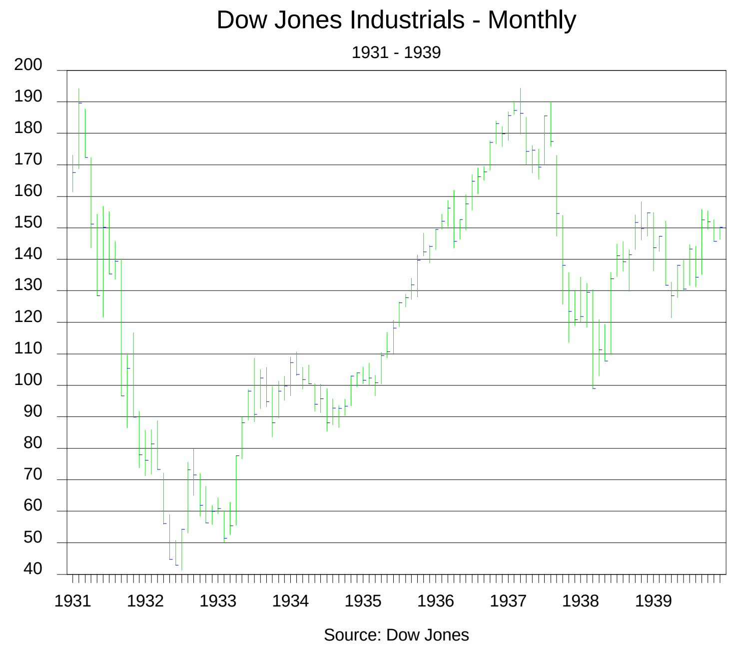
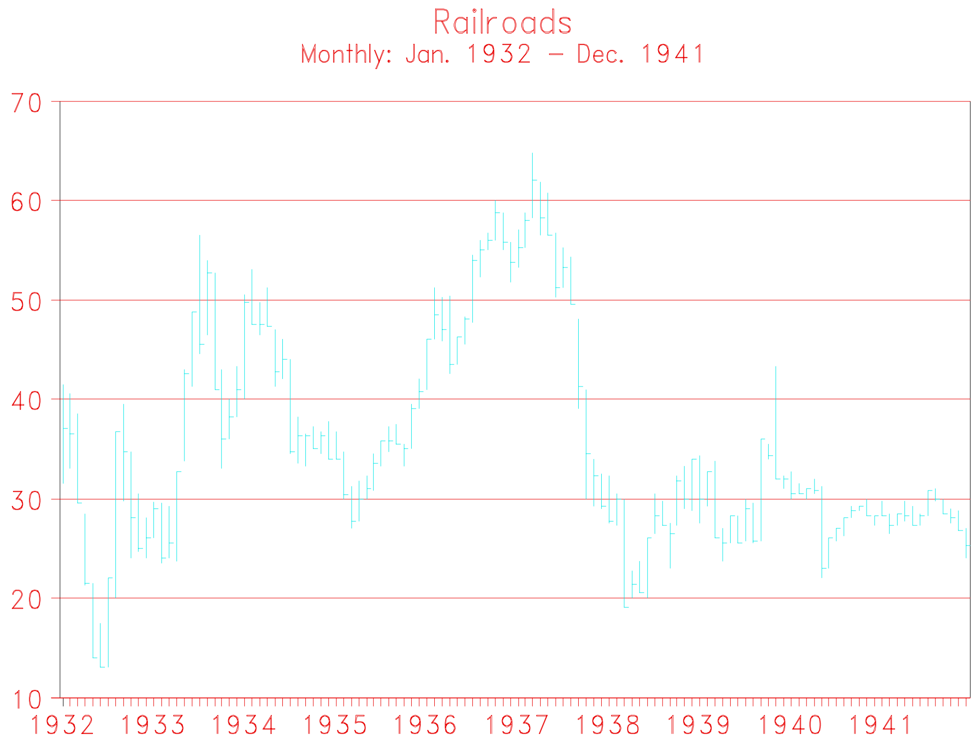


Confusion dominated the world economy as 1933 emerged. Much of the misconceptions of the Great Depression were propagated by the campaign of 1932 and the false accusations hurled at Hoover by Roosevelt. In every political campaign the participating parties usually attack their opponents with statements that are less than true. One of the dangers to society as a whole resulting from this type of political behavior is the tendency to influence the minds of the populace to such an extent that their ideas and concepts become changed and distorted thereby endangering future economic progress.

The Presidential elections of 1932 was by far the most dramatic influential event from the political economic perspective within the entire post 1929 era. The blame for the Depression as placed upon the shoulders of Hoover changed and shaped the public perspective of the political system from then on. The Republicans were marked as the party for the rich and the Democrats emerged clad in shining armour as the defender of the poor and working class. It was in fact many of the Democratic statements during this period which strengthened the communistic movement within the United States. I should point out that the Democrats were not outright supporting communism, but their political attacks on the Republican party as supporting the rich who had speculated forcing the entire world into depression with the collapse in the stock market made lovely ammunition for the communist as well.

In the decades that followed, the infrastructure of the political economy within the United States grew ever more closer to the socialistic ideals which characterized the "New Deal" as building society from the bottom up rather than from the top down. Spending programs began to drift toward social programs and the very direction of the political economy of the United States had been changed from a small less obtrusive form of government to a highly involved government structure. This was in many ways accompanied by shifting the blame for the Depression on the Republican party and the wealthy class within the American society. Despite the fact that this



was wrong, the populace bought the idea and was eager to pin the blame on someone.

It was therefore this misguided blame for the Great Depression upon the stock market and the Republican party which actually altered the decades that followed. The thinking process which once drove the stock market higher or lower began to alter and transform into a distinctly different method of fundamental analysis. The intentional misdirection of the causes of the Great Depression would serve as the basis for the very same errors and problems which would return following World War II. Competitive devaluations, trade wars, antitrust actions, all emerged with an uncanny sense of deja vu. Without honestly assessing the blame for the Depression on international problems of trade and fiscal irresponsibility, those very same errors would be made once again.

The accusations which Hoover had made against Roosevelt in regard to his position on the gold standard were perhaps dismissed by the Democratic party prior to the elections, but following them Hoover's warnings had become crystal clear reality. The massive population within the United States was largely uninformed of the true causes of the Depression. They did not grasp the idea or concepts which were at stake during the elections. As a result, ironically it was the poor and the middle class who were now about to suffer the lion's share of the hardships dealt by the worst banking crisis in all modern history. Its causes would stem from the very concepts of money and the gold standard itself. The general population did not understand the full impact of what would be termed "currency inflation" but by the end of 1933 there would be few Americans who did not understand the role that gold would play in this new economic tragedy.

The most serious problems resulting from Roosevelt's statements began to arise over his position on currency. He had made several vague statements in reference to a "managed currency" but distinctly omitted the word "gold." On the eve before the elections, pressure from many sectors de-

manded that Roosevelt clarify his position. He did. He pledged that he would not abandon the gold standard and inferred that concerns in that respect were not warranted.

Upon winning the election, his secret policies immediately began to emerge, casting devastating doubt upon the future, and rumors began to spread like wildfire that a devaluation was in the wind. The Democratic party had long been a symbol of "soft money." The 1890s were long remembered as the period of the "Silver Democrats" with William Jennings Bryan's famous speech of "Thou shalt not crucify mankind upon a cross of gold." When Hoover charged Roosevelt with planning to abandon the gold standard during the campaign, Senator Glass, at Roosevelt's request, furiously denied the allegations.

Nevertheless, following the elections, flood of rumors began to circulate that Roosevelt was planning a devaluation. These rumors became so widespread that on January 2, 1933, a distinguished group of over 30 economists issued a public statement in which they said "the gold standard of present weight and fineness should be unflinchingly maintained. Agitation and experiments would impair confidence and retard recovery!"

On January 4, 1933, Senators Wheeler, Thomas and Connally all made statements in the Senate in favour of a devaluation on that same day in the House, Garner pushed a resolution through in which he called for the publication of names of all financial institutions that had borrowed from the Reconstruction Finance Corporation. Several Democrats, including Green, joined the Republicans in protesting this action. Hoover pleaded against publishing the list for he feared that a panic would result.

As Hoover feared, the public began to assume that if a bank had borrowed from the RFC it must be in trouble. By the end of January 1933, 62 banks on the list were forced to close their doors, resulting in $70 million in losses. On February 18, Senator Robinson introduced a bill to stop publication, but the measure was defeated. Robinson pleaded personally with Roosevelt but he insisted that "everything should be public." The casualties continued and by the end of February, $200 million was lost through banks which had been forced to close. Curiously enough, Roosevelt blocked all efforts to stop the publication of RFC loans but immediately put a halt to this practice when he assumed office.

Meanwhile, the rumors of devaluation were creating a panic in foreign exchange and a flight from the dollar domestically as well. Many ran to the bank withdrawing gold coin. It appears that Roosevelt was following the advice of George F. Warren, a professor at Cornell University who contended that a devaluation would artificially create a great boom similar to the inflationary periods of the Spanish Conquest and the huge gold and silver discoveries in the U.S. and Australia between 1849-1860. The theory was that a devaluation would raise prices as well as wages naturally, a devaluation does raise the prices of goods since such items seek an international level of value among nations

Adolph Miller at the Federal Reserve claimed that Roosevelt had openly suggested the concept of devaluation to a private gathering of bankers in mid- January 1933. Europe was aware of the rumors but was still baffled by them since their view was clear, the dollar was not overvalued. Roosevelt was described in London as a man who "held no economic theory." Nevertheless, from the November low of $3.15, the pound jumped to $3.43 by February, an 11.25% gain. The smart money in the United States was buying foreign exchange which the masses were hoarding gold in ever increasing quantities in the end, those who had bought the foreign exchange profited handsomely. But those who hoarded gold found themselves subject to criminal prosecution if they did not surrender their gold holdings at the old value of $20 prior to Roosevelt's devaluation in January 1934, which fixed gold at $35 per ounce.

The situation was becoming intolerable. No one knew what was going on and banks were besieged by both those who were fleeing from the dollar as well as from the fear of insolvency caused by the publication of the RFC loans. On January 23, the New York Times urged Roosevelt to make a statement to confirm the pledge he made the night before his election not to abandon the gold standard. The New York Times wrote:

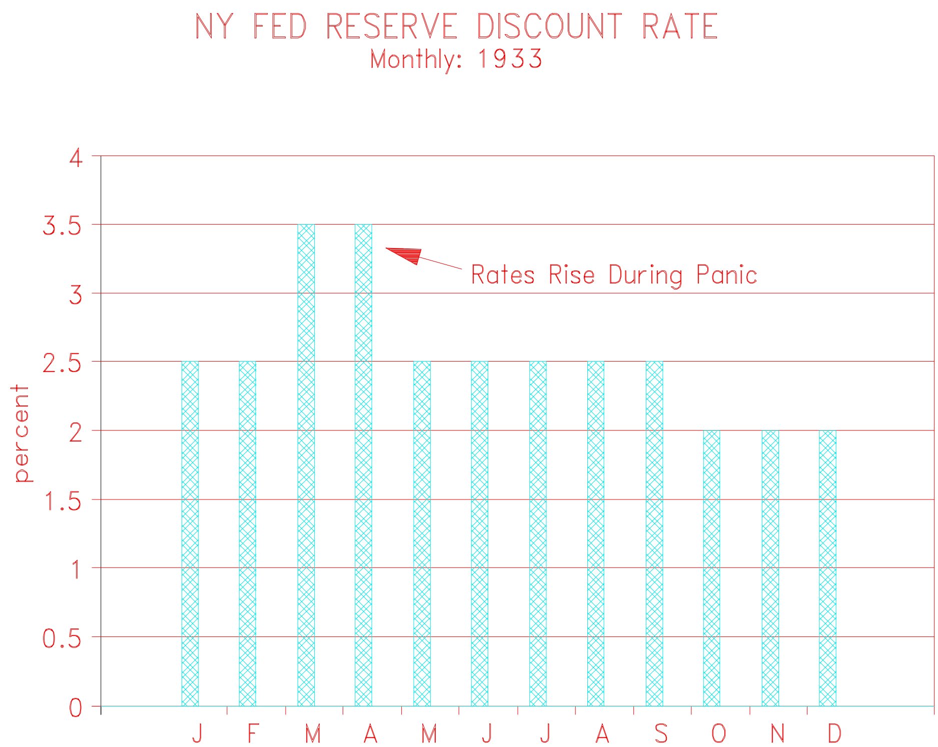
"It is probable enough that the present spirit of hesitancy, not only in financial mar-

kets but in general trade, is more or less influenced by lack of such reassurance...in numerous older similar occasions doubt and mistrust prevailed with exceedingly bad effect on financial sentiment, until the President-elect took matters into his own hands and publicly avowed his purposes. This was notably true in the pre-inauguration period of 1885 and 1893, at both of which junctures the maintenance of gold payments was being discussed uneasily and at both of which Mr. Cleveland stated so positively and so courageously his own views of the general problem as to remove at once all apprehension."

On January 30, 1933 Senator Thomas told the Senate:

"I am in favor of cheapening the buying power of the American dollar if this can be done; to the extent that the dollar is cheapened, to the same extent will commodity prices be increased."

The rumors were further intensified by Henry Wallace, an announced member of



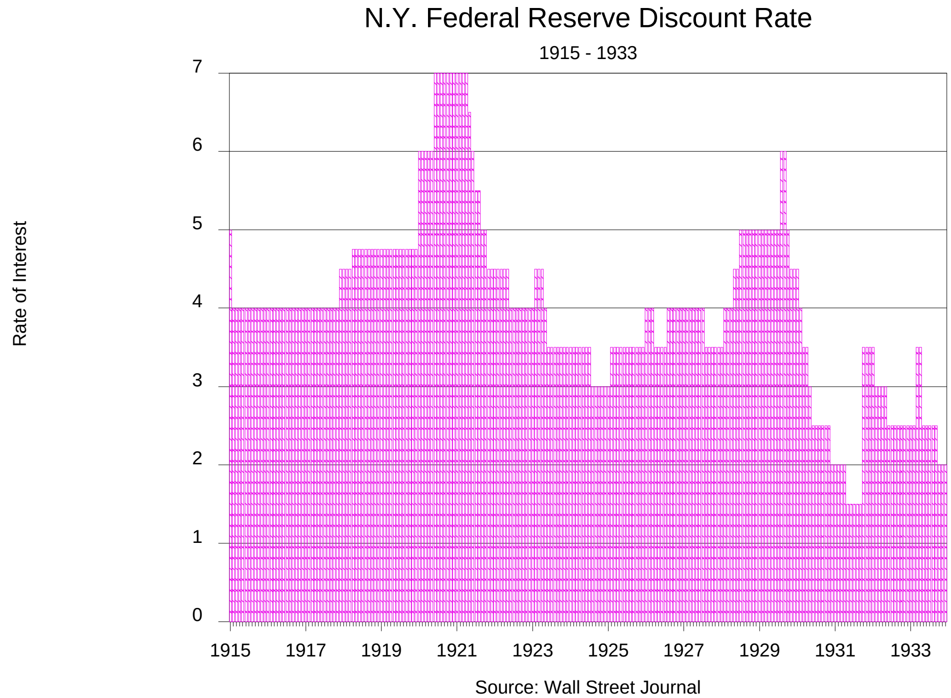
Roosevelt's forthcoming cabinet, who said: "The smart thing would be to go off the gold standard a little further than England has."

The same day, the Federal Reserve issued a statement warning of the dangers of devaluation. The press was besieged by all these comments and rumors and tried to obtain a definitive comment from Roosevelt, but failed Foreign banks began to redeem their dollars for gold, further increasing the drain upon reserves. The withdrawal of gold coin from the Treasury was approaching a crisis level. During the last 10 days in February, $80 million in gold coin had been withdrawn and during the first four days in March, $200 million had been withdrawn. The pressure upon the banks had become intolerable.

Throughout early February, many of Roosevelt's supporters, who had not known of his secret policies of devaluation prior to the election began to make public statements against him. Melvin A. Traylor, the well respected Chicago banker who had fought Benjamin Strong was originally a Roosevelt supporter. He spoke out, saying "Nothing but a declaration from Mr. Roosevelt that there will be no devaluation will save the situation from a general panic." Bernard Baruch warned the Senate committee that the situation had become the "most serious in history... If you start talking about devaluation you would not have a nickel's worth of gold in the Reserve System day after tomorrow." And on February 13, the New York Times again called upon Roosevelt to answer these wild rumors.

Roosevelt had left for a cruise and returned on the 17th of February. Hoover wrote a letter advising Roosevelt of the situation. It read as follows:

"A most critical situation has arisen in the country of which I feel it is my duty to advise you confidentially. I am therefore taking this course of writing you myself and sending it to you through the Secret Service for your hand direct as obviously its misplace-



ment would only feed the fire and increase the dangers.

"The major difficulty is the state of the public mind, for there is a steadily degenerating confidence in the future which has reached the height of general alarm. I am convinced that a very early statement by you upon two or three policies of your Administration would serve to restore confidence and cause a resumption of the march of recovery."

