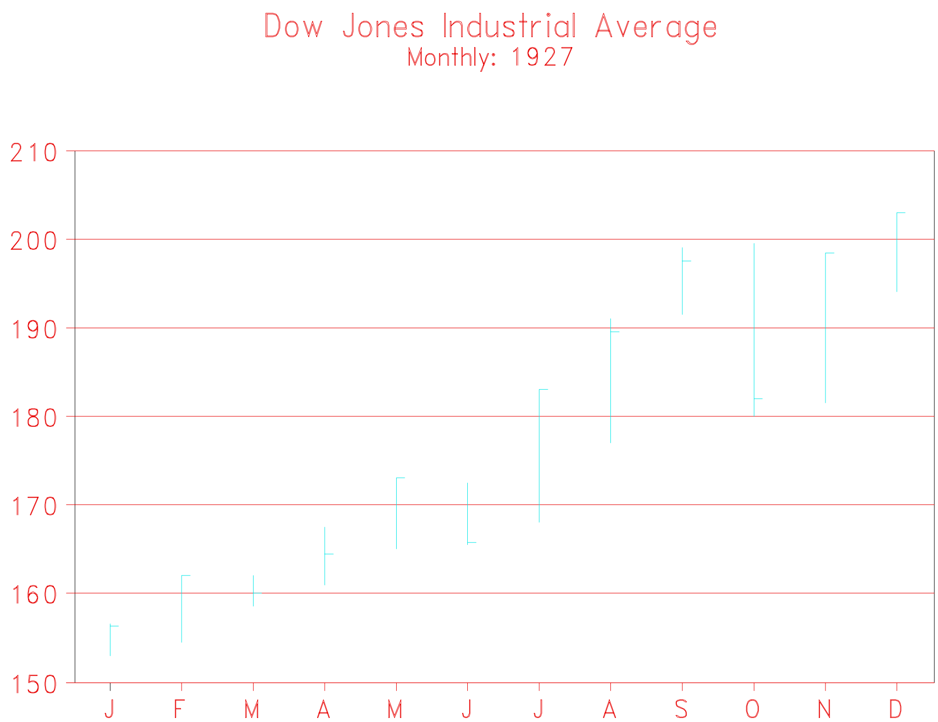
Chapter VII

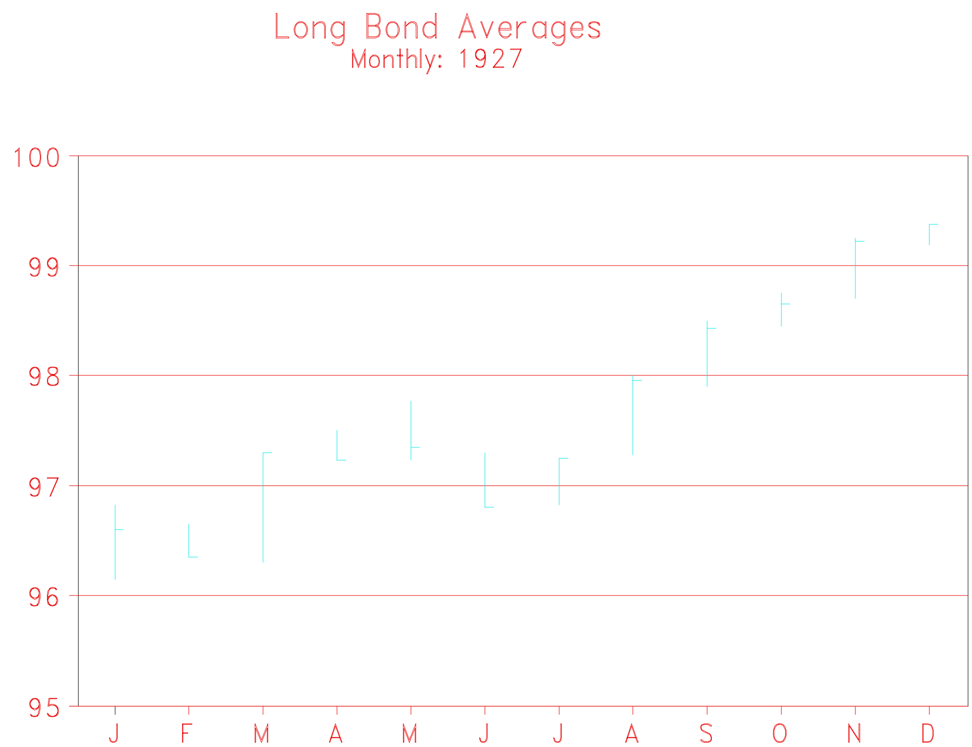
1927



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%.

