Chapter Eleven

INTO THE STRATOSPHERE

FOR the investment bankers—those midwives and attending physicians of the corporate world, whose function it was to provide, through the sale of securities to dealers and thus to the general public, the capital which governments and industrial and business concerns needed in order to carry on and to grow—the seven years 1922–1929 were fat indeed. The affiliates of commercial banks were taking some of the business which might otherwise have gone to them, yet there seemed to be enough for all, and the investment banking houses still enjoyed the cream of it.

They it was who, with the sleepless aid of their corporation lawyers, put into effect many if not most of the devices by which the promoters and organizers of corporations might do as they pleased without interference from the cohorts of the stockholders. During these years an endless stream of new issues of securities poured forth from their offices and were swallowed up by an eager investing public: foreign government bonds, foreign corporation bonds, railroad bonds, industrial bonds, utility bonds, preferred stocks, common stocks. And the stream grew in volume: between 1926 and 1929 the annual total rose from a mere seven billions to more than eleven and a half billions.

It was a very lucrative business. The profits of those investment bankers who had the prestige and the judgment to negotiate security issues successfully for the giants of industry were huge. Profits measured in terms of hundreds of thousands of dollars on a single issue were commonplace, and sometimes they rose well into the millions. For example, according to the report of the Senate Committee on Banking and Currency, the profits, commissions, and fees which went to Kuhn, Loeb & Co. for marketing securities for the Pennroad Corporation and for other services to this corporation during less than six months in 1929 amounted to about five million eight hundred thousand dollars. And the total profits of the House of Morgan for the year 1929 may be suggested by two recorded facts: first, that

the partners paid in Federal taxes for that year a total of about eleven million dollars, and second, that during that year the net worth of J. P. Morgan & Co. and of its Philadelphia ally, Drexel & Co., increased by more than twenty-seven millions.

What made investment banking lucrative was not simply the opportunity to buy issues of bonds from corporations at, say, a price of ninety-five and sell them to the public at a price of ninety-eight or ninety-nine. (Although on a big issue a three-or-four-point spread could add up to a great deal of money, such a spread was ordinarily not unreasonable in view of the risk involved and the number of banks and bond houses among which the money was divided.) It was also the opportunity to be numbered, again and again, among the insiders who got common stock for very little money when corporations were formed or refinanced. In such operations the practice which Morgan the Elder had pursued when he formed the Steel Corporation had now for a long time been orthodox.

Most of the money which a company needed in order to begin business was raised by selling bonds or preferred stock, or both; sometimes all of it was thus raised. The common stock, on the other hand, was not usually distributed in quantity to the general public—at least, not directly. Most of it was issued to the insiders—the promoters, the investment bankers, and their allies—for little or no cash: either handed out along with the preferred stock which these favored gentlemen purchased; or issued to them for "services," or bought by them at very low prices. (When two or more companies were merged, the common stock of the big corporation which took their place was usually issued in exchange for their stock; but ordinarily this stock too, if one were to trace its previous history, would be found to have had a very inexpensive origin.) Thus these insiders found themselves in a delightfully favorable position: a sort of heads-I-win-a-lot, tails-I-can't-lose-much position. If the company did badly (which of course very frequently happened) their losses on their common stock were slight. If, on the other hand, it prospered, they were very well off indeed.

For the shares leaped in value; after being listed on a stock exchange, they were taken up by speculators, often by speculative pools; sooner or later they found their way into the hands of investors; and then such insiders as chose to sell might make handsome profits. (You may remember that when the Steel Corporation was organized, the Morgan syndicate had walked off with a

profit of sixty-two and a half millions, of which considerably more than twelve and a half millions had gone to the House of Morgan itself.) It was very advantageous to be in on the ground floor in these operations.

During the nineteen-twenties the procedure was modified in many ways. For one thing, the eagerness of the general public to buy common stock made it often possible to sell such stock at round prices, even at the outset of a corporation's career. For another thing, the insiders now sometimes took their special advantage in the form of a new device, the option warrant which entitled them to buy more common stock in the future if they wished. For example, J. P. Morgan & Co., in 1929, were granted a million option warrants to buy United Corporation common stock at $27.50 per share at any time in the future. The amount of money allocated to the purchase of these warrants was one dollar per warrant. Heads-I-win-a-lot, tails-I-can't-lose-much again. If the stock did not gain in price, they need not exercise these option warrants; if it did, they could exercise them and at once sell the shares at a big profit, or they could sell the option warrants themselves. As a matter of fact, the Morgan firm sold 200,000 of their United Corporation option warrants during 1929 at a profit (based on the above allocated consideration) of over eight million dollars. The rest of the warrants were distributed among the partners of the firm.

