were still maintaining high rates on mortgages. Due to the sharp rise in short-term rates during 1929 banks had gotten burned severely in the real estate long-term loans. As a result they would be reluctant to return to long-term mortgages until the late 1930s.

The Harriman National Bank & Trust Co. issued a bulletin which it distributed to its patrons. The commentary is interesting and offers a little insight into the feelings of the time. They made the following statement:

"Merely being burdened with an incompetent incapable Senate gives us no reason for lamenting over our condition. Should we give as much care in attending the coming primaries and selecting proper, intelligent representatives for Congress as we do in selecting even our golfing and fishing outfits, that too, may be remedied. Fundamental conditions in America are safe and sound."

Indeed the majority of market analysts began to turn bullish during August of 1930.

The June decline had been sharp and severe; there was no mistaking that whatsoever. But it held the previous low! they argued heatedly. In Collier's, a well-read publication at the time, Col. Leonard P. Ayres of the Cleveland Trust Co., wrote his comments upon the situation: "Now arises the emotion of fear. Things were (last spring) brighter looking than they were. Now they look darker than they are. This is the last phase of the depression!"

In August Roger Ward Babson known by many as the "Prophet of Doom" since his correct call of the top in September 1929, issued his first buy signal. He made several recommendations of a variety of most active to best yields. Barron's ran a nasty article which took a shot at Babson asking if this prophet was able to foresee the decline then why didn't he have the power to prevent it as well. Nonetheless, Babson and Ayres were joined by Thomas B. Macaulay, President of Sun Life Insurance Co. Macaulay's statement was carried by Time magazine which called it the most "bullish utterance yet heard from a responsible financial rather than a political source." Macaulay's statement was: "I think by the end of this year selected common stocks of the type we have in our portfolio will on the average have regained in market value 60% to 70% of the loss sustained last autumn. By the end of 1931 or at any rate of 1932, I expect the average to have perhaps even attained the 1929 peak again."

As August come to an end the market rallied and closed at the July high. The holiday cycle seemed to be at work during 1930 as well. The market had fallen sharply in June and then after the July 4th holiday it had begun a rally. Now as Labor Day approached it was nearing the highs for this cycle. The market closed quite bullish going into Labor Day. But after the holiday the market pushed a touch higher peaking at 247.21 on the 10th of September before beginning its decent.

In September 1930, Russia was selling large short positions in wheat on the Chicago Board of Trade. The Soviets at this time were a net exporter of wheat which further helped to depress the price of agricultural commodities. The Soviets in need of hard currency were actually rationing food at home and selling much of their supplies in the Western markets. Hoover disapproved of the Soviet short sales and demanded that the Board of Trade prohibit short transactions by foreign governments. The Board of Trade was reluctant to go along with this proposal and Hoover threatened Federal control. The Board complied. Russia then turned and dumped its wheat in Europe driving the prices down several cents a bushel.

September collapsed with the market dropping and closing near the low of the month at 204.90. October managed to rally briefly, but then the selling pressure was too great. Down it fell closing near the low of the month once again but this time it was under the magic 200 mark finishing at 183.35 on the Dow Jones Industrials. October had violated the November 1929 low. There was no doubt about it. A bear market was still in place.

The news which broke the back of the market was persistent. During the first six months of 1930, 471 banks had failed taking with them $210 million in assets. It was reported that 62 were members of the Federal Reserve System. Most of the bank failures were small independents suffering from declining real estate backed loans largely in commodity oriented sectors of the nation.

In addition to the banking news, failure among brokerage houses seemed to have a more profound impact upon the market. That was the case on the day that the market penetrated the 1929 November low. Time magazine reported the events as follows in their October 13, 1930 edition:

"All Monday Wall Street was flooded with rumors that a house would fall. Tuesday morning stories of pending insolvencies were thicker, more persistent. At 1:30 President Richard Whitney mounted the rostrum of the Exchange. Trading was supplanted by a tense silence. Then an excited roar greeted the announcement that J.A. Sisto & Co. Inc. were unable to meet their engagements. Selling pressure increased. By the close of the market 34% of the common stocks listed were at least 20% below their old 1929 bottoms while 59% touched or dipped under that level. Thus was greeted the first notable failure of the year. On the Curb from which the company was also suspended support was practically withdrawn from stocks identified with Sisto."

A severe drought in the United States began in August 1930. Throughout the Midwest and the South, nearly 1 million farm families were affected, in addition to nearly 20 million animals. The initial crisis created a severe shortage of feed for the animals. Hoover arranged for the railroad freight rates to be cut in half for foodstuffs shipped into the stricken area. The drought merely became worse and turned much of the Midwest into a dust bowl.

The freight traffic on the railroad system dropped sharply. In October it was reported to have reached a ten-year low. The Chairman of Continental Illinois Bank & Trust came out in October with his prognostication of the economy. "The fact is that

While all the worrying is being done over business the improvement is already under way. I should not be surprised if by the middle of December we find conditions considerably improved."

The unemployment situation was not fading away. On September 9, 1930, President Hoover took steps to curtail immigration in the United States. All immigration was stopped with the exception of tourists, students and professional men and women. A large number of people were still attracted to the United States and many remained unemployed. In 1929, 279,678 immigrants entered the United States. In 1930, 241,700 had entered. Hoover's measures brought this down to 97,139 for 1931 and 35,576 for 1932. The Labor Department was also instructed to rigidly enforce the laws against illegal aliens and in 1930, 16,631 deportations were made. This measure continued, resulting in 18,142 deportations in 1931, 19,426 in 1932 and 19,865 in 1933. This policy was reversed by Roosevelt and deportations declined to 8,879 in 1934.

At the American Bankers association meeting held that October, members retreated from their position against branch banking. But they also released their statement upon the economic conditions. "The depression in this country is merely part of a world-wide situation due largely to the sharp decline in the price level of raw commodities. There are evidences that the present depression has just about run its course."

The New York Times published a survey of corporate dividends. There had been 91 companies which failed to pass a dividend to their shareholders. But the general trend seemed to refute the whole concept of a depression. Prior to the peak in 1929, dividends had played a sizable role in forging the market substantially higher. Yet here we find that the tactics of many companies included passing dividends which were perhaps unwarranted. Nevertheless, the New York Times composite of dividends on an industry by industry basis illustrated that 1930 dividend levels were by and large above those during the raging bull market. Clearly, upon reviewing this list, one must give second thought to dividends as being a reliable factor in a marketplace. The pessimism had actually reached such heights that it didn't matter how much a company was paying or earning. All that mattered centered around the pessimism that basically asked how long could they continue to pay?

The table published by the New York Times in October was as follows:

DIVIDENDS EXPRESSED IN MILLIONS
First 9 months each period

	1930	1929
Banks & Insurance	222.3	108.2
Chain Stores	85.8	49.0
Coppers	144.6	110.0
Department Stores	22.3	16.5
Food & Packing	195.5	106.7
Mail Order	21.5	10.0
Motors	161.1	167.2
Oils	349.1	241.9
Public Utility	730.8	448.8
Railroads	376.2	308.3
Rail Equipment Prod	41.9	40.8
Steels	146.2	100.7
Tobaccos	75.2	61.8
Misc	995.4	603.0

The above table clearly illustrates that even on an overall basis dividends were higher. Many industries were not yet feeling the pain of the depression as consumer spending did not apparently drop off that sharply at this point in time for some while others passed higher dividends in an effort to support their stock values. The rising dividends did attract some small investors buying for cash. This is supported by the fact that the number of shareholders of blue-chip companies was rising during the 1930-1932 period despite the decline in share value. But this is also a valid reason why foreign investors were also attracted. As the dollar rose in 1931 its appreciation helped to offset the decline in share value in terms of dollars while in terms of pounds, stocks still appreciated. The crisis seemed to loom largely among the "educated" U.S. classes of professional investors in respect to the markets.

The decline in the stock market definitely appeared to be highly influenced by the withdrawal of foreign capital. This thereby depressed the financial markets which had a lagging effect upon the economy. As the trade surplus continued to decline, this further increased unemployment and gradually affected the confidence of the working class as well. But the real drain upon the emotion of the nations was certainly the stories of failures and bank closings.

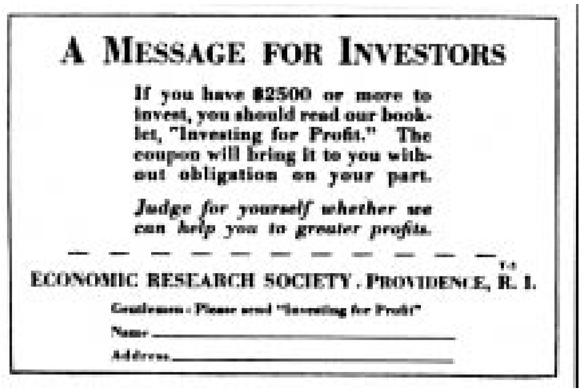
During November the market continued to press lower as 64 banks in Arkansas either failed or invoked a State law permitting them to close for five days. In the whole state there were but 437 banks at the end of 1929. In Kentucky 15 out of its 579 banks failed. Most of the failures were directly related to commodities as the prices in that category continued to decline.

The Dow Jones Industrials pressed lower still during November. December brought little relief as the market continued its decline, dropping to 158 and closing the year at 163. By the first week in December the New York Stock Exchange had suspended its seventh failure of a member. But up until now the majority of bank failures had been in the Midwest. But in December the Bankers Trust Co. in Philadelphia failed taking with it $55 million in assets. At last the banking failures were coming closer to Wall Street. The Dow Jones Industrials closed 1930 at 164.58 down 57.5% from the intraday high of September 1929.

But of all the banking failure stories perhaps the most distorted incident was the trouble at the Bank of the United States. It has been a popular legend that what started or contributed to the depression was the failure of this bank whose name many mistook for the Treasury. There was some hysteria but no one with half a brain believed that it was the U.S. Treasury. By December, the first 11 months of 1930 had brought with them 981 bank failures. Despite the fact that most were in the drought stricken commodity area tension had built as public confidence had continued to deteriorate.

In Bronx N.Y., a small merchant went down to the branch of the Bank of the United States and asked officials if they would buy back stock in the bank. The officials told the man to keep the stock because it was a good investment. The merchant somehow misunderstood what the bankers had told him and turned it around in his mind that it was a refusal to buy back the stock on the part of the bank.

By mid-afternoon the merchant had gone around telling everyone that the bank refused to buy back his stock and that obviously something was wrong. With news of numerous bank failures in the Midwest it didn’t take long before the citizens in the Bronx believed that the bank of the United States was about to fail. A sizable run on the bank broke out that same afternoon and the police had to be called in to restore order. The bad news spread like wildfire to all the other branches of the bank.



The run on the bank of the United States had become so widespread spawning absolute chaos that that same afternoon an emergency meeting of all the major New York bankers took place on the tenth floor of the New York Federal Reserve building. But in reality the run on the bank had actually begun in a quiet fashion several weeks prior. Rumor had it that the Fed was trying to set up a merger for the Bank of the United States with three other banks. Just two days prior to the run it had been announced that the third attempt to merge the bank had failed.

The emergency meeting of 100 banking executives brought back memories of the Panic of 1907 when a similar meeting had been held. Everyone from Mr. Lamont. of J.P. Morgan to Charles Mitchel of the National City Bank was in attendance. The meeting was held in the Governor's Room and it continued until 4 a.m. before it completely disbanded. The reporters were trying to stay awake hoping to grasp the first comment on the situation. Then Joseph A. Broderick, Superintendent of Banks in New York State came forward and told the reporters that he would have a statement in the morning. Everyone knew what that announcement would be. The bank had failed!

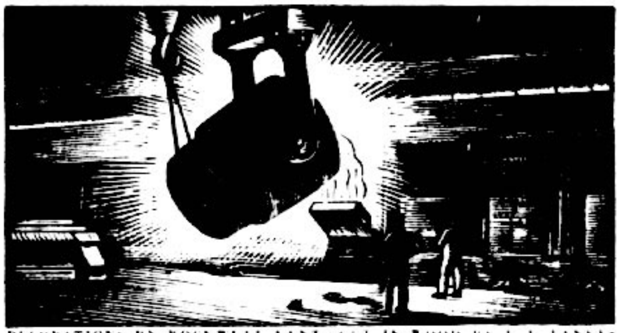
It was the European press that blow the entire affair way out of proportion. The ill-fated name of the Bank of the United States was equated in size and statue to the Bank of England which of course was "THE" central bank of Britain. But outside the Bank of the United States nervous depositors had been lining up since 7 am waiting for the bank to open. Of course the doors failed to open that day.

The banking industry insisted that the bank of the United States was merely a small state bank which had too many outstanding loans tied up in real estate. Its insolvency was further fostered by the outstanding loans to members of the fur trade.

On the New York Stock Exchange some nervous selling ensued but this was largely focused among the banking stocks themselves. Had that merchant been able to sell his stock the day he began the run he could have fetched about $11.50 a share. By the close of that same day he would have been lucky to have obtained $3. At the peak of speculation in 1929 shares of the Bank of the United States had once traded at $240 a share.

Thus ended the year 1930. Confidence among the "financially unaware" was beginning to crack and crack hard indeed. The lack of confidence would continue to spread gradually into 1932 bringing with it the demise of the world economy itself.

Selecting . . Industrial Investments



DECORATIONS BY ROCKWELL KENT · CUT IN WOOD BY J. J. LANKES

EIGHT years from 1919 to 1927 witnessed an increase in the horsepower used in manufacture of more than 9,500,000 and the annual value of manufactured products in 1927 was more than $718,000,000 above that for 1919. During the same period, however, there was a decrease in manufacturing establishments of more than 22,000.

During this period of great industrial expansion, many investors reaped an immense and virtually unparalleled profit, while others, less fortunate or less accurately informed, made no profit or suffered an actual loss.

In the year 1927, when the total of manufactured products was more than $62,718,000,000, nine of the sixteen "billion dollar" industries showed an actual decrease in production under 1925. Even in the industries showing the greatest loss, however, some companies showed a decided gain, both in production and in profits.

Interpretation of these figures shows the need of constant supervision of industrial investments. For while the gains have continued and will continue, the leaders of one period are not necessarily the leaders of another.

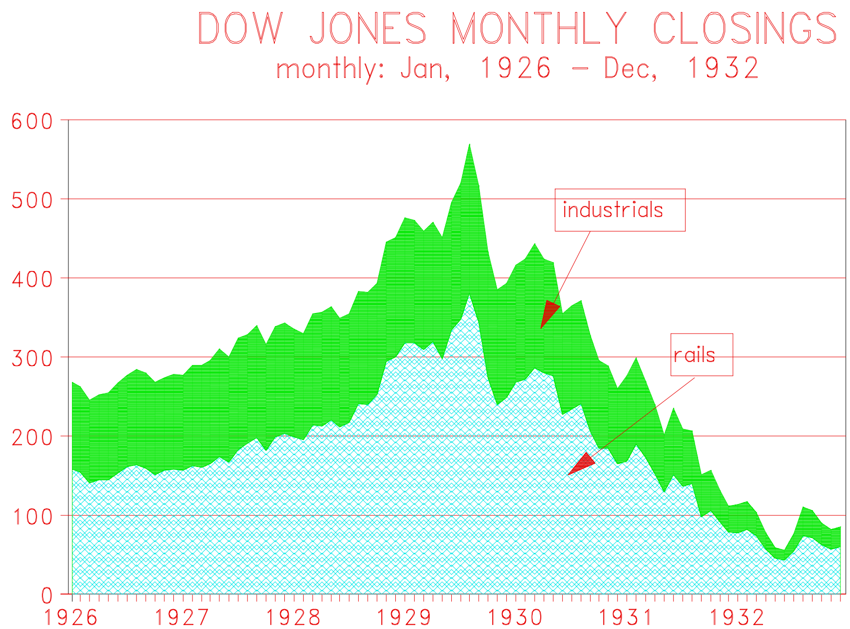
United Founders Corporation has in its consolidated portfolio many industrial securities. Through American Founders Corporation, it has a statistical and economic organization built up over a period of years. Through this organization, United Founders is able to study important investment situations and to maintain supervision over its industrial and other holdings.

UNITED FOUNDERS CORPORATION

This advertisement is the sixth of a series outlining the investment activities of United Founders Corporation

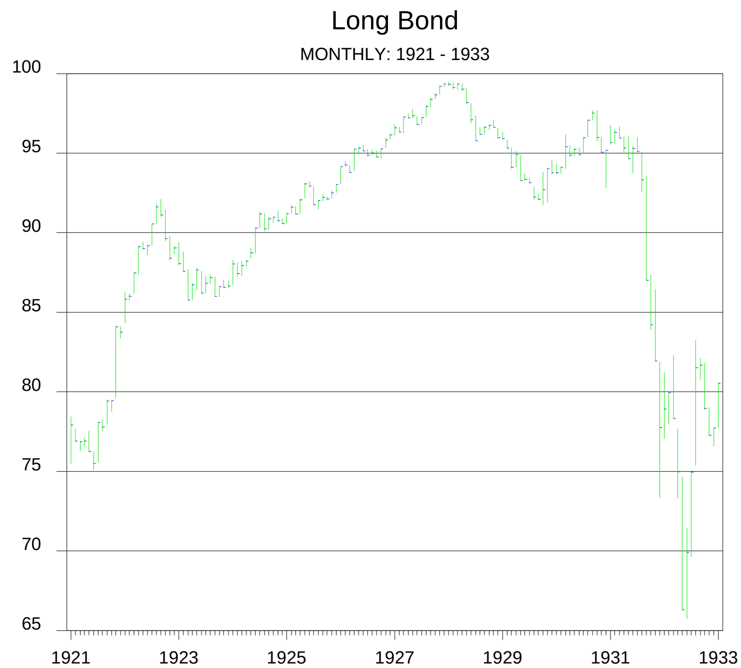
Click here for PEI's Homepage

As 1931 began, the effects of the depression were beginning to show more broadly throughout the world. In the New York Telegraph a small classified ad had appeared in January: Rolls-Royce. Must sell; will consider Ford trade. Garage, 1210 2nd Ave." The downturn in the economy was unquestionably emotional for many. Time magazine reported in January on the fate of one Robert German, steelworker residing in Berlin, Germany. Mr. German had finished his shift for the day after Christmas and went home. He then put on his best suit, fully adorned with an elegant, shiny top hat. It was going to be an unusual occasion at which Mr. German wanted to look his very best. He returned to the steel mill and chatted with the foreman along side the cauldron of bubbling 2786 degree molten iron. Mr. German wanted to look his very best so that he might depart from the world in style. After a brief conversation, Robert German suddenly dove head first into the molten iron. The foreman shut down the furnace immediately and searched without success. Not a trace could be found of his former friend. The toll on the emotions of people was not confined to merely the United States.



In the financial world, many eyes were trained not so much upon the investment trusts, but upon the life insurance institutions. This new giant among financiers was a mere new kid on the block when the bull market had begun from the depths of depression in 1921. The life insurance industry had prospered well during several bull markets since the turn of the century, thanks to an aggressive advertising campaign which in reality twisted a few words around. What one was buying was not insurance against the threat of living, but against the threat of a premature death. After all, if one bought insurance against the potential threat of fire destroying your house, it was called "fire insurance." But the salesmanship of advertising prevailed. Few people would like to buy insurance that was called "death insurance." It would be rather like having an undertaker come knock on your door to show you his latest selection of caskets. So instead of calling it "death insurance," they switched the words around and called it "life insurance."

The advertising campaigns had paid off. By the end of 1930, the life insurance indus-



try controlled nearly $19 billion dollars in investments which had doubled since 1923 alone. This vast sum of money had made the insurance industry a major player in all aspects of the financial marketplace. This sum represented nearly three times the amount of funds in the call money market. Of their nearly $19 billion in assets, 40.3% was invested in real estate mortgages. Next in line was a 37.6% investment in stocks and bonds of corporate America and 7% was invested in U.S. and foreign government bonds of federal and local issue. Some shifts within their investment portfolios had been noted. Railroad securities had accounted for only 17% of the total investments at the beginning of 1931 as compared to 35% in 1906 just before the Panic of 1907 when the railroads led the way down. Public utilities had risen to 9.4% in 1930 compared to 8.9% in 1929, demonstrating that sentiment at the time viewed the utilities as a more conservative stock investment. The trend within the shifting assets of the life insurance industry's portfolio was indicative of the nationwide investment trend.

Any time someone loses money in speculation, they always seek to pin the blame on someone. Never do they tend to point at themselves. Such was the case as the stock market continued to decline. Money managers were chastised when in reality, bonds, stocks, diamonds, furs, commodities and real estate offered nothing but devastating losses. The witch hunts of the Great Depression were merely in their infancy. The cries of many to punish someone, anyone for their losses were indeed numerous. It became common to talk of huge bears who were in control of the market, squeezing the very life blood from the market drop by drop.

One such early victim was a young broker, 32 at the time, named John W. Pope. He was reported to have been a soft-spoken chap, quite independent and a student of values. He firmly believed that stocks always sought their values - up or down, he added. John was accused of forcing Fox Films down, and it was alleged that if he had not been short the stock would not have plummeted as far. The New York Stock Exchange summoned the young fellow before their board of governors. They interrogated him in a way that Time magazine called a "harrowing trial by statistics." John W. Pope pulled out his charts and his studies of Fox Films and demonstrated that the stock had been seriously overvalued in comparison to historical measurements. The board found no malicious reports of rumours started by Pope, and his documentation as to why Fox Films had been overvalued won the day. He was completely exonerated, but this would be a dangerous trend that eventually led to the witch hunts of the 1930s.

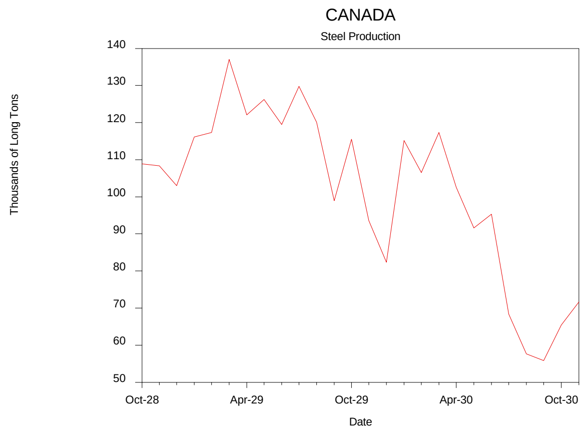
Another such man who had been hung out to dry was the infamous Charles Ponzi. That's right, the originator of the "Ponzi Scheme." As 1931 began, the creditors of his scheme were at least mailed their checks, which represented .5% of their original investment that had been made prior to his arrest in 1920. Ponzi was called the "duper extraordinaire," and "master and personification of the quick buck."

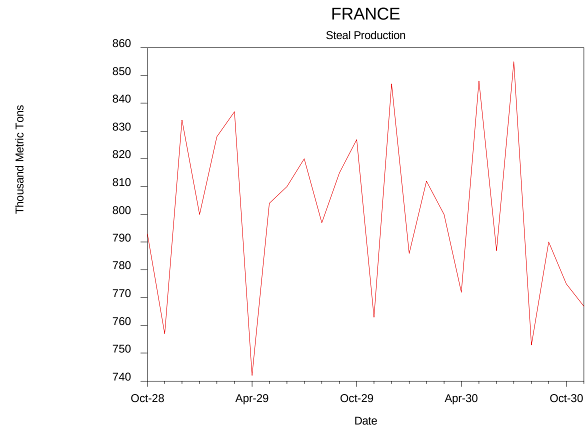
Back in 1920, Ponzi was viewed as the shrewd miracle man of Boston's Hanover Street district. Ponzi had promised his clients a 50% profit in 45 days. At times the crowds that were fighting in line in front of his office had to be controlled by police. On busy days, it took 14 policemen to keep the crowds in order. His famous scheme was to buy postal reply coupons in countries where foreign currencies had depreciated against the dollar. Under postal agreements, one could buy a reply coupon and send it to a friend, who in turn could take that coupon and redeem it for U.S. postage equivalent on a fixed basis to pay for the "reply." The scheme had its many critics who at least admitted that it was possible to profit in such a way, but they questioned whether or not one could make as much on the idea as Ponzi had claimed. In essence, Ponzi was

Charles Ponzi

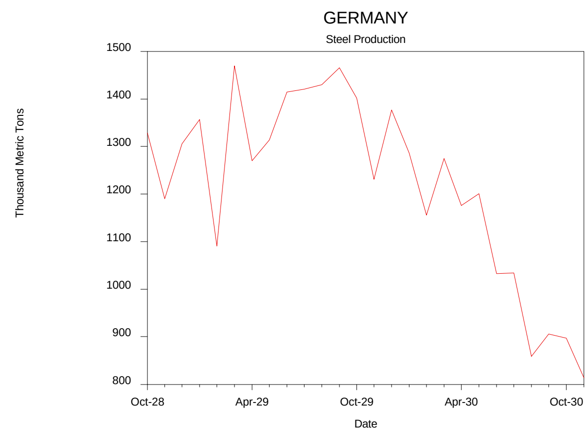
taking money from the second customer and handing it to the first, thereby creating satisfied customers to go around and honestly brag about how much they had made. But sooner or later, cash flow cannot keep up with the payments and hence the scheme folded. In its wake, bank runs had been created and several of Boston's trust companies had failed. Ponzi was eligible for parole in 1931.

Back on the more serious side of the times, economists remained in heated debate as to the causes of the deepening depression throughout the world. Even Benito Mussolini had come out blaming the depression on the U.S. collapse in the stock market. Others argued that the cause was sparked by overproduction, while others rebuffed this charge and claimed that it was the other way around. Still others blamed the overproduction on too much competition. They argued that small competitors could not afford to restrict output and that led to price cutting. Still others blamed the various pools and cartels. The Canadian Wheat Pool had been in opera-

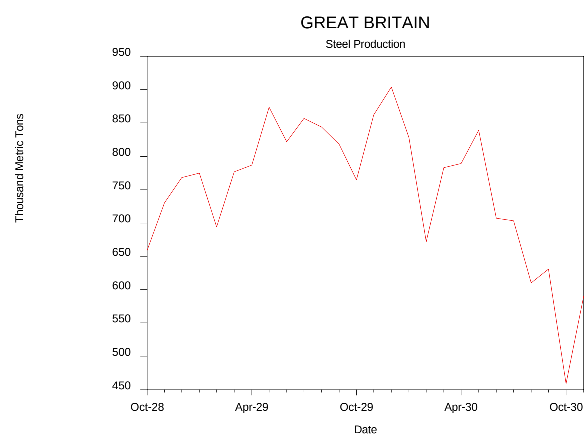




tion since 1924 and it had attempted to control world prices, but failed. Even Hoover's Federal Farm Board had attempted to peg prices, but ended up buying huge surpluses with no way of disposing of the grain.



In the oil industry, many blamed the anti-trust laws for putting the fear of God into the industry as a whole, leaving it wide open to many small producers who waged price wars to gain their share of the business while the giants were barred from merging. The European Steel Cartel had renewed itself at the end of 1930. U.S. steel producers had at least united to try to battle the Europeans rather than themselves, but still no direct mergers were allowed among the big producers. But anti-trust laws actually prohibited price agreements among the U.S. producers, and hence things were done off-the-cuff so to speak.



In copper, the formation of the Copper Exporters, Inc. in 1926 attempted to fix the price of copper in Europe. The American producers in this industry appeared to have some sort of gentlemen's agreement trying to ward off price cutting. But again this was done at the risk of the anti-trust laws. By 1931, copper producers were attempting to curtail production in an effort to hold the price. Copper had rallied from 9 cents to 12 cents back in November 1930. But as 1931 began, copper had drifted back down to 10 cents. Threats now loomed on the horizon of new discoveries in Africa, which would soon overshadow any curtailment on the part of the Western producers.

The tin market was also approaching the crisis level. The tin producers met in London during December 1930, but no agreement could be reached to curtail production. The battle between Bolivia and the Far East could not be brought under control. The improvement of new machinery in the Far East had raised the productive capability and they were determined to take full advantage of the situation.

Silver's perils were endless. Irving Trust in New York blamed Britain for the demise of the silver market by taking India off a silver standard and moving onto a gold standard. Thus, substantial selling of silver on the part of India prevailed.

The rubber market wasn't much better. Back in 1922, the British Empire passed the Stevenson Act which restricted the exportation of rubber from the British colonies. Despite the fact that this measure helped check an overproduction at the time, the Dutch merely continued to increase their production over the years, taking full advantage of the British measures which attempted to curtail the decline in rubber prices during the "deflationary" years of 1920-1922. During the boom, the British repealed the restrictions in 1928. Due to the lack of cooperation on the part of the Dutch during the 1920s, restrictions were not restored and overproduction was not checked during this decline in rubber prices.

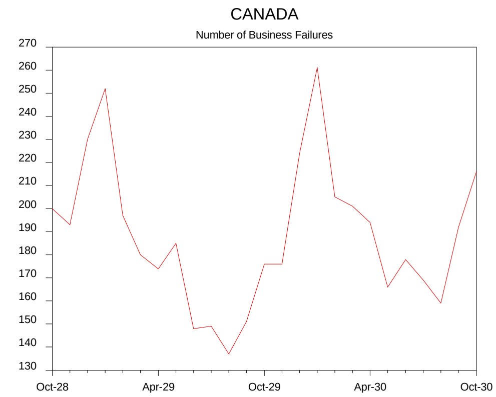
Of all the markets in which cartels had been formed, perhaps none was as powerful as those in the rayon industry. Here, power resided within a small group which controlled 80% of all production. But worldwide demand for commodities including rayon proved to be the all-powerful guiding force. The Rayon Cartel met in London during December 1930 and it too ended in bitter conflict with producers failing to reach an agreement to curtail production. Prices were falling as well as demand, and economic pressure prevented an agreement to stabilize prices.

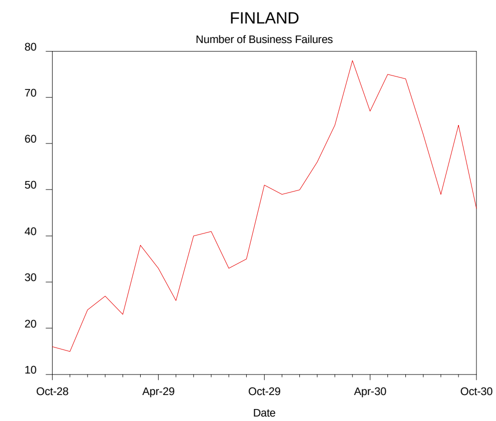
The overproduction was virtually universal throughout many industries. This was the state of affairs that had greeted the commodity producers as 1931 followed the dismal scene left in the aftermath of 1930. It was here that many economists chose to rest the blame for the depression. But we must ask ourselves an important question. Was it merely overproduction that forced prices lower? Obviously a sharp decline in demand had to account for part of the blame. What was it that cracked the confidence of capital? Surely there were many parallels with those of depressions that had been severe during the preceding era.

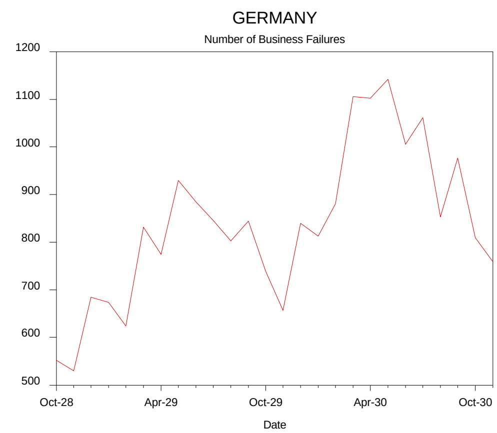
Before a special session of Congress on August 8, 1893, and in the midst of the famous panic of that same year, President Cleveland stood tall and delivered the following words:

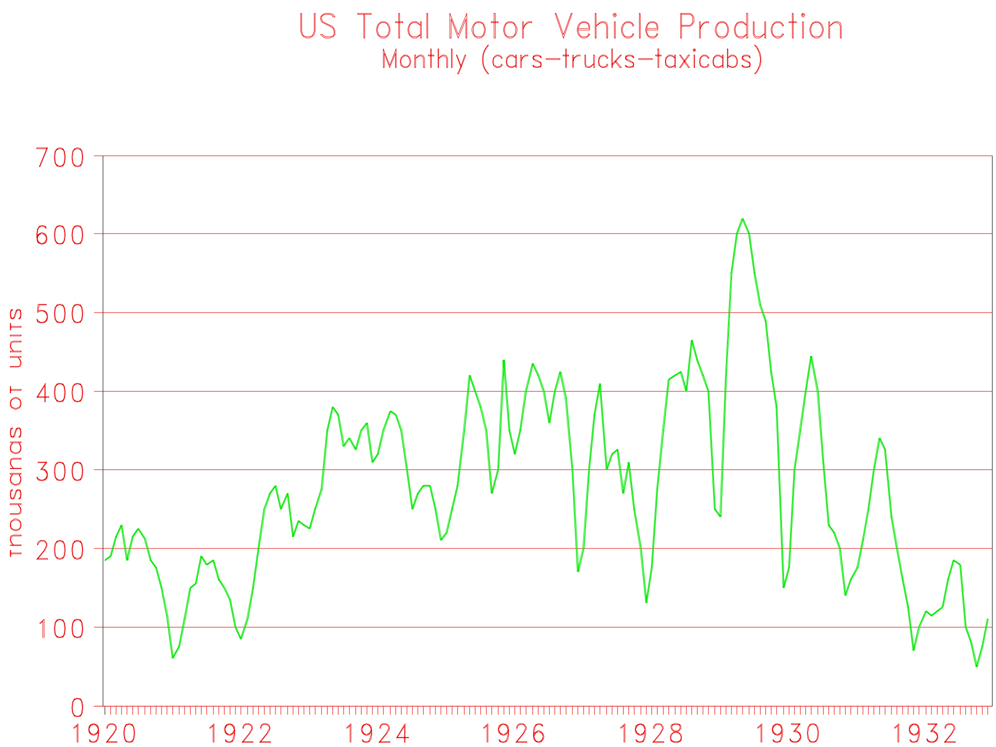
"At times like the present, when the evils of unsound finance threaten us, the speculator may anticipate a harvest gathered from the misfortune of others, the capitalist may protect himself by hoarding or may even find profit in the fluctuations of values; but the wage earner - the first to be injured by a depreciated currency - is practically defenseless. He relies for work upon the ventures of confident and contented capital. This failing him, his condition is without alleviation, for he can neither prey on the misfortunes of others nor hoard his labor."

Cleveland's words marked a panic which perhaps was one where a crisis in government had taken place. The Treasury, nearly bankrupt, had sparked wild fluctuations in foreign exchange and fleeing capital from the United States. Throughout my studies of economic booms and panics, one underlying factor had always played the deciding role. It was the level of confidence. Unsound financial conditions surrounding the value of the dollar had led to a crisis in confidence. Capital was hoarded by the entrepreneur whenever his confidence in the economy was shaken. This observation was also made by Marx back in the 1800s. Marx noticed that during periods when confidence was lost, the rich capitalists were afraid to invest and ended up hoarding their funds. He then contended that they merely created the depression by causing a contraction in business investment. Thus the solution was simple. Take all the capital









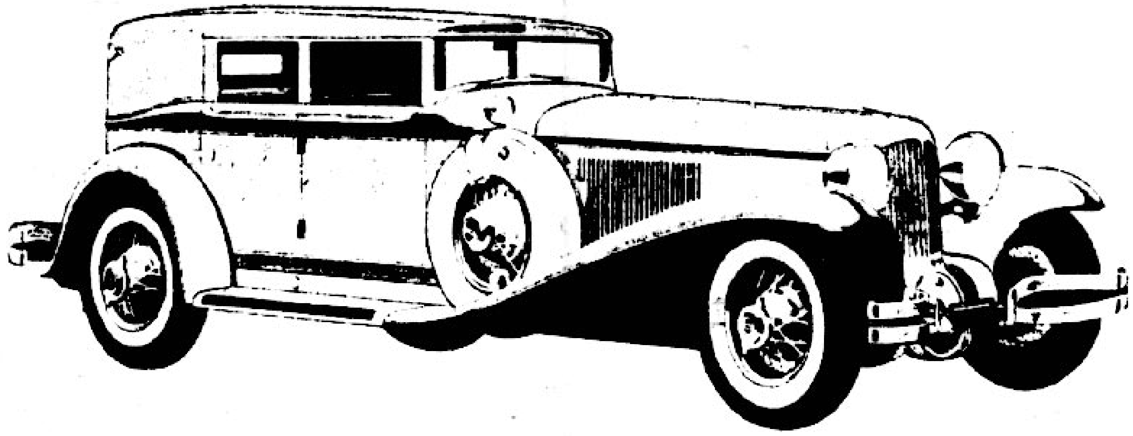
away from such people and then you did not have to worry about a lack of confidence. It was then logical that depressions could be eliminated.

During the postdepression era, it would be Keynes who provided the guiding light of hope. He contended that government could prevent depressions by increasing its spending to take up the slack caused by this contraction in business activity led by the decline in confidence.

Neither idea seems to have corrected the situation. Marx's idea essentially tried to eliminate human fears which led to the decline in confidence. The ultimate solution would be to eliminate man himself and that would get rid of greed, speculation, and the contraction in confidence which always followed the cycle. Keynes merely injected another player who lacked the wisdom to manipulate the situation, and the fears about reelection have proved to be just as corrupt as the graft with votes as the pay off. Hence, politicians vote for spending measures to keep their jobs rather than to curtail spending when it was not in the best interest of society as a whole.

This is the nature of events. The human urge to survive is the dominating force among the politicians as well as the capitalists. Both have condemned the other for actions of self-interest. Yet, if each individual did not act in his self-interest during times of strife then perhaps there would be nothing left to survive.

The repetitive cyclical forces which seem to dictate the business cycle are at least in part created through the cyclical forces of nature. It is nature which dictates the cycles in many commodity industries, swinging them back and forth between feast or famine. In many cases, man's financial destiny has been altered or guided by nature including at times such things as the San Francisco earthquake. Therefore, nature has played some part in the business cycle contributing to the rise of inflation in the food sector during droughts as well as deflation from



ANNOUNCING THE NEW 1931 PROGRAM FOR THE CORD FRONT DRIVE

In keeping with our long standing policy, we are again able to make the public the beneficiary of the savings obtainable through better manufacturing methods and greater buying power. For the first time, a Cord Front-Drive car is now offered to a larger market. Owners of the Cord Front-Drive will tell you it is the finest automobile in the world. Nothing less than a totally new *kind* of motoring could make possible the successful invasion of the Cord into the fine car field. Its sales in its first year represent nearly twenty per cent of all cars sold above $3000. The Cord has won more renown in Europe than any other American automobile, having emerged victorious in competition in thirty-nine important Continental Rallyes. The Cord is owned by more notables of the world than any other automobile, American or European. The Cord design has met with a more enthusiastic reception all over the world than any other new automobile. The Cord became the model for the entire automobile industry to pattern after. It is this car, which is the standard of fine car values, with its exclusive front-drive advantages, which we are now able to offer for the first time at the extremely low price of— $2395

BROUGHAM $2395 · SEDAN $2395 · CONVERTIBLE CABRIOLET $2495 · CONVERTIBLE PHAETON SEDAN $2595

Prices f. o. b. Auburn, Indiana · Equipment other than standard, extra · AUBURN AUTOMOBILE COMPANY, AUBURN, INDIANA

Showing in the Lobby of the Commodore Hotel and at the Automobile Show

CORD

FRONT DRIVE

THE FORD MOTOR COMPANY

announces a

REDUCTION in PRICES

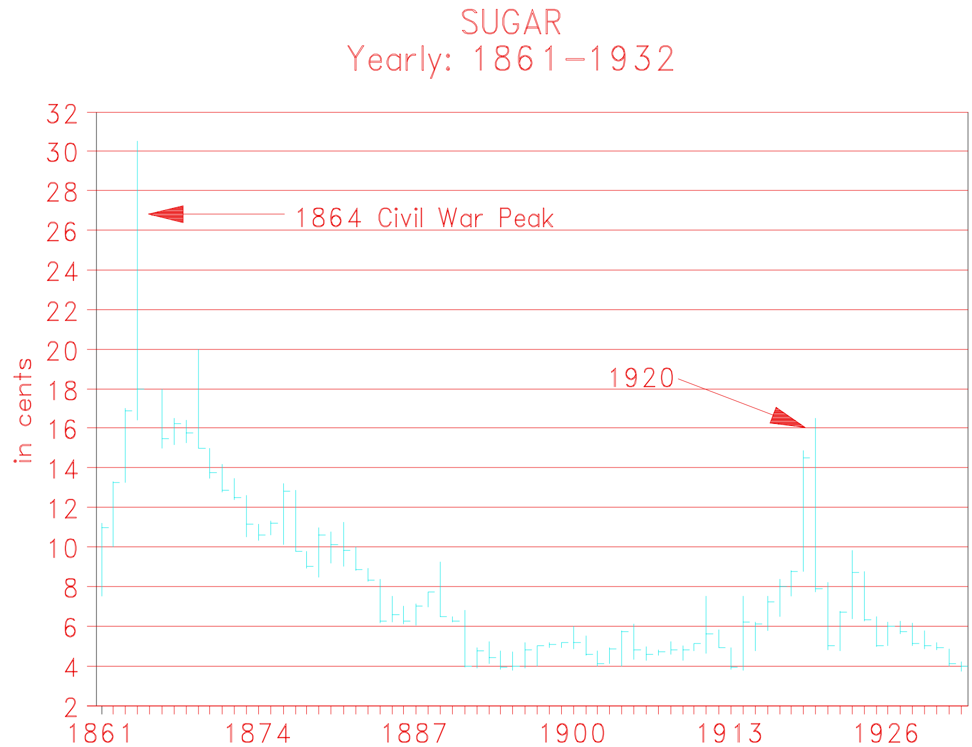
The following prices are effective Monday, January 19, 1931

	New Price	Old Price	Reduction
De Luxe Roadster	$475	$520	$45
De Luxe Phaeton	580	625	45
Phaeton	435	440	5
Roadster	430	435	5
Sport Coupe	500	525	25
Coupe	490	495	5
De Luxe Coupe	525	545	20
Tudor Sedan	490	495	5
Fordor Sedan	590	600	10
Town Sedan	630	660	30
Cabriolet	595	625	30
Victoria	580	625	45
De Luxe Sedan	630	640	10
Station Wagon	625	640	15
Model A Chassis	340	345	5
Model AA Truck Chassis, 131½-inch wheelbase	495	510	15
Model AA Truck Chassis, 157-inch wheelbase	525	535	10

(All prices f. o. b. Detroit, Michigan)

You may purchase a Ford car or truck on convenient, economical terms through the Authorized Ford Finance Plans of the Universal Credit Company

Ford Motor Company



oversupplied commodity markets - as was the case in point during this period in time. It is only logical, therefore, that government cannot foresee such events nor can it provide intervention in such matters. In many respects, man has always been at the mercy of nature.

The automobile industry was unquestionably the leading star throughout the bull market until early 1929 when the price of its common stock had begun to falter. From a domestic production level of 5.6 million cars and trucks in 1929, sales fell rather sharply. In January 1931, it was announced officially that 1930 production had fallen to 3.5 million units. The industry as a whole was a very important component within the American economy. It accounted for 82% of the demand in rubber, 55% of plate glass, 15% of all iron and steel, 57% of upholstery leather, 30% of the aluminum, 14% of all copper, 15% of hardwood and 24% of lead production. Time magazine reported that the automobile industry also accounted for 80% of the total gasoline consumption in the U.S. and it filled slightly more than 3 million freight cars a year in bringing its wares to market. Through direct measures, the industry employed 5 million people but through the innovation of this new contraption, originally called the horseless carriage, it provided countless other jobs in a variety of other industries, and it also gave rise to the future giant, the oil industry.

Thus, the auto industry was still something of vital importance to the financial market watchers. In January 1931, it had been reported that foreign sales of U.S. automobiles had declined by 44% in 1930 compared to a domestic drop of 30% in car sales. The 1931 Auto Show, held in New York, was an event of some importance. The trend for 1931 demonstrated lower prices, increased speed and performance, and an increase in the size of engines with far more eight cylinders along with 12s and 16s than ever before. But, to catch the eye of the consumer, pastel shades of paint were also introduced. But many viewed that the tariffs levied against the U.S. automobiles would still pose a deterrent in foreign sales. Many investors remained pessimistic about the outlook for 1931.

The sugar industry was also suffering from overproduction. The Russians were huge producers and they were dumping sugar on the markets, driving the prices downward in a clean break. To add more sweetness to the wound, the U.S. Secretary of Agriculture finally ruled that corn sugar could be used in foods without having to declare it on the label. The Corn Products Refining Co., manufacturers of Mazola Oil, Karo Syrup, Argo Starch, Linit Starch and Kremel Pudding Powder, immediately announced that it planned to double production. This was not welcome to Cuba, Russia, the Dutch, or German Sugar Cartel. After a long battle of trying to reach some sort of an agreement that would curtail sugar production, the Germans finally gave in. A five-year agreement was reached whereby production would be cut (in the amount of the preceding annual surplus, but Russia did not participate.)

On the banking scene, the turmoil over the failure of the Bank of the United States in late 1930 had not simply disappeared. Manufacturers Trust Co. in New York was one of the banks which was going to absorb the defunct Bank of the United States, but the deal had fallen through. Manufacturers was no small bank. On January 2, 1931, it released a statement on its current position at the time. Between September 24, 1930, and January 2, 1931, the psychological effect of the Bank of the United States' failure had led to a withdrawal of $109 million in deposits, leaving the bank with $219 million. A decline of $35.5 million in its capital, surplus and undivided profits had also occurred. To rescue the bank, instead of negotiating a merger, Harvey Dow Gibson, former President and later Chairman of the

N.Y. Trust Co., purchased 30% of Manufacturers Trust and assumed the presidency. Rumours told that Gibson's associates, whom Gibson would not identify, were a league including either the House of Morgan or the Rockefellers. Gibson publicly denied that rumor and stated that he would perhaps reveal his associates at some point in the future. Manufacturers Trust Co. thus survived, and in the years ahead a merger eventually came forth forming the famous

Manufacturers Hanover Trust Company as it is known today.

Banking failures were now beginning to become more widespread throughout the East, no longer being confined to the commodity stricken sectors of the nation. In the Industrial town of Gary, Indiana, the Central Trust & Savings Bank failed during January 1931, tying up nearly $1 million in deposits.

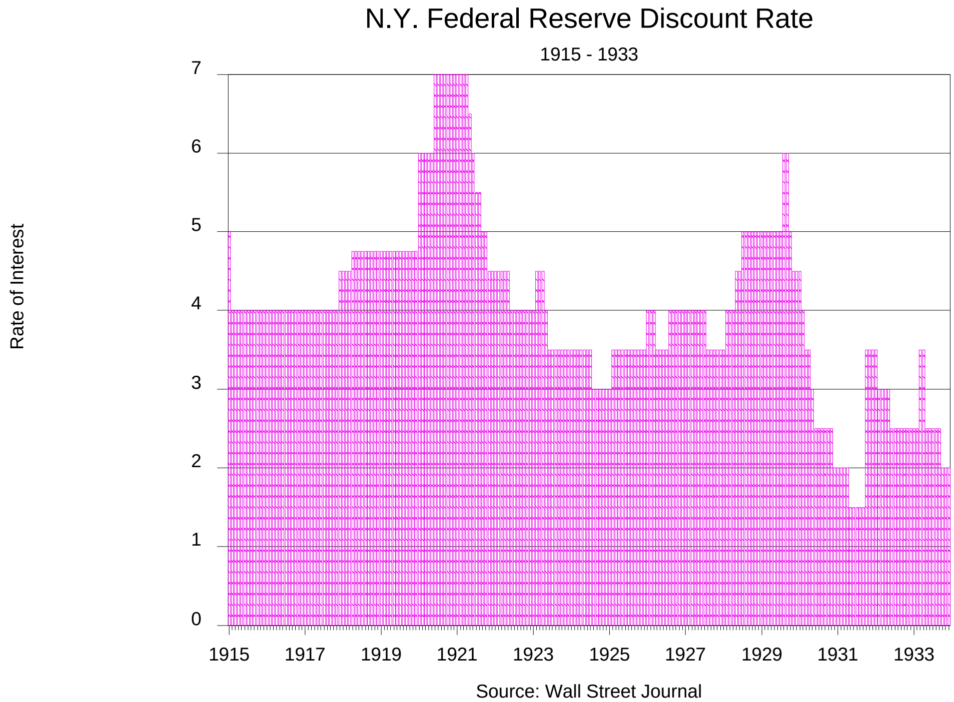
In the first section of this study, up to 1929, I provided numerous advertisements for real estate bonds. Many people have been led to believe that countless novice investors had been wiped out by the falling stock market. The truth of the matter is quite the opposite. Far greater amounts of capital were lost by the small investor who purchased bonds. Real estate backed bonds were one of the worst investments second to those of foreign issue. Many of the banking problems that brought down the banking institutions in the East were centered around heavy real estate exposure. As the depression continued to worsen, real estate became very nonliquid. Stock at least could be sold at a price quoted on the exchange as long as the company was of importance. But, bond issues backed by real estate simply went into default, taking with them countless dollars from the savings of the small investor. The carnage of the progressively widening banking crisis was summed up quite appropriately by Time magazine on January 12, 1931:

"So, in steady sequence, has many a U.S. community suffered the pangs of bank failures, of cash tied up, of prominent citizens suddenly under suspicion. Fear has followed faith; tragedy stalked prosperity. To tell of each failure would be impossible. To fail to search beyond the weekly figures of failures would be to miss the true social significance of the Depression."

The mood about the market itself was still quite mixed. On January 19, Time magazine reported on the comments of Albert Henry Wiggins, President of the largest bank in the United States, the Chase National. The event was the annual stockholders meeting held during mid-January of that year. While many other banks had suffered from withdrawals, at least a portion of the money was flowing into the books of Chase. It was reported that the resources of this famous bank had reached $2.6 billion, which was $753 million ahead of its nearest competitor. So when Mr. Wiggins had something to say, at least a few people listened.

"The most serious of the adverse factors affecting business is the inability of foreign countries to obtain dollars in amounts sufficient both to make interest and amortization payments on their debts to us and to buy our exports in adequate volume. From the middle of 1924 to 1929 we delayed the adverse effect of our high tariffs upon our exports by heavy buying of foreign bonds...Our alternative today is, therefore, either a reduction of our tariffs, or readjustment to our greatly reduced volume of exports...A reduction in tariff, made in the interest not of change but of stability, would still leave us our general protective tariff system.

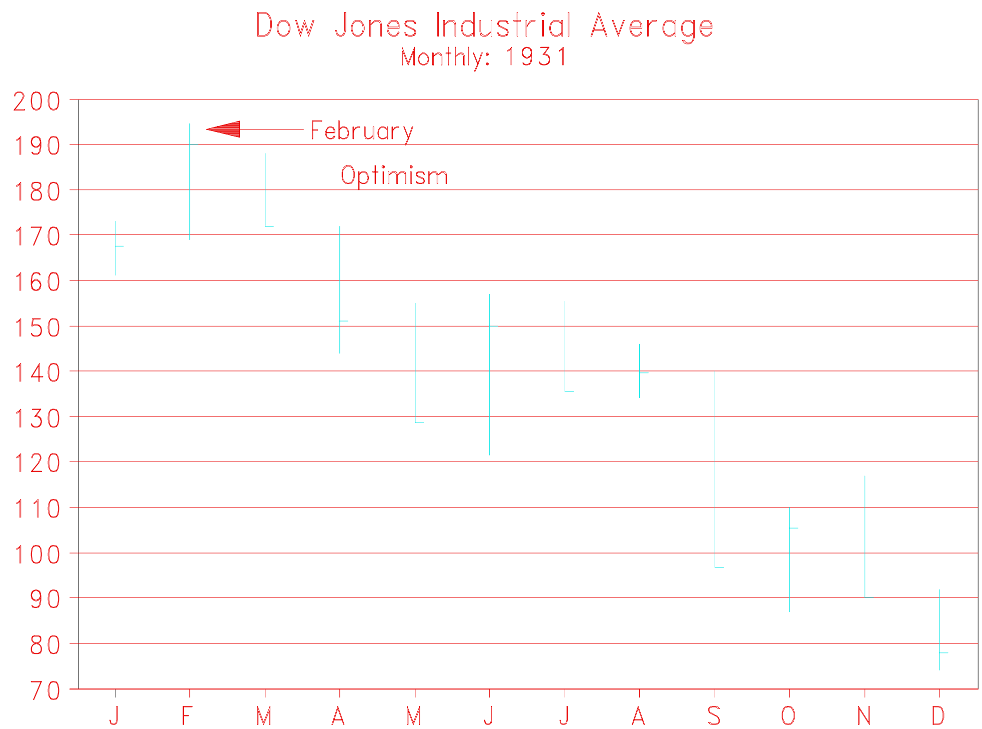
"Cancellation or reduction of the interallied debts has been increasingly discussed throughout the world. This question has an importance far beyond the dollar magnitude of the debts involved...I am firmly convinced it would be good business for our Government to initiate a reduction in these debts at this time."



Many bankers were opposed to the high tariffs despite the fact that in many cases there was a just cause for them and that most other nations had imposed tariffs far in excess of those in the United States. The bankers in general were concerned with the repayment of foreign loans. With the trade war going on, foreign nations were unable to earn enough dollars to make payments on their outstanding loans. It is true that the situation was always that way. It had merely been clouded over by the huge amounts of foreign bond issues which were floated subsequently following World War I. Therefore, the bankers in general normally held the opinion that the government should write off its loans to foreign nations so that those foreign nations could repay the loans outstanding at the banks.

Later investigation by the Senate revealed a wealth of corruption, which at this time was still not publicly known, in respect to these foreign loans. The profits in floating the foreign bond issues were reasonably handsome and competition fierce. It was revealed by the Senate investigations that Juan Legula, the son of the President of Peru, was paid $450,000 in connection with floating a $50 million bond issue in New York . The Chase had extended the dictator Machado of Cuba a personal line of credit which went as high as $200,000 in addition to hiring his son-in-law.

But despite these unethical bribes, the issue that Wiggins spoke of was real. With the trade war bringing the volume of international trade down, foreign nations were unable to earn enough dollars to pay their loans. But in reality, the extension of additional credits throughout the 1920s was not the answer to their problems either. In the case of Britain, it was a clear overvaluation of the pound which was to attain the goal of Montagu Norman, head of the Bank of England. The pound could not be restored to the prewar "par" level without creating massive deflation as slow economic growth. Thus, the mismanagement of governments around the world was leading contributor to the Great Depression of the 1930s.



Wiggins' comments did not stop with the international debt crisis. His words were of interest on issues of the time. On prices Wiggins commented: "We attempted, as a matter of collective policy, to hold the lines firm following the crash of 1929...The policy has had a 13 month test. It has failed...We must keep the markets open and the prices free."

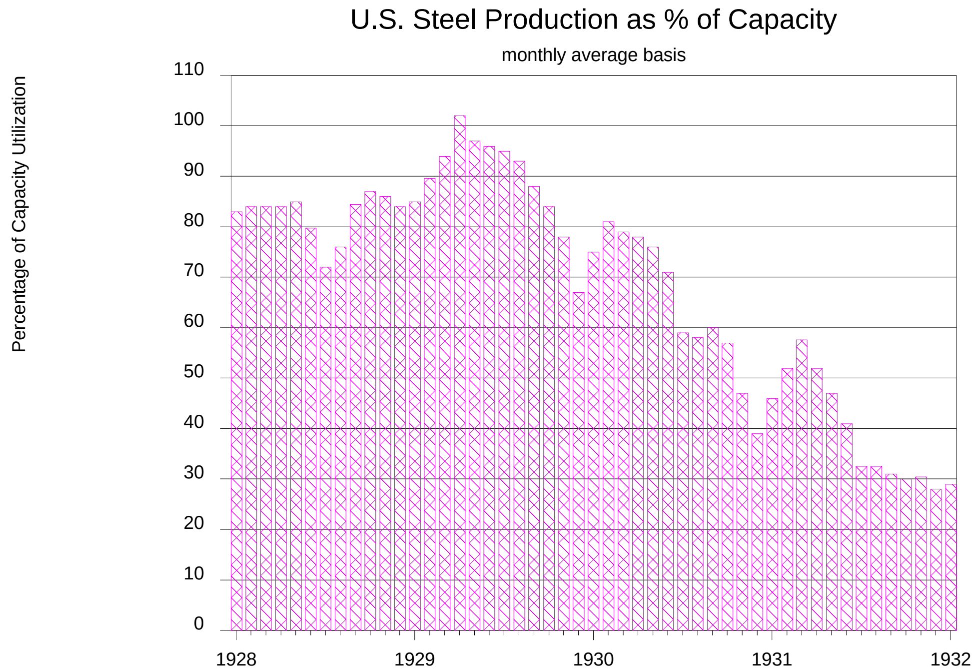
In reference to wages: "It is not true that high wages make prosperity. Instead, prosperity makes high wages. Many industries may reasonably ask labour to accept a moderate reduction of wages designed to reduce costs and to increase both employment and the buying power of labour."

On stocks Wiggins commented: "I do not know whether we shall see lower prices in the stock market or not...There are many securities, both stocks and bonds, which are now selling for less than they will be worth in normal times and at prices which should prove attractive to the investor."

His conclusion and forecast were: "It is not impossible to set a date for the beginning of the business recovery. I think that we are approximately at the worst of the Depression and that the next important move will be upward...I expect conditions at the end of 1931 to be a good deal better than they are at the end of 1930."

These comments fell up on eager ears. The Dow Jones Industrials had fallen severely during the previous year and had come to rest below the 160 level during December 1930. But, as 1930 was coming to an end, the Fed had lowered the discount rate for the seventh time since the crash of 1929. Thus, January began with the discount rate now resting at 2%, the lowest in history. But the Fed's action did not spark any spectacular rally in the Dow Jones Industrials for year end. Most traders remained very cautious. The bonds, on the other hand, rallied sharply from under 93 to the mid-95 level.

Thus Far, January had held above the Dece mber low, yet trading was far from



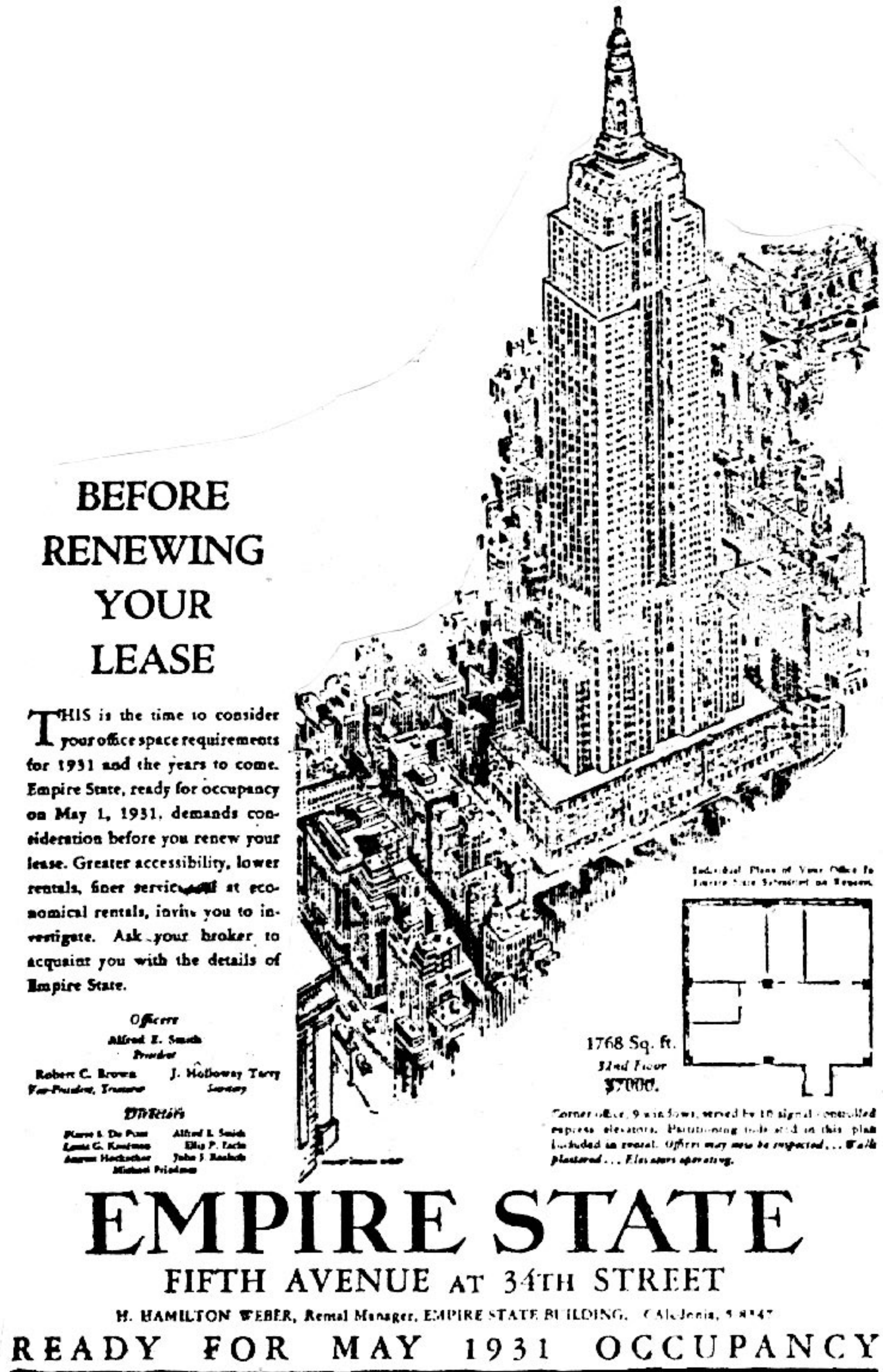
spectacular. The ranges were narrow in both stocks and bonds. The bonds rallied, exceeding the December high but traded within a full point range. Curiously enough, the bonds had closed December on the high of the month while the stocks closed much closer to the low of the month. Some divergence between the two still made its presence felt.

What was interesting was the trend in odd-lot purchases. Throughout most of the large blue-chip companies, the number of stockholders was increasing. Shares of common stock had been passing from the professional to the small investor who was perhaps afraid of the banking situation. This helped to provide some support during January following the banking scare prompted by the failure of the Bank of the United States.

In January, even Paul Moritz Warburg, who had become somewhat of a respected soothsayer for this denunciation of the "speculative orgy" just prior to the collapse and his forecast that it would lead to an inevitable crash, had a few optimistic words to say. Warburg was a well-known banker and a director of the Manhattan Co. with its various banking units.

"From the banker's point of view, I do not hesitate to say that within a few years hence the level at which some of our securities sell today will look... incomprehensibly low...even though one might anticipate a year or two of reduced dividends."

Indeed, these were impressive words coming from a man who many believed had called the events of history before they had revealed themselves. But Warburg had a few choice words to add about his view of government and the business cycle itself. He called the business cycle "a subject for psychologists" rather than for economists." He also said that government would serve a better purpose in squashing booms than trying in vain to halt depressions. He also denounced the high tariffs and any artificial measures designed to fix prices.


BEFORE RENEWING YOUR LEASE
THIS is the time to consider your office space requirements for 1931 and the years to come. Empire State, ready for occupancy on May 1, 1931, demands consideration before you renew your lease. Greater accessibility, lower rentals, finer services at economical rentals, invite you to investigate. Ask your broker to acquaint you with the details of Empire State.
Officers
Alfred E. Smith
President
Robert C. Brown
Vice-President, Treasurer
J. Holloway Tarry
Secretary
Directors
Individual Plans of Your Office In Empire State Submitted on Request.
1768 Sq. ft.
32nd Floor
$7000.
Corner office, 9 windows, served by 10 signal-controlled express elevators. Partitioning indicated in this plan included in rental. Offices may now be inspected... Walls plastered... Elevators operating.
EMPIRE STATE
FIFTH AVENUE AT 34TH STREET
H. HAMILTON WEBER, Rental Manager, EMPIRE STATE BUILDING, CAledonia
READY FOR MAY 1931 OCCUPANCY

Has the Bear Market Ended?

What will stocks do during the early months of 1931?

With increasing frequency favorable reports on business and employment are becoming available . . . Steel, that barometer of business conditions, shows steady improvement from December lows . . . Some observers point to these indications as showing that marked recovery is under way. Most authorities agree that the depression has passed, or shortly will pass, its lowest point.

If this is true, it should have a most important effect on the trend of the stock market in the reasonably near future.

Changes in Basic Conditions

If an advance can be soon expected, now is the time for investors to prepare. Always before, every great depression has worked certain fundamental changes in our economic structure. Each has reduced some companies from the ranks of class A investments and promoted others to their places.

At such a time as this expert investment counsel can be of particular value in seeing that, before a substantial advance takes place, you will be holding stocks that will lead the upward movement, the class A investments of the future.

The Value of Continuous Surveys

Continuous examination of the values underlying securities—in bad times as well as good—is necessary in order to take full advantage of current markets.

One great value of Van Strum service is its continuity. Over a period of years, in bull and bear markets alike, Van Strum experts have studied conditions that make security values.

Permanent Investment

To what extent Van Strum Financial Service determines the facts that will result in profits when markets are favorable is shown by a statistical study we have just completed. If one had invested $1,000 in the stocks included in the Dow Jones Industrial Averages in 1904 he would now have $13,000 with the help of stock dividends and the natural growth in value of those stocks.

From $1,000 to $90,500

But if he had then taken advantage of the cyclical swings of stock prices by selling when the Van Strum barometers turned bearish and buying the same stocks back when the barometers turned bullish *his capital would have been increased to $90,500 in the same period*. In other words, by buying and selling according to the barometers, this investor would have made 660% more than he could have by merely holding the stocks regardless of the general trend. A summary of the results of the survey follows:

$1,000 in 1904

Year of Investment	Dollars Invested	Year of Sale	Price Received	Per cent Appreciation
1904	$ 1000	1906	$ 2700	170%
1908	2700	1909	5160	91%
1910	5160	1912	6030	17%
1913	6030	1917	11700	94%
1919	11700	1920	16500	41%
1921	16500	1923	26500	61%
1924	26500	1926	48800	84%
1927	48800	1929	100000	117%

$90,500 today

You need this service with its weekly and special bulletins as a continuous aid in making your investments safe and profitable. Use the coupon for a copy of our latest bulletin, and the special report "From $1,000 to $90,500 in 27 years."

Do you know the Stocks of these four companies?

A Motor Company	Two Retailing Companies	A Metal Company
that has shown unusual strength in a year of depression.	with demonstrated capacity to make large gains.	yielding 9 per cent, at a price far below its true value.

These four stocks are discussed in our current bulletin. Use the attached coupon for a complimentary copy.

VAN STRUM FINANCIAL SERVICE, INC.

Investment Counselors

$1,000 to $90,500 in 27 Years

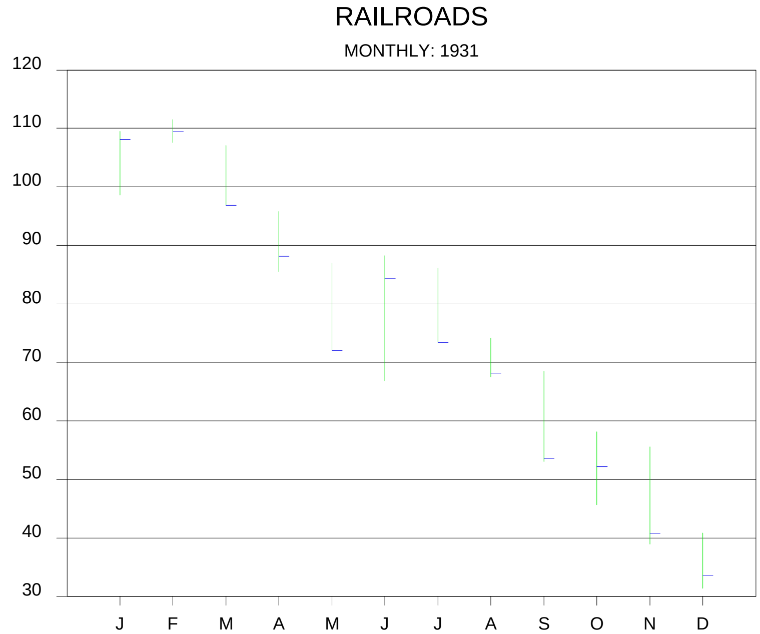
Van Strum Financial Service, 730 Fifth Avenue, New York, N. Y.

Please send me a confidential copy of your latest Bulletin and your special report "From $1,000 to $90,500."

Name ______________________________

Address ______________________________

Four Attractive Stocks



Time magazine reported on the comments of James Augustine Farrell, President of U.S. Steel. Despite the fact that Farrell had pronounced that he was bullish on the market as well as the economy at the end of 1929, his obvious error was not uncommon among business leaders at the time. But because Farrell had entered a period of silence in his public comments thereafter, many believed that he fostered a deep, dark opinion of still further declines.

At last during January 1931, Farrell broke his silence and uttered his opinion upon the current state of affairs. While many business leaders, economists and analysts were calling for a recovery to begin in a few short months, Farrell once again stuck his opinion where it was not exactly well founded. Instead of projecting a turnaround to begin in the months ahead, he told the world that it had already begun "30 days ago." Therefore, he contended that the sharp decline during December 1930 had produced a low. To Farrell that was "THE" low from which an uptrend was now in motion.

Farrell's perspective was perhaps colored by the fact that the steel industry was successful in actually pushing through a price hike in December as a result of the protective tariffs. In late November 1930, Carnegie Steel had announced that its prices were "minimums" and a few weeks later the price of finished steel products was raised $1 a ton. This brought steel bars up from $1.60 a pound to $1.65. This compared to $1.90 in 1929.

Steel production capacity had fallen to 39% from 100% of capacity peak in 1929. Therefore, Farrell's perspective was one which was based largely upon the developments within steel and it did not reflect industry as a whole. But Farrell's position was notably different from that of Mr. Wiggins. In response to wage cuts, Farrell replied: "Oh no. Wages in the steel industry are not coming down. It is my delicate judgment that a general reduction of wages in this country would set back the impending recovery by at least two years."

It was obvious. There were two schools of thought on virtually every issue of the time. Wiggins maintained that wages should be reduced while Farrell insisted that wages should be maintained. Opinions were numerous, but solutions few.

Owen D. Young, Chairman of both RCA and General Electric, stated before the American Bankers Association meeting that in his opinion the Depression had reached dead center and that improvement was forthcoming. This opinion was also shared by a statement to the press offered by the U.S. Chamber of Commerce, which concluded in a survey of its nationwide member chapters that "a slight increase in business activity and improvement in the employment situation" had taken place. Thus, their opinion embraced the concept that there was "hope that the 'dead center' of the Depression is past."

Various leaders within industry echoed these opinions. Although differences were noted among what policies should be implemented, the consensus was clearly one of optimism that the bottom had been reached. This sentiment was also beginning to be shared by the investing community. The Dow Jones Industrials rallied nicely moving into February, exceeding the January high as well as the highs that had been established during both November and December of 1930. The industrials had rallied coming close to 195 in an effort to test the key low which had been established during the Panic of 1929. The industrials came close to finishing February above the 190 level.

The railroad issues, however, rallied to nearly 112 in February, exceeding the high of December 1930 and that of January 1931. But the November 1930 high could not be exceeded. The rails, which had lagged during the bull market years, were still trailing behind the industrials.

The long bonds fell into stagnation during February 1931. They failed to exceed the January high and traded rather quietly, forming an inside trading affair in comparison to the range of January. The discount rate stood unchanged since the December cut to 2%. The banking failures continued, prompting many to view the industrials as the least of all evils and a better alternative to what was becoming a popular tradition, the mattress.

Trouble was still brewing among bond holders. Defaults were not spreading into the local municipal issues. After a cost of $13.8 million and little more than a year in operation, the holding company formed to own the assets of the bridge which connected the city of Detroit with Sandwich, Ontario, defaulted on its bond issue. Traffic had fallen substantially and the ferry companies began cutting their rates sharply rather than suffer the alternative, which was to go out of business. Of the $8 million in outstanding bonds which were to yield 7% interest, no payments were mailed.

For this reason, and many similar incidents, the bonds continued to decline from the February 1931 high despite lower rates. One would think that with the discount rate at 2%, bonds yielding 7% would have been trading far above par. But the reality of the situation was far from what the normal perceptions of relationships would have been. The safety factor of the bond market was much worse than that within the stock market itself.

February was also the month when most of the top corporations began to release their final figures for 1930. The vast majority of the companies reporting had declines in earings. G.M. reported $151 million in earnings for 1930 compared to $247 million in 1929. One exception, Coca-Cola, posted new record highs in earings, reaching $13.5 million compared to $12.7 million for 1929.

The following table offers a brief cross-section of various industries with a comparison of their earnings between 1929 and those of 1930, which were reported during February 1930.

CORPORATE EARNINGS COMPARISON
1929-1930
(in thousands)

	1929	1930	% change
Atlantic Refining	17,332	2,742	-84.1%
Bethlehem Steel	42,242	23,843	-43.5
Caterpillar Tractor	11,600	8,714	-24.9
Chrysler Corp.	21,902	234	-98.9
Cities Service	36,477	48,974	+ 34.2
Coca-Cola Co	12,758	13,515	+ 5.9
Colgate-Palmolive	8,910	8,550	-4.0
Cream of Wheat	1,882	1,868	-0.7
E.I. DuPond de Nem	72,300	49,990	-30.8
General Cigar	4,295	3,201	-25.4
General Motors	247,317	151,098	-38.9
General Outdoors Advertising	1,843	345	-81.2
B.F. Goodrich	7,446	(8,400)	-212.8
Hawaiian Pineapple	3,166	2,530	-20.0
Helena Rubinstein	794	554	-30.2
Household Finance	3,372	4,066	+ 20.5
Hudson Motor Car	11,594	324	-97.2
Inland steel	11,712	6,498	-44.5
Jewel Tea Co	1,691	1,705	+ 0.8
Lehigh Valley Coal	1,190	714	-40.0
Marshall Field	9,218	4,724	-48.7
McGraw-Hill Publish	2,231	2,021	-9.4
National Lead	10,560	4,675	-55.4
Natl Power & Light	13,557	12,630	-6.8
New York Central	77,428	35,981	-53.5
Parke Davis & Co	8,331	7,514	-9.8
Pierce-Arrow	2,566	1,317	-48.6
Public Service NJ	29,544	30,163	+ 2.0
Remington Rand	6,068	2,995	-50.6
Reynolds Metals	3,560	1,730	-51.4
S.S.Kresge	14,952	10 ,621	-28.9
Montgomery Ward	13,434	423	-96.8
Sears Roebuck	30,057	14,308	-52.3
Stewart-Warner	6,838	1,262	-81.5
U.S. Steel	197,531	104,465	-47.1
Western Dairy Prod.	1,401	1,124	-19.7
Woolworth	35,664	34,736	-2.6
Total	982,763	591,775	-39.7

According to a survey by Moody taken of the first 744 companies to report on their 1930 earnings, the across-the-board indications illustrated a 23.2% average decline in corporate earnings in comparison to 1929. But this figure is a bit misleading. Of the total of 744 companies, 375 were industrial corporations, which posted a decline in earnings of 35.9% for 1930. The railroads posted a 31.6% decline in earnings. The broad average was actually helped by the utilities including the telephone and telegraph industries. The group which was selected for the preceding table produced a combined earnings figure in 1929 of $982,763,000 compared to $591,755,000 in 1930, a 39.7% decline.

On the production side, the oversupply in commodities had also filtered over into the tobacco industry. A price war among the cigarette retailers had broken out. The price war had initially broken out during early 1930 and it appeared as though a truce had been called in late August of that year. But the truce came to an end in January 1931. The two main contenders were the United Cigar Stores Co. of America and Schulte Retail Stores Corp. Cigarettes were normally priced at 15 cents with a wholesale cost of 11.26 cents. During 1930, prices had dropped to 12 cents but when the truce of August arrived, prices moved back up to two packs for 25 cents.

When the battle was renewed in January 1931, it was sparked by United which offered two packs of cigarettes plus a pack of Gillette razor blades for 50 cents. The offer was limited to Old Gold, Camels, or Chesterfields , but the normal retail value was 65 cents. As insignificant as this might seem, Schulte reduced prices on those same brands to 11 cents, but they included Lucky Strikes. This meant that these brands were selling below cost.

As absurd as it might sound, the American Tobacco Company got into the act. They were outright mad at United for refusing to include their Lucky Strikes in its special price war. As a result, American Tobacco refused to sell its Lucky Strikes to United, in effect declaring an embargo. Both United and Schulte were large, nationwide chain stores so the battle was no small matter as evidenced by how it began to draw in the producers as well.

This example of a price war between two major retail chain stores was not unique. Price wars were taking place throughout many industries. As economic activity declined, including consumer spending, price wars were seen as a means of defending one's market share. Thus, the boom periods produce overcompetition and the subsequent contraction forces businesses to fight for their remaining share of sales, resulting in free competition but rising business failures. This was the atmosphere which began to spread throughout the business community.

Another unwelcome discovery came forth affecting the oil industry. With overproduction a serious problem for oil men, the last thing they needed was another new major find. But as 1931 began, so did the oil rush in eastern Texas. Land around the area of Kilgore, which had previously been selling for $5 an acre, was now bringing $2,000 an acre after a gusher on the Crim farm spilled oil out at the rate of 22,000 bbl. per day.

The oil industry was not exactly in the best of conditions. The Richfield Oil Company, which had been a giant in California, filed for bankruptcy in early February 1931. This Western giant fell victim to gasoline price wars and proration laws imposed by government. But stockholders were saved by a takeover offer of one share for every four of Richfield on the part of Cities Service. The Texas find continued to enlarge and threaten price stability in a very meaningful way.

Oil had not been included within the Smoot-Hawley Tariff Act of 1930 and thus imports were fairly significant. Again, government laws had been imposed which placed the American domestic interests at a decided disadvantage. The policy was called "proration" and its design was a means devised to curtail domestic production even though the U.S. was still an importer of oil. This measure thereby hurt many of the small independent oil producers throughout the Midwest. The large oil producers and the small were forced by law to cut oil production on a "proration" basis. Thus, the larger producers held the most profitable wells and a percentage cut in production did not necessarily threaten their viability for the long run. But the small producer, by and large, held older wells which barely skimped along. The proration basis was fair on the surface but not on a cost of production basis.

To further disrupt the industry, the "proration" restrictions did not apply to imports. This created unfairness between domestic and the foreign producer. Adding insult to injury, the Standard Oil of N.Y. and Vacuum Oil merger, discussed in the previous chapter, was still tied up in court. The government was fighting merger attempts vigorously, flexing its muscles under the guise of the Sherman anti-trust powers.

The big four in the industry were Shell, Gulf, Standard Oil of Indiana, and of course, Standard Oil of New Jersey with its numerous subsidiaries. All four of these companies maintained oil production outside the United States which qualified them as the four largest oil importers within the U.S. economy. The proration restrictions applied to crude oil and not to gasoline. Hence, imports of gasoline virtually doubled between 1929 and 1930 as a direct result of the proration restrictions. This meant that the big four complied on reducing their crude imports and domestic production, but gasoline was refined offshore and then imported to skirt around the restrictions on production. The breakdown was as follows:

Oil & Gasoline Domestic/Imports
(in thousands)

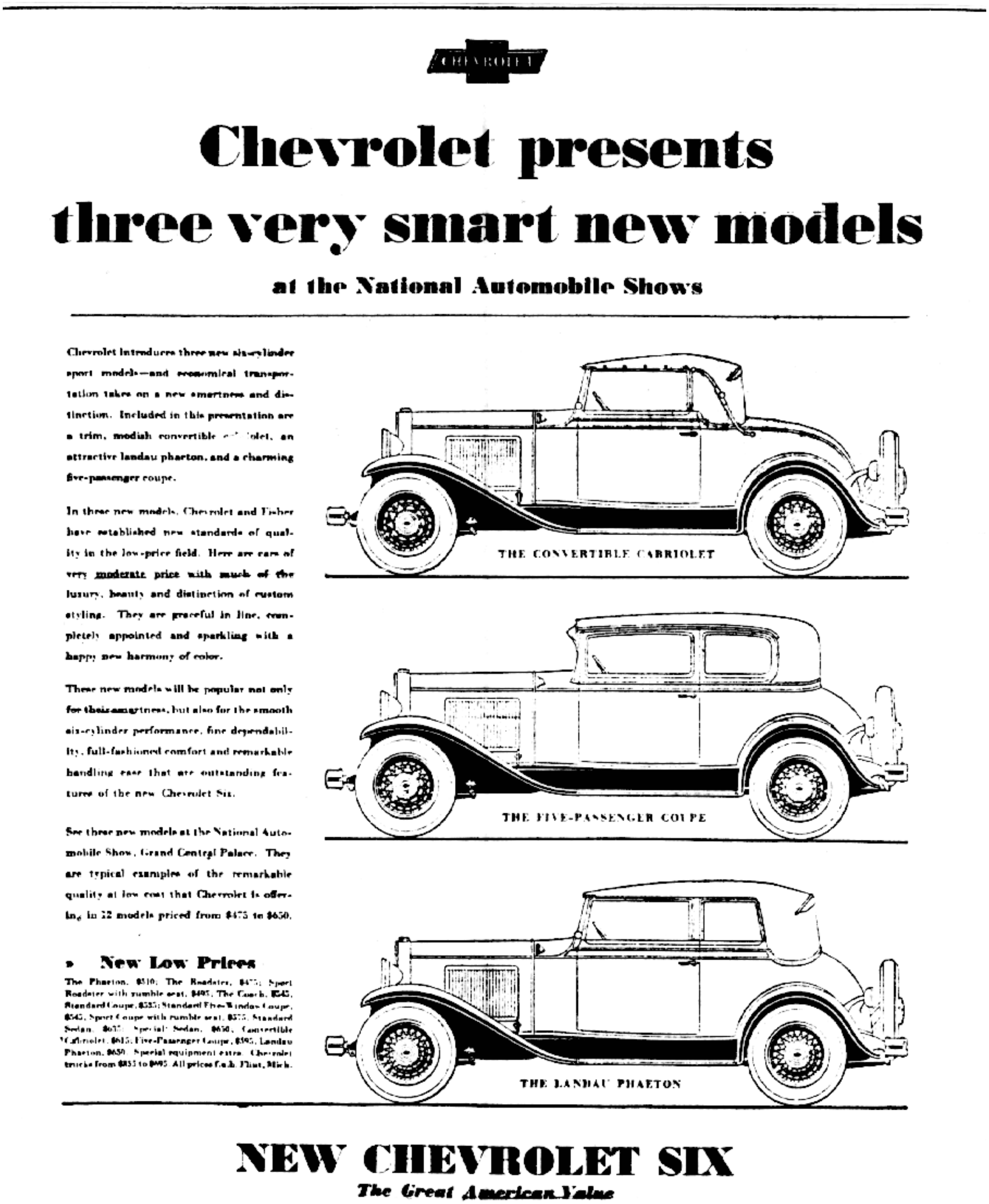
	1930	1929
Domestic Demand	922,000	940,000
Imports (Gasoline)	16,927	8,834
Imports (Crude)	62,129	78,933
US Crude Product	896,265	1,007,323
Exports (crude)	23,796	26,059
Exports (Gasoline)	64,978	62,059

*Note: Gasoline expressed in gallons and crude in terms of barrels.

The above table illustrates the decrease in U.S. domestic production of crude. While imports and exports of crude oil virtually balanced, there was a noticeable rise in the importation of gasoline. If we translate the gasoline back into barrels of oil required to yield the 16.9 million gallons of imported gasoline, then total imports of crude oil for 1930 came to 116,652,000 bbl. against 115,200,000 bbl. in 1929 and 90,625,000 bbl. in 1928.

Despite the Texas discovery, oil stocks began to rally during the early stages of February for one important reason. The cry of the small independents continued loud and strong. Only after numerous failures among this group of oil men took place, did government begin to wake up. The pres-


LET
SOCONY
SAVE YOU
MONEY
ALL THROUGH
1931
FOR 55 years Socony products have maintained their leadership because Socony engineers have each year improved them and made them more *economical* to use. 1931 Socony gasolines and lubricants sum up for you *all* the advantages of this long and successful experience. Try them. Make 1931 your most economical motoring year!
• SOCONY SPECIAL PLUS ETHYL — QUICKEST STARTING AND GREATEST ECONOMY IN THE PREMIUM FIELD. "Special" gives quickest starting even in sub-zero weather. It's brisker, livelier! It saves you coaxing and nagging on the self-starter. It reduces the amount of choke gasoline in your crankcase. It will not knock on the steepest of hills. In winter especially we recommend Special plus Ethyl —IT SAVES YOU MONEY.
• SOCONY BANNER GASOLINE—FASTEST STARTING AND GREATEST SAVING IN THE NON-PREMIUM FIELD. Banner is the most popular gasoline in New York and New England because it gives you quicker starting, faster pick-up, more power, more mileage, than any other non-premium fuel. Thousands of motorists have found —IT SAVES YOU MONEY.
• THE NEW SOCONY MOTOR OIL—THE MOST ECONOMICAL MOTOR OIL. It is a completely dewaxed, 100% paraffine base oil that maintains the proper body at all engine temperatures and flows freely in cold weather. It reduces wear on your engine. It saves drain on your battery, and gives perfect piston seal, maximum power, minimum gasoline and oil consumption. Perfected . . . proved aloft, ashore, afloat —IT SAVES YOU MONEY.
• SOCONY WINTER GEAR OIL—THE MOST ECONOMICAL COLD WEATHER GEAR LUBRICANT. Don't try to make a summer grade of lubricant in your transmission and differential do winter duty in gear shifting and gear lubrication. It's a costly experiment! Change to Socony Winter Gear Oil in your transmission and differential—IT SAVES YOU MONEY.
Make 1931 your most economical motoring year! Make this resolution: "I'll buy Socony . . . and start saving now!" Drive into a Socony station today. Make every start in the New Year a quick start— with Socony.
STANDARD OIL COMPANY OF NEW YORK


CHEVROLET
Chevrolet presents three very smart new models
at the National Automobile Shows
Chevrolet introduces three new six-cylinder sport models—and economical transportation takes on a new smartness and distinction. Included in this presentation are a trim, modish convertible cabriolet, an attractive landau phaeton, and a charming five-passenger coupe.
In these new models, Chevrolet and Fisher have established new standards of quality in the low-price field. Here are cars of very moderate price with much of the luxury, beauty and distinction of custom styling. They are graceful in line, completely appointed and sparkling with a happy new harmony of color.
These new models will be popular not only for their smartness, but also for the smooth six-cylinder performance, fine dependability, full-fashioned comfort and remarkable handling ease that are outstanding features of the new Chevrolet Six.
See these new models at the National Automobile Show, Grand Central Palace. They are typical examples of the remarkable quality at low cost that Chevrolet is offering in 22 models priced from $475 to $650.
New Low Prices
The Phaeton, $510; The Roadster, $475; Sport Roadster with rumble seat, $495; The Coach, $545; Standard Coupe, $535; Standard Five-Window Coupe, $545; Sport Coupe with rumble seat, $575; Standard Sedan, $635; Special Sedan, $650; Convertible Cabriolet, $615; Five-Passenger Coupe, $595; Landau Phaeton, $650. Special equipment extra. Chevrolet trucks from $355 to $695. All prices f.o.b. Flint, Mich.
THE CONVERTIBLE CABRIOLET
THE FIVE-PASSENGER COUPE
THE LANDAU PHAETON
NEW CHEVROLET SIX
The Great American Value

sures were naturally divided according to special interests. The big four were dead set against any tariff on oil and even the city of Baltimore, Maryland managed to get in on the act. Russian oil had been imported for the first time in history and it landed at Baltimore. This gave the city and the state reason to fight against a tariff which would cut off the hopes that Baltimore might become a booming port for Russian oil imports.

The big four argued that tariffs would cost the public an additional $980 million a year. The A.F.L. argued that the employment situation within the industry was "deplorable!" Ralph Arnold, an oil engineer, testified at the Senate hearings that with the new discoveries in Texas, the United States had enough domestic oil to last 500 years under present demand circumstances. The Governor of Kansas sent a rather lengthy telegram to President Hoover in reference to the plight of the small Kansas independent oil producers and the lack of restrictions on imports which he called "appalling." But the most impressive testimony came from the Secretary of the Interior who reversed his original position which was in favour of the proration scheme. He said: "if proration is the logical method of control of supply, it would seem to be logical to apply it to imports." The greatest support came for the oil stocks when the Senate Commerce Committee voted 9 to 6 in favour of the Caper Bill.

Senator Arthur Caper of Kansas introduced a bill that called for the total ban on the importation of gasoline and a limitation on crude, bringing imports down to only 16 million bbl. per year over the following three year period. Keep in mind that total crude importation in 1930 was 116.6 million bbls. The Caper Bill proposed that imports would be restricted on a proration basis according to 1928 levels applied to nations from which oil was being imported in the same fashion as those under domestic rule. The Caper Bill thereby affected the following imports on a per nation basis:

U.S. OIL IMPORTS
(in thousands bbls.)

	1928	1931-33(Caper)
Mexico	17,584	3,527
Venezuela	21,981	4,410
Dutch W. Indies	24,989	5,012
Columbia	11,836	2,374
Peru	1,224	245
Ecuador	765	153
Trinidad & Tobago	496	99

But the issue of the merger of Vacuum and SCONY was not completely dead. Vacuum was a large producer, but the Standard Oil of New York was an excellent distributor. Therein lay the incentive for the merger. After a year of battling, the issue was taken to the Federal Circuit Court of Appeals in St. Louis. The Court ruled in favour of the merger and against the government. Its opinion was stated as follows: "There is, and could be, no contention here that the present contemplated merger is a continuance...of the conspiracy and monopoly found to exist in the main suit (which dissolved old Standard Oil). The contention is, and must be, that it is an entirely new undertaking... The intent and purpose of the merger is solely to meet the normal and natural business necessities of the two companies." Despite this favorable ruling, the government was expected to appeal to the Supreme Court.

The new oil discoveries in eastern Texas sparked an oil rush which was beyond all imagination. In the depths of depression, 1929 had not been as generous as 1931 to this State in the Union. The press began to dub the event as "Oil Madness." The boom was moving at a rapid pace, dwarfing all gold, land, and oil rush eras which had preceded it.

By the end of February, deposits within the two National Banks in the district more than doubled from $750,000 to $1.9 million. The discovery had spread and now debate raged over how large the find might be. Oil rights in the form of leases passed from hand to hand at unbelievable figures. Airplanes flew above day in and day out mapping out the territory for the army of geologists that had invaded those parts. As hundreds of oil wells sprung up and oil seemed to spurt from nearly every hole the drillers forged into the ground, leases were being drawn up on neighboring counties as speculation over the size of the find heightened. One such lease on 2,500 acres traded hands for $3.5 million. This was the find of the century which the independents had dreamed of all their lives. At least they were getting in on the ground floor.

The boom brought with it a burst in economic growth to virtually every sector. In Longview in Gregg County, the local hotel and the bank kept builders working day and night hammering out buildings to double their size as people flooded into their once small town. An eight story office building at the cost of $400,000 was designed and brought to the groundbreaking stage in less than one month. An ice factory and a dairy pasteurization plant were rushed into construction. Oil was gushing forth in record quantities. An on the "spot" market had developed at which oil was trading at 40 cents a barrel down from the 70 cent figure which had prevailed in Texas. But it didn't matter. There were plenty more where that came from. Although prices were falling for the industry as a whole, the new oil-rich eastern Texas was basking in the glory of boom and speculation.

The rest of the nation, however, was not so fortunate. Although some sectors had shown some improvement, there were others that could not boast of fantastic earnings. The famous Winchester Repeating Arms Co. was one such casualty. Back in 1864, a foreman in a small Connecticut factory invented a repeating rifle. A few were actually supplied to the Union Army during the final stages of the Civil War. In 1867, the former Lieutenant Governor of Connecticut, Oliver F. Winchester, formed this firm bearing his own name by merging several small companies. During World War I, his firm employed 22,500 men in its huge 80-acre complex located at New Haven.

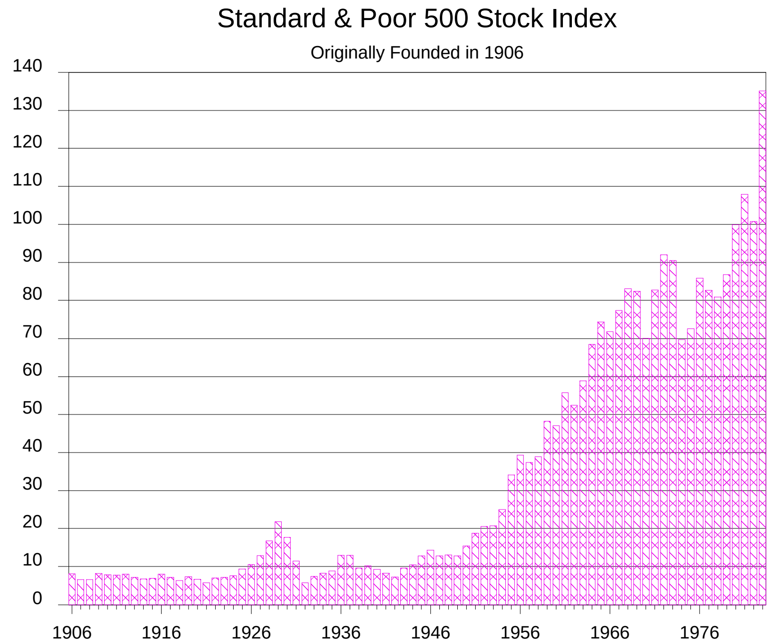
Despite the efforts to diversify the company by expanding it into the production of tools, cutlery, fishing tackle, skates, radiators, washing machines, batteries and even flashlights, hard times had taken their toll. The famous Winchester Repeating Arms Co. was forced into receivership. Its employment roles had shrunk to 3,000 men and most of them were on a four-day work week. No one blamed mismanagement or illegal activities, but merely stated that this famous company was a victim of the Depression.

Another victim was the securities markets themselves. There were 33 organized security exchanges in the United States at the time and business was not altogether that great. The Portland (Oregon) Stock & Bond Exchange announced that "until such time as the general conditions of the securities markets in the country and the particular situation in Portland" justified reopening, the exchange would be closed.

It was also during February 1931 when the entire brokerage business underwent a drastic change in its mode of business. Prior to this period, brokers were paid a salary and the commissions went to the house. But now the phrase "Secondary Distribution" was born. Under the old rules, a house could not buy a stock and then sell it to its clients. It would buy or sell in the open market on account for a client. But this new rule was something different. If a bank had a large block of stock that might be selling for $30 a share, the insiders knew that those shares were overhanging the market. Thus, this new rule allowed the bankers to give an option of the shares to a brokerage house, say at $28. The firm would then have its brokers try to sell the stock to investors who would hold the stock. Taking this large block off the open market would then support the price and perhaps the stock might even rally up to $32 . The brokerage firm would then sell the stock at the new price and pocket the difference between its option price of $28 and $32. A portion of that would then be paid as a commission to the individual broker. This was a plan devised to prevent massive layoffs in the brokerage industry due to lack of volume that persisted.

One industry that was booming was the financial statistical information services. The largest statistical organization was Standard Statistics Co., Inc., which was moving into new headquarters in Manhattan during February 1931. It occupied eight floors and employed 1,200 people which was a gain of 45% over the previous year. Sales of its information were also up 66% over 1930. Obviously, curiosity about the causes of the decline and about which companies were the best continued despite the depression.

The founder and President of this vast statistical company was Luther Lee Blake. He began his career as a telegraph operator at a brokerage house in Tennessee. He later moved on to the big time in Manhattan where he worked his way up to be the manager of a wire department at Laidlaw & Co., another brokerage house. He used to handle questions from the firm's clients who asked about different companies. Blake began to keep a scrapbook on various



companies so that he would be able to answer questions and help the clients out.

In 1906, he had the idea of taking 100 companies and printing vital information about each on a card type system which could be updated by simply printing a new card. He managed to persuade a printer to take a chance on his idea and cover the cost of manufacture. At first, Blake used bellboys to distribute the cards and soon A.M. Kidder & Co., a brokerage house at the time, became his first subscriber for $60 a year. Thereafter, J.P. Morgan, Kuhn Loeb & Co., and even the National City Bank joined his subscription ranks. By 1908, Blake had 300 subscribers.

In 1913, Blake acquired the Babson Stock & Bond Card System, but competition was also growing. Some of his competitors were John Moody's Service which pioneered rating various bond issues. There was also the Brookmire Service, the oldest economic advisory company at the time. Other competitors were Roger Ward Babson, Arthur Elliott of the National quotation Bureau and, the oldest of all services, Poor Manual Co., which later merged with Blake's Standard Statistics Co. forming what we all know as Standard & Poor.

February 1931 was a month of mixed economic data and human emotions. Opinions were naturally still divided between the bulls and the bears and at times the very same issue was used in support of an argument from each camp. The Texas oil discovery, for example was accused by the bears of driving prices lower as well as profits, which might impair the health of the large companies. But the bulls argued that this new great find would make the U.S. a net exporter by allowing prices to fall below world markets in the U.S. They added that the proration issue was being applied to imports and that would help establish stability within the domestic markets. They then added the court decision in favour of the Vacuum-SCONY merger and spouted optimism that if the U.S. Supreme Court would give its blessing, then the industry could become even stronger by allowing other weakened companies to merge.

There were countless rumours and numerous statements by business leaders and politicians which gave rise to optimism that the depression was at its end. The Dow Jones Industrials rallied sharply during February as confidence and optimism seemed to join hands that month. From the January 1931 low of nearly 161, the industrials rallied, coming close to 195 in February. It was a rally during which many selected stocks actually doubled in value during the four-week period. Time magazine reported on March 2, 1931 on the going-ons in the marketplace as follows:

"For three weeks prior to Washington's birthday, stocks churned higher on big volume. Bullish rumors flooded Wall Street. There were stories of big bears trapped; of big deals brewing. International Telephone & Telegraph gained 100% over its January low and there were tales that it will again attempt to buy Radio Corp's communication business. Auburn leaped from $101 through $210 and bulls said they heard that General Motors had agreed to use Auburn's free-wheeling (clutch) patents. Once again, the names of Mike Meehan and William Crapo Durant were heard where speculators gathered.

"Hope and a crowded short-interest rather than facts seemed to sponsor the rally. Steel ingot production hovered around 51% of capacity against 82% a year ago. But, companies catering to the automobile trade were busier than others. There were rumours of steel price-cutting. Automobile production during January came to 138,876 units against 161,223 in December and 283,606 in January 1930. Commodity prices hit a new low average but the swift January drop seemed checked. Failures for the week were 722 against 585 in the corresponding week of 1930. Bank clearings for the first week in February were 719,053 against 885,816 last year. Money was cheaper than last year, with New York time loans to brokers running at 2.10% against 5%, call loans at 1.5% against 4%.

"From the indices there is no indication that the improvement in business is more than seasonal, if that. But, if piblic confidence could be charted, a remarkable rise would be shown between December and February. And in that many a commentator based a strong conviction that the Depression has reached its depth that the next change will surely be for the better."

We can see that Time magazine was one of the skeptics. The majority of the press and comments by virtuous people in business were very bullish. For the Dow Jones Industrials to have rallied 20% from the previous December low and selected stocks to have doubled or more, there is no doubt that optimism must have been high. De-

Thawing Out Frozen Credits . . .

Sunshine on rainy days, for the more than 80% of the country's population that cannot borrow from banks, thaws out frozen credits for merchant, wholesaler, manufacturer, professional man, and banker. The above advertisement proves the importance of small loan financing and speeds collections by pointing out the only means available to the majority of families for obtaining supplementary funds in emergencies. It is one of a series now appearing in newspapers with four and three-quarter million circulation. Public spirited citizens are invited to write for information about the small loan business which is providing over a half billion dollars this year to hasten business recovery. Address Dept. T2, Household Finance Corporation, Palmolive Building, Chicago.

spite rumours of bears being caught in the rally, later Senate investigations illustrated that the rumors of large bear raids were without substantial evidence. Most of the famed operators had lost vast amounts of money from playing the long side.

As the February boom returned to the reality of events many began to reflect upon earnings and the drastically poor showings in most sectors with the exception of the drug industry and the utilities. Chrysler Motors announced its 1930 earnings during the last week of February, and then only $234,000 compared to $21,902,000 during 1929. Reality had struck optimism directly in the heart.

There were still a few mergers here and there and a few selected companies that still produced a handsome return although rare indeed. One such company was the Michigan Central Railroad. This stock could have been bought for $75 a share back in 1921 and by 1931 it had paid out $419 in dividends. There were only 1,283 outstanding shares in the market for the balance had been bought by the New York Central Railroad. Michigan was perhaps the most profitable railroad during the big boom even though it was a small company. In March, amid falling stock prices, the balance of the shares of Michigan were sold for $1,550 each to the New York Central. When the company was asked how in the world that price was reached, they laid it out quite simply. Michigan based their calculations on the fact that between 1925 and 1929 the best railroadstocks traded at about 15.07 times earnings. Since Michigan's earnings averaged $104 a share, they simply demanded $1,550 and the New York Central paid it.

The battle for world trade continued to take its toll. Canada imposed tariffs so stiff against U.S. steel that U.S. owners were forced to sell off assets in Canada. Republic Steel Corp. produced steel in Ohio. Much of its unfinished steel was then shipped to its wholely owned subsidiary in Ontario which was named the Canadian Metal Products Co., Ltd. Canada imposed tariffs that in effect created an outright embargo on the importation of steel. Republic had no other choice and it was forced to sell its Canadian manufacturing company for a song to Burlington Steel Co., Ltd. of Hamilton, Ontario. This move led to the downfall of Republic in the years ahead.

Despite the fact that interest rates were declining, banks were not big lenders to the small individual. The personal loan was not a practice that gained favour in the banking industry. Anything along those lines required the cosignature of a friend and as much collateral as possible, if not 150%. This gave rise to the small loan business of pawnbrokers and "usurers" as they were called.

The small individual seeking to borrow money was forced to pay 42% a year! Declining discount rates didn't help this segment of society at all. A common practice was that a wage earner's pay check was normally postdated. This gave rise to the often termed "salary-purchasers." These chaps offered $50 for a $55 paycheck, taking advantage of the person who needed the cash immediately. Pawnbrokers were reported to be lending money at the highest possible legal rate and then forcing the client to pay $10 for $1 worth of merchandise to get around the laws. The "userers" would collect $10 a month interest on a $50 loan for years at a time. Studies were conducted and it was learned that families of small means that were forced into bankruptcy were normally bled to death by these sorts of things for years.

The Morris Plan Banks were charging 6% interest plus a 2% service charge. This was taken out of the proceeds of the loan at the start and then the borrower was forced to make monthly payments along the way. By the time his first year was up, he was actually paying 17.3% in interest. Other private personal finance companies were charging 3.5% per month, bringing the total amount of interest paid by the borrower to 42% per year.

The interest rates varied considerably between the different companies that would lend money. The breakdown was as follows:

ANNUAL RATE OF INTEREST CHARGED

	Range of Interest (%)	
	Low	High
Life Insurance Co.	6%	6%
Building & Loan Soc	6%	12%
Credit Union	6%	18%
Commercial Banks (personal loan dept)	9%	22%
Installment Finance Co.	16%	25%
Industrial Banks	17%	34%
Remedial Loan Soc	12%	36%
Personal Finance Co.	30%	42%
Pawnbrokers	12%	120%
Salary Buyers	120%	480%

From the peak in optimism in February to the cold hard reality which struck in March, the Dow Jones Industrials fell closing March virtually on the low near the 171 level. The industrials had fallen almost 25 points which came very close to a 15% drop in less than five weeks. The initial tendencies to run back into bonds had shown life in this once popular relationship. The long bonds rallied, not by much granted, but they forged a new high for the year during March. But by the end of the month confidence in the bond market was not that convincing. The bonds fell closing under 96 near the low for the month following the stocks.

During the February rally there had been numerous rumours of bear pools that had been caught short. But despite the persistent rumours none ever surfaced. But in the sharp decline that took place during March, the demise of a bull pool did surface. This one was operating in Chrysler which had turned in a horrible earnings drop as was mentioned earlier.

A pool had been formed by the two brokerage houses of J.S. Bache & Co. and E.F. Hutton & Co. The terms of the pool were that it would exclusively trade in common shares of Chrysler but never hold more than 500,000 shares overnight. Others participated in the pool as well. Both Mr. Bache and Mr. Hutton sat on the board of Chrysler. The other big player was William F. Kenny who was a rich Brooklyn contractor, a one time director of Chrysler up until 1928 and best friend of Alfred E. Smith. It was revealed finally in March 1931 that the pool had been closed out on July 16, 1930 when Chrysler was $29. Both Bache and Hutton filed a suit in court claiming that everyone had paid in their share of the losses except William F. Kenny. The news that this once famous bull pool had met with disaster did not help the atmosphere during late March.

Retail sa1es at Sears were not that great. It was in March 1931 that Sears began what would become one of the larger insurance companies in the United States - All State Insurance Co. The new insurance company planned to write automobile, health, burglary, theft and accident insurance. Allstate got its feet wet by providing auto insurance to all the employees of Sears Roebuck & Co.

It was also in March of 1931 that the renowned firm for Kidder Peabody & Co. was dissolved and reborn. The firm was originally formed way back in 1865. By the turn of the century, Kidder Peabody had become one of the leading private banks in Boston. In August 1929, William Endicott, a key director who had entered the firm back in 1887 resigned. This was followed by the death of 89-year-old Frank G. Webster, a senior partner, in January 1930. Webster's death was sudden and unexpected and despite his age he had remained an active guiding light for the company. Then five days later, the key man who ran the day-to-day operations, Robert Winsor died suddenly as well.

Rumours continued to circulate that the firm was in trouble. It was Kidder Peabody that also held a sizable portion of the stock in Winchester. Finally it was official. The announcement came as a relief that the old partnership was dissolved and a new one would take its place but the firm would retain the same name and the tradition of Harvard schooled management.

At the meeting of the National Foreign Trade Council held in March 1931, its chairman addressed the Council with these words: "There are indications that the worldwide depression in business...is subsiding and that the upturn is beginning." The chairman was the same chap who headed U.S. Steel Corp., Augustine Farrell. His opinion had not changed from earlier in the year but he did add that the Council had taken a survey and estimated that world trade as measured through exports, dropped from $33.5 billion in 1929 to $27 billion during 1930. On a volume basis, not in terms of dollars, he stated that world trade was therefore off by 10%. Yet in terms of dollars, world trade was down nearly 20%. One could argue this point since the dollar was strengthening against many currencies around the world. Thus it would take less dollars to pay for the same amount of world goods.

Just the week before, Farrell, as President of U.S. Steel publicly pointed out that his company had just received the largest order for "structural steel ever placed!" The order came from Manhattan for the construction of what would become a famous New York landmark - the Radio City building.

Meanwhile, another merger caught the attention of many in the market during March of '31. It was the merger of RCA and Columbia. This merger had been a rumour that festered on and off for over six months and, in fact, it had appeared again prior to the peak in 1929. At last a rumour that had come and gone many times, prompting buyers in both companys' stocks, had come to pass.

There was also another court battle which had been going on for some time. This one was a test case that seriously affected the accounting industry itself. A company named Ultramares Corp. of London had lent Fred Stern & Co., Inc. of New York a fairly sizable amount of money based upon an independent audit prepared by the firm of Touche, Niven & Co. Fred Stern & Co. went into bankruptcy soon after the loan. Ultramares brought a suit against Touche charging negligence in preparing the audit. The first round produced a verdict that Touche was liable for an employee's negligence. But later a Court of Appeals in Manhattan overturned the lower court's decision. The court ruled that a financial statement which specifically figures as "true" would be guilty of negligence. But since the statement had concluded "in our opinion" no testament was intended. Hence accountants were relieved and adopted the phrases "we believe" and "in our opinion."

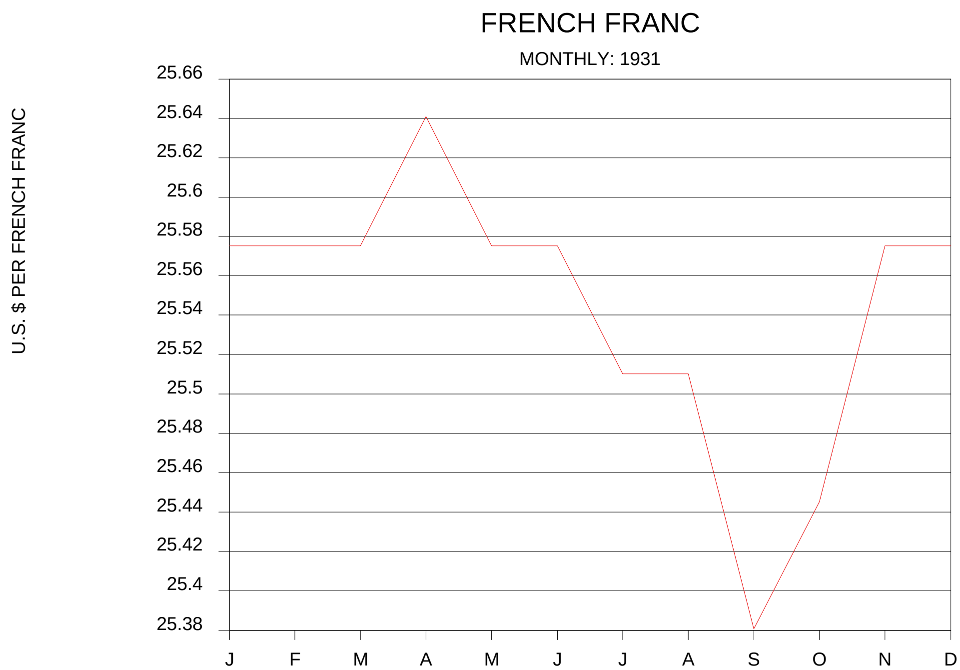
As lawsuits mounted and people fought over losses - sometimes in the courts and sometimes in the streets - the once bright notes of optimism could no longer be heard as April began to go to work on the market. The Dow Jones Industrials fell severely, penetrating not only the January 1931 low but the supposed low of the Depression which had been established back during December of 1930. The industrials had closed March at 172.36. April 1st had rallied to 173.72 on an intraday basis but fell back closing at 170.82. Thursday, April 2nd, remained nervous rallying back up to 173.15 but closing at 169.89.

The 3rd of April was Good Friday and the market closed for this solemn occasion. But Saturday it was business as usual and the market rallied once again back to 173.36, closing at 172.43. The market was closed for Easter Sunday and when Monday came, the holiday cycle seemed to make its presence felt. Easter Monday rallied to a new high for the month touching 174.69, but the gains could not be sustained. Selling came in once again and the market fell closing at 169.72. The selling pressure continued throughout the course of the week bringing the industrials down as far as 166.10 and closing the week at 168.03.

The following week began with Monday the 13th posting a rally as the market closed at 171.07. Tuesday tried to rally to new highs but the best she could offer was an intraday high of 173.24 and a weak closing at 168.43. The selling continued and by Friday the industrials had fallen to 158.50 closing that Saturday at 162.37.

The week of April 20th continued with sellers out-muscling the buyers. The market fell to a new low almost every day, dropping to 151.58 and closing at 151.98 on Saturday the 25th. The December 1930 low had been 158.41. The final week of the 27th began with continued selling pressure. The high of the week was 153.82 and the low was 141.78. This April low had held until May 18th, but in the meantime the industrials had at least rallied during May back to 156.17 at its very best.

On the world foreign exchange markets, pressure was building. The U.S. dollar began to strengthen. In April as the stock market dropped, the dollar began to rise against the French franc reaching its high for the year during this month at 25.641 francs per dollar. Against the Dutch guilder, the dollar had fallen to a low of 40.08 guilders to the dollar in March. But April brought a strong rally for the dollar against this currency as well jumping to 40.195. The dollar continued its rally against the guilder into October, finally reaching 40.35. Against the pound the dollar actually declined slightly from its March high of $4.85 as the pound rose in value to $4.86 in April where it remained until June. But there was no doubt something was brewing in the foreign exchange markets causing a slightly higher rate of volatility. The astute investors knew something was going to give. The question was what?

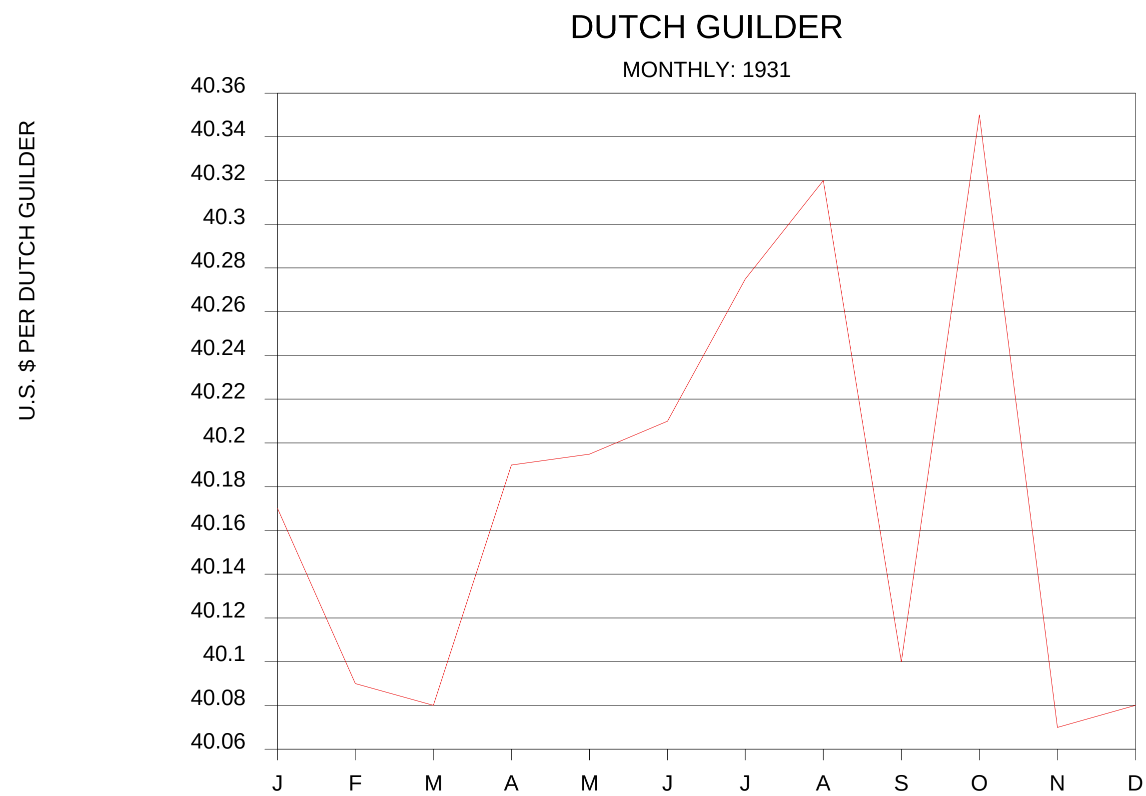


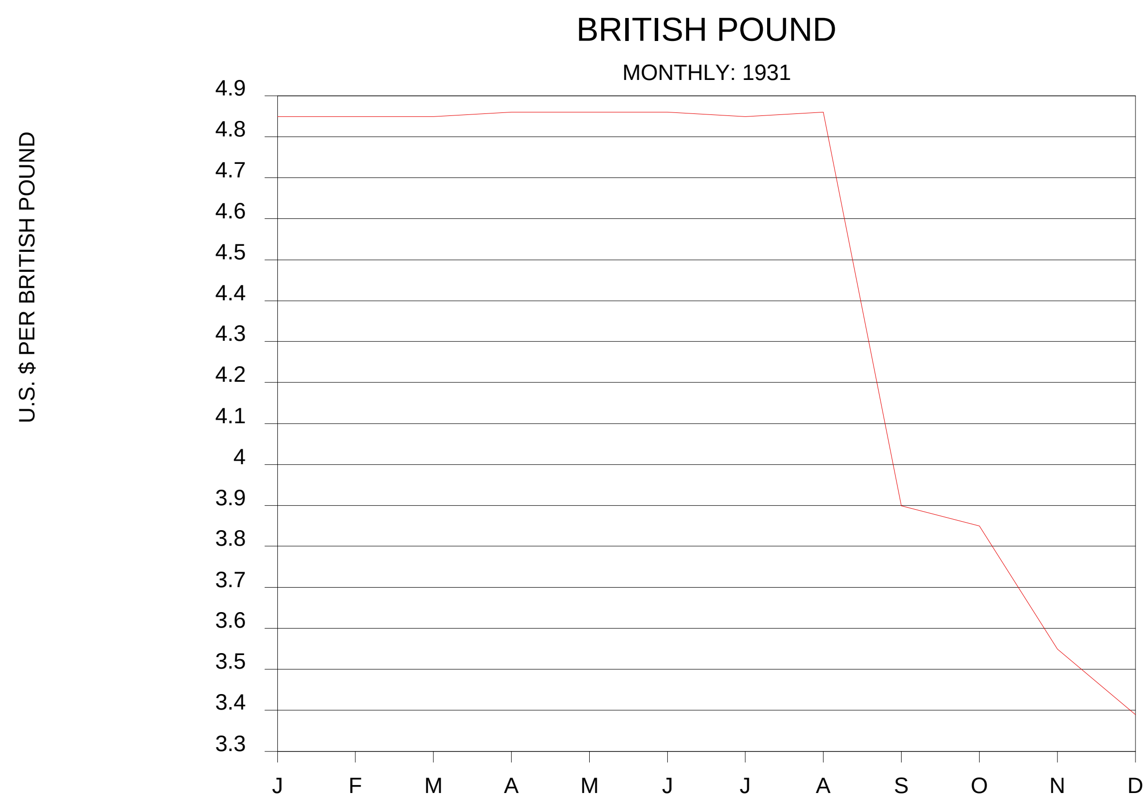
The causes for the sudden break were many. The effects of the depression were becoming severe in Canada which was a prominent trading partner. Canada had imposed stiff tariffs against steel as discussed earlier, but it also instituted tariffs against a number of finished products including automobiles. In effect an embargo against U.S. autos had been put in place. U.S. sales of automobiles to Canada dropped virtually overnight during the first quarter of 1931 bringing them down to nil. Nash Motors and Durant Motors of Canada joined forces and formed a subsidiary to produce autos at Leaside, Ontario in March. Both the Reo Motor Car Co. and Hupp Motor Car Corp. made arrangements to open plants directly in Canada. The auto industry was already off 40% in earnings on the average between 1930 and 1929. The fight to remain competitive only further weakened the industry and rumours that the first quarter of '31 was going to be disastrous spread through the stock market.

