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ALL ABOUT INVESTMENT

ALL ABOUT . . .
INVESTMENT

BY
HENRY LOWENFELD

POPULAR EDITION, WITH
INDEX AND SIDE-NOTES

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DEDICATION

BRITISH Banks have conclusively proved that the general public is capable of being financially educated. Formerly people used to hoard their spare cash, now they know that it is wasteful to do so Thus, by means of the education of the public, the finest banking system which has ever existed has been built up by the Managers of British Banks.

Bankers do not usually take charge of a customer's permanent investments in the same way as they take care of his actual cash, otherwise they would have taught the Public to invest in a similarly efficient manner to that in which they have taught it to deal with money itself.

Bank Managers are not only in constant communication with those who own spare cash, but, in addition, each customer's account shows them where financial knowledge would be useful.

This book is written with the object of explaining sound Investment Principles; the Author therefore most respectfully dedicates it to the Managers of British Banks, in the hope that it may prove of use to them in disseminating investment knowledge in a concise form.

4, HYDE PARK TERRACE,
LONDON, *January* 1909.

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ALL ABOUT INVESTMENT

CHAPTER I

CARELESS INVESTMENT AND ITS CONSEQUENCES

IT is success that colours all in life. A taste of success is the brain's best tonic, and to obtain so valuable a stimulus is of incalculable worth. The most successful of men are disproportionately downcast under the gloom of some partial failure, and, temporarily, their creative power is thereby impaired.

In order to achieve even a modicum of success, it is essential that man should cultivate constant perseverance. Nothing kills perseverance so quickly as failure, therefore even small failures must be sedulously guarded against if the mental powers are to be exerted to their full advantage.

To the idealist, worldly possessions are of but small account, dear though they are to the materialist. Yet even the idealist must live; and to live means to spend money. No

one is independent of the assistance of others, and this outside assistance must be paid for. Therefore we are all compelled to provide ourselves with ample means to remunerate our fellow-men, who minister to our requirements. In fact, services received must be compensated by services rendered in return.

Money is accumulated Energy.

In a state of civilisation, service is mostly paid for with money, and money thus becomes a concentrated form in which latent energy is accumulated, ready to be converted into active energy at any moment.

No matter how lofty or how artistic the creative aim may be, its pecuniary compensation can only take the form of money. A great thinker writes a book, an imaginative artist paints an epoch-making picture, a gifted musician composes an immortal opera —all these creations are bought and paid for like the output of the most prosaic manufacturer. In truth, the most wondrous production of the brain and the most insignificant results of manual labour receive material compensation similar in quality and differing only in quantity. So that the tangible return for human effort is measured by money, and money is latent energy, which in its turn commands the exertion of human effort.

Work is measured by Money.

Any one who expends his money without

receiving an adequate return for his outlay, is guilty of causing useless exertion. People who possess capital should regard it as the stored-up result of their own or of others' efforts. This being the true aspect of accumulated wealth, the capitalist is in duty bound to husband it, not only in his own interest, but also in the interest of his fellow-men.

A reserve fund of strength is an assurance that a man will accomplish his life's ambition. No one knows when he will be called upon to put forth an extraordinary effort. The larger a man's store of reserve energy, the more easily will he surmount a sudden emergency. It is noteworthy to observe how frequently the actual creator of some gigantic human achievement is an undersized and physically weak being. Some of the greatest creative triumphs have been the work of physical weaklings, whose force of character has been assisted by their ability to store up the energy of others, and put it to timely use. A rich man who advantageously employs his wealth commands respect and brings work, happiness, and contentment to his fellow-creatures. On the other hand, the poor man who is never able to make both ends meet is in a constant dilemma. Comparative wealth is within the reach even of people with the smallest of incomes if they will learn to regard

Wealth within every one's reach.

money as stored-up energy, and to treat it with proper care.

It is a foolish but popular fashion to regard the man who dissipates inherited wealth as displaying a generous disposition; whereas any one should be an object of general contempt who, without personal effort or exertion, obtains wealth, and has not the good sense to husband his possessions for the advantage of himself and others. Whether accumulated capital be the result of personal effort or of the efforts of others, it carries with it a responsibility which under no circumstances should be lightly treated.

Responsibility of owning Capital.

That money is, perhaps unconsciously, regarded in everyday life as accumulated effort, is easily proved. Two men jointly enter into a commercial undertaking. The contribution of one of them, to the partnership, is his personal efforts, whilst the other merely contributes his capital; the ultimate profit they divide between them, thereby confirming the fact that Capital, or accumulated wealth, is commonly accepted as the equivalent for personal effort. The use of Capital is paid for in interest; the use of labour is paid for in wages—a distinction without a difference.

Capital equivalent to Personal Effort.

If the ownership of money is to become profitable without active effort on the part

of its owner, it must be intrusted to others who will employ it. It is only when the means of rendering capital productive has been wisely chosen, that the original possession [Capital] remains unimpaired and that the result which its employment produces [Income] becomes stable and regular.

Profitable ownership of Money.

Thus the owner of accumulated effort—that is the capitalist—although he does not propose actually to work himself, is nevertheless bound to exert himself to the extent of seeing that his capital is properly employed, and he is thus performing a useful occupation. This act of putting money to profitable work is commonly called INVESTING; so that the care of money is in itself an enterprise, which, like every business, must be learnt by those who have been fortunate enough to accumulate, earn, or inherit wealth.

Definition of Investing.

No business can possibly succeed unless it is well looked after, and any carelessness in the conduct of a business is bound to entail serious consequences. At first sight it would seem that putting money to profitable employment is a complicated matter, in which no one can excel without a special training. The field of activity appears to be too wide for an amateur to comprehend its range, at least that is the view of the diffident investor; but there is also the over-confident investor,

The diffident Investor.

who is convinced that, without any investment-knowledge whatsoever, he can so intelligently cope with the problem of profitably employing his capital as will suffice for his own personal requirements.

The over-confident Investor.

To the over-confident investor it appears that the very width of choice which lies before him, in the numbers of individuals and companies who require money, is in itself a proof that investing must be easy. He imagines that his general worldly experience will guide him to make a wise selection, where the choice is practically limitless. Besides, with so many readily accessible advisers at hand, in the shape of bankers, brokers, solicitors, and others, it hardly seems worth while attempting to acquire any personal knowledge. Indeed there are many worthy people who would consider it presumptuous to attempt to master the art of investment. They would as soon think of studying law and medicine for themselves, and dispensing with the services of their lawyer and doctor, as endeavour to solve an investment question on their own responsibility.

In this way owners of accumulated energy [capitalists] tend to fall into two groups, the first of which does not even attempt to understand the principles of investment, while the second possesses just sufficient knowledge

to be a source of danger to itself. Naturally, neither class is ever more than rarely successful in putting its money to profitable employment.

The fact is, that there is a wide difference between the necessity for the personal study of investment and the necessity for the personal study of either law or medicine. A lawyer is required only when there is legal business to be settled, and a doctor's services are requisite only in the case of illness. When such emergencies arise they are self-evident, and skilled advice is promptly resorted to. But the necessity for investment-knowledge is continuous.

The Study of Investment a Necessity

Constantly occurring events in politics, and commercial and social developments, work great changes in the position of even old-established investments. The investor who relied solely upon the investment-knowledge of his financial adviser would really require to be in continuous touch with him. Unfortunately, it is the custom of some investors to acquire no financial knowledge of their own, and never to consult financial advisers until some irretrievable disaster has made a serious inroad into their capital account. Investments, when once acquired, are left to take care of themselves, with the result that, so far as the successful management of capital goes, there is little to choose between the investor who relies solely upon the financial advice of others,

and the investor who is guided by a smattering of financial knowledge of his own.

Cause of Investment-Failure.

This lack of investment-success arises from the fact that the various influences which control the comparative value of each individual security are constantly changing, and consequently the realisable price of the security changes likewise. Investments, in short, require looking after.

That there is a light but necessary work periodically to be done in connection with invested capital is understood by few investors; and yet upon the regularity with which this work is performed depends the whole question of investment-failure, or investment-success.

Invested Capital must be supervised.

The slightest consideration paid to the subject will suffice to reveal the danger of leaving invested capital to take care of itself. Practically all the great commercial enterprises are nowadays based upon joint-stock enterprise. This means that these important concerns are the property of thousands of investors, and that they are only very partially the property of the few men who conduct them. Yet all these vast undertakings suffer at times from trade depression, acute competition, and other detrimental effects. Circumstances perpetually arise which call for the greatest care and attention in their management. The generality of investors,

however, never attempt to interest themselves in these recurring crises, in spite of the fact that they are the people who have assumed practically the entire risk.

Weak indecision has induced the average shareholder to abdicate his right to exercise an intelligent control, until Company Directors have assumed an attitude which almost amounts to despotism. It is only fair to admit that in many cases this despotism is benevolent enough. But at times the actions of a Board of Directors are the very reverse of benevolent. However, it can scarcely be wondered at that Directors should regard themselves as the omnipotent masters of the situation, when the real owners betray a callous indifference to business details. How many shareholders are there who are capable of extracting the kernel from a balance-sheet, or how many are able to form an intelligent opinion upon a Directors' Report, when they receive these documents? In some cases no attempt is even made to read and much less to understand the highly important information which they contain.

Autocratic attitude of Company Directors.

Shareholders' meetings have long since descended to the level of formal farces, simply because the business of thousands becomes nobody's business. Every shareholder is possessed by the comforting, but erroneous, idea that if

anything were radically wrong, some public-spirited person would take the floor at the meeting and openly challenge the policy of the Board.

Indifference of Shareholders.

Even when a shareholder is prompted by his own misgivings, and feels that he would like publicly to raise some point which causes him uneasiness, he knows himself to be incapable of doing so. Want of accurate financial knowledge is his stumbling-block, and in some instances he is in the pitiful plight of not even knowing how to raise the question he wishes to ventilate without running the risk of transgressing the etiquette of a Company's meeting.

Such information as to Company-meeting procedure is easily obtainable; yet how many shareholders possess it?

The supineness of the average investor would be extraordinary if his own private interests only were at stake. But any one is grievously mistaken who may imagine that diminished Capital or diminished Income is a purely personal matter to the investor himself, and to those directly dependent upon him. It is true that the direct sufferer will doubtless have to curtail his personal expenditure, and put down certain luxuries which hitherto have made his existence a pleasant one. This curtailment of expenditure, however, cannot fail to react upon the whole community. For instance, a diminished Income may entail a

Far-reaching result of Investment-Loss.

diminished tailor's bill. The tailor's income is prejudicially affected, and, having less work to do, the tailor has less employment for labour: he buys less cloth, and his Bradford firm of cloth manufacturers receive a diminished order; and so the chain of consequences could be almost indefinitely prolonged until it extended to the station-hands employed on a sheep-run in the Antipodes.

The loss of this individual investor has been shown to be a loss to other members of the community; in fact, a fatality affecting the nation.

Annihilation of Wealth.

It is quite contrary to the fact to suppose that the loss of any one individual is bound to result in a corresponding profit to another individual. Wealth does not always merely change hands when it is injudiciously invested; it is either absolutely annihilated, or else it is so permanently diminished that it may be said to have pulled up at the half-way house on the road towards annihilation.

Example of annihilated Wealth.

A convincing example of the annihilation of wealth by injudicious investment is afforded by the failure of the Liberator Building Society and its group of allied companies. It is a well-known fact that tens of thousands of small, thrifty investors suffered cruelly by the Liberator crash; now let us ask who made a profit out of that

failure, corresponding in any way with the amount of the actual sums lost? Certainly the wirepullers made no money, for they were nearly all compelled to go through the Court of Bankruptcy; neither did the building contractors amass fortunes, for they shared the same fate as the promoters. Nobody, in short, did materially benefit by this great financial disaster, so the question naturally arises: What became of the money which these unfortunate investors lost?

Dangers of Over-capitalisation.

The answer is that it was disadvantageously expended in a number of over-capitalised building schemes which never had a chance of producing an adequate return upon their original capital-outlay. As income-earners, the undertakings proved barren, and the properties acquired with the buildings erected thereon proved to be assets incapable of realisation at anything approaching their cost price. A large proportion of the subscribers' capital had, in fact, been annihilated.

Depreciation of British Railway Stocks.

An even greater disaster, which has approached almost to the dimensions of a national calamity, has been the depreciation of British Railway stocks during recent years. This is an example of Capital being dissipated through a want of proper understanding of investment questions.

Let us take the case of a man who ten years

ago inherited and continued to hold some London and South-Western Deferred Ordinary stock, when this stock was readily saleable at about 90. To-day this stock is selling at 45, so that one half of the inheritance has been lost by the owner without any compensation having been received by him. It would be possible to multiply such examples indefinitely, for the fact that injudicious investment leads to the annihilation or the dissipation of Capital has been proved in every single market in the Stock Exchange, beginning with Consols, and concluding with the most hare-brained gamble that ever was perpetrated in the Mining Market or elsewhere.

Example of dissipated Wealth.

Were a careful account made of the losses sustained by the British investing public, through the annihilation of their capital, the result would show that the sum so dissipated would in no long period of time suffice to pay off the National Debt and provide Old Age Pensions for the entire nation.

Extent of Investment-Losses.

For many years past, Legislature has made spasmodic efforts to check this enormous waste of national financial strength by means of grandmotherly legislation, designed to regulate the formation of public companies. Patch-work legislation, however, must always prove abortive: the only legislation which is ever

of any practical value is the type which eliminates an evil at its source.

The problem which Parliament has vainly attempted to solve contains two factors: the first is the too wily promoter, and the second the too credulous investor. Parliament, however, failed to grasp the fact that the credulity of the investor was the source of the evil, and that when once a practical cure had been found for the public's credulity, the wiles of the promoter would become practically innocuous, and therefore, in its wisdom, preferred to believe that by throwing obstacles in the path of the promoter the grievous annihilation of Capital could be put an end to.

Mistakes of Legislators.

To accomplish this excellent object, various restrictions were gravely debated, and finally the law enacted that the way of the company-promoter should in future be obstructed by certain regulations, affecting the form and the clauses of the prospectuses issued for the purpose of attracting public subscriptions to new companies.

Futile Laws.

This proceeding was very like erecting a number of finger-posts in a country where none of the inhabitants could read, or, perhaps the analogy would be closer, if the Home Counties were liberally equipped with sign-posts in the Gaelic tongue. In the past, the investor who

knew what amount of explicit information a reliable prospectus ought to contain, had never fallen a prey to the insidious promoter, who withheld essential facts in his prospectus. On the other hand, the unskilled investor never understood which facts were material, and was always content to subscribe his capital to any venture which was put forward in a reasonably attractive form.

Parliament failed to see that the general diffusion of financial knowledge was the root-cure for the nation's reckless tendency to annihilate Capital. Even to the poor man the possession of sound financial knowledge is a valuable asset. Why, then, should not the broad principles of profitable investment be made an educational subject, and form a part of the ordinary school curriculum? For it is almost impossible to measure the amount of evil which results to the nation and the individual from investments ignorantly entered into and ignorantly persisted in.

A Cure for Investment-Ignorance.

The great want from which the English investor peculiarly suffers, when compared with the investors of almost all other countries, is that in England there is no standard by which investment-values can be measured.

Need for British Standard of Investment-Values.

Such a standard, to be of any practical use, must consist of some type of security which is

free from any but the very smallest fluctuations. England possesses no such standard, because British Consols fluctuate violently in sympathy with every movement of the money market, and English Railway Debentures sluggishly follow the movement of the too rapidly fluctuating Consols, which are the leaders of the market in Trustee Investments. In consequence of this, the Perpetual Debentures of the London and North-Western Railway have depreciated 25 per cent. in the short period of a decade.

Foreign Standard of Investment-Values.

In nearly all other countries, Railway Debentures, representing as they do loans made to permanent commercial enterprises of great magnitude, constitute the standard by which the value of money for permanent investment can be gauged. In those countries where the railways are owned by the State, some other type of stock of great stability of value takes the place of Railway Debentures. For instance, in Germany Land Mortgage Bank Bonds constitute the standard by which all other permanent investment-values are measured.

Carelessness of British Investors.

As Great Britain is the solitary example of a country which possesses no standard of measurement for investment stocks, there must be a good cause for the deficiency. The reason is, that Britons as a rule are careless investors.

who never take the trouble to ascertain the real character and soundness of any investment, with the result that they permit themselves to drift in a happy-go-lucky fashion, very different from that in which every other nation treats investment-questions.

If British investors as a class had taken the trouble to inform themselves fully as to the merits, and also as to the limitations, of London and North-Western Railway Perpetual Debentures no investor would have been so rash as to pay 120½ for a stock whose rate of interest is permanently fixed at 3 per cent. Further, if this debenture stock had never been allowed to climb to this absurd price-level, it would never have depreciated to the extent of one-fourth of its previous market-value. If the British investor had possessed a clearer sense of investment-values, the price of this stock would have remained somewhere near 88, or on a basis of value at which it would have yielded an investor about 3½ per cent. Further, on a permanent basis of value in the neighbourhood of 88 this stock would have served as an excellent standard of measurement for investment-values generally.

Value of an Investment-Standard

All the world over, except in England, sound Investment Stocks move in close relationship to the value of money for permanent investment

Relationship between Stock and Mortgage-Values.

on mortgages. This standard of value alters but very slowly and gradually in each country. This same stability of value will prevail in England so soon as the great body of investors fully realises that investing is exceedingly simple, but that it has to be effected according to fixed rules which are easily learnt. The business of investment, incomplex though it is, requires a sound rudimentary knowledge, which every one should seek to acquire, whether he is earning money or whether he has come into the possession of money through the exertions of others.

Business of Investment easily learnt.

On the face of it, the study of the subject of investment seems to cover an enormous field. There exists so bewildering a mass of stocks of so many grades of safety and of income-producing power, while these stocks appear to alter in their realisable value so frequently and to such an extraordinary extent, without apparent rhyme or reason, that it is small wonder if investors become settled in the conviction that the study of stocks is too intricate to be attempted by other than professional financiers.

But the most complicated subject becomes clear when it is reduced to fundamental principles and when the objects with which it deals are lucidly classified and explained.

Fortunately, in the case of stock and share investments the explanations and classifications are so elementary, that any one who devotes some attention to the subject will soon find his way through all its difficulties.

Investment Study interesting and profitable.

An attempt will be made to furnish investment-knowledge by means of this book, and it is hoped that its perusal will be found both interesting and profitable. Interesting —because the great majority of our great modern Commercial and Industrial Institutions are based upon joint-stock enterprise; and profitable—because every one who is a worker, be it in art, science, or commerce, is bound to become an investor as soon as his work obtains recognition and he achieves success in his calling.

Many investors lose in a few short weeks, more than it has taken them years to accumulate; and had they applied only a very small fraction of the time which they devoted to earning money to the subject of how to take care of money, they would now be much wealthier men than they actually are.

Let it be clearly understood from the outset that we treat here of the subject of investment pure and simple, and that we have nothing encouraging to say on the subject of speculation. If any one takes up this publication in

Speculation should not be encouraged.

the hope of finding some safe plan for making money rapidly, by imperilling capital in the hope of large profit, he will find himself sorely disappointed.

Ensuring Safety and Increase of Capital.

The questions to which we shall principally devote our attention will consist of how to avoid risks to capital, and how gradually to increase invested capital by sound and natural methods.

To enable an investor to do this, it is requisite that he should understand simple and common-sense principles which are based upon plain rules of comparison. Capital is a commodity, and, like every other commodity, it must be disposed of in the most advantageous markets. To attempt to invest money without first ascertaining which are the most advantageous markets, and the nature of the different wares which in these markets can be exchanged for money, is to be guilty of careless investment, the consequences of which we have described in this chapter.

Capital bought and sold as a Commodity.

CHAPTER II

INDISPENSABLE REQUISITE TOWARDS SUCCESSFUL INVESTMENT

MONEY, to be made remunerative, must be converted by its owner either into property, or into a security such as a public or private loan or a share in a public or private enterprise. The opportunities for investing money in this manner are innumerable, and cover a wide range of degrees of capital-safety, income-producing power, and chances of increase or decrease in capital-value. Thus, the first point, which presents itself to every thoughtful investor on starting to employ capital is, what sort of an investment would be most suitable to his personal requirements; and here he is immediately confronted by a great difficulty.

Investors' initial Difficulties.

He finds that whilst his bank might pay him from £1 to £3 per annum upon every £100 deposited, private traders are ready to pay a higher rate. On mortgages he might obtain from 4 to 5 per cent., and on the securities of public companies the rate varies from 2¾

per cent. to almost any reasonable yield, as every extensive stock and share list informs him.

Income-Yield *versus* Capital-Safety.

The first instinct, naturally, will be to accept as high a rate of income as is obtainable; but every investor, before deciding on any form of investment, is likely either to consult a friend who is assumed to understand these matters, or to draw on his own memory for what he might have heard people say about investments. In either case he is likely to be reminded of the old saying that "Large interest means bad security."

Thus a conflict arises between the amount of income to be made, on the one hand, and the degree of safety demanded, on the other. But

Investing for increase in Capital-Value.

there is a further and still graver matter, which increases the difficulty of decision. He has undoubtedly heard of large fortunes having been made by buying stocks at very low prices and selling at very high ones. In fact, the money article published by any newspaper informs him that stocks rose or fell on the previous day. As he is now taking up his position as an investor, surely, he tells himself, he should not neglect such chances of making money.

Any difficulty of selection from a large number of widely differing investment-opportunities, must invariably be settled in accordance with the wants, tastes, and inclinations of the in-

dividual who has to choose. In investment, above all other matters, a start in the right direction is the keynote to future success or failure; so that the first selection should be made with the greatest circumspection.

It will be shown later on in this book, that every reasonable investment-object is obtainable, provided that the right sort of investment is selected. The investor must, therefore, firmly make up his mind as to what his real investment-object is, and must begin to invest in a manner calculated to realise this object.

All reasonable Investment-Aims are obtainable.

Although most people, when embarking upon any kind of undertaking, do so with some particular object in view, experience shows that investors form the almost solitary exception to this general rule. In the majority of cases investors are but dimly conscious as to what their ultimate investment-aim may be; and this is one of the chief causes of investment-failure.

Necessity for ascertaining Investment-Aim.

A very cursory investigation would show that all investors have much the same investment-aim, for they all wish their capital to be quite safe and their income adequate; while they also desire that there should always be an opportunity to sell the investments held without trouble, and at a price higher than that which they originally paid for them. This is, perhaps, the wide general idea with which

some investors commence their investment-career, but they very soon discover that such a state of perfection is practically unattainable. Investments which seem to be quite safe to-day often become most dangerous to-morrow: the income varies, stocks which have commanded a ready market for years gradually become difficult to negotiate, and finally, instead of rising in value, they display a most disappointing tendency to fall.

Dangers of indefinite Investment-Aim.

After having suffered from several such disappointments, investors who started with an investment-object based upon wide ambition become discouraged. They lose confidence in their own or their adviser's powers to discriminate between good and bad; and so, having been defeated in a general engagement, they now confine themselves to mere skirmishing. In the vain hope of retrieving losses already incurred, they now dabble in a few speculative ventures, and so their capital becomes split up among a number of stocks which neither fit in with each other nor give their unfortunate owners any chance whatsoever of regaining that smooth road which leads towards investment-success.

Investment-Similes.

Investments should be looked upon as so many kinds of building material, which must be properly chosen and welded together to make up a strong and lasting edifice; or as so many

weak twigs, which, tied up with a strong cord, make an unbreakable bundle.

Every investor should firmly make up his mind that there is no single investment, no matter what its nature or quality may be, which can be relied upon to remain unchanged in its realisable value; and that it is only by furnishing himself with a selection of investments which in quality and quantity match each other, that capital-safety, income-stability, or any other investment-object can be attained.

An important Investment-Axiom.

This investment-axiom has now been conclusively proved to be true, not only in theory but also in practice, by putting thousands of actual cases to practical tests.

After having well considered the above fundamental principle of sound investment, it will so amalgamate itself with every intelligent investor's own habit of thought, that he will wonder why he did not originally discover it for himself. In fact, this principle will become a guiding star throughout his whole investment-career.

The advantages of working upon such a rule are obvious, for by its aid the vast field of investment, which at the first glance seemed too wide for any investor to comprehend, narrows itself down into a very small area of selection.

Advantages of settled Investment-Aim.

Without such an axiom, the investor has to search among Government, Municipal, and Corporation Loans, the securities issued by Railways, Tramways, Waterworks, Banks and Breweries, investments in Gas, Shipping, Telegraph, Insurance, Electric-lighting Companies, and the endless number of other commercial and industrial enterprises. Many of these, to his further bewilderment, he will find, have issued all kinds of stocks, such as Bonds, Debentures, and Preferred, Ordinary, and Deferred shares.

At the outset it appears that systematic selection is impossible amidst such an embarrassment of choice. But as soon as the investor has learned to apply the axiom already referred to, and has made up his mind what his real investment-object is, he will find that, not only is the class of enterprise suitable to his purpose definitely settled for him, but also the kind of stock which he must select. The result will show that his difficulty regarding selection is at an end, and, in addition, he will make that selection with the absolute conviction that the stocks chosen are the actual stocks which he wants.

The Possibilities of Stocks ascertainable.

Every class of stock is subject to a certain ascertainable class of risks, and has a number of equally well known qualities. Thus, there are some stocks which fluctuate widely in value,

whilst there are others whose investments are generally small and slow. There are some stocks which can be relied upon always to pay a certain and fixed rate of interest; whilst there are others which are supposed always to pay a fixed rate, but may fail to do so. There are others again which vary in the rate of dividend which they pay from year to year; and there are stocks possessed of solid intrinsic merit but paying no interest at all, which repay their holder solely through their gradual rise in value as they steadily approach the period of income-earning. Further, amongst non-dividend-paying stocks there are others possessing no solidity of value, which are purely a speculation on vague future possibilities.

Later on in this book all these different qualifications of stocks and shares will be considered, and it will then be shown how the probable future development of a combination of stocks can be foretold with sufficient accuracy to enable investors to know what they may reasonably expect the future to produce. Without such knowledge, investing even in the soundest securities in no way differs from mere gambling.

Combinations of Stocks.

As it has been asserted that the future possibilities of every investment-combination can be foretold with tolerable accuracy, and as the

assertion will be proved in this book later on, the first and fundamental question which every investor has to decide is which class of investment will best suit his particular purpose.

The Investor's First Decision.

This is a matter which entirely depends upon the results which he requires his stocks to produce. Now, there is quite as large a variety of investors as there is of investments, so it is necessary to classify the various types of investors with the same accuracy as will be required later on to discriminate between the various types of investments.

It will be found that investors naturally group themselves in the following manner:

Classification of Investors.

Group I.—*Investors who rely entirely for their maintenance upon the income produced by their investments.*

(*a*) Rich people who have more than sufficient income.

(*b*) Well-to-do people who need not strain their investments.

(*c*) People moderately well off who must make a large income.

(*d*) People who are compelled to make their investments produce the largest possible income.

Group II.—*Investors who live partly on their present efforts and partly on the*

income produced by their investments.

(*a*) People with ample means.

(*b*) People with insufficient income from earnings but ample income from investments.

(*c*) People with insufficient income from earnings and a small capital.

Group III.—*Investors who live entirely on the results of their present efforts.*

(*a*) People with surplus earnings, which they apply towards increasing their capital, the income from which is already sufficient to provide for their wants.

(*b*) People with surplus earnings, which they apply towards the building up of a capital, the income from their present capital being still insufficient to keep them.

(*c*) People with a moderate surplus and a very moderate capital, or no capital at all.

In the above three main sections, with their respective sub-divisions, nearly every investor will find his own position described. Should he, however, not readily recognise his own classification, he most likely belongs to a class which will

Respective Aims of Investors considered.

be covered by two sub-sections. An endeavour will now be made to inform every class of investor, as grouped above, what his attitude towards the investment-market should be, and what classes of stocks are most suitable for his requirements.

In the following explanation, the words "Geographical Distribution of Capital," and "Geographical Division," will be frequently used.

Geographical Distribution of Capital.

The Geographical Distribution of Capital is the division of capital into equal portions, and the investment of each portion in a separate part of the world; whilst the Geographical Division means that particular part of the world in which a portion of the capital is invested. This system of investment is fully described in a book called "Investment an Exact Science." *

Group I.—*Investors who rely entirely for their maintenance upon the income produced by their investments.*

(*a*) *Rich people who have more than sufficient income.*—This type of Investor should hold nothing but the very safest class of securities, such as the Loans or Debentures of Municipalities and Corporations of undoubted credit and standing, or of Railway and Gas Companies,

* "Investment an Exact Science." Demy 8vo, cloth, price 2*s.* 6*d.* net. Published by the *Financial Review of Reviews*, 2, Waterloo Place, London.

Waterworks, and Industrial enterprises which have been established at least fifteen years prior to the date of investment. The last-named must be either unquestionably guaranteed by a third party, or have at least three times the amount of their loan-issues represented by immovable property which is realisable at that value. They must also, during the seven years preceding the date of the proposed investment, have earned and distributed in the shape of dividend on their share-capital, at least three times the amount necessary to pay the interest on their loans.

Safest Class of Securities.

A combined investment consisting of securities of this type will return from $3\frac{3}{4}$ to $4\frac{1}{2}$ per cent. on the total invested sum, and the total capital-value and income will remain quite stable, if the system of *Geographical Distribution* is adopted when selecting the securities of which the combined investment is composed. The above plan of investment applies, of course, only to those Investors who have no ambition to increase their capital. Should they have any such desire, then the plan outlined later on under Group III., subsection (*b*), should be partly adopted by them.

Yield of Safest Class of Investments

(*b*) *Well-to-do people who need not strain their investments.*—This type of Investor is in a similar position to Investors who are rich, wealth having, after all, only a relative meaning. But

Consideration of higher Investment-Yield.

they will most likely be forced to aim at the attainment of a slightly larger yield on their capital, and consequently will be compelled to content themselves with a somewhat inferior class of security, such as Loans and Debentures of Municipalities and Corporations of lesser repute, and of Commercial undertakings which are not secured to the extent detailed above. They may also find themselves unable to procure suitable Debenture stocks in certain Geographical Divisions, and be forced to content themselves with unquestionably safe Preference shares. Government stocks should not be held, for reasons which will be explained later on. If really belonging to the type of Investor to which this sub-section applies, and not to the next sub-section, they should not attempt to make a larger yield than $4\frac{3}{4}$ per cent. on their capital. If their capital is properly distributed Geographically, they will find no difficulty in obtaining this yield without running any undue risk. Investors of this type who are anxious to increase the realisable value of their capital are also referred to in Group III., sub-section (*b*).

Cases where Government Stocks are undesirable.

(*c*) *People moderately well off who must make a large income.*—This type of Investor is forced to make a much higher rate of income, and must therefore be satisfied with a lower type of investment. In no case, however, should capital-

safety be sacrificed to a large income-yield, and it will be found quite unnecessary to run any special risk. The apparent lack of unquestionable security can be substituted by additional care being exercised in the distribution of risks, and in the supervision of the investments held.

Large yield decreases Capital-Safety

The difference between types (*a*) and (*b*) of this Group and the present one corresponds with the comparison between a rich housekeeper who does not mind how much she spends on a dinner, and a lady of economical habits who is desirous of procuring an equally good repast at less expense. The choice quality of the food provided by the former requires to be set off by the additional care exercised by the latter in the composition of her menu, and in the skilful preparation of her dishes. For, as inferior viands more carefully served frequently result in greater satisfaction than the most expensive food less carefully treated, in just the same way do many Investors manage to achieve greater capital-safety and a far larger income with inferior securities.

Careful treatment increases Investment Safety.

Investors belonging to type (*c*) should principally concern themselves with Debentures and Preference shares of well-founded commercial undertakings carrying on a non-speculative business. In the case of Debentures, the age of the Company and the actual money earned by

Combination of stocks yielding 5 to 6 per cent.

it, need not be so closely considered as the margin of safety offered by the assets upon which the Debentures are secured. Thus, supposing a Company has issued £50,000 Debentures, there should be security represented by assets of at least twice that amount at a break-up valuation. The annual earnings of the Company should cover the amount necessary to pay the Debenture-interest at least twice over. Government, Municipal, and Corporation Loans should not be held by this class of Investor unless the rate of interest current in the country which issues these loans is over 6 per cent., or if the Municipalities or Corporations are so small that they are forced to pay over $4\frac{3}{4}$ per cent. on their loans. Countries which have made default during the last fifteen years, or Municipalities and Corporations which are situated in countries where the Investor does not enjoy ample legal protection, should be habitually avoided.

Danger of fashionable stocks

All very large and frequently quoted stocks are dangerous to an Investor of this type. For if these issues were really desirable they would yield under $4\frac{3}{4}$ per cent., and this yield being too small, would make them ineligible; whilst if they yield more, there is some half-hidden danger lurking behind them although the Investor may fail to perceive it.

Well-secured stocks in less known companies

are infinitely preferable to insufficiently secured stocks in well-known companies.

Preference shares should only be selected in cases where no Debenture-debt exists, or can be created so that it ranks in front of them; unless the Company is of old-established respectability and has habitually distributed such large amounts for years past in the shape of dividends on the issues standing behind the Preference shares, that their safety can be considered as undoubted.

An important factor concerning Share Issues.

In the case of Debentures, the age of the concern issuing them is not of paramount importance; but with all Share-issues, the age and non-speculative character of the business is all-important. It is impossible to fix an age-limit, as some concerns settle down to solid business faster than others; but the concern must have a well-established record before its Share-issues can be accepted as a sound investment.

Cases where safe to buy Ordinary shares.

Ordinary shares in any undertaking should only be purchased if there are no Debentures or Preference shares in front of them or can be placed in front of them, if the Company has a stable business, is free from debts, possesses ample working capital, and enjoys at least ten years' record as a steady dividend-payer. To hold Ordinary shares in any undertaking which

do not yield at least 5½ per cent. on their saleable value, simply as an investment, is bad finance.

Investors of the type now under consideration should make from 5 to 6 per cent. on their money; such a return is quite feasible and possible without indulging in reckless finance, provided that the distribution of risks is perfect, and no part of the capital yields under 4¾ per cent. or over 6½ per cent. If any portion of the capital gives too small a return, the yields from the other portions have to make up for this, in order that the average yield may be maintained; consequently the purchase of risky stocks may become a necessity. In the case of this type of Investor, also, the stocks held must be closely supervised, and any substantial profits which accrue on a portion of the holding should be taken, so that a reserve-fund against investment-losses may be built up.

Building up a Reserve Fund.

It is inadvisable for Investors who are forced to make from 5 to 6 per cent. on their investments, to attempt to increase their capital by undertaking undue risks, for every speculation in stocks which offers a chance of profit also involves a risk of loss which is as great if not greater. Losses, therefore, being not only possible but probable, the Investor runs the risk of slipping out of the investment-category which

he at present occupies, into the type to be next described.

