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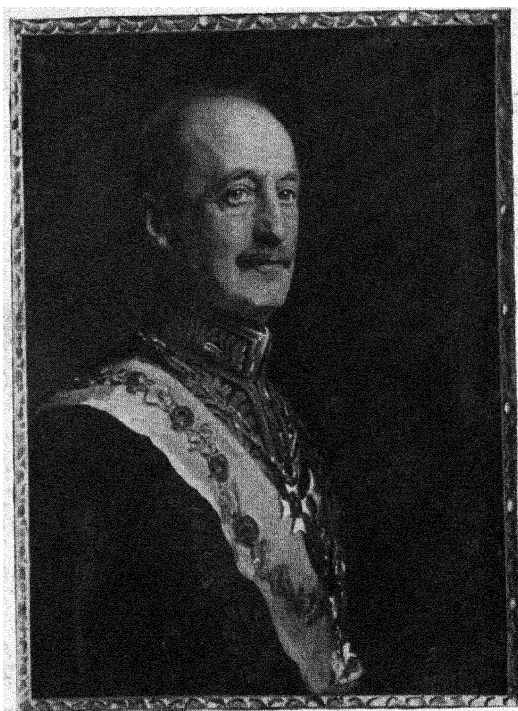
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**INVESTMENT
AND
INVESTORS**



From a painting by Philip de Laszlo.

THE RIGHT HON. LORD HARDINGE OF PENSHURST, K.G.,
Viceroy of India 1910-1916. Ambassador
in Paris 1920-1922.
Chairman of Investment Registry Ltd.

INVESTMENT AND INVESTORS

*20th Revised Edition
of a book formerly entitled*

INVESTMENT RISKS

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INTRODUCTION

THERE have been many books written on investment, but most have one common failing: they attempt to cover too much ground while not concentrating sufficiently on essentials. They incline to be over-technical. The reader is led through all the intricacies of Stock Exchange practice, but is given little definite guidance as to policy—what to look for when judging and comparing securities and how to differentiate between investment and speculation. Further, the mistakes to avoid are not clearly enough indicated.

Whatever merits this addition to the bibliography of investment may possess, are due to the fact that every statement in it is based upon experience; not upon that of one individual only, but upon the accumulated experience of many thousands of investors over a very long period. It is possible to be a very good theorist, to write books on a difficult subject, but through lack of experience to be unable to put the theories into practice. It will often be found in the case of professors of certain subjects that their

execution is not equal to their theories. It may be claimed that this little book is, at least, practical; it owes nothing to untried theories; it is the result of fifty years' experience of a big investment house which has had the opportunity of investigating the lists of more than 60,000 investors, following results, noting mistakes and learning from those abstract but most practical of all teachers—success and failure.

Before proceeding further, I owe it to the memory of a late chairman of Investment Registry, Limited, Sir John F. L. Rolleston, to say that the general construction of this book and many of the suggestions that it contains are based upon an earlier work of which he was the author. This was first published more than twenty years ago and was entitled "Investment Risks and How to Avoid Them." The book went through many editions to bring it up to date, having regard to the great changes that have taken place, and the 19th Edition published in 1933 had the title shortened to "Investment Risks," the former title suggesting that risks can be avoided altogether. They cannot, and the experience of the past few years has made this only too evident. However, the investor who appreciates the risk that he is taking is less likely to make serious mistakes than the one who believes that he is incurring no risks at all.

Investment Registry, Limited, the publishers of this book, has been established since 1880. In its earlier years the company carried on a general investment business on a comparatively small scale. In 1904 the first steps were taken towards investment specialisation. The business then began to grow and to gather around it a large connection of investors whose object was investment as distinct from speculation. Simultaneously with the growth of the business an organisation was developed for rendering service to investors, the kind of service that they most require—reliable statistical data—analyses of balance sheets—information concerning the comparative merits of different securities—informative circulars reporting on progress and prospects.

This is only a brief outline of the service department of Investment Registry, Limited. Actually, it covers much more ground, and it is due largely to this service that the company's connection has grown to such a large extent. Before the war, the premises were in Waterloo Place, covering the whole of the site occupied by the new building of Lloyds Bank. During the war, the building was requisitioned by one of the new Ministries, and the depleted staff was housed in the present premises at 6 Grafton Street, New Bond Street, W.1, which has since been largely extended to accommodate the

increased personnel. Since 1919, the new issue side of the business has grown considerably and Investment Registry, Limited, may now claim to be one of the leading London issuing houses specialising largely in debenture stocks. More detailed reference to this and to the service provided for the Registry's clients will be found in Chapter VI at the end of this book.

Sir John Rolleston was Chairman of the Registry from 1905 to 1910, when his Parliamentary work necessitated his resigning. He resumed the chairmanship, in 1916, succeeding the late Lord Downham (then the Right Hon. W. Hayes Fisher, M.P.) who, in the meantime, had accepted a seat in the Cabinet. During his long association with the Registry, Sir John was continually being consulted by investors who had filed lists of their investments with the company for valuation and revision. He had considerable financial experience, for, in addition to being Chairman of the Registry, he was director of an important bank in the Midlands and was also on the board of the old-established Law Union and Rock Insurance Company, Limited. The chairmanship later passed to Viscount Long of Wraxall, who preceded the present Chairman, Lord Hardinge of Penshurst, K.G.

This book is intended primarily for the guidance of those who have hitherto lacked the

opportunity to make a close study of investment, and who wish to employ their capital safely without looking for big returns or quick profits. Some of the points dealt with are, necessarily, of an elementary character ; otherwise the book would fail to some extent in its purpose—namely, as a guide to those who lack expert knowledge. The general principles, however, are not elementary ; they are the result of a long and practical experience in dealing with the business of many thousands of investors and have stood even the testing period of recent years.

PHILIP ROSSI,
EDITOR,
Financial Review of Reviews.

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CHAPTER I.

INVESTMENT AND SPECULATION

Unconscious Speculation. Speculators will find little to interest them in this book unless they have found by costly experience that the odds are more heavily weighted against the gambler in stocks than they are in the casino or on the race-course and are desirous of changing their objective.

The definition of investment and speculation is the first point to establish. Where does one end and the other begin? What are the distinguishing features that differentiate an investment from a speculation? The whole of this book may be taken as an answer to these questions, and in so far as we have answered them adequately we have produced a guide to "safe" investment.

Some people speculate deliberately, and occasionally with luck make money; it depends on the knowledge and judgment they bring to the task. Far more speculate unconsciously; they nearly always lose money because, through lack of knowledge and judgment, they follow haphazard

methods ; they have no fixed idea of what they want. In short, they are casual dabblers in finance and stand about as much chance of doing well as any other dabbler who lacks a thorough knowledge of his subject.

Some stocks are essentially speculative, but it does not necessarily follow that an individual buying them would be what is commonly known as a speculator. He may have studied his subject and know definitely what he wants, but the purchase of the same stock if undertaken carelessly without special research and merely on casual information in the hope of a rise is an act of speculation. Good examples in support of this statement are provided by stocks such as Canadian Pacific Common—or Argentine Railways. A substantial investor or a Trust or Insurance Company might very reasonably buy such stocks as investments. They are speculative in the sense that prices have always been subject to wide fluctuation, but those who have studied the potential resources of these companies might well include such stocks in a widely distributed investment list, not with a view to reselling quickly at a profit, but to holding firmly, ignoring temporary fluctuations until anticipations are realised.

The simplest definition of investment and speculation is that the investor buys to hold for income and possibly for eventual capital appreciation, having no intention of jobbing in and out to snatch profits, while the speculator is mainly concerned with buying something that he hopes he will be able to sell again quickly at a profit. Investors buy goods which they believe on intrinsic merits are worth the price paid. Speculators are pitting their knowledge and wits against the market. Often it is an unequal contest.

The Casual Investor. It is strange that a very casual attitude should be adopted by individuals who have money to place.

In spending money in other ways most people exercise great care in examining the goods and making comparisons. Few, for example, would buy a house without considering its suitability for their needs, getting a surveyor's report, studying the locality, and comparing the price with that of other properties on the market. Few would buy even furniture or wearing apparel without some thought as to whether they were getting value for their money; but investments are often entered into with slight knowledge—a tip from a newspaper, a recommendation from a friend, or an interesting prospectus is often all the information obtained. Even business men,

who are accustomed to give the closest attention to capital expenditure on goods of which they have expert knowledge, will enter lightly into the more important business of investing their own private funds. If a little knowledge is a dangerous thing, no knowledge at all is worse.

How Trust and Insurance Companies Invest.

Experts in investment—the great Trust and Insurance companies—adopt very cautious methods. They do not confuse investment and speculation; they bring knowledge to bear upon every purchase they make. The private investor cannot emulate a Trust company; he has not the resources, the influence, the access to special information, or sufficient capital to distribute his investment risks over a wide field. Often he is unable to bide his time and hold on to depreciated investments until they recover. Trust and Insurance companies have very strict regulations concerning the type of security in which they are permitted to invest their funds, such as :—

A definite margin of capital cover if they are going in for mortgages.

No default for a number of years past if they are buying debentures, or a long period of regular dividend payments if they are buying shares.

Even with such restrictions, however, no well-managed trust or insurance company would invest its funds in stocks which complied with these stipulations, without sound knowledge of the undertaking and without careful consideration of their future prospects. How many private investors are in the habit of approaching investment matters in this way ?

Investment Risks. In succeeding chapters we deal with the nature of investments and their special risks, stating general rules to determine what constitutes an essentially sound or a speculative holding. We also deal with an important point to which few investors attach sufficient, if any, weight—that is, the adaptation of an investment list to the particular requirements of the investor, and finally, with a question of equal importance—the adequate distribution of investment risks.

There is hardly any investment without at least some element of uncertainty, but there are some general principles that it is dangerous to ignore. One of the foremost of these is—“The greater the yield, the greater the risk.” In the quest of a high yield or a quick profit, the casual investor too often grasps the shadow and loses the substance. If the risk to capital is disproportionate, an extra 1% in yield is a small matter

compared with the loss of principal, yet 1% may mean the difference between a safe and a risky investment.

There are two ways in which losses may be sustained, and it is necessary to distinguish between them because they are due, or may be due, to quite different causes—(1) loss of capital through the realisable value of an investment falling below the price at which it was purchased; (2) loss of income through interest or dividend payments ceasing or diminishing.

Loss of capital through depreciation is not necessarily accompanied by loss of income. There are certain investments the interest upon which is practically sure to be paid whatever happens. The risks to capital arising through failure, liquidation, etc., are generally appreciated by investors, but the risk of serious loss through depreciation is often overlooked, and experience has proved that immunity from this loss of capital cannot be obtained simply through the purchase of securities on account of their individual soundness.

Depreciation of thoroughly sound investments may be due to monetary conditions which vary according to the state of trade, and other causes. Such losses may be considerable. Going back a few years, it may be sufficient to mention the

case of British Consolidated Stock. This, in the year 1896 (it was then $2\frac{3}{4}\%$, later reduced to $2\frac{1}{2}\%$) touched 114; it depreciated in 1920 to $43\frac{5}{8}$, and at the beginning of 1932 was at about 55. Owing to the conversion of 5% War Loan, and other causes which need not be entered into here, the price has now recovered to 93. Over this period equally severe depreciation occurred with practically all other similar securities. To some extent it is possible to guard even against such risks, and this is dealt with in Chapter II, "Types of Investments." At the time of writing monetary conditions are, to say the least, abnormal; the reduction in borrowing for new enterprises consequent upon the depression in industry, the elimination of so many foreign securities that were at one time favoured by investors, and the abundance of money awaiting investment, have led to very high prices for practically all good securities. There may be a gradual but very marked reaction towards dearer money and lower prices, particularly if a real trade recovery sets in.