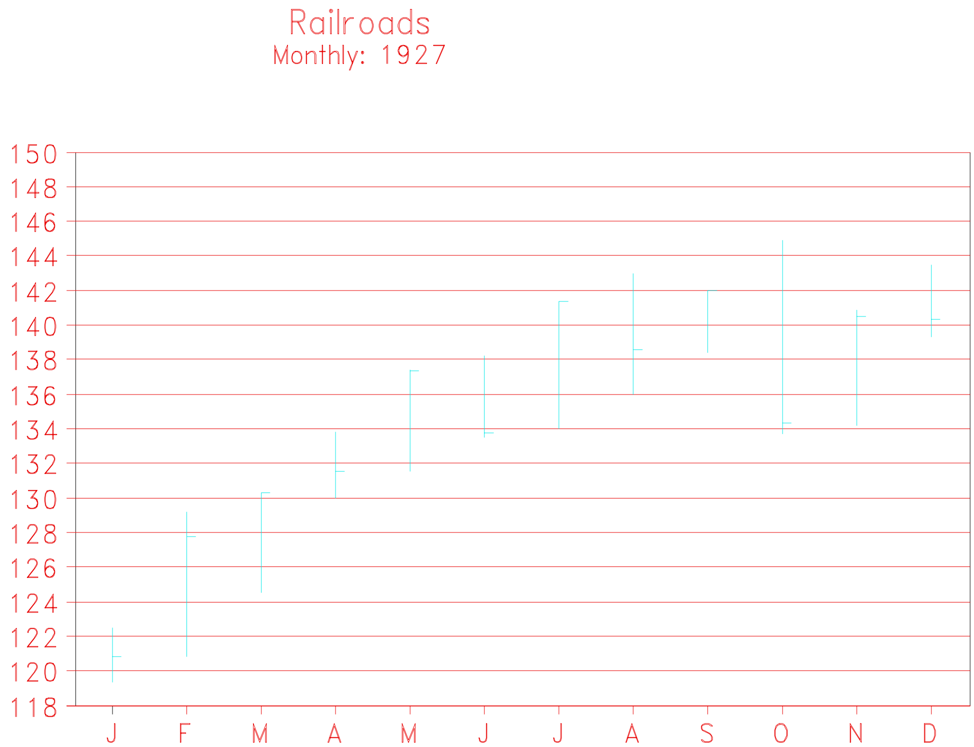
The Industrials rallied quite nicely during April, reaching new record highs once again. This was largely due to the fact that $500 million was paid out in dividends during April among 500 U.S. corporations for the first quarter of 1927. The largest of all dividend payments was noted by Time magazine, 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-

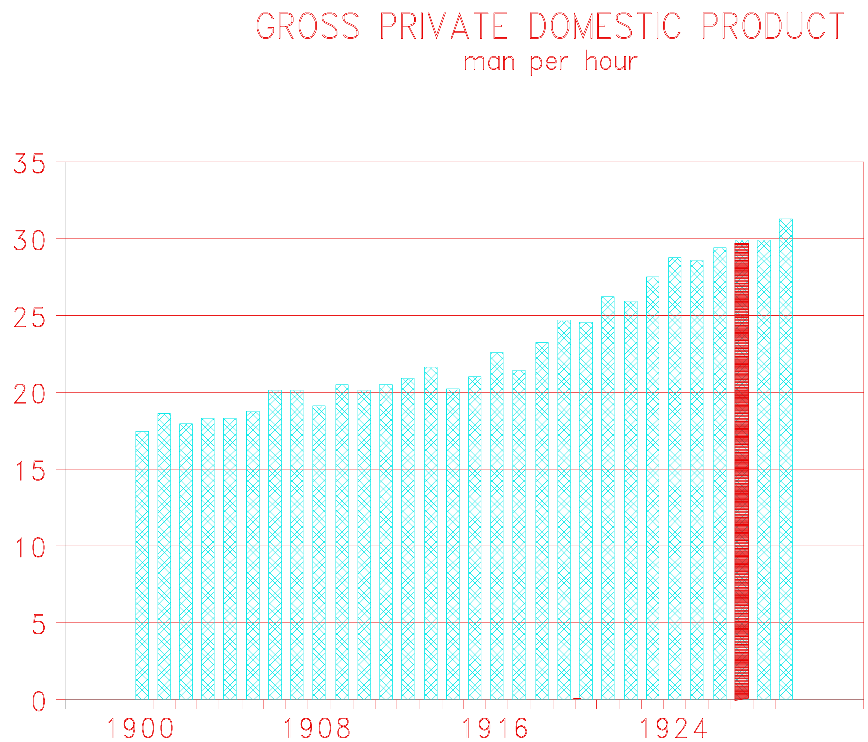


lion. The taxes levied were $2.5 billion and the national deficit on the local level was $400 million. Only 44 cities out of 247 had collected enough in taxes to meet obligations. Many local governments continued to waste money and raised necessary funds through new bond issues. Many of these issues 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.

