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THE SECURITIES BUSINESS AND CONSCIOUSNESS III

by

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before the

Joint Meeting of the

Indianapolis Society of Financial Analysts

and the Financial Executives Institute

Indianapolis, Indiana

December 10, 1970

THE SECURITIES BUSINESS AND CONSCIOUSNESS III

A person reading the financial pages these days might get the impression that the securities business--or some parts of it, at least--is in trouble. Failures have raised doubts about how adequately brokerage houses are capitalized and how well the industry is regulated. There is criticism of the commission structure. The "third market" is a continuing threat to the establishment. And the industry is arguing among itself.

I am not competent to analyze these problems and don't intend to talk about them. Instead, I should like to look into a development which could have even greater impact than these problems on your industry. This is criticism of the business by those--mainly young people--who are expressing an active concern about social justice and the quality of life. In fact, I am surprised that your industry has so largely escaped such criticism. After all, for those who profess to believe in the pursuit of the good life rather than the buck, the securities industry would seem to be a logical target. Considering the problems of our times, buying and selling securities, analyzing market trends, determining resistance levels and breakthroughs might seem to them rather frivolous and unproductive ways to spend one's time.

There is, of course, a rationale for securities markets and for those who work in them that makes good economic sense and is socially acceptable. What I want to do this evening is: (1) to spell out this rationale as I understand it; (2) to view this rationale (as nearly as I can) through the eyes of socially concerned youth; (3) to suggest

some implications of this view. At all times I am speaking as an outsider to the industry. As such, I bring to the subject no special expertise but, hopefully, some objectivity. And I am not so much interested in preaching conclusions of my own as raising questions to think about.

Rationale for securities markets

Let me now spell out in very simplistic terms the traditional economic role of the securities markets. The most important one is to help allocate scarce resources. Conglomerated Computers Corporation needs money to build a new safety pin factory and, through an underwriter, enters the new-issue market where it competes with others in need of funds. Investors--intermediaries like insurance companies as well as individuals--make decisions about whether to buy and at what price. Behind all of the financial trappings of this operation is a transfer in the command over real resources. Conglomerated Computers gets the wherewithal to buy materials and hire labor. And in all of this the security analyst plays a key role.

Only a small proportion of securities transactions, of course, involves shifts in the command over real resources; most of them involve trading in outstanding issues. There is a close relationship between trading in secondary markets and raising new capital; if investors like Conglomerated Computers and are willing to pay a high price for its stock, the corporation finds it easier to raise new money. But the main function of secondary markets is to provide liquidity. A good market for Conglomerated enables an investor to get out easily if he needs cash or wants to switch to IBM.

In the process of performing their economic role, securities markets respond to needs of society. When Conglomerated Computers raises funds to build its factory, it is responding to (or anticipating) a need for its product. If analysts and investors think the outlook for Conglomerated is good, they facilitate the shifting of real resources necessary to help meet society's needs.

Again, this is a greatly over-simplified description of the traditional role of securities markets and security analysts. But I think it is sufficient for us to take the next step and examine how the young person concerned with social matters might look at the same process.

Consciousness III

Perhaps the most up-to-date description of the state of mind of today's young people is that by Charles Reich in The Greening of America. Reich calls this state of mind Consciousness III.

Consciousness I, he says, is the traditional outlook begun in the 19th Century and held by the farmer, small businessman, and worker. It was a simple, human view of the role of the individual. Consciousness II describes the values of organizational society in which the "corporate state" dominates everything. These are the values of a non-human, technological, self-seeking, consumeristic society.

Consciousness III began in the mid-1960's. It is a new view of the promise of life but at the same time a disillusionment with existing conditions. It emphasizes the "discrepancy between what could be and what is." Those who hold this view stress human rather than material values, quality rather than quantity, emotion rather than reason,

technology as servant rather than master. They feel "full personal responsibility" to take action in matters that need reform. However, according to Reich, reform will not take place through violence or politics, but "revolution by consciousness." In other words, the kids either will convert the rest of us or, in any case, will soon take over anyway.

