THE SCREWING OF THE AVERAGE MAN:

The Wall Street Treatment

by Paul Dickson

The primary difference between the small child and the small investor is that, once burned, the former seldom returns to the source of his or her discomfort while the latter shows a puzzling proclivity to do so. In this regard, the experts now say that the disillusioned small investor of 1970 is showing interest again and will no doubt take the plunge at the first sign of a robust rally. In addition, of course, there are those millions of just plain folks who never got out, who swallowed their losses, weathered the financial storms, and are now waiting for the reward of the faithful: the big pay-off.

Wall Street is coming back after a series of nasty scrapes between 1967 and 1970, when confidence often drained from the ticker and when even respectable brokerage firms were embarrassed by demands for hard cash. Contrary to the scenarios of the doomsayers, 1929 did not repeat itself. Only part of the house of cards collapsed, as the tide of folding firms was stemmed at about 130, and today bright patches of bull instinct are poking through the gloom that was Wall Street 1970.

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All of this is not too surprising. In accord with the survival instinct, the nation's financial establishment worked hard to keep its cookie from crumbling: face-saving marriages were arranged between healthy and faltering firms and the New York Stock Exchange pumped in over $100 million to salvage the debris left by its fallen members. Congress helped with a law that put a money-back guarantee on future firm failures and did it without attaching a lot of strings and demands for reform to its largesse. On the heels of Congress, the Securities and Exchange Commission (SEC) has put profitability back into the picture by letting brokers roll up their commission rates for buying and selling the stocks of small investors. Although Congress is showing its first critical interest since the 1930s in the mechanics of Wall Street and a healthy crop of Wall Street exposés is appearing between hard covers, the

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financial world faces only minor irritants compared to the more fundamental problems of survival that were overcome not too many months back.

While it is not surprising that the institutions of absentee ownership are rebounding, it is surprising that the small investor may be assembling for a lemming-like return to the same theater where he was recently cast as an expendable extra in a festival of Wall Street horror films. In chronological order, the offerings included:

The Fried Chicken That Ate the World (1967-1969). In the beginning earnest men in nice suits told us that the world was soon to be covered with fried chicken take-out stands with nursing homes out back. These stands were to be linked together with computer systems and communications gadgets and, in turn, the people who owned the stands and the technicians who made the computers work were going to create a market for zillions of pre-cut homes, muffler repair shops, and driving ranges. As it turned out in the end, the fried chicken became popular but did not take over the world (for every Col. Sanders there were dozens of troubled Daniel Boones and Minnie Pearl's Chicken Systems which never became household names), and most of those that bet their nest egg on the chicken, the little go-go computer firms, the electronic pizza ovens, and the franchised nursing homes lost out.

The Great New York Paper Explosion (1968-1969). As public expectations of a quick profit rose and hordes of new investors came into the market to speculate, volume exploded, prices soared, branch offices proliferated, and men off the street were turned into brokers. With this boom the shadow of ecological peril appeared over the Street. For as the boom began, trees fell to produce the pulp for the paper to record it, and suddenly the system began to jam. Firms lost control over their books and records, and millions in securities floated about like so many copies of yesterday's *Wall Street Journal.* At one dark moment in late 1968 over $4 *billion* in securities were lost in the shuffle and almost everywhere customers' accounts were in disarray. Initial attempts at solving the dilemma often led to compound disaster. Firms that had long preached the gospel of the computer in order to sell stocks in electronics firms grabbed for a piece of that miracle, many true believers jettisoned manual accounting for untested and malfunctioning gray boxes right there at the firm. As brokerages started to go under in 1969 more than a few could trace a major share of their demise to their unflinching faith in automation. With everyone from the RAND Corporation to the SEC pitching in, some of the worst paper problems were finally showing signs of abatement by early 1970.