Such practices—and they were widespread—were defended on the ground that they offered a logical opportunity for profit to the men whose imagination had foreseen new industrial opportunities and whose enterprise had transformed them into actualities. But they also constituted an almost ideal system for building up potential claims upon the future fruits of industry and preventing these fruits from being distributed in wages or lowered prices (or, if option warrants were issued, from being distributed in increased dividends). Let us see for a moment how this system operated.

Suppose the company whose common shares had been distributed to insiders for little or nothing began to do well. The stock was listed on an exchange; it was tossed about by speculators; it was bought by investors. An investor who paid one hundred dollars a share for such common stock usually imagined that he had put one hundred dollars a share into the business; that he was justly entitled to a return upon these shares from the business; that if it failed to give him such a return because it was lowering prices or raising wages, an outrage was being perpetrated upon him; the sacred rights of

property were at stake. He did not realize that very little of the one hundred dollars a share which he had paid represented money which had ever gone into the business at all—had been used, let us say, for the building of factories; most if not all of it had gone into the pockets of the insiders and of the speculators and other investors who had preceded him in the ownership of this stock.

Nor was the investor in common stock without justification in feeling that a return upon what he had paid was due him. For as the stock passed from investor to investor, its curious origin seemed to have less and less to do with the merits of his claim. Common stock which had once been thought of simply as a bit of possible velvet for the insiders should their plans prove to have been well devised, became by gradual degrees something quite different in the public mind when it had passed through successive trades into the hands not only of the rich and powerful but of thrifty salary-earners, wage-earners, indigent gentlewomen, and the widows and orphans of orthodox financial apologetics. Its acquired value had been built into the economic and social structure so securely that to deny to this value a reasonable return in income would work real injustice to thousands.

A very remarkable system indeed, which could thus transform the slenderest into the stoutest of rights! How widespread it was—in other words, how large a proportion of the common stock outstanding represented money actually invested in industry or business, and how much represented merely insiders' and subsequent speculators' and investors' profits—no one apparently knows exactly. Yet if an exhaustive research were made into the origin of the common stocks listed on the New York Stock Exchange in 1929, it would probably show that the bulk of their value did not represent—as did the value of bonds and most preferred stocks—the bricks and mortar and steel and machines with which these corporations did business. Studies in the financing of the leading companies in certain industries are embodied in John T. Flynn's volume on *Security Speculation:* they confirm this hypothesis impressively.

As the public appetite for securities became keener and keener during the nineteen-twenties, it was not surprising that some investment bankers should have leaped at every opportunity, favorable or unfavorable, to form a new company, to merge two or three old ones, or to expand a company's business. The fruits of financial activity were so inviting that bankers began to operate

with more and more regard for these fruits and with less and less regard for the effect of such activity upon the businesses involved. The feet of the gentlemen of Wall Street began to leave the hard ground upon which stood factories and shops; these gentlemen began to float higher and higher in a stratospheric region of sheer financial enterprise—a region of reorganizations and mergers and stock split-ups and trading syndicates and super-super-holding companies and investment trusts.

The perfect illustration of this stratospheric activity was the wild proliferation of investment trusts which took place during 1927, 1928, and 1929. Now the investment trust, in theory and sometimes in practice, was a valuable financial institution, especially for the small investor, enabling him to achieve well managed and diversified investment. But as soon as the public began to show an interest in the shares of investment trusts, innumerable men in Wall Street and other financial centers saw a great light. Here was the perfect opportunity to form a new corporation, with all the benefits to themselves attendant upon such activity, without ever having to bother about manufacturing and selling at all. Here was the Wall Street answer to prayer; a company which need have no business at all outside of Wall Street!

All it had to do was to invest in other companies—and to sell its own stock. And incidentally, if the trust were so capitalized that control remained with the insiders even though millions of dollars' worth of securities were distributed to the public, it might become an agency which would aid the investment bankers in gaining financial control of this concern or that, with further benefits.

We need examine only one conspicuous example from among innumerable trusts to show how the formation of such concerns could profit the bankers on the inside. In the year 1924, when the investment trust idea was still a novelty to Americans, the investment banking firm of Dillon, Read & Co. formed what was known as the United States and Foreign Securities Corporation. The first preferred stock and a quarter of the common stock were sold to the general public for twenty-five million dollars. The second preferred stock and another quarter of the common stock were sold to Dillon, Read & Co. for five million dollars—a considerably smaller sum than twenty-five millions, it will be noticed. And the other half of the common stock went (through somewhat complicated channels) to Clarence Dillon and his associates, for a mere one

hundred thousand dollars—a very small sum indeed by comparison with the others. This small sum was equivalent to twenty cents a common share; and the number of shares which went to these men personally was half a million. Some years later, after the stock-market had been churning a long time, some of these men decided to sell some of this stock. So Dillon, Read & Co. made an arrangement with a firm of stockbrokers who in 1928 and 1929 churned the market some more, and disposed of 74,198 of these shares for approximately four million dollars; they also sold additional shares to the customers of Dillon, Read & Co., bringing their profits on this common stock which they had purchased (from themselves as the organizers of the trust) at twenty cents a share, to well over six million dollars.