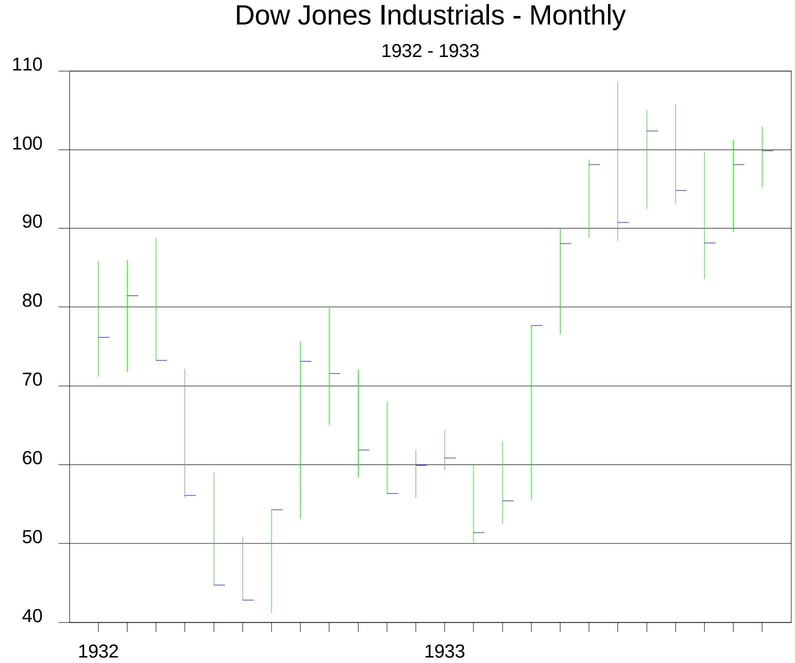
Up to this point in time, all talk was being conducted through Roosevelt's closer supporters. No word from him would deny or confirm whether or not these rumors had any basis in truth. The situation continued to degenerate on the 18th of February, Senator Glass, who publicly had accepted the post of Secretary of the Treasury under Roosevelt, announced that he had refused the post because upon meeting with Mr. Roosevelt, the President-elect would not provide the Senator with an assurance that the gold standard would be maintained. This only intensified the situation since Senator Glass had been a strong Democratic leader in the Senate and the originator of the bill that gave birth to the Federal Reserve. All the press from the New York Times on down carried the story.

The New York Times reported on the perspective from London:

"The judgment of financial circles here is that at no time in the recent economic history of America has there been greater need than at present for a flat declaration of a monetary policy by the new American government. It is believed that if the inflation bogy is definitely laid by the new Administration, the first long step toward restoring confidence will have been taken."

The perspective from Paris was also reported by the New York Times:

"The confusion of mind on Europe's markets concerning the future tendency of the dollar must be ascribed to lack of information regarding the definite intentions of the new American government. A declaration



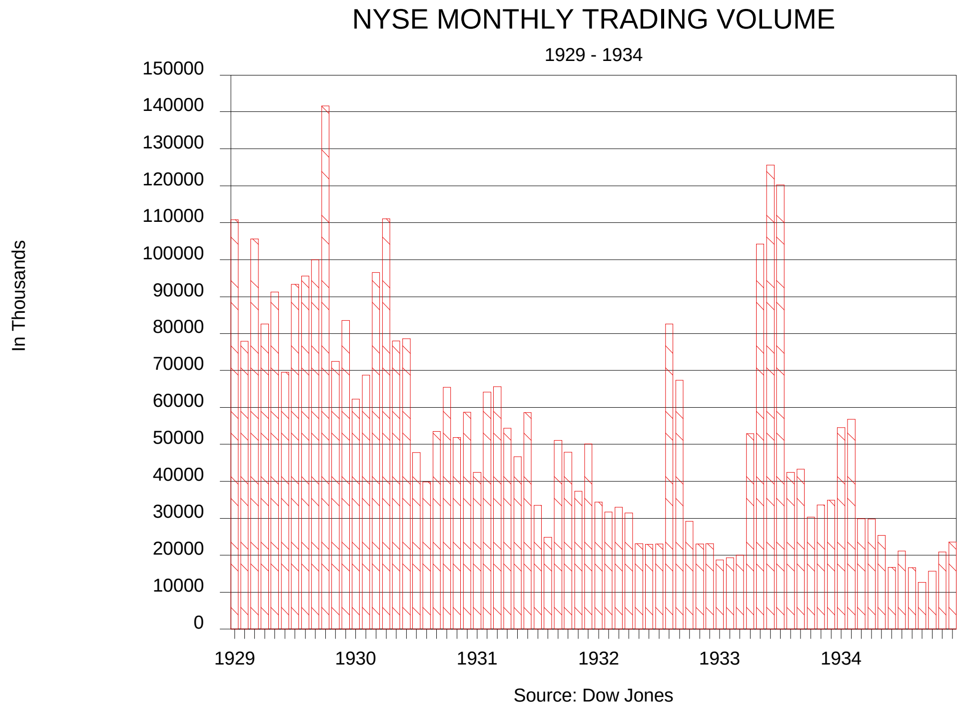
by Mr. Roosevelt declaring firm resolution to maintain a sound currency would have an extremely reassuring effect. So would a plain statement on the economic policy which he proposes to pursue."

On February 23, 1933, Roosevelt responded to President Hoover's letter, apologizing for the delay by stating that he had overlooked it. He gave no reply as to his forthcoming statement. Hoover attempted to use the War Powers Act to prevent capital from flowing out of the country, but the Democrats blocked it. He attempted to increase the loans to banks through the RFC; Senator Couzens blocked it.

The full accounts of the period from a number of sources including memoirs of various noted individuals as well as newspaper editorials all attest to the intentional political motivations of Roosevelt to allow the situation to reach a panic level so that he might reap the benefit of appearing as the hero. His actions resulted in the worst banking crisis in the history of the United States, all for his own personal political gain. The public's withdrawal of gold as well as foreign withdrawals were promoted by fear of his incoming administration. Numerous speculators with knowledge of his devaluations benefited greatly on foreign exchange speculations. For the average American who lost his savings through the unnecessary banking panic, there were no words of consolation.

Nevertheless, we have reviewed how many blamed the depression prior to July upon excessive pessimism. It is said that the stock market is often a leading indication for the future of the economy. This has been true over various intervals largely because the movement of any market is based upon future expectations. Economic expansion takes place when future expectations of business conditions look to be prosperous.

The incidents which took place between November 1932 and March 1933 were clearly an anticipation of future uncertainty and inflationary policies of a President-



elect. Indeed, much of the excessive decline in the stock market and in economic activity had a lot to do with the motions of the time. It was a depression of not merely price, but of attitudes and human emotions as well. This is what made the depression so "Great."

The stock market had peaked on the holiday cycle following Labor Day. It fell sharply reaching its lowest close following the elections in November. December hovered near the November low and then a rally developed on very low volume into early January. But as rumors spread during early January, the stock market began to fall. The flight from the dollar sparked numerous Europeans to dump their holdings, which forced the Dow Jones Industrials down from 62 to 50 moving into February 1933. Volume dropped to its lowest point in the history of the collapse during the early January rally which was perhaps a warning that February was going to drop sharply.

Of course, when Roosevelt assumed office on March 4, he declared a banking moratorium enacting the War Powers Act which he had prevented Hoover from using, claiming that the power had been taken away with the repeal of that law after World War I. The stock market and the banks remained closed. The stock market reopened on the 15th of March. The market opened higher initially near the 62 level but fell back to 56 for the end of the month. Volume increased to 23 million shares which was substantial considering it had only been open for two weeks.

In April, 1933, Time magazine reported the various consensuses of opinions as the market began to reverse to the upside.

'**HOPES.** Faith in better business conditions rested chiefly on the following ground:

Reopening of some 13,500 U.S. banks (75%) provided a broad enough credit base for commercial operations. The closing of weak banks makes that base much firmer than before.

Prospective balancing of the U.S. Budget means that the Government's credit should remain absolutely sound.

The Federal Reserve's gold holdings increased $327 million.

"Beer promises new profits not only to breweries (average brewery stocks rose nearly 50%), but to motor companies (manufacturing delivery trucks), to farmers (who grow barley and hops), to vendors of labels, bottles, bottle caps, advertising. Ownes-Illinois Glass Co. reported that orders for 62 million beer bottles had been received in the last month. Restaurants and hotels look for more profits when they can sell.

"**DOUBTS:** Businessmen looking ahead saw, however, these obstacles which must be overcome before recovery gets into full swing.

Healthy though it is to have weak banks cut out of the banking system, if 15% or 20% of the banks are liquidated it means that depositors will have to pocket losses of hundreds of millions of dollars. In liquidation, National Banks average only about 67% payment to depositors, state banks considerably less. Furthermore, while the Federal authorities appear to have been fairly rigorous in weeding out weak banks, there are no doubt cases on non-member state banks opened by local authorities who for political reasons were more lenient than they should have been.

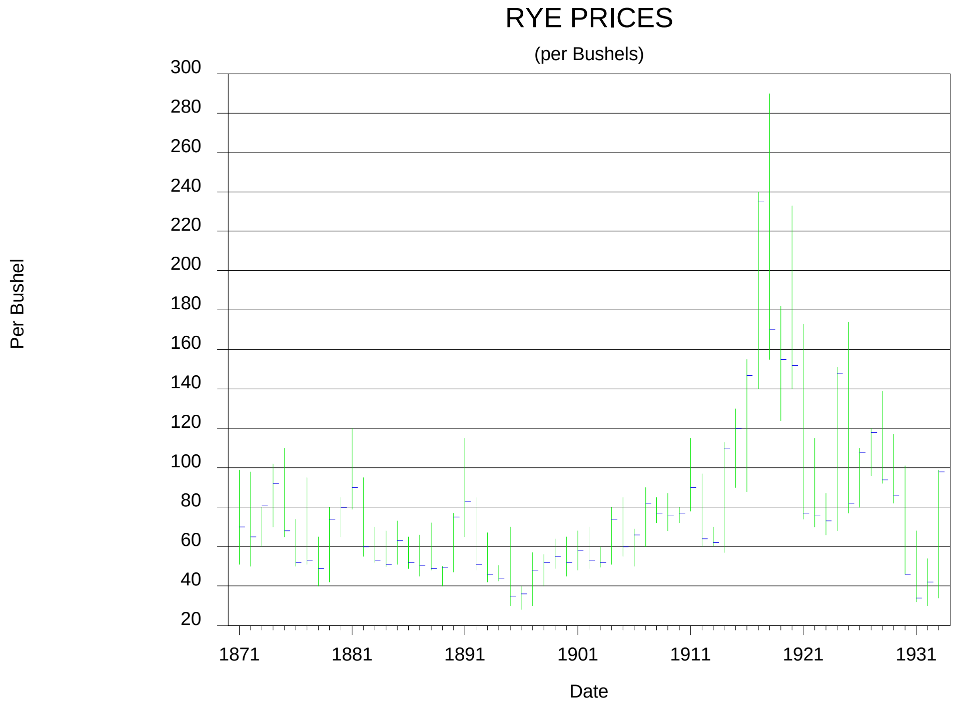
It remains to be seen whether the Administration's efforts will have any effect on restoring farm prosperity. Unless nature or government succeeds in restricting next year's crops, the farm surpluses bid fair to stay.

Many railroads must soon face reorganization.

There will have to be a readjustment of many mortgages, urban as well as rural. Last week in ever radical North Dakota, Governor Langer ordered the militia to prevent foreclosures where sheriffs disregarded his orders.

The bond and mortgage situations must be cleared up for the benefit of life insurance companies."

The stock market continued to press higher but confusion began to increase. Those who were bullish and looking for a balanced budget began to take profits on the April rally as rumors and perceptions began to change. The very fabric of analysis was under siege by forces which had not been disclosed prior to the elections. Many thought that Hoover was merely making up stories and unwarranted accusations against Roosevelt in respect to his "soft money" attitude. That was political hype, they thought; Roosevelt wouldn't conceive of an unbalanced budget. But this gave way to the reality of events and by mid-April, inflation was crowned to be the next savior of world doom. Arguments became fierce. Europeans became frightened. Many viewed that inflation in commodity prices would bring a great bull market as it had in 1907 and 1919. But this time they were getting in on the ground floor. Who cared if the budget was balanced? Corporate profits would rise and government would simply float bonds to finance the entire spectacle. Why not buy and buy more? Those who were bearish in March turned bullish in April and the confusion was leading to insanity.



Strange as it may sound, markets exploded during April on the news of inflation of all things. On the 17th of April, Time magazine reported on the situation:

"GREAT ANTICIPATIONS"

"Last week wheat had its first whirl on the Chicago Board of Trade since the excitement when that market opened after the bank holiday. Spot wheat touched 63 cents, up 5 cents for the week.

Last week corn had a whirl. Spot corn touched 35 cents (up 5 cents).

Last Week rye had a whirl. Spot rye touched 50 cents (up 6 cents).

"Last week Board of Trade seats touched $7,000 (up $2,000) and the Board of Trade began again to feel as if springtime were the only pretty ring time. Trader Thomas Howell was seen several times upon the floor contrary to his custom. Arthur Cutten was reported active. Oldtime Trader Gardner B. Van Ness was home from Manhattan. Herbert J. Blum, long inactive, was reported once more functioning. Jesse Livermore was back in Chicago with his new wife and reported bullish on corn.

"The end of depressions, the beginning of inflations are marked by rising commodity prices. Many a depressed trader began to take heart last week. Other commodities were on the mend. Sugar was up. Surpluses of sugar and wheat both reported down. Copper was up on news that U.S. mines were preparing for a six month complete shutdown.

"Stocks took their cue from commodities, mounted moderately led by such companies as American Sugar (in hope of sugar recovery). Homestake Mine (bigger profits in gold if the dollar is devalued). Corn Products (in hope of corn recovery).

"Many such boomlets had been off and on during the Depression. Traders looked for profit-taking, some of which took place. But in last week's bullishness there was more than a mere hope because prices and indices had shown a little upturn. There was the beginning of the attitude: what now if not inflation? Either inflation because commodity prices would be turned upward by natural and governmental stimuli; or inflation because the Government is committed to spending billions, must float bond issues to reopen banks, save mortgagors, provide relief and a dozen other costly enterprises. Or inflation because Government might reduce the gold content of the dollar. Or simply inflation in expectation of inflation. Inflation or inflation or inflation. What other alternative?"

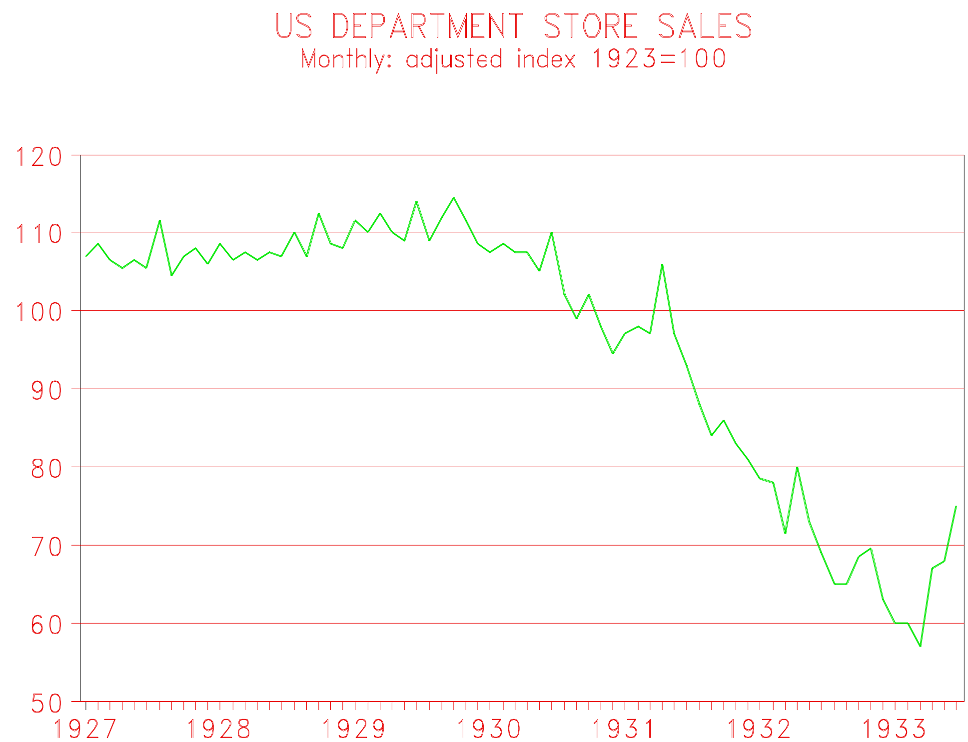
Here Time magazine reported several very important aspects as to how people viewed the situation. Today so many people hold the view that the stock market is not supposed to do well during inflationary periods. As we continue, I will show that such concepts have emerged only because of government's preoccupation with and harassment of the free market system which focused very closely upon the commodities and stock exchanges as a direct result of the Great Depression. This is no small statement; I am fully aware of that. But we will read further on how the government simply said it was against the law to trade below a previous low or sell a stock short on a down tick.

First, notice how the inflationary concept was viewed to be bullish. It was well remembered that the booms in 1907 and 1919 were inflationary periods, particularly pronounced in raw materials. Analysts realized one thing. All periods of great expansion and thus corporate profit were periods of inflation which were marked by rising interest rates as the bid for capital drove rates higher, just as stocks rose with continual bidding as demand increased. They realized that steady or recessionary to depressionary periods were not periods when stocks rose but instead declined. Such periods were marked by declining interest rates as demand for capital declined along with economic activity and thus expansion.

This is very important to understand. We today no longer look at rates of interest in this way. We have been conditioned to view interest rates in light of government harassment rather than in light of a free market from its economic prospects. Some will argue with this statement, but consider how much attention is paid to money supply and expectations of Fed actions because of such movements. we turn bullish because we expect a discount rate cut or we turn bearish because money supply rose and thus the Fed might tighten.

There is something seriously wrong here. Prior to Roosevelt, government was NOT the big brother and as a result its tentacles were less intrusive and less costly. Therefore, the private sector was the dominant sector. If interest rates rose, it was because demand within the private sector was rising. But beginning with Roosevelt, the balance between government and the private sector changed. As it changed, so did the relationship to some extent. Today we can have the private sector decline through a recession and interest rates would not drop back drastically between 6% to 1% as they did during this time frame. This is because government is a much larger part of the system since Roosevelt. This has distorted the perception as to when the market should literally explode to the upside.