Loss of income through interest or dividend payments ceasing or diminishing generally results in loss of capital as well, because if the income from a security ceases, becomes less, or even appears to be in jeopardy owing to declining revenues, the market value of the investment tends to fall proportionately. This is a risk that can be

minimised by careful selection, and in Chapter II the reader will find information which will guide him in discriminating between safe and risky investments.

As mentioned in the Introduction, it is not possible in a book of this size to furnish a complete guide to investment practice, or to deal with all the problems with which investors are likely to be faced; the book can only serve as an outline of the principles of safe investment. The subjects dealt with may be summarised as follows :—

- (1) The importance of distinguishing between investment and speculation.
- (2) The essential difference between various types of investment, and the particular risks to be looked for.
- (3) The advisability of having a definite investment policy, and considering the suitability of every stock purchased for contributing towards the object desired.
- (4) Distributing investment risks as a precautionary measure.

The following chapters deal with these subjects, and some examples are given, reprinted from a former publication, of sound investment practice. Later in the book the general principles advocated are summarised and a description is

given of the organisation that has been gradually built up by the publishers, Investment Registry Ltd., for affording investment service to their shareholders and other clients, and supplying reliable data.

CHAPTER II.

TYPES OF INVESTMENTS

Their Relative Safety. Some of the points dealt with in this chapter are elementary, but it is worth reading carefully as there is a fine distinction between the relative safety afforded by various types of investment, a distinction which is not always appreciated even by experienced investors. It is perhaps superfluous to say that no investment is entirely free from risk. In some the element of danger is almost negligible: an endowment policy, for example, obtained from a first-class British insurance office—this, incidentally, is an investment and at certain ages by no means a bad one. The risk is that the insurance office might fail, or that currency might depreciate to such an extent that the benefit, when received, would be of little value. But these are risks that we do not propose to discuss in this book; they seem more than remote, at least so far as this country is concerned, and so for the present

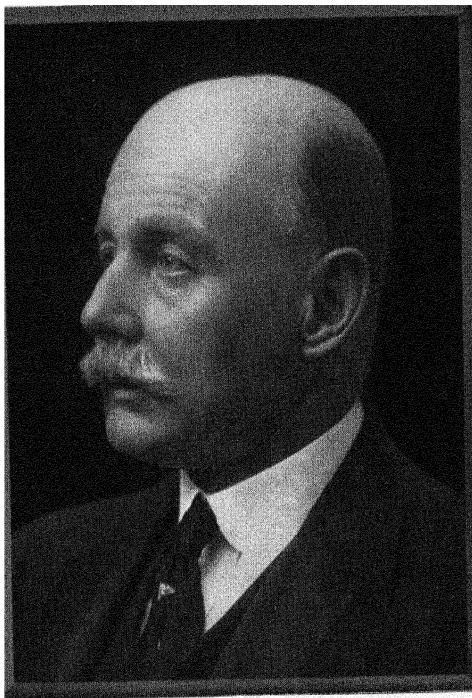


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THE RIGHT HON. VISCOUNT LONG OF WRAXALL, P.C.,
Secretary of State for the Colonies 1916-1919. First
Lord of the Admiralty 1919-1921.
Chairman of Investment Registry Ltd. 1923-1924.

purpose we will refer to an endowment insurance policy with a good British office as affording a very high degree of capital safety.

A private mortgage on good house property is another eminently safe investment. Cases of serious loss occurring on such investments are so rare, provided that the mortgage has been undertaken on a sound valuation, that the risk is scarcely worth considering. But neither of these forms of investment is suitable for the average individual who requires to place his capital in such a way as to give an immediately remunerative return, and to have it in such a reasonably liquid form that it can be withdrawn readily when desired. Moreover, it is difficult to place small sums in mortgages. We are, therefore, only dealing in this chapter with readily negotiable instruments of investment—various kinds of shares, debentures and bonds that can be bought or sold on the market—and discussing their general characteristics and their relative safety.

**State and Municipal
Loans, Debentures
and Bonds of
Public Companies.**

This brief description covers a wide range of investments, and under these headings may be numbered many of the soundest and best holdings for those who place capital safety first. They vary extensively and, therefore, we will deal separately but as briefly

as possible with the different types of loans and debentures, more or less in order of merit.

**British Government
and Municipal Loans.**

We place these first as it may safely be assumed that British Government and Municipal loans are in point of security the best investments that can be obtained. Prices may vary according to monetary conditions and even investments in such stocks have in the past, and may again in the future, occasion loss through depreciation, but as this applies to practically all securities it is dealt with later, in this chapter in the passages referring to "Redeemable and Irredeemable Debentures." It may be argued that circumstances might conceivably arise owing to which there might be a default even in British Government loans, as has been the case in other countries. But we will not pursue this line of argument. If British Government loans were to prove unsafe we believe that all the theory advanced in this book would prove unsound, and that the term, "security of capital," applied to any investment, would cease to have any meaning. Next in security to Government loans we would place those issued by British Municipalities. Again there is a risk of depreciation according to monetary conditions and the degree of such risk is governed largely by the terms of redemption, of which more later.

Dominion Loans. It is perhaps doubtful whether the loans of the British Dominions should come next in order of merit or the debenture stocks of important and monopolistic British public utility companies. Speaking generally, however, we would place the Dominion loans first. Most of them are more readily negotiable and at closer prices, while many of them are permissible for Trustees. It will not be necessary to refer to such loans in detail but the following points are worth noting: Principal and interest should be payable in sterling, as if in currency it imparts an undesirable element of risk. A definite redemption date is an advantage and it is an obvious disadvantage to pay a premium for a stock which may, at the option of the Government, be redeemed in a short term of years at par. Before buying, a comparison should be made with the yield afforded and with the redemption advantages or disadvantages of other Dominion loans, British Government and Municipal loans, and first-class public utility debentures. Dominion Municipal loans are not permissible to Trustees and must definitely be placed in a lower category than the State loans. Here it is necessary to discriminate between the big cities, such as Quebec, Ottawa, Cape Town, Sidney, Wellington, and the numerous little townships the loans of which are known

to the London market. It is presumable that the Dominion Government would come to the rescue if there were any question of default in the case of the big cities—it has, in fact, been done—but it is by no means so sure that this would happen if some of the little municipalities that may have borrowed money too freely got into difficulties. Again, there is the question of marketability. It is a mistake to lock up money in an investment that might be difficult to realise, the market price of which may be very wide, a sale of which, in fact, would be a matter of negotiation. There are some small Dominion Municipal loans to which this justly applies.

The Debentures of
Public Utility
Companies.

In referring to these as amongst the soundest securities obtainable it must be understood that we mean the debentures of *British* public utility companies. With those of foreign companies there is a political and economic risk that is dealt with in a later section under the heading “Foreign Bonds.” We would add that we do not regard all British public utility companies’ debentures as thoroughly sound without any qualification: we should make a distinction, for example, between the debenture stock of a railway company, the income cover for which was relatively thin, and the debenture stock of a

water or electricity supply company possessing a virtual monopoly in its own district and the earnings of which afforded ample cover for the interest and sinking fund requirements of the stock. The real security in these cases is the earning power of the company for, obviously, the assets of a railway or tramway company, or an electric supply, water supply or gas undertaking, would be of little value—in fact, probably quite unsaleable—if the concern ceased to be a paying proposition. Debentures of electric supply and water companies are amongst the safest investments obtainable as these undertakings have practical monopolies in their respective districts. It is most unlikely that any circumstances could arise leading to such a serious diminution of profits that debenture interest became endangered. Gas companies have also shown great stability of revenues, and most of the debenture stocks of such concerns may be regarded as safe investments. Railway debentures, as already stated, are in a somewhat different category. There are some stocks quoted to-day at lower prices than others because revenues have diminished and there is a less margin of cover after payment of debenture interest. The test of a good railway debenture is solely—how much profit remains after payment of the interest: it is on this

that they are priced. The best railway debentures and guaranteed stocks, the service of which is covered several times by revenues, yield little more than Government or Corporation loans. There are some good opportunities for this class of investment in the Dominions, but more care should be exercised than with similar stocks in this country.

Debentures of Trading Companies, Finance and Trust Property Owning Companies, etc. This section must be treated at much greater length as it includes a very wide range of

good stocks that are the most suitable medium of investment for those who require a reasonable yield without taking a speculative risk. It will be necessary to deal with the subject under several headings before discussing the more difficult and much more debatable policy of investment in foreign bonds and in industrial, ordinary and preference shares.

In the case of industrial debentures, under which general term we will include debentures of property-owning companies, trust companies, insurance companies and trading concerns, great discrimination should be exercised by investors in estimating the value of the assets as well as the income covering. Most readers will be aware that the holders of a first mortgage debenture stock secured upon the fixed and floating assets

of a company rank for repayment before ordinary creditors. If the interest is not paid, or even if the trustees have reason to believe that there is jeopardy, they can enforce their security, appointing a Receiver to carry on the business or to realise the assets, applying the proceeds in the first place to repayment of the first mortgage debenture stockholders. Whether or not such assets can reasonably be expected to produce sufficient to repay debenture holders in full is a matter for the investor to consider carefully before he buys a debenture stock. It must be remembered that, unlike a shareholder, he does not stand to gain if the company experiences prosperity, except in so far as the market value of the debenture stock may be enhanced. There would be no object in buying debentures with their relatively low yield and fixed interest unless the security were much greater than that afforded by ordinary or preference shares.

Enforcement of Security. We can well imagine some investors who are instinctively opposed to anything in the nature of harsh measures, bearing heavily upon some unfortunate enterprise, coming to the conclusion on reading this that they would not like to be in the position of a debenture holder who foreclosed upon a company's assets. They would feel like Shylock who demanded his forfeit ; yet

it is all part of the system under which industry is financed. It is what banks do ; they lend money at a reasonable rate of interest, and, as they do not stand to share in any way in the prosperity of the company, they expect security that can be enforced if the interest is not paid or the capital appears to be in danger. When companies finance their business by means of a debenture issue they do so because they prefer to pay a relatively low fixed rate of interest upon the capital raised rather than to issue further ordinary shares which would have the effect of reducing the distributions to the shareholders who own the business. When an undertaking is financed partly by a debenture issue it is the ordinary shareholders who stand to gain ; the debenture holders are merely creditors of the company and are entitled to the due observance of the terms of their contract. Of course, there are many cases where debenture holders, rather than break a business that has fallen upon bad times, agree to certain concessions or waivers of the strict terms of the Trust Deed if it is thought that by such action the business will be able to recover.

Debentures Secured upon Property.	Probably the best kind of security for a debenture stock is land and buildings, and that is why the debentures of property-owning companies keep so stable in value and command such relatively good prices. The
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common practise of banks, building societies and solicitors who arrange mortgages on property is to lend up to two-thirds of the value of the property as assessed by a professional and independent valuer. The lender has the security of the property, and if the valuation has been conservatively made there would have to be a very heavy depreciation in property values before the margin of security ran off. Any severe losses by investors in mortgages on property are of rare occurrence. There are many debenture stocks issued by property-owning companies that show considerably more than a $33\frac{1}{2}$ per cent. margin of security. There are debentures charged as a first mortgage on assets consisting of residential and business buildings, the value of which is estimated at double or treble the amount of the debenture stock outstanding. Such are very safe investments.

**Debentures of Trust
and Insurance
Companies.**

In the case of trust companies the security for debentures issued consists of investments, and a fair margin of cover to allow for depreciation should be required before the debenture stock can be regarded as safe. This, however, is the case with all of the leading trust companies' debenture stocks, which are sound investments and command high prices.

Debentures of insurance companies are also very sound, but few British offices raise capital in this way and the leading British companies are in such a very strong position that even their shares, let alone their debentures where these exist, are well covered by the value of their assets.

