

REPORT TO
THE SECURITIES AND EXCHANGE COMMISSION
ON
THE TRADING IN AMERICAN
SECURITIES ON THE
BRITISH MARKET

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I N T R O D U C T O R Y

The trading by foreigners in American securities, both directly in New York and on foreign exchanges, has had great effect on our economic life. Although their holdings of American securities, both as to quantity and kind, and their trading directly on American exchanges, have been the subject of analysis and report, the trading on foreign exchanges in American securities has not received the attention it merits. Its significance is shown by the fact that, as to the leading American shares, the exchange markets in London and Amsterdam are more important relatively than the exchange trading occurring on any of the American exchanges other than the New York Stock Exchange.

The claim has been made that this fact is not altogether fortuitous. For, after the adoption of the Securities Exchange Act of 1934, charges were frequently made that the measure had driven trading in American securities to foreign exchanges and that the American ones were thus losing business properly belonging to them, with the resultant frustration of American law.

In view of these several considerations, and the duties imposed by Section 30 of the Securities Exchange Act of 1934, the Securities and Exchange Commission deputed the writer to make a study of trading in American securities on foreign exchanges, particularly that occurring in Great Britain.

For that purpose, some months prior to the outbreak of the war, he went to London, where he interviewed a number of representative persons in the securities business. Since, unfortunately, at that time the markets were already abnormal due to the war threats, and since the writer's stay lasted only until shortly after the outbreak of the war, the time was not sufficient to explore fully the intricate subject matter. Further, there is a dearth of English statistical information, as contrasted with America, which is particularly true as to the stock exchanges; for example, the volume of trading is not reported either in total or by individual issues. Also, governmental statistics, commensurate to those issued in this country, are not published concerning the movements of capital and payments.

The ensuing report is thus based primarily on impressions gained from interviews with a number of competent persons connected with the securities business on the London and New York markets -- bankers, brokers, jobbers, representatives of American brokerage houses -- supplemented by a survey of the pertinent literature. Although, naturally, a study so based could not attain the exactitude that comes from statistical analysis, it still will give, it is believed, a picture of the relationship between the two markets, and will raise questions for future solution.

For, notwithstanding the lack of statistical exactitude, certain conclusions seem clear, first, as to the nature of the London market in contrast with our own, and secondly, as to the British trading in American securities, which we may briefly set forth in turn.

Certain vital differences between the New York and the British market appear, an understanding of which is necessary as a background for the London trading in American securities. Thus, as will appear upon examination of the report, the restrictions on trading in the English market are far greater than in our own. This is not because of their number, but because of the far-reaching effect of those which do exist. For example:

- a. The practically complete prohibition against persons in the securities business advertising or soliciting other than their customers.
- b. The specialization of function of the members of the Exchange --
 - (1) Members cannot engage in any other business nor be in partnership with persons engaged in any other business;
 - (2) The segregation between the broker and jobber.
- c. Prohibitions directed against speculative trading --
 - (1) Persons other than principals -- and, for example, a corporate official however high is not a principal -- cannot do speculative business through members of the Exchange, unless authorized by the employer.
- d. The more expensive and difficult access to the market, typified by the presence of the jobber's turn and the 1% transfer tax, and by the absence of the tape and brokerage branch offices.

And London generally affords much less opportunity for quick-turn speculative trading than does New York. Competent observers are emphatic in their statements to that effect. The difference in this regard, to use imprecise terms, can perhaps best be expressed by saying that the trading for capital gains in London has partaken far more of the character of true speculation than is so in New York.

It seems clear also that the English market has been much more stable in its price movements than New York. This is a statement universally made by observers in London. It is supported by studies of price movements in the two markets, which show that the amplitude of price swings is much greater in New York than in London. Multiplied by the total number of shares outstanding, these differences in price swings translate themselves into vast sums, affecting certainly the whole economic life.

The differences in the organization of the two markets contribute largely, it is believed, to the differences in violence of the price movements, particularly: the broker-jobber segregation; the absence in London of the ticker tape, brokers' branch offices and advertising; and, above all, the absence there of price continuity and the mechanisms which create it.

As to trading in American securities, the following conclusions seem clear.

In the first place, the London "American Market" partakes in its essential characteristics not of the London market, but of the New York one. It enjoys a special regime. Institutional organization and the limitations inherent therein, made for the general English market, do not have, from a pragmatic standpoint, full effect on the "American Market," since they are directed to the trading in English securities, the characteristics of which are quite different. The London trading in American securities, therefore, escaping from controls thought necessary for this market, does not fall into apposite ones in the London market.

This trading has been of importance, particularly as to securities setting the tone of our market, and has had grave influence upon our price structure. The best example is that of Steel common. The Steel market in London -- at times in any event -- has approached in volume that in New York. When there is added the Amsterdam market in Steel, the trading in this security

on foreign exchanges has often, it is believed, exceeded that in New York. The direct trading by the Europeans on the New York Stock Exchange in Steel has also, of course, itself been of large volume. When all of these are put together, clearly the total foreign trading in steel has often been dominant. This trading is, to a large degree, speculation for the quick turn. The European uses Steel as a counter by which to go long or short of this country.

And it is not impossible also that at times in the leading securities there has been direct European manipulation by persons with large funds, on the London Exchange, for effect on the general level of stock prices in this country.

It is clear, however, that the London "American Market" depends upon the ability to "undo" the balance of its transactions in New York. The reverse transactions naturally are within the area of American control.

The war has changed completely the relations between the New York and London markets, both because of its direct effects and because of governmental war measures. It has been thought appropriate, notwithstanding, to publish the ensuing report, with the hope that it may throw light upon the structure of our own market, and present facts of direct interest when relations return to normal.

Parenthetically, the first year of the war has apparently not had great effect in the reduction of the foreign holdings in American securities. Liquidation effected by some countries has been largely offset by purchases from others. Thus, it is reported in the Bulletin of the Treasury for November, 1940 (p. 36) that the total foreign purchases of domestic securities amounted to \$670,862,000 as against foreign sales of such securities of \$765,956,000, showing an excess in dollar amount of sales of only \$95,094,000.

Having the above in mind, no attempt has been made to describe the changes resulting from the war; and since the report was written concerning normal conditions, it is left in the present tense even though speaking of things at times which now may seem remote. Along the same line, the conversion of dollars into pounds, or vice versa, has been made at the rate \$5 per
—.

In the general discussions, where from time to time comparison is made with the New York market, there is taken into consideration, unless otherwise indicated, only the New York Stock Exchange, and not the curb or over-the-counter markets, because the British interest in American securities is concentrated largely in those actively traded on the New York Stock Exchange.