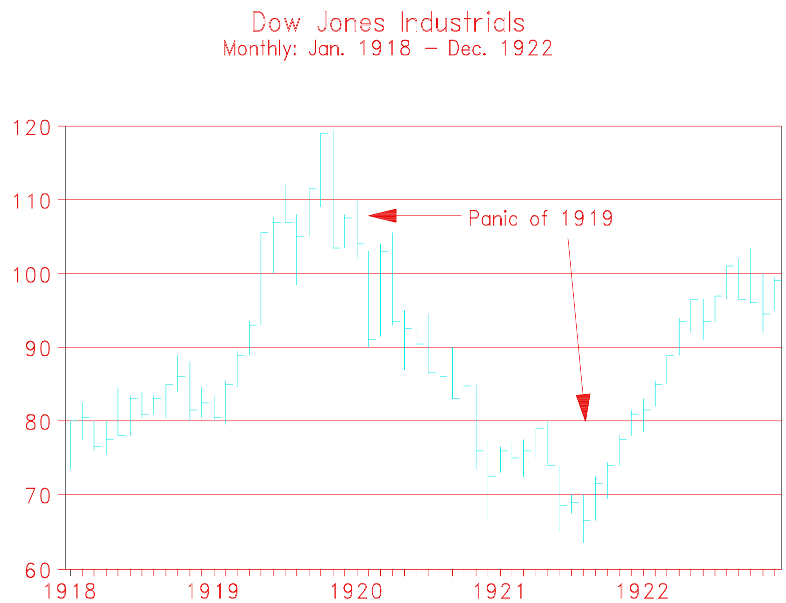
CHAPTER I

1921

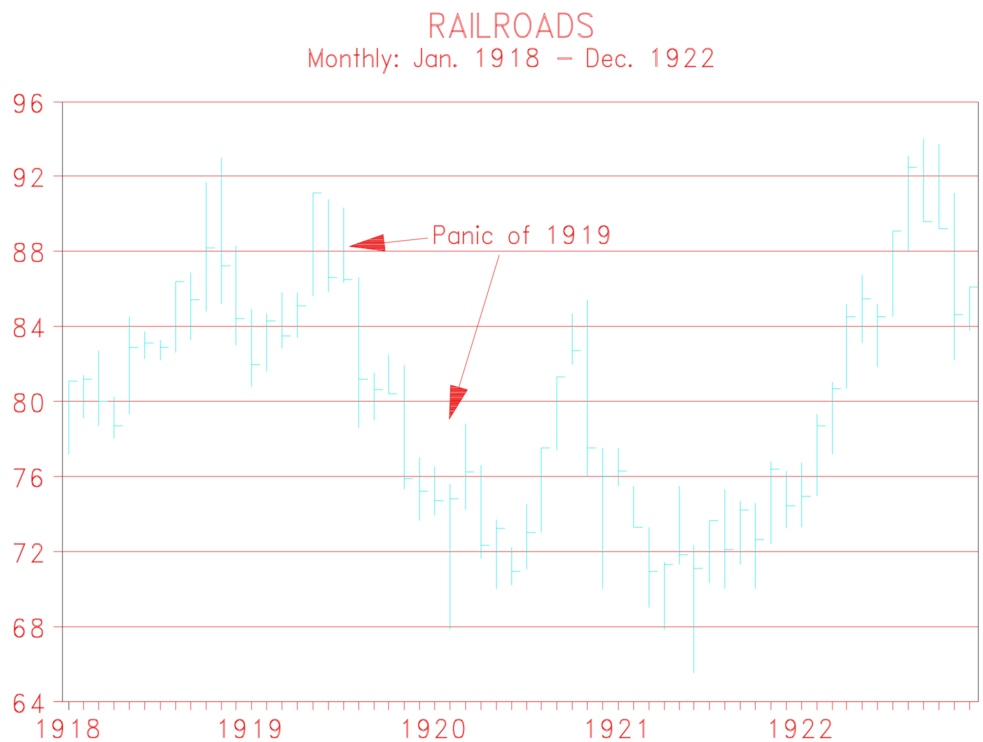


The year 1921 began on a sour note. The front page headline of the New York Times on January 8, 1921 read: "BUSINESS REVIVING, COUNTRY SANE AGAIN, SAYS W.P.G. HARDING - Governor of the Federal Reserve Board Sounds Keynote of Optimism. DEPRESSION AT AN END - EXTRAVAGANCE HAS PASSED." The article began as follows:

"All danger of a disastrous financial collapse has passed and there are signs that the widespread industrial depression is nearing its end, declared W.P.G. Harding, Governor of the Federal Reserve Board, last night at a dinner in Delmonico's tendered by officials of the Fidelity and Deposit Company of Maryland to Franklin D. Roosevelt, lately elected as Vice-President of the institution."

The article went on to say: "Now I think we can in taking an inventory of our present situation, congratulate ourselves upon two things. One is that the country generally has recovered to its normal state. We are no longer afraid. We are not indulging in the old idea of extravagance, living beyond our means. Nor are we troubled so much as we were a few weeks ago with that other extreme of over pessimism, where people get down in the tombs and they cannot see any daylight, cannot see any hope and see nothing but gloom and darkness.

"Now that situation is as bad as the other. They are both abnormal conditions of mind and we can congratulate ourselves gener-

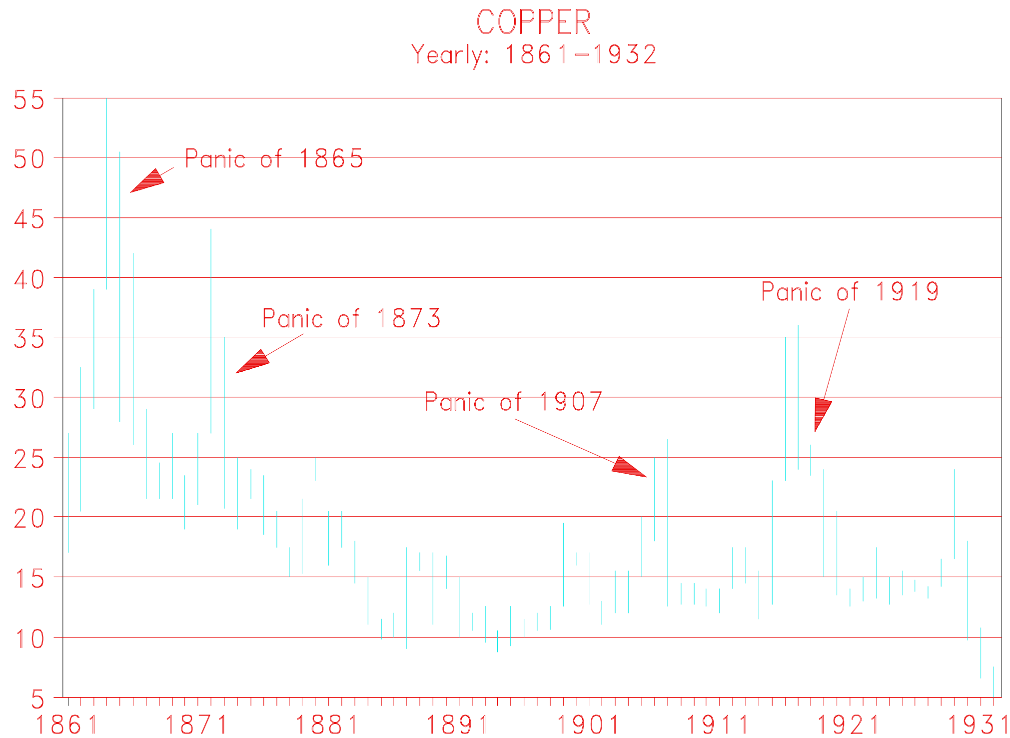


ally that the country has reached a more normal state of mind, if you please. This is not the time to try any remedies for the purpose of alleviating or deadening pain temporarily, of which the ultimate effects would be not to restore the patient to health, but to impair his strength and vitality.

"We ought to be safe and sound and calm in our judgments in living and in financing ourselves. I am thoroughly convinced that any danger which may have existed of a general collapse - and I have never thought that danger was as imminent as a great many people have thought it was - but any such danger as that has passed. I think undoubtedly that the worst is over. And while the Federal Reserve system cannot deal with individual cases, if there are individuals who have become so much over-extended that they will have to undergo process of readjustment, that, after all, is merely an individual condition which will have to be taken care of. We will have to let it take its course. The Federal Reserve deals with general conditions. It deals with the banking situation as a whole and the Reserve position. The inherent strength of the Federal Reserve Banks has so much improved that you need to have no apprehension whatever that the Federal Reserve position cannot take care of the banking situation in general. It can do so and it will do so."

The atmosphere during 1921 was far from optimistic. There was no analyst, economist, businessman or politician who held visions in his mind's eye of a future which would one day be remembered as the "Roaring 20s." There is no newsletter writer or market analyst who dared to claim that he had called the bottom, no less foreseen the ominous events.

As with most periods following wars, the ability to recover lay solely in man's desire to re-establish his economic way of life. Regaining his dignity and his sense of confidence was his only salvation. The panic



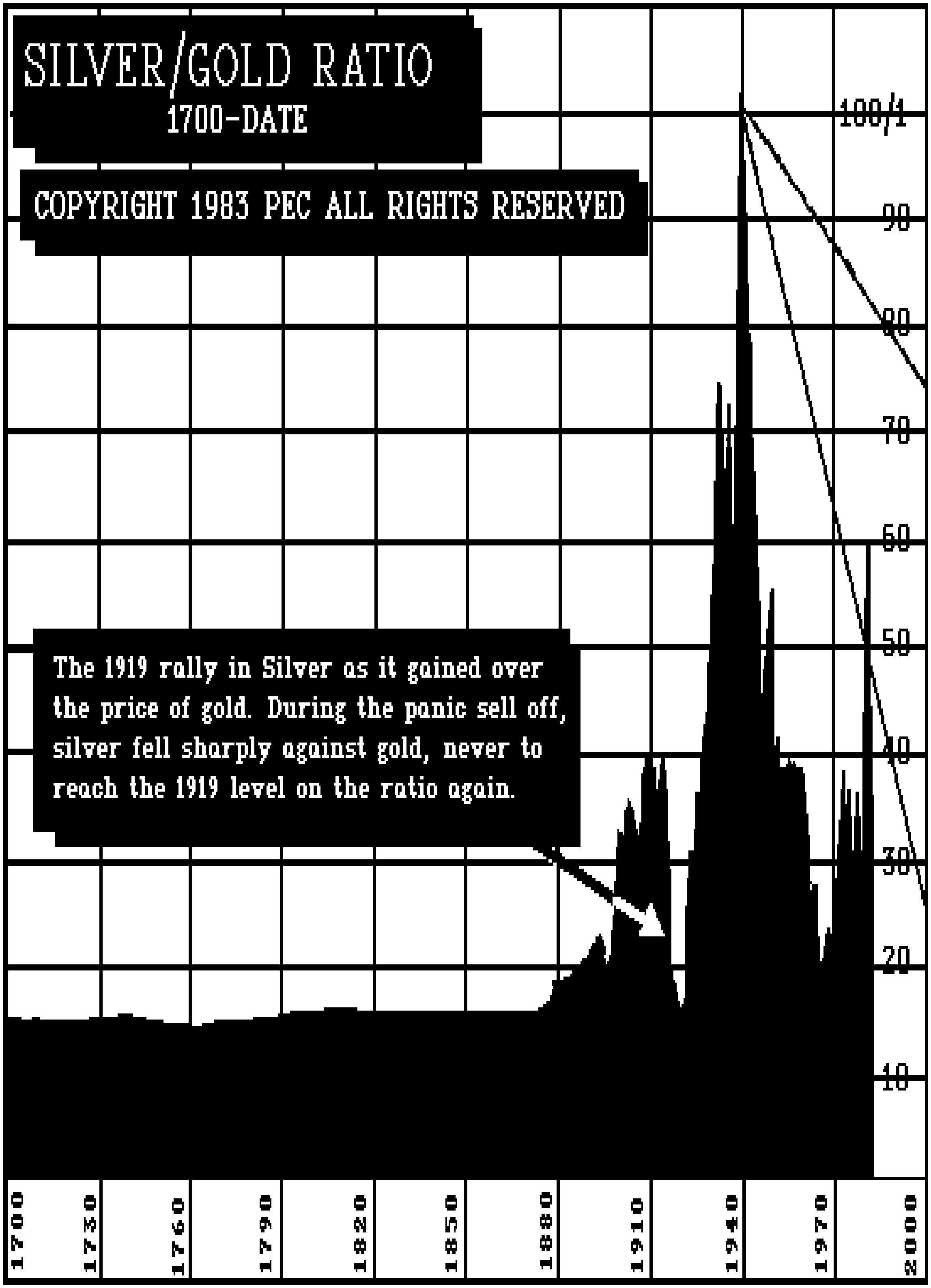
collapse of 1920 was swift, unmerciful, and devastating.

