Putnam's Investment Handbook

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A Stimulus and a Guide to Financial Independence

By

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INTRODUCTION

One of the chief elements of success in this world is the ability to save money and to invest it securely after it has been saved. It is the purpose of this book to explain in a practical way, that can be understood by all, how to invest the money which you, the reader, have succeeded in saving. Except for a few simple statements of fact in the introduction and first chapter, we will take it for granted for all practical purposes that the great majority of grown-up persons, and even many children for that matter, understand the wisdom and desirability of accumulating money. What the readers of this book are after, I take it, is to find out how to make their money work for them after they have saved it.

There are a few fortunate people who either inherit so much money or make so much that they do not need to think about saving. Emphasis had better be put upon the word few, because even the wealthiest spendthrifts often come to grief. But the overwhelming majority of mankind do need at all times to use their money as wisely as possible in order to get the most benefit out of it. In other words they need to save.

I sometimes wish that all my money responsibility would cease when the check comes from the publisher. It is hard enough for most of us to earn a living. It is certainly a great nuisance to have added to that responsibility another almost if not fully as great, namely the disposition of the contents of the pay envelope. Of course there is no nuisance involved in spending money, but alas, merely to spend does not discharge our full responsibility in the matter, especially if we have wife and children, or if we expect to grow old, or if we are ambitious to get ahead in the world.

The importance of this subject of saving and investing money is very much greater than it was a few years ago because so many more people are interested in it now than then. The war conferred at least one great blessing upon us as a nation. It taught us that we could save and invest. Before the war there were not more than half a million known bondholders at the outside estimate in the country. Now there are possibly twenty million, if we include the people who own War Savings stamps.

Of course all these twenty millions are not entirely new savers. Many of them had accounts in savings banks before the war. Still more had life-insurance policies. But many millions of them did not have either. They have learned to put money at interest. To them this lesson has been "just like finding money."

Indeed that phrase, "why, it's just like finding money," has been repeated countless times by all sorts of people who have bought Liberty bonds on the part payment plan and who have completed their payments It is true not only of wage earners but of many people with incomes even of $5000 a year or more. Those millions of people who bought a $50 Liberty bond or a $100 bond are ahead just that much. They cannot tell you just what they would have spent the money for if they had not bought Liberty bonds but they know that they would not have it now if the purchase of bonds had not been made.

Saving and the Nation. Now it is of the utmost importance to all these people, to the nation, and to the world, that they continue to save and invest. It is easy to slump now that the war is over. There is a tendency to become extravagant again, to buy everything we want or think we want. The welfare not only of the nation but of millions of individuals in it is bound up with the ability of these new bondholders to continue to accumulate money.

Saving money is just as important to the nation as to the individual. It makes for prosperity, provided it is not carried too far, and there is not much danger that we Americans will become too thrifty. It is the accumulation of small savings through the banks and insurance companies as well as from the individual investor, that makes our great industries possible. As one writer has said:

> Thrift is a double protection for wage earners. It not only leads to independence, but it produces those accumulations of capital upon which, husbanded and invested by savings institutions, the industries of the country must depend. It will keep the wheels turning, insure permanence of employment, promote activity in business and national prosperity, add to the country's wealth, and provide good wages. Money circulating from hand to hand is a convenience, a necessity, it sustains trade, but accumulated wealth reproduces itself, and in that process of reproduction labor must always be employed.

Of great importance is the fact that ownership in a good bond or stock gives one a feeling of personal interest, of partnership, in the country. House owners have long been considered better citizens as a class than renters. They have more interest in the community. Every earner in this country ought to own something tangible. If he has a substantial stake in the country he will not be a ready convert to Bolshevism, the disease which destroys the poor man's living along with the rich man's property.

Capitalists of the Future. Alfred C. Bedford, Chairman of the Standard Oil Company of New Jersey, recently said that he could foresee the time when the public might become the bankers for the industries of the country. Because of the policy of many companies to encourage employees to invest in securities of the companies which employ them, it is readily possible, he pointed out, that the big corporations would before long be owned by the workers.

Already the employees of the United States Steel Corporation own one sixth of the stock of the company. If every employee should save two dollars a week and put it into the company's stock the control of this huge corporation would be with the workers within ten years. This shows what the small savings of the people at large may in time accomplish.

"Such a condition appeals strongly to the student of industrial democracy," said Mr. Bedford in regard to the general possibility of which the case just cited is an example, "but not to the extreme socialists because it would continue to be the thrifty and industrious and intelligent who would be multiplying wealth."

The ability of France to continue the war despite her enormous losses was largely due to the saving and investing qualities of the people at large. As far back as 1911 there were eight million land owners in France and even the humblest peasants had shares in the railroads and great banks in addition to Government bonds. When the fishermen failed to make a single good catch in a whole year they were not dispossessed or "thrown on the town," for they had savings to fall back upon. Mr. John J. Arnold, a well-known Chicago banker, in referring to the tremendous investments of the people of France, recently said:

> Prior to this movement, France was in a state of almost constant political ferment and unrest, while since its development, which dates practically from the time of the Franco-Prussian War, the nation has experienced internal quiet and peace.
>
> She has been more free from strikes and labor trouble than other European countries, and the people as a whole do not appear to have been

in sympathy with the strikes which did occur, as is shown by the fact that very few strikes were successful. It is the opinion commonly held by students of the situation that most of this is due to the fact that the vast bulk of the people have had a direct financial interest in maintaining the credit of the nation as well as that of the industries, which cannot be done in the face of disturbances and labor strikes.

In 1905, which is looked upon as a most interesting year, France experienced only 830 strikes, while Germany in the same period had 2403.

Of greater importance perhaps, is the fact that as a direct result of the wide interest of French people in railroads and public utilities, laws in France are not passed for the purpose of interfering with their operation and fair earnings.

Saving and investing have an international aspect as well. Capital is needed to rebuild the world after the great war. It can be had only as people are willing to refrain from immediately spending all their income and learn the desirability of investments.

But this book is not concerned directly or mainly with national and international problems. It aims to discuss in a simple yet helpfully practical way the investment of money. But before the subject of investment is taken up at all it will be necessary to indulge in a little straight talk about the relation of saving to the individual.

CHAPTER I

THE TRUTH ABOUT SAVING

PERHAPS never in the history of the world has so much been said on the subject of saving as at the present time. If Benjamin Franklin, Samuel Smiles, and all the other famous apostles of thrift, were alive to-day it is doubtful if they could add a single word of argument to those which are being presented. Fortunately so much preaching and exhortation will do some little good; but the waste of ammunition, as it were, is terrific. People naturally dislike to go without comforts and luxuries when they have the money to buy; and people also are hardened to sermons, moralizing, and all the rest of the apparatus of the preacher.

I am not in possession of any new or fresh argument that will induce spendthrift people to become thrifty. I have no cure-all for what is a very complicated disease. But it does seem as if too much emphasis has been laid upon mere eloquence, rhetoric, and oratory in the thrift campaign, and not enough upon the hard-headed practical question of how well it pays the individual to save. What is the personal reward for the man or woman who saves?

Begin in Time. Truth to tell there are millions of men and women who could be made to turn pale at the thought of lost opportunities if only some one in whom they have trust should suddenly seize them by the arm and point out, in a few brief sentences, how they might have accumulated a small fortune—or at least a competence—if only they had started right.

There is no one person, no prophet or messiah, who can concentrate or expiate in his own person this widespread daily tragedy of millions. Most people do not realize until middle age, when it is usually too late, that if they had begun to save, say, a third of their earnings in the early twenties, and had stuck to it, they would have an income in the middle or late fifties equal to their former earnings. Youth is heedless because it is youth; middle age becomes heedless from habit, and often from despair. War and after-war thrift propaganda will no doubt relieve these moral defects to a slight extent; but it cannot eradicate them.

Mr. John G. Shedd, head of the Marshall Field store in Chicago, was recently quoted as saying that if young men between eighteen and thirty could be taught to save, there would be precious few men wearing frayed trousers when they were old; and he added that it was far better for a man to wear frayed trousers before thirty than later in life. But the important thing, he said, was that his own attention was first called to the benefits of saving when he was a boy and had happened to read an article telling what compound interest would do.

Doubtless thousands of new fortunes would be started, and the poorhouses robbed of most of their future occupants, if every young man of twenty in this country could be forced to spend five minutes with a cheap lead pencil and a scrap of paper, figuring where he would be, financially speaking, at fifty or fifty-five, if he should put aside at compound interest every week a fixed number of dollars—not more than five.

Causes of Success. And there is not a shadow of doubt that the most scientific analysis of the causes of business success and large fortunes, including even such elements as luck, trickery, and fraud, would put ability to save money 'way up in the list—almost next to what everybody knows to be the chief causes, which are industry and concentration.

Some time ago the editor of a magazine suggested as a subject for an article the following question: "Can a man get to the top in finance by brains alone?" It is not proposed to answer this question here, but it can be stated in the most emphatic manner that unless a young man (or a woman) accumulates some capital of his own, he cannot possibly overcome the lead of the inheritors of wealth. More and more young people do start with inherited money, and the millions that haven't any are handicapped to begin with.

To be successful a business enterprise and an individual alike need a backbone of money. The American Bankers' Association, through its Savings Bank Section, recently published an article that said:

> Whether it is a million-dollar corporation or a corner grocery, there must be a foundation, the investment of the proprietor. The man who starts out on a shoestring fails. No matter what he may have in the way of borrowing facilities, there may come a time when he finds the avenues of borrowing closed against him. Then his reserve capital comes into play.

This is both a spendthrift and a borrowing age. People are making money easily. Wages are high, and attractive ways of spending it more plentiful than ever before in the world's history. Facilities for borrowing are constantly increasing.

There is the Federal Reserve System to enable the banks to borrow more easily, a new Farm Loan System, a Morris-plan for small wage earners, and everywhere discussion and agitation to increase still further the means of borrowing.

The Backbone of Business. But don't forget that the backbone of every business, of every farm, and of every individual life, is the saved (or inherited) capital of the proprietor. More business failures are due to lack of capital than to any other cause, nearly one third of all failures being accounted for in this way.

Bankers know from bitter experience what this means. Before making a loan they like to see two dollars of quick assets to one dollar of quick debts. They require that the borrower keep several hundred dollars on deposit before they will lend him a thousand—not that they want the extra money, but they do want to be certain that the borrower has ample working capital, something to meet emergencies, something left over in the way of cash if all the debts had to be paid in a hurry.

One of the great weaknesses of American business life is the starting of a business on insufficient capital. Two carpenters and builders who have saved a few hundred dollars decide to become their own bosses, and by some scheming get a piece of land. They persuade friends to agree to lend them a certain amount on the building when complete, and lay their plans carefully and figure closely. Something goes wrong: the weather is bad, the work is delayed, strikes and liens not reckoned with interfere, and the result—failure. They lack capital; and lacking it, lose out. They cannot carry their load.

Clerks with a little money and colossal nerve begin business for themselves, only to find bankruptcy staring them in the face in a short time, due to lack of capital. A good year makes the proprietor jubilant, and willing to gamble that the next will be better. He moves into larger quarters, lives more expensively, buys a car, and hires his servants, only to find depression setting in, unsettled business conditions, competition, mishaps, and no way of retrenching.

The only sound way to start any proposition is to finance it in part yourself. Save the money. It is the only way to "finance" an invention. Elderly inventors often sell the brilliant results of their time and genius for a mere song, because they have no cash of their own. Even a few hundred dollars will help enormously when the time comes to enter business or float a new proposition.

Credit never comes to those who have NOTHING. The man with $500 has little trouble to persuade another to put in an equal amount or more. But the greatest silver-tongued orator cannot drag even a few dollars out of a lender, to help a man who has saved nothing get a start in the most promising business.

Seizing Opportunities. It is just as necessary for the wage earner and salaried employee to have working capital as for the business proprietor. In either case it is a sinking fund, a reserve, to be used at the right moment to seize an opportunity. Getting ahead in the world is nothing but seizing opportunities, and the person with no capital is rarely able to do it.

Without working capital one cannot bargain for a better position or for a higher salary. Employers always seem to have an uncanny perception as to when workers are not in a position to refuse offers made to them. Labor unions long ago learned this truth, and now they have great invested funds to tide their members over a strike. Without working capital you must take the first job offered.

Rich men's sons get ahead not so much because of greater pull, but because they can afford to wait for just the right position. Without working capital, you cannot resign, take a life-giving vacation, and then look for a better job. Even the best-known college professors are helplessly dependent unless they have a considerable nest egg.

You will never get started toward a better position or a business of your own unless you have a little working capital and self-control enough to keep it. Every millionaire started with a moderate sum of money—with a nest egg. If he inherited it, then one of his ancestors started that way. Trace every fortune to its source and you will find a little foundation of saved money.

Why People Don't Save. Almost every book and article on how to save money has some secret to present which is sure to show you how to do it; but I am certain there is no secret in the fact that most people fail to save money largely because they won't take enough trouble. And it is not altogether the people's fault either. They are urged to save—preached at, sermonized at, exhorted to save; but they are not instructed in the details of saving.

We are told how to save in the household, and all that sort of thing; but we are not told, to any extent, what to do with our money after we have saved it. Young men attend lectures and take correspondence courses on how to increase their will power, their personal efficiency, and their general business knowledge. But have you ever heard of a young man who took a course on what to do with his money after he had made it? And above all, what to do with the surplus after he had paid his bills?

Why, the average man does not even read the conditions printed on the back of his life insurance policy. He does not take one thousandth as much trouble to invest his money so that it will work for him as he does to earn that money,—which is a most curious fact, because money often works twenty-four hours a day without getting tired or going on strike or complaining, year after year, though no human being will or can labor in that way.

Young men think nothing of spending a hundred dollars to buy a set of books which pretends to tell them how to increase their business efficiency and salesmanship, and yet remain as ignorant as babes of how to turn the money that comes from their increased earning power into income power. Most marvelous of all is the fact that it never occurs to them that anything is lacking in their education.

It is most unfortunate that so much emphasis has been laid by the ever-increasing volume of business literature upon the earning side merely, and so little upon the investing side. As an illustration, take one course of business books. There are twenty-four volumes and only two of them deal with the use of money after it is made. Perhaps this is because the mechanical and technical details of investing money are cold, and seem lacking in human appeal, to the young man especially.

Almost all normal persons are intensely interested in their work, their means of livelihood, even though they do not altogether like it. Work nearly always brings one into contact with others. It consists largely of human relationships and adjustments. It is always very much alive. Just think of the marshaling of desirable mental and moral qualities and traits that a successful salesman or physician or factory superintendent is urged to develop! As compared with all this how insignificant, how absurdly trifling are the time, effort, and thought given by the same persons to the proper employment of the money they earn. We all know men who overwork themselves into nervous breakdowns for a very moderate salary, and who do not give twenty minutes a week to the details of saving a portion of their salary.

This ranges all the way up and down the scale. One man devotes incessant physical effort for ten long hours a day in a steel mill or in the dreary rounds of a clerkship, and pays no attention at all to his rather meager savings. But the high-priced lawyer or manager is just as careless. I suppose the truth is that the details of saving and investing —such as walking to the savings bank every week, care in depositing money before interest dates, care not to withdraw money before interest dates, purchasing safe mortgages or bonds, care and promptness in investing the interest, and vigor and punctuality in remedying bad investments—seem dreary and without heart or soul as compared with the vital daily occupation of earning money.

Saving Takes Time. Saving money is of little use unless it is persistent, regular, and long-continued. Ordinarily, saving alone does not get one anywhere unless persisted in for twenty-five or thirty years without ceasing. Now men work without ceasing for the same length of time; but usually there is variety in their work; the chance of promotion, of change of occupation and location. Almost always in a generation of work there is some variety, color, or change.

But saving money is often a dreaded, monotonous thing. As a rule it is only mathematics, and thirty years is a beastly long time to wait for the results of mathematics. Then there is the possibility of a bad investment and the loss of the money. It is natural for human impatience to prefer the pleasures that come from the present spending of money to the far-distant future pleasures of saving.

The sad thing is that it takes so little saving, provided it is regular and persistent, to lead to comparative wealth, even in one generation. In the same way it takes so little spending to lead to poverty. Ingrained deeply in the human race is the knowledge of just where the line lies. As Micawber said, a man with an income of one pound a week will reach poverty in time if he spends just one penny more than his income, and will reach opulence if he spends just one penny less.

Present and Future Spending. The great trouble with talking about saving is that people don't like to be denied. They dislike to be repressed. They dislike to be told not to do things. It is always far better to say to people "Do," rather than "Don't." We all like to be encouraged and inspired to do things. We dislike to be told not to do things. It riles us up and discourages us.

If a man has set his heart upon a new victrola or a woman has decided that life is juiceless without a new hat, it is foolish to urge them to go without these things. There is only one way to induce people to save and that is to tell them of something to do, to buy.

The real question is not whether we should spend money or save it, but what we should spend it for. The question is whether we want all our enjoyments now or some of them in the future. Do you want all your happiness now or some of it to-morrow? I suppose a man who has no dependents and is sure of dying to-morrow might as well spend every cent to-day. But not many of us, thank goodness, are in that boat.

The future is not necessarily or always preferable to the present. Saving is not always justifiable in itself, but only in so far as a wiser use of the money saved will be made in the future than in the present. But we may assume that we will want to spend some money in the future just as wisely, and, as we learn from experience, perhaps even more wisely than at present. If a man can be counted upon to spend money at all wisely in the future, then when he saves and invests he is buying future happiness in packages just as much as he (or she) is buying a certain amount of present happiness when he (or she) buys a very fine pair of gloves.

Nor is that all. If you have self-restraint enough to save, you are showing real unselfishness because your self-restraint will make it unnecessary for other people to support you and yours in the future. The man who saves nothing evidently expects that the "world owes him a living," which is pleasant enough in theory but does not always work out in practice.

Let me express the same idea differently. Is it not unfortunate that we have the word "saving" at all, with its repressed "kill-joy" implication? Would it not be better if we spoke of "delayed spending" rather than saving? For that is what saving really is. Of course there are a few people who save just because they are misers, because they love money in and for itself. They are merely despicable.

There is the man who agrees with me this far but says: "I am always going to be able to earn as much as I do now, so why shouldn't I have a good time now?" Well, it isn't true. Illness, death, business failure, misfortune, increased family responsibility, bad debts—a thousand accidents of life may reduce a man's savings. Common sense and experience both teach that in order to be able to spend money as freely five or ten years from now as we do at this moment, we must save something.

Saving and the Rich. From the point of view of self-interest, saving and investing are about as desirable for all classes of people as for any one group. Of course the very wealthy do not need to save and invest to secure their own comforts and luxuries. Mr. Rockefeller could throw the bulk of his stocks and bonds into the sea, or burn them up, or reinvest them in worthless securities, and still be able to live on a small fraction of his property. But who wants to do such a foolish thing as that? Mr. Rockefeller knows that if he invests a large part of his income in stocks and bonds of important corporations or in Government bonds, he is by just the amount of his investment making it possible for industry to "carry on" or for the Government to supply its needs.

Naturally the very wealthy cannot spend much of their income upon living. If they do they only serve to complicate their own life and litter it up with more material things than are good for them. To spend vast sums upon mere living is simply building up burdens and encumbrances for oneself.

I do not mean for a moment that there is anything wrong in "living well," within the limits of sanity and proportion. Luxury is far from being altogether wrong. It raises the standard of living and brings comfort into the lives of many who would never otherwise know its meaning. For the luxuries of to-day often become the mere conveniences and comforts of to-morrow, perhaps even the necessities. The rich by setting standards often indirectly serve to bring the poor up to those standards. Life is often made richer by expenditure, provided it be along lines of good taste and decency.

Carrying Thrift Too Far. It is a great mistake to extol saving as if all spending were wrong. If everyone lived on the barest necessities of life and put every penny they saved into Government bonds or into stocks of steel and copper companies, we would soon have terrible unemployment and want. If, on the other hand, people saved nothing and spent all their incomes upon luxuries, we would soon have no productive machinery left in the country to create the necessities of life, and want and unemployment would soon be upon us.

Anyone with a grain of common sense can see that as between saving and spending a happy medium must be struck. The woman who spends $75,000 upon a single garment, as much as a workman earns perhaps in a whole lifetime, and the miser who will not buy enough food and clothes to keep him in health, are both anti-social figures. They are ridiculous, harmful, and wicked, but probably the woman is the worse because she excites envy and hatred on the part of less fortunate people, whereas the miser excites only ridicule.

Our earnings and incomes cannot all go into savings without doing harm, nor can they all go into pleasures of the moment without doing fully as great or greater harm. But every reader of this book will probably admit that there is not much danger of the American people as a whole over-saving. No one can accuse our nation of that evil. No one can accuse most of our wealthy people or even those of moderate means of any such weakness. In every community there are one or two misers and a dozen or so of disagreeably "close" people. But common experience teaches us that the majority of people who earn or inherit comfortable incomes are inclined to save too little rather than too much.

Fashion, imitation of one's neighbors, fear of criticism—all these and many other false influences drive most people of moderate means into undue expenditure.

Saving on Small Incomes. No doubt there are millions of people who live so close to the margin of existence that saving is an impossibility for them. It is often an absurdity for bankers, capitalists, and employers to preach thrift to the working classes. It is one thing to talk about saving when you have something to save on, and quite another thing when you have barely enough to eat.

Nor does slow, regular saving and investment on a meager income lead to wealth in anything short of a generation. But as already shown in detail the small saving is more than worth while because it creates a buffer, a nest egg. We do not need to enter into the ethical question involved in the undoubted fact that millions are too poor to save even a few hundred dollars in years of work. That is a sore spot in our civilization, a pressing problem, and an old one as well, but not the subject of this book.

In this book I start out from the safe assumption that there are many, many millions of people on moderately small incomes who can save something. It is not an assumption; it is a fact, proved by the Liberty loans. Millions saved something during these loans. Now if the poor, or almost poor, man can save a little, if only a dollar a week, he is on the road to advancement.

For such a man saving is the one sure way of getting a start, of getting out of the ruck, of getting a foothold, even if it does not at once make him rich. It is the way to get his teeth in. Once he has saved something he ceases to be a slave of industry; he becomes a man. Perhaps it is not right that any human being should be a vassal. Perhaps some coming Utopia, perhaps even Bolshevism will remedy all that, although apparently Bolshevism has made conditions worse rather than better where it has been tried. But as things are to-day and are likely to be for a long time to come, the man who can be and is provident has an enormous advantage over his fellows.

I do not think I have ever heard this idea better expressed than by the secretary and treasurer of a large sales organization who sent this New Year's greeting to all salesmen in his employ on January 1, 1919:

THE BEST OF GOOD TIMES AHEAD

At this season, more perhaps than at any other, it is my chief duty to examine the records of the year just past. Among other records, I have just looked over the accounts of all men in the field. This part of my task has been particularly pleasant because of the splendid gains that nearly all of you have made in gross earnings, and what is even more satisfactory because of the net gains in permanent assets on the part of so many of you.

I believe that I can send you no better message than to urge every man in the Peerless Organization to make almost any present sacrifice to add to his material assets each year. In any year when a corporation or business house does not add to its assets, that concern is a failure. If it does not have a surplus laid by, on which it can draw, it becomes insolvent. The same thing applies to every one of us.

We do not have to SAVE large sums to get ahead.
We do not have to EARN large sums to get ahead.

I know one member of our organization, not yet twenty-eight years of age, whose earnings have not been over $2500 in any year of the four or five that he has been with us. I know that he has over $4000 in quick assets, and his position is far better to-day than that of many men who earn $10,000 to $20,000 a year. Even if he does not increase his earnings, but continues his savings at his present rate, he will, at the age of forty, be able to realize on these savings, at an ordinary return on safe investment, a sum equal to his present expenditures.

There is not a single member of the Peerless Organization who cannot earn $2500 a year. I do not believe there is a single member who cannot increase his earnings or regulate his expenses to the point where he can save $1000 a year.

Such a sum as this, growing year by year, becomes a business partner, and each year picks up a little more of the load until, after a few years, it is equal to the entire task. We can all acquire such a partner as this, but not without paying the fee that he will charge. That fee is present sacrifice and present saving.

As I look back over a very few years and see the progress made by some of you, it would be startling if I had not lived so long with figures and known how efficiently dollars will work for and with us. I can recall when some of our boys opened their first bank accounts, and to-day they own houses and cars and thousands of dollars' worth of dividend-paying securities.

The next few years will present the opportunity to Peerless Members to earn and to save large sums. I wish that before January 1, 1920, every member of our organization would acquire a business partner who would grow with him until the partnership should reach a position of financial independence. If any suggestion or word of advice that I can give will help any one of you, I am at your service whenever you may call on me. Best wishes for the best New Year you have ever known.

CHAPTER II

SIMPLE WAYS TO INVEST

Not as Easy as Buying a Cigar. One of the main reasons why people in this country do not save more money is because they do not know how to invest it. Such knowledge as they have is vague and hazy. With our enormous wealth and natural resources, we should save and invest relatively more than any other country; but to the great mass of the people there is an insurmountable barrier between their savings and its investment.

If it were as easy and simple to buy a bond for five, ten, or fifty dollars as it is to buy cigars, stockings, and shaving soap, the number of bonds purchased by people at large would make the eyes of the bankers pop out of their heads. There are hundreds of thousands, perhaps millions of people of small or moderate means—farmers, teachers, merchants, managers of small manufacturing enterprises, salesmen, mechanics—who could afford an almost continual stream of small bond purchases if they only knew how and where to make them. I have talked to many such persons and have read letters from still more of them. They do not begin to save up to their full capacity; and most of them know it.

Though there are plenty of silly empty-headed girls who spend all their wages on finery and pleasure, there are also legions of serious stenographers and other women workers, on rather small salaries, who would like to start a rainy day fund. The five-to-ten-thousand-dollar-a-year bond salesman cannot waste his time on such. But if every fifty-cent piece or dollar a week which these girls could save and invest, but don't, were piled up in one mass, it would finance many a big and deserving enterprise.

Here is the difficulty: Shaving soap, candy, cigars, and stockings are instances of thousands of commodities that can be bought practically anywhere without the purchaser taking much if any appreciable chance of being stuck. You can buy them pretty well standardized in any store in any village of two hundred inhabitants and up. And if a person lives so far from the nearest Four-Corners that he cannot go to a store, there is generally the rural delivery and the mail-order house.

To speak plainly, finance has not learned to sell its wares, to distribute them, in retail, except in a wholly limited, local, and isolated manner. There is no national retail distribution of bonds and good stocks. Of course, quack finance has learned the trick. It is easy enough to retail small quantities of cheap, worthless stuff. But then, it doesn't cost the distributors much of anything; and they have the further advantage of being without conscience, which always reduces selling expenses.

But more and more the honest, legitimate bond and stock dealers are learning how to sell good, high-class securities to small investors. Those of them who always believed that small investors could be reached have a tremendous vindication in the Liberty loans and a great stimulus as well. How the idea is spreading may be seen from a recent announcement of the president of one of the largest bond selling houses in the country at the time a branch office was opened on Fifth Avenue, New York City. The fact that this particular branch was opened to cater to people of considerable means does not alter the principle:

> Our opening of an uptown office on one of the most prominent and busy corners of the city of New York is but a logical step in our plan of merchandising. There is no reason why on Fifth Avenue, crowded as it is with people of means, there should not be a store in which money may be in-

vested as well as stores in which money may be spent. The location further offers to us a center from which our salesmen operating in the central part of the Borough of Manhattan may be located and quickly reach their customers.

We are attempting in our distributing scheme to handle investment securities in much the way as merchandise is, and throughout our twenty-five correspondent offices in the United States we are seeking ground-floor locations to the end that a person having surplus moneys may be able to walk from the street into one of our investment stores to buy a bond or short-term note with as little trouble as he would walk into a store to buy a pair of gloves.

Of course the small investor is able to find good securities if he will take the trouble to go after them. It is the purpose of this book to indicate the directions in which he should go, the measures he should take, and the choices he should follow, for even if the best securities do not come right to his door, he can often get them by going after them.

But before we discuss this subject of bonds and stocks in any detail let us see what different kinds of investments there are, and what we mean by investing money.

What Is an Investment? When money is saved and invested it may soon become a total loss, it may win a fortune for the lucky owner, or it may merely remain intact and pay interest. Investment is something like a thermometer. The extremes are very great, ranging from far below zero to a burning heat. Investments may turn out fabulously well or moderately well or not well at all.

Now it must be borne in mind that when we talk about investments in a book like this we mean what really should be known as a sort of indirect investment, the sort that involves only the investment of money and not of time, labor, muscle, service, supervision, management, brains, or any really extensive human effort except that of common sense and judgment in choosing the nature of the investment itself and watching its course after it has been made.

When a young man buys a garage and spends his days and nights there working like a horse to make it succeed, he has, it is true, invested money in it. But he has done a great deal more than that. He has put himself into the work. No one would come to this book for information about running a garage. But if the young man finally earns enough to have a surplus above what he needs to put into the business, he may read a book of this type to learn something about the general principles of investing his surplus funds.

At the very beginning we must make the distinction between using money in one's own business and investing it in some one else's business. And when we invest only our money in another's enterprise we cannot rightly expect such large returns as when we combine with it our time, labor, brains, and the like. Thus we have no right to expect that many investments separated from the personal activities of the owner will win large fortunes. And the facts are just what one might expect. Now and then a lucky person puts $100 into oil stock and sells out for $30,000. But such cases are rare. The element of chance enters into such operations so extensively that rules cannot be drawn up. If you wish to strike it rich in that way it will do you no good to read this or any other book. You must be a gambler by nature. Books will only hinder you.

At the other extreme there is no object in saving money only to lose it. Spending money is probably far wiser than investing it altogether badly as many people do. Often the wisest and most experienced persons make bad investments. There is some element of chance in all money operations, in life itself for that matter. But it is quite possible, quite easy indeed, to make a majority of one's investments safely if one will follow certain principles and practical rules.

Frankly, there is no royal road to the successful investment of money, nor is there any exact, absolute science about it. But the bulk of the loss can be avoided by knowledge, even if the more striking successes cannot be taught or reduced to rule. For most of us the essential thing is to preserve as nearly intact as possible the bulk of what we save and add a little to it if we can. If in addition we can add considerably to it, so much the better. But the first step is to learn the elements of how safety is to be attained.

Different Forms of Investments. Now the first difficulty which the average investor has to face is the bewildering number and complexity of things to choose among. He does know that some of his friends have lost money buying stocks and others have done exceedingly well. He knows also that others have lost in bonds and mortgages while still others have prospered. The first subject which this book must cover therefore is the variety of forms which investments take.

There is no intention of going into minute, technical details. What most people both desire and need is not a technical treatise on stocks and bonds, but a practical working guide. Therefore let us see what the chief forms are which investments take. There are many special forms which are not covered in this book, but they are not the securities which many people will ever have occasion to buy. You are most unlikely to invest your money through other than the following channels:

1. Savings bank deposits.
2. Life insurance policies and annuities.
3. Homes[1] and building and loan associations.
4. Real Estate.
5. Mortgages on real estate.
6. Bonds.
7. Stocks.

Savings Bank Deposits. The first investment for the great majority of people should nearly always be a savings bank deposit. It is usually the safest, and therefore the back log of the whole scheme. It is always the best investment for the poor, and the first two or three hundred dollars accumulated by the moderately well-off should not only be put in the savings bank but left there. Beyond this small back log, however, the savings bank is not adapted to the wants of the large investor.

The savings bank is intended primarily for the

[1] The ownership of a home is not discussed in this book because it is not so much an investment as it is a personal and social gratification. Often, however, it is also an excellent investment, and should precede the ownership of stocks and bonds.

small investor, the very small one, the man who has only a few hundred to spare. It provides him with absolute safety and a small rate of interest. Of course it is obvious that the larger an investor is, that is, the richer he is, the more chance he can afford to take in order to make big returns. But the wage earner, clerk, or professional man on a small income absolutely cannot afford to take any risk because he has no margin or surplus on which to depend. The rich man can afford to lose thousands of dollars because it will not reduce him to want, but the wage earner cannot afford to lose hundreds because he will go hungry or shabby.

Except in times of war or other great crisis I am inclined to believe that a small savings bank deposit and War Savings stamps are even more fundamental forms of investment than a Liberty bond. While perhaps having a few minute degrees or shades less safety than Liberty bonds the savings bank deposit is safe enough for all practical purposes, and vastly more secure than the great majority of other investments. It has a tremendous advantage over all known forms of bonds (including Liberty bonds) and stocks and all other investments except the War Savings stamp. The amount of cash invested can always be recovered without any loss whatever. The best bonds in the world may suffer a temporary decline in price. But the savings bank deposit neither falls nor rises.

Aside from the fact that savings bank deposits pay a relatively low rate of interest, their disadvantages for the investor of relatively small sums are less than any other form. The only serious "out" is the fact that deposits must be made before a certain specified date in order to obtain the interest. If the date is January 2d the owner may receive no interest for several months. In the same way interest is lost if money is withdrawn between dates. Many other investments such as mortgages and bonds have the advantage of adjusting the interest equitably between buyer and seller whenever the deal takes place.

One objection I have often heard urged against savings banks is the fact that they open only a few hours a day and that they can only be found in a few large cities, and mostly in the more thickly settled parts of the country at that. But many of the best savings banks will take deposits by mail, and anyone who is really anxious to save is willing to suffer some slight inconvenience. It must be admitted that many inconveniences characterize the savings bank system as a whole, but inconvenience is a small matter as compared with security.

Then, too, the savings bank has a great psychological advantage for the small investor. To him it represents money that is always available, at a moment's notice; whereas, buying a stock or bond appears like committing his money to something beyond retrieve. Then there is the difficulty and care attending the investment.

A savings bank official tells the story of a woman depositor in his bank who withdrew $1000 to buy a certain well-known bond. She returned the other day and handed the bond over to the bank with the request that the bank sell it for her and place the money to the credit of her account. "What's the matter, don't you like this bond?" said the banker.

"Oh!" she said, "I can't stand it any longer. Ever since I bought the bond I have been worrying about the price. In the morning I am all of a-fever until I get the paper to see whether the price has gone up or down. I worry about it all day and at night I lie awake thinking about my investment. I want to get back the peace of mind I had when my money was safe in the bank, drawing 4% interest. There is no market quotation on savings bank deposits."

Essentially an Investment Institution. A savings bank is really an investment institution more than it is a bank in the ordinary sense of the word. The commercial bank invests its funds in the credit of business men, lends them money, in other words. The savings bank invests its money more extensively in bonds, stocks, and mortgages. The commercial bank performs its chief service to depositors by providing them with checking accounts and making loans to them. Paying them interest is only incidental. The savings bank usually does not permit a checking account, but it pays a larger rate of interest. It is primarily for the investment of small sums rather than for financial convenience.

Savings banks pay an average rate of interest running from three to four and a half per cent. There are several kinds of savings banks, depending largely upon the laws of the States in which they are organized and located. In a few of the Eastern States the only savings banks permitted at all are the "mutual" kind, where all the earnings go to the depositors either as interest or as a surplus fund the further to protect them. Except where the laws permit only these mutual institutions, savings banks or savings departments in commercial banks and trust companies must be judged as other banks, on their individual business merits. It should be added, however, that in many

States the laws regulate so closely and carefully what investments shall be made that failure is rare in the extreme.

The savings banks and the savings departments of other sound banks were instituted for the small saver. Their fundamental purpose is to assemble the savings of the masses, invest them wisely, and pay over a goodly share of the profits by way of interest-dividends to the depositors. One savings bank in New York City has paid out eighty-eight million dollars in interest on deposits in seventy-five years, nearly all to relatively poor people. In such an institution the small investor is on safe ground. He cannot, as a rule, go wrong.

The advantage of a savings bank for investment purposes are easy to state: *it has stood the test of time.* More people invest their money in this way than in any other, except perhaps, in life insurance. There are more than four billion dollars in savings accounts. About ten per cent. of the people of this country are depositors.

In addition to most careful laws regulating the investments of savings banks, more rigid than are usually followed by individuals, is the highly important fact that the bank distributes its investments over such a wide variety of securities, that loss in one direction is minimized by the soundness of other securities. This the average individual cannot afford to do in his own investments. In other words the savings bank insures itself.

Not for the Rich. The question is often asked why cannot the man with $200 get 5 or 6 per cent. as readily as the large investor? Well, he can get as much if he wants to take the same risk. The point is this: one who has saved only a few hundred dollars to invest cannot afford to take any risk. Such a person obviously has neither the earning capacity nor the resources to afford risk. When you receive 4 per cent. interest from a savings bank you are paying half of 1 per cent. or 1 or even 2 per cent. in return for absolute safety and freedom from the necessity of knowing how to pick out securities yourself.

It is said that the savings bank buys certain securities, and why then should not the individual buy the same securities and get all the income himself? That question has just been answered. The difference goes into surplus to protect the depositor. But as one accumulates or saves larger sums the difference between 4 and 5 or 6 per cent. becomes appreciable. To the widow who has to live on the income from $25,000 the margin between 4 and 6 or 7 per cent., which stocks and farm mortgages bring, might be the difference between abject poverty and comfort. To her the savings bank would represent unnecessary privation. But if she had inherited nothing, and at once went to work as a boarding-house keeper, the first $100 she saved would be immeasurably better off in the savings bank than anywhere else.

Moreover, as money accumulates one can afford to deviate from the iron-clad safety rules of the savings bank. For, though certain of these rules have an element of the rigid which serves a great purpose well, they seem a little absurd when adhered to by those not forced thereto by stern necessity. Finally, the successful earner or saver of money should be able to judge good securities for himself. If you can save several thousand dollars a year you surely must know enough about business to invest it. If you don't you ought to begin to be a little ashamed of yourself and study the subject of investment. A man took $20,000 to the Postal Savings Bank which pays only 2 per cent. Bankers have said that man was either an idiot or a criminal trying to defraud his creditors. I believe their judgment was harsh, but there is an element of truth in what they said.

For the millions of wage earners or professional men who just make both ends meet, the savings bank is a blessing. But when persons with thousands to invest put their money alongside of the laborer's and clerk's and poorly paid teacher's, whether from miserliness, a mouse-like timidity, or mental indolence, then the beneficent purposes of the savings bank are abused and set at naught.

Finally, if the savings bank is the place for your first few hundred dollars do not let some slick promoter persuade you to the contrary. He will say that the savings banks buy bonds and mortgages that pay 5% or more and only give you 4%. But he always forgets to tell you the real, fundamental reason for this difference in interest rate. Of course the bank cannot afford to pay high interest rates because it is promising you something that no other form of investment can promise, namely, its willingness to pay you back your money whenever you ask for it. He cannot and will not do that.

The bank is never able to tell for how long it may have command over your money. Perhaps it may be for only a few days or a few weeks. If you lend money on a mortgage or purchase a bond the person who borrows from you obtains the money for anywhere from one to a hundred years or more. He usually knows just how long he can use it—an advantage for which he is willing to pay a higher interest rate. If you buy stock or real estate, the other person gets your money forever, practically. He does not have to make any provision for its repayment. Therefore he can afford to promise a still higher return. You yourself can sell to another buyer and in that way get back your money—or at least a part of it—but the medium of investment, the investment itself, does not automatically repay itself like the bank deposit. You cannot expect a savings bank to pay back your principal on demand and also hand you out a high rate of interest.

Life Insurance Policies and Annuities. Hand in hand with the savings bank deposit goes the life insurance policy. It applies chiefly to certain classes of people, that is, those who have some one dependent upon them, either in a personal or business sense. Moreover there are countless books on life insurance. Therefore anything like a detailed description of its features does not properly belong in a general book on investments.

Excellent arguments, it is true, can be produced to show that life insurance is of great advantage even to the person who has no dependents, that is, certain forms of life insurance. I strongly advise unmarried men and women to investigate the various forms of income policies and other types of so-called "bonds" sold by reliable companies.

