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COMPANY MEETINGS

Thursday, January 26, 1928.

NATIONAL MUTUAL LIFE ASSURANCE SOCIETY.

RECORD PROFITS.

PRINCIPLES OF INVESTMENT POLICY.

HOLDINGS IN ORDINARY SHARES.

MR. J. M. KEYNES'S ADDRESS.

The NINETY-EIGHTH ANNUAL GENERAL MEETING of the National Mutual Life Assurance Society was held yesterday at the Society's house, 39, King-street, E.C.

Mr. JOHN MAYNARD KEYNES, C.B. (chairman of the company), presided.

The ASSISTANT ACTUARY (Mr. G. H. Recknell, F.I.A., F.F.A.) having read the notice convening the meeting, the minutes of the previous meeting, and the report of the auditors,

The CHAIRMAN said:—Gentlemen,—Both in trading profit—i.e., profit apart from capital gains—and in total profit the past year has provided the highest totals which the National Mutual Society has so far experienced. Our gross profits amount to £226,481, made up as follows:—

Net miscellaneous profits from mortality, &c.	£44,264
Interest earnings in excess of 3 per cent. on mean fund, excluding carry-forward	65,981
Capital gains on securities sold or revalued (before making special allocation of £1,702)	86,065
Interest earned on the surplus carried forward from the previous year	30,171
	<hr/>
	£226,481

The corresponding total last year was £150,465. After increasing the reversionary bonus to 45s. per cent. compound on endowment assurance policies and to 51s. per cent. compound on whole-life policies at a total cost of £115,441, including the interim bonus, and allowing for a small special writing down of certain securities below market price (£1,702) and for valuation expenses, we are adding £111,040 to our undistributed surplus carried forward, bringing this up to a total of £751,246, which is now 17.8 per cent. of our liabilities as compared with 16.0 per cent. at the end of 1926.

BONUS RATES AND COSTS.

The broad results of the nine years since the War can be summarized as follows:—

I.—RATE AND COST OF COMPOUND BONUS.

Year.	Rate of Compound Bonus.	Cost of Compound Bonus.
1919-1923 (annual average of the 5 years)	42/-	£ 60,314
1924	42/-	76,580
1925	44/-	88,797
1926	44/-	100,923
1927	+ 6/- whole life 45/- + 6/- whole life	111,416

II.—PROFITS EARNED.

Year	(1) Trading Profit.	(2) Capital gains on Investments.	Total Profit (1+2)	Rate of Bonus earned.
	£	£	£	s. d.
1919-1923 (annual average of the 5 years)	73,186	72,352	145,538	101 6
1924	88,882	117,020	215,902	118 6
1925	109,214	44,650	153,864	76 6
1926	130,772	19,693	150,465	69 0
1927	140,416	86,065	226,481	96 6

Thus the cost of the bonus declared during these nine years has not exceeded on the average 80 per cent. of the trading profit, excluding altogether the capital gains on investments, which have aggregated £629,000. One further significant figure—we have earned in interest and capital gains together on the average of the nine years more than 6 per cent. per annum, free of income-tax, notwithstanding the large sums written off against depreciation at the end of 1919 and 1920, and more than 7 per cent., free of income-tax, on the average of the last seven years.

SUCCESS OF INVESTMENT POLICY.

An investment policy which has shown these profits can fairly claim to have passed the test of results.

On several previous occasions I have had something to say about the principles underlying this policy. Speaking very broadly, it has consisted in constant care and activity—a line of action which was the object of much more criticism when we began than it is now. We have acted in agreement with the following quotation from the annual report of the Carnegie Corporation:—

“The funds of a great endowment can be kept intact only by a systematic revision month by month of all the securities of the endowment and by a continuous process of sale and exchange as circumstances may affect the financial soundness of this or that security.”

In particular, we have been pioneers amongst the life offices in the practice of employing a substantial part of our funds in the purchase of Ordinary shares. The proportion of our funds so employed at the end of each year has been as follows:—

1918	..	3.04 per cent.
1923	..	16.35 ..
1924	..	18.67 ..
1925	..	9.56 ..
1926	..	15.66 ..
1927	..	18.33 ..

