The Marketing of Securities, 1930–1952

ONE of the major centrifugal forces in American economic history is the industrial revolution which has been taking place for the past 150 years. Corollary to it are the agricultural revolution and the transportation revolution. Most of the investment capital and working capital for the expanding enterprises involved in these revolutions came from plowing back profits, but a sizable amount had to be borrowed or obtained from outside investors. Mobilizing this capital was a major undertaking, especially in a new nation in which capital was relatively scarce. Its successful accomplishment involved a financial revolution.

The financial revolution has had three stages. The first one, between the American Revolution and the Civil War, witnessed the birth and early growth of most of our more important financial institutions, for example, the life-insurance company (1759), the commercial bank (1781), business corporations (1790's), the stock exchange (1792), the trust company (1818), and investment banking. The chief characteristics of this stage were a fumbling effort to mobilize capital and a near absence of governmental regulation.

The second stage lasted from the Civil War to the panic of 1929. Two major wars, improving technology, and broader markets enlarged financial operations. On a peak day in 1857, 70,000 shares changed hands on the New York Stock Exchange, whereas on an average day in 1926 the figure was 1,500,000 and on a tragic day in late October of 1929 a record of over 16,000,000 was reached. Common-stock values tripled between 1871 and 1926 and industrial stocks increased sixfold,[1] replacing railroads as the "blue chips" of the market. People paid their local bills about once a month instead of perhaps twice a year.[2] Capital was forming at an average rate of about 12.5 per cent a decade from 1869 to 1928 according to Simon Kuznets.[3] It was an age of fabulous profits and great fortunes. It produced Jay Gould, Jim Fiske, John

[1] United States Department of Commerce, *Historical Statistics of the United States, 1789–1945*, pp. 281–82.

[2] Rolf Nugent, *Consumer Credit and Economic Stability* (1939), pp. 48–51.

[3] Simon Kuznets, *National Product Since 1869* (New York: National Bureau of Economic Research, 1946) p. 84; National Industrial Conference Board, *The Economic Almanac for 1950*, p. 102.

"Bet-You-A-Million" Gates, and later such would-be financial Napoleons as Richard Whitney, Charles Mitchell, and Albert Wiggin. There were more constructive men, too, such as the elder J. P. Morgan. During his time, investment banking fell into the familiar three-step routine of investigation, underwriting, and selling and he frequently put a partner on the borrowing company's board to watch and assure good behavior. Men were very much measured by the profits they could make. The financial class behaved like a vigorous youth who enjoys satisfying his appetites but does not yet know his limitations. The dissipation ending in 1929 taught some of those limitations.

The third stage began about twenty years ago. The financial class demonstrated a more cautious attitude born of experience. The Federal Government began to regulate the securities dealers and the stock exchanges and again overhauled the banking laws. The trend has been toward the protection of the investor, elimination of unnecessary costs in handling capital, and the preservation of capital. Probably the chief threat to capital has been the government itself which has been a veritable Dr. Jekyll and Mr. Hyde. It has been Dr. Jekyll when acting through conscientious regulatory bodies, and Mr. Hyde when destroying the purchasing power of the dollar by indulging its bad fiscal and monetary habits.

These periods are not, of course, clear cut. New institutions appeared in each; regulations became more numerous every decade. There was some effort to protect the investor in earlier periods, and there is and always will be some irresponsible chasing after profits.

I

It is the third stage—that of capital preservation—that is of primary interest. What have been some of the chief financial developments in it?

The national income grew slowly during the 1930's and rapidly during the 1940's. Disposable personal income increased from $82.5 billion in 1929 to $92 billion in 1940 and to $231.5 billion in mid-1952. People began to save more. Personal savings averaged only 2.5 per cent of annual disposable income from 1929 to 1940, but during the Second World War they reached about 20 per cent and totaled over $125 billion. Since then they have slipped back to 5.5 per cent of disposable income in an average year. Net private capital formation was at a negative rate in the decade of the 1930's and during our participation in the

Second World War. It picked up sharply in the later 1940's.[4] Savings found more private investment outlets.

