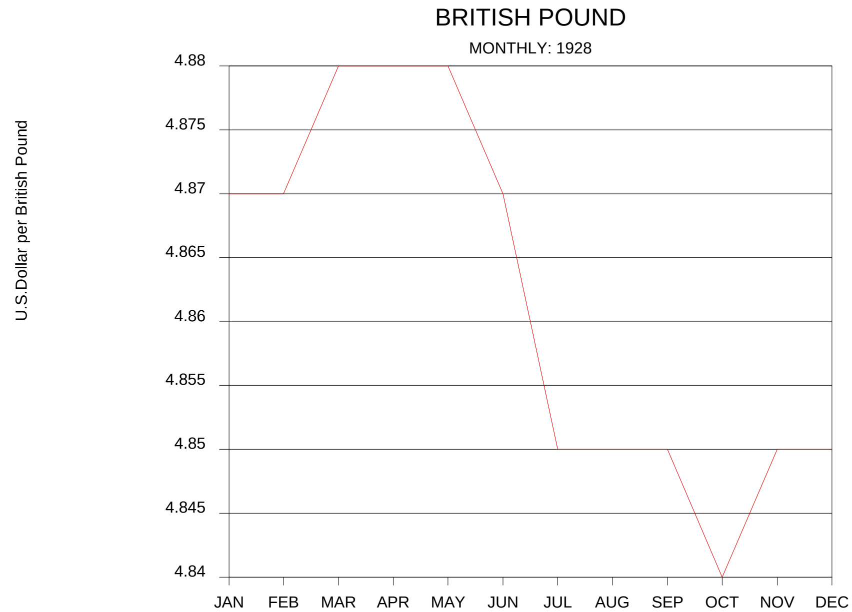


The year 1928 began with a declining dollar and a rising bond market. Against the British pound, the dollar had declined by 2 cents between July 1927 and January 1928. The pound continued to press higher into March, reaching $4.88 which was now 2 cents above the gold standard par value and 3 cents above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

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

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

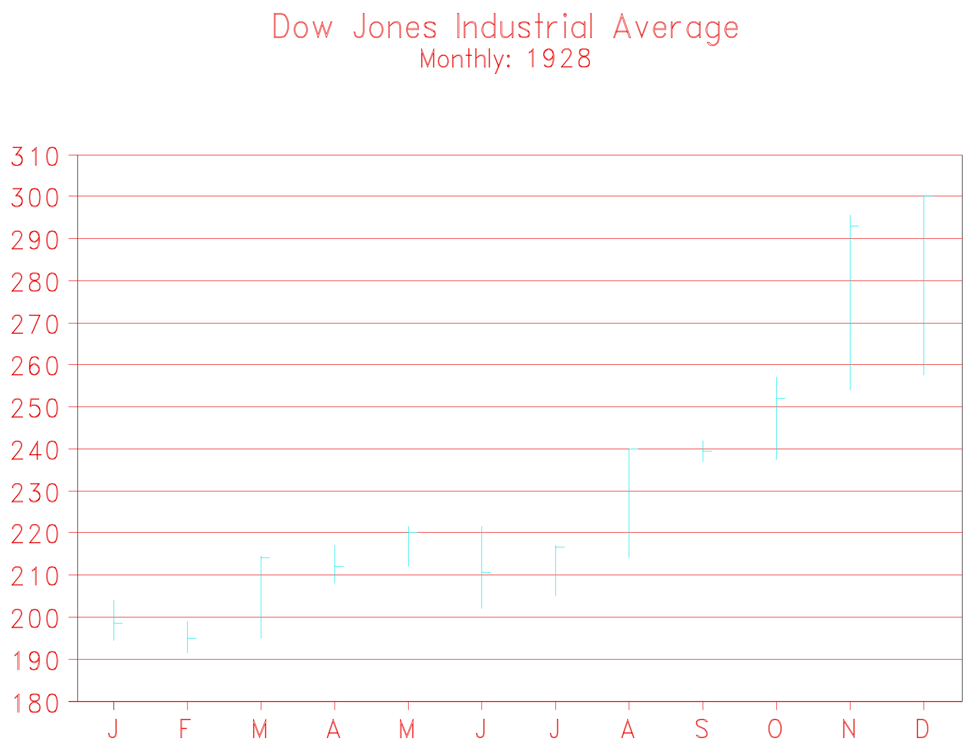
During January, the stock market pushed above the December 1927 high, but at the end of the month it finished below the 200 level. The bond market was unable to remain above the 1927 high and began to trade in a sideways pattern, yet still remained appreciably above 99. The railroads fell a bit lower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

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

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

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

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



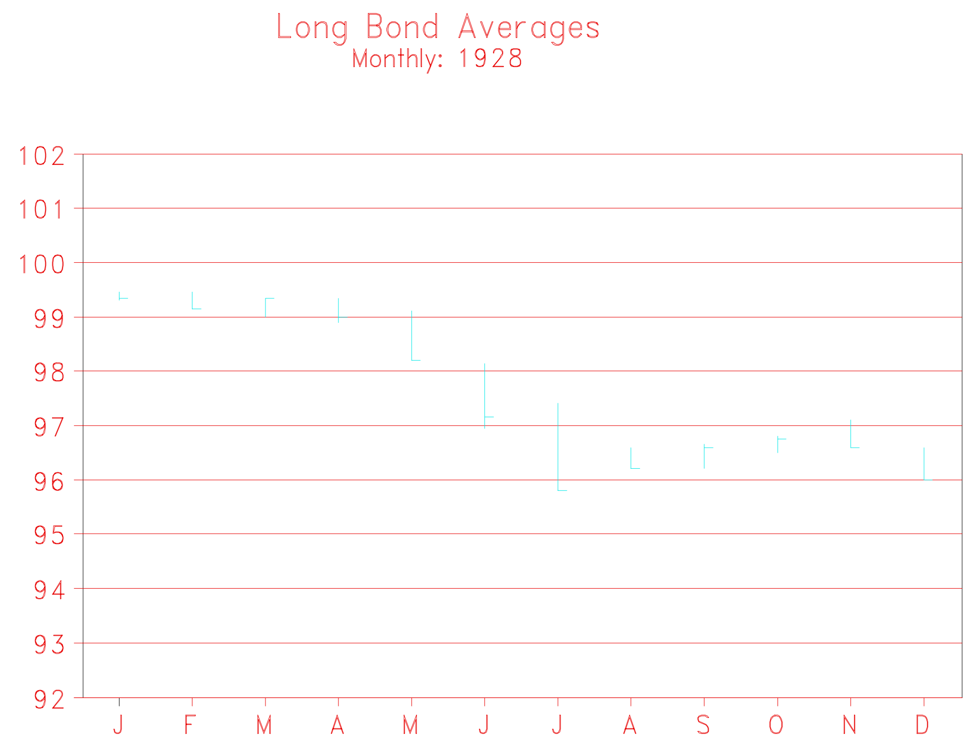
Continental Banking Corp. showed 1927 earnings of $5.5 million compared to $6.5 million for 1926. Even U.S. Steel turned in lower earnings for 1927 of $164 million compared to $199 million the previous year.

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

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

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

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



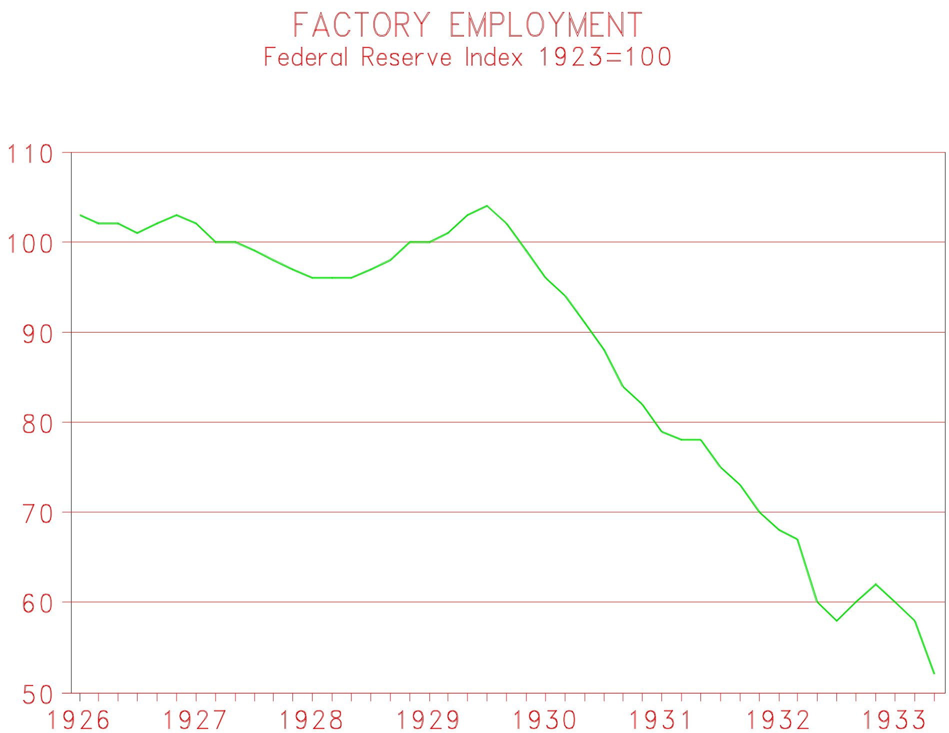
The foreign bond issues were not going away. The largest issue came again from Australia, which was estimated to be nearly $75 million. This would be the eleventh bond issue offered in the U.S. market at 5%, expecting to sell at 98.

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

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

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

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



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

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

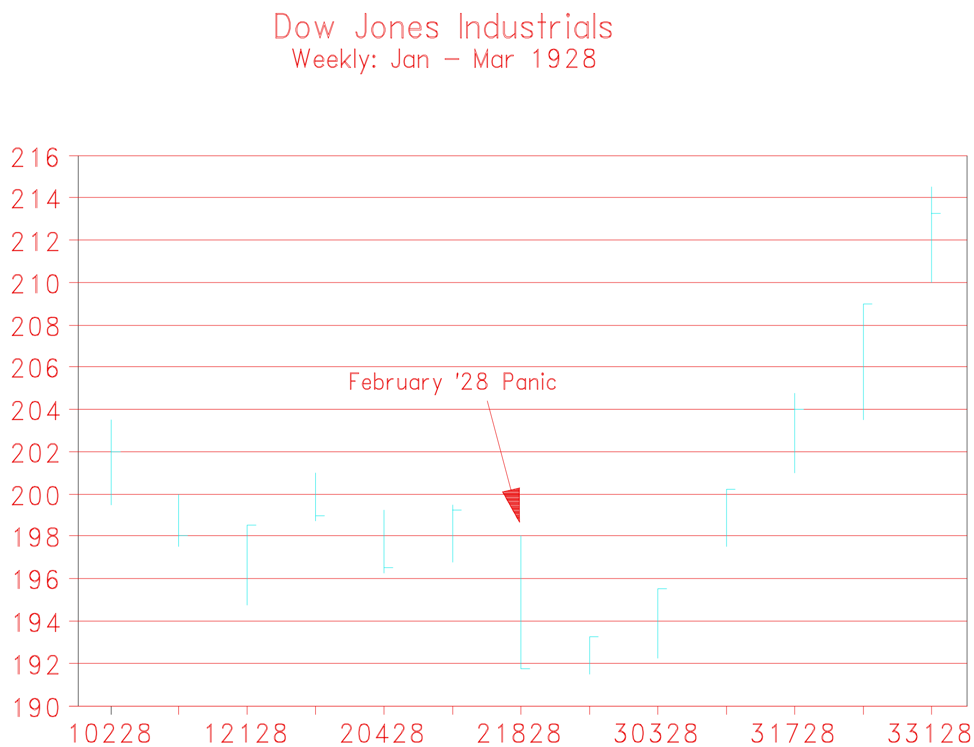
The month of February brought with it a very sharp break in the railroad stocks. After closing 1927 above 140, February fell to under 133. The bonds moved sideways but slightly to the downside, yet remained still above 99. The industrials, which had closed 1927 out abo**ve the 200 leve**l, now penetrated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

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

"TICKER LIGHTENING"

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

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



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

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

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

"Against these favorable influences were some unfavorable items:

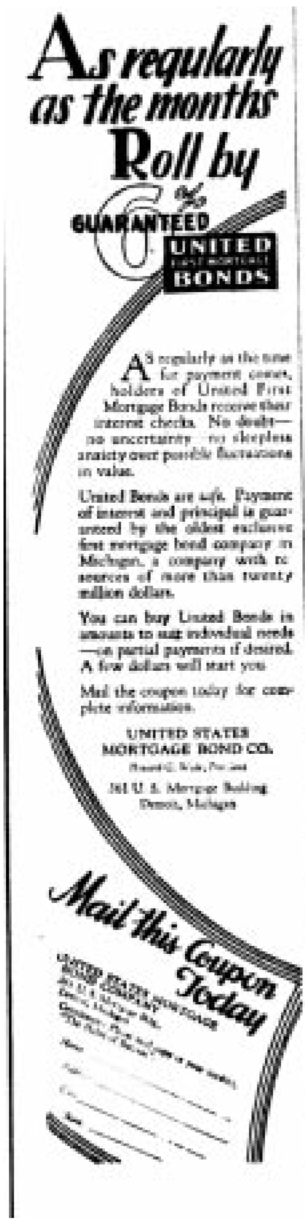
1) Spotty trade.
2) Unsatisfactory corporate reports, generally.
3) Further cut in oil prices.
4) increase of Unemployment in large centers.
5) Uncertainties in many commercial directions.

