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THE FUTURE OF INDIVIDUAL INVESTMENT

An Address By

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It was kind of you to give me this chance to rekindle happy memories and revive old associations. I'm glad to see that you still have buzz sessions -- although as I remember them with the Million Dollar Club Round Table on the Kungsholm to Bermuda some 10 years ago the disputation was not as learned or as profound as the subjects on your program indicate -- but the stakes were high and the cards were wild and voices were low unless you wanted to turn in while you were ahead.

Ten years ago we talked of estate planning as a balancing act between equity and dollars, taxes and inflation, retirement and family security, the risks of mortality and longevity.

Today, I'd like to scan the same horizons with you in terms of national need and capital markets, institutional forces and the creative talents represented by AALU and other segments of the financial industry.

Those ten years have been years of inflation and sweeping change in the world of savings and investment. Forces of institutionalization, of competition in the packaging of investments and financial services, have brought us to the threshhold of still greater change. If we are at a great crossroads, as I believe we are, where do the signposts point? What is the fundamental question we face? There are many questions but the one I would select as critical is whether we are going the European way--in which a few banks and insurance companies make the financial decisions, provide the markets, establish values and produce the funds-- or will we preserve and broaden the peoples' capitalism we have developed in America, with over 30 million individuals sharing ownership in our industry, with investment decisions being made and values established in every corner of the country, with talented and ingenious and trained professionals helping families use their savings to plan their future. I don't know which way we're headed. I do know that our savings and our markets are being institutionalized. I don't believe that's a bad thing as long as the alternative of individual saving and investing and planning is kept open, fostered, encouraged and serviced. That's where you and your counterparts in the securities industry have a great role to play. And your role can only be great if it is related to national need as well as to individual and family needs. The strength of our capital markets is vital not only to the 100 million Americans who have a stake in stocks, insurance policies, pension plans and mutual funds. They are vital to the welfare and economic progress of all 200 million Americans and to hope and progress in all parts of the world. To meet our needs during the seventies we will have to raise more new capital than ever before. Our corporations are top heavy with debt and more of this new money will have to be equity. In 1971, we did raise more new equity than ever before -- between 3 and 4 times as much as we had raised in any year prior to 1970. We'll have to continue at the 1971 pace for the rest of the decade.

Our great ability to mobilize capital from all over America may be our last great advantage in world economic competition. Other countries work longer for less and have better access to cheaper raw materials. They have developed their own technology and license ours. They have continental markets to serve. Our unrivaled ability to mobilize large amounts of capital quickly permits us to develop and apply new technology and other innovations and that has been our salvation; it is our best hope for the future in world economic competition. Even there, we face stiff competition now that the second best capital market, and possibly the most sophisticated, the London market has attached itself to a continental economy potentially as large as ours as England becomes part of the Common Market. Our banks, free of the Glass Steagall Act abroad, are competing in the Eurodollar market with a combination of muscle and talent which may show what other institutions will be doing here.

Our new money has come from insurance companies and pension plans. Pension plans have been providing most of it. But most of them were started during and after World War II. They are maturing to the point where almost as much money will be going out as going in. I believe that when you start selling equity or variable life insurance policies we will get another huge infusion of institutional equity money. The life insurance sale machinery hasn't set the world on fire in selling mutual funds, but it knows how to sell protection. When that protection has a built-in inflation factor, I see life insurance companies becoming an enormous factor in the equity markets.

But we must have the individual investor to absorb increased institutional trading and to take up the slack as pension plans mature. We have a very different market than we had ten years ago. Then, a large block of 10,000 shares or more would be traded about every hour---5 or 6 times a day. Today, we see this kind of a trade about every 3 minutes--100 times a day. During the first half of 1971, block transactions on the New York Stock Exchange ran 7,000 a month and accounted for 18% of total volume. Meanwhile, from 1968 to 1971, odd lot volume fell from 10% of total volume to 5%,and all trades of 200 shares or less fell from 41% of total volume to 24%. Institutions today account for more than 70% of all trading. This comes not so much from new savings coming into our institutions, although that is impressive too, but from pension funds and life insurance companies putting a larger portion of their portfolios into stocks and from more active trading by institutions. In the early 60's, mutual funds were turning over their portfolios 12% a year. Turnover moved to 45% in 1969 and is probably higher in 1971. To meet this, there has developed the phenomenon of block positioning, in which a relatively few houses will sell a portion of a large block and take the balance into inventory. These houses have maintained a liquidity for these large blocks at or close to the price for 100 shares -- a phenomenon we see nowhere else in our economy. Keep in mind that an institution may have researched a company for months and decided that its prospects do not satisfy their standards, yet it has been able to dispose of a large block of the company's shares at close to what the public pays for 100 shares.

