Practical Investing

BY

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PREFACE

THIS is a book for the man who has or may have money to invest, and who wants to learn how to invest it to the best possible advantage. While necessarily including a certain amount of discussion of abstract investment principles, the book is, in the main, a practical discussion of securities and of the things that influence the price and value of securities. To describe stocks and bonds as they *are*—as the man who goes into the market to invest money will find them—that, rather than theoretical discussion of the science of investment has been, throughout, the author's aim.

To his many associates in the investment business who have assisted him in the preparation of this work, as well as to Messrs. Harper & Bros. through whose courtesy some of the material contained in the book has been used, the author wishes to extend his thanks.

FRANKLIN ESCHER.

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CHAPTER I

INTRODUCTORY: WHAT EVERY INVESTOR OUGHT TO KNOW

IN the choice of an investment as in the choice of a house or a suit of clothes or an automobile or anything else, the primary consideration is suitability. A six-cylinder touring car that can make a hundred miles an hour and climb up the side of a house is all very well, but far less suited to the needs, for instance, of a country doctor, than is a little runabout costing perhaps one-fifth as much. Just so, in investment, different securities suit different requirements—what for one man would be an ideal investment might be totally unsuited to another's needs. What are my particular requirements?—that, in the investment of any sum of money, is the very first thing to be considered. Only after it *has* been considered can intelligent selection be made.

What his particular requirements are, each investor must settle for himself. Is he well along in years, dependent on the income from his investments? — in that case, absolute safety of principal is the primary consideration. Is he, on the other hand, engaged in some profitable business which yields him considerably more income than he needs?—in that case he can afford to take more of a chance. Is the investment being made for his own account or is he acting as a trustee?—obviously these are consderations to which due weight must be given. Individual circumstances must govern, and what these individual circumstances are, no one can tell better than the investor himself. Determining one's investment requirements is not a matter of finance at all, but of plain, everyday common sense. Filling them satisfactorily is what calls for a knowledge of the principles of scientific investment.

An art, indeed, is the proper investment of money in securities. There is nothing hit or miss about it. The country doctor can cover his rounds in a big, high-powered touring car that costs him two or three times what it ought to to run, and the successful business man can invest his surplus in three per cent. government bonds at par, but in both cases there is a really shocking degree of waste. Scientific management in investment, like scientific management in anything else, aims to eliminate waste. What are my needs and what is the maximum amount of income I can get out of securities filling those needs?—that is the problem with which everyone having surplus funds is faced and which only a knowledge of the principles of scientific investment can solve.

A big subject is investment and yet one of which a working understanding is not difficult to acquire. Knowledge of the different kinds of securities and their main attributes—that is, of course, the very first thing. After that, appreciation of the main investment principles—of the desirability, for example, of diversifying an investment, and of the relative importance of such qualities as marketability, price stability and chance of appreciation in value. Thirdly, at least a general idea of what makes security prices go up and down—of the bearing, on bonds and shares, of business and money-market conditions and the other main influencing factors. Informed along these three lines, and using a reasonable amount of common sense, the man or woman with money to invest is not going far wrong.

Investment Counsel

Great is the value of investment counsel, but only in proportion as the investor knows enough to seek such counsel as fits his particular case. A man desiring to purchase an automobile, but not knowing one kind from another, would, in all probability, were he to step in at the first great showroom upon which he chanced, acquire the kind of car sold there whether or not it were particularly suited to his needs. Exactly so with the investor having no clear idea of his needs or how to fill them. If he went to a banker making a specialty of steam railroad bonds the chances are that he would buy that kind of a security. A house specializing in public utilities would easily convince him that bonds of *that* type were the only thing to buy. What he would get, in other words, as the result of a random visit to some investment banker, would be not so much what he needed as what the banker happened to want to sell him.

Informed as to the various types of securities and with something of an idea of what ones fit his particular requirements, the investor is in an entirely different position. Wanting to make a selection of steam railway shares and bonds, he does not blunder into a house handling only public utilities. The advice he gets is along the line he wants. His requirements call for steam railroad securities, in which class of security the banker who is advising him is a specialist and thoroughly in touch with market conditions. For the prospective investor to know exactly what he wants may not be necessary, but what he *does* need to know is to whom to go for advice. As much better will be the results as if, having a toothache, he should go to a dentist instead of an ear specialist.

With regard to knowledge of the conditions affecting security values, very much the same thing is true. Is this a time to buy bonds?—ask that question of a bond dealer at any time or under any conditions and note how many times you get anything but an affirmative reply. What is the answer? Don't go for advice as to whether it is time to buy a thing to the man who has that thing to sell. Figure it out yourself; it is far less difficult than it seems. Not the fluctuations of the stock market—that is something neither you nor any banker or broker or anyone else to whom you appeal can know anything about—but the great, broad movement of security prices. Right now, are prices high or low? A working knowledge of the factors that govern values supplemented by an ordinary amount of business sense makes it possible to answer that question and answer it correctly.

Financial Information

Twenty years ago it was impossible for the average investor to tell anything about security values—the necessary information was simply not to be had. Individual companies made reports then as they do now, but not with anything like the same degree of honesty or fullness. Tabulation of the figures, moreover, on anything like the present scale or in the present scientific way, was unknown, except for private purposes. Pick up any financial paper today and you expect to find in it a most complete tabulation of statistics as to earnings, metal production, bank condition and the other things that go to make up the business barometer. All that is a development of the past few years. Two decades ago, one decade ago, the figures were simply not to be had. Such of them as were compiled were kept strictly for the compilers' own use.

Where the investor only a comparatively few years ago had little to go by, today he has everything. From a hundred different sources there is available the very fullest possible information not only as to the affairs of individual propertes, but as to all the great tendencies in finance and trade. Obtainable at trifling cost, this information puts the man who knows how to use it in a position to judge. For him to grope, to rely blindly on the opinion of others, is no longer necessary. You have some money to invest, and are wondering whether this is the time to buy?

Very well, here is the whole story; here are all the figures reflective of those conditions which make prices go up and down. No need to guess, to take a chance. Here's the whole thing, in black and white. It's *your* money that's going to be invested. Take the figures and settle to *your* satisfaction the question as to whether it is a time to buy or a time to hold off.

Investing for Profit

Do conservative people who understand the principles of scientific investment aim to increase their principal as well as to obtain a full rate of income? They certainly do, and, in accomplishing their purpose they are, moreover, about ten times as successful as those who use their money for speculation instead of for investment. No sudden fortunes, except in cases where some commitment happens to turn out particularly well, but a gradual appreciation in the value of the security purchased—that is the natural course of scientific investment. Increase in price, slow, perhaps, but like the grinding of the mills of the gods, exceeding sure—that is what, in the case of money invested with understanding of how money ought to be invested, may reasonably be expected.

There are cases, of course—the investment of trust funds is a notable example—where absolute safety of principal is of such paramount importance that the investment is necessarily limited to securities almost non-fluctuating, but even here there is a chance through the exercise of wise judgment to make something on the principal. Take the case of a fund of money which is to be invested in gilt-edged, first mortgage railroad bonds. Even in this class of security there is room for discriminating judgment. One bond, purchased now, in five years will be exactly where it is today. Another, just as safe to buy, may be selling three or four points higher. That is not much money to make in five years, but it does add materially to the amount of income received during that time.

But, it is objected, if there is a chance for a security to increase in value, is there not the same chance for it to go down? Not necessarily. Some active stock bought midway between its high and low of recent years on a legitimate prospect of price appreciation may, of course, go the wrong way—in such a case there is bound to be a certain amount of risk. But take the case of some absolutely good bond which happens to be down in price because, perhaps, the syndicate bringing it out has just been dissolved, or because, being new, not much of a market for it has yet been established. By competent judges of values securities like that are being all the time bought with the practical certainty that in the long run they will appreciate in price. Good judgment in the beginning and then patience—time will do the rest.

CHAPTER II

THE VARIOUS TYPES OF BONDS

THERE are many different ways in which bonds can be classified—according to the nature of the issuing company, for example, or according to the security—but to the author it has seemed best to adopt a classification which puts before the reader at a glance *all* the different kinds of bonds there are. Less scientific, perhaps, than some of the other classifications, this one seems best to fulfill the purpose of putting before the man who knows his needs and is looking for the right security to fill them, a complete list of the bonds from which he can choose.

First Mortgage Bonds, as their name implies, are secured by a first lien on all or part of a property. A railroad, for example, has built an extension costing several million dollars, and wants to reimburse itself by issuing bonds secured on the property. The first thing it does is to execute a mortgage on the new line, of which mortgage some trust company or other strong institution is made the trustee. Against this mortgage, and secured by it, the bonds are issued. Each bond, therefore, is nothing but a

CLASSIFICATION OF BONDS

I. Transportation	Steam Railway Electric Interurban	First mortgage. General and consolidated mortgage. Other mortgage. Debenture. Receivers' certificates. Collateral trust. Equipment obligations. Short-term notes. Guaranteed bonds.
II. Public Utility	Street Railway Gas and Electric Water	First mortgage. General and consolidated mortgage. Other mortgage. Collateral trust. Debenture.
III. Civil	Government State County City Township Precinct	
IV. Industrial and Miscellaneous	Manufacturing Real Estate Timber Mining Irrigation Power	First mortgage. Other mortgage. Collateral trust. Guaranteed bonds. Debenture.

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fractional part of the mortgage itself. If the company becomes insolvent and cannot pay the interest on the bonds, the trustee of the mort-

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gage simply sells the property and turns over to the bond-holders enough of the proceeds to satisfy their claims.

Careful distinction must be made between the terms "first mortgage" and "prior lien." A real first mortgage bond has nothing ahead of it—that is to say, if the company fails and is sold under foreclosure, the claims of the holders of these bonds take precedence over all other claims. A "prior lien" bond, on the other hand, may simply have priority over the claim of some other issue and may rank far down on the list. The Erie Consolidated Prior Lien 4s, for instance, are a sixth mortgage on the line.

General Mortgage Bonds and Consolidated Mortgage Bonds are issues secured on properties as a whole and subject to whatever prior liens may exist. Some big railway system, we will say, is made up of half a dozen or more smaller roads, each of which has bonds of its own outstanding. A time comes when more money is wanted, and an issue of "general" or "consolidated" mortgage bonds is determined upon. The first step will be the execution of a general mortgage on all the properties, which mortgage will then be trusteed. Should trouble later develop and the company be unable to pay its interest, it is to the trustee, in whose favor the general mortgage is made, that the bondholders must look for reparation.

The claim of the general mortgage, needless to say, comes after that of whatever mortgages may exist on the various properties. What determines the value of a general mortgage bond is, therefore, to a very large extent, the amount of these "underlying" issues. If the separate properties have already been heavily mortgaged individually, it is obvious that to issue a general mortgage bond on them collectively is to issue something that has mighty little value from a mortgage standpoint. If, on the other hand, the individual properties have been previously bonded to only a small extent, a general mortgage may be very nearly as good as a first mortgage.

General, Consolidated and Unifying Mortgage Bonds—the terms are practically synonymous—make up an important part of the railway bond list. Of late years, particularly, there has been a tendency to issue this kind of security. Some of them are very good, some of them very bad. In the case of the general bonds put out by several of our biggest railroads the prior liens are so small in amount as to be practically negligible and the "generals" are, to all intents and purposes, "firsts." In the case of other roads, properties already mortgaged to the hilt have been brought together and a general or blanket mortgage slapped on them which, in case of foreclosure, would not be worth the paper it is printed on. The fact that a bond bears the name of "General," "Consolidated" or "Unifying" does not mean that it is either good or bad. Each issue has got to be judged on its own individual merits.

Other Mortgage Bonds. Second, third and fourth mortgage bonds, at least under those names, are not issued much these days. By the investor, the issuing companies have found, bonds carrying some other name are better received. One road, we have seen, has outstanding a "Consolidated Lien" bond which is in reality a sixth mortgage. Under that name there would probably have been considerable difficulty selling it. And so it is with many of the new issues being put out under all sorts of imposing titles—they *are* second, third and even fourth mortgages even though they may be called "refunding," "first and refunding," "consolidated and refunding" or anything else.

Astonishing, indeed, is the number of titles under which mortgage bonds have come to be issued and sold during the past few years. Sometimes there will be but a single name, expressive not of the security behind the bond, but of the purpose for which it is issued. The term "Refunding" is a case in point. Sometimes there will be two names, expressive of the dual character of the bonds—as, for instance, "First and General," which indicates that the bond is a first mortgage on some part of the property and a general mortgage (subject to existing liens) on the rest of it. Again, the term "first" may be introduced into the name of a bond merely to show that it is the first issue of the kind the company has ever put out.

In the purchase of a bond not much weight should be given to the name under which the bond goes. Many a bond that can rightly be called a first mortgage is less desirable from every standpoint than some other bond which is only a second or third mortgage. Bonds, too, which have a double character—as, for instance, "First and Refunding" issues—must be carefully studied on their individual merits. Take the case of the Missouri Pacific First and Refunding fives. From their name it might be thought that the first mortgage element in these bonds was important whereas they are a first mortgage on only 165 miles of line out of 4000.

One is tempted to inquire, indeed, whether a little bit of unencumbered property is not sometimes included in the security behind some of these new bonds merely to make it legally possible to call them "First and" this or that.

Debenture Bonds, as the term is used in the United States, are bonds which are unsecured, by mortgage or otherwise. They are, in other words, pure and simple promissory notes running for a term of years.

The sole measure of value of a debenture bond is, thus, the standing of the issuing company and the amount of its assets. Put out by one company, a debenture bond may be a very excellent security indeed. Put out by another, it may have little if any investment value. Everything, as in the case of any other unsecured promissory note, depends upon the character and responsibility of the obligor.

It may seem at first thought as though the purchase of an unsecured bond were an unnecessary risk to take when there are so many secured obligations to be had, but the truth of the matter is that the unsecured bond of a really first-class corporation is a better investment proposition than the secured bond of a corporation about which there is a question. In the latter case the purchaser is "secured," nominally at least, if trouble comes. In the former case there is no trouble to be reckoned with. Take the case of a big railroad with an unbroken dividend record running back over a long series of years. What risk is there in buying the debenture bonds of such a company? Certainly much less than in buying anything but the first mortgage obligations of a company whose standing is not absolutely secure. To be protected in case of trouble is all very well. Not to have any trouble is even better. An ounce of prevention, in investment as in anything else, is worth a ton of cure.

Of one thing, however, the purchaser of debenture bonds should make sure, and that is that there is a provision forbidding the putting of any mortgage indebtedness ahead of the debenture issue. In the case of most of the prominent debenture issues such a provision exists. Prominent examples are to be found in the case of the debentures put out by the New York, New Haven & Hartford and the Chicago, Milwaukee & St. Paul. In both cases the obligor has agreed to create no further mortgage indebtedness without the debenture issues being equally and ratably secured thereunder.

Receivers' Certificates, of all debenture bonds, by whomsoever issued, are far and away the safest form of security. A corporation goes into bankruptcy and a receiver is appointed. Needing ready money to carry on the business, the receiver gets permission from the Courts to sell bonds of the form known as Receivers' Certificates. These bonds, while absolutely unsecured, come ahead of all other funded obligations, even any first mortgage bonds the corporation may have outstanding. If the receivership does not see the certificates paid off, they are assumed by the corporation after reorganization.

Because of the auspices under which they are issued and the certainty that both principal and interest will be paid, receivers' certificates rank with the best of first mortgage bonds and sell on about the same income basis. From an investment standpoint their principal drawback is that they are usually issued to run for only a comparatively short term.

Collateral Trust Bonds are bonds secured by the deposit, with a trustee, of stocks or bonds or other paper. There are several reasons for their issue. One company, for instance, may buy up the stock of another, and, in order to raise the necessary money, sell its own bonds secured by deposit of the stock which has been bought. That is what brought into existence the Atlantic Coast Line Collateral Trust Fours, the security behind which is the Louisville & Nashville stock owned by Atlantic Coast Line. Or, it may be that a company holding the stock of some other company and wanting to raise money by the issue and sale of the controlled company's bonds, may decide to sell its own bonds instead, putting the controlled company's bonds behind them as collateral. Such an operation, it is plain, might easily take place in the case of a big company holding the stocks of a number of smaller ones. The direct obligations of the smaller companies, in all probability, could not be disposed of as advantageously as the direct obligations of the big company, secured by the deposit of the bonds of the smaller companies. There is also the advantage of uniformity and marketability—one big issue put out by a big company instead of a lot of little issues put out by subsidiary companies unknown, perhaps, to the investment public.

What counts, therefore, in determining the investment value of a collateral trust bond, is principally the value of the collateral back of it. If the collateral is "good," and continues to pay interest into the treasury of the parent company, the parent company can go on paying the interest on the bonds it has itself put out. But if there turns out to be anything wrong with the collateral and the parent company doesn't regularly receive its interest, very possibly it will itself be compelled to default. That is, of course, the great danger with any collateral trust bond, however strong the issuing company may be.

As, in case of such default, the holders of the collateral trust bonds are supposed to be able to take over the collateral, it is most important that the trust agreement should be so drawn as to afford full protection. Instances have not been wanting where, after default, the holders of collateral trust bonds have had the greatest difficulty asserting their rights. Before buying a collateral trust bond of any sort the investor should make sure that the trust agreement is so drawn that in the event of trouble and default he and his fellow bondholders can enter into immediate control of the securities put up as collateral.

Equipment Obligations, as their name implies, are securities issued to enable a corporation to buy equipment (in the case of a railroad, usually cars and locomotives) and are of two kinds —car trust certificates and equipment bonds. They conform in general to one of two standard forms, what is known as the "conditional sale" plan and what is known as the "Philadelphia plan." In the case of bonds issued under the "conditional sale" plan the railroad pays ten or fifteen per cent. of the value of the cars purchased to a trustee (usually a trust company) in which trustee the title to all the equipment remains until the railroad has paid off the whole issue of bonds. In the case of bonds issued under the "Philadelphia plan," the equipment is purchased on behalf of the railroad by some Equipment Association which leases the cars to the railroad at a rental sufficient to pay interest on the bonds and provide for their maturity. This lease is then assigned to a trust company, as trustee, which issues the bonds, and takes care of interest and sinking fund requirements out of the rental it receives from the railroad.

Whether issued under one or the other of these two plans, equipment obligations are an exceedingly high class of security. In neither case, it is to be noted, does title rest in the railroad until all the bonds have been paid off. Both car trust certificates and straight equipment bonds, in other words, are on an entirely different footing from a railroad's other obligation, even its first mortgage bonds. If a road goes into the hands of a receiver and the receiver defaults the interest on its "equipments," the holders of these bonds (or, rather, the trustee acting for them) can take immediate possession of the cars and locomotives and sell them or lease them to some other railroad. Possession of this power usually makes its exercise unnecessary. Very well does the receiver know that he cannot operate the railroad without cars and locomotives, and very well does he know that if he doesn't manage to pay interest on the road's equipment obligations, the cars and locomotives will be taken away from him by their owners. For that reason if it is a toss-up between paying interest on the road's first mortgage bonds and on its equipment bonds or car-trusts, the receiver will pay it on the latter every time. By the courts, both State and Federal, indeed, the charges for principal and interest on a bankrupt corporation's equipment obligations have been placed on an equality with charges for wages, materials and other operating expenses.

