

INFLUENCES AFFECTING SECURITY PRICES AND VALUES

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In discussing the above question it is all-important to bear in mind that the word "values" refers to one thing, and the word "prices" refers to another and very different thing. Both are important, but in choosing a time to sell or buy securities we are primarily interested in *prices as compared to values*. Our great opportunities are created when the two are divorced. If prices and values always moved in consonance, our opportunities would be greatly limited.

For example, the low prices established in the latter part of the year 1907 were occasioned by artificial causes having no bearing on actual values. I do not mean to offer the opinion that the entire decline of that panic year was artificial, but prices had more to do with the case than did values. Prices went far above values in the latter part of 1906, and far below values in the latter part of 1907.

In order clearly to distinguish between these two divisions of the question I will briefly discuss the subject from both standpoints, *i. e.*, influences affecting security *prices*, and influences affecting security *values*. It will be impossible, in the limits which are assigned to me at present, to make any attempt to discuss fully all the minor influences affecting either prices or values, but that is really not necessary, as many of the influences are interdependent. I will therefore confine my statements to the most important factors as they appeal to me.

Manipulation is the most common reason for the segregation of prices and values. It is quite natural that when a man, or a number of men, wish to buy anything, they strive to buy it as cheaply as possible, and that, per contra, when they wish to sell anything, they strive to sell it at the highest possible price

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obtainable. This is readily understood and appreciated so far as the traffic in real estate or commodities is concerned, but it is one of the most remarkable phenomena of security price movements that when prices are artificially depressed to facilitate accumulation, or artificially inflated to facilitate distribution, people lose sight of values entirely and become panic-stricken at low prices and foolishly elated when high prices obtain.

The statement of Anselm Rothschild that the secret of his success was "buying cheap and selling dear" appears almost pedantic in its simplicity, yet any man who has had a long experience in the purchase and sale of securities would inform you that in actual practise this rule is diametrically opposed. If we take our most popular and widely advertised security as an example, we find that the broker who vigorously recommended it at ten or fifteen dollars a share was in danger of losing his clientele, and that the broker who laughed at it at ninety dollars a share was execrated. In both instances *values* were lost sight of. Only a few weeks ago a railroad stock selling normally around forty-five dollars a share sold up to about eighty dollars a share in fifteen minutes, and back to the starting point in fifteen minutes more. It would be ridiculous to assume that "values" could change so greatly in the course of a month, but the price changed in an hour. Even more recently a listed security with a discoverable value of between fifteen and twenty dollars a share advanced about ninety dollars and stood at that bad eminence for some time. The bubble was pricked and the false price corrected in a single day.

These specific instances may be construed, or misconstrued, as an argument that any attempt to reconcile prices and values is abortive; but not so. I have offered two extreme instances in order to emphasize the statement that prices and values get separated now and then through manipulation. The man who took the time and trouble to examine the statistical showing of Hocking Coal and Iron would not have considered buying it at ninety, or at eighty, or even at fifty, for that matter.

Fright is a very common cause of disparity between prices and values. Psychologists have written a great deal about the contagious fear of a crowd—whether of a crowd of animals or human beings. We have all observed the effect of one panic-stricken horse or steer on the band to which it belongs. There is but little

difference in the effect on human beings. We may examine the history of ancient and modern times and find that the temper of a mob changes instantly and simultaneously. Shakespeare aptly and clearly illustrates this in the speeches of Brutus and Mark Antony after the assassination of Cæsar. The Commune in France gave numerous evidences of such sudden changes of heart

It is not my purpose to discuss psychology here. Personally I have observed the movements of security prices for many years and tried to explain to my own satisfaction the philosophy of these sudden and apparently unwarranted sentimental changes, but have never succeeded. Nevertheless the fact remains that such periods occur and have their decided effect on prices, even when fundamentals point the other way.

In the latter part of 1907, after the prices of securities had suffered a great decline, people who had kept a good heart up to the crucial moment became suddenly and senselessly possessed with fear and began to throw away or sacrifice good property, and incidentally to aggravate the trouble by locking up and hoarding the medium of exchange. The foolishness of this method of procedure carried it into the ridiculous stages. Just at the time when purchases were warranted we sold; just at the time when we should have been bold we became timid. When our counters were littered with bargains we not only refused to buy, but we hastened to sell, and that is only one instance in a long series of like happenings.