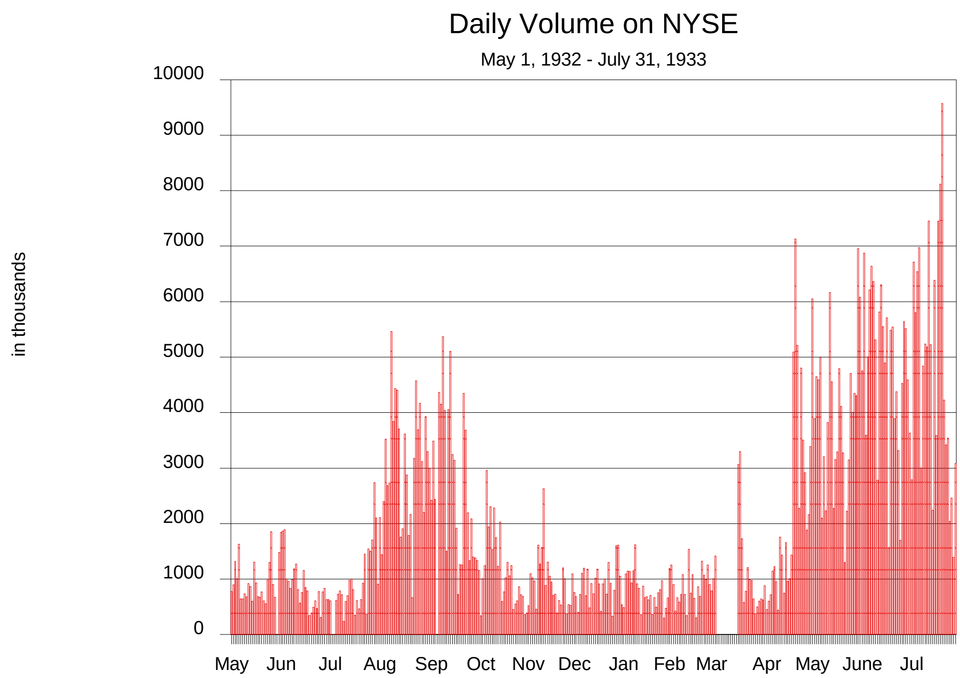
We find modern analysis bearish during inflationary periods largely out of fear of government intervention when in reality it



should be bullish. Economies only expand with inflation. They contract during deflation. In one aspect, inflation is a process where the public raises its demand for products, thus bidding the price for those products higher. Therefore, economic expansion takes place when such periods exist. Companies hire more workers to increase production to meet demand.

In the post-Roosevelt era, inflation became institutionalized by governmental forces apart from private demand. The benefits of increasing government spending to spark this inflationary demand greatly diminish because the aftereffect leaves high debt which must still eventually be repaid. That in turn prompts taxation to rise, and in the end government comes back to the private sector to repay the outstanding debt. The next cycle diminishes because more is being extracted from the private sector reducing future potential for expansionary waves. Thus, the free market system can continue to raise tax burdens to the point that it might as well become a communistic state where net wages are drastically reduced and productivity therefore declines through lack of worker incentive.

You will also recall that during the bull market of the 1920s many times the comments referred to the fact that money remained cheap and there was no appreciable sign of inflation. The reason for this confusion was twofold. First, the central bank conspiracy was seeking to influence foreign exchange by artificially maintaining lower rates which merely served to drive capital to where rates were higher. They had hoped that was going to be Europe to relieve their credit crisis. However, this also drove much capital into the stock market where it was seeking the higher level of dividend payments. Second, the raw materials were declining but the finished products were rising in price. The lack of monitoring inflation in a sophisticated manner led to this misconception. Inflation in finished products had risen significantly but primarily between 1927 and 1929. Diamonds and luxury items, as well as the real estate boom, were all side effects of the

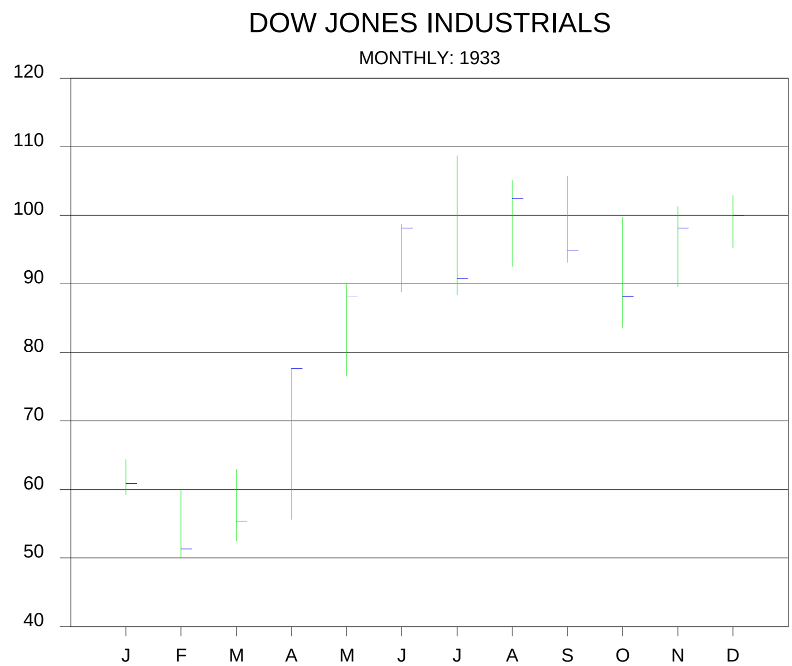


inflation that took place in the mark-up of finished products versus purely the raw materials. Time magazine reported as follows:

"While inflationary psychology was thus getting a start, it was abetted by talk of cutting the gold content of the dollar. President Roosevelt had finally issued an executive order under power given him by Congress in the emergency banking act, ordering all holders of gold to turn it in to the Government by May 1 or take the penalty. What else did this mean except that the Government was gathering in all the gold preparatory to melting it into smaller dollars? Or it might mean that Government wanted to gather up the maximum amount of gold to back the present dollar and permit release of earmarked gold of foreign nations."

In May, when interest on U.S. gold bonds was due, traditionally these issues called for interest to be paid in gold for the lender had lent gold, not paper. Nevertheless, Roosevelt broke the "covenant" as many screamed about receiving their interest in paper dollars. The Commercial & Financial Chronicle addressed the issue quite seriously stating, "The United States Government has taken a step backward into the darkness of the Middle Ages!"

Many people were very confused. They assumed that Roosevelt's recall of gold was intended to reissue gold coins with less weight and that would be the so- called devaluation. But when the May deadline for turning in the gold coins had passed and government gold bond holders were not being paid their traditional interest in gold, concerns began to crop up. Nevertheless, commodities continued to rise with copper reaching 7 cents per pound, up from 5 cents in January. Legitimate shortages were in effect taking place. Many of the curtailments in 1932 were now turning up as projections for 1933 had been overstated. In May, the Farm Board had sold its last 8 million pounds of cotton on the futures exchanges and cotton rallied to 9 cents.



The Federal Reserve's index on department store sales for April 1933 illustrated a 9% decline from April 1932. The first four months combined expressed a decline of 22%. April had at least begun to improve to some degree since the bank holiday but retail sales were still sharply lower compared to 1932 levels.

Commodities and stocks were still rising sharply in response to the anticipated inflation from one way or another. During early June the news finally hit. The President was not going to cut the gold content of the dollar but eliminate the gold clause from public and private contracts. "Speculators gave a mighty heave that shot prices to the best levels in two years. As the public rushed to buy and buy and buy, transactions on the New York Stock Exchange swelled to an all- time Saturday record for a bull market -4,300,000 shares. Only once had that figure been exceeded - in the bear market of May 1930. At the end of the two-hour session, the new high-speed ticker was 41 minutes behind the floor," reported Time magazine on June 5, 1933. Commodities rallied to their highest level since the inflation boom began.

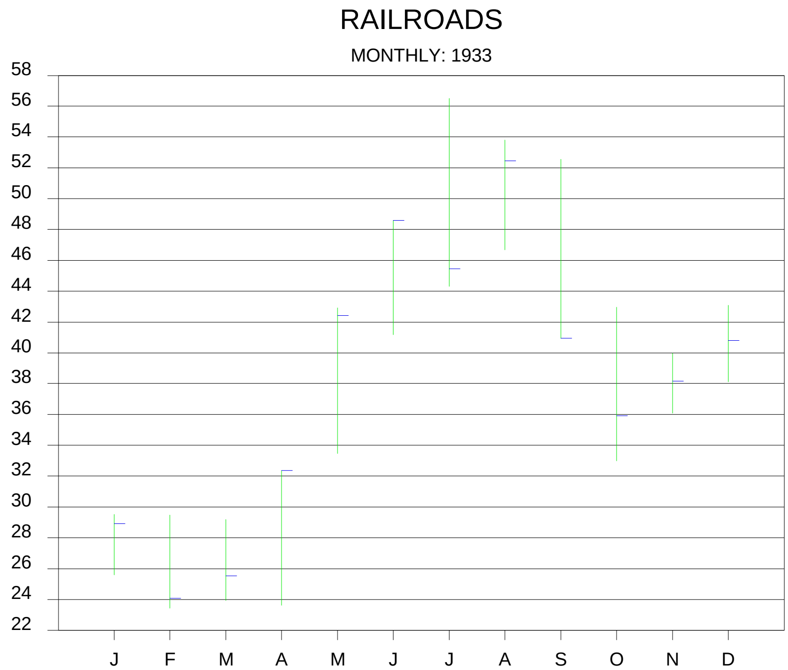
The Dow Jones Industrials had stormed virtually straight up since the February low. The industrials rallied from 50 points to slightly below the 100 level, closing near the high in June. Confusion over exactly what Roosevelt was doing persisted. Many assumed that only the gold clauses were being eliminated and had no conception that they had seen their last gold coin.

Another factor that emerged during June was the new Securities Act of 1933, which was written by Professor Felix Frankfurter who was Harvard's top man. Lawyers were desperately trying to find a loophole, but there was none to be found. This man was the best. He taught his pupils how to take apart laws and get around them. He knew how to do it and as such was the perfect man for the job. His Securities Act of 1933 had a very serious impact. Essentially it stated that if any "material" fact is misstated or if any "material" fact is omitted, each director is held personally liable for the loss incurred by a buyer of the security. Few lawyers were prepared to advise their clients that they could go ahead and offer any security. This led many to speculate that a shortage of stocks might develop.

The market continued to press higher into July, reaching very close to the 110 level. But then suddenly, the industrials collapsed hard, closing the month near the low back at 90 on the Dow Jones Index. The new Securities Act applied to new issues as well as the buying and selling of securities that were already on the market. A debate naturally ensued. This was not the reason for what became known as the July Crash, but it played at least a part during the summer of '33.

The volume for June 1933 was 125 million shares, the largest on record with the exception of October 1929. Between May and June the combined total was 230 million shares. The "wet" issues were clearly the biggest movers. In July the demand for this group had become so great that the exchange raised the margin requirement to 60% on the "wet" issues only. But the news which had all along driven this group up was that issue. The Feds left each state to decide for itself. The states that everyone was waiting for were in the South when the Southern States voted for repeal, the good news was out. The very next day the Crash of July 1933 began and the "wet" stocks led the way down. Along with them, the grains in Chicago tumbled. That day 7 million shares traded hands. Stops after stops were elected and the broad market fell 20% by the end of the month while many of the "wet" issues fell much more. The 20% drop didn't take long. It was all over in three days! The Dow Jones Industrials had fallen 19.96 points in just three days!

The market would have fallen much further during the summer of 1933 if it were not for new rules that the government imposed upon the various exchanges. Time magazine reported on the 7th of August "Banned from the pit forever were all dealings in indemnities (options on grain futures contracts generally regarded as pure



gambling)." The markets were also "forbidden" to trade below the July low. Time magazine reported upon the effects of this measure on the 14th of August:

"The great exchanges of the U.S. last week lacked natural stimulants. On the Chicago Board of Trade the energy building grains, limited not only to 4 cent and 3 cent daily fluctuations, but also forbidden (by a rule good until August 15) to fall below their July 31 closing levels, floundered ineffectually...From similar listlessness, begotten partly by regulation, Manhattan's Stock Exchange was saved by the outside stimulants. Following pricking of the speculative bubble three weeks ago, the Senate's busy Prosecutor Ferdinand Pecora called on Exchange President Whitney, told him speculation must be curbed. Last week the Exchange announced two new rules: 1) brokers must report weekly to the Exchange all that they know of the operations of pools and syndicates; 2) traders with debit balances of over $5,000 must maintain margins equal to 30% of the debit balance; those with debit balances less than $5,000 must maintain a margin equal to 50% of the debit balance. Calculated the ordinary way, the proportion of a trader's equity to the total value of the stocks in his account, the margins now required to 23% and 33%. Example: if a man buys $1,500 worth of stock and gives his broker $500, he is said to have put up a 33% margin. However, his debit balance is $1.000, of which $500 is 50% adequate margin under the new Exchange rules."

The market interest declined considerably. Faced with limits, increased margins, but worst of all investigation if you happened to make money on the short side, the only safe way to play the markets was from the long side.

The Administration therefore intervened or simply forbid the market to trade below the July low. It was as simple as that. How could they do such a thing? Well as impossible or as outrageous as it might sound, that is what happened. Nonetheless, they did it and the market churned back and forth. The traders themselves withdrew from the

market and liquidity shrunk. The rule was rescinded on August 15 but other measures were taken to support prices. Time magazine reported on the issue again in its August 28, 1933 edition:

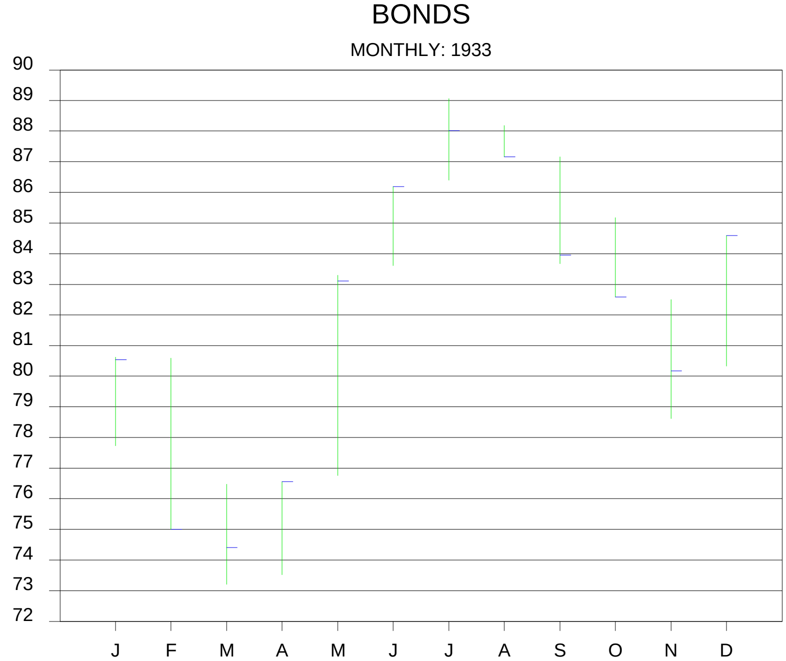
"SQUARE PEGS & ROUND PITS"

"Three weeks ago Chicago's Board of Trade instigated by Washington, set a temporary level below which grain future prices would not be allowed to sink. Last week that artificial floor was removed. Prices which had been bobbing along on the rule like balloons without lifting power promptly dropped the maximum amounts permitted in one day's trading. Great was the hullabaloo.

"Representative Jones of Texas and Senator Smith of South Carolina promptly swung inflationist thunderbolts about their head again. Letters and telegrams poured into Washington demanding that the Government re-peg prices.

"No such action was taken. Next morning the grain pits reopened and prices promptly dropped and bounced. They mounted rapidly and closed with substantial gains for the day. Thereafter they swung up and down, but neither sudden disaster nor abrupt boom followed.

"Contributory cause that certainly helped to steady the market was that, as the peg was removed, Secretary Wallace began to talk of the subsidizing of export of 50,000,000 bushels of wheat from the Pacific-Northwest, and of raising the wheat processing tax to pay for the subsidy. The Secretary of Agriculture has power to fix processing taxes at an amount equal to the difference between current prices and the average price 188 cents) for 1909-1914. The present tax of 30 cents a bushel represented that difference on June 15. For several weeks



wheat prices have been about 88 cents but the tax continues. But the processing tax can be increased only if wheat prices fall below the June 15 level.

"The threat of subsidized exports may have been partly intended to support the market. It served also as a club over the conference of wheat producing nations which met again this week in London to try to agree on crop restriction. What one nation calls 'subsidizing exports' other nations call 'dumping.' He proposed, however, to dump wheat in the Orient thereby cutting into the exports of Canada and Australia to those markets.

"Not according to the Golden Rule was Secretary Wallace's dumping threat for the U.S. Not only has a law against foreigners dumping in the U.S., but even when the Secretary made his announcement the Treasury Department was considering forbidding imports of steel from Germany, tennis shoes, electric light bulbs and calcium carbide from Japan, stearic acid and thumb tacks from Holland, rock salt from Canada, woven wire fencing, sulphide paper and binder twine from England, all on the grounds of dumping."

As a result of the processing tax and jawboning, the Administration was able to fix a cement foundation near the lows established by the crash of July 1933. Despite cries of "foul" from other nations, the Administration was clearly prepared to bend any law and impose whatever it deemed necessary to shape and mold the situation as it saw fit. Many such moves were undoubtedly questionable on a constitution basis, yet they went unchallenged.

Roosevelt's moves were creating havoc in all markets which was especially reflected with the foreign exchange. The inflationists continued to muddle into every aspect of the economy, launching investigation after investigation. The power industry was deemed to be a public utility and the price fixing attempts continued. These measures seemed to become a kind of crusade bent upon tearing down the very fabric of the free society and moving dangerously closer toward the idealistic goals of socialism and communism itself.

The group of Roosevelt's advisors became known as the Brain Trust. In a letter to the editor of the Wall Street Journal, I found this interesting note of personal expression which was published on the 17th of October 1933:

"Perhaps an old fashioned turn of mind has made it impossible for the writer to follow the Brain Trust advocacy of price boasting. Not only has he read no convincing exposition but he has heard none. Rather it has seemed as if prices ought to be let alone unless we have gone Soviet and the price of everything from birth to burial is to be government regulated as in the public utility field; and if such widespread regulation awaits, we have a good sample in the case of the railroads (they have been regulated longer than other utilities) fully illustrating the conflicts; huge costs forming a burden on both taxpayer and user and the consequences if it be assumed, as the Brain Trust apparently does, the task can be accomplished there comes the question, Will it be worth all the grief entailed to arrive at that point?"

