

1952

Common stocks and the small investor

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BOSTON UNIVERSITY
College of Business Administration

THESIS

Common Stocks and the Small Investor

by

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(B.S.B.A. Boston University 1950)

Submitted in partial fulfillment of *Edward H. Cronin*
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I. Introduction

A. The Purpose

The general purpose of this thesis is to make a comparative analysis between low priced and high priced common stocks in an attempt to discover the relative opportunities or advantages available to the investor of small means as regards this type of investment.

Since the small investor is limited in the amount of money he has available for investment in securities, he is naturally attracted to those with low market prices. It is almost universally assumed that one with limited resources would rather own ten shares of a particular stock than one share of another stock whose market value is ten times greater than that of each share of the former stock. The reason for this is possibly a combination of the psychological effect of owning ten shares rather than one, and the dream of very rapid capital appreciation through a soaring rise of a low price stock.

Many financial leaders are of the opinion that the man of small means should place his money only in those securities which give assurance of income with the least possible risk of capital, and many others believe that the man of small means should stay out of the stock market entirely. This group adheres to the philosophy that the man of small means can stand only the minimum of risk on his capital. However,

in recent years theory has developed to the effect that the man of small means can find as much room for sound investment in the stock market as can the large investor. It is further claimed that such investment would create a healthier condition not only in the stock market itself, but also in the economic and political position of the nation.

In this regard, Dr. Jacob O. Kamm, Director of the School of Commerce at Baldwin-Wallace College in Ohio, expressed the following opinion.

"Certainly, there has been too much emphasis on the need for a minimum of several thousand dollars in order to invest in common stocks. America has been built on the savings of small investors. A man with a few hundred dollars in addition to a savings account and a life insurance program is not exercising one of the most democratic privileges he has if he fails to own at least a few shares of stock in American private industry.

The broader stock ownership becomes, the less the menace of communism will be a domestic problem. Colleges and universities through their educational training in investing are helping to broaden the investing class and thereby helping to build a greater America."*

B. Work Done By Others

Much work has been done by others concerning low priced stocks. Most of this work, however, related to the relative current position of certain selected issues and the characteristics which should be sought in studying low priced

* 18, p.13

stocks for possible investment. Frequently, many investment advisory services and investment houses will make available information resulting from studies on selected low priced stocks as regards possible current investment. It is also common practice in many textbooks on investment to include information on certain favorable characteristics or positions sometimes found in particular issues in the low price group.

Some time after work on this thesis was commenced, the Magazine of Wall Street published in its January 27, 1951 issue an article by J. C. Clifford entitled "A Timely Evaluation of Low Priced Stocks". In this article, Mr. Clifford drew a comparison between high priced and low priced stocks regarding their recent market action and relative current position. In accomplishing this, Mr. Clifford made use of an index of 100 selected low priced stocks and an index of 100 selected high priced stocks which are kept by the Magazine of Wall Street. This portion of the article contained work more similar in nature to that included in this thesis than any other that could be discovered. However, even in Mr. Clifford's article the major thought was centered around the current position of certain low priced stocks and the present investment possibilities inherent in these selected issues under existing market conditions. This thesis is concerned more directly with low priced stocks as a group and

the investment opportunities and advantages of this group to the investor of small means in comparison with the high priced stock group.

II. The Small Investor

A. A Definition

It is a difficult task, if not an impossible one, to attempt to clearly and concisely define the small investor or, as he is often referred to, the investor of small means. No specific qualifications can be set down as rigid limits beyond which a small investor would automatically become a large investor. The writer has variously heard and read of the small investor being referred to as one with less than anywhere from \$10,000 to \$100,000 available for investment.

David F. Jordan, late Professor of Finance at New York University, had the following opinion pertaining to investors of limited means.