Technical conditions frequently cause or greatly accelerate an advance or decline in prices. Walter Bagehot, speaking of the great swings in prices, says: "At times a great many stupid people have a great deal of stupid money. This blind capital seeks for some one to devour it, and there is plethora. It finds some one, and there is speculation. It is devoured, and there is panic." Of course, Mr. Bagehot speaks of the great changes in prices, but we can readily reduce his statement to cover many of the smaller changes which occur intermediately.

Values are affected by more important matters—crop failures; disasters, such as the San Francisco earthquake; bad management; dishonesty, or the mistaken ventures of enthusiasts. We may feel quite safe in taking the stand that so far as crop failures are concerned we need have less apprehension from that trouble each year. The use of fertilizers, scientific farming, the government

reports, etc., all aid the farmer. It is quite improbable that we will witness a general crop failure at any time in the future.

Probably the one factor which is at present working most drastically against values is the high cost of living. I regret to state that figures produced by the United States government showing the movement of wages as compared with the advance in food products cannot be depended upon. Whether this is the result of politics or ignorance, I will not undertake to say, but whatever the cause may be, it appears that the government attempts to demonstrate that wages have advanced proportionately with the cost of living. There is an old saying that "figures cannot lie, but liars can figure." It is a very easy matter to take certain products which have actually declined in price, without properly weighting them, and strike an average which is entirely false so far as the actual movements of necessary commodities are concerned. It is also possible to take as a basis the wages which have risen the most rapidly, leaving out those which have not risen at all.

The Dun index numbers, which were suddenly stopped a short time ago for reasons which I presume are obvious to most observers, showed a very different state of affairs than that shown by the government. I talked recently with Professor Norton, of Yale, who is at present engaged with me in preparing an index number which we hope will be reliable, and he informed me that meats, since 1895, had risen ninety-five per cent., and vegetable foods eighty-five per cent. Of course, if we want to take the price of nutmegs, meats and vegetables, and add them together and then divide by three, we will have a grotesque result which would not at all represent the true state of affairs. That is what most of the compilers of index numbers are doing now.

I hear the statement on every hand that no one can really discover where the trouble is in this advanced cost of living. Most of us have the gold theory in our minds and attribute the advance in commodities to the increasing production of the yellow metal. Whatever the cause may be, the great question is: What is the cure and what is the final outcome? Personally I have an idea which I have not heard exploited, and that is that an equilibrium must be established in order to permit business enterprises which are not making a fair amount of money to have their share, and to take that share out of the pockets of those who are making an undue amount.

Mr. Selwyn-Brown, in a letter which he recently prepared for me, entitled "The Beneficiaries of Advancing Prices," finds, by rather elaborate calculations, that the farmer, of course meaning the owner of a well-managed farm, is making from fifteen to twenty per cent. on his capital invested, and that farm land has risen at the rate of six and seven-tenths per cent. per annum since 1900. This, of course, adds to the profits of the owner of the farm. In my opinion, it would simplify the problems both of transportation and wages if a more equable distribution were accomplished. The great trouble is that the farmer, who is making the most money, is the one who would object most strenuously to an advance in traffic rates. It is not the desire of railroad corporations to keep down the wages of employees. It is a matter of necessity. They cannot continue to pay higher wages for the cost of producing transportation without receiving higher prices for that product, and if freight rates were made more flexible there would be little trouble as far as wages are concerned.

Our miserable currency system is another thing which is liable to seriously affect values unless it is remedied. There are many theories on this subject. It has been talked over for years by every student, big or little, and each one has his own plan, not one of which appears to be reasonable. Contrasting our currency system with the methods employed in other countries, its rigidity appears outlandish. First we get conflagration, as in 1907; then inundation, as in 1908.

