

Comments by Ben Graham at luncheon on 11/21/62

In new edition of Security Analysis, Graham comes up with a valuation of 550. He asked our opinions.

Bert felt the averages wouldn't go below 550

I said I didn't ~~xx~~ try to figure intrinsic value of Dow Jones but instead tried to buy undervalued stocks.

Ed. Laufer agreed with me and Larry Kessel had no opinion.

Ben told us of his relationship with IDS. He was asked to make suggestions on improving methods of analysis. He charged \$10,000 for a preliminary study. His conclusions were that Analysts started out favoring a stock and then went out and talked to management which confirmed their ideas. They went for growth stocks justifying their recommendations on the fact that comparable companies were selling at even higher multiples.

Ben has changed his ideas on multiples of companies. Thinks stocks will sell at higher multiples in the future. Thinks 15 times past earnings and $13\frac{1}{2}$ times future earnings.

I indicated that investors are more sophisticated than in the past possibly because they have read E.G.'s books. (105,000 copies of S.A. have been sold according to Charles Tatham).

A lot of wealthy investors who will put some money in Tax Exempts but will now buy large quantities of an oil producer and then force *See*

B.G. Don't ~~Ben~~ didn't think there was much change in the ability of avg. investors altho he conceded there was more money around to buy things.

Larry felt opening of Common Market would cause great agony and competition for many American Companies and European Companies would penetrate American markets with lower profit margin than they were willing to accept in Europe. E.G. felt the Common Mkt gave us some protection as we would all be in the same boat. The Common Market would tend to operate the way our tariff barriers had in the past.

Ben is going to Washington to talk to Cary and Milton Cohen. *Henry Cohen*
Thinks S.E.C. can require several ~~xx~~ new things. 1. Require companies to file annual reports that correspond to reports co's make to S.E.C. (I.C.C. requires this). 2. Make O.T.C. co's file reports to S.E.C. or give stockholders similar ~~xxxx~~ info to Listed Companies

Are We Too Confident About Invulnerability of Stocks?

By Benjamin Graham, Visiting Professor, University of California, Los Angeles; Author: "The Intelligent Investor", and of "Security Analysis" (with D. L. Dodd)

Equities as the preferable investment medium for the future are analyzed in terms of their performance in the broad sweep of the past with particular inquiry raised as to the predictive significance of the 1871-1961, 1920's and 1949-61 periods. Skeptical about the invulnerability of stocks as a whole, and the success of dollar-cost-averaging and mutual funds, Mr. Graham advises accumulators of equities to have an equal stake in bonds in case we return to the old standard of values or until we redevelop a new level of sounder values. His current view of the market is one cut adrift from old standards of value without replacement of dependable new standards.

The terms of reference for this paper relate to systematic plans for saving or accumulation through common stocks. Such plans might include (a) a pension plan concentrating on equities, such as the CREF arrangement for college professors, (b) the very similar mechanics of the newly-developing variable annuities, (c) systematic purchases of mutual-fund or closed-end investment company shares, (d) an individual dollar-averaging plan, such as the monthly-purchase program of the New York Stock Exchange.



Benjamin Graham

I was asked to consider investment aspects of such plans in longer perspective, and to give my views on the following questions: What results can be expected from them in the future as compared with the results either of the shorter-term past—i.e., since 1949—or of the longer-term past, going back into the last century and farther? How good will common stocks be as an inflation hedge in the future? Can dollar-averaging be counted on infallibly to produce satisfactory results? More specifically, can the much better performance of common stocks as against bonds be counted on to repeat itself in the next 15 years?

These are difficult questions to answer authoritatively or even with an acceptable degree of professional expertise. We have not only to make a hazardous choice between the shorter-term and the longer-term past as our guide to the future, but also to face the possibility that the future may be much different than either. The major determining factor that controls the welfare of the investor as of everyone else is the factor of nuclear war. It is customary to dispose of this overshadowing possibility by some simple phrase such as "nuclear war excluded" or "ex-nuclear war." At first blush this attitude under today's conditions—something like staging "Hamlet" without the melancholy Dane. But perhaps we are all fagged to this recourse for want of a better. It

is indeed difficult to consider rationally the effect of a nuclear war on investment values. Can the investor construct a fall-out shelter for his portfolio? Somehow the question seems too unimportant in relation to larger values to take up seriously; even if we did, we have little ground for believing that bonds will necessarily be better than stocks, or vice-versa, if the dies irae comes upon us.

Hence, like other "investment experts" I too shall leave the chances and the effects of atomic war out of the following discussion, except for some observations regarding the indefinite continuance of the Cold War.

Which Period Will Stocks Resemble?