Short-Term Notes are simply bonds running for a short term of years. Concerning the exact point at which a note ceases to be a note and becomes a bond there is a good deal of difference of opinion, but as the expression is used in the investment markets, a "note" is a bond whose life is not over five years. Two or three years is the usual term.

Because of the limited period for which they run, short-term notes, unsecured by any sort of collateral or mortgage, can be sold by many corporations which would find trouble disposing of their long-term obligations on similar terms. A good many short-term notes are, however, secured by the deposit of stocks and bonds, making them out-and-out "collateral trust" issues. Very rarely are securities of this kind given a mortgage feature.

Short-term notes usually come into existence by reason of the fact that the corporation needs money and is unable to raise it on favorable terms by the sale of regular bonds. Some railroad, we will say, on sounding the market for capital, finds that in order to float an issue of thirty-year or fifty-year bonds it will have to pay six per cent. for the money. Rather than tie itself up to so high a rate for such a long term of years, the road will very probably decide to issue a three-year note. On these notes the interest charge (including the banker's commission) may very likely work out at as high as seven per cent., but this high rate will extend over only three years. By the time the notes come due, the company figures, bond market conditions are likely to be better, allowing of the sale of long-term bonds on a more favorable basis. By temporarily satisfying its need for money through the issue of notes, the company will thus have avoided tying itself up to the payment of a high rate of interest over a long term of years.

By the prospective investor in short-term notes the cause of their existence should be borne in mind. The reason the notes are offered him is because the borrower believes that the market for long-term bonds is lower than it will be two or three years from now. The man who has money to invest and who uses it to buy notes is, therefore, playing directly into the borrower's hands. If the market for long-term bonds is really so low, then this certainly is the investor's opportunity. For him to buy short-term bonds is simply to put himself in a position where, a couple of years from now, he will be faced with the problem of re-investing under much less favorable conditions.

For the bank and the business house seeking temporary employment for funds the short-term note is an ideal form of investment, but for the needs of the ordinary individual it is seldom suitable. What the man who buys short-term notes is doing is, in effect, to bet that the corporation issuing them is wrong in its estimate and that two or three years further along it will be possible to invest in long-term bonds on even more advantageous terms. Few conservative people, provided they realize what they are doing, are willing to make such a wager as that.

Guaranteed Bonds come into existence, generally, as the result of the absorption of one property by another, in cases where the identity of the absorbed company is not lost. The United States Steel Corporation, for example, took over at the time it was formed a number of independent companies, many of them having outstanding first mortgage bonds of their own. These companies are in existence just the same as they ever were and under the same names. The bonds have not been "assumed" by the parent company and remain the direct obligation of the company originally issuing them. They have, however, been guaranteed by the United States Steel Corporation. The latter, in other words, has agreed that if there is any trouble about payment of principal or interest, it will itself be responsible.

It might at first thought seem as though the guaranty of an industrial company like United States Steel or of a railroad like New Haven would make any kind of a bond, however, poor in itself absolutely safe; but the history of guaranteed securities suggests that in the purchase of securities of this class the greatest caution should be employed. To pay no attention to the security behind a bond and to buy it purely on the strength of a guarantee by some other corporation is a very great mistake. The two concerns it must be remembered, are engaged in the same line of business and conditions unfavorably affecting the one will unfavorably affect the other also. Let conditions sufficiently bad to get the subsidiary company into trouble develop, and the chances are that the parent company will find itself in trouble, too.

The majority of guarantees, moreover, are nothing but contracts, and, so, not enforceable against an insolvent maker if the receiver chooses to disaffirm them. A subsidiary company, on whose guaranteed bonds the interest is due in January, fails, we will say in August, and shortly after that the guarantor company fails also. The interest not being due for several months, no actual default takes place. Until January, so far as the guarantor corporation is concerned, the guarantee is simply a contract. And as what happens to a company's contracts when a receiver takes charge nothing need be said.

Even if the contract is affirmed, it must be borne in mind, it ranks last of the guarantor company's obligations. Take, for example, the securities guaranteed by the New Haven. In case of receivership the claim of the holders of these bonds would not be considered until even the debentures of the parent company had been paid off. The owners of the debentures would be preferred creditors. The owners of the guaranteed bonds would be general creditors and would only share equally with others having claims against the property.

The foregoing is not said in disparagement of guaranteed bonds, but simply to draw attention to the way in which the importance of a guarantee can be overestimated. What is of the utmost importance to see to is that the guarantee is so drawn that it is immediately enforceable—that is to say, that as soon as there is any trouble with the subsidiary company the guarantor can be made to step in and pay both interest and principal. That kind of a guarantee is worth having. Any other kind isn't—or, at least, isn't worth paying anything much for.

CHAPTER III

STOCKS—AS THEY ARE

THE classification of stocks, as will be seen by a glance at the accompanying table, is an entirely different proposition from the classification of bonds. What are the different kinds of stocks available for investment?—answer to that cannot, as in the case of bonds, be by reference to underlying security or conditions attending issue. The best classification, indeed, has seemed to the author the rather free-and-easy one herewith presented. From a strictly academic standpoint, perhaps, such a classification might not hold water, but as a complete list of the shares available to the man who has money to invest (which is what it aims to be) it seems to fill the bill. Take any stock in which you happen to be interested and you will have no trouble in finding it its place on the list.

Dividend-Paying Railroad Preferred Shares in American railroads rank among the very best investments there are—so highly esteemed are they, indeed, that they sell at a price to yield the buyer a lower rate of income than many high-

CLASSIFICATION OF STOCKS

Railroad	Dividend-paying preferred shares.
	Dividend-paying common shares.
	Dividend-paying shares having important equities.
	Guaranteed shares.
	Uncertain dividend-payers.
	Non-dividend-paying preferred shares.
	Non-dividend-paying common shares.
Industrial and Miscellaneous	Seasoned dividend-paying preferred shares.
	Seasoned dividend-paying common shares.
	Newly created preferred and common shares.
	Uncertain dividend-payers.
	Non-dividend-paying preferred and common shares.
	Dividend-paying shares having important equities.
	Shares in "Prospects."
Public Utility	Seasoned dividend-payers.
	Dividend-paying shares in newly created companies.
	Non-dividend-payers.

grade bonds. Take, for example, a preferred issue like that of the Union Pacific or the Northwest or the Atchison, followed by a large amount of common stock having a long and unbroken dividend-record. What safer security could be desired? A protracted period of hard times, it is true, might conceivably affect the dividend on the common; but when it is considered that in most cases preferred dividends have been uninterruptedly earned a number of times over for a long series of years, it will be apparent how secure these preferred dividends are. Very materially could the earning power of most American railroads be reduced without the dividends on their preferred shares being in the least endangered.

So safe, indeed, are most stocks in this class regarded, that, like good bonds, their price is principally regulated by the rise and fall in interest rates. Interest rates being high, shares of this kind decline to a point where they give a full yield to the buyer. A low money market, on the other hand, is apt to see them selling at prices where the return they yield is comparatively small.

Of the *Dividend-Paying Railroad Common Stocks* it is necessary to say little more in this place than that they constitute the largest and most important class of share investment—and also the most misused. Highly suitable, in spite of their fluctuation, for certain kinds of investment, they are the last thing in the world that a great many people ought to buy. More money, probably, has been made and lost in railroad common stocks of the dividend-paying class than in any other kind of security. Subject as they are to a great variety of influences, the price-range of these securities, even of the most stable ones, is very great. Pennsylvania, for example, which is regarded as one of the very best and steadiest of the railroad dividend-payers, has fluctuated in price, during the past ten years, all the way from 170 down to about par. New York Central's fluctuations have been through about the same range.

Railroad Stocks having important equities, as, for instance, Canadian Pacific in the lands owned by the company, and Reading in the company's great holdings of coal, almost invariably fluctuate over a wide range. The shares having an intrinsic value greater than that given them by the dividends they are able to pay, and there being always the chance of an extra distribution "out of assets," high prices are apt to be registered whenever the cutting of a melon seems really imminent. For this reason stocks of this class, except on those rare occasions when they happen to be selling down somewhere near where they would be entitled to sell on a straight investment basis, are exceedingly risky to buy.

Guaranteed Railroad Stocks, like guaranteed bonds, depend for their value largely upon the strength of the guarantor. The guarantee of a dividend by a company which itself has an unbroken record is, it is plain, about as great assurance as could be desired that the dividend will continue to be paid. By nothing short of the insolvency of the guarantor company can it be threatened.

Stocks whose dividends are thus guaranteed by strong companies enjoy the very highest standing as investments—rank, indeed, with high class bonds. To such an extent is this true that the best guaranteed stocks, like bonds are frequently quoted "on a basis." A stock on which, say, eight per cent. has been guaranteed by some big system, is apt to be quoted not at 160 or 150, but on a five per cent. or 5.33 per cent. "basis."

Among the *Uncertain Dividend-Payers (Railroad)* there must be included those many common and preferred issues which are paying a dividend now but whose broken dividend-record suggests that the next period of falling earnings will see the disbursement lowered or discontinued altogether. Needless to say, shares of this class are at all times a risky purchase and should never be touched except by those in a position to form an intelligent judgment as to conditions, as well as to take a risk with their money. Indiscriminate purchase of securities of this kind is almost a sure losing proposition. Actual knowledge of conditions, on the other hand, combined with sound investment sense, frequently results in the purchase of these "uncertain" dividend-payers at prices far below their intrinsic value.

Non-Dividend-Paying Railway Preferred and Common Stocks, like the class last spoken of, are suitable for the investment of the funds only of those really in a position to judge values. Have I really any definite and dependable knowledge as to what this stock is worth?—that is a question which everyone is bound to ask himself before he buys "securities" of this kind. Even then, purchases are best restricted to the preferred issues, which, for one reason or another, may not be paying dividends but which seem normally to belong in the dividend-paying class. There *are* instances to be found, it is true, of railroad stocks which have knocked around in the twenties and thirties for years eventually asserting their investment value and becoming dividend-payers of class. But they are few and far between. For every such instance there are to be found a dozen others where particular low-priced stocks, "touted" for years as being future dividend-payers, have sunk lower and lower, both in value and price. In ninety-nine cases out of a hundred the purchase of stocks of this sort, even where the full amount of the purchase price is paid down, is not investment at all, but the rankest kind of speculation.

The Seasoned Dividend-Paying Industrial Preferred Shares constitute a class of securities which offer the buyer a high income at a minimum of risk. Origin of most of these stocks dates back twelve or fifteen years to the time when the big industrial combinations were being formed. Whatever may be said about the common stocks created at that time being "water," the preferred shares, it cannot be denied, have in most cases given an excellent account of themselves. Glance back over the list of the preferred issues of this sort brought out during the five-year period following 1898, and it will be seen how few of them have failed to maintain a record of dividends unbroken, and, in the majority of cases, earned by a considerable margin.

These seasoned industrial preferred stocks, it can be said without hesitation, constitute a most attractive form of investment. We have never, it is true, had a long period of commercial depression since they have been in existence, but from the way in which they acquitted themselves in 1903 and again in 1907 and 1908, it is plain that in most cases their earning power is such that dividends can be regarded as certain, whatever industrial conditions may develop. Many of these stocks have not failed once, during the past five or six years, to earn their dividends at least twice over.

The Seasoned Dividend-Paying Industrial Common Stocks, too, while they cannot pretend to the standing of the preferred issues, are, in the majority of cases, securities of a good deal of investment merit. Times change, of course, and industrial conditions undergo readjustment, but where a stock over a series of years has always been able to earn its dividend by a fair margin there is good reason to believe that it will be able to continue doing so.

It is true, nevertheless, that even stocks like General Electric and Pullman fluctuate largely in price and so are suitable for the investment of the funds only of those in a position not to mind a fall in the market value of their holdings. For the investment of the business man's surplus the shares in this class are all very well, but where there exists a possibility that the money may at any time be needed they should never be bought. Along with the chance of appreciation in principal there is too much chance that when the need for liquidating the investment arises, the shares may happen to be selling below the price at which they were originally bought.

The Newly Created Industrial Shares—that is to say, the many issues put on the market in 1911 and 1912—offer some attractive opportunities, but should be bought only with the greatest caution. In the case of these securities it is impossible to apply that most important of all tests—What has been this stock's dividend-record? That makes it hard satisfactorily to judge the value of these new shares. By the banking house issuing them, a statement of earnings covering the past year or two is likely to be given out, but such a statement cannot take the place of a record of earnings actually achieved and of dividends paid.

In the purchase of securities of this class, indeed, the main thing the buyer has to go by is the standing of the banking house which brings out the issue. Presumably, before it agrees to distribute the shares, the banking house has made a thorough investigation and satisfied itself as to the soundness of the proposition. But even at that there is always the chance that the banker himself may not be able to get at the true state of affairs. It is of great importance, therefore, that the bankers bringing out the new stock be not only honest but capable. In only too many cases has it happened that the bankers themselves have been deceived, with the result that they as well as their clients have suffered. Experience, and a record of other issues successfully floated, is the greatest safeguard.

Many of the new preferred shares, hedged about as they are with all sorts of protecting provisions, offer a chance to invest money at a high rate with no more than a legitimate amount of risk, but of few of the new common stocks can that be said. There are exceptions, but in the great majority of cases these new common shares represent nothing but "good-will"—and that appraised at very high figures. Out of some of these common stocks the water will in the long run be squeezed, but at present the purchase of pretty much any of them is a risky proposition.

The Uncertain Industrial Dividend-Payers —stocks which a year or two ago may have been paying nothing and today be earning their dividends by but a scant margin—lend themselves much more to speculation than investment, and yet, intelligently bought, have a certain investment value. Definite and dependable information as to conditions in the industry—having that, many a man has made money out of the purchase of stocks of this sort and at no very great risk to himself. One of these stocks, we will say, has passed its dividend and is selling at a very low price. Conditions in that particular line, it is learned, are on the mend, and all indications are that within a few months or a year the company will be earning enough to warrant the putting of its shares back on a dividend basis. To make a purchase of these stocks under such circumstances is legitimate investment enough. What differentiates it from speculation is that in this case the buyer is supposed to have *definite first-hand* knowledge of conditions, not only as they actually are but as they are likely to shape themselves.

Non-Dividend-Paying Industrials. What is said in the paragraph immediately preceding applies to some extent to the *preferred* issues in this class, but of the non-dividend-paying *common* shares it can be said without hesitation that in only the fewest cases is their purchase anything but a rank speculation.

Here and there one of these "cats and dogs," as they call them in Wall Street, develops appreciable earning power, but in the great majority of cases stocks of this class do not represent even the capitalization of "good-will," being "water," pure and simple. To those who want to control the company stocks of this sort have a value because of the voting power they carry, but to the outside investor they are practically worthless. To buy them is simply to tie up money unproductively in anticipation of something which it is foreordained shall not happen.

Industrial Stocks having important equities are a very different sort of a proposition—constitute, in fact, a class all by themselves. Take, for instance, the subsidiary stocks of the old Standard Oil Company or of American Tobacco. Obtainable at relatively low prices immediately after the dissolution of the Oil and Tobacco Companies for the simple reason that the investment public had not the faintest idea of their equity value, these shares proved immensely profitable to those who bought them. As dividend-payers none of these shares were worth what they were selling for even before the big rise began. It was simply that the insiders knew that each share carried with it an equity in undistributed assets of immense value that made them willing to buy all the stock offered and at fast rising prices.

For the outsider, however, to buy stocks for the equity they may have in undistributed assets, is usually a risky proposition. To create the impression that a company which is doing well has assets not generally appreciated is comparatively easy—a few judiciously placed remarks by those "in the know" will often do the business. The investor who is paying an "equity price" for a stock, therefore, wants to be very sure of his ground. He wants to be very certain, for instance, that he is not buying on the strength of information handed out for the purpose of creating a market on which the insiders can unload.

Of *Shares in Industrial "Prospects"*—mines, for example, not yet on a producing basis—it need only be said that in this kind of security the element of speculation so largely overshadows that of investment as to make it almost negligible. There are occasions, it is true, when the opportunity legitimately to invest money in a non-producing property presents itself, but they are few and far between. In ninety-nine cases out of a hundred if a mine or a manufacturing plant or whatever the proposition happens to be has not yet reached the productive stage, it cannot be classed as an investment at all, however good the prospects may be.

Seasoned Dividend-Paying Public Utility Stocks, whether preferred or common, rank high among investments. Where, over a series of years, the shares have always regularly paid their dividends, they acquire an investment standing, indeed, inferior to that of no other class of stocks. The affairs of corporations of this kind are, to a large degree, public—it is possible for the investor to keep closer track of earnings than in the case of an industrial company or even a steam railway. Conditions affecting the business and the company's earning power are, moreover, being constantly discussed and brought before the public in such a way that if any shareholder does not know what is going on, he has only his own inattention to blame.

Dividend-Paying Shares in newly created utility companies have many of the same characteristics, but, because there is no record of earnings or dividends to fall back upon, should be bought only with considerable caution. Most of these shares have come into existence as the result of the combination of several companies, the earning power of which new units is necessarily uncertain. It must be remembered, too, that the chance of material appreciation in an investment of this sort is limited by the fact that it is quasi-public security and that the State Commission will not stand for more than a certain percentage of earnings. A man who buys an industrial stock, while he may be taking more of a risk, at least knows that if the company does well he will get the benefit in the form of dividends of one sort or other. Not so the investor in public utility stocks. "So much shalt thou earn and no more"

—that is the mandate of the people as expressed through their Commission. To earn more does not mean higher dividends. It means, on the contrary, an order to charge less for the gas or electricity or power or whatever it is that is being sold.

Non-Dividend-Paying Utility Shares, being subject to the same influence, are even less desirable from an investment standpoint. Among the shares of this class there are, without doubt, to be found some which have a good chance of working into a stronger position and of eventually getting on a dividend-basis. But in the great majority of cases there is always present this great drawback, the public's unwillingness to see a utility company make any real money. Interest on its bonds, yes, and perhaps a moderate dividend on the preferred. But as to a dividend for the common, particularly where there is a large amount of common and the newspapers have put the community under the impression that it is all or largely water—that is a hard proposition. Earnings sufficient to warrant such a distribution are only too likely to be used as argument to make the company reduce the price of the service it renders.

In the foregoing chapter the various kinds of bonds were classified and briefly described. If the author has achieved his aim, from this chapter the reader has gained something of an idea as to the various kinds of stocks in which money may be invested. Having before us the most important of the media of security investment, let us now proceed to a discussion of the art of investment itself and of the various influences which operate to make security prices rise and fall.

