INTRODUCTION

Many stories have been written about the the famous Stock Market Crash of 1929, but I am aware of none that have delved into the bull market beyond the last few months before the crash. Countless people have been fascinated with the crash and have made all sorts of false assumptions that the speculative fever was intensified by margins which are only 1O%. That statement is completely false and, in fact, many stocks were not available on margin at all. Others paint the picture that a vast portion of the population was involved, right down to shoe shine boys. Again, we will see that this was a gross exaggeration. One book, "The Day The Bubble Burst," is an excellent accounting of the social impact of those trying times. The cast of characters is unsurpassed and provides a look into the private lives of some of the people who were the biggest players.

But from an analytical perspective, the atmosphere that surrounded the market at that time is a very important area to explore. Far too often, economists and market analysts assume that such catastrophes are freaks in the marketplace and that they will never happen again. Others try to inject the famous Kondratieff cycle into the stock market and proclaim that the end is near. Some have been calling for a devastating collapse ever since 1982 and each year they crawl out from under their rocks to proclaim that this is the year that the market will collapse to 10 cents on the dollar as that infamous month of October approaches.

Other hard-money advocates beat their chests, warning that everyone must buy gold and claiming that this deflationary wave in the 1980s is only the beginning of a situation similar to that which took place in 1929. But they should go back in history and understand what took place. If they look at a simple chart they would see that the collapse from 381 to 40 points on the Dow Industrials took place in the span of three short years. Such disasters have always come without warning and the process has never dragged out over a period of four to six years. Normally the pain has always been swift and to the point and panics are just that, panics which take their toll in the course of one to three years.

It is a widely known fact that nearly 90% of money managers have been unable to beat the Dow or the S&P in performance. It is always easy for someone on the outside to look in and criticize a money manager for his performance. When it comes right down to it, most managers are damned if they do out-perform by critics who say they have been too aggressive. If they perform less than the Indexes their critics say that if they had just bought the Dow stocks they would have been ahead of the game.

Trading any market is difficult to say the very least. Judging someone's performance on the surface tells little about his system or his analysis. For example, take two managers who both made money on the stock market rally between September 1985 and April 1986. One bought the market because he felt that the economy was going to heat up and he realizes that inflation brings with it growth for many industries. The other manager bought the market because he thought there was going to be a discount rate cut. Both may have made money, but the gains were based on two totally different fundamental principles.

The difference between the two managers may eventually show up only when the fundamental long-term ideas of one trader or the other prove to be wrong. Then one will continue to make money and the other will suddenly become a net loser. The loser will chase the market, inevitably getting chopped up back and forth while the other will consistently do well if his long-term concepts remain in the proper perspective.

Therefore, we find that trading managers come and go not merely for small private accounts, but for the big institutions as well. People have a tendency to judge managers on a short-term basis and many scrutinize each and every trade, when, in fact, it is the long-term that counts the most.

The short-term trading or analysis of the stock market has always been the worst. Sure, some analysts have done quite well calling the market for short-term moves, but eventually it turns out to be periodic and lacks consistency. The long-term is something that most people vacillate over, switching their opinions on a short-term basis from bullish to bearish. How can an investor achieve consistency, or at least make sure that if he misses a short-term move, he is not caught on the wrong side of Wall Street?

If you want to know what the future holds, you need a map of the past to at least provide a guide as to what is or is not possible. Far too many people fail to look at the events of the past as a whole, but single out only an isolated period to support an unwarranted assumption to arrive at a foregone conclusion.

While some argue that 1929 is knocking at our door, others laugh insisting that such events are not possible in this day and age. Economists, in their efforts to support their biased Keynesian conclusions, attack the protectionism acts as the cause of the Great Depression. Others blame the massive collapse on the over-speculation that preceded it. In all, most accounts are totally inaccurate and others lack the details of the real events during that era because they have merely skimmed the surface.