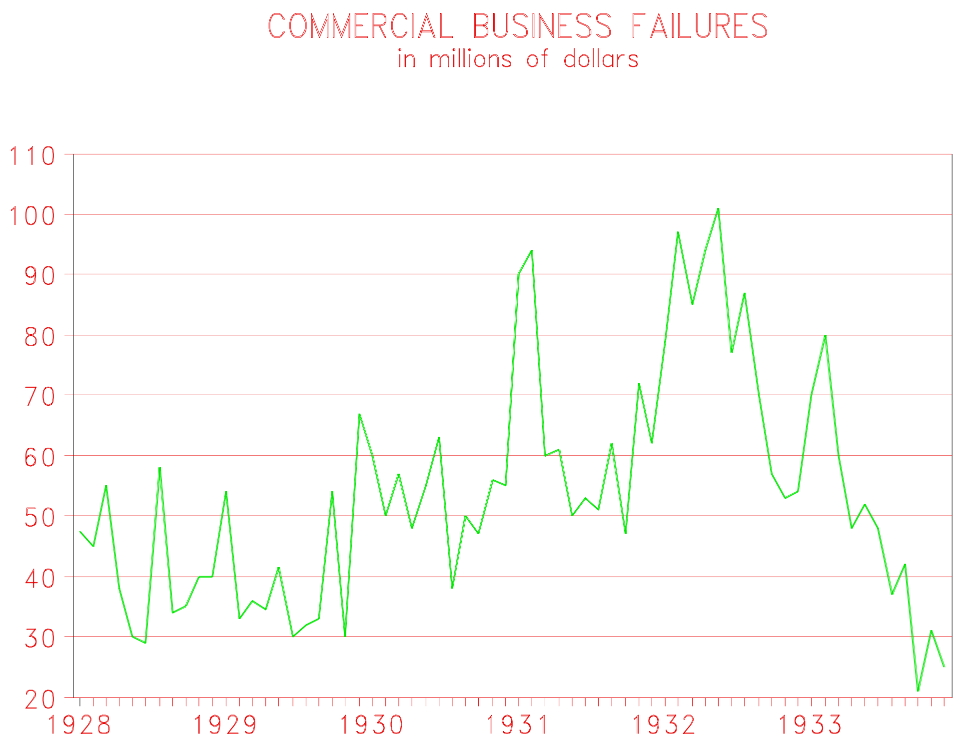
The production total for automobiles in April 1931 was nearly 350,000 units compared to 444,000 in April 1930. Chevrolet was still gaining over Ford. Its April production came to 85,000 units compared to March. Cadillac was also up 26% above March 1930 levels and on a quarterly basis it was up 20% over the first quarter of 1930. But these gains were at the expense of other competitors including both Chrysler and Ford.

In its April 13, 1931 edition, Time Magazine commented on the atmosphere as early April began:

"A heavy gale accompanied April to Manhattan. Wall Street ran with water-down. Offices were lighted all day. It was dismal, not exciting, on the floor of the New York Stock Exchange. Most traders kept an eye on Post 2, where United States Steel is traded in. Shortly after noon Steel sold at $138, one-eighth above its previous 1931 low. It was evident that what had a few weeks before seemed a run-away Spring market had petered out.


DUTCH GUILDER
MONTHLY: 1931
U.S. $ PER DUTCH GUILDER
40.36
40.34
40.32
40.3
40.28
40.26
40.24
40.22
40.2
40.18
40.16
40.14
40.12
40.1
40.08
40.06
J F M A M J J A S O N D


BRITISH POUND
MONTHLY: 1931
U.S. $ PER BRITISH POUND
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
J F M A M J J A S O N D



"Traditionally April 1 is the day when bankers and businessmen can look about them, size up the state of business. All last week figures were being issued which showed that the Spring recovery in business did not exceed the usual seasonal gain and was giving signs of dying away. Perhaps most frightening, so far as the stock market is concerned, have been the many dividend reductions and omissions, although these reflect past business not future. During March, 114 dividends were omitted, as against 57 such actions in March 1930; 115 dividends were reduced against ten last years.

"Insolvencies during March came to $60,386,000, a 6% gain over March of last year and the largest for the month since 1924. Insolvencies during the first quarter were $214,000,000 against $218,000,000 in 1922, $169,000,000 last year.

The market had taken the continually rising dividends and earnings as the keynote to a bull market throughout the 1920s. You will recall that the critics of the bull market did not deny that the earnings were spectacular, they merely kept saying from 1923 onward that such gains couldn't possibly last.

In the commentary taken from Time magazine above, we find that it was the omission of dividends and the poor earnings reports as well as expectations of the future which contributed in part to the decline from the February high in 1931. But in addition, there were numerous other indicators that the traders were watching very carefully. Bank clearings were off 22% suggesting that money was not only being hoarded, but sat upon by many out of fear of safety but also out of a natural urge to put something away for a rainy day. At that time the rain had turned into a typhoon.

Railroad car loadings were also off 15% from 1930 levels in March of '31 and down 22% from 1929 levels. Of the first 75 railroads to issue February reports, there was a 53% decline in operating income.

The optimism which had once existed even in the oil industry gave way to the logic of the pessimist. Government's harassment of this industry had continued in the early 1900s in breaking up the old Standard Oil Co. under the guise of the Sherman Anti-Trust Act. Ever since that time, government's oppression continued to plague the oil industry. In January 1930 in the Federal Court of Chicago, the government charged the Standard Oils of New Jersey and Indiana along with Texas Co. and 45 other oil companies with violating the Anti-Trust Act in keeping tight control over their patents and for a variety of cross-leasing of fields between companies. The government won that case back in 1930, but in April 1931 the U.S. Supreme Court held that the companies did not create a monopoly which hindered interstate commerce by maintaining patent rights. The battle had raged on for seven years costing the shareholders millions in the process. Despite this bit of good news, the new discoveries in Eastern Texas were officially estimated to have a capacity for the production of 500,000 bbls. per day. This worked out to be 182.5 million bbls. per year, which was a 20% increase above current domestic production. This obviously didn't help the oil stocks very much at this time.

In addition, the periodical, World Petroleum, reported on the rumours that Soviet oil production would capture the Chinese market which was primarily for kerosene. This naturally was viewed as a setback for U.S. interests which supplied that market. U.S. refineries in April 1, 1931 were operating at 65.3% of capacity compared to 70.9% on April 1, 1930. Prices of oil continued to decline and inventories of gasoline continued to rise as illustrated by the following tables:

U.S. CRUDE OIL PRICE MOVEMENTS

Jan 1 - Apr 1, 1931

	Jan 1	Apr 1	%chng
High-Grade Calif	1.48	.35-	76.3
Mid-Continent	.81	.53	34.5

U.S. GASOLINE INVENTORY IN BBL.

Jan 1 - Apr 1, 1931

Gasoline Stocks	42,218	47,444	+ 12.3%

The above tables clearly illustrate the plight of the oil industry during this phase of the Great Depression. By mid-April '31, Shell Oil cut its work schedule to a five-day work week. This merely added to the unemployment rolls. The trend was clearly developing into cutting both time and wages as opposed to the original suggestions made by Hoover to cut time but not wages to relieve the state of overproduction and maintain consumer purchasing power.

The government's intrusion under the guise of the Sherman Anti-Trust Act continued to broaden. The government even began a monopoly investigation of Ringling Brothers, Barnum & Bailey Circus. Despite the adverse effect upon U.S. competitiveness in world markets and the rising difficulties which faced U.S. industry, the government vehemently pursued the Sherman Anti-Trust laws under the promise of protecting the consumer. In many ways, it was the Anti-Trust Act that spawned the need for the Smoot-Hawley Tariff Act of 1930 which in turn merely stimulated the worldwide trade war.

The decline in the market at this time was also caused in part by additional banking failures. But perhaps within this sector of causes, none was as highly influential at the moment as the failure of the well-known brokerage house of Pynchon & Co. The failure of this firm was indeed a surprise. More than a year before there had been rumours that this renowned firm was in trouble. Nevertheless, it was also well known that the famous Chase National Bank stood behind it to some degree. Back in 1930 it was rumoured that Chase had loaned Pynchon anywhere between $10 and $20 million. Many were completely shocked by the flash across the ticker which read: PYNCHON & CO SUSPENDED FOR INSOLVENCY."

Despite the rumours, the majority just didn't believe that this firm would actually go down. The Exchange itself was in possession of a telegram in which a well-known Chicago tycoon was reported to be putting up needed capital. So most had thought that it was a temporary situation and that any problems had been forestalled. But the Chicago tycoon's capital never came to pass.

Pynchon & Co. was no small house. It had 11 offices including offices in London, Liverpool and Paris in addition to being a member of 16 stock and commodity exchanges. Pynchon & Co. had been around for 36 years, certainly qualifying it as one of the "establishment." Yet the amount of money involved came to $40 million, which qualified it as the largest failure in the history of the New York Stock Exchange up until this time. Indeed the effect that this also had upon the market was not one of the great expectations. Three days later, the firm of West & Co. based in Philadelphia also failed. West & Co. was not considered to be a major firm, but it helped to raise fears over the stability of the brokerage business in light of the numerous failures taking place within the banking industry.

Another factor that added to the heat of selling was the continual reporting on the first quarter earnings. Many investors, speculators and traders had just allowed their hopes to override reason, creating an atmosphere of jubilant expectation as the market rallied into the February high. But now those expectations proved to be very ambitious and all the comforting words from business leaders did little to improve the situation. The following table illustrates a few selected industries.

1931 FIRST QUARTER EARNINGS
(in thousands of dollars)

	1931	1930	%chng
American Bank Note	1,019	1,523	-33.0
Borg Warner	325	1,097	-70.3
Caterpillar Tractor	1,031	3,365	-60.3
Chrysler Corp	(-979)	180	-643.8
Corn Products Ref	2,389	3,152	-24.2
Curtis Publishing	4,654	6,533	-28.7
General Electric	11,488	15,042	-23.6
General Foods	5,572	5,990	-6.9
General Motors	28,999	44,968	-35.5
Gillette	1,421	2,164	-34.3
Hudson Motor Car	226	2,316	-90.2
Hupp Motor Car	(-680)	66	-1130.3
McGraw Hill Pub	372	534	-30.3
Montgomery Ward	(-1,783)	(2,318)	30.0
National Cash Regs	(-373)	912	-140.8
Otis Steel	20	634	-96.8
Parkard Motor Car	113	2,654	-95.7
du Pont	12,656	17,347	-27.0
Studebaker	809	1,347	-27.0
Westinghouse Elec	(-2,885)	4,546	-163.4

In studying the first quarter earnings for 1931, I found that on a broad basis, disregarding individual size of each corporation and without any weighting, that the once great auto industry reported a 271% decline in first quarter '31 earnings. The expanding electric industry reported a 93.5% average decline in earnings. Two of the least adversely affected industries were publishing, off 30.6% and food processors (not agricultural producers), off 15.5%.

It is ironic that when the stock market first began to crack back in 1929, many blamed the demise upon the "optimistic" statements by business leaders and politicians. If that line of thinking were valid, all the optimistic statements during the early part of 1930 and in January-February 1931 should have also supported the market. In the end, all the optimistic statements failed to have any effect. The public judges a given situation by what it sees, NOT by what it hears. Everyone was bullish back in 1929 based upon the continually rising prices of common shares, NOT based upon the words of Hoover or anyone else.

It was also in March 1931 that Wallace Brett Donham, dean of Harvard's Graduate School of Business Administration, published his book entitled: "Business Adrift" (McGraw-Hill). In this contemporary philosophical piece of the era, Donham struck at the heart of many issues. "How can we as businessman within the areas for which we are responsible, best meet the needs of the American people, most nearly approximate supplying their wants, maintain profits, handle problems of unemployment, face the Russian challenge and at the same time aid Europe and continue most to or disturb least the cause of international peace?" Essentially, Donham warned that the U.S. should not engage in ruthless competition with Europe. He felt that such a trade war would eventually lead to the spread of communism throughout Europe and even into Britain itself, causing the destruction of Western civilization.

Donham's views were quite forceful. On the Sherman Anti-Trust Act, he said: "The time has come for a complete reappraisal of the attitude toward competition which is expressed in the Sherman Act." On the issue of unemployment he warned: "Unemployment is as much a general social problem as it is a business problem and...solutions...must be worked out by business and politics in combination... The whole principle of insurance as applied to unemployment is unsound. The remedy for unemployment is work."

Donham also warned that "the job of each generation is to consider not only economic theory but the whole gamut of the complex sociological factors existing at the time and to stimulate progress...So far as possible it should avoid creating new dangers for its successors...I have, however, no doubt about the soundness of my conclusion that we must have a philosophy, a plan, and a method of thinking about the future. Without these, the influence of American business on civilization will be destructive...The danger in our situation lies not in radical propaganda, but in lack of effective business leadership. Great problems, upon the decision of which the whole history of the future may turn are receiving no adequate attention. Even the mechanism of thought

ROMANCE · INCORPORATED

There is a thrill that comes from owning common stocks, which you can't get out of any other form of investment. It is the thrill of participating, without any limitations, in the prosperity and growth of a business—of its products or service—of its leadership. As it rides to success you ride along!

Common stocks may be regarded as a sound investment if two basic safeguards are observed. One is expert selection. There are a hundred rigorous tests of a company's history, present position and future potentialities which it must pass for its common stock to be regarded as an A-1 security. The other safeguard is broad diversification. A single stock, no matter how wisely chosen, may suffer. A group of sound stocks, in widely varied fields of industry, is bound to prosper as America itself prospers.

Consequently, if you believe in the future of America, you are bound to believe in the collective future of the stocks in the portfolios of these two Fixed Trusts: North American Trust Shares and Cumulative Trust Shares. Each one of these widely diversified common stocks was chosen after hundreds had been eliminated by the most searching analysis and tests known to modern investment science. Each stock represents a major American industry with a brilliant record behind it, a magnificent future ahead of it. Collectively these stocks represent the cream of big business in the United States. They are what the big investor buys, now made available to even the smallest investor.

What the stocks are and exactly how the Fixed Trust operates is all described, simply but completely, in a new booklet, *Money and You*. May we send you a complimentary copy? Then you will understand why American investors have already purchased millions of dollars worth of North American and Cumulative Trust Shares.

While the limited supply lasts, a De Luxe leather-grained portfolio to hold valuable papers will be sent without cost to those who will mail the coupon promptly.

LISTEN! The Fortune-Builders Program, featuring America's captains of Industry, comes to you every Sunday and Thursday at 10:30 p. m., Eastern Daylight Saving Time (9:30 E. S. T.) from WABC and associated stations of the Columbia Broadcasting System.

NORTH AMERICAN TRUST SHARES

The *original* distributive type and by far the *largest* Fixed Trust.
Maximum distribution.

CUMULATIVE TRUST SHARES

The *first* and *only* Fixed Trust which accumulates capital to a maximum degree.
Maximum Accumulation.

DISTRIBUTORS GROUP, INC.,
63 WALL STREET, NEW YORK, N.Y.

Without obligation on my part, send me Booklet T-1 *Money and You* which gives complete information about North American Trust Shares and Cumulative Trust Shares, also the Valuable Papers portfolio.

Name

Address

Buying Dollars

at a

Liberal Discount

THAT, in effect, is what many careful buyers of well selected bonds are doing.

When sound bonds bearing a coupon rate of 5%, 5½% or 6% can be purchased at prices to yield seven or eight per cent or more, the purchaser is certainly getting his incoming dollars at a substantial discount.

Good bonds are a desirable form of investment at any time. At this time they present unusual opportunities for profitable income.

The conditions which have developed these opportunities for investors are rare, but they are by no means unprecedented. The more experienced investors will recall, for example, that unusual conditions also prevailed in the bond market during 1920-21.

There were then, as now, many sound bonds available at prices which presented exceptionally liberal income returns.

Numerous indications support the belief that the prices of carefully selected bonds will in the future, as in the past, show improvement when business returns to higher levels.

Our suggestions for investment adapted to varying individual and institutional requirements, and including a list of selected bonds selling at substantial discounts, will be submitted upon request.

Harris, Forbes & Company

Pine Street, corner William, New York

Uptown Office: Lincoln Building
60 East 42nd Street

Harris, Forbes & Company
Incorporated
Boston

Harris, Forbes & Company
Limited
Montreal

Harris, Forbes & Company
Limited
London

Harris, Forbes & Co
Paris

Harris Trust and Savings Bank
Bond Department
Chicago

necessary to the rational handling of such problems is not understood. I see nowhere signs of a general philosophical attack on the problems of the relationship of American business to civilization."

Donham neither came out against the tariff issue nor in direct favour of it. But he did advocate a tariff system for those industries in which their demise would lead to a drastic change in the social structure. He was against tariffs to protect newly developing industries which would attack the old established industry in another nation.

Donham was correct. The issue of unemployment insurance did not stop right there and the reasoning behind the issue did not strike at the problem itself. But from the unemployed's perspective, it at least provided food to sustain one's family. The philosophical issues of which Donham spoke were never addressed. Government continued to broaden its powers with little foresight to the damage it might create for future generations. The anti-trust laws were never repealed and they were used to eventually carve up AT&T in the 1980s, which did not save the consumer anything but instead seriously raised the costs in many areas on the local level. It is doubtful that the anti-trust laws have ever been successful in protecting the consumer. They have merely added to the arsenal of weapons which government has at its disposal for manipulating the free enterprise system.

Indeed, there were many issues of philosophical debate. One of the primary arguments resided within the issue of wages. Henry Ford had become the symbol of the theory that if wages could be maintained that in the long run purchasing power of the consumer would prevent a depression. You will recall in the 1929 chapter that we quoted Ford's famous statement on this issue made back in December 1929 following the Hoover White House conference with business leaders. There was considerable doubt about this theory by April 1931, particularly when the dismal first quarter earnings were released and the 1930 low was violated in the stock market.

Despite the claims from the high-wagers that maintaining high wages would increase purchasing power and speed the recovery, no evidence of this theory was present. Many of the opposition were bankers. The famous Melvin Traylor of First National of Chicago, former adversary of Benjamin Strong back in 1927, said that "employers must be as quick to recognize the real wage (based on purchasing power of the dollar) in a rising market as labor must be to recognize the real wage in a falling market." Others argued that by lowering wages it would reduce the cost of production, thereby reducing retail prices and stimulating purchases, which would speed recovery. Supporters of the high-wage theory warned that reducing wages would be socially dangerous and that it was not fair for the rich board directors to squeeze the working man's salary. The arguments were logical for both sides, but the reality of events indicated that maintaining high wages did not prevent the Depression from worsening and in many cases it threatened the survival of industry during such a sharp contraction in the business cycle. Labour may have received their high wages at first, but confidence in turning around and spending their earnings was not there. Hoarding of gold continued to rise thereby reducing the velocity rate of money turnover by 22% from the previous year as the second quarter of '31 began.

Indeed, gold became very attractive both in physical form as well as in gold stocks. One example of this was the performance of Noranda Mines, Ltd, a large copper and gold producer in Canada. Noranda's earnings for 1930 were $3,842,000 against $4,287,000 during 1929. Despite this decline, stockholders did not become discouraged. In late March news came out that Noranda had just struck a new vein of gold. The stock traded on the New York Curb Exchange and on the Toronto Stock Exchange. It was steady at the $17 level prior to the news and then buying activity soared taking the price of the stock up to $27 despite the broadly declining stock market.

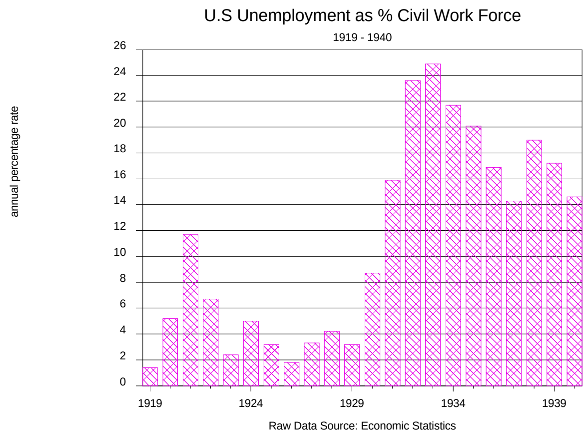
Noranda was a larger producer of copper than gold and, indeed, today it is still better known for its copper than its gold mines. This stock had peaked at $44 during 1929 and fell to $17 prior to the news of this new discovery. The total value of Noranda's outstanding 2.2 million shares jumped back by $22 million U.S.

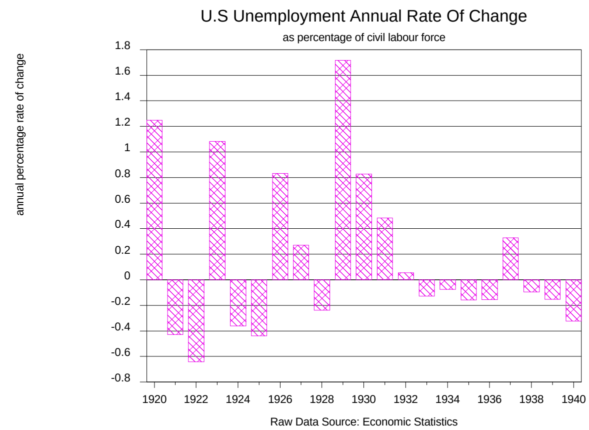
Homestake Mining is perhaps a more pure example of a gold stock. From the high of $100 back in 1906, Homestake fell $54, bottoming during the panic of 1907. During World War I, Homestake rallied to $135.50 in 1916, but failed to make a new high in 1919, stopping at $100 when the broad market was moving into uncharted territory. But Homestake continued to decline and eventually fell to its all-time low of $35 in 1924, closing the year at $43. By 1927, this stock rallied back to as high as $74.50 just prior to the central bank intervention which lowered interest rates in the U.S. in an effort to help Europe. Homestake continued to rally, but by 1929 it had peaked at only $93 closing the year at $77. The Great Bull Market had failed to take Homestake to new highs for this century when virtually all other stocks rallied substantially above previous bull market highs.

As the depression began to set in, Homestake fell to $72, bottoming during the first quarter when all other stocks were rallying sharply. But as the broad market declined, Homestake began to rally reaching $83 and closing the year at $79 7/8. Homestake then soared, gapping higher as 1931 began. The low for the year was $81 and as the international situation worsened, Homestake continued higher reaching $138 and closing 1931 at $129.

This was far from the high on this stock. During 1932, the yearly range was $163 to $110 and in 1933, it carved out a trading range of $373 to $145. Under the policies of Roosevelt, Homestake flourished eventually reaching $544 a share by 1936. Between 1924 and 1936, Homestake had appreciated 1,454%, far outpacing the broad market quite easily. It was in 1937 that Homestake split 8:1 and fell to its lowest point in 1942, reaching $23 which was equal to $184 expressed in terms prior to the split. It then rallied to $60.75 ($486 in pre-split terms) in 1945, culminating into its high for World War II. But that 1945 high had not exceeded the 1936 high of $544 when inflation was the primary fear at the time, more so than geopolitical tensions.

It was in the May 18, 1931 edition of Time magazine that a discussion about the Federal Reserve's latest move appeared - a cut in the discount rate to 1.5% which was the lowest in history for a central bank and the bottom for the Great Depression. "Anxious to give business a stimulant last week, the directors of the Federal Reserve Bank of New York slashed its rediscount rate from 2% to 1.5%. Money eased throughout the land. The immediate aim and probable result was to aid England which has been losing gold to the U.S. Over a longer period, agreed bankers last week, it should encourage foreign financing in the U.S.,



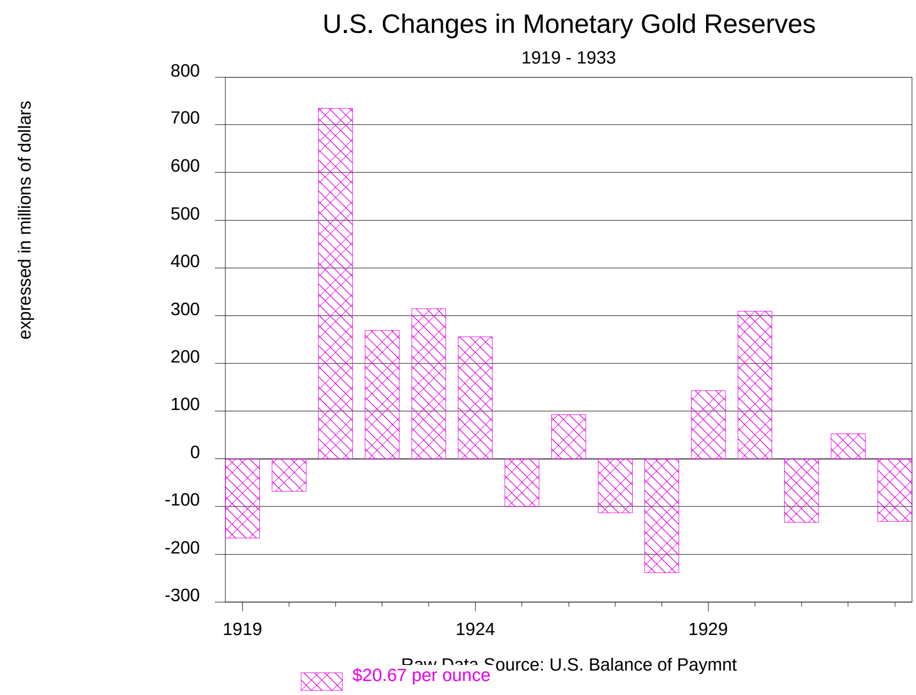


likewise issues by domestic companies. Yet last week the state of U.S. business was such that no sudden demand for funds was expected, no immediate revival held likely."

Money had fallen to its cheapest rate for the 20th century. Back in 1894, following the famous Panic of 1893, 30-day funds in New York had fallen to 1% as money sat idle in the face of a lack of confidence toward investing on the part of industry and capital. Even as late as 1895, the all-time low of 5/8 of 1% formed the bottom on the open market discounts in London. This time was no different. Capital, far from contented, was still afraid of investment. Industries by and large sought not to expand but to contract as with this trend demand for capital declined severely. This is perhaps evidence in itself that during periods of economic expansion, demand for capital rises from the business sector bidding up the price of money (interest rates) in the same fashion as increased demand causes the price of a given stock to rise. Our modern day perspective that the stock market should rise during periods of declining interest rates and fall during periods of rising interest rates cannot be supported when we review the facts that history has provided.

In the commonly accepted form of modern fundamental analysis, we have chosen to only remember that interest rates and the stock market usually peak in unison but we forget that such unions at the top do not translate into the maxim of "rates up-stock down." In reality, demand for both capital and stocks tend to peak in unison but there is no prescribed rate at which rising interest rates will change the trend of speculation or investment. In 1893, the stock market peaked when call money reached 75%. In 1899, the stock market peaked after a brisk two-year rally only when call money reached 184%.

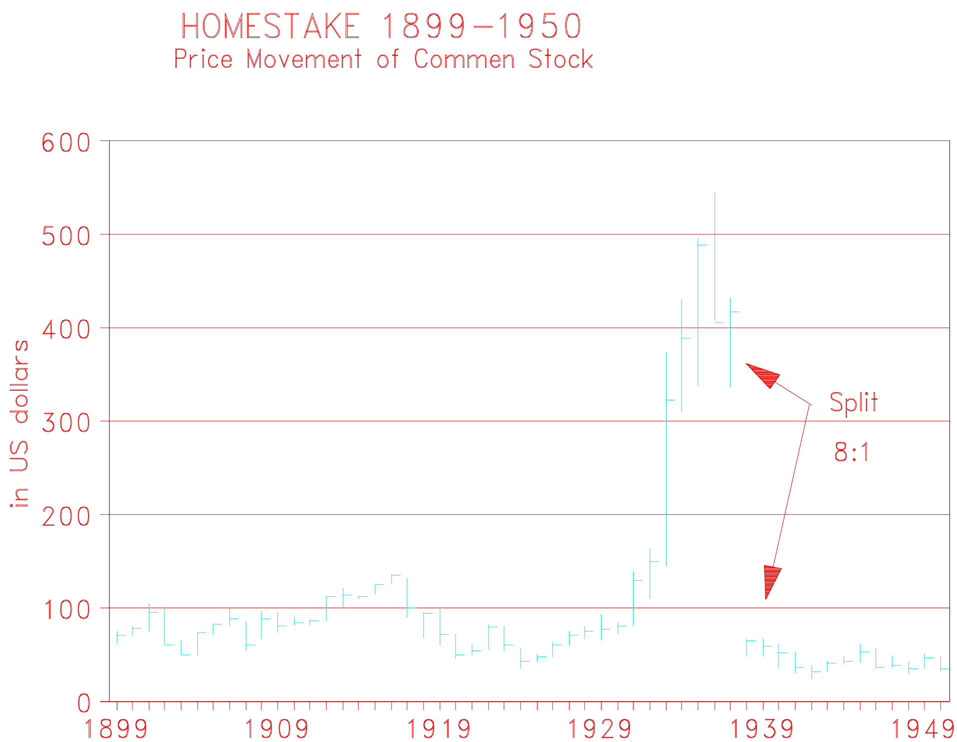
In 1905, call money soared to 125%, yet the stock market continued higher eventually peaking in 1906 when call money was 62% and the panic of 1907 took place when call money rallied back to 125%. The rally



in the market, which came to a crest in 1916, did so when call money peaked at only 15% and the next rally in 1919 peaked when call money finally reached 30%. Even the peak in the market during 1929, which was three times greater than the high achieved in 1919, came with call money rates at only 20%. The amplitude of rallies cannot be measured in direct proportion to the amplitude in the call money rate. Although the directional movements are similar, the levels of previous highs and lows between the two do not offer any direct correlation.

It also follows, therefore, that sitting in the chairman's position at the Federal Reserve, there is no way one could be sure to what degree manipulation of the discount rate would be necessary to turn the tide within demand. It has always been a hit and miss affair resulting in a serious problem from a timing perspective. The Fed reacts too late and then compensates too late as well. There is no guide book to speculation and free market manipulation that states definitively that if the discount rate is raised to such and such point that demand will decline. In each case, the reasons for the various panics prior to 1929 were largely quite different. In some cases, panics were caused by a drastic drop in the gold reserves prompting a lack of confidence in government's ability to meet its debts. This sent capital fleeing from banks into selected securities and even into hoarding gold. In other cases, panic was created by natural disasters which seriously disrupted the cash flow between various sectors of the United States sparking bank failures which gave rise to the birth of the Federal Reserve.

The Panic of 1837 saw heavy speculation in real estate and the subsequent collapse thereof. In the case of 1929, the speculation was concentrated within the stock market, focusing within the industrial sectors which were expanding rapidly. During the early 1900s, speculation was concentrated within the railroads as they became the bright new expanding medium of innovation. And in the panic of 1869, gold rose to $162 an ounce in New York, a figure when adjusted



into 1980 dollars far exceeded $5,000 an ounce.

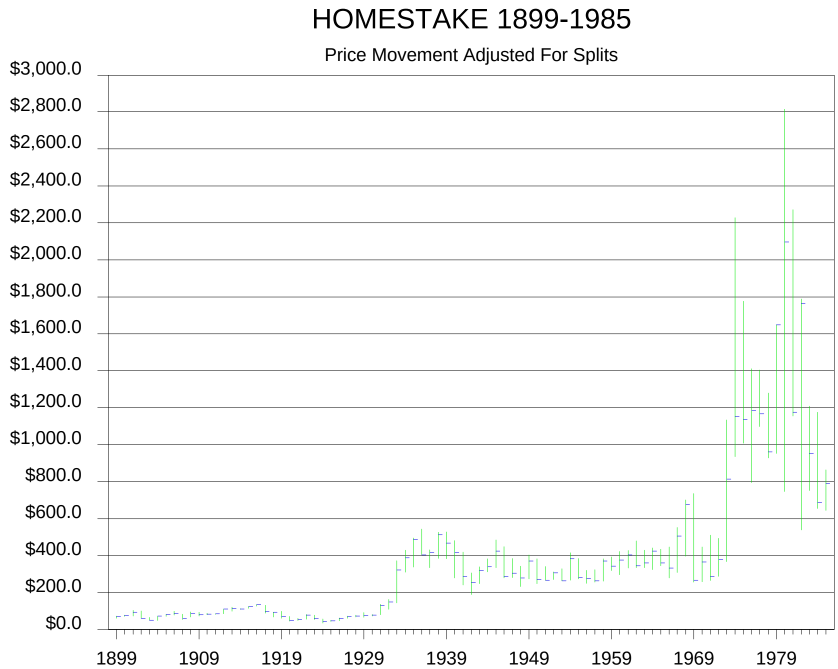
The article provided previously on this last discount rate cut to 1.5% specifically stated that the cut was instigated to help ease the pressure on Britain. Why did the stock market merely pause during early May and then soon drop to new lows once again ? Why did the discount rate cut fail to stimulate business? To answer these questions, we must move back to the events that were taking place in Europe during May of 1931.

World War I and the Russian Revolution both had a profound impact upon the European economy. First, Russia had become a communistic state which severed a once vital market for foreign trade among Western European nations. Russia was no longer an importer of fine lace, cut glass or crafted Swiss watches. It had degenerated into a nation that despised man's artistic qualities and God's divine guidance. This severed the right arm of European trade, leaving primarily its left arm which stretched across the Atlantic to America.

Second, the urge for power and the spoils of war had carved Europe into little pieces. Following the war, 12 new European states emerged and with them, imposing trade barriers through tariff laws sought to protect each state against the others. The war of guns had been concluded, but this was replaced by a financial war striving for that trade surplus as its ultimate goal.

In addition, the once great Danube Valley had been the Jewel of European productivity. This spoil was chopped up and shared by five nations. This left Austria in the poorhouse. Vienna had once depended greatly upon the resources and business that came its way from that valley. It now had its once thriving economy cut off at the pass.

These measures along with the Treaty of Versailles had isolated Germany and Austria, reducing their former economic viability significantly. It was this combination of

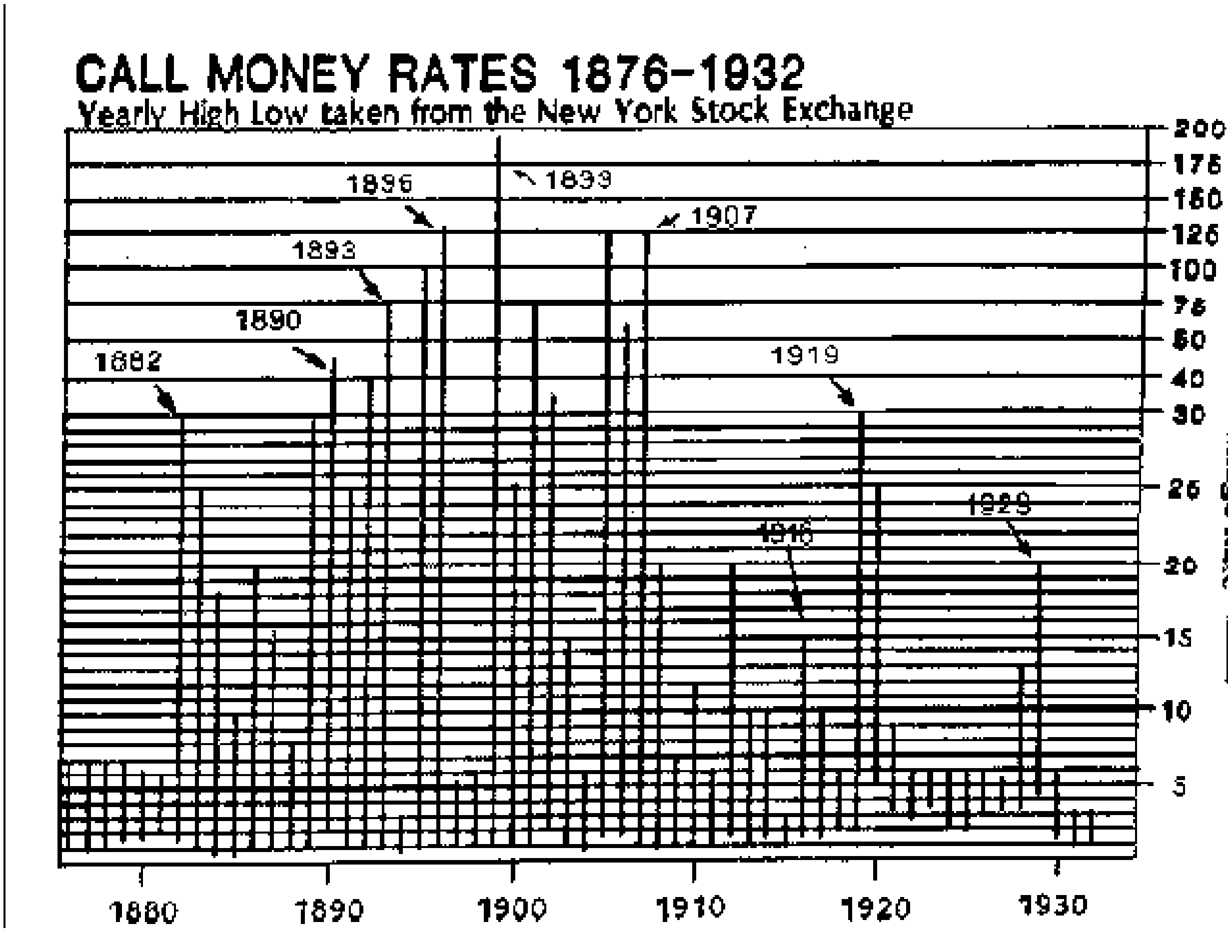


losing vital economic resources within Europe and the loss of Russian trade which prompted great tariff walls throughout Europe. Add to these problems the practices of "publishing" paper money through deficit spending, which was monetized creating higher and varied rates of inflation in Europe, and the mixture became a time bomb waiting to explode.

These circumstances led to the incentive toward price fixing and cartels which had trained their sights upon the U.S. markets when Russia had effectively been eliminated from capitalistic trade. It was this unusual set of problems which had given birth to the central bank manipulation of interest rates back in 1927 and the attempts which preceded it in 1925. The central bank intervention did not strike at solving the problems; it merely attempted to throw money at them hoping that they would simply go away. Instead, it weakened the U.S. position by allowing the U.S. to finance nearly the entire free world single-handedly. Thus the situation was similar in some respects to South America. All the loans in the world have not corrected the internal economic problems. The loans have merely postponed the inevitable until that final tomorrow comes around.

Fears over the banking situation were therefore just as alive in Europe as they were within the United States. The accusations that would arise during 1932 from Roosevelt, charging that responsibility for the worldwide depression lay with Hoover, were simply slanderous lies aimed at winning an election. There is no historical evidence that the depression resulted from any policies implemented by Hoover, nor was its origin within the United States. The tariff wars had raged on throughout Europe before Smoot-Hawley, which was a response not an instigation.

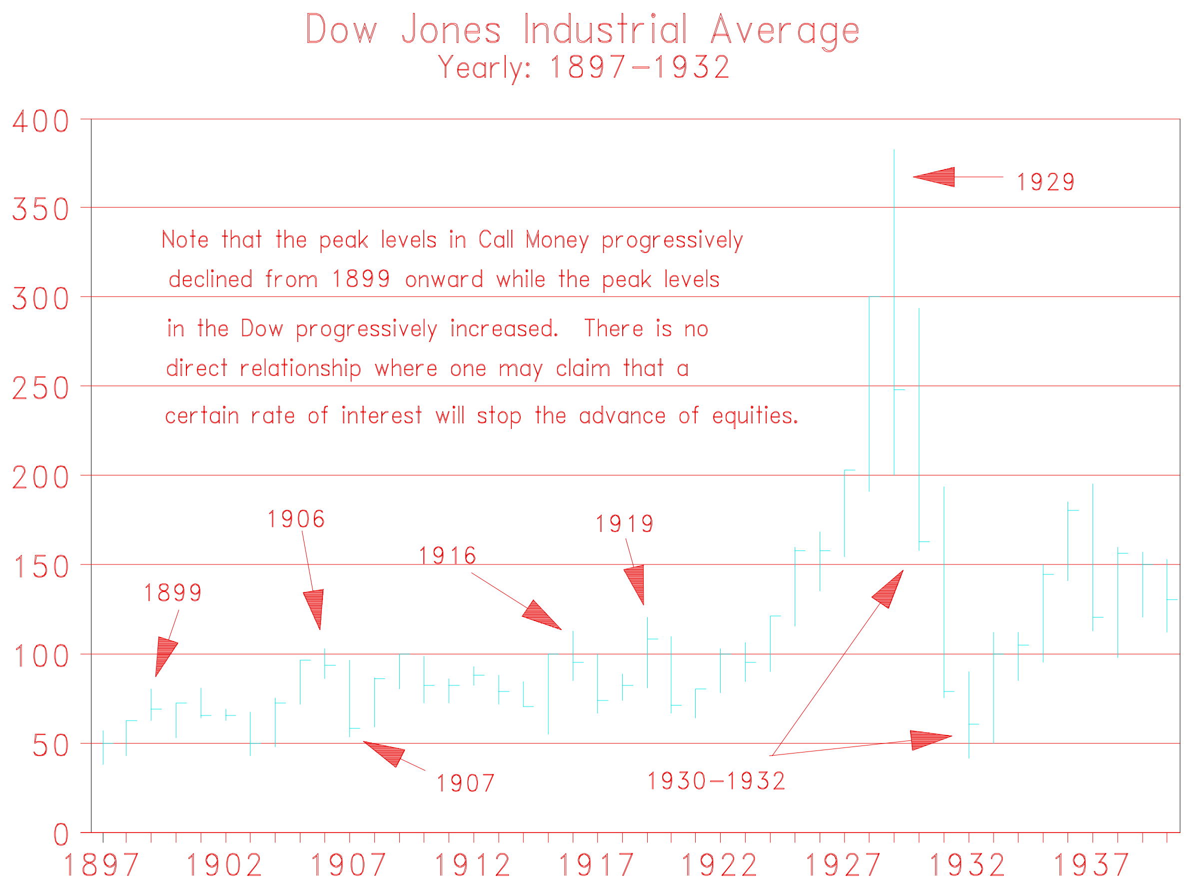
Germany, for example, was saddled with reparation payments it could not make. In turn any hope of achieving a trade surplus was beyond reason. Germany was forced to borrow dollars in order to meet much of its



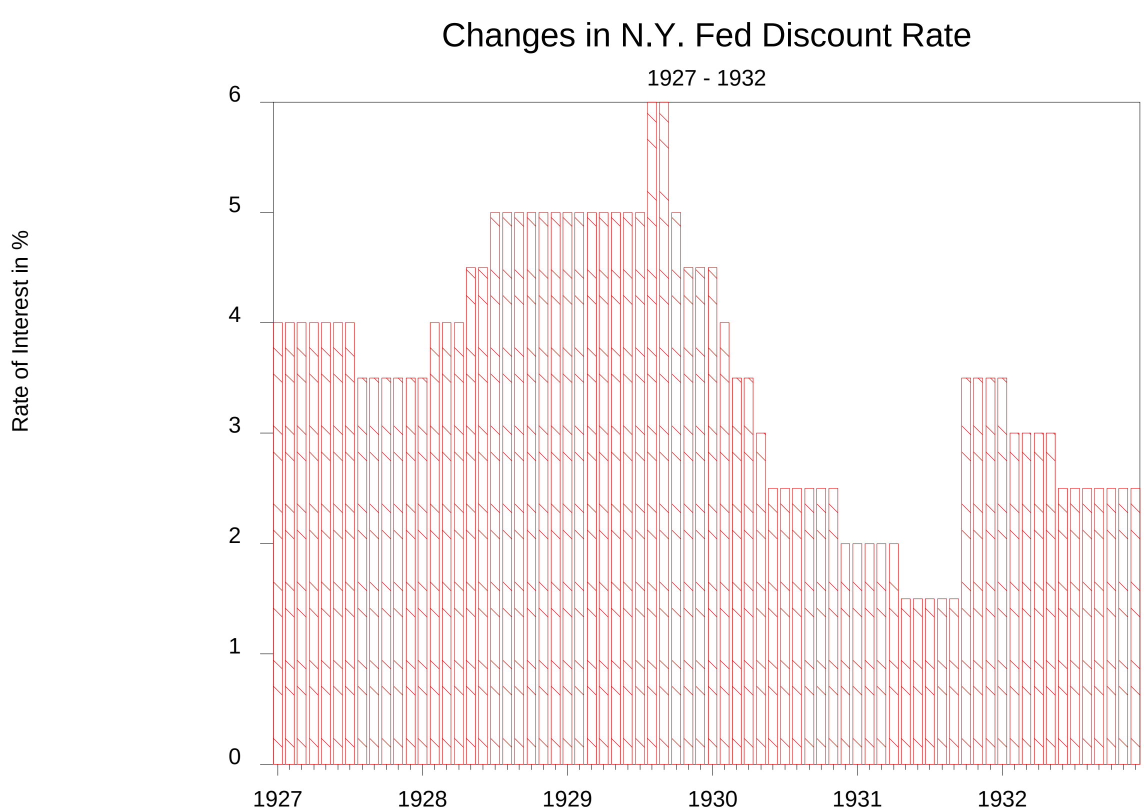
obligations, but without a trade surplus, it had remained a credit risk in some respects. Austria was in no better shape. The two were suffering greatly and they came to terms with each other on a customs agreement which would free up trade between the two and which they hoped would revive their stricken economies.

It was when this agreement between Germany and Austria took place on May 10, 1931, that financial war was declared by the French. France was perhaps the strongest European nation as a result of its intentional undervaluation of the franc in 1928. This gave rise to substantial flows of gold into France. Economically the undervalued franc and the fact that France was a heavily commodity-oriented nation which had imposed substantial tariffs to protect its economy both from the U.S. (prior to Smoot-Hawley) and its European neighbors, meant that France suffered least among the Western nations from the ills of depression. France protested the German-Austrian customs agreement, calling it a violation of the Versailles Treaty. In this the French were not alone. Britain also protested fearing that this was the resurrection.

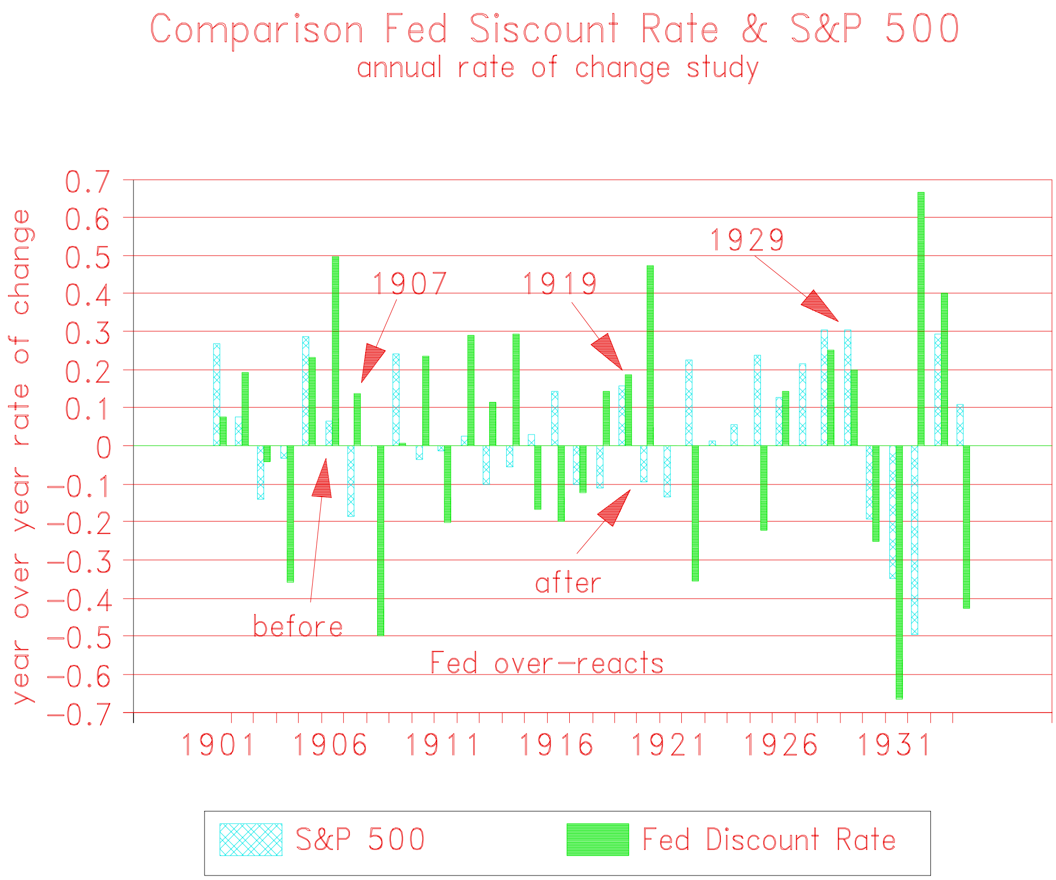
The French, however, virtually declared war financially. After the German-Austrian agreement was announced on March 21, 1931, and the formal protesting period had lapsed, France immediately turned. The Bank of France accompanied by many other French banks presented short-term Austrian bills which they held for redemp-

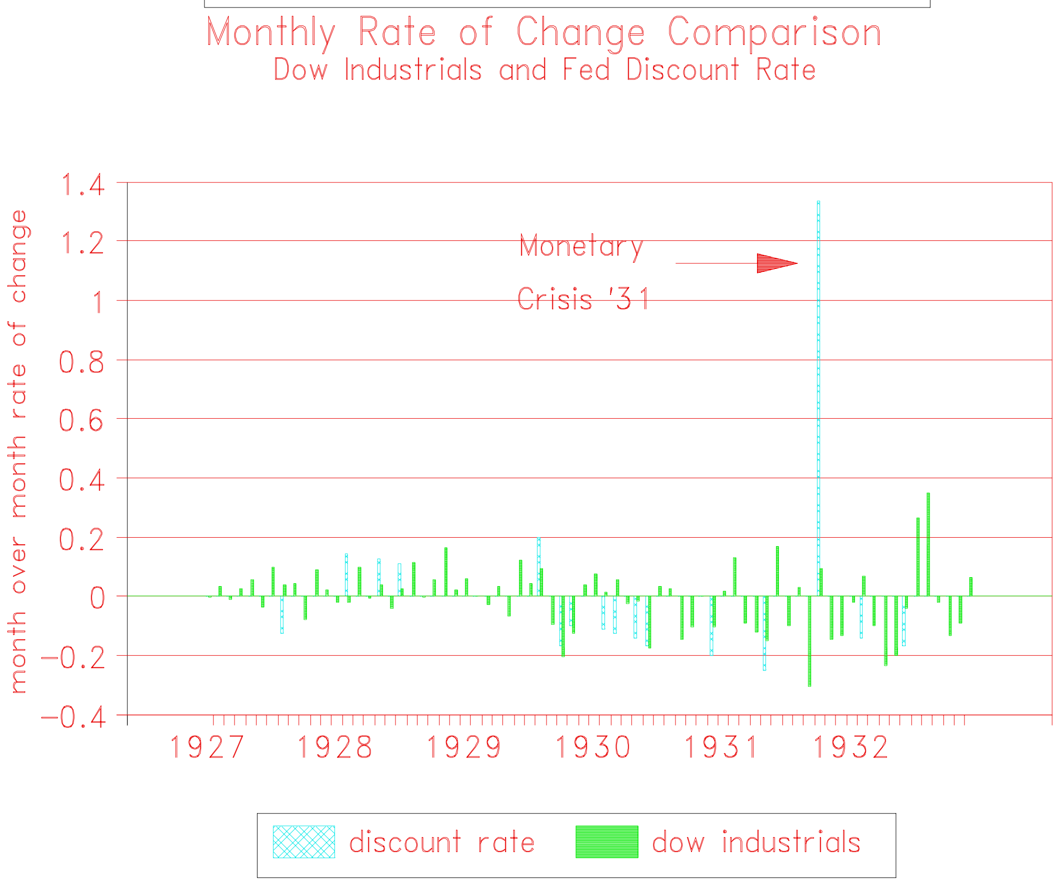


Dow Jones Industrial Average
Yearly: 1897–1932
Note that the peak levels in Call Money progressively declined from 1899 onward while the peak levels in the Dow progressively increased. There is no direct relationship where one may claim that a certain rate of interest will stop the advance of equities.
1929
1899
1906
1916
1919
1907
1930–1932
400
350
300
250
200
150
100
50
0
1897
1902
1907
1912
1917
1922
1927
1932
1937

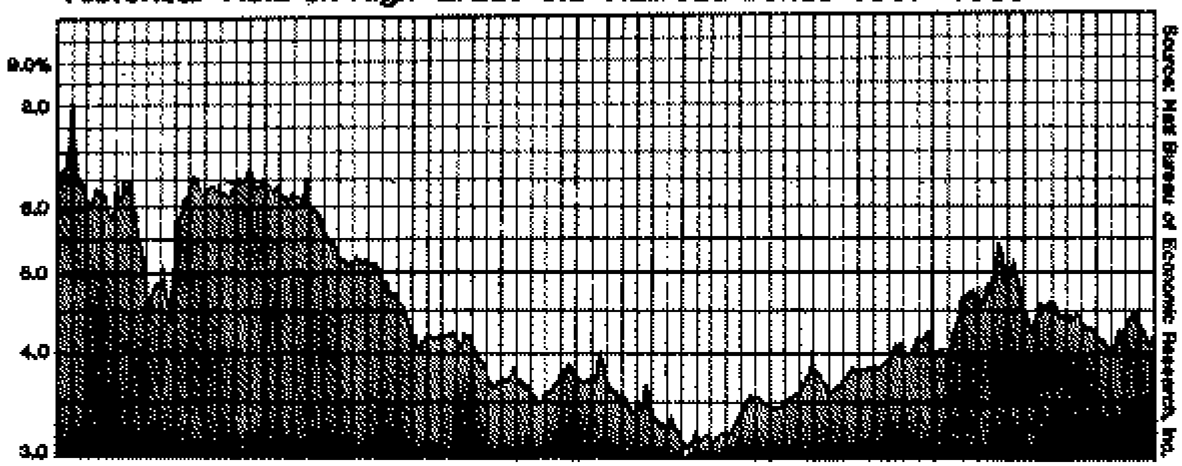


Changes in N.Y. Fed Discount Rate
1927 - 1932
Rate of Interest in %
6
5
4
3
2
1
0
1927
1928
1929
1930
1931
1932


Comparison Fed Siscount Rate & S&P 500
annual rate of change study
year over year rate of change
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
−0.1
−0.2
−0.3
−0.4
−0.5
−0.6
−0.7
1907
1919
1929
before
after
Fed over−reacts
1901
1906
1911
1916
1921
1926
1931
S&P 500
Fed Discount Rate


Monthly Rate of Change Comparison
Dow Industrials and Fed Discount Rate
month over month rate of change
1.4
1.2
1
0.8
0.6
0.4
0.2
0
−0.2
−0.4
Monetary
Crisis '31
1927
1928
1929
1930
1931
1932
discount rate
dow industrials

Historical Yield on High-Grade U.S. Railroad Bonds 1857–1930

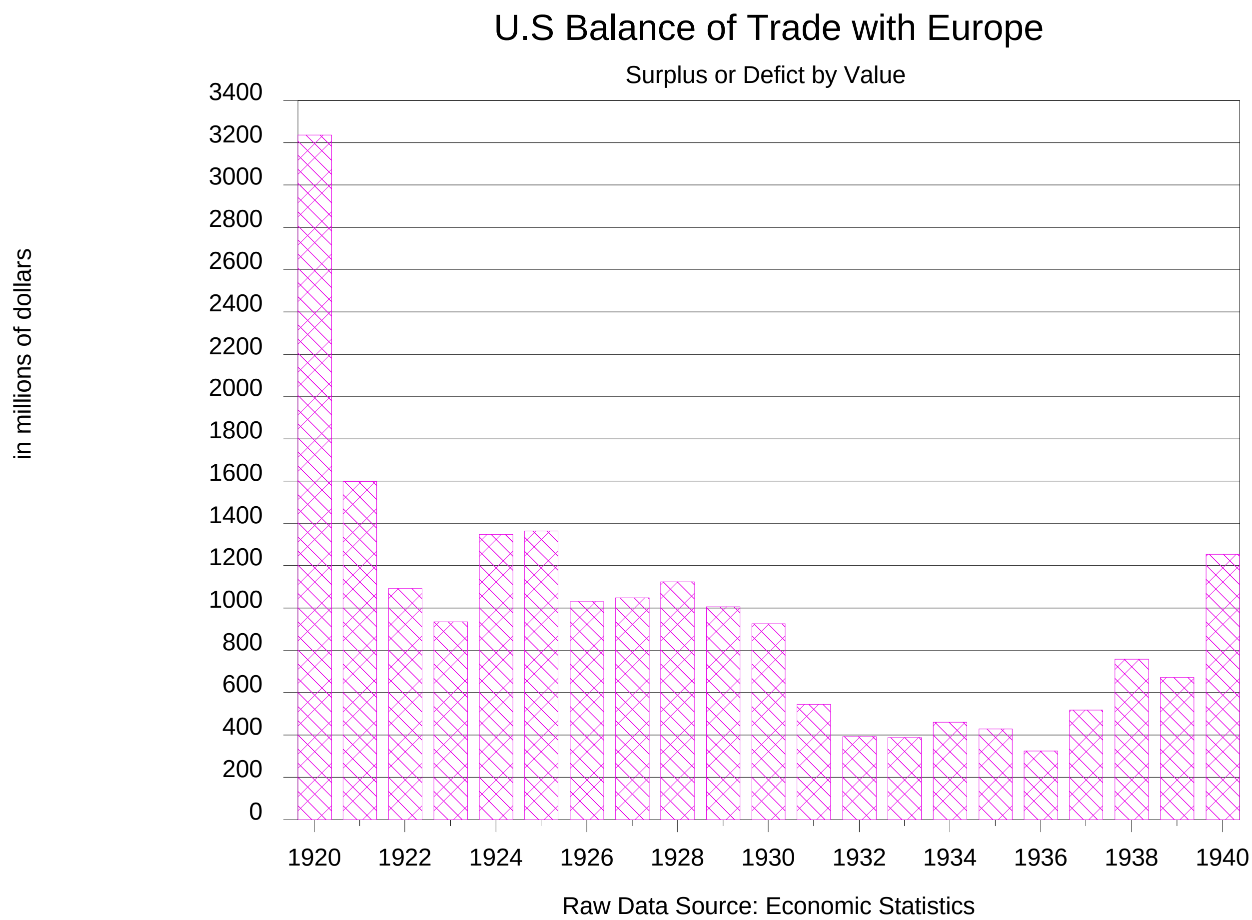


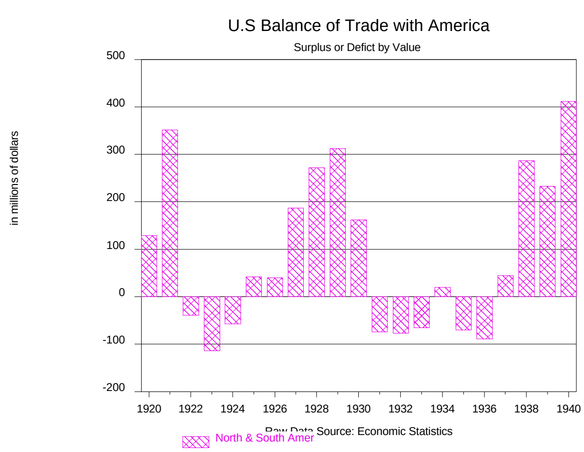
tion. They did the same with their German holdings. It was estimated that France held some $300 million worth of these bills at the time. This was the final straw which broke the back of the European economic system.

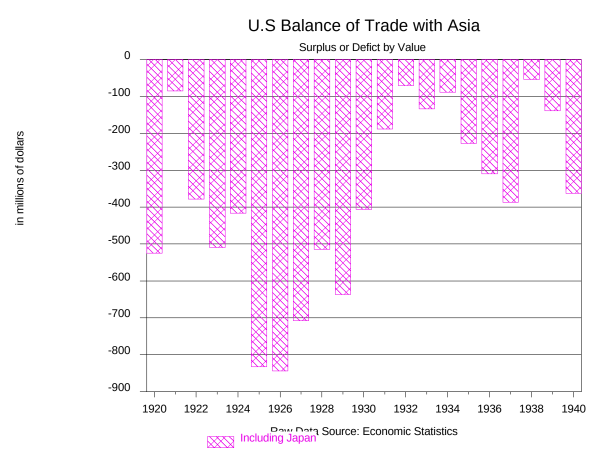
Britain, struggling to maintain the pound at the par level of $4.86, still suffered from a decaying domestic economy. The overvaluation of the pound had caused stagnation economically. British goods were high priced in the world market which did not help to stimulate a strong domestic recovery. Russia had been a close tie prior to the revolution and an important trading partner. Therefore, something had to give. If the pound remained overvalued then the domestic economy had to collapse. This state of overvaluation could not be endured forever.

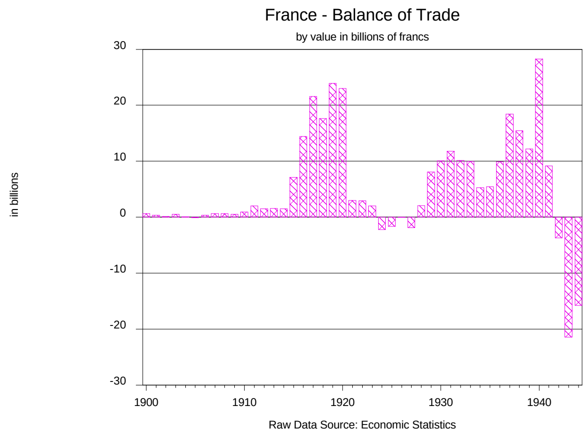
It was in May that the Credit-Anstait Bank failed in Austria, in part edged onward by the French. This was the oldest and most widely respected banking house in Austria. Its losses exceeded its total capitalization. The failure of the Credit-Anstalt had severe repercussions throughout Austria. Numerous banks all turned to the National Bank of Austria which quickly ran out of foreign currency reserves. Austria then had no other choice but to appeal to other nations. France, being the strongest, set the price as the dissolution of the German-Austrian customs agreement, which was a price Austria felt was too high. Toward the end of May, the Austrians then turned to Britain and the United States for help when the Austrian National Bank, their equivalent of the U.S. Fed, was on the verge of collapse. The French would not cooperate at all.

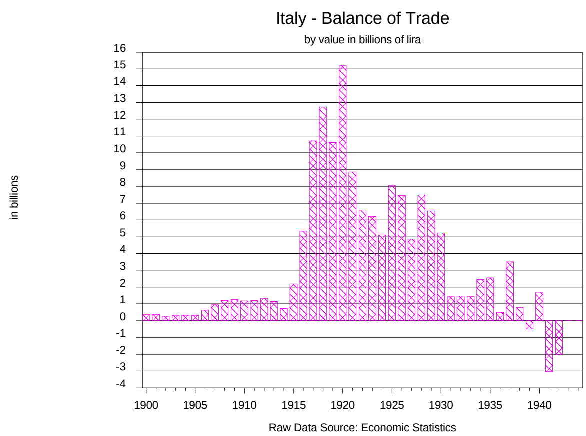
The economic policy of Britain was still largely in the hands of one man - Montagu Norman. As Governor of the Bank of England since 1920, Norman's unrealistic goal to maintain $4.86 on the pound at all costs was also accompanied by an international dream. Norman still saw Britain as the guiding light whose stature of former financial greatness was to be reclaimed. But at the same time, he was something of a tri-lateralist, so to speak. He believed in a European community working together, unlike the more self-centered aspirations of France.

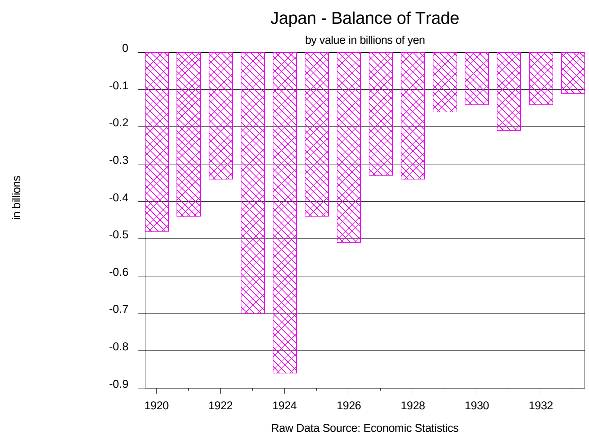

U.S Balance of Trade with Europe
Surplus or Defict by Value
in millions of dollars
3400
3200
3000
2800
2600
2400
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
1920
1922
1924
1926
1928
1930
1932
1934
1936
1938
1940
Raw Data Source: Economic Statistics


U.S Balance of Trade with America
Surplus or Defict by Value
in millions of dollars
500
400
300
200
100
0
-100
-200
1920
1922
1924
1926
1928
1930
1932
1934
1936
1938
1940
Source: Economic Statistics
North & South Amer


U.S Balance of Trade with Asia
Surplus or Defict by Value
in millions of dollars
0
-100
-200
-300
-400
-500
-600
-700
-800
-900
1920
1922
1924
1926
1928
1930
1932
1934
1936
1938
1940
Source: Economic Statistics
Including Japan

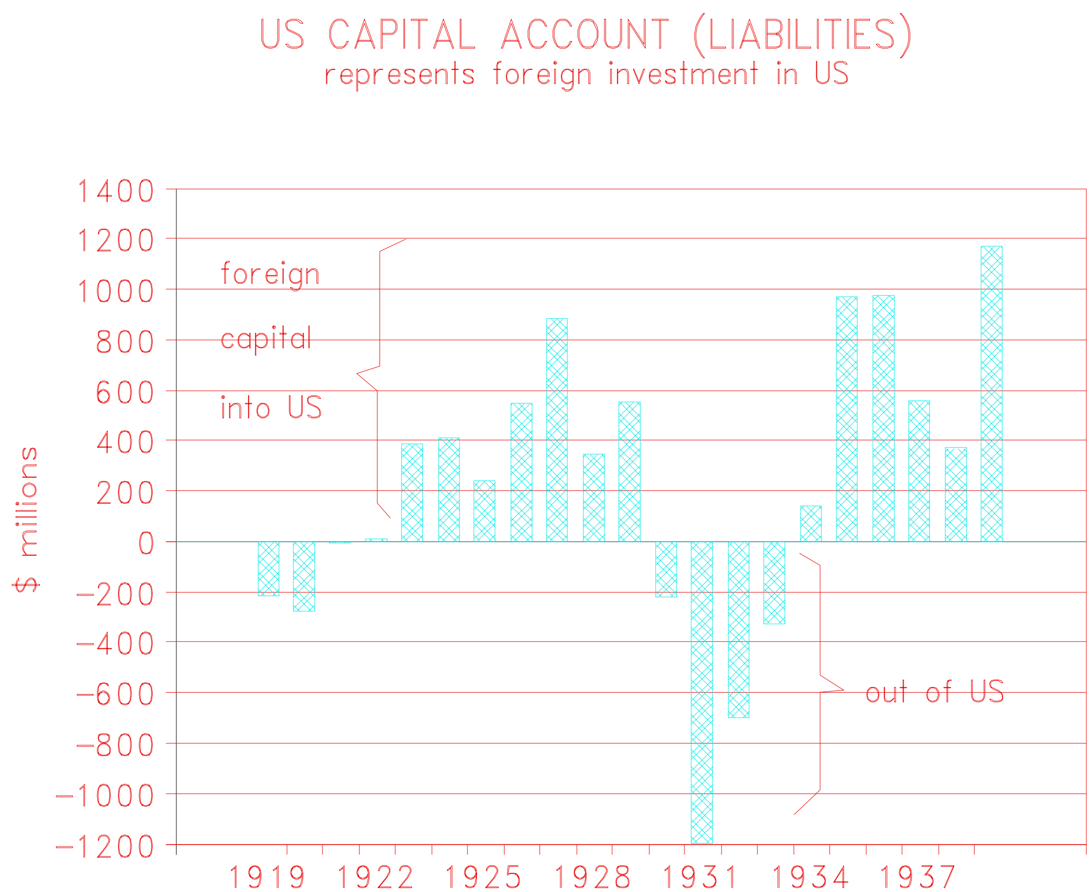


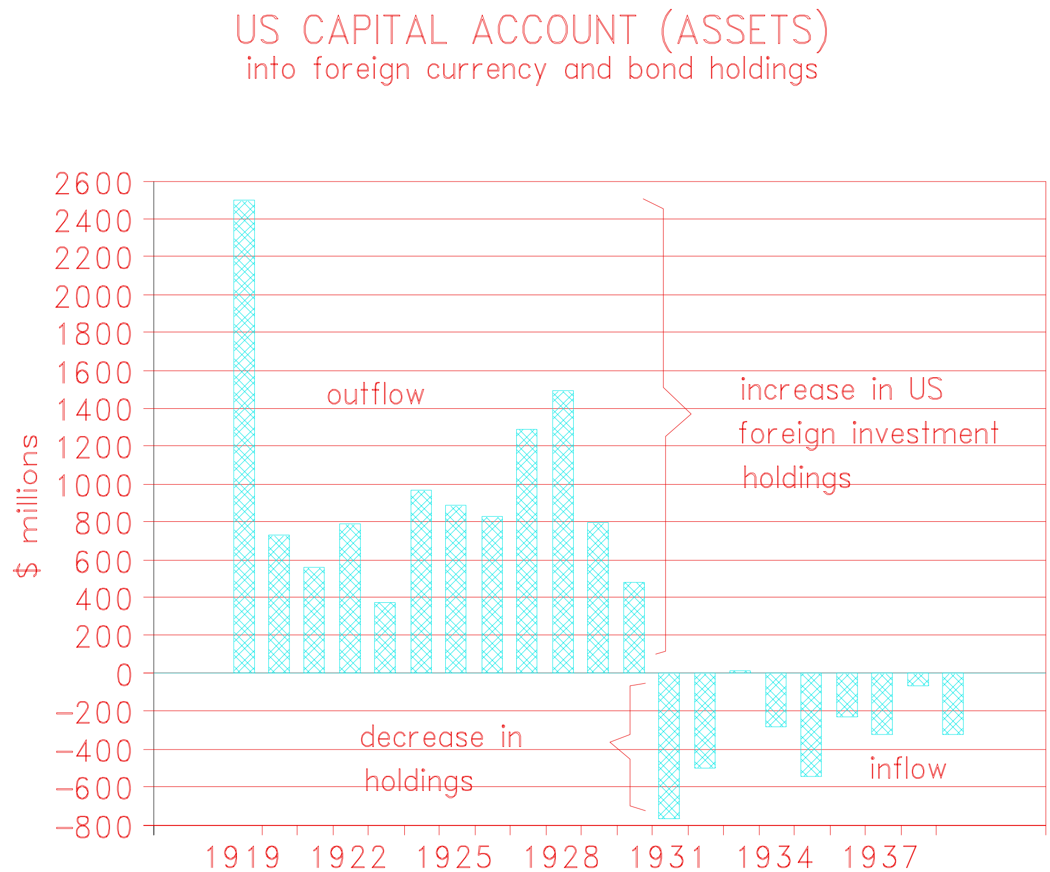


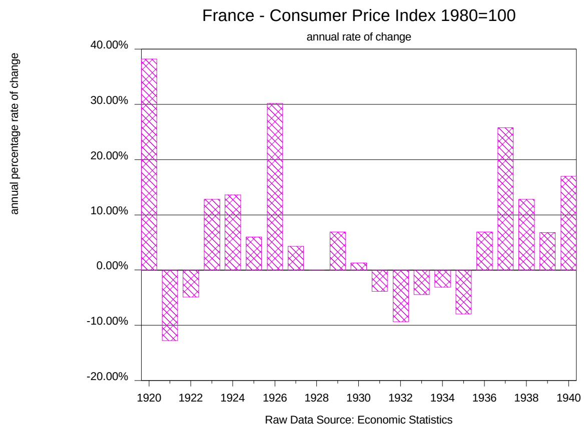


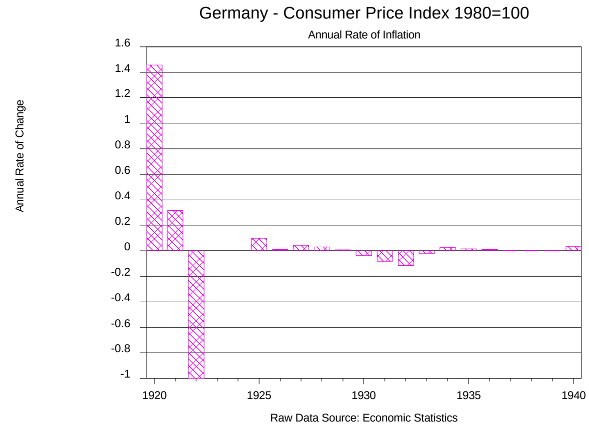
Britain came to the aid of Austria in a gallant fashion, advancing 4.5 million pounds. Norman, perhaps wrongfully to some degree, placed domestic British conditions second in this case in pursuit of his more broadly based international dream. But whatever the event, the condition of the decaying growth in British industry due to the overvalued pound would have caused the same events to transpire had Norman not rushed to the aid of Austria. The issue of whether this was the proper move or not is of no real concern. Someone had to try to pull things together. However, it was the French who became a bit annoyed with the British rescue mission, and in turn made matters worse. The French began selling the pound through the liquidation of their sterling holdings, intentionally trying to get back at Britain. The financial warfare had taken on a new front - the pound sterling.

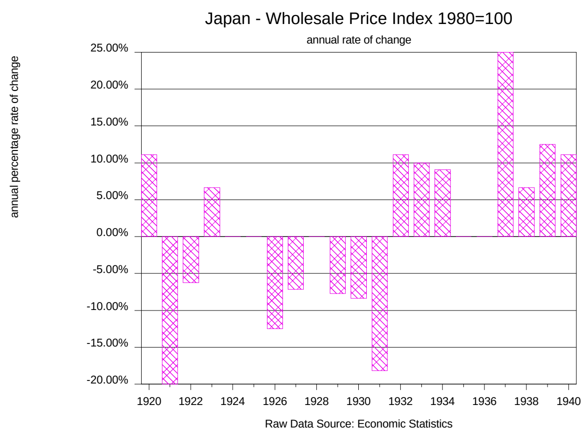
The problems which developed in Austria naturally spread resulting in massive withdrawals of funds in Germany by even its citizens. It was May 13, 1931 when riots broke out in front of Austria's Credit-Anstalt (Kreditanstalt). On May 15, runs were reported throughout Hungary as well. By

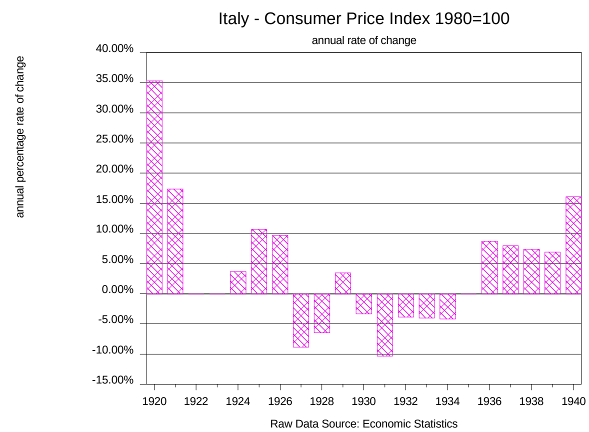

US CAPITAL ACCOUNT (LIABILITIES)
represents foreign investment in US
$ millions
1400
1200
1000
800
600
400
200
0
−200
−400
−600
−800
−1000
−1200
foreign
capital
into US
out of US
1919
1922
1925
1928
1931
1934
1937


US CAPITAL ACCOUNT (ASSETS)
into foreign currency and bond holdings
$ millions
2600
2400
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
−200
−400
−600
−800
outflow
increase in US
foreign investment
holdings
decrease in
holdings
inflow
1919
1922
1925
1928
1931
1934
1937



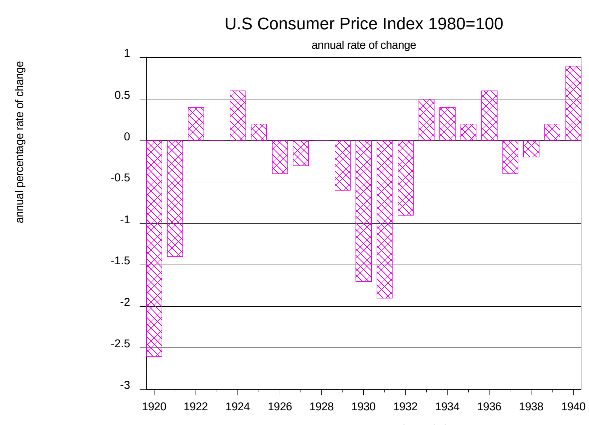


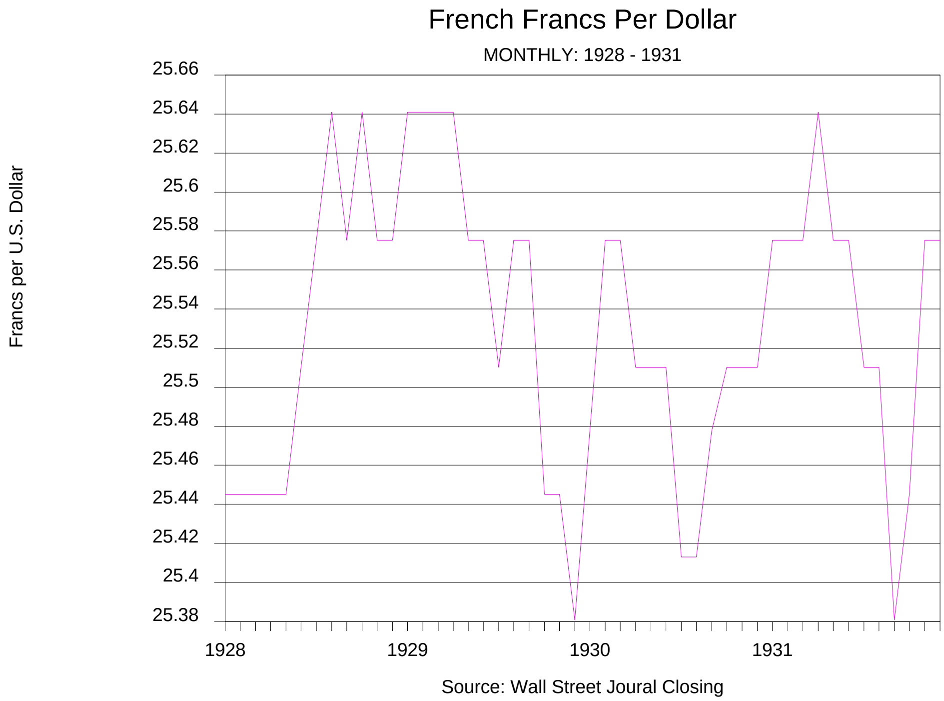




the end of May these pressures mounted against the Austrian National Bank.

Germany had nowhere to turn. France would not come to its aid while still expecting payments in turn from Germany. The various payments on reparations and war loans between nations resulted in about $1 billion of which the U.S. actually received only $250 million annually. As European banking failures spread along with the quiet financial war which was raging in the foreign exchange markets, the Fed got into the act by reducing the discount rate to 1.5% in hopes of making it less attractive for foreign



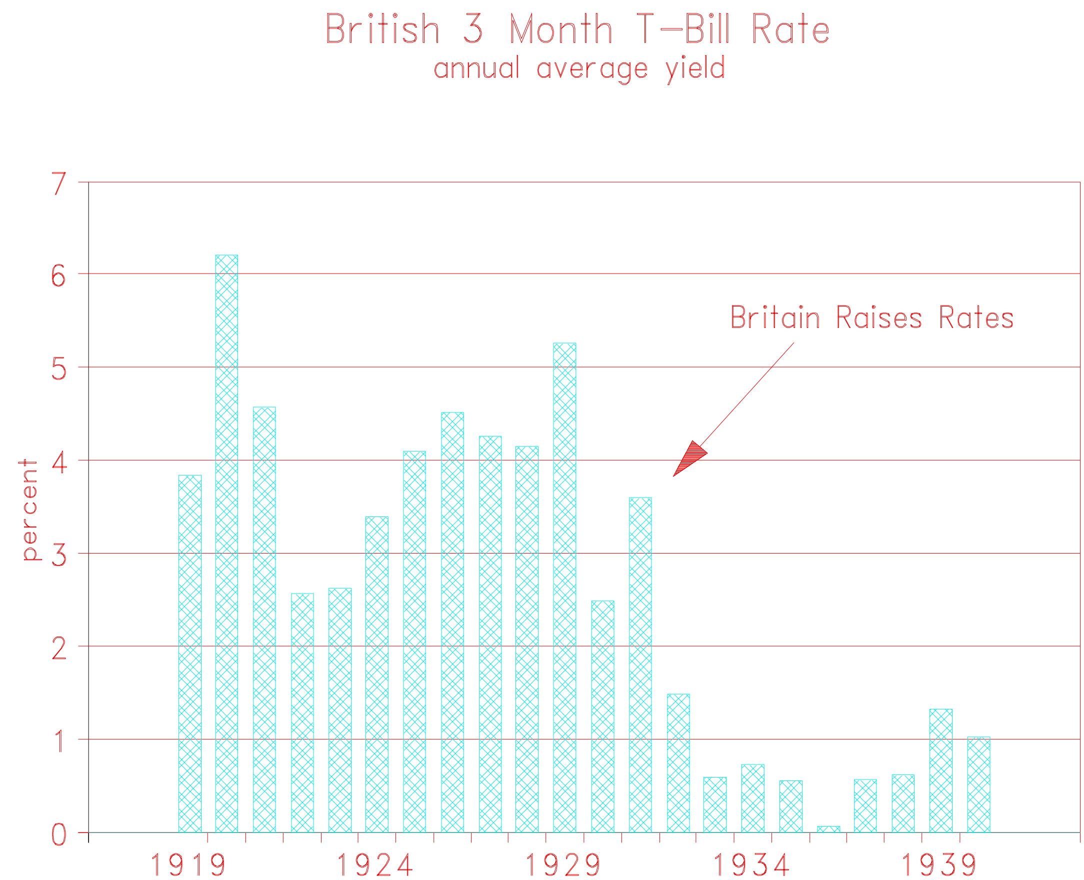


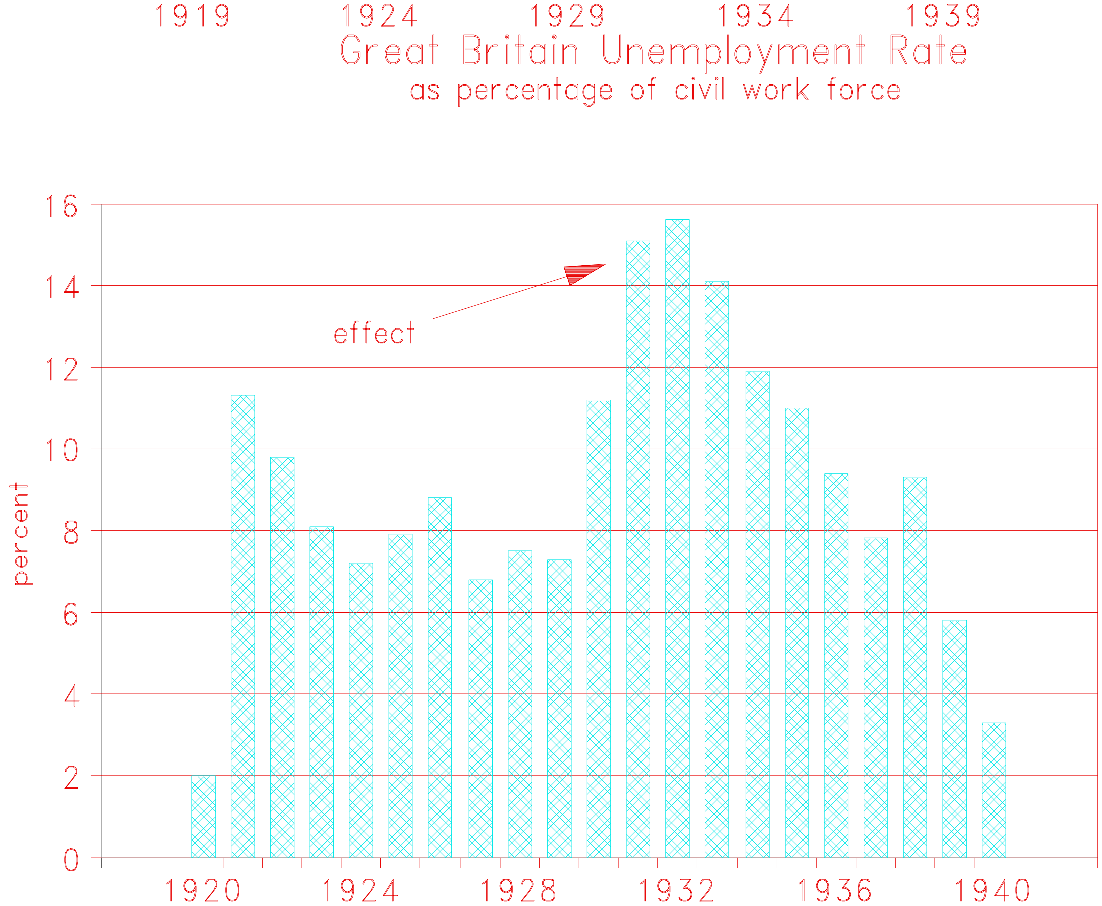
capital, which came pouring into New York looking to get away from the chaos that reigned throughout Europe. It should come as no surprise that the dollar began to strengthen as the "smart" money set sail once again for the United States.

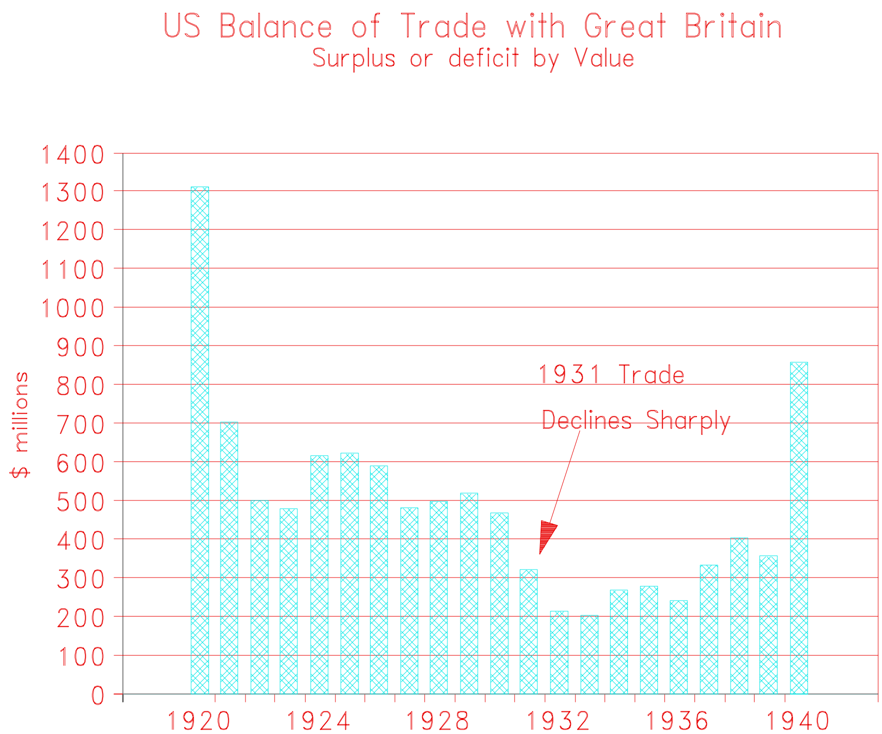
The Fed's actions were not by any means domestically oriented. Britain had been losing gold to the United States as capital fled the financial war zone. As a speculator, it was an easy bet. You essentially could short the pound by transferring into dollars. The downside was perhaps a penny at best and the upside was perhaps a return to the $3.20 level that had been seen following the panic of 1920. If you had any brains, you knew what to do - buy dollars!

The problems throughout the European community had indeed emerged into a financial war which had replaced guns with tariffs, restrictions, quotas and interest rate manipulations. The Central European states raised their interest rates in an attempt to attract foreign capital, the opposite move of the Fed. But that failed because confidence was far from present and no exorbitant rates of interest would suffice in restoring stability. This was then followed by a decree that capital was not permitted to leave the country. This may have solved the flight of capital, but it created a drastic side-effect - a halt to international trade. If capital could not be exported, commerce could not buy any goods. This was worse than high tariffs. Some increased their restrictions on imports and tried to stimulate their own exports. But this failed as diverse approaches continued to disrupt trade, which only heightened the urge for fleeing capital to the United States. In effect, this was the first crack in the gold standard. Although no one officially went off the gold standard in May of 1931, if the exportation of capital was prohibited then no gold payments were made. Thus, the same result as abandoning the gold standard transpired among the Central European states.

As June began, reports that some European banks had been selling U.S. securities were confirmed. This did not inspire a posi-


British 3 Month T-Bill Rate
annual average yield
Britain Raises Rates
percent
0
1
2
3
4
5
6
7
1919
1924
1929
1934
1939


Great Britain Unemployment Rate
as percentage of civil work force
effect
percent
0
2
4
6
8
10
12
14
16
1920
1924
1928
1932
1936
1940



tive feeling among U.S. stock traders who were now confused by the whole situation. Herbert Hoover wrote in his memoirs (MacMillan Co., 1952) this comment on the crisis:

"During this new stage of the depression, the refugee gold and the foreign government reserve deposits were constantly driven by fear hither and yon over the world. We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another. In fact, there was a mass of gold and short-term credit which behaved like a loose cannon on the deck of the world in tempest-tossed era."

In June of 1931, the European press began to point the finger at the United States. They tried to assert that it was the economic policies of the U.S. that were attracting the world's gold, creating the flight from European stock markets and the foreign exchange markets as well. The U.S. gold reserves had climbed by $600 million, despite the Fed's cut in the discount rate. Clearly, those charges by the European press were totally unfounded. Although Europeans sought to point the finger at the U.S. for causing their economic difficulties, the problems had their origin in Europe. Despite the depression in the U.S., it was viewed by world capital as still the safest place at that point.

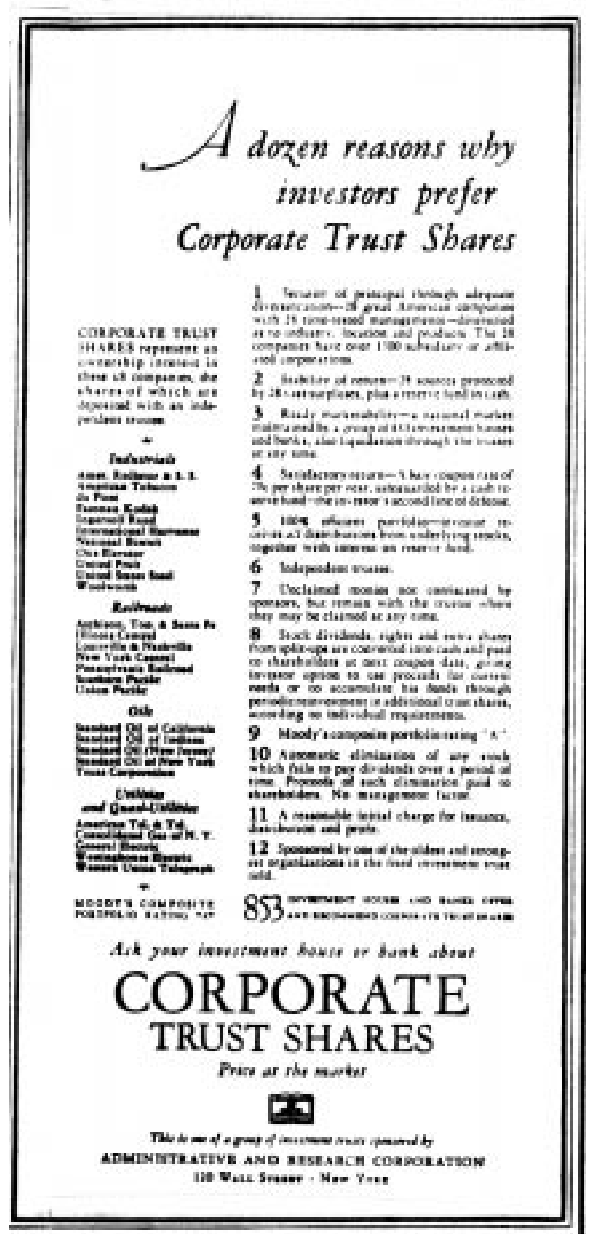
The financial warfare in Europe had created a massacre within the banking industry. The Federal Reserve's textbook attempt to lower U.S. interest rates to stem the influx of capital and provide an incentive for capital to flow toward Britain failed. Confidence was not restored and higher rates of interest were not among the concerns of nervous capital - outright fear of loss dominated the free markets.

Hoover believed that with the economic conditions strained as tight as they were throughout Europe, that these intergovernmental payments were adding pressure which tended to weaken confidence. This perhaps was evident when one considers the intentional actions on the part of France at this time. As early as May 11, Hoover had proposed to Secretaries Stimson and Mellon that they should study these intergovernmental payments and report upon their recommendations if any action should be taken. On June 5, Hoover called Mills to the White House and proposed that a moratorium of one year on all intergovernmental payments should be implemented. Mills and Stimson agreed, but Mellon objected. The next day Mellon left on a scheduled trip to Europe, Mills became acting Secretary of the Treasury and Hoover believed that with Mellon out of the way perhaps his plan might be able to go forward.

On June 7, the German Finance Minister publicly stated that the Austrian banking crisis would spread to Germany in about 60 days in his opinion. Of course, after making such a definite public statement, the panic began to spread immediately. Virtually every German bank was under siege and now foreign banks began wholesale demands for the immediate redemption of German trade bills and bankers' acceptances.

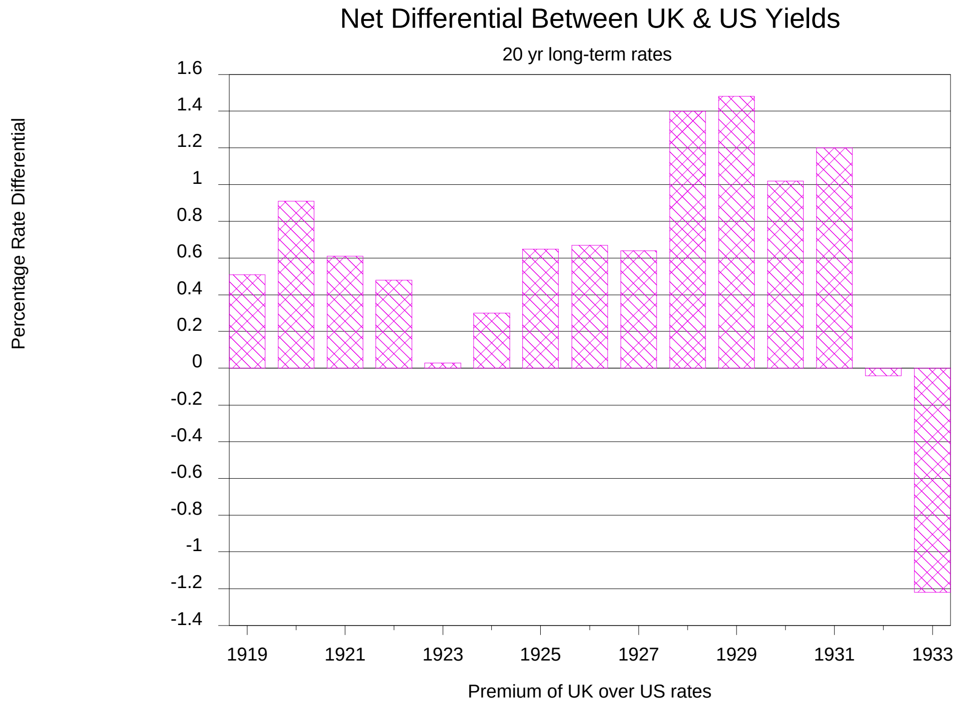
The situation was obviously becoming much more serious. After arriving in Europe on June 18, Andrew Mellon had "frantically" telephoned Hoover, according to Hoover's memoirs, reversing his former opposition to a moratorium on intergovernmental payments. Mellon then advocated quick action fearing that the American financial system was in grave danger from the events which were transpiring in Europe.

President Von Hindenberg of Germany had sent an urgent letter of appeal to Hoover which warned that Germany was in danger of collapse. The letter read as follows:



"Mr. President:

The need of the German people which has reached a climax compels me to adopt the unusual step of addressing you personally.



The German people have lived through years of great hardship culminating in the past winter, and the economic recovery hoped for in the Spring of this year has not taken place. I have, therefore, now taken steps, in virtue of the extraordinary powers conferred upon me by the German Constitution, to insure the carrying out of the most urgent tasks confronting the Government and to secure the necessary means of subsistence for the unemployed. These measures radically affect all economic and social conditions and entail the greatest sacrifices on the part of all classes of the population. All possibilities of improving the situation by domestic measures without relief from abroad are exhausted. The economic crisis from which the whole world is suffering hits particularly hard the German nation which has been deprived of its reserves by the consequences of the war. As the developments of the last few days show, the whole world lacks confidence in the ability of the German economic system to work under the existing burdens. Large credits received by us from foreign countries have been withdrawn. Even in the course of the last few days the Reichsbank has had to hand over to foreign countries one third of its reserves of gold and foreign currency. The inevitable consequence of these developments must be further serious restriction of economic life and an increase in the numbers of unemployed who already amount to more than one third of the total number of industrial workers. The efficiency, will to work, and discipline of the German people justify confidence in the strict observance of the great fixed private obligations and loans with which Germany is burdened. But in order to maintain its course and the confidence of the world in its capacity, Germany has urgent need of relief. The relief must come at once if we are to avoid serious misfortune for ourselves and others. The German people must continue to have the possibility of working under tolerable living conditions. Such relief would be to the benefit of all countries in its material and moral effect on the whole crisis. It would improve the situation in other countries and materially reduce the danger to Germany due to internal and external tension caused by distress and despair.

You, Mr. President, as the representative of the great American people, are in a position to take the steps by which an immediate change in the situation threatening Germany and the rest of the world could be brought about.

Von Hindenberg

Up to now, most of Hoover's discussions with various people were kept confidential. He had conferred with members of Congress and wanted their support before making any proposals to Europe only to have the Democrats shoot them down. When it appeared that he had the necessary support to insure approval of his moratorium proposal, he opened dialogue with other nations.

Hoover's proposal was leaked to the press by Senator King, but it was not reported in an accurate fashion. This forced Hoover to make a public statement on June 20, before any other nations had agreed. On the 29th of June, the New York Times hailed the measure as being constructive and the stock market responded favorably as well.

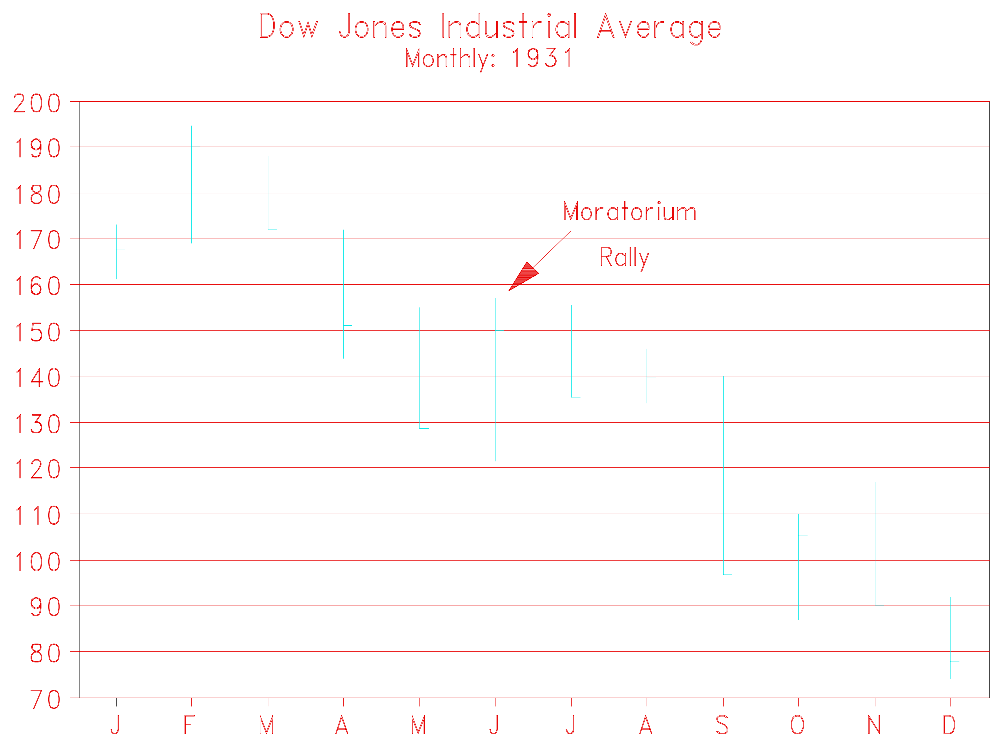
World confidence seemed to take a pause on Hoover's moratorium proposal. The stock markets in both Germany and France rallied strongly along with Britain's, but the leadership was clearly taken by the United States. This rally which took place during June of 1931 would later be dubbed the "Moratorium Rally" once it was perceived to have been only a glitch in the ultimate fate of the market. But for now even commodities leaped forward with a startling sense of optimism.

The Dow Jones Industrials rallied sharply on the moratorium news from a low of just above the 120 level to close at 157 during June of 1931. This was a smashing rally. And it was the strongest since the decline began on a percentage basis - nearly a 30% move. In London the favorites seemed to be across the board, but sharp gains were noted among the breweries, rubbers, home-rails, and silk companies. International stocks trading in London were also very popular including British-American Tobacco and Imperial Tobacco and even the South African mining shares.

In France, the rally in equities was led by Banque de France, Coty, Ford, Citroen, and even Compagnie Universelle du Canal Maritime de Suez. In Germany, the most popular was A.E.G., the German General Electric Company. Other favourites were I.G. Farbenindustrie, the large dye trust and Vereinigte Stahlwerke (United Steel Works).

Time magazine reported on the commodity rally in its July 6, 1931 edition as follows:

"But more significant than the rise in stock prices, last week was a worldwide gain in commodities. The most important gain was that registered in silver. The only calm thing about the Bomboy Silver Bullion Exchange is the sacred cow which, fat and lazy, spends most of her time in somnambulistic repose, blinking sadly and chewing her cud. During the Depression the sacred cow has seen many disconcerting things. Silver has dropped from 1929's high of 57.5 cents to the historic low of 25.75 cents per fine ounce. The only notable interruption was the remarkable corner staged last year by Chimauram Motilal, aged Hindu who drives in a Cadillac, carries a Malacca stick, wears but a white lion-cloth and a turban. But, last week with much yelling and ges-



ticulating Bombay silver buyers shoved the price up 166%. The gain was of paramount importance to the buying-power of 500,000,000 Far-Easterners. To China it was especially welcome. Long-coated silk-trousered members of the Shanghai Gold Stock Exchange of Kiukiang Road bought silver by the simple method of selling gold. How desperate is China's state is well illustrated by the ugly rumors heard in Singapore concerning the affairs of Tan Kah Kee, great rubber, pineapple, biscuit and brick tycoon, patron of Amoy University. Once a coolie, he became a multi-millionaire, is now thought to be heavily in debt, frantically trying to incorporate his private affairs.

"In addition to silver practically all commodities rose, including the base metals. The most spectacular performer of these was volatile copper which jumped from 8 cents (New York) to 9 cents as domestic and foreign buyers threw large orders into the market. Lead and zinc followed along. Typical of the increase in trading was the excitement in Manhattan's Raw Silk Exchange where trading reached almost 4,000 bales a day after being at 80 a few weeks ago. Startled pages and clerks hurried to put their summer linen-suits on a fortnight ahead of time. In Tokyo, Japanese bears talked of hara-kiri. On the Coffee & Sugar Exchange, Manhattan coffee continued its recent rise which had begun to die out; sugar started its first rally in months. Some $25,000,000 was added to the value of sugar supplies. Along with gold coast native farmers, men gathered in British villages to receive cable dispatches which told the glad tidings of what was happening on the New York Cocoa Exchange. Cotton, despite the bearishly small decrease in acreage, rose throughout the world. Textiles rose in the U.S. and on the great Manchester Royal Exchange. In the Chicago wheat-pit 36 stories under the 40-ft., 15-ton aluminum statue of Ceres which is the Chicago Board of Trade Building's talisman, grains rallied smartly, sent the theoretical total value of U.S. grains up $300,000,000. On the New York Rubber Exchange, where recently less than a dozen members have come down to trade, the volume increased 5005. Speculative buying from Wall Streeters was credited with having much to do with rubber's comeback.

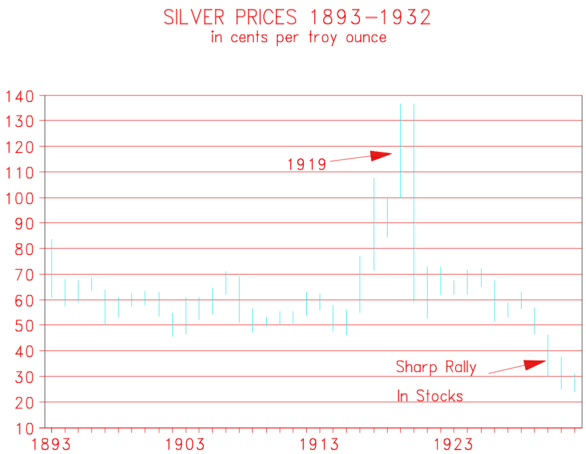
"While renewed confidence and the rise in commodities were the most important events of the week, the news-index of worldwide change was the New York Stock Exchange. Performing in a spectacular manner, that great market once again proved its world leadership. There were cheers when United States Steel again crossed par, a triumphant return from the recent nadir of $83 and an 1/8th. Twenty-six leading stocks gained $4,159,000,000 in value. Bullish rumors ran wild; there were tales of tremendous pools being formed, huge mergers in the making. Concrete bullish news in addition to the moratorium was the favorable decision to Radio Corp., the raising of the wholesale cigarette price, the declaration of regular dividends by Westinghouse, Anaconda, Baltimore & Ohio. Stocks with interests in South America soared on a baseless rumor that the President would soon make an important announcement regarding credits to Latin American countries. Long deferred investment buying appeared. Vivid tales were told of big bears trapped, fretting behind the bars of higher prices. One venerable member of the exchange was heard to sing that old bull war chant of the Chicago Wheat-Pit: "He who sells what isn't his'n must buy it back or go to prison." And even the most sanguine of optimists was willing to concede that the song was applicable in any market last week, that much of the recovery's violence was due to the running-in of bears who for months have sold "what isn't their'n."

The jubilant "Moratorium Rally," needless to say, did not last. In the July 20, 1931 edition of Time magazine, the commentary took on a distinctively different undertone which was much more brief and to the point. "Hope engendered by the Moratorium and the Moratorium Market on world exchanges failed to find reflection in important business indicators up to last week. Important straws showed that Depression's ill-winds were not yet blown out."

Within a week of Hoover's public announcement of his moratorium proposal, 15 governments had agreed with the plan "unconditionally!" The only important opponent was France who still held bitter resentment toward Germany. The French hurried excuse after excuse as to why Hoover's Moratorium should not be adopted. With each excuse that was answered and set aside, another quickly followed. The French kept this up for days, delaying Hoover's actions as much as possible.

The banking crisis in Central and Eastern Europe raged on during this time when the French were the only dissenters among the group of nations still insisting that Germany should not be relieved of her reparation payments. Then on July 5, Hoover had about all he was willing to take. Hoover informed France that he had secured enough support among other nations for the proposal and he did not need France's approval. He told France that it may continue to extract its payments, but that all other nations including the United States would not relieve France of its obligations either. Finally, the French had to agree. Hoover would effectively isolate them if they refused to cooperate.

The French tactics had sparked severe divisions within Europe. The level of confidence was restored only briefly as many feared that France would still apply pressure to the pound as well as to the outstanding short-term credits of Germany. The banking crisis continued almost unabated



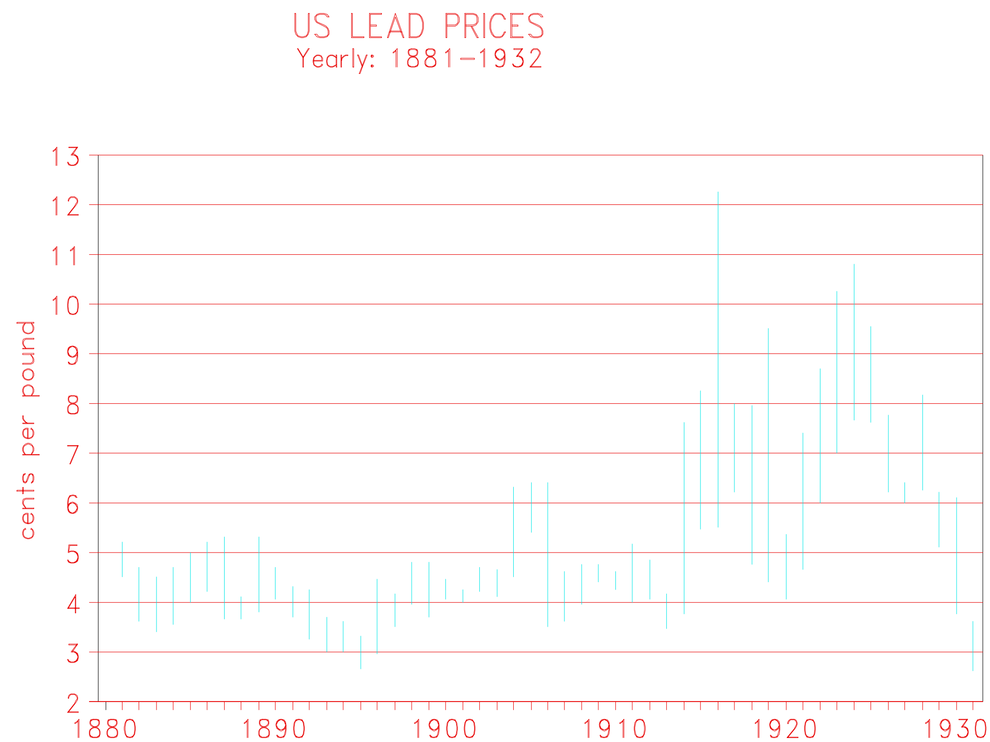
in Germany and Hungary in particular, as well as in the entire Eastern European group. By mid-July, virtually all German, Austrian, Hungarian and Eastern European banks were closed.

On July 20, 1931, a conference was called in London to discuss the European banking crisis. Secretaries Mellon and Stimson attended. The French surprisingly proposed that the British, French and Americans should lend $500 million to Germany. The French knew that this proposal would not be very popular in the United States and it almost appeared as if they were trying to force Hoover to publicly decline their proposal for propaganda purposes.

Hoover asked the Federal Reserve to provide information that would give him a fair appraisal of the extent of outstanding German short-term credits held by U.S. interests. The Fed replied that they estimated that only $400 to $500 million of these short-term debts were held by U.S. interests. Hoover wrote in his memoirs: "Worrying over the matter during that night I was somehow not satisfied with this report, and in the morning I directed the Comptroller of the Currency to secure an accurate report on such American holdings direct from the banks." The next day Hoover was handed a report that was based on a direct survey. The numbers that Hoover was handed came out to be $1.7 billion. The report broke them down, stating that about $1 billion was held by banks whose capitalization, in the event of the default of Germany, would be placed in great danger. Hoover wrote that he was appalled at the news. He further added: "Here was one consequence of the Reserve Board maintaining artificially low interest rates and expanded credit in the United States from mid-1927 to mid-1929 at the urging of European bankers. Some of our bankers had been yielding to sheer greed for the 6 to 7 percent interest offered by banks in the European panic area."