This brings us, too quickly perhaps, to the other major question confronting investors. Which of the two past periods will the future stock market resemble more closely—that of 1949-1961, or that of, say, 1871-1961?

The latter comprises the 90 years for which we have common stock indexes of earnings, dividends and prices, as compiled first by the Cowles Commission and then continued by Standard & Poor's. In discussing equity experience in terms of the future behavior of these indexes we are assuming that the various equity-accumulation plans within our purview are likely to show results in the aggregate approximating those of the S-P Composite or 500-Stock Index. It would seem easy enough to equal these average results; all that is needed is a representative diversification "across the board," and without that selectivity which is a watchword of today. But, paradoxically, if it is easy to equal the averages it seems almost impossible for the average skilled investor to beat them.

We have very full information regarding the operations and achievements of the investment funds. For the 1949-1960 period, as in the earlier years, they have not managed as a group to outperform the S-P 500 Stock Composite. (Based on the performance for 1951-1960 of the 58 investment companies included in the ten-year table appearing in Moody's Financial Manual for 1961.) It may be that professionally managed funds are too large a part of the total picture to be able to outperform the market as a whole; it

Continued on page 31

CONTENTS

Articles and News

	Page
National and International Monetary Problems and Policies —Alfred Hayes.....	Cover
Are We Too Confident About Invulnerability of Stocks? —Benjamin Graham.....	3
When to "Go Public" for the Acquisition of Capital —Lawrence H. Taylor.....	4
Commercial Banking's More Competitive Footing —George A. Newbury.....	6
Present and Future Status of New York's Banking Law —Hon. Oren Root.....	6
Life Insurance Stocks—Plateau or Launching Pad? —Ira U. Cobleigh.....	10
Is Our 25% Gold Reserve Really Important?—Reid Taylor.....	11
Puerto Rico's New Debt Limit and Rising Economy —Rafael Pico.....	12
There's More Than One Way to Consume Tree Pulp —Roger W. Babson.....	19
U. S. Gold Reserves and World Liquidity—James C. T. Mao.....	26
Federal Tax Administrator and Corporate Taxpayer —Mortimer M. Caplin.....	30

* * *

Helm Urges Government and Labor to Press for Sound Economic Growth.....	15
President Kennedy's First Budget Is Record High for Peacetime.....	28
Paul T. Babson Forecasts Strong Business Uptrend.....	29
1962 Institute of Investment Banking Opens on March 16.....	29

Regular Features

As We See It (Editorial).....	Cover
Bank and Insurance Stocks.....	22
Businessman's Bookshelf.....	36
Coming Events in the Investment Field.....	56
Dealer-Broker Investment Recommendations.....	8
Einzig: "British Pay Pause Ending—Enter Pay Restraint".....	9
From Washington Ahead of the News—Caroline Bargeron.....	7
Indications of Current Business Activity.....	37
Market . . . and You (The)—Wallace Streete.....	17
Mutual Funds—Joseph C. Potter.....	20
News About Banks and Bankers.....	23
NSTA Notes.....	27
Observations—A. Wilfred May.....	5
Our Reporter on Governments.....	22
Public Utility Securities.....	21
Securities Now in Registration.....	38
Prospective Security Offerings.....	54
Security I Like Best (The).....	2
Security Salesman's Corner.....	20
State of Trade and Industry (The).....	18
Tax-Exempt Bond Market—Donald D. Mackey.....	14
Washington and You.....	56

B. S. LICHTENSTEIN
AND COMPANY

HOME OF SHATTERED HOPES

Obsolete Securities Dept.
99 WALL STREET, NEW YORK
Telephone: WHITEhall 4-8551

Baird Electronics
Electronic Capital
Commonwealth Oil Ref.
Electronic Int'l Cap. Ltd.
Savin Business Machines

SINGER, BEAN & MACKIE, INC.

HA 2-9000 40 Exchange Place, N. Y.
Teletype NY 1-1825 & 1-4844

Direct Wires to
Chicago Cleveland Los Angeles
Philadelphia San Francisco
St. Louis Washington

KELLY GIRL SERVICE

KAY WINDSOR

MEASUREMENT SPECTRUM

BROWNING ARMS CO.

BAIRD-ATOMIC

J. F. Reilly & Co., Inc.

39 Broadway, New York 5
Digby 4-4970

Southern Gulf Utilities

WM V. FRANKEL & CO.

INCORPORATED
39 BROADWAY, NEW YORK 6
WHITEhall 3-6633
Teletype NY 1-4040 & 1-3540

For many years we have specialized in

PREFERRED STOCKS

Spencer Trask & Co.