(*d*) *People who are compelled to make their investments produce the largest possible income.*— This is the most difficult type of Investor to cater for, because, as his capital is small at the outset, every decrease in its quantity is dangerous; whilst it is quite impossible to make the required income without holding inferior securities. Furthermore, the Investor having no other income or other means of increasing it, his capital becomes the very sheet-anchor of his existence. For these reasons, every attempt to increase capital-value should be considered to be highly dangerous, involving, as it must, a possible loss, and being calculated to increase the risks to which the Investor is already exposed.

The most difficult Investment-Aim.

Men who have no power to earn money, or women who have a number of others dependent on them, are usually included in the present class; and it is at times quite useless to tell them that they should be content with 5 per cent. on their money, whilst 6 or even 7 per cent. is the smallest return which will satisfy their necessities. Investors of this class should be most careful not to hold a single stock which does not produce over 5 per cent.; while they must confine themselves to Ordinary stocks in well-established Companies, and to Preferred stocks in under-

Stock combination yielding over 6 per cent.

takings which are less securely founded. Some Geographical Divisions they will not be able to cover, as all of them do not offer sound stocks which yield 5½ to 6 per cent., but in other Geographical Divisions they will be able to obtain a high yield on desirable securities.

The utmost care should be exercised in constructing such an investment-scheme, and the securities held should be kept under the strictest surveillance.

Investment-Aim which requires special care.

Whilst it is specially desirable that Investors of this type should use their best endeavours to master the principles of investment, they should not trust entirely to their own judgment, unless they are really experts, or at least have always a really competent adviser at hand to check their proceedings. They should constantly bear in mind how very sad their case would be if they incurred a heavy loss, and such a contingency they must guard against with untiring vigilance.

Their position is by no means hopeless, and there are a large number of investments obtainable which, if properly selected, matched, and welded together, will produce the income-result which they desire; but only if the greatest circumspection be exercised and unnecessary speculations scrupulously avoided.

Group II.—Investors who live partly on their

present efforts, and partly on the income produced by their investments.

(*a*) *People with ample means.*—This type of Investor differs but little from the class described under Group I., sub-section (*a*), provided that his earnings from personal efforts do not form too large a proportion of the total annual income.

Earnings from personal exertion.

Everybody's personal earnings are contingent upon good health, energy, and security of position. These, unfortunately, are always to some extent uncertain, therefore every Investor belonging to this type should constantly keep before him the possibility, which may become a stern reality, of his earnings suddenly or gradually ceasing to exist.

If the income which would then remain to him is considered sufficient, there is no danger to be feared. But if this is not the case, and a loss of the income derived from personal exertions would be seriously missed, then timely preparation should be made to meet such a contingency. This can be done by making the investments held yield the return described under Group I., sub-section (*b*), viz. $4\frac{3}{4}$ per cent., and investing annually the additional income so gained. This is in order that the capital may eventually assume sufficiently large proportions, and that the income from it may alone suffice for the Investor's entire needs.

Investment of personal income

Heavy expenditure of professional men.

It is only too frequently the case that professional men of repute, with a fair amount of capital, neglect the prudent course of procedure here outlined. It is sometimes their habit to rely unduly on their large professional incomes. They accustom their families to a lavish scale of expenditure which is quite out of proportion to the income which they derive from investments, with the result that, in the winter of their lives, or after their death, those dependent on them have to live on a reduced scale which amounts almost to privation.

Such unfortunate occurrences can be avoided only by timely economy, assisted by a settled investment-plan and a fair-sized life-insurance policy.

(*b*) *People with insufficient income from earnings but ample income from investments.*—This type of Investor is perhaps better off in the long run than the type last described, provided that a satisfactory investment-plan is rigidly carried out by him. His earnings do not form the all-important part of his income, and therefore if they should fall off or discontinue, the breach is not so difficult to fill up. The proportion of income from investments to annual expenditure, settles in this case whether the investments should be of the kind described under Group I., sub-section (*a*) or (*b*). Pro-

vision, also, should be made for a gradual increase in capital, so that the income derived from earnings should, as soon as possible, be no longer required to assist in meeting the annual expenditure.

(*c*) *People with insufficient income from earnings and a small capital.*—Investors of this type no doubt realise daily that their position is insecure, and dread the day when their income from earnings may become impaired. The only advice which can be given in this case is to exercise the utmost caution, and to treat the capital in hand with that care and circumspection which its importance to the Investor peremptorily demands. For should the capital, or any portion of it, be lost, most serious consequences are bound to follow.

Small Investor should be doubly careful

The selection of investments and the general treatment of them for this type of Investor, is indicated in Group I., sub-section (*c*) or (*d*), the proportion of capital to usual expenditure indicating which of the sub-sections applies.

Group III.—Investors who live entirely on the results of their present efforts.

(*a*) *People with surplus earnings, which they apply towards increasing their capital, the income from which is already sufficient to provide for their wants.*—This type of Investor is in the most fortunate position, and with a proper investment-

plan, fairly accurately followed up, is safe from material want. The class of investment to be held by him should be selected either from those described under Group I., sub-section (*a*) or (*b*), and the investment-plan adopted should be so constructed that stocks may be added annually to each Geographical Division covered. It is essential that the Geographical Distribution be not impaired, owing to the investment of any additional capital earned.

Geographical Distribution of added Capital.

By closely following a scheme of this description, the Investor naturally changes from Group III. into Group I. as soon as his earnings from personal efforts discontinue, and with a little care he is bound to fall into sub-section (*a*) of this group, namely the rich.

(*b*) *People with surplus earnings, which they apply towards the building up of a capital, the income from their present capital being still insufficient to keep them.*—This type of Investor should be extremely careful, so that on the day on which his earnings cease, during his lifetime or at his death, he or those dependent on him may find themselves possessed of a capital-sum large enough to support them out of the income which it earns.

To some Investors income-yield unimportant.

The question of interest is of no very great importance to Investors of this type, because the income earned will naturally be treated,

year after year, as an additional sum to invest and increase the Capital Account. All that this class of Investor is working for is a gradual but sure capital-increase; and whether this increase results from dividends or from the growth in value of the investments held, is quite immaterial.

Investors of this type can provide for the wants of those who are dependent upon them, by means of a Life Insurance Policy. In the employment of the surplus income, then remaining, they should chiefly confine their attention to sound classes of enterprise which are in the making, such as the Ordinary stocks of younger public-utility undertakings in industrially growing countries with increasing population. In the Geographical Divisions in which commercial developments are more advanced, they should seek to invest in enterprises which are gradually coming to the front, or which, for the time being, have become unpopular. In making such a selection they must learn to distinguish between the dying undertaking which has no chance of recovery, and the live undertaking which is temporarily under a cloud; specially stocks which have depreciated through causes which are outside of the undertaking itself, offer good chances of this kind.

Enterprises in the making

Unpopular enterprises.

A strong conviction of future possibilities is

always a necessary outfit for an Investor of this type, as in most cases his opportunities to buy will occur at times when no one has a good word to say for the depreciated security which he selects. If people did not think badly of an undertaking, its stocks would not be selling at prices which made little or no allowance for future potentialities. An Investor belonging to this class should invariably attempt to buy latent possibilities, when others do not even admit their existence. He has an enormous pull over all other Investors for the reason that any immediate return on his outlay is immaterial to him. Consequently, he can afford to wait years, if necessary, for his stocks to improve in price.

Latent Investment-Possibilities.

Arithmetic plays a leading part in investments of this description, it being necessary to know that at compound interest capital doubles itself in $17\frac{2}{3}$ years when invested at 4 per cent., in $14\frac{1}{5}$ years when invested at 5 per cent., and so on. With this knowledge to assist him, he must compare the possible rise in a non-dividend-paying stock with the sure increase to be obtained from a dividend-paying stock, when the interest derived therefrom is constantly reinvested at compound interest.

Calculation showing Capital-increase at compound interest.

Gambles of any kind should be avoided. The real difference between this sort of in-

vestment and a gamble, is that the investment must display a probability of increase in value on the occurrence of certain clearly defined and strongly probable events based on well-known and ascertainable facts; whilst the gamble has only a chance of increasing in value through the agency of possibilities which cannot be foretold. Thus, for example, Waterworks, Gas, Railway, and Tramway Companies, or other stocks representative of works of general public utility, situated in a growing district, the growth of which is founded upon permanent factors, do not constitute a gamble, even if the stock is bought at a heavy discount.

Difference between investing and gambling.

Example of growing Investments

As the population increases, the use for the services of this class of undertaking must also grow; consequently, the revenues and also the price-level of the stocks of these enterprises tend to improve steadily. The growth of a population is an ascertainable fact, so are the terms of the monopoly enjoyed by a Company, and these factors, when carefully considered, remove the purchase of such a stock from the category of a gamble. Geographical Distribution of Capital is of the utmost importance for Investment-schemes of this kind, as it tends to reduce considerably the risk of non-success and makes for a gradual but steady Capital-increase.

Importance of Geographical Distribution to Capital-increase.

Land Companies are not always Investments.

Land Companies are not always an investment, because the ownership of land always entails an annual outlay and sometimes produces little or no revenue. For example, the British South Africa Company is a Land Company, yet its shares never were anything else but a pure gamble, because the expenditure has always greatly exceeded the revenue and the population barely increases.

It would be quite impossible, here, to do more than give an indication of the direction in which Investors of this type should seek their securities, for a whole volume could be filled with the potentialities of investments suited to them. Therefore, Investors must learn to discriminate for themselves, between reasonable probabilities and wild possibilities, and in cases of doubt should consult a really competent adviser. They should proceed to study closely the history of several stocks which are selling at a heavy discount, and after having formed their own ideas, submit them to an expert for confirmation. In this way they will very soon acquire a sound judgment on such questions.

Difficulties of Investment-discrimination.

It will repay them handsomely to do so, because there is more money to be made on these lines than perhaps on any other way. The number of Investors who can afford to entirely

Profit on non-dividend-earning Stocks.

disregard income, and are ready to wait five or ten years for their stock to develop, is very small; for this reason there is but little competition for the purchase of non-dividend-paying stocks, and fine opportunities are consequently numerous.

Premium *versus* discount.

In the rarest of cases only should Investors of this type buy stocks which are quoted at a premium, but they should favour securities which are procurable at the heaviest possible discount; if they have to select from a number of stocks, they should always give the palm to the cheapest, provided that this stock possesses real vitality. Life in stocks of this type consists of fair future probabilities, supported by present working capital of substantial dimensions. Stocks rise much faster from 30 per cent. to 60 per cent. than from 60 per cent. to 120 per cent. There are only 30 points difference between 30 and 60, whilst there are 60 points difference between 60 and 120, and yet for the Investor both events produce the same result, namely, the doubling of his capital.

Varying vitality of stocks.

Here again is another example of the importance of simple arithmetic in this class of investment.

Another, and most vital point, for Investors working for an increase of capital without regard to income, is to avoid becoming in-

Investment-infatuation to be avoided.

fatuated with any one of their stocks. Any Investor who endeavours to obtain the utmost advantage out of an increase in value is doomed to failure.

It is quite wrong to try and make more than a reasonable profit, and no remorse of any kind should be felt by the Investor, who, having bought at say 50 and sold at 80, subsequently sees the same stock rise to 110. A study of highest and lowest records covering a number of years teaches the lesson of the zigzag of price-movements.

A profit secured is always a good profit, and a wise Investor will learn to recognise this truth.

It is equally unwise to wait for the stock to fall still lower before purchasing, provided that at the ruling price the Investor sees his way to good future possibilities; and if, after having bought the stock its price should fall still lower, no discouragement need be felt. This further fall should only urge the Investor carefully to check again the soundness of his original calculations. If it is then discovered that some vital point has been overlooked, and this point is important enough to endanger the future prospects, then the Investor should promptly sell at a loss.

How to act when values fall.

There is a saying on 'Change that "top and bottom quotations are made by fools for fools,"

so one should never try to buy at the bottom or sell at the top. It is necessary to look after one's own business and not after that of the rest of the people who hold the same stock. As soon as a stock is done with, it should be forgotten, and new ventures planned. Whoever follows these rules will be a wise and rich man in the end.

Consider your own business only.

This type of Investor should rigidly adhere to a definite Investment-scheme, but instead of always covering all the main Geographical Divisions, as he should do at the start, he must be prepared at times to reduce the number to eight, and in exceptional cases to seven.

Reduction of Geographical Divisions of Capital.

This reduction in Geographical Divisions will be caused by periods of great investment-prosperity in any one or more of these main Divisions.

If, for example, the United States of America experience a boom, during the course of which the Investor has sold out all his *American North* stocks; and if, after having done so, he should fail to find any really good Investment-opportunity suitable to his purpose offering in the same Division, then he should examine the stocks of all those main Divisions which embrace several countries, and invest in one of those countries which he has as yet not covered. The ten main Geographical Divisions really represent over 25 separate trading influences. Thus,

Example of Geographical subdivision of Capital.

for example, America South is one main Division, but it includes Argentina, Brazil, Chili, Peru, Uruguay, and Venezuela; and every one of these countries has a trade of its own, which is only slightly influenced by that of all the other South American States. Similarly, the Divisions representing British Colonies, Europe North and South, Asia, and Africa, are subdivisible.

There will always be some stocks in the possession of this type of Investor which show a large loss. Therefore, when he has secured a

Averaging Investments.

profit, and is consequently possessed of capital to reinvest, he should, prior to the purchase of a new stock, overhaul all his holdings which show a loss, and if they are found to be still promising he should average them.

Averaging is one of the most important operations in connection with investments. Supposing £100 of stock is bought at 60, costing £60, and then a second £100 of stock is added at 40, costing £40; then £200 stock has cost £100, and the average price of the total holding is now 50. By this means, a purchase, originally comparatively dear, is put into a much better position. Great discretion should be used in averaging at all times, and no more than 15 per cent. of the Investor's total capital should be entrusted to one stock unless that stock is one of great inherent safety.

It has been previously explained that an attempt can be made to employ capital at compound interest, and so to add to its quantity annually. This can be done in two ways, namely, by buying safe dividend-paying securities and investing the dividends as an annual addition to Capital Account; or by purchasing securities without regard to the income which they produce, relying on an increase in their realisable value to produce the desired growth of capital. Of these two methods the former is the easier and safer method, although the latter is in reality the quicker and more profitable mode of procedure. But increased rapidity is almost invariably accompanied by increased difficulty; and the care requisite to build up a Capital Account quickly is so great that investors are warned not to try the more complicated method, unless their ability and temperament fit them for it.

Two methods of adding to Capital.

There is always a certain excitement to be derived from buying a stock at 30, holding it for a time, seeing it drop to, say, 22, and then gradually rising to, say, 40; watching it drop again, and ultimately rise to, say, 50, at which price it is sold. This excitement is the hotbed in which the germ of speculation thrives; and to have this germ developed in the constitution of any Investor might prove to be so

The germ of speculation.

dangerous to his capital as to outweigh the value of the resulting increase to his Capital Account.

For this reason, those who are speculatively inclined should not venture to adopt the method of increasing their capital by the purchase of stocks with a view to a rise in value. Only cool-headed Investors, who can tutor themselves to look upon stocks as income-producing machines, should attempt it. This latter type of Investor will only be guided by cold reason, and will never yield to the temptations of hot impulse. Our luck is inside ourselves, and not outside; we use our chances when they come, or else we neglect our opportunities; and the so-called unlucky ones are those who do not see their chance when it is staring them in the face.

The cool-headed Investor.

To render this book complete, it was necessary to give an explanation of the method in which a Capital Account can be built up by the purchase of low-price securities. This method of investment-procedure depends so entirely for its success upon the possession of a fine financial judgment, coupled with a nice discrimination between trading collapse and trading depression, that it is far too dangerous an instrument for the average Investor's use.

(*c*) *People with a moderate surplus and a very moderate capital, or no capital at all.* Life In-

surance Companies have been principally instituted to enable people, so situated, to provide without delay for those depending upon them. Life Insurance Policies are costly, as they are calculated at a very low rate of interest, and the companies have very large expenses, which must be paid for out of the pockets of the insurers; but the advantage of being able to provide a comparatively large sum, which is payable at death, at once, is well worth the additional expense. Whether it will be possible to accumulate such a sum during one's lifetime is uncertain. The ability to pay the premiums is possible to any age. Life Insurance is, therefore, the provident step to take by all those Investors, of this class, who have obligations to others.

Uses of Life Insurance.

Every man, no matter what his position may be, should have immediate command of a certain sum, however small, to carry him over any unforeseen emergency. If he does not yet possess such a sum, he should use his utmost endeavour to obtain it.

This sum should be considered as one of his most important possessions, and should be guarded with the sedulous care which it deserves.

Not having the command of a sum sufficiently large to be called Capital in the accepted sense of the word, the owner of a small sum will be disinclined to bestow any thought on the subject

The Investmen nest-egg.

of investment, and for this reason this all-important nest-egg may not be treated with the extreme caution which is essential to its welfare.

A warning to small Capitalists.

Experience has shown that, in the aggregate, owners of small sums lose much more in proportion to their individual wealth than people with larger means, and a hundredfold more than really rich people. Whenever there is any financial crash, it is always the small man who loses most; all the money swallowed up by bogus banks is the property of small Investors, who seem to require a financial earthquake to rouse them to exercise even a modicum of caution. Only when they are face to face with absolute loss, do they seem to realise how very important their little nest-egg is to them. The truth is that the smaller the capital-sum, the greater should be the caution in disposing of it.

Advice to small Capitalists

A small capitalist's first savings up to £100 should be placed in the Post Office Savings Bank. There is no danger of losing capital so disposed of, but this cannot be called investing at all. As soon as the second £100 commences to accumulate, the science of investment must be acquired; from that moment investment becomes a necessity to the growing capitalist.

If the owner of that sum is too indolent to acquire the fundamental principles of sound investment, let him purchase Consols, although

they are, in point of fact, the most unsuitable stock for any private Investor to hold. Their sole recommendation lies in the fact that the income which they produce is always paid, and that they always possess a realisable value of some sort. There are, of course, many investments which would be more suitable to the embryo capitalist; but to find out for a certainty which they are, and at what price they are good to buy, requires some real knowledge of the fundamental principles of finance. Therefore, before this knowledge is acquired, Consols are the only possible stock for the financially ignorant to buy and to hold. Consols as Investments.

As soon as the Investor has mastered the first principles of investment, he should, up to his first £1,000, strictly adhere to the principles of investment which were advocated as suitable to Investors of Group I., sub-section (*a*).

The Income obtained will be small, but his Capital will be safe.

By systematically covering a fresh Geographical Division with each further £100 of capital accumulated, the completion of the first £1,000 in Capital Account will witness a complete distribution of investment-risks upon a scientific principle. Scientific Investments.

The accomplishment of this first stage on the road to the acquisition of solid wealth will doubtless occupy some time, and during that time, on

nine separate occasions it will be necessary to buy stock. Each one of these purchases will require study, and in this way, gradually, and perhaps quite unconsciously, the Investor will become an expert. By that time he can decide for himself to which of the other nine classes of investors he rightly belongs, and which plan of investment he should adopt in his own best interests.

How Investors become experts.

The most usual types of Investors have now been described, and any Investor who does not find his precise case depicted among them should use his best endeavour to ascertain to which combination of sections he belongs; and consequently, what his tactics should be, before he attempts to settle upon a definite investment-plan.

To commence investing on a wrong plan is tantamount to taking a wrong kind of medicine, for investment-success is absolutely dependent upon the right kind of stocks being selected, so that the individual investor's definite investment-object may be achieved.

Success dependent on suitable tactics.

Having settled the Group to which he belongs, and thereby ascertained the class of stock he requires, the Investor should proceed to invest in the stocks advocated as best for that Group.

Alteration in Investor's circumstances.

But if, through an alteration in his circumstances, which may come upon him suddenly or gradually, he finds that his membership of the Group originally selected has, through these occurrences, been cancelled, and that he now belongs to another Group, the investments held should be gradually altered to suit the changed circumstances.

Although, if it is to be successful, the investment of Capital must be carried out according to certain fixed rules, there is fortunately no difficulty in gradually readjusting any existing List of Investments in accordance with these rules.

Readjusting Investment-Lists.

Such a transaction involves but a small outlay, and it can be carried out at any time. Most investments, however bad they may be, can, as a rule, be sold, and the proceeds invested in the very stocks which an Investor should hold. In doing this no actual loss is incurred, for every investment has its market value. On the contrary, the Investor's position is changed for the better, and not for the worse, when he equips himself with a properly balanced Investment-Scheme, instead of vainly hanging on to an indiscriminate medley of incongruous stocks in the hope that, through some miracle, the whole of the Capital, which originally was invested without due care, will be restored.

No loss incurred in readjusting Investments.

Losses must be faced.

The only point, which is bitter to Investors who have bought unsuitable stocks at higher prices than they now command, is the definite fixing of the exact sum of money which their bad mode of investing has cost them in the past. The realisation of his undesirable stocks must disclose the amount of the Capital so lost. An Investor must be prepared to look facts in the face, instead of imagining them, as he would like them to be; otherwise he is a lost man from an investment-standpoint.

It is hoped that no such irresolution will deter the readers of this book from promptly putting their investment-position on a sound basis.

Capital distinguished from Income.

To properly understand the art of investment, it is requisite that the reader should clearly discriminate between what is Capital and what is Income. In the recommendations which have been given, all sorts and classes of stocks have been mentioned, further particulars regarding which will be found fully explained in the chapters which follow. But as the reader has by this time quite made up his mind to which group and sub-section of Investors he really belongs, he will be able to read the passages referring to the stocks which interest him most, with additional care and attention.

CHAPTER III

ON CAPITAL

POLITICAL economists have written whole libraries on the subject of *Capital.* It is not intended in this book either to give subtle definitions or to deal with the subject in any way exhaustively. The aim is simply to give the reader a practical idea of that aspect of Capital which affects everyday life, and for this reason many points have been left untouched.

The real inward nature of the business of *investing,* as this word has been defined in a previous chapter, can only be thoroughly grasped by capitalists if they accustom themselves to distinguish closely between Possessions,—Money,—and—Capital. These three expressions are only too frequently accepted in ordinary conversation to express one and the same thing, and yet they have widely different meanings as applied to the science of investing.

Difference between Possessions, Money, and Capital.

Thus, ordinarily it is said that a man has large *possessions,* or that he has lots of *money,* or that

he has a large *Capital*, or a large *income;* one and the same thing being meant by these four expressions, yet property and possessions are certainly not money, and they are only Capital in certain events; while Capital itself is rarely actual money. It is true that possessions and Capital can be converted into money; but so long as they remain in their original form it is necessary to draw a sharp distinction between them and money.

Possessions are all that any person owns, including, of course, his *money* and his *Capital.*

Money has already been defined as stored human effort which is convertible, either directly into human effort again, or into any produce of human effort, or into one of nature's productions which has become valuable through human effort.

Definition of Capital.

Capital is that part of any one's possessions which either directly produces an income for its owner or is a necessary adjunct towards assisting its owner in the earning of an income.

It is this particular definition of Capital which every Investor should make quite clear to himself, so that he may make the most profitable use of his possessions.

Two men start with £50,000 in money; the one of them applies £30,000 towards buying a house, fine furniture, horses, motor-cars; and

devotes only £20,000 to the purchase of land and stocks, which yield him, say, an average of £5 per annum on every £100 invested. Then this man has £50,000 worth of *possessions*, only £20,000 of which is Capital, and his income is £1,000 per annum. The other man also buys a house, but a moderate one, and furnishes it modestly; this absorbs, say, £5,000. £25,000 he expends in buying business premises, and equipping them for the purposes of his trade; £15,000 he invests in land and stocks, producing him 5 per cent., and £5,000 he retains in cash, which remains unemployed for the present. Then this man also has £50,000 worth of *possessions*, but £40,000 of this is *Capital*, whilst £5,000 is *money*. Then assuming that the business produces the moderate return of 10 per cent. on the capital invested therein—most private businesses produce more—he has an income of £3,250 per annum.

A comparison in outlay of money.

Interchangeability of Possessions, Money, and Capital.

In common phraseology, the position of both these men might be taken as being equal, as both of them have £50,000 worth of possessions; yet, in reality, the actual facts differ very widely from each other, for an annual income of £1,000 cannot be compared with an income of £3,250.

The same outlay may bring different results.

Endless variations of this example could be given; one man, for argument's sake, applying £1,000 towards the purchase of jewellery,

Another example in monetary outlay.

another spending £1,000 on a motor-car, and a third investing the same sum in sound stocks. All these men may imagine that they have made INVESTMENTS because the jewellery, the car, or the stocks, are all saleable, while the money thus sunk in their purchase is to some extent refundable by a sale which could be effected at any time. Yet, although the articles purchased are to some extent saleable, only the money placed in stocks has been *invested*, because the jewellery produces no income, while the motor-car not only produces nothing, but involves a heavy upkeep. Only the stocks produce an income.

The three main classes of Possessions.

We are thus dealing here with the three main classes of possessions, the first of which —jewellery—is the type which produces no income and involves no annual expenditure; the second—typified by a motor-car—also produces no income, but, in addition, causes expenditure; and the third—stocks—which involve no annual outlay, but produce an annual income. The income produced by this third class of property need not be receivable annually, for it can result from an increase in realisable value, like building-land, non-dividend-paying stocks, or vintage wine, which increases in value year by year.

Any one who desires his *possessions* to produce

the largest annual income, should endeavour to own only a sufficient amount of that kind of property which involves no up-keep, like furniture, books, pictures, and such like; as little property as he can do with of the kind which costs money to maintain, such as houses, parks, horses, yachts, motor-cars; and as much as possible of the kind which produces an annual income, in the shape of houses and lands leased to others, stocks, bonds, mortgages, and other income-producing property.

Expensive and non-expensive possessions.

The first and second kinds of property enumerated are merely possessions, and only the last is *Capital* in the properly applied sense of the word. In fact, only that kind of property which produces income, be it in the form of actual money received annually, or in the form of increasing value, is Capital. Capital thus becomes the root of income, and, for this reason, its maintenance and augmentation should be the first consideration of every Investor.

Capital the root of Income.

All saleable possessions are convertible at any time into Capital, by the simple process of realising and applying the proceeds towards the acquisition of income-producing property. Capital is always convertible into possessions by selling the income-producing properties, and purchasing with the proceeds anything which either involves no expense in upkeep or which

costs money to maintain. Therefore, every one has it entirely in his power so to adjust his status that he owns the proper proportion of possessions of both classes as here distinguished in relation to his Capital. He can also ensure that the proportions are appropriate to his station in life and real wants.

Some aspects of property

It is now clear that the same property can at one time be a mere *possession*, and at another time *capital*, without this property itself altering in any way or changing its owner. For example, a house standing empty, is property; as soon as it is let on a rental it becomes *capital*. A yacht used for the owner's pleasure is *property;* if permanently let [for the pleasure of others] it becomes *capital*. A book in a private library is *property*, in a circulating library is *capital*. So that by converting idle property into income-producing Capital the Investor may increase the sum-total of his Income.

The question of money has, as yet, not been touched upon. Money, in its proper meaning, is only actual cash, and this cash can either be a property—when it produces no Income—or Capital when it is lent out at interest; and, in the latter case, it only then remains money when it is convertible into cash without any process of sale. Thus, money deposited with a banker at interest, or lent privately, or lent on a mortgage

Money as Capital.

which is terminable, is tantamount to cash; whilst stocks or bonds are not money, as they have to be sold before the cash can be obtained. It is very necessary to understand this subtle distinction, for the simple reason that money lent in a safe way cannot diminish or increase in amount, whilst money invested in stocks or bonds can and does alter in amount when converted into cash again by a sale.

Distinction between stocks and cash.

By means of these examples, it has been made clear that there are two ways in which Income is derivable from Capital, namely, by either employing Capital oneself in a manner which produces Income, or by letting others have the use of it and obtaining income from them in return.

Two ways of using Capital.

In all cases where Capital is used in business, either directly or indirectly by its owner, no one is responsible for its repayment, so that its permanent safety solely depends upon the success of the undertaking engaged in. But whenever Capital is lent to others, there is some one responsible for its ultimate return. Therefore, in such a case its safety depends in the first place upon the borrower's solidity, and, in the second place, upon any special security which has been pledged to the lender. It does not depend in a direct way upon the success of the business in which it may be employed.

Risk attending outlay of Capital.

No matter whether Capital is used in active participation in a business, or by lending to others, there is always a certain amount of risk involved and some portion may be lost in the long run. For this reason, it is self-evident that it would be highly unwise to place the whole of one's possessions in any one concern, unless the owner of the Capital were to look after that concern himself, and has sufficient confidence in his own business ability to make loss improbable. On the other hand, when Capital is intrusted to others, no matter how closely and carefully any investment-chance may be investigated and considered, the unforeseen may still possibly happen. Therefore, it is wise to guard against this risk also, by spreading the Capital over a number of separate investment-opportunities, so that the failure or partial failure of one of them may be counterbalanced by a greater or smaller success in another.

Balancing Investment Risks.

Every single investment may either rise or fall in realisable value, or it may remain stationary. Therefore, if a number of investments are held, and some of them fall in value, whilst the others remain stationary, there is a loss of Capital. There is also a further loss if all fall simultaneously, or if some of them [when taken conjointly] fall more than the rest [when taken

conjointly] rise in value. From the owner's point of view only the total result obtained from all investments is of importance. To have some of the investments rise, whilst others simultaneously fall to a larger extent than the first named have risen is tantamount to spending more than has been received;—therefore, a arudent Investor will never consider the results obtained from any one of his investments singly, but will always consider all of them as a corporate whole, and will accept as a guide to his true investment-position only the total results produced by them all.

Total Investment-Results alone important.

All investments held are in this way placed on one side of a scale, on the other side of which is the original Capital. The turning of these scales indicates the actual position. In fact, a balance sheet is established, and if both sides are equal, then no Capital has been lost. If the total realisable value of all the stocks held is larger than the capital invested in them, a profit has been made, if *vice versa*, a loss has been sustained. For these reasons, the vital point aimed at, when Capital is spread over a number of investments, is to maintain an even balance of value. To accomplish this *all investments held must not only be well matched in quantity and quality, but must also be so selected that no two of them are likely to move in an identical manner.*

How to maintain an even balance of Investment-Values.

Main principles of Geographical Distribution of Capital.

Supposing that of two stocks held, one falls while the other rises equally in value, and that the holder has twice as much of the first as he has of the second, then the balance has not been maintained; for the fall in the first case represents a larger sum than that covered by the rise in the second. This explains why *an even division of Capital amongst all the stocks held is indispensable.*

Stocks held should be of equal quality and quantity.

Suppose, further, that equal quantities of two stocks are held, but that the one is a Debenture stock, which moves but little in price, and the other is an Ordinary stock whose altering prospects and varying dividends cause considerable fluctuations. Then it is quite likely that the Debenture might move 2 per cent. against a simultaneous movement of 8 per cent. on the part of the Ordinary stock. But, as the quantities held in both cases are equal, the cash-value of the movement of the stock would be four times as large as the cash-value of the movement of the Debenture; and although the quantities held have been identical no equilibrium has been established. For this reason, *all stocks must be matched in quality and width of fluctuation.*

Suppose, lastly, that Stocks of equal quantity and equal quality are held, but both securities are subject to the same market influences, so that they rise and fall together, in close sympathy;

then, again, no equilibrium is possible, and, for this reason, *each of the stocks held must be subject to an entirely different set of influences which causes them to rise and fall.*

Stocks held must be subject to different influences.

The sentences printed in italics in the last four paragraphs embrace the main principles of Geographical Distribution of Capital.

Formerly, it was imagined that by splitting up Capital over entirely different industries, the Investor could guard against similarity of price-movements. Inspired by this idea, the same Investor would buy stocks of Brewery, Cotton Mill, Railway, Banking, Gas, Water, Telegraph, and Insurance Companies, and of other industrial enterprises, which seemed on their face to represent totally different interests. But practical experience has proved that such a splitting up of Capital is, under certain circumstances, quite unavailing. Under certain conditions all these investments, though they actually represent industries which are not subject to kindred influences, will invariably move together in the same direction.

Different industries not necessarily different influences.

The reason for this extraordinary phenomenon has been scientifically investigated, and, after laborious researches, it has been conclusively proved that it is not the dissimilarity of trading interests nor the varying internal developments of individual companies which really cause sound

Real causes of price-fluctuation.

investment-stocks to fluctuate in value, but that the all-predominating influence, which creates these movements, is the temporary position of the Money Market and the state of the investment-demand in the country in which these stocks are held and chiefly dealt in.

In "Investment an Exact Science," which is the companion volume to this book, this contention has been amply proved by a lengthy argument supported by statistical charts and tables; it would therefore be repetition to go into it here, but, as this subject is of the utmost importance to every Investor, we will illustrate it here by two simple tables. The one gives a selection of British stocks which covers all the important branches of investment, the other shows the Government stocks of the principal countries of the world, arranged according to the size of the indebtedness of each Government. It will be seen from these tables that whilst all the British stocks have slavishly moved together, although thirty-three different industries are represented, the Government stocks of the various countries have widely differed from each other in simultaneous price-movements.

Bad and good Capital-distribution.

It is interesting to note how large some of the price variations of the Government stocks given in the table have been.