(In fairness to Mr. Dillon and his associates it should be added that the figure of twenty cents a share was nominal; they considered their purchase of preferred and common shares as a single transaction. The point, however, is clear anyhow: men who had got their stock very cheap sold it for millions; and but little of the price paid by those to whom they sold it represented money originally invested in the Corporation.)

Needless to say, this is a somewhat extreme example; it suggests, nevertheless, one reason why investment bankers formed investment trusts by the score and why some of them could support racing stables, hunting preserves, and yachts.

With the investment banking business went power, too; the power that came from sitting on boards of directors, keeping a finger on what was being done, putting in a suggestion here and a word of warning there; the power that came from being able to hint that orders might well be placed with this or that other corporation within the charmed circle of one's influence; the power, sometimes, in foreign affairs that came from having huge commitments in foreign countries, which were supposed to be borne in mind by a State Department not always well-informed but usually anxious not to displease entrenched interests; and a further power—or rather, perhaps, an intangible influence—that could not be measured in terms of directorships or stock ownerships, but as we noted in an earlier chapter of this book was better measured in terms of the prestige which accompanies success.

The two most important of the private banking houses which dominated investment banking were Kuhn, Loeb & Co.—the firm which old Jacob Schiff had built up, and of which Otto Kahn was now the senior partner—and

the House of Morgan. Jew and Gentile; the division between them was sharp. The Kuhn, Loeb business in securities was as large as that of the House of Morgan if not larger, but the Morgan influence was far more pervasive.

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No longer, of course, did Morgan the Younger and his partners stand in the strategic position which had been theirs in 1915 and 1916, when they were selling bonds for the British and French and acting as purchasing agents for the war materials for which the proceeds of these bonds were to go. Nor was there anybody now in that solid, fortress-like building at the corner of Broad and Wall Streets—that building so modest in size, so massive in effect—who wielded the colossal personal authority which had been in the mighty hand of Morgan the Elder. He was gone; yes, and Davison, who during the war years had been the most vital personality at 23 Wall Street, was gone too. Yet the tradition of the firm went on. A partnership in the House was as high a prize as a financier could hope for; it meant terrific work, arduous responsibility, yet it meant also great wealth and something more than that: it was a place on the general staff of what the business world considered the headquarters of financial power.

Morgan the Younger, the head of the firm, set the tone of the establishment; listened to the counsels of partners more brilliant than himself, and put in the last word. A quiet and substantial gentleman, courteous and affable, he had the simplicity of assured position: seeing him, one thought of a constitutional monarch in mufti. In essence he was the good patrician: a little stiff, a little remote; contemptuous of democratic blunderings and vulgarities and proletarian clamor; quite unable to imagine what the world would look like to the eyes of a fifteen-dollar-a-week steel worker; yet straightforward, genuine, agreeable to those who were fortunate enough to penetrate his reserve, and far more conscious than most financiers of the imperial obligations which accompanied imperial power. At his right hand stood Thomas Lamont, the diplomat of the firm both abroad and at home—a man who could charm Chinese officials, Middle-Western bank presidents, and liberal editors into feeling that they saw eye to eye with him and that the power of the House of Morgan must be beneficent. About them were clustered veterans like Steele and Cochran and able juniors like George

Whitney and Parker Gilbert.

The private offices on the second floor of 23 Wall Street were islands of modesty and quiet in the splendor and uproar of Wall Street. Their atmosphere was subtly British and old-fashioned. Wood fires burned in the fireplaces on chilly days; the well-worn easy chairs and couches were restful; a financial discussion there was like a chat in a gentleman’s club. Whether or not the hand of the House of Morgan was a hand of iron, it wore a velvet glove of persuasiveness.

Was it a hand of iron? There were stories abroad to the effect that it was—stories of magnates to whom the law had been laid down in very positive terms: this is what you had better do. Yet the answer to the question was veiled in a becoming mystery. When directors of corporations were meeting in Wall Street and wished to refer to the influence or possible displeasure of the firm, they were often almost as hesitant to name it as an Italian would be to name Mussolini. In their euphemistic language, the House of Morgan became “the Corner.” “How will the Corner like that?” one director would say to another. Minor officials of banks and corporations would sometimes be even more vague. “I don’t know whether They’ll like that,” these men would say, as if the very walls had ears and might tell somebody who would tell a Morgan partner.