CHAPTER IV

HOW TO JUDGE THE VALUE OF A BOND

JUDGING the value of a bond is no different from judging the value of a house or a horse or anything else—it is simply a question of knowing the principles which apply. One horse is built for speed, another for dragging heavy loads, yet the same general principles enable the experienced dealer to tell the value of either and almost at a glance. So it is with bonds. There is just as much difference between them as there is between the 1,600-pound dray-horse and the slim racer that can do a mile in two minutes flat, but to all of them the same general principles apply. Know those principles and you can tell pretty well what any given bond is worth.

I

The general character of the corporation issuing the bond, its affiliations and the nature of its business—that is the very first thing to be considered. Is it a railroad?—in that case, what sort of territory does it operate in, is it making money, is it an independent road or part of a big system? Is it a public utility corporation?—then, what sort of a community does it serve, does it sell something people can't get along without, are its franchises all right? And so on, whatever the nature of the business. The business itself—is it stable, established, profitable, free from the danger of ruinous competition? In judging the value of the securities of any company those are the first things to be considered. If they are questions which cannot be answered in the affirmative and, as the saying is, right off the bat, the investigator can stop there and save himself further trouble.

For, after all, if there is anything the matter with a company's business or with the territory in which it operates or with the way in which it is managed, the bonds of that company are not a proper investment, however well-secured they may appear to be. Earnings several times in excess of the interest on the bonds, assets apparently more than sufficient to protect the bondholders—all very well on paper, but not of much account when things begin to go wrong. Better far a bond, apparently less well-secured, in a company in which the elements of future trouble are lacking.

II

Secondly, what of the security behind the bond? In the parlance of the Street, how close to the ground is it? If it is a first mortgage, what is the reasonable value of the property on which it is secured as compared with the total amount of the issue? If it isn't a first mortgage, what bonds come ahead of it and what is a reasonable estimate of the amount that would be left over if the property were sold and the proceeds applied to the paying off of these prior liens? Then, too, how about the amount of bonds junior to the one in question? Even though there are several issues that come ahead of it, if there are several that come after it and are appraised by the investment-knowing public at a good price, obviously the security behind the bond must be sufficient. If it were not, it would have been difficult to float the subsequent issues. Even though good banking-houses had been induced to bring out the bonds, they would quickly have sold down in price.

The amount of bonds ahead of and behind any given particular issue in its relation to the actual value of the property—knowledge of that will go a long way toward determining what the bond in question is actually worth. But, how, it may be asked, am I to ascertain whether the bonded indebtedness is reasonable or not? Principally, in the case of railroad bonds (and most corporations which have a number of different bond issues outstanding *are* railroad corporations) by comparison with the bonded indebtedness of other roads operating in the same territory and under the same circumstances. I am interested, for example, in one of the bonds of the St. Paul System; in that case it will be very well worth my while to look up the bonded indebtedness per mile of line of Northern Pacific, Great Northern and Chicago & Northwestern. To compare with some road like New Haven or Pennsylvania which operate in entirely different sort of country would be useless, but by examination of the per mile indebtedness of similarly located lines a pretty fair idea can be obtained as to whether that of the road in question is reasonable or not.

This fact, in judging the value of a bond, is particularly important—namely that whether the amount of bonds per mile is high or low is purely relative. It doesn't cost nearly as much, for instance, to build a piece of railroad through a flat, sandy country as it does through a mountainous country where there is much filling, excavating and tunnelling to be done. A bonded indebtedness of $35,000 a mile might, in the former case, be low, while, in the latter, particularly if the road owns valuable rights of way and terminal properties, several times $35,000 per mile might be quite admissable.

III

The third great point to consider in judging the value of a bond is the margin by which bond interest has been earned over a series of years. Is the company's stock on a dividend basis, with a good record of dividends earned and paid?—obviously, in that case, the security of the bond interest is greater than if, after fixed charges have been met, there has been little left. Not that a bond cannot be safe unless the stock is paying dividends; that would be too much to say. But, generally speaking, bonds in dividend-paying concerns are more desirable than bonds in non-dividend paying concerns. The actual payment of dividends over a series of years is a tangible and concrete proof of earning powers worth more than any amount of statements as to the ability of the company to earn its bond interest by a fair margin.

Very careful indeed should be the prospective bond buyer, especially where no dividends are being paid, to go over the record of earnings, both net and gross, for at least ten years past. Taking it on a per mile basis, what has been the trend of gross earnings during that time? Is the company drawing business from its competitors, getting its share of the increase in traffic resulting from the natural growth of the territory in which it operates? To the man who is thinking of buying the company's bonds that is a more important question than is generally realized. In a sense he is about to become the company's creditor, not for a day or a year but perhaps for ten years or twenty-five years or even more. What the company's credit is likely to be a number of years from now is, therefore, a consideration of the greatest importance. Obviously, if during the past ten years, earnings have been going the wrong way, the company's credit is not being strengthened. Good as it may still be, continuation of that tendency is, in the long run, bound to make trouble.

Careful study of earnings, gross and net, is not, it is true, generally considered as important in the case of an investment in bonds as in the case of an investment in shares. A large amount of trouble arising out of investment in bad bonds would, however, it is safe to say, be avoided, if the purchasers took the trouble to look into the margin by which the interest on the bonds is being earned. In the case of industrial and public utility securities he is apt to give this point careful consideration, but in the case of railroad bonds he is apt to look only at the security behind the issue, assuming that earnings must be quite large enough to care for interest charges. That, in the case of a number of issues made during the past ten years has led to serious trouble. In only too many instances has it turned out that a far larger amount of bonds were issued than were warranted by the earning power of the company. The mere fact that a big railroad gets hard up and manages to persuade some banking house to take an issue of bonds off its hands at a discount of fifteen or twenty points is no proof that the bonds have any value from an investment standpoint.

To lay down any definite rule as to how much gross or net a road ought to earn per mile is impossible, that, like its capitalization, varying according to location and the nature of the business handled. Here again it is simply a matter of comparison. This road whose bond I am thinking of buying earns so-and-so-much per mile. Is that much or little? Compare it with the per mile earnings of two or three other roads operating in the same territory. That is the way to find out.

IV

The fourth consideration of importance in judging the value of a bond is sponsorship. No more today than two thousand years ago do men gather grapes of thorns or figs of thistles. For the investor to say to himself, such-and-such a house brought out these bonds and that means that they are good and relieves me from the necessity of looking into them is, to say the least, incautious, but far better than to buy a bond through a doubtful house even after the most careful personal examination.

This matter of sponsorship—the responsibility of the issuing house—is one that deserves the prospective buyer's most careful attention. In the case of a great many bonds, of course—old-established issues that have been on the market for years—it does not figure, but in the case of every new issue it does figure and heavily. You are thinking of buying some Union Pacific or Pennsylvania First Fours; in that case it makes mighty little difference through whom you buy them as long as the firm is honest and will execute your order at the best possible market. But where you are thinking of buying some bonds in the A B C Power Company or the X Y Z Gas & Electric Company the case is different. Your banker will hand you a full statement of earnings, without doubt, and furnish you with all the information about the company you want, but all this information, you have got to bear in mind, comes from an interested source. If the banker is all right the information will be all right; if he isn't, you can't tell anything about it. To verify the figures is impossible. You have got to take his word for it.

How important it is, therefore, in buying the bonds of industrial and public utility corporations, to be absolutely sure of your banker, is plainly to be seen. Nor is it enough to be sure that your banker is honest; you want to be sure that he is capable as well. Many an issue, brought out in perfectly good faith by some banking house having more money than experience, has gone wrong for the reason that the bankers themselves were completely deceived as to the true state of things. To "doctor" books and accounts and to misrepresent conditions so that it takes the most expert knowledge to find it out is relatively easy. To know that your banker is an honest man is not enough. Before you touch the bonds you want to feel sure that before *he* touched the bonds he went to the bottom of the situation and in such a way that nothing could possibly have been hidden from him.

In the case of railroad issues, of course, and of other large flotations where the facts are more or less public, the responsibility of the issuing banker is very much less. Some railroad whose credit is not of the best, we will say, needs money, and arranges with a banking house for the sale of a lot of its "refunding" or "general lien" bonds at a low price. The banking house buys the bonds knowing full well that they are not securities of the first-class and, with full understanding of that fact on the part of its customers, passes them along. There is no deception about it. It is a business risk—a good business risk, the issuing house thinks—but it *is* a risk, nevertheless, and is so understood by all the parties to the transaction. Let anyone who isn't prepared to take a business risk with his money keep away from the bonds.

For any investor to figure that because some great banking house of international reputation has brought out an issue of bonds of this kind the bonds must be "all right" is very wrong indeed. Big banking houses, of course, like to keep their skirts clear of things that are going to turn out badly, and, unless they consider the proposition "good," will refuse to bring out the bonds. But by no means, in the case of issues of this sort, do they assume any responsibility.

This is not our private corporation, is their attitude; this is a great railroad, under government regulation, and concerning which you can go and get information first hand just the same as we can. Here are the bonds—*we* consider them a fair risk, but not by a thousand miles do we guarantee them. It is not *our* name that is behind this enterprise. We are simply bankers in the matter, raising money for a corporation that pays us for our services.

V

Fifth, in estimating the value of a bond there must be considered the rate of interest it pays and the degree of marketability it enjoys. Two bonds, we will say, are exactly equal as regards those things by which the value of a bond is judged, but one has a good market and the other has not—that is to say, one can at any time be readily turned into cash at a close price while in order to sell the other quickly it may be necessary to make a concession of a number of points in the price. The former bond will naturally sell far higher than the latter. One is just as safe as the other, but the bond with the quick market is naturally the more desirable. Having that, the investor practically has his cash in hand; any time he wants his money he can get it. In the other case, holding a bond not readily marketable, he is, so to speak, tied up. Should he want his money suddenly it might be that he would have to sell his investment at a big sacrifice in order to get it.

The natural result of that is that a bond quickly convertible into cash has a considerably greater value than an equally good bond not as readily convertible. Very strikingly is this illustrated in the case of the many absolutely excellent first mortgage public utility bonds which sell at a lower price than listed railroad bonds really much inferior so far as security is concerned, but with a more active market. Between many of the four per cent. railroad bonds listed on the New York Stock Exchange and many of the five per cent. first mortgage utility bonds not listed on the Exchange there can be no comparison at all, so far as intrinsic value is concerned. Yet in any number of instances the poorer security, carrying only four per cent., actually sells higher than the better security carrying five per cent.

Very fully, in estimating what is a fair price for a bond, must this question of marketability be taken into consideration. A house brings out a five per cent. bond, perfectly secured, all that a bond should be in fact, but of so small an issue that the market is sure to be limited. How will the bond sell? Fully ten points lower than if it had an active market. Par in the latter case might be a fair price. Ninety, under the circumstances, would be all that could be expected.

Finally, in figuring the value of a bond, the length of time it has to run must be taken into account. Obviously, the bond of a solvent corporation, when the time draws near when it is to be paid at par, is not going to sell very far away from par — above or below. Take the case of two equally good four per cent. bonds, one due next year and the other due in twenty years. The one due in twenty years, bought at ninety and held to maturity, would net the purchaser just four and three-quarters per cent. each year. The one due next year, bought at ninety and paid off at par, would net the buyer fourteen per cent. There could be no such thing, therefore, as these two securities selling at the same price. If ninety (a four-and-three-quarters per cent. basis) were a fair price for the bond still having twenty years to run, ninety-nine and one-quarter (also a four-and-three-quarters per cent. basis) would be a fair price for the bond due next year.

As a bond approaches maturity (when it will be paid off at par) its price, if it is selling at a premium, will tend downward toward par; while, if it is selling at a discount, its price will tend to sell up toward par. Granted that the corporation is solvent and that there is no question that the bond will be paid when it comes due, the chances are that during the last months of its life a bond, even though the security behind it be none too good, will sell on a basis almost as low as the rate for time-money.

CHAPTER V

HOW TO JUDGE THE VALUE OF A STOCK

JUDGING the value of a stock is a very different proposition from judging the value of a bond. A bond is a promise to pay money, a definite obligation due at a certain time, and, in most cases, backed up by security the value of which it is perfectly possible to ascertain. A stock is very different—far less tangible and definite, and, consequently, far more difficult to appraise in value. There is no maturity to a stock, no time when you can depend upon getting money for it, except as you may find someone willing to take it off your hands. It is an equity, pure and simple, a statement that the holder owns such-and-such a proportion of the company's assets. There is no way of getting at those assets unless the business be wound up and the bonds paid off. Then, if there is anything left, it goes to the shareholders.

Difficult as it may seem, the value of a stock can, nevertheless, be figured and with a good deal of definiteness. Whatever its market value, it is possible, by application of the four great principles which govern, to tell pretty closely what a stock is worth.

I

The first of these four principles, as in the case of bonds, is the character of the business. Is it stable and established—railroading, manufacturing, the furnishing of heat and light—or is it a business dependent upon the whim of the public—the production, perhaps, of some patented specialty? In the valuation of a stock that is the very first thing to consider. Shares in companies engaged in new and untried forms of enterprise in many cases turn out to be exceedingly valuable, but, from an investment standpoint, must be valued entirely differently from shares in the established forms of business.

Whatever the nature of the enterprise, the great question is always, What is the chance of this company's not only holding its own but of increasing its business and keeping pace with its competitors? If it is a railroad, how about the territory in which it is located—is it a growing country, able to originate a constantly increasing volume of business, or is it a territory which has already reached the maximum of its development? If it is a manufacturing concern, does it make an article for which there is a constant market; are its production methods up-to-date; is it free from the danger that some similar concern may be established which will put it out of business? All these things, and the many more which they suggest to the perceptive mind, are even more important in figuring the value of a stock than in figuring the value of a bond. The business itself—is it a good, safe, conservative *kind* of enterprise and run by people who know how to run it?

Furthermore, is it a business in which there is room for expansion, greater profits and greater dividends to shareholders? If not, that must be taken into account in judging the value of the shares. Take, for instance, the case of a public service corporation which has already had trouble over the price it charges for gas or electricity and against which there exists a strong feeling in the community which it serves. What is the chance of such a company's being allowed largely to increase its earnings or to raise its dividend? Take the case of a railroad on which, for one reason or another, passenger and freight-rates are high. Small, indeed, in these days of close government supervision, is the chance of such a road's being able appreciably to increase its earnings.

That does not by any means say that no public service or railroad stocks are suitable for investment, but it does strongly suggest the need of caution in buying shares of this kind. Obviously, if the dividend a stock can pay is practically limited to a certain set figure, and if greater earnings simply mean that some public commission will step in and order rates lowered, that stock has not the same intrinsic value as if it were free to earn and pay what it could. To buy such a stock at a low price may be all very well and an excellent way of investing money. But to pay such a price that the income yield, with the dividend at the highest point to which it can go, is small, is to make a very great mistake. Only just so far can these "limited dividend" stocks go up in price, and to buy them at anywhere near that figure is to buy something which can really move in only one direction—down.

II

The second great consideration affecting the value of a stock is the amount of bonds coming ahead of it. However small the stock issue may be, if the amount of bonds outstanding is large, the shares are not a desirable investment. Bonds mean fixed charges and fixed charges have to be met before there can be any question of dividends. A great amount of bonds outstanding means, too, that, in the event of the company's affairs being liquidated, by the time the bonds had been paid off there would be nothing left for the stock.

What is a "great amount of bonds" coming ahead of the stock? The only answer is by comparison with other companies operating in the same territory and under similar conditions. Take the case of the St. Louis & San Francisco which went into receivers' hands in the summer of 1913. Had the shareholders in that property taken the trouble to compare the bonded indebtedness of their road with that of the other roads operating around them, they would have found it to be several times as great. Such a condition is always fraught with danger. The bondholders and not the shareholders, indeed, are, in such cases, the real owners of the property.

Among American railroads there are many having a top-heavy bonded capitalization. The law of many States prohibiting the sale of stock at less than par, financing in only too many cases has had to be done through the sale of bonds at a heavy discount. By their constant need for money many roads have thus been driven to saddle themselves with big issues of bonds, many of them bearing a ruinously high rate of interest and all of them, of course, coming ahead of the stock. Take, for example, the roads which have authorized "blanket mortgage" issues, amounting, in some instances, to several hundred millions of dollars. Not all the bonds are issued at once, of course, and there is always a provision that new bonds under the authorization are only to be issued for value. But even at that the fact remains that the stockholders have got to stand by and see the constant creation of mortgage indebtedness on which interest has got to be paid before there can be anything for *them*. Stocks of that class, unless there exist the strictest provisions as to the purposes for which the bonds authorized can be issued, are hardly desirable from an investment standpoint.

III

The third thing that determines the value of a stock is the record of its earnings. How much has been earned on this stock during each, of say, the past five years?—by the answer to that question the value of any given security can be largely determined. By the amount "earned on a stock" is meant the amount left after the deduction of all running expenses, bond interest, taxes, and, if there is any preferred stock ahead of the issue in question, of the dividends on that. If it is said, for example, that fifteen per cent. was earned on Union Pacific common in 1913, it means that after all charges (including the four per cent. dividend on the preferred) were taken care of, there remained an amount equal to fifteen per cent. of the par value of the total common stock outstanding.

This item "earned on the stock" needs to be very carefully figured. In the case of a railroad, where the Interstate Commerce Commission prescribes exactly how the accounts are to be kept, there is not much chance to go wrong; but in the case of an industrial company, it will be readily seen, the amount shown earned on the stock can be made larger or smaller according as too little or too much is charged off for depreciation. Before the buyer accepts the statement that so-and-so much was earned on the stock last year, he wants to be sure that a sufficient amount was charged off for depreciation of the plant. How can he, a layman, tell what is a sufficient amount? Principally by comparison with what has been charged off in previous years and with what other concerns engaged in the same line of business make a practice of charging off. As a general rule, if an industrial concern has gone along several years without charging off a substantial amount to depreciation, its securities are hardly safe to buy. In many lines of business, allowance has to be made for renewal of the entire plant at least once in every ten years.

What percentage is earned on any stock depends, of course, on the size of the issue—the bigger the slice of bread, the thinner must be spread the butter. A company earns on its common stock, of which there is $10,000,000 outstanding, say, $1,000,000. That is ten per cent. on the stock. Had the total of common stock been $100,000,000 instead of $1,000,000, earnings "on the stock" would have been but one per cent. In the ability to pay dividends, therefore, the amount of the stock issue is principally the determining factor. A road like Lackawanna can pay high dividends because there is so little stock outstanding. A road like Erie, on the other hand, even though it earns a large amount on its common stock, cannot pay anything because the number of shares entitled to share in the distribution is so very great.