"Although investors include persons with only a few hundred dollars as well as others with many thousands, it is probably true that the individual with less than \$1,000 at his command would be well advised to place his funds in a savings institution rather than in securities. It might well be argued that the individual with less than \$5,000 might follow the same plan because it is only at the \$10,000 level that the investor approaches the point where he may intelligently spread his risks of investment. Elusive as the 'average investor' may be, it would be more correct to assume that he is a man with a

fund of \$50,000 or more, rather than any smaller amount."*

The writer has not established in his own mind any definite boundary between the small investor and the large investor. It might be safely concluded, however, that reference in this thesis to the small investor definitely implies one with less than \$50,000 available for investment and probably more nearly implies an investor with less than \$10,000 available for investment. Thus, it is obvious that the writer is closer in agreement with Dr. Kamm of Baldwin-Wallace College who adheres to the theory that satisfactory diversification can be accomplished with only a few thousand dollars or less rather than with the theory of the late Professor Jordan as mentioned above.

B. Primary Financial Requirements

1. Savings

In any discussion of primary financial requirements which should be satisfied prior to any common stock investment, it should be constantly kept in mind that every case is an individual one and, thereby, peculiar as to its own requirements. However, any person considering common stock investment should make prior provision for cash savings. The writer is of the opinion that a minimum of at least three months income should be set aside in a savings account as a

* 7, p.235-236

cash reserve. If the individual desires to keep a greater amount in cash, then, obviously, he will hold a much stronger financial position. The actual amount held, however, will be set by the personal requirements and desires of the individual. The need for a cash reserve can not be overstressed and one who fails to give proper consideration to this item is on the road to financial difficulty.

2. Insurance

Sufficient insurance protection is another necessary financial requirement to be considered prior to common stock investment. It is of vital importance that one makes adequate provision for those who might be dependent upon him. The insurance requirement of a man with a family will naturally be larger, especially where adequate provision for young children is to be made, than will the requirement of a man with only one dependent. It is, of course, dependent upon the decision of the individual as to what type of insurance best fits his particular situation and desires. Many find some type of life insurance sufficient, whereas, others desire, in addition, some form of annuity policy. The writer is of the personal opinion that term insurance accompanied by a self-investing plan has a decided advantage over other types of life insurance. It is admitted, however, that a great deal of determination must be exercised to keep up the accompanying self-investing plan and that without it the

advantage is lost.

3. Government Bonds

It is almost universally admitted in financial circles that any well-diversified portfolio of necessity includes some bonds, especially government bonds. It is difficult for the small investor to include a sufficient number of corporate bonds in his portfolio to provide proper diversification among the bonds. However, the writer adheres to the opinion that U. S. Government bonds can stand alone in any portfolio. The small investor would probably be most interested in Series E bonds, which yield 2.9% over the ten year period.

The amount of U. S. Government bonds the small investor should hold is dependent upon the amount of money he has available for investment and the amount of cash savings reserve he has set aside. It is advisable, however, that even the investor of most limited means hold some U. S. Government bonds in his portfolio.

4. Real Estate

It is argued by many financial writers that even the smallest investor should own real estate in the form of a home before considering investment in common stocks. The writer believes, however, that this decision should be left to the individual investor. Although it is desirable for the small investor to own his home, reasons advanced in favor of

this position do not seem to justify it as being a necessity. On the other hand, every small investor, allowing for certain exceptions, should have some established plan along this line.

C. Investment Knowledge Required

1. General Conditions

The small investor should make every effort to gain whatever knowledge he can of general business conditions and of economic factors which might affect the stock market, a particular industry or a particular company. It is not expected that the small investor make these subjects a full time study, but he should be willing to devote as much study as possible to a security previous to its selection for his portfolio, and keep a watchful eye on all the securities he owns or is interested in. This involves constant alertness on the part of the small investor to current business and economic conditions.

2. Factors To Be Considered

There are a number of factors that should be taken into consideration by any investor when contemplating investment in securities, and that warrant continued attention, should such investment be undertaken. Probably basic among these factors is the business cycle. The present phase of the business cycle along with its indicated trend is always an important element of control in the action of security markets.

"Business barometers" are considered a means of

measuring business activity and its direction. There are many "business barometers" available for those who might be interested in them, and their meanings may be self-explanatory or extremely complex. These "barometers" include such items as bank clearings and debits, commodity prices, crop conditions, gross national product, national income and the cost of living index. It is advisable that the small investor follow a few of these "barometers" which he feels would be of the utmost importance to his type of investment.

