4 The Tulips of the Sixties

Each wave of speculation has its own new concepts, or images as Le Bon would put it. Beguiling in their simplicity and seemingly foolproof, they dazzle myriads of investors simultaneously. Victor Hugo said nothing can stop an idea whose time has come. In the early 1960s the time had again come for a journey into fantasyland.

It had taken a very long time for investor confidence to recover from the holocaust of 1929–1932. The Dow Jones Industrial Average did not break through its 1929 high of 381.17 until November 1954, and by the end of 1954 it had crossed the 400 level. The market worked higher in 1955 and 1956 losing some of the gains in 1957. But in 1958 and 1959 it was up again sharply, and closed the year 1959 at 676.36.

Although the nation had suffered a sharp recession and high unemployment in 1957, the worst of the post-World War II period, business had moved up sharply thereafter, and there was widespread confidence in the "new economics" and the ability of the nation's economic advisors to keep the economy out of serious difficulties. This confidence was not to be dissipated for another 15 years.

As the decade of the fifties closed, the stock market again became the subject of widespread interest. Large profits had been made by people who picked up stocks at the distress levels of the 1930s and the 1940s. Gains of tenfold or more were not uncommon on blue-chip securities. By 1960 prices of many leading natural resource companies were up as much

as 25 times from their 1932 lows. Mutual fund sales were strong, and investors were shown via charts that even if they had purchased stocks at the top of the 1929 market, with price appreciation and reinvested dividends, each dollar invested then would have been worth many times more in 1960.*

An entire generation had grown up deprived of the memorable experience of a final margin call followed by insolvency. Confidence in the stock market had been fully restored. I was part of a new wave of university-trained investment professionals who were provided with theory of stock valuation which we believed, if properly practiced, would have prevented us from making the speculative errors of the twenties and allowed us to take advantage of the severely depressed price levels in the following two decades. And so we, like so many well-meaning, intelligent, seemingly totally rational experts of previous generations, marched confidently on toward the next cataclysm, and it was not far away.

Electronic Bubbles

In the market of the early 1960s some of the most spectacular gains were made by growth stocks, stocks whose earnings and dividends grew at a faster and more stable rate than the market as a whole, usually because they were in rapidly growing industries that often involved technology. IBM, Xerox, and Polaroid were examples as were Fairchild Camera, Texas Instruments, and General Instruments with the new technology of semiconductors.

At the same time, institutional ownership of stocks was increasing, accompanied by rising public interest in the market. With relatively few additional offerings of blue-chip shares, fears were being expressed that a shortage of high-quality investment stocks would develop. (The same fears

*Primarily the magic of compound interest. In *Rates of Return on Investments on Common Stocks* (Lorie and Fisher, University of Chicago, 1964), the average return on all stocks on the New York Stock Exchange was calculated to have increased 10.8 times from 1929 to 1960 with reinvestment of dividends excluding taxes. The Dow itself was only 62% higher.

had been expressed in the 1927–1929 market.) Smart investors were concentrating on finding new issues which would become "blue chips" because of their excellent growth records. Often such investment in solid young companies paid off. A purchase of discounter E. J. Korvette in the mid-1950s appreciated tenfold by 1961. The investor who bought a thousand shares of Control Data, a manufacturer of large-scale computers, when it was first issued at $1.00 in 1958, had stock valued at $121,000 in 1961. The acceleration of the U.S. space effort after the Sputnik launches in 1957 meant that tens of billions of dollars would be appropriated for the U.S. program in the ensuing years, with creative technological companies likely to benefit substantially. Once more we see both solid beginnings and excellent material for concept.

Intrigued with the gains made in new issues to date, a tremendous appetite for exciting new companies was fostered. The interesting feature of the early 1960s new issues market—and a link with speculative manias of the past—was that people were ready to buy almost anything: all that was required were one or two scientific Ph.D.'s who would promise to develop such items as iconoscopes, particle accelerators, photoelectric cells, or silicone semiconductors. The more esoteric the concept, the better the public liked it. Any company ending in "-onics" was almost automatically guaranteed an enthusiastic reception. Adler Electronics, Bogue Electronics, Nytronics, Bristol Dynamics (not "onics," but close) all were snapped up and commanded large premiums within a few months. (One is reminded here of the company established during the South Sea boom to extract oil from radishes—a product for which there was no known use. So, many investors in the early 1960s had not the slightest idea of how or to what end such technology was to be used.) Investors scrambled for such issues without the least idea of the company's fundamental situation. Promoters took advantage of the public's infatuation with technology to provide as much "merchandise" as possible.

