

The Essential Features of Securities

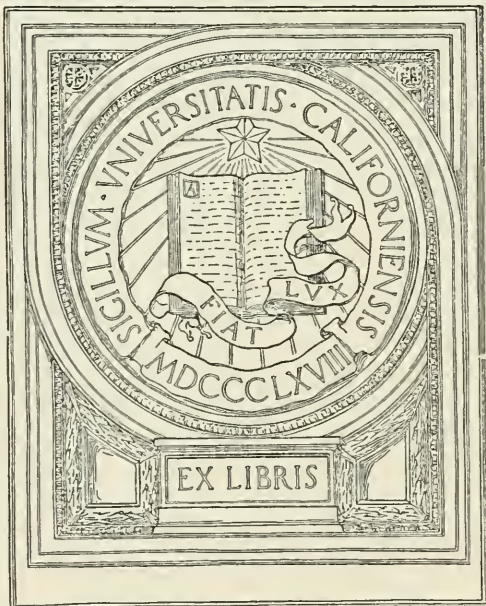
by

Byron W. Holt, A.B.
and
Arthur Williams, Jr., A.B.



UC SOUTHERN REGIONAL LIBRARY FACILITY

UNIVERSITY OF CALIFORNIA
AT LOS ANGELES



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GIFT OF
Dr. and Mrs. A.B. Pierce

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By
BYRON W. HOLT, A. B.

Stock Market Analyst. Manager, Investment Department,
Goodbody & Co.

Editor, Moody's Magazine, 1905-08. Manager, Investment
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AMERICAN INSTITUTE OF FINANCE

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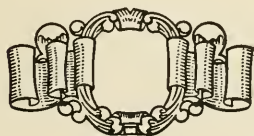
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AMERICAN INSTITUTE OF FINANCE
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OUR
"COMPLETE EDUCATIONAL COURSE"
IN THE SCIENCE OF
MAKING MONEY MAKE MORE MONEY

This list is arranged in the order of proper reading. The books are accompanied by a series of test questions, key problems and analyses outlines, enabling the student to apply the knowledge acquired to immediate stock market and investment conditions.

- | | |
|--|--|
| 1. <i>Developing Financial Skill</i> | 11. <i>Investment Securities</i> |
| 2. <i>Forces Which Make Prices</i> | 12. <i>Business Cycles</i> |
| 3. <i>Manipulation and Market Leadership</i> | 13. <i>Measuring and Forecasting General Business Conditions</i> |
| 4. <i>Handling a Brokerage Account</i> | 14. <i>The Technical Position of the Market</i> |
| 5. <i>Market Information</i> | 15. <i>Money and Credit</i> |
| 6. <i>The Essential Features of Securities</i> | 16. <i>Business Profits</i> |
| 7. <i>The Value of a Railroad Security</i> | 17. <i>Launching a New Enterprise</i> |
| 8. <i>Industrial Securities</i> | 18. <i>Securing Capital for Established Enterprise</i> |
| 9. <i>Oil Securities</i> | 19. <i>Internal Financial Management</i> |
| 10. <i>Mining Securities</i> | 20. <i>Search for Bargains</i> |

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CHAPTER I

KNOWLEDGE BEFORE PURCHASE

"Sound judgment is usually the fruit of persistent study from the ground up and from every angle of the proposition."

—T. COLMAN DU PONT, Financier and Business Executive.

What Our Problem Is

There are available for purchase or sale securities of the widest possible variety, issued by countless corporations, municipalities, states, nations, etc. Merely to learn the names of all of them represents a quite impossible task.

Equally varied with respect to their individual requirements are the purchasers and sellers of these securities. What is one man's meat is another man's poison, holds no more true of food than it does of securities.

The variety which prevails in the security market, nevertheless, represents a distinct opportunity to the person trained to discriminate, though it is a source of confusion to others. In either case, since mistakes once made cannot as a rule be corrected without loss, the only safe course to pursue is to investigate first.

Pursuing Sound Methods

The most persistent seekers of information, unfortunately, are those who already have purchased and are trying to find out what they have and why they made a mistake. This method ought not to prevail. Investigate first is the common-sense plan in taking hold of any new project. It should not be departed from when it comes to dealing in securities.

This plan, knowledge before purchase, does not mean that a person shall necessarily seek out the most gilt-edge securities — government bonds, prior lien railroad bonds, and other

ultra-conservative issues — but rather that he shall secure those which best meet his own requirements, be these low-yield municipal bonds or, possibly, some highly fluctuating common stock of a company close to bankruptcy. There are persons of a most varied taste when it comes to securities, and there are securities of all possible variety to meet these different tastes.

A person can be suited in his security dealings provided he knows what he wants and understands the various issues which are open to him for selection.

The Personal Equation

It will, perhaps, be well to discuss here some of the personal questions that each one must ask himself in regard to his security dealings. A man with extended responsibilities cannot afford to use the same proportion of his funds in speculation as can the man with few responsibilities. Responsibilities change with age. At the same time it would be a mistake for a young man between twenty and thirty to feel that he can afford to use all his funds in speculation. The period of most rapid money making is between the ages of thirty and fifty. If, at that time, a young man has learned the fundamentals of speculation and investment and how to apply them, he can conservatively use a greater portion of his funds in speculation than at any other period of his life.

Moreover, the entire question of handling one's money is complex. For example, while it is not our intention or place to discuss insurance, the man who has given his family protection through insurance can certainly afford to use a greater portion of his funds for speculative purposes than one whose family must simply depend upon the surplus funds he has available.

Many economists simply suggest an even division. That is, that a man should use 50% of his funds for speculative or profit-making purposes, while the other 50% should be used only for sound investment purposes. This does not take into consideration that the great majority of people can only gain Financial Independence through systematic building up of their surplus

funds. Many men never earn sufficiently so that simple saving will insure Financial Independence.

The result is, as stated above, every one must study carefully their individual situation. The man with few responsibilities and whose responsibilities are well protected can undoubtedly afford to use 75% of his surplus funds for profit-making purposes. A man, however, who has gone into the big earning period of life without much family protection must naturally be much more conservative in the use of his funds, laying aside at least 50% in sound investment securities, the purpose of which is simply to conserve capital and provide additional income.

Questions We Must Answer

The exposition of the problem here stated, viz., knowledge of securities and of one's own requirements, will occupy several of the Texts which follow. The present Text outlines the essential features only, thus paving the way for these more detailed discussions.

What are the essential features of securities? Why are they important? How can information upon them be secured? The classification which follows deals with these questions.



CHAPTER II

ANNUAL FLUCTUATION

Returns Afforded

There are many variations in securities with respect to the percentage of yield, the certainty of securing this percentage consistently, and the fluctuation in price. Two extremes are cited, between which, it may be added, is the broad field of speculative investment.

1. Income.

This is an amount secured from interest and dividends, in which the element of certainty receives emphasis — the investor's preference.

2. Profits.

These are secured by taking advantage of price changes — the speculator's chief aim.

Swing in Proportion to Price

Does this security, which we now assume is under consideration, swing much or little during the course of a year, in proportion to its price?