This is materially divergent from the prevailing practice. The Board of Trade Returns for life assurance companies—which include total funds in the case of the composite offices—show the following average results:—

Board of Trade Returns published in year.	Total of Balance-sheets.	Holding of Ordinary Stocks and Shares.	Percentage of (3) to (2)
(1)	(2)	(3)	(3) to (2)
1911	£467,000,000	£18,000,000	3.9
1926	946,000,000	41,000,000	4.3

Since papers read before the Institute of Actuaries by Mr. Raynes, of the Legal and General, and by others elsewhere during the past year have directed the general attention of the insurance world to a closer consideration of this policy, it may be in place if I enlarge somewhat upon it in the light of our own experience.

MARKET CAPITALIZATION OF ORDINARY SHARES.

The arguments in favour of holding a certain proportion of Ordinary shares are, from the point of view of the individual office, broadly two—one of them of a permanent character, the other possibly temporary. The permanent reason is to be found in the advantage of spreading the fund between assets such as bonds, expressed in terms of money values, and assets representing real values. Formerly, this result could be secured by means of investments in real estate; and, until recently, it was not practicable to invest

in real values on a large scale in any other way. To-day, however, the position is quite different. On the one hand, real estate as an investment is subject to serious drawbacks, and few insurance offices would wish to invest heavily at the present time either in agricultural land or in urban house property. On the other hand, the public joint stock company has taken a tremendous leap forward and now offers a field for the investment of funds which simply did not exist even 20 years ago.

Leaving out for the moment railways and public utilities, there are now quoted in the London Stock Exchange Official List about 188 commercial and industrial British companies each having an Ordinary share capitalization which amounts at present market prices to £1,000,000 or over, and 60 companies producing primary raw materials, mostly operating abroad, which satisfy the same test. The present market capitalization of the Ordinary shares of the commercial and industrial companies comes to about £1,177,000,000, or an average of £6,000,000 per company, and that of the produce companies to £342,000,000, which also gives an average of nearly £6,000,000 per company. In each category the average is greatly raised by the giants which head the list.

Now, when we speak of the new policy of investing a certain proportion of an insurance fund in Ordinary shares, we have primarily in view—without any intention of excluding investments in railways and public utilities—these (in round figures) 250 companies with a total Ordinary share market capitalization of about £1,500,000,000. These represent the live large-scale business and investment world of to-day, and any investment institution which ignores or is not equipped for handling their shares is living in a backwater.

In addition to the above, there are about 70 railway and other public utility companies—many of them with a much longer investment history behind them—which have on the same tests a market capitalization of about £392,000,000, or an average of more than £5,000,000. Finally, there are the Ordinary shares of companies overseas, particularly in the United States.

RAILWAY SECURITY VALUES.

In order to correct the old-fashioned sense of the perspective, it is worth remarking that the nine oil companies included in the produce companies with a market capitalization of £169,000,000 compare with seven home railway companies with £143,000,000; whilst 35 rubber, tea, and coffee companies with £81,000,000 compare with 12 foreign railway companies with £83,000,000. Thus 44 oil, rubber, tea, and coffee companies centred in London have an Ordinary share market

capitalization nearly equal to that of all the 30 home, foreign, Indian, and Colonial railway companies having a sterling capital. One could give many other startling illustrations. The Ordinary share market capitalization of Courtaulds at the end of 1927 exceeded by nearly 15 per cent. that of all the 12 foreign railway companies which satisfy our test added together, and the Ordinary shares of Courtaulds and Imperial Chemicals are together worth more than those of all the British railway companies. (Let it be remembered that I am taking Ordinary share capitalization, not total capitalization.) In short, the centre of gravity of business, and therefore of investment, is not where it was. A "conservative" investment policy is apt to mean in practice backing the enterprises which were in the van 50 years ago, instead of backing the new ones which are the characteristic achievement of the best business brains of to-day.

The second reason for investing in Ordinary shares is the fact that they are undoubtedly under-valued relatively to bonds after making all due allowance for risk and other relevant considerations. The fact that most well-managed and progressive concerns divide substantially less than they make introduces a cumulative, compound interest element which is often overlooked. Calculations made by Mr. E. L. Smith in America and Mr. Raynes here, confirmed by common experience, fully bear this out. For example, the results published during 1928 of 1,572 companies and analysed in the *Economist* show that in the aggregate the allocations to reserves equalled 2.02 per cent. of the Ordinary share market capitalization. Whether this under-valuation will still remain by the time that all our friends and colleagues in the insurance business have followed our example (*i.e.*, have invested some 20 per cent. of their total funds in this way), I am more doubtful.

