HOW MONEY IS MADE IN SECURITY INVESTMENTS

OR

A FORTUNE AT FIFTY-FIVE

BY

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PREFATORY EXPLANATION

A NUMBER of text books have been written to explain the character of the securities, which are sold through the banking and brokerage houses of the United States. They treat of stocks, bonds, notes and mortgages and describe the peculiarities of each. Other books have been published to define the meaning of the technical terms in vogue in the financial world. They all serve a useful purpose.

It seems to the writer, however, that there is imperative need of another work, which shall go beyond elementary facts, and, in the matter of advice, shall do more than dwell upon the simple truism that an investor, before all other things, should pay attention to the safety of his capital and the regularity of his income. An investor needs to know how he can actually accomplish those objects, and farther, not only how he can avoid the loss of part or all of his money, but also how to make money in securities. This book is devoted to the broad principle, that, unless there is a fair assurance that money can be made on stocks and bonds, it is almost certain that money will be lost on them or so locked up as not to be available for other uses for a period of years. If securities are going no higher, if the times do not promise greater profits and larger dividends, then all classes of securities are going lower, at a date not far distant.

A vast amount of money is either badly employed or wasted, every year, by investors, and great opportunities are lost, in consequence of inattention to cautionary signals, which are easily recognized by men experienced in finance but are entirely overlooked by others.

Coming danger and coming prosperity are always foreshadowed in various ways. An investor sometimes buys stocks or bonds, when it is of dominating importance that he should sell everything he has, both with a view to harvest the profit he has on them and to reinvest later—selling in times of bullish enthusiasm being the step the average investor is usually the most reluctant to take. Conversely, an investor only too often sells, when every financial consideration demands that he should buy. To guide him in buying and selling, and to urge him to take his profits on investments at certain critical periods, are the objects of this book.

History repeats itself in Wall Street with unfailing regularity, as in all other fields of human activity. A diligent study of Wall Street methods and the financial history of the past fifty years will reveal to any intelligent man considerations of great importance; and the fruits of such a study are here laid before the public in the belief that they will conserve the interests of actual investors. Attention will be called especially to the remarkable changes in prices of all securities, brought about by alternating periods of prosperity and depression, and to the smaller but also noteworthy fluctuations at certain seasons in each year, all of which will be utilized by a careful investor.

It may be well to say that this book is not written for the information of men of large fortunes. The man of millions needs no guidance from a work of this sort. He has private information not at all at the service of the generality, and he can proceed with the purchase and sale of securities, with a confidence which is denied to men less well informed. The subject of security investments, and how to make money in them, is here discussed to meet the requirements of many thousand Americans, who have moderate amounts of money, say from $500 to $5,000, which they desire to add to their permanent capital, and from which they wish to derive as large a revenue as is consistent with safety, and from the investment of which they can also gain an actual increment to their principal.

This work will not encourage the belief that a man can make himself rapidly rich by trading in Wall Street with a few thousand dollars of capital. The achievement is possible to men who have been trained to the business, but it is foreign to the purpose in view. The object will be to show that security investments can be handled in such a shrewd and conservative manner, that the principal will be safe and the income sure, and that when this is accomplished, a desirable increment can be added to principal in a perfectly legitimate way—a policy which will ensure a fortune possibly in a series of years and certainly in a life-time.

HOW MONEY IS MADE

I

A NATION OF INVESTORS

OLD TIMES IN AMERICA, COMPARED WITH THE PRESENT.— AMERICAN SECURITIES ONCE OWNED MAINLY ABROAD.— THE CHANGE SINCE 1825

PEOPLE were strong, healthy and happy in the "good old times" of the forefathers of the republic, but they were not rich. The skies were as blue as now, the grass as green, the streams were full of fish and the forests of game, the soil was fertile, and it was not difficult to make a living; but scarcely any one owned securities and the commonalty knew little about them.

Several millions of people occupied the thirteen colonies. They were courageous, industrious and thrifty. But in the simple occupations of the pioneer settlers of a new continent, no great amount of surplus wealth could be accumulated. Lands and plantations, stage coaches, toll roads, sailing vessels, petty manufactures for local sale, retail and auction stores and inns all existed and were the forerunners of lines of business, in which fortunes have since been made. At the time, they merely afforded a subsistence to the energetic men, who devoted their lives to them. Millionaires were almost unknown, while men worth several hundred thousand were extremely rare. General Washington was probably the only man on this continent in his day, who could have been rated as a millionaire.

