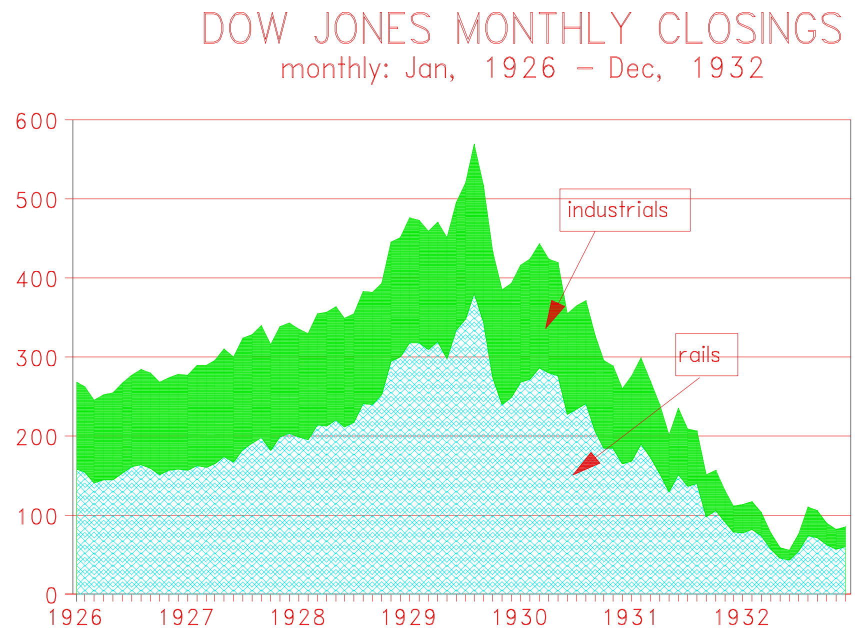
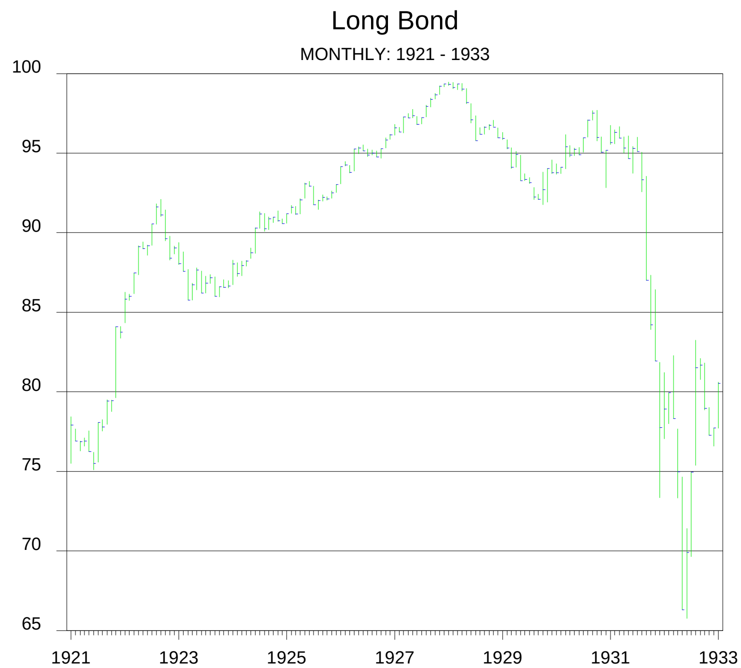
As 1931 began, the effects of the depression were beginning to show more broadly throughout the world. In the New York Telegraph a small classified ad had appeared in January: Rolls-Royce. Must sell; will consider Ford trade. Garage, 1210 2nd Ave." The downturn in the economy was unquestionably emotional for many. Time magazine reported in January on the fate of one Robert German, steelworker residing in Berlin, Germany. Mr. German had finished his shift for the day after Christmas and went home. He then put on his best suit, fully adorned with an elegant, shiny top hat. It was going to be an unusual occasion at which Mr. German wanted to look his very best. He returned to the steel mill and chatted with the foreman along side the cauldron of bubbling 2786 degree molten iron. Mr. German wanted to look his very best so that he might depart from the world in style. After a brief conversation, Robert German suddenly dove head first into the molten iron. The foreman shut down the furnace immediately and searched without success. Not a trace could be found of his former friend. The toll on the emotions of people was not confined to merely the United States.



In the financial world, many eyes were trained not so much upon the investment trusts, but upon the life insurance institutions. This new giant among financiers was a mere new kid on the block when the bull market had begun from the depths of depression in 1921. The life insurance industry had prospered well during several bull markets since the turn of the century, thanks to an aggressive advertising campaign which in reality twisted a few words around. What one was buying was not insurance against the threat of living, but against the threat of a premature death. After all, if one bought insurance against the potential threat of fire destroying your house, it was called "fire insurance." But the salesmanship of advertising prevailed. Few people would like to buy insurance that was called "death insurance." It would be rather like having an undertaker come knock on your door to show you his latest selection of caskets. So instead of calling it "death insurance," they switched the words around and called it "life insurance."

The advertising campaigns had paid off. By the end of 1930, the life insurance indus-



try controlled nearly $19 billion dollars in investments which had doubled since 1923 alone. This vast sum of money had made the insurance industry a major player in all aspects of the financial marketplace. This sum represented nearly three times the amount of funds in the call money market. Of their nearly $19 billion in assets, 40.3% was invested in real estate mortgages. Next in line was a 37.6% investment in stocks and bonds of corporate America and 7% was invested in U.S. and foreign government bonds of federal and local issue. Some shifts within their investment portfolios had been noted. Railroad securities had accounted for only 17% of the total investments at the beginning of 1931 as compared to 35% in 1906 just before the Panic of 1907 when the railroads led the way down. Public utilities had risen to 9.4% in 1930 compared to 8.9% in 1929, demonstrating that sentiment at the time viewed the utilities as a more conservative stock investment. The trend within the shifting assets of the life insurance industry's portfolio was indicative of the nationwide investment trend.

Any time someone loses money in speculation, they always seek to pin the blame on someone. Never do they tend to point at themselves. Such was the case as the stock market continued to decline. Money managers were chastised when in reality, bonds, stocks, diamonds, furs, commodities and real estate offered nothing but devastating losses. The witch hunts of the Great Depression were merely in their infancy. The cries of many to punish someone, anyone for their losses were indeed numerous. It became common to talk of huge bears who were in control of the market, squeezing the very life blood from the market drop by drop.

One such early victim was a young broker, 32 at the time, named John W. Pope. He was reported to have been a soft-spoken chap, quite independent and a student of values. He firmly believed that stocks always sought their values - up or down, he added. John was accused of forcing Fox Films down, and it was alleged that if he had not been short the stock would not have plummeted as far. The New York Stock Exchange summoned the young fellow before their board of governors. They interrogated him in a way that Time magazine called a "harrowing trial by statistics." John W. Pope pulled out his charts and his studies of Fox Films and demonstrated that the stock had been seriously overvalued in comparison to historical measurements. The board found no malicious reports of rumours started by Pope, and his documentation as to why Fox Films had been overvalued won the day. He was completely exonerated, but this would be a dangerous trend that eventually led to the witch hunts of the 1930s.

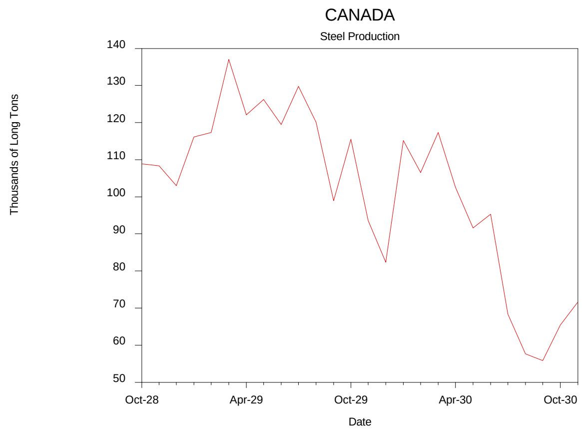
Another such man who had been hung out to dry was the infamous Charles Ponzi. That's right, the originator of the "Ponzi Scheme." As 1931 began, the creditors of his scheme were at least mailed their checks, which represented .5% of their original investment that had been made prior to his arrest in 1920. Ponzi was called the "duper extraordinaire," and "master and personification of the quick buck."

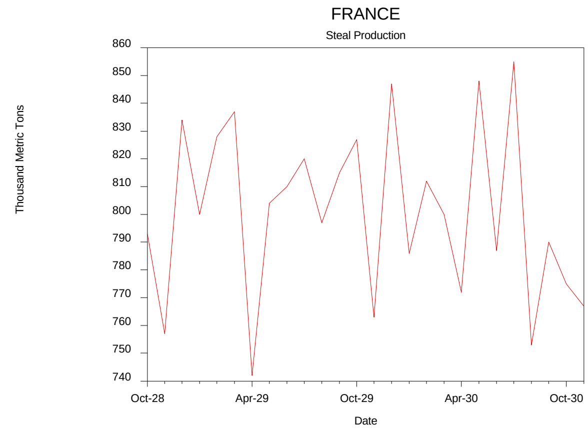
Back in 1920, Ponzi was viewed as the shrewd miracle man of Boston's Hanover Street district. Ponzi had promised his clients a 50% profit in 45 days. At times the crowds that were fighting in line in front of his office had to be controlled by police. On busy days, it took 14 policemen to keep the crowds in order. His famous scheme was to buy postal reply coupons in countries where foreign currencies had depreciated against the dollar. Under postal agreements, one could buy a reply coupon and send it to a friend, who in turn could take that coupon and redeem it for U.S. postage equivalent on a fixed basis to pay for the "reply." The scheme had its many critics who at least admitted that it was possible to profit in such a way, but they questioned whether or not one could make as much on the idea as Ponzi had claimed. In essence, Ponzi was

Charles Ponzi

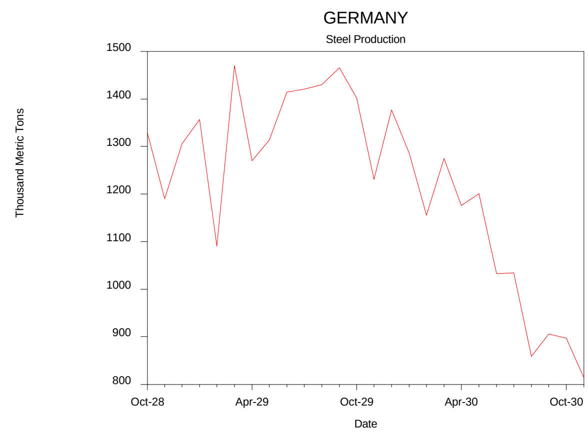
taking money from the second customer and handing it to the first, thereby creating satisfied customers to go around and honestly brag about how much they had made. But sooner or later, cash flow cannot keep up with the payments and hence the scheme folded. In its wake, bank runs had been created and several of Boston's trust companies had failed. Ponzi was eligible for parole in 1931.

Back on the more serious side of the times, economists remained in heated debate as to the causes of the deepening depression throughout the world. Even Benito Mussolini had come out blaming the depression on the U.S. collapse in the stock market. Others argued that the cause was sparked by overproduction, while others rebuffed this charge and claimed that it was the other way around. Still others blamed the overproduction on too much competition. They argued that small competitors could not afford to restrict output and that led to price cutting. Still others blamed the various pools and cartels. The Canadian Wheat Pool had been in opera-

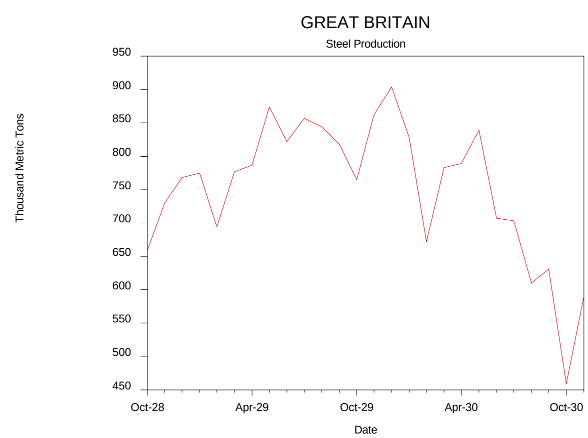




tion since 1924 and it had attempted to control world prices, but failed. Even Hoover's Federal Farm Board had attempted to peg prices, but ended up buying huge surpluses with no way of disposing of the grain.



In the oil industry, many blamed the anti-trust laws for putting the fear of God into the industry as a whole, leaving it wide open to many small producers who waged price wars to gain their share of the business while the giants were barred from merging. The European Steel Cartel had renewed itself at the end of 1930. U.S. steel producers had at least united to try to battle the Europeans rather than themselves, but still no direct mergers were allowed among the big producers. But anti-trust laws actually prohibited price agreements among the U.S. producers, and hence things were done off-the-cuff so to speak.



In copper, the formation of the Copper Exporters, Inc. in 1926 attempted to fix the price of copper in Europe. The American producers in this industry appeared to have some sort of gentlemen's agreement trying to ward off price cutting. But again this was done at the risk of the anti-trust laws. By 1931, copper producers were attempting to curtail production in an effort to hold the price. Copper had rallied from 9 cents to 12 cents back in November 1930. But as 1931 began, copper had drifted back down to 10 cents. Threats now loomed on the horizon of new discoveries in Africa, which would soon overshadow any curtailment on the part of the Western producers.

The tin market was also approaching the crisis level. The tin producers met in London during December 1930, but no agreement could be reached to curtail production. The battle between Bolivia and the Far East could not be brought under control. The improvement of new machinery in the Far East had raised the productive capability and they were determined to take full advantage of the situation.

Silver's perils were endless. Irving Trust in New York blamed Britain for the demise of the silver market by taking India off a silver standard and moving onto a gold standard. Thus, substantial selling of silver on the part of India prevailed.

The rubber market wasn't much better. Back in 1922, the British Empire passed the Stevenson Act which restricted the exportation of rubber from the British colonies. Despite the fact that this measure helped check an overproduction at the time, the Dutch merely continued to increase their production over the years, taking full advantage of the British measures which attempted to curtail the decline in rubber prices during the "deflationary" years of 1920-1922. During the boom, the British repealed the restrictions in 1928. Due to the lack of cooperation on the part of the Dutch during the 1920s, restrictions were not restored and overproduction was not checked during this decline in rubber prices.

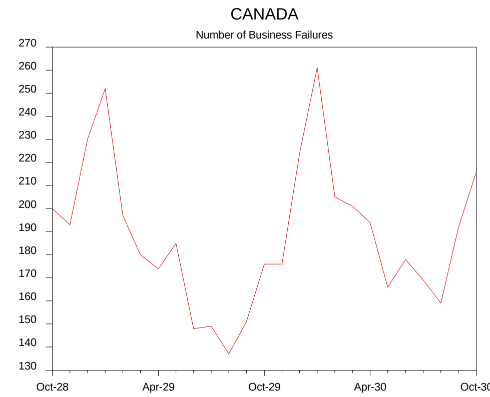
Of all the markets in which cartels had been formed, perhaps none was as powerful as those in the rayon industry. Here, power resided within a small group which controlled 80% of all production. But worldwide demand for commodities including rayon proved to be the all-powerful guiding force. The Rayon Cartel met in London during December 1930 and it too ended in bitter conflict with producers failing to reach an agreement to curtail production. Prices were falling as well as demand, and economic pressure prevented an agreement to stabilize prices.

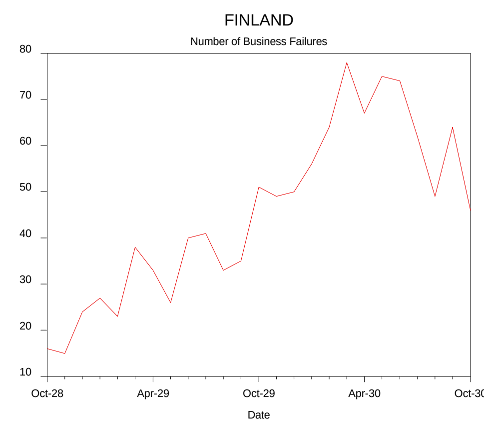
The overproduction was virtually universal throughout many industries. This was the state of affairs that had greeted the commodity producers as 1931 followed the dismal scene left in the aftermath of 1930. It was here that many economists chose to rest the blame for the depression. But we must ask ourselves an important question. Was it merely overproduction that forced prices lower? Obviously a sharp decline in demand had to account for part of the blame. What was it that cracked the confidence of capital? Surely there were many parallels with those of depressions that had been severe during the preceding era.

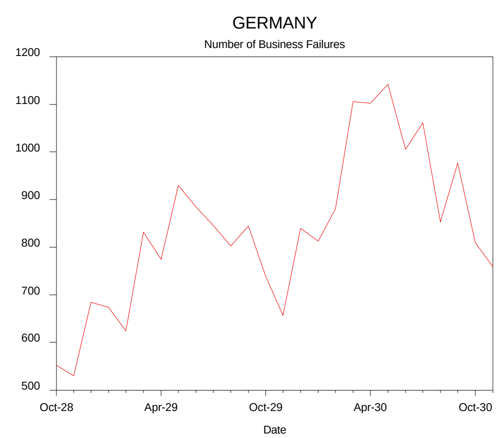
Before a special session of Congress on August 8, 1893, and in the midst of the famous panic of that same year, President Cleveland stood tall and delivered the following words:

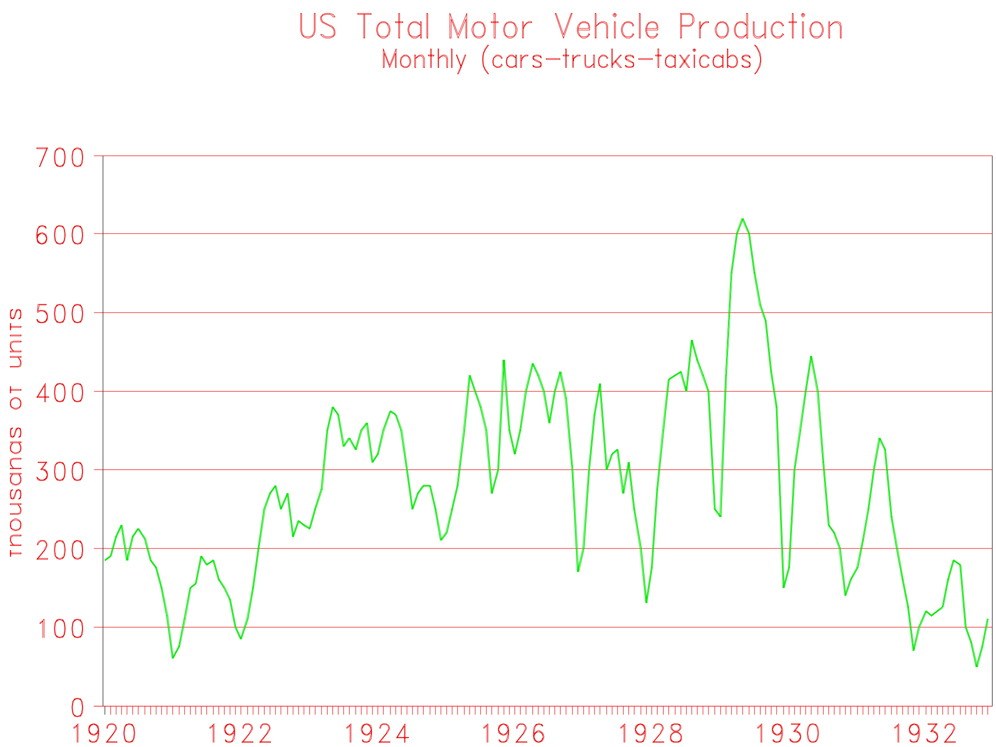
"At times like the present, when the evils of unsound finance threaten us, the speculator may anticipate a harvest gathered from the misfortune of others, the capitalist may protect himself by hoarding or may even find profit in the fluctuations of values; but the wage earner - the first to be injured by a depreciated currency - is practically defenseless. He relies for work upon the ventures of confident and contented capital. This failing him, his condition is without alleviation, for he can neither prey on the misfortunes of others nor hoard his labor."

Cleveland's words marked a panic which perhaps was one where a crisis in government had taken place. The Treasury, nearly bankrupt, had sparked wild fluctuations in foreign exchange and fleeing capital from the United States. Throughout my studies of economic booms and panics, one underlying factor had always played the deciding role. It was the level of confidence. Unsound financial conditions surrounding the value of the dollar had led to a crisis in confidence. Capital was hoarded by the entrepreneur whenever his confidence in the economy was shaken. This observation was also made by Marx back in the 1800s. Marx noticed that during periods when confidence was lost, the rich capitalists were afraid to invest and ended up hoarding their funds. He then contended that they merely created the depression by causing a contraction in business investment. Thus the solution was simple. Take all the capital









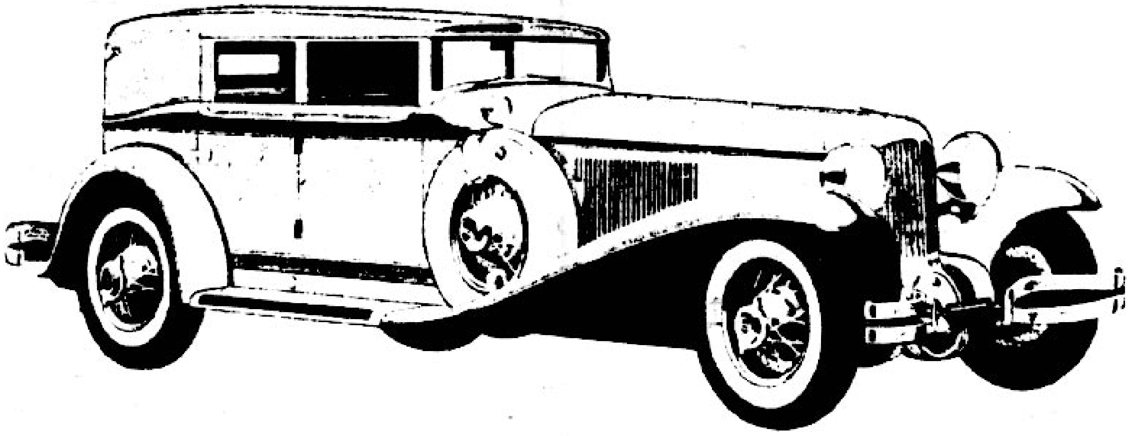
away from such people and then you did not have to worry about a lack of confidence. It was then logical that depressions could be eliminated.

During the postdepression era, it would be Keynes who provided the guiding light of hope. He contended that government could prevent depressions by increasing its spending to take up the slack caused by this contraction in business activity led by the decline in confidence.

Neither idea seems to have corrected the situation. Marx's idea essentially tried to eliminate human fears which led to the decline in confidence. The ultimate solution would be to eliminate man himself and that would get rid of greed, speculation, and the contraction in confidence which always followed the cycle. Keynes merely injected another player who lacked the wisdom to manipulate the situation, and the fears about reelection have proved to be just as corrupt as the graft with votes as the pay off. Hence, politicians vote for spending measures to keep their jobs rather than to curtail spending when it was not in the best interest of society as a whole.

This is the nature of events. The human urge to survive is the dominating force among the politicians as well as the capitalists. Both have condemned the other for actions of self-interest. Yet, if each individual did not act in his self-interest during times of strife then perhaps there would be nothing left to survive.

The repetitive cyclical forces which seem to dictate the business cycle are at least in part created through the cyclical forces of nature. It is nature which dictates the cycles in many commodity industries, swinging them back and forth between feast or famine. In many cases, man's financial destiny has been altered or guided by nature including at times such things as the San Francisco earthquake. Therefore, nature has played some part in the business cycle contributing to the rise of inflation in the food sector during droughts as well as deflation from



ANNOUNCING THE NEW 1931 PROGRAM FOR THE CORD FRONT DRIVE

In keeping with our long standing policy, we are again able to make the public the beneficiary of the savings obtainable through better manufacturing methods and greater buying power. For the first time, a Cord Front-Drive car is now offered to a larger market. Owners of the Cord Front-Drive will tell you it is the finest automobile in the world. Nothing less than a totally new *kind* of motoring could make possible the successful invasion of the Cord into the fine car field. Its sales in its first year represent nearly twenty per cent of all cars sold above $3000. The Cord has won more renown in Europe than any other American automobile, having emerged victorious in competition in thirty-nine important Continental Rallyes. The Cord is owned by more notables of the world than any other automobile, American or European. The Cord design has met with a more enthusiastic reception all over the world than any other new automobile. The Cord became the model for the entire automobile industry to pattern after. It is this car, which is the standard of fine car values, with its exclusive front-drive advantages, which we are now able to offer for the first time at the extremely low price of — $2395

BROUGHAM $2395 · SEDAN $2395 · CONVERTIBLE CABRIOLET $2495 · CONVERTIBLE PHAETON SEDAN $2595

Prices f. o. b. Auburn, Indiana · Equipment other than standard, extra · AUBURN AUTOMOBILE COMPANY, AUBURN, INDIANA

Showing in the Lobby of the Commodore Hotel and at the Automobile Show

CORD
FRONT DRIVE

THE FORD MOTOR COMPANY

announces a

REDUCTION in PRICES

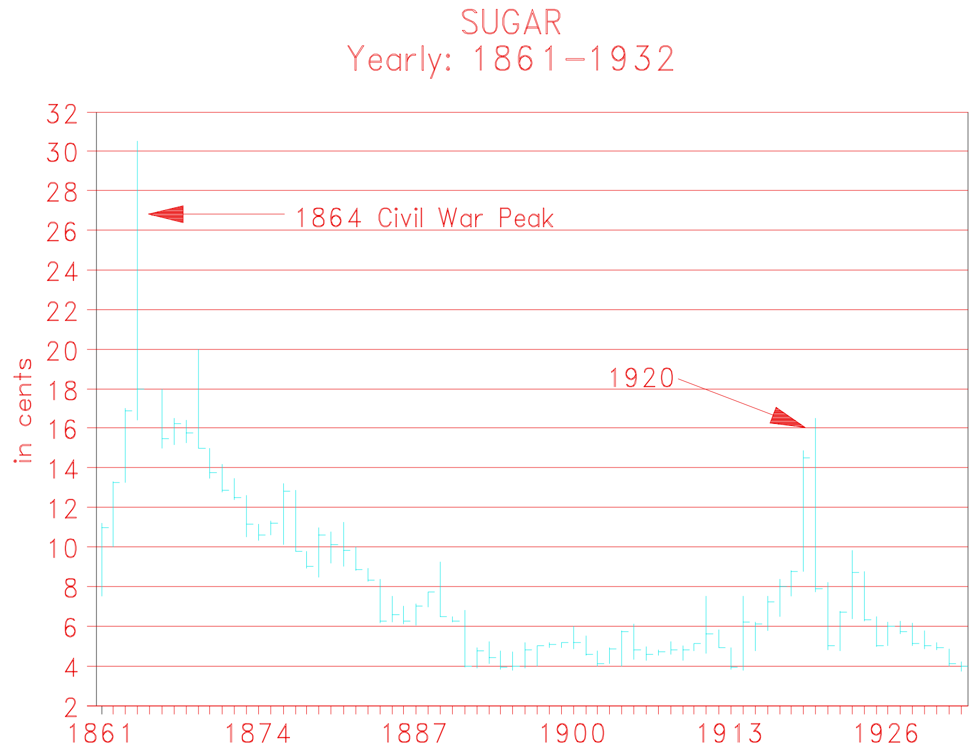
The following prices are effective
Monday, January 19, 1931

	New Price	Old Price	Reduction
De Luxe Roadster	$475	$520	$45
De Luxe Phaeton	580	625	45
Phaeton	435	440	5
Roadster	430	435	5
Sport Coupe	500	525	25
Coupe	490	495	5
De Luxe Coupe	525	545	20
Tudor Sedan	490	495	5
Fordor Sedan	590	600	10
Town Sedan	630	660	30
Cabriolet	595	625	30
Victoria	580	625	45
De Luxe Sedan	630	640	10
Station Wagon	625	640	15
Model A Chassis	340	345	5
Model AA Truck Chassis, 131½-inch wheelbase	495	510	15
Model AA Truck Chassis, 157-inch wheelbase	525	535	10

(All prices f. o. b. Detroit, Michigan)

You may purchase a Ford car or truck on convenient, economical terms through the Authorized Ford Finance Plans of the Universal Credit Company

Ford Motor Company



oversupplied commodity markets - as was the case in point during this period in time. It is only logical, therefore, that government cannot foresee such events nor can it provide intervention in such matters. In many respects, man has always been at the mercy of nature.

The automobile industry was unquestionably the leading star throughout the bull market until early 1929 when the price of its common stock had begun to falter. From a domestic production level of 5.6 million cars and trucks in 1929, sales fell rather sharply. In January 1931, it was announced officially that 1930 production had fallen to 3.5 million units. The industry as a whole was a very important component within the American economy. It accounted for 82% of the demand in rubber, 55% of plate glass, 15% of all iron and steel, 57% of upholstery leather, 30% of the aluminum, 14% of all copper, 15% of hardwood and 24% of lead production. Time magazine reported that the automobile industry also accounted for 80% of the total gasoline consumption in the U.S. and it filled slightly more than 3 million freight cars a year in bringing its wares to market. Through direct measures, the industry employed 5 million people but through the innovation of this new contraption, originally called the horseless carriage, it provided countless other jobs in a variety of other industries, and it also gave rise to the future giant, the oil industry.

Thus, the auto industry was still something of vital importance to the financial market watchers. In January 1931, it had been reported that foreign sales of U.S. automobiles had declined by 44% in 1930 compared to a domestic drop of 30% in car sales. The 1931 Auto Show, held in New York, was an event of some importance. The trend for 1931 demonstrated lower prices, increased speed and performance, and an increase in the size of engines with far more eight cylinders along with 12s and 16s than ever before. But, to catch the eye of the consumer, pastel shades of paint were also introduced. But many viewed that the tariffs levied against the U.S. automobiles would still pose a deterrent in foreign sales. Many investors remained pessimistic about the outlook for 1931.

The sugar industry was also suffering from overproduction. The Russians were huge producers and they were dumping sugar on the markets, driving the prices downward in a clean break. To add more sweetness to the wound, the U.S. Secretary of Agriculture finally ruled that corn sugar could be used in foods without having to declare it on the label. The Corn Products Refining Co., manufacturers of Mazola Oil, Karo Syrup, Argo Starch, Linit Starch and Kremel Pudding Powder, immediately announced that it planned to double production. This was not welcome to Cuba, Russia, the Dutch, or German Sugar Cartel. After a long battle of trying to reach some sort of an agreement that would curtail sugar production, the Germans finally gave in. A five-year agreement was reached whereby production would be cut (in the amount of the preceding annual surplus, but Russia did not participate.)

On the banking scene, the turmoil over the failure of the Bank of the United States in late 1930 had not simply disappeared. Manufacturers Trust Co. in New York was one of the banks which was going to absorb the defunct Bank of the United States, but the deal had fallen through. Manufacturers was no small bank. On January 2, 1931, it released a statement on its current position at the time. Between September 24, 1930, and January 2, 1931, the psychological effect of the Bank of the United States' failure had led to a withdrawal of $109 million in deposits, leaving the bank with $219 million. A decline of $35.5 million in its capital, surplus and undivided profits had also occurred. To rescue the bank, instead of negotiating a merger, Harvey Dow Gibson, former President and later Chairman of the

N.Y. Trust Co., purchased 30% of Manufacturers Trust and assumed the presidency. Rumours told that Gibson's associates, whom Gibson would not identify, were a league including either the House of Morgan or the Rockefellers. Gibson publicly denied that rumor and stated that he would perhaps reveal his associates at some point in the future. Manufacturers Trust Co. thus survived, and in the years ahead a merger eventually came forth forming the famous

Manufacturers Hanover Trust Company as it is known today.

Banking failures were now beginning to become more widespread throughout the East, no longer being confined to the commodity stricken sectors of the nation. In the Industrial town of Gary, Indiana, the Central Trust & Savings Bank failed during January 1931, tying up nearly $1 million in deposits.

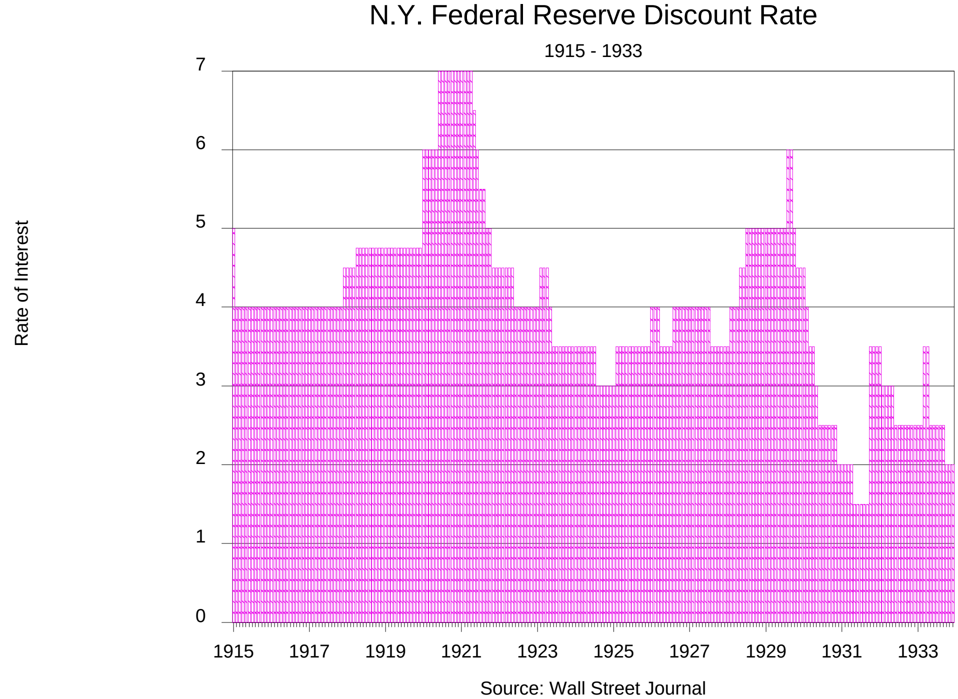
In the first section of this study, up to 1929, I provided numerous advertisements for real estate bonds. Many people have been led to believe that countless novice investors had been wiped out by the falling stock market. The truth of the matter is quite the opposite. Far greater amounts of capital were lost by the small investor who purchased bonds. Real estate backed bonds were one of the worst investments second to those of foreign issue. Many of the banking problems that brought down the banking institutions in the East were centered around heavy real estate exposure. As the depression continued to worsen, real estate became very nonliquid. Stock at least could be sold at a price quoted on the exchange as long as the company was of importance. But, bond issues backed by real estate simply went into default, taking with them countless dollars from the savings of the small investor. The carnage of the progressively widening banking crisis was summed up quite appropriately by Time magazine on January 12, 1931:

"So, in steady sequence, has many a U.S. community suffered the pangs of bank failures, of cash tied up, of prominent citizens suddenly under suspicion. Fear has followed faith; tragedy stalked prosperity. To tell of each failure would be impossible. To fail to search beyond the weekly figures of failures would be to miss the true social significance of the Depression."

The mood about the market itself was still quite mixed. On January 19, Time magazine reported on the comments of Albert Henry Wiggins, President of the largest bank in the United States, the Chase National. The event was the annual stockholders meeting held during mid-January of that year. While many other banks had suffered from withdrawals, at least a portion of the money was flowing into the books of Chase. It was reported that the resources of this famous bank had reached $2.6 billion, which was $753 million ahead of its nearest competitor. So when Mr. Wiggins had something to say, at least a few people listened.

"The most serious of the adverse factors affecting business is the inability of foreign countries to obtain dollars in amounts sufficient both to make interest and amortization payments on their debts to us and to buy our exports in adequate volume. From the middle of 1924 to 1929 we delayed the adverse effect of our high tariffs upon our exports by heavy buying of foreign bonds...Our alternative today is, therefore, either a reduction of our tariffs, or readjustment to our greatly reduced volume of exports...A reduction in tariff, made in the interest not of change but of stability, would still leave us our general protective tariff system.

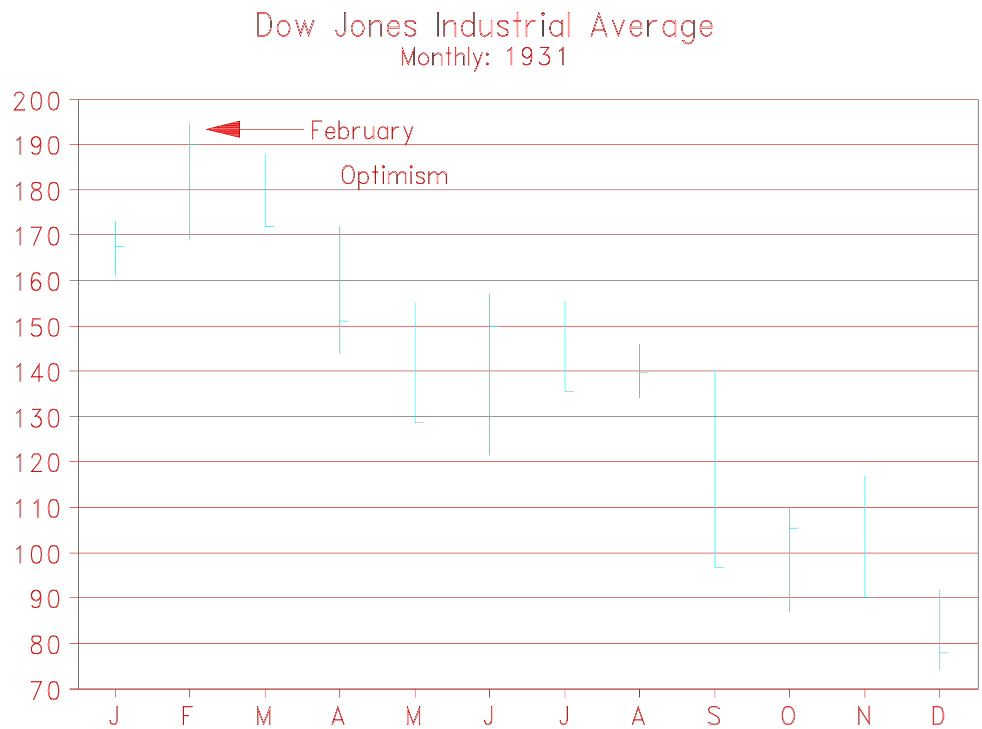
"Cancellation or reduction of the interallied debts has been increasingly discussed throughout the world. This question has an importance far beyond the dollar magnitude of the debts involved...I am firmly convinced it would be good business for our Government to initiate a reduction in these debts at this time."