Adverse legislation is given as one of the particular reasons for declines in the values of securities, but this, in my opinion, is absurd. There is no intention on the part of serious-minded legislators to do anything but remedy evil. The very methods which are criticized are the methods which have reduced speculation and investment to more or less of a science. The only kind of paternalism which is dangerous is ignorant paternalism. Even if some foolish legislator, backed up by a lot of foolish constituents, manages to get through a foolish law, such a law never endures.

Having mentioned these particular influences affecting prices and values, I will touch briefly on the present outlook as to the security movements. In January of this year I asked a number of gentlemen, who are competent to pass opinions on the subject, to set down in parallel columns the good and bad factors bearing on

the situation. Charles A. Conant finds on the credit side of his ledger: The soundness of American enterprises; the productive power of the country; judicial temper and open-mindedness of the national administration; and on the debit side: High prices of commodities; manipulation of stock exchange, and the proposed restrictions on investments.

William C. Cornwall considers the good factors: The new wealth from the agricultural and mineral crops; the sound credit conditions; the capability of the country to greatly expand business under favorable conditions. He considers the bad features as: Uncertainty as to Supreme Court decisions; proposed anti-trust legislation at Washington; probable reaction in trade; the result of the elections in England, leaving that country politically unsettled.

John Coulter put the good features as: Prospective ease in money; good railroad earnings; good crop prospects; business and trade expansion; elimination of vicious manipulation on the stock exchange; increased foreign and domestic investment in securities; continued economies in corporate operation; the regulation of pool operations; and among the bad features he points to the attitude of the national administration toward corporations; possible tight money later; coming court decisions; labor agitation; our extensive imports, and fear.

R. E. Edmondson, editor of the New York *Financial Bulletin*, among the good factors, points to the excellent crop conditions and prospects; favorable trade outlook; easier money; the probability of railroad rates advancing in the near future. On the other side of the question he mentions the high prices of commodities, the adverse legislation at Washington; labor troubles.

Frank Fayant refers to Mr. Taft's policies, and the fear of these policies, in the following words: "To be frightened by Mr. Taft's policies is hysteria. The President's attitude toward the business of the country has been repeatedly and emphatically stated by him in words that no one can misunderstand. Mr. Taft is a believer in the American big-business idea, and he believes that everyday wrongdoing should be punished. Mr. Taft's corporation policy, while perhaps displeasing to a few eminent financiers, will strengthen the American investment market, both here and abroad."

Bert C. Forbes, of the New York *Journal of Commerce*, points to the world-wide ease in money; unparalleled acreage to be culti-

vated this year; harmony among our banking powers, the prospective advent of the farmer as an investor when new issues are regulated. Mr. Forbes also speaks of the housecleaning by the stock exchange; the universal peace among leading powers; the readjustment of securities to attractive income level, as good factors. On the other side of the question he selects the high cost of living; hostility to Wall Street; extensive demands for new capital, here and abroad.

Byron W. Holt places under the head of good factors: The unparalleled gold output, amounting to \$450,000,000 a year, thus increasing our credit power by fully \$1,200,000,000 a year, and resulting in rapidly rising prices of commodities and property. Mr. Holt also points to the great prosperity of land-owning farmers, due to high prices for both products and farm lands; the excellent outlook for winter wheat; the moderate rates for money; the settlement of the English elections. On the side of bad factors he notes, first, high and rapidly rising prices; probability of higher interest rates; strike and labor troubles; general discontent and demand for investigation and reform.

Maurice L. Muhleman, ex-assistant treasurer of the United States, points to the international peace; friendly attitude toward American securities; continuously large gold output; confidence in President Taft's conservatism; sound condition of banks; the ease in rates for money, as the most prominent of the good factors. The deterrent factors he classifies as being the economic aspect of the British political situation; the serious losses by floods in France; the high cost of living; the need of the government to borrow large sums to make up for deficits in its revenue.

Arthur Selwyn-Brown points to the prospects of world-wide peace; prosperous commercial outlook for leading industrial nations; large harvests recently garnered in the world; unusually large volumes of savings in the banks. As adverse factors he mentions the discontent among the labor classes; increase in commodity prices, and our declining exports.