Securities were not unknown of course; but there were only a few joint stock companies and almost no corporations; and from the very nature of the case, stocks and bonds had little more than an academic interest to persons who had no money with which to buy them. Owners of securities were found only among a limited number of merchants and bankers in the larger cities and the proprietors of landed estates, North and South.

Stocks and bonds came into vogue, gradually, after the War for Independence, as wealth increased and the trade and natural resources of the country were developed. Before many years had passed, the necessity had arisen for enterprises, which could be set on foot only through the aid of the united funds of many different persons or the resources of the State. Bonds were issued by the public authorities for the payment of debts to the soldiers and others and for the construction of roads. New ventures outside of the province of Government were carried out by organizing joint stock companies and corporations; and as foreign trade had brought a great deal of money into the country, it was possible to secure the capital for the early modest enterprises mainly through leading men of the different localities, who took the stocks and bonds of new companies, largely from motives of public spirit and not because they were seeking desirable forms of investment for surplus funds. The first great stock company came into being in 1791, when Congress chartered the original United States Bank. Local banks were formed in the leading cities, followed later by fire and marine insurance companies. During the twenty years next after Independence, Americans had become familiar with the idea of devoting a part of their surplus capital to the purchase of securities.

For many years, however, it was practically impossible to float large issues of securities in the United States. The projectors of every important enterprise looked to Europe for a considerable part of the funds required. One of the interesting items of news in "Niles's Register" and other public prints, a century ago, was the quotations of American bank shares and State bonds in London, printed here about a month late as a rule.

An illustration of the inability of rich Americans, a century ago, to absorb a large issue of even the most gilt edged security is afforded by the experience of the first United States Bank, an institution of which the country was extremely proud. Measured by the times, the bank was a gigantic concern. It had a capital of $10,000,000, of which the Government took $2,000,000, the public $8,000,000. In modern times, it is on record that one man has supplied $8,000,000 for a single enterprise. In 1791, the sum was too large for the whole of the infant republic. While it is true, as reported by President Washington, that the entire capital stock of the Bank was subscribed for in one day, the fact remains that those who thus became partners in the Bank took the stock in most cases as a speculation, not as an investment; and, as was expected, the bulk of it speedily found its way abroad. In 1809, after the Government had sold its interest in the Bank, an official report stated the rather surprising fact that only 7,000 shares (of $400 each) were owned by Americans. The remaining 18,000 shares were held in Europe, mostly in London.

How little the ownership of securities interested our people in the early days is farther shown by the entire absence of special facilities for dealing in them. Bonds and stocks were bought and sold principally at the stores of leading merchants and auctioneers. Not until 1792, a year after the organization of the United States Bank, were steps taken which tended toward the creation of a specific market-place for securities. In that year, a start was made in New York, by an agreement between a few jobbers of stocks and bonds as to rates of commission. This was the germ of the New York Stock Exchange. In later years, dealers in securities in other cities started stock exchanges of their own.

After the dawn of railroad construction in 1826, investment in stocks and bonds began to play a distinct part in financial affairs. Wealth had continued to accumulate; and many persons were found in the cities, who had managed to save, through frugality and their talents as business men, dollar by dollar, sums of money not required in the prosecution of private business. This class of persons became considerable buyers of the securities of the pioneer railroad lines and public utility corporations, which sprang up in the '30s and '40s. Some of these investments were profitable, with the consequence that men of means turned more and more in the direction of corporate securities as a proper and safe employment of surplus capital. Each decade of progress added to the volume of stocks and bonds afloat and the number of buyers of them. The process was a gradual one, however, and more than one generation of active business men had crossed the stage of affairs and disappeared, before there was any striking increase in the transactions in securities or the roll of stockholders in corporations.

From Edmund C. Stedman's "History of the New York Stock Exchange" it appears that in 1827, trading at New York was confined to forty-two descriptions of security issues, as follows:

Twelve bank stocks.
Eight public bonds.
Nineteen fire and marine insurance companies.
Delaware & Hudson Canal stock.
New York Gas Light stock.
Merchants' Exchange stock.