Many bankers were opposed to the high tariffs despite the fact that in many cases there was a just cause for them and that most other nations had imposed tariffs far in excess of those in the United States. The bankers in general were concerned with the repayment of foreign loans. With the trade war going on, foreign nations were unable to earn enough dollars to make payments on their outstanding loans. It is true that the situation was always that way. It had merely been clouded over by the huge amounts of foreign bond issues which were floated subsequently following World War I. Therefore, the bankers in general normally held the opinion that the government should write off its loans to foreign nations so that those foreign nations could repay the loans outstanding at the banks.

Later investigation by the Senate revealed a wealth of corruption, which at this time was still not publicly known, in respect to these foreign loans. The profits in floating the foreign bond issues were reasonably handsome and competition fierce. It was revealed by the Senate investigations that Juan Legula, the son of the President of Peru, was paid $450,000 in connection with floating a $50 million bond issue in New York . The Chase had extended the dictator Machado of Cuba a personal line of credit which went as high as $200,000 in addition to hiring his son-in-law.

But despite these unethical bribes, the issue that Wiggins spoke of was real. With the trade war bringing the volume of international trade down, foreign nations were unable to earn enough dollars to pay their loans. But in reality, the extension of additional credits throughout the 1920s was not the answer to their problems either. In the case of Britain, it was a clear overvaluation of the pound which was to attain the goal of Montagu Norman, head of the Bank of England. The pound could not be restored to the prewar "par" level without creating massive deflation as slow economic growth. Thus, the mismanagement of governments around the world was leading contributor to the Great Depression of the 1930s.



Wiggins' comments did not stop with the international debt crisis. His words were of interest on issues of the time. On prices Wiggins commented: "We attempted, as a matter of collective policy, to hold the lines firm following the crash of 1929...The policy has had a 13 month test. It has failed...We must keep the markets open and the prices free."

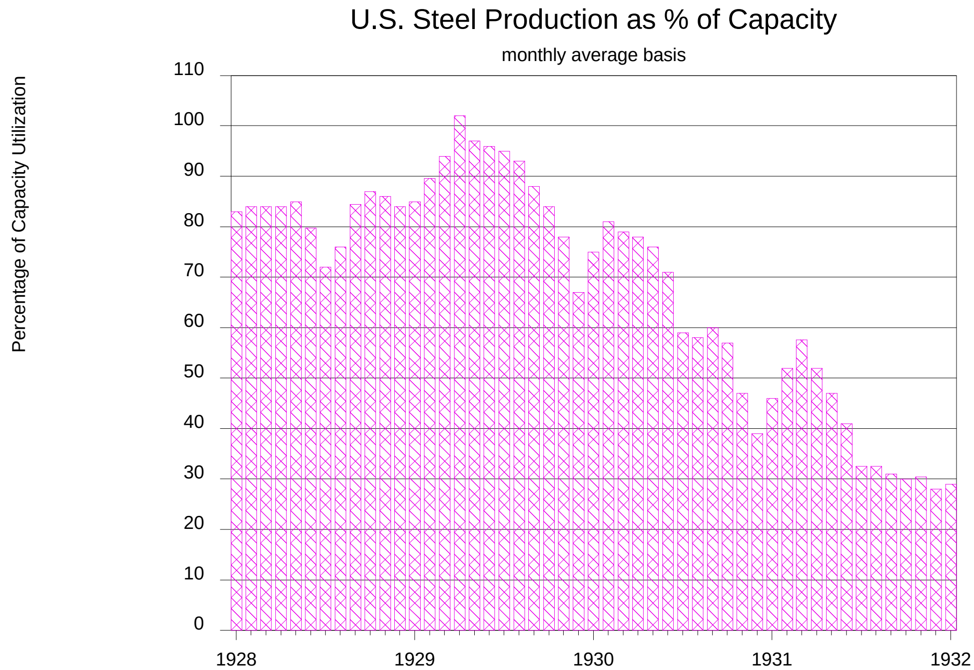
In reference to wages: "It is not true that high wages make prosperity. Instead, prosperity makes high wages. Many industries may reasonably ask labour to accept a moderate reduction of wages designed to reduce costs and to increase both employment and the buying power of labour."

On stocks Wiggins commented: "I do not know whether we shall see lower prices in the stock market or not...There are many securities, both stocks and bonds, which are now selling for less than they will be worth in normal times and at prices which should prove attractive to the investor."

His conclusion and forecast were: "It is not impossible to set a date for the beginning of the business recovery. I think that we are approximately at the worst of the Depression and that the next important move will be upward...I expect conditions at the end of 1931 to be a good deal better than they are at the end of 1930."

These comments fell up on eager ears. The Dow Jones Industrials had fallen severely during the previous year and had come to rest below the 160 level during December 1930. But, as 1930 was coming to an end, the Fed had lowered the discount rate for the seventh time since the crash of 1929. Thus, January began with the discount rate now resting at 2%, the lowest in history. But the Fed's action did not spark any spectacular rally in the Dow Jones Industrials for year end. Most traders remained very cautious. The bonds, on the other hand, rallied sharply from under 93 to the mid-95 level.

Thus Far, January had held above the Dece mber low, yet trading was far from



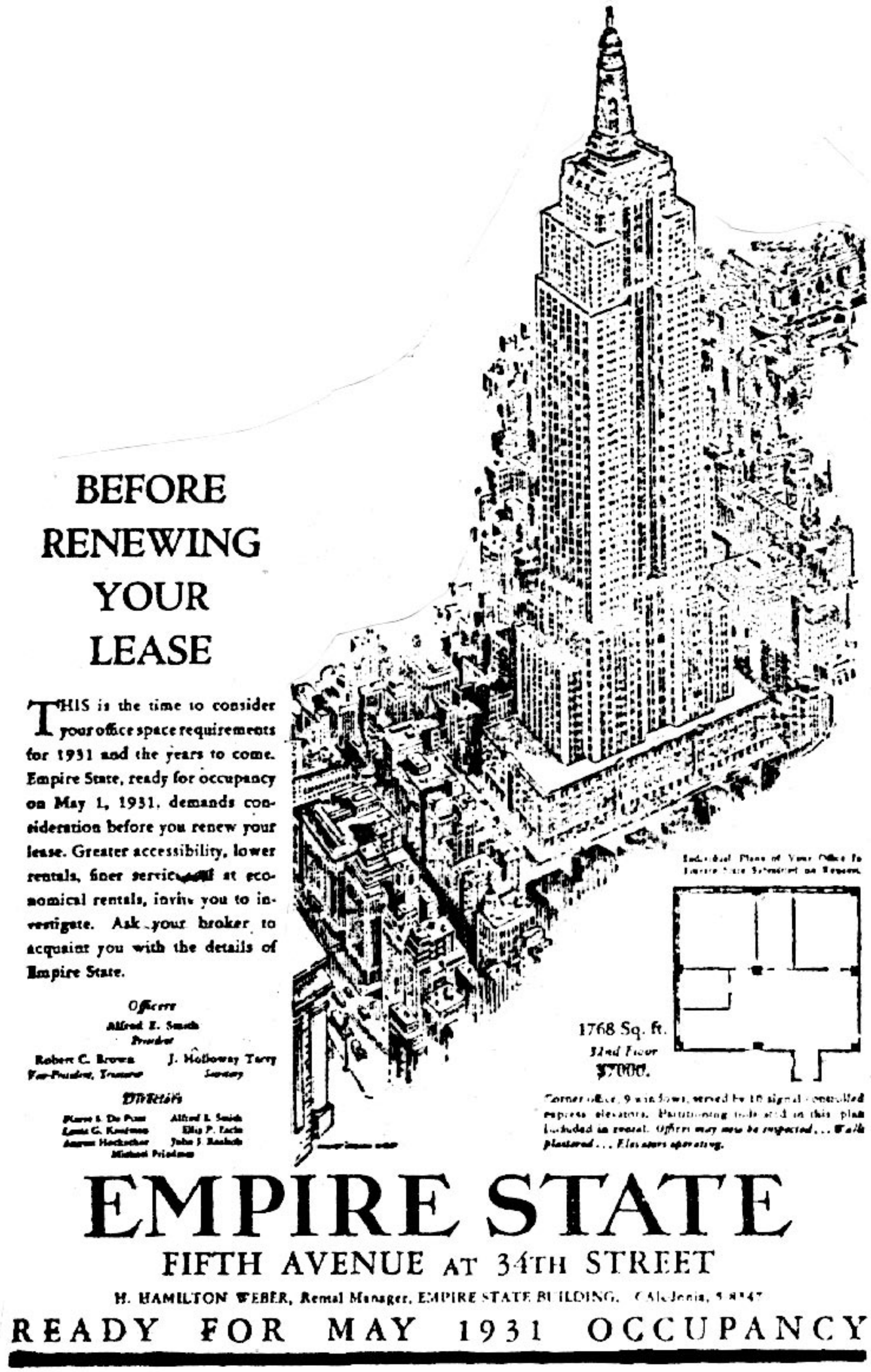
spectacular. The ranges were narrow in both stocks and bonds. The bonds rallied, exceeding the December high but traded within a full point range. Curiously enough, the bonds had closed December on the high of the month while the stocks closed much closer to the low of the month. Some divergence between the two still made its presence felt.

What was interesting was the trend in odd-lot purchases. Throughout most of the large blue-chip companies, the number of stockholders was increasing. Shares of common stock had been passing from the professional to the small investor who was perhaps afraid of the banking situation. This helped to provide some support during January following the banking scare prompted by the failure of the Bank of the United States.

In January, even Paul Moritz Warburg, who had become somewhat of a respected soothsayer for this denunciation of the "speculative orgy" just prior to the collapse and his forecast that it would lead to an inevitable crash, had a few optimistic words to say. Warburg was a well-known banker and a director of the Manhattan Co. with its various banking units.

"From the banker's point of view, I do not hesitate to say that within a few years hence the level at which some of our securities sell today will look... incomprehensibly low...even though one might anticipate a year or two of reduced dividends."

Indeed, these were impressive words coming from a man who many believed had called the events of history before they had revealed themselves. But Warburg had a few choice words to add about his view of government and the business cycle itself. He called the business cycle "a subject for psychologists" rather than for economists." He also said that government would serve a better purpose in squashing booms than trying in vain to halt depressions. He also denounced the high tariffs and any artificial measures designed to fix prices.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With increasing frequency favorable reports on business and employment are becoming available . . . Steel, that barometer of business conditions, shows steady improvement from December lows . . . Some observers point to these indications as showing that marked recovery is under way. Most authorities agree that the depression has passed, or shortly will pass, its lowest point.

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Continuous examination of the values underlying securities—in bad times as well as good—is necessary in order to take full advantage of current markets.

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But if he had then taken advantage of the cyclical swings of stock prices by selling when the Van Strum barometers turned bearish and buying the same stocks back when the barometers turned bullish *his capital would have been increased to $90,500 in the same period.* In other words, by buying and selling according to the barometers, this investor would have made 660% more than he could have by merely holding the stocks regardless of the general trend. A summary of the results of the survey follows:

$1,000 in 1904

Year of Investment	Dollars Invested	Year of Sale	Price Received	Per cent Appreciation
1904	$ 1000	1906	$ 2700	170%
1908	2700	1909	5160	91%
1910	5160	1912	6030	17%
1913	6030	1917	11700	94%
1919	11700	1920	16500	41%
1921	16500	1923	26500	61%
1924	26500	1926	48800	84%
1927	48800	1929	100000	117%

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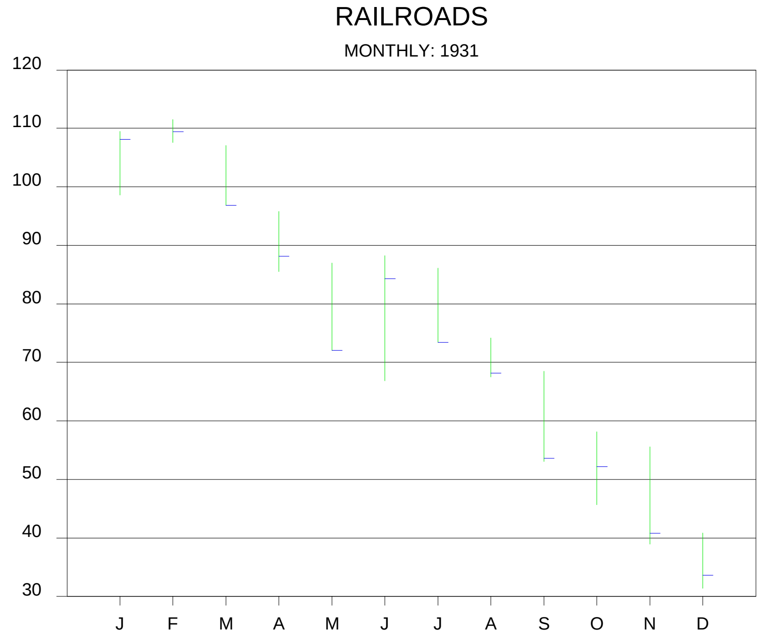
Four Attractive Stocks

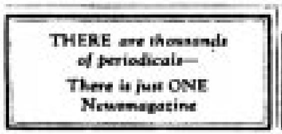


Time magazine reported on the comments of James Augustine Farrell, President of U.S. Steel. Despite the fact that Farrell had pronounced that he was bullish on the market as well as the economy at the end of 1929, his obvious error was not uncommon among business leaders at the time. But because Farrell had entered a period of silence in his public comments thereafter, many believed that he fostered a deep, dark opinion of still further declines.

At last during January 1931, Farrell broke his silence and uttered his opinion upon the current state of affairs. While many business leaders, economists and analysts were calling for a recovery to begin in a few short months, Farrell once again stuck his opinion where it was not exactly well founded. Instead of projecting a turnaround to begin in the months ahead, he told the world that it had already begun "30 days ago." Therefore, he contended that the sharp decline during December 1930 had produced a low. To Farrell that was "THE" low from which an uptrend was now in motion.

Farrell's perspective was perhaps colored by the fact that the steel industry was successful in actually pushing through a price hike in December as a result of the protective tariffs. In late November 1930, Carnegie Steel had announced that its prices were "minimums" and a few weeks later the price of finished steel products was raised $1 a ton. This brought steel bars up from $1.60 a pound to $1.65. This compared to $1.90 in 1929.

Steel production capacity had fallen to 39% from 100% of capacity peak in 1929. Therefore, Farrell's perspective was one which was based largely upon the developments within steel and it did not reflect industry as a whole. But Farrell's position was notably different from that of Mr. Wiggins. In response to wage cuts, Farrell replied: "Oh no. Wages in the steel industry are not coming down. It is my delicate judgment that a general reduction of wages in this country would set back the impending recovery by at least two years."



It was obvious. There were two schools of thought on virtually every issue of the time. Wiggins maintained that wages should be reduced while Farrell insisted that wages should be maintained. Opinions were numerous, but solutions few.

Owen D. Young, Chairman of both RCA and General Electric, stated before the American Bankers Association meeting that in his opinion the Depression had reached dead center and that improvement was forthcoming. This opinion was also shared by a statement to the press offered by the U.S. Chamber of Commerce, which concluded in a survey of its nationwide member chapters that "a slight increase in business activity and improvement in the employment situation" had taken place. Thus, their opinion embraced the concept that there was "hope that the ‘dead center’ of the Depression is past."

Various leaders within industry echoed these opinions. Although differences were noted among what policies should be implemented, the consensus was clearly one of optimism that the bottom had been reached. This sentiment was also beginning to be shared by the investing community. The Dow Jones Industrials rallied nicely moving into February, exceeding the January high as well as the highs that had been established during both November and December of 1930. The industrials had rallied coming close to 195 in an effort to test the key low which had been established during the Panic of 1929. The industrials came close to finishing February above the 190 level.

The railroad issues, however, rallied to nearly 112 in February, exceeding the high of December 1930 and that of January 1931. But the November 1930 high could not be exceeded. The rails, which had lagged during the bull market years, were still trailing behind the industrials.

The long bonds fell into stagnation during February 1931. They failed to exceed the January high and traded rather quietly, forming an inside trading affair in comparison to the range of January. The discount rate stood unchanged since the December cut to 2%. The banking failures continued, prompting many to view the industrials as the least of all evils and a better alternative to what was becoming a popular tradition, the mattress.

Trouble was still brewing among bond holders. Defaults were not spreading into the local municipal issues. After a cost of $13.8 million and little more than a year in operation, the holding company formed to own the assets of the bridge which connected the city of Detroit with Sandwich, Ontario, defaulted on its bond issue. Traffic had fallen substantially and the ferry companies began cutting their rates sharply rather than suffer the alternative, which was to go out of business. Of the $8 million in outstanding bonds which were to yield 7% interest, no payments were mailed.

For this reason, and many similar incidents, the bonds continued to decline from the February 1931 high despite lower rates. One would think that with the discount rate at 2%, bonds yielding 7% would have been trading far above par. But the reality of the situation was far from what the normal perceptions of relationships would have been. The safety factor of the bond market was much worse than that within the stock market itself.

February was also the month when most of the top corporations began to release their final figures for 1930. The vast majority of the companies reporting had declines in earings. G.M. reported $151 million in earnings for 1930 compared to $247 million in 1929. One exception, Coca-Cola, posted new record highs in earings, reaching $13.5 million compared to $12.7 million for 1929.

The following table offers a brief cross-section of various industries with a comparison of their earnings between 1929 and those of 1930, which were reported during February 1930.

CORPORATE EARNINGS COMPARISON
1929-1930
(in thousands)

	1929	1930	% change
Atlantic Refining	17,332	2,742	-84.1%
Bethlehem Steel	42,242	23,843	-43.5
Caterpillar Tractor	11,600	8,714	-24.9
Chrysler Corp.	21,902	234	-98.9
Cities Service	36,477	48,974	+ 34.2
Coca-Cola Co	12,758	13,515	+ 5.9
Colgate-Palmolive	8,910	8,550	-4.0
Cream of Wheat	1,882	1,868	-0.7
E.I. DuPond de Nem	72,300	49,990	-30.8
General Cigar	4,295	3,201	-25.4
General Motors	247,317	151,098	-38.9
General Outdoors Advertising	1,843	345	-81.2
B.F. Goodrich	7,446	(8,400)	-212.8
Hawaiian Pineapple	3,166	2,530	-20.0
Helena Rubinstein	794	554	-30.2
Household Finance	3,372	4,066	+ 20.5
Hudson Motor Car	11,594	324	-97.2
Inland steel	11,712	6,498	-44.5
Jewel Tea Co	1,691	1,705	+ 0.8
Lehigh Valley Coal	1,190	714	-40.0
Marshall Field	9,218	4,724	-48.7
McGraw-Hill Publish	2,231	2,021	-9.4
National Lead	10,560	4,675	-55.4
Natl Power & Light	13,557	12,630	-6.8
New York Central	77,428	35,981	-53.5
Parke Davis & Co	8,331	7,514	-9.8
Pierce-Arrow	2,566	1,317	-48.6
Public Service NJ	29,544	30,163	+ 2.0
Remington Rand	6,068	2,995	-50.6
Reynolds Metals	3,560	1,730	-51.4
S.S.Kresge	14,952	10 ,621	-28.9
Montgomery Ward	13,434	423	-96.8
Sears Roebuck	30,057	14,308	-52.3
Stewart-Warner	6,838	1,262	-81.5
U.S. Steel	197,531	104,465	-47.1
Western Dairy Prod.	1,401	1,124	-19.7
Woolworth	35,664	34,736	-2.6
Total	982,763	591,775	-39.7

According to a survey by Moody taken of the first 744 companies to report on their 1930 earnings, the across-the-board indications illustrated a 23.2% average decline in corporate earnings in comparison to 1929. But this figure is a bit misleading. Of the total of 744 companies, 375 were industrial corporations, which posted a decline in earnings of 35.9% for 1930. The railroads posted a 31.6% decline in earnings. The broad average was actually helped by the utilities including the telephone and telegraph industries. The group which was selected for the preceding table produced a combined earnings figure in 1929 of $982,763,000 compared to $591,755,000 in 1930, a 39.7% decline.

On the production side, the oversupply in commodities had also filtered over into the tobacco industry. A price war among the cigarette retailers had broken out. The price war had initially broken out during early 1930 and it appeared as though a truce had been called in late August of that year. But the truce came to an end in January 1931. The two main contenders were the United Cigar Stores Co. of America and Schulte Retail Stores Corp. Cigarettes were normally priced at 15 cents with a wholesale cost of 11.26 cents. During 1930, prices had dropped to 12 cents but when the truce of August arrived, prices moved back up to two packs for 25 cents.

When the battle was renewed in January 1931, it was sparked by United which offered two packs of cigarettes plus a pack of Gillette razor blades for 50 cents. The offer was limited to Old Gold, Camels, or Chesterfields , but the normal retail value was 65 cents. As insignificant as this might seem, Schulte reduced prices on those same brands to 11 cents, but they included Lucky Strikes. This meant that these brands were selling below cost.

As absurd as it might sound, the American Tobacco Company got into the act. They were outright mad at United for refusing to include their Lucky Strikes in its special price war. As a result, American Tobacco refused to sell its Lucky Strikes to United, in effect declaring an embargo. Both United and Schulte were large, nationwide chain stores so the battle was no small matter as evidenced by how it began to draw in the producers as well.

This example of a price war between two major retail chain stores was not unique. Price wars were taking place throughout many industries. As economic activity declined, including consumer spending, price wars were seen as a means of defending one's market share. Thus, the boom periods produce overcompetition and the subsequent contraction forces businesses to fight for their remaining share of sales, resulting in free competition but rising business failures. This was the atmosphere which began to spread throughout the business community.

Another unwelcome discovery came forth affecting the oil industry. With overproduction a serious problem for oil men, the last thing they needed was another new major find. But as 1931 began, so did the oil rush in eastern Texas. Land around the area of Kilgore, which had previously been selling for $5 an acre, was now bringing $2,000 an acre after a gusher on the Crim farm spilled oil out at the rate of 22,000 bbl. per day.

The oil industry was not exactly in the best of conditions. The Richfield Oil Company, which had been a giant in California, filed for bankruptcy in early February 1931. This Western giant fell victim to gasoline price wars and proration laws imposed by government. But stockholders were saved by a takeover offer of one share for every four of Richfield on the part of Cities Service. The Texas find continued to enlarge and threaten price stability in a very meaningful way.

Oil had not been included within the Smoot-Hawley Tariff Act of 1930 and thus imports were fairly significant. Again, government laws had been imposed which placed the American domestic interests at a decided disadvantage. The policy was called "proration" and its design was a means devised to curtail domestic production even though the U.S. was still an importer of oil. This measure thereby hurt many of the small independent oil producers throughout the Midwest. The large oil producers and the small were forced by law to cut oil production on a "proration" basis. Thus, the larger producers held the most profitable wells and a percentage cut in production did not necessarily threaten their viability for the long run. But the small producer, by and large, held older wells which barely skimped along. The proration basis was fair on the surface but not on a cost of production basis.

To further disrupt the industry, the "proration" restrictions did not apply to imports. This created unfairness between domestic and the foreign producer. Adding insult to injury, the Standard Oil of N.Y. and Vacuum Oil merger, discussed in the previous chapter, was still tied up in court. The government was fighting merger attempts vigorously, flexing its muscles under the guise of the Sherman anti-trust powers.

The big four in the industry were Shell, Gulf, Standard Oil of Indiana, and of course, Standard Oil of New Jersey with its numerous subsidiaries. All four of these companies maintained oil production outside the United States which qualified them as the four largest oil importers within the U.S. economy. The proration restrictions applied to crude oil and not to gasoline. Hence, imports of gasoline virtually doubled between 1929 and 1930 as a direct result of the proration restrictions. This meant that the big four complied on reducing their crude imports and domestic production, but gasoline was refined offshore and then imported to skirt around the restrictions on production. The breakdown was as follows:

Oil & Gasoline Domestic/Imports
(in thousands)

	1930	1929
Domestic Demand	922,000	940,000
Imports (Gasoline)	16,927	8,834
Imports (Crude)	62,129	78,933
US Crude Product	896,265	1,007,323
Exports (crude)	23,796	26,059
Exports (Gasoline)	64,978	62,059

*Note: Gasoline expressed in gallons and crude in terms of barrels.

The above table illustrates the decrease in U.S. domestic production of crude. While imports and exports of crude oil virtually balanced, there was a noticeable rise in the importation of gasoline. If we translate the gasoline back into barrels of oil required to yield the 16.9 million gallons of imported gasoline, then total imports of crude oil for 1930 came to 116,652,000 bbl. against 115,200,000 bbl. in 1929 and 90,625,000 bbl. in 1928.

Despite the Texas discovery, oil stocks began to rally during the early stages of February for one important reason. The cry of the small independents continued loud and strong. Only after numerous failures among this group of oil men took place, did government begin to wake up. The pres-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sures were naturally divided according to special interests. The big four were dead set against any tariff on oil and even the city of Baltimore, Maryland managed to get in on the act. Russian oil had been imported for the first time in history and it landed at Baltimore. This gave the city and the state reason to fight against a tariff which would cut off the hopes that Baltimore might become a booming port for Russian oil imports.

The big four argued that tariffs would cost the public an additional $980 million a year. The A.F.L. argued that the employment situation within the industry was "deplorable!" Ralph Arnold, an oil engineer, testified at the Senate hearings that with the new discoveries in Texas, the United States had enough domestic oil to last 500 years under present demand circumstances. The Governor of Kansas sent a rather lengthy telegram to President Hoover in reference to the plight of the small Kansas independent oil producers and the lack of restrictions on imports which he called "appalling." But the most impressive testimony came from the Secretary of the Interior who reversed his original position which was in favour of the proration scheme. He said: "if proration is the logical method of control of supply, it would seem to be logical to apply it to imports." The greatest support came for the oil stocks when the Senate Commerce Committee voted 9 to 6 in favour of the Caper Bill.

Senator Arthur Caper of Kansas introduced a bill that called for the total ban on the importation of gasoline and a limitation on crude, bringing imports down to only 16 million bbl. per year over the following three year period. Keep in mind that total crude importation in 1930 was 116.6 million bbls. The Caper Bill proposed that imports would be restricted on a proration basis according to 1928 levels applied to nations from which oil was being imported in the same fashion as those under domestic rule. The Caper Bill thereby affected the following imports on a per nation basis:

U.S. OIL IMPORTS
(in thousands bbls.)

	1928	1931-33(Caper)
Mexico	17,584	3,527
Venezuela	21,981	4,410
Dutch W. Indies	24,989	5,012
Columbia	11,836	2,374
Peru	1,224	245
Ecuador	765	153
Trinidad & Tobago	496	99

But the issue of the merger of Vacuum and SCONY was not completely dead. Vacuum was a large producer, but the Standard Oil of New York was an excellent distributor. Therein lay the incentive for the merger. After a year of battling, the issue was taken to the Federal Circuit Court of Appeals in St. Louis. The Court ruled in favour of the merger and against the government. Its opinion was stated as follows: "There is, and could be, no contention here that the present contemplated merger is a continuance...of the conspiracy and monopoly found to exist in the main suit (which dissolved old Standard Oil). The contention is, and must be, that it is an entirely new undertaking... The intent and purpose of the merger is solely to meet the normal and natural business necessities of the two companies." Despite this favorable ruling, the government was expected to appeal to the Supreme Court.

The new oil discoveries in eastern Texas sparked an oil rush which was beyond all imagination. In the depths of depression, 1929 had not been as generous as 1931 to this State in the Union. The press began to dub the event as "Oil Madness." The boom was moving at a rapid pace, dwarfing all gold, land, and oil rush eras which had preceded it.

By the end of February, deposits within the two National Banks in the district more than doubled from $750,000 to $1.9 million. The discovery had spread and now debate raged over how large the find might be. Oil rights in the form of leases passed from hand to hand at unbelievable figures. Airplanes flew above day in and day out mapping out the territory for the army of geologists that had invaded those parts. As hundreds of oil wells sprung up and oil seemed to spurt from nearly every hole the drillers forged into the ground, leases were being drawn up on neighboring counties as speculation over the size of the find heightened. One such lease on 2,500 acres traded hands for $3.5 million. This was the find of the century which the independents had dreamed of all their lives. At least they were getting in on the ground floor.

The boom brought with it a burst in economic growth to virtually every sector. In Longview in Gregg County, the local hotel and the bank kept builders working day and night hammering out buildings to double their size as people flooded into their once small town. An eight story office building at the cost of $400,000 was designed and brought to the groundbreaking stage in less than one month. An ice factory and a dairy pasteurization plant were rushed into construction. Oil was gushing forth in record quantities. An on the "spot" market had developed at which oil was trading at 40 cents a barrel down from the 70 cent figure which had prevailed in Texas. But it didn’t matter. There were plenty more where that came from. Although prices were falling for the industry as a whole, the new oil-rich eastern Texas was basking in the glory of boom and speculation.

The rest of the nation, however, was not so fortunate. Although some sectors had shown some improvement, there were others that could not boast of fantastic earnings. The famous Winchester Repeating Arms Co. was one such casualty. Back in 1864, a foreman in a small Connecticut factory invented a repeating rifle. A few were actually supplied to the Union Army during the final stages of the Civil War. In 1867, the former Lieutenant Governor of Connecticut, Oliver F. Winchester, formed this firm bearing his own name by merging several small companies. During World War I, his firm employed 22,500 men in its huge 80-acre complex located at New Haven.

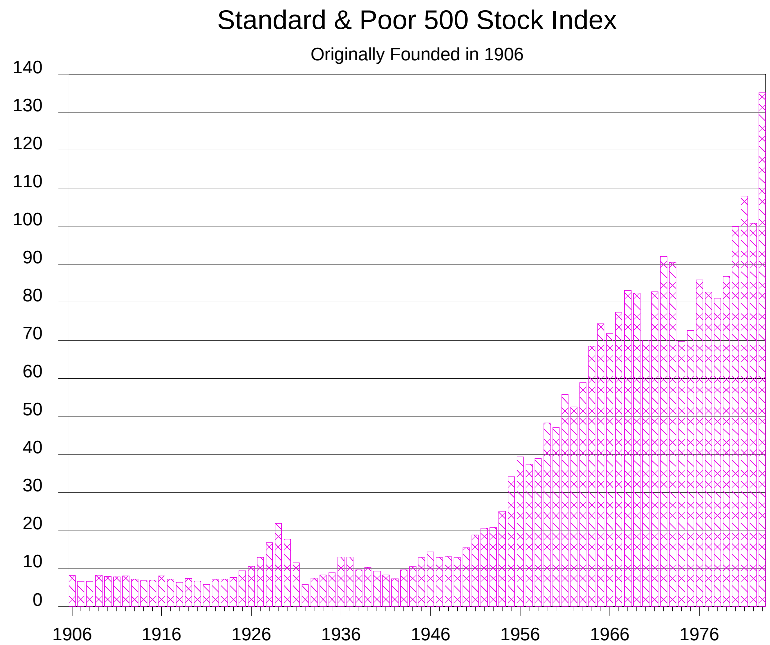
Despite the efforts to diversify the company by expanding it into the production of tools, cutlery, fishing tackle, skates, radiators, washing machines, batteries and even flashlights, hard times had taken their toll. The famous Winchester Repeating Arms Co. was forced into receivership. Its employment roles had shrunk to 3,000 men and most of them were on a four-day work week. No one blamed mismanagement or illegal activities, but merely stated that this famous company was a victim of the Depression.

Another victim was the securities markets themselves. There were 33 organized security exchanges in the United States at the time and business was not altogether that great. The Portland (Oregon) Stock & Bond Exchange announced that "until such time as the general conditions of the securities markets in the country and the particular situation in Portland" justified reopening, the exchange would be closed.

It was also during February 1931 when the entire brokerage business underwent a drastic change in its mode of business. Prior to this period, brokers were paid a salary and the commissions went to the house. But now the phrase "Secondary Distribution" was born. Under the old rules, a house could not buy a stock and then sell it to its clients. It would buy or sell in the open market on account for a client. But this new rule was something different. If a bank had a large block of stock that might be selling for $30 a share, the insiders knew that those shares were overhanging the market. Thus, this new rule allowed the bankers to give an option of the shares to a brokerage house, say at $28. The firm would then have its brokers try to sell the stock to investors who would hold the stock. Taking this large block off the open market would then support the price and perhaps the stock might even rally up to $32 . The brokerage firm would then sell the stock at the new price and pocket the difference between its option price of $28 and $32. A portion of that would then be paid as a commission to the individual broker. This was a plan devised to prevent massive layoffs in the brokerage industry due to lack of volume that persisted.

One industry that was booming was the financial statistical information services. The largest statistical organization was Standard Statistics Co., Inc., which was moving into new headquarters in Manhattan during February 1931. It occupied eight floors and employed 1,200 people which was a gain of 45% over the previous year. Sales of its information were also up 66% over 1930. Obviously, curiosity about the causes of the decline and about which companies were the best continued despite the depression.

The founder and President of this vast statistical company was Luther Lee Blake. He began his career as a telegraph operator at a brokerage house in Tennessee. He later moved on to the big time in Manhattan where he worked his way up to be the manager of a wire department at Laidlaw & Co., another brokerage house. He used to handle questions from the firm's clients who asked about different companies. Blake began to keep a scrapbook on various



companies so that he would be able to answer questions and help the clients out.

In 1906, he had the idea of taking 100 companies and printing vital information about each on a card type system which could be updated by simply printing a new card. He managed to persuade a printer to take a chance on his idea and cover the cost of manufacture. At first, Blake used bellboys to distribute the cards and soon A.M. Kidder & Co., a brokerage house at the time, became his first subscriber for $60 a year. Thereafter, J.P. Morgan, Kuhn Loeb & Co., and even the National City Bank joined his subscription ranks. By 1908, Blake had 300 subscribers.

In 1913, Blake acquired the Babson Stock & Bond Card System, but competition was also growing. Some of his competitors were John Moody's Service which pioneered rating various bond issues. There was also the Brookmire Service, the oldest economic advisory company at the time. Other competitors were Roger Ward Babson, Arthur Elliott of the National quotation Bureau and, the oldest of all services, Poor Manual Co., which later merged with Blake's Standard Statistics Co. forming what we all know as Standard & Poor.

February 1931 was a month of mixed economic data and human emotions. Opinions were naturally still divided between the bulls and the bears and at times the very same issue was used in support of an argument from each camp. The Texas oil discovery, for example was accused by the bears of driving prices lower as well as profits, which might impair the health of the large companies. But the bulls argued that this new great find would make the U.S. a net exporter by allowing prices to fall below world markets in the U.S. They added that the proration issue was being applied to imports and that would help establish stability within the domestic markets. They then added the court decision in favour of the Vacuum-SCONY merger and spouted optimism that if the U.S. Supreme Court would give its blessing, then the industry could become even stronger by allowing other weakened companies to merge.

There were countless rumours and numerous statements by business leaders and politicians which gave rise to optimism that the depression was at its end. The Dow Jones Industrials rallied sharply during February as confidence and optimism seemed to join hands that month. From the January 1931 low of nearly 161, the industrials rallied, coming close to 195 in February. It was a rally during which many selected stocks actually doubled in value during the four-week period. Time magazine reported on March 2, 1931 on the going-ons in the marketplace as follows:

"For three weeks prior to Washington's birthday, stocks churned higher on big volume. Bullish rumors flooded Wall Street. There were stories of big bears trapped; of big deals brewing. International Telephone & Telegraph gained 100% over its January low and there were tales that it will again attempt to buy Radio Corp's communication business. Auburn leaped from $101 through $210 and bulls said they heard that General Motors had agreed to use Auburn's free-wheeling (clutch) patents. Once again, the names of Mike Meehan and William Crapo Durant were heard where speculators gathered.

"Hope and a crowded short-interest rather than facts seemed to sponsor the rally. Steel ingot production hovered around 51% of capacity against 82% a year ago. But, companies catering to the automobile trade were busier than others. There were rumours of steel price-cutting. Automobile production during January came to 138,876 units against 161,223 in December and 283,606 in January 1930. Commodity prices hit a new low average but the swift January drop seemed checked. Failures for the week were 722 against 585 in the corresponding week of 1930. Bank clearings for the first week in February were 719,053 against 885,816 last year. Money was cheaper than last year, with New York time loans to brokers running at 2.10% against 5%, call loans at 1.5% against 4%.

"From the indices there is no indication that the improvement in business is more than seasonal, if that. But, if piblic confidence could be charted, a remarkable rise would be shown between December and February. And in that many a commentator based a strong conviction that the Depression has reached its depth that the next change will surely be for the better."

We can see that Time magazine was one of the skeptics. The majority of the press and comments by virtuous people in business were very bullish. For the Dow Jones Industrials to have rallied 20% from the previous December low and selected stocks to have doubled or more, there is no doubt that optimism must have been high. De-

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Sunshine on rainy days, for the more than 80% of the country's population that cannot borrow from banks, thaws out frozen credits for merchant, wholesaler, manufacturer, professional man, and banker. The above advertisement proves the importance of small loan financing and speeds collections by pointing out the only means available to the majority of families for obtaining supplementary funds in emergencies. It is one of a series now appearing in newspapers with four and three-quarter million circulation. Public spirited citizens are invited to write for information about the small loan business which is providing over a half billion dollars this year to hasten business recovery. Address Dept. T2, Household Finance Corporation, Palmolive Building, Chicago.

spite rumours of bears being caught in the rally, later Senate investigations illustrated that the rumors of large bear raids were without substantial evidence. Most of the famed operators had lost vast amounts of money from playing the long side.

As the February boom returned to the reality of events many began to reflect upon earnings and the drastically poor showings in most sectors with the exception of the drug industry and the utilities. Chrysler Motors announced its 1930 earnings during the last week of February, and then only $234,000 compared to $21,902,000 during 1929. Reality had struck optimism directly in the heart.

There were still a few mergers here and there and a few selected companies that still produced a handsome return although rare indeed. One such company was the Michigan Central Railroad. This stock could have been bought for $75 a share back in 1921 and by 1931 it had paid out $419 in dividends. There were only 1,283 outstanding shares in the market for the balance had been bought by the New York Central Railroad. Michigan was perhaps the most profitable railroad during the big boom even though it was a small company. In March, amid falling stock prices, the balance of the shares of Michigan were sold for $1,550 each to the New York Central. When the company was asked how in the world that price was reached, they laid it out quite simply. Michigan based their calculations on the fact that between 1925 and 1929 the best railroadstocks traded at about 15.07 times earnings. Since Michigan's earnings averaged $104 a share, they simply demanded $1,550 and the New York Central paid it.

