PERSPECTIVES

No. 1 June, 1932 Vol. 1

THE GREAT BULL MARKET AND COLLAPSE

Part 1. Fifty-seven Charts of Market Leaders

Part 2. Causes of the 1929-32 Decline and Present Outlook.

Information contained herein has been carefully compiled from sources which we believe to be reliable, but is not guaranteed.

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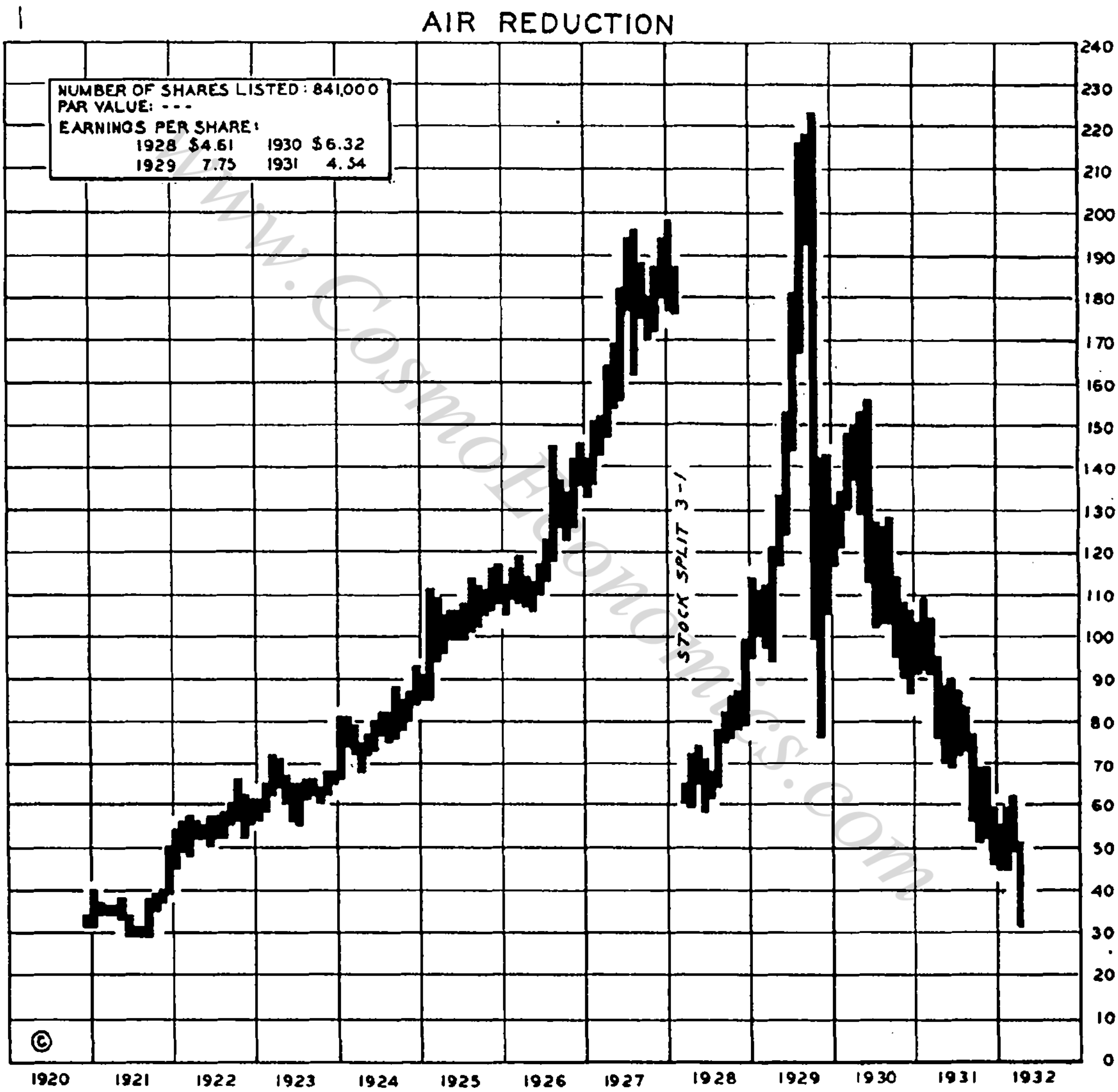
