

September 24, 1931.

If you listened in on these talks over W. I. B. O. during the last two weeks you know we have been discussing some of the distinguishing characteristics of certain kinds of securities and their relative value as investments. Also I pointed out that no matter what the kind of the security, none of them has any value unless there is property value back of the paper called a share of stock, a bond, a note, debenture or anything else. In other words gold seals attached to paper add no value to it, nor does the printing or the name give it any value. Its only value consists in the fact that it represents property of value. If there is no property there is no value to the paper.

So you see, you cannot just buy a bond or a share of stock blindly. The figures one hundred dollars par value on a stock certificate or one hundred dollars on a bond, in themselves do not mean anything. If the bond falls due or the corporation is wound up and the property owned by the corporation has to be sold, you won't get anything except your share of the sale price. Now if there are a million dollars' worth of bonds outstanding and five hundred thousand dollars par value of stock and the property only sells for seven hundred thousand dollars, you will be lucky to get fifty cents on the dollar for your bond while the holders of stock certificates won't get a cent. Indeed, if it is a bank the stockholder may have to dig up another hundred dollars for each share of stock he owns.

I have been stressing this point to a degree where I feel almost ashamed to say anything more about it but it is extremely important that people get it absolutely clearly fixed in their minds that they must check up on the property back of any or all securities. When I hammer away on any point, it doesn't mean that I think you are particularly dense. It means I want to be

sure. You know a lawyer was arguing a case in the Supreme Court (and by the way I am a lawyer). He kept pounding away one, two or three rather elementary rules of law and finally one of the judges said to him – “Mr. Smith, don’t you give us credit for knowing any law?” Mr. Smith replied – “Your honor, I made that mistake in the other Court.”

People, of course, differ sharply in what they want to do with their money and I for one am entirely willing that they all be permitted to select the character of security they may desire. Some people want safety above all things. Some want as high an income as they can have commensurate with reasonable safety. Others want a large income and are willing to take some chances while still others want to speculate. These latter frequently can afford to gamble but sometime they have the speculative desire to try for the big profits and are willing to run the risk of losing all.

But while I am willing that people shall do as they like with their money, I think it is highly important that they be not misled into doing one thing when they think they are doing another. For instance, suppose a man or woman has saved up ten thousand dollars, and they want to be sure that they don’t lose it. Now suppose someone sells them ten thousand dollars’ worth of bonds on some factory or other business, and suppose that there are half a million dollars worth of bonds outstanding against the property of the company which is worth less than half a million dollars. Now the man or woman who bought ten thousand dollars worth of these bonds is not doing what he wants with his money at all. He wants to buy a safe investment but buys a pure speculation. Indeed, he doesn’t even buy a speculation. He buys a gold brick. Now do I make myself clear? I want people to do as they wish with their money but I want them to have enough information so that they really do as they wish and don’t do something through misinformation that is exactly what they don’t want to do.

To take another illustration. Suppose a man wants to make a fairly safe investment along with a speculation. He may buy some six and one half per cent preferred stock in a corporation and may also buy common stock. Let us assume that the corporation at one period had a valuable plant and a good business which at one time would have been ample to give the preferred stock full value and would have held out prospects for future substantial increase in value. Now, suppose the business has been failing for some reason or other and the plant has run down. They need money and sell the preferred and common stock to get the money they want to bolster up the failing business. The promoters get out a prospectus or circular giving the book value of the plant without any depreciation for its run-down condition. They show the average earnings for fifteen years and these earnings will be very high. But if the investor knew that the average earnings for the immediate preceding years were practically nothing, he would not invest. Now anybody buying on the information contained in the circular would not have been doing what he wanted to do at all but something entirely different.

All this emphasizes what I have been talking about so much, namely, the need of investigation and extreme caution in buying. You cannot absolutely rely on any house or bank. If you are ignorant they soon find it out, or if you are careless. Then the temptation to unload on you and make a profit or escape a loss is too much for them and you are permitted to hold the bag.

You see from the foregoing that you cannot go out and buy a security like you buy apples. But even in buying apples the average housewife will look below the top layer to see whether the rest of the apples in the basket are good or not. In buying securities it just looks as if the average person did not even look below the top layer. I don't believe they even look at the

inside of the instrument. Certainly they practically never go back of the instrument itself to find out what it stands for.

Now the lessons of the last five or six years certainly ought to be enough to convince anybody that the purchasers of securities cannot depend on the integrity of financial houses and banks to protect them in their purchases. What has happened in financial circles has been extremely unfortunate and, in my opinion, it is going to take many years before the financial leaders regain the confidence of the American people. After the world war, when they found out that the political leaders, the newspapers and international bankers, through propoganda, had dragged us into a war under false representations of what was happening in Europe, we lost much of our confidence in these people. We are now in much the same attitude toward financial circles and I believe that during the next year or so more facts will come out which will make it clearer than ever that the American people were preyed upon by the men in whom they had placed their confidence.

At any rate, enough has happened to emphasize the importance of investors educating themselves so that they will know at least the rudiments about securities. It has become almost tiresome to me to say the things that I am going to repeat again here, and I do it only because it seems to take constant repetition to gradually get an idea across to the public.

It took the average person a long long time to save one or two thousand dollars. And if it disappears they may never be able to replace it. Therefore, it is highly important that they hand onto this money. I know many people feel that it is a rank injustice to them that they cannot rely on the sellers of securities to represent the facts about what they sell. But we are facing a condition and not a theory and we might as well accept it as a fact that when men are going to make money by selling something they are going to be sorely tempted to make a sale if the party

they are talking to has money to pay for the article that they are selling. Again let me say that if you do not want to take on the burden of learning about industrial and corporate securities so that you can buy with intelligence, then by all means buy some kind of a public bond like a State bond, a County bond, a school bond or something of that nature, even if you have to take a lower rate of interest.

As I have said time after time in my talks, men and women buy securities with less thought than they give to buying a new hat or a new overcoat. They will run around for months and months before they will buy a lot in their own neighborhood on which to build a house, or before they will buy a house in their own neighborhood. Perhaps all they expect to put into the house as a first payment will be a couple of thousand dollars but they use days and weeks of time finding out whether the house is a good buy or not. And then they pay a lawyer to investigate the title and see that everything is straight. But they will take two thousand dollars out and buy a bond or a share of stock from people they never saw before.

The first thing to learn when you start out to educate yourself is that there is a difference between a bond which matures at some given time and a share of stock. You can sue the corporation to recover on the bond and can cause its property to be sold to satisfy any judgment. But if you have a share of stock, the only right that you enjoy is to join with other stockholders in managing the corporation and if you are a small stockholder, naturally you do not have much influence.

When you buy a bond, if it matures within a reasonable length of time, say ten years, you can make a pretty fair estimate as to whether the bond will be good when it matures. But if the bond does not mature for fifty or sixty years, any estimate you may make as to whether the bond

will be good when it matures, is nothing but the wildest kind of a guess. Nobody can look ahead fifty years and form any kind of a valid judgment on whether a bond will be good at that time.

When you start to buy stock you may have other limitations that I did not mention before. The organizers of the corporation may have taken away your right to vote from the beginning so that you are nothing but a passenger in the financial vehicle with absolutely nothing to say about how it will be managed and with no right to sue the corporation. Anybody who buys any stock where they have nothing to say with the management is taking big chances. These are some of the simpler things and I will try and enlarge a little bit on them next week.