All British Stocks.	Industries Covered.	Highest Price.		Difference Per Cent.		Government Stocks. Arranged according to the Size of the Indebtedness.	Geographical Situation.	Highest Price.		Difference. Per Cent.	
		1896	1908	Rise	Fall			1896	1908	Rise	Fall
Nottingham, 3%	Municipality	122¾	91	..	25·8	Algeria 3%	Africa	470	447·50	..	4 7
L. & N.W Rly. Debs.	Railway	124⅞	91	..	27	Paraguay 3%	America South	16¼	52	220	..
E. London Water, 3%	Water Works	109	90	..	17·4	Chili 4½%	America South	87½	93	6·3	..
Liverpool United Gas Debs	Gas	138	108	..	21	Tunis 3%	Africa	503 50	468	..	7
S. London Elect. Supply	Electric	6	3¾	..	48	Bulgaria 5%	Europe South	90	101	12·2	..
Nat. Provincial Bank	Bank	56	47	..	16	Denmark 3½%	Europe North	100	95	..	5
Mercantile Trust Pref.	Trust	117	111	..	5·1	Servia 4%	Europe South	66½	84	26·3	..
Royal Exchange Assoc.	Insurance	378	210	..	44·4	Norway 3%	Europe North	103⅜	86	..	16·9
Millwall Docks	Docks	66	26	..	60 6	Sweden 3½%	Europe North	105¼	99	..	6·1
Grand Junction Canal Ord.	Canal	155	98	..	36 8	Greece 5% Funding	Europe South	31	49½	45·5	..
Nat. Telephone 1st Pref.	Telephone	19	13	..	31 5	Mexico 5%	America Central	101	104	2·9	..
Provincial Trams Ord.	Trams	6⅝	5¼	..	20 8	Switzerland 3½%	Europe North	102·70	99	..	3·6
London General Omnibus	Omnibus	198	47	..	76 4	Cape Colony 4%	Africa	110¼	102	..	7·6
Barclay, Perkins	Brewery	12	5½	..	56·2	Roumania 4%	Europe South	86	90½	5·2	..
Vickers, S. & Maxim Pref.	Armaments	130	108	..	17	Brazil 4½%	America South	72½	90	24·5	..
Gordon Hotel Pref.	Hotels	16¾	8	..	52·2	Canada 3½%	British held	111	102	..	8·1
Crossley & Sons Pref.	Engineers	7¼	5¼	..	26 3	Argentine 4½%	America South	64	98	53	..
Kynochs Ord.	Explosives	23	13	..	43 4	Egypt 3½% Unsd.	Africa	101½	95	..	9 09
J. & P. Coats, 6% Pref.	Sewing Thread	21	16¾	..	20 2	Holland 2½%	Europe North	93⅝	77 3/16	..	17·5
Waring & Gillow Pref.	Furniture	5⅞	4⅛	..	29·7	Japan 5%	Asia	105⅝	101½	..	3·9
Newnes, Geo.	Publishers	1½	1 1/16	..	35	China 5%	Asia	102½	106	3·6	..
Tower Tea Pref.	Tea	5⅛	3⅜	..	33·3	Turkey 4%	Internationally held	104⅜	102	..	2·6
Harrods Stores	Stores	7½	4⅞	..	32 7	Belgium 3%	Europe North	102	101·25	..	0·7
Dickinson & Co., 1st Pref.	Paper	126½	108	..	14·4	Portugal 3%	Europe South	64½	66	2·3	..
Causton & Son	Printers	14½	8½	..	41·5	German Empire 3%	Europe North	100	84½	..	15·5
Aerated Bread	Caterers	10½	6½	..	35·8	Hungary 4% Crown	Europe South	99·70	96	..	3·7
Apollinaris Pref.	Min. Water	11⅛	7⅛	..	33·3	Spain 4% Sealed Bas Rentes.	Europe South	64⅛	95½	48·1	..
Pears' Soap Pref.	Soap	14⅞	13¼	..	10 9	Austria 4% Crown Rts.	Europe Central	101·55	98	..	3·5
Price's Candles	Candles	43	36½	..	17	United States 4%	America North	131½	124	..	5·5
Lilley & Skinner Pref.	Boots	5¾	5	..	13	Italy 3½%	Europe South	92	104½	13·5	..
Belgravia Dairy	Dairy	1 1/16	1 1/16	..	37	Russia 4%	Europe North	104¾	79½	..	24·1
Bryant & May Pref.	Matches	20½	13	..	35	Great Britain 2½%	British	113¼	88	..	22·7
Spratt's Patent Pref.	Dog Cake M'n'f.	6	5½	..	12·5	France 3%	Europe South	103½	98	..	5·08

NOTE.—The 1908 Prices are up to November 1908.

33 British Stocks moving in unison.

Government Stocks with differing movements.

Government stock as indicator of price-movement.

The price-movement of the Government stock of every country governs the main direction of the price-movement of all other important investments chiefly dealt in in that country. Therefore, as it has been shown that the various Government stocks contained in the table differ from each other in their respective price-movements, the industrial stocks of all these countries must also have similarly varied in the amounts of their realisable values. In "Investment an Exact Science" charts are given showing that a similar selection of the stocks of every other individual country move in consort similarly to the British stocks given in the table overleaf.

Insuring dissimilarity of risk.

In this way, statistical evidence has proved that the only method of insuring a dissimilarity of price-movement amongst all the stocks which an Investor holds, is to invest in various countries of the world in such a way that every stock held is controlled by the separate market-influences of a different country. The best results are obtained when each country included in an Investment-List is as widely different as possible in its trading interests from all the other countries represented in the same List. So, for the guidance of Investors in the selection of their countries, the earth's surface has been split up into nine main divisions, the tenth being assigned to investments which are not peculiar to any

one country. These last named represent industries which embrace two or more parts of the world in their trading activities, such as Telegraph, Cable, Shipping, and Marine Insurance Companies' stocks.

Geographical Divisions and Sub-divisions.

By these means a natural division of the earth's surface into ten main groups has been arrived at and seven of these main groups can again be subdivided; and the annexed chart of the world explains the details of these subdivisions.

To summarise, the three main essentials requisite for maintaining capital-stability are as follows:

Summary of main requisites for Capital-stability.

1. An even division of Capital amongst all the stocks held.

2. All the stocks held to be similar in intrinsic merit and in width of fluctuation.

3. Every stock held to be under a different external influence.

As long as due weight is attached to these three points, every one of which is exceedingly simple in its application, the maximum of attainable capital-stability will result.

As has already been said, Capital is the root of all Income which does not result from personal exertion, therefore, the larger the Capital the larger should be the Income. It has been shown where the difference lies between

Possessions, Money, and Capital, and that every Investor has it in his own power to make his Capital the predominant part of his possessions. It is the wise apportionment of an Investor's Property amongst these three items which constitutes investment-strength, and it is by means of the subsequent scientific distribution of the risks, inseparable from the act of investment, that a sound and permanent Income is built up.

CHAPTER IV

ON INCOME

LIKE its predecessor, this chapter will also treat of finance in its purely practical and not in its theoretical aspect. Otherwise its contents might lead to endless controversy. There are some writers who assert that to pay interest on borrowed money is improper; there are others who hold similarly impracticable theories. The discussion of such points of doctrine would lead this handbook too far afield from the practical conclusions it proposes to establish.

Three sources of Income.

There are three ways of obtaining an income: the first is by personal exertion without the use of Capital; the second is by personal exertion, coupled with the use of Capital; and the last is by Capital pure and simple, without personal exertion and unassisted by grant or gift.

The first of these methods need not be here discussed; the more or less accidental way of obtaining income by grant or gift has also no place here, so our area is limited to income

derived from Capital either with or without personal exertion.

Modes of employing Capital.

As already stated in the last chapter, the owner can either directly or indirectly use his Capital himself or he can lend it to others, on their paying him interest for its use. Where the owner uses his Capital himself there is no one under an obligation to repay him the Capital employed. This can occur in a variety of ways: by using it in business, by purchasing properties of all kinds which the purchaser believes to have a chance of improving in value, by a sleeping partnership in any enterprise, and, lastly, by the acquisition of shares in any company or corporation. Here again only the last mode, namely, the holding of shares in an enterprise, is of importance for the purposes of this chapter.

Shareholders are sleeping partners.

A share in any limited liability company or corporation is most nearly akin to a sleeping partnership. The directors and managers are the working partners, and the whole body of shareholders are the sleeping partners. Whenever profits are made they are distributed by the directors among the shareholders; if the profits diminish, the dividends diminish also, or cease entirely when no profits are made. This shows that whenever an Investor buys shares he does not thereby obtain a right to a stable

income; and his chance of obtaining an income at all is dependent upon the prosperity of the enterprise.

Uncertain income of Shares.

As every shareholder has to run this risk of uncertain income, he should naturally receive some compensation for it; and therefore, it is only wise to hold shares when the income which they are likely to produce—be it in the shape of dividends or increasing value—is greater than the fixed rate of income obtainable from allowing other people to have the use of the Capital.

This is a point which every Investor should thoroughly understand.

Common mistake of Investors.

There are many companies which have regularly paid steadily increasing dividends to their shareholders for years. This fact has led many Investors to fall into the mistake of believing that such a happy state of affairs is bound to continue indefinitely. On this false assumption they have invested their Capital. In other words, they have laid the foundation of their income on a wrong conception of the material facts which control the realisable value of invested Capital.

Every Ordinary Share a Speculation.

Every share, whatever its nature, is a speculation on the business-future of the enterprise which issues it. As there is no certainty that the best established business will continue to

prosper, every holder of shares is a speculator on a future event. For this reason, shareholders are bound to follow closely the fortunes of their enterprises, as disclosed periodically in Directors' Reports and Balance Sheets; otherwise an unpleasant surprise may some day be sprung upon them. They should not, however, merely content themselves with perusing these documents, but in addition, they should demand from the directors such further information as is necessary to form a correct opinion upon their company's actual position. The directors and officers of a company are the stewards of the shareholders' Capital, and, as such, they should always endeavour to present the actual state of affairs, so that neither the existing nor possible new shareholders may be misled. This is the only real and proper view of the relation between directors and shareholders.

The use of balance sheets.

Relation between directors and shareholders.

At the time of their formation or flotation, companies and corporations can make all kinds of bargains with the various groups of partners [shareholders] which constitute the enterprise. For instance, they can arrange for one group to rank in front of the others for dividends, and issue Preference shares to them. Again, they can arrange with another group of shareholders that, provided the Company is successful, they shall receive the remaining profits after

Division of company's profits.

certain stipulated sums have been paid to other groups of shareholders. On these terms Deferred shareholders are content to rank behind everybody else in their claim upon the divisible profits. In this way many varieties of shares are created, all of which will be separately dealt with in a subsequent chapter; the point which is here insisted upon is, that every share, whatever its special rights may be, constitutes a partnership, and that the income to be expected from it depends entirely upon the business-success of the company which issues it.

Share-income dependent on business success.

Shares can produce income in two ways, namely, by the dividends actually paid by the companies, or by displaying an increase in their realisable value. It very frequently happens that the increase in value is a much greater source of income than the dividends distributed, and in many cases shares which pay no dividends at all actually produce in the shape of rising value a much larger rate of yield than the best dividend-payers.

Income as distinguished from Capital-appreciation.

To be able to make income out of increased value is, however, by no means easy; it requires a close knowledge of figures and a clear comprehension of future chances and prospects; therefore, only experienced Investors who possess sound financial knowledge should attempt to employ their Capital in this direction. It is

Futility of acting on rumours or tips.

merely trifling with the responsibility attached to the ownership of Capital, to follow rumours or act on tips or special information. An Investor should never be swayed by these, unless they are supported by indisputable actuarial evidence which he is fully able to grasp, and the market-effect of which he fully understands.

Quite different from the position of a shareholder who personally employs his Capital is that of an Investor who lets others have the use of his Capital in consideration of receiving interest from them for such loan.

Dividends *versus* Interest.

The shareholder receives *dividends*, the holder of Bonds or Debentures receives *interest*; and all Investors should thoroughly understand the difference between these two words, which many persons wrongly imagine to mean one and the same thing. *Dividends*, as has already been explained, are payable out of profits, and if there are no profits to divide the law prohibits directors from paying *dividends*. *Interest* in no way depends upon profits or prosperity: its payment falls due on regularly recurring due-dates, and on those due-dates it must be paid, no matter whether the borrower [Company, Corporation, or Government] finds it convenient to meet its obligation or not. There is, of course, a vast difference between being obliged

to pay and only paying when it is convenient to do so.

This is the main point of difference between a Company's obligation to its Bond or Debenture-holders and to its Shareholders. The former lend money at a fixed rate of *interest*, and so long as this interest is punctually paid, they have no concern in the success of the business. The latter, however, are partners, and some of them receive larger or smaller *dividends*, according to the prosperity of the undertaking. The prudent bondholder should ascertain prior to purchase that his Bond is well secured. Subsequently he should check the Company's Balance Sheets as they are issued, so as to make sure that the original security and the Company's income is not diminishing, either in quantity or in value. The shareholder, being directly interested in the business, must constantly keep his eye upon the Company's position and the general state of trade. These facts have now been repeated several times, and it is hoped that no Investor will overlook them, as they form one of the first principles of investment.

Difference between bondholder and shareholder.

Duties of bondholder.

Duties of shareholder.

Money can be lent either for a short period, to bankers and others, or for a long period, to Governments, Corporations, Municipalities, or Joint-Stock Companies; and it can be lent either against any security which is specially set aside

Different ways of lending money.

to secure the loan, or without any such special security. In the case of short loans, the lender receives either a simple acknowledgment, a bill, a mortgage deed, or an I O U. In the case of loans for a long period, he receives a scrip certificate, which is called a Bond or Debenture. To purchasers of British Consols and some Colonial loans, an entry in the books kept for that purpose by the Bank of England is the only evidence of proprietorship which exists, as the stock receipt is never called in when a transfer of the stock is made, and afterwards the transfer becomes a valueless document.

Two classes of Bonds.

Short loans do not interest us here; we will therefore confine ourselves to the Bonds and Debentures issued by Governments, Corporations, Municipalities and Joint-Stock Companies. First of all, we will divide these into two classes, viz., those with special security and those without special security.

Security of Government stocks.

Most of the Government, Municipal, and Corporation Loans are not guaranteed by special security, except in the case of young Governments or those older Governments whose financial past has not been so clean as to earn them a reputation for promptly meeting their engagements. But, as a rule, these loans are solely secured upon the honesty of the borrower.

This point is especially important to remember

in the case of Governments, because these cannot be sued in any court of law for their national debts. Later in this book all types of loans will be fully discussed; here it will suffice to point out that the incomes which they respectively yield vary in amount according to the credit which each particular Government or Municipality enjoys.

Nearly all other loans, be they raised by Companies which work under special Acts of Parliament, or Companies which are registered under the Limited Liability Acts, are specially secured either by a direct hypothecation of some specially earmarked property or by mortgaging the entire assets of the concern. Of the two, a special mortgage is the better security; because in that case the lenders [Debenture or Bond-holders] rank in front of all other creditors, so far as the specifically mortgaged assets are concerned. Therefore they run no risk, if only they are careful to see, before investing, that the property which is mortgaged to them is worth considerably more than the total amount of the Debenture or Bond-issue.

Specifically mortgaged securities.

It will be seen from the above explanation, that it is not only easier to ascertain the safety of a Debenture than in the case of a Share, but that the surveillance of the security is also much less complicated. The borrowing Company must pay its interest regularly, or it is liable to be forced

into liquidation; and from failure nothing need be feared by the Debenture-holders, so long as the value of the realisable assets considerably exceeds the amount of the Debenture-debt.

Enforcing bond-holder's rights.

A Debenture or Bond-holder, being simply a lender of money, is in a position to enforce his rights. In fact, in case of a default in interest-payments, all shareholders standing behind him would be compelled to look on patiently whilst the Bondholder realised a sufficiency of the assets to recoup himself for the money he had lent to the Company. For this reason Debenture-interest is, as a rule, promptly paid, except in such cases where the Debentures have not been amply secured in the first instance, or where some exceptional disaster has overtaken the concern. In short, if there is a substantial surplus of assets remaining, after the claims of the Debenture-holders are satisfied, the shareholders naturally strain every effort to preserve the assets in their own interests. In order to do this, they are prepared to make every sacrifice to avoid a forced sale on the part of the Debenture-holders. In any event, there is much less chance of losing either Capital or Income on Debentures than on Shares.

How shareholders assist bond-holders

This brief distinction between the respective positions of Share and Debenture-holders does

not strictly belong to this chapter, which deals mainly with Income. But it was impossible to explain the gradations of Income-safety without this partial digression.

Realisable *versus* intrinsic values of stocks.

There is another extremely important point which should be considered in this connection, namely, the temporary popularity of a stock. Investors should make up their minds that the actual selling-price of a stock has nothing whatever to do with establishing the relative value of that stock in comparison with other securities. Coldly and impartially considered, it would seem that no fancy value could ever attach itself to a stock returning a fixed rate of interest. It would appear inevitable that the market-value of such stocks would be fixed by the rate of interest charged on permanent loans at that time; but this is not the fact. There are some stocks which the newspaper articles keep constantly before the public eye. These stocks become what is termed "well-known," and, owing to their popularity, they command a fancy value. Investors prefer to buy stocks which they believe they would be able to sell at any time. In many cases, however, the popular fancy for stocks proves a very expensive hobby. If Investors were aware that they had to sacrifice frequently a fifth of their income to their indulgence of this fancy for fashionable

Popular stocks generally expensive.

stocks, they would pause before they gave way to it.

Example illustrating drawback of popular stocks.

A very pointed instance of this indiscriminating method of investing exists at the time of writing. So far as security is concerned, there is absolutely no difference between Consols and Irish Land stock, because both these securities are unconditionally guaranteed by the British Government. Yet during the current year (1908) at one time the $2\frac{1}{2}$ per cent. Consols sold at the same price as the $2\frac{3}{4}$ per cent. Irish Land stock. Or, in other words, the same sum of money invested in Consols to produce an income of £100 per annum would have been sufficient to buy as much Irish Land stock as would have produced £110 per annum in the shape of Income.

What would happen if any bank were to say that all its bills were equally secured and that it charged the same rate for them, but that bills printed on green paper would receive 10 per cent. more income than those printed on yellow paper? Why, no one would take yellow bills until they had fallen to such a price as would bring their yield into harmony with the yield obtainable from their green competitors. Why, then, did not the holders of the £577,342,000 Consols rush to sell, and buy the Irish Land stock in exchange? Simply because the one stock

Reason for comparative dearness of stocks.

is better advertised, better known, and consequently more highly esteemed than the other.

If any competent stockbroker is asked whether it has ever happened to him that, with a little patience, he has failed to find a purchaser for any good security at a fair price, his answer would be in the negative. All good securities, be they quoted, or unquoted, widely marketable or only locally marketable, are always saleable at a fair price. Therefore but little weight should be attached to the question of marketability when appraising the respective values of little known but good securities issued by fair-sized companies of repute in comparison with fashionable and much-advertised stocks.

Good securities always saleable.

It would hardly seem necessary to mention that holders of stocks should not calculate the yield which they obtain from their invested Capital upon the cost prices which they originally paid for their stocks, but upon the current prices at which these stocks can now be sold. This is clear, because if a 5 per cent. stock originally cost £100 it yielded its holder 5 per cent. at the time of purchase. But as soon as it can be sold for £125 it only yields 4 per cent., because its realisable capital value has risen to £125. Therefore its owner has now £125 of realisable Capital instead of only £100, as he originally had. Of this £125 £100 is his

Yield of stocks measured by market value.

Profits should be taken to build up Capital.

original Capital and £25 of it is part of his income, which has been made in the shape of increased value. There is no difference between receiving dividends and investing them in non-income bearing stocks and leaving increased value unrealised, or, in other words, invested. If the addition to Capital through invested dividends produced no additional income, dissatisfaction would be felt, and an equal feeling should result when increased value produces no equivalent dividend-increase. This is a very important point in connection with the building up of an Investor's income, as will hereafter be explained.

To all those Investors whose sole object it is to build up their Capital Account, it is quite immaterial whether this result is achieved by an increase in the realisable value of the stocks which they hold, or by reinvesting surplus dividends or interest as fresh Capital. This type of Investor is also indifferent as to whether or not the total amount of his dividends and interest is maintained on a steady basis year by year.

Regularity of Income-payments.

To all those Investors, however, who rely on the produce of their Capital for their maintenance, it is of the greatest importance that the income-payments should be regular. These points have been treated already in Chapter II. of this book in the discussion of investment-objects, but here a few additional hints will be given.

Every investor will do well to accustom himself to treat every point in connection with stock and share-investments as uncertain, and never to assume that there is any mathematical certainty of any kind in connection with them.

Discounting uncertainties of Income.

It is not difficult to spend more money than one is accustomed to, but it is always a hardship to be forced to reduce one's habitual expenditure. For this reason, no Investor should deliberately place himself in the position of possibly having to face a reduction of income. Such an end is most easily arrived at by discounting beforehand the future uncertainty; which can be done by one's making it a rule to live well within his means.

Income-regularity in relation to Income-yield.

The larger the yield on the Capital, the more risk is there of one or two of the stocks held reducing their dividend or interest, or some of them stopping dividend-payments altogether. For this reason, those who receive a total yield of 4½ per cent. on their Capital run a smaller risk of income-losses than do those who receive a yield of 5½ or 6½ per cent. So that it may be roughly said that regularity of income varies in inverse ratio to Income-yield.

Any one who has carefully considered the means advocated in Chapter II. for obtaining certain given investment-objects, must have

A Remedy for Income-irregularities.

been struck by the fact that it is possible to make income-yields varying from 4 to 7 per cent. It is this elasticity of possible income-yields which serves as a remedy against possible income-irregularities.

Supposing a capitalist has £10,000 to invest, and he is satisfied with an income of £400. Then he should not lay his plans to make an income of £400 per annum only, but his aim should be, £425. If he adopts a systematic plan of distributing his investment-risks scientifically, he will in all human probability make this income of £425 for many years without any reduction.

Income-irregularities met by Reserve Fund.

But as the possibility exists that such a reduction might occur on any dividend-date, he should only spend £400 of his income, and place £25 to Reserve for contingencies. This Reserve he should, of course, invest, and only draw on it when one of his stocks has failed to produce the full income which it was estimated to produce.

In this way the uncertainty of income is insured against and some provision is simultaneously made against any future Capital depreciation which might occur.

Likewise, a capitalist who determines to make an income of £475 on a capital of £10,000 should invest to obtain £525. His stocks are slightly lower in grade of safety, therefore his annual contribution to Reserve should be £50.

Whilst £25 annually placed to Reserve is sufficient to provide against the risks attaching to a £400 income, in the case of an income-requirement of £475 the Reserve-contribution should be correspondingly increased to £50 per annum. On an income-requirement of £550 per annum from £10,000 invested, the Investor should try for an annual income of £650, and he should place £100 per annum to Reserve; in fact, the amount of annual contribution to the Reserve should never be less than 5 per cent. on the income required; and such contribution need never be more than about 15 per cent. of the annual requirement.

How to build up Income-Reserve.

On this principle, an income-requirement of £650 should be backed up by an annual contribution to Reserve of about £130 per annum; that is to say, the total yield tried for should be £780 per annum on £10,000, or $7\frac{3}{4}$ per cent. This would be an unreasonable income to expect. Thus it becomes obvious that to attempt to make more than $5\frac{3}{4}$ per cent. per annum in the shape of income which the Investor may safely spend, is to court disaster.

Treatment of high Income-yields.

Every one who invests his money in accordance with the principle of the Geographical Distribution of Capital will from time to time be able to sell some of his stocks at a profit. Of such opportunities the Investor should in-

When to reinvest Capital.

variably avail himself, whenever he sees the opportunity of advantageously reinvesting the Capital liberated by such a sale in some other Geographical Division where general depression temporarily reigns supreme. The income thus accumulated by realisation-sales at a profit should be added to the Reserve-fund, which has already been opened with annual contributions out of revenue, as explained above.

A 10 per cent. Reserve-Fund against Contingencies.

It will be a pleasant and most welcome surprise to many to find how comparatively fast such a Reserve-fund will grow, if it is regularly fed in this way, out of income. As soon as the amount of the Reserve-fund is equal to 10 per cent. of the total original Capital with which the Investor commenced operations, then the owner of so respectable a Reserve has amply provided against every contingency.

Income-yields of Geographically Distributed Capital.

At the time of writing, Geographically Distributed Lists of Investments will yield on absolutely gilt-edged securities 4½ per cent. on an average; very safe Debentures and Preference shares will yield 5¼ per cent., and Debentures and Preference shares of medium quality 6 per cent., whilst Ordinary shares of fair quality are producing 6½ to 7 per cent. These are the extreme present yields of the three principal categories of securities, and Investment-Lists can be compiled to yield any rate of annual

interest between the two extremes of 4½ and 7 per cent.*

It has already been explained that to some extent the yield obtainable from a security indicates its character; also that it is one of the main essentials of an efficient distribution of risks that all the stocks comprised in the same Investment-List should be identical in character. Therefore Investors should, under no consideration, hold low-grade and high-grade securities simultaneously, nor endeavour by such incongruous means to obtain a high average of income-yield. If it is at all possible, Investors should try never to hold at one time securities which differ more than 1 per cent. in their respective yields, as otherwise there is a strong tendency to upset the perfect equilibrium which is characteristic of a scientifically constructed Investment-List.

Separation of high- from low-grade stocks.

The keeping of a proper account-book showing at a glance not only what stocks are held, what they cost, and at what price they have recently been saleable, but also what income was originally expected, and what income has actually come to hand, is an indispensable adjunct to every

A proper Account-Book indispensable.

* In "Scientific Investment in Daily Practice," by Sir John Rolleston, published at 2, Waterloo Place, London, a number of charts and tables are given showing the actual results at present obtainable from Geographically Distributed Investment-Lists varying from 4½ to 6½ per cent. in their yields.

Special knowledge of book-keeping avoided.

properly conducted investment-account. In order to meet this requirement, the present writer has designed such a book, which is published under the title of the "'Eyar' Investor's Account-book." This book has been so modelled that no special knowledge of book-keeping is necessary for keeping it up; it gives at a glance, and without any laborious system of re-entry, a complete bird's-eye view of the Investor's entire position.

Any Investor who uses this book will periodically have his attention called to the realisable value of his investments. As an increase in total realisable value is treated as part of the sum which makes up the net income, the Investor will perhaps be inclined to treat all rises in value as actual income made. To do this would not be wise, for stocks still in hand are always liable to go down again. For this reason, only those increases in value which have actually been realised by sales should be treated as income proper.

Three sources of Income.

There are thus three possible sources of income from investments:

1. Dividends and Interest; and of these the dividends may vary in amount, whilst the interest will in most cases remain stable.
2. Profits made on the sale of stocks.
3. Rises in value on stocks still in hand.

The rises in value on stocks still in hand should, as already explained, only be treated as a prospective income-estimate. The profits on sales of stock, as also part of the dividends and interest, should be placed to Reserve, and only from 85 to 95 per cent. of the actual sum received in the shape of dividends and interest should be expended.

How to assure a steady Income.

If an effective distribution of investment-risks has been arrived at and these rules are strictly observed, the Investor, will not only enjoy a steady and increasing income, but will also be enabled to make provision against the contingencies of Capital-Depreciation and Income Failure.

CHAPTER V

THE RELATION OF CAPITAL TO INCOME

IT has already been pointed out that the yield of income obtainable from the use of money varies very considerably in different classes of investments. This of course must be so in all those cases where the owner uses the money himself, as his skill and business experience play an important rôle in producing the ultimate results. But as soon as the factor of personal effort is eliminated, the yield of Income should be almost the same the world over, provided that the risk of losing Capital be also the same. In reality, this universal equality of yield does not exist on account of the uneven distribution of wealth over the earth's surface and the, as yet, imperfect understanding of the local risks attaching to the safety of Capital in those quarters which are geographically remote from Europe where Capital is more abundant.

No fixed ratio of Income-yield to Capital-safety.

When money is put out to earn interest there is always the risk of the borrower not repaying

the sum lent or not paying the interest thereon. These risks are insured against by retaining an adequate margin of safety. If, for example, a sack of wheat is selling for 25*s.* it is quite safe to lend 12*s.* 6*d.* on it, because there is no likelihood of wheat falling below that value. So that in case the borrower does not pay the interest or does not return the capital, then the wheat can be sold by the lender, and by this means he can reimburse himself for his capital and interest.

Insurance against Investment-Risks.

The nearer the sum lent is to the selling price of the wheat, the less safe does the loan become. Because the sale of the wheat by the lender might then result in the realisation of a sum of money smaller than the principal and interest due to him. This example explains the manner in which lenders insure themselves in the cases of loans upon a special security. A great many loans, however, are made without special security being deposited, and in all such cases the whole fortune of the borrower is considered to be the security on which the lender relies. Thus it is quite safe to lend £1,000 to any one who is possessed of £50,000, but it is less safe if he owns only £5,000, and hardly to be called safe if he has no more than £1,000.

In those cases where special security is deposited, the lender knows that he has a first

Difference between General and Special Security.

charge upon the value of the deposit. In the case of an open credit, without deposit, the lender is quite in the dark, because a person, who had £50,000, might have borrowed £1,000 from each of sixty separate people without any one of them being aware of the rest of the borrower's outstanding liabilities. In such a case, the total liabilities would be £60,000, and each of the loans so raised would be very doubtfully secured.

It will be seen that the gradations of safety attaching to loans is infinite, so that it would be reasonable if there were a standard rate charged for the use of the money lent, and if an additional premium were also charged commensurate with the extra risk incurred in special cases. Such, however, is not the practice, and, as the subsequent argument will show, Capital does not by any means command the same rate of interest the world over, although employed in loans of precisely the same degree of safety.

Rate of Interest varies in different countries.

Let us consider the simplest and safest form of loans, namely, those secured on freehold property, mortgaged up to one-half of its realisable value, and let us take land in the choicest positions in London, Berlin, Toronto, Buenos Ayres, Cape Town, Bombay, and Tokio respectively, as the security to be

borrowed upon. The security is unquestionable and absolutely equally good in all the towns mentioned, yet the borrower will have to pay 6 per cent. in Tokio and Bombay, 5 per cent. in Cape Town and Buenos Ayres, $4\frac{1}{2}$ per cent. in Toronto, 4 per cent. in Berlin, and $3\frac{3}{4}$ per cent. in London for the loan of money. Now the question will be naturally asked, Why does not the London lender send his money to one of the other cities, and thus obtain a higher rate, or why should a loan in Toronto cost less than a loan in Cape Town? Simply because the London or Toronto lender knows his own town, but does not know the conditions which prevail in the other towns; therefore he is not able to estimate the risks attached to lending money in distant lands. There is also more money to lend in one place than in another, and as money does not readily travel from place to place, different rates prevail.

Example of Interest-Variation.

Reason for anomaly in Interest-Rates.

A similarly chaotic charge for interest is made in the case of loans without security. Thus a London firm of merchants can borrow from their bank at 4 per cent., whilst the Calcutta house of the selfsame firm will simultaneously be compelled to pay 6 per cent., there being more available cash in London than in Calcutta. The London lender could make 2 per cent. more with equal safety if he were to send his money

to India, but he does not do it, because he is not directly in touch with the credit-conditions which prevail in India.

Capitalists afraid of unknown risks.

Every capitalist, being afraid of an unknown risk, endeavours to employ his money on a security which he personally knows, and thus an inhabitant of Birmingham would consider Corporation Street property the finest security, a Berlin man the Leipsic Strasse, a New Yorker Fifth Avenue, and a Londoner Piccadilly Circus. The Birmingham man will not willingly lend on Leipsic Strasse or Fifth Avenue property, nor a German on Piccadilly Circus or Corporation Street, although investigation would prove all these risks to be equal.

Factor affecting Interest-rates

Similarly, bankers the world over will only lend to people whom they know, and in this way Capital becomes tied to the place where it is owned, and does not freely migrate from one centre to another. So that, where there is more Capital and less demand, interest-rates are low, and where there is little Capital and much demand for it, rates are high.

In this respect money differs from the staple commodities of the world. Wheat, rice, skins, cotton, and every other great article of commerce have practically the same price the world over, and only freight, storage, and duty make up the difference between the various

quotations. This was not always so, but the fine development of commercial interchanges has levelled down all real price-differences. Although the local methods of dealing with money have been brought to a high state of perfection, the international exchange of spare cash amongst nations is still in its infancy. Until it is perfected, the present enormous differences in the interest-rates charged on borrowed money in different parts of the world will continue.

Interchange of Commodities wider than of Money.

Every country has two distinct rates of interest; the one, the permanent rate, is that which prevails on permanent loans on first-class security; the other, the ever-changing rate, is that charged for short loans. The latter rate depends mainly upon the state of actual cash in the country, and the question of floating supply and demand at the moment; the former alters very slowly with the financial development of the country. Thus, whilst the London bank-rate may be at 6 per cent., people will lend permanently at 4 per cent., and whilst the bank-rate may be 3 per cent., yet for permanent investment 4 per cent. is still obtainable.

Difference between rate of Interest and Bank-rate.

The Government borrows in most countries at the lowest rate, and for this reason the interest paid on the Government Loans of each country gives the keynote to the scale of rates prevailing in that country, and the other securities follow

suit in the order of safety in which they are regarded by the great mass of Investors. The following examples show how vastly the rate on different Government stocks varies :

Varied Interest-rates of different Governments.

Consols yield at the time of writing $2\frac{7}{8}$ per cent. ; French loans, $3\frac{1}{16}$ per cent. ; Dutch, $3\frac{5}{16}$ per cent. ; Swedish, $3\frac{3}{4}$ per cent. ; German, 4 per cent. ; Hungarian, $4\frac{3}{16}$ per cent. ; Spanish, $4\frac{5}{16}$ per cent. ; Chilian, 5 per cent. ; Argentine, 5 per cent. ; Japanese, $5\frac{3}{8}$ per cent., and these rates are directly reflected upon the local securities of these countries, first-class Debenture stocks yielding about $\frac{1}{2}$ per cent. more than the Government Loan, Debenture stocks of lower quality 1 per cent., and Ordinary shares 2 per cent. and more, above the rate yielded by the Government Loan.

Relation of Government to Local Securities.

Here, again, there is no difference between the safety of the relative stocks of the various countries which have good and enforceable laws, as a well-secured Dutch, German, or Japanese Debenture is as safe as an English or French Debenture of the same quality, yet the investment-yield obtainable differs in each case. It might be said that the Government Loans of the various countries vary in safety, although the inhabitants of each country are likely to consider their own Government stock the safest; but this argument does not apply

in any way to large commercial enterprises which issue Debentures.

Stocks in one country which are influenced by conditions in another.

There are a large number of examples of stocks issued by enterprises situated in one country selling at a valuation based on the rate of interest ruling in another country. Thus, for example, first-class Debentures held in Canada yield 5 per cent., first-class Preference shares 5½ per cent., and good Ordinary shares from 6 to 8 per cent., these yields being based upon the supply and demand of money in the Dominion; yet the fixed income-issues of the Canadian Pacific Railway sell in London to yield under 4 per cent., this being from 1 to 1½ per cent. less than the lowest rate paid in the country where the railway is situated. Similarly, Argentine Railway Debentures quoted in London yield 4 to 4½ per cent., whilst the rate in that country is from 5 to 6 per cent. Japanese Government stocks quoted in London yield 4¾ per cent., whilst precisely the same Government bonds sell in Tokio to yield 5½ per cent.

Cause of Investment-anomalies.

These anomalies are caused in the following manner. It has been stated that information in respect to real property and commercial credit does not readily travel. Thereby a difference in the loanable value of money in various countries is called into existence. But information concerning stocks and shares does

travel easily, for the balance sheets and reports of companies are issued in very much the same form throughout the world; they are easily translated from one language into another, and Investors have now become used to consider enterprises in every part of the globe.

Stocks held chiefly in other countries.

So free has the interchange of securities become, that the stock of a German Gas Company is principally held in England, the stock of an Austrian Railway in France, and the shares of an African Trading Company in Holland. The British markets especially are full of all kinds of enterprises situated in every part of the globe, and the British Investor seems, to his cost, to be unaware that these stocks should yield him a rate proportionate to the rate ruling in the country where the enterprise is situated. The London Stock Exchange measures the capital-value of these intruders by the value of money which prevails in England. In this way the British Investor is a great deal of money out of pocket, for whilst his Canadian Pacific Preferred only produces for him an income of £4 per annum on every £100 invested, this £100, if put into a first-class Canadian Debenture, as yet untainted by the British money-rate, would produce £5 per annum for him.

