

THE PRESENT AGITATION OVER SHORT SELLING

To the careful student of finance, the recent agitation against short selling appears only as a discouraging evidence the economic education remains decidedly limited. The bursting of every speculative bubble in recent history has produced similar outcries, and it is a sad commentary on human nature that mankind seldom admits guilt and through rationalization always discovers a scapegoat. Fundamentally, the present excitement is the age-long story of speculation, and of the moth that went too close to the fire. Many intelligent, though uninformed people, fail to discover ^{even} this basic factor and permit their vision to be obscured by personal losses and an anthropomorphic conception of so-called bears. And this failure to grasp the real issue has been further aggravated by placing undue emphasis on the much publicized activities of the New York Stock Exchange.

Then, in order to think clearly on this matter, let us recognize at the outset that the New York Stock Exchange is only one of the capital markets of the world. Historically it has arisen as a necessary adjunct to the industrial revolution. Capital markets became essential to finance big corporations, and as America became the leader in corporate development it followed as a natural sequence that in the New York Stock Exchange America evolved the outstanding share market of the world. Now there is more glamour in capital markets than in others, just as there is more appeal to the casual observer in the great rolling rooms of the United States Steel Corporation than there is in the storing of wheat or

the planting of rice. It was through this brain befogging fascination that General Dawes, in his picturesque manner, was attempting to penetrate, when he recently characterized Wall Street as a "peanut stand".

The New York Stock Exchange is even more mysterious to the average man than is electricity, but whereas he perceives quickly the dangers adhering to electricity, he fails utterly to sense the perils lurking beneath the babbling quotations on the Exchange. Many people are benefited by electricity, but these people do not play with the wires nor do they experiment with the current. Technicians, protected by rubber gloves and scientific knowledge and experience, are constantly working to further develop electrical energy, and yet despite their precautions many perish in the laboratory. And if a specialist often comes to grief it is small wonder that the layman is invariably injured. The same applies to operations on the New York Stock Exchange. One of the most marvelous mechanisms of the machine age, it has made it possible for the small man to participate in corporate development through purchases of shares in leading equities. And as long as he buys with savings and for the primary purpose of acquiring income he is similar to the consumer of electricity and we believe will in time derive as much benefit but as soon as he uses credit and buys on margin, he is like the man who plays with electricity without rubber gloves. The first man is an investor and if short selling works to his detriment we desire to abolish it. The second man is a speculator, and while we may urge him to exercise caution, if he fails to do so, we cannot feel any great responsibility for him. Because of his inexperience he struggles under the illusion that he is an investor and invariably purchases stocks. If the market

rises his equity increases and his worries over margin calls diminish. He was short money so he borrowed to go long stocks. His rallying cry was never to sell the United States short. Buy it, even if you can't pay for it. The short who has gone long money and short stocks has his margin cut down and must either buy in his stock or raise more money. The stock has proved more valuable than the money and he is forced out to the great delight of our eager bull. When the shoe is on the other foot and the stock goes down our bull speculator feels hurt and incensed to think that anyone should be taking advantage of his misfortune. He cries loudly about destroying the country and menaces to civilization, little realizing that his rampant enthusiasm may have been as unfortunate for the country as too violent exercise often is for the individual.

Now, every intelligent man and woman knows that countries are neither made nor broken on stock exchanges. Too many people have acquired the fantastic notion that patriotism centers on the floor of stock exchanges and that George Washington, were he to return in the flesh, would become the leading operator of the present day. What utter nonsense! The great bulk of the people, even today, despite stories of chorus girls, bellhops, etc. in the market, do not have the faintest conception of what the New York Stock Exchange is and move placidly about the factory or the farm, as their calling may be. The Stock Exchange is a visible reflection of their efforts, not they a reflection of its energy. The sooner we realize this the better off all of us will be. High wages do not produce prosperity, as President Hoover has endeavored to make us believe; on the contrary, property is the only thing that can make for high wages. And, similarly, it is putting the cart ahead of the horse to talk about higher stock prices leading to good business. One of the great troubles with

the present depression is that too many business men and bankers are looking at the reflection in the mirror rather than at the face itself. We talk and think in terms of reflections and illusions, rather than actualities and possibilities.

Neither the bull nor the bear can alter basic values over a period of time. These fundamental market values are produced by long buying and long selling, emanating principally from business men who know thoroughly their own companies. Both bull and bear attempt to sense the buying or selling, and ultimately their success or failure depends upon the rapidity of their adjustments to these norms. And it is on account of this elementary factor that short selling statistics become worthless and murky thinking evolves.