The only object in presenting the subject here at all (because it is usually regarded as a special subject to be treated by itself) is the fact that a person who has dependents is very foolish indeed to consider the purchase of mortgages, bonds, or stocks until after he or she has bought ample life insurance protection. It is just as foolish for the head of a family to go without life insurance and speculate in stocks as it would be for the owner of a grocery store to go without fire insurance and use what he saves in premiums for the same purpose.

Life insurance is an absolute answer to those who say they cannot save. If a man cannot save enough to buy a small insurance policy there is only one place left for him—the county poorhouse. Because a few cents a week will do it.

The great point about life insurance is that as soon as the first year's premium has been paid, the entire amount of the insurance is payable upon death. That is, by paying down a few hundred dollars to an insurance company, a man may provide his family with as much money as would have taken him twenty or thirty years to save. Of course, the man does not want to die, and his family does not want him to die, but the chance is always there, and if he does die all his good intentions about saving are worthless. Without life insurance, every word that has been written in this book up to this point should be considered fit only for the waste basket.

Suppose you die in the first year of saving. The savings bank will return your deposit plus some interest; the insurance company will pay the full face of the policy. From the bank your family can get only what you actually saved—from the insurance company they will get what you *intended* to save. And how many people make savings bank deposits regularly every year? How many people leave them in the bank after they have started them? How numberless are the pretexts under which they are withdrawn and spent, or loaned or lost?

Insurance and the Young Married Man. Suppose a young man of twenty-five, married a year and expecting an addition to his family, saves three hundred dollars a year. Of that sum he puts one hundred dollars in the bank and two hundred dollars in life insurance. If he dies a year later, his widow will receive one hundred and four dollars from the bank and ten thousand from the insurance company. Suppose he had put the entire three hundred dollars in the bank. What would become of his widow and unborn child with total resources of only three hundred and twelve dollars?

I assume that only a safe and reliable company is selected from which to buy insurance. There are hundreds of such companies in the United States. It is entirely possible for the average man, exercising ordinary judgment and common sense, to determine for himself the soundness of the concern in which he insures. Any state insurance department, which can be addressed at your state capital, will tell you whether any concern doing business in that State is reputable and dependable.

Among the great advantages of life insurance are these:

It eliminates worry and increases initiative. A man works much better if he knows his family is provided for.

It is absolutely safe. Among the "old line" companies there has been no failure and loss to policyholders in a very long period. Insurance companies spread their investments over so many different forms of securities that loss is practically impossible. Moreover, the companies are closely and minutely regulated by the state.

It encourages saving. People withdraw money from a savings bank more freely than they stop making their insurance payments. An insurance premium comes to be looked upon somehow as a fixed charge, which must be met no matter what else fails. It has an apparent element of compulsion which forces people to save.

It is a great assistance in business, investment, and home buying. A man buys a home on mortgage but is afraid that his widow will not be able to meet the mortgage if he dies. A life insurance policy for the amount of the mortgage takes care of all that. For a small cost what is known as term insurance may be bought to hedge or provide against almost any conceivable business necessity.

Another great advantage of life insurance is that after the first two or three years a policy can be borrowed upon at the company's office at a fixed and moderate rate of interest. It may also be surrendered for cash for an amount which steadily increases with the years, and tends to equal the face value of the policy after say twenty years. Thus one can always dispose of a life insurance policy after the first three years, which is not true of bonds, stocks, mortgages, and real estate.

Nor is it necessary to pay as long as one lives on an insurance policy. After the first few years, it is possible to stop paying anything and have the insurance go right on for a smaller amount as long as you live. For example, one can stop at the end of twenty years on a policy for one thousand dollars and have five hundred and seventy-five dollars of "paid-up" insurance the rest of one's life. Or at the end of twenty years one can stop paying anything and still have the whole one thousand dollars remain in force for thirteen years and five months longer.

A great many people say they can invest money to greater advantage themselves. Perhaps they can if they live long enough. A man will have to be sure of living twenty or thirty years to make his money earn more than a life insurance policy. But as a matter of fact, a very large number of people who do invest for themselves, lose their money. Life insurance practically never loses for you.

Annuities. One of the wisest forms of investment for many persons is the annuity. These may be purchased from almost any reliable life insurance company. They are really old age pensions. There are three general forms, but all partake of one general characteristic, namely, the company agrees to pay a fixed income as long as the annuitant lives. Thus the great advantage of an annuity is that it eliminates all worry. The income is certain because it is independent of any particular bond or stock.

In return for a lump sum an insurance company will agree to pay you a fixed income as long as you live from the date of your first payment. Or by paying the company a regular premium for a certain number of years during the prime of your life you will receive a considerable income for the rest of your life after you have reached the age of say sixty. Or you may purchase a fixed life income for another person, such as wife or mother. The outstanding advantage of all forms of annuities is the safety and certainty for the remainder of one's life of the income purchased.

Building and Loan Associations. The shares of building and loan associations are often excellent investments, especially where conducted as local and semi-mutual or beneficial enterprises. These shares are usually to be had in small amounts and pay moderately high rates of interest, such as 6% or more. It does not seem advisable to describe them in detail in this book because safe and successful investment in these shares depends wholly and solely upon knowledge and acquaintance with local community conditions and upon the integrity and good judgment of the officers of the associations. Frequently, however, persons who are making their first investment would do well to place a few dollars in their local building and loan, provided they investigate its standing and are acquainted favorably with its officers.

Real Estate. Often real estate proves exceedingly profitable. In many ways it is one of the best forms of investment. Land has a permanence which the stocks and bonds of railroads, manufacturing companies, mines, and the like often lack.

But real estate is much more of a profession and business than the purchase of mortgages, bonds, and stocks. Owning an apartment house or an office building is almost like running a store. It involves all the trouble and risk of management that any business involves. The average person may purchase a mortgage or a bond or even shares of stock without actually engaging in the sort of business those mortgages, bonds, and stocks represent. But the purchase of real estate except for personal use (such as home or farm) involves either a high degree of specialized expert knowledge or the employment of a manager or agent.

In large cities there are many wealthy people who own improved real estate such as hotels, office buildings, and apartment houses and who do not attend to the details of management. They employ agents or managers. But the small investor cannot enter the real estate business in that way. As a rule the only sort of real estate he ever buys is of the unimproved variety, a suburban lot somewhere, which of course yields no income. Property which does not pay an income can hardly be considered an investment and therefore is not treated in this book.

Of course, fortunes are sometimes made by the purchase of swamp lands or other despised property at a few cents an acre. But this represents a form of speculation, of business enterprise perhaps, for which rules cannot be laid down. What this book treats of is the employment of money to pay moderate returns which is within the reach of all, not the one chance in a thousand to make a fortune.

It must be borne in mind that real estate of necessity is handled differently than mortgages, bonds, and stocks. Each building, each lot, each piece of land is too separate, distinct, different, and individual from almost every other, to make it possible to draw up rules about buying and selling. There are five million shares of common stock of the United States Steel Corporation, there are many millions of Liberty bonds, but each share and each bond, is just like the other. If you once make up your mind regarding the value of a Liberty bond you do not have to study the subject again the next time you think of buying a bond. But each lot, each piece of land, each building differs. Therefore the buying and selling of real estate is more a business or profession than it is a form of investment.

CHAPTER III

MORTGAGES AND BONDS

FIRST mortgages on real estate are often, perhaps usually, a desirable form of investment for persons of moderate means. Their value is easy to get at. They are less complicated and confusing than stocks and bonds, and enjoy all the advantages of basic simplicity. A woman once wrote to me saying that her broker had suggested the purchase of a farm mortgage, but she said, "I know nothing about farming and so am in doubt."

If this woman had been advised to buy a farm, or an orange grove, or any other piece of land devoted to agricultural purposes, a most emphatic general answer of no would have been in order. But a mortgage is a horse of a different color. One may buy a farm mortgage and be no farmer.

The reason so much money is lost in ill advised "investments" is because people do not distinguish between investment on the one hand and speculation or business ventures on the other. A person may make several hundred per cent.

through the purchase and operation of a business or agricultural enterprise or by the mere purchase of shares of stock. But as stated in an earlier chapter, such a person really invests a great deal more than money. What is put in is an assumption of risk.

Now, it does not take a training in banking or political economy to tell the difference between the sound conservative investment and a business risk. It is neither an academic nor a technical distinction. It can be made by a child, almost. The trouble is that people are not contented with safety and a moderate rate of interest. They foolishly want safety and a fortune along with it. They simply won't face the inexorable facts.

I say that if my correspondent had been urged to buy an orange grove, I would answer no. Not because orange groves are not sometimes valuable property, but to own an orange grove one must know something about it, and this particular woman doesn't. All she wants is to make her money earn a reasonable return for her, and be safe in the process. In other words what she should do is not to buy property, but lend money to people who use property.

First mortgages, or liens, upon real estate, were well recognized investment securities back in the dim, early ages of mankind. But despite its antiquity the real estate mortgage grows more important every day. As population becomes dense and food supplies in this country fail to keep up with the mouths to feed, more attention is given to the farmer, and among his problems none is so important as that of borrowing money. The country fairly seethes with plans to make it easier for the farmer to borrow money, so there is forced upon the investor's attention this question of whether real estate mortgages are desirable for him to own.

Everyone knows what a mortgage is—a deed or instrument conveying property to a creditor as security for a debt, the deed being valueless provided the debt is paid off as agreed and provided interest is paid regularly. Many bonds also are secured by mortgage, but there is a sharp distinction between bonds of private and public corporations, and real estate mortgages. Often enough the corporation bonds are secured by mortgage upon real estate, but the real estate is generally incidental, not the main business. Another important distinction is that the real estate mortgage, so-called, is usually for a relatively small amount, a few thousand dollars, whereas a bond is one of many shares of a mortgage for millions of dollars, perhaps, upon a big railroad or manufacturing property.

Both bonds and mortgages are loans. They have many points in common. Bitter controversy ever rages as to which are the better investments. The distinguishing advantage of the mortgage over the bond seems to be the higher rate of interest that it pays. This may be due in part to inferior merit, or it may be more probably accounted for by the greater difficulty of disposing of a mortgage once it has been bought. It may be accepted as a fact that, with proper precautions, mortgages are as safe as bonds.

Money Tied Up. Mortgages are criticized as not being readily salable. This is true in a sense. One can usually sell a mortgage only through the dealer from whom it was bought, which also is true of many small bond issues. But safe mortgages are those that are issued for not more than ten years, being repaid in installments each year, or for not more than four or five years, if there is no provision for yearly reduction in the principal sum. Mortgages are pre-eminently a short-term investment. Of course, there is never any increase in the market value of the principal sum of a mortgage, as there often is in the case of bonds, but, on the other hand, as with all short-term investments, there is no decrease in price unless the value of the property becomes seriously impaired.

Strictly speaking there is no such thing as the price of a mortgage after it has been bought by an investor. All he is concerned with is the security of his principal, that is, whether he can sell the property for an amount equal this principal if there should be a default. No one should buy a mortgage unless it is strictly understood that the money is practically tied up for a few years, unavailable not only to realize upon easily but also difficult to borrow upon.

It is true that at times of depression in real estate, such as New York City suffered from in 1913, the selling price of numerous pieces of real estate falls to the mortgage loan figures. Such a condition merely proves that the greatest care is needed in buying mortgages, as with all other investments. Nevertheless the record of mortgages is on the whole a good one, and many individuals could safely follow the example of so many savings banks and insurance companies, which divide a large portion of their investment funds pretty evenly between bonds and mortgages.

Mortgages on real estate whether rural or urban, and corporation bonds, both have the disadvantage as compared with stocks of being far more subject to both Federal and local taxation. On the other hand both classes of investments are safer than stocks.

The business of dealing in bonds and stocks is largely centralized, whereas the business of dealing in mortgages is localized. There are big central markets for many stocks and bonds. There are none for mortgages. This is partly because mortgages are issued in such small amounts, and many issues of bonds in such great totals. Another reason is that American ingenuity has not yet reached the point of massing mortgages as the Crédit Foncier of France has done. In time mortgages will probably be massed in the hands of big corporations with prestige enough to get money at the lowest rates at which it is offered in the world's markets, and the money can be obtained by the same methods as those used by the Pennsylvania Railroad or the United States Steel Corporation—by splitting up the sum total of mortgages into transferable shares.

Different Kinds of Mortgages. Whatever changes the future may bring, at present investors can buy safe guaranteed mortgages in fairly large multiples of, say, $5000 or more in New York City to return 5 per cent., or certificates based on similar mortgages to bear 4½ per cent. in amounts as small as $200. These certificates and mortgages are sold by strong concerns under the supervision of the State Banking Department. In cities such as Chicago, Cleveland, and Pittsburgh, bonds directly secured by first mortgages on apartment houses and stores may be purchased from several strong and reliable firms to return from 5½ to 6 per cent. From dealers in Chicago, Minneapolis, and many other cities and towns in the West and South, direct first mortgages on farms may be purchased in amounts of from $250 up to $5000 and more, to yield 5½ to 6 per cent. Higher rates may be had, but in the best, selected sections a 6 per cent. net return to the owner of the mortgage is considered conservative and reasonable.

The safe rule is that a mortgage should not be drawn for more than from 30 to 60 per cent. of the actual value of the property. The Federal Reserve law permits national banks to lend on five-year farm mortgages at not more than 50 per cent. of the actual value. New York State savings banks are permitted to lend up to 60 per cent. of the value of property in the State; but most of the property they lend upon is excessively valuable city real estate. One of the oldest and most successful Minneapolis firms of farm mortgage dealers lends up to only 30 or 40 per cent. of the value.

Actual value does not necessarily mean purchase price. The value of land in many places can be determined only by its productivity, and to determine this accurately one must know the possibilities of soil, of climate, and of season. If these be disregarded, difficulty may result; if they be accurately and reasonably appraised, there will be practically no loss, as the big life insurance companies, which have recently been buying farm mortgages in an increasing ratio to their purchases of bonds, have discovered.

Only selected areas of the country are suitable for lending money on farm mortgage. Farm mortgages are worthless unless the farmers are a steady, honorable set of men, thoroughly good agriculturists, and tilling a soil which is not fitted solely for temporary, bonanza exploitation. The value of all farm land is far from stable, as the abandoned farms of New England clearly proves.

How to Select Mortgages. "But," says the puzzled investor, "I live in Boston. How am I to know a good farm mortgage in Iowa?"

The answer is that only dealers of experience and successful records should be consulted. There is a firm in Chicago which has lost only $675 out of $75,000,000 lent in fifty years. There are two concerns in a city in the Northwest with thirty years of successful record. All over the country this sort of thing can be duplicated. Dealing with such brokers, one is not only sure of a good mortgage, but all the details of looking after the interests of the creditor are attended to by the broker who gets his profit, not from the investor, but from the farmer, whose money comes considerably higher than the rate which the investor receives. To quote from a statement of perhaps the oldest of the Western farm-mortgage dealers.

> The farm-mortgage business, properly conducted, is not a haphazard venture, nor is every character of man equal to its proper management, any more than any good lawyer makes a competent physician. The business is a science, and may be reduced to a very certain one by those willing and able to recognize its laws; and it can be said to you of the future, and proved from the company's record of the past, that on the business during the next five years sixty foreclosures will be commenced; that of those, fifty-three will be paid off by the borrowers as soon as they have had legal advice that the foreclosure has been instituted. It can be promised that, of the remaining seven, four will be bought in on the court-house steps by the borrower against whom the foreclosure is instituted, and that of the remaining three the company becomes the buyer; it cannot promise you what the ultimate outcome of those remaining three will be, but it can assure you that in forty-eight years of business, involving something over seventy-five millions of dollars, just *one* farm

has been sold by it at an amount less than necessary to return all invested capital, all accrued interest, all costs of foreclosure, and expenditures of any other nature, and on that *one* particular farm, to its regret and shame, it was obliged to write off a loss of $675.

Mortgages are but little if any affected by such influences as politics, trust legislation, tariff reductions, government regulation, control, and ownership, and other similar influences. Nor do they suffer from high finance. The bonds of the Federal Farm Loan Banks may be purchased to pay a moderate rate of interest, and besides being free from taxation are practically a government security.

Beware of Substitutes. A great many substitutes have been made and offered to the public to take the place of the kind of mortgages so widely used by conservative investors as safe and profitable means of employing surplus funds for income. These substitutes range all the way from second or third mortgages, or bonds secured by such mortgages, to "debentures" that are not secured by any mortgage at all. The latter are an extremely common type. They are sometimes referred to as "equity bonds." They are mere promises to pay, and are seldom if ever any better than the credit of the company which signs them. Depending upon the ability of the issuing companies to make big profits, such debentures as a rule offer nothing more than participation in the real estate business and are, therefore, rarely of genuine investment merit.

In the case of mortgages on city property, the value depends largely upon earning capacity, which is rent producing capacity. Outside of the savings banks, insurance companies, and big investors, mortgages on city property are rarely held in their entirety by a single investor. But in many cities they are put up as deposit by mortgage firms which in turn sell bonds against the mortgage as a whole. Many of these bonds are regarded as safe investments.

There is one fact to bear in mind regarding all mortgages, whether on farms, on improved city property, or on homes in villages and towns. It is comparatively easy to estimate roughly what half the value of the security is. The margin is so large that even a slight error in appraisal does not make much difference. While it takes an expert to estimate exactly the value of a farm or an office building or even of a modest dwelling, almost any person can guess in a very rough way half the value in order to loan on mortgage.

A man may live in a house which he believes worth $8000 and which is taxed say at $6000. It is hard to get at the exact value, but if an investor knows that the assessed value is $6000 and the owner's price is $8000, he is probably safe in lending $3500. Even if the tax assessor and owner are way off in their appraisals the house is probably worth between $4000 and $5000 at forced sale and will therefore cover the mortgage.

The basic characteristic of the mortgage commends it to most investors, provided only they can afford to tie their money up for a period of years. Mortgages are to be had not only from dealers in farm and city property, but also from lawyers and insurance agents in the smaller towns and villages.

Bonds. Every investor should try sooner or later to save enough money to purchase either mortgages or bonds, and then after he has accumulated a good-sized nest egg of these investments he may feel free to try his hand at stocks. Take as an illustration the man on a small salary with a wife and children to support. His first duty is to insure his family against poverty in case he should die. Then the next few hundred dollars should go where it can be got at quickly and without loss, in case of need. There are only two investments which can be depended upon to answer this demand, bank deposits (preferably a savings bank deposit) and War Savings stamps. All of us should have a few hundred dollars which can be called in immediately in case of need.

Next in order comes the Liberty bond, and after these have been purchased there is time to think of mortgages upon real estate and other forms of bonds. The advantages of bonds over mortgages have already been pointed out. The chief of these advantages is that bonds are more readily disposed of in case of need. Probably the investor with sufficient means will have both bonds and mortgages. But it can be readily seen that bonds appeal to great numbers of people.

Beyond question, the chief requisite of a good investment is safety. One must be certain that the principal sum will be returned when agreed upon or when demanded, or that it can be converted into money. "Now, there is one, and only one, word in the language to designate the employment of funds in accordance with those requirements," says the leading reference book[1] on bonds. "It is the word *loan*."

As its name implies, a bond is an obligation, a loan, the same as a promissory note or a mortgage on real estate. The owner of a bond lends money

[1] *The Principles of Bond Investment*, by Laurence Chamberlain.

to some one else to conduct business with. He is a creditor. But a bond should be, and often is, more than a mere loan. It is often a secured loan. We speak of a bond being secured by mortgage, that is, by a pledge of the property in return for the money lent. You and I lend money to a railroad. In return, the property of the railroad is actually pledged to us, the pledge becoming void if the money is paid back to us as agreed. Such a bond is secured. We have a lien upon the railroad, a legal claim upon it, which we can enforce just as long as law and order exist.

Now, it is evident that few persons, unless very wealthy, can lend enough to carry on a large business enterprise. So the custom has grown up of lending great sums on one mortgage, which is taken by a third person, or trustee, in the interest of the many small lenders. Then the mortgage is split up, as it were, and portions sold as bonds to many investors. The trustee is usually a bank or trust company.

Bonds and Stocks. No matter how sound stock may be, it represents the risk-taking, profit-taking part of an enterprise—that is it is the buffer between the creditor and loss. Of course, if no one bought stock—if there were no risk-takers, no speculators—there could be and would be no bonds. Bonds, in fact, are safe only when there is a fairly large stock issue, representing actual cash invested either by subscribers or saved from surplus earnings. But it may as well be understood at the outset that inexperienced investors should leave stocks to persons of more experience who can afford to accept less security for the sake of a greater possible gain.

The reason for this is that the money which a stockholder invests is subject to all of the ups and downs of business. The stockholder of a corporation is a partner in every sense of the word. Moreover, as has been pointed out, corporations do not as a rule have to make provisions for repaying the money they get by the sale of shares, whereas bonds are created for a specific number of years, and must be paid off when they "come due," or "mature," which is at the end of the period, of course. As long as a corporation continues in business, therefore, the only way usually for a stockholder to get his money back is to sell his shares to some other buyer. If, on the other hand, the corporation discontinues business for any reason, the stockholders are entitled to receive only their pro rata share of whatever assets are left after the claims of the creditors (including the bondholders of course) have been satisfied. So that the primary considerations in stock investment, are, as a rule, marketability and the interest return. From what has been said, it is clear that stocks, as a class, should yield more income than bonds.

Bonds are of innumerable types and descriptions and range in countless degrees all the way from Liberty bonds down to those that are almost worthless. All bonds are not good investments. There are hundreds upon hundreds of stocks which are better investments in every way than are thousands of bonds. But on the whole, as a class, bonds are probably more secure than stocks. As a rule bondholders take less risk both with their principal and in the matter of getting a sure, steady income than do stockholders.

Then of course in any given concern bonds are more certain to be cared for than stocks. A company may prove very prosperous and pay enormous dividends upon its stock. It does not, however, except in the rarest cases, give the bondholders anything extra. The stockholders in the company may make several hundred per cent. more than the bondholders, but the latter have no cause for complaint. They know that if things had not gone well they would have been far more certain to get their 5 per cent. interest than the stockholders would have been to get any dividends at all.

A company always makes, or should make, a greater effort to pay both the interest upon and the principal of its bonds than it does to pay anything upon its stock. In ordinary practice if a company fails the bondholders always come out ahead of the stockholders. If one knew positively that a company would continue prosperous indefinitely he would be foolish to buy bonds rather than stock. But unfortunately most investors cannot tell whether a company will remain prosperous. So for them the bonds are always safer.

Classes of Bonds. The question of judging a good bond, of picking out a good one, would take a whole book by itself. It really differs but little from the selection of any other investment security, whether stock or mortgage. In a general way, of course, the investor should know just what he is buying. Bonds have so many different names that many buyers are confused. The most important kinds of bonds, issued by corporations (Liberty bonds, state and municipal bonds will be considered in a separate chapter) are as follows:

1. First mortgage or first lien bonds. These are generally secured by a first mortgage upon all or part of a company's property. It is always important to know just how much of a company's property the bonds are the first mortgage upon,

that is, whether any essential part is left out. Of course, the closer or nearer a bond is to valuable property the safer it is.

2. First and refunding mortgage, consolidated mortgage, and general mortgage bonds. These are usually placed upon a property many parts of which are already covered with first mortgages. They may or may not be considered attractive, according to how many actual first mortgages are ahead of them.

3. Equipment bonds, car trusts, and equipment notes. These are secured by specified railroad cars and locomotives. They have an excellent record for safety.

4. Debenture bonds and income bonds. Debentures are just promises to pay without any mortgage security. If there are many other bonds ahead of them they may be no better than stock. Of course, if there are no bonds ahead of them they may have a high rating. In England all bonds are known as debentures. Income bonds are those on which the company pays interest only in case the directors consider it has been earned. As a rule they are not considered a high type of security.

5. Collateral trust bonds. These are secured by deposit of other bonds, or more often of stock. They may also be secured by mortgage of other

kinds of property as well. They vary much in merit.

6. Convertible bonds. These are exchangeable on certain conditions into stock of the same company. They are a speculative type of bond, and are usually a junior lien, that is, a second, third, or fourth mortgage rather than a first. If issued by strong companies they may be safe enough, and in practice often are. They are of advantage to a concern because as they are exchanged for stock they are really paid off without reducing the assets.

7. Adjustment bonds. These are usually issued at the end of a receivership and are in reality income bonds. They are usually a junior lien or charge.

8. Short-term notes. These bonds run for short periods only, as the name implies, usually for one to ten years. They may be secured by mortgage or by deposit of collateral, meaning other bonds or stocks, but more often are merely the promissory notes of the company. They have an excellent record on the whole, however, because a company always seeks to keep its slate clean in regard to its short obligations. Then too the amount put out is usually smaller than the amount of bonds which the company has, so that the short-term notes are easier to pay off. Another advan-

tage of the short-term note is its early maturity, being paid off soon, it is less likely to decline in price than a long-term bond.

There are many other forms of bonds, but these are the most important. Several of these forms may be combined in one bond. There is nothing fixed, or hard and fast, about the names and conditions which may be adopted in issuing a bond. They are as variable as the circumstances themselves, which are multitudinous. Once having issued a bond in a certain form, however, the company cannot alter the form, name, and conditions.

CHAPTER IV

THE SAFEST CLASS OF BONDS—GOVERNMENTS AND MUNICIPALS

THERE is no doubt that the bonds of governments, states, and cities are relatively the safest in the world. We do not know at this time just what will happen to the bonds of a country like Russia which has apparently gone to pieces. But even in such a case the obligations of the government are more likely to be repaid than those of any private corporation or individual.

In this country with its wealth, resources, and stable government the bonds of the United States, of the states themselves, and of the cities, towns, and districts within them, are supreme among all bond investments in the element of security. We were told this many times during the war, but it is to be suspected that so many of us bought Liberty bonds because of patriotism, duty, and the desire to do our bit and follow the fashion, that the actual merits of what we acquired in return for our subscriptions was often overlooked.

War Savings Stamps. These are really a form of Government bonds. They are perhaps the safest investment in the world. Their great advantage over Liberty bonds is the fact that they do not fluctuate in price. They are suited to the needs of the small investor in exactly the same way that a savings bank account but instead of being secured by the resources of one bank they are backed up by every bit of property in the United States. These stamps and certificates are put out as we know in convenient amounts, can be bought anywhere, and are more convenient for many people than a savings bank deposit. It is inconceivable folly for any except the well-to-do to think of investing in stocks or other more or less risky forms of property until at least a comfortable nest egg of a few hundred dollars has been put in the savings bank or Government stamps, or preferably in both.

Liberty Bonds. War stamps and Liberty bonds have the same security back of them. The bonds, however, have both the advantage and disadvantage of being liable to fluctuation in price. They may go down or up. But whichever way they go they are always easier to sell than any other type of investment. For while Government stamps can always be redeemed without loss in price, ten days' notice must be given. Liberty bonds can be sold immediately. The market for them is naturally the largest and broadest for any bond or stock in the country. They are just as easy to buy of course as they are to sell. The price is published daily in the papers; it is a public matter and every bank, banker, and broker in the country is able and willing to sell or buy the bonds at that price.

This broadness of market is a great advantage to the small investor. Whether he buys or sells he knows that he is faring as well as any other person. There are tens of thousands of bonds and stocks of which this is not true. A few brokers control the price and no one else has any knowledge of the matter. In the case of Liberty bonds, however, much as the price may rise or fall over a long period of time the movement is more gradual than in any other stock or bond because on the chief market of the country, that of the New York Stock Exchange, Liberty bonds may be bought and sold at differences or variations as small as one one hundredths of one dollar, that is, one cent, or in the case of a $50 bond, one half of one cent.

Their Safety. It may be worth our while to consider the element of safety in United States Government bonds. Since our Government was formed no debt has ever been repudiated. All the money borrowed has always been repaid and all the interest due upon it has been paid. No one has ever failed to receive every cent due him in U. S. bonds. For one thing the Government does not fail. As Dr. Frank Crane has said:

> Your Uncle Sam can't fail. If he goes under you may as well know that nothing else will be left afloat. Banks can break, business houses can go bankrupt, millionaires may lose their fortunes and turn beggars, land may lose its value, houses may burn down, live stock may die, borrowers may repudiate their promissory notes; there isn't any kind of security anywhere that hasn't some weak spot. There is always a possibility that any kind of riches known to man may take wings.
>
> Except one.
>
> The promise to pay of your Uncle Sam.

The reason Uncle Sam's bonds are so safe is because he has the entire property of the country to draw upon in the shape of taxes to pay those bonds. Liberty bonds are really a promise to pay signed by every person in the country including all the millionaires.

Whenever a dealer in bonds offers an investor some of his wares he always lays great emphasis on what is known in investment science as the "Margin of Safety." Now there are generally speaking, two ways of looking at this question of the margin of safety. One is in considering how much money is left over after meeting all the running expenses of the corporation. The other is how much of a margin remains for the particular bond in case the property were to be sold or liquidated in some way. That is to say, if a corporation were to be sold out completely and the bondholders paid off the first mortgage bondholders would first get all their principal. Then would come the people holding a second mortgage bond and so on down the line.

Now we know that the Liberty bonds are the first mortgage really on the whole country, because every municipal and Government bond is in reality a first mortgage on the resources of the entire country or locality where it belongs and is backed up by the faith and credit of that territory and its inhabitants.

Taking the margin of safety test on the question of property values here is where we run into staggering figures. The difference between the amount of United States bonds outstanding and the property value of this country is so great that no general computation can even be approximate. The wealth of this country defies arithmetic.

Why then should we consider figures in this matter? It is useless to begin to compare the values back of Liberty bonds with the amount of bonds outstanding. The wealth visible and invisible of this country is such as to make them payable many times over.

It is easy to see, therefore, how the Liberty bonds stand in this matter of margin of safety. As to the matter of earnings we don't take this into consideration in the same sense that we do when a business corporation is involved. We don't have to worry about the amount of money left over after all necessary running expenses are paid. We know that the interest on the bonds of the country can be met under all conditions and in all times because the laws of the country provide ways for raising the money. In fact, the safety of interest is absolutely and always assured.

Price Changes. It is true that during the period of the war with Germany and after the war up to the time that this book was written, most of the Liberty loan issues had declined in price below what the public had paid for them. But no sensible person considered this decline a reflection upon the ultimate worth of the bonds. It was due to the fact that many patriotic persons had bought more of the Liberty bonds during the various campaigns than they could really afford to hold.

At this writing all authorities on finance, with practically no exceptions, regard an advance in Liberty bond prices to par, and perhaps above, as certain. The bonds were not sold by the Government as a good Wall Street stock market "trading medium," but as a permanent investment. The Government wanted buyers to hold their bonds not only for the period of the war but as long as possible, at least until such times as the Government could set itself about the task of repayment.

Following the accomplishment of what the Liberty loans were put out for the Government will set itself out to pay the loans. Investments do not ordinarily return themselves in a few months, nor do lenders ordinarily recall the loans they have just made. Individuals, corporations, and governments are all alike in the fact that they cannot pay off in full upon demand until after the work has been accomplished for which the money was borrowed. It takes time. Banks alone are an exception to this rule, because they use their money in such temporary fashion that immediate repayment of most of it is usually possible.

The interest rate on Liberty bonds is low, of course, but it is sure, and we have all read the fable of the tortoise and the hare. Before anyone becomes impatient with the small return of between four and five per cent. and turns away from this chapter in disappointment, I urge them to read what Ellis Parker Butler, author of *Pigs is Pigs*, has to say on the subject of "Bonds are Bonds."

BONDS ARE CERTAINLY BONDS

There are times when it is all right to "let George do it," and there are times when George should be headed off before he "does it."

The George I have in mind was young George, the son of Henry William, who was the son of Ebenezer J. Henry W. was a bookkeeper and living in an apartment in New York, and George was still living with the old folks, although he had a mind to marry Dorothy soon, and have a home of his own. George was not a bookkeeper, he was merely a clerk, but he was earning almost as much as his father and, with the $200 bonus the firm had handed him at Christmas, he had $1000 in the bank.

He came home one evening in quite a glow of excitement. This was only a couple of days ago, in March, 1918. He hung up his hat and threw his coat on the couch in the hall, and hurried into the "parlor" where his father was reading the evening paper.

"Well, dad," he said, "I've got things coming my way at last!"

"Got another raise, George?" his father asked.

"No, better than that! I'm going to buy some stocks. I've run across the greatest little chance in the world. You know Roddy, the fellow I had up here the other evening? Well, Roddy has hooked up with an oil company and, believe me! it is the greatest chance in the world. It is a million dollar company, two hundred thousand shares at $5 par, but old Roddy is going to let me in on the ground floor. He is going to let me have five hundred shares at $2 apiece, and the stock is dead sure to go up to $10 or even $100 the minute they strike oil!"

"Yes?" said his father sadly.

"Why do you say it that way?" asked George. "I tell you, dad, it is a sure thing! Even if the stock don't go up to $100 a share it will pay 10 per cent. at the very lowest——"

"Yes?" said his father still more sadly.

"There you go again!" said George disgustedly. "I thought you would be as pleased as I am. What——"

"I thought you had decided to buy Liberty bonds, George," said Henry William wearily.

"Liberty bonds? That only pay 4¼%, when I can get stock in the Rosy Dream Oil Wells Company that will pay 10%? Father, what was the highest the United States Spanish War bonds went to?"

"They went to 112, I think, after peace was declared," said Henry William.

"Yes, that's all. They cost 100 and went to 112, and Roddy says this stock that costs $2 may go to $10 or $100—maybe to $1000—nobody knows!"

"That's it," said Henry William. "Nobody knows!"

"Well?" queried George.

"George," said Henry William, "stocks may be stocks, but they may turn out to be worthless scraps of paper, but bonds certainly are bonds!"

"You say that, father, but—I don't mean any disrespect—although it sounds wise, you can't say you have been much of a financier. You are sixty now, and you have to work just as you always worked."

"That is what I mean when I say bonds are certainly bonds," said Henry William. "George, will you hand me that little black book in the second pigeonhole of my desk? Thank you! Do you know what this book is?"

"I never saw it before, dad."

"This is your grandfather's diary—my father's diary. There is his portrait on the wall, George—an enlarged photograph, he could never afford to be painted in oils. Neither could I. He stopped keeping this diary in 1870, and he began it in 1840, when he was twenty, just your age. I found it in his desk in 1880, George, after his death, and I began jotting things down in it. I was just twenty then, and that was thirty-eight years ago. It is a record of two generations and there are still many blank pages in the book. I am going to give it to you. You can write in it from now on."

Henry William turned the pages of the book.

"Here is his first entry, George," he said, and he read it aloud:

"'To-day I am twenty years old and by great economy I have saved the sum of $1000. Saving is slow and tedious work but by good luck I learned of an excellent opportunity for Investment to-day and I have put my $1000 into shares in the Royal Wealth Quarries Company.'"

"There are other entries, dealing with his life and his love for your grandmother, but here, three years later, he records the fact that he has quite given up hope of ever getting back a cent of the money he put into the Royal Wealth Quarries Company, which had failed ignominiously to live up to promise.

"Seven years later I find another entry. He has saved $3000 and his friend Roger Hopeful is forming a stock company. He writes:

"'There seems not the slightest chance of this venture being anything but most successful. The Golden Hope Gold Mining Company owns an entire mountain in California and Roger tells me it is said to be almost solid gold.'

"That was in 1850. The following years tell a story of hope deferred, with a final entry acknowledging that his investment was a total loss. He invested no more until 1860. It was hard for him to save money but he managed to scrape together $2000 by that time and there is an entry as follows:

"'My old friend James P. Eager was East this month and offered to let me participate in a new company he is forming to raise hogs in Louisiana. I have invested $2000.'

"A year later is this entry:

"'Eager writes me that the cholera has carried off all the hogs owned by the Eager Hog-Raising Company and that the concern is insolvent. He asks me to send him money to get back to New York.'

"There are few entries after that but my mother often said that she believed that unfortunate venture worried him until it caused his death."

George said nothing and his father turned the pages of the old diary.

"Here," said his father, "is the first entry I made in the book:

"'May 6, 1880. Bought $2000 Magic Wizard Silver Mine Stock.'

"That was money thrown away, George. For several years there were hopeful reports from the mine in Colorado and then the company simply faded away. There were no dividends and the stock was worthless. It taught me to be wary, but not to be wary enough. Here is another of my entries:

"'August 14, 1890. Wife and I bought to-day $3000 of the stock of the Glad Tidings Patent Medicine Co., of which my old friend O. B. Glad is to be president.'

"He was indeed president, George, at a nice fat salary. I liked Glad, so I should be thankful that someone got something out of the company; I never did—not a cent. It was a hard blow to your mother and to me. We had counted on that $3000 for our old age. But I scraped and saved, and in 1900 I was able to write this:

"'Everyone is making fortunes in copper these days and why not I? At any rate I mean to have my chance, and I have investigated carefully and have invested $1000—all I have in the world—in Castle-in-Spain Copper stock.'

"I think you have heard me speak of that stock, George, but not with mad delight. It is not worth the paper it is printed on and it never will be. That $1000 was thrown away.

"Altogether, George, your grandfather and I have 'invested' only $6000 each. It was not much, but it was all we had, and it is gone. There are good stocks, but all stocks are not good. Those that promise most brilliantly are often the most worthless. But that is not what I wanted to tell you, George. That is not all I wanted to tell you.

"You have scoffed at United States Government bonds that only pay 4¼% interest, but the fine fact is that they do pay it. Twice each year, when the interest is due it is ready for you. You get the money and not an explanation of why you do not get it.

"Suppose, George, your grandfather had not been so eager for magic. Suppose he had been able, in 1840 to buy United States Liberty bonds that paid 4¼% and had put his $1000 into them. If he had reinvested his interest at the same rate he would have had, in 1850, $1522.66. A nice increase, George.

"If, in 1850, your grandfather had then invested his $3000 in United States Liberty bonds bearing 4¼% interest, instead of in Golden Hope Mining Co. stock, he would have had $4522.66 and in 1860 this, with the interest reinvested, would have amounted to $6886.95. He would have had that much wealth, instead of nothing, as the result of his investments. I wish he had then put his final $2000 into Liberty Loan 4¼% instead of into Eager Hog-Raising stock, for then he would have had $13,519.89 to leave me when he died, instead of the nothing he did leave me.

"Yes, George, it is better to have an absolutely safe bond, like the Liberty Loan bonds, than anything doubtful. Imagine the difference it would have made in my life—and in yours—if father had invested in Liberty bonds. In 1880, when I was twenty years old the amount of my fortune would have been $21,022.64, plus the $1000 I had saved of my own earnings. My yearly income from father's investments would then have been $893.44. A nice little sum, George.

"But I have been guilty, too. If father had bought Liberty bonds and I had done the same whenever I had money to invest, at the times I have told you of, I would have been worth $35,092.68 in 1890. That is how the 4¼% you despise increases when there are no losses of capital. And the United States Government never fails, George. Your bonds never 'go bad.' Not if they are United States Government bonds.

"Have you any idea how a small income from safe bonds increases when it is reinvested regularly, George? Do you know that with the small investments father and I were able to make the income would have been $2039.52 each year by 1895? That is the truth, George! And in 1900 I would have been worth $56,921.91.

"In 1901 I would have been worth $60,359.74.

"In 1904 I would have been worth $70,104.88.

"In 1908 I would have been worth $81,221.81.

"In 1910 I would have been worth $90,225.94.

"In 1913 I would have been worth $100,251.85.

"That is how 4¼% interest compounds, George. It is amazing. Do you know what I ought to be worth to-day, at that rate, if father and I had not thrown our poor little capital into foolish investments? $124,675.31! Yes, George, I ought to be worth $124,675.31 to-day. My income from our investments would be $5298.70 each year.

"Well, father was not wise, and I was foolish. Some day you will be growing old, as I am now, and you will have a son you love to whom you can leave nothing, because you have nothing. Then you will know how I feel now. You will know how I regret my folly.