Many fortunes were lost to the boom and collapse of the postwar years. Many of the prominent individuals and their personal tragedies we will look at in due course. The panic and devastation was not merely confined to the United states. Its tentacles had stretched far and wide throughout Europe on the right and to Japan on the left.

The more I immersed myself in the past to try to gain a sense of the truth, the more surprised I became at how the historians have distorted many of the events. Feelings in Europe were still very bitter and the Treaty of Versailles had essentially divided Europe between the British, French and Italians. Turmoil ensued over the League of Nations Agreement in 1919 and the press in the States was filled with cartoons of Europeans still battling among themselves for their dominant share of the spoils.

The League of Nations Agreement sought to preserve the boundaries won in the War and the French inserted what was known as Article 10. This mandated that all nations which signed would fight against any nation which infringed upon the boundaries of another. Congress refused to ratify such a clause while President Wilson supported the League without any alteration. Indeed, the popular opinion in the United States was not in favor of signing the League of Nations Agreement. Herbert Hoover wrote in his memoirs: "Two million returning soldiers were, in the majority, very anti-European. They had little experience with the peoples of Europe and regarded them as just foreigners." They generally opposed the League on the ground that they never wanted to be sent out of the United States again."

In the Fall of 1919, British lobbyists began a campaign to obtain billions of dollars in loans from the U.S. government. There were many who were opposed to this idea and others who saw that lending Federal funds to Europe would potentially return handsome profits for U.S. business.


SILVER/GOLD RATIO
1700-DATE
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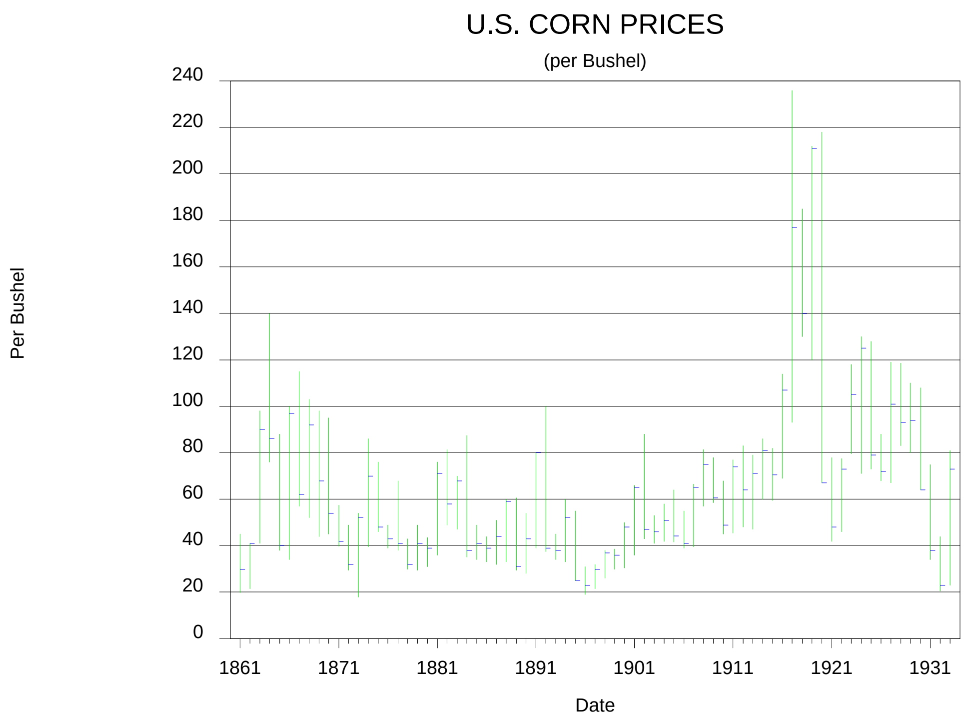
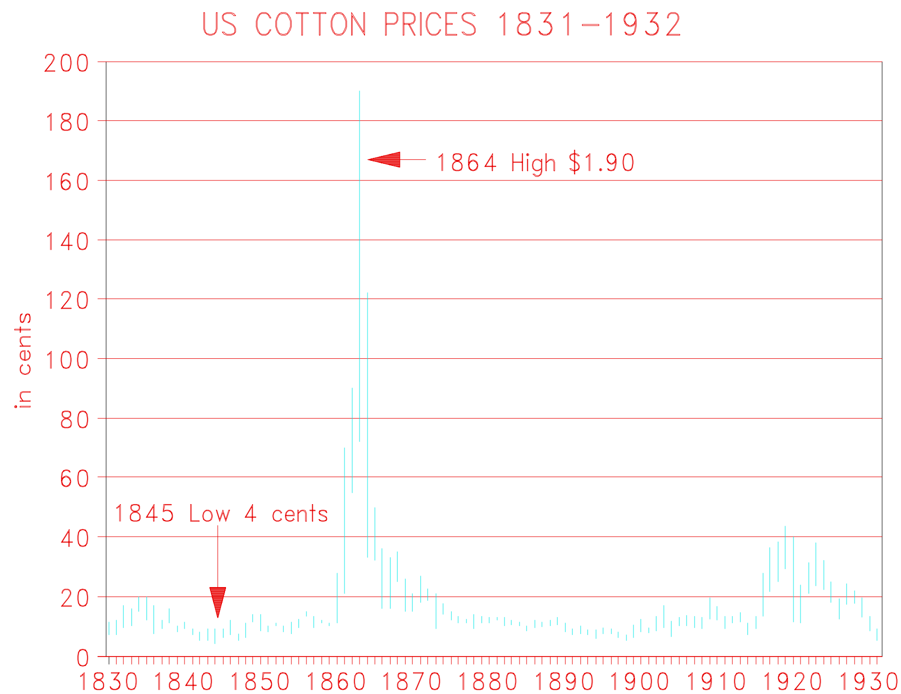
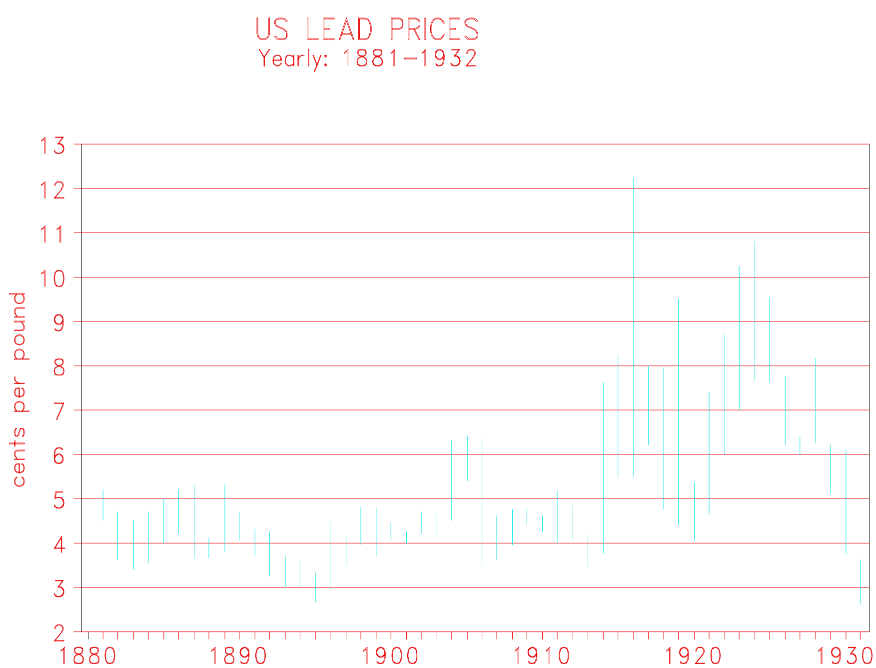
The 1919 rally in Silver as it gained over the price of gold. During the panic sell off, silver fell sharply against gold, never to reach the 1919 level on the ratio again.
100/1
90
80
70
60
50
40
30
20
10
1700
1730
1760
1790
1820
1850
1880
1910
1940
1970
2000