**Debentures of
Trading
Companies.**

With purely industrial debentures it is very important to consider the nature of the assets. When the security consists mainly of factory premises, plant and machinery, it may prove difficult to realise in case of emergency. There may be much difference between the value of such assets as a going concern earning profits and as a losing concern during depressed conditions in the trade. Yet, if the assets consist of business premises and land useful for some other purpose than that of the particular business carried on, the position would be different.

An excellent form of industrial debenture is that of a company owning a chain of multiple shops. Let us assume a debenture issue of £200,000, part of the security for which consists of a number of freehold and leasehold shops valued at more than this. That would be good security because, although the business might prove a total failure, the freehold and leaseholds

would be readily saleable for other trading enterprises, and it would go hard with the debenture holders if a Receiver were not able to realise the fixed assets for a sum sufficient to repay their capital. In such a case, however, there would in all probability be other assets as well, such as stock-in-trade, book debts, cash, etc., upon all of which debenture holders would have a first charge in the event of foreclosure.

**The Security of
Floating Assets.**

There have been so many cases of industrial assets proving difficult to realise under a Receivership that debenture issuing houses have, of recent years, been paying closer attention to procuring certain clauses in the Trust Deed that safeguard debenture holders against floating assets, such as stock, cash, and book debts, wasting away during a prolonged period of bad trade. For example, a company can borrow from its bank against such security. If a default occurs and the Trustees for the debenture holders have to foreclose, there is nothing for them but the fixed assets, which may be difficult to realise. The publishers of this book, Investment Registry, Limited, who have for many years specialised in the issue of debenture stocks, have on occasion thought it desirable when underwriting industrial debenture issues to arrange for the Trust Deed to contain certain

clauses to protect debenture holders against wastage of floating assets ; such as limiting the borrowing powers and stipulating that stock, book debts and cash should be constantly maintained at an amount bearing a certain fixed proportion to the debenture stock outstanding. Any failure to observe these conditions would constitute a default entitling the debenture holders to enforce their security.

Break-up Value of Assets. On the question of the possible break-up value of assets forming security for a debenture stock (a very different thing from value as a going concern), we might give numerous illustrations of what could, in this connection, be considered good security, and what bad.

The probable break-up value of the assets need not necessarily bear any relation to the character of the business. This may, in fact, be quite speculative, yet the assets good ; or a very steady kind of business, and the assets not good. To emphasise this point, let us take the following examples :—the debentures of a shipping company, a patent medicine company, a cinema or theatre owning company, and a greyhound racing company.

The shipping company might be an immense concern with assets valued during prosperous times at many times the amount of the debenture

issue. Yet, if it fell upon such bad times as to occasion a default upon its debentures, it would probably be because the shipping trade generally was in a deplorable state. In such case the value of the ships would have depreciated enormously, and they might prove impossible to sell at more than a fraction of their former value.

The patent medicine company might have a large capital and be earning good profits. There might be sufficient assets in the shape of land, buildings and saleable plant and machinery to cover the debentures ; there might not. The assets might consist mainly of goodwill—a legitimate asset on the basis of good profits, but of little value if the proprietary articles had been superseded by something else and profits had fallen away.

The theatre or cinema company might be a small concern with only moderate profits, but we have known of cases where the debenture stock has been covered by the value of the freehold land alone without taking into account the buildings erected thereon.

The greyhound racing company—an obviously speculative business—might also have a debenture issue with perfectly good security if, for example, the principal asset consisted of valuable land in some large town which could be used for other purposes and which would fetch its price under the hammer.

In judging debentures there are two main lines of investigation—what is the probable break-up value of the assets—what are the prospects of profits being maintained? In the case of industrial companies, investors should concentrate mainly on the first point because anything may happen in trade, and the prospects of profits being maintained is more a matter for the ordinary shareholders. In the case of public utility debentures, if the undertakings are monopolistic or practically so, the margin of income security should be the main consideration.

**Redeemable and
Irredeemable
Debentures.**

The following arguments should be considered most carefully. They are of particular importance at the time this book is going to press because monetary conditions are abnormal. For reasons that need not be entered into here, money in this country is cheaper and the yield of first-class investments lower than has been the case for a very long time past, and this, be it noted, corresponds with a period, not of good but of bad trade. A few years ago, when not only British but world trade was far better than it is now, good investments quoted on the English market were at very much lower prices than they are at present. There is no reason why in a few years what we all hope for may not come about—a big improvement in

British trade, both external and internal. If and when this does happen it is to be expected that there will be a great change in monetary conditions, and that some of the fixed income stocks which are now at high prices will depreciate considerably. This risk, and it should by no means be ignored, can, to a certain extent, be eliminated by purchasing redeemable loans and debentures.

Debentures are either irredeemable or redeemable. They are preferable in the latter form, because the purchaser of a sound redeemable debenture or bond who intends to hold until the date of repayment is unaffected by market fluctuation unless he has to sell before it is due to be paid off. Even in this event he may obtain a better price for a redeemable than for an irredeemable stock. The reason for this is quite clear; if a stock standing at a discount is to be repaid at par in 1950, the holder knows the sum of £100 will be due to him on each £100 of stock in 15 years; moreover, as the redemption date approaches the price should gradually improve, and, if it has declined in the meantime, approach par some years before the expiry of the period. This argument may be tested by the price records of any redeemable and irredeemable issues of similar yield over past years. To take a simple example, there are two issues of Newcastle-upon-Tyne $3\frac{1}{2}\%$ Stock, one redeemable in 1936, the

other irredeemable. In 1926, when interest rates were much higher than they are now, the redeemable stock with 10 years to go was at 88, the other at 71. The former subsequently advanced to par, which it would have done irrespective of monetary rates. The latter is now a few points above par but it would have stayed in the 70s if monetary conditions had not changed.

There was a time when there was a plentiful supply of sound redeemable debentures obtainable at a good discount. It is not so easy to obtain such stocks now, though there are many to be had at a few points below par. These are a suitable form of investment for those who have to pay surtax, because they are sure ultimately to appreciate, irrespective of general market tendencies, if the company, corporation or State remains sound, and the profit thus obtained, unlike dividends, is not assessed for tax. They are also suitable, even if bought at or near par, for those who are less concerned with immediate income than with the preservation of the capital sum intact. This matter is more fully dealt with in the chapter "Types of Investors."

Redeemable Debentures at a Premium. There are many redeemable loans and debentures, issued several years ago during a period of dear money, that are now quoted at a considerable premium. Just a few that might be

mentioned are Belgian 7% Stabilisation Loan at 113; Marks & Spencers 6% First Mortgage Debenture Stock at 128; Melbourne & Metropolitan Waterworks 5% Stock at 108. Such instances are very numerous, particularly among British Corporation loans and other high-grade stocks. When redeemable debentures reach a high premium it is often advisable to sell, especially if the holders are liable for income tax or surtax. The reason for this is that tax has to be paid on the full amount of interest, no allowance being made for the decline in capital value that must be expected as the redemption date approaches, although this should really be regarded as a deduction from the annual interest payments. When a stock stands above its redemption price, the risk becomes one-sided. There is little prospect of appreciation, while there is the certainty of ultimate depreciation, apart from the ordinary vicissitudes which may bring down the price of any investment. Naturally, this applies with particular force to foreign bonds, in the case of which there is often a considerable political or economic risk. How many investors must wish they had sold Chilean 7½% Bonds when they were at 109, Czechoslovakia 8% Bonds at 115, or German 7% Bonds when 110 could have been obtained.

Debentures Redeemable by Drawings. The Trust Deed securing debentures generally stipulates for a fixed sum to be set aside every year for amortisation. In the case of definitely redeemable debentures, it has to be applied by the Trustees in periodical drawings or by purchase. The terms of redemption are always well worth considering when buying debentures. If the sinking fund has to be applied to drawings at par, it sometimes imparts a favourable speculative element. If the price of the stock is at a discount, the holder has the chance of making a profit if his debentures are drawn. In any case, the establishment of a sinking fund tends to strengthen the market, the purchases from this source acting as a supporting influence. We have already alluded to the advantages of relatively short-dated redeemable debentures bought at a discount or not over par, these being much less liable to depreciation than long-dated or irredeemable stocks.

Marketability. It is rather inadvisable to hold debenture stocks of very small companies, the stock being in so few hands that an adequate market cannot be created and the sale of which, if required, might conceivably be a matter of some negotiation. An exception might, however, be made in the case of small local companies—gas, water, etc.—of which the

investor has personal knowledge. There are many stocks of this kind for which there is a constant demand by local people, which change hands rarely, and which are difficult to buy but quite easy to sell.

Definition of a Good Debenture. To summarise these notes on debentures, the ideal investment of this kind is one that returns a yield substantially higher than that which could be obtained from British Government or Corporation loans, or other gilt-edged stocks ; that is specifically secured on assets, the value of which can reasonably be expected—in the event of a forced sale—to realise enough to repay the debenture capital ; that is quoted at a discount, or at least not much over the price at which it is ultimately repayable, and that is issued by a company of repute—preferably not a new undertaking but one with some record of business success behind it. Debenture investments conforming generally to these requirements can, at the time of publication of this book, be obtained to yield from 4% to 4½%. In some cases an even higher yield can be obtained with very reasonable security.

Some readers of these notes on debentures may consider that such investments are not quite suitable for them ; they want something more exciting, something that affords prospects of

increased income and of capital appreciation to a considerable extent. They will find more to interest them in the references to industrial ordinary shares that follow, but here we would state that the experience of the publishers, extending over more than half a century, convinces them that good debentures are the most reliable form of investment for those who have no wish to speculate, who want to preserve their capital intact, and not be under the continual necessity of anxiously watching their holdings.

Preference Shares. These are a sort of halfway house between debentures and ordinary shares. Lacking the security of the former, they share the risks of the latter without the reward if great success is achieved. They are, in effect, ordinary shares with priority for dividend, and this fact should be clearly recognised. We stress this point because many investors think that preference shares are only slightly inferior in security to debentures. This is not so, or, rather, it is not so taking class for class, though there are some preference shares—and for the matter of that, ordinary shares—that are safer than inferior debentures.

There are few cases where debenture holders fail to recover something when a company goes into liquidation ; often they recover the whole

of their capital; but not infrequently, in such cases, preference shareholders incur loss of the whole of their capital. Preference shareholders rank not only after debenture holders, the bank, and all the secured creditors, but also after trade creditors, who must first be satisfied before the preference or ordinary shareholders receive anything. Before a company reaches such a pass that it has to go into liquidation, the assets are almost invariably so wasted that nothing remains for the shareholders.

**How to Judge
Preference
Shares.**

In judging a preference share, the balance sheet of the company can only be taken as a guide to the soundness of the position and the methods of finance. However substantial the assets, the preference shares cannot be considered to afford definite capital security. Their actual security depends upon the proved capacity of the company to earn dividends, and it is by that and by the surplus of profits over preference dividend requirements that the shares should be judged. The objection to preference shares is that, while lacking the specific security of debentures, dividends—except in the case of participating shares—are limited to a fixed amount. They lack also the particular attractions of ordinary shares which may advance to any price in the event of big profits being earned.

There is little point, therefore, in buying preference shares unless they yield considerably more than can be obtained from well secured debentures. The post-war years have been a most trying test for all classes of investment, and there are many preference shares issued by the biggest and most reputable British companies—shares which were at one time regarded as practically gilt-edged investments—that have failed to stand the strain, and have depreciated to a mere fraction of their former value. Nor, in saying this, have we only in mind such exceptional cases as Royal Mail and similar failures.

