Book Review

The Bursting of the Bubble

The Go-Go Years. By John Brooks. *New York: Weybright and Talley,* 1973. Pp. vi, 375. $10.00.

Reviewed by Joseph W. Bishop, Jr.†

The interest of homo sapiens in money is almost as prurient and pervasive as his interest in sex. Indeed, although accurate data are not available, it seems likely that he spends more of his time pursuing the former than the latter. At any rate, books about money seem nearly as numerous and popular as books about sex. Ralph Ginzburg demonstrated his characteristic flair for profitable publishing when he switched from *Eros* (under some legal pressure, to be sure[1]) to *Moneysworth.* But while good writers on sex are so few as to be virtually nonexistent, at least in modern times, there are several writers on finance whose works have genuine literary merit. Of these John Brooks is among the best. He may well be the best historian of high and low finance since those observant young men, Charles Francis Adams and his brother Henry, chronicled the rascalities of Jim Fisk, Jay Gould, Daniel Drew, and Cornelius Vanderbilt more than a century ago.[2] It is unlikely that *The Go-Go Years* will sell as well as Jacqueline Susann's current novel, whatever it is called, but it will deserve better reviews.

Mr. Brooks' new book on the rise and fall of the stock market in the five years or so which ended in 1970 is well-written, but I note with some regret that it is less so than his earlier works. Mr. Brooks is a regular contributor to *The New Yorker,* in which most of *The Go-Go Years* first appeared. That periodical has in recent years become not much more than a sort of upper-middlebrow version of *The New York Review of Books,* relieved at increasingly infrequent intervals by flashes of its old wit. The quality of its editorial prose has sunk to such a level that its advertising pages, directed at the

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1. *See* Ginzburg v. United States, 383 U.S. 463 (1966).
2. C.F. & H. ADAMS, CHAPTERS OF ERIE (Great Seal Books ed. 1956).

leftish carriage trade who account for most of its circulation, are far more effective arguments for social reform than the earnest and tedious homilies in "The Talk of the Town."

I fear that Mr. Brooks' clear mind and clear style show signs of succumbing to that debilitating influence. Thus, he commonly describes the left-wing street and campus demonstrators of the 1960's, most of them brawny, well-nourished youths in their late teens or early twenties and many of them quite ready to break glass or heads, as "boys and girls," and "kids," and even "children."[3] It is positively embarrassing to see a writer of Mr. Brooks' quality compose such a cliché-ridden sentence as this: "Which is worse in a time of national crisis: a young swinger who speculates with his investors' money but pursues high-minded investment policies, or a more conservative codger who keeps his clients in the comfortable blue chip stocks of corporations that fuel the wars and foul the rivers and the air?"[4] There are even inept metaphors: Pyramids do not fall because they become top-heavy.[5] Mr. Brooks' craftsmanship and care are not what they were.

No doubt I am captious because I expect so much more of Mr. Brooks than of common journalists. It is but just to say that most of his tale is well-told, entertaining and instructive, in part because its intrinsic interest is great. His subject is one of history's great orgies of speculation. This variety of mass mania is, of course, about as old as the development of societies in which sizeable numbers of citizens have more money than they can spend on the necessities of life. Rich Romans outbid each other, often to the tune of millions of sestertii, for citrus tables and murrhine glass.[6] Otherwise sober and hardheaded Dutchmen embarked on a spree of wild speculation in, of all things, flowers in the Tulipomania of 1634. Citruswood, glass, tulip bulbs, even the paintings of Jackson Pollock, have at least some intrinsic value, however slight. Not until the invention and development in the late seventeenth and early eighteenth centuries of shares of stock and stock exchanges were men able to speculate in things which frequently had no intrinsic value at all, things whose sole worth lay in the chance that the buyer could find a fool still greater to whom he could sell for a higher price than he himself had paid. That there was a surfeit of such fools 200 years ago is evidenced by the South

3. *See* J. BROOKS, THE GO-GO YEARS 10, 214-15 (1973) [hereinafter cited to page number only].

4. P. 270. The young swinger in question had, as Mr. Brooks shows, resorted to practices which were at best sharp and at worst dishonest. *See* p. 1105 *infra*.

5. P. 158.

6. *See, e.g.*, PLINY, NATURAL HISTORY 72, 76 (L. Haberly ed. 1957).

Sea Bubble and John Law's Mississippi Company.[7] The model of such enterprises is the Anglo-Bengalee Disinterested Loan and Life Assurance Society, directed by the adroit Tigg Montague. Though Dickens invented that company 130 years ago,[8] it has a strong generic resemblance to Equity Funding Corporation and would fit very naturally into one of Mr. Brooks' chapters. Mr. Montague could have done wonders with a computer.

