

C H A P T E R 6

1929

In the larger history of economics and finance, no year stands out as does 1929. It is, as I have elsewhere observed—like 1066, 1776, 1914, 1945, and now, perhaps, with the collapse of Communism, 1989—richly evocative in the public memory. That is partly because the speculative debacle that then occurred was of special magnitude, even grandeur, and more because it ushered in for the United States and the industrial world as a whole the most extreme and enduring crisis that capitalism had ever experienced.

Nineteen twenty-nine is also remembered because there were then evident all the elements of the euphoric episode and especially

the powerful commitment to presumed financial innovation. This last included, as ever, the rediscovered wonders of leverage, presently to be examined, and the parade of publicly celebrated genius. Optimism built on optimism to drive prices up. Then came the crash and the eventual discovery of the severe mental and moral deficiencies of those once thought endowed with genius and their consignment, at best, to oblivion, but, more grimly, to public obloquy, jail, or suicide. In 1929 and for years thereafter, all this was larger than life.

The justifying mood was the political, social, and economic order that was associated with the benign and, inevitably, Republican administration of Calvin Coolidge and his Treasury Secretary, Andrew W. Mellon. Then, beginning on March 4, 1929, came the presidency of the more experienced engineer, administrator, and statesman Herbert Hoover. It was a mood to be repeated a little less than 60 years later with the advent of Ronald Reagan. This recurrence was not entirely an accident. Most of those who manage investment operations or who have sizable amounts of money to invest are, indeed, Republican in their politics. Naturally, perhaps inevitably, they believe in the politicians

they support, the doctrines these profess, and the economic advantage flowing therefrom. It is especially easy for those seemingly so blessed to be persuaded of the new and approximately infinite opportunities for enrichment inherent in a Republican age under a Republican regime. So in 1929; so again before the crash in 1987. All so vulnerable and all so affected, whatever their politics, should be warned.

The first manifestation of the euphoric mood of the 1920s was seen not on Wall Street but in Florida—the great Florida real estate boom of the middle of that decade. Present, apart from the optimism engendered by Coolidge and Mellon, was the undoubted attraction of the Florida climate—to many, in its contrast with that of New York or Chicago, a shining discovery. And present also was leverage; lots could be purchased for a cash payment of around 10 percent. Each wave of purchases then justified itself and stimulated the next. As the speculation got fully under way in 1924 and 1925, prices could be expected to double in a matter of weeks. Who need worry about a debt that

would so quickly be extinguished?

There were other compelling forces. Choice “beachfront” lots could, by a flexible approach to mensuration, be 10 or 15 miles from the water. The noted Charles Ponzi of Boston, whose name is durably associated with investment operations that paid handsome dividends to earlier investors from the money coming in from later ones, had turned now to the real estate business.



Charles Ponzi was already a convicted forger and larcenist when he began a new career selling swampland in Florida to unduly eager investors.

He developed a subdivision said to be “near Jacksonville”; it was approximately 65 miles away. The momentum continued; such was the pressure on the serving railroads that they were forced to embargo unnecessary freight, including the building materials useful for the construction boom.

In 1926 came the inevitable collapse. The supply of new buyers needed to sustain the upward thrust dried up; there was a futile rush to get out. External and not wholly implausible explanations were available. Not the built-in culminating end of speculation but two especially vicious hurricanes from the



The 1920s Florida land boom came to an end when the supply of new and adequately gullible buyers dwindled and thousands were left homeless after a hurricane.

Caribbean in the autumn of 1926 were held to be at fault. Thousands were, indeed, left homeless. The responsibility for the debacle was thus shifted from man and his capacity for financial delusion to God and the weather. Also, if slightly, to misguided charitable enterprises in response to the wind. An official of the Seaboard Air Line was quoted in *The Wall Street Journal* as expressing the fear that the solicitation of Red Cross funds for hurricane relief would “do more damage perma-

nently to Florida than would be offset by the funds received.”

In 1925, bank clearings in Miami were \$1,066,528,000; in 1928, they were down to \$143,364,000.

By 1928, the speculative mood and mania had shifted to the far less equable climate of lower Manhattan.

Prices of common stock on the New York Stock Exchange had begun rising in 1924. The increase continued in 1925; suffered some setback in 1926, possibly in sympathetic reaction to the collapse of the Florida land boom; rose again in 1927; and, as it may properly be said, took clear leave of reality in 1928 and particularly in 1929.

