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The Royal Family Grows Restless

The Big Bull Market of the 1950's

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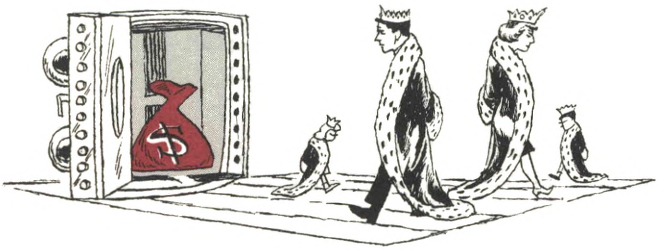
THE ROYAL FAMILY GROWS RESTLESS



In the American economy, every family is a royal family. Each consumer is a king, queen, prince, or princess. No mere figureheads, they dominate and rule the economy.

The royal family of consumers buys about two-thirds of all goods and services produced. And consumers wield despotic power. They can impose their wills on governments through the ballot box, and on businesses through free markets.

The royal family now seems to be getting restless after being relatively set in its ways through much of the postwar period. Consumers themselves are changing and so are their spending habits. Spending has shifted away from some old standbys and this could be an important cause of the current business setback. Some of our present excess plant capacity and unemployment certainly are located in industries whose products consumers no longer favor. Anthracite coal is the classic example but durable goods and houses should not be overlooked. Consumers are budgeting a smaller share of their income for these items than in previous years.

The shift away from these "hard" goods may have a significant effect on the course of business. The products and services consumers covet today do not have the explosive impact on the economy that durables and housing have. The dollars spent in 1961 may not ripple out quite so far or so fast or create so many jobs as they once did. Compare the immediate effect on production of $3,000 spent for an automobile versus $3,000 spent for college tuition.

But if the new spending mix is not so stimulating neither is it so volatile. Durables and housing are subject to wide cyclical swings. By spending more of their money for other things, consumers may be adding a note of stability to the economy.

The royal treasury is bulging. Incomes should remain high in 1961 and consumers will spend record sums. But the royal family will probably remain restive for some time. Consumers are more sophisticated and have more complex wants. They are more choosy and harder to please. They are interested in real value and will pay to get it. Sharper shoppers, consumers should be harder to manipulate. The creation of artificial demands through frequent style changes and "hidden persuader" advertising is becoming more difficult. In short, the royal family is turning into something of a tyrant and businessmen will have to work harder than ever to serve by "appointment to their majesties." Yet the rewards will be great for the firms that make the grade.

Aside from the broad drift to services, no clear new consumer spending pattern has emerged. Instead there seems to be a churning of trends—a kaleidoscope of demands. This may be just a gusty interim before the winds of trade steady in a definite direction. Or it could be a permanent thing. It could be that consumer spending during the early part of the 1960's will be characterized by the lack of a neat pattern such as we have seen in the past. This is a real possibility for consumers are subject to some very complicated, somewhat contradictory forces.

In this article, we sketch, as we see them, a few of the many changes that have taken place in the consumer market. Some are psychological, some sociological, some economic, but all could affect the way consumers spend their money—which products they favor and which they banish to oblivion. It is difficult if not impossible to measure the extent of these changes or indeed to prove they actually have taken place. Furthermore, many of their impacts and effects must, of necessity, be based on conjecture. We offer the following interpretations only to stimulate thought and discussion about the consumers of the 1960's.

THE DEATH OF A SPOKESMAN

The average consumer was a faceless spender who spoke for many millions of his fellows. Born of myriad surveys, he had been pried and probed by marketing men for decades. Know what the average consumer would do and you knew what consumers in general would do. In other words, the early post-World War II consumer market was relatively cohesive and predictable. Families tended to spend as units and the units often behaved in much the same ways.

The concept of the average consumer, the easy-to-understand model of all consumers, has much less validity today. The consumer market has begun to atomize—to split into many autonomous markets and submarkets. Family members are spending more as individuals and neither families nor individuals seem to fit neatly into any inclusive mold. No longer is the market well-gauged by over-all averages. No longer does it have a single spokesman.

The consumer market has divided many ways—by age, sex, marital status, race, region, and income, to mention but a few, and each group exercises discretion over increasingly larger sums of money.

What made spenders splinter?

The fragmentation of the consumer market has a number of causes. Most important, perhaps, is the great rise in discretionary income—income left over after the essentials of food, clothing, and shelter have been bought. This is income consumers can spend as they choose—for steaks, stereo sets, travel, etc. The National Industrial Conference Board estimates that discretionary income has risen 64 per cent since 1946.

The broad diffusion of income is another key feature. Increases in income have spread throughout the entire economy. Vast numbers of people have moved up from subsistence levels and now have money for other purposes. Many minority groups—Negroes are an example—have enjoyed greater-than-average income gains.

The rise in income has liberated individual spenders within families and has magnified differences among families. We don't mean to imply that consumer spending patterns were once all the same. There have always been important variations, of course. The point is that the patterns have grown considerably more diverse in recent years. In the early part of the postwar period, consumers seemed to have more spending goals in common.

Let's flash back to the end of the war—"that wonderful year," 1946. It was the year that the Red Sox played the Cardinals in the World Series and Joe Louis fought Billy Conn for the second time. "Annie Get Your Gun" was the big hit on Broadway and all over the country hemlines started down.

On the home front, 1946 was the year of the in-laws. There was a housing shortage and families doubled and tripled up. Returning servicemen and their brides moved in with parents who already may have been harboring a selection of grandparents and unmarried siblings. And don't forget Aunt Harriet who had moved East to do war work.

Incomes were partially pooled and much spending was done by the household for its members. Individual tastes and preferences tended to be laminated into a single market unit.