The Incredible Shrinking World (1970). Even after the paper crisis, Wall Street was again caught off guard as a bizarre shrinking phenomenon took hold of virtually everything save debts, which were immune. Business, profits, volume, investor confidence, price, and the number of firms doing business were all shrinking at alarming rates. In the nick of time, the shrinkage was held with a poultice of money, derring-do, shot-gun mergers, press releases, and a pick-up cavalry from Washington. As expert witness William McChesney Martin, Jr., former New York Stock Exchange president, remarked after the line was held, "Grave injury to the public was narrowly averted by hastily organized financial operations."

Today there is no reason why these epics will not be remade. Even now, variations on the popular *Fried Chicken* are getting into production, and the tip sheets and stock merchandisers are pushing new stars like Modular Home, Leisure Community, Canada Oil, Medical Electronics, and Snowmobile. And with them, there is a resurrection of the litany about those average Joes who picked up on IBM and Xerox in 1948 and prospered beyond their belief. Some say 1967 is

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just around the corner.

Never Say Gamble

What is perplexing is that all signs point to the conclusion that the small investor is ready to get in again even though reforms have not been made and it will cost him or her more to buy and sell. In his thoughtful, critical book *Wall Street: Security Risk*, SEC staff member Hurd Baruch reflects on the last few years and tells us, "The securities industry has repeatedly used its vast political influence to divert, delay or destroy proposals which would restrain its maltreatment of the investing public. If brokerage customers want their 'rights' to be respected by the brokerage community, it is up to them to speak out in Congress and on Wall Street itself. . . ." Will Baruch's book (and other current works like Sidney Margolius' *The Innocent Investor and The Shaky Ground Floor* and Christopher Elias' *Fleecing the Lambs: The Inside Story of the New York Stock Exchange)* serve as rallying points for the financial consumer? Probably not, since public confidence and reform have never mixed well. Says one of the SEC's young attorneys who, unlike the career-risking Baruch, is not yet willing to stick his neck out for attribution, "The problem is not one of apathy but enthusiasm. It would appear that a lot of people are eager to get in there again and mix it up—as if they look upon the last few years as a test of their sincere desire to make money."

A few hours out of the SEC attorney's office, a friend who should know better—by virtue of the fact that he lost heavily during the last two years when he never heard from his broker—has once again gotten the word and is telling me that Occidental Petroleum looks good and that it is a good time to take short rides with proven performers. The next day another friend, who had not long ago bought some pieces of paper that acted more like Kamikaze planes than shares in American industry, writes to tell me that this time around he's sure he has some winners. And as for yours truly, he likes mobile homes, natural gas, and science-oriented companies that don't make weapons with Cambridge, Mass. post office boxes. These are not tips—rather a confession of greed and the urge to "speculate." (Having once been in a Wall Street training course to become a seller of stocks and bonds, I know one never says "gamble" except when discussing horse racing or poker.)

Of the 200-odd million souls in the nation at this moment, 30 million are stockholders. If you add to this those who are in the market indirectly through mutual funds, pension plans, and insurance schemes, the total rises to over 100 million. While it is difficult to generalize about so big a group, it would appear that on the whole we are the more undemanding, faithful, and unflappable half of the population. Many of us know better, and our greed gets in the way of demands for reform. We listen and give people like Hurd Baruch a hearty "right on" while keeping our other eye on the Dow-Jones averages. We are the ones who deserve what we get—good, bad, and indifferent. Others are not so fortunate: they are the true believers who accept the mythology of Main Street/Wall Street and more often than not get hit right in the retirement nest egg. Too many are brought to the market with the promise of low-risk schemes that will get their kids through college, or give them enough to start their own business. These are the people who have never heard of the "shake out" when people like them stampede out of the market to get the $1,800 left of their dream which started with $5,000 to invest and who have never heard that timeless bit of Wall Street sarcasm, "where are the customers' yachts?"