How might a young person taken with Consciousness III react to traditional rationale for the securities industry? He could do no better than to go back three and a half decades for another view of the way the markets work. This he could find in that landmark of economics which you are all familiar with--Keynes' General Theory. Keynes, who as you know was no babe in the woods when it came to making a killing in the markets, had this to say:

> It might have been supposed that competition between expert professionals, possessing judgment and knowledge beyond that of the average private investor, would correct the vagaries of the ignorant individual left to himself. It happens, however, that the energies and skill of the professional investor and speculator are mainly occupied otherwise. For most of these persons are, in fact, largely concerned, not with making superior long-term forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the conventional basis of valuation a short time ahead of the general public. They are concerned, not with what an investment is really worth to a man who buys it "for keeps", but with what the market will value it at, under the influence of mass psychology, three months or a year hence....
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> Thus the professional investor is forced to concern himself with the anticipation of impending changes, in the news or in the atmosphere, of the kind by which experience shows that the mass psychology of the market is most influenced.... The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelop our future. The actual, private object of the most skilled investment to-day is "to beat the gun", as the Americans so well express it, to outwit the crowd, and to pass the bad or depreciating, half-crown to the other fellow.

... it is, so to speak, a game of Snap, of Old Maid, of Musical Chairs--a pastime in which he is victor who says Snap neither too soon nor too late, who passes the Old Maid to his neighbour before the game is over, who secures a chair for himself when the music stops. These games can be played with zest and enjoyment, though all the players know that it is the Old Maid which is circulating, or that when the music stops some of the players will find themselves unseated.

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If the reader interjects that there must surely be large profits to be gained from the other players in the long run by a skilled individual who, unperturbed by the prevailing pastime, continues to purchase investments on the best genuine long-term expectations he can frame, he must be answered, first of all, that there are, indeed, such serious-minded individuals and that it makes a vast difference to an investment market whether or not they predominate in their influence over the game-players. But we must also add that there are several factors which jeopardise the predominance of such individuals in modern investment markets. Investment based on genuine long-term expectation is so difficult to-day as to be scarcely practicable. He who attempts it must surely lead much more laborious days and run greater risks than he who tries to guess better than the crowd how the crowd will behave; and, given equal intelligence, he may make more disastrous mistakes. There is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable.

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...The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of laissez-faire capitalism--which is not surprising, if I am right in thinking that the best brains of Wall Street have been in fact directed towards a different object.

In effect, Keynes in the thirties argued that the way in which the market was supposed to work in performing its two main functions--providing liquidity and allocating resources--was quite different from what really happens. It might provide liquidity for the individual

investor but not for all investors combined; and preoccupation with short-run gains gets in the way of allocating resources according to long-run needs. Today, a casual glance around might suggest to our committed youth that "the best brains of Wall Street" are still pointed in the direction they were when Keynes observed them. Performance may not be quite the standard of success it was before recent chastening experiences, but it is still very much there. And, in contrast to the situation in Keynes' day, with the growth of mutual funds and other such investors it has become deeply ingrained institutionally.

The young person imbued with Consciousness III might well question not only the ethics of spending one's adult life trying to beat the other guy but whether there is something an industry might do that is socially more productive. Is it all worth the millions of manhours poured into analysis? Do the sharp fluctuations in stock prices serve a worthwhile social purpose? And, behind it all, are real resources being directed to socially worthwhile uses?

Implications

I don't really know what all the implications (if any) of such an attitude might be, but let me suggest some possibilities.

Possibility #1. A belief that your industry is failing to perform a worthwhile social function could lead to the kinds of criticism which some other industries have felt recently and which is forcing reforms. The automobile industry has been criticized for disregarding auto safety; it has been responding. Utilities and others have been criticized for polluting the environment; they have been responding. If the securities industry is criticized,

say, for favoring large institutional investors over small investors, or for undue secrecy in its operations, it too might have to respond. These and other kinds of criticism, of course, are coming from several quarters. But they might well be extended by another kind, directed toward the preoccupation of the industry with short-run gains and toward the impact on allocation of resources. The result of both kinds of criticism might be that the industry's freedom of action could be considerably more constrained in the future than it has been.

Possibility #2. An indifferent public could slow the growth of the securities industry. This might happen if, as today's youth take over the economy, they were to decide that analyzing, trading, and even investing in securities is really not worth all the time and effort it takes. At the same time, the industry might have difficulty recruiting enough interested people.

