

UNIVERSAL
LIBRARY

OU_152167

UNIVERSAL
LIBRARY

OSMANIA UNIVERSITY LIBRARY

Call No. 332.61

Accession No. 6837

Author King, W.T.C.

Title Stock Exchange

This book should be returned on or before the date last marked below.

THE STOCK EXCHANGE

By
W. T. C. KING

Author of
History of the London Discount
Market

PUBLISHED FOR THE COUNCIL OF
THE STOCK EXCHANGE, LONDON
BY GEORGE ALLEN & UNWIN LTD

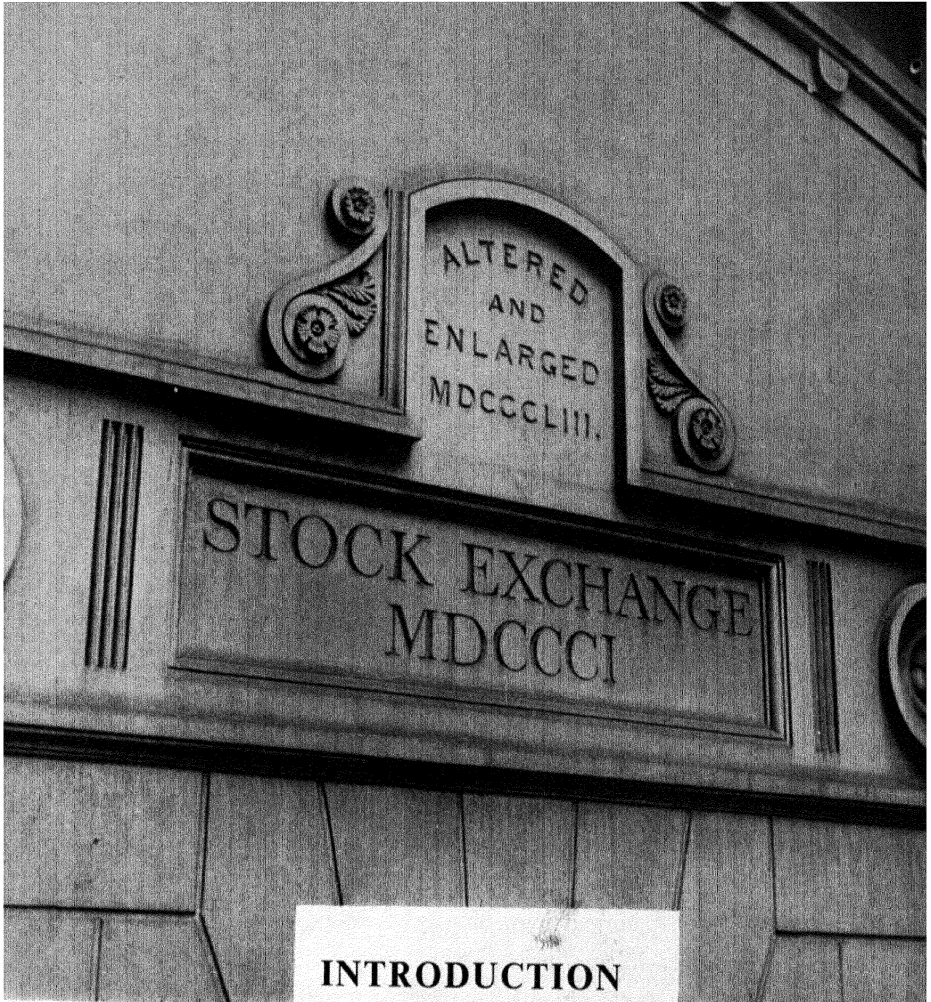
1947

CONTENTS

INTRODUCTION	3
I FROM JONATHAN'S TO CAPEL COURT .	7
II MOBILISING THE NATION'S SAVINGS .	15
III THE IMPORTANCE OF A FREE MARKET .	25
IV HOW THE STOCK EXCHANGE IS GOVERNED	31
V BROKERS AND JOBBERS . . .	34
VI A TOUR AROUND THE HOUSE . . .	41
VII EXECUTING A CLIENT'S ORDER . . .	47
VIII HOW SECURITIES ARE TRANSFERRED .	57
IX BULLS AND BEARS	67
X PROTECTING THE INVESTOR	74

APPENDICES

I TYPES OF STOCKS AND SHARES .	81
II MINIMUM SCALE OF COMMISSIONS/ .	83



WHAT is the Stock Exchange, and why does it exist? What part does it play in the national life, and how does it play it? These, surely, are simple questions. Most people could answer the first. But how many could honestly tackle the others? Yet these are matters of concern to many beyond the circle—the ever-widening circle—of the investing public. The work of the Stock Exchange, though few are aware of it, has its influence upon the lives and welfare of the whole community.

In these days of change and challenge, there is abroad a new search for truth, a healthy spirit of enquiry into the ways of British institutions. Among

Here, then, is the preliminary answer to the first question posed above. What of the others? Why are these activities important, and how can they be of concern except to those who own securities? Why, indeed, must dealings in stocks and shares take place at all? The short answer is that without an effective Stock Exchange the savings of the community -- the sinews of economic progress and productive efficiency -- would be used much less completely, and much more wastefully, than they are now. The waste of national resources and loss of efficiency would leave their mark very plainly upon the comforts and enjoyments of all. Thus it is that the Stock Exchange is intricately interwoven in the fabric of the nation's economic life.

Like most short answers to searching enquiries, this, admittedly, is question-begging. It does not explain how the Stock Exchange functions in this way. The explanation, it is hoped, will emerge clearly from the following pages, and especially from the reasoned argument of Section III. Other Sections describe and explain the practical working of the market, and the aims and functions of the Stock Exchange as an institution. They will, perhaps, do something to correct the misapprehensions that abound.

In these days, even quite humble folk -- hundreds of thousands of them -- have banking accounts. During the war, large numbers of people for the first time became 'investors'. They bought Savings Certificates, Defence Bonds and similar securities from the Government, instead of keeping their savings in a tin box. These changes, it might be thought, would have helped to dispel false notions about the part that 'finance' plays in the modern world. Yet the very opposite seems to have happened. It has grown fashionable to talk and think in 'real' terms -- in man-power, materials and ships -- instead of in pounds, shillings and pence. This is a healthy change. It makes for clear thinking on matters of high economic policy. But it has also led many folk to believe that the functions of 'finance' have been proved to be far less important than was formerly supposed.

Possibly for this reason, wrong ideas about the Stock Exchange are at least as common as they were before the war. Many people still speak of the Stock Exchange as if it existed only for the benefit of the wealthy, and have no notion of its public functions and responsibilities. Some, indeed, believe it to be a kind of 'rich man's casino' -- a mere place of recreation, which does

for the few what football pools do for the many. Others, apparently prejudiced as well as ignorant, impressively declare it to be the creature of nameless powers whose hidden activities dominate the lives of millions. And almost all popular descriptions credit it with an unmerited share of colour and romance.

Fortunately, these notions are all very wide of the mark. The Stock Exchange is not even a romantic place, much less a casino. It has a sober job to do, and the doing of it involves a surprising amount of wearisome and dull routine. If it has romance, it is a borrowed romance—the romance of the myriad business enterprises in whose stocks or shares it deals. Their hopes and fears, successes and failures, are mirrored in the market it provides. And almost the whole duty of the Stock Exchange is the quite unromantic one of keeping the mirror bright and clean, to make sure the reflections are true and undistorted.

This is not so easy a task as some might suppose. The object of this booklet is to explain in simple language just how it is done and why it is important.

SSS

II

FROM JONATHAN'S TO CAPEL COURT



THE Stock Exchange community governs itself by an elaborate set of rules—and does so more speedily, stringently and yet more flexibly than any legal control could do. A Royal Commission said as much some seventy years ago. And the rules then were certainly less exacting than they are now.

Yet in the eyes of the law the Stock Exchange is a most informal body. It shoulders great public responsibilities, but is not a public corporation. It has no Charter, nor is it even a registered company. A lawyer, with that precision which so frightens the average layman, would call it an 'unincorporated body of persons operating under a Trust Deed'. We shall best understand what that means if we think of its legal status as that of a rather formal kind of club. It came into being simply to promote the common interests of its members.

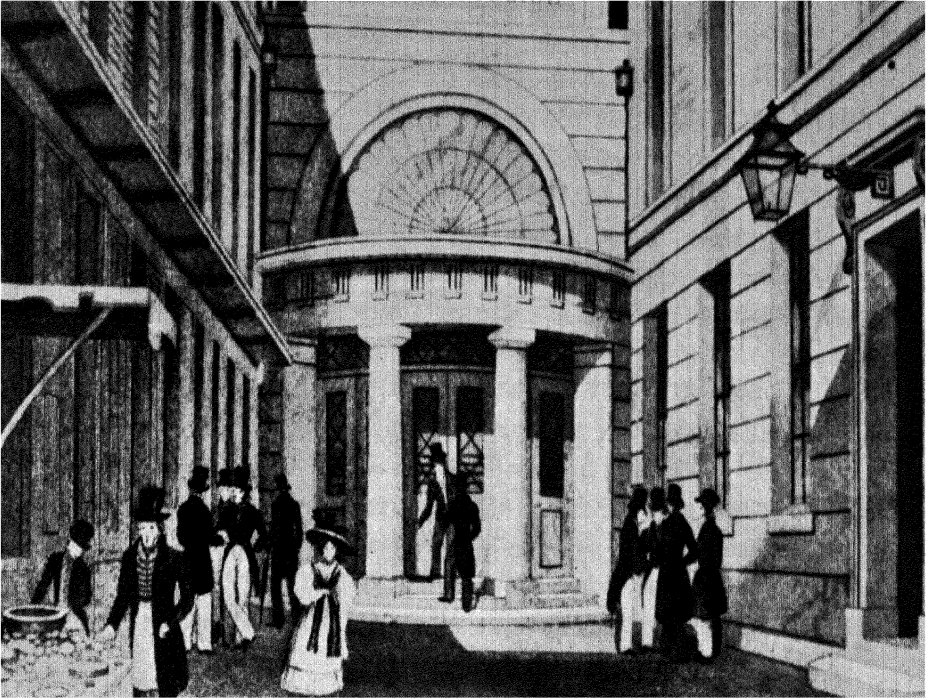
But though the Stock Exchange, as an institution, was created for this private purpose, the profession of stock-dealing which it served grew up spontaneously to meet a public need, especially that of the Government. It was in the reign of William III that stock-dealing first became important—through the same circumstance that gave birth to the Bank of England. The Government was pressed for money. The Stuarts had been needy, too. But they had borrowed haphazardly and defaulted brazenly. William was better advised. He discovered that it was actually easier to borrow steadily for long

periods than casually for short—provided only that the interest payments were promptly met and the securities easily transferable from one person to another. That discovery started the National Debt. But State credit was so shaky that the first loans could not be raised direct from the public. Instead, they were raised indirectly, through a corporation specially chartered for the purpose. That was in 1694, and the corporation was the Bank of England.

From that moment the stock-jobbers multiplied and prospered, dealing in Bank stock and in the stream of Government loans and lottery tickets that flowed in spate to meet the ever-growing needs of the Exchequer. About this time, too, an English company made a fortune for its proprietors by doing what men had often dreamt of doing but few had ever done. It brought home a rich haul of salvaged Spanish gold, lost some forty years before. That romantic episode fired public imagination, and in the warm glow of the first company-promoters' boom a crop of 'mushroom' companies sprang to life. The stock-dealing fraternity did a roaring trade in the stocks of these concerns—for a time, for hardly any of the new projects reached maturity. But among the companies of the day there were a few solid undertakings, of which the renowned East India Company—then nearing its centenary—was the most important. And in 1706 the first foreign loan was floated, for the Emperor of Germany. The excitement and noise of a company boom, or a foreign loan boom, recurred frequently in the following century and a half. But throughout this period dealings in 'the Funds', as British Government securities are often called even today, remained the mainstay of Stock Exchange business

THE CRITICS DECLAIM

So closely, indeed, was the growth of the stock market linked with that of the National Debt, that early critics of stock-jobbing (and they were many) seemed quite unable to separate cause from effect. Opponents of the Government blamed the stock-jobbers for what they called the 'ruinous' increase in State borrowing. Friends of the Government blamed them for not supporting Government loans. 'Everyone,' cried Robert Walpole, when one of his loan issues had had a chilly reception, 'is aware how the administration of the country has been distressed by stock-jobbers.' The famous essayists and satirists of the day joined in the chorus—and some of them in the specu-



This engraving by Thos. H. Shepherd shows the Capel Court entrance early in the nineteenth c

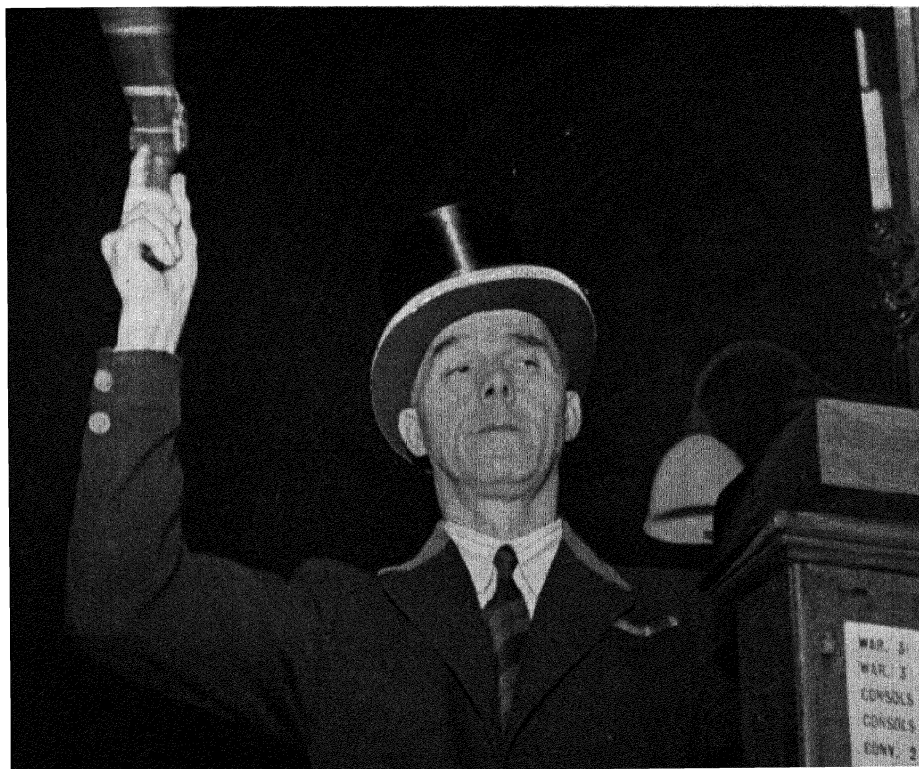
lations, too. Stock-jobbing, declared the creator of *Robinson Crusoe*, in a diverting pamphlet, was 'knavish in its private practice and treason in its public'.

But in those uncertain days, when the Funds themselves often fluctuated as wildly as an obscure mining share might do in modern times, all investment was speculation. The public was growing tired of keeping its savings in a strong box. It thought that the new alternative, 'investment', was a recipe for making a fortune overnight—and promptly became obsessed with the idea. The obsession had its abuses. In the days of the South Sea Bubble credulous folk rushed to put their money into the wildest of projects—among them a scheme to make square cannon-balls, and another to extract butter from beech trees! But this was also the era of the opening up of great continents, when British capital and enterprise laid the foundations of Britain's trade and Empire. The reckless daring of the speculator was the financial counterpart of the intrepidity of the explorer whom he financed. And the much abused stock-jobber—then often a financier as well as a dealer in securities—

provided facilities without which the growing needs of Government and trade could not have been met.

The stock-jobbers had their first home in the Royal Exchange—predecessor of the imposing building which now confronts the Bank of England and which by visitors to London (and even by illustrated ‘general knowledge’ books for the young) is so often mistaken for the Stock Exchange. But the jobbers were as exuberant as they were numerous, to the disgust of the (probably as noisy) merchants who were the particular frequenters of the Royal Exchange. In 1698 the stock-dealers deemed it wise to move. They crossed Cornhill and took their stand in an open courtyard, the renowned Exchange Alley. Thence, on wintry days, they sought warmth and shelter in the neighbouring coffee-houses—especially ‘Jonathan’s’. Unlike Lloyd’s, which proudly retains its link with the coffee-house of Edward Lloyd in which it was born, the Stock Exchange has long since dropped the name that served it for half a century or more. But its attendants and doorkeepers, like those of Lloyd’s, still answer to the call of ‘Waiter!’

is the strict order in the House — until, 15 minutes before the waiter sounds a rattle, and members gratefully ‘light up’



Not until 1762 was there any attempt at creating an organised Stock Exchange. In that year 150 dealers formed a club at Jonathan's. They paid subscriptions to the proprietor and tried to exclude non-members. One of the inevitable squabbles ended in the Courts, where, as Charles Duguid relates, the ejected non-member triumphed. 'Jonathan's', it was ruled, 'had been a place of resort for dealers in stocks and shares for a longer period than was covered by the memory of man.' Eleven years later the dealers again crossed Cornhill and for the first time took premises of their own—at the corner of Sweetings Alley in Threadneedle Street, opposite the site of the present 'House'. For the first time, too, the name 'The Stock Exchange' was formally adopted and was duly inscribed over the door. And the members appointed a standing committee to settle disputes and regulate business. This was the well-known Committee for General Purposes—an historic title that endured until 1945.

