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The pitfalls of speculation

Thomas Gibson

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The Pitfalls of Speculation

1916 Edition

BY

Thomas Gibson

**Author "Cycles of Speculation," "Elements
of Speculation," etc.**

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Book Company**

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1916

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**"So great are the opportunities offered
by speculative changes, that, with proper
methods and self control, the poor man
cannot afford to overlook them."**

Foreword

During the ten years which have elapsed since the "Pitfalls of Speculation" was first published a great many personal communications have been received by the author asking for enlightenment on various phases of the subject. The question most frequently asked is how the novice may most intelligently go about the task of determining when general basic conditions and future prospects are satisfactory. It also appears that a great many people have no conception of the rudimentary elements of a railroad or industrial report and that, in their attempts to interpret the multifarious details of these documents, without understanding the basic principles thereof, they become confused and discouraged.

In view of these facts, the writer has attempted in the 1916 edition to offer prescriptions and suggestions which may assist the reader. The two added chapters "Analyzing Basic Conditions" and "Simple Methods of Analysis" cover the essential points referred to above as fully as the limitations of space will permit.

In the added chapter "The Impossibilities of Speculation," it has been the desire of the writer to forcibly impress and vigorously expose the popular fallacies which bear upon speculative ventures. Much that is contained in that chapter was expressed in other words in the first edition, but the matter is important enough to bear reiteration.

Aside from these additions, it has not been deemed necessary to materially alter the original text, as the test of ten years has brought forth no serious criticism of the general contentions offered. What is sought in the 1916 edition is to amplify, rather than to revise.

I

The Impossibilities of Speculation

A Message.

THE man who contemplates embarking on any speculative venture in the stock market may, without the slightest danger of being deceived, adopt the following statements as being wholly sound, incontrovertibly true and fully supported by experience and precedent.

1.—It is impossible to gain an enormous return on a small capital in a brief period of time in speculative ventures.

The possession of "inside information," full knowledge of conditions bearing on the security in which the venture is made, or any other advantages, cannot alter this truth. In twenty years of study of the subject, covering all conceivable methods of operation and with an intimate knowledge of the affairs of thousands of speculators, the writer has never once seen this statement disproved. We hear and read of many such successes, but authentic cases are not established.

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This does not mean that, through wholly fortuitous happenings, large profits have not been occasionally realized in a very short time. During the great rise in Bethlehem Steel and other stocks of that character in 1915, a few owners of such issues were suddenly enriched. But to consider these instances a refutation of the principle expounded would be to beg the question. Such gains were the result of nothing more than accident. The holders referred to had no expectations of any such results and consequently did not speculate in anticipation of them. There is no possible way of turning such accidents into definite methods for future guidance.

It is also conceded that a few outsiders, influenced by the spectacle of rapid rises in prices of various war stocks in 1915, ventured their small funds recklessly and won very large sums by gambling operations. That frequently happens in time of excitement and rapidly advancing prices, but this class of operators never keep what they have won. They do not speculate at all—they gamble. In the nature of things, they will return to the game as surely as does the gambler with dice or cards, and they will eventually lose as surely as he does. To say that a man can recklessly plunge in the market, without knowledge of what he is about, and that he will, when accidentally for-

fortunate, conservatively invest his profits, is to endow him with two distinct and antithetical personalities.

Many cases have been observed where a fortunate gambler with an original capital of, say, five thousand dollars, finding himself suddenly possessed of fifty or a hundred thousand dollars, would accept his profits, invest the proceeds in government bonds and consider himself independent for life—but this conservatism is always evanescent. The fortunate man considers himself rich only until he grows accustomed to the suddenly increased income. Then he is poorer than ever, and sooner or later he returns to the game and loses all. The writer knows of many such cases. There may be exceptions, but they have not been personally observed.

There is one great fundamental law governing all successful speculative ventures. Rothschild expressed it in five words,—“Buy cheap and sell dear,” but the terse axiom is not simple—it is decidedly profound. To follow it, we must know when a thing is cheap and when it is dear. That is where the work begins and where the real success lies. Prices and values frequently become divorced. If we make our purchases when prices are below values, we are certain to succeed. If we buy when prices are above values we are certain to fail. Superficial

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appearances are useless in forming estimates of the relations of prices and values. They are, in fact, worse than useless, for when prices are far below values, appearances are invariably unsatisfactory and when prices are at the top, appearances are invariably promising. That is why the public always buys at the top, and sells, or refrains from buying, at the bottom.

In determining when a certain security is cheap—that is to say, when its price is below its value—we cannot be guided by present conditions. These may be entirely satisfactory—earnings may be large, business good, dividends high, etc., but earnings may fall off, business may dwindle and dividends may be reduced. Speculation has to do with the future, not with the present. Present conditions are usually reflected in current prices. To speculate on the present is a flat contradiction of terms. It is upon what may reasonably be expected to happen next month, or next year, or in the next decade, that calculations must be based. The precedents of the past and the conditions of the present are useful only in assisting us to determine what is probable in the future.

2.—No one can hope to succeed in speculative ventures unless he is financially fortified against any accidental happening which lies within the range of reasonable possibilities.

The man who buys one hundred shares of stock on a thirty-point margin is frequently found bewailing his fate and his lack of courage in not taking three hundred shares on a ten-point margin, and by that method trebling his gains. He would better be congratulating himself that he has properly conserved the factor of safety and made his gains on a sound basis. If he had yielded to the inclination to take three times as much stock as he did, he would have contracted a habit which is as certain to result in ultimate financial loss as day is to follow night. Courage and boldness are essential ingredients in all speculative ventures, but courage and rashness are not interchangeable terms, as many people appear to think. For that matter, no man can be truly courageous in his ventures, who is not sure of his ground and sure of his methods before he starts in. If he is not so fortified, every little wind that blows will chill him; every adverse happening or rumor will confuse or alarm him and he will either do the wrong thing at the wrong time, or lose too much sleep. Profits gained at the expense of peace of mind are a sorry bargain.

3.—No man can make a decided and sustained success in speculation who depends upon the advice or direction of others. He must think for himself.

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It is, of course, wise to obtain all the good counsel possible, and to treat the opinions expressed by others with such respectful attention and due consideration as they may deserve. But slavish dependence upon another man's views never made a great fortune for anyone in any line of business. Even if the advice given by others is of high repute and presumably dependable, it should be accepted as such only when it is fully understood. Ask your adviser, "Why?" and keep on asking him why until you are in full possession of his facts and deductions. Then you may weigh them, preferably after hearing the other side of the question, and be governed accordingly. If a man who anticipates speculating, recognizing his own limitations, confesses to himself that he has not the ability to understand, think and resolve, he would better adjure the business promptly and forever.

No doubt, the reader who has followed the statements so decidedly set forth above will arrive at the conclusion that the rewards of speculation are not so great as is popularly assumed and that the work involved is more than the ordinary man would have time or ability to undertake. In the first conclusion he is correct. The returns to be made from intelligent speculative ventures, conducted along sound lines, are large, but the belief in great

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fortunes made in a few days by gambling operations in stocks is merely a widespread popular fallacy. No more great fortunes have been made in that way than in any other form of gambling.

The thought and study involved is not so formidable a task as may appear. Many of the things which must be considered are matters of more or less general education. As the intelligent speculator will find it necessary to keep track of such current events as crop prospects, railroad earnings and general economic conditions, the pursuit of such information will broaden his knowledge and be of help to him in any line of enterprise in which he may engage. Speculation, properly followed, involves, in itself, a liberal education in many lines. Like most other branches of human endeavor, the necessary education is not nearly so difficult as it appears at first blush, and the pursuit of such knowledge soon becomes a pleasant as well as a profitable task.

The statement cannot be too frequently reiterated, nor too forcibly emphasized, that unless the man who contemplates employing his surplus funds in speculative ventures is willing to undertake the work with a clear recognition of the principles expounded, he will be much better off if he directs his attention to some other line of endeavor.

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"Many men," said the late James R. Keene, "come to Wall Street to get rich; they always go broke. Others come to Wall Street to operate intelligently for fair returns; they usually get rich."

II

The Public Attitude Toward Speculation

THE public attitude toward speculation is generally hostile. Even those who venture frequently are prone to speak discouragingly of speculative possibilities, and to point warningly to the fact that an overwhelming majority of speculative commitments result in loss, while those who venture not at all, and consequently are incompetent to judge, dismiss the subject with the statement that marginal trading is gambling, pure and simple, and is therefore pernicious.

Those who enter into the subject a little farther, and attempt to adduce more specific argument against speculative possibilities, lay stress upon the statement that manipulation, trickery and wholesale deception render it impossible for the outsider to enter the field safely or intelligently. These statements, usually unsupported, and frequently insup-

portable, are accepted by the prejudiced multitude as gospel truth, without any attempt being made to examine their foundation or correctness.

So far as the question of gambling is concerned, it would be entering a very large field to attempt to define just what is and what is not gambling.

The idea that the man who buys a certain stock outright invests, while he who buys on margin gambles, is a popular fallacy. The speculator purchases in the hope of an advance, and if two purchases are made for parallel reasons, one for cash, and one on margins, both purchases are speculative.

That speculative fluctuations are largely used as a basis for gambling operations, is unquestionably true, and possibly an acceptable dividing line may be drawn on the following hypothesis: gambling, in the general acceptance of the term, is founded upon blind chance, the equal possibility of certain events occurring or not occurring; this is modified in some cases by the exercise of superior skill in such games as admit of skill; but fundamentally, gambling is wholly dependent upon the equal chances of two or more opposed individuals.

The trader, therefore, who takes "flyers"

with no knowledge of his subject, or the properties in which he deals, merely gambles on the ultimate rise and fall of the market; but the trader, who, after careful investigation and study, purchases a property, either outright or on margins, because he has reasons for believing it to be cheap, and that it will enhance in value, is a speculator.

Those composing the gambling element are in the majority, and it is needless to say, are the greatest losers; in fact their losses foot up almost the sum total of speculative deficiency, and consequently the sum total of the gains reaped by the real speculator.

The statement that most public commitments are made on no better foundation than a mere guess, may seem a trifle bold, and the counter statement may be made that few people purchase a stock without some reason for so doing. This is admitted on the same basis that the man who bets on a certain number at roulette because it has not recently appeared, or in hope of an immediate repetition, considers that he has a reason for his action. Thus a great number of amateur, or semi-professional traders, buy a certain commodity for no better reason than that the stock has declined, or, more frequently, from a partici-

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pation in a period of speculative intoxication. They can give reasons for their ventures, but they are without foundation, and are no more worthy of consideration than the reasons given by the roulette player for "staking" upon a certain number.

On the other hand, the speculator, with a carefully acquired knowledge of the normal value of certain properties, fully posted on conditions in general, and those affecting, or liable to affect his favorite property in particular, patiently waits the opportunity to buy, not at a normal price, but at a price far below the actual value of his property. He knows that speculative prices move in cycles, more or less pronounced and prolonged, and in the revolution of this cycle he will be given an opportunity not only to purchase at a price far below a normal valuation, but to sell at a price far above it.

This looks simple enough in the telling, and is merely the operation of Anselm Rothschild's famous advice, "buy cheap and sell dear." But when the statement is made that over 90% of public purchases are made at the approximate high tide of a market and about the same percentage of sales at the approximate low tide, in short, that the most simple and reason-

able methods of making money are not only disregarded, but actually reversed, a great field for analysis and discussion presents itself.

Manipulation and trickery are vastly overestimated: popular prejudice continually accords to such causes events which were brought about almost wholly by the composite folly of public participators in speculative affairs, and which could not possibly have been effected by any individual interests.

That these stages of undue depression and inflation are to some extent assisted by the shrewd minority, is true; but the great work is that of the public itself.

That the money-making minority foresee, and take advantage of these extremes, is unquestionable. They are the cause of all speculative movements of importance, and through the errors and losses of the lambs the accumulations of successful operators are made possible.

After a careful examination, covering a period of ten years, and a study of the methods of successful and unsuccessful traders as shown in some thousands of speculative accounts, the following facts are adduced:

1st—The greatest causes of loss in specu-

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lation are ignorance, over-speculation, and carelessness, of importance in the order named.

2nd—The popular fallacy that business methods are not applicable to speculation is wholly erroneous.

3rd—Not one speculator in a thousand applies ordinary business precautions to his trades, nor founds his ventures upon knowledge of any value.

4th—The correct trader has little to fear, and much to gain from manipulative tactics.

5th—While extremes of prices move in irregular cycles, no "system" for judging changes is possible, or tenable, as such mechanical attempts to forecast price changes do not contemplate changed conditions, or provide for accident. The advocates of the "Chart System" are legion, and yet it is impossible to find a single permanent and substantial gain made by this method.

6th—The general idea that the actual value, and probable future of a property cannot be intelligently based, is erroneous.

7th—The greatest speculative profits are made in stocks, and the greatest speculative losses, in staples: wheat, corn, cotton, etc.

8th—There are certain technical stages, or conditions of markets which are followed by

certain invariable results, the study and recognition of which is valuable, and not difficult. These "ear-marks" are in some cases very plain, and do not in any way smack of the "systems" deprecated above, but are more or less visible signs of effects following certain causes.

9th—Almost every general idea of speculation is the exact reverse of the truth. Sometimes this is caused by false reasoning, but most frequently by the innate false appearance of the market quotations. For example, greatest activity and interest in a market occurs around top prices; while dulness and stagnation are invariable when properties are unreasonably low in price.

10th—Persistent short selling of stocks is fashionable in a certain class of semi-professional traders, and almost invariably results in loss.

11th—Tips are illogical. Any wide-spread dissemination of advance information as to a projected movement would defeat its own object. The so-called "tip" is usually mere guess work. The general consensus of public opinion on this subject is correct, i. e., tips are valueless; and yet the public continues to use them largely as a basis of trading.

12th—Too great facilities for obtaining information and executing orders, is, to the ordinary trader, of no advantage, and is frequently a source of loss. (The accounts mentioned above show the most intelligent trading to have been done by traders who were without facilities to interfere with their own original plans through fright or confusion.)

13th—Speculation is a safe business when business methods are applied to it. The changes in prices of standard properties offer yearly greater opportunities for profit than any other field. That is to say, for reasonable profits, not for the amassing of fortunes on small capital, in a brief period, but for steady accumulation of money and valuable knowledge. So great are the opportunities offered by speculative changes, that with proper methods and self-control, the poor man cannot afford to overlook them.

To make these rather radical statements in a general way is wholly insufficient; each statement must be supported by the presentation of convincing precedent and clear reasoning, and it is the purpose of these articles to point out the reasons for the failure of the majority, as well as the methods by which the minority succeed. This done, the knowledge

so gained must be insulated into useful channels, and combined into flexible rules, and inflexible laws.

It is not claimed that it is possible to set down in print a formula for speculative success: much depends upon the individual. A man is not a machine, and will be frequently swerved into paths which he, himself, knows to be dangerous, and an individual incapable of clear thinking and correct application of accrued knowledge, would not succeed at this, or any other business.

The most that may be hoped for, consequently, is to point out certain facts which will lead to a correct line of thinking, or open the way to profitable discussion. To this end, the various causes of loss mentioned will be discussed in turn.

III

Ignorance, Over-Speculation, Etc.

IGNORANCE, over-speculation, and the innate false appearance of market stages are the principal causes of speculative loss, and are, in truth, the principal causes of the great cycles of speculative extremes. These extremes are variously attributed to specific causes, affecting certain securities, to good or bad business conditions, or to accident or manipulation; but the fact of the matter is that the wide swings of the market are brought about almost wholly by the errors and ignorance of the great body of traders known as the public.

Conditions change, accidents occur, and manipulation exists, and all have their effect; but unless these factors were supplemented by alternate waves of general over-confidence, and subsequent undue depression, the fluctuations in market quotations for standard properties would be confined to such narrow limits that the repeated opportunities to purchase such properties at prices far below, and to sell

them at prices far above a normal value, would be eliminated.

Almost all the commitments made by public traders are made on faith, or on misleading surface appearances. The advice of people absolutely incapable of passing intelligent opinions, is eagerly listened to and frequently acted upon; large dividends on low-priced stocks are made the basis of optimistic views and shallow arguments; the fact that a certain stock has dragged back in a generally strong market,—usually the best evidence in the world of something radically wrong with that particular stock,—incites what may be very undesirable purchases. The development of certain long-heralded events, such as the payment, or increase of a dividend, is considered a good reason for the purchase of the security affected, when in fact it is no reason at all, as Wall Street always anticipates and discounts probable good news. These and a hundred and one other reasons, mostly ill-founded, are the groundwork of the great bulk of public ventures, and the individuals who operate on these unreliable signs, with full knowledge of the fact that the public has been misled by them time and again, seldom attempt to investigate the intrinsic value of the property in which

they have assumed and paid cash for a proprietary interest. Such an investigation is usually considered useless or impossible. If this were true any participation whatever in speculative affairs would be folly, but fortunately this common opinion is itself the result of ignorance.

Over-speculation, the composite result of ignorance, greed, and false appearances, may be classed as the primary cause of wide variations in prices, for as much too high as a market is carried by rash participation at high prices, just as much too low will it sink in the ensuing decline. The ill-advised traders who rush in at high prices with inadequate capital are the first to suffer; their overthrow topples over other weak accounts, and so on down the line, until the last of the wobbly row of bricks has fallen.

It might be contended that when this process of elimination had brought prices of good properties to a fair valuation, purchasers would be easily found, and such might be the case, were it not for the fact that the great lights of speculative finance know full well that the technical position of the market is still bad; that many venturers, already financially weakened by the decline from abnormal to normal

prices, are in a position which they can be forced to abandon; that the pendulum of prices will swing to the other extreme, and they refrain from buying at normal prices for the good and simple reason that they know they can eventually buy at prices that are very low. Perhaps these low prices will come about unaided, through the internal rottenness of the technical situation; perhaps the desirable consummation will require a little assistance, such as the passing of a dividend or two, the closing of a few mills or the laying off of a few men, all of which actions can in the future be pointed out as good and conservative business moves, but which will be received by the public with anger and disgust; for so dense is general ignorance on this one subject that the payment of a dividend is always considered good, and the reduction or passing of a dividend is always considered bad; a bond issue, for whatever purpose, is an unmixed evil, and so following.