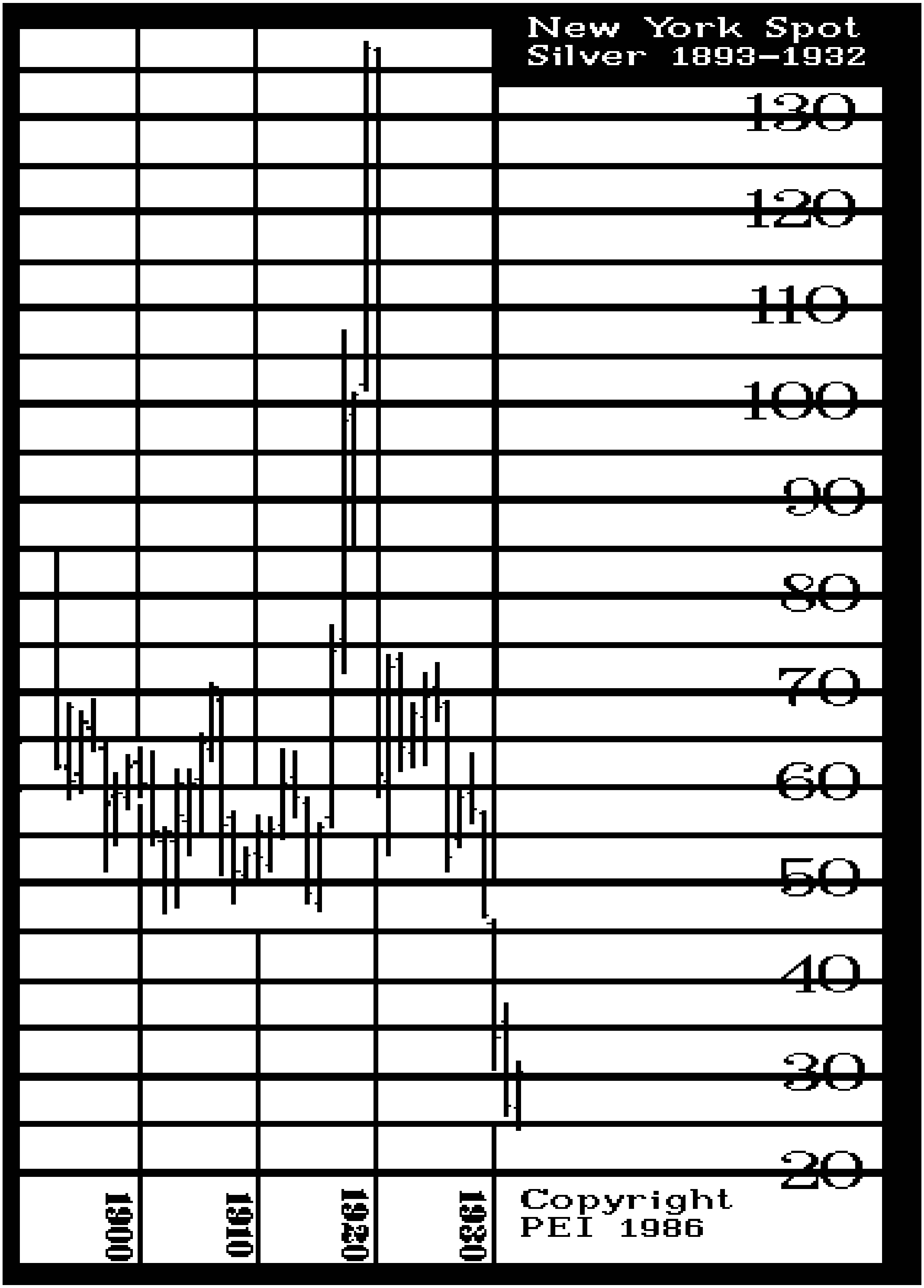


Herbert Hoover publicly denounced the proposals beginning on January 7, 1920. Hoover insisted that any loans should be made from the private sector and that government should not get involved. In December, 1920, he addressed the American Banker Association in Chicago. He stated right then and there his opinions upon an issue that later became an underlying problem, which erupted and forged the entire world into the greatest depression of the 20th century. "Our government," Hoover said, "would be subject to every political pressure that desperate foreign statesmen can invent and their groups of nationals in our borders would clamor at the hill of Congress for special favors to their mother countries. Our experience in war shows that foreign governments which are borrowing our money on easy terms cannot expend it with the economy of private individuals and it results in vast waste...The collection of a debt to our Treasury from a foreign government sets afoot propaganda against our officials, against our government. There is no court to which government can appeal for collection of debt except a battleship. The whole process is involved in inflation, in waste, and in intrigue. The only direct loans of our government should be humane loans to prevent starvation. The world must stop this orgy of expenditure on armament. European governments must cease to balance their budgets by publishing paper money if exchange is ever to be righted. The world is not alone in need for credit machinery. It is in need of economic statesmanship.

To understand the events of the bull market into 1929, and the subsequent collapse, it is also necessary to understand the period which had led to the greatest bull market in modern history. During World War I, most commodities had been fixed by the U.S. government. One such example was the Sugar Equalization Board. This establishment contracted to buy all the sugar crops from the U.S. as well as from the West Indian, Hawaiian and Philippine nations. Herbert Hoover recommended to President Wilson that the crop of 1919 should be


US COTTON PRICES 1831–1932
1864 High $1.90
1845 Low 4 cents
in cents
200
180
160
140
120
100
80
60
40
20
0
1830 1840 1850 1860 1870 1880 1890 1900 1910 1920 1930


US LEAD PRICES
Yearly: 1881–1932
cents per pound
13
12
11
10
9
8
7
6
5
4
3
2
1880 1890 1900 1910 1920 1930



New York Spot
Silver 1893–1932
130
120
110
100
90
80
70
60
50
40
30
20
1900
1910
1920
1930
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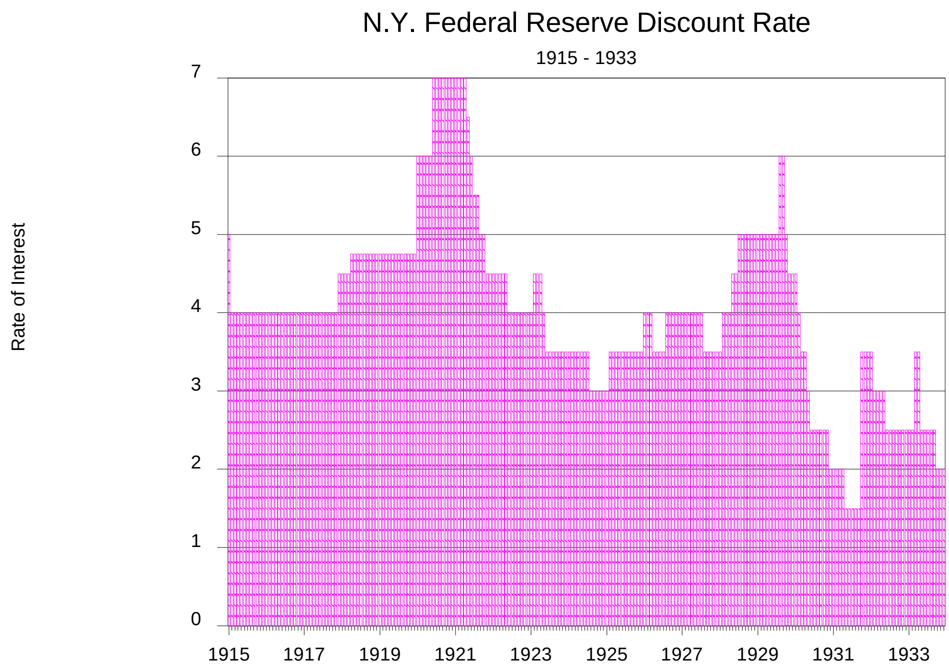


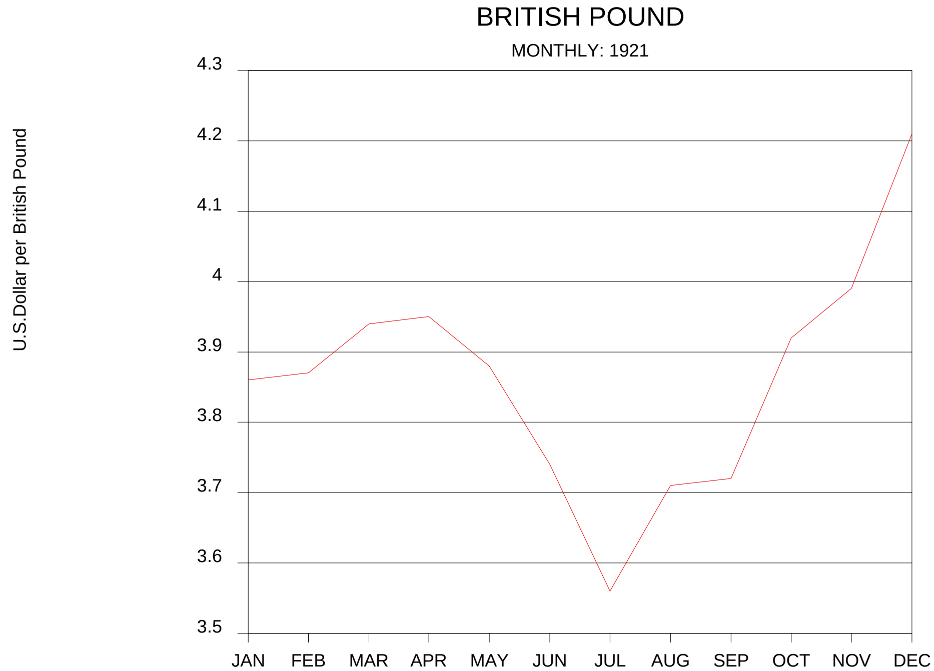
purchased until Europe could re-establish itself. But the President listened to Professor Taussig who had also sat on the Board. The controls were not renewed and the price of sugar jumped from 9 cents to 25 cents during 1919. This is merely one example of the drastic speculation in world markets during 1919 into early 1920.

Commodities had literally soared in value to their highest levels in over 20 years while many reached historic highs. Silver rallied to $1.40 after being as low as 45 cents in 1915. Corn reached a record high in 1917 at $2.50 per bushel prior to controls and fell back to $1.20. But in early 1920, it reached $2.20 compared to a 1915 price of as low as 60 cents. Cotton had soared to 43 cents compared to 7 cents in 1915.

The stock market had also followed suit. The wild speculation during 1919 to 1920 was predicated on the fact that most of the crops in various commodities had been destroyed in Europe and they were unquestionably in short supply. The stock market rallied because if commodities rose in value, so did the profits of American industry.

Clearly there was an extravagance of speculation following the War. This speculation was noted in European markets as well. It was undoubtedly a world wide event. But the world did not deal with the situation in the same manner.

In the United States, steps were taken to make money tight, and that the Federal Reserve did very nicely. The discount rate had stood at 4% during 1917. In December of 1917, the Fed began to raise the discount rate, jumping it to 4.5%. That was followed swiftly by another jump to 4.75% in March of 1918. There the rate stood throughout 1918 and 1919. The Fed waited until the fever of speculation had reached the very top. In January 1920, they raised the discount rate from 4.75% to 6% and then in June of that year it was raised again to 7%. The Fed had gone into overkill as usual, acting not in advance of a problem but in response to it after many of the markets had already peaked.



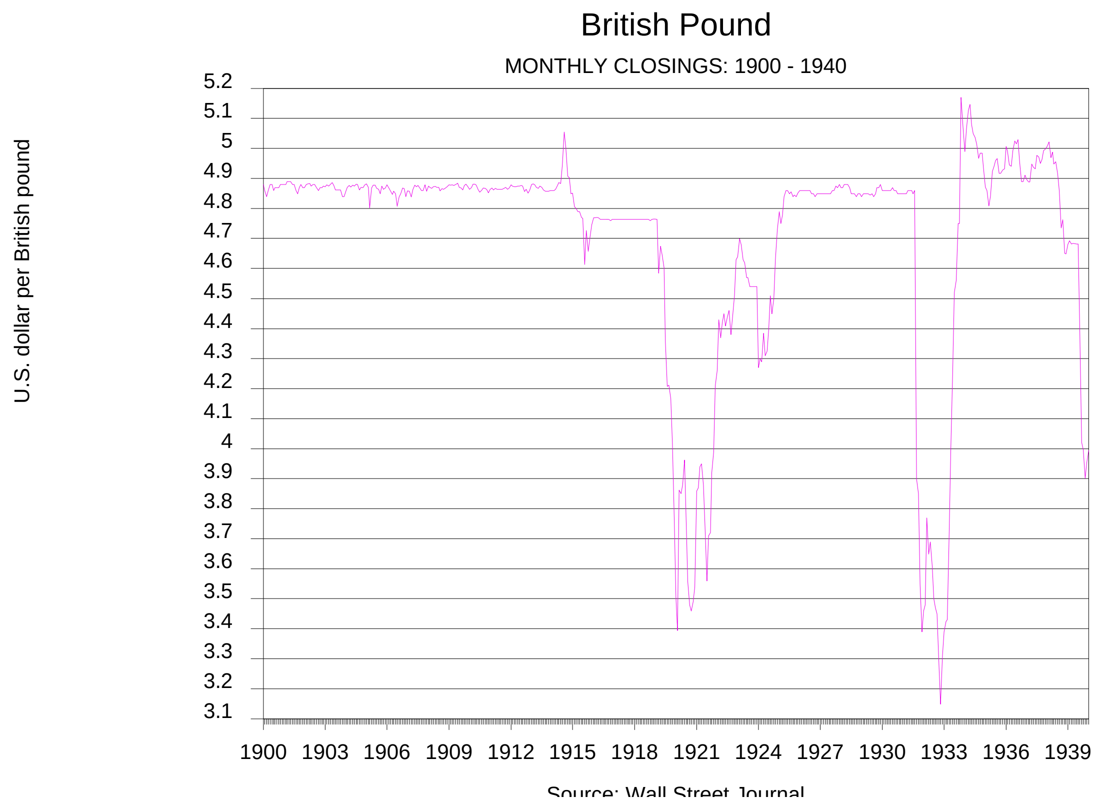
This was the U.S. solution to the inflation problem of the immediate postwar era. They chose to raise interest rates to force a deflation upon the free markets. Had they left the markets alone, the same action would have followed. As commodities began to come back into production during 1920, the markets had already sensed this was taking place and were in effect preparing in their own way to correct back in line with the newly anticipated increase in production.