In 1837, a day's trading sometimes amounted only to about 4,000 shares. Even as late as the outbreak of the Civil War, in 1861, in spite of the enormous advance in wealth and enterprise, only twenty-two stocks were dealt in on the New York Stock Exchange, in more than fractional lots, sixteen of them being railroad shares.

How remarkable is the change which has since taken place will appear from the fact, that in 1906, sales of stocks on that Exchange amounted to 289,425,000 shares, having a par value of $28,942,500,000, while bonds were sold in 1905 to the value of over $1,000,000,000. More than 250 descriptions of stocks were dealt in, and more than four hundred and fifty varieties of bonds.

In the eighty years or so since the whistle of a locomotive was first heard in the States, a change has been wrought in the wealth of the people, the volume and value of securities afloat and the number of investors, which is one of the marvels of the world's history. It is good to be an American and to have played some part in the betterment of conditions, which has brought about this transformation.

No figures are at hand, at all important, as to the actual wealth of the population in Washington's day. It is known, however, that by 1850, wealth had grown to about $7,000,000,000 and has since expanded to $95,000,000,000. In 1907, the country is rich and comfort is general, at least among the native born. Americans earn more, live better and save more than their forefathers did. Thousands are now capable of owning a few shares of stock or a few bonds, compared with a mere handful in the year of adoption of the Constitution, and there are more than 5,000 millionaires. So far as the people at large are concerned, one needs only to refer to the savings bank to gain a clue to the general diffusion of wealth —8,635 depositors in 1820, with total deposits of only $1,139,000, and more than 7,400,000 depositors now, while the average of accounts is thrice as large.

In every rank of life, one now finds investors in securities, and the number of them grows, year by year, as the natural product of the thrift of a busy people, laws which give equal opportunities to all, an inspiring climate, bountiful harvests from our rich soils, the energy shown in every branch of trade and manufacture, the discoveries of coal, oil and metals, the division of estates, and the opportunities for profitable speculation.

Here, as in older countries, in which there is entire freedom of thought and action, and which have risen from primitive conditions to wealth and prosperity, thousands of workmen have passed the stage where they often lacked bread to eat, and have saved a few thousand dollars and bought a few bonds or shares of stock. Many a village blacksmith and smart carpenter and grimy toiler in an iron mill is thus a capitalist on a small scale. More than 40,000 employés of the United States Steel Corporation alone are owners of stock in that concern. In New England, operatives are taking shares in the cotton mills.

Farmers, who, as a class, formerly struggled under the most trying conditions for a bare maintenance, are now recruiting the ranks of buyers of securities. A notable circumstance is the fact that in the West hundreds of small banks have been organized in the last ten years, an appreciable part of whose stock has been subscribed for by farmers.

Among the millions who are under salary as managers, teachers, journalists, officials and clerks, or who conduct small retail stores, there is now an army of frugal people who seek a larger return on their modest accumulations than a savings bank affords and who are receiving from 5 to 7 per cent. from stocks and bonds which they have bought.

A curious instance is known, in which the chambermaids and serving men of a Southern city became stockholders in a local shipyard, started for repair of the swarm of fishing and truck boats owned on Chesapeake Bay.

In the cities, a vast number of people, men and women, are owners of from five to twenty shares of bank, gas, or street railroad stock.

There is little need to multiply instances, since it is within the knowledge of every one, that investors are now to be found on every side among the ranks of people of moderate means, as well as among the men of wealth. Without dwelling further on the point, suffice it to say that Americans have fully learned the desirability of investment in securities and the United States has become a nation of investors.

There are no statistics as to the exact or even approximate number of investors in America. It is doubtful if any useful object would be served, if the number could be known. As long as the assessor and tax collector flourish in the land, insurmountable difficulties will stand in the way of an accurate census of security owners, although the facts would be interesting enough. A few of the foremost corporations, like the Pennsylvania Railroad and the United States Steel concern, have taken pride in publishing the number of their stockholders; but they are exceptions, and a policy of secrecy prevails among the majority of other stock companies. A few years ago, one of the New York mercantile agencies made a strong effort to compile the total number of stockholders in leading railroads but was obliged to abandon a task made impossible by official indifference.