With all this growth went other important changes. Particularly noteworthy are the changes in the methods employed by industry to get capital funds and those employed by investing institutions and investors in placing their savings. These changes were influenced primarily by one or more of five conditions that prevailed during most of these two decades: (1) Taxes in the 1940's were much higher than in the 1920's. In 1927, for example, Federal taxes were 5 per cent of national income and persons in the top income-tax bracket paid 27 per cent; in 1948 Federal taxes were about 18 per cent of national income and the top bracket paid 85 per cent. (2) The consumer's dollar lost purchasing power rapidly from 1939 on. About 5 per cent of its remaining value melted away each year until in 1952 it would buy only 53 per cent of what it did in 1939. (3) Interest rates fell sharply from 1929 to 1933 and reached an all-time low in 1946. During the 1920's the government was paying 4 to 4.5 per cent on most of its debt; in the 1930's, 2.5 to 3.5 per cent; and in the 1940's, 2 to 3 per cent. To an increasing degree government rates have set the standard for the market.[5] (4) The memory of the stock-market crash of 1929 made people very fearful of common stocks. In 1948 an investigation conducted by the Federal Reserve System revealed that 62 per cent of all people interviewed questioned the wisdom of owning common stocks in business enterprises, 33 per cent voiced no opinion, and only 5 per cent favored ownership.[6] Corollary with this, the new or Keynesian economics emphasized fear of depression. Many, perhaps most, economists believed there would be a postwar depression. (5) The restrictions of the Securities and Exchange Commission, although probably justified, discouraged somewhat the public marketing of securities. At least there were $350 million of new issues a year during the 1920's and only a little over $100 million a year from 1937 to 1947. When possible, corporations avoided the tedious and costly business of registering their offerings with the commission. This could be done by borrowing directly from not more than twenty-five lenders.

All this means that the income from a given bond investment is far less today than in the 1920's. Bascom Torrance, vice-president of the City Bank Farmers Trust Company, testified in 1950 before the New

4 Conference Board, *Almanac, 1950*, pp. 114–15; *Survey of Current Business*, monthly, 1946–50, *passim*.

5 Conference Board, *Almanac, 1950*, p. 453.

6 *Federal Reserve Bulletin*, July 1948, p. 777.

York legislature that a $50,000 trust in 1928 could easily produce an income of $2,300; by 1937 it could produce only $1,900, and by 1949 only $1,400.[7] Meanwhile taxes took a larger share and the dollar bought less. The higher yields on stocks offer one possible way to make up for the decrease in bond income. During most of the 1940's industrial common stocks yielded approximately twice what long-term government bonds or Moody's corporate AAA bonds did.[8] But the memory of 1929 and the specter of a postwar depression have discouraged men and institutions from seeking this avenue of escape. Those who have taken it have wanted the safeguards of professional advice and diversification and have sought some relaxation of their legal responsibility. Those who have clung to bonds have sought to eliminate the middleman as much as possible. The corporations have been anxious to co-operate and to side-step the S.E.C. The loser in all this has been the old-fashioned investment banker. Let us look at some of the new practices evolved by some chief types of financial institutions.

II

During the 1940's the income of life-insurance companies grew from half a billion to a billion dollars a month.[9] That is a lot of money to have to invest. And life-insurance companies have become increasingly concerned over falling interest rates. The average return on assets of life-insurance companies in 1925 was 5.11 per cent; by 1944 it had fallen to 3.19 per cent.[10] The difference, incidentally, between 3.19 and 3.18 per cent is $100 on each million dollars or $1,000,000 on ten billion dollars. So is the difference between buying securities at, say, 99.00 instead of 99.01. In the 1930's, the insurance companies began to wonder why they should pay for corporate bond flotations by investment bankers when they might just as well buy whole issues directly and eliminate these costs and make up in some way for falling interest rates. It was not an entirely new idea, but from 1937 on an increasing amount of direct buying was done, although rarely on a large scale until after the war.