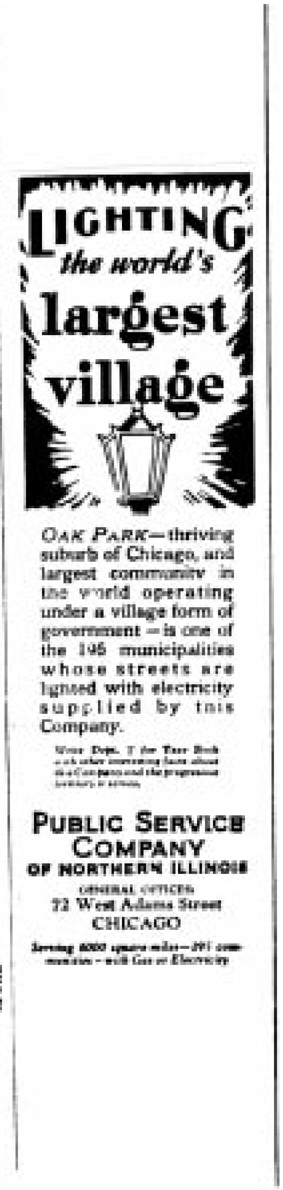
"Two classic explanations were offered for last week's break:

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

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

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

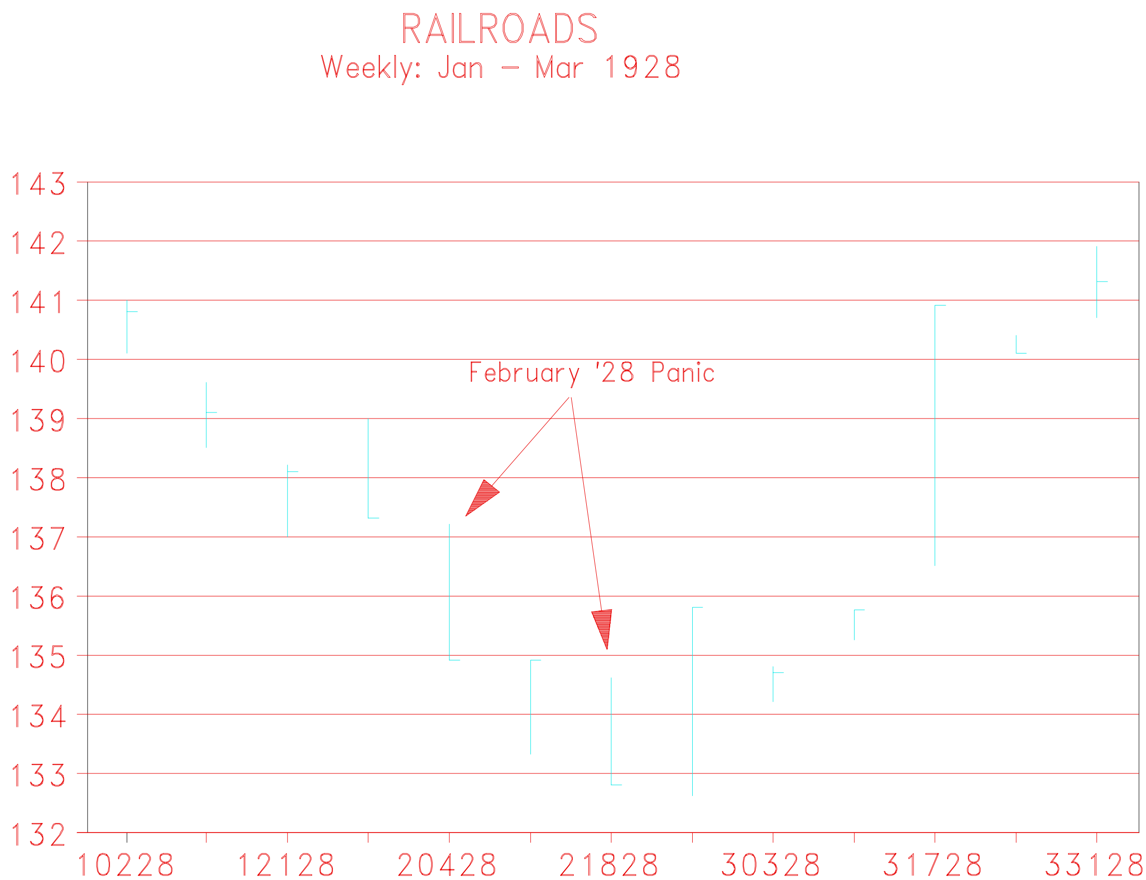


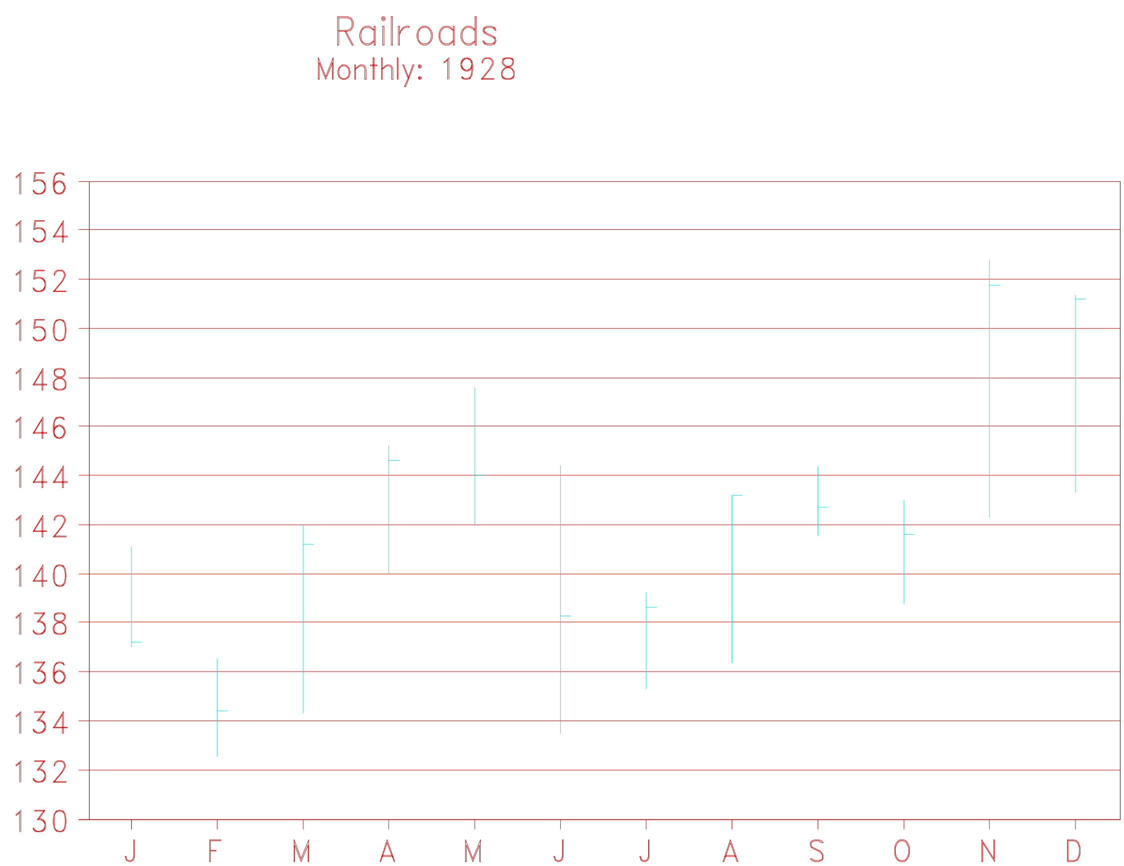


ness of any degree of gravity. Obstinate gamblers for the rise may have barked their shins. Or that undefined but still not mythical group of forces known as 'the largest interests,' the insiders of popular legend may have put the brakes on inflation. The only disquieting symptom last week was the pace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

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

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


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


Railroads
Monthly: 1928
156
154
152
150
148
146
144
142
140
138
136
134
132
130
J
F
M
A
M
J
J
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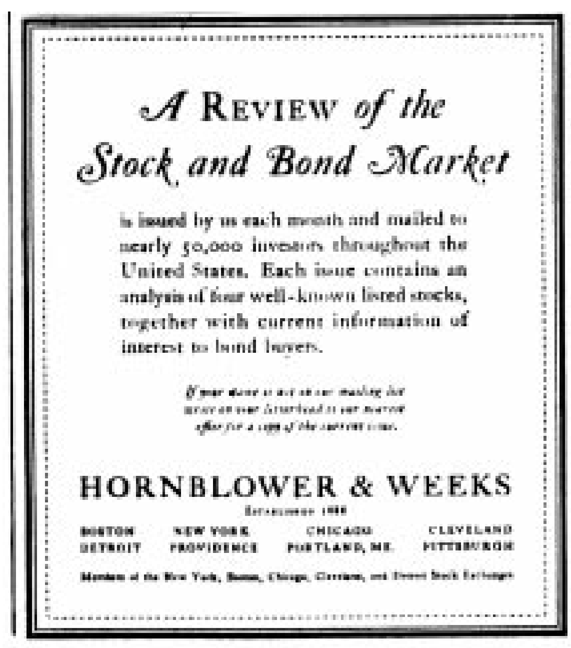
buyer wasn't Russia but Germany. Nonetheless, the wheat traders had a good time.

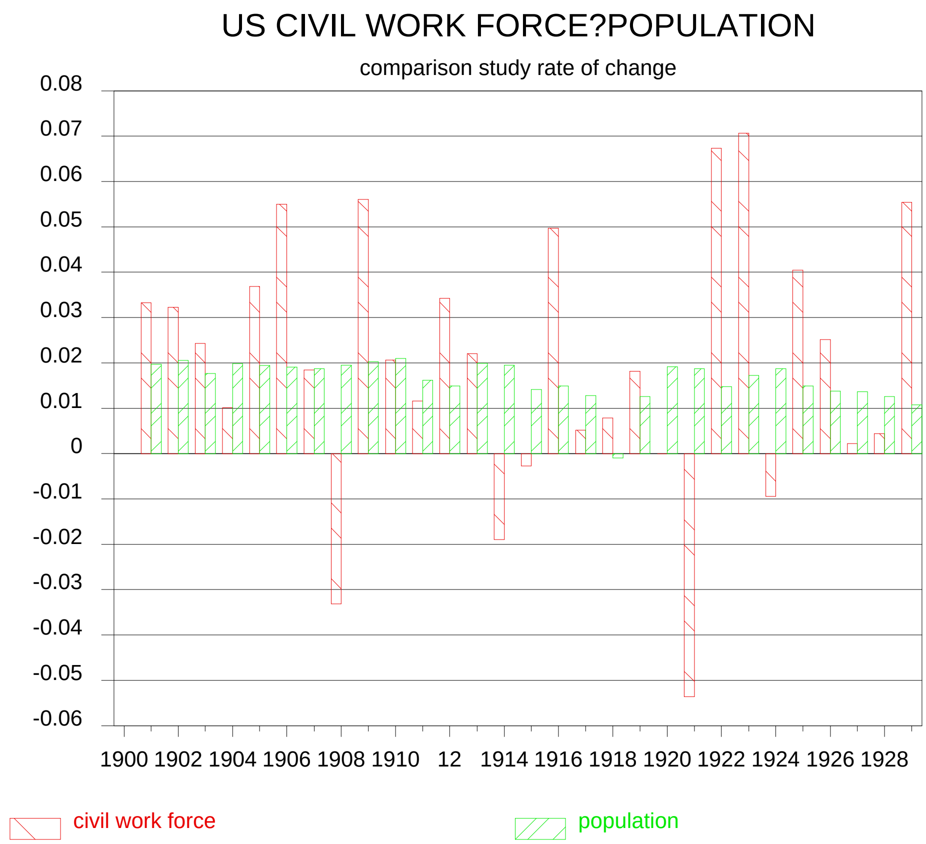
Over in the Rubber Exchange, back in Manhattan, the prices were in a state of panic. Down and dirty the price of rubber fell to an all-time low on the two-year old Exchange. The volume on the exchange had surpassed all previous records for weeks wrapped up in the course of four trading days. A telegram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

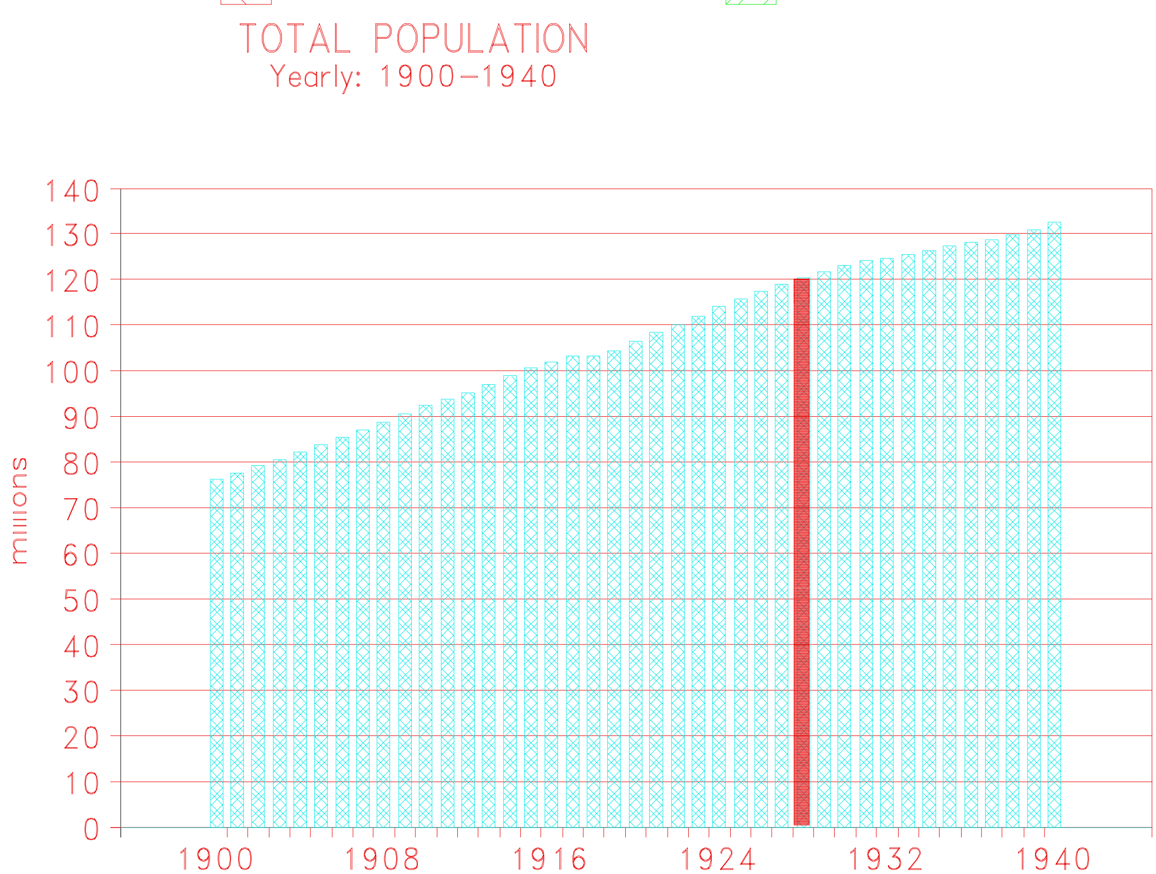
Trade with Russia was beginning to be quite impressive. At this point in time it was estimated to be $100 million annually. However, during February 1928, Russia had exported gold to the United States for the first time. It sat idle in the vaults at Chase National Bank and at the Equitable Trust Co.,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