Another spectacular growth area during the new issue boom was the more pedestrian one of bowling stocks. With the development of the automatic pinsetter, the sport became more profitable to the proprietor. There also seemed to be a growing public interest in the sport. So far, so good. But what happened in the marketplace bore little relation to this modest reality. Brunswick and AMF, principal manufacturers of the automatic pinsetters, became overnight glamour stocks. A flood of new issues came on the market representing bowling lane operators, pin and ball manufacturers, and even construction firms specializing in building new bowling alleys; all were greedily snapped up by the public. A few sane heads, including some people who had been in the business for some time, realized that there was indeed a finite limit to the future of the sport and that such overexpansion would come back to haunt everyone. The boom in bowling stocks continued merrily on despite the warnings.

Another phenomenon of this market was the rise of the Small Business Investment Companies (SBICs) authorized by an act of Congress in 1958. SBICs were encouraged by the federal government to invest in promising new companies; they were given both tax concessions and cheap federal loans, which had a leveraging effect on the money put into the company by private investors. The SBICs were the hatcheries from which the future new issues would come. They were in on the ground floor, normally having options on large blocks of stock in addition to making loans to the young companies. Through SBICs, investors would be getting a play on electronics, medical technology, bowling, and many other interesting sugarplums at bargain basement prices. And, of course, the SBICs were run by professionals.

According to *Forbes* magazine, between January and August 1961, 177 new SBICs were licensed, with almost 50 being publicly held.[1] Investors were frantically bidding up the prices of SBIC shares, and SBICs were just as hungrily buying the small companies they thought would be the next winners. In allowing investors a crack at the action earlier and being run by well-informed pros, the SBICs bore an interesting resemblance to the Investment Trusts of the 1928–29 market. Certainly investors regarded them in the same light.

The underwriters of new issues did of course operate

under some regulations, but many of the underwriting firms were one- or two-man organizations with a single secretary. At first, electronics were the favorites, but later the interest expanded to discount retailers, bowling, SBICs, and other areas. The countryside was scoured for companies that could be sold to the public. "Why go broke—go public" became the underwriter's rallying cry.

The promoter/underwriter had to properly package his merchandise. This meant that if it was remotely connected to technology, the company was given some sort of space-age name. Most buyers looked no further. Although a prospectus was issued few speculators examined it. It didn't matter if an electronics company had never made a profit, and likely never would. If the stock the speculator was getting at 5 was likely to open at 7 bid in public trading, who cared? With the small supply put on the market and the large public appetite, many stocks immediately opened at huge premiums, sometimes doubling or more. This sort of blind, almost willful ignorance of reasonable value is a danger signal in any market.

Not only did the promoter/underwriter earn an excellent underwriting fee, he often also took large positions in warrants at a nominal cost; and if the stock moved up sharply the underwriter made a second killing.

New issue prices were made to open artificially high by keeping the number of shares offered small, and carefully controlling the distribution. If a corporation wished to sell 200,000 shares and they could be placed easily, only 100,000 might be offered by a more unscrupulous underwriter. In a tight issue, price could be pushed much higher by telling a buyer he could have a given amount of stock only if he bought an additional prescribed amount at higher prices in the aftermarket. This procedure is illegal but is still followed among more unethical underwriting houses. (Widespread irregularities were found in an SEC study afterward.) Brokers kept their allotments until the issues opened at premiums, and hot stocks were distributed to relatives, privileged accounts, or people to whom favors were owed. Most investors either didn't know or didn't care about these goings-on. Images of wealth (perhaps more simply called greed) through

new issues were too strong to be overcome by such plain truths.

For a while the public made tremendous profits in new issues and interest was exceptionally widespread. Again, as in the 1920s, the discussion of exciting issues, the money made, and the "hottest" underwriting houses dominated conversation.

One way of judging speculative manias is by the literature they produce, and in this period there was no lack of books offering advice to investors. One of the better known was written by a dancer, Nicholas Darvas, entitled *How I Made Two Million Dollars on the Stock Market*. An art market guide even put together an average of 500 painters and advertised that it was increasing much faster than the Dow.

New issues were the speculative overflow of the get-rich-quick attitude prevailing in the overall market in 1960 and 1961. Established growth companies were venerated and their price/earnings multiples soared. At their peaks in 1961, IBM traded at 81 times earnings, Polaroid at 164 times, and Xerox at 123 times. Blue chips, too, continued to trade at higher and higher multiples. The price/earnings ratio of the S&P 500 moved from 7.2 to 22.2 between 1949 and 1961.