Most people didn't really like this communal arrangement. They put up with it because there was no choice. They were ready to move out when they got the chance. For many, the chance came in the late 1940's. A great number of houses were built in the years following the war and many existing structures were converted into apartments. Young couples went to development "castles" financed on the "G. I. Bill." Aunt Harriet moved to her own apartment. Many people had hefty accumulations of wartime savings which were a big help in getting started on their own. This undoubling process is the reason that the average size of households has declined during the postwar period in spite of the prevailing high birth rates.

A lot of new spending units were created, amoeba-fashion, but families still had many needs and desires in common. Two things stand out above the others—automobiles and appliances. Many people had gone without these glamour goods during the depression for the lack of income, and during the war for lack of production. Again, families tended to spend as a unit. They devoted much of their incomes, savings, and borrowing power to get their automobiles and appliances and they didn't have too much left over for other items.

Consumers stocked up on durables during the latter 1940's and part of the 1950's. In the past several years, however, the original demand has become pretty much a replacement demand. There is now one car on the road for every two persons over 18 years. Of all wired homes, 98 per cent have refrigerators, 93 per cent have washing machines, and 90 per cent have television.

Replacement demand is much less dynamic. Purchases can be postponed almost indefinitely by judicious repairing. Furthermore, the mouth-watering excitement of durables has been reduced by ownership and familiarity. Today, consumers have larger portions of their ever-increasing income left over to spend as they wish. As we pointed out, no single-minded, new spending trend has taken the place of houses and durables. Instead, the flow of discretionary dollars seems to be darting like quicksilver in many different directions.

Other postwar developments also have helped shred the consumer market. They are well-known and we shall only mention them here. Increased education has changed tastes and diversified desires. Widespread travel has had a broadening effect, pulling many out of their buying ruts. The growth of leisure has given greater range to consumer demand.

Meet the markets

Not long ago teenagers were economically submerged in the family spending unit. They had only nickel-and-dime allowances to call their own. Now our 16 million high school students spend an estimated $6 billion a year. The youth market is highly specialized. Highschoolers emphasize sports and sport equipment, clothing, hobbies, movies, records, and, of course, food and more food. As one writer puts it, the current teenage greeting is often "take me to your larder."

The moppet market is growing in importance. Children up to ten years of age spend little themselves but they determine how hundreds of millions of dollars are spent. Television, the electronic baby sitter, has made this market. Small fry spend hours watching Yogi Bear, Captain Kangaroo, and other heroes plead "tell your mother to get a package of Super Crunchies." Food, candy, clothes, and toys are the mainstays of the moppet market.

It is hard to define the senior market. How do you tell when a person is old? One way we have heard is when a woman is more interested in the fit of her shoes than the fit of her sweater. Statisticians usually take a more prosaic approach and draw an arbitrary line at age 65. There are 16 million people over 65 and they spend approximately $30 billion a year. They devote a relatively higher percentage of their income to housing, household operation, food, and medical care.

The Negro market is expanding rapidly as the economic status of the Negro improves. Negroes spend about $20 billion a year for goods and services. Their greatest need is for good housing for which, when available, they are willing to pay top dollar. An *Ebony* magazine survey indicates that Negroes spend a greater-than-average share of their income for clothing, automobiles, food, and cosmetics.

There are over 10 million single, adult consumers and their income is over $30 billion. They usually live alone in rented quarters, and they tend to gravitate to the cities. Clothes, entertainment, and eating out are big items in their budgets.

We also should mention the "country club" market, the 7 million families with incomes over $10,000 a year. These folks can afford many kinds of luxuries and are highly receptive to new products and ideas.

Then there is the newlywed market and the young parent market. People in the South have a distinctive spending pattern, and so do Westerners, and those from other sections of the country. Suburban families have their own special needs. Spenders also differ by ethnic origin and, to some extent, by religion.

Finally, in many families husband and wife have turned into separate spending units. They both have more money to call their own. Dad may treat himself to a shotgun and mother may choose French perfume or a new hair style. It is said that one-third of all married women hold jobs and that they add nearly $30 billion to the family coffers. Working wives spend more than their stay-at-home sisters on clothes, personal care, restaurant meals, entertainment, and household conveniences.

Split-level selling

The existence of many separate consumer markets makes merchandising more difficult. Many products do not appeal to all groups. Selection and variety are the "buywords."

Automobiles are a good example. Not long ago all available cars were much the same—big, chromy, and expensive. Now automobiles are highly specialized. There is a car for every purpose and purse. For the drive-to-the-station commuter there is the foreign "doodlebug"; for large families there are miniature buses; for the economy-minded there is a selection of compacts; for luxury-lovers and status-seekers there are several makes of "show boats"; for suburban hauling there is the station wagon; for city dwellers there is a variety of easy-to-handle and easy-to-park models.

Radio stations also cater to specific consumer markets. In Philadelphia, and no doubt elsewhere, there are many stations that offer nothing but specialized fare. One local station plays only "big band" music, principally the Tommy Dorsey, Glenn Miller, Benny Goodman recordings from the late 1930's and early 1940's. Several stations offer nothing but classical music, and still others fill the day with rock-and-roll for teenagers and culturally retarded adults.

The splintering of consumer demand has boomed the "doubles" market. Families who have everything now are getting two or more of it—TV sets, radios, telephones, cars, appliances, and even houses. Since the second item is usually to meet a specialized need—often for the children—it is likely to be of a different model or style than the first.

The growth of his-and-her products is further evidence of discretionary spenders within the family. Now mother and father may have their own separate types of deodorants, shampoos, electric razors, soda crackers, and even Scotch whiskey (hers is lighter and mellower).

A legion of products is aimed directly at individual markets. Specifically for the older folks, there are health products, retirement cottages, golf clubs with more whip, watches with easy-to-read faces. Certain clothing styles, records, and books are slanted at teenagers. The moppet market is featuring space toys and cowboy guns this year. And so it goes in endless variety.