The price change, of course, represents chance to profit. Thus, to the purchaser who pays in full for his securities, the practical question is: "Were I to put \$10,000 into this security at what is considered an attractive figure, will it likely afford me more or less profit than other securities would?" This way of putting the question shows the importance of considering not only the extent of swing but the relation of this swing to the price of the security.

Stock A, the average price of which is \$50, ranges at from \$30 to \$70 or \$40 in proportion to its price of \$50 — 80 per cent. Stock B, the average price of which is \$150, ranges from \$125 to

\$175, or \$50 in proportion to its price of \$150 — $33\frac{1}{3}$ per cent. Other things equal, the second stock bought outright affords less opportunity for profit. *This is a mighty important point.* It will be found, when we come to a study of individual types of securities, that there are many fundamental reasons why low-priced issues lend themselves most readily to speculation. This therefore is added to the fact that their swings in proportion to price are greater.

What factors should be watched in order to get at the causes of these broad swings of a security?

Nature of the Undertaking

The first to merit consideration is the nature of the undertaking itself — its relative soundness. Does this corporation occupy a field in which raw materials, labor, equipment, markets, etc., exist in such condition that its business is likely to prove normal, or do contrary conditions prevail? A concrete instance or two indicates the basic importance of this question.

"The failure of the American Bicycle Company," says Dr. A. S. Dewing, "was a conspicuous example of financial distress consequent on the collapse of an entire industry. The use of bicycles became so extended from 1892 to 1895 that it could be called a craze. The craze reached its height in 1897. It was maintained with but slightly lessened intensity to 1900, when it ceased even more suddenly than it had arisen. Public taste, fickle at all times, and especially fickle regarding its amusements, became suddenly weary of its plaything, and threw it aside. Millions of dollars worth of property invested in the manufacture of bicycles consequently became worthless." Those who bought a \$1,000 underlying bond of this prominent industrial consolidation in 1899, recommended by reputable investment bankers in Boston and New York and secured by actual tangible property costing at least twice the total bond issue, would have had in 1913 at the close of repeated drastic reorganizations two shares of common stock worth \$1 each. The original preferred and common stockholders in the mean time had been wiped out entirely.

The securities of brewing and distilling companies, unless the properties represented by them turned to other lines of business, have been recently subjected to influences somewhat similar to those which earlier confronted the bicycle combine.

Again, when we later take up the study of "Price Cycles" we will see how many public utilities, in the early 1900's most attractive, were forced, by the development of abnormal conditions, to undergo drastic reorganizations.

There were other consolidations formed the same time as the American Bicycle Company, whose management was no more efficient nor financial policy more wise, which, nevertheless, have flourished. Similarly, while the brewers and distillers are in difficulty today, other corporations, solely because their undertaking is more sound, show high earning power.

Undertakings Classified

With respect to their inherent soundness, undertakings may be broadly classified into these groups:

1. Well Standardized Undertakings.

Railways and public utilities, in ordinary times, represent this class of undertaking. Conditions met with in their construction, operation, and financing, while not without some variation and risk, have been so fully investigated and standardized that the soundness of these undertakings can be determined with a relatively high degree of precision.

2. Highly Speculative Undertakings.

Airplane makers, motion picture companies, the exploiters of new mines and oil fields, and the producers of novelties and fashion goods, represent this class of undertaking, although numerous companies are already far past the experimental stage and doubtless will, in due time, in many instances, attain a sound basis. Uncertainties and risk to a high degree characterize corporations in this class.

3. Moderately Speculative Undertakings.

Between corporations of class one, whose earning power is relatively stable, and corporations of class two, whose earning power fluctuates widely, lie most of the companies in whose securities the speculative investor is interested. Though there exist considerable differences among the members of this third class, some closely allied to the well-standardized group and others closely allied to the highly speculative, they comprise most of the prominent industrials, the carefully managed mining properties, and several rails, such as Reading and Southern Pacific, in which special attractions exist.

Underlying Influences

These securities, however, are all subject to certain underlying influences, to which it is convenient to apply the term "business cycle." When the cycle has a downward trend, or when business conditions move into a period of prosperity, United States Steel, Anaconda, American Telephone, Pennsylvania, etc., normally should respond.

Dr. Hickernell in his *Text on "Business Cycles,"* and Dr. Persons in *"Measuring and Forecasting General Business Conditions,"* describe these cyclical movements of trade and of the security market as a whole. What they say explains very well the relations between underlying influences of security market fluctuations.

The Corporation's Financial Structure

The falling off of earnings during a depression, however, or their increase when the trend of a cycle is upward, does not effect identical price changes in securities, particularly in common stocks. Much depends upon the corporation's financial structure.

Corporation X and corporation Y, let us say, are both capitalized at \$50,000,000, X's being all common stock and Y's

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\$40,000,000 — 5 per cent bonds and \$10,000,000 common stock. Each has been upon the average paying \$5,000,000 to its security holders. A period of depression ensues which renders it necessary to drop to \$2,500,000 after which, in due time, payments increase to \$7,500,000. What is the difference in the effect on stockholders?

Average	X	Y
Paid	\$5,000,000	\$5,000,000
Fixed charges	0	2,000,000
Dividends	5,000,000	3,000,000
Amount on stock	10%	30%

Depression

Paid	\$2,500,000	\$2,500,000
Fixed charges	0	2,000,000
Dividends	2,500,000	500,000
Amount on stock	5%	5%

Prosperity

Paid	\$7,500,000	\$7,500,000
Fixed charges	0	2,000,000
Dividends	7,500,000	5,500,000
Amount on stock	15%	55%

The amounts paid are identical, but since this resulted in X's payments to stockholders running 10 per cent, 5 and 15; while Y's payments ranged from 30 to 5 per cent and then mounted to 55 per cent, there would be a marked difference in the price swings of these two stocks.

The financial structure of corporations is to receive detailed treatment later in Part V; hence further discussion is unnecessary at this point. It is clear, however, that the stocks of corporation X, although of lower average dividends, are much safer, while Y's form a much more attractive speculative medium.

What Annual Fluctuations Are

What has been said so far indicates in a general way the nature of the problem and the methods of its solution. But what stocks do show wide fluctuations, what slight, etc.? With respect to the extent of their annual fluctuation in proportion to price, all the common stocks listed on the New York Stock Exchange were divided into these four groups:

- | | |
|--------------|-------------|
| A. Very wide | C. Moderate |
| B. Wide | D. Slight |

The method followed in assigning stocks to their respective groups was statistical.* The stock's range for the year is the difference between its high and low during that period and its average price is half way between its high and low. These price ranges were computed for the seven years 1913, 1914, 1915, 1916, 1917, 1918, and 1919, were added and divided by seven so as to give the average range. Similarly the average price for the seven years was found by adding the respective highs and lows and dividing by ten. Next, the percentage which the annual range bears to the average price was computed. Finally the one-quarter of the stocks which showed the highest percentage was marked A, the quarter which showed the lowest percentage was marked D, and the remaining two quarters B and C respectively. This represents considerable statistical work, much harder than it would have been to merely guess at it; but the results are unbiased and represent with some accuracy what fluctuations have occurred.