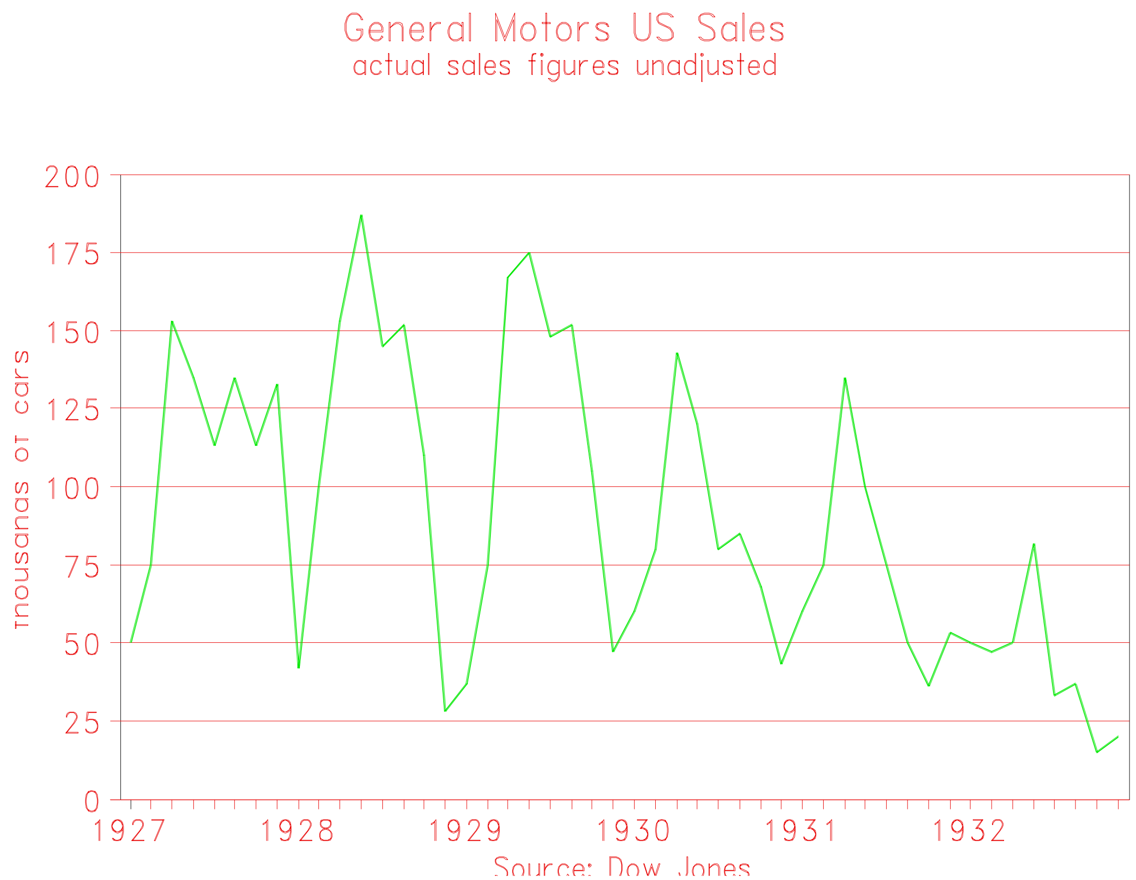
The markets began to recover during February as more earnings reports began to hit Wall Street. RCA released their 1927 statement showing an $11.7 million profit compared to $7.3 million for the previous year. Packard Motor Co. reported an estimated $10 million in earnings for the last six months compared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

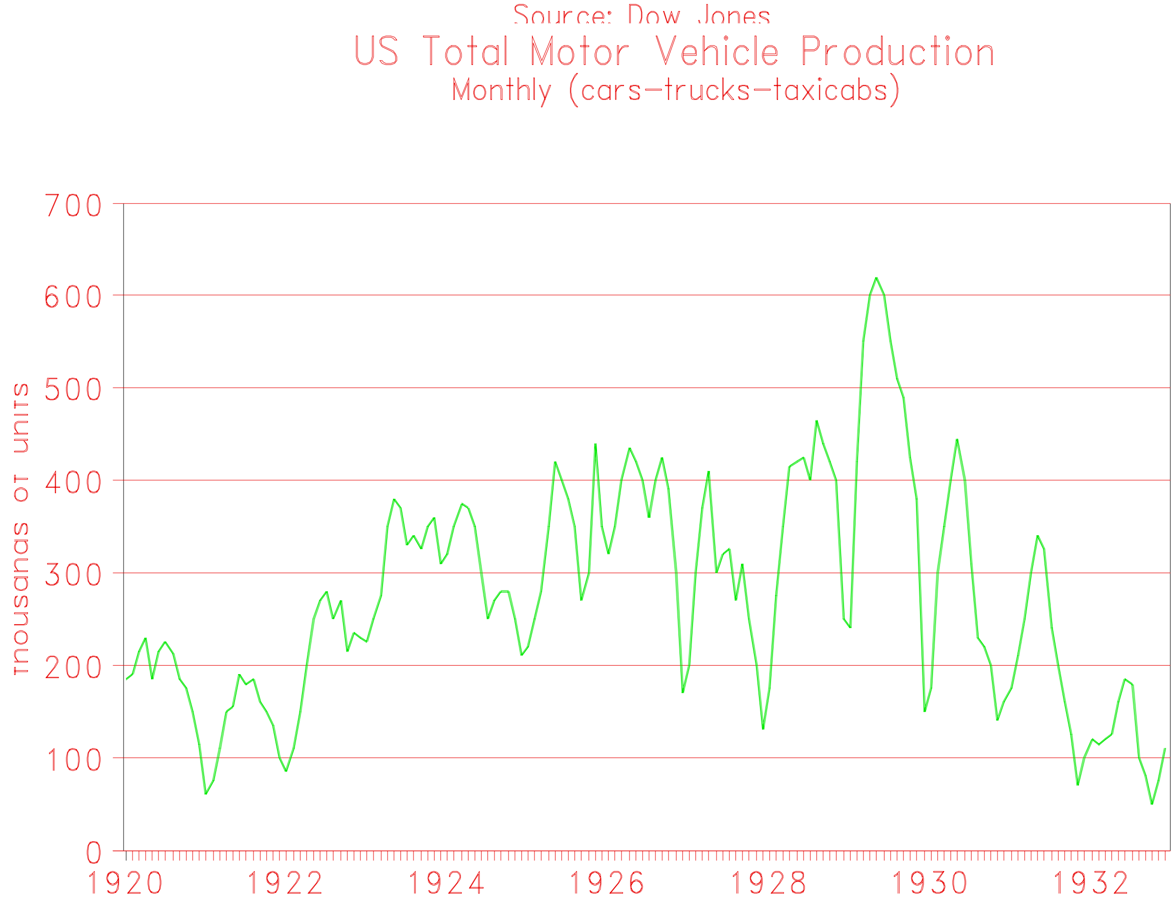
The fixation with unemployment was not over. In March it was reported that the number of jobless climbed to 5 million. Cities began to report unemployment figures.




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

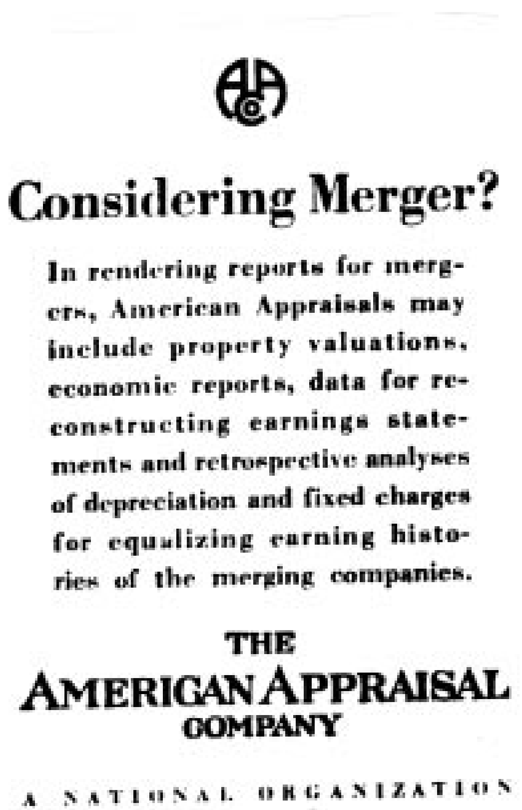

TOTAL POPULATION
Yearly: 1900–1940
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
millions
1900
1908
1916
1924
1932
1940


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


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

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

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



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

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

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

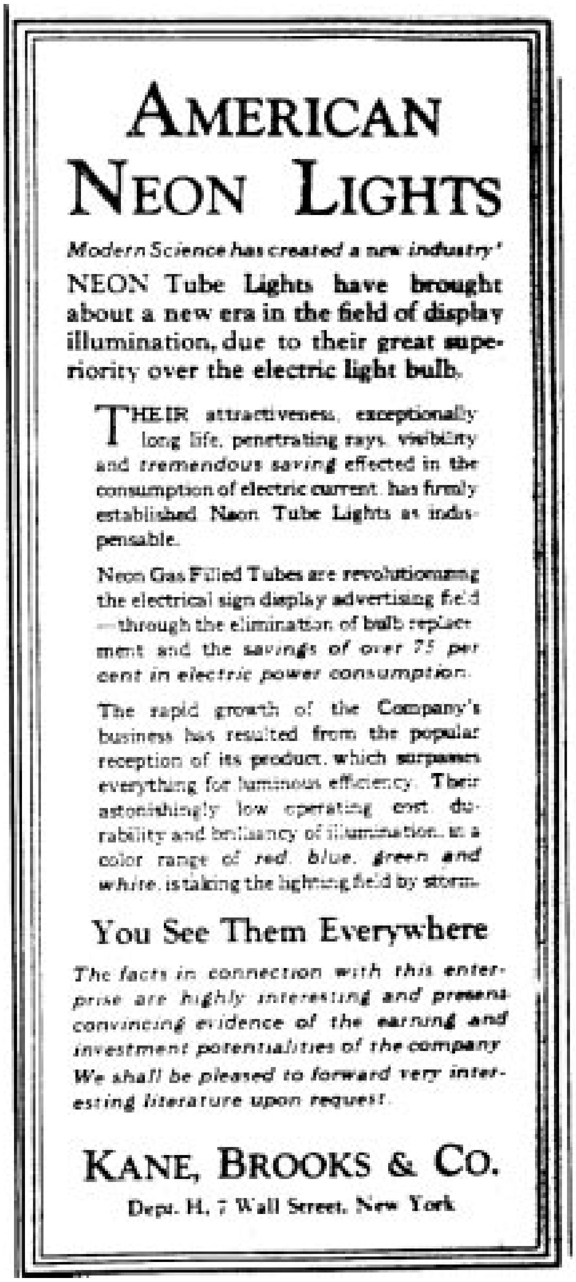
"Last week was perhaps the most remarkable speculative week in modern history of the New York Stock Exchange. Speculative, because there were no political or geological events like the declaration of War in 1914, or the San Francisco earthquake of 1906. Modern, because in older days (up to 1907), the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

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

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

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

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



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

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

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

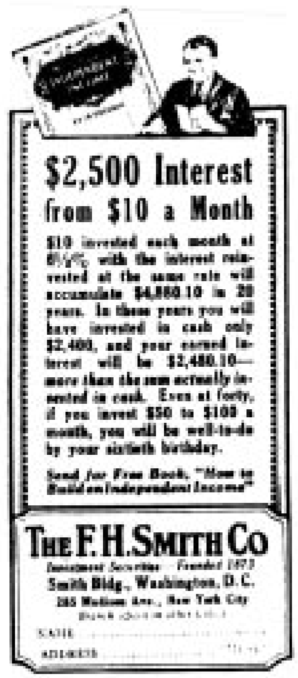
Obviously, the reports were mixed but overall the reports released during March were more turnaround surprises than disappointments. Only rubber and oil, both with huge overproduction problems, had been expected. Therefore, with G.M. showing an impressive report, wool and textile turning around and airplanes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

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

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

"THE PUBLIC INVITED"

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



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

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

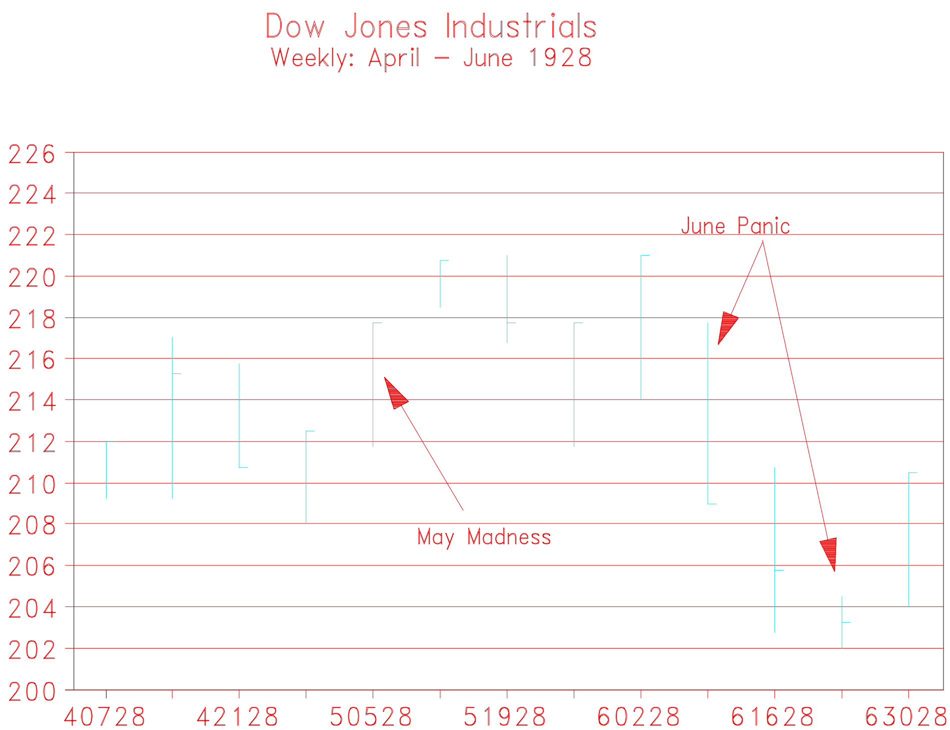
If we go back and read that article carefully, we will note a very interesting comment. It called the public tardy and clumsy and waiting to buy "at the top, as always." They assumed along with everyone else that the market had surely peaked this time.