Although the Stock Exchange was taking shape, it was not for another quarter of a century that it became in any sense an exclusive organisation. Members paid sixpence a day subscription, but anyone could enter the House on payment of this fee. Nor, at this stage, did the Stock Exchange embrace the whole stock market. The Rotunda of the Bank of England, a domed and circular hall opened in 1764, had become the main market for British Government securities, while the market in Foreign Loans was still to be found in the Royal Exchange—then, and for long afterwards, the focus of business in foreign money and all overseas intelligence.

WAR WITH FRANCE

By the end of the eighteenth century the Sweetings Alley quarters had been outgrown. Business was expanding fast. Especially was it stimulated by the prolonged war with France. That may seem strange today, when it is taken for granted that war causes a steep fall in Stock Exchange business and an even steeper one in members' earnings. But wars that were chiefly the affair of the professional soldier and adventurer had little effect on the monied classes who then were the main customers of the Stock Exchange. Money created by the Government to pay its war bills loosened public purse-strings. New war loans multiplied the volume of Government securities. Excitement

and uncertainty added zest to speculations. Such influences as these explain the seeming paradox that the modern Stock Exchange was conceived at the very height of the French war.

In Capel Court, a stone's throw to the east of the Bank of England, between Throgmorton Street and Threadneedle Street, stood some tumble-down premises, and Mendoza's Boxing Booth. On this 'central' site William Hammond, and eight others, planned a spacious building, a new Stock Exchange. It was, moreover, to be an exclusive Stock Exchange. When any Tom, Dick or Harry could join in the fun, as at Sweetings, shady business and fraud were apt to get mixed up with honest dealing. Charlatans and men of straw rubbed shoulders with dealers of substance and respectability, bringing their calling into disrepute. The new Stock Exchange was to change all that. It was to be a properly regulated body open only to reputable dealers chosen by ballot, with a subscription of ten guineas yearly.

1801

The scheme went well. The nine founders and twenty-one others became a new Committee for General Purposes, and quickly raised £20,000 in 400 shares. Building started in 1801. Less than twelve months later, the new House was opened. Its official purpose, as the foundation stone relates, was 'the transaction of business in the public funds . . . accumulated in five successive reigns to £552,730,924'. Forty years before, the total had been barely a fifth of that sum. Today even the quoted Government securities are fully twenty times, and the whole National Debt is over forty times, as much.

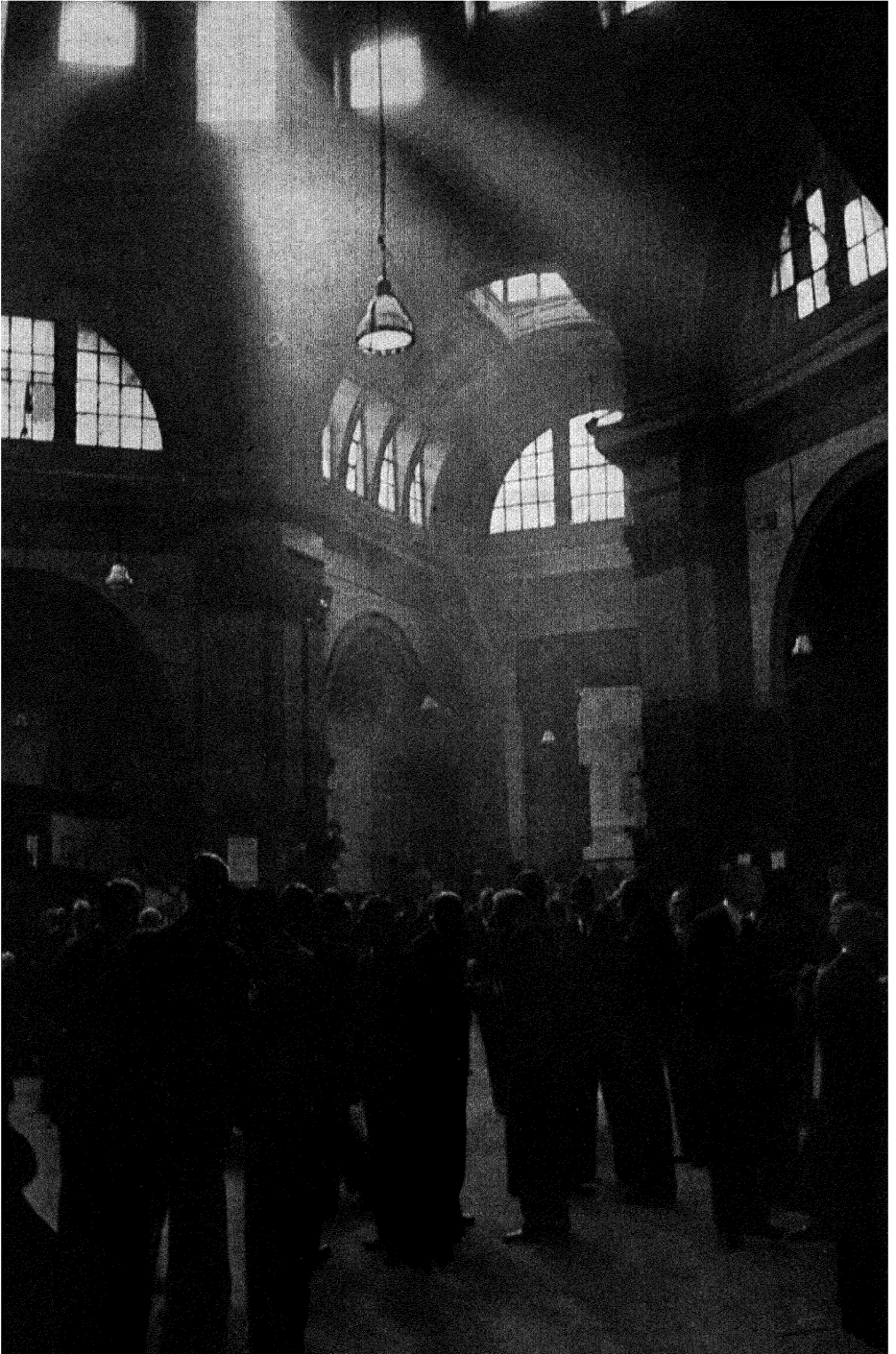
Rather more than 500 stock-market men joined the opening throng. Many others remained outside, and long afterwards were wont to cry their wares at the very door of the House. The 'outside' brokers of today depend upon the Stock Exchange in various important ways, but they no longer block its still too narrow doorways. The 'Street' market of modern times results simply from the unwillingness of members, on active days, to stop business at the official closing time—and, more directly, from the fact that Wall Street's working day begins and ends several hours after London's.

The constitution was a formal one. It was laid down in a Deed of Settlement, signed on March 27th, 1802. All money matters, and management of

the building, were entrusted to the nine founders, formed into a Board of Trustees and Managers. They looked after the interests of the proprietors, just as a company board of directors would do. Regulation of members' affairs, methods of dealing, and so forth was put in the hands of the Committee for General Purposes, to be elected annually. This committee may be likened to the committee of a club—without the usual 'finance' sub-committee. Thus arose what is known as the system of 'dual control'—a system that only now, after nearly 150 years, is beginning to disappear. Until 1945 when, for reasons that will later become clear, the two Committees were merged into the present 'Council', the constitution of the Stock Exchange remained substantially that of 1802. While the Rules and Regulations that govern all dealings have been altered almost beyond recognition, the original Deed of Settlement has remained the basis on which the whole structure rests.

The original building has long since disappeared. But since 1853, when a new one took its place, the needs of a huge increase in business and in Stock Exchange membership have been met, not by re-building, but by extensions and alterations, as well as by mere expedients, such as the removal of administrative departments to nearby premises. In the modern Stock Exchange, the only visible sign of the affluence that is popularly associated with the stock-dealing fraternity is the marble of its walls and pillars. But even that is a somewhat sombre symbol of a bygone age. The truth is that the House, nowadays, is very overcrowded and rather dowdy. Every one of the big banks can boast a better home.

But if the market-place is behind the times, that is certainly not true of market organisation, as the following pages will show.





MOBILISING THE NATION'S SAVINGS



WE live in a complex age. The economic machine that provides for our everyday needs is so intricate that it is hard to see the purpose of particular cogs in its mechanism. A primitive machine would have fewer cogs, and hardly any 'financial' ones. But it would be a much less efficient machine. Its products would be crude in type and limited in quantity. Many of the common necessities of today would not be produced at all. With such a machine, in other words, the nation's standard of living would be incomparably less ample even than that to which we have had to accustom ourselves in recent years, when half our productive capacity has been engaged in making war.

To produce in abundance the numberless goods and services that, in peacetime, we all take for granted, requires the highly specialised economic mechanism that exists today. Let us see why. The vastly greater production that we now enjoy compared with, say, a hundred years ago is due, above all, to the growth in the average size of individual businesses. Everybody knows how 'mass' production reaps to the full the economies resulting from 'division of labour' and use of specialised plant, and so cheapens the cost of goods. The development of large-scale industry would have been impossible without parallel development in the mechanisms of finance.

All economic progress depends on savings. If the community as a whole at once consumed everything that it produced, its industries would never be

able to enlarge their plants, or its scientists to seek better methods and better products. Everyone would be fully occupied in meeting the immediate needs of the improvident community. Labour and materials can be available for 'capital' development—the making and erection of new plants, building of factories, and the like—only if the public as a whole spends less than its current income. The saving habit and the creation of the nation's 'real' capital—its roads and its railways, its factories and its power-houses, its dwellings and its cinemas—have marched forward hand in hand.

But though savings are indispensable for capital development, they cannot of themselves produce it. The savers themselves are passive agents, and their savings, if not used by somebody else, will simply create unemployment. To become fruitful, the savings must be *mobilised* for use by active agents—the industrialists who plan new factories; the local authority that launches a new housing scheme; the engineers who build a railway; or the Government that spends beyond its income (as Governments often do), or controls vital industries or services (as modern Governments are increasingly doing). This task of mobilising and distributing savings is one of the main functions of the financial machine.

POOLING RESOURCES

When all business was conducted on a small scale, only a rudimentary financial machine was needed. Indeed, it chiefly existed to meet the needs of the Government, which in those days was virtually the only large 'business'. A one-man business would normally finance its expansion out of the savings of the proprietor. When these no longer sufficed, he would take one or more partners, and their resources would be pooled in the 'joint stock'. But as the scale of business grew, it became impossible for the active partners to provide enough finance. They needed to tap the savings of others who could be persuaded to invest money without taking part in the management. To facilitate this process, the partnership would be turned into a company, in whose 'joint stock' each investor acquired a share in proportion to his investment.

So long as sufficient money could be secured 'privately', from friends or business associates of the original proprietors, even this change could be arranged without complicated financial mechanisms. But as soon as the growing

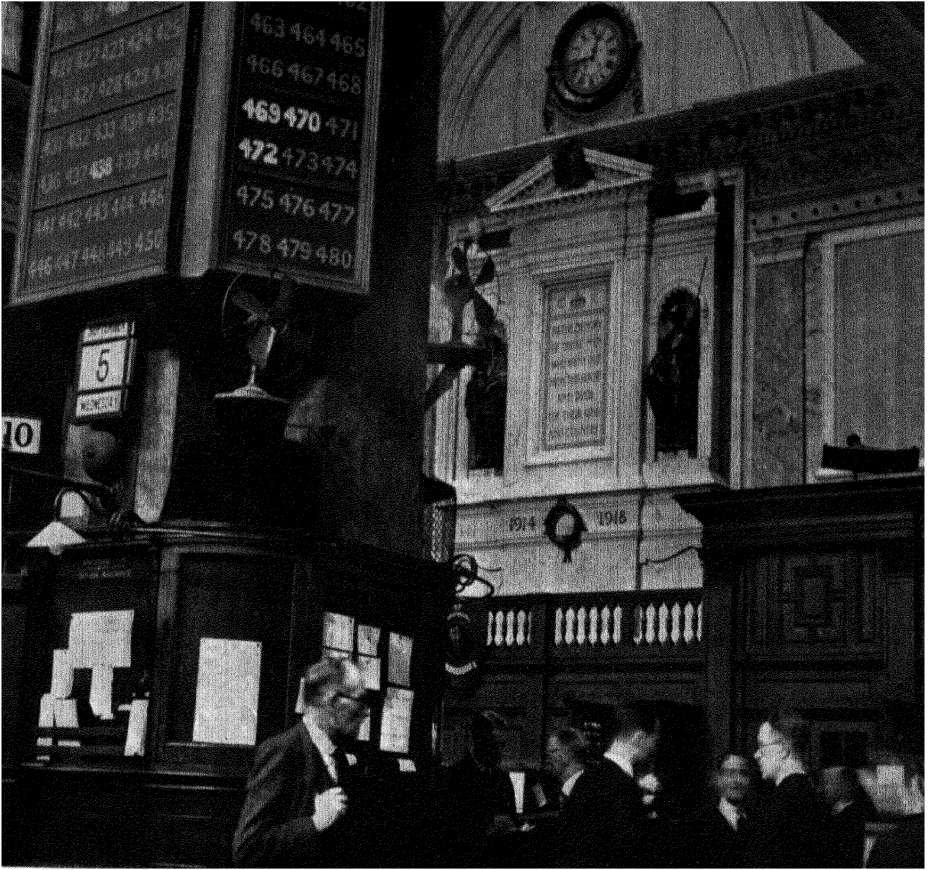
business needed to go farther afield for its finance, and to broadcast appeals to investors to buy 'shares' in it, these mechanisms became indispensable. Very few people would be willing to sink their savings *permanently* in a business run by others, however competent and trustworthy they knew them to be. Obviously, too, a business that needed money to buy, say, new machines could not undertake to return the money at a moment's notice - nor, in most cases, even after a few years.

EXCHANGING STOCK

Expanding businesses needed 'permanent' finance, and could not expand without it. Investors needed 'liquidity' - the ability to turn their investments into cash at any time - and would not invest without it. It was this dilemma that brought the Stock Exchange into being. As businesses (and Governments, too, for that matter) could not ordinarily return invested capital, an investor could not get cash for his investment unless he found somebody else who was ready to buy it from him - to take over his share in the company's 'joint stock', or his holding of Government securities. What was needed was a *market* for investments. The job of the Stock Exchange and its members is to supply that need - to bring the buyers and sellers of investments together, and to make the 'exchange' of stock between them as simple and fair a process as possible.

The second part of its task is of particular importance. An investor will not be satisfied simply to know that a buyer could be found after diligent and difficult search. He must be sure that, if ever he has urgent need of cash, a buyer can be found at once - and one, moreover, who will pay forthwith what the investment is worth at the time. He will insist, too, that he must be able to ascertain that worth at any moment.

These are exacting requirements. The extent to which they can be met in any given case depends upon whether there is a free and active 'market' in the particular investment. The larger the number of potential buyers and sellers of a company's shares, the easier it becomes for a holder to sell, and a fresh investor to buy, at any time. And the more frequently the shares pass from one owner to another, the more surely can each holder know what his holding would fetch if he wanted to sell. It used to be said of 'Consols' - at



one time, if not today, the leading British Government security-- that they 'could be sold even on a Sunday'. That was never literally true, but it precisely illustrates what is meant by perfect 'marketability'.

Mobilisation of the nation's savings on the scale needed to support modern business therefore requires a free and active market in stocks and shares. That is why the Stock Exchange, which alone provides such a market, is an indispensable part of the national economic equipment. Stock Exchange securities do not, of course, all enjoy equal marketability. The shares of a small company which is little known will change hands only infrequently; even with the best market organisation, it may be hard to tell at what price they could be bought or sold at any given moment. The same may be true of

the shares of larger companies, if the bulk are held by the original proprietors or other 'tight' holders who lock their investment away and only rarely sell. But the whole intricate mechanism of the Stock Exchange--and it is a very intricate mechanism--has been designed to ensure that the market in each case is just as free and active as it can be.

Moreover, nothing succeeds like success. The freer the markets, the more the public's savings are tempted out of barren idleness into fruitful employment. And the more that happens, the freer and more active the markets become. The public, it might be said, joins in unconscious partnership with the Stock Exchange, to help it do its job ever more effectively.

SHOCK ABSORBER

But the Stock Exchange, as the active partner, has wide and ever-growing responsibilities to the public. 'Free' markets are not simply a matter of many buyers and sellers. If the prices at which stocks and shares change hands are to be 'fair' prices, many important conditions must be satisfied. It is the whole vast company of investors, competing one with another as buyers and sellers, that decides what the level of security prices shall be. But the public is prone to sudden swings of hope and fear. If left entirely to itself, it would produce needlessly violent and often quite irrational fluctuations. The professional dealers inside the Stock Exchange, and those outside who depend upon it, absorb a large part of the shock of these movements. Just how they do so will shortly become apparent. But the effect of their operations needs emphasis now. They help to ensure that a seller of securities does not get an unduly low price or a buyer pay an unduly high one.

These are valuable activities. But if the public is to reap the full benefit of them, they need to be regulated by a recognised code of good conduct. 'Fair' prices and free markets require, above all things, clean dealing both by professionals and by the public--and dealing based upon up-to-date and reliable information, freely available to all. Stock Exchange members, through their elected representatives, have for many decades disciplined themselves by submitting to elaborate rules. These are constantly altered to keep them in harmony with business needs while leaving no possible loophole for abuse.



In recent years, moreover, the Stock Exchange has gone far beyond the discipline of its own members in its efforts to ensure clean dealing and fair prices. It has recognised that protection of the public also requires it increasingly to extend its control to those outside who use its facilities--the companies and other bodies in whose stocks and shares it deals. It has done so, in particular, in order to ensure that company boards of directors keep their shareholders fully and reliably informed. As will be shown later, the conditions that the Stock Exchange now imposes upon companies--the big ones equally with the small--before it admits their shares to the market, are more rigorous than those of the Law itself.