Hoover then inquired of the Bank of England as to the extent of their holdings of these bad, short-term German debts. Within two days the Bank of England replied that about $2 billion of these German debts were held by British banks and their dominions including Sweden, Norway, Holland, Denmark and Switzerland. They warned that untold amounts were also held by Latin America and parts of the Far East. The combined debts of Germany, Austria, Hungary and other Eastern European nations on a short-term floating basis appeared to slightly exceed $5 billion. This was a figure which was almost equal to the peak in money which had been lent on call within the stock market back in 1929. This figure did not include the outstanding long-term bond issues, war debts or municipal issues which had been floated and held largely by private investors.

The bottom line had become clear. Germany was able to meet its reparation pay-

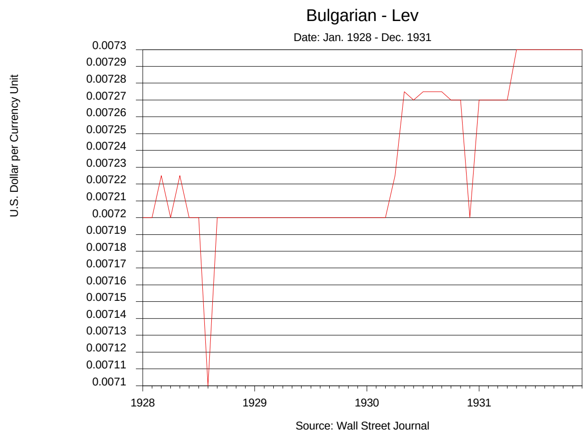


ments only through the floating of debt instruments. Nothing had been truly gained. Many of the buyers of German bonds were private citizens and then the proceeds had been paid to the foreign nations who demanded reparation payments. It was a giant shell game that transferred the earnings of the small investor into the hands of government through the medium of bonds which had offered 6%-7% in interest income. Germany was not alone in this tactic. Most Eastern European nations were in effect borrowing from Peter to pay Paul. In reality, this was very similar to the Ponzi scheme. Individuals go to jail for such practices, but governments seemed to be excused and bailed out, chalking it up to bad management.

Hoover wrote: "It was now evident why the European crisis had been so long delayed. They had kited bills to A in order to pay B and their internal deficits. I don't know that I have ever received a worse shock. The haunting prospect of wholesale bank failures and the necessity of saying not a word to the American people as to the cause and the danger, lest I precipitate runs on our banks, left me little sleep. The situation was no longer one of helping foreign countries to the indirect benefit of everybody. It was now a question of saving ourselves."

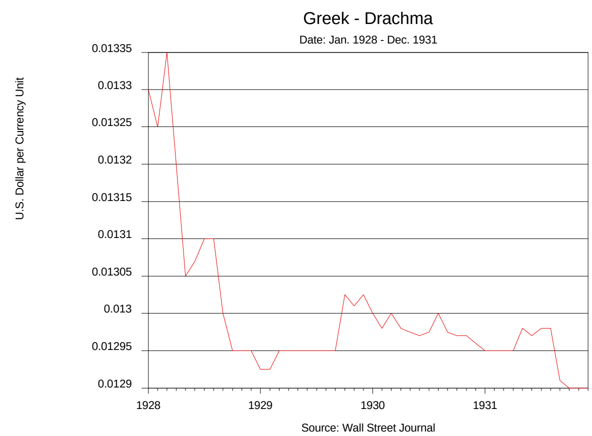
Hoover again rose to the occasion, trying to arrive at some solution. Lending more money would not solve the problem. The vast, intricate entanglement of the foreign debt situation was a time bomb waiting to explode at any moment. Hoover's proposal was to call a complete "standstill" among all banks everywhere, preventing anyone from calling upon German or Central European short-term obligations.

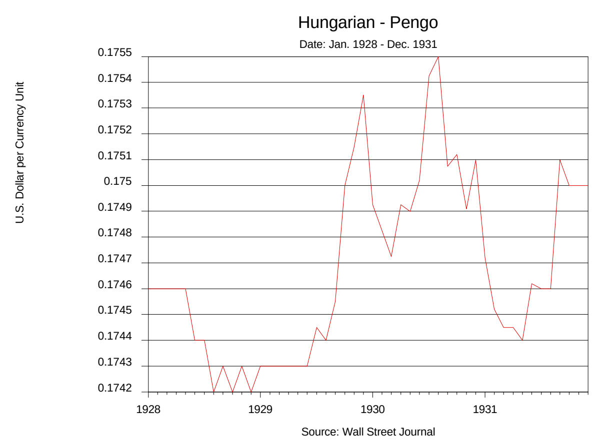
France still pressured for a $500 million loan to Germany. Hoover refused to go along with it. Mellon warned Hoover that if the U.S. did not go along with the plan the French intended to place all the blame on the United States, and he warned that he was playing into the hands of the French. Mellon strongly urged Hoover to accept the French proposal. Hoover lost his patience,

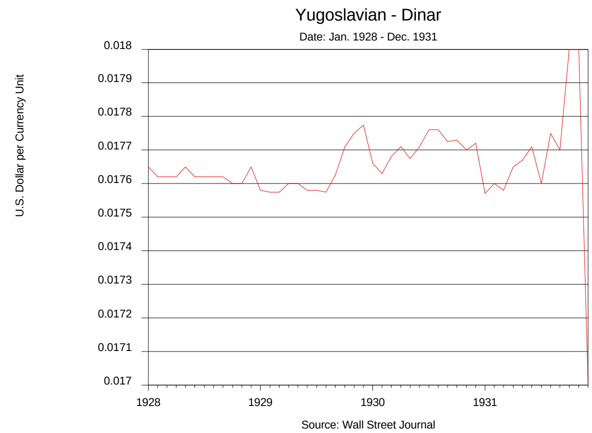


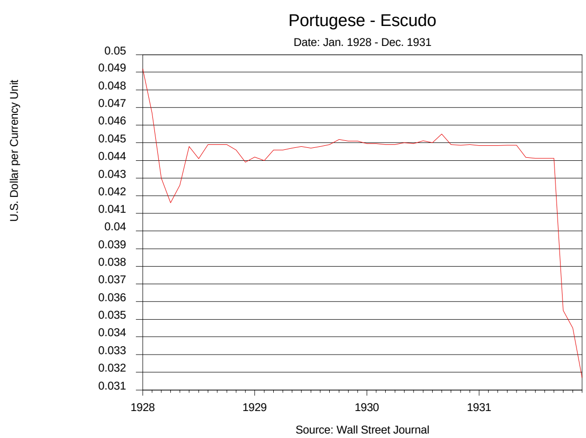
as he put it, and informed Mellon that his "standstill" plan was being released to the press at that very moment. When the news came out, the London Conference was forced to accept Hoover's proposal because the truth was at last coming out.

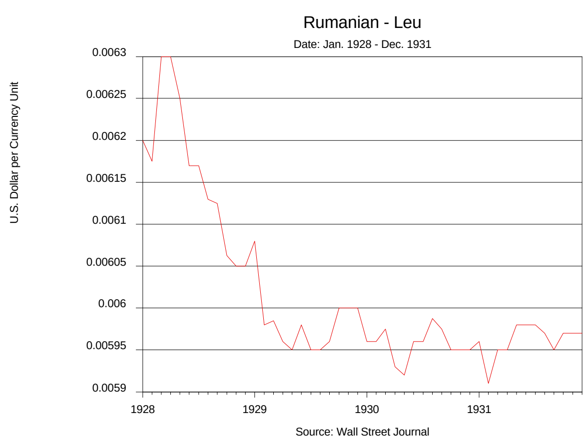
A group of New York bankers complained to the White House and warned that they would not comply with the standstill. They demanded that Hoover loan money to Germany so it could pay its debts which the bankers held. As Hoover wrote: "My nerves were perhaps overstrained when I replied that, if they (bankers) did not accept within twenty-four hours (his standstill proposal), I would expose their banking conduct to the American people." Needless to say, the bankers realized Hoover's determination and his opinion that the taxpayer should not pay for the banker's problems, which had been created by their eager solicitation of private citizens for foreign securities, and the bankers reluctantly backed off. Indeed, the actions of the banks and the Federal Reserve had bordered on the verge of treason as they acted as willing participants in what proved to be a game of musical chairs with the unsound foreign governmental debt instruments.











The situation was still far worse than the reports that were given to Hoover at the time. While he suspected that the short-term debt which had been brought to a standstill was about $5 billion according to both U.S. and British sources, it was not confirmed until a year later when the Bank for International Settlements issued a report illustrating that the amount was actually $10 billion! The BIS wrote: "At the time (1931), the magnitude of this indebtedness was not known..."

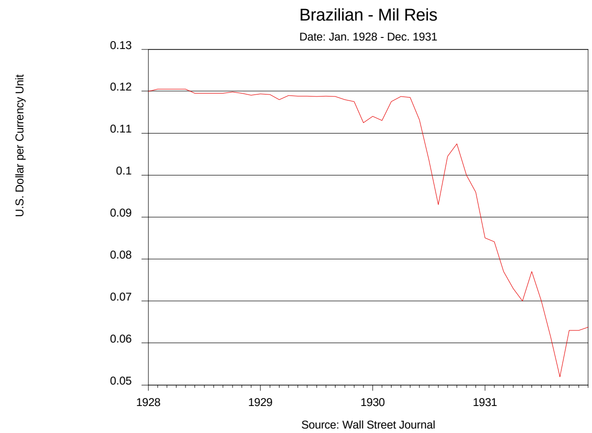
Hoover's measures had brought the situation under control, but only momentarily. The United States had been spared from wholesale banking failures due to panic that would have certainly spread had the full extent of the bad foreign loans been known. But Europe was still weak and the attacks that France had made against the pound in retaliation for the British helping to bail out Austria went deep into undermining the entire world economy. Not only was the level of international debt seriously high, but the greatest of all dangers remained in confidence. Once that confidence was lost, the momentum of events that followed was beyond the control of everyone involved.

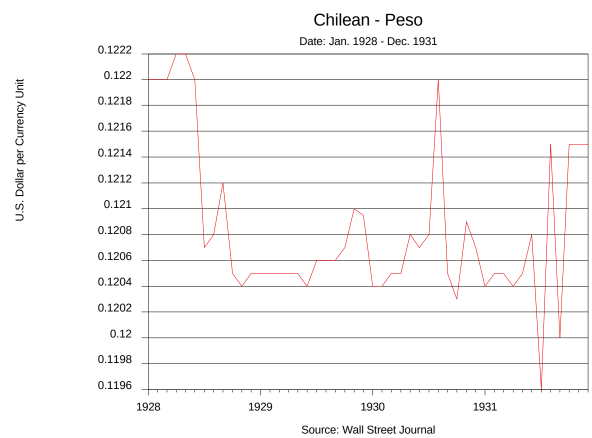
The problems could not be assessed quickly enough nor could politicians agree among themselves as to the proper corrective measures which were necessary.

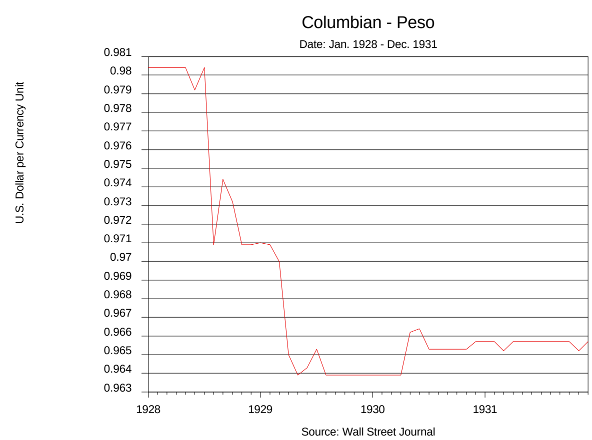
The stock market was taking a brief pause as everyone who understood the situation and its severity hoped and prayed that confidence would gradually be restored in Europe. But the French were still causing problems. On July 24, 1931, the French began sizable withdrawals of gold from London. French banks moved $800 million in gold out of British banks. It was clear that the French attack on the pound was not over. This move was quickly noticed among other central banks and confidence proved to be a vague memory. The dreams of Montagu Norman had been shattered once again.

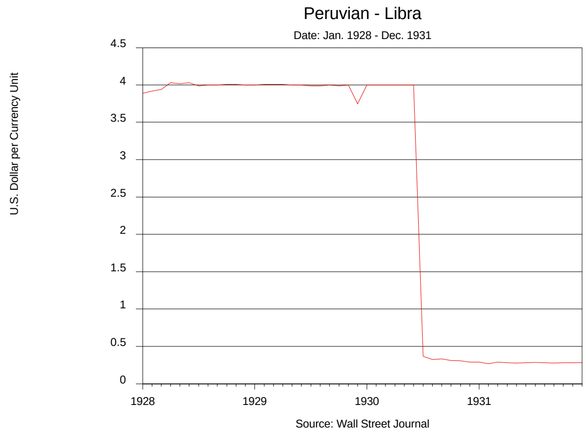
Britain had been built back to some degree and it remained in the position which was sort of a central clearing center among nations. It held sizable gold deposits from various nations and lent gold to others. When the French began to withdraw their gold deposits, other nations followed suit. Therefore, the final situation amounted to what one could loosely equate to a run on the IMF (International Monetary Fund) in today's terms.

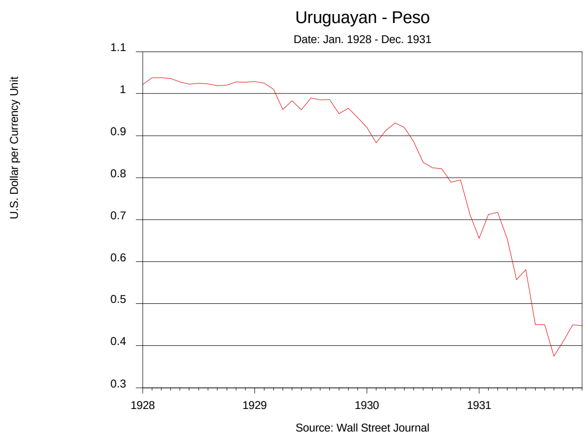
Essentially, the depositors of gold with London were cashing out but the debtors, chiefly Central and Eastern European nations including Austria and Germany, could not be called upon to repay their loans immediately. The Bank of England attempted to stem the run by implementing the typical textbook action - a hike in interest rates. The Fed held its discount rate at 1.5% in the United States. The run was not impressed by the higher rate of interest offered by the Brits. When confidence is shaken, NO LEVEL OF INTEREST IS

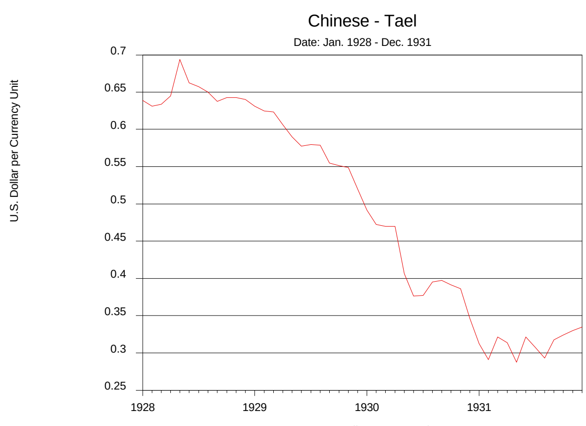












ENOUGH IF PEOPLE FEAR A DEFAULT. Capital is only attracted to a higher rate of interest when all things upon which confidence is dependent remain equal. If one nation or a person is seen to be in a weakened state and on the verge of bankruptcy, lenders are generally rarer than a hot summer night in Siberia.

On August 1, 1931, the Bank of England inquired of the U.S. government whether it would be permissible to borrow $250 million from private U.S. banks. Hoover encouraged this action to be taken immediately. But the selling pressure against the pound by private investors forced the Bank of England to request a $400 million loan on the 26th of August. Both loans were made giving Britain a $650 million loan, but even this proved to be far from enough to stem the tide.

Within Britain, turmoil had besieged the government. Montagu Norman still reigned as a dominant force within economic policies. Norman turned to his handy textbook and relied upon what under normal conditions would dictate the solution to the problems at hand. In addition to raising the interest rates, which failed to prevent the panic withdrawals, he then surmised that confidence could only be restored by cutting government expenditures, thereby forcing on its own people a greater level of deflation. The Brits also organized what was dubbed the "May Committee" which reviewed public expenditure. This committee recommended drastic cuts in government expenditures, including a 20% cut for government employees and unemployment benefits for its people. Only two out of the seven members of this committee dissented on this opinion.

Norman obviously relied upon the report of the May Committee in his suggestions which he delivered to the government. During August this led to the resignation of most of the Labour cabinet, which simply disagreed that the salaries of government workers and unemployment benefits should be cut drastically. In the aftermath, the formation of Macdonald's National Government resulted.

Norman demanded that these drastic cuts must be made immediately and he made them a prerequisite for obtaining the loans from the United States. These were the only steps that could save the pound, Norman asserted. From Invergordon, news spread around the world that the British Navy was in "mutiny" as a result of the drastic cut in pay. This news of mutiny did not help restore confidence whatsoever and the pay cuts had been hastily pushed through upon Norman's direction.


1791
A frenzy of speculation
swept the country
DURING the early Years of Washington's Administration, Hamilton, as Secretary of the Treasury, strove *diligently* to establish a sound System of Banking and to *stabilize* the Currency of the country. ¶But Speculation was the order of the Day. United States Bank scrip, originally offered for one hundred dollars, rose to 195, dropped rapidly to 110 and finally rallied to 145. Several failures were the result. ¶*In this crisis* Hamilton authorized the Cashier of the Bank of New York to *buy* government bonds and stocks to *relieve* the merchants of the City and to sustain the credit of the United States.
BANK of NEW YORK and TRUST COMPANY
CAPITAL, SURPLUS AND UNDIVIDED PROFITS $20,000,000
48 WALL STREET, NEW YORK
Uptown Office: Madison Avenue at 63rd Street

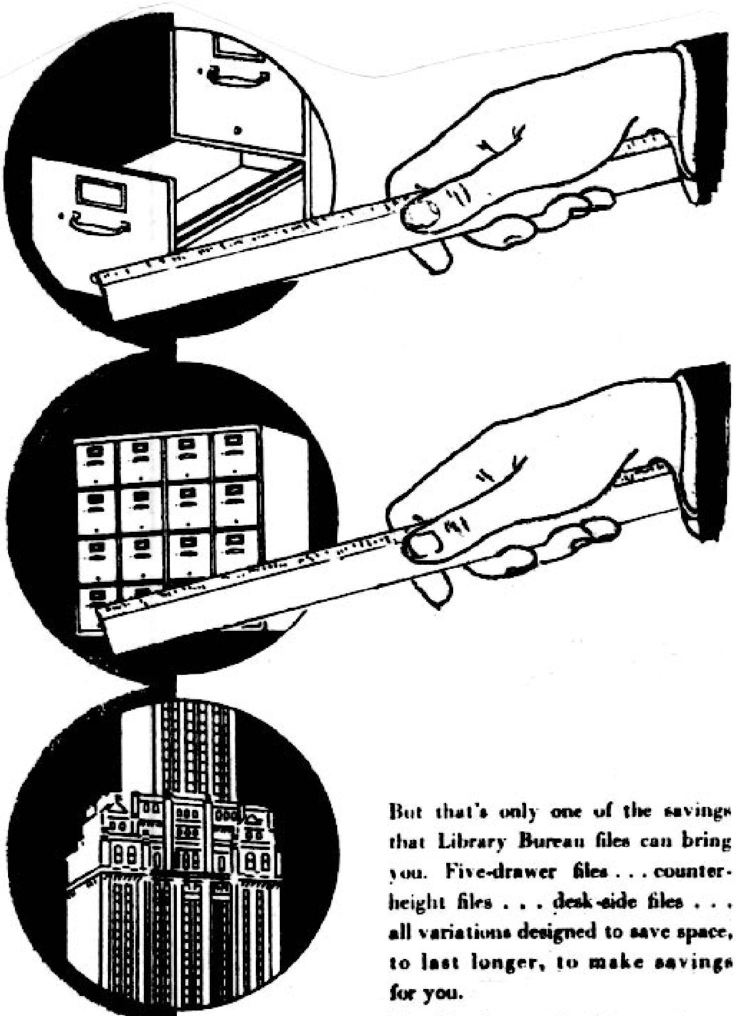
INCHES

that save

YARDS

that save

RENT..



You think there's nothing very dramatic about *inches* of filing space?

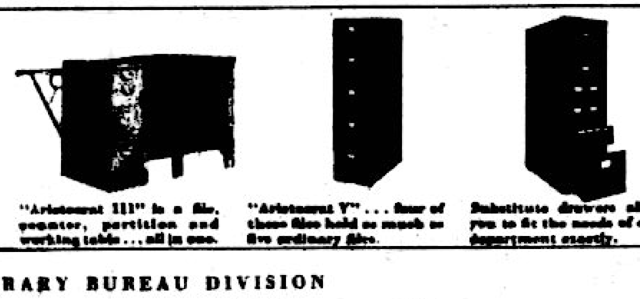
You might . . . if you could add all the inches you pay for and don't get . . . if you realised that you were going to buy six new files when five would be enough.

You certainly *would* . . . if you realised how much rent you pay for filing space . . . and how much of that is unnecessary.

Library Bureau has been building cabinets and learning how to save inches for fifty years. Take an inch-measure. Compare the filing space in a Library Bureau cabinet with any other.

But that's only one of the savings that Library Bureau files can bring you. Five-drawer files . . . counter-height files . . . desk-side files . . . all variations designed to save space, to last longer, to make savings for you.

The Remington Rand man knows where these savings can be made and how to make them. A telephone call brings him to your desk.



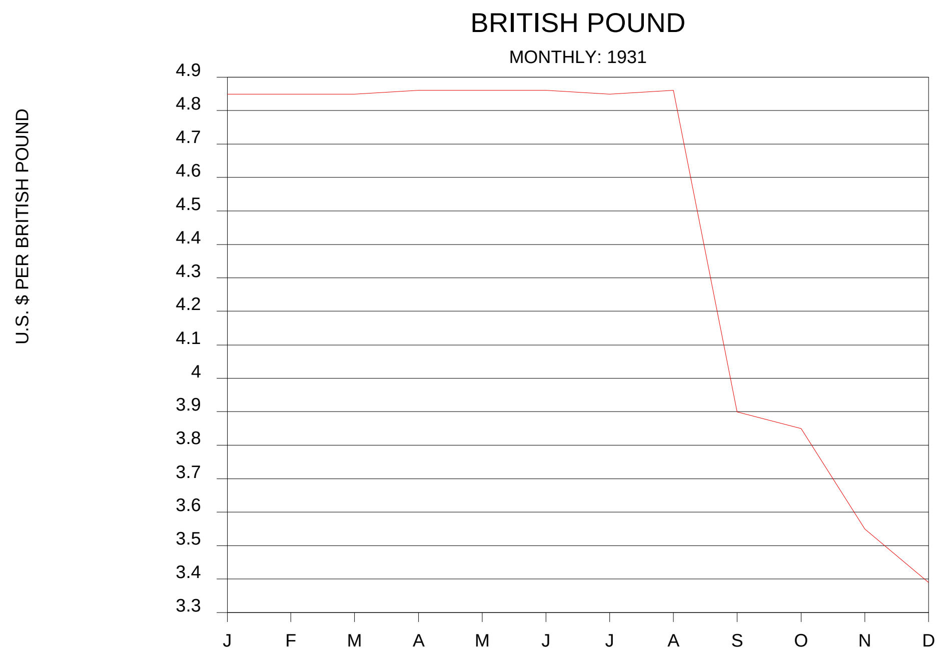
"Aristocrat III" is a file, counter, partition and working table . . . all in one.
"Aristocrat V" . . . four of these files hold as much as five ordinary files.
Substitute drawers allow you to fit the needs of any department exactly.

LIBRARY BUREAU DIVISION

Remington Rand

BUSINESS SERVICE

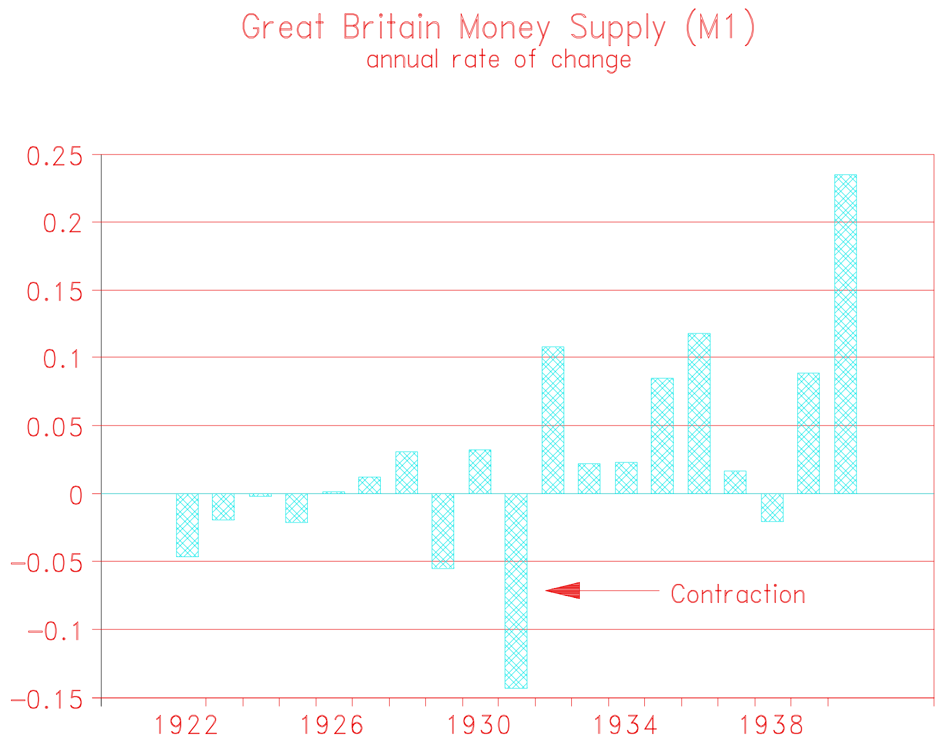
EXECUTIVE OFFICES, BUFFALO, N. Y. . . . SALES OFFICES IN ALL PRINCIPAL CITIES



Another committee, which history has referred to as the "Macmillan Committee," presided over finance and industry matters within the British government. Two prominent men sat on this committee; they were John Maynard Keynes and Ernest Bevin. The Macmillan Committee had recommended that the pound should be devalued. Of course, Norman had disagreed with this wholeheartedly. Keynes was also opposed to devaluation, but it is said that on August 5, Keynes wrote a letter to the Prime Minister in which he reversed his opinion and advocated a devaluation of the pound using the words: "The game is up."

Finally, on September 21, 1931, the Bank of England abandoned the gold standard and effectively defaulted on its foreign obligations. This, added to revolutions in South America, defaults by Germany, Austria and most of Eastern Europe, left the United States as one of the few nations which still clung to the gold standard.

It is important to note that the normal actions which a central bank should take to stem a run on its banks and currency were taken but failed to prevent the panic from spreading. Yet today our central banks have not revised these guidelines and under the same circumstances they will do the very same thing once again. Britain's measures considered the welfare of its own people as second to that of maintaining international confidence in the pound. It raised interest rates which battered an already weakened domestic economy. The drastic pay cuts of 20% would again be measures which could only deepen the domestic plight of its own citizens. In essence, Britain had become the depository nation for wandering gold which fled from Germany, Austria and Hungary as well as other Eastern European nations. A portion of those deposits were lent back to those nations in an effort to prevent their collapse. But when confidence was thereby weakened in the British ability to cover its outstanding foreign debts owed to depository of this frightened "fugitive" international

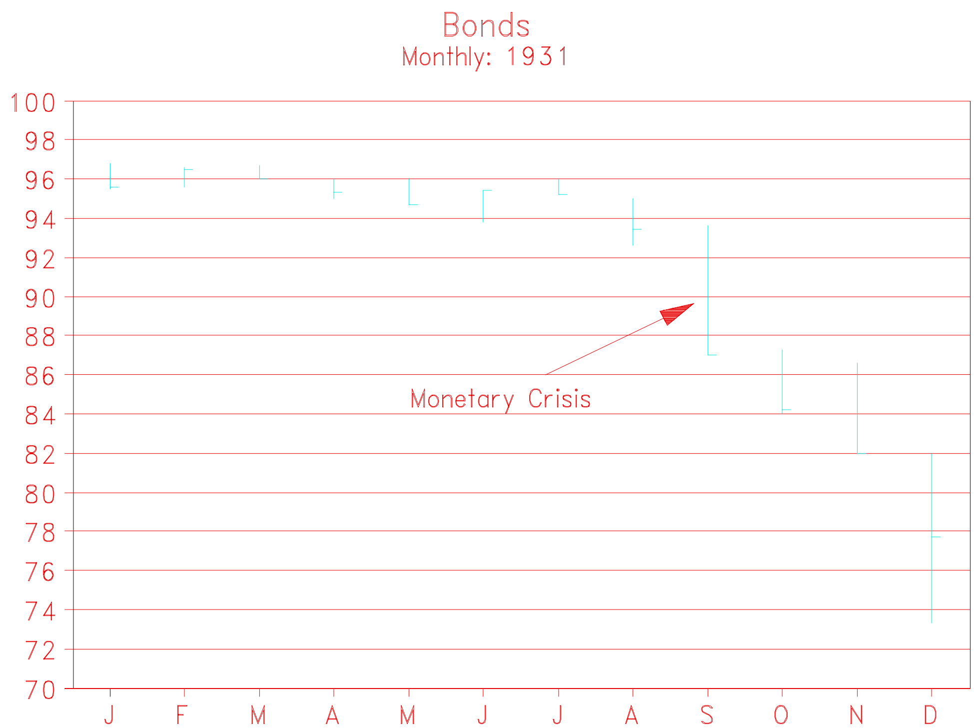


capital, it thereby destroyed the pound in its wake.

The huge and sudden swings within the international capital flows played havoc on foreign exchange. This did more damage to world trade than any tariff. Not only was commerce unsure of what exchange rate a transaction would finally yield, it also had concerns about whether or not payment could even be appropriated. Those who chose to lay the blame for the contraction in world trade solely on the shoulders of the Smoot-Hawley Tariff Act of 1930 have done a grave injustice to our memories of this terrible period. No one seems to mention the fact that international debt had been orchestrated in the same manner in which Ponzi had managed his scheme. Payments to one were merely appropriated by borrowing from another. This was a greater transfer of wealth from the people into government coffers than any taxation scheme ever devised. There can be no question as to why capital was far from contented and confidence proved to be a rare commodity in itself. With bonds becoming worthless from one nation to another, people became reluctant to invest their savings in anything, no less foreign bonds. For years the advertising had touted that bonds were the "safe" investment. But in the end, more capital disappeared through these international defaults than was ever lost on the stock market.

There are those who criticized Hoover for not coming to the aid of Britain. But at this stage in the game, world confidence was so shaken that it would have been similar to someone who was drowning trying to be saved by another who didn't know how to swim.

In the aftermath of the Depression, one of the steps to better organize this international system of payments was the creation of the IMF. The concept would be that the IMF could extend temporary loans to prevent such instant overnight pressure against one particular nation, which would prevent that nation's subsequent default. Although this new postwar mechanism would help to restore stability up until 1970, it would not



change the situation of confidence fleeing from one currency to another. Since the 1970s, we have seen these very same forces of confidence lay siege to various currencies. Expanding trade deficits, rising fiscal deficits, and a growing national debt did not prevent the dollar from rising to record highs moving into 1985. Reason does not necessarily follow logic. One cannot manage an economy based upon these tools that failed during the Great Depression and during every panic in confidence thereafter.

Time magazine reported in its September 28, 1931 edition on the shock of the British default. Their comments were as follows:

"Last Monday, all businessmen were shocked to read in their morning papers that the British pound sterling was no longer based on gold. The Tokyo Stock Exchange had announced that it would not open. Tokyo was followed by Bombay, Calcutta, Johannesburg, London, Berlin, Amsterdam, Copenhagen, Vienna, Oslo, Stockholm, Brussels and Athens. The Paris Bourse opened, but limited all trades to 5% of all holdings and no dealing in foreign exchange. Montreal's Exchange opened similarly restricted. The New York Stock Exchange remained open, but as in dark November 1929, short selling was forbidden. In the artificial market thus created, stocks gyrated unsteadily, closed higher; bonds closed at lows for the year."

There can be no doubt that the shenanigans of various governments did more harm to international trade than mere tariff restraints. Tariffs merely upset the balance of profit whereas disruption of foreign exchange injected tremendous risk and uncertainty which destroyed confidence in its wake. The lessons of the Great Depression are many but they certainly do not end with mere tariffs. Although in the decades that followed this period, several new inventions such as the IMF and the General Agreement of Tariffs & Trade (GATT) emerged, governments failed to draw upon their lessons from foreign exchange manipulation. Competitive devaluations would become the tool to combat world trade in the postwar era.

The Dow Jones Industrials dropped more severely than ever before, second only to that infamous collapse into November 1929. The industrials fell below the 100 level and closed September on the low of the month. As October entered, the havoc continued, forcing the industrials down to nearly 86 which was a far cry from the peak on the "moratorium rally" which was established during June of 1931 near the 157 level. This decline came close to a 42% drop, but the curious thing was that shortselling had actually been banned. World exchanges opened and quickly closed as soon as selling pressure resumed. "A mass exodus of capital," are the only words that can be used to explain the events in the wake of the British default.

It was at this time that sentiment toward shorts began to turn into open attacks which clearly demonstrated an undertone of hatred. With catastrophic losses dealt to stubborn bulls who held onto stocks through this decline, cries to outlaw shortselling began to be heard even on the floor of the House of Representatives.

In Time magazine we find an excellent article which portrays the sentiments that began to develop against the bears during this era. This sentiment eventually became much worse, turning into witch hunts on the part of the Senate throughout the years that followed.

"When Lawyer James Watson Gerard, one-time (1913-1917) Ambassador to Germany, arrived in Manhattan from Europe last week he was in a critical mood. He said President Hoover should up and say prohibition is nonsense. He chided Manhattan's bankers for paying more attention to Germany than to the U.S. He scolded big corporations for not giving out intelligible statements; he and Mrs. Gerard have some 2,300 shares of General Electric and he defied 'any one to tell from the statements of this company what it is doing.' Because Mr. Gerard has previously been known as a foe of shortselling, no Wall Streeter was surprised to read that he added: 'I also feel that shortselling here should be curbed immediately.'

"But this Gerard interview was only a prelude to a week replete with attacks on methodical bears. A few days later Lawyer Gerard declaimed that shortselling is illegal because it is gambling, is as bad as setting fire to property. 'It is selling something which the seller has not got and which he hopes to buy at a lower price, that lower price being made possible by the mere fact of the sale...The result is that the stock which the small investor bought on margin...is actually used as a club against him.'

"Although Wall Street has pat answers to this attitude, it became apparent last week that more than pat answers may be necessary if anti-bear legislation is to be headed off. The first attack on bears will probably come from the New York legislature. Through his business associate, Patrick Sullivan, Mr. Gerard last year presented a bill to make it necessary for a broker to obtain the written consent of an owner of stock before it can be loaned to shorts. The bill was shelved but will be aggressively revived this session by Assemblyman Sullivan, nephew of the Timothy Sullivan who sponsored New York's famed Sullivan Act against concealed weapons.

"Interference with shortselling in New York alone might lead to a rapid growth of some interior market. But last week's development included a resolution against shortselling passed by the Chicago City Council and given to the Governor's Revenue Committee. There was also an acceleration of agitation in Federal Government circles.

"Leader of the movement seemed to be James Eli Watson, Republican floorleader of the Senate, commonly regarded as a spokesman for the Hoover administration. Last week he said: 'It is the belief of many that we shall not recover from our present depression until transactions of this kind (shortselling) are either prohibited or greatly curtailed or properly safeguarded... I have no doubt that one or more resolutions of this kind will be passed (by Congress).' Since President Hoover last week was conferring with many a financial leader, it was felt that Senator Watson knew whereof he spoke.

"Heartily in agreement with Senator Watson were Senators of less orthodox views on financial matters. Iowa's Smith Wildman Brookhart exclaimed that he would see to it that interstate transmission of shortsale quotations is prohibited. Apparently he was unaware that the Stock Exchange's machinery does not include anything which tells whether a seller of stock owns it or not.

"Other stacks included: A resolution by United States Chamber of Commerce's directors that shortselling be limited to sellers who deposit a 40% cash margin and show evidence of possessing the rest. This would not materially alter the present situation, for bears must deposit 25% in most houses, present credit credentials before opening an account.

"The Scripps-Howard chainpapers, professional crusaders, also took up the battle "against bears."

We can see in this article thus far that the attitude toward shortselling was beginning to come to a head. Ever since the collapse first began in the autumn of 1929, resentment toward these rumoured groups of all-knowledgeable bears had persisted. Many brokers and analysts merely added fuel to the fire when lacking any true explanation for the market's decline, turning to the old cliche that it was being perpetrated by "bear-raiders." This would later prove to be incorrect as investigations failed to establish that any short interest had been present. No one bothered to look around them at the tremendous lack of confidence and official manipulations which existed in the much broader bond markets of the world. Many of the loudest cries against the bears came from wounded bulls. Even James Gerard was a substantial holder of General Electric. Could his resentment toward bears have anything to do with the losses he suffered in the stock market?

Time magazine went on to comment further on the events of this period as follows:

"With so much agitation against shortselling it was becoming apparent last week that the New York Stock Exchange would have to make some move itself or else run the risk of very drastic impositions upon it. One fair sized member firm, Pouch & Co., announced it would no longer lend stocks to bears because, while shortselling helps normal markets, it is 'utterly immoral and unwarranted' in a crisis. This attitude was not, however, officially that of the Exchange.

"As an opening move in its defense, the Stock Exchange last week ordered all members not to use the phrase 'bear-raid' unless they could substantiate it. The reason was clear: When a stock tumbles, perhaps on some internal development in the company, brokers often say it was because of a 'raid' and increase the feeling against bears.

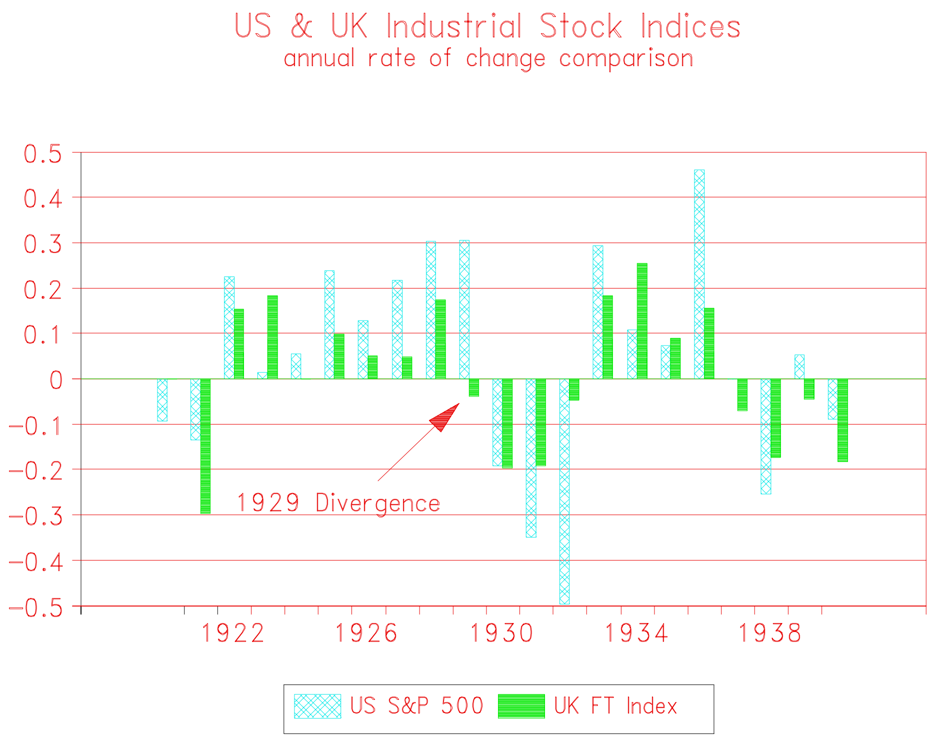
That the move was a little late seemed implied by the lack of differentiation last week between raids and real shortselling when bears were attacked. A raid is definitely aimed to depress a stock that will come on the market if the price can be shoved down a little. A legitimate short sells on values, feels that time and earnings reports will adjust the price downward. The difference is the same as between an operator and an investor."

Today we can pick up any leading newspaper and read that the market declined on expectations of higher interest rates or that gold declined because interest rates were expected to rise. On occasion, the very next day gold will rise sharply and Fed Funds may have also moved higher, but then the press will tout another reason in place of their interest rate explanation. The truth of the matter is that often moves are created on purely technical implications which lack any direct influence from interest rates, oil, or whatever. But the press does not generally understand technical moves or cyclical moves and always insists upon having some sort of fundamental answer even when none exists. Thus was the case in point and much of the decline was attributed to "bear-raiders" when, in fact, none existed.

Time also continued in presenting the opinions of Professor Irving Fisher as follows:

"Another commentator on the situation last week was Yale's Professor Irving Fisher. Said he: 'My former master in economics, President (Arthur Twining) Hadley, put it well when he said that speculation of any kind...is beneficial when it merely anticipates a rise or fall of prices.' For it then mitigates the rise or fall. It is injurious when it manipulates prices against the natural tendency. Manipulation is usually impossible when the supply is large and there is not much overextension of margin buying. Today, however, shortselling...is capable of extreme abuse.' The goated Professor also made this acute distinction between longbuying and shortselling; 'Borrowed money comes out of an almost infinite reservoir, whereas borrowed stock may come from a very small reservoir...It is practically impossible for speculators to manipulate the value of money.'"

Fisher pointed out that long positions could draw upon a vast reservoir of capital to borrow for the purpose of buying stock on margin. However, in his contention that shorts might be able to manipulate because the supply of stock is infinitely smaller, something is lost in the logic here. One could surmise that shorts could theoretically borrow enough stock to force the market down. But when a short borrows stock, he then sells it to another buyer. At all times there are two longs for each short. The first is the original owner from whom the short borrowed the stock, and the second long is the buyer to whom the short sells his position. In order for the short to sell he can only do so if there is a buyer. Because the reservoir of stock is limited, it becomes actually more difficult for shorts to manipulate a market. This can be proven by merely looking at the casualty list of short players during the bull market era up into 1929. The shorts merely fed the market higher, creating in the climax three buyers for the same stock. When the short is squeezed and is forced to cover his position, he becomes the third buyer. The argument that longs cannot manipulate a market because the supply of money is too vast and thus uncontrollable is ridiculous. The evidence that did come out of the Senate investigations in later years proved the existence of numerous "bull-pools" but not the existence



of "bear-pools" and that manipulation was evident throughout the bull market.

All the arguments that bear raids were the cause of the market's demise and that in turn the demise of the market created the Depression are without any foundation whatsoever. Time went on in this article as follows:

"So far during the Depression the Stock Exchange has moved against bears by the Questionnaire and the complete ban on shortsales which was imposed for two days when Great Britain suspended gold payments. The Questionnaire was used in the autumn of 1929 to learn the extent and personnel of the 'bear party.' President Richard Whitney (of NYSE) later revealed the short interest was at no time large during the days of great breaks. It was used again last May and members who were too aggressive in their tactics received sharp callings down. The Questionnaire in effect last week revealed every bear, whether he was short 10 shares or 10,000 for one hour or one month. It placed the Exchange in a position to act if it wished to, but did not deter 'gentlemen's agreement' to refrain from taking short positions."

The efforts spent against the bears were purely a waste of time. The exchange's own reporting failed to turn up any evidence of the almighty bear raiders who knew perfectly when to sell the market in September 1929. Indeed, the sentiment against shortselling was prevalent worldwide. Instead of governments accepting any blame for the sad state of the international economy, they turned against the free market forces in many varied ways but always with the same ultimate goal. Time reported on this aspect in this article as well.

"In few nations nowadays is there a 'free and open market.' The Berlin Bourse closed from July 13 to September 3, opened with shortselling banned, then closed again. In Great Britain all trades were put on a cash basis which practically eliminated shortselling as did restrictions imposed on the French and Athenian Bourses. On the Paris Bourse a seller must deposit 40%

margin, also 25% on the amount of the stock sold which makes bear activities a rich man's privilege. One of the most dramatic events of the present crisis occurred in Amsterdam on September 21 when after a terrific slump in prices, all transactions were cancelled, the Exchange closed in status quo. Montreal and Toronto met the British crisis by banning shortsales and establishing 'minimum prices' for securities, but both last week were open with no restrictions. The Tokyo Exchange has been closing and opening repeatedly during recent weeks. Tokyo stocks broke badly when the shares owned by interests who operate the Exchange collapsed.

Can you imagine that after a market collapses in sheer panic that an exchange would then declare all the trades null and void? That is precisely what happened in Amsterdam during September. Unfair laws and rules against the free markets were universal. The more governments improvised such actions, the greater the fears began to spread resulting in a lack of confidence which only the financial gods could chart. Despite all these numerous government interventions, the free market continued to decline for nearly a year beyond this point. Those who were outraged and brought suit against the Commodity Exchange in New York for raising the margins to go long in silver back in 1980 when the shorts held a distinct advantage could have suffered a worse fate. The exchange might have declared all trading for the previous year null and void and rolled silver back to $5 an ounce by law!

This was not the first time that shortselling was blamed for causing a depression. The issue of whether or not shortselling was illegal came to a head following the panic of 1903. Action was brought against the exchange in court, which sought to ban shortselling by charging that it was illegal to sell something that one did not have as if it were committing a fraud. The case rose to the U.S. Supreme Court from where the opinion was handed down in 1905 by the famous Oliver Wendall Holmes who said: "People will endeavor to forecast the future and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable...This court has upheld sales of stock for future delivery."

Despite the fact that the Supreme Court had upheld the legality of shortselling back in 1905 the growing sentiment was clearly seeking a scapegoat, and many in government preferred to point the finger at those supposed bears than at the real problems which had been created by the numerous bank failures and governmental defaults.

Richard Whitney, President of the New York Stock Exchange, had even become the target of personal attacks by several Senators. Whitney was working hard to gather as much information about shortselling as possible to ward off this attack by government. He went to Hartford, Connecticut, to speak before the Chamber of Commerce and the audience was packed. Whitney revealed for the first time in October 1931 the "short-interest" which had taken an extensive amount of time and effort to gather together.

On May 25, 1931, the short interest stood at 5,589,000 shares. He illustrated that it declined sharply during the "moratorium" rally and then rose back to 4,480,000 shares on September 11, and declined to 4,241,000 on September 18. Whitney illustrated that at its peak in May, short interest was only 4% of the 1,305,516,000 shares listed on the exchange. Of the accounts that hold long positions on the same date, a total of 59 million shares were held, which demonstrated that long positions outnumbered short positions by better than 10.5 to one.

The New York Stock Exchange had forbidden shortselling for two days following the British default and he explained why the exchange lifted this restriction so quickly. The market rallied instead of declining because the shorts covered positions fearing the restrictions. Within two days, the short interest declined from 4,241,000 shares to 1,079,000 shares. This, Whitney pointed out, left a great danger. If everyone was long and prices continued to decline, then lacking short-covering, there might be little incentive to be a buyer which could cause devastating declines.

Insofar as the threat that this interest was tightly held among the rumoured "bear-raiders," Whitney produced the accounting which illustrated that the short interest had been widely dispersed among 9,369 accounts with an average of only 400 shares. Despite this evidence, government was not satisfied and the Senate hearings would still be convened, turning into the most serious infraction of constitutional rights ever instigated against the public as a whole. Everyone would soon learn that the power of the Grand Jury does not need probable cause to investigate; all it needs is official curiosity.

The commodity exchanges were far from free of these interventions either, as reported by Time magazine in this same October 12, 1931 article.

"Restrictions exist in two important U.S. commodity markets. The New York Cotton Exchange does not permit a fluctuation of more than 200 points per unit (100 bales) in any one day. Since 1925 no single futures account on the Chicago Board of Trade may exceed 5,000,000 bushels at any one time, either long or short. This is a 'working agreement' with the U.S. Grain Futures Administration and is strictly enforced, although it does not apply to bona fide hedging. Thus, over-extension of a trader on a scale which would hurt all other traders is almost impossible."

In commodities, shorts are not limited by a definitive reservoir of stock. Contracts can totally outnumber the supply of any given commodity. But the commodity industry was besieged by the criticism which followed the panic of 1919. There interest was clearly focused within the commodity sectors as well as speculation. The rallies which any commodities had undergone

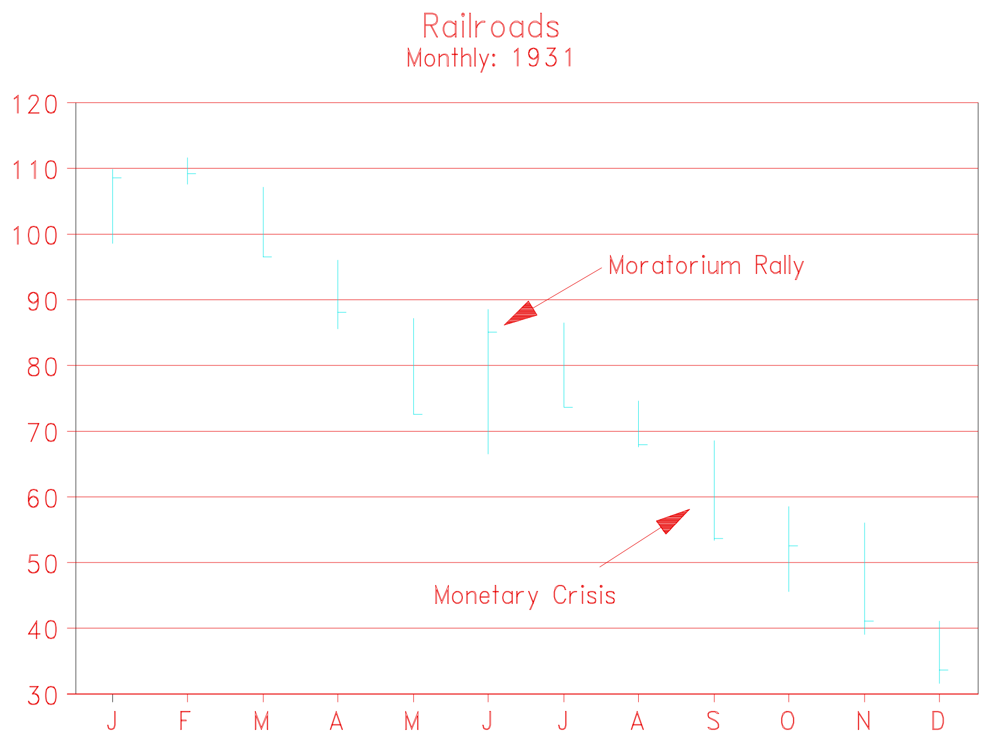
overshadowed the stock market as if the commodities were King Kong and stocks were represented by Flipper, the dolphin. This in part led to many restraints on the commodity markets including the imposition of trading limits on the amount a commodity could move during the course of a day as well as position limits. Those are rules which commodity traders deal with every day in this modern age. They are not questioned because to today's trader they have always been there. But, in fact, they were the intervention which followed the panic of 1919 when commodities had held the center stage. For this reason, commodities had declined in favour of the unrestricted stock market during the roaring '20s.

But it was also these restrictions in commodities which tended to bring about a lack of speculative interest in the futures markets. Without that interest, commodities suffered from stagnation. This has also led many to contend that because commodities declined by and large during the 1920s, that inflation was nonexistent and they always point to the 1920s and the "Nifty-Fifties" in support of their argument. As we continue through this study of the free markets and analysis, we will see how this assumption is also completely without foundation.

But unlike the illusive bears, the investment trusts did exist and published quarterly statements to verify that indeed they were still around. One of the first trusts to publish a report at this time was the Tri-Continental Corp., and a sister trust which it also controlled named Selected Industries, Inc. The Tri- Continental Corp. statement for September 30, 1931 showed a market value of its holdings of $29 million compared to $51 million for the year prior. The book value of the common stock had declined on a per share basis from $8.70 to $2.84. The listing of stocks sold by those two trusts began to illustrate who perhaps the real big sellers were. This one trust had sold off 16,100 shares of G.M., 3,700 shares of U.S. Steel, 14,724 shares of Studebaker and 45,400 shares of the Chesapeake & Ohio Railroad just to mention a few. Their statements reflected that most of their foreign bond holdings had been concentrated in German issues, but they were at least fortunate enough to have sold off much of this position during the first quarter of 1931. But their statements had also reflected a shift in assets which many other trusts had also closely paralleled. This was the outright selling of common shares of stock in favour of preferred shares as well as bond issues. This trend among the investment trusts is the reason why even though stock prices had declined, the NUMBER of share holders of the top blue-chip companies continued to rise and actually peaked during 1932. It was the investment trusts which had bought much of the stock in 1929 and it was the individuals who bought stock from them on the way down.

The sharp decline in stock prices during September of 1931 was also accompanied by a sharp decline in production within many industries. On the surface one could perhaps argue that stock prices had fallen badly due to large shortselling, but in reality, one could not blame the sharpest decline in productivity upon supposed shorts in the stock market.

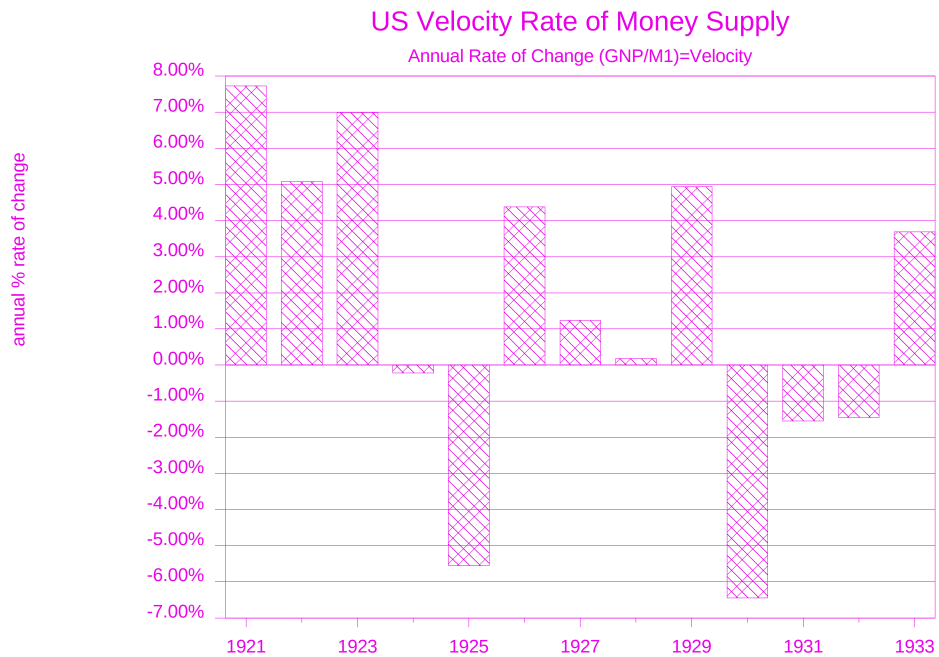
Auto production during September fell 25.6% from August levels and 37.7% from September 1930 levels according to the figures released by the National automobile Chamber of Commerce. Steel production fell to only 28.2% of capacity, a level which penetrated the lowest on record as far back as 1921.



The numerous banking statements which arrived at this time were of major interest to many. The trend toward withdrawals had clearly shown up, and to everyone's surprise even the largest bank, the Chase National, was not spared. Chase posted a decline in deposits of $214 million during the third quarter. The Philadelphia banks were in deep trouble, perhaps best illustrated by large advertisements which were prepared by prominent citizens within the community. These advertisements were pleading with the public not to withdraw their capital from the banks in town. The largest was the Philadelphia National Bank whose deposits declined $83 million during the third quarter of 1931, falling to $289 million.

It cannot be denied that the supply of money contracted during this period. If all banks reported a decline in deposits, obviously the money had to go somewhere. There are those who blamed the Federal Reserve for failing to expand the money supply during this period which caused the contraction and thereby the Depression. But again this argument is merely superficial. The causes and effects were not merely domestic, but also international. Watching the ups and downs of the supply of money in the U.S. cannot lead us to the ultimate cause for the Depression of the world. Besides, this argument ignores international circumstances and capital flows of international funds which fled from one nation to another as sovereign defaults sparked deep fears, and it ignores the issue of what money is and how it is created.

As in the example that I just provided to illustrate why a short cannot control and ultimately manipulate a stock on sheer numbers, money supply works in the same manner. In commodities, the number of contracts are not limited to any physical amount of goods available. Thus the short need not borrow 100 ounces of gold to adopt a short position. Therefore, longs and shorts always balance and neither side can actually outnumber the other. In stocks as in money, the short needs to physically borrow the stock and therefore since stock is of a definitive limited quantity, when the short borrows the stock from an original



owner and sells it to another, he has created two persons who both "believe" that they own a share of that company.

Imagine now that we are talking about General Motors which issued 1,000 shares. For argument's sake, let us say that a very bearish person borrows 1,000 shares and decides he wants to go short. He borrows from person A and sells it to person B. The broker who does the accounting for these three people will send them all a statement at the end of the day's transactions. Person A will show that he still holds his original 1,000 shares. B will show that he has just bought 1,000 shares and the short will show a statement that he owes 1,000 shares. In reality 2,000 shares are now thought to be owned by both A and B. Both A and B decide that they want to buy stock in U.S. Steel. The broker will lend them 50% against the fully paid positions in G.M. Now each can borrow against the combined 2,000 shares they own of G.M. and they buy U.S. Steel. But G.M. never issued 2,000 shares; all it ever issued was 1,000 shares of G.M. stock without the company having anything to do with it.

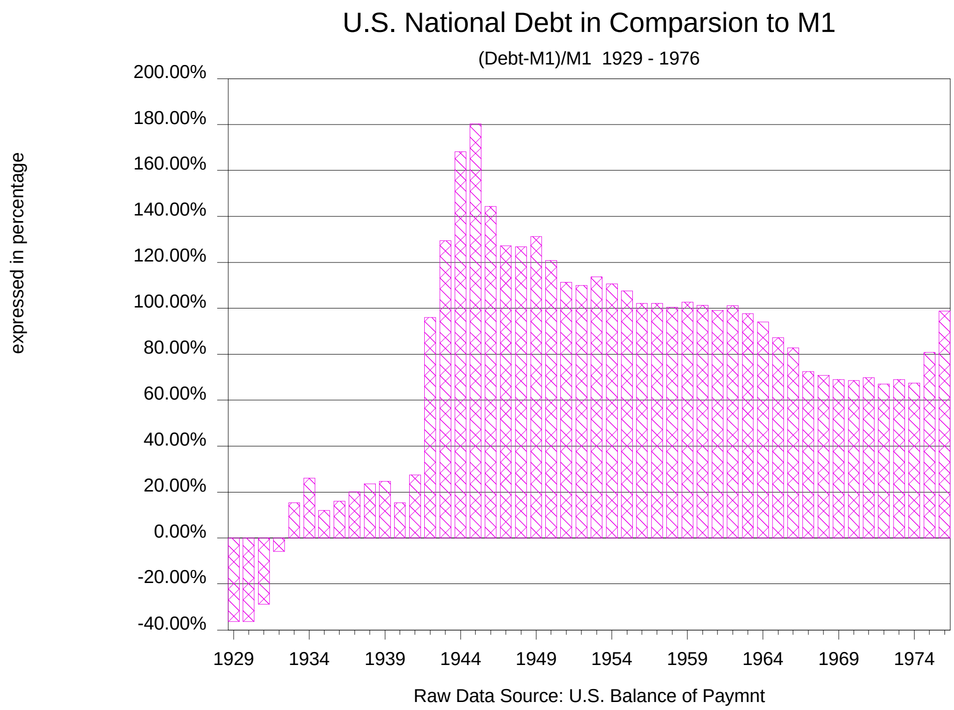
The creation of money works in the same manner. A vast amount of money was created by the booming stock market. Let us consider that A and B bought their G.M. stock at $40 and then they borrowed 50% and bought U.S. Steel for $20. After three months, let us suppose that G.M. rose to $100 and U.S. Steel moved up to $60. Now they decide that they want to borrow again and buy Sears which is selling for $60.

Against G.M. they borrowed $20 and now it is worth $100. The broker will therefore lend them another $30 against the G.M. shares. U.S. Steel they own outright and they borrow $30 against that. They now take the $60 and buy Sears. The value of those assets continues to move higher. The limit is not imposed by the outstanding money supply but by what someone is willing to pay for it. If we were to add up all the stock on the various U.S. markets, bank deposits, bonds, diamonds, real estate, etc., we would find that the intrinsic value placed by man on all these assets far exceeds the outstanding money supply. In fact, the total value of real estate in the United States exceeds the entire world supply of money. This quasi money in tangible form cannot be controlled by the Fed, no less counted. Its value rests solely upon the whims of confident and contented capital. When capital becomes less than confident and real estate suddenly becomes nonliquid, values plummet because the supply of these things vastly outnumber the actual supply of money used for exchange. Hence severe and rapid contractions always follow rapidly expanding inflationary periods. Those who wish to assert that the roaring '20s were a period of low inflation are insane. Inflation may not have been present in raw commodities, but insofar as stocks and luxury items were concerned, inflation was rampant as evidenced by the Florida land boom and the bull market itself. People were not standing in line, hoarding toilet paper or sugar as they were in the 1970s, but they were bidding up the price of housing, stocks, bonds, diamonds, furs and automobiles. This was a period of inflation in tangible forms of wealth, which in reality caused a great expansion in this tangible money supply that was just as good as gold and could be placed as collateral at a bank for borrowing purposes.

We read earlier that $1 in gold led to $13 in credit according to the Fed's own estimates during the 1920s. Of course this vast multiplication of credit has been somewhat reduced in modern times since banks are required to maintain higher levels of reserves. But still what becomes important is not so much the contraction by the Fed but the velocity rate at which money changes hands. When people lose confidence in a bank or the government and they hoard their assets, as was the case during the Depression, the hoarding of gold reduced the multiplication factor of credit. Since the Fed could not create gold, its only option was to create paper money. That it could not do at a rate of 13 times in good conscience while on a gold standard. Such a move would revive Gresham's law of bad money driving out the good and the end result would have been another hyperinflation as was seen in Germany during the early 1920s. Even so, it was not the lack of money or the contraction so much which disrupted the economy as it was the sharp decline in velocity.

The private sector has always been in control of its money supply to a large extent. Governments merely aggravates the situation by playing games. For example, the United States borrows money through issuing bonds, bills and notes. It is somehow believed that if government borrows to cover its debt rather than monetize it through issuing paper money that the effects will not be as inflationary. The National Debt stood at $16.9 billion in 1929 and rose to $22.5 billion by 1933; by 1976 it reached $620.4 billion. If we look at money supply through the strictest measurement M1 (currency plus demand deposits), we find that it stood at $26.5 billion in 1929, $19.5 billion in 1933 and $311.9 billion in 1976. In 1929 the amount of outstanding U.S. securities was considerably less than the outstanding currency and demand deposits but by 1933 debt exceeded M1 by about 15%. By 1976 outstanding debt was almost twice M1.

If everyone wanted to cash in their U.S. bonds, notes and bills at the same time, government would be forced to print money since not enough cash as measured through M1 exists to cover all the debt obligations. This is exactly what takes place through private investments such as stocks, real estate, antiques, fine art, diamonds, etc.



As long as people feel comfortable in viewing these things as a "store of wealth" everything is fine. But when confidence is lost, everyone runs in the direction of cash. There is simply not enough cash to go around and a massive contraction takes place. Therefore, the Great Depression was not only a massive contraction in the value of these tangible assets, but it was also a contraction in debt instruments as well. When nations began to default on their bonds, confidence in their paper money gave way as well, driving the whole world into gold and the dollar.

Debt has always been a huge problem to man. Because debt multiplies the value of these tangible assets, it creates a bubble of unprecedented danger which eventually comes to a head creating a stampede into cash.

Debt has always been a problem that has inflicted every society known to man. Even the great Julius Caesar was forced to deal with such financial decisions and, indeed, it may have been these decisions which prompted his assassination. Much of the political structure of Rome was built on lavish extravaganzas on the part of politicians to gain favour and thus votes from the people. To cover such costs, one would borrow vast sums to pay for public games and events. The rates of interest were often driven to well over 100% and indeed a debt crisis had besieged Rome during the period of the Civil War. It was widely believed that Caesar would be forced to declare all debts null and void to secure his position. Even Marc Anthony had bought up the auctioned property of several political exiles, including the very palace and slaves of Pompey the Great, in the belief that such debts would be wiped out by Caesar. But no matter how popular such a move would have been to such exploiters of the circumstances, Caesar cancelled all interest which had been accrued on debts during the Civil War or at least for a two-year period upon his return to Rome in September of 47 BC. Had he not taken such action the debt- ridden society would have created a civil war on the streets of Rome.

Today we question little about debt. We seem to accept that interest is a just thing which is owed to the man who holds the money. But in fact, philosophically, civilization had turned its back on debt and interest after it had been proven to have destroyed numerous societies throughout history. To charge interest was a sin of usury in both the Catholic Church as well as in the Arab religions. Only the Jews did not consider charging interest to be a sin. Throughout the Middle Ages, no Christian could charge interest to another. If he lent money to someone, it was considered to be a Christian act and to demand interest which might force that individual to repay two or three times what he had originally borrowed was a sin in that one merely exploited the misfortunes of others.

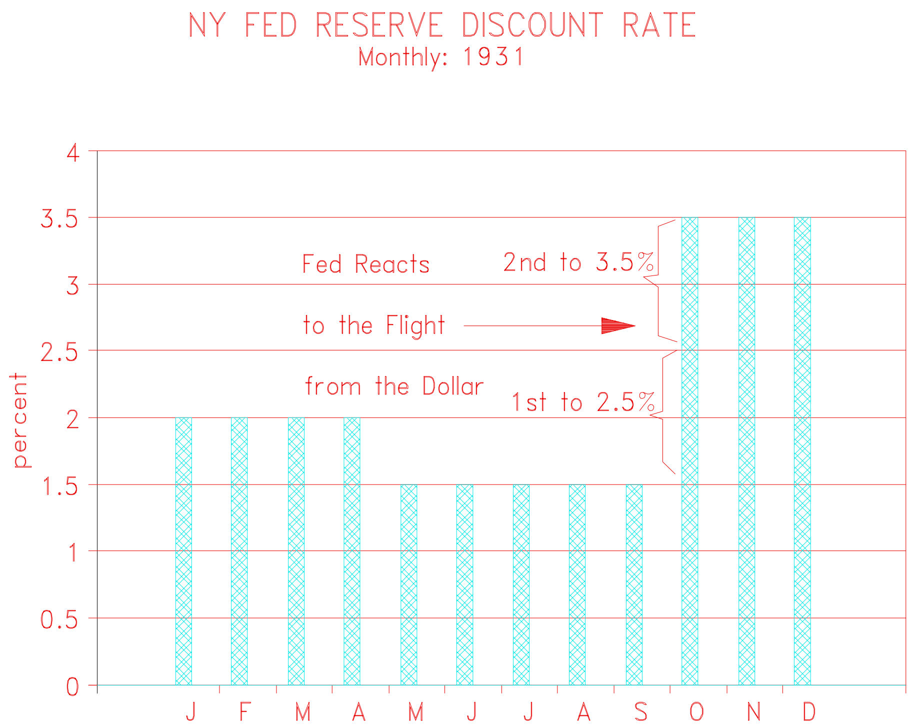
The Jews played a large part in the development of trade, for it was the Jews who lent money for business ventures and financed voyages. But the Jews were also moneylenders who debtors could not repay, and this often led to the excuse which most called anti-Semitism. Much of the killing of Jews had nothing to do with religion, but instead it was caused by the fact that they held the mortgages on much of the property. Things became so bad that the Pope threatened excommunication against anyone who harmed the Jews.

It was this same law of usury which eventually led to the breakup of the Catholic Church into various Christian sects. Christians wanted to be able to lend money and the Pope would not lift the law of usury. Thus a revolution in religion took place and the various Christian sects made it permissible to charge interest. However, they disguised many of their motives by calling the Pope the "Anti-Christ" because he sought to protect the Jews and because he sought to control debtors by maintaining the old laws of usury, thereby loosely fitting together a few lines of the Revelations which foretold of the coming of the Anti-Christ.

The world has therefore gone through the long-term cycle of debt several times. It was destroyed by massive overextension, then abandoned debt and interest payments and then reverted toward this system. We now live in a world highly involved in debt and interdependent payments both on a private as well as governmental level. The contraction in world trade was damaged far more by the default on foreign bonds, the flight of capital from one nation to another and the massive contraction in the value of both debt instruments and tangible assets than by any other forces during the period.

Little work if any has ever been devoted to studying the differences between a society based upon debt and one void of such instruments. Few economists are even aware that civilization has alternated between these two extremes throughout history. Consequently, few opinions as to the causes of the Great Depression have even focused on this very important aspect.

In actuality, most analytical commentary on the Great Depression has ignored the impact of debt and the soveriegn defaults on numerous government bond issues, including municipal issues within the United States. The sheer fact that confidence fled from the bond markets is evidenced by the fact that bonds declined even during 1931, peaked in February, declined in June, rallied in sympathy with stocks during the moratorium rally and then continued lower into year end. The discount rate cut to the historic low of 1.5% by the Fed in May of 1931 failed to create a reversal in the trend.



Bonds declined despite whatever the yield was. Such market action moving in direct opposition to what we would normally expect today is highly contradictory to what would be normally anticipated. Such a divergence could only be sparked by a complete collapse in confidence.

Governments were literally confused by the events that surrounded them. They did not understand how to restore confidence in their currencies or to dispel rumours which would shift vast hoards of capital from one nation to another. Although the United States became the object of affection for this refugee international capital immediately following the British default in September 1931, rumours soon sparked fears that it would be the United States that would fall victim to the turmoil of the era and capital began to flee from the United States. This disrupted the domestic economy insofar as the Fed's actions to try to restore confidence in the dollar were no different than those attempted by Germany, Austria and even Britain. The Fed raised the discount rate substantially, trying the typical textbook play, thinking that higher interest rates would attract the refugee capital once again.

The Fed turned to its textbook tactics and raised the discount rate from 1.5% to 2.5% in October of 1931. This rise in U.S. interest rates was not sufficient to convince anyone that the U.S. would not abandon the gold standard which thereby equaled a default on its foreign obligations. Still failing to see that it was not how much one would pay but whether or not one would even get paid, the Fed raised the discount rate again that very same month to 3.5%. But still this did nothing to dispel the sudden lack in confidence which had developed.

We find the commentary in Time magazine on October 26, 1931, as very helpful in giving us a feeling of what was taking place at the time.

"RATE UPPING"

"With gold flowing swiftly out of its vaults, last week Federal Reserve Bank of New

York raised its rediscount rate to 3.5%, a 1% advance from the rate which prevailed from May 8 to October 9. Through losses of gold to foreign countries and to U.S. hoarders, the Federal Reserve System showed last week a 61.8% ratio of gold on deposit and notes outstanding against 67.1% the week before, 78.4% before England suspended gold payments September 21. Legal minimum is 40%. In four weeks the U.S. lost $649,000,000 in gold, largest monthly drain on record. Previous record was a loss of $99,300,000 in June 1928. Last summer when Germany and England were experiencing like movements, the Reichsbank lost $247,000,000 in seven weeks, the Bank of England $779,000,000 in a fortnight. If last week's rate of decline in the Reserve Ratio were maintained, the legal limit of 40% would be reached in the next four weeks. Were the celegal minimum exceeded there would be a currency panic, even perhaps suspension of gold payments."

We can see as reported by Time that the drain was of historic proportions. There is no doubt that capital flows between nations were never greater. In the midst of all this turmoil the casualty was certainly world trade. Beyond tariffs, now international payments were cast in doubt. Tensions were only heightened when in mid-October Canada prohibited the exportation of gold except under valid license in payment for foreign trade. This helped take the speculative sting out of the Canadian dollar which had dropped to a discount with that of the U.S. But in all, the Canadian move was perhaps the smartest government action taken in the midst of this chaos for it simply eliminated the speculative withdrawal of gold but earmarked gold exports for legitimate trade circumstances only. This was in contrast to Britain and the United States which attempted to entice foreign capital to remain by raising interest rates. These were measures which failed to stem the panic and only further disrupted their domestic economies by forcing industry to suddenly bear the brunt of a sharp 125% rise in interest rates within one month without notice of any kind.

Even Hoover wrote in his memoirs: "The Bank of England tried to stop the run and attract capital - and thus gold to Britain - by the usual device of raising interest rates. That device does not work in times of fear, and in this instance had little effect except to spread more fear." Hoover went on to talk about the effects of the gold panic withdrawals from the United States and how they seriously disrupted U.S. trade. Hoover wrote:

"At this time foreigners concluded that the United States would be the next bulwark of international stability to collapse. They began to withdraw their deposits from our banks in gold. By the end of October we were to lose about $700,000,000 from our gold supply. This cramped our volume of credit and increased our bank demands on their borrowers. To add to our troubles, domestic hoarding of gold and currency by our citizens began. Our exports to the world dropped to about one third of the 1929 rate. Worse still, our exports of principal farm products to Europe had now dropped to almost zero, further demoralizing commodity prices. Our unemployment swelled."

From the time when the European panics first began in April, the Federal Reserve indexes illustrated marked declines. By the end of September, the Fed's index on industrial production declined 18%, factory payrolls 20%, construction contracts were off 30% and common stocks had taken a 40% decline. Clearly fears over international defaults can take their toll very quickly. Today we are not immune to such disturbances and we have experienced sharp capital flows into the U.S. dollar which came in spite of what traditional economics would lead us to believe. Confidence plays a very key role in international finance. It can overpower all logic and when shaken it spawns nothing but rumour and fear.

Again we find that the government took action which was adverse to its own domestic economic condition by raising the discount rate in favour of international circumstances.

Hoover once again rose to the occasion with ideas that were provocative and in reality not far from the philosophy of John Maynard Keynes, which was adopted during the aftermath of the Great Depression. Hoover's idea was dubbed by the press as his "Super Plan" aimed at the turmoil created by the nonliquidity caused by numerous banking failures.

The withdrawal of gold from U.S. banks on the part of foreign depositors and central banks caused several serious side effects within the domestic U.S. economy. Banks responded to the domestic urge to withdraw and hoard gold in a manner which was far from beneficial to businessmen and farmers as well as owners of mortgaged real estate. The bankers saw the turmoil as a threat, particularly against their liquidity, which in turn threatened the very survival of the banks. As a result, bankers were led to look out for number one, themselves. They began to call in loans from many sectors, trying to increase their cash reserves. Many homes and farms were forced into foreclosure, which merely added to the emotional depression that existed at the time.

Bankruptcies were increased as creditors called in all the markers of debtors. The contraction in the money supply was thereby not caused by the Federal Reserve intentionally, but in contrast by the withdrawal of foreign capital, domestic hoarding, and the needless foreclosure on property which further depressed the values of tangible assets.

Hoover's "Super Plan" was actually the formation of what was known as the National Credit Corporation. Numerous banks had been closed, tying up assets in the billions of dollars. Depositors' money, which had been lent on real estate, for example, was frozen when the banks were unable to collect enough from the repayment on loans to satisfy demands from its depositors. Thus, the value of real estate dropped substantially, disarming the multiplication effects which had originally contributed to the expansion in money supply.

Originally, the man who deposited $10,000 allowed the bank to lend that $10,000 to someone who wanted to buy a new home. The $10,000 was thereby paid to the builder, creating $20,000 in deposits throughout the banking system. But now the game of musical chairs came to a halt. Unable to sell the real estate to recapture the original $10,000 it had taken from the depositor, the reality of the game had hit home. The $10,000 no longer existed because it had been paid to the builder who deposited the money somewhere else. As everyone clamored for their money, these deposits simply vanished and the money supply contracted in its wake.

Hoover realized that vast sums of assets were frozen by this process and that, combined with international withdrawals, spelled potential national disaster. His idea was to create another form of central bank in a sense. The National Credit Corp. would be a private organization funded by $500 million in deposit contributions from the banks themselves. In turn, these funds would be used to bail out banks with cash flow problems by lending them cash upon good collateral hold on their books. This he viewed was essential to bring a halt to the bank failures and the foreclosures which further increased fears among the people and led to domestic hoarding of gold. This was a huge vicious circle which in the end added pressure on still other banks and contracted the money supply even further. The tangible assets far outnumbered the net cash available and as the velocity of money declined, so did the deposits and the multiplication factor within the banking system. This circle of events had to be stopped and this was Hoover's brilliant "Super Plan" to get the job done.

Hoover's plan actually began prior to the British default of September 21, 1931. It was at a confidential meeting during early September that Hoover called to the White House the entire Advisory Council of the Federal Reserve Board members, which consisted of 24 bankers and Treasury officials. Hoover proposed that the banks should pool together $500 million for the creation of this new project and that in addition, this pool should be given borrowing powers of $1 billion. The men in attendance seemed to support the idea and tentatively agreed to begin organizing banks around the nation.

In many ways this was quite similar to the Federal Reserve, which had been born out of the turmoil largely created by the panic of 1907. The Federal Reserve would not accept mortgages or industrial notes as collateral from banks as part of their reserve requirements. Thus, this new concept would accept collateral which the Fed did not.

Then the British default took place. Suddenly the gold reserves of the nation were under siege. Eleven days later, Hoover called a special meeting of the leading men from the banks, insurance, and loan agencies along with several top government officials. Hoover wanted to avoid publicity on this meeting, fearing that speculation by the press might adversely affect his plans while the matter was still in the planning stages. The meeting took place on October 4, at the home of Andrew Mellon rather than at the White House. This move was successful in avoiding the attention of the press who keenly noted the comings and goings at the White House.

Hoover also made plans which placed him in the position to call for a special session of Congress on October 6 just in case the private leaders refused to go along with his proposal. Hoover wrote that many in attendance at this meeting held at Mellon's house did not want to contribute funds to this central pool and urged that the government should put up the money. But Hoover's ideas were strongly against using taxpayer's money, and he believed that the private sector should participate in trying to save itself collectively. But he also realized that Congress would frown upon such government aid even more so than he. Although Hoover later wrote that this meeting at times became quite heated, it ended with the bankers agreeing to call a meeting of all major New York banks for the following day.

The insurance and loan agencies were far from cooperative. Hoover had proposed that they should hold back on foreclosures and that a central system of discounting mortgages should be established. Again, the concept was a central bank which would accept mortgages in the same manner as the Fed accepts cash or liquid notes. The insurance companies were not in the position of banks and they did not have the fear of public runs to withdraw deposits. Therefore, the insurance industry had no incentive and regarded foreclosures as simply a business decision which should not concern itself with the personal affliction that it might cause. The loan agencies were already charging much higher rates than banks and they too displayed a more self-centered approach. Only the savings banks and savings and loans were receptive. Hoover wrote in his memoirs: "I returned to the White House after midnight more depressed than ever before."

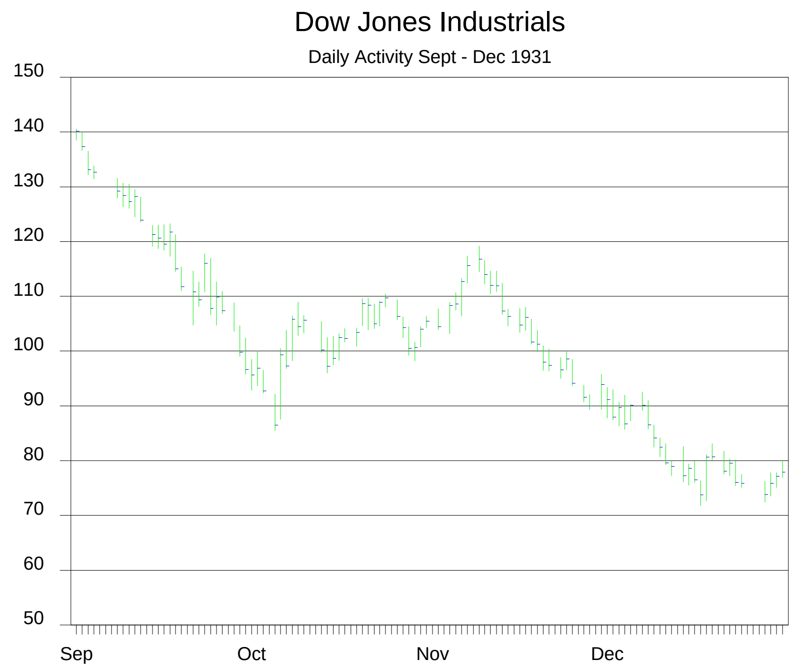
Hoover then met with Congressional leaders at the White House on October 6. He found them unwilling to fund any government structure to provide stability for the real estate situation. The next day, Hoover met again with the insurance, loan agencies and the savings and loan industries. The savings and loan group agreed with Hoover's proposals which called for an immediate end to foreclosures upon responsible people. The insurance industry refused to go along with the proposed banking structure which would have 12 districts and accept mortgages as deposits in the same manner as the Federal Reserve worked among its member banks. The insurance industry objected on the grounds that it would "create lower interest rates and thereby the income to their policyholders would be reduced." Hoover tried to point out that in many cases their precious policyholders were the very same people who were losing their homes in foreclosure. But the insurance companies would not cooperate.

Hoover then was forced to reduce the scope of his idea, creating the Home Loan Banks which stood in the middle of the savings and loans and had accepted Hoover's ideas as quite brilliant. The structure would set up 12 districts in the same manner as the Federal Reserve.

News of these new plans were accepted quite favourably by the marketplace and for one brief shining moment restored confidence both domestically and internationally. But at first, the Europeans misunderstood these proposals and assumed that they would be funded by government, which in that light meant inflation and a decline in the U.S. gold reserves. Therefore, initially, this news added some pressure to the dollar coming from Europe. Eventually, these fears that the United States would go into default began to subside along with the gold withdrawals going into year end. The concept of this new form of centralized private banking to unlock frozen capital and to help prevent further banking failures was welcome news to the markets as well.

The following table illustrates the U.S. gold situation and the ratio to currency as it developed throughout this immediate crisis period. Column (1) provides the U.S. gold reserves expressed in millions of dollars. Column (2) provides the ratio of gold reserves to Federal Reserve notes and deposits, while column (3) provides the actual Federal Reserve notes in circulation. Another point that should be made is that the only important nations which remained on the gold standard were the U.S. and France, and as of the week ending November 18, 1931, the U.S. held $2.8 billion in gold while France held $2.6 billion.

U.S. Gold Reserves & Currencies Ratios



Source: Dow Jones

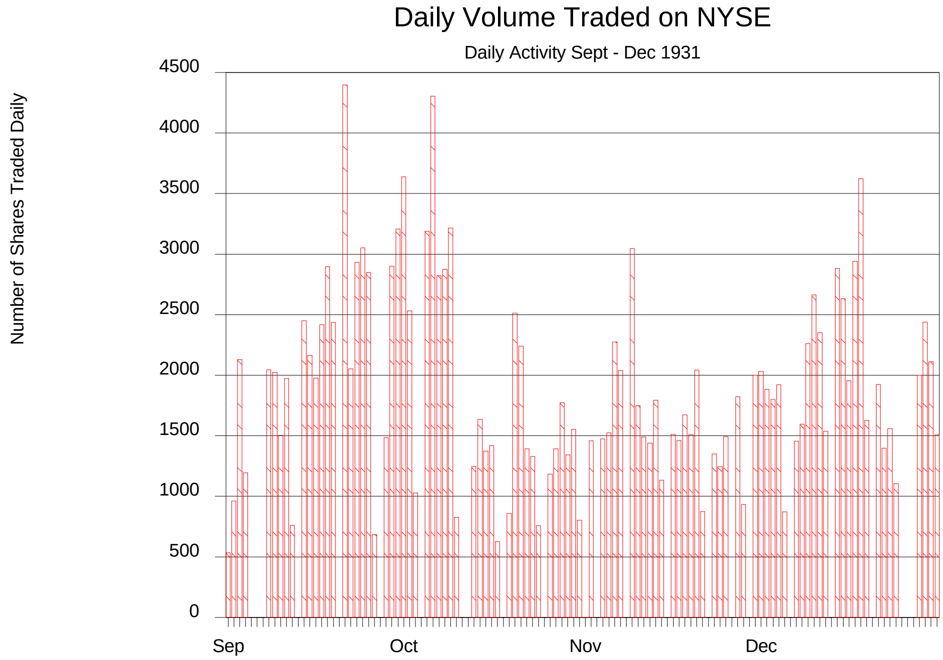
Week Ended	Gold Res	Ratio	Currency
Sept 10	3,485	74.9%	2,005
Sept 23	3,327	73.4%	2,045
Sept 30	3,138	73.4%	2,097
Oct 7	3,036	63.8%	2,269
Oct 14	2,836	58.5%	2,321
Oct 21	2,764	56.5%	2,383
Oct 28	2,738	56.6%	2,383
Nov 4	2,772	58.1%	2,447
Nov 11	2,826	62.4%	2,449
Nov 18	2,874	64.1%	2,433
Year Ago	3,040	81.9%	1,383

*Source: Time Magazine

The European fears which developed over the misunderstanding of Hoover's National Credit Corp. had their way of sparking a rise in commodity prices in terms of dollars. This was only natural since they feared the dollar's decline and the U.S. potential abandonment of the gold standard. This spelled one thing: a sudden price shock of inflationary involvement. The U.S. press was a bit confused at the sudden foreign buying of commodities. Many attributed this to unwarranted fears that perhaps the U.S. might institute tariffs on raw commodities, while others claimed that it was fears that Britain would impose a tariff. The European press centered on the fear of U.S. abandoning the gold standard. Added to these rumours, others circulated that buying was caused by the fact that Russia would no longer be an exporter of wheat. None of these rumours proved to be true and in the end, when Europe realized that Hoover's plan was not a license to inflate, commodity prices declined with the dollar's sudden rise. But this was a lesson which others would point to in the years ahead as evidence that currency inflation was the only way out of this mess.

In the November 2, 1931 edition of Time magazine, we find a short but descriptive account of the commodity rally which began during October. It was a strong technical reaction which began to lead toward much bullishness.

"On October 5, the price of May wheat was 48.25 cent s a bushel. Last week it rose



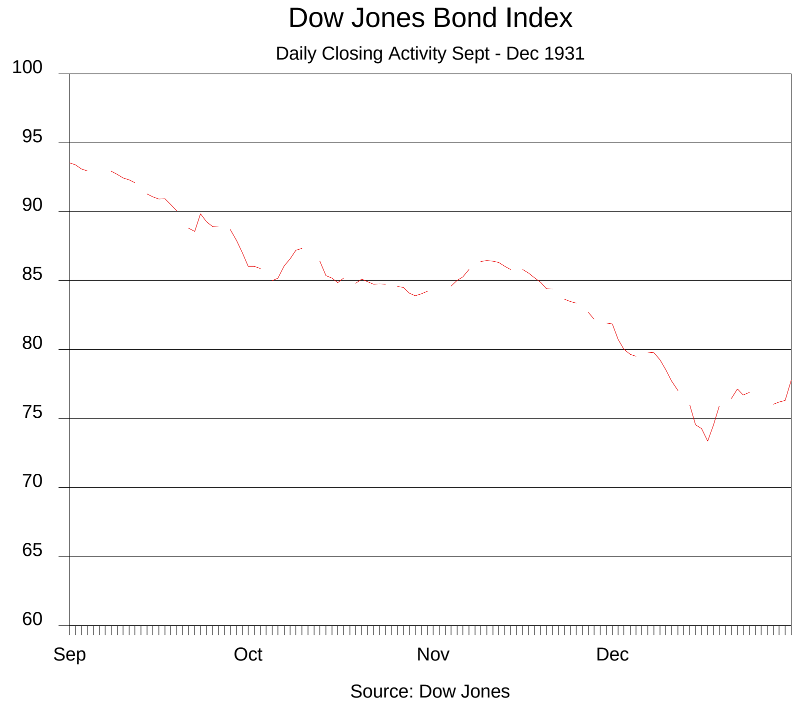
Source: Dow Jones

to 61.25 cents. Bullish factors were a reported 16% decrease in winter wheat acreage; the return of several bull operators to the pit after a long absence; heavy buying from England in anticipation of a tariff; covering of short positions and long-buying from foreign interests who were heavily short around the lows. Cotton advanced slowly, steadily. Factors were a September rate of consumption better then that of last year, re-opening of many Lancashire mills after the pound's fall, also British buying against a possible tariff. The revival of prices in these two big commodities brought cheer to Wall Street, Washington, and many a harassed farmer."

This rally continued to spread to various commodities including silver and, of course, stocks responded in a like manner. But the lead in this bullish frenzy had clearly been taken by commodities. The rally in the stock market came with actually little speculative margin buying. The exchange was collecting data religiously, trying to ward off its enemies. On November 1, brokers' loans stood at only 2.33% of the total market value which was down sharply from the 3.23% at the beginning of October. Brokers' loans were further hampered by the change in the policy of this market for funds. You will recall that in 1929 the Federal Reserve watched the brokers' loans quite closely, publishing figures broken down displaying loans from New York banks, out of town banks, and the controversial "others."

It was this category of "others" that had sparked much resentment and fury back in 1929. Corporations could lend their funds directly into the call money market which the banks complained was depriving them of deposits. Well at this point that practice was declared void. Now brokers' loans were listed as to their source either from New York banks or out of town banks. The others category simply disappeared as brokers' loans declined in volume and stood at a 2.5% yield on the average for this period.

The sudden sharp rally in commodities and stocks changed the tone of the press quite noticeably as we find in this excerpt



from Time magazine of November 16 , 1931.

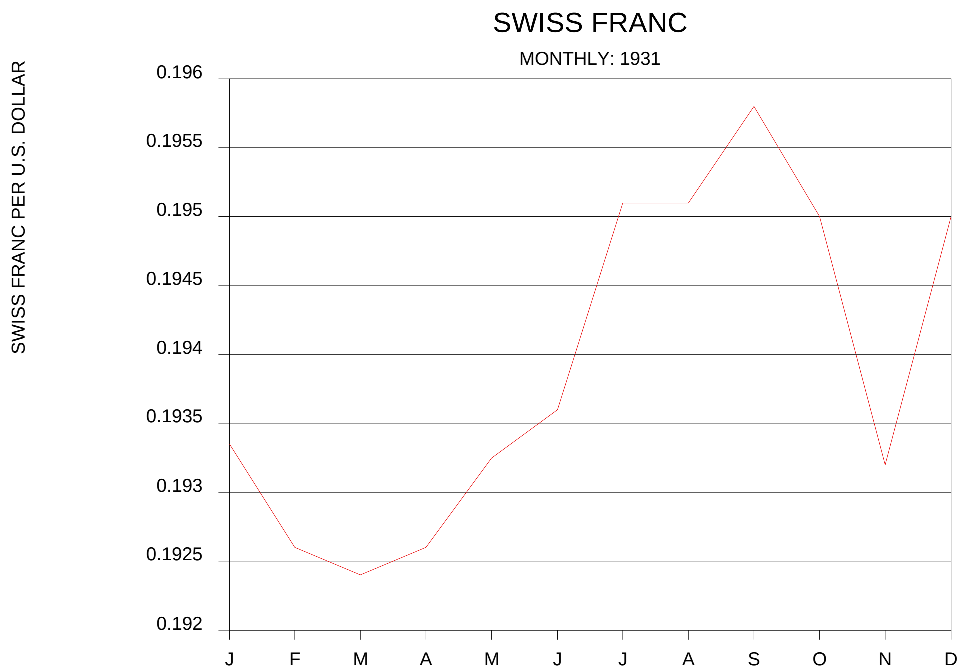
"Rising wheat prices rang the speculative tocsin loudly and fiercely last week. Other commodities became buoyant. Good cheer spread to Wall Street.

"Although the report that Russia would export no wheat for two years was denied, wheat surged upward. On every recession, buying by the public became more apparent. Seats on the Board of Trade jumped from $6,500 to $12,000. Arthur W. Cutten, greatest of living wheat bulls, became almost a national hero; telegrams poured in upon him asking how high wheat would go. He merely said he was bullish, naming no prices. But in the public imagination "Dollar Wheat" became something to be achieved, in some places already achieved.

"'Dollar Silver' was another speculative slogan last week, but more far-fetched than Dollar Wheat. Shorts covering and a general commodity rise sent the metal to 35.25 cents an ounce against the year's low of 25.75 cents. For the first time silver trading on the National Metal Exchange, Manhattan, became clamorous, wild. Public buying was attracted because silver can be bought on a 6% margin. Companies with stakes in silver-currency nations were in demand, shares of mining companies were widely bought. Copper remained at 7 cents but it was reported that consumers were taking oil offerings. Manchurian was talk aided bullishness in copper, but the strongest copper shares were those with big silver interests.

"With British mills more active, consumption in October running 69,83 bales higher than a year ago, it was natural that cotton should join the movement that last week's price of $33.50 per bale should be 22% higher than the year's low. Although the crop is large, unfilled orders for cotton cloth jumped 51.7% during October.

Other commodities to share in the jubilation included rubber, coffee, cocoa, wool,



hops, hides. Sugar failed to advance, however, and hogs continued in a rut. Mid-Continent oil prices rose 15% a barrel to 85 cents; in many sections of the country gasoline was upped."

Many selected stocks had risen by 40% to 50% and some had better than doubled. Everyone was quite bullish and indeed even the famed Babson ran a small ad with its headline "Is Bear Market Over?" The sharp percentage rise even in the value of seats on the CBT from $6,500 to $12,000 in one month surely brought back dreams that 1929 was off and running. With a rally so strong and only in the first month of its existence, it was not unexpected to see wild bullishness calling for fantastic new highs in the near future.

Banking failures did not cease. The banking industry was still fighting with government to allow what we all take for granted today: branch banking. The Comptroller of the Currency of the time, John W. Pole, continued throughout 1931 to assert his arguments in favour of liberalizing the banking laws to permit branch banking. Much of the weakness in the banking industry was in part caused by the isolation of banks themselves. Many in government feared that monopolies would creep up in this field as well and they held tight to their ideas as expressed by the Sherman Anti-Trust Act. But Pole spoke his mind in front of Congress in December of 1931, once again. He said:

"In brief, the purpose of the legislation recommended is to supplement our system of unit banking by permitting the stronger and better managed city banks to carry on banking operations in the surrounding rural communities by means of branch offices...Our present banking problem is one that concerns primarily and fundamentally the rural communities and which cannot be automatically solved by the return of general prosperity."

The issue of branch banking was one of many arguments. Smaller bankers feared being bought out or put out by the big banks, but a small bank's trouble was often caused by its location. Banks in the farming districts suffered greatly since the majority of their clients were dependent upon farm prices. If commodities did poorly, so did the bank. If that small rural bank were a branch of a city bank, its problems could be overcome through diversification. This cause received perhaps its greatest boost during December when the Secretary of the Treasury, Andrew Mellon, wrote in the annual report the following statements:

"The essential question involved is the inability of a large number of small banks to survive in the face of changing economic conditions...I can see no justification in the argument that banking should be confined to political or other existing artificial boundaries rather than to its natural economic lines.

"An additional argument against the unit form of banking and in favour of a diversified banking system called branch-banking was the evidence of several comparisons. For example, in England, branch banking

was the norm, not the exception. Not one bank folded in Britain between 1920 and 1931 even though Britain was clearly suffering the brunt of depression far worse than the United States. In Canada, where branch banking was also in place, only 12 failures had taken place between 1893 and 1931, and since 1914 there had been only one bank failure, that of the Home Bank in 1923. But opponents claimed that Canadas' experience proved that even branch banking would not avoid failures. This was hardly a decent case to argue since their one failure stood against the American contrast of nearly 4,000 bank failures between 1929 and 1933. But there are always those hard-headed individuals who are opposed to something for some strange reason, and even if this much of a stark difference stood against their position, they would not yield.

California was the only real branch-banking state in the Union. Strangely enough, during 1931 not one bank in California had failed. The system of unit banking was clearly a weak link in the financial system of the United States. This would be a major flaw which definitely contributed much anguish to the period, striking hard at the foundation of confidence which was vital to the entire economy.

Time magazine reported on December 28, 1931: "Undisputed good effect of National Credit Corp's formation was the resultant improvement in the nation's confidence, the return of much hoarded money to banks." Indeed the President's new "Super Plan" had struck right at the core of the problem, confidence. The low on the U.S. gold reserves had been reached during the final week in October and it rose steadily throughout November. That was the direct result of hoarded gold returning. But political bickering would stall branch-banking and uncooperation on the freeing up of mortgages and the halt of foreclosures would prevent Hoover's plan from really taking hold for the long run.

The year 1931 was a hard year, yet many public works had been completed in the midst of the turmoil. The Empire State Building in New York City, a symbol of the good times, opened its doors along with New York's Waldorf-Astoria Hotel and the famous Chrysler Building. The Rockefeller Center began construction, leasing the land from Columbia University. The Dorchester Hotel opened on Park Lane in London and on the lighter side of events, Mickey Mouse and Felix the Cat made their debut along with Kate Smith, who sang "When the Moon Comes over the Mountain" on radio that year.

But, there was another threat brewing around the world which Hoover alluded to in a memorandum to Congress when he solicited their support for his National Credit Corporation. His memorandum was as follows:

"The nations of Europe have not found peace. Hates and fears dominate their relations. War injuries have permitted no abatement. The multitude of small democracies created by The Treaty of Versailles have developed excessive nationalism. They have created a maze of trade barriers between each other. Underneath all this is the social turmoil of communism and fascism gnawing at the vitals of young democracies. The armies of Europe have doubled since demobilization. They have wasted the substance which should have gone into productive work upon these huge armies and massive fortifications. They have lived in a maze of changing military alliances and they have vibrated with enmities and fears. They have borrowed from any foreign country willing to lend, and at any rates of interest, in order to carry unbalanced budgets...

"The Allied countries of the Continent - France, Italy and Belgium - are obliged periodically to reduce their impossible debts by devices of inflation and devaluation. Nineteen countries in the world, in two years, have gone through revolutions or violent social disturbances. Whether or not Germany and Central Europe will avoid Russian infiltrated communism or some other 'ism,' is still in the balance and that does not contribute to a revival of world confidence..."

Indeed the battlefront was forming along the lines of communism and capitalism. On the very floor of the Congress echoed words claiming that even a dictatorship was better than the pains of depression. Socialism and communism gained much favour even in the United States. It has been said many times that this was a period in American history when revolution was close, brewing deep within the ranks of its citizens.

What was their thinking? Why would so many people begin to turn toward communism during periods of strifes? These are questions which are undoubtedly a part of this period and a part of economic theory as well. In many ways, communism surrounds us every day even with our working social and political environments. George Bernard Shaw once said: "In economics all roads lead to socialism, though in nine cases out of ten, so far, the economist does not recognize his destination."

Indeed, even within the United States many aspects of the "New Deal" were very socialistic. Today arguments can still be heard between social spending and tangible spending. Even the structure under which taxes are collected has been one which dis-

criminates against the upper classes in favour of the lower.

The lure of communism is not restricted to the political arena. It does not always take even the form of the Berlin Wall, which undoubtedly comes to mind when one mentions the word. All these various "isms" are to be found in man's own desires and at times they offer what logically can be very appealing to the masses.

Communism in many ways seeks to protect man from himself. It is the gossip, the jealousy and the greed which communism seeks to stamp out. People who steal from one another or plot against someone to gain their job, position, or wealth all represent the deplorable aspects of mankind which are perhaps exaggerated under the freedom of capitalism. If the wealth were not available and if everyone was only entitled to the same lot, then such dishonesty would theoretically cease to exist. When one looks at these things alone, the idea can be presented in a very pretty package if we look around us we can gain a sense of socialism, and also communism even in the United States. Our government leans in that direction when it takes many steps toward solving problems or correcting what many of us would call injustice. But often the complex maze of governing bodies and their laws can be horrifying. It is said that man has written over 3,000,000 laws but with this vast arsenal of rules and regulations, he has failed to improve upon the simple Ten Commandments.

Laws are continually changing, but in the process they tend to gravitate toward socialistic and even communistic objectives. George Bernard Shaw was correct in this observation. It is a natural tendency to continually write laws and to interpret them in order to get at the dishonest people who exploit freedom and capitalism through their greed and self-interest pursuits. For example, the Supreme Court recently ruled in a case where police raided a mobile home of a drug dealer. They did not have a search warrant and under the law they must have a search warrant before entering anyone's home. The Supreme Court ruled that a mobile home is somewhat different than a home made of bricks and mortar and there by claimed that the search was not illegal. Our first reaction is: why should we be appalled at such a decision because after all the guy was a drug dealer? However, the answer does not lie in that direction. The issue is not whether or not the man was guilty or innocent. The issue is our civil and Constitutional rights.

There is a great difference between being a liberal who is opposed to everything from sterilizing pigeons to nuclear energy and an issue of civil or Constitutional rights. The FBI raided a home and dragged a man and his wife out of bed and beat them, not to mention that they were treated like scum during the course of the drug raid. While his wife was partially unclothed and forced to remain that way in front of the agents in a demoralized state of shock after the FBI kicked their doors in, no drugs were found. What actually happened was that in the middle of the night the FBI had the wrong house. Had they been the guilty party, their rights were nonexistent. The FBI wouldn't listen to a word they had to say, perhaps assuming that everyone claims that they are innocent.

There are numerous cases where police have set up people, beat them, and openly violated rights, all in the so-called pursuit of justice. They, in many cases, have made a mockery of the Constitution and the cherished rights the founding fathers of this nation sought to protect. Recently, watching a television show, I was amazed how 20/20 exposed in Florida the Gestapo tactics of Florida police who arrested and convicted two men for a murder they did not commit. The police simply didn't like them and threatened witnesses that if they didn't identify these two men, they would be charged as accomplices. In many ways this is the beginning of communism. It is not that we should protect the drug dealer but ourselves. If you eliminate the right to privacy and circumvent the need for police to show probable cause before getting a search warrant, then in trying to get at the drug dealer you have waived the rights which everyone has fought long and hard for. Have our relatives and friends who died in war fought for nothing? Police could stop you on the street or enter your home with nothing more than curiosity. Your home would no longer be a castle but a target.

Slowly this urge to get at a certain group within society leads toward measures that erase the differences between the United States and Russia. In Russia anyone's home can be searched at anytime. People risk their lives trying to get out of there and when interviewed they say that they just want to be "free!"

Communism in many ways emerges from these tendencies to want to get at some group and in the course of events it takes away the freedoms of society in order to do so. Just because a man is a politician does not make him honest. Well neither does the profession of being a judge, a cop, or an FBI agent. There are honest politicians as well as crooks, but if you do not have definitive rules, then the crooks will be certain to take advantage of the situation. It is therefore insane to expect that if you eliminate all our civil and Constitutional rights that we can sleep soundly at night, knowing that our police will use self-restraint and not abuse the power given to them. Power corrupts, they say, but ultimate power destroys.

If you have ever read Karl Marx you would immediately notice a sense of anger in his writings. Marx portrayed the economy as not the natural "invisible hand" of Adam Smith, but as a cosmic war between labour and capital. In the example of getting at the drug dealer, the natural tendency is to ask why you should seek to protect the rights of such scum; he deserves what he gets. But this same urge to bend the rules to get at the drug dealer is what Marx wrote of in his works. Instead of taking the drugs away from the dealer to put him out of business, take the capital away from the owner to put him out of business. It is the same human anger in both cases. Perhaps we would not advocate a war against the capitalist, but we would against the drug dealer. But to get at each we ourselves must relinquish certain rights. If we have no rights, then there is nothing to give up, so take the drug dealer and throw him to the lions and we can all enjoy wreaking our vengeance in a public spectacle such as in Roman days. Thus, if you have lost all your capital, you have nothing to lose so get the bastard who has all the bucks and take his away to even the score. What is the risk of communism if one has nothing to lose?

Communism is in simplistic terms the urge to circumvent personal rights. It is said that for everything holy there is the unholy. The difference between capitalism and that of socialism and communism is as stark as day and night. Yet in every democracy the gravitation has always led in the direction toward communism and control. In many ways it is a gradual process which eventually comes to a head. But it has always come to a head at some point in time.

The rights given to us by the Constitution were well thought out by the founding fathers. They came from their experiences based upon first-hand knowledge of the abuses of government. Many of those rights have already been taken away by countless laws and Supreme Court decisions. In criminal court you hold the presumption of innocence and it is government's job to present the evidence of guilt. But in tax court, you are presumed to be guilty and you must prove your innocence. The IRS or State Revenue Agency can file a lien against you for an outrageous amount of money without even auditing you. If you do not fight, they can seize all your assets and sell them at auction. If you later prove that they were wrong, you are only entitled to the amount they obtained for your assets, even though that amount may have been 10 cents on the dollar.

There are millions of laws which have taken away the rights of Americans without them even knowing it. In some way or another these laws have been designed to get

at that someone or a group which the Constitution had sought to protect. The graduated income tax sought to take from the rich a greater portion of their assets than the middle class. But is not a free society supposed to be equal and provide justice for all? Where is it fair to take 75% of one man's earnings as opposed to 20% of another? It should not be unlawful to make a lot of money, but then government by law turns around and says that you are not entitled to keep that much.

Whenever some sort of tax cut is proposed, the argument is that the rich will benefit more than the poor and the middle class. What they are really saying is that the percentage break will be the same but a 10% cut for someone earning $10,000 will give him only a $1,000, while the $100,000 earner will get back $10,000. They claim that is not fair. Are we a Marxist society or are we supposed to be a democracy?

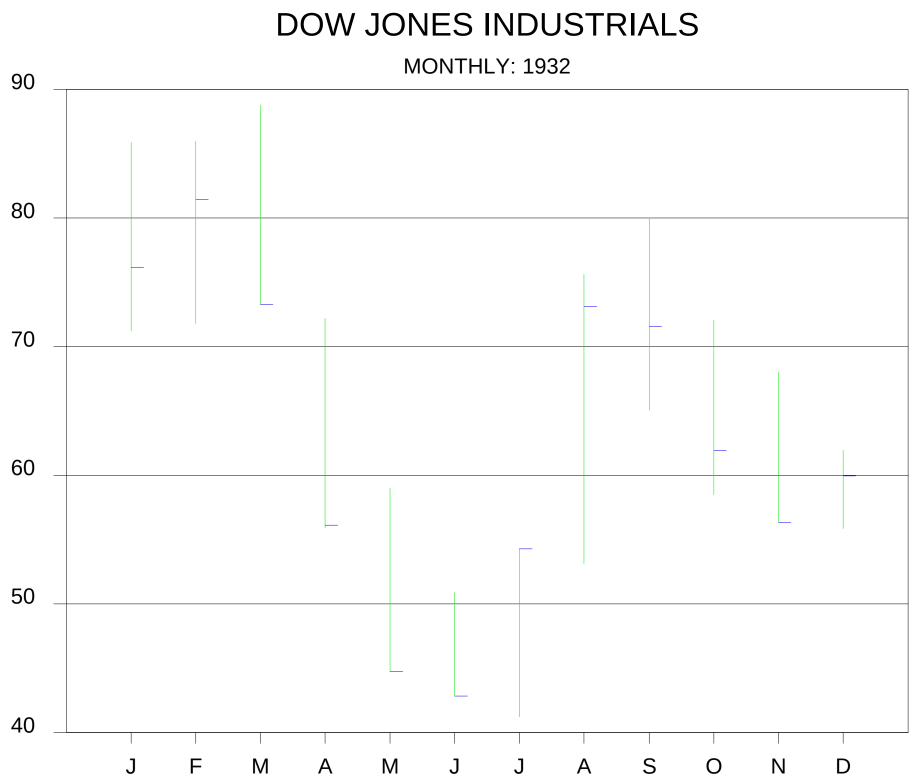
The Great Depression was a period during which this anger toward a group within society raged strongly. As we will read of the events which transpired in 1932, this anger and vindictiveness was never greater. Government, while in a rage, used its powers no more or less than those of communistic Russia. The fine lines between democracy and communism disappeared at many junctions during the events.

The target was not the drug dealer, but the stock market. The Democrats sought to symbolize this financial center as the evils which caused the Depression and with it for political gain, they then tied the knot linking it with the Republican party. The tactics of the Democrats were ruthless and vindictive but no more so than when the tide had turned and the Republicans were successful in exposing many Democrats with communistic links when that round of witch hunts began following World War II.

Click here for PEI's Homepage

Chapter XII

1932



1932 arrived on the heels of one of the worst monetary panics of the 20th Century. Although fears began to subside over a devaluation of the dollar or an American abandonment of the gold standard, optimism over the world situation was difficult to find. Capital still remained shaky and ready to shift from one currency to another with what often seemed as whimsical as the change in tides or a shift in the wind. The political scene within the United States degenerated to one of the worst depths of which any democracy could possibly fall.

1932 was a year which brought communist demonstrations in Washington and politicians turned their sights upon the investment community as a whole. Some politicians accused its banks of intentionally trying to destroy the economy of the world in an effort to force the United States to cancel the outstanding war debts of Europe so that normal commercial debts could be settled with the banks. Of course no such plot had evolved but accusations were painted with a viol color of hate in no different a manner than that which sparked the Russian Revolution.

As if directly out of a text book in psychology 101, people began to accuse others of faults and deeds which they alone perhaps nourished in the depths of their perverse inner egos. This would be a year in which the American political system sank to the level not seen since the Spanish inquisition as it took on many of its horrible predecessor's attributes. Some politicians supported the total abolition of the stock market while others urged that the shorts should be exposed and jailed as if their actions rose to the level of treason. Although the politicians of the era would not admit that they had taken on many similar characteristics which distinguished the Russian Revolution, the deeds, words, acts, and accusations hurled at the investment community rang a familiar bell sounding the words once written by Joseph Stalin in his "Kampf."

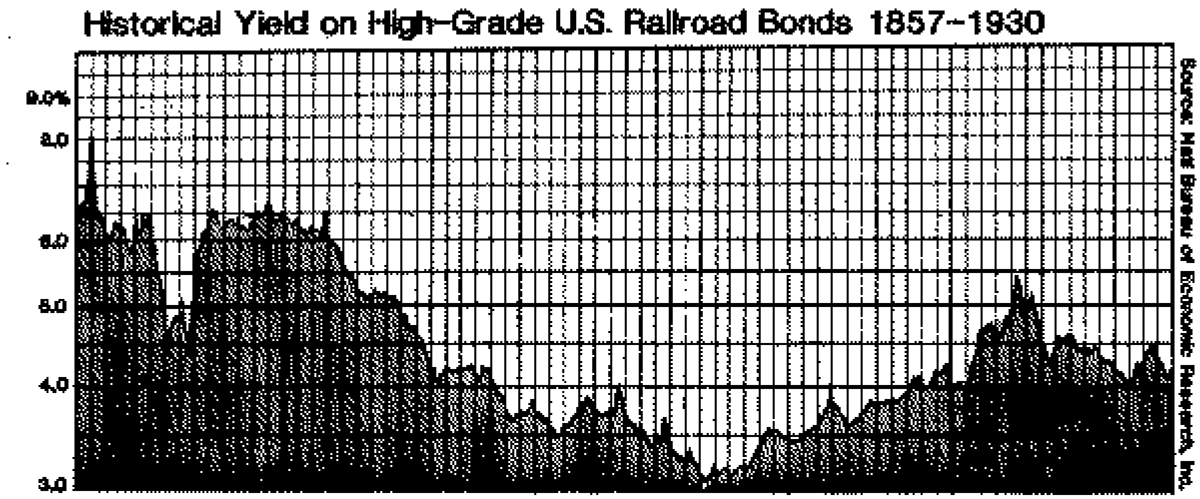
"What is the sharpening of the class struggle due to? It is due to the fact that the capitalist elements will not depart from the scene voluntarily; they resist and will continue to resist socialism, for they see that the last days of their existence are approaching. And they are still in a position to resist, since in spite of their relative decrease, absolutely, they still continue to increase; the petty bourgeoisie of town and country, as Lenin said, daily and hourly, throw up from their ranks capitalists and small capitalists and these capitalist elements go to any length to preserve their existence.

"There have yet been no cases in history when dying classes have voluntarily departed from the scene. There have been no cases in history when the dying bourgeoisie has not exerted all its remaining strength to preserve its existence. Whether our lower apparatus is good or bad, our advance, our offensive, will reduce the numbers of the capitalist elements and force them out of existence, and they, the dying classes, will resist at all costs."

Stalin's words ring loud of hatred and bitterness. The Russian Revolution had been born from the Panic of 1919 when commodity prices collapsed and unemployment ran high. When nothing is left to lose, revolution often fills the emptiness of the moment bringing joyous illusions of utopia and monetary equality for all. In the same manner that the Russian communist movement began with placing all the blame upon the rich, here too in the United States politicians turned on their own rich class with a sinister intention of placing the blame for all upon the yoke with which they now sought to enslave that class of society.

Despite the numerous spending programs implemented by President Hoover, nothing seemed to be working. Confidence was lacking and international distrust and skepticism reigned supreme. People were reluctant to fill orders unless paid in advance fearing that payment in the end might somehow never arrive. These fears only further dampened world trade and the prospects of recovery both economically as well as in the price levels of commodities and stocks not to mention bonds.

The bond markets of the world were devastated by the monetary crisis of 1931. Much of the municipal as well as federal issues of South American bonds had gone into default. Now only super well financed American corporate bonds retained any sense of value while everything else, with the exception of U.S. Liberty Bonds and Treasury Bonds, crumbled in wake of default fears. Many viewed the bond market as if it were a game of Russian roulette when at any moment some other play would be struck with a fatal wound.

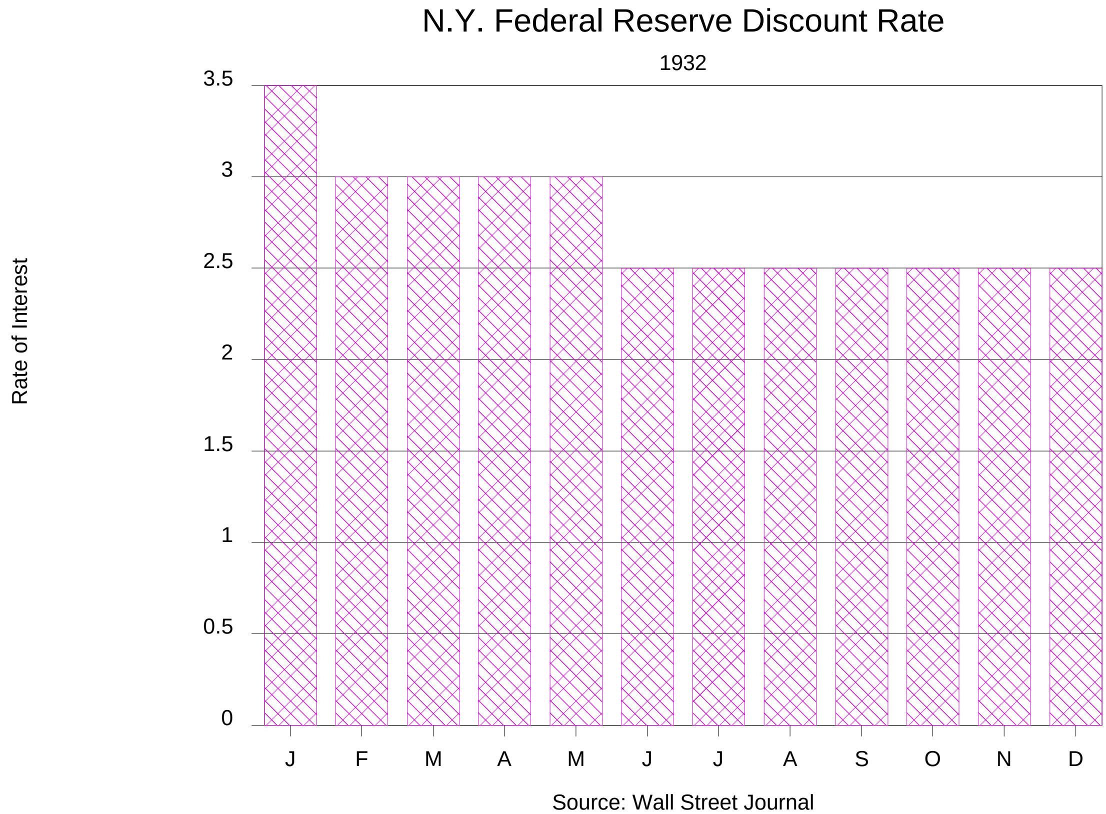


Despite the easing of interest rates on the part of the Federal Reserve, bonds collapsed as the market demanded yields that were now as high as 5 times that of the discount rate. Despite the easing by the Fed, the bond market continued to collapse as security dominated yield. Real estate backed bonds decayed as tangible assets far outnumbered hard cash and thus a sharp contraction in the value of all tangible assets could not be avoided.