"I say this will happen to you, George, because I fear the desire to make foolish investments runs in our family. It seems so to me, since you mean to begin by investing your first savings as I did mine, and as your grandfather did his.

"We did not have much to invest—father and I—only $6000 each during the course of each of our lives, and that is what any frugal man can save, but we threw it away. I hoped, George, now that these Liberty Loan bonds gave you a chance to invest in the best there is, that you would take advantage of the opportunity, but I see it is not to be. I am sorry."

For a moment the young man said nothing.

"Dad," he said presently, "you're right! I'm going to buy Liberty bonds." Those stocks may be real stocks, or they may be fake stocks, but—what was it you said a bit ago?"

"Bonds are certainly bonds," said his father with a smile. "And United States Liberty Loan 4¼% bonds, George, are the safest, sanest investment ever offered to an American. Buy them, George; it is time this family's luck turned. It is time we used our common sense. Remember this: stocks may be stocks or they may be scraps of paper, but bonds are certainly bonds!"

Liberty bonds have many other advantages besides their safety and marketability. The interest is not only sure, it is absolutely regular and always the same. It can always be counted upon. It is the same year in and year out. Many stocks and business enterprises pay ten or twenty per cent. one year and then they may pay nothing for several years.

Liberty bonds are easier to borrow money upon than any other known form of security in this country. They are entirely free from state and local taxes, the local assessor not even having the right to ask you how many you have. They are of an acceptable duration or maturity, that is they run for a period of time neither too short nor too long. There are many safe bonds which run for two or three years but they involve the trouble of an early reinvestment.

On the other hand a bond which runs for many years has an element of uncertainty about it because no one can predict what will happen in the far distant future. A final advantage is that Liberty bonds can be purchased just as readily in small as in large amounts. It is in every way a basic form of investment, a foundation without which the house cannot be built.

Municipal Bonds. The bonds of cities and towns in this country form one of the most desirable classes of investments for a large majority of persons. There are four or perhaps almost five billion dollars of these municipal bonds outstanding, ranging all the way from the obligations of small villages up to cities like New York and Chicago. They can be bought in great variety from a large number of banks, trust companies, investment bankers, dealers, and brokers. Advertisements of municipal bond offerings are very common on the financial pages of the newspapers.

The municipal bond really has only one drawback. It lacks speculative opportunity. They rise but little in price, neither do they fall. There has been a slight movement upward for several years now, but not marked enough to help any owner make a "killing," or even an appreciable profit. Municipal bonds are noted for their safety and moderate income. One who buys them is as absolutely sure of getting his principal back and reasonable income return as in any known form of investment.

Moreover, there is rarely any difficulty in selling a municipal, if you need to get rid of it. They are not commonly dealt in on the stock exchanges but there is always such a demand for this class of bonds from insurance companies, savings banks, and rich investors that a market in which to sell is easy to find. There might be some slight difficulty in selling the bond of a small town or village at the same or almost the same price at which it was purchased, but there is rarely any trouble in finding buyers for bonds of the larger cities.

The safety of municipals lies in the fact that they are secured by taxation. Bad management does not injure a municipal the way it does a railroad or industrial plant, and there is no competition to fear. Even if a city fails to make both ends meet because of excessive expenditure and rotten politics, the taxes can always be raised high enough to meet the interest on the bonds. The number of cities and towns which have defaulted upon their bonds is so small as to be negligible. With the exception of the bonds of our own Government and a few of the European nations, no other form of investment has anything like the record for safety that municipals may boast of.

The rate of interest depends upon the city, locality, and the amount of bonds outstanding. Usually state laws regulate the number of bonds which a city or town may issue in relation to the value of its taxable property. In some states it is impossible to sell bonds exceeding 5 per cent. of the taxable value of the property in the place. Such laws of course protect the investor. Some of the large cities especially in the East, are able to sell their bonds at such high prices that the interest return amounts to only 3½ and 4 per cent. Other cities, equally as good, have bonds which may be had to pay as high as 4½ and 5 per cent. In some of the less thickly settled portions of the country the interest rate runs above 5 per cent. and even up to 6 per cent.

Of course the one obvious caution to follow in buying municipal bonds is to avoid those of a boom town which lacks diversified industries. The wealthier and more stable the nature of a town the better. If a town depends solely upon one industry which may give out, such as one mine or oil well, only the proverbial sucker would buy its bonds. A town which has a variety of manufactures and also a large surrounding and contributory agricultural population is naturally one to tie to.

The average investor need not worry himself much about the different classes of bonds issued by a city or town. There are degrees of value, but they are mostly too slight to seriously matter.

Bonds secured by special assessments upon the property owners immediately benefitted by improvements are naturally less valuable than other classes, because they do not have the full weight of the town's taxable property behind them. But there is really very little difference as between school bonds and water-works bonds, or highway bonds, etc.

Municipal bonds are issued mostly in $1000 amounts, but often may be had for $500; now and then for $100, and in a few rare cases for even less.

CHAPTER V

HOW TO CHOOSE SAFE INVESTMENTS, ESPECIALLY BONDS

It might seem at first glance as if this book were proceeding somewhat illogically. After describing Government and municipal bonds, savings banks, life insurance, first mortgages, and the like, we now take up the subject of choosing a safe investment. Would it not be more logical to first describe the different forms of corporation bonds and stocks? Perhaps it would be a more desirable course in a college textbook or a theoretical discussion of any sort. But in this very simple and concrete little book it is my intention to be practically helpful rather than to attain what might be called literary unity.

There is a very important reason for breaking into the description of the different classes of securities at this point with a few chapters on how to test the investment, how to choose it, and how not to choose it. Up to this point I have described the more elementary and fundamental forms of investments which do not require much knowledge for making a happy choice; such as savings bank deposits, Government bonds and stamps, life insurance and annuities, building and loan shares, first mortgages upon real estate, and municipal bonds.

It is true that several of these forms of investment cannot be made haphazard any more than it is possible to select corporation stocks and bonds in a similar fashion. But the whole process is simpler and less complicated. All of these forms of investment come earlier. The sensible, normal man would naturally want to have a home, a bank deposit, life insurance, and such safe bonds as Governments and municipals before he ventures his money in other fields.

First mortgages upon real estate and building and loan shares may not be any safer than corporation bonds and stocks, and probably require almost as much care in selection. But they are nearer at hand for many people, and therefore their purchase is more natural and easy. If the people who throw their money away on unknown shares in oil and mining companies thousands of miles distant, would take a mortgage on a neighbor's property or a few shares in the building and loan which is managed by their friends, there would be less money lost in poor investments.

No Complete Safety. There is no such thing as complete or perfect safety in this world. We cannot be any surer of always making safe investments than we can be sure of living to a ripe old age. It is all comparative and relative. Everything wears out, investments and human beings alike. But here are laid down a few simple rules which should help to insure a reasonable degree of security.

First of all let me repeat that the surest way to keep one's savings intact and increase them moderately is to have at least part of them in the forms of investments already considered, especially in bank deposits, life insurance, Government and municipal bonds, and conservative first mortgages. But if there is yet more to invest, if the owner of surplus money feels the call to buy still other classes of securities, such as stocks and corporate bonds, then further rules are needed.

There can be no doubt that eternal vigilance is necessary to maintain any large aggregate of invested funds intact. It is true that less vigilance is required in watching the classes or forms already described. It is most improbable that Liberty bonds, savings bank deposits, or life insurance policies will "go bad." They are less likely to turn out badly than the usual run of mortgages, bonds, and stocks. Yet once in a great while an insurance company or savings bank does get into trouble.

When it comes to mortgages, bonds, and stocks, however, the importance of vigilance cannot be overlooked. I do not mean that an investor should constantly be shifting. The stock speculator who cannot keep even the best of stocks for more than a few days because he does not get any "action" out of them, that is because they do not rise immediately in price, is a pitiable object. He often needs as much sympathy as the hopeless drunkard, the drug addict, or the cripple.

I have known speculators who had bought stocks which everyone knew were certain to appreciate in value and which in the course of a few months or even a few weeks did rise considerably, and in many cases increased their dividend payments. But just because the stocks did not go up within a few days after they had been acquired the speculators became disgusted and let them go.

I do not mean that an investor should make this kind of hectic, speculative adjustment, that he should be always changing; or anything remotely approaching it. But just as a successful corporation is always the one which changes its policy to meet changing conditions, so the successful investor must be prepared to follow, or rather preceed if possible, the basic changes that are always going on in the industrial field. Too many investors are ruled by sentiment; just because an investment has always done well in the past they are unwilling to let go even if they see the business is steadily on the down grade. Because Grandfather owned a certain bond is no reason why you should always keep it.

It is difficult to lay down rules in this connection. It is my purpose merely to call attention to the fact that there are very few permanent investments. If you buy stock in the XYZ Manufacturing Company, and reasonably careful observation persuades you that the company has no future, don't hang on just through inertia or sentiment.

Reasonable Assurance Only. Only fifteen years ago bonds of ferry companies operating between New York and Brooklyn were considered good investments. They are worthless to-day because bridges and tunnels have destroyed their value.

Entirely aside from dishonesty, bad faith, and mere quackery all business enterprises are subject to countless hazards. Such influences as poor management, natural depreciation of physical property, new inventions, unexpected and destructive legislation, disappearance or change in demand for specific articles, violent changes in the general level of prices or in specific prices, excessive advances in wages, war, fire, and physical calamities—all these tend to destroy investments. It has been said, perhaps it is an exaggeration, that no business is good for more than a generation. One thing we may be sure of, present incomes cannot be exchanged for future incomes without risk. If you buy a bond it is a contract to pay money in the future and no human being can predict the future or be sure of living up to a future contract.

There are two great facts which face anyone who really studies this subject of investment—one is the risk inherent in all outlays of money and the other apparently contradictory fact is that thousands of people actually do make good, successful investments. That is the way with all life. Many people are ill, and many are well. Many are happy and many unhappy. Many "make money" and many do not. But there is no cause for despair. Money can be invested safely over a reasonable length of time.

There have been people who owned stocks which had paid several hundred per cent. in dividends over a reasonably short period of time and then the stocks declined in value and the owners cried out in dismay. They were very foolish, selfish, nearsighted people. For example, if some of the early purchasers of Standard Oil or Calumet & Hecla stock, both of which have paid out untold fortunes in dividends, should complain if those stocks happened to suffer, the world would laugh at them.

All we can reasonably ask is that investments should keep intact for a generation or perhaps two generations and pay moderate returns. Certainly no man has a right to expect more than to provide for his old age and give his children a start in the world. He has no right to place a burden of interest charges upon the back of unborn generations. An investor lends money for a definite purpose and expects to get his money back and moderate interest for a reasonable length of time until the principal is repaid. He has no right to expect the loan to go on earning interest forever, because the purpose for which any loan is made seldom outlasts a generation and to keep its charge alive forever is unfair to posterity.

Insurance. Now next to this elementary principle of vigilance, watchfulness, and the making of changes and adjustments when necessary, the surest way to avoid loss is to distribute the risks, that is, to diversify, or spread out one's investments as much as possible into different channels. Insurance companies and savings banks are safe just because they distribute the risk over a wide area. One issue of bonds may turn out badly, but the loss is averaged down to almost nothing because other securities turn out well.

Never keep on making investments in the same company, the same locality, or the same industry. By diversification investors increase the average return on their money and fortify themselves against adverse conditions, which might otherwise affect only the one type of investment, or the particular section of the country in which all of their money is employed.

Of course, individuals cannot distribute their money around as widely as big institutions do, but the great majority of investors can take this precaution against loss more than they do. Most of us are lazy, and if we find one type of bond or stock which suits us we stick to it. This is all very well with a suit of clothes. If we look well in blue why not always wear blue. But safety demands that we vary our investments.

To distribute or diversify one's investments means more than to put them into different companies and different classes of securities, such as bonds, preferred stock, and common stock. It means different industries, and, if possible, different geographical locations. In the case of bonds it means different maturities. It would be foolish for a man to invest $10,000 in ten different bonds all coming due on October 1, 1930, unless he has some particular and pressing reason for desiring the money on that date. It would be far better to have one bond coming due each year from 1920 to 1930. This would increase the element of safety to a large degree.

Know Your Broker. Next in importance I should place the necessity of dealing with a reputable, reliable broker or investment banker. That is half the battle. The best of brokers and bond dealers (so-called investment bankers) often sell poor wares. So do the best of physicians often lose cases. But the broker who has a good standing is far more likely to have desirable goods for sale than the broker of poor standing or none at all. If the investor knows just what he wants to buy he can often buy it through an unreliable broker. But he has to resist the urgings of the broker to purchase something else, and he takes a chance of not receiving the goods at all.

This subject is so important, however, that a separate chapter will be given to it. At this point I can only repeat that a highclass merchant is more likely to have good wares in stock than the merchant who has no reputation to keep up.

Essentials and Non-Essentials. Perhaps next in importance comes the injunction not to buy securities of any company which is not engaged in a reasonably necessary and stable business, unless either you have made an unusually careful investigation, or unless the company has an accumulated surplus so large that its bonds and stocks could be paid off at any time, or unless the property could easily be turned to another use. Try equally to avoid industries so monopolistic as to invite public hostility and those which are excessively competitive.

Highly competitive industries may be all right if the company already possesses an efficient organization and an established name. Use common sense in this respect. Stock in a company which makes a patent curling iron is not so likely to be a suitable investment, other things being equal, as stock in a company that manufactures every kind of steel on the market or which supplies electricity to thirty different towns. Try to stick to fundamental industries, where the demand is broad, stable, and permanent. Novelties and articles of luxury are usually to be avoided. If the products are varied in character so much the better. If a railroad, the more classes of freight the better. Be sure the source of supply is secure, if a manufacturing company.

Management. Another very important consideration in making any investment is the character and reputation of the men who manage and control the company. This is almost too obvious to put into a book, but investors often overlook this consideration. Of course, the average investor cannot investigate as far into such a subject as might be desirable. But he should find out as much as he is able to. Indeed the character of the management is perhaps the most important consideration because many of the other factors depend upon it. With the right management adjustments of policy will be made and earnings will be kept up.

Earnings. The next consideration is earnings and earning power. From a purely financial standpoint, this is the greatest of all investment considerations. It is more important really than property value, even in the case of a bond. A first mortgage bond may be secured by property supposed to be worth several times the amount of the bonds, but if the earnings dwindle off to nothing the property will not be worth anything. On the other hand if the earnings both past and present seem to show the right trend then it does not make much difference what anyone says the property is worth.

One of the clearest explanations of the importance of earnings is that given by a writer in a series of articles in the *Business Digest* and *Investment Weekly*. He has in mind bonds only, but much the same analysis applies to stocks, although the stockholder should probably rely somewhat more upon future or potential and less upon past earnings.

> The first step taken by the intelligent buyer of bonds should be a careful examination of the amount earned available for interest payments over a long period. If a corporation has been able to show a large margin over and above all charges for many years, all its bonds may be considered reasonably safe. If this improvement has been progressively favorable, so much the better. On the other hand a gradually dwindling margin of safety should be viewed with suspicion. The simplest way of determining this point is to consult the percentage of fixed charges (interest on funded debt[1]) to gross or net income. If the ratio remains stable or declines gradually the safety of all bonds is indicated. If the ratio rises steadily there is a

[1] Bonded, or other debt, of a more or less permanent nature.

strong inference of approaching danger. As an illustration of this, two great railroads, one of which has been going forward and the other backward—Atchison, Topeka, and Santa Fé, and New York, New Haven, and Hartford. The investor who took a little pains in order to safeguard his funds would have no trouble in discovering the trend of the fortunes of these two properties by reference to the course of fixed charges alone. New Haven's interest charges began increasing many years ago and this trend was continued even in recent years. In 1912 the ratio of gross income consumed by interest charges was 34.11 per cent. In 1916, it was 49.40 per cent. Atchison's ratio was 39.21 per cent. in 1912 and 26.60 per cent. in 1916. This showing if observed by the investor, would naturally have stimulated investigation and it would have been quickly discovered that New Haven was paying fancy prices for non-productive securities, borrowing heavily on the equities of the parent road and forcing up interest charges. Atchison, meanwhile, was plowing back earnings into the property instead of borrowing money and its profits were rapidly increasing. The improvement in one case and the decadence in the other was fully reflected in the quoted values of the various securities of the two roads.

Another simple method of tracing the progress of a corporation is to refer to the records of surplus earnings applicable to the common stocks. If this surplus is increasing it naturally follows that the integrity of the bonds is being augmented. This may be illustrated by a few figures, employing the same roads for examples.

EARNINGS FOR COMMON STOCK

Years	New Haven	Atchison
1908	8.38%	7.74%
1909	7.43%	12.11%
1910	10.78%	8.89%
1911	7.45%	9.30%
1912	4.96%	8.19%
1913	9.15%	8.62%
1914	1.47%	7.39%
1915	2.75%	9.18%
1916	3.53%	12.31%
1917	1.53%	15.02%

Ignoring the fluctuations due to good or bad years, we find a gradual decline in the case of New Haven and gradual improvement in the case of Atchison.

The Structure. The final general consideration or precaution I wish to urge upon my readers is to lay stress upon the financial position of the security they buy in the company. By this I mean its position relative to other securities. The first mortgage bonds in a given company are stronger than the second mortgage bonds of the same company. It requires no knowledge of accounting, no extensive financial education, to analyze the financial structure of a corporation. It takes only an ability to read English. That is one of the first steps an investor should take.

There have been numerous cases where railroads and other corporations have failed and yet the first mortgage bonds remained uninjured. That was because the interest upon them was a small amount relative to the entire earnings. Such cases illustrate what I mean by urging you to know the relation of your investment in the financial structure of the company. It is merely another way of emphasizing the importance of earnings. A common stock of a company with big earnings may be almost or just as safe as the first mortgage bonds of a company with small earnings.

The all-important question then is a sufficiency of earnings to take care of the required interest and dividends. Find out what is ahead of your bonds or stocks and what comes after them. One is almost as important as the other. If there are securities selling at high prices which come after yours, then probably the earnings are large enough. But the great thing is to know where you stand in reference to the earnings. Don't be fooled by a name. They may call your bond a consolidated general first mortgage. The real question is how many other mortgages come ahead of it to eat up the earnings first, and how many come after it upon which the company is able to pay.

Looking over Bond Circulars. A woman once wrote to me as follows: "Will you please let me know how you determine the value of a bond when looking over the average bond circular. That is, what points in the statement make you think it is all good or bad bond?"

By way of answer let us quote from the rules for testing a bond laid down by two different dealers in bonds. We will call them Nos. 1 and 2.

No. 1

1. Is the obligation that of an organization engaged in a necessary and reasonably stable line of business?

2. Is the bond secured by property which has a value in excess of the bonded indebtedness?

3. Have the earnings of the corporation for several years past been at least twice the requirements for interest on all bonds and other debts outstanding?

4. What is the position of the bond in the financial structure of the corporation?

5. What has been the past record of the corporation as to its management?

6. Is the bond marketable?

No. 2

Analyzing a bond is a life vocation, and requires experience and an investigating type of mind.

The first question is: What is the lien of the bond? If a railroad bond, is it a first mortgage on profitable mileage and terminals? If an electric lighting bond, is the mortgage on a power house in use or is it abandoned? These questions merely suggest that investors should always ascertain the exact lien of a bond offered to them for purchase.

Next comes earning power. Now, of what use, for example, is an abandoned railroad on the salt meadows? This mileage has no earnings, and, even though the bonded debt may be only $1000 a mile, the company cannot pay any coupons, because there are no earnings. Consequently, earning power is the second and perhaps the first thing one should learn about a bond.

By "earnings" is not meant simply the statement given on the bond circular, but a complete income account showing the full disposition of net earnings. Sometimes, instead of "net earnings double interest charges," one finds the company may not be earning interest charges because of large floating debts. Then one should ascertain the integrity of net earnings and inquire about depreciation, obsolescence, and similar charges.

Then comes another supreme test—the balance-sheet. No investor should buy bonds without studying the balance-sheet. Floating debts are the microbes that cause or precipitate most receiverships. Current indebtedness looms large and important, and investors learn the costly lesson that even first mortgages succumb before this enemy.

Past records, management, and many other factors must be considered.

Another important factor is marketability. Would you lend any individual your money for, say, fifty years? Would you take the chances of death, default, disaster, and disease? Never. Then never buy an unmarketable bond. Conditions may change—they always do—in fifty years. Your long-term bond is a long-term contract between yourself and the issuing corporation, and can be broken in only two ways: default by the corporation, and sale by you to another person. This is marketability, and make sure there always will be numerous persons willing to buy your bond without great sacrifice. In fact, ascertain the probability of marketability of a bond before buying, or even investigating.

Summary. Perhaps all this mass of advice can be summed up in a more graphic form. To invest with reasonable assurance of safety, follow these rules:

1. Change and adjust your investments as conditions require.

2. Do not confine yourself to one type, class, or group of securities. Get the insurance of diversification as far as your means permit.

3. Deal with as reliable brokers as possible.

4. Try to select solid reasonably stable industries and companies. Invest in real enterprises, not paper ones.

5. Try to tie up with companies that are managed by honest, reliable, and of course, efficient people.

6. Earnings, past and present, and especially in the case of stock, future or potential, form the surest test.

7. Consider the position of your bond or stock in the financial structure of the company, whether it is close to the earnings or far away from them.

8. Is the company successful in taking care of current debts? If not, avoid it.

9. Can the bond or stock be sold without serious loss after once it has been purchased? If not, avoid it.

(This subject of the salability or marketability of securities will be considered in later chapters.)

How Rich Men Invest. It may be illuminating to see with what success rich men invest. With all the extensive machinery at their disposal it is generally assumed that the rich invest more successfully than those of moderate means. Probably they do, but not enough more successfully to discourage the man of modest income. There is no more common error than to assume that a millionaire never makes a mistake. He and his agents are liable to error, perhaps not as much as persons of minor financial importance, but to a very great degree all the same. Jay Gould is said to have remarked that no man could guess right more than three out of five times. And even where it is not a matter of mere guesswork but of cool judgment, the rich man, indeed the fabulously rich man, very often goes wrong.

The millionaire has at his disposal powerful forces which make for safety in his investments. He can afford to employ an organization to investigate, and he can afford to distribute his holdings so extensively as to average down his losses. A still more important and perhaps even more simple factor that always works for him but that I have rarely heard mentioned is his greater experience. He has so many opportunities thrown at him that mere horse sense should teach him in time to avoid mistakes. The man of moderate means has no such advantage. He does not invest weekly or daily, and so he does not gain the first-hand experience of repeated selection and rejection. But there are just as powerful forces that work against the rich investor, forces within himself that do not operate at all in the case of the man of medium income. Indeed it may be fortunate that such is the case, else all the money in the world might become concentrated in the hands of a few.

The contents of the strong boxes of so many persons of great wealth have been exhibited to the world in the last ten years through death and the inheritance-tax appraisers that a very fair idea may be had of how these men actually do employ their funds. Taking only a partial list of those who left, say, $15,000,000 or more, we have before us the investments of such varied personalities as J. P. Morgan, E. H. Harriman, H. H. Rogers, Henry M. Flagler, John D. Archbold, Harris Fahnestock, John S. Kennedy, D. Willis James, Anthony N. Brady, Joseph Pulitzer, D. O. Mills, James B. Haggin, Alfred Vanderbilt, James Hobart Moore, Charles W. Harkness, Oliver H. Payne, L. V. Harkness, and John Jacob Astor. Further back, one may analyze the holdings of such giants as Russell Sage, Marshall Field, P. D. Armour, Jay Gould, and Commodore Vanderbilt. Before long it may be possible to discover how the enormous fortune of Hetty Green was invested, and gifts of large sums to various foundations by John D. Rockefeller and Andrew Carnegie have made it possible in part to discover their investment secrets.

Nearly always the self-made millionaire has to contend with his own too great self-confidence. His very success is often his undoing. Trained in one line, successful in that line, it is only with extreme difficulty that he can make himself realize that he cannot succeed in all lines. He is flushed with success and prosperity. He has unconsciously, perhaps, the feeling that he possesses the magic touch; that once he invests in an enterprise, once he becomes its backer, it simply must succeed. And in countless cases he is utterly wrong. Hundreds of millions of dollars have been thrown away by the self-made men on investments outside their own business.

The verdict of most observers is that self-made millionaires usually make their fortunes in an industry that they understand and lose a large portion in securities they know nothing about. In that sense the saying that it is easier to make money than to invest it is true. Vast sums were sunk by the millionaires of the Pittsburgh steel district in mining shares in Nevada. It is only his recent dazzling success with the Bethlehem Steel Company that has erased from Wall Street's memory Mr. Schwab's connection with mining ventures.

John D. Rockefeller's enormous wealth is largely due to the large proportion of his earnings which he has kept in his own business. It is commonly supposed that when several of his partners wished to engage in an orgy of railroad construction and investment Mr. Rockefeller took over part of their Standard Oil holdings. Indeed, if men like William Rockefeller, H. H. Rogers, and Henry M. Flagler had refrained from their enormous purchases of railroad stocks or had kept from building railroads of their own, their wealth would have about equaled that of John D.

It is only when our "billionaire" went outside of his own industry and indulged in the Colorado Fuel and Iron, Western Maryland, and other non-petroleum ventures that his investments turned out badly. Despite his staff of investigators and investment experts he would probably have more if his funds had been put in savings banks, if such a thing had been physically possible, than in these outside ventures. Of course his one great advantage is that he can afford to wait, to hold on, and himself finance a weak company through hard times. If it had not been for this saving grace, peculiar to him alone, because no other man in the country is quite rich enough to do it, John D. Rockefeller's outside investment losses would have been staggering indeed.

Rich men nearly always are most fortunate when they stick to their own line or at least to somewhat similar industries. The founder of a chemical firm left an estate of $7,000,000, the bulk of which consisted not in his firm interest but in stockholdings in two other companies in an allied line of business. That is often the true secret of investment success. But when copper men buy railroads and railroad men buy copper, is it any wonder they lose? Nor is there any doubt that rich men as well as others are prone to reason badly. The late Professor Münsterberg pointed out that the masses are constantly deceived by false analogies. They reason, so the great psychologist said, that because the Calumet and Hecla Copper Company multiplied its value a hundredfold other copper mines must do the same. He might have added that the classes as well as the masses are often the victims of weak logic.

Another great source of loss to men of wealth is their frequent attempt to play the market. The stock market is an impersonal thing that no one can beat. Nor does the possession of inside or confidential information seem to help the millionaire. Indeed it is a common conviction among Wall Street men that one reason for the size of John D. Rockefeller's fortune is that he has not tried to play the market, in the sense that many other men of unusual wealth have done.

"A man came into this office many years ago," said an old broker. "He sat where you are sitting now and sold out his factory to the trust for $2,000,000. Then he began to speculate and he lost nearly every cent."

"The current which sends market prices up or down," said one of the country's foremost bankers recently, "is far stronger than any man or combination of men. It would sweep any man or men aside like driftwood if they stood in its way or attempted to deflect it." And only the underground news of Wall Street, that which never sees the light and never can, completely tells the story of the distinguished millionaires who have been burned in the speculative game.

The fact that nearly all large estates contain "cats and dogs"—that is, utterly worthless stocks with no chance of salvage—has perhaps tended to make persons of smaller means feel more comfortable or has even influenced them to be more careless. Such conclusions are most unfortunate. Rich men acquire cats and dogs either because they feel they can afford to gamble, which other people cannot afford to do, or because of some personal interest. Millionaires often acquire the cat-and-dog type of stocks as gifts, or accept them as collateral for loans to friends, or buy them from friends to help them out.

We hear much of the saying "three generations from shirt sleeves to shirt sleeves," and of how great American fortunes are quickly distributed or dissipated through the improvidence of their inheritors. But though there are conspicuous examples of financial incompetence on the part of the inheritors of great fortunes, there are just as many cases where the fortunes have been kept intact, for the very simple reason that the owners, fully knowing their limitations, have taken no fliers, made no ventures, but trusted wholly to expert advice. No one ever suggested that the late Alfred Vanderbilt, whose interest in horse racing was well known, possessed any business genius. But he left a large estate invested in the most conservative securities, and apparently had never indulged either in cats and dogs or in ventures he knew nothing about. Both the Astor and Vanderbilt fortunes have been kept intact because the owners have not trusted themselves to take a fling the way the self-made man always feels free to do.

Curiously enough, cats and dogs rarely if ever appear in the estates of Standard Oil millionaires. That is a form of indulgence that these rather stern capitalists keep away from. And though some of their number have sunk scores of millions in rather unprofitable railroads, others have invested with extraordinary skill. John D. Archbold, a former president of the Standard Oil Company, was one of these; and so was Charles W. Harkness, who inherited only a couple of million dollars from his father, one of the founders of the company, and through the increase in value of Standard Oil stock and judicious outside investment increased the total to $60,000,000.

J. P. Morgan made many bad investments, but his motives seem to have been to interest himself in this or that undertaking rather than to set out deliberately to secure the largest profit. Then, too, he reduced the value of his estate by sinking vast sums in art. Money for its own sake did not appeal to Morgan much; and yet, like three other marvelously successful men—James

J. Hill, E. H. Harriman, and Marshall Field—he left a huge estate, chiefly because, in a strictly investment sense, the bulk of his income went into the business he knew the most about. Hill and Harriman invested most heavily in railroads, Marshall Field in the dry-goods business, and Morgan in banking.

It is rather significant that a rough approximation of the composite final judgment of these four business geniuses as expressed in their actual investments shows a heavy leaning toward stocks rather than toward bonds—that is, toward the equities and growth of the country rather than toward the mortgage upon it. None of them placed more than a quarter of his fortune in bonds. One safe general conclusion to draw from the study of rich men's investments is that they never do better than when they purchase bank stocks. The writer is not prepared to say that this would necessarily always hold true for the small investor. But for the man of large means bank stocks seem to hold out less of a prospect of loss and more of a chance for gain, on the average, than perhaps any other use to which he can put his money. This class of stocks will be discussed in another chapter.

CHAPTER VI

IMPORTANT FACTS ABOUT STOCKS

STOCKS probably have an even wider range than bonds all the way from the most valuable to the most worthless. To pick out extremely valuable and profitable stocks is more a matter either of good fortune or of expert knowledge of particular industries than is the choice of safe mortgages or bonds. Stocks as a whole involve more risk than bonds and therefore offer the opportunity of greater reward. Not only do the dividends on stocks vary more than the interest payments on bonds, but the market prices of stocks go up and down faster. Thus most stocks are not so well suited to the needs of the small investor or to those who are just beginning to invest.

Many stocks, however, approach the investment stability of bonds. Preferred stocks are often safe and desirable, paying a fairly large and steady income. If a company has only one kind of stock it is usually called common in this country (ordinary, in England). But many companies have both preferred and common, and several concerns have more than one class of preferred stock. As its name implies the preferred stock comes first, usually both in the matter of paying dividends before the common pays any, and distributing the assets of the company in case of dissolution. Also when a company fails the preferred stock usually receives better treatment than the common.

The usual practice is for a company to pay the full dividend upon the preferred stock at a fixed rate before it pays anything on the common. Often there is enough for the preferred and none for the common. But when the company becomes very prosperous it may pay several hundred per cent. in dividends upon the common stock and nothing additional to the owners of the preferred.

Relative Merits of Bonds and Stocks. The greater safety of bonds than stock as a class is most strikingly shown in the case of failure. When a company goes into receivership it often happens that the stock is entirely wiped out. While this sometimes occurs in the case of bonds it is comparatively rare.

The holder of a corporation bond is a creditor, one who lends it money. The stockholders are the owners of the property.

The bondholder in return for his money receives a promise to pay, secured by a lien against the property of the company. He is in the position of any other lender of money on security. Naturally he expects to receive back his principal at maturity with specified interest, payments thereof coming to him regularly in the meantime.

The stockholder, however, as one of the owners expects to receive his share of all the profit which the corporation can legally disburse, and in addition, with the other stockholders, owns the property of the company if there is any, after its debts are paid.

One very great merit of stock over bonds in the case of large investors is the comparative freedom from taxation. That is of no concern as a rule to the small investor, that is, to the wage earner or salaried man who has only a few hundred or a few thousand dollars to invest. To the widow, however, who lives upon the income from a sum of $10,000 and upward, taxes may bear very heavily. Such a person should study carefully the possibilities of buying conservative stocks.

Another advantage, of perhaps a minor nature, which stocks enjoy over bonds and mortgages is that it is easier to purchase them in small amounts. While there are a few small bonds, yet they are much rarer than small unit stocks.

In buying stocks it is always important to notice whether they are "non-assessable." In case of failure the owners of bank stocks may be forced to contribute large sums to pay the creditors. Oil and mining stocks also are sometimes assessable. The majority of stocks however are no longer assessable. Bonds and mortgages of course never have any such disadvantage.

Tests for Stocks. Nearly all the considerations or tests which apply to investments in general and to bonds in particular, as given in the last chapter, also apply to stocks. But there is this important difference. Many if not most people buy stocks in the hope that they will advance in price. It is true that bonds are often bought for the same reason and it is also true that bonds often fall in price.

But the ideal bond is one which does not fluctuate much. Short term bonds indeed do not rise or fall to any marked extent and mortgages do not fluctuate at all. And despite the fact that many bonds do rise and fall in price, the main consideration is usually the interest rate and the ability to sell the bond or have it paid off at substantially the same price at which it was purchased.

In the main the attitude toward stocks is different. A few classes of stocks, especially the very high class preferred issues, fluctuate but little and, indeed, have many of the qualities of bonds. But most stocks rise and fall to a very considerable degree, and most people buy them in the hope of enjoying the rise.

The stock buyer is looking for an appreciation or increase in value. He wants not only safety, if possible, but profit. Usually he is looking for a combination of investment and speculation. So he must study the relation of the price of the stock to the dividends paid, the earnings available for dividends, and the surplus. He must be careful that the price of the stock is not already high in relation to these items.

Par Value. In buying a stock the first thing to ascertain is the actual par value in dollars and cents. Every certificate for a share of stock bears on its face a statement that it represents a value of $100, $50, $25, $5, $1, one cent, or whatever the so-called par value may be, or else the statement is plainly made that there is no par value in which case each share merely represents literally what the word implies, a share in the company. Suppose there are one million shares of no par value. Then one share of stock represents a millionth part of the property after debts are paid.

The most common par value for stocks of railroads, public utilities (street railways, electric light and power companies), and industrial companies is $100. Smaller denominations are frequent, however, and especially in the case of mining and oil companies shares of stock are often found ranging as low as one cent in par.

The important thing for an investor to know is at just what per cent. of the par value a stock is selling. Stocks with a low par value often appear to be much cheaper than they really are. A certain copper stock was selling at $150. Its par value was $25. The stock had advanced 500% in the market. In this way a capital of $5,000,000 becomes quoted at $30,000,000. It may be worth that price, but the investor should always know the relation of the price to the par, for dividends are based on par value, not on selling price.

Oil and mining companies often issue their stocks in low par values in order to induce people to buy more freely. A man who would not think of buying one share of a $100 stock at $100 will buy one hundred shares of $1 stock at $1. He foolishly thinks, or feels, that he is getting more for his money. Very low par values merely cater to a silly trait in human nature. There are many reputable companies with stock having as low par value as $5, and no doubt not a few whose stock is put out at $1. But when stock is issued at a par value of a few cents a share, the whole business becomes grotesque. It becomes a sort of foolish circus mockery of important industrial and commercial processes.

An oil man tells the following story of the Wyoming oil field boom:

"My wife came home from a club meeting one afternoon, and told me that she had bought 30,000 shares of an oil stock. I remonstrated with her, because I had previously told her never to have anything to do with oil shares, and I could not understand why she had bought so large a block of stock. 'But,' she said, 'the club members own a controlling interest in the company.' Thereupon she told me that the company was capitalized at 6,000,000 shares of no par value, which were being sold at the ridiculously low price of a mill a share. Her holdings had cost her just $30."

No Par Value. With negligible exceptions it has been the practice in the past to create all bonds and nearly all stocks with a par, or face, values. But beginning with the business expansion of 1915 a few financial leaders defied the old custom and put out stock without any par value, thus openly admitting what had always been true, namely, that stock represents nothing but a percentage of ownership, and to assign it a nominal value through rich and poor alike tends to misrepresentation. It is different with bonds or mortgages, because they are promises and agreements to pay back specific sums of money, usually in gold; not simply evidence that the holder is a recorded owner, or partner, in an enterprise, entitled to his pro rata share of dividends.

In theory anyone who knows even the first elements of corporate finance is well aware that par value does not mean real value. But there is a persistent tendency to ignore the distinction between stocks and bonds; to emphasize unduly the face value of stock; to get the idea that stock must have value behind it equal to its face; to treat the shares as claims against the company, or even against the community, for the number of dollars they represent. We get the idea that if a stock purports to be worth $100 on its face, that the round figure $100 is not merely a convenient measure or standard, but is almost a sort of guarantee. Several score of big corporations have been formed recently with non-par common stock. Their promoters have frankly refrained from placing any nominal, merely convenient and artificial mark upon the shares. Time alone will prove their value.

Of course the advantage of a stock having a par value is that there is something to measure by, a standard. If the price goes far below par people begin to take warning. But there is no reason, say the advocates of non-par, why there should be any such standard or measure. It is all a question of management, earnings, and success in the issue of common stock. Physical values do not play much part in common stock. No company has yet put out preferred stock without par value. That is, common stock represents the speculative, risk taking, big profit taking end of the business. Preferred stocks and bonds should represent the solid, non-risk investment foundation of the business. Indeed, a number of companies which have sold non-par common stock have also issued preferred stock with a par value of $100 a share. Thereby is the distinction made so clear that the most ignorant must heed. The company practically says:

> We believe our preferred stock is worth somewhere around $100 a share because there is actual property to back it up. It will probably pay 7%

> dividends regularly from the start. It is an attractive investment. We do not pretend to tell you what the common stock is worth. It may or may not prove extremely valuable. Therefore in strict honesty we do not pretend to put any nominal value upon it.

As I see it, the great advantage of issuing common stock without par value is that it will force investors to be honest with themselves. As it is now a man buys a highly speculative stock and when it declines he feels disgruntled because somehow he has the feeling that it ought to be worth more nearly its par value. But when the certificate itself makes no pretenses whatever, the distinction between speculation and risk taking on the one hand and investment on the other is much more clearly drawn. It is absolutely necessary and legitimate that there should be risk takers, people willing to buy speculative stocks, but anything which will mark off more sharply that class of stocks from the investment type will prevent a great amount of loss.

I do not mean to imply that numbers of the new non-par stocks will not prove highly valuable. But they are mostly of new companies. Their bankers have been frank enough not to pretend to assign an artificial face value to what has not yet been tried out.

Stockholders' Rights. There are certain rights or privileges which go with stock ownership that do not as a rule accompany ownership of a bond. Stockholders of course have the right to vote at company meetings, but to the small investor this right means nothing as a rule.

In a successful company, stockholders often receive "rights," in quite another sense of the word. This is the right to buy new or additional shares of stock at less than market prices. Successful corporations frequently give out rights in this way rather than increase the cash dividend. A company may allow each owner of say four shares of stock to buy one share of new stock at $100 when the old stock is selling at $200 a share. In such a case the stockholders receive an immediate profit even if they do not care to increase their holdings. Among the ways in which the stockholders may profit are:

1. The owner may sell his right to subscribe to any broker. In the case cited the right would be worth about $20 a share and could be sold for almost that amount at once. Four shares of stock at $200 each make $800, which added to one new share at $100, makes $900. Divide this by the total number of shares (five) and the result $180 substracted from $200 gives the theoretical,

or mathematical, value of one right. Usually the market value is a trifle under the theoretical or mathematical value.

2. The owner may buy his one new share at $100, and will probably find that it will sell in the market much above that figure, although perhaps not as high as $200.

