



Betting on the Market

Pros Peter Bernstein

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A financial historian and head of an investment advisory firm, Bernstein has been in the investment world since the 1950's. He helped launch the Journal of Portfolio Management and is the author of "Capital Ideas" and "Against the Gods."

Q Tell your story of nobody wanting to go to Wall Street after college.

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Anecdotes of the '29 crash... comparing '29 to '87....the clientele of the 1950's.... what's kindled today's market fever...the 'blood money' in now in the market... sketches of Americans' attitude toward Wall Street over the years

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A When I came into this in 1951 nobody of my generation was interested. Everybody in the market was older...and they knew a great deal because they'd all survived this terrible experience (1929). \ And they were all terribly conservative in the way that money was to be managed. And there were laws, too. I mean, you couldn't put a personal trust more than 35 percent in common stocks in New York. And in some states you couldn't own any common stocks in any kind of a legal fiduciary. There's some state that's just now is changing. The state pension fund is mandated zero in equities.



So the memories linger on a long time. It wasn't a place that you were likely to make any money. Trading volume was a million shares, maybe less, and it didn't produce a living for the people who were there. Seats on the Exchange, which now sell for a million dollars and more, would sell for 15-20-30 thousand dollars at that point. It was just not a place to go. And it took a good ten years before those old guys began to die off and some younger men and

women began to come in, didn't have that memory bank and were more interested in taking risk.

1952, year after I started the stock market, "The Journal of Finance", the primary academic journal of people in the world of finance, carried no articles about the stock market. It was all about banks and insurance companies, nothing about the stock market. Carried a 14-page article called "Portfolio Selection" by a graduate student at Chicago named Harry Markowitz. In 1991, Harry Markowitz won the Nobel Prize in Economics for those articles. Well, he did things later built on it, but it was that article. He later wrote a book. Nobody paid any attention to that article for 15 years. It was in the backwaters. You look in the other academic journals, there are no citations to portfolio selection for ten years and then it begins to make its appearance. The stock market was not a serious place for research until it was at -- instead of being at 160, where it was in 1949, until it was around 400 or 500, three or four times where it had been at that -- at that point, that it began to be a respectable place to go to work and then a respectable place to do economic research. Now "The Journal of Finance" may have one or two articles on banking, a couple of articles on insurance. It's all about investing.

Q What was it about average people's lives that made the stock market irrelevant?

A Well, I think people on their way up didn't have any money. And the first thing most of the people, I guess, were thinking of were people who'd been in the war or matured immediately after the war, these are the parents of the Baby Boomers. I didn't have any money. I had a few hundred dollars in savings bonds. That was all I had in my late 20s. And when I went to work, I first thought about -- I was married and then there were going to be children and a family and there wasn't any money to put into the stock market. Pension funds -- and you sort of didn't think -- just it didn't exist. The pension fund was an invention of the late '40, early -- late '40s, early '50s by the very -- I think it was the United Automobile Workers, Walter Ruther, who got it out of the automobile industry. But it wasn't general until the 1960s people began. So it wasn't part of the mentality. But I remember in the early 1950s, sometime around 1952, '53 or so, this bridge was put in. And it then took several visits, and the dentist knew I was in the stock market. He was buying three- and four-dollar stocks and I was -- we were buying our wealthy

clients General Motors. And I said, "Why don't you buy a few shares -- why don't you buy General Motors?" "I can't afford to buy a hundred shares. So I buy the three- and four-dollar stock." Actually he could have bought two or three shares of General Motors and at that point made a lot more money, but he couldn't think that way. The amounts were very small. Today, I listen to radio ads and such-and-such minimum \$10,000 investment. To us in the '50s, \$10,000 was the world. I didn't earn \$10,000 until nearly 1960. I earned -- when I went in my investment council firm, I earned \$7,000. I guess by the middle '50s I was making ten. My wife as making \$50 a week.

Q What about the story you tell about the friend's father who jumped out of the building?

A One of my friends in high school -- I went to a respectable private high school in New York, graduated in 1936. And one of my friends in that class had a father who was in Wall Street who did jump out of the window. He's the only person I actually know that it happened, and there were lots of jokes about it. But it was a time when people felt very helpless, and that's when you commit suicide, when you feel helpless. No hope. When you think of not just the stock market at 45, but revered financial institutions disappearing and that the government clearly didn't know what to do when the British went off, devalued the pound in 1931, the pound had the same value to gold for hundreds and hundreds of years. And now they said, "Now we're going to -- we're going to blow it." Then, they'd gone off gold during World War I, but immediately after the war they were determined they were going to go back at that same value that has persisted forever. And now, in 1931, they said, "We can't stay there anymore." It was shattering.