Space does not permit the inclusion of all common stocks, many of which are unimportant, but certain of the better known issues will be specified. International Paper, Distillers' Securities (now United States Food Products) and United States Industrial Alcohol are typical of stocks, the annual fluctuations of which run high in relation to price; certain issues fluctuate an amount equal to, or more than, their average selling price. National Lead, American Radiator, and National Biscuit represent—at least they did represent at the time these calculations were made—relatively stable issues, in which the annual changes in price are slight. The table on pages 30–32 cites a number of the more important issues.

*The authors are indebted to Miss Grace M. Sullivan for performing the statistical work described here and on succeeding pages.

CHAPTER III

MANIPULATIVE ACTIVITY

Extent of Manipulation

Does a particular stock move much or little during the secondary swing?

This question interests the speculator primarily, since he tries to take advantage of these secondary swings. But those devoting themselves to speculative investment may well know something of this factor, because of its connection with the primary swing and the fact that an understanding of manipulative tactics affords one a clearer insight into the market's action.

There is considerable difference in the manipulative activity of securities. The gilt-edge bond, perhaps at the time of issue, receives "support," but otherwise is never manipulated, whereas certain mining stocks undergo a more or less continuous forcing process, under pool direction.

Speculative Flavor

Speculation thrives upon uncertainty. There can be no real speculation upon the obvious or upon known facts. Manipulation, needless to say, has to do with speculative and semi-speculative securities. The consequence is that where the outlook for a security is changing and uncertain, speculation accompanied by manipulative activity readily develops.

These changing and uncertain conditions frequently characterize a newly issued security, particularly if it be a common stock. Nobody knows what the outcome of many newly launched enterprises will be, not even their directors. Later on the status of the corporation tends to become established and in the end, if all goes well, investor absorption removes from the Street what was once its football of speculation. This has been

the market history of stocks such as Lackawanna, and Jersey Central, and perhaps to a relatively high degree of General Electric, Pullman, and similar issues.

But, it must be remembered, such developments are not necessarily permanent. As a matter of fact, it will be shown clearly in the Text, "Industrial Securities," that the majority of our industrial companies have stages of growth just the same as a human being. Many of them reach a period of old age and declining usefulness, just as a human being. The net result of such developments is that many industrial stocks of companies founded well and built well finally enter the so-called investment status, later to return to the speculative status, even after years of steady dividends.

There is no better illustration of such developments than the case of the American Sugar Refining Company. For twenty years this company continued 7% dividends or better on the common stock. It came to be considered a high-class investment. The company pointed with pride in its annual report to the fact that 45% of its stockholders were women and that the average holdings of its shares were only around thirty shares per person. Here again, however, as we will find later, viewed from the standpoint of the astute investor or speculator this distribution of shares of the American Sugar Refining Company to the public was a warning, rather than a condition denoting security, because it denoted extended distribution by insiders.

This much we should consider right here. Common stocks which have been removed from the field of speculation by long continued dividend payments, generally offer no attraction to the person who is using his money for profit-making purposes. It should be remembered that these issues are stocks of companies that have struggled through the formative period and have reached maturity. They are as near perfection as it is possible for common stocks to be. Under such conditions, is it not clear that the chances are in favor of poorer developments rather than better developments? The latter are practically impossible. In other words, the scale which favors a new well-managed industrial corporation is apt to turn against such a

corporation after it has been fully developed. How this develops is discussed later in detail.

There are numerous rail issues, such as Delaware & Hudson and St. Paul preferred, which had disappeared into investors' strong boxes but were brought once more into something of a speculative vogue by the unusual and uncertain conditions which developed.

"Inside Control"

There are some issues in which the uncertainty has rather the nature of a market mystery. Consider the former countless moves and countermoves of Reading, based on the possible or "imminent" or "assured" segregation of its assets! Reading certainly had valuable assets in its other-than-railroad properties. Now, however, these have been segregated and this old speculative favorite has been shorn of its mystery; so that in future, its market fluctuations will probably be confined to much narrower limits.

Issues not well distributed to the public and of relatively small capitalization lend themselves easily to "inside control" in the market, and manipulative activity often centers in them. Much depends upon the financial strength and ethical principles of directors and other "insiders" whether or not a stock will be made a speculative favorite. Some directors manage their corporations with a strict regard to the rights of stockholders. There have been officials who would puncture at most inopportune times the carefully woven misrepresentations of manipulators, and, if that did not suffice, dump upon them many blocks of shares when their time for taking profits was at hand.

At the same time, while we are considering "Inside Control" we must also remember the one basic fact in regard to stocks. It is this: STOCKS ARE MADE TO SELL. This is true regardless of whether stocks are manipulated flagrantly, or whether their movements are moderate and largely the result of underlying conditions. It is not only the securities of companies who have officials who misrepresent conditions that must

be watched carefully from this standpoint, but also the securities of our strongest companies.

Let us again use the illustration of American Sugar. When the American Sugar Refining Company was formed it was naturally formed by a relatively small number of men who had a clear and broad vision of the future of the sugar refining industry. Under such conditions it was only natural that they should acquire the majority of the common stock for a relatively small expenditure of money. The major portion of the working fund was undoubtedly supplied by the preferred stockholders. As the business prospered and earnings were put back into the property the value of the common stock increased materially and the issue advanced in price, at the same time paying a growing dividend.

Ultimately, dividends having been paid for a number of years, the stock came to be considered an attractive investment. Figuratively speaking, however, there was only one source from which the stock purchased on such a large scale by small investors, as an investment could come—that was from those who had originally formed the company and acquired the stock. It should be understood that it might pass through three or four different hands in such a process but it can be readily seen that the above statement must be necessarily true. It is, therefore, only natural that all industrial corporations with securities listed on the exchange should be operated from this viewpoint, that is, the ultimate distribution of its securities on a large scale to the public.

Stocks Cited

This “inside” stock then, which had originally been acquired at a low valuation, was finally disposed of during many years of prosperity, at high prices. Whether or not the “insiders” all this time foresaw the change in the company’s fortunes which came after the war, it is impossible to state; but the fact remains that Sugar had been well distributed when the collapse in its price came, and dividends were suspended, in 1921.

Our point of view here is the same as considered previously, viz., price change represents a chance to profit—with the difference

that here the secondary swing is considered, with manipulation as its cause emphasized. The extent of a stock's movement during the secondary swing has been taken without regard to whether the issue itself is high or low in price. In other words, margin trading and approximately the same size of margin for all stocks traded in, has been taken as the basis of our classification of manipulative activity.

With respect to their movements in the secondary swing, stocks have been divided into these four groups:

- | | |
|---------------------------|---------------------------------|
| A. Highly manipulated | C. Occasionally manipulated |
| B. Frequently manipulated | D. Rarely, if ever, manipulated |

These groups have also been worked out statistically. The monthly range of stocks was taken as a measure of their manipulative activity; and the extent of that range, that is, the difference between the high and the low during the month, was computed for the eighty-four months from January, 1913, until December, 1919. The one quarter of these common stocks listed on the New York Stock Exchange which showed the highest range were marked A, the quarter with the lowest range D, and the remaining two quarters B and C respectively.