The condition of the stock market itself is another factor important to any investor. Such condition of the market may be divided into its fundamental position and its technical position. The fundamental position of the stock market is dependent upon the overall current economic situation. On the other hand, the technical position of the stock market is dependent upon the action of stocks on the market itself.

There are many other miscellaneous factors which also deserve consideration. Among those which probably should be mentioned is the effect of the stock market on business. Although it is known that the stock market reacts to the condition and activity of business, it should be realized by all investors that business might react to the condition and activity of the stock market. Another relatively important factor to be considered is taxation. The effect of this

item on business profits is obvious from World War II experience. Strikes and political action also bear watching by the investor.

In summary, the investor must be aware of things, and have the capacity to give some kind of interpretation to them.

III. Low Price Vs. High Price Stocks

A. General Discussion

Assuming that the small investor has taken into account the necessary primary financial requirements previously discussed, he is then faced with the problem of selecting securities for investment. It is not the purpose of this thesis to advise the small investor as to the selection of any particular security. However, it is the writer's desire to bring to the attention of the small investor the relatively advantageous position he might, or might not, attain through investment in low price common stocks.

Such a theory is in sharp contrast with the more common one advanced by most financial men. The first and foremost point of consideration, according to the more common theory, is the safety of the investment, for the small investor can ill-afford to take the chance of having his investment wiped out. It is further thought that although any investment is the purchase of a risk, the small investor must be certain that his risk is not too great, for he must

be assured the best possible protection of his limited life savings.

The theory adhered to by the writer is that assuming the small investor has the necessary primary financial requirements, i.e., bank savings, insurance, government bonds and possibly home ownership, in an amount sufficient to cover his needs, then any interest he might have in common stocks is to "make money " either through a high dividend return or capital appreciation. It is agreed that the small investor should keep in mind the relative safety of his investment, however, he should be willing to accept a slightly greater degree of risk in order to receive a return on his money which would substantiate his slightest interest in common stock investment.

As previously mentioned, each individual case is peculiar as to its own requirements. Older people must consider the day when their earning capacity diminishes or ceases entirely, but such should be reflected in their primary financial requirements. Younger people who wish their money to "make money", and choose common stocks as the means, should be willing to accept the greater risk, and look for high yield and capital appreciation. Otherwise, the time involved for properly handling common stock investment would not be worthwhile, and it would be wiser to accept the 2.9% yield on Series E bonds, and use the time saved to a better

advantage. It must be remembered that even in the low price group some securities offer much safety, and also, that many stocks which have a low market value are actually relatively high-priced shares. Such considerations as these, however, are more directly involved with the choice of particular securities rather than the selection of the group from which the securities should be chosen.

B. Method of Comparison

Discussion of the method involved in comparing the low price stocks with the high price stocks was left until now so that it would be fresh in the reader's mind while the comparison is being discussed. In any discussion of statistical measurement the resultant figures might lose their meaning entirely unless the method of arriving at such figures is constantly kept in mind.

As a means of evolving the comparison desired here, a sample of twenty low price stocks, and one of twenty high price stocks were chosen. Immediately the question might be asked, "What is considered a low price stock, and what is considered a high price stock?" There is no official dividing line between the two groups, however, for purpose of comparison, an arbitrary line had to be chosen. A great many people consider a low price stock as one selling below twenty dollars. On the other hand, the writer knows of an investment advisory group which claims to specialize in low price stocks,

and considers such stocks as those selling below fifty dollars. The writer, for the purpose of comparison in this thesis, has considered a low price stock as one whose price is below thirty dollars.

In choosing the twenty stocks to make up the low price group sample, the writer attempted to be as unbiased as possible. The only requirement limiting their selection was that the market price of such stocks be below thirty dollars on January 2, 1940, and on December 31, 1949. This rule was set up in order to prevent the biased choice of stocks which were low price stocks on January 2, 1940, but which the writer knew were selling at a much higher price on December 31, 1949. In order to accomplish this, an arbitrary list of stocks selling below thirty dollars on the former date was drawn up, and then those which were found to be selling above thirty dollars on the latter date were discarded. Since the writer had no knowledge as to whether any stock split-ups may have been made, among the various issues, in the interval between the two selected dates, such was not taken into consideration in the drawing up of the respective lists.