The mythology problem is not restricted to the innocent, however, because we all let those myths take over at the first sign of a speculator's rally, nostrils dilating every time

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Walter Cronkite extols the bull market. These myths are far more secure than most stocks on Wall Street, even the blue chips, for they help us retain a belief that the big bucks might come home some day for nothing. They are also proclaimed by men and institutions of such dignity and such plush carpets—men whose opinions must be tied to reality because the Depression followed the stock market crash—that we are led to believe in the aura of Wall Street out of awe and respect. Although the myths are supported by our sneakiest desires and our respect for the bowlers and the established wizardry of Wall Street, it still might be useful to take a look at two of them to see what they cost the small investor in money, sleep, and general sucker's lament.

Share of a Feeling

Widespread among small investors and carefully nurtured by the industry, is the two-headed myth that it is both necessary and rational to put your money on the line to grease the economy and get your share of the pie. Yet, unlike soap or shoelaces, we certainly do not need the stocks nor can the business of buying be called rational. A share of stock is a share of a feeling. The fluctuation of the price of American Can has nothing near as much to do with the true value of the company as with the opinions, rumors, and moods that surround the name and the way the news breaks in *The Wall Street Journal*. But because the average investor probably can never fathom what makes stocks go up and down, the brokers must market them as a rational, utilitarian package. The finesse employed by brokers in the last decade has had phenomenal results in bringing small investors into the market. The myth of necessity/rationality is simply a myth created by shrewd merchandising.

One manifestation of this proven ability to keep us feeling good is the language or rationality which has been coined by the merchandisers to keep virtually all situations under semantic control. The operating principle of this language is making the market (or a specific stock) an animate entity which is doing or is about to do something quite in keeping with the nature of the beast. We don't quite understand, but its nice to have reassuring words passed over your stocks. For example, the market goes down a bit and you call your broker. Depending on his mood or school of thinking, you find that the market is "consolidating," "making a technical correction," "looking for good news," or "tired and trying to make up its mind"—to name a few. We are calmed by terms like "technical correction" and seldom venture to ask what it means.

No collection of merchandising myths is as widely promoted by the industry as those which have been shaped into slogans which offer extra reasons—ranging from the personal to the patriotic—for getting into the market. As a group these slogans embellish the promises of building one's holding for retirement or sending the kids through college with a nice feeling that leads one to half suspect that the President will be grateful. Wall Street's equivalent of Madison Avenue's "washday miracles" and margarine coronations are: "bringing Wall Street to Main Street," "taking stock (or buying shares) in America's future," "the best hedge against inflation," "people's capitalism," and others too numerous to mention. To analyze just two of the most outlandish: the flimsiness of the "hedge against inflation" was evidenced, at least, during the extremely inflationary 1969-70 period when stocks nosedived and, as for "the future of the nation," the U. S. has proven to be more economically durable than 1968's flock of high-flying fried chickens.

At its nadir this kind of selling gets into a hocus-pocus that inspires nausea rather than amusement. The blandishments that accompanied the franchised nursing home stocks of a

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few seasons back made both the greedy speculator and the true believer feel like Albert Schweitzer with lines about providing the capital to take care of the elderly. (People who bought that famous nursing high-flyer, Four Seasons, for over $100 a share in 1968 now are lucky to get a quarter a share on a good day.) Back when I was a trainee with the nation's largest brokerage firm, it was unloading Howard Hughes' TWA holdings and a line that the boys liked to use when calling their little clients was, "I've saved some of Mr. Hughes' stock for you"—as if the transfer included some of his Midas-like powers.

Since selling securities is a form of merchandising, it should come as no rude shock that a crop of merchandising gimmicks has become widespread. Too often the small investor looks upon them with embarrassing enthusiasm. For example, seldom is there an excitement to compare with that of the investor who finds that his 100 shares of a $10 stock is about to become 200 shares of a $5 stock through a stock split. The investor lights up inside as he contemplates his "doubled" holdings, his stock "taking off," his rainbow's end. He is unlikely to see the higher commissions that will be generated after the split. Under the new minimum commission rates it costs $25 to buy or sell 100 shares of a $10 stock and $32.80 to buy or sell 200 shares of a $5 stock. The widespread use of the split to gin up volume and commissions accounted for the addition of 5.5 billion "new" shares on the New York Stock Exchange between 1960 and 1970. The practice also contributed to the paperwork explosion.