As January of 1932 made its presence felt upon the nation, any hopes began to dissipate half way through the month. January 1 had begun with the total of listed securities on the New York Stock Exchange valued at $26.6 billion down significantly from nearly $90 billion at the peak in 1929. On January 1, the U.S. Bureau of Mines reported that world production of petroleum during 1931 had declined 2.8% from 1930 levels. This worked out to be 1.3 billion barrels for total world production, yet the U.S. production share was 850 million of that figure. Despite everything, the United States was still the major producer of oil prior to World War II.

Gasoline exports were off 30% during 1931 from 1930 levels. Storage of gasoline during 1931 had increased by nearly 5%. Bituminous coal production stood at 378 million tons for 1931, which was a decline of 19.1% from 1930 levels. Anthracite production declined 14.2% from 1930 levels, coming in at 59 million tons for 1931.

The value of exports during 1931 totaled $2.4 billion which was a decline of 36.7% from 1930 levels. Imports were $2.08 billion, a decline of 31.7% during 1931. The figures clearly illustrated that the U.S. trade surplus was still narrowing despite the so-called age of protectionism.



The bad news that January had brought continued. The American Railway Association announced that freight loading revenue had declined during 1931 by 18.8%. Union railway workers agreed to accept a 10% wage cut yet this was being interpreted as bullish at the time. Shipbuilding yards were working at 40% of capacity while at the end of 1931, ships under contract were $58 million compared to $90 million at the end of 1930. Steel ingot production was running at 28% of capacity and declining. Building construction, as reported from 354 cities across the nation, showed a decline of nearly 28% from the amount spent during 1930. Business failures were one of the few things to rise during 1931. For 1931, failures totaled 28,275 with liabilities of $733 million. In 1930, these figures were 26,355 with liabilities of $668 million.

The Senate Finance Committee was conducting hearings into international banking and war debts. Testifying was Otto Hermann Kahn who was requested to provide the Senate with a complete listing of all foreign bond issues which were currently in default. He obtained that information from the institute of international Finance and the Senate made that list public in January 1932. To the dismay of many, the list totaled $815 million worth of foreign bonds denominated in dollars. The default involved 57 issues and all were an obligation of a South American government, state or municipality. It was revealed that Bolivia, Brazil, Chile and Peru had all defaulted on their government obligations. In Columbia and Uruguay, local issues had lapsed into default.

Two shocking aspects were also revealed. First, the majority of the junk bonds were held by the small investor who had been lured into buying them by numerous advertising campaigns which touted bonds as the "safe" investment. The other interesting aspect was how the banks were coping with the situation. The Comptroller of the Currency issued a demand to all national banks that they report on what bonds they were holding. But this problem had been recognized back in August 1930. Even good bonds had been devastated and banks either faced huge paper losses on what they held, or suffered actual cash losses if they sold. The situation was deemed to be serious, but the Comptroller of the Currency decided to allow the banks to carry the bonds at their cost which naturally boosted their statements and masked many of the grievous problems that faced the banking industry at that time.

The report on the gold to paper currency ratio at the Federal Reserve clearly illustrated that gold hoarding continued to increase. The ratio of gold to bank notes and deposits stood at 73.7% at the end of 1930. But at the end of 1931 the ratio declined to 61.9%.

In Brooklyn, an excited woman was reportedly seen running down the street screaming "The bank is closed! The bank is closed!" What she was so boisterous about was in reality a false alarm. The bank involved was the East New York Savings Bank which had decided to cut its Saturday hours to noon instead of 4 PM and had posted a notice to that effect on the door. But the woman hadn't looked closely enough to see it. Well $8 million in cash and swarms of extra tellers managed to meet head on the run that she had caused. In the aftermath, withdrawals came to $3.5 million against deposits of $67.4 million. Although this had been an unfortunate false alarm, the majority of such circumstances were not.

In spite of the National Credit Corporation, bank failures were still hitting the papers almost daily. The fears of the people were obviously high and all a bank had to do was close early and a run was virtually guaranteed. The National Credit Corporation's policy, however, was to advance loans only upon sound collateral. In January 1932, it made its first draw of $50 million to cover payments due its creditors.

The good news during January 1932 was the talk of Hoover's Reconstruction Finance Corporation. Most of the optimism during January had been centered around this issue. Everyone talked about the huge reservoir of credit, which would stimulate the economy, combined with the proposed 10% wage reductions in the railroad industry. Many believed that these efforts would surely get the ball rolling once again.

The railroads, which had declined for six months straight during the second half of 1930, rebounded quite sharply during the first two weeks in January. From the December 1931 low of nearly 31 on the Dow Jones Index, the rails rallied sharply up to 41.5 in early January. The news that the unions were most likely going to accept a 10% wage reduction sparked a 33% rally which was awesome. But by the end of January, the rails fell back and closed at 37.

The Dow Jones Industrials, which had traded in a choppy yet essentially straight down pattern finishing 1931 on its low, rallied from that December 1931 low of 73. The industrials reached nearly 86 in early January which was about a 19% gain. But they finished January back down at the 76 level.

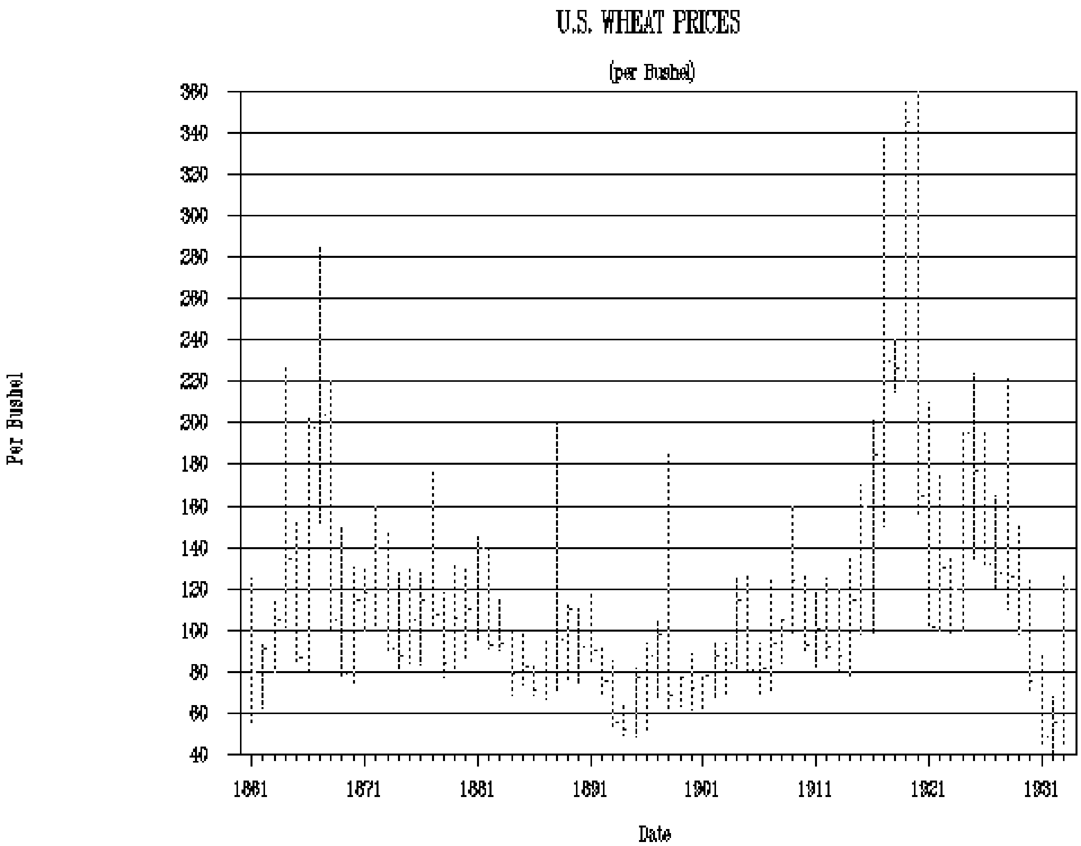
The bonds, which had collapsed primarily due to the South American defaults, did not rally that much and, in fact, they remained within the trading range that had been established during December 1931. They did manage to close only 1 point above the December closing at the end of January.

The automobile industry had come a long way. By 1932, it ranked next to agriculture and railroads in capital investment. It consumed 15.5% of all U.S. steel production, 17.4% of aluminum, 82.6% of the American rubber, 30% of nickel production and 26% of all lead produced. By this time G.M. had a market share of 43%. Commodity prices continued to decline as auto production also declined. 1931 auto production was 2.3 million units including cars, trucks and taxicabs. This compared with 3.3 million during 1930 and 5.3 million in 1929. The 1931 auto production was off nearly 33% from 1930 levels and nearly 55% from 1929 levels.

During February, the industrials rallied back to the January high but managed to close above the 80 level. The rally had begun rather abruptly on February 11 when news came from Washington that Hoover had managed to obtain cooperation from all parties to usher through the Glass-Steagal bill. This bill broadened the scope of paper which was eligible for rediscounting at the Federal Reserve. This was viewed as a liberalization at the Fed which would in turn help many banks to unfreeze assets that were previously unacceptable as collateral at the Fed. The bill was signed by Hoover on February 27.

The rally was further sparked by the new rules imposed by the New York Stock Exchange against short selling. The Exchange restricted brokers from lending customer stock to shorts without obtaining written permission from the customer that his stock may be used in that manner.

Another factor behind the rally was news of war between China and Japan. The war

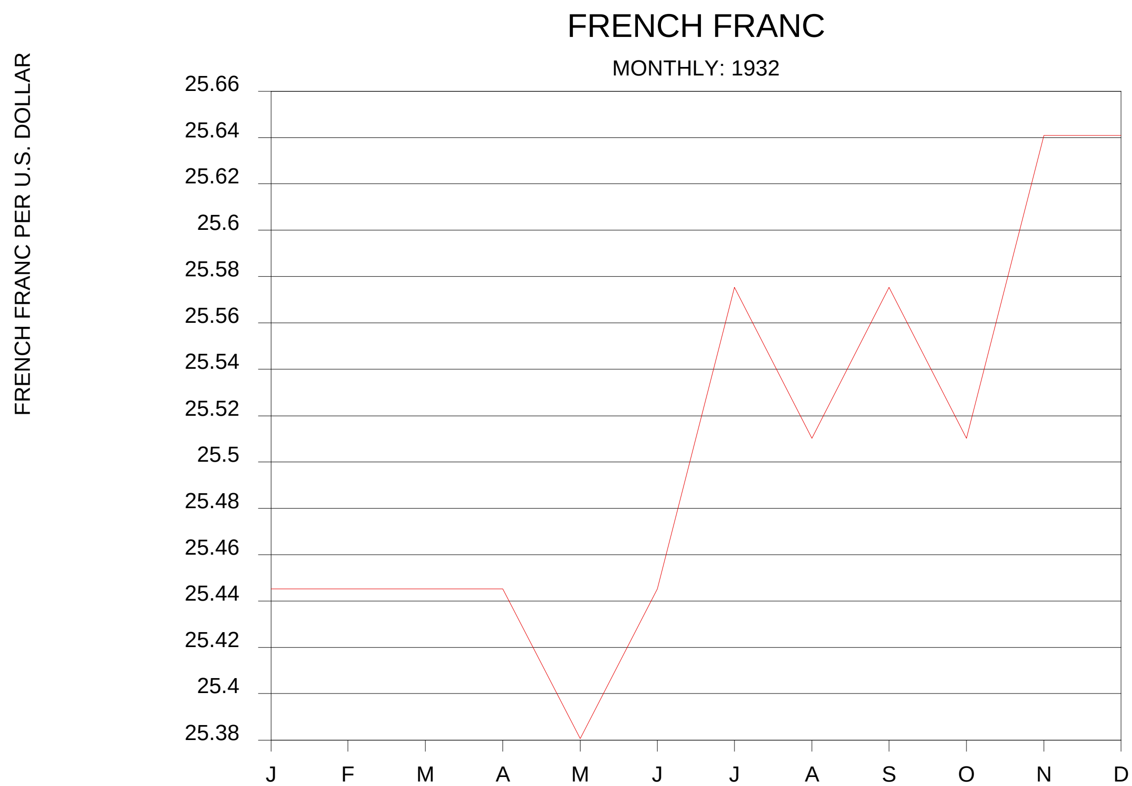


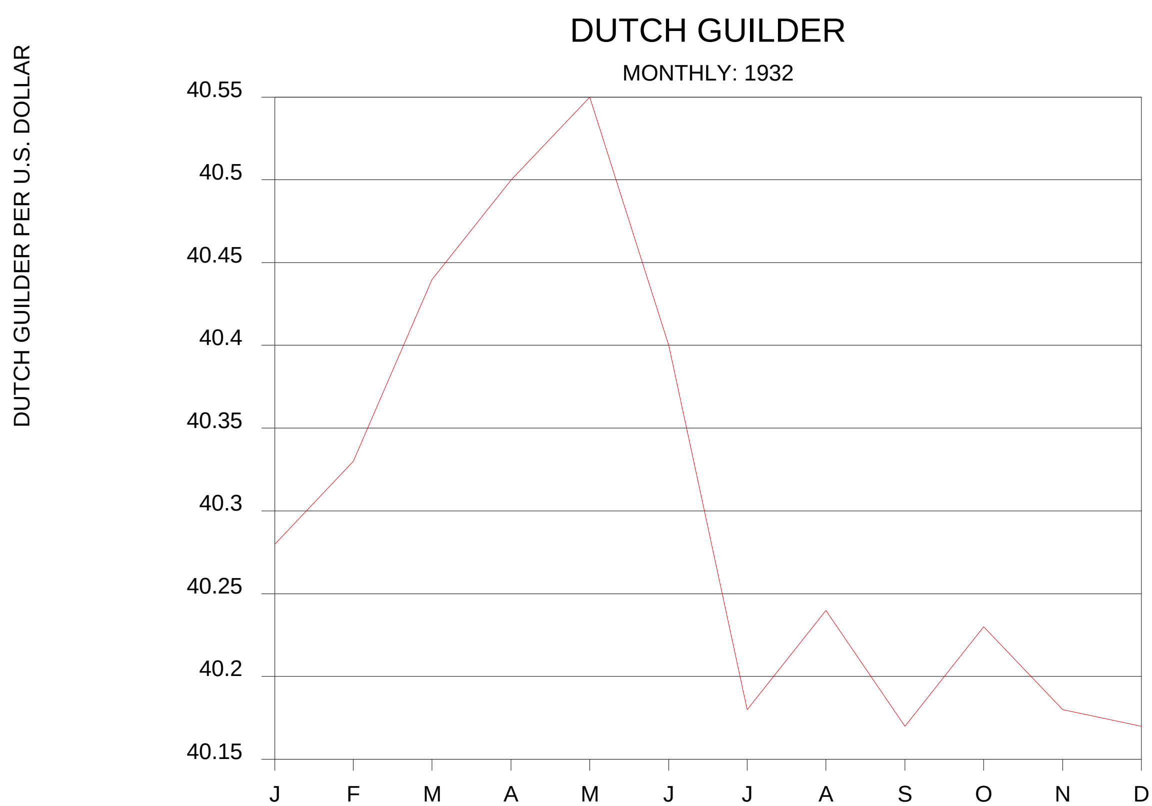
scare drove the price of March wheat in Chicago up from 2 3/8 cents to 58 3/4 cents. This is no typo. The rally was unbelievable but the declines that followed were equally great and wheat fell to new record lows in July and again in November. In the stock market many speculated on what companies would benefit. But the yen itself collapsed. Japan had abandoned the gold standard just a few months before. The yen fell from the par level of 49.84 cents to 35 cents. Japanese bonds collapsed from 100 to 61. The total U.S. investment in Japan was reported to be some $450 million, of which $390 million was Japanese bonds. The real concern centered over the fact that Japan's gold reserves had dropped to $190 million which represented half of the outstanding debt to the United States alone.

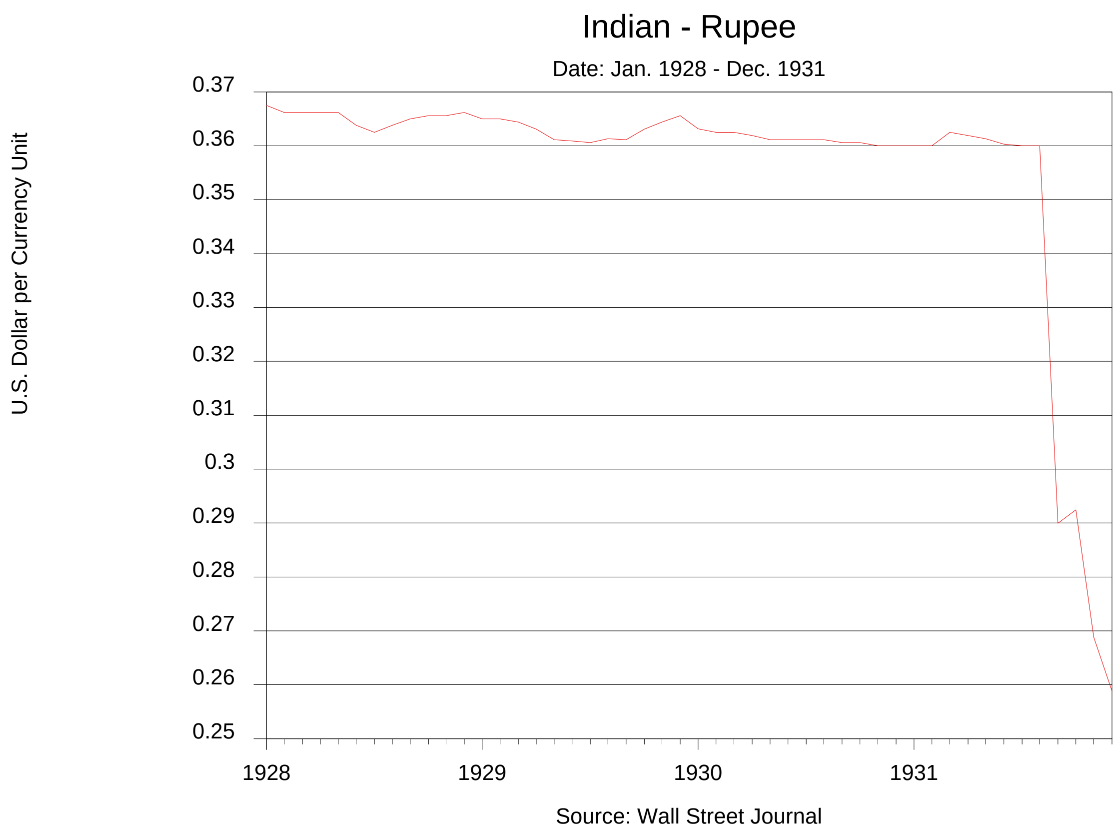
The Dow Jones Industrials sold off a bit toward the end of the month when on February 29 the State of New York raised the tax on stock transfers from 2 cents to 4 cents per share. Depression or not, some states offset declining revenue due to lower levels of economic activity.

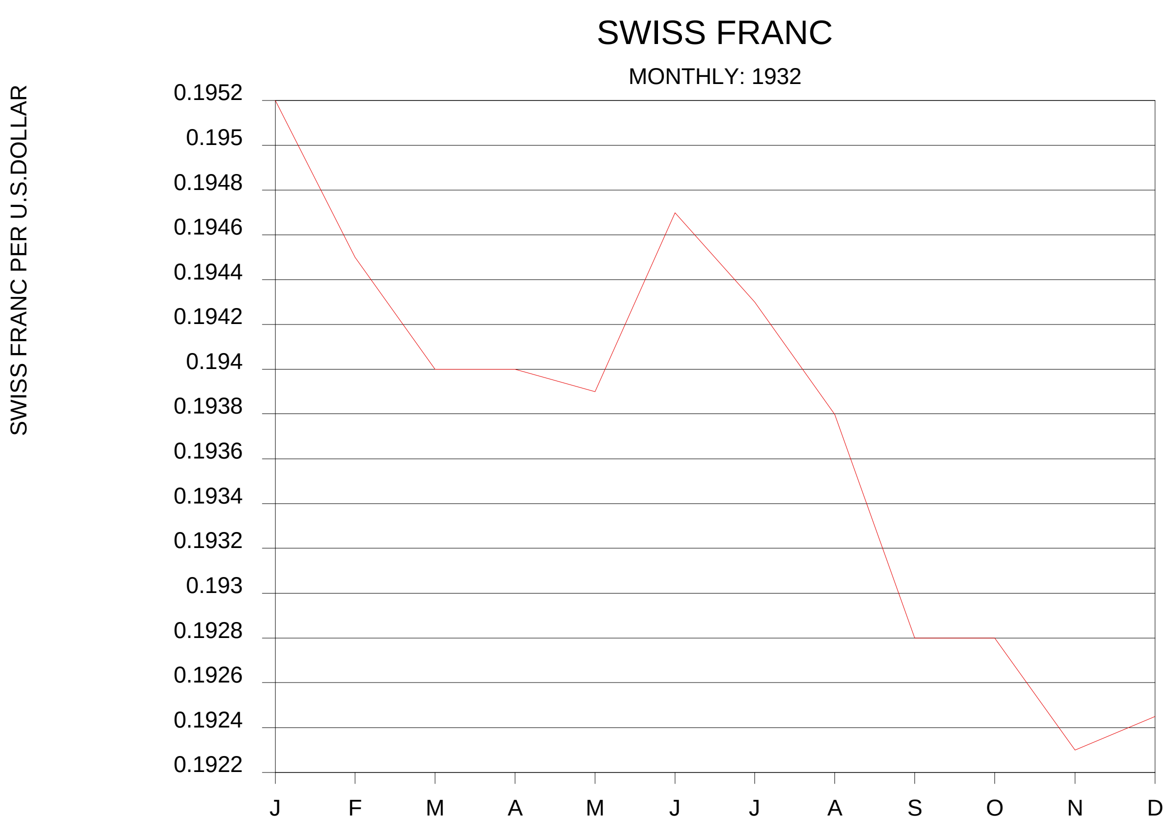
The Fed had lowered the discount rate from 3.5% to 3% on February 26 but this had little effect upon the market considering the dramatic increases that took place during October 1931. Call money remained low, averaging between 3.5% to 3% during the first quarter of 1932.

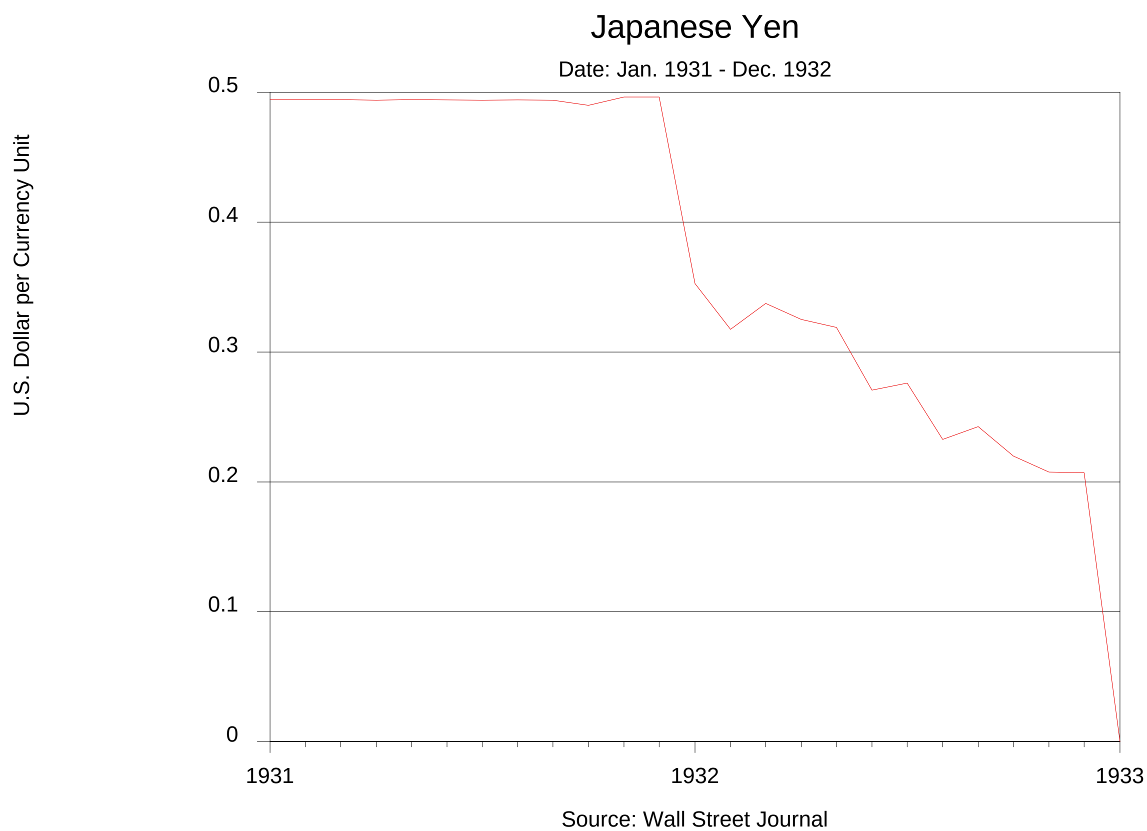
In Germany, the government approved the merger of two leading banks. They were Dresdner and Darmstaedter. In France, the government placed restrictions upon the amount of gold it would pay under its gold standard. To avoid demand from the French public, reputed to be the largest gold hoarding people in the world, the French government stated that it would only make gold payments in $8,000 lot mini-


FRENCH FRANC
MONTHLY: 1932
FRENCH FRANC PER U.S. DOLLAR
25.66
25.64
25.62
25.6
25.58
25.56
25.54
25.52
25.5
25.48
25.46
25.44
25.42
25.4
25.38
J F M A M J J A S O N D


DUTCH GUILDER
MONTHLY: 1932
DUTCH GUILDER PER U.S. DOLLAR
40.55
40.5
40.45
40.4
40.35
40.3
40.25
40.2
40.15
J F M A M J J A S O N D


Indian - Rupee
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
0.37
0.36
0.35
0.34
0.33
0.32
0.31
0.3
0.29
0.28
0.27
0.26
0.25
1928
1929
1930
1931
Source: Wall Street Journal


SWISS FRANC
MONTHLY: 1932
SWISS FRANC PER U.S.DOLLAR
0.1952
0.195
0.1948
0.1946
0.1944
0.1942
0.194
0.1938
0.1936
0.1934
0.1932
0.193
0.1928
0.1926
0.1924
0.1922
J
F
M
A
M
J
J
A
S
O
N
D



mums. As a result, gold coins were in high demand.

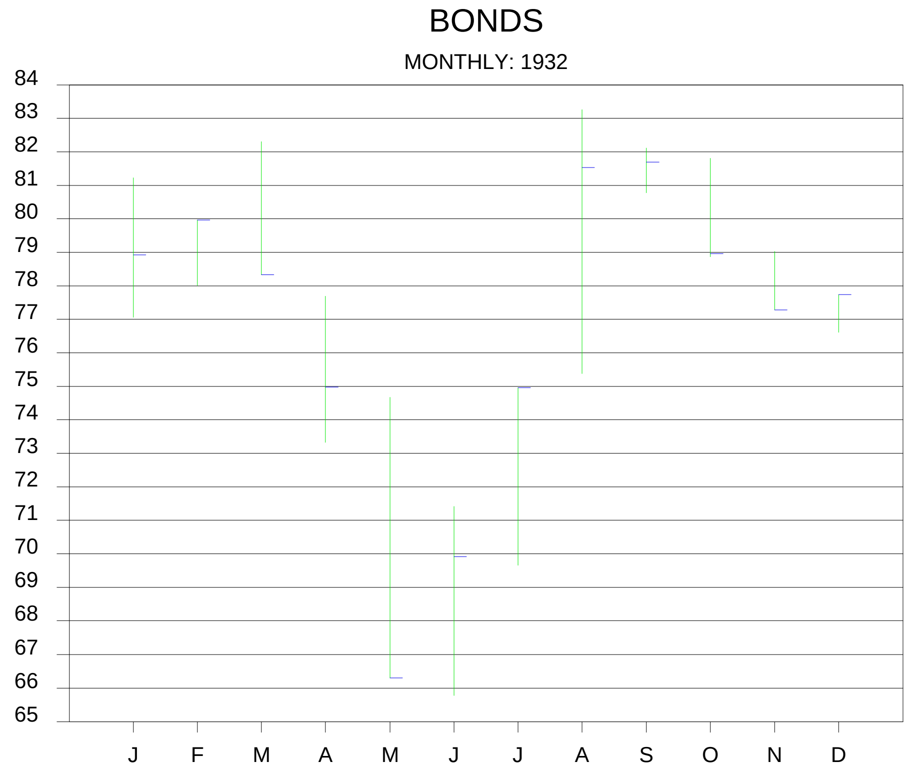
In the French papers, advertisements began to appear offering U.S. $20 gold coins at a premium. The coins were selling for $21.50 (550fr) at first and then began to rise to $25. The demand became so great that the shipping companies announced a price-hike to transport gold coin. The shipping rates are raised from $1.875 per million to $2,500. The New York banks, which did not profit from these transactions refused to release gold coins and informed the French gold dealers that they had to apply to the Federal Reserve Bank or the U.S. Assay Office. U.S. $20 gold coins began to rise even further reaching as much as $30. To this very day, huge hoards of United States gold coins remain in Europe.

Amidst the scramble for gold, a mining fever broke out in Sweden where some 41 claims had been staked out. Actual bullion mined during 1931 amounted to nearly $7 million.

In the United States, many contracts began to be issued in terms which required payment in gold coin. On the streets, U.S. gold coin began to command a premium over and above paper currency.

While gold was rising in street value, other commodities continued to decline. Sugar fell to 1 cent per pound a record low. Copper was bringing 6 7/8 cents per pound for export and 6 1/4 cents for domestic delivery. Copper was so depressed that an offer to throw in 50 shares of Anaconda or Kennecott was made for each 1,000 ton order. Rubber fell through its old historic low dropping to 4 cents in February.

In February, the business failure statistics for January were released. They were the



highest on record for any month. During the first month in 1932, 3,065 firms bit the dust and along with them $266 million in liabilities. Among the failure listings were 290 banks which accounted for $145 million in the liability figures.

Among those that went into receivership during January 1932, one found a variety of companies. Several sugar companies went down along with utilities such as Texas-Louisiana Power Co., Piedmont Utilities Co., and Arizona Edison. Also included were Hamilton Gas Co., Hudson River Navigation Corp. Western Steel Products Ltd., Long- Bell Lumber Corp., and the Cincinnati & Lake Erie Railroad Company. The list of failures was indeed widespread, touching commodity oriented companies as well as railroads and utilities industries which today are regarded as semi-blue chip.

Yet there are always exceptions. Some Utilities posted higher earnings for 1931 over and above those reported during 1930. There were some problems in analyzing the earnings. A number of companies were selling off assets and chalking up profits and posting them to the earnings columns. This naturally distorted some of the figures. F.W. Woolworth was one such example. It reported 1931 earnings of $41 million compared to $35 million during 1930. But the company had sold off stock in its British venture, realizing $10 million in profit. Therefore, the true picture from sales illustrated a $31 million earnings record for 1931 which was down slightly more than 10% from 1930.

Most manufacturers were not so lucky. In a survey released by the National City Bank, it was revealed that 1931 earnings were off 72% from 1929 levels and 52.9% from 1930 levels. Deficits were reported by 39% of U.S. corporations. The industries that seemed to do the best were tobacco, shoes, and chain stores. The following listing compares 1931 and 1930 earnings of a few selected companies.

Earnings Comparison in Millions US$

Company	1931	1930	% change
American Tobacco	46,189	43,294	+ 6.2
AT&T	166,666	165,544	+ 0.6
Auburn Automobile	3,579	1,018	+ 71.5
Brown shoe	1,356	1,334	+ 3.2
Caterpillar Tractor	1,361	8,714	-84.3
Coca-Cola	14,023	13,515	+ 7.2
Cream of Wheat	1,504	1,868	-19.4
Firestone Tire	4,219	1,541	+ 63.4
General Electric	40,956	57,490	-28.7
McGraw-Hill	869	2,021	-57.0
National Distillers	372	307	+ 17.4
R.J. Reynolds	36,396	34,256	+ 5.8
Scott Paper	997	986	+ 1.1
Standard Brands	14,542	16,402	-11.3

The bonds consolidated during February, trading between 80 and 78. During March they rallied slightly above the 82 level which at least had barely penetrated the December 1931 high. But by the end of March the bonds literally collapsed, falling to slightly above 78 and closing on the low for the month.

During the very early part of March, the markets were quite active. The Dow Jones Industrials had rallied to a new high for the year testing 88.78; railroads 38.65; and the utilities 35.92. But March was a busy month. The U.S. Senate adopted a resolution on March 4 to investigate stock market trading. The sentiment had turned in favour of blaming the entire affair on those who were selling the market short. Time magazine carried this little note on March 14 remarking about the sentiment toward the shorts.

"Most U.S. citizens have been hurt by the decline in prices. Many of them cannot believe present prices are justified by future prospects. Most of them believe bears 'selling what they did not own' depress prices. Many of them including their President are sure that the market's decline made business worse. In normal times nobody likes a bear. When the bear has been right and the people wrong, they dislike him even more intensely. Wall Street last week awaited the start of the Senate's investigation with some fear, much curiosity. Its fear was chiefly that the probe might evolve into a punitive bear-hunt out of which would grow legislative restrictions upon a free and open market."

When the Senate's investigation began there was no doubt in its members' minds that the target of their efforts was the bears. The sentiment was clear. There were few who did not enter that investigation without some malice toward the short sellers. The chairman of the Banking & Currency Committee Peter Norbeck, mounted the attack. When the press asked him for a comment as to what effect his investigation would have on the stock market, his reply was simply: "I don't know and I don't care!" Between Norbeck and the infamous Senator Glass, reputed for his hatred and his rash accusations throughout the collapse of the market, it was Senator Frederic C. Walcott and Senator James Couzens who at least managed to persuade the Committee to investigate the bulls as well as the bears. Senator Couzens told the press: "We are not seeking sensationalism...and we are going about this in a sane way. There is no intention...to seek legislation interfering with the regular operations of the stock exchanges."

On March 7, President Hoover authorized the American National Red Cross to distribute 40 million bushels of wheat for relief purposes. That wheat was provided by the Grain Stabilization Corporation. On

March 9, the Department of Agriculture announced that crops would be substantially higher. Corn production was estimated to rise from 703 million bushels to 1.1 billion. Wheat production was estimated to jump from 161 million bushels to 207 million. Commodities in general remained depressed and production seemed to only increase.

In March, a well-known accounting firm released its survey of the situation. The firm of Ernst & Ernst reported that a 1921 study of 379 industrials showed that the companies had suffered a decline in total earnings of 91.64% from the 1920 high into 1921. In 1931, however, their analysis illustrated a shocking difference. These same companies posted earnings which had declined by only 78.09%. The Dow Jones Industrials themselves were posting a combined decline in earnings from the 1929 high to the end of 1931 of some 79.78%. This study illustrated the paradox which faced the nation. Here earnings were still at least present and on the surface did not appear to be as devastated as they were during the panic of 1920 moving into the deflationary period of 1921. Yet in 1932, prices were substantially the same or perhaps lower in comparison to the lows which had been established during 1921. There was no logic to this period of the Great Depression. It was an emotional period of withdrawal which in turn was reflected in the prices of common stock. On March 12, 1932 came news that Ivar Kreuger, chairman of the famous Swedish Match Co., and Kreuger & Toll, committed suicide. This was the man who had lent nations money to promote his match monopoly. Details of why were not yet available but the market sold off as another wealthy industrialist joined his ancestors. The details would be known soon and the scandal only grew.

As the first quarter of 1932 came to a conclusion, most remained very confused. Banking scares continued to dominate the issue of everyday life and suicide reports continued to show up in the obituaries. Fear over the new investigations loomed over the stock market like ventures, and the future seemed to be bleak despite the various programs which Hoover continued to institute in hope of stemming the tide of pessimism as well as decline in economic activity. Spending levels on the part of government continued to bring nothing but fleeting hopes which soon disappeared with the next day's trading activity.

During the first quarter of 1932, volume in the New York Stock Exchange had declined sharply from levels recorded during the decline in December 1930 which had reached 50 million shares for the entire month. When the trend turned upward in January 1932, volume had declined to 34.3 million shares, a noticeable decrease from December when the trend had been down. As the market consolidated in February yet pushed a bit higher, volume declined even further, posting sales of only 31.7 million shares. As the market continued to rally during the early part of March, volume averaged 1.5 million shares per day. Toward the later portion of March as the market began to collapse, volume actually declined but overall the month of March showed a slight increase posting sales of 33 million shares.

The trend was still obviously biased toward the downside. Volume on the other hand began to diminish sharply, dropping to 31.4 million shares in April followed by 23 million share periods during May and June when the market was moving into its final low. Interest in the stock market had declined significantly as many a floor broker died a slow and boring death. Yet on a percentage basis, the market was about ready to equal the force of the panic of 1907 and that of the panic of 1920 on a price level. Volume clearly began to dry up after the sharp blood bath of 1931. Most of the speculative positions had been wiped out by that time. When the market moved into the summer of 1932 for its final low, trading was substantially lower than it had been during previous years.

As the second quarter of April emerged, the Dow Jones Industrials continued with the same trend that March had sustained until the bitter end. The industrials opened about unchanged and managed to test 74.38, closing at 72.18 that day. April 1 had established the high for the entire month. The railroads utilities and the bonds all established their highs for the month of April virtually on the opening bell. From there onward, April would bring only more devastation. By Tuesday, April 5, the industrials had fallen to within a few points of the 1921 low. Normally, any technical trader would expect that the market would at least pause at such an important previous low. But on April 8, the market hardly remembered what the 1921 low had been as it fell right through it, establishing the low of the day at 61.98 and closing under the 1921 low which was 63.90. Volume had reached 2.2 million shares that day. Such volume above the 2 million share level was becoming a rare event in itself. Volume on some days had declined to as little as 471,000 shares.

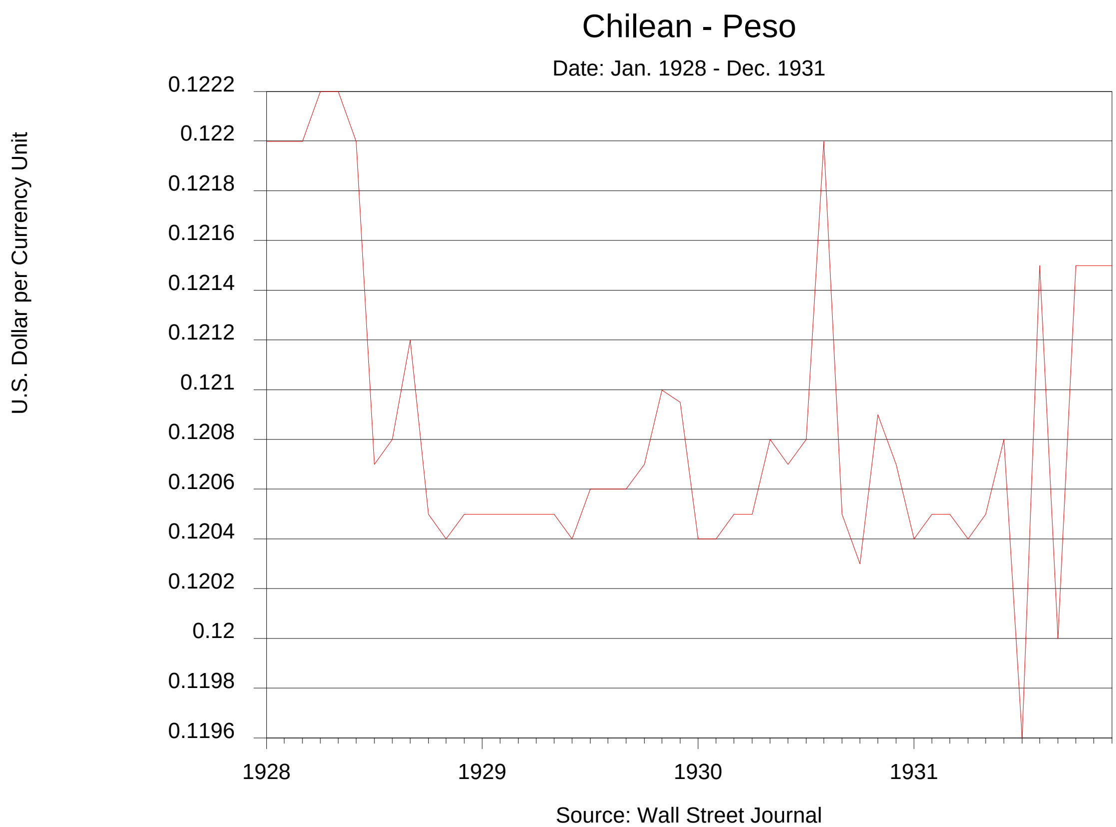
April seemed to exemplify the famous Murphy's Law of "whatever can go wrong will go wrong," to its full meaning. That was the fate for the stock market as the second quarter had begun. The month of April continued to witness a massive liquidation of stock positions. Week after week the market continued lower plagued by the threat of the Senate investigation coupled with bearish reports that railroad car loadings continued to fall. From Washington, the market feared the pending tax bill and among its own ranks, it was very displeased when U.S. Steel announced the omission of its dividend. Other companies began to follow this lead and dividend omissions began to rise.

On April 5, news came that Montagu Norman had been reappointed as the Governor of the Bank of England for the thirteenth time. In Stockholm a commission was appointed to investigate the dealings of Kreuger & Toll as rumor gave way to the reality of huge misrepresentations. Meanwhile in Germany, Paul Von Hindenburg was elected President by a majority of nearly 6 million votes on April 10.

The League of Nations reported on April 12 that international unemployment was estimated to be approximately 20 million. The U.S. State Department began holding a conference to consider what steps could possibly be taken to protect the U.S. holders of foreign bond issues which were in default.

On the 16th of April, the Middle West Utilities Co. applied for an application to enter into receivership. This was merely another nail in the coffin which sent shivers down the spines of those who had thought that at least utilities would weather the economic storm.

On the 19th of April, Chile abandoned the gold standard. For nine months, Chile unsuccessfully attempted to maintain the peso at par. They had imposed extremely rigid foreign exchange controls but sumptuary laws could not overcome the reality of the situation. Fears of further loan defaults sent the bonds crashing down nearly 30 basis points that day.



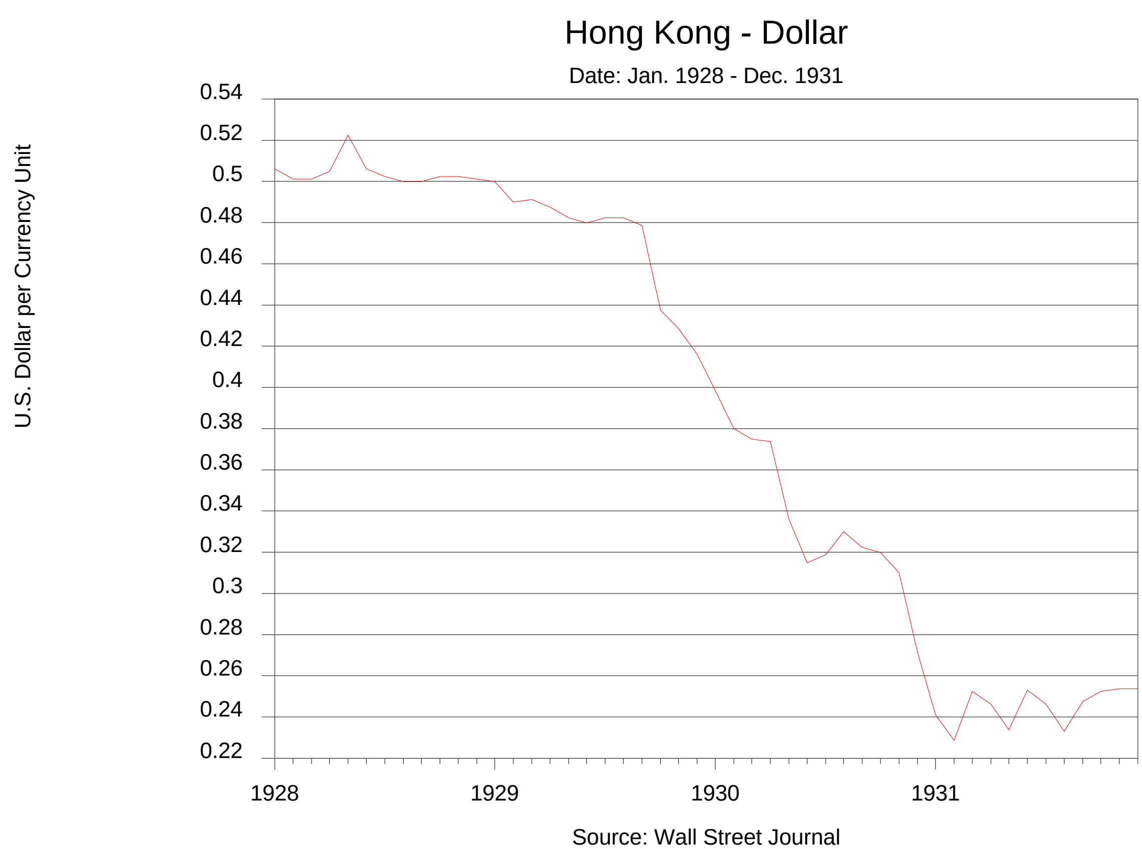
On the 25th of April, Greece also abandoned the gold standard. Foreign exchange markets were in disarray. The British pound, which had fallen from the par value last seen during April, 1931 before the devaluation, had begun to fall once again, dropping to $3.65 from its March high of $3.77. The downtrend would eventually continue into November of 1932 when the pound would drop to $3.15. Now only the French and the Swiss currencies remained steady.

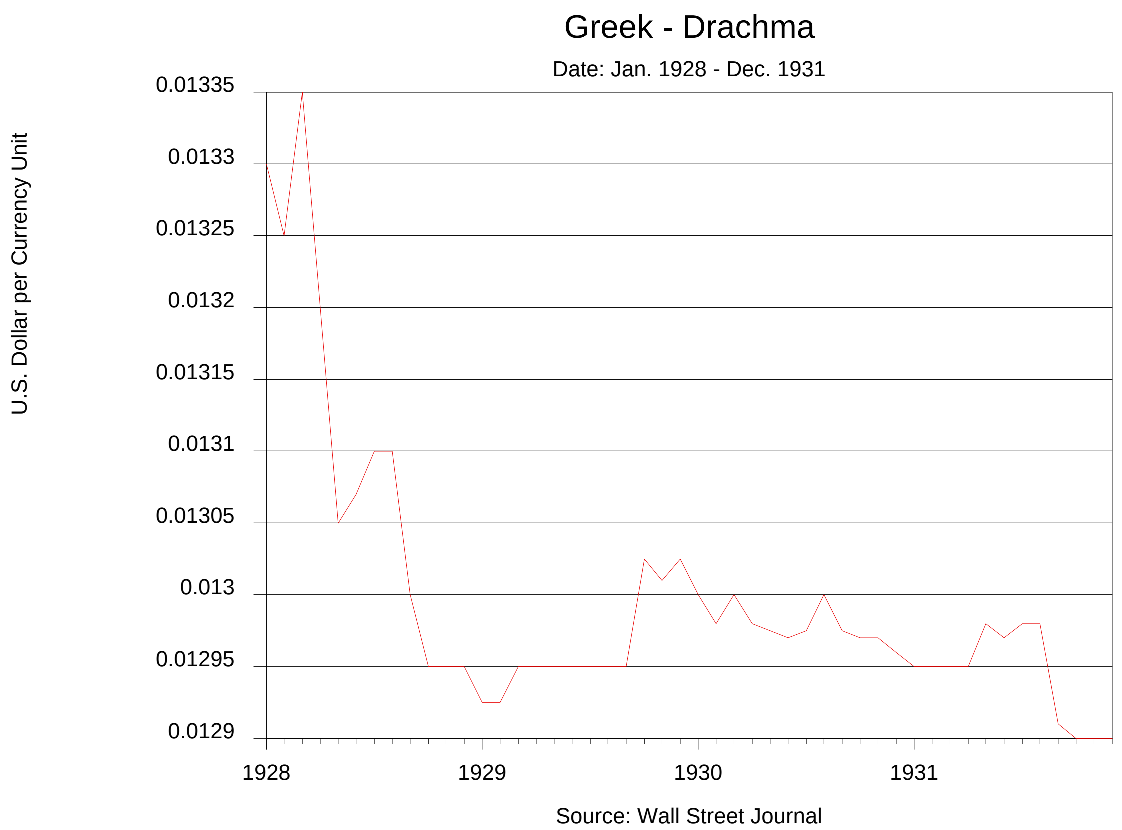
Trading volume on the New York Stock Exchange during April had declined to 31.4 million shares. This was the first panic sell off where new lows were achieved on lower volume.

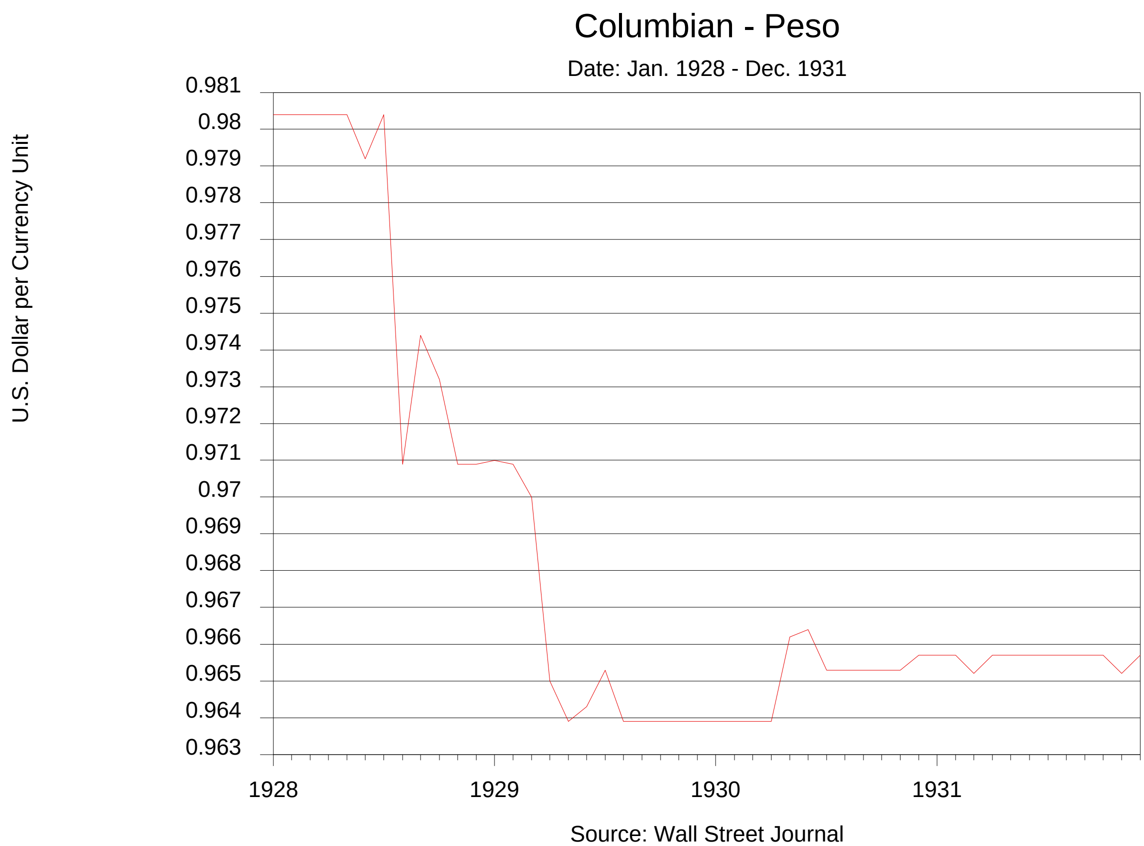
Time magazine reported in its April 4, 1932 edition that corporations were writing down the stated value of their common stock. Common stock was carried on the liabilities side of the balance shoot. By writing down the value of their common stock, they obviously reduced their liabilities and enhanced the overall appearance of the company's books. In many cases, this created a surplus which to some degree further clouded the true performance during the period. But in one sense, the liabilities had been greatly reduced. After all, the value of the Dow Jones Industrials was now 20% of the 1929 high. Therefore, their liabilities were considerably less in a very real sense.

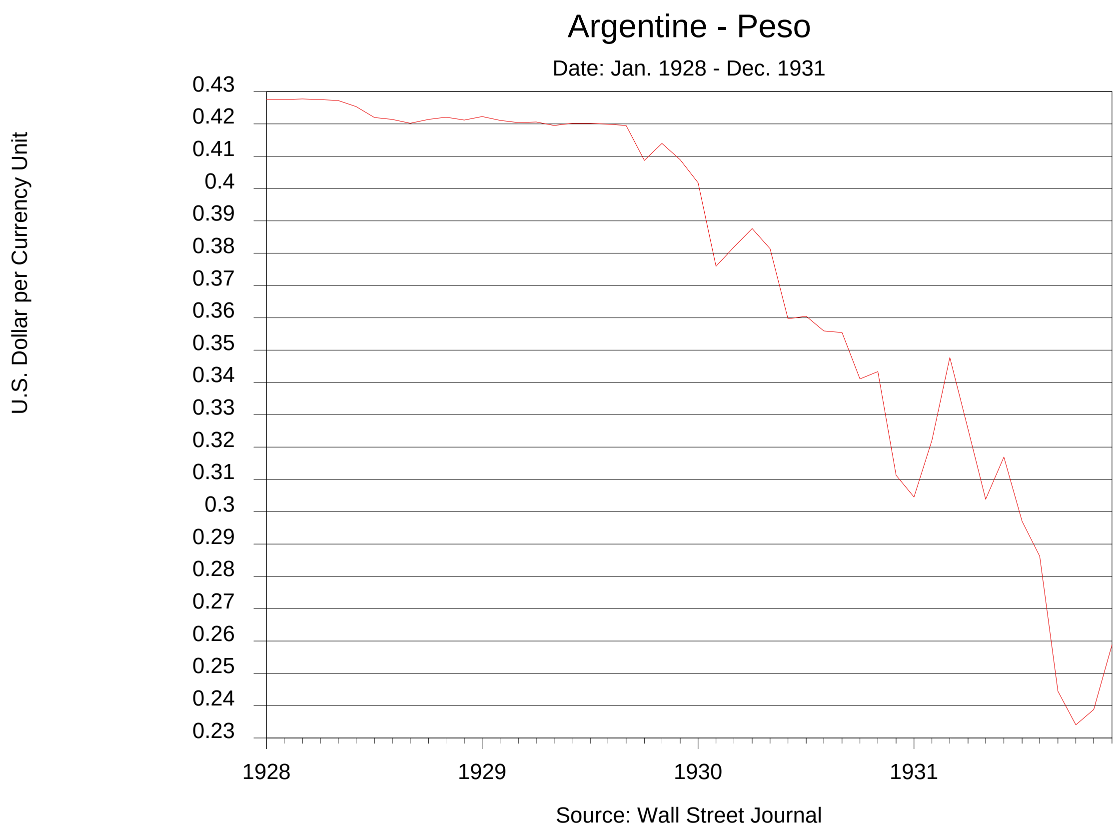
In Washington, the Senate investigation of Wall Street began to turn into a witch hunt. The President of the New York Stock Exchange, Richard Whitney was summoned to Washington by an urgent phone call. Apparently a telegram from a close friend of the President's was received in which it was alleged that a "billion-dollar bear raid" had


Chinese - Tael
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
0.7
0.65
0.6
0.55
0.5
0.45
0.4
0.35
0.3
0.25
1928
1929
1930
1931
Source: Wall Street Journal

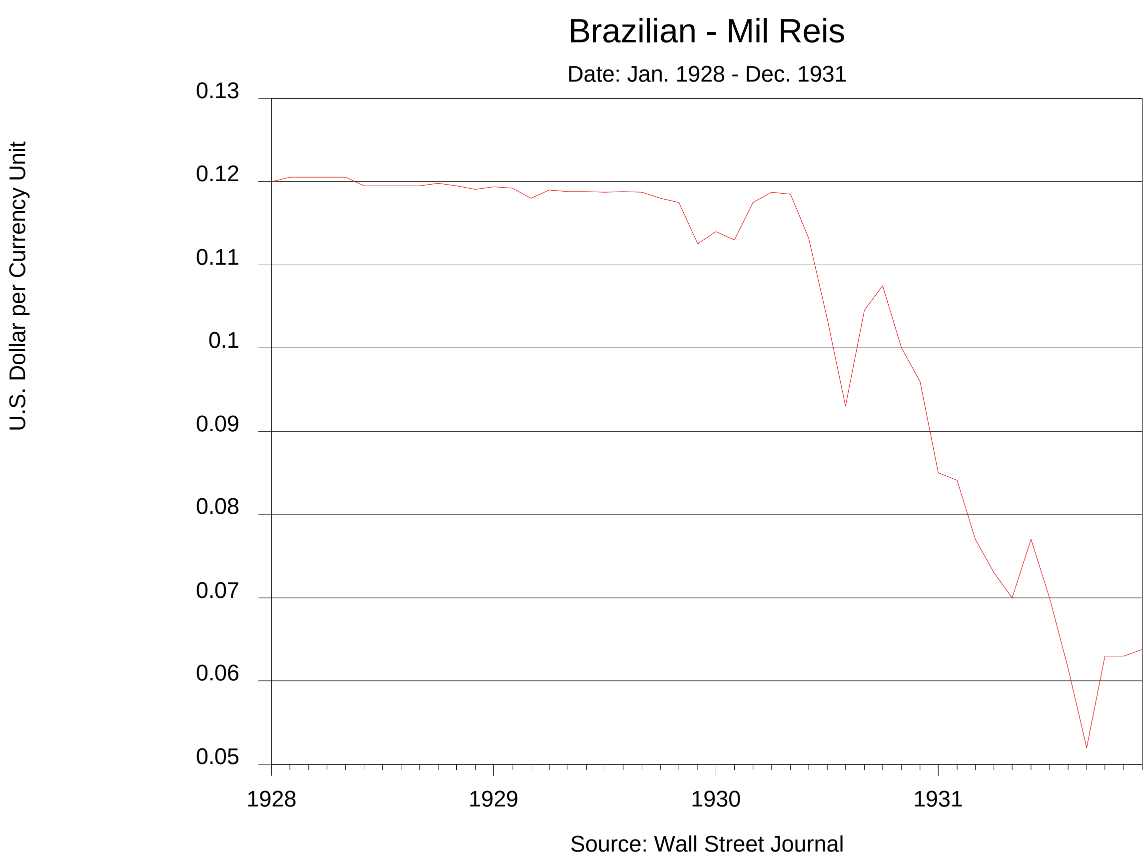

Hong Kong - Dollar
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
0.54
0.52
0.5
0.48
0.46
0.44
0.42
0.4
0.38
0.36
0.34
0.32
0.3
0.28
0.26
0.24
0.22
1928
1929
1930
1931
Source: Wall Street Journal


Greek - Drachma
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
0.01335
0.0133
0.01325
0.0132
0.01315
0.0131
0.01305
0.013
0.01295
0.0129
1928
1929
1930
1931
Source: Wall Street Journal

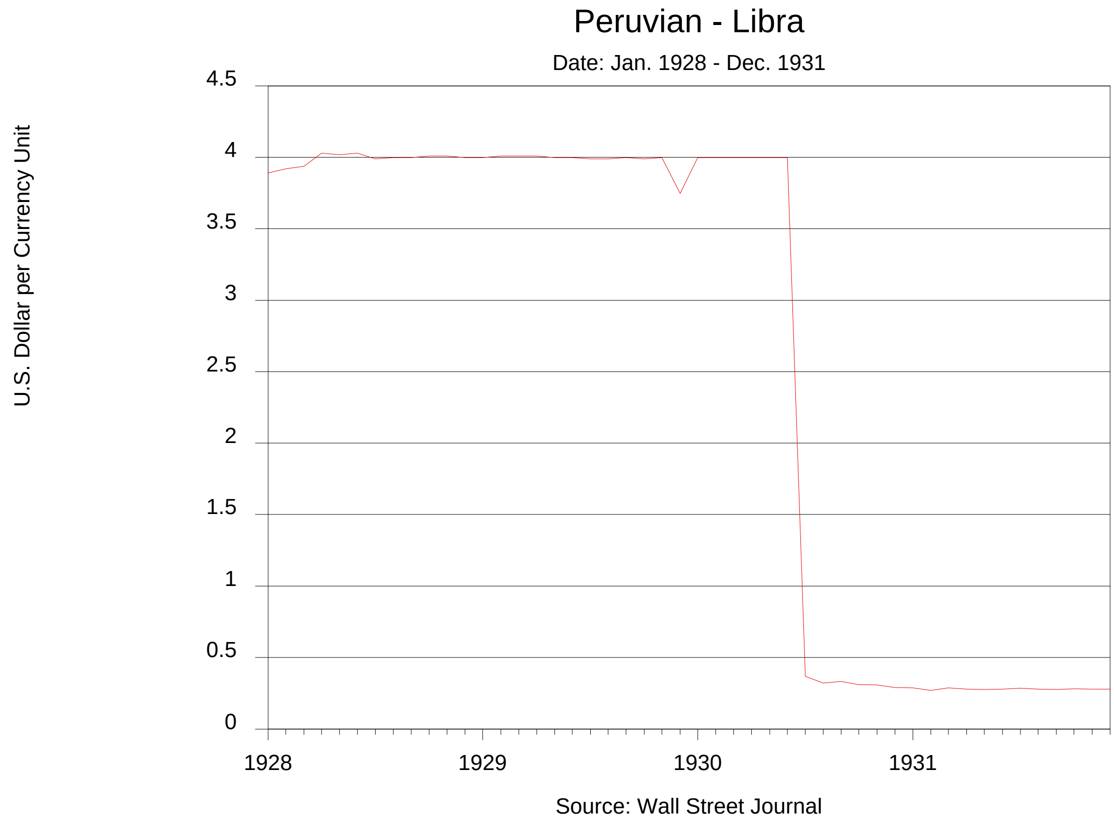

Columbian - Peso
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
0.981
0.98
0.979
0.978
0.977
0.976
0.975
0.974
0.973
0.972
0.971
0.97
0.969
0.968
0.967
0.966
0.965
0.964
0.963
1928
1929
1930
1931
Source: Wall Street Journal

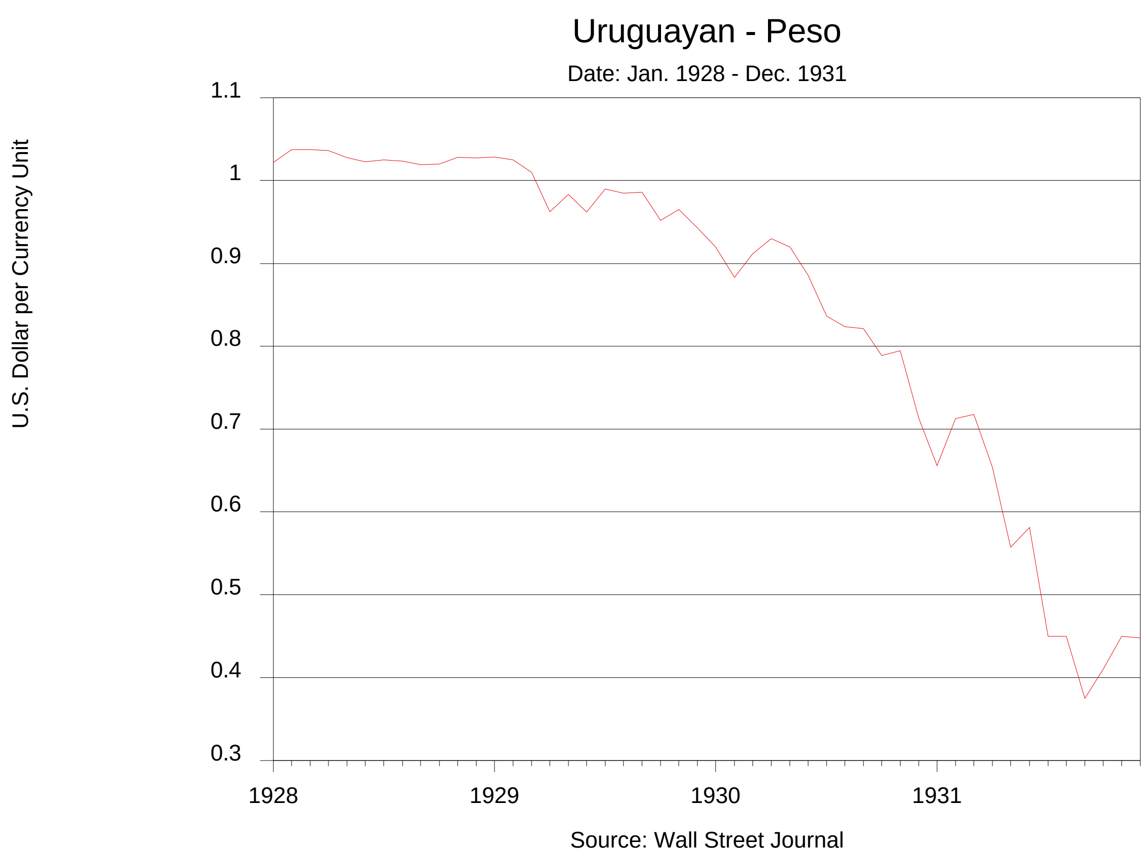


Argentine - Peso
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
0.43
0.42
0.41
0.4
0.39
0.38
0.37
0.36
0.35
0.34
0.33
0.32
0.31
0.3
0.29
0.28
0.27
0.26
0.25
0.24
0.23
1928
1929
1930
1931
Source: Wall Street Journal



Brazilian - Mil Reis
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
0.13
0.12
0.11
0.1
0.09
0.08
0.07
0.06
0.05
1928
1929
1930
1931
Source: Wall Street Journal


Peruvian - Libra
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
1928
1929
1930
1931
Source: Wall Street Journal


Uruguayan - Peso
Date: Jan. 1928 - Dec. 1931
U.S. Dollar per Currency Unit
1.1
1
0.9
0.8
0.7
0.6
0.5
0.4
0.3
1928
1929
1930
1931
Source: Wall Street Journal

been at work in the market. Senator Walcot asked Mr. Whitney to prepare a complete list of names of those who had sold short positions in the market.

Whitney faced what was reported as a somewhat hostile Committee. Time magazine reported that Claude R. Branch, the special attorney for the Committee was very zealous and "irritating." Senator Norbeck was noted to be very "impatient." Senator Glass was his usual self, "sarcastic," and Senator Smith Wildman Brookhard was very "belligerent."

They taunted and badgered Whitney as if he was a criminal. Whitney again denied that professional bears had anything to do with the decline in market values. Whitney pointed out that short interest had declined by 230,000 shares the week before yet the market still fell to a new record low. Whitney pointed out that a similar condition had existed the previous October when prices tumbled. In response to their inquisition of bear-raiders, Whitney replied: "Our investigations have disclosed no bear raids!"

The Committee managed to extract from him a statement in which he agreed that perhaps officials who had made bullish statements might have induced small investors into buying stocks which made Senator Glass' day. But when pressed as to why the market had then declined, Whitney replied: "Liquidation by frightened investors who are giving these United States of ours away."

The interrogation continued as if it were the Spanish inquisition.

Senator Couzens: It has come to my attention that a broker may use his customer's stock to depress the value of that stock.

Mr. Whitney: Senator Couzens, I deny that!

Senator Couzens: How do you detect it?

Mr. Whitney: Our men check the brokerage offices.

Senator Brookhart: Do you think the rules you are constantly citing are enforced or evaded?

Senator Blaine: Maybe he thinks they are enforced better than the Prohibition Law of the Federal Government.

Senator Brookhart: You brought this country to the greatest panic in history!

Mr. Whitney: We have brought this country, sir, to its standing in the world by speculation. You think you can affect the world by changing the rules of a stock exchange or board of trade?

Senator Brookhart: Yes, we can change them by abolishing the stock exchange and board of trade so far as speculation is concerned!

Mr. Whitney: And then the people of the United States will go to Canada and Europe to do those very things and pay their taxes there!

In reading over the dialogue of Mr. Whitney's interrogation, one begins to wonder whether or not he was before a committee of the Communist Party in Russia. Were these comments coming from elected officials in a so-called free society?

Before the Banking & Currency Committee, Mr. Whitney handed over the list of 24,000 names of those who had positions in the market. This was April 8, one day before the supposed "billion-dollar bear raid" had taken place. The Committee began to instantly sift through the list searching for the names of those who had shorted the markets. Many prominent and nationally well-known names were among the list. But Senator Walcot argued against the publication of any names.

During the later part of April, the market continued to tumble largely on the news of the Kreuger Scandal. It seems as though the King of the Swedish Match Co. had some cash flow problems back in 1931. He obtained some copper plates which were similar to that of Italian government bonds. He took the plates and ran off 42 bonds which each carried a face value of 500,000 pounds. He swapped the counterfeits with good bonds in the company's portfolio and proceeded to borrow against them. It was reported that when asked about the Italian bonds in the company's portfolio, he replied that relations between France and Italy were strained and that no mention should be made of his loan to the Italian government. This didn't seem out of line. If you recall, he had lent sizable amounts of money to both Germany and France in return for monopoly concessions for matches in these nations.

As May entered the arena there seemed to be no easing in the downtrend for equities. The Dow Jones Industrials fell almost continuously straight down, closing May on the low for the month. Yet volume declined considerably dropping to 23.1 million shares. Only Six days during the entire month managed to trade more than a million shares. Most days averaged between 600,000 and 700,000 shares. At the close of May, the industrials stood at 44.74 down virtually 50% since the March high. Bonds had also continued to decline and dropped down to close on the low for the month as well at 66.30 which was substantially below the March high of 82.30. The railroads had closed May at 14.30, off nearly 60% from the March high of 38.65. The utilities had also declined sharply falling from their March high of 35.92 and closing May at 17.74, off virtually by 50%.

Many of the same issues which had plagued and influenced the market merely intensified. The Federal Government had entered a deficit in its budget and the pending tax bill seemed to be going nowhere. Meanwhile, spending increased as Hoover sought to create jobs for the unemployed. It was the billions of dollars being spent in recovery attempts that scared Europe more than anything. Gold outflows began to increase. Many called for the end of the United States. Everyone had been used to budget surpluses and trade surpluses as well. The thought that deficits were taking place gave some hope that the increased spending would stimulate the economy while others saw a trend which pointed to the collapse of the nation through deficits.

The dividend news continued to get worse. The New York Central Railroad had omitted its dividend for the first time in 62 years. G.M. reduced its dividend sparking further pessimism.

On the 1st of May, a strike had been declared by 32 building trade unions in New York. On the 11th of May President Hoover vetoed the bill to amend the Smoot-Hawley Tariff Act of 1930 which sought to restrict the powers of the President under the flexible tariff provisions.

On the 16th of May, U.S. Steel Corporation again cut wages by 15%. Most commodities continued to decline and zinc fell to its lowest point on May 18, reaching 2.275 cents.

On May 24, 1932, the Kreuger & Toll Company, which was the parent company of the interests of Ivar Kreuger, filed for bankruptcy.

On May 25, 1932 Britain finally signed an agreement under which it would resume payment on its debt owed to the United States which had been postponed under the moratorium.

Sugar reached bottom for the year at .057 cents. Many had thought that sugar would hold the 1 cent level. But sure enough, the impossible had happened. Sugar fell below the 1 cent level that day.

In Washington, the witch hunt continued. During April's assault upon Mr. Whitney, Senator Norbeck lost his cool and shouted at Whitney "You're hopeless!" when Whitney refused to acknowledge that shorts had forced the market lower.

The Special Attorney was replaced by William A. Gray but he was not much better. Yet the shocking event came when the Committee began to publish the list of 350 short players who had taken part in the stock market. It was unbelievable. The entire affair made a mockery of this free system.

The list naturally included many well-known names. Among them were the following:

Percy Rockefeller
Matthew Brush
Bernard E. ("Sell'em Ben") Smith
Arthur Cutten (Famed bull in Wheat)
B.C. Neidecker (Head Travelers Bank)
Raymond Patenotre (French Deputy)
Marquis de San Miguel
Zalmon Gilbert Simmons (Simmons Beds)

The Senate began to drag them all in to rake them over the coals so to speak. Percy Rockefeller was taunted without mercy by Counsel Gray looking, as always, to make a name to himself over someone else's dead and battered body. Gray conjured up every deceitful scenario he could imagine accusing Percy Rockefeller of slanderous things including sitting on bank boards and having knowledge of distress sales in advance. But evidence never supported such wild accusations for Rockefeller never had a lot of short positions at any time.

Gray: There has been rumor that you broke with President Hoover and became a short seller to depress prices. Is that rumor correct?
Rockefeller: Now what object would I have in doing a thing like that?
Gray: Perhaps to hurt Mr. Hoover's chance for re-election.
Rockefeller: Oh no! I am a Republican.
Gray: Senator Walsh just said he believes international bankers have smashed the market to force the United States into a position where we must cancel War Debts. Do you think he is correct in that belief ?
Rockefeller: All those stories are ridiculous it seems to me.

Rockefeller at his peak had 12,000 shares short but had not been short for some time. They pressed him as to how much he made from the stock market. "My own losses have been terrible," said Rockefeller. Senator Couzens appeared as if he didn't want to accept the fact that Rockefeller hadn't made any money. "How much is terrible?" Couzens asked. "A good many million!" replied Rockefeller.

Senator Copeland of New York had just walked in to listen to what was going on. He stayed but for only a short while and found the entire proceedings very disdainful. A reporter for Time magazine overheard his comment which was "They are conducting this like a police court!" Indeed, the hearings were in search of capitalists who could be hung out in public and all wrongs thereby placed upon a few in no way different than the vengeful days of Stalin and Lenin.

The Senators continued probing and harassing their victims, hell bent on laying the blame for the depression upon the whole lot of speculators who had dared to sell the stock market short. Evidence which had been presented by the New York Stock Exchange which unquestionably failed to produce a massive bear pool was of no consequence. The Senators continued without probable cause and without restraint. If any such investigation should have been launched, it should have been conducted into the mismanaging of affairs on the part of government focusing not merely on the Anti-Trust laws, but on the dubious tactics of floating unsecured sovereign debt.

Thomas E. Bragg, a well-known stock market player, was next in line to be pulled apart by the inquisition. Bragg admitted to having at times as much as 50,000 shares on the short side, but on the average his position was 12,000 to 15,000 shares. Although Bragg was one of the largest short players uncovered by the blood-thirsty Senators, 50,000 shares in the midst of 5 million share days was still like spitting in the ocean and expecting to alter the tide.

Bragg denied taking part in any bear-raid or bear-pool but admitted that he had taken part in a bull-pool which totaled $32 million in Anaconda Copper prior to the break in 1929. The questioning thereby turned toward his bullish days when nothing of massive bear-raider could be hung around his neck.

Gray: How much did you put in?
Bragg: About $500,000. I think Ben Smith put in a half million and Mr. Rockefeller $120,000.
Gray: Go ahead and name the others.

Tom Bragg went on to name John Raskob, Chairman of the Democratic National Committee, Willy Durant, Frederic J. Fisher and others.

Senator Couzens: How did the operation come out?
Bragg: I lost $400,000, others may have lost more.
Senator Couzens: What representations were held out to get people to join?
Bragg: Possible profit.
Gray: Wasn't that pool formed because of the ability of this group to manipulate the market?
Bragg: I don't think there was any manipulation.
Gray: Oh be a little frank with this committee. You just didn't take $32 million into the market and sit down and wait. Tell us some truth!
Senator Glass: I protest against bully ragging the witness that way.

The Senator's bear-hunt continued, calling John Jacob Raskob, Chairman of the National Democratic Committee, to the stand. Senator Norbeck was dying to hang a few Democrats with the Presidential elections coming due in the fall. Senator Glass was a Democrat. He demanded of Counsel Gray:

Senator Glass: "Are you calling any prominent Republicans?"
Senator Norbeck jumped in: "If Senator Glass will name them we will gladly call them."
Senator Glass began to shout: "It isn't my place to call them!"
Gray broke in and said: "If I'm directed to proceed no further with Mr. Raskob because he is chairman of the Democratic National Committee, I'll go not further."

Senator Glass immediately backed off murmuring: "Oh no, I was just, ah, wondering, ah..."

Raskob had brought with him itemized accounts of his stock dealings. After some badgering, as seemed appropriate for this posse, it became clear that Roskob, famed bull was indeed a bull to the very end. Raskob had lost so much that they asked if it was indeed all his money to begin with? "All my own!" he sadly replied.

But Time magazine reported Raskob's closing words to the distinguished Committee,

"I have always been long of stocks. ... Nevertheless, I think that short-selling is a perfectly legitimate thing, though it may have been terribly abused. And I believe that if the American people had been more familiar with it ... during the boom our conditions would not have become so bad. Short-selling has its place and a very good place too."

The bear-hunt continued despite the emotional parting words of Raskob. Gray summoned William Fox, once the proud owner of Fox Films. William Fox, upon his arrival in Washington, became ill. Fox's doctor claimed he had an attack and stated that he believed Fox had diabetes. But Gray, depraved, perverse and suspicious a person as he was, held true to his character. Gray simply wouldn't believe him. Gray hired a physician to check Mr. Fox's condition with orders to report directly to Mr. Gray. When that doctor also reported that William Fox was seriously ill, Gray still refused to believe it and then hired a third doctor ordering him to check the condition of this Mr. Fox. All three doctors agreed that Fox was indeed very ill.

Gray still scoffed at the situation and proceeded with his case against Fox without his being present to raise his own defense. Gray charged Fox had "wrecked" his former companies through stock market activity. He revealed countless details of his stock transactions right down to how much his daughter had owned. But all the evidence which Gray had compiled did not show Fox as a bear-raider but as a dead and battered bull. Gray was still not satisfied. Gray uncovered what he called a fraud. Gray accused Fox on one transaction out of several thousands of willful fraud again while Fox was still confined to his bed. Fox had dealt in the name of his company as well as in his personal name from time to time. Gray charged that on one transaction Fox had deducted a loss incurred in the market which he claimed the company had originally paid for.

The Committee naturally flaunted this in the face of the press and then announced that they were turning Mr. Fox over to the IRS. Mr. Gray took much pleasure in announcing publicly that "the recovery of evaded income tax will offset the expense (of the proceedings) 100 times," as they voted to continue the investigation despite having failed to turn up the illustrious bear who had supposedly destroyed the market and perpetrated the Depression upon the entire world.

Thomas Jefferson once said "Sometimes it is said that man cannot be trusted with the government of himself. Can he then be trusted with the government of others? Or have we found angels in the forms of kings to govern him? Let history answer this question." Indeed history answered Jefferson. If man supposedly cannot be trusted with governing his own actions, for which reason the Senate instituted these proceedings, the men who sat at the table of that

Committee were of no different stock or breed. They were no better than those who they sought to judge and in the process they ignored those enlightened dreams which took form in the Bill of Rights.

William A. Gray and the rest of the Committee lowered those standards of government to the very gutter. Gray, with his full wavy head of hair and his beady eyes which hid behind a pair of wire rim glasses, tried to set himself up as God to rule and judge others. No one ever asked if he had owned a single share of stock. Perhaps he did; perhaps not. But he attempted to turn the only motive for buying stocks into the most seedy act worthy of the highest criminal penalty. All the freedoms which many an American had died for in every war since the Revolution were ignored by an enraged government bent on revenge. What of the Constitution? No words could protect the public from these self imposed tyrants.

Thomas Jefferson also wrote: "Still one thing more, fellow citizens - a wise and frugal government, which shall restrain man from injuring one another which shall leave them otherwise free to regulate their own pursuits of industry and improvement and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities."

It was with this rage toward the stock market that a new philosophy began to take hold in the United States and the balance of the free world. Although governments would stop short of full blown communism, laws progressively took a direction toward a socialistic state. The graduated income tax would eventually rise to 90%. The government used its taxing powers to get at the rich and upper classes who had participated in the stock market. Since one could not constitutionally take away their rights to invest government sought in the decades that followed to raise taxes to such heights that not much income would be left for speculation. The spirit of individualism was dealt a severe and shocking blow. The actions taken by the Senate could be taken just as easily and most assuredly again given an economic convulsion of this magnitude.

The infamous Mr. Gray was far from satisfied. His next victim in his Roman style of public spectacle was called in; Charles E. Mitchell, Chairman of the Board of National City Bank. Gray probed and badgered Mitchell whose bank had ill-advised many clients to buy Anaconda Copper. The bank had sold 300,000 shares at $125 a share which by now were trading at mere $4. Mitchell denied Gray's accusations that perhaps the bank used high pressure tactics to sell the stock to an unsuspecting public as if Mitchell or anyone could have foresaw the depths to which the market would have fallen two years in advance. Given the atmosphere at the time, the accusation was completely ridiculous. It didn't take high pressure salesman to sell stock back in the summer of 1929.

Gray's accusations and interrogations were reaching much too high a level of zeal. Most of the Senators didn't even show up the next day to listen to Gray's further inquisitions into the Anaconda Copper dealings. Only Senators Norbeck and Townsend appeared. Gray summoned the Chairman of the Board of Anaconda Copper himself, John D. Ryan. The interrogation continued as accusations from Gray grew more bold. The President of Anaconda, Cornelius F. Kelly, became so annoyed that he jumped up and yelled at the Committee, "Mr. Gray is trying to ride the witness for the benefit of the gallery!" Senator Norbeck threatened to put Kelly on the stand if he didn't shut up. Could this really be the land of liberty or was it a nightmare? Gray's accusations were totally unfounded. He would say anything and do anything to try to get somebody to admit to anything at all. It was hardly as if Anaconda's decline in the market was an isolated incident. Then perhaps one might be able to accuse manipulation. But Anaconda was but one issue in a tidal pool of declining stocks on every exchange throughout the world.

Gray's accusations were, of course, carried by the press. Whether they were well founded or not, they made great gossip to slander and destroy those who had been forced to submit to Gray's perverse rantings. The damage to reputations of many who had been placed on the rack was beyond repair. As a result of the hearings, William Fox had numerous law suits filed against him without evidence but solely upon the allegations made by Gray. Charles Mitchell, a long-time personal target of Senator Glass, was forced to resign as head of the National City Bank. Other resignations were also caused by Gray. The head of Chase Manhattan Bank, Albert Wiggin, was also forced to resign. In each case, no one had been a bear-raider but instead they were chastised for being bulls. Most had lost money but that didn't matter.

Herbert Hoover wrote in his memoirs that the inquisition was at his direction. He wrote..."I urged that the committee launch an investigation of practices of the Exchange, with a view to legislation and I gave them much information to start on. I was extremely loath to take this step as we had enough burdens to carry without all discouraging filth such exposure entailed...There was some doubt as to the constitutionality of the Federal control of the stock exchange...But when a representative government becomes angered, it will burn down the barn to get a rat out of it."

Although Hoover was defeated by Roosevelt in November 1932, credit for the establishment of the S.E.C. does not solely lie with Roosevelt. The birth of the S.E.C. actually originated with the witch hunts of 1932.

The S.E.C. still holds broad powers over the exchanges and indeed many laws which it enforces such as disclosure and financial statements from public companies have been a great service in preventing some of the dishonesty that took place in bogus stock offerings and outright forgery of stock. But to burn down the barn to get to one rat is not the proper action of a free society. One does not permit strip searches of people walking down the street in order to catch a suspected shoplifter. Protection against such activity is at least our supposed constitutional right but when government becomes enraged, you can't count on them to come to your aid.

It is hard to say whether or not these proceedings had a lot to do with the drastic decline in volume on the stock exchanges. All that can be surmised is that there was perhaps some hesitancy to participate since the Senate appeared to have the power to call in anyone who had bought or sold a share at some point in time.

One thing was certain; the short interests had dwindled significantly. At the end of May, the market had dropped to a new record low, well under those established during previous panics. As the market fell to 46.71 on May 28, volume was a mere 675,000 shares. But on Monday, May 31, 1932, the market fell to 44.72 and volume jumped back up to 1.4 million shares for the day. This was still a far cry from the 10 million share days of November 1929 or the 5 million share days during the recovery of the first quarter in 1930.

May had also brought the collapse of the Japanese price supports for the silk market. Seven thousand tons of silk had overhung the National Raw Silk Exchange. The Japanese had set up a price support system similar to the U.S. Farm Board program, which bought up excess supplies at fixed prices. Japan finally gave up the program and sold the entire lot of silk to E. Gerli & Co. of Manhattan for $16 million. In return, Japan agreed that they would in the future attempt to support silk by encouraging lower production rather than buying up excess production at fixed inflated prices. The price of silk on the New York Exchange was $178 a bale and the deal was struck at $150. Most silk dealers felt rather bullish once this supply was out of the way. E. Gerli & Co. proposed to sell the silk through its distribution network rather than dumping it on the exchange itself.

The steel industry was in shambles, turning in disastrous losses. The President of Bethlehem Steel, Eugene Gifford Grace, made a public statement about the situation in early May. "I cannot understand the inactivity of our labour friends who have not only failed to demand new laws protecting American manufacturers, but have not insisted upon the enforcement of existing laws." European steel manufacturers were dumping steel in U.S. markets for a loss, driving prices down even further. Although Bethlehem did pay a regular $1.75 dividend on its preferred stock, bringing the yield to 20%, the common share dividend was omitted and most assumed that by the end of the next quarter, Bethlehem would most likely omit even its preferred dividend.

U.S. Steel announced that another wage cut would be imposed from the President on down. Wages had already been cut 10% to 15% in August 1931, then 10% in October and the new cut which was proposed in May 1932 was an additional 15%. This brought the average wage down 23.5%.

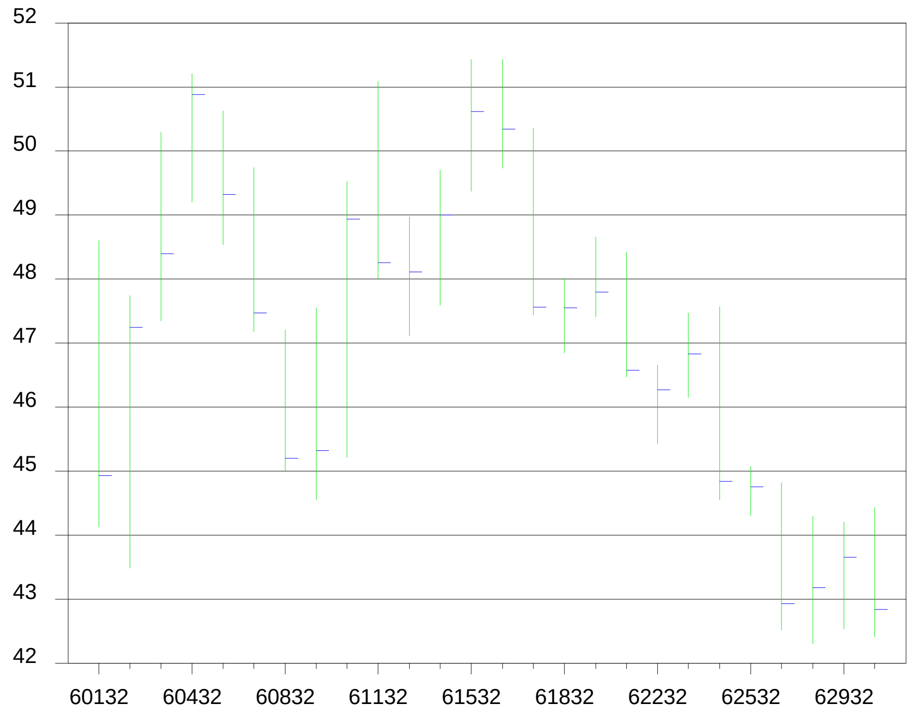
May brought troubles in other metals markets as well. The tin crisis of 1932 came about when the international Tin Cartel was forced to announce that production would be stopped entirely during June and July. The Cartel was comprised of Malay States, Bolivia, Dutch East Indies and Nigeria. They further announced that when production resumed during August, they intended to gear back up to only 40% of capacity.

Another statistical survey was released during May of 1932. This was a stock survey conducted by R.G. Dun & Co., which later would merge with Bradstreet. The survey centered its focus upon the ownership of securities in 1932. Dun found that over the past two years, the number of actual stockholders in the 346 company survey increased by 41.5% which stood at 5,848,000. The number of preferred stockholders had increased by only .3%. In a survey of bonds, it was found that ownership had actually declined by 3.8%.

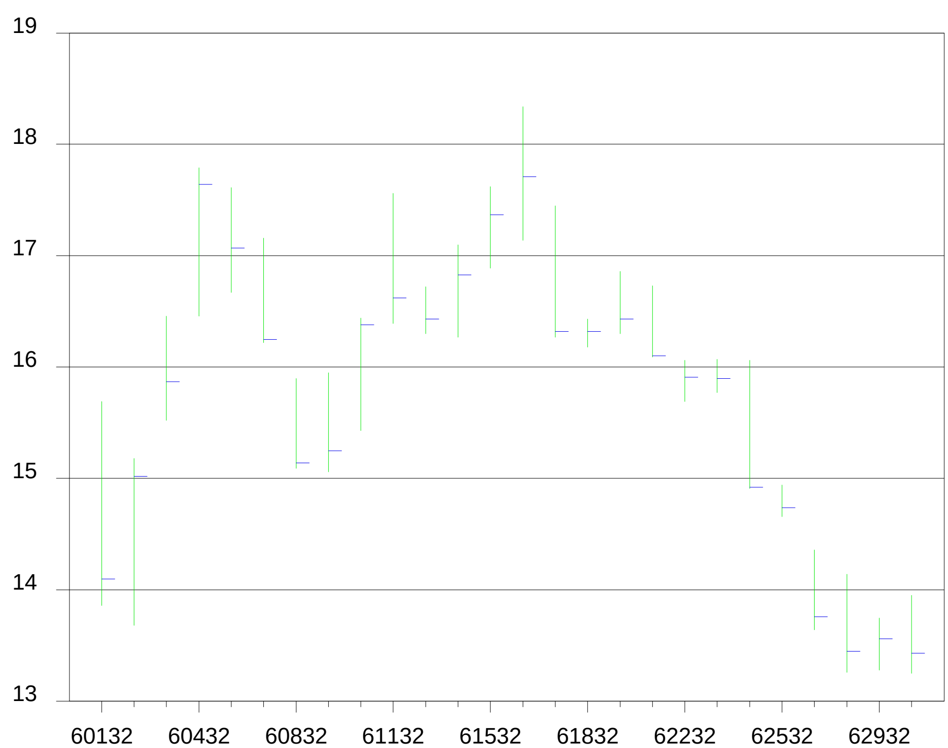
Dun’s survey turned up one interesting point. While stocks were purchased on margin, traditionally the stock remained in the name of the brokerage house. This survey at the very least demonstrated that more people were buying stocks outright rather than on margin.

It also suggested that small investors’ inequities still existed and, in fact, perhaps it was the big players and the professionals who were now out of the entire affair.

Dow Jones Industrials Daily June 1932



Dow Jones Railroads Daily June 1932



As June entered the scene, the Senate hearing continued to hit the press detailing Gray's nasty disposition. He come off as the type of guy who would turn in his own mother if he thought it would gain him the Presidency.

The Dow Jones Industrials continued to fall. But during the first few days of June, the market rallied from 44 back to 51. Volume picked up significantly, reaching 1.8 million shares for three days in a row. The second week the market again fell back to 44.45. Volume averaged 900,000 shares per day.

The third week in June saw the market rally back reaching a new high for the month testing 51.43. Volume declined that week to 568,000 on Monday, moving up to 756,000 on Tuesday. On Wednesday, the day of the high for the month volume reached 1.1 million shares. Distinctly, volume began to rise on up days, more so than on down days.

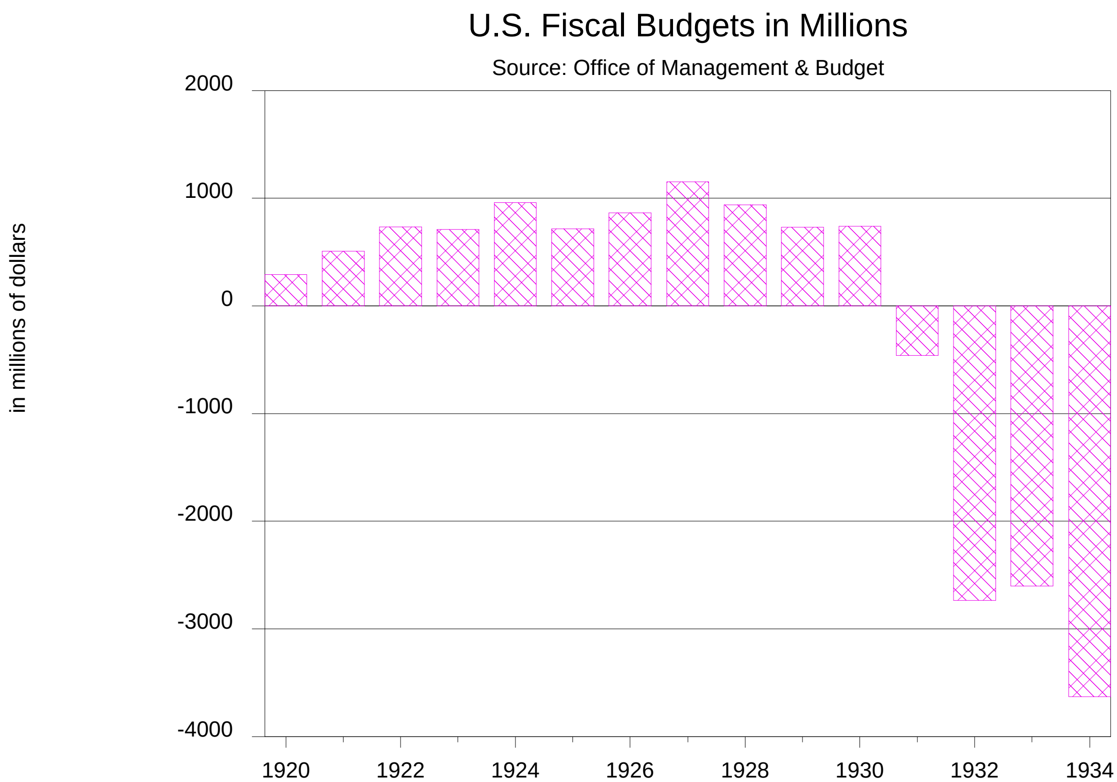
During the fourth week in June, the market fell back to 44.31 and volume declined to as low as 310,000 to a maximum of 773,000 shares on any given day that week. As June came into the final week of the 27th, volume remained at the 650,000 average level as the market dropped to new lows, testing 42.31 on Tuesday, June 28. June closed the month at 42.84.

What had prompted the early June rise was news that Congress had killed the Soldier's Bonus Bill. Oddly enough, sentiment began to invert the relationship of government actions to the market. At first, government programs to increase spending were looked upon by the market as being bullish. Fresh capital would enter the economy, people would buy goods, of course; thus earnings would rise and along with them stocks. But as we approach the low in 1932, the fundamentalists were looking at the events completely in the opposite direction.

The Federal budgets had turned into deficits. Now all of a sudden, raising taxes and killing spending were deemed to be bullish for the market. Why the sudden change? It was apparent that Hoover had established many various programs to institute spending which would in turn create jobs. But as billions were spent, no appreciable effect could be witnessed by the market. Prices merely continued to decline. There is no logic for the sudden change in fundamental analysis. At the peak there was no federal deficit. But deficits began only to occur in response to the depression. So now was the bottom in the market caused by the deficit which had just begun to manifest itself? It seems highly unlikely that this would be a reason why the market should decline or fall at this point in the game. Nonetheless, Congress' swift thrust to kill the Soldier's Bonus Bill was deemed to be the most bullish aspect in the market during early June.

However, the stock market enthusiast quickly turned bearish on news that wheat and cotton began to break. Some claimed that the market dropped because President Hoover and Vice President Curtis were renominated during the June Republican convention for the upcoming elections in November.

On June 3, 1932, there was another bullish piece of news. The banks had remained at a distance from the collapsing bond market. But the banks had publicly stated that a Federal balanced budget would in their opinions send cash diving back into the financial arena. They announced that they were forming the American Securities in-



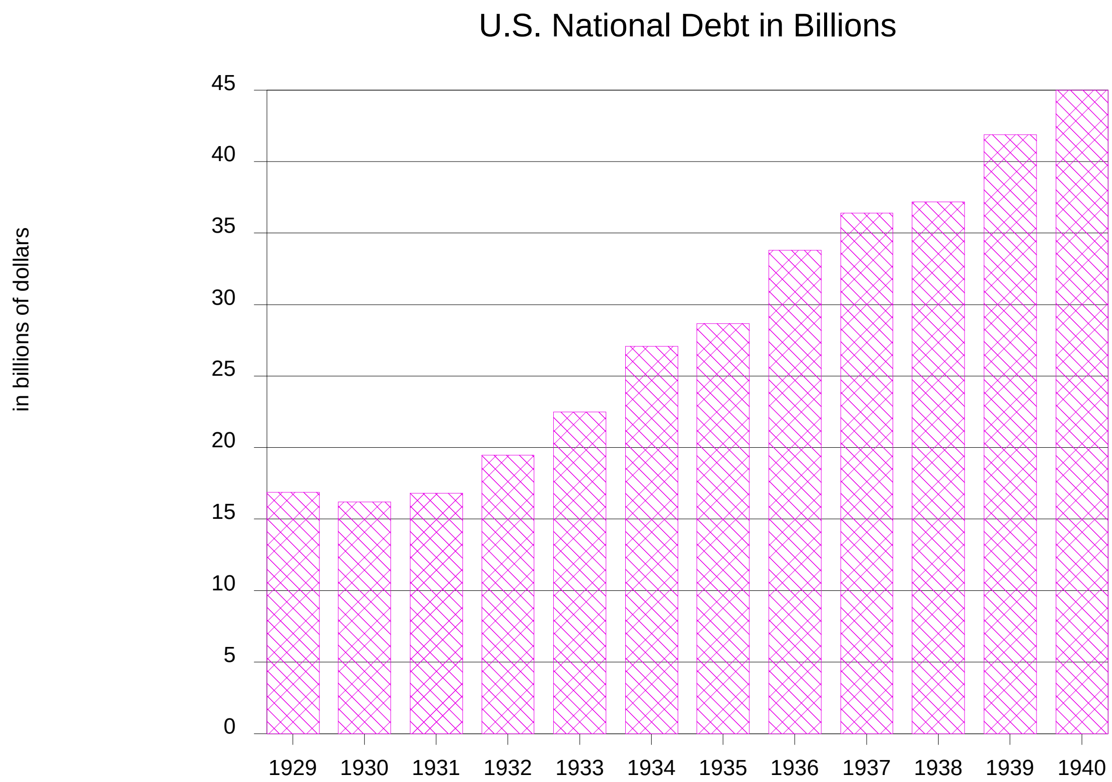
vesting Corp. in which 20 Manhattan banks proposed to dump in $100 million. The banks announced that this was no pool to stabilize prices and then fold up quietly, slipping out of sight and out of mind. This, they claimed, would be an ongoing company which would buy bonds to make a profit.

Upon this news, many people began to feel that the market had bottomed. Indeed, Time magazine stated on June 13: "While A.S.I.C. was expected to concentrate on first-class bonds, all values rebounded last week on the psychology that at last firm bottom had been found." The venture was once again put together by J.P. Morgan & Co., and Mr. Lamont took up the position of President while George Whitney assumed the role of Chairman.

In Europe, concerns of the deficit in the United States sparked heavy withdrawals of gold on the part of Europe. Within the first ten days in June, $152 million in gold bullion had been withdrawn. Europe scrambled for gold even though most of her nations had abandoned the gold standard.

On June 6, 1932, President Hoover signed into law the new Revenue Act which increased income taxes and corporation taxes along with a variety of excise taxes. The market responded favorably, believing that higher taxes would wipe out the deficit.

On June 10, 1932, cotton fell sharply to five cents a pound. This made the headlines as it broke the previous record low of 5 5/16 cents which had been established on the cash markets back on November 12, 1898. The very next day, the July cotton on the futures exchange fell to 4.91 cents, breaking its previous record low on futures established on November 4, 1898 at 4.94 cents.



On June 14, 1932, France withdrew her last gold which was held on deposit at the New York Federal Reserve. France was seemingly discontent to leave even a fraction of a gram on U.S. soil.

But the market began to turn lower as on June 15, the House passed the Patman Bill which called for the immediate cash payment of the Soldier's Bonus. This coupled with a large U.S. Treasury offering of $750 million in securities, dampened the spirits and hopes for a balanced budget.

On June 16 in Switzerland, a group of seven nations met and finally agreed at Lauzanne to reduce the German reparations payments from $64 billion to a more realistic figure of $712 million.

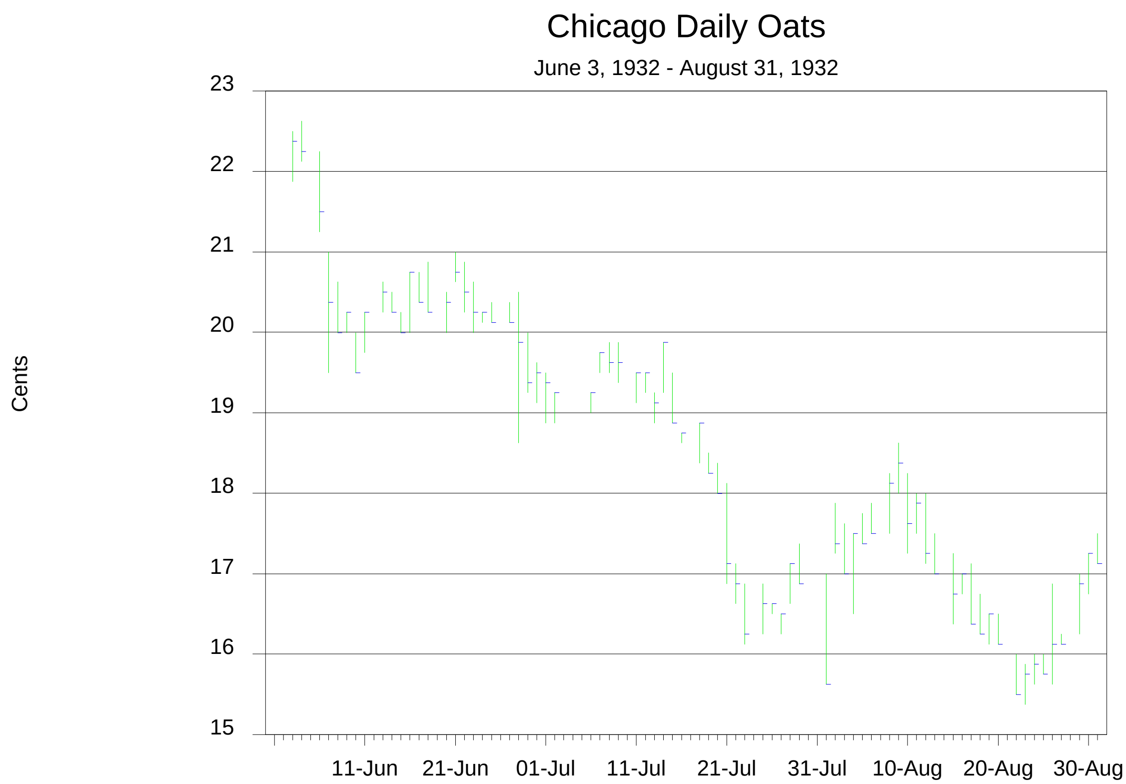
But on June 17, 1932, the Soldier's issue came to a vote in the Senate. The Senate voted against the bill and it died on the floor that day.

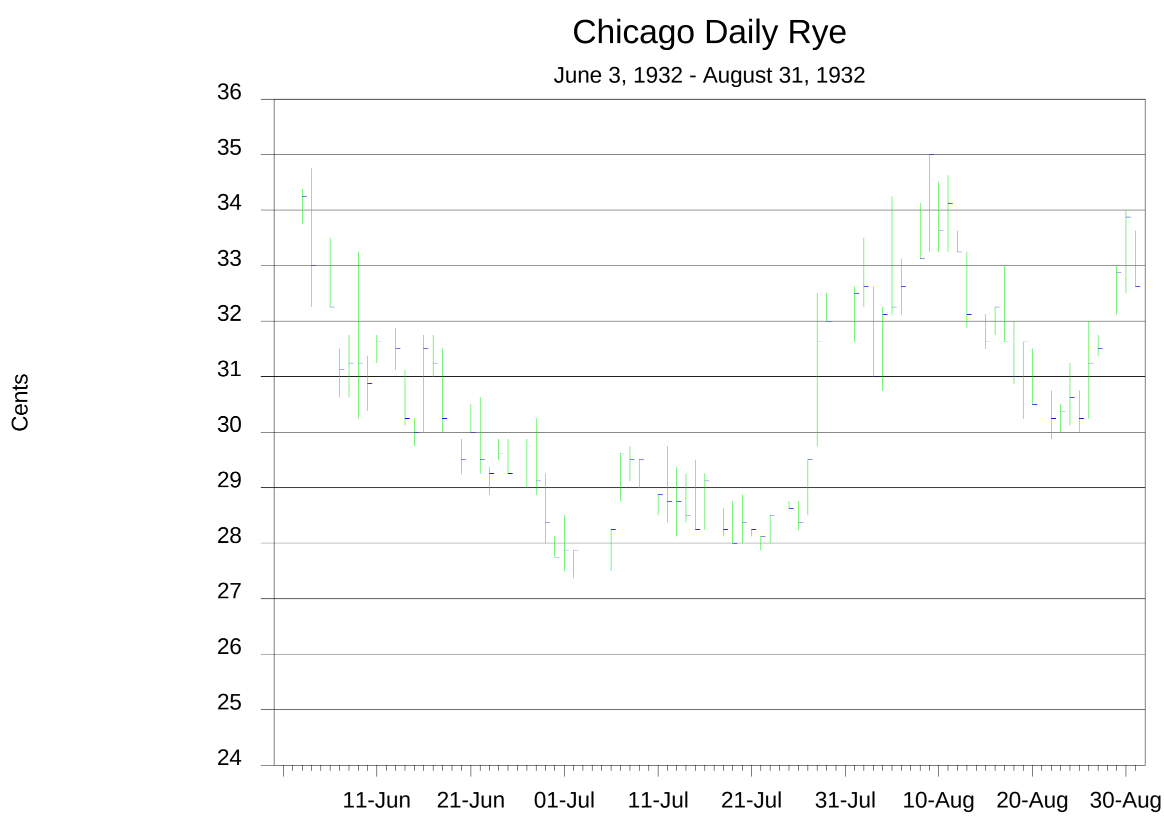
On June 22, 1932, Hoover proposed a general disarmament conference to be held in Geneva. Hoover called for a one-third reduction in all land, sea and air forces. He hoped that this measure would help not only to reduce the potential for further war but to reduce the arms race in Europe.

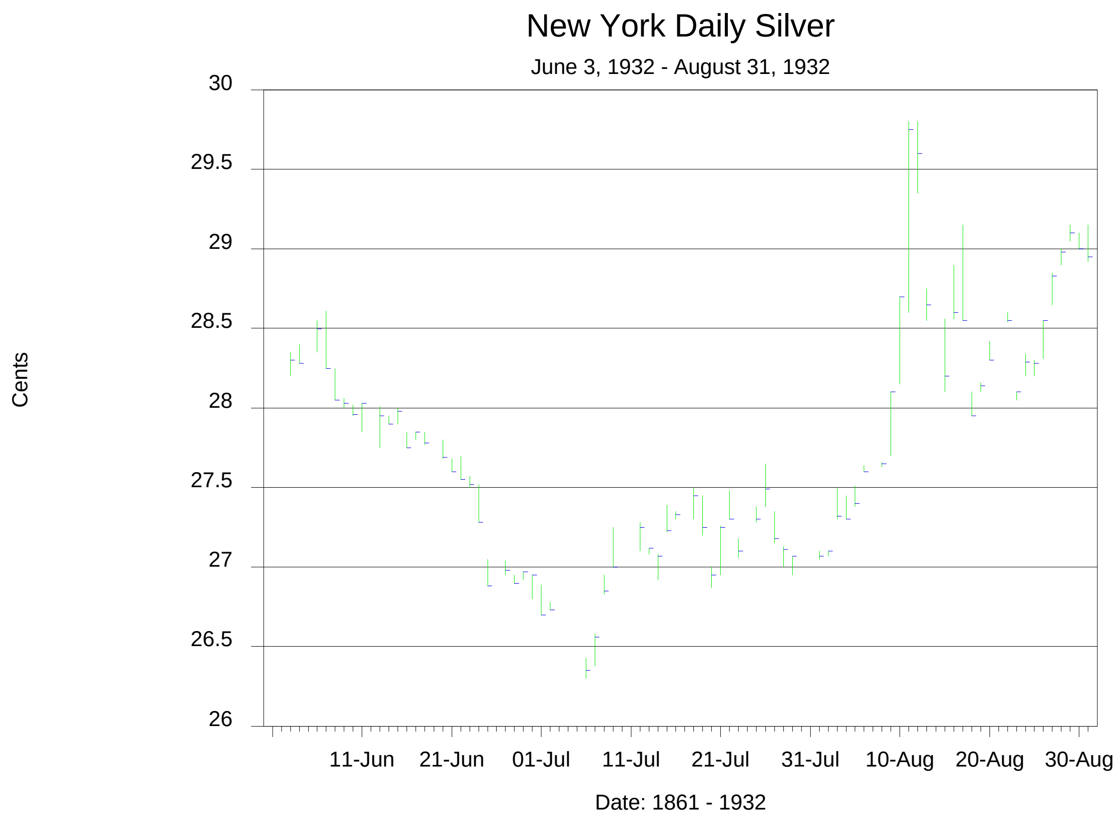
On June 24, 1932, the Federal Reserve lowered the discount rate from 3% to 2.5%. But the market barely even noticed as stocks continued their decline into July.

On June 28, 1932, rubber fell and made its final low for the depression and the bear market. It tested the 2.53 cent level.