Much judgment is required in selecting good preference shares, and importance should be attached to the nature of the business. There are some industries that are especially vulnerable to periods of acute depression, particularly those that depend for their success upon the maintenance of price of some staple commodity, and to a lesser extent those that depend upon some process or patent which may be superseded, or upon advertising, or upon certain foreign markets that may be cut into by competition. The least vulnerable businesses are those that are monopolistic or semi-monopolistic as, for example—as already stated—electric light, water, and gas companies; next in order being those which are

unchallenged leaders dominating certain industries, and the organisation of which is so efficient that they have little to fear from competition. An example of such a business is afforded by J. Lyons & Company, Limited. It is difficult to imagine any circumstances or combination of circumstances causing a sudden change of fortune to this vast and splendidly organised concern. The quality, however, of a preference share does not necessarily depend upon the size of the company. There are many big and heavily capitalised companies, the average profits of which show only a meagre margin of cover for preference dividend requirements. And there are relatively small companies, the profits of which have shown remarkable stability for many years and which cover preference dividend requirements many times over. At the time of publication reasonably good preference shares can be obtained to yield from $4\frac{1}{2}\%$ to $5\frac{1}{2}\%$. As to whether preference shares should form any considerable part of a good investment list depends upon the object that it is desired to attain, and some guidance on this subject will be found in the next chapter, "Types of Investors."

Ordinary Shares. To deal comprehensively with ordinary share investments would require a book several times this size, and as such shares are foreign to the general purpose of this short treatise we will only deal

generally with some of the risks that should be considered when making ordinary share investments.

Some of the remarks that we have already made about preference shares apply in a still greater degree to ordinary shares. Those who have had experience of investment in the shares of rubber, tea, tin, jute, copper, agriculture, textiles, and many other industries that have suffered so severely owing to the fall in commodity prices, will fully appreciate this point. There are certain classes of ordinary shares that are much less vulnerable to general depression, and the prices of which preserve considerable stability. Amongst these may be mentioned the shares of banks and insurance companies, certain public utility concerns, and of some of the industrial companies which have achieved supremacy in their own particular spheres—Lyons, for example, United Dairies or Imperial Tobacco Company, etc.—but these are few in number, and the experience of ordinary shareholders during post-war years, and particularly from 1929 to 1933, has not been entirely satisfactory.

A matter of great importance in judging ordinary shares is not to be influenced too much by what a company has done in the past or what price its shares have commanded. Statistical

cranks used to have a peculiar method of valuing shares ; they averaged out the market price over a certain period and called it the inherent value, the assumption being that the price fluctuated up and down for no particular reason and that, if depreciated, it would come back to what it once was. We have seen forecasts made of future price movements by means of graphs and charts tracing the fluctuations over a long period and deducing therefrom that market history would repeat itself. Nothing of the sort : conditions may have changed ; markets may have gone beyond recovery ; the mighty may have fallen never to rise again. The best test is what a company has done during the most difficult conditions ; those that have stood up to the depression and increased or even maintained their profits are worth following ; they will surely do better when conditions of real prosperity return. Those that have succumbed to the depression are not necessarily worth following ; they may or may not recover.

Ordinary shareholders are entitled to the whole of the profits remaining after payment of interest and preference dividends and after such allocations as the directors deem sufficient for reserve, depreciation, etc., but they also carry the whole of the risks. Too much care cannot be exercised in making such investments. Those who lack

experience, and who have no special knowledge of the business in which they propose to invest, and particularly no knowledge of the ability of the management, should, generally speaking, avoid new enterprises.

**How to Judge
Ordinary
Shares.**

When investing in the ordinary shares of established undertakings, the prospective buyer should pay close attention to the balance sheet and, of course, to the recent results obtained by the company. The soundest companies issue clear and informative balance sheets, but let it be said here that to detect weak points in a balance sheet is no simple matter; it requires some accountancy knowledge. Loans from bankers, for example, should not be passed over without question; such loans are usually secured by a first charge on assets, and it is not the business of a bank to advance funds to an industrial undertaking on a permanent or indefinite arrangement.

The reserves are very important and should be shown separately. Sound companies make a point of creating substantial reserves which will stand them in good stead during periods of bad trade and serve, if necessary, for equalisation of dividends. Some balance sheets show depreciation reserve, but it must not be assumed that this is necessarily a cash reserve. It is merely a

provision for the diminution in value that has taken place in the properties, plant or machinery, and may be represented by any assets other than cash.

Secret Reserves. It sometimes happens in the case of very sound and conservatively managed companies that the balance sheet does not present an adequate picture of the real strength of the undertaking. There are secret reserves that have been created by writing down assets, by making more than adequate provision for depreciation, bad debts, and other contingencies, or by writing off capital expenditure that has been incurred for the development and betterment of the business in the current year's profit and loss. These cases, however, are the exception. Balance sheets too often err in the other direction; assets appear that are by no means tangible, such as goodwill and preliminary expenses, and reserves that are not cash reserves and cannot be considered as liquid assets. Sometimes also development expenditure is treated as an asset whereas the more conservative policy would be to charge some part of it at least to current revenue. Another danger point in balance sheets is loans to subsidiary companies. This, in fact, is one of the greatest dangers and the financial history of the past few years has provided many examples of the disastrous results of interlocking finance.

The main points for an investor in ordinary shares to consider may be summarised as follows :

Is the business well established ?

Has it obtained steady results in the past, particularly in the recent past ?

Is it especially vulnerable to competition or dependent for its profits on the maintenance of the market value of some commodity, or on some patent or on some special process ?

Are there adequate reserves, and does the balance sheet give a clear presentation of the actual financial position ?

Are the finances involved with those of subsidiary companies, and, if so, what is the position of these subsidiaries ?

Does the yield, based on recent dividends at present price, compare favourably with that of other similar securities ?

Readers who have had experience of investing in ordinary shares during the past fifteen years will need no reminder that many companies which appeared at one time sound and in a strong position have been brought down by the failure of their subsidiaries.

It is true that in favourable circumstances, that is, with a certain degree of good luck, more money can be made by investing in ordinary

shares than in debentures, but the risks are far greater, and the investor who feels in doubt about his financial judgment and knowledge had better leave this class of investment—or speculation—to the more experienced.

CHAPTER III.

TYPES OF INVESTORS

A Definite Investment Object. A matter of great importance in the selection of investments is to make an attempt to conform to some definite object that the investor may have in view. There are many who pay little regard to this, thinking that if a stock is good it must necessarily suit everyone. It is clear, however, to take an extreme case, that what is suitable for a trustee is not so for an investor who wishes to obtain the highest possible return from his capital and *vice versa*. Means can, to some extent, be adapted to ends and, within reasonable limits, the investor can aim at a certain objective with good prospects of attaining it. For example, it would not be impracticable for an investor who is contemplating retirement in, say, fifteen years' time, and who is in receipt of an earned income sufficient in the meantime for his needs, to settle upon a definite investment policy—and keep strictly to it—as a result of which capital may be increased substantially over that period.

Another quite reasonable investment policy might be to so arrange that a portion of the capital would be realisable at any time without loss, in fact certain portions at certain times, as there are some investors who are able to anticipate what calls are likely to be made upon them and when, as, for example, money will be required for educational purposes, or for starting sons or daughters in business or professions. The safest way to attain this object is by means of debentures or loans which mature on certain dates. This policy is not incompatible with a reasonable yield, say an average income of about $4\frac{1}{2}\%$.

The formulation of a definite investment policy is much more important than most people realise. Investment lists consisting of very mixed holdings bought at random are all too common, and often produce unsatisfactory results. All our business readers will admit that organisation and system are necessary to achieve efficiency. The same applies to investment, though there are many who fail to realise it. Lists constructed in accordance with a well-considered plan are more likely to be successful and to fulfil the investor's personal requirements than those that have been formed without a well defined policy in view. It is possible by thinking ahead and by adhering to a well considered plan to reduce the element of chance and to make arrangements for the

future with some degree of assurance. There are some investors who can afford to take risks ; others who can not, and the latter should not, under any consideration, strive for a higher yield than is compatible with safety.

Having decided upon the investment policy to be adopted, the investor should adhere strictly to it whenever he makes any fresh purchases of stock.

Classification of Investment Requirements. In a book published at the offices of the *Financial Review of Reviews* in 1909 some twenty classifications of different investment requirements were given. With so many, the distinctions are necessarily fine, but in order to illustrate the point that we are making, that is, the advantage of adapting schemes of investment to special requirements, four broad classifications will suffice. We will show how they differ from one another and outline a policy which might be pursued in every case to achieve the desired result.

CLASS 1.—The provision of a definite capital sum for educational or other purposes within a short term of years.

CLASS 2.—A policy suitable for investors who are not dependent on the income from their capital, and who, for various reasons, anticipate the necessity of realising substantial sums from time to time at very short notice.

CLASS 3.—A policy suitable for investors who have sufficient income for their present needs but who wish to accumulate as much capital as possible against the time when they retire.

CLASS 4.—A policy suitable for those who do not anticipate the necessity to realise capital but who want to benefit as much as possible from their capital immediately and who, therefore, desire as large an income as possible without taking unreasonable risks.

These four classifications are simply given as an indication of what we mean by suggesting that investors should have a definite policy. Numerous slightly different investment objects might be named and readers will have no difficulty in suggesting other special cases which would require rather different treatment from that outlined below.

In the *Financial Review of Reviews* for March, 1922, four investment schemes were published, the subsequent results of which will serve to illustrate this argument.

CLASS 1.

Provision of a
Definite Sum
Within a Short
Term of Years.

The scheme on page 44 was suggested with this object in view. The valuation in the last column is that ruling at the date of the publication of this book, and it is interesting to note that the scheme has fulfilled its object, namely, rapid

SCHEME 1

SUITABLE FOR CLASS I.—INVESTORS WHO WISH TO PROVIDE A DEFINITE CAPITAL SUM WITHIN A SHORT TERM OF YEARS.

[This, and the following schemes, are reprinted in an abbreviated form from *The Financial Review of Reviews*, March, 1922. Columns have been added to show the values in May, 1931—before the conversion of 5% War Loan to 3½% Stock—and in February, 1935. The values of stocks that have been redeemed are included for purpose of comparison.]

Security.	Price Feb., 1922.	Cost.	Income.	Redemption Dates.	Values on Redemption.		Values May, 1931.		Values February, 1935.	
		£	£ s. d.		£	s. d.	£	s. d.	£	s. d.
£300 Midland Elec. Corp. 5% 1st Mge. Deb. Stk.	82	246	15 0 0	1933 at 102½	307	10 0	(c) 307	10 0	(c) 307	10 0
£300 Vickers 4% 1st Mge. Debs. (a)	70	210	12 0 0	1937 at par	300	0 0	298	10 0	312	0 0
£300 South Manchurian Rly. 4½% Stg. Bonds	76	228	13 10 0	1936 at par	300	0 0	294	0 0	300	0 0
£300 Victoria Falls & Transvaal Power 5% 1st Mge. (tax-free) Debentures	102	306	21 8 0(b)	1936 at 110	330	0 0	333	0 0	(c) 330	0 0
		£990	£61 18 0		£1,237	10 0	£1,233	0 0	£1,249	10 0

(a) Exchanged for 5% Debentures in 1924: the income, therefore, has been more than calculated.

(b) Tax is allowed for in the calculation.

(c) Redeemed.

appreciation in capital value. A slight digression is necessary here. It must not be supposed that what could be done in this way 13 years ago is so easy now. Monetary conditions have changed and there is nothing like the same choice of debentures quoted at a discount that are redeemable within a short term of years at par. Though the main object can be attained, that is, the provision of a definite sum within a short term of years, it would be much more difficult to construct a scheme that would be likely to show substantial capital appreciation.

It will be observed that the scheme provided for the distribution of the capital between four securities of good quality, all representing different investment risks. The gross annual income at the time the list was published was a little more than $6\frac{1}{4}$ per cent. The average period to maturity was $13\frac{1}{2}$ years and the profit on redemption £247. Thirteen years have elapsed and the value now, allowing no appreciation from reinvestment of capital from the one that was redeemed, is £1,249. A point to note is that the increase of capital thus obtained would not have been liable to the deduction of income tax. It was assumed that the interest from the invested capital would be required by the investor and retained for his own use. It will be noted, however, that one of the stocks in the above

scheme was redeemed in 1927 at 102½ and in calculating the appreciation this portion of the funds is assumed to have earned no further increment. In point of fact, however, it would have been easy in 1927 to have reinvested in another redeemable debenture stock at a discount, in which case the capital appreciation would have been greater.