The Stock Exchange has become, in fact though not in law, a public institution, with public responsibilities. Its primary and most vital task is to provide the market that mobilises the nation's savings. It also performs a second important function, which is really a by-product of the first. It does much to ensure that the flow of savings is put to the best use, from the community's point of view, though it does not itself decide what the different uses shall be.

NATURAL EQUILIBRIUM

To understand this second function, and this rather subtle distinction, it is necessary to take a first brief glance at one of the basic principles that govern the working of the security markets.

A buyer of stocks and shares behaves very like the buyer of anything else. He will pay more for an article of good quality than for a shoddy one. Some buyers will always go for the good articles, but there will generally be a demand for shoddy ones—provided they are cheap. And 'cheap', of course, really means 'cheaper'. Prices of Stock Exchange investments, like those of ordinary commodities, vary with their quality. Quality, in relation to investments in businesses, means their profitability and prospects. Many factors, often including some very complex ones, affect the level of security prices, but they do so only through their effect upon these two ingredients of quality.

In a perfect market, therefore, the difference between the price of one company's shares and another's would precisely represent the difference between their profitability and prospects— or, rather, the public's collective estimate of this difference. Suppose that in the same industry there are two companies, identical in all respects except that Company *A*, having (say) the advantage of exceptionally cheap power supplies, earns in profit a quarter as much again as Company *B* and pays a correspondingly larger dividend. *B* pays, say, 5 per cent. and *A* 6¼ per cent.—each on shares with a nominal (or par) value of £1. Then, if the shares of the less profitable company *B* are quoted at 20s. in the market, those of the more profitable company *A* ought to stand at 25s. —a quarter as much again, neither more nor less. At those prices, a buyer would get the same interest return on his money outlay —that

is to say, the same *yield*—whether he bought *A*'s shares or *B*'s, for *B* pays 5 per cent. on a £1 share which costs 20s. to buy, and *A* pays 6½ per cent. on a £1 share which costs 25s.

If, however, *A*'s shares stood momentarily at 24s., they would look cheap—or, alternatively, *B*'s shares would look dear. Investors would buy *A*'s shares or sell *B*'s, until the four-to-five price ratio was restored. There is thus a natural equilibrium of security prices, and in free and active markets seesaw movements of this kind are taking place all the time in order to maintain it.

PUTTING SAVINGS TO BEST USE

The more completely this equilibrium is attained, the more nearly will security prices approximate to their 'true' values—that is, the values at which the relative interest yields obtainable truly reflect the relative profitability and prospects of the businesses they represent. And the more surely will the flow of new savings be distributed to the best advantage into active employment. When, as now, the community's demand for capital—to rebuild its bomb-shattered cities, repair its war-worn plant, and restore its peacetime industries—far exceeds the spontaneous supply of new savings, it is obviously necessary that they should be available only to those who will use them for essential purposes. Since 1939 there has therefore been an official body, known as the Capital Issues Committee, whose job is to sift the many potential users of capital—the would-be borrowers on the market—and to reject all that are not essential. Quite recently, the Government has set up a further body, the National Investment Council, to advise it upon the wider aspects of Government policy in relation to national investment, with particular reference to the maintenance of 'full employment'. The chairman of this Council is the Chancellor of the Exchequer, and its members include the Chairman of the Stock Exchange, the Chairman of the Capital Issues Committee, and the Governor of the Bank of England.

The activities of these bodies, however, do not go beyond the first stage in ensuring the best use of national resources. If the community is to reap the full benefit of its labours and sacrifices, its new savings must be entrusted to enterprises which not only do essential work but do it efficiently. There

has to be a second sifting process, to separate the good projects from the indifferent or bad ones. The sifters at this second stage are the investing public as a whole; but the sieve is the Stock Exchange machine.

The capacity of a business to raise fresh capital for approved purposes by selling shares to the public, and the cost of this capital to the borrower, do not depend simply, or even mainly, upon the intrinsic merits of the business. They depend upon the public's estimate of the investment merits of its shares in comparison with those of other comparable securities. But these relative investment merits are measured very largely by the prices at which the new securities are offered, and the comparable existing securities quoted, in the market. More precisely, they are determined by the relative yields, actual or prospective, that can be obtained in interest or dividends on the capital sums that these market prices represent. The cost to a company of raising new capital is not the price at which the new shares are sold to investors, but the effective rate of interest that investors obtain by buying at that price. The 'price' of new capital is the interest yield that has to be offered in order to secure it. Other things being equal, investors will readily accept a lower interest yield from a progressive and promising company than they will demand from a slow-moving and inefficient concern.

THE SIFTING PROCESS

If there is a genuine market equilibrium, so that security prices closely approach to 'true' values, the differences between the yields obtainable will accurately reflect the differences in the real merits of the various businesses they represent. In that case, a good business will be able to borrow cheaply, and thus will be able to afford all the finance it deserves; a less efficient business will have to pay more, and thus may be unable to afford all the finance it would like; and a bad business may find the costs so high as to be entirely prohibitive, so that it gets no new finance at all. Under such conditions, the second sifting process (which in pre-war times was usually the only sifting that took place) will have achieved its object. The bad projects will have been rejected or penalised, and the good will have been graded according to their relative merits.

But suppose the investment markets were not active and free, that unscrupulous people were able to manipulate particular prices for their own ends, or that adequate information were not available promptly and widely. In any of these contingencies, the relative values of securities would no longer be 'true' values, so that the relative yields obtainable from them would be unnaturally distorted. Similar distortions would therefore be caused in the distribution of the flow of savings. The signposts which, in a well-regulated market, show the way along which savings ought to move, would point in the wrong directions. Good businesses would get less, and indifferent or bad businesses more, finance than they deserved. The savings of the community would be misdirected and wasted. In addition, some investors would incur losses which they might otherwise have avoided, and others might reap profits which would not otherwise have been made.

Any such unfairness as between one investor and another is obviously undesirable. Not for a moment, however, should it be supposed that this is the most important evil that may flow from distortion of the security markets. Much more far-reaching is the fact that any misdirection of savings forces the whole community to accept a lower standard of living than it could have enjoyed had its resources been rightly used.

Thus it is that the Stock Exchange is a vital part of the nation's economic equipment. First, it provides the security markets that are indispensable for the mobilisation of the community's savings. Secondly, it is ever-vigilant to maintain free dealings and fair dealings, and the widest spread of information - thereby to provide that kind of market which ensures that the savings are rightly used. These are functions which, so far from being of importance only for the few, add something to the daily fare of every family in the Kingdom - and to many others overseas, too.





THE IMPORTANCE OF A FREE MARKET



AN accident of history, we have seen, explains why the Stock Exchange building is so well hidden from the public gaze. There is nothing accidental about the privacy of the dealings within it. Each of its entrances bears the warning, 'Subscribers Only Admitted'. It is a warning that means what it says, as anyone who tries to elude the vigilant 'waiter' at the door will quickly learn. Stock Exchange men are a light-hearted crowd. They welcome any excuse for good-humoured, even boisterous, raillery. And the detection of an unescorted stranger is, by long tradition, a particularly good excuse. There is a special ritual for such occasions. A lusty shout of '*Fourteen Hundred!*'—a survival, apparently, from the days when House membership numbered 1,399—brings a lively throng to speed the parting guest. He is not detained for long, but quite long enough to make his visit memorable.

Both the privacy and the ritual are characteristic of the Stock Exchange. It is a market rich in tradition, moulded by years of ceaseless change to the needs and temperament of the investing public. British investors are of many types, but mostly, and certainly by contrast with investors in other countries, theirs is a sober temperament, with a bias against both the speculative and the spectacular. This relative sobriety is reflected in the Stock Exchange itself.

It is possible, of course, to speculate in Stock Exchange securities—as, indeed, in almost any other market or business. But the London market offers few attractions for the gamblers. Certainly, it has never set itself out to cater

for them, if only for the reason that they represent no more than a tiny fraction of its clientèle. Since 1939, moreover, the scope even for what is called 'legitimate' speculation has been greatly reduced, as we shall later show. But even before the war the would-be adventurer looked in vain for many of the aids to gambling that other centres provided. It is no accident that the Stock Exchange building has never had a visitors' gallery; that Stock Exchange members are strictly forbidden to advertise; or that the staid offices of London brokers bear no resemblance to the 'clients' parlours' that are popular in Wall Street—places where clients can sit at ease to watch, on screen or board, the minute-to-minute fever-charts of their favourite gambling 'counters'.

BAD FOR GAMBLERS

There is another, and more important, reason why London is not a gambler's market. It is a particularly free and steady market. A gambler thrives, if he thrives at all, on widely fluctuating prices. A man who takes big risks must see the chance of big profits, and these cannot generally be won from small price changes. In short, the gambler usually prefers a 'narrow' market. He will often deliberately choose for his operations a share for which there are rarely many buyers and sellers, and in which business takes place only spasmodically. With such a share, good news will produce a disproportionately big rise in price and bad news a disproportionate fall. But, whether the news is good or bad, the gambler may make a fat profit—provided only that he had rightly guessed which kind of news was coming. Moreover, if the rules of the Stock Exchange were slack, an unscrupulous gambler might not even need to guess. In narrow markets he might find ways to manipulate prices for his own ends.

For the genuine investor, a narrow market is obviously the worst possible kind of market. Unless he is very unlucky (or both very foolish and very greedy) he will escape the snares of the manipulator, for nowadays there are few rogues clever enough to slip through the mesh of any well-organised stock exchange. But in narrow markets the ordinary investor will always tend to pay too much when buying and get too little when selling—at all events if he needs to sell in a hurry.



212 217 218
21 222 223 224
26 227 228 229 230
231 232 233 234 235
236 237 238 239 240
241 242 243 244 245
246 247 248 249 250

8

The London Stock Exchange exists to serve the investor, the inexperienced as well as the expert, the small as well as the big. For many years now it has pitted its wits against those of the unscrupulous few, and set its face against every practice that might prejudice honest business. It watches ceaselessly to make sure that there are no loopholes in its code. But, on a long view, the altering of a rule *here* or the making of a new one *there* are simply the tactics of the war against abuse of Stock Exchange facilities. The grand strategy is to ensure that the markets for securities are wide and free and active. In the clean bright light of free markets the undesirable things shrivel and die.

LONDON'S STEADINESS

London is proud of its reputation as the freest investment market in the world. It deals in some ten thousand different securities, and its job is to 'make a market' in each one of them, to ensure that anyone can buy and sell, not after long negotiation and delay, but any time he pleases. This is a more difficult task than some might think. At moments of crisis, when the public is gripped by fear, there will be many who want to sell and few who want to buy. Unless the market machinery can somehow discourage the former and encourage the latter until the two groups are equal, the market will be brought to a standstill. Once the few buyers have been satisfied, the would-be sellers will be unable to sell. But this is a very unusual happening. Throughout the war, even in its many dark phases, there were few moments when it was impossible to deal in all the principal securities. It is this extreme freedom that makes London a much steadier market than the overseas stock exchanges. Between good times and bad, there are of course substantial changes in prices. But the fluctuations from day to day and month to month are always much less violent in London than in most other centres. And that is also true of the range from the peak of boom to the trough of depression.

This steady reliability, which makes London an 'investment' market as distinct from a 'speculative' one, is not simply a reflection of the temperament of the British investor. The London Stock Exchange is a world market, and in normal times business flows to it from every corner of the globe. The fact that investors in this country are less excitable than those of other countries would not alone save London from the violent ups and downs

that take place elsewhere. And even the phlegmatic British public often acts irrationally. When some major happening—the threat of war, a general election, or a Budget speech—stirs many investors into action simultaneously, they behave very like any other crowd, which sees only black and white and never grey. In a crowd, hope and fear are contagious, and reason takes flight. At such times, the mass selling or mass buying of the public would produce needlessly extreme movements of prices unless the mechanism of the market were designed so as to absorb part of the shock.

The real explanation of London's relative stability therefore lies in the way the market is organised. Especially is it due to a system that is not to be found in any other stock market, the division of Stock Exchange members into two classes—Brokers and Jobbers. Before examining what this means and how it helps to make the market a good shock-absorber, we must look a little more closely at the constitution of the Stock Exchange and the manner in which its membership is recruited. These matters, too, have an important bearing upon the freedom of the market.





IV

HOW THE STOCK EXCHANGE IS GOVERNED



VERY few people know that the Stock Exchange, besides being the market in stocks and shares, is itself a business enterprise that earns profits, pays dividends, and has shares of its own that are quoted on the market. Its present capital is £720,000 in 20,000 shares (£36 paid), with unlimited liability. That is to say, holders may be called upon to provide additional money to an indefinite amount—though not more than £2 per share in any one year—to meet the needs of the business. No dividend was paid during the war years 1939-45, but before the war substantial payments were made.

Only members of the Stock Exchange can hold these shares. That, no doubt, largely explains why the business aspect of the Stock Exchange rarely comes to the notice of the general investor. His interests, in any case, are only indirectly involved. What matters to him is the efficiency of the Stock Exchange as a market, not its prosperity (or the reverse) as a business. To protect his interests, all he needs to do is to satisfy himself that the Stock Exchange never puts business profits before market efficiency. And he can do that very easily—by examining the constitution of the Stock Exchange.

There was a time when the constitution would not have provided the answer. When the Stock Exchange building was owned and managed only by an exclusive few, as in the earliest days, it certainly could not be taken for granted that the interests of the proprietors would automatically coincide

either with those of Stock Exchange members as a whole or with those of the general public. Stock Exchange proprietors and Stock Exchange members then were by no means the same groups of people.

Since 1904, however, every new member has been obliged to acquire at least one share in the undertaking, though it may be noted that nobody can hold more than two hundred. Now, therefore, nearly all members of the Stock Exchange are also 'proprietors'. As members, they pay the fees that provide the main income of the business. As proprietors, they receive the dividends that their own payments have made possible. Moreover, the livelihood of members depends on their individual business activities as brokers or jobbers, not on their shares in the Stock Exchange. They live by serving the market. Not only the public duty of the Stock Exchange, but also the ultimate self-interest of its members, demands that market efficiency shall at all times dominate Stock Exchange policy.

Until quite recently, however, the arrangements for management of the Stock Exchange have firmly maintained the formal distinction between its business and its market aspects. For more than a hundred and forty years the business was run by the Board of Trustees and Managers, representing the proprietors, and the market by the Committee for General Purposes, representing the members. Now this dual control is disappearing. The constitution of 1802 is undergoing its first really sweeping change.

THE NEW COUNCIL

On March 25th, 1945, the two traditional committees were merged into a single governing body, responsible for every aspect of Stock Exchange affairs. This new body is the Council of the Stock Exchange, which is recruited from the general membership of the 'House'. Not more than nine members of the Council are elected by the proprietors, and are called 'foundation' members. Not more than twenty-eight (eventually twenty-seven) are elected by the members of the Stock Exchange, and are known as 'ordinary' members (of the Council); one-third of them retire each year, and the vacancies are filled by a ballot of Members. The Councillors, it may be noted, are all unpaid – despite the heavy and ever-growing load of responsibility and work that their duties impose.



Closing the vast doors of the strongroom. Here securities are carefully locked

The two streams are mingled in a single pool, though their separate sources can still be seen. Eventually, no doubt, they will be indistinguishable. But the final step has been deferred pending the return of the hundreds of Stock Exchange men from the Forces. It would not have been fair to alter the traditional system irrevocably while they were away, however certain it seemed that they would approve. For this change, formal though it may seem, is an important matter. Its practical significance is that it enables the Stock Exchange to present a single front to the world, thereby providing a fitting foundation for the wider responsibilities that wartime – and now peacetime – controls have imposed upon it. Already, it is facilitating the task of post-war reconstruction. Its symbolic significance is hardly less important. A system of government appropriate to a private undertaking, serving simply the interests of its constituents, has given place to one that befits a public institution. It has been put beyond doubt that the whole purpose of the Stock Exchange is to provide an efficient market – and, by so doing, to serve the public interest.

V

BROKERS AND JOBBERS



WHAT, now, of the Stock Exchange members themselves? Good generalship will not alone make a good army, nor good management alone an efficient market. That depends no less upon the quality of its rank and file. They must be men of integrity, experience, and business acumen. Their job is to serve the public, and through service to earn profits for themselves. But, lest profits be put before service, they need to be kept on their toes by a healthy spirit of competition within the market and a knowledge that, if their job is not well done, others may come from outside to take it from them.

This spirit of freedom and competition is one that the London Stock Exchange has always sought to foster. It excludes non-members from its premises, but never has it tried to set arbitrary limits to its membership. Any suitable person can become a member, and men who have had proper training in the ways of the market can do so at relatively low cost—low, that is, in relation to the financial responsibilities that the profession of stock-broking or stock-jobbing necessarily involves.

The popular belief that stock-brokers are rich has some foundation in fact. But the cartoonists' picture of wealth, cigars and ease is one that often brings

a wry smile to the worried countenance of many a stock-exchange man — despite his enviable capacity for taking cares lightly. The truth is that there are some rich stock-brokers, just as there are rich doctors and rich accountants. But the rules of admission to the Stock Exchange have for many years put experience before resources. The music-hall version of the 'typical' stock-broker is now very wide of the mark. A large proportion of members have graduated through the rough school of experience and hard work, and were certainly not born with silver spoons in their mouths.

The admission rules deserve closer examination. To travel along any one of the three roads into the Stock Exchange, a man must be British-born* and at least 21 years old, and must undertake, if elected, not to engage in any other business.