Firms will have to learn more about their customers—who they are and why they buy. This may mean increased expenditures for market research. Advertising also has become more complicated. With consumers behaving in unaverage ways, the effectiveness of mass media is weakened. There is, therefore, a trend to pinpointed advertising. Some companies are making extensive use of spot announcements on local radio stations. National magazines are accepting split-run ads that appear only in certain areas. The right market can be reached once it is known, but it may prove costly.

Producing goods for varied markets also may be more expensive. Specialized products must be researched and properly designed. And they often must be produced in smaller quantities than heretofore.

This matter of costs is the crux of the challenge businessmen face. As the magazine *Nation's Business* puts it, "We must shift from mass markets to custom markets for services as well as goods without losing the efficiency of mass production and mass merchandising methods."

THE BULLDOZER EFFECT

Powerful forces are working to bulldoze consumers into a vast, amorphous mass. These forces tend to submerge the individual and homogenize tastes and behavior. At first thought, it seems surprising that the consumer market has atomized at all while subject to such influences.

Television is one of the great levelers. Without getting into the controversy, we can report that many critics claim television is programmed for an egalitarian audience. If Madison Avenue feels that the mass likes westerns, private eyes, and situation comedies, that is what everybody gets, hour after hour.

Housing developments are another homogenizing force. Armies of similar box-houses stand in parade ranks on yesterday's farmland. Most development dwellers are about the same age, have the same income, and face the same problems—children, money, and crab grass, though not necessarily in that order. There is good reason for Suburbo-man to look, act, and think just like his neighbors.

Giant corporations and giant unions also can impinge on individuality. Workers, even managers, are small cogs subservient to the organization. In many cases they must conform to rigid codes of behavior—right down to the clothes they wear. How many bankers did you see last summer in sport shirts?

But consumers are resisting homogenization and refuse to be entirely squeezed into a mold. Without rebelling against established conventions they still are striving to express their individuality whenever they can. They have more income than ever before and they are willing to spend a good part of it to be different.

The splitup of the consumer market could be, in part, a reaction to these leveling forces. Original art and handmade items, now enjoying a boom, also may be antidotes to the bulldozer effect. The desire to be different helps to explain why exotic imports are so popular and why gourmet foods are selling at a $250 million clip. "Anyone for chocolate-covered caterpillars?"

Interiors of development houses are as different as the outsides are similar. No two are decorated alike. Furniture styles have run riot in the

past five years (see the November 1960 *Business Review*) and one reason is the housewife's desire to display her very own tastes.

Home from the office, "organization men" shed their grey flannel uniforms and become rugged individualists in their leisure activities. Do-it-yourself satisfies the urge for distinctive creation. Sports give the whole family ways to flex their identities. Good books and classical records provide ways to be different and they are also part of . . .

THE "EGGHEAD" SYNDROME

Culture is a hot item. There are 42 major American symphony orchestras and hundreds of others associated with colleges and small communities. Phonograph record sales in 1959 were 316 per cent of their 1950 level and "serious" records have been doing at least as well as the total. About $1 billion is spent each year on books — one quarter of that on encyclopedias alone. About 55 million people visit museums each year. In 1959, twice as many New Yorkers visited the Metropolitan Museum of Art as saw the Yankees play baseball. The attendance at concerts has doubled since the war, and the opera and ballet never had it so good. Painting and sculpture have become hobbies for millions. Adult education courses are thriving all over the nation.

Not long ago the "egghead" was considered a fuzzy bumbler—a comic character who was always misplacing his glasses. Today he is something of a hero, more to be emulated than snickered at. We wonder how many people now become scholars, artists, musicians, and scientists in their "Walter Mitty" dreams rather than athletic heroes, sea captains, and soldiers of fortune.

A large part of the new interest in culture probably is genuine. People truly have become more intellectual. Many have a better appreciation of art, music, and the like than their parents did. Here, too, increased income, education, and leisure are important factors.

But not all the "culturephiles" are real. No doubt many adopt a veneer of culture for status purposes—a sort of aesthetic one-upmanship. Many like to think of themselves as intellectuals when by any realistic test, they are not. How many husbands yawn through a concert because attending is the thing to do? Self-imagery, however, can be just as important economically as real appreciation. If consumers picture themselves as cultured, "thinking men" or even if they want others to see them as such, they will spend willingly for the trappings of culture. This is one reason for the rash of advertising campaigns with egghead appeal.

No matter what their own appreciation and backgrounds are, many parents want their children to get genuine exposure to culture. This is part of the reason for the increasing popularity of higher education. Higher education, in turn, has a most important influence on consumer spending patterns. The total cost of a college diploma is estimated to average around $10,000. A budget-wrecking expenditure like this usually takes plenty of planning and scraping. How many families are struggling right now to send children to college and how many more are putting money aside in anticipation of the struggle? Certainly some of the shift away from "hard" goods is being forced by saving and spending for college. And since birth rates have remained at high levels through the postwar period, education will be a big item in consumer budgets for the foreseeable future.

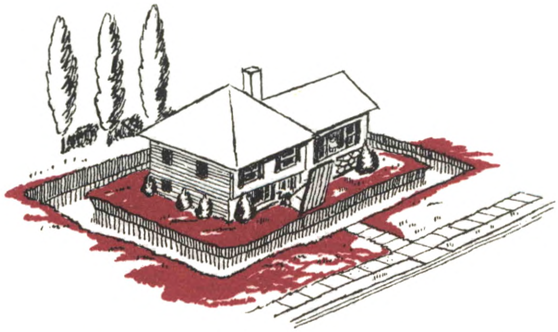
THE NEW ISOLATIONISM

We don't hear much about political isolationism these days. With distances shortened as the missile flies, it is hardly possible for America to snuggle down behind her oceans and ignore the rest of the world.

It is possible, however, for individuals to hide from the world. Some do it consciously and deliberately—hermits and beatniks—but they are a small minority. Experts say a far larger group of Americans is unconsciously trying to escape certain realities. This is the new isolationism—a psychological withdrawal from the world. Or perhaps we should say from several worlds. For the individual actually lives in at least four concentric worlds. The first is the international world, the planet, earth. The second is national, the United States. The third is the job world of farm, factory, or office. The fourth world encloses the home and family.