The list of stocks composing the high price group was selected in the same manner as that described above for the low price group, with the exception that the market price on the respective dates had to be above thirty dollars.

However, in choosing the stocks for the high price group, the writer did make some attempt to select those stocks which he thought would adequately represent a high type of investment in common stocks. Such was attempted, so that a fair comparison might be made between common stocks of the type most financial writers believe appropriate for the small investor, and common stocks of the low price group.

Other than the inclusion of one utility company and two railroad companies in each group, no attempt was made to include an equal number of companies from each industry represented in the samples. An attempt was made, however, to represent a wide variety of industries in each group. It was felt that this would make the samples more representative of high price and low price stocks. The resultant lists of low price and high price stocks, along with their market prices, are shown in Table I and II respectively.

After the stocks in each group had been selected, it was assumed that ten shares of each issue were purchased. The assumed purchase of one share of each stock, rather than ten shares, would have served the same purpose, however, it was thought that ten shares of each stock would give a more realistic atmosphere to the comparison. The date of purchase of the shares was assumed to be January 2, 1940, and the comparison of the two groups was made from that date to December 31, 1949.

Table I
Market Prices of Low Price Group

<u>Company</u>	<u>Mkt. Price</u> <u>1/2/40</u>	<u>Stk. Splits &</u> <u>Stk. Dividends</u>	<u>Mkt. Price</u> <u>12/31/49</u>
Amer. Locomotive	22	--	15 5/8
Armour & Co.	5 3/4	--	7 7/8
Bath Iron Works	12 3/4	--	14 5/8
Budd Co.	5 5/8	--	12 7/8
Bullard Co.	22 1/2	--	18 1/4
Com. Solvents	14 5/8	--	20 1/4
Electric Boat	16 3/4	*	17
Florsheim Shoe	24	--	14 5/8
General Baking	7 1/2	--	10 3/4
General Bronze	3	--	14
Gimbel Bros.	8 3/4	3-2, 4-3	15 3/8
G. M. & O. RR	3 1/2	--	13 1/4
Inter. Tel. & Tel.	4	--	9 1/4
Learner Stores	27 1/4	3-1	22 3/4
Nash Kelvinator	6 7/8	--	17
Nat. Dist. Prod.	24 1/2	3-1	22 3/4
Penn. RR	24 1/8	--	17
R. C. A.	5 5/8	--	12 1/2
St. Regis Paper	3 1/4	--	8 1/8
Socony-Vacuum Oil	12 3/8	2%	16 1/2

* 25% stock dividend of \$2 cumulative convertible preferred.
 Market price on 12/31/49 was 34 3/4.

Table II
Market Prices of High Price Group

<u>Company</u>	<u>Mkt. Price</u> <u>1/2/40</u>	<u>Stk. Splits &</u> <u>Stk. Dividends</u>	<u>Mkt. Price</u> <u>12/31/49</u>
American Can	113 1/2	--	106
Amer. Tel. & Tel.	170 7/8	--	146 3/8
Armstrong Cork	38 5/8	--	50 1/2
Chrysler	89 1/2	2-1	67 1/4
Dow Chemical	141	4-1, 2 1/2%	54 7/8
duPont de Nemours	182	4-1	61 3/4
Eastman Kodak	166	5-1, 5%	46 1/2
General Electric	40 5/8	--	42 1/8
General Mills	91	3-1	56
General Motors	54 7/8	--	71 3/4
Monsanto Chemical	107 1/2	3-1	56
Norf. & West. Ry.	214	4-1	49 1/2
Pitt. Plate Glass	100	4-1	37
Proctor & Gamble	65 1/2	--	85
Sears, Roebuck	85 1/4	4-1	44
Stand. Oil (N.J.)	44	2 1/2%, 2%	66 3/4
United Fruit	85	3-1	55 1/4
United Shoe Mach.	82 1/2	--	45
Union Carbide	86 3/4	3-1	44 1/4
Union Pacific RR	94	2-1	83 1/4

It is admitted that the ten year period selected was one of rapid growth and rising market prices, but such affected both groups, and should not rule out the selection. Also, since reports on all the various companies were not available for the full year 1950 at the time this part of the work was being compiled, December 31, 1949 was chosen as the final date.