The battle for world trade continued to take its toll. Canada imposed tariffs so stiff against U.S. steel that U.S. owners were forced to sell off assets in Canada. Republic Steel Corp. produced steel in Ohio. Much of its unfinished steel was then shipped to its wholely owned subsidiary in Ontario which was named the Canadian Metal Products Co., Ltd. Canada imposed tariffs that in effect created an outright embargo on the importation of steel. Republic had no other choice and it was forced to sell its Canadian manufacturing company for a song to Burlington Steel Co., Ltd. of Hamilton, Ontario. This move led to the downfall of Republic in the years ahead.

Despite the fact that interest rates were declining, banks were not big lenders to the small individual. The personal loan was not a practice that gained favour in the banking industry. Anything along those lines required the cosignature of a friend and as much collateral as possible, if not 150%. This gave rise to the small loan business of pawnbrokers and "usurers" as they were called.

The small individual seeking to borrow money was forced to pay 42% a year! Declining discount rates didn't help this segment of society at all. A common practice was that a wage earner's pay check was normally postdated. This gave rise to the often termed "salary-purchasers." These chaps offered $50 for a $55 paycheck, taking advantage of the person who needed the cash immediately. Pawnbrokers were reported to be lending money at the highest possible legal rate and then forcing the client to pay $10 for $1 worth of merchandise to get around the laws. The "userers" would collect $10 a month interest on a $50 loan for years at a time. Studies were conducted and it was learned that families of small means that were forced into bankruptcy were normally bled to death by these sorts of things for years.

The Morris Plan Banks were charging 6% interest plus a 2% service charge. This was taken out of the proceeds of the loan at the start and then the borrower was forced to make monthly payments along the way. By the time his first year was up, he was actually paying 17.3% in interest. Other private personal finance companies were charging 3.5% per month, bringing the total amount of interest paid by the borrower to 42% per year.

The interest rates varied considerably between the different companies that would lend money. The breakdown was as follows:

ANNUAL RATE OF INTEREST CHARGED

	Range of Interest (%)	
	Low	High
Life Insurance Co.	6%	6%
Building & Loan Soc	6%	12%
Credit Union	6%	18%
Commercial Banks (personal loan dept)	9%	22%
Installment Finance Co.	16%	25%
Industrial Banks	17%	34%
Remedial Loan Soc	12%	36%
Personal Finance Co.	30%	42%
Pawnbrokers	12%	120%
Salary Buyers	120%	480%

From the peak in optimism in February to the cold hard reality which struck in March, the Dow Jones Industrials fell closing March virtually on the low near the 171 level. The industrials had fallen almost 25 points which came very close to a 15% drop in less than five weeks. The initial tendencies to run back into bonds had shown life in this once popular relationship. The long bonds rallied, not by much granted, but they forged a new high for the year during March. But by the end of the month confidence in the bond market was not that convincing. The bonds fell closing under 96 near the low for the month following the stocks.

During the February rally there had been numerous rumours of bear pools that had been caught short. But despite the persistent rumours none ever surfaced. But in the sharp decline that took place during March, the demise of a bull pool did surface. This one was operating in Chrysler which had turned in a horrible earnings drop as was mentioned earlier.

A pool had been formed by the two brokerage houses of J.S. Bache & Co. and E.F. Hutton & Co. The terms of the pool were that it would exclusively trade in common shares of Chrysler but never hold more than 500,000 shares overnight. Others participated in the pool as well. Both Mr. Bache and Mr. Hutton sat on the board of Chrysler. The other big player was William F. Kenny who was a rich Brooklyn contractor, a one time director of Chrysler up until 1928 and best friend of Alfred E. Smith. It was revealed finally in March 1931 that the pool had been closed out on July 16, 1930 when Chrysler was $29. Both Bache and Hutton filed a suit in court claiming that everyone had paid in their share of the losses except William F. Kenny. The news that this once famous bull pool had met with disaster did not help the atmosphere during late March.

Retail sa1es at Sears were not that great. It was in March 1931 that Sears began what would become one of the larger insurance companies in the United States - All State Insurance Co. The new insurance company planned to write automobile, health, burglary, theft and accident insurance. Allstate got its feet wet by providing auto insurance to all the employees of Sears Roebuck & Co.

It was also in March of 1931 that the renowned firm for Kidder Peabody & Co. was dissolved and reborn. The firm was originally formed way back in 1865. By the turn of the century, Kidder Peabody had become one of the leading private banks in Boston. In August 1929, William Endicott, a key director who had entered the firm back in 1887 resigned. This was followed by the death of 89-year-old Frank G. Webster, a senior partner, in January 1930. Webster's death was sudden and unexpected and despite his age he had remained an active guiding light for the company. Then five days later, the key man who ran the day-to-day operations, Robert Winsor died suddenly as well.

Rumours continued to circulate that the firm was in trouble. It was Kidder Peabody that also held a sizable portion of the stock in Winchester. Finally it was official. The announcement came as a relief that the old partnership was dissolved and a new one would take its place but the firm would retain the same name and the tradition of Harvard schooled management.

At the meeting of the National Foreign Trade Council held in March 1931, its chairman addressed the Council with these words: "There are indications that the worldwide depression in business...is subsiding and that the upturn is beginning." The chairman was the same chap who headed U.S. Steel Corp., Augustine Farrell. His opinion had not changed from earlier in the year but he did add that the Council had taken a survey and estimated that world trade as measured through exports, dropped from $33.5 billion in 1929 to $27 billion during 1930. On a volume basis, not in terms of dollars, he stated that world trade was therefore off by 10%. Yet in terms of dollars, world trade was down nearly 20%. One could argue this point since the dollar was strengthening against many currencies around the world. Thus it would take less dollars to pay for the same amount of world goods.

Just the week before, Farrell, as President of U.S. Steel publicly pointed out that his company had just received the largest order for "structural steel ever placed!" The order came from Manhattan for the construction of what would become a famous New York landmark - the Radio City building.

Meanwhile, another merger caught the attention of many in the market during March of '31. It was the merger of RCA and Columbia. This merger had been a rumour that festered on and off for over six months and, in fact, it had appeared again prior to the peak in 1929. At last a rumour that had come and gone many times, prompting buyers in both companys' stocks, had come to pass.

There was also another court battle which had been going on for some time. This one was a test case that seriously affected the accounting industry itself. A company named Ultramares Corp. of London had lent Fred Stern & Co., Inc. of New York a fairly sizable amount of money based upon an independent audit prepared by the firm of Touche, Niven & Co. Fred Stern & Co. went into bankruptcy soon after the loan. Ultramares brought a suit against Touche charging negligence in preparing the audit. The first round produced a verdict that Touche was liable for an employee's negligence. But later a Court of Appeals in Manhattan overturned the lower court's decision. The court ruled that a financial statement which specifically figures as "true" would be guilty of negligence. But since the statement had concluded "in our opinion" no testament was intended. Hence accountants were relieved and adopted the phrases "we believe" and "in our opinion."

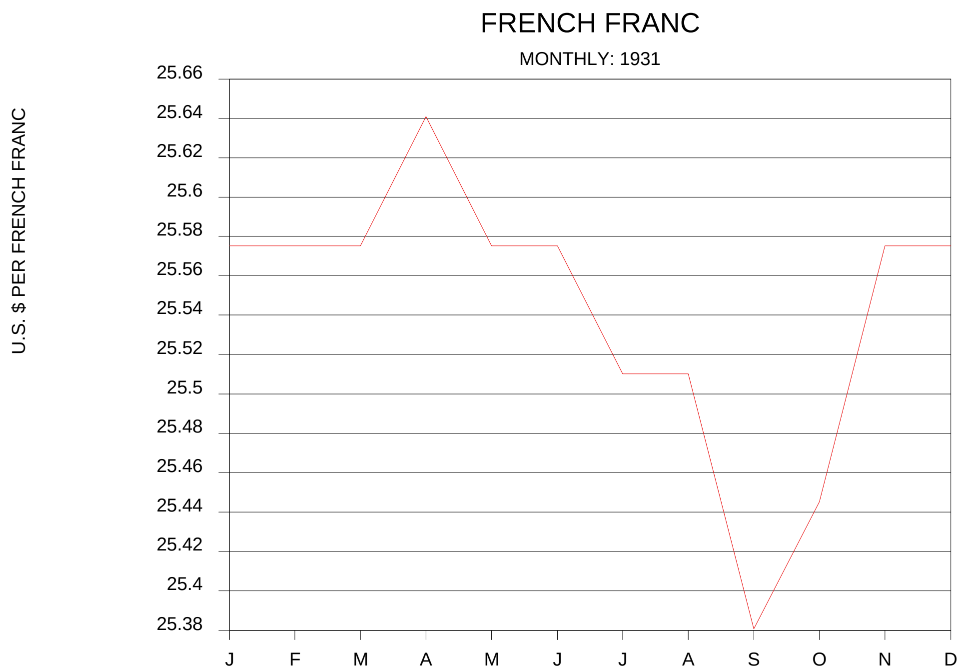
As lawsuits mounted and people fought over losses - sometimes in the courts and sometimes in the streets - the once bright notes of optimism could no longer be heard as April began to go to work on the market. The Dow Jones Industrials fell severely, penetrating not only the January 1931 low but the supposed low of the Depression which had been established back during December of 1930. The industrials had closed March at 172.36. April 1st had rallied to 173.72 on an intraday basis but fell back closing at 170.82. Thursday, April 2nd, remained nervous rallying back up to 173.15 but closing at 169.89.

The 3rd of April was Good Friday and the market closed for this solemn occasion. But Saturday it was business as usual and the market rallied once again back to 173.36, closing at 172.43. The market was closed for Easter Sunday and when Monday came, the holiday cycle seemed to make its presence felt. Easter Monday rallied to a new high for the month touching 174.69, but the gains could not be sustained. Selling came in once again and the market fell closing at 169.72. The selling pressure continued throughout the course of the week bringing the industrials down as far as 166.10 and closing the week at 168.03.

The following week began with Monday the 13th posting a rally as the market closed at 171.07. Tuesday tried to rally to new highs but the best she could offer was an intraday high of 173.24 and a weak closing at 168.43. The selling continued and by Friday the industrials had fallen to 158.50 closing that Saturday at 162.37.

The week of April 20th continued with sellers out-muscling the buyers. The market fell to a new low almost every day, dropping to 151.58 and closing at 151.98 on Saturday the 25th. The December 1930 low had been 158.41. The final week of the 27th began with continued selling pressure. The high of the week was 153.82 and the low was 141.78. This April low had held until May 18th, but in the meantime the industrials had at least rallied during May back to 156.17 at its very best.

On the world foreign exchange markets, pressure was building. The U.S. dollar began to strengthen. In April as the stock market dropped, the dollar began to rise against the French franc reaching its high for the year during this month at 25.641 francs per dollar. Against the Dutch guilder, the dollar had fallen to a low of 40.08 guilders to the dollar in March. But April brought a strong rally for the dollar against this currency as well jumping to 40.195. The dollar continued its rally against the guilder into October, finally reaching 40.35. Against the pound the dollar actually declined slightly from its March high of $4.85 as the pound rose in value to $4.86 in April where it remained until June. But there was no doubt something was brewing in the foreign exchange markets causing a slightly higher rate of volatility. The astute investors knew something was going to give. The question was what?

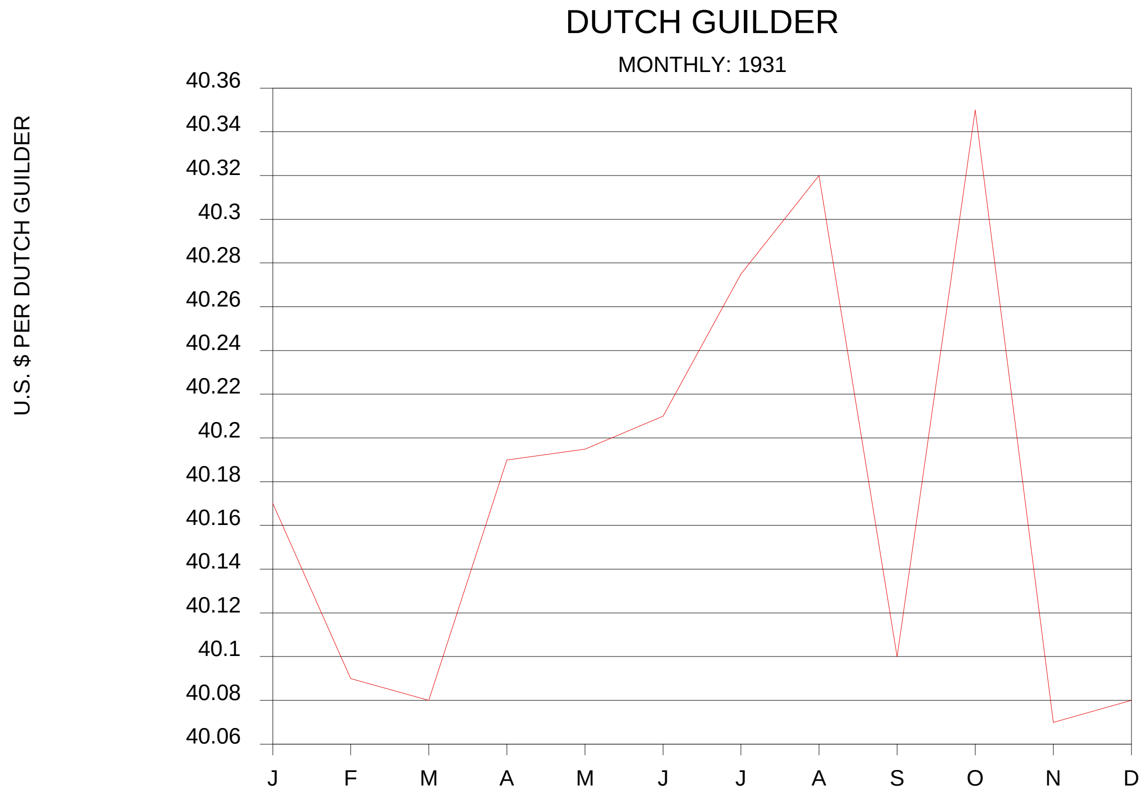


The causes for the sudden break were many. The effects of the depression were becoming severe in Canada which was a prominent trading partner. Canada had imposed stiff tariffs against steel as discussed earlier, but it also instituted tariffs against a number of finished products including automobiles. In effect an embargo against U.S. autos had been put in place. U.S. sales of automobiles to Canada dropped virtually overnight during the first quarter of 1931 bringing them down to nil. Nash Motors and Durant Motors of Canada joined forces and formed a subsidiary to produce autos at Leaside, Ontario in March. Both the Reo Motor Car Co. and Hupp Motor Car Corp. made arrangements to open plants directly in Canada. The auto industry was already off 40% in earnings on the average between 1930 and 1929. The fight to remain competitive only further weakened the industry and rumours that the first quarter of '31 was going to be disastrous spread through the stock market.

The production total for automobiles in April 1931 was nearly 350,000 units compared to 444,000 in April 1930. Chevrolet was still gaining over Ford. Its April production came to 85,000 units compared to March. Cadillac was also up 26% above March 1930 levels and on a quarterly basis it was up 20% over the first quarter of 1930. But these gains were at the expense of other competitors including both Chrysler and Ford.

In its April 13, 1931 edition, Time Magazine commented on the atmosphere as early April began:

"A heavy gale accompanied April to Manhattan. Wall Street ran with water-down. Offices were lighted all day. It was dismal, not exciting, on the floor of the New York Stock Exchange. Most traders kept an eye on Post 2, where United States Steel is traded in. Shortly after noon Steel sold at $138, one-eighth above its previous 1931 low. It was evident that what had a few weeks before seemed a run-away Spring market had petered out.


DUTCH GUILDER
MONTHLY: 1931
U.S. $ PER DUTCH GUILDER
40.36
40.34
40.32
40.3
40.28
40.26
40.24
40.22
40.2
40.18
40.16
40.14
40.12
40.1
40.08
40.06
J F M A M J J A S O N D


BRITISH POUND
MONTHLY: 1931
U.S. $ PER BRITISH POUND
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
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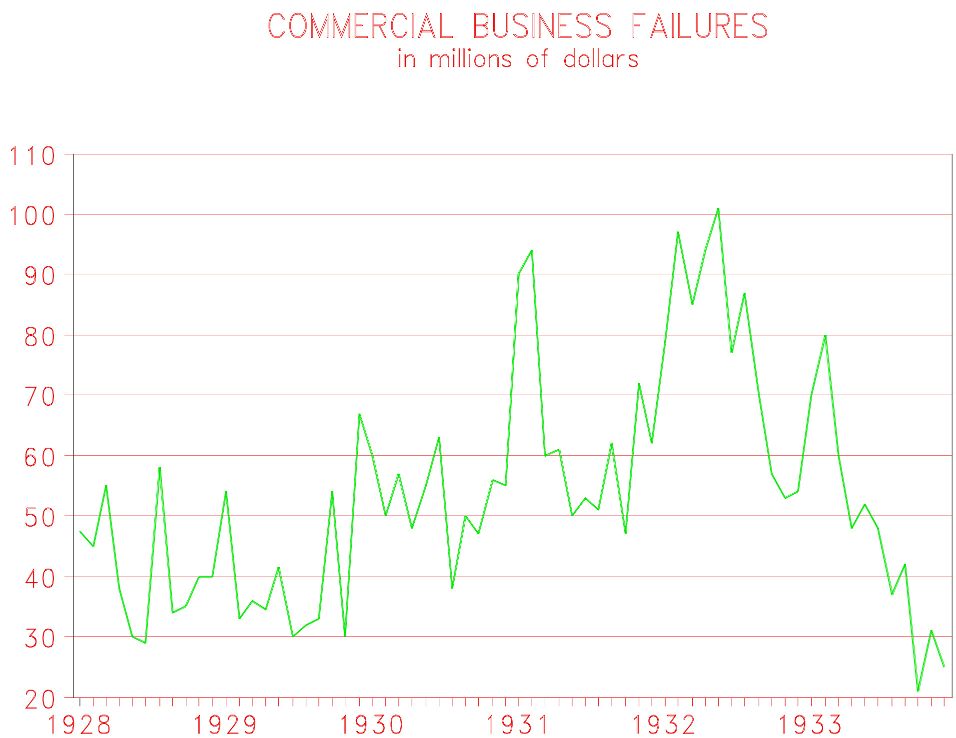

"Traditionally April 1 is the day when bankers and businessmen can look about them, size up the state of business. All last week figures were being issued which showed that the Spring recovery in business did not exceed the usual seasonal gain and was giving signs of dying away. Perhaps most frightening, so far as the stock market is concerned, have been the many dividend reductions and omissions, although these reflect past business not future. During March, 114 dividends were omitted, as against 57 such actions in March 1930; 115 dividends were reduced against ten last years.

"Insolvencies during March came to $60,386,000, a 6% gain over March of last year and the largest for the month since 1924. Insolvencies during the first quarter were $214,000,000 against $218,000,000 in 1922, $169,000,000 last year.

The market had taken the continually rising dividends and earnings as the keynote to a bull market throughout the 1920s. You will recall that the critics of the bull market did not deny that the earnings were spectacular, they merely kept saying from 1923 onward that such gains couldn't possibly last.

In the commentary taken from Time magazine above, we find that it was the omission of dividends and the poor earnings reports as well as expectations of the future which contributed in part to the decline from the February high in 1931. But in addition, there were numerous other indicators that the traders were watching very carefully. Bank clearings were off 22% suggesting that money was not only being hoarded, but sat upon by many out of fear of safety but also out of a natural urge to put something away for a rainy day. At that time the rain had turned into a typhoon.

Railroad car loadings were also off 15% from 1930 levels in March of '31 and down 22% from 1929 levels. Of the first 75 railroads to issue February reports, there was a 53% decline in operating income.

The optimism which had once existed even in the oil industry gave way to the logic of the pessimist. Government's harassment of this industry had continued in the early 1900s in breaking up the old Standard Oil Co. under the guise of the Sherman Anti-Trust Act. Ever since that time, government's oppression continued to plague the oil industry. In January 1930 in the Federal Court of Chicago, the government charged the Standard Oils of New Jersey and Indiana along with Texas Co. and 45 other oil companies with violating the Anti-Trust Act in keeping tight control over their patents and for a variety of cross-leasing of fields between companies. The government won that case back in 1930, but in April 1931 the U.S. Supreme Court held that the companies did not create a monopoly which hindered interstate commerce by maintaining patent rights. The battle had raged on for seven years costing the shareholders millions in the process. Despite this bit of good news, the new discoveries in Eastern Texas were officially estimated to have a capacity for the production of 500,000 bbls. per day. This worked out to be 182.5 million bbls. per year, which was a 20% increase above current domestic production. This obviously didn't help the oil stocks very much at this time.

In addition, the periodical, World Petroleum, reported on the rumours that Soviet oil production would capture the Chinese market which was primarily for kerosene. This naturally was viewed as a setback for U.S. interests which supplied that market. U.S. refineries in April 1, 1931 were operating at 65.3% of capacity compared to 70.9% on April 1, 1930. Prices of oil continued to decline and inventories of gasoline continued to rise as illustrated by the following tables:

U.S. CRUDE OIL PRICE MOVEMENTS

Jan 1 - Apr 1, 1931

	Jan 1	Apr 1	%chng
High-Grade Calif	1.48	.35-	76.3
Mid-Continent	.81	.53	34.5

U.S. GASOLINE INVENTORY IN BBL.

Jan 1 - Apr 1, 1931

Gasoline Stocks	42,218	47,444	+ 12.3%

The above tables clearly illustrate the plight of the oil industry during this phase of the Great Depression. By mid-April '31, Shell Oil cut its work schedule to a five-day work week. This merely added to the unemployment rolls. The trend was clearly developing into cutting both time and wages as opposed to the original suggestions made by Hoover to cut time but not wages to relieve the state of overproduction and maintain consumer purchasing power.

The government's intrusion under the guise of the Sherman Anti-Trust Act continued to broaden. The government even began a monopoly investigation of Ringling Brothers, Barnum & Bailey Circus. Despite the adverse effect upon U.S. competitiveness in world markets and the rising difficulties which faced U.S. industry, the government vehemently pursued the Sherman Anti-Trust laws under the promise of protecting the consumer. In many ways, it was the Anti-Trust Act that spawned the need for the Smoot-Hawley Tariff Act of 1930 which in turn merely stimulated the worldwide trade war.

The decline in the market at this time was also caused in part by additional banking failures. But perhaps within this sector of causes, none was as highly influential at the moment as the failure of the well-known brokerage house of Pynchon & Co. The failure of this firm was indeed a surprise. More than a year before there had been rumours that this renowned firm was in trouble. Nevertheless, it was also well known that the famous Chase National Bank stood behind it to some degree. Back in 1930 it was rumoured that Chase had loaned Pynchon anywhere between $10 and $20 million. Many were completely shocked by the flash across the ticker which read: PYNCHON & CO SUSPENDED FOR INSOLVENCY."

Despite the rumours, the majority just didn't believe that this firm would actually go down. The Exchange itself was in possession of a telegram in which a well-known Chicago tycoon was reported to be putting up needed capital. So most had thought that it was a temporary situation and that any problems had been forestalled. But the Chicago tycoon's capital never came to pass.

Pynchon & Co. was no small house. It had 11 offices including offices in London, Liverpool and Paris in addition to being a member of 16 stock and commodity exchanges. Pynchon & Co. had been around for 36 years, certainly qualifying it as one of the "establishment." Yet the amount of money involved came to $40 million, which qualified it as the largest failure in the history of the New York Stock Exchange up until this time. Indeed the effect that this also had upon the market was not one of the great expectations. Three days later, the firm of West & Co. based in Philadelphia also failed. West & Co. was not considered to be a major firm, but it helped to raise fears over the stability of the brokerage business in light of the numerous failures taking place within the banking industry.

Another factor that added to the heat of selling was the continual reporting on the first quarter earnings. Many investors, speculators and traders had just allowed their hopes to override reason, creating an atmosphere of jubilant expectation as the market rallied into the February high. But now those expectations proved to be very ambitious and all the comforting words from business leaders did little to improve the situation. The following table illustrates a few selected industries.

1931 FIRST QUARTER EARNINGS
(in thousands of dollars)

	1931	1930	% chng
American Bank Note	1,019	1,523	-33.0
Borg Warner	325	1,097	-70.3
Caterpillar Tractor	1,031	3,365	-60.3
Chrysler Corp	(-979)	180	-643.8
Corn Products Ref	2,389	3,152	-24.2
Curtis Publishing	4,654	6,533	-28.7
General Electric	11,488	15,042	-23.6
General Foods	5,572	5,990	-6.9
General Motors	28,999	44,968	-35.5
Gillette	1,421	2,164	-34.3
Hudson Motor Car	226	2,316	-90.2
Hupp Motor Car	(-680)	66	-1130.3
McGraw Hill Pub	372	534	-30.3
Montgomery Ward	(-1,783)	(2,318)	30.0
National Cash Regs	(-373)	912	-140.8
Otis Steel	20	634	-96.8
Parkard Motor Car	113	2,654	-95.7
du Pont	12,656	17,347	-27.0
Studebaker	809	1,347	-27.0
Westinghouse Elec	(-2,885)	4,546	-163.4

In studying the first quarter earnings for 1931, I found that on a broad basis, disregarding individual size of each corporation and without any weighting, that the once great auto industry reported a 271% decline in first quarter '31 earnings. The expanding electric industry reported a 93.5% average decline in earnings. Two of the least adversely affected industries were publishing, off 30.6% and food processors (not agricultural producers), off 15.5%.

It is ironic that when the stock market first began to crack back in 1929, many blamed the demise upon the "optimistic" statements by business leaders and politicians. If that line of thinking were valid, all the optimistic statements during the early part of 1930 and in January-February 1931 should have also supported the market. In the end, all the optimistic statements failed to have any effect. The public judges a given situation by what it sees, NOT by what it hears. Everyone was bullish back in 1929 based upon the continually rising prices of common shares, NOT based upon the words of Hoover or anyone else.

It was also in March 1931 that Wallace Brett Donham, dean of Harvard's Graduate School of Business Administration, published his book entitled: "Business Adrift" (McGraw-Hill). In this contemporary philosophical piece of the era, Donham struck at the heart of many issues. "How can we as businessman within the areas for which we are responsible, best meet the needs of the American people, most nearly approximate supplying their wants, maintain profits, handle problems of unemployment, face the Russian challenge and at the same time aid Europe and continue most to or disturb least the cause of international peace?" Essentially, Donham warned that the U.S. should not engage in ruthless competition with Europe. He felt that such a trade war would eventually lead to the spread of communism throughout Europe and even into Britain itself, causing the destruction of Western civilization.

Donham's views were quite forceful. On the Sherman Anti-Trust Act, he said: "The time has come for a complete reappraisal of the attitude toward competition which is expressed in the Sherman Act." On the issue of unemployment he warned: "Unemployment is as much a general social problem as it is a business problem and...solutions...must be worked out by business and politics in combination... The whole principle of insurance as applied to unemployment is unsound. The remedy for unemployment is work."

Donham also warned that "the job of each generation is to consider not only economic theory but the whole gamut of the complex sociological factors existing at the time and to stimulate progress...So far as possible it should avoid creating new dangers for its successors...I have, however, no doubt about the soundness of my conclusion that we must have a philosophy, a plan, and a method of thinking about the future. Without these, the influence of American business on civilization will be destructive...The danger in our situation lies not in radical propaganda, but in lack of effective business leadership. Great problems, upon the decision of which the whole history of the future may turn are receiving no adequate attention. Even the mechanism of thought

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When sound bonds bearing a coupon rate of 5%, 5½% or 6% can be purchased at prices to yield seven or eight per cent or more, the purchaser is certainly getting his incoming dollars at a substantial discount.

Good bonds are a desirable form of investment at any time. At this time they present unusual opportunities for profitable income.

The conditions which have developed these opportunities for investors are rare, but they are by no means unprecedented. The more experienced investors will recall, for example, that unusual conditions also prevailed in the bond market during 1920-21.

There were then, as now, many sound bonds available at prices which presented exceptionally liberal income returns.

Numerous indications support the belief that the prices of carefully selected bonds will in the future, as in the past, show improvement when business returns to higher levels.

Our suggestions for investment adapted to varying individual and institutional requirements, and including a list of selected bonds selling at substantial discounts, will be submitted upon request.

Harris, Forbes & Company

Pine Street, corner William, New York

Uptown Office: Lincoln Building
60 East 42nd Street

Harris, Forbes & Company
Incorporated
Boston

Harris, Forbes & Company
Limited
Montreal

Harris, Forbes & Company
Limited
London

Harris, Forbes & Cie
Paris

Harris Trust and Savings Bank
Bond Department
Chicago

necessary to the rational handling of such problems is not understood. I see nowhere signs of a general philosophical attack on the problems of the relationship of American business to civilization."

Donham neither came out against the tariff issue nor in direct favour of it. But he did advocate a tariff system for those industries in which their demise would lead to a drastic change in the social structure. He was against tariffs to protect newly developing industries which would attack the old established industry in another nation.

Donham was correct. The issue of unemployment insurance did not stop right there and the reasoning behind the issue did not strike at the problem itself. But from the unemployed's perspective, it at least provided food to sustain one's family. The philosophical issues of which Donham spoke were never addressed. Government continued to broaden its powers with little foresight to the damage it might create for future generations. The anti-trust laws were never repealed and they were used to eventually carve up AT&T in the 1980s, which did not save the consumer anything but instead seriously raised the costs in many areas on the local level. It is doubtful that the anti-trust laws have ever been successful in protecting the consumer. They have merely added to the arsenal of weapons which government has at its disposal for manipulating the free enterprise system.

Indeed, there were many issues of philosophical debate. One of the primary arguments resided within the issue of wages. Henry Ford had become the symbol of the theory that if wages could be maintained that in the long run purchasing power of the consumer would prevent a depression. You will recall in the 1929 chapter that we quoted Ford's famous statement on this issue made back in December 1929 following the Hoover White House conference with business leaders. There was considerable doubt about this theory by April 1931, particularly when the dismal first quarter earnings were released and the 1930 low was violated in the stock market.

Despite the claims from the high-wagers that maintaining high wages would increase purchasing power and speed the recovery, no evidence of this theory was present. Many of the opposition were bankers. The famous Melvin Traylor of First National of Chicago, former adversary of Benjamin Strong back in 1927, said that "employers must be as quick to recognize the real wage (based on purchasing power of the dollar) in a rising market as labor must be to recognize the real wage in a falling market." Others argued that by lowering wages it would reduce the cost of production, thereby reducing retail prices and stimulating purchases, which would speed recovery. Supporters of the high-wage theory warned that reducing wages would be socially dangerous and that it was not fair for the rich board directors to squeeze the working man's salary. The arguments were logical for both sides, but the reality of events indicated that maintaining high wages did not prevent the Depression from worsening and in many cases it threatened the survival of industry during such a sharp contraction in the business cycle. Labour may have received their high wages at first, but confidence in turning around and spending their earnings was not there. Hoarding of gold continued to rise thereby reducing the velocity rate of money turnover by 22% from the previous year as the second quarter of '31 began.

Indeed, gold became very attractive both in physical form as well as in gold stocks. One example of this was the performance of Noranda Mines, Ltd, a large copper and gold producer in Canada. Noranda's earnings for 1930 were $3,842,000 against $4,287,000 during 1929. Despite this decline, stockholders did not become discouraged. In late March news came out that Noranda had just struck a new vein of gold. The stock traded on the New York Curb Exchange and on the Toronto Stock Exchange. It was steady at the $17 level prior to the news and then buying activity soared taking the price of the stock up to $27 despite the broadly declining stock market.

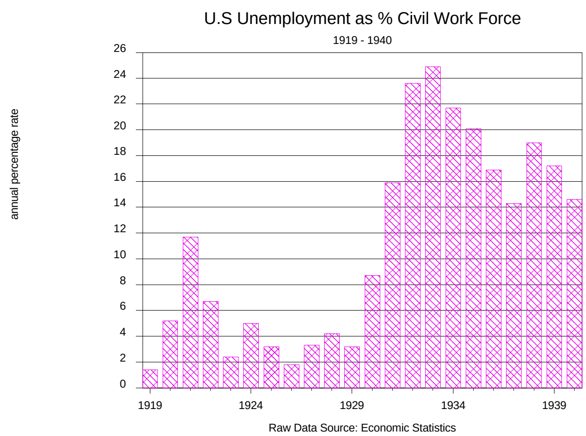
Noranda was a larger producer of copper than gold and, indeed, today it is still better known for its copper than its gold mines. This stock had peaked at $44 during 1929 and fell to $17 prior to the news of this new discovery. The total value of Noranda's outstanding 2.2 million shares jumped back by $22 million U.S.

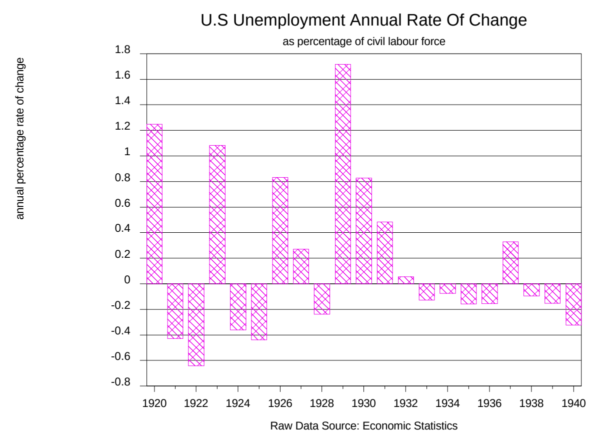
Homestake Mining is perhaps a more pure example of a gold stock. From the high of $100 back in 1906, Homestake fell $54, bottoming during the panic of 1907. During World War I, Homestake rallied to $135.50 in 1916, but failed to make a new high in 1919, stopping at $100 when the broad market was moving into uncharted territory. But Homestake continued to decline and eventually fell to its all-time low of $35 in 1924, closing the year at $43. By 1927, this stock rallied back to as high as $74.50 just prior to the central bank intervention which lowered interest rates in the U.S. in an effort to help Europe. Homestake continued to rally, but by 1929 it had peaked at only $93 closing the year at $77. The Great Bull Market had failed to take Homestake to new highs for this century when virtually all other stocks rallied substantially above previous bull market highs.

As the depression began to set in, Homestake fell to $72, bottoming during the first quarter when all other stocks were rallying sharply. But as the broad market declined, Homestake began to rally reaching $83 and closing the year at $79 7/8. Homestake then soared, gapping higher as 1931 began. The low for the year was $81 and as the international situation worsened, Homestake continued higher reaching $138 and closing 1931 at $129.

This was far from the high on this stock. During 1932, the yearly range was $163 to $110 and in 1933, it carved out a trading range of $373 to $145. Under the policies of Roosevelt, Homestake flourished eventually reaching $544 a share by 1936. Between 1924 and 1936, Homestake had appreciated 1,454%, far outpacing the broad market quite easily. It was in 1937 that Homestake split 8:1 and fell to its lowest point in 1942, reaching $23 which was equal to $184 expressed in terms prior to the split. It then rallied to $60.75 ($486 in pre-split terms) in 1945, culminating into its high for World War II. But that 1945 high had not exceeded the 1936 high of $544 when inflation was the primary fear at the time, more so than geopolitical tensions.

It was in the May 18, 1931 edition of Time magazine that a discussion about the Federal Reserve's latest move appeared - a cut in the discount rate to 1.5% which was the lowest in history for a central bank and the bottom for the Great Depression. "Anxious to give business a stimulant last week, the directors of the Federal Reserve Bank of New York slashed its rediscount rate from 2% to 1.5%. Money eased throughout the land. The immediate aim and probable result was to aid England which has been losing gold to the U.S. Over a longer period, agreed bankers last week, it should encourage foreign financing in the U.S.,



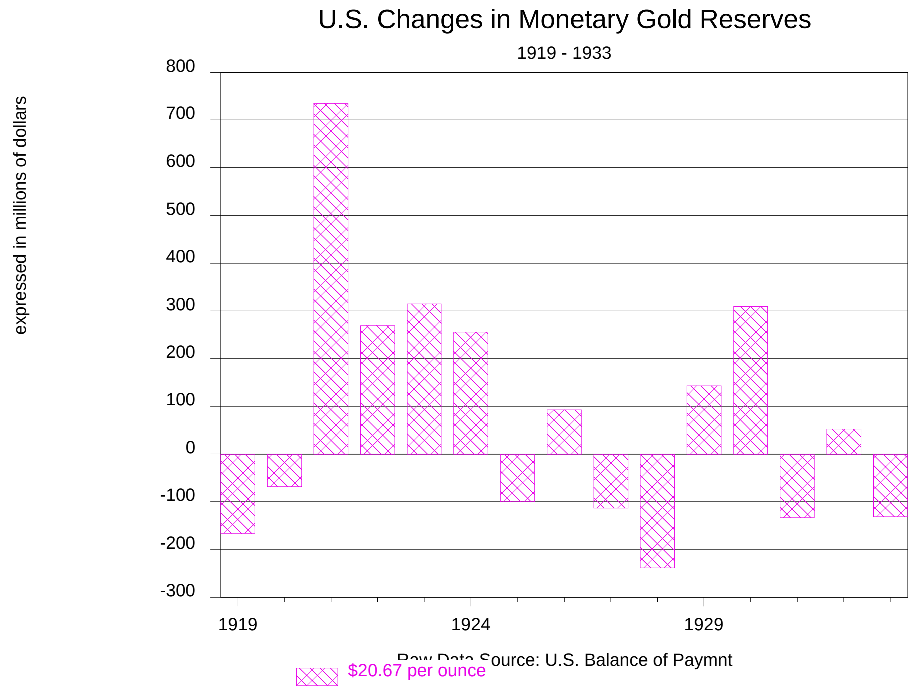


likewise issues by domestic companies. Yet last week the state of U.S. business was such that no sudden demand for funds was expected, no immediate revival held likely."

