Im plet

Speeches - SEC staff

CAUTION - ADVANCE
For Release Upon Delivery

SOME FUTURE ASPECTS OF THE FINANCIAL MARKETS

ADDRESS

of

GANSON PURCELL

Commissioner, Securities and Exchange Commission

before the

28th ANNUAL NATIONAL BUSINESS CONFERENCE

Babson Park, Massachusetts

Friday, October 17, 1941

The subject you have assigned to me is not an easy one -- unless one chooses the obvious answer. This would be that it is impossible to foretell the future of our securities markets unless one can know the future of the world and more particularly the future of our nation. We in Washington are no more seers and prophets than you at Babson Park or than the men of Wall Street. In times like these the known factors upon which conclusions as to the future can be safely based are indeed perilously few and far between. The most we can do is to concoct a mixture of guessing and hoping, with as much logic as possible in the guessing and as little blindness as possible in the hoping. We can, of course, draw to some extent upon the experience of the past, but we must be very careful not to fall into the tragic error of believing that what has happened can and must happen again. We have seen the grossness of that error on the military fronts of the present war abroad. Better it will be to study the past in order that we shall not make the same mistakes again -- in order that we shall know what kind of financial markets we shall want and be better able to achieve them.

As to our present securities markets, one thing is significant. That is that they are open. The violent shocks of a world at war have not this time been sufficient to force their closing. Even the fall of France and the depredation of most of Europe has not been enough. This fact, I think, is too often forgotten in the very common complaining about our present-day securities markets. In 1914, the quick march of the Germans through the low countries and into France brought chaos to our securities markets in short order. They had to be promptly closed. They could not take it. Today, as we have seen, they can take it. Therefore, it seems logical to assume that we have a stronger market machinery today than we have ever had before.

Many factors have undoubtedly contributed to that strength, but it is not necessary to explore them here. It is sufficient only to note the fact of the greater ability of the market to survive shock and to hope this indicates that for the future we have a better foundation upon which to build the kind of market structure we want.

I recognize of course, and sympathize with, the restiveness of the financial community in periods of market lassitude such as that through which we are now passing. But I am not very much surprised. The attention of our people, including our investors, is increasingly focused upon the great defense effort we are making. Furthermore, grave world uncertainties and higher taxes do not make for spontaneous resort to the securities markets. In short, I believe that, in looking to the future of the securities markets, we can be a great deal more encouraged by the fact that the present market has been vital and strong enough to stay open through such a period than we should be discouraged by the relative dullness of trading. I believe we can plan with a reasonable amount of confidence for the time when the diversion of public attention to defense, the world uncertainties and the necessity for directing a large portion of our national income to the manufacture of arms have evaporated. Our post-war economy, comprising both old and new industries, will require financing and that need should swell the flow of the capital stream.

But this can only be if we do well the job which is immediately before us. Few of us now doubt that the task of halting and defeating Hitler is probably the greatest ever undertaken by any group of nations in the history of the World. The German war machine has accomplished impossible after impossible. We know now, therefore, that we may no longer leave unturned a single stone which might conceivably add to the do-or-die effort to strengthen ourselves and rush aid to those who are fighting to resist and overcome that machine. Any man who looks upon the developments in the world today without real apprehension in his heart is simply refusing to believe what he sees. Our national confidence that Hitlerism is certain to be crushed must more than ever be carefully tempered with the qualification — "if we do everything in our power as a united nation". Any other kind of confidence is but the blind folly with which the road to destruction is inevitably paved. In short, we can no longer be cocky and over-confident. We must be energetically determined.

And we must, likewise, be energetically determined that we shall have, after the war, the kind of world we want to live in. With the world torn by the most horrible war ever known, it is no easy matter to retire to calm reflection of the problems we shall face after the roar of cannon has died away. But we must, nonetheless, make every effort to do this. It is an effort which must be made jointly by government and by every private citizen who has the capacity to think straight. In this war, we cannot wait until all actual fighting is ended to take the steps necessary to protect us from the after-effects. We must do everything we can not only now but henceforth as we see the road clear for protective action. Already your government is doing several very important things to counteract the present forces of inflation and to create a decisive cushion against post-war deflation. The Treasury Department is making every effort to convert the extra earnings of the defense boom into investment savings through the sale of defense bonds. This program is designed not only to help finance the defense effort but to give men and women something to fall back on when the war is over, thus releasing a new stream of purchasing power at a time when our economy will find it most welcome. The tax program of the Treasury will have the same effect. It will curb inflationary tendencies and, as the emergency taxes are repealed at a later date, will tend to counteract any decrease in earnings of business. The curtailment of installment purchasing by the Federal Reserve Board has the double effect of reducing present consumption of materials needed for defense and of building up a backlog of demand for civilian necessities for the period after the war. In addition, as you doubtless know, there is serious consideration of an increase in the social security tax, again to help to curb present inflationary tendencies while at the same time creating a substantial reservoir of savings for the future.