The Dow closed near its peak of 735 for the year, but by year end speculative ardor for both new issues and glamour stocks had already begun to cool and both groups were trading well below their highs. In an antiinflationary move, the Kennedy administration forced the steel companies to roll back price increases in April of 1962, and the market interpreted the action as antibusiness. This was the trigger for already mounting bearish sentiment. More and more people were beginning to believe the lofty ratios for growth stocks, and even the Dow itself, were out of line with historical standards, and that the new issue game was merely another variation of the greater fool theory.

Prices fell on rising volume. The week of May 25 was the poorest for the market in over ten years with $30 billion in values lost, and on the 28th, the Dow declined almost 35 points, the worst day since October 29, 1929. At the close it stood at 576.93. A wave of anxiety and fear again swept

through the boardrooms of America, shattering confidence and dreams. A question not thought about for years surfaced again: Was this the beginning of another 1929? The violent reaction also touched off panics in Europe.

In fact, it turned out not to be another 1929, but the credit for this belongs more to tighter regulations and higher legal margin requirements (70%) rather than to the wisdom of the speculators. Many individuals had circumvented the margin requirements by borrowing from banks to purchase the high-fliers and met the fate of their predecessors in 1929. In the midst of a day of particularly heavy, pessimistic trading, the market suddenly and inexplicably turned around. After being down by 23 points in the morning, the Dow soared to a gain of 28 points for the day.

TABLE 5

	Price When Issued		1961–62 High	1962 Low	% Decline from High
Electronics					
Alden Electronics	(April 1961)	8*	24	8 1/2	65
[illegible] Electronics	(June 1955)	8	16	2 1/4	86
Supronics	(April 1960)	9 1/2	13 3/4	2 3/4	80
Universal Elec. Labs	(Nov. 1961)	4	18	1 3/8	92
Bowling					
Bowl-Mor Corp.	(Jan. 1955)	3	51	3 7/8	92
Fair Lanes Inc.	(Sept. 1959)	10	12 3/8	4 3/4	62
Major League Bowling	(Nov. 1960)	9	14 1/4	5/8	96
Sports Arenas Inc.	(Nov. 1959)	4	14 1/2	1 1/8	94
SBICs					
Boston Capital	(Sept. 1960)	15	28 7/8	7 1/8	75
Electronics Capital Corp.	(June 1959)	10	66 1/2	8 3/4	87
Franklin Corp.	(June 1960)	10	25	6 3/4	83
Greater Washington Industrial Investments	(April 1960)	10	30 1/2	4 7/8	84

Sources: S&P Industrial Manual, 1962–1963; S&P Financial Manual, 1962–1963.

The panic was over, but the crash had wiped out over $100 billion in paper values. While the averages recovered and went on to new highs, the crisis had broken the back of the new issue market. Like the "binder-boys" before them, most of the small promoters closed their doors. Gone were the big paper profits on their warrants, many of which were valueless. Gone also were the tremendous paper gains made by investors in new issues. All too often they turned into large losses. Table 5 shows the issue price, the 1961–1962 high, and the 1962 low of selected issues.

And what became of all those hot new issues in the ensuing years? An SEC study of 500 randomly selected issues underwritten in the late 1950s and early 1960s revealed that 12% had simply vanished, 43% had gone bankrupt, 25% existed and were operating at losses, and only 20% showed any profitability whatsoever. Of the 500, only 12 appeared to be highly promising. The odds of a big kill were far less than playing a single number in roulette, and possibly even somewhat less than purchasing the bubble companies in Exchange Alley in 1720.

The Rise and Fall of the Gunslinger

The speculative spirit, so often dormant for centuries, rested only briefly after 1962 before possessing the market again in the latter part of the decade. A glance at the years 1967–1970 shows that a number of time-honored fiduciary and accounting principles were abandoned in favor of a new "reality." The operative image of the times, to which so much was sacrificed, was performance. In this era, it meant the rapid turnover of stocks in pursuit of the quick kill. And at the vanguard of the revolution was a group of fast-moving, free-wheeling young men in their twenties and thirties who were out to conquer the market by the speed of their reactions and the sureness of their instincts. They were called the gunslingers.