In the spring of 1929, there was a mild break. The Federal Reserve Board, departing very slightly from its then unexampled timidity and accepted incompetence, announced that it might tighten interest rates to arrest the boom, and the market receded a bit. The action of the central bank was seen as an exercise in economic sabotage. Charles E. Mitchell, head of—as it then was—the National City Bank and himself riding the up-



Charles Mitchell, head of the National City Bank in 1929, offered to lend the public enough money to offset any unwanted restraints by the Federal Reserve.

ward wave, stepped in to counter the threat. "We feel," he said of his bank in a statement of nearly unparalleled arrogance, "that we have an obligation which is paramount to any Federal Reserve warning, or anything else, to avert any dangerous crisis in the money market." The National City Bank would lend money as necessary to offset any restraint by the Federal Reserve.

The effect was more than satisfactory: the market took off again. In the three summer months, the increase in prices outran all of the quite impressive increase that had occurred during the entire previous year.

By now the wholly predictable and more than adequately identified features of the great speculative episode were again present and evident. Prices were going up because private investors or institutions and their advisers were persuaded that they were going up more, and this persuasion then produced the increase. Leverage was magnificently available, indeed a special marvel of the time. In its most commonplace form, it allowed the purchase of stock on a 10 percent margin—10

percent from the aspiring owner, 90 percent from the obliging lender. It wasn't cheap; by that summer the borrower paid at the then incredible interest rates of from 7 to 12 percent and once as high as 15.

The closed-end investment trusts of United Founders Corporation, Goldman, Sachs, and many other similar enterprises were especially celebrated for their genius in discovering and using leverage. The United Founders group, tracing back to an original promotion in 1921, foundered and was rescued with a \$500 infusion of capital from a friend. It then borrowed money and sold securities to finance investment in other securities for an eventual total of around a billion dollars. This—assets worth a billion dollars from an original investment of \$500—could have been the most notable exercise of leverage of all time, those Michigan banks and the notes leveraged against the ten-penny nails possibly excepted.

As dramatic was the leveraged extravaganza sponsored by Goldman, Sachs.

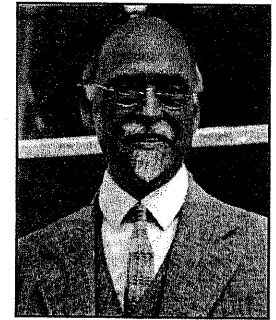
The Goldman Sachs Trading Corporation was launched by Goldman, Sachs in late 1928 with the sole purpose of holding and speculating in common stocks. The first stock offering was modest—\$100,000,000, which went, as

noted, to buy other securities. The following summer the Trading Corporation launched the Shenandoah Corporation, selling its stock and preferred stock to the public but retaining ultimate common-stock control in its own hands. The purpose of Shenandoah, also, was to buy and hold common stock; all gains in the value of the stock so held accrued to the holders of the common stock—including, notably, the Trading Corporation—and not to those of the fixed-return preferred. Then Shenandoah launched the Blue Ridge Corporation, repeating the process. The leveraged increase in the value of the Blue Ridge common stock accrued to the common-stock holdings of Shenandoah. These values, in turn, were reflected in yet greater magnitude to the holdings of the Trading Corporation.

Unrecognized only was the way in which this process would work in reverse—the fixed obligations commanding diminishing market values and revenues of the stocks. Diminution there was. The shares of the Goldman Sachs Trading Corporation were issued at \$104 and rose to \$222.50 a few months later; in the late spring of 1932, they stood at \$1.75.

The most celebrated men of the time were those riding and furthering the boom. Most notable were the Canadian Arthur W. Cutten; the perversely named Bernard E. “Sell ‘Em Ben” Smith; the especially celebrated market operator M. J. Meehan; the two great bank chairmen, the hitherto-mentioned Mitchell of the National City and Albert H. Wiggin of the Chase; the Swedish match king and international financier extraordinary Ivar Kreuger; and Richard Whitney, the most eminent and aristocratic of brokers, and vice-president, soon to become president, of the New York Stock Exchange. Supporting them and sustaining public confidence was a convocation of economics professors who assured all listeners that what was happening was well within the norms of contemporary and successful capitalism.