The most obvious recent parallel to the stock speculation of the Go-Go Years is the Great Bull Market of the 1920's,[9] which produced operators quite as picturesque and prehensile as Mr. Brooks' cast of characters.[10] The Go-Go Years, however, undoubtedly cost a far greater number of investors far more money than the bursting of the bubble 40 years before, for the simple reason that the herd of sheep had multiplied past counting, and the new and improved strain had thicker fleeces. In 1970 there were some 31 million stockholders, whose losses Mr. Brooks plausibly estimates at about $300 billion.[11] The public investors were left sadder, if not wiser, but hardly any of them jumped out of windows. No such cataclysm as the Great Depression of the 'thirties has ensued. All in all, the story is more picaresque comedy than tragedy.

The fact is, of course, that the stock market has always served two purposes. One is the eminently proper one of giving people a place to invest their savings, hopefully in ways that will earn income for the investors, create jobs, and produce more of the goods and services that people want. This is the aspect which the propaganda of the New York Stock Exchange naturally stresses. The other is that of a gigantic Casino, with branches in every city and hamlet in the land, offering action just as fast and more respectable than that available at Las Vegas or Aqueduct.

The dominance of the Casino avatar in the 'sixties was shown by the emphasis which the speculators put on earnings per share, the "bottom line." What the traditional thrifty investor cares about is divi-

7. *See* 1 L. Loss, Securities Regulation 3-5 (2d ed. 1961).

8. *See* C. Dickens, The Life and Adventures of Martin Chuzzlewit 427-48 (Oxford U. Press ed. 1951).

9. The best, or at any rate the most readable, work on the subject is J. Galbraith, The Great Crash 1929 (1955).

10. Perhaps the greatest of them was Howard Hopson, who is said to have printed proxies on the back of dividend checks, so that the stockholder gave Hopson a proxy by the simple act of endorsing the check. He certainly invented the collapsible debenture, convertible into common stock at the option of the issuing corporation. *See In re* Associated Gas & Electric Co., 61 F. Supp. 11 (S.D.N.Y. 1944), *aff'd*, 149 F.2d 996 (2d Cir. 1945).

11. P. 253. Mr. Brooks, whose guess is as good as any, thinks that only one-third of the 31 million suffered serious losses.

dends, the actual payout to stockholders. What gives a share of stock such intrinsic value as it has is the prospect that its owner will receive, sooner or later, his share of the corporation's actual, and hopefully large, income. But in the Go-Go Years the people who bought Leasco or Electronic Data Systems or National Student Marketing or Equity Funding, or even IBM or Polaroid, cared very little what dividend the stock paid, or whether it paid any dividend at all. Dividends are taxable as income, at rates up to 70 percent; it takes a long time to get rich from dividends. What the stock buyers of the 'sixties wanted, and got for a time, was a rapid increase in the stock's market price, which would enable them to sell it within a short time at much more than they had paid,[12] with the profit taxed as capital gains at a maximum rate of 25 percent.[13]

The market price, however, was a function of projected earnings. If a company's reported earnings per share had tripled every year for several years, the investors and their advisers projected that trend into the future, and even the hereafter, and bought the stock at perhaps 100 or more times its current earnings. This phenomenon, the magic of the price/earnings ratio, produced the fantastic rises in the market prices of some of the conglomerates,[14] the aggressive acquirers of other companies. The principle of success for conglomerates was, like the wheel and the bow, of magnificent simplicity. Let me give a somewhat oversimplified paradigm. Conglomerate *A* reports earnings of $2 a share, up from 30¢ four years ago, on its 1 million outstanding shares. It sells at 50 times earnings, $100. *B*, a stodgy manufacturing company, also reports earnings of $2 on its 400,000 shares, which is just about the same as its earnings for the past several years. It sells at ten times earnings or $20. *A* issues 100,000 shares, worth $10 million at the market, in exchange for all of *B*'s stock, and the *B* stockholders have an instant paper profit of $5 a share. *A* has outstanding 1.1 million shares but now shows consolidated earnings of $2.8 million—an instant increase of more than 25 percent in earnings per share. If the price/earnings ratio rises or remains constant, the market price of the stock will rise.

As *A* repeats the process, its reported earnings per share increase by leaps and bounds; the market price soars upward like a rocket. If investors extrapolate the increasing earnings over future years of suc-

12. *See, e.g.*, pp. 18-19, 156-57, 262.

13. At the present time capital gains for an individual stockholder are taxed at a maximum of 25 percent on the first $50,000 and a maximum of 35 percent on the excess. INT. REV. CODE OF 1954, § 1201.