The professional bear element also assists in the final downfall of prices. They will be well aware of the assailable condition of the weakened long interest, and will attack the market for the purpose of reaching stop-loss orders or forcing crippled speculators to sell. These same bears may later be hoist with their

own petard, for a chronic bear is a chronic loser, but meanwhile they assist the successful campaigners materially by forcing a temporarily lower level of prices and supplanting weak long accounts with a short interest, which is in itself a great advantage to the bull element.

So familiar is the experienced speculator with public weakness that he is usually found operating in direct reversion to prevailing sentiment. He knows by careful and clear-headed investigation the normal value of the property or properties in which he trades, and at such time as he finds the current quotations far below this fixed point and the public inveighing bitterly against his favorite issues, he begins his purchases. It does not require much shrewdness to deduce the fact that if a certain standard security has passed out of public, or weak hands, it has of necessity been concentrated in the strong hands of the giants of finance, and that the purchaser at such periods is at least in good company. He has no fear of any abnormal shrinkage in the value of his holdings, as such sudden shrinkages are the result of panic or financial necessity, to which the present holders are not subject. He also knows that any manipulation must now be for

the purpose of creating higher prices, as the next great speculative move will be to resell the cheaply purchased properties at high prices, and the public being absent, there is no one to manipulate against. He is certain that unless all precedents fail, he will, at some future time, see high prices and general good feeling supplant the present depression.

As has been stated, the innate false appearance of speculative surroundings does much to influence public participation at the wrong period. When stocks are low in price the brokerage offices are deserted, the newspapers say little of speculative affairs, transactions are limited, and those who have been worsted in the preceding decline speak in pessimistic terms of the future. A long period of dullness almost invariably follows a severe decline, new lambs must be born and the old ones suffered to grow a new fleece, and dullness is always unattractive. But at the crest of a great movement all is activity. Excited groups gather about the tickers and predict future events founded principally on illusions or hope, and stories of quickly acquired gains are heard on every hand. A fever of speculation fills the air and men who had no thought of venturing during the time of depression and low prices,

now purchase anything and everything at prices that are very high.

The mistakes discussed above—ignorance; the belief that speculative riches are the result of luck rather than of judgment, over-speculation and misleading surface appearances, combine to make it possible for the shrewd and successful minority to buy and sell periodically to great advantage by an almost exact reversal of public methods and beliefs. Their operations are not founded on such reversion, but on study and knowledge of past precedent, present conditions and future probabilities. The fact that public opinion is diametrically opposed to their views may be cheerfully considered as excellent proof of the correctness of their deductions, as the public is usually wrong.

If the statements made above are admitted to be correct the lesson they teach is obvious. To result successfully, speculative ventures must be based on sound reasoning and a knowledge of correct normal values; on a willingness to confine operations to reasonable limits and upon emancipation from the moving influences of general exhilaration or depression. The individual who begins or pursues his operations on these great fundamental principles has taken a great step toward the goal of success.

IV

Manipulation

THERE are two classes of manipulative tactics indulged in by the inside workers of Wall Street; the long range tactics of the great but silent workers who lay a plan contemplating a complete speculative cycle from high to low prices, and the more frequent and drastic operations of room traders who find a market in a bad technical position and operate for known effects, either as a matter of immediate profit or to rid themselves of a dangerous following. The success of both is dependent upon public folly.

In the first class lies the hidden and carefully calculated work of haute finance. It consists of creating, or helping to create, false impressions as to the value of a certain property, of lending encouragement to buy at high prices, or to sell (or at least to refrain from buying), at low prices. The motives are obvious: to create a demand for the goods for

sale, and to create a supply of the goods whose purchase is contemplated.

This high form of financiering is always helped by shrewd choosing of propitious periods and surroundings, and its moving factors, though potent with result, are so veiled and untraceable as to render supportable criticism impossible.

The recent price movements of the properties of the United States Steel Corporation furnish a pointed example of this method of financiering. The stocks were offered to the public at prices which were really fair, statements were issued which were unquestionably correct, and dividends were paid which were doubtless earned. The periodical reports were rosy, but they were true. The great earnings were made, and called attention to the high tide of a period of unusual activity and prices, but the public did not take the trouble to ascertain this important fact. They saw only one thing, that large dividends were being paid, and still larger earnings being carried to surplus, by a company whose stocks were selling at low prices. They looked neither backward nor forward, but glued their eyes upon the insufficient facts of the present. A little knowledge would have proven that not only

were the recent and present earnings unusually large, but that all such abnormal periods are followed by a reaction.

These simple facts, known and recognized in the abstract as being true of all businesses, were lost in the greed and fever of speculation. Knowledge and study played no part in the affair; the present was all-sufficient, and the public bought largely, both for investment and on margins; and by the same token, the promoter sold. Later the earnings fell off, which was perfectly natural, money was lavishly disbursed, their holdings increased by the purchase of new properties; the surplus dwindled, and dividends on the common stock were reduced and eventually suspended altogether.

A public change of heart took place, and views of the company's future changed from extreme rosiness to cross-grained cynicism. Again the present was made the only standard; the stock was watered; the common shares were absolutely worthless; future dividends were impossible, etc.

The fact that a great deal of money had been intelligently diverted into channels which could not but enhance the future value of the corporation was not considered, and so, during a natural period of reaction, the disgusted

public gradually relinquished their holdings, and they passed back, little by little, into the hands of their original owners at prices ridiculously low.

From the standpoint of the great manipulators, it was beautifully done. Not one argument could be brought against them which could not be amply defended. "We paid dividends because we earned them, and you, our stock-holders, clamored for them and approved of them; we gave to the world statements of every dollar received and disbursed; nothing was misrepresented, nothing was concealed. When the iron and steel business suffered a relapse, and our surplus had been lowered by excellent and necessary expenditures, we did what every business man does—decreased our expenses and our dividends until an improvement was apparent. We are not responsible for the actions of Wall Street, and if you, as an individual, made ill-advised purchases and sales, or over-speculated, that is no fault of ours. Yes, we did, as individuals, sell some stocks at prices which we considered fair, and likewise re-purchased at prices which are considered low. That was a matter of business, and was our privilege. We have absolute confidence in our properties and their future and

always have had. You cannot blame us for your mistakes; you beat yourselves; get out!"

This is unanswerable, but the fact remains that these men knew what the effect of their actions would be and acted accordingly. No one who has a personal acquaintance with Mr. Morgan and his principal lieutenants would harbor any thought of their having participated in the general enthusiasm, and making the error of themselves believing there would be no reaction in the large earnings and good condition of the affairs of the Steel Corporation. Never.

That they had faith in their properties is literally true, and it is doubtful if the largest holders would have parted so freely with their stocks but that they knew absolutely what would happen, and that the stocks would perforce be returned to them at low prices. Neither did they find it necessary to cripple or permanently injure their great consolidation to bring about their grand coup. The shares had the same inherent value at the lowest range, as at the highest.

It is unquestionably true that if the magnates "who never speculate" had not foreseen and acted upon public folly, no dividends would have been paid which could not have

been maintained, and instead of the wild pyrotechnics and wide-price range of steel stocks, the properties would have steadily increased in value from the birth of the concern.

There is nothing new in all this—it is a time-honored method of speculative financiering, from the repetition of which the public seems to learn nothing, and from which the most powerful interests make their largest returns.

The second class of manipulation, more recognizable as such, is more brief as to period and more restricted as to results, but is potent enough at times to bring about changes and appearances which either force or frighten holders out of a good position, or mislead them into a bad one.

The cry is frequently heard that the public is not in the market, and this state of affairs is usually pointed out as a reason for stocks not advancing. This view is another evidence of the reversed reasoning so prevalent in speculative matters.

The very last thing the great speculators want in the market is such an interest at low prices, or even at midway points in an advance. So undesirable, in fact, is such an element that its presence means defeat for the sponsors of the deal themselves, and a projected movement

is sometimes abandoned temporarily on account of too large a following. The most approved method, however, is to "shake out" and discourage this following. The process is simple; the great inside element finding themselves in company of numerous "tailers," whose weakness and liability to panic on the slightest pretext may ruin their own devices, take advantage of just such known weakness, and with the assistance of the professional bears, proceed to drive their undesirable friends away. To accomplish this, support is withdrawn and a portion of the accumulated holdings sold ostentatiously. The bear element, fully aware of the assailable state of the market, assists the manipulators by heavy sales and vicious drives. The enthusiastic public, crippled, discouraged and disgusted, drop their holdings, and a considerable number of half-baked bears join in the same game of "follow the leader," until a short interest is created. Meanwhile, the original projectors replace their holdings at opportune times, perhaps at a lower average than that at which their spectacular sales were made, perhaps not—but the physicking has been accomplished, the atmosphere is cleared, and the "deal" which they had never for a moment contemplated abandoning,

goes merrily on until such time as another purging may be necessary.

These two forms of speculative tactics, with their various off-shoots, constitute the fundamental basis of manipulation. They are widely different; the one, the long distance work of the great "financier" who pays no heed to ordinary movements, but works toward a great end; the other, the tactics of purely speculative interests. The first is responsible for the long swing of the market; the second for many of its sharp intermediate changes; but both are united in one thing, they work together for the undoing of the general public.

The man who invests, or speculates for the long swing may, like the first class, disregard all ordinary hippodroming, and await certain results.

The man who indulges more freely in speculative ventures must bring to his aid clear thinking, study and vigilance. Above all things he must provide for sharp changes financially, and if he is caught in a flurry, his embarrassment will be only temporary.

In both cases everything depends upon an intelligent basis of normal valuation, for to that basis, if correctly estimated, the price of his holdings will eventually revert.

All the manipulation, accident and trickery in the world can not keep prices too low nor too high for long. The needle of the compass may be disturbed and swing nervously from side to side, but it must point to the true north at last.

NOTE.—Since the foregoing chapter was written, ten years ago, there has been a marked change bearing on both the forms of manipulative tactics referred to. Happily, this change is for the better in both cases.

The long-distance inside manipulative tactics have suffered a decline. The exploiter of stockholders for personal profits is a decaying genus. This may not appear a correct statement in view of the Rock Island scandal and a few other cases of like character, but it is true, nevertheless. The names of the individuals or groups still struggling to carry out the predatory methods which were so popular in the Gould-Fisk-Vanderbilt days may be checked off on the fingers of one hand and, what is more important, these people are not meeting with their customary success. By the same token the properties which are discredited or in receivership will correctly check with the names of these individuals. Our railroads, considered as a whole, are no longer the toys of big gamblers and manipulators. A great majority of the properties are honestly and successfully administered. This is largely due to legal measures and restrictions. No matter how much people may criticize the actions of the Interstate Commerce Commission, that body is the stockholder's best friend. They have made it possible for him to analyze with some assur-

ance of accuracy the conditions, physical and financial, pertaining to his property. They have made the work of the exploiters increasingly difficult. They have been of genuine assistance to the railroads themselves in many ways, by eliminating free passes and rebates and by curtailing the activities of stock market buccaneers.

In the secondary form of manipulation, i. e., the active juggling of securities and quotations, there has also been great improvement. The Governors of The Exchange have adopted every intelligent means in their power to discourage and punish this sort of thing.

So far as "washed sales" are concerned, this pernicious practice is still carried on to some extent, but only when it cannot be detected and proved. Without the use of this laundry machinery, the manipulators find the bidding up of prices or the "shaking out" of holders a difficult and, at times, an expensive operation.

V

Accidents

ACCIDENTS or unexpected events frequently mark the beginning of sharp or extended declines. It is generally considered that anything in the nature of an accident must be in favor of the bear element.

This theory in the abstract is sound enough, as accident and disaster are nearly synonymous, but careful consideration of the subject will develop the fact that in the speculative world accidents are more frequently the excuse for, than the cause of, any severe or extended decline, and their effects are to be measured by the stage and condition of the market, rather than by their actual capacity for evil.

Nothing in the nature of the unforeseen can be conceived as happening which could permanently injure or retard the growth and value of good properties.

The United States has such recuperative power that the naturally increasing value of her properties can easily overcome the tempo-

rary effects of unforeseen occurrences. It is reasonable to believe that if all the accidents which have occurred and have been pointed out as the cause of great market changes in the last ten years had never happened, stocks would still be at the same approximate level as they are today.

It is admitted that accidents frequently administer the little shove to an already bad state of affairs which hastens a decline that must have eventually and inevitably occurred, accident or no accident. This is not wholly an unmixed evil, as it may be the means of checking excesses, which, if allowed to continue, might result in even more severe consequences.

On the other hand, an accident may sometimes mark the very beginning of a great upward movement by frightening from the market at low prices weak and foolish speculators whose very presence spells danger, and attracting to it far-seeing men who gauge prices by values.

The danger of adverse litigation, (which may be classed among unforeseen events), against good properties is slight. Annually, numerous tirades are begun against combinations and individual corporations in the legislative halls,

or in the columns of the public press, supplemented by the railing of the notoriety-seeking charlatans who find it popular to inveigh against capital in general, but the fact remains that no measures will be taken, or at least no measures can endure, that will prevent the builders of railroads, or the capitalizers of great industries from making good returns on their money, or from seeing their investments grow in value through the advance of demand and population. Such measures, expounded by dreamers, or socialistic tin-horn tooters, strike at the very foundation of business extension, and per contra, any individual or coterie of individuals, who seek to overdo the extension of capital, or make it bring exorbitant and unnatural returns, will, like the toad in the fable, burst by self-inflation.

Stripped of these two extremes, business conditions are sound and solid, and gradual growth and prosperity are assured.

The unexpected calling of loans, the exportation of gold, the killing of crops, sharp changes in the attitude of foreign markets, etc., are matters which are to be expected annually, either as natural or manipulated events under any and all conditions, and are almost wholly impotent to change the course of a long swing

to high or low prices. Like the boy who cried "Wolf, Wolf," on every occasion, they lose their importance by repetition.

True, these minor signs may to the close student sometimes appear as straws indicating the course of the financial wind, but generally speaking, nothing short of a wide-spread and severe disaster can change the course of the great cycles of speculation, the repeated and unchecked revolutions of the wheel of fortune.

A good illustration of the statement that accidents frequently prove merely the puff of wind which topples over an already rotten structure, is found in the death of the late R. P. Flower. This unexpected occurrence was followed by a radical and extended decline in the properties known as the "Flower Stocks." It cannot be reasonably claimed that the cancellation of Mr. Flower's personality affected the securities in question, as the number of stocks in the group, and the fact that he had no voice in the affairs of some of his favorites, combined to render any personal direction of the internal workings of the properties involved, impossible. His personal efforts, for instance, could not have sustained Brooklyn Rapid Transit above par; the stock was not, and never has been worth the prices at which it

sold. It may, probably will, at some future day be cheap at that figure, but at the time in question, the price was premature, if not ridiculous. What followed Mr. Flower's demise must have occurred from its own inherent weakness, sooner or later; the event simply hastened the inevitable.

It is not the intention in the above illustration to cast any aspersions upon the methods or memory of the financier; he was sincere, but an enthusiast. He told his friends certain things would happen, and believed they would. His speculative campaign attracted to him a large and dangerous following, and his views of values were based more upon optimism than reason. He was honest, but he was mistaken.

The death of a great financier is always considered for its probable market effect, which must, of course, be measured by the actual result. The probability of such an event acting as a fillip to an already over-strained condition may be eliminated on the theory that in such cases they become excuses, not causes. It is not reasonable to believe that the removal of any one man from the financial map will be followed by any sustained depression. The affairs of such men almost invariably revert to

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good hands by direct succession, and the popular fallacy about rich men's sons is being continually disproved by such men as the Vanderbilts, Rockefellers, and Ogden Armour.

Nor is the death of a rich man always an unmixed evil. Jay Gould's death was, if anything, a boon to the speculative world. He was a trickster and a wrecker. Even in the event of a great financier dying intestate his holdings would quickly find a resting place in strong hands.

The danger of wide-spread epidemic has always been regarded as a bear point, and were it not for the fact that the advance of science and the improvement in sanitary conditions now invariably confines even the most contagious and virulent diseases to limited areas, the devastations of a plague might be seriously regarded. As it is, the probability of any material damage from such a source is remote, and the bears, wont to welcome with open arms, ruin, devastation and death, have almost discarded them as weapons.*

The most serious of all events classed as accidents, is war, with its heavy entail and

*In the cholera scare of 1892, when the "yellow flag," indicating cholera on board, was shown outside the New York harbor, an excited bear rushed upon the floor of the Exchange, shouting, "Hurrah, hurrah, the cholera is here." He was suspended.

general disruption of affairs. That our country will not be plunged into a disastrous or prolonged war must be taken on faith, and the struggles of other nations, in which we are not involved, is productive of more good than evil; as, while it may bring about the forced selling of some of our securities held abroad, it also places the United States in the position of a huckster, and makes a market for our products at materially higher prices, which prosperous condition must be reflected in all lines of business. No better example of this could be given than the recent struggle between Russia and Japan.

The contention is therefore made that while accident is frequently made the excuse for speculative declines, it is seldom the cause, and that if conditions are sound and prices low, any sharp decline brought about by unforeseen happenings creates opportunities which would otherwise not have existed. On the occasion of public fright at such stages, it is frequently the case that great men come to the "assistance" of the market, and buy stocks heavily, (when they are low enough), and are hailed as public benefactors. That such purchases are made from purely philanthropic motives is, to say the least, doubtful.

The speculator, therefore, who has mapped out a well-formed plan of operation, can afford to ignore the probability, or possibility of accident, except to provide for any sudden flurry occasioned by such causes; or, if an active operator, may sometimes take advantage of unreasonable fright and apprehension to replace, or increase his holdings.

There is no gainsaying the fact that a serious accident or event is possible; but to be effective it must be in the nature of a far-reaching disaster, and may be viewed by the trader with about the same degree of apprehension as he views the danger of being struck by lightning in his daily walks.

NOTE.—In referring to the probable influence of warfare in the preceding chapter (which stands as it was written ten years ago) it was stated that no better example could be offered than the struggle between Russia and Japan, which added greatly to our wealth. But we have since then had a much better and more favorable example in the European war. However, the basic principle is the same in both cases. The outcome of the European struggle has faithfully supported the theory expounded.

