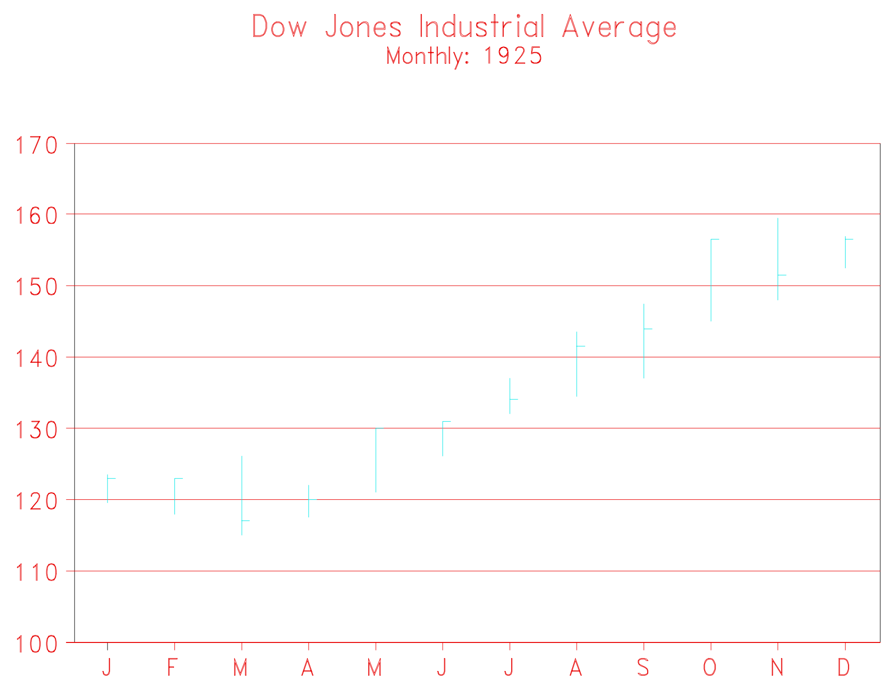
Chapter V

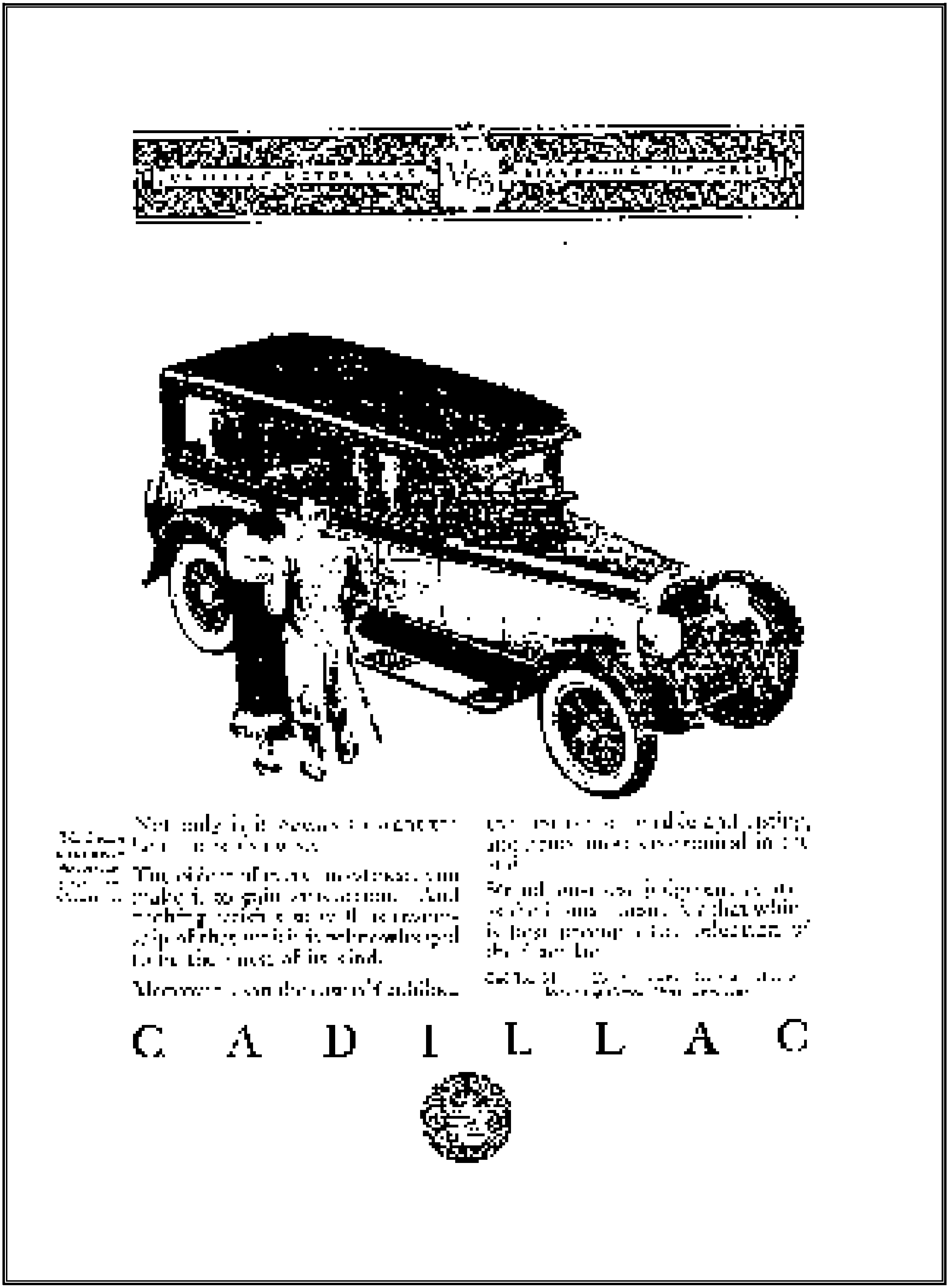
1925



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