Youth brought a new honesty to Wall Street. Stocks were not bought to be held forever. The difficulty of judgment was recognized, and errors were unashamedly acknowledged.

and the gunslingers would buy or sell in the blink of an eye. If one liked a story, he bought a large block of stock, often researching it later; if he turned negative on a security or the market, stocks were just as quickly sold. Quick turnover led to exceptional results, and the rapid buying and selling of large blocks of stock by the gunslingers became known as "go-go" investing. Trading as a result mounted sharply, and portfolios were often turned over in their entirety several times or more in a single year. Value, according to the new rules of the game, was not to be found in the established blue chips preferred by their elders. The real gains were in the new issues, the growth stocks, and the concept stocks. The year 1962 was already ancient history.

For some time prior to 1967 public attention was increasingly riveted on the better-performing mutual funds. Gerald Tsai, the young Chinese whiz who chalked up an exceptional record managing the Fidelity Growth Fund, became the first go-go star. Buying or selling at the drop of a hat, Tsai increased the asset value of this fund almost 50% in 1965. Tsai left the Fidelity Group and set up his own Manhattan Fund hoping to raise $25 million and surprised himself by raising $247 million in his initial offering. Tsai's fund was up 40% in the exceptional 1967 market, more than double the Dow, but even this performance was dull next to some of the emerging new go-go managers. By 1968, when his fund was down 7% and ranked near the bottom, 299th out of 305 funds rated by Arthur Lipper, Tsai's luster had already dimmed considerably. A low ranking in mutual funds often meant the withdrawal of capital by investors, which was then transferred into the more successful funds. In the long run, Tsai's business acumen seemingly proved significantly better than his market capabilities, as he was able to sell his mutual fund complex to CNA for approximately $30 million in its stock.

The new breed was bruisingly competitive. It paid to be. Fred Alger, at 34, ran $300 million in 1968 and received a million a year in compensation. He was quoted as saying "I would rather be down 60% in a year, and be number one [among funds] than be up 60% and be number ten."

Fred Carr, 38, ran the Enterprise Fund, the nation's leading mutual fund in 1967, with an almost 118% gain, and the best-performing large fund in 1968 with close to a 45% increase. So impressed were investors with his performance that in 1968, $1.1 billion worth of the group's funds were sold, approximately one-sixth of mutual fund sales nationwide. Carr's management company, which was public and commanded a high premium, gave him a net worth at the time of $30 million.

Enterprise purchased small, thinly capitalized growth stocks. Carr's buying, followed by swarms of eager investors, pushed such stocks up, a self-fulfilling prophecy as long as nobody sold. Carr, however, did not view events in this light. Believing he was a traditional conservative long-term investor, Carr was bothered that people thought his funds were risky.

Some of the games the fund managers played bore a distinct resemblance to the operations of investment trusts in the 1920s. One of the brightest meteors in the performance sky was Fred Mates whose Mates Fund began operations in mid-1967. Mates had a highly developed social conscience and would not buy stocks of cigarette or armament companies, nor of companies that polluted the environment. Even so, his fund was for a time the wonder of the industry showing a gain of almost 154% in late 1968.

For all his social conscience, Mates followed some very borderline financial practices. Along with other funds, he purchased "letter stock." This stock is not registered with the SEC and cannot be sold publicly. The buyer gives the selling company a letter stating it will not attempt to register the stock for a specified time period, often several years or more. Because such an investment is extremely illiquid, a discount from market of 30% or more is usually given. In September 1968, the Mates Fund purchased 300,000 shares of Omega Equities, a small conglomerate, at $3.25 a share with the stock trading at $24—a tremendous discount even for letter stock. Mates then revalued the stock at $16, a one-third discount from the market, giving his fund an instant profit of almost 500%. Not to fault Mates alone, the practice of revaluing letter stock was fairly common in the industry

at the time, and the records of other funds were also boosted by such machinations. Instant results was the name of the game.

The fact that so much of the gunslingers "performance" was achieved with mirrors and sleight of hand should cause us to wonder where all those prudent, rational investors had disappeared to. Anyone involved in the market should have known, even without the benefit of our historical review, that such practices as letter stock revaluation were very dangerous and would almost certainly end in disaster. Once again, the public either didn't know where such "performance" came from or, worse, didn't care.

So much money flowed into the Mates fund that its bookkeeping snarled and it could not accept new business after mid-1968. Orders for $50 million, three times the asset value in early June, were turned away. Hundreds of angry letters flowed in and the switchboard was flooded with calls. Even bribes were offered to get shares in this money-making machine.