The seven years, 1913-1919, were drawn upon for data rather than other years which might have been chosen, because they were more fully representative. The years 1913 and 1914 were, for the most part, periods of declining prices in which no special incentive to pool activity manifested itself; 1915 and 1916 were periods of exciting war markets, filled with manipulative activity. The years 1917-1919 were upon the whole both bear years and bull years.

American Smelting and Refining was a moving stock, during the years included, its average range per month being over eight points. Crucible Steel exceeded this, its monthly range having fallen not far below twenty points. General Motors was another speculative favorite, often manipulated. There are, on the other hand, issues, whose range did not average a full point. The table on Pages 30-32 cites a number of issues.

NOTE: In the revision of this text to bring it up to date, it has been considered desirable to change the ratings given to certain stocks in the tables referred to, in order to render these tables of current reference value in relation to the changed character of the markets for such stocks.

CHAPTER IV

MARKETABILITY

Markets

Markets are a natural growth resulting from the needs of buyers and sellers. Their locations are usually matters of convenience. A great business enterprise, as at present conducted, is too large to be owned by one or two people; hence corporations with their bonds and stocks, and numerous owners, have developed. When a man considers the purchase of a security, one of the factors which influences his decision is whether there is, or is likely to be, an active and reliable market for the issue. The owner of a bond or a share in a commercial enterprise is frequently engaged in an entirely unrelated business and should he desire to sell his holdings he has not the time nor the knowledge required to find an ultimate buyer. Hence, there exists need for a market, with persons qualified to conduct its operations.

The New York Stock Exchange occupies a place second only to London as the world's greatest market. There have been a succession of days on which the sales on the New York Stock Exchange have averaged one and a half million shares per day, probably involving an average of over \$100,000,000 in market value daily. The Exchange has a membership limited to 1,100; and the cost of a "seat," as the memberships are termed, now is around \$100,000. The machinery of this Exchange and the importance of Exchange membership have already been described in the Texts on "Developing Financial Skill," and "Handling a Brokerage Account" and it is now unnecessary to discuss the points more fully. We may add, however, that throughout the various Texts, unless otherwise stated, the New York Stock Exchange's methods and activities are assumed whenever mention is made of an Exchange.

Consolidated Stock Exchange

A short distance down Broad Street from the New York Stock Exchange stands the handsome building of the Consolidated Stock Exchange.

The Consolidated, unlike practically all other Exchanges in the country, is not a primary market. Its transactions, except in the case of a few specialties, are based solely upon quotations received from the New York Stock Exchange by telegraph and posted, by the aid of the ticker, on the board which occupies very nearly the entire length of the building. Floor traders upon the Consolidated do not, consequently, see prices made in the groups before them, but are followers of the other Exchange from whose prices, when posted on their own board, they take their cue.

The volume of transactions is considerably less than that of the New York Stock Exchange, which means that an active market prevails with respect to a much smaller number of issues. The unit of sale is ten shares, whereas it is 100 shares on the New York Stock Exchange. Ten, twenty and fifty share lots comprise the run of its business, with 100 and 500 share lots the exception.

The Consolidated has, for many years, served as a training school for the New York Stock Exchange. Those of its members who have found themselves successful, have very commonly gone over to the senior exchange. This has tended to deplete the Consolidated of its strongest members. More recently, another development which received country-wide publicity; namely, the wholesale failure of Consolidated Exchange houses as a result of the "Bucket-shop Crusade," dealt that Exchange a sad blow from which it is struggling to recover.

The Curb Market

The Curb Market, formerly on Broad Street, about half way between the New York Stock Exchange and the Consolidated,

was, for many years, one of the picturesque scenes in the financial district. The street, during active sessions, was filled from curb to curb with hundreds of traders, while in the windows of the buildings on both sides of the street telephone clerks would signal to them and transmit orders and information between these traders and the offices of their respective firms. The New York Curb is now indoors, like the other exchanges, and is more or less under the supervision of the major exchange, the New York Stock Exchange. It now ranks second, among the country's security markets, in the volume and importance of its transactions.

The securities dealt in on the Curb Exchange represent a wide variety. There are high-grade securities, such as Standard Oil stocks; some "when, as and if issued" securities; numerous "cats and dogs" of the market; and a large number of new issues, the outlook for which upon the whole is uncertain.

These securities are duly listed upon the Curb Exchange. There is an organization known as the New York Curb Market Association which supervises this listing and watches over the operations of the market in general. In practice, listing does not mean a great deal. There are no such stringent regulations regarding listing, as observed by the New York Stock Exchange. Under these circumstances, those buying and selling Curb securities need to exercise unusual caution even after making certain that they are dealing with a responsible firm.

There has been agitation for some years in favor of more strict regulations upon the Curb. Recently a considerable improvement has been brought about. The open-air location of the market has always been one element, however, which rendered reform difficult. With the housing of the Curb Market in a building of its own, many of the evils complained of heretofore have already been and will continue to be eliminated.

The Curb provides what may be termed a preliminary market for the New York Stock Exchange. Issues that prove their

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merit, very commonly are listed on the senior exchange, in which case trading in them in the Curb Exchange ceases.

Listed Securities

The exchanges, of which the three described are typical, exercise a more or less strict regulation over the securities that can be dealt in on their market. This regulation commonly is exercised through the Exchange's requirements for listing.

The listing of securities has already been described (see "Developing Financial Skill," Page 57) but it is well to point out here that listing does not, as it is often thought, guarantee the value of any security. The committee which approves, or disapproves, applications for the listing of securities upon the New York Stock Exchange, for instance, does not assume to pass upon the intrinsic worth of an issue. That it leaves for buyers and sellers in the market to do.

What then is the chief merit of listed securities? It is a matter of their marketability. Hence, before attempting to estimate the value of the marketability derived from listing on an exchange, it is essential to consider the over-the-counter method of buying and selling securities.

Over-the-Counter Market

The large banking houses and dealers in investment securities are primarily interested in the distribution of their issues, in which connection they find it desirable to maintain a market for them. Purchasers turn to this house when they want to add to their line in a particular issue, want information, or the opportunity to sell.

In view of the fact that investment securities are sometimes dealt in over-the-counter in larger volume than those listed, we shall describe with some detail one of these over-the-counter markets. This particular one is maintained by a prominent public utility investment house and represents what may be termed a fully organized over-the-counter market.

In the most secluded part of a space occupied by the bond department of this company, and in the nearest to a sound-proof room available are ten telephones, a ticker, space for two traders, an order clerk, two record clerks and a stenographer. This is the "trading room," one of the two main arteries through which all the security business of the company flows. The other is the underwriting department, through which new issues are offered, whose activities are not here described, but are taken up in detail in the Text "Securing Capital for Established Enterprises."

Through a system of private telegraph wires to the houses which regularly quote and trade in these public utility issues, connection can be had in five minutes or less, with every important city in the United States, the principal cities in Canada, and during the season with many of the out-of-town resorts, as in Maine, the North Carolina Mountains, Florida, and many others. Quotations are also sent regularly to Europe by cable. This "trading room" is the center of all such quotations.