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

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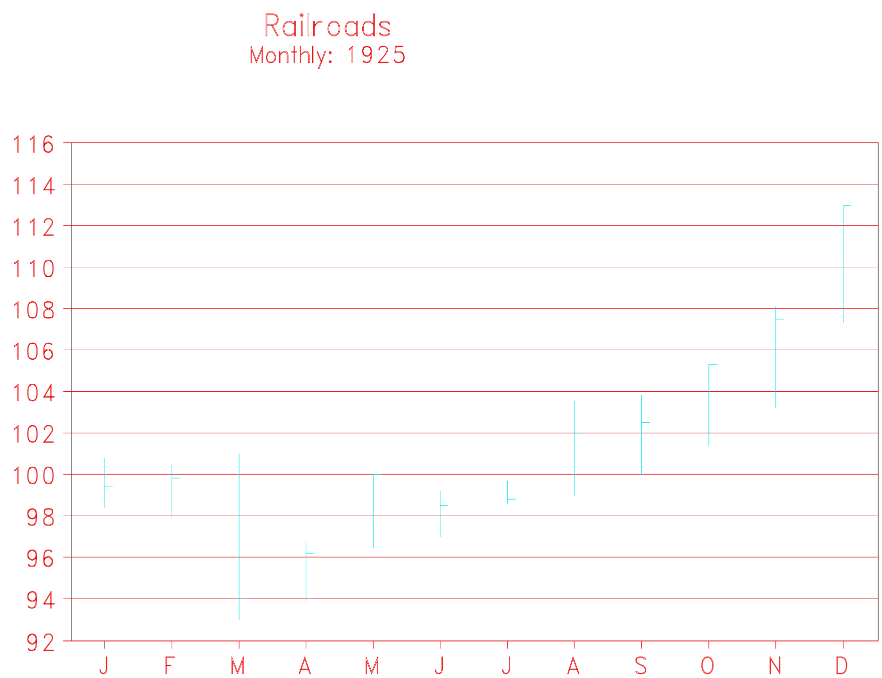
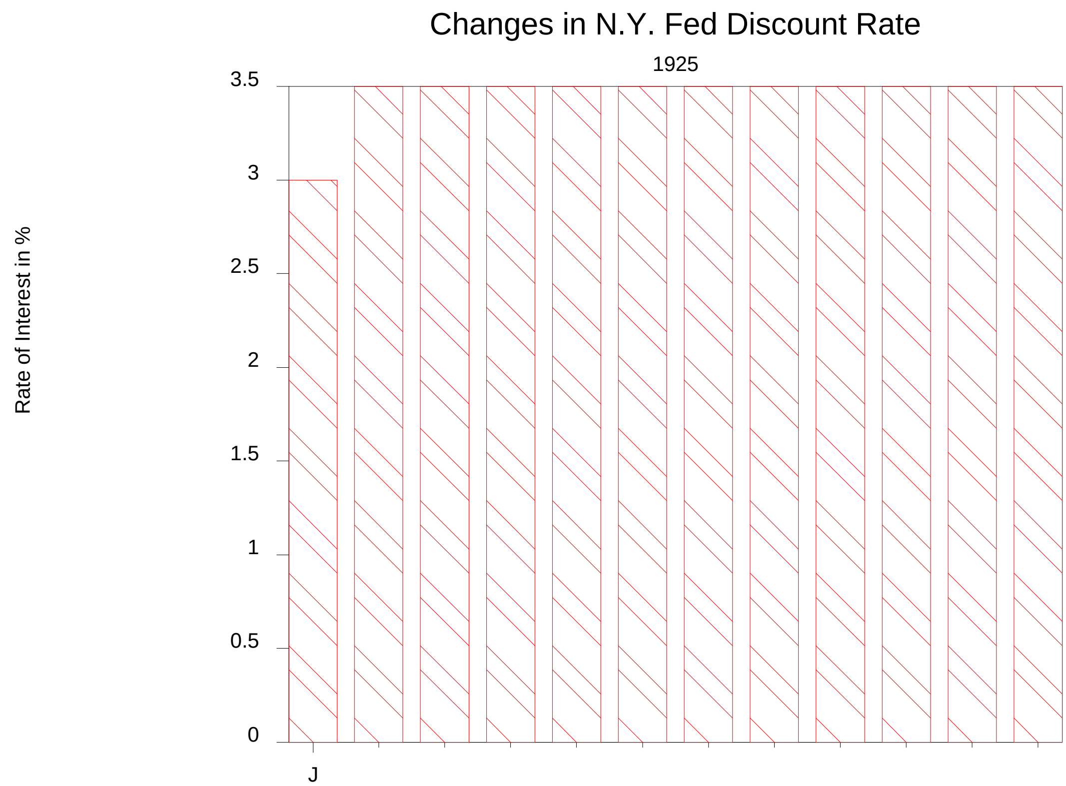