3. The owner may sell as many of his old shares at the market price as he is privileged to buy of new stock. He will then have the same number of shares as before, but will have made a cash profit on the shares sold.

The important point to bear in mind in connection with "rights" is to exercise them in some way before they expire, because there is always a limit of time set upon them.

Preferred Stocks. A few years ago when the stock market was booming a man wrote a letter to a newspaper seeking information about preferred stocks as follows:

> Will you advise why some common stocks are considered better investments and their prices are quoted higher on the exchanges than preferred stocks? For example, $560 is asked for Bethlehem Steel Common, while only $137 is asked for the preferred. I was always of the opinion that preferred stocks were the higher priced.

The same idea was expressed to me last summer by a woman who had owned United States Steel preferred for several years. It had been bought for her at $100 a share and for some nine years she had regularly received $7 a year in dividends on each share. She had just been congratulated on the fact that the stock was selling above 115.

> But, she sighed, "the common stock is said to be earning fifty per cent. a year. They have just paid an extra dividend and the papers say it will go to 100. If I had only bought some when it was down!"

Few of us like to admit the law of compensation into our own lives, even though we philosophically permit its operation in other people's affairs. Of course, preferred stocks are the higher priced when things are going badly. When the Bethlehem Steel Corporation was not earning such enormous sums it was paying dividends on its preferred stock and none on the common. The preferred stockholder is far more likely to get his dividends during bad times than the common stockholder, and as turn about is fair play the owner of common stock is more likely to get enormous profits when times are good.

Preferred stocks are in nearly all cases limited as to the amount of dividends. The company agrees to pay six or seven per cent., as the case may be, through thick and thin. Taken all in all the record is a splendid one. The preferred stocks of the better class of railroads, industrials, and public utilities in this country have, with few exceptions, paid their dividends for years. Although not on the whole as safe as bonds, they have offered many of the advantages of bonds, have been for the most part safe enough, and have afforded much higher returns. Almost any investor is justified in placing part of his funds in carefully selected preferred issues.

Limitations of Preferred Stock. The investor who buys a preferred stock expects, and if he uses common sense gets, a regular and ample dividend through good time and bad. But he does not get extra profits when they come. If he tries to, he displays either total ignorance of his true position, or just plain cupidity. The familiar reference to "eating one's cake and having it too," applies. But men always will try to eat their cake twice.

A few years ago the Union Pacific Railroad, which had paid four per cent. on its preferred stock for many years, decided to distribute a large extra payment to its common stockholders. At once the prior owners began litigation to force a distribution to them as well, but, although they fought bitterly, the courts decided that they had agreed to the four per cent. when they bought the stock and after receiving it for many years could not justly claim a share at that late date in what the common stockholders had so long waited for.

Dispute over their respective rights and privileges between preferred and common stockholders is one of the most frequent phenomena in the world of finance. The former are always afraid of some impairment of the corporation's assets which will endanger their security. This is right and natural enough, but the preferred owner cannot complain when boom times make it possible to pay fabulous dividends on the common issue.

At one time the many common stocks whose earnings, dividends, and market quotations dazzle the onlooker may seem like "better investments," as the inquirer puts it. They are certainly more profitable shares to hold, and for those fortunate persons who bought at low figures and have actually cashed in, these stocks are perhaps "better." But they paid nothing for years and they may pay far less and sell for far less a few years hence. Meanwhile the preferred shares will have steadily returned to their owners an invariable six or seven per cent.

There have been four great periods of preferred stock emission in this country. First came the railroads in the late 90's, then the so-called trusts or giant industrials in the early '00's, a group of smaller industrials, especially farm implement companies about 1912, and a multitude of miscellaneous companies in 1916. A preferred stock cannot be judged at once. It must settle to an investment basis. It must become seasoned. The purchaser of any new security, no matter how surrounded with theoretical safeguards or how plausible it looks on paper, must in the very nature of things take a considerable chance.

Further Facts about Preferred Stocks. Many facts concerning preferred stock are brought out in a series of questions and answers on the subject. The questions came from a man who was a large stockholder in a company about to issue preferred stock.

1. As a rule why is preferred stock issued?

2. Wherein does preferred stock issued differ from common stock?

3. In the event of liquidation or failure do the holders of preferred stock take priority over the holders of common stock in the distribution of assets?

4. In the event of failure no doubt the ordinary

creditors take precedence over both classes of stockholders. Is this correct?

5. Wherein does preferred stock differ from a mortgage or bond?

6. In the event of failure do ordinary creditors realize before bondholders are paid off?

7. In just what order are the following classes of creditors paid:

1st Ordinary creditors.
2nd Bondholders.
3rd Preferred stockholders.
4th Common stockholders.

8. What bearing, if any, does the issue of preferred stock have on the credit of a company?

9. Is preferred stock anything in the nature of a mortgage?

10. Are provisions usually made to retire preferred stocks.

11. Sometimes the same concern will have outstanding several different kinds of preferred stock. Why is this?

12. Does preferred sell more readily than common stock? If so, why?

13. Is the ownership of preferred stock less of a risk to the investor than common stock. If so, why?

ANSWERS

1. Preferred stock is issued for two purposes, one is to attract a conservative type of investor and the other purpose usually arises when a combination or merger of companies is formed and the preferred stock is issued in payment for either actual property or established earning power, whereas the common stock is issued in return for hopes and possible future earning power.

2. Usually preferred stock differs from common stock in that dividends must be paid on the preferred stock before any are paid on the common.

3. Usually the holders of preferred stock take priority from the holders of the common stock in the case of liquidation, although this is not always the case. Of course the rights of the different stockholders are provided for in the by-laws of the company, and usually are printed on the stock certificates themselves.

4. In the event of failure ordinary creditors always take precedence over both classes of stockholders.

5. Preferred stock differs from bonds and mortgages in that there is no promise to pay the principal back. A bond is always a promise to pay

and a stock is never that. In many other respects, however, preferred stocks have been tending of late years to become more like bonds.

6. As a rule, ordinary creditors are paid off before the bondholders.

7. You state the case yourself accurately.

8. Your question is too general to answer. It all depends on circumstances and each case must be considered on its merits. Of course, if the company runs along for several years without preferred stock and then issues the same, it may depress the price of the common stock but does not necessarily injure the credit of the company otherwise.

9. Preferred stock is hardly anything in the nature of a mortgage except in a very general way. It has only a resemblance in that it is usually a conservative and fairly secure form of investment.

10. Features as to the retirement of preferred stock differ widely, but a very common feature provides that the company retire a certain amount yearly.

11. The reason the same concern sometimes has outstanding several different kinds of stock is because at the time the company was formed, or perhaps when it was re-organized after the

receivership, there were differing parties at interest to be satisfied, and it was thought possible to do so by giving them different kinds of stocks. For example, if the company with first and second mortgage bonds should fail, it is probable that a new company would be formed with possibly first and second preferred stocks which would be given to the first and second bondholders respectively.

12. The question is too general to answer by Yes or No. It depends on circumstances. Preferred stock in a great number of cases sells more readily than common stock.

13. The ownership of preferred stock is always less of a risk to the investor than common stock, in the same company, for the reason already fully stated. However, common stock in one company may be better than preferred stock in another. In a general way it may be said that preferred stocks are supposed to be much more in the nature of investment securities than common stocks.

There have been very few times within the last twenty years in this country when the discerning investor could not purchase sound preferred stocks to pay 5, 6, and 7% upon his money. For brief intervals the prices of these stocks have been too high, but they have always come down to a reasonable level again. Of course the investor who has bought such stocks at the highest prices and sold them at the lowest has suffered. But the better class of these stocks has always recovered to a reasonable level.

Bank Stocks. An important class of stocks quite largely overlooked by most investors is that of successful banks. These institutions possess an important advantage in not having to contend with the element of labor costs and the high prices of materials. Whether general business is good or bad a well-managed bank usually earns a fair return upon its capital.

The disadvantages of bank stocks are obvious. Everything of course depends upon the honesty and conservatism of the management. But it does not require actual genius to run a bank the way it does to make a success of a great manufacturing plant. Any group of honest, reliable, conservative, aggressive, intelligent business men can make a success of a bank in most cities and towns provided there are not already too many such institutions.

There is always the possibility of defalcation in a bank, but if the institution is large it is extremely rare that any possible theft will make more than a small dent in its resources.

Stockholders in banks are usually subject to a double liability. That is, if the bank fails the owners can be compelled to turn in to the receiver a sum equal to the amount of their stock holdings to be used in paying off depositors. For this reason bank stocks are naturally not suited to the needs of very small or weak investors. Indeed no investor should buy this class of stock unless he has confidence in the management and possesses good reasons for that confidence.

Bank failures are relatively an exceedingly rare occurrence, but unfortunately when they do occur the losses which fall upon the stockholders are so great as to give the investment a black eye.

Another possible disadvantage attaching to bank shares is that they are not as a rule as salable as many other classes of investment.

But bank stocks have a peculiar merit which should recommend them to a greater number of investors. Bank stocks nearly always grow in both intrinsic and market value. Most of them sell at high prices and the immediate return upon the investment is small. But as the deposits of the bank increase, dividends are almost certain to be raised and frequently the stockholders are given "rights," or even in some cases new stock will be given to them as dividends.

The fairly steady increase which takes place in the value of most bank stocks renders their ack of ready marketability of small moment, and furthermore it furnishes an element of profit which many equally safe investments lack. Bank stocks are comparatively unpopular, not only because of the double liability, but also on account of the high prices at which most of them sell, and also by reason of the lack of immediate speculative opportunity afforded. There is never any "quick action" in a bank stock.

It is something to buy and hold for a gradual but usually certain appreciation in value and increase in dividends. Thus for those who have considerable sums to invest it seems wise, as a rule, to place at least a small portion in bank shares.

Many an investor would keep his precious dollars intact from loss if, instead of plunging them on some unknown and distant venture, he made inquiries regarding the shares of his own local bank.

Book Value. The term "book value" can be applied with considerable accuracy to bank stocks. Book value means par value plus surplus and undivided profits, or minus deficit. If a bank has a capital of $100,000, with shares of $100 par value, and also a surplus of $50,000 and undivided profits of $10,000, it is easy to figure the book value at $160. On the other hand if the capital is impaired to the extent of $20,000, the book value would be $80 a share.

Book value means very little in the case of a manufacturing company, but it may mean a great deal in the case of a bank, a mine, or an oil well. The book value of a steel plant may be anything. A steel plant is good only as a going, earning concern, and its earnings depend upon a thousand and one factors.

Now a bank, a mine, or an oil well is naturally more valuable as a going concern than otherwise. Yet it is much easier to liquidate the stock than with a manufacturing company. A bank's resources are liquid, or should be. It is possible at any given moment to say just what would be left if all depositors were paid off, all loans called in, and all investments liquidated. A mining company has a certain amount of ore on hand. It can suspend operations and yet may in some cases sell the ore, pay off its debts, and still leave much for the stock. The same general principle applies to many oil companies. But it does not apply either to "industrials" or to the public group of companies, such as railroads and utilities.

These characteristics give bank stocks a certain simplicity which many other investments lack.

A bank statement affords the investor a better means of analyzing the value of his investment than do the reports of most other classes of corporations.

Industrial Stocks. It is impossible in a book of this scope to describe all the various classes and types of what are known as "industrials." This includes every variety of manufacturing, trading, merchandising, and mercantile enterprise. A separate chapter is given to oil and mining stocks, but no book could even begin to set forth the principles which govern investment in the multitudinous variety of industrials.

The industrials represent a very large part of all American business, but the dominant characteristic of this great section of business is the variety of conditions in different lines, and the fluctuations in prosperity from period to period. Therefore the investor must study the conditions that govern the different classes, and preferably confine himself to a few rather than range over too wide a field. One may invest successfully in steel and chain stores and fail miserably in automobiles or cotton, or vice versa. Each line has its own distinguishing and peculiar fundamental conditions.

The wise procedure is to specialize on one or two classes, beginning by reading up on the particular business chosen. If steel is selected the investor should learn as much as possible about a number of the more important steel companies. He should read all that is said about them in some such reference book as Poor's *Manual* or Moody's *Analyses*, and then read articles in the trade journals and in such financial papers as the *Wall Street Journal* and *Magazine of Wall Street*. Then in time he will learn what to expect of the different steel companies, and will be able to form his own opinion as to whether their stocks are a "buy" or not.

In purchasing industrial stocks it is of the first importance to judge the earnings by the standards of normal times rather than by periods of unusual prosperity. Other important points to consider are these:

1. Good management, ability, even genius in management are more necessary than in other lines.

2. Industrial companies as a rule cannot stand heavy bond issues.

3. The item of good will and patents should figure very slightly in the balance sheet.

4. Beware of swollen inventories. That is, the company must always have a large enough

amount of money, known as working capital, to take care of its needs. Other things being equal the company whose bills receivable, cash, and other current assets overshadow its bills payable and other current liabilities is the one to buy into. A moment's glance at the balance sheet usually will develop the facts.

Railroads and Public Utilities. It is not thought that an extensive discussion of either railroads or utilities is desirable in this book. The future of the railroads depends entirely upon the outcome of Government control, which cannot be foretold at this time. A large part of all the investments of the American people have been placed in railroad securities, and anyone who has confidence in the future of the country cannot but believe that these investments will be protected. As to whether railroad stocks hold out any opportunity for profit in the future depends, however, so largely upon unknown factors that it seems unnecessary to go further into the subject.

Utilities include telephone, street railway, interurban railway, gas, electric lighta, and power companies. The telephone companies are at this writing under Government control. Street railways have suffered greatly from the fact that the rise in the cost of labor and supplies, without a compensating rise in fares, left many of the companies without adequate earnings. In many cases, however, this has been remedied by permission to charge higher fares. Companies selling gas and electricity have not suffered to quite the same degree.

The utilities often form a splendid basis for investment provided only that the companies are permitted by the public authorities to charge adequate rates. Utilities do not require such unusual talent in management as do industrials, and if only their rates can be made adequate, they would meet with no such great fluctuation in earnings, for their business runs about the same from year to year. The great problem with the utility is its relation to the public. If that can once be settled on a basis satisfactory both to public and company then the investor cannot do better than inquire into this channel for the employment of his money.

CHAPTER VII

PITFALLS FOR THE STOCK BUYER

It is assumed that the reader who is interested in stock investments has already gone over Chapter V. which was entitled "How to Choose Safe Investments—Especially Bonds." For while the emphasis was laid upon bonds the nine rules of safety first which summed up the chapter apply with almost as great a force to stocks. Read them over again if you have forgotten their import.

Now the next point in buying stocks is to learn to avoid the project which is doomed to failure from the start, either because the element of good faith is lacking or because it originates in the brain of an irresponsible crank. There is enough risk in even the most promising venture without throwing money away in what are essentially stock-jobbing propositions; the type that is variously dubbed get-rich quick, illegitimate, low finance, and cat and dog.

To those who lost in the New Haven, the Rock

Island, the Frisco, and other choice specimens of high finance, there may seem little to choose between the low and the high variety. But where high finance may wreck, either purposely or through misfortune, a score of conspicuous companies in a few years' time, low finance wrecks thousands of companies in one year. High finance is a sad thing when it goes wrong; but after all it is the comparative exception. It is too notorious and conspicuous to go unchallenged for long in any particular manifestation. But the low, cheap, penny-a-share, snide variety flourishes under the grass, as it were, too petty to be noticed, even in war time, but annually carrying ruin to thousands of families.

Low finance, of course, corresponds exactly to quack medical practice. The legitimate medical man makes many mistakes and is far from perfect; but the quack offers his victim no chance, because he is a humbug from the start.

Probably every reader of this chapter will agree with these general remarks of mine. "But," asks the reader, "how am I to know the difference? How am I to keep from being stung? What are the signs of the illegitimate promoter, the humbug broker, the wildcat stock?"

In the main, the stockjobbing type of promoter follows in the wake of any industry that happens to be especially prosperous at the moment. He changes his wares rapidly. He shifts from one boom to another. A year or so ago motor stocks were the choice mediums of the stockjobber. That was because the motor industry was then extremely prosperous. It was then perfectly apparent to any sensible man that the motor industry would narrow into a keen survival of the fittest, because the large profits had drawn in hundreds upon hundreds of new concerns.

Of course the pioneers in any field may start out in a very small way, and yet if there be ability and good faith at the helm they will succeed in a large measure. But after the field has been filled up, after there are scores of big concerns in it, it is extremely difficult for the small new concern to make good. At the beginning of a boom it is not necessary for a concern to have the most eminent and solid backing perhaps; but at the height of a boom no sensible man would touch a new concern unless it is absolutely AAA.

Nearly all the snide little motor companies that sprang up a couple of years ago, with stock selling rather than motor manufacture as their chief aim, have now gone to the wall; but the same gang of promoters has turned its attention to oil and gasoline companies. They also have taken up farm tractors and mail-order propositions. Oil, tractor, and mail-order schemes—many of them—will go the same way as the motor swindles.

Blue-Sky Commissions. Here is another method of keeping out of wildcats. At a time when the securities of sound established concerns in any given industry are selling at a big discount, don't buy the stocks of new companies that have no standing in the same industry. The best of stocks will fall often for reasons unconnected with the earnings or prosperity of their companies; but a decline in the price of snide stocks is almost always due to only one reason—the stream of victims has run dry.

The most amazing part of the whole business to the expert financial observer is the way people will buy stocks in new promotions, in companies that have no standing, no backing, and, most important of all, no place as yet earned in the particular industry to which they pretend to belong, when stocks that pay good dividends can be had in companies which form the chief units of those very industries. When the motor swindles were at their height, several years ago, and there were perhaps from five hundred to a thousand companies in the field, investors could buy stocks in all but one of the dozen companies that did eighty per cent. of the business, and get a large return on their money at that. Much the same situation exists to-day as regards the oil industry.

Obviously, one way of avoiding a worthless stock is to find out from one's bank how much they will lend on it. If the bank will lend nothing on the stock, then in all probability it is a good thing to let alone.

From the investor's point of view, all stocks and bonds offered him may be divided into three classes: There are securities about which very little is generally known, but which are practically worthless; there is another class about which very little is generally known, but which possesses value; and, finally, there is the large group, though smaller than either of the others, about which enough is generally known for the investor to form his own judgment.

How, then, is the investor to discover whether a stock is practically worthless—to all intents and purposes a swindle? Well, if you live in one of the Western or Middle-Western States which has a blue-sky law, the chances are nine out of ten that you can be saved from putting your money into manifest wildcats by applying to the blue-sky commissioner, banking commissioner, corporation commissioner, or whatever the official in charge may be called, and getting such information as his office has on the subject. Numerous wildcats have been driven out of the Western States by these commissioners.

California's Experience. California's experience is perhaps as interesting as any. The corporation commissioner has found it necessary in the last few years to issue a number of warnings to the public to beware of mining schemes which have not received the sanction of the commission, or which have evaded the law by organizing in neighboring States and selling their shares in California.

Thousands of inquiries have been received from stockholders who have been unable to secure satisfactory information from the companies in which they have invested, and are either ignorant of their legal rights or have not sufficient at stake to justify the expense of an independent investigation. The department seeks to become a clearing house of information regarding corporate securities generally, though it has no power to conduct examinations—except of such companies as come under its jurisdiction. Such a clearing house is a vital necessity in every State, a boon that private enterprise has utterly failed to provide.

In one case a widow, contemplating the exchange of a country hotel property for six thousand shares of stock in a refrigerating company which she was assured had always sold for a dollar a share, was saved from loss by means of the long distance telephone. Investigation by the department developed the fact that the company had expired some few years before, and the stock was wholly worthless.

Nor do blue-sky officials merely keep trashy frauds out of the States in which these laws operate. The rotten conditions of larger and more dignified enterprises have been unearthed in many cases. These are, of course, even more dangerous to the public because their securities are offered as conservative investments, but prove to be less than a bad speculation.

Unfortunately most of the States, especially in the eastern part of the country, have no blue-sky laws. As regards stocks of insurance companies, there never need be any doubt as to what course the investor should pursue. Nearly every State has an insurance department, and information may be had from that source. But when it comes to other classes of unknown securities there are practically no sources of information other than the banks and newspapers.

Banks will nearly always oblige their depositors by obtaining such information through their correspondents in other cities or through the medium of private reporting agencies. Or, if the investor prefers, the bank will secure for him the name of such an agency and the investor may get a first-hand report direct by paying a moderate fee. It must be admitted, however, that none of these channels of information are of much value if the investment is located at a great distance.

Information Worth Getting. Many people will not approach their banks on such subjects, and thousands of buyers of wildcat stocks are not bank depositors. For them the only recourse is the newspaper. Naturally the nearer the newspaper is to the State or city where the investment is located, the more likely it will be to have facilities for gathering information. It would be silly to ask a paper in Hartford, Conn., to investigate some little local venture in Los Angeles, Cal. But it would be eminently sensible to ask a Hartford paper to help one out on a stock offering from a mushroom concern in Meriden, Conn.

Investors use singularly little discrimination in seeking help from newspapers. Many papers have no facilities for this sort of work and do not wish to be bothered with letters from investors. Those that have the facilities, and do not mind being bothered, always advertise the fact. But investors fail to realize this distinction. By way of illustration it may be said that in New York City several papers have gone into this field extensively, and the most cursory glance at the various New York papers would quickly disclose which they are.

In regard to the second class of securities, those which are generally unknown, but which possess value, little need be said. There is only one way of discovering such investments, and that is through direct personal contact and connections. All the blue-sky laws and reporting agencies and newspapers will never bring one in touch with these opportunities. It is solely a question of personal acquaintance and negotiation; and of course strange brokers and promoters are considered personal acquaintances only by the proverbial suckers.

Naturally, the first step any sane person will take before investing in bonds or stocks is to discover whatever facts about the company are to be had from available sources other than the promoter himself, such as from newspapers and periodicals of standing, and from the recognized reference books,[1] to be found in any bank or broker's office and in all large libraries.

Obviously, if the investor can read about a company in a wholly cold and impartial reference book he is at once in a position to judge for himself to a considerable extent. He is not likely to be victimized. Very few of the fraudulent, cat-and-dog promotions ever last long enough to get into any decent reference or rating book. The promoters unload and disappear; and that is the end of it.

I do not mean that merely looking into a concern by means of reference books, banker's references, and the like will always prevent loss. The following question which I received several years ago will show how hard it is to keep out of investment bogs:

> "I was not hasty before I invested," writes a painfully astonished reader who signs himself G. E. "About two months ago I made an investment in the —— Company. At the present time it is in financial difficulties. Their rating in Dun and Bradstreet was AA1. I understand they were highly recommended by the —— Bank. What could I have further done to protect myself?"

[1] Poor's *Manual*, Moody's *Analyses*, *Corporation Service*, *Standard Statistics* (card system).

This is a pretty tough question to answer. It is one of the hardest that has ever come to me. The company in question was a large concern, with a steadily growing business. Now that it has fallen upon evil days anyone can see why its stock was a poor investment. Hindsight in financial matters is strikingly more common than foresight. By way of illustration, it is now pretty well established that the reason this particular company reported such big earnings, year after year, was because the expense that was incurred in placing certain lines of goods upon the market was carried as an asset even after those particular goods were no longer popular and salable.

In other words, the company did not set aside from its earnings enough to write off obsolete and worn-out goods. Thus the earnings appeared larger than they really were. But only the insiders knew that this species of gutting was going on, and even financial experts who were otherwise suspicious of the stock had to admit grudgingly that the earnings were large. I do not know of any way to prevent dishonest or reckless "insiders" from wrecking a company by failure to write off enough for depreciation, except perhaps where the Interstate Commerce Commission or some unusually strict public utilities commission has authority.

G. E. says he looked up the concern in Dun and Bradstreet, and he understood that a prominent bank spoke well of it. The true function of Dun and Bradstreet is to supply *trade* information, not that for the benefit of small investors. They indicate the amount of capital employed by a firm, and its general standing in its trade, which really means—and this is what the subscribers to Dun and Bradstreet want to know—whether the concern is prompt pay with dealers who sell it supplies, and so on. A company may have a big bank account, may pay its bills promptly, and yet its stock may prove a poor investment. In fact, often the most unscrupulous promoters keep the largest bank account and pay with the greatest promptitude, just to keep up a front.

As for the —— Bank recommending this stock, probably what the bank really did—and this is all a bank reference frequently amounts to—was merely to state that the company kept a large account with it.

Three Signs of Danger. The company was engaged in a profitable, legitimate, and extensive business. But the president, not satisfied with his great success, promoted almost a score of other concerns in all manner of diverse, unrelated enterprises, many of them risky in the extreme. This was the first danger sign. The second appeared when it was learned that customers of the original successful company were being exhorted to buy stock in many new and as yet untried enterprises.

But the one symptom that made financial people most wary was a certain sensationalism, a certain yellowness employed in selling stock. To illustrate, elaborate charts were published to show that the stock was better in every way than that of the Pennsylvania Railroad. Now, when a promoter tries to palm off his own wares by attacking standard established institutions, it is a danger sign. If anyone pointed out that reputable brokers and investment bankers never recommended the company's stock, the answer probably was that these brokers and bankers were jealous because the stock was being sold directly by the company instead of through them.

The failure of the —— Company is a large subject and cannot be covered in a few words. In general I should say to G. E.: The next time you make an investment, don't mistake the function of the commercial rating agencies; consult your own bank rather than rely on the purported indorsement of some other bank, which may mean much or little; and, finally, it is a pretty safe rule that any stock is dangerous whose promoters use up much white paper in denouncing established business or financial institutions.

Beware of Rosy Promises. Perhaps the chief sign of the questionable promotion is the extravagance and exaggeration of its promises. Responsible, reliable brokers and investment bankers, the sort that will be doing business at the same old stand several years hence—do not engage in the business of selling stocks which are pretty certain to make the purchaser fabulously rich. Concerns of this description do not as a rule go to either bankers or the general public for funds. They do not need to. They would be foolish to pay liberal commissions to bankers. Money is not given away in the business world and it pays to be suspicious of those who pretend to give it away. The only concerns that should go to the public for funds, either directly or through investment bankers, are those which can promise a fair and reasonable return and have something to back up their promises with, earnings, statements, balance sheets, etc., something tangible and concrete rather than mere vague promises.

Neither the thousands upon thousands of mere ventures, gambler's risks, that never amount to anything, or the few hundred concerns that turn out excessive profits, like Union Sulphur and New Jersey Zinc, should seek the public's money. And the second class practically never do.

I am not denying there are opportunities, many of them relatively speaking, to become rich from a single lucky investment. But the truth is that these come from being on the ground. And being on the ground does not mean taking the mere say-so of some fly-by-nighter who calls himself a broker, who has come from Lord knows where, and shortly will depart thence. Being on the ground means just exactly what it seems to mean. It means being right in the business or right up close to someone who is. It means personal contact, first-hand information, weeks, perhaps months of the hardest kind of inquiry, and then a gamble at the end of it.

The vast majority of people have not the knowledge, experience, acquaintance, expertness, or numerous other gifts and qualities to seize opportunities of this fashion. And it is manifestly silly to expect that a broker or investment banker or financial writer can or will discover them. It is the business of these men, if they are honest and intelligent, to discover ways of making money earn a reasonable return and be safe. If they could discover "gold mines" they would not be offering stock at a few cents a share to Tom, Dick, or Harry, or writing for newspapers and magazines at a moderate salary. No indeed! They would be doing exactly what Rockefeller, the du Ponts, Schwab, Ford, and others have done, make huge fortunes and keep them to themselves and their few trusted associates.

I defy anyone to prove that, with a few exceedingly rare exceptions, the companies which have made marvelous successes ever went out into the byways and hedges to find shareholders. Fabulously profitable concerns are never the ones which spread broadcast over the country, screaming appeals to buy their stock.

How about the Failures? Even more suggestive is the other side of the same proposition. Although thousands upon thousands of companies whose stocks have been peddled in a widespread and noisy manner have passed into oblivion, I doubt if a single instance can be found where a company financed in this cheap and discreditable way has been a success. The simple truth is that the louder the shouting and publicity at the birth of a new enterprise the more certain it is that its later years will be deathly quiet. In the same way a modest, quiet, private beginning often brings fame later on. Dividends shout for themselves. They need no announcement plastered clear across a newspaper page.

Thus it follows that legitimate stock promotions, those conceived in good faith, are free from flashy, flamboyant, sensational "flossy" and red ink literature. Legitimate stock promotions are advertised, if not always in a cold, formal manner, at least in a dignified, respectable, decent manner. Always does the legitimate proposition stick to facts and values which can be demonstrated rather than to vague generalities. The legitimate is always concrete and specific, the illegitimate is vague, glowing, flowing, enthusiastic, and merely expectant rather than actual.

First and foremost, naturally and obviously, avoid stock offerings in which unusual profits are either promised or hinted at. Even where a corporation honestly and intelligently expects to pay dividends of 10, 15, and 25% or more, it is not in the habit of openly and blatantly advertising that fact beforehand. It may assure the investor of 7 or 8% and lay facts before him from which he himself can draw the inference that speculative opportunities for even larger returns are not lacking. But that is all.

Beware the concern whose literature contains anywhere or in any connection such general statements as this: "$100 grows to $30,000." Be suspicious even if the promoters are careful to avoid a direct promise that this particular stock will pay that much. Hints of the rabbit-like fecundity of money are nearly always a danger sign in promotional literature.

The least experience in financial affairs is enough to set one dead against a stock offering in which a leading argument has to do with the profits made by other companies. That is a sure danger sign. Finally the oldest and most certain sign of danger is the statement that the price of the stock will be "immediately advanced." Twenty-five years ago John Hill, a member of the Chicago Board of Trade and chairman of its committee to clean up bucket-shops, warned the public against this particular trick of the sharks.

I have in mind two buncombe oil companies which for the last ten years have been selling their stock almost daily through the columns of certain complaisant newspapers, and almost every day they have announced an advance in price, although both stocks are still selling at a few cents a share and paying no dividends. Of course this type of stock, the kind which will advance in price immediately, never has any real market at all. You can't sell it on the curb, and the Stock Exchange authorities wouldn't "list" it any more than they would a German bomb. Several years ago thousands of people were induced to buy stock in a couple of automobile companies that existed on paper. Each advertisement contained the promise of an immediate advance in price, but now you cannot sell the stock anywhere and very little is being heard of these companies.

Views of a Veteran. One of the clearest little articles on the subject of stock buying I have ever seen was that recorded in the *American Magazine* several years ago by Ida M. Tarbell. She had been questioning Henry H. Rogers, one of the greatest capitalists that Wall Street had ever known. He was a power in Standard Oil, the history of which Miss Tarbell was writing at the time. He left a great fortune, and will be remembered not only as one of the men who built up the great Standard Oil but also single handed created a great railroad system. He was also the hero of Thomas W. Lawson's exciting adventures with the *System*. Says Miss Tarbell:

> In preparing the material for my *History of the Standard Oil Company*, I regularly discussed with Mr. Rogers the episodes I was taking up. My

understanding with him in doing this was that he was to give me all the information he was willing to on the points I was studying, and that I was to make my own conclusions as to the meaning of this material. A picturesque and distressing feature of the oil business—particularly in the early days—had been the number of wild-cat oil companies formed. These companies usually held their land, and usually this land was near producing territory. As a rule, however, no drill had ever pierced the surface, and often when it did no oil was found. They sold stock recklessly all over the country.

From the beginning of the publication of my story in *McClure's Magazine*, in 1900, inquiries were constantly coming to me—and indeed they still are—from persons who had held certificates of oil stocks from which they had never had dividends, and of which they had never been able to obtain any information. They all seemed to feel that I ought to be able to tell them what had become of the company and how they were to get back their money. I once showed Mr. Rogers one of these certificates that had been sent me with the pitiful story of its owner's need, thinking that possibly he might be able to help to trace the promoters.

"No," he said, "there is nothing to be done. The company was formed no doubt, with the hope that oil would be found, but formed and the stock sold before it was known whether the land had any oil under it or not. The stock was taken by people usually of small means *who hoped to be able to get a large return out of their savings without any effort on* *their part.* I am constantly asked by men and women in the professions and in small positions who have saved five hundred, one thousand, or two thousand dollars, to invest their money. They want ten, fifteen, or twenty per cent. they say. They wouldn't object to a hundred—but it must be safe. They can't afford to lose now.

"There is no man in the world that can honestly say that he can invest money and be certain of permanent large returns. The big dividends come from speculative ventures, and nobody should make them unless they are willing and able to lose all they put in. I had a thousand dollars sent me to-day from a woman who wants twenty per cent. I cannot place it so that I can be sure she will permanently get six per cent. It is all she has in the world. I have no right to lose it, and I shall not do it; I shall return the money. If she could afford to lose it, that would be another thing.

"There is only one safe way for people to invest —and that is to choose sound, conservative bonds or stocks, and that after consultation with trustworthy brokers or bankers. In the long run it will be worth much more to them than the uncertain large dividend, but nobody believes me; they all think that if I would, I could make a fortune for them. When I send this thousand dollars back, the last thing this woman will do will be to thank me."

Views of a Great Organization. The Chicago Association of Commerce recently sent broadcast a circular warning the public against the stock swindler. It stated:

By following the rules given below, you may save yourself thousands of dollars:

1. *Never* deal with a firm, even though it is recommending good securities, unless you have first investigated its standing.[1]

2. Do not buy securities, advertisements of which contain:

(a) Extravagant statements.

(b) Prospective earnings directly compared with earnings of old established companies.

(c) Suspicious use of such expressions as "absolute safety," "best investment ever offered to the American public," "immense profits on small investments," "you take no chance," etc.

(d) Guarantees or promises of large dividends from future earnings before earning power has been thoroughly demonstrated.

(e) Guarantees on part of the broker to resell the stock at a higher price than it is then selling for.

(f) Promises of advance in the stock after a specific date.

3. Do not buy stocks of any unproven prospects and developments, such as oil or mining securities, unless very carefully investigated and convinced of their positive merit.[2]

4. Remember that exceptionally large returns frequently involve not only greater risk, but the possibility of total loss of principal.

5. Do not buy hastily. It is difficult to make money, but very easy to lose it. When in doubt as to either the standing of the broker or the legitimacy of the security offered, *consult your banker*.

[1] See Chapter XIV.

[2] See Chapter VIII.

Industry and Stock Promotion. An essential point for an investor to bear in mind in buying a new stock of any description is whether the promoters, the backers, and managers of the company, expect to make their profit off of selling the stock or off the profits of the business itself. Remember that men like John D. Rockefeller and Henry Ford have made their great fortunes not from selling stock in their companies to Tom, Dick, and Harry, but from the dividends on the stock.

There is no absolutely infallible rule for distinguishing the stock promotion scheme from the project in which the promoters and backers have enough confidence to invest their own money. But it does not take any great discernment to smell out the difference. The character, experience, and record of the people who are pushing a company, the character of their "literature," their selling arguments—all these proclaim a new concern either a parasitical growth upon the investor's pocketbook, or an honest effort to produce and sell goods.

CHAPTER VIII

OIL AND MINING STOCKS

THE oil and mining industries have been of immense value to this country. They have produced wealth on a scale that fires the imagination and stirs the pulse. There is something about merely digging riches out of the ground that seems easier and more romantic than creating it by the slower and apparently more painful processes of agriculture and manufacturing. These last have none of the element of the marvelous, almost of the miraculous, that goes with a vein of pure gold or a gusher of oil.

Oil stocks and mining stocks have made many fortunes. In no other field is money made so rapidly. In no other industries do stocks become so swiftly valuable. But on the other hand there are probably no other stocks in which small investors lose more money. The very swiftness with which profits pile up when bonanza mines and gusher wells are discovered gives to these industries a fascination that leads people to invest in them with greater recklessness than elsewhere.

Oil and mining of course suffer from the rapidity with which profits pile up when things go well. The very possibility of enormous reward without the painstaking work that is necessary for large success in manufacturing or agriculture draws into mining and oil most of the country's adventurous as well as ignorant money. It leads people to invest and to engage in the business itself who are not honest, careful, proficient, or well informed. On the other hand it is probable that care, proficiency, and knowledge are fully as well, if not more amply, rewarded in mining and oil than is most other lines.

Dangers of Oil. It is a singular working out of what men call the law of compensation that an industry which has enriched more regions and more individuals perhaps than any other should be so hazardous in certain of its aspects. The production of oil—and it is in this branch of the business that nearly all small stock companies engage—is a highly speculative affair. Even the largest and wealthiest companies often spend millions of dollars and years of effort in fruitless tests. Frequently they have turned down fields that later proved to be highly productive. Often they do not drill deep enough, and spend great sums fruitlessly, only to have other producers come along later and by going a little deeper find plenty of pay oil.

The losses of the business are always enormous, entirely aside from the stock promoting end of it. The most astute and experienced oil operators, acting as individuals or in groups, and without any stock-promotion handicap whatever, often suffer back-breaking losses. I was once taken to see a most valuable well by two wealthy independent operators, but they showed me one only five hundred feet away which had cost them $20,000 to drill and which had not yielded a gallon of oil. The public hears, it is true, of the worthless oil stocks, but it never hears of the hundreds of really experienced operators, far too wise to be fooled on any fake-stock game, who lose their all in drilling dry holes.

"No one really knows what is under the ground," said the president of one of the largest and richest oil companies in the world a few days before this chapter was written; and whether his statement is true or not, great regions are dotted with proofs that at least a large part of the operators in the business did not know what was under the ground.

A professional oil operator once leased a big tract of land in Texas at twenty-five cents an acre. He drilled for oil but did not go deep enough. He lost his investment and forfeited the lease. He went away and when he came back a few months later he found that another operator had leased the same land at twenty-five dollars an acre.

An old and wealthy operator told me that he had once drilled seventy-two dry holes in succession. Another man, the leading capitalist in his part of the State and in oil only as a side line, said that he had drilled seventeen dry holes, mostly with his own money and at a cost ranging from $15,000 to $20,000 apiece before he found any oil. A prominent banker in charge of the affairs of one of the richest landowners in the Southwest, a man who would be worth many millions even without his vast income from oil, said that as a little personal venture, just to see if he couldn't make some of the money his wealthy patron was making, he had drilled three holes recently, and they were all dry.

Even the landowners in oil territory lose. Many a one has been offered scores and even hundreds of thousands of dollars for his interests, but preferring to develop the land himself has sunk all his own and his friends' money without getting out a cent's worth of oil. The reverse side of the picture is that landowners have taken in as high as $150,000 in cash for mere temporary leases on land which later proved to contain no oil whatever.

It is doubtful if any figures can be had to show what the average number of dry holes is. The secretary of a prominent producing company in the Mid-Continent and Texas fields said he figured that four wells out of every ten prove worthless. In other fields perhaps the losses have been as low as two out of ten. Now the average would not be so bad if it were evenly distributed, but there is no evenness in the distribution of these losses. They fall with crushing weight upon some few, while others make fortunes. The producer does not know beforehand which class he will fall into.

An old farmer in Kansas sold all his property for $30,000 and went to Oklahoma when the great boom was on in that State. He lost the entire sum operating in oil and went back to his home town without a cent with which to support himself and his wife in their old age. A man who is president of a large bank in the Southwest and who is the brother of one of the country's most successful oilmen said that he believed that any concern with an efficient organization, knowledge of the business, and sufficient capital was sure to win in the oil business in the long run.

But evidently he also believes that few have all this equipment, for he added: "The oil game seems to me like a group round a poker table—one or two win and the others go back to work."

Even when the winnings are great the cost has often been of a nature which to the average man or small company is prohibitive. A certain well-known concern in another line of business was anything but successful a few years ago. The outlook was dark indeed when certain discoveries led the president to test for oil. He spent enormous sums in hiring geologists, literally hundreds of them at a time, and finally discovered oil in huge quantities. It was a costly gamble, but on a scale so large that it ultimately won.