Pollution-free companies are not always pollution-free investment values. Omega Equities, which was 22% of the Mates portfolio, was suspended by the SEC from trading on December 20, 1968, and an investigation was begun. Mates revised the stock down to his cost of $3.25 a share, but with no market existing for it, he could not redeem his mutual fund shares. Investors who had so desperately wanted to get in six months earlier now wanted out but the door was bolted. It was all downhill from here. In early 1969, Omega resumed trading at $4.00. The Mates Fund asset value disintegrated, plummeting from $15.51 in late 1968 to under $4.00 at the end of 1970, where it stood close to the bottom of the Arthur Lipper Rankings.

Wealthy and more aggressive investors usually did not buy mutual funds; instead some received their kicks from hedge funds. Mutual funds are normally forbidden to borrow, short sell, or trade in commodities. A hedge fund, which is a limited investment partnership with ten to twenty shares normally ranging from $100,000 to $250,000, was free to do any of these. The hedge fund provided go-go action

at its fastest, and it was the ideal instrument for the high-powered gunslingers of 1967 and 1968. Large investors flocked to them and by the end of 1968, hedge fund assets had grown to $1.3 billion. Entrance was not cheap: a 1 or 2% annual fee and 20% of the profits to the manager. A $10 million fund up 50% provided $1 million a year to the successful manager. If a "High Noon" atmosphere existed on Wall Street in these years, the quickest draws and the highest turnover were generated by this group. The entire portfolio could easily be turned over four or five times in a year.

Many of the gunslingers were encouraged to take extraordinary risks by the nature of the beast itself. It was a heads-I-win, tails-you-lose situation. A gamble that paid off gave the manager 20%. If he lost, it was the client's money. Besides, if he was too conservative, a more aggressive gunslinger might easily lure the customer away with a more impressive performance record. Excessive risk does not stay caged for long. In the 1969–1970 crash, the hedge funds as a group were devastated, and the battered partners drew out a good portion of the remaining capital. Many of the managers, accustomed to lavish living on their six-figure profits, suddenly found themselves without any source of income. Some of the smoking pistols were traded in for bartender aprons, shoehorns, or cabdriver medallions.

What kind of stocks attracted the gunslinger in his heyday? The most important common denominator as always was concept.The stock had to have "a story," one that excited the gunslinger and would excite the market. The conglomerates were one of the first manias to sweep the market beginning in 1964 or 1965. Investors were mesmerized with the tremendous earnings growth of Litton Industries, Ling-Temco-Vought, Walter Kidde, Teledyne, and a cast of dozens of others and bid these stocks up to extremely high multiples. Many of the most highly regarded companies appreciated five or tenfold in a few years.

Conglomerate executives talked of new free-form management philosophies and techniques to go with the swinging times. Deadwood was immediately cut away from acquired

companies, marketing efforts were rejuvenated, and *voilà*, rapidly rising earnings resulted. Synergism (1 + 1 = 3) was mentioned often. A company that produced tennis racquets, fighter planes, and toilet paper would speak glowingly of its interlocking markets, which would allow it to pare costs and increase sales. The gunslingers, interested only in the "bottom line," loved the high-earnings streams of these companies, and the exciting concepts behind them.

The conglomerates gave them the rapid earnings growth they wanted, but it was done mostly by financial sleight of hand. In its essence, the game was played as follows:

International Dynamics is trading at 30 times earnings and acquires another company, Standard Broom, whose earnings are 50% of the acquirer's $1 million. International Dynamics pays ten times earnings for the acquired companies, some 30% more than it currently trades for on the market, and rather than paying cash pays for it in its stock at its current market value of $30 before the acquisition. The earnings are pooled; that is, the income of the two companies are added together and divided by the new number of shares outstanding. Table 6 demonstrates the effect of such pooling.

Because it commanded triple the P/E multiple of Standard Broom, International Dynamics increased its earnings per share 29% by the exchange. Only 16.7% more stock had to be issued to increase total earnings by 50%. If the market

TABLE 6

	International Dynamics before Merger	Standard Broom	International Dynamics after Acquiring Standard Broom
Net earnings	$1,000,000	$500,000	$1,500,000
Shares outstanding	1,000,000	Shares issued in Exchange 166,667	1,166,667
Earnings per share	$1.00		$1.29
P/E ratio	30		30
Price	30		38¾

keeps the same valuation on these earnings, the stock would rise to $38¾. To provide earnings growth in the following year, International Dynamics could, with its P/E multiple of 30, simply acquire another company with a low P/E multiple. It might then create an exciting earnings record accompanied by steadily rising stock prices (if the P/E multiple remains unchanged) such as the one shown below:

	Year 1	*Year 2*	*Year 3*
Earnings	$1.00	$1.29	$1.65
Price	30	38¾	49½

The process can continue for years with none of the companies acquired or International Dynamics itself increasing internal earnings one penny. Furthermore, the rate of earnings growth can be tailor-made by deciding what size companies to acquire in each period. If it continues to acquire low P/E ratio companies and maintains its multiple, the price of its shares will increase steadily. Nothing could be easier!