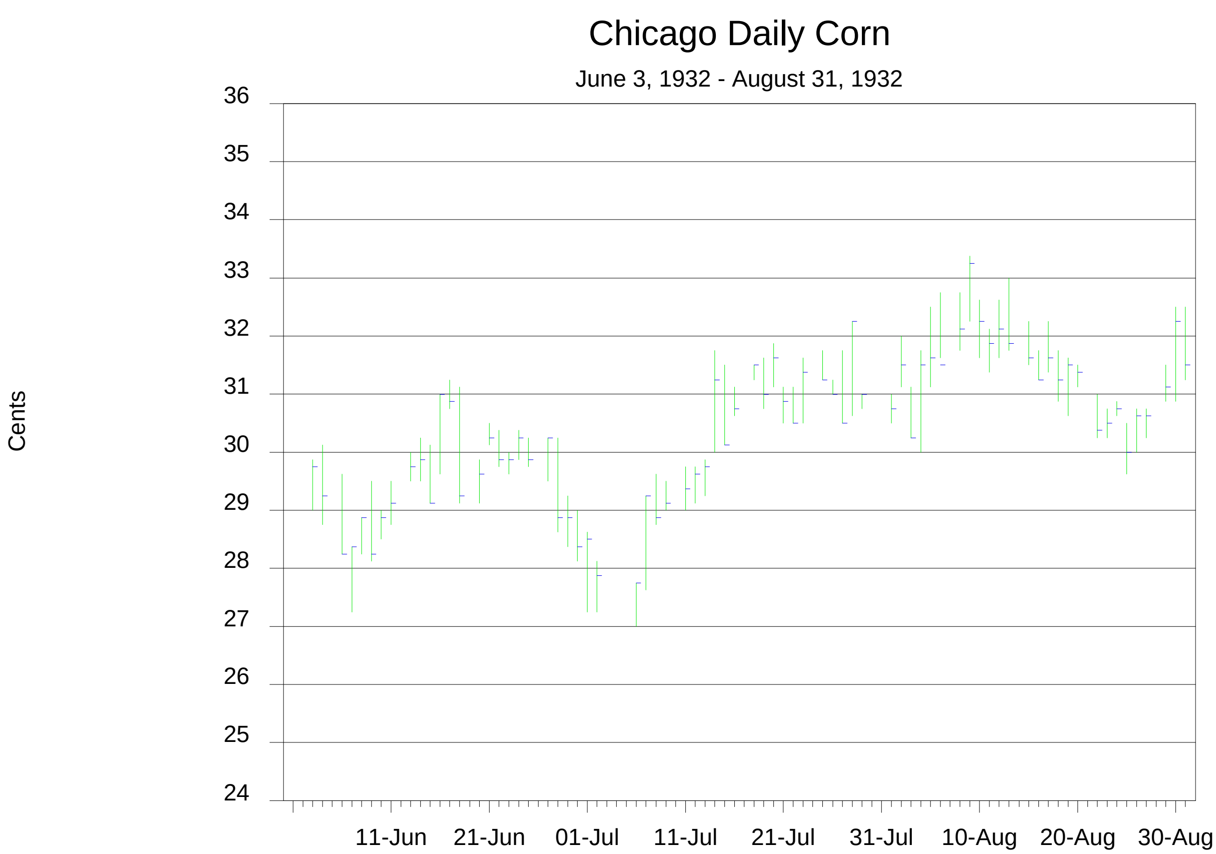
On June 30, 1932, the Bank of England cut its discount rate from 2.5% to 2% which


Chicago Daily Oats
June 3, 1932 - August 31, 1932
Cents
23
22
21
20
19
18
17
16
15
11-Jun
21-Jun
01-Jul
11-Jul
21-Jul
31-Jul
10-Aug
20-Aug
30-Aug

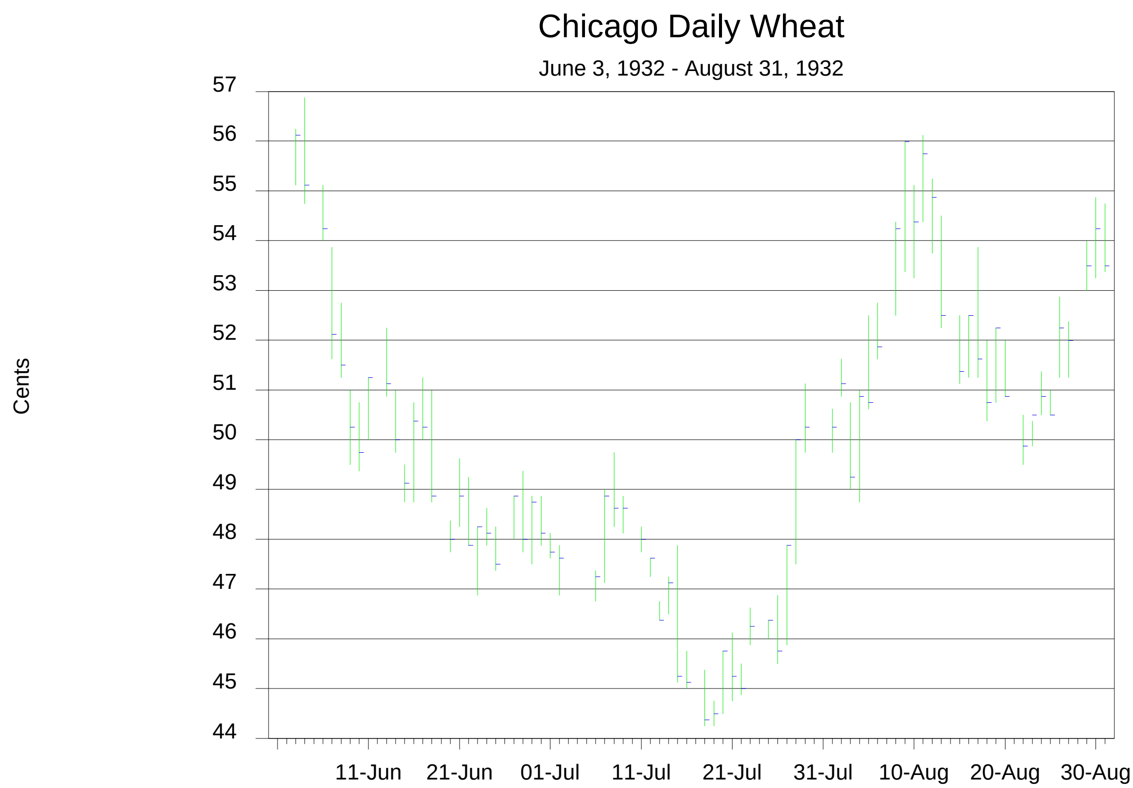

Chicago Daily Rye
June 3, 1932 - August 31, 1932
Cents
36
35
34
33
32
31
30
29
28
27
26
25
24
11-Jun
21-Jun
01-Jul
11-Jul
21-Jul
31-Jul
10-Aug
20-Aug
30-Aug



New York Daily Silver
June 3, 1932 - August 31, 1932
Cents
30
29.5
29
28.5
28
27.5
27
26.5
26
11-Jun
21-Jun
01-Jul
11-Jul
21-Jul
31-Jul
10-Aug
20-Aug
30-Aug
Date: 1861 - 1932



Chicago Daily Corn
June 3, 1932 - August 31, 1932
Cents
36
35
34
33
32
31
30
29
28
27
26
25
24
11-Jun
21-Jun
01-Jul
11-Jul
21-Jul
31-Jul
10-Aug
20-Aug
30-Aug



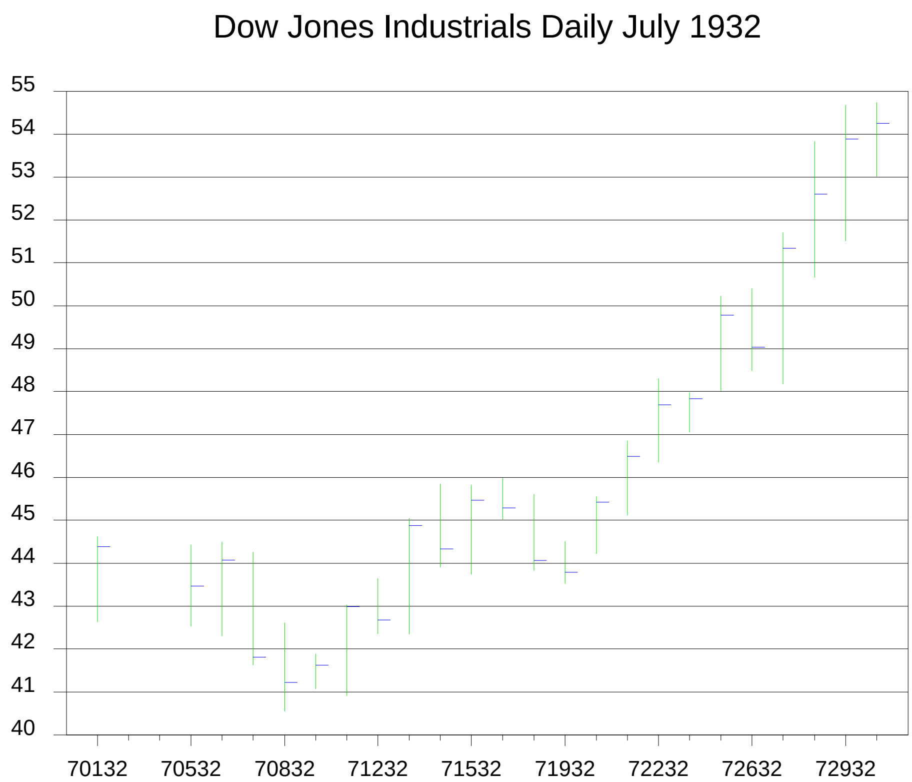
was the lowest rate of interest in Britain since 1897.

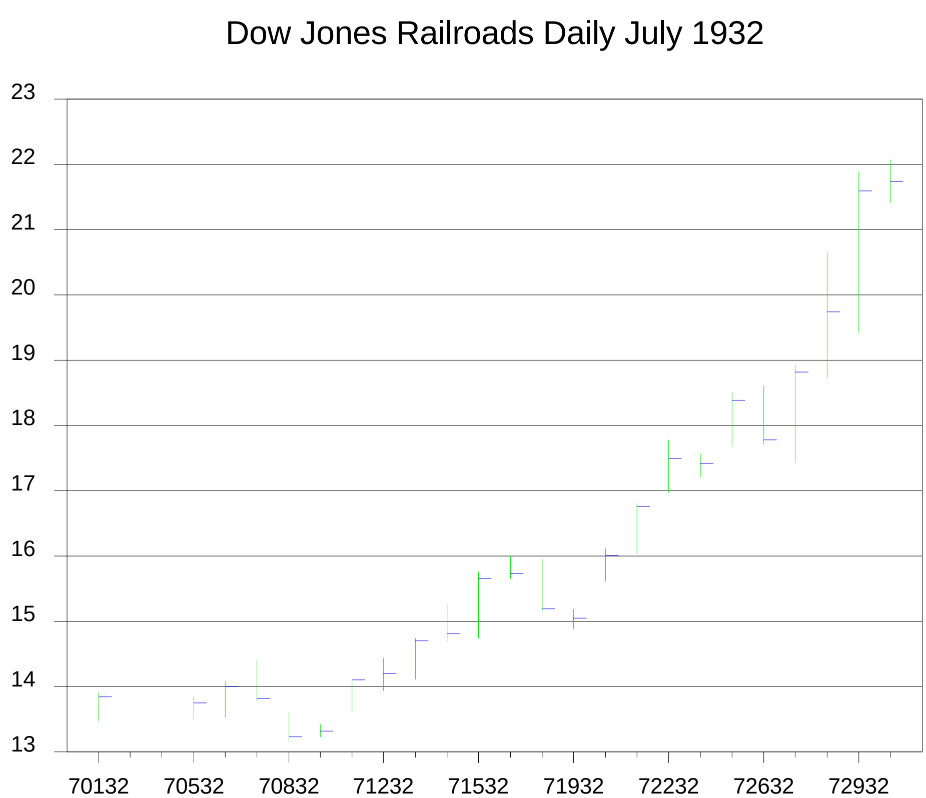
As July entered, bringing with it the third quarter, tagging along was the final low for this devastating bear market. At last it had arrived, disguised as just any other normal day on the calendar. Would this day hold some special meaning? What had distinguished this day from another? Why July? Why now?

As July opened, the total value of stocks listed on the New York Stock Exchange had declined to their lowest point, $15.6 billion, which was a far cry from where they had once stood following Labor Day in 1929. July 1 had opened down slightly, reaching a low quite quickly at 42.64 on the Dow Jones Industrials. As the day progressed, the market managed to rally back to 44.63 closing the day near the high at 44.39. That was it. The market would close for the Fourth of July weekend. Congress had adjourned as well and everyone had the holiday to think things over.

By a strange coincidence, holidays seemed to play some sort of invisible role in providing turning points for markets. The peak in 1929 came right after a holiday and then the market abruptly turned in the opposite direction. Once again, the long three-day weekend had some sort of strange and mysterious effect. For when traders returned, it became a different game altogether.

The Fourth of July had fallen on a Monday that year, so traders had another short five-day session ahead of them. The market opened a little stronger on Tuesday and moved upward to test out the overhead resistance. That didn't take very long and the high of the day was quickly formed at 44.63. From there the market fell to 42.64,


Dow Jones Industrials Daily July 1932
55
54
53
52
51
50
49
48
47
46
45
44
43
42
41
40
70132
70532
70832
71232
71532
71932
72232
72632
72932


Dow Jones Railroads Daily July 1932
23
22
21
20
19
18
17
16
15
14
13
70132
70532
70832
71232
71532
71932
72232
72632
72932

rallying back to nearly the midpoint and closing at 42.47. Volume was not especially significant, registering at 613,000 shares for the day.

On Wednesday, July 6, the market fell to test support, dropping as low as 42.31 and matching the previous record low which had been established during June. The market bounced rather quickly from that support level and reached as high as 44.50 intra-day before closing at 44.08.

Then on Thursday, July 7, the market opened near the unchanged level and moved up trying to get through resistance but failed. The high of the day was formed at 44.26. From there the selling pressure began to build and the industrials fell to a new record low, pushing through the June support area. This time the low formed at 41.63 and the market closed at 41.81.

The feeling most traders left with that day was one of bearishness. The consensus was looking for a test of 38 or at least 40. After all, the closing was under 42 which didn't speak well for support. Nonetheless, as Friday rolled around, the market pushed lower, dropping to 40.56. It rallied back to 42.61 but fell for the close and settled at 41.22, which was even lower than the previous record low of Thursday.

It was that Friday, July 8, 1932 which had won the special attention of the market gods. That was the lowest close as well as the lowest intra-day price this bear market had dealt. Volume was not especially out of line, merely pointing a figure at 720,000 shares which had changed hands. In fact, volume on Thursday had been greater, coming in at 784,000 shares.

Some have tried to look back to find a definitive reason why the market bottomed that week. But there was not much news that was shocking. On July 2, Franklin D. Roosevelt was nominated at the Democratic National Convention, but this was no great surprise. On July 5, Hoover had authorized that another 45 million bushels of wheat and 500,000 bales of cotton be given to the American Red Cross from the Federal Farm Board. Call money dropped to 2% for the first time since October 1931 so you couldn't blame the final decline on a money squeeze. But there was nothing of major significance other than those three events that week.

On Monday, July 11, the market attempted to test the support areas once again. Indeed, many still believed that the market was going to move lower. The Dow Jones Industrials fell to 40.92 that day but then suddenly, they rallied back to 43.03, closing at 42.99. Volume was not exceptional, registering only 597,000 shares that day. For the balance of the week, volume began to rise. Tuesday posted 700,000; Wednesday, 980,000; Thursday, 999,000; Friday, 807,000; and Saturday, an impressive 350,000 shares changed hands. The market essentially had traded between 42.35, reaching 45.98 on Saturday and closing near the high that day.

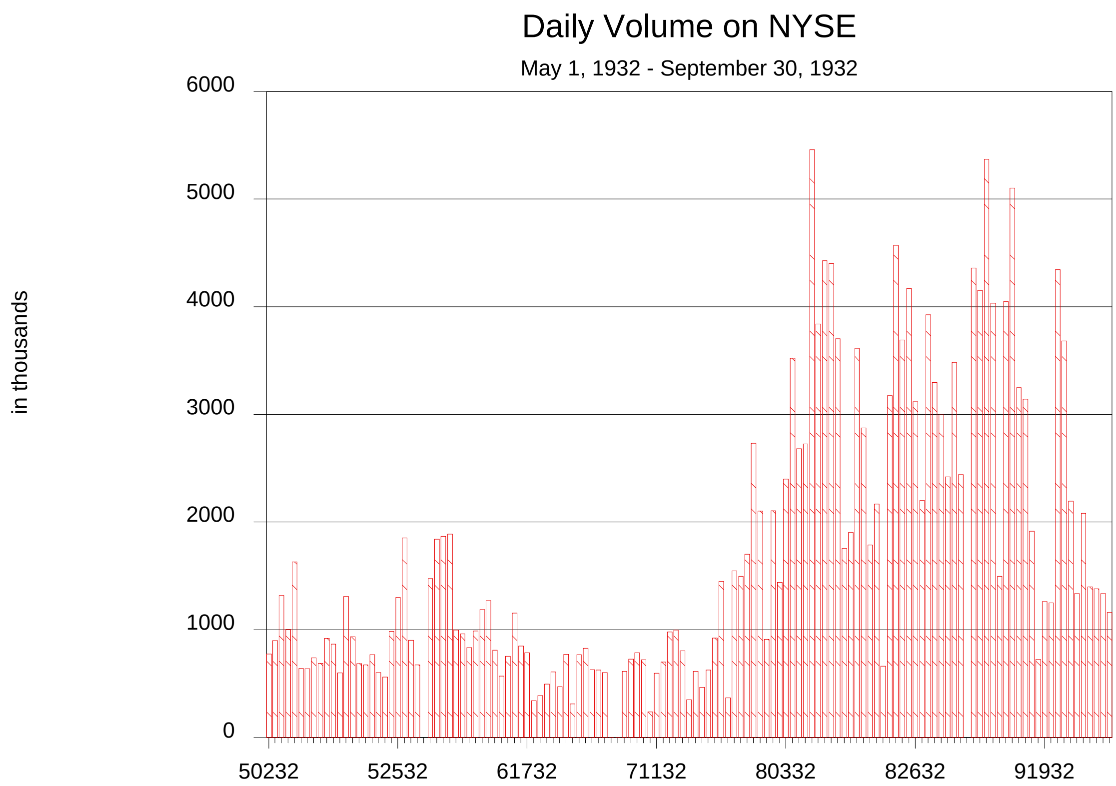
The following week of July 18, volume continued to increase with Friday posting 1.4 million shares. Volume hadn't exceeded the million mark on a daily basis for five weeks. The low for the week was 43.53 and the high came on Friday at 48.31. On a percentage basis, 8 points from the low was nearly a 20% rally.

The rally was being attributed to various things depending upon which newspaper you read. Some talked of noticeable foreign buying, others focused upon Hoover's signing of the $2.1 billion unemployment and farm relief bill of July 21. Some remarked that commodities were improving. Coffee was rising over an embargo against Brazil and talk of revolution in that country, but lead dropped to its final low at 2.65 cents on July 18. Still others pointed to the interstate Commerce Commission's approval for the merger of four eastern railroad companies. Still others talked of the Federal Home Loan Bank Bill, which created the system for guaranteeing mortgages signed by Hoover on July 22.

Perhaps one could make a case for each of those fundamentals. However, Hoover had instituted many programs and right from the beginning he took aggressive action to raise public spending. The truth of the matter is that the market began to turn largely upon a psychological explanation. Enough was enough!

During July of 1932, the most daring Communist insurrection took place in Washington. Some 11,000 veterans marched on Washington, demanding immediate cash payment of the soldier's bonus instead of spreading it out over several years. The mob was further enraged by several Democratic Congressmen who addressed the mob criticizing Hoover's opposition. The mob turned violent yet Hoover, unaware that it was actually Communist-backed, maintained his patience until late September when troops were called out. This was certainly bearish news at the time, yet it had little effect upon the market.

As the final week in July opened, the market gapped higher. The low of the day was quickly posted at 48.01 for all to see. The market continued to rally, reaching 50.23 and closing at 49.78 with volume of 1.5 million shares. Volume continued to increase steadily. On Tuesday, it reached

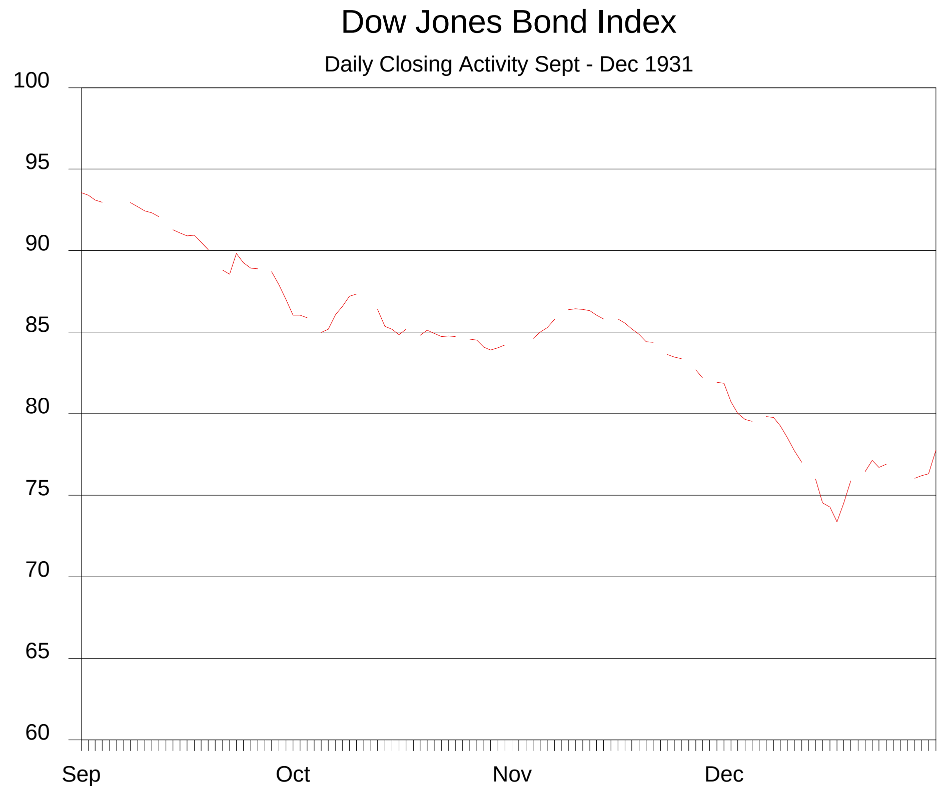


1.5 million; Wednesday, 1.7 million; Thursday, 2.7 million; and Friday, 2.1 million shares. There had not been a 2 million share day since March of 1932 and as far as back-to-back 2 million share days, well that hadn't been seen since February when the market was charging off to form the highs of the year.

July had posted so little volume during the beginning of the month that total volume was merely 23 million shares, a bare fraction more than June. But as the market continued to soar, volume intensified. August posted 82.6 million shares, the highest monthly volume since 1930. September turned a respectable volume of 67.3 million, but going into the elections, volume dropped off again and by January 1933, it had declined to record lows of 18.7 million shares which would be the lowest point on volume for the entire Great Depression. But to give you a hint of how nervous the market remained, in May 1933, volume jumped to 104.2 million shares.

August had opened perhaps only 1 point from what would become the low for the entire month. From there the rally continued. The Dow Jones Industrials reached a high of 77.01 on August 29 and closed the month at 73.16. The rails, which had also bottomed on July 8 at 13.16, had rallied up to 37.94, far outpacing the industrials largely on the approval of the railroad merger. The bonds, however, had actually bottomed on June 1, one month in advance of the common shares. From the June low of 65.78, the bonds reached their peak in August at 83.26.

The headlines during August as the market soared were not necessarily filled with buoyant, bullish news. On August 3, the Secretary of the Treasury resigned. On the 8th, the big news was the market reaching



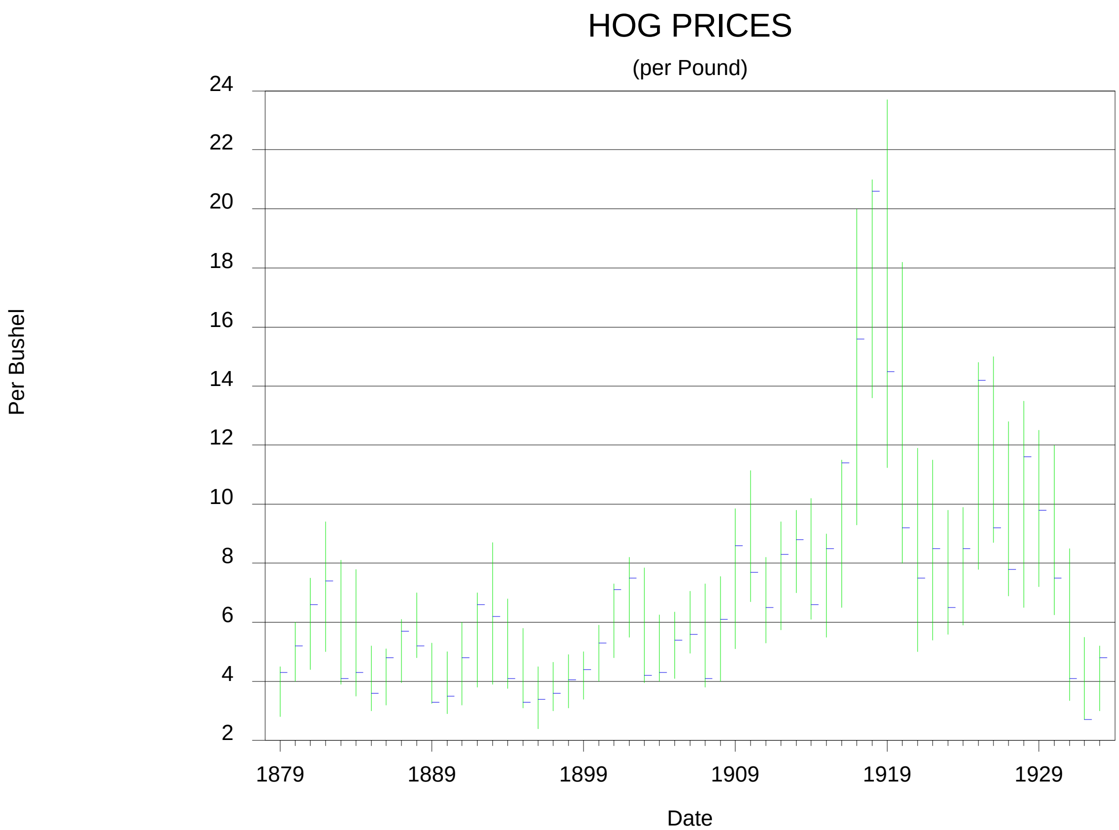
Source: Dow Jones

5.5 million shares in volume, the "largest since October 1930!" On August 16, the National Farmers' Holiday Association in Des Moines adopted a resolution to hold all farm products until prices rose above production costs. This was seen as bullish for the agricultural commodities so the stock jockeys joined in and claimed it was bullish for equities. On August 23, the papers turned their attention to the bond market since it tested 83.26 on the Dow Jones Index. But as usual, when it makes the front page the trend is over and that was the precise high for the balance of the year.

On August 23, tire shipments in June registered the highest on record, up 86.1% over June 1931. But the bearish note was that unusually large orders came flowing in due to the anticipation of the new excise taxes which were about to be imposed.

Steel ingot production was reported to have declined even further, nothing bullish there. Cotton soared and reached its high for the year at 9.2 cents on August 27. Banker's acceptances had declined by $400 million, reaching their lowest point for the depression in August at $681.4 million outstanding. In general, the gossip was the main market mover that month. That told tales of anticipated trade revival.

As the summer was approaching its end, Labor Day had arrived on September 5. The industrials exceeded the August high, reaching 79.22 on September 3 just as the market was preparing for the holiday. Then sure enough, when the market reopened on Tuesday, September 6, the industrials reached their peak at 80.36 and began a decline into the end of the month, falling back to 65.06 on a closing basis. The rails had continued into Thursday, September 8, reaching 40.85 and then falling back to



29.71. The bonds had peaked on Tuesday, August 23, well in advance of Labor Day.

The Fourth of July-Labor Day rally had sparked a lot of confidence that summer. Many people believed that the worst was over and it was back to happy-days-are-here- again. But from the Labor Day highs, the market fell rather sharply. The Wall Street Journal commented in its review of the month as follows: "In September the stock market showed reactionary tendencies which commenced around the eighth of the month and continued during the rest of the period with several breaks. A variety of reasons was responsible for this movement. The upward swing which commenced in July had been carried too high and there was the necessity of establishing a balance; then too prices of cotton and wheat again turned downward which lessened confidence considerably and finally the expected trade revival did not materialize. Political considerations likewise proved a disturbing element. In Maine the Democrats succeeded in gaining the Governorship and several Congressional seats which was construed to mean a Democratic victory in the fall."

Curiously enough, much apparently still rested upon the relationship between commodities and stocks. The fact that the commodities had never risen to new highs after the peak in 1919-20 did not prevent the stock market from scoring substantial new highs in 1929. But you will recall that in the pre-1928 years we found that the disbelievers of the bull market and the economic boom had based a large part of their bearishness upon the fact that commodities had remained depressed. Many analysts had seriously doubted a bull market could unfold unless commodities participated. Here at the bottom in 1932 we find commodities serving as a crutch for the stock market once again. The fact that the commodities by and large declined between 1920 and 1932 while stocks rallied into 1929 before falling to new lows for this century did little to change the traditional perspective of commodities and stocks moving in harmony.

From the Labor Day highs of 1932, the industrials continued to decline gradually, reaching their lowest point in February 1933 just prior to the closing of the exchange due to the Banking Crisis. But from that low, the market never looked back at the 50 level again. It continued a broad yet choppy rally which eventually saw the 100 level again before the end of 1933. The rally would continue into 1937.

What caused the abrupt rally which doubled the market between the July low and the Labor Day high? The Wall Street Journal attributed the rally to a cessation of gold exports, rumors of foreign buying, a general rise in commodity prices and the approval of the railroad merger. The New York Times basically stated that the obvious answer to the rally was that the market was severely oversold and added to this was a general rise in commodity prices.

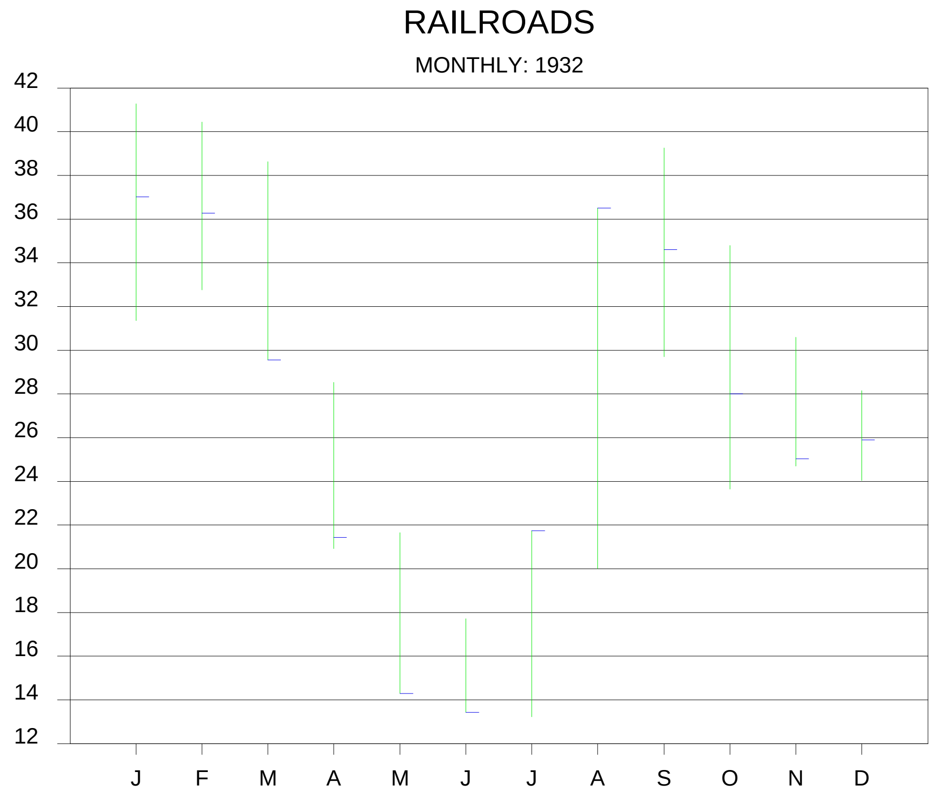
Perhaps in part some of the first stocks to rise were the "wet" stocks as Wall Street called them. In July, they began to rally as repeal of prohibition was bantered about. Wall Street had searched for companies that would benefit the most, and the list included Owen-Illinois Glass Co., National Distillers Products, American Commercial Alcohol, Crown Cork & Seal, and Park & Tilford. The "wet" stocks were the leaders getting the edge on the others by one week. Perhaps that was what Wall Street was waiting for all the time, a good old fashioned legal beer.

In the June 27 edition of Time magazine, a statement made by General Charles G. Dawes, the President of the Reconstruction Finance Corporation was quoted. The statement given in Chicago read: "I believe that we have reached the turning point in the Depression...It is the smaller business enterprises with low overhead expenses which seem to be showing improvement. But in time the larger ones must necessarily follow...I would attribute much more importance to the increase in electric power consumption in the country during the last two weeks than to stock or bond quotations." Time appropriately went on to state..."Only factors tending to discredit this Dawesian cheer last week were his past record and the still-sagging index of business conditions. In general Dawes' record are the following utterances: 'People do not realize that conditions are gradually improving,' June 5, 1930...'It (the moratorium) is an augury of improved financial conditions,' June 20, 1931."

There is no doubt that Dawes, like 99.9% of most people, was attempting to apply logical reason to why the business conditions should turn. The problem was that if you make such statements all the time, sooner or later you're gonna be right. This was published just one week prior to the turn in the stock market.

But the old adage that when a market declines on bullish news, it must mean that it's a bear market and, conversely, when a market rallies on bearish news, it must be a bull market, has some validity.

Trying to search for decisive bullish news was difficult. In July, Colgate- Palmolive Peet Co. cut its dividend from $2.50 to $1. This news prior to July was extremely bearish. Yet it did not prevent this stock from rallying sharply into August. In late July, it



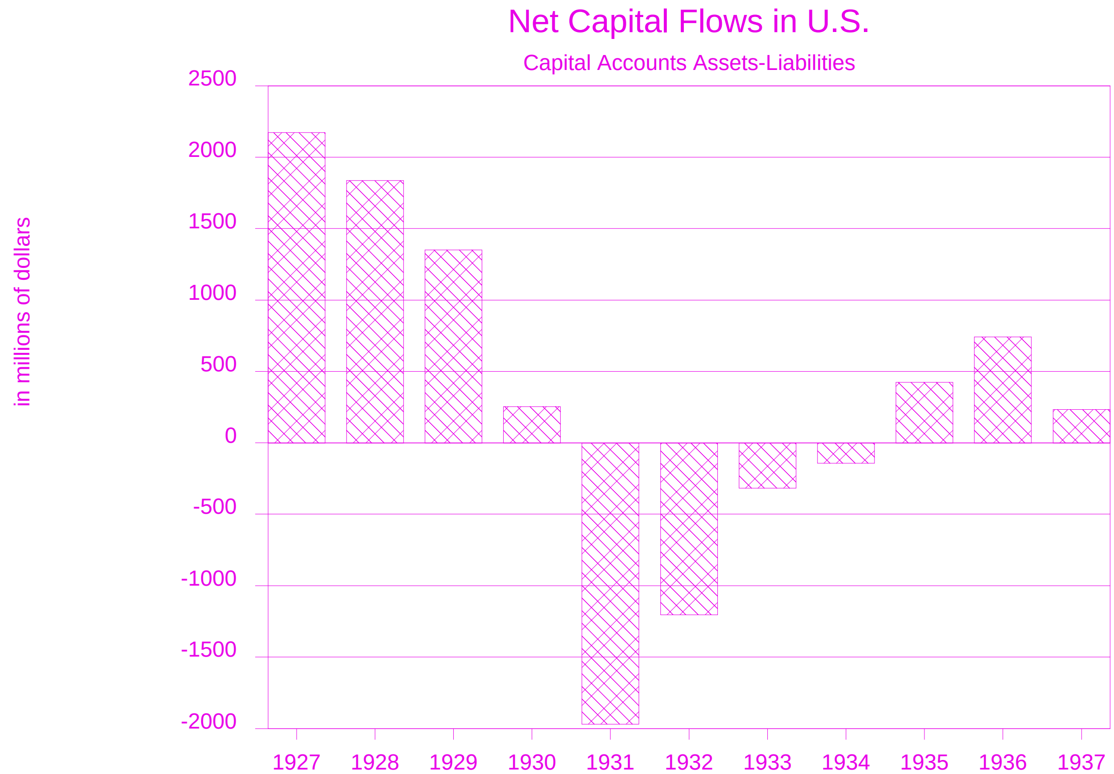
was reported that steel capacity utilization had fallen to 12%. Clearly a decisive bearish piece of evidence.

In the July 25, 1932 edition of Time magazine, it was reported that First National Bank of Boston would not have set about raising the money last week had they not expected higher interest rates in the autumn." Indeed, interest rates, using the discount rate at the Fed, had actually bottomed back in 1931. From the June low on the discount rate, the trend was clearly and decisively higher. The stock market had bottomed with the secondary low in interest rates which had taken place during 1932. Oddly enough, as rates moved higher so did the stock market. One could not make a case for the market bottoming because rates had risen. The opposite was in fact the case.

Throughout July and August the Kreuger/Swedish Match Scandal continued to dominate much of the press space. The list of casualties continued to widen as the debts he left behind after his suicide continued to mount reaching $225 million. Banks were chasing banks and everyone was scrambling for claims where several parties had been promised the same collateral. Even banks in New York were involved, yet this bearish news did not affect the rally.

In the August 8, 1932 edition of Time magazine the following commentary graced its business page which for so long had lacked much news about the market itself. The article reported:

"People who believe that pessimism has been the chief drag against business felt better last week. The mercury in the sensitive thermometer of sentiment went shooting up. Warmest of rays was a sensational



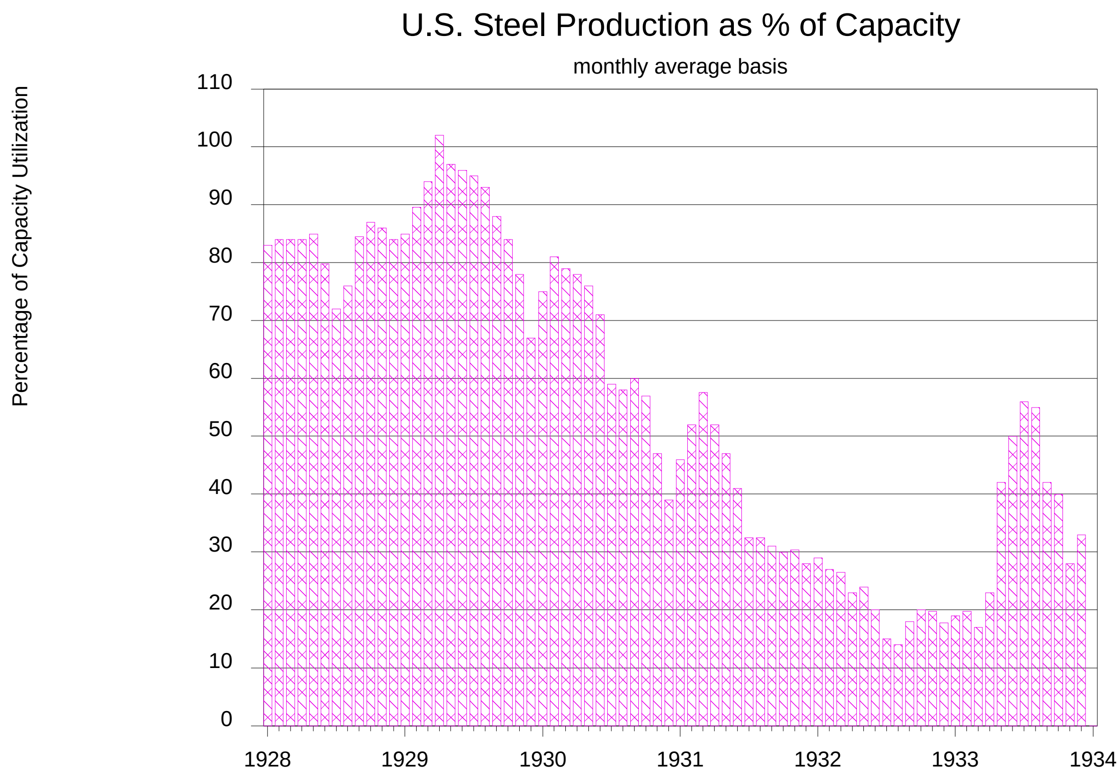
rally in stock prices. What had started three weeks prior as a slow creeping advance suddenly became a running leaping market. In percentages, even the famed Moratorium market with its 28.9% gain in 25 days was outdistanced. Railroad shares jumped a whopping 58%, utilities 38%, industrials 37% in 22 days, putting on millions of dollars of weight, much goodwill. Brokers bellowed with joy at the windfall of a 2.8 million share day.

"Observers were inclined to think the rally started through belated recognition of the following fundamentally bullish items:
1) the Lausanne Agreement.
2) the cessation of gold withdrawals and foreign buying of U.S. securities.
3) the ICC merger decision.
4) expansion of credit."

Time magazine went on to tout the rise in commodities. In keeping with the rest of the consensus, Time surmised that a rise in commodities would help many companies and in turn firm up earnings. The rally in commodities was the single biggest jump in across the board commodities since 1925.

The commodity market did literally soar. Sugar, metals, cocoa had all rebounded back to early year levels. Wheat jumped up 4 cents. Although some commodities had made periodic sharp rallies such as wheat over the Japanese war scare, this was the first broad-based commodities rally. But the nagging question remained. If the stock market rallied because the commodities took off, then what made the commodities rally? Stocks?

The truth of the matter is this. Although commodities rallied quite sharply due to various rumors involving Russia, wheat fell to its lowest historic point following the elections in November. At the same time



call money reached an historic low of 1%, and time loans (60 days) went as low as 1/2% compared to 3.5% in November 1931. Therefore, the market observers may have attributed the rally to the commodities, but the commodities eventually fell to new lows in November. The stock market held the July lows and never violated the 50 area again. The argument that stocks rallied because commodities had finally turned isn't logical since when commodities fell to new lows, stocks supported.

In the August 15, 1932 edition of Time magazine, the following comment upon the rally in the stock market appeared:

"Cornered bears, fat with three year's profits, fought madly to cover their short positions. Badly squeezed, they howled loud and long. Once the rally was well under way their frantic buying helped pool managers to push stocks up and up. Outstanding leader of the advance was American Telephone and Telegraph which soared from $70.25 a share to $114.25. U.S. Steel more than doubled its Depression low of $21.25; many stocks tripled in value. Large orders from European money centers swelled the volume of U.S. buying and the dollar rose smartly."

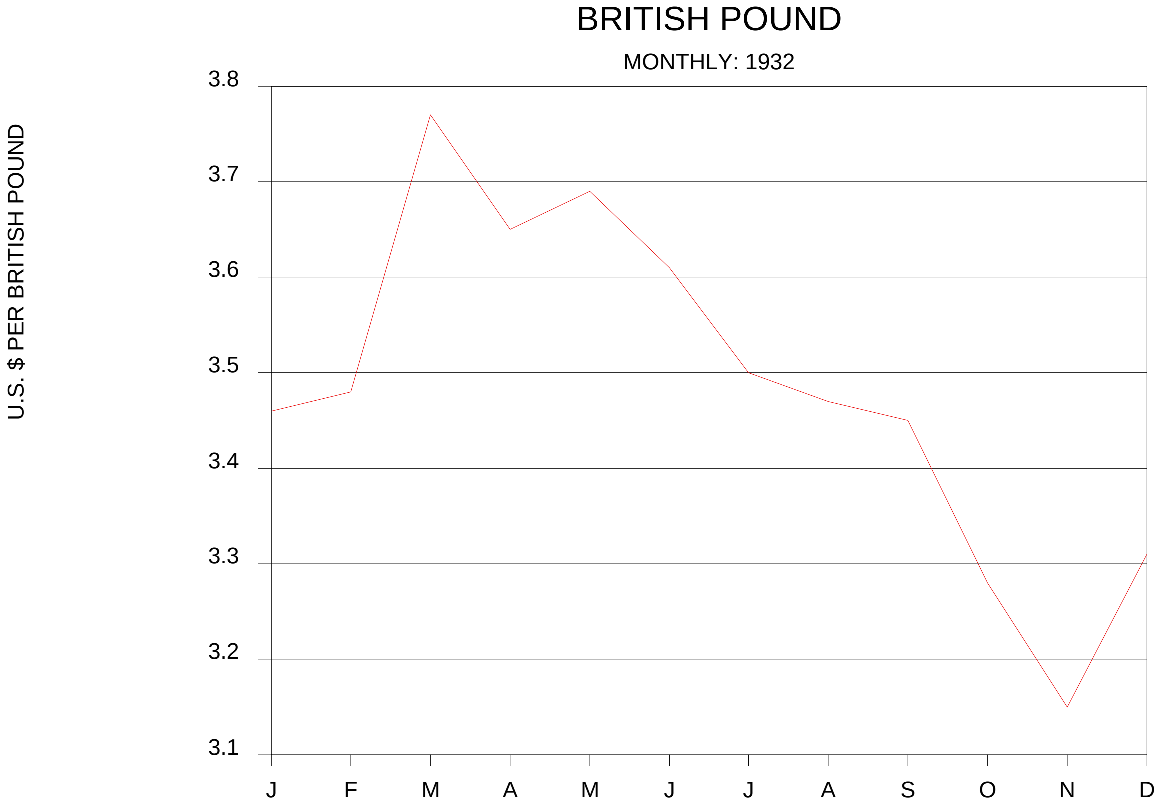
Here we find another reference to large European orders flooding the market and the dollar rising. Short covering was certainly noted, but keep in mind that with the witch hunt still going on and the publication of who was short, the actual short interest had declined significantly. Most of the buying seemed to be real and flowed from Europe into the States, pushing the dollar higher as foreign currencies were being converted into dollars to facilitate U.S. investment.

Note that Time magazine reported on the sharp advance U.S. Steel had made. Here is a comment on U.S. Steel published by Time magazine on the 8th of August. It read as follows:

"While newshawks who had been waiting about an hour held a mock directors meeting, irreverent and bawdy, the solemn directors of United States Steel Corp. pondered the worst quarterly earnings statements in the company's history. They finally decided to vote the regular preferred dividend, but in explaining the action to the press, Chairman Myron C. Taylor made it abundantly clear that 'improvement in business and net earnings must in future determine dividend action on the preferred stock.' Because a very similar statement had presaged omission of the common dividend, because steel operations last week were but 16.5% of capacity whereas they must be 35% to 40% to earn the preferred dividend, Wall Street assumed that when the Board meets October 25, two weeks before Election Day, the preferred dividend will be passed for the first time in the company's history."

Here we have definitive news, which had fueled the bear market into its July low. News of dividends being cut or omitted was what the bears fed on for a long time. Yet why would U.S. Steel be one of the leaders in the rally when in the very midst of it, Wall Street anticipated that U.S. Steel would eliminate its preferred dividend in October? Again we find that the prior analysis which had been bearish seems to have been ignored during the rally.

In Time magazine, the following report on the market contains some interesting commentary on the rally as well. Publication date was August 22, 1932.

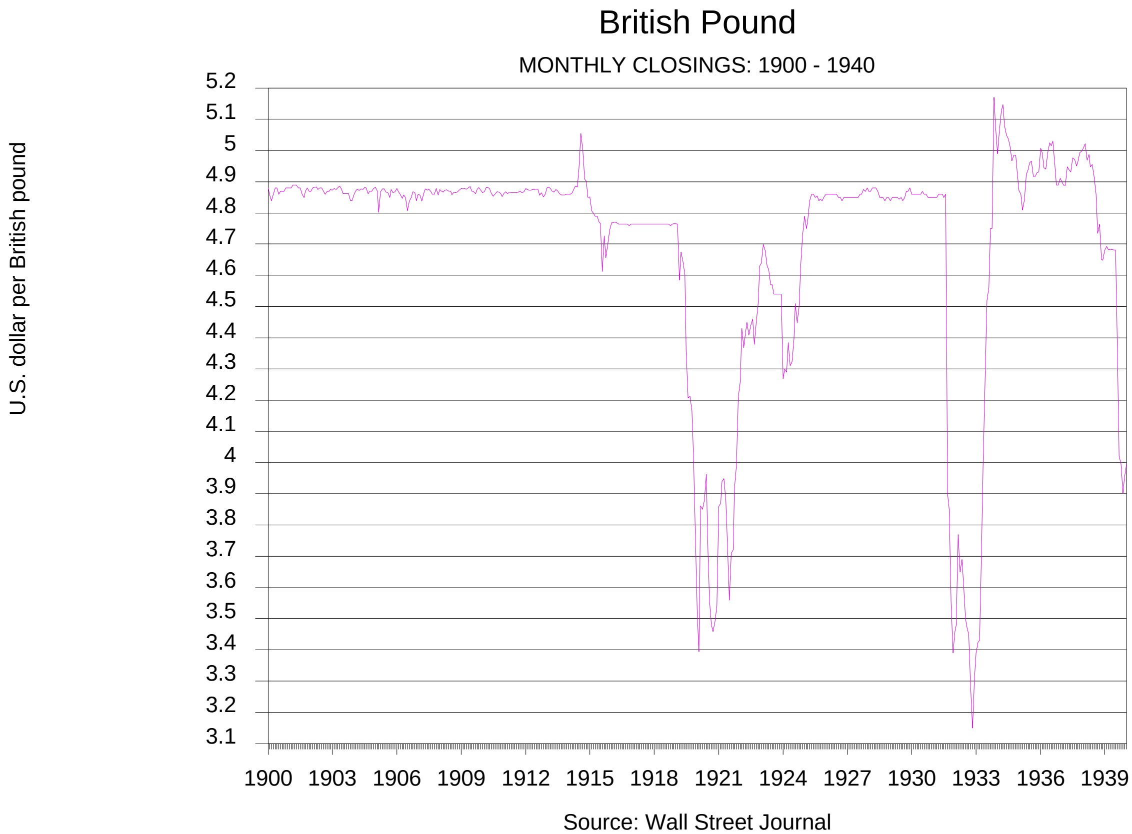


"The great pot of the New York Stock Exchange continued to boil hotly most of last week, but in the last two days the fire of bullish enthusiasm cooled, stock prices lost more than one-fourth of their month long rise. Speculators for the advance amazed at their swift-gotten gains, suddenly rushed to cash in. At the rally's peak, railroad shares stood 127% above their bear market lows, utilities 83%, industrials 74%. Stocks as a whole had climbed up the opposite side of the valley to a point abreast their prices last April. Market observers who had been wagging warning fingers at the almost perpendicular ascent of the last fortnight, smiled knowingly. Having predicted a sharp technical reaction, they were not surprised that it was all the sharper for being so long delayed."

The first portion of this commentary states that many observers were calling for a reaction. Of course that is always the case after such a rally. But the 25% correction from the August high was just that. The sentiment seemed to suggest that the market had peaked and it would not continue in its correction. But to the surprise of all, the market rallied and outdid the high mentioned in this report. Nonetheless, the commentary that followed is quite interesting. Time went on to report:

"Among the first to start the harvest were shrewd foreign buyers who were reported to have entered the market at its very trough. Volume of trading swelled to 23,595,000 shares for the week, largest in more than two years. Entering this week both stock and commodity markets steadied with trading at a reduced pace.

"In the last days of the wild uprush, rumors of pools flew thick and fast. Farm equipment shares were bulled vigorously on the reports (all denied) that Russia was about



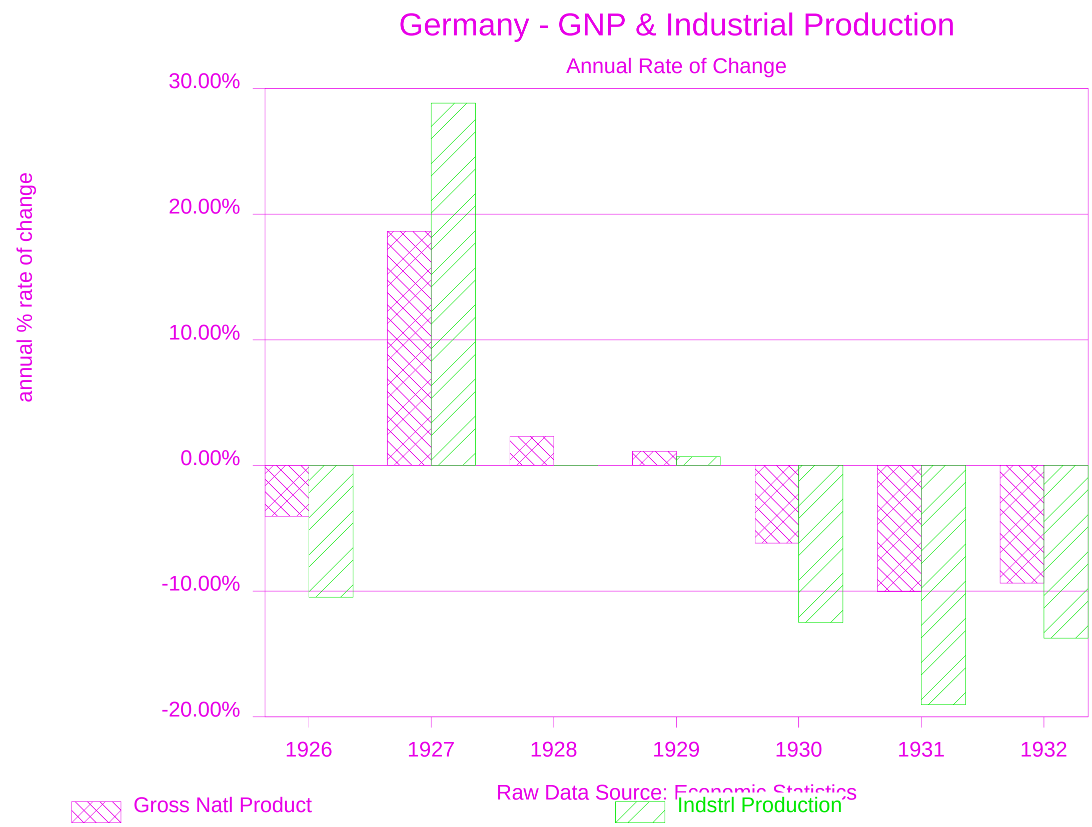
to float a bond issue in the U.S., would presumably use the funds to purchase farm machinery. From the June low of $16.75, J.I. Case shares (plows, harvesters) were whirled up to $62.50. In the two-day reaction they slumped to $46. If the Russian bond story was pool inspired, pool managers must have been amazed to see the old Russian Imperial issue, which has long slumbered on the Curb at less than 1 cent on the dollar, suddenly aroused and run up to 3.25 cents on the dollar."

In London, the noted publication entitled the Economist, carried this comment on the American situation in August:

"It would be rash to predict that America is within sight of general economic recovery, for the forces bearing down are almost as ineluctable as those which... forced her to the peak of prosperity. Nevertheless, there is reason to think the Giant of the West has passed the crisis in his sickness."

The American press had also commented on reports from brokers who noted increased "foreign buying." Did overseas buying contribute to the turn in the market? If so, why were European investors moved to suddenly buy U.S. equities once again? To solve these riddles, we must look at the foreign perspective and the influence of foreign exchange at that time.

The European situation was still greatly varied from one nation to another. The contrast was perhaps most noted between Britain and Germany. In Britain, contrary to wide belief, it had been the National Government which chose to abandon the gold standard back in 1931 and not the Labour Government. Despite the warnings that everything would collapse, Britain had finally made a smart move. The whole-



sale price index of the Economist initially rose 4 points following the devaluation, but from its peak in October 1931, it declined rather steadily into June of 1932 where it had reached its low for the depression and began to rise in July. Britain had not put up trade barriers to agricultural products and as a result it benefited greatly from imports in that sector, which had continued to decline in price.

The pound itself initially dropped, closing at $3.90 in September of 1931. From there it steadily declined against the dollar, reaching on initial low at $3.46 in January 1932. The dollar sharply declined into March coinciding with the stock market break, and the pound rose to $3.77. The pound began to decline steadily from that March high and by July it had fallen to $3.50. Buying from Britain was sparked largely due to the declining wholesale prices and fear that the pound would drift much lower. Therefore, European buying of U.S. securities which was reported from many sources in July, was largely driven by a hedge against a fear of further devaluation of the European currencies. They were correct in that respect because the pound declined into November, dropping to $3.15.

The general consensus of opinion in Britain was largely propelled by the abandoning of the gold standard and propaganda by the Labour Party that Britain would be headed toward another Great Depression as was experienced during 1922. The opinion of the dollar changed dramatically when the Democratic victory came in November.

Much of the 1932 Presidential campaign had centered around the gold standard and the tendency of Roosevelt toward a dollar devaluation. Even though he had at first supported this idea, he changed his opinion going into the election. The Europeans were sure that Hoover would win and that the American people would see through Roosevelt's continual vacillation on issues from one speech to the next. His attack of the tariffs was merely another example. When farmers became enraged, he changed his position to state that he would not lift the tariffs against agricultural products. Perhaps it takes a party outside the situation to make a less biased analysis of the situation.

Nonetheless, the Europeans began to sell the dollar dramatically when Roosevelt won the election. November 1932 was the lowest point for the pound at $3.15. Within one year, by November 1933, the pound had risen to $5.17, a completely new record high, out of fear of Roosevelt's policies.

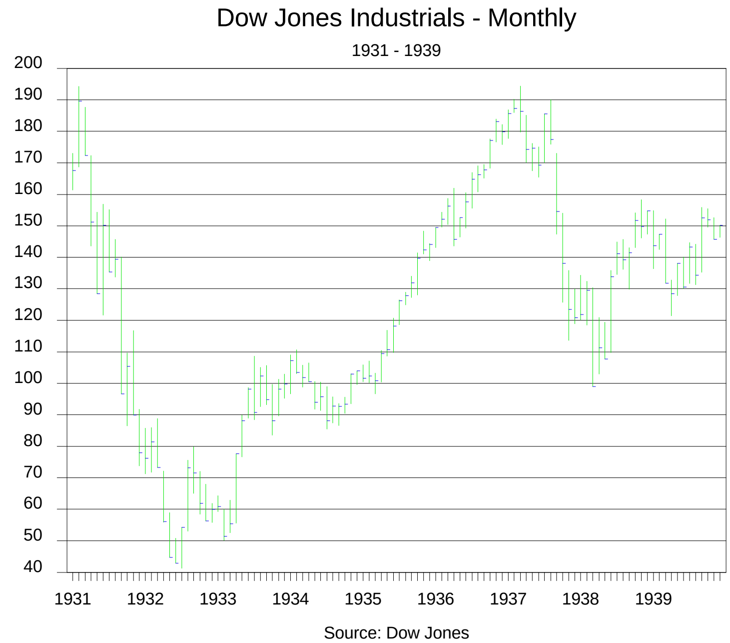
In respect to the foreign buying of U.S. securities in July 1932, it was clear that the sentiments in Britain at the time were bearish on the pound and the consensus of opinion was still looking much lower. For that reason, many astute Europeans were buying the dollar-based investments. This coupled with the general press, which seemed to express the opinion that the U.S. economy was turning around, helped make those U.S. common shares look attractive.

The situation in Germany was notably different. The policies of Bruning had forced upon Germany a severe deflation, which by the fall of 1932 had cut the standard of living by nearly 50%. Bruning had maintained high protective tariffs upon food imports largely at the request of the Prussian landowners. As a result, wheat was costing the German consumer twice as much as in the United States. Although Bruning had been driven from office, Communistic and Hitlerist groups were gaining much popularity. These serious deflationary policies led to Hitler's victory in 1932. Again, capital's motive was toward U.S. investment largely for political concerns.

If we refer back to the Wall Street Journal's comment of September 1932 that the decline from the Labor Day high was in part created by the Democratic prospects of a victory in November, then we should consider the effects of the campaign upon the market. The general consensus in Europe, as I stated earlier, leaned toward a Republican victory in the fall. Much of the financial community was also in favor of the Hoover ticket. The popular vote, however, swung in favor of the Democrats without real understanding of its implications.

Roosevelt had conducted a campaign based opon many outright lies and continually tried to assert that the blame for the entire world depression belonged to Hoover. In several addresses he misrepresented the situation and claimed that the depression had begun with Hoover and spread to Europe from his administration. Of course this was completely false because it had been clearly established that the depression had begun in Europe long before it emerged in the States. The entire central bank conspiracy, which Adolf Miller and Hoover tried to prevent in 1925, was evidence of that fact. This turned many bankers and leaders in the financial districts against Roosevelt. Nonetheless, the uninformed public at large knew little of the international circumstances.

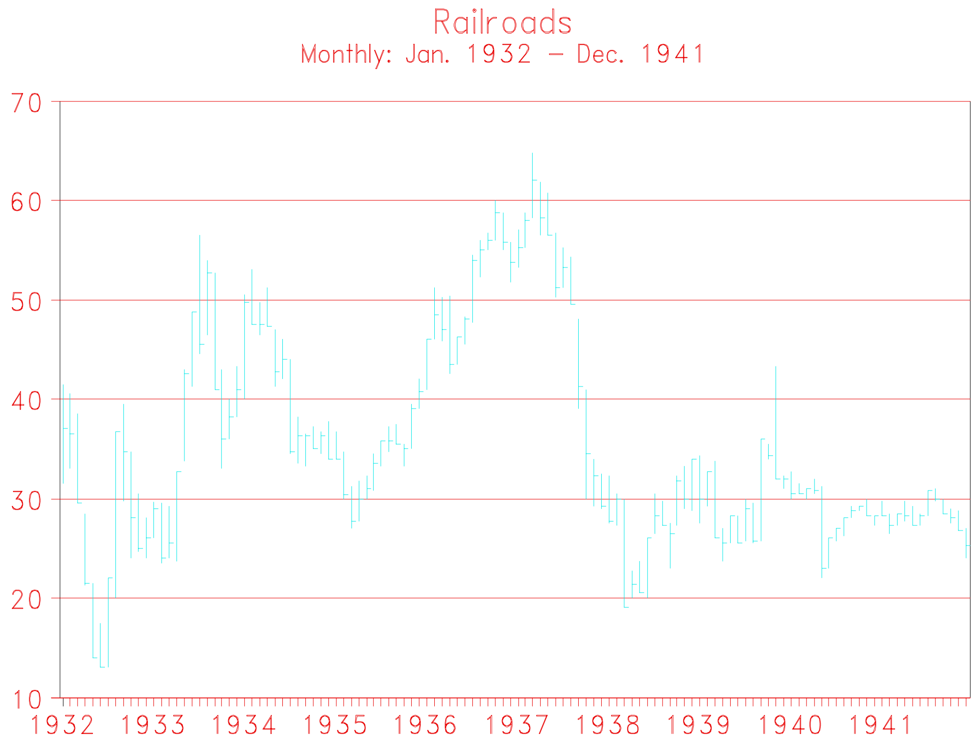
Click here for PEI's Homepage



Confusion dominated the world economy as 1933 emerged. Much of the misconceptions of the Great Depression were propagated by the campaign of 1932 and the false accusations hurled at Hoover by Roosevelt. In every political campaign the participating parties usually attack their opponents with statements that are less than true. One of the dangers to society as a whole resulting from this type of political behavior is the tendency to influence the minds of the populace to such an extent that their ideas and concepts become changed and distorted thereby endangering future economic progress.

The Presidential elections of 1932 was by far the most dramatic influential event from the political economic perspective within the entire post 1929 era. The blame for the Depression as placed upon the shoulders of Hoover changed and shaped the public perspective of the political system from then on. The Republicans were marked as the party for the rich and the Democrats emerged clad in shining armour as the defender of the poor and working class. It was in fact many of the Democratic statements during this period which strengthened the communistic movement within the United States. I should point out that the Democrats were not outright supporting communism, but their political attacks on the Republican party as supporting the rich who had speculated forcing the entire world into depression with the collapse in the stock market made lovely ammunition for the communist as well.

In the decades that followed, the infrastructure of the political economy within the United States grew ever more closer to the socialistic ideals which characterized the "New Deal" as building society from the bottom up rather than from the top down. Spending programs began to drift toward social programs and the very direction of the political economy of the United States had been changed from a small less obtrusive form of government to a highly involved government structure. This was in many ways accompanied by shifting the blame for the Depression on the Republican party and the wealthy class within the American society. Despite the fact that this



was wrong, the populace bought the idea and was eager to pin the blame on someone.

It was therefore this misguided blame for the Great Depression upon the stock market and the Republican party which actually altered the decades that followed. The thinking process which once drove the stock market higher or lower began to alter and transform into a distinctly different method of fundamental analysis. The intentional misdirection of the causes of the Great Depression would serve as the basis for the very same errors and problems which would return following World War II. Competitive devaluations, trade wars, antitrust actions, all emerged with an uncanny sense of deja vu. Without honestly assessing the blame for the Depression on international problems of trade and fiscal irresponsibility, those very same errors would be made once again.

The accusations which Hoover had made against Roosevelt in regard to his position on the gold standard were perhaps dismissed by the Democratic party prior to the elections, but following them Hoover's warnings had become crystal clear reality. The massive population within the United States was largely uninformed of the true causes of the Depression. They did not grasp the idea or concepts which were at stake during the elections. As a result, ironically it was the poor and the middle class who were now about to suffer the lion's share of the hardships dealt by the worst banking crisis in all modern history. Its causes would stem from the very concepts of money and the gold standard itself. The general population did not understand the full impact of what would be termed "currency inflation" but by the end of 1933 there would be few Americans who did not understand the role that gold would play in this new economic tragedy.

The most serious problems resulting from Roosevelt's statements began to arise over his position on currency. He had made several vague statements in reference to a "managed currency" but distinctly omitted the word "gold." On the eve before the elections, pressure from many sectors de-

manded that Roosevelt clarify his position. He did. He pledged that he would not abandon the gold standard and inferred that concerns in that respect were not warranted.

Upon winning the election, his secret policies immediately began to emerge, casting devastating doubt upon the future, and rumors began to spread like wildfire that a devaluation was in the wind. The Democratic party had long been a symbol of "soft money." The 1890s were long remembered as the period of the "Silver Democrats" with William Jennings Bryan's famous speech of "Thou shalt not crucify mankind upon a cross of gold." When Hoover charged Roosevelt with planning to abandon the gold standard during the campaign, Senator Glass, at Roosevelt's request, furiously denied the allegations.

Nevertheless, following the elections, flood of rumors began to circulate that Roosevelt was planning a devaluation. These rumors became so widespread that on January 2, 1933, a distinguished group of over 30 economists issued a public statement in which they said "the gold standard of present weight and fineness should be unflinchingly maintained. Agitation and experiments would impair confidence and retard recovery!"

On January 4, 1933, Senators Wheeler, Thomas and Connally all made statements in the Senate in favour of a devaluation on that same day in the House, Garner pushed a resolution through in which he called for the publication of names of all financial institutions that had borrowed from the Reconstruction Finance Corporation. Several Democrats, including Green, joined the Republicans in protesting this action. Hoover pleaded against publishing the list for he feared that a panic would result.

As Hoover feared, the public began to assume that if a bank had borrowed from the RFC it must be in trouble. By the end of January 1933, 62 banks on the list were forced to close their doors, resulting in $70 million in losses. On February 18, Senator Robinson introduced a bill to stop publication, but the measure was defeated. Robinson pleaded personally with Roosevelt but he insisted that "everything should be public." The casualties continued and by the end of February, $200 million was lost through banks which had been forced to close. Curiously enough, Roosevelt blocked all efforts to stop the publication of RFC loans but immediately put a halt to this practice when he assumed office.

Meanwhile, the rumors of devaluation were creating a panic in foreign exchange and a flight from the dollar domestically as well. Many ran to the bank withdrawing gold coin. It appears that Roosevelt was following the advice of George F. Warren, a professor at Cornell University who contended that a devaluation would artificially create a great boom similar to the inflationaryperiods of the Spanish Conquest and the huge gold and silver discoveries in the U.S. and Australia between 1849-1860. The theory was that a devaluation would raise prices as well as wages naturally, a devaluation does raise the prices of goods since such items seek an international level of value among nations

Adolph Miller at the Federal Reserve claimed that Roosevelt had openly suggested the concept of devaluation to a private gathering of bankers in mid- January 1933. Europe was aware of the rumors but was still baffled by them since their view was clear, the dollar was not overvalued. Roosevelt was described in London as a man who "held no economic theory." Nevertheless, from the November low of $3.15, the pound jumped to $3.43 by February, an 11.25% gain. The smart money in the United States was buying foreign exchange which the masses were hoarding gold in ever increasing quantities in the end, those who had bought the foreign exchange profited handsomely. But those who hoarded gold found themselves subject to criminal prosecution if they did not surrender their gold holdings at the old value of $20 prior to Roosevelt's devaluation in January 1934, which fixed gold at $35 per ounce.

The situation was becoming intolerable. No one knew what was going on and banks were besieged by both those who were fleeing from the dollar as well as from the fear of insolvency caused by the publication of the RFC loans. On January 23, the New York Times urged Roosevelt to make a statement to confirm the pledge he made the night before his election not to abandon the gold standard. The New York Times wrote:

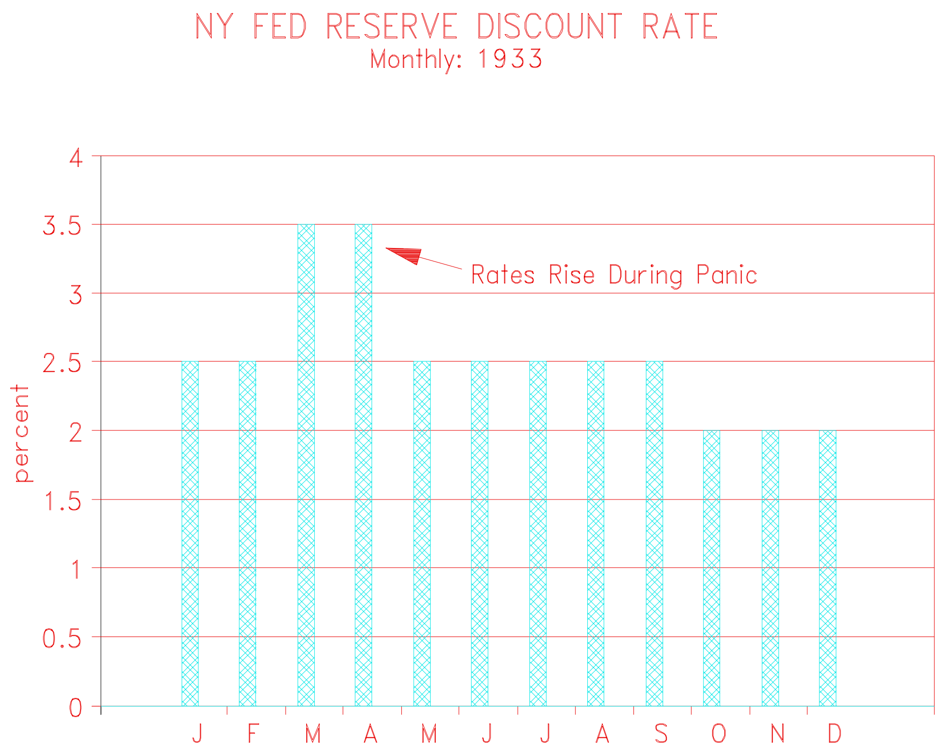
"It is probable enough that the present spirit of hesitancy, not only in financial mar-

kets but in general trade, is more or less influenced by lack of such reassurance...in numerous older similar occasions doubt and mistrust prevailed with exceedingly bad effect on financial sentiment, until the President-elect took matters into his own hands and publicly avowed his purposes. This was notably true in the pre-inauguration period of 1885 and 1893, at both of which junctures the maintenance of gold payments was being discussed uneasily and at both of which Mr. Cleveland stated so positively and so courageously his own views of the general problem as to remove at once all apprehension."

On January 30, 1933 Senator Thomas told the Senate:

"I am in favor of cheapening the buying power of the American dollar if this can be done; to the extent that the dollar is cheapened, to the same extent will commodity prices be increased."

The rumors were further intensified by Henry Wallace, an announced member of



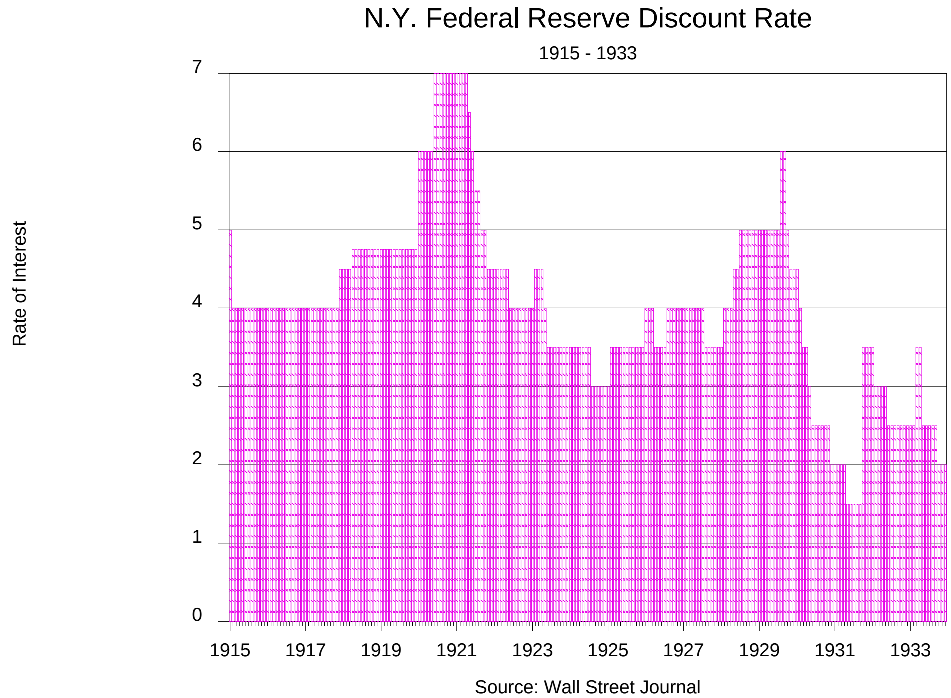
Roosevelt's forthcoming cabinet, who said: "The smart thing would be to go off the gold standard a little further than England has."

The same day, the Federal Reserve issued a statement warning of the dangers of devaluation. The press was besieged by all these comments and rumors and tried to obtain a definitive comment from Roosevelt, but failed Foreign banks began to redeem their dollars for gold, further increasing the drain upon reserves. The withdrawal of gold coin from the Treasury was approaching a crisis level. During the last 10 days in February, $80 million in gold coin had been withdrawn and during the first four days in March, $200 million had been withdrawn. The pressure upon the banks had become intolerable.

Throughout early February, many of Roosevelt's supporters, who had not known of his secret policies of devaluation prior to the election began to make public statements against him. Melvin A. Traylor, the well respected Chicago banker who had fought Benjamin Strong was originally a Roosevelt supporter. He spoke out, saying "Nothing but a declaration from Mr. Roosevelt that there will be no devaluation will save the situation from a general panic." Bernard Baruch warned the Senate committee that the situation had become the "most serious in history... If you start talking about devaluation you would not have a nickel's worth of gold in the Reserve System day after tomorrow." And on February 13, the New York Times again called upon Roosevelt to answer these wild rumors.

Roosevelt had left for a cruise and returned on the 17th of February. Hoover wrote a letter advising Roosevelt of the situation. It read as follows:

"A most critical situation has arisen in the country of which I feel it is my duty to advise you confidentially. I am therefore taking this course of writing you myself and sending it to you through the Secret Service for your hand direct as obviously its misplace-



ment would only feed the fire and increase the dangers.

"The major difficulty is the state of the public mind, for there is a steadily degenerating confidence in the future which has reached the height of general alarm. I am convinced that a very early statement by you upon two or three policies of your Administration would serve to restore confidence and cause a resumption of the march of recovery."

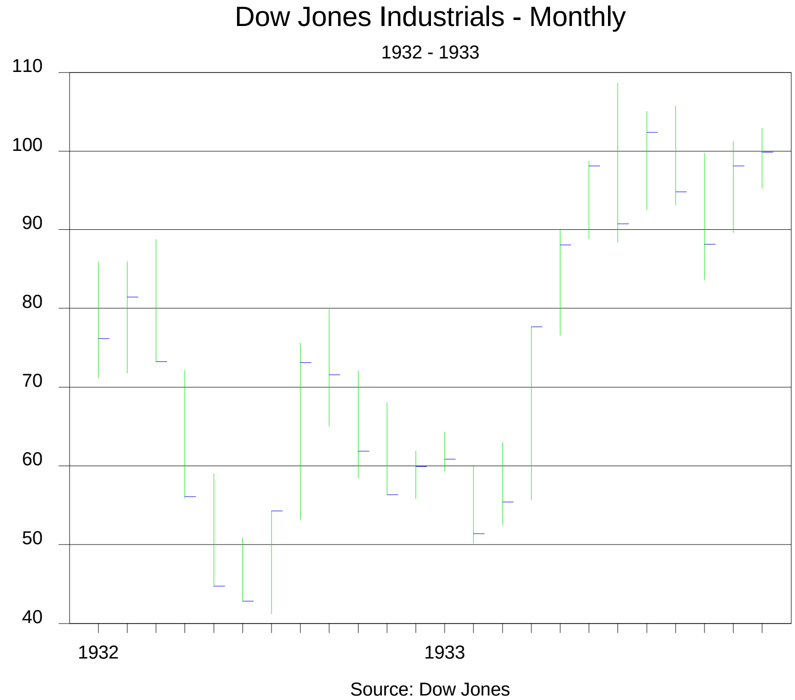
Up to this point in time, all talk was being conducted through Roosevelt's closer supporters. No word from him would deny or confirm whether or not these rumors had any basis in truth. The situation continued to degenerate on the 18th of February, Senator Glass, who publicly had accepted the post of Secretary of the Treasury under Roosevelt, announced that he had refused the post because upon meeting with Mr. Roosevelt, the President-elect would not provide the Senator with an assurance that the gold standard would be maintained. This only intensified the situation since Senator Glass had been a strong Democratic leader in the Senate and the originator of the bill that gave birth to the Federal Reserve. All the press from the New York Times on down carried the story.

The New York Times reported on the perspective from London:

"The judgment of financial circles here is that at no time in the recent economic history of America has there been greater need than at present for a flat declaration of a monetary policy by the new American government. It is believed that if the inflation bogy is definitely laid by the new Administration, the first long step toward restoring confidence will have been taken."

The perspective from Paris was also reported by the New York Times:

"The confusion of mind on Europe's markets concerning the future tendency of the dollar must be ascribed to lack of information regarding the definite intentions of the new American government. A declaration



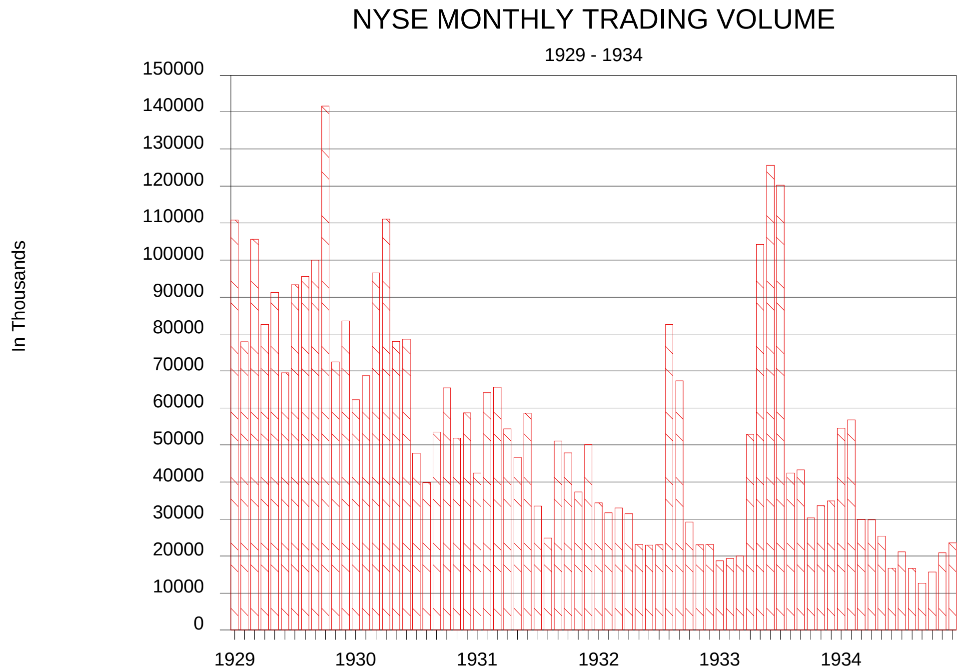
by Mr. Roosevelt declaring firm resolution to maintain a sound currency would have an extremely reassuring effect. So would a plain statement on the economic policy which he proposes to pursue."

On February 23, 1933, Roosevelt responded to President Hoover's letter, apologizing for the delay by stating that he had overlooked it. He gave no reply as to his forthcoming statement. Hoover attempted to use the War Powers Act to prevent capital from flowing out of the country, but the Democrats blocked it. He attempted to increase the loans to banks through the RFC; Senator Couzens blocked it.

The full accounts of the period from a number of sources including memoirs of various noted individuals as well as newspaper editorials all attest to the intentional political motivations of Roosevelt to allow the situation to reach a panic level so that he might reap the benefit of appearing as the hero. His actions resulted in the worst banking crisis in the history of the United States, all for his own personal political gain. The public's withdrawal of gold as well as foreign withdrawals were promoted by fear of his incoming administration. Numerous speculators with knowledge of his devaluations benefited greatly on foreign exchange speculations. For the average American who lost his savings through the unnecessary banking panic, there were no words of consolation.

Nevertheless, we have reviewed how many blamed the depression prior to July upon excessive pessimism. It is said that the stock market is often a leading indication for the future of the economy. This has been true over various intervals largely because the movement of any market is based upon future expectations. Economic expansion takes place when future expectations of business conditions look to be prosperous.

The incidents which took place between November 1932 and March 1933 were clearly an anticipation of future uncertainty and inflationary policies of a President-



elect. Indeed, much of the excessive decline in the stock market and in economic activity had a lot to do with the motions of the time. It was a depression of not merely price, but of attitudes and human emotions as well. This is what made the depression so "Great."

The stock market had peaked on the holiday cycle following Labor Day. It fell sharply reaching its lowest close following the elections in November. December hovered near the November low and then a rally developed on very low volume into early January. But as rumors spread during early January, the stock market began to fall. The flight from the dollar sparked numerous Europeans to dump their holdings, which forced the Dow Jones Industrials down from 62 to 50 moving into February 1933. Volume dropped to its lowest point in the history of the collapse during the early January rally which was perhaps a warning that February was going to drop sharply.

Of course, when Roosevelt assumed office on March 4, he declared a banking moratorium enacting the War Powers Act which he had prevented Hoover from using, claiming that the power had been taken away with the repeal of that law after World War I. The stock market and the banks remained closed. The stock market reopened on the 15th of March. The market opened higher initially near the 62 level but fell back to 56 for the end of the month. Volume increased to 23 million shares which was substantial considering it had only been open for two weeks.

In April, 1933, Time magazine reported the various consensuses of opinions as the market began to reverse to the upside.

'**HOPES.** Faith in better business conditions rested chiefly on the following ground:

Reopening of some 13,500 U.S. banks (75%) provided a broad enough credit base for commercial operations. The closing of weak banks makes that base much firmer than before.

Prospective balancing of the U.S. Budget means that the Government's credit should remain absolutely sound.

The Federal Reserve's gold holdings increased $327 million.

"Beer promises new profits not only to breweries (average brewery stocks rose nearly 50%), but to motor companies (manufacturing delivery trucks), to farmers (who grow barley and hops), to vendors of labels, bottles, bottle caps, advertising. Ownes-Illinois Glass Co. reported that orders for 62 million beer bottles had been received in the last month. Restaurants and hotels look for more profits when they can sell.

"**DOUBTS:** Businessmen looking ahead saw, however, these obstacles which must be overcome before recovery gets into full swing.

Healthy though it is to have weak banks cut out of the banking system, if 15% or 20% of the banks are liquidated it means that depositors will have to pocket losses of hundreds of millions of dollars. In liquidation, National Banks average only about 67% payment to depositors, state banks considerably less. Furthermore, while the Federal authorities appear to have been fairly rigorous in weeding out weak banks, there are no doubt cases on non-member state banks opened by local authorities who for political reasons were more lenient than they should have been.

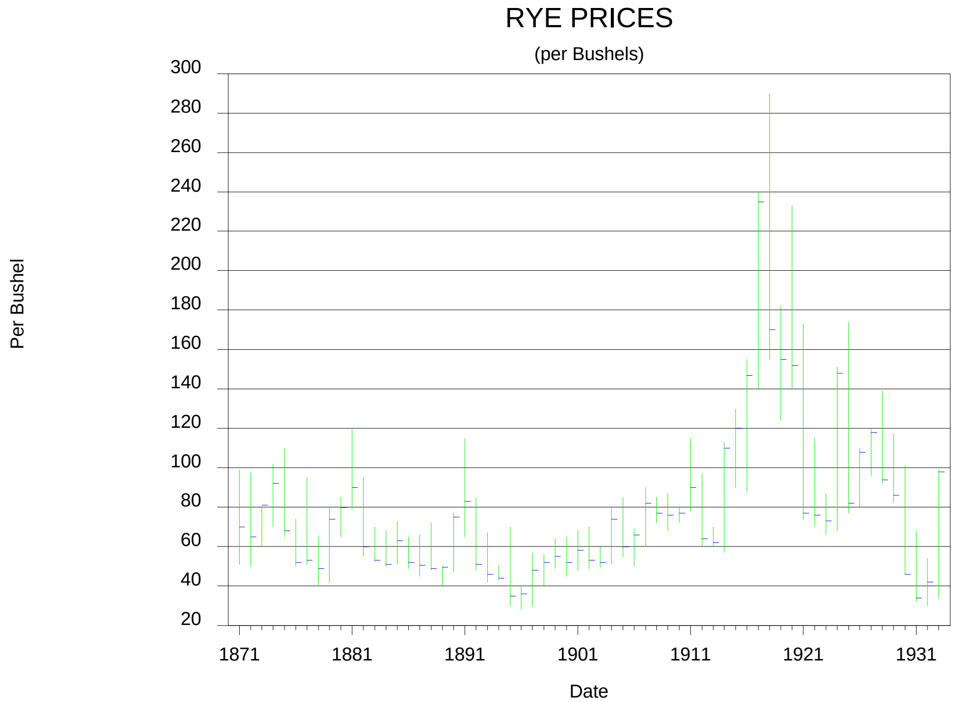
It remains to be seen whether the Administration's efforts will have any effect on restoring farm prosperity. Unless nature or government succeeds in restricting next year's crops, the farm surpluses bid fair to stay.

Many railroads must soon face reorganization.

There will have to be a readjustment of many mortgages, urban as well as rural. Last week in ever radical North Dakota, Governor Langer ordered the militia to prevent foreclosures where sheriffs disregarded his orders.

The bond and mortgage situations must be cleared up for the benefit of life insurance companies."

The stock market continued to press higher but confusion began to increase. Those who were bullish and looking for a balanced budget began to take profits on the April rally as rumors and perceptions began to change. The very fabric of analysis was under siege by forces which had not been disclosed prior to the elections. Many thought that Hoover was merely making up stories and unwarranted accusations against Roosevelt in respect to his "soft money" attitude. That was political hype, they thought; Roosevelt wouldn't conceive of an unbalanced budget. But this gave way to the reality of events and by mid-April, inflation was crowned to be the next savior of world doom. Arguments became fierce. Europeans became frightened. Many viewed that inflation in commodity prices would bring a great bull market as it had in 1907 and 1919. But this time they were getting in on the ground floor. Who cared if the budget was balanced? Corporate profits would rise and government would simply float bonds to finance the entire spectacle. Why not buy and buy more? Those who were bearish in March turned bullish in April and the confusion was leading to insanity.



Strange as it may sound, markets exploded during April on the news of inflation of all things. On the 17th of April, Time magazine reported on the situation:

"GREAT ANTICIPATIONS"

"Last week wheat had its first whirl on the Chicago Board of Trade since the excitement when that market opened after the bank holiday. Spot wheat touched 63 cents, up 5 cents for the week.

Last week corn had a whirl. Spot corn touched 35 cents (up 5 cents).

Last Week rye had a whirl. Spot rye touched 50 cents (up 6 cents).

"Last week Board of Trade seats touched $7,000 (up $2,000) and the Board of Trade began again to feel as if springtime were the only pretty ring time. Trader Thomas Howell was seen several times upon the floor contrary to his custom. Arthur Cutten was reported active. Oldtime Trader Gardner B. Van Ness was home from Manhattan. Herbert J. Blum, long inactive, was reported once more functioning. Jesse Livermore was back in Chicago with his new wife and reported bullish on corn.

"The end of depressions, the beginning of inflations are marked by rising commodity prices. Many a depressed trader began to take heart last week. Other commodities were on the mend. Sugar was up. Surpluses of sugar and wheat both reported down. Copper was up on news that U.S. mines were preparing for a six month complete shutdown.

"Stocks took their cue from commodities, mounted moderately led by such companies as American Sugar (in hope of sugar recovery). Homestake Mine (bigger profits in gold if the dollar is devalued). Corn Products (in hope of corn recovery).

"Many such boomlets had been off and on during the Depression. Traders looked for profit-taking, some of which took place. But in last week's bullishness there was more than a mere hope because prices and indices had shown a little upturn. There was the beginning of the attitude: what now if not inflation? Either inflation because commodity prices would be turned upward by natural and governmental stimuli; or inflation because the Government is committed to spending billions, must float bond issues to reopen banks, save mortgagors, provide relief and a dozen other costly enterprises. Or inflation because Government might reduce the gold content of the dollar. Or simply inflation in expectation of inflation. Inflation or inflation or inflation. What other alternative?"

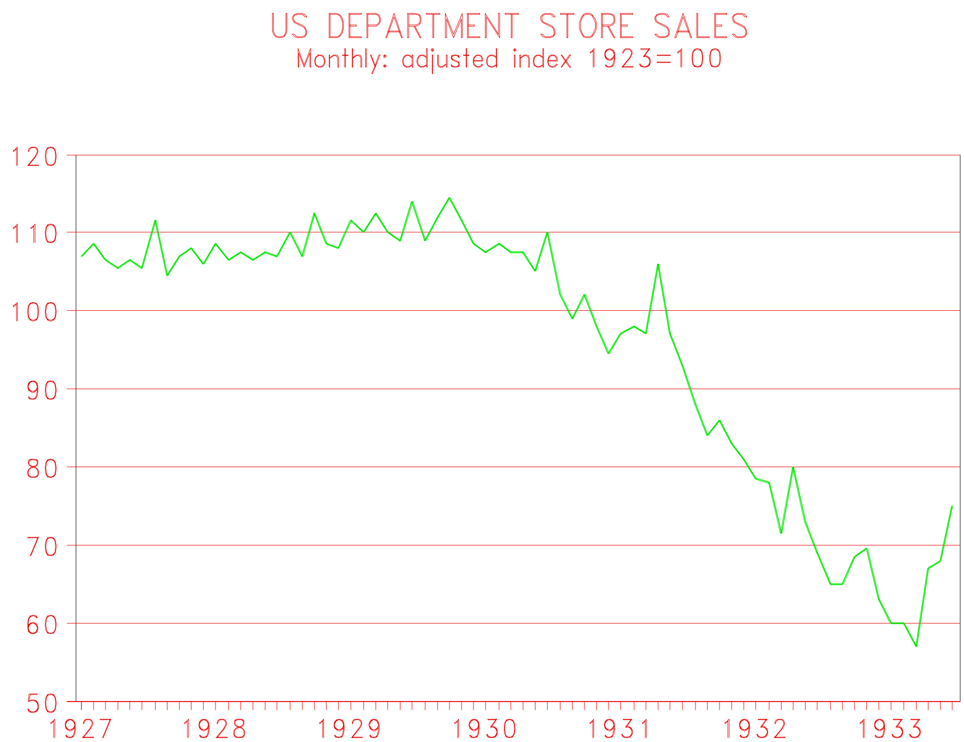
Here Time magazine reported several very important aspects as to how people viewed the situation. Today so many people hold the view that the stock market is not supposed to do well during inflationary periods. As we continue, I will show that such concepts have emerged only because of government's preoccupation with and harassment of the free market system which focused very closely upon the commodities and stock exchanges as a direct result of the Great Depression. This is no small statement; I am fully aware of that. But we will read further on how the government simply said it was against the law to trade below a previous low or sell a stock short on a down tick.

First, notice how the inflationary concept was viewed to be bullish. It was well remembered that the booms in 1907 and 1919 were inflationary periods, particularly pronounced in raw materials. Analysts realized one thing. All periods of great expansion and thus corporate profit were periods of inflation which were marked by rising interest rates as the bid for capital drove rates higher, just as stocks rose with continual bidding as demand increased. They realized that steady or recessionary to depressionary periods were not periods when stocks rose but instead declined. Such periods were marked by declining interest rates as demand for capital declined along with economic activity and thus expansion.

This is very important to understand. We today no longer look at rates of interest in this way. We have been conditioned to view interest rates in light of government harassment rather than in light of a free market from its economic prospects. Some will argue with this statement, but consider how much attention is paid to money supply and expectations of Fed actions because of such movements. we turn bullish because we expect a discount rate cut or we turn bearish because money supply rose and thus the Fed might tighten.

There is something seriously wrong here. Prior to Roosevelt, government was NOT the big brother and as a result its tentacles were less intrusive and less costly. Therefore, the private sector was the dominant sector. If interest rates rose, it was because demand within the private sector was rising. But beginning with Roosevelt, the balance between government and the private sector changed. As it changed, so did the relationship to some extent. Today we can have the private sector decline through a recession and interest rates would not drop back drastically between 6% to 1% as they did during this time frame. This is because government is a much larger part of the system since Roosevelt. This has distorted the perception as to when the market should literally explode to the upside.

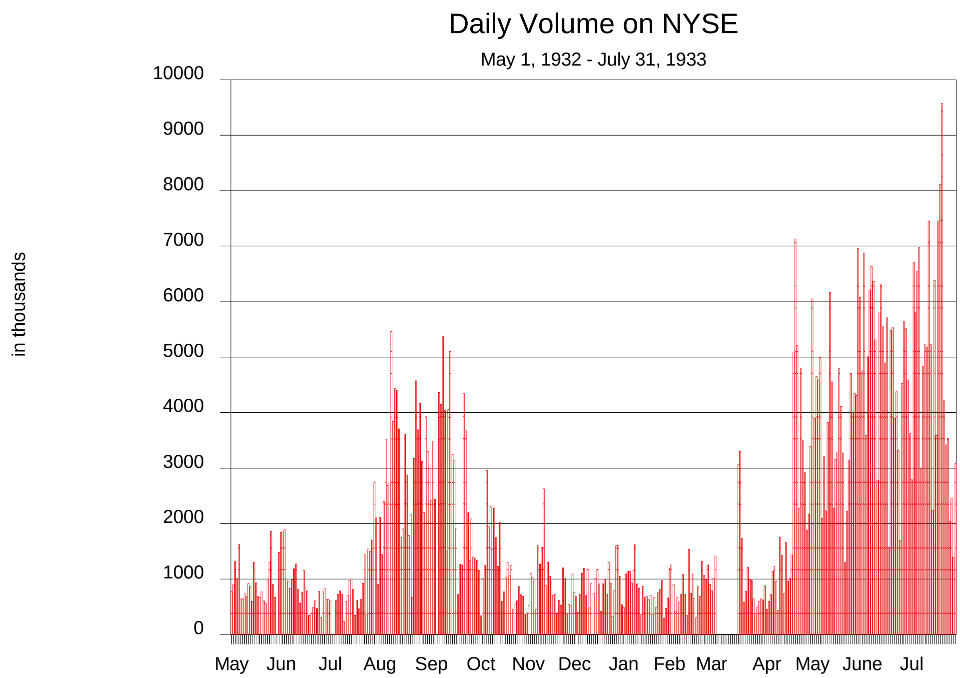
We find modern analysis bearish during inflationary periods largely out of fear of government intervention when in reality it



should be bullish. Economies only expand with inflation. They contract during deflation. In one aspect, inflation is a process where the public raises its demand for products, thus bidding the price for those products higher. Therefore, economic expansion takes place when such periods exist. Companies hire more workers to increase production to meet demand.

In the post-Roosevelt era, inflation became institutionalized by governmental forces apart from private demand. The benefits of increasing government spending to spark this inflationary demand greatly diminish because the aftereffect leaves high debt which must still eventually be repaid. That in turn prompts taxation to rise, and in the end government comes back to the private sector to repay the outstanding debt. The next cycle diminishes because more is being extracted from the private sector reducing future potential for expansionary waves. Thus, the free market system can continue to raise tax burdens to the point that it might as well become a communistic state where net wages are drastically reduced and productivity therefore declines through lack of worker incentive.

You will also recall that during the bull market of the 1920s many times the comments referred to the fact that money remained cheap and there was no appreciable sign of inflation. The reason for this confusion was twofold. First, the central bank conspiracy was seeking to influence foreign exchange by artificially maintaining lower rates which merely served to drive capital to where rates were higher. They had hoped that was going to be Europe to relieve their credit crisis. However, this also drove much capital into the stock market where it was seeking the higher level of dividend payments. Second, the raw materials were declining but the finished products were rising in price. The lack of monitoring inflation in a sophisticated manner led to this misconception. Inflation in finished products had risen significantly but primarily between 1927 and 1929. Diamonds and luxury items, as well as the real estate boom, were all side effects of the

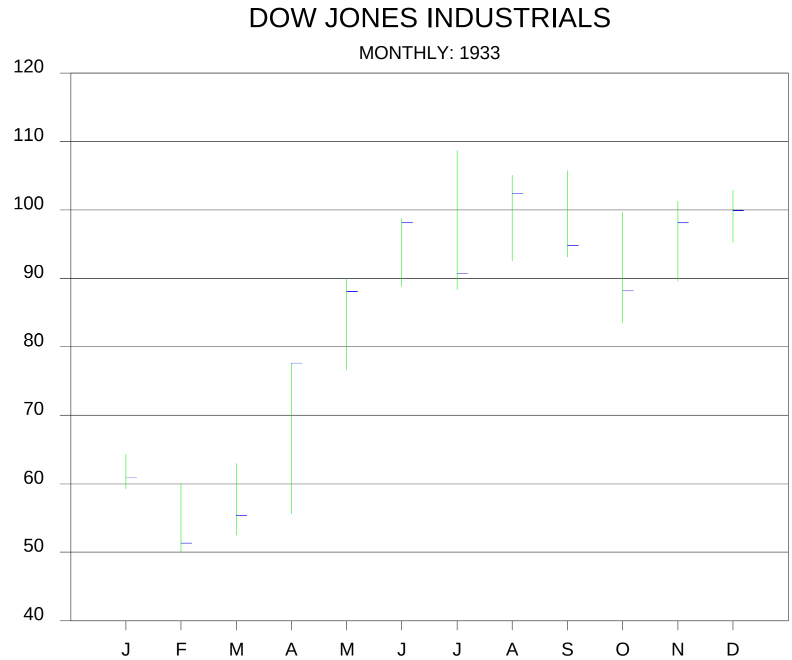


inflation that took place in the mark-up of finished products versus purely the raw materials. Time magazine reported as follows:

"While inflationary psychology was thus getting a start, it was abetted by talk of cutting the gold content of the dollar. President Roosevelt had finally issued an executive order under power given him by Congress in the emergency banking act, ordering all holders of gold to turn it in to the Government by May 1 or take the penalty. What else did this mean except that the Government was gathering in all the gold preparatory to melting it into smaller dollars? Or it might mean that Government wanted to gather up the maximum amount of gold to back the present dollar and permit release of earmarked gold of foreign nations."

In May, when interest on U.S. gold bonds was due, traditionally these issues called for interest to be paid in gold for the lender had lent gold, not paper. Nevertheless, Roosevelt broke the "covenant" as many screamed about receiving their interest in paper dollars. The Commercial & Financial Chronicle addressed the issue quite seriously stating, "The United States Government has taken a step backward into the darkness of the Middle Ages!"

Many people were very confused. They assumed that Roosevelt's recall of gold was intended to reissue gold coins with less weight and that would be the so- called devaluation. But when the May deadline for turning in the gold coins had passed and government gold bond holders were not being paid their traditional interest in gold, concerns began to crop up. Nevertheless, commodities continued to rise with copper reaching 7 cents per pound, up from 5 cents in January. Legitimate shortages were in effect taking place. Many of the curtailments in 1932 were now turning up as projections for 1933 had been overstated. In May, the Farm Board had sold its last 8 million pounds of cotton on the futures exchanges and cotton rallied to 9 cents.



The Federal Reserve's index on department store sales for April 1933 illustrated a 9% decline from April 1932. The first four months combined expressed a decline of 22%. April had at least begun to improve to some degree since the bank holiday but retail sales were still sharply lower compared to 1932 levels.

Commodities and stocks were still rising sharply in response to the anticipated inflation from one way or another. During early June the news finally hit. The President was not going to cut the gold content of the dollar but eliminate the gold clause from public and private contracts. "Speculators gave a mighty heave that shot prices to the best levels in two years. As the public rushed to buy and buy and buy, transactions on the New York Stock Exchange swelled to an all- time Saturday record for a bull market -4,300,000 shares. Only once had that figure been exceeded - in the bear market of May 1930. At the end of the two-hour session, the new high-speed ticker was 41 minutes behind the floor," reported Time magazine on June 5, 1933. Commodities rallied to their highest level since the inflation boom began.

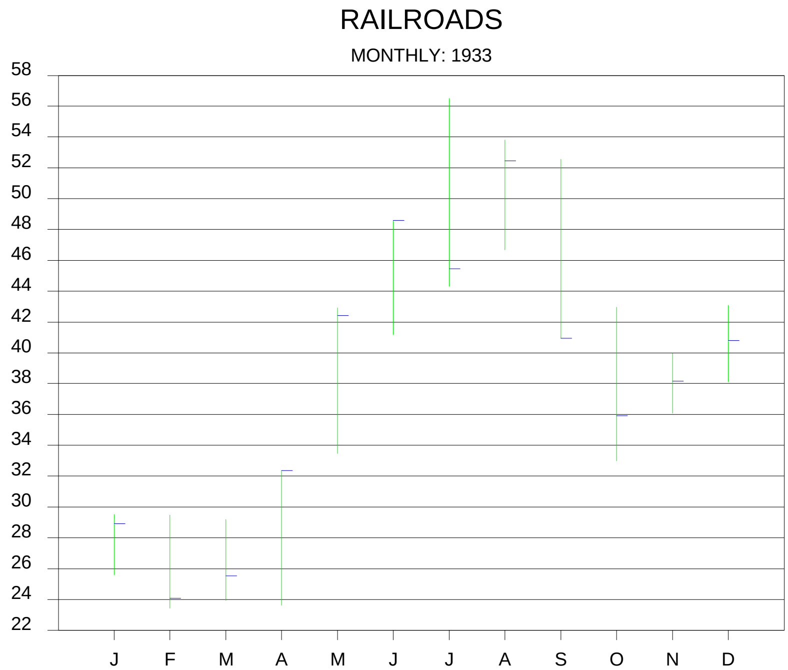
The Dow Jones Industrials had stormed virtually straight up since the February low. The industrials rallied from 50 points to slightly below the 100 level, closing near the high in June. Confusion over exactly what Roosevelt was doing persisted. Many assumed that only the gold clauses were being eliminated and had no conception that they had seen their last gold coin.

Another factor that emerged during June was the new Securities Act of 1933, which was written by Professor Felix Frankfurter who was Harvard's top man. Lawyers were desperately trying to find a loophole, but there was none to be found. This man was the best. He taught his pupils how to take apart laws and get around them. He knew how to do it and as such was the perfect man for the job. His Securities Act of 1933 had a very serious impact. Essentially it stated that if any "material" fact is misstated or if any "material" fact is omitted, each director is held personally liable for the loss incurred by a buyer of the security. Few lawyers were prepared to advise their clients that they could go ahead and offer any security. This led many to speculate that a shortage of stocks might develop.

The market continued to press higher into July, reaching very close to the 110 level. But then suddenly, the industrials collapsed hard, closing the month near the low back at 90 on the Dow Jones Index. The new Securities Act applied to new issues as well as the buying and selling of securities that were already on the market. A debate naturally ensued. This was not the reason for what became known as the July Crash, but it played at least a part during the summer of '33.

The volume for June 1933 was 125 million shares, the largest on record with the exception of October 1929. Between May and June the combined total was 230 million shares. The "wet" issues were clearly the biggest movers. In July the demand for this group had become so great that the exchange raised the margin requirement to 60% on the "wet" issues only. But the news which had all along driven this group up was that issue. The Feds left each state to decide for itself. The states that everyone was waiting for were in the South when the Southern States voted for repeal, the good news was out. The very next day the Crash of July 1933 began and the "wet" stocks led the way down. Along with them, the grains in Chicago tumbled. That day 7 million shares traded hands. Stops after stops were elected and the broad market fell 20% by the end of the month while many of the "wet" issues fell much more. The 20% drop didn't take long. It was all over in three days! The Dow Jones Industrials had fallen 19.96 points in just three days!

The market would have fallen much further during the summer of 1933 if it were not for new rules that the government imposed upon the various exchanges. Time magazine reported on the 7th of August "Banned from the pit forever were all dealings in indemnities (options on grain futures contracts generally regarded as pure



gambling)." The markets were also "forbidden" to trade below the July low. Time magazine reported upon the effects of this measure on the 14th of August:

"The great exchanges of the U.S. last week lacked natural stimulants. On the Chicago Board of Trade the energy building grains, limited not only to 4 cent and 3 cent daily fluctuations, but also forbidden (by a rule good until August 15) to fall below their July 31 closing levels, floundered ineffectually...From similar listlessness, begotten partly by regulation, Manhattan's Stock Exchange was saved by the outside stimulants. Following pricking of the speculative bubble three weeks ago, the Senate's busy Prosecutor Ferdinand Pecora called on Exchange President Whitney, told him speculation must be curbed. Last week the Exchange announced two new rules: 1) brokers must report weekly to the Exchange all that they know of the operations of pools and syndicates; 2) traders with debit balances of over $5,000 must maintain margins equal to 30% of the debit balance; those with debit balances less than $5,000 must maintain a margin equal to 50% of the debit balance. Calculated the ordinary way, the proportion of a trader's equity to the total value of the stocks in his account, the margins now required to 23% and 33%. Example: if a man buys $1,500 worth of stock and gives his broker $500, he is said to have put up a 33% margin. However, his debit balance is $1.000, of which $500 is 50% adequate margin under the new Exchange rules."

The market interest declined considerably. Faced with limits, increased margins, but worst of all investigation if you happened to make money on the short side, the only safe way to play the markets was from the long side.

The Administration therefore intervened or simply forbid the market to trade below the July low. It was as simple as that. How could they do such a thing? Well as impossible or as outrageous as it might sound, that is what happened. Nonetheless, they did it and the market churned back and forth. The traders themselves withdrew from the

market and liquidity shrunk. The rule was rescinded on August 15 but other measures were taken to support prices. Time magazine reported on the issue again in its August 28, 1933 edition:

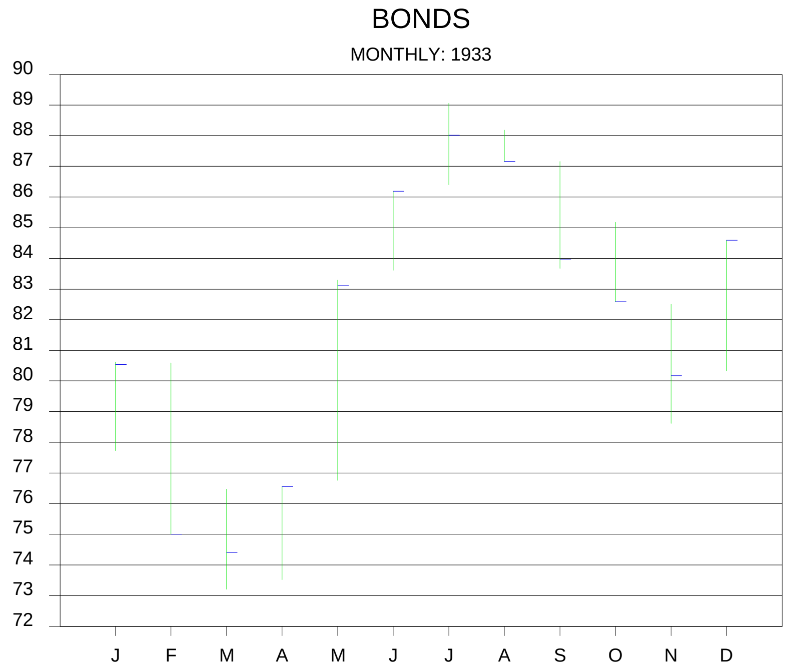
"SQUARE PEGS & ROUND PITS"

"Three weeks ago Chicago's Board of Trade instigated by Washington, set a temporary level below which grain future prices would not be allowed to sink. Last week that artificial floor was removed. Prices which had been bobbing along on the rule like balloons without lifting power promptly dropped the maximum amounts permitted in one day's trading. Great was the hullabaloo.

"Representative Jones of Texas and Senator Smith of South Carolina promptly swung inflationist thunderbolts about their head again. Letters and telegrams poured into Washington demanding that the Government re-peg prices.

"No such action was taken. Next morning the grain pits reopened and prices promptly dropped and bounced. They mounted rapidly and closed with substantial gains for the day. Thereafter they swung up and down, but neither sudden disaster nor abrupt boom followed.

"Contributory cause that certainly helped to steady the market was that, as the peg was removed, Secretary Wallace began to talk of the subsidizing of export of 50,000,000 bushels of wheat from the Pacific-Northwest, and of raising the wheat processing tax to pay for the subsidy. The Secretary of Agriculture has power to fix processing taxes at an amount equal to the difference between current prices and the average price 188 cents) for 1909-1914. The present tax of 30 cents a bushel represented that difference on June 15. For several weeks



wheat prices have been about 88 cents but the tax continues. But the processing tax can be increased only if wheat prices fall below the June 15 level.

"The threat of subsidized exports may have been partly intended to support the market. It served also as a club over the conference of wheat producing nations which met again this week in London to try to agree on crop restriction. What one nation calls 'subsidizing exports' other nations call 'dumping.' He proposed, however, to dump wheat in the Orient thereby cutting into the exports of Canada and Australia to those markets.

"Not according to the Golden Rule was Secretary Wallace's dumping threat for the U.S. Not only has a law against foreigners dumping in the U.S., but even when the Secretary made his announcement the Treasury Department was considering forbidding imports of steel from Germany, tennis shoes, electric light bulbs and calcium carbide from Japan, stearic acid and thumb tacks from Holland, rock salt from Canada, woven wire fencing, sulphide paper and binder twine from England, all on the grounds of dumping."

As a result of the processing tax and jawboning, the Administration was able to fix a cement foundation near the lows established by the crash of July 1933. Despite cries of "foul" from other nations, the Administration was clearly prepared to bend any law and impose whatever it deemed necessary to shape and mold the situation as it saw fit. Many such moves were undoubtedly questionable on a constitution basis, yet they went unchallenged.

Roosevelt's moves were creating havoc in all markets which was especially reflected with the foreign exchange. The inflationists continued to muddle into every aspect of the economy, launching investigation after investigation. The power industry was deemed to be a public utility and the price fixing attempts continued. These measures seemed to become a kind of crusade bent upon tearing down the very fabric of the free society and moving dangerously closer toward the idealistic goals of socialism and communism itself.

The group of Roosevelt's advisors became known as the Brain Trust. In a letter to the editor of the Wall Street Journal, I found this interesting note of personal expression which was published on the 17th of October 1933:

"Perhaps an old fashioned turn of mind has made it impossible for the writer to follow the Brain Trust advocacy of price boasting. Not only has he read no convincing exposition but he has heard none. Rather it has seemed as if prices ought to be let alone unless we have gone Soviet and the price of everything from birth to burial is to be government regulated as in the public utility field; and if such widespread regulation awaits, we have a good sample in the case of the railroads (they have been regulated longer than other utilities) fully illustrating the conflicts; huge costs forming a burden on both taxpayer and user and the consequences if it be assumed, as the Brain Trust apparently does, the task can be accomplished there comes the question, Will it be worth all the grief entailed to arrive at that point?"

In the September 11, 1933 edition of Time magazine, we find the following commentary in respect to the Administration's policies which affected the gold mining industry. Many investors had been buying the gold mining stocks believing that gold was going to rise as a result of the inflationist policies. Time reported on the situation as follows:

"Because the world is round, what is right side up in the U.S. is upside down to China. Because of the geography of economics, gold miners like Chinese, are upside down compared to other men. Most businessmen worry about what price they will get for their product, but in normal times gold miners never worry, since an ounce of gold is (normally) the 'makings' of $20.67, the price they can get for their output never varies a penny. If other prices go up, other men are apt to profit, but for the gold miner that means only higher costs (no bigger income) and consequently smaller profits.

"Last March when Franklin Roosevelt ruled that money was not gold, he broke the old equation; $20.67 would no longer buy an ounce of gold. He cheapened the dollar to make prices go up to let businessmen profit. But he did not break the equation so far as gold miners were concerned. He would not let them sell their gold to anyone except the U.S. Government and the Government would pay only $20.67. Gold miners were out of luck - their costs mounted but the price of their product remained the same."

This situation had become intolerable and grossly unfair to the gold mines. The costs were rising rapidly. The mere cost of living had jumped 9% since March of 1933. Therefore, Roosevelt decided to allow the gold mines to deliver their product to the Federal Reserve and the Fed would sell gold to foreign buyers at the world price. This tended to export inflation to other nations, such as France, that had remained on the gold standard. At the same time, this meant that gold was a commodity in that respect and the proceeds were then credited to the trade balance. The annual U.S. production was about 2.5 million ounces so this would add approximately $75 million to this economic statistic which previously had not been included.

However, along with that decision came a harsh rule as well. It had been estimated that $500 million in gold coin had not been

TIME TO FIGHT

THE time has come when the intelligence of the country must speak its mind on the question of currency inflation, and speak it forcibly. It can no longer, it seems to this newspaper, stand by and permit the impression to gain ground in Washington that the Pittmans, the Thomases, the Bankheads and others of their kind are representative of the responsible and thinking mass of opinion in the nation.

There can be no question that those who understand monetary matters and who are familiar with the history of previous experiments in currency inflation are irreconcilably opposed to subjecting the country to the grave dangers inherent in these fatuous proposals. Unlike the inflationists, however, this great body of thoughtful citizens lacks, at the present time, the leadership and the organization that are essential if it hopes successfully to combat the uninformed but highly articulate propaganda of those who would resort to the printing press.

Any counter-movement launched against the inflationists should be non-partisan politically and should have leadership in which people could place confidence. Its objectives should be two: first, to educate the public in the dangers and fallacies that underlie demands for paper money inflation; second, to organize informed opinions so that the latter would make itself effectively felt in Washington.

Those who do not already realize it should be made to understand that there is no more vicious illusion in the world than the illusion that a shortage of money can be remedied by placing an official stamp on paper and declaring that such paper shall have a stated value. During every paper-money inflation of the past, whether one takes the case of the French assignats, the German marks or our own greenbacks, the result has always been the same: the faster the paper was printed, the greater and the more poignant the cry of a "shortage of currency." The reason for this is, of course, that such paper depreciates in value much faster than the printing press can produce new supplies. This is the essential fallacy of paper-money schemes. It is this fallacy which makes paper-money inflation, as an eminent German authority, Dr. Peter Reinhold, has put it, "the most terrible thing that can happen to any civilized state."

But it is the record of inflation of the currency that its evils do not end with an accentuation of the problem that it is expected to remedy. In the process it works an inequitable and a cruel redistribution of a country's wealth. As one historian has trenchantly written, "It leads to the absorption of the means of the workingman and the man of small fortune; it impoverishes men living on fixed incomes, salaries or wages, and creates on the ruins of this large group a small class of debauched speculators, the most injurious class that a nation can harbor—more injurious than professional criminals, whom the law can reach and throttle; it stimulates production at first, and leaves every industry prostrate afterward; it breaks down the idea of thrift and develops social and political immorality."

We want no experiments of that sort in the United States. But there is grave danger that we may have them forced upon us if those who are aware of their hidden dangers do not make their opinions felt. Friends of sound money cannot afford to permit an issue fraught with such grave economic and social consequences to go by default.

New York Herald Tribune Editorial
September 22, 1933

This is one of eight editorials on inflation that have appeared in the New York Herald Tribune. All eight have been reprinted and will be sent on request to business men who are interested in following the campaign for sound money.

NEW YORK Herald Tribune

The Oldest Bank in New York
Established in 1784

New York Clearing House
Membership Number One

Banking Paralysis?

in 1907

A few days ago one of our customers reminded us of the incident which led to his choosing this as his bank. In the midst of the panic of 1907 we wrote to a large number of potential borrowers, offering to make substantial loans for sound purposes. The individual just mentioned was not one of our customers at that time, but he applied for and received a credit line of $100,000—largely to find out whether we meant what we said. He liked our attitude as well as our prompt action, opened an account, and established a relationship which has continued for over 25 years.

in 1934

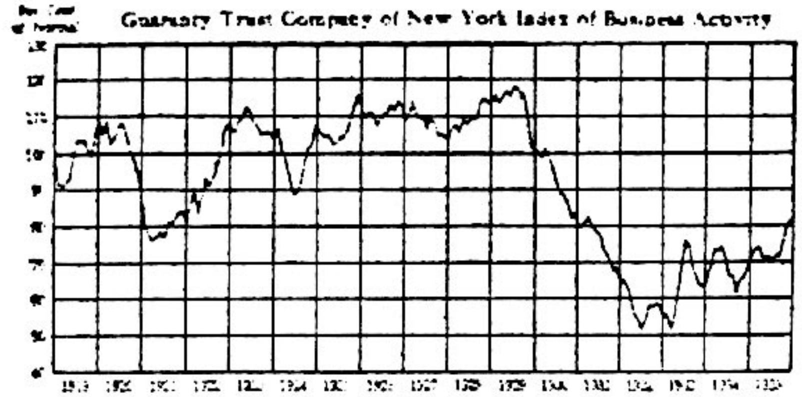
Ever since March 1933 attention has been focused upon the so-called "paralysis of the country's banking system." Perhaps you have gained the impression that all the banks in the country have stopped making loans. The fact is that there is more credit available today for sound enterprises than business men are able or willing to employ. This bank is not paralyzed—and the same thing is true of any number of other banks in various parts of the country. This institution has ample liquid resources, and in recent months has frequently renewed the offer made in 1907.

Alternating periods of panic and prosperity for 150 years have not affected the character of our banking service to customers.