On the contrary, the events which took place between 1921 and 1929 are very important. The fundamentals in many areas are the same as we see today and there are undoubtedly many parallels between the past and the present. However, was the blame for the Great Depression justifiably put on the stock market? In fact, is the stock market the almighty leading indicator to the economy as it was believed then and as it is still perceived today? Should we be listening to the "warnings" of impending disaster or are we on the verge of a new era where the Dow industrials will soar to 3500 or beyond? How does one get a feeling for what the future holds? Should we wait and watch for moves in the discount rate? Does the first up tick in interest rates mean disaster cannot be avoided?

One of the best ways to get a grip on the situation is to clearly define what the market has done under what conditions. Analysis is supposedly the art of taking a known relationship or a proven technical method from past performance and projecting what the future performance maybe. If this is the only means by which we can objectively take a shot at the future, then perhaps it is best to sort out those fundamental relationships and make certain that the stock market does react in the manner that "generally" accepted beliefs would have us assume.

One huge problem for most people is an understanding of just which fundamentals truly move the market. At times you find analysts cheering for deflation and lower interest rates, which, in their minds, will entice people to buy stocks. But just think about it for one minute. If deflation is the situation and the economy cools down, doesn't business in general also cool off, thereby reducing corporate income?

The generally accepted relationship of the stock market to interest rates has been higher rates mean lower stocks. The thought behind this is that higher rates increase the cost of margin. Accordingly, people will buy fewer stocks and therefore stocks must go down. The emphasis has been placed upon the speculation and not the true economic impact. During the early 1920s prior to the crash, the generally accepted fundamental relationship was that stocks rise with higher rates and decline with lower rates.

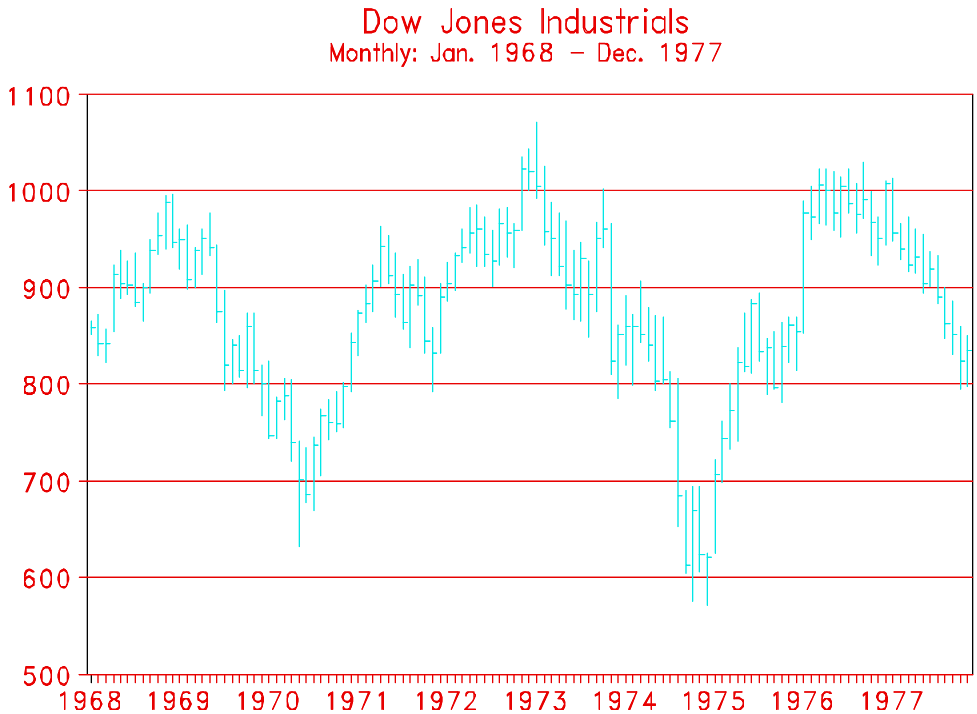
It is true that interest rates collapsed between 1929 and 1932 along with the market. Interest rates collapsed from 1919 to 1921 and so did all commodities and stocks as well. Each depression had been marked by a decline in interest rates and each bull market took place when business expanded and borrowed more to fund their expanded levels of business. It is true that interest rates bottomed in 1976 and rose into 1981 while the stock market held the 1974 low and moved up with the inflationary cycle into 1981, peaking only slightly ahead of interest rates. There was no direct relationship to the contrary.