The Equitable Life Assurance Society of the United States then showed the way. In the spring of 1945 the Pennsylvania Railroad was

7 *Business Week*, March 11, 1950, p. 111.

8 *Federal Reserve Charts on Bank Credit, Money Rates, and Business*, August 1952, pp. 25–26.

9 *Life Insurance Fact Book, 1951*, p. 47. Life-insurance companies' total annual income in 1940 was $5.2 billion; in 1950, $11.3 billion.

10 *Ibid.*, p. 50.

asking for bids on the handling of a $53 million 40-year issue of 3 per cent bonds. Halsey, Stuart & Co. and Kuhn, Loeb & Co. were the chief bidders and Halsey Stuart felt sure they had it with their bid of 99.3899 and were going ahead with preparations to market it. To their surprise they lost it to Equitable which put in a last-minute bid of par or 100 and took it.[11] This was quite a jolt to the investment-banking fraternity at the time and they made much of the fact that Equitable had paid a high price. A month later Equitable took another prize, $25 million of Gimbels Department Store debentures,[12] and the postwar trend was on. In 1946, $1.6 billion of corporate obligations were placed privately. For example, General Electric sold $150 million of notes to eleven life-insurance companies and three trustees; Inland Steel sold $50 million of bonds to eight life-insurance companies, and Monsanto Chemical sold $30 million of bonds to five life-insurance companies.[13] Between 1947 and 1951 about 40 per cent of all issues were sold privately (see Table I). The Equitable Assurance Company purchased 84 per cent of its investments directly in 1951. Most direct placements in 1951 were unsecured bonds with twenty-year or more maturities, which paid 3 to 4 per cent.[14]

The investment houses of Wall Street and LaSalle Street were quick to realize that they must adjust themselves to this new trend. When a big industrial corporation sought out a big insurance company there was nothing much the investment houses could do. But there are plenty of good and relatively unknown corporations wanting to borrow and many small and middle-sized insurance companies wanting to invest. When investment bankers bring about a meeting between these, and perhaps help draw up the terms, they charge the borrowers a "finders' fee" for the service. Investment bankers collected $6 million in 1950 in such fees. The rates ranged from 20 cents on $100 for large issues to $1.70 for small ones.[15]

It may be asked what the attitude of the Securities and Exchange Commission has been to this development. That body was set up to protect the small investor. Big financial institutions have little need of the commission. Insurance companies and other direct buyers such as pension trusts, investment trusts, or trust companies have sufficiently

11 *Business Week*, May 19, 1945, p. 64.

12 *Ibid.*, June 19, 1945, p. 78.

13 *Ibid.*, December 14, 1946, pp. 118 ff.

14 E. V. Hale, *1952 Yearbook of Private Placement Financing* (Chicago, 1952). Also *Business Week*, August 24, 1946, pp. 80, 90; July 3, 1948, p. 59.

15 *New York Herald Tribune*, September 5, 1952, p. 24; *Business Week*, November 22, 1947, p. 90.

experienced personnel and good enough sources of information to take care of themselves. The investment bankers would like to see S.E.C. registration of direct placements and the insurance companies are opposed. Chairman H. A. McDonald of the S.E.C. said in January that the S.E.C. would be sympathetic to registration, but believes that the initiative must come from the investment industry.[16]

III

A corollary of private or direct placements has been long-term loans by big banks to corporations, called "term" loans. These began in the