The most prominent and most to be regretted of the academic sages was Irving Fisher of Yale—as already indicated, the most innovative economist of his time. Heavily involved in the market himself, he too surrendered to the



Irving Fisher, a truly renowned economist at Yale, was caught up by the speculative euphoria of 1929.

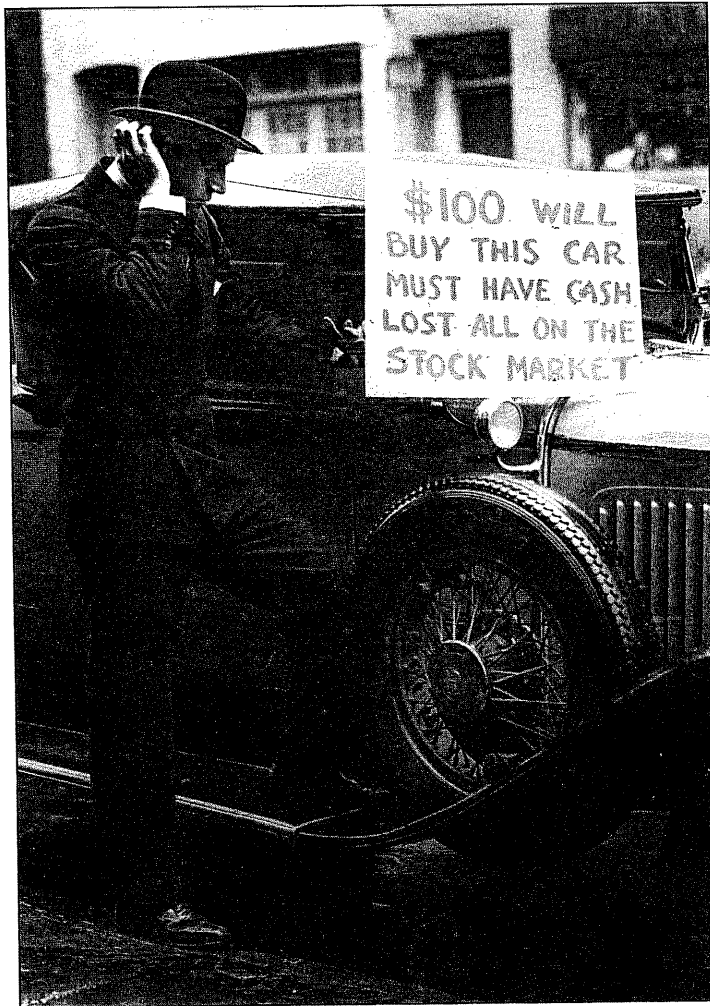
basic speculative impulse, which is to believe whatever best serves the good fortune you are experiencing. In the autumn of 1929, he gained enduring fame for the widely reported conclusion that "stock prices have reached what looks like a permanently high plateau."

There was also optimistic expression from Harvard, Michigan, Ohio State, and notably from a young Princeton economist, one Joseph Stagg Lawrence, who, as stocks reached their peak, offered the widely quoted comment, "The consensus of judgment of the millions whose valuations function on that admirable market, the Stock Exchange, is that stocks are not at present overvalued." He added the question, "Where is that group of men with the all-embracing wisdom which will entitle them to veto the judgment of this intelligent multitude?"

A few did, and they did not escape articulate and even savage denunciation. As earlier noted, Paul M. Warburg, who, at least until he spoke out against the market, had been one of the most respected bankers of his time, was especially condemned, as was the equally well-known, if somewhat less reputable, Roger Babson.

The sequence of events that made the history of those days has often been detailed, and there is little need for an extended account here. The market opened badly the week of October 21, with heavy trading by the standards of the time. Things turned worse on Wednesday; Thursday was the first of the days of disaster. Prices dropped seemingly without limit that morning; the ticker, as had been the case on Monday, ran well behind the trading. Calls went out for more margin to people who knew not their full misfortune. The common reference was again to panic.