So what is the answer? Does the market rally with lower rates all the time? Obviously not! So under what conditions will the stock market rally when higher rates exist? This is just one vital question that needs to be answered.

The past has a tremendous amount of knowledge to offer if one merely takes the time to study what took place. For example, did you realize that foreign loans were also a major concern in the 1920s? Did you also realize that the economy has always expanded only during inflationary times and never during periods of deflation? But then why do most people say that the stock market doesn't do very well against inflation if true industrial expansion takes place during inflationary periods? Is the stock market overbought because it stands at its all-time highs or is it in fact the best buy in 50 years? What about all the takeovers? Is that good or bad for the market? There was a tremendous number of takeovers and mergers between 1927 and 1929 just before the crash. Does that parallel mean it is a warning of impending disaster?

Many people are trying to forewarn of a massive collapse in the stock market. Others say it will remain bullish as long as interest rates decline. Still others have honestly projected that interest rates will continue to drop into 1989 and the Dow will reach in the "thousands." A few doom and gloom guys crawl out from under their rocks every year to proclaim that October will collapse just like 1929. Widows and orphans will be cast into the streets and suicides will become a common everyday event on your local street corner. Earthquakes will strike Wall Street itself and man will be punished for being so presumptuous as to have ever taken the Dow above 1,000 in the first place.

Well perhaps if those people (who are just outright mad at the rest of the world for



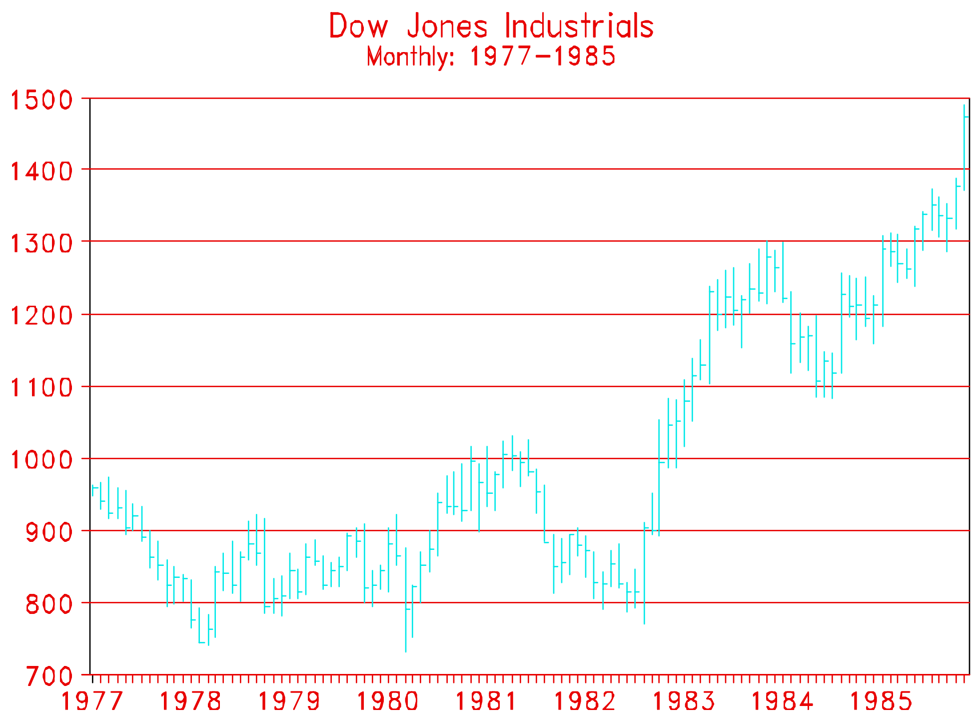
making any profits when they have been short every step of the way up) keep crawling out every year, one of these days they may be right during that fatal October. But perhaps they should go back and read the newspapers from 1869. Then it was September 24, 1869 which became known as "Black Friday." So maybe they had better hedge their bets and not let everything ride on October every year. And those people who foolishly think that interest rates will continue to ease beyond 1986 had better read each page of this report twice and commit it to memory!