An influence so indefinable cannot be charted in a graph, to show its ups and downs. Yet there seems to have been a subtle change in it during these years. It was generally considered a conservative influence, skeptical of strange new financial devices and of the careers of young financial Napoleons. When, for example, Lamont spoke out about the preposterous competition in foreign financing in 1927, he was speaking in what had come to be regarded as the customary Morgan role. The House was thought of as a balance wheel. Yet as the financial Napoleons of the nineteen-twenties—the Mitchells, Dillons, Insulls, Van Sweringens, Gianninis, Wiggins—rose higher and higher in prestige and in confidence, and some of them began apparently to bother less about what might be said on the Corner, the weight of this balance wheel became a matter of some question. Presently the Morgan firm was flirting with the brothers Van Sweringen; then it was backing them; by 1929 it was floating their giant Alleghany Corporation; and in that same year it entered the competition for influence over the public utility systems by forming another giant of the new finance, the United

Corporation, a super-holding company for public utility stocks (with a little of the flavor of an investment trust too). Apparently the change in the atmosphere of Wall Street had had its effect. “It was the times.”

Yes, the reader may say, but suppose the House of Morgan had really wanted to call a halt in the wild financial proceedings? Could it have done so?

The answer, I believe, must be no. The influence which was referred to with such bated breath in Wall Street was after all limited in scope. Over the financial policy of corporations within the Morgan orbit it was great; in contests with strictly business or financial rivals it could be great. But it was not so great that the firm could risk a pitched battle with an Insull, let us say, or a Mitchell, unless he were to tread on Morgan ground, and thus offend against the accepted principle of mutual tolerance among financiers. Only to a very moderate extent could it be exerted on behalf of a general principle of finance. It was by no means a police power. The House of Morgan was *primus inter pares* among the financial powers of the day: unquestionably *primus*, but not a dictator. There was no dictator.

A great deal has been said in these pages about the concentration of economic power into a few hands. But in essentials those few hands were mutually independent. Indeed, one of the strange things about the capitalist system in America was that, although it had undergone a revolutionary change as more and more devices were discovered and widely utilized by which the men at the top could acquire power and wealth, it was not really a system at all; not a hierarchy, but a free-for-all-insiders; not an order, but a disorder of irresponsible forces.

On certain things these men might agree and act together. They could unite, after a fashion, for the defense of their common prerogatives against radical assault. Yet broadly speaking they could not unite upon any positive economic program. Least of all could they have united upon a program which might interrupt or endanger the financial enterprises in which individuals among them were engaged. Even had any one group of men in Wall Street had the time to think steadily about the possible economic and social effects of what was going on, or the capacity to understand what these might mean to ordinary men and women, this group would have been virtually powerless to stop the mad rush toward the edge of the abyss.

3

In a vacant lot in the dreariest part of the dreary town of Cambridgeport, Massachusetts, there used to stand, many years ago, a huge bedraggled-looking signboard on which was printed the single phrase, VOICI LE CENTRE DU MONDE. What forgotten enterprise it had once advertised, few of those who saw it from the lumbering Boston-bound trolley cars had any idea. It stood there, in a dust-swept waste, as an ironical reminder of the vanity of some promoters' dreams.

There have been times in recent years when such a sign would have seemed almost as out of place in the hall of the New York Stock Exchange. Yet during the nineteen-twenties, and above all during the years 1928 and 1929, that great hall on the western side of Broad Street, just below the corner of Wall Street and just opposite the quiet Morgan fortress, was in a very real sense the center of the world.

The trading in securities, and especially in common stocks, which took place here had become the most powerful engine of American economic expansion. The enthusiasm generated here by an extravagant uprush in prices was driving financiers and industrialists forward into vast and perilous schemes for the development and control of industry and trade. We have seen it shaping the schemes of men like Insull and the Van Sweringens and Mitchell and Dillon; what it did for them it did also for hundreds of others. The money which changed hands here was flowing out into the market-places of the country and providing one of the chief stimuli to business. The theories of American prosperity which were forced in this hot-house were finding their way into the thinking of men and women all over the country—even men and women who had never owned a share of stock—and were determining more and more surely the economic temper of the land. The roar which rose here from the throats of hundreds of jostling brokers as they made their purchases and sales, and the chatter of the tickers in innumerable scattered brokers' offices, had become the leit-motifs of American life.

Nor was America the only country to feel the power of this mighty engine of inflation. Money from abroad was tempted here; the prices established here influenced prices on the European bourses; profits made here found their way to foreign countries; and as in a hundred subtle ways the New York level of security prices affected the flow of international trade, the sales made by

brokers on the paper-littered floor of this arena altered the fortunes of Zulu miners in the Rand and Malayan rubber-growers in the islands of the East.