Making the Over-the-Counter Market

The setting of prices and the putting through of purchases and sales is done within this room by what is termed the company's trader. The work of this trader calls for both native aptness and special training. The problems that a trader must handle require that he possess fairness, quickness, accuracy, courtesy, a good memory, and a knowledge of psychology.

A reputation in the Street for fairness is a great asset. The work is all done over telephones and no confirmations of transactions occur until the close of the day or the next morning. It is all done over telephones whose functioning is frequently imperfect. Opportunities for misunderstanding continuously arise. If the man with whom one deals believes in the trader's fairness, an adjustment without friction can usually be made.

Business men as a rule when they enter into transactions, particularly when these involve any amount of money, have opportunities to make comparisons and form their opinions.

No such conditions of leisure arise in this trading room. The telephone will ring. The man at the other end may want to buy or to sell anything from a fraction of one share to a thousand shares, or from a fractional bond to \$100,000 of bonds or more. The trader to succeed as he should cannot afford to keep the prospective customer waiting. His decision ought to be made promptly, taking into consideration his buying and selling orders, the general condition of the market, not only in his own special issues but in the issues quoted on the Stock Exchange, which is the great barometer of security values and general business conditions. He has to form an opinion quickly as to the price at which he will be able to buy the amount of securities that the purchaser wishes, or to sell them if some other broker is offering them for sale.

Bids and Offers

Cards are always kept in this "trading room" showing bids and offers in connection with any of the company's securities; also a record of the "long" and "short" positions at the time. It is impossible to match a buying against a selling order at all times and the trader frequently takes a position in a stock—that is, he is willing to buy at a price which he thinks will enable him to sell at a profit, or to sell when he thinks he can buy in securities at a lower price from the Street, or a customer. The cards are valuable aids, but any trader who relies on them slavishly, except in the case of very inactive securities, would soon lose standing in the Street. All these facts he needs to have at his command at all times. It takes a highly specialized and active memory to do this work.

The activities of this "trading room" are largely confined to the handling of the company's own issues. They do, however, execute orders in any security that has a reliable market for customers who have no regular brokerage connection. This service is usually without charge except the brokerage commission paid by them to the stock exchange or other firm which executes the order. This is purely an accommodation and no effort is made to increase the volume of this kind of business.

Chief Object Sought

The company's main object in maintaining this "trading room" for the handling of its over-the-counter business is distribution, and not profit. The desire is to furnish a reliable market and to secure a wide distribution among its clients and the investing public. The volume of business handled in this particular "trading room" is considerable. \$2,000,000 days are not unusual. When one takes into consideration that there are five or six conversations for each order that is executed, some idea may be formed of the speed at which the work must be done.

Most of the foregoing has been descriptive of the work done by a house direct with New York brokers and investment houses. In the "trading room," mail and local customers' orders are also handled, thus centralizing the work under one head. This has been found more productive of speed and accuracy in handling the business.

Other Over-the-Counter Markets

What has been said describes the over-the-counter business as conducted by one of the larger investment houses, which has devoted considerable attention to the matter and which has evolved a well organized market for its own issues. This is typical, rather than otherwise, however, of what the largest banks and investment houses are doing. They each maintain more or less elaborate facilities for the providing of a market for their securities.

The smaller investment houses and the investment departments of brokerage houses provide a market in much the same way for over-the-counter investment securities, though they do not have the volume of transactions which justifies all the organization that has been described.

Finally, least organized of all, is the work of a single "trader" who, oftentimes with little else than desk room and telephone as his equipment, seeks to render himself an effective connecting link, or market, between purchasers and sellers of whatever

securities he may have chosen to deal in. Perhaps he may advertise in the papers his offerings and wants, and otherwise seek to extend his influence in bringing buyers and sellers together, at a difference between buying price and selling price which leaves him a margin as profit.

Functions of the Market

The facilities that have been described, though in external appearance varying widely, as for instance the New York Stock Exchange and a lone "trader" over his one telephone dealing in an over-the-counter security, all represent useful cogs in the financial machine.

These markets register the supply and demand for their respective securities, and interpret them in terms of price — bid and asked — for the convenience of buyers and sellers.

Sales Activity

Now that the facilities or machinery of the different security markets have been examined, let us look with more detail into the New York Stock Exchange's market for common stocks. Two points merit special attention, viz., sales activity and closeness of quotations.

Is the stock under consideration an active issue, frequently traded in?

This question has special significance to speculators who are trying to take advantage of short swings in the market — the professional office trader for example. This trader possibly scents a move upward; stocks gradually harden and then briskly advance. With his order ready to hand in, is it not a matter of decided concern to him whether the stock in which he contemplates trading appears frequently upon the tape? What the trader wants when he enters his order "at the market" is a market; it does not help him much to have to wait an hour or two, let alone days and weeks, as will be the case with certain inactive issues, to have his order filled. Moreover, his broker

must be stricter with margin requirements when inactive issues are dealt in.

Classification

With respect to their activity, the common stocks listed upon the New York Stock Exchange have been divided into these four groups:

- | | |
|------------------|-----------------------|
| A. Very active | C. Generally inactive |
| B. Fairly active | D. Rarely quoted |

In arriving at this classification the total number of shares traded in on the Exchange during the seven years 1913-19 were computed and the one quarter of the stocks whose transactions were largest were marked A, the quarter whose transactions were smallest were marked D, and the remaining two quarters B and C respectively. A few issues are being cited as examples:

Kings County Electric Light & Power Co., and International Salt represent issues in which transactions seldom occur. Weeks may go by without issues of this type appearing once upon the tape. Scarcely a quarter hour of the market session passes, however, without several sales of United States Steel, General Motors, Crucible, Studebaker, and other similarly active issues. Pages 30-32 present a number of issues classified.

Market Quotations

Closely associated with sales activity, the time one has to wait before his order is filled, is that of a change in price between successive quotations. Here again the matter concerns the investor who buys and sells infrequently, decidedly less than it does the in-and-out trader.

The stock in which he contemplates a commitment appears upon the tape, let us say, 400 shares at $80\frac{1}{2}$. Were he to enter his order at the market what would he likely get? With some issues he can count upon, as a rule, no more than an eighth or a quarter away from the last quotation, if not the same price itself. But, in others his transaction may be put through at

one-half or possibly even two or three full points from its last price. Obviously, these differences mean considerable to him, particularly if he is trying to take advantage of the shorter swings.

With respect to their market quotations, stocks have been divided into these four groups:

- | | |
|---------------------|---------------------|
| A. Very close | C. Moderately wide |
| B. Moderately close | D. Wide and erratic |

The market for a stock consists of two parts, the bid and the asked prices. When a customer asks his broker for a quotation, the latter finds out by 'phoning over to the floor what these respective bid and asked prices are. What these bid and asked prices are at closing appears upon the tape just after the market session has ended and newspapers often print them as an item of useful information along with the record of transactions.