Is the Dow really in lofty heights? How does one measure such territory where charts have never before dared to enter? A little exercise in comparisons might shed some light on the subject. But then again, it might not mean anything at all. Nevertheless, it's certainly worth exploring.

The Dow Jones Industrials reached a peak of 381.44 in September of 1929. The CPI stood at 51.3. In 1985, when the Dow hit a new high in July, the CPI stood at 322.8. If we adjust the 1929 high for inflation, we find that the 1929 high in 1985 terms would be 6,064. The CPI has increased 629% since 1929. Boy, talk about being a poor investment over the long haul!

Just for the hell of it, let's see how the Dow held up to the expansion in the money supply. Money supply (M1) stood at $26.5 billion in 1929 compared to $595.8 billion in 1985. That comes out to be a 2,248% increase. If the Dow had appreciated in comparison to the growth in money it should be 8,574.77! Well, so it's lagging a little, big deal.

How about a comparison of the Dow to public debt? In 1929, the public debt stood at $16.9 billion and in 1985 it has grown up quite impressively to $1.823 trillion, which works out to be a 10,787% increase. Obviously, if the Dow had kept up with government spending it should be 41,145. Boy that certainly makes 2,500 seem awfully cheap.



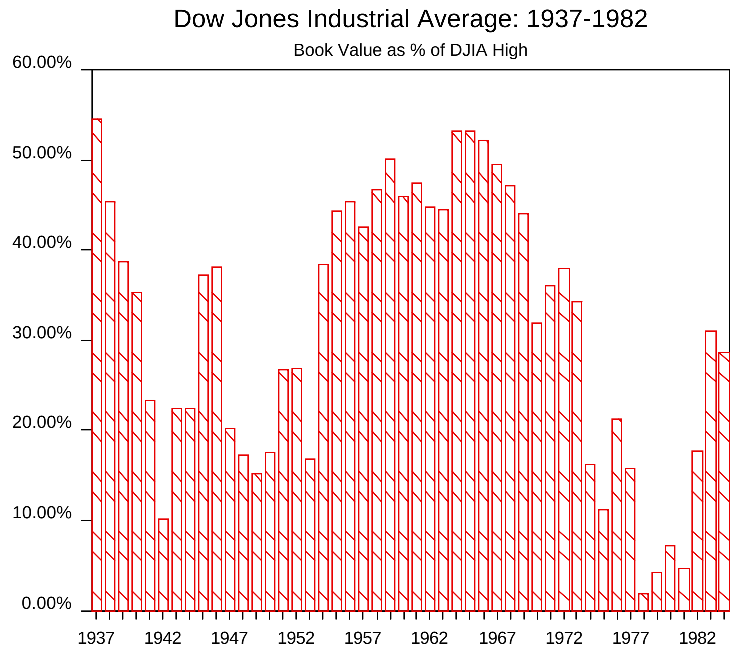
Well, these comparisons might be the revelation of a lifetime, but then again put them alongside a dollar and they just might buy you a $1 cup of coffee around Wall Street these days.

Is there something in this world which one can measure anything against to render a fair comparison of worth from one day to another? Ever since we abandoned the gold standard and moved on to this politically backed paper monetary standard, comparisons seem to be far more difficult to come up with. There is a huge imbalance from what everything used to be and where it now stands.

Since we are looking at industrial stocks, perhaps we should use the GNP to compare their performance with the production expansion to which these companies contributed. GNP, expressed in constant 1972 dollars, stood at $103 billion in 1929. In 1985, it stood at $1,671.6 billion ($3.8 trillion in current dollars). Therefore, in constant terms GNP had grown 1621% since 1929. The Dow would have to stand at 6,183 in order to maintain parity with the GNP.