CLASS 2.

Provision for Realising Capital From Time to Time at Short Notice.	The requirements in this case differ from those of investors who are described under Class 1 in so far as it is anticipated that calls necessitating the realisation of capital may come at frequent intervals and at short notice. It is, therefore, desirable that the stocks selected should be of good quality, and it is also necessary to ensure that at least some portion of the capital should be realisable at any time without loss.
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An investment scheme suitable for this class was also published in the *Review* in March, 1922, and is reprinted on page 47. Here we would state that the schemes we are reprinting were only intended as an illustration of how to obtain the various objects proposed. No investor who came to the publishers for suggestions of how to invest a considerable amount of capital would be

SCHEME 2

SUITABLE FOR CLASS 2.—INVESTORS WHO ARE NOT DEPENDENT ON THE INCOME FROM THEIR INVESTED CAPITAL, BUT WHO MAY REQUIRE TO REALISE SUMS FROM TIME TO TIME AT VERY SHORT NOTICE.
(See note to Scheme 1.)

Security.	Price Feb., 1922.	Cost.	Income.		Redemption Dates.	Values on Redemption.		Values May, 1931.		Values February, 1935.	
		£	£	s. d.		£	s. d.	£	s. d.	£	s. d.
£200 Queensland 4½% Loan 1920/5	93	186	9	0 0	1925 at par	200	0 0	(c) 200	0 0	(c) 200	0 0
£100 War Loan 3½% 1928	91	91	3	10 0	1928 at par	100	0 0	(c) 100	0 0	(c) 100	0 0
£100 City of Yokohama 5% Loan 1929	83	83	5	0 0	1929 at par	100	0 0	(c) 100	0 0	(c) 100	0 0
£200 Cammell Laird 5% 1st Mge. Debs. (a)	82	164	10	0 0	1930 at 103	200	0 0	151	0 0	150	0 0
£200 Underground Electric 4½% tax-free Bds.	98	196	*13	0 0	1933 at par	200	0 0	(c) 200	0 0	(c) 200	0 0
£100 Prov. of Saskatchewan 5½% Stock	95	95	5	15 0	1934 at par	100	0 0	(c) 100	0 0	(c) 100	0 0
£100 S. American Stores 5½% tax-free Debs.	102	102	*7	16 0	1937 at 105	105	0 0	105	0 0	107	10 0
£100 Newcastle - on - Tyne Elec. Supply 4½% 1st Mge. Debs. (b)	78	78	4	10 0	1939 at par	100	0 0	91	0 0	(c) 105	0 0
		£995	£58	11 0		£1,105	0 0	£1,054	0 0	£1,062	10 0

* Allowing for tax.

- (a) Due for redemption in 1930, but arrangements were made to extend the redemption date and raise the interest to 5½%.
- (b) Name changed to North-Eastern Electric Supply Co., October, 1932.
- (c) Redeemed.

told to choose so few stocks ; a much wider distribution would be desirable. The fact, however, that the schemes have fulfilled the requirements stated despite the inadequate distribution, still further emphasises the advantages of formulating a definite investment policy.

At the time Scheme 2 was published, the income from the stocks selected averaged over $5\frac{7}{8}\%$ with a prospective profit on redemption of £110. As already stated, it was assumed that the investor expected to have calls made upon his capital periodically and wished to be in a position at any time to sell out some of his investments without loss. Income and redemption profit were, therefore, to some extent, subordinated to this consideration.

It will be noted that this scheme differed from the first one in that redemption fell due on various dates following quickly on the year 1925. Prices have been brought up to February, 1935, and the scheme has realised its object in that one or other of the investments named would have been saleable at any date subsequent to March, 1922, at a profit. Unfortunately one of the companies was unable to withstand the depression and there was a default in interest payments, with consequent heavy depreciation in capital. Despite this some appreciation is shown. It is, of course,

possible—in fact, probable—that the investor might have sold the Cammell Laird debentures at a much better price than that now ruling when it appeared that redemption on the due date was not likely to be effected, and if some of the money from the redemption of other stocks had been reinvested this scheme might have shown better results. The main point is that it well fulfilled its object of providing capital at short recurring intervals.

CLASS 3.

Provision for
Capital
Appreciation.

Before discussing the scheme on page 51 which was also published in 1922, it is necessary to point out that it would be far more difficult at the present time to construct a scheme making provision for substantial capital appreciation. It could be done, but conditions are less favourable; prices of good stocks are abnormally high, and even in the case of quite speculative stocks future prospects are often discounted some way ahead in the price. Investors who are working for capital appreciation can perhaps afford to take slightly greater risks than those who are described under Classes 1 and 2, but clearly it would not be good policy to buy essentially speculative stocks: the risk to capital would be too great and there would need

to be exceptional results from the lucky investments to make up for any complete failures. Unless retirement is anticipated at an early date and it is then proposed to purchase an annuity or to deal with the capital in some other way, there is no necessity for an investor described under Class 3 to acquire very short-dated stocks. Securities maturing in a period of from 15 to 25 years might be more suitable, and some of these afford greater scope for ultimate capital appreciation.

The scheme on page 51 was published at the same time as the others and was designed to meet cases falling under Class 3. It originally provided for an income of over 7% with ultimate capital appreciation of over 50% upon the original amount invested. It was judged better to confine the selection to definitely redeemable stocks as appreciation might then be relied upon as maturity approached, independently of whether money became dearer or cheaper. It would not be so easy to find such stocks now and in constructing a scheme likely to show good capital appreciation it might be necessary to include other kinds of investment; possibly the shares of some first class industrial company or banking or insurance shares, or the shares of monopolistic or semi-monopolistic undertakings, such as electric supply, gas, etc. It will be noted that with

SCHEME 3

SUITABLE FOR CLASS 3.—INVESTORS WHO HAVE SUFFICIENT INCOME FOR THEIR PRESENT NEEDS
BUT WISH TO ACCUMULATE AS MUCH AS POSSIBLE AGAINST THE TIME WHEN
THEY RETIRE.

(See note to Scheme 1.)

Security.	Price Feb., 1922.	Cost.	Income.		Redemption Dates.		Value on Redemption.		Values May, 1931.		Values February, 1935.	
		£	£	s.	d.		£	s.	d.	£	s.	d.
£200*Palmer's Shipbuilding & Iron 5% 1st Mge. Debs.	76	152	10	0	0	1940 at par	200	0	0	94	0	0
£200 Sir J. L. Hulett's 5% 1st Mge. Debs.	71	142	10	0	0	1940 at par	200	0	0	(a) 210	0	0
£200 Canadian Vickers 6% 1st Mge. Debs.	83	166	12	0	0	1941 at par	200	0	0	(b) 206	0	0
£200 Edmonton, Dunvegan & B. Columbia Rly. 4% 1st Mge. Deb. Stk.	74	148	8	0	0	1942 at par	200	0	0	184	0	0
£200 Japanese 5% Loan 1907	56	112	10	0	0	1947 at par	200	0	0	188	0	0
£200 Mappin & Webb 4½% 1st Mge. Debs.	62	124	9	0	0	1948 at 105	210	0	0	162	0	0
£300 Freehold & Leasehold Investment 4% 1st Mge. Debs.	51	153	12	0	0	1950 at par	300	0	0	208	0	0
		£997	£71	0	0		£1,510	0	0	£1,252	0	0
										£1,299	10	0

* Exchanged for 6% 1st Mortgage Debenture Stock, 1927.
(a) Redeemed at 105%, 1927. (b) Redeemed at 103%, 1928. (c) Redeemed at 105%, 1933.

the prices brought up to February, 1935, this scheme would have given the investor a very satisfactory income with capital appreciation of over £300.

At any time within the past nine or ten years a considerable profit would have been shown. The scheme included one very unfortunate selection—Palmer's Shipbuilding and Iron 5% Debentures—which, owing to the prolonged and severe depression in the shipbuilding industry, got into a bad way. This stock might have been sold before such heavy depreciation occurred. It will be noted also that two of the stocks were redeemed at a premium, and in calculating the appreciation the actual amount received on redemption has been taken. It may be assumed, however, that the investor would have replaced these holdings by other redeemable stocks purchased at a discount, which by this time would have improved in value, thus increasing the total appreciation.

CLASS 4.

Provision for a High Yield.

Investors to whom this classification applies are concerned mainly with income; it is easy to imagine circumstances which would make them indifferent to some degree of risk. They might be advanced in age with no dependents;

SCHEME 4

SUITABLE FOR CLASS 4.—INVESTORS WHO WANT AS LARGE AN INCOME AS POSSIBLE FROM THEIR SECURITIES AND DO NOT ANTICIPATE THAT THEY WILL REQUIRE TO REALISE CAPITAL.

(See note to Scheme 1.)

Security.	Price Feb., 1922.	Approximate Cost.	Annual Income.	Values May, 1931.	Values February, 1935.
	£	£	£ s. d.	£ s. d.	£ s. d.
£200 Westinghouse Brake & Saxby Signals 8% 1st Mge. Debs. ..	100	200	16 0 0	(a) 200 0 0	(a) 200 0 0
£200 Thos. Summerson & Son 8% 1st Mge. Debs.	96	192	16 0 0	(b) 210 0 0	(b) 210 0 0
£200 Rbt. Heath & Low Moor 5½% Tax-Free Debs.	85	170	*15 14 0	†20 0 0	**
£200 Prov. of Buenos Ayres 4½% Ext. Gold Loan 1909	58	116	9 0 0	148 0 0	115 0 0
£300 Freehold & Leasehold Investment 4% 1st Debs.	51	153	12 0 0	208 0 0	280 10 0
£200 Natal Land & Colonisation 8% Cum. Pref. Shares (£5 each) ..	par	200	16 0 0	230 0 0	240 0 0
		£1,031	£84 14 0	£1,016 0 0	£1,045 10 0

* Allowing for Tax.

† For Valuation Purposes.

** Company in liquidation.

(a) Redeemed at par, 1927.

(b) Redeemed at 105, 1931.

they might have endowment assurance money coming in at a later date ; or they might have reversionary interests. In such cases it would be a very natural policy to stretch income as far as possible without taking unreasonable risks. The scheme on page 53, also published in the *Review* 13 years ago, was designed on the assumption that the necessity for realising capital was not likely to arise. It was, therefore, a matter of some indifference whether the stocks were redeemable or not. It was considered better to disregard short-dated stocks altogether as their inclusion might call for the reinvestment of capital at a time when interest rates might be less favourable.

The plan proposed provided for a yield of nearly $8\frac{1}{4}\%$, the maximum which could then have been obtained without great risk. Now, of course, the yield obtainable is much lower. The debentures included, with one exception (Thomas Summerson & Sons 8% Debentures, due 1936), were long-dated and were not expected to be called in at short notice. Interest on every stock has been paid regularly except in the case of the $5\frac{1}{2}\%$ Debentures of Robert Heath & Low Moor, which company went into liquidation in February, 1928, when a receiver and manager was appointed on behalf of the debenture holders. Interest was paid until February,

1927. This company, in common with others engaged in the coal and iron industries, was severely affected by the coal strike of 1926 which rendered it impossible to carry on except at a heavy loss. In this case the investor might have avoided much of the loss by taking warning from the trend of events and selling before the collapse came. Notwithstanding this total loss of capital, the scheme shows a slight appreciation, and during the twelve years the investor would have had many opportunities for realising at a substantial profit.