Founded 1868

Members New York Stock Exchange

25 BROAD ST., NEW YORK 4, N. Y.
TELEPHONE HANover 2-4300 TELETYPE NY 1-5

Albany Boston Chicago Glens Falls
Nashville Newark Schenectady Worcester

Published Twice Weekly
The COMMERCIAL and FINANCIAL CHRONICLE
Reg. U. S. Patent Office
WILLIAM B. DANA COMPANY, Publishers
25 Park Place, New York 7, N. Y.
REctor 2-9570 to 9576
CLAUDE D. SEIBERT, President
WILLIAM DANA SEIBERT, Treasurer
GEORGE J. MORRISSEY, Editor
Thursday, February 1, 1962
Every Thursday (general news and advertising issue) and every Monday (complete statistical issue—market quotation records, corporation news, bank clearings, state and city news, etc.)
Other Office: 135 South La Salle St., Chicago 3, Ill. (Telephone STate 2-0613).

Copyright 1962 by William B. Dana Company

Reentered as second-class matter February 25, 1942, at the post office at New York, N. Y., under the Act of March 8, 1879.

Subscription Rates
Subscriptions in United States, U. S. Possessions, Territories and Members of Pan-American Union, \$65.00 per year; in Dominion of Canada, \$68.00 per year; Other Countries, \$72.00 per year.

Other Publications
Bank and Quotation Record—Monthly, \$40.00 per year. (Foreign Postage extra).
Notes—On account of the fluctuations in the rate of exchange, remittances for foreign subscriptions and advertisements must be made in New York funds.

corporations with no real business purpose or function, unrealistic sales or purchase prices, and artificial sales, rents, royalties and allocations of expenses. We have discovered that these devices are used by all types of taxpayers, regardless of size or reputation, and many cases involving large corporations now are under active audit in the field.

Our biggest problem right now is the development of adequate information to deal with the situation. Recent legislation requiring reporting should be of great assistance. In addition, the National Office is working very closely with our field offices on cases with international aspects. We already have received some 1,170 reports concerning some 6,000 foreign subsidiaries in a controlled audit program we are conducting, and we expect to improve our auditing procedures with the data obtained from this survey. Recently, our Chief Counsel set up an International Operations Branch, which should prove of value in coordinating our studies in this complex area.

We also are expanding our operations abroad to increase our scope of operation and to develop more effective audit procedures. We now have five permanent posts in London, Paris, Manila, Ottawa and Santiago, and we are in the process of increasing both overseas posts and personnel. Any new legislation in the foreign field will obviously heighten this expansion program.

Enforcement of our tax laws must necessarily be on a worldwide basis. The American businessman and American taxpayer must be assured that these foreign transactions with U. S. connections are bearing their proper tax burden.

A very large part of the operations of the Internal Revenue Service goes far beyond enforcement alone; rather it is aimed at assisting businessmen to understand the tax laws and fostering greater respect for our tax system.

In the last analysis, we are doing everything reasonably possible to encourage more effective voluntary compliance with the tax laws. For only in this manner will we be able to raise the revenue needed by our government for all its important programs—defense, national and international.

Although the relationships between the Service and the business community have been emphasized here, a strong workable tax system is the property of all Americans. To carry out the grave burden of administering our highly complex tax laws, the Commissioner and the entire Revenue Service must have the active cooperation and strong support of every American, and this is sometimes said to be a painful course to pursue willingly.

By administering the laws given us in the fairest and most equitable manner, we shall at least persuade the vast majority of Americans that their interests are being guarded to the best of our abilities. This is one of the most effective ways we can build confidence and compliance in the Federal tax system.

To do this, of course, we need the understanding and help of every business, every farmer, every professional man, every citizen of our country. We cannot promise to please everyone, but we can promise to carry out our function honestly and fairly.

In this context we ask for the cooperation of every American taxpayer. In this manner, we all can be proud that we have met our responsibilities as free citizens in a democratic society—and that we are making full contribution to the strength of our government in a crucial period of its history.

*From an address by Mr. Cavilla, before the Federal Tax Forum, New York City.

Are We Too Confident About Invulnerability of Stocks?

Continued from page 3

may also be true, as I suspect, that certain weaknesses in their basic principles of stock selection tend to offset the superior training, intelligence and effort that they bring to this task. But our main point is to establish that what happens to the stock market in general is going to happen to the typical or average accumulator of equities by any plan or under any auspices.

Analyzes Two Periods

Let us attempt to summarize briefly the chief characteristics of the two market periods to which we are turning for clues to the future, and among which we may have to choose. Table I gives some data covering the three salient factors of earnings, dividends and price behavior. We bring down the 1949-1961 period into two six-year halves. The longer span can be handled in a variety of ways; we have decided to supply average computations for each of the nine decades between 1871 and 1961.