There are, of course, new shares of excellent quality being all the time issued and sold, in which case there are no earnings records to go by. In such instances, however, the buyer should be very careful to get statements showing what the company has actually earned during the past five years and should carefully figure out what would have been earned on the stock had it been outstanding during that period. Because a concern has earned so-and-so-much in the past, it is by no means proved that it is going to earn that much in the future. Fundamental conditions remaining unchanged, however, there is no better way of estimating what a company's earnings are going to be than by what they have actually been.

IV

The fourth great criterion of a stock's value is its dividend-record and the kind of a market it enjoys. By many shrewd appraisers of security values, the former consideration is given more weight than almost anything else. Just as actions speak louder than words, so dividends actually paid speak more forcibly for the value of a stock than earnings statements or anything else. Take a stock which during the past ten years, through good times and bad, has been able to maintain its dividend at a fixed rate. That, in itself, while it proves nothing, is a strong presumption that the company can go on paying that amount.

To judge the value of a stock solely by its dividend record would, however, be a very great mistake—there are too many cases like New Haven and Missouri Pacific and Denver & Rio Grande where long, unbroken dividend records have, as far as investors are concerned, had a sad ending. For the investor to say to himself, "Here, this stock has paid six per cent. for the past ten years; it'll pay six for the next ten; I'll let it go at that"—would be foolish, indeed. Important in judging the value of a stock its dividend record certainly is, but a safe thing to go by only when taken in connection with the other measures of value.

In the preceding chapter the importance, as a measure of a bond's value, of the kind of a market it has, was pointed out. The same thing is true of stocks to an even greater degree. A bond, at least, has a definite maturity, and if the holder finds it impossible to sell it at a satisfactory price he can hold it till it comes due and get back his money. In the case of a stock there is no such provision. Having once bought a stock the only way in which you can ever get back your money is by finding someone willing to take it off your hands. The "market" in any stock you buy is, therefore, a consideration of great importance.

It does not follow, by any means, that the only kind of stocks that should be bought for investment are stocks which have a market in which they can be bought and sold at close quotations. It does follow, however, that stocks that have such a market, all other things being equal, are more valuable than stocks that haven't. A man may have put his money into some stock with the idea of holding it as a permanent investment, but the ability, should occasion arise, quickly to realize on his holdings, is worth something even to him. To others it may be worth so much that for one stock having a steady and active market they may be willing to pay as much as thirty or forty points more than for some other stock not one bit better, but having no market in which it can be disposed of.

Again, price fluctuation must be taken into account in judging shares from an investment standpoint. A stock like Reading, for example, or Union Pacific, is all very well for the speculative buyer, but much less well suited to the needs of the genuine investor than are stocks like Pennsylvania or Steel preferred. Some fluctuation is, of course, to be expected in any stock, but shares which habitually swing up and down over a wide range suffer in their investment standing thereby. There is, of course, the chance of catching the stock on the up-swing and thus profiting greatly, but along with that chance there comes inevitably the danger of a big decline in price which is apt to leave the buyer "hung up" with his purchase and unable to get out of it perhaps for years. For investment purposes, stocks whose past records show that they do not move through too wide a range are decidedly preferable.

CHAPTER VI

THE CARDINAL VIRTUES OF THE IDEAL INVESTMENT

IN investment, as in human-kind, the ideal is difficult of attainment. The man highly developed in one direction is apt to lack development in another. If he can run a hundred yards in ten flat or make the round of any standard golf course in the seventies, the chances are that his mental attainments will not be such as to qualify him for the conduct of great affairs. A man, on the other hand, might be a distinguished mathematician or a chess player of recognized standing without your being willing to entrust to him the conduct of the most unimportant business matter. All-around development, physical and mental, is extremely rare. If some of the qualities which go to make the ideal man are there, others are sure to be lacking.

Just so it is with an investment. To find a security which combines the five qualities which would make a stock or bond ideal, is impossible. Is a security safe and marketable and has it a good chance of appreciation?—then the chances are that it is unstable in price and that it yields but a low rate of income. Is the income satisfactory, the price stable, the chance of appreciation there, the safety unquestioned?—then it is a certainty that the all-important quality of ready marketability is lacking. Certain qualities at the expense of others—that is the rule in investment as in everything else.

According as an investment security possesses these attributes, its price is fixed in the market. Safety alone will not make a bond sell at a high price, nor will a high rate of interest nor any other one feature. There has to be a big "factor of safety," of course, but besides that, a bond, to sell on a four per cent. basis, has to have a certain amount of price stability and a very great degree of convertibility into cash. Many a perfectly safe security bearing a high rate of interest sells at a comparatively low price because it is lacking in the other attributes attaching to the ideal investment. Many a bond, the security behind which is none too good, commands a comparatively high price because it yields a fair rate of interest and has a market which is always well taken care of. The conclusion is, that in the fixing of the price of a bond, the degree in which it possesses these main attributes is what counts. *The ideal investment would be perfectly safe, perfectly marketable, would yield a high rate of* *income, would be free from large fluctuation in price, and yet would have a good chance of appreciating in value.*

Safety

Of these five attributes safety is, of course, the one of the greatest importance and the one which must attach to every investment security worthy of the name—whether a security is steady in price, or marketable, or yields a high income is of little account compared to whether it is or isn't safe. That is the primary consideration, the first thing to be looked into in the making of any investment. But even here it is possible to overdo the thing. There is such a thing as a point of absolute safety, a point beyond which additional security means simply that a higher price must be paid for the bond, without the bond being one whit better. It is perfectly possible to pay for excess security; a man does that, for instance, when he buys government bonds to net him three per cent., when he can buy the bonds of the country's richest cities and States to net him four. These State bonds and municipals are away across the line of absolute safety, as are the first mortgage bonds of the big railroads. The investor who passes them up and puts his money into "governments" which net him three per cent. is simply paying for excess safety and buying something he doesn't need.

Especially is this true in the case of the business man whose income is reasonably assured and who is investing money that is surplus. Where the question is of the investment of trust funds a factor of safety so high that some excess safety is being paid for is, perhaps, desirable; but the money saved by the average business man is usually not so great in amount that he can afford to sacrifice anything in the way of income to be derived therefrom. For him to take his income and buy bonds with it that yield him only three or three-and-a-half per cent. when he could with perfect safety get bonds to yield him well up toward five per cent., is simply to pay for something he doesn't need.

Marketability

But where one dollar is wasted in buying excess safety, probably two or three dollars are wasted in buying a greater degree of marketability than is required. Marketability costs money. Here are two equally good five per cent. gas bonds. One sells five points higher than the other. Why? Because an active market is maintained in one, while in the other transactions are few and far between. The man owning the bond with the active market knows that at any moment he can turn it into cash and that any bank will lend him money on it. The man owning the other bond knows that while it is always possible for him to realize on it, conversion into cash at a fair price may take some little time. The market knows these things, too, and places a higher valuation on a bond which can be readily sold or borrowed on than on a bond which can't. Marketability, in other words, is a desirable feature just like safety or a high rate of interest, and has to be paid for.

In this country where the science of investment is probably less well understood than in any other civilized country in the world, an immense amount of money is annually spent to secure marketability where marketability is not required. The man who is putting his money into bonds just for the time being and who knows that he may need it at any moment—it is a primary consideration in the case of such an investment that the security be quickly convertible into cash. But what proportion of investment is of that kind? How much more often is it the case that the man who puts his money into bonds puts it there with the idea of leaving it there for a long term of years. We are not speaking now of semi-speculative purchases made with the idea of realizing a profit on the principal employed, but of straight investment made for income. What is the particular advantage, in such case, of a high degree of marketability? That he can at any time dispose of his investment and get back his money—the investor, of course, wants to be sure of that. But of what particular advantage is it to see that his security is being heavily traded in every day and that at any time during the day he can tell, within an eighth, what he can get for his bonds? He doesn't want to sell. He didn't buy for the purpose of selling. If the fact that his bonds enjoy an active market made them cost five points more than an equally good bond without an active market would have cost, isn't the investor paying a pretty stiff price for the pleasure of looking at newspaper quotations?

Marketability, under some circumstances, is all-important—worth paying any price to get. In other cases it is of but little account. The business man putting idle capital into bonds, the bank investing funds at the moment unlendable —in such cases quick convertibility into cash is a *sine qua non.* But in the case of the average individual investment, quick marketability is no such important consideration. The investor wants to find out before he buys that there is enough of a market in that particular security so that if he is ever forced to turn it into cash he will not have to accept a heavy loss in order to get out his money. But if he has made the thorough investigation which is bound to precede every intelligent investment of money, and if he is putting in his money with the idea of leaving it there for a term of years, the investor need not give too much attention to the feature of quick marketability. He didn't buy the security to sell, but to keep. Under the circumstances, why should he pay a heavy premium for a privilege he has no idea of exercising?

Income

Income, the third cardinal point about an investment, is largely governed by the other four. How much interest does a bond net the buyer? That depends not at all upon whether it is a four per cent. bond, or a five per cent. bond, or a six per cent. bond, but entirely upon the price at which its safety, its marketability and its other investment attributes cause it to sell. On its face the bond may bear only three per cent. interest and yet sell higher than par, so that it nets the buyer even less than three per cent. Or, on the other hand, in the features of marketability and stability of price the bond may be so weak that, though a six per cent. issue on its face, it may sell at ninety and net the buyer six and one-half or seven per cent.

Price Stability

Price stability, the fourth cardinal point about an investment, is something to which the cautious buyer of securities will give careful attention. Even though the investment may be made with the idea of leaving it undisturbed for a long term of years, the wise buyer will not overlook the fact that for one reason or another he may want to change his investment or withdraw his money, and that if that time ever comes it will be important that the price of the security be somewhere near what he paid for it. Unless the money is "surplus" in so complete a sense that there is no chance of any occasion arising to make the investor want it back, he will do well to see to it that the security he buys is of such a sort that it will not fluctuate too far from the purchase price. That investment virtue, of course, like marketability, commands its price; but if the operation is on a straight investment basis, the price is well worth paying.

Chance of Appreciation

Fifth and last of the qualities that go to make up the ideal investment is the chance of price appreciation. Why, it is asked, how can a security have this last mentioned quality of stability in price and still have a chance of increasing in value? Is not that a contradiction in terms? By no means. Take the case of some junior railroad bond of not super-abundant security but of excellent prospects, brought out at eighty. On its merits it may continue to sell around eighty, displaying a very great degree of price stability, but always there is present the element of a possible and substantial increase in value. But isn't there the same chance that the bond will go to seventy as that it will go to ninety? Not necessarily. It depends on the quality of the bond. If the bond is worth more than eighty it may remain on that level for a good while, but when it does start to move it will move in only one direction—up. In such a bond there are to be found both the qualities of price stability and of possible appreciation in value.

Chance of price appreciation is, however, a quality to be sought only with full realization of the fact that where it exists it is generally at the expense of other important investment qualities. Where safety, price stability and income are the important considerations, to look for a security offering much of a chance of price appreciation as well is all but futile.

Of all the five investment qualities, indeed, the chance of price appreciation is the one the seeking of which involves the greatest amount of risk. Before seeking it the investor will do well to pause and ask himself whether he is in a position to forego those other qualities which the presence of this one usually proves are lacking.

CHAPTER VII

HOW TO DIVIDE UP AN INVESTMENT SO AS TO GET INTO IT A REAL ELEMENT OF DIVERSITY

IN the foregoing chapters the attempt has been made to set forth those things which govern the value of any particular security—stock or bond. The next thing is to get clearly in mind the principles which govern the combination of various kinds of securities into one investment. There are many cases, it is true, where a fund of money may properly be placed in one kind of security, but in the great majority of instances scientific investment demands the introduction of the element of diversity. And that is true whether the fund be large or small. The trust fund of moderate size may properly be invested all in one kind of bond and the business house having temporarily idle capital may properly place it all in one issue, but not so the business man having surplus funds. Be the amount $3,000 or $30,000, if he is going to make the money for which he has worked so hard do the maximum amount of work for him, he must invest it not only so as to get the most income compatible with safety but the greatest chance of price appreciation as well. And that, whatever the size of the fund, cannot be accomplished except by the introduction of the element of diversity. However good any one particular security may be, it cannot satisfy all the legitimate needs of the average investment fund.

Take, for instance, the very usual case of the man whose business yields him an income somewhat in excess of his expenses and who is under the constant necessity, therefore, of finding employment for his surplus capital. For such a man to make up his mind that railroad bonds or public service bonds or any other kind of securities are the one thing for him to buy, and then to keep putting all his money into that particular kind of security is foolish indeed. Safe as high grade railroad bonds may be, they do not afford the chance of appreciation of principal to which an investment such as the one in question is legitimately entitled. Attractive as the interest rate on public service securities may be, they do not, as a rule, possess a sufficient degree of marketability to warrant all one's funds being tied up in them. And so it is with whatever class of security may be named. Well suited, because of its investment attributes, to form *a* *part* of an investment, a security may yet be utterly lacking in qualities which a well-rounded investment is bound to have.

The answer is that where the fund in question is of any size at all—say, a few thousand dollars or over—intelligent investment demands that it be split up not only into different kinds of securities of the same general type, but into securities of different type. A man, for instance, having a fund of $5,000 which he wants to invest in high grade railroad bonds might buy five different bonds in five different companies without introducing any real element of diversity into his investment at all. Any influence bearing on one of his bonds would bear on all of them, and, so far as safety was concerned, any risk of loss that might exist would be rather increased than otherwise. Simply to scatter an investment over a number of issues of identically the same type is not to diversify it. To do that, it is necessary to buy *different kinds* of securities—in the above case, for instance, a couple of gilt-edged railroad "firsts" having a quick market; a high class public service bond not so readily marketable but yielding a full rate of income; an industrial bond having a first class chance of appreciation in value; and, perhaps, a thousand dollars' worth of some high grade, seasoned, preferred stock. With such an investment the holder, besides getting what was coming to him in the way of safety and income, would never be at a loss. Needing money suddenly, he would always have his gilt-edged railway bonds, with their ready market and their full hypothecary value, to fall back upon. The public service bond and the preferred stock would contribute strongly to raise the rate of income on the investment as a whole. As to the chance of price appreciation, that would be provided by the industrial bond, the preferred stock contributing as well.

The above division is purely illustrative and by no means to be taken as the ideal way of investing a fund of $5,000. That depends entirely upon circumstances. It might be important, for instance, that a greater part than two-fifths of the fund be readily convertible into cash. In that case, either more than two high grade railroad bonds would have to be bought, or else the other securities chosen would have to be of a more readily salable type than those mentioned above. It might be that the investment was being made by a person extremely unlikely to need the money for a long time to come. In that case, to put even as much of it as $2,000 into low-interest-bearing railroad mortgage bonds would be an entirely unnecessary sacrifice of income. The circumstances and particular needs of the party whose money is being invested —that must always be the determining consideration.

In cases where surplus income is being invested as received, even if the amount involved be moderate, the same procedure can be followed. To take a concrete case, suppose a man with an assured income of $10,000 a year and total expenses amounting to $7,000. At the end of each year he has a fund amounting to $3,000 to invest. For him to put that $3,000 into one kind of security would be for him, in the course of a very few years, to acquire a most ill-balanced investment fund. What such a man should do would be to plan a scheme of investment according to his needs, and each year distribute his surplus accordingly. Then, as time went on, he would find himself not with a lot of one kind or another of securities on his hands which might or might not have gained in public favor, but with a well-rounded investment having all the attributes required by his particular case.

In cases where the annual amount of surplus is too small to be thus distributed, the same result can be obtained by rotating the investment in the various kinds of securities involved in the general scheme. This year the investor will buy a first mortgage railroad bond; the next, a public utility or municipal issue; the next, a thousand dollars' worth of preferred stock. By that method the same result will in the long run, of course, be obtained. Necessarily a slow process, it is nevertheless amazing how in the course of a few years money regularly invested in this way will result in the possession of a substantial and well-balanced fund.

Another way of accomplishing the same thing, where the total annual surplus is small, is to divide it into the desired parts through the purchase of $100 bonds. Practically every type of bond can now be had in the hundred-dollar denomination, so that there is not a great deal more difficulty in dividing up a fund of $500 than one of $5,000.

On the question as to whether, before he does anything else, the man with surplus income ought not to "salt away" a certain amount in the very best securities that money will buy, investment experts disagree. That is, of course, a conservative thing to do, but it is very much of a question whether it is right or necessary. In the case of the man who, in the hope of increasing his principal, is going to take risks with his money, there can be no question that the more he "salts away" at the very beginning the better. But in the case of the conservative and intelligent individual who proposes to invest his money according to a definite and well-thought-out plan, it is hard to see why it should be necessary to accumulate a reserve fund before he starts in. His investment plan, as a matter of fact, if it is well conceived, makes all the provision necessary for a reserve fund. Out of what he puts away a certain proportion is to go into just such securities. To have a fund of that kind established at the beginning would, of course, be desirable; but whether in order to create such a fund all savings should be deflected from the many more profitable forms of investment is, indeed, open to doubt. It is not, it must be borne in mind, as though chances were going to be taken with the money not so invested. After all, high grade bonds and shares, even though they be not of the "savings bank class," can be realized on in case of emergency.

The principle of diversifying an investment by dividing it up among different kinds of securities is everywhere recognized by shrewd security buyers, but it is well to bear in mind that the thing can be overdone. The writer once saw a fund of $102,000 divided up between the shares and bonds of no less than fifty-two different companies. That was overdoing the principle of diversification and with a vengeance. The investor in this particular case thought he was doing something particularly cautious, but what he was really doing was greatly to increase his chances of loss as well as to give himself a vast amount of unnecessary trouble. Infinitely better off would he have been if he had sat down in the beginning, and, having determined his needs, decided to invest his hundred thousand in three or four different classes of securities with, say, three different issues in each class. That would have given him ten or a dozen individual securities to look out for instead of fifty; while, on the other hand, his investment would have been safer. At least general track can be kept of the affairs and earnings of a dozen companies by the man who is willing to give time and attention to it, whereas with fifty companies that is out of the question.

In putting into practice this principle of diversity it is important, too, that securities in companies whose earnings statements are not readily accessible should be avoided. By no means is it necessary to confine one's purchases to securities in corporations which make monthly or even quarterly reports; but it is important that

that class of security be avoided on which reports are only irregularly made and then in incomplete form. Very easy indeed is it for one or two securities of this sort to slip into a diversified investment at the time it is being made. The "back-log" bonds in it—the railway "firsts," for example—look so very solid and easy to watch that the buyer is only too prone to listen to the suggestion that he take on a few of this or that obscure bond in which the house happens to be interested. To go even that far is a very great mistake. Especially important is it, where there are several issues making up an investment, that each one be of such a nature that its affairs can be kept track of without trouble or expense.

Again, in diversifying an investment, it is important to choose securities on which the interest or dividends are payable at different times. To the very well-to-do man it makes not so much difference whether the income from his investments comes in all at the same time or not, but to the great majority of investors it is preferable to have such income on a monthly basis. That is easy enough to arrange. In every class of security there are numerous issues which come due on the first of each of the twelve months.