This example is simplified but provides the essentials of how the conglomerate game was played. The extent to which the concept was bought is shown by the price/earnings ratios of the various favorites in Table 7. The 1970 low prices again give us an idea of the tremendous drops that take place when disillusionment sets in.

James Ling of Ling-Temco-Vought was a particularly colorful conglomerater. Ling went public by selling the stock of his company from a booth at the Texas State Fair in the mid-1950s. At its pinnacle, Ling's corporation ranked among the country's top 15 industrial companies. To raise capital and get an even higher value for his stock in the late sixties, he decided to sell to the public a portion of three companies owned by the conglomerate: a pharmaceutical concern, a sporting goods company, and a meat packer. The subtle humor of the Exchange floor dubbed the companies Goof Ball, Golf Ball, and Meat Ball. Ling considered himself a high priest of finance. One year he urged his shareholders after reading his elaborately embossed report to present them to students as a model in understanding

TABLE 7. The "Glamours"—and 1929.

Thirty growth stocks lost 81% of their value in the 1969–1970 crash, just a shade under the drop in history's worst market break.

	Stock Prices			
	1967–68 High*	1970 Low	Extent of Decline	P/E Ratio at High
Computer Stocks				
Control Data	163	28	83%	54
Sperry Rand	65	18	72	28
Mohawk Data	111	18	84	285
University Computing	186	13	93	118
IBM	375	218	42	49
Data Processing Financial	92	6	94	38
Leasco Data	57	7	88	31
Levin Townsend	67	3	96	38
National Cash Register	81	29	64	39
Electronic Data Systems	162	24	85	352
Average decline of computer stocks			80	
Technology Stocks				
Polaroid	141	51	64	72
Xerox	115	65	43	50
Optical Scanning	146	16	89	200
Texas Instruments	140	61	57	46
Itek	172	17	90	71
Recognition Equipment	102	12	88	†
Fairchild Camera	102	18	82	443
EG&G	72	9	88	100
General Instruments	63	11	83	42
Kalvar	73	11	85	**
Average decline of technology stocks			77	
Conglomerate Stocks				
Litton Industries	104	15	86	57
Gulf & Western	66	9	87	24
Ling-Temco-Vought	135	7	95	47
Bangor Punta	61	5	93	24
Kidde	87	15	82	28
ATO	74	6	92	**
Teledyne	72	13	82	42
Northwest Industries	60	8	87	23
Textron	57	15	74	28
United Brands	58	12	80	44
Average Decline of Conglomerate Stocks			86	
Average Decline of All Stocks			81	
Average Price/Earnings Ratio				84

*Several stocks reached highs after 1968; in such cases, the post-1968 high is used. †Company had earnings deficit. ** In order to avoid distortion, the P/E ratios of Kalvar (1.216) and ATO (740) are omitted. Had they been included, the average P/E ratio would have been substantially higher.

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finance. Ironically he may have been right. The report is as good a starting point as any to study how the bubblemaker thralls his audience.

One of the most interesting performance concepts of this market was National Student Marketing, a company we met briefly in Chapter 1. A conglomerate, NSM dazzled both institutional and individual investors alike. So good a concept spinner was its president, tall, polished Cortes W. Randell, that the company's shares rose from $6 to $14 the first day it traded in April 1968, although the bloom was already fast fading from conglomerates at that time. It reached a high of $82 later that year and $143 in 1969. All in a bear market! In 1969, while investors were annihilating the P/E ratios of other conglomerates, NSM was trading at the astronomical multiple of 104 times earnings.