14. *See generally* pp. 150-81.

cess, the P/E ratio may itself rise, and for market price the blue sky is the limit. So long, and just so long, as the P/E ratio of *A* remains high and unglamorous target companies with lower P/E ratios can be found, the conglomerate will enjoy marvelous success. The new discovery produced such astonishing Jonah-swallows-the-whale exhibitions as Leasco's successful ingestion of Reliance Insurance Company (more than four times its size), and its nearly successful effort to engorge the $9 billion Chemical Bank New York Trust Company (more than 22 times its size).[15]

Not all the rapid rises in earnings, of course, were produced by such a technique. Some, such as those of IBM, Xerox, and Polaroid, were perfectly genuine. In others the galloping earnings were produced by "creative accounting," which some people might call fraud and which Mr. Brooks justly and thoroughly excoriates.[16] National Student Marketing, for example, managed to generate practically all of its reported earnings for 1969 by including the profits of subsidiaries which in fact had not been acquired until after the end of the year.[17] We may hope that some day Mr. Brooks will write the story of Penn Central, whose apparent income for several years preceding its collapse was the result of accounting creativity at least as imaginative and far larger in scale. Penn Central, to select but one example, manufactured nearly $10 million of income in 1968 by purchasing its own bonds on the open market at a deep discount, using cash it could ill spare, and reporting the difference between par and the purchase price as "profit."[18]

The almost perpendicular rise in the price of some stocks naturally produced go-go or "performance" investment companies which sold their own shares to the public, invested the proceeds in the stock of go-go companies, and thus showed enormous and rapid increases in their own asset value per share. Some of the youthful "gunslingers" who managed the investment portfolios were gifted and lucky gamblers, like Gerald Tsai, whose career is brilliantly described by Mr. Brooks.[19]

15. Pp. 227-59. Mr. Brooks, who seems to admire the dash and enterprise of Leasco's founder, Saul Steinberg, fails to mention the litigation arising out of Leasco's takeover of Reliance Insurance Company, in which the court determined that Steinberg and his associates had violated the Securities Act of 1933. Feit v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N.Y. 1971).

16. *See, e.g.*, pp. 158-63.

17. Pp. 283-84.

18. *See* SEC STAFF REPORT TO THE SPECIAL SUBCOMM. ON INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE 52 (1972). The Report cites many other examples of inspired creativity. *See, e.g.*, pp. 45-47, 49-50, 53, 57-60, 84-94, 127-30, 173-76.

19. Pp. 132-49.

Some, like Bernie Cornfeld,[20] who avoided the officious prying of the SEC by selling the shares of his fund (whose assets consisted of the shares of American mutual funds) only to foreign investors, and Fred Mates resorted to their own varieties of creative accounting. Mr. Mates, for example, bought 300,000 shares of something called Omega Equities for $3.25; at the time Omega was, for no particular reason, trading over-the-counter at $24. The catch was that the stock Mates bought, not being registered under the Securities Act, could not be sold to the public—and certainly there was no other market for it. Mates compromised with his conscience by valuing it on the books of The Mates Investment Fund at only $16, but still showed an instant increase in asset value of nearly $4 million. When the SEC blew the whistle on Omega by suspending trading in its stock, and Mates' own shareholders attempted to redeem their shares, he simply suspended redemptions—an unheard-of event in the mutual fund industry. Ultimately, Omega shares proved to be worth about a nickel.[21]

There are many, many other fascinating items in *The Go-Go Years.* Among the abundance of picturesque personalities are such men as H. Ross Perot, who lost $450 million (on paper) on a single day in 1970, and still had about a billion left.[22] Mr. Brooks' book offers a large and engaging rogues' gallery, and also some honest and able men, like Bernard Lasker and Felix Rohaytn, who managed (with the aid of Perot) to pull the New York Stock Exchange through the worst of the crisis of 1970.[23] Mr. Brooks is to be commended as well for his lucid explanations of the workings of such esoterica as hedge funds,[24] and his objective dissection and criticism of such serious evils as insider trading, the high-pressure sale of "hot issues," and "churning," which results from the constant temptation of brokers to increase their own commissions by persuading customers to sell sound stocks and buy others which may or may not be sound.[25] Most of the analysis of the stock market's workings is good reading, cautionary and occasionally encouraging.