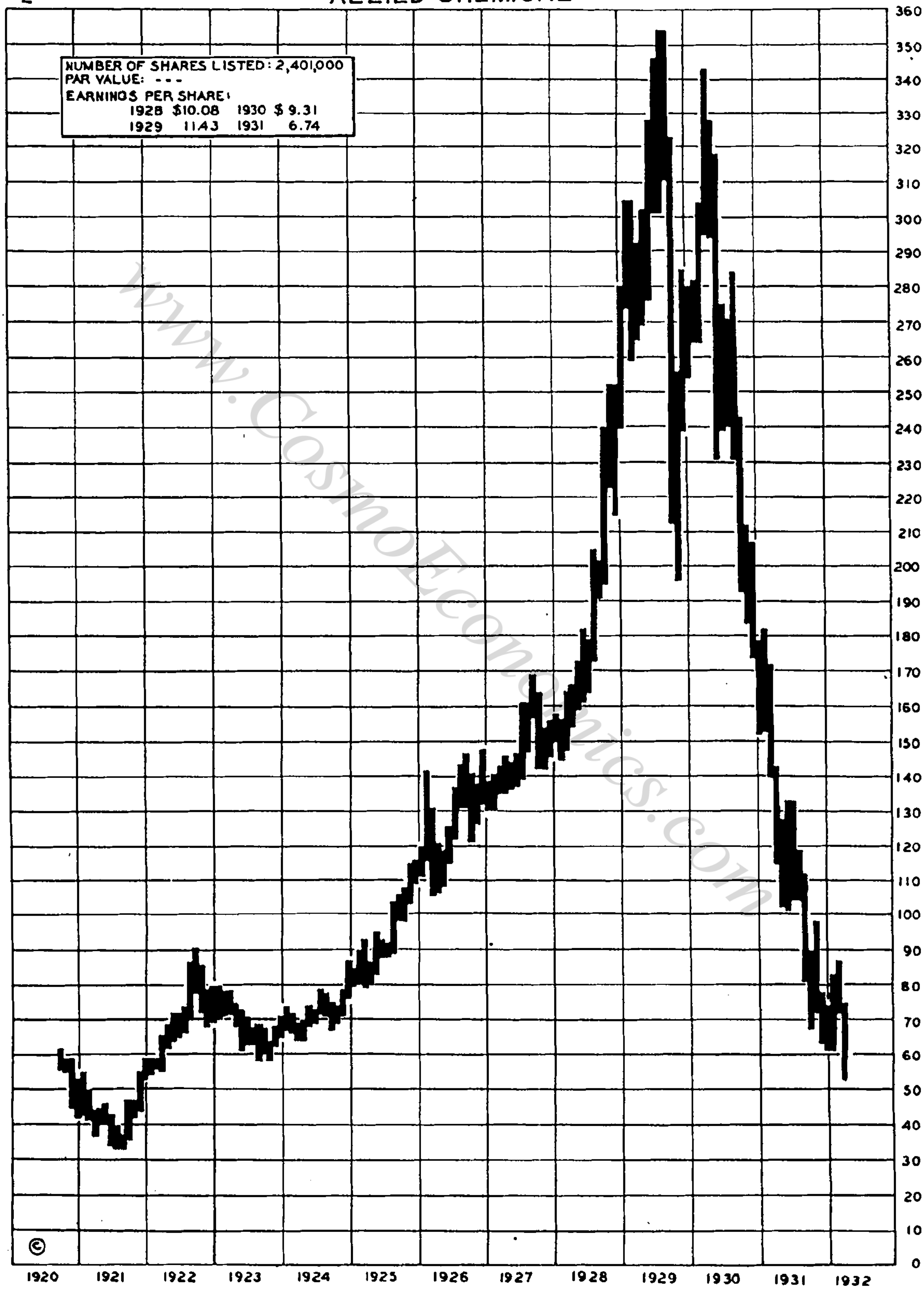
NOTE: Figures on number of shares listed and par value of stock are as of May 1, 1932. Figures on earnings per share are on the basis of present stock. Where split-ups or other important capital changes have occurred during the past four years, proper adjustments have been made so that the per share earnings as they appear on the insert are comparab