In Britain, a different approach was selected to bring an end to the speculation fervor which also centered around foreign exchange. There a committee was formed consisting largely of bankers. This committee became known as the "Cunlife Committee, named after its chairman, Lord Cunlife, Governor of the Bank of England. This distinguished group of bankers had little sense of reality and the decisions that they made were the first turn of the screw which would eventually led to the greatest deflationary period in the history of that nation. As a result of the decisions of Cunlife, the economic devastation suffered in Britain between 1920 and 1922 was actually far worse than the Great Depression of the 1930s.

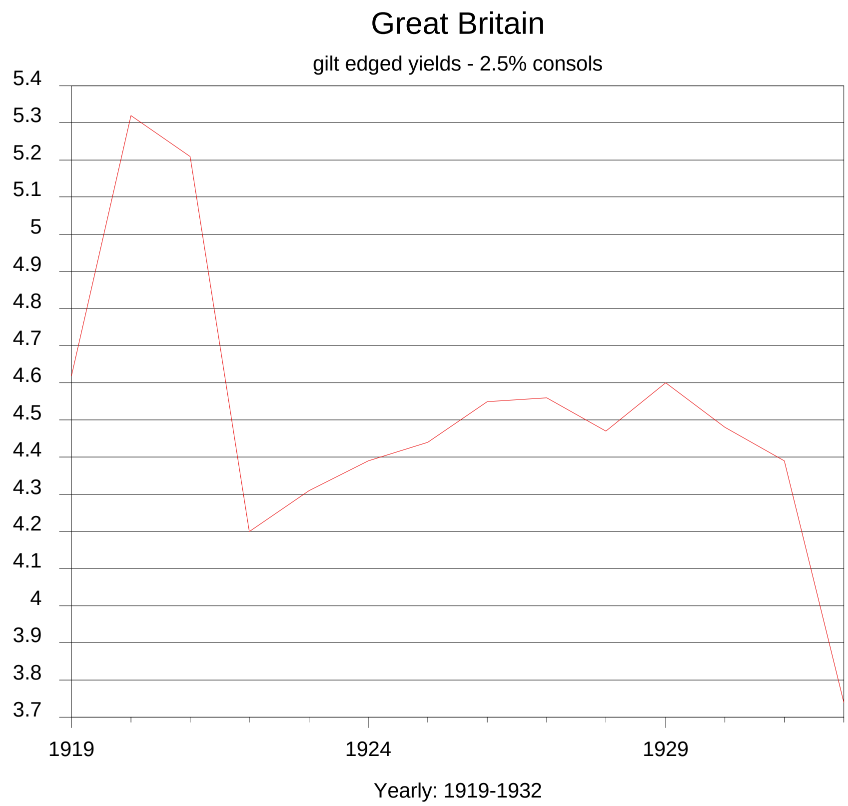
This group of bankers decided that on paper everything could be brought under control by maintaining the gold standard at the old parity of $4.86. They believed that Britain could maintain the old parity and keep the pound at prewar levels by raising taxes and reducing money supply.

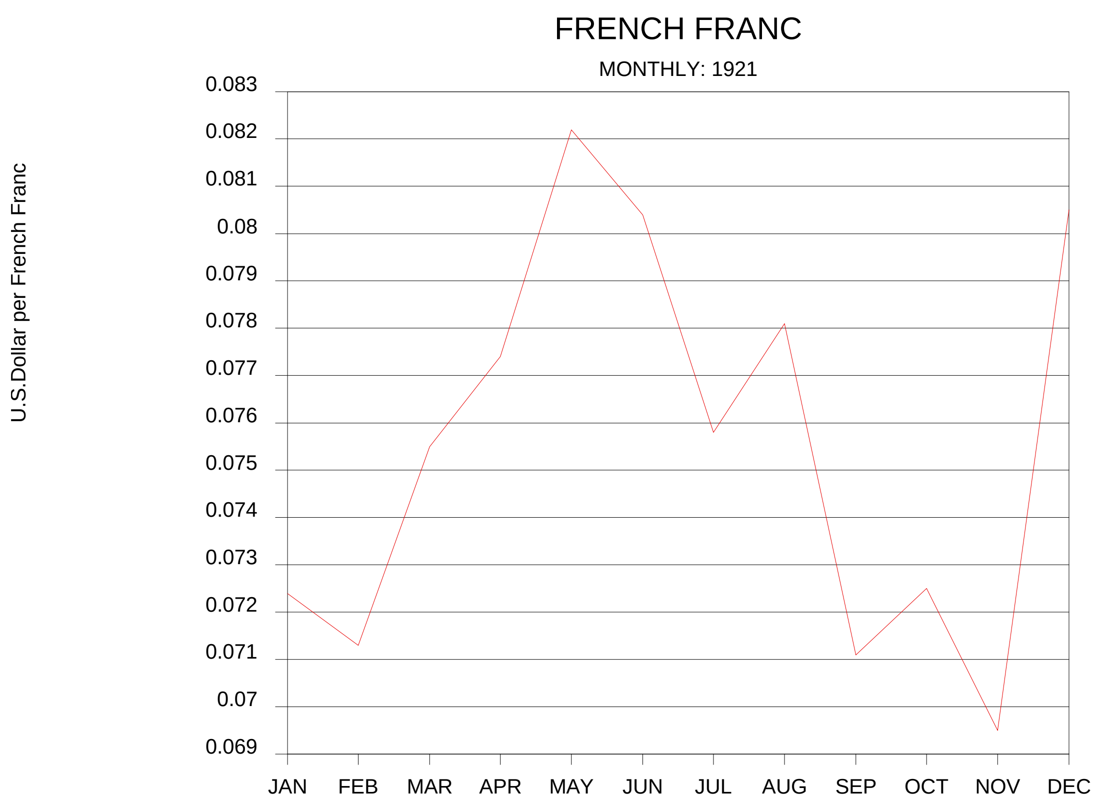
There was a great deal of speculation in Britain as to how far the pound would fall once the War was over. The Cunlife Committee seems to have had no sense of what the pound would have actually been worth in a free market and as such the gap between reality and fiction would soon become clear.

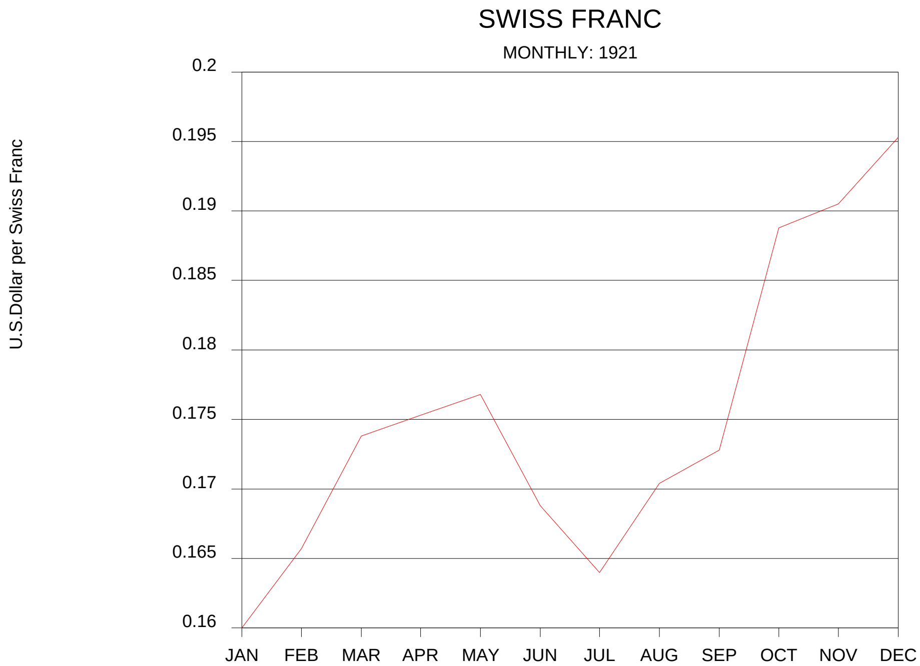
In August 1918, the Cunlife Committee published its first report. They merely


British Pound
MONTHLY CLOSINGS: 1900 - 1940
U.S. dollar per British pound
5.2
5.1
5
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
3.2
3.1
1900 1903 1906 1909 1912 1915 1918 1921 1924 1927 1930 1933 1936 1939
Source: Wall Street Journal


Great Britain
CPI - ALL ITEMS 1980=100
11
10
9
8
7
6
5
4
3
1900 1905 1910 1915 1920 1925 1930
Yearly: 1900-1932


Great Britain
gilt edged yields - 2.5% consols
5.4
5.3
5.2
5.1
5
4.9
4.8
4.7
4.6
4.5
4.4
4.3
4.2
4.1
4
3.9
3.8
3.7
1919
1924
1929
Yearly: 1919-1932


FRENCH FRANC
MONTHLY: 1921
U.S.Dollar per French Franc
0.083
0.082
0.081
0.08
0.079
0.078
0.077
0.076
0.075
0.074
0.073
0.072
0.071
0.07
0.069
JAN
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC



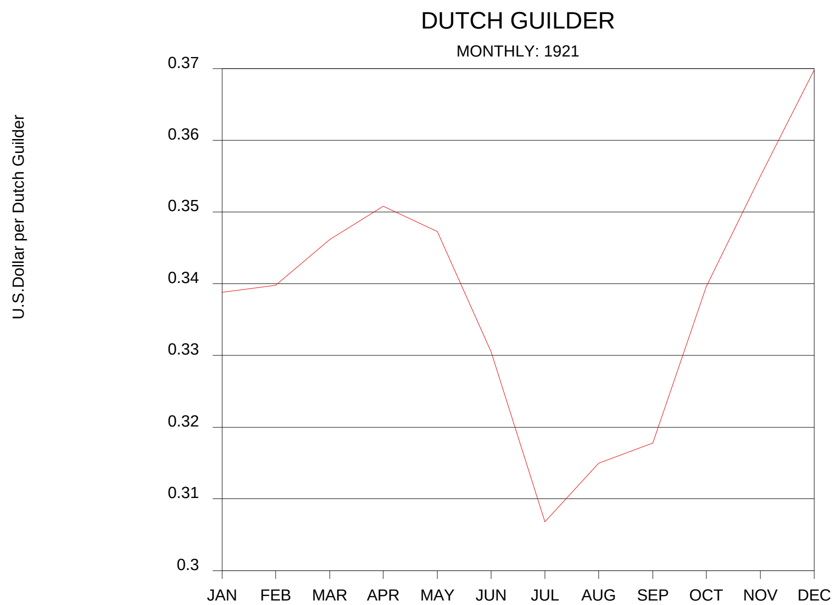
stated that Britain should live within its means and use revenue to retire most of the war bond issues held by the banks. Furthermore, much of the increase in paper money which was in circulation was also to be retired.

When the Armistice was signed on November 11, prices of goods and services initially fell for a four month period in Britain. But then in March 1919, Britain was forced to abandon the wartime fixed rate of $4.86 on the pound. Between March of 1914 and April of 1920, prices in Britain rose more dramatically than in the United States, increasing by 50%. The primary reason was the pound itself. The pound fell literally straight down to a low of $3.20, illustrating dramatically how overvalued the pound had been under the Cunlife recommendations.

To the American, the sudden dramatic rise in the dollar became noticeable only through the means of a drastically lower commodity value. In a sense, commodities declined in value, but not as dramatically on a worldwide basis. To the British, commodities began to rise because the declining value of the pound was reflected in higher prices since those base prices were in terms of dollars. Had the commodities risen in terms of dollars, the British would not have seen a rise in price levels of merely 50%, but could have experienced nearly a 100% price level increase.

Foreign exchange has been a major factor in all markets including stock prices. This, however, has seldom taken part in most analytical approaches. Yet as we pour through the wealth of price movements, we will see just how coincidentally tops and bottoms have come into play with foreign exchange movements.