Randell surrounded himself with all the trappings of power: a Lear Jet named Snoopy, a suite in the Waldorf Towers, a 55-foot yacht that slept 12, and a $600,000 castle on the Potomac, which even included a mock dungeon, possibly for disbelievers. In addition, he had a net worth in NSM stock of $50 million. How did he do it? Randell dazzled Wall Street with an idea that was perfect for the time: the youth market. The company estimated that the disposable income of this market was $45 billion in the late 1960s. It projected that the key 18-to-24-year-old segment would grow from 11% to 25% of the population in the next seven years* and their income would rise to $72 billion by 1980. NSM had 600 students acting as part-time sales representatives on college campuses. He told analysts his company had a "lock" on this market, and to continue his expansion program he was acquiring only "core" companies (a wonderful Wall Street term meaning vital companies whose successful future cannot be doubted; I sometimes wonder if "rotten

*According to Andrew Tobias in *The Funny Money Game*, a book about the rise and fall of NSM, these population growth figures were highly exaggerated. In order for these percentages to be realized, 25 million 18- to 24-year-old immigrants were needed, or 100 million outside of this age group had to be disposed of. Apparently few outsiders checked these figures. Another indication of the "rationality" often found in markets.

to the core" might also apply all too often).

Randell preached youth, and through youth, earnings tripling annually. Investors took the bait and kept the stock at a tremendous price/earnings multiple. This allowed Randell to make his fast-paced acquisitions program using his stock to buy other companies. Some of his acquisitions only remotely dealt with the youth market: shirt making, housing, insurance and travel companies, as well as a sports jacket manufacturer. Randell's program was in fact a kind of acquisitions treadmill—he was spinning the wheels faster and faster in order to make his earnings projection come true. Randell could pay high prices for the companies he acquired, often 20 or 30 times earnings, double or triple what could be realized elsewhere, because his stock traded over 100 times earnings itself. Such is the power of "funny money." Most amazing of all was his ability to carry it off in the cold light of 1969, when all conglomerate tricks and "buzzwords" were completely discounted by a disillusioned and burnt Street.

Randell's secret was his extraordinary ability to romance Wall Street. Analysts were showered with attention, their sense of importance flattered by being called from the skyphone in his Lear jet and taken as guests to his castle or for a cruise on his yacht down the Potomac. Some of the believers were prestigious indeed: Morgan Guaranty, Donaldson Lufkin and Jenrette, the Harvard Endowment Fund, the General Electric Pension Fund, the Cornell Endowment Fund, and Gerald Tsai's Manhattan Fund (122,000 shares for $5 million) to name just a few. With such prestigious fellow investors, highly regarded lawyers (Covington and Burling) and auditors (Arthur Andersen), and Randell's dazzling visions, it was easy to overlook the signs of trouble.

In November 1969, Randell made a speech to the New York Society of Security Analysts stating that NSM's earnings in 1970 would triple to $2.00 a share. Other executives in the company objected, saying it could only be done with acquisitions which had not even been considered to date. As the stock was nearing its peak, a group of officers and directors sold almost $10 million of their own shares as letter stock to institutions at a 40% discount. Less than a week

later Randell made another smaller sale. Like their South Sea counterparts 250 years earlier, they were getting out.

In the company's fiscal 1969 year (ended August 31) earnings were created entirely through ingenious accounting. One rule after another was stretched, all duly footnoted, of course, for those who had the bad taste to look. The biggest item was the consolidation into income of $3,750,000 in earnings from acquisitions not even consummated at the fiscal year end. Legally they were said to have been agreed to in principle. With middle-of-the-road accounting procedures the company would have taken a loss for the fiscal 1969 year. It did show a loss in the first quarter of the next year, and interestingly enough it was the announcement of this reverse in earnings, rather than the readily available evidence of corporate chicanery, in its annual report that sounded the death knell for this company. The bubble broke as quickly as and more severely than the South Sea Company itself. From a high of $143 on December 22, 1969, it was down to $3.50 in July 1970.

Another group of stocks that caught the enthusiastic attention of the gunslingers was the franchisers. Fast food chains, particularly fried chicken outlets, were expanding at a terrific rate. One analyst wryly noted that with the completion of current expansion programs every man, woman, and child in the country would have to eat a pound and a half of chicken a day to justify the present prices. Nursing homes were also a heavily exploited area. With increasing federal money going into health care for the aged, many gunslingers naturally concluded that chains of nursing homes were the way to riches and big positions were taken in them. One of the favorites, Four Season Nursing Homes, got up to over a hundred times earnings and turned a handsome profit for the institutional holders before going bankrupt. Accounting again!

The earnings growth of many of the concept stocks of this market were put together by creative accounting* but few bothered to analyze statements thoroughly. The new

*I will discuss this further in Chapter 12.

generation had the "feel" for this market and were proved right as the prices of their choices shot up. Images exercised a stronger influence over investors than facts or rational analysis.