Of the three roads, only one — let us call it the 'high' road — is open to a man without approved experience. His first step must be to acquire a Stock Exchange 'nomination' (originally, this simply meant the right of a member to nominate his successor) from a retired or deceased member. The supply of nominations is therefore not unlimited, and at times of great activity in the markets the demand for them has been so great that their price has risen as high as £2,000. At present it is around £200.

Secondly, he must persuade three existing members to act as his 'sureties'; that is, to undertake to pay £500 each to his creditors if he should default on his obligations within four years. The end of that period, when the new boy comes safely 'out of his sureties', is always a fitting occasion for celebration — and of hospitality for the relieved guarantors. Thirdly, he must buy (and hold throughout his membership) three shares in the Stock Exchange, which early in 1947 cost about £180 each. Fourthly, he must pay an entrance fee of 600 guineas, and an annual subscription which, since 1920, has been fixed at 100 guineas.

ELECTION FOR ONE YEAR ONLY

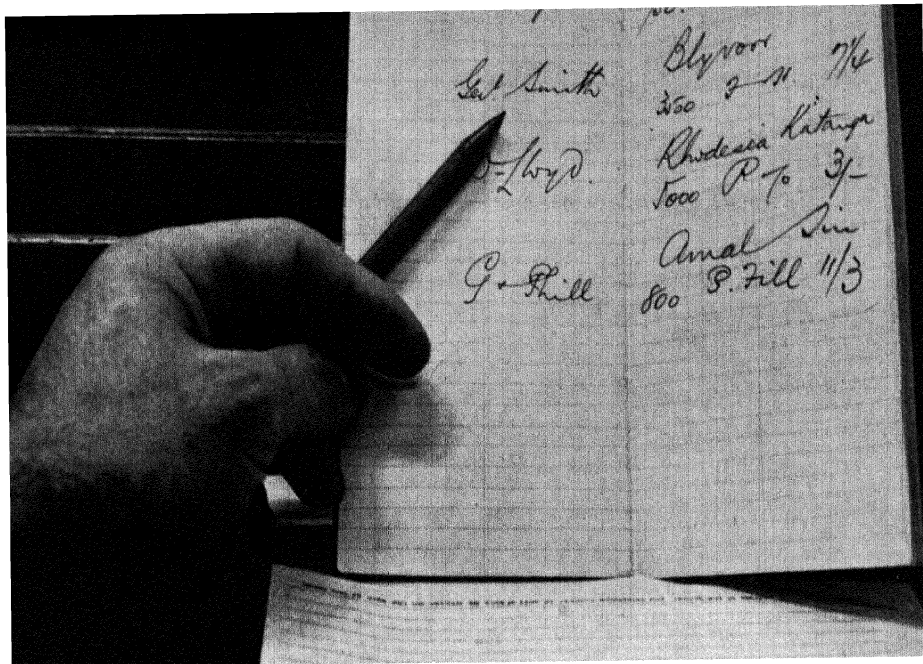
The candidate's ability to find these substantial sums, totalling over £1,400 (quite apart from the sureties), will not, however, ensure him a seat

* Except that the Council may exercise discretion in favour of naturalised British subjects of at least five years' standing.

automatically. He, like all other candidates, must disclose full details of his previous career; must submit to a personal examination by a committee appointed by the Council; and then must secure a three-quarters majority in a vote by the Council itself. Moreover, membership will be granted for one year only. Every member has to be re-elected annually, and the Council is empowered to reject any application, whether for election or re-election, without giving reasons for its decision, which is final. It will be seen, therefore, that the Stock Exchange authorities not only have the means to exclude from membership people of doubtful character or unsatisfactory business records, but hold in their hands a very powerful weapon for preventing any kind of abuse by members themselves. If a member misconducts himself, even if he does not go so far as to break specific Stock Exchange rules, the Council can deprive him of his livelihood as a stock-exchange man.

What might be called the middle road is the most common route into the Stock Exchange. It is available to employees of stock-market firms who have worked on the actual trading floor of the House. Employees who are thus privileged are either 'authorised' or 'unauthorised' clerks. The former, a person of standing, is so-called because he is authorised to deal on the market. Indeed, except that he deals as agent for his employer and not for his own account, he enjoys virtually the same privileges as a full member (and, in fact, often *is* a member). An unauthorised clerk fills a more humble rôle: he is not permitted to deal, but is allowed on the trading floor for the purpose of getting quotations or taking messages, and thus provides a vital link between the broker's office and the actual market-place. To prevent overcrowding, he is expected to do his job quickly and then leave the House. The distinctive blue button worn in his coat lapel serves not only as a ticket of admission, but as notice to House officials that he ought to be outside unless he is obviously fulfilling a commission for his employers. It also distinguishes him from the 'red-button' clerks, who serve their employers in the great Settling Room below the 'floor' of the House.

Clerks that have served in these capacities for four years, and have been either unauthorised or authorised clerks for three of them, may become full members on easy terms. They have to face the usual election formalities, and must also acquire a nomination. But the number of sureties required is two



This little notebook records the thousands of pounds of the Jobber's transactions with various Stockbrokers

instead of three, and the amount £300 instead of £500 each. They are known as 'two-deckers', whereas those who enter by the high road are 'three-deckers'. They need buy only one Stock Exchange share (instead of three) and both their entrance fee (300 guineas) and annual subscription (50 guineas) are at half the rates charged to three-decker members. The initial outlay for a candidate who has served his apprenticeship is thus about £750, but many a valued clerk gets in for much less than this, because his employers are glad to find some of the money for him.

The third road is the cheapest of all, but it is also the longest. Clerks with four years' experience may join the Council's special Waiting List, and wait their turn for the privilege of becoming members without having to purchase a nomination, thereby reducing the initial cost (at present) from about £750 to around £500. This device not only gives special chances to men with good experience though limited means, but also enables the Council to influence the total membership of the House. Its disadvantage to the candidate is that the Waiting List is generally long, whereas the number elected from it each year, though variable within quite wide limits, is relatively small. It is rarely as high

as fifty. Members elected on these easy terms therefore form only a small minority.

Total membership of the House is larger than most people imagine, though by no means large in proportion to the huge volume of Stock Exchange transactions. It is, moreover, much smaller than in former times. Throughout the nineteenth century the House grew rapidly, and membership increased tenfold, reaching an all-time record of almost 5,500 in 1905. On the eve of Hitler's war it was down to 4,100, and during the war dropped to 3,560, with 1,310 members in the Forces. Now, after a year of post-war transition, it has recovered to 3,850, and is still rising.

At the end of 1946, the membership was grouped into 635 separate firms (144 fewer than before the war), each of which has its office as close to the Stock Exchange as it can get; it must not, in any case, go beyond the City boundary. The partners of these firms must all be full members of the Stock Exchange, and big firms often include additional members acting for them as authorised clerks. Each partner is liable for the whole amount of the firm's debts, up to the limit of his private resources, for 'limited liability' partnerships or companies are prohibited. There have been instances recently of firms registering themselves as companies, but these are 'unlimited' companies, so that the essential protection for the public remains unimpaired.

It has been said that members of the Stock Exchange, and firms too, are of two kinds. They are either Brokers or Jobbers, and each member on election or re-election must declare which he intends to be. The distinction between the two will be most easily grasped when we take a tour round the market and listen to members at work, as we do in the ensuing sections. Here all we need do is to note three fundamental differences.

TWO KINDS OF MEMBERS

Brokers are the only Stock Exchange members who deal direct with the public. If you want to buy or sell securities, you go to a broker, who becomes your agent for executing your order on the market. And because brokers have clients of every sort and kind, each one of whom may want to buy or sell any one of ten thousand different varieties of securities, every broker must be prepared to do business in the whole range. He is a general practi-

tioner, but, like some medical practitioners, often finds that the nature of his clientèle leads him to perform some kinds of operation more frequently than others. Thus it is not quite true to say that brokers, though open to do all kinds of business, are never specialists in particular categories of securities.

The jobber, on the other hand, is a specialist by nature. He is like a wholesale merchant, but one who both buys from and sells to the retailers. He stands ever ready to supply the brokers with, or to take from them, any of the particular class of securities in which he deals. He may specialise in Government securities, or Bank shares, or Mining shares, or in any one of a score or more of other groups. He never deals direct with the public, but works always through the brokers, on the brokers' initiative. He makes his living from the difference between the prices at which he buys and sells, but keen competition from other jobbers specialising in the same securities (or, as the phrase goes, in the same 'market') usually ensures that it is a small difference. And at times the swing of prices puts the balance on the wrong side. The broker, by contrast, gets a fixed return, as befits an agent. His income takes the form of commission, the amount of which is regulated by Stock Exchange rules, is paid by his customer and varies with the size of the order he executes.

The three differences must be kept firmly in mind by all who would understand the workings of the market. Let us repeat them briefly. The broker deals direct with the public (and, of course, with the jobbers), whereas the jobber deals only with brokers or with other jobbers. The broker is a general practitioner, the jobber a specialist. The broker lives by commissions or 'brokerage', and is the agent of the public, whereas the jobber is a dealer who lives by the 'turn' he makes between the prices at which he buys and those at which he sells.



VII

A TOUR AROUND THE HOUSE



NOW, at last, it is time to watch the Stock Exchange in action. Like good Stock Exchange clerks, we have had to learn something of the ways of the market before venturing upon the actual floor of the House - and perhaps have waited no less impatiently for the privilege.

So come, without more ado, through one of those narrow doorways, paying no heed to the curious but good-natured glances of the habitués who brush briskly past us as we enter, and penetrate to the very heart of the Stock Exchange. Two things strike us at once. Having been told that space in the House is cramped, we are astonished at its size. The trading floor, extended successively as business demanded and circumstance dictated, is irregular in shape, surmounted by a vast dome. Though broken up by massive pillars and a dozen pulpit-like stands towering above the throng, it is at once seen to be very large.

Our second impression is one of bewilderment. The floor is crowded, and humming with activity. Several thousand members and their clerks can make a deal of noise, even on 'quiet' days. But we are conscious that this is not just the noise of a crowd. There is an urgent insistency about it, and a pulsating rhythm, like the throb of machines - many machines - in a big factory. And above the general clamour there rises every so often a stentorian shout from a 'waiter' in one of the pulpit-stands. We perceive, as we look a



Seen from the dome gallery, the floor of the House looks confused, unplanned. Actually, each group of Members represents from long tradition one particular kind of market

little closer, that he is not only a very active waiter but also a highly mechanised one, with an array of telephones, speaking-tubes and conveyor channels and a battery of perhaps fifty electric switches. We see, too, why it is that electric light signals are twinkling in and out all over the House. Above each 'stand,' in a glass-panelled frame, is a set of consecutive numbers that spring to life as the waiter plays on his switches. Each of these numbers, we learn, is in effect the House 'address' of a stock-market firm. A shout from the waiter, or a signal on the panel, tells of a message, from near or far, awaiting the firm whose number has been 'rung'—there is a caller at Door No., a cable from New York or Johannesburg (delivered direct from the Post Office through the conveyor channel), or simply a call on the private telephone from the broker's office across the way. Thus is the House efficiently and continuously linked with all parts of the world. We are no longer in doubt that the hum we hear is the hum of business—eager and organised business.

Yet, at first glance, there is little that seems organised about the behaviour of the crowd itself. It is active, certainly. The benches around pillars and walls, and on the floor itself, find few occupants. Almost every man is on his toes, literally and (we feel sure) metaphorically. The whole throng seems to be in motion, but it is hard to discern a pattern in its movement. Could we but see it from the gallery round the great dome, we might well imagine that we watched, as one member has put it, an ant-hill into which a stick has been thrust. But there *is* a pattern, and slowly we discover what it is. Men come and go all over the House, threading their way in, out and around the thicker clusters. But most of these clusters, though changing in size from moment to moment, and though some are larger than others, remain always in the same place.

JOBBERS ON THE JOB

Each of the clusters is one of the 'markets' of the House, the spot where jobbers dealing in the same group of securities always assemble. Every jobber, like a stall-holder in a street market, has his customary pitch. There every day he sets up shop, but needs neither stall nor barrow to carry his wares; and there he stands till the day's trading is done. In common with a dozen or more competing jobbers on adjacent pitches, he is prepared at any moment to buy

or sell the particular stocks in which he deals, and to state, without equivocation or an instant's delay, the terms upon which he will do so. It is the same with every other market in the House. Though the boundaries between them are fixed by nothing more tangible than habit—and in active sections, when the press around the jobbers is great, may be quite indistinguishable to the uninitiated—the markets are all definitely localised.

This system saves time and money, and contributes greatly to the freedom and efficiency of dealings. The competing jobbers in each group, being usually in close proximity, well know what prices their rivals are quoting, and can shrewdly guess the extent of their operations. Thus are supply and demand accurately assessed at any moment, and only minute variations in prices are possible from firm to firm at the same time. If the jobbers in a particular security were scattered all over the House, or wandered about from place to place, the broker with a client's order to execute would not only waste much time in finding them, but would probably get quite different quotations from each. However diligent he might be, he would never be sure that he really was dealing on the best possible terms, as it is his duty to do.

CONSOL MARKET

Before enquiring how dealings actually take place, let us first take a rapid tour around the various markets. If we start from Capel Court, at the oldest part of the House and the end nearest the Bank of England, we come at once, appropriately enough, to the so-called Consol market. 'Consols', of course, means British Government 'Consolidated Stock', and the Consol or Gilt-edged market is the market in British Government issues and a number of stocks customarily grouped with them. In this part of the House you can buy or sell securities representing the borrowings of every Dominion, Colony, and many cities of the British Empire. And though the jobbers in this market, as in all others, will deal in quite small quantities if asked, the total volume of their transactions makes up a very large proportion of the whole vast turnover of the House.

Turning towards the Throgmorton Street side, we pass on through the sedate markets in Bank and Insurance shares, and those in the numerous stocks of the Home and Empire Railways (where dealers, when time permits, are keenly debating complex issues of nationalisation). And so we come to the

American market. Here, in normal times, there are often noisy scenes of the greatest excitement, especially around 3 o'clock, the time corresponding to the morning opening of the New York stock exchange. This market, it may be observed, often finishes its day's work in Shorter's Court outside the House, because Wall Street is open for some five hours after the official closing-time in London.

Then comes the market for Foreign Government bonds, scene of much animation in the days when Britain was financier to needy Governments throughout the world, but quiet and depressed for a decade and more, though now expectantly watching the prospect of world rehabilitation. On, then, to the light of the great dome, home of the markets in shares of the myriad of mining enterprises that London has financed (and managed, too) in all parts of the world. Here, in turn, we find the South African mining market (formerly, and too familiarly, dubbed the 'Kaffir Circus'); the Rhodesian, Canadian, Australian and Miscellaneous mining markets; and, on the Old Broad Street side, the West African market, or 'Jungle' —markets where men dwell in a mysterious world of mining technique, with a jargon more forbidding even than that of finance. The layman is more concerned with pence than pennyweights, yet, however ignorant of the technique, he often finds it hard to resist the lure and romance of the mines. But those who stand beneath the dome have no monopoly of romance, as we soon find as we pass quickly back (via the Tea market and that for Foreign Rails) to the Rubber market — a section depressed now by Japan's treachery and America's counterblast, a huge synthetic industry; but one that has seen big fortunes lost and won in the heyday of plantation development.

And so to the great Industrial markets—Textiles, Breweries, Motors and Aircraft, Tobaccos, and the like—which occupy most of the centre portion of the House. Here we might linger long, on familiar ground, and among names that are household words. That brings it home to us that in the business the jobbers are doing, in the intangible 'market' their higgling creates, is the barometer of the financial prospects of every section of British industry. But time presses . . . reluctantly we turn away, skirting the Oil share market as we go, back to the market in Bank shares; and so, like Omar, to leave by the same door as in we went.

VIII

EXECUTING A CLIENT'S ORDER



PEOPLE who have had little to do with stocks and shares are often puzzled by the fact that Stock Exchange quotations, which they see in the City columns of their newspapers, usually give two prices for each security. The explanation is quite simple. It is also very important, for the double price is the very foundation of the Stock Exchange method of doing business. A dealer in stocks and shares, unlike the ordinary wholesalers or retailers of commerce, is prepared either to buy or sell. Moreover, when fixing his price, he usually doesn't know which he will be asked to do. The jobber, therefore, has to quote two prices, one for buying (known as the 'bid' price) and one for selling (the 'offered' price). This is called 'making' a price.

If a jobber makes a price of $103\frac{1}{2}-\frac{5}{8}$ for $3\frac{1}{2}$ per Cent. War Loan, this means that he is prepared to pay £103 10s. for each £100 of War Loan Stock offered to him or to sell it at £103 12s. 6d. per £100 of stock. The selling price is, of course, always above the buying price, and the difference between the two is known as the jobber's 'turn', from which he hopes to get his profit. In this particular case, it is only one-eighth of one per cent.—a mere half-crown per hundred pounds. That is because the market for gilt-edged securities is very free and active: jobbers in this market have so large a turnover that they can afford to quote very narrow or 'close' quotations, though the



width varies from time to time. In other markets—in Industrial shares, for example—the spread is wider. Broadly speaking, the more restricted the market and the less frequent the dealings, the wider is the quotation.* But even where the quotation is narrow, it happens only infrequently that the jobber is able to deal in such a way as to secure the full ‘turn’ as profit.