II

HOW AN INVESTOR MAKES MONEY

GREAT RICHES POSSIBLE IN STOCKS.— MOST FORTUNES IN AMERICA ENHANCED BY SECURITY INVESTMENTS.— HOW THE THING IS DONE

TO the young man and the uninitiated, one of the most mysterious of phenomena in the business world is the accumulation of magnificent fortunes by men who began life without a dollar. With rare and conspicuous exceptions, the men of to-day who live in splendid houses and own estates in the country, and who have steam yachts, motor cars, art collections and practically unlimited means, have come up from poverty. How can such fortunes be made in one life-time? Machiavelli took the ground, that no man could ever rise to great wealth or power, without the use of either force or fraud. This might have been true in his times and country. It may be true, in these times and this country, of more than one man who has obtained opulence by trampling others under foot or by taking unfair advantage of his countrymen. But the assertion is not true of every rich man; it is not even true of many; and the life story of such men as Marshall Field, J. P. Morgan, George Peabody, John W. Mackay and thousands of other well-known Americans is a sufficient refutation of Machiavelli's heartless and immoral doctrine.

But how do rich men make their money? What is the process? Is the way yet open to men of moderate means? Can a young man, who starts in life with a clear head, an honest heart, a strong physique, and a willing spirit, but without a cent to his name, ever expect under present circumstances to gain such opulence as other men enjoy? The answer is, certainly; and John D. Rockefeller and Andrew Carnegie are authority for the statement and they ought to know.

While there is more than one way to make money, it is an interesting fact, that most of the conspicuous fortunes in America have been enhanced by, and thousands of them have been chiefly due to, investments in stocks; and it may also be stated that the majority of men make their big money after they are fifty years of age. Every young man who has saved a thousand dollars can take his place among the capitalists of the future, if he will depend upon some regular occupation for his means of support, and will spend a reasonable amount of his leisure time in the study of finance, the tariff and banking, and will follow sound and sane methods in his security investments and cultivate his own judgment and powers of intuition. Such a man ought readily to be worth a million at middle age. Does this seem a chimerical idea? Let us see, as we go on.

Before passing on, however, let the writer disavow any intention to encourage active speculation in stocks. His purpose is a different one. So far as that is concerned, however, nothing that any man can say will ever put an end to speculation, which is the principle of barter carried to the point of taking risks. Bold spirits have always speculated in something, from the days of primitive man

—in lands, cattle, mines, mulberry trees, tulips, potatoes, iron, gold, grain, beans and whatever else has been in great demand at different periods in the world's history. No power on earth has ever been able to prevent this. The instinct to make money by buying something or creating something, which stands a chance of being sold at an advance, is deeply implanted in the human breast; and the necessity of making money by some such process is so imperative to the majority of men, and there are so few "sure things" in life, that it would seem to be as useless to try and stop the taking of risks, as to seek to level a brick wall by throwing dandelions against it.

With reference to taking risks in stocks, the great objection is that many persons incur them without the slightest knowledge of Wall Street history or methods. Their Wall Street ventures are unequivocal gambles. A deep student, be he a plodder or a man of genius, will succeed, where others fail. With legitimate business as a means of livelihood, with close study of underlying factors, infinite patience and conservative methods, an investment in stocks should be profitable in nine cases out of ten. An investor would then be following the line of action, by which the captains of finance have been able to amass riches in Wall Street.

Long ago, it was observed that the market prices of all securities were subject to serious variations. In the early part of the last century, bank stocks sometimes sold for 50 per cent premium. Bonds often sold below par. The stocks of various of the pioneer railroads underwent fluctuations of great violence. Some of the first railroad lines, especially in the West, and more particularly those which were fostered by Government land grants, were built while population was scanty and before the routes traversed could supply business enough to ensure dividends or even the expense of operation. Each railroad proved a powerful stimulus to local trade and to the value of lands; but the companies themselves often languished for years and many of them became insolvent for lack of money. The decline in value of the stocks of some of those roads will never be forgotten by men yet living. On the other hand, the bankers who financed, the men who managed, and the larger stockholders who clung to those corporations, during their years of trial and until settlement had wrought its miracles of development, discovered one secret of great wealth in the rise in value of their stocks when dividends had become assured.