TABLE I

PRIVATE PLACEMENT FINANCING, 1900–1952

	SECURITIES AND EXCHANGE COMMISSION		COMMERCIAL AND FINANCIAL CHRONICLE	
Year End	*Millions of Dollars*	*Per Cent of Corporation Placements*	*Millions of Dollars*	*Per Cent of Corporation Placements*
1900–33	——	—	1,000.0	3
1934–38	1,900.0	18	——	—
1938	——	—	680.5	32
1939	789.9	36	728.6	33
1940	773.7	29	834.6	30
1941	823.8	31	957.3	37
1942	422.2	40	433.9	42
1943	371.9	32	272.9	25
1944	791.7	25	870.0	27
1945	1,021.7	17	1,283.6	20
1946	1,917.7	28	1,581.6	24
1947	2,235.9	34	2,123.3	39
1948	3,271.8	46	2,512.0	40
1949	2,526.4	42	1,947.9	37
1950	2,726.0	43	2,448.3	41
1951	3,455.6	45	2,581.4	39
1952 (June)	1,977.1	40	1,194.2	31

Sources: United States Securities and Exchange Commission, *Statistical Bulletin,* monthly since 1942; *Commercial and Financial Chronicle,* annual reports on Capital Flotations, about mid-February each year, 2d section. Each of these authorities revises its estimates for the year repeatedly as new information pours in. The S.E.C. figures for percentage of corporate placements were calculated by me.

The S.E.C. and the *Chronicle* both count all public utility and railroad offerings as public, since the initial bids must be made publicly. This is despite the fact that the eventual buyer may be only one company—the Equitable buying Pennsylvania Railroad bonds in 1945—or a small group and that the securities may never be offered to the public.

16 Report of speech in *Commercial and Financial Chronicle,* January 10, 1952, p. 98.

middle 1930's. Banks had had bad experiences with unamortized corporate bonds in their portfolios. What might take their place? Each bank had lots of deposit money to lend out and was competing with other banks in the same predicament. Loans pay higher interest rates than do government bonds. The big banks began experimenting, at first timidly with one-year term loans, amortized quarterly, made to their very best customers. The First Bank of Boston was a pioneer in making this new type of loan. Gradually the term lengthened to five and even ten years, more customers were favored, and the proportion of term loans grew to be quite sizable. The corporations liked term loans because they were easier to arrange than a bond flotation, because they paid only a stand-by or commitment fee of ½ of 1 per cent on unused portions of the loan, and because they did not fall under S.E.C. jurisdiction.

About 1946, banks began to shorten the time of their term loans and limit themselves to a maximum maturity of no more than five years. If a customer now wants to borrow for a longer period, say fifteen years, a "tie-in" arrangement is sometimes made with an insurance company. The bank will collect its principal during the first five years and the insurance company will collect its principal during the last ten. That also makes possible bigger loans.[17]

Since the National Banking Act forbids a national bank to make an unsecured loan to one borrower of more than 10 per cent of the bank's unimpaired capital and surplus, it is only the big banks in New York, Chicago, and a few other big cities that can handle the multimillion dollar loans desired by the big corporations. The banks generally share these loans.

Term loans today constitute close to 25 per cent of the loans and discounts of the big New York and Chicago banks. This is hardly in keeping with Walter Bagehot's once famous dictum that the first thing a banker must learn is the difference between a promissory note and a mortgage, for his business is with the former. Yet since the changes of 1933 and 1935 in the banking laws and banks' huge acquisitions of government securities, banks do not have to be as liquid as they once did.

[17] Much of this information was obtained while I was a Fellow of the Foundation for Economic Education at the National City Bank of New York for six weeks during the summer of 1952.

IV

There were 2,976 trust institutions in the United States in 1947 with $36.2 billion of trust assets.[18] The assets of individual trusts in national banks increased over 1,000 per cent between 1928 and 1951.[19]

A trustee must carry out the provisions of his trust instrument. If that does not direct him how to invest any funds, or grant him discretion, then he must choose only from a list of securities, called the "legal list," deemed by state authorities to be safe. A majority of trust instruments allow the trustee discretion.[20] Yet a large minority, covering $4 billion out of $13 billion in New York in 1949, for example, are so drawn that funds must go into legal list securities.[21] These are generally government bonds or other debt securities.