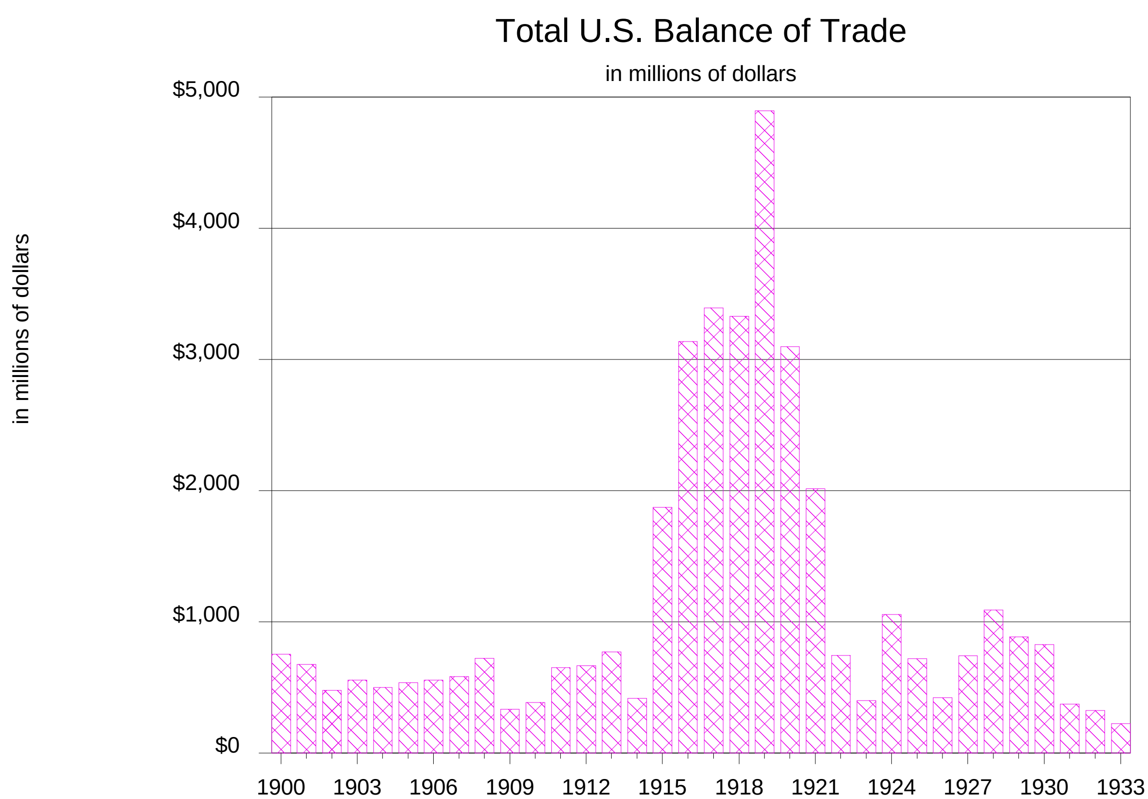
the rails experienced their largest gains in December.

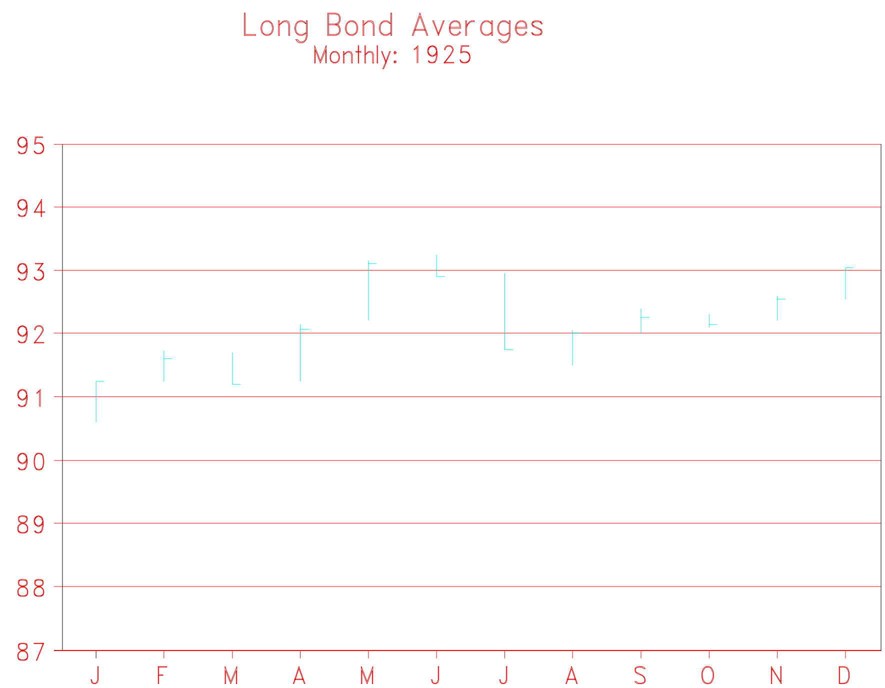
Fundamentally, January began with a positive note as President Coolidge announced: "The Business of America is Business!" This was essentially true. The railroad stocks had made an outstanding recovery after the railroad depression of some years before. Actually, 1924 proved to be a tremendous year for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