Another favored gimmick is the one in which the broker offers a new issue or special distribution of stock with the pitch that the stock is being offered without any commission and, sure enough, when your statement comes through there is no commission charge listed. Unknown to the small investor who thinks he is getting something for nothing, the broker is getting a double commission from the company issuing the stock and that fee is built into the price of the stock.

Never Say You Don't Know

A second major myth is that the stock salesman is worthy of our trust and money. The myth is not entirely his fault, as it is partially nurtured by what we require and demand from him and the way in which he is made to do business.

Normally a salesman is in training for only six months, during which time he hangs around a salesroom and spends some time in a class. Each exchange has a multiple-choice exam which is ever so easy, predictable, often available in advance, and really serves as more of a test to see if the prospective broker can handle the terms of the industry—so he can sound like a broker—rather than to see if he comprehends what is going on.

Once the exam has been passed, our man goes off salary and onto commission which means that in order to do well he has to keep us buying and selling stock. The system is so structured that it is not to his advantage to let us sit on those future Xeroxes and IBMs for a decade or two. It is illegal to "churn" or switch a customer around in stocks for commissions rather than profits, but it is a hard charge to pin on anyone since the distinction between churning and an "active account" is often blurred.

Despite the electronic gadgetry and impressive titles on their cards, a stock salesman buys and sells stocks with little or no knowledge of the company behind them. This is not especially surprising since he has 25,000 brands of the stuff to choose from. When we call our brokers and ask them about some obscure Canadian oil stock, they have two alternatives: (1) to say they don't know or (2) intone something about Canadian oils looking good for the next six months. During my days as a Wall Street trainee, the prime message was, never say you don't know.

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Brokers spend the bulk of their time swimming around in the language of the market, parrying customers with the lingo. Hardly more enlightened by this exercise than their prey, they themselves often read tips according to the attractiveness of the package. For instance, one slow day during my apprenticeship, a salesman got a call from an old college buddy who had moved into the realm of high technology. He told the broker that some little data processing firm had licked a "significant" software problem. Despite the fact that few Americans were even aware of the problem, and few in the office could give more than a three second definition of software, the story was bought whole, and within an hour the salesmen were imparting the seductively sibilant story of "software" and "significance" to their customers. The customers loved it. The problem for the small investor is that he neither demands quality nor timeliness in his stories. He seldom considers the fact that the big institutional investors get their stories earlier and in better shape.

To become a good broker you must be capable of surmounting the fact that you are ignorant of most of what is going on in the stocks you are handling and push ahead. Some eventually do all right for their clients, especially if the market is healthy. (The average investor should derive little cheer from the existence of skilled brokers, however, because the firms quickly siphon them off to handle the big accounts—leaving the proven dumbos and the try-outs to service 100-share transactions.) Other brokers cannot get over their incompetence. The author is one such case. I bolted Wall Street after six months' training with Merrill Lynch, Pierce, Fenner and Smith on the eve of my examination for the New York Stock Exchange. A few days before the exam, I was taken aside by the branch manager I was to work under and given a specialty. A specialty is not a group of stocks, rather a type of person each novice is assigned to by the manager. One is expected to contact, attract, and learn to deal with this group—which becomes the nucleus of your business. For reasons that were never made clear, my peers were deemed proper for specialties like taxi fleet owners and New Jersey dentists, and I was picked to work with the recently widowed and was promised that by the time I was assigned to a desk in the branch office I would be given a list culled from the obituary pages.

Sharks in a Feed

Attendant to these two major myths are a host of lesser myths. If you are a small investor, you probably believe that your funds and securities are held in an account with your name on it. This is on paper only. The money and stocks are used by most brokers for whatever uses they deem fit. For example, if you leave cash in your account you get no interest, but you can rest assured that the firm is investing it for its own ventures. For this reason it is standard operating procedure for brokers to tell you that it is safer and more convenient to leave your stocks and extra cash with him. In this respect, the brokerage firm becomes a bank that gives no interest. As summed up by Hurd Baruch in his book, "Clearly customers place a great deal more of their own funds at risk in the business of their brokers than do the brokers themselves."