The simplest way to understand how the system works is to follow through an actual transaction. Suppose you have come into money, and are minded to invest in the Harridges Stores Company. You have had a little to do with stocks and shares before, and know where to look in your morning newspaper for the previous day’s price. Here it is, under ‘Industrials’—

* An exception may be noted here. For shares that are so infrequently or so spasmodically dealt in that there is not, in any true sense, a ‘market’ in them at all, jobbers generally abandon the double quotation altogether, and quote only a single price—either ‘bid’ or ‘offered’, according to the state of demand or supply at the moment. In such conditions, the market is said to be ‘one-way’. In the most extreme case of all, when it is quite uncertain whether and on what terms buyers (or sellers) of a particular security will be forthcoming, there may not even be a one-way quotation. Business then is a matter for negotiation.

1946

STOCK EXCHANGE

STOCK E PR

A GENERAL DECLINE

Although the gilt-edged market did not look like rallying around midday, no support was forthcoming and prices eased again to close at the lowest levels of the day, another $\frac{1}{4}$ to $\frac{1}{2}$ down. This set the tone for the rest of the House, prices generally giving ground on fairly wide-spread small offerings, some of which were induced by talk about whether the sustained upward movement in prices had reached a peak. There were a few notable exceptions to the decline in the industrial market. Markings numbered 12,088, against 10,751 on Thursday last week.

Gilt-edged jobbers again took stock on their hooks, although some of them doubted whether the offerings were as large as on Wednesday. The impression in the market was that the selling was mainly for reinvestment in the "tap." Peruvian issues remained a firm feature in the foreign market, but Japanese, Chinese, Brazilian, and European bonds were all heavy. Some of the Argentine railway prior charges showed a rallying tendency, although the market in general remained dull. Antofagasta Preference improved further to 50 $\frac{1}{2}$. The home railway market remained quiet; some of the junior issues picked up a little.

The weaker tendency reached almost all groups in the industrial market. Declines of around 2s. were recorded in such leaders as Woolworth (95s. 6d.), Associated Cement (71s. 3d.), and Leyland Motors (108s.), and smaller falls were numerous. Dunlop Rubber, after being fully steady earlier in the day, reacted to 74s. 6d. Cunard provided one of the exceptions to the general tendency at 34s. 4 $\frac{1}{2}$ d., and in the heavy industry group Barrow Hematite advanced to 26s. 6d. and Lambert Brothers continued their advance to 74s. 3d. Anglo-Newfoundland Development were weak at 3 $\frac{1}{2}$. Broadcast Relay improved to 29s. 7 $\frac{1}{2}$ d. Dollar stocks followed the weaker tendency in New York.

The heaviness in the oil market was unrelieved, with Shell back to 49-16. The tea group hardly maintained their recent firmness and rubber shares were dull. The South African market showed no definite tendency. O.F.S. leaders improved in the morning, but closed below the best levels. A strong feature of the Far West Rand issues were for some of

THE MARKET DAY BY DAY

The City page, and especially the Exchange report, has a technical jargon all its own. The layman forgiven if he finds it a little forbidding. But if he tries to follow the market by day, he will quickly learn its essentials, especially if a more knowledgeable or fellow traveller can supply a few pointers during the early readings.

1 On this occasion, the investment was in uncertain mood and prices sagging. But the jobbers in the market came to the rescue, and by buying part of the stock sold by them limited the fall in prices.

2 The 'tap' here means the Government offer of 23% Savings Bonds when previous 'tap' issues, were available times 'over the counter' at the instigation of any stockbroker. On this occasion, it seemed that investors preferred to invest its surplus cash in new securities rather than by buying securities on the market and was actually selling its existing holding to 'switch' into the new loan.

3 This refers to the number of actually marked by the handing in to officials in charge of the marking. The total is larger than the number of bargains recorded in the Stock Exchange Official and Supplementary Lists in these only one entry is made for at any given price, no matter how many bargains are actually done at that price.

4 The words 'dull', 'weak' and 'sagging' indicate, in varying degrees, that the market is sagging or tending to sag. The words 'bright', 'firm' and 'strong' indicate when prices are rising or when there is a strong upward tendency.

5 This is the market in South African mining shares, and 'O.F.S. leaders' refers to the principal gold mining ventures.

BRITISH
Security

Consols	21 $\frac{1}{2}$ %
Do.	4 $\frac{1}{2}$ %
War Loan	3 $\frac{1}{2}$ %
Do.	3 $\frac{1}{2}$ %
Standing Loan	4 $\frac{1}{2}$ %
Do.	59-69
Do.	56-61
Do.	52-57
Victory Bonds	4 $\frac{1}{2}$ %
Conversion	4 $\frac{1}{2}$ %
Do.	48-49
National Defence	2 $\frac{1}{2}$ %
Do.	3 $\frac{1}{2}$ %
Nat. War Bds.	2 $\frac{1}{2}$ %
Do.	49-51
Do.	51-53
Do.	21 $\frac{1}{2}$ %
Do.	54-55
Exchange	13 $\frac{1}{2}$ %
Savings Bds.	3 $\frac{1}{2}$ %
Do.	960-70
Do.	965-75
2 $\frac{1}{2}$ % Redemption	
Local Loans	3 $\frac{1}{2}$ %
Treasury	4 $\frac{1}{2}$ %
Newfoundland	3 $\frac{1}{2}$ %
Do.	3 $\frac{1}{2}$ %
Do.	56-60
Do.	58-61
Do.	51-54
Do.	51-54
Metropolitan	3 $\frac{1}{2}$ %
Do.	4 $\frac{1}{2}$ %
Metropolitan	3 $\frac{1}{2}$ %
Port. of Lond.	3 $\frac{1}{2}$ %
Do.	3 $\frac{1}{2}$ %
Central Elect.	3 $\frac{1}{2}$ %

Security

Australia	3 $\frac{1}{2}$ %
Do.	58-60
Do.	61-64
Do.	65-68
Do.	69-72
Do.	73-76
Do.	77-80
Do.	81-84
Do.	85-88
Do.	89-92
Do.	93-96
Do.	97-100
Kenya	2 $\frac{1}{2}$ %
Do.	55-57
N.S.W.	2 $\frac{1}{2}$ %
Do.	31-32
Do.	33-34
Do.	35-36
Do.	37-38
Do.	39-40
Do.	41-42
Do.	43-44
Do.	45-46
Do.	47-48
Do.	49-50
Do.	51-52
Do.	53-54
Do.	55-56
Do.	57-58
Do.	59-60
Do.	61-62
Do.	63-64
Do.	65-66
Do.	67-68
Do.	69-70
Do.	71-72
Do.	73-74
Do.	75-76
Do.	77-78
Do.	79-80
Do.	81-82
Do.	83-84
Do.	85-86
Do.	87-88
Do.	89-90
Do.	91-92
Do.	93-94
Do.	95-96
Do.	97-98
Do.	99-100

ISSUE

subscription
Per Cent.
at 21s. 6d. a
Company
Monday.
to a public com-
manufacturing
as equipment for
businesses were
The main work
peace-time produ-
is now being
increased.
the war years and
the post-war refund
laying regard to the
last, to the large
the fact that the

Harridges, 52/6... +3d., which you know (though the paper doesn't say) refers to the £1 Ordinary Stock units of the Company.* This particular newspaper chooses to give only one price, the 'middle' price between the buying and selling prices, which has risen by 3d. during the day. You guess (and guess rightly) that the jobbers at the close of business were actually quoting something like 52s. 53s. As the price had been rising on that day, you fear that you may have to pay anything between, say, 53s. and 53s. 6d. for the units, but are definitely not prepared to give more than 53s. 9d. You ring up your broker forthwith, and instruct him to buy for you 500 *Harridges*, with a limit of 53s. 9d.

PLAN OF CAMPAIGN

The broker's notebook, known as his dealing book, contains already a list of orders (some perhaps much larger, but many smaller, than yours) received that morning by post, 'phone or cable. He adds yours, and quickly surveys his dealing programme. Many of the securities on his list enjoy an active market, and he well recalls the course of dealings in them on recent days. But there are a number that he himself has not handled for some little time, and others which are so inactive that there may have been no dealings in them at all for some days, or even weeks. To refresh his memory about these, he turns to the price-lists issued overnight by the Stock Exchange authorities, and scrutinises the 'markings' in the securities in question. These daily Lists, 'Official' and 'Supplementary' the reason why there are two will emerge later--show not only the 'closing' market quotation† for each security, but also the price (or 'mark') at which each recorded bargain took place, and, for inactive stocks, the date and price of the last bargain. Study of the Lists, in the light of the broker's market experience and knowledge of the particular securities involved, quickly gives him an accurate picture of the background against

* Stock units, by the way, are for most practical purposes exactly the same as shares. Originally, stock was distinguished from shares by the fact that it could be dealt in for odd amounts and was quoted at so much per cent. This is still true of the stocks of Governments, Municipalities, public corporations, and many old-established companies, as well as of debentures as a class. But, whereas the ordinary capital of most trading concerns was formerly almost invariably in the form of shares, in recent years many important companies have turned their ordinary shares into stock (in order to avoid the complexities which arise from the serial numbering which is obligatory for shares). In such cases, £1 shares usually become £1 stock units, which are both quoted and dealt in as such.

† In order that the Lists can be printed in time for issue in the late afternoon, the 'closing' prices have at present to be those ruling shortly before the official close of business in the House.

which he is to deal. Thus equipped, he hurries across the road to the House.

He will take first his orders in active stocks, and yours will be one of them, for Harridges are on the move. When your turn comes, he will thread his way at once to the group of jobbers in that part of the Industrial market known as the 'Stores' section. But he will not usually rush in to deal forthwith. Instead, he pauses for a moment, listening to the business that is in progress, and noting especially the prices shown on the boards that leading jobbers exhibit above their pitches. This preliminary reconnaissance is of particular value. Together with the background survey, it speedily enables the experienced broker to get the 'touch' of the market. He feels its pulse, as it were, and listens to its heart-beats, before he starts to operate.

The broker now has a pretty definite idea of the price at which he ought to be able to carry out your order. He approaches one of the leading jobbers, with the simple query, 'Harridges?' The jobber replies at once, and no less briefly, 'Two-and-six, three-and-six', meaning that he would buy at 52s. 6d. or sell at 53s. 6d. -the 'big figure', in this case 'fifty', is almost invariably taken for granted as a matter of common knowledge. Your broker nods, and turns away to the next jobber. Fifty-three and six, though 3d. below your limit, was definitely not good enough when measured against the previous day's list and 'marks'. The broker's instinct tells him that he may do better.

‘500 AT THREE-AND-THREE’

Jobber Number Two, after some preliminary banter (designed, without success, to trap his enquirer into revealing whether he wants to buy or sell), quotes 52s. 4½d.-53s. 4½d. But still the broker isn't satisfied. He asks the jobber to 'come closer' which means, not a prelude to a dark conspiracy, but simply that he wants a narrower price. The jobber knows your broker as a tough bargainer, and doesn't want to lose the business. But he himself is at that moment more anxious to buy than sell, and is definitely not prepared to reduce his selling price. So he narrows the quotation from the lower end by responding, 'All right, seven-and-a-half, four-and-a-half'; in other words, 52s. 7½d. - 53s. 4½d. That, of course, is no improvement from your broker's point of view. So he tries again.

Often, indeed, a broker will 'check his market' with as many as six or eight jobbers before dealing. But, this time, the third attempt succeeds. Jobber

Number Three, after an equally terse interchange, narrows his price from 52s. 3d.–53s. 3d. to 52s. 6d.–53s. 3d. So he, too, wants to buy rather than sell. That convinces your broker that he cannot do better than 53s. 3d. and may do worse if he delays, for the market trend is plainly upwards. Indeed, he is well pleased to have secured an offer at 3d. below the first jobber's quotation and 6d. below your limit. He clinches at once. 'Buy 500 at three-and-three', he says, and turns away to negotiate his next order, noting the bargain in his dealing book as he does so. Jobber Number Three does the same in *his* book, and turns to the next man in the press of brokers around him.

BY WORD OF MOUTH

A little while later—if his other orders are very absorbing, it may be some time later—the broker or his clerk (and perhaps the jobber's clerk as well) will 'mark' the bargain. That is to say, he fills up a marking-slip, by writing simply 'Harridges Ord., 53/3' followed by his name, and delivers it at the counter before one of the marking-boards displayed in various parts of the House. If this is the first marking of the day at that price, the official in charge will add it to the Harridges prices already shown on the board. The whole series of 'marks' will later be reproduced (in the order of marking, which is not necessarily that of the bargains themselves) in the 'Business Done' column of the Official (or Supplementary) List for the day. It will be seen that the marking, important though it is as material for the statistical record of market trends, is in no sense a memorandum of the bargain as such. The only record of that is the entry in the notebooks of the two members concerned.

In this informal way, the bargain is struck. As a result of the swift interchange between your broker and Jobber Number Three, another investor quite unknown to you (who, by a similar process through *his* broker, has sold Harridges) will soon transfer to you stock worth over £1,300. The formalities would have been no greater even had the amount involved been ten times as much, though the interplay between broker and jobber would have followed a different and more subtle course. In particular, the broker would have indicated at an early stage the quantity in which he wanted to deal: where no figures are mentioned, the jobber's quotation binds him only for quantities

which, by market custom, are 'marketable amounts'. If the amount were really large, the broker might also have to 'open' to the jobber—that is, to state whether he was a buyer or seller—but he would always try to avoid doing so until the brief negotiation was well advanced. Other niceties of big deals need not concern us here. The point to note is that whether the bargain is small or large, no written confirmation of it ever passes, either at the time or afterwards, between the immediate professional parties.

On the Stock Exchange, it will be seen, a man's word really is the same as his bond. Mistakes occur sometimes in the flurry of dealing when markets are active. But it very rarely happens that they cannot be settled amicably between the members concerned. And even in that case the private investors will be protected: the loss, if any, will be borne by the brokers or jobbers, or shared between them. Moreover, if you were to default in payment for the stock you have ordered, your broker would still have to fulfil his bargain with the jobber. The investor who was to have sold to you would still get his money on the due date.

The business of completing the transfer of the stock from the seller to you presents formalities which, to the uninitiated, look rather formidable. Actually, they will not be allowed to trouble you, for it is your broker's responsibility to attend to them. But they do create a deal of work for his office staff, as well as for the Stock Exchange authorities. We will shortly examine how the matter is arranged. But we are not yet ready to leave the trading floor. These complications of transfer of stock and settlement of bargains are strictly 'office' matters, and an elaborate code of rules is especially designed to ensure that the inherent complexity of Stock Exchange business never obstructs the trading floor or impairs the essential simplicity and freedom of actual dealings.

MARKET LIMITS UPS AND DOWNS

Let us return, then, to the jobber from whom your 500 Harridges have been bought, at the keenly negotiated price of 53s. 3d. The jobber in some ways resembles the wholesaler of commerce, but he is not a warehouseman who keeps a substantial stock of the goods in which he trades. When prices start to fall, and private investors as a group are, for the moment, sellers

rather than buyers, the jobber finds it hard to avoid taking stock 'on his book', as the market phrase goes. Indeed, therein lies the value of the jobber. By absorbing stock when outside sellers predominate, and holding it until buyers come along, he steadies the market on the fall. But even if he wanted to absorb large quantities of stock at such a time, his capacity to finance it - that is, to take delivery of it and pay for it - is not unlimited. He dare not overstrain his finances. Thus, when the public suddenly turns seller, he is obliged to protect himself by lowering his prices. This has the double effect of tending to discourage sellers and of encouraging the more hardy type of outside investor to buy. Experienced operators know that every fall, like every rise, tends to be overdone before it exhausts itself; and there are almost always some, especially among the outside professionals, who are prepared to support the market after any substantial fall. Hence the jobber, by lowering prices, succeeds in lightening the excessive load on his book.

Conversely, when prices start to rise, and the public is buying rather than selling, the jobbers are hard put to it to keep pace with the demand. As one broker's order after another turns out to be a buying order, the jobber may soon find that he has sold more stock than he has on his book. If this had happened when your broker bought your 500 Harridges, the jobber will have to do some quick thinking to avoid loss. When 'coming closer', by quoting 52s. 6d. - 53s. 3d. instead of 52s. 3d. - 53s. 3d., Jobber Number Three probably hoped your broker was a seller and thought to attract him by the resultant threepenny increase in the 'bid' price. Instead, he has contracted to deliver a further 500 units. He finds that this leaves him 'short' of, say, 300 units; that is to say, the total of his sales of Harridges units during the morning exceeds by that amount the total of his purchases plus the quantity on his book at the close of the previous day's business.

Unless he is pretty confident that a reaction in prices is imminent, he will lose no time in making good the deficiency. When next asked to make a price in Harridges, he not only maintains his buying price at the increased level of 52s. 6d. but restores his 'turn' to 1s., quoting 53s. 6d. as his selling price, hoping to choke off buyers for the time being. He succeeds in this, for the enquiring broker simply passes on. But it quickly becomes apparent that other jobbers, taken unawares by the sudden wave of public demand, are also short of Harridges. Competition then becomes keen. The rival jobbers, each

anxious to 'level' his book before the rise in prices involves him in loss, vic with one another in their efforts to attract sellers to come in. Until that happens, prices rise more steeply, and jobbers resolutely decline to narrow their quotations. In the end, the jobber who sold to your broker at 53s. 3d. will consider himself fortunate if he is able to buy the shares in the market at any lower average price than that, and so avoid actual loss on the deal.

In practice, of course, dealings in active securities are not often as difficult as those imagined above. Ordinarily, a small rise will quickly attract sellers, and a small fall will bring in buyers. It very rarely happens that the jobbers are forced into a position in which their books can be balanced only at prohibitive cost. They are therefore willing to go short of stock when buyers temporarily predominate, just as they will absorb stock when sellers predominate. In both directions, their activities help to prevent price movements from going to extremes.