The ending of this mania was similar to all the others. Greater and greater risks were taken, but no matter how large the odds appeared to be against them, investors seemed to win most of the time. Professionals and amateurs alike appeared drunk with the incredible gains that had been made in less than two years. Articles appeared by senior Wall Street figures condoning the current speculation and rationalizing why it should continue. One young money manager exuberantly told *Forbes* at the peak, "It's going up, up, up; we're going to get accustomed to higher and higher price-earnings ratios." *Forbes* added prophetically, "While the ups can be exhilarating, the downs can be terrifying."[2]

The break that followed was the most severe since 1929. The Dow fell from 985.21 on December 2, 1968, to 631.16 on May 26, 1970, some 35%. But this was not where the real damage was done. The devastation was in the concept stocks of the gunslingers. (See Table 7.)

Many of the more famous gunslingers ended up on Boot Hill. Some of the money men I knew who had made five- or tenfold or more on their personal portfolios lost even their original investments. If they were lucky enough to hold their jobs, they were often finished with investing for themselves.

The Common Characteristics of the Manias

The most surprising thing about speculation is its remarkable similarity from period to period. Similarity in the conditions necessary to breed the manias, in the abandonment of prudent principles, and in the infatuation with concepts. Most important, there is a tremendous similarity in the attitudes of the market participants. In each case—tulipmania in seventeenth century Holland, the South Sea Bubble in eighteenth century England, the "new era" market of the twenties, and the go-go years of 1967–1970—the bulk of

people in the market were intoxicated with the idea of wealth and the ease with which it could be procured. The image was so simple. One merely had to own a tulip bulb or land in Florida or a computer leasing company share to build a fortune. There is even a remarkable similarity in owning exciting "concept" companies in 1720, 1929, 1962, and 1967–1968.* Each mania created its own social reality far removed from past standards of value. Caution was tossed aside by many, and justifications were made about why things were really different "this time."

In each market excessively risky actions were justified as prudent, and those who did not go along were pushed aside. A young gunslinger at the height of the go-go euphoria of 1967–1968 was interviewed on TV and discussed his aggressive investment "strategies." When the name of Benjamin Graham, whose measured approach emphasizing full evaluation of risks and conservative pricing formulas, came up, the money manager said "the trouble with old Ben is that he just does not understand this market."

He was right. Benjamin Graham could not, for it violated all his investment standards. Shortly it came crashing down, carrying most of the go-go crowd with it.

In every era, once the crowd begins to realize the excesses of the boom, there is a scramble to escape, resulting in panic which most often carried values far below the point from which the manias began. Perhaps the most curious fact of all is that the sharp percentage drops from each highwater mark were so similar—on the order of 90%. (See Table 8.)

Our history lesson, then, has shown us that speculative bubbles are not simply relegated to the realm of the past; and the examples of recent history—all too recent for comfort—would indicate that any theory or hypothesis which assumes consistently rational, prudent behavior on the part

*John Kenneth Galbraith, for one, noted that the concept of glamour stocks in the 1967–1968 market perfectly duplicated the market of the late 1920s, with even the industries to an "extraordinary extent being the same." The mutual fund boom was the counterpart of the investment trust, with the public in both cases paying homage to the brilliance of their managements. Galbraith concluded "Financial genius is a rising stock market."[3]

TABLE 8. Market favorites of different eras.

	High Price	Low	Price Decline from High, %
Holland, 1637			
Semper Augustus (tulip bulb)	5,500 fl.*	50 fl.	99
England, 1720			
South Sea Company	£1,050	£129	88
1929–1932			
Air Reduction	223	31	86
Burroughs	97	6 1/4	94
Case	467	17	96
General Electric	201	8 1/2	96
General Motors	115	7 5/8	94
Montgomery Ward	158	3 1/2	98
1961–1962			
AMF	63 3/8	10	84
Automatic Canteen	45 5/8	9 3/4	79
Brunswick	74 7/8	13 1/8	82
Lionel	37 7/8	4 1/2	88
Texas Instruments	207	49	76
Transitron	42 3/8	6 1/4	85
1967–1970			
ITEK	172	17	90
Leasco Data Processing	57	7	88
Ling-Temco-Vought	135	7	95
Litton Industries	104	15	86
National Student Marketing	143	3 1/2	98
University Computing	186	13	87

*Florins

of investors is simply building on sand. The academic explanation of professional investment performance is gravely flawed because its hypothetical assumptions simply do not apply to the cases just touched on. For all its usefulness in focusing attention on the difficulties in beating the market, the efficient market hypothesis does not satisfactorily explain why investors do not outperform the market. In the next section we will analyze the irrationality we have viewed in the market in an attempt to formulate a better explanation.