Proponents of the new isolationism theory claim the first three worlds have become more and more unsatisfactory to many Americans. Crisis follows crisis in the international world. As this is written, the morning paper headlines four critical areas—the Congo, Algeria, Cuba, and Laos. Others such as Berlin and Quemoy are smoldering ominously. And what happens when Red China gets The Bomb? Many people, however, are past the point of being afraid. The sharp pain of panic has worn into numbness. People worried for years and it did no good; conditions only became more depressing. Recently, the theory goes, many citizens have turned away from the international world and tried to shut it out of their minds. Readers bypass front pages and quickly turn to the sports and comics. At social gatherings, conversation usually runs to small talk rather than serious issues. There are exceptions, of course. The "New York Times set" and others are deeply concerned with international affairs but they are probably in the minority.

The national world is also beset with ugly problems—integration, inflation, juvenile crime, unemployment. Gold is a serious concern to some, and so is our alleged lack of national prestige and purpose. Although the tendency to withdraw is not nearly so great here as it is



from the international world, many people are reluctant to think too much about national questions.

The job world also is often less than satisfactory. True, people are working shorter hours and earning higher pay than ever before but modern jobs can also be dull and stultifying. The old-time craftsman put in long hours but he enjoyed variety and creativity and took pride in his work. Today's mass production demands specialists. Workers make small contributions to giant projects and feel little sense of identity with their work. The emphasis is on the team and, as we mentioned earlier, the individual can often become frustrated.

The international, national, and job worlds are big worlds, driven by big forces. The individual, it is claimed, often feels powerless to do anything about them. As a result, many have tended to isolate themselves psychologically in the fourth world of home and family where things are more pleasant and manageable. Professor Paul Samuelson of M.I.T. said: "In the face of a world grown more dangerous, people's attitudes and values seemed to turn inward toward the home."

The new isolationism may play a part in some basic sociological trends. Earlier marriages may be to some extent an attempt to get more out of life in uncertain, frustrating times. Alfred H. Williams, past president of this Bank, has suggested that the high postwar birth rate may be partially due to some "deep-seated drive to perpetuate our kind in the face of a daily diet of tension and trouble."

The sharper focus on home and family has had its effect on consumer spending. It probably is a factor in the rapid rise in home ownership. The new isolationism is a reason why homes are more important as status symbols and entertainment centers. It also helps to explain why people are spending heavily on furnishings, patios, and yards.

The desire to make the home and family world as pleasant as possible extends to the immediate community. Possibly as a result of this, there is a revival of interest in local affairs. Husbands and wives are said to be more willing to participate in community clubs, P.T.A.'s, church work, and local governments. Taking part in community groups carries quite a bit of status and prestige in some neighborhoods.

The new isolationism came to flower in the late 1950's. In the past several months, some of our associates here at the bank claim to have sensed a greater public interest in national problems, a greater willingness to face up to the international ugliness, especially on the part of our youth. If true, this could be the start of a major trend or it could be only a flurry associated with the recent elections and the change of Administrations. At any rate, it is not likely that the consumer's concern with home and family matters will diminish significantly in the near future.

The new isolationism is part cause, part effect of the last factor we shall discuss.

LINUS' BLANKET

Linus is a little boy in the comic strip "Peanuts." Like many small children, he is firmly attached to his blanket. For some reason, the feel of it against his cheek gives him a sense of cozy security.

Adults outgrow their blankets but not their need for security. It is economic security that concerns us here. The quest for economic security seems particularly strong these days. People are demanding and, to a large extent, getting freedom from poverty. They want assurance of a steady income both during their working years and after retirement.

This is one of the most natural desires, yet it is criticized by some. They say the price of economic security runs high, that sometimes one must settle for less chance of gain to minimize the chance of loss. The premium on security, it

is claimed, can lessen initiative, ambition, and the desire to compete. Security also can reduce the mobility of the labor force as people become chained to jobs by seniority and pension rights. A less vigorous, less mobile work force can reduce our economy's ability to grow and, in the end, may undermine the very security people seek. It is a gloomy thought but it is only a thought. The quest for security has other, more definite effects on the enonomy.

Security-conscious consumers now squirrel away more money for rainy days and retirement and, as a result, spend less for immediate consumption than they otherwise might. Personal savings are at record levels and retirement funds of all types amount to about 100 billion dollars. Most consumer savings are invested and insofar as they become available to businesses, they serve to finance economic growth without inflation.

Relatively few consumers invest their savings directly. Rather they put their money in a financial intermediary, such as a commercial bank, mutual savings bank, savings and loan association, or insurance company which does the investing for them. It's the desire for safety and security again. Savers choose a smaller, surer income over the chance for a greater but riskier return.

Financial intermediaries are concerned with safety, too; they have to be for they are dealing with other people's money. With huge sums to invest, they tend to favor large blocks of "blue chip" securities. This policy, it has been said, diverts funds away from venturesome small and new businesses where the investment risk may be greater.

In their quest for economic security, many individuals turn to unions. Many others, however, turn to governments. Governments, particularly the Federal Government, are in the economic security business in a big way. Pensions, social security, unemployment compensation, veterans' benefits, agricultural programs all provide economic security for large groups.

Such benefits never can be manufactured out of thin air. Their cost is high and, no matter how you look at it, the public in general must pay. It could be through contributions or direct taxes, or through the cruel, hidden tax of inflation which just as surely and probably more inequitably takes away consumer spending power. Thus the desire for security has shifted funds to governments that might otherwise be spent by consumers. Whether one thinks this is good or bad depends on his own persuasions and political beliefs. Our point is that it has altered consumer spending patterns.