It is simply a case of combining the securities in the investment in such a way that at the intervals desired a proportionate amount of the annual interest comes due.

Finally, in his desire to introduce the element of diversity, the investor must not be led to follow after strange gods. Glance at the chart showing the various kinds of stocks and bonds and you will readily see that it is possible to diversify an investment to the highest possible degree without going outside of those classes of securities with which you are thoroughly familiar. To get a real element of diversity into an investment, even one of considerable size, it is by no means necessary to include in it irrigation bonds or power bonds or any of the other "specialties" with which you may not happen to be familiar. To do so is, indeed, generally to open the door to an element of uneasiness and uncertainty.

CHAPTER VIII

THE TRUE NATURE OF BONDS CONVERTIBLE INTO STOCK

THERE is in all the world no more misunderstood security than the convertible bond—a record of the crimes against investment committed in its name would fill a library. To an exposition of the real nature of this form of security it has been deemed worth while, therefore, to devote an entire chapter.

Of the true nature of the convertible bond and the causes which bring it into being, the following incident offers apt illustration: A successful manufacturing business in the Middle West once found itself in need of additional capital. The man who had built up the business went to the town capitalist, showed him the profits of the concern, and suggested that he put some money into it. The man of means thought it over and then refused. The business was a good one and making money, he knew, but he was past the point of taking risks on his investments. The manufacturer then proposed to the capitalist that instead of putting money into the business he lend it a certain sum, out-right, on mortgage. Again the answer was in the negative—there was not enough in it that way for the lender, it appeared. On what terms, then, would he let him have the money? On mortgage, the capitalist replied, he (the lender) to have the privilege at any time of changing the loan into an equivalent interest in the business. "I won't put this money into your firm as a partner," he said, "and I won't put it in as a creditor. But if you're willing to give me the option of being either of the two I choose during the next five years you can have what you want."

On that basis the arrangement was made. And on that basis many other arrangements for securing needed capital have been made during recent years. Corporations needing money have tried to get it by selling common stock—in other words, by offering the investment-public an interest in the business, just as the manufacturer mentioned above offered the town capitalist an interest. Nothing doing, has been the reply; we don't want to take the risk. Offers of bonds bearing a fixed rate of interest have met a reception no better. "There's not enough in it for me," the manufacturing man's wealthy friend replied when approached along those lines. "The cost of living is too high for any ordinary fixed rate of interest to attract us," investors cry. So what happens? Exactly what happened in the other case. The investor finally "comes across," but only in exchange for a writing which makes him not only a creditor, but which gives him the right, lasting for a term of years, of at any time and at his own option becoming a special partner to an equivalent amount. If business gets bad and earnings fall off and shares in the company are depressed in price, he has merely to "stand pat" with his bonds and collect the interest as it comes due. If, on the other hand, business is good and earnings are large and the company's shares increase in market value, the fortunate owner of these "convertibles" can change his position to that of a shareholder by simply turning in his bonds and demanding stock in exchange.

An ideal arrangement from the investor's point of view—that is the thought which naturally first comes into one's mind. But not too fast—before jumping to that conclusion there are one or two things to be considered. An absolutely safe bond, bought at a price low for it, as a bond, and yet convertible into stock—that would, indeed, represent the *ne plus ultra* in investment. But how about all these convertible bonds (not the new ones, particularly, but the rank and file of them so popular at the present time)—are they ideal investments *as bonds?* And how about the prices at which they are selling? Can they be bought at the prices warranted by their standing purely as investments, or must more be paid for them because of the privilege of conversion into stock which goes with them?

From An Investment Standpoint

As to the intrinsic investment merit of the convertibles, a slight knowledge of security values is all that is necessary to realize that most of them hold no exalted rank. Some of these issues, it is true, are secured by mortgages of one sort or another, but only in the fewest of cases can this security be called first class. And in the majority of cases there is no security at all, the bonds being mere "debentures"—promises to pay.

Now it is quite true that the debenture bond of a big railroad like the New Haven or the Atchison can be an investment security of considerable merit. From an investment standpoint, indeed, such a security outranks an innumerable number of so-called "first mortgage" bonds secured on properties which, under foreclosure, would not begin to bring the face value of the bonds. But because the principal "convertibles" are better than some of the mortgage issues that cannot be called good at all, it is by no means said that they rank well among bonds which have actually a high degree of investment merit. As a matter of fact, taking them as a class, they do not. The man who is looking for bonds of really high grade will not find them in the convertible class. What he will find there in the great majority of cases, if he knows enough about judging security values to be able to recognize what he sees, are bonds of just fairly good grade—the kind of bonds in which a business man can legitimately invest some of his surplus money.

As to the price of these securities, few of them can be bought at a figure representive of their intrinsic investment value. With real first-mortgage railroad bonds of high grade obtainable to net the buyer four-and-a-quarter per cent. or over, bonds of the grade of most of these convertibles ought to yield at least five per cent. How many of them do? Run down the list of percentages yielded by the prominent convertibles, and it will be seen that in most cases the yield is as small as or smaller than if the securities were first mortgages of the highest grade. Take even the convertible bonds of companies whose stock sells far below the conversion price and where there seems little likelihood that it will ever be possible profitably to exercise the conversion privilege, and even there it will be found that the mere possibility of the thing causes the bonds to sell higher than they otherwise would. It is impossible to get away from it. To take a chance is human nature. Stipulate that a bond is convertible into stock, and, at whatever price that stock is selling and however remote may be the chance that it will ever sell up to its conversion price, the fact that the bonds *are* so convertible will add a number of points to their market price. The gamble that something may happen suddenly to increase the market value of the company's shares is, the buyer of the bonds will tell you, worth the few extra points that he has to pay. In only too many cases he doesn't realize that he is paying a good many extra points.

The convertibles as a class, then, are not a suitable form of investment where absolute safety and as high an income-yield as is consistent therewith are the main considerations. By no means, however, does that damn them, even from an investment standpoint. There is a good deal of real investment conducted with objects in view other than the obtaining of the greatest amount of safety possible. Drawing the exact line between speculation and investment is a ticklish business, but certain it is that there is a large amount of legitimate investment for profit. The widow dependent upon the little income from her investments and the holder of trust funds cannot, of course, sacrifice anything in the way of safety or income yield for the chance of increasing the principal. But there are a good many classes of investors which legitimately can. A man with an established business, for example, who is making more money than he needs to live on is by no means bound to invest his surplus in the kind of first-mortgage bonds that never move more than a point or two one way or the other and that bring in only four per cent. Some of his accumulated surplus can very properly be invested that way, but after that has been attended to he is free so to invest his money as to give the principal a chance to grow. It comes pretty close to being his duty, as a matter of fact, to do so.

For investment of that sort, the convertibles, undoubtedly, present great possibilities. A bond, exchangeable for shares which have risen far above par, and which consequently sells at so big a premium that it yields only a low rate of income is, of course, no investment proposition from any angle. But where profit possibilities exist and have not been discounted, it is a different story.

How the Convertibles Measure Up

In investing for profit, as in investing for income or anything else, safety remains the primary consideration. In the case of the business man's investment, it is not necessary that the security be a first mortgage or that it be backed up by the kind of collateral that ought to be there in the case of a savings bank or trust-fund investment. But it is necessary that the bond be absolutely "good." Is the security in question a debenture? Well, then it ought to be backed up by demonstrated earning power—dividends paid on the stock over a long series of years. Is it a mortgage issue? In that case the buyer wants to be very sure that the property on which it is secured is valuable enough to cover the whole issue—that just a little really good "stuff" hasn't been put back of the bonds, perhaps, to make it possible to sell them as a mortgage issue. In any case and whatever the type of bond, the great thing to be sure of is that it is a good bond of its own type.

The goodness of the bond having been passed upon, the rate of income is the next thing to think of. Nobody who knows what he is doing buys convertible bonds for the income they yield, but, on the other hand, there is no reason why a reasonable income should not be had. A convertible bond, indeed, that sells so high that the income-yield is very low is not a suitable investment even for the business man's surplus. Far more reason is there for the prospective buyer of such a bond to buy the stock into which it is convertible. The income in that case will be materially higher and the security not much less.

What counts principally, of course, in the intelligent purchase of convertible bonds, is the chance of price appreciation in the security into which they are convertible. For that the buyer is, in the great majority of cases, sacrificing a good deal in the way of income and even something in the way of safety. He is lending his money, to come back to the original idea, only on the stipulation that, at any time he may elect, he may change his role from that of creditor to partner. What such a partnership may be worth to him—that, of course, is something he is going to have all figured out before he goes into the deal at all.

To put it another way, before he buys convertible bonds he is going to have a very definite idea as to what is likely to happen in the stock for which they are exchangeable. That the stock is going to rise in value and carry the price of the bonds up with it is something which, of course, neither he nor anyone else can definitely know; but the possibilities of that happening constitute, actually, the underlying motive for the purchase. I don't believe in this proposition quite enough to buy the shares, is the line of reasoning, but I do believe that the shares are going up and that if I can get bond protection for my money and a "call" on the stock thrown in, it is a good proposition.

The business prospects of the company, therefore, and the past market record of the shares into which the bonds in question can be converted, become matters of the greatest importance—the latter particularly so. Here is a bond which, at any time during the next five years, can be exchanged for ten shares of stock, say, in the X Y Z Railroad. What is the first thing which comes to mind in any consideration of what that privilege may be worth? The price, naturally, at which these shares have sold in the past. Prospects for future business are, of course, important, but even more so, in the opinion of the average buyer, is the black-and-white record which shows him what, had he had his privilege during the past five years or so, he might have made. If during that time the price of the shares has on several occasions sold higher than the point at which the convertible bonds can now be bought, there is a first-rate chance that they will sell there again. It doesn't prove it, of course, but granted that nothing has happened in the meanwhile to reduce the intrinsic value of the company's securities, there is a strong presumption in favor of recurrence.

One thing, however, has got to be remembered, and that is that the creation of a large issue of convertible bonds in itself acts as a drag on the price of the stock and keeps it from rising as it otherwise might. As soon as the stock begins to get up, holders of the bonds begin to exchange them for shares, with the result that the floating supply of shares is largely increased. If the outstanding issue of convertibles is a big one, the increase in the company's share capital may be very considerable—so considerable, indeed, that not only is everyone who might want to put the stock up in price scared off, but the intrinsic value of each share made appreciably less. Numerous are the instances to be found, in the market, of shares which, because they have big issues of convertibles "overhanging" them, have been weighted down in price. The logical deduction is that, other conditions being equal, the smaller the issue, the more likely is the conversion privilege to become valuable.

Convertible At a Price

Another important point in connection with the conversion of bonds into stock, not always appreciated, is that where the bonds are convertible "at a price"—say, 175, as in the case of the Union Pacific fours—the stock has got to move up a good deal more than a point in order to carry the bonds up a point. "Convertible at 175" means that for each $175 in bonds the holder may care to turn in, the company will hand over one share of stock, irrespective of what the market quotation of the shares may be. When the convertible bonds are purchased at 100 and the stock into which they are convertible can be sold at 175, there is no profit or loss on the operation—the two quotations are on a parity. A rise of a point in the stock to 176 will not, however, carry the price of the bonds up a point, to 101. It needs $175 par value of bonds to get $100 par value in stock—from which it follows that the "pulling power" of a rise in the stock toward a rise in the price of the bonds is in the ratio of 100 to 175, or four to seven. Differently expressed, the stock has got to go up seven points to carry up the bonds four points.

In the case of bonds convertible at a price high above par this is a serious disadvantage. It means, in the first place, that the stock has got to sell at a high price before the conversion privilege is of any value at all. It means, in the second place, that of any rise in the stock above the conversion point the holder of the convertible bonds only gets a partial benefit. The deal, in other words, isn't that the lender of the money is to have the right at any time to buy an interest in the business equivalent to the amount of his loan, but only to the extent of a part of it. And that, whether the bond buyer realizes it or not, wasn't the original proposition.

A very excellent form of investment is the convertible bond but, like firearms and whiskey and lots of other things, suitable only for those who fully understand their use.

CHAPTER IX

AN UNBIASED COMPARISON OF BONDS AND REAL ESTATE MORTGAGES

THE question of the relative merits of bonds and real estate mortgages is one that practically concerns every person with money to invest. This man will tell you that he wouldn't buy a bond at any price—that when he lends his money he lends it on security he can *see*. Another person just as conservative and with just as good business sense will tell you that the man who puts his money into mortgages instead of bonds is throwing away his opportunities. There is only one conclusion and that is that both classes of security—the good bond with a good market and the well-issued mortgage secured on real estate—have their own individual investment merits.

The following is not an attempt to prove the merit of one security over the other, but to show forth the advantages of each, so that, with the facts before him, the reader may be in a position to judge.

Bonds—Their Marketability

Assuming absolute safety for both classes of security, the first great advantage of bonds is their ready convertibility into cash. The man who has put his money into bonds has bought something which he can at any time sell. He is not tied to his commitment; if at any time he wants to get out of it he has a broad and open market in which he can sell. There is no red tape to be untied, no large commissions to be paid. He takes his bonds to a broker and sells them and gets his money. The broker charges him $1.25 per $1,000 bond. Under the circumstances the investor is free to act as he likes—he has his money invested and still has it liquid. It is where he can get it at a moment's notice and no opportunity can slip by him because he is tied up so that he cannot take advantage of it.

Furthermore, this quality of quick marketability makes it possible to borrow easily on his bonds. Among the qualities which collateral must possess to make it acceptable to banks as a basis for loans, marketability takes the first place. Can this collateral be readily sold in case the loan is not paid?—that is the first question the bank asks. In the case of good bonds there is only one answer and that is that it can.

It is more than a matter, furthermore, of whether or not the loan will be granted. It is a matter of rate as well. A man need have had but very little experience in borrowing money from banks to know that the quality and marketability of the collateral offered make a lot of difference in the rate charged.

It is unnecessary to say much here regarding the importance of being able to borrow fully and readily on one's investments. In the case of the individual it may be some unexpected expense, such, for instance, as the burning down of one's house, which makes imperative the need of ready money, while in the case of the business firm it may be some unavoidable reverse. In either case, where resources have been banked in the form of good bonds, it is unnecessary to sell out the investment, the bonds forming a kind of security on which any bank will lend freely and at a low rate of interest.

Bonds—Profit Possibilities

The second great point in favor of bonds is that they offer the discriminating investor the opportunity not only for a steady income, but for a decided increase in principal. Reference is here made to bonds of high grade only, the other kind of bonds having their uses, but not being concerned in this discussion at all.

This matter of increment in principal is one of the main points made in favor of bonds by those who advocate their purchase for investment. The intrinsic value of a bond, it is pointed out, is something which can be definitely ascertained. The dividend-paying stock of a railroad may be known to be worth a great deal of money, but just how much it is worth it is impossible even for the expert analyst to say. A good bond, on the other hand, is intrinsically worth just about so-and-so-much, nor is there any great difficulty about determining its price. Under the weight of an over-issue of the bonds the price may go down, or under the stimulus of easy money-market conditions it may go up, but always it is possible to tell just about where the bonds are selling relative to where they ought normally to sell. Stocks have a par value, but no absolute ascertainable point from which it may be said that they are "up" or "down." Bonds have.

Far from being a disadvantage, such fluctuations as take place in the price of good bonds, their friends claim, are of the very greatest advantage to investors. A first-class four per cent. bond selling at 103 or 104 is palpably above its investment value—too high too buy and as plainly so labelled as though its real value were inscribed on the bond itself. Similarly, when bonds of this sort get down around ninety, bankers and investors realize that they have swung down below their true level. High money-rates, high cost of living, the tying up of capital—these or other things may have brought about the decline; but by the man who is familiar with what has happened before it is realized that the operation of such influences is bound to be temporary and that the bonds are bound to "come back" sooner or later.

Plainly stated, it is often possible, on account of the operation of outside influences, to buy the best railroad bonds at such a price as to make a profit on the purchase almost a certainty. Nor by any stretch of imagination or of the English language can the man who buys in this way be said to be speculating. The intrinsic value of a Pennsylvania or Baltimore & Ohio first-mortgage bond is as ascertainable as the value of anything that can be named. The chance which occasionally comes around to buy securities of this sort at several points below their true value is just one of those conditions developed by the imperfect state of our financial system, and is welcomed by patient and discriminating investors in every part of the country.

Bonds—Their Impersonal Character

The third point in favor of railroad bonds is what might be called their impersonal character. A man who buys a bond is, in effect, lending money, and where the party to whom he is lending it is a great railroad, he is going to have his dealings with a pretty desirable sort of a debtor. There is going to be no running around after the interest, no need of threatening foreclosure proceedings unless it is speedily paid. January and July bring with them no necessity for worrying as to whether the regular check will be received or not, no wondering as to whether the poor fellow ought not to be given a little more time to pay up. Where the debtor is a big corporation, the personal feature does not figure at all. The interest day comes around and the bondholder clips off his coupon and sends it around to the bank where the money to pay it will long before have been deposited. There will be no question about its being paid on presentation. Among bankers, bond coupons are treated exactly like currency.

Mortgages—Their Price Stability

So much for the particular advantages of bonds. How, now, about those attaching to real estate mortgages?

First, perhaps, comes the fact that mortgages do not fluctuate in price—that the buyer puts so-and-so-much in and can count upon drawing so-and-so-much out. If the fact that a security fluctuates means that the buyer has a chance to make a profit on his principal, must it not necessarily mean that there exists also the chance to make a loss? How often has it happened that investors have bought what they considered "good" securities, only to have the price decline materially below what was paid. Allow that the interest *is* regularly paid, and that upon their maturity the bonds are going to be paid off, how about the intervening period when the price is down and the investor who wants to sell out finds that he can do so only at a loss? That never happens in the case of a mortgage. The holder in looking over his newspaper never comes across the pleasant information that the security he has bought can be had in the open market at a price considerably under what he paid for it.

Mortgages—Tangible Security

The second point in favor of the real-estate mortgage is that it is usually secured on property which the holder of the mortgage is able to keep track of. Apartment houses, dwellings, office buildings, hotels—the holder of the mortgage can see the security on which he has lent his money and can at any time tell definitely just what the security is worth. How is it in case of bonds? The security back of the first-mortgage bond of the Pennsylvania or Baltimore & Ohio needs no watching, but there are numberless issues of bonds rated as first-class which have no such security back of them. Many bonds of exceedingly high standing, in fact, are not mortgage issues at all and are secured by earning-power only. Granted that this earning-power has been demonstrated and that there is every probability of the road's continuing to earn very much more than is necessary to take care of the interest on its bonds and pay them off when they mature, can such security in any way be said to compare with the security of a mortgage based on tangible real estate? In the one case the lender can at any time see with his own eyes just how much the value of the collateral security exceeds the amount of money he has loaned on it. In the other, he is absolutely dependent for his information upon published statements of earnings which may or may not represent the actual state of affairs.