The equivalent was the oil price hits in 1972 -- 1973 and a much bigger one in 1978. It was the same kind of thing. "My God, there's something of that -- the root of our civilization is being shaken loose." And running on a bank. Imagine, you go to the bank any time you want. You can cash a check or put your card in the ATM. But if you hear the bank is not going to be able to pay off and you'd better get them before somebody else.

Q In the '20s, was there a general American attitude towards the stock market?

A The stock market, was, I think increasingly became a public icon in the course of the '20s. Certainly not at the beginning, but as it went higher and higher and people discovered the glories of buying on margin, it became much more of a Main Street phenomenon. It was very much a front page of the newspapers phenomenon. And, there was a sense a little bit like after World War II, that here was this great powerful country and we had solved all our problems. There's a marvelous quote from Coolidge when he was inaugurated in 1924 about really all problems were solved and that the whole thing could just move forward in peace and tranquillity, and if that was the case, why not a piece of that action? It seemed to say something very familiar. It seemed riskless. So, yeah, Main Street did come and, I don't remember the number of people, but there were millions of Americans in the market. Again, somewhat similar to today, not all direct owners of General Motors and General Electric, but investment trusts were set up, things that were similar to the mutual funds of today. And they were tremendously popular and sold at very, very high prices. And they were a vehicle established for the smaller investor. Odd lot sales, sales of less than a hundred shares, were a much larger proportion of the trading than they are today. They're minuscule, but in those days they were important. So, yeah, Main Street was very much involved and when the thing collapsed, Main Street was very much involved.

Q Explain what buying on margin is.

A Buying margin is simply borrowing the money to buy the shares. Instead of putting up all the money, you borrow it. In those days and today, substantially this is true, but in those days I guess totally true. For the average investor, they borrowed the money from the broker. And the broker, in turn, borrowed the money from the bank. So there were what were called "brokers' loans", which were the measure of how much margin debt was outstanding. That's also now regulated today. In those days it was not regulated. So that people could borrow 60-70 percent, buy a thousand shares -- a thousand dollars worth of stock and borrow six or seven hundred dollars of the total. Obviously, if the stock went down and the broker's margin, which was the difference between the loan and the market value, that margin began to shrink, the broker would say to the customer, "Either you put up more cash or we're going to sell you out." So this is why when the thing started to go down and those

margins, shrank, the selling from people who couldn't raise the additional cash was a significant part of what fed the steepness and the abruptness of the decline until all that debt was wiped out.

Q **1929 Crash begins with one dramatic day, but doesn't stop there, right?**

A The closest thing to the Crash of 1929 was the Crash of 1987 in sort of what led up to it and what it felt like at the moment. 1987 didn't go anywhere, but, the market was weak during August-September, but it wasn't as though on October 29th, that the whole thing just fell apart. It was getting weaker and weaker. It wasn't anything very, very dramatic, but it was leading up -- you had the sense the ball had started to roll. So, when the big day came, which I think was October 29th, but the 16 million-share day would be the equivalent to over a billion shares of trading today when the 1987 was 500 million. To give you an idea of kind of a normal day now in 1996 is 400 million. It was a tremendous smack, but it wasn't out of the blue. There had been some leading up to it.

Q **Was this obvious only in retrospect or was it clear at the time that there was weakness in '29?**

A It was clear at the time that there was weakness and commentators were beginning to divide into the bulls and the bears. And after the big crash, there was one I've forgotten the exact day and then there was another very big day four or five days later, big smack. No. There was concern.

Again, it wasn't so different from what happens today. The Federal Reserve had been raising interest rates and it had become very profitable to make these loans to brokers. They were willing to pay very high rates of interest to lend to the customer, who was willing to pay a very high rate of interest because he thought his stocks would go up forever. So a lot of corporate money was coming into the brokers' loans. The corporations were lending money to the brokers and the Federal Reserve was concerned that was money that was being taken away from normal business activity. So that when the Federal Reserve began to crack down on this, not only by raising interest rates, but by talking to the banks and talking to the corporations, it was not something that was obscure.

Q Is the image of people jumping out of buildings real?