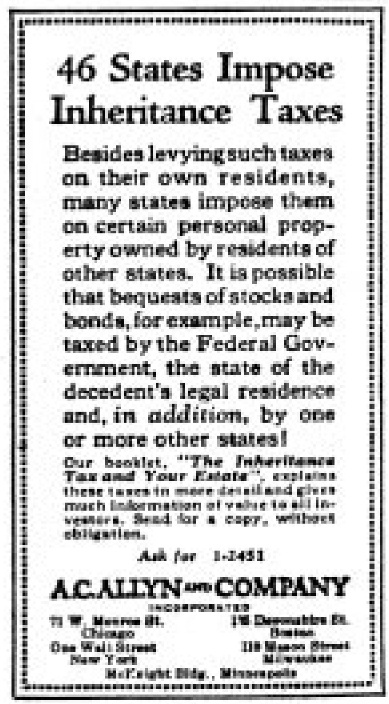
This wave, in our analytical terminology, was a wave of "private confidence." Money flowed from overseas into the U.S. stock market largely because it was a safe haven from declining or unstable currencies in Europe where an atmosphere of distrust existed toward government itself. Money rates remained 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."

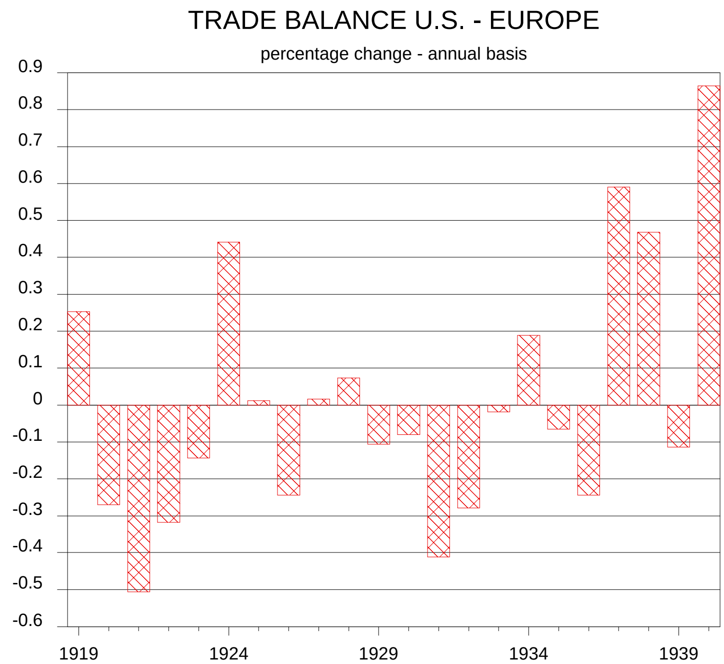
The actions of the State of New York to tax not only on current earnings, but on the future ability to make profits, is not unique. Every state as well as the Federal government has at one time or another attempted to collect taxes in an unethical manner, making a total mockery of the Constitution and 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.

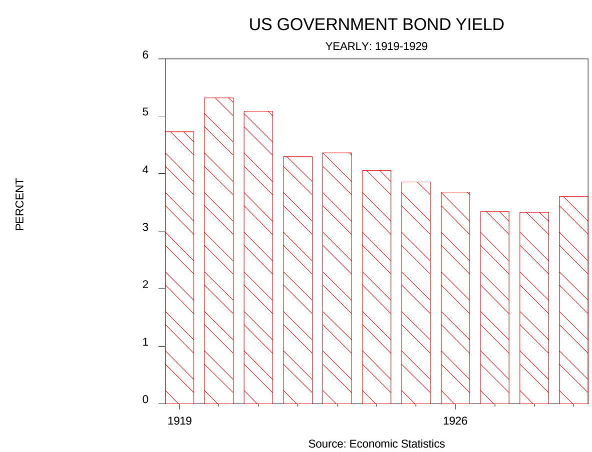
As September came rolling around, the Dow Industrials soared once again, this time nearly reaching the 200 level. The papers were filled with the raging war between America's Standard oil and Britain's Royal Dutch-Shell. The one curious power play the Russians did use against Britain for bouncing their 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.