All these are important steps. They indicate that we have a much more definite understanding of our long range responsibilities and problems than we had at the time of the last war. At that time, we simply drifted from an intensely regimented war economy into an almost completely laisee faire economy. Once we had won the war, we assumed that our responsibility to the nation and the world was fulfilled. All the restrictions, both actual and psychological, were off. There was no period of transition. There was no gradual relaxation. There was no organized program, or even any effort to formulate a program, to ease the transition from a wartime economy to a peacetime economy. Everyone was suddenly and completely on his own. There was no thoughtful effort made to assist the economy in the adjustments made necessary by the advancement of technical skills. Technological unemployment went unnoticed, because those who were working and those who were speculating were so well off personally that they didn't bother or think to look around them. Malignant pains which should have been red flags of danger went unnoticed in the wild joy of those extravagant days until their cause pulled the whole system down and nearly extinguished it. Had we been sober enough to feel the pain, we would have searched out its source and brought it under control much earlier -- at least we would have tried. So the first lesson it seems to me, to be drawn from our experience after the last war is that this time we must take care that our transition shall be more gradual. War is a disease, and we shall have to plan to be under the doctor's care for some time, until we can be sure that we have got our strength back for normal healthy pursuits. We must not again jump out of bed and into the bar-room.

There are other steps we should take right now to build our defenses against a repetition of these past errors. It is sufficient to remember that the Maginot Line was regarded as impregnable so far as it went, but it simply did not extend far enough. We cannot afford the risk of leaving any of our economic front undefended from the violent forces of post-war demoralization. For example, there is a great deal which can and should be done right now in the field of corporate finance. In the First World War, the problem of the nation was the immediate shortage of capital. Steps had to be taken then to meet the relatively simple problem of conserving capital for war purposes. It was necessary to set up informal committees which could say that capital could or could not be used for specific purposes. A corporation desiring to sell securities submitted its plans to the local committee to find out whether or not they would conflict with the capital needs of wartime production. As I have pointed out, the concern in those days was almost wholly with the prosecution of the war. Too little thought was given to the problems which the nation would have to face after the war. Today, as a result of that experience, we know that we have a two-fold job to perform. We must do everything in our power to help the free nations of the world crush Hitler and his Axis allies; and at the same time we must build defenses against the economic forces which may otherwise eradicate our way of life after the war.