Endless examples of a similar nature the reader can find for himself by glancing at the

London Share List, and comparing the yield on Government stock of any country with the yield on securities situated in that country. The Government stock of a law-abiding civilised country should, in normal cases, yield from ½ to 2 per cent. less than the other securities of that country.

Relative yield of Local to Government securities.

In this way the ruling rate of interest in every country influences all the stocks principally dealt in in that country, and this is one of the reasons why all the principal stocks of every country rise and fall in price simultaneously, a certain fixed distance of yield from each other being perpetually maintained. This distance of yield is settled by the quality of the stocks and the manner in which they rank in public esteem.

A country's principal Stock fluctuate in unison.

Every Investor is, of course, anxious to derive the largest possible income from his Capital which is compatible with safety. It has been shown that there are some places in the world where money is cheap, and others where it is very dear, and that the quality of the security offered is in most of them more or less alike. Thus, of two equally well-secured Debentures of the same commercial standing, the one would yield 4¼ per cent. per annum, because it is held in England and valued by the money-rates ruling in our country, whilst the other, being a Japanese Debenture, and valued by the

rates current in that country, would yield 6¼ per cent. The largest profit is made by taking the goods which any one has for sale to the best market. The goods in this case are money, therefore the first inclination would naturally be to invest all one's money in Japan, and such other countries where money-rates are high; but this would not be wise, as capital might have to be realised and it would then be exposed to violent fluctuations.

In Chapter III. of this book it has been explained that all the stocks of any one country move together; therefore, by investing in a limited area the Investor would endanger his capital. A simple arithmetical example will show how very unwise it is to risk Capital for the sake of Income. The lowest rate which Capital should yield, when the Income from all stocks is added up and an average struck, is at the time of writing 4¼ per cent., whilst the highest rate should not exceed 6½ per cent. The difference between the highest and lowest rate is therefore 2¼ per cent. per annum, and it would take 44 years [without compound interest] to make up the whole Capital by means of this difference, 22 years to make up half of the Capital, and 11 years to make up a quarter of it. A quarter of the invested Capital is very easily lost through a faulty distribution of

Folly of risking Capital for sake of Income.

risks, viz., by trusting the entire Capital to the stocks of one country. All holders of exclusively British stocks of the best kind lost nearly a quarter of their Capital between the years 1897 and 1907; and what has happened in a highly civilised country like Great Britain could, of course, happen at least with equal ease in any other part of the world.

Result of exclusive investment in British Stocks.

Capital, being the root of all Income, should never be risked in order to obtain a high yield. Therefore, however alluring it might appear, in theory, to take all one's Capital to the best market, such a course should not be adopted, because the ensuing concentration of the individual Investor's Capital could not do otherwise than impair the safety of that Capital.

Concentration of Capital impairs its safety.

Investors should always keep a careful watch on their Capital, and be satisfied with the yield which a proper distribution of risks affords. By distributing his funds Geographically on the principles which have already been explained, the Investor obtains the average rate which is ruling the world over, and he should not aim for more. On first-class securities he would be compelled to accept $3\frac{3}{4}$ per cent., if he held all British stock. But by taking a first-class stock in every Geographical Division, he can obtain an average of $4\frac{1}{2}$ per cent. on this class of

Advantages of Geographically Distributing Capital.

security. From a safe but slightly lower grade stock in England he would obtain 4¼ per cent., and from similar stocks if geographically distributed the world over he would derive an average yield of 5¼ per cent. Good Ordinary shares in England yield 5 per cent.; a geographical assortment of similarly good Ordinary shares will yield 6½ per cent. So that the Geographical Distribution of Capital actually tends to increase the income considerably, as the following table shows:

Geographical Distribution increases Income.

				£	s.	d.
£1,000 British Debentures	yielding	4¼ %	Income	42	10	0
£1,000 Colonial	,,	5 %	,,	50	0	0
£1,000 Europe North	,,	4½ %	,,	45	0	0
£1,000 Europe South	,,	4½ %	,,	45	0	0
£1,000 Asia	,,	6 %	,,	60	0	0
£1,000 Africa	,,	5½ %	,,	55	0	0
£1,000 America North	,,	4¾ %	,,	47	10	0
£1,000 America Central	,,	5¼ %	,,	52	10	0
£1,000 America South	,,	5½ %	,,	55	0	0
£1,000 International	,,	4¾ %	,,	47	10	0
£10,000	Total Income	..		£500	0	0

The yield on the British stock is 4¼ per cent., on the other European stocks it is 4½ per cent., but *the average yield obtained is* 5 *per cent.* The individual risks attaching to all the stocks in the above table are practically identical.

This table applies to the yields of income obtainable at the prices current at the time of writing; but it must not be taken as a con-

stant standard, because the price-levels, and consequently the yields of income in all these countries are liable to constant alteration on account of the ever-changing value of money at the various trading centres covered by this list. Thus, on some future occasion it may occur that the African Division will only afford a yield of 5 per cent., or the International stock 4½ per cent., but in all such cases the yield in some other countries will have advanced, so that the average ratio of yield will be found to correspond closely with that displayed in the table.

World's average rate of Interest constant.

The practicability of increasing income without increasing risk by adopting Geographical Distribution of Capital is as yet not so fully understood by Investors as the importance of this subject warrants, and it should therefore be carefully studied.

When shares in any undertaking are either bought or sold, the yield which they afford to the purchaser is one of the important items which helps to decide the wisdom of the sale or purchase. The value of an investment should be measured not by the price at which it was originally bought, but by the rate of yield which it affords to its owner, calculated at the stock's current quotation. A share which originally cost £10 and pays 3½ per cent. in

Share-value measured by rate of yield.

dividend might sell for £6, and another £10 share which pays 20 per cent. in dividend might sell for £32. In the issuing Companies' Balance Sheets, both these shares stand at £10, therefore the £6 share is bought £4 under its Balance Sheet valuation, whilst the £32 share is bought £22 over its Balance Sheet valuation, and the Investor is neither putting his £6 nor his £32 into the Company, but simply steps into the shoes of another person who originally paid £10 for his share.

Necessity for examining Balance Sheets.

This is a point of extreme importance which should be thoroughly understood by Investors, and before they purchase shares of any kind they should examine the Balance Sheet, and satisfy themselves from the figures therein given what is actually the break-up value of the share which they propose to buy. This is done by adding up, first of all, the Company's Liabilities, including all the Debenture and Share-issues which stand in front of the shares which are being inquired into; then adding up the Assets at a fair valuation, and finally deducting the Liabilities from the Assets. By this means the actual Balance Sheet value of the shares which it is contemplated purchasing, is arrived at.

Break-up value of a Share

When making such investigations Investors will frequently find, and especially so in the

case of high-priced shares, that they are asked to pay twice or three times as much as they obtain in tangible property through their purchase. They must understand that in all these cases this excess of valuation is paid for Goodwill, pure and simple. If they are still satisfied to pay a large sum for Goodwill, they should buy; but if they are in the least doubt, they should refrain, because Goodwill is a very mercurial property, frequently depending upon a solitary manager or director. It is invariably a better policy to buy under the original cost [that is, below par value] than over it, provided that the Company is well established and has ample working Capital, and it is highly dangerous to buy at a large premium. In all cases where a considerable premium which is not represented by Balance Sheet assets is paid, a very high yield ought to be the compensation for the risk which the buyer runs.

Goodwill a mercurial property.

Buy below not above par.

In the case of Railway, Gas, Water, Tramway, and several other classes of shares, it is impossible to arrive at the selling value of the assets; and here the dividends paid, their steadiness and the Companies' future prospects, are the only guides to real value.

To pay a high premium for shares of any kind is a dangerous proceeding; the purchaser not only pays to the former owner in full for

the tangible property, which is represented by the shares, but also a large proportion of the purchase-money for Goodwill, which is a very unstable form of investment and liable to diminish in value without timely warning.

Danger of partly-paid Shares.

Nearly all Companies and Corporations are constituted with the liability of shareholders being limited to the face-value of the shares originally subscribed for. In most cases this liability is paid up in full, shortly after the formation of the Company; in some cases, and principally in the shares of Banks and Insurance Companies, a certain amount of the liability is left outstanding. It is always dangerous to hold shares on which there is a liability, and especially so when this liability is likely to remain outstanding for a large number of years.

Shrewd financiers have invented this mode of obtaining additional credit for their institutions; as a rule, the now living generation of shareholders receive no compensation for thus guaranteeing the solvency of the Company, for partly-paid shares in large Banks yield no better return of income on their current quotations than fully-paid shares in similarly safe institutions. These liabilities are never called up unless the institution is near bankruptcy, and in that case not only is the original investment in jeopardy, but the freshly called-up Capital

is equally endangered. There are innumerable cases on record where partly-paid shares in Banks and Insurance Companies fell so seriously in value that the owners paid large premiums to speculative buyers and, in addition, gave them their shares for nothing, in order to rid themselves of the serious responsibility of being perhaps compelled to pay up the uncalled liability.

Shares which are given away.

Government, Municipal, and Corporation Loans, Bonds, and Debentures in commercial enterprises are also, like Shares, sold according to the yield which they afford to the purchaser. When this yield is calculated, care should be taken that the date when the principal is repayable be taken into account. There are some Bonds and Debentures which are perpetual, and in all such cases the purchaser should understand that he is buying an annuity, and that he can only then demand the return of his Capital when his interest is not punctually paid. There are other Bonds which are repayable on a certain date at their nominal value, others which are repayable on a certain date at a premium. If a 6 per cent. Bond is bought at 120 it yields 5 per cent. upon the purchase-price, but if that Bond is repayable at 100 in ten years, then the £20 difference between the purchase-price and the £100 capital sum which

Measuring the value of Bonds and Debentures.

Redemption an important factor in Bond valuation.

will be received in ten years' time in exchange for the Bond, must be made up out of income during the ten years of the life of the Bond. This will require about $1\frac{3}{4}$ per cent. per annum in the shape of a Sinking-fund, therefore this Bond does not really yield 5 per cent., but only $3\frac{1}{4}$ per cent. If this same Bond had been redeemable in twenty years, then about $\frac{3}{4}$ per cent. would have sufficed for a Sinking-fund, and the Bond would then yield $4\frac{1}{4}$ per cent. net.

Had the Bond been repayable at a premium, a still smaller sinking-fund would have sufficed.

Buying Bonds at a premium.

When Bonds which are repayable at a fixed date are bought at a premium, great care should be taken to ascertain the terms of their repayment, otherwise the Investor might be living upon part of his Capital without being aware of the fact.

Bonds subject to annual drawings.

There are also a considerable number of Bonds which are repayable at par by annual drawings, so that the whole of them are drawn and repaid within a certain fixed period. To purchase such Bonds at a premium is a speculation, as at any of these recurring drawings the particular Bond held might be drawn, and the premium paid for the Bond thereby irrevocably lost.

If we now proceed to sum up the true relation

of Capital to Income, we find that the magnitude of the Income is only, to a very slight extent, related to the Capital-safety afforded, and that in one country it might be impossible to obtain a certain high rate without imperilling Capital, whilst in another country that same high rate could be obtained with a high degree of safety.

Income subservient to Capital-Safety

We find, further, that Income should invariably be made subservient to Capital, and that every Capital-risk which is accepted should be counterbalanced by an adequate chance of gain, be it in the shape of a high yield of Income or in the shape of a chance of improved Capital-value.

It has been established that the issues of any concern should yield an adequate rate as measured by the value of money in the parent country of the undertaking, and not by the monetary conditions of the country where the stock is held; and lastly, that to buy stocks at a premium, or partly-paid stocks, is unwise and calculated to cause a Capital-loss in the long run. By distributing Capital over the earth's surface, the average rate ruling for money the world over forms the basis of the Income-calculation In this way the maximum of Capital-safety compatible with the maximum of Income should result.

Maximum investment Results.

CHAPTER VI

ON STOCK EXCHANGE SECURITIES

STOCK Exchange Securities are divided into two main groups, the one denoting a partnership in the concern, and the other signifying a loan made to the issuer of the security. The latter main group comprises all Government, Municipal, or Corporation Loans, Bonds, Debenture Bonds, Debenture Stock, Mortgage Debentures, and Debentures—all these words signifying that a loan is meant. The former main group comprises stocks and shares of all kinds, such as Guaranteed, Preferred, First, Second, Third, etc., Preference, Ordinary, Preferred Ordinary, Deferred Ordinary, Founders', and other shares.

Shareholders are Partners: and Bondholders are lenders.

There is practically no difference between the word "stock" and the word "share," for both these words are frequently interchanged at random, one person describing the same security as a Preference Stock, the other as Preference Shares, and both being equally correct. It is sometimes said that a security is a "stock"

No practical difference between Stock and Share.

when its nominal value is £100, and a "share" when the nominal value is another multiple of money. Others make the definition that "stock" can be transferred in any multiple of the coinage of the realm, whilst a "share" can only be transferred in multiples of single shares; but in reality no specially distinctive meaning attaches to either word. All that is important to know is that "stock" is usually quoted at so much per cent. and that "shares" are usually quoted at so much each.

Difference between Bond and Share.

There is, of course, a vast distinction between a Debenture or loan on the one hand, and a Share or participation on the other, so Investors will not only do well to thoroughly comprehend the real difference which exists between them, but also to familiarise themselves with all the various kinds of Loans and Shares which exist.

Importance of distinguishing between Bonds and Shares.

Such a knowledge is quite indispensable, because the mode of ascertaining the safety of one kind differs so vastly from the methods employed to value the others, that certain points which are all-important in the one case are of no consequence in the other.

Let us assume, for example, that a shopkeeper owns the premises in which he carries on his trade, and that he has two distinct business propositions to make, the one being to raise money on his premises, the other to take a

Difference between Share- and Debenture-holder explained.

partner into his concern. Under such circumstances the prospective lender would devote his attention to the house offered to him as such, namely, its value to anybody, and not only to this particular shopkeeper. The incoming partner, on the other hand, would consider the goodwill and reputation of the business, the saleability of the stock of goods on hand, and the past profits made in the business, as the items which should chiefly engage his attention. The premises themselves he would regard as an important, but secondary, consideration. The lender of money on the house would be, in such a case, in the position of a *Debenture-holder*, whilst the intending partner would be in that of a *shareholder*. Both these men had a totally different matter to consider, and in the majority of cases the purchaser of a Debenture differs from a purchaser of Shares in precisely the same way. Hence, to thoroughly understand the meaning of the description of a security, is tantamount to knowing what point is of the greatest importance in the estimation of its value.

Method of valuing Bonds and Shares differs.

It is hoped that the reader will, in his own best interests, not skip this chapter, which, owing to the nature of its contents, is bound to take the form of a descriptive catalogue. In any event, the chapter should be used for reference.

Government Loans and their redemption.

The oldest and, quantitatively, the largest form of Stock Exchange Security, is a Government Loan. It is originally created by any Government being driven to the immediate expenditure of a larger sum than it is able, or considers it prudent, to ask its taxpayers to contribute there and then. Therefore the Government borrows the necessary funds in the first instance and repays them by suitable instalments at a future period. In some cases a fixed plan of repayment is adopted from the start, so that the Loan becomes extinguished automatically within a specified period; in other cases, the Loan is so large, and the possibility of repaying it such a very uncertain quantity, that no period of repayment is fixed. In these cases, the Government reduces its indebtedness as and when the collected taxes leave a surplus in hand.

The Loan of the French Government, for example, is quite indefinite as to the repayment of the principal sum lent, and therefore it takes the shape of an Annuity. In England there is a Sinking Fund in operation, but, unfortunately, the Sinking Fund—like an uncertain watch—is more often out of use than in full working order.

British Government Sinking Fund.

Security of Consols.

Some people are under the impression that Consols, being such a valuable property, are represented by something. As a matter of

fact, they are not represented by anything stronger than a moral obligation on the part of the Government of England to repay the sum of money lent to it. The money itself, which has been raised by the Government by means of this issue, was spent as soon, or even sooner, than it was received. Beyond its Army, Navy, and a few Crown properties, the Government, as such, owns nothing. In fact, Consols are nothing better than a note-of-hand backed by the nation's credit, and nearly all other Government Loans are in the same position.

Government Loans secured on Revenue.

There are some minor Governments which are obliged to pledge as security certain specific revenues, so that they may be enabled to borrow. But these special hypothecations, as they are termed, invariably take the shape of some special obligation on the part of the subjects of the borrowing nation to make payments, such as Custom House revenues, certain monopolies, and such-like, so that the floating security offered is again of an intangible nature. In a few isolated cases Government Loans are well founded,

Security of German Government Loan.

as, for example, the majority of the German Loans which are secured upon a vast network of State-owned railways; but, as a rule, a Government Loan has no real security behind it.

No Government can be sued in a Court of

Law for its obligations to its creditors, so that on any Government deciding to stop its interest-payments, the unfortunate lenders have no real means of enforcing their rights. Governments also can impose taxes upon the interest which they have to pay.

Investors at mercy of Government.

This is a form of legalised robbery for which any private individual would be put in jail. Nevertheless, the Italian Government did impose a tax of 20 per cent. on the coupon-payments against its State Loans. Governments can also reduce the rate of interest which they originally contracted to pay. Thus, England declared that after a certain day Consols would pay only $2\frac{1}{2}$ per cent. interest instead of the formerly agreed rate of 3 per cent. A great pretence is made in such cases that the lender can have his money back if he does not like the terms of the new contract. But, since the law insists that certain funds must be invested in Consols, this is analogous to the case of a school-boy, who is told he is at liberty, but that he must remain in the class-room during his hours of freedom.

Governments and legalised robbery.

When closely analysed, the relative positions of borrower and lender in the case of unreasonable Governments are, that the borrower, having obtained the money, can give or not give the agreed equivalent, just as he likes; whilst the

lender must be thankful for anything which he receives, and is obliged to accept it with a smile of satisfaction.

Drawback of Government Stocks.

In addition to the lack of real security and the inability to enforce the lender's rights, there is another highly important drawback to the holding of Government stocks.

Gambling in Stock Exchange values was invented simultaneously with the creation of the first Stock Exchange and of the Stock Exchange securities dealt in thereon. It has proved an expensive pastime, the world over, ever since. Since ordinary public gambling and lotteries have been suppressed, a fresh impetus has been given to the game of guessing what a stock is likely to fetch to-morrow; as this is the only seemingly respectable public method of staking money on wagers which is now left.

Government stocks are gambling counters.

All gamblers must have counters to play with, and the larger the amount of such counters, the merrier the game becomes. As Government stocks not only represent the largest nominal value, but as real business in them must take place daily, speculators convert them into one of their "happy hunting-grounds." Besides, it is always well to give some semblance of reason to every price-variation; and what better motive could there possibly be than a war-rumour or a change in the

Cabinet, or one of the innumerable ups and downs which occur daily and make up the life of a nation? So, on the score of rises and falls, a Government stock is almost a champion amongst all other Stock Exchange securities. Rumours as price-influences.

As a result, in most countries the Government stock is the football of an army of professional manipulators who, year in, year out, make large incomes out of the gambling spirit of the general public. Grave statesmen, wealthy bankers, highly respectable merchants, and professional men join the spendthrift, gambler, and ne'er-do-well, in trying to define the possible future price of Consols when the German Emperor storms or the Prime Minister threatens to expropriate all the apple trees in the country at the public expense, so that, in the cause of temperance, the manufacture of cider may be suppressed.

The Government of England is not only directly or indirectly the largest holder of Consols, but also has by far the largest cash turnover of all the business concerns in the kingdom; for its annual revenue amounts to over 150 millions. In the daily course of its business, men in charge of the administration of the country buy and sell the largest amounts of Consols, whether these transactions be for the Post Office Savings Bank, the Law Courts, or any other public office. Furthermore, the The Government as a business concern.

Government constantly borrows money on bills. In short, the Government not only has practically any amount of Consols at its command, which it could deliver to buyers, but also has abundant use for any cash which may come into its possession.

Government could, therefore, regulate the price of Consols with the utmost ease, without speculating in any way.

How to regulate the price of Consols.

Whenever a demand for Consols springs up, Government can supply it out of its holding of stock, and invest the proceeds in some other first-class security. Whenever Consols are offered in abundance, it can take them up and provide the purchase-money by the issue of Exchequer Bills. Whether the Government chooses to increase its liabilities by selling Exchequer Bills and simultaneously to reduce its liabilities by purchasing Consols is quite immaterial, because the bulk of the nation's indebtedness would remain unaltered.

This proposition must not be gauged by the past history of Consols, for they would immediately become stable in price, and the Government could regulate and control the Consol market absolutely. The price of many articles is regulated in this way; why, then, should not the Government so regulate the price of its loans, of which, in reality, it is the master? Not only would public confidence in Consols be

increased, if this were done, but the gambler would be prevented from using the property of widows and orphans as a counter in his game. Advantages of Government control over Consols.

The Financial article in the newspapers would inevitably lose certain sonorous paragraphs with which it customarily opens its description of the previous day's doings, but a healthier and cleaner atmosphere would be introduced into all investment-questions.

In England, the Government Debt enjoys the distinction of being blended by the Bank of England with its stock of gold to form the security against the bank-note issue. This fact has most likely originated the idea with English bankers of using Consols as the repository for any spare funds which they do not need at the moment, but which they might want to use at any time and on the shortest notice. As all banks share this idea, a very free market is created, and Consols can be bought and sold more readily than any other stock, and at less expense. Consols thus serving as the bankers' cash reservoir, they, as a consequence, yield, as a rule, about 15 per cent. less in interest than any other security. Consols the Bankers' cash reserve.

It is hoped that the above explanation will make it plain that Government stocks of any kind are the most unsuitable form of security for any Investor who is not *nolens volens* obliged to

Dr. Siemens on drawback of Government Stock.

hold them. The famous Dr. Siemens, founder of the Deutsche Bank of Berlin, has made a calculation that £50 invested in Prussian Consols would, over a period of twenty-five years, have yielded £25 less in income than if it had been invested in well distributed Foreign securities; and £12 less than if it had been invested in good Prussian securities. In this calculation he has allowed for a number of losses which would have been made on the foreign holding.

Proof of ownership of Government Bonds.

In the case of British Government stocks, either Bearer Bonds of certain denominations are issued, or the ownership is proved by an entry in the books of the Bank of England. In the case of nearly all other Government Loans Bearer Certificates only are the proof of ownership.

Municipal, Corporation, County, Provincial, and Dependent State Loans are, in their origin, and the security which they offer, quite similar to Government Loans, and yet there is, as a rule, a vast difference between the two. For, whilst a Government cannot be sued for its State Loans,

Advantages of Corporation Stocks.

Towns, Corporations, Counties, Provinces, and Dependent States can. Here we have not only an enforceable bargain between borrower and lender, but, in addition, in most countries of the world the State exercises a control over the finances of the public bodies above enumerated.

The State is under no such control, and is

thus free to incur any liability for which the supporters of a democratic Government may clamour. Public bodies, which are subservient to the State, work under laws which settle the maximum which they can borrow, and this restriction shelters the lender behind a protecting barrier, making these Loans much more desirable. If a Dependent Government or a Corporation does not pay its interest promptly, or does not repay the principal, it can be sued in a Court of Law, and the judgment thus obtained can be enforced. Examples of this kind have occurred, and have, as a rule, resulted satisfactorily to the lenders. In those cases where they did not, it was, as a rule, due to bondholders having neglected to ascertain that their rights were properly set forth in the bonds which were issued to them.

Corporations are subject to the law.

The Municipal, County, Provincial, and Dependent State Loans are secured upon the rates of the issuing Corporation. In some instances they are, in addition, guaranteed by the Sovereign Government. This extra guarantee is looked upon as additional security, and makes the Loans so guaranteed rank in quality with the issues of the guaranteeing Government. Some Loans of this class are secured by the special hypothecation of a specified part of the revenue of the borrowing Corporation.

Security of Corporation Loans.

Corporation Stocks free from speculation.

Municipal, Corporation, County, Provincial, and Dependent State Loans do not attract the speculator, and this is another reason why they should commend themselves to Investors. Comparatively very little money has ever been lost by investing in Loans of this kind at a fair price, and whenever the issuing authority works under a settled Government which enforces respect for law and order, they are really one of the finest forms of security. Even in new countries, and when issued by quite small townships, they offer generally but little risk, and in the entire history of the development of Canada, only two cases have been known of townships defaulting. In neither case did the holders of the Loans lose any money; in fact, with the exception of a few instances, defaults have been very rare indeed.

British Insurance Companies make it a practice to take up entire Loans issued by small municipalities and to hold these Loans for investment.

Currency risks of Specie Loans.

The denominations of the bonds representing these Loans vary considerably, and some of them are issued in the local currency of the country. Whenever a country has a silver or paper currency, it is unsafe to hold specie loans, as the rate of exchange between a gold currency, such as England possesses, and a silver or paper currency is liable to fluctuate widely at times.

Whenever the country has a gold currency, no fluctuation in the rate of exchange need be feared.

Corporation Stocks do not fluctuate like Government.

It is quite a common occurrence for the Government stock of a country to fluctuate 5 or 10 per cent. in value in any one year, whilst, at the same time, the Municipal, Corporation, and County issues of that same country have hardly fluctuated at all. Thus, for example, in 1907 the Chilian Government 5 per cent. Loan varied eight points in value, whilst the Loan of the capital city, Valparaiso, only moved to the extent of four points during the same year. This is the more remarkable as Valparaiso was damaged by an earthquake in the summer of 1907, and proves how stable a stock can become so long as the speculator's deadly influence does not interfere with it.

TABLE SHOWING HOW WIDELY THE PRICES OF GOVERNMENT LOANS HAVE FLUCTUATED DURING THE PAST SEVEN YEARS IN COMPARISON WITH THE PRICE OF A LARGE MUNICIPAL LOAN OF THE SAME COUNTRY DURING THE SAME PERIOD.

Fluctuations of Government and Corporation Stocks.

			Points
Norwegian 3 % Loan of 1896, seven years' fluctuation			1 1/4
City of Bergen 4 % *Loan*	do.	do.	4 1/2
Japanese 5 % Bonds, 1895–6	do.	do.	28 3/8
City of Yokohama Waterworks 6 %	do.	do.	10 1/2
Chilian 4 1/2 % Loan, 1886	do.	do.	23 1/4
City of Valparaiso 5 1/2 % *Bonds*	do.	do.	6 1/4
Brazilian 4 1/2 % Loan, 1883	do.	do.	23 1/2
City of Santos 6 % *Bonds*	do.	do.	5

Corporation Stocks secured on public works.

There are a number of Corporation Loans which are not guaranteed by the rates but are secured upon special works, such as Harbours, Land Reclamation, Water, and other public works. In all such cases it is necessary to examine the annual earnings of the special works, as these earnings represent the sole security offered. Most of the other Municipal, etc., Loans which are secured on the rates, are so well protected that it is hardly necessary to examine their special merits; in fact, in 95 cases out of every 100 they constitute the finest form of investment in existence.

Company Loans.

The next form of Loans which has to be considered is that issued either by a Company which is working under any Charter or Act of Legislature, or by a Company formed according to the laws of any country.

Every Company, no matter how constituted, is a legal entity, and can, as such, contract debts; these debts can either be secured upon some special property, or they can be general debts without any special security. The debts can be either perpetual or repayable at any specific period, or by instalments.

Classes of Company Loans.

The name of the security issued in respect of a Loan as a rule indicates the conditions under which the indebtedness has been contracted. Thus, a 5 *per cent. thirty-year First Mortgage Gold*

Bond would be a bond secured by first mortgage upon some special property, the Loan being repayable thirty years after the date of its issue; the rate of interest would be 5 per cent., and the principal and interest would be payable in some gold coinage. A Second or a Third Mortgage Bond would be secured by a second or third charge upon a certain property. A General Mortgage Bond would not be specially secured, but would form a floating charge upon the entire undertaking. In all these descriptions the word "Debenture" can be substituted for the word "Bond," without altering the meaning. Whenever a security is simply known as a "Debenture" or "Bond," without any additional description, it is necessary for the Investor to ascertain prior to purchase how this particular issue is secured. This can be done either by reference to a statistical text-book or by inquiry at the issuing Company's office.

The grading of Mortgage Bonds.

Debentures and Bonds are issued in every type of coinage and every kind of nominal value. They are sometimes transferable in multiples of the coinage in which they are issued, and at other times in multiples of a certain stated nominal value. Debentures or Bonds are sometimes to Bearer, sometimes Registered, and, on many occasions, the same Debenture is issued in both forms, so that

Various types of Debentures.

Bearer Debentures can be registered, and Registered Debentures can again be re-exchanged for Bearer Bonds.

It is necessary to find out all these details prior to the purchase of any Debenture, as they differ in almost all cases.

How payments on Bonds are made.

The interest on Registered Debentures is paid, as a rule, either quarterly or half-yearly by cheque, which is forwarded direct to the registered holder. On Bearer Bonds or Debentures it is paid by coupon. The coupon is a small part of the Bond which requires to be cut off from the Bond on the date of maturity, and handed in at the place of payment against the amount of interest due. As soon as all coupons printed on the original Bond are exhausted by being cut off in this way, the issuing Company or Corporation provides the bondholder with a new coupon sheet in exchange for a so-called "*Talon*," which forms part of the coupon sheet.

Bonds redeemable by annual drawings.

At the date of maturity of a Bond, viz., the date on which it is paid off, the Bond itself is exchanged for the amount due for it. Bonds which are subject to annual drawings are paid off as soon as their numbers are drawn. In the case of Bearer Bonds the fact that any number has been drawn is announced by advertisement in the newspapers, and it is very necessary that all holders of Bearer Bonds which are liable to

be drawn should either watch these advertisements carefully, or instruct their bankers to do this for them, otherwise they will lose interest, as from the date of the drawing, up to the coupon date next following. Then, the presentation of a coupon belonging to a drawn Bond will lead to an official notification that the Bond has been drawn, and that interest ceased on the date of the drawing.

Some countries do not notify drawn Bonds.

In the case of certain Government Bonds the neglect of this matter leads to still more unfortunate results. It sometimes happens that the coupons of drawn bonds are cashed, but the amounts paid are deducted from the capital sum which is due for repayment, and the Investor eventually discovers that he has been not living upon his Income, but drawing upon his Capital. Russia treats its creditors in this way.

The use of a Debenture Trust Deed.

There is a great and grave distinction between Debentures which are either secured by Trust Deed or have some specific charge upon certain assets and those which are not so secured, for in the first case no legal claim can be placed in front of the Debenture, and in the other case it can.

If a Company owns certain immovable assets and desires to give its Debenture-holders a real security, these assets are mortgaged to Trustees for the total amount of the Debenture-issue,

and they are then held by the Trustees for the Debenture-holders. In this way the Company loses control of the legal title to the property, and no one can obtain a charge on it in front of the Debenture-holders, without the consent of the Trustees. If this same Company were not to vest its assets in the names of Trustees, but were to issue Debentures without a special charge, then to the uninitiated the security would still appear to be the same. But the well-informed Investor knows that the Company can, in such a case, take its assets to a bank or to any other lender and specifically mortgage them, and in this fashion it might deprive its Debenture-holders of their security at any future time.

Disadvantages of a General Debenture.

Many Companies, in times of prosperity, have issued Debentures not specifically secured, and subsequently, in times of adversity, have mortgaged their properties in the interest of their shareholders and to the detriment of their Debenture-holders. With a special charge, properly secured at the outset, the Debenture-holders are certain of their security. Without such a charge, their Capital might be excellently secured to-day, but their security could be taken away from them at any future time.

Distinction between General and Special Debenture.

To give a homely example, the Debenture without special charge is like lending money to

any one on an I O U; the Debenture with a special charge is like lending money on the deposit of a man's watch.

Valuation of specially secured Debentures.

Whenever Debentures are issued on a special mortgage, the value of the property which secures them should be examined, and if there is an ample margin between the total issue of the Debentures and the break-up value of the charged property, then no further inquiry is needed. In all cases where this is not the case, the remaining assets and the general standing of the concern must also be examined; and only so long as there is a very ample margin left after paying the trade creditors should the Debentures be looked upon as safe. The net earnings of the Company, after paying all trading expenses, must also be taken into consideration, and there should always be at least twice as much of net earnings as is necessary to pay the Debenture-interest. In addition, these earnings must display stability, year by year, before a not fully secured Debenture can be pronounced eligible.

Should a Debenture fail to satisfy all these requirements, it falls into one of the lower categories of "fairly safe" or speculative.

Fixing the quality of a Debenture.

It is the margin between the capital sum ultimately repayable to the Debenture-holders and the break-up value of the mortgaged pro-

Debentures should be covered at least one-and-a-half times.

perty, which settles the quality of a Debenture or Bond. If there is twice or three times as much property as the amount of the Debenture-issue, then the latter are well secured. If there is less, they become merely fairly well secured; but in all cases, where there is not at least one-and-a-half times as much property as the amount of Debenture-issue, then the security is so insufficient that the Debenture descends to the rank of a Preference share. The possibility of the Debenture-holders receiving their money back in full, in the event of liquidation, then becomes very remote. The proportion between annual net earnings and the amount necessary to pay the full annual Debenture-interest, should be the same as the above-described proportion between the realisable assets and the whole Loan. That is to say, if the annual net income amounts to twice or three times the sum annually due for Debenture-interest, the Debenture is well secured as to Interest; and if nearly twice, fairly so. If the annual income is only equal to one-and-a-half times the amount of Debenture-interest, then the Debenture cannot be regarded as secure.

Valuing Security of Debenture-interest.

Two factors governing Debenture-safety.

It is thus seen that there are two factors which decide the safety of a Debenture—viz., the margin of property and the margin of income, and these two factors should be considered conjointly.

For instance, there are Debentures which are three times covered as to Capital and only one-and-a-half times as to Income, and *vice versa*. In all such cases the Capital-security should be the first consideration, the Income-safety being subservient to it.

To hold Debentures which are, say, ten times covered as to Interest by earnings, and only one-and-a-half times as to Capital, is only safe in cases where the business which produces the income is stable and non-speculative.

In the case of Railways, Canals, Docks, Tramways, Gas, Water, Electric, and other permanent and immovable works which have only a value for the purpose of carrying on the particular trade for which they have been constructed, there is no break-up value attaching to the assets. The solidity of the security for any Debentures issued by such undertakings rests solely upon the earning power of the works which they own, and the permanent nature of the business carried on by them. Due regard should also be paid to the terms on which a property of this kind may be taken over by the corporation of the district which it serves.

Capital invested in permanent works.

It is well to look very carefully into the real permanence of the business in cases of this kind, as all businesses are liable to com-

Dangers of Business Competition.

petition. Who, for example, would have imagined sixty years ago that Canals, which were then the traffic highways of England, would one day become obsolete properties? Or that the North London Railway would lose its traffic through tramway competition? Yet these apparent impossibilities have come to pass.

No industry exists which has a really permanent trade, with the sole exception, perhaps, of Waterworks, for there does not seem any chance of this necessity being superseded.