In the September 11, 1933 edition of Time magazine, we find the following commentary in respect to the Administration's policies which affected the gold mining industry. Many investors had been buying the gold mining stocks believing that gold was going to rise as a result of the inflationist policies. Time reported on the situation as follows:

"Because the world is round, what is right side up in the U.S. is upside down to China. Because of the geography of economics, gold miners like Chinese, are upside down compared to other men. Most businessmen worry about what price they will get for their product, but in normal times gold miners never worry, since an ounce of gold is (normally) the 'makings' of $20.67, the price they can get for their output never varies a penny. If other prices go up, other men are apt to profit, but for the gold miner that means only higher costs (no bigger income) and consequently smaller profits.

"Last March when Franklin Roosevelt ruled that money was not gold, he broke the old equation; $20.67 would no longer buy an ounce of gold. He cheapened the dollar to make prices go up to let businessmen profit. But he did not break the equation so far as gold miners were concerned. He would not let them sell their gold to anyone except the U.S. Government and the Government would pay only $20.67. Gold miners were out of luck - their costs mounted but the price of their product remained the same."

This situation had become intolerable and grossly unfair to the gold mines. The costs were rising rapidly. The mere cost of living had jumped 9% since March of 1933. Therefore, Roosevelt decided to allow the gold mines to deliver their product to the Federal Reserve and the Fed would sell gold to foreign buyers at the world price. This tended to export inflation to other nations, such as France, that had remained on the gold standard. At the same time, this meant that gold was a commodity in that respect and the proceeds were then credited to the trade balance. The annual U.S. production was about 2.5 million ounces so this would add approximately $75 million to this economic statistic which previously had not been included.

However, along with that decision came a harsh rule as well. It had been estimated that $500 million in gold coin had not been

TIME TO FIGHT

THE time has come when the intelligence of the country must speak its mind on the question of currency inflation, and speak it forcibly. It can no longer, it seems to this newspaper, stand by and permit the impression to gain ground in Washington that the Pittmans, the Thomases, the Bankheads and others of their kind are representative of the responsible and thinking mass of opinion in the nation.

There can be no question that those who understand monetary matters and who are familiar with the history of previous experiments in currency inflation are irreconcilably opposed to subjecting the country to the grave dangers inherent in these fatuous proposals. Unlike the inflationists, however, this great body of thoughtful citizens lacks, at the present time, the leadership and the organization that are essential if it hopes successfully to combat the uninformed but highly articulate propaganda of those who would resort to the printing press.

Any counter-movement launched against the inflationists should be non-partisan politically and should have leadership in which people could place confidence. Its objectives should be two: first, to educate the public in the dangers and fallacies that underlie demands for paper money inflation; second, to organize informed opinions so that the latter would make itself effectively felt in Washington.

Those who do not already realize it should be made to understand that there is no more vicious illusion in the world than the illusion that a shortage of money can be remedied by placing an official stamp on paper and declaring that such paper shall have a stated value. During every paper-money inflation of the past, whether one takes the case of the French assignats, the German marks or our own greenbacks, the result has always been the same: the faster the paper was printed, the greater and the more poignant the cry of a "shortage of currency." The reason for this is, of course, that such paper depreciates in value much faster than the printing press can produce new supplies. This is the essential fallacy of paper-money schemes. It is this fallacy which makes paper-money inflation, as an eminent German authority, Dr. Peter Reinhold, has put it, "the most terrible thing that can happen to any civilized state."

But it is the record of inflation of the currency that its evils do not end with an accentuation of the problem that it is expected to remedy. In the process it works an inequitable and a cruel redistribution of a country's wealth. As one historian has trenchantly written, "It leads to the absorption of the means of the workingman and the man of small fortune; it impoverishes men living on fixed incomes, salaries or wages, and creates on the ruins of this large group a small class of debauched speculators, the most injurious class that a nation can harbor—more injurious than professional criminals, whom the law can reach and throttle; it stimulates production at first, and leaves every industry prostrate afterward; it breaks down the idea of thrift and develops social and political immorality."

We want no experiments of that sort in the United States. But there is grave danger that we may have them forced upon us if those who are aware of their hidden dangers do not make their opinions felt. Friends of sound money cannot afford to permit an issue fraught with such grave economic and social consequences to go by default.

New York Herald Tribune Editorial
September 22, 1933

This is one of eight editorials on Inflation that have appeared in the New York Herald Tribune. All eight have been reprinted and will be sent on request to business men who are interested in following the campaign for sound money.

NEW YORK Herald Tribune

The Oldest Bank in New York
Established in 1784

New York Clearing House
Membership Number One

Banking Paralysis?

in 1907

A few days ago one of our customers reminded us of the incident which led to his choosing this as his bank. In the midst of the panic of 1907 we wrote to a large number of potential borrowers, offering to make substantial loans for sound purposes. The individual just mentioned was not one of our customers at that time, but he applied for and received a credit line of $100,000—largely to find out whether we meant what we said. He liked our attitude as well as our prompt action, opened an account, and established a relationship which has continued for over 25 years.

in 1934

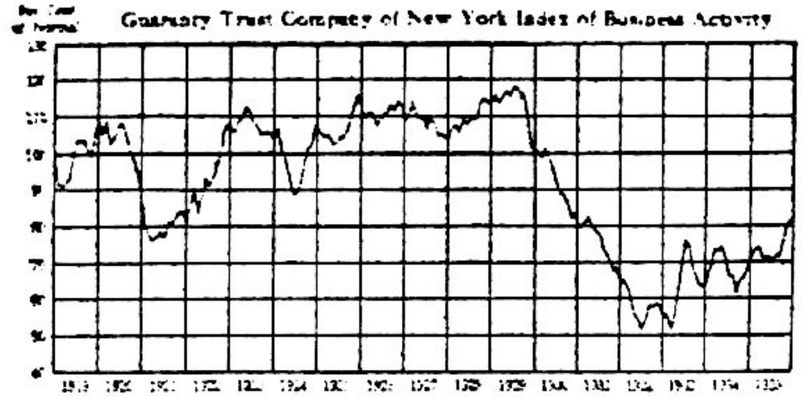
Ever since March 1933 attention has been focused upon the so-called "paralysis of the country's banking system." Perhaps you have gained the impression that all the banks in the country have stopped making loans. The fact is that there is more credit available today for sound enterprises than business men are able or willing to employ. This bank is not paralyzed—and the same thing is true of any number of other banks in various parts of the country. This institution has ample liquid resources, and in recent months has frequently renewed the offer made in 1907.

Alternating periods of panic and prosperity for 150 years have not affected the character of our banking service to customers.

BANK OF NEW YORK & TRUST COMPANY

48 *Wall Street · New York*

UPTOWN OFFICE: MADISON AVENUE AT 63RD STREET



An Index of Business Activity

IN the present period there is keen interest not only in the current trend of business activity but also in the record of recent years as a basis for comparison.

This Company's index of business activity is published in each issue of THE GUARANTY SURVEY, a monthly review of general economic conditions in the United States and abroad. This weighted index, developed through long observation of business factors and tested for sensitiveness to changing conditions, covers the period 1919 to date.

This publication also includes a chart showing indices of wholesale prices for the period 1919 to date, and a table showing the range of prices of representative basic commodities from 1913 to date.

We are pleased to place the names of business executives on the mailing list to receive THE GUARANTY SURVEY.

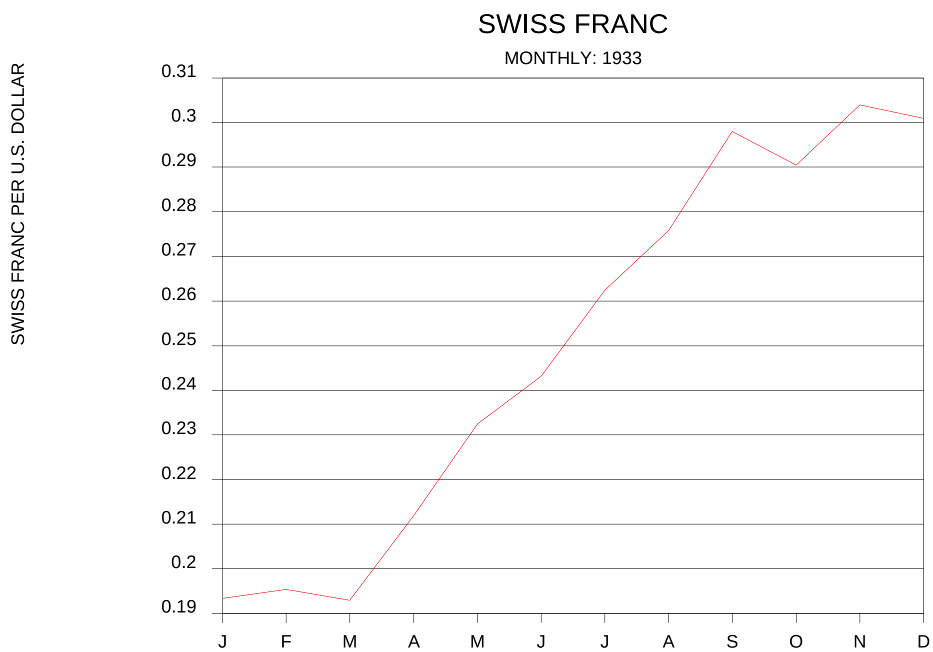
Guaranty Trust Company of New York

140 Broadway

Fifth Avenue at 44th Street — Madison Avenue at 60th Street

LONDON PARIS BRUSSELS LIVERPOOL HAVRE ANTWERP

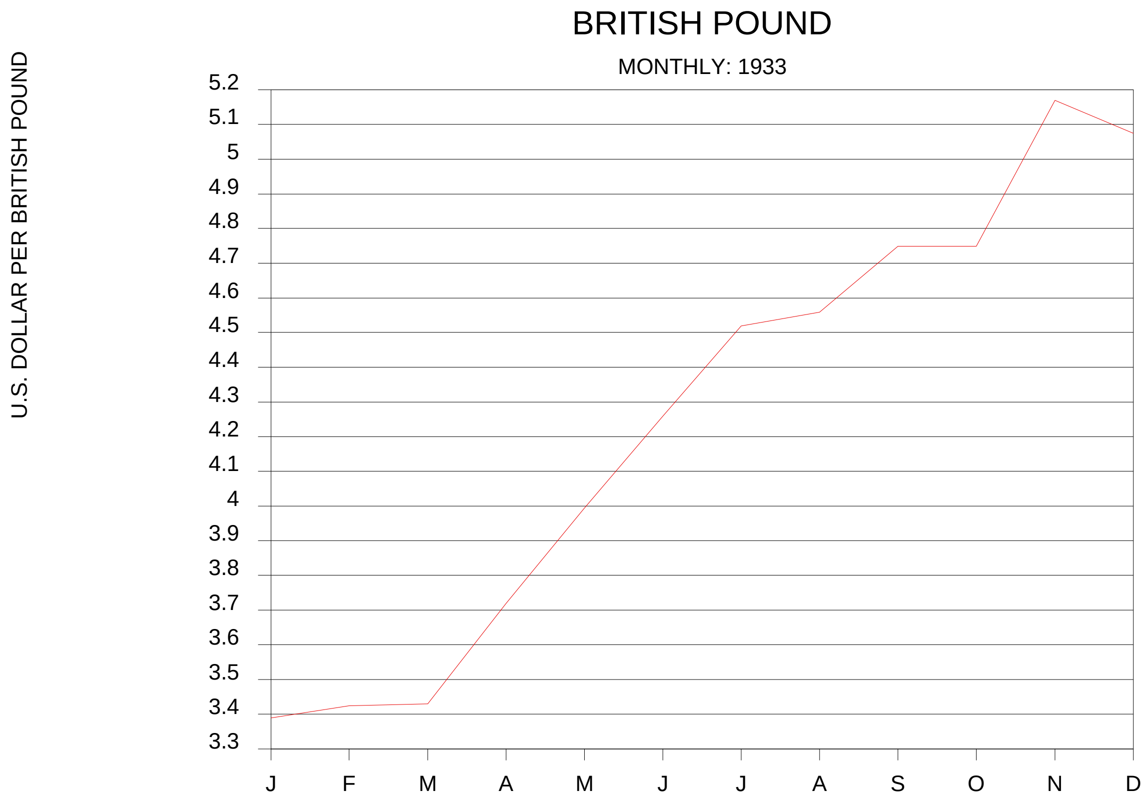
(Member Federal Deposit Insurance Corporation)

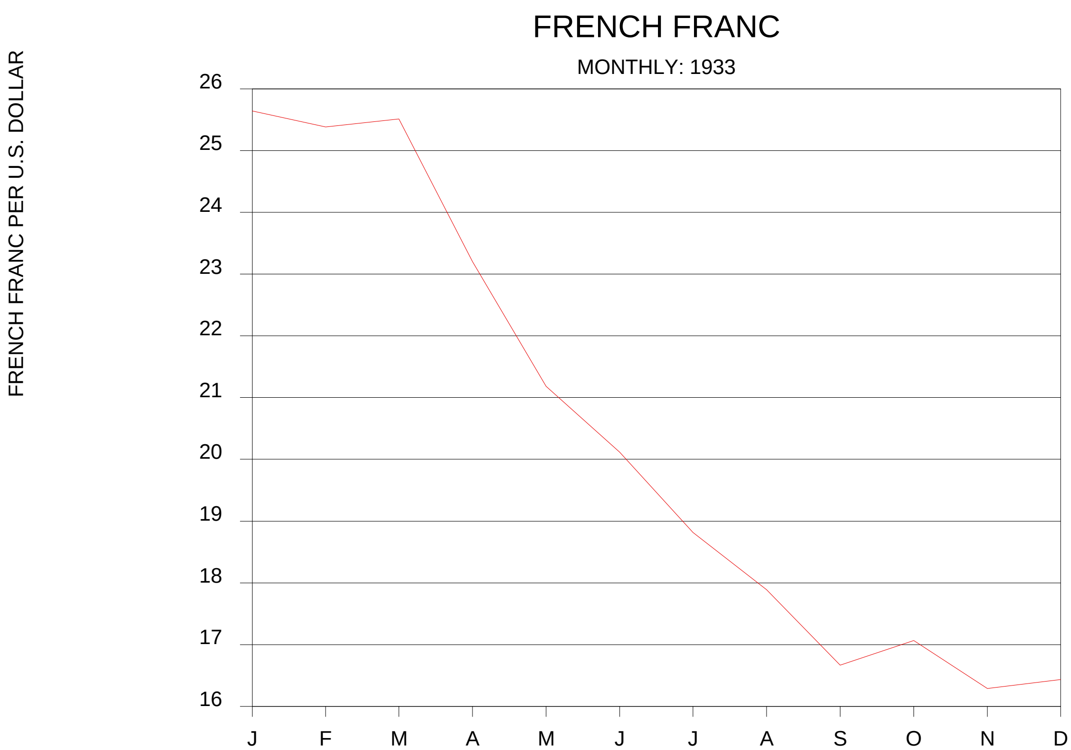


returned to the government as the edict had demanded back in May. The Attorney General was then armed with another new law. Roosevelt could not declare it to be illegal outright to own gold since that would have been a flagrant violation of the Constitution. So he took another approach which the courts ruled permissible. It was thereby ordered that all U.S. citizens file a report to declare how much gold they held. Failure to file the report carried a $10,000 fine or ten years in jail. So technically it was not illegal to hoard the gold, it was just illegal not to tell the Government that you were holding it. This was merely one example of the sumptuary laws which were being implemented through the clever tactics of switching a few words here and there to circumvent the true liberties which had been originally granted by the Constitution.

Although the free press in many cases was hard at work trying to protect the rights of the nation, it was a losing battle. Reprinted here is an advertisement which the New York Herald Tribune took out in the Wall Street Journal. This was one of eight advertisements in which the Tribune took upon itself to stand up and fight back. The headline "Time To Fight" was well taken. The biggest crime perpetrated upon the nation was that the people voted for a man who had not revealed his true intentions of how his "New Deal" was going to achieve its goals.

As October emerged, the dollar continued to decline sharply on foreign exchange markets. The commodities and the stocks were still bouncing off of support but losing their strength from one bounce to the next. In October, the Dow Jones Industrials dipped below the July low by 1 point and then quickly scooted up as to not bring down the wrath of the demigods of Washington. The Senate's probe into the stock market continued and investigations continued in an ever increasing scope. Those it questioned, it delved into whatever areas it could and then hauled people off for income taxes or whatever violation of law it could muster up. To refuse to appear meant imprisonment. It was indeed a Spanish in-


BRITISH POUND
MONTHLY: 1933
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
J F M A M J J A S O N D


FRENCH FRANC
MONTHLY: 1933
FRENCH FRANC PER U.S. DOLLAR
26
25
24
23
22
21
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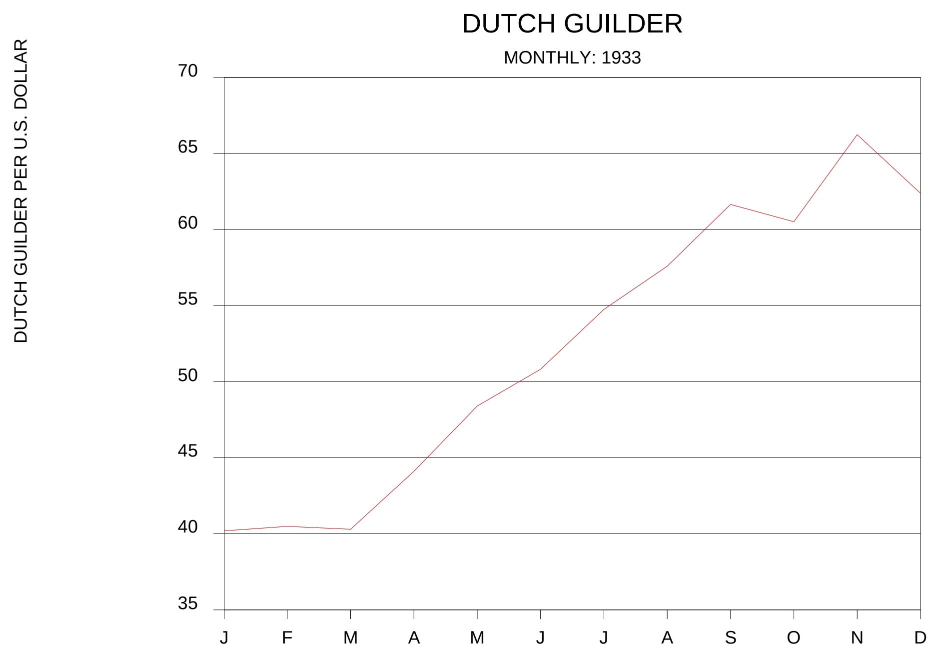
19
18
17
16
J F M A M J J A S O N D



quisition and its probe became known as the "book of revelations."