Money had fallen to its cheapest rate for the 20th century. Back in 1894, following the famous Panic of 1893, 30-day funds in New York had fallen to 1% as money sat idle in the face of a lack of confidence toward investing on the part of industry and capital. Even as late as 1895, the all-time low of 5/8 of 1% formed the bottom on the open market discounts in London. This time was no different. Capital, far from contented, was still afraid of investment. Industries by and large sought not to expand but to contract as with this trend demand for capital declined severely. This is perhaps evidence in itself that during periods of economic expansion, demand for capital rises from the business sector bidding up the price of money (interest rates) in the same fashion as increased demand causes the price of a given stock to rise. Our modern day perspective that the stock market should rise during periods of declining interest rates and fall during periods of rising interest rates cannot be supported when we review the facts that history has provided.

In the commonly accepted form of modern fundamental analysis, we have chosen to only remember that interest rates and the stock market usually peak in unison but we forget that such unions at the top do not translate into the maxim of "rates up-stock down." In reality, demand for both capital and stocks tend to peak in unison but there is no prescribed rate at which rising interest rates will change the trend of speculation or investment. In 1893, the stock market peaked when call money reached 75%. In 1899, the stock market peaked after a brisk two-year rally only when call money reached 184%.

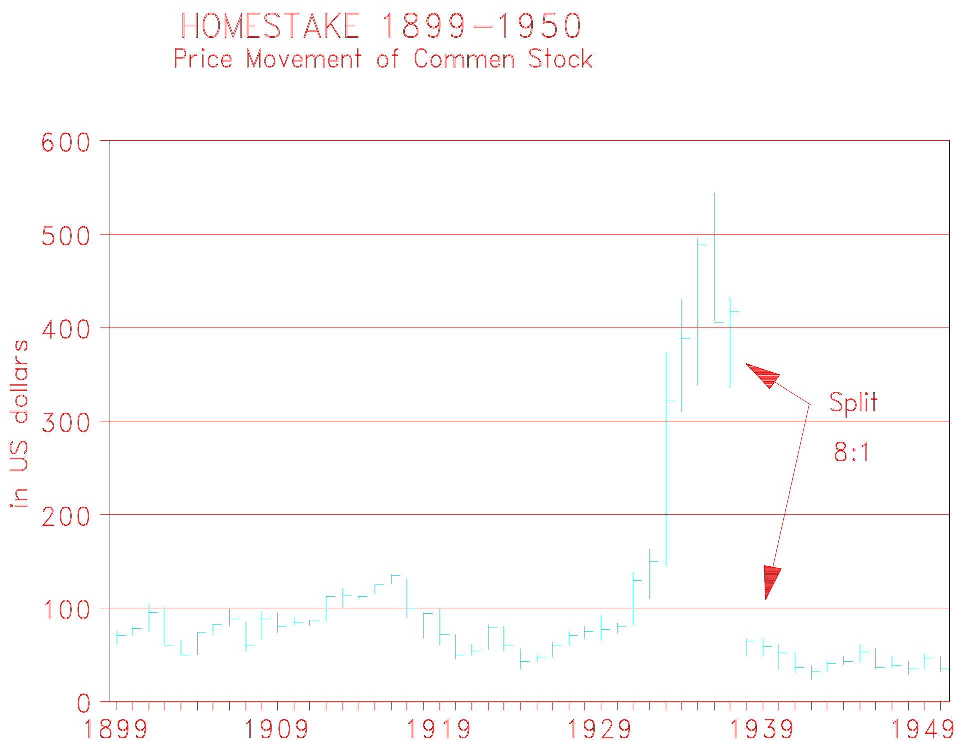
In 1905, call money soared to 125%, yet the stock market continued higher eventually peaking in 1906 when call money was 62% and the panic of 1907 took place when call money rallied back to 125%. The rally



in the market, which came to a crest in 1916, did so when call money peaked at only 15% and the next rally in 1919 peaked when call money finally reached 30%. Even the peak in the market during 1929, which was three times greater than the high achieved in 1919, came with call money rates at only 20%. The amplitude of rallies cannot be measured in direct proportion to the amplitude in the call money rate. Although the directional movements are similar, the levels of previous highs and lows between the two do not offer any direct correlation.

It also follows, therefore, that sitting in the chairman's position at the Federal Reserve, there is no way one could be sure to what degree manipulation of the discount rate would be necessary to turn the tide within demand. It has always been a hit and miss affair resulting in a serious problem from a timing perspective. The Fed reacts too late and then compensates too late as well. There is no guide book to speculation and free market manipulation that states definitively that if the discount rate is raised to such and such point that demand will decline. In each case, the reasons for the various panics prior to 1929 were largely quite different. In some cases, panics were caused by a drastic drop in the gold reserves prompting a lack of confidence in government's ability to meet its debts. This sent capital fleeing from banks into selected securities and even into hoarding gold. In other cases, panic was created by natural disasters which seriously disrupted the cash flow between various sectors of the United States sparking bank failures which gave rise to the birth of the Federal Reserve.

The Panic of 1837 saw heavy speculation in real estate and the subsequent collapse thereof. In the case of 1929, the speculation was concentrated within the stock market, focusing within the industrial sectors which were expanding rapidly. During the early 1900s, speculation was concentrated within the railroads as they became the bright new expanding medium of innovation. And in the panic of 1869, gold rose to $162 an ounce in New York, a figure when adjusted



into 1980 dollars far exceeded $5,000 an ounce.

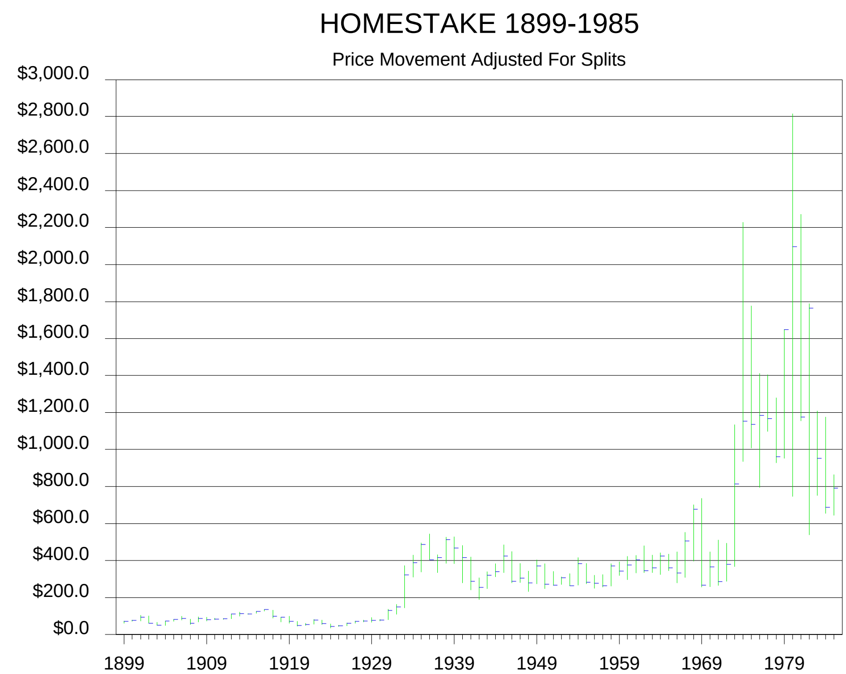
The article provided previously on this last discount rate cut to 1.5% specifically stated that the cut was instigated to help ease the pressure on Britain. Why did the stock market merely pause during early May and then soon drop to new lows once again ? Why did the discount rate cut fail to stimulate business? To answer these questions, we must move back to the events that were taking place in Europe during May of 1931.

World War I and the Russian Revolution both had a profound impact upon the European economy. First, Russia had become a communistic state which severed a once vital market for foreign trade among Western European nations. Russia was no longer an importer of fine lace, cut glass or crafted Swiss watches. It had degenerated into a nation that despised man's artistic qualities and God's divine guidance. This severed the right arm of European trade, leaving primarily its left arm which stretched across the Atlantic to America.

Second, the urge for power and the spoils of war had carved Europe into little pieces. Following the war, 12 new European states emerged and with them, imposing trade barriers through tariff laws sought to protect each state against the others. The war of guns had been concluded, but this was replaced by a financial war striving for that trade surplus as its ultimate goal.

In addition, the once great Danube Valley had been the Jewel of European productivity. This spoil was chopped up and shared by five nations. This left Austria in the poorhouse. Vienna had once depended greatly upon the resources and business that came its way from that valley. It now had its once thriving economy cut off at the pass.

These measures along with the Treaty of Versailles had isolated Germany and Austria, reducing their former economic viability significantly. It was this combination of

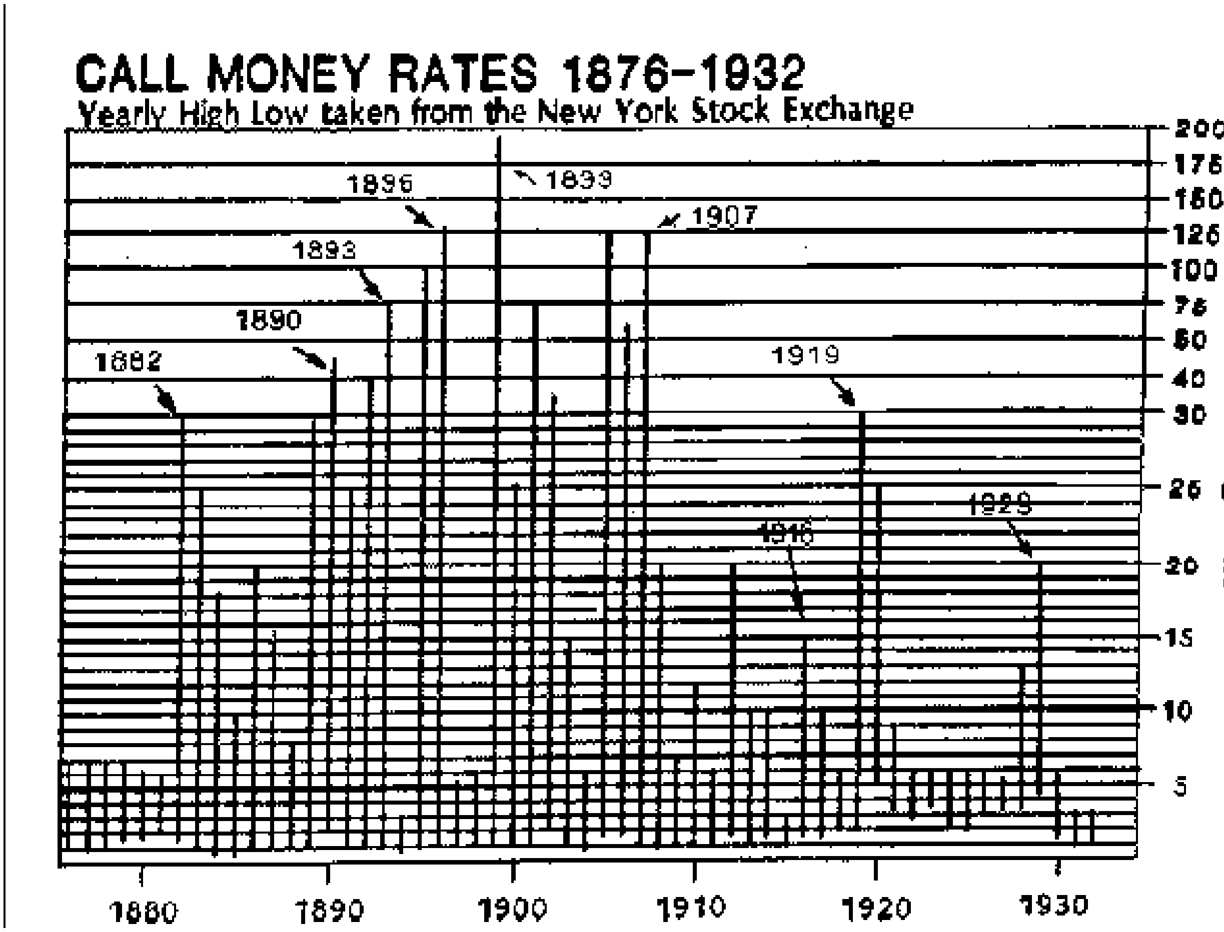


losing vital economic resources within Europe and the loss of Russian trade which prompted great tariff walls throughout Europe. Add to these problems the practices of "publishing" paper money through deficit spending, which was monetized creating higher and varied rates of inflation in Europe, and the mixture became a time bomb waiting to explode.

These circumstances led to the incentive toward price fixing and cartels which had trained their sights upon the U.S. markets when Russia had effectively been eliminated from capitalistic trade. It was this unusual set of problems which had given birth to the central bank manipulation of interest rates back in 1927 and the attempts which preceded it in 1925. The central bank intervention did not strike at solving the problems; it merely attempted to throw money at them hoping that they would simply go away. Instead, it weakened the U.S. position by allowing the U.S. to finance nearly the entire free world single-handedly. Thus the situation was similar in some respects to South America. All the loans in the world have not corrected the internal economic problems. The loans have merely postponed the inevitable until that final tomorrow comes around.

Fears over the banking situation were therefore just as alive in Europe as they were within the United States. The accusations that would arise during 1932 from Roosevelt, charging that responsibility for the worldwide depression lay with Hoover, were simply slanderous lies aimed at winning an election. There is no historical evidence that the depression resulted from any policies implemented by Hoover, nor was its origin within the United States. The tariff wars had raged on throughout Europe before Smoot-Hawley, which was a response not an instigation.

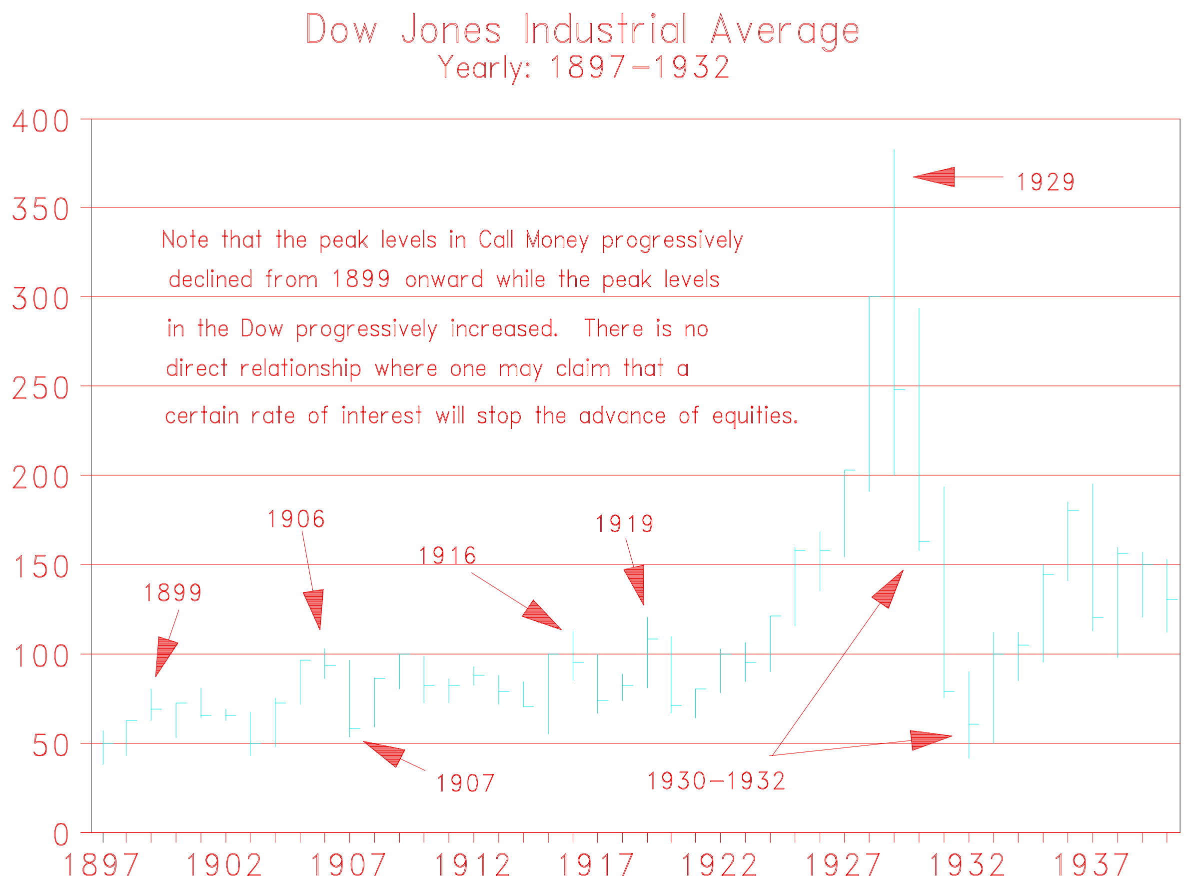
Germany, for example, was saddled with reparation payments it could not make. In turn any hope of achieving a trade surplus was beyond reason. Germany was forced to borrow dollars in order to meet much of its

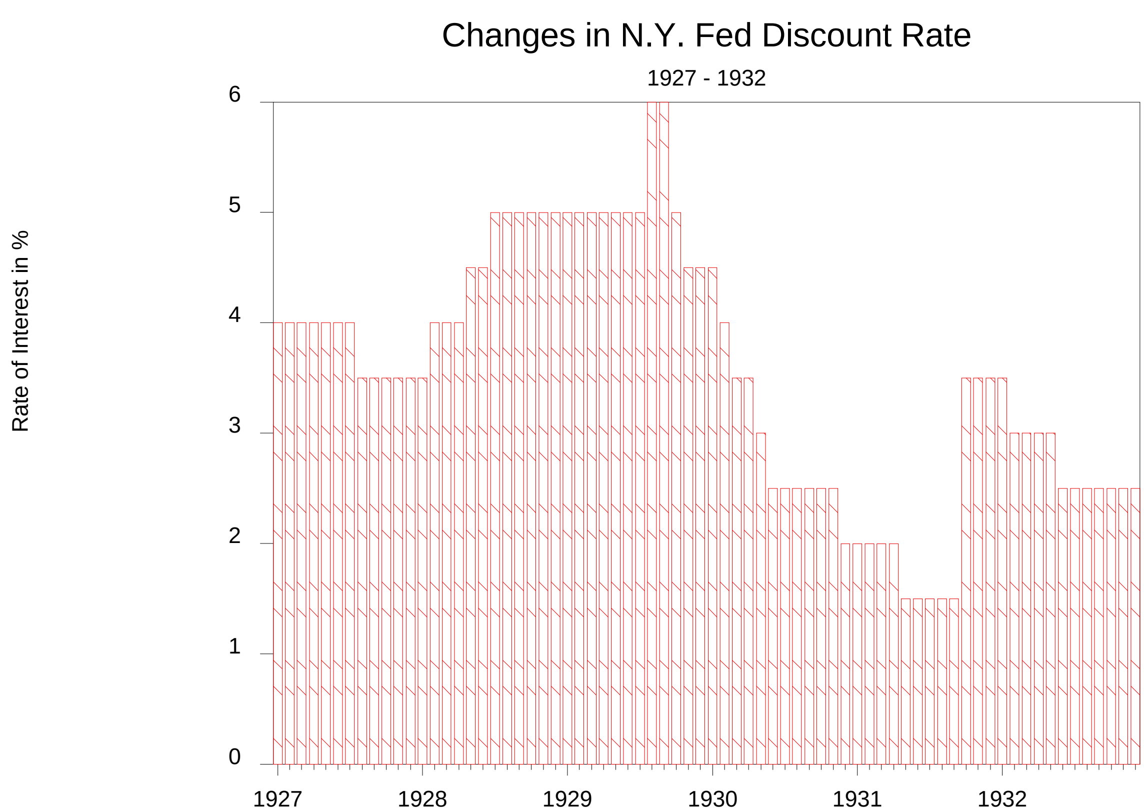


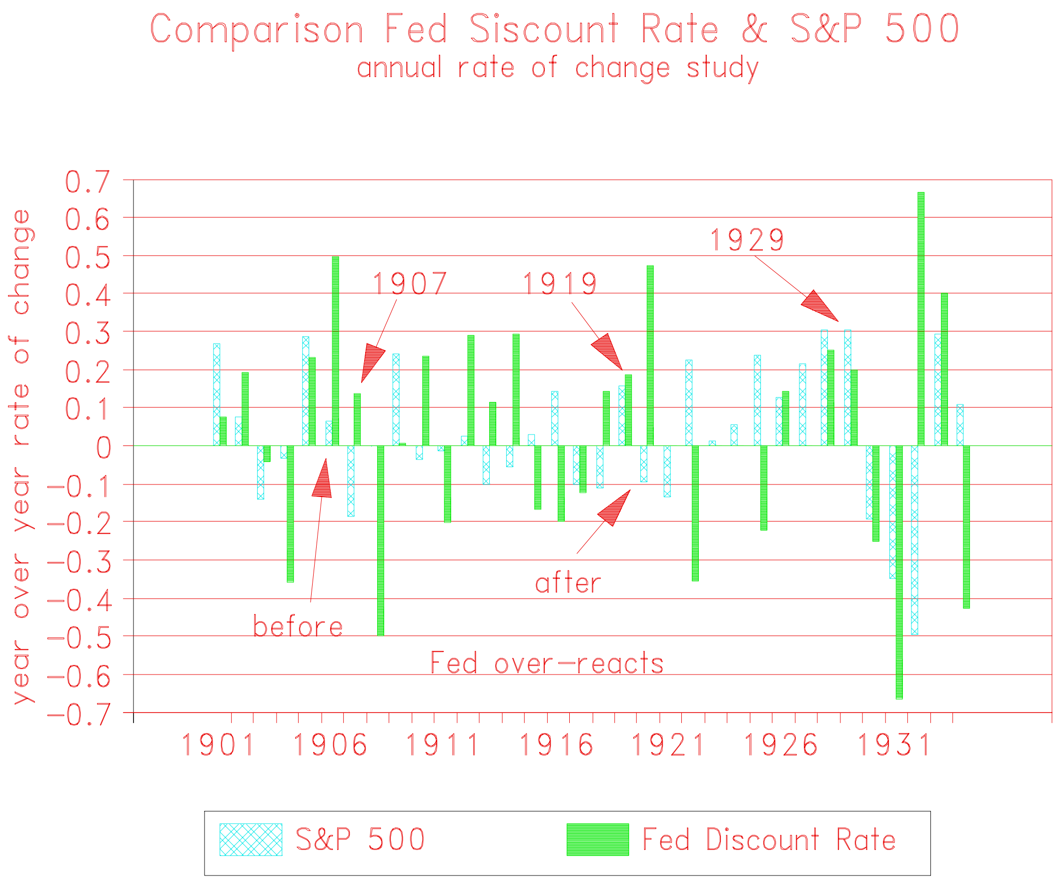
obligations, but without a trade surplus, it had remained a credit risk in some respects. Austria was in no better shape. The two were suffering greatly and they came to terms with each other on a customs agreement which would free up trade between the two and which they hoped would revive their stricken economies.

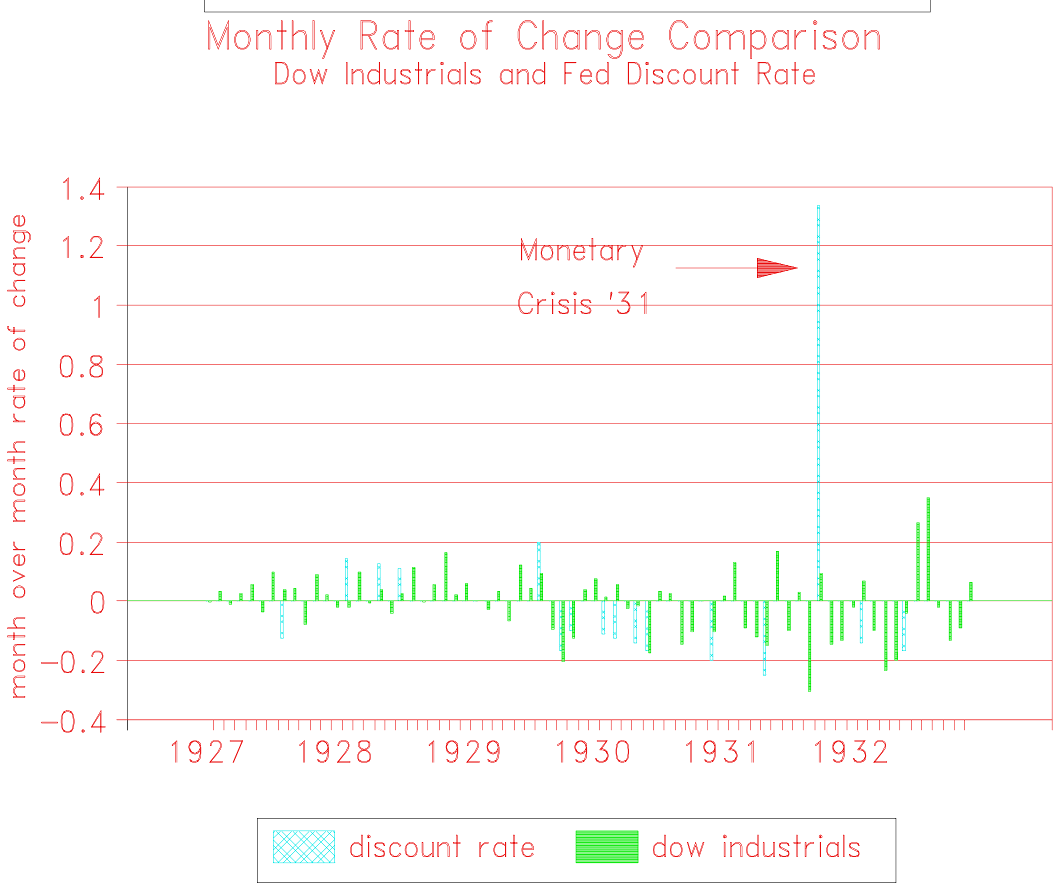
It was when this agreement between Germany and Austria took place on May 10, 1931, that financial war was declared by the French. France was perhaps the strongest European nation as a result of its intentional undervaluation of the franc in 1928. This gave rise to substantial flows of gold into France. Economically the undervalued franc and the fact that France was a heavily commodity-oriented nation which had imposed substantial tariffs to protect its economy both from the U.S. (prior to Smoot-Hawley) and its European neighbors, meant that France suffered least among the Western nations from the ills of depression. France protested the German-Austrian customs agreement, calling it a violation of the Versailles Treaty. In this the French were not alone. Britain also protested fearing that this was the resurrection.

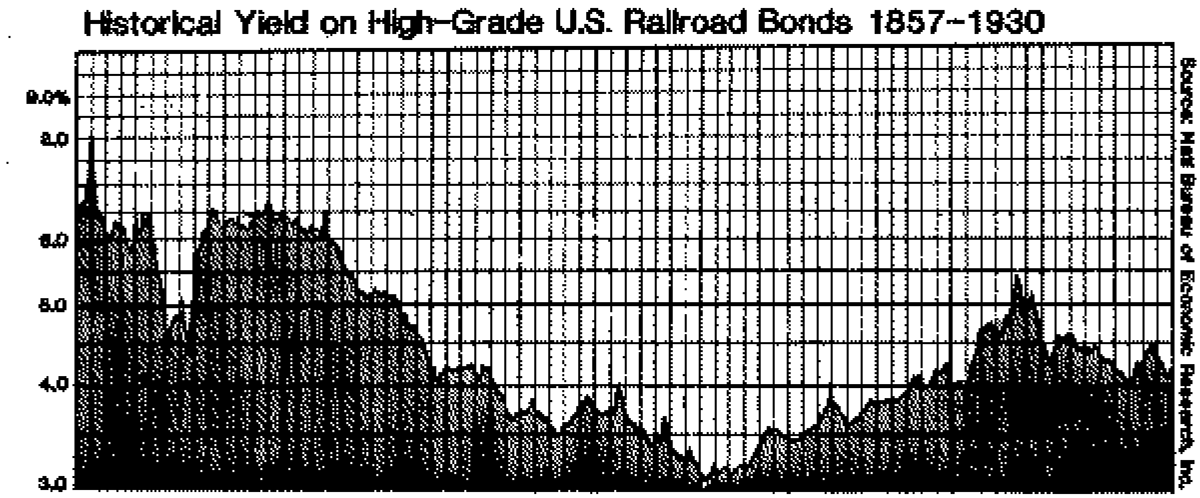
The French, however, virtually declared war financially. After the German-Austrian agreement was announced on March 21, 1931, and the formal protesting period had lapsed, France immediately turned. The Bank of France accompanied by many other French banks presented short-term Austrian bills which they held for redemp-


Dow Jones Industrial Average
Yearly: 1897–1932
400
350
300
250
200
150
100
50
0
1929
Note that the peak levels in Call Money progressively
declined from 1899 onward while the peak levels
in the Dow progressively increased. There is no
direct relationship where one may claim that a
certain rate of interest will stop the advance of equities.
1906
1916
1919
1899
1907
1930–1932
1897
1902
1907
1912
1917
1922
1927
1932
1937


Changes in N.Y. Fed Discount Rate
1927 - 1932
Rate of Interest in %
6
5
4
3
2
1
0
1927
1928
1929
1930
1931
1932


Comparison Fed Siscount Rate & S&P 500
annual rate of change study
year over year rate of change
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
−0.1
−0.2
−0.3
−0.4
−0.5
−0.6
−0.7
1907
1919
1929
before
after
Fed over−reacts
1901
1906
1911
1916
1921
1926
1931
S&P 500
Fed Discount Rate


Monthly Rate of Change Comparison
Dow Industrials and Fed Discount Rate
month over month rate of change
1.4
1.2
1
0.8
0.6
0.4
0.2
0
−0.2
−0.4
Monetary
Crisis '31
1927
1928
1929
1930
1931
1932
discount rate
dow industrials

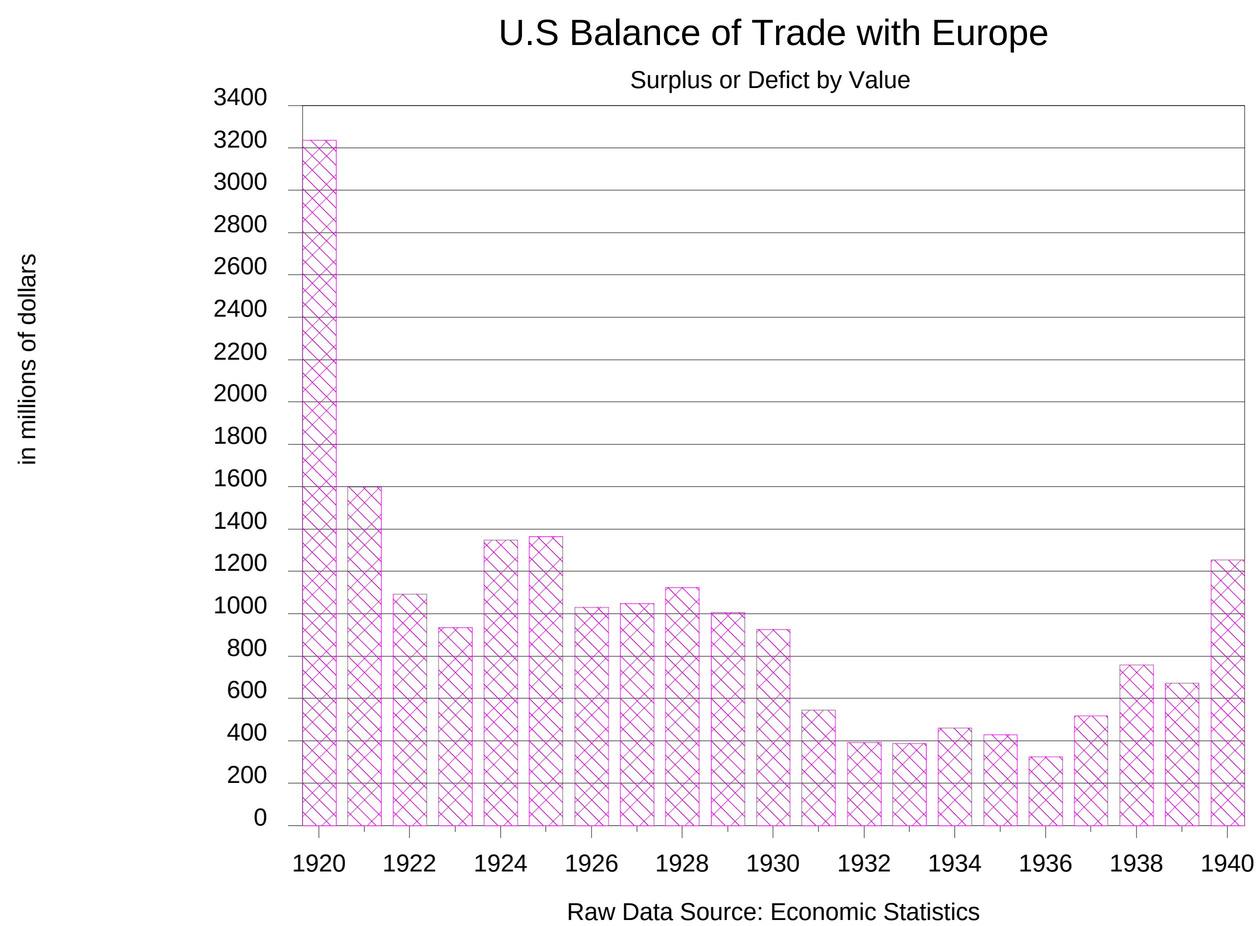


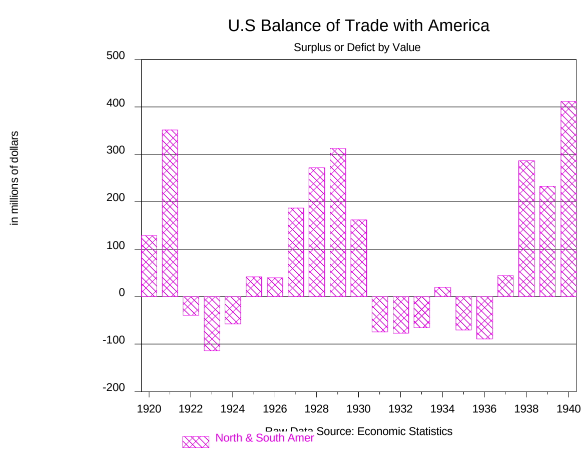
tion. They did the same with their German holdings. It was estimated that France held some $300 million worth of these bills at the time. This was the final straw which broke the back of the European economic system.

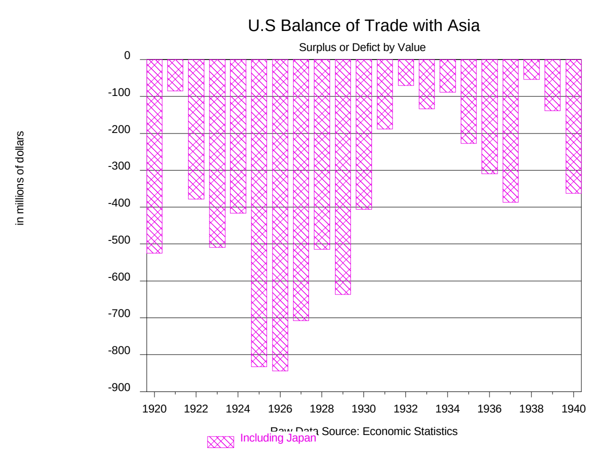
Britain, struggling to maintain the pound at the par level of $4.86, still suffered from a decaying domestic economy. The overvaluation of the pound had caused stagnation economically. British goods were high priced in the world market which did not help to stimulate a strong domestic recovery. Russia had been a close tie prior to the revolution and an important trading partner. Therefore, something had to give. If the pound remained overvalued then the domestic economy had to collapse. This state of overvaluation could not be endured forever.

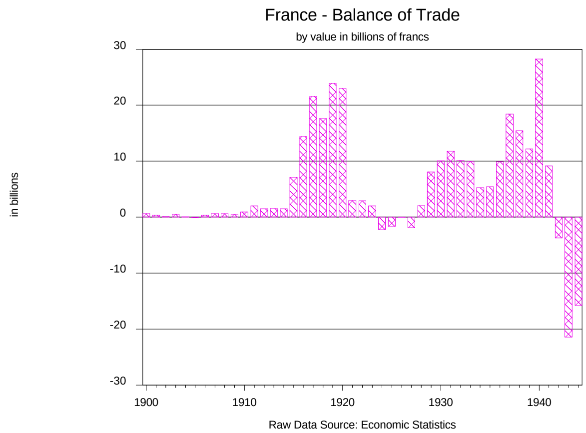
It was in May that the Credit-Anstait Bank failed in Austria, in part edged onward by the French. This was the oldest and most widely respected banking house in Austria. Its losses exceeded its total capitalization. The failure of the Credit-Anstalt had severe repercussions throughout Austria. Numerous banks all turned to the National Bank of Austria which quickly ran out of foreign currency reserves. Austria then had no other choice but to appeal to other nations. France, being the strongest, set the price as the dissolution of the German-Austrian customs agreement, which was a price Austria felt was too high. Toward the end of May, the Austrians then turned to Britain and the United States for help when the Austrian National Bank, their equivalent of the U.S. Fed, was on the verge of collapse. The French would not cooperate at all.

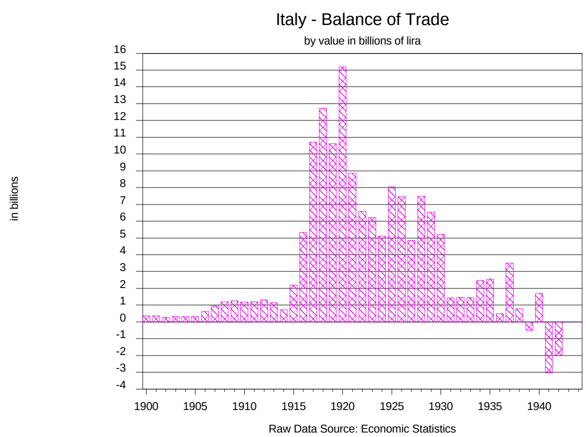
The economic policy of Britain was still largely in the hands of one man - Montagu Norman. As Governor of the Bank of England since 1920, Norman's unrealistic goal to maintain $4.86 on the pound at all costs was also accompanied by an international dream. Norman still saw Britain as the guiding light whose stature of former financial greatness was to be reclaimed. But at the same time, he was something of a tri-lateralist, so to speak. He believed in a European community working together, unlike the more self-centered aspirations of France.