A cursory study of our Table shows a number of striking differences between the exhibits of the two periods. Molodovsky has demonstrated that the overall gain to investors for the 88 years 1871-1959 has averaged about 5% per annum in dividend return and 2 1/2% per annum in price appreciation—both taken against annual market prices. The 2 1/2% annual increase, compounded, in market price was closely paralleled by the annual rate of growth in both earnings and dividends.

But between 1947-49 and 1959-61 the growth rates for the various components have been quite

(See N. Molodovsky "Stock Values and Stock Prices," *Financial Analysts Journal*, March 1960.)

TABLE I
A Picture of Stock Market Performance 1871-1960 and 1947-1961

Period	Average Price	Average Earnings	Average P/E Ratio	Average Div.	Average Yield	Average Payout	Annual Growth Rate	Earnings	Dividends
1871-80	3.58	0.32	11.3x	0.21	6.0%	67%	-0.64%	-0.66%	-2.23
1881-90	4.00	0.32	15.6	0.24	7.1	75	-1.04	+3.94	+5.33
1891-1900	4.65	0.30	15.5	0.19	4.0	64	+6.91	+2.84	+2.29
1901-10	8.32	0.63	13.1	0.36	4.2	58	+3.35	+2.15	+2.29
1911-20	8.62	0.86	10.0	0.59	5.8	58	+10.60	+3.25	+5.90
1921-30	13.89	1.05	13.3	0.71	5.1	68	+2.5	+3.5	+7.8
1931-40	11.55	0.68	17.0	0.78	5.1	95	+5.7	+5.9	+5.9
1941-50	13.90	1.46	9.5	0.87	6.3	60	+2.7	+3.5	+7.8
1951-60	39.20	3.00	13.1	1.63	4.2	54	+5.7	+5.9	+5.9
1947-49	22.34	2.45	9.1	1.41	6.3	58	+2.5	+3.5	+7.8
1950(H)	78.20	3.10	25.2	1.97	2.7	64	+5.7	+5.9	+5.9
1947-49	15.71	2.18	7.1	0.97	6.4	45	+5.7	+5.9	+5.9
1950(L)	31.64	3.52	10.1	1.51	4.8	50	+3.5	+5.9	+5.9
1959-61	59.70	3.24	18.3	1.94	3.2	58	+3.5	+5.9	+5.9

NOTE: The above data are based largely on figures appearing in N. Molodovsky's article, "Stock Values and Stock Prices," *Financial Analysts Journal*, May, 1960. These, in turn, are taken from the Cowles Commission book, "Common Stock Indexes" for years before 1926 and from the applied-on Standard Poor's 500-Stock Composite Index for 1926 to date. The annual-growth-rate figures are Molodovsky compilations covering successive 21-year periods ending in 1890, 1900, etc. The lower-growth-rate figures cover the ten years ended 1961, the six years ended 1953-55 and the 12 years ended 1959-61. The 1961 price is the high to Dec. 7.

TABLE II
Major Stock-Market Swings Between 1871 and 1949

Year	Cowles-Standard 500-Composite		Dow-Jones Index, Average—	
	High	Low % Decline	High	Low % Decline
1871	-----	4.74	-----	-----
1881	6.58	-----	-----	-----
1885	-----	4.24	28	-----
1887	5.90	-----	-----	-----
1893	-----	4.08	31	-----
1897	-----	-----	-----	38.85
1899	-----	-----	77.6	-----
1900	-----	-----	-----	53.5
1901	8.50	-----	78.3	31
1903	-----	6.26	26	43.2
1904	10.03	-----	103	45
1907	-----	6.25	36	48
1909	10.30	-----	100.5	47
1914	-----	7.35	29	53.2
1916	10.21	-----	110.2	48
1917/8	-----	6.80	33	73.4
1919	9.51	-----	119.6	33
1921	-----	6.45	32	63.9
1929	31.82	-----	381.0	47
1932	-----	4.40	86	41.2
1937	18.68	-----	197.4	89
1938	-----	8.50	55	90
1939	13.23	-----	158	50
1942	-----	7.47	44	92.9
1946	19.25	-----	212.5	41
1949	-----	13.55	30	161.2

that the gyrations of past stock markets may not properly be viewed as taking place around a well-defined and persistent upward trend line, sloped at 2 1/2% per annum. Both the price record and the earnings record disclose an irregular rather than a regular trend line. This should be evident from an inspection of our successive 10-year average figures between 1871 and 1950, and the Molodovsky growth rates appended thereto.