The panic of 1920 was swift and severe, led by the oversupply in commodities and the drastic price movement in foreign exchange. The Dow Jones Industrials peaked during 1919 at nearly the 120 level. The year 1920 had opened at slightly above 100 and began to fall sharply after the dollar began to rise abruptly. At the end of 1920, the



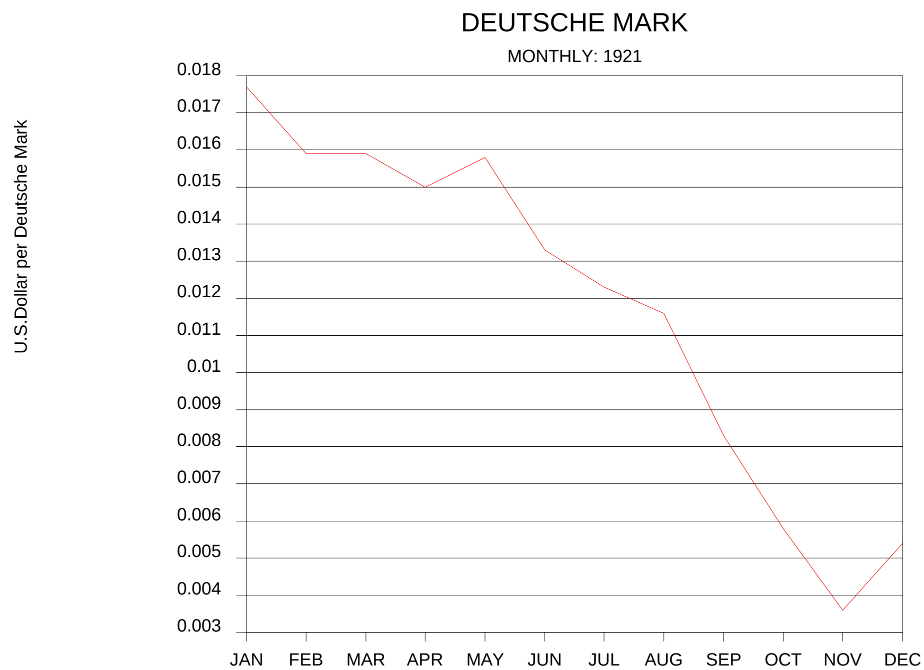
Industrials closed the year at 71, which was slightly more than a decline of 40%. The sharp decline in the stock market had equaled the rise in the dollar.

Numerous Americans had lost a fortune during that decline, yet at the same time something strange was taking place. While most were talking about the panic of 1907 and deciding that a depression was certainly at hand, foreign capital from the private overseas investor continued to flow into the United States.

One rule that we have found through the course of our research is that corrections in a market are normally 50% to 60% moves. A trend comes to an end when a decline moves beyond this percentage level as the 88% decline from the 1929 high. The fact that the panic of 1920 was severe is undenied, but the fact that the economy survived is a strong point in its favor as being merely a correction to economic conditions and not the end of an era.

Europe was still in turmoil following World War I. In Germany, the National Assembly had been established in 1919 to provide public elections for the office of the President. Paul Von Hindenburg was actually the first and last President elected by this new constitution. Although World War I was essentially over with the defeat of Germany, the world was not completely at rest. The Russian Civil War, which began June 1918 between the Soviet Communists and White Russian forces, had brought with it some international participants. British forces had landed at Murmansk in June of 1918 followed by the French at Archangel in August 1918. Japan and the United States also sent troops. By 1919 Poland invaded Russia, seeking to regain land over which it had long claimed ownership. Despite the Civil War, foreign invasion support and the Russian-Polish War, the Soviets eventually won. A treaty with Poland was signed on the 12th of October in 1920 and one month afterward the Civil War came to an end when the White Russian forces under General Wrangel were forced to evacuate the Crimea in November 1920.

In January 1921, Greece invaded Turkey. The Turkish forces eventually repelled the



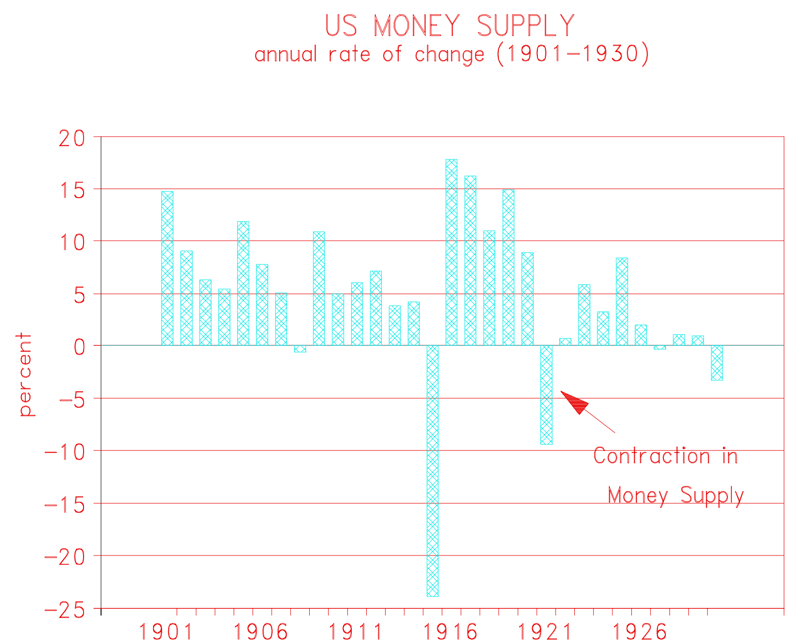
attack but the peace did not come until the signing of the Armistice of Mudanya on the 11th of October, 1922.

In Italy, a crisis in democracy had split the nation into moderate and nationalistic camps. An economic crisis spurred on by raging inflation brought the failure of the Cabinets of Giolitti in June 1920 and the succeeding Cabinet of Giolitti in June 1921. Terrorism became the battle tactic of the Fascists against the Socialists. With the country breaking apart at the seams, the King empowered Mussolini to form a Cabinet in October 1922. By November, Parliament granted unrestricted powers to Mussolini. Eventually in 1926 the final stages for the Fascist state were in place.

Europe lay in shambles and it was not merely the world economic structure that had been seriously fractured, but the very foundation of democracy itself. The side effect had been a serious curtailment of international trade. Much of the industry had turned toward armaments, which were a big business. Europe had lost much of its gold reserves and would continue to do so for the next few years. By and large, this had been caused by the establishment of industries in neutral overseas countries, such as in Latin America, to process much of its raw materials.

Another great problem for Europe, of course, was the extent of damage to productive facilities caused by World War I. In addition, the work force had taken a serious turn. Women represented a greater percentage of the work force while the men served on the front lines. Europe was also hampered in the early 1920s by the "planned" economy of the USSR, which at first was a world exporter of food. Russia would lose its exporter status in the 1930s but at point its exports hampered European agricultural production through increasing the supply which in turn depressed prices.

Chaos is a fair word to use in trying to describe the state of Europe at this point in time. In 1922, a World Economic Conference was finally held in Genoa but the United States and Turkey did not partici-



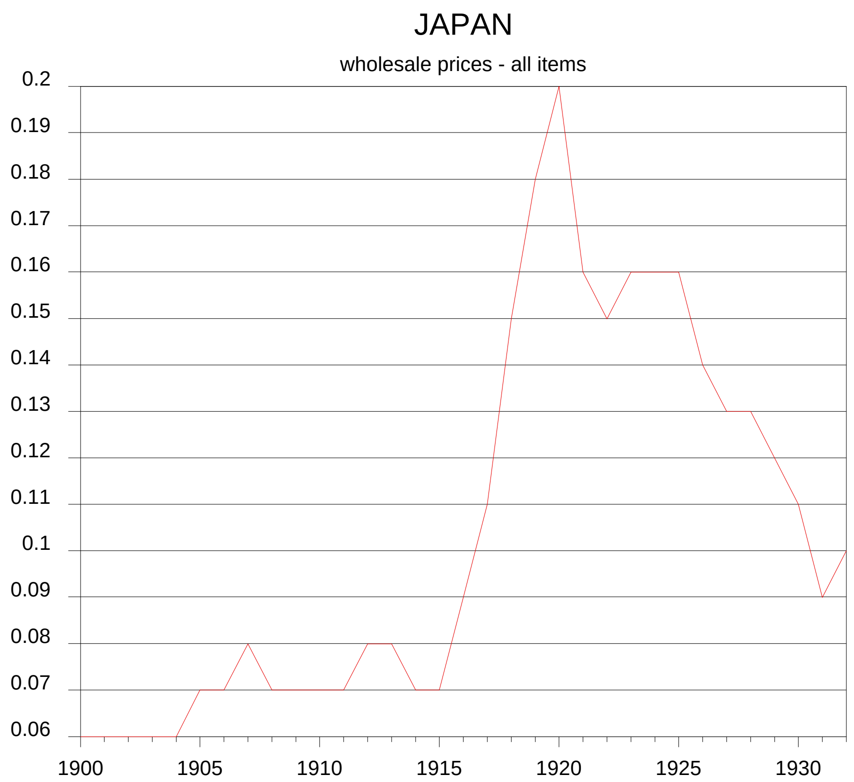
pate. This conference brought calls for the abandonment of the unchecked printing of money, and the creation of a currency unit for international exchange based on gold was proposed as a solution for the economic strife which faced the world.

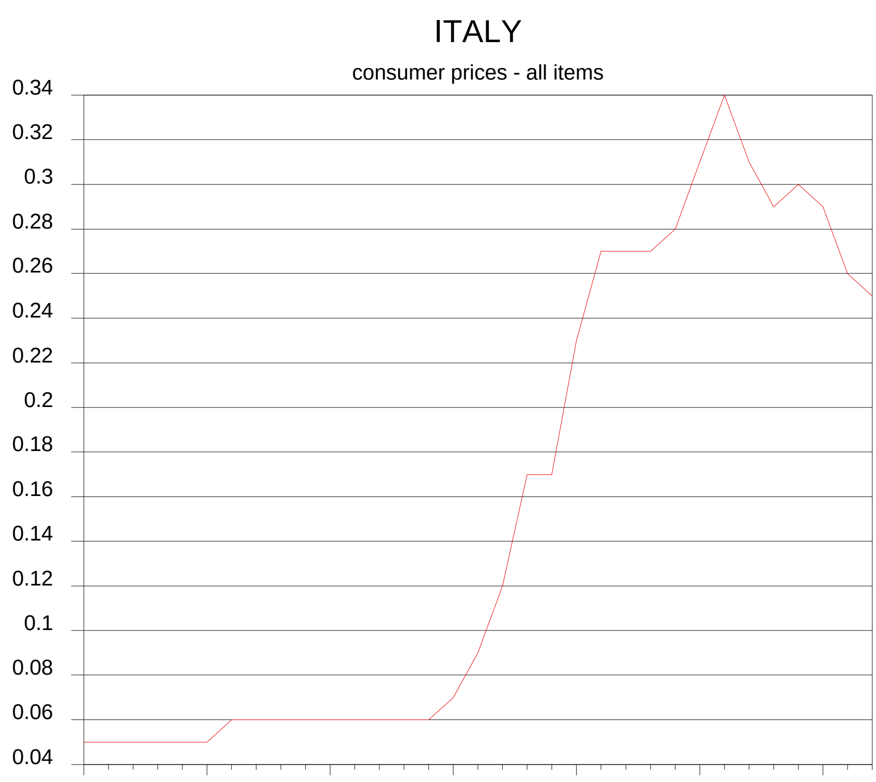
The United States had chosen to fight the inflationary pressures that had brought the 1919 rally in commodities as well as stocks by jacking the discount rate to what was then called the "7% Crisis Level." It did not raise taxes but money supply had contracted by 10%, dropping from $23.7 billion in 1920 to $21.5 billion as reflected by M1 in 1921. The flight to the dollar from the European currencies caused them to collapse, and perhaps aided the U.S. money supply which otherwise would have declined as much as 20%.