Nor does the "personal element" enter into modern mortgage investments to any very great extent. Where one neighbor lends money to another on the security of his house or farm, the personal element figures largely in the transaction and the collection of interest may be a mighty unpleasant business. Most mortgage investments nowadays are, however, not made on that basis. The man who wants to invest his money in a mortgage nowadays is more apt to go to some one of the big companies making a speciality of investments of that sort, and the mortgage he gets is apt to be secured on some million-dollar hotel, apartment or office building. Often, too, the mortgage will be guaranteed by the company which sells it to him, that institution standing between him and the borrower and seeing to it that all details pertaining to insurance, taxation, etc., are properly attended to.

Mortgages—The Interest Feature

Thirdly, in favor of mortgages there is to be considered the fact that such investments do not usually have a distant maturity date, as do most railroad bonds, and that an adjustment of interest rates to current conditions is, therefore, possible. The man who buys a mortgage which has been made during a time of cheap money and which bears a comparatively low rate of interest is not tied up to his investment for a long period of time—within a few years, presumably, his mortgage will mature, and if by that time the money-market has come to favor the lender, he will be able to reinvest his capital in a mortgage bearing a correspondingly higher rate of interest. Bonds run for a long term of years and are rigid as to the interest they pay. With mortgages, the interest varies according to current conditions.

From what has been said in favor of bonds and real estate mortgages as investments, it is evident that a very high degree of excellence attaches to both classes of security and that selection between the two is bound to be very largely a matter of individual opinion. If any distinction at all can be made, it is that on account of the profit-possibilities and the ready convertibility into cash of bonds, that form of investment is more likely to appeal to the active man of business in touch with current affairs.

CHAPTER X

BUSINESS BAROMETERS AND HOW TO READ THEM

A GOOD deal has been said in previous chapters about "general business conditions" and their influence on the rise and fall of security prices. But how, asks the average investor, how can I tell anything about "general" business conditions? To keep in touch with the local situation is all I can possibly hope to do. How can I tell anything about conditions in communities thousands of miles away, or for the country as a whole? And even if I could, how would that help me to forecast the state of trade in this locality six months or a year from now?

It is not so many years ago that the proposition of having the Government maintain a bureau for the purpose of forecasting weather conditions was received with open ridicule. Weather conditions cannot be foretold, it was argued, and the maintenance of an expensive organization for any such purpose is an extravagant waste of money. People think differently about it nowadays. They think differently, too, about business "barometers"—reports of bank clearings, railroad earnings, iron production, etc.—which have come to play so important a part in the intelligent business man's calculation. They had these in more or less complete form twenty years ago, but the science of concentrating and grouping them had not been developed, and, so, except among students, they didn't count for much. They count for a good deal nowadays. The trader on the floor of the Exchange who makes a living knocking eighths and quarters out of the market in "Steel" or "Union" doesn't know or care about what the "barometers" show of underlying conditions, but the bank man who lends him money knows and the merchant knows and the manufacturer knows. And furthermore, according as these men of business find the barometer, they direct the course of their affairs.

Nor is there anything mysterious or "inside" about these barometers of business. They are represented by no chart or table issued by the many companies in the business of selling information. Nobody has made any wonderful discovery. The whole point is simply that during recent years the gathering of certain kinds of statistical information has been developed to such a degree that it is possible now to put one's finger upon half a dozen compilations which, like the data upon which the weather bureau bases its forecasts, enable the intelligent observer to read the financial skies. Not, of course, infallibly, but with a degree of assurance sufficient to make well worth while the knowledge of what these barometers are and how they can be read.

Out of the mass of statistical information published at present, six compilations stand forth clear and sharp as guide-posts to the man who prefers figuring out things to guessing at them. They are (1) The condition of commodity prices as shown by the so-called "index-number." (2) Bank clearings—the volume in which checks are being drawn. (3) The amount of business being done by the railroads as shown in their earnings statements. (4) The nature and extent of our foreign trade. (5) Iron production. (6) The general condition of credit disclosed by the periodic bank statements for the whole country.

Commodity Prices

Of these various lights on the shoals of unintelligent investment and finance, none shines clearer and yet is more generally misunderstood and disregarded than the condition of commodity prices. People realize, in a general way, that the price of things is up or down, but by comparatively few it is understood to what an extent the exact state of things can be gauged by a glance at the "index-numbers" published each month. As may be inferred from its name, an index-number is a sort of composite picture of prices as a whole, and is found by reducing the price of all the important commodities to a common denominator and then striking an average. By no means an infallible reflection of the price of all commodities, the index-number does, nevertheless, reflect, and with remarkable faithfulness, the trend of the general price movement. By following it from month to month (in this country the leading index-number is issued by Bradstreets), it is possible to keep close track of whether prices are rising or falling and how much.

To the business man or the investor the course of commodity prices is of interest because it shows so much about the supply of capital on which the country's business has got to be done. One need understand little about the science of economics to know that when the price of everything is high the supply of capital is apt to be short. From the standpoint of the economists, it means that capital is being "absorbed"; as the business man sees it, it means that more money is needed to do the same amount of business. It all comes to the same thing—that when the price of cereals and cotton and textiles and other commodities gets unreasonably high, capital gets tied up and the supply begins to run short.

The trend of commodity prices, therefore, makes a lot of difference to the man who runs his business on conservative lines. Is the index-number near its high record and still rising? He will hesitate, however favorable other conditions may seem, about allowing himself to get into an extended position. Just before the panic of 1907 the index-number reached a new high record, a fact which caused a good many experienced people to shorten sail. Again, at the end of 1909, when everything looked lovely, the price inflation denoted by the index-number's new high record kept a good many people from extending themselves as they would otherwise have done. Nineteen hundred and ten saw no panic, but for the steady liquidation by which the year was marked, the price inflation at the end of 1909 was largely responsible. And that condition of things was perfectly apparent to everyone who was keeping track of the way in which the index-number was rising notch by notch to a new high record. A new high record doesn't necessarily mean the advent of a panic or a year of liquidation, but it does mean that it will pay the banker or the business man or the investor to be very careful as to how he extends his commitments.

Bank Clearings

The second great business barometer is the weekly statement of bank clearings appearing in the leading financial journals. Bank clearings, after all, are no more than the record of the volume of bank checks drawn, and as ninety-five per cent. of the country's business is done with bank checks, it follows that such a record must be a close measure of the actual amount of business transacted. Now the statement of bank clearings, as it is made up at present, gives the figures not only for the whole country, but for individual cities, States, and groups of States. It is possible, therefore, to take any given section of the country and to make up, from the published clearings figures, a statement which will be a faithful record of the volume of business transacted in that particular locality or section.

Such a record being available, it is easy enough to figure what the normal degree of activity is and from that to deduce, at any given time, whether things are on the up or down grade. Special influences may from time to time tend to obscure the real drift, but over any considerable period, the real course of business will find accurate reflection in the clearings of the banks.

In the use of bank clearings as an index of conditions, it must, however, be borne in mind that to no inconsiderable extent are they affected by the level of commodity prices. So large a proportion of the country's business being done on checks, it might be thought that whenever the amount of checks passing through the clearing-houses is on the increase, the business which gives rise to the drawing of these checks must be on the increase, too. But by no means does that necessarily follow. Suppose, for the sake of illustration, that the total business done during this present week and during the corresponding week a year ago is exactly the same. Would exactly the same amount of money be required to do that business, and the same volume of checks pass through the various clearing-houses? Not necessarily. That would depend entirely upon prices. If wheat and cotton and leather and the other great staples were higher in price now than they were then, obviously it would take more money to do the same amount of business in them. The check drawn in payment, for instance, of a shipment of a thousand bushels of wheat would be considerably larger if wheat happened to be selling at a dollar a bushel than if it happened to be selling at only ninety cents. No more merchandise would have changed hands, but in the amount of money used and, so, of checks cleared, there would have been about a ten per cent. increase.

The index-number, therefore, which is a sort of composite picture of commodity prices, must be taken into account in connection with this matter of bank clearings. Small variations may be disregarded, but when the index-number is well above or well below the point at which it stood during the period whose clearings are being compared with those of the present, full allowance must be made. To fail to realize that a decided rise in commodity prices is in itself bound to make clearings seem large, would be completely to misunderstand their significance.

Another important thing to bear in mind in connection with this matter of clearings is the locality in which the increases or decreases take place. A big increase in clearings for the country as a whole, we will say, is shown. Assuming that commodity prices are the same now as then, does it follow that general trade is more active? Not necessarily. The entire amount of the increase, it may be, has taken place at New York or the other big cities, clearings out through the country having remained stationary. What would be shown by a condition like that? That stock speculation, presumably, was more active. Had the increase in the clearings of the cities come from larger commercial business, that would not have failed to find reflection in clearings at the smaller towns with which the cities do business.

Railroad Earnings

The third of the great barometers of business is to be found in the earnings statements of the railroads. Years ago, before the Interstate Commerce Commission exercised supervision over railroad reports, earnings statements were issued in such form as to make them of little use individually or as a whole. Now, however, that is different, and the introduction of the element of uniformity has made the earnings of the transportation companies one of the most important parts of the business barometer.

In the use of earnings, however, as in the use of clearings, there are certain allowances to be made. Increases or decreases, for instances, are in comparison with the same period during the previous year. What conditions were during that previous period, is, therefore, of the very greatest importance. If conditions then were good and earnings were showing a satisfactory increase over the corresponding period of the year before that, a further substantial increase really means something. If, on the other hand, because of floods or strikes or any one of a hundred different causes earnings during the corresponding period last year were poor, what may look like brilliant increases may mean merely the getting back again to normal. Too much care cannot be taken, especially following periods when railway traffic is known to have suffered, to note the actual condition of affairs during the period with which comparison is made.

Allowance must also be made for the fact that railroad earnings are necessarily somewhat late in reflecting business conditions. In the case of most manufactured products a number of weeks or even several months intervene between the time when the order is placed and the time when the goods, ready for shipment, are started on their way. Railroad earnings during any given month, therefore, do not, necessarily, reflect the activity of business during that particular month, but are rather a measure of orders previously placed. It is perfectly possible for general business to suffer a decided set-back and orders to fall off sharply, and still for railroad earnings to go on for a month or six weeks exactly as though nothing had happened. Of what use, then, if railroad earnings reflect a turn in business only after it has happened, are they as an indication of what is to come? Of no use at all if one thinks that he can pick up a report of a month's railroad earnings and from it tell anything about the course of business, but of a good deal of use if one knows enough to compare earnings for several months back and to determine tendencies therefrom. Railroad earnings now coming out, we will say, reflect the business done a couple of months ago. Can I, by taking these earnings for the past week or the past fortnight, find out anything from them as to the probable course of business during the current month? Certainly not. But suppose I take those current earnings and those of the month before and those of the two or three months before that, and find, upon examination, that there was a distinct tendency one way or the other. As a business man, wouldn't it be of the greatest use for me to know that during a number of months preceding there was a decided movement up or down in progress? Wouldn't that help me in forming an intelligent estimate as to current conditions and those likely to prevail in the near future?

In the use of figures showing railroad earnings another important thing to bear in mind is that while month-to-month comparison is safe enough, year-to-year comparison is not, unless increased capitalization is allowed for. Every year the railroads of the country, to take care of their natural growth, increase the amount of their capitalization by several hundred millions of dollars. On this new money, so to speak put into the game, earnings have got to be shown. Suppose the railroads as a whole report gross earnings for this year the same as last year or the year before—does that signify that business has merely stood still? By no means. So much new capital having been employed, *earnings ought to show a corresponding increase.* If they don't, it is a sign not that business has stood still, but that it is actually going back. Nor can the figures be reduced to a per-mile basis, and comparison made that way. Increase in capitalization by no means necessarily results in corresponding increase in mileage. The money may be spent for cars, rails, improvement of roadbed, or a hundred other things. After it has been spent, the road *ought* to earn more per mile than it did before.

Foreign Trade

The fourth barometer of conditions is the nature and extent of our foreign trade. However economists may decry the importance of a balance of exports over imports, it is a matter of plain, common sense that when a country sells more than it buys it is somewhere accumulating a credit. Whether this credit be left where it is, to offset accruing debts, or whether it be brought home in the form of gold makes little difference—in either case it is a clear gain of just so much, and adds just so much to the banking power of the country. Substantial excess of exports over imports for any considerable period of time is, therefore, a stimulating factor of great importance, and the drift of our foreign trade toward or away from such a balance a matter of moment. About two weeks after the end of each month the figures are sent out from Washington and are given wide publicity. From them it is possible to keep close track of the trend of our foreign trade. The fact that the excess of exports over imports has so direct a bearing on the business outlook makes this a barometer well worth watching.

The figures for foreign trade are, however, another part of the industrial barometer which need to be read not only with care, but with understanding of the fact that they do not always mean the same thing. A big balance in our favor—that is to say, a big excess of exports over imports—is very generally taken to mean satisfactory business conditions. And so it does, as a rule, but by no means always. What caused the balance is of very great importance. Was it caused by a big increase in exports, imports holding up, too?—in that case, without question, conditions most satisfactory are reflected. But suppose that the balance in our favor turns out, upon examination, to have been the result not of an increase in exports, but rather a decrease in imports. That would put a different face on the matter entirely. Stationary exports and decreasing imports would have this effect of bringing into existence a big balance in our favor, but the existence of such a balance would be anything but a favorable sign.

Exactly that thing happened in 1908. Exports during that year were not so very much less than in the year before, but, owing to the post-panic business depression, imports fell off from $1,423,000,000 to $1,116,000,000. What was the result? That the balance of trade in our favor, naturally, suddenly swelled to big proportions. During the twelve months of 1908, as a matter of fact, the balance of trade in our favor ($636,461,360) broke all records. And that occurred in a year three-quarters of which was marked by acute depression in business.

Evidently the conclusion that a big balance of trade indicates prosperous business conditions is one that should be arrived at only after examination of what brought the balance into being.

Even the premise that rising exports denote increasing trade activity is at times subject to modification. Take it at a time when the crops —particularly the great export crop, cotton— have been large two seasons in succession. Total exports, in that case, are almost sure to run large. And even if agricultural exports are excluded and manufactures are considered by themselves, it does not always follow that big exports of manufactures indicate active trade. Back in 1910 and the first part of 1911, for instance, when business was contracting, exports of manufactured products ran big, for the simple reason that in any number of important lines it was a case either of finding an export outlet or of shutting down. Rather than do the latter, export agents, instructed to make such prices as would "keep things moving," were sent posthaste to all the possible foreign markets. The result was a very considerable increase in our exports of manufactured goods. But anyone who drew therefrom the conclusion that business here was particularly active would have been sadly mistaken.

In the case of big imports, too, as indicating prosperity, allowances must sometimes be made. As a general rule, rising imports do denote active trade and increased purchasing power. But, by a rise in commodity prices, imports are sometimes artifically stimulated. Under such circumstances, this being a good market in which to sell, merchandise is sent here in such quantity as to make it seem as though the demand for it and the activity in trade must be very great. Whenever the index-number shows commodity prices in general to be high, full allowance must be made therefor in the use of the figures for imports as a gauge of activity.

Iron Production

The fifth barometer, the country's monthly production of iron, is perhaps less closely watched than the others mentioned, but is quite as important. Iron, it is true, is only one of many commodities produced, but the steel industry is, after all, the basic industry, and representative of conditions as a whole. When the steel business is in good shape general trade is usually active, and vice versa.

A glance back over the monthly statements of iron production, published by the iron trade papers, and very generally reprinted by the general press, is all that is needed to show how closely the figures have reflected prevailing conditions and foreshadowed conditions to come. Production of the raw material, from which steel manufactures are made, is in the hands of no single interest to whose advantage it might be to have production represented as greater or less than it actually is. By the compilers of the statements, moreover, exceptional advantages are enjoyed for getting at the actual figures. The monthly record of iron production is not only a faithful portrayal of conditions as they have been and are, but furnishes a solid basis for deduction as to the future trend.

Bank Statements

The sixth barometer of business is the condition of credit as shown by the statements made by the Comptroller of the Currency. Contained in these statements there is much that is of interest to bankers only, but one item, that of bank loans, is so highly illustrative of the state of credit that it is worthy of the closest attention. Is the credit position in a state of strain so that liquidation is bound to take place?—prevalence of such a condition is immediately reflected in immoderate increase in bank loans. Are the banks in a position to finance another forward movement in trade?—loans relatively low will show that to be the case. Nowhere can there be found more succinct expression of the real state of credit.

Of the greatest importance, too, is the percentage of reserve to deposits, shown in the Comptroller's statements. High percentage of reserve to deposits means fundamentally easy conditions. Low percentage of reserve to deposits means strain. Slack requirements for money may keep the latter condition from manifesting itself in high rates, but as long as it exists it needs only a moderate demand for funds to make itself felt.

The foregoing are the fundamentals on which the intelligent business man or investor bases his estimate of future conditions. Like other barometers, they are not infallible, but by their aid the trend of things can be figured out with a reasonable degree of assurance. It is mainly a question of knowing the signs and of how to read them.

CHAPTER XI

EUROPE'S INFLUENCE ON THE AMERICAN MARKET

YOU are thinking of buying some bonds in a street railway company out in the Middle West or some shares in a copper mine in Arizona, and you ask your broker what he thinks of it. He tells you to wait—that the "foreign situation" doesn't look right to him. Very probably you go away wondering what the "foreign situation" has to do with street railroading in Illinois or copper mining in Arizona. It doesn't seem reasonable. What possible bearing can conditions abroad have on the value of the shares you have in mind?

What possible bearing?—were you familiar with the intimate relationship between the foreign markets and our own you wouldn't ask the question. Conditions in London? Of infinitely more importance are they to the New York market, for instance, than conditions in Philadelphia or Chicago. Twenty years ago, ten years ago, that may not have been true, but it is true today. The past few years have seen a great increase in the volume of security dealings between ourselves and the Old World. With the doubling of our foreign trade in the last decade, the financial relationship between American and European banking houses has been becoming continually closer, and as a consequence international trading in securities has been greatly facilitated. "How's the London market?" is about the first question the broker is apt to ask when he comes down to his office in the morning. And with good reason, for there are times when "London"—through the London market is concentrated most of Europe's business in American securities—is absolutely the dominant influence in shaping the course of our markets.

To get to the real root of the reason why "London" *is* the influence it is, it is necessary to go back of the day-to-week or week-to-week speculation in "Americans" by the foreigners, to the time when American enterprise was dependent upon European capital. Back in the thirties and forties, when our railways began to come into existence, it was foreign money with which they were built. After the discovery of gold in '47 we were in a little better position to further enterprise with our own money, but so great was the development of the country that our own financial resources were entirely inadequate, and foreign capital kept pouring into the

United States. Fresh inducements to the foreign investor while the West and Northwest were being opened up accelerated the flow, until the amount of Europe's capital invested in American enterprise amounted, probably, at the beginning of this century, to close on six billion dollars.