Part 2. Article

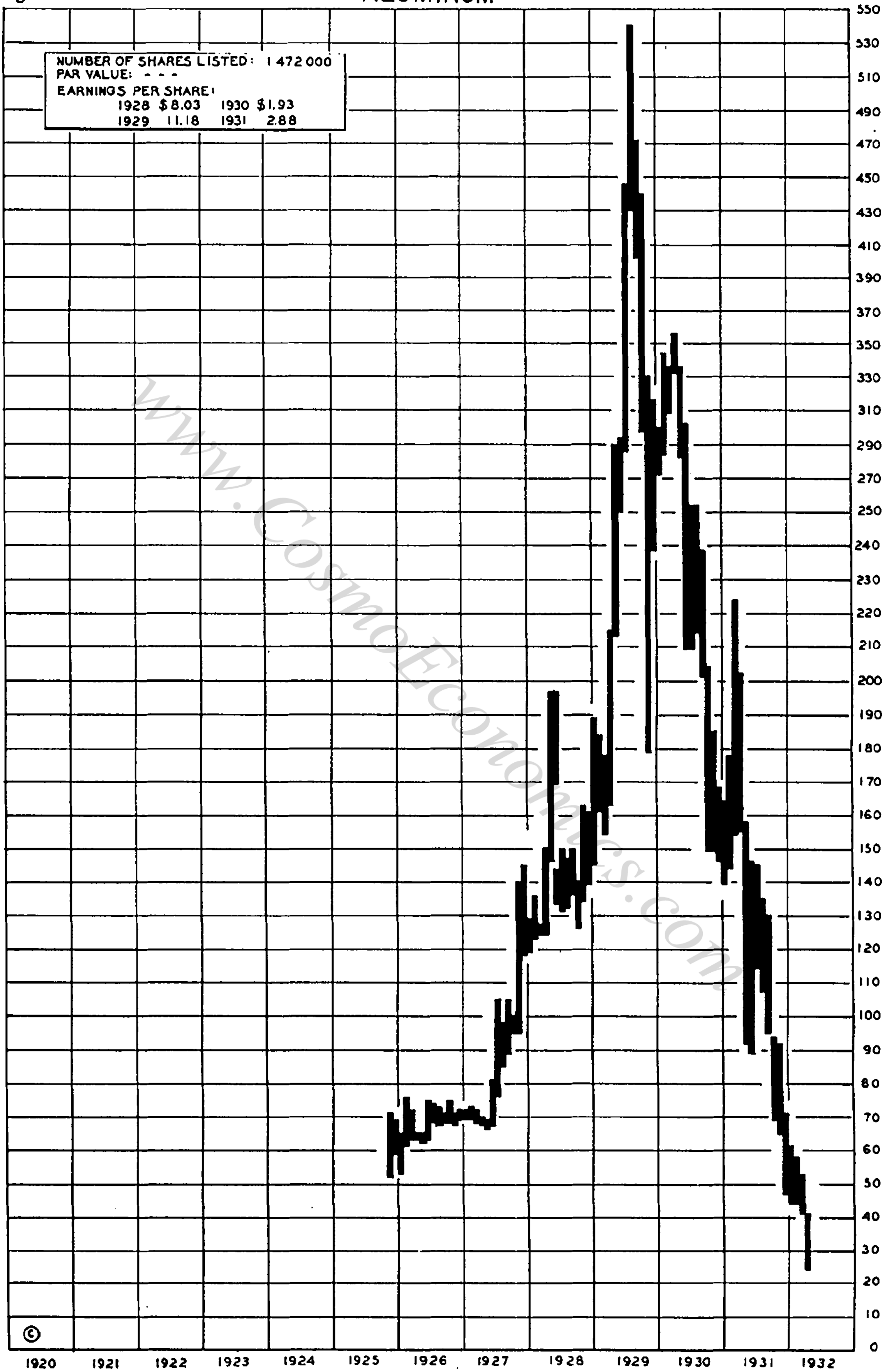


AIR REDUCTION
NUMBER OF SHARES LISTED: 841,000
PAR VALUE: ---
EARNINGS PER SHARE:
1928 $4.61 1930 $6.32
1929 7.75 1931 4.54
STOCK SPLIT 3-1
©
1920 1921 1922 1923 1924 1925 1926 1927 1928 1929 1930 1931 1932
240 230 220 210 200 190 180 170 160 150 140 130 120 110 100 90 80 70 60 50 40 30 20 10 0

ALLIED CHEMICAL



ALUMINUM


NUMBER OF SHARES LISTED: 1 472 000
PAR VALUE: - - -
EARNINGS PER SHARE:
1928 $8.03 1930 $1.93
1929 11.18 1931 2.88
550
530
510
490
470
450
430
410
390
370
350
330
310
290
270
250
240
230
220
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170
160
150
140
130
120
110
100
90
80
70
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30
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1920
1921
1922
1923
1924
1925
1926
1927
1928
1929
1930
1931
1932

CAUSES OF THE 1929-32 DECLINE IN BUSINESS ACTIVITY AND PRICES AND AN ESTIMATE OF THE OUTLOOK

The following discussion is an examination of the causes of the severe decline in business activity and prices of the past three years, a survey of the present position of these factors, and an estimate of the probabilities of recovery.