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

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

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

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

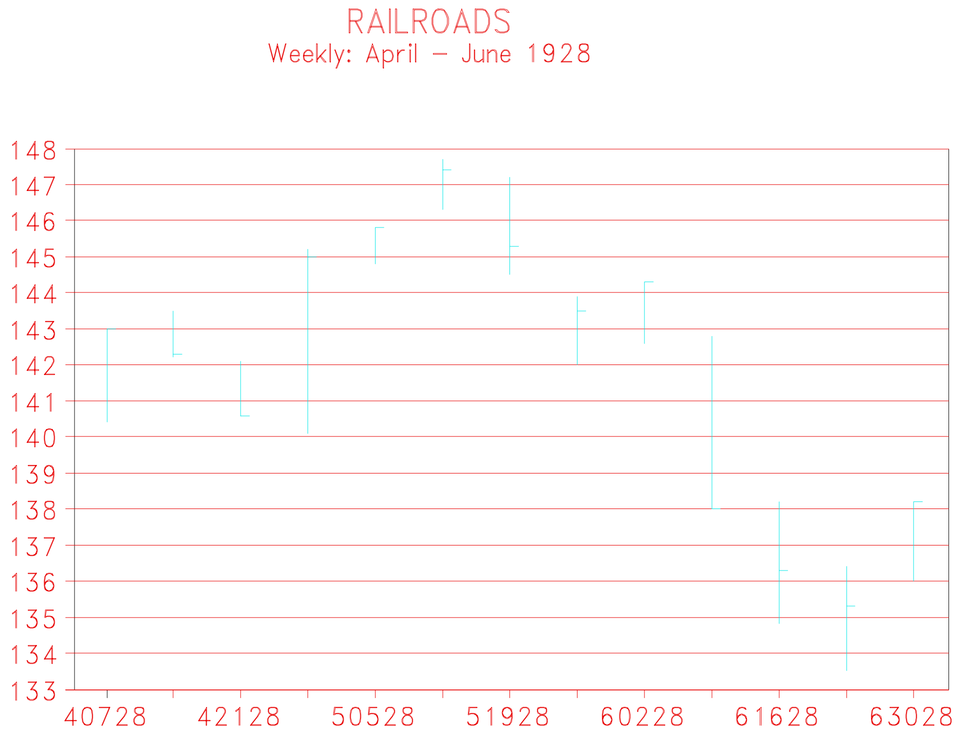


"Ides of March Terror," the rails advanced, tested the 1927 high and closed well above the high established during March. Although the April railroad high was not above that established in 1927, it was the highest monthly closing achieved. The bonds fell sharply dipping below the 99 level for the first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

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

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

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

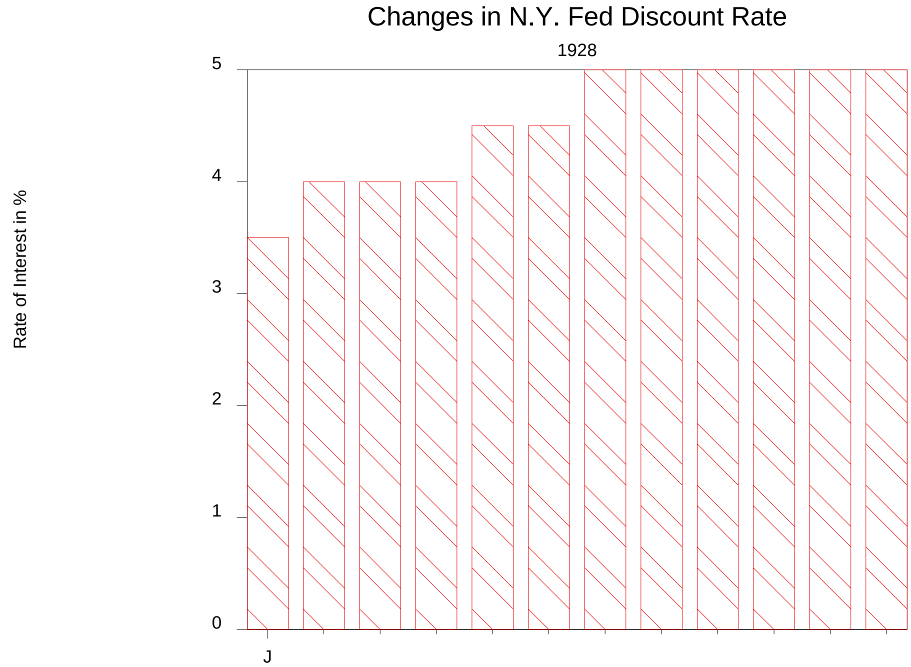


person was employed. The rate of interest to be charged was 6%. All loans were to be for one year only. The personal loans were under the stipulation that only responsible, employed persons without collateral may apply, provided the note was endorsed by two respectable friends. This was not actually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

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

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

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



on this newly favoured industry on May 28 as follows:

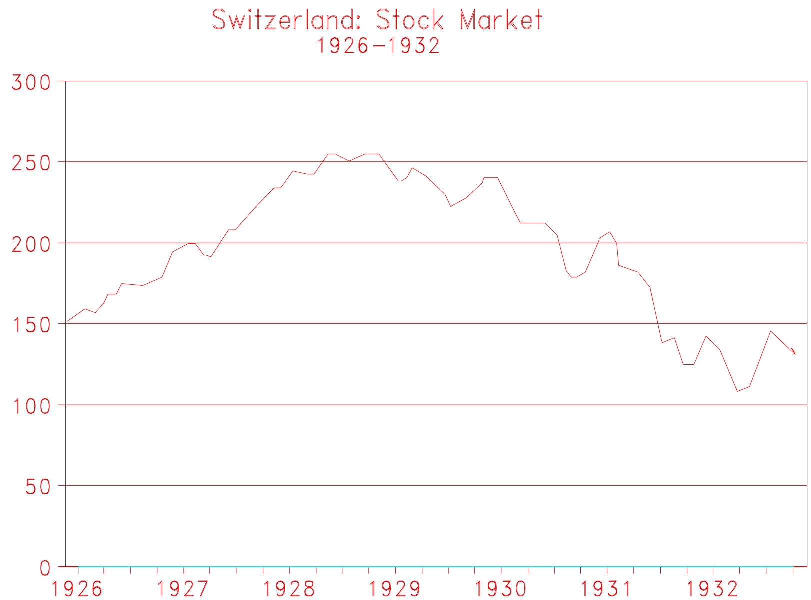
"Thousands of small speculators, who have been largely responsible for the three months hubbub in Wall Street, were last week seized with the same idea. Each of them wanted to stow away, or play with, a few shares of air stock. True enough they had played intermittently with air stocks since the Paris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

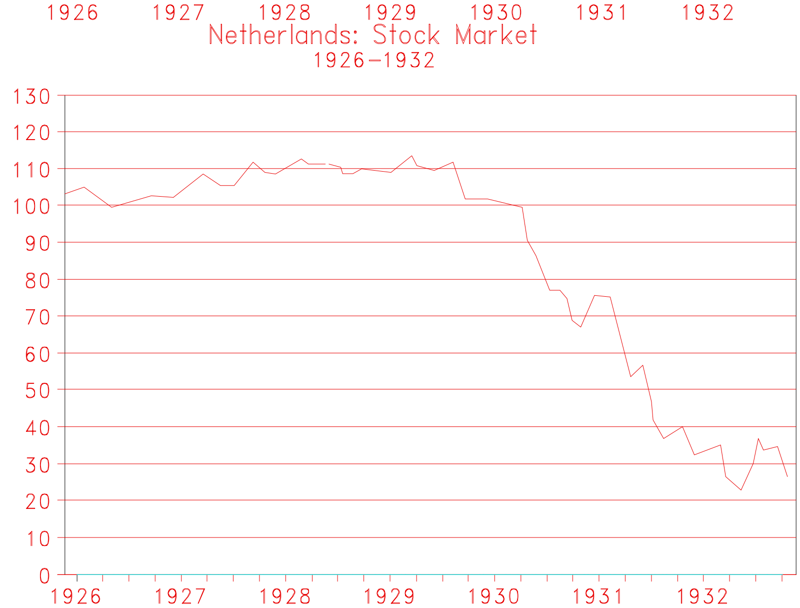
Much of this had to do with a few new issues in this industry that underwriters had placed at $12.50 but that soared on the Curb Exchange to $25 and rose even further to $30 in a single day. One of the best known was Wright (Wright Brothers). They were producing about 100 airplane motors a month and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

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

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

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

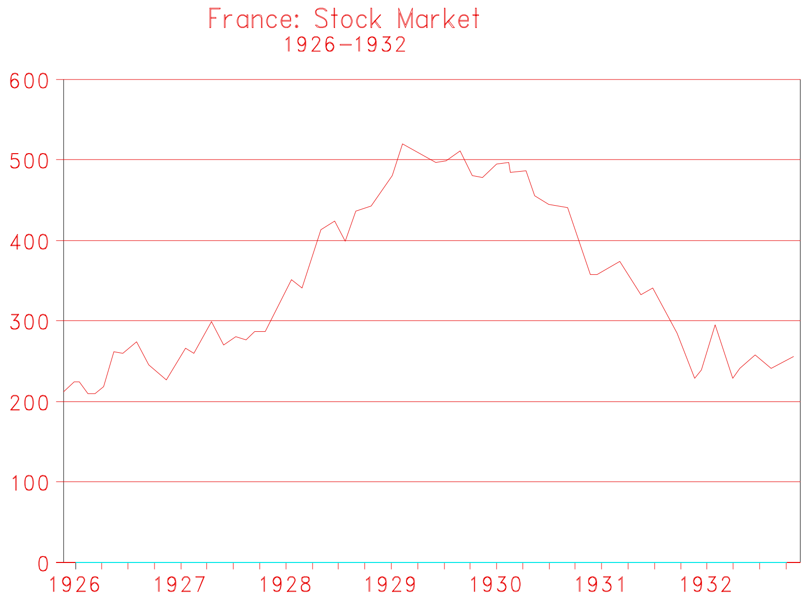


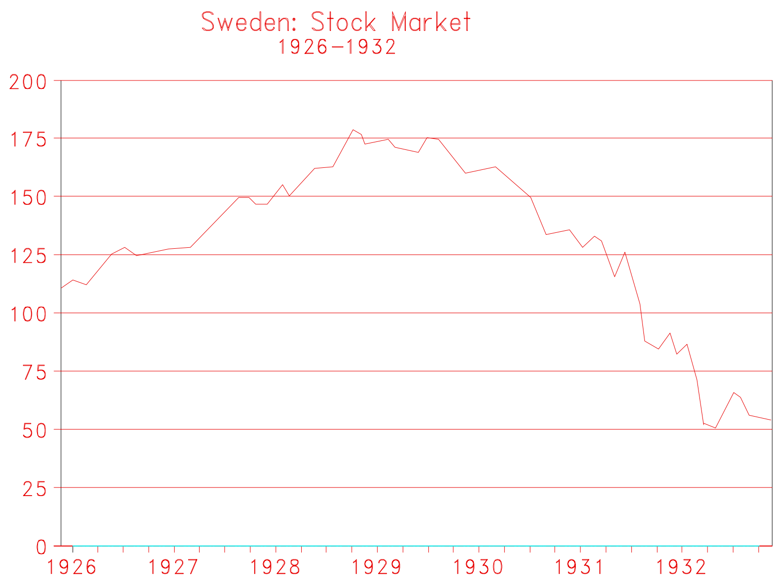


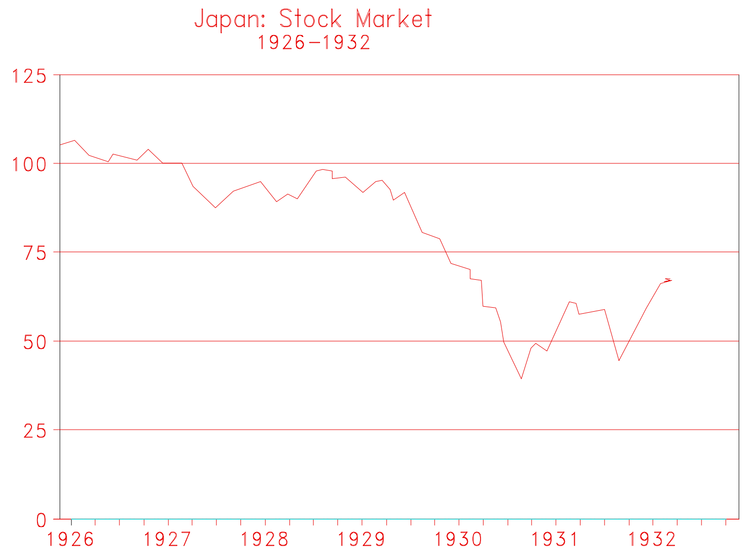
AT&T didn't decline, but instead they rallied to new highs when others were falling and looking for some sign of support.