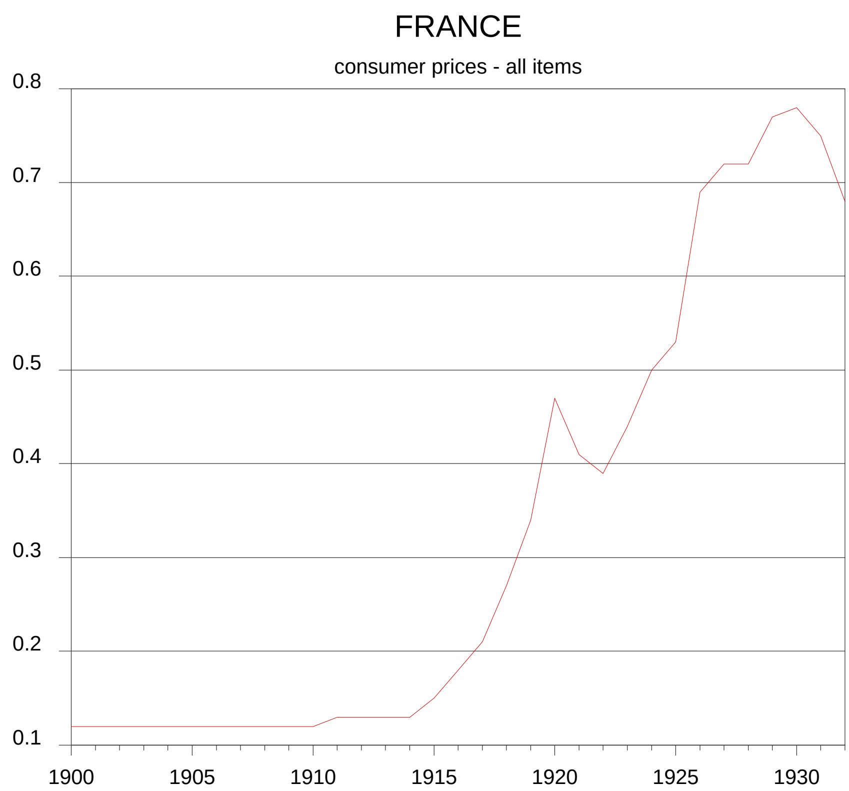
Britain, after abandoning the gold standard, attempted to fight speculation and inflation by raising taxes and contracting its money supply, forcing the pound to collapse from $4.86 to $3.20. But France, Belgium and most of the recently created central and Eastern European nations chose the inflationary road which had brought about a flood of unchecked printing of paper money. These were essentially the three courses of economic action taken by the major industrialized nations. The flight to U.S. based assets would have a major role in the years ahead.

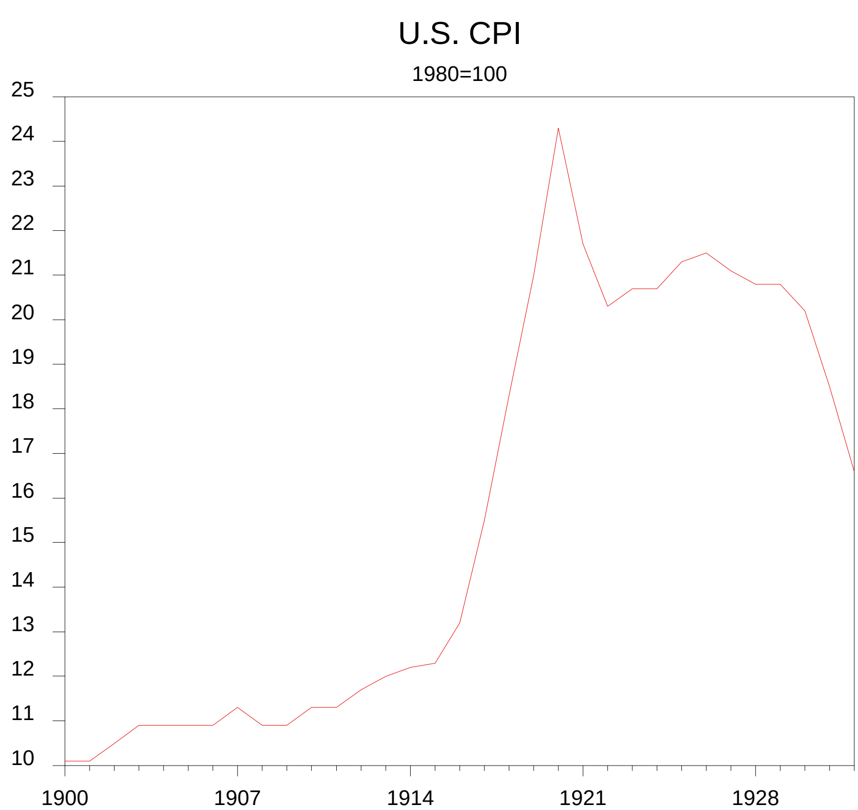
The year 1921 was marked by what had become known as the 1921 London Ultimatum. This British decree demanded the prompt fulfillment of the Peace Treaty, which called for the trial of war criminals, disarmament, and, the most important of all demands, fixed conditions of payment of the reparations by Germany. This Ultimatum had been preceded by the London Conference, which had seen the rejection of the German counter proposals.

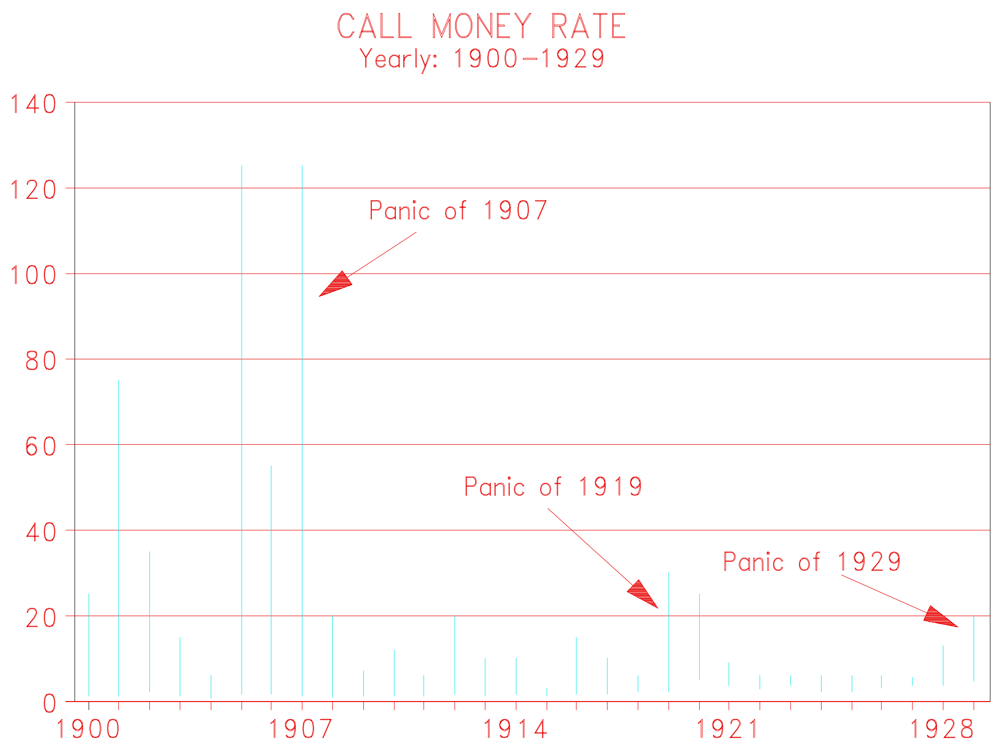
The deflationary forces in the United States, with a sharply rising dollar and an economy retaining for the most part its productive capability, began to attract much foreign capital. But perhaps the greatest attraction was the inflationary rates in


JAPAN
wholesale prices - all items
0.2
0.19
0.18
0.17
0.16
0.15
0.14
0.13
0.12
0.11
0.1
0.09
0.08
0.07
0.06
1900
1905
1910
1915
1920
1925
1930


ITALY
consumer prices - all items
0.34
0.32
0.3
0.28
0.26
0.24
0.22
0.2
0.18
0.16
0.14
0.12
0.1
0.08
0.06
0.04


FRANCE
consumer prices - all items
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
1900
1905
1910
1915
1920
1925
1930


U.S. CPI
1980=100
25
24
23
22
21
20
19
18
17
16
15
14
13
12
11
10
1900
1907
1914
1921
1928



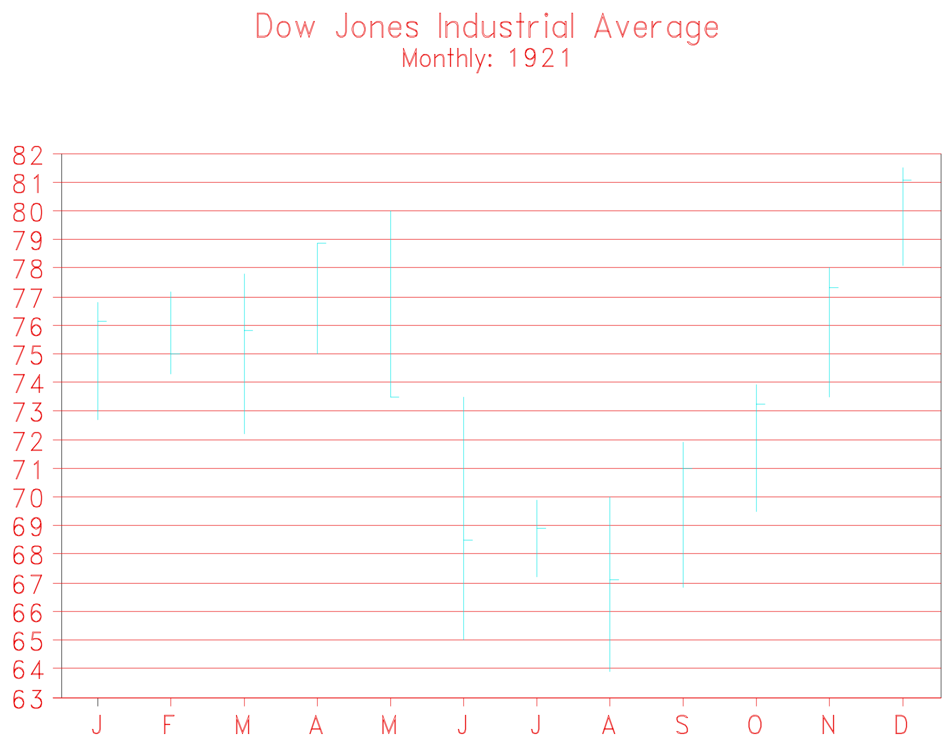
Europe between 1910 and 1921: in France, the consumer price index rose from 12 to 41; in Britain, it rose from 4.1 to 9.7; in Germany from 18.2 to 265.5; and in Italy, from .06 to .27. in Japan the wholesale prices rose from .07 to .16 between 1910 and 1921 while in the U.S., the CPI rose from 11.3 to 21.7. Although this period would later be called the deflationary years," in the U.S. the cost of living had risen sharply but perhaps at a lesser rate than the rest of the world.

Interest rates had risen sharply with call money (demand deposits) reaching a peak in 1919 of 30%. Even in 1920 call money reached a peak of 25% and by 1921 call money traded within a range of 9.25% to 3.5%. In Britain, interest rates on three month average treasury bill rates jumped from 2% in 1912 to 3.4% in 1919 but continued higher in 1920 to 6.2%, declining slightly to 4.5% in 1921.