VI

Business Methods In Speculation

FEW men embark in a business pursuit of any kind without a careful examination of the prospects and environments of their ventures. If a business, or an interest in a business; is to be purchased, the past, present and probable future of that business are carefully examined. The assets and liabilities are compared, the record of past sales and profits are considered, and the probable future of the community, or territory from which the business draws its revenue, is given particular attention, and also, the danger of a decimation of profits through competition is considered. The character of the individuals concerned as partners or managers is weighed, and if found wanting, the proposition is discarded, as confidence between men is the foundation of all successful combinations.

Neither does the prospective purchaser enter his field without some special education for the business in hand, or at least not without a

determination to watch and learn daily something of the technicalities of his enterprise.

These simple facts are recognized the world over as merely plain, sensible precautions adopted by all business men in all businesses—all except one—the widely patronized business of speculation.

This disregard of recognized business rules and laws is caused largely by the fact that the multiplicity of speculative properties with their large capitalizations stagger the ordinary mind, and lead a man into the error of considering himself incapable of grappling with so great a problem, and partly by a misplaced confidence in the expressed belief of others.

The opinions of brokers are given a degree of credence to which they are seldom entitled, for, sad to relate, the lack of study and method is almost as prevalent behind the office railing as outside of it, in addition to which the desire to make commissions frequently leads the broker to an expression of encouraging views running parallel with the ideas of the client, whether such views are sincere or not.

The emphatic opinions of friends and acquaintances are also greatly over-rated at times, especially if the advisor has been fortunate in his recent ventures, which fact alone is

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a dangerous and insufficient guide. This willingness to accept the alleged thinking and knowledge of others frequently results in almost total elimination of thought and knowledge as a basis of operation. It is doubtful if a single case of sustained success in speculative ventures can be pointed out that was not founded upon individual study and investigation.

The idea that large properties cannot be investigated intelligently is a mistake. Every standard listed security must, under the rules of a well conducted exchange, offer to the public every facility for such investigation. The size of a property is only a matter of degree, a multiplication of what represents and belongs to a single share of stock; or, per contra, the value of one share of stock is a division of the whole.

Facts and figures as to assets, earning capacity, territory and past history are easily obtainable, and the value of the deductions resulting from the thorough and painstaking scrutiny of a property is to be gauged only by individual capacity for clear thinking, stripped of foolish credulity and pig-headed prejudice.

The advantages of choosing for operations

the standard properties listed upon the New York Stock Exchange are manifold. There is always a market for these properties, which is not true of wild-cat securities; they are admitted to the benefits of the exchange on demonstrated merits, and under inflexible rules. True, a few bad properties have made their way into the exchange, but they have been the exception, not the rule.

The governors of the exchange are men of unquestioned business integrity and honor, and exercise every precaution to exclude undesirable stocks.

It may be contended that the public has been dumped, time and again by the fluctuations of listed stocks, which is exactly true; but that has been the fault of public error, and not of the rules of the stock exchange, nor lack of merit in the properties themselves.

The man who begins his investigations as to the actual value of a listed property, therefore begins with one which holds a high place in the business world, and which certainly has some value. It is his business, therefore, to estimate carefully this value, and upon the result to base his operations.* This knowledge of

*The writer's views as to the best method of making such an investigation will appear in a succeeding chapter.

an approximate valuation will prove of great importance, and will materially aid the possessor, and prevent him from undue exhilaration or depression.

He may reasonably argue that all general depression will be followed by improvement, and that every bubble of inflation will be pricked. The United States will take care of itself and all of its good properties.

Matters of moment bearing upon his particular property will, of course, be weighed carefully, and, if of sufficient importance, may necessitate the changing of his basis of valuation, either to a higher or a lower level, but this will be done carefully and slowly.

One thing the investigator may safely consider in his favor, and that one thing is of high importance: that the good properties of a new country are certain to gradually advance in value, with a tendency to restricted fluctuations until final absorption takes place.

This fact is easily explained: a new country offers in the sudden development of its virgin resources opportunities which render fair percentage returns unattractive, and speculative, or even investment capital seeks these channels. But as these opportunities are gradually restricted by development, money seeks the

dividend paying properties which will yield perpetual returns.

The man who speculates in a business-like manner will at once see the necessity of entirely eliminating abnormal possibilities and rashness from his plan of operation. The difference between expecting from the market what is reasonable, and expecting too much; and between buying what can be reasonably protected, and even increased, and plunging, is exactly the difference between success and failure.

He who buys one thousand shares of stock on a total capital of ten thousand dollars is ruined before he begins trading. He may succeed once, twice, or twenty times, but his ultimate failure is as certain as death.

Many men with sound ideas, and whose ventures have proved ultimately the correctness of their views, have, by the one fault of overtrading, become paupers, when, with business methods, they might have become millionaires.

It is one of the many strange facts about the great field of opportunity called speculation, that men who consider ten per cent. a good return on capital in ordinary business are wholly dissatisfied with one hundred per cent. in a speculative venture.

The business man in speculation will find it expedient to divorce himself from the alluring attractions of the ticker itself. Many traders whose long range views of values and approaching conditions are good, get their noses so close to the ticker as to shut out the true perspective. They deceive themselves into the belief that they are keeping well posted by haunting the brokerage offices and following the mass of good, bad and indifferent gossip, conflicting opinions, canards, and predictions, as well as being swayed by the innumerable flurries which occur almost daily, and are always accompanied by an excuse. For a man is human, and no matter how phlegmatic by nature or cultivation, is more or less moved by these pernicious influences.

Anything worthy of consideration may better be considered in cold blood, than in the active time and place of speculation, and if commitments have been intelligently made and provided for, propinquity to the ticker will far oftener prove a detriment than an aid to profits. There are no doubt many professional scalpers, whose business is the chasing of fractions, who watch the slightest variation in quotations, and by so doing make some money—a great deal less, by the way, than is popularly sup-

posed—and who find their constant presence at the ticker a necessity to their particular scheme of operation, but these articles are not written for their benefit.

The time spent in gathering a bewildering mass of false impressions, so untrustworthy as to be ridiculous, and so numerous as to be confusing, can be much more profitably spent as every really successful operator spends his time, in study and sound reasoning.

The choosing of a broker is important, financial responsibility and personal integrity being the first considerations. Brokers who offer reductions from the fixed standard of interest and commissions should be regarded with suspicion; such advantages are usually dearly purchased. Standard charges are not unreasonably high, and are not to be considered a drawback if general methods are correct.

A good broker may also frequently aid in the forming of opinions, or in the confirmation of opinions already formed; but as every trader, to succeed, must do his own thinking, this is not of so much importance as is the assurance of stability and probity. It is cold comfort to see one's carefully figured deductions confirmed, and then see the results vanish

in the failure of an unreliable house, and yet this same event occurs again and again.

Summing up, the man who speculates in a business-like way trades only in standard properties with whose history, physical condition, earnings and prospects he has thoroughly familiarized himself; forms for himself a careful estimate of normal value and uses this value as a gauge by which to decide when prices are too low and too high; takes into consideration also the technical condition of the market, and does not embark with bad company, even at low prices; is not misled by the thrills of inflation, or the chills of depression; operates, not for the purpose of gathering a small profit from many transactions, but to gather a large profit from a few; trades with responsible middle-men, and, above all things, is patient. In short, he maps out for himself an intelligent and well-founded plan of operation, contemplating all that may occur, and having mapped it out, follows it.

Very few speculate in this manner, and—very few succeed.

VII

Analyzing Basic Conditions

SINCE the foregoing chapter was first published many inquiries have been received, asking for instructions as to the simplest methods of judging a sound or unsound basic situation. An exhaustive discussion of the subject is forbidden by the limitations of space, but a few suggestions may prove of value to the reader.

While it is true that many things require consideration, and it is not safe to relax vigilance in scrutinizing minor factors, a great deal of redundant and unnecessary work is done by zealous students. They either duplicate their work by examining factors which are interdependent or collateral, or go at the problem backward by uncovering some unimportant ingredient and tracing it laboriously to the root, instead of finding the root influence first and later giving to the branches such attention as they may deserve. Credit and money conditions, bank clearings, average return on money invested in sound securities, and a few other dominant factors, are usually sufficient guides or are at least sufficient to direct atten-

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tion to divergences, or to extraordinary influences which may merit examination. It goes without saying that to this broad perspective we must add the more trying and time-consuming practice of examining the individual status of each security which we may own or which we contemplate owning. A general perspective loses much of its value unless backed up by painstaking discrimination in the matter of selection of securities.

In their studies of the causes of crises and periods of depression, several of the leading economists have pointed out a number of easily recognizable phenomena which precede and indicate the appearance of such periods. There is very little divergence of opinion as to the character of such indicia. They are matters of precedent and record—after-event wisdom. As to the basic causes of crises, however, the theories are numerous and divergent ranging all the way from sun-spots to personal extravagance.

The preceding indications of trouble are placed under seven heads by Burton, in his book, "Crises and Depressions," and these rules practically represent the composite view of students of economics. They are as follows:

Preceding Indications of Crises.

"I. An increase in prices, first, of special

commodities, then in a lesser degree, of commodities generally, and later of real estate, both improved and unimproved.

"2. Increased activity of established enterprises, and the formation of many new ones, especially those which provide for increased production or improved methods, such as factories and furnaces, railways and shops, all requiring a change of circulating to fixed capital.

"3. An active demand for loans at slightly higher rates of interest.

"4. The general employment of labor at increasing or well-sustained wages.

"5. Increasing extravagance in private and public expenditure.

"6. The development of a mania for speculation, attended by dishonest methods in business and the gullibility of many investors.

"7. Lastly, a great expansion of discounts and loans, and a resulting rise in the rate of interest, also a material increase in wages, attended by frequent strikes, and by difficulty in obtaining a sufficient number of laborers to meet the demand."

Unfortunately, neither Mr. Burton nor the other writers offer a specific formula of the reverse set of indications, i. e.: those preceding a period of prosperity. Probably they assume that a contraposition of the symptoms is understood. It may be illuminating to para-

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phrase these rules in order to make them apply more specifically to the movements of security prices and also to attempt to construct an inverted or transposed set of preceding indications of a boom. This the writer will undertake.

Preceding Indications of a Major Decline in Security Prices.

- 1. High and rising prices of securities, accompanied by heavy general business.**
- 2. Expanded credit conditions, showing the full or over-employment of money. Also high rates for call and time money.**
- 3. Large net earnings of railroad and industrial corporations, together with increased dividends and extra distributions.**
- 4. A low rate of return on money invested.**
- 5. Large transactions in securities, with public excitement and enthusiasm.**
- 6. Record-breaking bank clearings, both in New York and outside of New York.**
- 7. A wide and active range of security prices with alternate sharp declines and rapid recoveries. This is the final period of manipulation, during which the public is kept interested and insiders are unloading.**

Preceding Indications of a Major Advance.

- 1. Low and usually moderately declining security prices, accompanied by much irregular-**

ity in the price movements of specific stocks. General business dull.

2. Sound or easy credit conditions and low rates for call and time funds, indicating much unemployed money.

3. Low railroad and industrial earnings. Some decreased dividends, receiverships and reorganizations.

4. A high rate of return on money invested.

5. Small transactions in securities. Very little outside speculation.

6. Bank clearings falling in New York and not making much increase outside. The New York clearings reflect the absence of heavy Stock Exchange transactions or new financing. Clearings outside of New York reflect general business activity and should naturally show an increase in volume from year to year.

7. A narrow and irregular stock market, with a considerable period of backing and filling. Public apathetic and traders bearish. Far-sighted interests take all offerings. If the market is in the final stages of liquidation bad news of any kind has no effect. This is the period of accumulation.

The above is the general prescription. The simplest means of carrying on an examination of the influences which are always more or less submerged will now be suggested:

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First—Credit Conditions.

The credit situation is most simply shown by the relation of loans to deposits and specie to loans. If loans greatly exceed deposits, that is to say, if the banks are not only loaning all their deposits but part of their capital and undivided profits, the credit situation is more or less strained. If, at the same time, the percentage of specie to loans is very low the situation is obviously worse.

Second—Price of Money.

If money rates are high and rising, as is usually the case when the credit situation is unsound, liquidation of securities is sure to occur. The banks, needing funds, or able to employ them at higher rates, call in their collateral loans and this brings about selling of securities.

Third—Volume of business on the Stock Exchange.

Dulness and small transactions are always present just before a great advance. Activity and public enthusiasm are always present just preceding a great decline.

Fourth—Bank Clearings.

Bank Clearings are the best barometer of business activity. As stated heretofore, the clearings in New York are more representative of financial operations than of trade, while the clearings outside New York give us a fair idea

of general business activity in the country at large.

Fifth—Average Stock Prices.

It makes a great deal of difference whether stock prices are high or low when certain good or bad conditions obtain. However, it is almost invariably the case that the level of prices is at its apex when the barometers show the worst conditions and at its nadir when the best conditions obtain. This seeming paradox, thoroughly appreciated and understood, is of the utmost importance. It frequently leads to correct action in the face of the most alluring and deceptive surface indications.

Sixth—Dividend Increases and Reductions.

Here is another paradox. The rapid increases in dividends or the distribution of "melons" usually comes at the approximate top of a market, while the reductions and disappointments come at the bottom. This is because the stock market has anticipated the good or bad news. The same law holds good as to receiverships and reorganizations. These actually occur in greater number just before a market begins advancing than at any other time.

Seventh—Return on Money Invested.

When the average return on money invested in seasoned dividend-paying shares falls to a very low rate, the market is too high, un-

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less, indeed, numerous increases in dividends are to be expected. Conversely, when the return is very high, prices are too low. This law needs no extended explanation.

As an illustration and confirmation of the dependability of these simple barometers, let us examine the conditions which have existed at the beginning and end of the two great advances of the last fifteen years.

From 1900 until the latter part of 1902 there was a tremendous advance in security prices with only one serious interruption, which was caused by the Northern Pacific corner in May, 1901. The average prices of securities attained a level never before reached. In 1902 bank clearings were record-breaking both in and out of New York, showing heavy financing, speculation and general business. Credit conditions grew very bad in the latter part of the year and money rates were high. Net earnings were very large, dividends were increased, the return on investments was low, Stock Exchange transactions were large and public excitement was at its height. The panic of 1903 followed on the heels of these conditions.

In the early months of 1904 all these appearances were reversed and stocks began an advance which carried them to a new high level.

The period of distribution preceding the decline of 1903 covered the last quarter of 1902

and the period of accumulation covered the second quarter of 1904. The indications may be tabulated for convenient reference as follows:

**Basic Conditions Preceding Decline of 1903
and Advance of 1904.**

	Last Quarter, 1902	Second Quarter, 1904
Per cent. of loans to deposits (avg.) ..	100.16%	94.40%
Per cent. of specie to loans (avg.)	17.74%	21.85%
Call money (avg.)	6¾%	1½%
Time money (avg.)	6%	3¼%
Sales on N.Y. Stock Exchange (shares)	49,205,853	18,468,445
Clearings, New York	+7.4%	—12.6%
Clearings, outside New York	+5.6%	—4.3%
Avg. price 20 Rails	120	95
Avg. price 12 Industrials	63	48
Dividends increased (year)	21	4
Railroad receiverships, miles (year) .	278	744
Return on money invested	3.75%	5.65%

NOTES.—Credit conditions based on conditions shown by New York Clearing House banks, no other figures being available at regular intervals. It is found, however, that the condition of the Clearing House banks is a good barometer of general banking conditions.

The bank clearings in New York and outside of New York are given in percentages of advance (+) or decline (—), as compared with the preceding year.

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Average prices of 20 rails and 12 industrials are the "Wall Street Journal's" averages.

Return on money is based on prices and dividends of ten leading dividend-paying railroad stocks.

The same notes apply to the table which follows:

The period of distribution preceding the decline of 1907 was apparent in the last quarter of 1906. The period of accumulation covered the first quarter of 1908. Indications were as follows:

Basic Conditions Preceding Decline of 1907 and Advance of 1908.

	Last Quarter, 1906	First Quarter, 1908
Per cent. of loans to deposits (avg.)	101.60%	98.89%
Per cent. of specie to loans (avg.)	17.60%	22.35%
Call money (avg.)	8 $\frac{1}{4}$ %	1 $\frac{3}{4}$ %
Time money (avg.)	7%	3 $\frac{1}{2}$ %
Sales on N.Y. Stock Exchange (shares)	61,751,312	42,373,856
Clearings, New York	5.5%	28%
Clearings, outside New York	9.2%	15.1%
Avg. price 20 Rails	135	90
Avg. price 12 Industrials	95	62
Dividends increased (year)	21	5
Dividends reduced (year)	3	26
Railroad receiverships, miles (year)	204	8,099
Return on money invested	3.50%	5.95%

An examination of the exhibits given above shows very distinctly that our last two great

declines in security prices began at a time of activity, heavy trading, excellent general business and increased dividends. There were plenty of warning signals, such as credit conditions, money rates and the low return on investments, but in the general excitement the favorable was exploited and the unfavorable ignored. And the reverse of all this was true when the evil conditions were remedied.

It will be observed that the decline of 1903 amounted to 25 average points in rails and 15 average points in industrials, and the decline of 1907 amounted to 45 points in rails and 33 points in industrials. In this regard it should be stated that calculations do not show either the extreme top or extreme bottom of any movement. It is invariably the case that in a great upward or downward swing prices are carried beyond all reasonable limits in the final spasms. This is followed by a sharp and immediate reversal of a few points and then the period of real distribution or accumulation begins. Attention is, therefore, properly confined to the stages last mentioned, i. e., the period of backing and filling at the approximate top or bottom.

We have now seen what followed the first set of appearances which attracted the outsiders to their undoing. Now look at the other set and see how plainly the indications point

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to a recovery. At the end of 1904 the average price of 20 rails was 119, and 12 industrials 70, advances during the year of 24 and 22 points respectively. At the end of 1908 average of 20 rails was 120, and 12 industrials, 86, advances of 30 and 24 points respectively. Nor was that the end of the recovery. In December, 1905, rails were 133 and industrials 96. In August, 1909, rails reached 134 and industrials 99

These indications are not theoretical, any more than are the indications set down by Burton and the other economists. They are matters of precedent applying to all such periods and are subject to analysis and logical conclusions. It must be admitted, however, that with all these important aids to examination forecasting price movements is not and never will be an exact science. Extraneous influences, which cannot be foreseen, such as wars, politics and crop prospects, sometimes upset or temporarily restrain the workings of basic conditions. It is found, however, that in the past such influences have usually been of minor importance. There is also a tendency to attribute market action to whatever is obvious, regardless of what the real, but submerged, causes may be. So far as the extraneous influences referred to are concerned, all we can do is to watch developments, prospects

and probabilities from day to day and give them their proper weight and consideration. Crop prospects are the most important of the unknown factors, but we may gather comfort from the fact that crop failures are the exception, not the rule.