Unfortunately, as I suggested earlier, Mr. Brooks sometimes yields to the temptation to engage in cosmic and rather mushy philosophizing on such topics as youth and urban problems. Such stuff is probably mandatory under *The New Yorker*'s House Rules, but it stands in

20. Pp. 270-71.
21. Pp. 266-70.
22. Pp. 1-2, 14-23.
23. *See generally* pp. 291-347.
24. Pp. 141-44.
25. *See* pp. 220-21, 278-83.

painful contrast to the prose he produces when he sticks to his last. Some of it is unintentionally funny, which is unusual for Mr. Brooks —as when he describes with a straight face and every appearance of edification the efforts of the with-it pastorate of Trinity Church to modernize religion, and improve the spiritual state and generally "enrich the lives" of Wall Streeters: The means chosen were rock bands, balloons, peace demonstrations, folk singers, and inadequately clad dancers capering in the sanctuary.[26] Mr. Brooks has a keen eye for the unctuous hypocrisy of the old generation of Wall Streeters, who sometimes combined regular prayer and church attendance with sharp and occasionally fraudulent practice. But he does not recognize the hypocrisy in the chic piety of some new Wall Streeters. Thus, the above-mentioned Mr. Mates referred to his youthful staff as "flower children" and refused to buy the stock of corporations producing armaments, cigarettes, or pollutants (few of which, as it happens, were in the go-go class). Mr. Brooks, impressed by so much sanctity, says that Mr. Mates acted "bravely and honorably"[27] when (after suspending redemption of the shares of his mutual fund) he reduced the value at which the Mates Fund carried Omega Equities from $16 to the $3.25 he had paid for it, thereby effecting a corresponding reduction in the redemption price of the Fund's shares (which, however, remained unredeemable). I fail to see either bravery or honor; it seems to me, from Mr. Brooks' account, that Mr. Mates was caught and had no alternative if he wanted to stay in business. When Mr. Mates actually resumed redemptions, he reduced Omega's value on his books to 50 cents.

Similarly, Mr. Brooks accepts at face value the hoary merchants-of-death myth that Wall Street thrives on wars and rumors of war and goes into a decline whenever a threat of peace develops[28]—or at least that it did so until the Vietnam War, when it was reformed by Abbie Hoffman and Trinity Church. The historical facts are otherwise. World War I, when capitalists were even more ruthless and predatory than they are now, supplies the most dramatic example: On August 1, 1914, the New York Stock Exchange was hit by such a tidal wave of sell orders that it suspended trading for more than four months.[29] On December 21, 1916, when Secretary of State Lansing said that the

26. Pp. 222-26.
27. Pp. 269-70.
28. *See, e.g.*, pp. 10, 213-14.
29. *See* M. SULLIVAN, 5 OUR TIMES 48-49 (1933). Bond trading was resumed on November 28, 1914, and cash trading in stocks on December 12. Unrestricted trading was not permitted until April 1, 1915.

United States was being drawn into the war, a wave of frantic selling produced a volume of more than three million shares[30]—an enormous figure for those days. On December 8, 1941, stock prices declined more than seven percent, equivalent to a drop of about 59 points in the present Dow-Jones average. Stocks dropped approximately six percent at the outbreak of the Korean War. They dropped a little when the Cuban missile crisis developed and rose a little when it ended. The market generally rose during World War II, but probably less because traders anticipated huge corporate profits[31] than because of inflation and the related fact that incomes were high and consumer goods scarce. A similar pattern developed during the Korean War, whose effect Mr. Brooks calls "modestly bullish."[32] The truth seems to be that Wall Street dislikes war scares, precisely as it dislikes any variety of uncertainty.

Generally, however, Mr. Brooks gives a very accurate picture of the boom and bust of the late 'sixties and of the influences which produced it. Some of those influences, such as the human urge to get rich quick, are probably ineradicable. Are there cures for other causes of the orgy and the ensuing *katzenjammer*? The South Sea Bubble produced the Bubble Act of 1720.[33] The 1929 crash produced the Securities Act of 1933,[34] the Securities Exchange Act of 1934,[35] the Public Utility Holding Company Act of 1935,[36] the Trust Indenture Act of 1939,[37] and the Investment Company Act of 1940.[38] The primary emphasis of the 1933 and 1934 Acts was on full disclosure—*i.e.*, to insure that investors were given the information they needed to make rational decisions. Mr. Brooks concludes that, "Full disclosure in the nineteen sixties market was largely a failure, giving the small investor the semblance of protection without the substance"; he questions whether it can ever accomplish much.[39] Certainly there is room for tougher enforcement, both by the SEC and private suitors, as demonstrated by the boom in litigation under § 10(b) of the 1934