The expanded institutional presence in the marketplace has given rise to another type of firm -- the institutional firm attracting business through its research capability. Somewhere between 20 and 50 firms with a cadre of highly knowledgeable and well paid analysts perform a critical function in pricing the market and helping it perform its critical function in directing the flow of economic resources.

All this emphasizes the importance of continuing the growth of our peoples' capitalism, which has extended stock ownership to more than 30 million individuals --- many times as many as there were only a short time ago. Ten years ago, we used to say that the middle class American needed $100,000 of capital to provide for his family's and personal security. I have pointed out that pension plans have over the last ten years been the great generator of capital and that this source may be leveling off. But half of the national work force is not covered by any pension plan at all. In addition, many people want to supplement their company pensions. Millions in business and professional activity have to provide their own retirement security. For most families that kind of capital can come only from a combination of pension, insurance, social security and savings. You have great expertise and ingenuity in designing how this family security capital can be generated from savings that can be picked off and set aside from the stream of income.

President Nixon's proposal to Congress to extend tax incentives to these millions of Americans who provide their own pensions can spread ownership in American industry to millions and millions of additional Americans.

The process of planning family savings at which you are so expert has clearly reached towards higher insurance protection balanced by equity accumulation. Perhaps the best indication of this is that term insurance accounts for about

60% of all the life insurance in force today -- while twenty years ago, it accounted for only a third. Similarly, policy loans have more than doubled over the last five years as almost $10 billion was borrowed by policy holders against their insurance policies and shifted to other uses. I am mindful that while the savings that you put into insurance policies become institutionalized, the estate planning which you do with these policies keep family capital in private ownership available for individual investment, and as policies you sell mature, these funds become available to broaden this peoples' capitalism of ours. The trust and confidence of millions who do not now own stock must be merited and won if our economy is to meet the needs of the nation.

That's why it is urgent to move with dispatch to resolve uncertainties and create a sense of direction and movement in improving the structure and efficiency and the performance of our capital markets.

That is why the small investor must have the continuing assurance that he is getting the same quality of information about the progress and performance of public companies at the same time as the company insider and the large investor.

That is why our markets must be structured to give all investors access to the same disclosure of prices, volumes and quotes and to the best available buying and selling opportunities.

On the basis of almost four years of hearings, the Securities and Exchange Commission has just promulaged a policy statement on the market structure which we believe will be the basis of a central market system in which every investor will know all about the trades made on all markets in any part of the country and will know that when he buys or sells, he has gotten the best price available. This system will be designed to put competition to work for the investor. It will seek to eliminate the use of gimmicks to rebate and recapture commissions and to spotlight the important question -- which is not who gets the commission but rather was the best result obtained for the investor. We intend to eliminate the use of undisclosed compensation for the sale of mutual funds in the form of commissions on transactions made from the fund's portfolio. Let me emphasize that while doing all this to encourage the participation of the individual investor in the market, we do not intend to neglect the contribution to the economy and to family financial planning which investment companies and other institutions are equipped to make. We want to see an open choice with compensation and other elements fully disclosed so that individuals can determine on the basis of the facts to what extent they prefer to invest directly or through a pooled account. The movement of public saving into different forms of investment and different kinds of use is determined by the nature of the returns, the nature of the sales incentive and distribution channels, and the nature of the packaging. Right now, pursuant to Congressional mandate, the National Association of Securities Dealers is engaged in a far-flung study on the basis of which it will make a recommendation to the Commission as to what is the appropriate sales load on mutual funds. This determination will have to be made some time in June. Today, we see a considerable shift of investment sales effort to tax sheltered packages. Oil, real estate, cattle, citrus and farm packages are today accounting for a very high proportion of all the new money raised in this country. This in large measure comes from the fact that higher sales commissions are paid on the sale of these tax sheltered packages than on other types of investment. Congress has required the SEC to make recommendations as to whether and how oil and gas investments should be made subject to a specialized type of regulation. At the same time the NASD is studying the kind of controls it should establish over the structure, the presentation and the sales charges made on tax sheltered packages. The decisions made in this process will have a great deal to do with how new money is raised and where it will be applied. But most important of all will be the kind of planning and money management guidance which is available to the public. One of the important decisions made in our policy statement on the structure of the markets is that the road should be left open for brokerage firms which have the talent and the experience to provide money mangement services. This is something which will stabilize brokerage income and will provide much needed guidance for the public. At the same time, we left the road open for institutions willing to serve the public in a brokerage capacity to commit needed capital to that business. In all of this our work, and that of the self-regulatory bodies, provides only a framework. The investment future will be determined by creative men providing guidance in financial and estate planning and investment decisions -- men in regional investment houses throughout the country -- men in money management and investment research -- men doing a professional sales job like you. It is the skill and professionalism put into the work which marshals the capital, directs it into balanced and promising channels and builds family security based on a balanced stake in the future of our economy. I know you will move forward in professionalizing that work during this week, and I thank you for letting me be a part of it.