The price-earnings ratio has also shown wide fluctuations. Since earnings have been even more unstable than prices—because of the recurrent business cycles—there has been a clear-cut tendency for the highest earnings multipliers to be established in years of depression when profits tended towards the vanishing point. Our average figures by decades smooth out this type of variation; but they do not show the upward trend in price-earnings ratios that we might have expected to accompany improvement in the underlying strength of our corporations and in the dependability of their earnings figures. Actually the ratio of 6.2 times for 1949-50, at the beginning of the present bull market, was the lowest for any two-year period in our 90-year history of stock prices and earnings. A departure from the popular-swinging theory of economic phenomena might well explain the current record high multiplier as a reaction to the opposite extreme from the 1949-1950 depreciation of the earnings dollar.

With these two quite diverse stock market pictures before us, let us now inquire what are the respective arguments for considering the 1949-1961 period as an integral continuation of the 1871-1949 span, or for recognizing it as a new dispensation which will determine the character of the markets of the future. It is not too difficult for the student to fit the pattern of the recent market into that of the longer past. True, both the duration and the extent of its rise are already greater than any other's. But that a pattern of many decades should establish new records of various kinds from time to time is only to be expected. A new record does not create a new pattern or character.

Are We Repeating the 1920's? It is possible then that we are living through a modified but not essentially different version of the experience of the 1920's? That there must be impressive differences goes without saying; for otherwise all of us would have been so struck by the incipient similarity as to make its continuation impossible. What may be more likely—speaking in abstract terms—is that the original differences have convinced us that the 1920 experience is irrelevant, but that the similarities have been developing later, gradually and so insidiously as to find us psychologically incapable of recognizing them. Let us attempt an enumeration of the major resemblances between the current market and that of the 1920's, as they appear to this observer.

The two major internal differences relate to financial manipulation of various sorts and to excessive borrowing for speculation. The bull-market heights of 1929 were made possible by a huge wave of buying on thinner margins than are now permitted. Brokers' loans rose from \$2,769 million in 1929 to \$6,549 million in 1929, at which time they constituted about half of total member-bank loans. By contrast, the corresponding rise to date has been relatively much smaller. (Borrowing on smaller margins through other sources are no

Resurrection of the 1924 Doctrine Those who study the record of the 1920's will find that reasons similar to most, but not all, of the above were advanced to justify the ill-fated market rise of those years. The doctrine of "Common Stocks as the (Best) Long-Term Investments" emerged in 1924 and was made the cornerstone of the market's philosophy and its excesses. There was the same optimism about the future growth of the country, and perhaps a better-founded confidence in the share of common-stock earnings in that growth. (The rate of return on invested capital was better maintained between 1922 and 1929 than between 1950 and 1961.)

Old standards of value—particularly the once normal relationship between bond yields and

doubt significant at present but not sufficiently so to change the broad picture.) In the field of financial practices, the major abuses of the 1920's consisted of mass manipulation of stock prices by speculative pools and of corporate pyramiding through successive tiers of holding companies of various types. Both stock-market manipulation and corporate-structure manipulation have been greatly restricted by the SEC legislation and by tighter stock-exchange supervision. The amount that escapes detection is comparatively small, in my view. Although the various investigative agencies now under way produce some startling exposures, whatever abuses now exist will not be found to have permeated the whole fabric of finance as was the case 30 years ago.

Offerings Increase and Quality Decreases

An exception to the above reassuring statement may have to be made in the field of new offerings of common stocks. Here I think a set of at least semi-manipulative practices has developed in handling so-called "hot issues." The number of such offerings has been increasing steadily in the past two years, and their quality has been retrogressing at an equal rate. It is in this speculative area that I sense the closest parallel between internal market conditions of the late 1920's (and particularly of 1919) and today. Whether the new-issue financing of dubious merit will prove to be so heavy in aggregate dollars as ultimately to turn the market scales definitely downward, I shall not venture to guess. It is not impossible.

The widespread belief that we are in a new stock-market era, differing in its essential character from the bull-and-bear sequences of the past, rests on a number of claimed differences between then and now. These go well beyond the reforms in stock trading and in corporate financial practices. The case to justify the present unprecedented level of stock prices and earnings multipliers is essentially that which would justify the concept of a permanently changed character and future for the stock market.

The safety and attractiveness of common-stock investment today is thought to be solidly grounded on a complex of favorable factors. Among them are (a) assured growth of population and GNP; (b) a rate of expansion more rapid than formerly, created by technological progress and the rivalry with Russia; (c) an assurance against major depression provided by the government's new responsibility to prevent or quickly terminate them; (d) the public recognition that common-stock investment is a necessary protection against continued inflation; (e) the emergence of mutual-funds, pension trusts and other institutional investors as the chief source of demand and continuous support for common stocks.