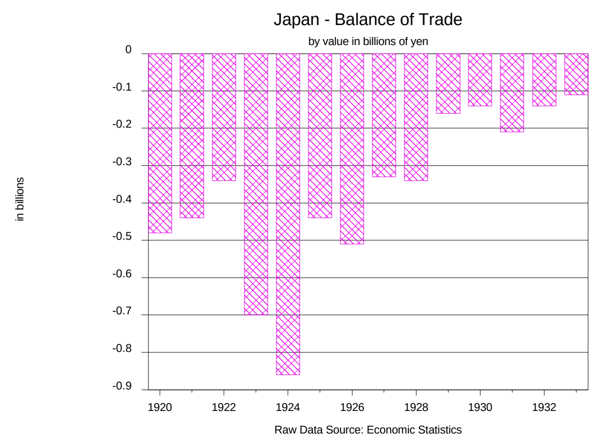

U.S Balance of Trade with Europe
Surplus or Defict by Value
in millions of dollars
3400
3200
3000
2800
2600
2400
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
1920 1922 1924 1926 1928 1930 1932 1934 1936 1938 1940
Raw Data Source: Economic Statistics


U.S Balance of Trade with America
Surplus or Defict by Value
in millions of dollars
500
400
300
200
100
0
-100
-200
1920 1922 1924 1926 1928 1930 1932 1934 1936 1938 1940
Source: Economic Statistics
North & South Amer


U.S Balance of Trade with Asia
Surplus or Defict by Value
in millions of dollars
0
-100
-200
-300
-400
-500
-600
-700
-800
-900
1920 1922 1924 1926 1928 1930 1932 1934 1936 1938 1940
Source: Economic Statistics
Including Japan

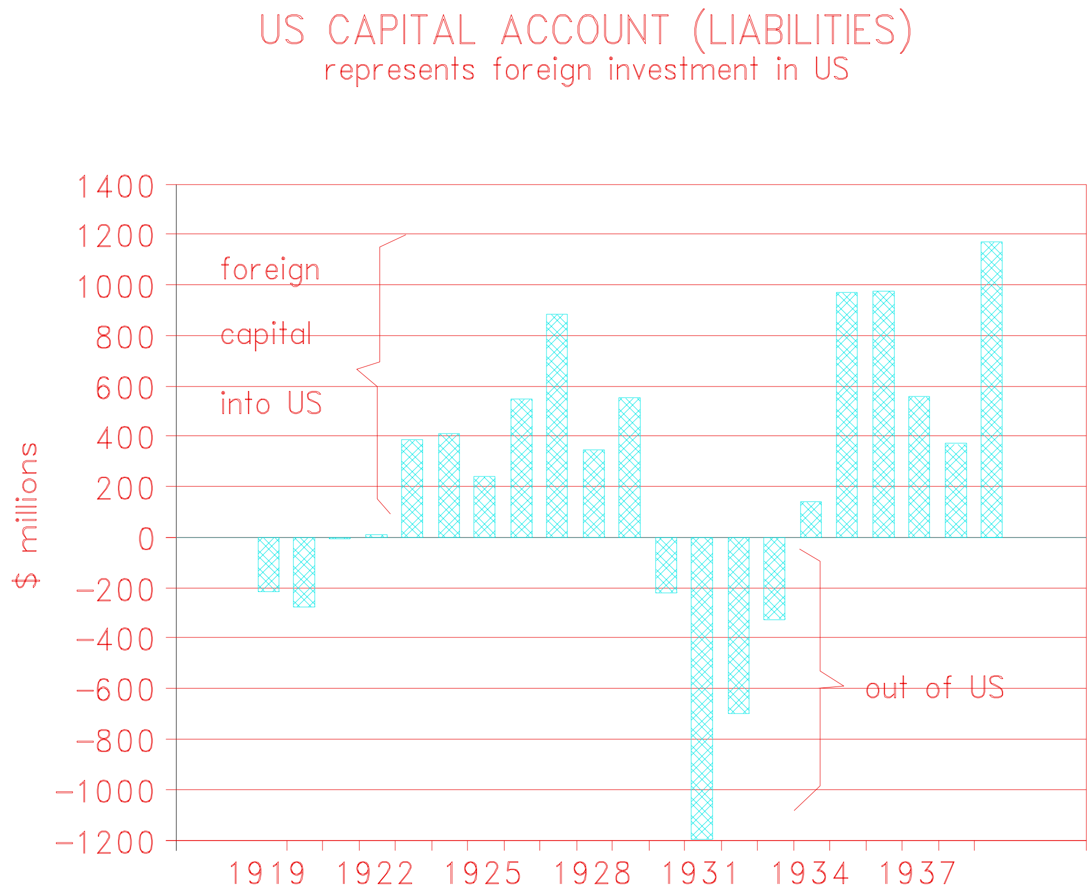


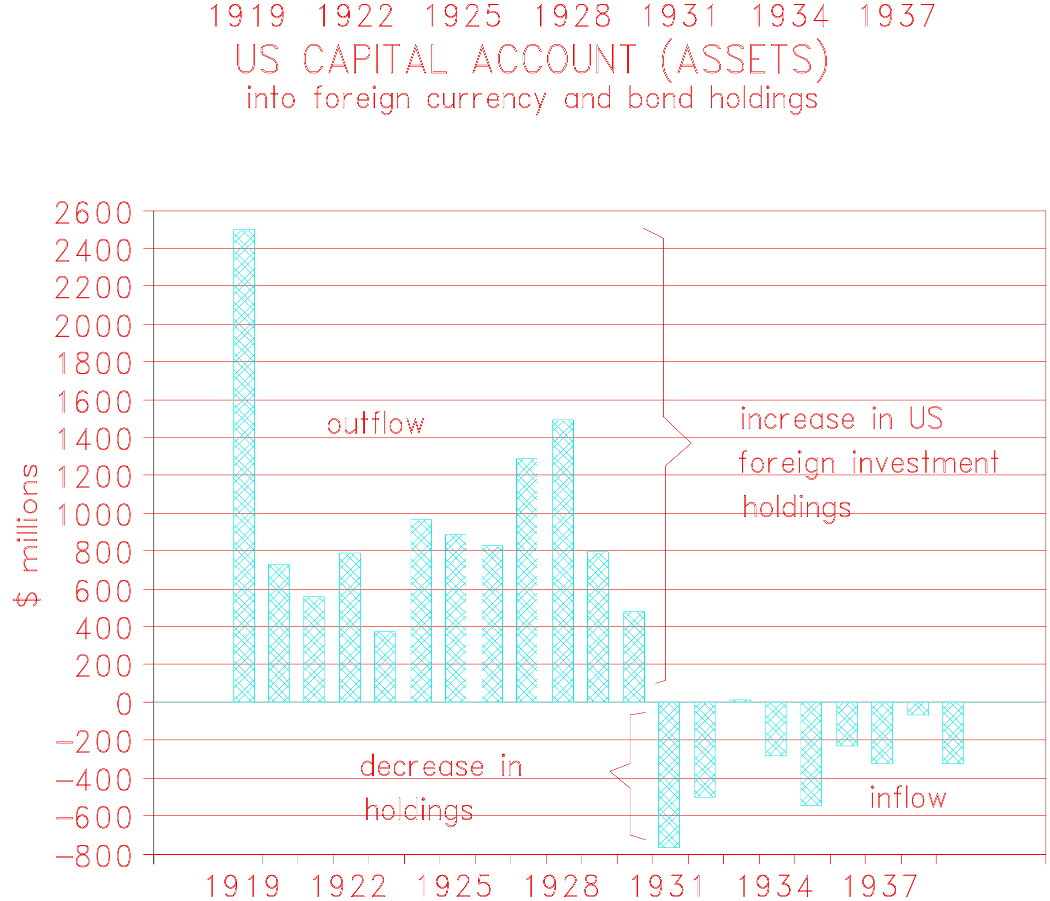


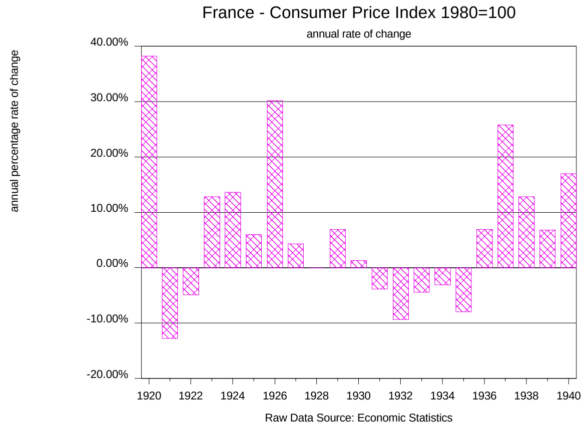


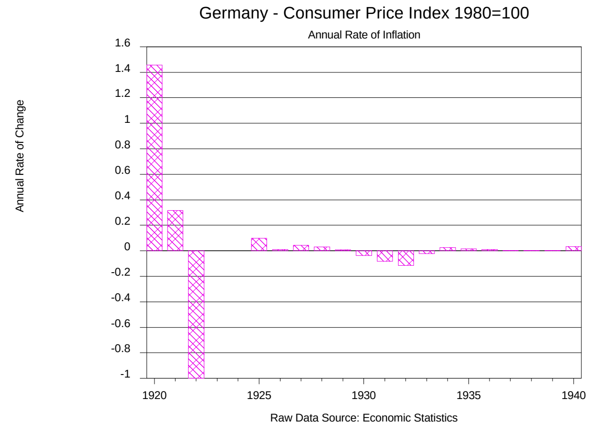
Britain came to the aid of Austria in a gallant fashion, advancing 4.5 million pounds. Norman, perhaps wrongfully to some degree, placed domestic British conditions second in this case in pursuit of his more broadly based international dream. But whatever the event, the condition of the decaying growth in British industry due to the overvalued pound would have caused the same events to transpire had Norman not rushed to the aid of Austria. The issue of whether this was the proper move or not is of no real concern. Someone had to try to pull things together. However, it was the French who became a bit annoyed with the British rescue mission, and in turn made matters worse. The French began selling the pound through the liquidation of their sterling holdings, intentionally trying to get back at Britain. The financial warfare had taken on a new front - the pound sterling.

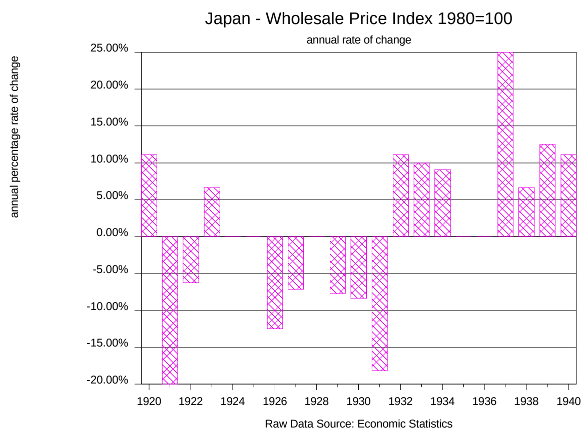
The problems which developed in Austria naturally spread resulting in massive withdrawals of funds in Germany by even its citizens. It was May 13, 1931 when riots broke out in front of Austria's Credit-Anstalt (Kreditanstalt). On May 15, runs were reported throughout Hungary as well. By

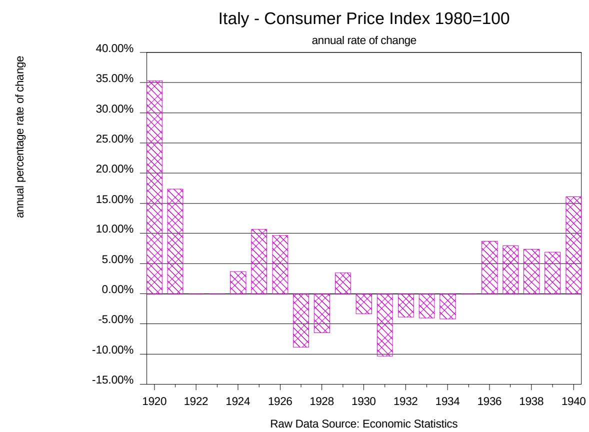

US CAPITAL ACCOUNT (LIABILITIES)
represents foreign investment in US
1400
1200
1000
800
600
400
200
0
-200
-400
-600
-800
-1000
-1200
$ millions
foreign
capital
into US
out of US
1919
1922
1925
1928
1931
1934
1937


US CAPITAL ACCOUNT (ASSETS)
into foreign currency and bond holdings
2600
2400
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
-200
-400
-600
-800
$ millions
outflow
increase in US
foreign investment
holdings
decrease in
holdings
inflow
1919
1922
1925
1928
1931
1934
1937



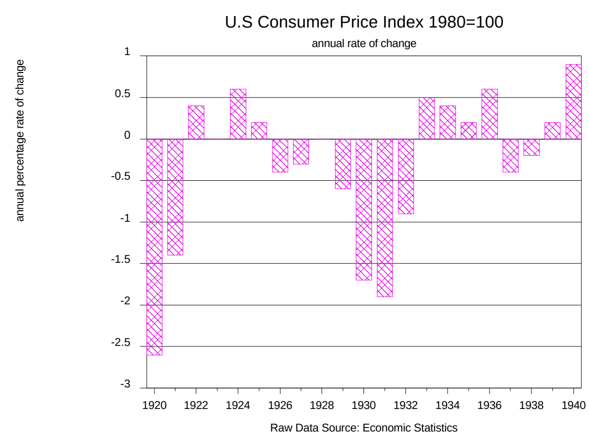


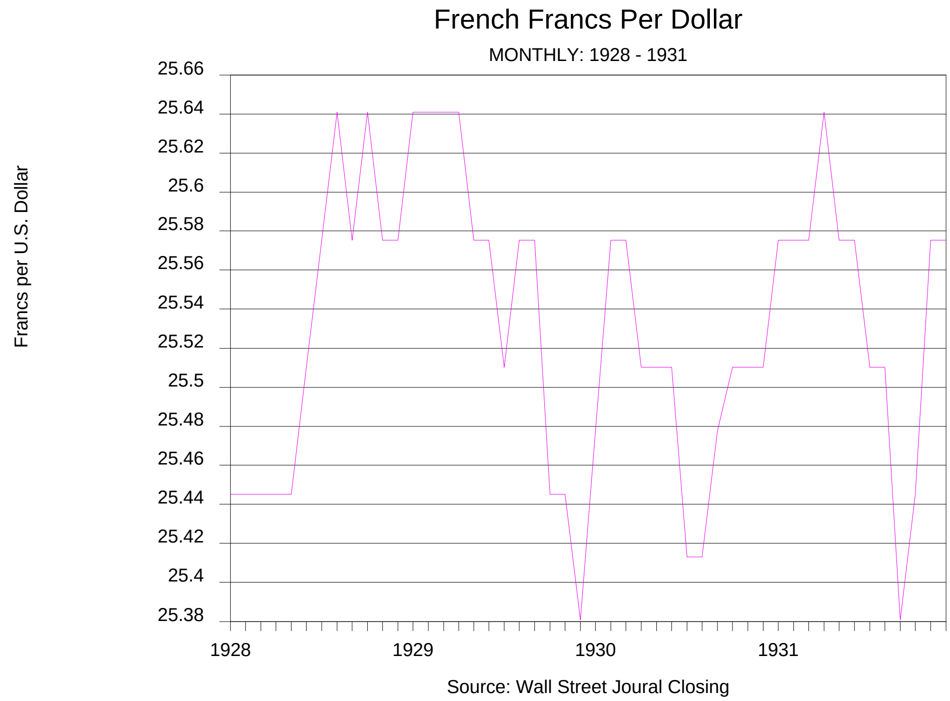




the end of May these pressures mounted against the Austrian National Bank.

Germany had nowhere to turn. France would not come to its aid while still expecting payments in turn from Germany. The various payments on reparations and war loans between nations resulted in about $1 billion of which the U.S. actually received only $250 million annually. As European banking failures spread along with the quiet financial war which was raging in the foreign exchange markets, the Fed got into the act by reducing the discount rate to 1.5% in hopes of making it less attractive for foreign



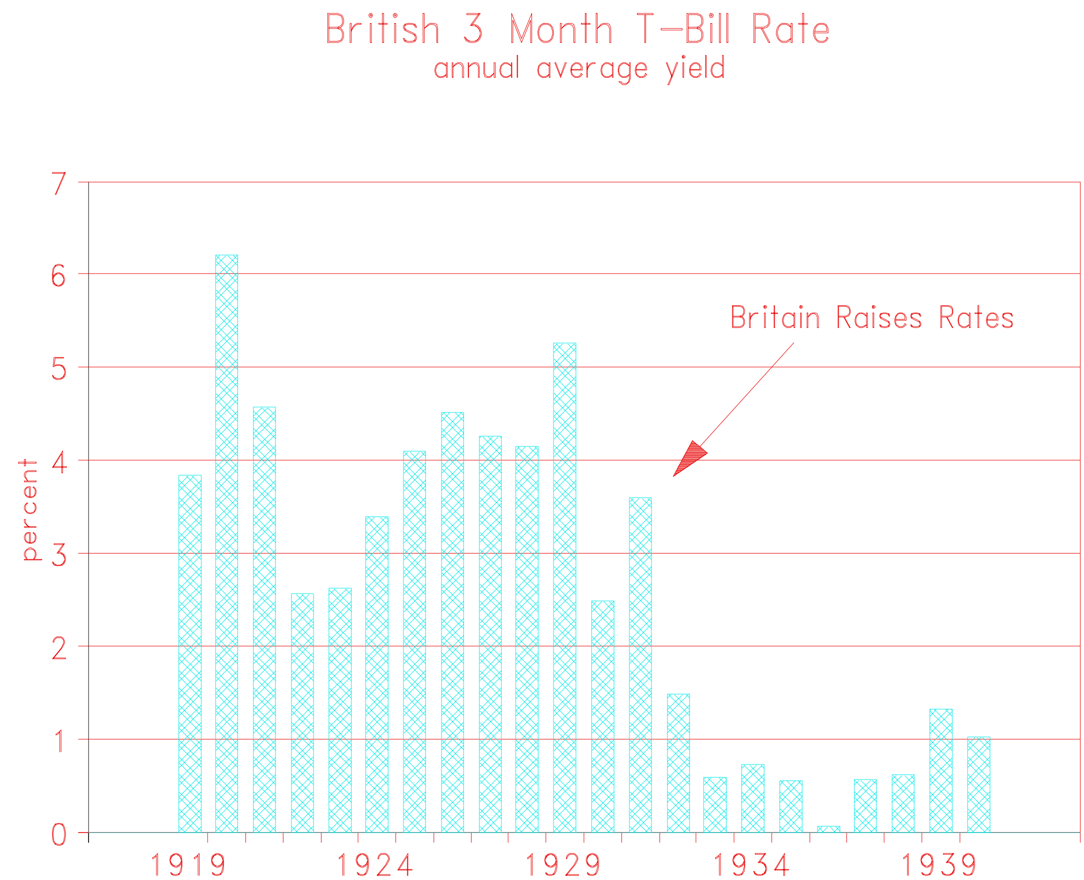


capital, which came pouring into New York looking to get away from the chaos that reigned throughout Europe. It should come as no surprise that the dollar began to strengthen as the "smart" money set sail once again for the United States.

The Fed's actions were not by any means domestically oriented. Britain had been losing gold to the United States as capital fled the financial war zone. As a speculator, it was an easy bet. You essentially could short the pound by transferring into dollars. The downside was perhaps a penny at best and the upside was perhaps a return to the $3.20 level that had been seen following the panic of 1920. If you had any brains, you knew what to do - buy dollars!

The problems throughout the European community had indeed emerged into a financial war which had replaced guns with tariffs, restrictions, quotas and interest rate manipulations. The Central European states raised their interest rates in an attempt to attract foreign capital, the opposite move of the Fed. But that failed because confidence was far from present and no exorbitant rates of interest would suffice in restoring stability. This was then followed by a decree that capital was not permitted to leave the country. This may have solved the flight of capital, but it created a drastic side-effect - a halt to international trade. If capital could not be exported, commerce could not buy any goods. This was worse than high tariffs. Some increased their restrictions on imports and tried to stimulate their own exports. But this failed as diverse approaches continued to disrupt trade, which only heightened the urge for fleeing capital to the United States. In effect, this was the first crack in the gold standard. Although no one officially went off the gold standard in May of 1931, if the exportation of capital was prohibited then no gold payments were made. Thus, the same result as abandoning the gold standard transpired among the Central European states.

As June began, reports that some European banks had been selling U.S. securities were confirmed. This did not inspire a posi-


British 3 Month T-Bill Rate
annual average yield
Britain Raises Rates
percent
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1
2
3
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1919
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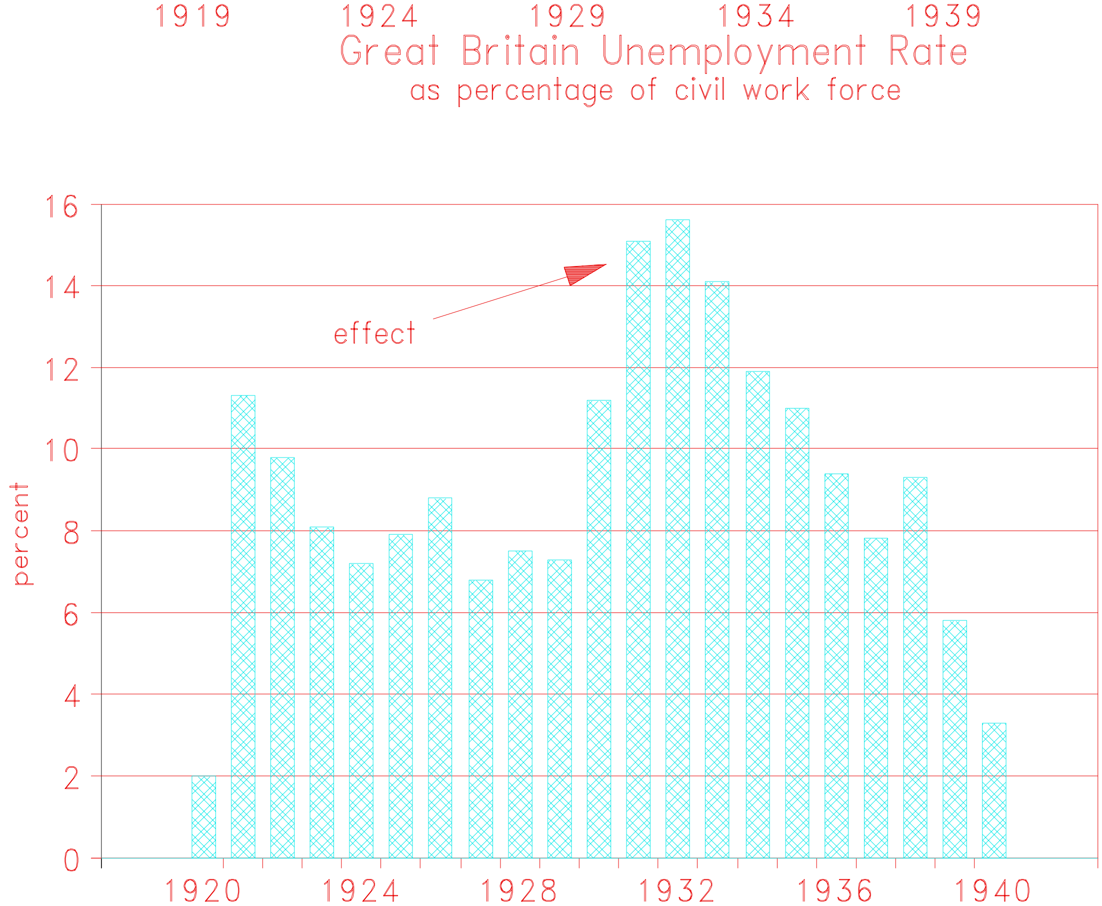
Great Britain Unemployment Rate
as percentage of civil work force
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percent
0
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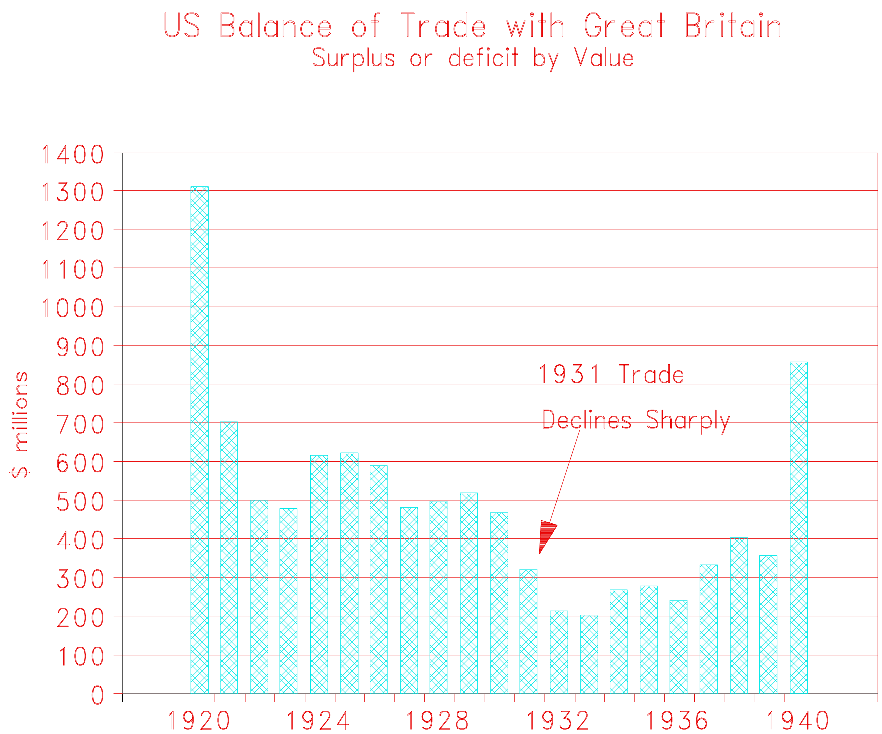


tive feeling among U.S. stock traders who were now confused by the whole situation. Herbert Hoover wrote in his memoirs (MacMillan Co., 1952) this comment on the crisis:

"During this new stage of the depression, the refugee gold and the foreign government reserve deposits were constantly driven by fear hither and yon over the world. We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another. In fact, there was a mass of gold and short-term credit which behaved like a loose cannon on the deck of the world in tempest-tossed era."

In June of 1931, the European press began to point the finger at the United States. They tried to assert that it was the economic policies of the U.S. that were attracting the world's gold, creating the flight from European stock markets and the foreign exchange markets as well. The U.S. gold reserves had climbed by $600 million, despite the Fed's cut in the discount rate. Clearly, those charges by the European press were totally unfounded. Although Europeans sought to point the finger at the U.S. for causing their economic difficulties, the problems had their origin in Europe. Despite the depression in the U.S., it was viewed by world capital as still the safest place at that point.

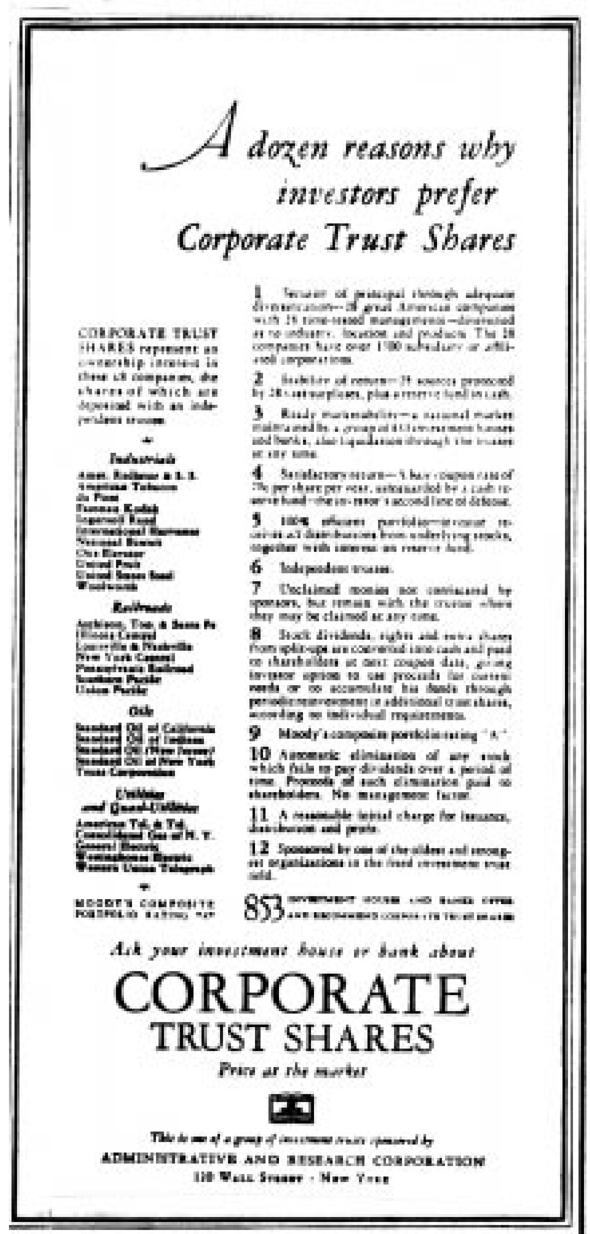
The financial warfare in Europe had created a massacre within the banking industry. The Federal Reserve's textbook attempt to lower U.S. interest rates to stem the influx of capital and provide an incentive for capital to flow toward Britain failed. Confidence was not restored and higher rates of interest were not among the concerns of nervous capital - outright fear of loss dominated the free markets.

Hoover believed that with the economic conditions strained as tight as they were throughout Europe, that these intergovernmental payments were adding pressure which tended to weaken confidence. This perhaps was evident when one considers the intentional actions on the part of France at this time. As early as May 11, Hoover had proposed to Secretaries Stimson and Mellon that they should study these intergovernmental payments and report upon their recommendations if any action should be taken. On June 5, Hoover called Mills to the White House and proposed that a moratorium of one year on all intergovernmental payments should be implemented. Mills and Stimson agreed, but Mellon objected. The next day Mellon left on a scheduled trip to Europe, Mills became acting Secretary of the Treasury and Hoover believed that with Mellon out of the way perhaps his plan might be able to go forward.

On June 7, the German Finance Minister publicly stated that the Austrian banking crisis would spread to Germany in about 60 days in his opinion. Of course, after making such a definite public statement, the panic began to spread immediately. Virtually every German bank was under siege and now foreign banks began wholesale demands for the immediate redemption of German trade bills and bankers' acceptances.

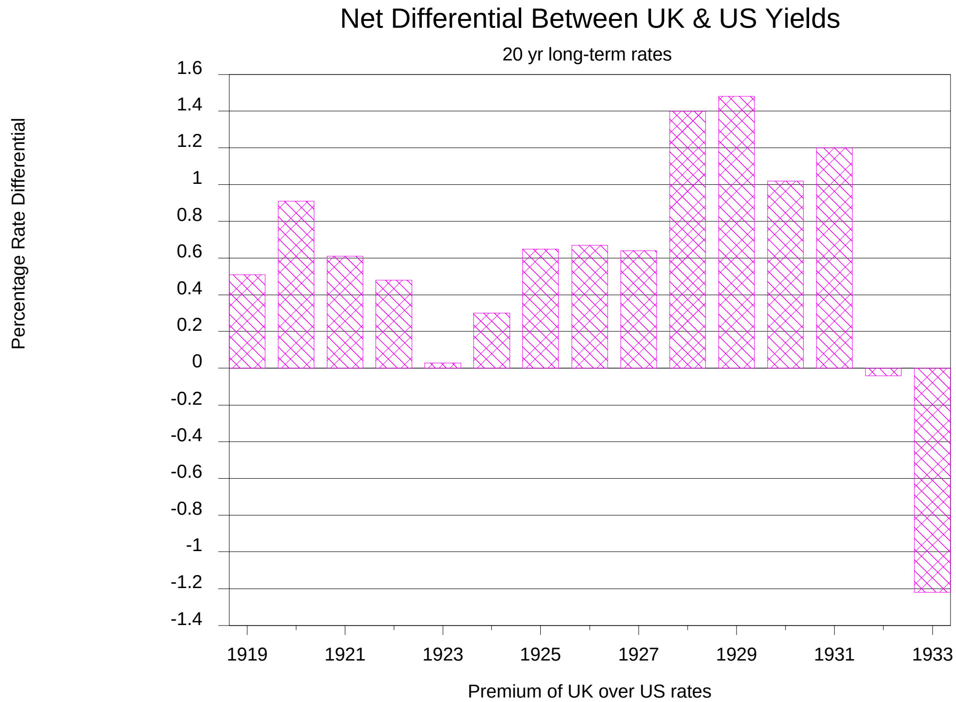
The situation was obviously becoming much more serious. After arriving in Europe on June 18, Andrew Mellon had "frantically" telephoned Hoover, according to Hoover's memoirs, reversing his former opposition to a moratorium on intergovernmental payments. Mellon then advocated quick action fearing that the American financial system was in grave danger from the events which were transpiring in Europe.

President Von Hindenberg of Germany had sent an urgent letter of appeal to Hoover which warned that Germany was in danger of collapse. The letter read as follows:



"Mr. President:

The need of the German people which has reached a climax compels me to adopt the unusual step of addressing you personally.



The German people have lived through years of great hardship culminating in the past winter, and the economic recovery hoped for in the Spring of this year has not taken place. I have, therefore, now taken steps, in virtue of the extraordinary powers conferred upon me by the German Constitution, to insure the carrying out of the most urgent tasks confronting the Government and to secure the necessary means of subsistence for the unemployed. These measures radically affect all economic and social conditions and entail the greatest sacrifices on the part of all classes of the population. All possibilities of improving the situation by domestic measures without relief from abroad are exhausted. The economic crisis from which the whole world is suffering hits particularly hard the German nation which has been deprived of its reserves by the consequences of the war. As the developments of the last few days show, the whole world lacks confidence in the ability of the German economic system to work under the existing burdens. Large credits received by us from foreign countries have been withdrawn. Even in the course of the last few days the Reichsbank has had to hand over to foreign countries one third of its reserves of gold and foreign currency. The inevitable consequence of these developments must be further serious restriction of economic life and an increase in the numbers of unemployed who already amount to more than one third of the total number of industrial workers. The efficiency, will to work, and discipline of the German people justify confidence in the strict observance of the great fixed private obligations and loans with which Germany is burdened. But in order to maintain its course and the confidence of the world in its capacity, Germany has urgent need of relief. The relief must come at once if we are to avoid serious misfortune for ourselves and others. The German people must continue to have the possibility of working under tolerable living conditions. Such relief would be to the benefit of all countries in its material and moral effect on the whole crisis. It would improve the situation in other countries and materially reduce the danger to Germany due to internal and external tension caused by distress and despair.

You, Mr. President, as the representative of the great American people, are in a position to take the steps by which an immediate change in the situation threatening Germany and the rest of the world could be brought about.

Von Hindenberg

Up to now, most of Hoover's discussions with various people were kept confidential. He had conferred with members of Congress and wanted their support before making any proposals to Europe only to have the Democrats shoot them down. When it appeared that he had the necessary support to insure approval of his moratorium proposal, he opened dialogue with other nations.

Hoover's proposal was leaked to the press by Senator King, but it was not reported in an accurate fashion. This forced Hoover to make a public statement on June 20, before any other nations had agreed. On the 29th of June, the New York Times hailed the measure as being constructive and the stock market responded favorably as well.

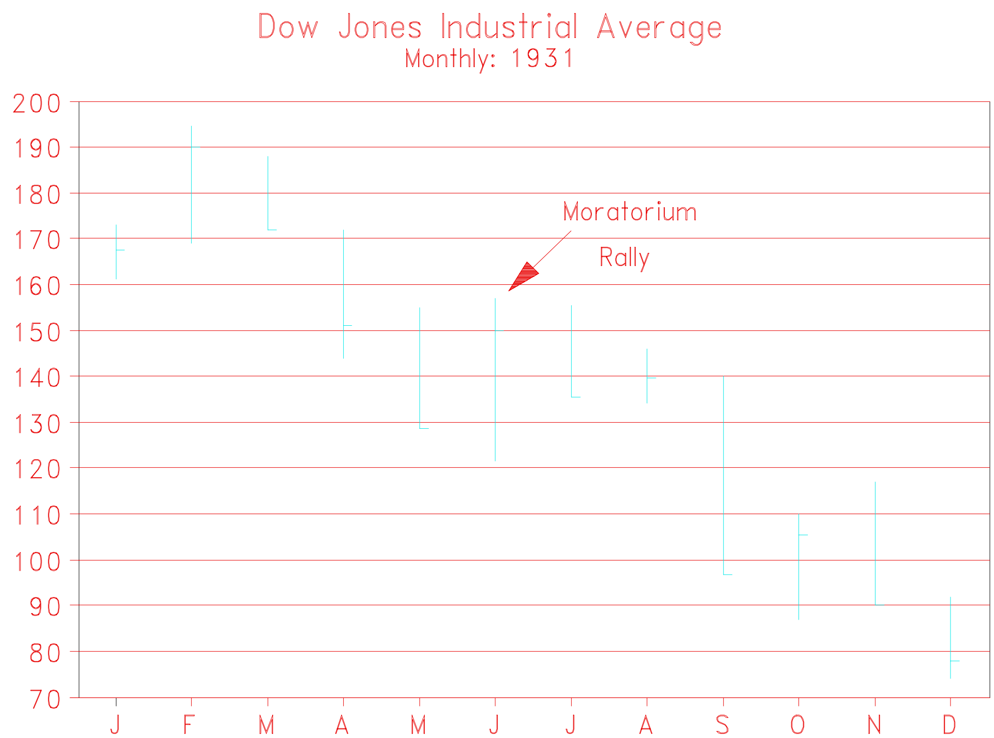
World confidence seemed to take a pause on Hoover's moratorium proposal. The stock markets in both Germany and France rallied strongly along with Britain's, but the leadership was clearly taken by the United States. This rally which took place during June of 1931 would later be dubbed the "Moratorium Rally" once it was perceived to have been only a glitch in the ultimate fate of the market. But for now even commodities leaped forward with a startling sense of optimism.

The Dow Jones Industrials rallied sharply on the moratorium news from a low of just above the 120 level to close at 157 during June of 1931. This was a smashing rally. And it was the strongest since the decline began on a percentage basis - nearly a 30% move. In London the favorites seemed to be across the board, but sharp gains were noted among the breweries, rubbers, home-rails, and silk companies. International stocks trading in London were also very popular including British-American Tobacco and Imperial Tobacco and even the South African mining shares.