The story of the last two feverish years of the big bull market on the Exchange—the years when it got quite out of hand—I have already told in some detail in *Only Yesterday*. But there are certain aspects of that story which deserve a passing mention here, in order that the mania for speculation in common stocks may assume its proper place in the larger story of American finance.

First let us attempt roughly to measure the astounding growth of this speculation. A reasonable measure is the number of shares of stock that changed hands year by year. Between 1910 and 1920 this number had never been higher than 312 million. Nor was this figure soon touched again, despite the fact that the Liberty Loan campaigns had provoked a new interest in investments and that the newspapers of the country were beginning to give more and more space to stock-market price-tables. During the next few years the annual trading fluctuated as follows:

1920 .... 223 million
1921 .... 171 million
1922 .... 260 million
1923 .... 237 million
1924 .... 282 million

But by 1925 Calvin Coolidge had been elected, the Florida boom was reaching its climax, stock prices were rising fast, and the momentum of trading in shares began to quicken. (In this year the Van Sweringens already had control of the Chesapeake and Ohio, the Erie, and the Pere Marquette, and were looking for more worlds to conquer; out in California, Giannini was battling with opposing California bankers for the right to expand his Bank of Italy all over the state; Insull's empire was beginning to grow by leaps and bounds.) In 1925 the number of shares which changed hands on the New York Stock Exchange jumped from 282 million to 452 million.

In 1926 it lapsed a little—to 449 million. But in 1927 it shot up once more to 576 million. And then came the years of the great madness.

It was in March, 1928, that the daily doings in that great hall at the corner of Broad and Wall Streets began to be a front-page sensation: that the rise of

Radio and General Motors became topics of furious discussion at thousands of dinner-tables; and that the record for daily trading which had been set during the Northern Pacific panic was at last broken. It was in November of this same year that Herbert Hoover defeated Al Smith for the Presidency, thus assuring the speculative community that the United States would enjoy “four years more of prosperity.” During 1928 the volume of trading climbed from 576 million to 920 million. And in 1929 it set an all-time record of 1,124 million—something like fifteen times the annual average for the war decade!

Or suppose we watch the rise in prices, another measure of the speculative boom. Here are the Standard Statistics common stock averages for the years from 1924 to 1929, expressed in terms of an index in which 100 represents the average for the year 1926:

June, 1924 .... 65.6
June, 1925 .... 85.1
June, 1926 .... 96.9
June, 1927 .... 114.

and then

June, 1928 .... 148.2
June, 1929 .... 191.

and at last

September, 1929 .... 216.1

The significance of these figures is clear. A well-diversified investment in the more substantial common stocks would have more than tripled in value in the space of scarcely more than five years. The total value of all listed stocks increased by many billions of dollars. These dollars were in a very real sense new money manufactured by the processes of the Stock Exchange. Some of them were being spent by lucky speculators, and thus were stimulating business. They were available as collateral for bank loans. To a considerable extent they were being recorded as profits by corporations, as we have seen. The whole American economy was becoming geared to the price-level which they represented. This is one reason why we may speak of the speculation on the Stock Exchange as a great engine of inflation.

But there was another reason. The bulk of these millions of purchases of

stocks at rising prices was made on margin—that is to say, mostly with borrowed money. The loans to brokers to carry customers' accounts also made a sensational rise. In the year 1922 these loans had not amounted to as much as two billion dollars. By the summer of 1926 they had risen to the very considerable total of almost three billion dollars. But that was nothing to what was to come. In 1927 they rose to nearly four and a half billion; in 1928, to nearly six and a half billions; and by September, 1929, to the incredible figure of over eight and a half billions.

Yes, but how many people were actually speculating? To Wall Street it seemed as if the whole American population were in the market, and this indeed has been the orthodox defense of the debauch of 1928 and 1929 submitted by some of the gentlemen of the Street. For example, when Richard Whitney, president of the Stock Exchange, was asked by counsel for the Senate Committee how it happened that stocks rose so high, he replied, "Ask the one hundred and twenty-three million people of the United States." The best available evidence would seem to indicate, however, that in this statement the president of the Exchange indulged in hyperbole. During the year 1929 the member firms of the Exchange had on their books a collective total of a little over half a million margin accounts. They had altogether a total of 1,371,920 customers, including those who bought stocks outright for cash. If we adopt John T. Flynn's method of arriving at an estimate, and double these figures to allow for those who did their business through non-member concerns and on other exchanges, we cannot be very far wrong. Let us say, then, that in 1929 there were probably well over a million people speculating on margin; that there were perhaps two or three million in all who were buying and selling stocks with an uneasy eye on the financial quotations, whether or not they gambled on margin; and that of course there were other investors—perhaps one or two millions of them—whose fortunes, large or small, were directly affected by what was going on in the Street, even if they had never learned to flip the evening paper open to the stock-market page. Unquestionably there were far more people speculating than ever before; unquestionably there were great numbers of clerks, stenographers, janitors, chauffeurs, and waiters in the market. Yet probably not much more than one person in a hundred in the American population was playing stocks on margin, and not much more than one person in twenty was directly affected through changes in the value of his or her possessions. The effect of

the mania on the rest of the population was great, but it was indirect—brought about by the results of economic inflation and unbalance.