The next step was to compute the cost of the shares purchased in each company, and find the total cost of all the shares in each group. It should be mentioned at this point that no broker commissions were taken into consideration in this comparison of the two common stock groups. Although it is admitted that the broker commission is a factor to be considered by all investors, the writer felt that its inclusion here would merely serve to complicate the question being considered.

After the total purchase cost of ten shares of the stock of each company in the low price and high price group was computed, the market value of the shares on December 31, 1949 had to be found for each group. This involved reference to the records of each company in the two groups in order to determine whether any stock split-ups or stock dividends had been made during the ten year period. If any stock split-ups had been made, the resultant number of shares was computed. Where stock dividend payments were made, whole shares were

Table III

Cost and Final Value of Stocks in Low Price Group

(Based on Purchase of 10 Shares)

<u>Company</u>	<u>Cost (\$)</u> <u>1/2/40</u>	<u>Resultant</u> <u>No. of Shares</u>	<u>Value (\$)</u> <u>12/31/49</u>
Amer. Locomotive	220.00	10	156.25
Armour & Co.	57.50	10	78.25
Bath Iron Works	127.50	10	146.25
Budd Co.	56.25	10	128.75
Bullard Co.	225.00	10	182.50
Com. Solvents	146.25	10	202.50
Electric Boat	167.50	10	170.00
Florsheim Shoe	240.00	10	146.25
General Baking	75.00	10	107.50
General Bronze	30.00	10	140.00
Gimbel Bros.	87.50	20	307.50
G.M. & O. RR	35.00	10	132.50
Inter. Tel. & Tel.	40.00	10	192.00
Lerner Stores	272.50	30	682.50
Nash Kelvinator	68.75	10	176.25
Nat. Dist. Prod.	245.00	30	682.50
Penn. RR	241.25	10	170.00
R. C. A.	56.25	10	125.00
St. Regis Paper	32.50	10	80.00
Socony-Vacuum Oil	<u>123.75</u>	<u>10</u>	<u>165.00</u>
Total	2,547.50	250	4,070.00

Ave. Cost / Share \$12.74

Ave. Final Value / Share (250 shs.) \$16.24

Percentage Increase in Total Value 59.7%

Table IV

Cost and Final Value of Stocks in High Price Group

(Based on Purchase of 10 Shares)

<u>Company</u>	<u>Cost (\$)</u> <u>1/2/40</u>	<u>Resultant</u> <u>No. of Shares</u>	<u>Value</u> <u>12/31/49</u>
American Can	1,135.00	10	1,060.00
Amer. Tel. & Tel.	1,708.75	10	1,463.75
Armstrong Cork	386.25	10	505.00
Chrysler	895.00	20	1,353.00
Dow Chemical	1,410.00	41	2,249.88
duPont de Nemours	1,820.00	40	2,470.00
Eastman Kodak	1,660.00	52	2,418.00
General Electric	406.25	10	420.00
General Mills	910.00	30	1,657.50
General Motors	548.75	10	717.50
Monsanto Chemical	1,075.00	30	1,680.00
Norf. & West. Ry.	2,140.00	40	1,940.00
Pitt. Plate Glass	1,000.00	40	1,480.00
Proctor & Gamble	655.00	10	850.00
Sears, Roebuck	852.50	40	1,760.00
Stand. Oil (N.J.)	440.00	10	667.50
United Fruit	850.00	30	1,657.00
United Shoe Mach.	825.00	10	450.00
Union Carbide	867.50	30	1,327.50
Union Pacific RR	940.00	20	1,665.00
Total	20,525.00	493	27,793.13

Ave. Cost / Share \$102.63

Ave. Final Value / Share (493 shs.) \$56.37

Percentage Increase in Total Value 35.4%

considered to be held along with the original shares to December 31, 1949. However, in the case of resultant script, it was figured at its market value on December 31, 1949 and added to cash dividends received during the ten year period.