A That's real, but it's not really real about 1929. The crash itself in 1929 was on the order of 20-25 percent, which when they used to be bear markets, not like today, 20-25 percent was a normal bear market. So it was bad and it was painful and those few days were real panics. But then things quieted down and 1930 was kind of a spooky year. I've always thought it was a year that deserved more research and attention, because the market rallied back. It didn't get back to 360 on the Dow, which had been the 1929 high, but it rallied back in the spring and there was a sense that maybe the worst was over and everything was going to be all right. Business activity was getting weaker. There was a genuine recession going on, again, nothing bad, kind of conventional, but the business activity was getting weaker. But at the end of 1930, a bank called Bank of United States, not "Bank of the United" -- Bank of United States, a small bank that was really what we called an uptown bank, but had recently opened a Wall Street address, that bank had a run, failed. And, there was some sense that the other banks should have gotten together to support it, but they didn't. This was a bank with Jewish ownership and largely Jewish customers. So a lot of small people. And so when the Bank of United States failed, not only was it a New York City bank, but it was a bank of the United States, it triggered more runs. And then the banking system began to go down and the bankers were already very scared because they'd lost a lot of money on the broker's loans when prices went down so fast, that they couldn't get back what they had lent. And so following that, raw material prices were falling, as happens in a business recession, but, business in Europe was also slow. So price of copper and wheat and that kind of thing were beginning to go down. So the banks were very scared anyway and when the runs began to hit the banks, which is really the story of 1931, that's when people really were getting into trouble. And business firms couldn't refinance their own loans and there was just a kind of a general wave to liquidate-liquidate-liquidate-liquidate. And that's when people really got frightened. And when people couldn't renew their mortgages -- in those days a home mortgage was not an amortizing mortgage the way it is now, where you pay a little bit off every month. It all came due on a date and you either had to refinance it or find the money or your house would get sold. And the banks didn't want to refinance the mortgages at the old rates. People couldn't find the money to pay down their

loans. And so all of that was added to the general desperation. The government, in its wisdom -- this was not a Republican, a parochial Republican view; the Democrats agreed, that the deficit that was created -- the budget deficit was created because tax revenues we're falling, was terrible. That was only gonna make things worse. And so in 1931, income taxes were raised and then in 1931, tariffs were raised. All the wrong things, in retrospect. And there was concern that the dollar would be weak because money would leave the United States and so the Fed Reserve raised interest rates. Everything was done to make it worse.

Q And what was the market doing during this time?

A Falling very sharply. The high on the Dow Jones was 360. The low, which was hit late in 1932, was 45. So, at this moment when we're talking, it's 6000. So you imagine it going to one-tenth of that, which is 600, or somewhere in there, which is where it was in 1974 at the worst. It was very bad. And, because it was something that was so much in the public view and, because substantially banking institutions were failing and everything, everybody was affected by it. I don't think there was anybody who was unaffected by it.

One of the interesting aspects after the crash, the immediate aftermath, was that people felt something bad had happened, but they had no inkling of how bad it was going to get. My father was with a brokerage house at that time and he was in Europe in late October when the big hits came. And when he came home, I remember my mother and I -- I was a little boy -- my mother and I went down to meet him at the boat and he was very elegant in a Hamburg hat -- I don't know whether anybody knows, but he looked very opulent. And my mother said, "Alan, Alan, what are we going to do? What's going to happen?" And he said, "You know, prices are still higher than they were when my mother died." His mother died in 1927. So he says, "There's nothing really -- this is bad, but it not awful." It never occurred to him that just 'cause they were higher than 1927, they couldn't go a lot lower. But it was really the bank -- the problem with the banking system and international concerns, everybody calling in everybody's debts that pushed the thing over the brink in 1931 and really we went down to a point where it almost could not have gone any lower.

Q What was the attitude about Wall Street, among your peers?

A Well, first of all, that it wasn't a very nice place to work. It was off-color. The stock market was generally considered off-color as a result of all of these events. The SEC, that legislation was passed at the end of the 1930s and was supposed to clean things up, but it wasn't really an established procedure yet and then it was also a place where nobody could make any money. I mean not only was it not nice, but who made money in the stock market? It was not a good place to go.

Q What happened to investment trusts?

A The investment trusts-- the individual, bought shares in the investment trust. Then the investment trust bought shares in other companies, but they borrowed money to do that, so you may have been on margin to buy shares in the investment trust and the investment trust was using borrowed money also. So as the prices came down, those were all wiped out. Very respectable names, like Goldman Sachs was one of the most famous investment trusts, I think it sold at a fraction at the end. Whether it liquidated out, I don't know, but I mean a fraction of a dollar. It was selling for less than a dollar, has been in the three-digit area at its peak. So they were just wiped out. There were very, very few open-end investments in mutual funds such as we know today. Because they declined tremendously in value, but they didn't get wiped out because they always traded -- there was no margin or anything involved with them.

Q Any other anecdotes about the lowest period?

A I had an investment counsel client, a man who had been a broker during the crash. And at the bottom the only stock that he still owned and which he had a profit was IBM. Everything else was way down. So he said, "I'd better take this profit while it's still there." So the very bottom he sold his IBM in 1932. I don't know what for, but you can imagine how much pain that gave him over the years. I did have a friend whose father jumped out of the window and did kill himself, yes. It did happen.

Q You got into the business at the bottom of what now ranks as the second greatest bull market...