In France, the rally in equities was led by Banque de France, Coty, Ford, Citroen, and even Compagnie Universelle du Canal Maritime de Suez. In Germany, the most popular was A.E.G., the German General Electric Company. Other favourites were I.G. Farbenindustrie, the large dye trust and Vereinigte Stahlwerke (United Steel Works).

Time magazine reported on the commodity rally in its July 6, 1931 edition as follows:

"But more significant than the rise in stock prices, last week was a worldwide gain in commodities. The most important gain was that registered in silver. The only calm thing about the Bomboy Silver Bullion Exchange is the sacred cow which, fat and lazy, spends most of her time in somnambulistic repose, blinking sadly and chewing her cud. During the Depression the sacred cow has seen many disconcerting things. Silver has dropped from 1929's high of 57.5 cents to the historic low of 25.75 cents per fine ounce. The only notable interruption was the remarkable corner staged last year by Chimauram Motilal, aged Hindu who drives in a Cadillac, carries a Malacca stick, wears but a white lion-cloth and a turban. But, last week with much yelling and ges-



ticulating Bombay silver buyers shoved the price up 166%. The gain was of paramount importance to the buying-power of 500,000,000 Far-Easterners. To China it was especially welcome. Long-coated silk-trousered members of the Shanghai Gold Stock Exchange of Kiukiang Road bought silver by the simple method of selling gold. How desperate is China's state is well illustrated by the ugly rumors heard in Singapore concerning the affairs of Tan Kah Kee, great rubber, pineapple, biscuit and brick tycoon, patron of Amoy University. Once a coolie, he became a multi-millionaire, is now thought to be heavily in debt, frantically trying to incorporate his private affairs.

"In addition to silver practically all commodities rose, including the base metals. The most spectacular performer of these was volatile copper which jumped from 8 cents (New York) to 9 cents as domestic and foreign buyers threw large orders into the market. Lead and zinc followed along. Typical of the increase in trading was the excitement in Manhattan's Raw Silk Exchange where trading reached almost 4,000 bales a day after being at 80 a few weeks ago. Startled pages and clerks hurried to put their summer linen-suits on a fortnight ahead of time. In Tokyo, Japanese bears talked of hara-kiri. On the Coffee & Sugar Exchange, Manhattan coffee continued its recent rise which had begun to die out; sugar started its first rally in months. Some $25,000,000 was added to the value of sugar supplies. Along with gold coast native farmers, men gathered in British villages to receive cable dispatches which told the glad tidings of what was happening on the New York Cocoa Exchange. Cotton, despite the bearishly small decrease in acreage, rose throughout the world. Textiles rose in the U.S. and on the great Manchester Royal Exchange. In the Chicago wheat-pit 36 stories under the 40-ft., 15-ton aluminum statue of Ceres which is the Chicago Board of Trade Building's talisman, grains rallied smartly, sent the theoretical total value of U.S. grains up $300,000,000. On the New York Rubber Exchange, where recently less than a dozen members have come down to trade, the volume increased 5005. Speculative buying from Wall Streeters was credited with having much to do with rubber's comeback.

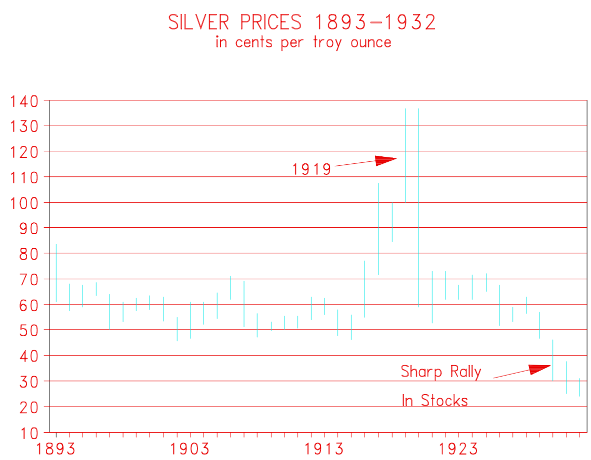
"While renewed confidence and the rise in commodities were the most important events of the week, the news-index of worldwide change was the New York Stock Exchange. Performing in a spectacular manner, that great market once again proved its world leadership. There were cheers when United States Steel again crossed par, a triumphant return from the recent nadir of $83 and an 1/8th. Twenty-six leading stocks gained $4,159,000,000 in value. Bullish rumors ran wild; there were tales of tremendous pools being formed, huge mergers in the making. Concrete bullish news in addition to the moratorium was the favorable decision to Radio Corp., the raising of the wholesale cigarette price, the declaration of regular dividends by Westinghouse, Anaconda, Baltimore & Ohio. Stocks with interests in South America soared on a baseless rumor that the President would soon make an important announcement regarding credits to Latin American countries. Long deferred investment buying appeared. Vivid tales were told of big bears trapped, fretting behind the bars of higher prices. One venerable member of the exchange was heard to sing that old bull war chant of the Chicago Wheat-Pit: "He who sells what isn't his'n must buy it back or go to prison." And even the most sanguine of optimists was willing to concede that the song was applicable in any market last week, that much of the recovery's violence was due to the running-in of bears who for months have sold "what isn't their'n."

The jubilant "Moratorium Rally," needless to say, did not last. In the July 20, 1931 edition of Time magazine, the commentary took on a distinctively different undertone which was much more brief and to the point. "Hope engendered by the Moratorium and the Moratorium Market on world exchanges failed to find reflection in important business indicators up to last week. Important straws showed that Depression's ill-winds were not yet blown out."

Within a week of Hoover's public announcement of his moratorium proposal, 15 governments had agreed with the plan "unconditionally!" The only important opponent was France who still held bitter resentment toward Germany. The French hurried excuse after excuse as to why Hoover's Moratorium should not be adopted. With each excuse that was answered and set aside, another quickly followed. The French kept this up for days, delaying Hoover's actions as much as possible.

The banking crisis in Central and Eastern Europe raged on during this time when the French were the only dissenters among the group of nations still insisting that Germany should not be relieved of her reparation payments. Then on July 5, Hoover had about all he was willing to take. Hoover informed France that he had secured enough support among other nations for the proposal and he did not need France's approval. He told France that it may continue to extract its payments, but that all other nations including the United States would not relieve France of its obligations either. Finally, the French had to agree. Hoover would effectively isolate them if they refused to cooperate.

The French tactics had sparked severe divisions within Europe. The level of confidence was restored only briefly as many feared that France would still apply pressure to the pound as well as to the outstanding short-term credits of Germany. The banking crisis continued almost unabated



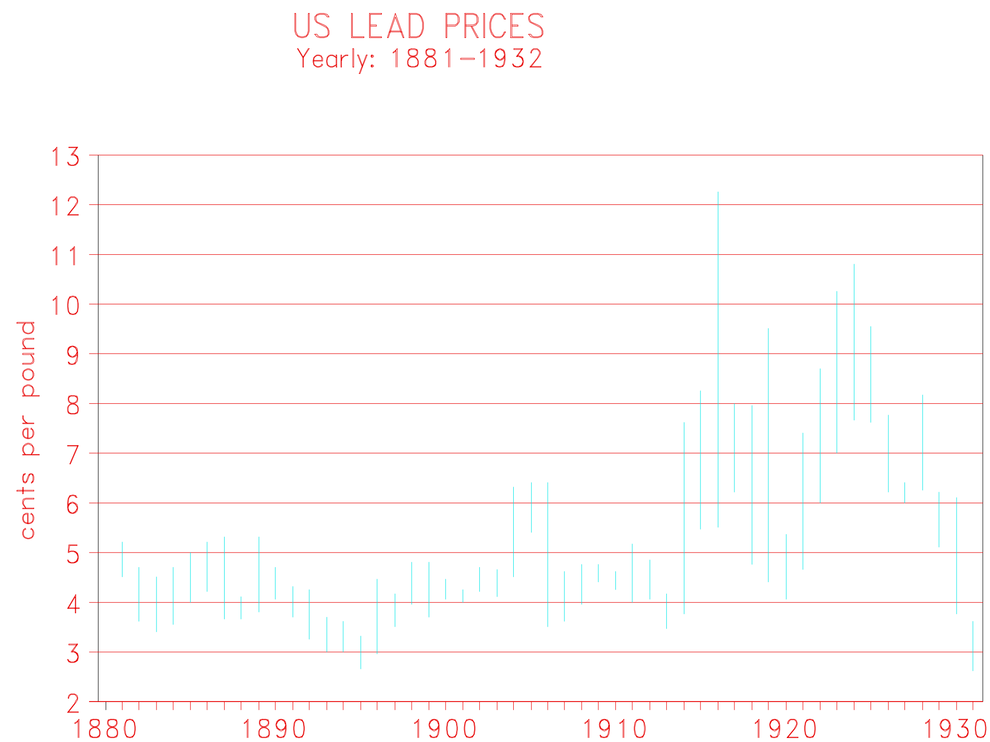
in Germany and Hungary in particular, as well as in the entire Eastern European group. By mid-July, virtually all German, Austrian, Hungarian and Eastern European banks were closed.

On July 20, 1931, a conference was called in London to discuss the European banking crisis. Secretaries Mellon and Stimson attended. The French surprisingly proposed that the British, French and Americans should lend $500 million to Germany. The French knew that this proposal would not be very popular in the United States and it almost appeared as if they were trying to force Hoover to publicly decline their proposal for propaganda purposes.

Hoover asked the Federal Reserve to provide information that would give him a fair appraisal of the extent of outstanding German short-term credits held by U.S. interests. The Fed replied that they estimated that only $400 to $500 million of these short-term debts were held by U.S. interests. Hoover wrote in his memoirs: "Worrying over the matter during that night I was somehow not satisfied with this report, and in the morning I directed the Comptroller of the Currency to secure an accurate report on such American holdings direct from the banks." The next day Hoover was handed a report that was based on a direct survey. The numbers that Hoover was handed came out to be $1.7 billion. The report broke them down, stating that about $1 billion was held by banks whose capitalization, in the event of the default of Germany, would be placed in great danger. Hoover wrote that he was appalled at the news. He further added: "Here was one consequence of the Reserve Board maintaining artificially low interest rates and expanded credit in the United States from mid-1927 to mid-1929 at the urging of European bankers. Some of our bankers had been yielding to sheer greed for the 6 to 7 percent interest offered by banks in the European panic area."

Hoover then inquired of the Bank of England as to the extent of their holdings of these bad, short-term German debts. Within two days the Bank of England replied that about $2 billion of these German debts were held by British banks and their dominions including Sweden, Norway, Holland, Denmark and Switzerland. They warned that untold amounts were also held by Latin America and parts of the Far East. The combined debts of Germany, Austria, Hungary and other Eastern European nations on a short-term floating basis appeared to slightly exceed $5 billion. This was a figure which was almost equal to the peak in money which had been lent on call within the stock market back in 1929. This figure did not include the outstanding long-term bond issues, war debts or municipal issues which had been floated and held largely by private investors.

The bottom line had become clear. Germany was able to meet its reparation pay-

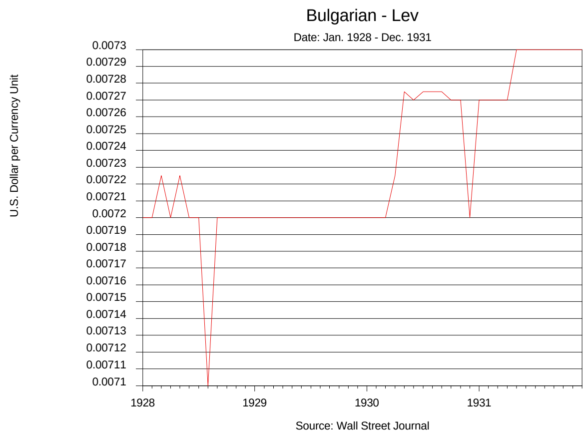


ments only through the floating of debt instruments. Nothing had been truly gained. Many of the buyers of German bonds were private citizens and then the proceeds had been paid to the foreign nations who demanded reparation payments. It was a giant shell game that transferred the earnings of the small investor into the hands of government through the medium of bonds which had offered 6%-7% in interest income. Germany was not alone in this tactic. Most Eastern European nations were in effect borrowing from Peter to pay Paul. In reality, this was very similar to the Ponzi scheme. Individuals go to jail for such practices, but governments seemed to be excused and bailed out, chalking it up to bad management.

Hoover wrote: "It was now evident why the European crisis had been so long delayed. They had kited bills to A in order to pay B and their internal deficits. I don't know that I have ever received a worse shock. The haunting prospect of wholesale bank failures and the necessity of saying not a word to the American people as to the cause and the danger, lest I precipitate runs on our banks, left me little sleep. The situation was no longer one of helping foreign countries to the indirect benefit of everybody. It was now a question of saving ourselves."

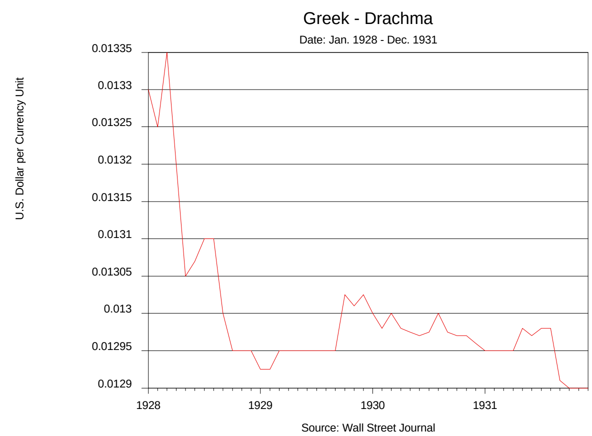
Hoover again rose to the occasion, trying to arrive at some solution. Lending more money would not solve the problem. The vast, intricate entanglement of the foreign debt situation was a time bomb waiting to explode at any moment. Hoover's proposal was to call a complete "standstill" among all banks everywhere, preventing anyone from calling upon German or Central European short-term obligations.

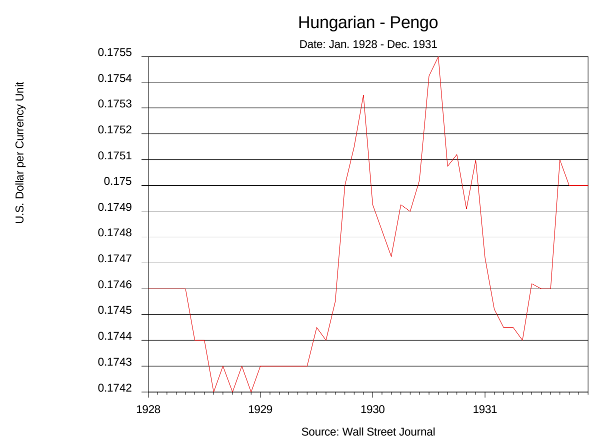
France still pressured for a $500 million loan to Germany. Hoover refused to go along with it. Mellon warned Hoover that if the U.S. did not go along with the plan the French intended to place all the blame on the United States, and he warned that he was playing into the hands of the French. Mellon strongly urged Hoover to accept the French proposal. Hoover lost his patience,

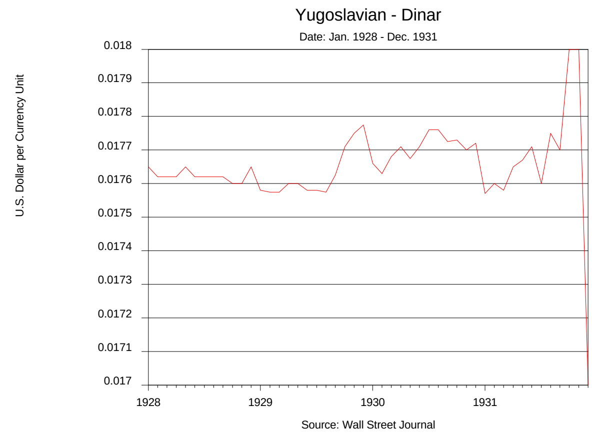


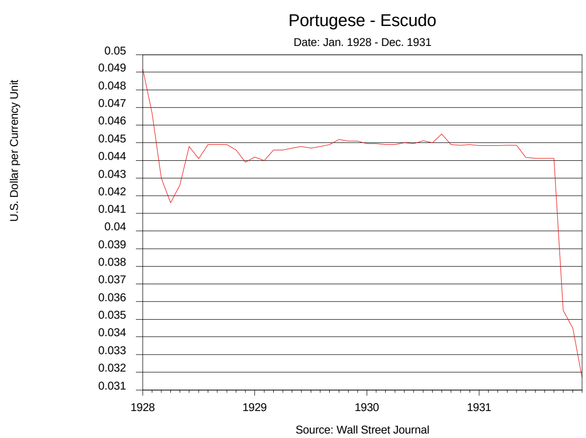
as he put it, and informed Mellon that his "standstill" plan was being released to the press at that very moment. When the news came out, the London Conference was forced to accept Hoover's proposal because the truth was at last coming out.

A group of New York bankers complained to the White House and warned that they would not comply with the standstill. They demanded that Hoover loan money to Germany so it could pay its debts which the bankers held. As Hoover wrote: "My nerves were perhaps overstrained when I replied that, if they (bankers) did not accept within twenty-four hours (his standstill proposal), I would expose their banking conduct to the American people." Needless to say, the bankers realized Hoover's determination and his opinion that the taxpayer should not pay for the banker's problems, which had been created by their eager solicitation of private citizens for foreign securities, and the bankers reluctantly backed off. Indeed, the actions of the banks and the Federal Reserve had bordered on the verge of treason as they acted as willing participants in what proved to be a game of musical chairs with the unsound foreign governmental debt instruments.

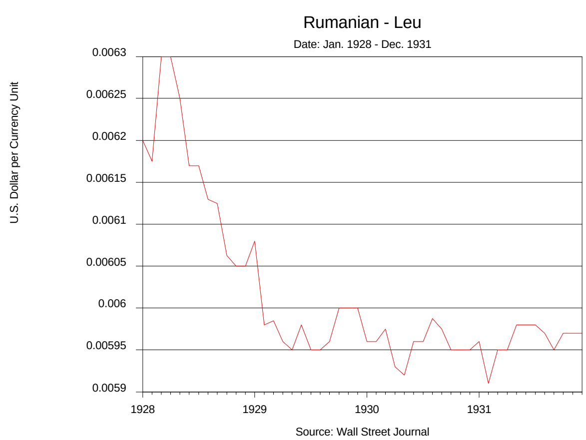








The situation was still far worse than the reports that were given to Hoover at the time. While he suspected that the short-term debt which had been brought to a standstill was about $5 billion according to both U.S. and British sources, it was not confirmed until a year later when the Bank for International Settlements issued a report illustrating that the amount was actually $10 billion! The BIS wrote: "At the time (1931), the magnitude of this indebtedness was not known..."



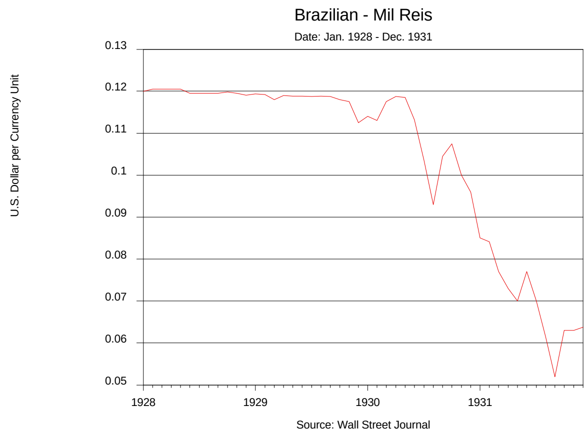
Hoover's measures had brought the situation under control, but only momentarily. The United States had been spared from wholesale banking failures due to panic that would have certainly spread had the full extent of the bad foreign loans been known. But Europe was still weak and the attacks that France had made against the pound in retaliation for the British helping to bail out Austria went deep into undermining the entire world economy. Not only was the level of international debt seriously high, but the greatest of all dangers remained in confidence. Once that confidence was lost, the momentum of events that followed was beyond the control of everyone involved.

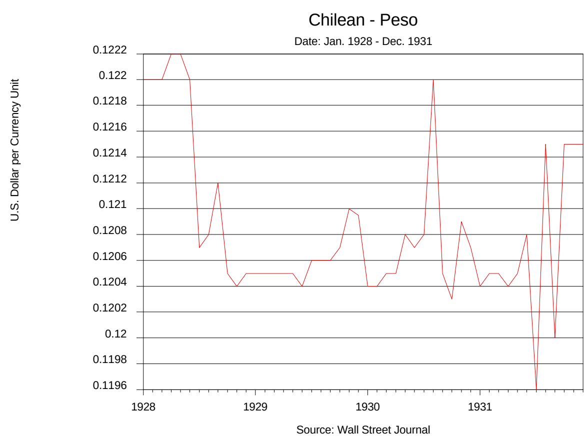
The problems could not be assessed quickly enough nor could politicians agree among themselves as to the proper corrective measures which were necessary.

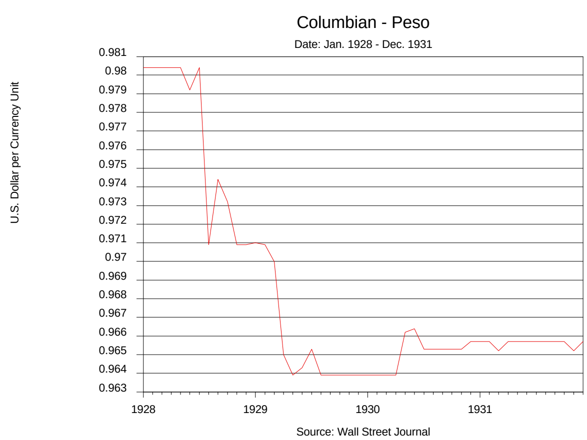
The stock market was taking a brief pause as everyone who understood the situation and its severity hoped and prayed that confidence would gradually be restored in Europe. But the French were still causing problems. On July 24, 1931, the French began sizable withdrawals of gold from London. French banks moved $800 million in gold out of British banks. It was clear that the French attack on the pound was not over. This move was quickly noticed among other central banks and confidence proved to be a vague memory. The dreams of Montagu Norman had been shattered once again.

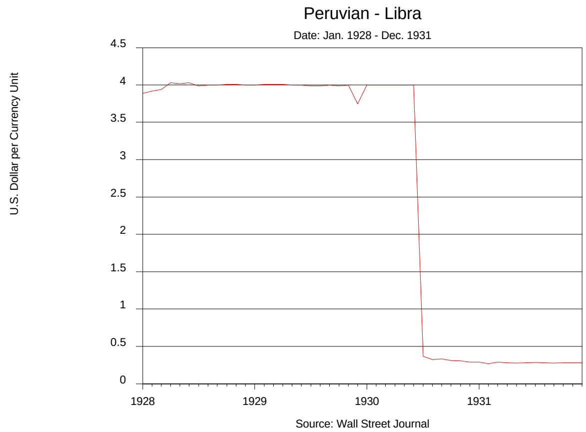
Britain had been built back to some degree and it remained in the position which was sort of a central clearing center among nations. It held sizable gold deposits from various nations and lent gold to others. When the French began to withdraw their gold deposits, other nations followed suit. Therefore, the final situation amounted to what one could loosely equate to a run on the IMF (International Monetary Fund) in today's terms.

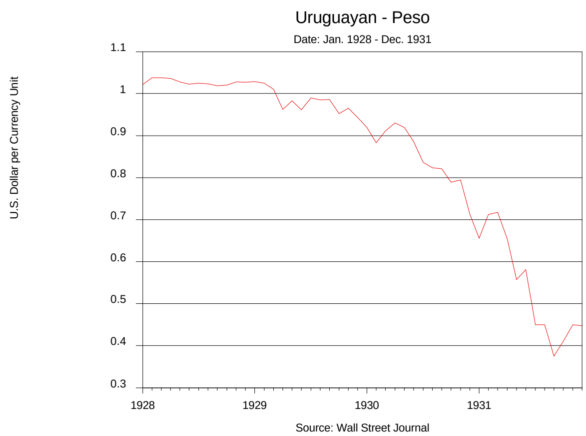
Essentially, the depositors of gold with London were cashing out but the debtors, chiefly Central and Eastern European nations including Austria and Germany, could not be called upon to repay their loans immediately. The Bank of England attempted to stem the run by implementing the typical textbook action - a hike in interest rates. The Fed held its discount rate at 1.5% in the United States. The run was not impressed by the higher rate of interest offered by the Brits. When confidence is shaken, NO LEVEL OF INTEREST IS

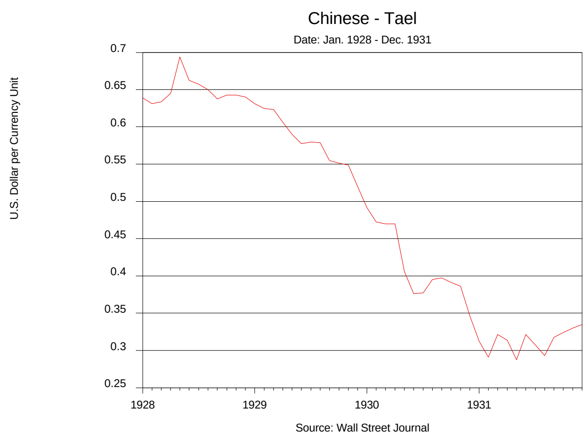












ENOUGH IF PEOPLE FEAR A DEFAULT. Capital is only attracted to a higher rate of interest when all things upon which confidence is dependent remain equal. If one nation or a person is seen to be in a weakened state and on the verge of bankruptcy, lenders are generally rarer than a hot summer night in Siberia.

On August 1, 1931, the Bank of England inquired of the U.S. government whether it would be permissible to borrow $250 million from private U.S. banks. Hoover encouraged this action to be taken immediately. But the selling pressure against the pound by private investors forced the Bank of England to request a $400 million loan on the 26th of August. Both loans were made giving Britain a $650 million loan, but even this proved to be far from enough to stem the tide.

Within Britain, turmoil had besieged the government. Montagu Norman still reigned as a dominant force within economic policies. Norman turned to his handy textbook and relied upon what under normal conditions would dictate the solution to the problems at hand. In addition to raising the interest rates, which failed to prevent the panic withdrawals, he then surmised that confidence could only be restored by cutting government expenditures, thereby forcing on its own people a greater level of deflation. The Brits also organized what was dubbed the "May Committee" which reviewed public expenditure. This committee recommended drastic cuts in government expenditures, including a 20% cut for government employees and unemployment benefits for its people. Only two out of the seven members of this committee dissented on this opinion.

Norman obviously relied upon the report of the May Committee in his suggestions which he delivered to the government. During August this led to the resignation of most of the Labour cabinet, which simply disagreed that the salaries of government workers and unemployment benefits should be cut drastically. In the aftermath, the formation of Macdonald's National Government resulted.

Norman demanded that these drastic cuts must be made immediately and he made them a prerequisite for obtaining the loans from the United States. These were the only steps that could save the pound, Norman asserted. From Invergordon, news spread around the world that the British Navy was in "mutiny" as a result of the drastic cut in pay. This news of mutiny did not help restore confidence whatsoever and the pay cuts had been hastily pushed through upon Norman's direction.


1791
A frenzy of speculation swept the country
DURING the early Years of Washington's Administration, Hamilton, as Secretary of the Treasury, strove *diligently* to establish a sound System of Banking and to *stabilize* the Currency of the country. ¶But Speculation was the order of the Day. United States Bank scrip, originally offered for one hundred dollars, rose to 195, dropped rapidly to 110 and finally rallied to 145. Several failures were the result. ¶*In this crisis* Hamilton authorized the Cashier of the Bank of New York to *buy* government bonds and stocks to *relieve* the merchants of the City and to sustain the credit of the United States.
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CAPITAL, SURPLUS AND UNDIVIDED PROFITS $20,000,000
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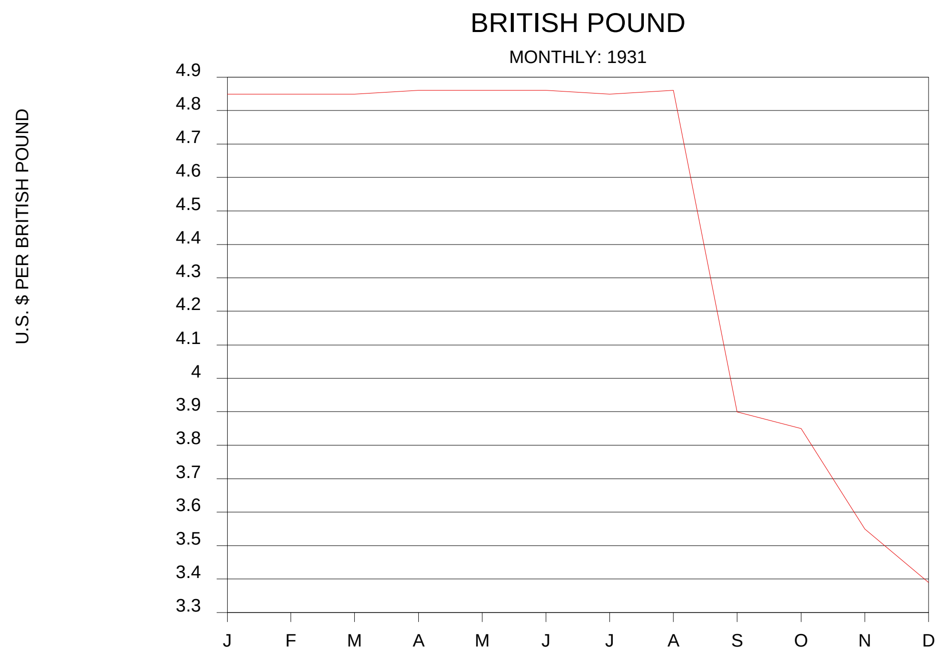
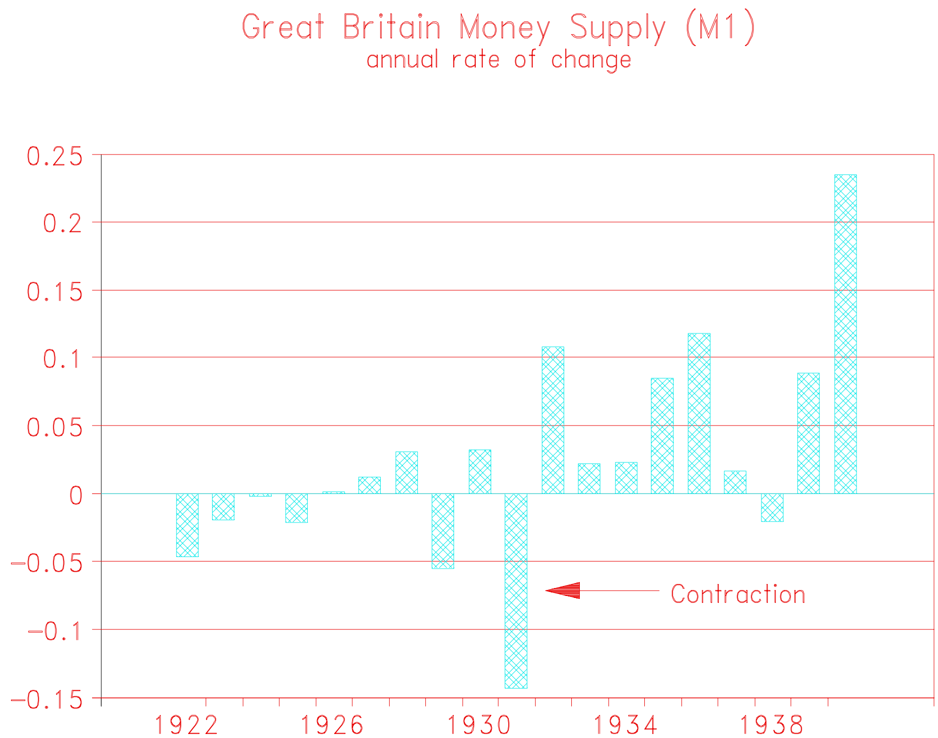


Another committee, which history has referred to as the "Macmillan Committee," presided over finance and industry matters within the British government. Two prominent men sat on this committee; they were John Maynard Keynes and Ernest Bevin. The Macmillan Committee had recommended that the pound should be devalued. Of course, Norman had disagreed with this wholeheartedly. Keynes was also opposed to devaluation, but it is said that on August 5, Keynes wrote a letter to the Prime Minister in which he reversed his opinion and advocated a devaluation of the pound using the words: "The game is up."

Finally, on September 21, 1931, the Bank of England abandoned the gold standard and effectively defaulted on its foreign obligations. This, added to revolutions in South America, defaults by Germany, Austria and most of Eastern Europe, left the United States as one of the few nations which still clung to the gold standard.

It is important to note that the normal actions which a central bank should take to stem a run on its banks and currency were taken but failed to prevent the panic from spreading. Yet today our central banks have not revised these guidelines and under the same circumstances they will do the very same thing once again. Britain's measures considered the welfare of its own people as second to that of maintaining international confidence in the pound. It raised interest rates which battered an already weakened domestic economy. The drastic pay cuts of 20% would again be measures which could only deepen the domestic plight of its own citizens. In essence, Britain had become the depository nation for wandering gold which fled from Germany, Austria and Hungary as well as other Eastern European nations. A portion of those deposits were lent back to those nations in an effort to prevent their collapse. But when confidence was thereby weakened in the British ability to cover its outstanding foreign debts owed to depository of this frightened "fugitive" international

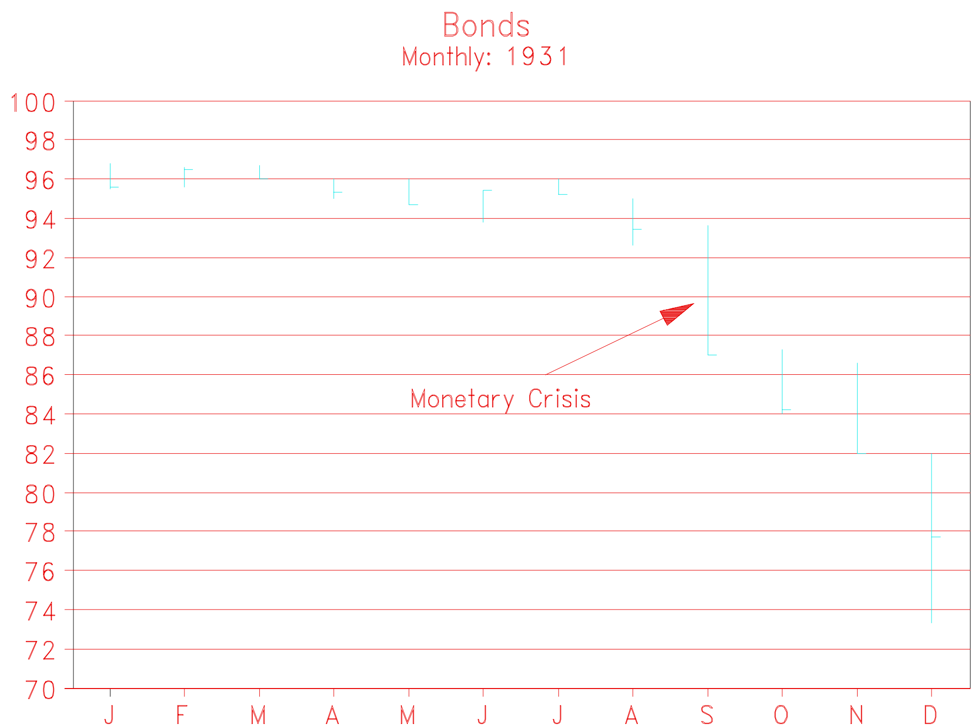


capital, it thereby destroyed the pound in its wake.

The huge and sudden swings within the international capital flows played havoc on foreign exchange. This did more damage to world trade than any tariff. Not only was commerce unsure of what exchange rate a transaction would finally yield, it also had concerns about whether or not payment could even be appropriated. Those who chose to lay the blame for the contraction in world trade solely on the shoulders of the Smoot-Hawley Tariff Act of 1930 have done a grave injustice to our memories of this terrible period. No one seems to mention the fact that international debt had been orchestrated in the same manner in which Ponzi had managed his scheme. Payments to one were merely appropriated by borrowing from another. This was a greater transfer of wealth from the people into government coffers than any taxation scheme ever devised. There can be no question as to why capital was far from contented and confidence proved to be a rare commodity in itself. With bonds becoming worthless from one nation to another, people became reluctant to invest their savings in anything, no less foreign bonds. For years the advertising had touted that bonds were the "safe" investment. But in the end, more capital disappeared through these international defaults than was ever lost on the stock market.

There are those who criticized Hoover for not coming to the aid of Britain. But at this stage in the game, world confidence was so shaken that it would have been similar to someone who was drowning trying to be saved by another who didn't know how to swim.

In the aftermath of the Depression, one of the steps to better organize this international system of payments was the creation of the IMF. The concept would be that the IMF could extend temporary loans to prevent such instant overnight pressure against one particular nation, which would prevent that nation's subsequent default. Although this new postwar mechanism would help to restore stability up until 1970, it would not



change the situation of confidence fleeing from one currency to another. Since the 1970s, we have seen these very same forces of confidence lay siege to various currencies. Expanding trade deficits, rising fiscal deficits, and a growing national debt did not prevent the dollar from rising to record highs moving into 1985. Reason does not necessarily follow logic. One cannot manage an economy based upon these tools that failed during the Great Depression and during every panic in confidence thereafter.

Time magazine reported in its September 28, 1931 edition on the shock of the British default. Their comments were as follows:

"Last Monday, all businessmen were shocked to read in their morning papers that the British pound sterling was no longer based on gold. The Tokyo Stock Exchange had announced that it would not open. Tokyo was followed by Bombay, Calcutta, Johannesburg, London, Berlin, Amsterdam, Copenhagen, Vienna, Oslo, Stockholm, Brussels and Athens. The Paris Bourse opened, but limited all trades to 5% of all holdings and no dealing in foreign exchange. Montreal's Exchange opened similarly restricted. The New York Stock Exchange remained open, but as in dark November 1929, short selling was forbidden. In the artificial market thus created, stocks gyrated unsteadily, closed higher; bonds closed at lows for the year."

There can be no doubt that the shenanigans of various governments did more harm to international trade than mere tariff restraints. Tariffs merely upset the balance of profit whereas disruption of foreign exchange injected tremendous risk and uncertainty which destroyed confidence in its wake. The lessons of the Great Depression are many but they certainly do not end with mere tariffs. Although in the decades that followed this period, several new inventions such as the IMF and the General Agreement of Tariffs & Trade (GATT) emerged, governments failed to draw upon their lessons from foreign exchange manipulation. Competitive devaluations would become the tool to combat world trade in the postwar era.