CONCLUSION

We have mentioned only a few of the factors we feel are influencing consumers. There are many more—some run at cross purposes and all are complex and complicated. The net result could well be that consumer spending patterns will grow more diverse and over-all demand will continue its restless churning. Not that consumers are becoming more flighty or faddish but they are enjoying the freedom of intelligent choice that goes with affluence, education, and a degree of satiation with goods.

As consumer preferences shift, they often leave unemployment and excess capacity in their wake. As a result, pockets of chronic unemployment may continue to plague the economy. The solution usually offered to this problem is to increase the mobility of productive resources. Let capital and labor move between companies or between industries to follow consumer demand. But this is often easier said than done. We have indicated how the desire for security tends to inhibit the mobility of labor and capital.

Consumers are playing an increasingly active role in determining the course of the economy. Once consumer spending was linked closely to production— how much consumers spent largely depended on how much they earned by producing goods. Consumers were relatively passive, and fluctuations in production caused the ups and downs in the economy. Today, however, the tie between spending and production has been loosened considerably by increased savings, the greater availability of credit, the growing importance of services, and by governmental income-generating programs. Thus, consumer market decisions—to buy or not to buy—are, more and more, a causative factor in the business cycle.

With this additional power in their hands it becomes more important to understand the royal family of consumers and to try to figure out what they are going to do. But, as we have attempted to show, consumers are complex and psychoanalyzing them is more difficult.

As we see it, the royal family will be a tremendous sustaining force in the economy during the rest of the year. But their shifting spending patterns do not seem to contain the ingredients for explosive growth. In fact, the royal family may decree little more than a gently rising economy for several years to come.

THE BIG BULL MARKET OF THE 1950's

Stock market news follows the sun across the country
into the commuter train on the way home from town
and into the living room after dinner
to be digested with smiles and sometimes tears
and discussed in excited or exasperated whispers
on the train back to town the next morning
mixed with advice on howtomakeafortune
from insiders outsiders relatives friends enemies brokers
and other casual acquaintances

Probably no institution is more closely identified with American free enterprise than the stock market. Concentrated in New York City, its activities comprehend the entire country and a good part of the world. The stock market, however, is more than just another important economic institution. Its rise and fall have marked off eras in American life. The 1950's have been a period of resurrection for the stock market and perhaps, as were the 1920's, a distinct era in American life.

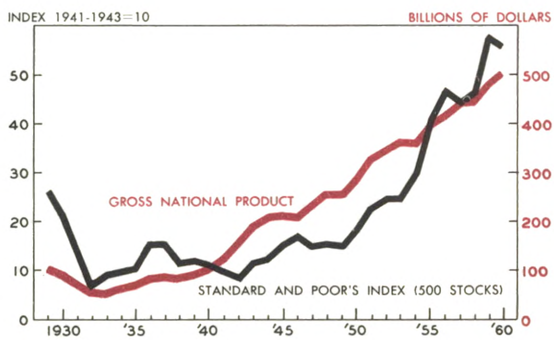
The stock market rose during World War II but then fell somewhat as the war ended. The late 1940's were characterized by stock price stability, despite the fact that the economy was expanding rapidly and prices were rising. The resurgence really got under way in 1950. In that year, Standard and Poor's index of 500 stocks rose about 20 per cent. This was the beginning of the bull market that over the decade of the fifties increased stock prices by more than 275 per cent.

There were breathers during the stock market ascent, particularly during the recessions of 1953–1954 and 1957–1958. While the market was breathing, skeptics held their breath wondering if a serious readjustment was in the offing. But before each economic recovery began the market had already discounted a rosy glow in the minds of investors, rallied, and begun again its mercurial upswing.

Over the long pull, as can be seen in the accompanying chart, the economy and the market have moved together. The 1950's were a period

OVER THE LONG PULL

Since 1929 the stock market and gross national product have generally moved together. In the 1940's the market, by comparison, rose somewhat sluggishly. But in the 1950's stock prices began to increase very rapidly; by the middle of the decade the market had made up all the ground it had lost in the forties; and by the end of the decade, its growth over the previous 20 years, had exceeded that of gross national product.



of economic advance for corporations as well as the economy, and the stock market fully reflected this and then some.

As the decade wore on, people seemed to become more aware of the market and of the possibilities for making money by investing in stock. The market apparently became more important to more people, to their personal prosperity, and perhaps to the prosperity of the economy. For it is possible that during this period the market became more than merely a mirror of current and expected economic conditions. Conceivably, it was also helping to determine what was coming. The stock market depends on the state of the economy, and the state of the economy depends in part, perhaps, on the stock market. There is an old saying in economics that everything depends on everything else.

THE MARKET'S CONTRIBUTION

If you asked ten people at random why they think a stock market exists, the chances are that eight or nine would tell you "to permit people to make money." This is something of a misconception.

The history of security trading goes back to Colonial days in the United States. The history of an organized market goes back to about 1792. In that year, brokers who were conducting business on the lower end of Manhattan Island reached an agreement to conduct their business in certain specified ways. From this beginning, the New York Stock Exchange developed.

The market arose to fill a need. It was a place where buyers and sellers of outstanding securities could meet and exchange securities for money, and money for securities. The market operates to fill the same need today. It exists because owners of securities sometimes desire to trade these securities for cash, and because people who have cash will frequently desire to convert it into the outstanding securities of a going concern. The market facilitates the exchange of cash for securities; and because exchange can be managed so easily investors get a feeling of liquidity, and are encouraged to save and invest. The market's chief function seems to be the encouragement of investment by facilitating disinvestment.

The market also allocates savings into promising issues. A firm with good prospects would find its stock rising and would therefore find it easier to raise funds by selling new stock. In this way the market may help to allocate capital to firms whose products are in great demand.

Some have credited the market with an additional accomplishment—an ability to see around corners and to catch the turns in economic affairs.