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

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


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

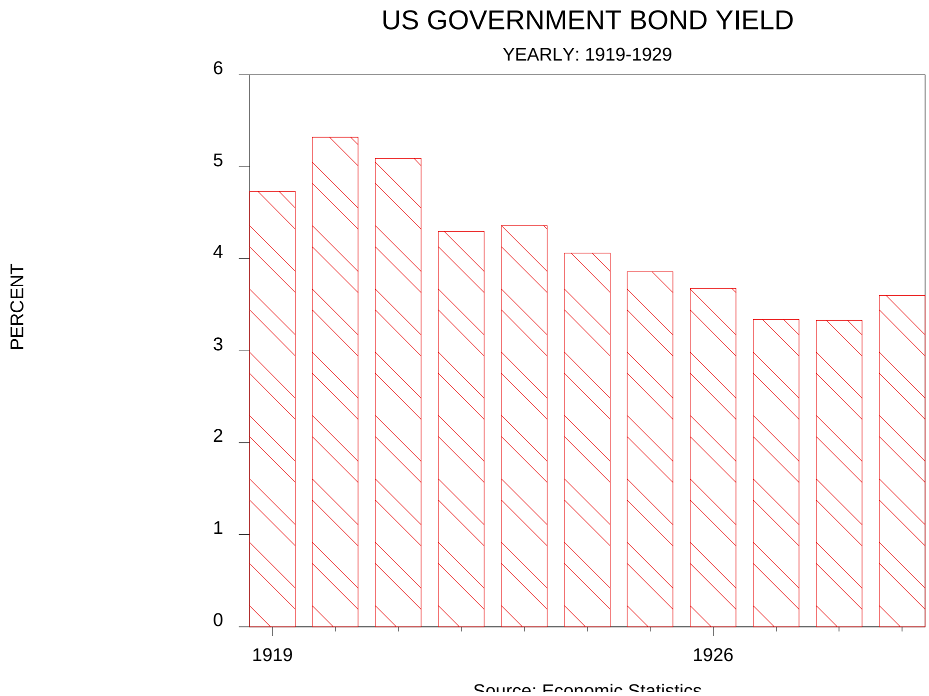

Total U.S. Balance of Trade
in millions of dollars
in millions of dollars
$5,000
$4,000
$3,000
$2,000
$1,000
$0
1900
1903
1906
1909
1912
1915
1918
1921
1924
1927
1930
1933



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

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

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



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

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

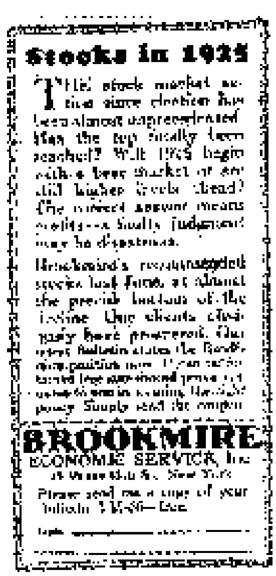
It seems consistent that as soon as the market fell even 8% everyone jumped all over it pouring out their doom and gloom. The speculative issues were declining more, simply because the speculators are always the weakest in the lot. The mere fact that one industry such as textiles had performed poorly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

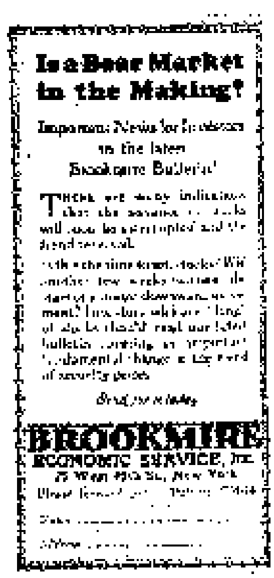
This we noted in 1985 moving into the November period. After the Dow had corrected from the July 1985 high, falling back to 1288 on September 17, it began to rally and made new highs far in advance of the S&P 500, transportations, utilities and Value Line. Everyone looked at all the other indicators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

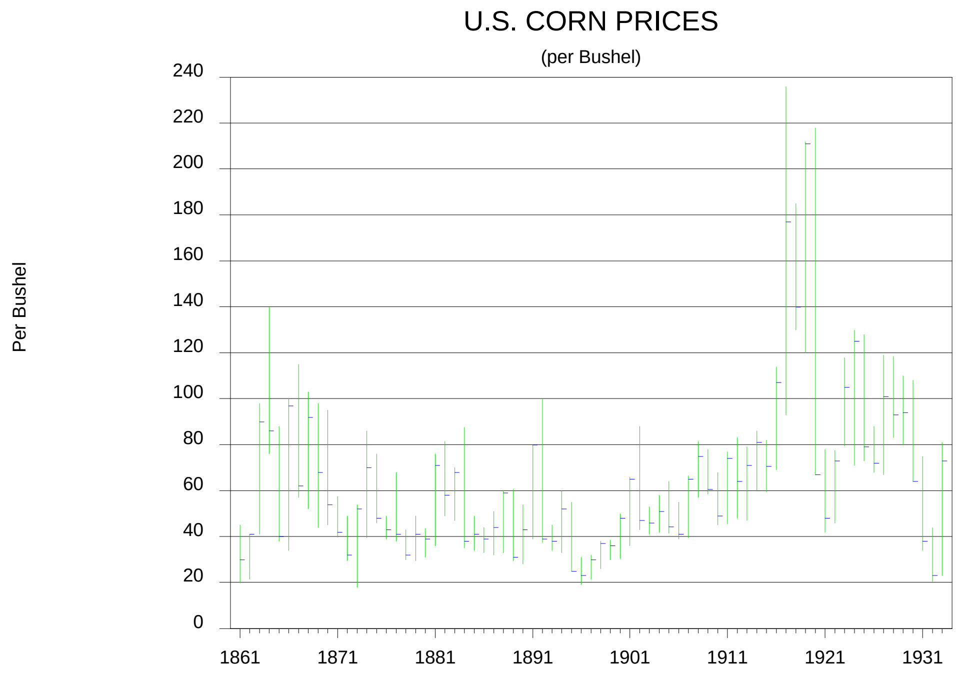
In fact, what took place was that the broad market had declined by a mere 6% while the Dow Industrials declined merely 10%. It was only the speculative issues that declined by 20% and everyone assumed that they were the leading indicators.