Trustees have little to gain by investing trust funds in equities, for if the stocks prove bad, the trustee runs the risk of being sued for speculating. On the other hand, even if the dollar should lose, say, 90 per cent of its purchasing power, and the trustee kept all trust funds in government bonds and never lost a cent—just 90 per cent of purchasing power—the law could not touch him for dereliction of duty.

Declining real income from trust investments in recent years because of inflation, higher taxes, and lower interest rates has led trust beneficiaries to complain to corporate trustees, and the trustees in turn to seek a change in the old laws so that more trust funds may be invested in stocks. During the last twenty-five years there has been a strong swing to the so-called "Prudent Man Rule."

In 1831 Justice Samuel Putnam of the Massachusetts Supreme Court handed down this famous decision in Harvard College *vs.* Amory. He said, in part, "All that can be required of a trustee to invest, is, that he conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income,

18 Gilbert Stephenson, *Trust Business in the United States in 1947*, Studies in Trust Business, 4th Series, Study No. 4, pp. 19–20.

19 Conference Board, *Almanac, 1950*, p. 92; *Annual Report of the Comptroller of Currency* (1951), p. 100. An average individual trust in 1946 was $109,000.—*Trust Bulletin*, May 1948, p. 12.

20 Bascom Torrance, "Legal Background, Trends, and Recent Developments in the Investment of Trust Funds," *Law and Contemporary Problems* (Duke University), Winter issue, 1952, pp. 138–43, 161.

21 *Business Week*, March 11, 1950, p. 111.

as well as the probable safety of the capital to be invested."[22] This Prudent Man Rule, long effective in only a few states, is now effective in twenty-four states and partially effective in ten more. New York partially adopted the rule in 1950. Bascom Torrance of the City Bank Farmers Trust Company pointed out to the New York legislature that between 1928 and 1940 some $800 million of legal list bonds had defaulted. Now trustees in New York are allowed to invest up to 35 per cent of legal list funds in stocks. As a result New York trust companies are cautiously yet steadily buying more high-quality stocks.[23]

The cost of separate administration of many trust funds is high, and trust companies like everyone else are faced with rising costs. In the interest of efficiency and economy the trustees have sought permission to set up so-called "common trust funds" and laws have been passed granting this in thirty-seven states. Now under certain conditions each trust company or trust department of a bank may set up its own investment trust run solely for the benefit of trust accounts. By 1950 New York trusts had $52 million invested in such funds and Pennsylvania trusts had $219 million. The New York common trust funds earned 4 per cent in 1950, compared to 2.6 per cent by legal list funds, according to State Bank Superintendent William A. Lyon.[24]

A third important development in the trust field is the rise of pension trusts which are growing rapidly. The number of pension plans was recently estimated to be 15,000 and to cover almost 15 million workers. In 1949 about $1.2 billion was pouring into these funds each year to be invested; the figure is now believed to be close to $2.25 billion.[25] Trust companies handle most of the large pension trusts. For the same reasons as apply to other trusts a part of the funds is being put into common stocks. A few pension trusts place half or more of their funds in common stocks, although about 30 per cent is a more generally followed proportion.

22 *Massachusetts Reports,* 9 Pickering, 446, 457, 461 (January 10, 1831).

23 *Business Week,* March 11, 1950, p. 111; June 17, 1950, pp. 100 ff. Under the New York law trustees may invest up to 35 per cent of legal list funds "in such securities as would be acquired by prudent men of discretion, using intelligence in such matters, who are seeking a reasonable income and the preservation of their capital."

24 B. Torrance, "Legal Background," pp. 138–43, 161; *Business Week,* July 8, 1950, p. 81.

25 Morgan Stanley and Co., *Pension Plans and Common Stocks* (New York, 1950), p. 9; Henry C. Alexander (President of J. P. Morgan, Inc.), "Observations on Pension Funds," *Commercial and Financial Chronicle,* June 26, 1952, p. 28.