Not a Business for Lambs. Beyond a certain depth the cost of drilling an oil well seems to increase geometrically rather than arithmetically. Many small stock companies and individual operators fail to estimate the costs properly. They may allow enough for the drilling itself, but they often fail when it comes to the water supply, the fuel, and provision of living accommodations for the workmen. The whole Southwest is filled with uncompleted, bankrupt wildcat wells.

Frequently an entire well may be spoiled through some slight mechanical error in the drilling. Tools are lost, the shooting is done in a wrong way, the casing collapses, the cable breaks and water filters in. The smallest error of a day laborer may destroy twenty to fifty thousand dollars of capital or at least make necessary its immediate replacement. In other words the bait is so expensive that there is grave danger at all times of the turtle rather than the fish swallowing it.

Finally no one knows how long a pool or well will last or how soon the flow will diminish. Every pool has its limits, the largest perhaps in the world having started at four hundred thousand barrels a day and only a few years later shading off to fifty thousand.

They tell the story of the old negro night watchman who had bought a share of stock in the oil company for which he worked. Returning from the well early one morning he rushed into the office of the company and shouted: "Everybody's rich now! Nice clear oil in the well dis morning, boss." But the nice clear oil was water which had filtered in, and an inspection showed that the well itself had run dry.

Now all these hazards apply to the production end of the oil business, even as conducted by professional operators without the intermediary of stock promoters. All I have said is true, even where the operator or investor gets a first-hand run for his money, but in ninety-five cases out of a hundred where oil stock is offered for sale to the public the investor does not get any run for his money at all, in addition to bearing all the normal hazards of the business. Nor is this due entirely to the crookedness of promoters. Much of it is inherent in the very nature of the industry.

The plain fact is that drilling for oil is a business that can be successfully conducted only by those who command large sums of capital readily. A small company with a considerable number of small stockholders is simply helpless. The reasons are obvious. The big company or the well-to-do individual operators or group of operators is always able to protect its investment and the valuable commodity it is after. If the tools are lost or any other of the innumerable accidents which the oil fields are subject to come along, the big operators merely chip in another $10,000 or $20,000 and go ahead until they get the oil or discover that the hole is entirely dry.

But the stock promoter, no matter how honest, is helpless when he gets into technical trouble.

He cannot go to thousands or even hundreds of small investors, who have put in anywhere from ten dollars to a few hundred dollars, and induce them to chip in again. It takes too long for one thing, and the stockholders are too ignorant and frightened for another. Thus drilling for oil by small stock companies that depend upon popular subscriptions is an uneconomic proceeding. It wastes the natural resources of the country and usually produces nothing.

There are hundreds of little stock companies which have potentially valuable oil wells. But having failed once they are done for. They cannot assess their stockholders, for the stockholders are either not in a position to pay or are too ignorant of the operations to be justified in taking the chances involved. In California there were holes which cost as high as $150,000 and did not pay a cent. Yet the Standard Oil kept right on and finally struck great quantities of pay. If the development had been left entirely to little popular subscription stock companies the field might never have been developed at all.

Where Small Companies Come In. Of course I do not mean that drilling should be done entirely by big companies. Often it is just as successfully done by small companies, but these are close corporations made up of, say, ten or a dozen business men who are prepared to risk several thousand dollars, who can be reached quickly and who will back up their investment with several thousand dollars apiece additional.

Another great disadvantage the small stock company suffers from is that good drilling contractors are hard for them to get. Even well-to-do business men cannot get as good results from the drillers as professional oil operators, and stock promoters rarely get any results at all. The driller knows that the promoter is probably in it to make money out of selling stock rather than from the oil, and so he charges more, gets all he can out of it while the going is good, and at the first sign of the money running out departs. So well is all this recognized in the industry that several leading men in the Southwest told me there is nothing the typical oil-stock promoter so hates as to find oil.

"He gets into trouble only if he strikes oil," said one of the leading government officials, who comes in contact with the financial side of the oil industry. "For then he has got to go and do something about it. He has got to attend to it and care for it, and there is less money in that than in selling stock."

There is one case on record of a notorious promoter having made good on an oil proposition and having paid the stockholders off twenty-nine to one. But the fact developed in a subsequent lawsuit that he had sold out his own stock before he struck oil, showing that he had not believed in the proposition himself.

Nor have worthless oil stocks been limited wholly to those of producing companies. Following the discovery of the great Cushing pool in Oklahoma, refineries sprang up like weeds. Everyone went into the business, all the way from the biggest capitalists to the worst fakers. "Many of the refineries consisted," to quote the words of the *Oil Trade Journal*, "of from two to a half-dozen three-hundred-barrel stills, a worried president elected by the stockholders after the promoters had got through, $2,000,000 of stock issued, and $200,000 of actual assets."

In one of the largest cities in Oklahoma there is a refinery, the oldest in the place, whose stock is still selling at a few cents a share, though other refinery companies, started after this one, have proved extraordinarily profitable. The reason is solely this: The one concern was essentially a stockjobbing rather than an oil enterprise; the others were engaged primarily in the oil business, and stock issue was only secondary with them.

Very few oil stocks offered for popular subscription have any chance from the start, owing to the large sums that go to the promoters. The value of the stock depreciates the moment it is sold to an investor, because that moment there is a generous rake-off. Out of $30,000 stock sold in behalf of one company only $5000 went to the company itself. A most friendly former resident of one of the boom towns in the oil field once admitted to me that land which might properly support one well, whose drilling cost would not exceed $20,000, had been capitalized for $200,000.

Too Much Excitement. Many of the losses, both in oil stocks and oil leases, are due solely to the element of excitement. Perhaps this is more evident near the oil fields than at a great distance, but the slick stock salesman who calls upon a prospect in Newark, New Jersey, does all he can to simulate the excitement and stampede of the oil fields by means of telegrams, telephone messages, and the like. Even professional operators are often carried away by mob psychology.

At one time ten acres of land outside of Ranger, Texas, could be leased at exactly the same price as one half an acre within the town limits, though both tracts were precisely the same distance from the big discovery well, and no human being could say that oil was more likely to be found at one place than the other. This curious twist of mankind's supposedly cold-blooded pursuit of money is known to oil men as "town-lot craze." I asked a veteran operator to account for it.

"It is this way. Two oilmen go out in the country and sit on a rail fence looking at a piece of land. They hear only an occasional crow cawing above them; or now and then the farmer beside them drawls out some remark. It is so quiet that they begin to get skeptical of the value of the land. But when the same two men get into a big crowd where people are talking and eagerly poring over maps it works the other way.

"They hear someone call out, 'Hello Bill!' And one of them asks, 'Who's Bill?'

"'Why, don't you know Bill? He was a driller a few years ago and now he's worth $17,000,000.' Then they all get excited and will pay anything."

The smaller in area an oil proposition is the greater the excitement and stampede, because a greater number of people can get into it. For that reason big companies nearly always avoid town-lot propositions and seek to use their large resources to handle large acreage, because they know the little fellow cannot get into big acreage and so will not rush, compete, and stampede prices up to inflated heights. But unfortunately most of the oil stocks offered the public, though not necessarily confined to town lots, are naturally small propositions and therefore almost always involve the element of small, ignorant competition and inflated prices.

Most small oil companies have no chance to make a gambling success, for the simple reason that the promoter has to play his cards before the draw. The big company, or the professional oil proposition which is confined to professional oilmen and their associates, has more cards to draw from. One dry well usually does not break a big company, but one dry well usually breaks the average stock concern whose shares are offered to the public.

The Acid Test. One of the acid tests of an oil stock is whether it is really sponsored by experienced and reliable oilmen. Several operators in the fields told me that a great evil is the rush of unsuccessful real-estate agents and life-insurance men into the game. Except for a few lucky gamblers who happen to get in on the ground floor at the start of a boom, and leaving out of consideration of course the original landowners who cannot help themselves, the oil game is distinctly one for specialists. The presence on the board of directors of a company of country bankers, prosperous farmers, and business men argues but little.

There is no dirtier game than that of inducing country bankers to lend their names to stock-jobbing oil companies. One such banker has gone to jail for his activities in this direction. Of course the consideration is usually a good-sized block of stock at rock-bottom prices. One prominent local banker told me of his experiences in fighting off the sharks who were almost daily after him. Though he would be classed technically as a country banker this man is rich and influential. His name is magic in half a dozen counties. One promoter was especially anxious to get the use of the banker's name. But he consistently refused to be drawn in.

"Finally I remembered a woman who works for a company of which I am a director," is the way he told the incident. "Every time I go to a directors' meeting she draws me aside and asks me to put her in on something good in the way of a speculative stock. So I told the promoter that though I never went in on any of these stock-promotion things myself I would take $500 of the stock for the woman. I told him that if it turned out all right she could have it, and if it turned out badly I would take it.

"What do you suppose that promoter did? On the strength of that little purchase he advertised all over the State that I was deeply interested in the company. In fact, they went so far as to sell stock on the misrepresentation that I was director."

Plenty of Good Oil Stocks. The uninitiated investor can play the oil game safely only in the stocks of the big, well-known, established companies. Naturally the profits on these stocks will not be as large as on the shares of smaller, new, and generally unknown companies. But the outsider who buys stocks in small, new oil companies is gambling just as truly as if he threw his money on the table at Monte Carlo. To make fortunes out of this class of stock, as not a few people have done, needs close, intimate, inside knowledge, or else just the lucky gambling chance.

But while no such huge profits are to be made on the stocks of the large, established, well-known companies, yet the rate of dividends is often exceedingly high. Many an investor would do well to investigate the more reputable oil companies and put a part of his funds in such enterprises.

Oil and mining have great advantages in common over most other investments. It is often supposed that the great risk in oil and mining is the varying price of crude oil and the metals. But this is only a question of conservatism. Indeed this risk can be eliminated entirely if a sufficiently low figure is used in estimating. There is no competition in the sense that exists in manufacturing.

Another great advantage which these two industries possess over manufacturing and "industrial" lines of all kinds is that the elements of good will and extraordinary ability in management do not enter in to anything like such an extent. The management of an oil or mining company must be honest of course and technically efficient, but it proceeds along comparatively well-known lines. The future is not so dependent upon the actual genius of the founder or manager as is the case with industrials. On the other hand there is not the danger of public and governmental antagonism which exists against railroads and other utilities.

In buying stock in a new oil company the investor should always demand a profit and loss statement, a balance sheet, a detailed description of the properties so that they can be found on an oil map, a statement as to how much the promotion is going to cost the company and just how it will be paid, and a statement as to who owned the property and for what amount they are turning it into the company.

Profit and Loss in Mining. It is probable that more money has been lost in promiscuous mining investments than in any other form. But this is not because mining investments are bad. Indeed it is because they are so good. As stated in the preceding paragraphs the very magnitude of the profits in oil and mines attracts both the unprincipled promoter and ignorant investor.

Great as the losses in mining have been it is probable that they are relatively small as compared with the enormous wealth which has been taken out of the ground in the form of minerals. It has been estimated that worthless mining stocks could not possibly equal 10% of the mine production. Unfortunately, however, much of the wealth produced by mines has gone to a comparatively few persons, whereas the losses have been distributed among many.

If the investor will confine himself to large, widely known development companies he will probably do exceedingly well in mining investments. I refer to the non-professional investor, that is, the man or woman who has some other occupation to follow. These big companies average the risks of the business and thus reduce the element of risk to very moderate proportions. Of course many of the largest copper, gold, and silver producers are privately owned by a few wealthy capitalists. But it is true also that others of the largest producers are owned by many stockholders and their stock is listed on the reputable stock exchanges where it is open to purchase.

The investor who is not in immediate first-hand contact with the mining industry will do well to keep away from companies which do not actually produce an appreciable percentage of ore, that is, enough to make them real factors in the industry. It is most unlikely that anyone who buys stock in, let us say, a copper company which is one of the dozen chief factors in the copper industry will suffer severe loss. Indeed he will probably receive big dividends year in and year out. Whereas if he buys into a "prospect," the chances are all in favor of total loss.

The Fatal Prospect. The great evil of mining investments is the apparent inability of the average investor to distinguish between prospects and real mines. The vast majority of all mining stocks offered for sale and bought by the public at large are merely shares in undeveloped prospects.

Mining business from an investment view is of two sorts, prospecting ventures and developed mines; that is, mines where little or no ore is exposed and mines where a definite quantity of ore is known to exist. All mines must pass through the prospecting stage and the Aladdin profits of mining come to those who buy a successful prospect. But the actual industry of metal production is based on developed mines and it is these alone which the non-professional investor should buy into. The reasons therefor can be gathered from the following statement made by Daniel Guggenheim, former President of the American Smelting & Refining Co.

> Even where there are undoubtedly surface indications of ore value, it should be borne in mind that one in 300 is a conservative estimate of the proportion of prospects that eventually fulfill their promise. The 299 failures are forgotten in the one success, and that one is made the bait with which the public is tempted to 300 more ventures.

The investor who buys stock in the ordinary promotion prospect is helping to furnish all the real cash going into actual development, to underwrite other expenses charged to operation, the nature of which he does not know and the amount of which he is not told. He is paying all the expenses of the stock-selling campaign by which he is caught, and by which the whole enterprise is kept moving. Among the risks of such an investment are, that the prospect contains ore in paying quantity, that the operative force of the company has the skill to develop it so as to create a margin of profit above operating expenses, that the promoters are honest, and that no legal complication or business depression will halt the stock-selling campaign before enough shares are sold to develop the property into a mine. The prospect of success is very small. It is this type of project presented to the public as "mining," which gives a bad name to a great and legitimate industry.

A group of wealthy Canadians once formed a company with $5,000,000 capital to examine a large number of mining prospects. They looked into fifteen hundred and not a single one proved worth while. They dissolved the company and returned the money.

Even the large development companies find only a few prospects that are worth while. The United States Smelting, Refining, and Mining Co. is a large, reputable, and highly successful concern and yet look at the record of four years of mines offered for its purchase:

	Mines offered	*Partly examined*	*Measured and tested*	*Bought*
1913..........	614	100	24	3
1912..........	694	121	36	4
1911..........	921	144	28	1
1910..........	684	124	46	2
Total.......	2,913	489	134	10

In other words, only about one third of one per cent. stood examination well enough to purchase. Eighty-three per cent. were refused without even an examination, simply on the basis of geological formation and working costs of the various districts.

Thomas Gibson has given an excellent explanation of why the great majority of prospects offered the mining investor are of so little merit. He says:

> In the nature of things, they are usually poor prospects, for the large exploration companies carefully examine and try out all promising districts. These corporations have efficient scouts and engineers constantly on the lookout for bargains, either undeveloped or partly developed. They acquire most of the good propositions and underwrite the necessary capital before offering the securities to the public. The wild-cat promoter, on the other

hand, ordinarily has little or no money and he turns to the public or his friends for funds. In nine cases out of ten the owner of what he sincerely believes to be a good prospect will go to the big corporations first, and he can always get a hearing. If he is turned down, he attempts to do his own financing and the property is usually a failure. There are just enough exceptions to keep the cupidity of the public stimulated and to keep the promotion game alive. We may safely adopt the rule that a mine or a prospect which cannot be sold to the large interests at a fair price is a very questionable investment. Another good rule is to invest only in mining stocks which are listed on a reputable stock exchange. Not all the listed stocks turn out satisfactorily, but the percentage of failures is infinitely smaller than in the outside field. Keep the fact in mind that mining is a business—a highly specialized business—and that a really good property will never need to go begging for development funds. The rich specialists are constantly on the lookout for good mines of any kind and they make very few mistakes in their judgment as to the value or prospects of any proposition laid before them.

Test Questions. Many lists of test questions have been prepared by mining engineers to enable the investor to obtain sufficient information before risking his money in prospects and new projects generally. A committee of the American Mining Congress once prepared this list:

Presuming that the prospective investor is anxious to acquire definite information regarding a mining company and its property, the committee urges that, as a preliminary step, he secure precise statements from the promoter in answer to the following questions. Inasmuch as the misuse of the mails is a felony, be sure to preserve the replies, together with the stamped envelopes containing them:

1. Company organization, where and when incorporated?

2. Capital stock, how issued and apportioned?

3. What steps have been, or will be taken, to raise funds for the development or equipment of the property?

4. Is any of the stock pooled?

5. How was the property acquired by this company?

6. Are there any debts against the company?

7. Are there any encumbrances against the property?

8. Location of the property and total acreage? Nature of the titles?

9. Nature and extent of developments and equipment, and how much has been expended in this work?

10. How much treasury stock has been sold and at what price?

11. How much cash is in the treasury?

12. Has the property ever produced, and if so how much has it produced under the present management?

13. Has the property ever been examined by a competent and honest mining engineer? Give his name and address, and send copy of his report.

14. Is the property working at the present time? If so, how many men does it employ, exclusive of stock solicitors?

15. Has a comprehensive financial report of the operations to date been issued? If so, send a copy? If not, count the writer out.

Selling Mining Stocks. Most people seem to have at least a few shares of dubious mining stocks in their possession. I am continually being asked by people how to get rid of mining shares which appear to have little if any value. Usually there is no answer, for the simple reason that the stock is worthless. Here is the sort of inquiry that often comes:

> I have some shares of mining stock my husband bought some years ago. I do not know whether they are of any value or not. My husband is dead and I would like to sell this stock. How will I go about selling or finding out whether it has any value?

Unfortunately this woman does not mention the name of the stock she owns. If she had given the name, it might be possible to tell offhand whether the shares have any value.

My answer is, write to the Secretary of State, at the capital of the State where the company was chartered (always printed on the face of the certificate) and ask him whether the company is still in existence. This you have a perfect right to do. Also, ask him what has become of the company in case it is no longer alive in his State. He may or may not reply to this part of the question. In any case, if he says the company has gone out of existence, the probability although not certainty is that the stock is valueless. If the official merely says the company is in existence and has paid its taxes, your search for information has only begun.

Usually a broker can find out for you whether a mining stock has any value. There is a very elaborate system by which bankers and brokers are able to obtain information one from another.

Although the majority of brokers are reliable and honest, there are a few who pretend to buy stocks that most of their fellows consider worthless. This they often do merely as "bait." These gentry actually buy what are generally considered worthless stocks at a few cents a share, but in so doing persuade the owners to buy from them something else.

There are probably half a million mining companies that are dead or worthless. As for copper stocks, practically all of any importance, except a few new ones, will be found in the *Copper Handbook* published at Houghton, Michigan. The larger gold and silver companies are reported in such standard reference manuals as Poor's.

There are two or three large volumes, usually on file at brokers's offices, that give the names of "obsolete securities." These lists cover perhaps a hundred thousand names. One mining broker in New York has records of his own of more than 60,000 companies. A specialist in "uncurrent" or worthless securities has himself run down 70,000 companies. Two New York reporting agencies have card catalogues of 100,000 names apiece. There are similar agencies in Boston, Philadelphia, Chicago, and Pittsburgh.

The Boom Evil. The investor must also be on the lookout to avoid buying stocks in dangerously inflated boom camps. The history of a mining camp usually consists of one or more rich strikes, the rapid acquisition of the best locations by local interests and the "big" interests, that is, by the well organized groups of mining capital in the form of the large exploration, development, and holding companies, and then the inrush of thousands of adventurers who take up unpromising land on the outskirts and sell stock to the public at large.

For a time the entire camp is judged by the record of the few big producers. After the boom has quieted down, however, it is usually found that most of the ore has been produced by a few companies, usually anywhere from four or five to a score at the most, and that the public has bought stock in hundreds, perhaps thousands, of companies which never had a look in.

For these reasons I cannot urge upon the investor too strongly the necessity of sticking to recognized, established concerns which are already a real factor in the mining business. Of course if the investor is able to drop everything—business, family, children, and the like—in order to join the rush to a new camp, he may be able to get in on the ground floor. But as a rule the local interests, professionals, and big companies are in first. This applies to oil as well as to mines.

Safeguards in Mining. Once the investor has learned to leave prospects to wealthy capitalists, big companies, and reckless gamblers, he can study the value of real producing mining companies. He must remember of course that a mine or oil well is a wasting proposition, that unless replenished with new mines or wells, his company is giving away its capital when it pays dividends.

Thus the great point is to be sure that there are ample ore reserves and that they can be worked at a cost which will permit continued production even when prices for the metal are low.

The great difficulty in mining is the liability to sudden disaster through the exhaustion of the deposit. The company may have a large mine which has been worked for a number of years with great profitableness and suddenly the ore runs out or the vein decreases in value so that further profitable operation is out of the question. If this happens, the investment in the expensive plant is practically lost, for the machinery is worth little above the price of scrap iron. To avoid this disaster the more conservative companies develop their workings in advance of their immediate necessities. That is to say. they run tunnels and leads into the veins to ascertain how much ore is in sight. This blocking out process enables them to assure their stockholders that there is at least a certain amount of raw material in prospect.

It is obvious that if this process is carried far enough the company should be able to assure its owners positively that there is enough ore in sight to warrant its successful operation for a long period of time.

The Transvaal companies in South Africa have, in many cases, blocked out sufficient ore to insure the repayment of the original investment many times over. Where this has been done, and the investor, therefore, has positive assurance that there is a large amount of ore actually in the possession of his company, mining stock may become almost as safe as any other form of investment and far more profitable than most.

It is important to remember in connection with mining investments that unless some provision is made for the perpetuation of the assets of the company, the stockholder of a mining company should expect dividends much above the average, for he is not only receiving in reality a return upon his investment but is getting his original principal back in the form of annual installments.

Of course the investor who receives large dividends on mining stocks should consider part of this sum a return of his capital, and lay it aside as such. If the life of a mine is known, it is a very simple arithmetical calculation to figure just what the dividends should be in order to return the investment and 6% interest during the life of the ore bodies.

In actual practice few investors take the trouble to make such calculations. The larger mining companies of good standing attempt to maintain a permanent investment by constantly buying more property. Many of them have been able to pay unusually large dividends and yet maintain to a high degree the integrity of the original capital. At the same time the investor should not expect to receive huge dividends permanently.

CHAPTER IX

WHERE TO INVEST: WALL STREET AND OTHER MARKETS

ONE of the most common mistakes made by investors is to neglect local enterprises in favor of distant concerns. This is often very foolish, especially on the part of the small investor, because it is much easier for him to get the essential facts in regard to a local bond or stock.

What perverse trait of human nature makes us overlook the near-by opportunity? Why is all the romantic glamour monopolized by far away things? These questions have a direct bearing upon investment proclivities, and observation tends to show that investors are just as interestingly human as other people. The man with a thousand dollars to invest displays exactly the same pathetic but very human trait that the boy or girl who supposes they would be much happier if they could get away from home.

Several years ago the Texas legislature had the right idea but the wrong method when it passed a law compelling life insurance companies to place a certain proportion of their funds in Texas mortgages and other local investments. Of course the method was wrong because the companies simply withdrew from the State and there was less capital available for Texas industries than before.

If the people of Texas could have been taught to buy their own securities instead of dallying with a trickster in New York or a fakir in Chicago with worthless mining stock to sell, there would have been no lack of capital in Texas. Taken from my correspondence at random is a letter from an Oklahoman who wants to buy stock in some new device promoted in Indiana. Doesn't this man know that his State is one of the richest in the Union, that its plains are fertile, that its farms are profitable, and that mortgages based upon them are among the best of investments? Does he not realize as any man with common sense should, that to investigate a new invention in Indiana would cost him much money and trouble, that his own vicinity probably cries for capital and afford's opportunities for investing which fairly strike him in the face?

Look about You. We all know how little honor a prophet appears to receive in his own country. But he seems to get more than a local investment does. A man in Cleveland wants to know about a picayune, irresponsible, fly-by-night promoter in New York. There are dozens of strong banking and brokerage firms in Cleveland. A resident of Maryland wants to know about a swindling bucket shop in a certain Western State. Does he not know that some of the oldest and strongest investment dealers in investment securities hail from Baltimore? A man in South Carolina wants to buy stock in a new mining company in Alaska. Why does he not investigate some of the public utility securities of his own State, or perhaps cotton mill shares, or at least the bonds of the great railroad systems that traverse his State and without which it would be a wilderness?

This country is so big and so full of splendid opportunities that no man can hope to know of all that exist in every corner. A reader in an important Southern city asks about three different investments, one offered by a California firm and secured by California property; another put out by a dealer in another Southern State; and the third, six per cent. mortgages sold by a large savings institution in his own city. I confess to never having heard of that particular institution before, but upon investigation find it to be of high standing. It claims to have sold $30,000,000 of first mortgages in amounts ranging from $250 to $10,000 of which $6,000,000 are now outstanding, and "not one of them has ever lost a dollar." By all means should this inquirer make his first investment in his own city with such opportunities, instead of in California or in a neighboring State.

Frequently local securities of the highest standing are offered in small and convenient amounts. This is true even in States which one would not suppose to be at all advanced in investment banking. My attention has recently been called to a strong concern in the Southwest which makes loans upon improved farm property and sells 6% coupon bonds in $300 units. Good local securities in small sums are by no means confined to the mortgage field.

Stocks near Home. Every now and then the highest class of municipal bonds, or even state bonds, may be had right at home. One Middle Western city often has its bonds on sale for amounts as small as $30, $50, $70, and $100. Investors simply do not take the trouble to find out what local offerings there are, and yet they might so easily save themselves no end of time and loss. Often the very highest class of bank and industrial stocks are to be had in one's own town. It hardly needs to be repeated here that safe investments can be had in almost every community in the form of first mortgages, which may be bought from the real estate and insurance men.

Many people will find plenty of use for their money without ever going near Wall Street or getting in touch with a stock broker or even an investment banker. If you happen to be employed by a large corporation, find out if the company is willing to sell you some of its stock. Many of the largest corporations are encouraging the purchase of stock by their employees. The company takes care of all the details, saving the investor all of the bother of getting in touch with a broker.

In a number of cases druggists are being asked to buy stock in wholesale or manufacturing drug firms with which they deal. Another tendency is for the large electric light and power companies to sell stock direct to their customers, charging them for it so much a month just like a gas bill. Nearly all such coöperative stock selling plans have merit. It is far more natural and sensible for a retail druggist who buys heavily from a manufacturing concern and who knows that thousands of other druggists are doing likewise, to become an investor in that company than in some oil well or mine about which he knows absolutely nothing.

Frequently high-class bonds and stocks are offered for sale by corporations direct to persons who are already bondholders or stockholders. If you happen to own common or first preferred stock in a large rubber manufacturing company you may be offered second preferred stock by the company. If capital can be raised in this way it is sometimes economical for the corporation and often advantageous to the investor. Nor in these cases is any intermediary needed in the way of a banker, broker, or stock market.

Why there Is a Wall Street. But it must not be supposed that because investments are often obtainable without the services of bankers, brokers, and stock exchanges that these various institutions are unnecessary or non-essential. The majority of large corporations cannot raise capital, or at least have not yet learned how to raise capital, without the services of investment bankers, bond dealers, brokers, and stock exchanges. Wall Street, and to only a somewhat lesser extent the financial districts of Boston, Philadelphia, Baltimore, Chicago, St. Louis, Cleveland, Detroit, San Francisco, and a number of other cities, are merely final clearing houses which are rendered absolutely necessary because of the investments which the American people make in stocks and bonds.

You can make your investments in the most local manner possible but ultimately your transaction will play its part in creating and maintaining the institution known as Wall Street. For what is this Wall Street? It is nothing but a concentration of big banks, trust companies, main offices of large corporations, bankers and brokers engaged in supplying capital to corporations and buying and selling the stocks of those corporations, stock markets, or exchanges, formed by these bankers and brokers, and individual capitalists and trust estates gathered together where the facilities for buying and selling investments are most highly developed.

"But," you say, "what has this to do with the $5 I put in the savings bank in a little New Hampshire town, or the life-insurance policy I buy, or the shares in the foundry in an Illinois county seat?"

The answer is not simple, but once understood it seems simple enough. You may make your local investments, but that process, wise as it is in many cases, will not build the great industries of the country. The little foundry may be financed for a while in its own home town but after a time it may become too big for that. Then the managers have to go elsewhere for funds. Now the moment any business ceases to be wholly local it of necessity becomes tied up with Wall Street, or one of the smaller Wall Streets in Boston, Chicago, or a dozen other cities.

Finance and investment tend to become concentrated in Wall Street just as beef packing is concentrated in Chicago, art in Paris, bills of exchange in London, and so on. Naturally also people go there to buy securities because more is known about a larger number of securities in Wall Street than anywhere else. One does not necessarily make better investments there than elsewhere, but there are more to choose from. Being the most highly specialized market for bonds and stocks there is a larger body of opinion regarding them than elsewhere.

The investor, or the speculator, has a wider range of choice, a larger body of information, quicker information, easier access to general information, in Wall Street than he has locally. The very fact that he is one of tens, of hundreds, of thousands, who are buying and selling creates a "market" wherein the action of all these people is quickly reflected. In Four Corners he may buy a perfectly safe share of stock in a foundry or a flour mill or a bank, but nobody else is doing it and therefore there is no general concensus of opinion regarding that share of stock. His may be the only purchase in six months.

Of course there is a very great deal of speculation in Wall Street. Perhaps there are evils connected with it. For that matter there may be bad management, even crookedness, in the local foundry, flour mill, and bank. But because some people speculate too much in Wall Street, or even because some of them are gamblers, is no reason to condemn the whole institution.

There is a lot of speculation in Wall Street because there are a great many people there buying and selling a great many stocks and bonds. Of course there is no rampant speculation in stocks in Four Corners. There are not enough people or enough stocks. One might just as well condemn the art center of Paris as being a greater evil than the art center of Four Corners. It would be just as sensible to say that the abuses in the clothing trade in New York are greater than those in Four Corners, or that the evils of the oil industry in Tulsa, Oklahoma, are greater than they are at Savannah, Georgia. Of course, but then there are no clothing factories in Four Corners, and no oil industry to speak of in Savannah. The New York Tribune recently said:

> There are places in Wall Street where one can get swindled. There are such places in every business district on earth. Generally it is one who wants

something for nothing that loses his money in the financial district. From long experience with the human nature and practices of that mysterious place, we take leave to say that if a woman with all her savings were to get off a Broadway car at the top of Wall Street, turn east and stop anywhere asking for a safe investment she would get it. If she wanted something that was sure to go up, and went far enough, she would perhaps find somebody to give her what she ought not to have. But she would have to insist. For one person deliberately swindled in Wall Street one thousand swindle themselves. The investor is safe enough, no matter how little he knows. The speculator is his own evil.

The Markets of Wall Street. Wall Street consists of several different markets, or exchanges. First there is the New York Stock Exchange. This is the largest single market for stocks and bonds in the whole world. Only the larger corporations have their bonds placed on this market. While there are many, in fact tens of thousands, of important companies whose securities are not on the New York Stock Exchange, yet the influence of the Exchange dominates the entire investment structure of the country. This is not as strange as it might seem at first sight.

The Stock Exchange might be compared with a complete, well-equipped, well-disciplined army division. Round about it are hundreds of bands of troops unorganized, isolated, scattered. The influence of that division is far out of proportion to either the bravery or inherent worth of the individuals in it as compared with those in the roving bands.

This comparison is not intended in any way to disparage what are known as unlisted securities, that is, those not on the Stock Exchange. The illustration is merely intended to show why the movements of the unlisted securities do not have the same influence as the movements of the stock market, which means the New York Stock Exchange. The Stock Exchange is primary, central, concentrated, highly developed, compact and supreme. There are many investments off the Stock Exchange as good, some far better, than most of those on the Exchange. But no one can understand the movement of prices or the values of securities in general, unless he studies the movements on the Exchange.

The great power wielded by the Stock Exchange can be better understood when the fact is brought out that no bond or stock can be "listed," that is, admitted to the Stock Exchange market, until after the company issuing it has provided the Exchange with exhaustive information regarding the security, which information is at once made public.

The great fact about the Stock Exchange, however, is that hundreds of men gather in crowds and buy and sell openly. Four hundred men may be buying and selling the same stock at the same moment, all in a compact, noisy howling group. The telegraph reports instantly every sale and the price at which it is sold. Nowhere else is there anything of that open, public kind (there are other stock exchanges both in New York City and elsewhere, but they are merely smaller editions of the same thing).

All other kinds of buying and selling of stock are private, isolated, scattered, disconnected. Therefore they have no influence in making a common, generally known price. It can be seen at once that the influence of the Stock Exchange operations are out of proportion to their size.

I have just said that hundreds of men gather openly and publicly in crowds. This does not mean of course that anyone can enter. Only members who have bought a "seat," at cost varying from $50,000 to $95,000 apiece, are admitted. This means that the only buyers and sellers are persons of considerable financial responsibility.

Functions of the Exchange. Some idea of the importance of the Stock Exchange can be gathered from the none too friendly report to the House of

Representatives in Washington, in February, 1913, of the Money Trust Committee, which said:

> The stock exchanges in our principal cities, and especially those in New York, Chicago, Philadelphia, Pittsburgh, and Boston, are essential instrumentalities in the conduct of modern business and finance. Their local habitation has little relation to their sphere of usefulness or to their capacity for evil if permitted to be utilized for illegitimate ends. The main inquiry into this subject has been into the operations of the New York Stock Exchange, which are probably greater in volume of transactions than all the others combined, but the conclusions reached as to that apply also to the others.
>
> It is the market-place of the entire country and foreign countries for securities and the only public market in the United States where money is loaned and borrowed.
>
> The business transacted by its members comes to them from almost every corner of the civilized world. Its hall mark as to the genuineness of a certificate of interest in a corporation passes current everywhere and is rightly supervised with jealous care and at considerable expense to the corporations concerned.
>
> It undertakes to prescribe the form and conditions of every corporate security in which it authorizes dealings and its determination is final through its control over the listing of such securities. It reserves the right to exact minutest details of the business and affairs of the issuing corporation, to impose its will in the manner of the procedure by which such corporation shall declare and pay inter-

est and dividends, and in the manner of the transfer agents and registrar, and as regards endless other details; all this very properly on the ground that it is performing a national public function.

It jealously controls the reports as to every transaction on its floor, issues and distributes the records of every purchase and sale, or offer of purchase and sale, which it thereby impliedly represents as an honest and genuine transaction. Courts of justice, trustees, financial institutions, and the public the world over act on this information. It exacts compensation for the service of listing securities, sells its quotations to interstate and international telegraph companies for large sums of money and scatters them broadcast over the country through the newspapers, over the telephone and telegraph, but always under its control.

Great and much needed reforms in the organization and methods of our corporations may be legitimately worked out through the power wielded by the Stock Exchange over the listing of securities. Much of the confusion and many of the defects in corporate regulation due to the diversity of State laws and to the bidding of the States against one another in laxity of administration in order to attract corporations within their borders may be corrected and uniformity of methods introduced through the listing department of the Exchange.

The Curb. The next largest market is the so-called "curb" in New York City. This is an open street [1] market, to which practically anyone may be

[1] As this chapter goes to press it seems more than possible that the curb may soon move into a building of its own.

admitted. Immense quantities of stocks are bought and sold here, but with few of the safeguards and regulations that surround the Stock Exchange. The stocks bought and sold, and the dealers in them, have a wide range of merit, all the way from the highest to the lowest and crookedest.

One of the most picturesque and instructive sights for a visitor to the metropolis is the New York Curb Market. There is also a curb market in Exchange Place, Boston, which does a large business, but is not of such national importance as the one in New York. This market takes its name from the fact that it overflows, in periods of activity, the curbs and sidewalks. It has no building and therefore none of the external manifestations of an "exchange." This peculiar circumstance distinguishes the curb from all other markets.

An area is marked off by means of iron standards and ropes, but the curb constantly overflows its supposed area. It has no legal rights upon the street, except upon police sufferance, but its economic function is so great that the police overlook the fact that it technically constitutes a public nuisance by blocking traffic of all kinds on a very important street.

Curb markets are among the oldest of financial institutions. A curb existed in London on Change

Alley for nearly a century. Paris had a roped off curb as early as 1720. The New York Stock Exchange dates from a meeting of brokers under a tree at what is now 68 Wall Street.

To those unacquainted with its way, the curb market appears to be an angry, shouting, howling mob. But there is almost as much system on the curb as on the Stock Exchange. Being in the open street, subject to the weather and often to the traffic, there can be no mechanical devices for recording transactions or even for transmitting orders to the brokers. This end is effected by a deaf-and-dumb sign or wigwag system between the brokers and clerks who sit in the open windows of surrounding buildings. Of course the noise is too great for vocal communication. The near-by windows are filled with hundreds of boys transmitting orders. Just behind them are the telephone and telegraph instruments by means of which communication is had with other parts of the city and country.

Only severe rainstorms drive the curb off the street. Any ordinary bad weather affects it not at all. The curb derives great advantages from being on the street. This peculiar location serves as a sort of free advertisement which makes the curb a distinctive market, and without doubt appeals to persons of small means, who cannot gain admission to the Stock Exchange even as spectators.

Although the curb has an organization and regular membership, and also has a regular "listing" process, it is an "open" market. All stocks, except those listed on the Stock Exchange, can be bought and sold on the curb, and all persons have the right to trade there. In these respects the curb differs radically from the Stock Exchange. Another important point of difference is that a broker on the curb is not obliged to take the first contract offered to him at an acceptable price. In fact he can refuse any contract he cares to, and can pick and choose as much as he likes.

The curb has many important functions. More or less of a market is afforded for high-class stocks which are not on the Exchange because the companies will not publish the information required. The curb also furnishes a market for many low-priced, low-class mining and oil stocks which the Exchange does not admit. It also furnishes a market for many classes of temporary securities, such as "when issued," that is, bonds and stocks whose issue is contemplated but not actually accomplished. The Stock Exchange is loath to admit such securities, although they may be of high merit.

The curb also admits securities of companies which have failed and which are going through reorganization, such stocks and bonds usually having been thrown off the Stock Exchange. The curb also furnishes an entry way or preparatory market for the Stock Exchange. Many valuable stocks are first put upon the curb to see how they will behave before they go to the Exchange. Finally the curb is quick to admit stocks of new classes of industries and is willing to try them out. The Stock Exchange prefers to let some other market try out the new ventures first.

The curb thus performs many valuable functions, but naturally there are many pitfalls and dangers attaching to promiscuous purchase of curb securities.

Over the Counter. Finally there is a great "over the counter" or "outside" market in New York City. This consists of hundreds upon hundreds of brokers and dealers in stocks and bonds buying and selling from office to office, mostly by means of telephone. They have no central meeting place. Sometimes they buy and sell the same stocks and bonds which are being dealt in on the Stock Exchange itself or on the curb, but this is comparatively rare. Mostly they buy and sell bonds and stocks which, for one reason or another, have no "market" on the Exchange or openly on the curb.

In this great outside and over the counter market many of the highest class securities are dealt in. But they are often those of relatively small companies or of concerns in which there are only a few stockholders. The Stock Exchange, it should be noted, does not welcome the stocks or bonds of small companies or any concern unless there is what is called a very wide distribution of stock holdings. Otherwise there would be no opportunity, or occasion, for hundreds of brokers to buy and sell the same stock.

The bond departments of the great national banks and trust companies and such concerns as J. P. Morgan & Co. all "trade" actively in the over the counter market.

Listed or Unlisted. There is always a great dispute as to whether listed or unlisted securities are the more desirable. Let us see just what listing means. As already stated only certain securities are admitted to the Stock Exchange. These are not necessarily the best or most desirable. They are usually those of the largest companies with the most widely diffused ownership. A common error is the belief that securities traded in on the Exchange having been selected impartially because of their merit, those which are not listed must have been denied the privilege because of some inherent defect. This idea is inaccurate. Listed securities range from one extreme to the other in point of desirability. Some are of the highest grade while others are practically worthless.

It cannot be too strongly emphasized that listing a security does not prove its worth. It may be neither safe nor desirable. The Stock Exchange assumes no responsibility and affords absolutely no guarantee. But in the great majority of cases, companies whose stocks are listed must be important and sufficiently established to furnish the most exhaustive information. No stock or bond has gone on the Stock Exchange in recent years unless all the information reasonably and humanly possible to furnish, as far as the Exchange authorities could then determine, had been given. A few cases where accountants' reports were found later to be either misleading or totally inaccurate prove nothing except that perfection is impossible and that no one can foretell absolutely the future movement of securities, or estimate exactly the value of good will and other intangible items.