The decline is found to have been due chiefly to:

(1) The very high level to which stock prices were carried in 1929.

(2) The severe world decline in commodity prices.

(3) Certain features of the American general business situation.

(4) The decline in export trade.

(5) The agricultural collapse.

(6) Various miscellaneous influences.

(7) The European political crisis of 1931.

These influences have in large measure spent themselves.

Strong forces exist which will presently bring about revival.

But the immediate action of these recovery forces is blocked by certain unfavorable factors, chiefly financial and political.

The next six weeks and the next six months are critical.

I. CAUSES OF THE 1929-32 DECLINE

I. The Extraordinarily High Level of Stock Prices in 1929 and the Subsequent Readjustment.

Stock prices in 1928-29 were high in relation to earnings. A study of the ratios of prices to what might reasonably at the time have been regarded as normal earning power indicated that many leading issues were selling two or three times as high in relation to normal earnings as at the peaks of earlier bull markets.

Many buyers of stocks believed that the expansion in earnings in 1924-29 was merely part of an upward trend that was likely to continue indefinitely. This anticipated growth was discounted many years ahead by the prices of 1929.

On this abnormal level of stock prices was built up an unusually large credit structure. The volume of securities issued in 1928-29 reached record proportions. Securities were distributed throughout the country as never before. A great volume of bank loans was based, either directly or indirectly, on security prices, and the banks were involved in the security price level through their loans, through the bonds they held, and through the stock speculating operations of their security affiliates. Both banks and individuals bought large quantities of foreign securities.

The security price decline of 1929-32 has been based directly on: (1) the necessity of readjusting the <u>ratio</u> of prices to normal earning power; (2) a radical downward revision of popular ideas of normal earning power itself.

This decline in stock prices has naturally caused severe losses to speculators, many of whom probably considered themselves investors. This has reduced the buying of commodities by these individuals. This has further decreased corporation earnings, and so on in the familiar circle. The decline in security prices has ruined many financial enterprises and has made it impossible to liquidate many of the loans contracted on the basis of 1929 prices. Part of this mass of credit entanglement has been cut away, through the failures of the past two years, but some of it still remains.

This entire set of influences is financial. The physical equipment represented by the corporations whose securities have declined so drastically is substantially the same today as it was three years ago. But it is currently valued for less than 20 per cent of what it was in 1929.

Even if nothing else had been wrong a stock price decline so severe as that of 1929-32 would have had a serious effect upon business.

II. The Commodity Price Decline.

The prices of important commodities have declined rapidly the past three years. The fall has been particularly severe in the international raw materials, such as wheat, cotton, rubber, copper.

There are several reasons why the supply of these commodities has been greatly in excess of demand:

A. War stimulation of production, which was very slowly readjusted after the war.

B. Improvements in production technique and the development of new sources of supply.

C. Price control combinations.

D. The decline in trade in this country.

E. The decline in foreign trade.

F. Abnormal distribution of the world's gold supply, resulting chiefly from vicious political influences.

During the war the production of many commodities, particularly of raw materials, was reduced and consumption stimulated. New producing areas were brought in. After the war the old producing areas came into the market again but the war-developed capacity was not promptly eliminated. Over the past dozen years consequently, we have had a chronic excess of supply in many of the important international raw materials.

An example is sugar. The elimination of European beet production during the war naturally resulted in a rise in prices and the stimulation of non-European production. With the close of the war European production began to increase. Other producers have been slow to curtail, and chronic over-supply has developed.

In wheat new producing land was brought in during the war. Production methods have been bettered. In copper the technique of production has been greatly improved. In rubber, also, there have been important improvements and lowering of costs and capacity has been increased by bud grafting.

This situation has resulted in a long decline in commodity prices beginning shortly after the close of the war. The course of this decline has been irregular, partly because of the effect of fluctuations in business activity and international trade and partly because of attempts at artificial control of prices. In sugar, rubber, coffee, wheat, cotton, copper, and other raw materials combinations of producers have attempted to maintain prices by artificial means. This kept prices up for a time and postponed the curtailment of production capacity called for by economic conditions.