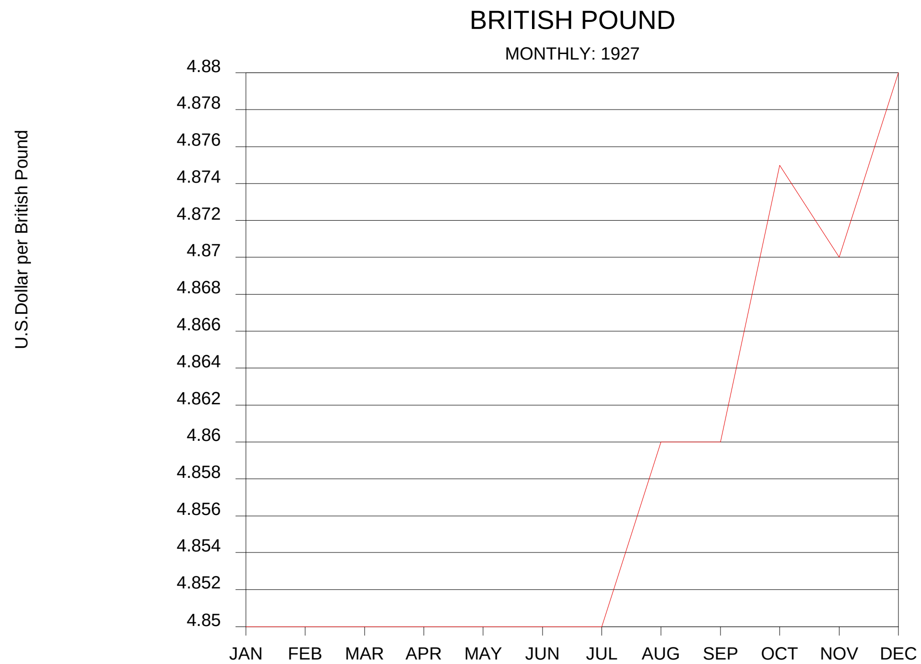
In the midst of all this, commodities were not exactly making new highs. Many farmers were suffering from low prices. In August, the Kansas City Federal Reserve Bank lowered its discount rate from 4% to 3.5%. This left the remaining 11 Federal Reserve branches all fixed at 4%. But within two weeks thereafter, 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.

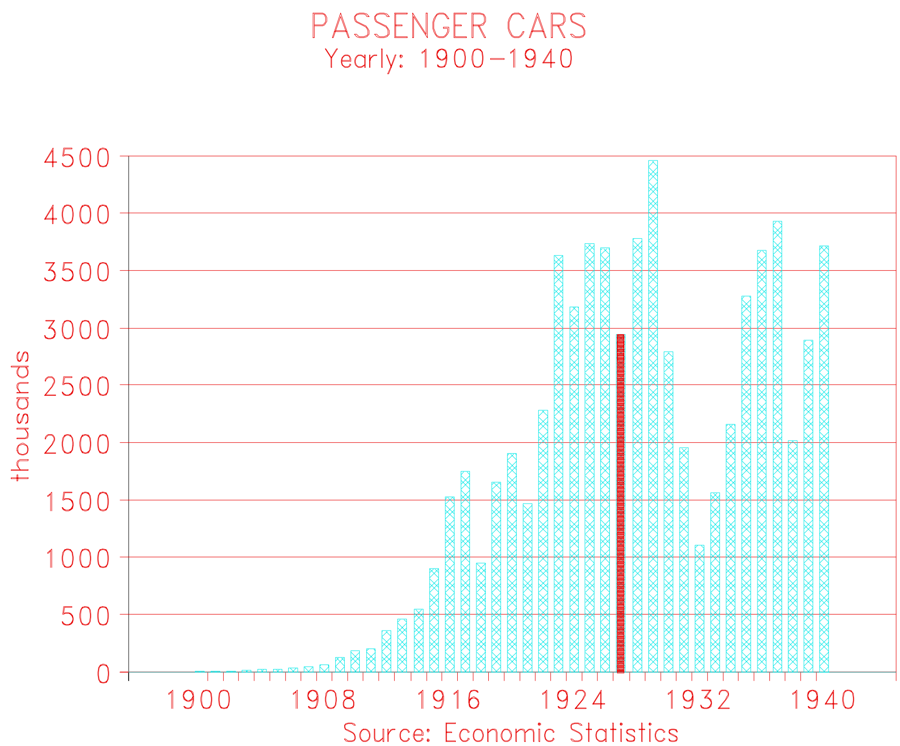
The chairman or Governor of the Federal Reserve Board in Washington was Daniel Richard Crissinger. His response to the press's allegations of what was really taking place was short and brief: "The Federal Reserve Board established the rate of 3.5% for sound reasons. That is all there is to it." The Chicago 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.