This much may be said of listed securities: the investor has all the available facts upon which to form an opinion. It is true that numerous companies whose stocks and bonds are listed have been ruined by high finance or mismanagement; but even in these cases the companies have had enormous amounts of actual property, and have not been patently fraudulent schemes, mere paper projects, such as are offered to the investor outside the Stock Exchange, literally by the scores of thousands.

It is neither possible nor necessary to name the various securities listed on the Stock Exchange. Reference to a daily paper will quickly afford practically a complete list. Most of the great, interstate corporations are listed. But the Stock Exchange does not care to take in even the largest corporations during their period of inception and incubation. It prefers to leave these to the curb market. It wants the stock to be at least a year old.

The requirements for listing securities are strictly enforced by the committee. After the corporation secures admission to the list, however, this supervision virtually ceases. There is little checking up of its affairs and no further statements are made compulsory until further issues are listed. It is this fact that justifies the previous assertion that the mere fact of being listed on the Exchange does not guarantee the merit of the security in question.

The corporation may drift into an unsatisfactory condition without any official objection being raised by the Exchange and its securities may drop from a high value to a practically worthless condition.

It would be inaccurate to say, however, that the Exchange does nothing at all by way of supervision. On the contrary it recommends that the listed corporations publish and distribute to the stockholders an annual report with full details concerning the income and expenditures of the corporation and a balance sheet showing the true financial condition at the end of the fiscal year. Observance of this rule is not compulsory, but the recommendation has almost the force of law and nearly all the corporations comply with it.

Nor will the Exchange allow any listed company to declare secret dividends by which only "insiders" profit. Due notice must be given of all dividends, new stock issues and other essential details. Anything in the nature of actual fraud in the issue of stock, forged stock, illegal issue of stock, improperly engraved certificates, overissue of stock and other actually fraudulent measures are forbidden by the Exchange in a long list of rules and regulations which are rigidly enforced. It compels all companies to maintain in the city of

New York two separate offices, one where stock can be transferred and the other where this process is checked up. This rule prevents any possible delay or fraud in having securities transferred to a new owner's name.

In other words while practically guaranteeing the physical genuineness of its securities, the Stock Exchange consistently refuses to guarantee their worth. If the Exchange were to attempt such a colossal task it would undertake one of the biggest problems and burdens in the whole of modern industrial life. It is absurd to expect such a thing.

Marketability. The marketability of any security is obviously increased by listing. Yet it must not be supposed that no unlisted securities have a broad, active market. Many unlisted securities enjoy an excellent market. Indeed there are listed bonds whose chief market is not on the Stock Exchange at all, but "over the counter." But such a market is not dependable. The outside buyer is wholly at the mercy of the dealer. He has few published quotations to go by. There is nothing open about the dealings even if the outsider knows to what dealer to go, which is rarely the case. Many people may be interested in his stock, but for him to ascertain their whereabouts is difficult, requires much time, expense, and above all, causes delay and uncertainty.

Listing on the New York Stock Exchange gives a security a wide market and a definite current value, making it easier to sell and always easier to borrow upon. In fact, securities are not generally available as collateral for Stock Exchange loans unless they are listed. Banks accept the quotations on the Exchange as the basis for computing how much they will lend upon given securities. The practice is to value the securities at 10 points below the quotations and lend 80% of such valuation. In advertisements and circulars describing securities offered for sale it is always stated as an inducement to purchasers that they are listed on the New York Stock Exchange, when such is the case.

The difference between listed and unlisted securities may be boiled down thus. It may be just as possible to buy or sell as good or better stock and bonds off the Exchange as on. But it is more a matter of individual bargaining and individual specialized knowledge. Because of the very absence of publicity unlisted securities often offer exceptional opportunities for big profits. Opportunities do not enter one's door and eat right out of one's hand.

But the investor who is not very thoroughly initiated into the game is less likely to go wrong on the Exchange. Besides he knows just what he will have to pay on the Exchange, because he can read the price every day in the paper or every minute on the ticker tape for that matter. He knows just what "commission" the broker will charge. If he buys an unlisted security he may not pay any commission as such, but he may have to pay a much higher price than the last previous buyer. It all depends upon the dealer. The dealer may be willing to maintain a splendid market for a particular bond or stock, especially if he has sponsored it from the beginning.

Many investment bankers who "bring out" issues of bonds always try to keep a market for them, whether they are listed or unlisted. But there is no assurance or guarantee of such a market. It all depends upon the individual dealer or investment banker. It is not an institution like the Stock Exchange where many hundreds of brokers meet day by day.

Unlisted securities are like foreign money. They are all right perhaps where known, but they have no standing elsewhere. The listed security is usually known everywhere.

Large issues of securities, especially of large and well-known companies, enjoy a better market, whether listed or unlisted, than do small issues. More people are interested and therefore the market is wider. In the case of bonds those which have a short life usually vary less in price and can be sold with smaller loss than long-term bonds. This applies both to listed and unlisted bonds.

CHAPTER X

ODD LOTS AND SMALL BONDS

"What is the Smallest Amount of Stock I Can Buy?" This question in varying forms comes to me repeatedly. Evidently there are many people who want to make a beginning as stockholders, but they do not know how much they must have to make that beginning.

Theoretically there is no minimum. I have seen stock offered recently in glaring newspaper advertisements for two cents a share. It may be good, but all the presumptions are against it. I suppose a person could insist upon buying one share of that stock; but the absurdity of such a proceeding is evident.

In order to prevent forgeries and other irregularities, the leading stock exchanges have adopted stringent rules regarding the engraving of securities. These standards are also adopted by most of the legitimate corporations whose stocks and bonds are not dealt in on the exchanges. To meet these requirements, it costs a corporation, on the average, perhaps fifteen cents to issue a single certificate of stock. Obviously then there would not be much profit for a corporation to sell a two-cent share of stock, pay a big commission to salesmen or for advertising and have the mere work of engraving transfer, etc., cost fifteen cents in addition.

Clearly no corporation wants to sell a single share of stock at two cents. Indeed, people who buy two-cent shares are probably urged to buy several thousand of them bunched in one certificate. And even allowing for the fact that corporations that sell two-cent shares must issue ordinary printed instead of engraved certificates there will still remain in the mind of any business man a suspicion that stock selling for a few cents a share cannot even pay its way.

But, when we come to stocks of good standing and a par and market value that is not ridiculous, it will be found that any number of shares from one upward are obtainable. Taking the New York Stock Exchange merely as a standard, it will be found that many brokers are just as willing to buy one share of stock as ten. They make the same charge—$1 or $1.25—for buying any number of shares from one to ten. Above ten shares the regular and usual rate of commission is from 7½ to 20 cents per share, according to the price of the stock, although the broker has a perfect right to charge more if he so desires.[1]

There is no reason why a man with $50 or $100 should not begin to buy sound dividend-paying stocks. Indeed purchases may be made at $10, but usually anyone who is thinking of investing at all has as much as fifty.

Small Stockholders It is known that many of our largest corporations have great numbers of stockholders. Three of them, the United States Steel Corporation, the American Telephone and Telegraph Company, and the Pennsylvania Railroad, have in the neighborhood of one hundred thousand shareholders apiece. It is interesting to speculate as to how many small owners of stock there are in the country.

Learned men have wrangled for years over the distribution of wealth. What percentage of the total wealth do the rich own? How many rich people are there? Do they constitute two per cent. or ten per cent. of the population? How many poor people are there and how much do they own? The economists, statisticians, and sociologists discuss and do not arrive anywhere, because they have not enough facts. But one fact we can cling

[1] For further facts on Commissions see Chapter XII.

to is the relentless increase from year to year in the number of property owners.

Less than a generation ago Andrew Carnegie had sixty-odd partners, and his rivals were equally few in number. To-day these same properties constitute a corporation whose direct owners number more than a hundred thousand. Hardly more distant were the days when John D. Rockefeller, along with a dozen partners, started a new industry. To-day there are at least ten thousand partners in his enterprise. Even in fifteen years the owners of scores of great concerns have trebled, quadrupled, and multiplied yet tenfold. In that time there has sprung up an entirely new national army of property owners, the small stockholders and bondholders.

It was primarily the panic of 1907 that so widened the base of our industrial structure. For at that time many thousands of small investors bought odd lots of stock outright at the very time that large capitalists were selling. There have been numerous stock market panics, in all of which a considerable amount of stock went to small investors at rock bottom prices. This was true also during the early part of the European War when stock prices were very low. Moreover the closing down of many bucket shops has driven small buyers into the actual purchase of securities.[1] Still another force has been the various corporation profit sharing and stock participation plans by which employees have become shareholders.

But perhaps the most powerful and least known agency through which wealth in the form of stock ownership has become widely distributed in this country, is a bit of private business enterprise, of technical jobbing machinery with which the public never comes in contact. I refer to the little group of odd-lot dealers on the New York Stock Exchange. We have seen in the last chapter that there are many other places where many stocks may be bought. But most of the largest and best known companies are on the Stock Exchange, and if you want to buy anywhere from one to one hundred shares of stock in any of them your "order" will go through the hands of an odd-lot dealer, although you will never see him or have anything to do with him.

Your order to buy will go to a broker, a commission broker, whether you send it to him directly or whether it comes to him indirectly from your bank. Suppose you live outside of Pittsburgh and wish to buy one share of the common stock of the United States Steel Corporation, one of whose

[1] See Chapter XII.

subsidiary companies, the Carnegie Steel, is near your home. From whatever point your order starts it probably will reach a commission broker on the New York Stock Exchange, but he will have very little success unaided in buying that share of stock for you. He might have to hunt for two weeks before finding anyone who had a single share to sell. Naturally he couldn't afford to take so much time, because you couldn't afford to pay him more than a few cents, or at the most a dollar, for his services; while he might just as well be buying thousands of shares for other clients in just as a short a space of time.

The Unit of Trade. Stock exchanges are forced to have units of trading, just as a grocer must have a unit when he sells sugar—one pound in his case. The grocer cannot sell sugar by the single grain because it would clog his business too much. So the brokers on the "Big Board" have one hundred shares as a unit. So thoroughly is it recognized that unless a broker specifies when he is buying the seller takes it for granted that he wants a hundred shares, just as the shoe dealer takes it for granted that you want one pair of shoes. He will gladly sell more, but he does not expect as a rule to sell more.

Of course the illustration is not altogether a fair one because you can hardly buy less than one pair of shoes and your broker can buy less than one hundred shares of stock. Indeed there are many people who think the unit is far too high. For a stock selling at $100 it involves an investment of $10,000.

But there have been times when a customer could not persuade his broker to buy even a hundred shares of stock, so huge were the operations on the Exchange. In the great speculative mania of 1915–1916 a man literally had to have a pull to induce a broker to buy him as few as one hundred shares. This was because the volume of business was so vast that brokers rushed half crazed from the building, vowing that they would never go into the place again so nerve racking and exhausting had been their efforts to execute orders in the pandemonium then reigning.

Stocks can be bought or sold in an active market, even in large lots, only by detailing a broker actually to watch the course of prices and jump in at exactly the right moment. No broker could be employed to watch one share when he might just as easily be watching a thousand. If one share were the unit, or if ten shares were the unit, it would be necessary to sell thousand-share lots in one or ten shares at a time. This would mean the complete breakdown of an active market. Besides, the price made for one share, or even for ten, would have no real significance in the reports and would convey a false impression of value. Nor could the banks attend to the physical details of accepting loans based on one-share certificates. If ten shares were the unit it would be almost impossible for a man to buy thirteen or seventeen shares; for, though he might get the ten easily enough in a dull market, he would wait weeks perhaps before finding the odd number.

The mere human limitations of the telegraph operators and the physical limitations of their machines seem to preclude the use of the small unit. At the opening of the market, which means the first ten or fifteen minutes after the gong booms at the stroke of ten o'clock, as many as fifty or sixty thousand shares of stock of a single company are often hurled upon the market, or a hundred brokers fight madly to buy that many. At such times the telegraphers must bunch even thousand-share orders, and sometimes even ten-thousand-share orders. They cannot report ten shares or a single share.

Yet one or three or thirteen shares, or any other amount of stock, can be bought by the small investor almost as quickly and easily as a pound of candy; and even when the market is frantic he can get his stock about as easily as the writer could get a pound of sugar in 1918. Anything less than a hundred shares is an odd lot, a fractional lot, a broken lot, or, as the Scotchman said, a cracked lot; and it is just as easy, contradictory as the statement may seem, to buy or sell one of these broken parcels as to buy or sell a full or board lot. This is because there are four wholesale dealers in odd lots who handle them on a scale so vast that they are able to breast the torrent, however swollen it may be.

Odd Lots Easy to Buy. There are more than five hundred brokerage firms on the New York Stock Exchange, and only four of these regularly handle odd lots. Yet these four houses are normally responsible for about one-fifth of the entire volume of business on the Exchange, and the senior partner of the oldest of the four houses was long president of the Exchange. One of them has handled as high as one hundred and seventy-five thousand shares of stock in a single day, which would represent anywhere from ten to twenty-five million dollars. For long periods of time two of these firms have been responsible for at least one hundred thousand shares a day each. Stocks pass through their offices almost like toys through a chain of five-and-ten-cent stores.

The public never comes into contact with the odd-lot dealer, because he is forbidden to buy or sell stock for anyone except a member of the Exchange. Any broker on the Exchange will take an order from an outsider for an odd lot, but he simply turns it over for execution to one of the four dealers. The outsider usually pays twelve and a half cents a share more if he buys, or gets that much less if he sells, an odd lot than he would pay for a full lot. Sometimes he does not pay a cent more or get a cent less than for full lots. In any case, the odd-lot dealer undertakes to deliver the stock at once, which normally means within twenty-four hours, meantime having it transferred on the books of the corporation to the name of the new owner. He always stands ready to buy and sell, deliver and transfer any stock in broken lots, up to a daily aggregate that may run all the way from three or four thousand to two hundred thousand shares.

When an odd-lot dealer buys an accumulation of broken lots he puts them together into hundred-share certificates and sells the hundreds in the regular market. When he sells a variety of broken lots he must go into the regular market and buy hundreds. Now as the investing and speculating public, through its five hundred different brokers, is inclined to flock at one period to the buying side and at another to the selling side, the odd-lot dealer is constantly obliged to risk a great sum. If the public is buying preponderantly the dealer is forced to deliver thousands of different small certificates of stock, though the market may go much higher before he has a chance to cover these orders by the purchase of hundred-share certificates. And when the public is madly flinging bales of stock at him, prices may take a sickening drop before he has an opportunity to get out from under the hundreds he has pieced together from the odds.

So the odd-lot dealers either make big profits or sustain big losses. They are nearly always obliged to take a position involving enormous sums. In reality their business at any given moment appears to be the height of speculation; yet if they were not ready thus to speculate there would exist no market whatever, except in dull times, for small lots of stock. Even in slack periods these dealers employ as many as two hundred clerks, and two of the firms each occupy three complete floors of large office buildings. Each of these two houses has twenty brokers stationed at strategic points on the floor of the Exchange. As seats on the Exchange have cost all the way from forty to ninety thousand dollars in the last fifteen years, it will be seen that each of these firms has a capital ranging from eight hundred thousand to one million eight hundred thousand dollars tied up solely in the privilege of doing business.

Many large corporations, for one reason or another, close their books for many days at a time to transfer of stock to new owners.[1] If a dealer happens to have bought a quantity of stock in any particular company just before its books close he is prevented from transferring them to the buyers, and may be obliged to employ extensive capital in merely carrying them over. The severest strain comes during the thirty days when the books of the United States Steel Corporation are closed for the annual meeting. The dealer's work is complicated by the fact that stocks bought on Friday and Saturday are not delivered until Monday, and by the further fact that odd lots do not go through the Stock Exchange Clearing House[2] as hundred-share lots do.

No odd-lot dealer has ever failed. Indeed, the very nature of the business requires such strength

[1] See Chapter XV.

[2] Stocks that go through the Clearing House require less capital to handle.

and large capital that in panicky times, when ordinary brokers distrust each other, they often try to sell exclusively to odd-lot dealers, knowing that contracts with those dealers are good.

Of course it is absurd to suppose that just because a man buys or sells less than a hundred shares of stock he is necessarily an investor. It is just as possible to speculate or trade in odd lots as in full lots. Wall Street's daily business is chasing fortunes—little ones as well as big. Many brokers encourage the ten-share trader, hoping he will be the hundred-share or even thousand-share operator of the future. Odd lots permit the operator to diversify and average his holdings and reduce the risk.

But in the main the odd-lot buyer or seller is an investor. Twenty brokers were asked what proportion of full lots of stocks represented investment, and the replies, reduced to an average, made it eight and a half per cent, which tallies with much other similar data. The same brokers figured that eighty-nine per cent. of odd lots represented investment.

Advantages of Stock Owning. It must be remembered that the stock certificate makes it possible for the poorest and least intelligent to become partners in business with the richest and most intelligent. The average man hasn't enough money to engage in business for himself. He must work for wages or salary. His means are too small to enable him to buy into a desirable partnership or firm. His capital and experience are both inadequate to enable him to succeed in business by himself. But he can buy stock in some safe business enterprise, well managed, honest, and having ample capital.

Nor is the desirability of owning even small pieces of stock and bonds wholly to be measured by the strictly financial results. There is a great sense of pride in owning stock or bonds in a high-class business enterprise that does not go with a savings bank deposit. There is a moral effect involved in being in partnership with the richest and ablest men.

Small Bonds. Although it is much easier and much more common to buy stock than bonds in small amounts, yet many good bonds can be had in $100 pieces. Bonds are most commonly sold in pieces or units of $1000, and the market thus far has been largely geared to that figure. However, it is possible to buy and sell Liberty bonds in $50 units as well as $100 and $500 without any loss.

Of course when states, municipalities, and corporations issue $100 bonds they are exactly of the same character as the $1000 pieces. They are just as safe and are paid off exactly the same when due. Interest is paid upon them in exactly the same way.

There is no such extensive dealing in small bonds on the Stock Exchange as there is in odd lots of stock, except perhaps in the case of Liberty bonds. But almost any broker, investment banker, or bond dealer can furnish a list of $100 bonds of all descriptions. It is true that a point or two more has to be paid usually for $100 bonds than for the regular units, and a point or two less is received for them when they are sold. This is a great disadvantage, but it is offset to some extent perhaps by the fact that a person can diversify his investments far more by the purchase of ten $100 bonds than by one of the larger variety.

Not only can bonds be bought in these small units, but several firms handle mortgages also in $100 pieces. It is frequently possible to buy $100 bonds by making weekly payments. Several banks and trust companies have regular arrangements for doing this and almost any bank or trust company would be willing to lend a customer part of the sum required to buy such a bond, taking the bond itself as security until the loan is paid off.

There is much dispute as to whether it is wiser for an investor to buy $100 bonds or accumulate money in a savings bank until he has enough to buy a $1000 unit. The question is not easy to answer. Probably it is wise for an investor not to buy bonds until after he has accumulated some money in the savings bank.[1] A savings bank deposit is of course easier to convert into cash without any loss than a small bond. Many people who have sufficient funds prefer to have both a savings bank account and a few small bonds.

An excellent plan is for parents to buy $100 bonds for their children. As the children grow older it may be possible to accumulate enough to change small pieces over into a regular $1000 bond, in which case it will be more readily salable.

[1] Exception had to be made to this rule in time of war as regards Liberty bonds.

CHAPTER XI

MARGIN AND PARTIAL PAYMENT PURCHASES

THERE are three distinct ways of buying bonds and stocks: outright, on margin, and by part payments. Technically the partial payment method is merely one form of margin buying, but in practice it is often associated with a different class of buying. Stocks are more frequently bought on margin or part payments than bonds.

By outright purchase I refer to those cases where the buyer pays in full by means of cash or check, or possibly by means of other securities. He gives the broker cash or a check for the complete amount including the commission, if there is one. Margin buying is a payment on account. Instead of giving the broker an amount equivalent to the full cost of the stock, the customer hands him a check for perhaps 10% of the amount. The part payment purchase is the same except that the customer agrees to continue to make regular monthly payments on account until the full amount is paid up.

A very large part of all the stocks bought and sold in Wall Street are on margin. The buyer or seller is said to trade on a margin. The broker is said to "carry" the customer. The operation is sometimes described by the phrase "carrying stocks on account," but the word "margin" is far more common.

Margin buying and selling is much associated with speculation, and many people believe it is extremely harmful, especially when employed by ill-informed, unintelligent, and weak speculators. But whether it is a good or bad thing there seems no way of stopping it. The present machinery of margin trading might be broken up, but there would be nothing to prevent exactly the same thing springing up in another form. All the speculator would have to do would be to first borrow money from a bank and then buy the stock. The effect would be exactly the same.

Exactly similar operations are very common of course in all forms of mercantile business. Most such business is conducted on a basis of very little cash and a great deal of credit. Most business men make only part payments in cash.

Details of Margin Buying. There is a great deal of margin trading on the New York Stock Exchange. But whether a man buys outright, on margin or on part payments, the broker in any case actually buys and pays for the stock. The stock is then the property of the customer, who has all the rights in it; but if he buys on margin or part payments, he does not obtain possession of the stock. Thousands of people buy houses on margin or part payments and at once secure possession, but that is because the house is not easily removed. Stock on the other hand is easily made away with, and as long as the broker's interest in the stock is so much greater than the customer's it is necessary for the broker to retain possession.

As a matter of fact when the brokers buy the stock for a customer on margin or part payment, he pays in full, either with his own money, or what is more likely, with money he has borrowed from a bank. Thus it usually comes about that the bank has the largest interest of all in the stock, and although the stock is the property of the customer it really stays in possession of the bank. Banks lend enormous sums to brokers for this purpose, often many hundreds of millions of dollars. This money is loaned by the banks both on call and on time.

Now it may be said that a person who pays for stock in full is a conservative investor and that the person who buys on a margin is a speculator. As a generalization this is well enough, for even a moment's reflection will show the novice that an outright purchase is safer and more conservative than the other. But it must not be supposed that there is any hard and fast line between margin dealing and outright purchase.

It is easy enough to draw a line between the man who regularly "trades" on a 10% margin at a broker's office, and the outright investor who never borrows a cent. But there are innumerable gradations between these two transactions. There is the man wellknown to his broker who desires to buy a stock to-day but has not sufficient means to pay for it although to-morrow he will have a note of many thousands of dollars coming due and he will then complete the purchase.

A man of large wealth, also wellknown to his broker may wish to buy a stock at once, but may not have even a check book with him. Another man buys on a margin and the next day decides to complete the purchase in full. Again, the man who buys, for example, one hundred shares of stock on a 10% margin, and after a few days instructs his broker, as he has a perfect right to do, to reduce the account to ten shares, in which case he is no longer a margin trader at all but the outright owner of ten shares, provided of course, there has been no decline in price and he has paid all the expenses.

Finally there is the man who buys outright and the next month goes to his bank and borrows 80% of the value of the stock. He is no longer an outright owner but a margin operator. These illustrations show the danger of generalizations about margin trading and indicate also the dangers attending upon the passage of any legislation on the subject. A law might be passed forbidding margins of less than 20% but in an active market a man might have a 25% margin one moment and regard himself as both within the law and safe. The next moment his margin might be 19% and he would be outside the law even before he could write a check. In other words it is dangerous to legislate or generalize on the question of how much credit a broker may extend to a customer.

Margins and Ethics. There is nothing inherently wrong about a margin operation. It is a question of one's resources and ability to meet inevitable debts. It is not more wrong in itself to contract a margin operation in stocks than to purchase real estate on a mortgage or to contract any other debt. It is solely a personal question, to be decided on its individual merits. But unfortunately thousands of persons do operate on margins who have not sufficient resources, and consequently much loss and suffering results.

The difference between dealing in real estate and dealing in securities is illustrated by the difference in land and water—one is solid and the other liquid, one is steady and the other fluctuates. The changes in the value of real estate are gradual and external, while differences in the value of securities are constantly going on from internal as well as external causes, just as the ocean is continually in motion, with waves and tides due to its liquid state and the winds and storms which sweep over it. The daily ups and downs of the market in securities are like the waves, while the longer sweeps of market conditions correspond to the tides. To navigate the seas is more dangerous than to travel on land, and one who would sail the ocean or deal in securities must have on the one hand, a large and strong ship instead of a rowboat or canoe and on the other, plenty of backing and capital and a thorough knowledge of securities and of the currents and winds of finance. Those with small boats or little capital should stay near shore.

Advantages and Disadvantages of Margins. The reason why people buy stocks on margin is very simple. The profit is greater that way, just as the profit is greater in business if the operator is able to do a large business on a small capital. Suppose a margin buyer purchases one hundred shares of stock at $100 a share, putting up $1000 margin. If it goes up fifty points he makes $5000 (minus expenses) on a capital of $1000. This is a profit of 500% (minus expenses). But if he buys the stock outright his profit would be only 50% (minus expenses).

There is nothing dangerous about margin buying if the buyer has ample reserves. If prices fall the broker calls for more margin because the bank in turn is calling upon him for more security to protect his loan. If a customer puts up ten points margin and the stock falls ten points without the customer putting up any additional margin he will be wiped out. That is, he will then have no possession, equity, or ownership in the stock.

But obviously if the customer puts up enough more margin he is safe. It is solely a question of his reserves. It is a very common thing, however, for stock buyers to let their margins be wiped out, and thus suffer great loss.

Just how much additional margin a speculator is obliged to put up; how big a decline is necessary before he should be asked to put up "additional"; how long a period of time the broker should give the customer to comply with the call for more margin; how much notice the broker should give before selling the customer out—all these are questions the answers to which, in thousands upon thousands of cases, vary with circumstances. The courts have been called upon repeatedly to decide them.

In general brokers do not call for "additional" unless a stock has declined a full point or more. The broker must always give "reasonable" notice. In giving notice everything depends upon the credit and resources of the speculator. Unless the speculator is convinced that he has bought a worthless stock or one which will never again rise in price, he shows common sense in keeping his margin ample at all times to protect himself against any decline that may take place.

The most usual margin on the Stock Exchange, averaged over a period of years, is ten points, or $10 a share. In abnormal times much larger margins are required. Some brokers require more margin than others. Well-known, wealthy, and highly responsible persons will be allowed smaller margins than others. Highly speculative stocks are not bought on margin at all by responsible brokers. Very high-priced stocks are not safe to buy on margins. Low-priced but steady stocks do not require much margin. In buying on margin therefore, everything depends not only on the quality of the stock and its marketability, but also on the extent of its fluctuations.

The Interest Charge. The rate which a broker charges for carrying stocks for a customer, that is, for the money which he supplies him, also varies.

If a customer has a big and active account the rate may be reduced, just as a large store is able to buy goods at a lower price than a small store. Brokers try to make a profit on their "interest account"; which is the technical expression for the money they loan to customers. They usually charge a trifle more interest for money loaned than they themselves pay to the bank for it, and they are not permitted by the Stock Exchange to charge less. Customers are often charged 6%. As an offset the customer is invariably credited with all dividends and interest on the stock, no matter how small his margin, provided he is a buyer and not a seller.

Partial Payment Plan. Since the partial payment plan of buying stocks was introduced some fifteen years ago a very large number of investors have become interested in it. The idea, as already stated, is to pay something down and then a fixed sum on the first day of each month until full payment is made. With most plans full payment takes place in about one year.

This method of course is really a margin purchase because it always provides that a further payment may be required should necessity arise. The first payment, however, is usually so large that additional payments beyond the regular monthly sums are seldom asked for, but if further demands are made the customer must meet them.

The partial payment method of buying securities is sometimes known as periodical or installment investment. If properly used it is an excellent incentive to the wise saving and investment of money. It is an ingenious and at the same time simple device to enable persons with small means to purchase high-grade securities.

Questions naturally arise regarding the operation and meaning of partial payments, and like all other financial subjects people cherish numerous conceptions about it. The following letter from a woman in Detroit is typical:

> Would you give me your candid opinion whether you consider buying stocks on the partial payment plan a safe investment for a woman, particularly purchasing them through a New York broker, whose standing and reliability, on account of distance and lack of knowledge, would be hard for me to ascertain. I am very anxious to invest my savings in this manner, if I knew of some absolutely reliable house. However, I have been rather unfortunate in former investments and want to be careful. Locally there is no broker who sells on partial payment' as far as I can learn. But there are a number in New York; only I am afraid to venture without advice. I want firms that have strong financial backing and are absolutely reliable. I am afraid

of those whose names I see in the papers, not knowing anything about them.

Let us answer this question rather indirectly. Until all payments are paid the broker charges 6% on unpaid balances, but the investor receives the full dividends, or they are credited to his accounts. The payments required are usually about as follows:

	First Cash Payment Per Share	Monthly Payment Per Share
Stocks selling from \$150 to \$200 per share	\$50	\$5
Stocks selling from \$100 to \$150 per share	30	5
Stocks selling from \$50 to \$100 per share	20	5
Stocks selling from \$30 to \$50 per share	15	3
Stocks selling under \$30................	10	2

	First Cash Payment Per Bond	Monthly Payment Per Bond
\$1000 bonds...................per bond	\$100	\$50
500 bonds...................per bond	50	25
100 bonds...................per bond	10	5

It will be seen at once that a person with only \$100 can thus become the owner of five shares of the highest grade railroad, industrial, public utility, or any other established preferred or other sound investment stock, and complete the payments as he or she saves the money—\$5 a month for each share. The first or initial payment is supposed to be so large that the broker rarely feels obliged to ask for anything further before the first of the following month, and of course the safety of the operation grows as each month's payment comes in. If the monthly payments are not met the purchaser's complete ownership is merely delayed. He suffers no actual loss.

The partial payment plan can also be applied to the purchase of good bonds. An honest and conservative broker will refuse to make a purchase on this basis which he considers particularly dangerous; but naturally he is not likely to refuse to buy a stock merely because he regards it as unwise.

The broker has the right to object to the purchase of certain stocks; perhaps, because they seem too high, because their prospects appear too uncertain, because their past history is unsatisfactory, or for some other reason. The broker, however, assumes no responsibility for the stocks he does permit to be purchased.

Obviously, no one should buy stocks or bonds in this way unless fully competent to meet the payments. It is exactly like the purchase of anything else on installments—a house, for example—and naturally attended with the same possibilities of danger. One respect in which the installment purchase of stocks and bonds is safer than the purchase of a house on mortgage is that the stock-buyer can usually call for the delivery of such amounts of stock as he has actually paid for. If one has paid only $200 on five shares and cannot meet the remaining payments, he can instruct the broker to deliver two shares. This is not so easy to do with a house.

When the Plan is Good. Some people seem to have an idea that there is something special or patented about the partial payment plan that guarantees and safeguards it. Its safety depends solely and absolutely upon the circumstances of each case. These are:

1. Whether the stock or bond is a fairly secure or steady one. If it fluctuates violently in price no partial payment plan would be safe.

2. Whether the payments, or deposits, are relatively large, as such things go in Wall Street, for the particular stock in question.

3. Whether the broker is strong and has ample resources to meet inevitable declines in the market.

4. Whether the investor has the resources to pay for his stock in full, or nearly so, if the price should suffer a severe decline. This is most important of all.

A number of brokers of good standing and ample resources have built up an extensive business cater-ing to small investors and speculators who buy on part payment. They have excellent facilities for carrying on the business; they expect small accounts, and show no snobbish attitude toward them. Most of these brokers advertise extensively, and they deserve the confidence and patronage of the public.

On the other hand, scores of petty, irresponsible persons posing as brokers have adopted the partial payment plan as a device to secure new accounts. It is merely a scheme to get people to speculate with them. Investors should confine their partial payment purchases to well-known and responsible members of leading stock exchanges, or to investment bankers of known standing and reputation.

To buy stocks on partial payment from sudden new mushroom firms that are not favorably known to banks and mercantile and reporting agencies is the height of foolhardiness. This was well illustrated a few years ago in New York, when hundreds of investors bought a very strong and attractive Standard Oil stock, Ohio Oil, on the partial payment plan from a then unknown firm which later proved to be a mere device to conceal the identity of a notorious promoter who has since been sentenced to jail.

Despite the value of Ohio Oil, complete loss confronted the confiding customers.

It is just as dangerous to buy cheap, new, unproven oil, mining, and industrial stocks on the part payment plan. Almost any scheme that pretends to buy securities other than those of recognized position and standing upon a partial payment plan is a swindle. The reason is perhaps not generally known. Brokers who buy stocks for you, either on margin or on a partial payment plan, must as we have already seen obtain money from banks, with the stocks as collateral security, in order to make the purchases. But banks practically never lend on unknown and unrecognized wildcat promotions; at least they never make such loans except at very exorbitant rates of interest, which would, in turn, make it impossible for the brokers to carry the securities.

The actual method by which a certain class of brokers handle cheap wildcat stocks on margin or partial payments is extremely interesting. Most investors in such stuff—or in any stocks for that matter—incline to buy when prices are high. Such is the natural psychology. But it plays directly into the hands of the snide broker for if a stock is high in price it is likely to decline before the full number of payments are made; and if the broker does not buy until, say, the next to the last payment there is a good chance that he may be able to buy the stock at a much lower price than the customer paid for it. At the same time, the customer is paying to the broker interest on money the broker never actually borrows; and more than that the broker is having the use of the money the customer has turned in on payments.

Many customers do not hang on if a stock goes down. They get discouraged and discontinue their payments. Then, of course, the broker has made a clear profit of all the money paid in, as he has bought nothing and borrowed nothing.

Not a Patented Article. While the brokers in New York who have built up and developed the partial payment business deserve the patronage of investors, it would be absurd to pretend that they have any patent on the plan. There is hardly a broker, or for that matter a bank or trust company in the United States that will not accommodate a purchaser of securities by lending part of the purchasing price and allowing the loan to be repaid in regular monthly installments, which is all the partial payment plan amounts to.

I do not believe for a moment that it is impossible to find a Detroit broker who will thus handle business. Perhaps there are none who so advertise. But I am sure that any person in Detroit with a bank account and good standing can borrow money and repay it by the month at his own bank if he so desires. And if the woman in Detroit is afraid to deal with New York brokers, let her deal with a Detroit bank.

It seems wise to close this chapter with two actual instances of how the part payment plan works out. The first is taken from the *American Magazine* of October, 1916, the second came to me in the course of correspondence.

No. 1.

Since last March I have bought each month one or two \$100 shares of stock or \$100 bonds. This has been accomplished on an income of \$100 a month. In six months I had in my own name seven shares of stock, par value \$100, and two \$100 bonds. Each purchase was made on the partial payment plan. All of the stock and the two bonds were bought at approximately 100, with a first payment to the broker of \$25. Every month, besides the first payment on further purchases, I paid my broker \$5 on each share or bond already bought. This monthly payment plan is to be kept up until the entire purchase price of each share or bond shall have been paid in full and I own it outright.

My "books" for six months will show how I have worked out my plan.

Shares or bonds bought		Initial payt. to broker	Mo. payt. of $5 share	Amt. of note to broker	Interest on note for 1 mo.	Total payt. for mo.
Mar. 1st	2	$50	...	$150	$0.75	$50.75
April 1st	2	50	$10	290	1.45	61.45
May 1st	2	50	20	420	2.10	72.10
June 1st	1	25	30	465	2.33	57.33
July 1st	1	25	35	505	2.53	62.53
Aug. 1st	1	25	40	540	2.70	67.70

I shall have paid for each of the stocks or bonds in a little over a year's time. In the meantime, however, if they appreciate in value and I want to sell them, they are mine.

The broker holds them for me as collateral on my notes for the balance due him. I make the notes for one month's time and for the entire amount I owe him, taking up the old note and making a new one each month. The income I receive on my investments is more than double the interest I have to pay him.

This fall I will have to knock along for a few months without making any new purchases, as the monthly payment of five dollars each on those already bought, together with a few accounts that I will have to meet, will take all I can spare. In a few months, however, I shall be in a position to start buying again.

In the meantime, through dividends and interest coupons, I am getting six per cent. on my savings.

Let me add that none of my investments was made without the approval of my broker. When I started this game I went to the best-known broker in town, a man of known integrity, told him my plans, and placed myself in his hands. This is the only safe course to follow.

I recommend my system to everyone. I have gone without nothing that I really need, and I am making fair speed toward financial independence.

G. F.

No. 2.

Five young business men in a Southern city devised a plan that has proved safe, practical, and profitable.

These five men, who worked together in an office, agreed to buy five shares of stock listed on the New York Stock Exchange, and to pay for it in regular monthly installments of $20 each. Local brokers bought five shares at $120, a total of $600. When the certificate was received, the five put up $20.50 apiece, or $102.50 in cash.

Then, having previously arranged with a bank, one of them signed a note, indorsed by each of the other four, for $500, receiving from the bank $500, less the interest for one month, $2.50, and leaving the certificate of five shares of stock with the bank in addition to the note. The $600, plus a small commission, was paid to the brokers.

At the end of the month each man paid in $20.40, a total of $102, paying the bank $100, and $2 interest on a new note for $400. This plan was carried out each month until the stock was paid for. The certificate was then delivered to the five men. It was returned to the treasurer of the corporation, and one share was issued to each of the five.

It had been agreed that if any one of the five desired to sell his interest before the stock was entirely paid for, it would be offered at auction to the highest bidder among the other four. The entire transaction had been planned, not for speculation, but for the purpose of saving a few dollars a month.

In this instance, the stock paid at the rate of 8% per annum, and the dividends a little more than equaled the interest and the brokerage charges; so that at the end of the transaction each man possessed a share of good stock that could be sold on an hour's notice or held for dividends.

These five men have continued to buy stock on this basis. They have found local brokers glad to buy fractional lots for them; and the bank, to whose cashier they explained their scheme, has given them the fullest coöperation. In some purchases they have paid as little as $10 each per month. Their bank has indicated its willingness to lend 90% of the market value of good stocks listed on the Stock Exchange, provided the stock is left with it as security, and that the note is reduced by at least $10 each month and the interest is paid monthly.

Doubtless this arrangement with banks may be made in any city of the United States, making it possible for men working on salaries to buy stocks or bonds in small quantities. Small banks especially should be glad to make such an arrangement.

The club plan of buying stocks has proved a great incentive to saving, as is instanced in the case of one of the five. This man had been working for about twenty years at a fair salary and supported a small family. Aside from his household effects, he had no assets except one bank account of $200.

In a very few years since he has saved in the manner described above nearly $3000, having most of it invested in local bank stocks which have highly appreciated in value, and the balance in stocks listed on the New York Stock Exchange, which he can convert into money at an hour's notice with reasonable brokerage fees, and upon which he is receiving net about 6%.

CHAPTER XII

WALL STREET PROCEDURE AND CUSTOMS

Orders. The great bulk of the orders executed on the Stock Exchange for buyers and sellers of stocks and bonds are carried out in what is technically known as "regular way." This means that the broker will go at once into the market and make the deal. But as no actual stocks or bonds ever appear on the Stock Exchange the broker really agrees to buy and sell. His verbal agreement to that effect is a binding bargain, however.

The buying and selling brokers both report back to their respective offices (the Stock Exchange and curb are merely meeting places; brokers have no offices there) and the next day before 2.15 in the afternoon the selling broker sends the stock or bond around to the buying broker's office and receives his pay.

Orders to buy or sell are turned into the brokers by their customers in various ways. They may come by telegraph, telephone, and letter. They may be given by person, either verbally or on a little printed slip, many of which are always found handy in any broker's office. The orders given are "open" or "market" orders, which direct the broker to fill the order as he can, regardless of price; or they are "limited" orders in which the price is set. They are "day" orders, "week" orders, good only for that day or during that week; or they are "g. t. c." orders, good until cancelled or countermanded; they are "stop" orders, to be carried into effect, if possible, when the price named is reached at which time they become market orders, and must be filled as soon as may be, regardless of price. Then there are "scale" orders, to buy (or sell) at regular price intervals as the market changes.