In another respect the orthodox Wall Street apology fails to conform to the facts. It suggests a picture of the big men of the Street standing helplessly by while Tom, Dick, and Harry put the prices of stocks up. The actuality was quite different.

Unfortunately no such exhaustive studies of the great speculation of 1928 and 1929 were ever made as it was possible for the Senate Committee's investigators to make of the lesser speculative outburst of the spring and summer of 1933, during the first few months of the New Deal. But the figures for that latter outburst—when the money-changers were supposedly somewhat chastened—are illuminating in many ways.

They show, for one thing, that during the month of July, 1933, the total trading on the New York Stock Exchange was about 120 million shares. The members of the Exchange and their partners bought or sold nearly 65 million shares *for their own account*. In short, they were on the buying or selling side of the market in over half the transactions; or, to put it another way, they did over a quarter of the total business for themselves.

In some of the stocks which rose most sensationally in value during that brief boom in 1933, and attracted most inevitably the little shoestring speculators who throng the brokers' board-rooms during a bull market, the part which the big speculators of the Street played in the trading was much greater. One of the wildest leaps of 1933 was made by the stock of the American Commercial Alcohol Corporation, the price of which rose in a little over two months from less than 25 to over 90—and then collapsed abruptly to less than 30. The Senate Committee's study of that egregious operation shows that fifty men were on one side or the other of three-quarters of the transactions during this period; and that *a mere five men were on one side or another of more than half of them. These five men did 27 per cent of the purchasing and 27 per cent of the selling*. What is more, if one examines carefully the records of the trading, day by day, in this stock—they are set forth in detail in John T. Flynn's *Security Speculation*—one will discover that the days when the volume of trading suddenly expanded, thus drawing the eyes of quantities of little speculators to American Commercial Alcohol as a promising speculative vehicle into which to put their meagre capital, were not days when these five big speculators stood by and idly watched. On these

days they themselves were doing the bulk of the trading. And these five men were the specialist in the stock (the man who served as the Stock Exchange's referee, so to speak, between buyers and sellers); a market operator named Thomas Bragg, who was the manager of the pool; and three officers of the American Commercial Alcohol Corporation itself!

A glimpse of these five men in action—during a brief part of their sustained operation—may be instructive as showing how big operators could attract the public into the market and thus push prices up to their own profit. On June 26, 1933, the pool in American Commercial Alcohol had been at work for over six weeks. How it had obtained a supply of the stock to play with, by obtaining an option on shares which had fallen under the control of the insiders in the corporation, and how it had already pushed up the price considerably and then had sold a good deal of its stock while the price held steady, we need not recount in detail. Let us see what happened on June 26 and the succeeding days.

On June 26, 1933, the five speculators bought 14,200 shares and sold 12,800. (The total volume of trading in the stock that day was 31,900 shares.) This sudden burst of activity in American Commercial Alcohol, after a period of comparative quiet, brought the outside speculative public in with a rush. There always seem to be hundreds of traders at such times standing ready to buy a stock that is moving upward and appearing constantly on the ticker tape; speculative operators count upon such traders in their plans. And the fact that the five men on the inside bought more stock than they sold helped to put the price up: it went up two or three points. The next day these five men were a little less active, and they sold 800 more shares than they bought (purchases, 11,-100; sales, 11, 900), but with the public swarming in, the price nevertheless went up again, several points. (The total volume of trading was larger than on the preceding day: 49,200 shares.) So far, so good. The little outsiders were now eager; wild expectations inflamed them; a lot more of them, anxious to get aboard the bandwagon before it was too late, decided to buy—and the five men on the inside were ready to sell to them. On the 28th of June the volume of trading rose again to 52,300 shares, the biggest figure of this movement; the volume was so large, in fact, that it effectively masked the fact that although the five men bought 10,500 shares, they also sold many more, they sold 14,400 shares. And the price hardly sagged at all, so gladly did Tom, Dick, and Harry buy. During these three days the price of

American Commercial Alcohol had risen several points, the outsiders had come in in large numbers to buy, and the five men at the center of things had actually succeeded in selling, at these rising prices, 3300 more shares than they had bought! That is how pools make money by coaxing in the general public.

This American Commercial Alcohol pool offers in some respects, it is true, a somewhat extreme example of manipulation of prices by insiders, including insiders who are officers of the companies whose stock is being taken for a ride; but it is not unreasonable to suppose that there must have been dozens of such pools during the wild years of 1928 and 1929. And it is certainly safe to say that a large proportion of the pools were carried on with the aid of corporation officers, directors, or other large stockholders.