Factors ensuring stability of Interest.

In ascertaining the stability of the income of any undertaking of a permanent character, which has no assets with a break-up value, there are two main factors to be taken into consideration, viz., the size and permanence of the population served, and the working costs. A permanent and increasing population is the all-important factor, for even Waterworks, in an abandoned city, are valueless; while any town which has suddenly sprung into existence from a mining camp, is liable suddenly to return to its original state.

In Europe such depopulations are rare; but in certain districts they occur. Many Italian cities have fallen to one-third of their original population, and Ireland at the present moment is losing its inhabitants at an alarming rate.

Advantages of a growing population

In the case of new Railways, Gas, Water, and

Electric Light undertakings, it is not necessary to insist upon a large margin between the net profits and the Debenture-interest; provided that the population served be steadily growing as shown by past statistics, and that, consequently, the business of the Companies be steadily expanding.

Importance of Working Costs.

Working Costs are important, as they not only indicate the margin of profit made, but also the degree of rapidity with which profits might entirely disappear through a rise in the price of either labour or raw material. This danger is especially present where labour and coals form an important proportion of the cost of the finished article. Any trade working with a very small margin of profit is dangerous, and it is, for these reasons, always wise to compare the annual turnover with the gross profit and the net profit, and choose such undertakings as show a considerable difference between the turnover and the gross profits as well as between the gross and net profits.

One Company may have many issues.

It very frequently happens that Companies or Corporations have incurred several Loans and, therefore, have issued several classes of Debentures. In all such cases it is of the greatest importance to ascertain with certainty, not only how the various Debenture-Issues rank in relation to each other, but also whether some

part of the Company's property has not been specially mortgaged for the benefit of a specific Debenture-Issue.

Investigating-safety of Debentures.

Investigations of this kind should be most carefully made, for they touch upon the first essential towards establishing the safety of any Debenture, which is one among several Debentures or Loans, issued by the same Company.

In some cases the various issues of Debentures are distinguished from each other by the year in which they were issued; in others they are alphabetically arranged as A, B, C, etc., Debentures. Sometimes they are called First, Second, Third, etc., Mortgage Debentures; while in several cases the words "Prior Lien Debentures" are used. The same rule applies to all these types of Debentures, viz., to ascertain, first of all, the total value of the assets and income; secondly, to fix the rank of the various Debentures, and to settle in this way the margin of safety offered by any individual Debenture-Issue.

Capital-safety of Second and Third Debentures.

Second or Third Debentures, before they can be considered as safe, require a great deal more Capital and Income behind them than First Debentures. For, supposing a Company has £100,000 of 5 per cent. Debentures, and a property worth £200,000, then these Debentures are

covered twice as to Capital; and if the Company were wound up and the property sold for 60 per cent. of its value (equal to £120,000) the Debenture-holders would be paid in full. But supposing that a Company had £100,000 5 per cent. First Debentures, £100,000 5 per cent. Second Debentures, and a property worth £300,000. It would seem as if the Second Debentures in this case were as well secured as the First Debentures in the former case, for after deducting £100,000 from the £300,000 worth of property, there would still be £200,000 left to secure the £100,000 of Second Debentures. But this is not so, for if this latter Company were wound up and the property sold for 60 per cent. of its value, then the sale would produce 60 per cent. on £300,000 (equal to £180,000). Out of this sum £100,000 would have to be paid to the First Debenture holders, and there would only be £80,000 left to pay the £100,000 Second Debentures.

Increasing Income-safety of Debentures.

As it is with Capital so it is with Income. If net earnings amount to £10,000 and the First Debenture interest requires £5,000, then the Income is doubly secured, and net earnings would have to fall over 50 per cent. before there would be any failure to earn the full Debenture-interest. But supposing that net earnings were £15,000, and the First Debentures

required £5,000 for interest, then there would be £10,000 left for Second Debentures, and if these again require £5,000, the interest on the Second Debentures is seemingly covered twice. If net earnings were, however, reduced by 50 per cent., then only £7,500 of the original £15,000 net earnings would be left, consequently the Second Debenture-interest could not be paid out of earnings. In fact, a reduction of over 33 per cent. in net earnings would endanger the income of the Second Debenture-holders.

Third Debentures are naturally still worse off than Second Debentures, as they have two prior charges in front of them. For these reasons all Second and Third Debenture-charges require a very ample margin behind them before they can be pronounced safe.

Special security for Second Debentures.

Whenever a Second or Third Debenture-issue, or some other exceptional kind of Loan-issue, is secured on a special property which is not otherwise mortgaged, then, on this special security, the particular Debenture-issue ranks as a First Mortgage. In such a case it is quite possible that the Second, Third, or exceptional Debenture might be better secured than the First Debenture. Such a case would arise if the first Debentures were only partly secured, and if the special property, which secures the exceptional Debenture, were worth over twice

as much as the total amount of the particular Debenture-issue specially secured on it.

Guaranteed Debentures.

Sometimes Railway or other Companies promote a subsidiary Company for the purpose of constructing a bridge or a railway station, or some kind of work necessary for the development of the parent Company, and the promoting Company guarantees the Debentures of the new Company. In all such cases it is important to consider the value of the guarantee; and if this guarantee be good, then it renders the subsidiary Company's Debenture secure whether or not the subsidiary Company's own property is either saleable or valuable.

Position of Guaranteed Bonds in America.

In America, particularly, Railway Companies pay for new rolling stock by issuing Car Equipment Bonds, which the Railway Companies guarantee. The American Law Courts have decided that such Debentures are trade-liabilities of the Railway Companies, and therefore rank in front of such of the Railway Companies' Bond-issues as are not specially secured.

Income Bonds generally a bad security.

On occasions when Railway Companies have been unable to pay their Debenture-interest, they have compromised the matter by paying this interest in bonds instead of in cash: such bonds are called *Income Bonds*, and they are in many cases bad security.

If it occur that one Company has leased pro-

Rent-charges.

perty from another at a rental, or if a Company has borrowed money by vesting some part of its own property in the names of Trustees—agreeing to pay the Trustees a certain annual sum, secured upon the rent receivable, from the property which has been vested in the Trustees—the Bonds which represent loans of this description are called *Rent-charges*.

Investigating safety of Rent-charges

To investigate the safety of such *Rent-charges*, it is necessary to ascertain the solidity of the Company which has mortgaged its future rent-receipts; this inquiry practically settles the safety of the Rent-charge Bonds. Because, it must be understood that Rent-charge Bonds have, as a rule, no margin of safety. So that if the Rent is not promptly paid, the holders of the Rent-charge have, as their principal recourse, the solvency of the Company guaranteeing the payment of the rent.

Shipping Companies sometimes issue Bonds on single ships, and the safety of these Bonds depends on the saleable value of the ship. Such Shipping Bonds do not, in reality, differ from any other kind of Debenture, and the same rules respecting soundness apply to them as apply to the more usual type of Debentures.

Value of conversion rights

Some Debenture-holders have the right to convert their Debentures into Shares in the same Company, and in many cases these rights

are very valuable. Thus, for example, certain Union Pacific 4 per cent. Debentures are convertible into Union Pacific Ordinary shares, and these Ordinary shares command a high premium. The value of this right of conversion entirely depends upon the future prospects of the stock into which the Debentures can be converted.

This privilege of conversion of Debentures into Shares at the will of their owner forms a pleasant potentiality of a prospective profit and is a valuable adjunct to an otherwise good Debenture, but is of very little value when the future prospects of the undertaking are limited.

Having now dealt with all the most usual types of Loans, Bonds, and Debentures, the second main group of securities, viz., that of Shares of all classes, comes up for consideration.

It has already been stated on several occasions that whilst the *interest* on Debentures must be paid, no matter whether the Issuing Company makes profit or not, the *dividends* on shares of all kinds are entirely dependent upon profits. This point so completely explains the shareholder's position that it is here repeated once more.

Dividends of Shares dependent on Profits.

Every Company or Corporation is—subject to such limitations as may be comprised by its Charter of Incorporation or its Memorandum of

Company may issue different types of Shares.

Association or by prior contract—at liberty to issue either one kind of shares or a considerable number of share-issues. For example, the London and North-Western Railway has only four stock-issues, whilst the Great Central Railway Company has no fewer than 18, every one of which has distinct rights of its own, which differ from the rights of all other classes of stock.

A Company with a single share-issue is very easily understood, especially if this Company has no Debentures or Loans outstanding. To

Assessment of value of Shares.

value the tangible assets of such a Company, it is only necessary to total up the trading liabilities as they are disclosed by the Balance Sheet, to deduct these from the total assets, when appraised at a fair valuation, then to take the sum of money representing the excess of Assets over Liabilities and divide it by the number of shares issued.

In this way the individual break-up value of each share is ascertained.

In every case where a Company with a solitary share-issue has also an issue of Debentures or Loans, the sum-total of the ultimate redemption-value of these must also be deducted from the assets before the individual value of the shares can be ascertained.

Only such part of the net profits of a company

is divisible among its shareholders as remains after the Debenture or Loan-interest has been paid, and after the necessary provision has been made for Reserve Funds or for Sinking Funds to provide for the redemption of Debentures or Loans.

Rights of Shareholders on Liquidation.

In case of the liquidation of a Company its Debentures have to be paid off first and in full, whilst the shareholders only participate in any residue which may remain thereafter. So that, as a natural consequence, the shareholders are entitled, after satisfying creditors, to divide all the assets in any Company in which no Debentures exist. If there are Debentures, the shares only rank second both in the division of profits and in the division of assets.

Different classes of Shareholders have different rights.

Whenever a Company has more than one share-issue, it is well first of all to consider all the existing Debenture-issues as one whole, and deduct their total nominal amount from the assets. Then the sum remaining should again be considered as a whole, and this sum represents the property of the shareholders. The various share-issues have respective rights, both as to capital and income priority, and these rights are strictly defined by the terms of the issue. In fact, various share-issues rank behind each other in practically the same way as the various Debenture-issues.

In some cases the special names given to the various share-issues indicate the order in which the different issues follow each other in right of priority; but it is not safe to rely on these names alone, as there are many exceptions to the general rule. It is always better to make quite sure, by reference to the Articles of Association, and the terms and conditions of each issue, how the shares do rank.

Articles of Association show rights of Shareholders.

The following is the most usual order in which shares follow each other in priority.

Classification of Shares.

Guaranteed Shares.—These are usually fixed-income shares, and should be guaranteed by some one who is fully responsible, and is the owner of some assets which are outside those of the issuing Company. A guarantee by the issuing Company alone would be valueless: because this Company can only then fulfil its guarantee when its profits permit of it.

Disadvantages of Preference Shares.

Preference Shares.—These bear, as a rule, a fixed rate of interest, and cannot receive more than that fixed rate. The drawback to them is that they suffer if the Company does badly, for they then are compelled to forgo their dividends; whilst they do not correspondingly share in any special prosperity, because their dividends are fixed.

Cumulative Preference Shares.—These are similar to Preference shares; but if the dividend

on them is not paid in any one year, this dividend accumulates, and the unpaid arrears must be satisfied out of the earnings of future years before any profits can be divided among the shareholders ranking behind them.

Non-cumulative Preference Shares.—These are similar to Preference Shares, and have also no claim for unpaid dividends which have not been earned in any one year, and therefore have not been paid.

Preferred Shares, Cumulative Preferred Shares, Non-cumulative Preferred Shares.—This is a description sometimes used in America, the shares are in every respect similar to Preference shares.

Ordinary Shares.—These have, as to dividends, no special rights or privileges. They never carry a fixed rate of dividend and are merely entitled to receive that portion of net earnings which may belong to them after the Reserve Fund and the Debenture Redemption Fund have received such contributions as were stipulated for in the Articles of Association or elsewhere.

Ordinary Shares have no special Dividend Rights.

Preferred Ordinary Shares.—These rank behind Preference or Preferred shares, but in front of Ordinary shares. They carry, as a rule, a fixed rate of interest. *Participating Preferred Ordinary* receive, in addition, a share in those surplus earnings which remain after the shares

standing behind them have received certain fixed dividend-amounts.

Deferred Ordinary Shares.—These rank behind the Preferred Ordinary and Ordinary shares, and receive a certain fixed rate. But if there is a surplus still left after the dividend on them has been paid, they usually share this surplus with the Preferred Ordinary shares.

Ordinary Shares are sometimes split.

Note I.—In some Companies the original Ordinary shares have been split up into Preferred Ordinary and Deferred Ordinary. This splitting process could not be made compulsory, so that a certain portion of the original Ordinary shares have remained intact. Such Companies thus have: Ordinary shares, receiving the originally stipulated share of profit; Preferred Ordinary and Deferred Ordinary, receiving that share of profit which the Ordinary shares, out of which they have been created, would have received.

For example, the London, Brighton and South Coast Railway still has Ordinary, Preferred Ordinary, and Deferred Ordinary issues, of which the Ordinary stock is the old undivided Ordinary.

Note II.—In many cases there are various classes of Preferred, Preference, Preferred Ordinary and Deferred Ordinary shares, and these are distinguished from each other either by the year of issue being placed behind the word Preferred or by letters of the alphabet, viz., Preferred A, Preferred B, etc., or by numbers, viz., Preferred No. 1, Preferred No. 2, etc.

Deferred Shares.—These, as a rule, rank behind all other classes of shares, and only receive the tail end of any sum divisible in dividends.

Founders' Shares.—These are similar to *De-*

ferred Shares, and are given to the promoters of a Company. They have, as a rule, no right to participate in the division of assets, but receive a certain proportion of the profits. This proportion of profits, and the manner in which it is calculated in relation to the dividend-rights of the other shareholders of the Company, differs in each individual case. In some instances Founders' shares receive large profits, and there are instances where Founders' shares are the basis of a subsidiary Company, which holds them. Such subsidiary Companies have no tangible assets, and rely solely on their right to participate in the profits of the parent Company for their sustenance.

Founders' Shares absorb large profits.

Leased Line Shares.—In some instances the entire assets of a Company are let on lease to another Company, and this leasing Company guarantees a certain fixed rate of interest on the shares of a Company which owns the property, let on lease. Such an arrangement particularly applies to railways, and in many cases the Ordinary shares of a small Railway Company, which is leased to another large Railway Company, are so safe, that the Trustee Acts have recognised their eligibility to rank as Trustee Stocks.

Leased-line Shares are safe Investments.

Trust Certificates.—It happens at times that it is deemed desirable to vest the entire control

of a Company in a Committee. In such cases a sufficient number of shares to carry any resolution proposed at a meeting are deposited with that Committee, and the Committee, in exchange for the share certificates, issues *Trust Certificates* to the depositing owners. These *Trust Certificates* are to all intents and purposes similar to the shares which have been deposited against them, except that they carry no voting power.

Trust Certificates carry no voting-power.

It will be gathered from the above long list of various classes of shares that at times it is very difficult to arrive at the true position of any particular share-issue which is one of a long list of other issues. The best method of arriving at an unquestionably sound valuation of shares so situated is, to treat all the issues which stand in front of any individual share-issue as one whole: that is to say, to add up their total nominal Capital-values and separately to add up the total Annual Interest and the total Annual Dividend sums to which they are severally entitled; then treat these totals as if they represented the Capital and Annual Interest of one first charge. Deduct the total Capital-sum from the Assets, and the total Annual Interest and Dividends from the Profits, and consider the two amounts then left as the Security respectively for the Principal and Interest, of the share-issue which is being inquired into.

How to value an Issue of Shares when one of a series.

It must here again be pointed out, as was done in the case of Debentures, that the margin of security for any issue, which ranks behind a large number of prior charges, should be very much greater than the margin of security for an issue which has little or nothing standing in front of it.

Greater margin of Security required for Shares where prior charges exist.

Any stock or share which has no charges in front of it naturally enjoys an undisputed priority of claim on the assets. In this way Ordinary shares, with nothing in front of them, are frequently safer than Debentures or Preference shares with charges ranking before them. Similarly, Preferred or Preference shares in a Company which has no power to issue Debentures, are just as safe as Debentures in such a Company would be, except that their holders cannot claim to be paid off at some future date. These shares are practically on all fours with Perpetual Debentures.

Shares sometimes safer than Debentures.

All shares have a certain nominal value, this being the amount which the holders of the shares are liable to contribute towards the Company, and the total nominal value of all shares which are issued constitutes the Company's capital. If a Company has issued Debentures or Loans, the proceeds of these Loans are, of course, also employed, as Capital, by the Company in its business. But these Loans, belonging to

What constitutes a Company's Capital.

persons who have no direct interest in the Company's business, do not constitute a part of the Company's own Capital.

In Limited Liability Companies, as soon as the shares are fully paid up the shareholders' liability on them is at an end; shares which are only partly paid up can be made fully paid on the legal demand of the Directors. In the case of most banks there is a reserved liability, payable only in the event of liquidation.

Danger of holding partly-paid Shares.

To hold shares which are partly paid is always dangerous, no matter how solid the Company may appear to be at the time such shares are acquired. Prudent Investors should never hold or purchase partly-paid shares unless the income-yield afforded by such shares amply compensates them for the undeniable extra risk which they thereby incur.

Shareholders' control depends on voting-power of Shares.

Shareholders control the business of a Company by means of the voting power which their shares carry.

This voting power is settled by the Articles of Association of the Company, and it varies, almost in every case. As a rule, Investors do not understand how very important this voting power should be to them, and they therefore carelessly invest even in shares which actually carry no voting power.

It is quite unnecessary for a Debenture-holder

to possess voting power, because he simply lends money upon stated conditions, and he has the right forthwith to demand the repayment of his loan if these conditions are not fulfilled. The holder of shares, whatever their class, is not so situated: he cannot demand the return of his money in any event, and he is only entitled to receive his dividends when and if the Company has earned them. It is clear, therefore, that any shareholder is very directly interested in the welfare of the Company; and, this being the case, he has a right to demand a voice in the conduct of the Company's business.

Adequate control by Shareholders is important.

Investors' failure to rightly understand the responsibilities of shareholders has in many cases been abused by promoters of Companies. The tangible assets they sold to the new Company for cash, and raised this cash by the issue of Preference shares, which had no voting power. Simultaneously they sold the goodwill of the concern to the Company for Ordinary shares, which had a voting power, and these shares they retained. Translated into plain English, this bargain means that the Preference shareholders furnish all the money, for the owners of the goodwill to do what they like with. In exchange for providing all the tangible assets of the business, the Preference shareholders take a rigid

Some Company Promoters' subterfuges.

maximum of dividends, which may dwindle down to zero, the Ordinary shareholders taking all the rest and being masters of a concern in which they have no money invested. There are always more ways than one of making a legal profit out of a Company, and it is quite possible for the directors and managers to benefit more by salaries, fees, discounts, and such like privileges, than by dividends which may be paid on the shares. The holders of votes regulate the business. So that in all cases, where the Preference shareholders possess no voting power, the real bargain is "give us your money and we will give you in exchange whatever we please."

Directors benefit sometimes at Shareholders' expense.

An excuse for one-sided bargains of this kind is frequently made by stipulating that the Preference shareholders shall have votes, as soon as their dividends remain unpaid; but it is rather cool comfort to have permission to lock the stable only after the horse has gone. Instances have been known where Preference shareholders have even been denied the right to attend meetings or inspect Balance Sheets. Yet the unsuspecting public took up such issues, and even paid premiums for the privilege of occupying such an exceedingly dubious position. It should be the future resolve of every reader hereafter to carefully inquire into the voting power which

Prospective Shareholders should look to voting-power.

the shares, which he proposes to acquire, carry, and regard the privilege of voting on the subject of the welfare of his invested Capital in a somewhat more serious light than he may consider his voting rights at County or Municipal elections.

Most Companies send out proxies and ask the shareholders to hand over their voting power to the Chairman or one of the Directors. Many Investors have become so indifferent to their own interests that they sign and return these proxies, without even taking the trouble to find out on what subject a vote is to be taken. Such a procedure is almost equivalent to signing a cheque in blank and giving another person permission to fill in any amount which he pleases. Although every one has the right to do what he likes with his own property, it is the duty of every shareholder to consider not only himself but also his fellow-shareholders. It frequently happens that the Directors have entirely mismanaged a Company's business, and that a certain small section of the shareholders, being aware of this fact, are desirous of bringing the guilty parties to book. Such a reasonable endeavour on the part of a small body of shareholders to save their own money is often defeated by the large number of proxies, which other thoughtless shareholders have sent to the Directors without troubling to ascertain the point at issue.

Danger of signing Proxies without inquiry.

In such a case, to sign a proxy without thoroughly understanding its purpose is culpable negligence of which no right-minded person should be guilty, and a conscientious shareholder has really only one of two courses open to him :—namely, either to make up his mind that he does not care what happens, and in that case not to vote, or else to study the case and to vote as his judgment and his own interests direct.

A small boy once said :—" Serves my parents right if I get chilblains ; why don't they provide me with proper gloves ? " Unfortunately, many Investors adopt a similar attitude towards the persons whom they entrust with the management of their capital. As long as the Directors manage to pay dividends, no one cares what happens, nor pauses to inquire whether these dividends are being paid out of Capital. A matter of such vital importance as whether the assets are being judiciously nursed or carelessly dissipated, does not seem to trouble shareholders as a rule.

Shareholders lack proper interest.

There are many Companies which pay regular dividends, and at every annual meeting experience difficulty in collecting a quorum of shareholders, although their lists of shareholders number many hundreds. But so soon as the dividends cease, armies of shareholders attend,

and do not hesitate to describe themselves as very badly used individuals. The proverb concerning the horse and the stable door is so feebly lacking in personal condemnation as to be inappropriate to such conduct. "Don't lead your Directors into temptation, and don't shirk your own share of the work," would fit the case far more closely.

Sufficient Working Capital indispensable.

Any Company, which so locks up its assets, or so squanders them that sufficient Working Capital is no longer available to carry on the business, is compelled either to wind up entirely or else to undergo a process of reconstruction.

In the case of a winding-up, the assets are used to satisfy trade creditors and to pay off the Debentures first of all. Any surplus which may remain is then distributed among the shareholders in accordance with the respective rights of the various issues. The winding-up of Companies has become a very profitable business, and there are many firms of accountants and solicitors who do nothing else.

Priority of rights in a winding-up.

Investors have only themselves to blame for the enormous sums of money which are annually lost by them through Companies winding up. In the first place, they take up shares without due investigation, and, as soon as they have acquired an interest in a Company, they take no further trouble to protect their capital.

Many Liquidations due to apathy of Shareholders.

Unfortunately, in Great Britain the excellent laws which have been passed to regulate the acts of promoters, directors, and liquidators, are very loosely applied. This laxity results solely from the fact that the actual owners of the concern—the shareholders—do not trouble to enforce their rights. If shareholders would only exercise an intelligent supervision over their capital, there would be fewer liquidations to start with; and such liquidations as were inevitable would return fairly substantial surpluses to shareholders.

Company reconstructions often result of reckless finance.

The reconstruction of Companies is perhaps still more unsatisfactory than the winding up of Companies. Directors first of all collect Capital from Investors, next they waste this Capital, and, having done so, they express their sorrow for what has happened. Finally they propose a scheme for the wholesale writing-down of the Capital Account, accompanied by a further scheme for raising a supply of fresh Capital. Occasionally the shareholders may grumble a little at first. But they subsequently send in their proxies and cheques with marvellous docility, and the same set of incompetent Directors remain in office, perhaps to repeat the same operation on several subsequent occasions.

Especially in the case of Mining Companies

is it sad, but highly instructive, to follow the history of reconstructions. There is one case on record of a Mining Company which was started in 1882: it never paid a dividend or did any real mining, yet was reconstructed no fewer than eleven times. In each reconstruction fresh Capital was provided by some sanguine spirits. The last reconstruction took place a few months ago, and the shareholders who attended the meeting which sanctioned it, actually congratulated the Chairman and Directors upon the splendid *prospects* which they had been able to put before the shareholders. It should be added that the most hopeful speakers at the meeting were absolutely independent Investors, and that it does not seem to have occurred to their relatives forthwith to apply to the magistrates for power to place them under restraint.

Example of Capital-waste due to reconstructions.

Legislation has been at work since the year 1862 devising laws for the protection of Investors in public companies. But legislation will prove unavailing until the investing public realises that holding shares in Companies involves a responsibility which cannot be neglected with impunity.

Holders of Loans, Bonds, and Debentures, being merely lenders of money, need only see that their claims are secured by valuable assets in the

Bond- and Shareholders have different interests.

first instance and that the value of these assets is subsequently maintained. Owners of shares of all kinds are partners in the concern, and as such should recognise their responsibility, not only in their own interests, but also in those of their fellow-shareholders. Proprietors of well-secured Preference shares incur but a remote personal responsibility, but holders of speculative Preference, Ordinary, and Deferred shares, are almost directly responsible for the conduct of a Company.

Directors the servants of Shareholders.

It is their duty to watch the undertaking throughout its career, to understand and appreciate the extent of the rise or the fall in its fortunes, and actively to co-operate in warding off any disaster which may threaten it. The Directors of the concern are their servants, and as such should do their bidding.

So soon as this spirit of mutual help and assistance among shareholders shall have begun to display itself, there will be no more Capital wantonly squandered, and our Railway, Dock, Canal, Water, Banking, and Insurance Companies, Iron, Steel, Coal, Cotton, and other works, which employ more than three-quarters of our entire working population, will be more prosperous and more capable of earning and distributing wealth than they have ever been in the past.

CHAPTER VII

ON NEW ISSUES

BETWEEN 100 and 200 million pounds' worth of new issues of Capital are annually offered to the British investing public for subscription, and the majority of the stocks so offered are either publicly or privately taken up. Annual Amounts of new Capital Issues

Some of these new Capital-creations are constituted on a sound basis and are offered to Investors on exceedingly favourable terms; others are so faulty in their conception that any financially trained mind can foresee, almost at a glance, that the Capital ventured in them will most probably be lost.

The framing of a prospectus is a fine art, which consists of bringing every favourable point into the greatest prominence, covering up all elements of weakness and slurring over, so far as the law will permit of this being done, all the unfavourable features of an enterprise which is endeavouring to attract public subscriptions. The most alluring form of prospectus is that which is framed with the greatest apparent wealth of detail, and The Art of Prospectus-framing.

the least dangerous consists of a few simple statements which make no appeal to the Investor's imagination.

Simplicity of Prospectus a good sign.

To the financial student the reading of prospectuses is a most instructive pastime; because frequently the soundest and best securities are offered in so clumsy a form that they appear to be unattractive, whilst at other times Bonds or Shares, which are quite unfit to be called *securities*, are so skilfully described that even an expert is obliged to examine the statements and figures repeatedly before he can arrive at their true meaning.

Form of Prospectus often misleading.

Investors who have no financial skill will find the reading of prospectuses a very expensive amusement. For in most cases the sound propositions will strike them as uninteresting, while in all probability the most dangerous of speculations, in which the chances are ten to one against ultimate success, will prove the most attractive. A sound investment is considered by its sponsors to be of such obvious merit that little or no effort is made to proclaim its attractions. So that really good securities often fail to arrest public attention. On the other hand, new issues of a dubious nature make their appearance to the accompaniment of such a flourish of trumpets that the investing public are led to overestimate their true merits.

Investor's attitude towards New Issues.

The average Investor has a craving for vague possibilities. This hankering after the untried and the unknown investment is at complete variance with the business-prudence which guides mankind in other matters. As a rule, people prefer to purchase a well-known article of proved merit. The flourishing condition of many old-established manufacturers and dealers is usually due to a long series of years of honest trading, whereby they have won the confidence of the public. As soon as the question of investment is approached, however, the established article, the quality of which can be gauged to a nicety, no longer seems to prove attractive. Unconsciously, perhaps, Investors are possessed by an inborn yearning to gamble. A sound security which will bear the most searching scrutiny the Investor rejects as uninviting. He wants to buy a stock at par and to see it ultimately rise to some fabulous price. Such a possibility is only offered by the crude and untried venture: and it is the crude and untried venture which the average Investor appears to prefer.

Untried ventures a gamble.

Such immoderate investment-cravings are deserving of small pity. They are the outcome of an attempt to gamble, cloaked under an outward display of decorum. It is only when an Investor has, however unconsciously, thrown

prudence to the winds that he yields to the temptations of a flamboyant prospectus.

Really sad is the case of the perfectly innocent Investor whose financial horizon is limited and whose knowledge of sound securities is scanty.

Fascinations of Prospectus to small Capitalist.

To a small capitalist of this type new issues prove an irresistible attraction. He has money lying idle. He does not care to ask advice, nor does he believe in the financial discrimination of his friends. The few stocks which are quoted in his newspaper are either uninviting to him or the particulars given of them are so very sketchy that he cannot understand them. To him a new prospectus is like an oasis in a desert, or like a spring of fresh water in an Australian bush. There he can have his fill of detail: everything seems so nicely explained and so full of prospect.

There are tens of thousands of such Investors distributed all over the country. It is principally their money which makes up the millions of pounds which are carefully recorded by the Registrar of Joint-Stock Companies as lost in new ventures.

There is another point also which is of great assistance to promoters, namely, the inborn dislike of the public for second-hand articles.

Merits of new and old Investments.

The Investor asks himself why he should buy a share, which no one seems to want, when

there is a nice new article of the same kind offered to him, so to speak, fresh from the mint.

The public fails to understand that well-established or tried investments are somewhat like pictures by old masters, or the early editions of classical books. Many pictures are painted, many books are written, but the vast majority of them disappear in time, no one knows where. Only the works of real merit survive to be admired by future generations and cherished in art collections.

Every Investor is bound to hold several stocks, so he, too, is a collector of a kind. Why, then, should he not purchase properties which have been approved and which have stood the test of time? This brings us to the first important axiom in connection with new issues of stock, namely, that no part of a new issue should be bought unless it is *cheaper, safer, and more remunerative* than a similar stock of tried merit which can be bought at the same time in the market.

An important Axiom in reference to New Issues.

The prospectus of a new venture can give no more than probabilities and possibilities. The position of an old stock is based upon actual facts.

Therefore, only when the probabilities and possibilities of a new issue after a thorough examination appear likely to become realities,

Possibilities *versus* Realities

should its purchase be considered. Unless he had every confidence in his own judgment no one would buy an expensive article from an itinerant pedlar, yet this is the folly which Investors are prepared to commit. They are frequently without the slightest conception of the quality of the various types of investment which are on offer daily. Yet they will hastily subscribe to a new stock without understanding its true comparative value.

At the same time, it must be understood that the Investor must exercise great caution even when purchasing stocks of old standing. If he relies upon the judgment of his broker or some other financial authority, he must satisfy himself that the authority so consulted has familiarised himself with all markets by constant study, and that he is therefore capable of selecting the cheapest, safest, and most remunerative stocks of their kind. A wide field of selection is essential to judicious investment. A prudent housekeeper does not ask her tradesmen to submit to her a few samples for selection. She is aware that it is invariably more satisfactory to go to the largest emporium and make her own choice from the greatest assortment.

Stockbroker's qualification as Investment-authority.

In the case of investments a broker's office does not constitute such an emporium. The

widest choice of investments is to be found in some statistical periodical which gives full information regarding the largest possible number of stocks; for example, the *Financial Review of Reviews* gives details of 5,000 securities, so that Investors are always able to consult an extensive catalogue of investments. This Review, consulted conjointly with the *Investor's Shilling Year Book*, lays before the Investor the largest selection of stocks which has ever been printed in any periodical. For the price of 2*s*. both these books can be procured, and no one should invest even so small a sum as £50 without first consulting them or some other similarly extensive and comprehensive record.

How to obtain the widest selection of Investments.

But the reading of books entails trouble, and trouble of any kind most Investors are loth to take.

Investors' illogical dislike to taking trouble.

Curious as it may seem, nevertheless it is a fact that many people will laboriously collect sums of money by studied economy. They will frequently work hard for a whole week and make perhaps only £5 by their exertions. Yet when it comes to the investment of £50 or £100, or even more, it seems to them to be too much exertion to see that this sum is securely invested.

Rather than take the trouble to develop their own judgment, they prefer to leave the

responsibility of making a wise investment-selection to the judgment of others. These others are prone to lightly regard the duty thus thrust upon them, and so the money is dissipated in imprudent investment. Only those things are really well done which are done for one's self; consequently only those Investors who learn to become self-reliant are permanently successful.

The self-reliant Investor succeeds.

The whole of this lengthy argument is based upon the present writer's quarter of a century of experience among investors. This advice to acquire a knowledge of the principles of sound investment is given with a warm feeling of sympathy for all those who part with their hard-earned savings without due consideration, and who gamble recklessly with a laboriously collected sum of money without being aware of their own imprudence.

Methods of introducing New Issues.

New issues are made either by Governments, Dependent States, Provincial Governments, Corporations, Municipalities, existing Joint-Stock enterprises, or by New Companies.

The Governments, Dependent States, and Provincial Governments as a rule employ a banker, broker, or financial agent to make the issue for them; Corporations and Municipalities sometimes make the issue themselves and sometimes pursue the same course as do Governments. One of two

methods is employed when issues of this sort are made, namely, either an issuing house buys the whole issue outright, or the Government, etc., employs the issuing house as its agent. In the first case the issuing house runs the risk of failing to place the whole issue, in the second place the Government, etc., assumes the risk itself. In the case of British Government issues, subscriptions are generally invited by tender, and allotment is made to the highest bidders. This form of offering new stock is highly unsatisfactory to the private investor and the issuer alike.

New Issues subscribed by tender.

In the case of Joint-Stock Companies, as soon as the terms upon which the issue is to be made have been settled, a prospectus is drawn up, and then the promoters decide as to whether the intended issue shall be underwritten or not.

Underwriting means that a number of persons, in return for a certain fee, guarantee the success of an issue in the following manner. Every one of the underwriters makes himself responsible to take up a certain amount of the issue. The public is then invited to subscribe. If the public take the whole of the issue, or over-subscribe it, then the underwriters are free from any further responsibility. If the public takes only part of the issue, then the total amount subscribed for by the public is deducted from

Underwriting New Issues.

the total intended amount of the issue, and the underwriters are bound to take the unissued balance in proportion to the amounts which they each individually underwrote. For example, supposing the total intended issue to be £100,000, and that the public subscribes £60,000, then it falls upon the underwriters to take up £40,000 between them. In such a case any one who has underwritten £1,000 of stock is bound to take up £400 of it.

The underwriter is paid a percentage which varies from 1 per cent. on the amount underwritten, up to 6 per cent. or even more in the case of issues of new companies which are speculative.

Underwriting a profitable business.

The business of underwriting is rather profitable, for if £1,000 has been underwritten at a 3 per cent. underwriting fee, and the public has applied for 60 per cent. of the total intended issue, then the underwriter has to take 40 per cent., or £400 stock, out of every £1,000 which he has underwritten: his underwriting fee is 3 per cent., or £30 on the £1,000 underwritten. His £400 stock, therefore, will have cost him £30 less than the public has paid for a similar quantity, or, in other words, he has bought his supply at a discount of about 8 per cent. In many cases the public applies for a far larger proportion than 60 per cent. of an

intended issue. On such occasions the underwriter obtains his stock still cheaper, because he receives the same underwriting fee and he has to offset the same fee against the smaller unissued balance of stock for which he is responsible.