THE MARKET AND THE CYCLE

The belief that the stock market is a good forecaster of general business conditions goes back a long way. Perhaps the classic statement was made by S. S. Huebner in 1922. "Without exception," Mr. Huebner asserted, "every major business depression or boom in this country has been discounted by our security markets from six months to two years before the dull times or the prosperity became a reality."*

More recent studies have indeed confirmed the fact that stock prices generally turn down before recessions and up before recoveries, but the relationship has not been so consistent as many once thought. The current belief is that stock market prices frequently lead business conditions and are useful, along with other information, in anticipating the course of the economy; but in and of themselves, stock prices present

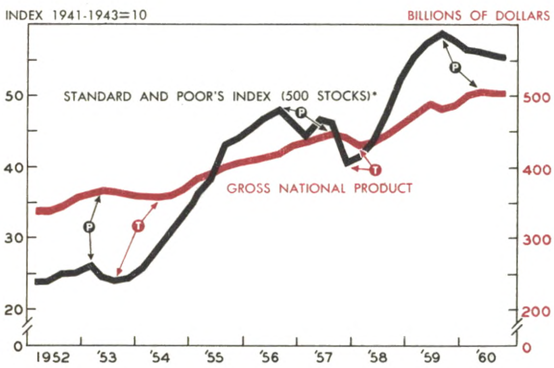
* S. S. Huebner, *The Stock Market*, 1922, pp. 36–37.

some difficulties to the would-be forecaster. They do not invariably lead business conditions and consequently they may at times signal changes that never come about, and fail to signal changes that are imminent. In addition, when they do lead business conditions the time of their lead may vary considerably. It has been found that stock market prices have run as far as 21 months ahead of the business cycle. This makes short-term forecasting on the basis of the stock market alone a bit hazardous.

During the 1950's, however, the market was a pretty good signal of coming events. Each recession, including the current slowdown, and each recovery was foreshadowed one quarter to four quarters in advance by the stock market. In all, there were five cyclical turning points in gross national product and all five were preceded by cyclical turning points in the stock market. (It is, of course, easier to see the turns looking back on the data than looking ahead; short-term fluctuations frequently obscure turning points for a considerable period of time.)

THE STOCK MARKET—A LEADING INDICATOR

During the 1950's, turns in the stock market have generally led cyclical turning points—the peaks (P's) tnd troughs (T's)—in gross national product. In the last half of 1959, a drop in the market anticipated the decline in economic activity in mid-1960.



* Quarterly average of monthly data.

Perhaps the most widely discussed explanation of why the stock market leads general business conditions over the cycle is based on a conception of the market "as the pivotal center where thousands of the leading minds of the world [act] on judgments that [have] reference to the future, not the present." Since these "leading minds" generally watch business conditions very closely and frequently have access to inside information, it was reasoned that their collective judgments, as reflected in the stock market, actually discounted the future and accurately forecasted economic change. "It is only natural, therefore, that the rank and file should regard the stock market as a most incomprehensible affair, always going contrary to what is so perfectly evident at the time."*

While this explanation does not seem unreasonable on the surface, it implies much about the modern-day stock market that has not been really proved. It suggests that the cyclical market movement is largely determined by sophisticated traders who are interested primarily in short-term gains rather than long-term growth. Some traders may move in and out of the market at the drop of a tip about corporate earnings in the next quarter. Some may try to outguess the market by anticipating the reactions of rank-and-file investors to the business news that accompanies ups and downs in the economy. "The . . . object of the most skilled investment today," said Lord Keynes in the mid-1930's, "is 'to beat the gun' . . . , to outwit the crowd, and to pass the bad or depreciating half-crown to the other fellow."†

Of course, once the "rank and file" get wind of an impending change, they are likely to emphasize it by their own buying or selling. But it is also possible that a turn in the market may

* Both quotations are from Huebner, *The Stock Market*, pp. 37, 39.

† John Maynard Keynes, *The General Theory of Employment, Interest and Money*, 1936, p. 155.

not only discount the future, but help to shape it. For a turn in the market does have some significance for the people whose spending largely determines the level of economic activity—consumers and businessmen.

What the market means to the consumer

Between 1952 and 1959 the number of individuals owning stock almost doubled. The records of the New York Stock Exchange show that stock market trading increased and spread out over the country. In these years, when the financial assets of consumers were rising rapidly, corporate stock became the most important asset in the consumer's portfolio.*

Some of the awakening interest in the stock market can no doubt be traced to a rising level of income in the 1950's. During these years, it was typical for about two-thirds of all stock owners to have incomes of at least $5,000 a year. Over the decade, the number of families and individuals making at least that amount moved up from about one-quarter to over one-half of the population.

Continual reports on the progress of the bull market also did their share in attracting public attention. Stock market news was available daily to everyone who read a newspaper, watched television, or listened to radio. Closely following the closing averages were, probably, a large proportion of all who owned stock and all who were thinking of purchasing. The ups and downs of the market may well have been the single most widely disseminated bit of business information.

One would think, therefore, that the stock market and consumer feelings of optimism or pessimism would frequently be closely related; and that the relationship between the market and consumer attitudes might have become increasingly close in the latter years of the decade.

In fact, consumer attitudes and the stock market do seem to have a good deal in common. As can be seen on the following charts, both stock prices and attitudes led the major upturns and downturns of the economy during the 1950's. And stock prices appear to have led attitudes in the recession and recovery of 1957-1958. Moreover, the cyclical movements of the stock market and the cyclical changes in consumer attitudes appear to have moved more closely together as the decade wore on.

Of course, consumer attitudes are, in and of themselves, interesting; but are they crucial to consumer spending? Some, but far from all, strongly believe that they are—that consumer feelings of optimism or pessimism significantly influence consumer spending for "big ticket" items such as automobiles, refrigerators, and washing machines.

The available evidence by no means *proves* that the stock market strongly influences consumer spending. But it does suggest that in the 1950's, there was some relationship between the stock market and the way an increasing number of consumers viewed the world around them.

What the market means to business

The market value of a firm's outstanding stock is one measure of the cost of capital to the firm. When a company's stock is rising, it often becomes more advantageous and less costly to tap the rising market for needed funds.