A No. Our clientele were primarily people who'd always had wealth; I started in 1951. As the decade wore on, we began getting some clientele, also nobody young, but people who had maybe begun to make some money in the post-war prosperity and had also gotten up some courage. The '50s was a decade of disbelief. The market did go up and there was one bad bear market in 1957, which, the older people thought, "Oh, this is now we're going back down." But, it didn't. Went down 20-25 percent, stopped, and things did get better. But Wall Street was full of old-timers and nobody young and so they could not believe what was happening. I think, looking back, that the younger people were beginning, very tentatively, to come into the stock market, that mutual fund business was beginning to revive, and it was pretty irresistible because stocks were selling -- the dividend yields were six-seven-eight percent in those days. Now they're a little over two, whereas bond yields were three to four percent. And so you got twice as much income owning stocks as bonds. And even though people felt it was very risky, they felt, well, the difference in income made it worthwhile. And so then something absolutely amazing began to happen as the decade wore on. The stock market began to go up and dividends didn't go up that fast. So yield fell to around four percent, four to five percent. In this meantime, the bond market, bond prices began to go down. Business was very good. People began to worry about inflation for the first time. And so around 1958, if you bought a bond, the income on it was more than if you bought a stock. Dividend yields went below bond yields. This had never happened in history. It was a really unique experience. It wasn't supposed to happen, because stocks are supposed to be riskier than bonds. I had two older partners. They were 15 years and more older, and they were veterans of the Depression and the one, my closest friend in the firm, always called me "Kid". He said, "Don't worry, Kid. This'll reverse itself. This is unreal and not to be sustained. This will reverse itself." Well, I'm still waiting. Stocks have yielded less than bonds ever since then.

Q He meant things were going to go down?

A Yeah, the stock market would go down, so the yields would

once again be higher than on bonds. Well, you had a couple of hundred years of history and it had never happened.

So, in my experience, this was the single biggest event, and I never forget it, because it proved to me that when people say something can never happen and for 200 years it couldn't, hadn't been true, anything can happen. It was both very exhilarating, but also very humbling.

Q You're the saying the great mass of Americans didn't know what was going on in the '50s?

A Not in the '50s..... The reason that the '50s were the decade of disbelief was that most of the people -- I really could say almost all the people -- who were still in the stock market were veterans of the Depression. No new people had come in. So the memory of this event was very strong and you really had to go through about ten years more so that the event was, by 1959, it was 30 years since the crash. Those people were beginning to die off and a few younger people were beginning to come in, because it began to look like a place where you could make some money. But, there were many days there were less than a million shares traded, and a couple of million shares was a very big day. This was about 18 percent, more than -- less -- about 15 to 18 percent of the number of shares listed on the New York Stock Exchange. Today, a 400-million-share day today is about 40 to 50 percent -- I mean a big day's about 40 to 50 percent of the shares traded. So activity -- even though there were many fewer shares, the activity was much slower, much quieter. Amazing. The stock market in 1951 and 1952 was still open Saturday mornings until noon time. It was open from nine to twelve. I don't know. They must have done a couple hundred-thousand shares. In 1952, they stopped being open on Saturdays. But it was a very quiet time, but big stocks went up a lot, with not much movement in little stocks. What was then called the Curb Exchange, now the American, or, God forbid, over-the-counter, was there was very little activity. Low-priced stocks, which is what little investors bought, weren't moving. But General Motors, General Electric, Atcheson-Topeka and Santa Fe, which was a blue chip, and Union Pacific, the blue chip of the railroad business, which was then a big industry, they split five for one. General Electric spit -- split three for one. American Telephone was selling \$160 a share, paid \$9, was beautiful. It was like a bond. The blue chips moved. The Dow Jones

Industrials moved, but, something else interesting about what the market was like. There were 30 chairs, as there still are, in the Dow Jones Industrials and sort of a funny way of calculating the average because you had to adjust for splits. So, the ticker tape every ten minutes would print what the Dow Jones Average was. And you got the prices, then you had to do this arithmetic without computers, maybe an adding machine. So every ten minutes you'd get the market. The S&P -- Standard & Poors started their indexes I guess in the 1950s, but 'cause they had an index with 500 stocks in it, you couldn't figure that every ten minutes. So it was published, I think maybe only monthly, but certainly the most frequently weekly. You didn't get it every minute. Like now you push a button and there it is because the computer can do it. So this is the reason that the Dow was always kind of the benchmark, was because it was easy to do the arithmetic and figure out what it was doing. Also it was "the" blue chips in the market.

Q Do you think being able to push a button now has helped kindle the market fever?

A Yes. Yes. There's a substantial amount of academic work that says that the more frequently you can value your portfolio, the more frequently people trade, and that the more information they have and the more that the market is open, the more people trade. The movement, the market closes Friday afternoon and doesn't open up until Monday morning. So it's closed from Friday afternoon to Monday morning. The movement from Friday afternoon to Monday morning is less than the movement from open on Monday morning to close on Monday morning, or the days that it's open. This is not just 'cause it's a weekend. It's true of holidays and they've checked days when there's a lot of news, days when there's not much news, the statement is still correct. The market is more volatile when it's open than when it's closed.