Underwriters' responsibility for fictitious quotations.

As soon as the underwriting arrangements are completed, the prospectus is advertised in the public Press. The underwriters are either Stock Jobbers, Banks, Trust Companies, or minor Financial Houses who are capable of exerting a market-influence on the Stock Exchange. By these means transactions in the new stock are passed through often at a premium. These transactions are recorded in the Money Article of the newspapers, and in this way the public is induced to believe that there is a great demand for the new issue. Accordingly, they fill in application-forms to obtain the stock at par, in the belief that it is saleable above par.

In many cases, of course, new issues are genuinely over-subscribed and the dealings at a premium are perfectly legitimate. But, unfortunately, in some instances such dealings are quite fictitious. The possible chance of snatching a premium frequently induces stock gamblers to apply for especially tempting new issues. This operation is called "Stagging."

Snatching a Premium on New Issues

As these men have no use for the stock, they sell it immediately in the hope of obtaining an allotment. Such sales frequently interfere with *bona fide* premiums being maintained.

As soon as the public applications have been received, the issuing house closes the list and issues letters of allotment to the applicants.

Requisites for a Stock Exchange Quotation.

All the documents in the case, including the prospectus, the applications, and proof of the receipt of the application-money, are now submitted to the Committee of the Stock Exchange, and are examined by the Share and Loan Department of that institution. If all is found in order, the Committee of the Stock Exchange appoints a special settling day, on which all the bargains which have taken place in the stock are settled. If the application for a special settling day is refused, then all bargains contingent upon the granting of a special settlement are void. Whenever application for an official quotation is made, and the case warrants it, this request is also granted by the Committee of the Stock Exchange, and the stock is then quoted officially.

Expense of Issuing Stock.

The cost of an issue depends entirely upon the number of prospectuses sent out, the amount spent on advertising, the fees paid to the bank which receives the applications, to the brokers, solicitors, and accountants whose names appear

on the prospectus, and the cost of the underwriting fee. These expenses are very heavy in any case, and hardly ever amount to less than £2,000, even on a modest issue. But as there are some firms of brokers and solicitors who consider themselves but poorly remunerated by a fee of 1,000 guineas for merely giving the promoters the right to print their name on a prospectus, their work and out-of-pocket expenses being paid extra, and as it is quite easy to spend £5,000 on advertising a prospectus, the cost of launching some issues very considerably exceeds the smallest sum which can be expressed in five figures. Whenever the issue is large this does not matter, as even £25,000 is only $2\frac{1}{2}$ per cent. on £1,000,000; but on small issues of £50,000 or £100,000 the expense is proportionately burdensome.

How to judge the merits of new Loan Issues

It is extremely easy to ascertain whether an issue made by a Government, Corporation, or Municipality is cheap or dear, desirable or undesirable. There are but few borrowers of this class who have not borrowed before. Of these, the past statistics of former issues indicate to a nicety between what extremes of quotation the new issue is likely to fluctuate in the future. If a borrower has ever made default in the past he is likely to do so again, unless his financial conditions have greatly changed for the better.

A prudent Investor will insist upon very strong proof of such an altered state of affairs before he will entrust any part of his capital to a dubious borrower.

Effect of new Loan Issues on old Stock.

The dearness or cheapness of the price at which a new issue of this kind is offered, depends rather upon the normal price-levels of former issues, over a period of years, than upon the prices ruling for such issues at the date of the fresh flotation. For it is a well-known and frequently practised manœuvre, temporarily to enhance by artificial means the ruling prices of kindred stocks or of stocks ranking *pari passu* with a new issue, in order to float the new stock at a high level.

First Issues of Stock judged by comparison.

If a borrower appears who has never made an issue before, then the stock-lists should be examined, and a parallel case of a similar borrower, hailing from the same part of the world, should be found, and the terms of the new issue compared with the terms upon which the similar issue has been dealt in in the open market over a period of years.

In fact, a new issue of any kind should not be judged merely by the particulars given in the prospectus, but the surrounding circumstances must also be taken into account.

The remarks made in the preceding chapter respecting Government and Municipal Loans

should be constantly borne in mind before new issues of this kind are applied for.

Whenever the underwriters have been obliged to take a considerable portion of an issue, owing to the lack of applications on the part of the public, the amount of stock in the hands of the underwriters is certain to come to market sooner rather than later, because it is no part of an underwriter's business to hold stock permanently. An effort is therefore made to get the underwriters out by what is technically known as "Making a Market."

"Making a Market" in New Issues.

In such circumstances several jobbers are given the right either to buy from, or sell to, the underwriters at a certain price, which is fixed beforehand, so that these jobbers can deal freely without running any risk of being landed with any stock. Firms of brokers are pressed into the service, being induced to offer the stock to country brokers and other large clients at a price which is below the ostensible market quotation, so that country brokers can apparently secure exceptionally advantageous terms for their clientèle. Purchases and sales are passed through the Stock Exchange which equalise themselves by the same firm sending in one broker to buy and another broker to sell simultaneously. In America bargains of this sort are called *Wash Sales:* such dealings result

"Wash Sales."

in the marking of business done, and cause an artificial free market and close quotations. In this way the public is gradually induced to absorb the entire issue, and as soon as this object is accomplished, the hitherto interested promoters are no longer concerned in the stock's welfare, but retire from the scene, and let the stock and its quotation take care of themselves for the future.

Making a market is thus a perfectly legitimate way of disposing of stock. Provided that the stock is a good investment, and is sold at a fair price, this process of making a market is harmless enough; but it deteriorates into a most objectionable procedure when a worthless or speculative security is thus retailed at high prices. The more reluctant the public to take the stock, the worse it is for thoughtless investors, for in such a case they are whipped in by what is known as the "Premium Dodge."

The "Premium Dodge" as Underwriters' bait.

Man has ever been, and will ever be, an imitative animal who dearly loves to follow a leader. Many people are indifferent to a stock which is offered at par and would not take any notice of anything quoted at a discount; but at a premium they eagerly buy, and the higher the premium goes, the more anxious do they become to join in the game. This is easily explained by the fact that most

Investors do not take the trouble to find out what a security really is worth, but much prefer to lean on the judgment of others. The reasoning with them seems to be that there are many shrewd judges of stocks in the City, so that, if it is good enough for these experts to pay premiums, it is surely good enough for private Investors to do so too. The idea that this is a kind of mock auction, in which the owners themselves bid up their wares, with a view to inducing an outsider who is a poor judge of value to make a bid, and so become the purchaser, does not strike them at all.

Reason why Investors succumb to Premium Dodge.

It is really pitiful to see some highly speculative and ill-secured shares, which are dear at their original issue-price of £1, being sold a few weeks later at 30*s.*, or 50 per cent. premium, and to know that innocent Investors are actually paying this exorbitant price: but it does not seem possible to assist light-hearted and light-headed Investors in retaining their money.

Any one who does not inquire what is the real comparative value of the stocks which he acquires, hardly deserves to retain his capital. Perhaps, after all, pity is only wasted on those who succumb to the *Premium Dodge.*

In the case of an established Company making a new issue, be it of Shares or Debentures, the

procedure adopted is, as a rule, precisely the same as in the case of Municipalities, Corporations, or Governments issuing loans. In such cases the offer to the public is made either by the Company direct, or through a house of issue.

New Issues as Investment-opportunities.

The public has sometimes a good chance of picking up a bargain when issues of this kind are offered, because the new stocks are usually sold under the ruling market price of the Company's existing securities; also an opportunity is given to purchase, free of market competition, a stock which is well known, which has an established record of extreme quotations, and which can be valued to a nicety in every respect.

The prospectus offering a new stock of this kind should disclose:

Essential Contents of Company Prospectus.

1. The existing liabilities of the concern.
2. A detailed list of the assets held, and the price at which they stand in the balance sheet.
3. A reliable and independent valuation of all assets which have a break-up value.
4. A clear and explicit Profit and Loss Account.
5. A statement of the turnover and net profits made during the last few years, covering, in the case of old-established concerns, a period of not less than five years.

With such a statement before him, the Investor can ascertain how far the new capital will clear

off any existing liabilities and provide additional Working Capital, or defray the cost of contemplated extensions; what degree of security the new stock offers; whether the business is increasing or decreasing; whether the margin of profit made has risen or fallen—in fact, the whole of the necessary details for appraising the value and safety of the new stock should be clearly set forth. Reading a Company Prospectus.

Whenever a prospectus fails to give a full list of the details above enumerated, then the prospectus is either badly drawn up or the Company is anxious to conceal some material fact.

Frequently the inexperience of the draftsman of a prospectus is responsible for such omissions, and this is easily remedied by writing a letter to the secretary, and asking for the additional information. In many cases, however, material facts are withheld, and the Investor must then judge for himself whether he will, in such circumstances, risk his Capital.

The main point which the Investor must always keep before him is capital-safety, therefore a statement of assets and their break-up value, together with full information concerning existing liabilities, is indispensable in every case. It is also very necessary to know how the business has progressed in the past, and how each year's turnover compares with the net profits. Capital-Safety the Investor's main point.

When new Stock may be valued as old Stock.

In the case of Corporations or Companies which are paying dividends on a vast amount of Capital which ranks behind a new issue, it is only requisite to ascertain what the shares behind the new issue are selling at, and how much dividend has been paid on them during the past few years. In fact, in such cases the new stock can be valued like an old stock. But whatever the prices of the stocks may be and whatever dividends may have been paid, it is always more satisfactory to have the above described detailed statement of the Company's realisable assets.

Investors should always bear in mind that a Company, when attempting to raise fresh capital, is anxious to put its position in the best possible light, and that, if material facts are withheld, it is only reasonable to conclude that there is a conccalment of items which might prove detrimental to the success of the issue.

Valuing new Issues with a guarantee.

Whenever a new issue is guaranteed by another Company or by a State or Corporation, it is as well to inquire carefully into the value of such a guarantee; and if this guarantee is found to be good, then it is not necessary to inquire so closely into the merits of the issuing Company.

It is a good plan to examine the list of shareholders of the Company offering new stock, either

at Somerset House or at the Company's office, before making an application. This list any member of the public is entitled to inspect, on payment of a fee of one shilling, at either place. The list not only shows how much money the Directors have personally invested in the concern, but also who holds the shares, and how they are distributed. If it is found that the Directors are but small shareholders, there is the risk that the management may not display active intelligence. If there are large blocks of shares held in a few hands, then the price of the shares is uncertain, as an avalanche of stock may descend upon the market at any time. In an ideal list of shareholders the Directors should have large personal holdings of old standing, and the rest of the shares should be distributed in the smallest possible lots among *bona-fide* Investors who have no City address.

Advantages of examining list of Shareholders.

The most difficult task in the whole field of finance is to be able to gauge the merits of an entirely new creation, and no Investor should attempt this truly puzzling problem unless he either has access to an experienced adviser, who is able to point out the existing difficulties to him, or unless he is possessed of a great amount of practical financial knowledge.

Difficulty of gauging new enterprises

It is necessary to make an attempt to draw

up some general rules of guidance, by the aid of which an Investor may subject prospectuses to a searching analysis. In applying these rules it must be remembered that there is such a vast difference between various prospectuses that it will be quite impossible to frame any rules so widely as to cover all the points which possibly may rise.

Comparative length of survival of new Companies.

First of all—if at starting the prospects of success of all new Companies are taken to be equal—there is a chance of 5 to 95 against the new Company surviving its first year of existence, a chance of 1 to 9 against its surviving the third year, and a chance of 22 to 100 against its surviving its fifth birthday, these ratios being based upon the mortality figures published by the Registrar of Joint-Stock Companies, so that it is hardly necessary to insist upon great caution in the selection of a new Company's shares.

Rules for analysing Company Prospectus.

We will now take the salient points of a prospectus in the order in which every Investor should consider them.

1. *The Class of Enterprise.*—There are but few Investors who have a special like or dislike for any particular class of enterprise. They should gradually acquire an instinctive taste in this direction, and learn to discriminate between those enterprises which have the germ of per-

manency in them, and those which come and go like gnats, whose span of life is a single summer's day. The best way to acquire this knowledge is to examine a share-list which gives the year of birth of the securities which it contains, and to single out those classes of enterprise which have seen the largest number of winters.

Relative life of different classes of enterprises.

It will then be seen that Railways, Banks, Insurance Companies, Breweries, Telephone, Waterworks, Gas, Telegraph, and Shipping Companies as a rule live long, whilst Mineral Water, Drapery, Cycle, Mining, and Oil Companies generally have short lives.

The list here given should by no means be taken as exhaustive, but purely as indicative, and it should also be remembered that, by examining a share-list, the inquirer is moving among the living, and that mortality inquiries should really be made on burial-grounds. There are but few old men who suffer from consumption, because consumptives usually succumb to the malady while they are young; in the same way, if there are not a good number of old and prosperous concerns carrying on any particular form of enterprise to be found, the inference is that the nature of that enterprise does not permit of longevity.

Enterprises based on new inventions should be avoided.

Entirely modern types of enterprises based upon new inventions, like the manufacture of

motor-cars, or wireless telegraphy, should be shunned by careful Investors, as every new industry involves large losses before it settles down to the steady profits of a stable trade. Venturesome spirits have their imagination roused by the potential profits accruing to the pioneers of a new industrial development. But it is more prudent to remember that every business must pass through its dangerous experimental stage.

Every Investor who has reason to doubt the solidity and permanent character of the class of enterprise to be exploited by a new Company, will do well to lay that Company's prospectus down unread, lest perchance he may fall into the clutches of a clever draftsman who may deftly succeed by the aid of a few neatly turned sentences in removing this first and all-important objection from his mind.

Reason for forming Company an important factor.

2. *Reason for forming the Company.*—This should be quite clear from the first few lines following the word "Prospectus," and it must be a good and valid reason. Whenever it is said that the Company is formed "*for family reasons,*" or "*to reduce Working Expenses* through an amalgamation" of trade-competitors or "to *unite opposing interests,*" the Investor must exercise great caution, and he must make quite sure that receding trade is not the real reason

for the formation of the new Company. Whenever the reason is "*to obtain fresh Working Capital*," or "to make extensions," these ostensible objects should never leave the Investor's mind. He should carefully ascertain whether the new Capital asked for will really accomplish its stated object.

He must on no account forget that the real reason for forming private businesses into public companies is only too frequently a falling off of trade.

Time required for developing new enterprises

If an entirely new enterprise is started, be it to build a railway or a factory, to exploit land, a mine, or such like, then the Investor should bear in mind that almost all of these enterprises would require from two to five years to attain their full development, and that if such enterprises are to be really honestly worked, no dividends can be paid during this period of development, except out of capital and by the depletion of Capital Account. If the prospectus gives statements or calculations to the effect that a new enterprise is likely to earn dividends immediately after starting, this prospectus is not likely to be straightforward, for there are extremely few new enterprises which can spring into maturity through the magic wand of the promoter.

To launch a new venture or to form a sound

existing business into a Company is not a work of philanthropy: in all such cases the promoters are the sellers and the investing public are the buyers. Also where a going concern is converted into a public company the promoter usually makes his own terms, and then tries to add a substantial profit for himself—a fact which he manages to conceal so far as he possibly can behind a screen of verbosity.

Company Promoters' Profits should be looked for.

All entirely new enterprises are speculative, no matter what their nature may be, so that only an ultimate pronounced success can compensate for the inevitable original risk.

Relative importance of officers named in Prospectus.

3. *The People connected with the Enterprise.*—Of these the directors and managers are the most important, and the bankers, brokers, auditors, solicitors, of the least importance. It is not the province of banks to inquire into the possibilities of an enterprise for which they are prepared to receive subscriptions, and they never pretend to do so; neither is this the auditor's duty. The solicitors act as a rule for the promoters, and are therefore not retained in the special interest of the Investor. The brokers look upon the new stock as new merchandise in their own special line of trade, while all these functionaries are appointed by the promoters, and in their case the matter of a Company's formation

is an everyday business. As a rule, the chief point which affects them is the respectability, and only secondarily the ultimate success of the concern. As a guarantee of respectability, all the firms occupying official positions are a useful indication, but in no way do they form an index to the future prosperity of the undertaking.

Success of Company dependent on directors and managers

The directors and managers of the new enterprise are the persons who will create success or failure; hence they should be most carefully considered, not only from the point of respectability, responsibility, and social standing, but principally as to their business ability and former business success. A glance at the Directory of Directors shows in which other Companies the directors hold office. If these other Companies are successes, then the prospects of the new enterprise should be good, as far as the management is concerned; if there are failures in many of the Companies managed by the same directors, then caution is more than necessary.

The saying that "birds of a feather flock together" is nowhere more strongly exemplified than in the case of company directors, and really good men of business will only most reluctantly join an enterprise which has not a germ of success in it, or where they will have to collaborate on the Board with colleagues who

have proved themselves to be commercial failures. Applicants for shares in new enterprises should make certain that the directors who will manage the Company thoroughly understand the business in hand, and that they have not been placed on the Board solely on account of their social position.

Directors should possess business knowledge.

The vendors of a business frequently join the Board of a new Company; and in cases of established businesses it is desirable that they should; but if their number predominates, the new shareholders' interests are inadequately represented.

4. *Is the Proposed Bargain Fair?*—After having ascertained that the enterprise is likely to be permanent, that the Company has been formed for a valid reason, and that the directors are capable of making the business a success, the proposed bargain between the vendors on the one hand and the new shareholders on the other hand, should be inquired into. This will in many cases be found a very difficult task, as the statements which bear upon this part of the proposition will crop up in various parts of the prospectus.

Bargain between Vendors and Shareholders must be just.

The best plan is to imagine that the applicant for shares intends to purchase all the shares offered for subscription, for which purpose he puts down the value of all the

property which is being sold to the new Company, while against that total he places the price asked for the property. Such a simple statement discloses at once the probable future value of the shares offered and the real intentions of the vendors.

Whenever the assets sold are valued by a person of repute, and the past earnings are certified by an accountant's certificate, it will be easy to ascertain the true meaning of the intended bargain, and to estimate the real value of the goodwill which is included in the purchase. But in all cases where no such reliable data are given, to apply for any of the new shares involves a great risk.

Share denominations and their participation in profits.

The future division of profits is disclosed by the division of the Company's Capital into Preference, Ordinary, Deferred, and Founders' shares. Whenever the Preference shares are more than twice covered by the actual break-up value of assets, it is fair that they should participate to a small fixed extent in the profits only, because in such a case these Preferred shares carry no appreciable Capital-risk. If no such security is given to the Preference shareholders, then the bargain is unfair, and such Preference shares are undesirable. If there are Debentures in front of the Preference shares, then the remaining assets, after deducting the

amount of the Debentures, should cover the Preference shares at least two and one-half fold.

The Ordinary shareholders run most of the risk, therefore they should receive most of the profit. The Deferred shares run a still greater risk, therefore, provided that cash has been paid for them, or tangible property transferred in consideration of them, they should receive more of the profit in case of great success than the Ordinary shares. Ordinary, Deferred, and Founders' shares which are obtained for goodwill or form part of the promotion profit, are not entitled to the lion's share of the dividends.

A guide to fair distribution of future profits.

The following axioms should serve as a guide to a reasonable distribution of future profits.

Debentures and Preference shares, if they are fixed dividend stocks, should run no Capital-risk of any kind, and if they are asked to take some Capital-risk, they should receive a counterbalancing addition to their fixed interest in times of great prosperity.

Ordinary shares should first of all rank for a fair rate of dividend. This should be calculated to amount to at least one and a half times the yield of interest allotted to the Debenture and Preference shares. In addition, they should receive one-half of the remaining surplus profits

until these amount to, say, two and a half or three times the rate which has already been allocated to them.

Deferred shares, if paid for in cash, should have the lion's share of all large profits; but shares of this type merely representing goodwill or promotion should never receive more than the Ordinary shares.

Deferred Shares deserve large profits.

Founders' shares should only receive what is left after all other classes of shares have been provided for as above explained.

Founders' Shares should rank last.

With these axioms in his mind, the applicant for shares in a new Company can easily ascertain whether the proposed division of profits in the new Company is fair.

The distribution of the voting power is quite as important as the division of future profits. As a fair bargain, all the shares which are paid for in cash or acquired through the transfer of tangible property, should, as a combined body, have two-thirds of the entire voting power distributed in fair proportions between them. The remaining one-third of the voting power, but in no case more, should be held by the sellers of the goodwill or the promoters.

Voting Power should be regulated by value invested.

Whenever it is found that the new Company acquires its property for a high price, or that the future profits are not distributed in proportion to the risks undertaken, or that the voice

in the future conduct of the Company, as determined by the voting power, is not proportionately balanced, then to apply for shares is imprudent and is attended by undue danger.

5. *The New Company's Business Prospects.*—There should be a clear conception in the mind of every applicant for new shares as to the financial position which his Company will occupy in the future. He should carefully inquire into the amount of Working Capital which will be left, after paying the vendor and providing the preliminary expenses. A great many Companies fail because the Working Capital is insufficient, the Companies' financial plan, as explained in the prospectus, having been based on the assumption that all the shares offered would be taken up, and the directors having gone to allotment on a smaller amount. It is a good plan to state on the subscription-form: "I subscribe on condition that the minimum amount of £—— has been subscribed for by others." Through this simple precaution individual Investors would protect themselves against numerous losses.

Importance of sufficient Working Capital.

Investors' protection against insufficient Working Capital.

Any one who is interested in ascertaining how far the law is capable of assisting inexperienced investors should make a study of the minimum amount of subscription upon which some new companies propose to go to allotment. The law

now forces promoters to state this amount in the prospectus. Cases have been known where the directors proposed to go to allotment on a sum which was smaller than the estimated preliminary expenses, so that such a company might have started as a bankrupt. Yet small investors have subscribed to such concerns, and the directors did go to allotment on applications which they knew to be quite inadequate.

6. *The Chances offered by the New Issue.*—After being fully satisfied on all the above points, the applicant should carefully examine the estimates of possible future profits given in the prospectus, and after making a large allowance for disappointed hopes, calculate what in that case his shares would be worth, when compared with the prices of similar shares in already established Companies.

New Shares must compare favourably with old Shares.

If he finds that in the most favourable event new shares compare with shares which are quoted at about 50 per cent. premium, and that after making a liberal deduction from the estimated profits they would still be worth 20 per cent. premium, then the chances of the subscription are fair. Should he find that he could purchase similar shares at the same price, or for, say, 10 per cent. more, he should buy shares in the established Company rather than

Risks of Investment in new Company.

take up the new shares. The chances against the best-founded new Company proving itself to be a good investment cannot be taken at less than 7 to 5 against.

7. *New Guaranteed Stocks or New Debentures secured on double the value of Assets.*—If a new stock is unconditionally guaranteed by a really responsible party, and if new Debentures are doubly secured by assets, it is not necessary to make very elaborate further inquiries, as in that case the Capital is safe.

It will be seen from the above explanation that taking up new issues is by no means an easy business, and that a great deal of careful analytical reading has to precede every prudent investment in new stocks. There are a large number of minor details to be observed when taking up new issues which it has been found impracticable to enumerate here. Hardly ever are there two prospectuses which are really similar, and this prevents the possibility of giving full directions in a short sketch.

Established Stocks safer than new Issues.

It is invariably safer to buy an established stock than to take up a new issue, unless this new issue takes the shape of a Government, Municipal, or Corporation Loan of ascertained quality,

a Guaranteed stock, or a fully secured Debenture, or unless the new stock is offered by a well-established Company at a lower price than the already existing issues of that Company can be bought for.

CHAPTER VIII

THE MANAGEMENT OF COMPANIES

MEETINGS, BALANCE SHEETS, AND REPORTS

THE management of a Company is vested in a Board of Directors and a Secretary, who have entire charge of the Company's business progress. In most cases the Directors are only eligible to hold office so long as they are shareholders; so that they act in the double capacity of the personal superintendents of their own invested capital and of the salaried stewards who are paid to safeguard the interests of the other shareholders. Whenever a shareholder is a business-like person and is not likely to divulge any of its working secrets to trade competitors, that shareholder has a right to know as much of the inner working of the concern as any director, secretary, or other official, for he is in every sense of the word a full partner.

Shareholders' rights governed by Company's Articles.

The relation of the shareholders to each other and to the Directors and Managers is governed by the Company's Articles of Association,

which are open to the inspection of shareholders. Their main points should be familiar to every shareholder, so that he may understand the terms which govern the partnership of which he is a member. The names of all the owners of shares are kept in a share register, and this register is also open to the inspection of shareholders.

Duties of Directors to Shareholders.

Directors and Managers are not only morally, but also legally, bound to afford shareholders full information as to the position of the Company and its business progress. But as in some Companies there are as many as 30,000 shareholders, these moral and legal rights could not be enforced without gravely interfering with the Company's routine of work. An intelligent shareholder will only exercise his rights when any real necessity arises.

The Directors and Managers should, by means of circulars, keep the shareholders well posted on every extraordinary occurrence which may affect the Company's business, whilst they are bound by the Companies Acts to furnish them at certain fixed intervals with a statement of account setting forth the Company's position and trading progress. A concise Report, issued by the Directors, should tend to elucidate these periodical accounts.

Every Company must appoint an Auditor,

Auditors and their functions.

whose function it is to verify the Directors' accounts in the interest of the shareholders. He is bound to insist upon the Directors making a lucid and full statement of account to him as representative of the shareholders, and to report to them any point upon which, in his opinion, the accounts are not explicit. Thus, the Directors are responsible for the Company's books being fully and lucidly kept under the Auditors supervision, and the Auditor is responsible for the true position being embodied in the Statement of Accounts which is submitted to the shareholders.

Meetings of Shareholders must be held annually.

At least once in every year a meeting of shareholders must be called by the Directors, the idea of these meetings being that all parties interested in the enterprise should have an opportunity of ascertaining how the Company is progressing, and of discussing all questions of general interest to the Company. These meetings are by no means called for the purpose of giving individual shareholders a chance of publicly ventilating any personal grievance which they may have, and any shareholder who does this at a meeting is abusing his powers. Personal questions should be put to the Directors privately, or when they assemble for the purpose of transacting the ordinary business of the Company.

The profits made by a Company are ascertained by the Directors and verified by the Auditors. The division of Profits among the shareholders, as proposed by the Directors, requires to be confirmed at a meeting of shareholders. Interim divisions of Profits may be made by the Directors, if the Articles of Association give them power to do so.

Interim Dividends must be confirmed by Shareholders.

Alterations in the general constitution of the Company, and acts of vital importance to it, are decided by the shareholders at special meetings, which are called "extraordinary," in contrast to the "ordinary" meetings which must be held in accordance with Statute. These extraordinary meetings may be called either by the Directors or must be called at the request of the number of shareholders specified in the Articles of Association. The voting-powers of shareholders at meetings are settled by the Articles of Association, and votes can be given either personally or by proxy.

"Extraordinary" Special Meetings of Shareholders.

The above are the general fundamental principles which govern all Joint-Stock Companies, and whenever they are faithfully carried out, all parties concerned should be satisfied. But, unfortunately, through the lethargy of shareholders on the one hand, and the want of consideration on the part of Directors on the other, they are rarely complied with strictly.

Companies fail through Shareholders' apathy.

Shareholders are too prone to leave everything to the Directors, and Directors are inclined to consider the shareholders as a necessary evil, which has to be dealt with, firmly or even brutally. Through the want of co-operation between Directors and shareholders, many otherwise sound enterprises fail.

One of the principal points which tend to make shareholding precarious, is the want of explicitness in Companies' Balance Sheets and Reports, and the manner in which Companies' profits are first of all calculated and subsequently divided.

How to read a Balance Sheet.

A Company's balance sheet, when once properly understood, is an extremely simple document. On the one side there should be scheduled everything the Company owns, valued at its estimated realisable market-value; while, on the other side, the Company's Capital and all its obligations should be stated. The Asset side should be larger than the Capital and Liability side, and the difference between these two sides constitutes the Company's undivided profit. Unfortunately, balance sheets are sometimes rendered obscure by the Directors putting on the asset side items which are not assets at all, and on the liability side items which are not liabilities. The whole situation is often further obscured by various items which should be set

forth separately being lumped together in one sum.

When reading the subjoined argument, it is suggested that the reader should have open before him any balance sheet which he may have handy and that he should follow the items as they are here discussed. It is also suggested that on subsequent occasions, when any special balance sheet is investigated, this same course be adopted.

Proper construction of a Balance Sheet

When treated in this way balance sheets will be found to unfold their true meaning readily enough. Taking the asset side first, it is futile to insert values which are incorrect. For example, a Company owns works and machinery, which originally cost the Company a certain sum; but in the course of time the works have depreciated, and the machinery has worn out. This depreciation and wear-and-tear is a trading expense, and should be duly met out of each half year's profits, for to value works and machinery at their cost in a balance sheet is to obscure the true state of affairs. No item of real or immovable property should ever figure in a balance sheet at more than its fairly estimated realisable value. It sometimes happens that certain parts of a Company's immovable property become useless to the Company's business and cease to be revenue-earning, and

Assets and their valuation.

although they are still entitled to appear in the balance sheet at the price at which they could be sold, they should never do so at a higher value. Perishable stock, particularly stock which is likely to go out of fashion or out of use, should be put in a balance sheet at what it would fetch, less the Company's ordinary trading profit. To value such items at cost, if that cost is above the valuation here advocated or below it, is misleading. Investments in other Companies should be carried into the balance sheet at their selling value, and debtors should be written down to the actual amount which the Company has a fair expectation of being able to collect.

Perishable goods valued at sale price.

In America there is an admirable system in vogue of separating out assets which are convertible into cash at any time from assets which could not be sold without impairing the Company's business. These are called "*quick assets*," as distinguished from assets which are difficult of realisation, and this point will be closely considered when the financial position, as disclosed by a balance sheet, is discussed.

Meaning of "quick assets."

Every item of realisable asset having been properly valued, these values should be set out in detail in the balance sheet, so that the shareholders may have a correct idea as to what the Company's property consists of.

To lump items together and to give a final total is improper and misleading. Supposing a Company has the following assets: Freeholds £200, Leaseholds £800, Machinery £1,100, Patents £40,000, and the Directors give these in the balance sheet as: *By Freeholds, Leaseholds, Machinery, and Patents,* £42,100, then the balance sheet becomes quite useless as a means of affording information. A balance sheet is meant to show the true state of affairs, and this item of £42,100, when lumped as above described, is open to any number of different hazardous guesses. Thus, the freeholds might be worth £20,000, the leaseholds £10,000, the machinery £11,000 and the patents only £1,100. Yet on again adding the last-mentioned very much more substantial items, the same result of a total of £42,100 would be arrived at.

Assets should be detailed.

No Directors have a right to fog their shareholders in this fashion, and shareholders should strongly protest against attempts to put before them such inexplicit accounts.

In cases where the Directors refuse to furnish important details, and the objecting shareholder is not influential enough to compel them to do so, his remedy is simple. The Auditors, when verifying a balance sheet, are furnished by the Directors with a detailed

Shareholders' remedy for obscure Balance Sheet.

statement setting out minutely how each item of the balance sheet is made up. This statement is open to the inspection of every shareholder, and by insisting upon seeing it, he obtains the information which the Directors may attempt to withhold from him.

Object of Balance Sheet frustrated by incorrect valuation.

To settle the values of the assets as they should appear in the balance sheet is a very serious business, and, as has already been explained, the placing of an improper value against these entirely contradicts the intention of a balance sheet, which is to give a true and correct account of the Company's actual position. If the assets are overvalued, then the Company is worse off than the figures show; while if the assets are under-valued the Company is much better off than it appears to be. Either process of valuing frustrates the true purpose for which balance sheets have been instituted; hence, shareholders should not only insist upon their Directors valuing at fair prices, but they should also stipulate that from time to time competent independent valuers should be called in to corroborate the Directors' opinions on this point.

It has only too frequently occurred, that shareholders have been kept either in a fool's paradise or in a state of suspense for years, by the Directors wilfully overstating or under-

stating the value of the assets. The true position of affairs is bound to see the light of day at some period or other, and then some shareholders lose heavily, those with inside knowledge personally having protected themselves against the inevitable disaster; or, many shareholders do not obtain the full benefit of their position, again owing to insiders profiting by an impending disclosure of surplus values, of which the majority were entirely unaware.

Shareholders the victims of unimparted knowledge.

To have inside information which can be turned into £ *s.* *d.* is a temptation which, unfortunately, but few can withstand, and shareholders have only themselves to blame if they permit their Directors to subject themselves to such a temptation.

The liability side of a balance sheet is much simpler than the asset side, as here there are but few chances of over-valuation or of under-statement. We find, first of all, the Company's issued Capital, then the Company's permanent indebtedness in the shape of Debentures or Bonds, and lastly the Company's current liabilities. All these items, except the liabilities, perhaps, are fixed, and therefore not subject to a valuation. The liabilities might be understated or overstated, by either excluding items for which no account has yet

How to estimate the Company's Liabilities.

been rendered by creditors, or by including items which are not likely to ever become claims.

It is rarely that such over-estimates or under-estimates are of real importance, therefore the liabilities as disclosed by a balance sheet can, as a rule, be safely accepted without much inquiry.

The majority of Companies have a Reserve Fund, or sums set aside to meet contingencies or for any other purpose. This Reserve Fund should be separately invested in securities unconnected with the Company's operations, and should not be utilised in the Company's business.

Reserve Fund must be separately invested.

The idea of a Reserve Fund, as the word implies, is a certain sum which can be made available at any time, to meet special emergencies. If the Reserve Fund is invested in the business, it becomes quite impossible to realise it at any time, and therefore it fails to fulfil its object. A fund which is invested in the business is in reality a profit which has not been divided, but reinvested, and such an item should be called "Undivided Profit." Many Companies fog their shareholders by not writing off depreciation but by placing the item which should be so written off on the liability side of the balance sheet as a "Reserve." The only way in which

Reserve Fund as mere undivided profit.

shareholders can put a stop to such practices is to insist that whatever sum is called "Reserve Fund" be so invested that it can be made liquid at a moment's notice. It is desirable that every Company should have such a fund, however small it may be.

Importance of Liquid Reserve Fund.

The Reserve Fund appears on the liability side of the balance sheet. It is, however, not a claim on the Company, and every one should learn to distinguish between sums due to creditors, which are real liabilities, and sums which the Company has set aside, such as Reserves or funds to meet special emergencies, which are not liabilities, and only count as such as between the partners [shareholders] themselves. In analysing a balance sheet, these items, as will be shown hereafter, can be entirely disregarded. The balance brought forward, if it be a credit balance, and the profits made during any period, also appear on the liability side of a balance sheet. These represent undistributed profits which have, as yet, not been set aside, and are also unimportant for the purpose of analysis.