During the 1950's, while the stock market was advancing, yields on corporate bonds were moving up also. Stock financing was becoming less expensive and bond financing more expensive.

In the past, when this has happened, corporations have increased their use of equity financ-

* See "The Public's Portfolio" in the *Business Review* for October 1960.

ing relative to bond financing. The years 1928 and 1929 are striking examples. In 1928 and 1929 stock prices rose rapidly and corporate bond yields moved up also; the ratio of new stock issues to total security issues increased from .24 in 1927 to .46 in 1928 and .69 in 1929.

The influence of similar conditions in the 1950's is not so apparent. While new stock issues increased over the period, the ratio of new stock issues to total security issues showed no persistent upward trend.

Many observers have pointed out that the corporate income tax today creates a bias against equity financing. The earnings of a company and its owners are taxable, but interest payable on bonds is tax deductible. The tax situation may clearly throw the weight of profitability to bond rather than stock financing—despite changes in market yields and prices.

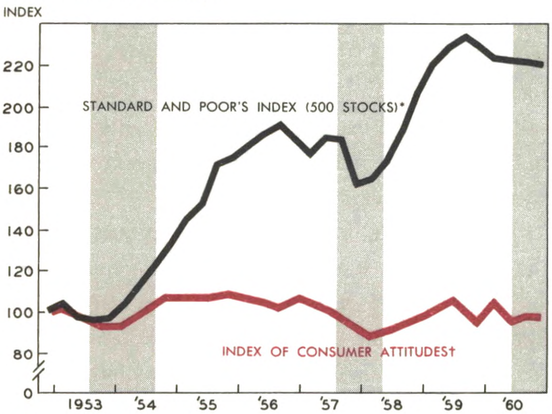
Nevertheless, there is some evidence that suggests corporations did respond to changing market yields and stock prices during the 1950's. In the years of 1947, 1948, and 1949, both stock prices and bond yields were relatively stable. The ratio of new stock issues to security issues averaged .19. During the general upswing in stock prices and bond yields of the 1950's, the ratio averaged .23. And, during the past decade, if we take only the years in which both stock prices and bond yields were rising, we find an average ratio of .26. It seems clear that firms did, at propitious moments, substitute stock financing for bond financing in order to avail themselves of lower costs.

No one is sure of the extent to which high costs of financing deter corporate spending for new plant and equipment. But it seems reasonable to believe that to some extent they do. It also seems reasonable, then, that a rising stock market during the 1950's encouraged some corporate spending that otherwise might not have taken place. Moreover, in each recession of the fifties, the stock market began rising while the rest of the economy was still slumping. A leading stock market would seem favorable to both corporate spending and economic recovery.

The direction of the market, it appears, means

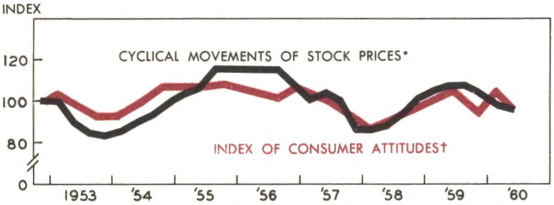
MARKET-SENTIMENT

Consumer feeling of optimism and pessimism, along with stock market prices, typically move in advance of general business conditions. While turning points are not completely clear, the stock market probably moved in advance of consumer attitudes in the recession and recovery of 1957–1958; and, discounting consumer pessimism during the steel strike, moved in advance of attitudes in the most recent downturn in economic activity.



* 4th quarter 1952 = 100.
† Source: Survey Research Center, University of Michigan (Proceedings of the American Statistical Association, 1960); November–December 1952 = 100. Growing optimism is shown by a rising index of attitudes; pessimism by a falling index.
Shaded areas cover reference dates for recessions established by the National Bureau of Economic Research.

Since 1953, cyclical movements in the stock market and consumer attitudes have been fairly close—especially in recent years.



* Cyclical residuals of trend fitted to Standard and Poor's 500 stock index for years 1952–1959.
4th quarter 1952 = 100.
† November–December 1952 = 100.

something to both consumers and business. Perhaps sophisticated traders do discount the future accurately in trading stocks and money; but if their trading is strong enough to change the direction of the market, they would seem to set in motion forces that tend to confirm their beliefs. Other investors may follow their lead and so may business and consumer spending.

THE MARKET AND THE ECONOMY—QUO VADIS

Neither the business cycle nor economic growth can be traced directly to the stock market. The strongest forces probably operate in the other direction, with the market reflecting changes in the level of economic activity. But it would probably be just as much of a mistake to assume that the stock market has no influence at all on business conditions.

Contrary to the beliefs of many, the Great Depression of the 1930's was not initiated by the stock market crash in 1929—the depression began well before those bleak days in late October and reflected underlying structural weaknesses in the economy. But the ragged course of the economy in the years that followed was certainly influenced by the crash. To paraphrase a recent commentator: when a house, however fragile, succumbs in a storm, some of the blame is usually placed on the storm; one must accord some significance to the typhoon which blew out of lower Manhattan in 1929.

Similarly one must accord some significance to the balmy breezes that blew out of lower Manhattan in the 1950's. They made many people feel good and probably encouraged many to spend.

In some ways this was good. For there were times during the fifties when a fillip to spending was desirable. But there were other times during the fifties—and perhaps more of them—when the economy could have done with a little less spending.