While it is necessary to conduct our investigations along the broadest possible lines and to exercise eternal vigilance in regard to shifting influences, if we permit ourselves to lose sight of what is basic—the real foundation, we make the vital error of eliminating from our calculations the most important equations.

It is, of course, not necessary for the student to compile the ingredient calculations given above at the expense of his time and labor. All the figures can be obtained from one source or another at very little expense.

In conclusion, it is proper to state most emphatically that the student of basic conditions who begins or pursues his labors without a reasonable grasp of the principles of political economy, will waste much time and thought and will certainly labor under a great handicap. The misleading term "political economy" carries to the lay mind an idea of great profundity and the necessity of arduous research and study. If this branch of economics had been called "the science of wealth," which is ex-

actly what it is, its principles would be more widely sought and assimilated.

It is not necessary to enter upon an extended or exhaustive course of reading or study in order to obtain a working knowledge of the fundamental principles of political economy. These may be found condensed in simple form in a single text-book and, once they are understood, a great deal that is vague and mystifying will disappear. As an illustration of this let us take one case in point.

We hear much talk, from time to time, of the creation or destruction of capital. Yet a vast majority of people do not even appear to know what capital is. They constantly confuse money, wealth and capital, and arrive at astounding conclusions.

There is no divergence of opinion among economists from Adam Smith down to the present day as to the definition of capital. Wealth is the accumulation of past labor. Capital is that part of wealth which is used in reproduction. To paraphrase a familiar example, if a man has wealth to the amount of \$100,000 and invests \$75,000 in a palatial residence, drawing his income from \$25,000 invested in a factory, his capital is \$25,000 and no more. Reverse the illustration and his wealth is still \$100,000, while his capital is \$75,000. No part of the wealth invested in a residence is capital

further than what is actually necessary to adequate shelter. The rest is luxury—unproductive wealth.

Again, we hear of the tremendous amount of capital destroyed, say by the use of munitions of war. "A shell costs \$100," says the incompetent observer, "when you fire it \$100 of capital is destroyed." That is not true; the cost of the shell has nothing to do with the matter. The profits gained by the numerous people providing the ingredients or fabricating the completed article are not destroyed, they represent nothing but a shifting of circulating capital from one place to another. The actual capital loss is confined to the initial basic value of the ingredients destroyed by the explosion.

There is nothing obscure or recondite in this, nor is there in any other phase of the subject when we strip away the multitude of words in which economic discussions are usually clothed, and get down to comprehensive facts.

VIII

Market Technicalities

THE study of technicalities, of which little is generally known, and about which nothing has been written, is of great importance to the speculator, and particularly to the active trader.

The two most glaring, as well as the most important technical appearances which mark the top and bottom of a speculative cycle, have been commented on in a previous chapter; they consist of dullness and stagnation at the bottom of a movement, and crazy recklessness and universal participation at the other extreme.

In addition to the facts that have already been presented in regard to these two extremes, the following rule may be set down:

It is practically impossible for an overbought market to advance materially, or for an over-sold market to decline materially.

This seemingly radical statement is so well based as to be operative regardless of actual

values. That is to say, if a certain stock is selling at sixty and is intrinsically worth par, it is very unlikely that it will reach par while there exists a general marginal participation for the long account; and on the other hand, a stock which is selling at par and is worth only sixty, will not decline if there is a heavy short interest in it.

These statements may at first blush seem opposed to the previous contention that any security must eventually seek its correct level; not so, for the fact is that correct levels will finally be reached, but not until the preponderance of participating opinion has been equalized; or, what is more common, exactly reversed.

There have been many cases where the better class of traders have made a strong favorite of a certain security, and have been wholly unable to account for its dullness or depression. Frequently their original deductions have been correct, but after long and patient waiting for the price of the stock to readjust itself to what they correctly considered its true valuation, they have withdrawn in disgust, or have even allowed themselves to believe that there must be some concealed rottenness about the affairs

of the corporation which they are unable to ferret out.

The analysis of this state of affairs is neither profound nor difficult. First, and most important, is the fact that the buying power which is necessary to any marked advance is absent. The public having made a favorite of the stock, has loaded up and is waiting for an advance. The public buying is completed, and no matter how inviting the proposition may be, so far as intrinsic merit goes, the big men will not buy while this public interest exists. They will not participate in a deal which contemplates a *hoi polloi* partnership, and aside from this, they are aware of the fact that they can certainly purchase cheaper in time if the present holders are left to their own devices.

In order to pursue any deal looking to an advance in the security in question, the professionals realize that should they enter the lists now they would be working for public benefit. They must not only buy in a restricted market at advancing prices, but must be prepared to take over at higher prices the present holdings of the public.

This is not the method used by great speculators; they do not bid for and assist the public in its speculative affairs, but accept at low

prices what the public is throwing away. The professional element therefore cannot be counted on to forward prices. They will wait.

Meanwhile the numerous friends of the stock sit and twiddle their thumbs and wonder what in the world is the matter.

This state of affairs, it is evident, would cure itself in time through the certain and unstoppable assertion of intrinsic merit, but the required time will not be granted by the impatient holders. Something entirely different (and more rapid) will occur. The impatient public will throw over its stocks in disgust one by one, and each decline will confirm others in the belief that there is "something rotten" in the stock. It being impossible to uncover or point out anything detrimental, something is invented, and the well-meant plans of the holders end in a general decline, and after a time, in the hands of people who know both values and methods, the stock is first absorbed, then galvanized into activity, and finally hippodromed back into public hands at prices higher than they had first figured as its value.

The statements made above are not calculated to encourage the public trader. It certainly looks as if he had a hard row to hoe when even intrinsic valuation, correctly estimated,

will not always produce satisfactory results; but the knowledge of this important technical condition and its cause and effect will prove of the highest value to the trader. He may reason as follows: I have figured and estimated the value of this security and find it to be too low, but unfortunately it is a public favorite. Its cheapness is so apparent as to attract to it a large following incapable of either patient waiting or sustained action. The widespread nature of these holdings, and the character of the holders render any concerted action for a more or less manipulated advance out of the question. On the other hand, the holders who now believe in the stock will daily grow more impatient at its torpidity, and will eventually begin to liquidate. This will be followed by numerous canards inimical to its price, and the stock will, at the bottom prices, be friendless so far as the public is concerned. When this consummation is reached, the stock will rest in the hands of men who possess all the qualifications of speculative success—patience, money and a full knowledge of how to start the machinery of an advance at the right time.

In following this reasoning the trader is doing exactly what the great inside interests do, and if he refrains from purchasing, even at

low prices, when a security is too popular, he may rest assured that he will be able to purchase more cheaply in time. The chances are a hundred to one that no safe or material advance will occur under such conditions. The amateurs and the professionals cannot win on the same side in a speculative deal. It is the survival of the fittest, and the trader can soon decide with which side he wishes to identify himself. On the one hand are narrow margins, over-speculation, absolute lack of method; on the other, wealth, knowledge, concentration, and organization.

These are cold, hard facts and require only the directed exercise of good reasoning to be taken advantage of.

The same rule in inverse ratio applies to an oversold market, except that the danger to the seller is even greater. The professionals, a purely speculative party with whom the greater lights of speculation do not hesitate to ally themselves occasionally, are always on the lookout for an over-sold market, and the squeeze they sometimes administer to a widespread short interest is very severe.

There is nothing in the speculative world more hazardous than short-selling in a numerous company.

In digesting the above statements, the question naturally arises: "How may a bad technical condition be recognized?" This is not so difficult as it might appear.

It is first necessary to lay aside any preconceived personal opinions and prejudices bearing on the stock in question, and conduct inquiries unhampered by "the wish that is father to the thought."

The published opinions and interviews in the newspapers, the expression of opinions among the speculators generally, and if possible, a frank inquiry from a friend at court, viz.: a broker who has means of knowing whether or not a widely scattered and considerable long or short interest exists—will usually prove sufficient.

A successful Western trader for many years gained this information from the books of a single large private wire house in Chicago, and claimed that he found the method an infallible barometer, and that he would frequently find every office of the company's system on one side of a stock, with scarcely a single trade on the other side. This man, whose word there is no reason to doubt, made the interesting statement that at the approximate high prices of Steel Preferred and Amalgamated Copper

he found that the long account in these two stocks, representing the operations of a large and indiscriminate public trade, exceeded those of all other stocks combined, without a single short trade, and that later when Steel Preferred had sold below fifty and started on its upward road, there was not one of the hundred offices in the system whose customers were not short of the stock, while the long account was limited to a few scattered trades.

Such a state of affairs is astonishing, and were it not for a realization of the loss and suffering brought about by such widespread folly, it would be laughable.

The wide general swing of a stock market from high to low prices is marked by an almost unvarying set of extraneous appearances which may be used to advantage by the observant trader.

The bottom of the cycle is marked by dullness and a sawing back and forth in narrow limits, with general sympathizing in the entire list. The successful large interests are accumulating stocks by their time honored method of picking up offerings and bidding for nothing. When this extended period of torpidity has left the public sufficiently bare of

stocks, and has also created distrust and pessimism, the advance begins.

The beginning of a bull period is almost always marked by the bidding up of a single stock, and is followed by the picking up of one stock after another until the entire list of values has been materially advanced. There is a hazy public idea that a bull movement is accompanied by a general advance which extends to all active securities. This is not shown by any precedent, but on the other hand the culmination of a bull market is marked by just such a general advance. This may be explained by the statement that the genuine and intermediate advance from low prices to the approximate top is more or less assisted and engineered by the inside factors, who, however well fortified in organization and funds, would not be guilty of endangering themselves, (a la public), by attempting too much at once. These interests, therefore, concentrate efforts and capital, and lift their stocks one at a time, probably returning to the first security in time, and again furthering their favorites in rotation. This is the one and only stage of a market in which a considerable number of public traders make money, for the appearance of one stock after another advancing sharply is so glaring

that the more or less sophisticated trader learns to recognize the appearance, and to buy a stock the minute he sees it "start," or develop sudden activity. This period is the brief and golden time for the trading element, but alas, they either over-speculate so rashly that the first natural reaction or engineered shake-out lands them bottom side up, or they absolutely refuse to recognize that there is a top to a movement, and are caught with a large line at the highest prices.

As has been stated, the actual culmination is usually marked by a general advance, which means that the public has entered the lists in force, and are buying any thing at any price. This is the exact condition for which the insiders have worked and waited—a broad and general market for their holdings.

Another public idea is that in the course of a bull market from one extreme to the other there are numerous setbacks and shake-outs. There is nothing in history to show that this view is correct; such declines are limited to one or two breaks of importance during the progress of the entire cycle. This mistake of looking for repeated reactions of importance is another factor which works against the public, for, having seen one or two shake-outs follow-

ed by a continuation of the advance, they look for an indefinite repetition of such action, and do not recognize the fact that there will eventually be a decline with no subsequent advance.

The question at once asks itself: "How may the top of the market be discerned, and the dangers of the eleventh hour be avoided?" The answer is more or less complex.

It is, of course, necessary above all things to revert to the estimated and fixed value of the stocks traded in and to find out how much above this normal point the securities are selling. This done, common sense, plus prudence, and minus piggishness, may determine the question and dictate the time for liquidation. This action, however, once decided upon must be adhered to with great rigidity, for thousands of traders who thus take time by the forelock have been dissatisfied afterwards by seeing a still greater advance in which they had no interests, and through greed and impatience have re-entered the lists at a most inopportune time.

The trader who realizes his profits, and sees a further advance follow his own withdrawal from the market, may console himself with the fact that he has made and secured a profit; that trying to guess the exact extreme of a

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cycle is hazardous, and that the advance which followed his withdrawal is unsound, being founded on speculation rather than valuation.

But this is a digression from the technical phase of the matter. So far as it is possible to judge the culmination of a speculative campaign by extraneous appearances, it may be said that a long period of backing and filling, a swinging back and forth of prices at the approximate high level marks the beginning of the end. This is occasioned by the following facts:

The definition of the "top" of a market is that point at which the great traders have almost in unison decided to unload, and per contra, the public has reached its highest degree of enthusiasm.. At the beginning of this period the insiders possess an enormous aggregate of stocks which must be sold in such a manner as not to break the market. This operation will take weeks, or even months to accomplish, as any precipitate selling would be disastrous. The wise element, therefore, sells all the market will absorb without any severe decline, and ceases selling, or even takes the buying side at the first appearance of "softness." In short they do all they can to maintain a good feeling and high prices, at the same

time parting with securities as rapidly as possible.

This statement may convey the impression that the shrewd speculators act in unison. This is true, but not necessarily in the sense that there is any preconceived arrangement between them.. The unison is more or less unconscious, and is founded on the fact that there are only two sides to the market—the right side and the wrong side, and that those of the speculative world who have sufficient wisdom and experience to know what is right are working to the same end, while all the inexperienced or unthinking horde are working on theories diametrically opposed to reason or even probability.

A careful perusal of the above statements will bring out the following stages as the appearance of a speculative cycle:

First, a long period of dullness, then the rocketing of one stock after another until the entire list has been greatly advanced, one or two shake-outs (always accompanied by specious excuses), a renewal of the advance, and finally general participation and a long period of "see-sawing." These, so far as precedent goes, are the earmarks of a bull period, and may be exactly reversed in a long decline, except that in

declines the general list is more greatly affected; that is to say, the whole list crumbles at once.

Aside from the fundamental principles considered above there are numerous minor technicalities which are of value to active traders, but are dangerous and not wholly dependable. For instance, the appearance of strength and heavy buying in a certain security in a low and weak market is almost invariably followed by a decided advance in that particular stock. The analogy of this feature is that this unnatural moving against the current shows heavy accumulation for some reason which will probably be developed later. But such an appearance in a high market might mean exactly the reverse, as one stock may be bid up sharply to permit of liquidation in a dozen others under cover of the sympathetic good feeling engendered by the isolated advance.

The minor technicalities are of use only to experienced traders who have every facility for acting upon them, and to enlarge upon them in a work of this character would be to run the risk of being misunderstood, or even of making statements which might be misleading. In view of this fact, and also as they are not of

primary importance, any discussion of them is omitted.

If the idea has been conveyed in the above statements that technical conditions or appearances may be made the sole groundwork of speculative operations, let the impression be at once corrected. That these appearances and conditions exist, and that they can be made valuable by correct application there is no doubt.

Every affair of life is preceded by certain signs, and "coming events cast their shadows before" in the stock market as well as in other affairs. But these appearances should be made use of as valuable adjuncts to more solidly formed opinions; as a confirmation of judgment more tangibly adduced, or as warnings of possible danger.

Care has been taken to present nothing in these pages which cannot be analyzed and explained, and while the statements made are confirmed by both logic and precedent, they may be easily contorted or abused.

IX

T i p s

THE tip may be briefly described as illogical.

In considering this statement the dividing line between tips and information must be clearly drawn, for one is frequently found masquerading in the habit of the other.

The difference may be acceptably defined by saying that a tip is a statement that certain market movements will occur, with no accompanying reason for such movement, and that information points to the expectation of movements, founded on demonstrable probabilities.

"Smith says to buy steel," is a tip; "Smith says that the price of steel is low and that earnings are increasing," is more or less informative. In one case Smith is taken on faith and in the other his statement is open to investigation and confirmation.

The illogical character of tips will at once be apparent to the student of technical conditions. The large operator who contemplates

a manipulated movement of any importance, even if such movement be based on sound reasoning, jeopardizes his own chances of success by creating a public following. This fact is so well recognized by large operators, that where a projected deal is discovered by too many people or where inside intentions have leaked in the form of a tip, they frequently abandon their plans entirely or temporarily. This point has already been discussed under the head of Technicalities, but is here reiterated as being pertinent to the subject.

The promoter of a certain speculative movement who takes the public into his confidence, is therefore either foolhardy or insincere, and the ordinary man who receives a tip may be sure his knowledge is public property. If he has good reasons for believing to the contrary and that he is the recipient of valuable and circumscribed information, his action of course depends largely on his confidence in his patron's ability to perform what is promised. He simply acts on the principle that the capacity of his informant is superior to his own, and that his integrity is unquestioned.

There are no doubt cases where manipulators have put into circulation a whispered word which they were confident would travel and be

made the basis of considerable buying at a period when they wished to sell. It is related of the late Jay Gould that when approached by the pastor of a rich and fashionable New York Tabernacle, he whispered to him that purchases of Pacific Mail were very advisable, and that he, Gould, would reimburse him from his private purse if operations in that stock resulted in loss. When the pastor came to him later, deeply distressed by his large personal loss, Mr. Gould was as good as his word and promptly handed him a check to cover the deficit. "But how about my parishioners?" inquired the reverend gentleman, "you placed no ban of secrecy upon me, and their losses are enormous." To which Mr. Gould replied calmly, "They were the people I was after."

Whether or not the story is true, it points a moral.

It may be said that it would be possible for a manipulator to create public buying in a stock of sufficient volume to advance prices materially, and to thus assist or accomplish his object. This has been done, but aside from the hazard to the manipulator himself through being in the company of an easily frightened herd, which he could not control, it must be admitted that the advance created by a certain

amount of buying must be offset by the ensuing liquidation, and some one must suffer.

The individual who imagines himself astute enough to evade this danger, simply flatters himself that he is wiser than his fellows, and even if he is justified in this belief, the composite result is unchanged.

The great majority of so-called tips are, however, founded on nothing better than guesswork or pure invention. Although valueless, openly distributed and untraceable to any reliable source, they are always clothed in a garb of mystery and importance and are capable of much mischief, for there is a considerable speculative element who possess no individual ideas of importance and who will act rashly on the most ill-founded advice.