Carl Snyder, author of "American Railways as Investments," takes a rather blue view of the situation, and, to quote his own words: "Precisely, because the business outlook is good, it would seem as if the reverse must prove true. Otherwise prices would tend steadily downward. First, because the long rise invariably precedes the full recovery, and because securities in the last half of

last year were very high. They are still high. Many of the poorer securities are selling for at least twice any actual, potential or prospective value they may possess." Mr. Snyder modifies his views somewhat by stating that in the former cycle there was no fundamental force like the present unparalleled gold production with an attendant depreciation of its purchasing power. This, of course, makes for higher prices. "Conceivably, for this reason, we may still see slightly higher prices than in 1906 before we reach the long downward turn. The prospect for this, however, is distinctly less favorable now than six months ago."

S. V. White takes an optimistic stand, stating that all conditions of business and crops throughout the country are normally good, and there is no hysteria among the inhabitants of the country as distinguished from Wall Street and Wall Street markets. Mr. White emphasizes his remarks by saying, "This is America and the twentieth century." Under the head of bad factors Mr. White points out the unrest of the people over the price of foods.

Many other views were given, but they were practically the same as those already offered, and to refer to them would result in unnecessary reiteration. It may be stated that the consensus of opinion is largely favorable to higher security prices in good times. One thing in particular characterized almost every report, and that was the mention of the high cost of living as a bad factor. And there we may look, as has already been stated, for the most important problem we have to face.

From the facts that I have at my command, and after a careful investigation of the underlying business situation, I see no occasion for alarm. I believe that the trouble we are now encountering will be rapidly adjusted and a correct equilibrium established, without anything revolutionary in the re-establishment. We may have trouble now and then, but that is to be expected from one year to another. We have always had it in the past.

George Paish, editor of the London *Statist*, and James Wright, of Mackay, Irons & Co., have both been in this country recently on a particular errand, to examine conditions and the prospects of our securities and security prices. I have had the pleasure of talking with both these gentlemen, and they feel very cheerful, and have so reported to their European followers. Mr. Paish shows, from very careful calculations, that the investments in American

railroad securities alone, by Europe, amount to over £600,000,000. This is the greatest investment they have in any country, or any two countries, which is an evidence that they have confidence in the future of America.

Almost every writer who follows the cycle theory is beginning to tell us now that we will have a panic in 1912-13. The very fact that there is such a consensus of opinion on that subject leads me to believe that we may escape the trouble. If our barometers are correct, we have plenty of time to reef our sails, and escape damage from the coming storm. Personally I held the same opinion a few months ago, that we would have trouble in 1912-13, but have modified my views as stated above. Panics usually come upon us as surprises, and seldom come when they are widely predicted.

It goes without saying that the great and all-important factor affecting security values favorably is accretion. Improved methods of handling business, better management because of greater experience, and, most particularly, the expansion of traffic because of increased population, are the things to which we must look for future values and prices. Fifteen years ago Atchison common sold at \$3.50 a share; Baltimore & Ohio at \$32.50 a share; Canadian Pacific at \$33; Chicago, Milwaukee & St. Paul at \$53.87 a share; Louisville & Nashville at \$39; Northern Pacific at \$2.50; Norfolk & Western at \$1.25; Reading at \$16.75; Southern Pacific at \$16.34; Union Pacific at \$4 a share, and so on through a long list of securities. The figures I have given are extreme low points, and to escape the accusation of unfairness I will give the figures on the same stocks ten years ago:

In 1900, Atchison sold at about \$19; Baltimore & Ohio at about \$55; Canadian Pacific at about \$85; Chicago, Milwaukee & St. Paul, \$108; Louisville & Nashville at about \$68; Northern Pacific at about \$46; Norfolk & Western at about \$23; Reading at about \$15; Southern Pacific at about \$30, and Union Pacific at about \$45. The intending purchaser of any or all of the securities mentioned could have accomplished little by a resort to mere statistical showings. When these low prices prevailed, the synthetic view and the proper judging of the future was infinitely more important than the analytic view or the scrutiny of statistical exhibits—so it will continue for many years to come.