Europe's "Fixed" Investment in Americans

With all the changes and consolidations and reorganizations which have taken place, the bulk of this foreign capital has remained steadily in "Americans," and constitutes what may be called Europe's "fixed" investment. Now the mere existence of this huge foreign investment means continuous international trading in our securities. There are, in the first place, the maturities to be considered—the fact that of this great mass of bonds large amounts are falling due all the time—which in itself necessitates an annual reinvestment business amounting to hundreds of millions of dollars. After that, there are all the refunding and replacing operations and the retirement of old bonds by new issues, transactions which necessarily result in continuous dealings of great magnitude.

So that on the foundation of the "fixed" foreign investment in American stocks and bonds there is raised the superstructure of what might be called the "floating" investment—much as though an individual owned and held a large block of some kind of security, and then traded continuously in lesser amounts of the same thing. Kept well in mind, that idea will go a long way toward making clear the extent and nature of the financial relationship between the markets of the Old World and our own.

As a market influence, the fixed foreign investment in "Americans" is of far less importance than the floating investment, mainly because it takes a violent disturbance or change in economic conditions here to dislodge any considerable quantity of our bonds permanently held on the other side. During severe disturbances such, for instance, as the one which occurred in 1907, foreign-held bonds, which have lain untouched for years, are apt to be sold in this market. During such a period as early 1908, again, when the best corporation bonds in the world were selling to net five per cent., the foreign fixed investment is likely to be largely added to. But these times when the inducements are strong enough to make the managers of the big foreign estates in which so many American bonds are held sell or buy in quantity, are rare. Episodes and phases over which our financial press works itself up to a high pitch of excitement go entirely unnoticed on the other side of the water, and the main body of the holdings of "Americans" remains unchanged.

The Floating Investment

But with the floating investment the case is entirely different. Out of the closeness of our financial relationship with foreign banking houses there has originated a perfectly enormous volume of speculative and semi-investment dealing in securities. There is never a day when the international trading in our stocks and bonds does not run up into the millions, and at times there are continuous currents of securities running from one market to the other. London being the funnel into which most of Europe's business in American securities is directed, that market is the point of primary importance in its relation to our own. We do a certain amount of business direct with such points as Paris, Berlin, and Amsterdam, but the great volume of Europe's orders are cabled to the British capital and executed there, or from there.

International security-trading of this kind divides itself naturally into three classes. First come the operations, sometimes of a semi-investment, but more often of an out-and-out speculative character, which the international banking houses here carry on in connection with their European correspondents. After that there is the class of trading which results from the buying and selling done by the great European Investment Associations. Finally there is the continuous trading in both stocks and bonds which is bound to occur between any two great centres in close connection where large amounts of the same security are dealt in—"arbitraging," it is called.

With regard to the speculative transactions in American securities carried on by the foreign houses and their clients, it can be said that their extent has become very much greater than most people imagine. The partners of one of the foreign banking houses located in New York, we will say, make up their minds that a move is going to take place in some stock. If the house is one of a dozen or more prominent firms which go in for this sort of thing, it will probably have no trouble in getting several houses abroad to join it in the deal. Arrangements are easily completed by cable. The New York house is to engineer the actual operation and supply itself with all the cash it needs by drawing sixty or ninety day bills of exchange on its friends in Europe. That will allow two months or three months, as the case may be, in which to complete the deal without putting up any actual money.

Just here lies the importance of these foreign operations in our market, and the reason why they can be carried on to so great an extent without anybody being able to trace the buying or selling to its true source. There are no banks with whom the stocks bought are being deposited, no banks who know of the loans being made on them. There are really no loans being made at all. And yet the managing house here can supply itself with unlimited amounts of capital (always providing its credit is good) by simply drawing on its foreign friends. After three months these bills, of course, will come due and have to be "covered"—but usually, before that, the whole operation is closed. If not, the bills can be renewed for another ninety days, and so on indefinitely.

The great "Investment Associations" on the other side, in the second place, are responsible for continuous buying and selling in our market. There are a number of these organizations, many of them in Holland, whose main business is to deal in American securities. In most cases it is speculation, pure and simple, in which they are engaged, but speculation of such a kind, and carried on in such a way, that money is made out of it. The people who put their money into these associations know exactly for what purpose it will be used. They have faith in the managing officials, and, judging from the success and growth of these organizations, their faith is not misplaced.

The recently published lists of leading stockholders in American railway systems disclosed the extent to which these foreign Investment Associations hold our shares. There is nothing hasty or ill-judged about their operations. There is no delusion on the part of their hard-headed managers that they can make money out of in-and-out trading. It is simply a case of having a definite idea as to when prices are low and then going in to buy. They look at the matter in a far more dispassionate manner than we do, with a better perspective; and, consequently, make fewer mistakes. When prices get up, they are never obsessed with the idea that the advance will go on forever. They know what they think Missouri, Kansas & Texas or Baltimore & Ohio are worth, and when the price gets there they sell out. If the market keeps on going up—

very well, they are content to wait until it comes down. Then they go in and buy again.

The third class of operation consists in the minute-to-minute "arbitraging" between two markets, by which the parity is continuously maintained; also of the more deliberate trading in bonds by which bids and offers are kept on the same level in both markets. "Arbitraging" in the ordinary use of the word means the taking quick advantage of any slight difference in quotations between, say, London and New York. Sometimes, when some influence bears more heavily on one market than on the other, it is possible to make quarter and even half points, and at such times trading often becomes very heavy. These trades, however, being immediately closed off at both ends, have but little effect on prices.

The same thing is true of the arbitraging in the open bond market. There are houses here and in London employing high-salaried men whose sole business it is to keep in touch with bond-market conditions and quotations in both markets. Should someone here, for instance, offer a block of bonds, say at par, when one of these international bond men knows of a bid of par-and-a-quarter in London, the bond man will snap up the bonds offered and sell them out on the other side. This is a kind of business going on on an enormous scale and all the time; it must be so to maintain the parities between the two markets. There are influences continually arising which bear on one market more heavily than the other, and which, unless there were present this balancing influence of a force of keen and ever alert arbitrageurs, would be continually disturbing the parity of the two markets. As it is, it is just about as unusual for quotations of active issues materially to differ between London and New York as it is for them to differ materially between New York and Philadelphia.

The place, then, which should be given to "London" as an influence on our market is that of a permanent holder of a vast quantity of our securities—Middle Western street railway bonds as well as Arizona copper mines—disposed to trade continuously with us, and unceasingly in the closest touch with financial conditions here. What "London" thinks and what "London" is doing often makes all the difference in the world to the market here.

CHAPTER XII

THE INFLUENCE OF GOLD PRODUCTION ON SECURITY VALUES

ABOUT the discussion as to whether the increase in gold production has anything to do with the rise in commodity prices and the fall in the price of gilt-edged bonds there is nothing academic—it is, indeed, intensely practical. Here we have the two facts: first, that gold production *has* increased and second that bond prices *have* fallen. Is it cause and effect? If so, old-fashioned notions about the desirability of gilt-edged bonds as investments and the rate of income they ought to yield will bear some radical revising. If not, there is removed from the situation something which for several years past has given investors in every part of the world a good deal of concern.

Briefly stated, the theory is this: Gold is a commodity like anything else and exchangeable for wheat or corn or cotton or any of the other necessities of life. Now as you produce more and more gold it gets less valuable and a fixed quantity of it will exchange for (buy) less of any other given commodity. Which, of course, is only another way of saying that the price of that other commodity has gone up.

That is the first half of the theory. The second half is this: As the supply of gold is increased and the prices of all commodities rise, speculation is engendered and money is tied up. That means a gradual advance in interest rates, and that, of course, means a decline in the market value of securities bearing a fixed rate of interest (as for instance, bonds). Securities whose interest rate is not fixed (as for instance, stocks) will be favorably affected, especially where the shares are in companies having large natural resources likely to appreciate in price.

Now it is perfectly true that if there were just so much wheat and corn and cotton and other things in the world, and the supply of gold were suddenly to be doubled, an ounce of gold would buy just exactly half what it would before. If we were all on a desert island, for example, with just so-and-so many barrels of flour to go around, and flour was selling at $100 a barrel, the discovery of a gold mine on the island would quickly enough send the price far above $100. But, unfortunately for the gold theory, we are not living on a desert island; and if it is true that the world's *supply* of gold is increasing, it is just as true that the world's *need* for gold is increasing also.

The World's Need for Gold

Before we come to the conclusion, therefore, that the increase in gold production is going to raise prices and interest rates and react on bond values, it is well to consider what these needs are and how they are increasing. Take, in the first place, the simple fact that the world's population is all the time growing, and that the number of people engaged in producing commodities is continuously on the increase. Take, in the next place, the fact that with the increase in population and the advance in civilization the total amount of business done in the world (and, consequently, the amount of money necessary to do that business) shows a great gain from year to year. Add to the foregoing the fact that more and more gold is all the time being used in the arts and sciences, and it will readily be seen that the world can take care of a substantial annual increase in production without its exerting any influence on prices at all.

Any attempt to figure what the annual increase in the world's need for gold amounts to would be little better than random guesswork, but a glance at each of the three main sources of demand mentioned above is enough to show that it runs into big figures.

I

Let us consider first the increase in population which is ceaselessly adding to the number of those engaged in production. That the world's consumptive needs are thereby added to, is, of course, perfectly true, but that in no wise alters the fact that production of commodities is all the time increasing, and on a very great scale. Take, for example, the figures showing the present output of copper or iron or cotton or almost anything you can think of, and compare them with those of ten or fifteen years ago. By this great annual increase in commodities, it is evident, a large increase in the gold supply is offset. Had the production of gold not increased with the increase in the total supply of commodities, it is evident that the precious metal would be even more precious than it is; or, in other words, that commodity prices would be lower.

II

Consider, in the next place, how the world's need for gold is increasing as a result of the general advance of civilization. More business is all the time being done; more money to do it with is all the time being required. Not long ago the Bureau of Statistics at Washington issued some interesting figures on this point. They show, for example, that the whole world's international commerce, which stood at $16,000,000,000 in 1896, at the present time amounts to over $35,000,000,000. Taken altogether, in other words, imports and exports of the world's leading countries doubled in the last two decades.

Imports and exports are not paid for to any extent by shipments of actual gold, it is true, but the financing of foreign trade is accomplished by the use of bank credit, and the extending of credit, of course, necessitates the holding of gold reserves. With the great increase in foreign trade, therefore, and the greater amount of financing necessary, there has had to take place a great increase in the gold holdings of the banks all over the world. Very simply put, it is a case of the banks doing more business and needing larger gold reserves to do it on. Comparison of the gold holdings of the banks of any great commercial country now and fifteen years ago would show a great light to many of those at present disposed to worry about what is to become of all the gold being produced.

III

Then, in the third place, there must be taken into account the great increase in the use of gold in science and the arts. Year by year, with the progress in the scale of living, there has been a steady gain in the amount of the precious metal so used. Not many years ago the proportion of gold produced in this country and not coined was inconsiderable. At present a full third of our gold production is being used for other than coining purposes.

Along with the steady gain in the world's gold production, then, there has come a great increase in the world's need for gold—an increase in need far greater than most advocates of the "gold depreciation" theory realize. We have seen new mines opened up, new processes of extracting gold invented. We have seen, on the other hand, a growing demand for gold which has absorbed the increased supply as a dry sponge absorbs water.

What strikes the ordinary business man who thinks about it is this: Here we have an increase in the gold supply and an increase in the demand for gold, and, over a series of years, the one has about offset the other. But what assurance have we that these forces are constant? Suppose that one or the other of them begins to vary—that gold production, for example, begins to decline, or that the world's need for gold begins to fall off? What would happen then?

The probability of any considerable decline in the world's need for gold does not, it must be admitted, seem very great. As has been pointed out, the fact that the world's population is steadily growing and that business is all the time being done on a larger scale means a continuously increasing need for gold. What is going to cause any abatement in it, it is hard to see. There are bound to come times when there will be a slackening in the pace, but whatever may happen in the distant future, the world's business and its needs for gold are reasonably certain to go on increasing during the lifetime of every one now on earth. The question, indeed, is not one of whether there will be any abatement in the need for gold, but rather as to the extent to which these needs are likely to grow.

Production

The matter of production, on the other hand, is entirely different. It is quite true that the record of the world's gold output during the past half century shows a series of almost continuous increases, but that by no means proves that this tendency is indefinitely to continue. What has happened since the beginning of this century, indeed, has led a good many people to come to the conclusion that if we are not actually at the crest of gold production for the time being, we are very near it.

Pretty much the whole increase in gold output during the past ten years has taken place in just one field—the Transvaal. Gold production there is still on the increase, but in the opinion of those qualified to judge, this increase is not going to keep up many years longer. Not long ago the statement was put out over the signature of the National City Bank of New York that the increase in gold production at the present time "is almost wholly in one field, a territory all within a radius of twenty miles of Johannesburg, and that field is well defined and approaching the limit of its output." Other authorities agree that such is the case. The Transvaal gold field is far and away the richest ever discovered, but even at that can hardly continue to yield two hundred million dollars a year for very many years in succession. However full the barrel may be you are bound to get to the bottom of it after a while.

There is the chance, of course, that new fields will be discovered or that new processes will be invented to get gold out of ore not now commercially workable; but even in that case it is by no means said that there will be an increase in total production. Scientific mining methods and the application of the cyanide process have prolonged the life of many a mine far beyond original estimates of productivity, but sooner or later a mine gives out and that is the end of it. Since 1903 production of the Australian mines has fallen off steadily and production in the United States is showing the same tendency, though not yet in so marked a degree. If the world's output is merely to be maintained (to say nothing of any increase), new mines and new methods will have to be discovered.

From the standpoint of the investor, therefore, this matter of gold production is hardly as serious as it might seem or as some of the alarmists would have us believe. As a result of the Rand's great production, total output may still show an increase for some little time, but with the world's needs for gold increasing as they are, such increases will be more than taken care of. From this matter of gold production the investor in sound securities has nothing to fear.

CHAPTER XIII

THE SWING OF SHARE PRICES

WHILE the day-to-day or week-to-week fluctuation of share prices is without rhyme or reason and as impossible to foretell as the direction of the wind or the temperature of the air, there is no doubt whatever that the great swings of the market take place in entirely logical response to ascertainable conditions. An average of 70 for fifty active stocks at the end of this week as against an average of 71 for the same stocks at the end of last week—that is something which no human being can foresee or speculate on with any degree of intelligence. An average of 70 now as against an average of 65 or 85 six months or a year ahead—that is something which a good many people *can* and do foresee. During that period there are sure to be times when the immediate movement of prices will be entirely unreasonable and illogical, but always the general trend will be in the same direction. Governed as it is absolutely by business and money-market conditions, there is nothing unreasonable or illogical about that.

Business and money-market conditions—under those two heads can be summed up pretty much all the influences which bear on stock prices. What is the outlook for earnings and dividends? Then, what is the outlook in the money-market that deserved credit will be easy or difficult to obtain? Answer those two questions and you have the answer to the question as to whether the swing of the market is to be up or down.

In the accompanying diagram the main divisions of the two great influences are set forth. There are, of course, a number of other minor influences, but to enumerate them would be simply to cloud the main issue. Take the market at any given time and the real forces which are operating to put it up or down or to hold it steady will be found among those given.

THE MAIN INFLUENCES BEARING ON STOCK PRICES

- Business
  - Dividend Prospects
    - Seasonal—the crops, etc.
    - Conditions affecting particular industries.
    - Labor conditions.
    - Government regulation.
  - Economic developments, such as changes in the corporation laws, the tariff and the currency system.
- Money
  - Speculative buying and selling
    - By the public.
    - By operators.
    - By pools.
  - Investment operations conducted partly on borrowed money.

The Business Influence

Most important of the various influences bearing upon the value of a stock is its dividend prospect. A thing that exists in perpetuity, it has been aptly said, is valuable in exact proportion to the income it will each year bring to its owners. A stock is of that character. The stockholder, it is true, has an equity in the assets of the corporation, but that equity is of little account unless the business is actually wound up and the assets distributed. It is not in order to acquire an equity in the property owned by the Pennsylvania Railroad or the United States Steel Corporation that the investor buys the shares of those corporations, but rather because of the income, present or prospective, yielded by them. If business conditions are such as to suggest future earnings great enough to warrant increases in dividends, prices will advance in anticipation.

To be able, then, at any given time to take the current business situation and from it correctly to read whether we are running into a period of dividend-increases or the contrary, is to be able to get a very definite line on the swing of stock prices. If it is a fact that a year from now business is going to be so much more active that the then earnings of the railroads and other corporations will warrant the raising of dividends all along the line, an upward swing of prices in the near future is absolutely assured. If, on the other hand, the signs point to contraction in trade and earnings which may make necessary dividend reduction, the market is just as sure to decline in anticipation of the event. Far in advance of the time when good or bad conditions actually prevail, the market "discounts" their arrival.

Whence this prescience on the part of the market? Simply because the "market" reflects the will and actions of those who do have the ability to gauge future conditions and far in advance. In March of 1907, a full half year before the panic, general business was extremely good and the average man had not the slightest idea of what was impending. Yet at that time and apparently out of a clear sky there came an avalanche of stock-selling which drove the price of a good many stocks almost as low as they subsequently went during the panic itself. Why was that? Simply because men representing large business interests and in a position to judge came to the conclusion that however good business at the time might be, a period of depression was impending. So, while the uninformed bought stocks at what seemed bargain prices, these large holders who foresaw the trouble to come sold out everything they could. That is always the way it is when there is a change in business conditions impending. Far in advance, the market, reflecting the mental attitude of those in a position to know, will "discount" what is coming.

In the chapter on "Business Barometers and How to Read Them" there are given a number of suggestions which ought to prove of value in making a correct estimate of the business outlook. Aside from general conditions, however, there are certain specific influences bearing on the future of dividends which ought carefully to be watched.

Dividend Prospects

In the first place there is the seasonal influence, an important one in this country where the state of the weather during the course of two or three months makes an enormous difference in the total of new wealth produced. To securities aggregating several billion dollars this annual question of the crops, indeed, means all the difference between good and bad business. Take, for example, the great railroads operating in the Northwest. To them, big crops are an assurance of active business not only while the actual produce is being hauled to market, but during the whole time that the return flow of merchandise, purchased with the proceeds of the crops, is in progress. Let there be anything like a crop failure, on the other hand, or even a shortage in the normal yield, and a period of poor business and declining earnings is inevitable.

In figuring the dividend prospects not only of the railroads directly affected but of practically all large corporations in the country, this seasonal influence must be taken into account. Are the earnings of any important group of roads adversely affected?—the influence is bound to make itself unpleasantly felt from one end of the country to the other. The biggest buyers of merchandise in the country are the railroads. Whole industries have been built up dependent upon them, upon which, again, other industries have come to depend. Let anything happen to hurt the railroads' buying power and, as when a stone is thrown into a pond, the resulting ripples will lap the furthest business shore.