The classification here shown has been arrived at by securing 25 closing bid and asked prices, not upon successive days but drawn from various markets; subtracting to find the difference between the two prices on the respective days; averaging these differences, which gives the average difference or closeness of the stock's quotation. The one quarter of the common stocks listed upon the Stock Exchange whose quotations were closest were marked A, the one quarter whose quotations were widest marked D, and the remaining two quarters B and C respectively.

United States Steel has a very close market; upon the tape successive changes in price vary as a rule only an eighth. This contrasts sharply with Liggett & Myers, for instance, the spread between the bid and asked prices of which frequently is ten full points; or with S. S. Kresge, another high-priced inactive issue the spread of which at times exceeds twenty points. The tables presented later, on Pages 30-32, cite a number of issues.

Market Essentials

Marketability in the minds of most persons means that the issue is listed on the New York Stock Exchange. There are many hundreds of issues listed on the Stock Exchange, however, while, as the daily papers show, only a relatively few are active. Due to the fact that they are rarely traded in, few issues are so obscure as some of these listed securities.

There are other issues, moreover, not listed on any Exchange, yet for which, as was shown above in the case of certain over-the-counter securities, an excellent market obtains. This

emphasizes the fact that after all a good market represents only the place where demand and supply register with effectiveness. their forces and where buyers and sellers can conveniently get together with fairness to each other.



CHAPTER V

STATISTICAL SUMMARY

Factors Studied

The results of the statistical study cited on preceding pages may now be summarized. This study concerned four factors, as follows:

Annual Fluctuation

- | | |
|--------------|-------------|
| A. Very wide | C. Moderate |
| B. Wide | D. Slight |

Manipulative Activity

- | | |
|---------------------------|---------------------------------|
| A. Highly manipulated | C. Occasionally manipulated |
| B. Frequently manipulated | D. Rarely, if ever, manipulated |

Volume of Transactions

- | | |
|------------------|-----------------------|
| A. Very active | C. Generally inactive |
| B. Fairly active | D. Rarely quoted |

Closeness of Market

- | | |
|---------------------|---------------------|
| A. Very close | C. Moderately wide |
| B. Moderately close | D. Wide and erratic |

Classification of Common Stocks

	Annual Fluctuation	Manipulative Activity	Volume of Transactions	Closeness of Market
STEEL				
U. S. Steel	B.....	A.....	A.....	A.....
Bethlehem Steel "B"	A.....	A.....	A.....	A.....
Republic Iron and Steel	A.....	A.....	A.....	A.....
Gulf States	B.....	A.....	A.....	B.....
Crucible	A.....	A.....	A.....	B.....

	Annual Fluctuation	Manipulative Activity	Volume of Transactions	Closeness of Market
COPPERS				
Anaconda	B.....	B.....	A.....	A.....
Utah	B.....	C.....	B.....	A.....
Kennecott	B.....	B.....	B.....	A.....
Inspiration	B.....	B.....	B.....	A.....
American Smelters	B.....	B.....	B.....	A.....

EQUIPMENTS

Baldwin Locomotive	A.....	A.....	A.....	A.....
American Locomotive	B.....	A.....	A.....	A.....
Am. Car and Foundry	A.....	C.....	B.....	B.....
Pressed Steel Car	B.....	B.....	C.....	C.....

MOTORS

Studebaker	A.....	A.....	A.....	A.....
Chandler	B.....	A.....	B.....	B.....
General Motors	C.....	B.....	A.....	A.....

RUBBERS

U. S. Rubber	B.....	B.....	A.....	A.....
Goodrich	B.....	B.....	A.....	B.....
Kelly-Springfield	B.....	B.....	B.....	B.....
Lee Rubber & Tire	C.....	B.....	B.....	B.....

MACHINERY AND MANUFACTURING

General Electric	B.....	B.....	B.....	B.....
Westinghouse	C.....	B.....	C.....	A.....
Advance-Rumely	B.....	C.....	C.....	C.....
American Can	A.....	A.....	A.....	A.....

OILS

Texas	C.....	B.....	A.....	A.....
Pan-American Pet.	A.....	A.....	A.....	B.....
Associated Oil	C.....	D.....	C.....	B.....
Sinclair	B.....	A.....	A.....	A.....
Royal Dutch	C.....	B.....	B.....	B.....

FOODS

National Biscuit	B.....	B.....	C.....	B.....
Loose-Wiles	A.....	B.....	C.....	C.....
Corn Products	B.....	B.....	A.....	A.....
California Packing	B.....	B.....	C.....	B.....

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FOODS—(continued)	Annual Fluctuation	Manipulative Activity	Volume of Transactions	Closeness of Market
American Linseed	B.....	B.....	B.....	A.....
American Sugar Ref.	A.....	B.....	B.....	A.....
American Beet Sugar	A.....	A.....	B.....	B.....
Cuba American Sugar	B.....	A.....	A.....	A.....

MISCELLANEOUS INDUSTRIALS

Va.-Carolina Chemical	B.....	C.....	C.....	B.....
Allied Chemical	B.....	A.....	B.....	B.....
American Tobacco	C.....	A.....	B.....	C.....
Tobacco Products	B.....	A.....	C.....	A.....
American Woolen	A.....	B.....	B.....	B.....
Int. Mer. Marine	B.....	B.....	A.....	B.....
United Fruit	B.....	A.....	A.....	C.....
Central Leather	A.....	C.....	B.....	A.....
Am. Hide and Leather	A.....	B.....	B.....	C.....

MERCHANDISING

S. H. Kress	B.....	D.....	D.....	D.....
May Dept. Stores	C.....	B.....	C.....	C.....
Sears-Roebuck	B.....	A.....	B.....	B.....
S. S. Kresge	A.....	B.....	C.....	D.....
Woolworth	A.....	B.....	B.....	C.....

RAILS

Union Pacific	A.....	A.....	A.....	B.....
Canadian Pacific	A.....	A.....	A.....	B.....
Pennsylvania	D.....	D.....	A.....	A.....
New York Central	B.....	B.....	A.....	A.....
Southern Railway	B.....	B.....	A.....	A.....
C., M. & St. Paul	B.....	B.....	A.....	A.....
Reading	B.....	A.....	A.....	A.....

PUBLIC UTILITIES

American Tel. & Tel.	C.....	C.....	B.....	A.....
Consolidated Gas	B.....	B.....	B.....	A.....
Brooklyn Union Gas	D.....	C.....	D.....	D.....

Conditions Change

The foregoing classifications represent what obtained in these stocks, with respect to annual fluctuation, manipulative

activity, volume of transactions and closeness of market, during the years 1913 to 1919 for the most part. However, in accordance with the note at the bottom of Page 18, the editors have considered it advisable to make certain changes in the original calculations in order to make the tables of current value in aiding the reader to appraise the characteristics of the stocks reviewed in the light of their action in present day markets.

It must be remembered, however, that the market is in a constant state of flux. Changes are continuously taking place. New issues are being listed and are displacing the old standbys in point of speculative favor. Former favorites, such as certain of the "war brides," have dropped into relative neglect. This process goes on in the market month by month, which means that in studying a security with respect to its market behavior one must always be open to new conditions and ready to revise his views.