Quite frankly, trying to find something against which the Dow has performed appreciably better is simply not so easy. If we compare the price of gold to the Dow, we find that in 1929 gold was $20 and in 1985 at the end of July, when the Dow had reached its new high, gold closed the month at $327.10 on spot in New York. This is a gain of 1635.5%, while the Dow from the 1929 peak to the July 1985 peak had appreciated only 361%. The truth of the matter is that the only thing I was able to find that lagged behind the Dow was the increase in the civil labor force, which stood at 49.2 million in 1929 and currently stands at 115.3 million, an increase of merely 234%.

Why has the Dow performed so miserably in comparison to just about every other indicator and to gold itself? Is there something we are missing? Is there something the Dow has to offer to vindicate itself for such a terrible long-term performance? To

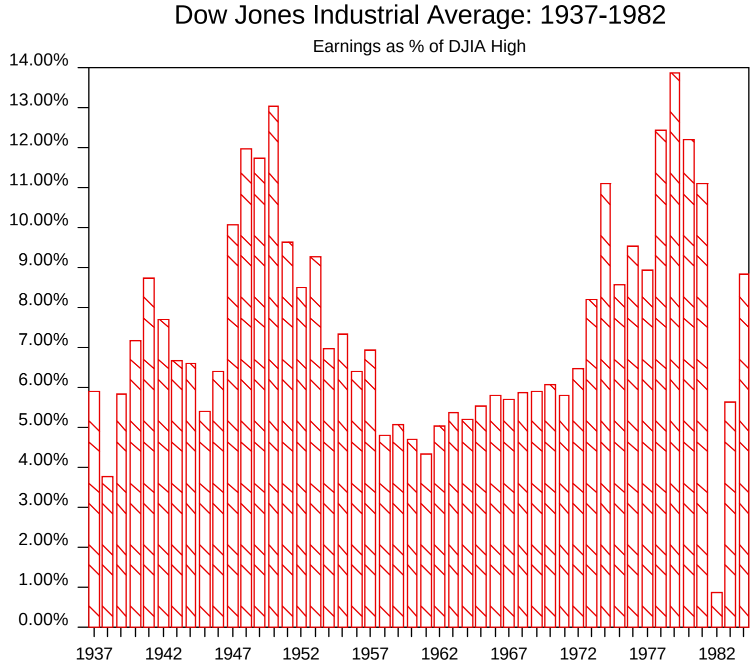


some degree the answer to that question is yes. Since 1929 the total amount of dividends paid on the Dow Industrials has been 1305.42 at the end of 1984. If one were to add this to the July 1985 high, it would be equivalent to nearly 2700.00. Although this is still a far cry from 6000.00, it is at least bringing it up a little closer.

Let us look at the Dow in comparison to the composite book value. In 1937, the book value was 88.30 while the Dow had reached a peak on March 10 at 194.40. This meant that the Dow was trading at better than double the book value. At the end of 1984, the composite book value was 916.70, while the Dow closed out the year at 1211.57. Obviously, a comparison of this rally to the rally of 1937 still shows the Dow lagging behind. On the 1973 rally when the Dow closed at 1051.70 on January 11, the book value stood at 690.23. Again, this rally was shy of the levels achieved during 1937, but the 1985 rally has still not reached the heights of the 1973 rally in comparison to book value trading ratios.

When we look at the Dow from book value, CPI, GNP or its performance against gold, it comes up shy every time. Recent rallies are not trading at the same heights as they have during the past 56 years. By such fundamental comparisons, it is extremely difficult to imagine that the Dow is overpriced and in jeopardy of a major panic collapse.