Q The '60s marks the modern era of the mutual fund industry.

A Yes. I guess 1960-61 was a period when the little stocks took fire. Again, not so different from today, hi tech and people getting defense contracts and little companies were getting it because defense was becoming more hi tech. So by the end of 1961 there was

a real bubble. And in 1962 we had a 20-25 percent bear market. Very abrupt and that killed off activity so much that for the latter part of 1962 there were many without a million shares trading. And the old-timers were convinced this was the beginning of another big bear market and they were flabbergasted when, by 1963, the market was going back up again.

FL: In the '73-74 bear market, was this sort of the end of the era for the old-timers?

A Most of the old-timers were gone. There were some big ones. Gus at Goldman Sachs ...

Q Gus Levy?

A Gus Levy, yeah. And a guy at Bear Stearns, remember? Big bald head? There were some who were still there, but mostly the old-timers were gone. But, the '60s, in general was a time of great optimism, again, that problems had been solved, the US was triumphant. The Russians had backed away during the Cuban Crisis and we were going all these years without a big recession. The last big recession was 1957. So we went more than ten years without a real recession. So that the kind of overconfidence that has existed in the late '20s was making a reappearance.

But the problem with what happened in the '60s as we went on into the '60s, was inflation. We got into the Vietnam thing. Johnson, at the beginning, refused to raise taxes and was financing the war by the deficit, by deficit financing. Then the Fed got scared about that. Interest rates began to go up and when that happens, the stock market always gets into trouble. So there was quite a smack in the market in 1970 and then we came out of recession in 1970. We came out of that and inflation took hold again. So that in 1972, Nixon put on price controls, but the thing was bubbling. And in 1973, OPEC decided that if prices were going up everywhere, why should oil sell for \$2 a barrel, which is what it was selling for. So we had these big increases in the price of oil and then that was very bad. And very big jumps in interest rates to try to keep inflation under control, cataclysmic declines in the bond market. I mean bonds were selling to yield amounts that had never been seen in history. So the stock market went down and it stayed down.

Q Talk about the direct correlation between interest rates and the stock market.

A Inflation -- there are two ways to fight inflation. One is to raise taxes and the other, and the more sort of conventional way it normally happens, is that the Fed Reserve tries to make money tighter so that it's more difficult to borrow to finance higher prices. But if prices are rising, which is what inflation is, if what you pay for bread is more -- going to be more tomorrow than it is today and you've just bought a bond that's gonna come due in 10 years, 15 years, 20 years, you've made a long-term loan to somebody and it's gonna pay -- say, a thousand-dollar loan is going to pay \$50, for the next 10 or 15 years that \$50 is going to be buying much less tomorrow and certainly much less 10 or 15 years from now. So you may have paid a thousand dollars for that bond, but if you want the money and try to find somebody else to buy it, they're not going to pay a thousand dollars for it because who wants a steady income of \$50 when \$50 buys less and less every year? So the prices of the bonds will go down. And they will go down to a point where -- where you can buy \$50 -- you don't pay a thousand dollars to get that \$50 income, but maybe you can get it for \$850. Then it becomes more interesting because you're investing less than a thousand dollars to get the \$50 income. So that's what pushes the bond market down. But if you can buy a \$50 income for \$850 and a stock is paying -- a hundred shares of stock is paying, say, \$50, the price of the stock is gonna go down, too, because stock is more risky even than a bond. So if the bond price -- bond prices went down, they pulled stock prices down with them.

Q Talk about inflation by itself. Did it change the way average Americans thought about their money?

A Yes, absolutely. One thing was that going into debt became much more attractive--and owning a house. People began to think about their house as an inflation hedge. In the long run, stocks will be an inflation hedge because stocks depend upon the volume of business that a corporation is doing. And in an inflationary period, the volume goes up. But when the inflation is unexpected and when it prompts restrictive policy by the Federal Reserve or fiscal policy people don't want to own stocks but, they also don't want the own

money because money depreciates every day. This was a left-over, a vestige from the Depression. Interest on savings accounts was regulated and could not go up. And so a little guy who couldn't afford to buy a million-dollar CD in some bank where the interest rates did go up was getting three or four percent and that was terrible. And then somebody invented the money market fund. This was started in 1972-1973, in which they said, "We'll sell you shares in a fund and we'll get a lot of money together and then we can buy those big CDs and pay the interest back to you." So people began taking money out of conventional savings accounts and beginning to buy money market funds because that way, they got an interest rate that paid them for holding their money. But they began to hold as little as possible in their checking accounts because it was a sure way to lose. Cash, money in your pocket bought less every day. And all during the '70s the oil price increases were very terrifying. And the terrible stock market was terrifying and the terrible bond market. So it was a very scary time and hard to understand. People pressed for wage increases. I mean usually wages only went up a lot when unemployment was low, but wages went up a lot even when unemployment was high in the 1970s.