When a customer turns in an order to a brokerage house it is at once telephoned over to the Stock Exchange to the firm's clerk stationed there at a telephone at one side of the floor upon which the brokers trade. The clerk then sends it to the firm's floor member by a messenger boy a few feet away or pushes a button which puts up the member's number on an annunciator board. When the member gets the order he goes to the proper post around which the particular stock is traded in. There he will find other brokers buying and selling the same stock. If it is "active" he may find hundreds of brokers engaged. If the stock is very quiet he may find only two or three.

To an outsider the noise made by even two or three men all shouting at once is quite bewildering. There appears to be no order or method, but in reality everything is going smoothly.

When a member secures an order to buy, he goes to the proper post where the security is dealt in, and calls out how much he desires to buy and the price he is willing to pay. The brokers who have that stock for sale gather around the post, each shouting out the price at which he will sell the quantity desired. At first the buyer and the sellers may be far from a common ground of agreement, but gradually they approach each other until some broker offers the stock at the price which is agreeable to the buyer.

The first bid and offer to buy or sell, takes precedence when it can be heard, and if there is a dispute as to which particular bid or offer was first, a committee decides. Prices are made by eighths of one per cent. of the par value, never less.[1] The fractions are ⅛, ¼, ⅜, ½, ⅝, ¾, ⅞; no other fractions are used. An eighth is the equivalent of

[1] Except in Liberty bonds, where the rate of fluctuation is 1/100.

12½ cents. Stocks are also spoken of as rising or falling one or two or any number of "points." A point is one dollar, unless the stock happens to be selling at less than a dollar, in which case a point would be one cent.

Commissions. In addition to the commission brokers, from one of whom the customer has ordered his stock, there are the odd-lot dealers, described in a previous chapter, the "floor" or "room" traders, members who buy and sell stock solely on their own account, and "floor" or "two dollar" brokers, who merely relieve overworked commission brokers having more orders than they can attend to, and the specialists. As the name implies the two-dollar broker receives $2 a hundred shares from the commission broker for helping him out.

Specialists are, as their name indicates, brokers who specialize in a few securities, or perhaps only one. Like the room traders, the two-dollar brokers, and the odd lot dealers they do not come into contact with the public. Commission brokers are the only ones which the public meets. The commission broker is quite inclined to go to a specialist rather than to another commission broker if he has inactive stocks to buy or if he is very busy. Specialists stay at one post, instead of going wherever their different orders lead them like the commission brokers.

The commissions charged to non-members, that is, to the public at large, are based on the par value of bonds, and on the selling price of stocks. Stocks selling above $10 per share and under $125 are charged at 15 cents per share; those under $10 per share, 7½ cents per share. Those at and above $125 are charged 20 cents. The commission on bonds is $12.50 per face value of $10,000. Certain bonds, such as government, state, and municipal bonds, and those which mature in less than five years, may be handled at a less rate.

Commissions on the curb are less strictly regulated and standardized, but work out about the same. As there are many low-priced stocks on the curb the average commission is probably lower. Brokers and dealers who do not buy securities for you on any exchange do not charge a commission so-called, but they sometimes charge you many dollars per share or bond more than the prevailing market price. Of course this would not be as true of the most reputable non-member brokers and dealers.

Puts and Calls. There are several other ways in which a person can operate in stocks in addition to the actual purchase or sale. "Puts," "calls," "straddles," and "spreads" were formerly much used here by stock speculators and are still extensively employed in London. They are forbidden on the New York Stock Exchange, and their use seems to be less popular than formerly.

These methods of dealing in stocks are collectively known as "privileges." They are sometimes called "true options" because the buyer has the option of carrying them out or not as he sees fit. In principle they correspond to an option on real estate, where an operator pays a few dollars down for the privilege of buying a lot two months later for say $5000.

A "put" may be defined as an option which gives the buyer of the "put" the privilege of making the seller of the "put" take a certain amount of produce or securities at a stated price within a specified time.

A "call," on the other hand, gives the buyer the right to demand a certain amount at a stated price within a specified time.

A "straddle" is a combination of a "put" and a "call." It gives the purchaser the privilege of either putting or calling the produce or securities at the named price within a given period. A "spread" is similar to a straddle, differing only in that the put and call prices are not alike.

These four privileges are used almost entirely in speculative transactions. They are simply bets upon anticipated changes in the price of the security or product which is traded in. Let us suppose that a man believes that the price of a certain stock will fall owing to some circumstances which he feels reasonably certain will be brought about. He desires to profit by this decline in price. He therefore seeks out someone and purchases a "put" by which he is given the privilege of delivering the stated number of shares of the stock within a given time at a price which is named.

Now if his judgment proves to be correct and the price of the stock falls, he can go into the open market and purchase the number of shares mentioned in the "put" at a price much below that at which the seller of the "put" has agreed to buy it. He will then take over the stock, demanding the fulfillment of the contract named in the "put," and will make the difference between the price at which he bought the stock and the price at which he sold it under the "put"—less, of course, the commission on the purchase of the securities and the amount which he paid in order to purchase the privilege. As a matter of fact in most cases this transaction is never carried out, for a put is in reality a pure gamble and settlement is made by the payment of the difference in price to the lucky speculator.

Calls are used by those who believe that the price of securities will advance above the price named in the call. They do not care to invest in stock but purchase instead this privilege which gives them the right, in case their predictions are verified, of calling for delivery of the stock at a price which is lower than that then prevailing in the open market. This, of course, enables the speculator to make a profit.

Puts and calls are rarely employed by any except the most experienced operators. As stated before they are not allowed upon the Stock Exchange.

The Ticker. The most important single agency engaged in the spreading of news in and about the exchanges is the ticker. It is a marvelous electrical typewriter worked from the headquarters of the companies that rent the tickers to subscribers. It prints a narrow strip or ribbon of paper known colloquially as the "tape." The tape is not confined to the Stock Exchange nor to the Wall Street district. It is used both by members of the Exchange and by outsiders. The New York Produce Exchange, the Chicago Board of Trade, the New York Coffee Exchange, and the New York Cotton Exchange each have tickers of their own, giving the actual prices or "quotations" made in these exchanges and distributed throughout the country.

Each system is operated by separate companies but all are conducted on a similar plan and with a common purpose. There are twenty cities outside New York that have their own ticker services. About a century ago doves were used in England to carry news and reports, but their usefulness ceased with the development of the cable, telegraph, telephone and, finally, the ticker for price movements.

The ticker seen in banks, in brokers' offices, and in hotel lobbies and cafés, is a machine about four feet high, resembling somewhat in shape and size a subway or theater ticket receiver. Within is a spool of narrow paper ribbon which feeds itself into the printer, and upon which the machine operates like a visible typewriter. After the printing by telegraphic conveyance of the first quotation the spool slowly revolves to make room for the printing of the next quotation. Near the ticker is placed a basket into which the ribbon gradually falls as the price quotations continue to come in.

As there are over fifteen hundred bonds and stocks listed on the Stock Exchange, it is inadvisable to spell out in full the name of the security dealt in. Abbreviations, often one letter in length, are employed and the number of stocks sold, together with the price are given.

Except when the market is very dull the ticker never quite keeps up with it, being from one to ten minutes behind according to the activity of the market. Only in an extremely busy market would it be ten minutes behind. Mistakes though rarely made are quickly corrected.

The sale of 700 shares of Utah Copper at $\$63^5/_8$ per share would read UT. $700.63^5/_8$. The ticker prints 225 characters per minute and 65,000 on a busy day. The prices are gathered by official quotation reporters in the employ of the Exchange (*not* newspaper reporters) who go from crowd to crowd jotting down the various deals on pads of paper. These they immediately transmit to the tickers by means of the four telegraph instruments placed at convenient points upon the floor of the Exchange.

Delivery and Transfer. The Stock Exchange rules provide in minute detail just what constitutes a "good delivery" that is, what sort of a stock certificate or bond may be delivered by a selling broker to a buying broker.

The usual method of transferring ownership in stock from one person to another is for the holder to fill in on the back of the certificate his name and that of the new owner.[1] The certificate then goes to the transfer office, or agent, of the corporation, and a new certificate with the new owner's name on the front is issued, and the old certificate cancelled. But if the first holder sells the certificate to another person and does not write the name of the new owner on the back, then the certificate is transferred, or indorsed in blank, and may pass from owner to owner indefinitely until it is worn out, without a new certificate being issued.

In Wall Street the great bulk of speculative business is carried on with these blank certificates, commonly known as "street certificates." The Stock Exchange permits delivery either by transfer or by certificate. Many of these street certificates are made out in the names of clerks, but to be good deliveries they must be indorsed and witnessed by Stock Exchange firms. Of course the loss, theft, or destruction of such a certificate causes more complications than would the loss of one still in the hands of the original owner. When dividends are declared, it is necessary for the last owner to trace his right to it back to the original owner because the corporation knows

[1] See last chapter for details.

only one owner, the one whose name is on the certificate.

A vast volume of business is conducted with these street certificates. In fact speculation would hardly be possible without them, for quick operators could not wait for the slow processes of actual transfer on a company's books.

Of course most people who buy stock outright, paying for it in full, prefer to receive a new certificate in their own name as the result of an actual transfer on the books of the company issuing the stock, rather than a blank certificate. For special reasons outright owners of stock occasionally prefer street certificates, but not the average investor. Street certificates, however, are necessary in the case of margin purchases and sales.

Bucket Shops. The greatest evil in stock speculation is the bucket shop. Although not found to so great an extent as formerly the bucketer still exists. The distinctive feature of the bucket shop consists in the fact that stocks are not usually purchased or sold for the customer, and selling and buying does not take place with a view to delivery. The intention of the customer is merely to pocket the difference between the price which he pays and the price to which the stock rises. The owner of a shop always takes one side of a deal, whether the patron realizes and consents to it or not, and in the long run comes out the winner as is the case in most gambling establishments. The dealings are simply in profits and losses, not in the securities themselves. As prices fluctuate the differences flow into the pockets of the winners. The interest of the bucket shop is always opposed to that of its patrons, as the profits of the shop are measured by the losses of the patrons.

The bucket shop usually asks only a very small margin, about 2%, so that the customer is sure to lose in any case. The man who deals in a bucket shop really has no intention of becoming the owner of stock; he merely bets upon the prices made for certain stocks upon the Stock Exchange.

Short Selling. One of the least understood practices in Wall Street, both on the Stock Exchange, the curb, and other markets for stocks and bonds as well as on those where cotton and grain are traded in, is short selling. Any market of course is made up of two classes, buyers and sellers. In the markets which we are considering, however, the sellers are themselves further made up of two clearly defined groups, those who sell what they own and those who sell what they borrow, known as short sellers.

The "bulls" are persons who expect or hope that prices will go higher. The "bears" are those who expect or hope that prices will go lower. Now a man may have owned a thousand shares of a certain stock for years, and becoming convinced that the price is about to decline, sells it out. In a sense he is a bear, but that is not the way in which the word is commonly employed. When we speak of bears we usually mean not those who sell stock which they have owned for some time but those who are borrowing stock to sell in the hope of buying it in at a lower price to repay their loan.

In fact the man who sells something which he has owned would be more probably classed as a bull who is "realizing," or "liquidating," or merely selling out. Bear and short are practically synonymous. Buyers are called "long" of stocks or "long" of the market. Those who have stocks to sell, as just stated, are simply sellers. But those who have stocks to sell which they do not own, are "short" sellers, or "short" of stocks, or "short" of the market.

The number of short sellers is very small as compared with the buyers, or bulls, or "longs." Short selling is largely confined to professional, or semi-professional operators. As a rule they alone have the resources to sell short, not to mention the courage and knowledge.

Short selling depends entirely upon the ability of the seller to borrow stock, for when he makes a short sale he must deliver stock the next day to the buyer just as if he had owned it. If he can borrow stock for the purpose, and then later buy in an equal amount at a lower price to return it to the lender he will make a profit.

Borrowing Stocks. But why should anyone be willing to lend stock?

There are a number of persons in Wall Street, and some connected with every exchange who make a business of loaning stocks to brokers who desire to put through short sales. In the New York Stock Exchange there is a post on the floor, around which those who wish to loan stock or to borrow it can gather and effect their transactions. It may upon first thought seem strange that anyone should desire to loan stock, yet such a transaction is not without its advantages.

The borrower of the stock must deposit with the lender a sum of money equal to the market value of the stock at that time. In other words, he must deposit the equivalent of its purchase price in the open market. This deposit gives to the lender the full value of the stock, and at the same time entitles him to demand at any time, upon short notice, that the stock be returned. If he had decided to borrow money upon the stock as collateral, instead of loaning it, and had taken it to a bank, he would not have secured its full value, but would have been given only 80 per cent. of the full amount at the most. He, therefore, can raise 20 per cent. more money upon his security by loaning it to brokers selling short than he can by using it as collateral for loans at a bank. It is largely because of this fact that there are usually many lenders of securities in the market.

The course of a short sale may be described as follows:

1. A sells stock, which he does not own, to B.

2. A borrows stock from C and delivers to B, who never learns that it was borrowed stock, and does not care, since he actually has possession of the stock.

3. A goes into the open market and buys an equal amount of the same stock from any broker, D, and hands it over to C, thus covering and completing the transaction.

It must be remembered that when C lends stock to A, he receives as security its full market value at the time, in a certified check, which must be kept "market to market" that is, if the stock goes up several points, C receives a check for the difference from A, if it goes down, he sends a check for the difference to A. To put it in other words, payments are made either way as prices fluctuate, in order that the lender of the stock may always have the cash equivalent of the present market value of his stock. But C pays A interest on this cash at a trifle more than the prevailing bank call-loan or demand-loan rate. He is willing to make this arrangement for reasons already mentioned.

If, however, the stock that C lends is very scarce and hard for "shorts" like A to borrow, C may pay a very low rate of interest indeed—far less than the call-loan rate.[1] He may even pay nothing at all, in which case the stock is said to loan "flat." This happens only when that particular stock is very hard to borrow. Finally, the stock may become so scarce that C, instead of paying interest, may actually receive interest. Then the stock is said to loan at a "premium." In that case, C, the fortunate possessor of stock, not only gets the full cash market value for the temporary use of his stock, but a commission for its use besides. These interest rates and premiums are expressed in percentages such as 1/32 per cent. (per day).

Dangers of Short Selling. There are certain peculiarities about short selling which set it apart

[1] Call, or demand, loans are those which banks can call in at any time.

from the purchase of stocks, and usually make it a more dangerous process. It is true that the short does not have to pay interest to the broker on money borrowed; in fact the broker usually pays the short seller interest on the amount of margin furnished him by the short. But this is the only *general* respect in which the short is better off than the long, unless of course his judgment is right and the stock goes down.

The buyer of stocks may make a bad guess. He may think that the price is going up whereas it goes down. But if dividends are paid he at least receives them. The short does not receive dividends; on the contrary he has to pay them to the person from whom he borrowed the stock.

Most important of all, however, is the danger that the short may be "caught" at any time. A buyer cannot be caught in the same sense. His stock may become worthless, but except on a very few classes of personal liability stocks, he can lose only the amount he paid for it. But a short may sell at $100 a share and the stock may go up to $600, in which case he might lose six times the amount he put in, that is, if he hangs on all the way up.

Short selling is dangerous for the seller unless there is plenty of stock available for borrowing purposes. This is because lenders of stock can call in their loans at any time. Thus the short seller may be faced with ruin unless there is another lender ready. As a matter of fact, loans of stocks are constantly being called in, renewed or placed with other lenders.

Short selling is safe only when the stocks that are sold have a large "floating supply"—in other words, only when a large proportion of the outstanding stock is available for speculation, instead of being locked up in the vaults of investors. The only kind of stock which it is really safe to sell short is that which is constantly in the hands of brokers and actually entered, in their names, on the company's books. For many years United States Steel common, was such a stock, because most of it was held by brokers, in their own names, for customers who had bought it on margin. The largest lenders of stock are brokers, and the stocks that are most available for lending are those which brokers hold on margin for speculators.

Preferred stocks, choice investment stocks and those that are very high-priced are not suitable for selling short. When shorts cannot borrow stocks at all, a corner exists.

On the curb market corners are often worked even in stocks of no value. By the aid of questionable manipulation brokers interested in putting doubtful stocks up are able to corner their opponents who have sold short. The short seller should always stick to well-known stocks which can be borrowed from reputable brokers.

Value of Short Selling. It is often argued that there is something wrong in selling short. It is often dangerous for the operator, true enough, but the weight of expert opinion holds that it is a good thing for the market to have a certain amount of short selling. It prevents prices from becoming too high. Markets in which there is short selling are usually more steady and dependable than those without this feature. Prices move in less extreme manner when short selling exists.

If there is no short selling and prices once begin to fall they tumble with great rapidity. Of course the shorts always begin to buy when prices fall in order to cover their obligations, and this buying steadies an otherwise panicky market. On the other hand the shorts often start a break in the market by their selling. However, it seems no more possible to have a sound, steady stock market without short selling than a sound government without a minority party. Short selling often goes too far. It is carried to excess, but the perpetrators themselves usually suffer the most. Besides it is far more frequent for bulls to carry the upward movement to excess than it is for bears to drive prices too low.

CHAPTER XIII

WALL STREET OPPORTUNITIES

To many people Wall Street seems to be a closed book, a complete mystery past all human understanding. To others stock market operations are synonymous with recklessness, with gambling. They approach the great market in a spirit of devil may care. "I'll take a flyer," is a common expression. There are people who "play" the market just as they would the races, and they look upon it in the same spirit.

Many people associate Wall Street, the Stock Exchange, and the stock market with the word speculation and therefore either stand in awe of it or condemn it. But almost everything in the world is speculative. There is nothing essentially mysterious or wrong about speculation. All business practically is speculation; all life is speculation.

"There is no form of human enterprise which is not in some degree speculative," says Thomas Gibson. "No great fortune has ever been honestly acquired in a reasonable length of time except through speculation. The word "speculate" means any form of transaction which contemplates, in addition to income return, a further return through accretion of principal. It may be added that comparatively few purchases of securities are ever made which do not contemplate such a profit. Rothschild's celebrated prescription for getting rich, "Buy cheap and sell dear," could not possibly be followed without involving the highest form of intelligent speculation.

Almost every sound, conservative stock and bond of great earning power that is looked upon as an investment to-day was a speculation to begin with. Such securities would not exist if someone had not speculated. This country has by no means reached the limit of its development. There is practically as much speculative money needed now as ever before.

In the first part of this book emphasis was laid upon the desirability of conservative investments, such as savings-bank deposits, life insurance, first mortgages upon real estate, Liberty bonds, municipal bonds, and other equally conservative securities. The person who invests in such things expects a sure return of principal, a minimum risk, no profit, and a moderate but certain income.

Now speculation expects a return of principal and it hopes for a regular income, but it is by no means certain that such will be forthcoming. It also hopes for a profit. In this respect it does not differ much from the great bulk of business enterprises, and there is no reason why people should not engage in speculation just as they engage in business, provided they are fitted for it to as great a degree. One is just about as risky as the other. There is little if any choice.

Ill-Fitted Speculators. The truth is that many people are fitted to engage neither directly in business nor in any other form of speculation. If they have any spare money it is better off in a conservative investment, such as a savings-bank deposit or a first mortgage.

But the great evil of speculation is not so much the risk in itself as the fact that people go into it who have no knowledge of what they are about. They have no preparation, no education or special training, as they do in business. If a man investigated the stocks of steel companies as carefully before buying them as he would investigate a partnership which buys and sells steel products before he puts his money into the firm he would probably do as well.

People do not start a business on "tips," yet they buy stocks on tips every day, and then wonder why they lose.

In his *A.B.C. of Speculation*, S. S. Nelson said: "The man who is prudent and careful in carrying on a store, a factory, or a real estate business, seems to think that different methods should be employed in dealing in stocks; nothing is further from the truth."

The great evil of speculation lies in the fact that unskilled amateurs, without adequate reserves of capital or the proper mental equipment, seek in childish manner to make money without work, mental or physical. People speculate in stocks whose minds are easily influenced, whose judgment is feeble, and who allow anxieties to prey upon them. Such people fail in stocks but they also fail in business. They should work for salary or wages and invest their money in banks, first mortgages, Government bonds, and the like.

One great difficulty with many people who buy stocks is their reckless haste to get rich. If they have a little success they immediately plunge. They try to eliminate the element of time.

Lack of Capital Fatal. An even more serious mistake is the effort to operate on insufficient capital. Countless business men fail because of insufficient capital, and the same thing is true of those who buy stocks. In the same way business men with ample capital rarely fail, and persons who buy stocks with ample reserves probably succeed fully as well as business men similarly equipped. Business men and speculators both start in in a big way too often, soon get beyond their depth, and fail. Then they blame business or speculation, as the case may be, instead of themselves.

"In thirty years of close observation," says a well-known financial writer, "I cannot name a single individual who has made and kept a large fortune on small capital in a brief period of time."

Finally the most important caution to give the stock buyer is this: to buy only sound securities. The soundness of the purchase in itself is absolutely fundamental. The stock or bond which is bought for any purpose, whether we call it investment or speculation, should have a good record, should represent a company in sound financial condition at the time of purchase, and should have a good outlook for the future.

Non-Dividend Stocks Questionable. Many people buy non-dividend-paying stocks because a larger number of shares can be had for the same amount of money. They forget that the stock will have to rise considerably more than the one which pays dividends merely in order to come out even. It is the old story of the tortoise and the hare. It is all very well for the few wise or fortunate ones who buy a cheap, non-dividend stock that soon begins to pay dividends and rushes up to high prices. But there are many cases where people have held stocks for years which did not pay dividends, and made less on them in the long run than if they had bought conservative bonds paying 5 per cent.

The desire to buy a "respectable" number of shares, an amount "worth while," keeps many people out of stocks that really are worth while. The *Odd Lot Review* once cited a case which illustrates the point:

WHAT WAS HIS PROFIT?

"A man came in here the other day," remarked the Customers' Man, "to sell a hundred Southern Railway common bought back in 1915. 'I bought this stock at 27,' he remarked. 'I see that it's over 30 now. I've carried it along and now that at last I have a nice little profit on it I think I'll let it go.'

"'How much do you figure your profit?' I asked him.

"'Why,' he replied, 'I paid 27 for the stock and here it is at 31. I make over $300 on the transaction.'

"'Are you quite sure that you do?' I asked him. 'As I remember it, you bought this stock almost exactly three years ago, paying $2700 for it. Now you are going to sell it for $3100. Apparently you are going to make $300 on the transaction. But how about the interest you have lost in the meantime? For three years your $2700 has been tied up without your getting a cent's worth of interest on it. It would have been easy enough for you to invest at that time so that you would have gotten at least 7% per annum on your money. In the course of three years that would have been 21%. 21% on $2700—which is the amount you have lost—amounts to almost twice $300—which is the amount that you have gained. As I figure it, you haven't *made* $300; you've *lost* $300.'

"He hadn't thought of it that way," concluded the Customers' Man. "He was just like the thousands of others who put their money into these non-dividend paying stocks without realizing what it costs them to do it—that the stock has to rise so-and-so-much in price each year just to keep the account even. Stocks don't always do that, do they?" he finished.

We admitted that we knew of cases where they hadn't.

Investigating Before Investing. One of the most important steps in making an investment, a speculation, or an investment-speculation (it matters little by what name we refer to the employment of money) is to investigate first. Most people buy first and inquire afterwards, thus putting the cart before the horse. Most people invest or speculate with their money in haste. But haste is the surest sign that something is wrong. Money should be laid out for earning purposes only after the most cold and careful calculation.

People buy stocks in concerns without even knowing the correct name of the company, or what state it is incorporated in, or what its earnings are. They buy from impulse, tips, and supposed hunches. I am the last to decry all hunches, but they should be allowed to influence one only after an exhaustive investigation in which every known fact is considered. Then if one wishes to act upon impulse, instinct, intuition—all very well. But most operators in stocks follow their impulses first without studying the facts.

Of course if one is slow in the stock market he may miss many opportunities, but a lost opportunity is often better than lost money. Besides there will be as many more opportunities in the future probably as in the past. They come week after week, month after month, year after year.

Of course the fakir, the swindler, the paid tipster, and unfortunately also the legitimate salesman, bent upon making a commission, all urge haste. And sad to relate the people who make undue haste in investing and speculating are usually those who have taken years to make the money which they foolishly invest so quickly.

Many investors seem incapable of reading the English language and of the arithmetical art of subtraction, which we are supposed to study early in childhood. At least it does not seem possible that people could lose so much money if they knew how to read and subtract. Why will people buy stocks and bonds without first reading everything that is to be had on the subject?

The Manuals. If you are thinking of investing in some stock or bond, usually the first thing to do is to look it up in one of the standard reference books. Perhaps the best known books of this class are Poor's *Manual*, *The Corporation Service*, and Moody's *Analyses of Securities*. You will usually find one or all of these books in a bank or broker's office. Go in and look it up yourself before you bother people with questions. Many times you can get all the information you need out of one of these big volumes. If you find enough information describing the character of the company's business, its earnings and its financial condition, the next step is to discover from your bank or some other agency the standing of the people in the company. Although the books I refer to probably contain the names of nearly one hundred thousand different companies, yet there are innumerable concerns so small or so local as not to appear therein. That fact does not necessarily condemn them, but it requires greater caution on your part.

As far as the larger and better known companies are concerned, you can get from almost any broker a little book known as the *Investor's Pocket Manual*, which gives one not only the salient facts about the company, but the range of prices of its stock. The book is entirely reliable. Practically all members of the leading stock exchanges distribute this booklet free to their customers, or it may be purchased for a nominal sum, at 124 Front Street, New York City. It is not gotten out by brokers at all, but by a publishing company, which supplies the booklet wholesale to brokers and stamps their names on the cover. In the same way, the General Service Company, of 52 Wall Street, gets out pocket manuals containing all the latest and essential information about particular stocks, such as "Coppers," Standard Oils, independent oils, etc., and sells the booklets wholesale to brokers who distribute them gratis among prospective customers. These booklets also are entirely reliable.

There are any number of reliable reporting agencies that make a regular business of getting up reports on specified securities. Among these are the Babson Service of Wellesley Hills, Massachusetts; John Moody of New York City; and the Standard Statistics Bureau of New York City. The latter concern also issues a card service giving detailed information about thousands of different companies, and in addition publishes a daily bulletin containing news clippings from about one hundred newspapers. This is probably the most convenient and comprehensive source of information, but is rather expensive for an individual. It can be found, however, in any large brokerage office.

The Bishop Service, of New York, specializes in digging out the secrets of "get-rich-quick" concerns. There are similar agencies in Boston, Philadelphia, Pittsburgh, and Chicago. Your bank will get you the names of such concerns, which charge only a few dollars for a single report.

Having once picked out a good broker or dealer in investment securities, a person should feel entirely free to consult the firm in regard to all financial subjects. Brokers maintain extensive libraries, statistical and research departments, and employ experts to answer questions. Nor must it be supposed that a broker necessarily expects a great many orders from a person who writes to him for information. Naturally the broker maintains such a department to stimulate his business, and a fair sense of the "give and take" in business would prevent a person from abusing such a privilege. But, while the broker expects the free service to render him a return, he looks at that department of his business in a broad-minded way, and gives all the service he can to small as well as to large customers.

One curb brokerage house in New York has the most extensive list of mining companies in existence. Other houses specialize on different subjects. But any firm of standing possesses facilities for quickly getting information regarding almost any security. Of course, it must be distinctly understood that a broker or dealer in bonds prefers to recommend his own particular securities, and of course the customer must bear that fact in mind and make due allowance for it. But, all the same, many excellent booklets on different financial subjects have been published by brokers and also by bankers and trust companies. By following the advertisements of such institutions a person may often learn of circulars and little books that can be secured free and which cover subjects treated nowhere else.

The *Wall Street Journal*, a daily newspaper which also has special editions in Boston and Philadelphia, is devoted entirely to financial matters, and is widely read by the larger investors. It costs $15 a year, but can be found at many libraries. For $10 a year the investor can secure the *Commercial and Financial Chronicle*, the leading weekly in this field. It contains less comment and analysis of corporations than the *Wall Street Journal*, but it has all the available news. It also furnishes without extra cost frequent supplements on special classes of securities, which serve the same purpose as a manual, or reference book. It can be found at nearly all large libraries.

The *Magazine of Wall Street*, published every two weeks, costs $5 a year, and contains a great quantity of information and analytical comment on all classes of securities. It should be read by investors in connection with the *Wall Street Journal*, if possible, and only after referring to one of the reference books. Opinions are expressed by both the *Wall Street Journal* and the *Magazine of Wall Street*, and the investor before accepting these opinions should form his own, based upon the cold statement of facts in the reference books.[1]

[1] Poor's *Manual*, Moody's *Analyses*, *Corporation Service*, *Standard Statistics* (card system).

Prices of Securities. The stock market is a sort of collective mind on business, financial, and even political subjects. It represents the opinion of hundreds of thousands of the leading experts in the country. It is the largest single body of collective commercial, industrial, and financial opinion we have. Thus it acts as a barometer.

Nowhere does the changing value of property become so quickly known to all who read. The exchange thus acts as a barometric indicator of future conditions. It anticipates or discounts the ebb and flow of prosperity. Those who trade or operate upon the exchange have in mind the future rather than the present, and their every action in buying and selling tends to discount coming events. Prices reflect, not so much present as future dividends, not so much actual as potential earning power.

As one authority says:

> The stocks and bonds of our corporations aggregate so large a proportion of the world's wealth, and represent such a variety of industries, that a marked rise or decline in the general level of prices is the surest indication, in fact an almost unfailing index, of coming prosperity or depression. And the all-important fact is, that such changes of prices on the exchange always precede, that is to say, discount the event, and do not follow, or occur concurrently.

Without an exception every business depression in this country had been discounted in our security markets from six months to two years before the depression became a reality.

But the practical question which confronts the individual buyer and seller of stocks is how to take advantage of this barometer, how to get in on it, so to speak. To begin with it must be said that most people who buy and sell stocks follow others too blindly. This tendency to buy when others buy and sell when others sell must be fought bitterly if the operator is to survive.

Of course it is extremely difficult for speculators to resist the influence of the mob. When nearly everyone is going in one direction it is hard to swim against the tide. The "lamb" blindly follows the herd. So for hundreds of years we have had speculative crazes in which prices were carried to excess, largely because of mob psychology rather than any intrinsic value.

We know that a stock, or the stock market as a whole, goes up or down because there is an excess of buying or an excess of selling orders. But why an excess of one or the other? We have already seen that the market is a great barometer, that "discounts" or anticipates the swings of trade, the ebb and flow of prosperity, and the changing value of property. Thus to draw up a rule to cover all possible movements of stocks is like finding an instrument which will predict the movements of a barometer. It is impossible.

Countless forces play upon any large market. Each share of stock bought or sold affects the whole, and who can say why a particular share is bought or sold? Each loaf of bread eaten affects the price of wheat. These considerations are what a great economist has called "the imperceptibles of commerce." Who can weigh them all? The speculator must make a careful study of a large number of conditions that are only remotely connected with the earning power of any company, in order to be able to understand the fluctuations which occur in the prices of its securities. It has been aptly said that hardly an event occurs in the world which does not have some effect upon the prices of securities.

Nevertheless the effort to foresee the future and make profit by so doing enters more or less into all business activities, and it can be proved that stock prices do not fluctuate so irregularly but that they can be foreseen, provided the speculator has the proper mental equipment and knowledge. . Those who do possess this knowledge and equipment are, however, comparatively few.

The stock market is like the ocean; no man can control it. It is full of eddies and currents. The thing to do is to watch them, to exercise a little common sense, and possibly on the wave of speculation to come in on top.

Values and Prices. Fundamentally, and always in the long run, the general trend of prices is controlled by prospective values, by the intrinsic earning power of corporations. This is only another way of saying that speculation reflects the changing values of properties. That is the reason, of course, why I laid so much emphasis earlier in this chapter upon the necessity of studying a stock or bond before buying it.

In the long run, despite the ceaseless backing and filling of price movements, "prices" and "values" tend approximately to coincide. This is always the case if the period of comparison be made long enough, but it is not always the case for short periods, and sometimes not for a year at a time. For one thing, the stock market may often be ahead of the country. That is, in its discounting process the advance in stocks may precede the wave of corporation prosperity. Thus stocks may decline when prosperity actually comes.

Besides considering the intrinsic earning power, especially the prospective earning power, of the corporation whose stock he contemplates buying, the operator in stocks must also consider the effect upon stocks in general of commodity prices, the money market in its relation to stock prices, the likelihood of panics and business depressions in general or of business booms, together with prospects for crops, and finally the manipulation of the market itself along with what is called its "technical" condition. The most basic and fundamental of all influences is the intrinsic earning power. Changing commodity prices may also prove a basic influence. The others mentioned are more or less temporary.

It is impossible in this place to discuss all these influences, as they involve pretty much the whole field of business. In a general way it may be briefly stated that rising commodity prices are supposed to imply rising stock prices and often falling bond prices. High money rates often depress stock prices, and low money rates frequently cause them to rise. Panics and depressions may of course drive down stock prices, including even those of companies little affected by the panic. On the other hand waves of prosperity may carry up even doubtful stocks. Corners, matched orders, and other similar forms of manipulation (artificial influences) are too temporary and relatively unimportant to consider at length in this volume, but they often influence stocks for the time being.

The "technical condition" of the market refers to the state of being "overbought" or "oversold." By these terms it is meant that there has been, in view of the normal supply and demand of a given security, an unusually large amount of buying on margin or an unusually large amount of short selling. If this overbought or oversold condition is discovered the opposing interest in the market may seek to compel a decline, or to compel the short interest to cover. Such a situation, known as the technical condition of the market, is rendered worse at times by the existence of (1) pyramiding[1] and (2) an unusually large number of stop-loss orders.

Theories of Price Movement. The various influences that have been described interact and produce a complex which is the price level of the moment. Now one set of influences seems to predominate, now another. One stock appears to react to this influence, another stock to that. Even where there is a close correspondence between intrinsic values, or earning power, and an

[1] The purchase of stocks on profits not yet cashed in (paper profits).

upward movement of prices, it must not be inferred that values and prices change simultaneously or in unison.

Although, as has been noted, the prices of stocks are influenced by a multitude of complicated influences, it is necessary to again mention the general principle that values tend to fix prices for periods of time long enough to eliminate temporary disturbances. Price and value continually tend to approach each other.

One of the best known classifications of price movements is that of Charles H. Dow, one of the founders of the *Wall Street Journal*, who was himself credited with being a very successful speculator. This classification is based on the principle that in the long run prices are governed by the intrinsic value of the security, and the variations therefrom are the result of extraneous influences. Dow's classification is threefold:

1. The "primary movement"—governed by intrinsic values,—which is the most powerful of the three.

2. The "secondary movement" or the "swing"—governed by manipulation, by current reports, and by the market machinery.

3. The "tertiary movement"; in other words, the daily fluctuations in the market, which are

caused by the most trifling circumstances—rumor, the operations of room traders, or some other similar influence.

The "swing" may continue for weeks or even months. Prices of securities may be artificially inflated or depressed by the operations of a powerful syndicate, or clique, the members of which have created unnatural conditions in carrying out a policy for which they have banded together.

Mr. Dow claims that the primary movement, or that based on value, lasts the longest and is ultimately the controlling factor in speculation, as it is in investment. The only speculators who have had any long-continued success in the market are those who follow the primary movement. They disregard daily fluctuations and carry their securities with a very heavy margin, or pay for them outright, waiting for the real value of the property to be reflected in the price of the security. Those who gamble upon the daily fluctuations or who stake their hopes upon the success of manipulative efforts sooner or later come to grief.

The primary movement in either direction usually covers a considerable period of time, and often it is several years before its effect is consummated. A careful study of the variation in the prices of securities over a period of years shows that at more or less regular intervals, averaging perhaps four or five years, there is a reversal in the prices. Starting from a low point, securities will advance with some degree of steadiness to a high point, and will then decline with more or less suddenness. Although during the years while the securities are running this range there will, of course, be many retrogressions, nevertheless the general tendency is unmistakably apparent. These more or less regular intervals of changes are spoken of as "cycles" of advancing or declining prices.

The late Sereno S. Pratt, in his *Work of Wall Street*, treats the subject of market movements in concise, picturesque language:

> A bicycle rider starts over a new road. The actual distance is twenty miles, but his cyclometer, at the end, registers thirty, owing to the fact that he has not traveled in a straight line, but has gone from one side to the other in an endless succession of curves in order to avoid teams and ruts, and perhaps because he has been maliciously misdirected. In a like manner, prices travel through an endless succession of daily curves or fluctuations and sometimes miss the road altogether, and, misled by manipulation, travel a long distance astray, but in the end they arrive at the true destination value.

CHAPTER XIV

HOW TO CHOOSE A BROKER

In a previous chapter we have seen that the Wall Street market although the largest is by no means the only place where money may be invested in stocks and bonds. Bonds and stocks are to be had through ordinary banks and trust companies, through so-called "investment bankers," who are in reality bond merchants or retailers, and through brokers, both those who are members of a stock exchange or curb market and those who have no such membership.

Thousands of men and women work hard, struggle to save a few hundred dollars, and then lose it all by intrusting it to irresponsible promoters, or so-called "brokers." It is no easy matter to know whom to trust, and the loss of money often reflects, not the ignorance of those who lose it, but the great difficulty in knowing which way to turn.

Don't invest money with strangers unless you first look into their standing and record. There are countless swindlers and fakers who make it a business to worm their way into the confidence of persons with money to invest. Often, too, it is a safe rule not to combine business with friendships and relationships. Many exceptions to this statement probably suggest themselves, but I think it is at least wise to check up any advice that a personal friend or acquaintance gives you on financial subjects with a wholly outside and disinterested opinion.

One difficulty that I have to meet in answering questions on the general subject of "Whom can I trust?" is that people fail to make distinctions between the trust that may safely be reposed in a reliable broker or bond dealer and the quack or faker. Once having picked out an honest, reliable broker, there is no reason why you should not send money to him and order stocks or bonds without the fear of being robbed. The great structure of business is reared on confidence. Brokers on the New York Stock Exchange buy and sell millions of dollars' worth of securities to each other with no other security than a word or a nod. But be well assured that no one is admitted to the Exchange unless his standing has first been carefully investigated.

The time to be nervous about one's relationship to a broker is usually before you have chosen him, not afterward. If he has a good standing in his community he will not knowingly or willingly cheat you. You can send him thousands of dollars and he will not run away with it, because he is receiving far larger sums every day. That is his method of doing business. But first be sure that, in the opinion of bankers, associates, and reporting agencies, he is not the kind of broker that *does run away*, because there are many that do.

Failures among Brokers. I do not mean that brokers belonging to reputable stock exchanges never fail. A few of them do, and the customers often lose heavily. There are 1100 members of the New York Stock Exchange, and the average of business failures among them during the past ten years has been less than ½ of 1% a year—of these, half settled with their creditors and were reinstated, reducing the absolute failures to ¼ of 1%. The failures of national banks during the same period of ten years was 1¼% a year, so that it will be seen that the number of New York Stock Exchange brokers that fail is very small.

Even when brokers on the best known of the exchanges fail the only customers as a rule to lose heavily are those on margin. Margined stocks, as we have already seen, remain in possession of the broker.

The average person who buys a stock or bond outright from a broker should not leave it with the broker, but should place it in a safe deposit vault.[1] However, billions of dollars' worth of stocks and bonds are left with brokers and only an insignificant fraction is ever lost or stolen. Even when a firm fails the customers usually have very little trouble in recovering stocks and bonds owned outright even though these have been left in the broker's hands.