Now the battle to stem the collapse of the dollar came to the forefront during October. Time magazine reported on the flight from the dollar in its September 25, 1933 edition.

"FLOWN DOLLARS"

"Dollars sank last week to the lowest level since the U.S. quit the gold standard, 63 cents. Because President Roosevelt had not yet seen fit to devalue the dollar, the price is determined by supply and demand in international exchange. And because the U.S. has a favorable trade balance, demand is normally greater than supply. Whence the dollar flood has eaten away 35 cents of every 100 cents in each U.S. dollar since last April. Continental money-changers, canniest of whom are reputed to be 'the Greeks,' delight in selling dollars short, but bankers know that accounted for only a fraction of the drop. Last week from the British Commonwealth Relations Conference in Toronto came confirmation of what Wall Street has long suspected; that U.S. citizens have exported their dollars by the hundreds of millions.

"'One of our problems,' droned Viscount Cecil of Chelwood, chairman of Britain's delegation, 'is the flood of unwanted money that is pouring into our banks. These funds, deposited in the main by U.S. investors, are subject to withdrawal at 24- hour notice and are of little or no value, though it has not yet been discovered how to get rid of them.'

"Standard Statistics Co., Inc., world's largest figure factory, estimated that $1,000,000,000 had flown the Atlantic, the bulk of it to London. France, whose tie to gold is none too secure, has received little, but Holland and Switzerland have been drowned in dollars. Unlike exports of gold which is strictly banned (for private citizens) the flight from the dollar has been quietly encouraged by Washington; it pushed down the price without requiring devaluation by Presidential decree."

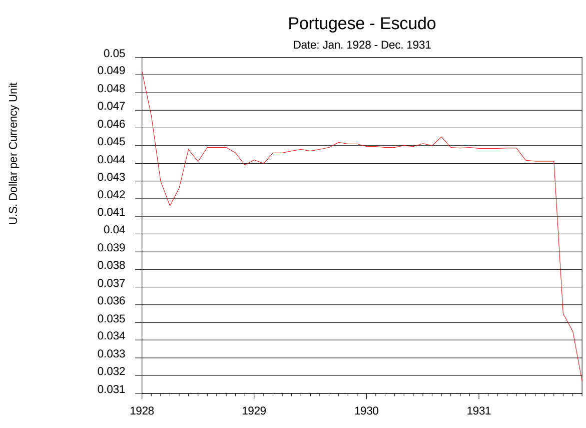
On October 11, 1933, the Wall Street Journal reported on this new battle against the short positions in the dollar.

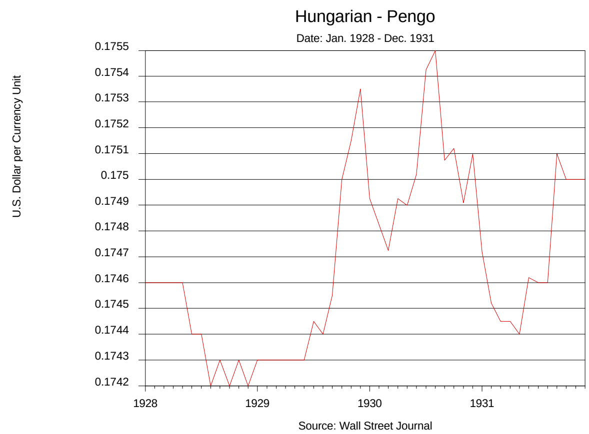
"U.S. STRIKES AT DOLLAR SHORTS"

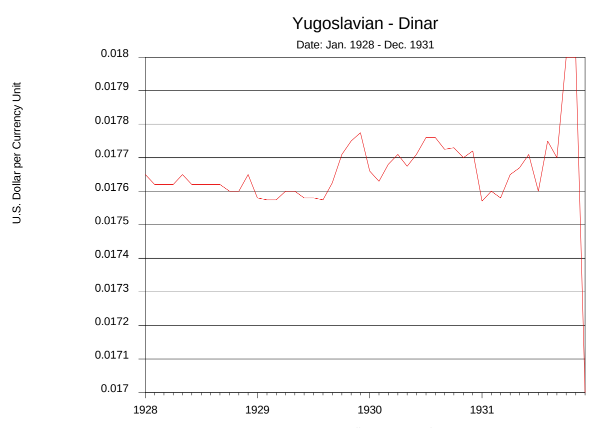
"For the past two weeks there have been growing indications that the federal government is tightening its grip on the foreign exchange control or official intervention such as is practiced by the British Exchange Equalization Fund but the market is convinced, nevertheless, that hitherto uncontrolled fluctuations in dollars exchange.

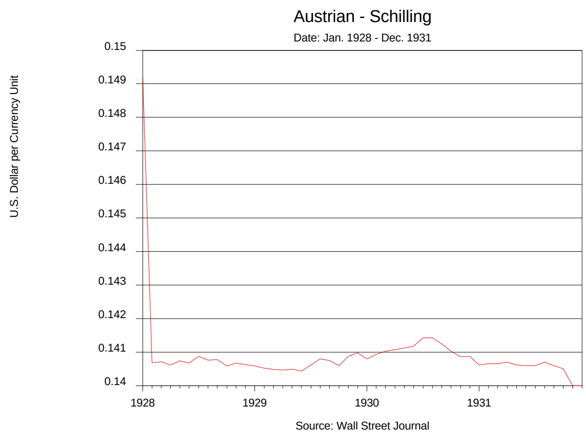
"Thus far it has taken the form of a tightening of the control with regard to 'swaps' in the futures market. This is a blow aimed directly at the foreign speculator who has been maintaining an open short account in dollars in the belief that the American unit is headed for still lower levels in the world's markets.

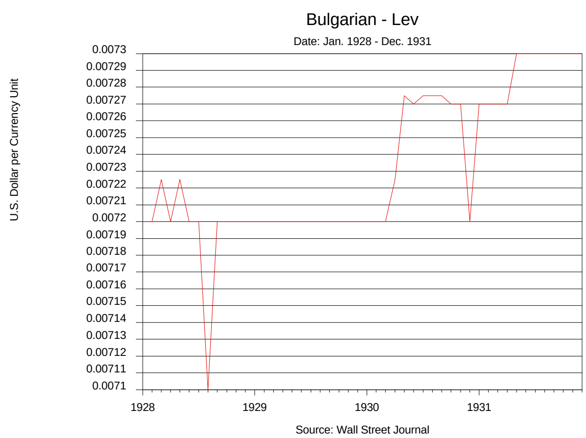
"Up until present, the foreign speculator, operating abroad has maintained his short position by 'swapping' contracts which are falling due for other contracts, say 90 days away. For example, if dollars had been sold for October 15 delivery, at the approach of that date October 15 would be bought and











January 15 dollars sold against them. This produces a temporary demand for spot dollar exchange but the continued pressure on the forward market is depressing influences on the rate. The 'swap' really amounts to borrowing of dollars for speculative purposes.

"Permission is being granted to execute 'swaps' when it is shown that they are based on legitimate commercial needs. For example, if a shipment of goods has been delayed in delivery, it may be necessary to extend the exchange position until the goods are delivered and the exchange contract settled. No difficulty is experienced in obtaining permission for this type of transaction.

"The Continental exchange speculator, however, has no such basis for his transactions, which are financial rather than commercial, and permission for financial swaps is being refused. The effect of this procedure, it is believed in the foreign exchange market, will be to produce a growing outright demand for dollars as the short contracts mature, and which will not be offset by sales of futures. Commercial supply of dollar exchange is said to be very small."

Here we find another example of what would today be unthinkable. The foreign exchange futures which are being referred to here are cash forwards. If you sell a January position you could find yourself with no means to legally buy back your position. So strange as it might sound, they drove speculators out of the short positions. Government just didn't want any short bets against them in any market. They sought to have their cake along with a full belly and free rent all at the same time. If it couldn't be achieved by a free market system, then they would make up their own rules and limit the freedoms of the market to their liking.

The last four months of 1933 were marked by numerous shocking issues. Many of the steps taken to force the markets to yield to the will of government are steps which will one day soon be reimplemented. Today we are all aware of the G-5 group of central banks and the political consensus around the world that promotes the manipulation of foreign exchange to achieve economic stability. The methods of the present are no different from those attempted by the central banks first in 1925, again in 1927 and finally by Roosevelt in 1933. In the September 25, 1933 edition of Time magazine, we find an interesting comment as to how the stock market was viewed to be a hedge against the currency inflation policies of Roosevelt. This is very important because I seriously doubt that anyone would view the stock market today as a hedge against inflation. Nevertheless, this issue was the primary factor which led the stock market into its rally which eventually peaked during 1937. Time magazine reported upon this aspect as follows:

"Methods of hedging against inflation within U.S. frontiers have become a favorite coffee-&-cognac topic. Purchase of industrial stocks is, of course, the most popular hedge, but commodities and land have been creeping up fast since the NRA threatened profits with higher labor costs. Some shrewd businessmen with little capital at stake argue that the best thing is to go as deep into debt as the banks (or friends) will allow; eventually they will pay off with cheaper dollars. Carl Snyder, economist for the Federal Reserve Board, was asked

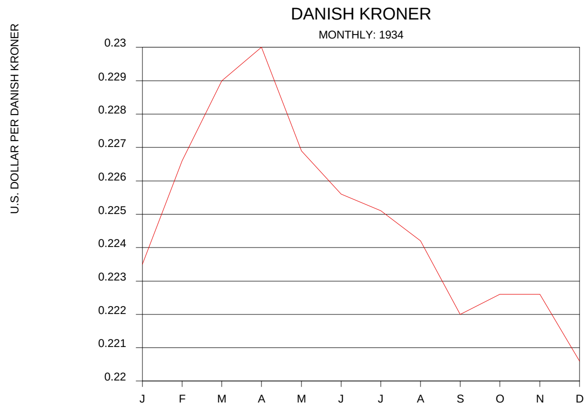
lately by a wealthy friend how he could hedge against all possible contingencies including deflation or stabilization so that he would die as rich as he was at that moment. 'One way,' snapped Economist Snyder, 'is to shoot yourself.'"

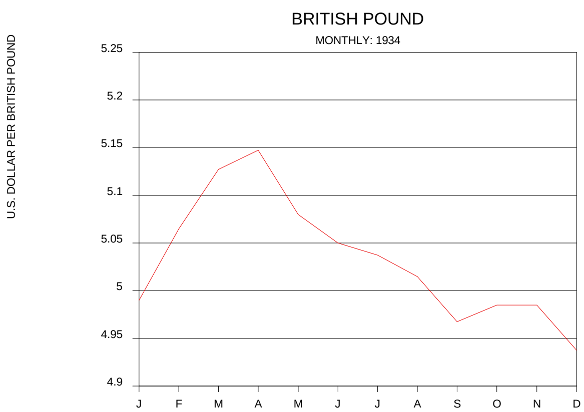
The comment of economist Snyder in a very realistic sense was quite true. The only guarantee that one would die with essentially his current assets in this situation was to commit suicide for you never know what tomorrow would bring.

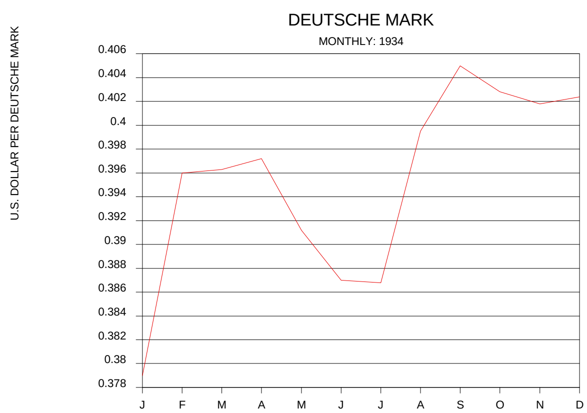
There is no doubt that during the year 1933, the stock market gained significantly on the prohibition issue which anticipated that the country would turn "wet" as of January 1, 1934. But the entire issue of Roosevelt's currency inflation had a large impact upon the performance of the market as well.

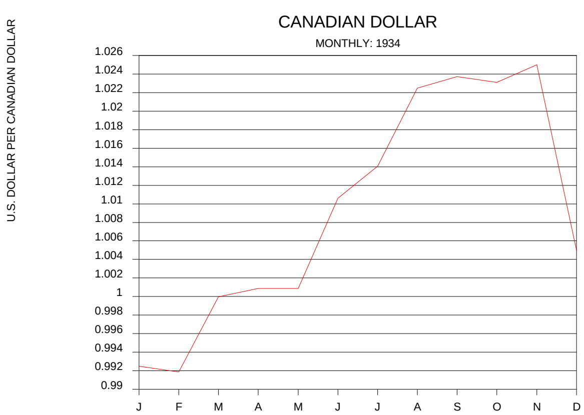
The market began to rally finally from the summer of 1933 lows on the perception of a hedge against inflation. After a rally into January 1934, the market fell back and consolidated into a July low during 1934 once again. From there, commodity prices began to rally after the convertibility of gold for U.S. citizens had been officially abandoned in January 1934 and the effects of inflation began to spread throughout the world. Eventually, the inflation scenario continued to drive the markets higher into 1937.

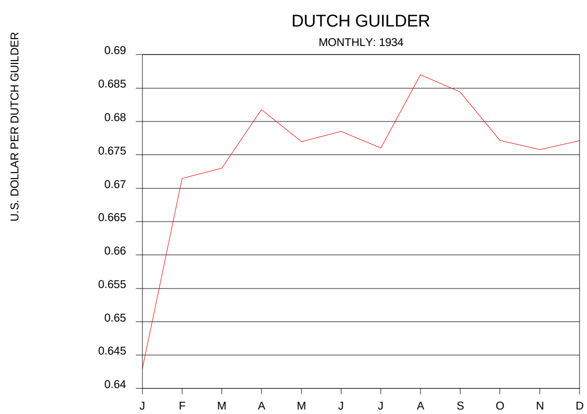
From March 1933 into 1937, stocks rose largely upon the belief that inflation would raise the price levels of commodities and therefore earnings would rise as well. Stocks were also viewed as a hedge against inflation as we read in the September 25, 1933 edition of Time magazine. Therefore, we find some continuity in the analysis which took the position that stocks would rise in the shadow of commodities. This was largely created by the fact that much of the economy was heavily commodity oriented. High techs were not exactly the rage of the times. Keep in mind that the automobile was viewed to be a large consumer of


DANISH KRONER
MONTHLY: 1934
U.S. DOLLAR PER DANISH KRONER
0.23
0.229
0.228
0.227
0.226
0.225
0.224
0.223
0.222
0.221
0.22
J F M A M J J A S O N D


BRITISH POUND
MONTHLY: 1934
U.S. DOLLAR PER BRITISH POUND
5.25
5.2
5.15
5.1
5.05
5
4.95
4.9
J F M A M J J A S O N D


DEUTSCHE MARK
MONTHLY: 1934
U.S. DOLLAR PER DEUTSCHE MARK
0.406
0.404
0.402
0.4
0.398
0.396
0.394
0.392
0.39
0.388
0.386
0.384
0.382
0.38
0.378
J F M A M J J A S O N D


CANADIAN DOLLAR
MONTHLY: 1934
U.S. DOLLAR PER CANADIAN DOLLAR
1.026
1.024
1.022
1.02
1.018
1.016
1.014
1.012
1.01
1.008
1.006
1.004
1.002
1
0.998
0.996
0.994
0.992
0.99
J F M A M J J A S O N D