If the distribution of such advice were limited to charlatans and mountebanks the effects would be greatly reduced, but many of the recognized brokerage concerns load their private wires with just such matter for the purpose of creating business, usually beginning their messages with the statement that "we have it from a good source" and ending with a ridiculous injunction to keep it dark. This statement is not lightly made, but is founded upon proven and provable fact. The statement

does not in any way reflect upon houses which give out such current gossip for what it is worth and allow the patrons to decide for themselves what is wheat and what is chaff. Even under such circumstances the dissemination of such news is capable of harm, but the distributors cannot be considered culpable. They are merely the purveyors of news unaccompanied by comment or recommendation.

The brokerage offices of the country are daily visited by people who have had their imagination inflamed, or their cupidity aroused by personal ideas or exaggerated stories of speculative possibilities. As they possess no special knowledge of speculative affairs they are soon lost in a maze of intricate figures, which not being understood, are productive of nothing but indecision and mental confusion. To this numerous class the tip at once appeals. Out of the mass of conflicting reports, technicalities and evasions, comes the terse advice, "Buy Southern Pacific." Here, at last, is something definite, and its air of being confidentially imparted, its transmission by telegraph from a distant city by a great brokerage concern, and its decided tone combine to lend it an importance which it in no way possesses. The man who wants to do something, but does not know

what to do, acts upon it at once, and even the more seasoned traders who will cheerfully admit that tips are worthless, are moved by advice so unimportant.

And right here a word in regard to following the advice of so-called "leaders" in speculative shares or commodities. Of late this game of follow my leader has been more or less popular, especially in the cereals and in cotton. Sometimes the outspoken views of these self-constituted mentors are made public by published interviews or even by means of paid advertisements, in which emphatic opinions and advice are set forth.

This form of public invitation, fathered by names of more or less importance or notoriety in speculative circles, is frequently effective in creating a considerable following. A little analytical thought will adduce the fact that the individual who invokes such a following must do so for one of two reasons: either because he is ignorant of the necessary ingredient of a successful campaign or because he wishes to sell what he is inviting the public to buy. Take your choice.

Follow mentally the operation of such advice and the danger is most apparent. At the first sign of this public touting the men of weight

and importance who are interested in the stock or commodity involved, far from welcoming such assistance, liquidate their holdings quietly and step aside. They may be convinced of the merits of their original venture, and may even admit that the arguments set forth by the public prophet are correct, but they also know that his advice will invariably result in the commodity recommended passing from strong into weak hands, a fact which reduces the chances of profit, and increases the danger of decline, or even panic.

The trader who believes in his speculative Daniel may see the most favorable signs for a time, but he may ponder on this fact: that however honest his prophet may be in his advice he will not publicly express himself as to a consummation or reversal of his ideas and hopes until he, himself, has liquidated.

In other words, after the aimable instructor of the people has sold to his own followers all he possesses he may bluffly and candidly state that he has sold out, and advise his friends to do likewise in a market which will not now absorb their composite holdings.

The danger in such a campaign as that illustrated above is increased just in proportion to the chief promoter's influence. Each new

public follower means a worse condition of affairs, and all such campaigns have finally terminated in disaster. The leader of these "come-on-boys" affairs is always a tremendous gambler, and usually an unscrupulous one.

It goes without saying that tips are frequently more or less correct. If founded on mere guesswork, the chances of success or failure are equal. If the tip failed always or even in a large majority of cases, the evil would cure itself, but the percentage of satisfactory results is great enough to encourage its deluded followers.

So prevalent is this practice of trading on flimsy advice that a large number of concerns dignified with the title of "Information Bureaus" have recently been formed. As these concerns continue to increase in number and scope, it is the natural presumption that they find followers. These "Bureaus" make extravagant claims of inside information and advance knowledge of certain future market movements in the face of the fact that no man, great or small, knows positively the result of even one day's movement. The greatest speculator or manipulator in Wall Street may enter the arena in the morning confident of certain results, and leave it at night a ruined man.

Nevertheless, claims of accurate foreknowledge by these mountebanks find a resting place in the minds of people otherwise intelligent. It is needless to add that the tipping bureau exploits its correct guesses in glowing colors, and maintains a dignified silence on the subject of its errors.

The man who invests in such so-called "information" may save his money and obtain just as good results by basing his operations on the flipping of a coin.

The concerns criticized above are in no way to be confounded with the reliable bureaus of information, of which a few are in existence. These latter are exactly what their names suggest. They gather, compile and distribute general news on speculative matters, and are useful to the active trader in presenting to him statistical results involving considerable labor, and general news which might have been overlooked. Such bureaus do not issue tips; they may allude to the existence of a certain tip, but only as a matter of current gossip. In this regard they are no more to be criticized than the editor of a newspaper who prints the record of a murder.

So far as the efficiency of the tip is concerned as shown by precedent, it may be dis-

missed by again falling back on the statement that no sustained speculative successes are traceable to its use.

The tip holds no dangers for the man who knows because he has taken the trouble to find out. If it conflicts with his well-grounded opinions it is discarded as being merely an unsupported statement, and opposed to more dependable deductions. If it accords with his opinions it is of no value as it is merely a belated expression of what he already knows. To such individuals the only tangible effect of which the tip is capable is its possible stimulation to investigation.

X

Mechanical Speculation

ANY system or method of speculation which is founded on repetition, or which contemplates ventures founded entirely on certain prices being reached regardless of conditions or values, may best be described as mechanical.

The use of such methods is extensive, and even where no set figures or forms are employed we find the average trader continually harping on last month's or last year's low points and forming for himself a mental chart by which he is frequently induced to make commitments.

Of these numerous mechanical methods of speculation only two possess sufficient merit to warrant serious consideration. These two exceptions are the scale order and the stop loss order, both of which may be made useful under certain conditions. That these methods are frequently abused goes without saying. They are often made the sole basis of operations in-

stead of adjuncts, in which case they fail of their purpose.

Either method is useful only as an auxiliary to sound judgments already formed. So employed they possess certain merit in that they permit of a fixed mechanical arrangement for accumulation or protection.

The contention is here submitted that the scale order should be used only for the purpose of acquiring a line of stocks at low prices, and the stop loss order for the protection of profits after an advance. Otherwise employed they become useless, and in some cases even assist in producing loss.

The intelligent use of the scale order contemplates the purchase of a certain stock or commodity at fixed intervals below the first purchase price until the total proposed purchase is completed, the mechanical principle being that an advance of one-half the decline on which the purchases are made leaves the trader without loss, and the broader general principle being that the votary of the method at all times allows for declines due to accidents or errors of judgment. If such declines occur, he gradually acquires his line at a lower average price for the whole.

As an example, embodying both these prin-

ciples, suppose that a purchase of one thousand shares of Union Pacific common is contemplated. The scaler begins his purchases at, say 100, taking one hundred shares at that price and entering an order to buy one hundred shares at fixed points below the first price, say for instance, at 99, 98, 97, 96, 95, 94, 93, 92 and 91, at which last named price his purchase would be completed at an average price of $95\frac{1}{2}$.

The amount to be purchased on each decline, the width of the gap between declines, and the point to which purchases are to be continued are of course matters of individual determination. The principal drawback to this method, which is at once apparent, is the danger of the original, or some intermediate purchase, being made at such a low point as to prevent the accumulation of the proposed line. In the extreme case of only the initial purchase having been possible, the trader finds himself with a profit on only one hundred shares of stock where he had intended to carry one thousand.

But this argument against the merits of the method may be answered as follows:

The average speculator may safely assume that a decline from the point he considers low

is probable. If he happens to catch the low price it is an accident and not because of his method, whose virtues must be reserved for future usefulness. He may congratulate himself on an unusually fortunate purchase and be satisfied with his comparatively small but quickly acquired gains. A profit is a profit, and the market is always with him. On the other hand, if he is so good a judge of the market that his purchase was a result of judgment rather than accident, he has no use for the scale order or any other such assistance.

The scale order is frequently misused by depending too much upon inherent virtues which it does not possess. That is to say, it is made the basis of operations which are indulged in more on a belief in the merits of the method than on any intelligently formed opinion of the probable action of the stock, or a sufficient consideration of actual value, technical conditions, etc. The probabilities of an advance equal to half the preceding decline is upheld by precedent and makes the method alluring, but granting such an advance, and no more, nothing has been gained when it materializes.

In short, it may be said that the scale order used as a basis for poor purchases is generally

useless. So employed it differs from ordinary methods only in the fact that it will take the trader a little longer to lose his money.

But he who admits that natural market action, manipulation or accident render it improbable that even a careful study of his intended venture will find for him the lowest price and who wishes to adopt a methodical plan of operation—for him the scale order presents some very favorable features, and is recommended for serious consideration.

The study of precedent will show that the scaling method could have been successfully employed in almost every standard listed security. In fact precedent will show entirely too much, in that it presents the fact that the method carried out indefinitely would seldom have resulted in loss from any point, high or low. Even taking the worst possible example, a stock so greatly inflated and so widely discredited as Amalgamated Copper, scaling from its extreme high price of 130 in 1901 to the extreme low price of $33\frac{5}{8}$ in 1903 would give an average price of 82, a point recently exceeded in market prices.

But such figuring as this is useless. An extended campaign of this kind contemplates

the use of a vast sum of money, always available in cash.

The danger of pursuing statistics so alluring as those presented by a study of past market movements as applied to the scaling process lies in pointing to what money can do rather than what it should do, and in indulging in mental and statistical proofs, the actual operations of which are past the possibilities of the purse. Even if the financial equation is granted, few men possess the stability, patience and courage to adhere to the rules of such an extended and unsatisfying campaign, and without such adherence the whole structure falls to the ground.

The best use that can be made of the scale order is, therefore, to use it only for the methodical making of purchases already deemed advisable. If the first purchase by this method is made at the point at which prior investigation and judgment has pointed out as the time to buy, irrespective of any inherent virtues which may lie in the scaling process, it can seldom result in injury, and will generally prove beneficial. If the method is adopted it must be adhered to rigidly, unless for some good reason the deal is abandoned entirely. In the majority of cases this is not done, the operator for some reason, impatience, greed, or fright, changing

his plans, in which case the usefulness of the method is impaired or eliminated.

The stop loss order is one of the most abused of the methods employed by traders, for, like the scale order, it is frequently used at the wrong periods, or given credit for too much inherent virtue.

In speaking of this method, no reference is made to the stop order as employed by brokers for self-protection, in which case it is a matter of necessity. The point to be considered is its value when used voluntarily by the trader for his own benefit.

There is an axiom among traders that the best principle in speculation is to take small losses and large profits. So popular is this axiom that many speculators consider it the great secret of success, and in following it employ the stop loss order continually in a most haphazard manner.

The expressed theory of small losses and large gains sounds good and is all very well in itself, but it may be relegated entirely to a class who wish to gamble on quotations on a reversal of ordinary public methods, which is to take large losses and small profits. The small loss trader pins his faith wholly to the belief

that a market will swing not to, but past the point where he placed his stop loss.

On this theory all intelligent figuring as to the probable future movements is eliminated, and the success is based wholly on mechanical chance, in which case the probability of loss and gain is exactly the same; that is to say, the probability of ten losses of one point each, or one gain of ten points, is the same. Those who combat the truth of this statement at once array themselves as opposed to the expressed and accepted consensus of opinion of the world's greatest students of the doctrine of mathematical chance.

To contend that any element of intelligent forecast of market movement could be combined with the use of the small loss theory as outlined above, is untenable, for if a purchase is made because research has shown such purchase warranted by conditions and the price of the stock, we find the stop loss trader in the ridiculous position of selling his holdings below a price he first considered should be cheap, at which point he should in reality be contemplating further purchases.

So rooted in some minds is the principle of small loss and large gain, that an attack on the virtues of such a proceeding will no doubt be

bitterly contested. The argument against it however, is sound; it is purely mechanical, cannot be combined with intelligent operations, has no marked success to its credit, and is not adopted by successful traders, i. e. those who buy because they consider a thing too low, and sell because they consider it too high.

But there are certain periods when the use of a fixed limitation of decline is entitled to consideration. The trader may find himself in possession of certain profits in a market which is high, but which his judgment tells him may, for technical or other reasons, still advance materially. At such a period he may wish to provide against accident, or a vicious raid by placing stop loss orders below his holdings at a point which will insure him the bulk of his profit, advancing the point at which loss shall be stopped as the market advances.

Taken the year round, the chance of loss or profit from such a course is, as has been stated, demonstrably equal; but in the case of high prices, the extraneous dangers of accident or manipulation, and the advisability of protecting profits by systematic orders contemplating such dangers, the placing of stop orders is frequently useful. Even at such periods its principal virtue lies in the pre-arrangement of

a desirable course which might be disturbed by mental confusion or personal absence.

It is a debatable question whether it would not be better to buy when conditions and prices show that purchases are warranted, and, per contra, to liquidate when danger threatens or when prices look high enough. But to most traders systematic arrangement is desirable, and to some minds absolutely necessary.

As recommended above, the scale order and stop loss order in no way interfere with the workings of study and judgment, and are frequently employed by traders whose opinions are entitled to respect. Let the fact be taken to heart however, that employed as a means of speculation, rather than as an aid to it, neither method possesses any merit whatever.

"Chart System"

There is an incredibly large number of traders who pin their faith to the so-called "chart system" of speculation, which recommends the study of past movements and prices, and bases operations thereon. So popular is this plan that concerns which make a business of preparing and issuing such charts do a thriving business.

The theory propounded is that history repeats itself, and that because a property sold at a certain low price on some previous occasion and then advanced, the same thing will occur again! There are various offshoots and modifications of the system, but the basic plan is founded wholly on repetition, regardless of actual conditions. The idea is absolutely fatuous, entirely untrustworthy, and highly dangerous. The study of the past is interesting and instructive in showing what may be expected in the way of general movements, but when we are asked to throw reason and research to one side in favor of only half-demonstrated repetitions, the theory becomes untenable.

The chart traders would have us pore over musty records of past movements, and have us buy a stock at a certain price because it sold there before, without stopping even to investigate the fact that conditions in that particular stock have changed materially. The votary of this plan might find himself cheerfully buying the shares of a bankrupt and ruined corporation in its very process of financial disintegration, or on the other hand might refrain from purchases at very low prices because it sold at still lower prices on some previous occasion.

Another class of retrospective speculators base their operations on seasons, or even corresponding weeks and months, forming their opinions on insufficient research, or on nothing at all. If there were in truth any certain period of the year or month from which movements would occur, the whole world would know it, and such knowledge would reverse expectations by the rotten technical conditions it would create.

It is useless to enlarge upon the various methods employed by the mechanical traders, for they are all alike in that they resolve the whole speculative structure into a gambling machine, with a large percentage against the player. To the large number of people who risk their money in this manner, and who contend that there is no use in trying to accurately forecast probable movements by actual investigation, let the following statement be made:

The man who buys a stock at fifty dollars a share because he has good reasons for believing that it is worth one hundred dollars, or who sells at one hundred dollars on account of having good reasons for believing it worth only fifty dollars, is the only man in the speculative world who succeeds.

When the study and thought necessary to

forming such conclusions intelligently are eliminated in favor of any or all other methods, the colossal error is made of expurging from the plan of operations the only possible chance of sustained success, the great basic principle to which all other knowledge, technical or statistical, is purely subsidiary.

XI

Short Selling

THE practice of short selling, which was formerly largely confined to the professional element, has of late years become quite fashionable among those members of the trading public who speculate regularly, and has been even more disastrous than have ventures for the long accounts.

The basis for this action, and the growing popularity of the short side is founded on natural pig-headed pessimism which will listen to no argument, and is incapable of clear reasoning; or what is more common, on contentions so shallow and silly that it seems superfluous to record them on a printed page.

Everywhere one hears the belief expressed that the "big money" is made on the short side, and that the greatest inside speculators are Bears. This view is entirely erroneous.

One of the favorite arguments of the public bear element is as follows: the public generally buys, and the public generally loses money.

Therefore the buying side is the losing side and the short side is the winning side. By this absurd and wholly unfounded deduction many bears are created.

Now, the fact of the matter is that the fortunes made on the short side of stocks are few and far between, while those accumulated by judicious operations on the long side are legion. The public loses its money, not because it purchases, but because its purchases are made at the wrong periods and its methods of operation are bad.

The accumulated wealth of the Vanderbilts, Rockefellers, Astors and Goulds has accrued from the continued increase in the valuation of properties in which they were interested. True, all these lights of finance have been justly accused at times of operating for lower prices. This is particularly true of the late Jay Gould, who was widely known as a wrecker. But the wrecking operations were solely for the purpose of driving other holders out of a certain corporation and creating a sentiment and condition which would permit of the purchase of a controlling interest in the corporation in question at low prices.

So few have been the individuals who operated on the short side habitually and success-

fully that the names of Travers and Cammack stand out in bold relief among the horde of great traders, and the operations of the successful minority were carefully calculated as to periods and safety. Their skillful work and clear foresight would probably have made more money for them if their operations had been reversely conducted.

"It took me ten years, and cost me two fortunes to become an optimist, but it was worth all it cost," said a successful speculator of to-day, and in that terse sentence is much food for thought. It is possible to make money on the short side of the market, but it is very difficult, and the man who is capable of acting with enough judgment and decision to accumulate gains working against the current is doubly capable of succeeding by swimming with it.

The semi-professional traders who trade on the short side, as a rule, exercise no more judgment or study of actual valuation than do the army who purchase. They are moved by blue talk and general pessimism, and sell at the bottom and are frightened out at the top. Their operations are simply bad in inverse ratio. There is one difference: the purchaser who has the means and patience to stand by an

ill-timed purchase will eventually see daylight, while there is no certainty of this desirable consummation for the bear. On the other hand, he may see his venture grow more and more disastrous as time and the advance of the country increases the value of the stock he has sold. The cycles of speculation will of course bring him occasional hope, but these cycles occurring from a gradually ascending pivotal point carry him further from his original price at each revolution.

The short seller of stocks has against him at all times the natural future enhancement of values, and more specifically, the earnings and dividends of the securities in which he trades.

To make this more clear let us say that one hundred shares of a certain stock, paying 6%, are sold short at par, its normal price, and the commitment endures for one year. For the sake of argument all speculative movements will be eliminated, and the assumption made that at the end of the year the selling price of the stock is still par. It will be seen that the seller has had his account charged with six hundred dollars in dividends, and thus while there has been no advance in the posted value of his stock, he has lost six hundred dollars.