The broker and the investment banker may often be one and the same person. The distinction, however, between the two classes is not a difficult one to understand. A broker is a mere agent, one who acts for another. The investment banker, on the other hand, does not necessarily merely buy securities on behalf of the customer, either on the Stock Exchange or off, but often virtually creates the securities and offers them for sale as a principal. That is, he buys a large block of bonds directly from the corporation, and usually secures representation on the board of directors and keeps an eye on the management. In actual practice many of the larger investment banking firms are also members of the Stock Exchange and do business both as dealers and brokers. They deal

[1] See last chapter.

in bonds on one hand, and on the other, through the Exchange membership, are enabled to buy and sell stocks.

Investment Bankers. As a rule the majority of investment bankers specialize on bonds rather than stocks, and the majority of brokers specialize on stocks rather than bonds. Probably the majority of bonds sold by investment bankers are not listed on the Stock Exchange, although many of them are. Where bonds are listed on the Exchange and active there, the bulk of the dealing in them is done by brokers rather than by investment bankers. The investment banking business is a very important one, and it is probable that the following view of themselves taken by one leading house is not at all exaggerated:

> The responsibilities of investment banking are particularly heavy. Unlike the situation of the average merchant, who can offer his commodities for the personal inspection of his customers, the bond dealer recommends to investors simply evidences of indebtedness which may be the obligations of cities or corporations located at another end of the country or even of the world. The bond business is, therefore, more truly than almost any other, founded on confidence—the investor in buying bonds must rely very largely upon the representations of the bond house offering the bonds.
>
> The bond business is in consequence one requir-

ing sound judgment, broad experience, and a trained organization for the purchase and sale of securities. Bonds must be as good at maturity, which in many cases may be ten, twenty, or even fifty years later than the date of issuance, as when first brought out.

Moreover, bonds are purchased by such institutions as savings banks, insurance companies, trustees of estates, and the most conservative of individual investors—in short, by institutions and individuals to whom a loss would be an extremely serious matter. Careless, inexperienced, and superficial dealers have, therefore, no place in the investment banking field.

The foregoing will serve to emphasize the importance of a careful selection of the investment banker. We say advisedly that for the average investor even more importance is attached to this selection than to the choice of his bonds.

The person who intends to buy mostly stocks, and especially the person who expects to do considerable buying and selling, will as a rule do better to form a connection with a reputable broker who is a member of one of the larger exchanges. Often bond dealers will not handle stocks at all, although as already stated quite a number of them do. One argument in favor of the investment banker as over against the broker is thus summarized by a large investment banking house:

Unlike the situation of the broker who simply executes orders, in most cases without assuming any

> further responsibility, our transactions do not end with the sale of our securities. Throughout the life of bonds sponsored by our organization we are in constant touch with the companies whose bonds we have handled. Any vital information, regarding earnings, etc., we pass on to our customers. Our feeling of moral obligation to our customers does not cease until every interest coupon has been paid and the principal sum returned at maturity.

It would be easy for the brokers to answer the foregoing argument. Most of the stocks and bonds handled by brokers are of a description which do not require the broker to assume any further responsibility. They already have a good market. They are well known to the public, and do not require the "sponsorship" of an investment banking firm. A large part of the bonds handled by investment bankers, even of the better class, are in new or small companies and therefore require high-class sponsorship to make them acceptable to the investor at all.

Looking up the Broker's Standing. Of course if you live in a small city or town and intend to do business with a bond merchant or broker there, you hardly need any advice from me as to how to look into his record. But most investors buy from firms at a distance, and probably the majority of investors deal with firms in New York City, while very large numbers favor those in Boston, Philadelphia, Baltimore, Chicago, and San Francisco. In choosing a distant broker or investment banker ask your local bank to write to its correspondent in the broker's city for information. This is especially easy to do in case the house you are thinking of dealing with is in New York City, for practically all banks have correspondents in the metropolis.

This is by far the best method of getting a line on any broker, and your bank will be glad to do such a small favor for you. Even if your bank account is only a few hundred dollars, do not hesitate to ask this business favor. All large investors do it, and there is no reason why you should not take the same measure of precaution. If you do not keep a bank account ask some friend who does, to get the desired information for you.

The reason I insist upon the desirability of consulting the officers of the bank where you keep your savings or checking account is that bankers learn by long experience to detect quickly the difference between a fake broker and an honest one. It gets to be a matter of instinct with bankers and trained financial experts whereas with the ordinary layman there is nothing visible on the surface to indicate the absolutely necessary distinction.[1]

If you dislike to ask too many favors of your local bank or newspaper, ask them to recommend a reporting agency. Usually these agencies will make specific reports for moderate fees, often as low as five dollars.

In practically all cases, the financial editors of newspapers will give you an honest opinion regarding brokers in their cities. Even where the newspapers accept disreputable financial advertising the financial editors themselves usually have too much personal self-respect to recommend a faker, and financial writers usually know a faker when they see him, just as bankers do.

Of course many newspapers and magazines carry the advertising of only responsible and reputable brokers and investment bankers. Many other newspapers, however, accept almost any advertising which is given to them. Study the advertising of brokers and investment bankers and learn to judge for yourself. If you compare the different advertisements you will in course of time learn to some extent, to separate the sheep from the goats.

[1] In a previous chapter it was pointed out that a bank reference does not necessarily stamp a concern as sound. It all depends upon what the reference says.

Make a habit of replying to several of the advertisements which most appeal to you. It involves no obligation on your part, and the "literature" which the various firms send you will form a still more adequate basis upon which to judge them.

An excellent plan is to write to the Vigilance Committee of the Associated Advertising Clubs of the World, 110 West 40th Street, New York City, for information concerning any broker who advertises. Usually also the president or secretary of any reputable stock exchange will furnish information to a limited extent both about his own members, and also about brokers in the same city who are not members. While naturally an official of a stock exchange must be careful what he says about either his own members or persons who are not members, he can frequently prevent innocent people from becoming entangled with disreputable promoters and sharks. Most stock exchanges carry on extensive inquiries regarding the activities of many of the get-rich-quick promoters.

Still another source of information is the secretary of the chamber of commerce or the merchants' association in the city where the broker is located. Also in cases where the advertising men are banded together they often attempt to root out frauds and will furnish information regarding the standing of brokers whom they are suspicious of. Of course the District Attorney is the most authoritative person to inquire of if you have any doubts as to a broker's honesty, but naturally he cannot draw fine distinctions among brokers who have no criminal record. The chairmen of the various Federal Reserve banks also have a great amount of information concerning brokers, investment bankers, promoters, and the like.

Of course a safe precaution in buying securities of any kind is to write to more than one firm. Ask several different brokers and investment bankers to suggest investments for a given sum, or to make other recommendations. Then compare them and take what seems the best. If more than one broker agrees on the same stock or bond that is naturally a good sign as a rule. Or send all the lists to the financial editor whom you most trust and ask his advice.

The Sign of an Honest Broker. Remember that the more responsible and reputable a broker is the less rosy the promises he will make you. It is only the irresponsible promoter and fly-by-night, mushroom broker who will make big promises. Reliable brokers are only too glad to furnish information, but they hesitate to make downright recommendations.

In choosing a broker try to avoid one who speculates heavily on his own account. Many brokers do not speculate at all, and they are to be preferred. The more capital a broker has the better. Usually you can get some line on the amount of his resources.

A broker should never be slack in calling for more margin from his customers. Curiously enough customers sometimes leave a broker because he is strict in making them put up ample margin. That is the very reason why they should stay with him, because strictness is their surest protection.

A broker should always be willing to give his client information and opinions, but whether he should actually advise a client is an open question. Avoid brokerage firms whose members are reckless, lavish, immoral, and overinclined to gamble.

It is no more difficult to open an account with a broker at a distance than with a mail-order house. One is selling brokerage service and the other is selling merchandise. There is no essential difference. A single inquiry, based on a postal card, will cause them to be interested in your investment. No investment is too small to be beneath the notice of most firms. The details of sending money, etc., will be covered in the next chapter.

CHAPTER XV

THE CARE OF SECURITIES

In sending money to a broker it is often necessary to buy a bank draft on the city where the broker is located, or a postal money order or express order. Some brokers, however, will accept your personal check. Obviously the thing to do is to write to the broker beforehand asking him how to remit, whether he will accept your check, etc.

Naturally people who have not had extensive financial experience and are not well acquainted with a broker, prefer not to remit to him before receiving the securities, no matter how reliable he may be. This difficulty can be met by arranging the transaction through your local bank. The bank will transmit the order to its correspondent in New York, Chicago, or wherever your broker is. The corresponding bank in the large city will turn the order over to a broker for execution, will arrange for the transfer of the stock into the name of the purchaser if so desired, and will deliver the certificate to him at his local bank.

In the case of coupon or bearer bonds, a firm is willing to send them with draft attached on your local bank; but it can not do so with stocks, which must be transferred. No broker, of course, would use his own money to purchase stocks transferred to the name of a stranger and send it to him, unless he is in some way guaranteed against loss. The same is true of registered bonds. The moment a broker registers a bond or transfers a stock he loses all title and interest in them.

A certificate is not transferred to a customer's name until it is fully paid for, unless the payment is guaranteed by a bank, for the reason that title passes to the party in whose name the certificate is issued, and the transfer agent would refuse to recognize any claim the broker might have for non-payment. A transfer of stock without payment in full or a bank guarantee, is the same as placing a deed for real estate on record before receiving the purchase price.

Just as you can buy stock from a broker through the medium of your local bank, so you can sell in the same way. The beginner probably feels safer to put his stock or bond in the hands of his bank to dispose of than to send it to a stranger many miles away. In any case, if you are at all uncertain how to proceed, consult both the broker by letter or wire, and the banker. It is impossible to lay down detailed rules of procedure in a book like this because customs differ in various localities, with different brokers and according to the stock and bond handled. It may be said as a general rule that a beginner feels rather more comfortable if he makes his first investments through his local bank. As he becomes more familiar with his broker he usually sees no reason why he should not deal directly through him.

Reliable brokers always seek to expedite their orders as much as possible and will explain delays. Deliveries of inactive, outside, and unlisted stocks, especially of mining shares, are much slower as a rule than those of listed stocks. The New York Stock Exchange requires every corporation whose stocks and bonds are listed to maintain a transfer office in New York City. The curb, however, has no such requirement and delays in curb stocks are naturally more frequent.

In case you should be unfortunate enough to deal with an irresponsible broker who does not send you your stock or your money as the case may be, it usually happens that he can be hurried up by reporting any unreasonable delay to the District Attorney of the county, which is always the law officer who has such matters in charge.

In the case of reputable investment bankers and stock exchange brokers delay in remitting securities is relatively very rare. Of course in the case of stocks there is more delay if the transfer books of the corporation are closed than if they are open.[1] It also naturally takes longer to secure a registered bond than a coupon bond.

Transferring Stock. In Chapter XII, on Wall Street Procedure and Customs, reference was made to the fact that most investors prefer to have stock transferred on the books of the company issuing it to their own name. It is usually best to have a certificate transferred to the buyer's name as he then becomes a stockholder of record and receives all literature and reports sent out by the company; and if the stock is a dividend payer it saves confusion and a possible loss through inability to collect from the party in whose name the certificate stands.

When you buy stock the broker always attends to having it transferred to your name, and then of course it is your property and no one else's. In requesting the transfer of certificates the first names should be given in full, as many transfer

[1] Corporation transfer books close for a definite period of time for the annual meeting and often they are closed for several days at each dividend period to allow for the correct issuing of dividend checks. No stocks can be transferred while the books are closed.

offices refuse to issue certificates in initials. When the time comes that you want to sell that stock be very careful to endorse it properly before sending it to your broker to sell.

The following general facts about endorsing certificates should be borne in mind. The customer should not fill in any of the blanks of the assignment on the reverse side. If the certificates are in his name, he should simply endorse his name on the back of the certificates in the space provided, exactly as it appears on the face of the certificates, without abbreviations or additions; and some person, preferably male, must witness the signature and sign his name on the line indicated for that purpose.

If the certificates are in the name of another person and endorsed in blank by such person and the signature guaranteed by some responsible broker or banker, they may be deposited with a broker without any further endorsement.

A stock in the name of a woman (unless the word "Miss" is a part of the name on the face, and the certificate is so signed) must have a notary's acknowledgment showing that the lady is single, married, or a widow, as the case may be; if married, her husband must also assign the certificate, and the notary so state in his acknowledgment.

A leading authority gives further instructions for women as follows:

Certificates should always be made out in one's full Christian name. In the case of a married woman "Mrs." should be prefixed, and in the case of an unmarried woman "Miss." In case of marriage, or remarriage, a new certificate should be issued at once with the change of name. To have this done, fill in the transfer blank on the back, as follows:

"Mrs. Maria Roe, formerly Maria Morton." Sign the transfer blank the same as on the front, "Maria Morton" in this example, and forward for transfer. A woman must never use her husband's Christian name in the issuing of a certificate: for instance, it should be issued to Mrs. Maria Roe, not Mrs. John Roe.

A very important reason for transferring stocks to the name of the owner is the comparative ease of recovery in case of loss, destruction, or theft. Stocks and bonds are nearly always sent by registered mail, and few are lost in the mails. But many are lost in other ways. In the case of blank or street certificates of stock, loss, destruction, and theft often raise very serious questions. If you should lose a share of stock or a bond notify at once the broker from whom you made the purchase and in case of stock, the transfer office of the company, instructing them to stop further transfer on that certificate.

Ex-Dividend. In buying a stock it is always important to know whether the buyer is entitled to the nearest dividend to be paid, that is, whether the stock is "dividend on," or "dividend off," this latter expression being more commonly known as "ex-dividend." Every corporation sets a date beyond which buyers of its stock do not receive the nearest dividend paid and it is important of course for an investor not to buy just after he has missed a dividend, so to speak. The ex-dividend dates are published in financial newspapers, are usually sent on a postal card to stockholders, and can always be had from any broker.

Flat and with Interest. The question of whether a stock buyer gets the nearest dividend is naturally of little importance if the rate of dividend is small, but it may be a serious matter if the rate is large. Naturally the most profitable method, other things being equal, would be to buy a stock just one or two days before it sells ex-dividend. But this is usually offset by the fact that the price of the stock logically tends to rise prior to the ex-dividend day, and also often falls off immediately after. If a stock fails to decline right after the dividend goes off it is a sign that the demand for the stock is so great that buyers do not bother over a matter of a few dollars in dividends.

Persons who buy stocks for investment, however, should take care not to make their purchases immediately after a dividend is off, because they may have to wait three or six months to get another. There is no adjustment of the dividend between buyer and seller on most stocks, except as already stated, the tendency of the market itself is to discount a dividend, either on or off. In the language of Wall Street stocks always sell "flat."

Bonds on the other hand always sell "with interest," or with "accrued interest," both of which phrases simply mean that the interest is always adjusted as between buyer and seller, so that it makes no difference when a person buys a bond. No matter when a corporation may pay interest on its bonds you will receive only your proportionate share of the interest on whatever date you make the purchase. This is directly opposed to the method employed in stock purchases.

Suppose you purchase a bond on December 29th and on January 1st the company pays interest for the six months ended December 31st. You will receive the full six months' interest because you are in possession of the bond, but when the bond is sold to you on December 29th the broker will add to your bill a charge for the proportionate amount of interest which does not belong to you. Many investors are puzzled by this item on their bill from bond houses, but if they will figure how many days of the nearest interest coupon they are really entitled to they will quickly understand the reason.

Yield. Any mortgage, bond, or stock which is purchased at its face, or par value, and which bears interest or dividends, gives a "net yield," or "net return," or "true income return" exactly equal to the rate of interest or dividend. Thus a $1000 bond bought at $1000 and bearing 5% interest gives a "yield" of 5%, no matter whether the bond runs for one or a thousand years.

In the case of a stock bought either above par (at a premium) or below par (at a discount) the method of finding the yield, or true income return, is simply to divide the price into the rate. If you pay $49 for a 4% stock it yields 8.16%. If you pay $149 for a 4% stock it yields 2.68%. The result is arrived at by simply dividing 49 into 4 and 149 into 4.

But in the case of a bond the element of time comes into play, that is, the number of years before the bond is to be paid off. Suppose you bought the bond at $965, and it is to be paid off at $1000. It is obvious that you are really receiving more than 5%. The only way you can discover exactly what return you are receiving is to add to the 5% a year, or $50, a sum that, placed in a bank at compound interest, will exactly equal $35 (the difference between $1000 and $965) at the end of the life of the bond.

If the bond runs for one year only, it is clear that the return on your money is $85, or 8½%. If it runs for two years, the return per year will naturally be less. Therefore, the longer it has to run the less gain you receive by buying under par. To discover just how much to add to the nominal interest of 5% each year is determined by algebraic formulas which have been worked out by mathematicians. In practice, dealers in bonds rarely work these formulas out, but employ books containing bond tables, from which the desired information may be almost instantly obtained. Such books may be purchased for a few dollars.

Suppose the bond that you purchase at 96½, bearing 5% interest payable twice a year, comes due in twenty-five years. What is the real return on your money—the actual or net return, or, to use the technical expressions, the "yield" or the "basis"? According to the bond tables, the yield is 5¼%. In the same way, if you buy a bond above par you must set aside each year a certain amount to make up for the premium. That is, you must kill the premium, or amortize it. If you buy a bond at 110 at 5% for one year, you evidently actually lose $50, or 5%. But if you buy a 5% bond at 110, to run for thirty years, that premium of 10% is spread over so much time that the loss is small.

In actual practice, an investor does not lay aside anything. The same result is obtained by turning to the bond tables and finding out what the yield is. In other words, if you buy a 5% bond at 110, to mature in thirty years, instead of receiving 5% a year you say that you receive 4.40% a year, thereby automatically writing off the premium. The bond tables are, of course, built on the assumption that the bond will be held until it comes due.

Keeping Bonds and Losing Them. "What shall I do with the darned thing after I get it?" asked a poet who had been persuaded to subscribe freely for Liberty bonds. His fix was that of many people who have become acquainted with securities for the first time in their lives. For a bond or stock is not a thing to be left about the house carelessly, like an old hat or yesterday's newspaper. Buying a safe security is the most important step in becoming an investor; but the annoyance that results in having the piece of paper burned up or stolen is so great that it must be guarded against with real care.

Of course it is better to own a safe bond and have it destroyed, lost, or stolen than to own an investment of poor grade and keep it physically safe; for there is nearly always some method of replacing lost or destroyed securities. Yet the time and trouble to be saved by not losing securities are so great now, when some twenty or thirty million people have bought Liberty bonds, that the subject becomes one of almost major importance. There is not much danger that readers of this book will fall into the error which one of two women made. Said the first woman:

"My husband says we must economize; all his securities are falling every day."

"Ours are all right," was the reply. "We keep them in a safe-deposit vault."

There are only two ways of fully appreciating the loss of time and the vexation and expense incident to the loss of securities. One is to go through the experience personally, and the other is to watch the machinery of Wall Street when handling this daily nuisance. Nearly every day the stock ticker carries a notice of lost securities. Occasionally there is notice of stolen securities. But the great majority of notices refer to those which have been misplaced. Most of these turn up eventually, but often not until months have elapsed. It is a fairly common experience for messenger boys to drop bonds or stocks out of their wallets. In at least two instances street sweepers have found valuable stock certificates. For a week two clerks in a brokerage office spent their entire time in hunting for a ten-thousand-dollar certificate that had disappeared. Several weeks later it became necessary to rip up all the bags of refuse on one of the docks of the street-cleaning department; and in one of the bags the stock was found!

Nearly all securities that disappear are lost through carelessness. But this form of neglect means that in every brokerage office, bank, and trust company in New York City elaborate lists of lost and occasionally stolen and forged securities must be kept at the window of one of the tellers. He must detect at a glance a lost, stolen, or forged certificate; and the amount of information along this line that several men must carry in their heads is truly amazing.

But carelessness is a common trait elsewhere, as well as in the great stock-market centers. It pervades the whole business of security ownership. In safe-deposit vaults there is far less danger of loss through theft than from carelessness. Men carefully lock up blotters in their boxes and leave their bonds on the table. In several such places waste-paper baskets are taboo, because so many patrons drop their securities into the baskets by mistake.

Carelessness on the part of individual investors takes two forms: one is to lose stocks and bonds or leave them lying about; another is to fail to read them. Millions of dollars of government bonds that long ago stopped paying interest because they had been called in are still out. The same statement holds true of corporation bonds. One of the most trying petty annoyances a corporation treasurer has to deal with is to get people to turn in securities that have been called for payment. Such indifference may be excusable in cases where bonds are called before their regular maturity. Extensive advertising fails to reach owners in distant places. But there would seem to be no excuse in cases where bonds are paid off at the regular maturity date, printed in large type on the bond itself.

Of course there are a few eccentrics who collect matured bonds and never present checks for payment. One old man collected three thousand checks for payment of interest and dividends on bonds and stocks. He had collected them for forty years, and they amounted to fifty thousand dollars; but he had never cashed in. In 1912 there were ten thousand interest checks on government bonds issued during the Spanish-American War that had not been presented for payment. Then, too, failure to present matured bonds or interest checks often means that the securities have been lost, or that the owners have died or disappeared without their securities being discovered.

But, after making every allowance for eccentricity and accident, it is a safe general statement that thousands of persons never take the trouble to read the face of the bonds they purchase. Most of the readers of this chapter probably know the difference between a coupon bond and a registered bond. In the case of registered bonds the issuing corporation or government has the name of the owner and mails him the interest checks. Coupon bonds have small interest checks attached to the bond, each one dated; and as the date comes round the coupon is cut off and deposited in a bank just like any other check.

Most coupon bonds are "registerable," that is, may have the name of the owner inscribed thereon, thus insuring safety in case of theft. A stolen "unregistered" coupon bond is difficult of recovery from one who has bought it. A registered bond, however, is easier of recovery, and if not recoverable, may be replaced by another, under proper conditions, including cost of issue (which is small) and deposit of a proper indemnity bond.

Lost coupons are seldom recovered; they are, at payment dates, almost cash. Coupon bonds usually sell for a slightly better price than registered bonds of the same issue, because coupon bonds are almost like cash, and are deliverable without the delay that characterizes registered bonds. They are also less liable to be taxed than registered bonds.

Nothing is more common than for investors to cut off the wrong coupon, though each one is plainly dated in large type. Another common practice is the cutting off of all coupons at once. Neither of these pieces of carelessness does much harm, but often causes annoyance. Bonds that run for many years cannot conveniently hold all the coupons, because the sheet would be so large as to be unwieldy. In such cases a notice is printed on the bond, which, let us say, matures in 1980, stating that on July 1, 1940, an additional sheet of coupons will be supplied by the treasurer of the company upon presentation of the bond.

But, despite this printed notice on the face of the bond, it has frequently happened that months or even years after a customer had purchased a bond he would rush into his broker's office, red in the face, and demand to know what had become of the coupons for 1940 to 1980! At the treasurer's office of a large Western railroad I was told that hardly a month passes when bondholders do not write or call to discover why forty years of coupons are missing. If my memory is correct, it has become necessary for this railroad to specially mark the paragraph that provides for the issuance of additional coupons in 1940.

There are four ways of caring for bonds: (1) Hide them. (2) Put them in a tin box. (3) Put them in the care of a bank, trust company, banking, or brokerage firm. (4) Put them in a safe-deposit vault.

The surest way to lose a bond is to put it in an unused fireplace, an old sofa, an eight-day clock, in one's clothing, or behind the mirror. In the panic of 1907 a man pinned three thousand dollars in bills on the inside of one of his trousers' legs, and lost one thousand dollars while walking. The loss of bills or securities that have been hidden supposedly in safety is one of the commonest experiences. The elements of change, chance, accident, and carelessness play an enormous part in disturbing hidden articles. An entire chapter or series of cases can be collected concerning Italians who have hidden all their savings in old stoves and lost all because fires were lighted in their absence.

Some private investors have iron safes; but this method of protection is comparatively rare. A common and fairly safe method is to use a tin box and make several duplicate lists of the securities placed therein. The list should include every detail, such as the exact name of corporation and bond issue, number of bond, amount, rate of interest, and so on. One list should be placed in the box and another kept in an entirely different place —in another building, if possible. Of course a thief may carry off a tin box; but the chance of theft is insignificant compared with that of loss through fire or sheer carelessness. The trustee of a large estate in New England swept a two-hundred-and-fifty-thousand-dollar bond off his desk into the waste-paper basket and it was burned up in a furnace. The company that issued the bond had to apply to the state legislature for authority to issue a duplicate.

More and more banks and trust companies are assuming the safe-keeping of securities. Many of them have agreed to care for Liberty bonds up to a thousand dollars for nothing. Naturally, persons who have no bank accounts would hesitate before accepting favors from a bank. But those who have a bank connection, and whose total ownership of securities is so small as to make the payment of even a small fee impossible, need feel no hesitance in asking their banks to care for a fifty-dollar or a hundred-dollar Liberty bond.

But there are great numbers of persons who have, besides one or two bonds or shares of stock, a deed, a life-insurance policy, a fire-insurance policy, perhaps a mortgage and valuable family papers. For such the economy in going without a really safe place for their papers seems misplaced and petty. Banks and trust companies not only will keep the papers safe but will attend to many details that individuals overlook or of which they are ignorant. One large trust company has published a seventy-five-page book devoted solely to describing its services in the safe-keeping of securities. Banks and trust companies, besides safe-keeping securities, collect and credit dividends, attend to income-tax details, watch for called bonds, rights to convert bonds into stock, rights to subscribe to new bonds or stock, opportunities to sell bonds at a premium to sinking funds, appointment of receivers and reorganization committees, and like developments.

Naturally, no sensible person would leave securities with a bank without getting a receipt for them; and it is doubtful whether any bank would accept objects for safe-keeping without giving a receipt. The advantage claimed for this method of safe-keeping securities over placing them in a safe-deposit vault is that an equal element of safety is provided, along with more ready access. When a company rents out safe-deposit boxes its only duty is to keep the box inviolate and permit access to it only by duly authorized persons. The routine work of depositing or withdrawing securities, detaching and cashing coupons, and gaining information that can be had only from an examination of the securities devolves directly upon the boxholder or his accredited agent. But banks and trust companies will do all this work for the owner, making it unnecessary for him to go near the place.

There is very little danger in leaving securities with banks and trust companies. Persons who have left securities merely for safe-keeping are naturally the first creditors when such an institution fails. It is doubtful whether any substantial losses from failure have ever taken place. Many wealthy men leave securities with brokers in the same way. If the brokers are strong and sound, this is well enough; but the practice is not to be recommended to the uninitiated.

One great advantage of leaving one's securities with a bank is the fact that a bank or trust company can provide so many different financial services. Most of them will buy the bond for you, in the first place. You pay for it with a check on the bank. Possibly you will borrow the money from the bank, which also will keep the bond for you and collect the interest.

There is no intention in this chapter to minimize the great services performed by safe-deposit companies. In the large cities there are separate companies engaged in this business; and in smaller places banks and trust companies rent out boxes, to which only the owner and his accredited agents have access, as well as accept securities, which are placed in their own vaults and for which receipts are given. Undoubtedly many persons have a more secure feeling when they know that their investment and private papers can be seen only by themselves. Usually safe-deposit boxes can be opened by only two keys—one owned by the renter of the box, and the other by the employees of the bank or safe-deposit company. Often boxes can be rented for as low as $5 a year.

The principle of the safe-deposit vault seems to have been employed in ancient Babylon and in Egypt; but Rome first developed the institution, the corporation being called the Roman Safe-

Deposit Vault. Slaves guarded it inside and out—those inside being locked in.

Safe-deposit vaults have developed to a point where they defy fire and earthquake. After all great fires and earthquakes in large cities the safe-deposit business has boomed, because the contents of the vaults were found to be safe. In one large Italian city this business did not start until after the earthquake in Messina. Millions of cash were buried beyond recall in that disaster, and the business men of Milan immediately established a safe-deposit system.

All the safe-deposit vaults of San Francisco appear to have escaped injury; and many other similar cases might be cited. Many hundreds of millions of dollars in securities were contained in vaults under the old Equitable Building, in New York City, which was burned several years ago. It became necessary to suspend the rules of delivery on the Stock Exchange until the securities could be examined; but, after several days, it was found that no damage had been done.

The Biblical injunction, "Lay not up for yourselves treasures upon earth, where moth and rust doth corrupt, and where thieves break through and steal," does not apply to modern bank and safe-deposit vaults. So do not take any chances of losing your investments in the actual physical sense of losing the certificates. It is difficult to choose a safe investment, to begin with; but with a little care it is easy to keep after you have it, and to save yourself confusion, nuisance, and expense.

Appendix

LIST OF FINANCIAL PUBLICATIONS USEFUL TO INVESTORS

Commercial and Financial Chronicle, New York City: Everyone should read it who wants to keep track of weekly developments in the financial world.

Financial World, New York City: This is a popular paper and is one of the best for the inexperienced investor to read. It is strong in its exposures of get-rich-quick swindlers and illicit propositions in general.

Wall Street Journal, New York City: Chiefly a stock market paper that gives considerable news about bonds and a pretty good commercial department.

Boston News Bureau, Boston: Especially useful for various Boston stocks, particularly the coppers. Like the *Wall Street Journal*, it has interesting editorials.

United States Investor, Boston: Useful for its treatment of New England specialties and New England Banks and for its farm mortgage department.

Economist, Chicago: An authority on Chicago securities and general real estate.

Magazine of Wall Street, New York City: Useful information about securities.

Commerce and Finance, New York City: An interesting feature publication on finance, setting forth the point of view of able writers.

Annalist, New York City: Contains excellent statistics on business and economic subjects.

Rand McNally Bankers' Magazine, Chicago: Useful for bank news.

Trust Company Magazine, New York City: Its name indicates the field in which it operates.

Bradstreet's, New York City: Useful for its summaries of business conditions and statistics.

Dun's, New York City: Similar to Bradstreet's.

Investment News, San Francisco: Specializes in Pacific Coast securities.

Oil Trade Journal, New York City: Gives the important news about oil and oil companies.

Real Estate Record and Guide, New York City: The authoritative paper on New York real estate.

LIST OF REFERENCE WORKS FROM WHICH INFORMATION IN REGARD TO SECURITIES MAY BE OBTAINED

Moody's Manual. Three volumes, each published annually. Vol. I, Steam Railroads. Vol. II, Public Utilities. Vol. III, Industrials. Moody Manual Co., 33 Broadway, New York.

Moody's Analyses of Investments. Three volumes, each published annually. Vol. I, Steam Railroads. Vol. II, Public Utilities. Vol. III, Governments and Municipals. Moody's Investor's Service, 35 Nassau St., New York.

Manual of Statistics. One volume, published annually. Railroads, Public Utilities, Industrials, and Municipals. Manual of Statistics Co., 38 Park Row, New York.

Investor's Pocket Manual. Published monthly. All leading stocks in all exchanges. Only 25 cents a copy. The Financial Press, 116 Broad St., New York.

The Copper Handbook. An authority on Copper Stocks. The back files also contain information on defunct companies. Published at Houghton, Mich.

Standard Statistics, Card File. To be found in many banks and brokerage offices. Published at 47 West St., New York.

RATE OF

ON DIVIDEND PAYING

Price %	2%	3%	4%	5%	6%	7%	8%	Price %	2%	3%	4%	5%	6%	7%	8%
20	10.0	15.0	20.0	25.0	30.0	35.0	40.0	50	4.0	6.0	8.0	10.0	12.0	14.0	16.0
21	9.5	14.3	19.1	23.8	28.6	33.3	38.1	51	3.9	5.9	7.8	9.8	11.8	13.7	15.7
22	9.1	13.6	18.2	22.7	27.3	31.8	36.4	52	3.9	5.8	7.7	9.6	11.5	13.5	15.4
23	8.7	13.0	17.4	21.7	26.1	30.4	34.8	53	3.8	5.7	7.6	9.4	11.3	13.2	15.1
24	8.3	12.5	16.7	20.8	25.0	29.2	33.3	54	3.7	5.6	7.4	9.3	11.1	13.0	14.8
25	8.0	12.0	16.0	20.0	24.0	28.0	32.0	55	3.6	5.5	7.3	9.1	10.9	12.7	14.6
26	7.7	11.5	15.4	19.2	23.1	26.9	30.8	56	3.6	5.4	7.1	8.9	10.7	12.5	14.3
27	7.4	11.1	14.8	18.5	22.2	25.9	29.6	57	3.5	5.3	7.0	8.8	10.5	12.3	14.0
28	7.1	10.7	14.3	17.9	21.4	25.0	28.6	58	3.5	5.2	6.9	8.6	10.3	12.1	13.8
29	6.9	10.3	13.8	17.2	20.7	24.1	27.6	59	3.4	5.1	6.8	8.5	10.2	11.9	13.6
30	6.7	10.0	13.3	16.7	20.0	23.3	26.7	60	3.3	5.0	6.7	8.3	10.0	11.7	13.3
31	6.5	9.7	12.9	16.1	19.4	22.6	25.8	61	3.3	4.9	6.6	8.2	9.8	11.5	13.1
32	6.3	9.4	12.5	15.6	18.8	21.9	25.0	62	3.2	4.8	6.5	8.1	9.7	11.3	12.9
33	6.1	9.1	12.1	15.2	18.2	21.2	24.2	63	3.2	4.8	6.4	7.9	9.5	11.1	12.7
34	5.9	8.8	11.8	14.7	17.7	20.6	23.5	64	3.1	4.7	6.3	7.8	9.4	10.9	12.5
35	5.7	8.6	11.4	14.3	17.1	20.0	22.9	65	3.1	4.6	6.2	7.7	9.2	10.8	12.3
36	5.6	8.3	11.1	13.9	16.7	19.4	22.2	66	3.0	4.6	6.1	7.6	9.1	10.6	12.1
37	5.4	8.1	10.8	13.5	16.2	18.9	21.6	67	3.0	4.5	6.0	7.5	9.0	10.5	11.9
38	5.3	7.9	10.5	13.2	15.8	18.4	21.1	68	2.9	4.4	5.9	7.4	8.8	10.3	11.8
39	5.1	7.7	10.3	12.8	15.4	18.0	20.5	69	2.9	4.4	5.8	7.3	8.7	10.1	11.6
40	5.0	7.5	10.0	12.5	15.0	17.5	20.0	70	2.9	4.3	5.7	7.1	8.6	10.0	11.4
41	4.9	7.3	9.8	12.2	14.6	17.1	19.5	71	2.8	4.2	5.6	7.0	8.5	9.9	11.3
42	4.8	7.1	9.5	11.9	14.3	16.7	19.1	72	2.8	4.2	5.6	6.9	8.3	9.7	11.1
43	4.7	7.0	9.3	11.6	14.0	16.3	18.6	73	2.7	4.1	5.5	6.9	8.2	9.6	11.0
44	4.6	6.8	9.1	11.4	13.6	15.9	18.2	74	2.7	4.1	5.4	6.8	8.1	9.5	10.8
45	4.4	6.7	8.9	11.1	13.3	15.6	17.8	75	2.7	4.0	5.3	6.7	8.0	9.3	10.7
46	4.4	6.5	8.7	10.9	13.0	15.2	17.4								
47	4.3	6.4	8.5	10.6	12.8	14.9	17.0								
48	4.2	6.3	8.3	10.4	12.5	14.6	16.7								
49	4.1	6.1	8.2	10.2	12.2	14.3	16.3								

INCOME TABLE

STOCKS AT VARIOUS PRICES

Price %	4%	5%	6%	7%	8%	9%	10%	Price %	4%	5%	6%	7%	8%	9%	10%
76	5.3	6.6	7.9	9.2	10.5	11.8	13.2	106	3.8	4.7	5.7	6.6	7.6	8.5	9.4
77	5.2	6.5	7.8	9.1	10.4	11.7	13.0	107	3.7	4.7	5.6	6.5	7.5	8.4	9.3
78	5.1	6.4	7.7	9.0	10.3	11.5	12.8	108	3.7	4.6	5.6	6.5	7.4	8.3	9.3
79	5.1	6.3	7.6	8.9	10.1	11.4	12.7	109	3.7	4.6	5.5	6.4	7.3	8.3	9.2
80	5.0	6.3	7.5	8.8	10.0	11.3	12.5	110	3.6	4.6	5.5	6.4	7.3	8.2	9.1
81	4.9	6.2	7.4	8.6	9.9	11.1	12.3	111	3.6	4.5	5.4	6.3	7.2	8.1	9.0
82	4.9	6.1	7.3	8.5	9.8	11.0	12.3	112	3.6	4.5	5.4	6.3	7.1	8.0	8.9
83	4.8	6.0	7.2	8.4	9.6	10.8	12.1	113	3.5	4.4	5.3	6.2	7.1	8.0	8.9
84	4.8	6.0	7.1	8.3	9.5	10.7	11.9	114	3.5	4.4	5.3	6.1	7.0	7.9	8.8
85	4.7	5.9	7.1	8.2	9.4	10.6	11.8	115	3.5	4.4	5.2	6.1	7.0	7.8	8.7
86	4.7	5.8	7.0	8.1	9.3	10.5	11.6	116	3.5	4.3	5.2	6.0	6.9	7.8	8.6
87	4.6	5.8	6.9	8.1	9.2	10.3	11.5	117	3.4	4.3	5.1	6.0	6.8	7.7	8.6
88	4.6	5.7	6.8	8.0	9.1	10.2	11.4	118	3.4	4.2	5.1	5.9	6.8	7.6	8.5
89	4.5	5.6	6.7	7.9	9.0	10.1	11.2	119	3.4	4.2	5.0	5.9	6.7	7.6	8.4
90	4.4	5.6	6.7	7.8	8.9	10.0	11.1	120	3.3	4.2	5.0	5.8	6.7	7.5	8.3
91	4.4	5.5	6.6	7.7	8.8	9.9	11.0	125	3.2	4.0	4.8	5.6	6.4	7.2	8.0
92	4.4	5.4	6.5	7.6	8.7	9.8	10.9	130	3.1	3.9	4.6	5.4	6.2	6.9	7.7
93	4.3	5.4	6.5	7.5	8.6	9.7	10.8	135	3.0	3.7	4.4	5.2	5.9	6.7	7.4
94	4.3	5.3	6.4	7.5	8.5	9.6	10.6	140	2.9	3.6	4.3	5.0	5.7	6.4	7.1
95	4.2	5.3	6.3	7.4	8.4	9.5	10.5	145	2.8	3.5	4.1	4.8	5.5	6.2	6.9
96	4.2	5.2	6.3	7.3	8.3	9.4	10.4	150	2.7	3.3	4.0	4.7	5.3	6.0	6.7
97	4.1	5.2	6.2	7.2	8.3	9.3	10.3	155	2.6	3.2	3.9	4.5	5.2	5.8	6.5
98	4.1	5.1	6.1	7.1	8.2	9.2	10.2	160	2.5	3.1	3.8	4.4	5.0	5.6	6.3
99	4.0	5.1	6.1	7.1	8.1	9.1	10.1	165	2.4	3.0	3.6	4.2	4.8	5.5	6.1
100	4.0	5.0	6.0	7.0	8.0	9.0	10.0	170	2.4	2.9	3.5	4.1	4.7	5.3	5.9
101	4.0	5.0	5.9	6.9	7.9	8.9	9.9	175	2.3	2.9	3.4	4.0	4.6	5.1	5.7
102	3.9	4.9	5.9	6.9	7.8	8.8	9.8	180	2.2	2.8	3.3	3.9	4.4	5.0	5.6
103	3.9	4.9	5.8	6.8	7.8	8.7	9.7	190	2.1	2.6	3.2	3.7	4.2	4.7	5.3
104	3.9	4.8	5.8	6.7	7.7	8.7	9.6	200	2.0	2.5	3.0	3.5	4.0	4.5	5.0
105	3.8	4.8	5.7	6.7	7.6	8.6	9.5								

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