BANK OF NEW YORK & TRUST COMPANY

48 *Wall Street · New York*

UPTOWN OFFICE: MADISON AVENUE AT 63RD STREET



An Index of Business Activity

IN the present period there is keen interest not only in the current trend of business activity but also in the record of recent years as a basis for comparison.

This Company's index of business activity is published in each issue of THE GUARANTY SURVEY, a monthly review of general economic conditions in the United States and abroad. This weighted index, developed through long observation of business factors and tested for sensitiveness to changing conditions, covers the period 1919 to date.

This publication also includes a chart showing indices of wholesale prices for the period 1919 to date, and a table showing the range of prices of representative basic commodities from 1913 to date.

We are pleased to place the names of business executives on the mailing list to receive THE GUARANTY SURVEY.

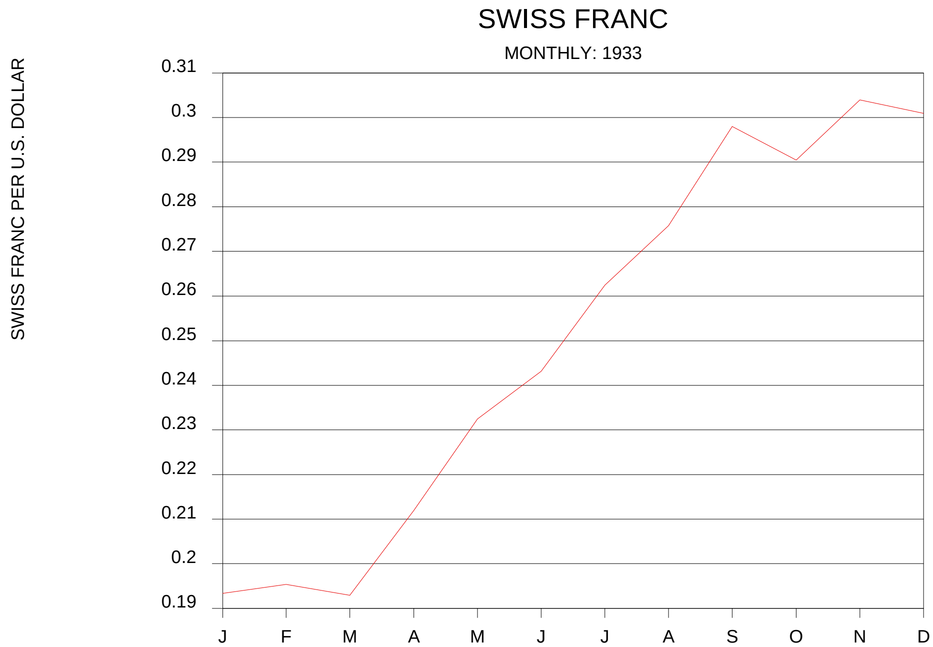
Guaranty Trust Company of New York

140 Broadway

Fifth Avenue at 44th Street | Madison Avenue at 60th Street

LONDON PARIS BRUSSELS LIVERPOOL HAVRE ANTWERP

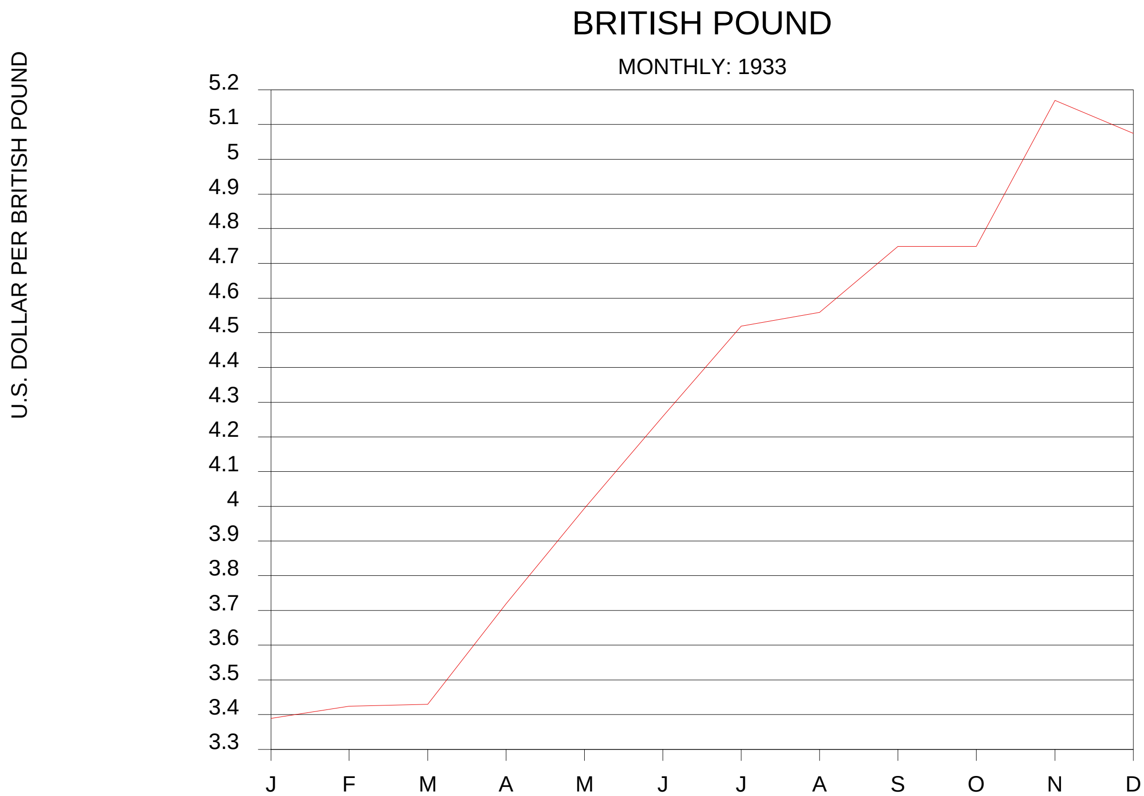
(Member Federal Deposit Insurance Corporation)

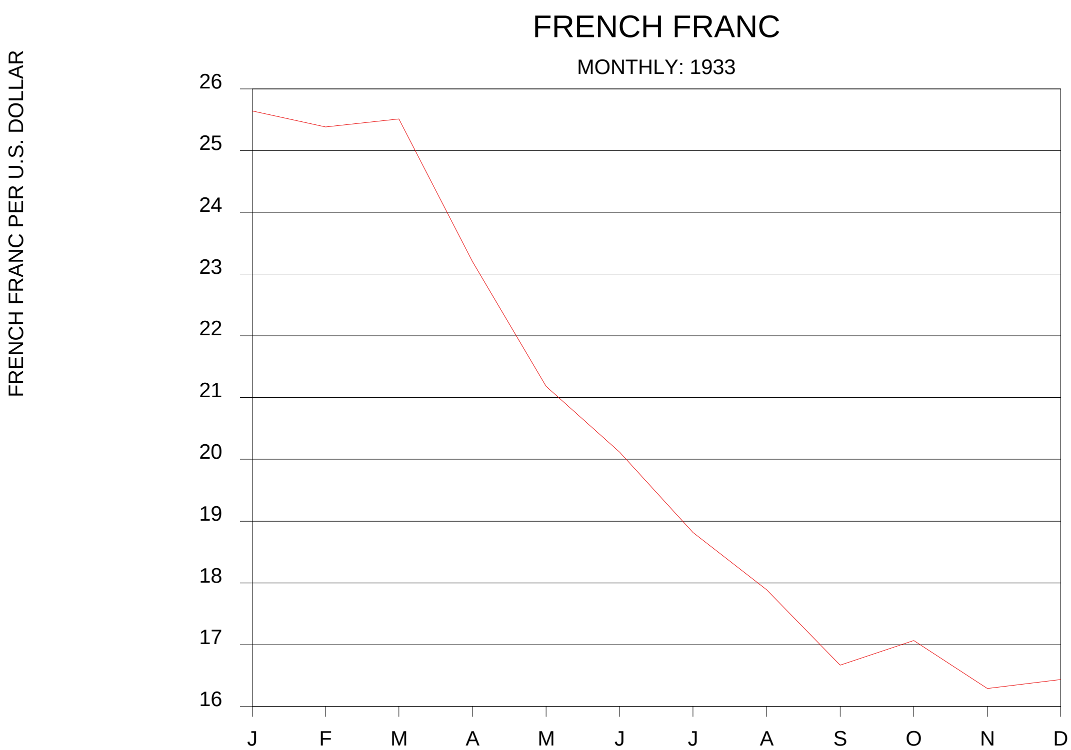


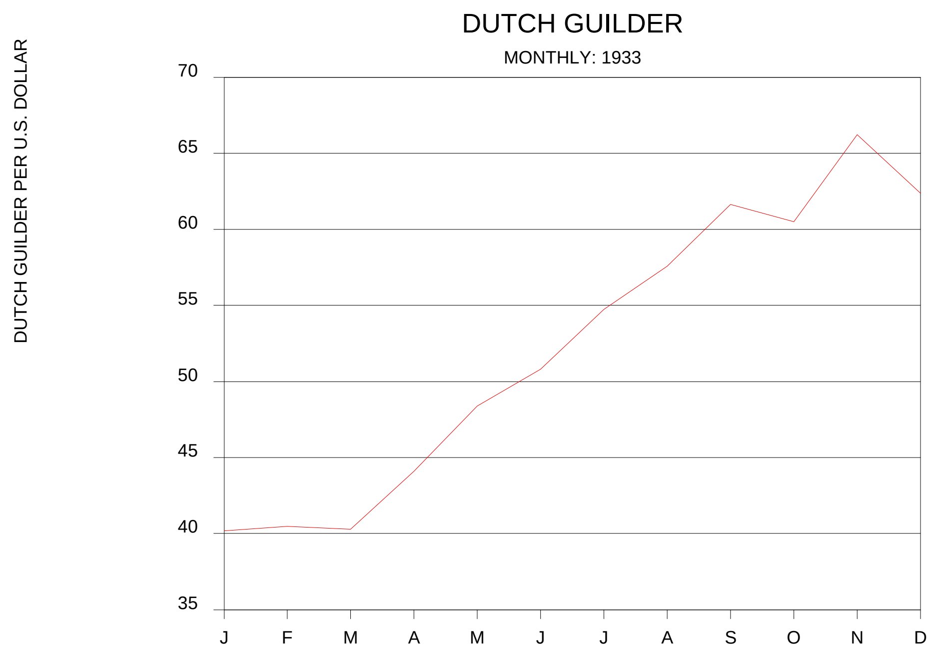
returned to the government as the edict had demanded back in May. The Attorney General was then armed with another new law. Roosevelt could not declare it to be illegal outright to own gold since that would have been a flagrant violation of the Constitution. So he took another approach which the courts ruled permissible. It was thereby ordered that all U.S. citizens file a report to declare how much gold they held. Failure to file the report carried a $10,000 fine or ten years in jail. So technically it was not illegal to hoard the gold, it was just illegal not to tell the Government that you were holding it. This was merely one example of the sumptuary laws which were being implemented through the clever tactics of switching a few words here and there to circumvent the true liberties which had been originally granted by the Constitution.

Although the free press in many cases was hard at work trying to protect the rights of the nation, it was a losing battle. Reprinted here is an advertisement which the New York Herald Tribune took out in the Wall Street Journal. This was one of eight advertisements in which the Tribune took upon itself to stand up and fight back. The headline "Time To Fight" was well taken. The biggest crime perpetrated upon the nation was that the people voted for a man who had not revealed his true intentions of how his "New Deal" was going to achieve its goals.

As October emerged, the dollar continued to decline sharply on foreign exchange markets. The commodities and the stocks were still bouncing off of support but losing their strength from one bounce to the next. In October, the Dow Jones Industrials dipped below the July low by 1 point and then quickly scooted up as to not bring down the wrath of the demigods of Washington. The Senate's probe into the stock market continued and investigations continued in an ever increasing scope. Those it questioned, it delved into whatever areas it could and then hauled people off for income taxes or whatever violation of law it could muster up. To refuse to appear meant imprisonment. It was indeed a Spanish in-


BRITISH POUND
MONTHLY: 1933
U.S. DOLLAR PER BRITISH POUND
5.2
5.1
5
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
J F M A M J J A S O N D


FRENCH FRANC
MONTHLY: 1933
FRENCH FRANC PER U.S. DOLLAR
26
25
24
23
22
21
20
19
18
17
16
J F M A M J J A S O N D



quisition and its probe became known as the "book of revelations."

Now the battle to stem the collapse of the dollar came to the forefront during October. Time magazine reported on the flight from the dollar in its September 25, 1933 edition.

"FLOWN DOLLARS"

"Dollars sank last week to the lowest level since the U.S. quit the gold standard, 63 cents. Because President Roosevelt had not yet seen fit to devalue the dollar, the price is determined by supply and demand in international exchange. And because the U.S. has a favorable trade balance, demand is normally greater than supply. Whence the dollar flood has eaten away 35 cents of every 100 cents in each U.S. dollar since last April. Continental money-changers, canniest of whom are reputed to be 'the Greeks,' delight in selling dollars short, but bankers know that accounted for only a fraction of the drop. Last week from the British Commonwealth Relations Conference in Toronto came confirmation of what Wall Street has long suspected; that U.S. citizens have exported their dollars by the hundreds of millions.

"'One of our problems,' droned Viscount Cecil of Chelwood, chairman of Britain's delegation, 'is the flood of unwanted money that is pouring into our banks. These funds, deposited in the main by U.S. investors, are subject to withdrawal at 24- hour notice and are of little or no value, though it has not yet been discovered how to get rid of them.'

"Standard Statistics Co., Inc., world's largest figure factory, estimated that $1,000,000,000 had flown the Atlantic, the bulk of it to London. France, whose tie to gold is none too secure, has received little, but Holland and Switzerland have been drowned in dollars. Unlike exports of gold which is strictly banned (for private citizens) the flight from the dollar has been quietly encouraged by Washington; it pushed down the price without requiring devaluation by Presidential decree."

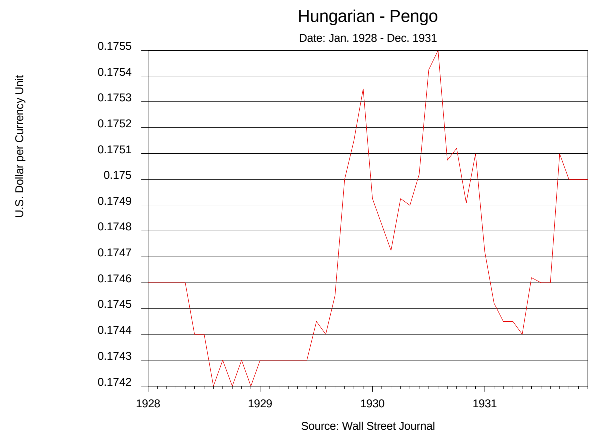
On October 11, 1933, the Wall Street Journal reported on this new battle against the short positions in the dollar.

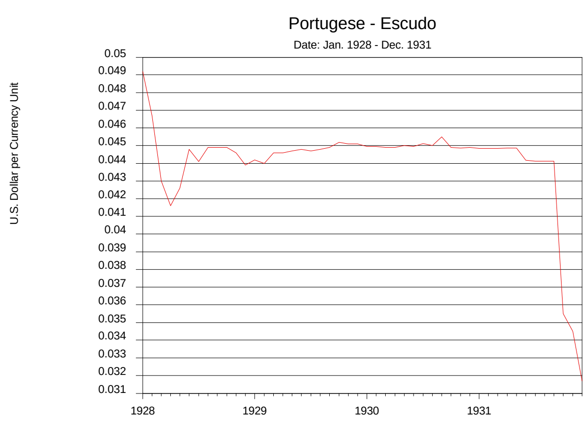
"U.S. STRIKES AT DOLLAR SHORTS"

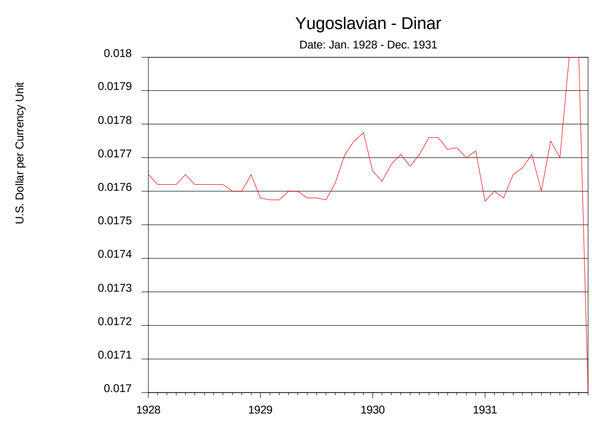
"For the past two weeks there have been growing indications that the federal government is tightening its grip on the foreign exchange control or official intervention such as is practiced by the British Exchange Equalization Fund but the market is convinced, nevertheless, that hitherto uncontrolled fluctuations in dollars exchange.

"Thus far it has taken the form of a tightening of the control with regard to 'swaps' in the futures market. This is a blow aimed directly at the foreign speculator who has been maintaining an open short account in dollars in the belief that the American unit is headed for still lower levels in the world's markets.

"Up until present, the foreign speculator, operating abroad has maintained his short position by 'swapping' contracts which are falling due for other contracts, say 90 days away. For example, if dollars had been sold for October 15 delivery, at the approach of that date October 15 would be bought and



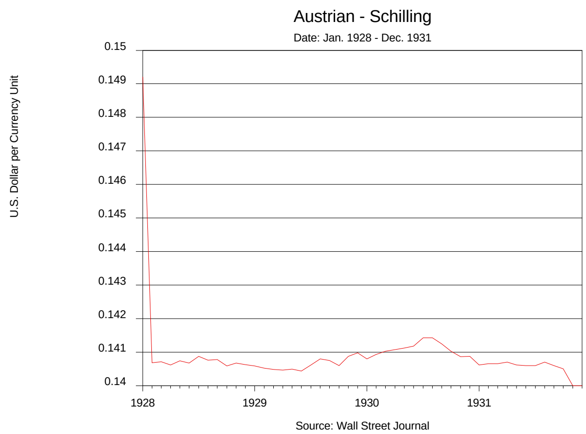


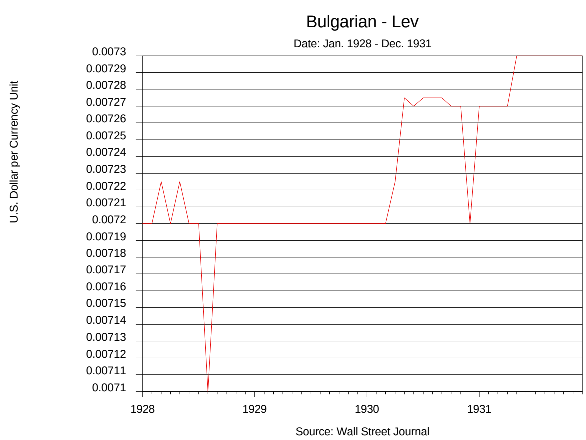


January 15 dollars sold against them. This produces a temporary demand for spot dollar exchange but the continued pressure on the forward market is depressing influences on the rate. The 'swap' really amounts to borrowing of dollars for speculative purposes.

"Permission is being granted to execute 'swaps' when it is shown that they are based on legitimate commercial needs. For example, if a shipment of goods has been delayed in delivery, it may be necessary to extend the exchange position until the goods are delivered and the exchange contract settled. No difficulty is experienced in obtaining permission for this type of transaction.

"The Continental exchange speculator, however, has no such basis for his transactions, which are financial rather than commercial, and permission for financial swaps is being refused. The effect of this procedure, it is believed in the foreign exchange market, will be to produce a growing outright demand for dollars as the short contracts mature, and which will not be offset by sales of futures. Commercial supply of dollar exchange is said to be very small."





Here we find another example of what would today be unthinkable. The foreign exchange futures which are being referred to here are cash forwards. If you sell a January position you could find yourself with no means to legally buy back your position. So strange as it might sound, they drove speculators out of the short positions. Government just didn't want any short bets against them in any market. They sought to have their cake along with a full belly and free rent all at the same time. If it couldn't be achieved by a free market system, then they would make up their own rules and limit the freedoms of the market to their liking.

The last four months of 1933 were marked by numerous shocking issues. Many of the steps taken to force the markets to yield to the will of government are steps which will one day soon be reimplemented. Today we are all aware of the G-5 group of central banks and the political consensus around the world that promotes the manipulation of foreign exchange to achieve economic stability. The methods of the present are no different from those attempted by the central banks first in 1925, again in 1927 and finally by Roosevelt in 1933. In the September 25, 1933 edition of Time magazine, we find an interesting comment as to how the stock market was viewed to be a hedge against the currency inflation policies of Roosevelt. This is very important because I seriously doubt that anyone would view the stock market today as a hedge against inflation. Nevertheless, this issue was the primary factor which led the stock market into its rally which eventually peaked during 1937. Time magazine reported upon this aspect as follows:

"Methods of hedging against inflation within U.S. frontiers have become a favorite coffee-&-cognac topic. Purchase of industrial stocks is, of course, the most popular hedge, but commodities and land have been creeping up fast since the NRA threatened profits with higher labor costs. Some shrewd businessmen with little capital at stake argue that the best thing is to go as deep into debt as the banks (or friends) will allow; eventually they will pay off with cheaper dollars. Carl Snyder, economist for the Federal Reserve Board, was asked

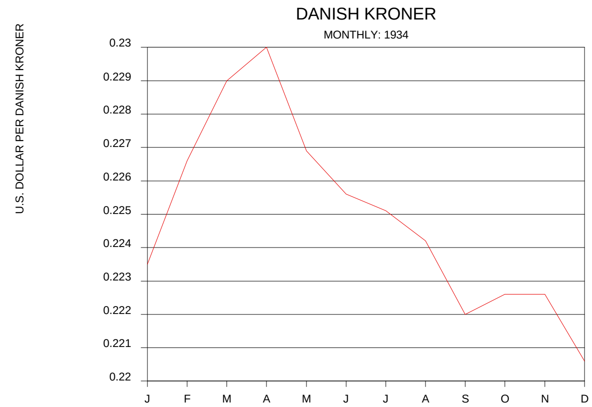
lately by a wealthy friend how he could hedge against all possible contingencies including deflation or stabilization so that he would die as rich as he was at that moment. 'One way,' snapped Economist Snyder, 'is to shoot yourself.'"

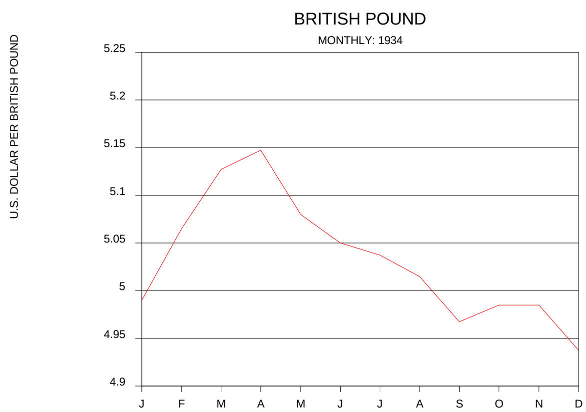
The comment of economist Snyder in a very realistic sense was quite true. The only guarantee that one would die with essentially his current assets in this situation was to commit suicide for you never know what tomorrow would bring.

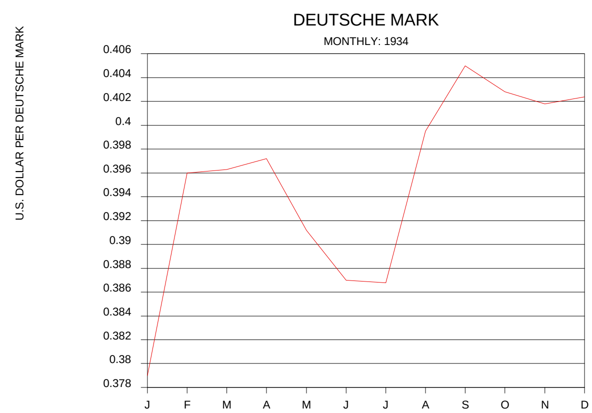
There is no doubt that during the year 1933, the stock market gained significantly on the prohibition issue which anticipated that the country would turn "wet" as of January 1, 1934. But the entire issue of Roosevelt's currency inflation had a large impact upon the performance of the market as well.

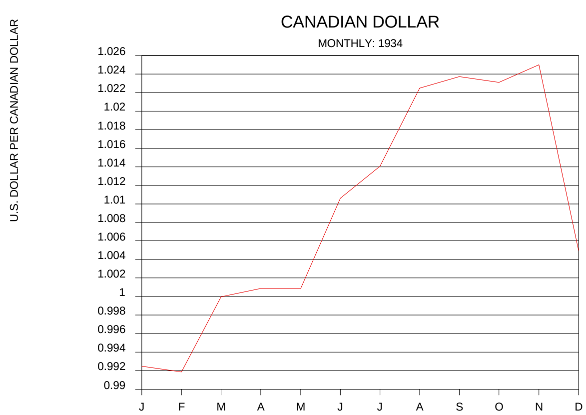
The market began to rally finally from the summer of 1933 lows on the perception of a hedge against inflation. After a rally into January 1934, the market fell back and consolidated into a July low during 1934 once again. From there, commodity prices began to rally after the convertibility of gold for U.S. citizens had been officially abandoned in January 1934 and the effects of inflation began to spread throughout the world. Eventually, the inflation scenario continued to drive the markets higher into 1937.

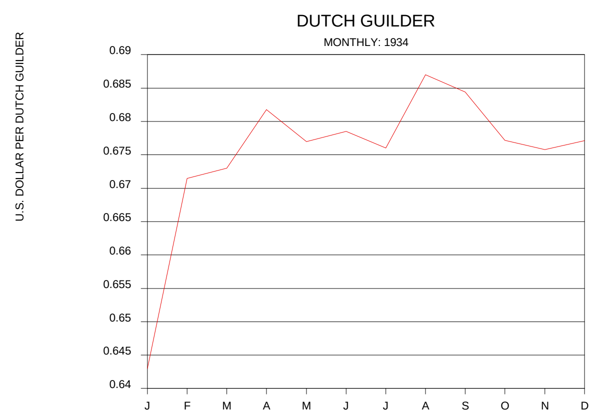
From March 1933 into 1937, stocks rose largely upon the belief that inflation would raise the price levels of commodities and therefore earnings would rise as well. Stocks were also viewed as a hedge against inflation as we read in the September 25, 1933 edition of Time magazine. Therefore, we find some continuity in the analysis which took the position that stocks would rise in the shadow of commodities. This was largely created by the fact that much of the economy was heavily commodity oriented. High techs were not exactly the rage of the times. Keep in mind that the automobile was viewed to be a large consumer of

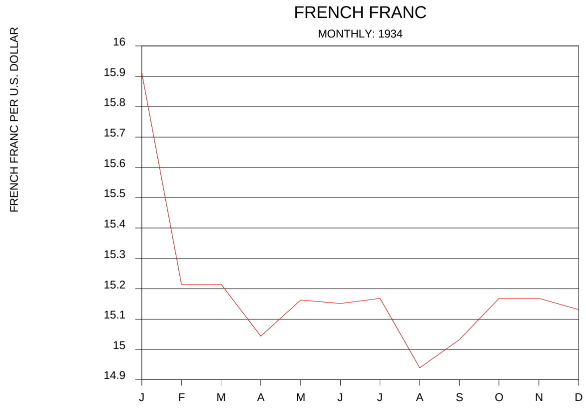

DANISH KRONER
MONTHLY: 1934
U.S. DOLLAR PER DANISH KRONER
0.23
0.229
0.228
0.227
0.226
0.225
0.224
0.223
0.222
0.221
0.22
J F M A M J J A S O N D


BRITISH POUND
MONTHLY: 1934
U.S. DOLLAR PER BRITISH POUND
5.25
5.2
5.15
5.1
5.05
5
4.95
4.9
J F M A M J J A S O N D

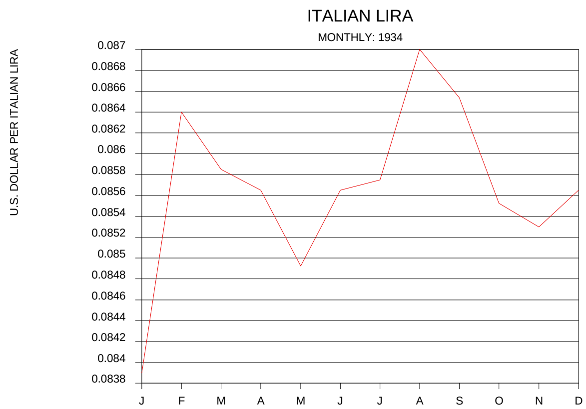

DEUTSCHE MARK
MONTHLY: 1934
U.S. DOLLAR PER DEUTSCHE MARK
0.406
0.404
0.402
0.4
0.398
0.396
0.394
0.392
0.39
0.388
0.386
0.384
0.382
0.38
0.378
J F M A M J J A S O N D

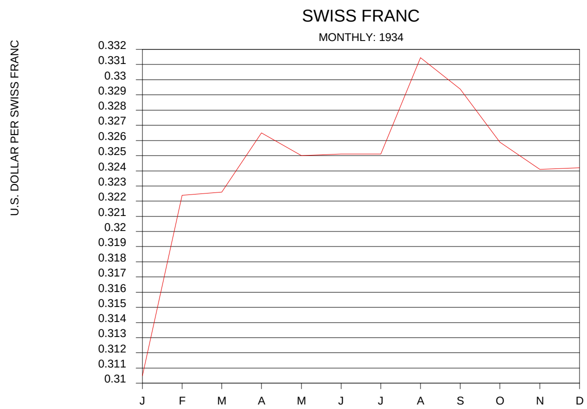

CANADIAN DOLLAR
MONTHLY: 1934
U.S. DOLLAR PER CANADIAN DOLLAR
1.026
1.024
1.022
1.02
1.018
1.016
1.014
1.012
1.01
1.008
1.006
1.004
1.002
1
0.998
0.996
0.994
0.992
0.99
J F M A M J J A S O N D

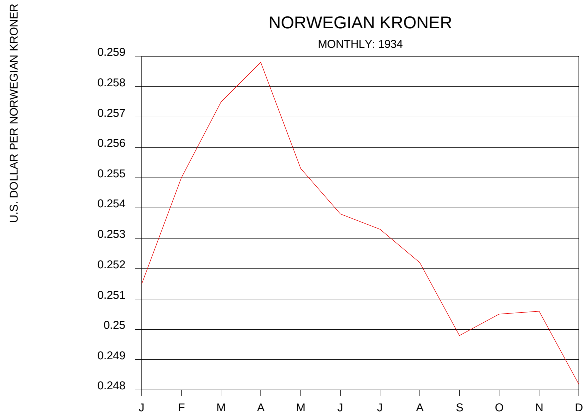

DUTCH GUILDER
MONTHLY: 1934
U.S. DOLLAR PER DUTCH GUILDER
0.69
0.685
0.68
0.675
0.67
0.665
0.66
0.655
0.65
0.645
0.64
J F M A M J J A S O N D

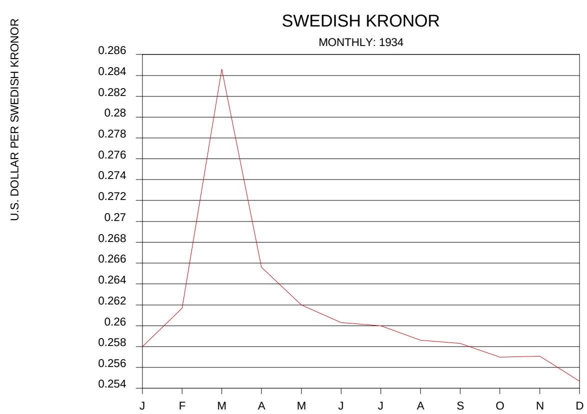

FRENCH FRANC
MONTHLY: 1934
FRENCH FRANC PER U.S. DOLLAR
16
15.9
15.8
15.7
15.6
15.5
15.4
15.3
15.2
15.1
15
14.9
J F M A M J J A S O N D

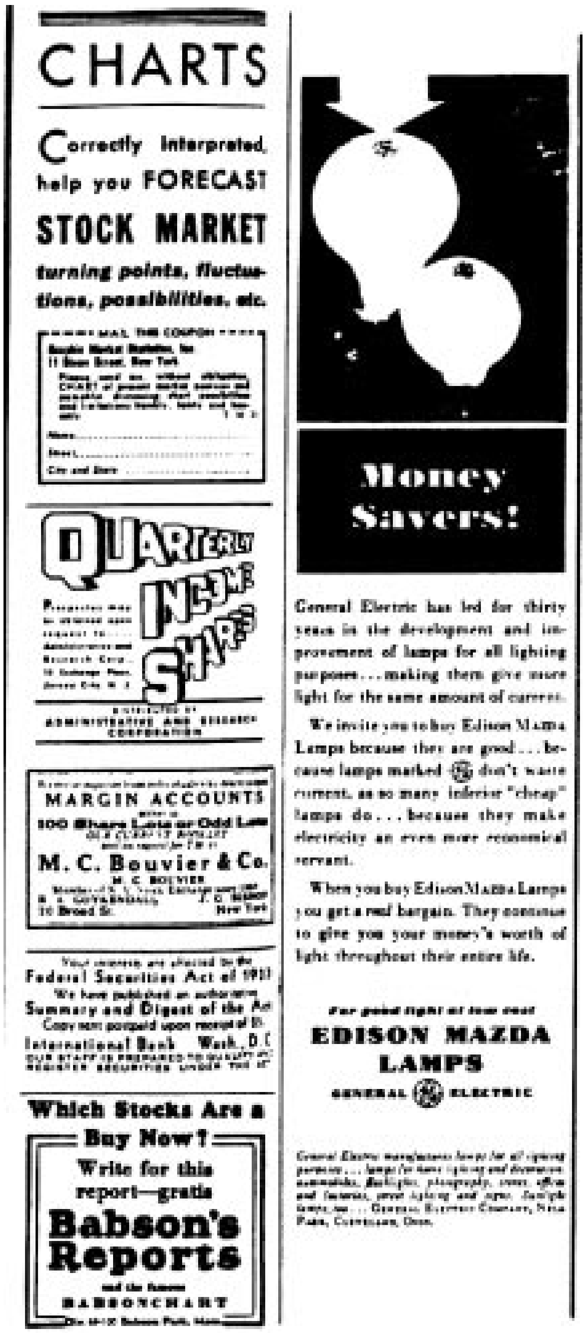

SPANISH PESETAS
MONTHLY: 1934
U.S. DOLLAR PER SPANISH PESETAS
0.139
0.138
0.137
0.136
0.135
0.134
0.133
0.132
0.131
0.13
0.129
0.128
J F M A M J J A S O N D


ITALIAN LIRA
MONTHLY: 1934
U.S. DOLLAR PER ITALIAN LIRA
0.087
0.0868
0.0866
0.0864
0.0862
0.086
0.0858
0.0856
0.0854
0.0852
0.085
0.0848
0.0846
0.0844
0.0842
0.084
0.0838
J F M A M J J A S O N D


SWISS FRANC
MONTHLY: 1934
U.S. DOLLAR PER SWISS FRANC
0.332
0.331
0.33
0.329
0.328
0.327
0.326
0.325
0.324
0.323
0.322
0.321
0.32
0.319
0.318
0.317
0.316
0.315
0.314
0.313
0.312
0.311
0.31
J F M A M J J A S O N D


NORWEGIAN KRONER
MONTHLY: 1934
U.S. DOLLAR PER NORWEGIAN KRONER
0.259
0.258
0.257
0.256
0.255
0.254
0.253
0.252
0.251
0.25
0.249
0.248
J F M A M J J A S O N D


SWEDISH KRONOR
MONTHLY: 1934
U.S. DOLLAR PER SWEDISH KRONOR
0.286
0.284
0.282
0.28
0.278
0.276
0.274
0.272
0.27
0.268
0.266
0.264
0.262
0.26
0.258
0.256
0.254
J F M A M J J A S O N D



commodities. So we do find that there is some logic to the commodity relationship prior to World War II. But as the economy developed over the next several decades, the U.S. industrials and service oriented business sectors began to play a much more dominant role in the GNP of the United States. Thus, the concept of commodity relationships with the stock market has been divided and almost forgotten for the broad market as a whole.

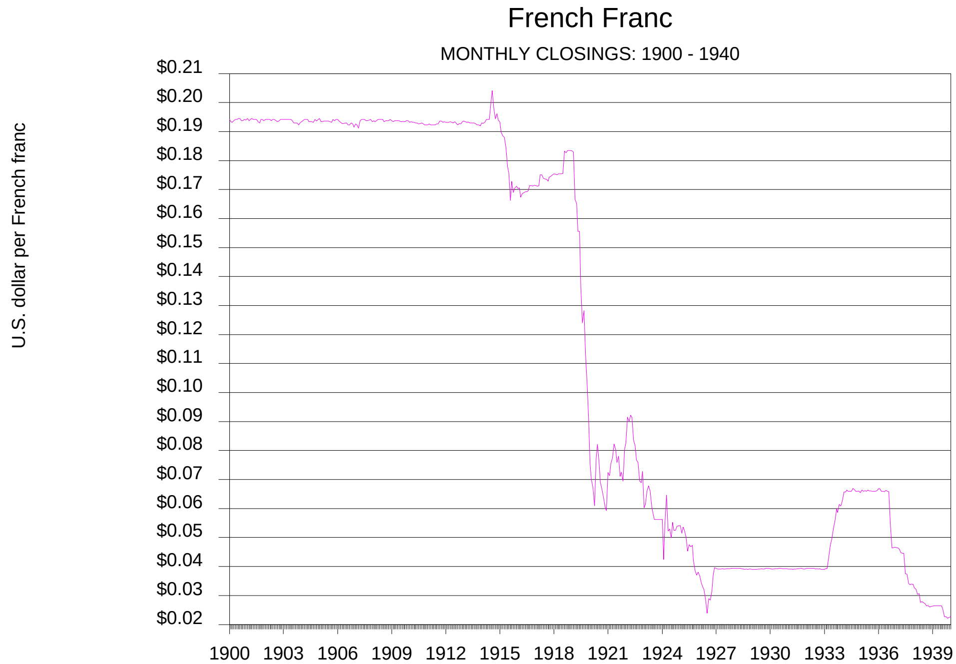
After inflation spending continued yet commodities and stocks declined from the 1937 high, that scenario of currency inflation disappeared and Roosevelt's theories appeared to be a total failure. If Keynes' theory that government could increase spending to stimulate the economy was correct, then there should have never developed the depression of 1938-1940.

There are some historians who have tried to claim that the recovery of 1933-1937 was largely created by the rearmament of Europe. This is a gross misrepresentation because although the rearmament process had begun to some degree in Europe, the greatest amounts of spending took place in the post-1937 period in direct contrast to the contraction within the private economy. However, governmental spending in Europe rose three times that of consumer spending during the 1930s.

What had evolved between 1934 and 1936 was a strange new battle among western nations. It was the battle of official devaluations to gain price and trade advantages. The recovery which had developed from 1933 was most pronounced within the non-gold bloc nations. Those who had remained on the gold standard such as France were left in a position where their currencies became overvalued, adversely affecting their trade positions in some sectors.

Trade Surplus (Deficit)*

	U.S.	Britain	France	Germany
1933	224	(258)	(9.96)	.67
1934	478	(284)	(5.25)	(.27)
1935	236	(275)	(5.47)	.11
1936	33	(346)	(9.92)	.55



Source: Wall Street Journal

1937	165	(432)	(18.45)	.42
1938	1134	(388)	(15.47)	(.19)
1939	859	(400)	(12.70)	.44
1940	1396	(663)	(28.86)	(.12)

*U.S. in millions, U.K. in millions
France in billions, Germany in billions

The shift in trade in favour of the non-gold backed U.S. dollar in 1934 resulted in increasing the trade deficits in Britain and Germany. This devaluation of Roosevelt's merely increased the trade pressure in the same sense as imposing tariffs. Eventually, the French franc's overvaluation led to domestic pressure to devalue from the business sector. This was viewed as a means of making French goods more competitive. This eventually caused the French to devalue their franc in September 1936. As part of that devaluation, the Tripartite Agreement was finally reached among the United States, Britain and France. This agreement essentially stated that each nation would refrain from competitive exchange depreciation. Roosevelt's devaluation theory proved that other nations could just as easily devalue their currencies in response and as such a war of competitive devaluation would merely follow until everyone was right back where they began. The purpose of this agreement was to smooth out the erratic swings within the foreign exchange markets and to regain some sense of stability once again. But this agreement failed to prevent the French franc from falling against both the pound and the dollar between 1936 and 1938. Against the pound, the franc fell from 105 in 1936 down to 178 to the pound by June 1938.

Up to this point in time, economic contractions had officially been referred to as a depression. It was the contraction from the 1937 high which gave rise to a new term which was recession. This new term was purposely introduced in an effort to refrain from giving any suggestion that the economy was shipping back into a depression such as that which had just been experienced during the 1929-1933 era.

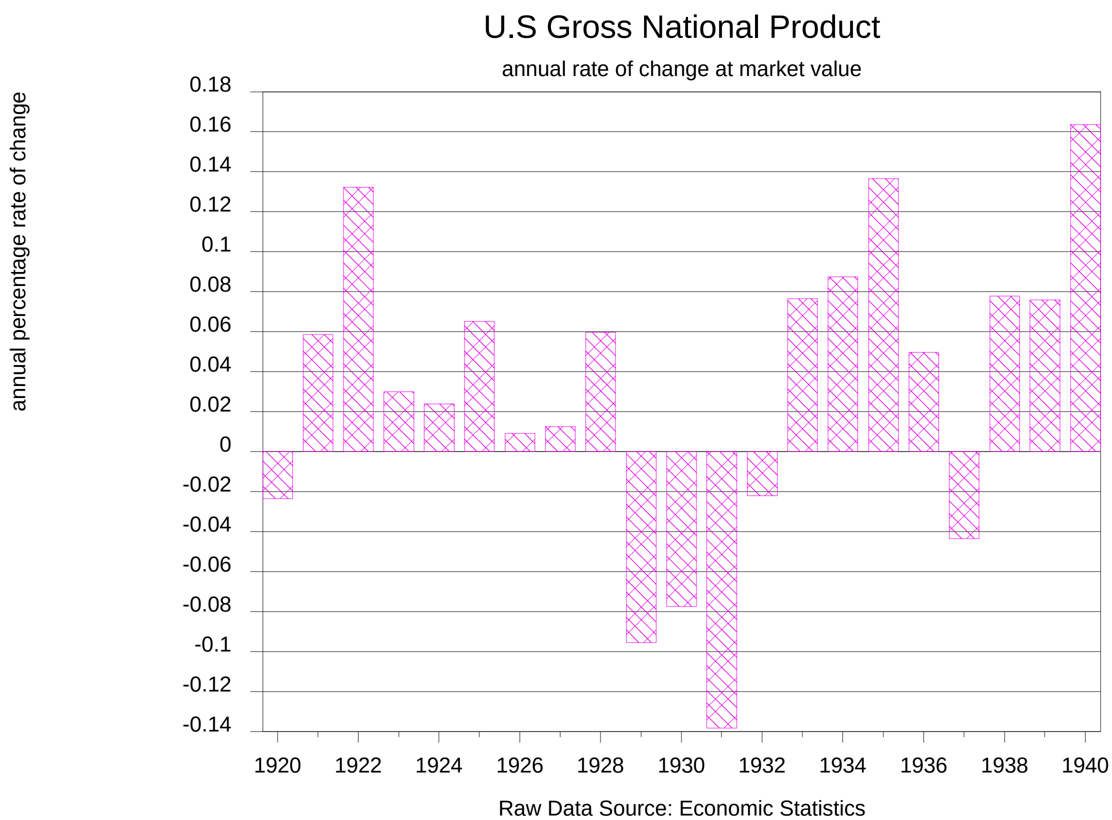
Curiously enough, the dollar began to rise significantly against the French franc and the Italian lira and moderately against the British pound moving into 1937. Again the stock market was influenced by foreign exchange during this period.

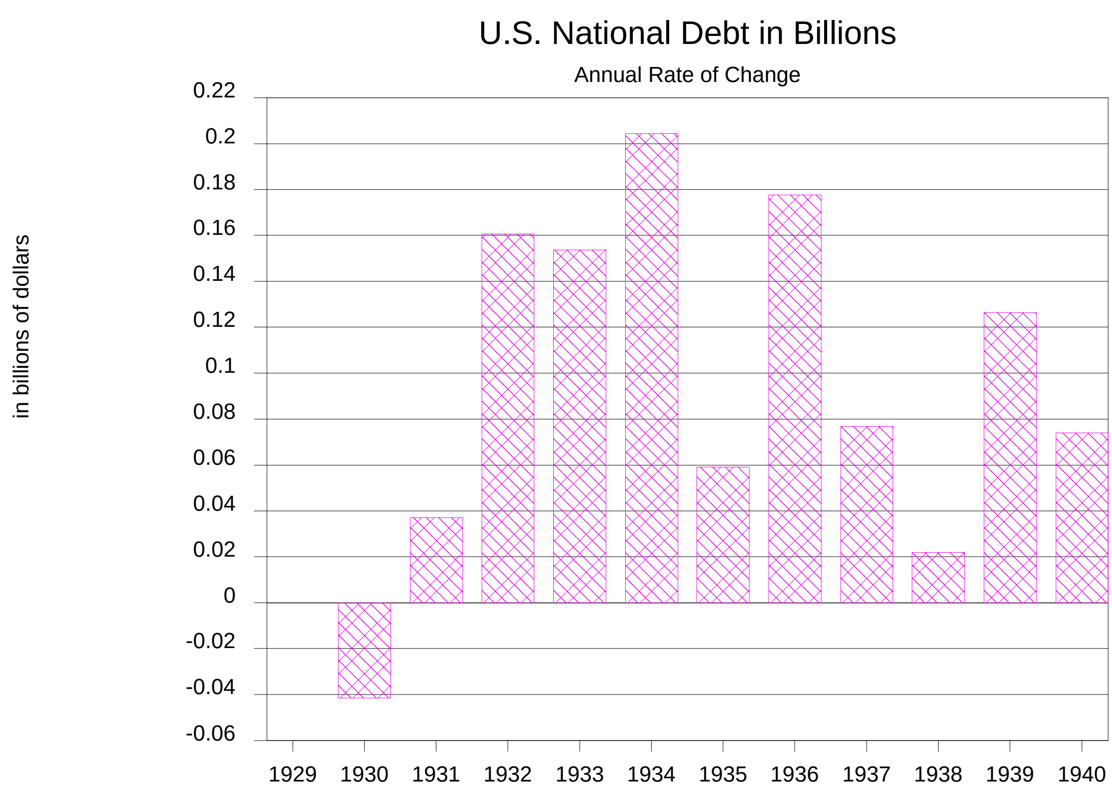
The depression which evolved from 1937 is very important to our understanding of what makes a market move, as well as to our perspective of economic theory itself. The following table illustrates some interesting points within the U.S. economy.

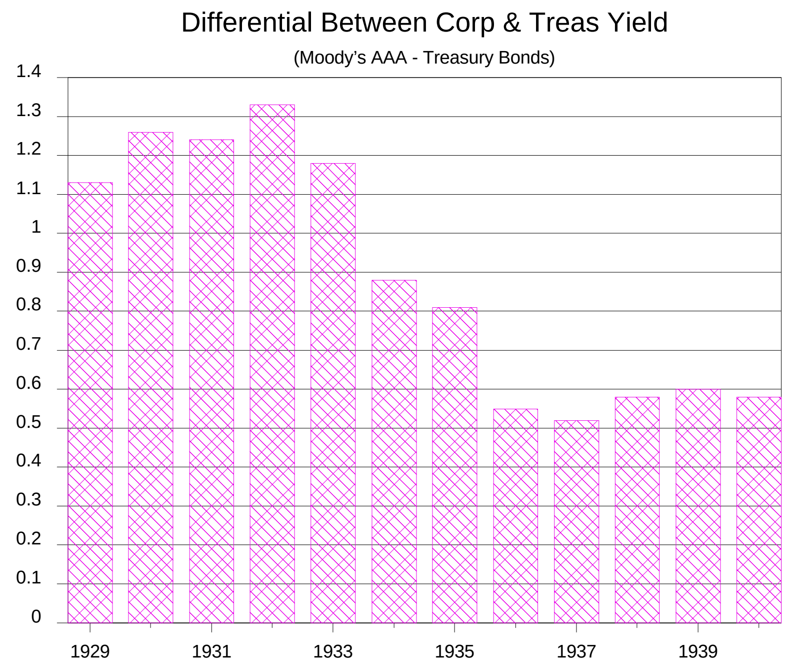
Between 1933 and 1937, confidence definitely began to move back toward the private sector. The spread between Moody's AAA corporate bond yield and that of U.S. Treasury issues began to narrow significantly. Corporate yields declined by 27.3% while Treasury yields declined by 17.2%. Although many people were looking at stocks as a hedge against inflation, they also recognized that eventually a cost of that inflation posed a rise to some extent in the risk of government bonds. Therefore, corporate bond yields declined at a far more rapid pace during the inflationary period of 1933-1937.

	1933	1934	1935	1936	1937	1938
Military Spending (mil)	41	34	41	38	41	41
Government Purchases (bil)	43	48	50	58	56	61
Money Supply M1 (bil)	20	22	26	30	31	30
Federal Budget (bil)	-2.6	-3.6	-2.8	-4.4	-2.8	-1.1
Natl Debt	22.5	27.1	28.7	33.8	36.4	37.2
G.D.P.	15.2	16.4	17.9	20.3	21.3	20.4
G.N.P	222.1	239.1	260.0	295.5	310.2	296.7
Wholesale Price Index	34.0	38.6	41.3	41.7	44.5	40.5
Government Bond Yields (%)	3.31	3.12	2.79	2.69	2.74	2.61
Moody Corp. Bond Yield (%)	4.49	4.00	3.60	3.24	3.26	3.19

The above table illustrates that government spending was rising significantly on the social side. I have provided the military expenditures, which you can see for yourself remained relatively stable. Money supply, as measured by M1, rose some 55% between 1933 and 1937. The wholesale price index rose 30.8%, reflecting a sizable jump in inflation under Roosevelt's Administration. The Gross Domestic Product increased slightly more than inflation, posting a gain of 34.2% which was actually 3.4% greater than inflation. GNP, which includes government expenditures, rose 39.6%. The National Debt, which stood at $22.5 billion in 1933, rose to $36.4 billion, a shocking rise of 61.7%. Therefore, it is obvious that the currency inflation and massive government spending did not produce the same percentage recovery within the economy. Roosevelt's policies increased the national debt by 61.7% while the Gross Domestic Product rose merely 34.2%. The


U.S Gross National Product
annual rate of change at market value
annual percentage rate of change
0.18
0.16
0.14
0.12
0.1
0.08
0.06
0.04
0.02
0
-0.02
-0.04
-0.06
-0.08
-0.1
-0.12
-0.14
1920
1922
1924
1926
1928
1930
1932
1934
1936
1938
1940
Raw Data Source: Economic Statistics


U.S. National Debt in Billions
Annual Rate of Change
in billions of dollars
0.22
0.2
0.18
0.16
0.14
0.12
0.1
0.08
0.06
0.04
0.02
0
-0.02
-0.04
-0.06
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939
1940



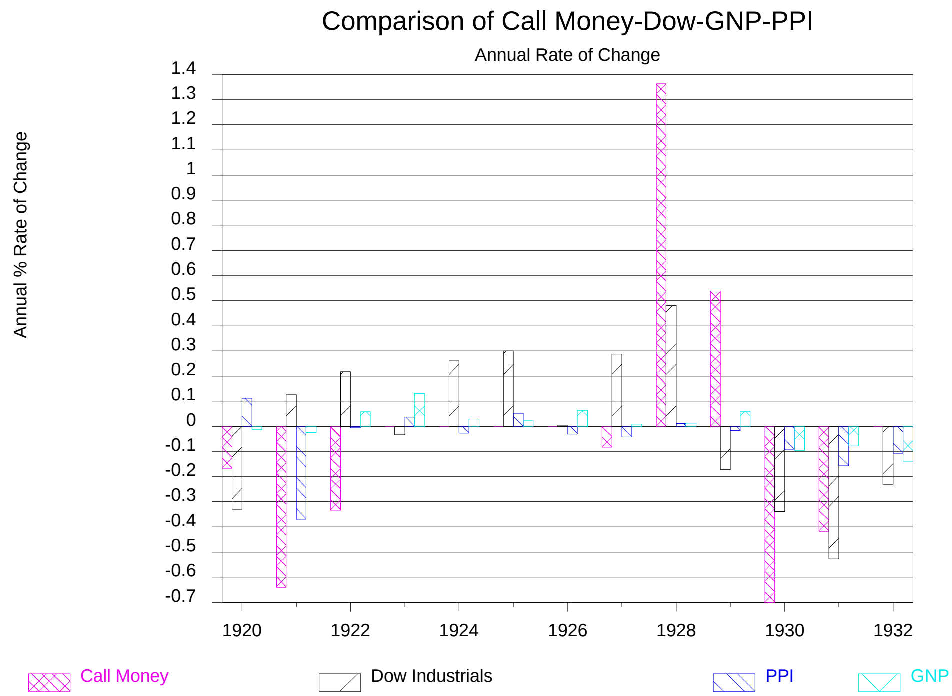
cost to extract those economic improvements in the long run were far greater than the benefits.

Commodities at their peak in 1937 by and large barely managed to rally and test the lows which had been set during the panic collapse back in the 1921 postwar era. The stock market had rallied back to the November 1929 low. When the severe recession into 1938 began, government expenditures continued to rise in the United States. Total government purchases rose 8.7% while the Gross Domestic Product declined 5% along with GNP. Unemployment rose 32.8% between 1937 and 1938. Interest rates actually began to decline from their 1937 high. Corporate income taxation rose 363% between 1932 and 1938. European government expenditures rose at a rate 300% greater than consumer expenditures. In all cases, the sharply higher government expenditures failed to prevent the "recession" of 1938. If there was ever a clear warning signal to illustrate that Keynesian economics only worked in theory and not in reality, it was at this early juncture in the world economy.

A seldom remembered economist of the turn of the century wrote a textbook which was in use prior to the Keynesian-Roosevelt era. His name was Professor Richard Ely of the University of Wisconsin and his book, "Outlines of Economics" was published by the Macmillan Company in September 1923, first edition 1893. The book relays a very basic fundamental of economic observation, and the chapter on the Business Cycle contains a very important description of the business cycle which has been long since forgotten.

"BANKING AND THE BUSINESS CYCLE"

"That the way the mechanism of banking operates has much to do with the cyclical oscillations of business is scarcely open to doubt. Banks furnish an elastic supply of purchasing power, swelling in volume as business transactions increase and therefore the supply is elastic only up to a certain

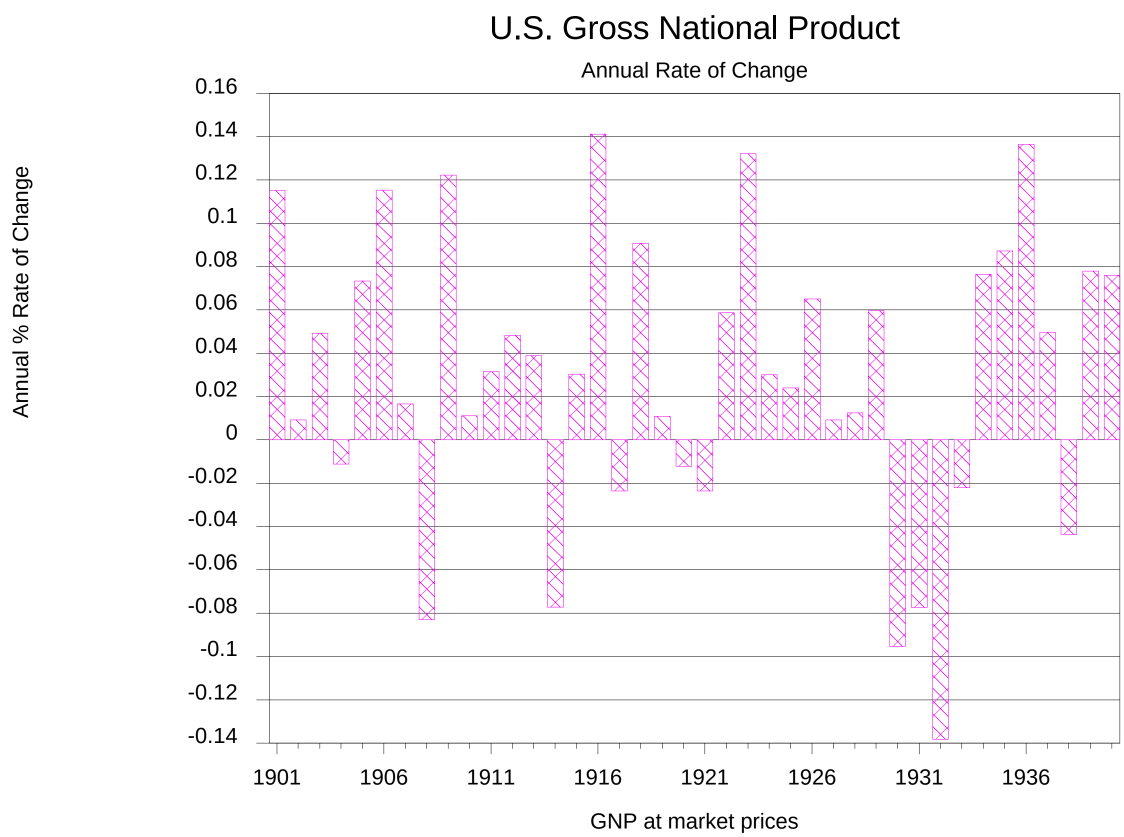


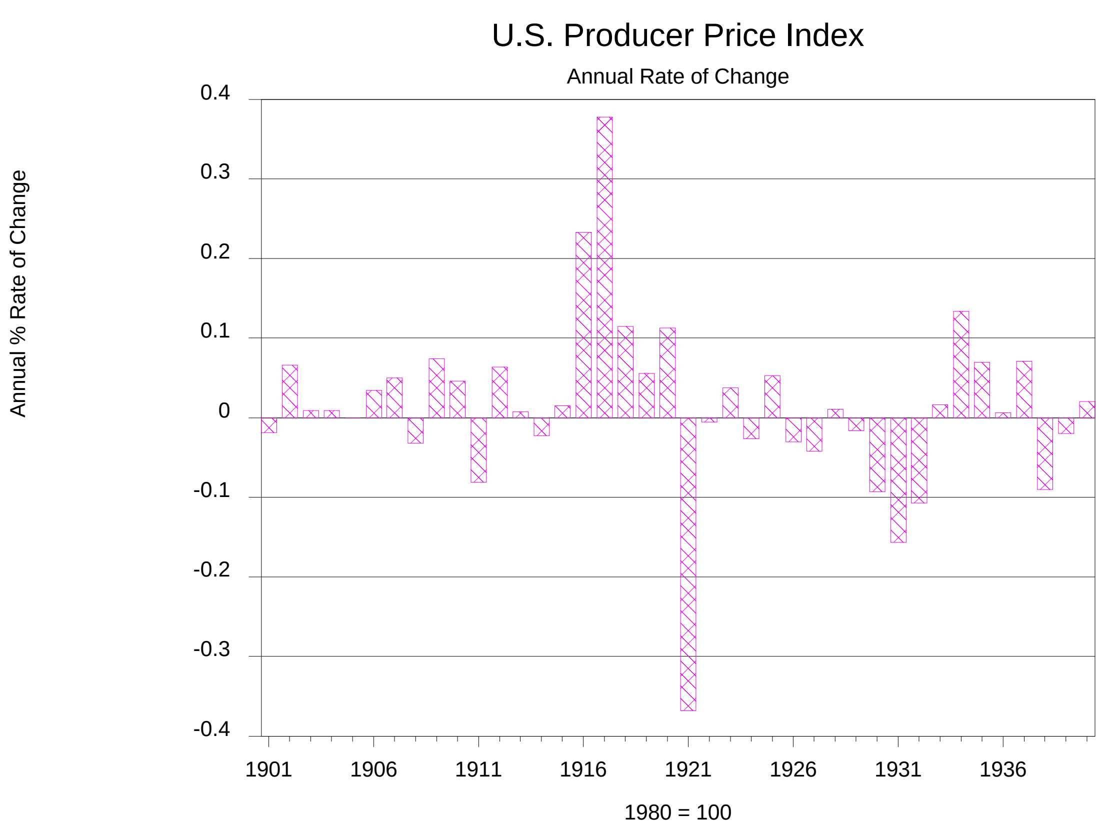
point often enforcing a sudden halt to further expansion.

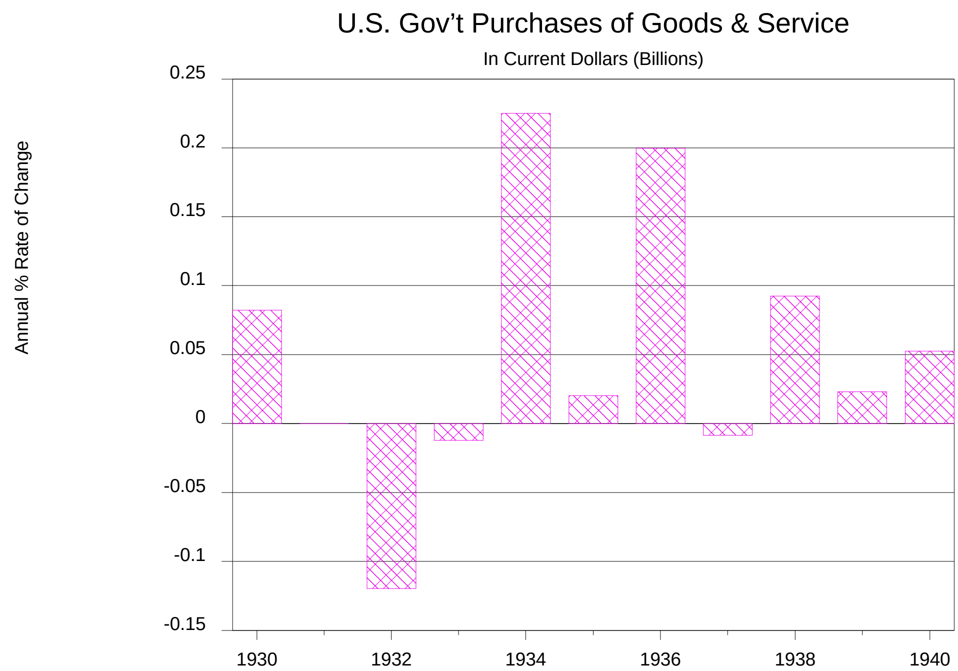
"The period of depression following a crisis is a period of liquidation. Business firms reduce their debts. The loans and the deposits of the banks decrease and thus their reserve ratios increase. Furthermore, with low prices and a sluggish movement of trade, money that had been in hand to hand circulation collects in the banks. Low prices stimulate exports and discourage imports, so that a favorite turn of the balance of trade sometimes brings in gold from other countries. In such ways the reserve ratios of the banks are still further augmented. Low discount rates result, and make business undertakings more attractive. Bonds sell at good prices, so that the time is propitious for building new plants and for other undertakings requiring large permanent investments of capital.

"Important as the cyclical oscillations of bank credit are, however, they do not suffice to explain the business cycle. Cheap supplies of credit help to give the stimulus that turns business upward, enabling it to pass from depression into the period of recovery. Exhausted supplies of credit, moreover, may bring prosperity to an end. But for the most part credit plays a passive role. Its expansion follows rather than precedes the expansion of business and even if the supply of credit were unlimited, business could not continue to expand indefinitely. The world's recent experience with irredeemable paper money has proved once more that no amount of inflation will carry business and industry up with it beyond a certain point. It operates like a drug, of which increasing doses are required to keep vitality from sagging below its normal level. Inflation may delay but cannot prevent the inevitable collapse."

Professor Ely's explanation is undoubtedly a voice calling from a long forgotten past. Roosevelt chose to ignore the eventual outcome of inflation and focused only upon its early stages where prices begin to rise. But it is absolutely true that there is what I call a certain stall factor in the inflationary cycle. It is similar to that of an


U.S. Gross National Product
Annual Rate of Change
Annual % Rate of Change
0.16
0.14
0.12
0.1
0.08
0.06
0.04
0.02
0
-0.02
-0.04
-0.06
-0.08
-0.1
-0.12
-0.14
1901
1906
1911
1916
1921
1926
1931
1936
GNP at market prices


U.S. Producer Price Index
Annual Rate of Change
Annual % Rate of Change
0.4
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
-0.4
1901
1906
1911
1916
1921
1926
1931
1936
1980 = 100

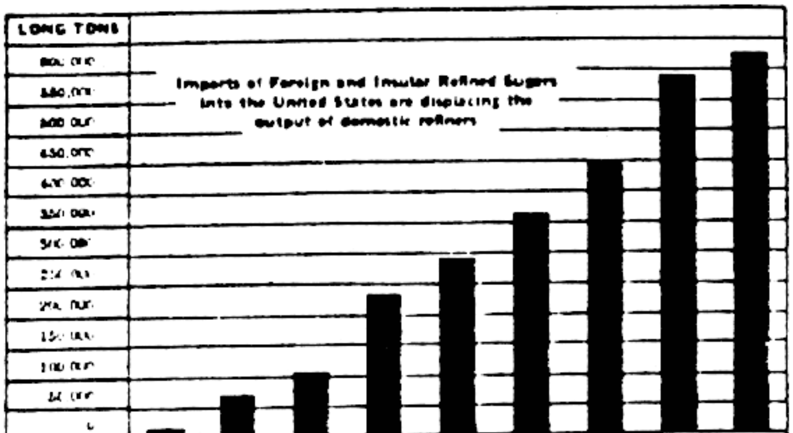


airplane at takeoff. Somehow it may have enough thrust to lift off from the ground but if enough thrust is not maintained, the gravitational forces will go to work and the plane will stall and fall back to earth.

The economy also has this stall speed. It is not easy to pinpoint the precise point where an economy will stall based upon all the various indicators, but it is unquestionably there. This is why the recession which came upon the economy abruptly in 1938 stands as a witness to the failure of Keynesian theory that government spending can help control the economy, thereby smoothing out the bumps. Perhaps it can help during the very depths of depressed markets but it is clear that this theory does not work indefinitely. If it did work, then the 1938 recession would not have taken place while government spending continued to rise 8.7% between 1937 and 1938. It is at best possible in theory that if "government expenditures" had been increased in proportion to the contraction in consumer and business expenditures that the "recession" could have been avoided. However, when the definition of a recession is two quarterly declines in the GNP, it becomes impossible for government to know when to increase its expenditures to compensate for the contraction within the economy.

The "recession" of 1938 had a profound impact upon the thinking behind the marketplace. It was here that the fundamental analysis began to change, realizing that inflation also raised the cost of doing business and in downturns, companies seemed to be even more sensitive because their cost of doing business had risen sharply as well. Thus, the concept that the stock market does not do well during inflationary periods emerged as a direct result from the rise in inflation through government spending between 1937-1940 while the market declined by 50% and then consolidated. This, by and large, has remained with the general analysis of the market. Take careful note that prior to the emergence of Roosevelt's bigger government, stocks had previously rallied significantly during inflationary periods and declined during deflationary periods. Now we view inflation as a nega-

American workers must have higher wages than Tropical workers!



From	1926–	1926	1927	1928	1929	1930	1931	1932	1933
Cuba	1,682	31,859	79,201	166,720	228,541	244,485	326,662	423,252	459,519
Puerto Rico .	707	2,891	10,584	40,006	38,919	66,164	72,314	85,558	97,129
Hawaii	8,592	7,244	12,328	14,641	8,723	15,003	9,720	19,901	22,006
Philippines .	2,647	6,000	1,836	7,103	8,596	25,197	32,009	50,309	61,752
Other Foreign	3,654	5,394	917	5,200	1,820	9,197	6,499	8,295	6,392
Total	16,782	69,388	104,866	233,670	286,199	360,046	447,204	587,318	626,598

THE flood of *refined* sugar into the United States today from the Philippines, Puerto Rico, Cuba tells its own story of a commercial invasion throwing Americans out of work in ever-widening circles.

In 1933 alone this increasing flood of *refined* cane sugar prevented the refiners of the United States from supplying the needs of 15,000,000 Americans. On April 18, 1932, Congress was informed by Petition that three domestic refineries had been closed and "the remainder are working on part-time."

What this represents in loss of employment to American workers may be judged by the fact that 19 U. S. *refineries* between 1922 and 1931 spent $231,605,137 in salaries and wages. They pay out for materials and supplies, including coal, oil and power, approximately one billion dollars in a normal ten-year period, furnishing business for many industries and employment for many thousands of our people.

This condition is the result of a Government policy that inadvertently encourages the construction and operation of *refineries* in the Philippines, Puerto Rico and Cuba, which are tropical producers of *raw* sugar. The policy assumed that these tropical islands would not duplicate United States *refineries*. The assumption has proved to be wrong. Tropical refineries hum. United States refineries work part-time.

The United States is the only nation today that permits sugar *refined* in the tropics to enter in competition with its home refiners. All other countries protect their refining industries and safeguard their home market from duplication of *refineries even in their own colonies*.

The United States provides the world's greatest market for *raw* sugar. For 200 years it has developed the manufacturing industry of *refining* sugar to meet the needs of an expanding country, serving it in every emergency.

No country can surpass the United States in modernness, efficiency and sanitary cleanliness of its sugar refineries. Experience demonstrates that the cane sugar industry attains its highest development by producing *raw* cane sugar in the tropics and *refining* it in the country of consumption.

Since N. R. A., the refining costs of United States refiners have increased greatly. N. R. A. does not apply to Cuban refiners, who also escape certain processing taxes, and also benefit from tropical labor and also enjoy a subsidy in addition!

A very small group of tropical *raw* sugar producers now demand United States quotas for their *refined sugar* to make permanent the unfair position they have secured recently in the United States market—thus permanently displacing American workers and the refineries in which tens of thousands of Americans have invested.

We cannot believe it fair to America for Congress to permit tropical manufacturing competition to jeopardize a home industry of such widespread benefit to our people.

"Men are never so likely to settle a question rightly as when they discuss it freely."

United States Cane Sugar Refining Industry

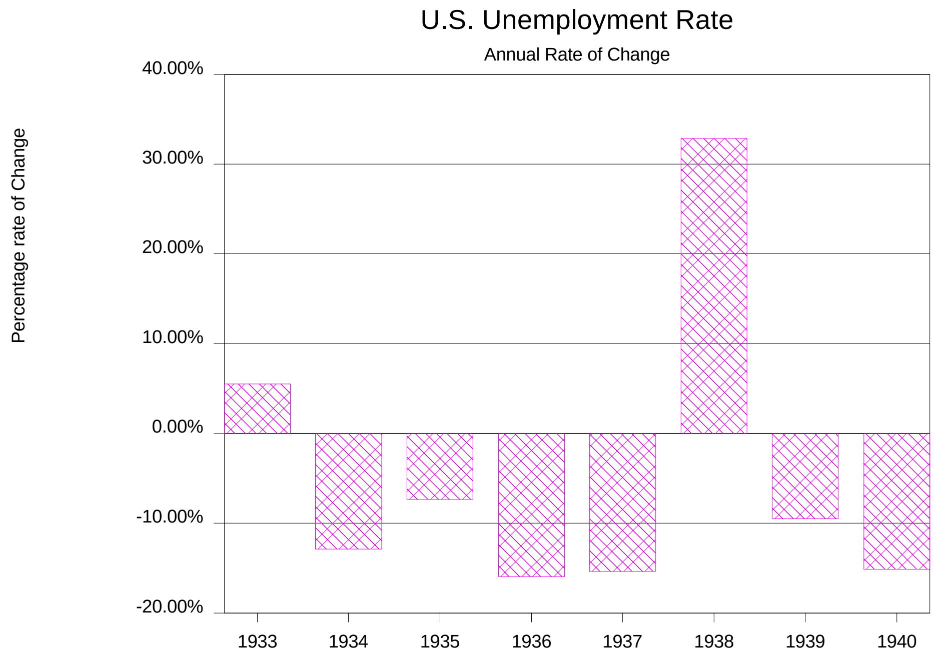
Refineries in Massachusetts, New York, New Jersey, Pennsylvania, Maryland, Georgia, Louisiana, Texas and California

tive influence upon the market and at times I have been astonished to listen to some analysts who have even viewed increases in taxation as anti-inflationary and thereby bullish for the market. In the future, expect that this analysis will once again shift and in its place will emerge the realization that corporate assets appreciate with inflation as well as profits. The negatives which many view today will flip around into positives in the years ahead. The majority may at first be astonished that stocks will rise with inflation once again until it hits that stall speed which is most likely going to occur during 1989-1990.

In reality, prosperity is a period where business profits increase. Those profits depend upon the spread between expenses of production and the income from the sale of production. The reason that profits increase during inflationary periods is actually quite simple. Much of the overhead in business, such as rent, interest on bonds, etc., is fixed. As economic activity begins to expand, these portions of overhead remain constant, thereby reducing their impact on a percentage basis as prices of output rise. Many management decisions look at the demand and begin to expand their production and, in doing so, their fixed overhead rises significantly. Raw materials generally lag behind the business cycle because most commodities cannot be expanded as rapidly as business. As a result, commodity prices rise rapidly toward the end of the cycle. As the economy expands, employees themselves begin to become a rare commodity. As unemployment declines, business then must raise wages to obtain competent help. Therefore, when the stall speed is reached, much of the overhead has risen significantly. Eventually, competition increases and with it, profits are normally cut as price wars and overproduction begin to emerge. Cost reductions are implemented, which

usually cut first at employees because leases on premises are generally long term to some degree and represent fixed levels of overhead. Therefore, unemployment begins to rise once again.

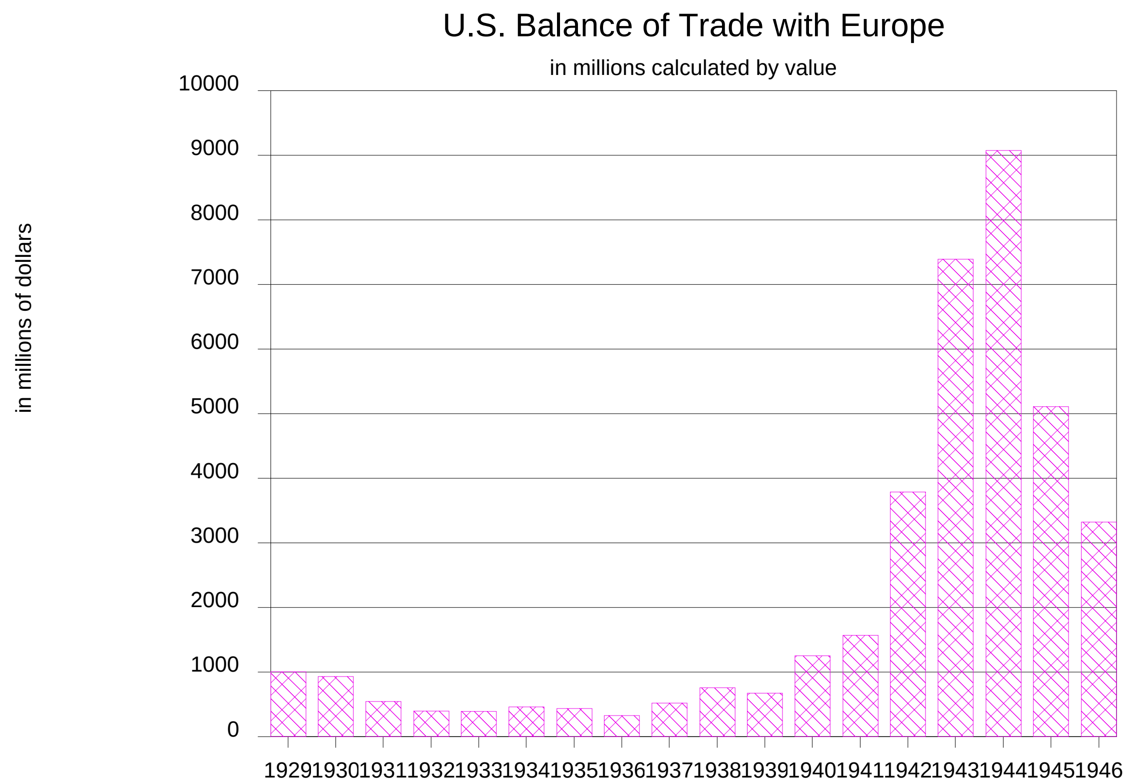
Roosevelt's experiment chose to raise the price of commodities first through currency inflation. In the normal business cycle,

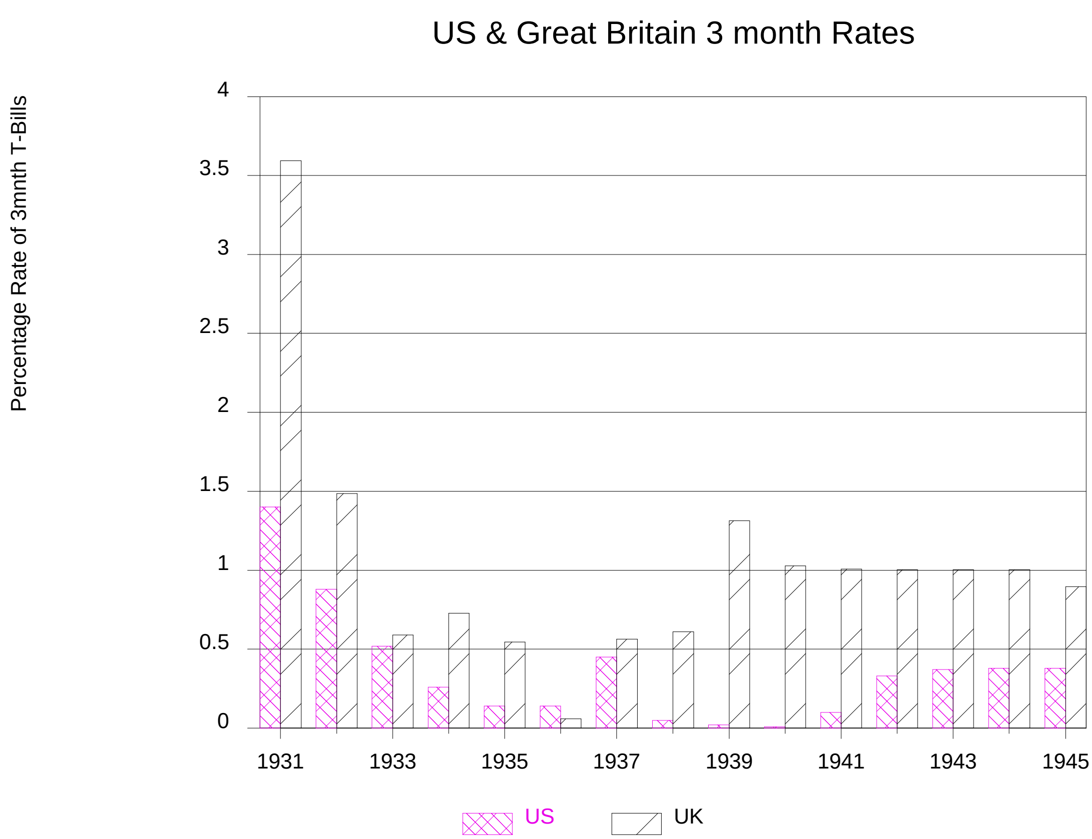


commodities rise toward the end, not at the beginning, because they are responding to the higher levels of demand. Therefore, the period of 1933-1937 is different from most expansionary recoveries. Here we had commodities rise first as Roosevelt attempted to artificially create a boom. But it failed and as a result the capital expenditures rose significantly for government. The cost of production for business rose dramatically from the outset; thereby the underlying profits, which are accrued during the early stage of the business cycle, were not available for utilization during the later part of the business cycle. Therefore unemployment, which had peaked at 24.9% in 1933 and declined to 14.3% in 1937, rose 32.8% in 1938 back to 19% of the civilian labour force. The civil labour force in 1929 was equal to 40.3% of the population. In 1938, the civil labour force was 42%. Therefore, the number of persons thrown into unemployment during 1938 exceeded the rise in number between 1929 and 1930.

This is why the recession of 1938 was sharply expressed by the 50% decline within a 12 month period from the 1937 high in the Dow Jones Industrials. Continued profits depended solely upon a continuation of price inflation. This in a very real sense turned business into a speculative venture gambling upon inflation to raise the price of its products. When the economy is built upon such a flimsy foundation, once demand declines, the situation is ripe for crisis in a shorter period of time.

The trade picture between Europe and the United States increased in general gross levels but essentially exports to and imports from Europe remained relatively stable. In 1932, U.S. exports to Europe were $784 million and imports were $390 million. In 1937, exports were $13 billion while imports were $843 million. Exports increased 73.4% while imports increased 86.09%. Roosevelt's policies had increased price levels, but the trade surplus continued to decline. On a net accounting basis, the situation became worse and the inflationary policies raised employment, but the trend dictated that it was still a negative growth factor that was being artificially maintained


U.S. Balance of Trade with Europe
in millions calculated by value
in millions of dollars
10000
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
1929 1930 1931 1932 1933 1934 1935 1936 1937 1938 1939 1940 1941 1942 1943 1944 1945 1946


US & Great Britain 3 month Rates
Percentage Rate of 3mnth T-Bills
4
3.5
3
2.5
2
1.5
1
0.5
0
1931
1933
1935
1937
1939
1941
1943
1945
US
UK

by government's inflationary policies. On a total world trade basis, the U.S. trade surplus under the Smoot-Hawley Act was $324 million and in 1937 it was $270 million. In one respect, the salaries of those who were put back to work during the 1933-1937 recovery were paid by the dramatic rise in government spending, which turned up in the national public debt. Today we are still paying interest on Roosevelt's spending from this era. Had Roosevelt hired those people and placed them on the government payrolls, the economic effect from an accounting standpoint would have been no different. The situation would have improved had the trade surplus grown and not declined.

Another interesting effect began to take place in response to Europe's arms build-up. The dollar began to strengthen significantly from 1936 when France devalued the franc. The British pound continued to fall from the $5.00 level to $4.67 by the end of 1938. But as rearmament began to spread throughout Europe, the pound plunged desperately from $4.67 in mid-1939 to $4.03 on September 3, 1939 when exchange controls were introduced to fix the pound at that level for the next ten year period. The pound never again saw the old pre-World War I level of $4.86.

As fears of war began to increase throughout Europe, capital once again began to flee toward the United States. This caused the dollar to rise on world markets and the old scenarios began to come alive. Foreign buying actually supported the U.S. stock market in 1938. Even though the economy was not exactly booming just yet, the lack of interest on the part of U.S. investors was more than augmented by European capital inflow. Therefore, foreign exchange had played an important role once again at the turning point for the U.S. stock market.

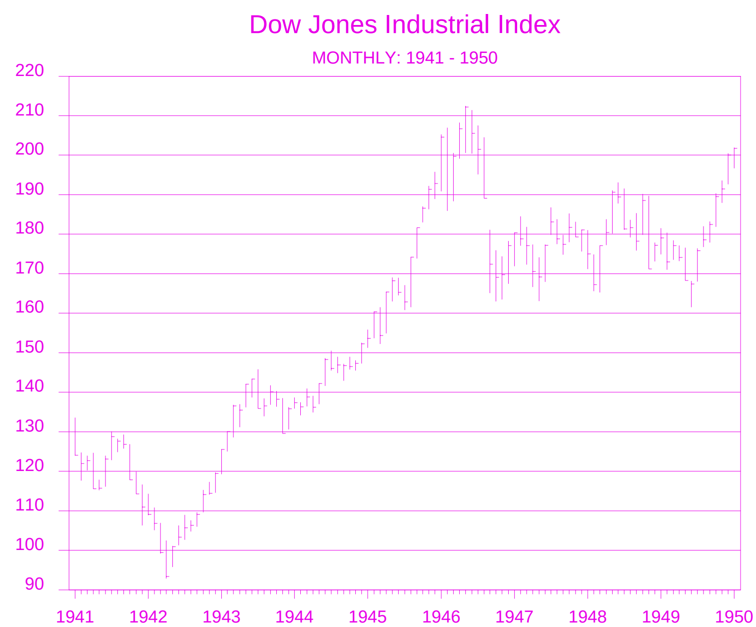
Smoot-Hawley Tariff Act was $324 million and in 1937 it was $270 million. In one respect, the salaries of those who were put back to work during the 1933-1937 recovery were paid by the dramatic rise in government spending, which turned up in the national public debt.

The side effect of this foreign capital entering the U.S. economy was exactly the same as it had been during the 1920s. Interest rates, which had initially begun to rise between 1936 and 1937, reversed their trend in the United States quite abruptly. The

British Treasury Bill rate for three months jumped from .563% in 1937 to 1.315% in 1939. It would drop back under 1% eventually only after World War II. The United States Three Month Treasury Bill rate declined from .45% in 1937 to .02% in 1939, continuing to its lowest point in history during 1940 at .01%. The dramatic swings between the short-term rates in the United States and those in Britain illustrate just how intense the capital flow into the United States had become.

Click here for PEI's Homepage

From the 1937 high in the Dow Jones Industrials, the market essentially traded sideways back and forth between the 160 level, eventually falling under the 1938 low moving into April 1942. Then the trade surplus began to widen in favour of the U.S. as Europe needed the production facilities from its industries. By the spring of 1946, the Dow Jones Industrials rallied from 93 to 212 throughout the course of World War II.

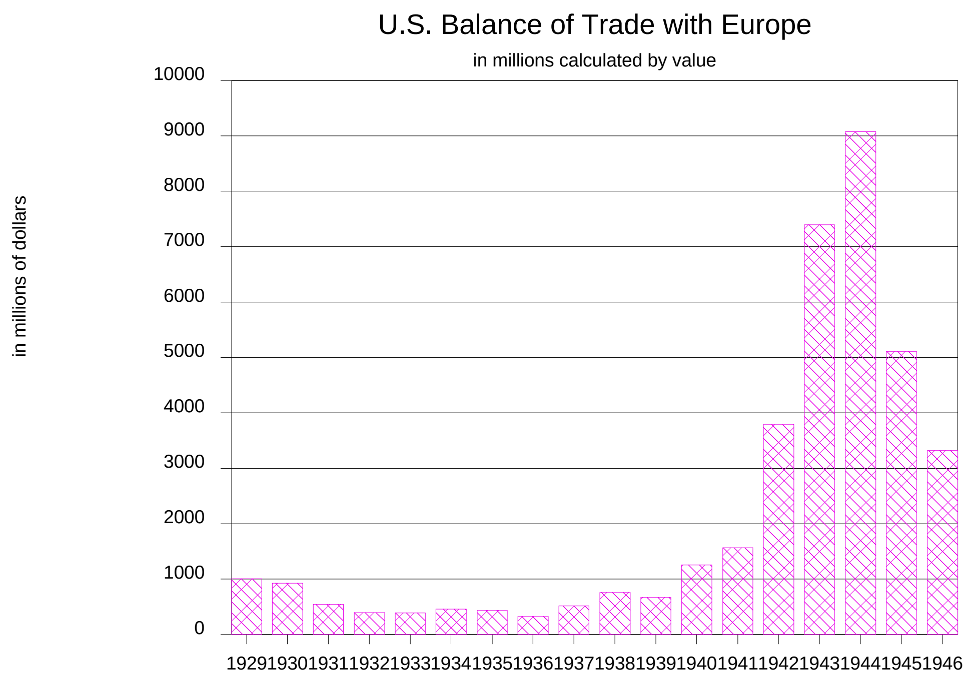


Trade Surplus (Deficit)

	U.S.	Europe	U.K.	France
1941	1,675	1,566	(649)	(9.16)
1942	5,247	3,789	(721)	3.71
1943	9,461	7,693	(994)	21.45
1944	10,233	9,364	(1,027)	15.79
1945	5,426	5,106	(654)	(45.63)
1946	4,767	3,318	(336)	(16.33)
1947	9,530	4,853	(597)	(17.38)

The above table of foreign trade illustrates how the world situation stood between 1941 and 1947. The first column represents the total world trade picture of the United States expressed in millions of dollars. The second column, U.S./Europe, is exclusively the trade between Europe and the U.S. in millions of dollars. Note that Europe was the largest trading partner. The United Kingdom (Britain) is expressed in millions of pounds and the French data is provided in billions of francs.

We can see clearly that the huge swing in the trade surplus for the United States as supported by the above table, provided two aspects to the U.S. economy and marketplace. First, the capital inflow sparked virtually a straight up move in the Dow Jones Industrials between 1942 and 1946. If you refer to the chart covering the years between 1941 and 1950, notice that the only pause in the trend came during the later part of 1943. Other than that five month correction, the trend was virtually straight up with only seven other months which even briefly penetrated below the previous month's low. When the market came to its abrupt high in 1946, the bottom was well established during the five month panic collapse in 1946 from the major high.



The second effect that this huge trade surplus in favour of the United States had upon the economy was reflected in the official gold reserves. It was America's industrial production through the innovation of the automobile and the airplane that provided goods for European consumption. For that productivity, Europe paid in terms of gold and in 1950 when all the dust had settled, the United States held 76% of the entire official world gold reserves. This factor would serve as the primary reason why the U.S. dollar would gain world dominance from 1950 onward.

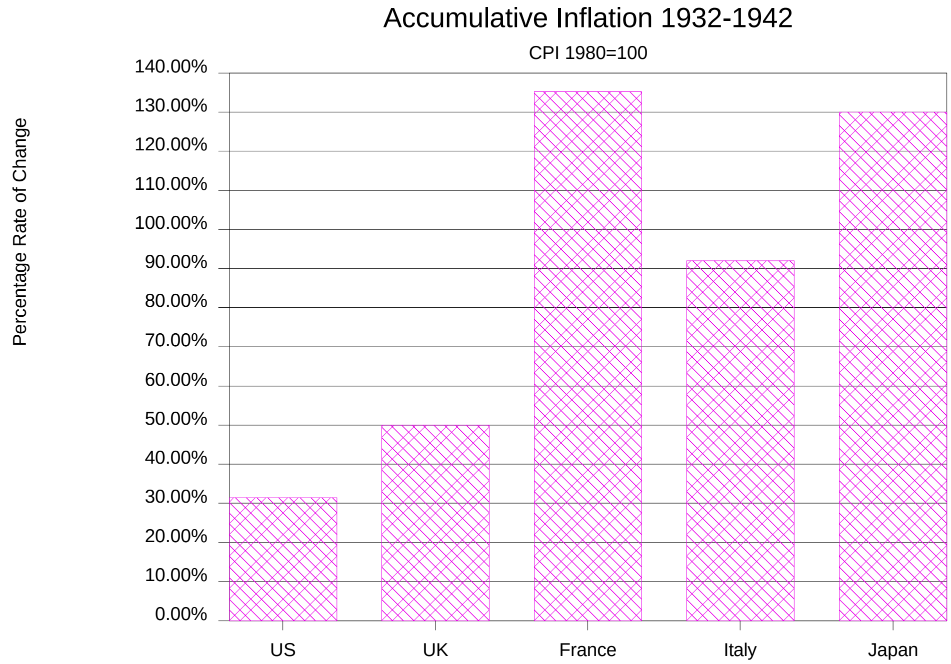
Again, immediately following the war, many commodities were in short supply and the reconstruction which was anticipated led to much immediate postwar speculation going into 1946. But this was nowhere as significant as that which followed World War I preceding the panic of 1920.

Following the early 1946 high, a recession period set in as trade declined and government spending for armaments decreased. The trade surplus expanded in the United States during 1947 but much of this was for raw materials and civilian goods. The stock market regained about 50% of its loss from the high in 1946. But the economy was shifting from war to peace and this took some readjusting on the part of industry.

There are several points which should be made in respect to the rally in the stock market between 1942 and 1946. We have read how during the rally of 1933-1937, the attitude toward the market was one of a hedge against inflation. It is important to our understanding of market behavior that we look at the inflationary aspects of the 1942-1946 period as well. The following table compares the Producer Price Indexes on an international basis. Roosevelt's currency inflation actually exported inflation to other nations, which prompted the battle of devaluation practices.

Producer Price Index 1932-1942

	1932	1942	% Chg
U.S.	12.5	19.0	+ 52%
U.K.	4.1	7.6	+ 85%
France	0.61	1.9	+ 211%



Italy	0.26	0.55-	+ 111%
Japan	0.10	0.23	+ 130%

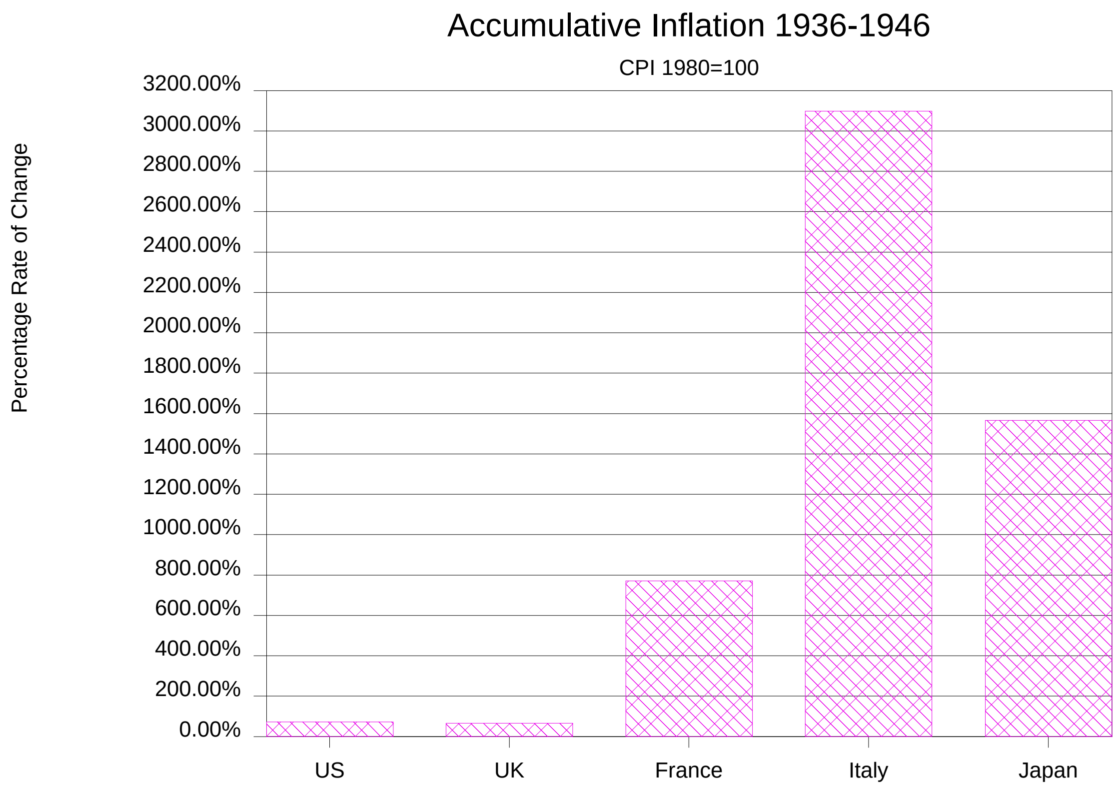
The above table illustrates that inflation was varied from one nation to another. But there is no question that the 1932-1942 period was one of inflationary trends. The curious factor is that although government spending continued between 1936 and 1942, the economy itself had entered a recession. Therefore, the concept that government could increase its spending to stimulate the economy did not unfold as some would like us to believe.

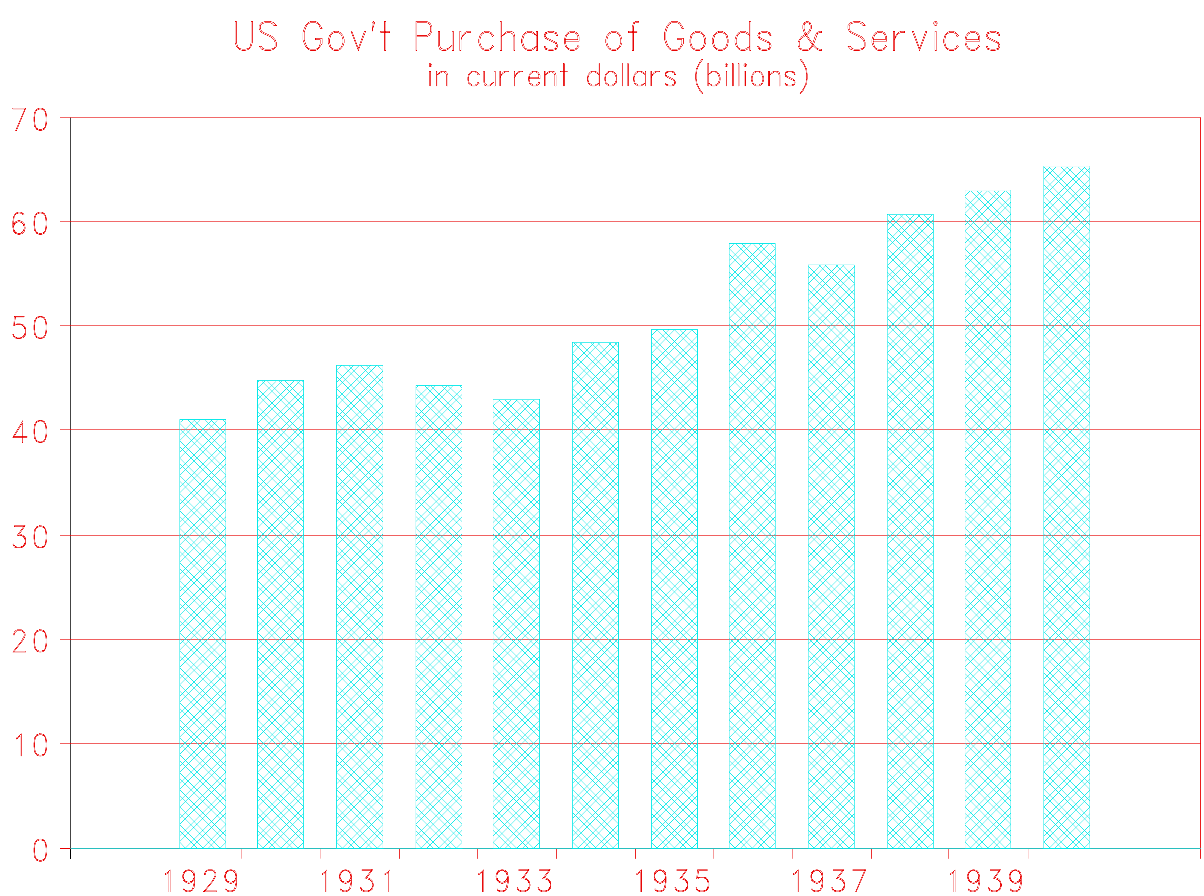
The economy finally improved in the United States in response to the huge increase in foreign buying due to the war as reviewed in the previous table on Trade Surplus from 1941-1947. The effects of World War II on the inflationary picture are quite clear. Between 1936 and 1946, inflation rose much greater than in the 1932-1942 period. The following table of Producer Price Indexes illustrates this quite bluntly.

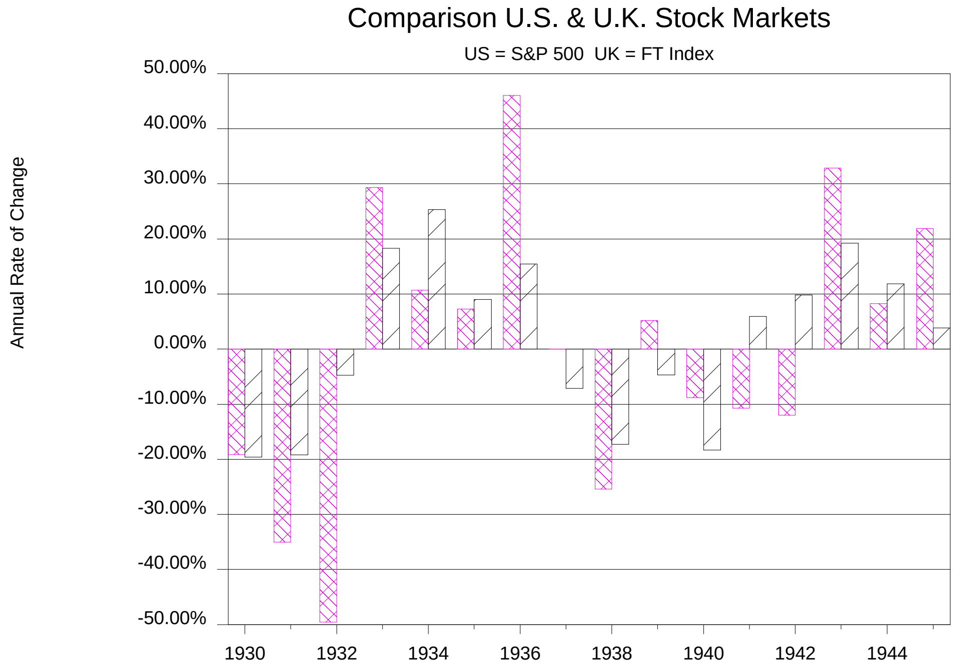
Producer Price Indexes 1936-1946

	1936	1946	%Chg
U.S.	15.5	23.2	49.6%
U.K.	4.6	9.2	100%
France	0.60	6.0	1,000%
Italy	0.29	10.4	3,486%
Japan	0.12	2.0	1,566%

Inflation in the United States was not that dramatically different in the 1936-1946 period compared to the 1932-1942 period. The prewar period posted a 52% inflation rate while during the war, when price controls and rationing were employed, inflation actually declined to 49.6%. Still this was a sizable gain in inflation for this war period. It did not hamper the stock market from rallying whatsoever. The European situation was much more different when we compare the previous inflation tables. In Britain, inflation rose from 85.3% in the prewar period to 100% during the 1936-1946 era. In France, inflation rose from 211% to 1,000%, while Italy bore perhaps the largest brunt of inflation, jumping from a prewar rate of 111% to 3,486% during the 1936-1946 period.


Accumulative Inflation 1936-1946
CPI 1980=100
Percentage Rate of Change
3200.00%
3000.00%
2800.00%
2600.00%
2400.00%
2200.00%
2000.00%
1800.00%
1600.00%
1400.00%
1200.00%
1000.00%
800.00%
600.00%
400.00%
200.00%
0.00%
US
UK
France
Italy
Japan


US Gov't Purchase of Goods & Services
in current dollars (billions)
70
60
50
40
30
20
10
0
1929
1931
1933
1935
1937
1939



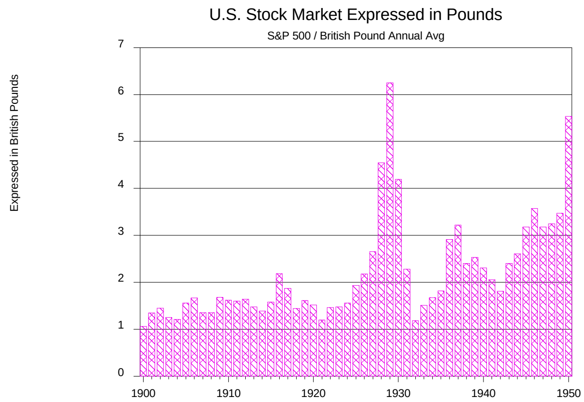
If we look at the stock markets in Britain and the United States, we can see clearly that it was the U.S. market which offered the hedge against worldwide inflation once again.

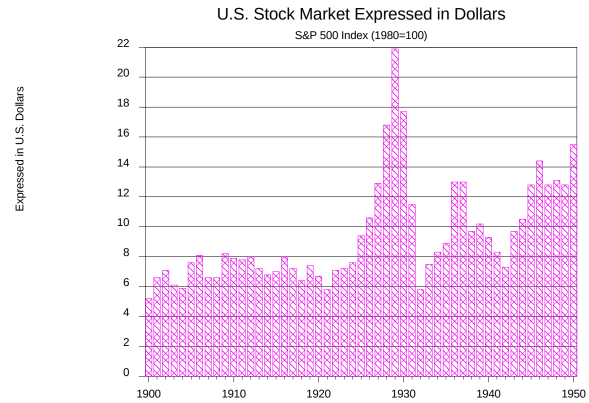
Industrial Stock Indexes

	1936	1946	%Chg	Adj. for Infl.
U.S. (Dow)	160.00	180 .00	12.5%	(-36.9%)
U.K.	11.2	11.9	6.25%	(-93.7%)
(Dow in terms of pounds)				
Pound Avg	4.971	4.03	(18.9%)	
Dow in terms of pound			31.4%	(-17.9%)

The above table introduces the concept of how the U.S. market appeared to the British investor seeking a hedge against inflation. Although the Dow Jones Industrials rose only 12.5% in the face of 49.4% domestic inflation, the sharp rise in the dollar against the pound, 18.9% with exchange controls, actually increased the value of the Dow by 31.4% in their eyes, ignoring the inflationary considerations. Taking into account the inflationary trends in the United States, the Dow Jones Industrials declined in terms of pounds by only 17.9% compared to the British stock market, which declined by 93.7% after adjusting for British inflation.

For some reason, the majority of analysts in the United States have lived in a fish bowl of isolation. They have formed their conclusions based upon domestic considerations. The rise in the stock market between 1942 and 1946 was not outstanding in terms of dollars versus inflation. It managed to exceed the 1936 high of 193 by reaching only 212 in 1946. Some would definitely point to this period as evidence that the stock market does not prosper during periods of inflation. But to the contrary, it at least rallied and moved to new highs. From an international perspective, the dollar was rising in international purchasing power. Even though U.S. domestic accumulative inflation was 49.4%, Its purchasing power against a basket of currencies, including the franc, lira, yen and the pound, increased





31.8%. Therefore, $100 in 1936 would have purchased nearly $132 in foreign goods during 1946. Therefore, let's create a basket basis 1949 and compare it to 1929.

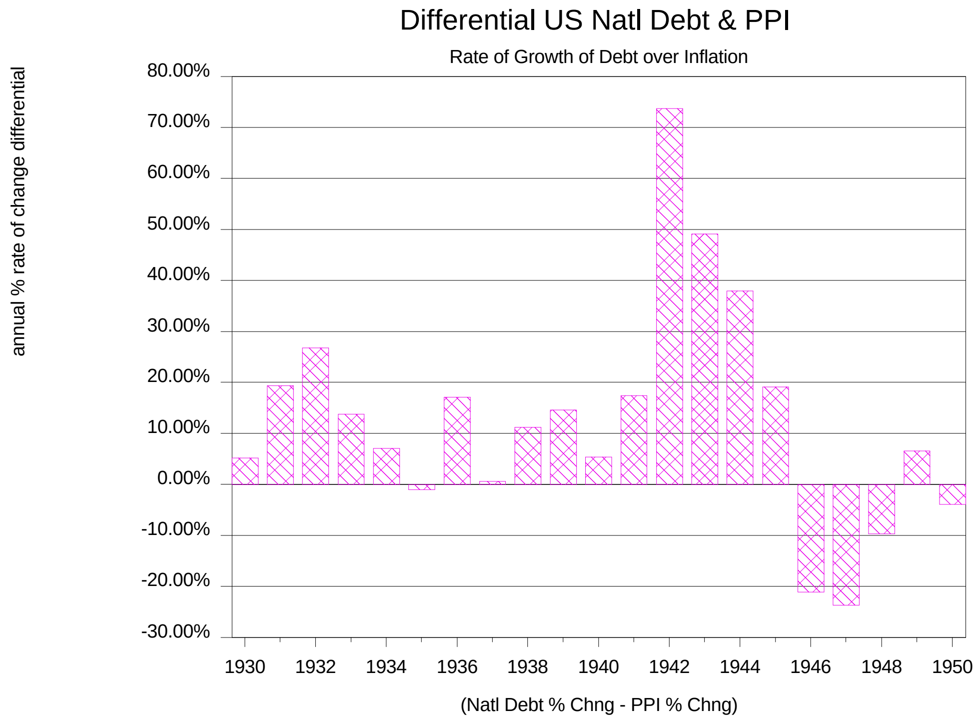
Dow Jones Industrials Expressed
in a Basket of Currencies

	1929	1949	% Change
Pound	$4.857	$3.680	(24.2%)
Franc	.039	.003	(92.3%)
Lira	.052	.001	(98.0%)
Yen	+ .460	.003	(99.3%)
Basket (X)	5.408	3.687	
(X+ 1/5) (Y)	1.280	.937	
(1/Y)= I	.78	1.06	
Dow Ind	386	212	
(Dow x I)	301	225	(25.2%)

The basket in the above table was created without weights. I obtained the sum of the four currencies and added 1 to represent the dollar and then divided by 5 which gave the figure "Y." I then divided 1 by "Y" to establish a unit of international value "I" which is easier on the eye to comprehend from the U.S. perspective. In 1929, that international unit of value was equal to 78 cents so to speak. In 1949, it was worth $1.06. Therefore, this illustrates the overall appreciation of the dollar itself during this 20 year period. Then taking this figure and simply multiplying it against the Dow, we obtain an adjustment in terms of international purchasing power. This exercise demonstrates that purchasing power between the international Dow was only 25.2% less than the 1929 high, whereas, in contrasting terms the Dow was still 45% below the 1929 high.

Much of the real inflation never hit home during the 1940s. This was largely due to the fact that a fair portion of the debt was resulting from foreign loans which again were being floated through U.S. bonds. The following table illustrates the impact of government spending and the lag in inflation on a percentage basis to the rise in the national debt.

	Fed Budget Surplus (-) ($mil)	Wholesale Price Ind (1967= 100)	National Debt ($bil)
1937	(2,777)	44.5	36.4
1938	(1,177)	40.5	37.2
1939	(3,862)	39.8	41.9
1940	(2,710)	40.5	45.0
	Fed Budget Surplus (-) ($mil)	Wholesale Price Ind (1967= 100)	National Debt ($bil)
1941	(4,778)	45.1	57.9



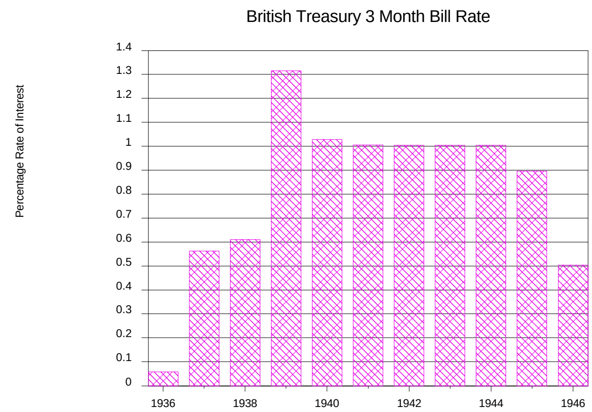
1942	(19,396)	50.9	108.2
1943	(53,812)	53.3	165.9
1944	(46,138)	53.6	239.6
1945	(45,022)	54.6	278.1
1946	(18,201)	62.3	259.1
1947	6,600	76.5	256.9
1948	8,864	82.8	252.8
1949	1,006	78.7	257.1
1950	(2,207)	81.8	256.7

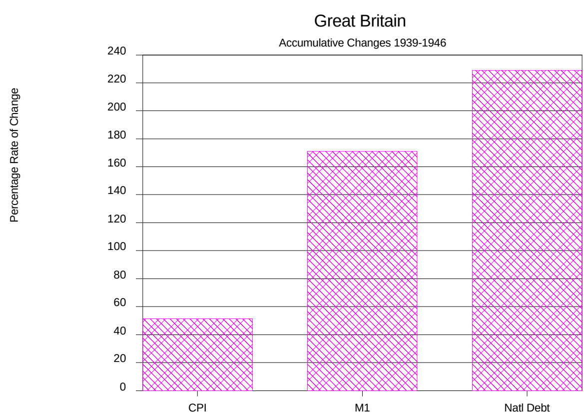
Upon Roosevelt's death in 1945, Truman immediately attempted to end the inflationary policies of his predecessor. This is evident by the sharp reduction in the fiscal deficit for 1946 and the immediate return to surplus during the years of 1947-1949. The national debt came to a screeching halt and did not exceed the 1946 high until the early 1950s.

Much of the inflation in the United States was highly controlled by Roosevelt. The army actually seized the gold mines and all production was under government management. Rationing and strict price controls sheltered much of the domestic economy from the real inflationary trends hidden in the national debt.

In the midst of all this chaos, the United Nations managed to put together an economic summit during July 1944, held at Bretton Woods, New Hampshire. It was at this conference that the theory of manipulating foreign exchange rates, such as those of the central banks back in 1925-1927 and the devaluation practices of Roosevelt, were attacked. Bretton Woods brought forth the establishment of the World Bank and the International Monetary Fund (IMF). Although the war was not yet over, the member nations sought to look forward to the economic problems which would face them once the war had come to an end.

The monetary system that was formulated at Bretton Woods was based upon a pledge from all member nations to keep their currency within a percentage point or to an agreed dollar value. The IMF was designed to provide moral suasion and credit to keep the system alive.

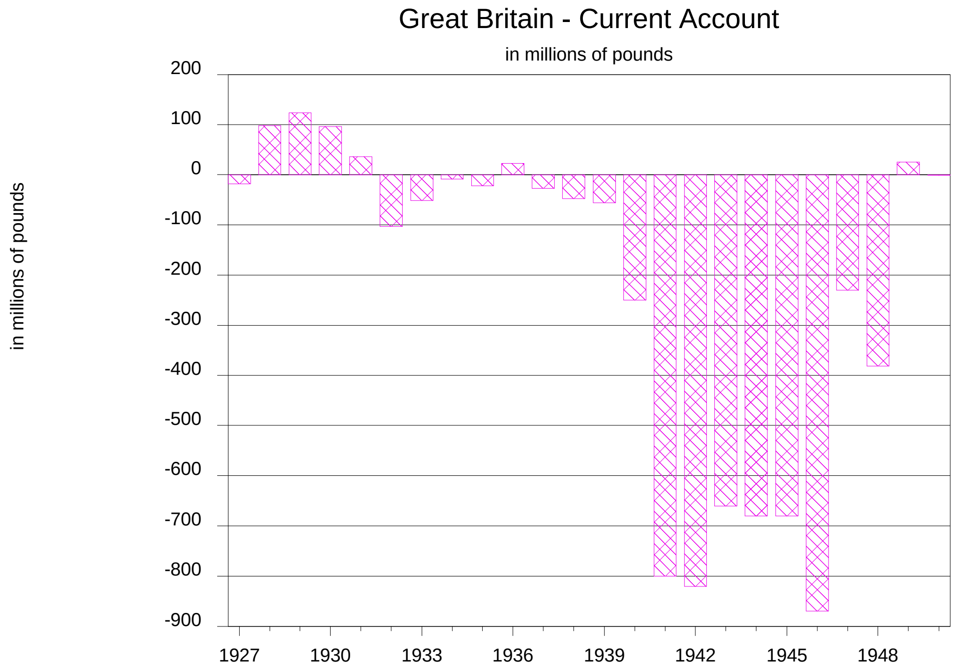




But the economic problems could not be swept away by Bretton Woods. In Britain, the national debt had risen from 7.2 billion pounds in 1939 to 23.7 billion pounds in 1946. where it was absolutely necessary, rationing and campaigning to promote lending to the government. Through these measures, excess capital was absorbed by government and not used by the private sector for speculation, or investment expansion. In one sense, it was like a communist state where most of the capital and profits are absorbed by government through strict controls which hold off inflation on domestic products at the very least.