This result may be regarded as satisfactory, but it is only right to add that the capital security of the stocks selected on account of their high yield could not have been expected to equal that afforded by lower yielding investments. In cases of this sort a wide distribution of investment risks is particularly important, and from this point of view the scheme scarcely covers a sufficiently wide field. The same may be said of the other schemes, and with greater diversification of risks better average results would probably have been shown.

At the present time an investor looking for capital appreciation and prepared to take some risks, though not purely speculative risks, might possibly obtain a yield of about 6%, but he

would not get this return nor his scope for appreciation from good debentures.

It may be added that all four schemes included foreign bonds which would certainly find no place in similar investment plans constructed to-day. These served their purpose well for a number of years, but in actual practice ought to have been sold when the position became so speculative that they could no longer be judged suitable for the particular objects aimed at by the investor.

In the chapter that follows attention is called to a very important, almost a fundamental, principle of sound investment—distribution of risks.

CHAPTER IV.

DISTRIBUTION OF INVESTMENT RISKS

The Principle of Averaging. All investors are familiar with the saying “Do not put all your eggs in one basket,” but this does not go far enough. The baskets might all be on one cart and the distribution, therefore, quite ineffective. Some investors who have been very successful have paraphrased this old adage by advising people to put all their eggs in one basket and look after the basket—in other words, to invest in something of which they have a thorough knowledge and concentrate to the utmost in following progress and watching for developments which may have a favourable or unfavourable effect upon the prosperity of the particular undertaking. However, investors who are capable of doing this and who trust their own knowledge and judgment to such an extent are not in need of any advice.

The most risky business in the world but for distribution would be that of an insurance company—yet, in fact, owing to scientific averaging of risks it is one of the safest. The same principle

applies to investments, and while it is not practicable for the private individual with a relatively small capital to achieve the wide distribution effected by insurance companies, it is possible to guard, to some extent, against the unexpected by dividing capital evenly amongst investments that are not likely to be adversely affected by precisely similar political, economic or industrial conditions.

A Bad Distribution. We have already alluded to rubber, tin, tea, jute and other industries, dependent for their prosperity upon the price maintenance of these commodities at an economic level. Whatever knowledge had been possessed some years ago by an investor who had concentrated on rubber holdings, even if none but the very best securities in this group had been chosen, enormous losses would have been experienced. But we need not take such a speculative market as rubber. Recently, when Australian Commonwealth and State Loans (trustee investments) were considered likely to default, prices were 40% to 50% down. At the time of publication the danger has passed but many investors who had disproportionately large holdings in Australia received a severe shock, and the advisability of distribution of investment risks was forcibly brought home to them.

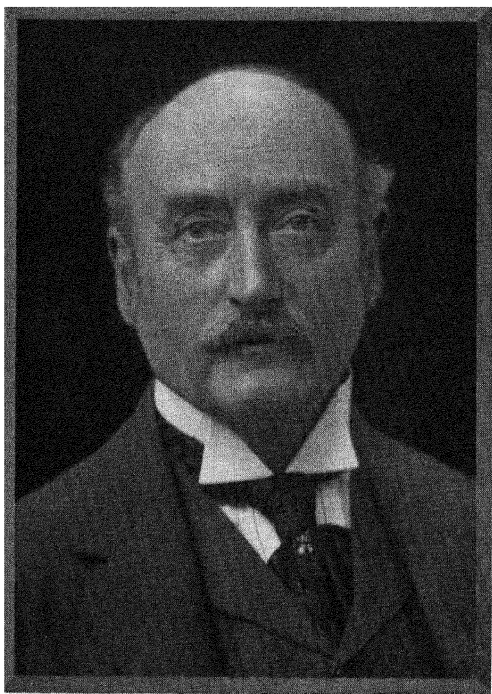


Photo by Elliott & Fry Ltd.

THE RIGHT HON. W. HAYES FISHER, P.C., afterwards
LORD DOWNHAM, President of the Local Government
Board 1917-1918.
Chairman of Investment Registry Ltd. 1911-1915.

The Effects of the World Depression. Distribution of investment risks is, as already stated, one of the main principles of sound investment, and when carried into practice it is reasonable to expect that, while some stocks may show a loss, a well-distributed list of sound investments may, in normal times, maintain its total value reasonably well. The experience of 1929-33 has unfortunately shown that, given conditions that are entirely abnormal and world-wide in their incidence, the avoidance of loss is extremely difficult whatever precautions are adopted. The economic and financial distress during that period was so severe and so unforeseen that few investors, even those with the soundest and best balanced lists, succeeded in escaping misfortune. The matter is relative. Those who were careful in the selection of their stocks and in the distribution of risks lost much less than those who invested indiscriminately.

Main Principles of Distribution. It is not enough to divide the capital between a number of securities. Mere multiplication of the holdings does not necessarily ensure the risks being adequately spread. It is very important that each holding should, so far as possible, be influenced in its price movements by different conditions. For instance, if the

investor wished to confine his holdings entirely to British stocks it would not do to purchase three or four different railway investments, or several textile companies' shares, or a number of investments all more or less connected with the iron and steel or engineering trades. This would not provide a satisfactory distribution, as the same causes that might adversely affect one investment would probably affect all others connected with that industry. Failure to observe this principle is a fruitful source of loss, and investors who have watched the course of the particular industries referred to above will realise the truth of this.

Again, many investors have a partiality for the stocks of a particular industry because it is connected in some way with the trade or profession they practise. This is a dangerous policy since it frequently happens that bad results from investments come at a time when the investor is also hit in his own business.

An all-British list should comprise investments that are dissimilar in character and, therefore, not likely to be affected in their price movements by similar industrial influences. For example, if the list were to consist of ten or twelve holdings, a good distribution would be—one Government or Municipal loan, one or two public utility stocks, and a number of securities representing different industrial interests such as iron and

steel, textile, breweries, chemicals, investment trusts, property, catering or stores and general manufacturing such as tobacco, soap, etc., for which there is a large and steady demand. This would not be an ideal distribution of investment risks but it would be a reasonably good arrangement for an investor who wished to confine his interests to this country.

To give some sort of concrete example, a satisfactory distribution, assuming the capital to be invested were £5,000, might be obtained by investing £250 or £300 in fifteen or twenty investments of the following kinds :—

The debentures or shares of a British electric supply company ;

A British real estate company ;

A British industrial debenture secured on multiple shop property ;

Three or four British industrial debentures secured on general industrial assets, but covered several times over both as to capital and interest, no two being in industries of an entirely similar character ;

Two or three Dominion, State or Provincial loans, or Provincial guaranteed railway debentures ;

Dominion land mortgage debentures ;

British or Dominion banking shares ;

British insurance shares ;

Possibly one or two of the very best foreign bonds.

For the information of those who have not hitherto considered the methodical distribution of investment risks, we summarise briefly the main principles of good distribution :—

- (1) The securities selected should, so far as can be done, be diverse in character ; to repeat what we have already said, it would be no effective distribution to have a number of textile investments or home railway stocks all of which are likely to be affected in their price movements by the same conditions.
- (2) Reasonable equality in the amount of each holding is desirable.
- (3) The stocks selected should, so far as possible, be similar in quality, as this helps to equalise risks.

We would explain that these principles, although obviously sound, are in a sense generalisations. It may be necessary or advisable to depart from them to some extent according to the particular policy of the investor, or exceptions may be made according to the particular stocks selected, or special circumstances.

The reason for (1) will be apparent to any investor who consults reference books giving quotations for stocks for a number of years back. He will find that certain classes of industrial shares have, with a few outstanding exceptions, all moved the same way. The industries are

subject to similar economic influences or there may be political circumstances which affect them all alike. To mention an extreme case, we might suppose the advent of prohibition and imagine its effect upon the whole of the brewery and distillery trade. In such cases, it would be no protection to have the capital divided amongst a number of good brewery investments; they would all be affected alike. We have seen during recent years a heavy fall in the prices of first-class long-dated or irredeemable fixed income securities, all moving the same way. More recently, we have seen a remarkable recovery which also was shared by all alike. These movements are due to exceptional monetary conditions, but there are many circumstances that may cause certain general groups of investments to be all more or less favourably or unfavourably affected in price. In many cases, investors who have failed to achieve a good distribution of risks have suffered very severe losses. Distribution, to be effective, must cover various industries or even countries.

Balancing the Risks. The reason for (2) and (3) will be equally obvious when it is remarked that the main object of distributing capital in this way is that a fall in the price of one stock may be offset to some extent at least by a rise in another. The necessary balance is not

likely to be attained if the amounts invested in some securities are several times greater than in others. A less important point is that some attempt should be made to obtain fairly uniform quality. Without this, the investor might have a large part of his capital in quite speculative stocks, liable to very heavy fluctuation, and the rest in fixed income stocks which, owing to redemption terms or other reasons, could not possibly appreciate sufficiently to counterbalance any losses sustained from the speculative section. While no hard and fast rule can be laid down, the general principles that we have indicated are at least worth considering very carefully.

Alternative Investment Plans. Investors who have read this chapter up to this point may make this criticism, namely, that the biggest and most expert investors in the country do not adhere to such rigid rules. It will be seen from the lists that are published of trust companies and insurance companies' investments that British gilt-edged stocks, Government loans, etc., industrial debentures, public utility companies' debentures, preference shares and even ordinary shares are held, while in some of these lists will be found a very fair sprinkling of foreign stocks. The answer to this criticism is that such companies are investment experts ;

they are continually changing their investments, and they carefully watch them ; they have access to information that is not readily available to the lay investor ; they are in touch with markets. In short, they know what they are doing and they have such large funds for investment that they have to take what seems to them best for the time being. The small capitalist cannot hope to emulate the skill of these big investors.

Some careful investors think it a good plan to set aside a certain proportion of their capital for investment in what are commonly known as gilt-edged stocks—British Government and Corporation loans and such like—and to take risks with the remainder. Others devote fixed proportions to various classes of securities as, for example, 20% in trustee stocks, 20% in second grade debentures, 20% in preference shares, and the balance in ordinary shares or foreign bonds. Plans such as these, although far better than no plan at all, lack the advantage of really well-balanced investment risks. There is no relation between the separate classes, and the individual items are so dissimilar in quality that, apart from the question of the risks overlapping, they cannot be expected to have that balance of price movements that it should be the object of capital distribution to achieve.

World-wide Distribution of Capital. We have referred to the system of dividing the capital for investment into equal parts and the number of holdings should naturally vary according to the amount involved. We have also referred to the great importance of distribution by industries, the ideal to be aimed at being that no two holdings should be influenced by similar industrial conditions, a counsel of perfection which it is not always practicable to attain. But distribution can be carried a step further by spreading risks geographically as well as by industries.

At the date of publication of this book, the foreign investment field is greatly restricted, and there are few countries, the political and economic conditions of which can be considered sufficiently stable to justify investment by those who wish to pursue a "safety-first" policy. If, however, the distribution of risks is extended to the British Dominions and a few of the very soundest foreign countries, the prospects of average stability of capital value are enhanced. The investor who pays close attention to distribution of risks obtains at least partial protection from the serious effects of some unexpected political or industrial development, and generally is able to obtain a somewhat higher average income yield.

The system we are describing is not an arbitrary scheme drawn up in accordance with the theories of an individual, but is a commonsense application of the law of averages. It is not claimed to be an infallible safeguard against loss, for there is no system that can withstand the combination of every adverse circumstance that may arise, but it has been proved by experience to be a reliable means of reducing investment risks.