Even among stocks on which dividends had always been paid, extreme fluctuations in price were witnessed from year to year, and season to season, in response to trade conditions, the abundance of money and the public demand for securities.

It certainly took no observing man long to grasp the fact, that the varying price of securities supplied an opportunity for profits much beyond the income to be derived from them as investments. Cool and far sighted men have materially added to, and made, fortunes in stocks, carefully bought in years of panic and depression and sold in later periods of prosperity.

The primary object of every man who buys a share of stock or a bond is, and should be, to invest his surplus money safely and derive a suitable income therefrom. But it is a maxim of Wall Street, that "a good investment is a good speculation." It is so indeed. If properly bought, stocks will in time show an increment on the purchase price. A few examples of fortunes, which have been made in stock investments, will not be out of place. They are taken from the history of the last generation.

Commodore Vanderbilt began life as the owner of a canoe, which he sailed as a ferry boat from New York to Staten Island. He borrowed money to go into a steam ferry line and extended his operations to steamboats in general. Late in life, he went into railroads and made the name of his family famous by buying good stocks when they were cheap and selling some of them afterward at an advance, often at almost fabulous prices.

Moses Taylor, who had grown up in the mercantile business in New York, surprised even some of his business associates by dying worth $40,000,000, made by backing Delaware, Lackawanna & Western at a critical period in its affairs and after a thorough investigation.

The Astors owe their immense holdings by no means entirely to real estate. They have always been careful and shrewd buyers of stocks in violent declines. They are often in the stock market.

Crocker, Huntington, Stanford and others of that group of remarkable men were merchants in a small way in the neighborhood of the California gold mines. Their fortunes were due in part to railroad contracts but mainly to the rise in value of the stocks owned by them.

Jay Gould, one of the most daring and intellectual men Wall Street has ever known, left more than $70,000,000 to his family, the bulk of which arose from the purchase of stocks in times of depression and their appreciation in price after he had built up the properties they represented.

George Peabody derived his great wealth from stocks, bought and sold wisely.

Thousands of other men, some of them not known outside of their immediate circles, until the Probate Court or their gifts to public objects revealed the extent of their possessions, acquired entire financial ease through stocks, bought when they were low and sold advantageously when they were high.

What took place in that respect during the last generation is being also done, to-day, by a throng of men, on every side, who have risen from modest beginnings in trade, mines, manufactures, etc., and are now among the captains of finance and industry in these States.

Among the men who have added to their wealth by stock investments, there are, of course, a few persons of exceptional qualities, who have themselves called into play the forces, which made stocks in general or those in which they were particularly interested, high or low. All the others, and that means all except one out of every thousand, have simply taken advantage of the situation as they found it. They bought stocks, when they could do so, safely and cheaply; and they sold, when the good times or the manipulation of prices by insiders had forced stocks to high figures. It is this policy only which can be followed by the small investor. He can do little or nothing whatever to affect the price of stocks, one way or the other; but he can buy them, when they are extremely low, all things considered, and he can sell them in boom times, at or near the top of a long rise.

Now, what results can be produced in a series of years by the ordinary investor?

Suppose that a young man, starting in 1870 with a thousand dollars which he had earned and saved, had put it into New York Central stock. That was an approved and good stock, with a great future, and a dividend payer. Ten shares could have been bought for $900. New York Central has always been an investment stock, very steady in price, and very safe. If the investor, starting with his ten shares, had sold the stock within four or five points of the top of every considerable rise, and had reinvested all the money in New York Central somewhere near the bottom of every marked decline, from 1870 to 1905, he would have been worth at middle age the sum of at least $150,000; and this would have taken care of him, all the rest of his life. No panic could have touched him, because his shares would have been fully paid for. He would not have been obliged to go into the market and give an order (to buy or sell) more than once or twice a year, as a rule. He would have learned by experience, when New York Central stock was too high to keep, and conversely when it was so low that he ought to buy it. He would have had to be a diligent student of financial conditions in general and of the earnings and prospects of New York Central in particular. He would have received a number of dividends while the stock was in his name between times; and at the moments of reinvestment, he would always have had a little surplus cash left over after making his purchases.