V

Another important financial development has been the investment trust. This is a company whose business it is to buy and manage a list or portfolio of securities. The funds originally come from the company's stockholders who pay in money to be invested and take the investment trust's stock in return.

On an organization basis, investment trusts fall into two categories, the closed-end and the open-end. The closed-end is the older but now the less important variety. The closed-end company has a fixed capitalization, like any normal corporation, which can only be increased by appeal to the stockholders. It can issue common and preferred stock and bonds. A major selling point is the "leverage" profits this may produce. Tri-Continental Corporation of New York is an example of a closed-end investment trust.

On the other hand, the open-end company or mutual fund can issue only common stock but can issue new stock daily and use the money paid in to buy new securities. The mutual must redeem its stock on demand and may sell some of its holdings to do so. All this means a daily revaluation of the stock. It is primarily the fast-growing mutuals which interest us.

The first American investment trust was the Boston Personal Property Trust established in 1893. But it was not until the 1920's that the investment trusts were of any importance. The first and still the largest open-end trust is the Massachusetts Investment Trust, known as M.I.T., founded in May of 1924. By the end of 1949 it had a quarter of a billion dollars invested in 136 corporations for its 72,000 stockholders. Many closed-end trusts were set up in 1927, 1928, and 1929 in time to buy securities at high prices. The 1929 crash and poor management too in some cases gave investment trusts a dubious reputation for several years.

When the securities markets began to revive in the 1930's, it was the flexible open-ends that grew. The 1937 panic slowed them for a while again. The Securities and Exchange Commission in 1938 called the growth of investment trusts "probably the most important single development in the financial story of the United States during the past 50 years." [26] That was before the startling increases of the 1940's. After some preliminary sparring between the investment trusts and the

[26] Quoted in *Business Week*, March 26, 1949.

S.E.C., they jointly prepared the Investment Company Act of 1940.[27] Its passage was assurance that the investment trust mistakes of the 1920's were not likely to be repeated. Since 1940, the total number of mutual-fund shareholders has more than quadrupled and total assets have increased eightfold, as Table II shows. The assets of 103 open-end companies were $3.5 billion on June 30, 1952, while those of closed-end companies were $.9 billion.[28]

TABLE II

SHAREHOLDERS, NET ASSETS, AND GROWTH OF LEADING MUTUAL FUNDS, 1940–1952

Year	Number of Funds	Number of Shareholders	Net Assets (in thousands)	Percentage Annual Growth
1940	68	296,056	$447,959	——
1941	68	293,251	401,611	−10.4
1942	68	312,609	486,850	21.2
1943	68	341,435	653,653	34.4
1944	68	421,675	882,191	34.9
1945	73	497,875	1,284,185	45.6
1946	74	580,221	1,311,108	2.2
1947	80	672,543	1,409,165	7.5
1948	87	722,118	1,505,762	6.9
1949	91	842,198	1,973,547	31.6
1950	98	938,651	2,530,563	28.2
1951	103	1,110,432	3,129,629	23.3
1952 (June)	103	———	3,510,593	12.2 (6 mos.)

Source: National Association of Investment Companies, 161 Broadway, New York. Growth percentages calculated by me.

There are several reasons for this remarkable growth. There has been, with only occasional interruptions, a long-run favorable market for stocks, and mutual funds tend to concentrate on stocks. Also, the investment trusts stress their ability to provide professional management and diversification of risk.[29] This advantage attracts investors who want the higher return of good common stocks and hope for a rise in market values and yet doubt their own ability to choose wisely.

[27] Hearings of Subcommittee of Committee on Interstate and Foreign Commerce of House of Representatives, 76th Congress, 3rd Session, on HR 10065. June 13–14, pp. 78–79 and *passim; Business Week,* October 12, 1940, p. 57.

[28] July 14, 1952, Release of National Association of Investment Companies.