Summary of As mentioned in the preface, a
Preceding common defect of books on invest-
Chapters. ment is that they cover too much
ground and the reader is left with
only a vague impression of how to put the
theories advanced into practice. The subject is
too comprehensive for adequate treatment in a
small volume ; to do justice to it an encyclopædia
of investment could be written. Readers who
are interested in the suggestions made can
supplement their knowledge by referring to the
financial and economic Press or to standard works
on particular industries and markets. This little
treatise is no more than a general guide to the
underlying principles of sound investment ; it is
based on the experience of an investment house,
founded over half a century ago, which in
rendering service to its large connection, has had
the opportunity of analysing closely the results

obtained by investors large and small—by speculators as well as by those who thought they were playing for safety—and this during times of depression and “booms,” during war and peace, during periods of severe political tension and of stable conditions. The book will have achieved its purpose if it convinces the reader of the importance of

Distinguishing between investment and speculation ;

Approaching investment matters systematically ;

Having a definite object in view and paying due consideration to this in connection with all purchases or alterations ;

Distributing investment risks in such a way that no undue proportion of the total capital is likely to be affected by similar industrial, economic or political vicissitudes ;

Judging investments on their real merit and acquiring sufficient knowledge to arrive at a correct judgment (see chapter II) ;

Attaching more importance to capital security than to yield and, if a moderate yield will suffice, preferring debentures with a specific charge on tangible assets to preference or ordinary shares.

Here we may add a few ‘don’ts’ which will help a little to summarise the points made in the preceding chapters.

Don’t buy anything that you know little or nothing about. Make reasonable enquiries first.

If, after having made such enquiries, there is something that you do not understand or are doubtful about, leave it alone. It will be safer.

Don't be either an optimist or a pessimist. Something good may turn up, but more probably it will not. Something good turned up for Micawber in the end, but he did not deserve it. If you have to be one or the other it would almost be better to be a pessimist. Anyone can be excused pessimism who has had much to do with optimists.

Get to understand the assets side of a balance sheet: that is where the doubtful points are likely to be. Consider the balance sheet as the most important exhibit when you are making enquiries as to some intended purchase.

Distribute risks, and don't take unnecessary risks for the sake of a little extra yield. The value of diamonds increases out of all proportion according to their size, and the risks attached to investments increase out of all proportion according to their yield. Many investors endanger their capital for an extra $\frac{1}{2}\%$ or 1% . It is not worth it.

Don't hesitate to cut a loss if circumstances suggest it. Ignore past results and prices and judge a business by what it has done recently particularly by what it has done during difficult conditions. Balance prospects of appreciation against those of loss. To take an extreme example an investor might have a doubtful foreign bond quoted at 85. Owing to redemption terms its scope for increase might be limited to 15% , but in certain unfavourable circumstances it might result in complete loss. If debentures

are being bought consider the actual security of the assets, not as a going concern, but the probable break-up valuation if the assets had to be compulsorily sold.

In buying ordinary or even preference shares that have no specific security, judge by the margin of dividend cover, the reserves and also as to what the company has done during recent years, especially during times when business has been bad. What it has done years ago under favourable conditions is past history and may have little or no bearing upon the present.

The chapter entitled "Types of Investments" should be read carefully ; it deals with important questions of policy to which most investors rarely give any thought. Those acting on the lines indicated will, at least, avoid many of the losses and disappointments that are experienced by people who handle their investment affairs in a casual way.

CHAPTER V.

RE-SHAPING INVESTMENT LISTS

Initial Mistakes. In the foregoing chapters the subject of investment has been dealt with mainly from the point of view of those who do not hold any securities and who are entering upon investment for the first time. Doubtless many of the readers of this book already possess investments and will be desirous of ascertaining whether their capital is placed in accordance with sound investment principles, and, if not, how any defects can be remedied.

From what has already been said it will be appreciated that capital is often invested with but a vague idea of the degree of security afforded and certainly with no attempt towards a definite investment policy. The very skilled investor may know quite clearly what he is doing; his policy is to apply knowledge to investing as he would to business. He acts according to his own theories, his own judgment, and is not in need of advice. But the unskilled investor is very apt to go sadly wrong and, even

if he makes no serious mistakes involving him in heavy loss, he may become possessed of investments that, although satisfactory in their particular class, are quite unsuited to his individual requirements.

Setting the Crooked Straight. Initial mistakes made can, to some extent, be rectified by subsequent action. It is not necessary to continue holding stocks that do not fulfil the investor's requirements, and, provided that the securities are capable of realisation, even the most ill-assorted list can be revised and put on a proper basis in a comparatively short time. Nor need the expense of brokerage, Government stamp and transfer fee, be a deterrent. The expense involved in the revision of an investment list is small compared with the advantages that can often be derived from a rearrangement.

There are three metaphorical animals on the Stock Exchange—bulls, bears, and stags. Most investors are bulls, inclined to rush at things; otherwise optimists. Bears are more subtle and more cautious; they are to be found mostly amongst the professional classes. The stags, who are having a fairly good time at present, number in their ranks both amateurs and professionals, but the latter cease being stags when they see markets beginning to fall. This leads

up to the natural tendency of investors to buy on a rising market, to stag new issues when the going seems to be good, but to be most averse to selling when prices are down. The peculiar view is taken that what has been, will be ; that if a stock bought at a certain price is now very much lower it is only a case of the swing of the pendulum for it to come back. But, of course, that is all wrong. The price the stock commanded in the past has no relation to its present value ; circumstances may have changed completely. Depreciation too often deters investors from selling securities that, for one reason or another, have ceased to be attractive or that no longer conform to the investment object in view. Prices are constantly fluctuating, and income is subject to variation ; accordingly, investments that may have been desirable at the time of purchase may subsequently become unsuitable. This not only applies to stocks that have become unsound and the prices of which have depreciated, but in some cases also to those that have fulfilled the investor's object and risen to prices at which they are relatively unattractive.

Reluctance to Sell. The investor's attitude towards every stock held should be : " If I were investing the capital to-day, would I buy that particular stock ? " If the answer is in the negative it is doubtful whether the stock

should be retained, assuming that it can be sold at a price not much below that at which it can be purchased. This, however, is not always the case. When the position of investments becomes unsatisfactory or, in fact, dangerous, there is sometimes a wide margin between the prices at which they can be bought and sold, and such circumstances might influence the investor's decision.

We would repeat that there is a strong tendency to retain stocks for the simple reason that they cannot be sold at the prices originally paid for them. The decline in value may be due to unsatisfactory developments that were never contemplated when the purchase was made—indeed, the position of the undertaking may be such that a further fall is more than probable—yet the stubborn disinclination to sell remains. The retention of such a stock in the hope that it will ultimately recover to its former price level frequently leads to further loss of capital which it is the investor's principal object to preserve intact.

Rearrangement— In order to get a good grasp
How to Proceed. of the position it is advisable
in the first place to prepare a
valuation and income statement containing a list of
all the holdings. Then against each security there

should be entered the following particulars:— original cost price, current quotation, present value, income derived during the past year and yield per cent. based on the present price. When this is completed and the columns totalled, the investor should be able to ascertain how he stands, for the statement will show what fluctuations in capital value and income have taken place in respect of his stocks, both individually and collectively. An attempt at classification should next be made to ascertain the distribution of risks—how much of the capital is being exposed to what might reasonably be considered the same investment risk.

This information will prove of great assistance in determining what alterations, if any, are desirable. Should the investor not have the necessary facilities for preparing such a statement, the required information can be obtained from the publishers of this book. (See page 94.)

Attainment of Investor's Object. Other points which should be considered are whether the stocks are suitable for the attainment of the particular investment objects which the investor has in view (see Chapter III) and, finally, further consideration should be given to the relative quality and attractiveness of the individual holdings. This

is rather more difficult ; it calls for expert knowledge and facilities for the careful analysis and comparison of securities. It is not hard to decide that a certain stock is reasonably safe—this can be ascertained from published facts and figures, especially if it is debenture stock—but it is more difficult to pick out from a large number of stocks of similar type and quality those which seem to be the most attractive as regards yield and security. In this respect the publishers of this book can be of assistance. (See Chapter VI.)

Many investment lists which are otherwise well constructed include one or more stocks that have not come up to expectations or that are not revenue-producing. These stocks may have been held for some years and their value may have been steadily declining, yet the investor has hesitated to realise. Individually, these stocks may not fetch good prices, but in the aggregate they may realise an amount which, if invested in sound income-producing securities, might make all the difference to the yield from the investment list as a whole. An investor who attaches importance to a high income should, therefore, scrutinise these stocks most carefully and come to a decision whether his interests would not be better served by making exchanges. By this means further capital loss may frequently be avoided and the income appreciably increased.

If Capital Appreciation is Desired. Investors whose main object is capital appreciation will be able to ascertain from the valuation statement which stocks have appreciated and should consider whether the rise, having regard to the position of the undertaking, warrants retention or realisation. This comparison should be made periodically so that no opportunity of securing profits may be overlooked. Conversely, the value of the investments held may have diminished and the future outlook of the undertakings concerned may be such as to render sales advisable with a view to the prevention of further depreciation. Such losses can frequently be made good by reinvesting the proceeds in other securities producing a higher income or affording better prospects for appreciation.

A watchful eye should also be kept on redeemable securities. Owing to the abnormal conditions that have prevailed in the money market for the last year or so all sound companies have been taking the earliest possible steps to redeem or convert debenture stocks issued when money was dearer. There are many debenture issues still outstanding that are liable to be called in on early notice; there are others which are liable to yearly drawings at par by the operation of a sinking fund and if prices are well above par it

is desirable to consider whether such stocks are worth retaining. Largely it is a matter of yield, allowing for loss on redemption, and again of the investor's particular requirements.

Cost of Reconstruction Negligible. The publishers have had very long experience in analysing investment lists and preparing reconstruction schemes. In the great majority of cases investment lists submitted for criticism are capable of improvement in some respects, particularly as regards capital safety or increased income yield. The expense of carrying out the reconstruction of a bad investment list is a negligible factor. Sales can be balanced against purchases in such a way that brokerage expenses are fully covered without the necessity of finding additional capital, and the cost may be rapidly made up out of the advantages gained by the investor.

CHAPTER VI.

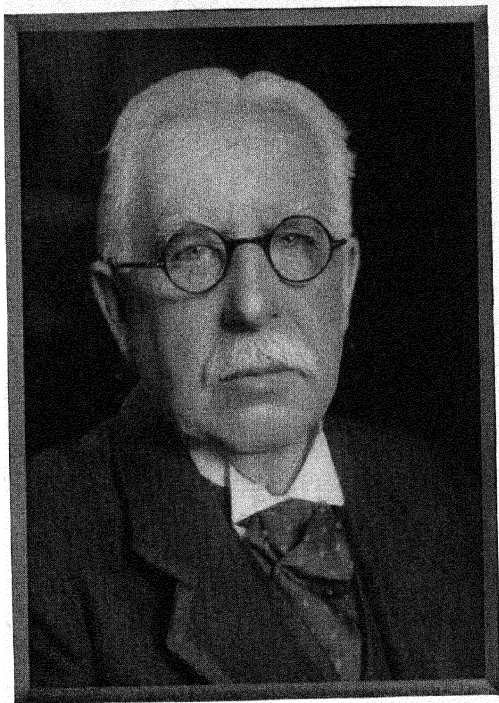
THE WORK OF INVESTMENT REGISTRY LTD.

A Description of the Business. Before referring in detail to the particular services that Investment Registry, Limited, affords to its regular connection, a brief description of the business may here be given. Investment Registry, Limited, is mainly an issuing house, specialising in debenture stocks. It underwrites the whole of any approved issues, and the directors undertake that application will be made for permission to deal on the London Stock Exchange, and orders that are received by the company for the sale or purchase of these stocks are carried out through Stock Exchange brokers.

The issuing side of the business has increased very largely during recent years, and the success that has attended the new issues sponsored and underwritten by the company is partly due to the fact that its connection consists of many thousands of substantial investors who are interested in the type of security in which the company specialises and who are regular supporters of the new issues underwritten.