Possibility #3. Ways might be sought to guide the securities industry into what are considered more socially desirable directions. In recent years young people have used their influence on universities to vote proxies with certain social ends in view. It is now fashionable to talk of the social responsibility of business; corporations are being urged to look beyond short-run profits to the longer-run impact of their actions. Similarly, security analysts might be urged to pay more attention to social

costs which certain industries may impose or social benefits which certain industries may confer. These costs and benefits would require analysts to develop unconventional accounting and analytical techniques.

Possibility #4. Government action (either by incentives or restraints) to deal with social problems might influence the profitability--in the conventional sense--of certain industries. The hope would be that if Government could take steps to induce corporations to undertake socially desirable action because it is profitable for them to do so, the traditional market process might be made to work better.

Possibility #5. Consciousness III may turn out to be limited to relatively few people or just a passing phase. In either case, there might be little or no impact on the securities industry at all.

Conclusions

Which of these possibilities do you prefer and what might the securities industry do to influence the outcome? First, you might be tempted to hope the problem will not amount to anything (Possibility #5). If you want to take this tack, I suggest the first thing to do would be to burn all copies of Adam Smith's The Money Game. I can imagine the dismay and indignation of a sincere Ralph Nader type as he stumbles onto the book for the first time. Chapter 17 on "Losers and Winners" might hit him particularly hard. You may remember the part about Poor Grenville, the fund manager whose "nails are bitten down to the nubs" because he

is in the awkward position of holding $25 million in cash with the market going up. It finally was decided that he should get

> ...back in the market, $25 million in one big gulp. He bought a mixture of high flyers like Xerox, Polaroid, and garbage. And that was part of the reason for the roily-boily market we had a while ago. The cyclical stocks reflecting business were sold down all they would go. Then along came Poor Grenville and his gunslinger competitors selling stocks because stocks were going down, riding with the trend instead of against it.... When the gunslingers hit the volatile stocks, Fairchild and Xerox and Polaroid and what have you, they knocked them down so hard that the x's on the chart made downtrend lines and then the downtrend said sell, and then you just didn't want to show a bombed-out stock in your portfolio; it made you look dumb. So out went all the bombed-out stocks. Somebody has to be last at this sort of game.

Since I doubt if you can cover up all aspects of the game, you might be better advised to prepare yourself for some criticism (Possibility #1). Chances are already good that you will be reading headlines like: Congressional Report Recommends Drastic Change in Commissions. But in addition, there could be others: Students Stage Sit-in; Demand Voice in Running Stock Exchange. You may be harder pressed than ever before to justify your existence, to explain just how the pursuit of short-run capital gains helps solve problems of the poor, the city, and the environment.

As you prepare your case, I suspect you may find it difficult to show a clear and direct relationship between the search for profit and social welfare. (Possibility #3) One can argue, as many do these days, that, say, corporation investment in the ghetto is perfectly consistent with the profit motive if one takes the long view; corporations may not have any profits if they don't do something about the core city. But this solution requires such radical changes in orientation, in calculating profits, that it may be expecting too much.

Perhaps a more feasible approach is that in Possibility #4; that is, for the securities industry to work with Government in providing whatever inducements are necessary to make social action by business profitable even in the short run. If this can be accomplished, the securities industry might, with some modifications, still act in its traditional ways and come closer to meeting social needs. For example, suppose the Government were to devise means--say, by tax incentives--to make investment in anti-pollution devices profitable. Analysts would recognize this, the market would reflect the analysts' judgment, and shifts of resources to this kind of effort would be facilitated. There would be no need for business and analysts to make elaborate calculations of social costs and benefits, trying to factor them into their evaluation of securities, and then trying to convince everybody that a security is really worth something other than the market thinks it is.

Finally, to the extent you succeed in reexamining and justifying your reason for existence in today's world of social concerns, I suspect you can minimize Possibility #2--that is, a diminishing role in society. You may find gunslinger types like Poor Grenville becoming a rarer breed, and you may find fewer people on commuter trains preoccupied with the day's closings; but this is pure speculation. In any case, the industry should be on a sounder basis for growth if it can feel comfortable with itself that it is fulfilling a worthwhile social purpose and if it can make that purpose understood and acceptable to the people who, before very long, will be running things.