CHAPTER VI

PROVISIONS UNDER WHICH ISSUED

Conditions of Issue

There are certain conditions under which a security is issued that merit consideration in this classification. Of these we may cite:

1. Maturity.

Bonds in general have a stated maturity; common stocks do not, nor do preferred stocks as a rule. Occasionally a bond or preferred stock is made callable at a specified price. This is discussed in detail in the Text "Investment Securities."

2. Issuance.

Stocks may be (a) issued and outstanding, that is, sold or otherwise disposed of; (b) unissued, that which is authorized but not yet disposed of; (c) treasury stock which has been issued and once was outstanding but which has since been acquired by the corporation and is now held as an asset in its Treasury.

3. Full Paid or Assessable.

Full paid stocks represent those fully paid for in money, property, or labor as required by law, the certificates being stamped "Full paid and non-assessable," whereas assessable stocks means that the holder is still subject to further payments.

This does not mean that certificates that are stamped "Full paid and non-assessable" insure their holders against the

possibility of assessment. It is true that those certificates themselves cannot be assessed. This, however, is circumvented by the following method: A new company is formed to take the place of the old company which was not successful. Stockholders of the old company are offered the opportunity of exchanging into the stock of the new company upon the payment of a certain amount per share.

For illustration, let us suppose that the United Creek Mining Company, having outstanding "full paid and non-assessable" shares, goes into receivership. Certain interests may form the United Creek Copper Company, an entirely new company, but operating the same property. Stockholders of the first company are then offered the privilege of buying stock in the United Creek Copper Company upon the payment of \$1.00 a share. In such a case the assets of the old company must be sold and some small distribution might be made on the old stock, although in general practice this does not amount to anything. This illustration shows, that, for practical purposes, the statement "Full paid and non-assessable" should be given little weight.

Par Value

Stocks and bonds are usually issued bearing a nominal or face value. This value is called "par." Par value is important in the case of bonds, as it indicates the principal sum which the corporation agrees to pay the holder at maturity, and on which it agrees to pay interest in the mean time.

With stocks par value has relatively little meaning. It is convenient to designate three classes:

1. Regular.

The great majority of corporations have issued stock with a par value of \$100.00 and bonds at a par value of \$1,000.00. For this reason par values of such denominations may be termed regular.

2. Special.

A number of companies have issued stock whose par value is \$50.00, \$25.00, \$10.00, \$1.00 or as low as 10 cents. Similarly bonds are often issued in smaller denominations than \$1,000.00. These being known in the Street as "baby bonds."

3. No Par Value.

The fact that a certificate has a certain face value stamped upon it does not guarantee, by any means, as later Texts will render evident, that this sum can be obtained for it in the market. Inasmuch as a share of common stock represents a share in the equity, the important thing to ascertain is not the par value, but the number of shares outstanding among which the equity in assets or earnings, if any, must be divided. Recognition of this fact has caused an increasing tendency to issue stocks of no stipulated par value. Corporations issuing stock in this way list the number of shares and the equity represented in their financial statement.

This is an important point. Investors should recognize right at the start that "par value" has little meaning. For example, let us consider a corporation which has 200,000 shares of stock outstanding with a par value of \$100. This would form a liability of the company amounting to \$20,000,000. Let us assume that the value of the property owned by such company, figured on a conservative basis, is \$10,000,000. Under such conditions, the actual value of the common stock, if the company had no other liabilities, would be \$50 a share, not \$100 a share, its par value. Such a company, it may be noted in passing, to make its Balance Sheet balance would carry on the asset side Plant, Inventories, etc., \$10,000,000. Good-Will, Trade Marks, Patents, \$10,000,000. On the liability side would appear Common Stock \$20,000,000.

In many respects, then, the increasing use of no-par value

stocks is to be commended. It allows the corporation to give the common stock a value on its books that it considers commensurate with the actual asset values available for application to common stockholders. To take the company illustrated above: If the stock had no par value and the plant, machinery, etc., was worth \$10,000,000, a conservative Board of Directors would immediately set up a balance sheet showing \$10,000,000 of assets and 200,000 shares of common stock as a liability with a value of \$10,000,000. From an examination of the balance sheet this would give a clearer conception of the actual values behind the common stock than would the carrying of the issue at \$20,000,000 in accordance with the first balance sheet mentioned.

Control

Control over the corporation legally is exercised through voting power. Certain issues here again have prior claims, though, as compared with the foregoing, the conditions as a rule are reversed.

1. Common Stock.

The holders of the common stock, as a usual condition, control the corporation in that they possess the voting power.

2. Preferred Stock.

The preferred usually has no voting power, though under special conditions, such as non-payment of dividends, it may have equal or perhaps superior power over the common.

3. Bonds.

The situation is much the same as in the case of the preferred stock; so long as their interest is paid, bondholders have no control, but, should interest payment be defaulted, their power mounts until, if considered necessary, they may take over the direction of the company.

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The relation of these different factors—conditions of issue, par value and control—to the financial values and selling prices of the different types of corporation bonds and stocks is discussed fully in later Texts. All that is desired here is to have the existence of these various factors well fixed in the mind of the investor.



CHAPTER VII

PRIORITY OF CLAIMS

Right to Assets and Earnings

Certain issues have prior claims to earnings, and, should these earnings not suffice to meet their claims, a prior lien on the corporation's assets. Arranged in the order of priority, these are:

1. Bonds.

Bonds usually bear interest at a stipulated rate on the face value and are payable upon maturity at par. Therefore, no matter how prosperous the issuing corporation may be, the bondholder will receive only a fixed amount, but he must be well assured of receiving this or he will not be willing to forego the possibility of a speculative profit.

Priority of claims upon earnings and assets represents the usual form of this assurance. Bonds take precedence over other securities. But certain classes of bonds themselves in a given corporation take precedence over other issues. Thus there are: First mortgage bonds, second mortgage bonds, first refunding, collateral trust bonds, debentures, etc. The bondholder is a creditor, to whom the corporation has legally obligated itself to make payments.

2. Preferred Stock.

Preferred stocks have claims on assets and earnings junior to the claims of all creditors, but prior in some or all respects to the claims of common stocks.

They may be preferred as to assets alone, or as to assets and earnings.

They may be preferred up to a certain percentage of dividends and after a like amount has been paid on the common they may participate in any further distribution. Such a preferred stock is called "participating."

Provision is usually made that, in the event of dissolution, the preferred stock is entitled to its par value and accrued dividend before anything is distributed on the common. Some provisions go further and give the preferred stock the right to a premium over par before any assets are distributed to the common stockholders.

In the case of accumulative preferred stock it is provided that any dividend unpaid shall accumulate and must be paid before any distribution can be made on the common.

3. Common Stocks.

The common stock of a corporation represents, as a rule, ownership and management of the company. Should the company be financially unsuccessful the common stock is entitled to what is left over of assets after all creditors and preferred stockholders have been satisfied. But as long as the company is active and successful the common stock is concerned chiefly with its equity in earnings.