Resurrection of the 1924 Doctrine

Those who study the record of the 1920's will find that reasons similar to most, but not all, of the above were advanced to justify the ill-fated market rise of those years. The doctrine of "Common Stocks as the (Best) Long-Term Investments" emerged in 1924 and was made the cornerstone of the market's philosophy and its excesses. There was the same optimism about the future growth of the country, and perhaps a better-founded confidence in the share of common-stock earnings in that growth. (The rate of return on invested capital was better maintained between 1922 and 1929 than between 1950 and 1961.)

Old standards of value—particularly the once normal relationship between bond yields and

Continued on page 32

Are We Too Confident About Invulnerability of Stocks?

Continued from page 31

common-stock yields — were thrown aside then as now, on the grounds that they had no relevance to the new economic climate. There was great confidence, also, in the future stability of business and its immunity from severe depressions. This was founded on the idea that scientific management, careful control of inventories, the absence of inflation, and other helpful factors would help our business leaders avoid the costly mistakes of the past.

Differences in 1920's and Today Compared

In my view there are three major differences between the economic realities of the 1920's and the present. The first relates to the inflation factor, the second to the role of government in business. The bull market of the 1920's ran its course without the aid of commodity-price inflation; the market rise since 1949 has been accompanied by an irregular, but virtually continuous, advance in wholesale and consumer prices. It is difficult to say whether the investor's current emphasis on future inflation possibilities should be considered primarily as a recognition on his part of objective fact, or rather as a strong subjective reaction to an element that is by no means new to the financial scene. We had more inflation in wholesale prices from 1900 to 1910 than from 1950 to 1960; the rise from 1900 to 1920 also exceeded that from 1940 to 1960 (the equivalent of from 36 to 100 vs. from 51 to 120).

Most of us believe that inflation is the path of least resistance for governments, labor leaders and business heads, and that hence it will be followed. But the record of the past will not help us much to determine what the amount of inflation will be over future decades, whether its course will be regular or interspersed with sharp deflations as in 1921 and 1932, and whether investors will remain as inflation-conscious in the future as they are today. The reaction to inflation, as almost every other investment and speculative attitude, seems to be more the result of the stock-market's behavior than the cause of it.

My view of the effects of the Cold War on common-stock values is quite a personal one, not shared by many I am sure. In the first place I think it has contributed a good deal to the business expansion and relative stability of the past decade. But, in a contrary sense, I cannot see how the kind of Cold War we are now living through can continue throughout "our lifetime and that of our children." Sometime within the present decade, a way will have to be found to terminate the Cold War, or it will be transformed into large-scale hostilities, with all their nuclear implications.

If our prosperity since 1949 has in fact rested rather heavily on our defense expenditures, and if in truth we must fairly soon have either no war or nuclear war in place of Cold War, then today's international situation cannot be termed more favorable for common stocks than the cloudiest one of 1920.

The government's commitment to prevent large-scale unemployment and serious depressions is both a new factor and one of major importance. The most logical reason for expecting a different kind of stock-market cycle in the future than in the long-term past would appear to be by analogy with the business cycle. The

record since 1949 strongly supports this thesis.

The new material on "Business Cycle Developments," now available monthly, shows four periods of business contraction since 1948 — in 1949, 1953-4, 1957-8, and 1960. All of these were very moderate as compared with the sharp recession of 1937-8 and the major depressions after 1919 and 1929. The three declines of about 20% each in the stock averages since 1950 appear to correspond fairly well with the three setbacks of about 10% in the index of industrial production. If we have now entered a new era that excludes old-time business depressions, it seems reasonable to deduce that we are also in a new era that precludes old-fashioned bear markets.

Both my analysis and my instinct warn me that there may be a catch in this plausible and reassuring parallel. If the recent picture had been one of the stock market's advancing in step with the national product, and in close proportion with it also, then the observer might conclude—something to his amazement—that not only has the economy been reformed but human nature as well. But here the facts part company with the hypothesis.

The stock market level has not been governed primarily by the level of business, but rather by the development of new investment theories and attitudes and by a typical growth of speculative interest and activity. Some of the old financial abuses that characterized former bull markets have indeed been virtually eliminated. But some have again raised their head, and some new ones have appeared and are spreading space. These are in the areas of corporate reporting, corporate financing, the quality of the enterprises offered for public sale, and the ways in which new issues of common stocks are offered and subsequently traded.