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

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







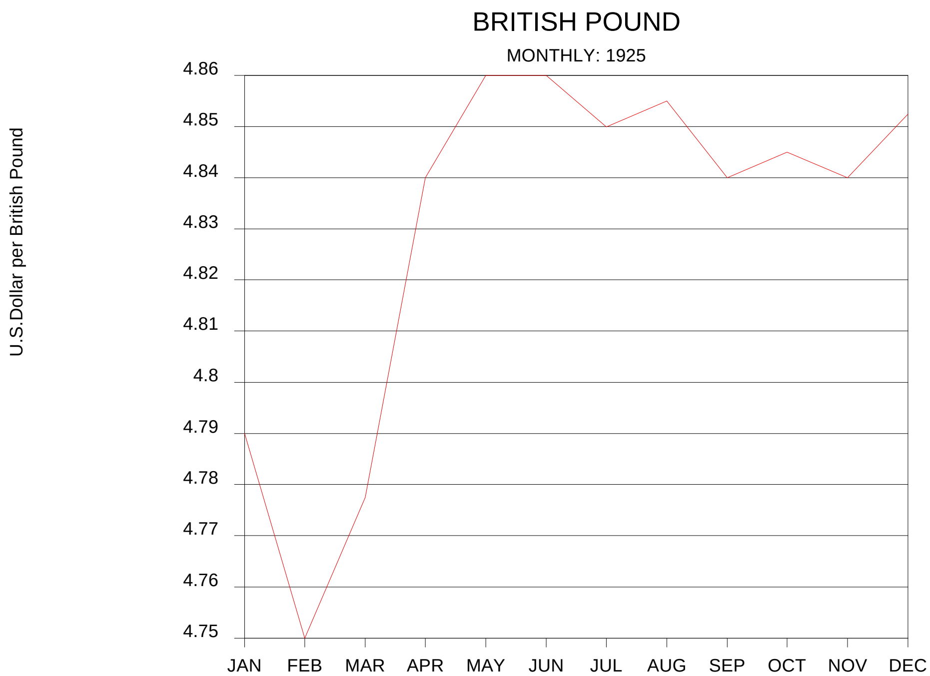
ter speculator' in Florida, supported by a powerful group of interests."

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

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

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

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



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

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

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

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

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

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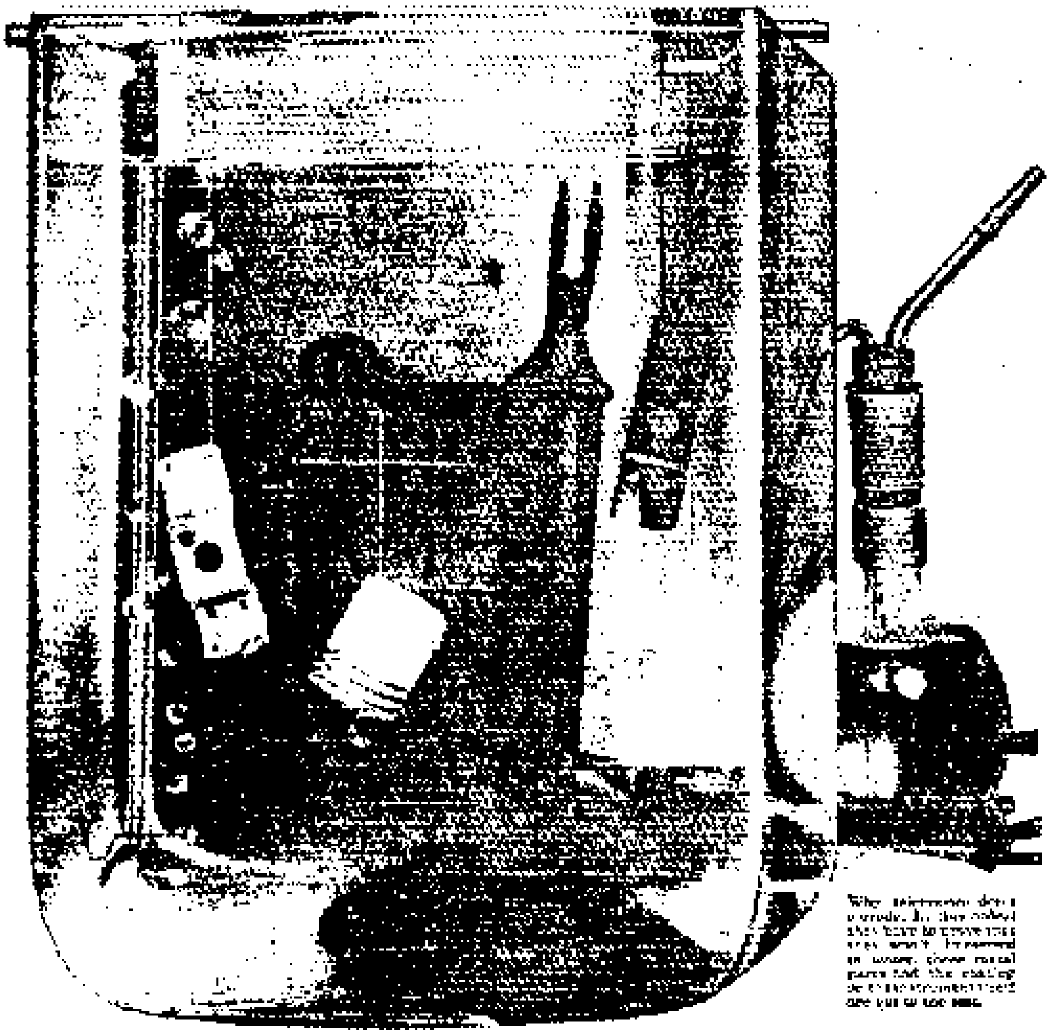
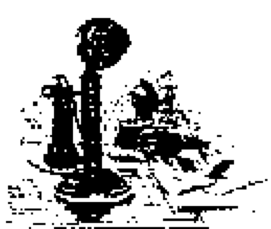