PUBLIC DETERMINES PRICE LEVELS

Two main conclusions will have emerged from these illustrations of how business takes place in the markets. The first is that the Stock Exchange is quite powerless to influence the underlying trend of security values. The long-term trend is determined by the great stream of business that comes to the brokers from investors of all kinds, big or small, private or institutional, from every part of the world. The jobbers who 'make' the prices could not for long swim against the current, even if they dared to try. Suppose the public takes fright at some development, actual or expected, affecting a particular group of securities. The jobber is sure that it is wrong. He may be convinced that big profits await anyone bold enough to stand in mid-stream and buy eagerly what others sell. But there is very little he can do about it. He will absorb as much stock as his finances permit, and his colleagues in the same market may do likewise. But their combined power of absorption is very small by contrast with what the public may sell at times of major change in sentiment. In self-defence, the jobbers have to put prices where the public rightly or wrongly — thinks they ought to be. The same is true when the public is in confident mood, and buys extravagantly. In the one case, the public sales could never be absorbed unless the jobbers put prices down to induce other

members of the public to buy; in the opposite case, the public demand could never be satisfied unless jobbers put prices up to encourage other members of the public to sell.

The second conclusion is that, thanks to the jobber system, the Stock Exchange both can and does exert a quite substantial influence upon the range of *short-term* fluctuations. If there were no jobbers (or no professionals functioning in somewhat the same way as the jobbers do) the price at any moment would depend absolutely upon the balance between selling and buying orders from the public at that moment. A temporary excess of selling orders would produce a fall to the extent necessary to bring in public buyers at once which might well be offset by a corresponding rise caused by a temporary excess of buying orders half an hour later. Prices of securities that now are regarded as very stable would often fall steeply one day and recover no less sharply the next day. As it is, the jobbers' capacity themselves to absorb what the public sells at one moment, or themselves to supply what the public wants at another, enables them to supplement public demand when that is deficient and to supplement supply when public demand is in excess. Moreover, the market is in close touch with many large investors mainly 'professionals' outside the House who are likely to be prepared to buy particular securities on any substantial fall or to sell on any substantial rise. When such a movement occurs, these professionals will be quickly informed. Many of them, indeed, will have given standing instructions to their brokers to buy on their behalf when the price falls to x or to sell if it rises to y .

In effect, therefore, their activities reinforce those of the jobbers. Indeed, in certain securities the capacity of the professionals outside the House to absorb or supply stock may be larger than that of the dealers inside. At times of major movement, even their combined capacity will, in most securities, appear relatively small. But in normal times it is quite sufficient to enable the market to iron out a large part of the effect upon prices of hour-to-hour, day-to-day, and even week-to-week excesses of public purchases over sales, or sales over purchases. The result, at all such times, is the maintenance of much more continuous dealing facilities for the public, and a much greater stability of prices, than could otherwise be achieved. That is why the jobber system, which alone makes this possible, is so valuable a feature of the London market.

VIII

HOW SECURITIES ARE TRANSFERRED



WE must now consider, quite briefly, how the 500 Harridges that your broker has bought for you actually come into your possession. Having learnt that the bargain has been irrevocably struck by the speedy and informal negotiation with Jobber Number Three, you might imagine that all that remained was for him to deliver the securities to your broker and for the broker, in turn, to pass them on to you against payment. But the matter is very far from being so simple as that.

In the first place, the obligation of Jobber Number Three to ensure that 500 Harridges are duly delivered does not mean that he must deliver them himself. Indeed, it is quite unlikely that he will do so. He may have bought them from Jobber Number Four, who in turn bought from Jobber Number Five, who bought from a broker selling on behalf of a client. All these transactions may have happened on the same day; and in active securities a day's chain of dealings may be a good deal longer than that. If every momentary owner—in this case Jobbers Three, Four and Five—had physically to handle the securities, to take them up and retransfer them, free and active markets would be impossible. Stock Exchange procedure (with the assistance, for most 'active' stocks, of a special official department, known as the Settlement Department—familiarly, the 'Clearing House') therefore eliminates all intermediate links in the chain, and joins together the two end-links. The selling client transfers his 500 Harridges direct to you—with the aid of his broker and yours.

Secondly, the actual process of transfer is both formal and complicated. Most securities dealt in on the London market are of the type known as 'registered' securities, which can be transferred from one holder to another only by 'deed of transfer' – that is to say, by a formal agreement 'under seal' bearing a Government revenue stamp and duly signed by both buyer and seller. Before the war, two other varieties of security were important – 'inscribed' and 'bearer'. In the case of British Government securities, both have virtually disappeared, the former because of the extreme cumbersomeness, and the latter because of the undue ease, of the transfer procedure involved. 'Bearer' securities in many ways resemble banknotes, and could pass from hand to hand with almost equal freedom. No register of holders is kept by the issuing authority – Government, municipality, corporation or company – and mere possession of the bond or certificate is presumptive evidence of ownership. If such securities are lost, stolen or destroyed, the rightful owner may find it impossible to establish his claim. For these and other reasons, the British Government has ceased to issue bearer securities, is discouraging their use by other issuers, and has recently required all existing securities to be permanently kept by their owners at any of a number of 'authorised depositories'. The present policy is to encourage instead the use of registered securities, which, in this physical sense, are much safer.

TRANSFERS

A holder of registered securities does, indeed, receive a stock (or share) certificate; but he cannot transfer the stock merely by transferring the certificate. His title is established not only by possession of the certificate, but also, and more particularly, by the record of his name in the register of stock (or share) holders maintained by the issuing authority (or, in the case of Government stocks, by a bank on its behalf). When your broker did his bargain with Jobber Number Three, you acquired the privileges, and assumed the responsibilities, of ownership of 500 Harridges from that moment; but Harridges Stores Ltd. will not recognise your existence until your name has replaced that of some other stockholder in its books. Nor will the company alter its register in your favour merely on production of the stock certificate held by the seller. It requires, in addition, a duly executed deed of transfer of the

stock to you. Then, and only then, will it admit you to the register, and in due course will issue to you a fresh certificate made out in your name.

To understand how these and certain other rather prosaic matters are arranged—and it is important to do so—let us enquire what happens after your Harridges were bought on the floor of the House.

Your broker's office staff will have to do three things. First, they will despatch to you that evening a signed and stamped contract note, recording the bargain that has been done and the total due from you. In this case, the amount should be £1,357 10s. 6d., made up as follows :—

500 Harridges Stores Ltd. Ordinary Stock Units	
@ 53s. 3d.	£1,331 5s.
Your Broker's commission (in this case, 6d. per unit)	12 10s.
Stamp on Transfer Deed (1 per cent.)	13 10s.
Stamp on Contract Note	3s.
Transfer Registration Fee (charged by Harridges' Registrar)	2s. 6d.
	£1,357 10s. 6d.

Every prudent investor will examine the contract note carefully, and at once : unless you notify him of any mistake immediately, your broker is entitled to assume that he has correctly executed your order.

No such formal document is needed for the second operation, which is to confirm the bargain with the jobber. All that happens is that clerks from the two firms meet on the following day in the great settling-room beneath the floor of the House, and there *verbally* check the particulars. They do this from books which are duplicates of their employers' dealing books—except that, to safeguard the secrecy of the broker-client relationship, the clients' names do not appear.

Your name must be made available, however, to the eventual seller at the other end of the chain, for otherwise the selling broker cannot prepare the necessary deed of transfer. This third operation is, in fact, known as 'passing the name'. This is done on a name-ticket, which sets out your name, address and description ; particulars of the bargain ; the cost of the stock at the price stated (£1,331 5s.) ; and the amount of the transfer deed stamp (£13 10s.). By issuing this ticket, the buying broker undertakes to pay these two sums



forthwith to any member who 'delivers' the 500 Harridges to him, that is, who returns the ticket with a properly prepared transfer signed by the seller and accompanied by the seller's stock certificate (or by evidence that it has been lodged either with Harridges Stores Ltd. or with the Share & Loan Department of the Stock Exchange).

The ticket is prepared by your broker and passed to the jobber from whom he bought. But, as Jobber Number Three is not proposing to deliver the stock himself, he simply passes it on to Number Four, from whom *he* bought. Number Four, similarly, passes it on to Number Five, who passes it on to the selling broker. This passing of the tickets is done by hand, and not by post, in order to avoid delay; and, in many active stocks, the whole process is carried through by the central Settlement Department—a centralisation which not only saves time but also relieves member firms of much arduous routine work. Thus is the eventual seller 'traced', and preparation of the transfer can proceed. To clear up a common misunderstanding, it may be noted at this point that the amount shown on the transfer as the 'consideration' for which the seller agrees to sell is the net amount payable by you, the buyer (£1,331 5s.): only by accident would this also be the amount the seller will actually receive—that will depend upon the price at which his broker had sold to Jobber Number Five. If the sale took place several days before you bought, as it might have done, the seller may get appreciably less than you pay, for Harridges have been rising: if he sold afterwards (which is also possible) he may get more.

SETTLING UP

This process of passing names, which is the very essence of the Stock Exchange mode of business, is governed by detailed and very strict rules, especially as to the time allowed. During the war period—indeed, until late in 1946—all dealings were 'for cash'. This meant, not that the buying broker had actually to pay cash at the moment the bargain was struck, but that he had only a very short time—actually five days—in which to commit himself to pay, against delivery of the stock. In other words, he was allowed only five days in which to issue a name-ticket. The client, for his part, was expected to pay immediately he received the contract note, and that, subject to postal delays, is normally the day following the date of the bargain.

Now, however, a different and less stringent arrangement operates. For reasons given on pages 68-70, brokers and their clients are allowed a longer time for the settlement of their bargains—except in gilt-edged securities, which have been dealt in ‘for cash’ throughout. In other securities, most dealings are ‘for the Account’. That is to say, they are entered into for settlement on fixed ‘Settling’ days, which recur at intervals of a fortnight, for that is the normal duration of an ‘Account’. Delivery of securities on the one hand, and payment for them on the other, in fulfilment of bargains struck during each Account, takes place so far as possible on a single ‘Settlement’ (or ‘Account’) day—the Tuesday following the end of the Account. The first dealing day of each fortnightly Account is normally a Wednesday and the last is the following Tuesday week.* Then follows a week of preparation for the settlement, which is thus completed midway through the next Account. A broker who buys on the first day of the Account therefore has fully a fortnight before he needs to pass the name of the transferee. His client, similarly, need not pay for his purchase until the following Settlement day except that, if he pays by cheque drawn on a bank outside London, his broker will expect a remittance two or three days earlier.

This rigid timetable for settlement does not, however, cover the process of transfer itself. To return to your purchase of Harridges, whether you pay for them on the day after you first ‘phoned your broker (as you normally would have done under the wartime arrangement) or defer payment until the Settlement day at the end of the Account in which you bought (as most people do now) you must not be surprised if some time elapses before the whole transaction is completed. Many things have to be done before the stock can be delivered. The selling broker must secure not only the name-ticket, in the manner just described, but also his client’s stock certificate (assuming that the operation is not further complicated, as it frequently is, by the fact that the seller’s own purchase still awaits completion). From these documents, he must prepare the transfer deed, and send it to the seller for signature. But the seller may be ill, or otherwise unable to sign at once. Or there may be joint sellers (especially common in the case of trustees or executors), each of whom must sign—and one or more may be abroad. Even when

* Except when the incidence of Easter or other holiday necessitates a three-week Account.

such troubles as these have been surmounted, the transfer may still not be ready for delivery. The seller may be selling, not simply the 500 units you have bought, but 1,000, and his broker will be preparing two or more transfer deeds instead of one. Obviously, he cannot deliver the single stock certificate with each transfer. In that case, he must despatch the documents to Harridges (or, in certain circumstances, he may send them to the Share & Loan Department of the Stock Exchange instead), and await its 'certification', on each transfer, of deposit of the appropriate certificate (or equivalent document).

Only when this has been done is the transfer ready for delivery to your broker. He will send it to you as soon as he receives it, and will expect you to sign (in the presence of a witness) and return it at once, so that he can arrange for the stock to be registered in your name. For this purpose, he will promptly lodge the documents with Harridges, and pay their registration fee, receiving in return a transfer receipt. This he will retain until the time comes – some weeks later – to exchange it for the new stock certificate showing you to be the registered owner of the 500 units. Then, at last, he will send the certificate to you, and the whole operation will be complete.

OUTSIDE DELAYS

You will observe with relief that none of these complications, nor the many others that can arise, will trouble you. They concern the ordinary investor only because they explain why delivery of stock – and, still more, the issue of the new certificate – often takes so long. People who are unfamiliar with the procedure naturally tend to blame the Stock Exchange for these delays. After these illustrations, they may find it easier to believe (what is certainly the fact) that much more delay arises outside the Stock Exchange than within it. However efficient the Stock Exchange machine, it cannot work faster than the speed at which its clients, and the registrars of companies and public bodies, are able to work. But if a purchaser, despite these explanations, thinks it unfair that he should pay his money at once or on the next Settlement day, and yet have to wait several weeks, even months, for his stock, the broker will often be prepared to suggest a remedy. He may allow him to defer payment until delivery (of the transfer deed, not the new certificate) actually takes place – provided this is arranged through a bank in London, and

irrevocable instructions are accepted by the bank to pay the broker when he delivers.

But whether you pay for your Harridges on receipt of the Contract Note or against delivery, you cannot make delay in delivery a ground for repudiating the bargain. The reasons for this should by now be apparent. Not only is your broker irrevocably and personally committed to Jobber Number Three, but, as already indicated, you acquired the full rights of ownership of the Harridges from the moment of that commitment. You are not prejudiced by delay in delivery and, until delivery takes place, your broker is definitely responsible to you for ensuring that you duly receive any payments, dividends or 'rights' to which your ownership entitles you.

Sometimes, indeed, this is an onerous responsibility. Obviously, Harridges Stores Ltd. will not pay any dividend to you, or notify you of any offer of new stock to stockholders, until you are a *registered* owner. Shortly before a dividend is payable, the company will 'close' its transfer books (and, for the time being, refuse registration of transfers) in order that dividend warrants may be prepared in the names registered at the moment of closure. If a registered holder sells thereafter, he will still receive the dividend from the company. At approximately the moment of closure, therefore, the normal market rule that a buyer is entitled to any subsequent dividends temporarily ceases to operate. Instead of being quoted at a price including ('cum') the dividend, the stock is then quoted 'ex dividend', the *net* amount of which is deducted from the 'cum' price ruling at the moment the change is made, and the abbreviation *XD* is written after the quotation in the Lists.* If a broker buys 'ex dividend', he naturally has no responsibility for the dividend, for his client is not entitled to it, since he has received an equivalent abatement in the price he pays.

But suppose Harridges went ex dividend shortly after you bought. It is improbable that the transfer to you will have been prepared and lodged with Harridges before the books are closed; and the dividend, to which you are entitled, will be paid by the company to your transferor, or even to a prior seller. In that case, if the stock has not yet been delivered, your broker can

* 'Net amount' of course, means the amount of the dividend minus income tax on it at the current standard rate.

sometimes deduct the net dividend from the amount payable to the selling broker on delivery; otherwise he must lodge a separate claim upon him. Even though the recipient of the dividend should fail to refund it, the selling broker remains liable to your broker (unless there has been unreasonable delay), and he in turn remains liable to you. Similarly, if you receive a dividend after you have sold the relevant stock 'cum' dividend, it is your duty to hand it over to your broker, and he in turn must pass it on to the buying broker.

THE COST OF DEALING

After this outline of some of the routine functions that brokers perform on behalf of clients, it is appropriate to refer briefly to the costs of dealing through the Stock Exchange. As a buyer of Harridges, you had to pay four items in addition to the actual purchase price of your stock, viz., broker's commission; stamp duty on the transfer deed; stamp duty on the contract note; and transfer registration fee. The amounts shown on page 59 are of course those appropriate to your particular purchase, for the costs vary according to the size and nature of each transaction. It is impracticable to give complete details here, but the Scale of broker's commission charges is reproduced in full in Appendix II, which appears on pages 83–4. A few guiding principles will enable any ordinary investor to form a rough idea of the total cost of any particular deal. Let us take each item of cost in turn, but in reverse order.

Registration fee, payable by a buyer but not a seller, is the only item that does not vary with the amount of the deal. For gilt-edged securities, there is usually no charge, but companies and other bodies generally charge half-a-crown per transfer, and in some cases a little more.

Contract stamp duty is 6d. where the purchase or sale money is £100 or less, and rises in several 'steps' to 2s. per £2,500, except that the first £2,500 bears duty at 4s. The maximum total duty is one pound.

Transfer stamp duty also rises in steps based on the consideration money involved. At the 'top' of each scale it is 1 per cent., but at the lower end of each it works out at slightly more than this. It is payable by the buyer, and not by the seller.

No such simple rule-of-thumb can be framed for estimating the amount of the broker's commission. The commissions are governed by somewhat complicated rules, obligatory upon all members (and similar rules apply to members of the provincial Stock Exchanges). As Appendix II shows, they are carefully graduated in several scales with the object of ensuring that the sum chargeable for each operation is reasonably proportioned to the amount of work and trouble to which the broker is likely to be put in carrying through the transaction. The lowest rates are for dealings in British Government stocks, for which the charge is usually $\frac{1}{4}$ per cent. on the nominal (par) value of the stock involved. For shares or stock units, the charge ranges from about 4 per cent. on the money involved when the market price is as low as 1s. per share (the commission then is $\frac{1}{2}$ d. per share) to $\frac{1}{2}$ per cent. when the market price is £25 or more. The minimum charge for any one deal is £1, except that for bargains of less than £100 the broker may reduce his charge to 10s. (or to 5s. for bargains below £20). On the other hand, for bargains of more than £2,500 the broker may charge only half the scale commission on the amount by which that sum is exceeded. There is also a special concession, available for small orders as well as big, where a client changes his investments by selling one security and reinvesting in another within a limited period (varying from 14 to 28 days). In such a case, he may be charged at half rate on whichever transaction would otherwise have produced the lower total commission; except that, if the two transactions are not equal, the concession will be limited to the amount of the smaller of the two.