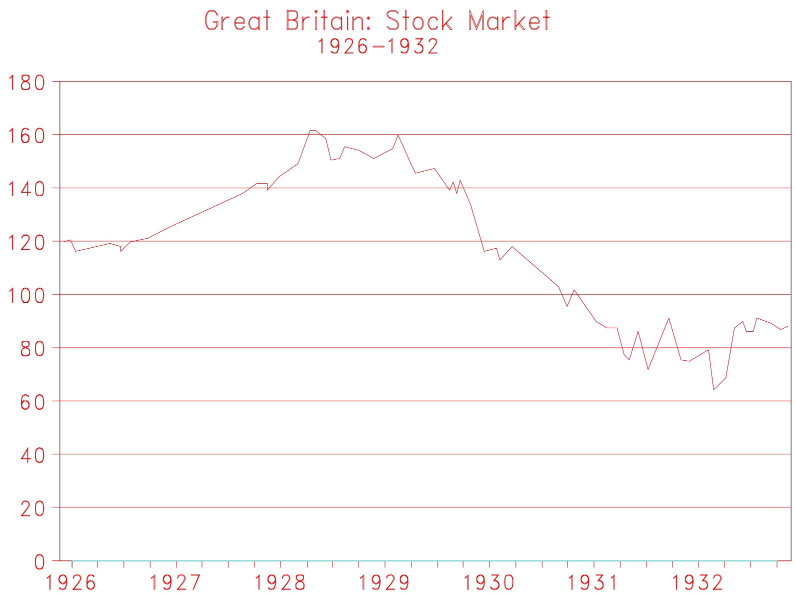
The exchange closed that Saturday and even shortened the days. Normally the market traded from 10 am to 3 pm, but it was ordered to close by the governors at 2 pm each day that week. One of the more famous seers who was often quoted in those days was the well-known economist Colonel Leonard Porter Ayres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

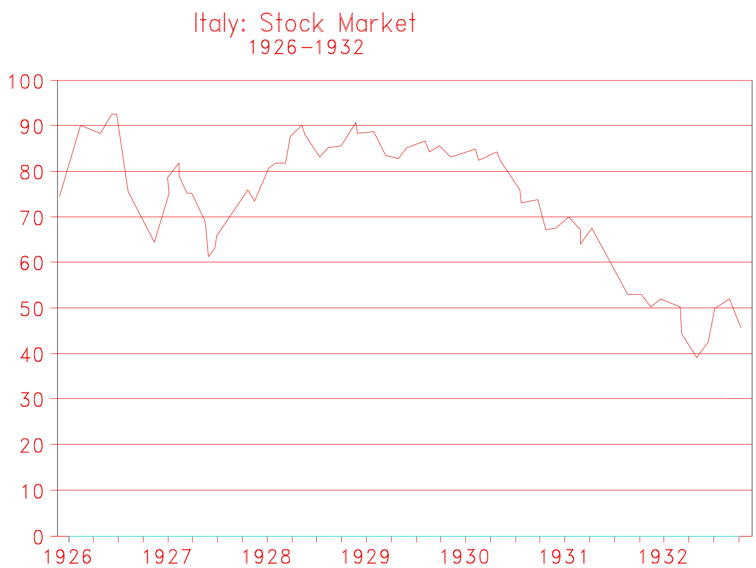
"This wave of speculation has extended to all parts of the country, and drawn in all parts of the country, and drawn in all classes of population. Increasing thousands of first-time speculators are watching their paper profits mount, and are concluding that anyone who works for a living is a boob. It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

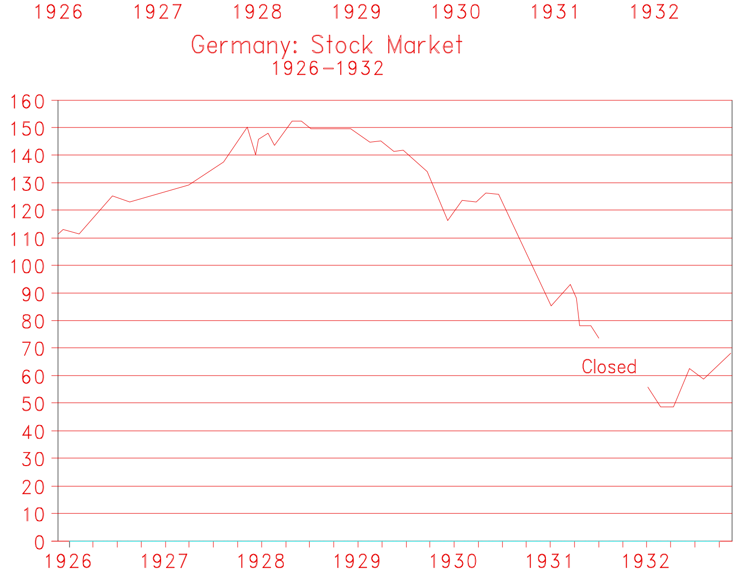

France: Stock Market
1926–1932
600
500
400
300
200
100
0
1926
1927
1928
1929
1930
1931
1932

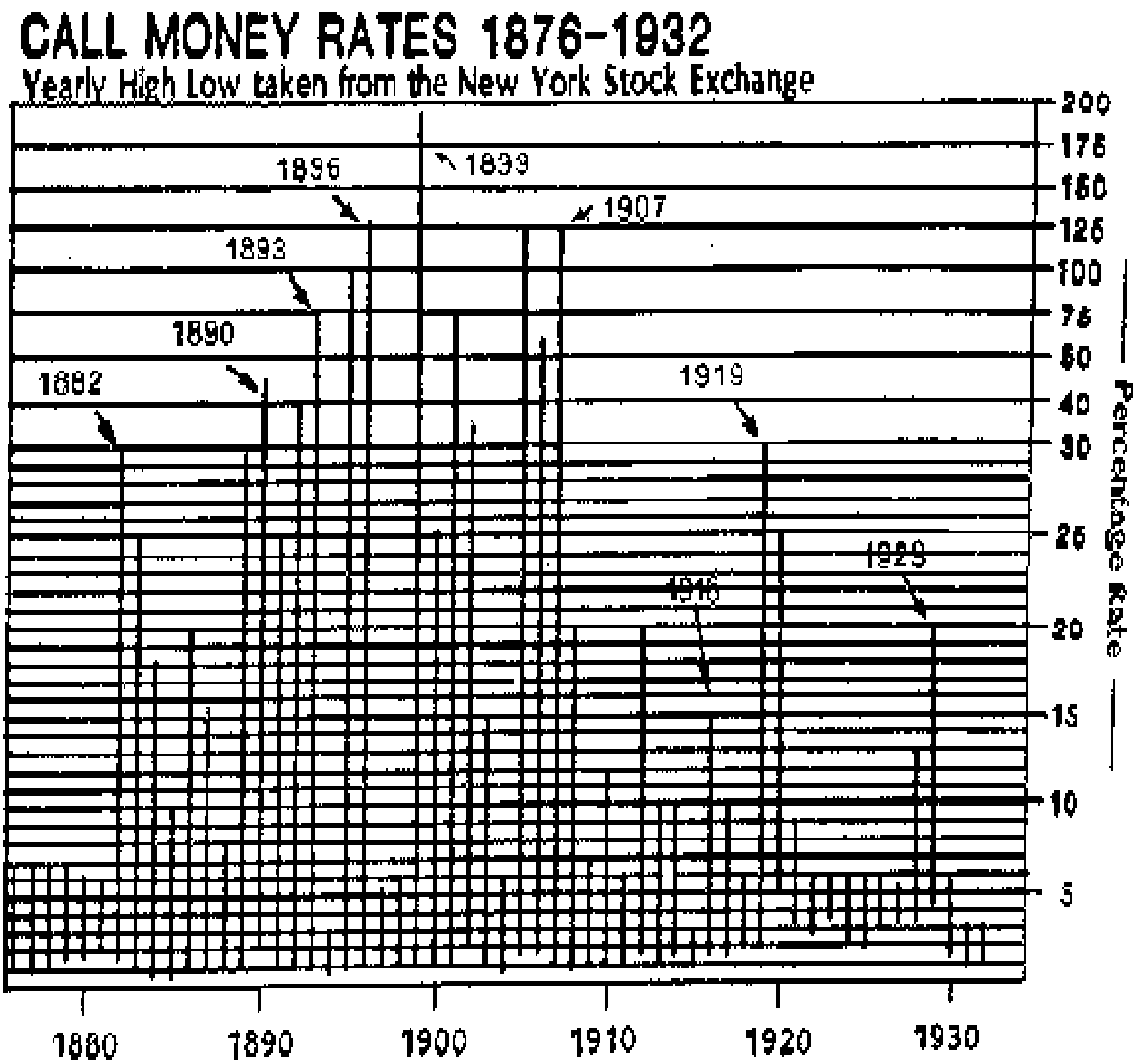

Sweden: Stock Market
1926–1932
200
175
150
125
100
75
50
25
0
1926
1927
1928
1929
1930
1931
1932


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


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

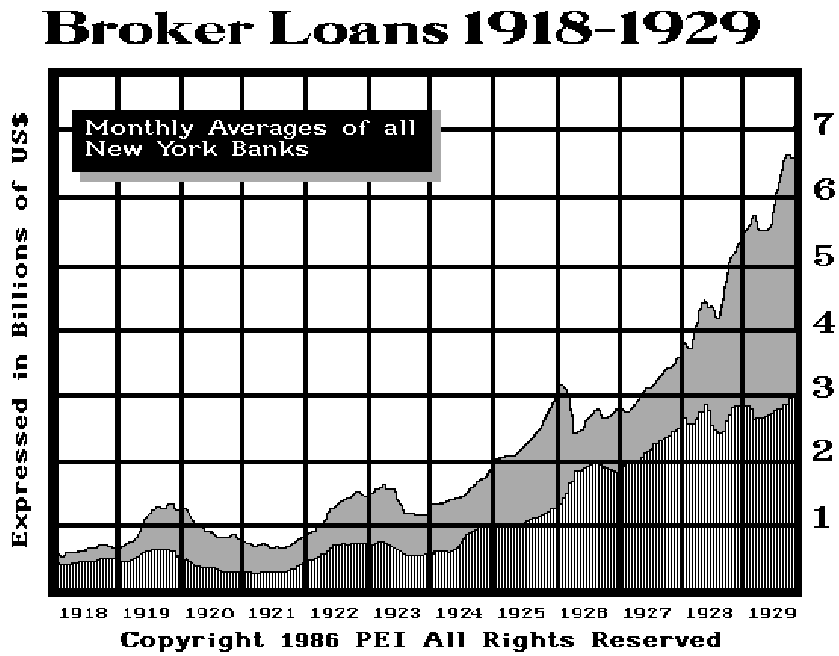

Italy: Stock Market
1926–1932
100
90
80
70
60
50
40
30
20
10
0
1926
1927
1928
1929
1930
1931
1932


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



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

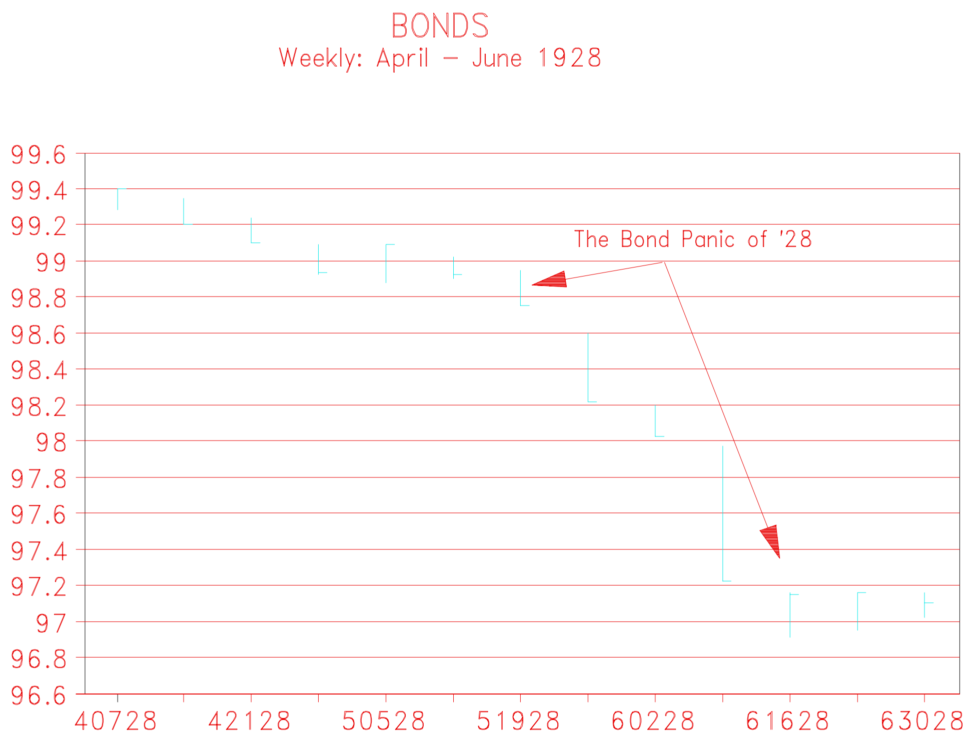
The public was not concerned so much with margin. Figures in historical studies revealed that most of the buying again was for cash which was being funded by the withdrawal from the bond markets. Concern was building over many areas. The fact that the discount rate was raised in May to 4.5% by the New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



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

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

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



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

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

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

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

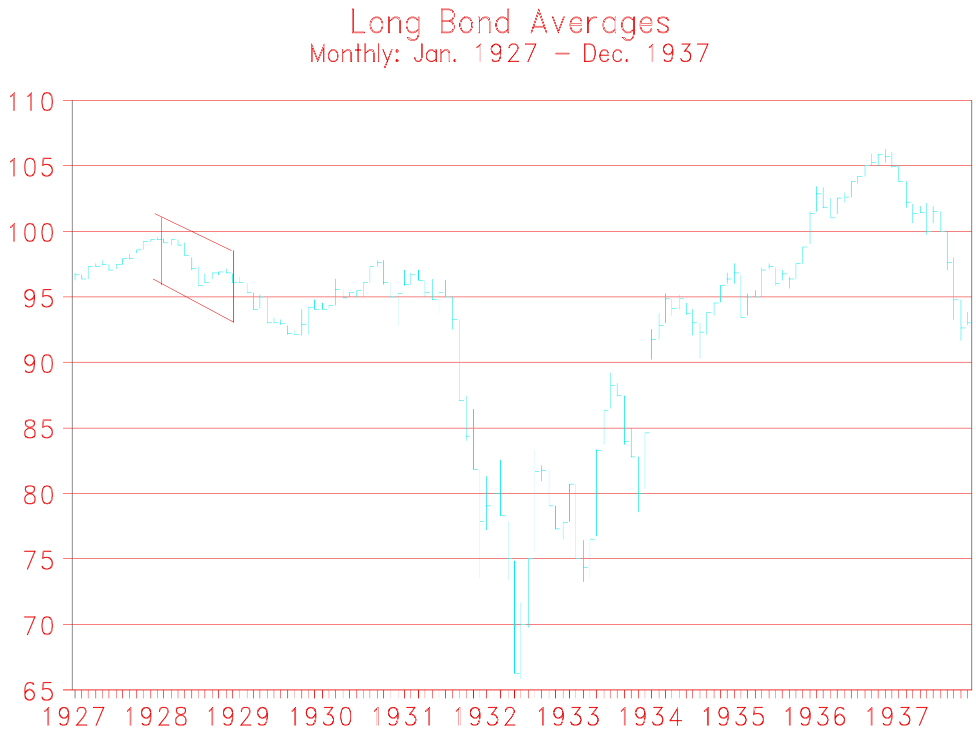
In the June 25, 1928 edition of Time magazine, the commentary on the "Stock Market Break" that month was as follows:

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

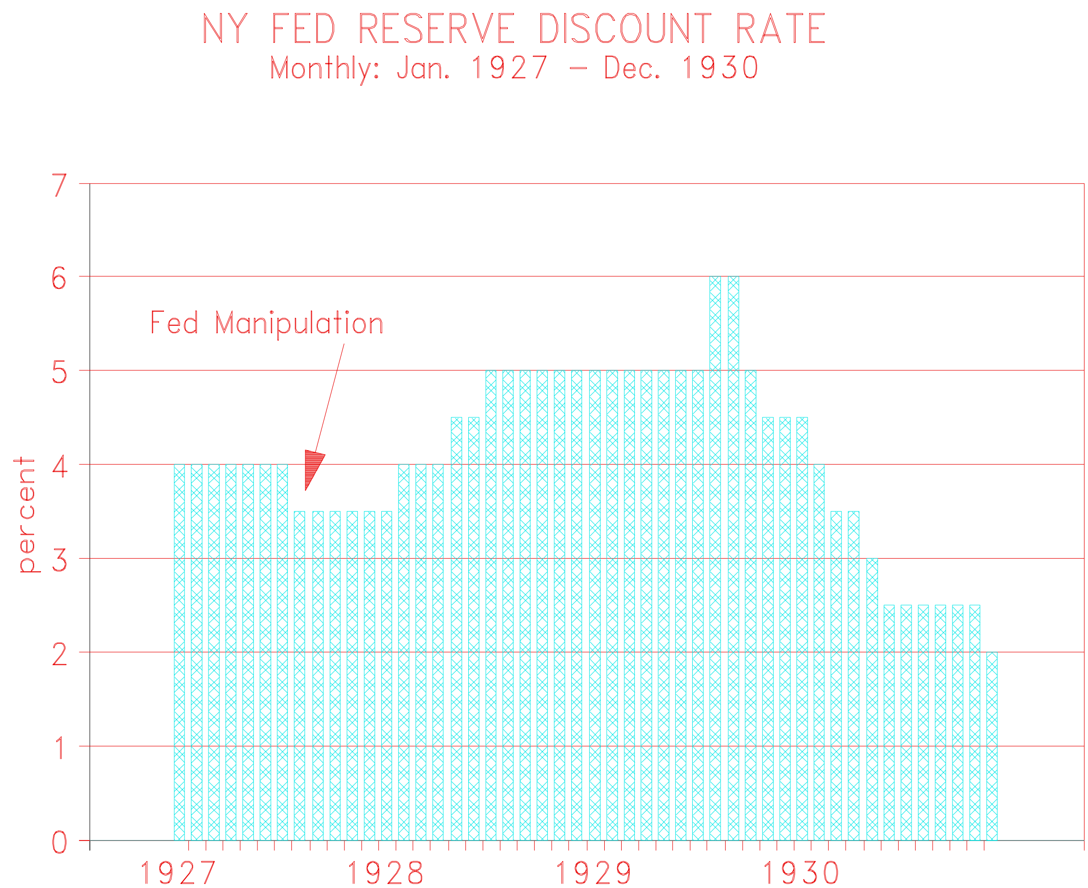
"BETS. Experts foresaw tight money throughout the summer, or until member-banks repay some of their debts to the Federal Reserve and brokers' loans show a marked drop. Col. Leonard Porter Ayres, famed economist of the Cleveland Trust Co., saw the stock market as a 'great national bet against the continuation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

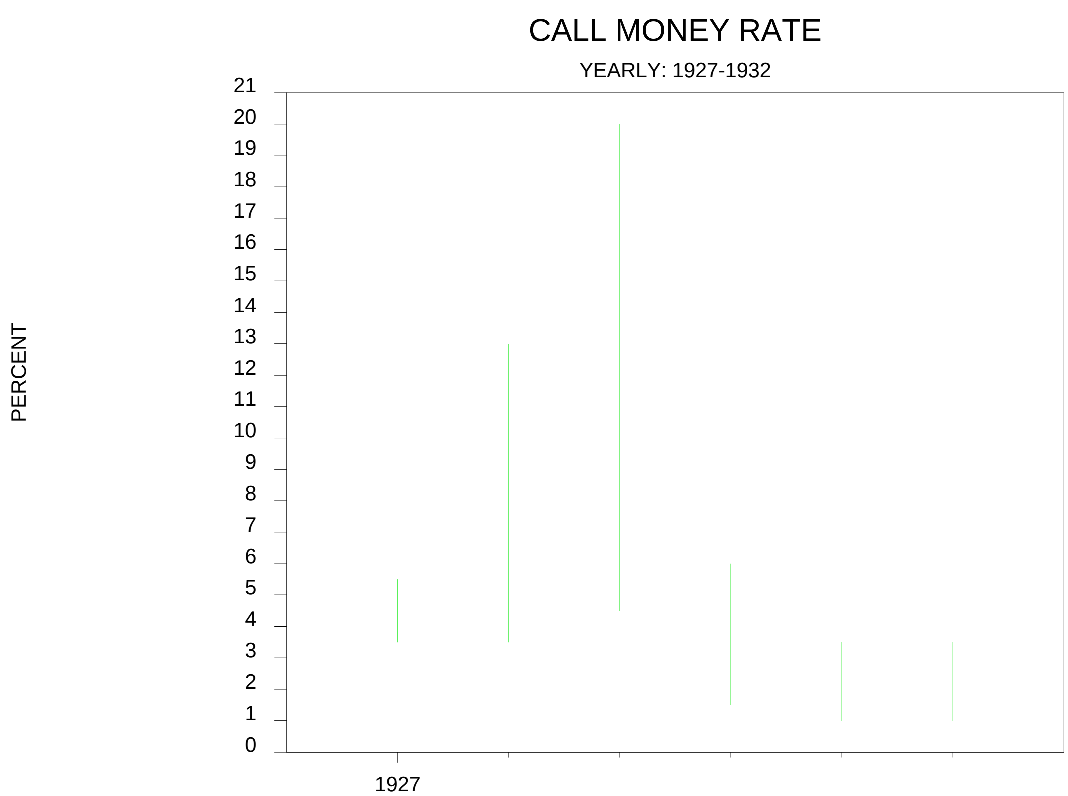
"MORBID. Stock speculation shouted 'Paternalistic!' and 'Mollycoddling!' They cried: 'What business is it of the Federal Reserve whether General Motors is at 150 or 200?' Bond houses watched a continuing weakness in their market with foreboding.

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

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

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


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


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

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

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

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

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

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

Hjalmar Schacht, stern President of the German Reichsbank;

Emile Moreau or Charles Rist of the Bank de France.

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

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

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

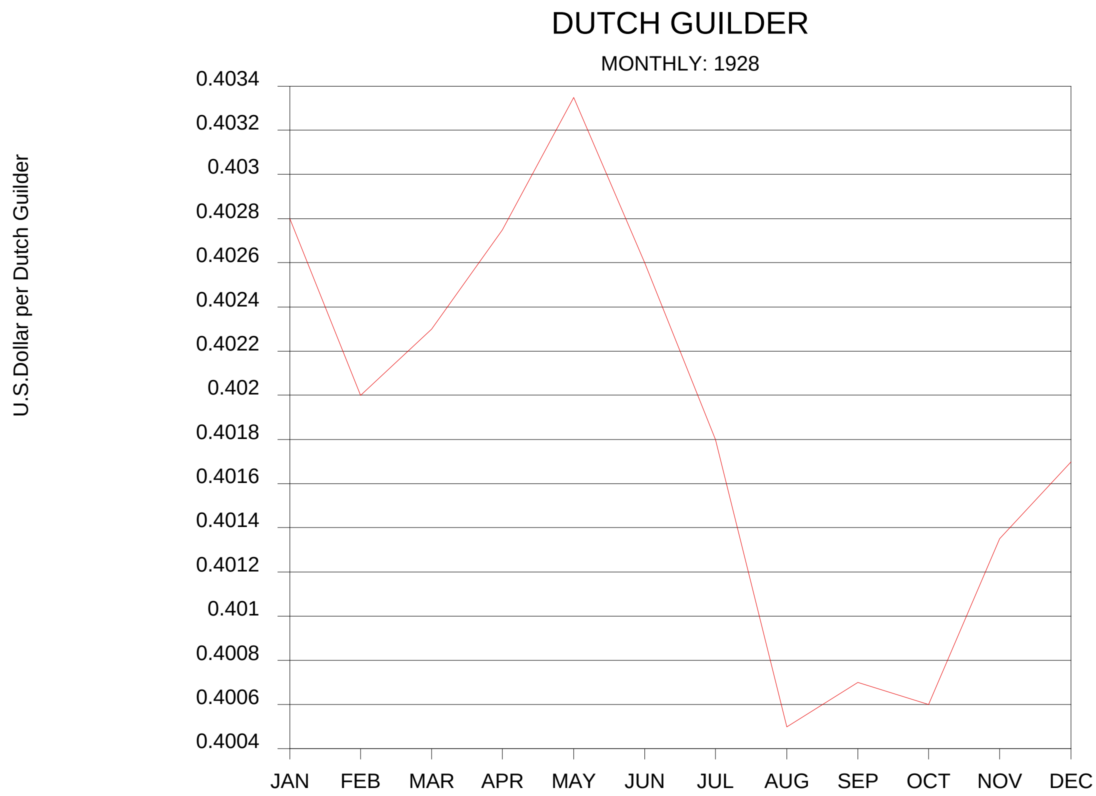
BENJAMIN STRONG

MELVIN ALVAH TRAYLOR

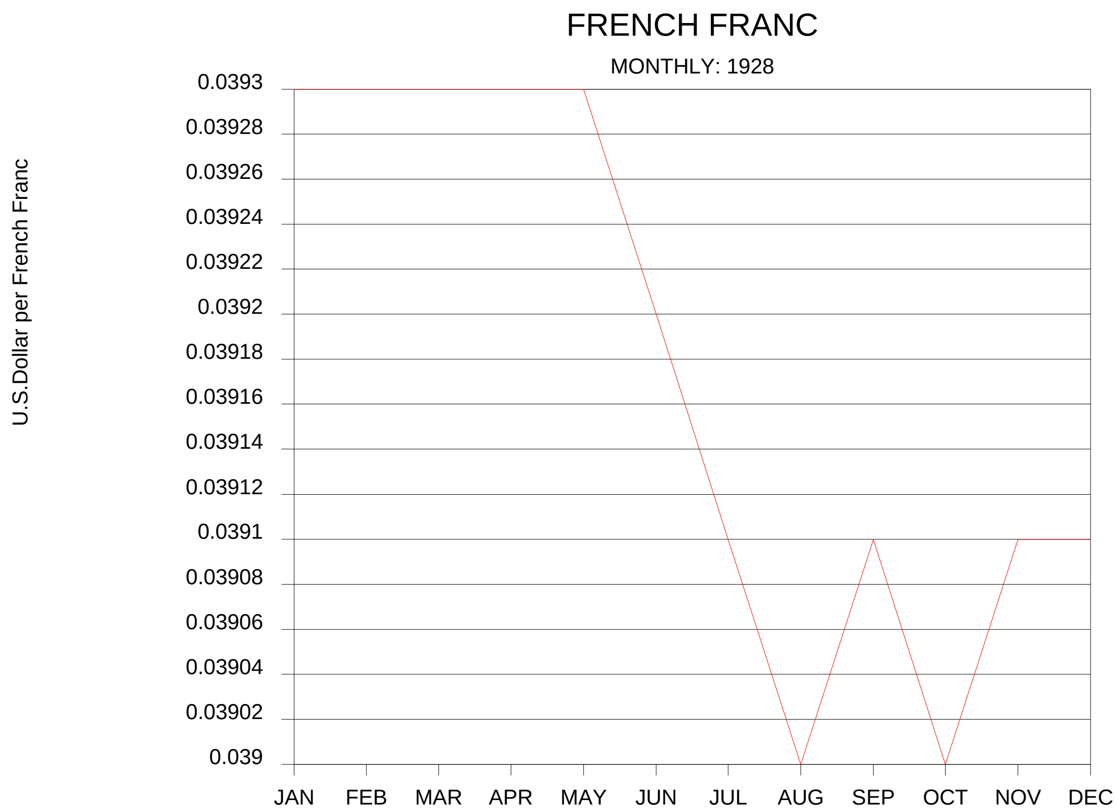
reserves and wild speculation, jumped its rediscount rate to 5%. Manhattan, accustomed to lead, was forced to follow. Chicago's press openly flayed the absent Gov. Strong; screechingly demanded his resignation.