This connection has been built up by service, and equally it may be said that the service has been brought to its present state of efficiency by the connection. Most successful businesses have found that specialisation pays, supplying the particular kind of goods and services that the customers want. Even in its very early days, the Registry was, to some extent, a specialised business catering for the investing classes as distinct from speculators. Gradually this aspect of the business became more pronounced; debenture issues began to be made, and the connection that gathered round the company became confined, not exclusively but very largely, to investors whose principal concern was capital security, a difficult enough object, but, as those who have read this book will probably agree, less difficult and less hazardous than attempting to obtain good results by haphazard investment or speculation.

What kind of service is most required by the investing classes? A very long experience of corresponding with investors, of interviewing them, of publishing a monthly investment magazine, of investigating investment lists and following results, has enabled the company to answer this question and act accordingly.



THE RIGHT HON. LORD MORRIS, P.C., K.C.M.G.,
Prime Minister of Newfoundland 1909-1918.
A member of the British War Cabinet 1916-1917.
Chairman of Investment Registry Ltd. 1919-1923.

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What kind of service is most required by the investing classes? A very long experience of corresponding with investors, of interviewing them, of publishing a monthly investment magazine, of investigating investment lists and following results, has enabled the company to answer this question and act accordingly.

There have been instances where the Registry, through being able to get into touch quickly with the majority of stockholders in some particular company, has achieved results which could not have been done without the aid of some central organisation experienced in work of this kind. Particularly in those cases where there are outside holders, it is often the policy of the Registry to obtain on behalf of its connection the assistance of the well-known Shareholders Protection Association Limited. This is an organisation entirely independent of any financial house or company, and has at its service trained and forcible speakers who attend general and other company meetings on behalf of debenture holders or shareholders when it is considered desirable. It has a virile and energetic management for the work for which it was formed.

Thirdly, a need felt by many investors is to be in touch with a financial institution that can answer, and will spare no pains in answering questions—sometimes long, difficult and numerous questions—on matters not only pertaining to individual stocks but political, economic and industrial conditions and tendencies. To answer such questions very thoroughly and fully would not be a paying proposition for a business house unless it had a very large connection, and a

specialised connection at that. It does pay the Registry to perform this service, which is given freely and without obligation, but it is not something for nothing. The return comes by increase of goodwill and widening of connection, which of course means increased business.

Nature of Services Rendered. The following is a more detailed account of how the Registry keeps contact with its customers, and supplies the services referred to above. Shareholders and regular clients who have filed their investment lists with the company receive the following services :

- (1) Periodical valuations of their investments as required, accompanied by a general report on the position of the investment account as a whole.
- (2) Circulars from time to time containing information that may become available concerning the stocks held.
- (3) Detailed replies to any specific enquiries, and statistical reports upon the position of any companies in which the investor is interested.
- (4) Constructive suggestions—when desired—with regard to future investment policy.

In addition to the above there are many other directions in which regular clients can make use of the Registry's organisation.

Reports Furnished Free of Charge. In the case of investors who have not previously transacted business with the Registry, the procedure adopted is as follows :—

- (1) Investors who get into touch with the Registry are first invited to submit particulars of stocks held together with any information which they think will be helpful for a proper understanding of their particular requirements.
- (2) This list will be returned to the investor in due course together with—
 - (a) A valuation statement giving current values, income and yield ;
 - (b) Statistical reports dealing thoroughly with the position of the principal stocks held ;
 - (c) A general report upon the list as a whole, indicating whether the investment policy adopted is considered good or bad.

No charge is made for these services as they afford the Registry an opportunity of giving a practical demonstration of the value of its organisation, and this generally leads in time to business.

Difficulty of Buying Good Debentures. In preceding chapters great emphasis has been laid on the special advantages of well-secured debentures for permanent investment but, apart from certain largely held and popular securities which are generally rather low-yielding, good debentures are as a rule strongly held and are often difficult to buy.

Opportunities for investment of this kind are only occasionally provided by large issues of well-known companies. Most of these are too dear to be attractive to the average investor. There are numerous industrial and public utility companies' debentures quoted in the financial papers which afford excellent security and which would be very suitable for permanent investment if they could be bought. But here arises a difficulty with which investors requiring really attractive debentures are faced—very few of them are readily obtainable.

The Registry's Issues. To overcome this difficulty Investment Registry Limited, in its early days, was in the habit of carefully watching the market and purchasing, when available, small lines of approved securities

for re-sale to its customers. Subsequently, the business developed to such an extent that complete issues were purchased outright. The Registry during the last twenty years has bought and resold in this way or, more latterly, underwritten a considerable number of debenture stocks aggregating many millions of pounds. This was a natural development of the business as a result of which a much wider range of investments is rendered available to shareholders and customers of the Registry.

Ready marketability is a desirable feature in all investments, and the policy of the Registry in underwriting complete investment issues tends to increase their marketability as, in addition to the normal demand from outside investors, there is a steady turnover in these issues through the Registry's customers. This enables a considerable number of buying and selling orders to be passed to the Stock Exchange, thus helping the market. Normally, a relatively small issue, say £100,000 debenture stock, might be and often is rather difficult to deal in, no stock might be offering on the market, and jobbers might be unable to make a dealing price; or it might happen that in the absence of immediate buyers they were not prepared to deal, and a would-be seller might have to wait some time before he

could realise. In the case, however, of small issues underwritten by the Registry, this is much less likely to happen. Being in touch with so many of the holders, the company has special facilities for interesting both buyers and sellers when stock is wanted or offering.

A type of security that the company has particularly favoured of late years is that of debenture stocks secured upon freehold and leasehold land and buildings, this having been found to be one of the most reliable forms of investment. During the recent depression such stocks maintained their prices to a very satisfactory extent.

In the course of its negotiations with the borrowers prior to underwriting a complete debenture issue the Registry uses its best endeavour to ensure the provision of such safeguards as may be considered proper for the protection of the debenture holders. In some cases it is instrumental in nominating a director to the board and generally in the appointment of the Trustees, while in all cases of debenture issues a comprehensive and binding Trust Deed is insisted upon. In this way the Registry maintains touch with the various borrowing companies until such time as the debentures have been redeemed or its clientele has ceased to retain any interest in the respective securities.

Terms of Business. As previously stated, investors who consult the Registry are not charged any fee for the services supplied or for filing in the office registers particulars of stocks in which they are interested. The profits of the company are mainly derived from underwriting new issues, and the widening of its clientele is ample recompense for the work undertaken.

Business entrusted to the company is transacted through brokers on the London Stock Exchange, this applying not only to stocks that the company has issued or underwritten, but to those in which it has no direct interest. The usual official scale of brokerage is charged and completion can, if desired, be effected through the investor's bankers.

The Registry places a very large amount of business through various brokers on the London Stock Exchange, and it is to their interest to see that every transaction receives the utmost care and attention so that clients may rely upon all business being done at the best possible prices.

CHAPTER VII.

STOCK EXCHANGE PROCEDURE

The buying and selling of stocks and shares is simpler, more expeditious and less expensive than the buying and selling of other forms of investment property, such as land or houses.

The broker, on being instructed to carry out a purchase or sale, goes into the Stock Exchange and finds a jobber who is prepared to deal in the particular stock. If it is an "active" stock—one that is changing hands constantly and in large amounts—he will have the choice of several jobbers keenly competing for business and quoting "close" prices, *i.e.*, prices with only a small margin between buying and selling. If, on the other hand, the stock is one in which transactions are infrequent, the margin will be wider—it may be four points per cent. or even more—and he may in an extreme case have difficulty in locating a jobber who is willing to deal at all.

In a normal instance, the jobber quotes a double price such as $100\frac{1}{4}$ - $100\frac{3}{4}$, or in the case of a £1 share, such as $23\frac{1}{6}$ - $24/-$. The jobber

does not know whether he will be called upon to buy or to sell, and his double price means that he is prepared to take a reasonable amount of stock or shares at the lower price or to supply a moderate amount at the higher figure. If the broker is satisfied he may do business at the price quoted to him, but often, especially if his client has imposed a price limit, he will challenge the jobber for a closer price or else he will try other jobbers to see if they are more accommodating. It may happen that the jobbers dealing in a particular stock have already enough of it on their books, or conversely, that they are over-sold. In such cases they will either quote a price with reservations, or else they will declare that they are only prepared to deal one way—that is to say, they are willing to sell but not to buy, or *vice versa*. The point is that prices and business are always subject to supply and demand, and the quotations that are published in the newspapers can rarely be taken as anything more than an approximate guide to the state of the market on the previous day.

A Stock Exchange jobber, having to rely for his profits upon the differences between prices at which he buys and at which he sells, must obviously make a difference between the price at which he will take in shares that come on the market and that at which he will supply. The

published reports of business done do not show whether the bargain was a sale or a purchase, and to those not well versed in Stock Exchange procedure they sometimes prove misleading. Another point to note is that there may be numerous markings of business done during the day, but it does not necessarily follow that the order in which they are recorded is an indication of the times when they were done. The last marking may not have been the last bargain done just before closing time; it may even have been the first.

A Stock Exchange jobber is not allowed to deal with the public, but only with other members of the Stock Exchange. He has to make his profit out of the difference between buying and selling prices and he runs the risk of sustaining losses if prices move against him. The broker, on the other hand, is merely an agent and for his remuneration he charges commission according to a fixed minimum scale approved by the Stock Exchange Committee. This scale is binding upon all brokers who are members of the Stock Exchange.

The scale of commission, more correctly termed "brokerage," at present in force is reproduced on pages 95 and 96.

When a client's order has been executed the broker confirms the fact by issuing to his client

a contract note, stating the price and other details, and showing the amount which the client has to pay or to receive and the date when settlement has to take place.

With coupon bonds or other securities "to bearer," the handing over of the actual bonds against payment completes the transaction. With registered securities delivery usually takes the form of a transfer signed by the original seller, accompanied by the certificate of stock or shares standing in the seller's name. For this a little more time has to be allowed, the general rule being ten days' grace after the settlement date. If the seller lives in a remote place there may be some delay in getting his signature to the requisite transfer. The act of handing over to the purchaser a "certified" transfer, executed by the seller, constitutes effective delivery, and it is against such documents that payment is usually made. The buyer having himself completed the transfer by affixing his signature and having it witnessed can then lodge the transfer with the company concerned and obtain in due course a new certificate in his own name. In practice, after the buyer or "transferee" has completed the deed of transfer he invariably leaves it to his broker or other agent to lodge the transfer at the proper office and obtain the new certificate for him. These are matters of office routine,



After a cartoon by "Sey" in "The World."

SIR JOHN F. L. ROLLESTON, M.P.,
Chairman of Investment Registry Ltd.,
1905-1910 and 1916-1919.

well understood by those who are conversant with the work and have facilities for the purpose. This is one of the duties which Investment Registry Limited carries out for its clients without charge.

There is often a delay in the delivery of certificates after transfers have been registered. This is only natural when it is considered that there may be a large number of certificates to prepare and that various formalities have to be observed. This is particularly so in the case of a new issue when there may be hundreds or even thousands of certificates to prepare.

In the ordinary way, several weeks may elapse before the new certificate is ready to be handed to the buyer and the latter may be left under the impression that the stock has not been delivered to him. This idea is quite erroneous. If, for example, the purchaser wants to resell the stock immediately, he need not wait for the certificate. The dividends, rights, or other benefits accruing to him as a result of his purchase depend wholly on the date when the bargain was done, subject to any rules framed by the Stock Exchange Committee to cover a particular case.

Readers requiring information regarding any investment in which they are interested are invited to communicate with Investment Registry Limited, 6 Grafton Street, London, W.1, either personally or by letter, when the closest attention will be given to their requirements. The special list form facing page 88 with a questionnaire on the back should be filled in and returned by readers who would like to put the company's organisation to the test by obtaining a comprehensive report on their investment position. This course will involve the enquirer in no liability or expense.

In the case of all suggestions for investment the Registry takes reasonable care to verify the accuracy of the data given, but, like other issuing houses, cannot accept responsibility for the results of investments bought or sold by its clients.