[29] Vernon Vivian speaking for Fundamental Investors, a large and successful mutual fund, pointed out that $10,000 invested in the nation's favorite stock, American Telephone and Telegraph Common, on January 1, 1942, would have risen 21 per cent (to $12,124) by December 31, 1951, ten years later, and have paid $6,983 in dividends. The same $10,000 in Fundamental Investors would have risen 164 per cent (to $26,383) and have yielded $7,198 in dividends and also $4,333 in capital distributions (personal interview).

That appeals to the small investors, too, although it is a mistake to assume that these are the chief buyers of mutual shares. The average holding is about $3,000. Dividends range between 3 and 5.5 per cent.

The mutual funds are still subjects of controversy. Critics say that mutuals have not been tested by a really serious stock-market storm and express the fear that, if one occurred, redemption demands would force the mutuals to sell large blocks of stock on short notice with disastrous consequences to the market and themselves. The mutuals reply that they weathered the storm of 1937—and some older ones rode out the hurricane of 1929 as well—and the squalls of 1946 and 1949 quite satisfactorily and their shareholders are investors and not easily panicked.[30]

TABLE III

INVESTMENT ASSETS OF LEADING SAVINGS INSTITUTIONS, 1940–1952

(IN BILLIONS)

Institution	*December 1940*	*December 1950*	*June 1952*
Life insurance	$30.8	$64.0	$70.3
Savings accounts	27.7	56.5	61.2
Government E & H bonds	none	34.5	57.7
Savings and loan associations	4.3	14.0	17.6
Mutual funds	.4	2.5	3.5

Sources: Life Insurance Fact Book; Spectator, September, 1952; *Business Week,* May 17, 1952, p. 148; *Treasury Bulletin; Federal Reserve Bulletin;* National Association of Investment Companies; National Industrial Conference Board, *The Economic Almanac for 1950;* and United States Savings and Loan League, *Quarterly Letter.*

Despite their rapid growth, the mutual funds do not yet have the billions at their disposal that some other savings institutions do, as can be seen from Table III. But currently they are growing at a more rapid rate. The good ones provide an important new way for the investor, large or small, to invest in American business and share in its growth. Such investors get professional advice and the benefits of diversification at bargain rates, both of which should increase their chances of success.

VI

Brokerage houses would, of course, rather have the public buy their stocks individually and directly through them. Yet until the formation

[30] *Fortune,* December 1949, pp. 117 ff.; *Business Week,* July 16, 1949, pp. 70–71; June 30, 1951, p. 92; February 9, 1952, p. 120; July 12, 1952, pp. 112 ff.

of Merrill Lynch, Pierce, Fenner and Beane in 1941 the brokers had done relatively little to educate the public on the merits of corporate securities. The reason was that the business of the 5- and 10-share buyer was hardly worth cultivating. This house undertook that job and became widely known for its activities. It is familiarly known as "We, the People," "The Thundering Herd," or simply Merrill Lynch, but prefers to be called the "Department Store of Securities." To be able to serve many small buyers profitably, it has installed rows of IBM and teletype machines. It even has escalators between floors. It spends hundreds of thousands on advertising, conducts free courses in investing, and has 108 branches scattered over the country. Merrill Lynch is the biggest brokerage house in the country: it did almost 10 per cent of the round-lot business on the New York Stock Exchange in 1951 and 15 per cent of the odd-lot business. It is also the third largest investment banking house in New York. Merrill Lynch is unquestionably playing an important role in promoting more widespread ownership of corporate securities in the United States.[31]

VII

Despite the efforts of various financial institutions, there are not a large number of stockholders in the United States. Indeed, until this year, no one had more than a shrewd guess how many there were. Berle and Means had estimated in 1927 that there were 4–6 million; the Twentieth Century Fund guessed 5–6 million in 1935; the Temporary National Economic Committee made four estimates varying from 5–11 million in the late 1930's, and the Federal Reserve System guessed between 4.5 and 5.4 million on three occasions in 1947–1950.[32] None of these took a census or made an extensive survey. It remained for a college president, George Keith Funston of Trinity College, Connecticut, now head of the New York Stock Exchange, to see that was done. At his request the Brookings Institution undertook the study. Brookings got reports on 3,954 stock issues. That is about a quarter of the 16,655 issues listed in Moody's Manuals of 1950 as being of appreciable public interest. It sent questionnaires to 20 stock exchanges, 2,991 corporations, and numerous banks, investment houses, and others.