DUTCH GUILDER
MONTHLY: 1934
U.S. DOLLAR PER DUTCH GUILDER
0.69
0.685
0.68
0.675
0.67
0.665
0.66
0.655
0.65
0.645
0.64
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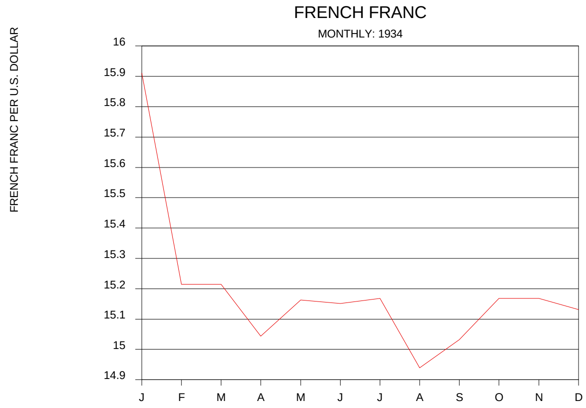
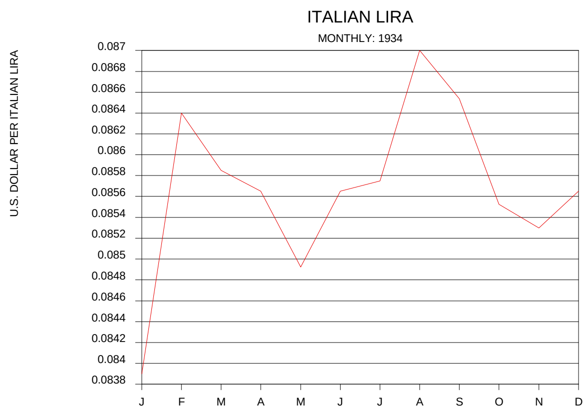
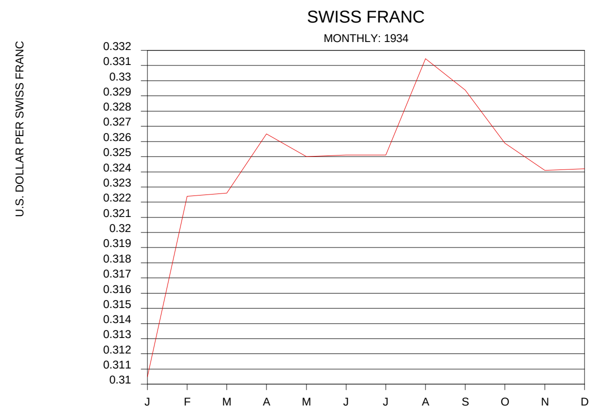
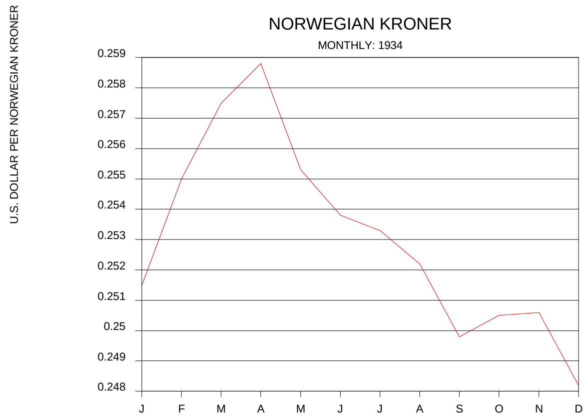
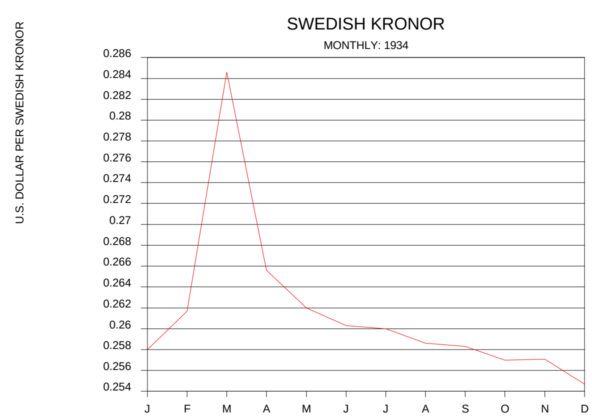

FRENCH FRANC
MONTHLY: 1934
FRENCH FRANC PER U.S. DOLLAR
16
15.9
15.8
15.7
15.6
15.5
15.4
15.3
15.2
15.1
15
14.9
J F M A M J J A S O N D

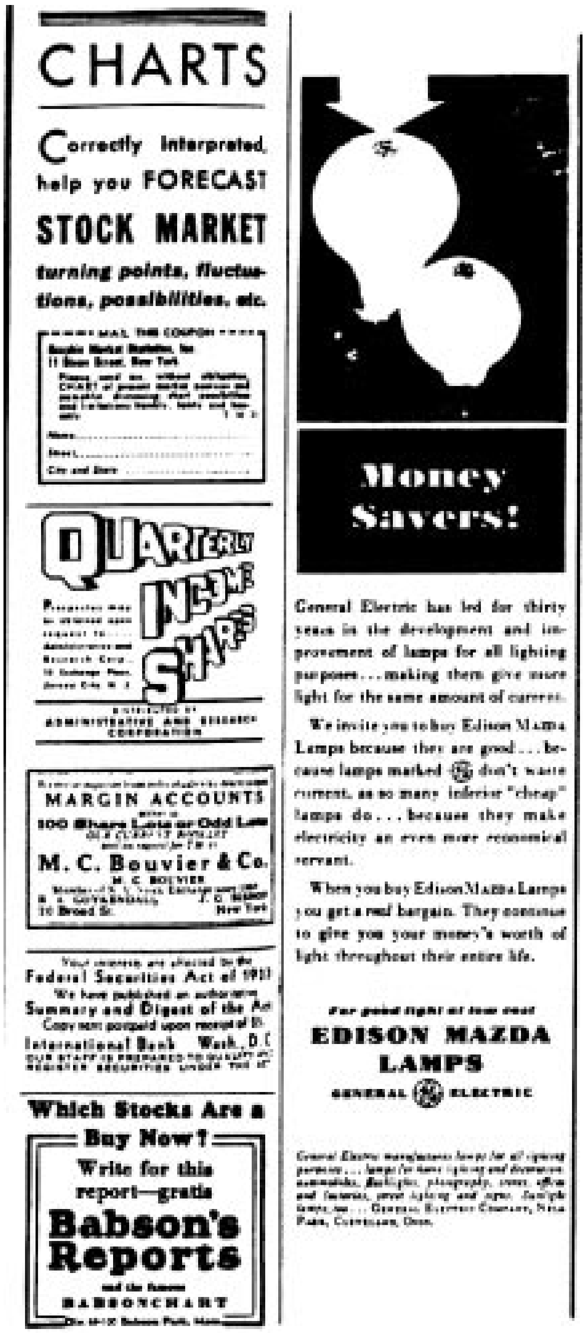

SPANISH PESETAS
MONTHLY: 1934
U.S. DOLLAR PER SPANISH PESETAS
0.139
0.138
0.137
0.136
0.135
0.134
0.133
0.132
0.131
0.13
0.129
0.128
J F M A M J J A S O N D


ITALIAN LIRA
MONTHLY: 1934
U.S. DOLLAR PER ITALIAN LIRA
0.087
0.0868
0.0866
0.0864
0.0862
0.086
0.0858
0.0856
0.0854
0.0852
0.085
0.0848
0.0846
0.0844
0.0842
0.084
0.0838
J F M A M J J A S O N D


SWISS FRANC
MONTHLY: 1934
U.S. DOLLAR PER SWISS FRANC
0.332
0.331
0.33
0.329
0.328
0.327
0.326
0.325
0.324
0.323
0.322
0.321
0.32
0.319
0.318
0.317
0.316
0.315
0.314
0.313
0.312
0.311
0.31
J F M A M J J A S O N D


NORWEGIAN KRONER
MONTHLY: 1934
U.S. DOLLAR PER NORWEGIAN KRONER
0.259
0.258
0.257
0.256
0.255
0.254
0.253
0.252
0.251
0.25
0.249
0.248
J F M A M J J A S O N D


SWEDISH KRONOR
MONTHLY: 1934
U.S. DOLLAR PER SWEDISH KRONOR
0.286
0.284
0.282
0.28
0.278
0.276
0.274
0.272
0.27
0.268
0.266
0.264
0.262
0.26
0.258
0.256
0.254
J F M A M J J A S O N D



commodities. So we do find that there is some logic to the commodity relationship prior to World War II. But as the economy developed over the next several decades, the U.S. industrials and service oriented business sectors began to play a much more dominant role in the GNP of the United States. Thus, the concept of commodity relationships with the stock market has been divided and almost forgotten for the broad market as a whole.

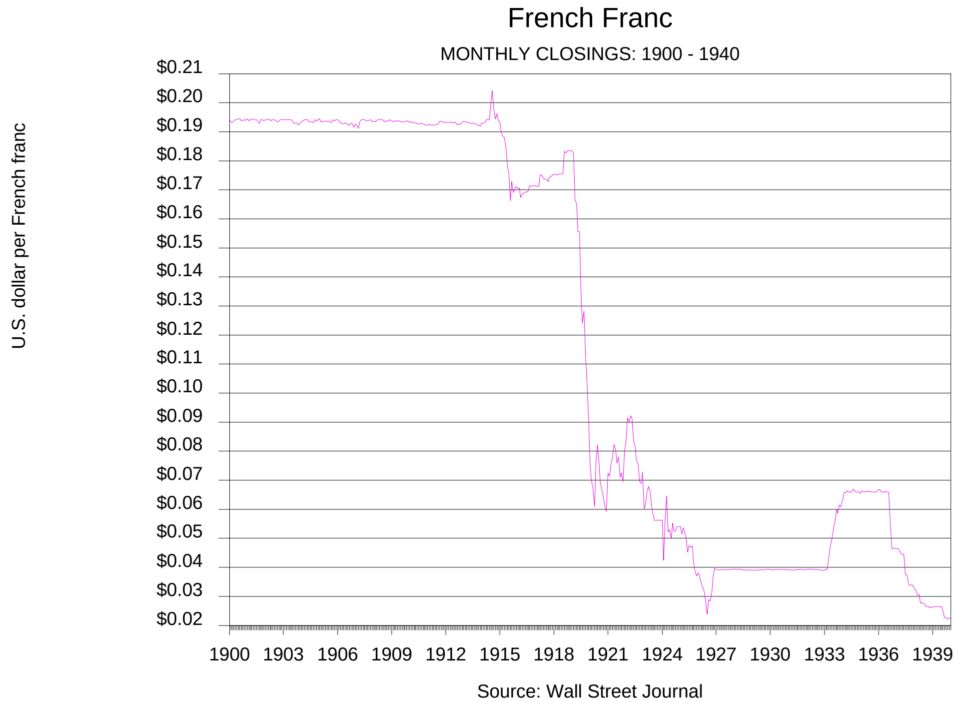
After inflation spending continued yet commodities and stocks declined from the 1937 high, that scenario of currency inflation disappeared and Roosevelt's theories appeared to be a total failure. If Keynes' theory that government could increase spending to stimulate the economy was correct, then there should have never developed the depression of 1938-1940.

There are some historians who have tried to claim that the recovery of 1933-1937 was largely created by the rearmament of Europe. This is a gross misrepresentation because although the rearmament process had begun to some degree in Europe, the greatest amounts of spending took place in the post-1937 period in direct contrast to the contraction within the private economy. However, governmental spending in Europe rose three times that of consumer spending during the 1930s.

What had evolved between 1934 and 1936 was a strange new battle among western nations. It was the battle of official devaluations to gain price and trade advantages. The recovery which had developed from 1933 was most pronounced within the non-gold bloc nations. Those who had remained on the gold standard such as France were left in a position where their currencies became overvalued, adversely affecting their trade positions in some sectors.

Trade Surplus (Deficit)*

	U.S.	Britain	France	Germany
1933	224	(258)	(9.96)	.67
1934	478	(284)	(5.25)	(.27)
1935	236	(275)	(5.47)	.11
1936	33	(346)	(9.92)	.55



1937	165	(432)	(18.45)	.42
1938	1134	(388)	(15.47)	(.19)
1939	859	(400)	(12.70)	.44
1940	1396	(663)	(28.86)	(.12)

*U.S. in millions, U.K. in millions
France in billions, Germany in billions

The shift in trade in favour of the non-gold backed U.S. dollar in 1934 resulted in increasing the trade deficits in Britain and Germany. This devaluation of Roosevelt's merely increased the trade pressure in the same sense as imposing tariffs. Eventually, the French franc's overvaluation led to domestic pressure to devalue from the business sector. This was viewed as a means of making French goods more competitive. This eventually caused the French to devalue their franc in September 1936. As part of that devaluation, the Tripartite Agreement was finally reached among the United States, Britain and France. This agreement essentially stated that each nation would refrain from competitive exchange depreciation. Roosevelt's devaluation theory proved that other nations could just as easily devalue their currencies in response and as such a war of competitive devaluation would merely follow until everyone was right back where they began. The purpose of this agreement was to smooth out the erratic swings within the foreign exchange markets and to regain some sense of stability once again. But this agreement failed to prevent the French franc from falling against both the pound and the dollar between 1936 and 1938. Against the pound, the franc fell from 105 in 1936 down to 178 to the pound by June 1938.

Up to this point in time, economic contractions had officially been referred to as a depression. It was the contraction from the 1937 high which gave rise to a new term which was recession. This new term was purposely introduced in an effort to refrain from giving any suggestion that the economy was shipping back into a depression such as that which had just been experienced during the 1929-1933 era.

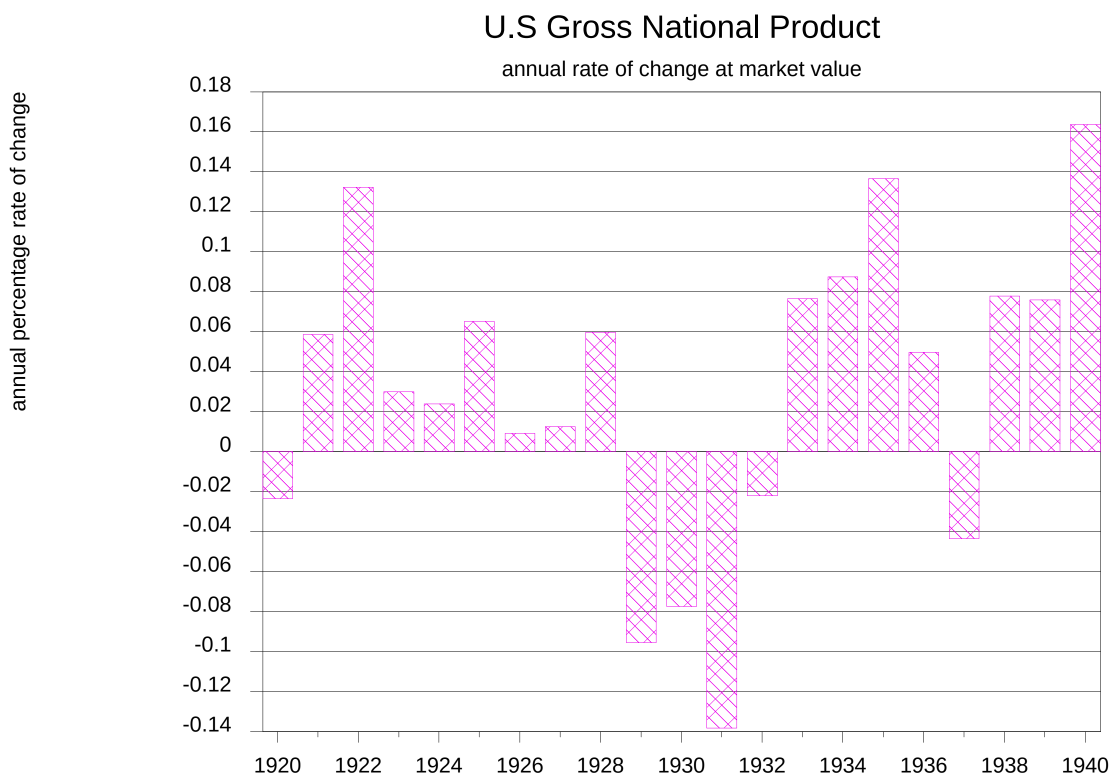
Curiously enough, the dollar began to rise significantly against the French franc and the Italian lira and moderately against the British pound moving into 1937. Again the stock market was influenced by foreign exchange during this period.

The depression which evolved from 1937 is very important to our understanding of what makes a market move, as well as to our perspective of economic theory itself. The following table illustrates some interesting points within the U.S. economy.

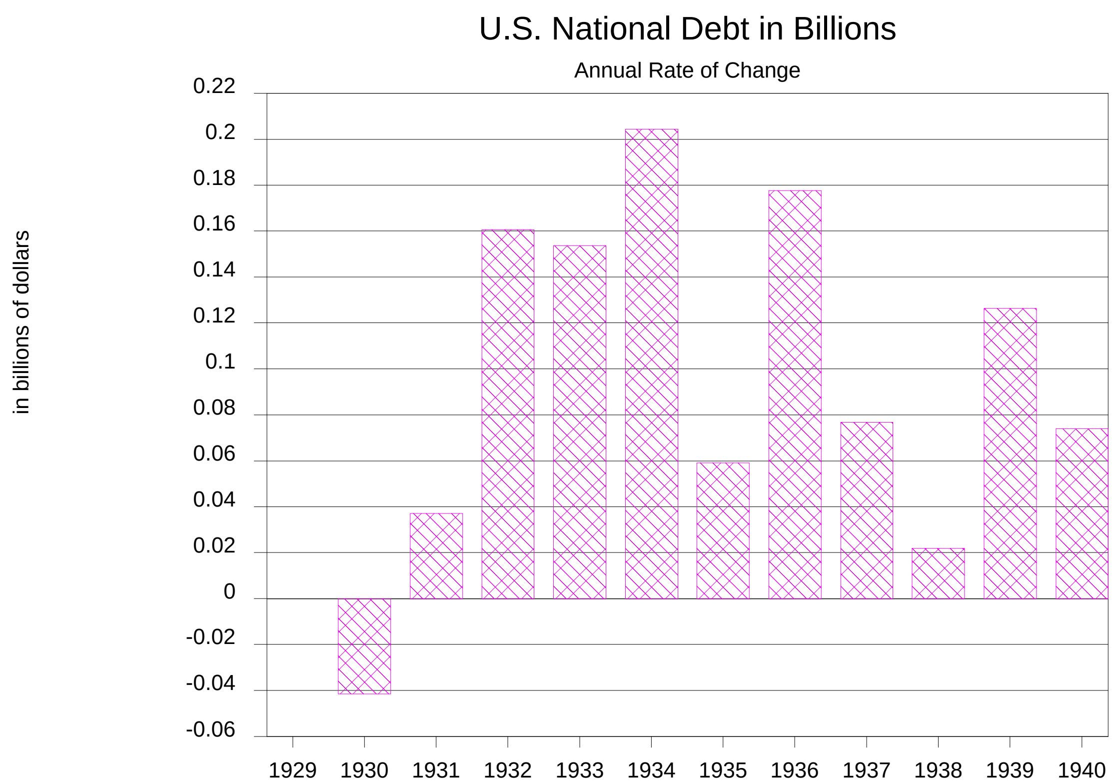
Between 1933 and 1937, confidence definitely began to move back toward the private sector. The spread between Moody's AAA corporate bond yield and that of U.S. Treasury issues began to narrow significantly. Corporate yields declined by 27.3% while Treasury yields declined by 17.2%. Although many people were looking at stocks as a hedge against inflation, they also recognized that eventually a cost of that inflation posed a rise to some extent in the risk of government bonds. Therefore, corporate bond yields declined at a far more rapid pace during the inflationary period of 1933-1937.