Here again, we hit upon a point which is most vital to every investor. We repeat, common stockholders are chiefly, if not entirely, concerned with the equity in earnings. This is why a common stock should never be considered a true investment for the conservation of one's funds. The common stockholder is always a partner in the enterprise, never a creditor.

A man who wishes to conserve his funds and receive a return while doing so should lend his money and not enter an enterprise as a partner, either industrial, railroad, or public utility.

Instances corroborative of such advice have been shown in a previous chapter. We will simply again call to your attention the history of such companies as the Chicago, Milwaukee & St. Paul, American Sugar Refining Company, New York, New Haven & Hartford Railroad, and Brooklyn Rapid Transit. All of these companies had, at one time, common stocks on which dividends had been paid continuously for a number of years. Many supposed that these continued cash payments had removed speculative conditions from these stocks. It is of vital importance to note that when a great number of investors had reached such a conclusion, future developments immediately brought about a reverse condition.

Cycles of depression and prosperity and cycles of price changes follow each other in this country with considerable regularity, as we will see from following Texts. As long as they do, we can hardly expect to see the development of permanent stability underneath common stocks. They are essentially speculations on the prosperity and reverses of corporations. Bondholders are creditors and are generally secured by a lien on the assets of the issuing corporation. They are not, for that reason, as vitally affected by a series of business ups and downs. They are the only true investments.

The Value of a Security

The priority of an issue's claims upon earnings and assets does not constitute, of course, that which at first glance it may appear to be, viz., an easy test of safety, or degree of security.

Yet the latter is, along with one other question, viz., the time to buy and sell, the most important fact in stock and bond transactions.

Investors will see in the following Texts the reason for these statements. The value of any security depends upon its earnings. Therefore, after we have determined the position in the business cycle, the question of priority of claims, first upon earnings, and second upon assets, is vital. Assets are only valuable as they produce earnings. The value of assets fluctuate with the amount of earnings. For illustration: An iron and steel plant operating at 100% of capacity may be worth \$20,000,000. The same plant operating at 20% of capacity, in a period of depression, with the outlook dark, would do well to sell for \$5,000,000 under forced sale. It will be appreciated that what has caused such a depreciation in the value of the assets is the inability of the company to do more than 25% of the business, and hence earn less than 25% as much as it did when the first valuation of the plant was made.

Saying that the value of any security depends upon earnings does not refute the previous discussion of the relation of bonds and stocks. It is naturally true that the stock of Atchison paying \$6.00 a share and earning \$12-\$18 is superior to a 4% bond of the Sea Board Air Line, which is in a very weak financial position and barely earning fixed charges. Such a statement is obvious from a casual examination of both the asset values and earning power of the respective companies.

Earnings of virile progressive corporations, however, must be considered on the basis of stock against stock and bond against bond. That is, the ability of Atchison, for example, to earn twice the dividend payments of 6% cannot give its stock a rating comparable with the bonds of the St. Louis Iron Mountain and Southern, a strong subsidiary of the Missouri Pacific System. Atchison's stock, in spite of its satisfactory earnings simply represents a partnership in the property. The bonds of the St. Louis Iron Mountain and Southern represent a lien on that company's assets, as well as a claim upon its earning power prior to stockholders.

The importance of determining the value of a stock or bond is such that later authors will treat the matter at some length. The next Text deals with railroad securities and those which follow it in turn treat industrials, mines and oils. These four Texts have a single aim, that the client become better able to determine the true value of the securities in which he is interested.



KEY PROBLEM
 ESSENTIAL FEATURES OF SECURITIES
 Given Two Companies A and B

	A	B
Preferred Stock 7%	\$7,000,000	\$9,000,000
Common Stock	19,000,000	12,000,000
Bonds 5%	5,000,000	10,000,000
Earnings in Prosperity	3,300,000	3,200,000
Earnings in Depression	2,100,000	1,500,000

Which common stock offers the best speculative opportunities and why? Consider carefully relative capitalization, earnings available for charges and dividends and fluctuation in earnings on the two common stocks.

TEST QUESTIONS

"THE ESSENTIAL FEATURES OF SECURITIES"

The Test Questions which are unstarred can be answered directly from the Text discussion. You will find them helpful for purposes of review.

The questions which are starred call for original thought, the ability to apply the knowledge gained from the Text to the solution of new problems.

1. When does most investigation of securities by investors take place, before or after purchase?

2. What factors should be watched in order to get at the causes of the broad swings of securities?

*3. Does a low-priced, or a high-priced, stock fluctuate more, as a rule, in proportion to its price?

4. What various elements give a stock speculative flavor? (See Pages 15, 16 of present Text; also Chapter 4 of "Manipulation and Market Leadership.")

*5. "I hold 50 shares of Babcock & Wilcox, which has come to me as part of an inheritance. Where can I find out what it is selling for at present, and dispose of it, if the price appears satisfactory?"

6. Does listing a security upon an exchange insure its marketability?

*7. Your investment banking firm, let us say, floats issues from time to time. Why is the question of providing a market for these securities worth serious consideration? What arrangements will you make?

8. Specify certain stocks which, in proportion to their average prices, undergo wide swings? Certain stocks which vary little in proportion to their price?

*9. Is it better to give orders "at the Market" or specify the prices?

*10. Is the significance of par value over-emphasized or underemphasized by investors, as a rule?

11. What type of security lends itself best to speculation? What to INVESTMENT?

12. WHAT ARE STOCKS? WHY DO THEY EXIST?

ANSWERS TO STARRED QUESTIONS

"THE ESSENTIAL FEATURES OF SECURITIES"

*3. The high or low price does not necessarily in itself determine that a security shall fluctuate widely in proportion to its average price. But stocks the future of which is uncertain, whose basis is a highly speculative undertaking, whose directors are not conservative, etc., tend to sell at low figures compared to stocks where contrary conditions prevail. Due to these reasons, low-priced stocks swing more widely in proportion to price than do high-priced stocks.

*5. "We refer you to Blank & Co., of 74 Broadway, New York, N. Y. This firm will supply you bid and asked prices on Babcock & Wilcox, and we consider their service as specialists in this stock very satisfactory when the limited dealings in the issue are taken into consideration."

*7. The providing of a market for these flotations aids in their distribution because marketability represents an attractive feature, which customers, and prospective buyers, are willing to pay something for. When thinking of what arrangements you might make in order to secure them this marketability, consider the various exchanges and note also what is said on Pages 22-25.

*9. Much depends here upon whether one is an investor, who can wait for weeks, if need be, until his specified price is reached, or is a trader, who wants to get the stock, if he gets it at all, almost immediately. Orders "at the market" have the distinct advantage that they are filled, whereas those put in at specified prices may miss the market by a fraction. Much also depends, however, upon whether the market is wide or close. Should the market be wide the specified prices have advantages, since an order "at the market" may be filled at a price several points away from that expected.

*10. Over-emphasized, as a rule. Investors are swayed far more than they should be by the words printed on the certificate "Par value \$100"; these words constitute no guarantee in reality that equivalent values are behind the certificate. The four Texts which follow point out the factors upon which the value of a security does depend.

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