This does not hold good in the case of a pur-

chase, for even if the high rate of 6% is paid on the unmargined balance, these charges are covered by the dividends credited to the stock, and the normal gain of 6% has been made on the actual money deposited as margin.

For example: one hundred shares of a 6% stock purchased at par on ten points margin, and sold at the same price one year later, shows as follows:

Total purchase price of stock.....	\$10,000
Marginal deposit.....	1,000
	<hr/>
Unpaid balance.....	\$9,000
Int. for 1 yr. at 6% on unpaid bal.	\$540
Credit account dividends.....	600
	<hr/>
Credit balance.....	\$60

Or 6% on the thousand dollars actually involved.

And on the other hand:

One hundred shares of the same stock sold at par and re-purchased at the same price one year later:

Total credit from sale of stock.....	\$10,000
Total debit from purchase.....	\$10,000
Debit for one year's dividends..	600

A loss of \$600. If it is presumed that one

thousand dollars has been deposited as margins, on which amount an allowance of 6% has been made by the broker, there is still a net deficit of \$540, with no adverse market action.

In the above examples no account is taken of commission charges, but the exhibit is in no wise affected by this omission, as the commission charges on the short side would increase the loss on that commitment exactly as much as it decreases the gain on the purchase.

It will be seen, therefore, that the short seller has working against him at all times a tangible effect capable of exact demonstration. The contention is sometimes made that short commitments are seldom carried for any considerable period, and that the man who sells short to-day and re-purchases tomorrow, escapes this onus. This view is so shallow that it is unnecessary to state to thinking men that the difference is wholly a matter of degree, and that the Bear in dividend paying shares swims constantly against the current.

What is true of one year is equally true of one day, and repeated short time operations multiply the infinitesimal drawback until it is as great as when lumped on one longer contract.

And the seller of non-dividend paying stocks is no better off, for he combats either the earnings which are accruing, or the gradual enhancement of the stock through a wise distribution of these earnings. In short, whether a habitual short seller sells dividend or non-dividend paying shares he tampers continually with progress. He makes his venture on the side of disaster, accident, dishonesty, mismanagement, and pessimism, rather than on the side of gradual improvement in the business affairs and conditions of the country.

Another pitfall which besets the short seller is the danger of deliberate cornering, or of a fight for control in his stock. Tremendous advances are possible in either case, and even if his sales have been made at high prices he faces this hazard. The plea that such great twists are infrequent will not do, for to be overtaken by one such squeeze in a decade is sufficient to wipe out a great portion, or all, of the accumulated gains of that period.

Concentration of wealth and power make such upward manipulation more possible from day to day, and this latter statement develops another argument, and another important fact in answer to that argument.

The argument is simply that history shows

that severe breaks, and drives against certain stocks have been made more frequently than corners or squeezes. Drives have been made against a certain stock which in a few days carried that stock to ridiculously low figures, and later it was re-purchased by the same interest which wrought the havoc in values.

This is admitted—as a record of the past. Such action is out of the question today. The method is pursued to some extent, but great declines in a brief period no longer come from savage individual attacks on certain securities. The reason for this is simple; the concentration of capital mentioned above, makes such action too hazardous. There was a time when Mr. Keene would, for a single great interest, pound the price of Sugar off twenty, thirty, or forty points in a day or two, and then re-purchase it at low figures. Mr. Keene will never do it again, for the enormous sales necessary to accomplish this coup would place him and his sponsors in danger of losing control of the stock. There are now other powerful interests well enough aware of the value of Sugar stock which would welcome any opportunity of wresting the control from present hands, and if the well-named manipulator were to do to-day what he did even a decade ago, he would

wake up some morning not only minus the control of the property, but opposed, in a market sense, to interests even more powerful than those he represented.

This places the moneyed speculative interests in the position of allowing public folly, rather than individual efforts, to bring about great declines and low prices, under which condition the danger of losing control is a matter of vigilance and a matching of wits, or possibly a community of interests against this same public.

There is no gainsaying the fact that it is possible to so accurately judge of values and periods as to make money on both sides of a market cycle, but those who have been successful in so doing may be numbered on the fingers.

The frequently quoted aphorism of a great latter day speculator: "If it's a good sale at all it's a good short sale," meaning that if one is justified in selling holdings to realize profits, he is also justified in selling short, will not bear the light of calm analysis.

There is a vast difference between accepting accumulated profits, and being absolutely free from further risk with an acquired gain in

bank, and being in a position to lose heavily through market action.

In view of the above facts it would appear that for the speculator in the ordinary walks of life, the safest course is to confine operations to purchases of stocks when they are cheap, and to limit sales to the realizing of profits. This course necessitates periods of non-participation which are decidedly beneficial. It permits the operator to look with an unprejudiced eye upon market actions, frees him of a direct percentage working against him in dividends and earnings, and best of all, maps out for him a fixed and settled plan of operations, conducted with the current of irresistible improvement and certain accretion.

XII

What 500 Speculative Accounts Showed

AN examination of almost four thousand speculative accounts, extending over a period of ten years, developed results interesting and instructive in many ways. The examination was of an exhaustive character, and covered operations of every conceivable nature in both stocks and cereals.

In these accounts all the errors of speculation were distinctly illustrated.

The three principal points developed by the investigation were that 80% of the accounts showed a final loss; that the tendency to buy at the top and sell at the bottom was most prevalent; and that most of the operations appeared to be of a purely gambling character. The further fact was established that success almost invariably led to excesses.

The mass of figures derived from so exten-

sive an examination being voluminous and complicated, it was considered advisable to simplify the matter for presentation in this work, pursuant to which decision, the following plan was hit upon.

It was decided to use for illustration a single stock, trading in which predominated in the operations covering a certain period. In order that the illustration should be perfectly fair it was decided to make the period begin and end with the stock considered, selling at the same approximate price.

As U. S. Steel Common offered the best illustration, 500 accounts, either confined to operations in this stock, or showing a large percentage of deals in that security, were selected. The period originally contemplated was from January to December of the year 1901, but was discarded on the theory that the results shown would be abnormal, owing to the panic of May ninth of that year. It might be contended that the tremendous losses sustained in this panic were offset by the unusual opportunities for purchases at low prices, but as few purchases were shown it was thought best to seek a period during which nothing abnormal occurred, but which presented numerous advances and declines of an ordinary character.

Such a condition existed from July, 1901, to March, 1903, during which time there were numerous advances and declines in Steel Common ranging between $29\frac{3}{4}$ and $46\frac{3}{4}$. In July, 1901, the stock sold at 37, and in March, 1903, it touched the same price, and as the price at the beginning and ending of the period is the same, and furthermore is nearly midway between highest and lowest prices, it would appear that about equal chances had been presented for profit or loss if the element of knowledge and mental acumen were cancelled.

In other words, viewed wholly as a gambling proposition the chances, not considering the percentage of commissions, were about equal. The reason for making this comparison will be apparent later.

The books of the different firms showed a marked unanimity of public action at all times, reflecting a general consensus of opinion. This applied not only to the 500 accounts chosen for this illustration, but to all which were originally examined.

In selecting these 500 accounts every precaution was taken to exercise absolute fairness. No picking over was indulged in, as it is obvious that the balance of gain or loss might be thrown materially to one side or the other

by such a process. In order to prove the total result as compared with the whole, the loss on the entire number of shares handled in the 500 accounts was compared with the loss on the total number of shares in the entire four thousand accounts, (operations in grain and other commodities not being considered), and the result was found to be harmonious.

No preconceived ideas nor prejudices were permitted to enter the investigation, the object sought being to establish figures which might be considered fairly indicative of what usually occurred in public speculative affairs under normal conditions.

It will be understood that the facts and figures hereafter presented were based wholly upon total results, the entire number of accounts being finally viewed in a composite light. On this theory the following results were discovered:

Three hundred and forty-three accounts resulted in a net loss at their termination; 88 accounts resulted in a net profit; 52 accounts were even or showed inconsiderable differences. The result of 17 accounts is unknown, as the Steel stocks represented were taken up by the purchasers, in all cases at a considerable paper loss.

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The total deficit on all losing accounts was.....	\$1,245,000
The total gain on all profitable accounts	288,000
	<hr/>
Leaving a net deficit of.....	\$957,000

The total number of shares handled was 1,112,000, of which 820,000 shares were originally purchases, and 292,000 originally short sales.

The total brokerage charges, commissions, interest, etc., were \$275,000, which amount is included in the total loss.

The comparative losses on short sales, share for share, were about 20% greater than the losses on purchases.

The favorite method of operation was to purchase or sell on slight reactions from high or low prices.

The average price of all purchases for long account was $42\frac{5}{8}$, and the average price of all short sales was $35\frac{3}{4}$.

The scale order was employed in 53 accounts, (42 long and 11 short), but was either abandoned or interfered with in all but eight instances.

There were numerous evidences of systems being used; this is not susceptible of proof, but

the uniform character of the trading as shown by constant repetitions was considered good evidence of a fixed method. Over 90% of the accounts of this description resulted in loss.

In 23 instances an inverted scale order was employed, purchases being made at fixed intervals as the stock advanced. This is the principle called "going with the market." It failed in every instance.

In considering the above figures, the first and most vital point is the predominance of loss over profit under conditions as nearly equal as possible to present. The reason for considering the matter in the light of a gambling transaction was to develop the fact that the total loss was distinctly greater than the percentage against the trader as represented by commissions, the loss being \$957,000, and the commission charges only \$275,000.

As the price of the stock at the beginning and end of the period considered was the same, and as nothing of an abnormal character occurred, this additional loss must be attributed to other causes, and here the mechanical drawback ends and the personal equation enters.

Everything being equal, the surplus loss of \$682,000 must be attributed to erroneous mental operations, and when the further fact is

considered that the average price paid for stocks was $42\frac{5}{8}$, and the average price at which stocks were sold was $35\frac{3}{4}$, the theory that the public reverses the methods dictated by reason is confirmed. It is apparent that if this proclivity had not been indulged in the result would have been a net profit; that is to say, if 37 had been taken as a pivotal point, and purchases made below, or sales above it, numerous gains could have been made on either side, especially on purchases, as the short seller would have had about 6 points in dividends against him during the period, which has not been considered in the figures given, but which is reflected with considerable accuracy in the composite result.

An examination of financial columns and current gossip at corresponding periods of high and low prices showed no well founded reasons for the consensus of opinion at such times.

The gossip rather reflected than incited the prevailing cheerful or pessimistic feeling, and no particular mischief can be attributed to this source.

Next in importance to the suicidal tendency to sell cheap and buy dear was the widespread evidence of greed. In almost every case where an account was successfully begun, the operations were immediately extended in volume

until, even after a large number of successful results, a single reverse wiped out the entire credit. Even those operators who showed apparent good judgment in buying and selling were subject to this fault to so marked a degree that after being right nine times and wrong once, they were on the debit side of the ledger.

The inability of the average trader to map out a plan and follow it was also distinctly exemplified. Methods and systems begun and pursued for a time with mathematical precision almost invariably ended in a mass of indiscriminate operations caused apparently by fright or confusion in case of loss, and exhilaration and enthusiasm if successful.

Another interesting development was that the accounts of those speculators who operated from a distance, or from points where no brokerage office was located, made a better showing than those of local traders. The losses were smaller and the gains larger. The contrast was so marked that it would appear that isolation has its advantages. The marginal provision made by these distant traders was more ample, and the operations were fewer in number. These two points alone were a decided advantage. They also escaped the ill-advised

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action frequently induced by flurries and canards, and altogether seemed to operate more intelligently, possibly because the opportunities to make fools of themselves were restricted.

In considering the above figures and deductions, it must be constantly borne in mind that the market covered a comparatively narrow range for an active stock; that no unusual opportunities for profit or loss existed, and that the end of the period showed the stock unchanged in price.

In comparing it with a great cycle of speculative prices the results would be greatly magnified. The object in view was to submit results entirely of a normal nature.

It is doubtful whether operations in U. S. Steel stock were particularly desirable at any time during the period mentioned, as it presented no great immediate promise, and numerous dangers at all times. There were many surface indications of a warning character. The stock was untried; the earnings were comparatively so large as to suggest inflation, and the fact of it being a public favorite was proof of a bad technical condition.

The student of the technical position of shares would have reasoned that the enormous

floating supply of the stock in public speculative hands would make any marked or sustained advance impossible, as any considerable appreciation in the market price would meet with enough selling to stop the upward trend, while the danger of panic or severe decline would be increased for exactly the same reasons.

It is therefore probable that the better class of traders shunned the stock entirely, especially when the fact is considered that numerous other active stocks presented better opportunities during the period considered.

For instance, Louisville & Nashville made and maintained an advance of \$25 per share from July, 1901, to March, 1903, the advance being justified by improved conditions in the South.

Nevertheless U. S. Steel was the public favorite, and was obviously the best example of public speculation.

Viewed in the light of comparative results, the loss of \$682,000 on total transactions of 1,112,000 shares may at first blush be considered small, only a little over fifty cents per share, but it must be remembered that this was a total deficit on all operations, and that the numerous profits made at various times were

used as an offset to losses. The question is, why should any loss have occurred when there was no decline in market valuation?

If the barometrical character of the examination outlined above is admitted, the fact is established that a loss was sustained which can be attributed to nothing but mistaken methods and impulses. In other words, the actual percentage against the trader was more than trebled by personal actions, a thing which would not have been possible with any mechanical gambling device.

The matter presented in this chapter offers much food for thought. It is not in line with the alluring view of speculative opportunities frequently presented to the public eye. The statements already made that speculation could be made profitable, are in no way modified, but the disease must be diagnosed before it can be treated, and some of the medicine necessary to financial health has a bitter taste.

Written large between the lines of every disastrous speculative account are the reasons for failure. True, this is cold comfort, for the losses represented cannot be recovered by analysis, but the lesson may be of great value in its bearing on future ventures.

Discovering and charting submerged and

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**dangerous rocks by a process of shipwrecking
is an unpleasant method of acquiring knowl-
edge, but a most forcible one.**

XIII

Grain Speculation

AS a confirmation of the preconceived theory that the percentage of loss in grain speculation was much greater than in stocks, an examination of accounts was undertaken based on the same general lines outlined in stocks.

The commodity chosen for investigation was No. 2 Wheat, and the transactions considered were made on prices established on the Chicago Board of Trade.

The period covered was from January, 1901, at which time the price was $76\frac{3}{8}$, to December, 1903, when the price was $77\frac{3}{4}$.

During this period of three years the lowest price touched was $63\frac{1}{8}$ in July, 1901, and the highest price, 95 in September, 1902.

The range for each of the three years was:

$63\frac{1}{2}$ to $79\frac{1}{2}$ in 1901.

$67\frac{1}{2}$ to 95 in 1902.

$70\frac{1}{4}$ to 93 in 1903.

These figures are presented as evidence of

numerous wide speculative movements occurring between the same comparative basic prices at the beginning and ending of the three years.

Five hundred accounts were found available for dissection, and the same appearance of unanimity of operations as that apparent in stocks was shown.

The principal seeming difference between stock and grain trading was that the public indulged more freely in operations for the short account in grain than in stocks. Several instances were discovered where for a time the preponderance of operations were for short account, invariably at low prices and on the eve of an advance.

All the errors illustrated in stocks were found to exist in grain on a magnified scale. The tendency to buy at the top, and sell at the bottom, was particularly marked, and while the average buying price of $79\frac{1}{8}$ may look low, it may be said in explanation that the prices of 95c. in 1902, and 93c. in 1903, were of a manipulated nature, and of very brief duration, and that comparatively few transactions were possible at very high prices. If these two abnormal periods are eliminated, the average price was high.

The investigation resulted as follows:

412 accounts showed a final loss.

74 accounts showed a final profit.

14 accounts were neutral.

The total deficit on all losing accounts was \$923,000. The total gain on all profitable accounts, \$52,000, leaving a net deficit of \$871,000.

The total amount of grain handled was 90,000,000 bushels (the speculative equivalent of 900,000 shares of stock), of which 62,000,000 bushels were originally purchases, and 28,000,000 originally short sales.

The total brokerage charges were \$112,500.

The comparative losses on short sales were 16% less than on purchases.

The scale order was employed in 140 accounts, (92 long and 48 short), but was pursued to an uninterrupted conclusion in only 21 instances.

The average buying price was $79\frac{1}{8}$, and the average selling price $70\frac{3}{8}$.

The principal facts illustrated as compared with stock operations are a net loss of \$757,000 over and above an actual mechanical percentage of only \$112,500, and the small total of gross profits as compared with the total of gross losses.

It has been stated that the grain investigation was begun with the preconceived opinion that losses in grain would be proportionately larger than those in stocks, and the result, as far as it goes, is confirmatory. It is only fair to state in this respect that losses shown in corn were comparatively larger than in stocks, but much smaller than in wheat. This is probably explained by the fact that corn has undergone a readjustment of valuation through its increased uses, and enormous increase of exportation, both of the cereal itself and its by-products, and also the fact that we raise 80% of the world's corn, and that available acreage is about exhausted.

These facts were so patent as to be of assistance to even the obtuse mind of the ordinary speculator, and as purchases predominated, and the price has gradually advanced, comparative losses were smaller.

The preconceived opinion as to losses in grain operations was based upon the irrefutable fact that study and judgment must in such operations be largely superseded by purely gambling principles. In other words, the probable price of grain cannot be intelligently forecasted by the ordinary speculator, as no reliable figures are obtainable, and no

prophecies as to future conditions can be reliably adduced. The annual crop scares are not dependable, and actual conditions which bear upon future prices are available only to the chosen few who can afford to make their own expensive investigations!

It is needless to say that possessors of valuable knowledge do not diffuse their information, nor expose their operations to public view until the psychological moment arrives at which they wish to sell.

It is possible to obtain figures as to the earnings of corporations, and such figures being at hand, the rest is a matter of judgment and study, but no figures which may be considered a safe basis of operations are obtainable anent cereals.

In addition to the gambling elements which this lack of knowledge injects into operations in cereals, they are much more subject to manipulation. The record of a single individual "dumping" the entire speculative public in wheat, is not rare in the history of grain speculation, and the capital employed in the operation would not make a hearty meal for Wall Street.

There is another drawback to grain speculation as compared with stocks, and while it is

apparently overlooked or ignored by the average trader, it is important, and is as follows:

The possessor of 100 shares of stock bought at a normal price, is the recipient of dividends, or may naturally expect ultimate improvement in his security if it is a good one.