Submerged
—one of many hard tests



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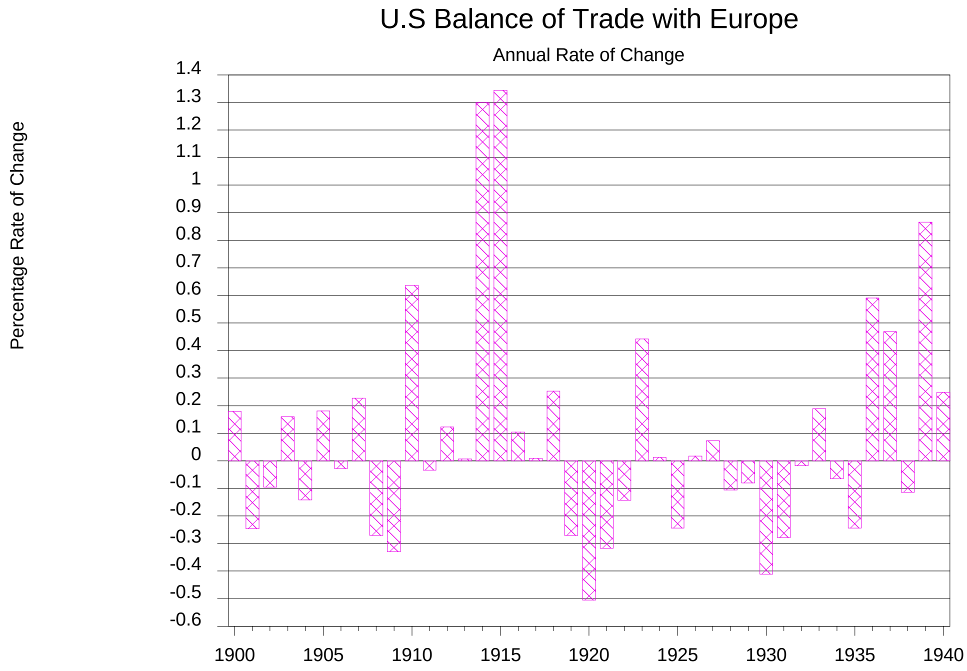