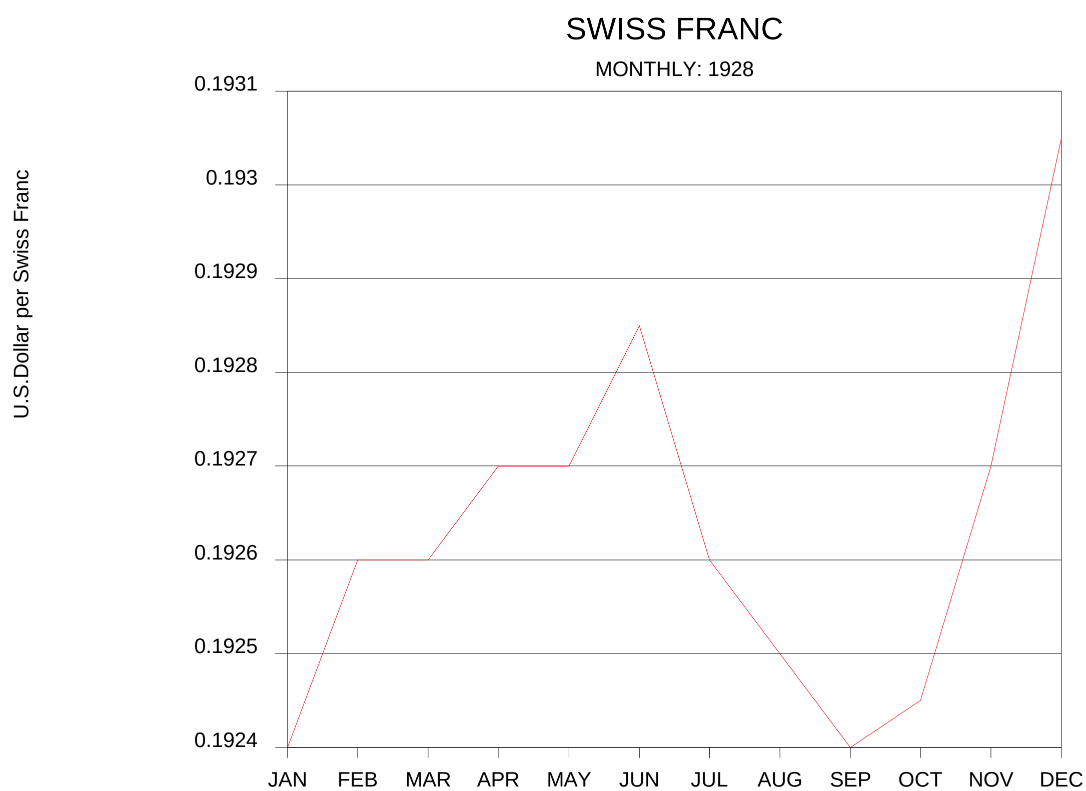
"Puzzled, irritated, New York bankers asked questions. Who gave provincial Chicago the right to criticize internationally-minded Manhattan and its Gov. Strong? In New York papers, an anonymous banker charged the regional bankers suffered 'delusions of grandeur.' And if it came to that, who were these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

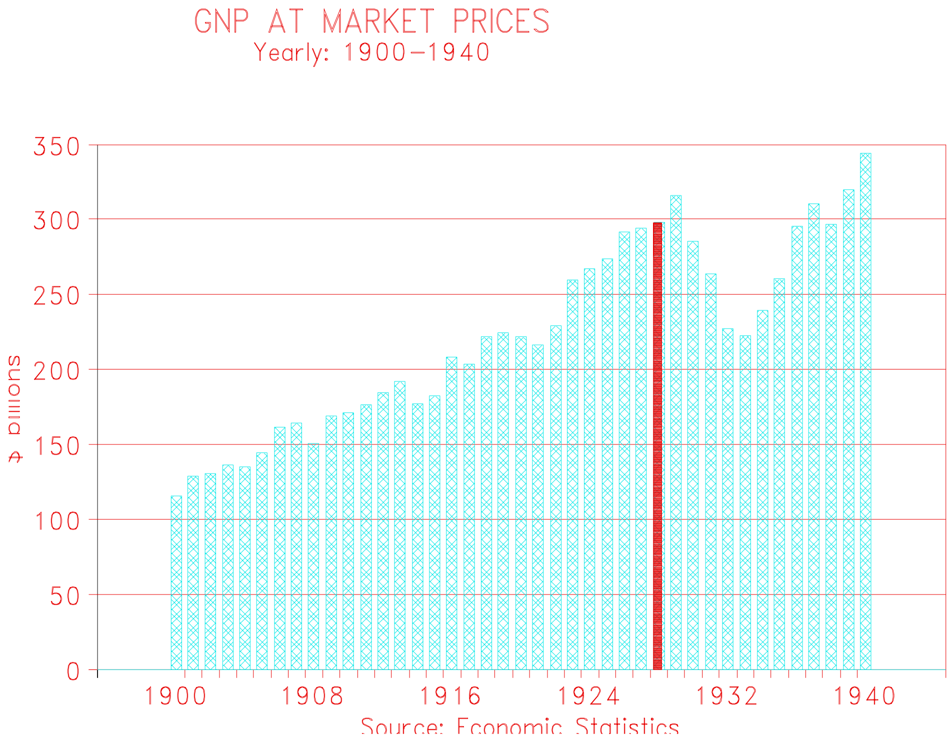
It is surprising with all this fanfare about speculation and the interest rates that the Chicago hike to 5% on the discount rate in July 1928 did not send the market to new lows. If we look at the charts, we can clearly see that the railroads rallied back from the June low of under 134, nearly reaching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


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


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


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


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



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

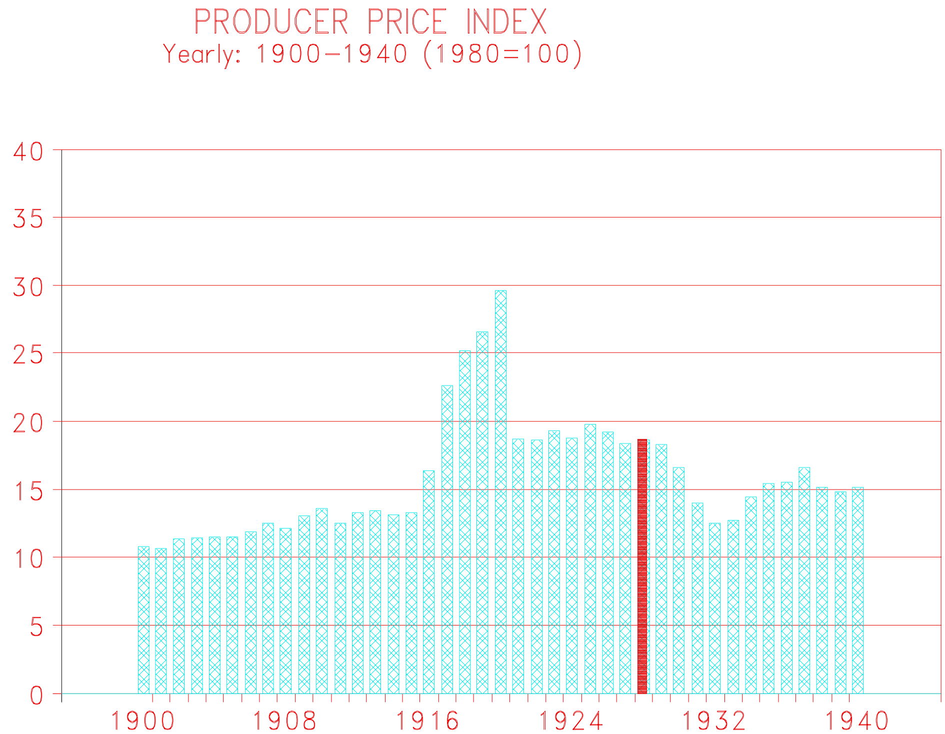
July was still marked by mergers and takeovers much like the period during the 1984-1986 era. One of the most important mergers was in the soap industry that July. The two famous firms were the Colgate Co. and the Palmolive-Peet Co. This merger would provide a combined estimated sales for 1927 of $100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

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

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

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

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



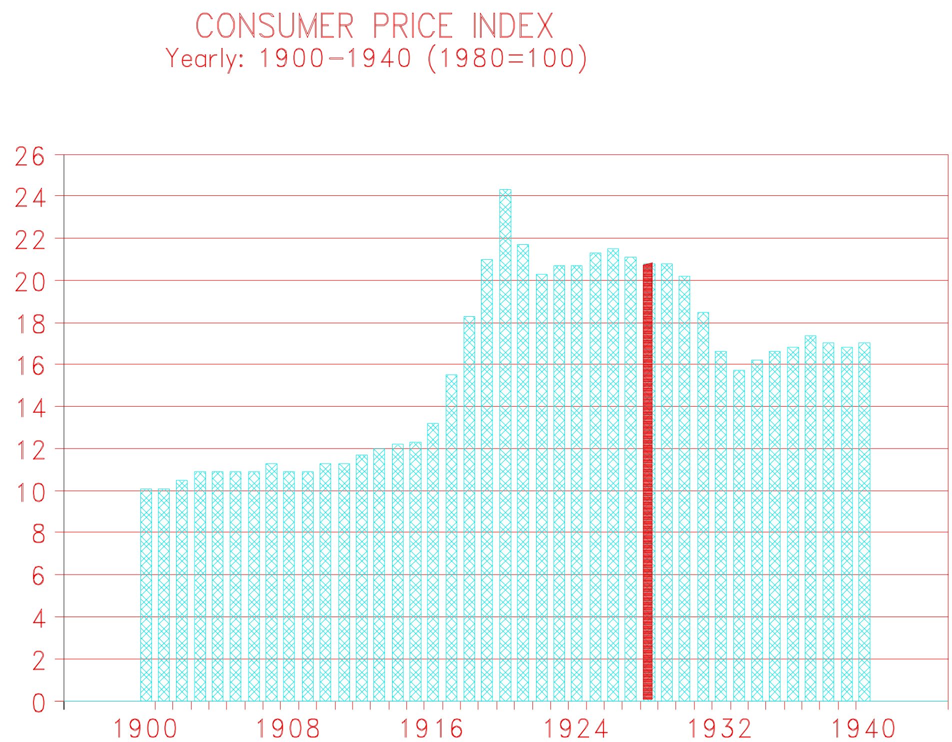
was now being fueled in an unending circle of funds. Corporations, with rising surplus cash and cash obtained through the sale of securities, were attracted to the call money market much as individuals were attracted to the money-market funds in the early 1980s.

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

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

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

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



form is needed in New York banking practice."

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

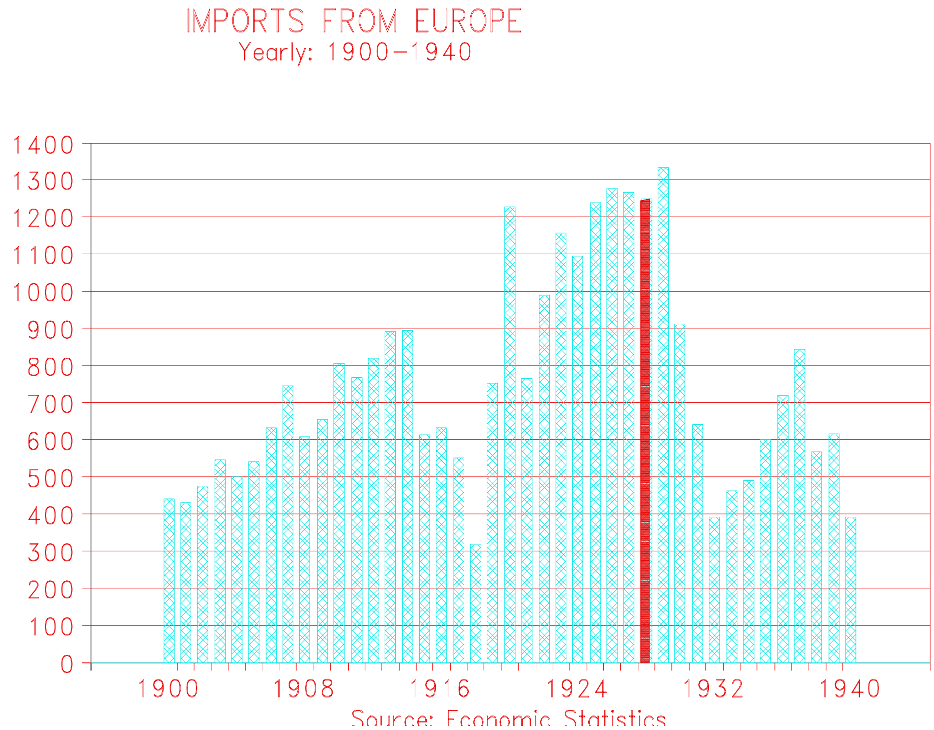
Then August came onto the scene. Suddenly the market raged onward in the face of climbing rates around the nation. The Dow Industrials soared to a new record high straight up in virtually a single breathless move closing August above 240. The rails rallied smartly but remained below the May high of nearly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

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

'STOCK MARKET"

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

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



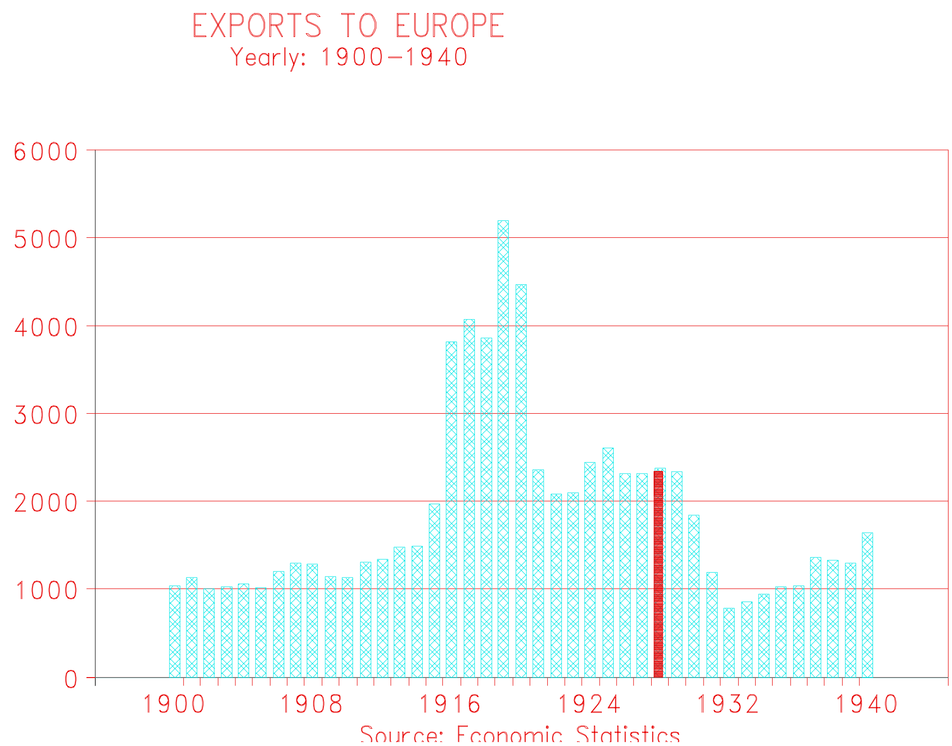
coinciding with the issuance of a serious warning by the Federal Reserve Bank of New York. Banks were 'overloaned.' The discrepancy between deposits and loans was becoming too great.

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

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

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

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



market falls with higher interest rates is clearly NOT TRUE!