Today you feel if you don't buy the car this year or you don't carry a lot of canned goods in the closet, that's okay because you can go do it later. Time is not terribly important in planning purchases. At that time you really felt you couldn't wait. If you needed something, you couldn't wait because it was going to cost more. We extrapolated the experience that we'd had into the indefinite future. That it was scary and everybody was asking for raises all the time--the people who worked for us. And then we had to worry about whether we could get our prices up. To be a seller, as well as a buyer, was difficult. And if you wanted to get a new mortgage, interest rates were in double digits. It was great when you had money in the CD or the money market account, but very scary when it came to spending it.

Q Do you mark the rise of modern mutual fund industry with the bull market of '82?

A No. I think the mutual fund industry, I guess, did okay in the '80s. I don't think it was as vivid an institution as it was in the late '60s when the performance thing and the go-go guys got going, that mutual funds attracted a lot of public attention and the managers were known, like the Peter Lynch or Vinick of today. There were a

lot of managers whose name were so popular in the late '60s. But, no, the mutual fund business I think got going after 1987. There were a number of kind of ear mark years. 1981 is ear marked because it was the year that interest rates peaked and that inflation peaked. And it took a little while to understand that had come to an end. But then the fantastic thing about 1987 was not that the crash happened, but that nothing else happened, well, 1961 is a little like it, but it was much less dramatic -- unlike other crashes, we didn't have a recession, the market didn't keep going down, no big businesses failed, no banks failed. There'd been a lot of bank failures and financial crises during the '70s and even New York City nearly went belly-up in the 1970s. But here this crash came in 1987 and nothing else happened. And that led to the feeling that this kind of idea that in the long run being in the stock market is great, that weak markets are buying opportunities, not times to sell, that the market drops -- well, I can't even remember anymore. In 1987, that it didn't go any further I think is a vivid -- it's like 1929 to my older partners in the 1950s, the wonderful event in 1987 is what people today are carrying around in their head. "Don't worry if the market goes down. Nothing bad can happen."

Q What do you think about that opinion?

A This is very subjective, very personal, but, and I don't think it's necessarily because I've been at this for a long time. It's how one feels about life. I believe the forecasts will be wrong and that I have to run my life on the basis that forecasts will be wrong. I believe in being hedged. I believe in being diversified. But, as I say, I believe that what we've learned about risk in the last 300 years is that we can manage it, but managing it means that you don't put all your eggs in one basket. And so, I do not believe that even though we have 200 years of history, that in the long run the stock market can only go up and in the long run, the stock market is the least risky asset. That's what history tells me. It doesn't tell me what's gonna happen tomorrow.

The fund industry is feeding the demand for it, but if you imagine individuals with a few thousand dollars, because most 401K balances at this point are hardly 30 or 40, and even if they were 30 or 40 or 50 thousand dollars, buying individual stocks and trying to do it that way would be really catastrophic. And, we read recently about a penny stock fraud that had gotten very active and there's a lot of

fraud going on in the penny stock areas, but if you didn't have mutual funds that would give people a chance to speculate in some kind of a fashion where at least the companies that the mutual funds are buying are not selling for 45 cents a share, the whole penny stock business, I think, would be much worse.

Q What is the appeal of mutual funds?

A The appeal to the average investor is that it does provide some kind of diversification. You're not just buying one or two stocks. And, I think there is an illusion, which is sometimes true, sometimes not so true, that you're getting professional management. "That guy knows more than I know." And to a significant degree you get liquidity, too. You can change your mind if you want. It's easy to get out. If we were in the middle of a 1987 crash, it wouldn't be so easy to get out, but in the normal course of events, it is.

So, it makes life a lot easier for a person. I think most people understand that trying to pick stocks themselves would be very difficult, very time-consuming. We know people do it now. With the Internet, you read about the guy who spends all day at the computer, and so on. But the ordinary Joe who goes to work every day isn't gonna have the time to do that and he has to turn it over to somebody else. This is the most economical and effective way to do it. I think he's right.

Q Did the super stardom of Peter Lynch play a role in that appeal?