If we look once again at the chart of the Dow Industrials on a percentage basis over book value, it becomes distinctly clear that 1978 was the LOWEST point in recent history. If we look at the annual chart provided for the Dow Industrials from 1890 to date, we find that the 1978 low was substantially above that major sharp correction which took place back in 1974. Even the 1982 correction, when almost everyone was calling for an impending collapse and the Dow was unquestionably moving down to 500, it was still trading on a percentage basis over book, above the low which had been estab-

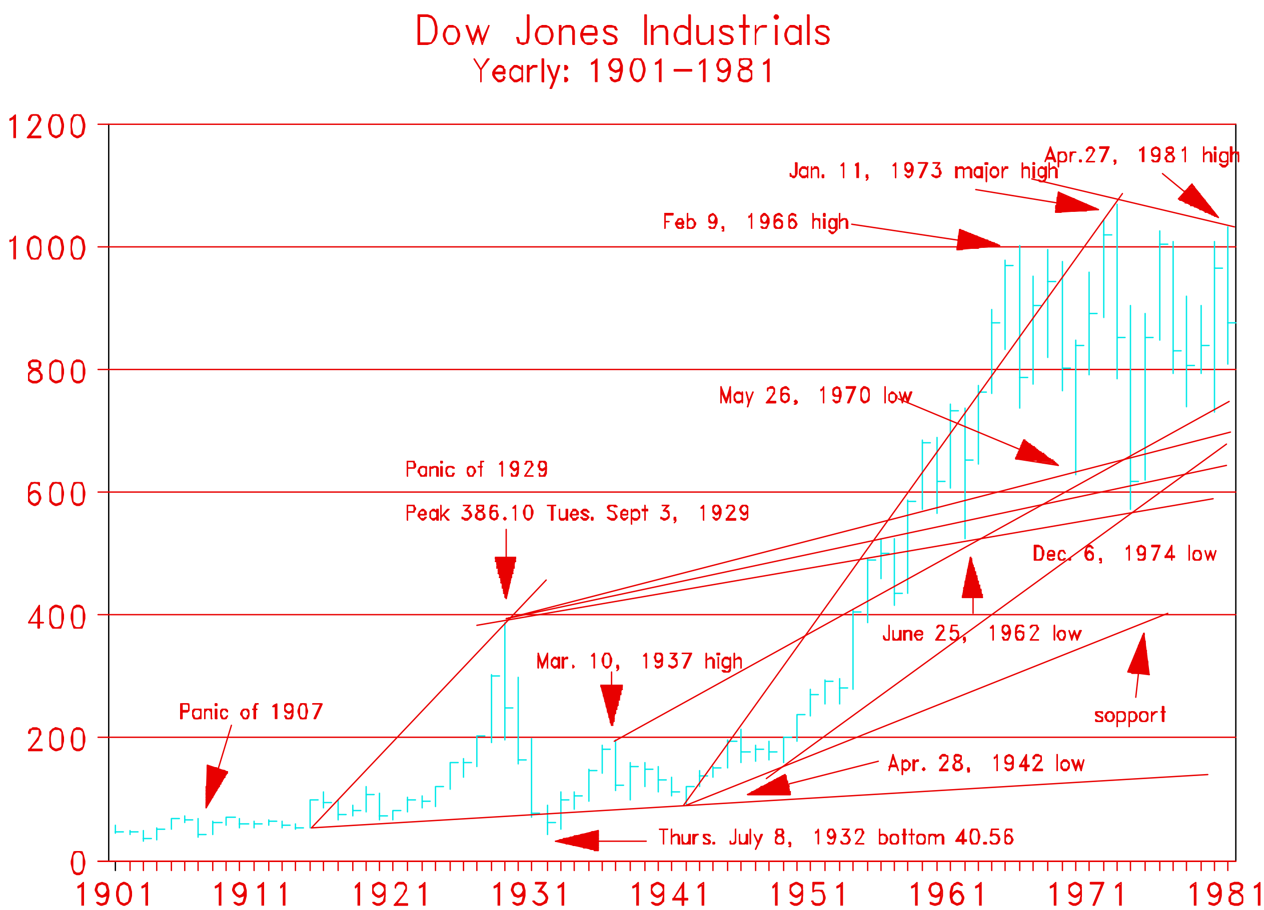


lished during 1978, as well as on the index itself.

What is this book value we speak of? It represents cash and the depreciated value of all assets, including real estate and other subsidiaries. This is what the takeover boys are looking at. They look for companies that are selling for $30 a share and they calculate that if they were to sell off all the assets they might end up with $75 a share. We all know that these situations have been numerous. So why is it a fact that so many companies are selling far below book value? Doesn't this suggest that perhaps the market is under-priced? If so, then why all the doom and gloom every time the market turns downward?