It is understandable how depression, both in the economy as well as in the emotional state of the world population, had risen substantially. Business conditions in the U.S. had been quite brisk. When W.P.G. Harding said: "We are not indulging in the old idea of extravagance," he was referring to the shift of much European manufacture to the U.S. during the war period. Businesses were extravagant, overexpanding as if the trend would continue forever. Many were simply caught off guard by the sheer velocity of the fail, which was similar to the decline in the commodity markets between 1980 and 1982, yet far worse and in a shorter time span.

The depression of 1920 had not only seriously affected the economy within the United States, but also the lives of many individuals. One such man, who will remain in our writings throughout this period, was William C. Durant.

In 1908, Durant put together a half dozen automobile companies and called them General Motors Co. of New Jersey. In 1911, he was ousted from control and immediately formed Chevrolet Company; in May 1916, he regained control of General

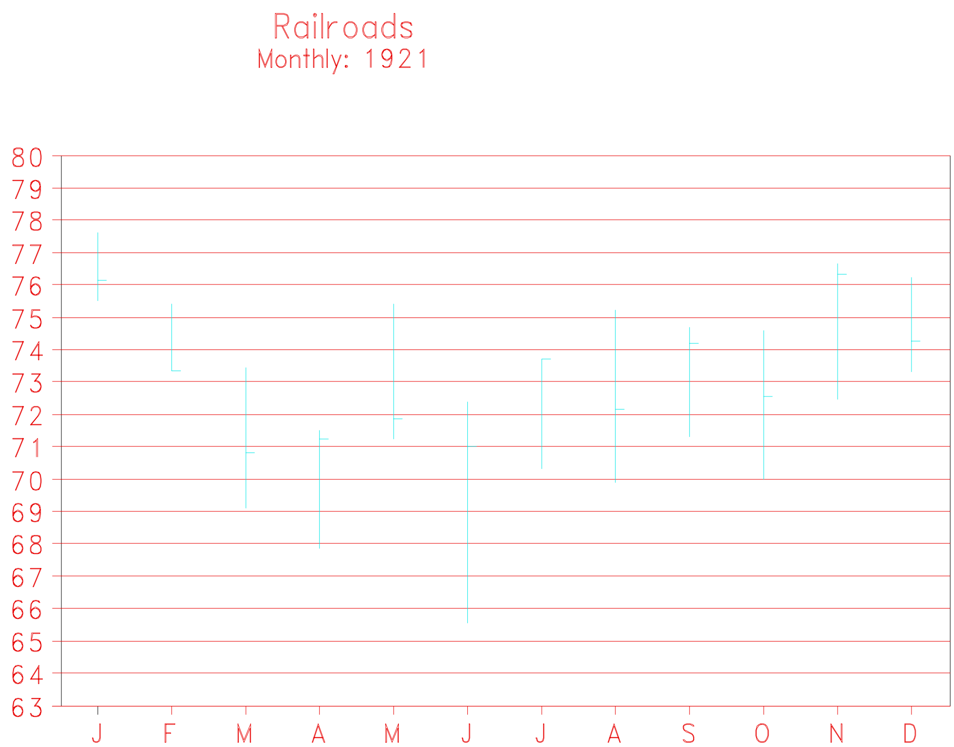


Motors. In the aftermath of the panic of 1920, Willy Durant was ousted once again but this time he would never return to his beloved General Motors. Many prominent men lost their fortunes as the worldwide economic convulsions engulfed a world and its people in a swift and sudden blow in the aftermath of World War I.

The sharp collapse in all markets between 1920 and 1921 cannot be given proper justice in words, even with the aid of hindsight. Jonathan Ogden Armour, founder of the famous meat packing company which still bears his name today, met with perhaps the most unbelievable fate of any tycoon. Armour's personal fortune had amounted to $150 million at the peak in 1919. No one suspected that a complete devastation was about to take place in all markets from commodities to stocks. Armour supplied the bulk of meat and grain supplies to the Allies during World War I. At the end of the war he found himself overstocked and overexpanded along with everyone else.

When all markets broke in a state of panic, the slide was straight down. Armour's vast fortune in today's terms, adjusted for inflation, would be $107 billion. Nonetheless, he lost $1 million dollars each day for 130 days straight without exception. He eventually died in 1927 while living in England, totally insolvent and owing a lot of money. There really are no words one can find which are capable of describing the personal tragedy that this once great supporter of freedom suffered during the panic of 1920. Swift and fast, the fortunes of many disappeared along with that of Jonathan Armour in the first 130 days of that panic. In an interview shortly before his death, he commented on his past and stated that he held the distinction in history of losing more money than anyone ever before. This was the atmosphere which surrounded the financial markets and the investment community at that time. The severity of the decline had stirred the memories of those horrifying days of the panic of 1907.

The Dow Industrials were initially steady as 1921 was ushered in. It was trading above



the 1920 low and continued in a sideways pattern rising into April. Then without notice, it began to collapse in May once again simultaneously with the rise in the dollar. Fears suddenly rose and the doom and gloomers were now predicting almost the end of civilization itself. How much more could society endure?

Despite the fact that January through March brought stable prices in the stock market, investors and traders remained very nervous. As the market rose into April, the Treasury released its report which revealed another deficit. This coupled with a labor crisis raging nearly out of control in Britain, and the end of military purchases of commodities from the Europeans, sent the stocks down that May. The downward pressures continued into June, steadied somewhat in July, and then plunged lower again into August. The pessimism continued despite the bright words or promises from the Fed. By September, 20,000 business failures had taken place and 3.5 million Americans were unemployed. Even the great mail order house of Sears Roebuck chalked up an operating loss of $16,435,468 by the end of 1921, while Montgomery Ward revealed a loss of $9,887,396. Eventually, the year 1921 would become known as the "Year of Deflation."

The world itself was in turmoil. In Britain, unemployment reached 2.5 million in July of 1921, one month before the Dow bottomed in the U.S. That was the peak in unemployment for both Britain and the United States but this would not be known for nearly two years.

Moreover, the rest of the world was still torn apart by the depression. A revolution took place in Portugal after one of the founders of the republic was assassinated. In Japan, the trend continued as Prime Minister Takashi Hara was assassinated on November 4. In Persia, there was a bloodless coup but in Morocco in July, the Spanish army was defeated by the Rifs. General Fernandez Silvestre committed suicide,

creating a political crisis in Madrid which nearly destroyed the government.

1921 was also the year when the "New Economic Policy" was announced by Nikolai Lenin in Russia. The U.S. Secretary of State, Charles E. Hughes, denied Russia's requests to resume trade relations and the cold war began as long as Communism prevailed.

But the stock market survived, and 1921 held at near the 62 point level, which was above the previous major low established in 1915 at 54 points. As the world drew nearer to its own economic destruction and desperate, hungry people began to flock toward the idealistic goals and dreams of Communism, some strange and invisible hand was making its presence felt. At the peak of pessimism and the deplorable news that couldn't possibly have been worse, the market held while short interest climbed.

In the midst of depression the American Stock Exchange had its beginnings from what had been known as the New York Curb Exchange. This exchange literally obtained its name from the location of its transactions. Clerks would position themselves on the streets signaling to traders perched in various windows along the street. But finally in 1921, they moved off the street corners and into their own building at Trinity Place. This was perhaps a subtle hint that just maybe the financial system of the marketplace would cheat death one more time.

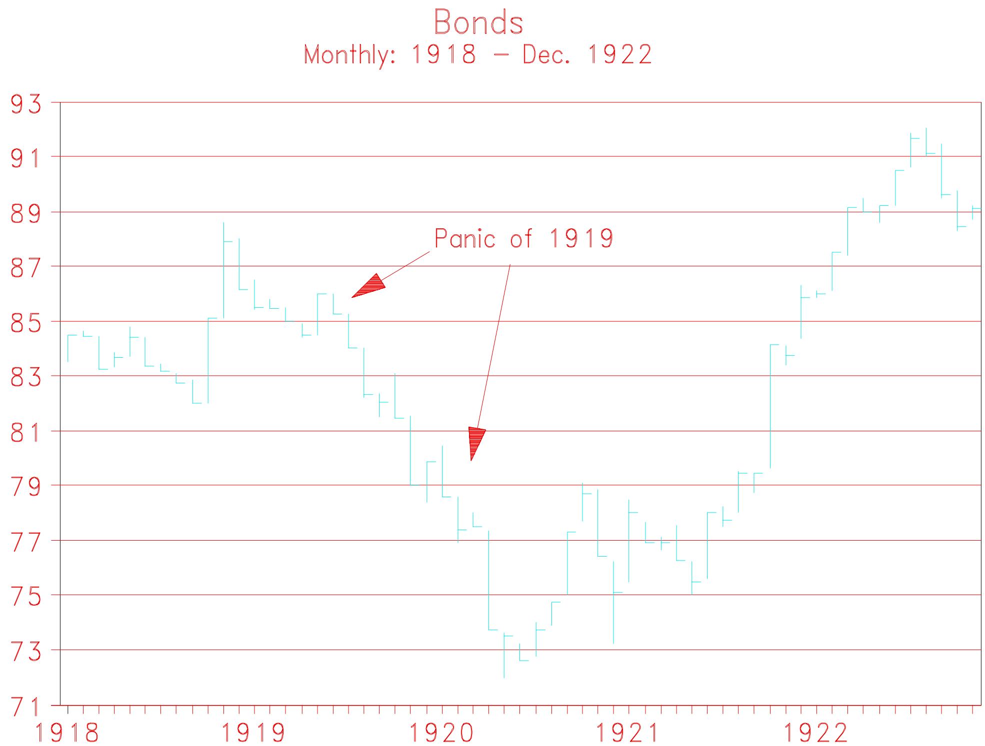
The Dow Jones Industrials had come under pressure because unemployment was high, business activity was low, and business failures were still rising into 1921 as a result of the Depression. The call money rates had subsided from the 30% high of 1919 but the Federal Reserve was not too quick to act. In the midst of the panic in 1919 the discount rate stood at 4.75%. Despite the fact that all markets were collapsing, money became tight and in January 1920, the Fed raised the rate to 6% from 4.75% in a single move. The markets literally crumbled as the Fed tried to smash the inflationary wave which had ensued.

In June of 1920, the Fed again raised the discount rate a full point to 7% trying to insure that inflation would come to an end. There the rate stood until May 1921, when only after devastating the economy did the Fed perhaps realize that it had gone into an overkill mode of operation. In May 1921, the discount rate was cut to 6.5% but obviously the economy and the emotions of the public were not impressed. Again, in June, the Fed cut the discount rate to 6% but the Dow Industrials still were not impressed and the market collapsed to 65 points. In July, the Fed cut the discount rate again to 5.5% and the market merely consolidated. In August, the Fed took no action but the markets sold off violently with the Dow Industrials reaching their final low at 64 for the entire panic of 1919 to 1921.

Despite the Federal Reserve's actions to finally lower the rates, their measures had little, if any, effect. In September, the Fed cut the discount rate to 5% but still it remained above 1919 levels. October brought no change but pessimism was still high. In November, the Fed cut the rate again to 4.5% where it remained for the balance of the year.

Germany began making payments according to the reparations agreement and gold reserves climbed to their highest point since 1917 in the United States. The railroads dropped sharply from January directly into April. There was a rally in early May but then a sudden, violent collapse into June. Perhaps it was a subtle signal that August would be the final low for the industrials and also the turning point for the economy since the railroads failed to make a new low and instead supported prior to the industrials.