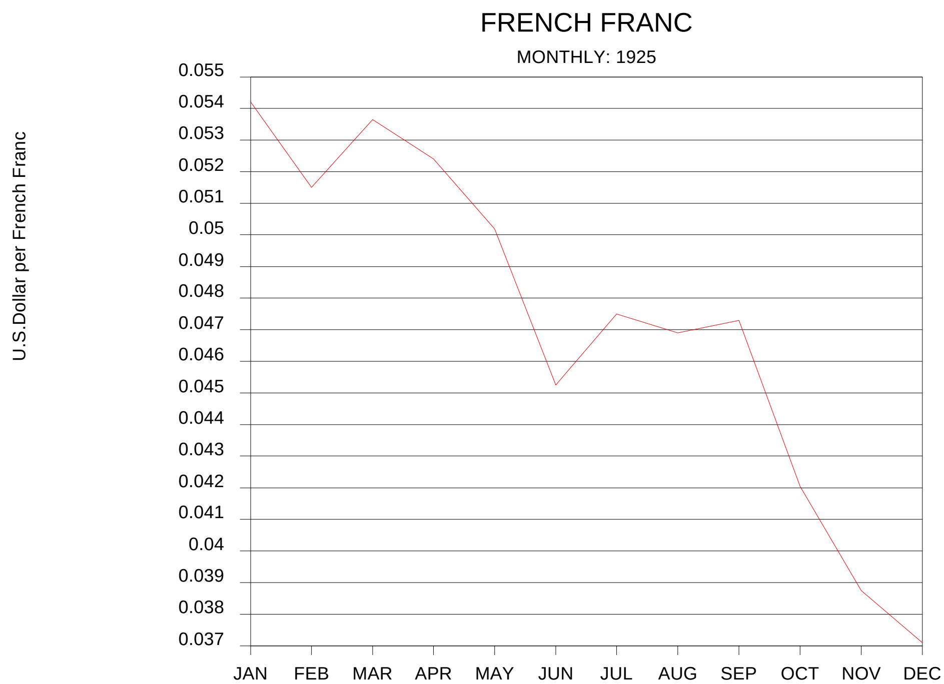
Raw Data Source: Economic Statistics

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

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

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

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



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

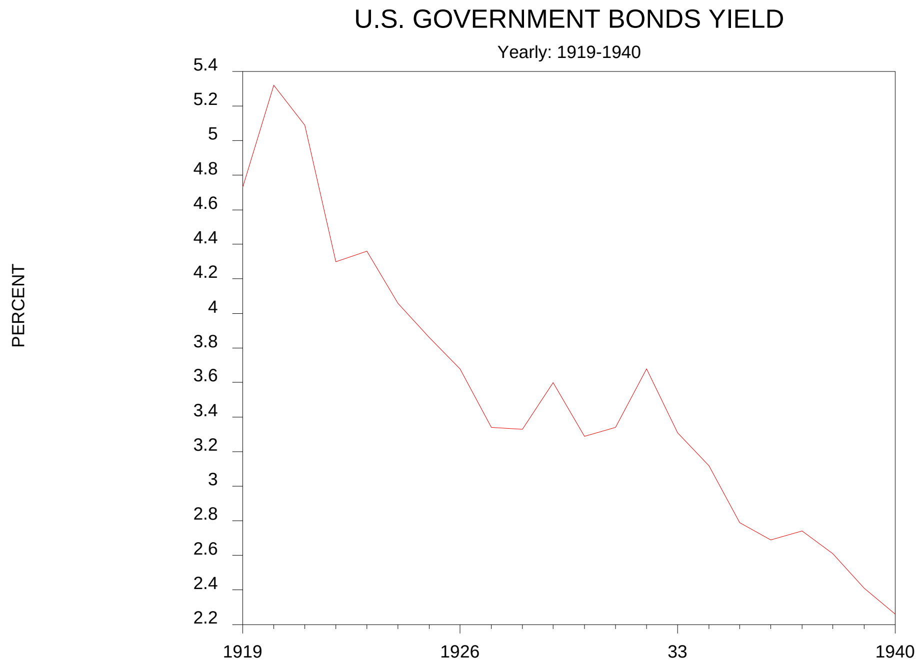
Nevertheless, they let their bias stand in the way of interpretation. That is so often the case with fundamental analysis. One is always forced to line up the negative reports and take a guess based upon the positive reports as to which will be the leading or the lagging indicators. At best, it has historically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

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

'Market Decline?"

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

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



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

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

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

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

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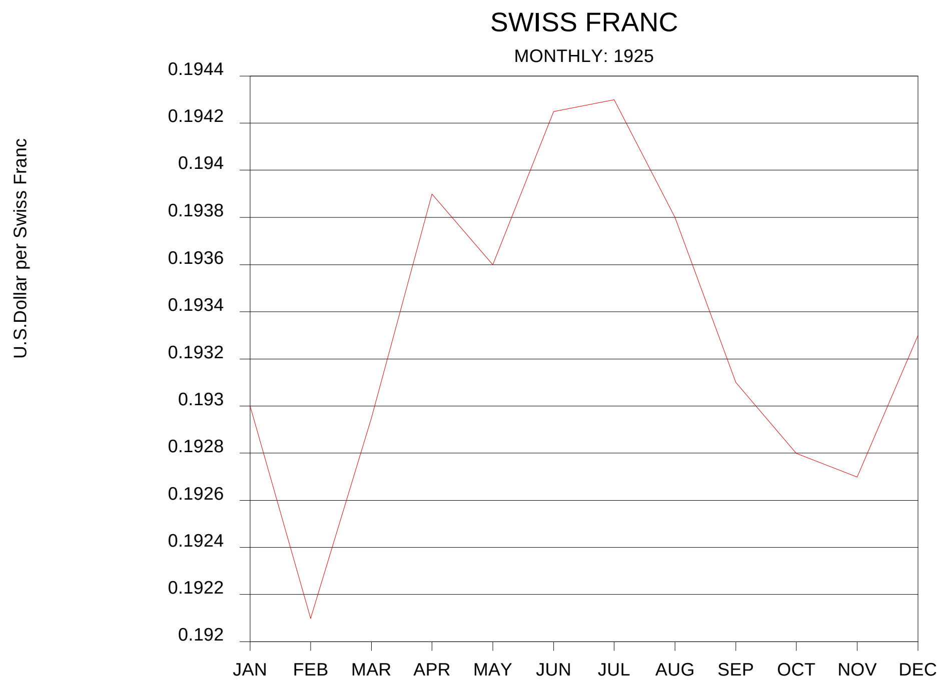
declared to be over by June 1925 and real estate began to decline in value while the stock market still raged onward for four more years.

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

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

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

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



New York Times. The reaction was just that.