A Yes. Many academics, and I'm not an academic, but I believe that somebody who has a track record of beating the market, that the chances are either that they took greater risks or that they were lucky, that skill is very hard to detect and probably isn't there. If anybody had it, Peter Lynch had it. Well, I mean you have to give him the benefit of the doubt, but every once in a while there will be somebody like that. Doesn't mean that the typical fund manager is like that. But that the Magellan Fund in its glory, that it proved that you could do it, I think, yes, is a big attraction to make people think that hiring managers who are out there trying the do it will work. And in a bull market, the manager who takes great risks or the investor who takes great risk is gonna look terrific. This is really

what happened in the late '60s, that we had these go-go managers who -- this is when the word "performance" entered the vocabulary. It was not part of the vocabulary before the late '60s. The most fabled one was Jerry Sy, who had a fantastic track record. You'd pick up the phone and say, "What's the China man doing?" You'd want to know where Jerry Sy was buying, because then everybody else would buy what he was buying, made his bets look great. But, that was fine when you had a modest amount of money and the market was going up, but that little group of hot managers disappeared from sight after 1969 and, I'm sure the same thing will happen here. Peter Lynch got out while he was ahead.

Q Isn't that a little bit what's happening today?

A The idea that these managers are heroes and that it's possible, if you find the right guy, to have your money and make your retirement safe for the indefinite future is a very popular activity, yeah. I don't have numbers that we all read. I have an impression that people are taking bigger risks with their retirement fund. It feeds off the 1987 syndrome basically, though, that if it goes down, it doesn't matter because "By the time I retire, it will have come back."

Eighty-seven is important to the modern investor. It's a symbol. It's a syndrome, because here we had, for a singly day, probably the biggest drop we've ever had in market history and enormous volume and panic and everything, and the next couple of days also. And nothing happened. And, in time and really not so long, the stock market got back to where it was at the 1987 top. And so the lesson from that, or the lesson that people believe they learned was the 1987 crash didn't cause anything else to happen. Other crashes had caused bank failures, corporate failures, business failures, New York City almost failing. The 1987 crash didn't cause anything bad. And so, "Why worry? If the stock market goes down, by the time I retire, it will be back up." And if you look back at the long history --this is history that goes back to 1920, a lot of ups and downs, but in the long run, that trend is up. So even if I bought here, the 1929 high, by the time I retire, it's going to be higher. And that's what this history shows. My philosophy is that that's history and that we really do not know. Other countries had histories like that and Germany and Italy had no stock market after World War II. Russians had a gorgeous stock market until 1920. We don't know what's gonna happen in the next 50 years.

Q Why was '87 different from '20?

A First of all, 1929 was associated with a recession. 1987 was -- well, 1929 also, really because the banks were in the market in that they were financing the margin borrowing, immediately had an impact on the banks and, therefore, immediately had an impact on what the banks were doing as far as lending to the people outside the market. That might have happened in 1987 because the banks normally finance brokerage houses. Brokerage houses are all operated on borrowed money. That's just normal operating procedure. So the banks are normally associated with brokerage houses. In 1929, the Fed Reserve either sat on its hands, or said they were going to constrict credit even more. In October 19th, 1987, Alan Greenspan called the banks and said, "You can borrow from the Fed if you're in trouble. Don't worry. We will not let the loan -- we will not have this cumulative liquidation that we had in 1929," very important lesson learned. So I think Greenspan deserves a lot of credit for what happened.

Q Then could another '29 happen again?

A I guess the critical question for someone who's saying, "Well, I'm going to invest for the long run," is whether we can have not only 1929 again, but this whole kind of cumulative mess which pulled everything down with it. And I have to answer the question it's not will it happen, but could it happen? The answer has to be yes. First of all, people who were in their 30s and 40s putting away money for their retirement are thinking in terms of the next 20 to 30 years, and who knows what can happen in the next 20 to 30 years? Anything. But even in the nearer term future, could it happen in the next five years with all this agitation and excitement in mutual funds and the market at record highs? I think you also have to say, yes, it could happen. In this sense, that the world is very globalized today. What happens in other markets affects us and we affect other markets. And we don't know what kind of a mess might exist in some other market that would then trigger some bank failure and we've been good so far at stemming bank failures. Look at what happened to Japan. But certainly the ingredients are there in the sense that it's globalized and we have markets we don't know very well and don't understand very well and financial institutions that

aren't as well regulated as ours. Where have literally trillions of dollars of derivative kinds of transactions -- options and futures and swaps and all this exotic stuff. Again, carefully supervised and so on, but in a global sense you just don't know what could happen that might trigger the cumulative thing. So, while the probabilities are against it, no probability is a hundred percent. This is something new to history. The old history is not relevant to this kind of a world. It's a very new -- our experience in it's very limited. So, yes, I think that we could have another 1929 in the next five years or so and in the next 25 years. The longer you go, I think the higher the probabilities get.

Q What does that say about us as a society...