Balance Sheet entries which may be ignored.

Both on the asset and liability sides of balance sheets items frequently appear, which are difficult to express in £ *s.* *d.* and represent mere book entries of no real value. It is necessary to insert these items, as otherwise the account would not balance. If, for example, a Company

has incurred an expenditure for preliminary expenses at its formation, it would hardly be possible or fair to pay this item out of the first year's trading, but this would be necessary if the item of expenditure did not appear in the balance sheet at all. This expenditure has to be met out of the profits of several years, so, for this reason, it must be kept in the balance sheet, although it is not a tangible asset; it must be inserted on the asset side of the balance sheet until it is paid off, although it does not represent any value.

Intangible Assets should be written off.

Similarly, a Company spends an extra large sum on advertising. The benefit of these advertisements will only gradually accrue in increased trade turnover. Perhaps a mine has spent large sums of money on development work which has no selling value. In fact, there are endless cases of expenditure having been made upon work which does not represent any break-up value, and this expenditure must be gradually met out of several years' profits. In the meantime, these items must figure on the asset side of the balance sheet. Goodwill is also an item of this kind, which has been purchased and must be gradually written off; but in the meantime it must appear in the Accounts.

It is quite impossible to make any general rule as to the amount which companies should

write off annually out of profits, from the items in its balance sheet which do not represent tangible property. The general tendency should be to write them off as fast as profits will permit this to be done. No Company should ever pay more than 5 per cent. in dividends on its Ordinary shares until all imaginary items have disappeared from its balance sheet, while Deferred and Founders' shares should receive no dividends at all until these items have been wiped out. It is quite easy for a Company to distribute dividends which have really not been earned unless such a rule is made. Supposing £20,000 annually is spent on advertising, and only £15,000 of profit is made, then the Company is trading at a loss. But, by placing the £20,000 to Goodwill or special advertising account in the balance sheet, a profit of £15,000 is fictitiously shown, and this profit can then be paid away in dividends. This example shows how very dangerous fictitious Reserve or large Goodwill items may become. A young and growing Company may have an excuse for holding book assets, but any dividend-paying Company which has such assets in its balance sheet on its tenth birthday is improperly distributing imaginary profits.

Rule for writing down imaginary items.

If a Company has issued shares at a premium, or obtained any other item which the Acts of Parliament declare to be Capital, these must

also be carried on the liability side of the balance sheet, merely as a book entry.

All such items, on both sides of the balance sheet, can, for all practical purposes of valuation, be disregarded, with the exception of those which make up *Goodwill* in any way, be it as advertising expenditure, development work, or the actual Goodwill item which the Company has bought.

Goodwill can be estimated.

The Goodwill of almost every business has a selling value, and even doctors sell their practices. The basis upon which Goodwill is valued is the amount of profit which the business produces after the Capital which is employed in the business has received a fair rate of interest. Thus, a business which only returns, say, 5 per cent. upon the Capital sunk in it, has no Goodwill of real value, as this same Capital can be made to produce 5 per cent. without this Goodwill, and perhaps with less Capital-risk; whilst a business which produces, say, 10 per cent. upon the Capital used for its purposes has a distinct and valuable Goodwill, for the Capital alone could not produce such a return.

Thus, the value of Goodwill (including patents, trademarks, copyrights, which are really Goodwill) is ascertained by deducting from the average annual net profit made during, say,

three or five years, the interest calculated, at, say, 5 per cent., upon the Capital invested in the business, and multiplying the sum so resulting by a number of years. The number of years to be taken into calculation depends upon the stability of the business.

Stability of business a factor in valuing goodwill.

Thus, in average trading concerns, Goodwill would be conservatively estimated at three years' and extravagantly at six years' purchase; an hotel at seven years' purchase; a well-established newspaper at eight years' purchase; a gas, electric light or waterworks, which has a monopoly, at twelve years' purchase; in fact, every particular case would have a ratio to itself. This ratio can easily be ascertained from an estate agent, a partnership negotiator, or any man having daily to deal with the transfer of Goodwills.

Goodwill generally overvalued.

It will be found that in most cases the Goodwills, Patents, Trademarks, and Copyrights are over-valued in Companies' balance sheets, as in most cases the purchase-consideration paid for them has been excessive. This fact should not deter Investors from making their own valuation, based upon sound business lines.

Attached to most balance sheets is a Profit and Loss Account, showing how the items of profit which have been already dealt with in the

Profit and Loss Account should show net profit.

balance sheet were arrived at. There are two ways of making up such a statement. The one is to give the entire gross takings of the period on the one side, and the expense incurred in making this profit on the other side, in detail. Whenever this plan is adopted the entire trading system of the Company is disclosed. This is not always desirable, therefore the second plan of deducting from the gross profits all actual trade expenses, and giving the difference of these two items only, as the basis of the Profit and Loss Account, is frequently adopted.

Pros and cons of detailed statement of Profit and Loss.

It is not possible to obtain a real insight into a Company's trade without seeing the entire gross takings and the kind of trade which has produced them, on the one side; and the principal items of expenditure on the other side. Therefore, a knowledge of the full details of the Profit and Loss Account is indispensable to all those who have a large stake in the Company, but it certainly is detrimental to many businesses to publish such a statement, for trade competitors to see. So, in many cases, shareholders will have to be satisfied with fewer particulars.

From the difference between takings and expenses are ultimately deducted such items as directors' fees, etc., and the final balance, being the actual net profit left, is carried to the

balance sheet. It is important to know the amount of gross turnover and compare it with the net profits made. The gross turnover not only discloses how the Company's business compares with former years, but also on what ratio of profit-margin the Company is working.

Gross turnover should be compared with previous years.

There are many kinds of undertakings, which issue, in addition to the Balance Sheet and Profit and Loss Account, separate sets of working statements, and also accounts showing how the annual profits are appropriated. These are exceedingly important, especially in the case of railways. But the object of this chapter is to give a general fundamental idea of the inner working of balance sheets, and not to go into the very large subject of Accounts, as applied to all kinds of enterprises. Therefore, no further reference to special forms of Accounts will be made.

If the reader understands that on the Asset side of the Balance Sheet he sees a schedule of all that the Company owns, and that only the tangible portion of these items, in addition to moderately valued Goodwill, are of substantial value; that the Liability side of the Account need only be noted as to current debts or liabilities temporarily incurred; and that, finally, the total real value of assets, with all liabilities, including Debentures, deducted therefrom, con-

Balance Sheets summed up.

stitutes the shareholders' existing Capital, it will suffice for all ordinary investing purposes.

Many have assets which cannot be separately sold, such as Railways, Tramways, Gas, Water, Electric Works, Docks, Canals, etc. It has been stated in a previous chapter that in cases of this kind it is almost immaterial at what figure these assets appear in the Balance Sheet, and that a valuation of them can only be arrived at by ascertaining the average annual revenue which they produce.

Having, therefore, now defined how a balance sheet should be drawn up, and how it should be dissected, the practical use of such a document will be apparent.

Companies' dual position defined.

There are two separate and distinct points of view from which every Company should be considered, namely, the Company's position as against the persons trading with it, and the position of the persons directly interested in the Company as debenture or shareholders. The outside position determines the financial solidity and trading prospects of the Company; the inside position, the value, capital, and income safety of the Company's stock-issues.

Ascertaining measure of Working Capital.

By ascertaining what the Company owes, and by deducting this sum from the immediately realisable assets of the Company, it is ascertained how much actual Working Capital the

Company has, and whether it is able to meet its liabilities with ease and comfort. The realisable assets are the *quick assets* already referred to, namely, those assets which the Company can realise without interfering with its business to provide funds for paying its way. If there are more liabilities than *quick assets*, then the concern's business is hampered; the Company will therefore not only trade at a disadvantage but will also be unable to pay cash or meet its bills promptly, and might, on the slightest stagnation, become involved. In fact, the Company suffers from insufficiency of Working Capital.

Advantage of "quick assets."

If the *quick assets* exceed the liabilities, then the Company has ample Working Capital and is able to meet its liabilities promptly and efficiently. Investment in Companies which are short of Working Capital is always dangerous.

Danger of paying dividends with borrowed money.

In making the calculation as to the actual financial position of a Company, the dividends declared at the last annual meeting must be included as a liability, and deducted from the *quick assets*. Many Companies declare dividends without having the actual cash in hand which is necessary to pay these dividends. The money is then borrowed, and the Company's financial position weakened. This is not sound finance, and frequently leads to disaster. The history of Joint-Stock Companies shows that

insufficiency of liquid assets is the cause of 70 per cent. of all liquidations.

A test of sound trading.

The soundness of a Company's trading is shown by a comparison of the stock of goods and materials in hand with the Company's annual turnover and Capital.

Whenever there is a comparatively large stock in hand, the trading is precarious, and especially so when the stock-in-trade is perishable or liable to go out of fashion. It is quite impossible to give any actual data in this connection, for a draper would naturally have a larger stock than an engineer, and a fishmonger would have no stock at all, so special inquiries on this very important point must be made in each separate case.

A test of steady trading.

Steadiness or otherwise of the trading is disclosed by a comparison of the annual turnover with the Company's debtors and creditors. A cash business, which is the safest kind of business, has no debtors and ought to have no more than six weeks' turnover of creditors. The larger the list of debtors comparatively becomes, the more hazardous is the business, unless those debtors are exceedingly safe, and consist entirely of Governments or substantial traders. Whenever the creditors are considerably larger than the debtors, and the Company has not the difference in actual cash in hand,

the trading is unsound. In all such cases the Company is not trading with its own Capital, but with Capital which it has borrowed in the shape of goods.

Many small better than few large customers.

Any Company which has one or more very large creditors which it is unable to pay off at any time, is in a bad position, for it depends upon the goodwill of these creditors for its solvency. Similarly any Company which has one or more large debtors may be forced into liquidation by one of these debtors not meeting his obligations. Any business which is too much in the hands of a few of its customers is dangerous, and only those businesses are really safe which rely on a trade which is done with a large number of people.

It is extremely important for every Investor to consider his own and his contemplated investments from all these points of view, so as to know, as an absolute fact, what the future has in store for him.

Ascertaining position of Debenture and Shareholders.

The position of the debenture and shareholders of a Company is ascertained as follows: Here again the total value of all tangible assets and the goodwill is taken, and from this the current liabilities are deducted, the balance representing the property in hand. From this sum the nominal value of the Debentures is again deducted, and the remainder is the

margin of safety of the issued Debentures. From this margin the nominal value of the issued Preference shares is deducted, and the sum now remaining is the margin of safety of the Preference shareholders. In a similar way, the margin of safety of every following class of share is ascertained, until the final margin, left after the shares which rank before the last issue of shares, shows the amount of tangible assets which this final set of shares represents.

Proper margin of Capital-Safety.

In a previous chapter it has been said that Debentures and Preference shares, which rank first, should have at least 100 per cent. margin behind them before they can be pronounced to be safe, and that shares which have issues in front of them must have an additional margin. It has also been explained previously that any premium paid for shares is not tangibly represented in the Company's balance sheet, and that such a premium is another mode of making a payment for Goodwill.

Future disasters foreshadowed in the Accounts.

Investors should not only study a Company's actual position before they purchase an interest in it, but should continuously follow the Company's development throughout the period during which they hold them. Every year's trading produces a change in the affairs of a Company. Failure seldom comes suddenly; in

most cases it makes itself felt very gradually, and generally future disasters cast strong shadows before, and are easily discernible by comparing previous with present balance sheets.

Most Investors do not discover these unmistakable signs because they are careless, and thus the careful student of balance sheets and reports obtains a perfectly legitimate advantage over his fellow shareholders. There are numbers of shares now selling above their comparative value, and a very large number selling under their comparative value. It is by shunning the former and buying the latter that money is most legitimately made on investments. Advantage of Balance Sheet analysis.

The investigation of values is simple and follows rigid lines, so that any one can acquire this art. Careless Investors never take the trouble to learn it, and for this reason their Capital gradually wastes away.

CHAPTER IX

THE WORLD'S STOCK MARKETS

OF all business pursuits dealing in Money is the most stable and profitable, hence most bankers are rich. The next branch of business which offers the best chances for making the maximum of money with the minimum of risk is that of a well-established stockbroker who transacts a non-speculative business.

The general public frequently have a slightly mistaken idea as to the special knowledge of their brokers. It is not quite fair to compare the mental outfit necessary for a stockbroker with that required by a doctor, lawyer, architect, engineer, analytical chemist or, in fact, any member of the learned professions. Whilst any one of these cannot be successfully pursued without years of special training, the outfit of the average stockbroker consists principally in solid business habits, coupled with tact and a fair amount of common sense. The most recent developments of scientific methods of investment have of course produced Stock Exchange experts, but the knowledge required by

A Stockbroker's qualifications.

these is not that which the ordinary stockbroker possesses.

The opportunities for dealing in stocks are usually seized upon as soon as they occur, and almost simultaneously with the creation of stocks in any part of the world, a crop of stockbrokers is produced, the new recruits hailing from almost every branch of the trades and professions.

"Stockbroking" defined.

Stockbroking means "buying and selling stocks" as agents or brokers for others; therefore there must always be at least two parties to each bargain, the one buying from the other. Stockbrokers congregate for the purpose of their business, as it would be waste of time to be constantly calling upon each other, and a common meeting-place is arranged, where all stockbrokers can assemble daily.

Development of a Stock Exchange.

So long as there are but few people who habitually deal in stocks in any town, these meet in the existing corn, cotton, fruit, cattle, or other market, and there are no special rules or regulations which govern their transactions, the necessary stipulations being made when each contract is entered into. As soon as the number of stockbrokers is sufficiently large, they form a kind of club, draw up rules, hire, purchase, or build a meeting-place, and then what is known as a *Stock Exchange* has come into existence.

In this manner stockbrokers and Stock Exchanges are created as soon as there are stocks to deal in anywhere, and in many mining camps a Stock Exchange is erected before a church or a school has been contemplated. This process of creating brokers and Stock Exchanges is constantly going on the world over.

Origin of London Stock Exchange.

The origin of the present governing financial centres of the world, namely, the London, Paris, Berlin, Amsterdam, Vienna, Brussels, and New York Stock Exchanges did not differ in any material way from that of the new and crudely organised Stock Exchanges now being born. English stockbrokers originated in the days of Charles II., when the first foundation of the present National Debt of Great Britain was laid. They commenced by congregating in the Royal Exchange; they then adjourned to Change Alley, and ultimately built a meeting-place of their own. No one can foresee whether the Stock Exchange in Bulawayo, which was started but yesterday on similar lines to all other Stock Exchanges, or the Stock Exchange of some other at present quite unknown hamlet, will not some day become a leading unit of the financial Republics which now play so important a part in every nation's trade and commerce.

The influence and importance of every Stock

Exchange is constantly waxing or waning, as is exemplified in the case of the Vienna Bourse, which played an important part in international finance some thirty years ago, but whose influence is now gradually disappearing. On the other hand, the Brussels Stock Exchange used to be of secondary importance, but is now gradually advancing into the front rank.

Rise and Fall of Stock Exchanges.

As Stock Exchanges gained in power and commenced to exercise an influence upon national life, they gradually began to attract the attention of Governments, who saw in them not only a means of raising public loans, but a factor which determined the use of the national savings. So important did some Governments consider the power which the Stock Exchange could exercise, that they nationalised these institutions and used them as a lever for their external politics. It is said at the present day that the influence of France upon the world's political development is not caused by its Army, Navy, or diplomatic relations with other nations, but principally by the Paris Bourse.

Power of the Paris Bourse.

The French Government has gradually erected such barriers against free trade in stocks that no stock can be freely dealt in in France unless it is officially quoted; and no stock can be quoted on any French Stock Exchange unless it is passed

French Government controls Nation's Investments.

by the French Government. In this way the Government exercises a complete control over the employment of the nation's savings, which amount to over £200,000,000 per annum; and as the major part of this sum is available for foreign investment, the goodwill of the French Government is coveted by all borrowing nations. French diplomatists are exceptionally well received by all of these, and French trading interests are as carefully protected as is the interest of the brewer in an English tied public-house.

British Stock Exchanges are private clubs.

All nations do not receive a similar indirect benefit out of their position as international lenders of Capital, and in Great Britain, although the London Stock Exchange has been a world's power almost for centuries, and the Provincial Stock Exchanges are quite important factors, all the Stock Exchanges are still private clubs quite unfettered by any special Government regulations. Thus, British accumulated wealth can come and go as it pleases, and the country, as a whole, does not reap the slightest indirect benefit from financing the world's trade and commerce in that truly British liberal manner.

Necessary incidents to Purchase and Sale of Stocks.

There are certain simple, but necessary, details which govern the completion of every purchase and sale of stocks, such as the date of settlement,

the manner in which the stocks are to be delivered and paid for, the cost of stamps and transfer fees, the question of interest or dividends accrued on the stocks sold, and such like.

These differ slightly in every Stock Exchange, and as it would be too complicated to agree specially on all these points for every single transaction, a code governing the transactions is drawn up by the Government, or the Committee of each Stock Exchange. It is also necessary to establish a clearly defined relation between the members themselves as to the manner in which they should conduct their business, the way stocks should be quoted, and many other points. These are settled by the local Committee, and, as a result, every Stock Exchange has its own rules and regulations, which differ slightly from those of other Stock Exchanges; but in every instance they conform closely to the laws of the country in which the Stock Exchange is situated; for Stock Exchanges cannot effectually frame any regulation which is not in accord with the laws of the country in which they are situated.

Rules and Customs of Stock Exchanges.

Private Investors are only affected by Stock Exchange rules when they buy and sell stocks, and the questions which govern these transactions are few and simple.

Questions governing Private Investor's Stock Transactions.

There is, first of all, the price which is to be paid and received for the stock. This is settled by mutual agreement and not governed by any rule. Then there is the date and mode of settlement. The date is also a matter of mutual agreement, and, as all deliveries of stocks are settled for in cash on delivery, only the agreement as to the actual place for exchanging stock for cash is of importance. The next question is the payment of transfer fees and stamps [if any]; here, usually, the buyer pays the expenses, but on this point special inquiries should be made. Finally, there is the question of dividend or interest which has accrued on the stock at the time of its sale, a point which also must be inquired into.

Thus, with the exception of the place of completion, the expenses of transfer, and the accrued interest, deliveries of stocks are not subject to special rules; and as soon as these three points are settled satisfactorily, every Investor can freely buy and sell on any Stock Exchange in the world, without reference to the special rules which govern these institutions, of which it is quite unnecessary to treat in detail in this book.

Every Stock Exchange available to the Investor.

The other British Stock Exchanges have framed their rules somewhat on the model of the London Stock Exchange, and as this institution is

of especial interest to English readers, its constitution and regulations will be briefly described.

Principal Rules of London Stock Exchange affecting Private Investor.

The London Stock Exchange is, in every sense of the word, a private club. Its members are admitted on certain conditions, and they elect a Committee which frames the rules and regulations. Of these rules only the following are of special interest to non-members:

1. No stranger is admitted into the Stock Exchange. Members must not advertise or send circulars, except to their business connections.

2. Every member must be either a dealer in stocks [jobber] or an agent who acts for the public [broker]. The broker's function is to obtain instructions from his client and then transact the business in question with a jobber. As remuneration, he receives a commission from the client who instructs him.

Distinction between Jobber and Broker.

Theoretically, the jobber's function is to be a constant market for the securities in which he specialises, and to be always ready to buy or sell these securities. He buys at one price and sells at a higher price, the difference between the buying and selling prices constituting his profit. Jobbers, who are members, must not deal with the public, and are supposed to confine their transactions to brokers.

3 All bargains are settled on specified days,

which occur twice a month for all stocks, except the Consol Settlement, which occurs once a month. The buyer pays all transfer expenses and stamps. He also receives all accrued interest, or dividend due on the stock, up to a specific day, as from that day the accrued dividends are excluded from the purchase. The date on which the dividend is thus separated from the purchase is publicly announced, and from that day the stock is dealt in without dividend [ex div.].

Stock quoted "ex div."

Business of Stock Exchange Settling Days.

4. There are three preliminary and one final settling day. On the first day mining stocks are carried over; on the second day arrangements to continue all other bargains which it is not convenient to settle by actual delivery or by actual payment are made. On the third day the names and addresses of all those purchasers who are taking up registered stocks are given out, so that the transfer documents may be prepared. On the final day all stocks which are ready for delivery are handed over to the purchasers against cash, and all differences which arise out of bargains which have been postponed in their delivery are settled. All stocks to bearer must be delivered on the final day of settlement. Registered stocks may also be delivered on that day; but as the completion of transfer

documents frequently includes the obtaining of several signatures to be given by persons who sometimes reside in different parts of the country, ten days' grace is given for the delivery of registered stocks.

5. If the selling broker or jobber fails to deliver bearer stocks on the final settling day, and registered stocks within ten days of it, an official of the Stock Exchange can be called into requisition to bid for that stock, and thus the bargain is enforced. Unfortunately the Committee of the Stock Exchange has framed most effectual regulations, which make the operation of this rule ineffectual and uninforceable.

Official List of Stock Quotations unreliable.

6. An Official List is issued, which gives the quotation at which it is supposed that the stocks included could be dealt in; but this quotation is frequently arbitrary, and it often happens that the price of a stock remains unaltered for months, and that when a purchase or sale of it is contemplated it is found that the existing quotation differs widely from the price at which business is possible. Every stock has two prices set against it, the lower one denoting at which price jobbers might buy, and the higher price at which jobbers might sell. Brokers who care to do so can have any bargain transacted by them

permanently recorded, as "a mark of business done," but this mark does not indicate whether in that case the jobber has sold or the jobber has bought the stock. As there is frequently a difference of £2 between the jobber's buying and selling prices, these "marks of business done" lose their value as an indication of what has really taken place.

Registered Stocks *versus* Bearer Stocks.

In Great Britain the delivery and taking up of stocks becomes a slightly complicated business, owing to the large quantity of British stocks which are registered and require transfer documents before they can pass out of one owner's possession to another. In other parts of the world most stocks are to bearer, and one settling day a month suffices to settle all current transactions.

Some Distinctions between British and Foreign Stock Exchanges.

In some countries, like the United States of America, there are no settling days at all, and all bargains are settled forthwith. The institution of jobbers and brokers is also peculiar to England. Other countries do not find it necessary to have two distinct classes of members of the Stock Exchange; all of them are brokers, and these brokers naturally deal direct with each other. Except in England, all Stock Exchanges are open to the public, and members of all these institutions may also advertise their businesses.

In fact, in London the business of buying and selling stocks is quite unnecessarily complicated. A monopoly, as far as possible, is maintained, the public being kept out of the precincts of the "House," and mystified to an uncalled-for extent. This is not in keeping with the general development of twentieth-century trade tactics. Simultaneously, the members of the London Stock Exchange are hampered by fatherly internal regulations and prevented from legitimately extending their business by openly competing with each other for public favour.

Drawbacks of British Method of Stock Dealing.

These conditions exercise an unfortunate influence upon British Investors, and prevent them from appreciating the fact that there is absolutely no difference between the buying and selling of stocks and dealing in any other commodity.

There are Stock Exchanges in every part of the world, wherever there is a sufficient number of Investors and a sufficient quantity of stocks to deal in. But the principal Exchanges are in the commercial capitals of each country. While most of the European Stock Exchanges deal in securities which represent enterprises in all parts of the world, the Exchanges of the other four Continents deal principally in their own local stocks.

Extra-European Stock Exchanges mainly confined to local Stocks.

How the chief Market for a particular Stock is determined.

The locality of an enterprise does not determine the Stock Exchange on which its stocks are dealt in, for the principal market of each stock adjusts itself naturally to the locality where the largest number of holders of that stock reside.

A Gas Company, for example, is floated successfully in England for the purpose of supplying a number of German cities with gas, and the stock of that Company is principally subscribed in England. Then, although the seat of the enterprise is in Germany, and the management may be German, England will be the principal market for this stock until the Germans, or some other nation, gradually buy up the major portion of it, and, in this way, shift its market to another locality.

The Market for a Stock frequently alters.

There is a constant interchange in investments among nations, which is caused either by wholesale imports of stock, or by the gradual and constantly altering ratio of the value of money in different countries, as compared with other countries.

A French bank discovers what it considers a very favourable American investment, and buys large quantities of it, for import into France and sale amongst French Investors. These purchases remove the predominant amount of stock from an American city to a French town, and this

is how large imports influence the seat of the market in a particular security.

A country gradually becomes richer, and there is more money in it seeking permanent investment. Then that country gradually reimports such of its own securities as it had previously, in time of poverty, sold to other nations. Thus, the principal Italian stock used to be held chiefly in London, Paris, and Amsterdam, until, during the last decade, it has been gradually bought up by Italian brokers and sold to Italian Investors, thus shifting the weight of the market from the north of Europe to Italy. Example of change in chief Market for a Stock.

Sometimes large issues are made in several countries simultaneously, or several countries commence to import the same stock at the same time from its native country; then that stock has as many markets as there are countries in which it is held in sufficient amounts.

The importation of large quantities of stock in bulk is usually done by banks or large financial houses. The sending of stocks backwards and forwards, in a constant stream of individually small amounts, is done by ordinary brokers, and this class of business is called *Arbitrage Dealings*. Arbitrage Dealings.

Let us suppose that there is a stock which is held in New York, London, Paris, and Berlin; then four firms of brokers—one in each city—

Example of Arbitrage Dealings.

agree among themselves daily, nay hourly, to communicate the selling price of that stock to each other. Whenever there is a larger amount offered for sale than there are buyers to absorb it in any one of these four cities, or whenever there is a demand larger than the local supply, the price of the stock rises or falls in the centre of the disturbance. In the other three cities the price may in the meantime have remained stationary, or, whilst there is a rise in one place there might be a simultaneous fall in another. These price-variations are, of course, very slight as a rule, but as soon as they are large enough to permit of a profit, the Arbitrage dealer buys in one place and sells in another.

To such perfection have these Arbitrage transactions been brought, that it now takes only a few minutes to buy a stock in London, cable this fact to New York, sell the stock in New York, cable the result of the sale back to London and receive this reply completing the transaction in London.

Arbitrage dealings account in this way for the very small difference in the price at which the same stock is quoted simultaneously in various cities which are thousands of miles apart, but these dealings are confined to a few stocks in which there is, for the time being, a fever of speculation; for it must be

Effect of Arbitrage Dealings.

understood that ordinary investment transactions are hardly ever sufficiently large and frequent to make them attractive to the arbitrageur.

Arbitrage Dealings rare in Pure Investment Stock.

In many instances, in fact in all those cases where investments are dealt in *as investments*, and in the really legitimate way, the arbitrageur is conspicuous by his absence, and consequently the same Japanese Government Bonds, for example, are frequently selling in London several points higher than they can be bought in Tokio, and similar examples occur daily the world over.

The Marketability of Investments

This brings us to the highly important and rarely understood subject of the marketability of investments. Most Investors imagine that when they see a stock quoted in an Official List, this mere fact is proof positive that the stock is not only always saleable, but that it can be bought or sold at that official quotation. This entirely erroneous notion creates in them a preference for officially quoted stocks, frequently to their own detriment. Therefore an attempt will be made to explain clearly the inner working of Stock Markets and the consequent marketability of all Stock Exchange securities.

None of those persons who act as intermediaries between the actual holders of stocks —be they brokers, jobbers, or arbitrageurs— absorb securities.

They may buy and temporarily hold, in view of a subsequent advantageous sale, or they may sell without having the stock, in the hope of obtaining it at a cheaper rate later on; but, sooner or later, *bona-fide* buyers must absorb the supply or the actual owners must fill the temporary want.

Price-level of Stocks dependent on Public Demand.

It naturally follows that the real ultimate exchange must take place between two investing members of the public, and that the jobber or dealer can buy only when he has a good chance of selling again soon, and can only sell when he is fairly certain to be able to repurchase quickly.

Whenever the public is slow in buying, selling becomes difficult, and whenever the actual holders are reluctant in parting with their investments, there is no purchase of them practicable. In this way the Official Quotation becomes entirely dependent for its reliability on what the investing public decides to do. Jobbers and brokers may say that there is a certain ruling official quotation, but unless the public support them in this view they are powerless in making it a reality except by themselves becoming permanent holders of that stock, and this they hardly ever desire to do.

The Jobber's *raison d'être.*

Jobbers have been instituted in London with a view to creating permanent markets for securities, but practice has proved that no

possibility exists which can make such artificial means of permanent practical value.

Where the Jobber fails.

As long as the public is constantly changing its investments, the jobber institution seems to work admirably, but as soon as the public come in, predominantly as a buyer or predominantly as a seller for any lengthy period, the jobber proves to be an unqualified failure.

Example of Jobber's Inutility.

For many decades the British Railway Market was normal, and buyers and sellers equalised themselves; then the jobbers flourished. In 1898 there commenced a preponderance of selling by the public, and almost from that moment the free market in Home railways disappeared, and the jobbers became useless. It became just as much a matter of negotiation to sell, say, £5,000 Caledonian Railway Preference stock as it was to sell 100 unquoted shares in a small trading company.

A "Market" does not depend upon official quotation

The small value of an official quotation has long ago been recognised, principally through the introduction of the very large number of South African Mines in 1895, very few of which have an official quotation. Through the hundreds of these stocks it has been conclusively proved that the market does not in any way depend on a quotation, and that the not officially quoted stocks are, if anything, more readily bought and sold, and at a smaller dif-

ference between the buying and selling price, than the officially quoted securities of the same kind.

Whilst there is no actual advantage in an official quotation, and the free market does not in any way depend upon it, there is a very considerable danger and drawback to an officially quoted stock.

Dangers of a Free Market in Stocks.

It is quite impossible to centre a speculative movement in a security in which there is no free market, therefore securities without a free market do not attract speculators and tend to sell at their true relative value. It is quite unnatural for a safe investment stock to have a free market, for a stock of this kind is firmly held and not bandied about.

Free Market often created by speculators.

As soon as the speculators take up a stock they create a free market for a time, but they ignore the true relative value of the stock, and there is no knowing how far they may succeed in inflating or depressing it, or where they may ultimately leave it, for the speculator only remains so long in a stock as his money lasts, or so long as he can induce others to gamble. As soon as either eventuality occurs he leaves the stock again, and simultaneously with his exit the free market disappears. The stock is then left either on a disproportionate height, quite out of breath, or in a sad hollow, with broken limbs.

The free market of to-day becomes the stagnant, discredited, tedious negotiation of to-morrow; and any one really instructed in finance need only read up the history of stocks which were the free markets of, say, thirty, twenty, and ten years ago, to satisfy himself how very pernicious speculative influences are to sound investments.

Inconstancy of Free Markets in Stocks.

There are over 35,000 investments in Great Britain, of which only about 5,000 are officially quoted on the British Stock Exchanges, and of all these less than 400 have at any time a free market. These 400, however, are constantly changing, some dropping out and others taking their place. The free markets are the stock-in-trade of promoters and speculators, and every Investor should feel glad if they have left his own particular holding untouched. Besides, if the securities which ever had or now have a free market are analysed, it will be found that with the exception of Consols, which are, unfortunately, a constant gambling counter, and a few other isolated instances, they are not stocks suitable for permanent investment.

Free Market Stocks generally unsuitable for permanent Investment.

The 30,000 stocks which have no quotation, and the 4,600 which have quotations but not a free market, are firmly held and but rarely change hands; yet each one of them which is a really good security invariably can be sold.

Good unquoted Securities always saleable.

If any reader desires to satisfy himself on this point, let him call on a large number of brokers and ask whether they have for sale any not officially quoted stocks or good investments which have not a free market. He will then find, perhaps to his astonishment, that these brokers will be eager to sell him any quantity of free-market securities which will, in most cases, be comparatively dear and not very safe, but that he will have no good unquoted stocks or good stocks with a stagnant market to offer.

Having thus made sure that there are no suitable unquoted stocks on offer, let him ask among his circle of acquaintances whether they have ever tried to sell a really good not officially quoted security at a fair price and not succeeded in soon finding a purchaser.

The result will be that he will find no fair instance of inability to realise.

Sale of Stocks by Public Auction.

The only occasions upon which any considerable quantities of not officially quoted securities are purchasable are at public auctions of stocks which certain highly respectable firms of auctioneers arrange from time to time. Let any votary of officially quoted securities attend one of these sales and see the crowds assembled and the spirited bidding which ensues. Let him subsequently interview the members of these firms of auctioneers, who have been constantly

conducting auctions of this kind for decades past, and ask whether they have ever failed in selling a good security at a reasonable price. The reply will be that such an occurrence is quite unknown. These facts will tend to alter his mind on this important point.

Realisable and Intrinsic values distinct.

Some Investors have an idea that an official quotation, or the market price, or the then realisable value of a stock is bound to reflect the intrinsic or comparative value of that stock. If this were so, it would be impossible to pick up bargains in Investments and, as a matter of fact, it is in a great many cases not so.

Forced sales of Stock.

The price or "*realisable*" value of a stock depends upon the supply and demand of the moment. If frequently happens that an exceedingly good stock has for some reason to be sold immediately in large quantities. If, for example, money has been borrowed upon it, and the borrower does not meet his engagements, or if a large Investor finds himself in monetary difficulties and has to realise promptly, or if a trust estate is forced to realise: in all such cases a sort of Dutch auction ensues. The existing demand is satisfied first at normal prices and every subsequent purchaser pays less and less for the stock until the entire quantity has been sold.

On stocks which have no Official Quotation a

Defects of Officially quoted Stocks.

disastrous sale of this kind has but little effect, as it is not recorded, and it is quite possible to deal on the next day at the normal relative value. On a stock with an Official Quotation the effect is quite different, for a permanent record of the disastrous sale is maintained, and this record not only prevents transactions at normal relative prices until the Official Quotation rises again, but also establishes a permanent slur upon the future history of the stock. In fact, an abnormal occurrence, which had nothing to do with the true relative value of the stock, has created a precedent which adversely influences the future of that stock for years to come.

Meaning of Intrinsic value of a Stock.

The so-called "intrinsic" value of a stock is settled—similarly to every other value—by a comparison of the capital-safety and income-producing power of that stock with those of similar securities. Every investment has two functions: the one is to be a depository for capital, the other is to produce an income. As soon as the quality of these two functions is alike in two stocks then they are equal in *intrinsic* value; if the qualities differ the *intrinsic* values differ, and the degree of difference settles the difference in *intrinsic* value.

This explanation proves that only a change in the safety of a stock, or a change in the comparative amount of yield which it produces,

can alter its *intrinsic* value. Neither of these changes can be brought about by any one selling the stock, and thereby depressing its price, or any one buying the stock, and thereby raising its price; and this establishes the fact that *intrinsic* value and *market* value need not be in any relation to each other.

Intrinsic and Market values compared.

The *intrinsic* value influences the *market* value, because every one desires to buy as cheaply as he can, and every stock which sells below its *intrinsic* value is a bargain; but it is quite impossible for the *market* value to influence the *intrinsic* value.