To explain the commission rules and scales more fully here would overburden this booklet, and perhaps weary the reader. Anyone who seeks more information can obtain it readily from any broker or from the Secretary of the Stock Exchange. And for those who wish to examine the matter at first hand, so to speak, there is available, free of charge, a copy of the actual rules (also incorporating the Scales reproduced on pages 83-4), which will be sent upon application.

IIIX

BULLS AND BEARS



MANY readers may have noted with surprise that there has been no need so far to refer to the Stock Exchange 'zoo'. Ninety-nine per cent. of the voluminous jargon of the House sounds almost like a foreign language to anybody who is not a professional, but everybody has heard about 'bulls' and 'bears'. Popular imagination, indeed, seems to regard the Stock Exchange as almost entirely populated by these animals.

The truth is that 'bulls' and 'bears' of the traditional breeds hardly exist nowadays. The lively thoroughbred strains could not stand the close confinement enforced by the wartime system of dealings, and during the war they languished and virtually died out. Their post-war descendants are altogether a tamer and more retiring race. In one rather loose sense, anybody is a 'bull' if he hopes a stock will rise so that he may sell, or a 'bear' if he hopes it will fall so that he may buy. But such people are not bulls or bears in the strict sense unless they have quite special reasons for their hopes. The thoroughbred bull buys stock without intending to take it up; he wants the price to rise so that he can re-sell at a profit before the time for payment arrives. The thoroughbred bear sells stock that he doesn't possess; he wants the price to fall so that he can buy it back at a profit before the time arrives for him to make delivery.

Speculative operations of this kind therefore depend upon a time-interval - on the one hand, between moment of purchase and due date for payment, and, on the other hand, between moment of sale and due date for delivery. The wartime 'cash' system sought to reduce the interval to only five

days. It was, so to speak, a strait-jacket for bulls and bears, whose speculative antics of the pre-war variety could not be undertaken within so short a period. This constriction of the inmates of the Stock Exchange zoo was, of course, the whole object of the war-time rule. It was felt that, under war conditions, the Stock Exchange ought not to provide facilities even for short-term speculation, whatever its technical advantages in normal times.

THE RELUCTANT BEAR

The stringent wartime system was, however, very difficult to operate without impairing the efficiency of the market. The stabilising function of the jobber, as was shown in Section VII (pages 53–56), is performed only because he is prepared to take stock on his book when the public is mainly selling and to go ‘short’ of stock when the public is mainly buying. In the first case the jobber becomes a ‘bull’ and in the second a ‘bear’ in a technical rather than a speculative sense. Jobber Number Three, when he sold 500 Harridges to your broker, became a ‘bear’ because he sold more stock than he possessed at that moment. But he was an involuntary even reluctant bear. His ‘short’ sale was not made because he thought the price would fall. On the contrary, he knew the trend was upwards, and hurried to buy back the stock as soon as he discovered what had happened. Similarly, when the public is selling rather than buying, and the price trend is downwards, the jobbers often become involuntary ‘bulls’ because, though they do not want to take stock on their books at such a time, they cannot avoid doing so. Jobbers are dealers, and although speculation of a kind is inseparable from all dealing—whether in securities or merchandise—they are not speculators in the popular sense. Generally speaking, they do not, except over the shortest periods, deliberately run a ‘bear position’ by selling more stock than they possess or a ‘bull position’ by buying more stock than they need. The size of their ‘position’, and whether it is minus or plus are determined chiefly by the actions of the public.

But technical bulls and bears, whether reluctant or not, have this at least in common with the purely speculative breeds: they want time in which to ‘turn round’—that is, time to ‘level up’ their books. The shorter

the time available, the smaller will be the bull or bear positions they are prepared to carry and the greater will be the temptation to try to keep the book level by 'marrying' each public sale to a corresponding public purchase. That temptation, moreover, will be even greater if there are not many professional operators outside the House who are constantly ready likewise to buy when the public sells and sell when it buys, and thus to help the jobbers to close their open positions.

Strict enforcement of the wartime five-day rule therefore severely cramped the activities of the jobbers. It gave them very little time, and, by curtailing the volume of outside professional support, greatly increased the risk of loss through running either a bull or bear position. In these circumstances, the proper functioning of the stabilising jobber system was hardly possible, with the result that markets became much 'narrower' and price movements much more erratic.

WARTIME DIFFICULTIES

But that was not all. Though the mere existence of the five-day rule had these constricting effects, it was not in fact possible to enforce it in all cases. It imposed an almost intolerable burden on members' office staffs. Before the war each firm would mobilise all its staff resources for an all-out settlement effort once a fortnight, and could then work to a familiar and ordered timetable. During the war, although staff was desperately short, every day had to be a settlement day. And, quite apart from these office difficulties, there were excellent reasons why it was impossible in many cases to pass the buyer's name within five days. Where the reasons for delay were good, it was obviously necessary to allow some latitude and, in particular, to suspend the automatic machinery for orderliness in settlement. Normally, if a member is unable to make or take delivery of stock on the due date, a special official department (the Buying-in and Selling-out Department) promptly steps into his shoes and, at his expense, does what he has failed to do, by buying or selling (for immediate delivery) an equivalent amount of stock on the market. During the war, these sanctions were only rarely called into action.

Such evident weaknesses of the 'cash' system seemed, in wartime, a reasonable price to pay for safeguards against speculation which, it was

thought in some quarters, might have distracted public attention from the market in gilt-edged securities, then of such vital concern to the Government. These securities, of course, were not directly affected by the wartime restrictions, for dealings in them were for cash even before the war.

Since the war, however, the urgent task of financing industrial reconversion and export expansion has been restoring the importance, from the widest standpoint of national interest, of other securities relative to gilt-edged. Moreover, the cumbersomeness of the cash system had begun to defeat its main object. The latitude necessarily granted in the working of the five-day rule was degenerating into excessive latitude. The concessions created new opportunities for speculation by the knowledgeable, often with an appreciably longer time-interval than was allowed by the pre-war fortnightly account, and free from the healthy discipline which the system of fixed settlement days imposed.

END OF BATTLEDRESS

The reasons for the resumption, as from the end of 1946, of dealings 'for the Account' will now be apparent. It was designed, first, to restore to jobbers and outside professionals reasonable facilities for 'technical' speculation, and thus to improve the flexibility of the increasingly important markets in industrial securities. Secondly, it was important to reimpose the automatic settlement sanctions, and thus to discipline the post-war breeds of speculators, whose operations, instead of extending five days into possibly as many weeks, have now to be completed within each fortnight's account. Thirdly, there was need to relieve the pressure on members' office staffs.

The new system, though it is naturally available for public as well as professional speculation, is not intended to re-create the thoroughbreds of the Stock Exchange zoo. Those who yet survive still wear the strait-jacket, and though the regulation garment is now a little looser than the battledress version, it is decidedly tighter than the off-standard patterns which were being worn by the ingenious in the later phase of the war period. In particular, it excludes all the traditional facilities for speculation.

Though the fortnightly settlement has been restored, there has been no revival of the pre-war 'carry-over' system, and dealings for settlement at a

future Account are prohibited.* Such facilities were essential in pre-war days to enable London to fulfil its rôle as an international market, and may be resumed if similar conditions again arise. They make up the machinery of organised speculation, and are therefore mainly of concern to the professional especially the outside professional. For that reason, even if this machinery were not now laid aside, like idle plant under a wartime concentration scheme, it would not have justified any prominent place in this booklet. But real understanding of the working of the market, and of the way in which professional speculation can provide a shock-absorber to give stability to the whole system, does require some knowledge of the pre-war machine.

When markets have a pronounced trend in either direction, speculators whether professional or not - may readily compress their operations within the period of the fortnightly Account. If the trend is upwards, a bull who buys early in the fortnight may be able to resell the same stock at a higher price before the end of it, and thus make a speculative profit without ever needing to pay for the stock he buys. If the trend is downwards, a bear who sells, early in the Account, stock which he doesn't possess may be able to repurchase it at a lower price in time to give delivery when the Account ends. So he, too, makes a profit on stock without ever having to put up the money it represents.

But when prices have no decided trend, or are moving only slowly, a fortnight's 'run' generally looks too short to all but the most practised operators, so that speculation is then mainly of the 'technical' variety.† It is arguable, therefore, that the bridging of the temporary gaps between sales and purchases by the investing public, which can be performed only by speculation, may not be effectively achieved unless speculators are allowed a longer period in which to 'undo' a purchase by a subsequent sale, or a sale by a subsequent purchase. Healthy discipline requires that every bargain shall be settled on each succeeding settlement day. But, before the war, this

* Dealings in 'options' are also prohibited. Option-dealing was a pre-war device whereby a speculator, for a relatively small sum, could acquire the right (without, however, the obligation) to buy or sell a stock in the future at a price agreed in the present. Such operations, though they had their legitimate technical uses, lent themselves to sheer gambling.

† Especially under the present system, when anyone who buys and sells the same stock within a single Account must pay full commission on both deals. Before the war, commission was payable only on one deal, even though the closing sale (or purchase) was delayed until the next Account.

necessary discipline was yet combined with extra time for the speculator - through the device of 'carrying-over' or 'continuation' of bargains from one Account to the next.

CONTANGO

A simple example will show how the system worked. Suppose a sudden excess of public sales over purchases was depressing the price of a particular stock. A bull speculator, sure that the fall was not justified on a longer view, would promptly buy, thereby preventing the fall from being as large as it would otherwise have been. His purchase would be 'for the Account'. But suppose at the end of the Account the recovery he still confidently expected had not materialised. He would not want to sell then, and never intended actually to take up the stock in any case; yet the bargain he had made would have to be settled on Account day. The pre-war 'carry-over' procedure solved his dilemma by permitting him, through the agency of his broker, to find somebody else who would take up and pay for the stock he had bought, and hold it for him until the end of the next Account. For that service he would pay interest (called 'contango') on the money involved. The operation could, in fact, be repeated at the end of the second or subsequent Accounts. But suppose the public, within the second fortnight, realised that the stock looked cheap. When its buying forced up the price the bull would resell-- thereby tending to keep the rise within reasonable bounds.

'Continuation' by a bear was the same process in reverse. He would sell when he thought the price of a stock too high, thereby moderating its rise. If the fall he still expected had not occurred by the end of the Account, he had to find someone who would deliver the stock to the purchaser on his behalf. Ordinarily (but not always), he would *receive* interest on the amount involved, because by 'borrowing' stock he would have relieved someone else, for a fortnight, of the need to pay for it.* If during that period the expected

* Sometimes, when more people wanted to borrow stock than to borrow money against it - that is, when the bears outnumbered the bulls - the bear would have to *pay* interest for the carryover facilities. The payment in that case was called 'backwardation.' It should also be noted that, although the settlement of the original bargain and the continuation of it were two distinct transactions, the carryover facilities were often provided by the jobber with whom the bargain was done.

fall occurred, the bear would close his deal by buying the stock he was due to deliver to the lender—thereby moderating the price-fall.

Thus do bulls and bears, by helping to maintain active markets, and by buying on any excessive fall or selling on any excessive rise, tend to keep short-term fluctuations of prices within bounds—provided their actions are well informed and their forecasts accurate. And this is true whether they operate only within each Account or, as they did before the war, also over longer periods. Professional speculation, if regulated by sound market organisation, with due vigilance to ensure that the facilities are not abused, has a valuable part to play in providing continuous dealing facilities for genuine investors and in protecting them from extreme or irrational price movements.

The same cannot be said of speculation by the uninformed or inexperienced. Such operations are apt simply to reinforce, rather than correct, the fluctuations caused by the ebb and flow of genuine investment purchases and sales. That is why, when the carry-over system operated before the war, only a limited number of stock-broking firms would ordinarily arrange continuation facilities for their private clients. The main source of the market's business, flowing through good times and bad, is the broad stream of genuine investment dealings. Most brokers well understand that anything which might disturb the main stream, such as spasmodic and frothy bursts of inexperienced speculation, is in the long run bound to be contrary to their own interests, quite apart from its undesirability on general grounds.

SSS

X

PROTECTING THE INVESTOR



IN various ways, it has been shown, the mechanism of the stock market operates to protect the investing public. But there are other forms of protection, in some respects even more important, that result from the policy and activities of the Stock Exchange authorities themselves. Before passing to these, let us recall briefly the safeguards already discussed.

Members are absolutely liable for the fulfilment of their bargains. Brokers act only as agents: hence a client pays or receives the same price as that at which the deal is done in the market. It is the broker's duty, moreover, to execute each transaction to the best advantage of the client. If he goes beyond a 'limit', or otherwise ignores the client's instructions, he is responsible to him for any loss that may result. For these and other services, including the giving of investment advice, the broker's sole remuneration is his commission, the amount of which is closely regulated by a published (but not inflexible) tariff.

In the market itself, when a jobber quotes a double price (as he does in most cases), he cannot refuse to deal on that basis whether the broker turns out to be a buyer or a seller—provided only that the deal is for a 'marketable amount'. In other words, the dice cannot be loaded against the broker or his client. With rare exceptions, competition between dealers ensures that dealing margins are no wider than is justified by the activity of the market. Finally,

professional activities provide shock-absorbers which limit the range of fluctuations and, in most securities, ensure a continuous market at reasonable prices.

These valuable facilities—and many others besides—all flow naturally from any effective and highly-organised market; some of them, indeed, are common to the more formal of the commodity exchanges. There was a time when the Stock Exchange authorities considered that their whole duty was to provide such a market, and to discipline their own members just so far as was necessary for that purpose. They were not concerned with the quality, or even the types, of securities which the market handled. They existed to serve the interests of members, and therefore left them free to deal in any securities they chose. Had they acted otherwise, they would have had to influence the behaviour of persons and companies—the issuers of the securities—far beyond the circle of Stock Exchange membership. This they did not do. In consequence, doubtful securities and doubtful practices gained currency, to the detriment of the public. In those days, in short, the Stock Exchange was still a private institution in fact as well as in law.

IMPOSING A CODE

It is very different today. The Stock Exchange now takes the widest view of its responsibilities: it does not shrink from the task of disciplining all, whether individuals or corporations, who use its facilities, and rigorously controls the entry of securities to the market. In its power to exclude them, the Stock Exchange has a weapon with which to enforce better ethical and technical standards throughout the whole field of public borrowing and investment. Its policy now is guided first by the public interest, and only secondarily by the interest of members. It has learnt that in the long run what best serves the public will best serve the Stock Exchange community. As a result, there is protection for the investor far surpassing anything known in the past. And the progress continues.

This evolution of the Stock Exchange from private to public status is instructive. It extends over thirty years, moving slowly at first, but since 1930 with ever-increasing tempo, notably in the past decade. Before 1914, the only securities dealt in that had to satisfy conditions as to quality were

those quoted in the Official List; the remainder were not quoted at all. During the first world war, however, it became necessary to record bargains in all securities. For this purpose, a 'Supplementary' List was officially published, embracing those securities for which no official quotation had been granted. The two Lists still appear side by side, but will shortly be merged, for the qualitative distinction between the two categories of securities has largely disappeared. The reason for this is that since 1921 members have been prohibited from dealing in any 'new' security — new, that is, to the market — until the authorities have given 'permission to deal'. And the conditions that must be satisfied before such permission is granted are now so stringent as to be hardly distinguishable from those required for an official quotation.

This progressive tightening of requirements for permission to deal is the central feature of recent evolution. In 1928, however, the rules still left room for many unsubstantial and even fraudulent new companies to be foisted on to a gullible public by over-optimistic or unscrupulous company promoters. And the evil effects of these abuses were accentuated by the notorious Hatry crash of 1929. The Stock Exchange authorities were determined that such happenings should not recur. They could not, and cannot, actually stop the promotion of unsound concerns, or prevent the public from subscribing to them. But they could deny their shares any place in the market, thereby both isolating the infection and providing a salutary reminder of the consequences of ill-considered investment — especially in new enterprises. To drive the lesson home, there was need to warn the public that permission to deal was liable to be refused or withheld in every case unless and until rigorous conditions had been satisfied by the promoters, the company, and all concerned with the making of an issue.

USING THEIR POWERS TO THE FULL

Such was the strategy of the campaign. It was launched in 1930, by a sweeping overhaul of the permission-to-deal rules. Among the new requirements was an obligation to publish such searching particulars of each 'new' security that an investor — or at least his professional adviser — would have little difficulty in separating the wheat from the chaff. Since then the public

has come to realise that a share which cannot be sold through the Stock Exchange may be a very undesirable, even dangerous, investment. This realisation has greatly curtailed the scope for unsound company promotion and other malpractices.

The process of reform has not stopped there. In recent years the authorities have not only further tightened their control over new entrants to the market, but have used their powers to the full to ensure steady improvement of the financial practices of companies (and other borrowers) whose securities were already dealt in on the market. Companies, and all who operate in their securities, now know that they continue to enjoy the facilities of the market only on conditions: if their financial conduct does not reach the requisite standards, the Stock Exchange Council can suspend or withdraw those facilities, wholly or partially. And the standards expected of them are being raised year by year. It is now well understood that the Council will intervene promptly whenever a false market exists, or is in danger of arising, in any security whether that is due to improper or unsatisfactory behaviour by the company concerned or to attempted manipulation of the market by others.