30. *Id.* at 626.
31. Mr. Brooks says that "World War II failed to produce a major bull market in large part due to the excess profits tax . . . ." P. 214.
32. *Id.*
33. 6 Geo. I, c. 18. More than 20 years before, Parliament had passed an act, which proved ineffective, "to restrain the number and ill practice of brokers and stock jobbers." 8 & 9 Wm. III, c. 32 (1697).
34. Act of May 27, 1933, ch. 38, tit. 1, 48 Stat. 74 (codified at 15 U.S.C. § 77 (1970)).
35. Act of June 6, 1934, ch. 404, 48 Stat. 881 (codified at 15 U.S.C. § 78 (1970)).
36. Act of August 26, 1935, ch. 687, tit. 1, 49 Stat. 803 (codified at 15 U.S.C. § 79 (1970)).
37. Act of August 3, 1939, ch. 411, 53 Stat. 1149 (codified at 15 U.S.C. § 77aaa (1970)).
38. Act of August 22, 1940, ch. 686, tit. 1, 54 Stat. 789 (codified at 15 U.S.C. § 80a-1 (1970)).
39. Pp. 354-55.

Act (liability under which is generally grounded on misleading or inadequate disclosure)[40] since the Second Circuit's landmark decision in *S.E.C. v. Texas Gulf Sulphur Co.*,[41] which held that directors and officers violated § 10(b) when they traded in their own company's stock on the basis of inside information which was not disclosed to the public. The Securities and Exchange Commission could undoubtedly use a larger staff to police the adequacy of disclosure in registration statements, proxy solicitations, and the various reports required under the statutes and the Commission's regulations. Yet not even the fullest disclosure can prevent some fish from biting on unbaited hooks. The SEC may, and often does, require registrants to state that the prospect of dividends is remote, that the sale of the issue will instantly increase the book value of the promoters' shares and dilute the value of the public's shares to a point far below the sale price, or even that the issuer is actually insolvent. The stock still finds buyers.

Congress and the Commission cannot prevent fools from parting with their money, but they can devise more protections from dishonest or incompetent brokers. The Securities Investor Protection Act[42] and the Securities Investor Protection Corporation[43] now protect the customers of bankrupt brokers. In the aftermath of the Go-Go Years, reforms of the internal management of the investment industry, including stricter disciplinary procedures and higher standards for entry into the business, are under consideration in Congress.[44] Some evils might be alleviated by outlawing the conflicts of interest which produce them. The functions of broker and investment adviser might be separated, thus reducing the temptation to churn customers' portfolios in order to generate commissions.

The record of even the most honest and disinterested portfolio managers, however, is something less than brilliant. It may well be that there is no such thing as an expert adviser on the market: Many knowledgeable lawyers and economists believe that there are only two ways to make money by trading in securities—luck and inside information.[45] There is much evidence that an investor can do quite as well by shutting his eyes and sticking a pin in the list of stocks traded on the Exchange as by consulting the most learned and ex-

40. 15 U.S.C. § 78j(b) (1970).
41. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).
42. 15 U.S.C. §§ 78aaa *et seq.* (1970). *See* S.E.C. v. Wick, 360 F. Supp. 312 (N.D. Ill. 1973).
43. *See* 15 U.S.C. § 78ccc (1970).
44. *See* Painter, *An Analysis of Recent Proposals for Reform of Federal Securities Legislation*, 71 MICH. L. REV. 1576 (1973).
45. *See generally* B. MALKIEL, A RANDOM WALK DOWN WALL STREET (1973).

perienced securities analysts, every one with an M.B.A. from Harvard or the Wharton School. As many mutual funds did worse than the averages as did better.[46] Harvard itself took a bath in National Student Marketing.[47] The list of supposedly sophisticated investors taken into camp by the fraudulent promoter of Atlantic Acceptance Corporation, Ltd., included Morgan Guaranty Trust Company, First National City Bank, Kuhn, Loeb and Company, and Princeton University.[48] When Penn Central sank, a dozen huge insurance companies (including the Equitable, the Metropolitan, and the Prudential) went down with more than $400 million of its bonds.

There may, in short, be little that even the wisest and most benign laws can do to keep the public and the professionals from making imprudent investments. Kipling summed up what is perhaps the best hope:

> I make my proper prostrations
> to the gods of the Market Place;
> Peering through reverent fingers,
> I watch them flourish and fall,
> And the gods of the Copybook
> Maxims, I notice, outlast them all.[49]

One of the most reliable copybook maxims is biblical: "He that maketh haste to be rich shall not be innocent."[50]

46. P. 349.
47. P. 282.
48. Pp. 120-21.
49. R. Kipling, *The Gods of the Copybook Headings* (excerpts from Stanza 1, 1919), in T.S. ELIOT, A CHOICE OF KIPLING'S VERSE 295 (1963).
50. *Proverbs* 28:20.