Other important individual influences bearing on dividend prospects are the relationships existing between particular companies or groups of companies and their employes, and between them and the Government. The fact that a company has a strike on its hands or is threatened with a strike is no reason for any great depreciation in the value of its stock; but, on the other hand, if in any particular industry labor conditions are chronically bad, in the long run an adverse influence on the shares of the companies engaged in that industry is bound to be exerted. To no small extent, for instance, can the decline in the value of railroad shares which set in after the post-panic recovery be attributed to the highly unsatisfactory labor conditions prevailing in the railway industry during the past two or three years. With conditions as they were—successive demands by one class of railway labor after another being made—it is hardly surprising that the average investor was unwilling to put his money into railway securities.

That the other influence mentioned, regulation by the Government, has an important bearing on dividend-prospects, is only too evident in whatever direction one may turn. Take the case of the shares even in the smaller industrial companies where there is no question of unlawful organization. Even there dividend-prospects are under the shadow of what may result from the Government's crusade against the big combinations engaged in the same line. A small manufacturing company may know itself to be well within the law, but if greatly disturbed business conditions are likely to result from govern-mental efforts to break up similar concerns of greater size, the smaller company's earnings are bound to suffer.

In the case of railroad and public service corporation stocks the strong tendency toward Government regulation is, of course, a particularly important influence on earnings and dividends. As a matter of fact it has come to be pretty well understood that the various State Commissions which regulate intrastate commerce, and the Interstate Commerce Commission at Washington, will not stand for dividends in excess of a certain amount on stocks in companies operating under public franchise. Whoever buys the shares of a railway or an interurban electric road or of a gas and electric company or of any other public service concern should, therefore, do so only with full understanding that the amount of dividends he can hope to receive is strictly limited. Should the company's earnings increase beyond what has come to be considered a fair return the excess will either have to be put back into the plant, or, even worse, at least from the shareholder's point of view, the Commission is likely to step in and order a reduction in the charge made for the transportation or whatever it is the company sells.

Economic Changes

Aside from dividend prospects the other main business influence bearing on the movement of share prices is the chance of change in established conditions. The publication of this book is likely to find in effect a complete revision of a tariff which, with minor changes, has been in force for years. Complete overhauling of the banking and currency system of the country is another such change of great economic importance, and yet another is the rewriting of the outworn Sherman anti-trust law which is bound to come in the not distant future.

On share prices all such great developments, even during their period of gestation, exert an important influence. Long in advance of the time when the tariff revision was actually begun —as far back, indeed, as the time when it became evident that the Democratic party would be successful at the polls in 1912—business and the markets began to shape themselves in anticipation of the economic changes which it was plain were impending. So it always is when such great changes are in the wind. By no means does the market wait until they are actually under way. A year or more perhaps, before they are really seriously thought of by the general public, the market begins to discount them. By the time one great change such as the tariff or the currency is made, share prices may already be feeling the effect of the next great change, such, perhaps, as the revision of the trust laws. It is not a matter of what is going on now or of what may be going on tomorrow, but of what lies a considerable distance ahead.

The Money Market Influence

So much for what may be called the "Business Influence" on share prices. The other great influence—that of the money market—is an entirely different proposition. Roughly, as shown by the table at the beginning of this chapter, it may be divided into two parts. In the first place the money market impinges on the stock market through the buying by the public, by operators and by pools which is always induced by low rates for money, and through the selling by these same parties which always happens when money rates get high. In the second place there is an important point of contact through investment buying and selling started by low or high rates for money.

Of these two divisions of the "money influence" on stocks, the first mentioned is by far the most important. Let us consider in the first place what happens when for any reason it becomes possible to borrow money from the banks freely and at a low rate of interest, and then glance at the reverse of the picture and note the effect, on the price of stocks, of a rise in the money rate.

Speculative Operations

Money in plentiful supply and at low rates—of that condition the public, as a rule, is not slow to take advantage. Very generally is it appreciated these days that whenever the sinews of war are available on easy terms large individual operators and the combinations known as "pools" may be counted upon to "start something" in the stock market. And, in anticipation, the public begins to buy. The price of this stock and of that stock is down—with so much money around the chances are that the pool which operates in it will get active and begin to move up the price. So, in the hope that something like that will happen, people go in and begin to buy. With money so plentiful, every facility is accorded them. Margins required are small, rates charged are low. To get into the market under such conditions, to follow up one purchase of stocks with another, is extremely easy. Let the ball once be started rolling and the papers begin to print accounts of this and that person's big winnings, and people who have never before taken any interest in the market or in stocks will begin to come in and add the force of their buying to that already in progress.

The public comes into the market at such times because it believes that the big operators and the pools will take advantage of money conditions and put up the market. The operators and pools, on the other hand, are only too willing to do that very thing, realizing as they do that the public, once interested, will overstay the market and eagerly absorb whatever is handed it even at the top price. It is a pretty game and one which always has the same ending. A small part of the public —a very small part—knows what it is up against and while the pools are still apparently accumulating stocks, takes its profits and gets out. But by far the great majority of people play the game as it is intended they should play it and keep on buying stocks long after the crest has been reached and the pools and professionals have begun to sell out.

The foregoing may seem to deal with a speculative rather than an investment phase of the markets, but by the swing of prices, it must be borne in mind, the very best investment stocks are likely to be affected as much, or almost as much, as the most speculative ones. Cheap money and the consequent formation of pools is by no means limited in its influence to the speculative favorites. The movement of prices is as a whole, and the fact that half a dozen big pools are operating in as many of the speculative issues may result in a movement quite as extensive in other issues in which no pools exist.

The reverse condition, that is to say a time when money is hard to borrow from the banks and a big price has to be paid for its use, invariably means selling and on an extensive scale. On the stocks being carried for their customers the commission houses are forced to charge a high rate of interest, with the result that a good many customers begin to sell out. Operators, too, who are carrying lines of stocks on money borrowed from the banks, begin to figure that the interest charge is eating them up and begin letting go of their holdings. The same thing is true of the pools, which, however, have the additional selling incentive that in times of high money the banks discriminate against them and force them to repay their loans at the earliest possible moment.

From these sources and a number of others which might be mentioned there is sure to come heavy selling of stocks every time that money rates begin to get up and it looks as though there were a period of high rates ahead. And very far in advance does this influence make itself felt. Let bankers and others in close touch with the financial situation become convinced that conditions are shaping themselves for a high money market, and far ahead of the time when the rise in rates is expected to materialize quiet, "inside" selling will begin to take place. Many a time May and June have seen extensive liquidation of this sort, predicated exclusively on the expectation of a money shortage during the closing months of the year. It is a case of everyone doing his selling before the other fellow begins his.

Semi-Investment Operations

The second phase of the "Money Influence" on the price of stocks has to do with the buying and selling of semi-investment holdings, carried partly with the aid of borrowed money, which takes place whenever money rates fall or rise. To a greater extent, probably, than is generally realized, operations of this sort are carried on. Take the case of a wealthy man who makes up his mind that certain stocks are low and can safely be bought for a rise. In some cases he will pay cash for what he buys but in many other cases he will not. His money, it may be, is tied up in real estate or in some other way, so that it is inconvenient for him to realize the cash necessary to buy the stocks he wants to buy. He is more than likely in that case to put up a small amount of actual cash and to borrow the rest. A "margin" transaction? Yes, it is, in a sense, but not necessarily a speculative operation. The stocks bought may cost only a fraction of what the purchaser is worth and yet, rather than liquidate his other investments, he may choose to buy them largely with borrowed money.

On operations of this sort the money market, palpably, has a strong influence. If money is scarce and hard to borrow that, it is plain, will be a strong deterrent. If, on the other hand, at a time when the market looks low, it is possible to borrow money easily, a good many wealthy men are likely to put up some of their other securities as collateral and go into the market extensively on borrowed money.

Any sharp change in money rates can be counted upon to bring about heavy buying and selling of this sort. There has been a long period of low money, let us say, and a large amount of this semi-investment buying has been done. A time comes when it is evident that the money market is about to move up to a higher level. At once liquidation of these stocks will be begun. To hold them during a time when the dividends they yielded took care of the interest charge on the money on which they were being carried, was one thing. To hold them through a time when this interest charge is not so being taken care of, is an entirely different proposition.

There are, as has been said, other influences which bear upon stock prices and at times drive quotations up or down, but, so far as the long swing is concerned, the market is pretty well governed by the two broad influences mentioned — money and the outlook for dividends. Is the business outlook such that dividends generally have a good chance of being put up a peg and is the sky clear so far as the money market is concerned? —in that case the trend, whatever the day-to-day or week-to-week fluctuation of prices may be, can only be in one direction, upward. Is the dividend outlook, on the other hand, uncertain, and is the prospect that not so far ahead there may be a time when money will be scarce and hard to borrow?—in that case a period of declining stock prices may reasonably be expected. About the broad swing of the market there is nothing hit-or-miss. It is in entirely logical response to conditions which can be read —by those who know how to read them.

CHAPTER XIV

THE MOVEMENT OF THE PRICE OF BONDS

ON the price-movement of high grade bonds—that is say, of bonds whose security is unquestioned — the sole controlling influence is money. A bond is an obligation entitling the holder to receive a sum of money at the end of a certain period, with interest payable at fixed intervals in the meantime. What is the right to receive such principal and interest worth?—that, evidently, is purely a question of how much the same amount of money would earn if otherwise employed. If the money market is low and all a bank desiring to loan out funds can realize is, say, three per cent., any such obligation as a gilt-edged bond conferring the right to receive, say, four per cent. interest, is going to be held in esteem and sell at a high price. If, on the other hand, the money market is such that by loaning out its funds direct the bank can get five or five and one-half per cent., it is not going to pay much for a bond or any other kind of obligation conferring the right to receive only four.

By no means is it merely a flat question of the relative amount of interest to be derived from this form of loaning or that; but, in the long run, the underlying principle inevitably does govern, and the amount of interest derivable from the best bonds swings into line with the amount of interest otherwise obtainable. Which, of course, is only another way of saying that when money rates are low, bond prices tend to rise and that when money rates are high, they tend to fall. The higher the price paid for a bond, naturally, the lower will be the amount of net income received, and vice versa.

The price of good bonds moves slowly and every little change in the market for money does not, of course, find reflection in the market for bonds; but by the movement of money rates the price of bonds is, in the long run, absolutely governed. Is the situation such that ahead of us we have a period when rates are going to be high and money hard to borrow?—in that case a downward movement of bond prices may confidently be expected. Are we, on the other hand, running out of a period of high rates into a time of distinctly easier conditions?—if so, a substantial advance in bond prices is almost sure to take place. Far in advance, the bond market discounts whatever sort of a money market is to prevail.

The Three Sources of Buying Power

How intimate is the connection between the market for money and the market for bonds can perhaps best be shown by assuming a period of low money rates and then noting the bond-buying power developed thereby first among the banks; second, among business houses; and third, among the many people of means who, when ever money can be borrowed at a low rate, utilize this credit to buy securities yielding a higher rate of interest than the money costs them.

Let us consider first the banks, which, during the past few years, have come to use a constantly increasing proportion of their loanable funds for the purchase of high grade bonds. A time comes when money for commercial purposes is not much in demand, and when the banks and trust companies all over the country are hard put to it to find profitable employment for their loanable funds. What more natural, under the circumstances, than that they should turn to the bond market? Confining themselves to the best issues, they can find plenty of bonds which combine safety, price stability, and a high degree of marketability, with a very fair rate of income. Four or four-and-a-half per cent. is not, it is true, a high rate of interest, but it is better than the bank can do elsewhere. And the money, it must be remembered, is not tied up—should a sudden demand arise the bank does not have to await some maturity date, but can sell its bonds and at once have its money in hand.

Ten years ago the banks, with the exception of the larger city institutions, bought bonds to only the most limited extent. To-day the practice is general. The little bank and trust company out through the country as well as its town correspondent keeps part of its funds in high grade bonds, considering this investment as a kind of "secondary reserve." A time of slack money rates finds these institutions adding largely to their holdings. They have come to see that not only can money which would otherwise be idle be profitably so employed, but that, on bonds discriminatingly bought at the beginning of one of these periods of cheap money, a profit of several points is likely to be realized.

In the market for the best grade of bonds, buying from this source becomes a potent factor whenever a period of low loaning-rates is in sight. There are upwards of 30,000 banks in the country, everyone of which may legally so use its funds. Buying of this sort does not often force a sudden rise in prices, bankers being generally indisposed to "follow the market up"; but by it there is likely to be performed that absorption of offerings which must always precede any pronounced advance.

The second important source of buying developed by a period of low money rates is from among the many corporations and individual business firms which, when business is inactive, employ a part of their idle capital in the bond market. Low money rates—that in itself almost says that business is quiet and that firms using large amounts of capital during times when trade is good have funds on their hands for which employment must be found. Very naturally does a substantial proportion of this money come into the market for bonds. The problem is to keep it on hand, ready for use in the business, and yet earning more than the meager rate of interest the bank will allow. Almost ideally does a good bond fill those requirements. The money, in the first place is safe—safer, if good judgment is exercised, than in the local bank. In the second place, it is where it can at any time be reached, all the firm having to do if it needs the money being to order the bonds sold. Furthermore, instead of drawing the two per cent. the bank would be likely to allow, the money is drawing at least twice that amount.

In gauging the effect of this sort of buying on the bond market it must, however, be borne in mind that it is confined to the very highest grade issues and only to those having an exceedingly high degree of marketability. However safe a bond may be or however attractive may be its yield, unless it can be turned into cash at a moment's notice it is unsuitable for the investment of the idle funds of a business house. Overnight, occasion may arise where the firm's entire capital will be wanted. The bonds it buys must, therefore, be such that without delay and without price-sacrifice they can be converted into cash. It is only on bonds of this sort, therefore, that buying by business houses has any effect. The great rank and file of bonds, good though they may be and yielding an attractive rate of income, do not get the benefit of buying from this source.

The third class of buyers who may be relied upon to come into the market for high grade bonds whenever money rates get low and give promise of so remaining are the individual capitalists, large and small, who make a practice of using money cheaply borrowed to purchase bonds yielding a higher rate of interest. Operations of this sort were formerly undertaken only by men of large means and strong banking connections, but are nowadays being carried on by a large number of people all over the country. A man finds, we will say, that on the security of good bonds, he can borrow money for sixty days at two and one-half per cent. With that money he can turn around and buy bonds of the very best grade netting him well above four per cent., which bonds he puts up as security for his loan. The bank will not, of course, lend him quite the full value of the bonds, but on such security will lend him so nearly the total value that he can make practically the whole difference between the two and one-half per cent. he pays for the money and the four per cent. he gets. That is, assuming that the bonds do not fluctuate in price. If, when the time comes to pay off the loan and sell out the bonds, they have risen in price, he makes just that much more. As to the other possibility, that the market will have gone down in the meantime, it must be remembered that the bonds can have declined considerably without the operators having lost anything more than a profit he would otherwise have made.

To the man who understands bonds and has the necessary credit and facilities, operations of this sort present themselves in an exceedingly attractive light—that that is so is proved by the increasingly large scale on which they are being undertaken. Let the money market show signs of weakening, with any reasonable prospect of a period of continued low rates, and from all over the country orders begin to come in to the bond houses to buy blocks of this and that issue at a price to yield such-and-such an income. The profit to be made is, it is true, moderate, but so is the risk. Bought during the early stages of a period of low money, a high grade bond is not likely to show depreciation in price for a considerable length of time.

Here, again, however, as in the case of business houses having surplus capital to invest, only bonds of very excellent quality and having a ready market get the benefit of the buying. Price-stability in operations of this sort is, naturally, a prime consideration, and a sufficient degree of price-stability can only be found in bonds of the very highest grade. Very much sought after indeed for operations of this sort are short-term obligations yielding a high rate of interest. With its maturity near at hand, the short-term obligation of a strong company will not decline materially in price however unsatisfactory conditions in the rest of the market may become.

Holding such a security, the man who has borrowed the purchase money from the bank can afford to sit still and await the time when it will be paid off at one hundred cents on the dollar.

The above is a description of what happens in the market for high grade bonds upon the advent of a period of cheap money. Fully to describe what happens when the turn in the money market is the other way is unnecessary—the process is simply reversed and from the three sources described above there comes selling instead of buying. The banks, feeling that they will before long be able more profitably to employ their funds, begin gradually to liquidate their bond investments. Business houses, foreseeing the need of having the full amount of their capital in hand, do the same thing. And as to the individual operator dependent for his profit upon the rate the bank is charging him on the loan, the quicker he sells out and pays off what he owes, he realizes, the better off he will be. Let but the probability of higher rates come across the face of the money situation and from all three of these sources selling will only too quickly be begun. Neither the bank manager, nor the shrewd business man, nor the individual enterprising enough to buy bonds for an interest-profit imagines that he is the only one who will have some selling to do.

Bonds Not of the First Grade

The foregoing has to do purely with the market for high grade bonds—the market for issues of lower grade is an entirely different proposition. To a large extent the money market is there, too, a factor, but by no means is it a factor of dominating importance. Take the record of the movement of bonds of secondary grade during the past few years, and, on several occasions, it will be found, while the money market was on the way up the price of bonds of this sort was on the way down. The money market may have been pulling in the direction of higher prices, but other influences were pulling harder the other way.

Of the price movement, as a whole, of second-grade bonds, nothing very definite can, indeed, be said. Securities of this sort, looking attractive as they do during times of active business and most unattractive during times when earnings are falling off, follow, in a general way, the course of trade. A time when business is active and the outlook bright is apt to find people buying bonds of this sort on the idea of impending betterment in market position. But in the movement of prices there is little uniformity. While one second-grade bond is going up on the strength of earnings prospects and the probability of interest being earned by a wide margin another is apt to be declining by reason of a fresh lot of the bonds being forced on the market or for some other cause. Each issue by itself and judged on its own merits—that is the only rule to follow in the purchase of securities of this kind.

Exactly the same thing is true with regard to the great mass of public service bonds and "specialties" being distributed by the bond houses among their clients. In the price movement of issues of this sort there is not the slightest uniformity. Influenced by totally different considerations, some of them rise in price while others fall. There is, indeed, nothing that can be called a "market" in this type of bond. One company does well, and its bonds go up in price. Another does not fulfill expectations and its bonds go down. I am thinking of buying some of the bonds of a power plant in Colorado, or of a timber company in Florida—is this a favorable time? To that question there can be no answer. It is not a matter of markets or of the influences bearing on them. It is a purely individual matter. This particular security—is it sound and does it fit my particular requirements?—that is the question at issue. In its price movement it will be influenced not in the slightest by the fact that the stock market may happen to be going down or by the fact that the market for first mortgage railroad bonds may happen to be going up. Each individual bond of this sort on its own merits—that is the only rule for the buyer to follow.