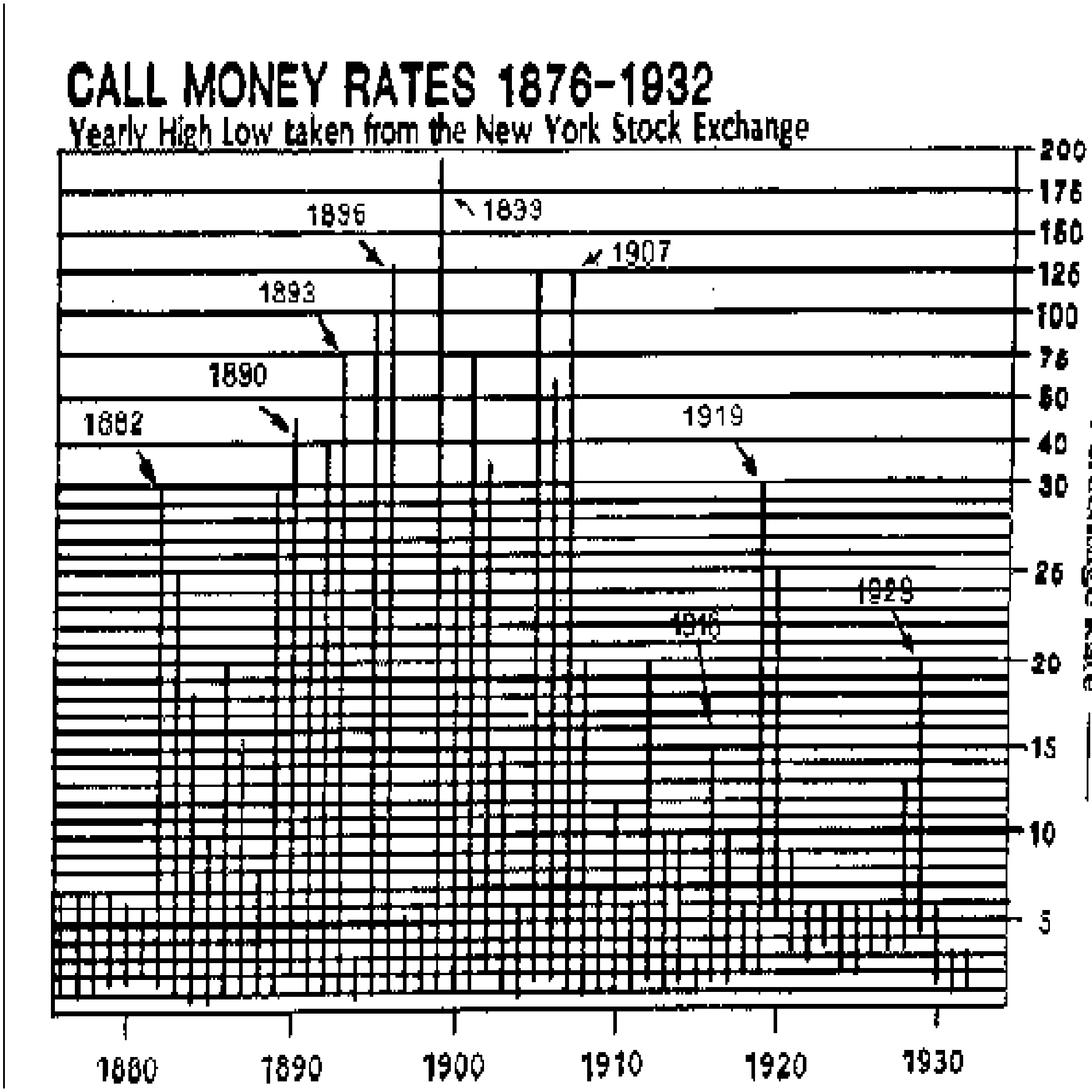
The reaction passed and instead the market thrust violently higher into October reaching almost 158, which was nearly a 20% gain from the reaction low. The Dow Industrials closed the month on the high amid those who began to spread rumors of a discount rate hike, but nothing happened. The rumors served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

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

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

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

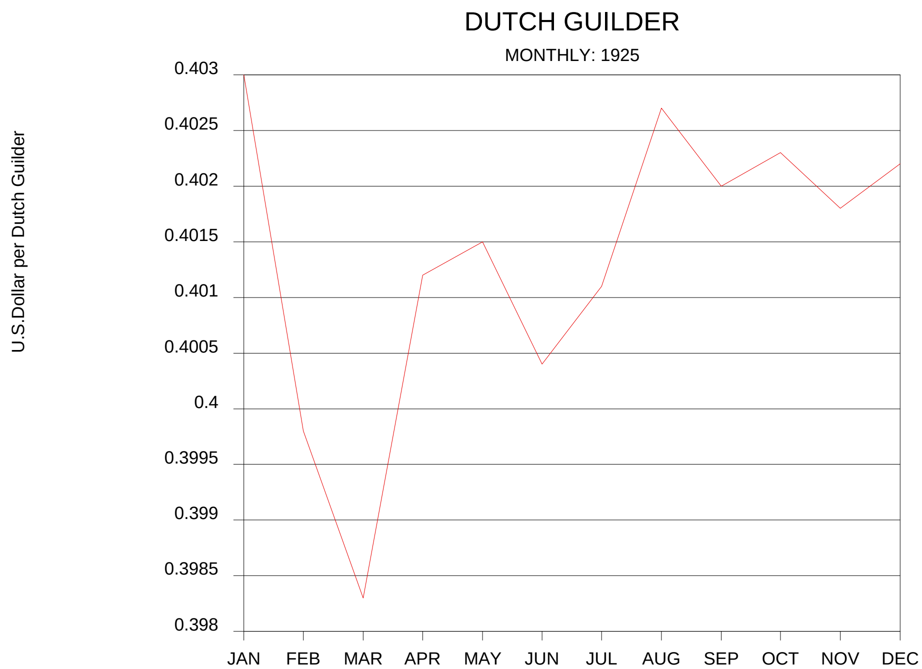
The unexpected rate hike came during late November but not from the N.Y. Fed. Instead, the Boston Reserve Bank raised its discount rate from 3.5% to 4%, which pro-



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

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

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



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

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