Another step taken both in Britain and in the United States was the "official" management of interest rates. In Britain, the bank rate had jumped to 4% in 1939. But this was brought down to 2% and remained there during the war. The normal forces of supply and demand were simply not permitted to work. This is why interest rates did not rise in response to the huge borrowing on governmental levels in both Britain and the United States.

Had there not been a commitment on the part of the public to stand behind their respective governments, these practices would not have worked. It would be dangerous to assume that this could have been successful under peacetime situations. The public spirit was directly behind the war and sacrifices were given in full knowledge that when it was over, things would return to normal. Some argue that since it worked once, it would work now to solve our economic problems. But this is merely a communistic idea disguised among economic principles. People were deprived of their fruits from labour and to suggest that strict price controls, higher taxation, and huge government spending for social programs can be maintained indefinitely is pure madness. These are the grounds for revolution



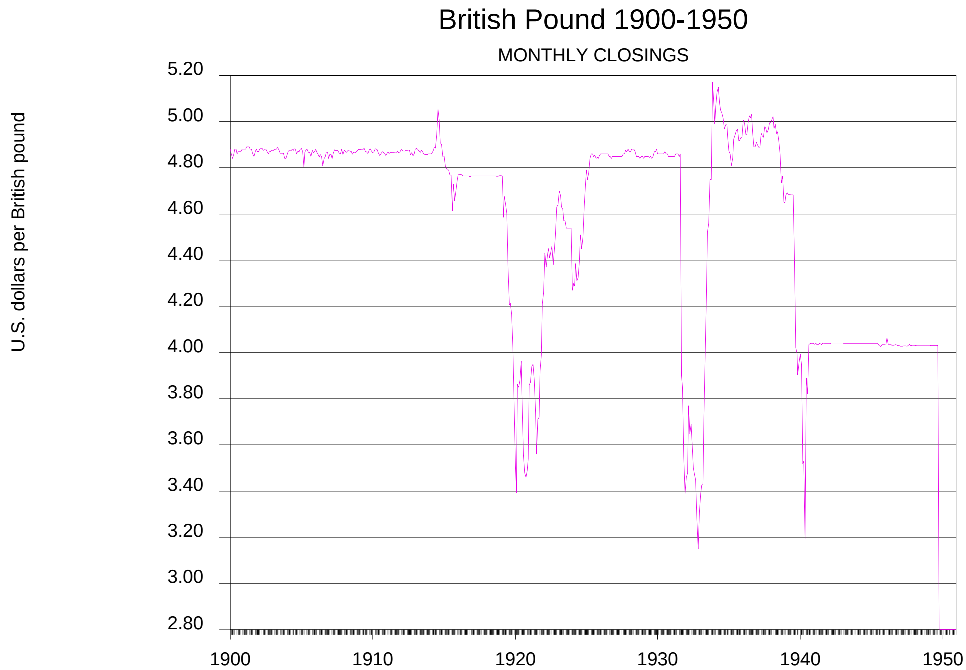
Raw Data Source: Economic Statistics

and indeed, they are some of the very reasons the colonists revolted against Britain back in 1776. Nonetheless, government did not relinquish all of its usurped power. Although Federal rent control was abolished after the war, some states such as New York did not. Eventually the State of New York dropped rent control, but the City of New York still maintains that power to this very day.

Early on in the War, drastic steps were taken on the part of Britain to help finance the huge expenditures. Britain "requisitioned" investments overseas, including the business operations of British insurance companies. Between 1940 and 1941, British investments in the United States were sold for 200 million pounds. Another 225 million pounds worth of investments were sold to Canada. In addition to these sales, Britain borrowed 425 million pounds from the Reconstruction Finance Corporation (RFC) in the U.S. which had originally been established by Hoover to support the banking industry. Despite all of this borrowing, the reserves of dollars and gold held by Britain in 1939, which amounted to 606 million pounds, declined to 75 million by the end of 1940.

Even after Bretton Woods the problems continued. After Roosevelt's death, Truman cancelled the Lend-Lease program. This magnanimous lending policy for Britain was explained to the American people by Roosevelt in simple terms. Basically, he said, if your neighbor's house is burning down, you should not bargain with him for a fee. You should put out the fire first. This was Roosevelt's clever way of lending vast sums to rebuild Britain. When Truman cancelled this blank check, the new government of Clement Attlee, which had promised sweeping social programs and reforms to the British population, was left with the balance of payments completely uncovered.

Attlee had not made the grave mistakes of Cunlife following World War I. Attlee's government at least viewed the pound as merely a unit of account, and he disassociated himself from the traditional pride of



Source: Wall Street Journal

the British to maintain the old $4.86 par value at all costs. The pound was still controlled for internal purposes, but its value on the international markets was now at risk. If it declined severely, the desperately needed imports for the reconstruction would rise in cost. This was the dilemma which faced Attlee in the first few months of his administration.

A delegation headed by the famous economist, John Maynard Keynes, left Britain for Washington. In September 1945, Keynes arrived in Washington with a huge shortfall in Britain's external account which had to be covered. Keynes had estimated that he needed to go home with 1.7 billion pounds just to break even by 1949. He was shooting for a loan of 1.5 billion pounds or roughly $6 billion. He asked that a large part of this sum be merely a grant and that the U.S. should not expect to be repaid. But "give'em hell Harry" was not in the mood for any free handouts. After three months of negotiation, Truman sent Keynes home with $3.75 billion, nearly half of what Keynes was looking for. But the entire amount was considered not a grant, but strictly a loan, carrying an interest factor of 2%. Canada added another 280 million pounds under similar terms.

Truman had attached to his loan two stipulations. The first was that the pound would be made completely convertible into foreign currency and exchange controls would be lifted within one year. Second, the proceeds from the loan could not be used to pay off Britain's wartime debts. This stipulation was attached based upon a theory of the "International Dream," as I have dubbed it. The concept was that if the United States loaned money for the reconstruction of Europe and Japan, that the reemergence of their economies would become viable markets for U.S. goods. This in turn would keep employment high in the United States and hopefully avoid the normal postwar depression phase. Truman was not the only man to conceive of this dream. It was essentially the goal following World War I with the huge influx of foreign loans and the goal of the Central Bankers back in 1925-1927.

Today we still chase the illusive international dream through the very structure of our new modern system for the international economy. Many believe that we have achieved it at brief moments in history. Ironically, man has scoured the earth in search of wealth and stability. He has assumed that everyone can prosper and live happily ever after simultaneously around the globe. He has been torn between the contrasting theories of communism and capitalism in his pursuit of his dream and often he has struck down the very fruits of freedom to achieve his goal. But every ideology from capitalism to socialism has its weakness.

There is one element which has been largely ignored in economics and in the analysis of the events of the Roaring 20s and the post-World War II era. The rise and fall of the world's monetary system was primarily caused by a tremendous experiment in internationalism which failed. That experiment has taken the form of manipulation in foreign exchange rates, interest rates and tariffs all in an effort to achieve equalized prosperity. Even now in this age, the Group of Five nations, led by the Secretary of the Treasury Baker, is making the very same mistakes as Benjamin Strong made in 1925.

In Herbert Hoover's memoirs on Page 85 of Chapter 12 on Foreign Loans, he begins by saying: "A part of the whole program of export expansion revolved around the provision of loans or credit to foreign enterprises and governments with which to buy American products." Indeed, this was the philosophy, the great international experiment which began in the aftermath of World War I and became the doctrine in the post-World War II era as well. The concept was simple. During the War, America was hard at work producing food which kept Europe alive. We produced many arms which Europe purchased. Americans were hard at work and Europeans paid in gold for the products. At the end of the War, the U.S. gold reserves had swelled to record levels. But American workers were unemployed since Europe no longer needed its military productive capabilities.

The great international experiment began at that time following World War I. One way to keep Americans working was to maintain the high levels of exportation. America had become addicted to it. Rather than focus upon the domestic revitalization, the focus was placed upon foreign exports. The concept of lending money to Europe with which they would then in turn buy American goods sounded very nice. It would raise the levels of employment, so the administrators believed.

However, Hoover was very astute and in his memoirs he continued on the subject as follows:

"In 1920 and 1921 the foreign governments and business were slow to realize that our era of taxpayers' largess was over; but by 1922 they came to understand it, and the whole problem took another complexion. A boom began in foreign loans with the offer by foreign countries of extravagant interest to private lenders, from 5 to 8 per cent per annum.

"These loans soon began to raise disturbing questions as to their security, their reproductive character, and the methods of promotion. To serve any good purpose, such loans had to be adequately secured and should increase the productivity of the country of their destination. Out of such increases alone could they be repaid. Loans used for military purposes, for balancing budgets, and for nonproductive purposes generally would be disastrous."

Hoover's comments offer some keen words of wisdom. If foreign loans were used for balancing budgets forced into deficit by social programs or military expenditures, there would be little hope of expecting repayment.

In order for those foreign loans to be loans which would have been repaid, they must produce income. That income, in turn, must come from another foreign nation. Let us simplify the situation by reducing the world down to three people. The first represents Europe, the second the United States, and the third Asia. Let us now introduce the element of money. There are only 12 ounces of gold in the world evenly distributed, which means that each has 4 ounces. Asia and Europe go to war but the U.S. produces all the supplies for Europe. Europe pays the U.S. 4 ounces of gold and now has no gold left. The war is over and now the U.S. has 8 ounces. It lends 4 back to Europe so that Europe will spend that on U.S. goods. So for a while this goes on and the U.S. now has 6 ounces plus a note from Europe that it owes it 4 ounces. The only way Europe can repay the 4 ounces is by selling goods to the U.S. for which it will be paid in gold. If that takes place, then the U.S. will decline in its exports and cries for protection from foreign imports will be heard from its people.

Therefore, the great international experiment failed. The United States could not expect to rebuild the world while expanding its own. When Europe essentially defaulted along with South America on its loans from the United States, capital losses were suffered both on a Federal level as well as on a private individual level. Thus the Great Depression in part was caused by much of the defaults of the time. Studies clearly illustrated that when South America defaulted on their bond issues, much of that was held by private investors and not banks. They could not write off losses against reserves. The losses were real and to the point. Thus, these events struck hard at the very spirit of the population. Those who had not speculated in stock yet believed the advertising that stated bonds were the "safe" investment, may have survived the crash of the stock market but not the crash of the bond market. Those who had tucked their capital away in real estate were wiped out by the lack of liquidity caused by the domino effect from the stocks and bonds. The great international experiment to lend money to the world in an effort to rebuild their economies as a viable market for U.S. exports backfired and created the Great Depression.

Today we still seek to achieve this "International Dream." Following World War II, the very same philosophy took hold and the United States once again lent its capital to rebuild Japan and Europe. In more recent times, Europe has joined in this pursuit and lent much of its capital to foreign nations in the third world. Now they too suffer at the hands of other nations.

As we look at the remaining period following World War II, we will see that Roosevelt's abandoning of the gold convertibility in 1934 had a very profound impact upon the future of the world. In the United States, the lack of convertibility of gold for domestic U.S. citizens acted as a mask hiding the true economic shift of wealth and the cost of the 'International Dream" to the United States. Under a full gold standard, if government spending got out of hand, the people would sense this and if they lost confidence in the government's ability to meet its obligations due to dwindling gold reserves, panic would normally strike.

Under Roosevelt's limited gold standard, he successfully eliminated the domestic gold panics by simply outlawing gold ownership. Thus, government spending could continue and over the long-term inflation of goods resulted. Thus, private investments would rise sharply in varying cycles of popularity. Panic dumping of dollars and buying of goods, or a commodity or at times stocks replaced the old panic into gold. As long as government did not back its currency with condominiums or shares of G.M. or bushels of wheat, such panics in the post-World War II era did not create a run on the Treasury. Therefore, Roosevelt's limited gold standard did manage to eliminate the crisis in currency which had existed since the days of the revolution.

Those who criticize the gold standard will always point out this drastic departure. But what they fail to realize is that although the Roosevelt limited gold standard may have eliminated the domestic gold panics, it merely allowed government to spend huge sums of money it never had without any immediate consequence on the domestic political scene. As a result, we will see how various investments as well as currencies and even bonds at various times have replaced gold in so far as the medium into which panic is focused. The elimination of gold convertibility has not eliminated man's emotional tendency for financial panic.

In 1950, the United States held 76% of the entire official world gold reserves. When President Nixon was forced to abandon the gold convertibility of the dollar for foreign nations, the U.S. reserves stood at 23%. Roosevelt's limited gold system may have sheltered the domestic economy for a longer period of time, but that was not achieved without a cost. Gold panics between nations still took place. As the United States lent vast sums of dollars under the theory of the "International Dream," there were no stipulations that those dollars could not be handed back for gold bullion at the Treasury. In the mid-1960s, the press began to talk about France's apparent distrust of the dollar and desire for gold. France was the largest withdrawer of gold from the U.S. Treasury during that period. The lack of confidence by foreign nations led to massive withdrawals until Nixon was forced to close the gold window to allow the dollar to "seek its own level."

By 1971, most Americans had no concept of what those words even meant. To them, a dollar bill still looked the same. Most were very young when Roosevelt had taken office and few were alive who would have remembered the terrible consequences of wildly fluctuating foreign exchange. An old problem had reemerged in a generation that had grown up completely oblivious to the idea that money was in reality another commodity. Its price had merely been fixed for 35 years in the same fashion that OPEC attempted to fix the price of oil. Eventually no matter who it is, the free market forces will emerge victorious.

It is ironic that some who have a long list of fancy degrees in economics have done their best to contrive a means around reality. If we reduce the "International Dream" down to a simple example, we can see through all its fallacies. Let us take seven people and let each represent a nation or group of nations (Britain, Canada, France, Germany, Japan, U.S. and Mexico). If we assume that each person has $10 and one person decides that he wants to produce something that the others will buy so that he can make a profit, then if all the money in the world only amounts to $70, obviously that is the maximum that any one person could have. So let us say that this person is Japan and he has invented a car. All the other people would like to buy one so they do and pay Japan $1 each. So Japan has $16 and the remaining people in the world have $9 each. In order for Japan to have earned that profit, the other nations had incurred a "trade deficit." You can see clearly now that it is impossible for all seven people to earn a profit. Not all nations can have a trade surplus simultaneously.

The trade game can become more complicated when the players are no longer tied to a fixed amount of money. When they all agree that they will no longer use dollars but each will now issue its own currency, we introduce the element of inflation. But if one nation, for example, Mexico, has no trade surplus and instead it continues to print pesos, the others automatically begin to discount Mexico's currency. They lose their confidence in Mexico's ability to remain as a player in the game. When there is no tangible item being used for money and all that is used is merely paper currency, then the value of those currencies swing back and forth on a factor of confidence. This we know is true today and I have illustrated how the currencies have swung greatly between 1920 and 1924 based upon everything from war to new political elections and fears of political actions.

Therefore, the concept that all nations can prosper simultaneously is absolutely absurd. Yet at the same time, a trade surplus is the goal of every nation. But when one nation lends to another and that nation refuses to repay, the net effect is quite simple. In the case of the United States, it had acquired 76% of the world's official gold reserves by producing food and arms for

Europe. If the U.S. lent $100 to Europe, $100 to Japan and $100 to the third world, and those nations indeed bought U.S. goods and kept Americans working, then at 8% interest, those nations will double their debt to the U.S. in just 9 years. Therefore, unless they swing the trade against the United States in equal proportion to the debt, they will never be able to repay those loans. If they are successful in obtaining a trade surplus, then the U.S. will have a trade deficit and the objective of employment for the U.S. is lost in the end. If they are not successful in turning the tide of trade and continue to maintain a trade deficit or a surplus which is not sufficient to repay the interest, then they will eventually default. In that case, all the labour of the U.S., which created the goods sold to the other nations through credit, go unpaid. If there is one science that is not based upon theory but reality, it is mathematics. 1 + 1 will always equal 2, no matter how hard a politician or economist may try to turn it into 3.

In the reality of international default, the world is faced with several factors. If a nation cannot meet its obligations and the creditor nation merely lends additional capital so that the debtor can then take the new funds and pay the interest on the old debt, the bottom line effect is to merely postpone the eventual default. The public who has been paid for its labour has invested in various mediums including its homes. On the surface the labourer believes that he has profited as his house has risen substantially in value but in reality if he sells that house, he will find that he cannot buy a new home of similar quality and size. His savings depreciate in value according to the level of inflation that takes place. If goods are merely produced and given away without true tangible repayment, the deficit is made up by government spending and accumulated debt. In turn, government raises taxes and the labourer ends up repaying what he had received for his own labour, which government chose to give away. Daniel Webster once said: "Of all the contrivances for cheating the labouring classes of mankind, none has been more effective than that which deludes them with paper money."

One can make two cases of this situation. The argument that money should be something tangible like gold has carried a lot of weight in some circles. But the rigidness of such a system does not allow for imbalances to go on for extended periods of time. The books must be balanced. Thus, it may have a tendency to promote more panics or crises as long as fiscal irresponsibility on the part of government is a way of life. Waves of inflation under the gold standard are directed by new discoveries of gold. Thus the inflationary wave in the 1850s caused by the California discoveries and the Spanish conquest of the Americas in the 1500s are classic examples. At times, the rigidness of the gold standard promoted war for the object of profit, or in modern terms increased money supply. This has been a favorite motive long before the days of Alexander the

Great and, in fact, was a primary reason for the American Revolution:

"No taxation without representation!"

Those who argue that a gold standard would force responsibility upon government to contain its spending forget that governments were irresponsible under the gold standard as well. Adam Smith wrote the modern textbook of all time on the subject of economics. In 1776, he published his "Wealth of Nations" in which he stated the following:

"It is the highest impertinence of kings and ministers to pretend to watch over the economy of private people and to restrain their expense, either by sumptuary laws, or by prohibiting the importation of foreign luxuries. They are themselves always, and without any exception, the greatest spendthrifts in the society. Let them look well after their own expense, and they may safely trust private people with theirs. If their own extravagance does not ruin the state, that of their subjects never will."

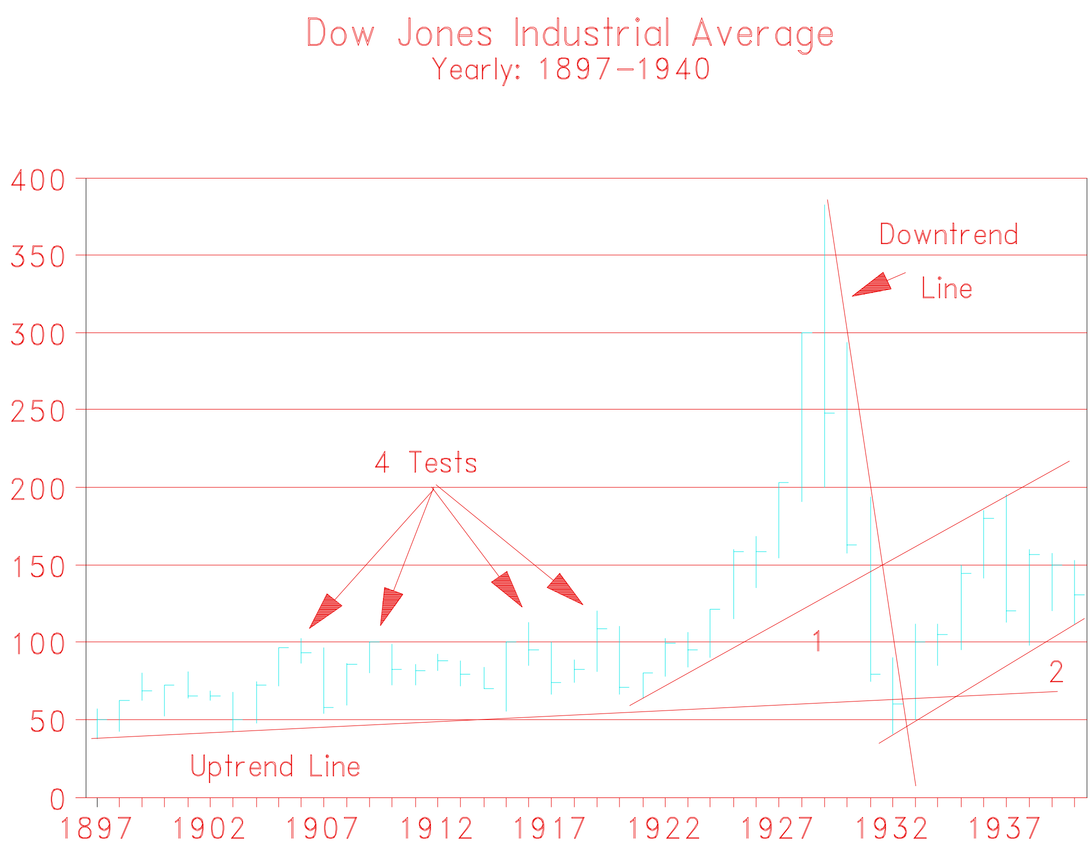
Those who argue that the gold standard is a barbarous relic of the medieval days for maintaining reserves, do so only to promote the system of blank checks. Under the paper system the panics have not been eliminated. The frequency of the panics seems to be returning to the pre-1934 days. Under the limited gold standard between 1934-1971, those panics were not as noticeable nor as drastic. Most crisis situations took place between the treasury of one nation versus another and the domestic economies were spared the knowledge and the fears.

From the government's perspective, the advantage of the total paper standard lies in the fact that government does not have to wait for new gold mines to be discovered in order to increase the money supply. All they need do is pass an act of Congress to extend its debt limit so it can increase the money supply. Eventually the laws of mathematics and the natural forces of human nature itself will undermine the confidence in the paper system and it will collapse just as easily as it did under the gold standard. The swings in foreign exchange during the period we have reviewed in this study closely paralleled the swings in the investment world as confidence compelled investors to flee from one currency to another, thereby affecting the various stock markets around the world.

The Great Depression was not invented by the stock market. It was created by the forces of unsound international finance and sumptuary laws imposed upon the subjects of various nations both in the United States and in Europe. There is no doubt that the fate of the stock market in the future will be largely dictated by the swings in confidence within the international monetary system. Unaware domestic investors and analysts may attribute the current rise in the market going into the summer of 1986 to expectations of lower interest rates, but with hindsight this will prove in the end to be a totally erroneous explanation of what took place in the late 1980s.

In conclusion, the fundamental explanations of the ups and downs of the stock market and the world economy cannot be simply drawn between an inference with interest rate actions or with corporate earnings. The impact of public confidence is by far the most profound influence in both the investment world as well as the world economy. Capital flowing back and forth between nations affords the closest relationship with the movement within the stock market and this perhaps can be most readily seen through the movement of foreign exchange markets as well. The issues are never purely domestic. No matter what market one may look at in whatever nation you may reside, the international influences will always be a subtle guiding force behind the more illuminated domestic issues of the day.

Click here for PEI's Homepage



A technical review of the trading patterns of the Dow Jones Industrials prior to 1940 reveals several interesting notes which should be remembered. The chart above covers the yearly activity between 1897 and 1940. This chart provides a few technical patterns which are not only interesting, but also vital to a technician's perspective. The patterns take place in various commodities, interest rates and whatever involves human emotion and interaction. If it is something that can be charted, then these aspects will apply.

I have drawn on this chart two simple standard technical lines. The first is labeled the Uptrend Line and its construction was accomplished by tying together the two extreme low points on this chart. These points were the price lows of 1897 and 1903. We can see that from there onward the general activity of the market held above this technical support area. The panics of 1907 and the panic sell off of early 1915 both managed to support above this line. You will note that it was not until 1932 when this technical support line was violated.

Quite often, many students of technical analysis view a break of the Uptrend Line to be something indicating extreme bearishness. In fact nothing can be further from the truth. Normally major lows in a market take place when the long-term Uptrend Line is violated. The major low quite often lies somewhere just below. Look at the price action which took place in 1933. You will notice that 1933 opened below the Uptrend Line, but it managed to penetrate it on the upward movement that followed during the inflationary expectations under Roosevelt.

If a break of the Uptrend Line is indeed the sign that the market will continue sharply lower, then a subsequent rally must move back up to test the Uptrend Line, and then fail to exceed it. In other words, it will bounce off the Uptrend Line and then if it drops below the previous low, then the market is in real trouble. But when a major low is forming, the Uptrend Line is normally penetrated and then the subsequent rally gets back above the Uptrend Line as was the case in 1933.

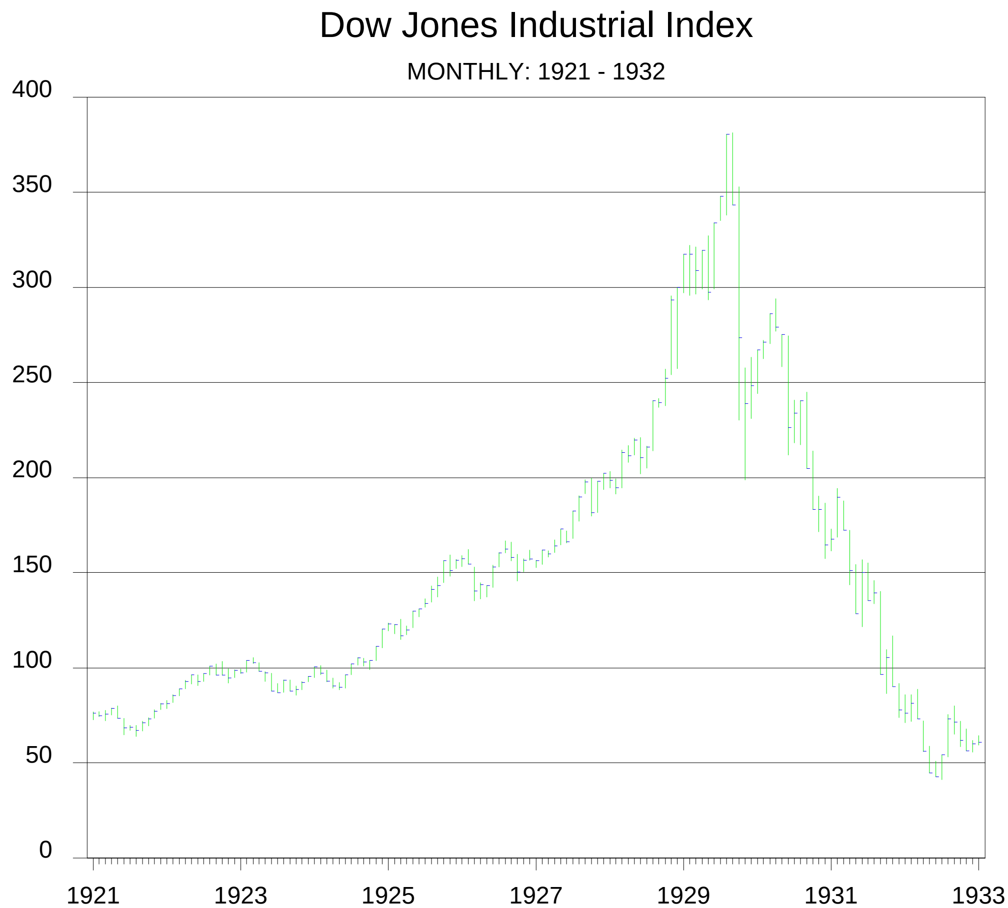
To help illustrate this normal technical reaction, I have drawn two additional Uptrend Lines marked # 1 and # 2. Line # 1 was constructed by tying the lows of 1921 and 1924 together. Here you will notice that during 1931, the market penetrated this Uptrend Line and there was no rally back to even attempt to test it on a yearly level. This is the indication of a very bearish atmosphere. Obviously, the market continued to collapse into 1932. But take special note of the rally which came about into a peak during 1937. Note that the high of 1937 stopped dead, bouncing off of this Uptrend Line # 1. This is the type of pattern which indicates that the market has merely made a reaction and that a further resumption of the downtrend will unfold. Indeed, the market fell back to Uptrend Line # 2, which was constructed by tying together the lows established during 1932 and 1933. Had this Uptrend Line # 2 been broken and a test or rally back up to it bounced off as was the case at the 1937 high, then perhaps we would have dropped back to test the 1932 low once again. But the market held the Uptrend Line # 2 and subsequently a consolidation phase developed to bring about a renewed uptrend into the years ahead.

Another important factor about this chart is the use of the Downtrend Line. This line is constructed by tying together the highs made during 1929 and 1930. Just as the market remained above the major Uptrend Line from 1897 all the way into the 1929 high, indicating that an uptrend was still in motion. But note that the market remained below the Downtrend Line during 1930, 1931 and 1932, indicating that a downtrend was still in motion as well.

The importance of this downtrend line is perhaps even greater in the determination of whether or not a major low is in place. Note that during 1933, even though the market opened below the Uptrend Line, it opened above the Downtrend Line. These two lines therefore served a purpose of focusing our attention on a major junction within market activity. Note that the 1933 price low actually bounced off the Downtrend Line. Again, just as the 1937 high bounced off the Uptrend Line # 1 indicating that "resistance" had been encountered, the market bounced off the Downtrend Line indicating that "support" had been encountered in 1933.

This is the value of technical analysis. We have reviewed the countless fundamentals which were a part of the day-to-day situation through the 1921 period up to 1940 thus far. Trying to determine where the market was headed based upon fundamental assessment of the events surrounding the market was not always a clear-cut case. Confusion was prevalent and we read how most analysts had remained bearish throughout the 1921 era up even into 1928. We read how when Jesse Livermore publicly stated that he was bullish, he was accused of trying to talk the market higher to help Coolidge get re-elected. Technical analysis smooths out all the bumps, ignoring these sorts of comments by providing pure unbiased guidance.

Although technical analysis can be applied to gold, cotton, wheat, interest rates or the retail sales of any company, each market or indicator does retain a certain uniqueness. Although the general princi-



ples of technical analysis may be applied to anything that can be charted, the actual patterns of a given market may not be the normal patterns in another.

Referring once again to the annual chart from 1897 to 1940, I have marked out four rallies prior to the major top in 1929. Part of the reason why many analysts were bearish in 1924 when chastising Livermore is the fact that the market had tested the 100 area four times before and subsequently failed by dropping at times as much as 50% in the aftermath. Because people had been burned four times before, they remained skeptical when the market began to approach that lofty 100 area in 1924.

Take note that four tests of that 100 area had taken place. Each high was slightly different from its predecessor, but each had been followed by a sharp collapse the year thereafter. Now let us look at the Monthly Chart # 1 covering the period of 1921 to 1932. Note that during the early stages, the market once again, on a monthly level, attempted to test the 100 level four times before successfully pushing through it in 1925. Whatever pattern you find on one level will also exist in all others. That means that the patterns on a yearly chart will be repeated within a monthly, weekly, daily or even intraday chart pattern. The general patterns are actually like a brainwave. Each person has his own distinctly different brainwave pattern and such is the case with markets themselves. The patterns that we are looking at here will be repeated during the 1960-1970 period when dealing with the 1,000 point level of the Dow. The classic four attempts apply to the stock market but not necessarily to gold, copper or bonds for that matter.

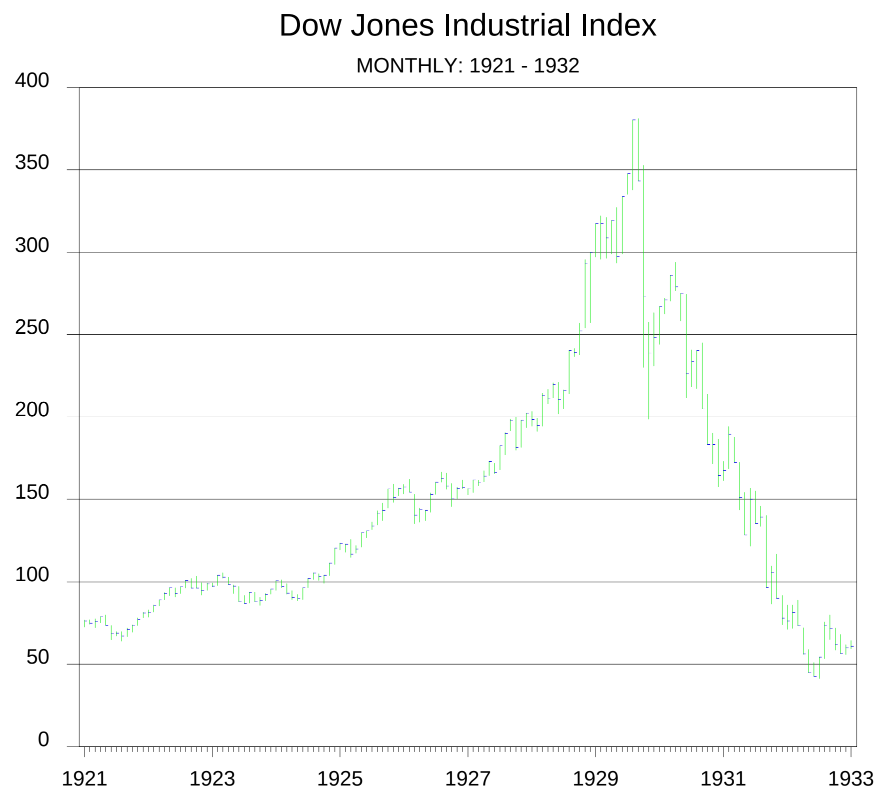
Let us look at the Uptrend Lines on this monthly chart. Here we can see that the major Uptrend Line was penetrated during 1931. On a monthly level the market rallied back to test it, but failed to close above it. Take note of the minor Uptrend Line marked # 1. Here the panic collapse of November 1929 punched through it, but failed to close back below it. That indicated that the market was ready for a consolidation phase before resuming any continued downtrend. But after the recovery of early 1930, the market turned downward again with a vengeance. It closed below the Uptrend Line # 1 and for the next two months it attempted to close back above it without success. That was the test which indicated that one had better be out of there from the long side.

You might be thinking that perhaps this is easy to talk about in hindsight, but that is not true. This same form of analysis applies to current trading activity and if you look for this type of testing pattern, you will find that it works every time. Once the previous low is penetrated, then you have the confirmation that the trend should press lower in the near future. Caution is advised when you arrive at a junction such as the case between the Downtrend Line and the Uptrend Line on the annual chart during 1933 as we reviewed earlier.

Now take note of the Downtrend Line. This line was the last Downtrend Line constructed by tying the 1929 high to the September 1931 high. You may ask what about the previous highs between these two points and why didn't I use those instead? The answer is that I did. But the market kept pushing through those Downtrend Lines periodically, but kept failing. This was the final Downtrend Line, and for right now this is the one we are concerned about. The others we will discuss shortly.

Note here that the market finally exceeded this Downtrend Line during the month of the major low in 1932. It also managed to close above it. Note that the pattern is one of a testing pattern in respect to this Downtrend Line. Exceeding the Downtrend Line intraday is not a major buy signal. But the pattern clearly displayed a tendency to continue higher rather than lower. Therefore, the market successfully accomplished a test of the Downtrend Line from the upside downward. That was the test which signaled that the market was coming to an end insofar as the downtrend was concerned. Most major downtrends come to an end by testing the final Downtrend Line taken from the major high.

Now let us try to answer that question about how do we know which points we should use to create the Downtrend Line. The Monthly Chart # 2 illustrates the first Downtrend Line. This line was constructed by taking the 1929 high to the 1930 recovery high. Looking at this chart we can see that the market remained below this Downtrend Line until the February rally of 1931. Everyone was quite bullish if you recall with many prominent people going on record saying that the depression and the downtrend had finally come to an end. But there was no follow-through during March of 1931 as the market fell back gravitating toward the 1930 lows. It was April of 1931 when the major Uptrend Line was broken slightly, but at month end the final bell had rung when the market lacked enough

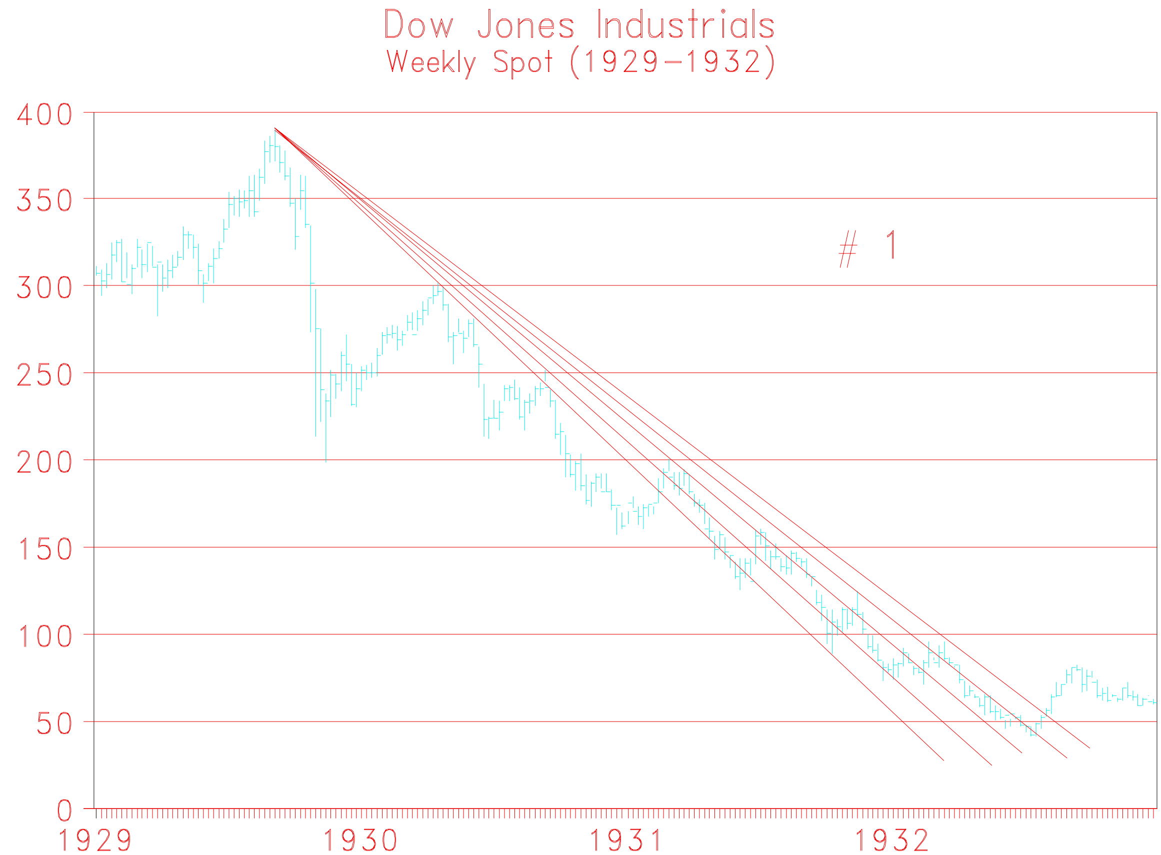


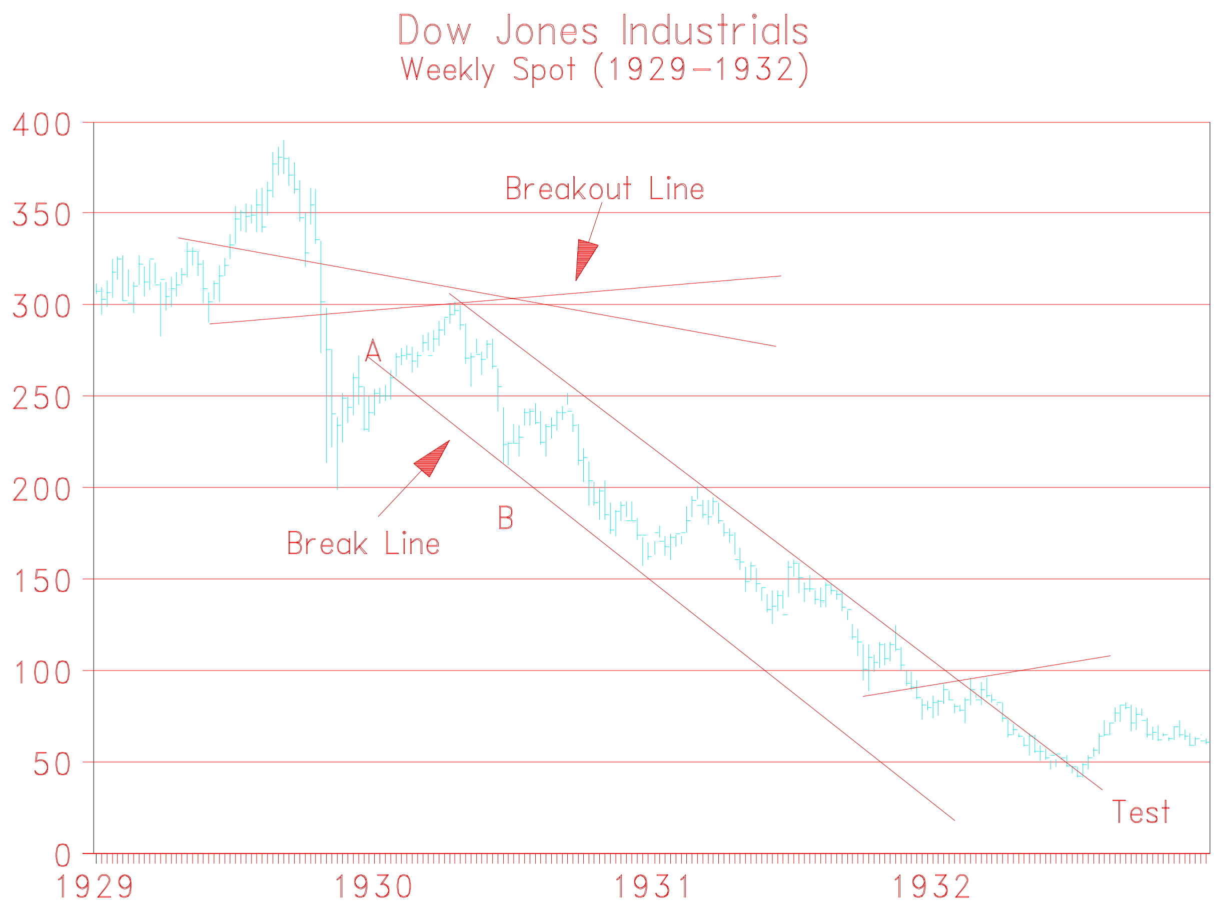
strength to close back above it. This conjunction of testing the Downtrend Line and penetrating the Uptrend Line could have been a technical bottoming action as we saw in 1933 on the annual chart. However, unlike 1933, which rallied back above the Uptrend Line, here we find that the market tested the major Uptrend Line early in May of 1931, but collapsed into the end of the month. This was the opposite type of pattern needed to signal a low. June fell and tested the Downtrend Line and then rallied back to the Uptrend Line but it failed to close above it. July merely headed back down again.

This was undoubtedly a confusing conjunction period. But the testing of the Uptrend Line with the subsequent failure to remain above it on a closing basis signaled further weakness in the market. Therefore, looking at the Monthly Chart # 3, you can see that we would have continued to draw new Downtrend Lines from the major high to each new high until we found the correct pattern which eventually unfolded at the bottom in 1932.

There is another method which I have taught at numerous seminars on technical analysis. This is the development of a Reaction Channel. To illustrate this, let us now look at the weekly chart covering the period of 1929 through 1932. The first chart illustrates the five Downtrend Lines which were constructed throughout the course of the collapse. We can see that the market broke through to the upside, creating five Downtrend Lines in the process. The Weekly Chart # 2 illustrates a method of technical analysis which I developed through studying market activity.

Beginning with the first spike reaction in early December 1929 (point A), and tying that to the first reaction low following the


Dow Jones Industrials
Weekly Spot (1929–1932)
400
350
300
250
200
150
100
50
0
1
1929
1930
1931
1932


Dow Jones Industrials
Weekly Spot (1929–1932)
400
350
300
250
200
150
100
50
0
Breakout Line
A
B
Break Line
Test
1929
1930
1931
1932

1930 high (point B), we have captured more than merely highs and lows. We have captured the thrusting reaction forces to form both strength and weakness. I have named this line the "Break-Line" because it provides a more definitive source of technical support in comparison to the standard uptrend line normally taught in technical analysis. Here we have taken the reaction high before the major 1930 recovery peak and joined it with the reaction low thereafter. Taking a parallel off the 1930 high provides us with this reactionary force in a channel format.

You will immediately notice that throughout the course of the bear market, the oscillations of the market activity remained by and large within the confines of this channel. This helps to quantify the market direction far better than employing the simple Downtrend Line. Again, if we focus at the bottom of the chart where the market finally made its low, you will notice once again a testing pattern. The market on a weekly level tested the top of the channel early that week and then rallied away from it. Clearly we have a reversal in trend like no other throughout the entire course of the bear market.

This channel provided guidance on all rallies insofar as defining the technical points where the trend would have begun to reverse between 1930 and 1932. At no point did the market exceed the top of the channel, fall back to test it, and rally away from it until the major low had come into play during 1932.

Technical analysis was thought to be a lot of mumbo-jumbo. Even today, many fundamentalists assert that technical analysis is of no use. Those who purport such statements are normally unfamiliar with this form of analysis and lack the understanding of market patterns and movements to provide any form of a fair assessment. Although fundamental analysis is by far the most widely employed, the thinking process of man evolves and changes to such an extent that what used to be bullish often becomes bearish. There are no definitive rules which one can go by to say that if interest rates reach a certain level then the market will peak or bottom, whichever is the case. There is no such concrete rule book because the market reacts to a broad set of fundamentals on an international as well as a domestic level. Only a full and complete understanding of the international forces at work will provide a clear understanding and successful implementation of fundamental analysis. Most fundamentalists have failed over the long haul to remain consistent because they have not grasped the entire scope of the thousands of variables involved internationally to come up with the true underlying forces that are at work.

Click here for PEI's Homepage

Chapter XVI

Fundamental Review

There have been many who have written of the causes and effects of the Great Bull Market and its famous demise. Many market analysts and economists have looked back at this turmoil taking only what they desired in an effort to support a current theory that was most likely preconceived from the outset. In the final conclusion of this work, I too will make an attempt to tie everything together in a neat and orderly theoretical package. But for now, it is much more important to gather all the facts and to make certain that they are absolutely correct and within the proper perspective so that our conclusions will not be based upon an unwarranted preconception.

When I began this project, I too had many preconceived ideas and notions, but in trying to draw some logical sense from current market trends in the 1970s and 1980s, I found stark contradictions to what we have all come to simply accept as standard economic theory. When you line up all the various writings about the Great Depression and the opinions as to its causes and effects, one is left with perhaps more questions than answers. Most economists and analysts have tried to view the causes of the Great Depression solely in a domestic light. A few have broadened their mind's eye by glancing at the corresponding events in other nations. But for the most part, the political propaganda of the 1932 Presidential elections has lived on in the minds of the majority who cite the tariffs, while others seek to draw conclusions to support a socialistic model by pointing the finger at disproportions of wealth among the various classes.

There is little doubt that the events of the Great Depression had a profound impact upon the world both socially as well as geopolitically. The seeds of the tragic world war that followed were unquestionably sown through the hardships of the Great Depression. The drastic escalating income tax structure within the United States was born from the notion that it was the rich who were responsible for the Depression through the collapse in the stock market at the hands of speculation. The socialistic forms of government that emerged in Britain and throughout Western Europe are also the children of interpretations of this tragic era.

Yet most of the conclusions and theories that have surfaced in the post- Depression years are based upon observations that perhaps skimmed the surface of the issues of the time. Politicians and economists alike drew conclusions and answers only from what they wanted to see. Those who were convinced that the entire affair was forged into history at the hands of wild and uncontrolled speculation clung to those ideas despite the fact that the Senate investigations failed to turn up any evidence to support the notion that huge groups of bear-raiders purportedly destroyed the stock market for pure profit. The issue of governmental bond defaults hardly gained any press, for this issue would have tainted the political structure, shifting in part some of the blame from the private sector to wild and uncontrolled government spending.

Trying to fundamentally assess the Great Depression and its causes is by far no easy task. No matter what I could ever write, there will always be someone who will disagree. Fundamental analysis lacks definition in itself. For example, picture a man who is standing on a ladder painting the side of a building in downtown New York. Suddenly a cat runs by a little old lady who is walking her dog. The dog becomes excited, breaks away from the little old lady and runs after the cat, dragging the leash just behind him. The cat runs under the ladder and the dog is in hot pursuit. The leash gets caught around one of the legs of the ladder and the jerking motion that results from the dog's running speed pulls the ladder right out from underneath the man. The man falls and along with him the can of paint. The paint lands upon the head of a grumpy sort of chap who now becomes enraged at the painter. He proceeds to pick the painter up by his neck and blames him for dropping the paint on his head.

The painter in turn blames the man for walking too close to his ladder, while a witness to the whole scene breaks in to point out that it was the dog's fault. The little old lady finally catches up to the scene and then everyone blames her for letting go of the dog. She gets upset and blames the little boy down the street who let his cat out. The little boy blames his friend for holding the door open at his house, allowing the cat to get out in the first place. Since the boy is just a boy, everyone will pin the blame upon his father who just happens to be the painter.

Well you could go on and on and blame the person who gave the little boy the cat or you could chalk the entire affair up to just a freak accident. Such is the case of fundamental analysis. Often there are so many complex relationships existing simultaneously that any attempt to sort them out and place them in the proper order becomes impossible. This is now the task which I will attempt to complete in a rational and logical sequence. Anyone who attempts to argue must realize that placing the blame for the Great Depression on any one source is doing society a grave injustice. Extracting only what we want to hear to support a theory for socialism or to usurp some new power in the hands of government will not help us to avoid similar circumstances of this nature in the future. If we allow such personal biases to color our words, there can be no hope of social or economic progress. The time has come when honesty must prevail over personal desires. If we do not make an honest assessment of society's past mistakes, we will be doomed to repeat them. That is a terrible legacy to leave our children. Perhaps at the very least, progress should allow each generation to make its own NEW mistakes rather than to repeat the old because they were ignorant of lessons which history has tried to convey. If we fully understand our mistakes even within our own personal lives, then we have something upon which we can build to create a new future, which hopefully will not be a rerun of the past.

GALBRAITH

One of the famous books on this period was written by John Kenneth Galbraith and entitled the Great Crash. Galbraith basically concluded that the Depression was something which could be explained in part by five causes. According to Galbraith, these five causes of the crash were:

1) BAD DISTRIBUTION OF INCOME:

The well-do, Galbraith claimed, made up only 5% of the population yet they accounted for one-third of the wealth. Thus this disproportionate measure of wealth could not be counted upon for great expenditures within the economy other than in luxury or investment areas. Thus, he claimed that this type of spending was subject to greater fluctuation than spending upon necessities from the wage earner. He concluded that this type of high-bracket spending and investment was especially susceptible to the sudden drop in the stock market.

2) BAD CORPORATE STRUCTURE:

Galbraith asserted that the period was marked by excessive "promoters, grafters, swindlers, impostors and frauds" which created a sort of flood-tide of corporate larceny. In addition, another weakness in the corporate structure was the advent of the holding companies and investment trusts. Galbraith concluded that these holding companies and investment trusts controlled too great a portion of stocks which were dependent upon regular dividends. If the dividends stopped, this would influence investment trusts to liquidate the shares in that company. Thus, corporate loans diverted capital into dividends instead of expanding their business and new plants. This, he concluded, added to the deflationary fears and pressures. Income was then earmarked for repayment of debt instead of new business expansion.

3) BAD BANKING STRUCTURE:

Galbraith wrote that the bankers were not exceptionally foolish in their lending. But as the value of their collateral declined, many loans were needlessly called through no fault of the borrowers who became victims of the times. As market value for goods and services as well as real estate, bonds and stocks declined, good loans under normal conditions were made to appear as foolish ventures on the part of banks. This is the net effect during any serious recession as Galbraith pointed out. Lending $60 against IBM today may be prudent for the moment, but if IBM falls to $12, or 10 cents on the dollar, everyone chastises the banker for being foolish since he should have foreseen such an event.

But Galbraith went on to point out that the inherently weak structure of the banking industry itself was something separate and apart from good loans turning bad. This weakness in the banking system lay solely within the large number of independent banks. As one bank fell, this often sent vibrations of fear into the public who would then turn on their bank, often forcing its closure as well through needless panic withdrawals. Thus one failure led to other failures, and these spread with a domino effect. Galbraith concluded that this domino effect of banking failures influenced depositors not merely to withdraw funds, destroying weak banks, and weakening even strong banks, but this effect also had a repressive influence on the spending of the various classes as well as investment. Therefore, the hoarding of funds further contracted the money supply and greatly reduced investment.

4) THE DUBIOUS STATE OF THE FOREIGN BALANCE:

Galbraith pointed out that the United States had become a creditor nation. This meant that the loans that it had extended to foreign nations both during the war and in the immediate post-war years had to be repaid through expanding trade with the

United States. Failing to achieve a trade surplus, payments for the difference were made to the U.S. in the form of gold. But this could only be maintained on a temporary basis. Galbraith concluded that when Hoover increased the tariffs, thereby cutting off the possibility of the Europeans gaining a trade surplus against the United States, he also cut the only means of settling their debts, which forced their debts into default. Thus he concluded that the tariffs hampered the U.S. economy. The reduction was not vast in relation to total output of the American economy, but it contributed to the general distress and was especially hard on farmers, Galbraith added.

5) THE POOR STATE OF ECONOMIC INTELLIGENCE:

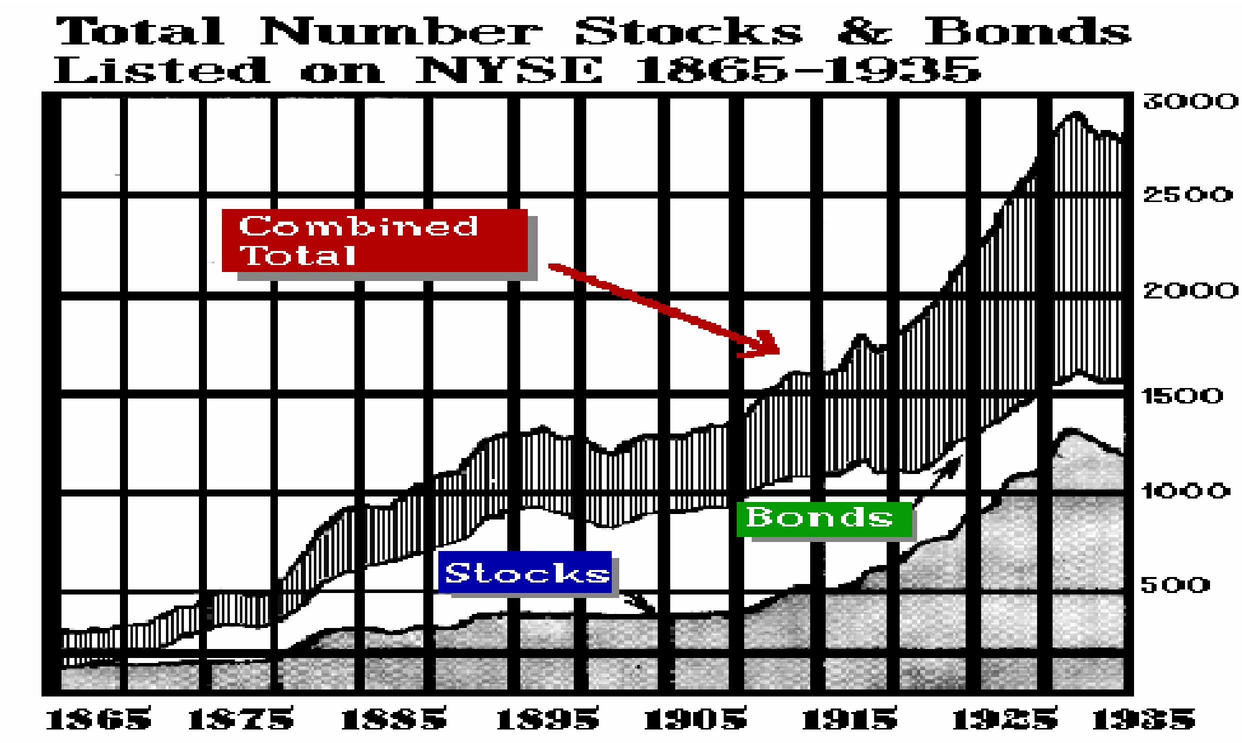
Here Galbraith stated that the economists and those who offered economic counsel in the late twenties and early thirties were almost uniquely perverse. He suggested that the tax breaks instituted by Hoover in late 1929 were negligible because they gave a greater break to the upper income brackets. In my opinion there is a little contradiction here. Galbraith, in part, blamed one of the causes on the concentration of wealth within the upper 5% of the population, stating that the stock market crash hurt this segment especially helping to curtail investment. To now say that the tax breaks favoured the higher brackets because they were an equal cut across the board contradicts the first observation. If the upper classes lost the most through the crash in proportion to their total net assets, where is an across-the-board tax cut unfair? This seems to be an argument trying to attack the upper classes for a high degree of concentration of wealth.

Galbraith then jumps to the 1932 era pointing out that both parties were calling for a balanced budget. He said: "A commitment to a balanced budget is always comprehensive. It then meant there could be no increase in government outlays to expand purchasing power and relieve distress. It meant there could be no further tax reduction.

Here Galbraith hints that perhaps the distress could have been reduced had government lowered taxes and shifted into deficit spending. Galbraith does point out that the budget went into a deficit under Hoover, but this he concludes was not enough. Perhaps this is true, but the issue of public confidence seems to have played a more definitive role in this debacle rather than a passive role as we will soon explore.

Professor Irving Fisher took another approach. In referring to the stock market crash he wrote:

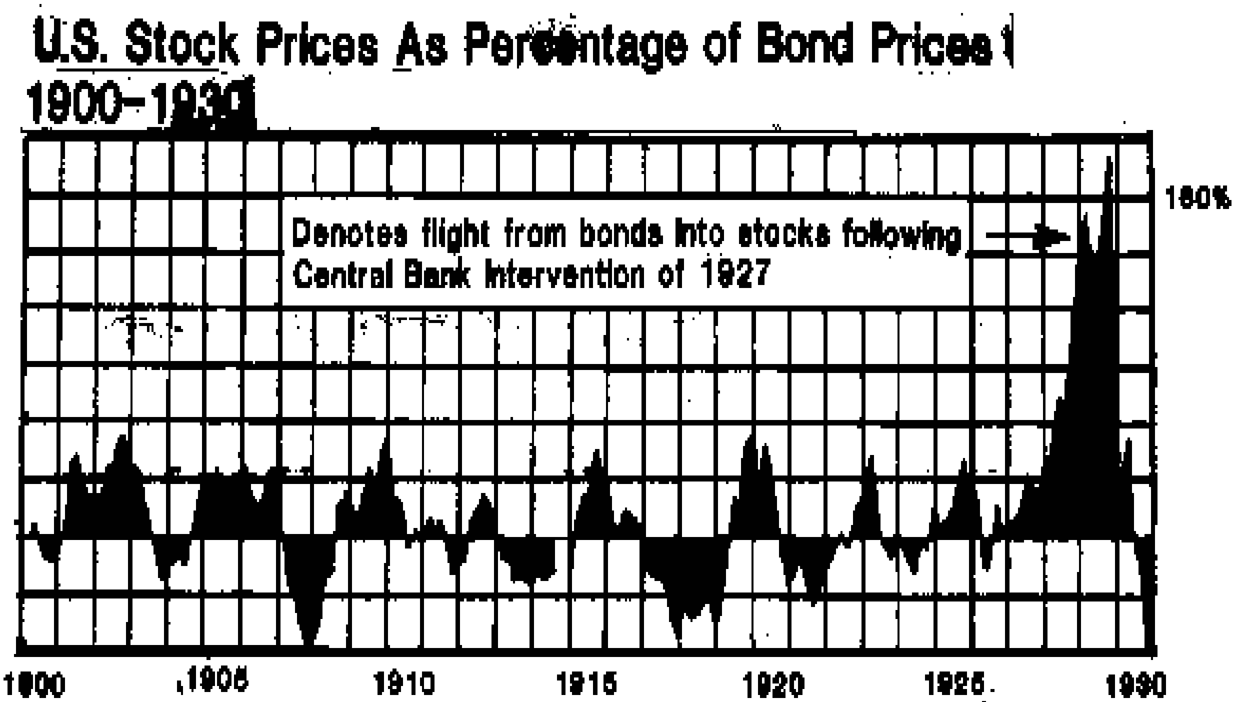
"That the stock market crash was primarily precipitated by foreign liquidation is the view expressed by John S. Sinclair in the New York Times of October 27th. This liquidation accompanied the so-called Hatry Panic on the London Stock Exchange which resulted in a deeper fall of the London stock price level - 45.4 per cent from August 30th to December 27th (1929), according to the British Index - than occurred on the New York Stock Exchange between the high point on September 7th and the bottom of November 13th. Few realize today that the greatest fall of stocks in British history comparable only with the Baring Panic of 1890, preceded and was an actuating cause of the American panic, and that a coincident fall in Paris and Berlin accompanied the British liquidation. It began with the failure of the banking house of Clarence Hatry in August, followed by his arrest in September and subsequent conviction for a gigantic forgery of stock certificates. This



started the British liquidation in London and in New York. Barron's Weekly of December 9th (1929) notes that Britons were extremely active in distributing stocks at the high level in New York during September as seen by the movement in sterling exchange..."

Indeed, in both cases, Galbraith and Fisher touched upon certain issues which no doubt contributed to the greatest panic in history. But neither offers a conclusive statement to sum up the events of the era. Both admit that some influence from foreign sources played a role in the events of the times but dealing with the situation by purely increasing U.S. government spending was not the answer either. The problem facing any author on this period is still the famous question: who was responsible for knocking the painter off the ladder?

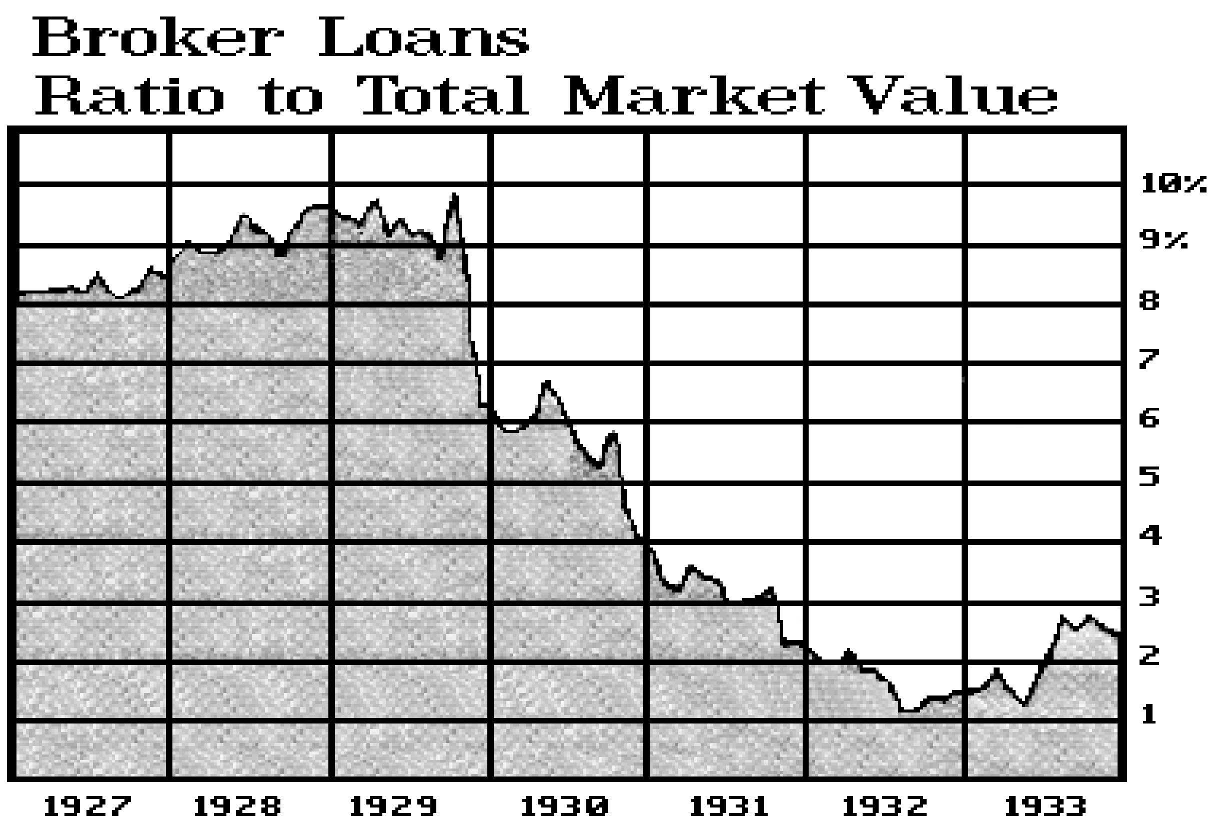
A historian on any subject can go over the facts of a period and draw a different conclusion from another. I personally disagree with those who have focused upon the high concentration of wealth within the upper 5% of the population as being a leading cause of the Great Depression. This concentration of wealth during this period served as the excuse for using the escalating tax brackets which at one time were as high as 90% in the United States. This is **PURE SOCIALISM** disguised in the cloak of democracy. There is simply no excuse for such laws in a land where the slogan of its Supreme Court is: "Equal Justice For All." If the super rich become richer, they are the very people who funded and built General Motors, Ford and Alcoa Aluminum. With wealth greatly dispersed, capital must be pooled together among so many to form such new ventures. Far too often those types of situations are impossible. The rich who do not invest in new companies, which in turn create jobs for the middle class, perhaps leave their funds in a bank on deposit, which in turn provides loans for mortgages so that the average person can buy a home. But above all, destroying the upper

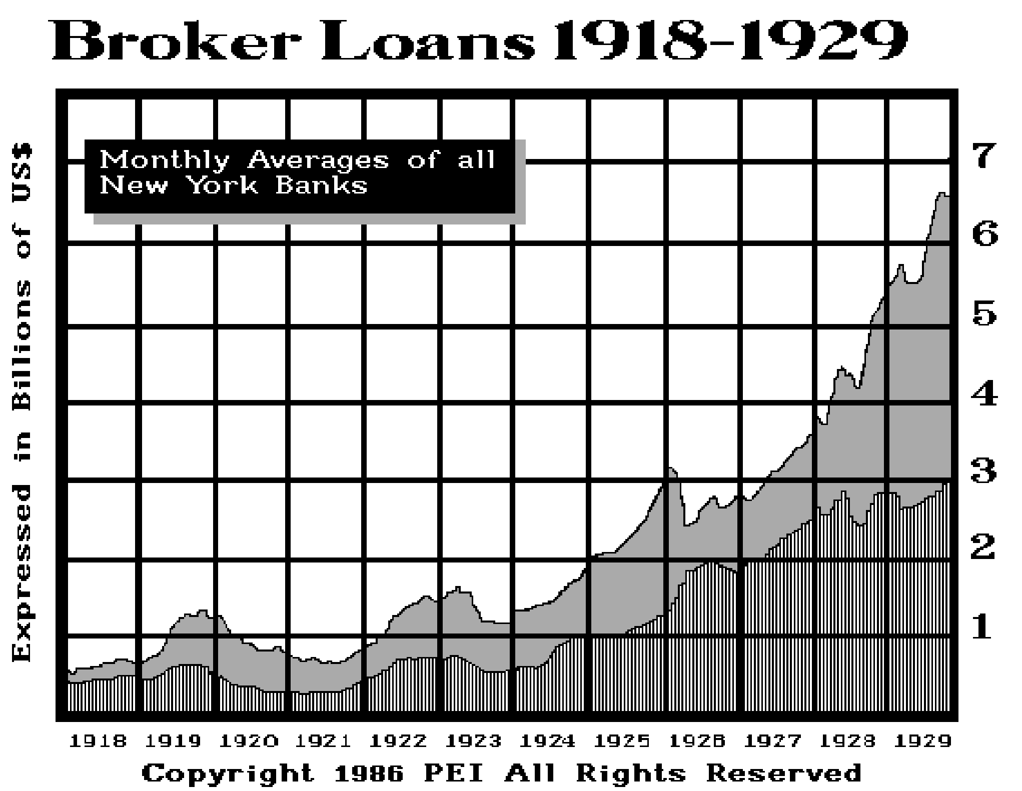


class destroys the American dream. It is that hope of becoming successful that has made the concept of the United States great. It is the inspiration of the young to achieve their degrees. To attack the success of the upper class out of petty jealousy is merely an attack upon the very concept of the free system. Those who often attack the upper classes are those who lack the drive, brains, and ambition to achieve those goals and in turn they lash out from a jealous bitter attitude as did Karl Marx.

The populace can be so easily swayed into thinking that success is fine but super success is something that is a sin and should be outlawed. Man has to face the facts. He is a horrible creature who derives pleasure from attacking his own kind be it through physical action or through the rumor mills that attempt to assassinate another's character because of his success or notoriety. Man's actions are often similar to a pack of dogs fighting over a single bone. Just a few of the men we have discussed thus far - Willy Durant (founder of General Motors), Ogden Armour (Armour Meats), William Fox (Fox Films) - have each helped in their own way to create a part of that American dream and many jobs to this day owe a debt of thanks to these men for their visions. It is exactly as Adam Smith described in his "Wealth of Nations" back in 1776. Society is guided by an "Invisible Hand." Each person does not necessarily act with the intention of building a society. But while in his own pursuit of financial success, he in turn furthers the advancement of society as a whole. Each of these men indeed furthered the American dream for us all. Yet each died a poor and beaten man at the hand of bitter and jealous enemies.

Among the advertising that has illustrated this first section leading into the Crash, you will find several examples that refer to the manner in which the bond market was portrayed. Bonds were the "safe" investment while stocks were the "speculative" ventures for high rollers.


Broker Loans
Ratio to Total Market Value
10%
9%
8
7
6
5
4
3
2
1
1927
1928
1929
1930
1931
1932
1933


Broker Loans 1918-1929
Monthly Averages of all New York Banks
Expressed in Billions of US$
7
6
5
4
3
2
1
1918
1919
1920
1921
1922
1923
1924
1925
1926
1927
1928
1929
Copyright 1986 PEI All Rights Reserved

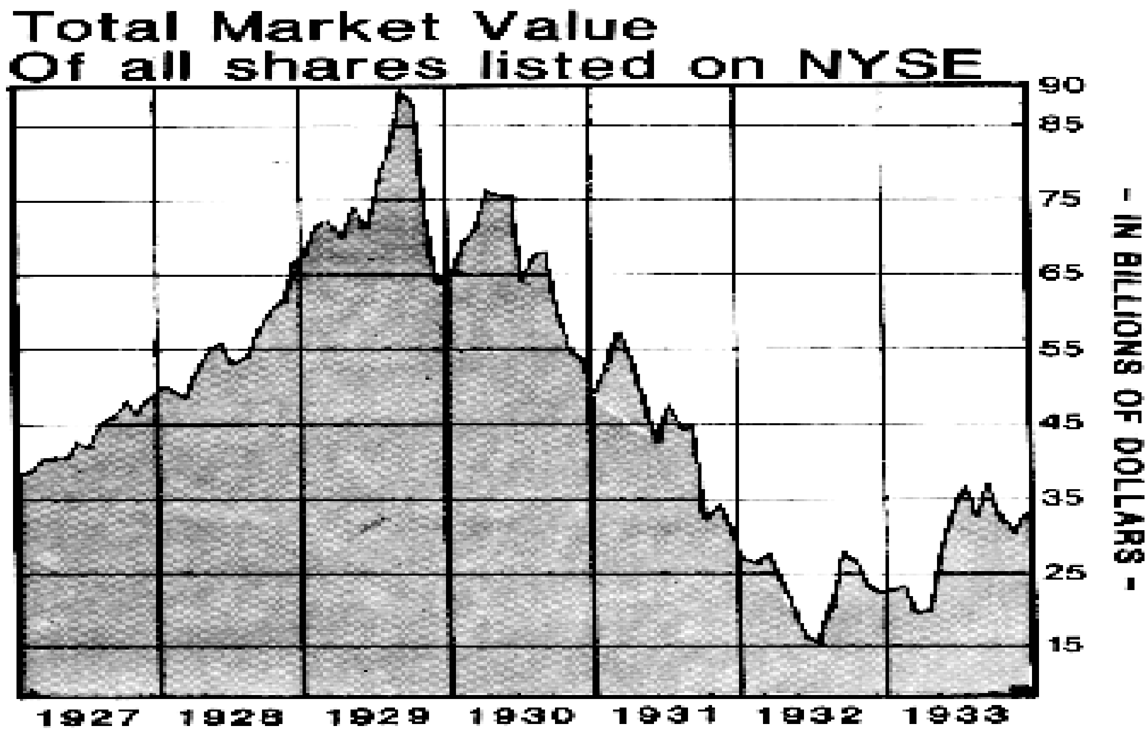
One main factor that must be placed in perspective is the scope of the bond market in comparison to that of the stock market. We have undoubtedly heard much about this stock market's demise and little of the collapse in the bond market. To this day, if you ask a municipal bond dealer if any U.S. municipal bond has ever defaulted, his answer will be **NO** with the possible exception of some obscure fire company in the Bronx. History has chosen to bring us facts about the stock market's demise but not about that of the bond market.

The Senate hearings revealed years later that the total number of accounts within the nation's twenty-nine various exchanges came to 1,548,707 customers out of a population of 120 million. Of this, only some 600,000 accounts traded on margin. The balance were cash accounts. And among the 600,000 margin accounts, there was duplication because obviously there were high rollers who held an account at more than one broker.

Now let us take a look at the chart provided here which illustrates the **NUMBER** of stock versus bond issues listed on the New York Stock Exchange. Take note that bonds greatly outnumbered stocks. Far more capital was lost in the bond markets during the Great Depression than in the stock market. This chart illustrates that the number of listed bonds since 1865 had always been greater than the listings of stocks. Although the greatest gap between the number of bonds listed versus stocks came during the late 1890s, overall it has essentially remained close to that level of better than a 2 to 1 ratio until 1921. By 1929, the growth in the number of stock issues had still not surpassed that of the bond market numerically as the Great Bull Market came to a peak. This chart definitely illustrates that during the 1920s, stock offerings grew more favorable than new bond offerings in the eyes of the public at large.

In our second illustration, "U.S. Stock Prices As Percentage of Bond Prices 1900-1930," we can see clearly that a flight from bonds into common stock picked up great momentum beginning directly in 1927 during the period of the Central Bank intervention. Stocks reached a multiple of 168% above bond prices. Note that stock prices also peaked during 1902 just prior to the panic of 1903, and again in 1906 just prior to the panic of 1907. The peaks in 1909 and 1915 also corresponded to peaks in the Dow Jones Industrials as well. Therefore, in each crest on this chart we find waves of speculation where capital began to shift from bonds into stocks. But still the wave between 1927 and 1929 was greater than at any point in previous history. Concern over the vast amount of bond offerings on the part of shaky foreign governments at rates of three to five times that of U.S. domestic time deposits somehow began to lose their attractiveness when security was to be questioned.

We read how the Fed and government officials became concerned over the amount of money in the brokers loans. Yet here we can see that the ratio of brokers loans to total market value never even reached 10%. At the peak in brokers loans, a total of nearly $6.5 billion was involved. We read that the amount of kited short-term German bills and notes in 1931 amounted to $10 billion. By the time you add up all the vast amounts of foreign debt and losses incurred through U.S. municipal bonds as well as real estate loans, which became frozen assets or outright defaults, the figures came close to $100 billion. This amount vastly overshadowed the amount of money on loan in the U.S. stock market.

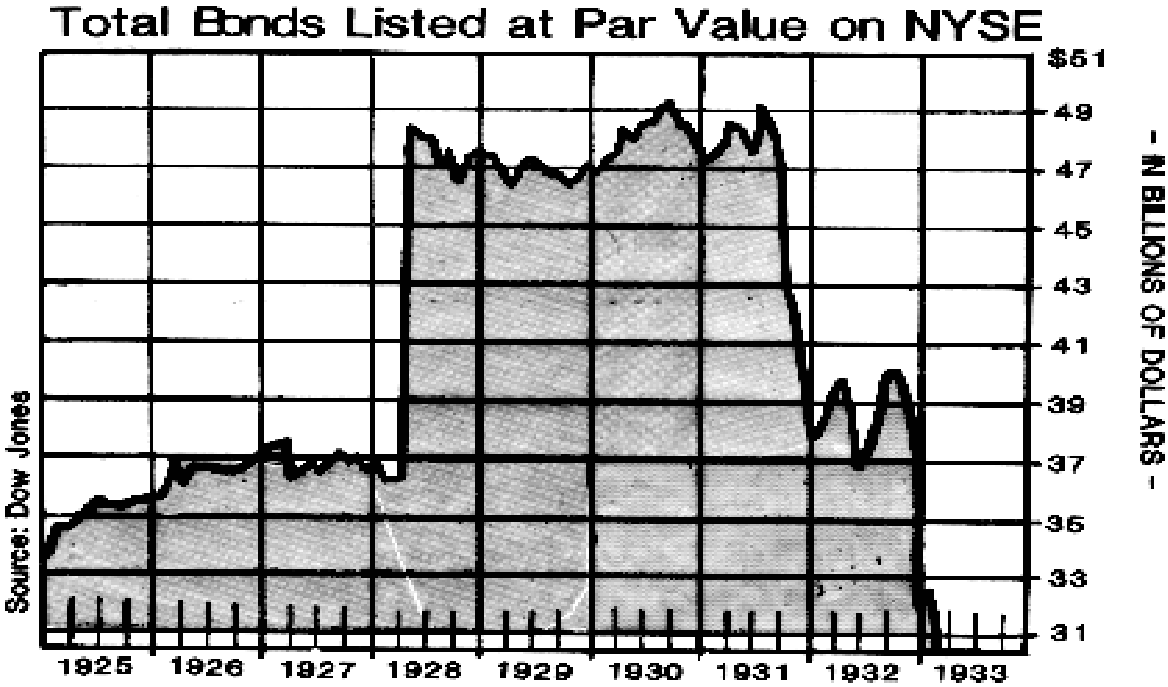


Indeed, the $10 billion kite of German debt had made the brokers loans out to be a minor problem considering the low ratio to total market value.

The next two charts that have been provided to illustrate that at the market's peak in 1929, the total value of all stocks listed on the New York Stock Exchange amounted to nearly $90 billion. The total bonds listed at par value on the New York Stock Exchange came close to reaching $49 billion in 1928. When the stock market began to decline in 1929, capital immediately began to flow into the bond market taking with it a rise in the total par value up to slightly above $49 billion. The abrupt up move in total par value in 1928 is attributed to the listing of the British War Debt issue which was later withdrawn after 1932.

Keep in mind that 99% of the total stock values were U.S. issues, NOT foreign which had been precluded from listing during the pre-1928 years. No flood of European stock issues came rushing into the NYSE when the ban against foreign issues was eventually lifted. Remember that foreign stock had to show a track record of consistent dividends in order to gain a listing. This prompted a greater tendency for foreign issues of bonds to be listed where the qualifications were odd enough, less stringent. The vast majority of bonds were not listed on the NYSE. They traded within the cash markets. Peru, Chile, Germany, etc., were among these off exchange issues. Therefore, in a very real sense they were out of the major lime-light of the Indexes, which meant that history too has tended to forget their impact on the causes and effects of the circumstances. The stock market, however, was right up front and it managed to capture center stage.

The yield on corporate U.S. bonds rose sharply from just below 5% in early 1929 to nearly 9.75% in 1932. You can imagine what happened to the yield on many foreign issues which had previously been 7% prior



to 1929 and exceeded 25% by 1931. The flood of weak bond issues and the default on municipals, such as that of the City of Detroit, did more damage to the aftermath resulting in the Great Depression than any other single factor. Capital was literally scared to death of bonds as well as stocks. As a result, corporate bonds of even the highest quality were somewhat tainted. Common stock in the very same companies was often viewed as still better buy than bonds. Capital did swing, however, into U.S. government bonds. Here I have provided several yearly charts of the U.S. Liberty Bonds of various yield and issue. In all cases, we can see that an important low had been made in 1929 as the Fed hiked the discount rate up. Note, however, that the initial reaction of the U.S. Treasury Bonds was one of a positive nature, rising into early 1931. But during the Monetary Crisis of 1931, when rumor spoke of the U.S. abandoning gold, the Liberty Bonds collapsed. Confidence internationally had reached a low and the treasury bonds by and large bottomed during early 1932 along with the dollar. Their gains made into early 1933 were again shattered under the prospects of the inflationary policies of Roosevelt.

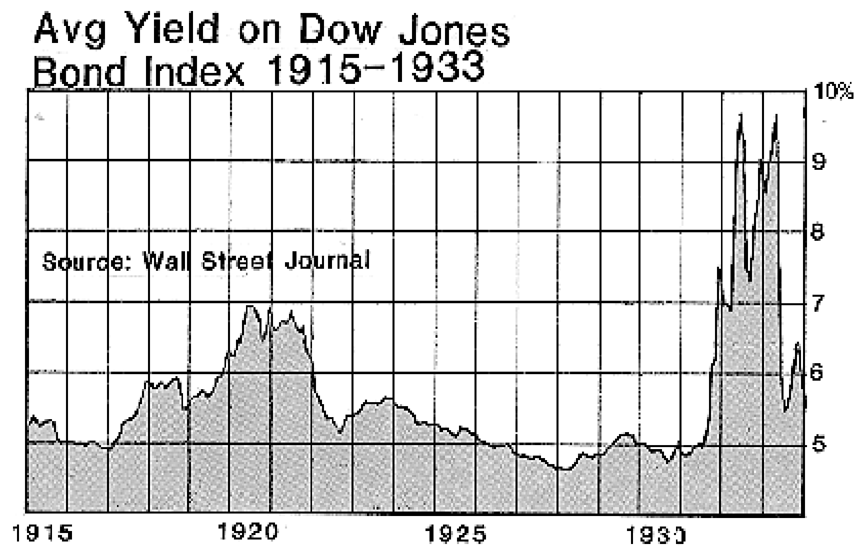
The next illustration of the yield on high-grade railroad bonds from 1857 to 1930 illustrates the general overall trend of corporate bond yields for an 87- year period in the United States. The 1920 high on the railroad bond yields was not as high as that on the overall corporate bond yields if you compare this chart to that of the Dow Jones Bond Index. The Dow Bonds registered nearly a 7% peak in 1920, whereas the rails reached only 5.5%. The railroads had been the leading companies during the Bull Markets up to 1907. The public viewed the rails as less speculative as if one might consider them to be a utility in today's terms. To some degree, the rail bonds were among the best performing corporate issues during the debacle.

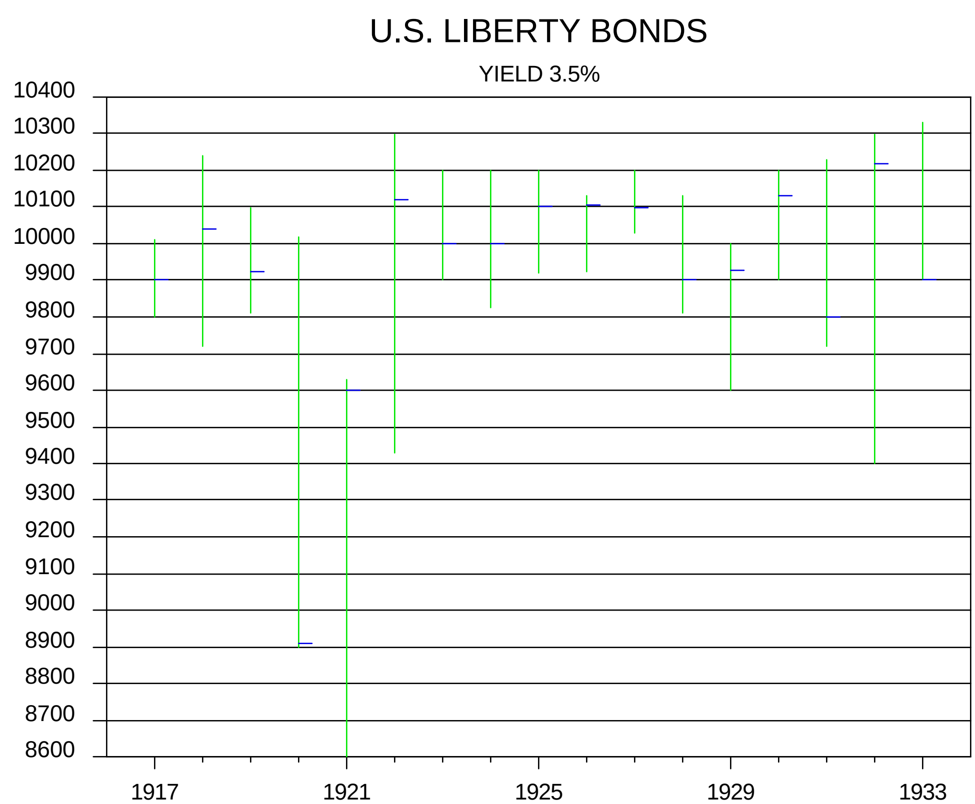
The United States was undoubtedly a greater lender of money during this period. Capital flowed back and forth internationally on the whims of confidence as we have noted for various reasons, including war and foreign exchange fears of devaluation. The greatest of all factors which led to the Great Depression was the collapse in this credit structure resulting in the contraction in money supply which many have blamed on the Federal Reserve's fears of reflating. Although Galbraith criticized the economic thinking of the period as perverse because of the calls for a balanced budget in 1932, I find myself in disagreement. The economic logic of calling for a balanced budget emerged after the monetary crisis of 1931. Hoover indeed took the road toward deficit spending, trying to stimulate and prop up the economy as Galbraith claimed was necessary and, indeed, as Keynes portrayed as mandatory. The switch to balanced budget did not arrive until 1932 when rumor had attacked the dollar. Calling for a balanced budget was a step toward trying to restore confidence to the international economy in so far as the U.S. would stand by the gold standard, assuming the role of the lighthouse in a torrent of fiscal irresponsibility. The unbalanced budget did not support the U.S. markets and those who simply argue that Hoover didn't spend enough and that is why Hoover did not work must convince me that huge government expenditures can prevent a deflationary mode when such periods as that of 1981-1985 exist. Never before did the U.S. fiscal budgets go so far out of balance year after year, yet inflation yielded to deflation in spite of such theory to the contrary. No, criticizing Hoover for not spending more as being a cause of the Depression is not logical in the face of economic circumstances of today. The call for a return to a balanced budget did not come in 1930 nor in 1931, but only after the monetary system of the world cracked wide open within its very foundations at the hand of fiscal irresponsibility stemming from abroad. Yet again, we find the philosophies of the spend thrift extracting only what he wants to hear and claiming that it could have been prevented by not less irresponsibility, but instead greater fiscal irresponsibility.

Another example of a period when government spending continued to rise while the economy failed to be stimulated was the recession of 1937-1940. During those years, further advances in government spending failed to prop up the economy in exactly the same circumstances that took place between 1930 and 1931.

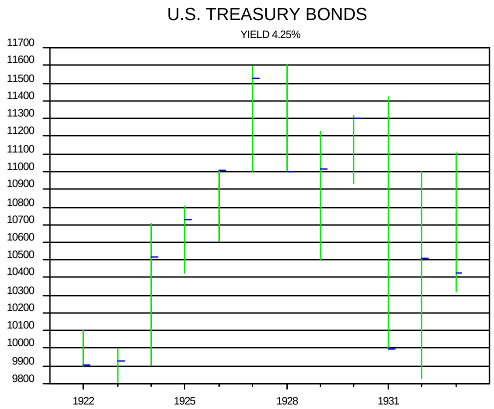
The calls for a balanced budget were not perverse. The entire investment stimulus around the world had been dealt a shocking blow by the numerous banking failures along with sovereign defaults on outstanding bond issues. Investment capital was driven into hibernation and its emergence in 1933 was not a testament to the policies of Roosevelt, but to the fears of a dollar devaluation and a hedge against inflation. As long as capital viewed deflation before its eyes, hoarding of resources was the smart thing to do. When inflation of major proportions was suspected on the horizon, idle cash would then depreciate and the smart thing to do was to invest in something else which would appreciate with the new trend. Thus Roosevelt's policies were not brilliant in the sense that they offered a formula for future generations to follow. But they were successful in scaring capital out of hiding and under such circumstances they would work. But when capital is not in hibernation, such policies have failed.

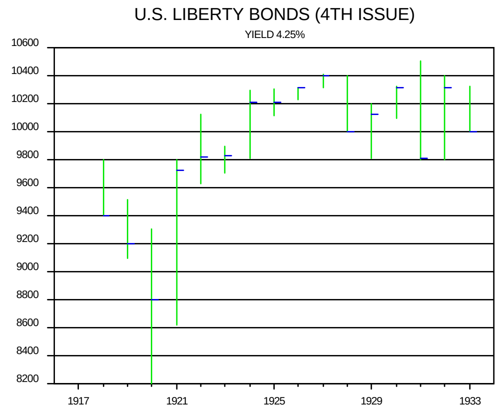
Thus, the state of the international situation dominated the time. The collapse in the credit structure perhaps dealt the most

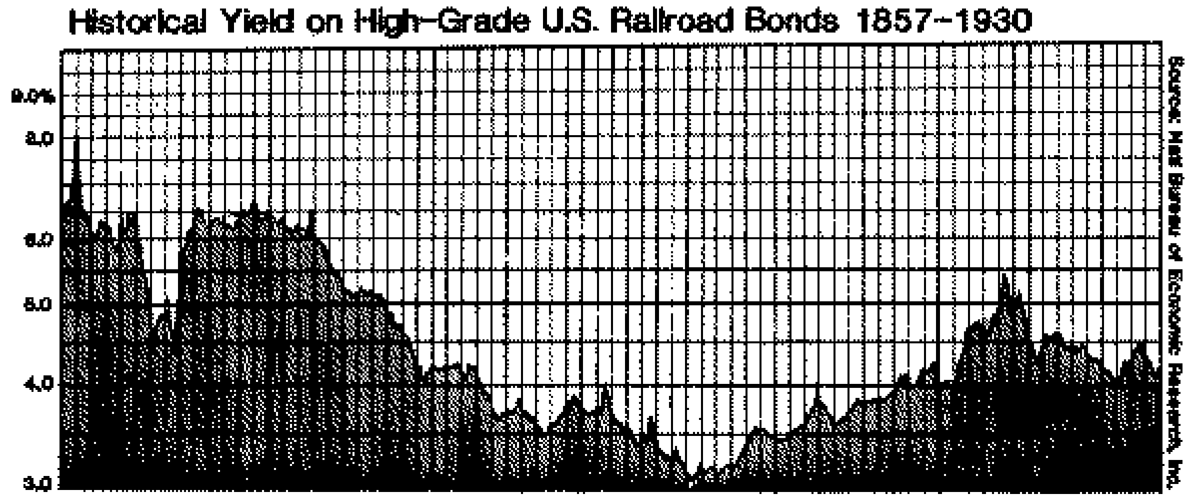

Avg Yield on Dow Jones
Bond Index 1915-1933
Source: Wall Street Journal
10%
9
8
7
6
5
1915
1920
1925
1930


U.S. LIBERTY BONDS
YIELD 3.5%
10400
10300
10200
10100
10000
9900
9800
9700
9600
9500
9400
9300
9200
9100
9000
8900
8800
8700
8600
1917
1921
1925
1929
1933


U.S. LIBERTY BONDS (1ST ISSUE)
YIELD 4.25%
10500
10400
10300
10200
10100
10000
9900
9800
9700
9600
9500
9400
9300
9200
9100
9000
8900
8800
8700
8600
8500
8400
1917
1921
1925
1929
1933


U.S. TREASURY BONDS
YIELD 4.25%
11700
11600
11500
11400
11300
11200
11100
11000
10900
10800
10700
10600
10500
10400
10300
10200
10100
10000
9900
9800
1922
1925
1928
1931


U.S. LIBERTY BONDS (4TH ISSUE)
YIELD 4.25%
10600
10400
10200
10000
9800
9600
9400
9200
9000
8800
8600
8400
8200
1917
1921
1925
1929
1933



serious blow to all nations, particularly in 1931.

Perhaps the simplest example of this credit structure can be viewed as a parallel to a popular child's game of musical chairs. Five children begin the game with five chairs. When the music begins, they all stand up and begin to walk around the chairs but the adult watching over the group takes one chair away. When the music stops, the five children fight for the four remaining chairs. The process continues until only two children and one chair remain and when the music stops for the final time only one will win the game. He is the lucky soul holding the last chair.

Thus was the fate of the credit situation which dominated this era. Germany, for example, was saddled with reparation payments it could not make for France, and others were reluctant to allow it free reign in selling its exports. Each nation contributed by its various tariffs in a game of competition to rebuild. Each also floated substantial amounts of bonds, notes and bills seeking capital largely aimed at rearming itself rather than in stimulating economic growth. Germany was forced to issue short-term notes which it used to make its reparation payments as well as to pay its interest on its long-term bond obligations. Thus the game of musical chairs began, but in real life it was a deadly game of musical kiting bonds.

Capital had become concentrated within the United States following World War I and was largely in the form of gold. This capital came from two basic sources. First, it came through American supplies sold to Europe during the war, which resulted in direct profits for American industry and agriculture. Second, capital arrived in the U.S. on the heels of fear which spread around Europe as war cast doubt on not only who would survive as the victor but on the victor's ability to meet its incurred debt as a result of fighting the war.

The vast concentration of wealth produced the inflationary period which came to its crest in 1919. With European capacity to manufacture and even cultivate food for itself destroyed in the ensuing European battle, commodity prices had to rise. This spawned criticisms that American business had been extravagant in 1921 which led to the deflationary years of 1920 and 1921.

American business had become addicted to the high demand for its products and expanded as if it would retain that high level of demand in the post-World War I era. That was a bad business judgment which cost the financial fortunes of many, including Ogden Armour.

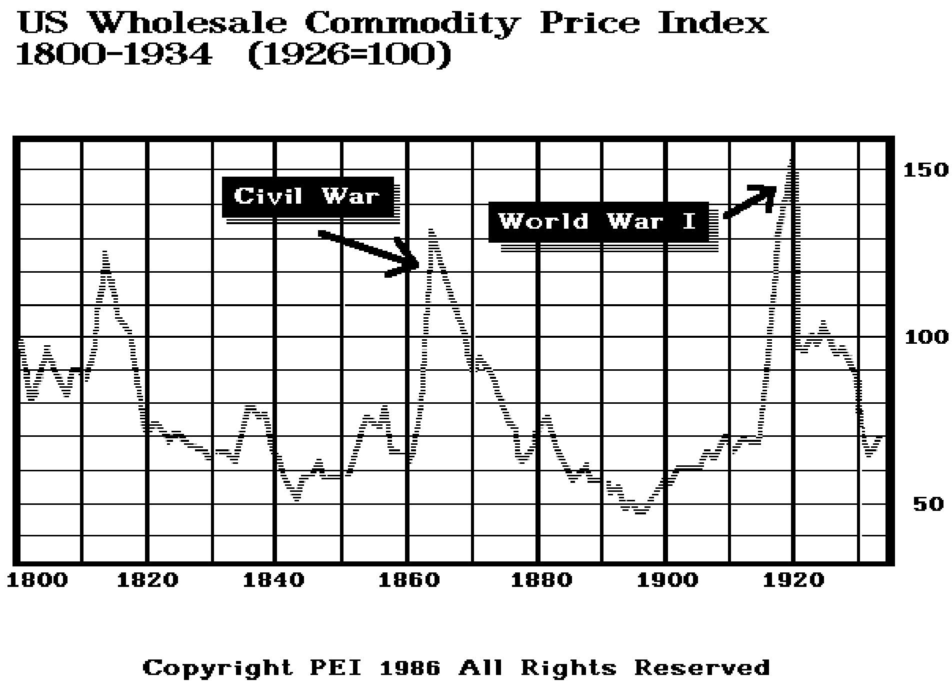
If we look at the chart of Wholesale Commodity Prices in the United States from 1800 to 1934, commodities reacted in a normal manner as they had previously during the War of 1812 and the U.S. Civil War. Whenever productivity is disrupted by war, prices of raw commodities rise rapidly.

But unlike the events which followed the War of 1812 and the U.S. Civil War which necessitated the rebuilding of the United States' industry itself, the aftermath of World War I left U.S. industry all dressed up with nowhere to go and in a vulnerable over-expanded state. However, industry became fat and loaded with cash following 1920, which is why it was capable of gearing up quite rapidly to supply the rebirth of Europe in the post-1921 years and the resurgence of economic expansion through the guides of new and exciting developments in technology.

That rebirth of Europe came on the notion that lending to foreign sources would in turn result in their buying of U.S. goods. This was the concept and the dream at first, but toward the end of the 1920s, a trade war began and the U.S. saddled its own industry through numerous anti-trust proceedings. This had a dampening effect upon U.S. competitiveness during the late 1920s, which finally gave way to imposing tariffs to protect U.S. industry instead of lifting the very restraints which had made it uncompetitive in the first place - the Sherman Anti-Trust Act.

With wealth concentrated in the United States, Europe had to attain a trade surplus in order to repay its loans. Thus the essence of a trade war began. American industry had provided goods for which it was paid out of lending U.S. capital to its foreign consumers. Therefore, this created a vast amount of foreign debt which floated around waiting to be repaid like a game of musical chairs. With American industry being prohibited by trade barriers set up by the Europeans and U.S. capital being sucked up by foreign sources, the foundation of the American economy was undermined.

We read that for each dollar in gold, $13 in credit was created in the banking system. Money is merely a medium of exchange. It cannot be eaten or used for anything unless the party on the other end recognizes it to be worth something. Thus the strict perception of money was not actually paper dollars but gold bullion when all things were sold and done. There are two forms of wealth which man accrues in life - cash and tangible assets. Within these forms of tangible assets, one finds stocks, bonds, real estate, fine art, precious stones, automobiles, etc. As credit is created, these forms of tangible wealth increase greatly. Thus the rise in the stock market does not create more gold nor does it create more paper dollars in physical form. It creates paper profits as we call



them which expand the available credit structure.

Therefore, during great waves of prosperity and speculation, these forms of tangible assets gain in value tremendously yet no more physical gold or paper currency was created in the process. When the musical floating bonds came to a halt, suddenly hitting the world economy, a massive wave of liquidation took place. People naturally become frightened and in the process try to sell off these tangible forms of wealth. Because these forms of wealth vastly outnumber the actual real gold bullion or physically existing dollars, the value of these tangible assets drops dramatically on a reverse leverage basis. As the value of these tangible assets declines, the value of collateral also declines at the bank. Thus, the Great Depression was a period during which a massive contraction in the "tangible value" of hard assets took place.

As this unfolds, the dollars created at the bank through multiple loans contract in proportion. There is only so much gold or physical paper dollars to go around. In this case, new gold could not be created. Thus many blame the Fed for contracting the money supply because they nourished fears of rekindling inflation. Although they did have such fears which were unjustified, they did not understand the magnitude of the reverse leverage which was taking place within the economy. We will see when we review the Monetary Crisis of 1971 that the only vital difference between 1971 and 1931 was in what the public physically considered to be money itself. The 1971 monetary crisis internationally came when the U.S. gold reserves could not meet its international debts exactly the same as we have seen in the case of Germany, Britain, and many other nations during the 1931 period. The only difference was that there was not a shortage of paper dollars in 1931, but a shortage of gold. As long as Americans were prohibited from owning gold and after two generations being ignorant as to gold actually being money, no domestic panic took place within the United States during 1971. No hoarding of paper dollars took place in 1971 so the banking deposits did not contract to spark massive banking failures as occurred in 1931 to 1933. The confidence of the population was not lost because they knew not of gold, nor of its role in the international monetary system. But in 1931, gold was money and with everyone demanding only gold around the world, the contraction in credit was inevitable, unlike the monetary crisis of 1971.

During the Great Depression, hoarding of gold by American citizens further contracted the credit reserves of the banks, forcing more failures and a further deterioration in the value of tangible assets including bonds, stocks, and real estate.

There is little question as to the major role foreign debt played during this period. Shifting international capital from one nation to another sparked currency controls which brought the international trade almost to a screeching halt, inflicting for more damage than tariffs alone. Thus it was the changing tides of international confidence which both gave America vast amounts of excess wealth during the 1920s that in turn had taken it away through the monetary contraction and international defaults. The Great Depression was no more created by the rise and fall in stock prices nor by the frauds perpetrated by stock brokers and bankers in the 1920s than the lack of effect which the rising U.S. trade deficits and federal budget deficits had on the massive rally in the dollar between 1980 and 1985.

The massive hoards of capital and debt which revolved around the world simply came to a halt and in the process the slightest increase in demand for cash, in this case gold, resulted in a reverse leverage effect upon the money supply within the world. The Fed would have had to have created in physical form enough paper dollars equal to the amount of "paper profits" placed as collateral for loans at the banks in order to offset the contraction within the money supply. This was a position both highly inflationary in perspective yet in reality non-inflationary. The inflation within the value of these tangible assets had already been created through the banking system by means of credit. The Fed did not understand the magnitude of this reverse leverage effect and therefore the increased government spending implemented by Hoover was vastly overshadowed by the wiping out of $10 billion on the part of Germany alone.

The effects of the Great Depression are not unique to this period. It was not a freak in man's history, merely a repeat of similar circumstances in a more advanced international economy. These same forces are at work at all times and the threat of setting them off again will never disappear. Government's concept that by borrowing from the public rather than monetizing its deficits neither creates less inflation nor does it solve the problems. It merely postpones the issues at hand as did Germany through its massive rolling over of debt throughout the 1920s and early 1930s. Eventually the problem must come to a head and this is what politics seem to fail to understand.

Enacting laws and sanctioning witch hunts to chastise traders who shorted stocks were merely futile exercises in trying to shift the blame from official defaults on bonds into the laps of the speculative stock traders. No massive bear pools were ever uncovered and most who were prosecuted had lost their fortunes in the decline of the market itself.

Those who look back at the 1920s, claiming that it was a period of no inflation and therefore drawing the conclusion that stocks rise during periods of noninflation, have missed the entire lessons this period had to offer. It was a period of great transition from a heavily commodity oriented economy into a new age of mass-production. Inflation is not purely a rise in commodity prices but it is a rise in the general level of all tangible assets including stocks and real estate. The very presence of the Florida land boom in the mid-20s is reflective of the rise in the value of real estate throughout the United States to varying degrees. The rise in the value of stock was in reality inflating the assets of American industry. Raw commodities declined because of a wave of great overproduction which followed 1919 and kept prices in check for twelve long years.

The United States vastly improved its capacity to produce but the growth rate of the world to consume did not keep pace. Once the saturation level was reached, a decline was inevitable. Looking for causes within the domestic situation will no more lead to the answers of the Great Depression than trying to blame the inflation of the 1970s on the backs of the Hunt brothers for bidding up the price of silver into 1980.

In the post-World War II years that followed, the free markets have been greatly influenced by the shifting tides of international capital flows. The quest of nations for a trade surplus continued and the trade battles and competitive devaluations merely became a tool in the postwar era to gain trade advantages. The lessons of the Great Depression were not learned and instead governments would seek to control many more aspects of their economies, resulting in greater levels of taxation and public debt. The war over trade and the exchange controls on capital nearly brought the international economy to a final end in 1931-1932. But those tactics would not be relinquished in the decades that followed.

Click here for PEI's Homepage

Chapter XVII

Thus far we have reviewed this tragic period in economic history from the perspective of the fundamentalist, the technician and now we will look at it from the economic side of the street. Each view has its own distinct merits and by and large perhaps the answers lie within the combination of all three. The political explanations are not worthy of exploring since a Democrat or a Republican would just as soon tear the nation apart with outright lies about each other to gain the power of their adversaries. Therefore, whatever the Democrats had to say about the blame for the world depression resting upon the shoulders of Hoover was not void of personal motive and certainly had little resemblance to the true facts.

But up to now, both the technical perspective and that of the fundamentalist has been largely biased toward the domestic aspects of the events. Regardless of what political factions would have us believe, we must broaden our mind's eye to view the world from a more global perspective. This is not the norm in analytical thinking but I believe it will help to settle many issues which otherwise go unanswered.

Economics itself is a social study which is prone to great biases according to philosophical ideas. Economics has often been the manipulative tool of politics as it tends to twist events and logic to suit a particular idealized goal. Politics and economics are two words which have been married from nearly the dawn of civilization, yet at the same time they are so incompatible that they should have been divorced right after their first date. Nonetheless, this conflicting political-economic interrelationship is something which we must understand and come to terms with. It is this very biased conflict in politics which draws conclusions from economics to support an idealized political goal. In reality, the Berlin Wall was erected with political bricks held together by Marxian-Philosophical mortar. The conflicting economic systems of capitalism, socialism and communism are all the children of economic supposition.

Politics has been a parasite living off economics and exhorting what often appears to be logical conclusions. But logic itself can be a deceiving thing. For example, if you asked a man who was 105 years old how long he expected to live, he could reply that it is known fact that very few people die beyond the ripe old age of 100. Granted this statistic is true and to some degree you could claim that the odds of dying before the age of 100 are greater than after 100. But this is where logic is confronted with reality. Unfortunately or fortunately, whatever may be the case, man is not immortal, only immoral. The same trick one may play with these statistics has been the name of the game when political economics comes into play.

One might argue that the economic contraction during the Depression was caused by the reluctance on the part of capital to invest. Therefore, the recovery was hampered by the rich who hoarded their wealth. However, the "but" in this case was the prosperity which preceded the Great Depression. Had capital not been free to struggle for new means of profit, then the innovations such as the automobile would never have been made affordable for the average citizen. Logical one-sided arguments are easy to draw from any such situation. But the standard of living under communism and even under socialism is far lower than under a free capitalistic system. Those who claim that this is propaganda devised by capitalists should take a trip to Berlin and walk through "Check-Point-Charlie." Stories of food lines and seven year waiting lists for cars or reports of having to obtain governmental permission before moving are real, not fiction. I had to see it for myself as well in order to believe what often appeared to be exaggeration. As with anything, the reality of events must eventually come face to face with theory. And this is also true of socialism, communism or capitalism.

There have been many famous economists who have added their two-cents to the kitty since the first book on the subject was written by a Greek chap named Xenophon way back in the middle of the fourth century B.C.

The word economics is Greek in origin, compounded from "oikos" (household) and the complex root, "nem-" (to regulate, administer, organize). Xenophon's book, "Oikonomikos," was the guide for the gentleman landowner beginning with a chapter on the proper use of wealth. Xenophon then leads into a chapter on the virtues and leadership qualities which a landowner must maintain. Some of the other chapters go into the proper training and management of one's slaves and it even dives headfirst into a modern controversial topic, the proper training of a wife. In many respects, Xenophon's book combines the proper management of one's wealth with the moral ethics suited for one's status, something that modern man has forgotten in his quest for wealth.

Xenophon's book was largely copied or at least served as the model for a 1742 publication titled: "Short Introduction to Moral Philosophy" written by Francis Hutcheson, Professor of Philosophy at the University of Glasgow. It was Hutcheson who was the teacher of Adam Smith. It is with Smith that most consider the field of modern economics to have its origin. But in reality, Hutcheson's book follows that of Xenophon nearly chapter by chapter.

Ever since the days of Xenophon, economics has been sorting out who struck John in what has seemed to be an endless battle suitable for a Greek tragedy itself. The arguments over such things as even the validity of interest rates stems back as far as Aristotle who in 322 B.C. considered money as purely a medium of exchange while interest was simply unacceptable. In the middle of the 13th century, Saint Thomas Aquinas dealt with the field of economics in his monumental 20 volume work, "Summa Theologica," in which he believed that interest should only be taken if it was earned, while unearned interest was tantamount to the sin of usury which meant that it was wrong to extract interest from someone who was in desperate financial condition. But more importantly, Thomas tackled an issue which to this very day haunts modern economics.

Saint Thomas Aquinas discussed his concern with the concept of the justice in the distribution of income. He stressed the need for a just wage and just price. Although he saw in the economic system the inequities within the distribution of income, he concluded that despite such inequities, it was immoral to attempt to alter the distribution of income in any way. Indeed, many have argued this very point, including Marx, but from the other side of the coin. Yet to disrupt the inequities within the distribution of income, one must violate the personal freedoms of another. Therefore, by trying to strike at what some may believe is an injustice, they themselves create another injustice - the violation of personal rights and freedom. Saint Thomas Aquinas was canonized in the year 1323.

In 1755, "Essai Sur la Nature du Commerce en General" was published by Richard Contillon, an Irish international banker. Although Cantillon's writings are largely forgotten today, he was nonetheless one of the very first writers to challenge a concept which had dominated the political economy of Europe up until this time. This concept of how things should work was known as the mercantilist's perception of what actually formed a nation's wealth. It was the merchants who argued, from their own biased viewpoint, that a nation's wealth lay solely within the amount of gold or money it possessed. Therefore, it was justified to block imports and bar free trade, thus affording a domestic monopoly so that the nation might avoid a trade deficit which resulted in a drain upon its national wealth - gold.

Cantillon's argument was that money was merely a measure of wealth and that wealth itself was really derived from production. It was with Cantillon that we begin to see the concept of something beyond purely gold or paper money constituting a nation's wealth. Even though Aristotle viewed money as merely a medium of exchange, this simple concept had been lost for a great number of years. Indeed, chronic trade deficits had drained the treasuries of many great empires between the days of Xenophon and those of Cantillon. It was the great Virgil who wrote in 19 B.C., "Accursed thirst for gold! what dost thou not compel mortals to do?"

Although the forums of many ancient societies had long recognized the evils of wealth, they had explored the issues of what was wealth in the glorious days of Athens. But those great thoughts seemed to lay somewhat silent. The stone freizes could not speak of the downfall of Mycenae, of Athens nor of the once great city of Thebes. The 17th through 20th centuries would find economics still regurgitating the same age-old debates striving to define what actually composed a nation's wealth.

Francois Quesnay (1694-1774) was a French economist who was actually a physician to Louis XV in 1752. But in 1758 he published his "Tableau Economique" which made him the father of what became known as the "Physiocrats" of the day. Quesnay's work divides society into three groups: agricultural workers, proprietors, and the "sterile manufacturing sector." The Physiocrats believed that NATURE was the source of all wealth and therefore agricultural workers provided society's means of receiving the surplus, or "produit net" given forth by nature herself.

Quesnay's work set about attempting to show how this "produit net" was distributed among the various classes within society and in reality this was one of the earliest attempts at looking at the inter-workings of the "domestic" economy as a whole. Quesnay's doctrine, therefore, concluded that society should be governed by a natural order inherent in itself. Land and its unmanufactured products, Quesnay preached, were the only true wealth and the precious metals were actually a false standard of wealth. Thus he concluded that the proper source of state revenue should be the direct taxation of land. But he also maintained the right to free trade, person, opinion and property. Thus it becomes understandable why some of the first paper money issues of France were not backed by gold, but by land.

Perhaps you can begin to see why arguing over what even constituted wealth could alter the concept of how society should be managed. Concluding that a nation's wealth was purely the amount of gold it held led to the protectionist philosophy of the merchants who thereby sought to block competition to enhance their own domestic monopolies, of course, in the good name of the country. Concluding that land was the true source of wealth gave rise to the excuse to tax the landowners and also tended to justify war for the sake of acquiring land.

It was at this junction in history when Adam Smith, the "father of modern economics," entered. The thoughts of this Scottish political economist and philosopher changed the course of thinking in a dramatic way. In his classic work, "The Wealth of Nations," published in 1776, Smith advocated a simple system centering around political liberty. Within this bold idea, each man should be free to "pursue his own interest and bring his capital and industry into competition with any other man or group of men." Smith essentially turned his back upon the concept of mercantilism which dominated his day. Smith proposed that the true wealth of a nation resided within its **LABOUR** and not with the amount of gold it held nor was wealth strictly confined to agriculture. "Labour...is the real measure of the exchangeable value of all commodities." Smith recognized that the value of a commodity was not always based strictly upon supply and demand but also it remained dependent upon the amount of labour it to ok to produce it. "The whole produce of labour does not always belong to the laborer. He must in most cases share it with the owner of the stock which employs him."

Adam Smith did lay out a design in which he believed that a nation's capital should be brought to bear first upon developing agriculture, secondly upon manufacture and only thirdly upon foreign commerce. It was Smith who influenced the enlightenment era and truly dissected the economy from taxation right down to supply and demand. His greatest single contribution in my opinion is his concept of the invisible hand. It was here that Smith explained that by each individual pursuing his own desires to improve his personal financial condition, he contributed to the advancement of society as a whole in an orderly fashion incapable of duplication by any law or decree. Each and every one of us in our quest to better our own position helps to advance the economy as a whole. Herein lie the seeds of freedom. It was the innovation of Henry Ford who raised the standard of living for us all today. It was the gamble of Rockefeller that gave birth to the oil industry. It was the dream of Willy Durant that spawned General Motors and it was the faith of Andrew Mellon that created the aluminum industry. Smith was right. Each in his own pursuit may perhaps benefit disproportionately on an individual basis, but collectively society benefits much more from the freedom of the entrepreneur.

Too often most people are jealous of the wealth accumulated by such an individual. But Smith's observations stand. These individuals have given society thousands of jobs and the income derived by the working class as a whole far exceeds the income of the individual. Yet it is the jealousy which causes men to compare things on an individual basis, but the labourer has merely contributed his own production to society whereas the entrepreneur has created thousands of jobs within society. The two cannot be compared on an individual wealth basis without taking into consideration the individual contribution of each toward the expansion and growth of society as a whole.

Although most modern economists credit this theory of the "invisible hand" to Adam Smith, the same observation had been made nearly 2,000 years before. In 336 B.C., Aristotle explained: "That which is common to the greatest number has the least care bestowed upon it. Every one thinks chiefly of his own, hardly at all of the common interest; and only when he is himself concerned as an individual." Epictetus in 138 A.D. also observed this self interest of the individual benefiting society as a whole. "In general Zeus has so created the nature of the rational animal, that he can attain nothing good for himself, unless he contributes some service to the community. So it turns out that to do everything for his own sake is not unsocial."

Adam Smith had in part been influenced by another distinguished Scottish philosopher, David Hume, who had published his work, "Political Discourses," in 1752. David Hume's best contribution was an essay entitled "Of Money." In this bold essay, Hume also attacked the mercantilism of his day and its fears concerning free trade. Hume pointed out that money movements actually responded to a rise or fall in prices, which prevent permanent surpluses or deficits. Hume actually anticipated the quantity theory of money and in plain language, the concept that a rise in the supply of money is followed by a rise in prices or inflation. "It seems a maxim almost self-evident that the price of everything depends on the proportion between commodities and money. In all due respect, if anyone should be given the credit for supply and demand theory as well as theory of inflation, perhaps that distinction truly belongs to David Hume.

The thinking process in economics was further shaped by David Ricardo who published many works but whose most important was the "Principles of Political Economy and Taxation." Among Ricardo's most important theories was that of Comparative Advantage. It was here that one can see that nations would be better off if they specialized in producing goods where they held a comparative advantage instead of blocking trade or subsidizing an uncompetitive domestic industry which merely supports artificially high prices within their own nation. In essence, Ricardo touched upon a very key issue which today is still far from being clearly understood. Many a nation raises trade barriers to protect an uncompetitive domestic industry. Quite often, this urge to protect an industry results in a higher price paid by its own consuming populace. Thus a nation would spend its resources in a better area if it promoted an industry where it held a comparative advantage.

It is most probable that it was actually Ricardo's thoughts upon labour which highly influenced Marx years later. It is not to be understood that the natural price of labour, estimated even in food and necessities, is absolutely fixed and constant. It varies at different times in the same country, and very materially differs in different countries. It essentially depends on the habits and customs of the people. There is little doubt that one might interpret at least in part from Ricardo's words that the value of labour could be changed under this explanation or observation. It may have been this thought itself which sparked the mind of Karl Marx.