Naturally, the Stock Exchange cannot ensure that all securities handled by the market are 'good' investments. But it can ensure that the public has access, speedily and readily, to all the information required to enable it to estimate their relative merits. And it can also ensure that this information is published in such a way that every investor has the same chance of using it. These have been the main objectives of the latest improvements in the rules. Companies applying for permission to deal now have not only to furnish very detailed information at the moment of application, but also to undertake to publish adequate information in the future. They must, for example, report their net profits to the Stock Exchange authorities as soon as the directors have determined them, giving also proper comparative figures for the previous year and 'any other information necessary to enable the shareholders to appraise the position of the company and to avoid the establishment of a false market in the shares'. The onus of deciding what is significant, it will be noted, is placed squarely upon the company itself. This is a very important provision, for in the past a company's full report and accounts have often

revealed a position very different from that suggested by its preliminary announcement of the year's results, thereby causing needless disturbance of the market and frequently inflicting loss or injustice upon shareholders.

Another valuable requirement is that any proposals circulated for submission to shareholders at a forthcoming meeting shall (unless relating to purely routine matters) be clearly intelligible without reference to other documents, such as the company's articles of association. Moreover, to safeguard the rights to shareholders who may be unable to attend the meeting, the circular must be accompanied by forms enabling votes to be cast by proxy, either for or against the proposals.

THE COHEN REPORT

By steady pressure in such ways as these, the Stock Exchange authorities have been gradually enforcing better standards of conduct over a very wide field of investment and company finance. Indeed, the standards imposed by the Stock Exchange have long been more stringent than those of the Law itself. When the recommendations of the Cohen Committee on Company Law* are adopted, the Law will at many points be brought into line. But in other cases, as that Committee fully recognised, the Stock Exchange, with its flexible machinery, will always be able to do more than can possibly be achieved by rigid legal control. A rule that is stringent enough to stop all abuses and trap the fraudulent will often check legitimate business and injure the honest. Hence, a rigid statutory rule has to be framed so as to strike a balance between the advantages of the one and the disadvantages of the other. But the Stock Exchange authorities can always, at their discretion, waive their rules, and are under no obligation to give reasons for their actions. Their requirements can be severe enough to stop bad practices because they are also flexible enough to avoid injuring the good.

On at least three weighty matters, therefore, the Cohen Committee decided against any change in the Law, preferring to rely upon control by the Stock Exchange. In the matter of preliminary profits statements and proxy arrangements, it said as much quite explicitly, and thought it 'most important'

* Committee on Company Law Amendment, appointed by the President of the Board of Trade and presided over by Mr. Justice Cohen, which reported in June 1945 (Cmd. 6659).

that companies should comply with the wishes of the Stock Exchange authorities. On new issues, the Cohen Committee pronounced as follows :

Some of the requirements of the London Stock Exchange Committee* as to the information to be disclosed in prospectuses and advertisements go beyond the requirements of the Companies Act. The sanction behind these requirements, and it is a powerful one, is the fact that if the London Stock Exchange Committee are not satisfied, they can refuse permission to deal or defer their decision on the matter. On the other hand, as the requirements are not laid down by statute, the London Stock Exchange Committee can waive some or all of them in suitable cases. Their flexibility makes it possible for the rules to be more stringent and to afford the investor a greater measure of security than could be achieved by a statute except at the cost of hampering legitimate business. We recognise that particularly in recent years the London Stock Exchange Committee have exercised a beneficial influence in the matter of issues and we consider that they should approach the provincial Exchanges with a suggestion that in respect of new issues it would be in the public interest for . . . the provincial Exchanges to be brought into line.

NEW STATUS—NEW STANDARDS

These authoritative comments plainly set the seal upon the evolution of the Stock Exchange into a public institution. Not only does the Stock Exchange Council work in closest co-operation with the appropriate Government authorities—especially the Treasury, Board of Trade, and Bank of England—on all matters within its province: it is now revealed to the world as an authority with responsibilities comparable to theirs. It is a body charged with functions which it shares with the Law itself, and which in other countries are discharged by governmental bodies. America's remedy for the excesses of the stock market boom of 1928-29 was the creation of a standing supervisory and investigating committee, working under Government auspices. This body, the Securities and Exchange Commission, with its vast code of regulations and voluminous form-filling requirements, disciplines the market 'from above'. The London market, in the British tradition, disciplines itself.

This public function, moreover, is performed entirely at private expense. The Share and Loan Department of the Stock Exchange, upon which the brunt of the work falls, costs many thousands of pounds a year. The money comes from the subscriptions paid by members of the House. Other depart-

* Now the 'Council' of the Stock Exchange. When the Cohen Report was prepared, the Committee for General Purposes was still the operative body of the Stock Exchange.

ments, too, play their part. The Records Department maintains comprehensive files of companies and issuing houses, and also of directors and other individuals - particularly those of doubtful repute - with details of the financial activities in which they have engaged. These records, more revealing than any that a private organisation could build up, often raise danger signals which otherwise would be seen only when trouble became imminent. For this reason, brokers handling new issues may be liable to censure if they fail to consult them.

One word more. Let no one suppose that the Stock Exchange authorities are, like the market facilities themselves, approachable only through a broker. Every year hundreds of investors seek the aid of the Council of the Stock Exchange. Anyone who has grievances or queries is at liberty to write either to the General Secretary or to the Secretary of the Share and Loan Department. These officials are ever ready to give help and advice—not, indeed, about which investments to choose or when to buy or sell, but about every matter relating to the proper conduct of the market and of all who use its facilities. Nor should it be supposed that this advice, and these facilities, are designed only for the large investor. Of these particular services, the very opposite is indeed true. Already, small investors make up a large proportion of the clientèle of the Stock Exchange, and their numbers continue to grow. The authorities well know that the small man may need more advice and help than the big, and somewhat different facilities. They are shaping their policy accordingly.



APPENDIX I

TYPES OF STOCKS AND SHARES

In a textbook on the Stock Exchange, a description of the principal different types of securities in which the market deals would ordinarily be found among the early chapters. But a booklet addressed to the general reader — the reader who wants to know what part the Stock Exchange plays in the national life, and whether it plays it badly or well — need not conform to the conventional pattern. Much information that is vital to the student or investor is, from this wider standpoint, of only secondary importance. In the main narrative and argument, therefore, as little as possible has been said about the nature of the market's stock-trade. Hence this Appendix.

Stock Exchange securities can be classified in three different ways: (1) according to the different types of enterprise they represent: for example, Government financing, Industrial

companies, Mines, and so forth; (2) according to the different methods by which they are transferred from one investor to another; and (3) according to the different rights as to interest or dividend, redemption or repayment, which they carry with them. The first two kinds of classification have been sufficiently discussed in the main text (Sections VI and VIII respectively). Here we are concerned solely with the third — the differences between 'bonds,' Preference capital, Ordinary capital, and certain hybrid types of security.

Financial ingenuity has devised many different varieties of security, but the broad distinction is between (a) Fixed-interest securities i.e., those which carry the right to a fixed rate of interest, at so much per cent per annum on the nominal or par value, and (b) Variable-dividend securities.

FIXED-INTEREST SECURITIES

Government & Municipal Loans Almost all the securities issued nowadays by Governments, Municipalities and many public or quasi-public bodies fall into this category. Whether the issue is described as Loan, or Stock, or Bonds or otherwise, its nature is that of a loan by the investor to the issuer. The investor is entitled to the letter of his 'bond' and no more; he does not acquire any 'share' in an enterprise or any voice in its management. Because his rights are so limited, and because he is simply a lender, securities of this kind are usually redeemable by the borrower on prescribed terms and dates. Where two dates are stated (e.g., Savings Bonds, 1965-75), the later is the date when the borrower *must* redeem and the earlier is the date on or after which he *may* redeem provided that he gives notice in a prescribed form. Sometimes, too, an issue is additionally (or alternatively) redeemed steadily throughout its life; in that case the borrower regularly provides monies for a 'sinking fund' and applies these to 'amortise' the issue either

by buying the securities on the market or by direct redemption of a prescribed fraction of the issue, the particular securities being selected by drawings, as in a lottery. Not all securities in this category are, however, 'redeemable.' Governments of high credit-standing sometimes issue 'perpetual' or 'irredeemable' stocks, or, more commonly, stocks that have no final redemption date but are redeemable, on or after a specified date, only at the borrower's option. The British Government, for example, may repay its 3½ per Cent. War Loan in or after 1952, but there is no date on which it is bound to repay.

Debentures In a legal sense, debentures or debenture stock issued by statutory or chartered corporations — especially favoured by railways and other public utilities — or by ordinary industrial companies, in many respects resemble the securities issued by Governments. The investor, in this case, too, makes a loan and becomes a creditor; he does not make a 'participation' and become a proprietor of the enter-

prise. Sometimes, indeed, specific assets of the borrower are pledged to secure the loan, and if the borrower defaults in payment of interest or repayment of capital the trustees for the debenture-holders can seize those assets and, if necessary, sell them in order to satisfy the claim. In any case, the trustees can usually secure the appointment of a 'receiver' to administer the enterprise until the arrears due have been met and future payments assured—though it does not, of course, follow that either the assets or profit-earning capacity of the enterprise will suffice for the purpose.

Preference Capital In practice, the distinction between preference capital and debentures often becomes blurred, but the legal distinction is clear and fundamental. An investor in preference shares is not a creditor of the issuing company. He is a proprietor with a limited interest. Sometimes, indeed, preference capital is redeemable like a debenture (in which case the practical difference between the two becomes particularly hazy); but, in general, preference capital is just as much part of the permanent resources of the company as its ordinary capital is. A preference shareholder is entitled to a 'dividend'—that is to say, to a share in the profits if earned and if the directors decide to distribute them—as distinct from 'interest', which is due on a debenture whether profits

have been earned or not. His profit-share is, however, restricted to the prescribed fixed percentage, and for that reason his claim ranks (in 'preference') before that of other proprietors. The fixed dividend may be 'cumulative' or non-cumulative. If the latter, the right to dividend is lost absolutely if in any year the directors are unable to recommend any payment. But if the shares are cumulative, any unpaid preference dividend is carried forward and must be paid, together with the current preference dividend, before any payment can be made to the ordinary shareholders. Normally, preference shareholders have no voice in the management, except when their dividends are in arrear—when their voting rights sometimes give them effective control of the undertaking. It is usual, too, for preference capital to enjoy the same preference 'as to capital' as it does 'as to dividends': if the enterprise is wound up, and its assets are realised, the preference shareholders are entitled to get their money back, plus any arrears of dividend, before anything is returned to other shareholders. Many companies, of course, have more than one class of preference capital, generally known as 'First', 'Second' or 'Third' preference shares, in which case the issues rank for dividend and capital in the order stated, the fixed interest rate being usually highest for the issue with the lowest ranking.

VARIABLE-DIVIDEND SECURITIES

Ordinary Capital This is usually the true proprietorial capital—the capital that carries with it the ultimate ownership of the enterprise. Holders of Ordinary shares are said to own the 'equity' of a business because they are entitled to all profits and all assets after the contractual claims of 'prior charge' and preferential capital—debentures and other fixed-interest capital—have been met.

Deferred Capital Where this type exists, it is almost invariably the 'equity' capital, and is identical with Ordinary capital as defined above. If a company has both Deferred and Ordinary capital, the latter is generally not true 'Ordinary' capital at all, but is simply a species of preference or preferred capital with limited rights either to dividend, or

capital repayment in a liquidation, or both.

Participating Capital Capital of this kind attempts to combine the distinctive features of both the 'fixed' and the 'variable' dividend capital. In its most common form, holders are entitled to a fixed percentage dividend in priority to subsequent classes, but then are given, additionally, a 'participation' in the equity (i.e. in the residual profits) up to a maximum further percentage. Parallel rights are usually given to 'participate' in capital in a liquidation. Such shares have a variety of names, such as Participating Preference or Preferred Ordinary capital; or, where Ordinary and Deferred capital exist in the same company, the 'Ordinary' capital will be participating capital, either with or without a preferential 'fixed' rate of dividend.

APPENDIX III

MINIMUM SCALE OF COMMISSIONS

SECTION A

2½% Consols, 2¼% and 2½% Annuities	¾ per cent. on Stock.
Other British Government Securities: Indian Government Stocks, Metropolitan Consolidated Stocks, London County Consolidated Stocks, Dominion and Colonial Government Securities, County, Corporation and Provincial Securities (British, Indian, Dominion, or Colonial)	¼ Stock
County, Corporation and Provincial Securities (British, Indian, Dominion or Colonial): -	
Annuities (dealt in per unit of Annuity)	¼ per cent. on Money
Public Boards (Great Britain and Northern Ireland):—	
Inscribed Stocks free of Stamp Duty	¼ per cent. on Stock.
Inscribed Stocks subject to Stamp Duty	As on Registered Stocks
Registered Stocks whether free of or subject to Stamp Duty*	(Section C).
*NOTE: Metropolitan Water Board 'B' Stock	As on Inscribed Stocks free of Stamp Duty.
Bank of England and Bank of Ireland Stock	¼ per cent. on Money.

SECTION B

Bonds to Bearer other than those included in Section A. Price 1 or under	At discretion.
Bonds to Bearer other than those included in Section A. Price 5 or under	¾ per cent. on Stock.
Bonds to Bearer other than those included in Section A. Price 10 or under	1/10 Stock.
Bonds to Bearer other than those included in Section A. Price 20 or under	¼ Stock.
Bonds to Bearer other than those included in Section A. Price over 20	¼ Stock.

SECTION C

Registered Stocks (quoted per cent.), Registered Debentures and Bonds:—	
Price 5 or under	¾ per cent. on Stock.
.. 10	1/10
.. 25	¼
.. over 25	¼ Money.

SECTION D

Shares or Units of Stock, Registered or Bearer (other than Shares included in Section E).	
Price 0 1 0 or under	At discretion.
Over 0 1 0 to 0 2 0	s. d.
.. 0 2 0 to 0 3 6	0 0½
.. 0 3 6 to 0 5 0	0 1
.. 0 5 0 to 0 15 0	0 1½
.. 0 15 0 to £1 10 0	0 3
.. £1 10 0 to £2 0 0	0 4½
.. £2 0 0 to £3 0 0	0 6

			s.	d.	
Over	£3 0 0	to	£4 0 0	..	0 7½ per share or Unit.
..	£4 0 0	to	£5 0 0	..	0 9
..	£5 0 0	to	£7 10 0	..	1 0
..	£7 10 0	to	£10 0 0	..	1 3
..	£10 0 0	to	£15 0 0	..	1 6
..	£15 0 0	to	£20 0 0	..	2 0
..	£20 0 0	to	£25 0 0	..	2 6
..	£25 0 0	..	..	..	½ per cent. on Money.

SECTION E

Shares of Companies incorporated in the United States of America or Canada (whether dealt in in London on a Dollar or Sterling basis), with the exception of Shares which are transferrable by Deed of Transfer.

Price 25 cents (1) or under	..	..	..	..	At discretion.
					s. d.
Over 25 cents (1) to 50 cents (2 )	..	..	..	..	0 0½ per Share.
.. 50 cents (2) to 87½ cents (3/6)	..	..	..	..	0 0¾ ..
.. 87½ cents (3/6) to \$1¼ (5 )	..	..	..	..	0 1 ..
.. \$1¼ (5) to \$3¼ (15 )	..	..	..	..	0 1½ ..
.. \$3¼ (15) to \$7½ (30 )	..	..	..	..	0 3 ..
.. \$7½ (30) to \$10 (£2)	..	..	..	..	0 4½ ..
.. \$10 (£2) to \$15 (£3)	..	..	..	..	0 6 ..
.. \$15 (£3) to \$25 (£5)	..	..	..	..	0 7½ ..
.. \$25 (£5) to \$50 (£10)	..	..	..	..	0 9 ..
.. \$50 (£10) to \$100 (£20)	..	..	..	..	1 0 ..
.. \$100 (£20) to \$150 (£30)	..	..	..	..	1 6 ..
.. \$150 (£30) to \$200 (£40)	..	..	..	..	2 0 ..

With 6d. rise for every \$50, or portion thereof, in price.

SECTION F

INDIAN RAILWAY ANNUITIES	..	..	..	..	..	½ per cent. on Money
OPTIONS FOR MORE THAN ONE ACCOUNT	..	..	..	..	..	As on bargains.
OPTIONS FOR ONE ACCOUNT OR LESS.						
BARGAINS IN PARTLY-PAID STOCK OF NEW ISSUES OR PARTLY-PAID SHARES OF NEW ISSUES.						
BARGAINS IN RIGHTS FOR CASH.						
POWERS OF ATTORNEY FOR INSCRIBED STOCK.						At discretion.
PROBATE AND OTHER VALUATIONS.						
SECURITIES MADE-UP OR MADE-DOWN.						
SHORT-DATED SECURITIES (HAVING FIVE YEARS OR LESS TO RUN)*.						
*NOTE: Not applicable in the case of securities in default.						
TRANSFERS OF STOCKS AND SHARES	..	..	..	..	..

SMALL BARGAINS No lower Commission than £1 to be charged except in the case of:—

- (a) Transactions amounting to less than £100 in value on which a Commission of not less than 10s. must be charged, or
- (b) Transactions amounting to less than £20 in value on which a Commission of not less than 5s. must be charged.

These minimum Commissions on Small Bargains are optional in the case of transactions in British Government Securities for Brokers as defined in Clause (1) of Rule 203.