[31] 1951 *Annual Report* of Merrill Lynch, Pierce, Fenner and Beane. Also interviews with several employees, present and past. *Business Week*, February 18, 1950, p. 102; March 11, 1950, p. 112.

[32] Lewis H. Kimmel, *Share Ownership in the United States* (Washington, D.C.: Brookings Institution, 1952), pp. 138–40.

Lewis H. Kimmel wrote the final report. Some of the findings are pertinent here.

The Brookings investigators concluded that there were about "6,490,-000 individuals in the United States who are share owners in publicly owned corporations." That is about 4.2 per cent of the population. Men slightly outnumber women as shareholders. Somewhat over a quarter of the population over fifty years of age own stock. Persons who finished high school or college are more apt to own stock than those of less education. The higher a man's income, the more likely it is that he owns stock. Families with incomes of $5,000 to $10,000 constitute 44 per cent of all stockholders. By profession, administrators, professional men, salesmen, and merchants are most likely to own stock. Very few unskilled or semiskilled workers own stock. Shareholding is fairly evenly distributed geographically except that the Far West is below average. Owning stock is more common in metropolitan than in rural areas. About half (46 per cent) of all stockholders own only one issue. There are only about a million persons who own five issues or more.

The reasons why people acquired stock are revealing. First, they sought a rise in market value; second, they wanted the income from the dividends; third, they were given it or inherited it. Only one per cent acquired stock as a hedge against inflation.[33]

Judging by the record of 45 large corporations, and this is only a rough criterion, stock ownership has about doubled in the last twenty-one years.[34]

VIII

The changed conditions of the last twenty-two years, namely, higher taxes, lower interest rates, a depreciating dollar, the presence of the Securities and Exchange Commission, the scarring memory of 1929–1933, and fear of another depression have profoundly affected the handling of capital funds. Big investors like insurance companies seek to buy more directly, trust companies are trying to enlarge their authority to protect the purchasing power of the funds they are entrusted with, the investment trust has appeared to give the investor the professional assistance and diversification that he needs at lower

[33] *Ibid.*, p. 89, *passim.*
[34] *Ibid.*, pp. 129–31.

cost, and the citizen with an above-average income is beginning to show more interest in stocks again.[35]

Financial middlemen are encountering the same fate as those in merchandising. When buyers begin to buy in large amounts, there is need for fewer intermediaries between consumer and producer and some middlemen are eliminated. The investment banking class is suffering. Other middlemen have found that the only way to survive is to increase efficiency and to make many small sales to somewhat lower income groups.

In this third stage of the financial revolution, the forces that threaten capital are different from those in the second stage. The Securities and Exchange Commission can and does protect investors from many of the old dangers but can do little about the new ones. The only way that private capital can partially protect itself from undue erosion by high taxes, low interest rates, and depreciating dollars is through the new methods and new institutions that have been developed. Financiers are today acting more responsibly and sensibly in protecting the money of others (and their own too) than perhaps ever before in our history.

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[35] According to the University of Michigan Research Center, in 1949 six out of ten holders of savings bonds listed that type of security as their first investment choice. By 1951 the proportion had dropped to four out of ten. On the other hand, the "pollsters" found that, whereas in 1949 only one out of nine persons interviewed preferred to invest in stocks or real estate, assets whose value fluctuated considerably, by 1951 one out of four preferred stocks and real estate. "1952 Survey of Consumer Finances," *Federal Reserve Bulletin*, July 1952, pp. 743 ff.