To these ends, we have the clear duty to see to it now that the financial condition of our American industry is such that it will be able to absorb the post-war shocks resulting from technological change and the job of shifting back to peace-time production of goods. We cannot begin too soon on this vast and complicated undertaking. Each financial transaction of each of our major businesses must be fitted into the program. Consider, for example, the tremendous wave of refunding of outstanding corporate bond issues which has been in progress for some years. This refunding is stimulated by the current low level of interest rates. Corporations naturally feel the temptation to call in their outstanding issues and put out new issues with more distant maturities at substantial savings in interest. In many instances this is sound, both from the present and from the long range standpoint. But there are many cases in which a simple refunding operation might not be wise. In our Commission's administration of the provisions of the Public Utility Holding Company Act we have not infrequently found it advisable to propose that, instead of refunding an issue on a long-term basis, a company should make plans now to scale down its funded debt. By doing this now, it will be in a better condition to earn money on its junior securities and, more important, it will be better able to withstand the strain of future periods of depressed earnings which may develop. Heavy funded debt means continuing fixed charges. Heavy fixed charges have meant the death of many important corporations and the wiping out of tens of thousands of investors in the depression periods of the past. We cannot afford to have our corporations go under water after the war is over. A deluge of bankruptcies at a time like that would as seriously endanger our way of life as a major defeat on the battlefield. So, at the present time, refunding programs in general should be carefully and currently scrutinized in the light of the financial condition and prospects of the individual corporation to determine whether a better long-range program may not be developed. It may be that, in some instances, it would be better for the corporation to replace its present bonds partly with preferred or common stock. Again, there will undoubtedly be instances in which the replacing should be done with short-term serial notes or debentures to be amortized out of current abundant earnings. This plan, where feasible, would have the advantage of providing a systematic program of debt retirement in the period of high earnings, thus giving corporations a greater resiliency with which to meet post-war conditions. In some other cases a requirement for substantial sinking fund savings each year may well appear to be the wise move. Such sinking fund reserves might be used to redeem bonds from time to time and it might well be that for the present investors whose securities were redeemed would invest the proceeds in government bonds — or employ them in anti-deflationary spending for needed consumer goods after the war. Corporations could and should be encouraged, where indenture provisions permit, to invest in government bonds any sinking funds not yet used for redemption. These are just a few of the aspects of corporate financial activities which ought to be regularly scrutinized during this emergency not only to increase investment in government securities at the present time but to clear up a lot of weak corporate structures the failure of which after the war might seriously aggravate strained economic conditions.

There is little doubt that, after this war, this country is going to be the only half-way healthy producer of goods in the world. Our responsibility will be tremendous but it will not be a responsibility without the prospect of long range profit if we are in a position to do the job. Hundreds of millions of persons throughout the world will be largely dependent on us for food, clothing, and the multitude of manufactured products which are the necessities of life. And nations will have to look to us for the capital and capital goods with which to rebuild their own productive machinery. We must be prepared to do a very large part, if the victory is to be worth having. It will do us little good to aid in the defeat of Hitlerism if the world is to degenerate into a rabble of roaming, starving, lawless bands. And it will do the world little good if we treat our responsibilities simply as an opportunity for exploitation from which we may become rich while the rest of the world becomes poorer. We can become stronger and richer economically only if we seek eagerly to meet the moral responsibilities which will clearly be ours. And we must begin to get ready for that job now. We cannot wait until it stares us in the face, because then there will be no time. The opportunity to become the most powerful moral and economic force on earth is one which we shall find ourselves impotent to accept unless we are prepared.

The soundness of our productive machinery will be a very vital factor. Today we find we find ourselves making every effort to convert a very large part of that machinery to the production of wartime necessities. Tomorrow the job will be just the opposite, but it will be not one whit less difficult. The transition will not just happen automatically. There may be great, and often violent, readjustments. Men who have been working at defense production may find themselves out of jobs when war materials are no longer needed on such a huge scale. The loss of their spending power can throw us into the bottom of a depression very quickly unless we are prepared. One way to cushion the repercussions of these events upon our people and our economy is to do everything in our power to make those men save all they can right now out of their increased defense earnings. This the Treasury is endeavoring to do. But there is the parallel job of making American industry take advantage of its increased defense earnings to strengthen itself against the repercussions of a post-war letdown. Corporate structures which are streamlined now will be that much better able to make the transition from production for war to peace-time production without having to drop men from their payrolls. Reserves not needed for defense activity must be carefully stored up against the day when they will be needed for this vital post-war purpose. And where those reserves are in excess cash they can, in the meantime, be put to defense work by investment in government work.

This job of preparing for the future while constantly stepping up our defense activities for the present is one which in the field of public and private finance the regular machinery of government is better equipped to handle than ever before in its history. In 1917, the Federal Reserve Board was only two or three years old and there was no Securities and Exchange Commission. Nor had the Treasury Department then had the breadth of experience in corporate financial matters which it has since acquired. Government machinery for scrutinizing the affairs of coporations outside of the field of fair practices and the railroads was virtually unknown. To establish a broad national program for the defense of industry against post-war conditions would have been a task so titanic that it would have been virtually impossible while trying to wage a war. Today, the picture is entirely different. Most of the large corporations have had nearly a decade of experience in revealing the full details of their corporate and financial activities to government agencies and these agencies have acquired the understanding and the techniques necessary for administration of such matters. Furthermore, a great proportion of the public utility industry is already subject to the further government activity of specific regulation of all financial transactions to the end of financially rehabilitating that industry. So the task of meeting these new problems of preparing for the future while producing for defense is greatly simplified by the existence of well organized machinery already operating as a part of government. No special private committees are needed for this task. Such a program will, nonetheless, not be palatable to short-sighted management who will regard it as merely another government intrusion upon their private affairs. But, unfortunately for that point of view, the well-being of American industry as a whole is not their private affair. It is a matter of national concern because upon it may rest the wages and the spending power of our millions of workers and the economic health of our nation and of our people. Wiser management will not only recognize the truth of this general economic axiom, but will see that such a program will in most instances specifically relieve them of serious future financial headaches.