In many ways, economics was still trying to define exactly what was the wealth of nation. Was it gold, land, agriculture, manufacture or labour? The distribution of wealth within society also remained violently controversial topic which was merely exploited further by Karl Marx during the mid-1800s.

As the father of communism, Marx was a German philosopher and economist who obtained his doctorate in 1841 from the University of Jena. Karl Marx lived a very nomadic life style wandering around Europe and finally settling down in London in 1849. His Communist Manifesto was written in 1848 with his friend Frederick Engels. Marx's famous "Das Kapital" was published finally in 1867. Much of his later pamphlets and two additional volumes were published between 1885 and 1899 posthumously by Engels. It was through this extensive work that Marx attacked capitalism for the exploitation of the working class. In essence, his view was that the value of labour was the wealth of a nation to a large extent and it was the suppression and exploitation of the working class which led to revolution and the ultimate socialistic state.

Marx viewed the world through a class struggle between the rich and the poor. "You are horrified at our intending to do away with private property. But in your existing society private property is already done away with for nine-tenths of the population; its existence for the few is solely due to its non-existence in the hands of those nine-tenths!" Marx himself said that you could sum up his theory of Communism in one sentence: "Abolish all private property."

In part it was the British system of long leasing property for 100 years in which the ownership merely remained within the hands of a noble family for generations. Thus the pearly white townhouses of Victoria and Kensington never changed hands, merely tenants. Thus property was withheld from the working class who had nothing to leave their heirs whereas the tangible wealth of the noble families passed down from generation to generation.

In part it was also Marx's logical pursuit of value and price which persuaded him toward his communistic theory. "We arrive, therefore, at this conclusion. A commodity has a value, because it is a crystallization of social labour. The greatness of its value, or its relative value, depends upon the greater or less amount of that social substance contained in it; that is to say, on the relative mass of labour necessary for its production. The relative values of commodities are, therefore, determined by the respective quantities or amounts of labour, worked up, realized, fixed in them." (Value, Price and Profit published 1899)

Marx's statement here is logical and in reality his observation is the same as that of Adam Smith: "Labour...is the real measure of the exchangeable value of all commodities." It is true that the majority of the price of a commodity is actually the cost of labour it took to produce it. Seed itself is cheap but it is the cost of the labour of the farmer which by and large determines the minimum value of wheat. Marx, however, allowed himself to get caught up in trying to define what was the real value of something which he saw as labour. But he forgot the human nature side of competition and the importance of ideas and the entrepreneur who plays a large role in Smith's "invisible hand." Without the pursuit of self-interest, new innovations come slowly. Marx's solutions were drastic and motivated by a materialistic jealousy and bias toward interpreting history itself. He viewed that it was the entrepreneur who exploited the labour classes to gain his wealth. He tried to compare the wealth of that individual to an individual labourer. He neglected to see that it was the entrepreneur who created the jobs for labour and that the income derived by everyone he employed vastly exceeded the income of the individual entrepreneur. Marx attempted to disrupt the distribution of income which in itself became an injustice upon social freedom. For it was Cicero who commented in 65 B.C.: "If we all seized the property of our neighbors and grabbed from one another what we could make use of, the bonds of human society would necessarily crumble."

You can see that up until the beginning of the 20th century, economists were still fighting over the very same issues. The antitrust laws enacted within the United States in part struck at this concept of the distribution of income. The graduated income which evolved after World War I was also a child of some of the same thoughts that enraged Marx himself. The Great Depression would only further this notion of fairness within the distribution of income and the blame that would be laid upon the doorstep of the stock market would merely serve as the excuse and the tool to reshape a new political economy in the decades that would follow.

Off the beaten path came the cyclical long-term wave theory which was pioneered by Nicolai Kondratieff, a Russian economist who spent his time in researching price fluctuations within a basket of commodities. It was Kondratieff who identified long-term cyclical waves in price activity ranging from 50 to 60 year periods. These waves he identified were 1780-1840, the Industrial Revolution, and 1840-1890. Although Kondratieff essentially believed that these long waves were something of a rhythmic pattern inherent within the capitalistic system, he also maintained that communism would not eliminate them either. As a result, he was sent off to Siberia in 1930 and never heard from ever again. Not much credence has been given to cycle theory in economics. Yet today we are only beginning to flirt with the notion that perhaps man's emotions are driven to the rhythmic beat of gravitational forces just as the moon thrashes the oceans from one side to the other like clockwork each day. But this new and strange thinking process of looking at the economy from a rhythmic pattern played a role in influencing a later economist, Joseph Schumpeter.

But it was at this junction in economic evolution when John Maynard Keynes made his entrance into this Greek tragedy of financial intrigue. John Maynard Keynes shocked the world in 1923 and again in 1936. Keynes took the position that government intervention could smooth out these choppy waves of up and down movements within the economy. It would be Keynes who would now shape the destiny of our modern society as his ideas fell upon eager ears in government. For here at last they had someone who in a sense advocated more power and responsibility to the hands of government officials who became the new race of economic demigods of the 20th century.

In later years, economics would be further expanded by the theories emanating from Milton Friedman, John Kenneth Galbraith, Alban Philips, Paul Samuelson and Joseph Schumpeter. Friedman would attack government in some ways advocating a free market economy, and he was perhaps the greatest spokesman for the monetarist theory which asserted that the business cycle was largely dictated by the supply of money and interest rates.

Joseph Schumpeter took a distinctly different approach. He believed that trade cycles and growth were sparked by great waves of innovation. He also argued that the abnormal profit was the just reward for the entrepreneur's innovation which in turn provided new industries and jobs. It was Schumpeter who explained the rhythmic economic waves of Kondratieff in a fundamental sense. As some new innovation was created, it spread throughout the economy allowing greater expansion. Thus the railroad expanded the United States both socially and economically. But lacking a new startling innovation, the prosperity contracts when the economy reaches an over-expanded state. Thus the innovation of the automobile indeed helped to expand the economy during the 1920s but as competition heightened and the market became saturated, it was the auto stocks which first signaled that the trend was over when they peaked during the first quarter of 1929. The secondary industries which had expanded on the coattails of the auto industry continued higher into late summer and collapsed from exhaustion. This would be the essential interpretation based upon Schumpeter's theory of innovation.

We can see that when dealing with a severe depression, economic theory itself had been long divided. Each of these men, including Marx, caught a glimpse of a piece of the puzzle but somehow missed the entire scope of the beast. Each observation was correct. Sweat shops did exist at one point in time, which caused an enraged Marx to advocate total confiscation of private wealth. But that was not the entire problem and confiscation was not the entire answer nor was it the logical human conclusion. The theory of Keynes who advocated government intervention was not the answer either. For politicians argue for months before they can ever agree and then the actions are often too late because they themselves fail to understand the true underlying events.

The economy is a very complex structure. Dissecting it and trying to figure out who was responsible for knocking the painter off his ladder is not easy. Each observation and theory which we have just briefly looked at was formed largely within the context of an assumed isolated domestic economy.

It was Sir Thomas Gresham, the financial advisor to Queen Elizabeth I of England back in 1566-1568, who remains famous for his observation of capital movements. Gresham's Law is short and to the point - Bad money drives out good. This observation was very profound. Whenever a sovereign nation chose to increase its money supply causing inflation, prior to the invention of paper money it had to do so by flooding the money supply with copper or silver coins. Whenever this transpired, the population naturally began to hoard the more scarce form of money - gold. We saw this ourselves during the mid-1960s when silver coins were being replaced with the copper-nickel clad coins. Even though silver had not yet risen in value enough to make smelting the coins profitable, the perception that they would be more valuable than the clad replacements at some point in the future gave rise to their immediate hoarding. Thus, the bad (clad) drove out the good (silver).

However, with the invention of paper money this application of Gresham's Law changed dramatically. During the pre-paper currency system, capital movements were restricted on a domestic basis. Capital did not leave a nation unless it was under siege by an enemy. Instead, capital would rush into gold when it perceived that silver coins were flooding the money supply. But in the paper currency system, capital still flowed into gold as we read during the last days of the Great Depression. Particularly after Roosevelt essentially made it illegal for Americans to own gold in an effort to prevent Gresham's Law from disrupting the economy, the capital flows became much more intensified on an international basis. Even prior to 1934, capital rushed from one currency to another as it perceived danger of default on the part of one nation and then another. This basically created the Monetary Crisis of 1931.

Even though the economy of the 1920s was perhaps not as finely tuned to international events on a split second basis as it is today, news still traveled faster than it had before World War I. Capital flowed freely for the most part until exchange controls were instituted during the Monetary Crisis of 1931 by many European nations to stop the outflow of capital according to Gresham's Law, which now applied to devaluations on an international level as well. But by and large, the economic models and thinking of the day were not advanced enough to understand the full impact of this new age of world communication. When money was merely gold coin, hoarding was the normal action taken during periods of a lack in public confidence. But under a paper system even where notes were supposed to be redeemable into gold upon demand. people quickly learned that such promises were easily broken. Therefore, capital would flow from one currency to another riding the fears of confidence. Gresham's Law had become international law.

All things considered, each of the theories which we have just examined was in its own way correct. Those who argued that gold was the only true form of wealth were not wrong in so far as gold was the medium of exchange and that it was the instrument by which wealth could be transferred from one person to another. Those who argued that a commodity's value lay in the amount of labour involved in its production were also correct. Those who saw land as the true value of wealth were also correct in their own way as were those who argued that a nation's wealth lay in its productive capability or in the size of its labour force. The problem that each theory faced was not unique. Each dealt with only a small piece of the entire puzzle but none of these theories could stand the test of time alone.

You must realize that prior to World War II, the distribution of employment around the world was distinctly different from that of today. This is illustrated by the following table:

DISTRIBUTION OF EMPLOYMENT
1900 & 1980

	US		Britain		Japan	
	1900	1980	1900	1980	1900	1980
Agriculture	41%	3%	13%	2%	70%	10%
Manufacture	20%	20%	33%	27%	12%	36%
Services	17%	44%	36%	48%	18%	54%
Other	22%	33%	18%	23%	---	---

Source: Economic Statistics

We can see by the above table that at the turn of this century, 41% of the civil work force in the United States was employed within the agricultural sector. Today that sector accounts for only 3%. Obviously, during the 17th and 18th centuries, one could easily be led to believe that a nation's wealth resided within its land and agricultural capabilities. We can also understand why the stock market was so closely in tune with the price movements within commodity prices themselves. It is also obvious that a drastic decline in commodity prices impacted the economy as a whole far more during the Great Depression than it would today. It is also obvious why the cyclical waves discovered by Kondratieff based upon a basket of commodities closely followed the ups and downs in economic movement itself.

But things have changed between then and now. Little talk of commodity prices impacting stock movement as a whole is ever discussed. Yet there are those who still try to employ Kondratieff's wave, proclaiming that the end is near and that another great depression will befall us soon. In all these statements we are taking apples and comparing their price movements to that of oil to come up with conclusions that merely meet logical sounding arguments on the surface but lack the definitive knowledge of events and conditions long since past.

Because the nature of the economy has evolved, changing drastically from what it once was at the dawn of this century, it is only right that we should reconsider economic theory in light of these changes and more. The issues of what is wealth have still not been decided. The Monetary Crisis of 1931 found people acting as if gold were their only concept of wealth. Can we in theory dream up something and proclaim that yes it is total production which constitutes a nation's wealth, yet in practical circumstances we find that the masses still adopt the old mercantilist's concept of wealth by immediately hoarding Gresham's good money gold?

Theory must survive the test of reality, not merely the academic philosophical discussions of a Sunday afternoon on cam pus. In reality, a nation's wealth is everything combined. It changes form and evolves with time, ideas, and technology. Labour is merely a commodity. It is not the extent of a nation's wealth. At times the greater the labour force the less it is worth and the more it drains upon the resources of a nation as a whole. For if labour were the wealth of a nation, then China should be among the richest and Saudi Arabia the poorest. The theory that labour composes a nation's wealth does not stand the test of reality.

The true wealth of a nation lies within its ability to bring to bear its efficient capacity to produce. This was born out by Germany which twice rose from poverty into a formidable industrial nation within less than 10 years. It was the attitude of its people that inspired its efficient productive forces. It was not the amount of gold that she held but her human drive to achieve.

But wealth is still something more. It takes the form of many things, but by and large there are three forms of wealth and it is the intermovement between these three elements which must be understood. The major dividing line between the various forms of wealth can be defined as productive and nonproductive. The first is some form of tangible wealth which produces by itself an income. Cultivated land which is harvested is one example of wealth brought to bear on an income producing basis. A piece of real estate which is rented out is in a real sense income producing. An example of non-income producing wealth would be a residential home. It is consuming wealth, not producing wealth even though it may serve a purpose and appreciate over time.

The third form of wealth is the medium of exchange. This is merely a measure of wealth yet one which is very necessary. It allows capital to flow from one form of wealth, real estate, into bonds or stocks. It is the translation dictionary between the various different languages in the financial world.

Great periods of prosperity are always accompanied by speculation. It is speculation in the tangible forms of wealth which we call inflation. At times this inflation may be largely in the price movements of commodities. At other times it was centered within the confines of land speculation as was the case in the Panic of 1837. In the Panic of 1907 it was the speculative fever which focused upon the innovation within the railroads, and during the Roaring 20s this speculation was centered within the U.S. stock market.

In all cases, the tangible forms of wealth, both productive and nonproductive, increase in price rapidly as investors and speculators are driven to accumulate what they can. The medium of exchange buys less and less as time goes on. Those who try to claim that the stock market did well because inflation as measured through commodities was low fail to realize that stocks themselves are merely another tangible asset which went through its own inflationary cycle.

But we must also come to understand that the world was on a paper money system backed by gold. But, many foreign nations fluctuated back and forth between a gold standard and a paper standard. Wealth moved from nation to nation following the same laws of Gresham but now in an international arena. This meant that capital no longer drifted within a single nation but within the entire international economy. It was not merely the domestic speculation in U.S. stocks that drove the Dow Jones Industrials upward by nearly 800% during the 1920s, but the international capital flows that sought a safe port for investment, which was clearly the United States.

The theories that we have looked at were all basically observations which were made under domestic situations. Inflation had been defined as an increase in money supply, which meant that if a nation did exceptionally well in international trade, more gold flowed into its economy. Hume's observations were correct that prices then also rose in response to that increase in the supply of money. This theory was not wrong, but it took on a new meaning during the 1920s. Capital had flowed into the United States but this did not produce inflation in terms of commodities. The reason why is that capital was still in the hands of many foreign citizens who bought U.S. investment but did not affect the consumer goods or services. The inflation, therefore, took place in the equity markets due to the influx of foreign capital.

All these various theories had to be changed and altered to take into consideration a new force of international capital flows. Therefore, a rise in the quantity of money in one nation no longer meant that it was inflationary in the old sense. It now became reflective of a growing international network of investment and at times frightened capital which fled from one nation to another.

The economies of the world flow in a logical and orderly fashion dictated by and large through the whimsical elements of human emotion. Often logic seems to lead down a dark and narrow alley and it can be quite deceiving. But if you follow logic's path religiously, it eventually emerges into a new realm of understanding.

The one thing you must take into consideration is the fact that all these theories which we have reviewed were conceived during a period when the world was on a one currency based system - gold. Today we no longer have that one world currency system and as a result things cannot be compared between then and now so easily. With the emergence of many diverse issues of international paper money, the concepts and theories changed from a domestic isolated economy to a new world economy.

In reality, all these various theories are correct, including those of the mercantilist. The wealth of a nation in all respects is the total combined forces of all productive levels. However, the medium of exchange is very important as well. At times during inflationary periods, land, commodities and stocks all rise in value to the best of different timetables. But when these sectors of capital investment are overextended due to speculative forces, they tend to outpace the growth rate within the medium of exchange. As a result, when a crack in confidence begins as it did in 1929, prices of these tangible forms of capital investment crash rapidly. This takes place because they far exceed in total value the outstanding money supply (medium of exchange). The relationship between the increase in the quantity of the medium of exchange is not in direct proportion to that of the tangible assets which include everything from stocks to real estate. It is a leveraged relationship between the two sectors and, therefore, during contraction the reverse leverage effect can be quite devastating.

It is because there is far less quantity of the medium of exchange available in proportion to the total outstanding stocks, bonds, real estate, collectibles, etc., that the value of these things in total contract at a rapid pace, attempting to once again achieve a sense of balance or equilibrium. Therefore, in all reality, the arguments which we have just gone through as to what constitutes the wealth of a nation are in total a mere exercise in futile thought. This is because in part each theory is correct while not one is totally encompassing the situation alone.

During expansionary periods, capital investment is drawn to industry for profit because this is where the action is, so to speak. Therefore, if one were to look at the economy as a whole at that particular moment, one would be forced to conclude that it was industry that accounted for a nation's wealth. During periods of famine, food becomes the all-important commodity within the economy as a whole and therefore it would be logical that one could conclude that the wealth of a nation at that particular time was indeed the total agricultural ability of a nation. During the oil crisis of the 1970s it was suddenly found that the total productive ability of a nation was undermined by its consumption of oil because the trading partners who produced the oil were not consumers of their manufactured goods in equal proportion. Therefore, oil suddenly became the most powerful form of wealth transfer.

Perhaps you can see that it was not the many varied arguments as to what was wealth itself, but the mere fact that each idea was correct for its time. Indeed the Monetary Crisis of 1931 proved that above all, even the old concept that gold was the only form of true wealth also surfaced as evidenced by the massive worldwide panic and hoarding. All the fancy theories that claim that it was not gold but total productive capability of a nation which encompassed a nation's wealth did not stand the test of reality when the world could care less about stocks and bonds but instead cared about the quantity of gold.

Each concept of what is wealth is in itself correct under certain circumstances. As my mother always tried to tell me as a child, there is a time and place for everything. Those words are also very true about economic thought itself in the realm of everyday reality. Therefore, during periods of contractions, cash, or the medium of exchange as the mercantilists saw it, becomes the most desirable asset to hold. Tangible assets appreciate considerably during inflationary periods and suddenly far exceed in total market value the total available cash within society. It becomes only natural that this equilibrium is suddenly driven in the opposite direction to the point where the two optimistically seek a par level.

Capital and wealth are in many respects guided by laws similar to those of the divine laws of nature. They will flow from one nation to another by an invisible hand which is as powerful as that within nature itself. Capital will flow from one nation to another for many varied reasons. First, it may be affected by taxation in modern times such as today. Second, capital can be driven by fears of a geopolitical nature - war primarily. Third, capital is also driven for economic reasons of stability and security. If the threat of Russia invading Europe becomes a viable potential, then you must realize that capital will flee Europe to the next safe port, which most likely would be the United States. These are some of the reasons for the movement within the stock market during the events which transpired during the 1950s and 1960s.

But there are many other things which also move according to this invisible hand which now transcends all borders. Imagine for a moment that you are nothing more than a pawn within the financial game of chess. But a pawn, who may be of the lowest rank on the board, also holds the power to place a king in check when joined by other pawns when the opposing force is reckless in its strategy.

We are all basically like a pawn. Our labour is nothing more than a commodity which we sell to the highest bidder for the most part while there are perhaps a wise few who endeavor to place enjoyment and fulfillment above monetary value. If I were a grower of wheat and I decide that my labour is somehow more valuable than yours, then the wheat which I cultivate will be more expensive than that which you grow. But the buyer to whom I sell my produce suddenly realizes that perhaps I have priced my produce 50% higher than yours. Eventually, that buyer will wake up and elect to buy from you rather than me.

Within the international economy all things have a tangible value. It may become confusing at times when everyone tends to judge their values in a medium of exchange bearing different names and unit structures, but for the most part wheat is wheat no matter what country you may live in.

In the 1980s we can see how American industry has been besieged by imports. Manufacturers have tried to stay competitive and in the course of events, they have shifted much of their factory work to less costly labour nations. The American worker cannot compete with the worker in China, Korea, Japan, or the Philippines. In this way, manufacture has flowed like water seeking the lowest level of labour costs in a battle to remain competitive.

The international economy in a strange way has also been quite similar to baseball. Each team is at least given the opportunity to come up to bat. Over the centuries, it has been the natural order of virtually every society for its labour ranks to continually increase the price they set upon their toll. In 63 B.C. the famous Senator of Rome, Marcus Tullinus Cicero, stood before the Senate of Rome and said:

"The budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed lest Rome become bankrupt!"

These words are almost applicable to the events of today just as they easily might be applied to the events of the Great Depression. Their importance is far-reaching if taken apart and reviewed carefully. Indeed the Roman Empire did crumble from within before the final blows were struck by the encroaching peoples who surrounded it. Rome fell victim to a social struggle in which its population began to feel that its labour was too valuable. Trade deficits mounted as labour in outlying provinces produced goods and services at prices which were far more attractive.

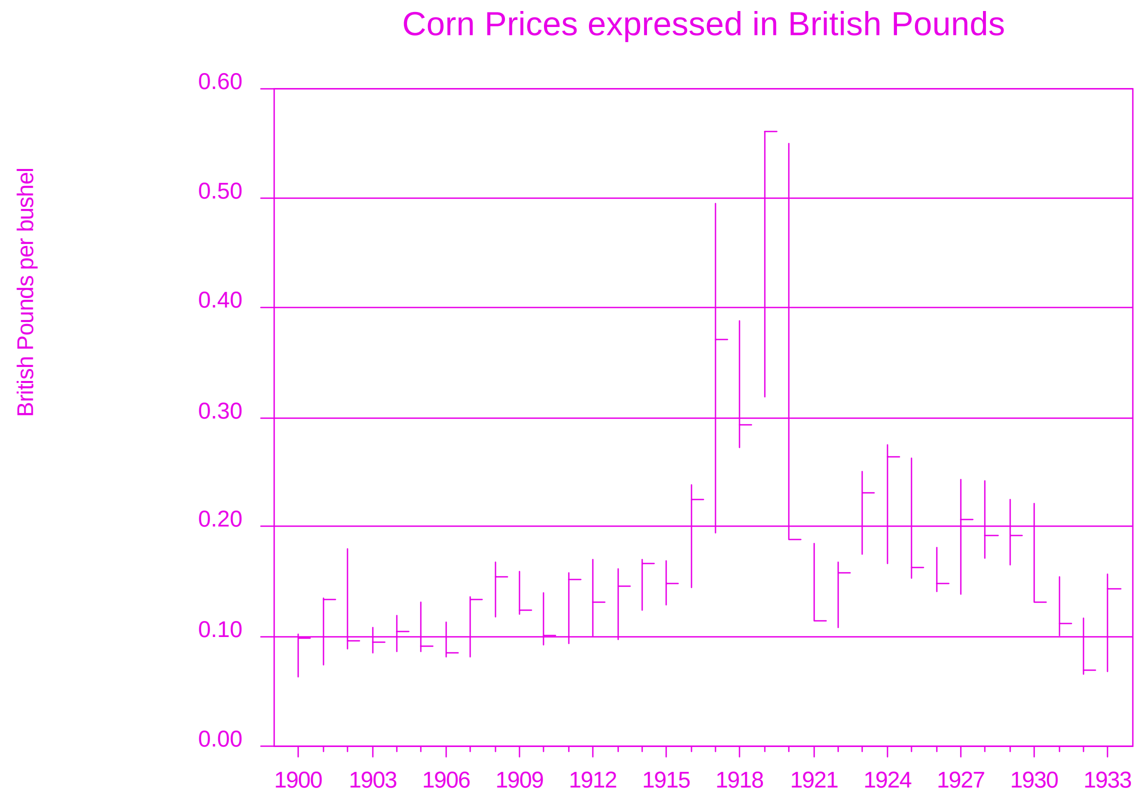
Within every great society since the dawn of civilization, this tendency for labour to rise in price as prosperity befalls its economy has been present without exception. When the United States was in its infancy, it too was the source of cheap labour for Europe. But as Europe lost its competitiveness due to rising wages, America flourished. As prosperity came to the shores of the new world, eventually American labour rose in value and now our unions complain of cheap labour in the Far East.

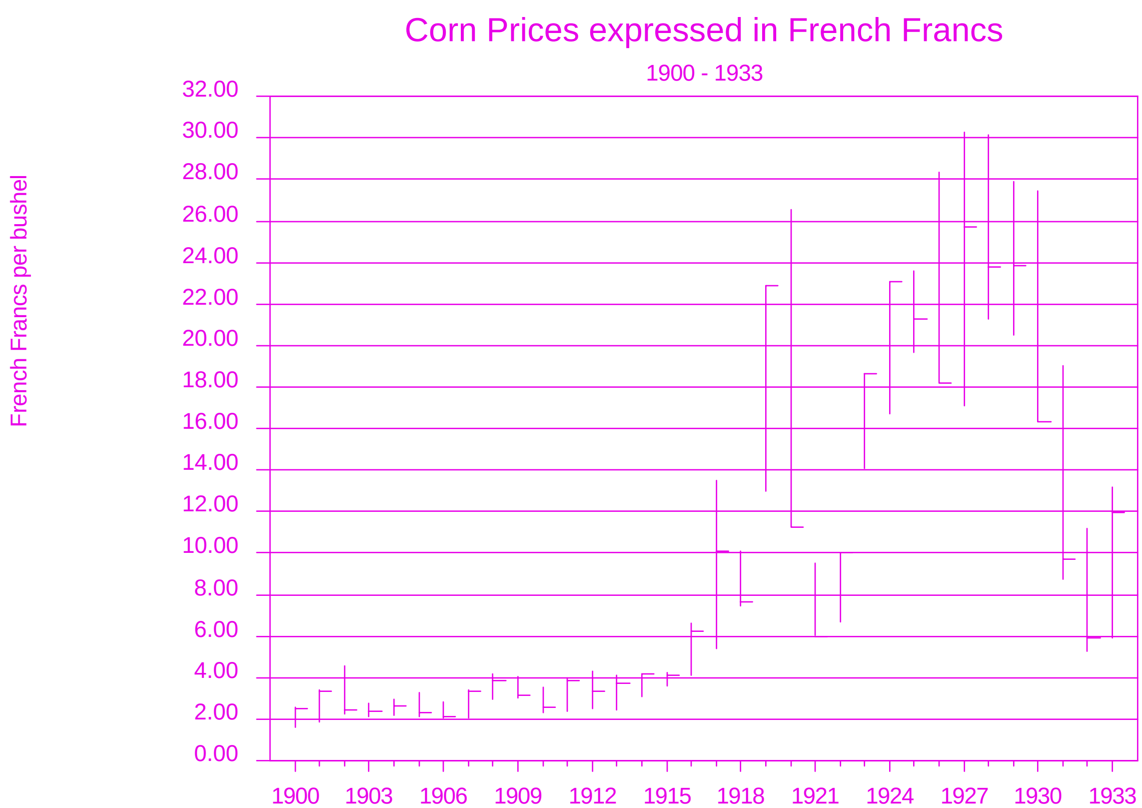
This is merely one of the natural orders in which wealth is transferred from one society to another. Sumptuary laws and great tariff walls cannot prevent this natural gravitation and transfer of wealth. Each society fights hard to hold on to its prosperity, but never has any society been successful in retaining it.

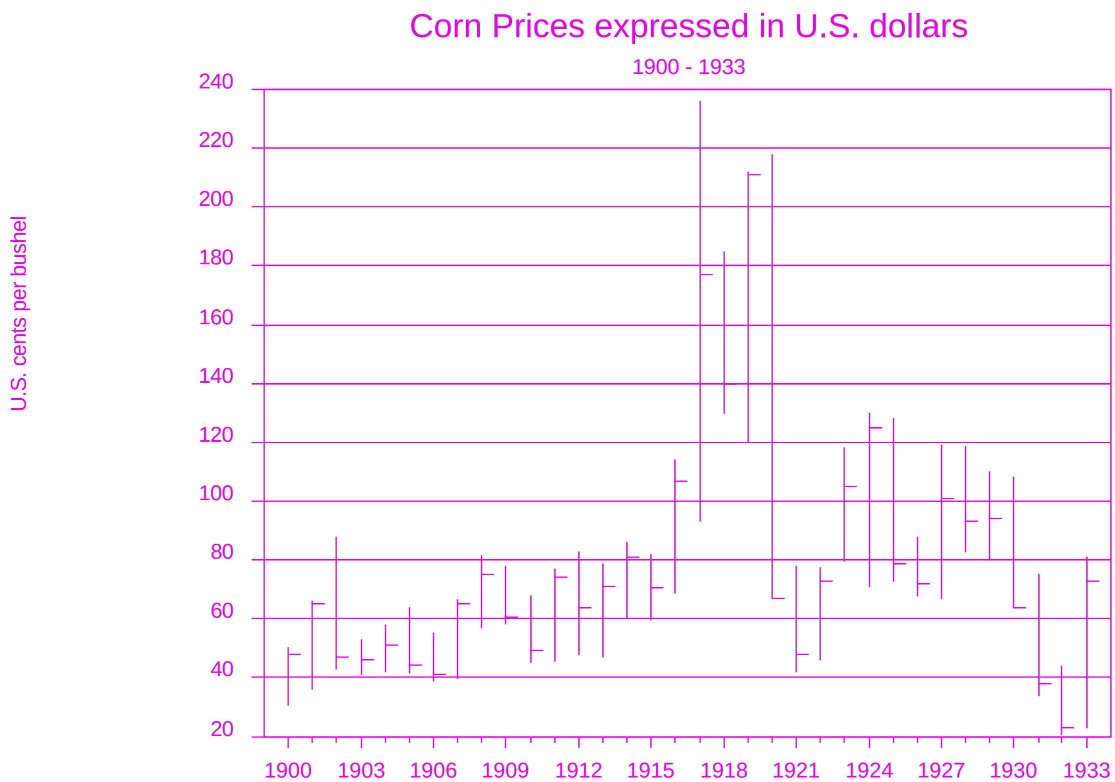
Everything from labour to commodity prices has this certain mystical international value. It is hard to measure such things without creating a complex basket of world currencies in this day and age. Back then, the pivot point was gold and everyone pegged a fixed amount of their currencies against a fixed amount of gold.

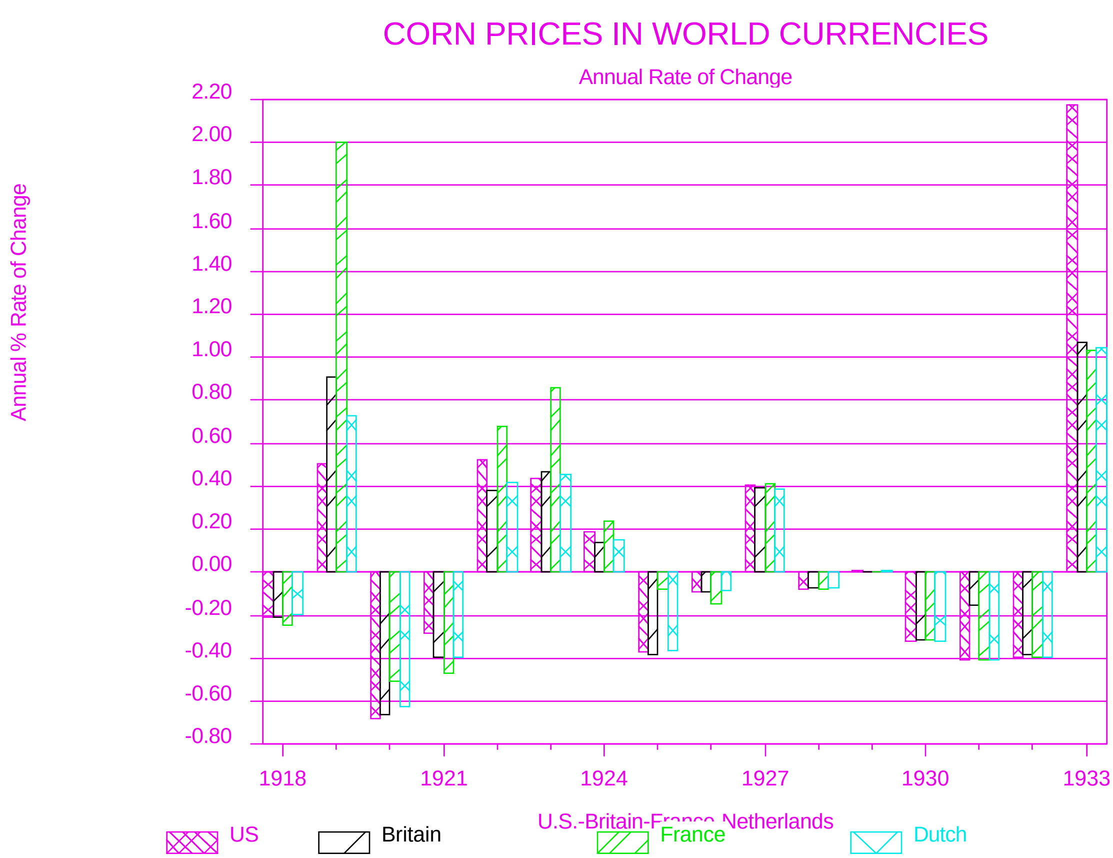
For periods of time, imbalances take place. Tariffs can be effective for a short duration of even a few decades, but they have never staved off the problem eternally. Ironically, tariffs attempt to preserve a domestic industry by allowing it to charge more for its produce than what it can be purchased for on the international market. Protectionism, therefore, has been popular among the labour and manufacturing segments of most nations throughout history. In one sense, it holds a kinship with the concepts of the mercantilists of the 17th and 18th centuries. This very issue is but one which has forged many a revolution including that of the United States against Britain. It has taken many various forms such as the King demanding that the American Colonies pay for their goods in gold while the British were allowed to pay the Colonists in overvalued copper.

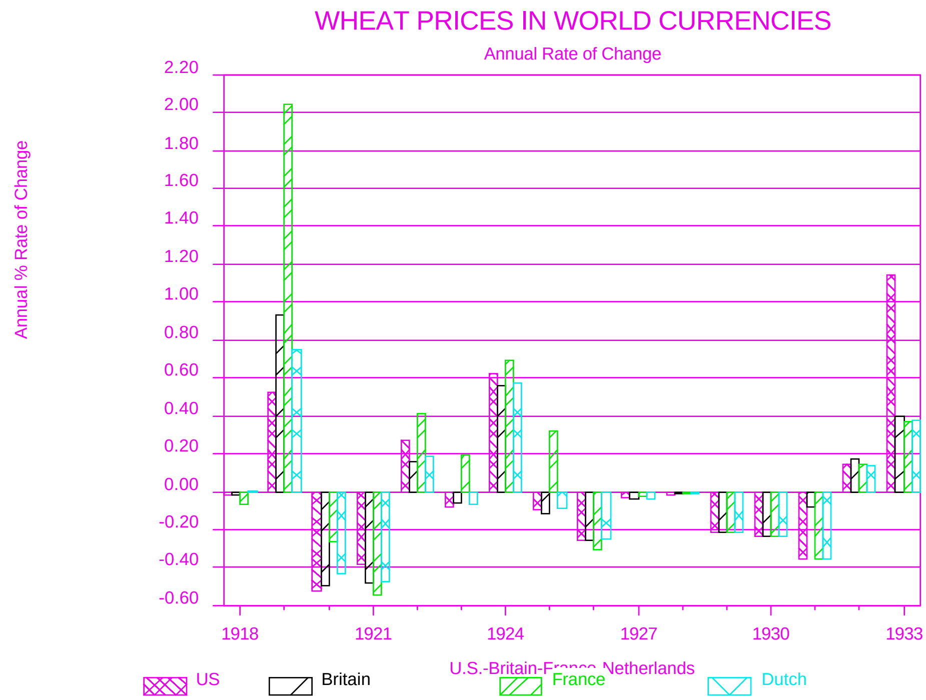
Yet the U.S. government also instituted the Sherman Anti-Trust Act of 1914 under the guise that a monopoly could set a price for its produce above its true value. Competition was deemed to be healthy and the consumer's right to be able to buy at the cheapest possible price was the objective of this law. Strangely enough, protectionism and anti-trustism are opposing forces bent on exactly opposite goals. The break up of AT&T did not benefit the consumer one bit.


Corn Prices expressed in British Pounds
British Pounds per bushel
0.60
0.50
0.40
0.30
0.20
0.10
0.00
1900
1903
1906
1909
1912
1915
1918
1921
1924
1927
1930
1933


Corn Prices expressed in French Francs
1900 - 1933
French Francs per bushel
32.00
30.00
28.00
26.00
24.00
22.00
20.00
18.00
16.00
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
1900
1903
1906
1909
1912
1915
1918
1921
1924
1927
1930
1933


Corn Prices expressed in U.S. dollars
1900 - 1933
U.S. cents per bushel
240
220
200
180
160
140
120
100
80
60
40
20
1900
1903
1906
1909
1912
1915
1918
1921
1924
1927
1930
1933


CORN PRICES IN WORLD CURRENCIES
Annual Rate of Change
Annual % Rate of Change
2.20
2.00
1.80
1.60
1.40
1.20
1.00
0.80
0.60
0.40
0.20
0.00
-0.20
-0.40
-0.60
-0.80
1918
1921
1924
1927
1930
1933
U.S.-Britain-France-Netherlands
US
Britain
France
Dutch

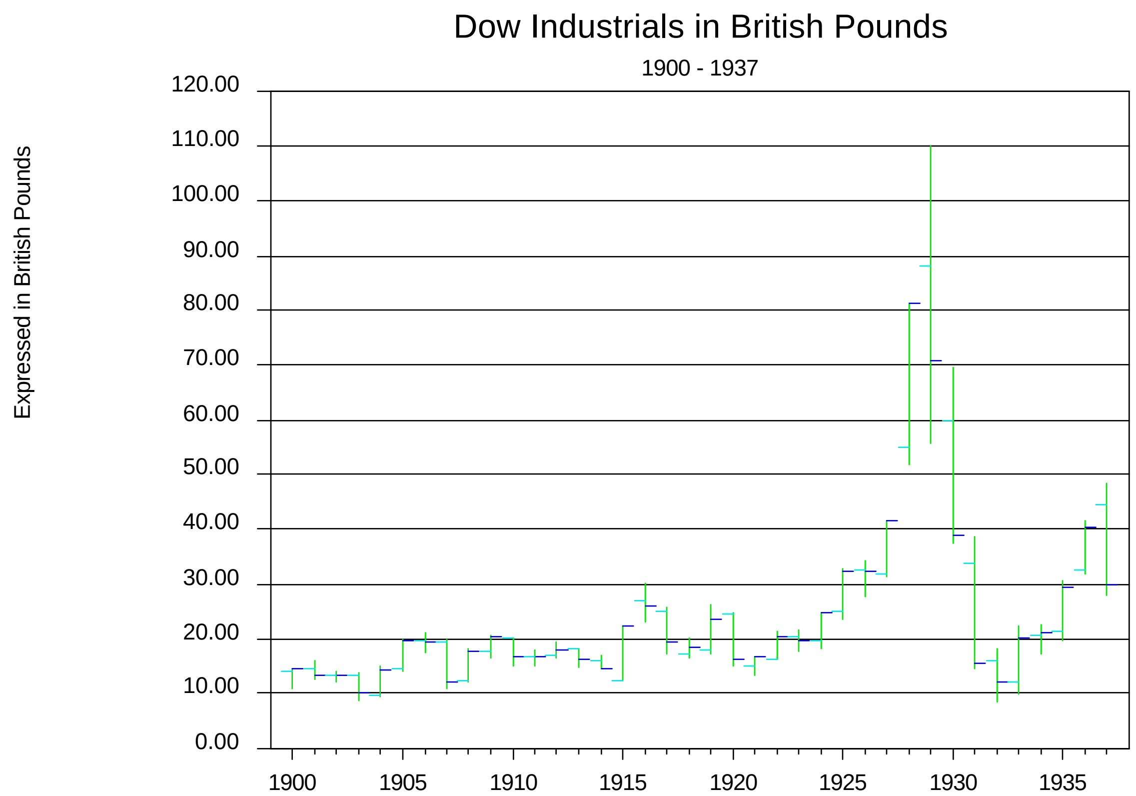


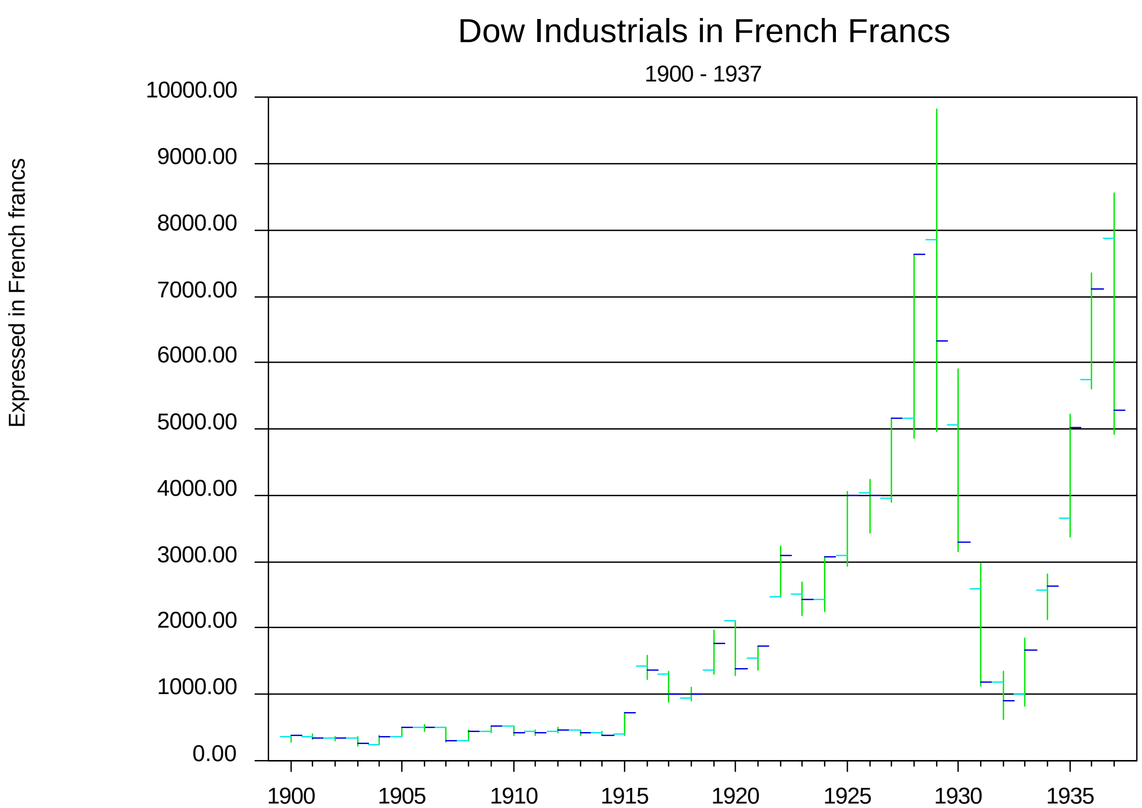
Yet in the original context, that was the objective of the Anti-Trust Act.

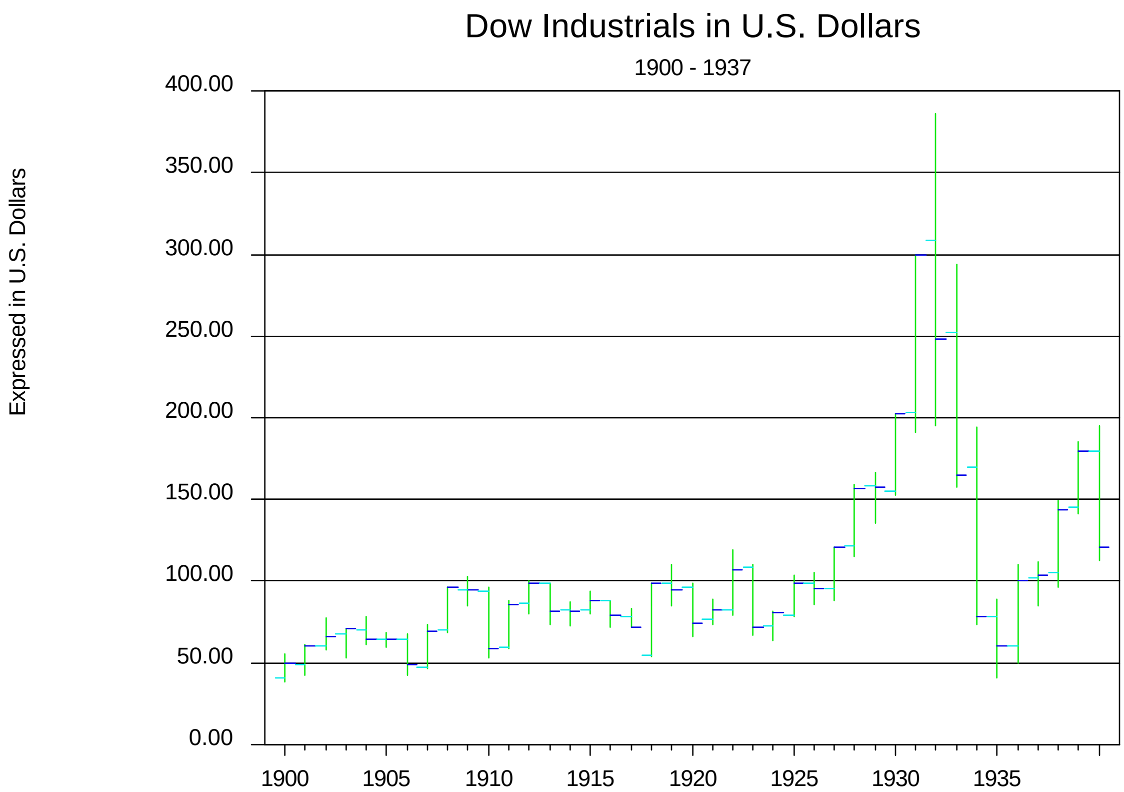
Societies throughout recorded history have battled against this age old problem. Thus far the United States was able to improve its standard of living above those in other lands not through the benefits of protectionism nor through anti-trustism, but instead through expanding technology. As innovation continues, then new concepts and new jobs form. As they form, the value for the labour required is somewhat higher as skills advance. Only through continued innovation can labour hope to improve its standard of living and retain it. If no new technology enters, then raising the cost of labour may raise the standard of living temporarily, but eventually someone else will do the job for less. This is when a society begins to decay.

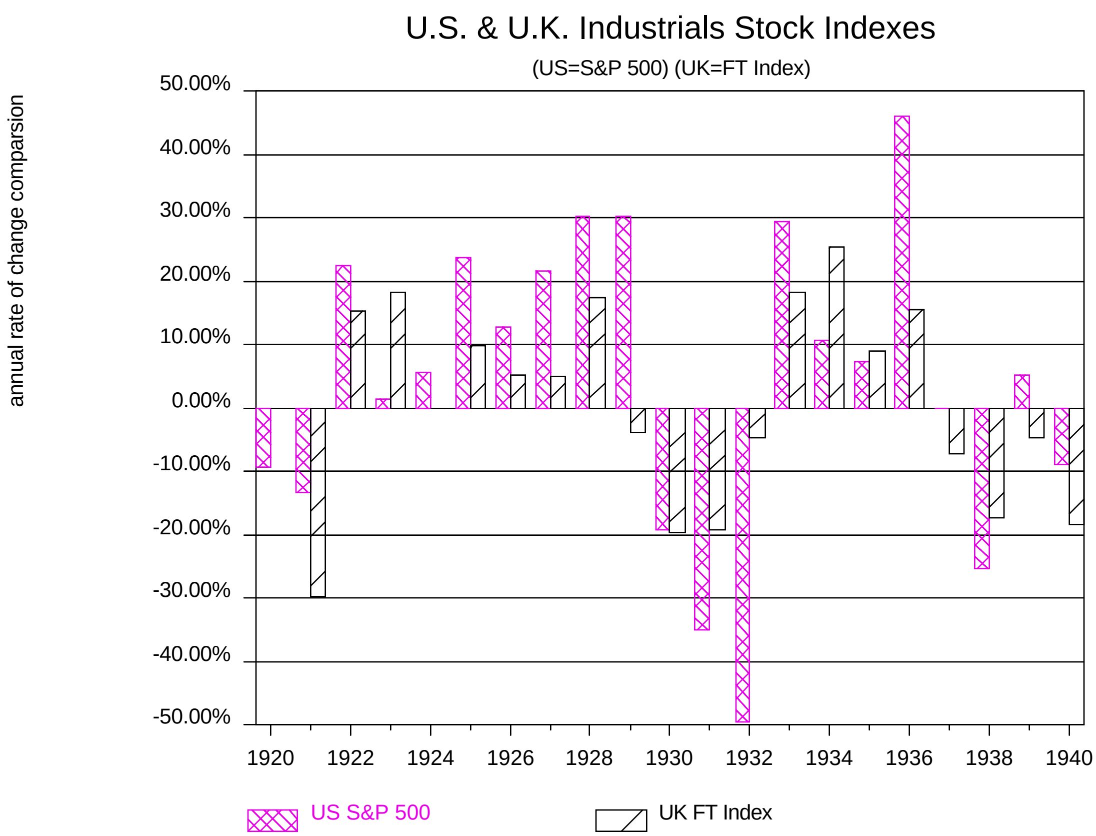
Labour in many respects is similar to a commodity. When the California gold rush came, rooms for rent in 1849 were fetching as high as a $1,000 a month. Gold had become so plentiful that its purchasing power declined drastically. This is what we call inflation. The same is true of labour. The more specialized a job, the more it is worth. Sweeping a street is hardly a skilled task and the job can be filled by a greater quantity of labour and as such it is worth less. When we look at the early 1960s, we will see how real wages outpaced inflation because of expanding technology and a shortage of skilled labour. But in the 1970s, inflation outpaced wages when a shortage in labour was replaced by a shortage in raw materials.

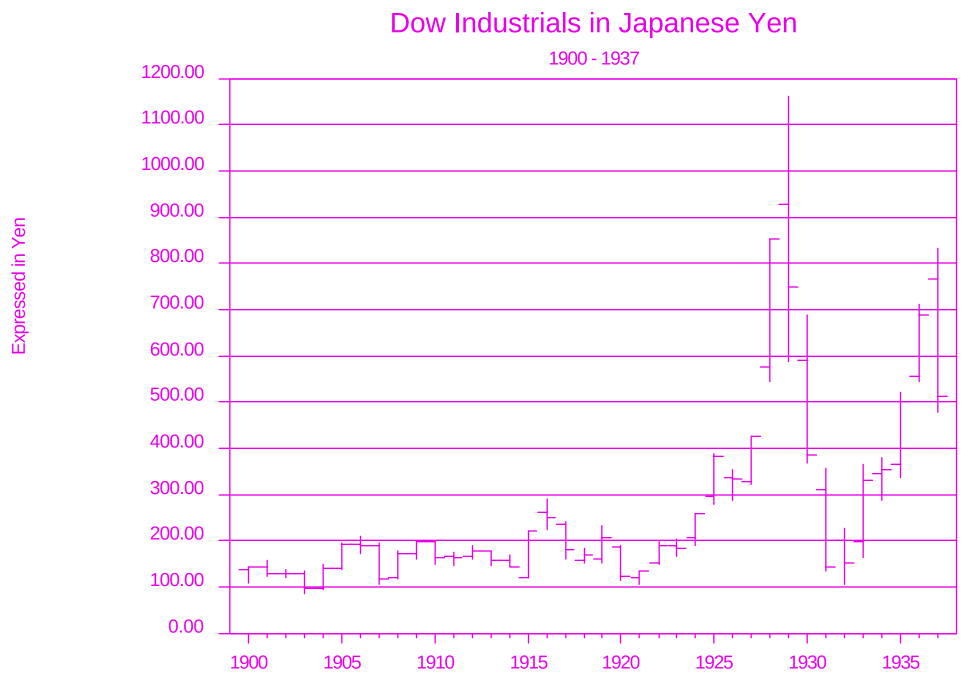
Thus, these natural relationships of supply and demand as Hume explained do work in all aspects of our lives including the price we place upon our own time. The international implications of this are not often understood. They certainly are not popular slogans to preach if you are running for election to the Senate or White House. As a result, politicians give the people what they want through protectionistic legislation, which in the long run will not aid society but in the short run perhaps might stop the immediate bleeding.


Dow Industrials in British Pounds
1900 - 1937
Expressed in British Pounds
120.00
110.00
100.00
90.00
80.00
70.00
60.00
50.00
40.00
30.00
20.00
10.00
0.00
1900
1905
1910
1915
1920
1925
1930
1935


Dow Industrials in French Francs
1900 - 1937
Expressed in French francs
10000.00
9000.00
8000.00
7000.00
6000.00
5000.00
4000.00
3000.00
2000.00
1000.00
0.00
1900
1905
1910
1915
1920
1925
1930
1935


Dow Industrials in U.S. Dollars
1900 - 1937
Expressed in U.S. Dollars
400.00
350.00
300.00
250.00
200.00
150.00
100.00
50.00
0.00
1900
1905
1910
1915
1920
1925
1930
1935


U.S. & U.K. Industrials Stock Indexes
(US=S&P 500) (UK=FT Index)
annual rate of change comparsion
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
-10.00%
-20.00%
-30.00%
-40.00%
-50.00%
1920
1922
1924
1926
1928
1930
1932
1934
1936
1938
1940
US S&P 500
UK FT Index

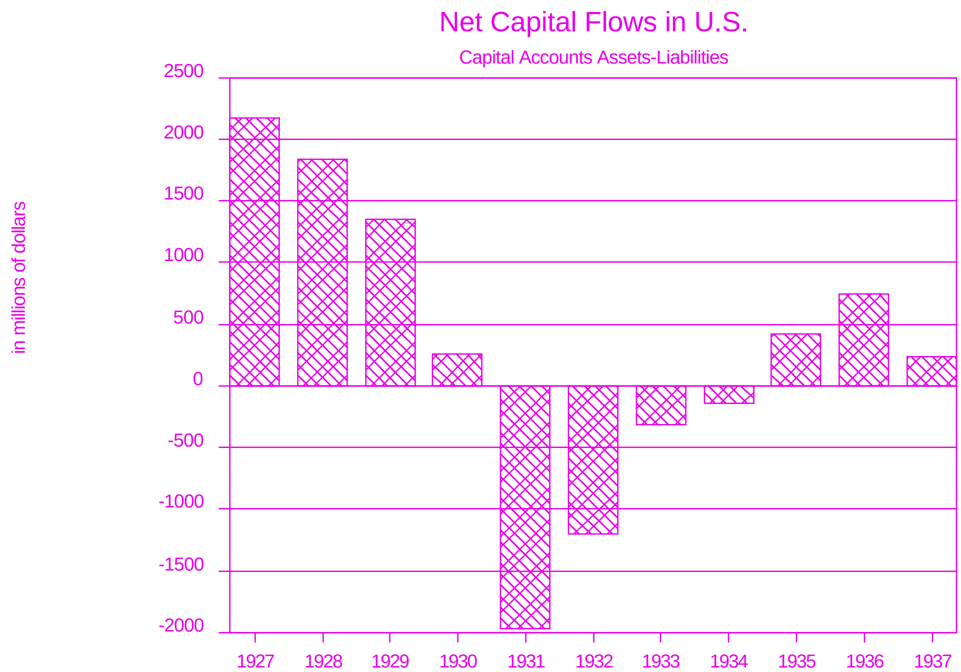


Therefore, despite the fact that labour unions might seek to fix the price of labour or that we might feel that because we are human beings we are above the mere classification of a commodity. It is completely false. We cannot overvalue ourselves any more than OPEC was able to sustain a high price for oil which became far too plentiful. Marx's theory that labour was the source of a nation's true wealth does not withstand the test of reality.

In all due respect, the Roaring 20s and the fabulous bull market were created by several key events. First, by the war which destroyed the productive capability of Europe, leaving the United States as a major source for civilian and military manufactured goods. In addition, the United States was a leading source of agriculture during this period and in simple terms it was as if the U.S. had attained nearly a monopoly upon world trade. This naturally produced a wealth beyond the scope of imagination as gold not merely gravitated toward the U.S. due to trade, but also due to the urge to find a safe port for capital on the part of Europeans.

But in the process of these two emerging forces, American labour became overvalued to a large extent. As the world began to recover, European workers were willing to work for far less. This in turn led to trade wars not merely between Europe and the United States, but within Europe itself. The equilibrium had to once again be restored and the natural effects were merely postponed until the eventful year of 1929.

Thus the Roaring 20s became a period of intense capital flows that followed upon the heels of confidence, which became shaken by both fiscal irresponsibility as well as war. In studying the capital flow accounts within the balance of payments of the United States, it becomes clearly visible how the international capital flows closely paralleled the movements within the equity markets around the world. The closest relationship of the Dow Jones Industrials is with capital flows and foreign exchange



movement more so than anything else, including interest rates.

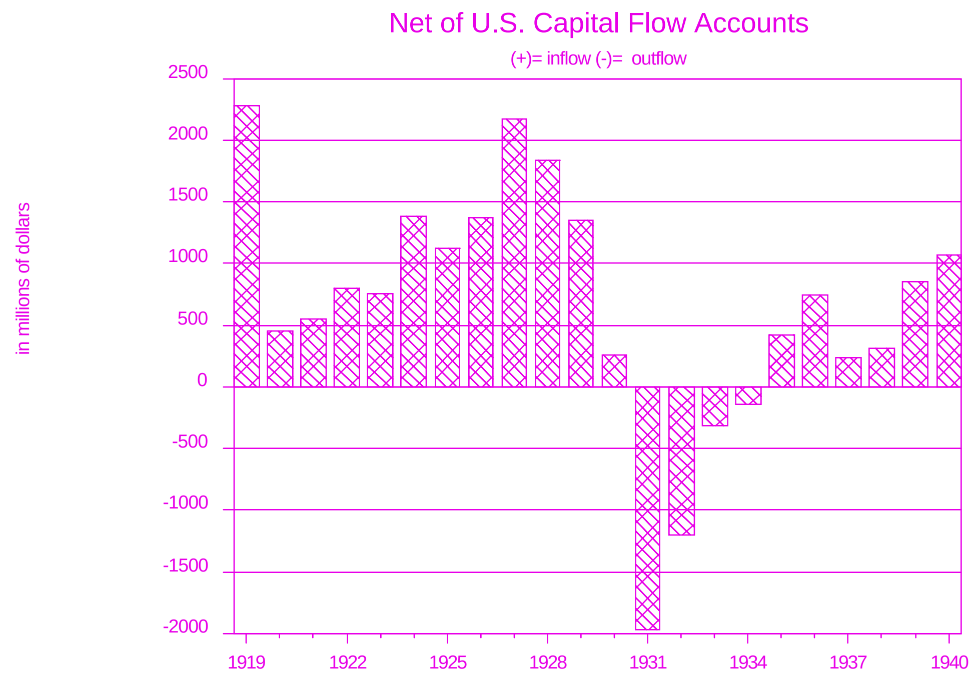
The movement within foreign exchange markets is perhaps the most profound on an international economic basis. To illustrate this statement, I have taken the price of corn and charted its price movements in terms of the British pound, French franc and the U.S. dollar between 1900 and 1933.

Let us look at the chart of corn in terms of U.S. dollars. Here we can see that the actual price high was achieved during 1917. During the speculative rally into 1919, corn did not make a new high although it did achieve the highest yearly closing at that time. Notice also that in 1932 corn had fallen to new lows for this century in terms of U.S. dollars.

Now compare the chart of corn in terms of British pounds. The price high here took place not in 1917 but in 1919. To the British consumer, food was costing more in 1919 than it was in 1917 even though this was not necessarily the case in the United States. Now look at the 1932 low. Corn did **NOT** make a new low intraday during 1932 in terms of pounds. It held above the low of 1900.

Now let us compare these patterns to the third example, which is corn expressed in terms of French francs. Right off the bat we can see that the 1919 high was exceeded and that the peak in corn prices in terms of francs took place in 1927 Not in 1917 nor in 1919. The 1932 low in terms of francs was well above the highs prior to 1915. Although we are looking at the same commodity, the American, British, and the French each saw different patterns when viewed through their own currencies.

Now let us look at corn from an annual rate of change basis using the yearly closing figures in terms of U.S. dollars, British pounds, French francs, and Dutch guilders. We can see that during 1919, corn rose in price the least in terms of dollars whereas



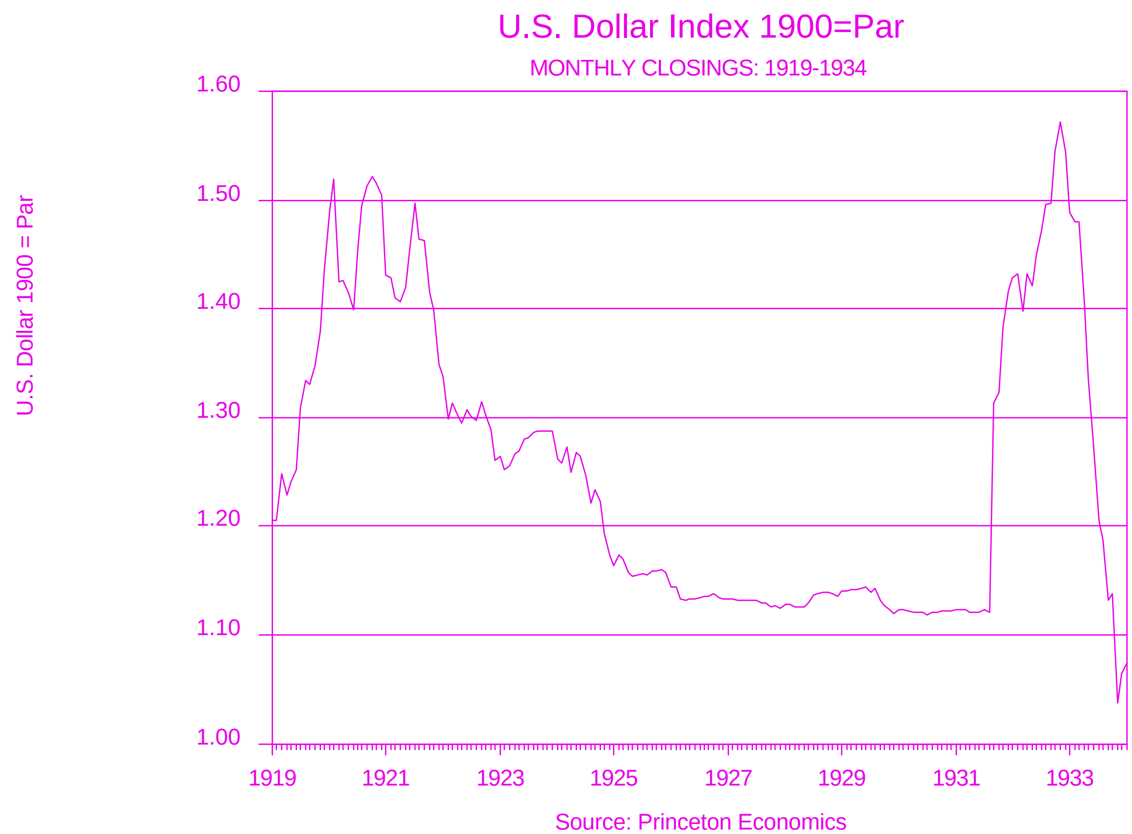
the greatest price rise was in terms of French Francs.

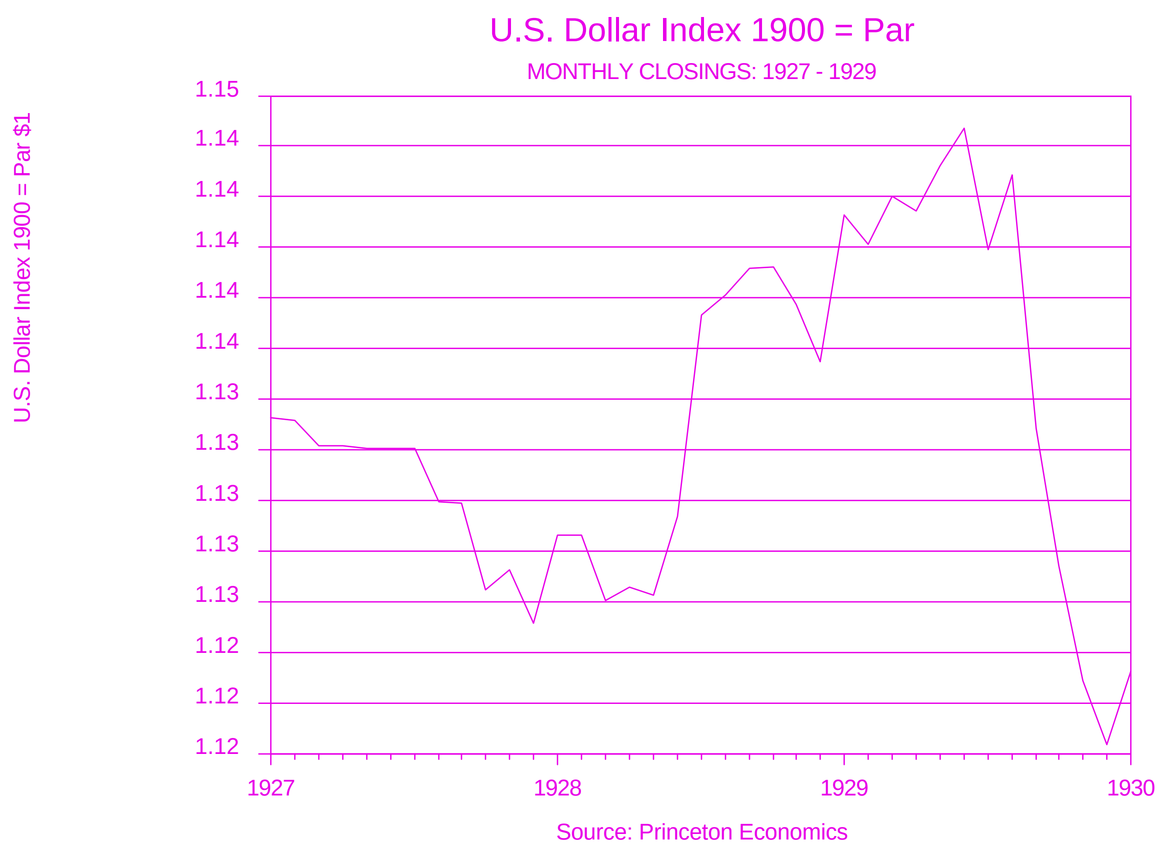
For the most part, corn prices remained more volatile in France than in any other nation. This was not because of corn itself, but because of the swings within the French franc on the foreign exchange markets.

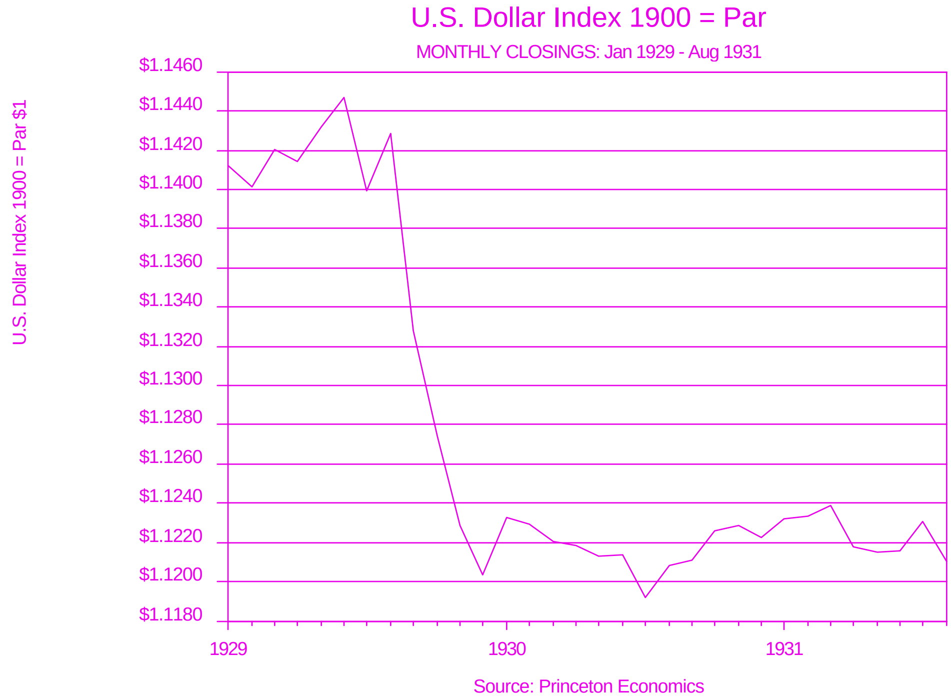
We read for ourselves that the idea of currency inflation under Roosevelt had its goal of creating a rise in the price of commodities in terms of the dollar. If we look at this rate of annual change in corn prices, we will see quite clearly that the highest rate of change in 1933 took place within the price of corn in terms of dollars. Corn rose in terms of dollars nearly 220% whereas in terms of pounds, francs and guilders, corn rose less than half that amount.

Therefore, corn did double in value on an international level while in the eyes of the American it better than tripled by the end of 1933. If one were to ascertain what the true appreciation of a commodity might be, he must not only take into consideration the domestic inflationary pressures, but the depreciation or appreciation of the currency in which he is trying to make his calculations.

Let us now take a look at three charts which have been provided for the Dow Jones Industrials expressed in terms of dollars, pounds, and francs. The chart of the Dow in terms of U.S. dollars illustrates that the high achieved in 1937 virtually bounced off the low which had been established in 1929 at the outset of the famous panic. Now let us compare this same technical point in terms of British pounds and French francs. The Dow in terms of francs illustrates a shocking difference. Here the 1937 high came very close to reaching the 1929 high. This pattern was caused by the drastic decline in the French franc in comparison to the dollar on world foreign exchange markets. Therefore, the French investor in American stocks clearly experienced the wildest swings within his American portfolio.


U.S. Dollar Index 1900=Par
MONTHLY CLOSINGS: 1919-1934
U.S. Dollar 1900 = Par
1.60
1.50
1.40
1.30
1.20
1.10
1.00
1919
1921
1923
1925
1927
1929
1931
1933
Source: Princeton Economics


U.S. Dollar Index 1900 = Par
MONTHLY CLOSINGS: 1927 - 1929
U.S. Dollar Index 1900 = Par $1
1.15
1.14
1.14
1.14
1.14
1.14
1.13
1.13
1.13
1.13
1.13
1.12
1.12
1.12
1927
1928
1929
1930
Source: Princeton Economics

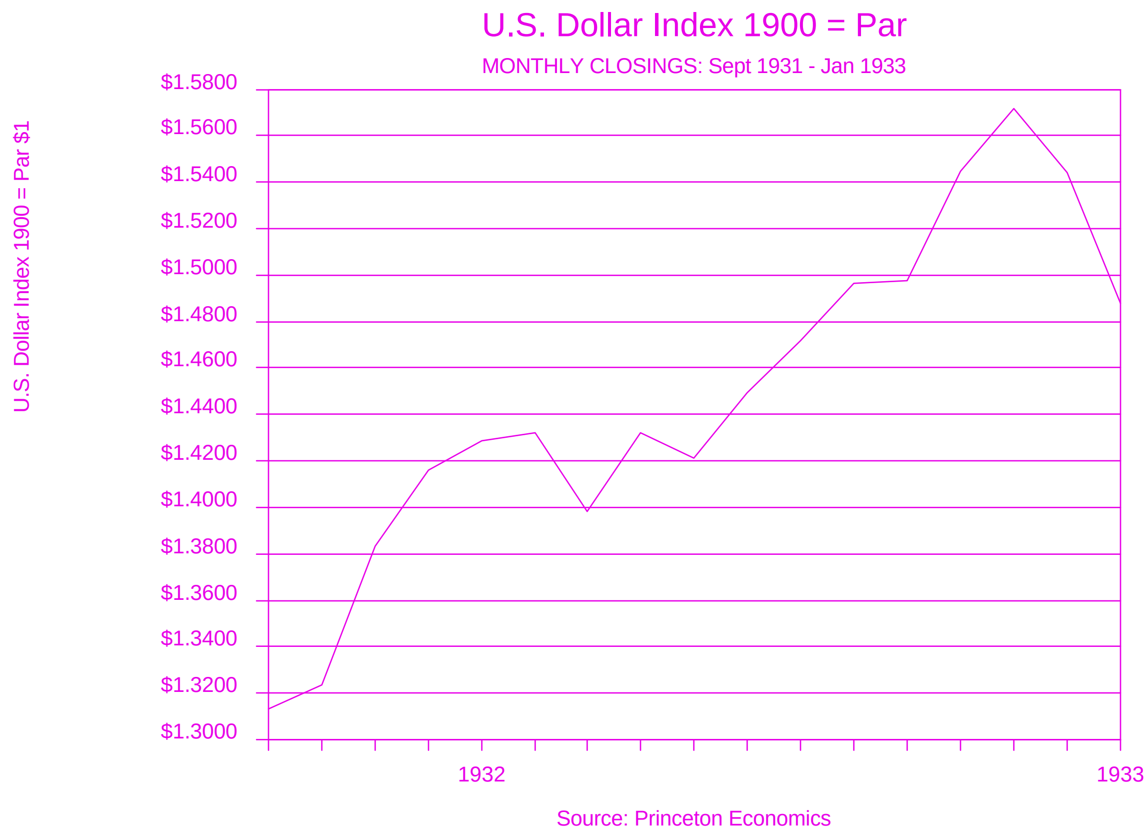


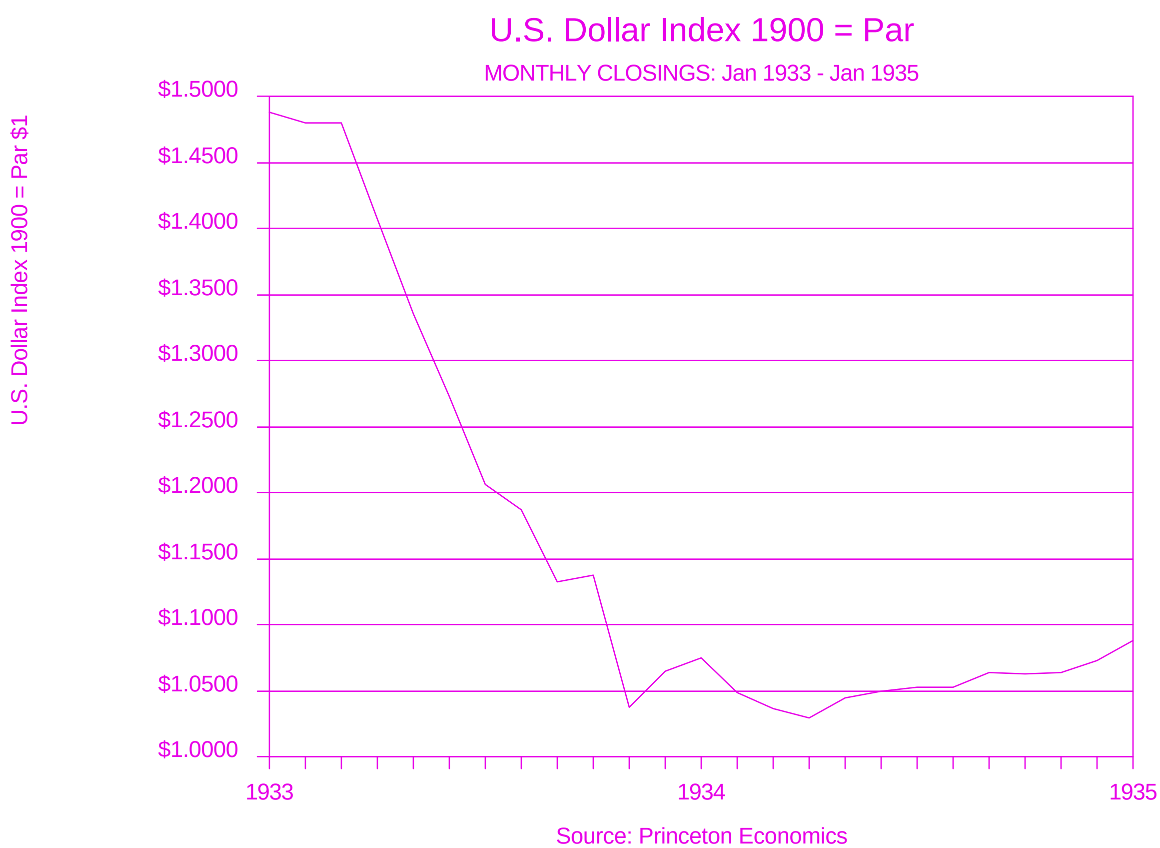
Before we look at the British chart, look again at the French chart and take close note of the pattern which emerged after 1916. Note that while the U.S. stock market collapsed following the peak in 1919 into a major low during 1921, in terms of French francs, the Dow held a fair amount of its gains. The uptrend was clearly intact, affording good reason why French investment looked upon the U.S. market in a very favorable light.

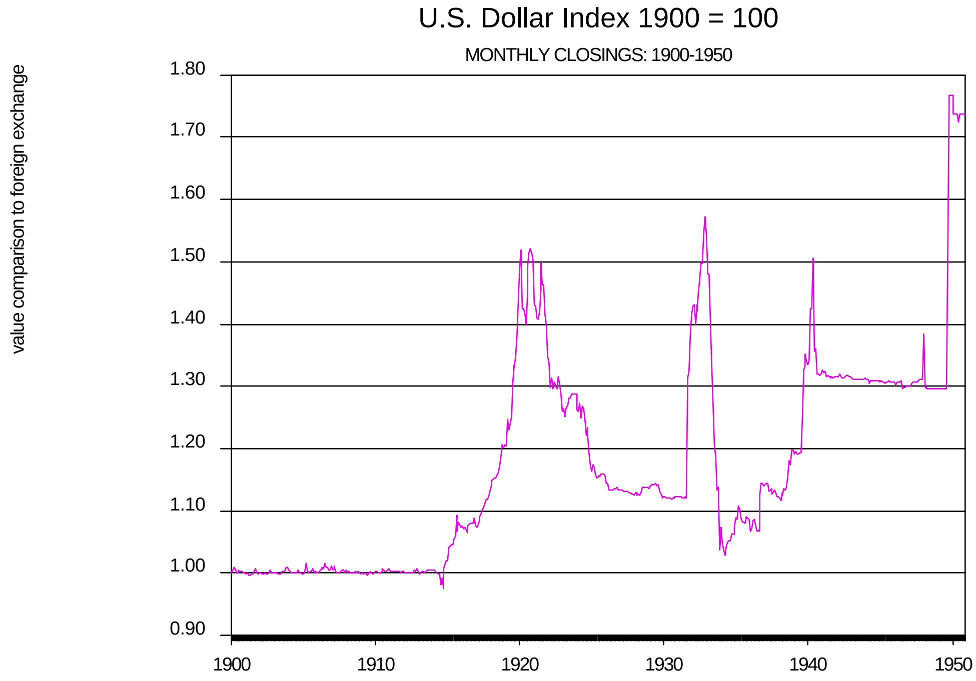
Now let us move on to the Dow expressed in terms of British pounds. Note here that this 1937 high failed to reach the low of 1929. This was caused by the fact that the dollar had actually depreciated against the pound under the inflationary policies of Roosevelt. On an international purchasing power basis, a U.S. investor who sold his stock when the Dow was at 200 in 1929 would have actually been able to purchase more British goods than the investor who sold his stock at 200 points in 1937. On a net tangible basis, the Dow was actually 20% below its same levels of 1929 on a foreign exchange basis when using the British pound as the medium of measure.

Perhaps you can begin to see that foreign exchange plays a very big role in the movement of all markets. We read first hand that for the most part the commentary concerning the U.S. stock market up until 1927 was by and large net bearish. New highs were always questioned largely due to domestic considerations. As a result, the foreign implications which made the U.S. stock market attractive overseas were by and large ignored due to the lack of understanding at the time.

Today we find foreign investment funds boasting of large and impressive returns. But in reality, these returns have again been caused by foreign exchange movement. In Canada, investment funds in Japan have been very popular in 1986. These offshore investment funds have run numerous advertisements headlining 50 to 60 per cent return in a single year. The uninformed investor looks at such returns as an excellent or fantastic investment opportunity.


U.S. Dollar Index 1900 = Par
MONTHLY CLOSINGS: Sept 1931 - Jan 1933
U.S. Dollar Index 1900 = Par $1
$1.5800
$1.5600
$1.5400
$1.5200
$1.5000
$1.4800
$1.4600
$1.4400
$1.4200
$1.4000
$1.3800
$1.3600
$1.3400
$1.3200
$1.3000
1932
1933
Source: Princeton Economics


U.S. Dollar Index 1900 = Par
MONTHLY CLOSINGS: Jan 1933 - Jan 1935
U.S. Dollar Index 1900 = Par $1
$1.5000
$1.4500
$1.4000
$1.3500
$1.3000
$1.2500
$1.2000
$1.1500
$1.1000
$1.0500
$1.0000
1933
1934
1935
Source: Princeton Economics

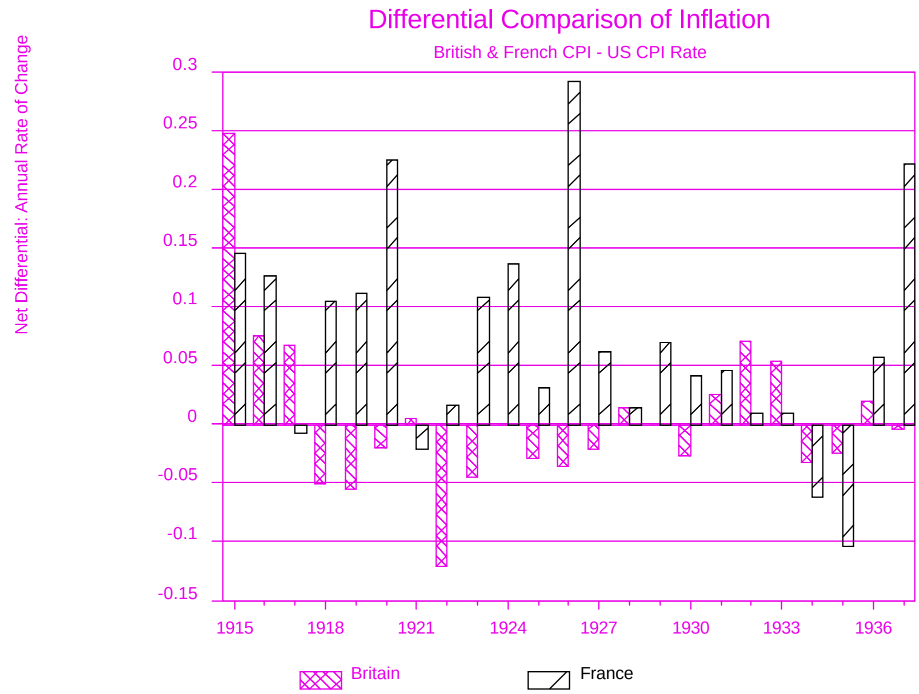


However, in reality the Canadian investor did not make a profit because the Japanese investments were better than those in his own country. The Japanese yen advanced 73% between 1985 and the summer of 1986. Therefore, if a stock fund investing in Japan realized a 60% gain, it did not really make a true "net profit" over and above the international purchasing power. In order for the fund to have actually made a true profit, you must subtract the foreign exchange gains of 73%. If no gains were made above the foreign exchange movement, there was no real net profit on an international level.

Nonetheless, the average investor has looked favorably upon foreign investment in 1980 not realizing that in all due respect he has been merely playing the foreign exchange markets and not true foreign investment as long as those gains fell short of the foreign exchange movement. This was also the case during the 1920s but then gains in the U.S. stock market did exceed the foreign exchange gains for the overseas investor. Therefore, the U.S. stock market became an attractive bull market not merely because of the innovation of many new industries, but because the foreign exchange movement yielded an additional plus for the European investor in U.S. markets.

Despite the bearishness which prevailed, we can see that the U.S. stock market remained attractive to foreign investment even though the domestic analysis within the United States did not share in that optimism. If we now look at the U.S. capital accounts, we will find that the actual swings within capital flows between the U.S. and the balance of the world corresponded to the turning points within the Dow Jones Industrials.

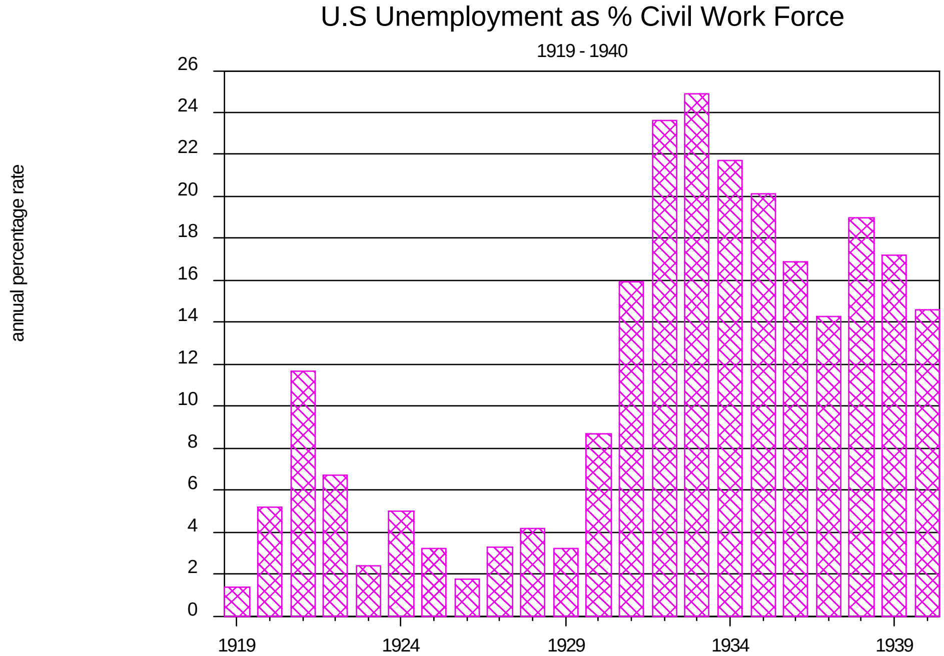
The Net Capital Flows chart covering 1927 to 1937 clearly illustrates several important trends. Note first of all that the central bank intervention came in 1927 at the peak of capital movement into the U.S. economy. From 1927 onward, we find that capital did gradually begin to turn away



from the U.S. but still not significantly until 1930. Foreign buying within the U.S. stock market was at its peak in 1927. However, overall, foreign buyers were active between 1921 and 1927. This activity began to gradually die down and you will recall the commentary in 1929 that it was the foreign selling which initially began to show up in June just prior to the decline from the September 1929 high. The withdrawal of capital continued from 1923 into 1931 but if you refer to the commentary in 1932 once again you will note that it was the foreign buying at the low which provided support in the market. It was not that the foreign buyers had a superior knowledge of when to buy or sell the stock market in the United States. What it really had to do with was their tendency to buy or sell according to foreign exchange considerations. Therefore, it was foreign selling in 1929 which helped to etch the peak in the Dow and foreign buying in 1932 which help to carve the "V" shape bottom.

The second chart illustrating the Net Capital Flows of the U.S. covers the period of 1919 & 1940. Here you will note that the peak in capital flows into the U.S. come in 1919 at the height of the inflationary rally in both commodities as well as stocks. You will note that during the 1921 - 1927 period, not one single year turned toward a negative outflow. Capital investment still drifted steadily toward the U.S. marketplace adding to the confusion of the domestic analytical community as it helped to produce the Greatest Bull Market in History.

Gresham's Law undoubtedly worked on an international scope far beyond the expectations of the contemporary analysts of the day. The movement of the dollar itself was a key role in the overall trend of the tangible investments within the United States. In trying to obtain a clear perspective of the dollar and its movements during the era, I created what I have called the "U.S. Dollar Index 1900 = Par." In effect, all the various currencies from Europe, South America and the Far East have been gathered together in a basket. The starting point was chosen as 1900 and this point has

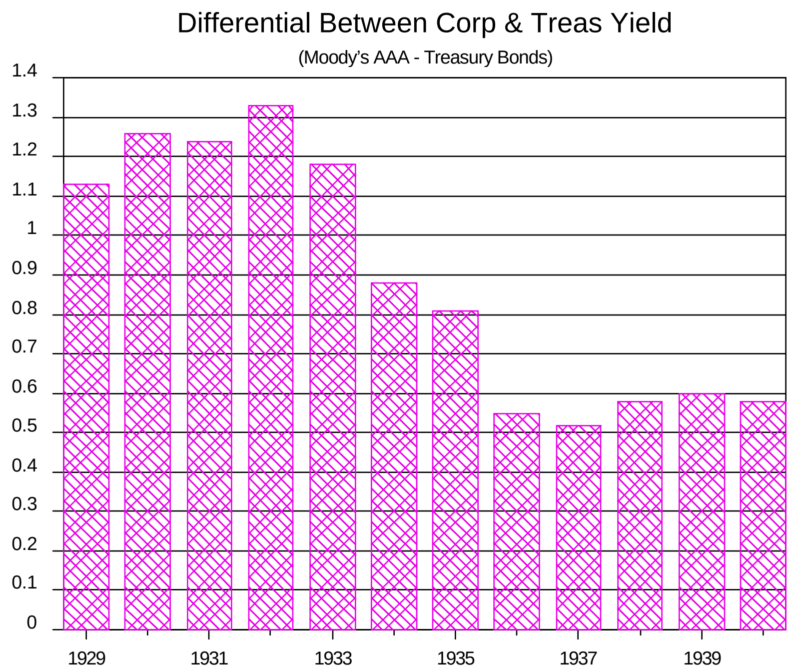


Raw Data Source: Economic Statistics

been taken to equal $1 or par. This Index does not measure inflation nor any other factors and it is **NOT** weighted according to economic strength. It simply measures the broadest possible basket of currencies and tracks that basket relative to the starting point which is 1900.

Here we can see in the chart provided covering the period of 1919 to 1934, that the volatility within the dollar itself was very drastic. The dollar rose to its first major high during this century in 1920 after the U.S. stock market had peaked the year before. Between 1922 and 1931, the dollar had been manipulated for the most part trying to support the European currencies. This undervaluation of the dollar during this period eventually gave way to reality once it became understood that the U.S. was in fact not going to abandon the gold standard in late 1931. The defaults of foreign government debt issues, including the default of Britain, drove the dollar upward at a pace which far exceeded anything imaginable by today's standards.

There are several other important points which this Dollar Index tends to illustrate. The period of 1927 to 1929 begins with the central bank intervention which attempted to manipulate the dollar downward and ends with a rush into the dollar followed by the stock market panic. Let us now look at a detailed chart of the monthly closings in our Dollar Index for this period. Note the 17% rise in the dollar between December 1927 moving into June 1929. This 17% rise was small in comparison to the drastic swings following World War I and those during the aftermath of the Monetary Crisis of 1931. However, this illustrates that the initial selling which came in at the peak in the stock market from foreign sources early in the summer of '29 corresponded to the peak in the dollar itself which was in June 1929 nearly 3 months prior to the peak in the stock market. We also see that from the June high in the dollar, there was an initial decline into July 1929. That was followed by a small rally into August which in effect was a technical reaction pattern testing the previous high. From there onward, the dol-



lar fell rapidly straight down into December 1929.

Foreign selling in the U.S. stock market during the early summer of 1929 was by and large sparked by the peak in the dollar. This provided the incentive for overseas investors to take profit even though the Dow Jones Industrials continued higher overall.

If we now look at the period from 1929 moving into August 1931 just prior to the British default and the Monetary Crisis of 1931, we can see that the trend in the dollar was fairly steady after the initial panic in 1929. We can see that the lowest point came in July 1930 when the dollar dipped under $1.12. This followed the initial panic low in the Dow which came during June of that year when the Smoot-Hawley Tariff Act was signed. The tariff issue was indeed a stabilizing factor for the dollar itself on foreign exchange markets.

We can also see in the detailed chart covering the September 1931 period on through into December 1932, that the dollar's strength was also an important factor in creating the attraction for overseas investment to return into the U.S. stock market in 1932. The dollar rose out of the Monetary Crisis of 1931 into an initial high established during February 1932. It declined into March, rallied back into April and fell for the last time into May just prior to the low in the stock market. The foreign buying was noted in U.S. equities at the very bottom in the Dow during June of 1932. This buying, coincided with the breakout in the dollar to new highs exceeding the double top pattern established during February and April of that year. The dollar continued to rally into December of 1932 and then began a collapsing pattern as international fears spread over the upcoming inflationary policies of Franklin D. Roosevelt.

Between January 1933 and January 1935, we can see that the trend in the dollar was virtually straight down until it reached bottom during April 1934. This decline was caused by the fears that a devaluation would come about as rumor eventually turned into reality. The devaluation of the dollar in January 1934 through the means of inflating the price of gold from $20.67 to $35, had created nearly a 30% decline in the value of the dollar on world foreign exchange markets.

If we look at the chart of the Dollar Index for the period 1900 to 1950, there is another important point to take note of. The low which was made during the Roosevelt devaluation in 1934 was above the previous lows prior to the peak in 1920. Gold was $20.67 prior to 1920 whereas in 1934 it was $35. Theoretically, the 1934 low should have been under that of even the 1900 par level. Yet it was not! Still the dollar remained well above the major lows prior to the period which illustrated a very important point. The fact that the 1934 low had held above all previous lows during the 20th century indicated that capital world-wide still looked quite favorable upon the U.S. markets despite the short-term considerations. Indeed, the trend in the dollar would continue higher into the decades to come and the long-term confidence for foreign investment in the United States would be a leading factor in creating the modern economic system of today.

Foreign exchange is not the only motivation behind international investment and capital flows among nations. Inflationary trends in one nation compared to another are an important influence as well. Here we have a chart which illustrates the differential between the British and French inflation rates according to their CPI (Consumer Price Index) and that of the United States. The dark bars are Britain and the light are those of France. We can see that up until 1917, the rate of British inflation had remained above that of the U.S. and in 1915 it had been as much as 25% over and above the U.S. domestic inflation rate. The strict deflationary policies taken by Britain killed the pound during the early 1920s as well as their economy. The British were successful in keeping their inflation rate under that of the U.S. until 1928.

But the story in France as in most other European nations was notably different. With the exception of 1917 and 1921, the inflation rate in France had remained above that of the United States. This is also true for most of the Far East and Japan. The simple rate of inflation being greater in other nations was a positive factor in helping to create the bull market of the 1920s in the United States. Capital tends to flow on an international level toward nations where the purchasing power will not erode so rapidly. This tends to be one factor behind not merely market movements, but also influences capital flows and foreign exchange movement as well. The sharply higher rates of inflation in other nations tended to shed a positive light upon U.S. investment during the bull market. It was also the fears of Roosevelt's inflationary policies which carved a peak in the dollar during December 1932 and the low moving into April 1934.

Therefore, David Hume's observations of inflationary trends not merely apply to strict domestic economies but it also plays a major role within the entire international economies. If one nation is experiencing an annual rate of inflation in the area of 100%, then even another nation with a 50% rate of inflation will appear to offer an island of stability by comparison. International capital flows will tend to follow the world inflationary trends as well. This is why when Ronald Reagan was elected to the Presidency of the United States, the "confidence" in the fact that he was serious about ending the inflationary trends in the United States sparked an immediate "anticipation" of such and event and inflation began to subsided right there and then. It was this new level of "confidence" which most misread in the overall trend for the dollar between 1980 and 1985.

It was this anticipation of a trend change with Ronald Reagan in 1981 which altered the events of recent economic history. It was also the anticipation of the change in trend under the Roosevelt administration which sparked the fears of inflation driving the stock market higher along with commodities while the dollar declined. In both cases, the free market forces reacted in "anticipation" prior to any official action being taken. During the Depression, no one anticipated higher prices. They lost their optimism so to speak. This is what not only created the Great Depression from an economic perspective, but also from an emotional perspective as well. Therefore, even though Roosevelt's policies failed to restore a healthy robust economy as evidenced by the 1937 recession, those policies created an anticipation that prices would rise under the guides of devaluation and that they did. Once people believed that prices would rise, speculation returned. Prior to that, speculation had nearly died in so far as no one in 1932 anticipated a change in trend or sharply rising commodity prices.

We can see that the trend in U.S. unemployment began to subside in 1934 from the peak of nearly 25% in 1933. But the inflationary policies of Roosevelt managed to only artificially extract price advances in the marketplace as commodities and equities rose seeking to readjust to their international purchasing power. But the unemployment rate remained high declining to its lowest point in 1937. But that decline left unemployment substantially higher than the previous record high which had been established during 1921. It was not the New Deal which lowered unemployment, but the advent of World War II.

This intangible level of confidence can also be seen in the differential between corporate AAA bond yields and that of the U.S. Treasury. Oddly enough, during robust periods of prosperity where confidence runs high among the private sector, the yield differential between corporate and Treasury yield on long-term bonds narrows. The chart provided here illustrates the net differential between Moody's AAA bond yield and that of Treasury bonds. We can see that the net differential widened during the Depression peaking at above 1.3% in 1932. Note that the differential between corporate and Treasury bond yields declined during the inflationary period bottoming exactly when the stock market itself peaked during 1937. To a large extent, this illustrates that during periods of prosperity and rising market prices, confidence within the private sector rises allowing corporate yields to decline in respect to those of governmental. During periods where confidence in the economy itself declines, corporations are forced to pay higher yields to attract capital away from the perceived safer bonds offered by the Treasury.

But this chart also illustrates another factor in the private versus public confidence game. Note that during the Monetary Crisis of 1931, the differential between corporate and Treasury yields declined once confidence in governmental issues was shaken. Confidence itself is a force which not merely flirts with international considerations, but also with domestic considerations to the point that the private sector tends to compete against the public sector. It is that human element of emotion which tends to judge situations on all levels comparing investment in one nation to that of another as well as between public and private sectors within each nation.

In conclusion, the forces which merged together forging what became not only the Greatest Bull Market In History as well as the Greatest Crash in history, were diverse and invisible to those of the time. There is no doubt that the influences were international and not of domestic origin within the United States nor within any other single nation. They were the combination of many events spurred onward by a distrusting world who was perhaps at peace with the sword but not in the financial arena.

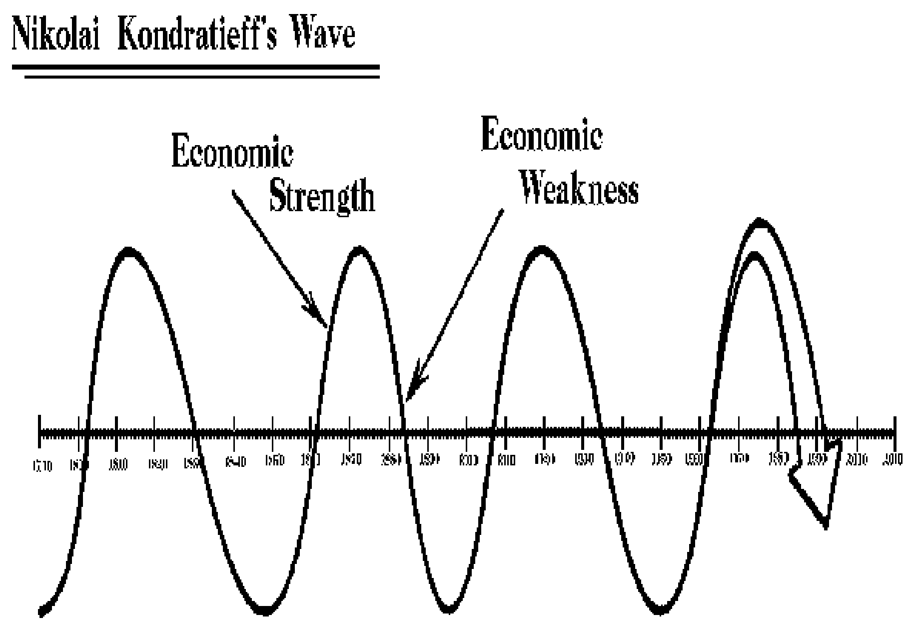
The Crash was not the single-handed result of speculation nor was it delivered by blunders attributed to Hoover. The Crash was not the child of Smoot-Hawley but it was the child of warring financially driven nations. To claim that it could have been prevented by increasing government spending in the United States is as absurd and as impractical as claiming that the bull market was created by shoeshine boys who dabbled in the market toward the end.

All those who have attempted to blame certain sectors or factions within society have all had their personal biases as fuel for their motives. The press did not make the bull market. As we read for ourselves the majority of commentary had remained bearish even into 1928. As is the case today, when the press finally became impressed and the stock market monopolized the front pages, the end was not far behind.

The Greatest Bull Market in History was created for the most part by war. World War I had torn the very fabric of Europe apart leaving the United States not merely the manufacturer and supplier of food, but also the reservoir for frightened capital. That capital concentration which initially peaked in 1919 within the United States, lined the pockets of American business with the seed capital which began one giant leap forward in economic progress. The birth of the mass produced automobiles and even the airplane brought forth new waves of expansion within the U.S. economy. It was not merely this attraction which lured foreign investment to American shores, but the turmoil which still raged on throughout Europe.

Despite the fact that the war was over, war still was being waged between nations on financial battle grounds. This left an unsettled foundation upon which to build the future. The demands placed upon Germany were unrealistic but this was not recognized until after the Monetary Crisis of 1931.

The Great Depression was an emotional depression sparked by a massive contraction in the value of tangible assets worldwide. The appreciation of dollar denominated assets far exceeded the increase within the money supply itself. When the liquidation began, tangible assets at inflated prices out numbered the money supply by better than 25 to 1. As a result, tangible assets including stocks, bonds and real estate, contracted in price rapidly in an attempt to realign itself with the vastly smaller supply of money. In part, those who sought to blame the Federal Reserve for contracting the money supply and Hoover for not increasing government spending enough, were touching upon this aspect. But this is a double edged sword. If inflation is defined as an increase in the quantity of money versus tangible goods, then one might understand t he fears of the Fed during this period. However, the U.S. tangible assets were inflated in value not because of domestic policies as much as international considerations. Therefore, if it is true that



the lending ratio as we read earlier was 13 to 1 based upon gold reserves, theoretically the Fed would have had to have increased the money supply 13 times to have stabilized prices at the 1929 levels. You can see that such massive expansion is not only impossible in the space of 1 to 2 years, this understanding of the forces of confidence and leverage were not present.

In reality, the swings within the economy are a constant battle between the forces of public and private confidence. These forces are ongoing and live on as vividly today as they did then during the 1920s as well as within the monetary crisis periods which preceded them during centuries long since forgotten. Whether or not such contractions lie ahead in our future depends greatly upon this balance between the forces of public versus private confidence in combination with the political understanding of the whole. The Great Depression was in reality the break down of the world economy and the leverage obtained through expanded credit turned around into a reverse leverage which came back to haunt society internationally. Whether the over-leveraged debt situation through the alarming outstanding international governmental loans will once again spark a break in world confidence levels seems at least possible in the years ahead. Indeed today manipulation is viewed as a means to an end, but that end may not be any different than in prior scripts.

The blame for the events of the Great Depression does not rest upon the shoulders of one man, nor group of men within society. It does not even rest upon the mantle of any particular sovereign nation. The causes are equally shared among all nations and all political parties. They did not suddenly emerge in 1929 out of the clear blue sky. They festered and grew being multiplied by many and in the end, magnified by all.

Trying to second guess the future is never an easy task. The decisions we often make sometimes grow up and come back to bite us. Getting from point "A" to point "B" may often appear to be a straight line. But when you try to draw that line, there is never a guarantee that the straight edge won't slip. With the passing of time we all tend to grow older. But those changes which take place in our own personal appearance cannot be seen each day when we look at ourselves in the mirror. But pull an old photograph out of the drawer and soon you will see just how much hair has been lost, how much weight gained, or how many wrinkles and bags have gradually formed miraculously before your very eyes.

Such is the case with the long-term effects and trends within society as a whole. Each step we take as a nation or as a group, each decision combines to shape our destiny as in our own lives. Each little decision we personally made in life has fulfilled our own destiny. Who we decided to marry. What courses we took in school. The friends we chose to keep. And the dreams we once used to motivate our goals. It is like standing before a mirror. We cannot see how that particular decision will affect the outcome of our life years ahead. We can only judge it within the context of that very moment. Such was the case during the Great Depression.

Everyone chose to place the blame upon someone else never once trying to understand what was behind the events of the day. Each subtle decision politicians had made to expand world trade through increasing foreign loans to attempting to manipulate foreign exchange, all played a major role in the outcome. No one could step back to view the problems from afar and instead acted rashly with tariffs, embargoes, taxation, political slander and witch hunts which made a mockery of the very dreams which once sparkled in the eyes of a lady who had stood proud and tall in New York harbor.

We pay for our mistakes made rashly or in haste be it within our personal lives or collectively as a society. Circumstances may change and had they been foreseen then perhaps we may have made a different decision. Nonetheless, we all pay dearly for those rash or poor decisions eventually because each and every one of them combines to form our personal destiny. There is never any going back to correct them. Opportunity knocks, but only once and if the door is not opened, the future will be filled with nothing more than a bunch of "what ifs" or "should haves." Once decisions are made, they are made forever!

The future is the product of our personal hopes, dreams, failures, fears and misgivings. Every time we shy away from something which our gut told us we should have done, the price will eventually be paid in the end. We cannot run away from ourselves nor our inner feelings no more than society can run away from the reality of its transgressions.

Collectively, each subtle movement between the markets as they interact with one another is as important to the entire picture of the economic world as those small events in our own personal lives. The combined forces are poised together in harmony which in the end are cast upon the winds of fate.

Society is managed by our politicians who are as human as you or I. They too are not free from their human errors and the decisions which they have made collectively from one administration to the next have indeed combined and molded the world in which we now exist. Their rash decisions for war and power or decisions to raise taxes rather than balance current budgets, have all shaped and molded today's world. It was the over extension of debt in the 1920s which came back to haunt the world during the Monetary Crisis of 1931. Each transgression, each attempted manipulation, all formed a part of the whole. Nothing is too small or insignificant. Nothing exists nor does it take place without some meaning and long-range effect.

Often we seem to think that there is someone in control. Someone who is all powerful in the marketplace deciding whether today shall be an up or down day for us all. But the truth of the matter is that there is no one great demigod in stocks nor in commodities. We are all moved by one another and our lives indeed cross paths. But still nothing takes place in that financial arena nor in our personal lives without shaping and molding our own future.

The events of the Great Depression were tragic. The pain and suffering among those who lived through it goes beyond description. Many who under normal circumstances would have prospered lost everything they had becoming a mere victim in a contracting world obsessed with self preservation.

There have been many analysts in numerous fields. Often they have argued upon one premise or another each based upon a single piece of the entire puzzle. No one has the answers in the palm of his hand because the beast is too large for us to comprehend. There are those who toy with the meaning of life and ponder the alpha and omega never truly understanding much more than what has already been written. The mysteries within the movements of the economy are as profound and as perplexing as life itself because it is not stocks or bonds nor even gold which rises and falls of its own accord. It is the human action and reaction which one charts and attempts to forecast. It is man chasing man in a battle of self preservation in the financial arena of modern survival.

There are rhythms to this perplexing movement even though at times it may seem to have none at all. These rhythms which the markets and the economy possess are endless in their own right and their movements have been tied to everything from the stars and the changes in the tide of the seas to the greed of an entrepreneur. But still nothing has yielded the golden key to their fortune for the secret does not lie in a single resting place. The bonds impact commodities, which in turn impact the bonds. And this is merely the beginning for then the formula grows to include stocks, gold, foreign exchange, real estate, interest rates, foreign trade, taxes, politics, finance, inflation, deflation, recession, boom, prosperity, poverty and war. Then the formula expands even greater for all these things take place within each nation among the world of nations, and in turn each nation then interacts with one another.

The combination of this vast array of variables is beyond the scope of our imagination. Just as a stone cast into the center of a lake sends waves which impact the shoreline on all sides, each movement, no matter how subtle, each decision, no matter how subtle, has a lasting effect upon the destiny of the whole. It is inescapable. This is the answer to why it became possible for the National Debt of the United States to double in less than 5 years during the 1980s while the dollar rose to record highs in 1985 around the world and inflation plummeted until it reached its low in that same year. The text book impossibility became reality because the forces around the world offset our supply demand expectations.

Life itself has its beginning and its end. It is never straight up, for it has its peaks and then there are the deep valleys. Society is merely the combination of many cycles of life itself. No civilization has reached immortality. Man has abused and mismanaged each of his dreams. True freedom and democracy seems to be one of those dreams which has undergone numerous transgressions. Man's jealous nature has always brought the means to a dismal end and the Great Depression was indeed a crisis in democracy. Shifting the blame upon the stock market or the rich did not solve the problems but instead it merely generated others and clouded the true deeper errors made by society as a whole.

No market has ever rallied continually. All booms and fads come to an end. The periods of economic expansion and prosperity are always longer in duration because we as human beings take more time in giving our confidence to someone or some thing. But periods of depression are always swift and to the point with a duration far less than periods of expansion. We may all take our time before we become convinced that gold is really going to rise but we all act quickly out of self preservation when prices begin to tumble. As a result, the economy as a whole has acquired oscillating cycles of boom and bust. For it is man himself which has impressed those actions and reactions upon society as well as the economy as a whole.

Many have recanted the wave theory of Kondratieff while others have laughed in amusement. Does the Kondratieff wave offer a valid road map of the future? Or is it a bunch of wavy lines that add up to nothing? Unfortunately, most people have no idea of what the Kondratieff wave is all about. The wave was discovered by this man after studying the price movements of a basket of commodities. But in 1900 41% of the total U.S. work force was employed in the agricultural sector. In 1950, agriculture accounted for only 11% of the total work force. In 1980, the percentage of agricultural workers had diminished to merely 3%. Obviously, if an economy were 41% dependent upon the mere movement within the commodity prices, the cycles within commodities themselves would closely mirror the economy as a whole.

Those who lack the understanding of all the forces within the economy and how they play a special role within the complete picture have also failed themselves to understand the significance of the cyclical work of Kondratieff. As a result, they have made a rash judgment and then attempted to apply the Kondratieff wave to the stock market, bonds, gold and even the economy. The net result has been dismal failure. Instead of predicting another "Black Tuesday" as in 1869, they have misread the entire overall outlook of what this wave has to offer mankind.

The Kondratieff wave perhaps grew in fame only during the mid-1973s after it accurately portrayed the peak in commodity prices along with the stock market. The wave itself is not indicating an economic crisis as many have tried to read into it. Instead, the Kondratieff wave continues to accurately portray the movement of commodities as a whole for which it was originally based upon. Coincidentally, when an economy during the 1800s was dependent upon commodities for nearly 60% of its employment rate, the economy will follow this cycle accurately. But that relationship is no longer the case today.

The real significance in this wave and its value to us for the future does not lie in its ominous forecast for an economic collapse but for an economic revival. This wave indicates that we are in a bottoming out phase in commodity prices on a whole including oil. The years ahead will not bring disaster in terms of deflation, but instead the other side of the coin will be at hand. The years ahead will begin to show a marked increase in inflation particularly after 1987. Commodities themselves effect price levels overall but when they decline only those directly involved in their production suffer. Users reap the benefit of their lower prices.

The forces of deflation and inflation coexist within the same plane. It is as if they were the elements of heat and cold. When cold becomes severe it too is capable of burning flesh. Although these two forces are opposite, when left to their extremes they both possess the capability of destruction as far as human life is concerned. The forces of deflation and that of inflation may also appear to be opposite trends but when also left to their extremes, they too will destroy an economy.

Therefore, the Kondratieff wave or any other wave need not predict the destruction of an economic order through the sole means of deflation as was the case in the Great Depression. The future may just as easily be faced with an ominous inflationary force. The outcome has been decided by the mistakes of the past.

Just as in our own lives each subtle little decision has merged over time to shape and mold our destiny into what it has become today, the political decisions of many throughout this century have also combined to shape and mold our current situation. It is impossible to unravel such a montage of poor decisions within the economic structure without destroying the very fabric which holds it together. Once the forces have been set in motion, they become impossible to stop.

As we emerge into the years ahead, even stronger events will be seen. The stock market will continue to rise even though inflation itself will rise as well. Hopes for the promise land where interest rates remain forever low will not grace our door steps in the years ahead. All the subtle little mistakes society has made these last few decades will continue to grow bigger adding confusion to the reality of everyday survival. The Kondratieff wave is not warning of a deflationary age which will end in a dismal collapse, but instead it warns of an inflationary age about to dawn. It is calling for the bottoming out of the long- term forces in deflation and the resurgence of inflation.

The rally out of 1932 was one based upon the fears of inflation sparked by Roosevelt. Stocks, said the Wall Street Journal in 1933, were everyone's hedge against inflation.

Perhaps this might sound quite foreign to you in this day and age when we are brainwashed into thinking that stocks only do well with low inflation and low interest rates, but nonetheless it is very true. When inflation takes place, the value of your house rises. So do the assets of corporations as well. We are on the verge of a new era in analysis where the books must be rewritten and understanding broadened. When tomorrow comes, she will bring new relationships between the markets and a new meaning to the word confusion. The thinking process behind the markets which we have reviewed throughout the 1920s will again emerge during the late 1980s. The fears of the Fed and government intervention will give way to the fears of mismanagement and international volatility. Markets around the globe will gyrate with greater frequency and price movement as capital will once again shoot from one nation to another like the loose cannon described by

Herbert Hoover during the Monetary Crisis of 1931.

The public trust or confidence has begun to shift away from the public sector and it will be lured into the private sector as we continue to move into December 1989. Ultimately, the forces of reality will over power the mixed up thinking process of today. The reverse leverage effect by contracting world credit and expanding debt will once again rear its head as it has before.

It has been the sheer confidence which Reagan brought to the office which began the decline in inflation between 1981 and 1985. It was the anticipation of the people who believed that he would turn things around thereby pulling back on their inflationary expectations themselves. In reality, the deficits continued to mount. Not because of defense or any other programs which Reagan instituted. The cancer within is the interest on carrying the National Debt.

If spending were balanced between the various programs and income, with a National Debt approaching $2 trillion, it will double again in 8 years at an annual rate of 8% in interest expense. Spending, therefore, must be cut not merely moderately, but drastically to avoid this ominous situation. But to do that, all the special interests will cry foul. Everyone wants to cut the programs which provide direct employment such as defense while boosting the social benefits which create far less direct employment. If that continues, then the private sector must expand to accommodate the increased unemployment caused by a curtailment in such direct employment expenditures.

It becomes a nasty cycle which continues to move with a subtle momentum all of its own. There is no stopping this cycle unless everyone realizes that it must come to an end. Otherwise, until the worst makes itself known, you will find few who are willing to take the drastic steps necessary to ward off the impending outcome of another reverse leverage situation in world credit and debt.

The best and most accurate forecast which I can offer for the next 4 year period is quite simple. There will be no 1929 style deflation on the horizon before 1990. The next four years will be a period of extreme volatility of unprecedented proportions. The logic of our text books will give way as it has many times in the past. The very fiber of the marketplace will be torn and taxed to its maximum potential. The swings both up and down will become greater with each passing year. 100 point moves in the Dow will become real daily events. The dollar may fall lower but eventually it will rise like a phoenix from the ashes left behind by those who foolishly attempt to artificially manipulate themselves out of the reality of their transgressions.

In the end, the impossible will have not merely become possible, but reality. The once stable years of recent vintage will be looked upon as the staging grounds before the storm. But through it all, opportunity will knock upon our door and should it go unanswered we will look back and weep. The key to the future lies in understanding the past. The debt crisis of the 1920s and 1930s is quite similar to that of today. How it influenced capital is a lesson which should not be forgotten so easily. It will serve us well to remember what once was, could again someday be.

PEI Homepage