A few scattered operations during these years have been investigated in detail sufficient to show us the corporate insiders at work. Let us look at one or two of them.

In 1928 there was a pool operation in the stock of the Sinclair Consolidated Oil Corporation. The manager of this operation was Arthur W. Cutten, one of the wiliest of the professional speculators. The participants included among others the Chase Securities Corporation (the affiliate of the Chase National Bank); one of Albert H. Wiggin's private corporations, the Shermar Corporation; Harry F. Sinclair of Teapot Dome fame, who was the head of the Sinclair Consolidated Oil Corporation itself; and several other officers and directors of this corporation. The total profits of the operation were nearly thirteen million dollars; in these profits, the share of the officers, directors, and large stockholders of the Sinclair concern amounted to more than two and a half millions. It is hardly necessary to remind the reader that these profits in large degree were made by buying stock from, and selling stock to, stockholders (old or new) of whom these insiders were ostensibly the servants.

Perhaps the most spectacular of all the advances made by individual stocks during the big bull market was that of the stock of the Radio Corporation of America. At the time when this market entered upon its final eighteen-month period of frenzy the quotation for Radio was $94 a share (this was on March 3, 1928); at one time during 1929 it got as high as $549 a share. This amazing advance did not come about without the active intervention of insiders. Of one phase of this advance we have precise knowledge. A syndicate which

operated in the stock during a period of scarcely more than a week in March, 1929, made a net profit of over four million, nine hundred thousand dollars. This syndicate bought and sold most of its stock through the brokerage firm of M. J. Meehan & Company. The specialist in Radio stock was a member of that firm. And among the participants in the syndicate—along with Percy A. Rockefeller, Walter P. Chrysler, John J. Raskob, William C. Durant, and other men potent in the Wall Street of the day—was Mrs. David Sarnoff, wife of the president of this very Radio Corporation.

Among the participants in a pool in General Asphalt stock in 1929 was Horatio G. Lloyd, chairman of the executive committee of the company (and also a Morgan partner). Among the participants in a pool in Underwood-Elliott-Fisher stock in 1929 was one of the private corporations of Albert H. Wiggin, then a director of the company. When we add to these scattered examples those of which we have already caught a glimpse—Insull selling shares of Insull Utility Investments at thirty dollars a share which he had been assigned at $7.52 a share, at a time when he was the sole owner of the stock of this concern; Wiggin's private corporations making over ten million dollars in the shares of the bank of which he was the head; Mitchell joining with officers of the Anaconda Copper Company in a pool operation in copper stocks; and Dillon, Read & Co. arranging with a firm of brokers to distribute blocks of the shares of United States and Foreign Securities which men associated with the firm had so inexpensively acquired—we need be under no illusion that throughout this whole bull market there were not large numbers of insiders pumping up values, thereby adding to the speculative frenzy, and profiting hugely in the process. The public came in eagerly, it is true, but they came in at the urgent and adroitly contrived invitation of Wall Street. The Stock Exchange was a private association; during those years it might well have been called the Association for Improving the Condition of the Rich.

Nor should we overlook the part which leading American corporations played in the orgy by lending money from their surpluses to brokers to carry speculative loans. To give but a few examples: during the year 1929 the average amount which the Standard Oil Company of New Jersey had outstanding in call loans was about sixty-nine million dollars; the Electric Bond & Share Company and its subsidiaries, one hundred million dollars; the Sinclair Consolidated Oil Corporation, twelve and a half million dollars. At one time the outstanding loans by the Cities Service Company reached more

than forty-nine million dollars. More than half of the colossal increase in loans to brokers consisted of loans like these from corporate treasuries. The interest rates were high and so the corporations took advantage of them—that was all. What was done with the money was apparently not their affair. The episode was an interesting example of self-rule by business.

If it is preposterous to regard a bull market so stimulated and so financed as the product of the spontaneous speculative madness of the entire American population, it is also, of course, almost equally preposterous to imagine, as some radical writers have done, that the big financiers and industrialists pocketed their profits and stood aside in the autumn of 1929, leaving the dear public to its doom. To suppose that this happened is to miss the crowning irony of the whole adventure. The truth is that for so many long months had pool operators unloaded their holdings and then shortly seen the stocks in which they had operated go roaring up again, either because new pools had stepped in or because the public had taken the bit in its teeth; so wild and unprecedented had the whole advance become, so persuasive was the doctrine that America was entering a new era in which none of the old rules for determining value were any longer applicable, and so thoroughly had the darlings of speculative fortune lost their heads, that when the month of October, 1929, arrived, most of them went over the edge of Niagara with their victims. They succumbed to the fate of propagandists who in the end come to believe all too fully their own propaganda.