I do not believe we can delay much longer in attacking this problem of corporate finance in the light of national defense and post-war needs. And I feel certain that upon the success of our efforts may well depend the future of the securities markets. If we are successful in creating sound financial structures and practices, capable of withstanding the shocks of the reconstruction period, there is little doubt in my mind that the securities markets will be able to perform a very important service in post-war finance. There will be a large job for those in the securities business. In the first place, it will in many instances be found desirable to capitalize those defense plant expansions which can be turned to peace-time purposes. Secondly, technological advancement is always greatly accelerated in periods of war. New products are being discovered which can later be turned to general commercial purposes and financing will be necessary. Other products not heretofore commercially practicable will be made so under the exigencies of defense needs. And very important indeed will be the immense backlog of consumer needs being built up by the necessity of curtailment of civilian goods at the present time. Civilian housing needs for example, may well be at an all time high and the possibility of great activity in this field is not without its promise for the securities markets. Another factor, not directly related to the effects of war, is that as a result of the Securities and Exchange Commission holding company program, many hundreds of millions of bed-rock operating utility securities, now locked up in holding company portfolios, will be available for public investment.

Furthermore, it seems almost certain that this nation will become the most important source of capital in the world after the clouds of war have been dissipated. And this is both an opportunity and a responsibility which we must grasp with the greatest of humility. We can not lick our chops over the prospect of enriching ourselves at the expense of an already prostrate world. We can, it is true, make investments abroad which will bring us a rich yield both financially and politically. But we can do this only if we bear in mind that our job is to recreate for those war-torn nations a healthy economy which will provide a sound basis for trade -- which means that our capital must be soundly invested in the future prosperity of those nations.

We must not permit a repetition of the high finance of the twenties, when both the American investor and the foreign borrower were squeezed so badly that in the end only the banker made anything out of the transaction. In the task ahead after the war, there will have to be a close liaison between government and finance to the end that American capital seeking investment abroad shall have at least a fair chance of returning not only a proper yield to the investor but of making a good customer for the nation as well.

In all this one thing stands out -- our securities markets must be equipped to do their part in the job, and to do it with sense and sobriety. This constitutes a challenge to those in positions of leadership in our financial institutions today. For those institutions must be built and shaped to keep abreast of rapidly changing world conditions and requirements. Antiquated customs and practices must be abandoned and modernized mechanics substituted. In some portions of the securities markets a good start has been made. It must be continued and extended.

You have asked me to forecast the future of our securities markets. I have consciously shrunk from that task and devoted myself to developing what I consider to be some of the problems that will confront our markets and our economic system in general. In addition I should like to venture one or two suggestions as to the direction that might be taken by those who are or may be charged with the responsibility for perfecting and protecting our market machinery.

In the first place, the advances that have already been made in the interest of public protection since the passage of the Securities Exchange Act must be consolidated and continued. Our securities exchanges throughout the country must be made stronger and on a basis of sound service to the public. It is of course obvious that the standards of the securities markets can be no stronger than those of its practitioners. There must be an end to secret profits and all manner of sharp practice, for only in this way can the restoration of public confidence be completed. The welfare of the investors must be energetically and faithfully served for it is in this direction that the greatest self-interest of the financial community lies. Competition in all elements of our markets must be encouraged and kept open. But above all things, business must be conducted with complete and unreserved disclosure. To accomplish these ends courage and vision will be required, but I know that both are to be found in our financial leaders. Finally, let us bear in mind that in the last analysis the future of our securities markets is inevitably linked to confidence -- the confidence with which we as a nation undertake the task before us and which we inspire in the hearts of our people and of the peoples of the world.

417115