Despite the fact that interest rates were easing, the bonds were performing terribly. They continued to decline directly into June as confidence was in short supply. Even the discount rate cuts didn't help the bonds as they only moved lower on that news. People became afraid of bonds as foreign governments teetered on the brink



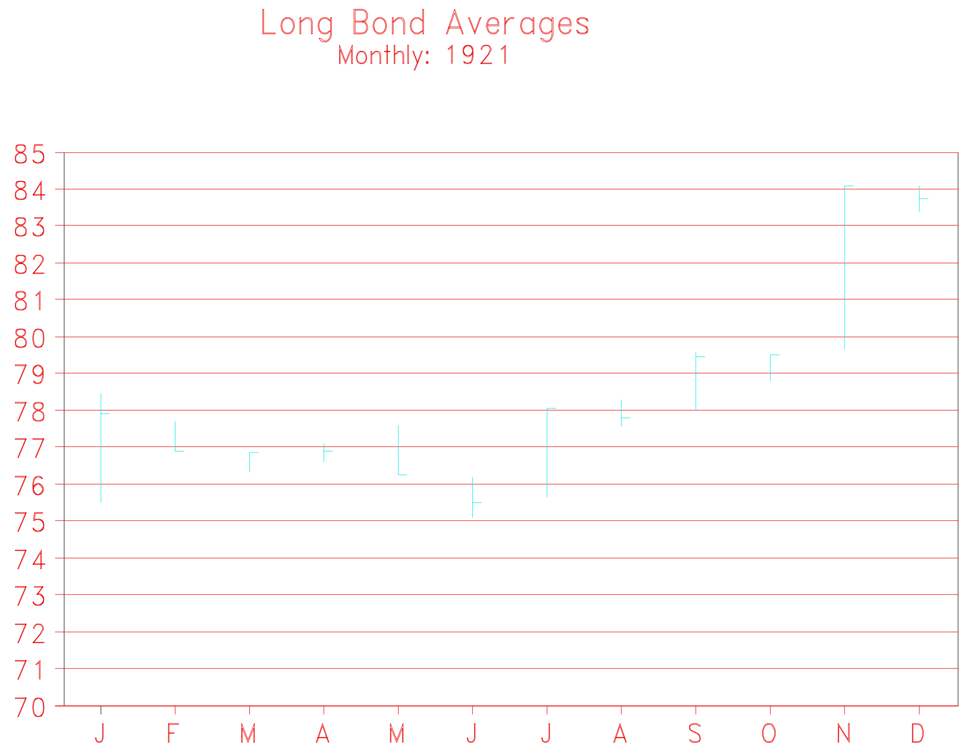
of financial ruin. Many questioned even the soundness of U.S. bond issues.

In the New York Times in July of 1921 the commentary under the Financial Column echoed the disappointed national tone:

"Looking back at the completed half year of 1921, the prevalent feeling is unmistakably one of disappointment. There was manifestly strong belief six months ago that the money market would revive, that the decline in commodity prices would end, and that mercantile trade in the spring months would reflect the stimulating influence of accumulating needs, of real consumers at the lower level of prices. None of these things has happened in accordance with the hopes of January.

"Money is not as tight as in 1920 but it is dearer and far less easy to obtain than in 1919 or in wartime. The investment bond market, after a brief recovery, has sunk back into apathy. Its present prices are not only below those of the January 'reinvestment movement' but substantially under those of last October. The pace of the fall in commodity prices slackened in early summer, but the average decline continued and, with its continuance, demand from the retail trade remained cautious and hesitant; the trade revival did not come. The stock market, meantime, continued to fall to a lower range of values after each temporary recovery, and as lately as June was governed by heavy liquidation for the account of embarrassed millionaire speculators of 1920."

As is the case today, people are moved only by that which lies before their own eyes. The fundamentalists, who cannot see beyond the next round of figures, failed then as they still fail today to foresee the subtle changes in trend and sentiment. As we continue through our accounting of the greatest bull market in the history of the United States, and the world for that matter, it will become blatantly clear that despite the sharp rise in the stock market into the late 1920s, the analysts wouldn't believe

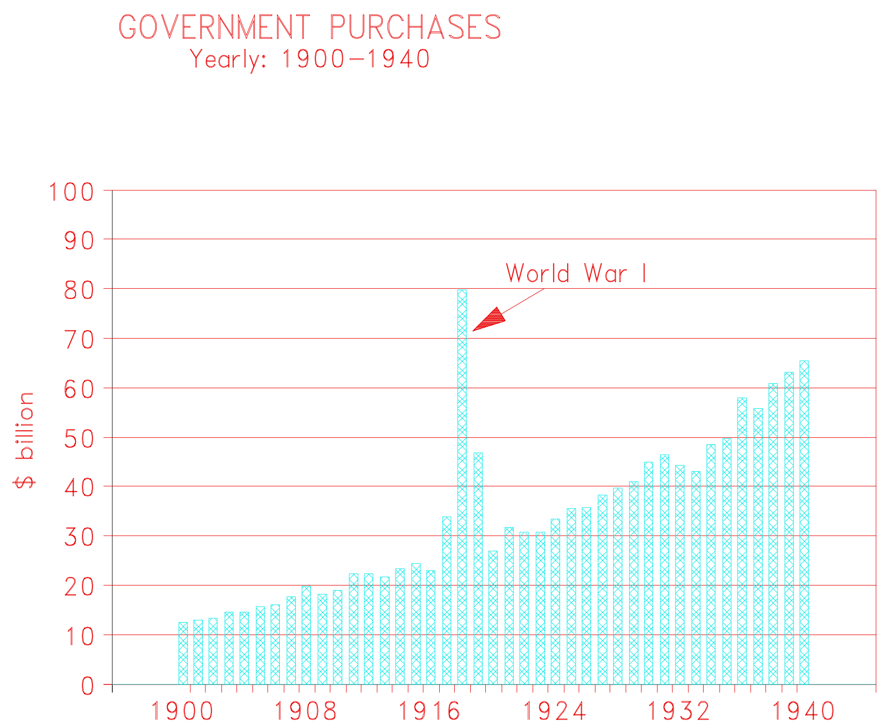


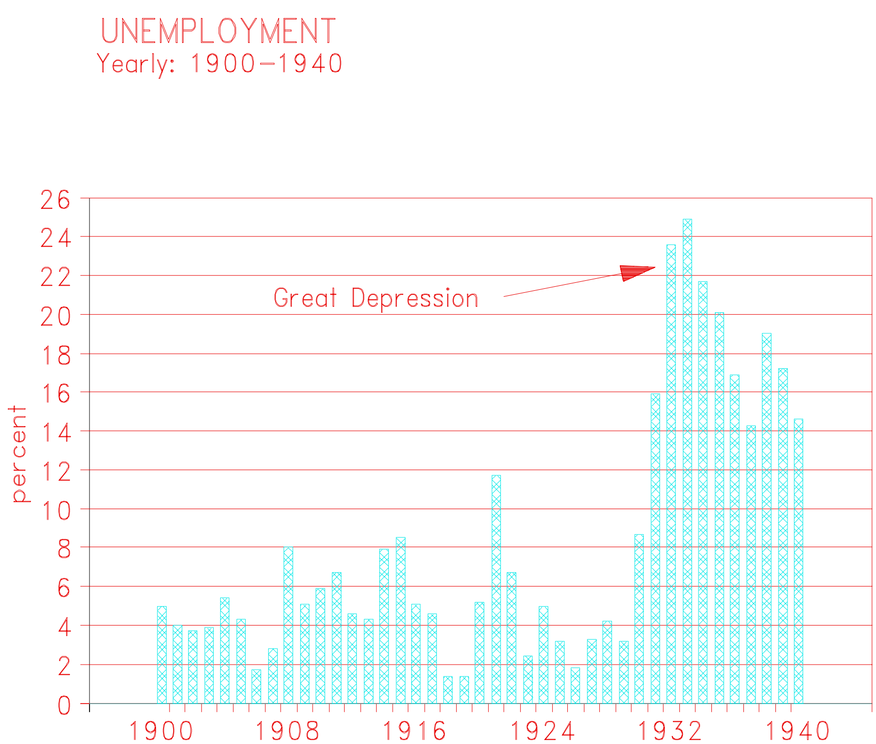
it and continued to cry depression for many years to come.

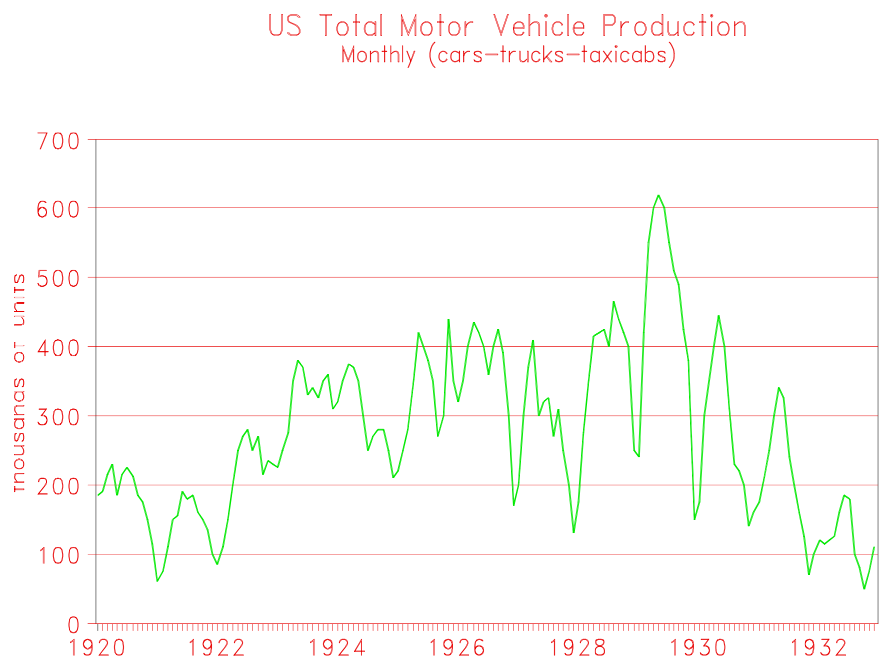
At this time, the economist Schumpeter formulated his economic theory, which has stood in direct contrast to both Keynes and Marx. Schumpeter's theory was centered around his concept of innovation. He believed that economic waves of prosperity begin because of some innovation that helps to broaden the economy. Once the prosperity peaks, the resulting collapse comes about due to the lack of some new innovation. Therefore, the over expansion results in too much competition, which reduces profits and forces the weakest out of business.

The bottom in the stock market in 1921 can be safely attributed to several reasons. The most important, a purely technical reason, was that the economy was fundamentally sound and despite the collapse in the agricultural sector, industry was expanding upon new frontiers with bright new ideas and the traditional spirit of American innovation. The first coast-to-coast airplane flights had been achieved and airmail service began to take off, so to speak, at the post office. This carried over into many other areas and helped to broaden the business connections which could be vital for future economic expansion.

The automobile industry became a rising star and by 1922, Henry Ford was proclaimed by the Associated Press to be a billionaire making $264,000 per day. The Lincoln Motor Company was started in 1921 and was bought by Ford in 1922 for $12 million. In 1922, Durant Motors come out with the "Star," priced at $348 to compete with Henry Ford's Model-T, an attempt by Willy to regain his former fame and influence. Chevrolet began to use Du Pont paints and offered cars in a variety of colors. Hudson, Deusenberg and Checker Motors Corporation also joined America's latest industrial innovation, the automobile. For despite the doom and gloom sayers, those who had money were buying cars. Perhaps still in the stages of infancy, the auto indus-


GOVERNMENT PURCHASES
Yearly: 1900–1940
World War I
$ billion
100
90
80
70
60
50
40
30
20
10
0
1900
1908
1916
1924
1932
1940


UNEMPLOYMENT
Yearly: 1900–1940
Great Depression
percent
26
24
22
20
18
16
14
12
10
8
6
4
2
0
1900
1908
1916
1924
1932
1940



try was embarking on a new age of industrialism. It was Schumpeter's Theory of Innovation that saved the decline and fall of the U.S. financial system.

The devastation of the 1920 panic and that of early 1921 was senselessly brought about by a government which was incorrect in its assessment of the economy and its fear of inflation. The overkill tactics of the Federal Reserve were a serious mistake which would carve a cold image in the minds of many for years to come.

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