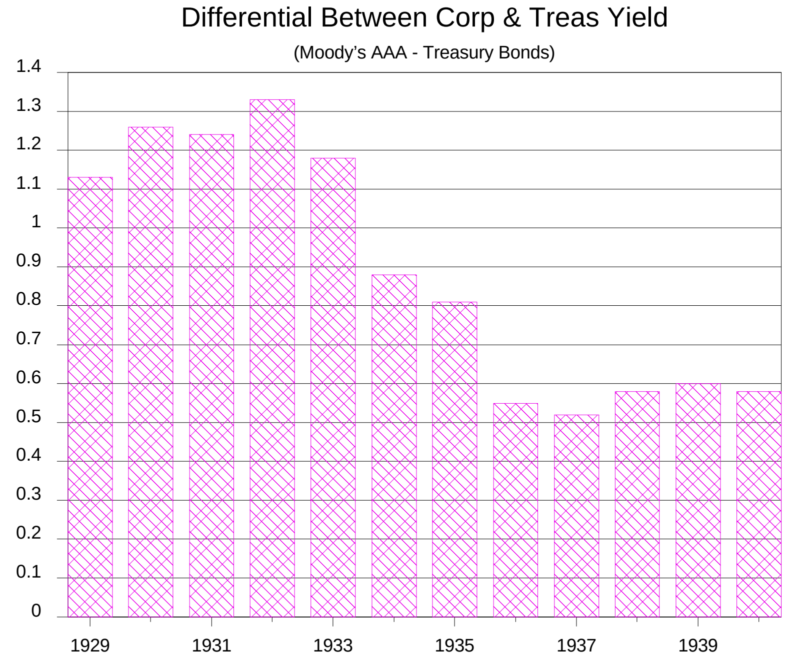
	1933	**1934**	**1935**	**1936**	**1937**	**1938**
Military Spending (mil)	41	34	41	38	41	41
Government Purchases (bil)	43	48	50	58	56	61
Money Supply M1 (bil)	20	22	26	30	31	30
Federal Budget (bil)	-2.6	-3.6	-2.8	-4.4	-2.8	-1.1
Natl Debt	22.5	27.1	28.7	33.8	36.4	37.2
G.D.P.	15.2	16.4	17.9	20.3	21.3	20.4
G.N.P	222.1	239.1	260.0	295.5	310.2	296.7
Wholesale Price Index	34.0	38.6	41.3	41.7	44.5	40.5
Government Bond Yields (%)	3.31	3.12	2.79	2.69	2.74	2.61
Moody Corp. Bond Yield (%)	4.49	4.00	3.60	3.24	3.26	3.19

The above table illustrates that government spending was rising significantly on the social side. I have provided the military expenditures, which you can see for yourself remained relatively stable. Money supply, as measured by M1, rose some 55% between 1933 and 1937. The wholesale price index rose 30.8%, reflecting a sizable jump in inflation under Roosevelt's Administration. The Gross Domestic Product increased slightly more than inflation, posting a gain of 34.2% which was actually 3.4% greater than inflation. GNP, which includes government expenditures, rose 39.6%. The National Debt, which stood at $22.5 billion in 1933, rose to $36.4 billion, a shocking rise of 61.7%. Therefore, it is obvious that the currency inflation and massive government spending did not produce the same percentage recovery within the economy. Roosevelt's policies increased the national debt by 61.7% while the Gross Domestic Product rose merely 34.2%. The



Raw Data Source: Economic Statistics





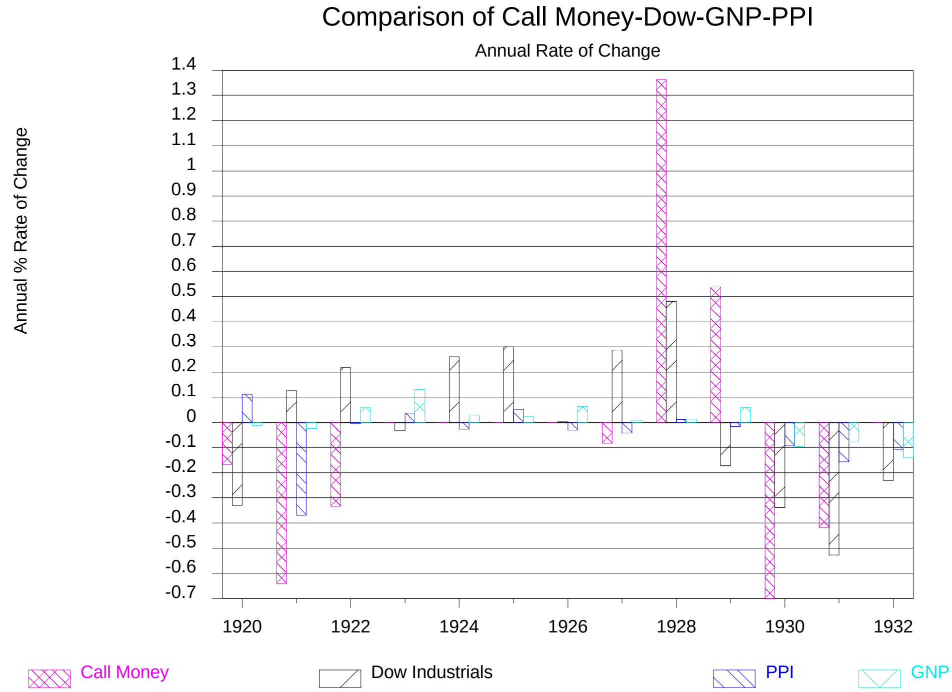
cost to extract those economic improvements in the long run were far greater than the benefits.

Commodities at their peak in 1937 by and large barely managed to rally and test the lows which had been set during the panic collapse back in the 1921 postwar era. The stock market had rallied back to the November 1929 low. When the severe recession into 1938 began, government expenditures continued to rise in the United States. Total government purchases rose 8.7% while the Gross Domestic Product declined 5% along with GNP. Unemployment rose 32.8% between 1937 and 1938. Interest rates actually began to decline from their 1937 high. Corporate income taxation rose 363% between 1932 and 1938. European government expenditures rose at a rate 300% greater than consumer expenditures. In all cases, the sharply higher government expenditures failed to prevent the "recession" of 1938. If there was ever a clear warning signal to illustrate that Keynesian economics only worked in theory and not in reality, it was at this early juncture in the world economy.

A seldom remembered economist of the turn of the century wrote a textbook which was in use prior to the Keynesian-Roosevelt era. His name was Professor Richard Ely of the University of Wisconsin and his book, "Outlines of Economics" was published by the Macmillan Company in September 1923, first edition 1893. The book relays a very basic fundamental of economic observation, and the chapter on the Business Cycle contains a very important description of the business cycle which has been long since forgotten.

"BANKING AND THE BUSINESS CYCLE"

"That the way the mechanism of banking operates has much to do with the cyclical oscillations of business is scarcely open to doubt. Banks furnish an elastic supply of purchasing power, swelling in volume as business transactions increase and therefore the supply is elastic only up to a certain

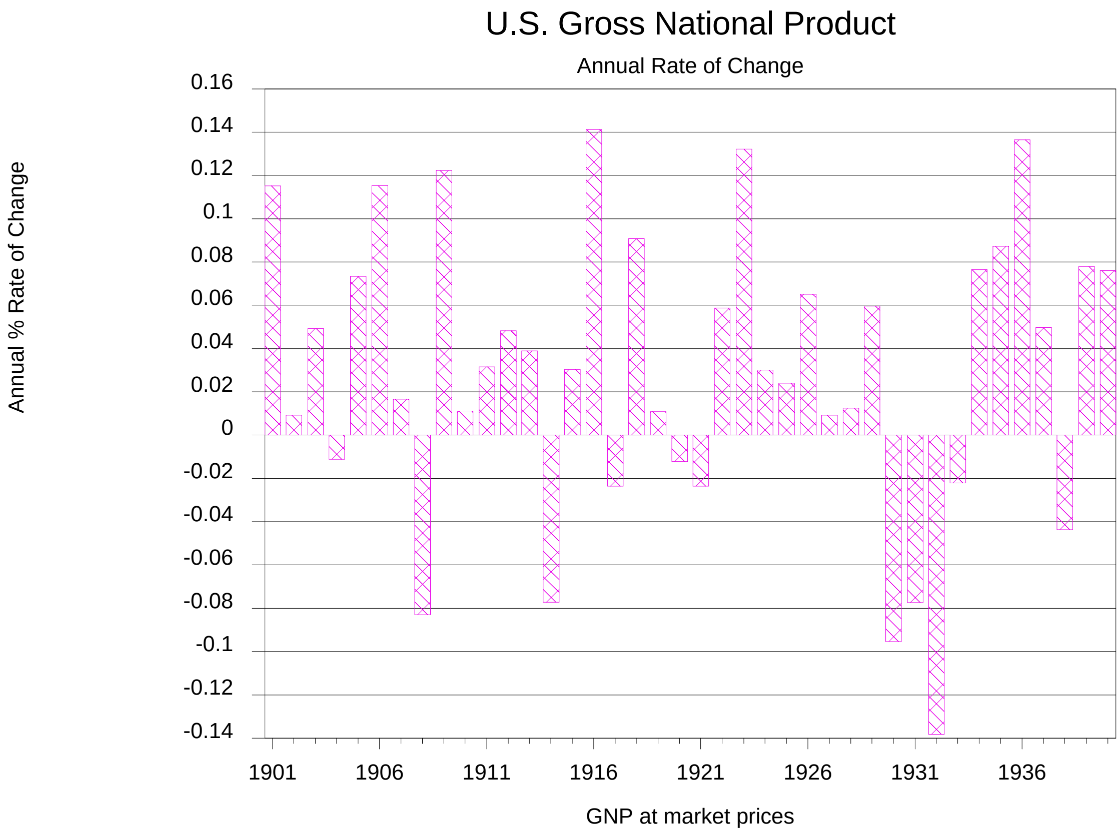


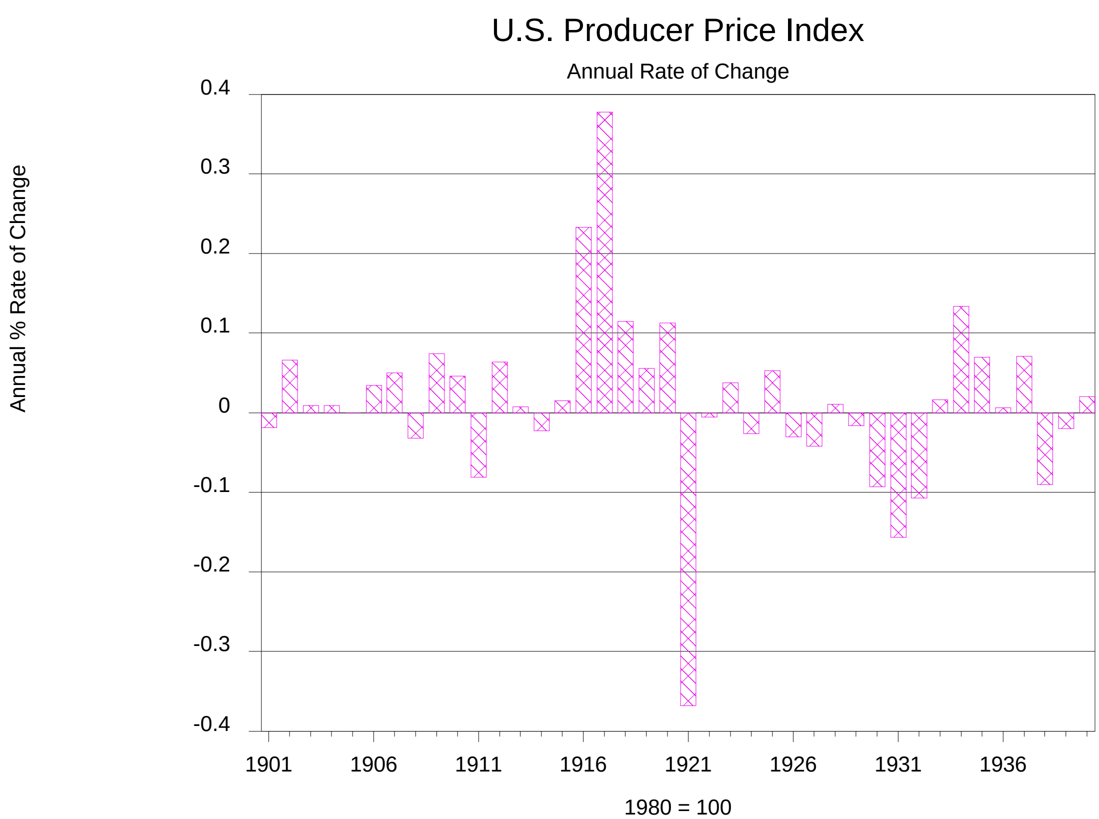
point often enforcing a sudden halt to further expansion.

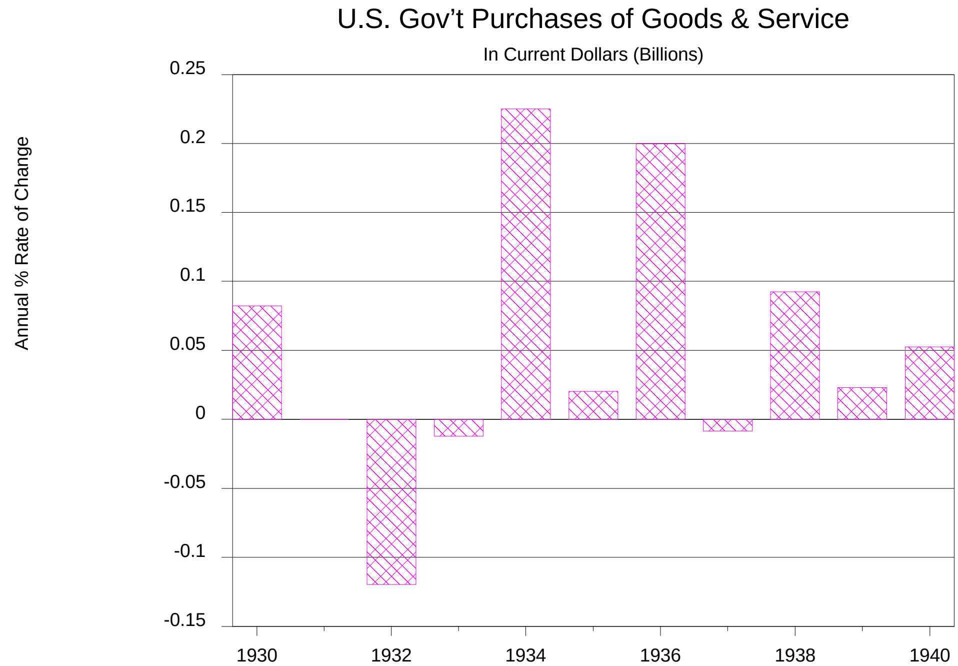
"The period of depression following a crisis is a period of liquidation. Business firms reduce their debts. The loans and the deposits of the banks decrease and thus their reserve ratios increase. Furthermore, with low prices and a sluggish movement of trade, money that had been in hand to hand circulation collects in the banks. Low prices stimulate exports and discourage imports, so that a favorite turn of the balance of trade sometimes brings in gold from other countries. In such ways the reserve ratios of the banks are still further augmented. Low discount rates result, and make business undertakings more attractive. Bonds sell at good prices, so that the time is propitious for building new plants and for other undertakings requiring large permanent investments of capital.

"Important as the cyclical oscillations of bank credit are, however, they do not suffice to explain the business cycle. Cheap supplies of credit help to give the stimulus that turns business upward, enabling it to pass from depression into the period of recovery. Exhausted supplies of credit, moreover, may bring prosperity to an end. But for the most part credit plays a passive role. Its expansion follows rather than precedes the expansion of business and even if the supply of credit were unlimited, business could not continue to expand indefinitely. The world's recent experience with irredeemable paper money has proved once more that no amount of inflation will carry business and industry up with it beyond a certain point. It operates like a drug, of which increasing doses are required to keep vitality from sagging below its normal level. Inflation may delay but cannot prevent the inevitable collapse."

Professor Ely's explanation is undoubtedly a voice calling from a long forgotten past. Roosevelt chose to ignore the eventual outcome of inflation and focused only upon its early stages where prices begin to rise. But it is absolutely true that there is what I call a certain stall factor in the inflationary cycle. It is similar to that of an


U.S. Gross National Product
Annual Rate of Change
Annual % Rate of Change
0.16
0.14
0.12
0.1
0.08
0.06
0.04
0.02
0
-0.02
-0.04
-0.06
-0.08
-0.1
-0.12
-0.14
1901
1906
1911
1916
1921
1926
1931
1936
GNP at market prices


U.S. Producer Price Index
Annual Rate of Change
Annual % Rate of Change
0.4
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
-0.4
1901
1906
1911
1916
1921
1926
1931
1936
1980 = 100

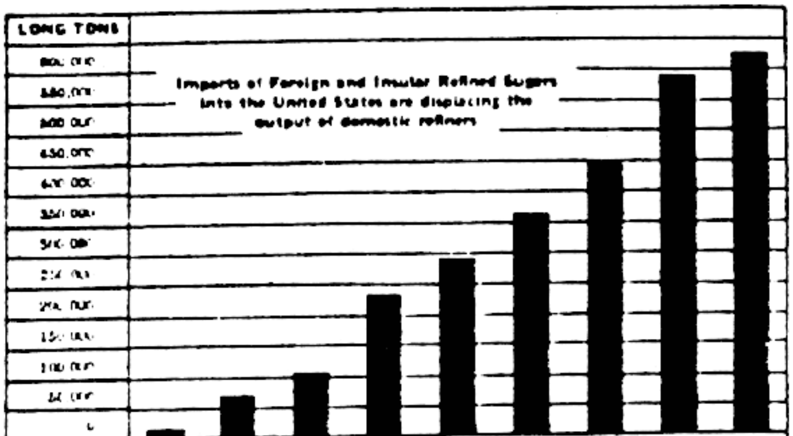


airplane at takeoff. Somehow it may have enough thrust to lift off from the ground but if enough thrust is not maintained, the gravitational forces will go to work and the plane will stall and fall back to earth.