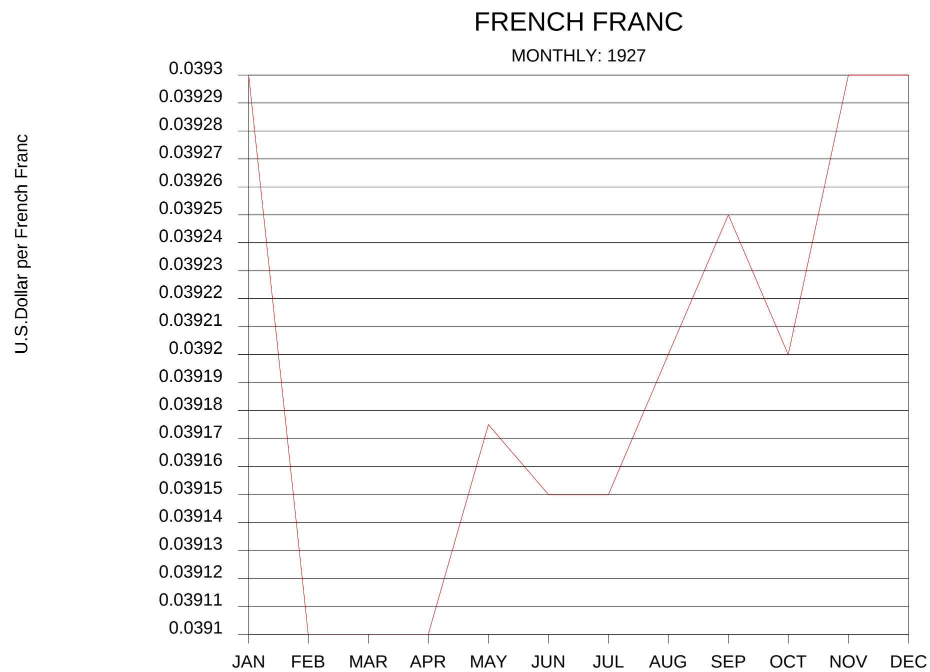
When the press turned its attention to the outstanding foreign loans, the market became nervous indeed. After all. there were 255 foreign bond issues on the New York Stock Exchange floating around with a value of $4,650,000,000. And in addition, the exchange had just approved foreign stock issues for 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



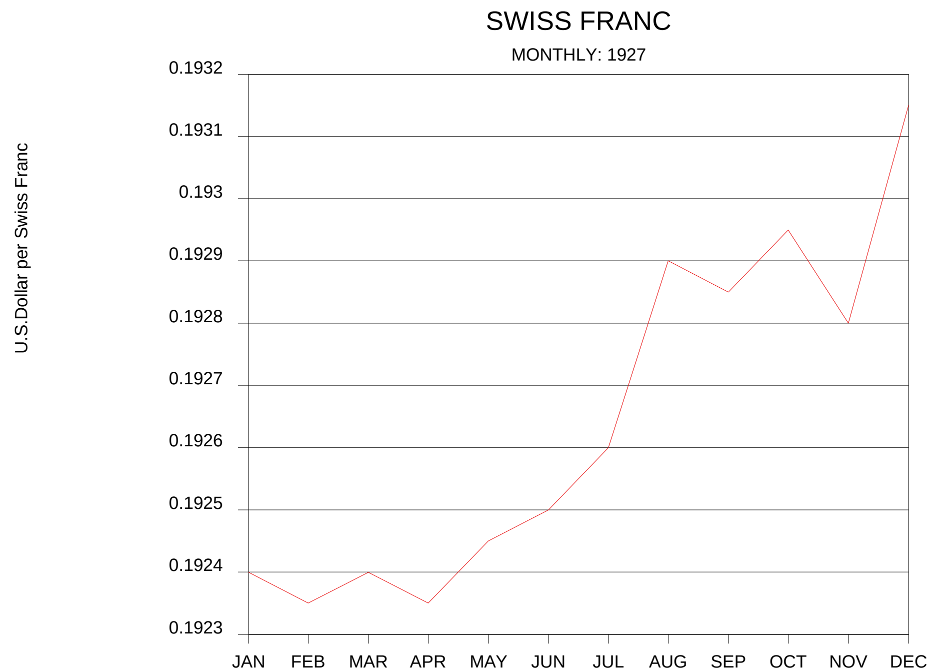
from the U.S. in ever increasing amounts to form monopolies and then fix the prices, for which any American firm would have been thrown into jail, the trade war could only be expected to become worse in the years ahead. Once again, government's lack of foresight and refusal to relinquish power once seized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