A I don't think it says so much about us as a society as it's about us as human beings. The most vivid memories are the ones that with use as the basis for the decisions. And even 1987 is fading now. And 1929 is ancient history that there's almost no one around who was in the market at that moment. I saw the other day Roy Neuberger, of Neuberger Berman, he's 92 and still trading, goes to the office every day. Roy, I guess was probably there, but he's a rare specimen. So even the 1970 period which was very difficult and, I think, in many ways with the oil thing, very frightening, not many people remember that. So it's about how we are as human beings. As a society, I suppose greed is -- is part of being a capitalist society, part of what drives a capitalist society, but I think it's more anxiety that drives us. I'm worried about my retirement. It's a long way off and the only way that I know, the only way that anybody has taught me to be sure that I can secure it is by being in the stock market. I don't see how I can do it in the bond market. Bonds may protect me on the down side, but they don't provide any up side. And cash to earn four or five percent, what's that? This is the reasoning. My answer to that is, the stock market story seems to make sense, but we don't know enough to be certain. And, therefore, I would have some other assets because I don't know. And if I don't know, I have to be diversified. And I'm not afraid to say I don't know. And I don't believe the guy, even the professor who's written a book who says he does know, because all he's telling is what happened in the last 200 years. And that doesn't tell me what's gonna happen in the next 30 years. Gives me an opportunity to make some judgments perhaps and to think about it, but it does not tell me.

Q One of the reasons people are so invested in the stock market is not because of the fact it's going up. It's because of the sense of "There's nothing else out there left for me anymore." Job security or pension or whatever. Do you have any thoughts about that?

A It's funny that people are motivated by anxiety to take a risk. You'd think that anxiety would make them risk averse. But should I tell you an anecdote? Many years ago I taught a course and at the end of the course a senior came up to me and he said, "I need an investment advisor. Would you be interested?" And he looked at me and I said, "Well, we have a minimum." He said, "I'll send you my portfolio." He had a couple hundred thousand dollars in three stocks, all at enormous profits. And we looked at it and said, "What can we do for this guy?" So he came in with his wife, who is a schoolteacher. He had worked for the Brooklyn Eagle, and this was the local Brooklyn newspaper, long since gone. When it folded, he had \$15,000 in the world. And he said, "If just shepherd this, I'll be broke in a year, but if I shoot the moon with it, I might be broke sooner, but maybe I can get myself out of this hole." And that's what he did. And now he needed somebody to help him unwind it. The wife was very nervous. She was apparently very relaxed when he began, but now they had \$200,000 and she was frightened. And I think there's some of that in what drives this, that, if you feel you're in trouble, you can get out by being conservative because you'll remain there. Conservative will help prevent you from going down the tube maybe, but it won't get you out of trouble, and that, therefore, risk-taking becomes more important. The lack of alternatives is true to some extent because the bond market, you can do very well compounding seven percent a year. You'll double your money. At seven percent, you'll double your money every ten years. It's not bad. The stock market over the long run with all these goodies has returned nine or ten percent. So the bond market is not a bad thing at seven percent where you can compound in a tax shelter to count. But the bonds that you buy today are going to come due and when they come due, you don't know what you're going to replace them with. You may not be able to replace them with seven percent. You may not be able to reinvesting the interest that you earn at seven percent. So there are uncertainties about bond market returns, too. And the one great, glorious asset, the home that people in the '70s and in the '80s, which was what made a poor man feel wealthy and secure, that's not so sure anymore either, because many

people's homes are worth less than they were ten years. So they don't feel sure about that. So the stock market, given that it has done so well for 10-15 -- really since 1982, 15 years with just that one weird episode which proved that you don't have to worry about it, the stock market looks like the place to go. But it is really using hindsight.

Q Is there something qualitatively different about the number of people, the amount of money, the growth of mutual funds, the risk-taking by fund managers, risk-taking by individuals that is also different enough to throw history out the window?

A It's an impression that because everybody is now in the market, or lots of people are in the market who weren't there before and that has given a new dimension. I think there is some truth to that and we see it -- I think the stock market itself acts -- reflects mutual fund buying and selling. It used to reflect pension fund buying and selling. Way back, it reflected individual, wealthy individual buying and selling. Yes, I think that's true. But at the same time direct individual ownership of equities is shrinking, so that the total amount that individuals have in the stock market isn't going up as much as the growth of the mutual fund industry would suggest.

But I think there's a qualitative difference today in this sense, and this is sort of what scares me when I look at it. The money that people used to put in the stock market was money that they hoped to get rich on or play with or maybe finance a trip to Europe or something. What's going in today is blood money. With jobs less secure and with really the wonderful corporate pension fund that promised you the pension of X percent of your final salary when you retired, well that no longer is important and taking care of the smaller and smaller proportion.

This is blood money that's in there. And, ah, exactly how people really would respond. It's easy if it goes down 10 or 15 percent, great, that's wonderful I can buy more. But, we've been in an economy which has been wonderfully serene. Maybe it didn't grow as much as people wanted, but there's been very little volatility in the economy. And that's not gonna be true forever. And if you get a volatile economy, you'll get more volatile markets and exactly what happens then, I don't know. It could feed real panic, yes. But that's blood money.

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