The economy also has this stall speed. It is not easy to pinpoint the precise point where an economy will stall based upon all the various indicators, but it is unquestionably there. This is why the recession which came upon the economy abruptly in 1938 stands as a witness to the failure of Keynesian theory that government spending can help control the economy, thereby smoothing out the bumps. Perhaps it can help during the very depths of depressed markets but it is clear that this theory does not work indefinitely. If it did work, then the 1938 recession would not have taken place while government spending continued to rise 8.7% between 1937 and 1938. It is at best possible in theory that if "government expenditures" had been increased in proportion to the contraction in consumer and business expenditures that the "recession" could have been avoided. However, when the definition of a recession is two quarterly declines in the GNP, it becomes impossible for government to know when to increase its expenditures to compensate for the contraction within the economy.

The "recession" of 1938 had a profound impact upon the thinking behind the marketplace. It was here that the fundamental analysis began to change, realizing that inflation also raised the cost of doing business and in downturns, companies seemed to be even more sensitive because their cost of doing business had risen sharply as well. Thus, the concept that the stock market does not do well during inflationary periods emerged as a direct result from the rise in inflation through government spending between 1937-1940 while the market declined by 50% and then consolidated. This, by and large, has remained with the general analysis of the market. Take careful note that prior to the emergence of Roosevelt's bigger government, stocks had previously rallied significantly during inflationary periods and declined during deflationary periods. Now we view inflation as a nega-

American workers must have higher wages than Tropical workers!



From	1925	1926	1927	1928	1929	1930	1931	1932	1933
Cuba	1,682	31,859	79,201	166,720	228,541	344,485	326,662	423,252	459,319
Puerto Rico .	707	2,891	10,584	40,006	38,969	66,164	72,314	85,558	97,129
Hawaii . . .	8,592	7,244	12,328	14,641	8,723	15,003	9,720	19,901	22,006
Philippines .	2,647	4,000	1,856	7,103	8,396	25,197	32,009	50,309	61,752
Other Foreign	3,654	5,394	917	5,200	1,820	9,197	6,499	8,295	6,392
Total . . .	16,782	69,388	104,866	233,670	286,199	360,046	447,204	587,318	626,598

THE flood of *refined* sugar into the United States today from the Philippines, Puerto Rico, Cuba tells its own story of a commercial invasion throwing Americans out of work in ever-widening circles.

In 1933 alone this increasing flood of *refined* cane sugar prevented the refiners of the United States from supplying the needs of 15,000,000 Americans. On April 18, 1932, Congress was informed by Petition that three domestic refineries had been closed and "the remainder are working on part-time."

What this represents in loss of employment to American workers may be judged by the fact that 19 U. S. *refineries* between 1922 and 1931 spent $231,605,137 in salaries and wages. They pay out for materials and supplies, including coal, oil and power, approximately one billion dollars in a normal ten-year period, furnishing business for many industries and employment for many thousands of our people.

This condition is the result of a Government policy that inadvertently encourages the construction and operation of *refineries* in the Philippines, Puerto Rico and Cuba, which are tropical producers of *raw* sugar. The policy assumed that these tropical islands would not duplicate United States *refineries*. The assumption has proved to be wrong. Tropical refineries hum. United States refineries work part-time.

The United States is the only nation today that permits sugar *refined* in the tropics to enter in competition with its home refiners. All other countries protect their refining industries and safeguard their home market from duplication of *refineries even in their own colonies*.

The United States provides the world's greatest market for raw sugar. For 200 years it has developed the manufacturing industry of *refining* sugar to meet the needs of an expanding country, serving it in every emergency.

No country can surpass the United States in modernness, efficiency and sanitary cleanliness of its sugar refineries. Experience demonstrates that the cane sugar industry attains its highest development by producing *raw* cane sugar in the tropics and *refining* it in the country of consumption.

Since N. R. A., the refining costs of United States refiners have increased greatly. N. R. A. does not apply to Cuban refiners, who also escape certain processing taxes, and also benefit from tropical labor and also enjoy a subsidy in addition!

A very small group of tropical *raw* sugar producers now demand United States quotas for their *refined* sugar to make permanent the unfair position they have secured recently in the United States market—thus permanently displacing American workers and the refineries in which tens of thousands of Americans have invested.

We cannot believe it fair to America for Congress to permit tropical manufacturing competition to jeopardize a home industry of such widespread benefit to our people.

"Men are never so likely to settle a question rightly as when they discuss it freely."

United States Cane Sugar Refining Industry

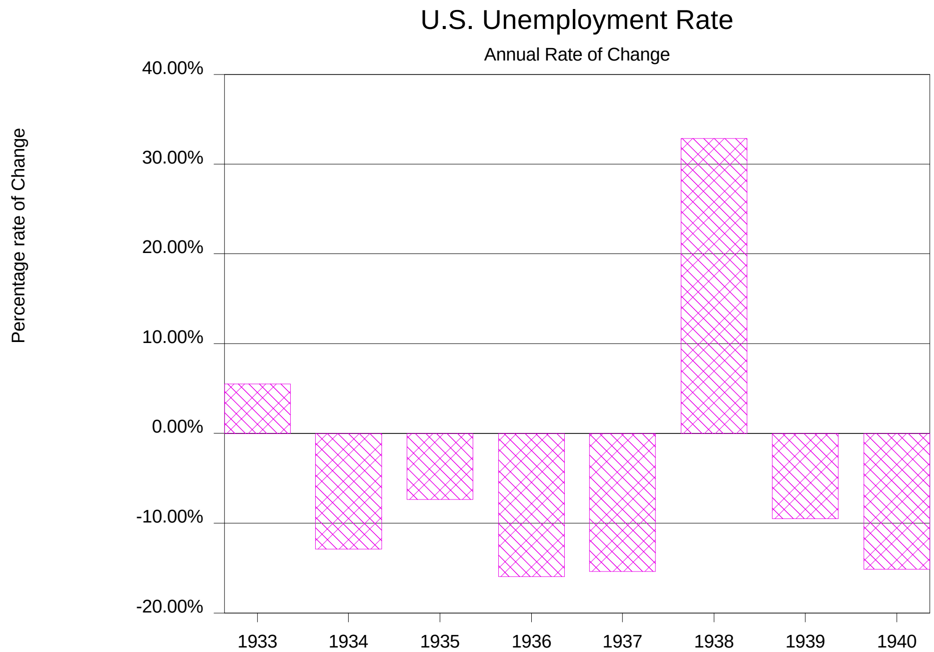
Refineries in Massachusetts, New York, New Jersey, Pennsylvania, Maryland, Georgia, Louisiana, Texas and California

tive influence upon the market and at times I have been astonished to listen to some analysts who have even viewed increases in taxation as anti-inflationary and thereby bullish for the market. In the future, expect that this analysis will once again shift and in its place will emerge the realization that corporate assets appreciate with inflation as well as profits. The negatives which many view today will flip around into positives in the years ahead. The majority may at first be astonished that stocks will rise with inflation once again until it hits that stall speed which is most likely going to occur during 1989-1990.

In reality, prosperity is a period where business profits increase. Those profits depend upon the spread between expenses of production and the income from the sale of production. The reason that profits increase during inflationary periods is actually quite simple. Much of the overhead in business, such as rent, interest on bonds, etc., is fixed. As economic activity begins to expand, these portions of overhead remain constant, thereby reducing their impact on a percentage basis as prices of output rise. Many management decisions look at the demand and begin to expand their production and, in doing so, their fixed overhead rises significantly. Raw materials generally lag behind the business cycle because most commodities cannot be expanded as rapidly as business. As a result, commodity prices rise rapidly toward the end of the cycle. As the economy expands, employees themselves begin to become a rare commodity. As unemployment declines, business then must raise wages to obtain competent help. Therefore, when the stall speed is reached, much of the overhead has risen significantly. Eventually, competition increases and with it, profits are normally cut as price wars and overproduction begin to emerge. Cost reductions are implemented, which

usually cut first at employees because leases on premises are generally long term to some degree and represent fixed levels of overhead. Therefore, unemployment begins to rise once again.

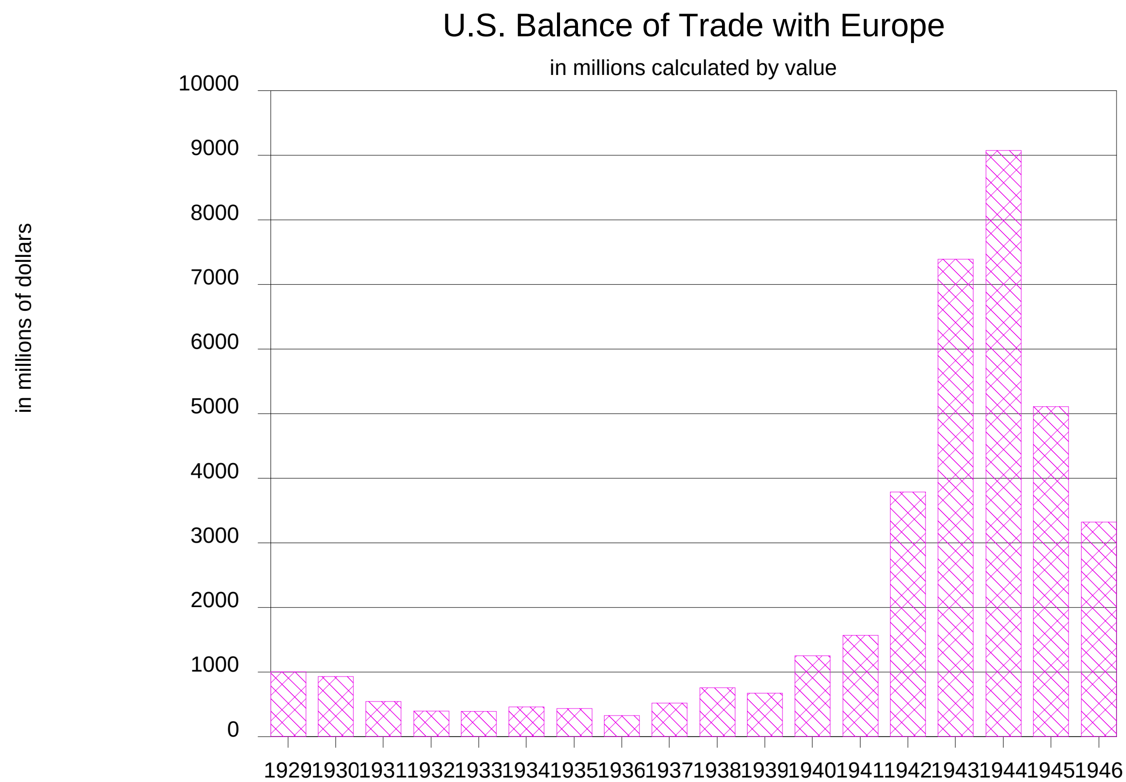
Roosevelt's experiment chose to raise the price of commodities first through currency inflation. In the normal business cycle,

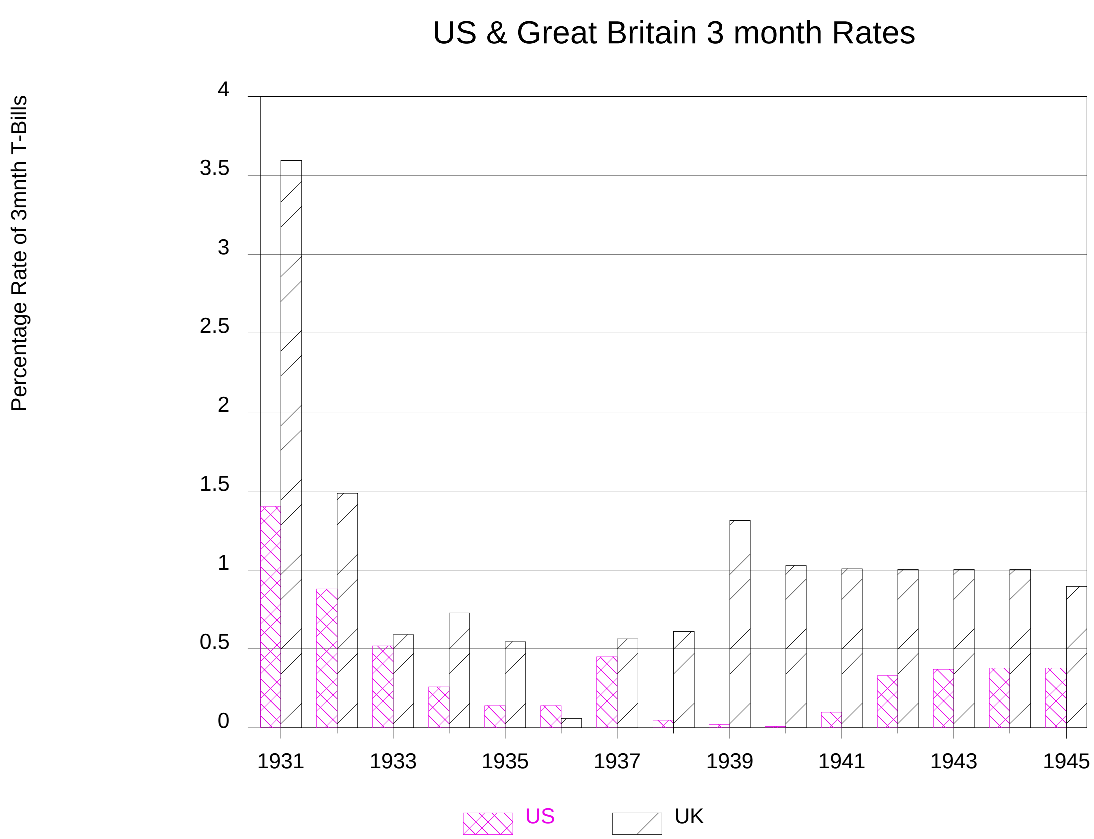


commodities rise toward the end, not at the beginning, because they are responding to the higher levels of demand. Therefore, the period of 1933-1937 is different from most expansionary recoveries. Here we had commodities rise first as Roosevelt attempted to artificially create a boom. But it failed and as a result the capital expenditures rose significantly for government. The cost of production for business rose dramatically from the outset; thereby the underlying profits, which are accrued during the early stage of the business cycle, were not available for utilization during the later part of the business cycle. Therefore unemployment, which had peaked at 24.9% in 1933 and declined to 14.3% in 1937, rose 32.8% in 1938 back to 19% of the civilian labour force. The civil labour force in 1929 was equal to 40.3% of the population. In 1938, the civil labour force was 42%. Therefore, the number of persons thrown into unemployment during 1938 exceeded the rise in number between 1929 and 1930.

This is why the recession of 1938 was sharply expressed by the 50% decline within a 12 month period from the 1937 high in the Dow Jones Industrials. Continued profits depended solely upon a continuation of price inflation. This in a very real sense turned business into a speculative venture gambling upon inflation to raise the price of its products. When the economy is built upon such a flimsy foundation, once demand declines, the situation is ripe for crisis in a shorter period of time.

The trade picture between Europe and the United States increased in general gross levels but essentially exports to and imports from Europe remained relatively stable. In 1932, U.S. exports to Europe were $784 million and imports were $390 million. In 1937, exports were $13 billion while imports were $843 million. Exports increased 73.4% while imports increased 86.09%. Roosevelt's policies had increased price levels, but the trade surplus continued to decline. On a net accounting basis, the situation became worse and the inflationary policies raised employment, but the trend dictated that it was still a negative growth factor that was being artificially maintained


U.S. Balance of Trade with Europe
in millions calculated by value
in millions of dollars
10000
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
1929 1930 1931 1932 1933 1934 1935 1936 1937 1938 1939 1940 1941 1942 1943 1944 1945 1946


US & Great Britain 3 month Rates
Percentage Rate of 3mnth T-Bills
4
3.5
3
2.5
2
1.5
1
0.5
0
1931
1933
1935
1937
1939
1941
1943
1945
US
UK

by government's inflationary policies. On a total world trade basis, the U.S. trade surplus under the Smoot-Hawley Act was $324 million and in 1937 it was $270 million. In one respect, the salaries of those who were put back to work during the 1933-1937 recovery were paid by the dramatic rise in government spending, which turned up in the national public debt. Today we are still paying interest on Roosevelt's spending from this era. Had Roosevelt hired those people and placed them on the government payrolls, the economic effect from an accounting standpoint would have been no different. The situation would have improved had the trade surplus grown and not declined.

Another interesting effect began to take place in response to Europe's arms buildup. The dollar began to strengthen significantly from 1936 when France devalued the franc. The British pound continued to fall from the $5.00 level to $4.67 by the end of 1938. But as rearmament began to spread throughout Europe, the pound plunged desperately from $4.67 in mid-1939 to $4.03 on September 3, 1939 when exchange controls were introduced to fix the pound at that level for the next ten year period. The pound never again saw the old pre-World War I level of $4.86.

As fears of war began to increase throughout Europe, capital once again began to flee toward the United States. This caused the dollar to rise on world markets and the old scenarios began to come alive. Foreign buying actually supported the U.S. stock market in 1938. Even though the economy was not exactly booming just yet, the lack of interest on the part of U.S. investors was more than augmented by European capital inflow. Therefore, foreign exchange had played an important role once again at the turning point for the U.S. stock market.

Smoot-Hawley Tariff Act was $324 million and in 1937 it was $270 million. In one respect, the salaries of those who were put back to work during the 1933-1937 recovery were paid by the dramatic rise in government spending, which turned up in the national public debt.

The side effect of this foreign capital entering the U.S. economy was exactly the same as it had been during the 1920s. Interest rates, which had initially begun to rise between 1936 and 1937, reversed their trend in the United States quite abruptly. The

British Treasury Bill rate for three months jumped from .563% in 1937 to 1.315% in 1939. It would drop back under 1% eventually only after World War II. The United States Three Month Treasury Bill rate declined from .45% in 1937 to .02% in 1939, continuing to its lowest point in history during 1940 at .01%. The dramatic swings between the short-term rates in the United States and those in Britain illustrate just how intense the capital flow into the United States had become.

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