From the records of the various companies, cash dividends were computed on all shares held as of the time the payments were made. These payments were then totaled for the ten year period, together with any script held as mentioned above, and a grand total was taken for each group.

A special explanation should probably be made at this point regarding the handling of the preferred stock dividend paid on Electric Boat Company common stock. On July 10, 1946 a 25% stock dividend was paid on the common shares in the form of Electric Boat Company \$2 cumulative convertible preferred stock. For the purpose of uniformity, it was assumed, as in the case of script, that the resultant preferred shares were held until December 31, 1949. At this date, the preferred was assumed to have been sold at the prevailing market price, and the resultant sum was added to the dividends received on the whole shares of preferred during the period held. This total was in turn added to the cash dividends received on the common stock over the ten year period.

Dividend yields were computed as an average annual per share yield for the ten year period based upon the

purchase price. It is appropriate at this point to clarify the above statement for it is not as simple as it might at first appear. When the writer says, "annual average per share yield", he has in mind the original shares purchased on January 2, 1940. If the original ten shares purchased have later increased to thirty shares, through a stock split-up, and dividends over part of the period have been collected on thirty shares, such dividends were still considered to have been paid on the original ten shares. In other words, the writer interpreted that although the number of shares actually increased three-fold, the total amount of dividends received over the period was a return on the original capital invested. For this reason, it is stated that the yield is "based on the purchase price". Thus, the yields stated in this comparison are applicable only to the particular stock when purchased on January 2, 1940 and held to December 31, 1949. The average yield for each group was also computed.

The percentage increase in the value of the shares (percentage of capital appreciation) was computed for all the various companies. This percentage was also computed for each of the two groups.

The resultant computations are shown in Tables I, II, III, IV, V and VI.

After the results of the comparison described above have been discussed, the writer will briefly analyse the

Table V

Income, Yield and Appreciation
of Stocks in Low Price Group

<u>Company</u>	<u>Total Income</u> <u>Received (\$)</u>	<u>Ave. Annual</u> <u>Yield (%)</u>	<u>% Capital</u> <u>Appreciation</u>
Amer. Locomotive	81.50	3.71	-34.6
Armour & Co.	9.00	1.57	36.1
Bath Iron Works	232.50	18.23	14.6
Budd Co.	15.00	3.76	128.8
Bullard Co.	152.50	6.78	-18.9
Com. Solvents	90.00	6.12	38.5
Electric Boat	221.88	13.25	1.5
Florsheim Shoe	121.23	5.04	-39.1
General Baking	66.50	8.87	43.3
General Bronze	58.00	19.33	366.7
Gimbel Bros.	146.50	16.75	397.5
G.M.&O. RR	10.00	2.86	278.5
Inter. Tel. & Tel.	Nil	Nil	144.3
Lerner Stores	310.00	11.38	150.0
Nash Kelvinator	75.25	10.94	156.4
Nat. Dist. Prod.	442.50	18.05	178.6
Penn. RR	172.50	7.16	-29.6
R. C. A.	24.00	4.27	122.2
St. Regis Paper	16.50	5.08	146.2
Socony-Vacuum Oil	75.80	6.12	30.0
Total	<u>2,341.16</u>		

Average Yield 9.2%

Total increased value of investment (appreciation plus dividends) in percent equaled 151.7%

Table VI

Income, Yield and Appreciation
of Stocks in High Price Group

<u>Company</u>	<u>Total Income Received (\$)</u>	<u>Ave. Annual Yield (%)</u>	<u>% Capital Appreciation</u>
American Can	305.00	2.69	-6.6
Amer. Tel. & Tel.	900.00	5.26	-14.3
Armstrong Cork	203.50	5.27	30.7
Chrysler	460.00	5.14	51.2
Dow Chemical	350.00	2.48	59.6
duPont de Nemours	713.50	3.93	35.7
Eastman Kodak	690.75	4.16	45.6
General Electric	159.00	3.92	3.4
General Mills	498.80	5.49	82.2
General Motors	352.50	6.43	30.7
Monsanto Chemical	365.00	3.39	56.3
Norf.&West.Ry.	1,325.00	6.19	-9.3
Pitt. Plate Glass	513.50	5.13	48.0
Proctor & Gamble	310.00	4.74	29.8
Sears, Roebuck	575.00	6.77	106.7
Stand. Oil (N.J.)	293.24	6.65	51.7
United Fruit	587.50	6.90	94.9
United Shoe Mach.	338.75	4.12	-45.4
Union Carbide	350.50	4.03	53.1
Union Pacific RR	<u>730.00</u>	7.77	77.1
Total	10,323.54		