These combinations were in some cases financed by loans from this country and the curtailment of our loans abroad in 1929 helped to maintain production at unwarrantably high levels and eventually produced an untenable situation.

Rubber is an example. The Stevenson Plan for control of exports by British producers for a time resulted in high prices for rubber. But this stimulated Dutch production until eventually world output, even with the British restriction, was large enough to force a considerable price decline. Presently the British, tired of supporting the market for the Dutch to sell in, abandoned their restriction plan and prices collapsed. Many producers held on in the hope that rubber would eventually recover, with the result that the readjustment has been prolonged and prices have been forced down below direct cost of production, even after allowing for improved methods.

The decline in trade in this country has greatly affected the demand for many items, notably rubber and silk.

The decline in foreign trade, resulting partly from conditions abroad, partly from the curtailment of our foreign loans, partly from the distribution of the world's gold supply, has hurt these international raw materials badly.

The fact that the world's gold supply has been concentrated in a few countries has had an unfavorable influence on prices. In the countries with small gold supplies the tendency has naturally been for prices to decline. In the United States our excessive credit supply of 1924-30 was used chiefly to force up prices of non-importable goods, of securities and real estate, rather than of commodities. This and our tariff prevented the usual process of readjustment (export of commodities from countries with low price levels to those with high price levels) from redistributing our gold.

No doubt the payments of European countries on their debts have to some extent tended to reinforce the influences mentioned above. But there can be no question that the importance of this factor has been greatly exaggerated by European economic writers. The real trouble lies in our failure to develop our import trade.

The root of the economic difficulties since 1919 has been the slowness of politicians and peoples to adapt themselves to the radically changed economic conditions resulting from the war. The United States had become accustomed before 1914 to being a debtor country with an export surplus and the leading European countries to being creditor countries with import surpluses. Since the war, with debtor and creditor roles reversed, we have resisted the development of an import surplus, and Europe has not been inclined to make the sacrifices called for by her position as debtor.

Our high tariff, moreover, has inevitably encouraged imitation, with the result that today high tariffs everywhere restrict international trade.

The financial collapse of England and the Central European countries has hurt foreign trade. At the present time numerous restrictions on foreign exchange transactions form an even more powerful barrier to trade than tariff walls.

These influences have worked directly against the prices of the important raw materials by reducing world demand, and have also worked indirectly against them by preventing a redistribution of the world gold supply -- thus reducing demand in countries with small gold supplies and preventing a compensating expansion in demand in the countries with excessive gold supplies.

These several sets of factors explain well enough why prices have declined, but they do not explain fully why the decline was gradual from 1923 to 1929 and very rapid thereafter. One explanation is that our foreign loans helped to support foreign demand and also helped to support some of the price control combinations until the 1929 business decline set in here. The decline here was a very important factor in many commodities and helped to precipitate the readjustment. Political restrictions on international trade have increased during the past three years. The financial situation of Central Europe and of England has been an important depressing factor during the past year.

As a result of the above influences wholesale commodity prices here have declined about 40 per cent in the past three years. What have been the effects of this decline?

As usual we must differentiate between the effect (1) of the downward movement itself and (2) of the low level of prices resulting from that downward movement. The effect of a decline in commodity prices is to curtail demand for the commodity in question and to cause losses to speculators, producers, and consumers, who hold stocks of it. The effect of the 1929-32 commodity decline has in some ways been even more serious than that of the decline in stock prices, because larger numbers of people have been affected, and because the connection with business operations has been more direct. Naturally the decline in commodities has increased the credit entanglements produced by the stock market decline.

A low level of prices, as distinct from declining prices, is not a bad thing. Low prices tend to stimulate consumption. Once buyers can be reasonably sure that a further severe decline will not occur they can calculate production costs and can take advantage of the cheapness of things. A low level of prices provides a good base for an advance, and advancing prices tend to stimulate business just as declining prices depress it.

For some enterprises, however, a low level of prices is unfavorable. It makes it possible for new business units to develop which can construct plant and compete on advantageous terms with older businesses. And in the public utility field it raises the question of rates based on replacement costs.

We may conclude, then, that the severe commodity price decline of the past three years has had a very depressing effect upon business. When the decline finally ends and the necessary failures have been cleared out of the way, however, the low level of prices will tend to assist rather than to hinder trade revival.