The Dow Jones Industrials dropped more severely than ever before, second only to that infamous collapse into November 1929. The industrials fell below the 100 level and closed September on the low of the month. As October entered, the havoc continued, forcing the industrials down to nearly 86 which was a far cry from the peak on the "moratorium rally" which was established during June of 1931 near the 157 level. This decline came close to a 42% drop, but the curious thing was that shortselling had actually been banned. World exchanges opened and quickly closed as soon as selling pressure resumed. "A mass exodus of capital," are the only words that can be used to explain the events in the wake of the British default.

It was at this time that sentiment toward shorts began to turn into open attacks which clearly demonstrated an undertone of hatred. With catastrophic losses dealt to stubborn bulls who held onto stocks through this decline, cries to outlaw shortselling began to be heard even on the floor of the House of Representatives.

In Time magazine we find an excellent article which portrays the sentiments that began to develop against the bears during this era. This sentiment eventually became much worse, turning into witch hunts on the part of the Senate throughout the years that followed.

"When Lawyer James Watson Gerard, one-time (1913-1917) Ambassador to Germany, arrived in Manhattan from Europe last week he was in a critical mood. He said President Hoover should up and say prohibition is nonsense. He chided Manhattan's bankers for paying more attention to Germany than to the U.S. He scolded big corporations for not giving out intelligible statements; he and Mrs. Gerard have some 2,300 shares of General Electric and he defied 'any one to tell from the statements of this company what it is doing.' Because Mr. Gerard has previously been known as a foe of shortselling, no Wall Streeter was surprised to read that he added: 'I also feel that shortselling here should be curbed immediately.'

"But this Gerard interview was only a prelude to a week replete with attacks on methodical bears. A few days later Lawyer Gerard declaimed that shortselling is illegal because it is gambling, is as bad as setting fire to property. 'It is selling something which the seller has not got and which he hopes to buy at a lower price, that lower price being made possible by the mere fact of the sale...The result is that the stock which the small investor bought on margin...is actually used as a club against him.'

"Although Wall Street has pat answers to this attitude, it became apparent last week that more than pat answers may be necessary if anti-bear legislation is to be headed off. The first attack on bears will probably come from the New York legislature. Through his business associate, Patrick Sullivan, Mr. Gerard last year presented a bill to make it necessary for a broker to obtain the written consent of an owner of stock before it can be loaned to shorts. The bill was shelved but will be aggressively revived this session by Assemblyman Sullivan, nephew of the Timothy Sullivan who sponsored New York's famed Sullivan Act against concealed weapons.

"Interference with shortselling in New York alone might lead to a rapid growth of some interior market. But last week's development included a resolution against shortselling passed by the Chicago City Council and given to the Governor's Revenue Committee. There was also an acceleration of agitation in Federal Government circles.

"Leader of the movement seemed to be James Eli Watson, Republican floorleader of the Senate, commonly regarded as a spokesman for the Hoover administration. Last week he said: 'It is the belief of many that we shall not recover from our present depression until transactions of this kind (shortselling) are either prohibited or greatly curtailed or properly safeguarded... I have no doubt that one or more resolutions of this kind will be passed (by Congress).' Since President Hoover last week was conferring with many a financial leader, it was felt that Senator Watson knew whereof he spoke.

"Heartily in agreement with Senator Watson were Senators of less orthodox views on financial matters. Iowa's Smith Wildman Brookhart exclaimed that he would see to it that interstate transmission of shortsale quotations is prohibited. Apparently he was unaware that the Stock Exchange's machinery does not include anything which tells whether a seller of stock owns it or not.

"Other stacks included: A resolution by United States Chamber of Commerce's directors that shortselling be limited to sellers who deposit a 40% cash margin and show evidence of possessing the rest. This would not materially alter the present situation, for bears must deposit 25% in most houses, present credit credentials before opening an account.

"The Scripps-Howard chainpapers, professional crusaders, also took up the battle "against bears."

We can see in this article thus far that the attitude toward shortselling was beginning to come to a head. Ever since the collapse first began in the autumn of 1929, resentment toward these rumoured groups of all-knowledgeable bears had persisted. Many brokers and analysts merely added fuel to the fire when lacking any true explanation for the market's decline, turning to the old cliche that it was being perpetrated by "bear-raiders." This would later prove to be incorrect as investigations failed to establish that any short interest had been present. No one bothered to look around them at the tremendous lack of confidence and official manipulations which existed in the much broader bond markets of the world. Many of the loudest cries against the bears came from wounded bulls. Even James Gerard was a substantial holder of General Electric. Could his resentment toward bears have anything to do with the losses he suffered in the stock market?

Time magazine went on to comment further on the events of this period as follows:

"With so much agitation against shortselling it was becoming apparent last week that the New York Stock Exchange would have to make some move itself or else run the risk of very drastic impositions upon it. One fair sized member firm, Pouch & Co., announced it would no longer lend stocks to bears because, while shortselling helps normal markets, it is 'utterly immoral and unwarranted' in a crisis. This attitude was not, however, officially that of the Exchange.

"As an opening move in its defense, the Stock Exchange last week ordered all members not to use the phrase 'bear-raid' unless they could substantiate it. The reason was clear: When a stock tumbles, perhaps on some internal development in the company, brokers often say it was because of a 'raid' and increase the feeling against bears.

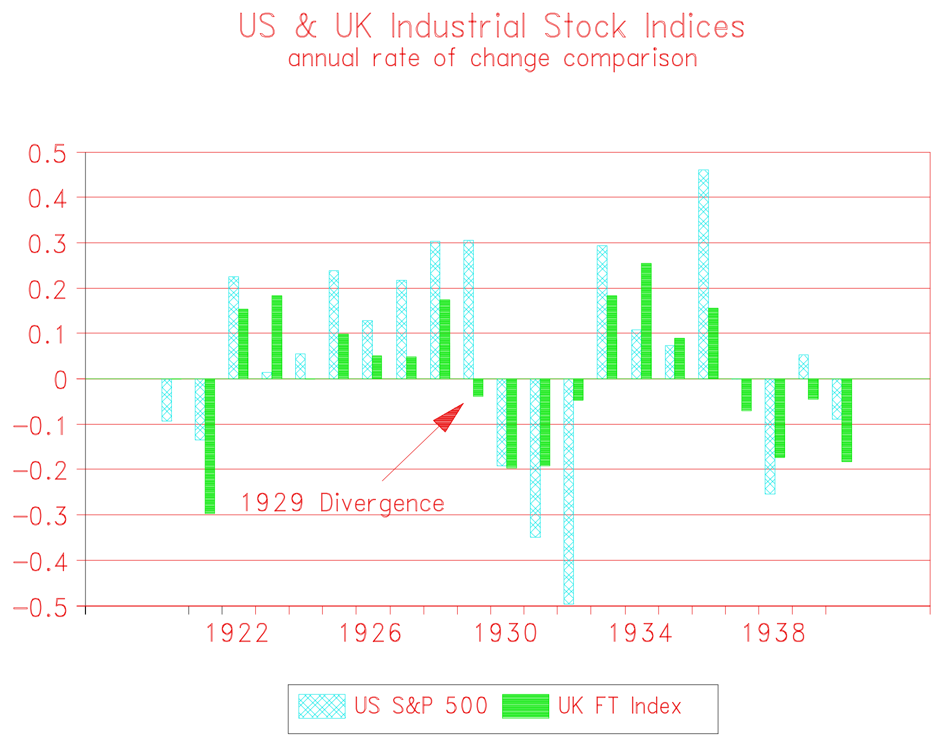
That the move was a little late seemed implied by the lack of differentiation last week between raids and real shortselling when bears were attacked. A raid is definitely aimed to depress a stock that will come on the market if the price can be shoved down a little. A legitimate short sells on values, feels that time and earnings reports will adjust the price downward. The difference is the same as between an operator and an investor."

Today we can pick up any leading newspaper and read that the market declined on expectations of higher interest rates or that gold declined because interest rates were expected to rise. On occasion, the very next day gold will rise sharply and Fed Funds may have also moved higher, but then the press will tout another reason in place of their interest rate explanation. The truth of the matter is that often moves are created on purely technical implications which lack any direct influence from interest rates, oil, or whatever. But the press does not generally understand technical moves or cyclical moves and always insists upon having some sort of fundamental answer even when none exists. Thus was the case in point and much of the decline was attributed to "bear-raiders" when, in fact, none existed.

Time also continued in presenting the opinions of Professor Irving Fisher as follows:

"Another commentator on the situation last week was Yale's Professor Irving Fisher. Said he: 'My former master in economics, President (Arthur Twining) Hadley, put it well when he said that speculation of any kind...is beneficial when it merely anticipates a rise or fall of prices.' For it then mitigates the rise or fall. It is injurious when it manipulates prices against the natural tendency. Manipulation is usually impossible when the supply is large and there is not much overextension of margin buying. Today, however, shortselling...is capable of extreme abuse.' The goated Professor also made this acute distinction between longbuying and shortselling; 'Borrowed money comes out of an almost infinite reservoir, whereas borrowed stock may come from a very small reservoir...It is practically impossible for speculators to manipulate the value of money.'"

Fisher pointed out that long positions could draw upon a vast reservoir of capital to borrow for the purpose of buying stock on margin. However, in his contention that shorts might be able to manipulate because the supply of stock is infinitely smaller, something is lost in the logic here. One could surmise that shorts could theoretically borrow enough stock to force the market down. But when a short borrows stock, he then sells it to another buyer. At all times there are two longs for each short. The first is the original owner from whom the short borrowed the stock, and the second long is the buyer to whom the short sells his position. In order for the short to sell he can only do so if there is a buyer. Because the reservoir of stock is limited, it becomes actually more difficult for shorts to manipulate a market. This can be proven by merely looking at the casualty list of short players during the bull market era up into 1929. The shorts merely fed the market higher, creating in the climax three buyers for the same stock. When the short is squeezed and is forced to cover his position, he becomes the third buyer. The argument that longs cannot manipulate a market because the supply of money is too vast and thus uncontrollable is ridiculous. The evidence that did come out of the Senate investigations in later years proved the existence of numerous "bull-pools" but not the existence



of "bear-pools" and that manipulation was evident throughout the bull market.

All the arguments that bear raids were the cause of the market's demise and that in turn the demise of the market created the Depression are without any foundation whatsoever. Time went on in this article as follows:

"So far during the Depression the Stock Exchange has moved against bears by the Questionnaire and the complete ban on shortsales which was imposed for two days when Great Britain suspended gold payments. The Questionnaire was used in the autumn of 1929 to learn the extent and personnel of the 'bear party.' President Richard Whitney (of NYSE) later revealed the short interest was at no time large during the days of great breaks. It was used again last May and members who were too aggressive in their tactics received sharp callings down. The Questionnaire in effect last week revealed every bear, whether he was short 10 shares or 10,000 for one hour or one month. It placed the Exchange in a position to act if it wished to, but did not deter 'gentlemen's agreement' to refrain from taking short positions."

The efforts spent against the bears were purely a waste of time. The exchange's own reporting failed to turn up any evidence of the almighty bear raiders who knew perfectly when to sell the market in September 1929. Indeed, the sentiment against shortselling was prevalent worldwide. Instead of governments accepting any blame for the sad state of the international economy, they turned against the free market forces in many varied ways but always with the same ultimate goal. Time reported on this aspect in this article as well.

"In few nations nowadays is there a 'free and open market.' The Berlin Bourse closed from July 13 to September 3, opened with shortselling banned, then closed again. In Great Britain all trades were put on a cash basis which practically eliminated shortselling as did restrictions imposed on the French and Athenian Bourses. On the Paris Bourse a seller must deposit 40%

margin, also 25% on the amount of the stock sold which makes bear activities a rich man's privilege. One of the most dramatic events of the present crisis occurred in Amsterdam on September 21 when after a terrific slump in prices, all transactions were cancelled, the Exchange closed in status quo. Montreal and Toronto met the British crisis by banning shortsales and establishing 'minimum prices' for securities, but both last week were open with no restrictions. The Tokyo Exchange has been closing and opening repeatedly during recent weeks. Tokyo stocks broke badly when the shares owned by interests who operate the Exchange collapsed.

Can you imagine that after a market collapses in sheer panic that an exchange would then declare all the trades null and void? That is precisely what happened in Amsterdam during September. Unfair laws and rules against the free markets were universal. The more governments improvised such actions, the greater the fears began to spread resulting in a lack of confidence which only the financial gods could chart. Despite all these numerous government interventions, the free market continued to decline for nearly a year beyond this point. Those who were outraged and brought suit against the Commodity Exchange in New York for raising the margins to go long in silver back in 1980 when the shorts held a distinct advantage could have suffered a worse fate. The exchange might have declared all trading for the previous year null and void and rolled silver back to $5 an ounce by law!

This was not the first time that shortselling was blamed for causing a depression. The issue of whether or not shortselling was illegal came to a head following the panic of 1903. Action was brought against the exchange in court, which sought to ban shortselling by charging that it was illegal to sell something that one did not have as if it were committing a fraud. The case rose to the U.S. Supreme Court from where the opinion was handed down in 1905 by the famous Oliver Wendall Holmes who said: "People will endeavor to forecast the future and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable...This court has upheld sales of stock for future delivery."

Despite the fact that the Supreme Court had upheld the legality of shortselling back in 1905 the growing sentiment was clearly seeking a scapegoat, and many in government preferred to point the finger at those supposed bears than at the real problems which had been created by the numerous bank failures and governmental defaults.

Richard Whitney, President of the New York Stock Exchange, had even become the target of personal attacks by several Senators. Whitney was working hard to gather as much information about shortselling as possible to ward off this attack by government. He went to Hartford, Connecticut, to speak before the Chamber of Commerce and the audience was packed. Whitney revealed for the first time in October 1931 the "short-interest" which had taken an extensive amount of time and effort to gather together.

On May 25, 1931, the short interest stood at 5,589,000 shares. He illustrated that it declined sharply during the "moratorium" rally and then rose back to 4,480,000 shares on September 11, and declined to 4,241,000 on September 18. Whitney illustrated that at its peak in May, short interest was only 4% of the 1,305,516,000 shares listed on the exchange. Of the accounts that hold long positions on the same date, a total of 59 million shares were held, which demonstrated that long positions outnumbered short positions by better than 10.5 to one.

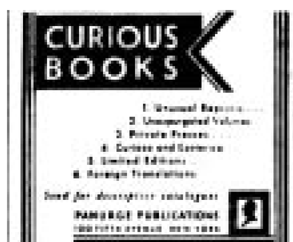
The New York Stock Exchange had forbidden shortselling for two days following the British default and he explained why the exchange lifted this restriction so quickly. The market rallied instead of declining because the shorts covered positions fearing the restrictions. Within two days, the short interest declined from 4,241,000 shares to 1,079,000 shares. This, Whitney pointed out, left a great danger. If everyone was long and prices continued to decline, then lacking short-covering, there might be little incentive to be a buyer which could cause devastating declines.

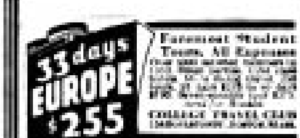
Insofar as the threat that this interest was tightly held among the rumoured "bear-raiders," Whitney produced the accounting which illustrated that the short interest had been widely dispersed among 9,369 accounts with an average of only 400 shares. Despite this evidence, government was not satisfied and the Senate hearings would still be convened, turning into the most serious infraction of constitutional rights ever instigated against the public as a whole. Everyone would soon learn that the power of the Grand Jury does not need probable cause to investigate; all it needs is official curiosity.

The commodity exchanges were far from free of these interventions either, as reported by Time magazine in this same October 12, 1931 article.

"Restrictions exist in two important U.S. commodity markets. The New York Cotton Exchange does not permit a fluctuation of more than 200 points per unit (100 bales) in any one day. Since 1925 no single futures account on the Chicago Board of Trade may exceed 5,000,000 bushels at any one time, either long or short. This is a 'working agreement' with the U.S. Grain Futures Administration and is strictly enforced, although it does not apply to bona fide hedging. Thus, over-extension of a trader on a scale which would hurt all other traders is almost impossible."

In commodities, shorts are not limited by a definitive reservoir of stock. Contracts can totally outnumber the supply of any given commodity. But the commodity industry was besieged by the criticism which followed the panic of 1919. There interest was clearly focused within the commodity sectors as well as speculation. The rallies which any commodities had undergone





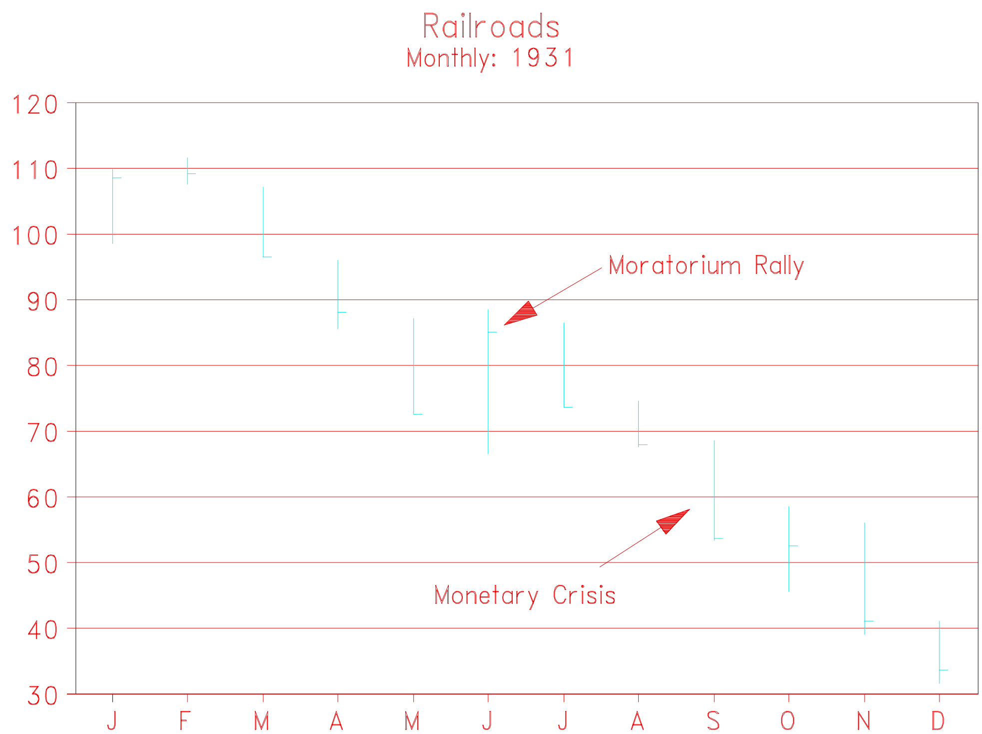
overshadowed the stock market as if the commodities were King Kong and stocks were represented by Flipper, the dolphin. This in part led to many restraints on the commodity markets including the imposition of trading limits on the amount a commodity could move during the course of a day as well as position limits. Those are rules which commodity traders deal with every day in this modern age. They are not questioned because to today's trader they have always been there. But, in fact, they were the intervention which followed the panic of 1919 when commodities had held the center stage. For this reason, commodities had declined in favour of the unrestricted stock market during the roaring '20s.

But it was also these restrictions in commodities which tended to bring about a lack of speculative interest in the futures markets. Without that interest, commodities suffered from stagnation. This has also led many to contend that because commodities declined by and large during the 1920s, that inflation was nonexistent and they always point to the 1920s and the "Nifty-Fifties" in support of their argument. As we continue through this study of the free markets and analysis, we will see how this assumption is also completely without foundation.

But unlike the illusive bears, the investment trusts did exist and published quarterly statements to verify that indeed they were still around. One of the first trusts to publish a report at this time was the Tri-Continental Corp., and a sister trust which it also controlled named Selected Industries, Inc. The Tri- Continental Corp. statement for September 30, 1931 showed a market value of its holdings of $29 million compared to $51 million for the year prior. The book value of the common stock had declined on a per share basis from $8.70 to $2.84. The listing of stocks sold by those two trusts began to illustrate who perhaps the real big sellers were. This one trust had sold off 16,100 shares of G.M., 3,700 shares of U.S. Steel, 14,724 shares of Studebaker and 45,400 shares of the Chesapeake & Ohio Railroad just to mention a few. Their statements reflected that most of their foreign bond holdings had been concentrated in German issues, but they were at least fortunate enough to have sold off much of this position during the first quarter of 1931. But their statements had also reflected a shift in assets which many other trusts had also closely paralleled. This was the outright selling of common shares of stock in favour of preferred shares as well as bond issues. This trend among the investment trusts is the reason why even though stock prices had declined, the NUMBER of share holders of the top blue-chip companies continued to rise and actually peaked during 1932. It was the investment trusts which had bought much of the stock in 1929 and it was the individuals who bought stock from them on the way down.

The sharp decline in stock prices during September of 1931 was also accompanied by a sharp decline in production within many industries. On the surface one could perhaps argue that stock prices had fallen badly due to large shortselling, but in reality, one could not blame the sharpest decline in productivity upon supposed shorts in the stock market.

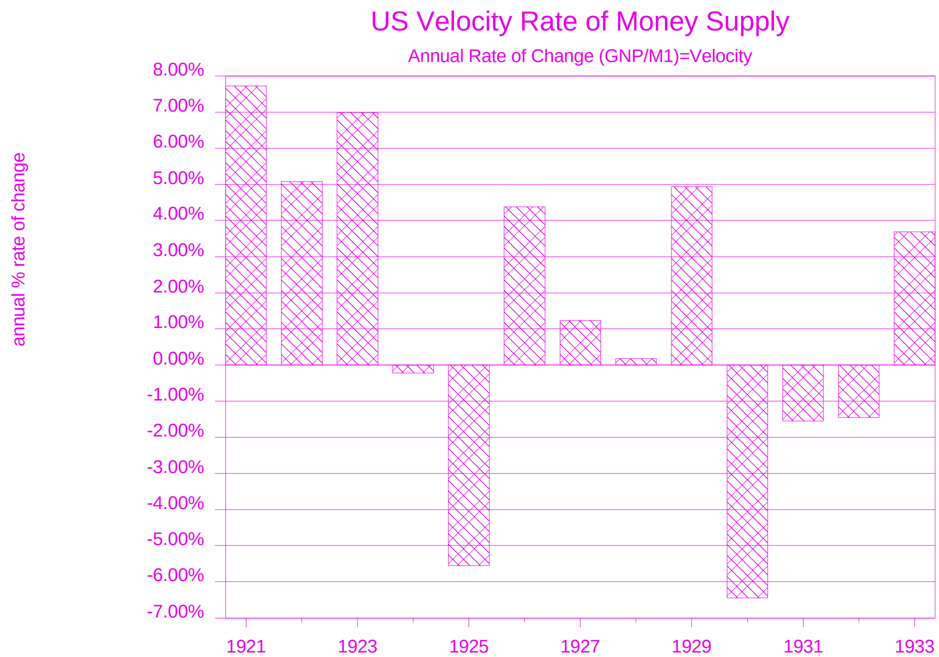
Auto production during September fell 25.6% from August levels and 37.7% from September 1930 levels according to the figures released by the National automobile Chamber of Commerce. Steel production fell to only 28.2% of capacity, a level which penetrated the lowest on record as far back as 1921.



The numerous banking statements which arrived at this time were of major interest to many. The trend toward withdrawals had clearly shown up, and to everyone's surprise even the largest bank, the Chase National, was not spared. Chase posted a decline in deposits of $214 million during the third quarter. The Philadelphia banks were in deep trouble, perhaps best illustrated by large advertisements which were prepared by prominent citizens within the community. These advertisements were pleading with the public not to withdraw their capital from the banks in town. The largest was the Philadelphia National Bank whose deposits declined $83 million during the third quarter of 1931, falling to $289 million.

It cannot be denied that the supply of money contracted during this period. If all banks reported a decline in deposits, obviously the money had to go somewhere. There are those who blamed the Federal Reserve for failing to expand the money supply during this period which caused the contraction and thereby the Depression. But again this argument is merely superficial. The causes and effects were not merely domestic, but also international. Watching the ups and downs of the supply of money in the U.S. cannot lead us to the ultimate cause for the Depression of the world. Besides, this argument ignores international circumstances and capital flows of international funds which fled from one nation to another as sovereign defaults sparked deep fears, and it ignores the issue of what money is and how it is created.

As in the example that I just provided to illustrate why a short cannot control and ultimately manipulate a stock on sheer numbers, money supply works in the same manner. In commodities, the number of contracts are not limited to any physical amount of goods available. Thus the short need not borrow 100 ounces of gold to adopt a short position. Therefore, longs and shorts always balance and neither side can actually outnumber the other. In stocks as in money, the short needs to physically borrow the stock and therefore since stock is of a definitive limited quantity, when the short borrows the stock from an original



owner and sells it to another, he has created two persons who both "believe" that they own a share of that company.

Imagine now that we are talking about General Motors which issued 1,000 shares. For argument's sake, let us say that a very bearish person borrows 1,000 shares and decides he wants to go short. He borrows from person A and sells it to person B. The broker who does the accounting for these three people will send them all a statement at the end of the day's transactions. Person A will show that he still holds his original 1,000 shares. B will show that he has just bought 1,000 shares and the short will show a statement that he owes 1,000 shares. In reality 2,000 shares are now thought to be owned by both A and B. Both A and B decide that they want to buy stock in U.S. Steel. The broker will lend them 50% against the fully paid positions in G.M. Now each can borrow against the combined 2,000 shares they own of G.M. and they buy U.S. Steel. But G.M. never issued 2,000 shares; all it ever issued was 1,000 shares of G.M. stock without the company having anything to do with it.

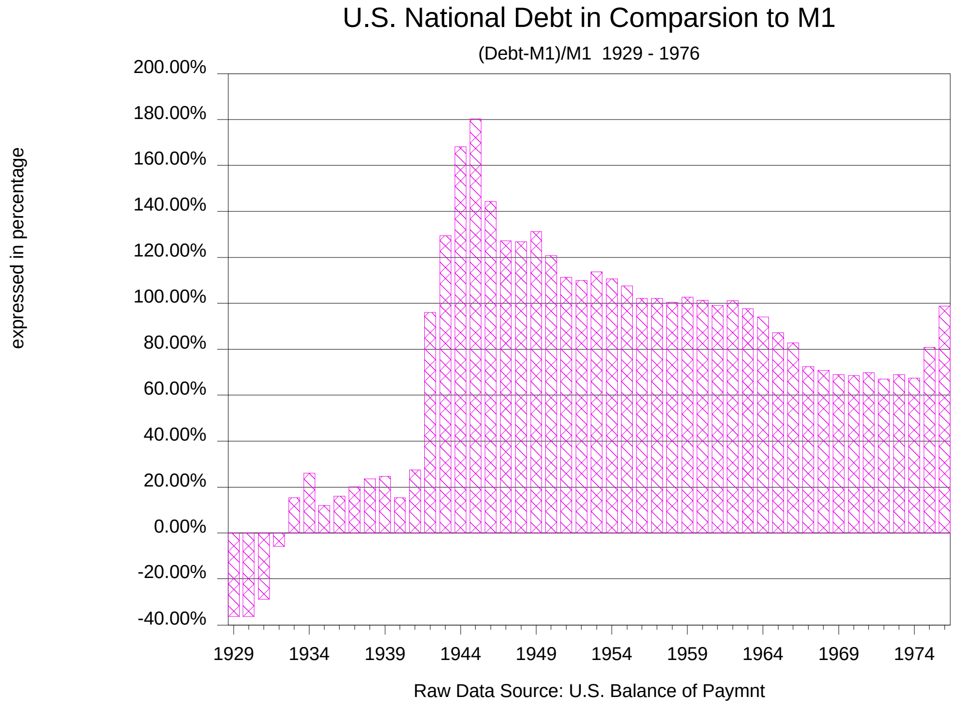
The creation of money works in the same manner. A vast amount of money was created by the booming stock market. Let us consider that A and B bought their G.M. stock at $40 and then they borrowed 50% and bought U.S. Steel for $20. After three months, let us suppose that G.M. rose to $100 and U.S. Steel moved up to $60. Now they decide that they want to borrow again and buy Sears which is selling for $60.

Against G.M. they borrowed $20 and now it is worth $100. The broker will therefore lend them another $30 against the G.M. shares. U.S. Steel they own outright and they borrow $30 against that. They now take the $60 and buy Sears. The value of those assets continues to move higher. The limit is not imposed by the outstanding money supply but by what someone is willing to pay for it. If we were to add up all the stock on the various U.S. markets, bank deposits, bonds, diamonds, real estate, etc., we would find that the intrinsic value placed by man on all these assets far exceeds the outstanding money supply. In fact, the total value of real estate in the United States exceeds the entire world supply of money. This quasi money in tangible form cannot be controlled by the Fed, no less counted. Its value rests solely upon the whims of confident and contented capital. When capital becomes less than confident and real estate suddenly becomes nonliquid, values plummet because the supply of these things vastly outnumber the actual supply of money used for exchange. Hence severe and rapid contractions always follow rapidly expanding inflationary periods. Those who wish to assert that the roaring '20s were a period of low inflation are insane. Inflation may not have been present in raw commodities, but insofar as stocks and luxury items were concerned, inflation was rampant as evidenced by the Florida land boom and the bull market itself. People were not standing in line, hoarding toilet paper or sugar as they were in the 1970s, but they were bidding up the price of housing, stocks, bonds, diamonds, furs and automobiles. This was a period of inflation in tangible forms of wealth, which in reality caused a great expansion in this tangible money supply that was just as good as gold and could be placed as collateral at a bank for borrowing purposes.

We read earlier that $1 in gold led to $13 in credit according to the Fed's own estimates during the 1920s. Of course this vast multiplication of credit has been somewhat reduced in modern times since banks are required to maintain higher levels of reserves. But still what becomes important is not so much the contraction by the Fed but the velocity rate at which money changes hands. When people lose confidence in a bank or the government and they hoard their assets, as was the case during the Depression, the hoarding of gold reduced the multiplication factor of credit. Since the Fed could not create gold, its only option was to create paper money. That it could not do at a rate of 13 times in good conscience while on a gold standard. Such a move would revive Gresham's law of bad money driving out the good and the end result would have been another hyperinflation as was seen in Germany during the early 1920s. Even so, it was not the lack of money or the contraction so much which disrupted the economy as it was the sharp decline in velocity.

The private sector has always been in control of its money supply to a large extent. Governments merely aggravates the situation by playing games. For example, the United States borrows money through issuing bonds, bills and notes. It is somehow believed that if government borrows to cover its debt rather than monetize it through issuing paper money that the effects will not be as inflationary. The National Debt stood at $16.9 billion in 1929 and rose to $22.5 billion by 1933; by 1976 it reached $620.4 billion. If we look at money supply through the strictest measurement M1 (currency plus demand deposits), we find that it stood at $26.5 billion in 1929, $19.5 billion in 1933 and $311.9 billion in 1976. In 1929 the amount of outstanding U.S. securities was considerably less than the outstanding currency and demand deposits but by 1933 debt exceeded M1 by about 15%. By 1976 outstanding debt was almost twice M1.

If everyone wanted to cash in their U.S. bonds, notes and bills at the same time, government would be forced to print money since not enough cash as measured through M1 exists to cover all the debt obligations. This is exactly what takes place through private investments such as stocks, real estate, antiques, fine art, diamonds, etc.



As long as people feel comfortable in viewing these things as a "store of wealth" everything is fine. But when confidence is lost, everyone runs in the direction of cash. There is simply not enough cash to go around and a massive contraction takes place. Therefore, the Great Depression was not only a massive contraction in the value of these tangible assets, but it was also a contraction in debt instruments as well. When nations began to default on their bonds, confidence in their paper money gave way as well, driving the whole world into gold and the dollar.

Debt has always been a huge problem to man. Because debt multiplies the value of these tangible assets, it creates a bubble of unprecedented danger which eventually comes to a head creating a stampede into cash.

Debt has always been a problem that has inflicted every society known to man. Even the great Julius Caesar was forced to deal with such financial decisions and, indeed, it may have been these decisions which prompted his assassination. Much of the political structure of Rome was built on lavish extravaganzas on the part of politicians to gain favour and thus votes from the people. To cover such costs, one would borrow vast sums to pay for public games and events. The rates of interest were often driven to well over 100% and indeed a debt crisis had besieged Rome during the period of the Civil War. It was widely believed that Caesar would be forced to declare all debts null and void to secure his position. Even Marc Anthony had bought up the auctioned property of several political exiles, including the very palace and slaves of Pompey the Great, in the belief that such debts would be wiped out by Caesar. But no matter how popular such a move would have been to such exploiters of the circumstances, Caesar cancelled all interest which had been accrued on debts during the Civil War or at least for a two-year period upon his return to Rome in September of 47 BC. Had he not taken such action the debt- ridden society would have created a civil war on the streets of Rome.

Today we question little about debt. We seem to accept that interest is a just thing which is owed to the man who holds the money. But in fact, philosophically, civilization had turned its back on debt and interest after it had been proven to have destroyed numerous societies throughout history. To charge interest was a sin of usury in both the Catholic Church as well as in the Arab religions. Only the Jews did not consider charging interest to be a sin. Throughout the Middle Ages, no Christian could charge interest to another. If he lent money to someone, it was considered to be a Christian act and to demand interest which might force that individual to repay two or three times what he had originally borrowed was a sin in that one merely exploited the misfortunes of others.

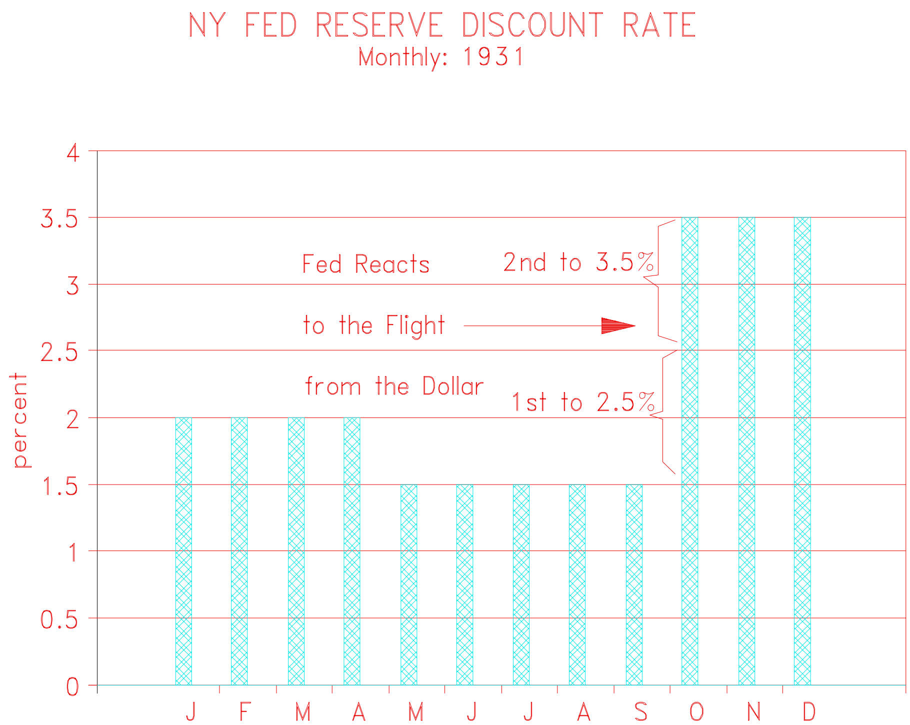
The Jews played a large part in the development of trade, for it was the Jews who lent money for business ventures and financed voyages. But the Jews were also moneylenders who debtors could not repay, and this often led to the excuse which most called anti-Semitism. Much of the killing of Jews had nothing to do with religion, but instead it was caused by the fact that they held the mortgages on much of the property. Things became so bad that the Pope threatened excommunication against anyone who harmed the Jews.

It was this same law of usury which eventually led to the breakup of the Catholic Church into various Christian sects. Christians wanted to be able to lend money and the Pope would not lift the law of usury. Thus a revolution in religion took place and the various Christian sects made it permissible to charge interest. However, they disguised many of their motives by calling the Pope the "Anti-Christ" because he sought to protect the Jews and because he sought to control debtors by maintaining the old laws of usury, thereby loosely fitting together a few lines of the Revelations which foretold of the coming of the Anti-Christ.

The world has therefore gone through the long-term cycle of debt several times. It was destroyed by massive overextension, then abandoned debt and interest payments and then reverted toward this system. We now live in a world highly involved in debt and interdependent payments both on a private as well as governmental level. The contraction in world trade was damaged far more by the default on foreign bonds, the flight of capital from one nation to another and the massive contraction in the value of both debt instruments and tangible assets than by any other forces during the period.

Little work if any has ever been devoted to studying the differences between a society based upon debt and one void of such instruments. Few economists are even aware that civilization has alternated between these two extremes throughout history. Consequently, few opinions as to the causes of the Great Depression have even focused on this very important aspect.

In actuality, most analytical commentary on the Great Depression has ignored the impact of debt and the soveriegn defaults on numerous government bond issues, including municipal issues within the United States. The sheer fact that confidence fled from the bond markets is evidenced by the fact that bonds declined even during 1931, peaked in February, declined in June, rallied in sympathy with stocks during the moratorium rally and then continued lower into year end. The discount rate cut to the historic low of 1.5% by the Fed in May of 1931 failed to create a reversal in the trend.



Bonds declined despite whatever the yield was. Such market action moving in direct opposition to what we would normally expect today is highly contradictory to what would be normally anticipated. Such a divergence could only be sparked by a complete collapse in confidence.

Governments were literally confused by the events that surrounded them. They did not understand how to restore confidence in their currencies or to dispel rumours which would shift vast hoards of capital from one nation to another. Although the United States became the object of affection for this refugee international capital immediately following the British default in September 1931, rumours soon sparked fears that it would be the United States that would fall victim to the turmoil of the era and capital began to flee from the United States. This disrupted the domestic economy insofar as the Fed's actions to try to restore confidence in the dollar were no different than those attempted by Germany, Austria and even Britain. The Fed raised the discount rate substantially, trying the typical textbook play, thinking that higher interest rates would attract the refugee capital once again.