The possessor of 10,000 bushels of grain at a normal price is subject to storage charges and insurance, and has equal chances of profit or loss in future prices.

To illustrate this: The man who invests \$10,000 in a 6% stock, at par, receives \$600 per year on his investment, while he who invests the same amount in 10,000 bushels of wheat at \$1.00 per bushel, pays about \$1,200 a year to carry his property. This is looking at the matter as a cash proposition, but the comparative drawback cannot be escaped by any form of operations for the long account, whether the transaction be for one day or one year.

The optional nature of grain presents another drawback in that an unfortunate operation cannot be continued indefinitely, except by the process of transferring to more deferred options with a multiplication of commission charges. Even by this process the transferred trade may be regarded in the light of a new

transaction, as the buyer's original reasons for believing that the present, or coming crop, would be salable at a certain price before the maturity of the option purchased, have been entirely obliterated by the lapse of time, and he now finds himself depending upon the chances of recovering in the new transaction the losses sustained in the old.

If he accepts and pays for the commodity, and a year later finds that the price has advanced 12 cents, his position is in no way improved, as the expense of carrying his product for that period has offset the higher market value.

The trader who purchases wheat has against him, therefore, all the ordinary drawbacks of misleading appearances, manipulation, etc., but in addition, the element of purely gambling chance is greatly increased, and a tremendous submerged percentage added.

The foregoing statements at once suggest the question, "If successful operations for the long account are so difficult, why should not operations on the other side present advantages in direct inverse ratio?"

The point is well taken, and the answer is simply, "they do present such opportunities." This advantage is illustrated to some extent

by the fact that operations for the short account, in grain, showed a larger ratio of profit, or rather, a smaller ratio of loss, than was found in purchases.

But in public short selling we find that a too general recognition of its advantages would lead to the undoing of the trader by creating a technical position which would be very inviting to the moneyed manipulators. This danger must be considered, as well as the fact that the theory of accidents being in favor of the short seller of stocks, is exactly reversed in grain. For instance, war, classed as the greatest of all calamities under certain conditions, is an invariable reason for higher prices in food products. The tendency to sell at low prices also prevails and must be overcome if operations for the short account are to prove profitable; but brushing aside all these elements of accident or error, it may be stated that the short seller of cereals possesses a distinct advantage.

The fact will no doubt be pointed out that short operations have proved uniformly disastrous in the past few years. While this is granted, it in no way interferes with the arguments but rather supports them in its demonstration of the possibilities of manipulation by

one or two individuals. But there is another reason for this reversal of form which was apparently recognized by a few men and stubbornly overlooked by the majority. The fact is that all staples have recently undergone a process of revaluation to a higher basis and that the seller of every product has worked against the current of this universal readjustment.

That the public is slow to recognize changed conditions is demonstrated by the fact that the period of high prices from the latter part of 1888 to early in 1892 finally educated them to consider one dollar the normal price of wheat at just the time when a readjustment to lower valuation took place and enormous losses were sustained by a tenacious adherence to this theory of dollar wheat until the expensive lesson had been ground into them that a change had occurred. The more recent readjustment to high prices was likewise unrecognized and vigorously combatted.

This is a very marked evidence of the fact that speculators generally move more on a mental chart of recent market action than upon any broad lines of thought.

It would be really amusing to review the opportunities set forth by the advocates of the

so-called chart system as applied to grain trading for the last fifteen years. We find them in the position of purchasing wheat through a period of depression and later selling it persistently through a period of advancing prices, for it must be admitted that changed conditions cannot be contemplated in a fixed system founded on past, not future events. The votaries of the charts will no doubt attempt to evade this statement by demonstrations covering an insufficient period or by claiming that changed conditions were recognized and their little machines readjusted to meet them. The first refutation is simply unfair, and if the second is true, correct recognition would have been sufficient without any auxiliary machinery.

The difficulty of successful operations in cereals by ordinary traders is very pertinently shown by the remarks made by the most successful bucket shop man in the United States.

"I can better afford to trade flat in grain than to trade in stocks at one quarter commission; they have nothing to go on."

This is the statement of a man who looked upon the matter in a purely gambling light and admitted that he could eliminate the actual

percentage in grain transactions and depend wholly upon the speculator beating himself.

Even the greater lights of speculation, fortified by large capital, have found the hazards of grain speculation so great, and the most careful forecasts so unreliable, that in many instances, and after disastrous experiments, they have transferred their operations wholly to stocks. Mr. James R. Keene twice retired from the Chicago arena a badly whipped man, and it is related of him that he refused an intimate friend financial assistance in a grain deal with the terse remark that he would be doing him no kindness, as it was impossible to win.

This is, of course, an extreme view, for money lost by one man must necessarily be gained by another; but this fact does not interfere with the broad general principle that stocks of good corporations are productive, and that the possession of staples is an expense. One is for perpetual existence and natural enhancement, the other for consumption.

The contention of Mr. Keene that it is impossible to make money in cereal speculation cannot be wholly concurred with. The man who is astute enough to foresee a final read-

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justment of values or who purchases staples at an extremely low price in periods of depression, and vice versa, will succeed; but the average grain trader will find his opportunities and possibilities reduced, and his obstacles multiplied by comparison with operations in stocks.

XIV

Suggestions as to Intelligent Methods

IN deciding what to buy and when to buy it, the speculator faces the most formidable of his problems, for upon his decision upon these two points rests success or failure.

It will be necessary for him to concentrate upon this task research, labor and clear thinking, coupled with technical knowledge and sustained by precedent.

In approaching the first phase of the question—What to buy—it may be well to employ the time-honored method of elimination, and to consider primarily what not to buy.

It seems incredible that the numerous oil, mining, and other companies which advertise large returns on low priced stocks, or immense values for small investments, should find a market, but the fact remains that the money annually invested (?) in this class of stocks is so considerable an amount as to demand some comment, and warrant a note of warning.

This class of so-called securities may be

said, by and large; to have no value at all. Securities which have an actual dividend earning power of any probable duration do not go begging long in this day and age, and are seldom advertised for sale in the newspapers.

Let this fact be remembered: a mine, an oil well, or any other producing company with a demonstrable value can command a market price at all times. That is to say, if the owner, or owners of a mine can show a certain amount of ore in sight, or can prove that such ore exists, they can command a fair price for that ore as surely as if the commodity were flour in a storehouse instead of gold, silver, or copper in a mine. Any man who has a knowledge of mining affairs, (and who has no mining stock for sale), will confirm this statement.

If, therefore, the sellers of stock in such companies have a property, capable of producing a certain commodity which may be sold at a profit, they must, in order to reap any substantial benefit from the "stocking" operation, sell as much of the stock at high prices as to cover the great expense of time, a costly advertising campaign, officers' salaries, a large commission to fiscal agents, (usually 20%), and leave a margin of profit for themselves. They must, in short, sell to the public at about double the

value placed on the property by men of wisdom and experience.

There are no doubt cases where the promoters of such securities believe that the value of their own property is greater than any appraised market, in which case we find their judgment opposed to that of shrewd men seeking to invest capital. In such opposition of judgment the owners may be right—the chances are a hundred to one that they are wrong.

But even the above examples are too broad, for the great majority of these concerns have no property of any demonstrable value whatever. Their stocks are made, like Hodge's razors, to sell. The promoters depend upon golden promises, statements misleading, or actually false, and public gullibility to create a market for their stocks. That they are able to sell them at all is remarkable.

These companies use every means for deceiving the public. They employ the best of writers to get up glowing prospectuses, and not infrequently the names of prominent men are found among their officials or directors. These latter individuals participate sometimes through ignorance and enthusiasm, sometimes through actual dishonesty. In either case it may be

justly stated that a prominent name added to the roster of an advertising company is not sufficient proof of the property's merit.

In addition to these facts there is no recognized market for this class of stocks, and they cannot be disposed of like listed securities, at a moment's notice. This is in itself a great drawback.

In making these statements there is no prejudice nor desire to be unfair. There are no doubt exceptions to the rule, but these exceptions are so rare that the best plan possible is to eschew all such properties entirely, no matter how alluring the promises, or how apparently well founded the venture. There are plenty of good listed securities, the prices of which periodically reach high and low points, the value of which is founded upon recognized business principles and necessities.

The listed securities of Wall Street are divided into two distinct classes: Industrial and Railroad; and viewed from a speculative standpoint the former class is the most hazardous, in that they are generally more subject to manipulation, competition, or harmful legislation. Those who possess a sufficiently tenacious speculative memory will recall the affairs of the Whiskey trust and the Cordage trust and their

sad demise; and while great declines, and even assessments, have occurred in railroad stocks, they have always eventually proved their real value. Good Industrials may occasionally be purchased safely and profitably, but the rails present the same opportunities, and are safer and more open to comprehensive investigation and correct judgment.

At the rails, therefore, we stop. It may be argued that the process detailed above is a matter of degree, and that it might be continued until only government, or other gilt edged bonds, remained; but the question here discussed is speculation, and it is taken for granted that what is sought is the golden mean between certain loss and certain cent per cent.; i. e. properties which combine a fair amount of stability and future promise with periodical opportunities for advantageous purchases and sales.

Viewing the future of railroad securities in a broad general light, their gradually increasing value appears certain. The continued increase of population produces for them present returns from travel and shipping, and the demands of the settled districts ensure more permanent returns. So far as probable competition is concerned, it grows daily less with the concentration of capital. It is likely that even today the

projectors of a railroad which would come into harmful competition with present lines would find it impossible to raise the money for the furtherance of their plan.

A brief perusal of statistics will show that the oldest and best railroad securities, representing the properties traversing a densely populated territory, are subject to the smallest comparative range of fluctuation. These stocks are gradually undergoing a process of absorption which will in time reach to the newer roads of less developed country.

The West, with its enormous undeveloped territory and resources, presents great promise to the prophetic mind. The problem of extensive irrigation is yet to be solved, but aside from agricultural pursuits, the West possesses a wealth of mineral and lumbering industries, and possibilities which independently guarantee its future.

"The Atchison Railroad is a streak of rust running through a desert," said the elder Woerishoffer thirty years ago, as he industriously sold the stock short at prices which would seem ridiculously low today. Possibly Atchison bore that aspect at that time, but today it is a modern, well equipped, dividend paying property, traversing a rich and constantly im-

proving territory. The improvement of that brief period is significant.

The South also presents promise of great future improvement. The readjustment of cotton prices to a higher general level, and the development of important mineral resources are combining to dispel the long lethargy of this section, and the growing competitive importance of its gulf ports is too glaring to be misunderstood.

The believer in the continued growth and prosperity of the United States, the progress of the largely undeveloped West, and the awakening South may safely assume a gradual and rapid growth in the value of railroad securities of these sections. The consensus of intelligent opinion points to their long-continued improvement and advance.

The contention is therefore made and offered for consideration that the railroad properties of the West and South offer the best speculative opportunities, combined with the greatest degree of safety.

The foregoing will, possibly, appeal to the reader as looking rather to the long future of properties than to immediate speculative opportunities, but the fairness of the following statement must be admitted:

The hazards of speculation are so great that it is expedient to primarily consider a solid groundwork for ventures. The trader who deals in stocks, the future of which he considers secure, can operate more actively and courageously than under other circumstances. It does not follow that because he has faith in the long future of his chosen properties, he shall at once jump in and buy and await the accretion of time. The proposed plan of operation—to await low prices—is in no way changed by the cheerful view of the future.

Having formed a definite idea as to the general outlook of a certain group of properties, the investigator has narrowed his research to individual stocks. In this he will be guided by three periods—the past, present, and probable future.

In examining the history of a stock it will be found that in almost all cases the security has undergone, in early stages, a radical advance and decline. This is largely occasioned by the fact that the public always makes a favorite of a new security, and will participate freely in the affairs of an untried corporation, while standard issues go begging. This brings about a state of affairs already explained both technically and theoretically, and

offers to the moneyed interests an opportunity to sell their holdings to the public at high prices, and recover them later at their own figures. Thereafter, the stock will probably take its place among the standards of the Street, and follows the general swing to high and low extremes with a gradual trend toward increased valuation.

Eliminating this abnormal period of initiation, the investigator will find a careful study of the past to be of great value. In all cases it will be found that earnings have gradually increased, allowing, of course, for abnormal periods of depression and inflation. The fixed charges and expenses have also increased, and by an examination of both these factors, as well as an allowance for the diversion of funds for purposes of purchase and improvement, which expenditures if intelligently made must add to the value of the property, the net result of the past may be considered a reasonable guide to future expectations.

The mere payment of dividends cannot be accepted as a safe basis of value, for dividends are often paid to the great detriment of the property, and on the other hand are frequently withheld when they might be safely paid. Earnings are the all important point, and

when the investigator has answered to his satisfaction the questions, "What have they earned, and what have they done with the money?" he may consider himself well on the way to his goal.

With this record of the past formed, the present earnings may be scrutinized. They may recently have undergone a sudden advance out of proportion to normal growth, or vice versa. In either case a reversal of present conditions may be confidently expected.

This simple form of reasoning applied to the affairs of the United States Steel Company in 1901-1903 would have sounded a most distinct note of warning, the correctness of which has been amply demonstrated.

The probable future is based upon a gradual improvement from the normal value of the present as indicated by the past.

The consideration of assets, so far as a railroad property is concerned, must be founded principally on its ability to earn, and continue earning perpetually.

Minus its usefulness, the total assets of the greatest railway system in existence would be little better than a mass of old junk; but if a million dollars has been so expended as to bring a continued fair return, that amount may be

considered an asset. The investigator therefore finds that his calculations must be based almost wholly upon the ability of a property to increase its earning power until territorial development reaches high tide, and thenceforth to maintain such earnings indefinitely.

It will not be necessary for the trader, personally, to compute the various and voluminous figures which show the net earnings—that is to say, the amount applicable to distribution to the various bond and stock holders. A comprehensive statement of income and expenditure may be obtained from different published statistical works, or by application to the secretary of the corporation in question. With these figures before him, the task of the student is one of examination rather than of compilation, and with such information at hand, the matter may be viewed in the same light as any other ordinary business transactions. The total income, less the fixed charges, is the amount applicable to dividends and surplus.

The man who undertakes such an investigation will be surprised at the ease with which he may arrive at interesting results.

The legal provisions of the company, the rights of holders of preferences, and of holders of common stock, etc., are all matters which

should be examined, as they frequently have an important bearing on values.

If the plan mapped out has been intelligently followed, the investigator should, by comparing his result with the value of money, be able to judge of the normal value of any standard security. If his figures vary materially from the market price, and no important error nor omission has been made, the stock is selling either below or above a fair valuation, and the information which was the object of all his research has been gained. Possessed of this valuable knowledge, the speculator now turns his attention to the second phase of the question—the time to buy. It may be that the price of his favorite security is very low, but that a bad technical position exists which will warrant a belief in lower prices, or an extended period of dullness. This situation has already been sufficiently enlarged upon.

Recapitulating the matter offered above for consideration, the course recommended would appear as follows:

First, decision as to the securities to be dealt in, eliminating all wildcat and untried stocks, and choosing for operations standard listed securities.

Second, determining what stocks offer the

greatest promise of continued increase in value, as determined by territory and its probable development and growth.

Third, an examination of the physical and financial condition of the individual property, or properties, chosen, and a forecast of the probable future, based upon the demonstrated past.

Fourth, the fixing of a present normal value to be used as a pivotal point in actual operation.

Fifth, a consideration of the manipulative and technical conditions of the machine speculative in order to be able to judge of the more immediate action of the market. In other words, to locate the position of the stocks, whether in weak hands or strong.

This form of reasoning should not appear complicated; it is the same process which any business man would pursue in following a determination to enter the grocery business, and yet it may be emphatically stated that not one speculator in a hundred enters his field equipped with even the most desultory knowledge of what he is doing. Out of ten traders in U. S. Steel Preferred who were experimentally questioned two years ago, only half the number knew what the issue of preferred

stock amounted to; only two were aware of the important fact that the dividend on the preferred stock was cumulative, and not one was reasonably well posted as to its properties and earnings.

And yet every one of these individuals could adduce specious reasons why the stock should advance or decline, reasons which at best were incomplete, and at their worst, silly or false. The outcome of their individual efforts has not been followed, but it is safe to surmise that all made mistakes which research, coupled with intelligent judgment, would have prevented.

In the plan of study submitted in this chapter, there will, no doubt, be a sense of incompleteness, but the object has been rather to guide the reader into a correct line of reasoning and investigating than to adduce specific cases or pile up statistical proof.

Everything is left to individual effort and judgment, and the man who begins the process of research suggested will make rapid progress. One developed fact will suggest another point to be investigated, and the process will become interesting and profitable.

The man who studies and knows, is the only man who makes permanent gains in speculation.

To those who refute the possibility of obtaining the necessary information for the forming of such opinions, or who consider the task too great or too complex for the ordinary mind, let the fair reply be made, "Try it." It is this hazy idea of mystery where none exists which deters the ordinary speculator from even attempting to use his own brains, and which leads him to base his operations upon hearsay or guesswork. Cases will occur where concealment, either partial or total, will be found. For such the remedy is simple: let these properties alone.

If the first step toward the investigation of the affairs of Amalgamated Copper had been taken, it would have appeared at once that the corporation was a mere shell, a holding company, and furthermore, a blind pool of the most pronounced type. The value of such knowledge employed in a negative sense, that is, in preventing operations in such hippodromed stocks, is a matter of history. The enormous public losses sustained in Amalgamated Copper would have been impossible in any business on earth except speculation, for in any other business affair examination would have been the first thought, and negotiations under

parallel conditions would have been abruptly dropped.

It is not meant to say that a mere examination of figures and periods is by any means sufficient, but it is believed that once started in the correct path of examination and judgment, as opposed to the prevalent methods of guesswork and gambling, the trader will find ample opportunities and incentive for pursuing his researches to a logical conclusion. After this has been accomplished, success will be measured by his own capabilities and business acumen.

The chapter headed, "Analyzing Railroad Securities," in Mr. John Moody's book, "The Art of Wall Street Investing," will be of great assistance to the student who attempts to follow out the suggestions made above.