Another myth with remarkable resilience is that the securities industry is heavily regulated. The SEC holds fast to the tenet of "self-regulation with proper oversight," yet even those in high financial positions question the concept. The president of the American Stock Exchange said recently, "... the self-regulatory machinery does not exist for solving industry-wide problems." His point is well taken since there is no central authority within the industry to regulate, so a bit of tidying up by the members of one exchange does not

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necessarily have anything to do with the others.

A further misconception of regulation is that the federal government and the dealers themselves have so structured things that it takes a lot of money and impressive credentials to start a brokerage firm. In truth the SEC requires just about as much as you need to start a good bookie joint: specifically, $5,000 and a telephone. This does not mean that the sins of the exchanges are monopolized solely by the small brokerage outfits and the fly-by-nighters, but is rather an illustration of the laxity of regulation enjoyed by all.

Even lower than the financial qualifications are the mental ones. The National Association of Securities Dealers, which regulates over-the-counter firms, gives a 170-question multiple-choice and true-false examination to qualify one as an officer of a firm. Only two of the questions relate to books and records—a fact that has attracted the interest of a House subcommittee looking into the reasons why books and records started getting so mixed up a few years back.

While there are many examples which show why self-regulation does not work, two recent ones should suffice. A classic case appears in several published analyses and congressional inquiries into what went wrong at the end of the 1960s. One of the most pressing problems was that while Wall Street was gagging on paper and snarled up in Victorian procedures, firms continued to advertise, promote their wares, hire salesmen, open branch offices, and usher in new and often immature stocks. Each exchange politely suggested to its members that they cool it, and there was a flurry of letters from the SEC, but nothing happened. It was as though they were asking sharks in a frenzied feed to consider the problem of indigestion. Another case in point is that of Francis I. duPont and Company which, during a period of two years, attracted 45,269 customer complaints having to do with such things as lost securities, accounts in error, and failure to credit dividends to customers' accounts. Neither the SEC nor the Exchange took stern action, although rebukes and fines were leveled. The problem was summed up by the House Interstate and Foreign Commerce Committee looking into troubled firms when it said, "The problem is how drastic can the actions be against a firm such as duPont that has had an aggregate indebtedness of as much as $332 million, most of which was owed to its customers."

The problems of regulatory shortcomings are compounded by the widely held article of faith that the financial shape of your neighborhood broker/dealer is watched closely by federal authority and can, if you desire, be checked out in person. All too often the SEC takes a few years to get around to checking a firm, which is a long time in an industry where firms have been known to go under in less than a year. It is difficult to check things out for oneself because many firms will give out no information on their operations or financial position. Ironically, while the SEC takes pains to make public the information on the companies one is investing *in*, it has never pushed for public information on the company one is investing *with*.

Never Say You're Sorry

Perhaps the most telling myth of all, however, is that Wall Street loves the small investor. There is truth in this but only if you believe that love means never having to say you're sorry. Wall Street looks at the small investor as a commodity to be turned on and off as the market and its volume dictates. For instance, the New York Stock Exchange recently asked the SEC to approve the Investors Service Bureau which the Exchange explained this way: "Should small investors find difficulty in getting member firms to handle their accounts, they will be given by phone or mail the names of member firms in their area interested in handling small

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investor accounts." Sounds nice, but the SEC read between the lines and balked because the request was in truth a request by Exchange members for a legitimate way to dump or not accept small accounts when they got in the way. Another manifestation of the attitude towards the small investor as a commodity is contained in the little myth that the customer's account is a sacred and confidential trust. Not so. During the dim hours of 1969-70 troubled houses were selling accounts to other firms like so many shares of American Tobacco, with nary a peep from the SEC.