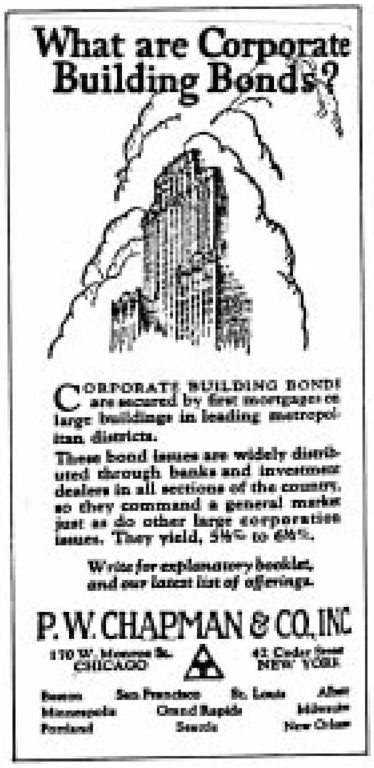


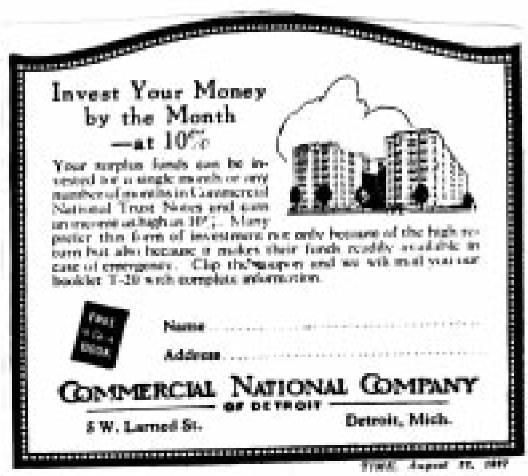
any foreign nation from selling their bonds in the U.S. unless they had reached an agreement with the U.S. government to repay any official loans outstanding from the War.

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.



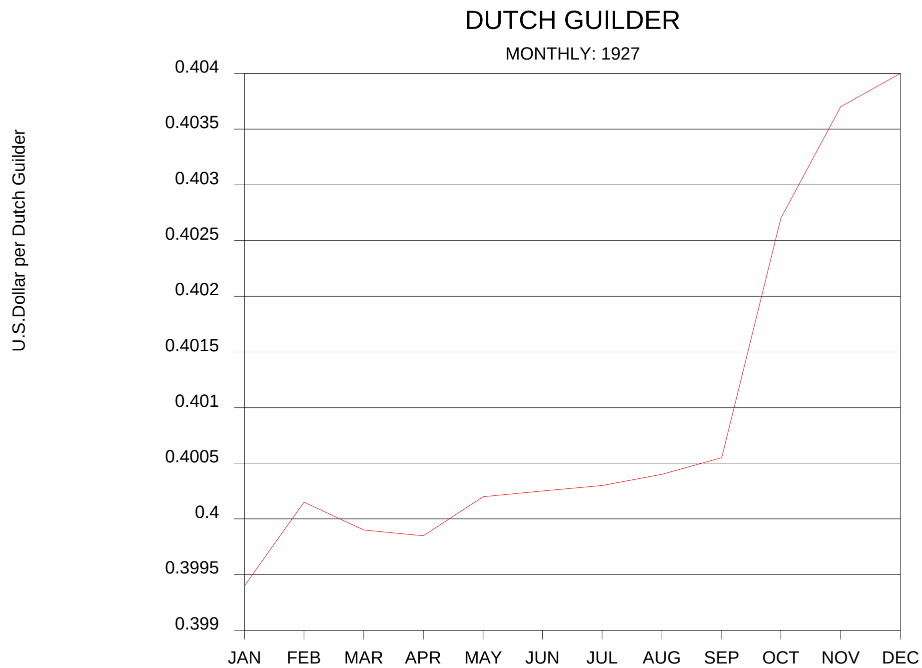


There can be no doubt that the banks were willing lenders to foreign nations as well as private companies. The primary reason was that foreign loans traditionally paid a minimum of 2% over that of domestic U.S. loans. Thus, the Central Bank intervention sought to lower the dollar and strengthen the European 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%.