However, at noon on that Thursday things turned briefly for the better. The great bankers of the time, including Thomas Lamont of Morgan's, Mitchell of the National City, and Wiggin of the Chase, met at the House of Morgan and resolved to do something about it. Richard Whitney, the Morgan broker, then appeared on the floor of the Exchange to make stabilizing purchases with money the great bankers had placed at his disposal. As in the days of John Law, the Bubble, and other episodes, it was thought



The Great Crash forced stock-market innocents into selling off personal assets such as this 1929 Chrysler Roadster, which at the time had a list price of \$1,555.

that by reassuring statement and action all could again be made as before. Alas, and predictably, the confidence evaporated over the weekend. There was heavy selling on Monday; Tuesday, October 29, was, until that time, the most devastating day in the history of the Exchange. Nothing now arrested the rush to sell or the likelihood of being sold out. Things were not helped by the rumor that the great bankers were themselves getting out, which may well have been the case. In succeeding weeks, Mondays being particularly bad days, the market went on down.

How little, it will perhaps be agreed, was either original or otherwise remarkable about this history. Prices driven up by the expectation that they would go up, the expectation realized by the resulting purchases. Then the inevitable reversal of these expectations because of some seemingly damaging event or development or perhaps merely because the supply of intellectually vulnerable buyers was exhausted. Whatever the reason (and it is unimportant), the absolute certainty, as earlier observed, is that this world ends not with a whimper but with a bang.

In the aftermath of the crash, there were two other predictable developments. John

Law, living out his last and dismal years in Venice, may have been more fortunate in his fate than the great financial wizards of the 1920s. Charles Mitchell and Albert Wiggin were both peremptorily sacked. Mitchell, deeply involved in the market, spent much of the next decade in court defending himself against income tax evasion charges. He had unloaded his depreciated stock on his possibly unsuspecting wife and taken a major capital-loss deduction. On the criminal charges he eventually won acquittal, but he faced heavy civil charges and payments. Wiggin, also a large operator and heavily short in the stock of his own bank, was denied his pension. Cutten, Meehan, and Sell 'Em Ben Smith were called before congressional committees. Cutten suffered from acute amnesia; Meehan, when summoned, absent-mindedly went abroad but soon came back and apologized. Richard Whitney went to Sing Sing for embezzlement. In Paris in 1932, Ivar Kreuger, once a world-class financier, promoter, and speculator and now established as a major larcenist, went out one day, bought a pistol, and shot himself. Along with much else, he had been discovered to have counterfeited Italian government bonds—an undue mani-

festation of the freedom of the press. Irving Fisher lost millions and was rescued in a modest way by Yale. Two giants of the time, Joseph P. Kennedy and Bernard Baruch, were to share the rewards and lasting esteem that came from having gotten out early.

Predictable also in the ensuing explanations of events was the evasion of the hard reality. This was in close parallel with what had occurred in previous episodes and was to have remarkable, sometimes fanciful, replication in 1987 and after. The market in October 1929 was said only to be reflecting external influences. During the previous summer there had been, it was belatedly discovered, a weakening in industrial production and other of the few currently available economic indices. To these the market, in its rational way, had responded. Not at fault were the speculation and its inevitable aftermath; rather, it was those deeper, wholly external influences. Professional economists were especially cooperative in advancing and defending this illusion. A few, when dealing with the history, still are.

They were not, however, completely persuasive. Some steps were taken—the creation of the Securities and Exchange Commission;

restraints on holding-company pyramiding, which had been particularly great in electric utilities; the control of margin requirements—and these were not without value. But, as ever, the attention was on the instruments of speculation. Nothing was said or done or, in fact, could be done about the decisive factor—the tendency to speculation itself.

The crash in 1929, however, did have one therapeutic effect: it, somewhat exceptionally, lingered in the financial memory. For the next quarter of a century securities markets were generally orderly and dull. Although this mood lasted longer than usual, financial history was not at an end. The commitment to Schumpeter's mania was soon to be reasserted.

C H A P T E R 7

OCTOBER REDUX

Let it be emphasized once more, and especially to anyone inclined to a personally rewarding skepticism in these matters: for practical purposes, the financial memory should be assumed to last, at a maximum, no more than 20 years. This is normally the time it takes for the recollection of one disaster to be erased and for some variant on previous dementia to come forward to capture the financial mind. It is also the time generally required for a new generation to enter the scene, impressed, as had been its predecessors, with its own innovative genius. Thus impressed, it becomes bemused by the two further influences operating in this world that are greatly seductive of er-