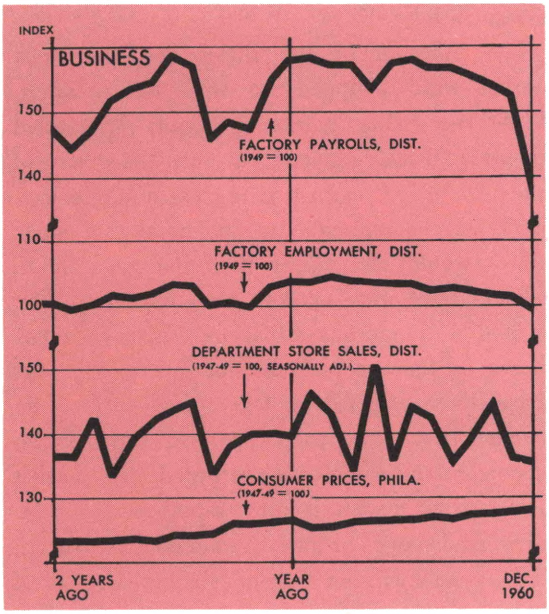
The inflation of the fifties and the stock market were wrapped up with one another. While the rising market probably stimulated spending, it also reflected, in part, the desire of many to hedge against rising consumer prices. Stock purchases, made in the hope that stock values would rise faster than the price level, helped drive the market up; but they also created a dangerous situation. Experience has shown us that people will not indefinitely purchase stocks at prices that give them little or no income now and really promise little or no income in the foreseeable future. If the market rises beyond reason, it must fall when reason returns. And sooner or later, reason does return. All of the people will not discount the hereafter all of the time.

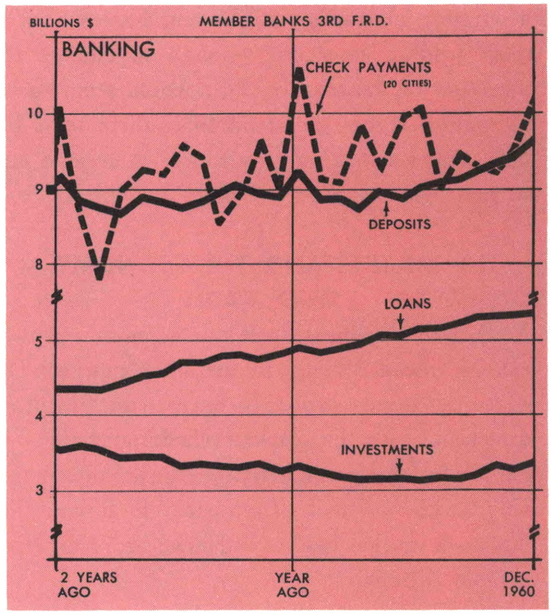
As to the course of the market and the economy in the decade we have now entered, no one is of course certain. In the past few months, the market has shown considerable strength. Observers have wondered if it were not signaling—and, we would add, perhaps helping to shape—the future course of the economy.

Despite its recent show of strength, however, many are predicting that the market will not repeat its rapid ascent of the 1950's in the 1960's. They seem to believe that the current high price-earnings ratios and a more stable consumer price level may prove a barrier to the continuation of the bull market.

Forecasting the stock market is difficult enough a month or a year in advance, much less a decade. But if the forecasters are right in their anticipations, the implication for the economy is clear. Some of the intoxication of the fifties will be missing in the so far so-so soaring sixties.

FOR THE RECORD...





SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	Dec. 1960 from		12 mos. 1960 from year ago	Dec. 1960 from		12 mos. 1960 from year ago
	mo. ago	year ago		mo. ago	year ago	
OUTPUT						
Manufacturing production	−10	−15	− 2	− 5	− 6	+ 3
Construction contracts	−20	−17	−10	− 6	+22	0
Coal mining	− 7	−28	− 4	− 3	−16	0
EMPLOYMENT AND INCOME						
Factory employment (Total)	− 2	− 4	+ 1	− 2	− 4	+ 1
Factory wage income	− 9	−12	+ 2	....	....	....
TRADE*						
Department store sales	0	− 3	0	+ 4	+ 1	+ 1
Department store stocks	− 1	0	....	− 1	+ 4	....
BANKING (All member banks)						
Deposits	+ 3	+ 5	+ 2	+ 3	+ 3	+ 1
Loans	+ 1	+ 9	+11	+ 3	+ 5	+ 8
Investments	+ 3	+ 2	− 5	+ 2	+ 4	− 7
U.S. Govt. securities	+ 3	+ 2	− 7	+ 2	+ 5	− 9
Other	+ 2	+ 1	− 1	+ 3	+ 2	− 3
Check payments	+ 6†	− 4†	+ 4†	+ 9	− 2	+ 6
PRICES						
Wholesale	....	....	....	0	+ 1	0
Consumer	0‡	+ 1‡	+ 2‡	0	+ 2	+ 2

*Adjusted for seasonal variation. †20 Cities ‡Philadelphia

LOCAL CHANGES	Factory*				Department Store†				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change Dec. 1960 from		Per cent change Dec. 1960 from		Per cent change Dec. 1960 from		Per cent change Dec. 1960 from		Per cent change Dec. 1960 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Lehigh Valley	− 2	− 2	− 6	− 8	....	....	....	....	0	− 5
Harrisburg	− 4	− 9	− 8	−19	....	....	....	....	− 1	− 6
Lancaster	− 2	− 5	− 6	− 6	+ 5	0	+ 7	+ 4	− 4	− 9
Philadelphia	− 2	− 3	− 9	−11	− 1	− 5	− 1	− 1	+ 5	− 7
Reading	0	− 4	− 5	−10	+12	+ 1	− 3	− 5	0	− 2
Scranton	− 1	− 5	− 1	− 5	+ 8	− 2	+ 2	− 3	+ 1	− 4
Trenton	− 5	−16	−10	−23	+ 1	0	− 2	+ 8	+ 4	+ 2
Wilkes-Barre	− 3	− 5	− 3	− 5	+ 2	− 3	− 1	−12	+ 5	+ 5
Wilmington	− 1	+ 2	− 1	+ 5	0	− 4	+ 2	+ 2	+28	+ 6
York	− 1	− 1	− 8	− 9	− 4	− 4	+ 4	+ 4	+ 3	−14

*Not restricted to corporate limits of cities but covers areas of one or more counties.
†Adjusted for seasonal variation.