During the boom there were, to be sure, voices raised in protest and warning—voices like Paul Warburg's, or that of Alexander Dana Noyes of the *New York Times*, or that of the staid *Commercial and Financial Chronicle*, which on January 5, 1929, said flatly that the huge increase in brokers' loans constituted a "menace to the entire community" and added that it was "a public duty for anyone in authority, or having influence and weight, to speak in unsparing terms in denunciation of what was going on." The Federal Reserve Banks tried to stem the flood in 1928 by making three successive increases in the rediscount rate; early in 1929 the Federal Reserve Board tried by direct pressure upon the member banks to prevent them from using Federal Reserve credit for loans for speculative purposes; and subsequently the Federal Reserve Bank of New York sought repeatedly to raise its rediscount rate still higher, though it was prevented from doing so by the Board in Washington, which preferred to rely upon the method of direct

pressure and was moreover divided in opinion as to what to do. But these somewhat spasmodic efforts on the part of the various Reserve authorities were of little avail; the weapons at their disposal were ill-adapted for dealing with such a situation. As for those who had most "influence and weight" in the Street, the House of Morgan appeared to be otherwise occupied—in planning to launch the Alleghany Corporation and United Corporation. As for "those in authority" in the Administration at Washington (aside from the Reserve Board), President Coolidge and his multimillionaire Secretary of the Treasury had for some years past been giving intermittent aid and comfort to the bull party in the market by uttering soothing words when stocks showed signs of sagging; the President had once, in the early days of 1928, gone so far as to state publicly that he did not consider brokers' loans too high; and the nearest that Andrew W. Mellon ever came to that "unsparing denunciation" which had been urged by the editor of the *Commercial and Financial Chronicle* was to say very mildly that it was an opportune time for the prudent investor to buy bonds.

Meanwhile a host of prophets of the new economic era were shouting their fatuous proclamations of hope. They upbraided the Reserve Board for its attempts to interfere with the constructive forces of business. They defended speculation on the ground that the great men of all time had been adventurous, that Columbus, the American Revolutionists, and the pioneers of the West had been in heavy bondage to speculative fortune, and even that "Christ himself took a chance." So altered, indeed, was the whole economic atmosphere, that many distinguished and hitherto conservative economists were persuaded that a New Era had indeed begun.

And so the tickers chattered throughout the land, and the prices leaped and fell back and leaped yet higher, and the big manipulators pushed up this stock and that, and the little speculators ventured in and got something for almost nothing and bought new radios and new cars with a part of their winnings and staked the rest on new ventures, bigger and bigger ventures, and wherever there were men and women with invested capital the talk was of stocks, stocks, stocks, and the summer of 1929 came and went with prices soaring higher and higher, and it seemed as if the great advance had only just begun.

What shall we say of this wild bull market?

First, that for most of those engaged in it, it was a gamble pure and simple —if not, indeed, something much less pure and simple: a gamble in which

some of the players had the inside knowledge and the financial power to determine the immediate outcome.

Second, that the economic justification offered for it by some of the apostles of the new era was fantastic. The current argument was that as the shares of successful companies became more and more widely distributed, the country would approach a condition in which everybody would prosper by holding stock, receiving dividends from it, and enjoying its appreciation in value. In so far as this argument dealt with income from dividends, it implied that the population could become prosperous by living on a sum of money which represented the difference between what they paid for goods and what they were paid for making them. In so far as it dealt with income from appreciation, it implied that during these years the population would live upon money which represented the expectation of such a difference in the nineteen-thirties: that, in effect, they would borrow and spend at once what they hoped that the nineteen-thirties would produce.

In the third place, the boom was not by any means an isolated phenomenon, apart from the general financial tendencies of the day. It was merely the most spectacular manifestation of those tendencies; of the spirit of some-thing-for-nothing with which innumerable financiers and business men had become imbued.

Finally, this gamble drew into the stock market over eight and a half billion dollars of credit, introduced inflated values everywhere into bank portfolios and corporate financing, built up preposterous claims upon the profit-making powers of business concerns, invited unsound industrial expansion, and in these and other ways added to the increasing instability of the American economy. Harshly as one may justly comment upon the treachery of corporation officers who gambled in their own stocks at the expense of their stockholders, and upon the timidity or irresponsibility of supposed business and financial leaders who let the madness go on without lifting a hand to stop it, the morals of the big bull market were unimportant compared with its economic effects. The sublimest folly of those days was the often-expressed belief that the speculative gamble was after all an unimportant affair—that if it were to end in a shakeout, a few speculators would lose their shirts and this would be the sum of the damage. Never were words spoken which betrayed a more tragic incompetence to understand what such collective frenzy must precipitate.