There are innumerable instances where official quotations have been permanently depressed by causes which had nothing to do with the intrinsic value of the investment, whilst hardly any case exists where not officially quoted stocks have similarly suffered; and this is one of the many reasons why there are bargains to be found in almost any official list.

As it is in England, so it is the world over; really good investments find ready markets everywhere, not by means of official quotations, marks of business done, and Arbitrage dealings, but through the constant and never-failing public demand for a good and sound investment at a fair price.

The transactions of the Stock Exchanges of the

world are locally and internationally recorded by all the principal newspapers; but these references principally interest the speculator.

Different Interests of Speculator and Investor.

The difference between the information required by the speculator and that which is of real interest to the Investor is very great. The speculator does not care what may be the real comparative value of the stock in which he deals; he is not interested in a permanent, but merely in every temporary improvement in the position of an enterprise. Neither does he care whether the stock which for the time being attracts his attention is gradually decaying; there must be sensational developments if he is to benefit. Dividends must jump, bridges must fall in, world-moving inventions must be made, railway trains must collide, frauds of magnitude must be unveiled, new mineral veins must be discovered, Governments must quarrel with each other, amalgamations must take place, rates must be cut, strikes must commence. Only occurrences of this kind can form the plausible pretext for violent fluctuations.

Fluctuation in Stocks mainly due to speculation.

If good investment-stocks are left to themselves, no great sudden change in price ever occurs, and only very gradual rises and falls can ensue. It never happens that a large number of actual holders of stock simultaneously desire to sell their investments suddenly, and only such

an occurrence could cause a violent fluctuation. It is solely through speculative influence that stocks fluctuate daily, and speculation is whipped up by sensational news. The reason which the newspapers give for rises and falls hardly ever are that the holders wanted money and therefore sold, they mostly refer to some purely speculative development; and hence we used to read that because Napoleon III. sneezed, Brighton "A" fell.

Speculator depends on sensational news.

The speculator, further, has no interest in the relation of the real comparative value of securities to each other. All that matters to him is whether his stock is selling a point or so above or below his purchase-price. A speculator will tell you, "I bought at $5\frac{1}{4}$ and sold at $6\frac{1}{8}$." Whether this means $55\frac{1}{4}$ or $75\frac{1}{4}$ hardly interests him, and frequently he has quite forgotten to look. Thus, sensational news and constant up-and-down movements are as the life-blood of the speculator.

Investors depend on sound statistical facts.

The Investor is principally concerned with the safety of his Capital and Income. To ascertain these facts requires a lengthy expanse of figures; to show any difference between an investment-position as it was and as it is now, demands extensive comparative statements. A slight difference in the price which he pays for a stock is not a matter of great moment to him, for he

does not consider the chance of selling again very soon, but looks upon stocks from an Income point of view. Whether a 4 per cent. stock yields 4 per cent. or 4¼ per cent. is determined by a price-difference of six and a half points; and sound investment-stocks yielding 4 per cent. sometimes do not move so much in a couple of years. Therefore small variations are of no interest to real Investors, who prefer comparative yield and Capital-safety, and look to figures, together with sound statistical facts, proving this or that investment to be comparatively cheaper or dearer, safer or more speculative.

Newspapers mainly cater for speculator.

The Financial Article in the newspapers is compelled to deal with the news of the day, and can devote little of its space to statistics and comparisons; it therefore gives principally the changes in quotations which the day's business has produced, and the rumoured reasons for such changes. The details of the stocks quoted are of necessity scanty, and the selection of the stocks is limited to those which fluctuate most, and which, for this very reason, are unsuitable for Investors.

In fact, the very nature of the Financial Article forces its editor to cater for the speculator, and he can give little to interest the Investor. This fact is gradually being realised by the most

important financial writers of the day, and the Money article is undergoing a slow but sure change of front. The compilers are becoming aware of the unwholesome influence which the old-fashioned Money article used to exercise on the public mind, and are making strenuous efforts to give to Investors—who, after all, form the majority of their readers—the solid investment-statistics and comparisons which they require.

An Investment simile.

Investment is a child, with statistics as father, common sense as mother, and speculation as a dissipated family relation. The closer the union between father and mother for the purpose of boycotting this reprobate relation, the larger will be the heritage of the legitimate heir.

CHAPTER X

ON SPECULATION

The spirit of venture a beneficial element.

THE spirit of Venture, which is inborn in humanity, has made the world what it is to-day. Without it America and Australia would be unknown Continents; no steamboat would be crossing the seas; no railway would traverse the long stretches of magnificent prairie; no factory-chimney would be smoking to-day. We owe a debt of deepest gratitude to the strangely reckless and self-assertive instinct which Nature has so strongly planted in our hearts, for it has made us masters of that portion of the universe which is our domain.

It would seem almost ungracious to raise our voice against this all-powerful influence, which urges us on from glorious achievement to further adventure. Nevertheless, just as the strongest light casts the deepest shadows, so the spirit of adventure, directed to wrong purposes, is converted from a boundless blessing into a disastrous curse.

There is a vast difference between the venturesomeness which is likely to be productive of good to a portion of the community, and the mere speculation which, in the best of cases, only results in some personal monetary gain. Thoughtless people frequently subordinate their inbred love for new and striking developments—an inclination which, if properly applied, might make them leaders of men—to the pure desire for gain. It seems to them that it is the love of victory, of success, of personal enrichment, for which their better self prompts them to battle; but when they have obtained success of this kind it is like the seizure of a nest from which the bird has flown. That achievement only is worth striving for which is beneficial to the victor and to his fellow-man alike, but such an achievement can only be effected when personal exertion is joined to right opportunity.

Right and wrong use of venturesomeness.

It is a duty which every man owes to his fellows to develop his instinct of venture and speculation, so that he may assist in enslaving the forces of nature and bringing the products of the earth into use for the general advantage; but he must apply these instincts in a positive and personal manner, and not by merely staking part of his accumulated wealth on some undertaking in which he takes no personal interest.

Business instinct and ability must be employed as well as capital.

Legitimate speculation *versus* reckless gambling.

Every new enterprise is a speculation, be it a railway, a mine, or a factory, and every one should assist in fostering undertakings of this kind, for they bring work and consequent happiness to many, and at the same time afford employment to make capital useful. No one should be content merely to venture his money; his mind and brain should also assist in procuring the hoped-for success. It is this combination of capital with personal effort which creates the true difference between legitimate speculation and reckless gambling.

He who carefully studies the chances of success of any venture, analyses the factors which are likely to result in failure and those which tend to be advantageous, and, with the full knowledge of the facts, joins an undertaking, is a tower of strength and in no case a gambler, for he knows what difficulties have to be met, and why success or failure results. On the other hand, he who does not appreciate the risks, and merely ventures on the chance of making money, without any personal understanding, is in no way different from the gambler who stakes his money on the turn of a card.

Most of us are born with the love of risk, but not all of us are capable of giving it a proper

application. The test as to whether we are capable of using this instinct for venture can be applied by endeavouring to grasp fully and to enter into the real object and ultimate aim of a given enterprise. If we are capable of doing this, and in doing it become imbued with a desire to aid in the work and to follow its progress constantly and intelligently, then we are true adventurers and capable of right speculation. But if we cannot follow the root idea of an enterprise, and merely desire to stake our money so that it may increase in quantity, then we are gamblers pure and simple, and should shun every kind of financial risk. For a pure gambling instinct is as dangerous to Capital as the germ of yellow fever is to humanity.

The true adventurer not a gambler.

The first essential to successful speculation is a full recognition of the fact that speculation is in progress. He who speculates under the impression that he is merely investing is lost from the start.

Essentials to successful speculation.

The second essential to successful speculation is a proper appreciation of the extent and nature of the risks which are undertaken; for one who is inclined to make light of unfavourable contingencies and to consider favourable possibilities as the more likely to occur, is bound to be unsuccessful. Only the forewarned are forearmed.

The third essential to successful speculation is the ability to realise facts as they are, and not to imagine them to be as would best suit one's purpose.

The fourth and cardinal essential to successful speculation is the power to rise to an emergency, to meet difficulties with effective remedies, and to appreciate the first signs of proved failure, so that as many planks as possible may be saved from a financial wreck.

Reason for difficulty of successful speculation.

Successful speculation is thus no easy undertaking, and requires a number of essentials which but few possess. This is the true reason why failure so often dogs the steps of those who are speculatively inclined.

Every Stock Exchange security, no matter what its nature, is a speculation, for it is liable to rise and fall in value, and to a greater or lesser extent may fail to fulfil its promises.

Investment-Risks must be properly distributed.

The speculative element which every security contains can only be successfully eliminated by a proper distribution of risks. To insure one house against fire would be risky, for this house might burn down, and the insurance premiums received would not be sufficient to make up the damage caused by the fire. To insure a large number of houses, which are distributed over a wide area, is not risky, as only a few of them are likely to burn down during any one

year, and the premiums received will more than cover every probable loss. Thus, whilst each individual insurance is a grave risk, a large number of insurances are not only no risk, but a safe business which produces a profit. But if a large number of houses, which all abut upon each other, were insured, then their number would not lessen the risk, as then they would all be liable to burn down simultaneously, and such an insurance would again become risky.

An Investment simile.

In the case of the insurance the fire is the risk; in the case of stocks the alteration in capital-value is the danger which makes every investment a speculation. More than one house is likely to burn down at any given moment when all houses insured stand close together, and more than one stock is likely to go down in value if it be subject to the same trade-influence as the other stocks held. Thus, by holding stocks, every one of which is under a different trade-influence, the same distribution of risks is effected as by insuring houses which are distant from each other. All insurance companies are based upon this principle of distribution of risks. They are eminently successful, although every single insurance which they undertake is a grave risk. Similarly, investing becomes a very safe and profitable business if the risks are

properly distributed, although every single investment held is a risk in itself.

Unknown risks run by Investors.

Many Investors imagine that there are some Stock Exchange securities which are purely investments and can be safely held without any investment-risk being incurred. This unfortunate fact leads to a very large amount of unconscious speculation, and it is, for many reasons, the most dangerous form of investment-hallucination which can possibly be imagined. To hold stocks without realising the fact that each one of them is a speculation, is like handling a revolver without knowing that it is loaded. How many Investors are there who bought exclusively Consols and other British Trustee securities a few years ago and realised at the time that they were speculating? Would any Investor have placed the major part of his capital in British securities if he had known that by so doing he was risking fully 20 per cent. of his outlay in a speculation? What Investor, without intending to speculate, would pay a high premium for shares in a trading company if he were aware that he was paying this premium entirely for Goodwill, and that the slightest adverse turn in the company's trade might cause him to lose part of his capital? Would any doubtfully secured Preference shares in new companies be taken up if the applicants realised

that they were staking their money on a great chance of probable loss and a remote chance of possible gain ?

Danger of not appreciating Investment-Risks.

Reference has already been made to the quotation that "forewarned is forearmed." Any one who buys a speculative investment which does not fit in with his general Investment-Scheme, with the full knowledge that he is speculating, naturally watches that stock and sells out when he finds his venture turn out badly. But most unfortunate is that man who imagines that his money has been safely invested whilst it is actually exposed to serious risk. His stock reposes in a strong box, he is lulled into a feeling of security by receiving his dividends regularly; but when a crisis arrives and he does look into the matter, he finds that he would have been much better off if he had kept his money in a stocking and had not invested it at all.

British Investors' unconscious speculation.

There are at present innumerable Investors in England who are in this position. They have received less in the shape of interest and dividends during the last few years than they have lost in actual Capital. These investors attempt to disguise the fact of their failure; they desire to find some plausible reason which will account for such misadventure. Nothing was farther from their mind than to speculate; in fact, they assert that they have not speculated. How,

therefore, could the money have been lost? It must have been some unforeseen calamity, for which neither they nor any one else can be blamed.

Losses due to improper distribution of risks.

Yet this is not so. They did speculate, although they held the safest securities and never had the slightest chance of making a profit. Their money was distributed over many ventures, every one of which was sound, yet, all the same, they lost. The reason behind the fact which appears to them so mysterious is shown in the long table of stocks, embracing over thirty kinds of enterprises, all different from each other, which has been given in Chapter III. of this book. Actually, their risks were not distributed, and thus, unconsciously they speculated. If the British Investment Market had been favourable during the last decade they would have made large sums. Unfortunately, the reverse took place; hence they lost.

Geographical Distribution of Capital the only safeguard against loss.

The essence of speculation lies in the fact that there are chances of gain and chances of loss, and the mere fact that such chances exist is proof positive that a speculation is in progress.

He who desires to invest and not to speculate must so distribute his risks that the chances of gain and loss are small. Geographical Distribution of Capital enables him to do this, and whether he has adopted it effectually is easily

found out by ascertaining the total selling value of all securities held at the end of each of a number of years. If the result is steady and shows but little variation year by year, then the risks are well distributed. If there are considerable variations year by year, then the risks are badly distributed.

One of the most important objects with which this book has been written is to make Investors realise when they are speculating and when they are investing. If they desire to speculate, and can afford to do so, there is no reason why they should baulk their fancy. By realising that they are speculating, and also where the speculation is centred, they will greatly improve their chances of success. Should, however, investment be their aim, and not speculation, then a road is opened up before them which leads safely to that goal.

Conscious speculation analysed.

Successful conscious speculation in stocks consists (*a*) in buying a stock under its relative value and selling it at its relative value, thus making the difference between both prices as a profit, or (*b*) by selling a stock at above its relative value and ultimately repurchasing it at or below its relative value, and again pocketing the difference.

When stocks are bought for a rise, they are either paid for outright or the purchase-

money is borrowed from or owed to another, who holds the stocks in the meantime. When stocks are sold for a fall they are either borrowed in the meantime or owed to the party who has bought them. Whether the purchaser pays for his stocks outright or buys them with other people's money, does not make one iota of difference, if he does not overstep his credit and stake a larger sum than he can legitimately afford to risk. The sole difference between investment and speculation is whether the stocks bought fit in with the existing Investment-Aim and the adopted Investment-Scheme. If they do, then their purchase is not a speculation; if they do not, then a speculation is in progress.

True distinction between Investment and Speculation.

There are always two parties to every transaction, and the cleverer and more powerful of the two wins in the end. Thus in all Stock Exchange speculations the best founded ideas lead to loss if there is an opponent in the field who understands how to annihilate their legitimate and proper consummation. A stock may be selling much under value, and this fact may be quite conspicuous, and yet it will fail to rise in price if there is a strong clique at work who keep up a steady stream of sales of stock which they do not own. And, *vice versa*, a stock may be selling much above its value and yet it will

Cause of artificial Stock-values.

not fall if there is a sufficient number of wealthy people behind it who assist to maintain its price. In this way the surest calculation may be frustrated, but in the long run all these artificial methods of preventing prices from going to their proper level are as ineffective as the strongest dam would be to permanently stop the flow of the smallest river. Just as, sooner or later, the river will overflow, so it is only a question of time when a stock will come to its proper selling price.

Temporary nature of artificial Stock-values.

This is wherein lies the real advantage enjoyed by the speculator who pays for his stock outright, over his confrère who speculates on borrowed money. The owner who has paid for his stock can calmly await events and is independent in his actions, whereas the speculator on borrowed money has to conform to the dictates of his creditor, and might be forced to realise on the very eve of success.

Dangers of speculating with borrowed money.

To speculate in stocks is a pastime in which a great many indulge. The turf is responsible for a considerable amount of gambling, but horse-racing wagers are insignificant transactions compared with the bets made on the Stock Exchange, both as to number and the amount of money which is at stake. In both cases the Press is to a certain extent responsible for fostering the

gambling spirit, owing to the manner in which the turf and the Stock Exchange news has to be given. Nevertheless it is true that a vast improvement in respect of the Financial articles has taken place, and Editors are now endeavouring not only to extend their information, but to give it in such a form that Investors can readily use it.

Stock Exchange speculation fascinating but dangerous.

There is such a fascination about Stock Exchange speculation that almost every owner of accumulated funds falls a victim to this expensive pastime in a greater or lesser degree at one time or another. The present writer was once just as much engrossed in this subject as most people, in fact, he endeavoured repeatedly to invent such improvements and new methods as would make Stock Exchange speculation a certainty. He was young then, and full of energy, but as he grew older and his experience matured, his ideas changed, until he turned his back for ever on this unfathomable quicksand, in which so many fine fortunes have been engulfed. If a Royal Commission were appointed to inquire into Stock Exchange speculation, and that Commission had the power to force all the stockbrokers in the country to produce their books, it would be found that for every thousand speculators who lose money by gambling in stocks, hardly one makes a per-

manent profit. The reason why it sometimes seems that people do make speculative profits is that the winners boast of their success, while few, if any, are sufficiently candid to narrate their losing experiences.

It is quite useless to inveigh against gambling; it is like the wild oats which every young man has to sow, and as long as gambling is conducted within proper limits no one is really hurt by it. Gambling, however, must not be confounded with legitimate speculation, where money is staked on sound ventures with the full knowledge of the risks incurred. Immense and permanent fortunes have been and will continue to be made in this way.

Legitimate speculation not a gamble.

CHAPTER XI

THE READER'S OWN INVESTMENTS

THE art of purchasing to the best advantage consists: first, of making up one's mind clearly as to what is really wanted; second, finding out where the required commodity is obtainable in its largest and best selection; third, clearly establishing the relative value and utility of all the commodities of the required kind which are offered; and last, purchasing the one which is the most advantageous.

Investments regarded as commodities.

These simple rules apply to purchases of all kinds, and especially to the purchase of investments.

In almost every kind of trade there is a large selection of similar articles, and there are merchants who keep a stock of them open to the inspection of intending purchasers. Similarly, there is an endless variety of stocks and shares constantly on offer, but there are no warehouses in which they are collected and displayed. Investors who call upon their bankers and brokers asking for advice as to how they should

Why investors receive insufficient advice.

invest their money, very rarely state what they really need; and they thus lay themselves open to the danger of receiving advice other than they actually require, although the bankers and brokers endeavour to serve them to the best of their knowledge and ability.

It has been explained in the pages of this book that safe investment is only possible when the Investor knows his ultimate aim, and has decided upon the class of security which is best suited to attain his investment-object. He should then divide his capital into equal parts, and invest each of these parts in the securities which will answer the purpose; but these securities must each be equal in quantity, quality, and width of fluctuation, and every one of them must be dissimilar from all the others in the external trade-influences which govern its price-movements. To add successfully to existing investments, therefore, the Investor's object must first be considered, and this naturally decides the quality of the stock which he requires. This selection must also be influenced by the type of securities already held and the Geographical Divisions already covered by the Investor's Capital.

Every new Stock-purchase should be governed by original Investment-Aim.

If the owner's investment-object is explained to a banker or a broker, and he is shown the list of stocks held, he would then be able to

suggest a new investment after due consideration. But if either of these persons is simply asked what an Investor should buy, he cannot tell what is actually wanted, and he is just as much at sea as any Investor would be who had not considered his own position. Under such circumstances the banker or broker can only suggest what seems to him a cheap and desirable investment for the time being; but the cheapest, safest, and most desirable investment of its kind may become dear, unsafe, and undesirable, unless it fits in precisely with the investments already in hand.

The soundest Stock may prove an unsafe holding.

The cardinal point of safe investment is that all stocks held must match each other in several ways; and it is quite impossible to match anything unless a complete knowledge of the article to be matched has been previously obtained. For these reasons, the Investor must give to either his banker or broker a clear definition of the quality and class of investment required, with its Geographical Division particularised, or he must ask him to decide these points from a copy of the existing list of investments held. Otherwise the Investor cannot hope to buy to the greatest advantage.

Stocks need to be matched.

It is a simple matter to give such instructions as, "I require a sound Debenture or Bond which never fluctuates more than

5 per cent. in any one year, yielding 4½ per cent. and situated in Asia"; or, "I want a 5 per cent. Preference share situated in America North, which never displays a difference of more than about 8 per cent. between its highest and lowest price annually." Such orders are clear and distinct and they are likely to be accurately carried out.

No difficulty in re-arranging Investment-Lists.

There is one advantage regarding investments which can be utilised by all Investors, namely, no one is compelled to continue holding a list of stocks which does not fulfil his requirements. Therefore, the most ill-assorted list can be put into proper working order in a comparatively short time and with little expense.

It has been pointed out in a previous chapter that all stocks are saleable at fair relative prices, and that there is no such thing with investments as stale goods or remnants which no one cares to buy. It is true, of course, that investments cannot be always sold at or near their cost price, and that they must be realised at the market-price of the moment; but this point is not one which holders of ill-assorted lists should consider, unless they are prepared to continue occupying their present speculative position.

Cost-price of unsuitable holdings a negligible factor.

Beyond the purchase-expense it is quite

impossible to establish the fact that there is a difference between a person who now holds a stock and one who now purchases it. Both these persons are in precisely the same position, for there is nothing to prevent any one buying any stock at the market price. Every Investor can at any time put himself in the position of any other Investor who has held a certain stock for years. It may be that the holder of long standing has paid a very much higher price than the new purchaser, but this does not alter the fact that the Investor who has just appeared on the scene has quite equal chances with the holder of long standing, although he may have paid far less for the stock.

Holding on to unsuitable Stocks is a speculation.

It therefore naturally follows, that to hold on to a security which is unsuited to a given Investor's purpose is, in effect, precisely the same as if that Investor were now to buy that unsuitable stock. This irrefutable logical conclusion may be very unpalatable to many holders of investments which have considerably receded in value. They naturally like to believe that their investments technically represent the price which they paid for them; they try to find some reason why the present ruling market-price is untenable, and hope that sooner or later the price which they have paid will prevail again. They definitely make up their

minds to get out of the unsuitable investment as soon as they can do so without a loss, but in the meantime they prefer to wait.

A short analysis of these reasons will show that they feel inclined to rely on future possibilities, and this conclusion proves that they are simply speculators.

Buying a stock which clearly does not fit in with an Investor's object, is a speculation; buying a speculative security which does so fit in, is no speculation at all. Investors who know that some of their present holdings do not fit in with their investment-objects, are speculating in this hazardous way.

The practical treatment of existing Investments.

The purely practical application of the teachings of this book to existing investments has now been reached.

Quality of Stocks must be considered.

Every reader who is an Investor should first of all consider the various investment-objects which have been divided into ten sub-divisions in Chapter II. of this book. He should select from these the sub-division which applies to his case, and then read the description following that sub-division. This will inform him what kind and quality of stocks are requisite to enable him to attain his individual investment-object. As the next step, he should examine his existing list of investments, and ascertain roughly and approximately at what price each

of them could now be sold. The selling values should be added up, and the total will give him the amount of Capital he owns.

The explanation accompanying his particular investment-object as given in Chapter II. of this book has shown him what percentage of yield he may expect, and by multiplying his Capital by the percentage and dividing by 100 he ascertains his future income. His Capital can then be most advantageously divided into even proportions on the following scale:

Proper division of Investor's Capital.

Size of Capital.	Number of Sub-divisions of Capital.	Number of Stocks to hold.	Number of Geographical Divisions to cover.
Up to £1,000	4	4	4
Between £1,000 and £2,000	6	6	6
,, £2,000 and £4,000	8	8	8
,, £4,000 and £8,000	10	10	10
,, £8,000 and £16,000	10 or 20	10 or 20	10
,, £16,000 and £50,000	20	20	10
£50,000 and over	20 or 30	20 or 30	10

Whenever this table indicates that more than ten stocks should be held, the investments must not only cover the ten main Geographical Divisions, but in all those divisions which contain more than one country, they must cover various countries of that division. In the case of the *International Division* separate industries should be covered.

EXCEPTIONS.—To the following investment-objects given in Chapter II. of this book, the above table does not apply, and the division of capital for these should be as follows:

Group I. (*c*). Divide capital up to £5,000 into 10 equal

portions, capital between £5,000 and £30,000 into 20 equal portions, capital over £30,000 into 30 equal portions, and cover the 10 Geographical Divisions in each case.

Group I. (*d*). Divide capital up to £3,000 into 10 equal portions, capital between £3,000 and £10,000 into 20 equal portions, capital between £10,000 and £30,000 into 30 equal portions, capital over £30,000 into even multiples, the maximum amount in each stock not to exceed £2,000, but never less than 30 securities should be held.

Group II. (*c*). Divide capital similarly to Group I. (*c*) or (*d*) as above explained.

Group III. (*b*). Divide capital similarly to Group I. (*d*) as above explained.

How to construct an Investment-Scheme.

Having divided his capital into the portions indicated in the above table, the Investor has now ascertained the following main facts:

1. The present size of his capital.
2. The class of investments which he should hold.
3. The number of stocks which he should hold and the income which they ought to regularly produce in each year.
4. The number of Geographical Divisions which his stocks should cover.

In fact, with the aid of an extensive share-list he can now construct an ideal investment-scheme for himself, which he can rely upon to fulfil his investment-object in the future.

He should now continue the examination of his existing investment-position. If any Investor should find it difficult to make a

clear statement of this, be it for want of time or lack of statistical facts, he is recommended to ask either his banker or broker to do the work for him, or, failing them, to consult the publishers of this book by sending them a list of his holdings and stating his investment-object.

Expert investigation of Investment-Lists.

The suggestion is made so that the teachings of the book may not only be of practical use to all its readers, but in order to bring its precepts within the reach of all Investors who are without the means of arriving at statistical facts. The publishers of this book not only insert in their monthly publication a form on which investment-lists may be submitted to them, but they also include the charge for investigating such lists in the annual subscription to that publication.

Investors need feel no hesitation in submitting their actual investment-position to others for investigation, on the ground that they have invested unsatisfactorily in the past. The majority of Investors are in precisely the same position, and it would have to be an extraordinarily bad case indeed to excite special attention in the mind of any one whose business is to habitually and daily investigate private investment-lists. Besides, all communications of this kind are treated as strictly private documents, and no banker, broker, or adviser

would, under any circumstances, divulge their contents. As a final safeguard, by marking the investment-list and its accompanying letter as "Private and Confidential" strict privacy is ensured.

Rules for examining Investment Position.

It is always preferable for Investors to investigate for themselves their own investment-position, as the researches which they make clear their minds and give them valuable experience. All readers who are inclined to fall in with this suggestion should proceed as follows:

1. All stocks held should be classified according to their Geographical Position; the value of the stocks held in each Geographical Division should be added together, and the Geographical Distribution of the Capital will thus be ascertained.

2. The various qualities of all the stocks held should be investigated upon the principle explained in Chapter VI. of this book. It will then be seen how closely alike they are in quality, and whether that quality is in keeping with the investment-objects of the Investor.

3. The income received during the last few years should next be ascertained, and compared with the amount which the Investor would receive regularly if he followed the investment-scheme which suits his case best. The actual

income-yield from each stock held should be considered from the point of view explained in Chapter V. of this book.

Realising Capital without loss.

Whilst this investigation is in progress, there is another exceedingly important point of view from which existing investments should be considered, namely, the power of the Investor to realise a portion of his investments at any time without loss. There are some Investors who say they will never require to convert any part of their invested capital into cash, nevertheless this is an eventuality which might happen at any unforeseen moment. When it does happen, and there are no stocks held which can be sold without a loss at the critical moment, a heavy Capital-loss is possible.

Advantages of Geographical Distribution when realising Capital.

Every properly constructed Investment-List, which is based upon the principles of Geographical Distribution of Capital, gives its owner an opportunity of realising at any time at least one quarter of his Capital without loss. On Geographically Distributed lists of investments which have had time to mature, this realisation can, as a rule, be effected at a profit. It is not intended to enlarge upon this point here, but the reader is referred to a publication entitled "Investments Practically Considered," a collection of articles on investment-questions, written by the present

Author. There, under the heading *Tests for every Investor's Real Position*, he will find the foregoing contention fully proved by statistical facts.

It is a convenient plan to group all the salient facts under investigation in the form of a table, as thereby their relative proportion to each other becomes strikingly apparent.

A Test Sheet for Investor's use.

For the purpose of summarising an Investor's actual position, the annexed form of *Test Sheet* is suggested. The reader can either prepare such a form for his own use, or he can use the form contained in this book. In case of need the publishers will supply a full-sized *Test Sheet* on application being made to them.

The quantities and names of the stocks held should be entered on the *Test Sheet* in their geographical order, together with their cost and present value; and the total value held in each Geographical Division should be shown in the second left-hand column. The values of the stocks held as they stood, say, ten years ago, five years ago, two years ago, and last year, should be ascertained from a statistical handbook, and entered opposite each stock on the left-hand side of the *Present Value of Stocks held in each Division* column. When the cost price of a stock is not ascertainable, the average price ruling in the first year of the period

covered by the investigation should be taken as a substitute for it. Then, by comparing the *Cost Price* column with the amounts entered in the *Value at Average Prices* column, it will be ascertained how many stocks were saleable each year at or above cost price. All the stocks which were so saleable should be entered in the *Stocks Realisable* column. The Dividends or Interests which were paid on the stocks held during the identical years which have been selected for the *realisable values* should next be ascertained, either from the Investor's own Account Book or from a statistical handbook, and they should be entered opposite the stocks in the *Annual Income* column. All columns of figures should now be cast up, and the table is complete.

How to read Investor's position from completed Test Sheet.

The Investor has now ascertained how the total value of his investments has altered in each of the five separate years; this is seen from the totals of the *Values Columns*, and gives him an infallible clue to the distribution of his investment-risks. A properly distributed list of investments does not vary more than 8 per cent. in its total realisable value year by year [*see* "Investment Practically Considered"], and every list which habitually shows variations of over 5 per cent. in its total realisable value, in any two consecutive years, is badly distributed as to investment-risks. Especially is this so

when several successive years show either a steady and prolonged increase or decrease in the total realisable value.

Absolute steadiness of the total realisable value, or a jumpiness from increase to decline and back to increase again, is the unfailing sign of a properly distributed investment-list.

Sign of a well-distributed Investment-List.

The Investor will further have ascertained from the totals of the *Stocks Realisable* columns what proportion of the Capital was realisable without loss in each year under review. As has already been stated, a properly Geographically Distributed List of Investments is always realisable to the extent of at least one quarter of its total value without loss. If the list which the owner is investigating does not display this important feature, there is grave danger of Capital-loss in the case of forced realisation.

Capital-loss from forced realisation avoided.

The totals of the *Annual Income* columns disclose the steadiness of income. All badly constructed investment-lists show considerable variation in this respect. Especially is a gradual and steady decline in income a danger-signal which no Investor should treat lightly.

Every point of the existing investment-position has now been dealt with. The Investor has two clear examples before him: (1) The model investment-list, which fulfils every one

A useful Investment-comparison afforded.

of his requirements and is likely to show a steady realisable value, which will allow of the realisation of a portion of the capital without loss, and give a steady annual income; (2) the existing investment-list with all the weak points, if such there be, exposed.

If no great difference in any vital details exists between these two models, it has been ascertained beyond doubt that the existing list is well constructed. If there are great differences between the two, then a glance at the existing list itself will show where and to what extent this combination of investments is faulty, and the reader would be extremely ill-advised if he did not forthwith set about remedying these defects.

What Stocks ought to be sold.

Assuming the investment-list to be unsoundly constructed, a careful selection of all the stocks to be sold should be made, and the total realisable value of these ascertained.

All stocks which are superfluous in any one Geographical Division or which do not fit in with their owner's investment-objects [*see* Chapter II.] should be placed on this list. The Capital realisable by the sale of these stocks should then be apportioned over those Geographical Divisions which the stocks to be retained do not cover.

A broker should now be asked to recommend

investments which answer to the Investor's requirements in every detail, and which are situated in the vacant Geographical Divisions. He should furnish the Investor with such details concerning every separate investment recommended by him as will enable the Investor to form his own opinion as to its suitability when judged in the light of the explanations given in this book.

How to exchange undesirable for desirable Stocks.

The Investor should investigate each stock which is recommended to him, and if he approve of it he should sell a sufficient quantity of the most undesirable of his holdings to enable him to purchase the new stock.

This procedure he should continue gradually until every undesirable stock held has been exchanged for a suitable security. As soon as this task has been successfully accomplished, the Investor's actual holdings should in every way coincide with the model list which he himself drew up at the start of his investigation.

No actual Cash needed for reconstructing Investment-Position.

It will be noticed that no actual cash is required for effecting a reconstruction of an existing list, and that every Investor who has independent control of his own investments can at any time proceed to reconstruct his investment-position.

The expense of effecting a reconstruction will depend upon the means employed for

carrying it into effect. Perhaps the broker will charge a special fee for giving additional attention to the case and supplying statistical details, but in no instance should the reconstruction cost more than 1 per cent. upon the total value of the stocks exchanged. This 1 per cent. is an extremely trifling matter when compared with the results obtained. In addition, the entire expense should invariably come out of the proceeds of the stocks sold, so that the Investor has no actual cash of any kind to find for the reconstruction.

Expense of reconstruction a negligible quantity.

By glancing at the variations in the total realisable value year by year, the Investor will perceive that the reconstruction expense is almost negligible when it is compared with the wild annual fluctuations of a badly constructed investment-list. The cost of a reconstruction is rapidly made up out of the advantages gained by the Investor in capital and income.

Why unsuitable Stocks find a market.

A pessimistic reader who has not quite parted with his former conviction that all stocks are similar in character to each other, and that an investment which has been found undesirable by one Investor must necessarily also be considered undesirable by all other Investors, may now ask the seemingly pertinent question: "How is it that ready buyers can be found

for all the undesirable stocks which have to be sold through a reconstruction ? "

The answer to this question is that a stock which is unsuitable for one investment-object may yet be suitable for another, and that, in fact, there is no investment which is quite unsuitable to every investment-object, unless it be worthless or such a rank speculation that it does not deserve the name of either *security* or *investment.*

Interesting example of adaptability of Investments

A very interesting example of the general adaptability of investments is contained in a little book by Sir John Rolleston, published at 2, Waterloo Place, London, S.W. In that book a number of charts are given, each chart covering the investment-area of a different country; another set of charts is then given which contains the same stocks as the former charts, but the investments of different countries are included with them, so that a Geographical Distribution of Capital is effected.

The results obtained from these charts prove that whilst a combination of the investments of any one of these countries makes up exceedingly undesirable investment-schemes, these identical investments make very desirable investment-lists when one stock out of each country has been taken as the material out of which to form an investment-combination.

An ideal Investment-Scheme.

In fact, if the Investors of nine separate nations, each of them holding stocks of his own country to the same value, were to put their combined investments into a pool, they would obtain an ideal investment-scheme, which they could divide at any time among themselves in such wise that all would hold ideal investment-schemes. But if each continued to hold the stocks of his own country every one of them would have a bad investment-scheme.

A more striking proof of the fact that the same investment may be bad for one Investor but highly desirable for another, can hardly be imagined.

Periodical supervision of Investment-List.

After the Investor has adjusted his investments and secured a desirable investment-plan, he should, by means of proper book-keeping, keep in close touch with his stock throughout his investment-career, and thereby make sure that his investment-plan is properly maintained.

THE END

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