If, in 1870, he had put his money into Illinois Central, another sedate investment stock, with a great record as a dividend payer, he would have had to pay about $1,300 for ten shares of it. If he had sold, and bought again, as above outlined, dealing in Illinois Central alone, his holdings would have grown to about 900 shares by 1905, worth about $170,000, all the outgrowth of the original $1,300.

Ten shares of Delaware, Lackawanna & Western, bought in 1870, for $1,020, would have grown to 1,000 shares in 1905, worth about half a million.

There were fewer stocks to choose from in 1870, than now—only about seventy actively traded in at the New York Stock Exchange, then, compared with over 250 now. It is therefore quite possible, that a neophyte in investment in 1870 would have put his first thousand dollars into some stock, which afterward ceased to pay a dividend for a time, or into a stock which did not pay a dividend even then, but which like Union Pacific had a great and certain future.

Suppose that he had gone into St. Paul, a stock with a checkered career, but now a gilt edged investment. He could have bought fifteen shares in 1870 for $900, paying about $60 a share. In 1877, St. Paul was worth as low as $11 a share. The price rebounded from that low figure and in 1881 St. Paul sold as high as $129¼. In 1888, dividends were suspended for a time. Hundreds of men have followed the fortunes of St. Paul through good and evil days until the present time. They saw the stock rise to $198¾ in 1902. If an investor in fifteen shares of St. Paul (bought in 1870 for $900) had sold anywhere near the top of the next considerable rise, and had reinvested all the money in the same stock anywhere near the bottom of the next heavy decline, and had pursued this policy consistently, he would have made about $2,000,000 by 1905.

If our investor had chosen Union Pacific for his studies and investment, from 1870 to the present day, he could have started with fifty shares costing about $1,000 and sold out his interests in 1905 for something like $3,000,000, and this, too, without having had to pay the assessment when the company was reorganized in 1897.

Central of New Jersey would have yielded about $6,000,000 in thirty-five years from an original investment of $950.

Does it not begin to be clear how magnificent fortunes have been made in stocks, by many actual investors?

Now, it must be admitted, at once, that no private investor can ever be in such close accord with the ruling spirits in the stock market, or have such an intimate acquaintance with underlying conditions, as to be able to know when the exact top of a boom has been reached, or when prices are actually scraping on the bottom of a long decline. An outsider can never sell at the highest or buy at the lowest, except by the merest accident; and he will probably go in, or out, several dollars a share away from those extremes. He will often experience the chagrin of seeing his favorite stock go higher after he has sold and lower after he has bought. Allowance has been made for that in the foregoing calculations.

No man can expect to do better than the real insiders. It is perfectly understood that they begin to sell, a little at a time, on the way up, as the top is approached, and they begin to buy "on a scale down" as the market is nearing its bottom. The real point for an investor is to be able to tell, approximately, when the major swings of the market, extending over a series of months or years, are coming near their turning points. That is near enough for him.

But this is the very gist of the whole matter. How shall a man know when to go in and when to go out of stocks? In order to accomplish anything like the results referred to above, a man must know this and know it for himself.

An investor has a thousand dollars to invest. He reads the daily newspaper for a week and he notes that stocks go up to-day. Tomorrow, they mysteriously go down, for no reason at all that he can see. The end-of-the-week financial columns discuss the general situation; and the writers are blue or cheerful, as the case may be, and what they have to say is most interesting and informing. A very few of them are bold enough to say now and then, in their own phraseology, "Investors, the time has come; buy stocks as quickly as you can." Has any one ever known a good newspaper to advise everybody to sell their stocks and retire from the market? The newspapers cannot do this. They can and do call attention to the fact, when distribution is in progress. But this is as far as they have any right to go, considering what the province of a newspaper is. The reader has the facts and must judge for himself.

An effort will be made in following chapters to supply an investor with the means of forming his own judgment in this matter.

An investor may follow one of two courses. He may put all his eggs into one basket, and watch the basket. That is not a bad policy, and it is the only one which may be pursued at the outset of the future capitalist's career. A little later, he can diversify his investments; and there are advantages in having three or four stocks, moderate amounts of each, one or two of them industrials. This latter class of stocks are apt to swing more violently and farther than the railroad securities. In case industrials are added to a man's investments, those stocks are preferable which make public reports and which supply the actual data from which the fortunes of the company can be followed. No need to specify.