ARGUMENTS AGAINST ORDINARY INVESTMENTS.

What are the arguments on the other side? For there are undoubtedly important objections. To judge from our own experience, they are mainly two. In the first place, the knowledge required and the care and attention which must be given are much greater, with the result that the burden of work and responsibility which is thrown on the board and on the executive is increased. It means that the directors have serious duties to perform, and in cases where the directors have not performed serious duties for many years, and are perhaps between 70 and 90 years of age, there must always be a doubt whether it is wise to put new duties on them. Moreover, however much care and attention is given,

it is extraordinarily difficult to acquire enough information to justify a substantial investment. The next great step forward in the evolution of joint stock enterprise of widely diffused ownership will follow, I think, from a revised company law which will insist on much greater publicity of accounts and will strengthen the hands of the auditors.

The second objection is to be found in the relative narrowness of the market—in spite of the fairly large total capitalization—except in a few cases. Out of some 250 commercial, industrial, and produce companies, you will have your work cut out to discover 50 which are *prima facie* attractive and about which you can acquire adequate information. The National Mutual, although our total fund now exceeds £5,000,000, is one of the smaller units amongst insurance offices. With a larger fund the dilemma would soon be reached between having to invest an amount in given companies which is rather too large for the market and having to go outside the range of the detailed information at the disposal of the office. We have sometimes tried to overcome this difficulty by deciding to back an industry rather than a particular business, dividing our investment between all the leading firms in the business, even though we might not know much about them individually. We have had considerable success along these lines. But the difficulty still remains.

NATIONAL FINANCE.

In conclusion, I venture to urge that there are important grounds of public policy why institutions such as insurance offices and investment trusts, which are now responsible for administering an ever-increasing proportion of that part of the national savings which finds its way to the Stock Exchange, should be encouraged to develop their policy, their organization, and their experience along these lines.

In the first place, it is extraordinarily important that we as a nation should not become, as time goes on, a *rentier* nation depending on interest from bonds and cut off from the living enterprises of the day, where constructive things are being done and to-day's wealth is being earned. (Hear, hear.) In a sense there is always a risk in doing anything new, but there are at least gains to balance losses, whereas the bondholder sometimes loses and can never win. At any rate, it would be a great misfortune if we were to see others, let us say the Americans, owning the Ordinary shares, in other words, the equities, of the new enterprises of each generation—to-day, for example, oil, motors, artificial silk—whilst the life offices of Great Britain were diverting the savings of their policyholders almost exclusively into the bonds of the old things, which,

as it is politely expressed, " have stood the test of time."

In the second place, the insurance offices might, if between them they held large blocks of Ordinary shares in leading companies, do much to remedy one of the greatest difficulties and evils of the present stage in the evolution of joint stock enterprise—namely, the complete impotence, when things are going wrong, of the shareholders, separated from one another, each with only a tiny stake in the concern, and practically incapable of joint action, against a board of directors who may, as shareholders, have no great sum at risk. There may be important future possibilities in cooperative action between insurance offices, and a committee representing them might be able to play the part of the reasonable, well-informed shareholder able to make his views and wishes felt, which is at present so signally lacking in the existing scheme of things. (Hear, hear.)

In short, I believe that considerations of public and of private advantage are in this

instance happily combined. It will increase the wealth and efficiency of this country if those responsible for the investment of large funds come to consider it a part of their duty to participate as Ordinary shareholders—to a moderate extent and within the due bounds of prudence—in the leading enterprises of their day and generation.

Gentlemen, I move the adoption of the report and accounts. (Cheers.)

Mr. CHARLES T. DYNE BURCHELL (deputy chairman) seconded the motion, which was carried unanimously.

The retiring directors (Mr. Oswald Toynbee Falk, C.B.E., Mr. John Maynard Keynes, C.B., and Mr. Walter Thomas Layton, C.H., C.B.E.) were re-elected, and the auditors (Mr. G. S. Pitt, F.S.A.A., and Messrs. Ball, Baker, Ash and Co., chartered accountants) were re-appointed.

A cordial vote of thanks was given to the chairman and directors, and the meeting terminated.

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