The Fed turned to its textbook tactics and raised the discount rate from 1.5% to 2.5% in October of 1931. This rise in U.S. interest rates was not sufficient to convince anyone that the U.S. would not abandon the gold standard which thereby equaled a default on its foreign obligations. Still failing to see that it was not how much one would pay but whether or not one would even get paid, the Fed raised the discount rate again that very same month to 3.5%. But still this did nothing to dispel the sudden lack in confidence which had developed.

We find the commentary in Time magazine on October 26, 1931, as very helpful in giving us a feeling of what was taking place at the time.

"RATE UPPING"

"With gold flowing swiftly out of its vaults, last week Federal Reserve Bank of New

York raised its rediscount rate to 3.5%, a 1% advance from the rate which prevailed from May 8 to October 9. Through losses of gold to foreign countries and to U.S. hoarders, the Federal Reserve System showed last week a 61.8% ratio of gold on deposit and notes outstanding against 67.1% the week before, 78.4% before England suspended gold payments September 21. Legal minimum is 40%. In four weeks the U.S. lost $649,000,000 in gold, largest monthly drain on record. Previous record was a loss of $99,300,000 in June 1928. Last summer when Germany and England were experiencing like movements, the Reichsbank lost $247,000,000 in seven weeks, the Bank of England $779,000,000 in a fortnight. If last week's rate of decline in the Reserve Ratio were maintained, the legal limit of 40% would be reached in the next four weeks. Were the celegal minimum exceeded there would be a currency panic, even perhaps suspension of gold payments."

We can see as reported by Time that the drain was of historic proportions. There is no doubt that capital flows between nations were never greater. In the midst of all this turmoil the casualty was certainly world trade. Beyond tariffs, now international payments were cast in doubt. Tensions were only heightened when in mid-October Canada prohibited the exportation of gold except under valid license in payment for foreign trade. This helped take the speculative sting out of the Canadian dollar which had dropped to a discount with that of the U.S. But in all, the Canadian move was perhaps the smartest government action taken in the midst of this chaos for it simply eliminated the speculative withdrawal of gold but earmarked gold exports for legitimate trade circumstances only. This was in contrast to Britain and the United States which attempted to entice foreign capital to remain by raising interest rates. These were measures which failed to stem the panic and only further disrupted their domestic economies by forcing industry to suddenly bear the brunt of a sharp 125% rise in interest rates within one month without notice of any kind.

Even Hoover wrote in his memoirs: "The Bank of England tried to stop the run and attract capital - and thus gold to Britain - by the usual device of raising interest rates. That device does not work in times of fear, and in this instance had little effect except to spread more fear." Hoover went on to talk about the effects of the gold panic withdrawals from the United States and how they seriously disrupted U.S. trade. Hoover wrote:

"At this time foreigners concluded that the United States would be the next bulwark of international stability to collapse. They began to withdraw their deposits from our banks in gold. By the end of October we were to lose about $700,000,000 from our gold supply. This cramped our volume of credit and increased our bank demands on their borrowers. To add to our troubles, domestic hoarding of gold and currency by our citizens began. Our exports to the world dropped to about one third of the 1929 rate. Worse still, our exports of principal farm products to Europe had now dropped to almost zero, further demoralizing commodity prices. Our unemployment swelled."

From the time when the European panics first began in April, the Federal Reserve indexes illustrated marked declines. By the end of September, the Fed's index on industrial production declined 18%, factory payrolls 20%, construction contracts were off 30% and common stocks had taken a 40% decline. Clearly fears over international defaults can take their toll very quickly. Today we are not immune to such disturbances and we have experienced sharp capital flows into the U.S. dollar which came in spite of what traditional economics would lead us to believe. Confidence plays a very key role in international finance. It can overpower all logic and when shaken it spawns nothing but rumour and fear.

Again we find that the government took action which was adverse to its own domestic economic condition by raising the discount rate in favour of international circumstances.

Hoover once again rose to the occasion with ideas that were provocative and in reality not far from the philosophy of John Maynard Keynes, which was adopted during the aftermath of the Great Depression. Hoover’s idea was dubbed by the press as his "Super Plan" aimed at the turmoil created by the nonliquidity caused by numerous banking failures.

The withdrawal of gold from U.S. banks on the part of foreign depositors and central banks caused several serious side effects within the domestic U.S. economy. Banks responded to the domestic urge to withdraw and hoard gold in a manner which was far from beneficial to businessmen and farmers as well as owners of mortgaged real estate. The bankers saw the turmoil as a threat, particularly against their liquidity, which in turn threatened the very survival of the banks. As a result, bankers were led to look out for number one, themselves. They began to call in loans from many sectors, trying to increase their cash reserves. Many homes and farms were forced into foreclosure, which merely added to the emotional depression that existed at the time.

Bankruptcies were increased as creditors called in all the markers of debtors. The contraction in the money supply was thereby not caused by the Federal Reserve intentionally, but in contrast by the withdrawal of foreign capital, domestic hoarding, and the needless foreclosure on property which further depressed the values of tangible assets.

Hoover’s "Super Plan" was actually the formation of what was known as the National Credit Corporation. Numerous banks had been closed, tying up assets in the billions of dollars. Depositors’ money, which had been lent on real estate, for example, was frozen when the banks were unable to collect enough from the repayment on loans to satisfy demands from its depositors. Thus, the value of real estate dropped substantially, disarming the multiplication effects which had originally contributed to the expansion in money supply.

Originally, the man who deposited $10,000 allowed the bank to lend that $10,000 to someone who wanted to buy a new home. The $10,000 was thereby paid to the builder, creating $20,000 in deposits throughout the banking system. But now the game of musical chairs came to a halt. Unable to sell the real estate to recapture the original $10,000 it had taken from the depositor, the reality of the game had hit home. The $10,000 no longer existed because it had been paid to the builder who deposited the money somewhere else. As everyone clamored for their money, these deposits simply vanished and the money supply contracted in its wake.

Hoover realized that vast sums of assets were frozen by this process and that, combined with international withdrawals, spelled potential national disaster. His idea was to create another form of central bank in a sense. The National Credit Corp. would be a private organization funded by $500 million in deposit contributions from the banks themselves. In turn, these funds would be used to bail out banks with cash flow problems by lending them cash upon good collateral hold on their books. This he viewed was essential to bring a halt to the bank failures and the foreclosures which further increased fears among the people and led to domestic hoarding of gold. This was a huge vicious circle which in the end added pressure on still other banks and contracted the money supply even further. The tangible assets far outnumbered the net cash available and as the velocity of money declined, so did the deposits and the multiplication factor within the banking system. This circle of events had to be stopped and this was Hoover's brilliant "Super Plan" to get the job done.

Hoover's plan actually began prior to the British default of September 21, 1931. It was at a confidential meeting during early September that Hoover called to the White House the entire Advisory Council of the Federal Reserve Board members, which consisted of 24 bankers and Treasury officials. Hoover proposed that the banks should pool together $500 million for the creation of this new project and that in addition, this pool should be given borrowing powers of $1 billion. The men in attendance seemed to support the idea and tentatively agreed to begin organizing banks around the nation.

In many ways this was quite similar to the Federal Reserve, which had been born out of the turmoil largely created by the panic of 1907. The Federal Reserve would not accept mortgages or industrial notes as collateral from banks as part of their reserve requirements. Thus, this new concept would accept collateral which the Fed did not.

Then the British default took place. Suddenly the gold reserves of the nation were under siege. Eleven days later, Hoover called a special meeting of the leading men from the banks, insurance, and loan agencies along with several top government officials. Hoover wanted to avoid publicity on this meeting, fearing that speculation by the press might adversely affect his plans while the matter was still in the planning stages. The meeting took place on October 4, at the home of Andrew Mellon rather than at the White House. This move was successful in avoiding the attention of the press who keenly noted the comings and goings at the White House.

Hoover also made plans which placed him in the position to call for a special session of Congress on October 6 just in case the private leaders refused to go along with his proposal. Hoover wrote that many in attendance at this meeting held at Mellon's house did not want to contribute funds to this central pool and urged that the government should put up the money. But Hoover's ideas were strongly against using taxpayer's money, and he believed that the private sector should participate in trying to save itself collectively. But he also realized that Congress would frown upon such government aid even more so than he. Although Hoover later wrote that this meeting at times became quite heated, it ended with the bankers agreeing to call a meeting of all major New York banks for the following day.

The insurance and loan agencies were far from cooperative. Hoover had proposed that they should hold back on foreclosures and that a central system of discounting mortgages should be established. Again, the concept was a central bank which would accept mortgages in the same manner as the Fed accepts cash or liquid notes. The insurance companies were not in the position of banks and they did not have the fear of public runs to withdraw deposits. Therefore, the insurance industry had no incentive and regarded foreclosures as simply a business decision which should not concern itself with the personal affliction that it might cause. The loan agencies were already charging much higher rates than banks and they too displayed a more self-centered approach. Only the savings banks and savings and loans were receptive. Hoover wrote in his memoirs: "I returned to the White House after midnight more depressed than ever before."

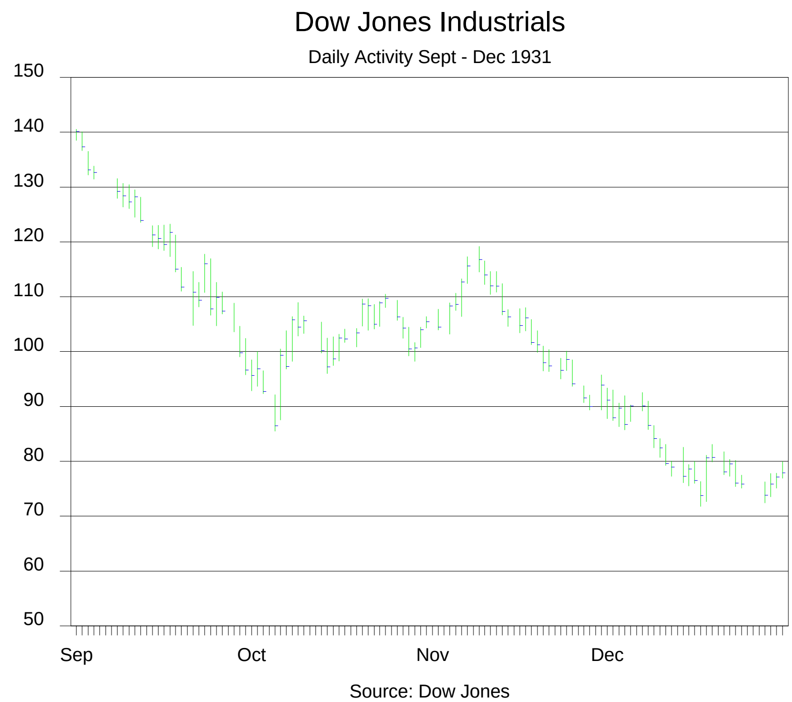
Hoover then met with Congressional leaders at the White House on October 6. He found them unwilling to fund any government structure to provide stability for the real estate situation. The next day, Hoover met again with the insurance, loan agencies and the savings and loan industries. The savings and loan group agreed with Hoover's proposals which called for an immediate end to foreclosures upon responsible people. The insurance industry refused to go along with the proposed banking structure which would have 12 districts and accept mortgages as deposits in the same manner as the Federal Reserve worked among its member banks. The insurance industry objected on the grounds that it would "create lower interest rates and thereby the income to their policyholders would be reduced." Hoover tried to point out that in many cases their precious policyholders were the very same people who were losing their homes in foreclosure. But the insurance companies would not cooperate.

Hoover then was forced to reduce the scope of his idea, creating the Home Loan Banks which stood in the middle of the savings and loans and had accepted Hoover's ideas as quite brilliant. The structure would set up 12 districts in the same manner as the Federal Reserve.

News of these new plans were accepted quite favourably by the marketplace and for one brief shining moment restored confidence both domestically and internationally. But at first, the Europeans misunderstood these proposals and assumed that they would be funded by government, which in that light meant inflation and a decline in the U.S. gold reserves. Therefore, initially, this news added some pressure to the dollar coming from Europe. Eventually, these fears that the United States would go into default began to subside along with the gold withdrawals going into year end. The concept of this new form of centralized private banking to unlock frozen capital and to help prevent further banking failures was welcome news to the markets as well.

The following table illustrates the U.S. gold situation and the ratio to currency as it developed throughout this immediate crisis period. Column (1) provides the U.S. gold reserves expressed in millions of dollars. Column (2) provides the ratio of gold reserves to Federal Reserve notes and deposits, while column (3) provides the actual Federal Reserve notes in circulation. Another point that should be made is that the only important nations which remained on the gold standard were the U.S. and France, and as of the week ending November 18, 1931, the U.S. held $2.8 billion in gold while France held $2.6 billion.

U.S. Gold Reserves & Currencies Ratios



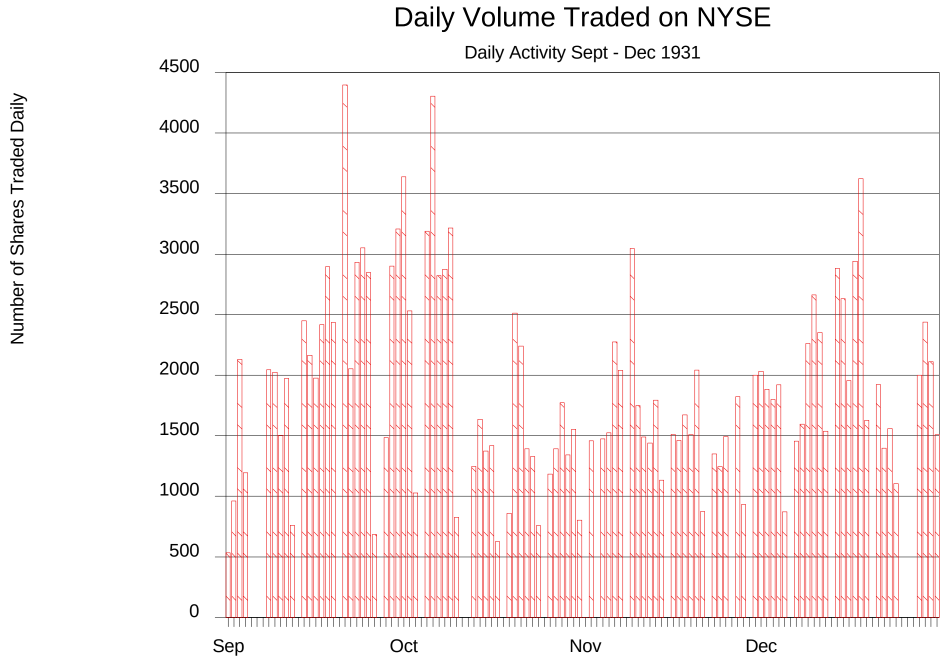
Week Ended	Gold Res	Ratio	Currency
Sept 10	3,485	74.9%	2,005
Sept 23	3,327	73.4%	2,045
Sept 30	3,138	73.4%	2,097
Oct 7	3,036	63.8%	2,269
Oct 14	2,836	58.5%	2,321
Oct 21	2,764	56.5%	2,383
Oct 28	2,738	56.6%	2,383
Nov 4	2,772	58.1%	2,447
Nov 11	2,826	62.4%	2,449
Nov 18	2,874	64.1%	2,433
Year Ago	3,040	81.9%	1,383

*Source: Time Magazine

The European fears which developed over the misunderstanding of Hoover's National Credit Corp. had their way of sparking a rise in commodity prices in terms of dollars. This was only natural since they feared the dollar's decline and the U.S. potential abandonment of the gold standard. This spelled one thing: a sudden price shock of inflationary involvement. The U.S. press was a bit confused at the sudden foreign buying of commodities. Many attributed this to unwarranted fears that perhaps the U.S. might institute tariffs on raw commodities, while others claimed that it was fears that Britain would impose a tariff. The European press centered on the fear of U.S. abandoning the gold standard. Added to these rumours, others circulated that buying was caused by the fact that Russia would no longer be an exporter of wheat. None of these rumours proved to be true and in the end, when Europe realized that Hoover's plan was not a license to inflate, commodity prices declined with the dollar's sudden rise. But this was a lesson which others would point to in the years ahead as evidence that currency inflation was the only way out of this mess.

In the November 2, 1931 edition of Time magazine, we find a short but descriptive account of the commodity rally which began during October. It was a strong technical reaction which began to lead toward much bullishness.

"On October 5, the price of May wheat was 48.25 cent s a bushel. Last week it rose



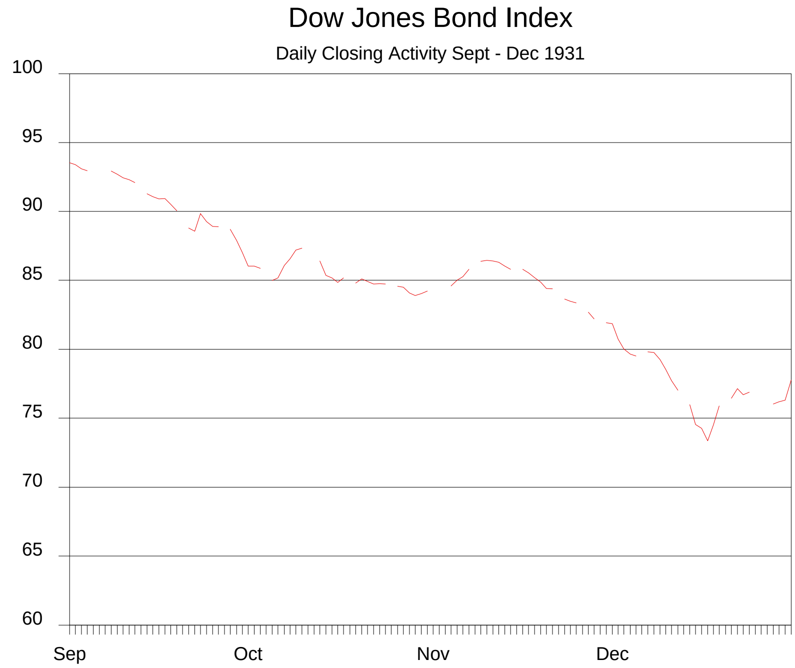
Source: Dow Jones

to 61.25 cents. Bullish factors were a reported 16% decrease in winter wheat acreage; the return of several bull operators to the pit after a long absence; heavy buying from England in anticipation of a tariff; covering of short positions and long-buying from foreign interests who were heavily short around the lows. Cotton advanced slowly, steadily. Factors were a September rate of consumption better then that of last year, re-opening of many Lancashire mills after the pound's fall, also British buying against a possible tariff. The revival of prices in these two big commodities brought cheer to Wall Street, Washington, and many a harassed farmer."

This rally continued to spread to various commodities including silver and, of course, stocks responded in a like manner. But the lead in this bullish frenzy had clearly been taken by commodities. The rally in the stock market came with actually little speculative margin buying. The exchange was collecting data religiously, trying to ward off its enemies. On November 1, brokers' loans stood at only 2.33% of the total market value which was down sharply from the 3.23% at the beginning of October. Brokers' loans were further hampered by the change in the policy of this market for funds. You will recall that in 1929 the Federal Reserve watched the brokers' loans quite closely, publishing figures broken down displaying loans from New York banks, out of town banks, and the controversial "others."

It was this category of "others" that had sparked much resentment and fury back in 1929. Corporations could lend their funds directly into the call money market which the banks complained was depriving them of deposits. Well at this point that practice was declared void. Now brokers' loans were listed as to their source either from New York banks or out of town banks. The others category simply disappeared as brokers' loans declined in volume and stood at a 2.5% yield on the average for this period.

The sudden sharp rally in commodities and stocks changed the tone of the press quite noticeably as we find in this excerpt



from Time magazine of November 16 , 1931.

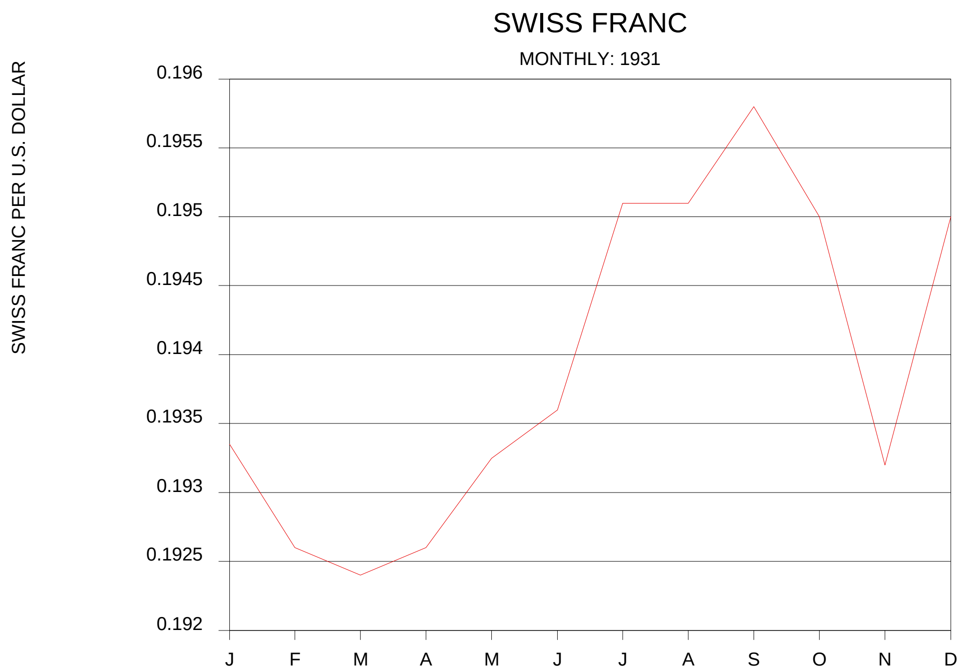
"Rising wheat prices rang the speculative tocsin loudly and fiercely last week. Other commodities became buoyant. Good cheer spread to Wall Street.

"Although the report that Russia would export no wheat for two years was denied, wheat surged upward. On every recession, buying by the public became more apparent. Seats on the Board of Trade jumped from $6,500 to $12,000. Arthur W. Cutten, greatest of living wheat bulls, became almost a national hero; telegrams poured in upon him asking how high wheat would go. He merely said he was bullish, naming no prices. But in the public imagination "Dollar Wheat" became something to be achieved, in some places already achieved.

"'Dollar Silver' was another speculative slogan last week, but more far-fetched than Dollar Wheat. Shorts covering and a general commodity rise sent the metal to 35.25 cents an ounce against the year's low of 25.75 cents. For the first time silver trading on the National Metal Exchange, Manhattan, became clamorous, wild. Public buying was attracted because silver can be bought on a 6% margin. Companies with stakes in silver-currency nations were in demand, shares of mining companies were widely bought. Copper remained at 7 cents but it was reported that consumers were taking oil offerings. Manchurian was talk aided bullishness in copper, but the strongest copper shares were those with big silver interests.

"With British mills more active, consumption in October running 69,83 bales higher than a year ago, it was natural that cotton should join the movement that last week's price of $33.50 per bale should be 22% higher than the year's low. Although the crop is large, unfilled orders for cotton cloth jumped 51.7% during October.

Other commodities to share in the jubilation included rubber, coffee, cocoa, wool,



hops, hides. Sugar failed to advance, however, and hogs continued in a rut. Mid-Continent oil prices rose 15% a barrel to 85 cents; in many sections of the country gasoline was upped."

Many selected stocks had risen by 40% to 50% and some had better than doubled. Everyone was quite bullish and indeed even the famed Babson ran a small ad with its headline "Is Bear Market Over?" The sharp percentage rise even in the value of seats on the CBT from $6,500 to $12,000 in one month surely brought back dreams that 1929 was off and running. With a rally so strong and only in the first month of its existence, it was not unexpected to see wild bullishness calling for fantastic new highs in the near future.

Banking failures did not cease. The banking industry was still fighting with government to allow what we all take for granted today: branch banking. The Comptroller of the Currency of the time, John W. Pole, continued throughout 1931 to assert his arguments in favour of liberalizing the banking laws to permit branch banking. Much of the weakness in the banking industry was in part caused by the isolation of banks themselves. Many in government feared that monopolies would creep up in this field as well and they held tight to their ideas as expressed by the Sherman Anti-Trust Act. But Pole spoke his mind in front of Congress in December of 1931, once again. He said:

"In brief, the purpose of the legislation recommended is to supplement our system of unit banking by permitting the stronger and better managed city banks to carry on banking operations in the surrounding rural communities by means of branch offices...Our present banking problem is one that concerns primarily and fundamentally the rural communities and which cannot be automatically solved by the return of general prosperity."

The issue of branch banking was one of many arguments. Smaller bankers feared being bought out or put out by the big banks, but a small bank's trouble was often caused by its location. Banks in the farming districts suffered greatly since the majority of their clients were dependent upon farm prices. If commodities did poorly, so did the bank. If that small rural bank were a branch of a city bank, its problems could be overcome through diversification. This cause received perhaps its greatest boost during December when the Secretary of the Treasury, Andrew Mellon, wrote in the annual report the following statements:

"The essential question involved is the inability of a large number of small banks to survive in the face of changing economic conditions...I can see no justification in the argument that banking should be confined to political or other existing artificial boundaries rather than to its natural economic lines.

"An additional argument against the unit form of banking and in favour of a diversified banking system called branch-banking was the evidence of several comparisons. For example, in England, branch banking was the norm, not the exception. Not one bank folded in Britain between 1920 and 1931 even though Britain was clearly suffering the brunt of depression far worse than the United States. In Canada, where branch banking was also in place, only 12 failures had taken place between 1893 and 1931, and since 1914 there had been only one bank failure, that of the Home Bank in 1923. But opponents claimed that Canadas' experience proved that even branch banking would not avoid failures. This was hardly a decent case to argue since their one failure stood against the American contrast of nearly 4,000 bank failures between 1929 and 1933. But there are always those hard-headed individuals who are opposed to something for some strange reason, and even if this much of a stark difference stood against their position, they would not yield.

California was the only real branch-banking state in the Union. Strangely enough, during 1931 not one bank in California had failed. The system of unit banking was clearly a weak link in the financial system of the United States. This would be a major flaw which definitely contributed much anguish to the period, striking hard at the foundation of confidence which was vital to the entire economy.

Time magazine reported on December 28, 1931: "Undisputed good effect of National Credit Corp's formation was the resultant improvement in the nation's confidence, the return of much hoarded money to banks." Indeed the President's new "Super Plan" had struck right at the core of the problem, confidence. The low on the U.S. gold reserves had been reached during the final week in October and it rose steadily throughout November. That was the direct result of hoarded gold returning. But political bickering would stall branch-banking and uncooperation on the freeing up of mortgages and the halt of foreclosures would prevent Hoover's plan from really taking hold for the long run.

The year 1931 was a hard year, yet many public works had been completed in the midst of the turmoil. The Empire State Building in New York City, a symbol of the good times, opened its doors along with New York's Waldorf-Astoria Hotel and the famous Chrysler Building. The Rockefeller Center began construction, leasing the land from Columbia University. The Dorchester Hotel opened on Park Lane in London and on the lighter side of events, Mickey Mouse and Felix the Cat made their debut along with Kate Smith, who sang "When the Moon Comes over the Mountain" on radio that year.

But, there was another threat brewing around the world which Hoover alluded to in a memorandum to Congress when he solicited their support for his National Credit Corporation. His memorandum was as follows:

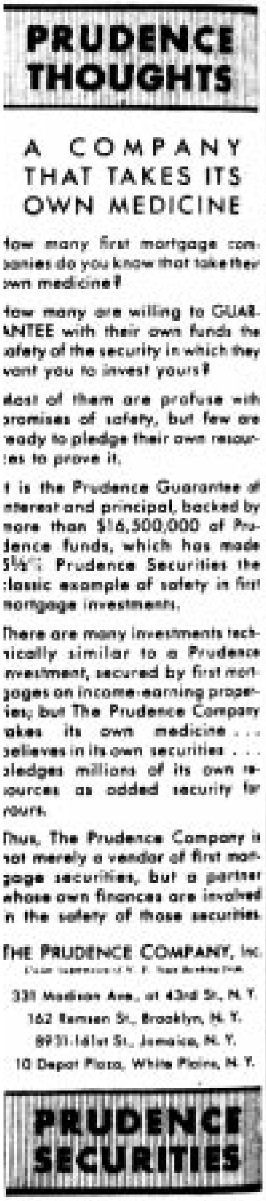
"The nations of Europe have not found peace. Hates and fears dominate their relations. War injuries have permitted no abatement. The multitude of small democracies created by The Treaty of Versailles have developed excessive nationalism. They have created a maze of trade barriers between each other. Underneath all this is the social turmoil of communism and fascism gnawing at the vitals of young democracies. The armies of Europe have doubled since demobilization. They have wasted the substance which should have gone into productive work upon these huge armies and massive fortifications. They have lived in a maze of changing military alliances and they have vibrated with enmities and fears. They have borrowed from any foreign country willing to lend, and at any rates of interest, in order to carry unbalanced budgets...

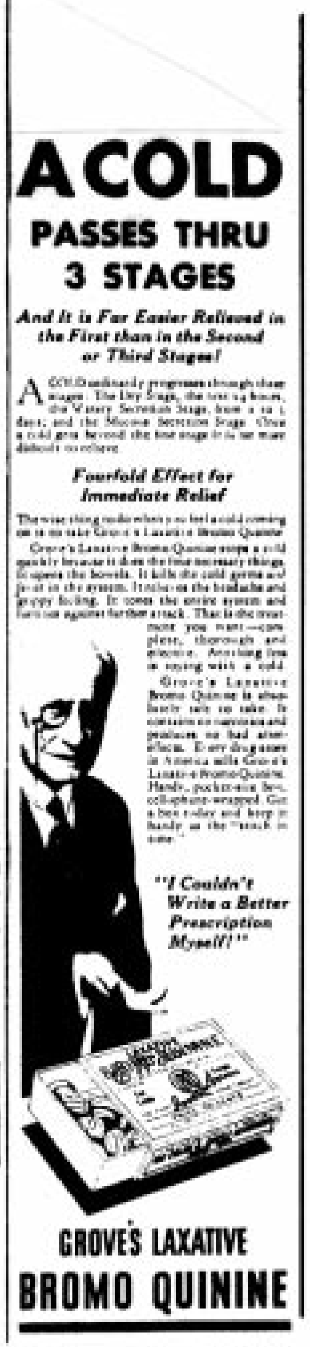
"The Allied countries of the Continent - France, Italy and Belgium - are obliged periodically to reduce their impossible debts by devices of inflation and devaluation. Nineteen countries in the world, in two years, have gone through revolutions or violent social disturbances. Whether or not Germany and Central Europe will avoid Russian infiltrated communism or some other 'ism,' is still in the balance and that does not contribute to a revival of world confidence..."

Indeed the battlefront was forming along the lines of communism and capitalism. On the very floor of the Congress echoed words claiming that even a dictatorship was better than the pains of depression. Socialism and communism gained much favour even in the United States. It has been said many times that this was a period in American history when revolution was close, brewing deep within the ranks of its citizens.

What was their thinking? Why would so many people begin to turn toward communism during periods of strifes? These are questions which are undoubtedly a part of this period and a part of economic theory as well. In many ways, communism surrounds us every day even with our working social and political environments. George Bernard Shaw once said: "In economics all roads lead to socialism, though in nine cases out of ten, so far, the economist does not recognize his destination."

Indeed, even within the United States many aspects of the "New Deal" were very socialistic. Today arguments can still be heard between social spending and tangible spending. Even the structure under which taxes are collected has been one which dis-





criminates against the upper classes in favour of the lower.

The lure of communism is not restricted to the political arena. It does not always take even the form of the Berlin Wall, which undoubtedly comes to mind when one mentions the word. All these various "isms" are to be found in man's own desires and at times they offer what logically can be very appealing to the masses.

Communism in many ways seeks to protect man from himself. It is the gossip, the jealousy and the greed which communism seeks to stamp out. People who steal from one another or plot against someone to gain their job, position, or wealth all represent the deplorable aspects of mankind which are perhaps exaggerated under the freedom of capitalism. If the wealth were not available and if everyone was only entitled to the same lot, then such dishonesty would theoretically cease to exist. When one looks at these things alone, the idea can be presented in a very pretty package if we look around us we can gain a sense of socialism, and also communism even in the United States. Our government leans in that direction when it takes many steps toward solving problems or correcting what many of us would call injustice. But often the complex maze of governing bodies and their laws can be horrifying. It is said that man has written over 3,000,000 laws but with this vast arsenal of rules and regulations, he has failed to improve upon the simple Ten Commandments.

Laws are continually changing, but in the process they tend to gravitate toward socialistic and even communistic objectives. George Bernard Shaw was correct in this observation. It is a natural tendency to continually write laws and to interpret them in order to get at the dishonest people who exploit freedom and capitalism through their greed and self-interest pursuits. For example, the Supreme Court recently ruled in a case where police raided a mobile home of a drug dealer. They did not have a search warrant and under the law they must have a search warrant before entering anyone's home. The Supreme Court ruled that a mobile home is somewhat different than a home made of bricks and mortar and there by claimed that the search was not illegal. Our first reaction is: why should we be appalled at such a decision because after all the guy was a drug dealer? However, the answer does not lie in that direction. The issue is not whether or not the man was guilty or innocent. The issue is our civil and Constitutional rights.

There is a great difference between being a liberal who is opposed to everything from sterilizing pigeons to nuclear energy and an issue of civil or Constitutional rights. The FBI raided a home and dragged a man and his wife out of bed and beat them, not to mention that they were treated like scum during the course of the drug raid. While his wife was partially unclothed and forced to remain that way in front of the agents in a demoralized state of shock after the FBI kicked their doors in, no drugs were found. What actually happened was that in the middle of the night the FBI had the wrong house. Had they been the guilty party, their rights were nonexistent. The FBI wouldn't listen to a word they had to say, perhaps assuming that everyone claims that they are innocent.

There are numerous cases where police have set up people, beat them, and openly violated rights, all in the so-called pursuit of justice. They, in many cases, have made a mockery of the Constitution and the cherished rights the founding fathers of this nation sought to protect. Recently, watching a television show, I was amazed how 20/20 exposed in Florida the Gestapo tactics of Florida police who arrested and convicted two men for a murder they did not commit. The police simply didn't like them and threatened witnesses that if they didn't identify these two men, they would be charged as accomplices. In many ways this is the beginning of communism. It is not that we should protect the drug dealer but ourselves. If you eliminate the right to privacy and circumvent the need for police to show probable cause before getting a search warrant, then in trying to get at the drug dealer you have waived the rights which everyone has fought long and hard for. Have our relatives and friends who died in war fought for nothing? Police could stop you on the street or enter your home with nothing more than curiosity. Your home would no longer be a castle but a target.

Slowly this urge to get at a certain group within society leads toward measures that erase the differences between the United States and Russia. In Russia anyone's home can be searched at anytime. People risk their lives trying to get out of there and when interviewed they say that they just want to be "free!"

Communism in many ways emerges from these tendencies to want to get at some group and in the course of events it takes away the freedoms of society in order to do so. Just because a man is a politician does not make him honest. Well neither does the profession of being a judge, a cop, or an FBI agent. There are honest politicians as well as crooks, but if you do not have definitive rules, then the crooks will be certain to take advantage of the situation. It is therefore insane to expect that if you eliminate all our civil and Constitutional rights that we can sleep soundly at night, knowing that our police will use self-restraint and not abuse the power given to them. Power corrupts, they say, but ultimate power destroys.

If you have ever read Karl Marx you would immediately notice a sense of anger in his writings. Marx portrayed the economy as not the natural "invisible hand" of Adam Smith, but as a cosmic war between labour and capital. In the example of getting at the drug dealer, the natural tendency is to ask why you should seek to protect the rights of such scum; he deserves what he gets. But this same urge to bend the rules to get at the drug dealer is what Marx wrote of in his works. Instead of taking the drugs away from the dealer to put him out of business, take the capital away from the owner to put him out of business. It is the same human anger in both cases. Perhaps we would not advocate a war against the capitalist, but we would against the drug dealer. But to get at each we ourselves must relinquish certain rights. If we have no rights, then there is nothing to give up, so take the drug dealer and throw him to the lions and we can all enjoy wreaking our vengeance in a public spectacle such as in Roman days. Thus, if you have lost all your capital, you have nothing to lose so get the bastard who has all the bucks and take his away to even the score. What is the risk of communism if one has nothing to lose?

Communism is in simplistic terms the urge to circumvent personal rights. It is said that for everything holy there is the unholy. The difference between capitalism and that of socialism and communism is as stark as day and night. Yet in every democracy the gravitation has always led in the direction toward communism and control. In many ways it is a gradual process which eventually comes to a head. But it has always come to a head at some point in time.

The rights given to us by the Constitution were well thought out by the founding fathers. They came from their experiences based upon first-hand knowledge of the abuses of government. Many of those rights have already been taken away by countless laws and Supreme Court decisions. In criminal court you hold the presumption of innocence and it is government's job to present the evidence of guilt. But in tax court, you are presumed to be guilty and you must prove your innocence. The IRS or State Revenue Agency can file a lien against you for an outrageous amount of money without even auditing you. If you do not fight, they can seize all your assets and sell them at auction. If you later prove that they were wrong, you are only entitled to the amount they obtained for your assets, even though that amount may have been 10 cents on the dollar.

There are millions of laws which have taken away the rights of Americans without them even knowing it. In some way or another these laws have been designed to get

at that someone or a group which the Constitution had sought to protect. The graduated income tax sought to take from the rich a greater portion of their assets than the middle class. But is not a free society supposed to be equal and provide justice for all? Where is it fair to take 75% of one man's earnings as opposed to 20% of another? It should not be unlawful to make a lot of money, but then government by law turns around and says that you are not entitled to keep that much.

Whenever some sort of tax cut is proposed, the argument is that the rich will benefit more than the poor and the middle class. What they are really saying is that the percentage break will be the same but a 10% cut for someone earning $10,000 will give him only a $1,000, while the $100,000 earner will get back $10,000. They claim that is not fair. Are we a Marxist society or are we supposed to be a democracy?

The Great Depression was a period during which this anger toward a group within society raged strongly. As we will read of the events which transpired in 1932, this anger and vindictiveness was never greater. Government, while in a rage, used its powers no more or less than those of communistic Russia. The fine lines between democracy and communism disappeared at many junctions during the events.

The target was not the drug dealer, but the stock market. The Democrats sought to symbolize this financial center as the evils which caused the Depression and with it for political gain, they then tied the knot linking it with the Republican party. The tactics of the Democrats were ruthless and vindictive but no more so than when the tide had turned and the Republicans were successful in exposing many Democrats with communistic links when that round of witch hunts began following World War II.

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