Questions Today's Investment Theories

Equally important and dangerous, in my eyes, is the ready acceptance by security analysts of the going market levels and earnings-multipliers as the proper standard of value and of comparison for any issue under study. The new analytical concepts of growth-stock valuation, of "cash flow," of the desirability of tax-free dividends from companies which are triumphantly able to report earnings deficits—all have enough plausibility and lack of inner discipline to lead both investors and speculators astray. In sum, the new investment theories and techniques remind me very much of 1928-1929, and the outpouring of common-stock issues of secondary and lower-degree enterprises reminds me equally of 1919. If the relative stability of general business and corporate profits produces an unlimited enthusiasm and demand for common stocks, then it must eventually produce instability in stock prices.

We have already seen the working of this paradox in the area of growth stocks. The price of a successful and promising concern such as Texas Instruments can be driven up so high by speculative emphasis on its prospects that the ensuing reaction has cut the price in half—with no change in the underlying worth of the business. Examples of this sort are now numerous.

Conceivably this behavior of issues in the growth-stock class may give us a preview of the ultimate behavior of the general market—as represented by comprehensive averages—if common-stock in-

vestment becomes essentially identical with common-stock speculation. In that case the stock market will have a life cycle of its own quite independent of the business cycle. The market cycle will once more prove to be the human-nature cycle; its economic background will have changed, but not its basic character nor the consequences of its character.

These arguments against a new character for the stock market are not necessarily arguments that the present levels are too high, although they certainly would be adjudged so by older standards. Conceivably, and even probably, new factors in the economic figure have moved upward the central value of the average dollar of corporate earnings, and justify a more favorable relationship than heretofore between stock yields and bond yields. This would certainly be true if the general business picture can be counted on to continue indefinitely the relative immunity to depression it has shown since as far back as 1941. What we are concerned with here is not the future central value of the stock market but rather the amplitude and the consequences of possible future variations around this value.

To soften a possible charge of old-foginess and prejudice against new standards of value, may I take this paragraph to show how the recent record level of stock prices may be justified by some not implausible calculations. Let us assume that the investor wants an overall return of 7½% annually, as a composite of dividend income and average market appreciation. (This 7½% target is itself taken from the long-term record of dividend yields and price advances; it seems reasonable as a guide to the future.) Assume next that earnings and dividends will grow in the indefinite future at the annual rate of 4½%, which appears to be the projection for this decade. Then the investor should be satisfied with a 3% dividend return. This would justify a current level of 65 for the S-P Composite, only 10% below the recent high. A small adjustment here or there would put us over the top. [Ed. Note: S-P industrial average reached 75.93 on Dec. 27, 1961, the day of Mr. Graham's address.]

It is by no means impossible to assume a permanent growth rate of 4½%; we have been told we must increase our GNP faster than this or lose out in the race with Russia. The basic objection is that it is only an assumption, that the experience of the longer past puts the figure rather at 2½%, and that the difference between 4½% and 2½% in this calculation means the difference between 65 and 39 for the value of the S-P Composite. My experience leads me to predict that the action of the market will govern the investor's choice as to probable future growth rates, rather than vice-versa.

Sees Ominous Portent

This completes my case for and against a new era and character for the stock market. If the market since 1949 foreshadows the stock markets of the future, the investment aspects of equity accumulation are unbelievably favorable. All that will be needed will be the funds to buy a representative assortment of common stocks and a little patience to sit through periods of mild reaction. The annually-compounded rate of overall return from the 500-Stock Composite has been about 13%—curiously enough, this has been about the same as the average from a selected list of growth stocks.³

A much lower annual rate, without severe interruptions, will prove amply rewarding.

³ See, for example, Table A in "The Growth Stock Philosophy," by J. F. Behm-falk, Jr.; The Financial Analysts Journal, Nov. 1960.

But if, as I deem it more likely, the fundamental character of the stock market must be as unchanging as that of human nature, then the accumulator of equities who starts today is faced with quite a different prospect. The new appearance of the variable annuity suggests a broad tuning that bull market that investment trusts had their first important development in this country. Most of the arguments in their favor were the same as those now used for the sale of mutual-fund shares and for equity accumulation in general. The collapse of 1929 resulted in a severe and protracted setback for the investment-trust movement, as part of a widespread loss of faith in common stocks generally. It is true that many—although perhaps less than half—managed to survive the bitter subsequent experience and to re-establish themselves more firmly than before in public esteem. Furthermore, the principle of dollar-cost averaging—which is the most systematic of the equity-accumulation techniques—was able to vindicate itself in the end, after perhaps 20 years of unsatisfactory-to-mediocre results.⁴

