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August 29, 1934

Mr. Marriner S. Eccles
Assistant to the Secretary of the Treasury
Washington, D. C.

My dear Mr. Eccles:

In accordance with our telephone conversation last night, I am writing to give you our views regarding the detrimental effect of the weak market for guaranteed obligations upon Government security prices. The possibly irrational but nevertheless very real distrust-psychology now existing among institutional holders of U. S. Government bonds has, of course, been the result of a number of factors. Very important among these, we feel, is the poor reception accorded the Home Owners' Loan Corp. offering, together with the unfavorable market action of this and the Federal Farm Mortgage Corp. issue. The unsettlement created by these incidents was obviously out of proportion to the amount of bonds involved. For instance, one of the larger New York banks was allotted a million or two of the Federal Farm Mortgage Corp. bonds, representing a very small percentage of their total investments in Governments; yet for two weeks the attitude of the bank towards the Government bond market was dominated by the bad feeling engendered by the purchase of two million bonds above the current market.

Unfortunate timing of these issues just before unexpected adverse developments was, of course, in large part responsible for their relatively cool reception. This could not be avoided because news developments, such as Dollfuss' death, could not have been anticipated. It is our belief, however, that the method of receiving tenders on a bid basis for these issues had much to do with the unsatisfactory distribution, and in itself fostered hesitation in the Government bond market. I know of one syndicate that would have made a fairly high bid for a substantial amount of bonds had they not feared that competing bidders might obtain a block of the issue at lower prices, leaving the syndicate, therefore, unable to dispose of its higher-priced bonds for some time. One solution in the future would be to permit "all or none" bids. I doubt, however, whether this would be advisable in view of the fact that Government bond houses, unlike municipal dealers, do not go into joint accounts. It is our opinion that it might have been more satisfactory to offer the Home Owners' Loan Corp. bonds at a price for general subscription, and I believe that, if this method had been followed, the issue could have been marketed at a substantial premium.

We are wondering whether there is any possibility of additional offerings for cash of either Home Owners' Loan Corp. or Federal Farm Mortgage Corp. bonds. If no further offerings of this type are likely, an announcement to this effect in itself would improve market psychology.

If you are in a position to advise me that no further offerings are contemplated I would appreciate it, and would be glad to make the information available to our institutional clients.

Another factor which may have had a detrimental influence on the market for guaranteed obligations is liquidation from closed banks. It is perfectly apparent that these issues will be subject to constant dribbling liquidation, since they are exchanged for mortgages and delivered to individuals who, in many cases, immediately sell the bonds for needed cash. This type of liquidation can, of course, not be avoided; however, we have often wondered whether the liquidation from closed banks was being properly coordinated with Treasury bond market policy. It has appeared at times as though large-scale liquidation, which might have come from closed banks, was taking place simultaneously with Treasury support to the Government list. If it is true that disposal has been made of most of the Home Owners' Loan Corp. and Federal Farm Mortgage Corp. bonds in the hands of receivers of closed national banks, it would seem advisable to announce this fact. If you should be in a position to disclose this information to me, I would very much like to have it.

As I told you over the 'phone yesterday, the Comptroller of the Currency's ruling to the effect that national banks must list guaranteed obligations under a separate heading, has also contributed to their relatively poor marketability. We know of a number of banks which had contemplated the purchase of these bonds but did not wish to do so after they knew of the separate itemization. Some of the large institutions sold out their holdings before the statement date in order to avoid the complications of a separate entry on their public statements. I have discussed this matter with Mr. F. G. Awalt and others, at Mr. Gaston's suggestion, and I believe they were somewhat skeptical as to the importance of the effect of this ruling on the bond market. I have since obtained the opinion of a large number of people who are active in this market, and it is their belief that an announcement that banks could list these guaranteed obligations under the headings "U. S. Government Securities" or "Obligations of the U. S. Government" would probably close up the spread between the Home Owners' Loan Corp. bonds and similar direct Government securities as much as a point or a point and a half. It is not in itself conclusive, but interesting to note, that before the Comptroller of the Currency's ruling was made, the spread between Home Owners' Loan Corp. long bonds and similar direct Government maturities was only about a half point. While discussing this matter with Mr. Awalt, I was told that it was felt it would be a deception for banks to list obligations guaranteed by the U. S. Government with direct Government bonds. I, personally, fail to see the merits of this suggestion. In listing general bonds, banks include Eries with B&Os under one heading. They group their inferior loans with their good loans on the statement. Many banks have shown undivided profits and then failed a week later. For this reason this argument seemed to me like splitting hairs. Another argument which appeared to have had important bearing on the adoption of this ruling was the thought that if banks were allowed to group guaranteed and direct obligations on their statements, it might be inferred that the Treasury should include these guaranteed bonds

under their public debt figures. Personally, I fail to see the connection between the two.

It might also be worth considering the possibility of amending the law so as to make these bonds eligible for open market purchases by the Federal Reserve. In view of the fact that the Government has guaranteed these obligations, I fail to see why they are not just as much of an obligation of the Treasury as Treasury bonds. It is surprising, however, to hear some bankers say, for instance: "Suppose the Supreme Court held this guaranty to be unconstitutional?" Others inquire whether the Home Owners' Loan Corp. must try to liquidate its holdings of mortgages before the Treasury financing becomes effective. These questions are widely asked, even though irrationally, in view of the language contained in the guaranty. The fact that these bonds are not eligible for purchase by the Federal Reserve Bank lends force to the belief of many of these bankers that the guaranteed obligations are not as good as direct Government securities. Since the stock of the Home Owners' Loan Corp. is owned by the Treasury, it would seem that, from a purely financial viewpoint, the Government should be just as much interested in obtaining the best possible interest rates on these obligations as well as on direct Government bonds.

With these thoughts in mind, therefore, I take the liberty of suggesting that if, in the near future, you could announce (1) the reversal of the Comptroller of the Currency's ruling; (2) that no further cash offerings of these guaranteed obligations were contemplated, and if they were to be made, that they would be offered for subscription at a price rather than by tenders; and (3) that liquidation from closed banks was about complete - I believe the market on the guaranteed obligations would be greatly improved, and that it would have an excellent and important beneficial effect on the entire Government bond list.

I expect to be in Washington early next week and will call you for an appointment. I should be very glad to discuss the actual conversations I have had with bankers regarding these matters, upon which I base the above conclusions. I fully agree that the attitude of a good many institutions on these topics is somewhat irrational, but if it is the desire to improve these markets, it is necessary to take this banking psychology into consideration.

Thanking you for your many courtesies, I am,

Very truly yours,

Thos. R. Goldsmith

TRG:KK

P.S.: I am enclosing a copy of this letter, in the belief that you may wish to send it to Mr. Gaston, with whom I have discussed this matter previously.