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

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

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

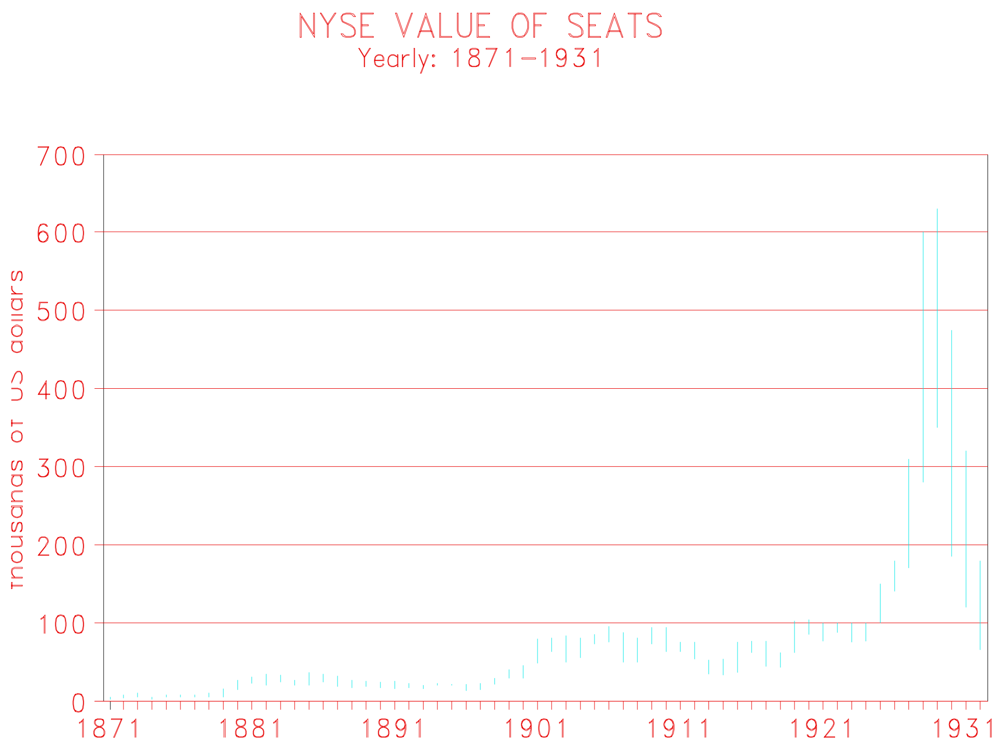
As the month of September, 1928 arrived on the heels of new highs in the industrials, the rails still failed to exceed the May high but did manage to push above the August high. Bonds regained a little during September but still traded within a half-point range. The industrials consolidated in one of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

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

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

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

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



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

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

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

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

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

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

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

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

The New York Stock Exchange came out and made a statement that the month of September had broken all records for volume trading, some 99,906,718 shares which was substantial compared to 67,703,538 shares during August. The industrials rallied again, reaching a new record high and breaking right through the September highs that now had proven to be the calm before the storm. The rally took the Dow Jones industrial average from the September high of 240 to 258. Dividend reports were flooding the market and in the last few days of September, the quarterly dividends paid out on stock were an estimated $125 million. The interest paid on the corporate bond issues including governmental was an estimated $375 million. Call money lurched ahead to 10% but still the stock market didn't falter.

During October, the press was filled with reports of foreign governments seeking more loans from the U.S. markets. Germany was reported to be looking for another $100 million, Greece $75 million and Hungary $5 million. Time magazine reported that President Charles E. Mitchell of the National City Bank in New York told the German government that $150 million in German bonds remained unsold on the market already. Through hindsight, it became clear that outstanding foreign loans in the U.S. had saturated the market. This combined with the Fed's policy of helping Europe out by lowering the domestic U.S. interest rates artificially, only heightened the move from bonds to the stock market. Therefore, cash indeed became scarce because of the drain on U.S. gold reserves and the outstanding foreign bond issues, but even a new high in call money up to 10% did not deter the market from moving substantially higher.

The sentiment during that fall of 1928 was still very mixed. The bearish camp was still well entrenched with the so-called professionals and was even enlarging. It was as if many a bitter bear was either broke or turning into a bull. In the October 15, 1928 edition of Time, an article appeared concerning the annual banking conference being held in Philadelphia. The article began:

"Bulls, of whom there are many, and bears, of whom there were few, looked last week toward Philadelphia. Traders felt, and with reason, that the deliberations of 5,400 U.S. bankers gathered for the meeting of the American Banker's Association, held a more or less potent threat to the stock market. Many a banker, speaking for himself or his bank, had warned against frenzied speculation. The market had kept its strength; had soared through a record month. But traders feared the effect of a solemn and public pronouncement from the Philadelphia convention. Resolute bulls faced the 5,400 bankers with hostility."

One of the more famous long-term bulls in the stock market had been John Jacob Raskob who had recently become the Chairman of the Democratic party. His statement hit the market as a surprise, particularly since he had been such a prominent bull.

"Since I have taken this position as Democratic National Chairman, I have not purchased any stock whatever. It is my opinion that security prices have so far outrun demonstrated values, earning power and dividend returns, that a material readjustment is necessary before they will again be attractive to the prudent investor. My name has frequently been mentioned as being prominently identified with Chrysler Corp, and Radio. As a matter of fact I have never owned and do not own a single share of Chrysler Corporation stock. And the stock in Radio Corp. which I hold was purchased outright by me a long while ago and held as an investment. I am not interested directly or indirectly in any pool or stock market operations."

Mr. Raskob's statements were a shock at first but the market fell but a few points and essentially held its ground during October 1928.

Another well-known name came forward with statements on the market. He was Col. Leonard Porter Ayres of the famed Cleveland Trust Co. His statement was as follows:

"The transition to a new and sober era is not going to be easy. The American people are in a mood of invincible optimism. Three years ago they were speculating in Florida real estate and finally that bubble burst. They then speculated in urban real estate and now they have turned to the stock market where prices of the stocks of mail order houses, chain stores, motor companies and soft drink firms are selling on a basis to yield half as much as the obligations of the U.S. government. All the experience of the past points clearly to the conclusion that prices are too high and must come down. However, our concern is not about what may happen in the stock market. We may look forward to the future with confidence but the great rewards of business and banking during the next decade will probably go to the plodders rather than to the plotters, to the calculators rather than to the speculators, to the thrifty and not to the shifty."

The Representative Louis T. McFadden, chairman of the House Committee on Banking and Currency also had a few comments about the situation that month. In regard to the Federal Reserve policy of tight money, he warned that it would "produce a business slump without intending to do so." However, he also warned that easing the policy might send more cash into the speculative sector. He therefore advocated that government should assume a more authoritative role and extend to the Federal

Reserve "a commanding position...controlling all the elements in the credit situation."

The Chairman of the Federal Reserve, Roy Young, also had a few remarks at the 1928 banking conference. He stated:

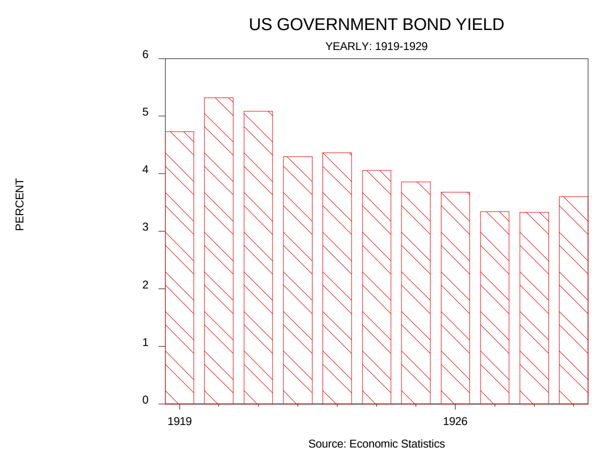
"Responsibility of banks does not end with their depositors and stockholders. Banks also have a responsibility to the community in which they are located. It is my conviction that a healthy banking situation is the best guaranty of a healthy economic development." In regard to credit he stated: "The Federal Reserve cannot earmark its credit. But it can help steer the credit ship. People must not expect the impossible."

Despite all this bad news, the market rallied. Perhaps one bit of news which was to some degree a piece of relief but merely added some confusion was the death of the New York Federal Reserve Governor Benjamin Strong. Many viewed it as hopeful that the U.S. would no longer waste its resources in defense of Europe while others interpreted it as Europe losing its last hope. Either way it was bullish for stocks coupled with the fact that Roy Young had little to really state about the speculative money in the stock market. The industrials that October rallied by 10%, but the rails declined from the September high, falling from just above 144 to slightly under 139. The bonds rallied slightly but still remained within half a point trading range.

November brought with it the elections. Wall Street remained firm and held its ground, never really giving into fears of a Democratic victory. The market rallied like a charging bull paying no attention to barriers or prominent "professional" bears which may have stood in its path. The Dow Jones Industrials gained nearly 20% in a single month. The index rallied from 254 to 296, closing at the 293 level. The bears were simply astonished and speechless. Again, despite the fact that the professionals all felt that the market had topped they became even more confused. The public clearly voted not merely for the Republican ticket but for the stock market as well. The Republican era of prosperity would continue and Europe, begging on its knees for more borrowed money, was shunned at the door.

At last even the railroads charged ahead, rising from the depths of 142, reaching for the stars and coming close to 153, a new record high. The bonds rallied prior to the elections, penetrating above 97 for the first time since the devastation of the past July. But then the bonds fell and closed below the October close. It was the final reaction rally in a collapse which would now unfold into a massive liquidation of bonds as capital shifted into common stock.

Another bullish aspect came during the first week in November. President Alfred P. Sloan of General Motors announced that the third quarter earnings for 1928 were $79



million. That brought the first nine-month period of 1928 earnings for G.M. up to $240 million. This was reported by the press as being the largest corporate profit in peace time history. What had become known as the Raskob's rule of 15X earnings meant that G.M. should have been selling for $270 a share which was $50 above the closing price during the first week in November. U.S. Steel also announced earnings of $52 million for the third quarter. That was $10 million above 1927 and the largest in two years. U.S. Steel did rise to the 15X earnings rule and closed the first week of November at $160 7/8.

Brokers' loans were on the rise. For five weeks in succession they continued to make new highs throughout October and into early November, reaching $4.9 billion compared to $3.3 billion in 1927.

There is no doubt that this was a serious event and that government was calling it a speculative frenzy. But the shift in capital from bonds to stocks was also significant. Given the total outstanding stock on the exchange, if all purchases were margined, brokers' loans would have been $150 billion. Obviously the margined position was not as far out of whack as the press and government would have us believe. The importance of this perspective is quite significant. Although brokers' loans were at record highs, in proportion to total outstanding equity holdings, it was quite small. This signified that outright cash positions far outnumbered margined positions.

The second important point of this perspective is how corporations chose to raise money and how the public preferred to participate in that debt servicing. From January 1, 1924 to November 1, 1928, total new issues of common stock placed on the market were $38 billion. The brokers' loans represented about 12.5% of those new issues. Prior to this period, it was common to find corporations that needed to borrow doing so through the bond markets. There was a decisive shift between the bonds and the stocks as a means to borrow money. The bond market continued to decline from this point onward due to the large offerings of foreign governments and the general lack of buying interest. Dividends in many cases offered comparable performance during this five year period. Where interest earned failed to meet a bond yield, the market more than compensated for the difference. The margin accounts did not care if call money rose to 10%, for the leveraged position provided healthy dividends which more than covered interest costs on margined accounts.

Therefore, from an analytical perspective, higher interest rates are obviously not a deterrent to the stock market. The conditions under which the market has fallen with rising interest rates have been solely due to the fact that rates rise faster or beyond the yields on stocks. If the yields are higher than the cost of money, rates will rise but they will not deter the market until this imbalance is equalized. As we continue to explore the market performance, we will also begin to notice that interest rates are also affected by international political conditions. Stocks have also risen ignoring earnings and in the face of rising interest rates when foreign political conditions have sparked a flight to the dollar based assets.

The buying continued throughout November and it is best to let Time magazine add the flavour of the moment. November 19, 1928:

'FOOLISH? STUBBORN?"

"Oils, coppers, utilities up 3 to 7 points as the market opens Wednesday, then churn back and forth. Kennecott copper up 12, Curtiss Aero 12.25, Wright Aero 15.5. Turnover 4,894,670 shares...More on Tuesday, 5,037,330 shares, second 'five million' day in history, only a handful less than on record-breaking June 12. Montgomery Ward closes at 366. Net gain; 17 points. Mounting, too, are Wright (6.5 points more, 22 in two days), Coty, Inc. (10.5). Where is the ticker? Over an hour behind (might as well have been a week) on Thursday, 47 minutes the day before, 46 minutes on Friday. Friday Montgomery Ward adds another 18 points, closes at 384. It was 349 on Wednesday morning. What is happening to Radio? Climbing whole points at a time, Radio soars from 234.5 to an incredible 270. Who is pushing it? No one knows?...Thus, the Hoover market. Like its predecessor, the much-loved, much-criticized Coolidge market, it is the joy of bulls, despair of bears. Will it last? Will it break? Foolish bulls or stubborn bears?"

Perhaps it was stubborn bears at this point in the game desperately trying to pick the top and send the market up even further. Oddly enough it was the very professionals being pushed around by the little guy on the street. What a day! And December offered only a small short-lived glimmer of hope for the bears. The market broke, tumbling back nearly 15% yet the industrials hadn't even penetrated the November low. It was an incredibly sharp drop. Largest in history! But did it signal despair and the end of the bulls? Not even a 15% drop could stop this bull from its divine destiny.

December rallied for year-end, and after the industrials fell to 258 and just when the pros thought they had the bull by the horns, or maybe it was the other end, it kicked up a storm and rallied straight up again, charging right through this November high reaching for that ultimate brass ring, which by now was replaced by pure gold, and closed a hair under 300. Indeed, who was the fool?

The railroads fell sharply that cold December but rallied back quite impressively for year end. Nonetheless, the rails failed to exceed the previous month's high, clearly yielding first place to the industrials. The great era of the rails had come to an end and now they were clearly reduced to a second place bet.

The bonds fell straight down from the opening bell that memorable December. They fell dropping below the previous four-month consolidation period and finished desperately clinging to 96, a level which it would see only once during 1929 and then never again for over a year.

In the final glimmer of analysis, 1928 was a year of many lessons and stories. Its complete disregard for fundamentals, its disregard for the so-called well established relationships, is a omen for the future. The words of two very famous men come to mind as we end one of the most impressive years in the history of the market. In 1901 Charles H. Dow stated: "In most bull markets there comes a time when the public controls fluctuations and the efforts of the largest operators are insufficient to check the rising tide." Those words were certainly true 27 years later as they are today. The contrast is perhaps Andrew Mellon who once said in 1926: "Gentlemen prefer bonds."