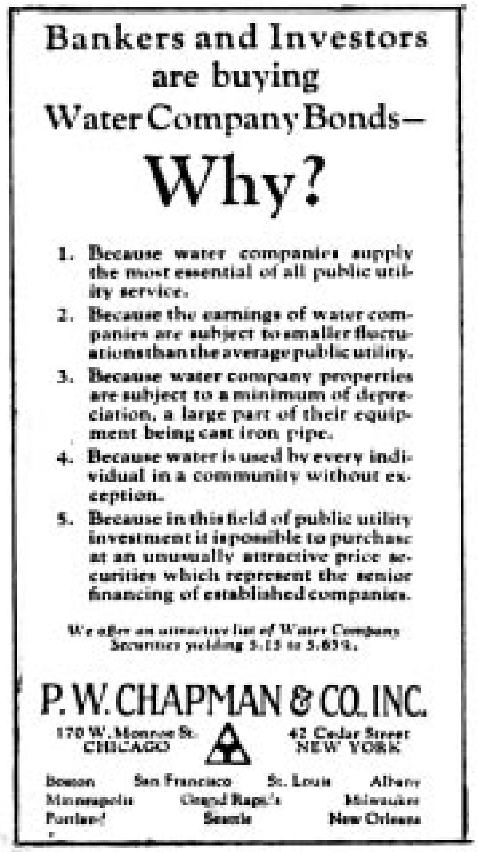
There were numerous other foreign offerings from Berlin, Hanover, Saxony, Prussia, Baden, Munich, Bresiau, Frankfurt, Hamburg, Chemnitz, Lepzig, Mannheim, Essen, Dusseldorf and Hagen, many of which would never be repaid.

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:

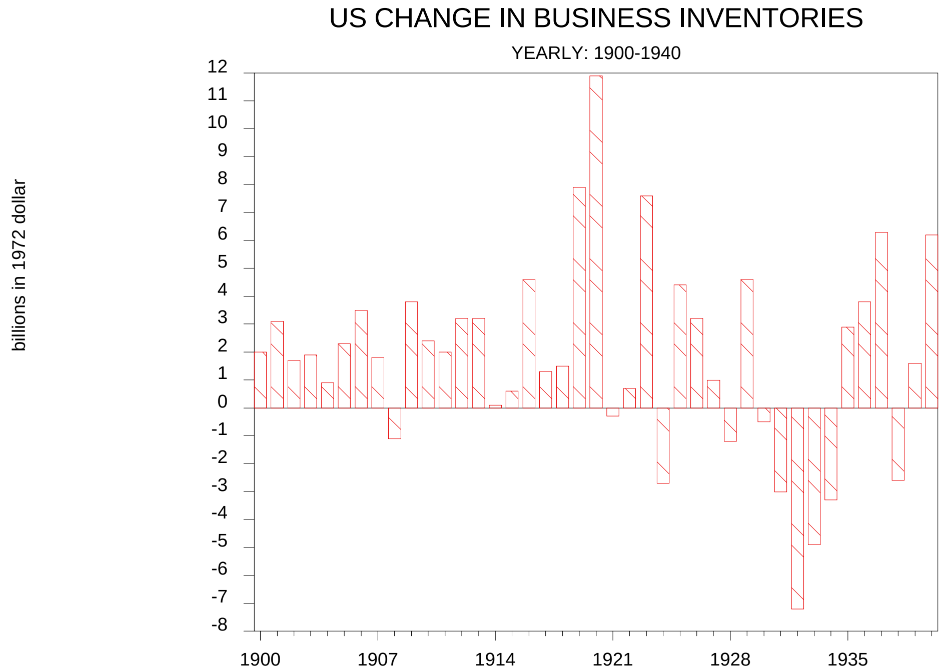
"The stock market last weak registered one of the most exciting periods in its history. Prices of time-tried shares, long leaders in what has become known as the Coolidge market were slashed unmercifully by the short interests, marking a decline on the exchange that reflected the country wide depression 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