If one adheres to the view that short selling stabilizes the market, and it does in the relative sense that it would be even less stable without it, nevertheless, how can we explain the fact that there are invariably less shorts at the top and more at the bottom of the market than at any other time? Yet the answer is quite simple; it is that ~~very~~ factor which determines a top or a bottom. Whenever there are a great many shorts in the market, look for a bottom, and whenever there are a great many longs, look for a top. This is because despite popular ideas on the subject, speculators are followers, not leaders. They do not initiate trends, except in the sense that they lead them after their base has been laid. And recognizing this it takes little reflection to perceive that short selling is far more beneficial to ~~amarket~~ than is long marginal buying, and that if we permit the latter while abolishing the former, we have inflicted a severe penalty on the investor. If one desires to abolish both short selling and long marginal buying, we cannot

quarrel with his logic, except on the grounds of economic retrogression, but to eliminate one without touching the other is to deliberately unbalance the scales.

We fully admit that short selling is neither the constructive influence in the market its proponents hold (because in practice it does not work as in theory) nor is it the destructive force its critics suppose. In some cases it serves as a market stabilizer, while in others it unquestionably is a demoralizing influence. However, in both instances these are particular situations and quite aside from the general rule. The functional purpose of short selling is to facilitate business in much the same way as checks do. It is simply stated the keystone in the arch of liquidity and as such protects the investor by furnishing him with one of his most necessary requisites.

We hear a great deal about bear raids and the demoralization of the market by unscrupulous operators. We do not deny that such exist, any more than we deny that there are murderers and kidnappers still in existence, despite our laws. Against this rare contingency every stock exchange has legislated from the beginning and the New York Stock Exchange, under Article XVII, section 4, has provided for expulsion of any member deemed guilty of attempting to do this. If we were to destroy all the instruments that can occasionally be misused there would be little of our machine age remaining. And while we hear a great deal about bear raids we quietly acquiesce in bull raids and bull pools. They, of course, are patriotic. Put prices up to the sky and never a word of warning. And yet we maintain that if legislation honestly desires to protect the American investor it must begin here for this brings us to the root of the entire matter.

When one inveighs against short selling one cries out against market speculation. There has been an intelligent outcry against this from time immemorial, and from a theoretical standpoint, justly so. Millions of dollars are lost every year by speculation and over a long period of time the number of speculators who have made big money and kept it can be listed on the fingers of one hand. Yet from a practical standpoint, all sane economists have been forced to recognize the legitimate place of such speculators. Their losses have been the insurance premiums which little and big investors would have been otherwise forced to pay for that element so necessary to successful investing in a world of varying vicissitudes, namely, liquidity. We do not condone this loss, but we recognize it as a definite factor in modern economy, just as we recognize the physical loss so often incidental to human achievement.

However, we must pause here for a moment to emphasize the thin but none the less tangible line dividing speculation from gambling. The speculator buys or sells for the purpose of making a profit. The gambler neither buys nor sells. He simply bets that prices will go up or down. Now it is our contention that credit became so abundant in 1928-1929 that great hordes of people were usurping the place of speculators and so meagre was their actual purchasing power they were virtually bucket shop gamblers. One prominent and well informed floor trader, in recounting 1929 experiences apologized to the writer for being caught long in the market when it broke, as follows: "What could I do," he said "but follow the band wagon when I discovered to my sorrow that to sell short several thousand shares of a medium priced issue was like throwing fish to a sea lion, and that while I worried about having such a large

possession, some chauffeur or gardener probably bought my entire line and slept soundly dreaming of the money he'd send his folks in dear old Ireland." Such a regrettable state of affairs was not caused by the absence of short selling any more than the present decline has been caused by its presence, but by a failure to control credit. Credit is the base of this whole structure.

Let us not then waste our energies attacking ghosts such as short sellers, unknown individuals which assume superstitious proportions as Voodoo idols. How many times have we heard about the Machiavellian "They"? "They" are going to push up Copper or Can. "They are bearish or bullish." "They are selling Telephone." "They are about to raid the market." Let us educate ourselves beyond this stage of "the goblins will get you if you don't watch out," and casting aside this personalized intangible "they" perceive the impersonal tangible "they" that is connoted by the word credit. Literally, billions of dollars have been utterly destroyed and untold human misery and tragedy caused by excessive and unwarranted grants of credit. Let us then face the problem squarely and recognize that when we are able to devise a means of controlling credit within reasonable limits we will not worry about such straw men as short sellers and the world will have a sounder prosperity than it has ever had before.

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