A case can undoubtedly be made for the market being overpriced or underpriced. Obviously one or the other is eventually going to be right. But which one? What does the future really hold in store for the stock market? Are we in a phase similar to 1921-1929 when prices soared and the Dow rose from 62 to 381, which was a 515% rally in seven years? Or perhaps the doom and gloom boys are correct and the Dow will drop 50% or maybe 88% as it did between 1929-1932.

There are some who argue that we are about to collapse. Others suggest that the famous Kondratieff cycle is upon us and that the market will collapse under its mighty influence. Joseph Granville became perhaps one of the most famous analysts of our time because of his strong opinions. Most other analysts envy the attention he gained back in 1982 and love to kick his name about like a football. But in his recent book entitled "The Warning," Joe admits: "Probably more than anything else, I bypassed the August 1982 upturn because of how the market looked against the template of the Kondratieff Wave...In relation to the 1982 bottom I had made a timing error, but I knew my basic analysis was right."



We will see as we explore the market's past, which to this very day remains shrouded in an obscure fog of mystifying confusion of untold proportions, that timing has always been the elusive element in analysis. Wall Street's chastisement of Joseph Granville is typical. Wall Street has always sought that infallible analyst who will descend from the mountain bringing with him the definitive rules of the game. That elusive mountain has never provided the man who possessed a record of consistency. No one beat the game in the 1920s. No matter how flawless their record, the countless analysts of the roaring 20s all lost in the end - including the bears.

And for those who were correct for long periods of time, Wall Street still bore a hatred when it was wrong and the analysts were proven right. Even the Wall Street Journal refused at one time to report the comments of Jesse Livermore despite his superb track record. Then other journalists chastised the Wall Street Journal for its pompous attitude.

Like the President of the United States, an analyst is immediately subjected to a continuous series of criticisms. The President is blamed for everything from foreign affairs to how much money it costs every time you buy a loaf of bread. It is as if the President's sole existence has caused every problem imaginable and, of course, he must carry the blame for the errors of each and every predecessor. The press will judge him based solely upon what they see, making no allowance whatsoever for any other factors. Problems of all past administrations suddenly become the track record of the man currently in office. Like the interest on the back debt, which haunts each year's administration, today there still exist serious international and shifting domestic events, which were inherited by Hoover when he took office in 1929.

The art of analysis is, in fact, taking fundamental concepts built upon the record of the past and projecting the assumption that the future will offer more of the same. If there has never been that infallible soothsayer of the marketplace, then perhaps we have drawn the wrong conclusions from the past. The press and the analysts were all bearish in 1982. They judged the market based solely upon what was lying in front of their noses. They judged the market by current events and ignored the long-term signs that were pointing to a new round of internationalism. Oddly enough, the parallels of the past were quite similar to the 1980s, if you know where to look.

We will explore the avenues of fundamentals. We all know the often told stories about the speculative frenzy which supposedly destroyed the economy and created the Great Depression. But do we really know the truth? Do we honestly know what created the most spectacular bull market in the history of the stock market? Was it uncontrolled speculation? Was there a relationship to the dollar and its postwar historical swings? Are the so-called parallels that people draw between then and now valid? Are these proposed opinions and parallels truly non-biased or have people selected only a small segment in time to suit their own foregone conclusions?

Anyone who takes it upon himself to write of the events in the past immediately subjects himself to becoming some sort of a historian. In so doing he injects his own biased viewpoint. As a result, the events he chronicles are automatically colored by his own thoughts and the accounting is still one man's opinion. This report will offer a different viewpoint of the past. The speaking will be quoted from those who commented on the events of the day and the commentary offered will be a collective interpretation of what took place.

Let me say now that I too had some preconceived ideas when I began this project. But listening to those who cried out from the past changed my own unwarranted assumptions and, in the end, I emerged with a conclusion quite different from what I had expected it to be.

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