Another way to look at this curious love affair is to examine the influence of the small investor on the thinking of Wall Street. The small investor has compiled a miserable track record which has been summed up in the adage, "The public is always wrong." It has long been axiomatic that the odd-lot public—or that section of investing Americans which buys its stocks in peasant-like lots of less than 100 shares—always goes in the wrong direction and that the smart thing to do is the opposite. Generally, the odd-lot public buys heavily near the end of an ascending market, and again as prices start to tumble.

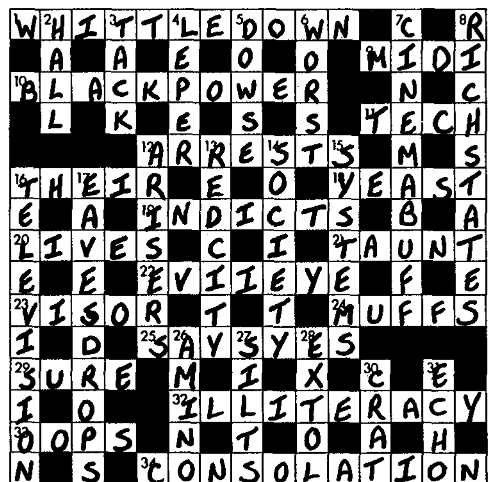
So it goes in the world of people's capitalism. The small investor hangs on at the edge of the ticker tape by his three-figure orders. His lack of insight leads him to admire those with better averages than himself or Dow Jones. He thinks the large investors who get richer in the market possess some extra measure of bravado. Actually, the small investor is much more the daring, winner-take-all capitalist than his wealthy counterparts. In effect, he is taking more blind risks than any well-heeled investor would ever dream of. He thinks the masters possess some additional cunning, when a great part of their clairvoyance is that of the stacked deck.

This misguided admiration is also parlayed into the belief that all investors are one big happy family, and the Stock Market a fiscal commune, where 100 shares are entitled to as much respect as 1,000, where everybody gets his cut from the big haul—to each according to his ability.

To the small investor with any memory, however, the hospitality of the Exchange must seem curiously uneven. Wall Street trumpets its periodic welcome, as it did in 1960, but just as abruptly closes the door again, as it did in 1969, with the high surcharges and other discrimination against the minutia of capital. The small investor can be brought in at certain times, or kept out at certain times—his money serving the governmental function of pump-priming or accomplishing for the Market what the government accomplished for Lockheed.

This function contradicts the notion, advanced by the Exchange publicly, that everyone can win in the long run. The other possibility, as one broker puts it, is that "somebody must win so somebody else can gain." Here amid the peaks and troughs, after he has been doused with cold tips and run through the brokerage wringer, the small investor can't bring himself to believe that he is not even the last one on the gravy train, but usually a mere dribblet of the gravy.■

Solution to October Puzzle:



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Memo of the Month

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
MEMORANDUM
OFFICE OF THE SECRETARY

DATE: August 24, 1971

TO : ORCD Staff

FROM : Paul L. Niebanck
Deputy Assistant Secretary/ ORCD

SUBJECT :

I leave for vacation (August 25th to September 8th) with a light heart. Our new organization has survived its birth trauma. It has established itself as an enterprise worthy of respect. It has broken new ground with the regional offices, with HEW Washington and with HUD. A common mission and a degree of creative interaction beyond the ordinary have emerged.

Much is ahead of us. To convert an embryonic OPS system into a meaningful management tool; to open HEW to new modes of doing business; to empower and enliven the regions; to strike meaningful relationships with communities and interest groups; to make connection with the reform initiatives in the agencies; and to help OS become more aware of its field responsibility–these are but a few of our important roles.

You have all taught me a great deal in a very short time. The loyalty and hard work that were required during the recent "OPS crunch" are exemplary of the support I have been given. I think we can all look forward to the fruits of what has taken place during these first six months. My goal is that ORCD (however it is named!) become the most effective changed agent in HEW. That is what the Secretary has asked of us.

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