Average Yield 5.0%

Total increased value of investment (appreciation plus dividends) in percent equaled 85.8%

December 31, 1949 capital position of the three best performers in each of the two groups. The price performance of these six companies from 1944 to the present will then be described and compared.

C. Discussion of Results

The market prices of the stocks included in the low price group on January 2, 1940 ranged from a low of 3 to a high of $27\frac{1}{4}$. The group had an average market price on this date of \$12.74 per share. Thus, the total purchase cost of ten shares of common stock of each of the twenty companies in the low price group was \$2,547.50. Stock split-ups and stock dividends were infrequent among the companies in this group, and only in the case of three companies was the resultant number of shares on December 31, 1949 greater than the original number purchased. However, the total value of the number of shares held in the low price group on December 31, 1949 was \$4,070.00. This amounted to a capital appreciation over the ten year period, on the original investment, of \$1,522.50 or 59.7%. The percentage change in the value of the shares over the period for the various companies included ranged from -39.1% to 397.5%. Of the twenty companies in the low price group, the shares of sixteen companies appreciated in value, and the shares of four companies depreciated in value. Dividends were paid, at some time during the period, by all companies, with the exception of

International Telephone and Telegraph. Of those companies paying dividends, the dollar amounts for the ten year period on the number of shares held ranged from a low of \$9.00 to a high of \$442.50. In the low price group, the average annual yield per share, over the ten year period, based on the original purchase price was 9.2%. The total dollar amount of such dividends for the group amounted to \$2,343.16. Therefore, assuming such dividends to have been held until December 31, 1949, and considering the market value of the shares held on that date, the total value of the original investment has increased to \$6,413.16. The increase in value over the original investment amounted to a percentage increase of 151.7%.

The companies in the low price group whose shares showed the highest percentage of capital appreciation were: Gimbel Brothers; General Bronze; Gulf, Mobile and Ohio Railroad; and National Distillers Products. These companies are shown with their percentage figures, along with a similar group from the high price stocks, in Table VII.

Those companies in which the value of their shares depreciated over the period were: Florsheim Shoe, American Locomotive, Pennsylvania Railroad, and The Bullard Company. These companies are shown, along with their percentage figures, in Table VIII.

The companies which showed the highest average

Table VII

Stocks Showing the Largest
Percent of Capital Appreciation

<u>Company</u>	<u>Rank</u>	<u>% Capital Appreciation</u>
Low Price Group:		
Gimbel Brothers	1	366.7
General Bronze	2	366.7
Gulf, Mobile & Ohio RR	3	278.5
Nat. Distillers Prod.	4	178.6
High Price Group:		
Sears, Roebuck	1	106.7
United Fruit	2	94.9
General Mills	3	82.2
Union Pacific RR	4	77.1

Table VIII

Stocks Showing the Largest
Percent of Capital Depreciation

<u>Company</u>	<u>Rank</u>	<u>% Capital Depreciation</u>
Low Price Group:		
Florsheim Shoe	20	-39.1
Amer. Locomotive	19	-34.6
Pennsylvania RR	18	-29.6
Bullard Co.	17	-18.9
High Price Group:		
United Shoe Mach.	20	-45.4
American Tel. & Tel.	19	-14.3
Norfolk & Western RR	18	-9.3
American Can	17	-6.6

annual yield for the low price and high price groups are listed in Table IX along with their respective yields. In the low price group, these companies were: General Bronze, Bath Iron Works, National Distillers Products, Gimbel Brothers, and Electric Boat Company.