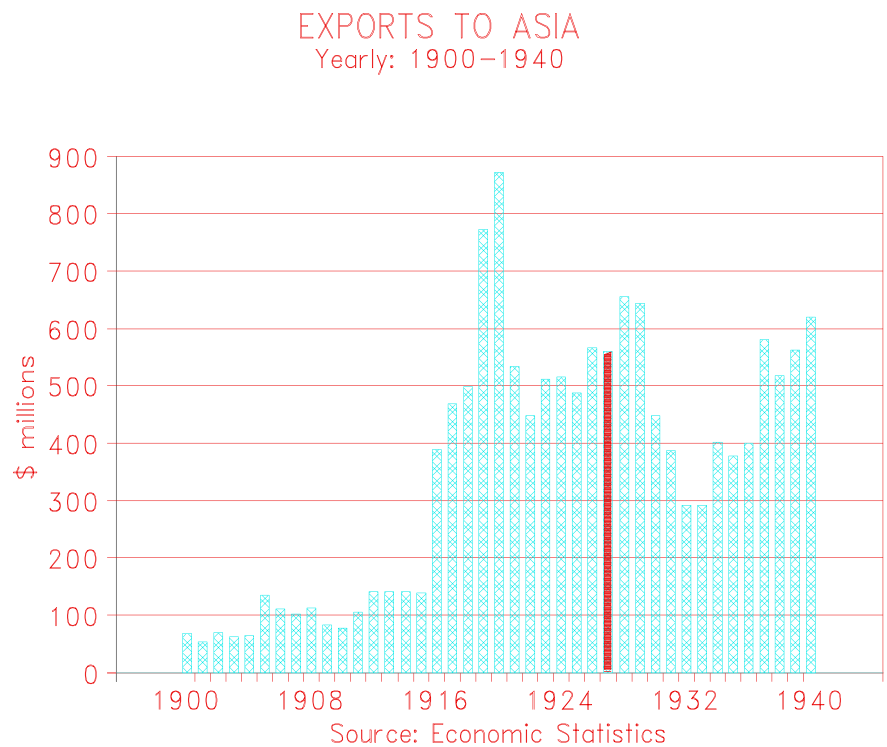
February 4 1927 which had totalled $303 million.

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

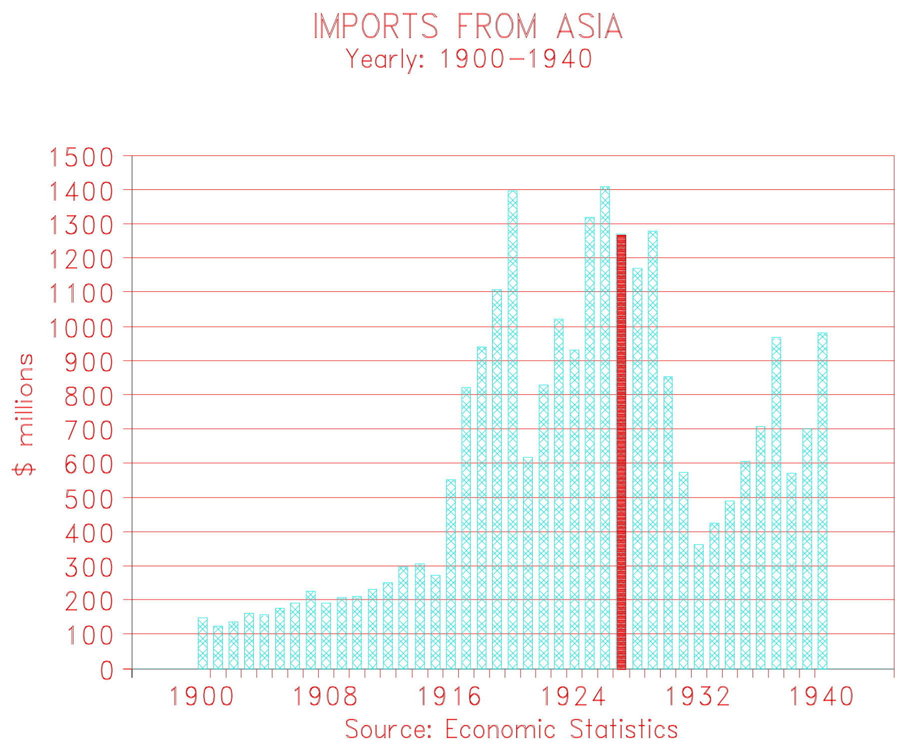


would pay a bonus dividend of $2.50 per share. This meant that on the outstanding 17.4 million shares G.M. was paying a record $62,250,000 in dividends. This set a record for the largest dividend ever paid at one time by any industrial company. G.M.'s earnings up to the end of the third quarter were $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.