XV

Simple Methods of Analysis

IT was stated in the first edition of this work that it would be obviously impossible, in the limits of a single volume, to set forth in detail the methods which should be employed in a scientific analysis of the conditions and prospects of railroad and industrial stocks. There are, however, a few salient points in the study of the status of a security which are more important than all the details combined. If we are sure of our ground so far as these essentials are concerned, the probabilities of a serious error are greatly reduced. It is the purpose of this added chapter to present in simplified form the vital elements of a corporation report and to suggest methods by which these elements may be examined and interpreted.

1. Interpreting Railroad Reports.

The business of a railroad is no different, in its fundamental points, than that of any other enterprise. The basic problems which present themselves for solution may be outlined as follows:

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A—How much money is being taken in.

B—What is it costing to operate the road?

C—How much is required to pay the interest on the money borrowed?

D—What are the profits?

This condensed formula requires some explanatory elaboration:

A—How Much Money is Being Taken In.

This point, of course, refers to the gross earnings. These should be examined, not only in bulk, but on a per-mile basis. Otherwise, the results are apt to prove misleading. The gross earnings of a railroad naturally grow larger from year to year, as population and density of traffic increases. The figures may show that the gross earnings of a certain road have doubled or trebled in a decade, but the exhibit standing alone may be meaningless, for the miles of road operated may also have been doubled or trebled, in which case no actual improvement would be shown. The per-mile earnings of a road are simply the gross for that period divided by the number of miles operated. In this regard the student should exercise care in discriminating between miles of line and miles of track. The old method of taking miles of line as the divisor was sound enough in the days of single-track roads, but now that many roads have multiple tracks such

a prescription would bring grotesque results. Also, even where double tracking has not yet been extensively employed, we find many "lap sidings." These are, in reality, long stretches of track in the form of siding which permits two trains going in opposite directions to pass without stopping. They are, therefore, in effect, double track.

As a general rule, it is much better to base figures on miles of track, as each mile of track must in some way add to the efficiency and earning capacity of a road, else it would not be built. At any rate, there is no danger of arriving at any incorrect conclusions if we adopt this rule.

After examining the progress of per-mile gross earnings over a period of years the student may bring his investigations up to date by following the same process in regard to the monthly and weekly earnings which the roads are required to submit to the Interstate Commerce Commission.

Having arrived at a satisfactory conclusion as to gross earnings, the next step is to determine what portion of these earnings has been used for

B—Operating Expenses.

These figures cover the transportation expenses (which are principally labor); the main-

tenance of way and structures (upkeep of "roadbed," bridges, depots, etc.); the maintenance of equipment (cars, engines, etc.) and traffic and general expenses (advertising, officers' salaries, stationery, etc.). There is no rule of thumb by which we may determine the condition of a road by reference to its ratio of operating expenses to gross earnings, as much depends on the amount required for interest on funded debt, taxes, and other items which must be adjusted after operating expenses have been paid, but, roughly speaking, if operating expenses consume more than 70% of gross earnings, the condition of the road is not very favorable.

Assuming 70% as the operating ratio, it is next essential that we determine what proportion of this 70% is being expended for maintenance and what proportion for cost of conducting transportation, which are the two big factors in operating expenses. A low cost of conducting transportation, together with high expenditures for maintenance, is almost invariably a favorable sign, as such conditions represent economy in operation and good physical conditions. Conversely, high cost of conducting transportation and small expenditures for maintenance is distinctly unfavorable. In this case also it is impossible to formulate any set rule, as 20% of gross would be high main-

tenance in one territory and 25% would be low in another. Comparisons of several roads in the same sort of territory will greatly assist the student in his calculations. It will not be necessary to do any considerable amount of personal compilation in this direction. There are several excellent works which give all the percentages for years back. I will mention these at the conclusion of this chapter.

Subtracting the expenditures for operating expenses from the gross earnings, we now have the operating income. The operating income, plus the "other income," if any, is the net amount available for

- 1—Payment of taxes.
- 2—Payment of interest on bonds or notes.
- 3—Disbursements in the form of dividends, expenditures for improvements and betterments, or reserves for surplus.

The item of "other income" should always be carefully scrutinized. Sometimes this is very important, as in the case of Southern Pacific, which derives a large part of its income from interest and dividends on stocks owned.

This brings us down to

C—Fixed Charges.

It may be found that while a road is being operated economically and maintained properly, so that the total expenditures for operat-

ing expenses are low or reasonable, the amount of interest required on outstanding bonds and notes is so great that little or nothing can be saved for dividends or surplus. The stock of such a road has little value until, through natural growth of earnings, because of increased density of population and traffic, the trouble is cured and profits are available or in sight. If a road consumes more than half the net income (after all operating expenses) in taxes and fixed charges, there can be no assurance of stable dividends. This is because in a lean year fixed charges and taxes remain rigid, and operating expenses do not shrink rapidly. A very small decrease in gross will, therefore, have a very serious effect on profits. Mr. Carl Snyder, in his admirable book, "American Railways as Investments," which is now out of print, explains this point very clearly by means of a simple example, which is reproduced below:

"The high degree of stability imparted to interest payments and dividends by a low percentage of fixed charges, and the high degree of instability imparted by a large percentage, is so elementary that it would seem to need no emphasis. And yet this item is habitually disregarded by perhaps 90% of bond and stock buyers. On this account it may be worth while to illustrate by simple comparison the effect of

a 20% decline in gross or net earnings. We will compare the conditions of two roads whose fixed charges are respectively 75% and 25% of the total net income. The operation would be as follows:

Suppose a 20% Decline		
Say Earnings.....	\$1,000,000	\$800,000
Exp. (70%).....	700,000	560,000
Net.....	\$ 300,000	\$240,000
If F. C. 75%.....	225,000	225,000
Surplus for div.....	\$ 75,000	\$ 15,000 (Case I)
Decrease.....		.80%
If F. C. 25%.....	75,000	75,000
Surplus.....	\$ 225,000	\$165,000
Decrease.....		.26% (Case II)

"It will be seen from the above that a 20% decline in the net earnings would, in the first instance, mean a decrease of 80% in the surplus; while in the second case, the same decline would mean a decrease of only 26% in the surplus—figures which sufficiently indicate what a high percentage of fixed charges means."

D—Profits or Surplus.

For the sake of simplicity, let us take the case of a hypothetical road with gross earnings of \$100,000,000 per year.

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Gross Earnings	\$100,000,000	
Operating Expenses		
Transportation Traffic, etc.	\$30,000,000	
Maintenance	30,000,000	60,000,000
Net Operating Income	\$	40,000,000
Fixed Charges and Taxes		15,000,000
Net Income	\$	25,000,000
Stock Dividends (6% on		
\$250,000,000)	15,000,000	
Additions and Betterments	5,000,000	20,000,000
Surplus	\$	5,000,000

This would represent a sound and well-managed road. Operating expenses are 60% of gross; cost of conducting transportation is 30% of gross, and maintenance 30% of gross, showing economical operation and high physical condition. Fixed charges are low, being less than 38% of net income, and there is a good margin over dividend requirements. There is an old saying that a dollar ploughed back into additions and betterments is eventually worth two dollars to the stockholder, so the money thus diverted may be considered an emolument, in addition to the liberal dividend rate. Also the surplus cash will serve to stabilize dividends in lean years.

The Question of Stock Capitalization.

It may happen that net income after all expenses or charges will be found very large and that all the items of distribution of gross earn-

ings up to this point will be satisfactory. But this does not necessarily mean that the stock would be valuable. That would depend largely upon the amount of stock capitalization. Net income which would be sufficient to pay 6% on \$100,000,000 of stock would only be equivalent to 3% on twice that amount of capitalization. Also the property equities would be diluted in the second case. It is necessary to ascertain, therefore, what percentage the net income amounts to as applied to the stock. In the hypothetical case illustrated above the \$25,000,000 of net income would be equal to 10% on the stock. As dividends are at the rate of 6% the "margin of safety" is 4%.

This is all very sketchy and, in examining the reports of railroads, many items of minor importance will be found. But if the fundamental principles involved are clearly understood the details will give comparatively little trouble. The suggestions offered are also very simple and will no doubt appear absurdly so to the more sophisticated reader, but there are a surprising number of people who invest in railroad stocks who do not appear to have the remotest idea what their property is worth. To this class the foregoing is addressed in the hope that it will start them along the right road to intelligent investigations.

Interpreting Industrial Reports.

A historian once wrote a most interesting "History of Iceland" in which appears the following:

"Chapter XXV—Snakes in Iceland."

"There are no snakes in Iceland."

In present circumstances it looks as if we might almost follow this time-saving practice by stating that there is no way to satisfactorily interpret the reports of industrial corporations. Almost all these corporations issue only annual reports six months or so after the fiscal year closes. These reports are also incomplete, being, in most cases, no more than an income account and balance sheet, which are interesting enough as records of the past, but not very illuminating as guides to the future.

It is a sad commentary on the intelligence of the investment and speculative public that they will put their funds into the stocks of corporations which refuse to keep them informed as to the progress or status of their business. The stockholders are the real owners of most of these concerns and the directors and managers are merely their servants. Yet they are never allowed to know what is going on. There is no conceivable valid excuse for this state of affairs. It prevents the public from making advantageous purchases of stocks or from disposing of such stocks when business and profits

begin to dwindle. What is more serious, it permits a few insiders, who are constantly in touch with true conditions, to operate in the stock market to their own advantage.

There are some exceptions to this rule, and in the course of time this practice of concealment will either be voluntarily abandoned as a matter of policy, or will be legislated out of existence. The greatest corporation of all—the United States Steel Corporation—has already abandoned it in part and now gives the public frequent reports of unfilled orders on hand, prices secured, monthly earnings, etc. A few others are falling into line and it is to be hoped that the day will soon come when the same facilities for investigation will be offered in the industrials as in the railroad stocks.

About all we can do in attempting an analysis of industrial stock values is to determine, as nearly as possible, the property value, aside from earning capacity; to look up the history of past performances and the character of the management and, finally, to depend upon the conditions and prospects in the particular line of business handled by the corporation under review.

In regard to property value, there is one point which should always receive careful attention. This is the item in the assets side of the balance sheet designated as "good-will."

There has been much discussion among accountants as to whether good-will should ever be entered as an asset and the consensus of opinion now is that it should not. The present writer holds that there are certain conditions in private lines of business, or in corporations the stocks of which are closely held, where the propriety of considering good-will as an asset is debatable. But in the case of stocks which are listed and quoted on our exchanges and widely distributed to the public, the practice is a miserable one. In nine cases out of ten it would be better to specify huge sums as "water" instead of "good-will," for then the truth would be stated.

A certain corporation with \$25,000,000 of common stock outstanding will have in its assets an equal amount of "good-will." Now, this stock has a par value of \$100 per share, all of which is offset by this intangible asset. But the stock may fall to \$5 per share, giving the total issue an aggregate value of \$1,250,000, yet the offsetting \$25,000,000 of "good-will" remains rigid as \$25,000,000 of "assets."

This is preposterous. Good-will can mean nothing, in the final analysis, but ability to make profits. This ability vanishes and the stock declines to very low figures, but the assets do not decline at all. If tangible property was to vanish it would have to be written off.

For example, suppose a \$5,000,000 uninsured plant is destroyed. It would be absolutely necessary to write \$5,000,000 out of plant and property account.

The proper method of procedure, in the case of stocks which cannot be covered by tangible assets, is to give them no par value at all, and some new corporations are adopting this plan. Where this is done the public can decide for themselves, according to profits and dividends, what the price of the stock should be, without being confused or misled by assets which are not assets.

Mining Stocks.

Mining stocks are usually classed as industrial. This, however, is a palpable misnomer. They are mining stocks and nothing else.

A mining stock differs from railroad or industrial stocks in that the latter are perpetual and are supposed to increase in value and earning capacity as time goes on, while a mine is constantly consuming itself. When the mine is worked out, the stock is worthless. In most cases mining stocks are a good deal of a gamble, as there is no way of telling how long the supply of ore will last. The porphyry copper stocks, however, are an exception to this rule. The reason for this may be briefly explained.

The length, breadth and depth of a porphyry deposit having been determined, the ore is sam-

pled at various points and the results averaged. We now know the total amount of ore in the body and about how much metal it will run to the ton. In short, the actual amount of metal is a known quantity. The next step is to ascertain how much it will cost per pound to produce and market the copper. As the capacity for daily production is also a known quantity, the life of the mine is easily estimated. This leaves only one speculative equation, i. e., the average price at which the metal can be sold.

As the copper is taken out and sold the cash received is distributed to the shareholders in the form of dividends, but the fact should be kept steadily in mind that each dividend so received reduces the value of the shares of stock, for the disbursement means that less ore now remains to be mined.

The simplest way to look upon a share of stock in a porphyry mine is that it represents so many pounds of metal in the ground, which can be determined by a little figuring. The number of pounds represented by the share will be decreased gradually until nothing is left and the stock is worthless. This process of amortization may be scientifically applied to various arbitrary average prices for the metal in such a way as to quite accurately determine the value of the stock at any price for the metal.

That is to say, if we assume that the average price of the metal during the life of the mine will be 15 cents per pound, we have a complete basis for arriving at a tentative value for the stock. At 16 cents the value would be greater; at 17 cents still greater, and so on. This should make it clear that in buying this class of stocks we need speculate only on what the future demand for and prices of the metal will be.

It is not necessary for the man who speculates or invests to build up an extensive statistical library. The following books will give him all the salient facts and figures regarding all leading properties:

"Moody's Analyses" (Railroads and Industrials).

"The Earning Power of Railroads" (Mundy).

"How to Analyze Railroad Reports" (Moody).

In order to keep up to date on statistics and current events, the following periodicals may be suggested:

"The Financial Chronicle."

"Moody's Magazine."

"The Financial World."

The Standard Statistics Company furnishes a card system by which the statistics of all corporations are fully set forth and reduced to percentages whenever advisable. These figures are constantly kept up to date. The cards may

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be secured either to cover only such properties as the subscriber may be interested in or in a cabinet containing data of all the leading railroad and industrial companies.

There are dozens of other excellent books and publications which it may be found advisable to purchase from time to time, but the above will cover all the ordinary necessities of the occasional operator.

XVI

Conclusion

THE three stages necessary to the development of the theories advanced in this work were, first, a recognition of the fact that public ventures were, considered as a unit, generally disastrous; second, an analysis of the causes which were responsible for this unsatisfactory fact; and finally, a confirmation of such analysis by statistical exhibits.

Relative to the latter feature, the necessarily condensed and restricted nature of the figures submitted may be considered insufficient evidence, but as it is certain that there is never a material division of public speculative opinion at any time, the books of even one house with a public clientele may be considered a fair indication of all others.

If the four thousand accounts, with their tens of thousands of operations, could be presented in detail, this unanimity of action would be more apparent, and their barometrical value greatly magnified.

The figures submitted, however, are confirmatory and not basic, and while they are important, in that they dovetail with preconceived opinions, the logical conclusions presented must stand on their own bottom.

That the public loses money in speculation is a notorious fact; that such losses take place in an arena which presents equal opportunities for profit or loss is indisputable, and it must follow, as the night the day, that the losses sustained are the result of mistaken judgment, erroneous methods, or misleading appearances.

In presenting the different pitfalls which beset the path of the speculator, and suggesting a means of avoiding or bridging them, it is felt that a thorough understanding of such dangers was necessary to safety and maximum good results.

Fortified with a knowledge of the machinery of the speculative world, and its workings, the trader may indulge much more actively in his ventures than if he depended wholly upon even the most excellent judgment of intrinsic value. Thus the trader who is justified in believing general or individual current prices to be at low ebb, may act boldly and frequently with good results. He enters his campaign satisfied that material decline is improbable, that public

liquidation is complete, and that the next important move will be upward. He brings to bear upon his operations his knowledge of technical conditions and natural market actions, and his foundation being secure, makes repeated successes. He bears constantly in mind the fact that a limit will eventually be reached, a fact which is easily submerged by undue enthusiasm, and he knows that it is far better to quit too soon than too late.

All these things are a distinct advantage in increasing profits and preventing loss, but they are of secondary importance. They are the branches, without which it is possible for the trunk to thrive, but which, themselves, will die if removed from the parent stem.

The great basic principle of speculation, the foundation upon which the entire structure rests, is the recognition of value. No sustained success is possible without this knowledge, and most failures are traceable to the lack of it. Yet so generally is this important element disregarded, or refuted, that we find it playing only a small part, or no part at all, in the operations of the average speculator.

In the speculative world we find many men capable of clear thinking, correct analysis, and sound business judgment falling over each

other in the rush to make purchases of properties of which they know nothing. The incentive to such purchase may be a whispered tip, or contagious enthusiasm, and the ridiculous equation of luck plays no inconsiderable part. The result is always the same.

To those who contend that all the obtainable knowledge of speculative anatomy is limited and unreliable, let this fair question be put:

Was there ever to your personal knowledge a period of speculative extremes where all, or most of the appearances and conditions herein detailed did not exist in recognizable form? To be more specific, when the public favorite, U. S. Steel, was selling at its lowest prices were not the technical appearances of dullness, pessimism, and public disgust as distinct as the activity and optimism had been at high prices? And furthermore, were not the figures by which an intelligent estimate of real values and probabilities could have been demonstrated in the face of claims of watered stock, lack of demand, and general decay, always obtainable?

It was stated in the first chapter of this work that the maximum result obtainable in such a treatise would be the direction of thought into proper channels. The theories, and even the

established facts advanced will no doubt meet with opposition from that class of persons who allow a general denial to take the place of answering arguments, and who sniff at theoretical deductions. Such shallow reasoners may at once be relegated to the ranks of the numerous whist players who maintain and express an opinion that there is nothing in the "book game," and who, in the face of overwhelming evidence that they are wrong, go on losing games, and actually take pride in proclaiming to the world their benighted condition.

Theories, if correct, are embryotic facts, the value of which lies wholly in their proper application, and no refutation, of even a faulty theory, is worthy of consideration unless accompanied by answering argument.

There is, however, a large class of men capable of clear thought and sound judgment who speculate unsuccessfully through allowing these faculties to be contorted, or lie dormant before the apparent mystery enveloping the affairs of the bourse. The properly directed exercise of the capabilities of these men would soon rob the speculative arena of both its mystery and its bugbears, and resolve it into

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a place of business where extraordinary opportunities were annually presented.

To this latter class, the statements and deductions made herein are respectfully submitted.

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