Doubts Success of Dollar-Cost-Averaging

The computations made of theoretical dollar-averaging experience in the past embolden us to predict that such a policy will pay off ultimately regardless of when it is begun, provided it is adhered to conscientiously and courageously under all intervening conditions. This is by no means a minor proviso. It pre-supposes that the dollar-cost-averager will be a different sort of person from the rest of us, that he will not be subject to the alternations of exhilaration and deep gloom that have accompanied the gyrations of the stock market for generations past. This I greatly doubt—particularly because most of the dollar-cost-averagers we are speaking of will be typical members of the public who have been persuaded to embark on an equity-accumulation program by the arts of salesmanship now so highly developed in the mutual-fund field. Let me return once again to the problem of the proper perspective for viewing the character of the stock market and the investment aspects of equity accumulation. At the outset I presented a statistical comparison of the market's behavior over the past 12 years and over the past 90 years. But our knowledge of stock-market behavior goes back a good deal more than 90 years—a full two centuries and a half, in fact, to the inception of the South-Sea Company in 1711.

In our first edition of Security Analysts, published in 1934, we characterized the stock-market madness of the 1920's as a repetition or rerun of the famous South-Sea Bubble. By comparison the behavior of our present market appears more rational, dignified and reassuring. No one today, not even ingrained conservatives such as myself, expects consequences to this market and the economy even faintly resembling the catastrophe of 1929-1932. Yet I have a feeling that the financial world has become too complacent about the future, too confident of the invulnerability of common stocks as a whole to a drastic change in their fortunes.

Quotes Walter Bagehot

Fifty years ago, when I first read a bit of economic history, there were some lines by Walter Bagehot about stock-market speculation that every student was

⁴ For calculated results of dollar-cost-averaging results for 10-year periods ending from 1929 through 1952, see "Practical Formulas for Successful Investing," by Lucille Tomlinson, New York, 1953, Table 3, p. 42.
⁵ "Literary Studies—Edward Gibbon," 1855.

supposed to know almost by heart. These lines, not without their dry and wry humor, read as follows:

"Much has been written on panics and manias. But one thing is certain: That at particular times a great many stupid people have a great deal of stupid money. Several economists have plans for preventing improvident speculation—our scheme is not to allow any man to have a hundred pounds who cannot prove to the satisfaction of the Lord Chancellor that he knows what to do with a hundred pounds. . . . At intervals . . . the money of these people—the blind capital (as we call it) of the country—is particularly large and craving; it seeks some one to devour it and there is plethora; it finds some one and there is speculation; it is devoured and there is panic."⁵

This paragraph was written nearly 150 years after the South Sea Bubble episode, and it seemed relevant to financial affairs for nearly another century to come. Interestingly enough, the South Sea Company itself had lasted almost 150 years after its disastrous beginning. I see in these dates an evidence of the persistence and the repetitions of history. A great corporation can withstand great vicissitudes; the same is true of great institutions, among which not the least important is common-stock investment and equity accumulation over a span of time. But a bull market has never become a financial institution, and I have great doubts whether this attractive development is an admissible possibility, when the frailty of human nature is taken into account.

My own inward picture of the present stock market is that of an institution cut adrift from old standards of value without having found dependable new standards. (In this respect present-day investment may be in somewhat the same position as present-day painting.) The market may either return to the old measures of central value; or—as is perhaps more probable—eventually establish a new and more liberal basis for evaluating equities. If the first happens, common stocks will prove highly disappointing over a long period for many accumulators of equities. If the newer and higher value levels are to be established on a sound basis, I envisage this working out by a process of trial and error, covering an unpredictable period of time and a number of pendulum swings of unforeseeable magnitude. I do not know whether bonds will do better than stocks over the next fifteen years, but I do know that the people behind the College Retirement Equity Fund (CREF) are eminently wise in insisting that its beneficiaries have at least an equal dollar stake in bond as in stock investment.

*An address by Mr. Graham before the American Finance Association, New York City, Dec. 27, 1961.

Joins Irving Lundborg

(Special to THE FINANCIAL CHRONICLE)
SAN FRANCISCO, Calif.—Clarence J. Richardson is now affiliated with Irving Lundborg & Co., 310 Sansome Street, members of the New York and Pacific Coast Stock Exchange. He was formerly with Reynolds & Co.

McDonnell Adds

(Special to THE FINANCIAL CHRONICLE)
SAN FRANCISCO, Calif.—Alvin F. Neal has been added to the staff of McDonnell & Co., Incorporated, Russ Building. He was formerly with E. F. Hutton & Company.

With Harris, Upham

(Special to THE FINANCIAL CHRONICLE)
ATLANTA, Ga.—Edmund S. Nash, Jr. has become associated with Harris, Upham & Co., 44 Broad Street, Northwest. He was previously with Thomson & McKinnon.