The January 2, 1940 market prices of the stocks included in the high price group ranged from a low of 38 $\frac{5}{8}$ on Armstrong Cork to a high of 214 on Norfolk and Western Railway. The group had an average market price on this date of $\$102.62\frac{1}{2}$ per share. Thus, the total purchase cost of ten shares of common stock of each of the twenty companies included in the high price group was $\$20,525.00$. Stock split-ups and stock dividends were much more frequent in this group than in the low price group, and in twelve companies the resultant number of shares on December 31, 1949 was greater than the original number purchased. The total value of the number of shares held in the high price group on December 31, 1949 was $\$27,793.13$. This only amounted to a capital appreciation over the ten year period, on the original investment, of $\$7,268.13$ or 35.4%. Just as in the case of the low price group, the shares of sixteen of the twenty companies appreciated in value, and the shares of four companies depreciated in value. This is a startling result, in that, if high price stocks provide better protection for invested capital than do low price stocks, as is normally considered to be true, then

Table IX

Stocks Showing the Highest
Average Annual Yield

<u>Company</u>	<u>Rank</u>	<u>Ave. Annual Yield (%)</u>
Low Price Group:		
General Bronze	1	19.33
Bath Iron Works	2	18.23
Nat. Distillers Prod.	3	18.05
Gimbel Brothers	4	16.75
Electric Boat Co.	5	13.25
High Price Group:		
Union Pacific RR	1	7.77
United Fruit Co.	2	6.90
Sears, Roebuck	3	6.77
Standard Oil (N.J.)	4	6.65
General Motors	5	6.43

one would rightfully expect a better result from them on this score than was actually shown.

In the high price group, all companies paid some dividends during the ten year period, and it must be admitted that the average of the group was much steadier in this respect than was the average of the low price group. The dollar amount of dividends paid by the high price group over the period on the shares held ranged from a low of \$159.00 on General Electric to a high of \$1,325.00 on Norfolk and Western Railway. However, in the high price group, the average annual yield per share, over the ten year period, based on the original purchase price was only 5.0%. This compares to 9.2% for the low price group as mentioned above. The total dollar amount of dividends for the high price group was \$10,323.54. Assuming such dividends to have been held until December 31, 1949, as was with the other group, and considering the market value of the shares held on that date, the total value of the original investment has increased to \$38,116.67. The increase in value of the high price stocks over the original investment amounts to a percentage increase of 85.8%. This compares to 151.7% for the low price group as mentioned previously.

The companies in the high price group whose shares showed the highest percentage of capital appreciation were: Sears, Roebuck; United Fruit; General Mills; and Union

Pacific Railroad. These are shown along with those of the low price group in Table VII.

Those companies in which the value of their shares depreciated during the period were: United Shoe Machinery, American Telephone and Telegraph, Norfolk and Western Railway, and American Can. These are shown with a like group of the low price stocks in Table VIII.

The companies in each of the two samples which showed the highest average annual yield are shown in Table IX as pointed out previously. In the high price group, these companies were: Union Pacific Railroad; United Fruit; Sears, Roebuck; General Motors; and Norfolk and Western Railway.

Three of the four companies in both the low price and high price groups, who had the highest percentage of capital appreciation in their respective groups, were also among the five companies of each group having the highest average annual yield. This being the case, the writer thought it would be interesting as well as revealing to go a little deeper into the comparison of these six companies. Thus, certain statistics on these companies as of December 31, 1949 are shown in Table X, and their capital positions as of that date are shown in Table XI.

In Table X, it is obvious that although the earnings per share of the high price stocks for 1949 are much higher than those of the low price stocks, the price-earnings

Table X

Price, Earnings and Dividend Statistics
of Group Leaders -- December 31, 1949

<u>Company</u>	<u>Market Price</u> <u>12/31/49</u>	<u>Earn./Sh.</u> <u>1949(\$)</u>	<u>P/E</u> <u>Ratio</u>	<u>Div./Sh.</u> <u>1949 (\$)</u>	<u>Yield</u> <u>(%)</u>
High Price Group:					
Sears, Roebuck	44	4.58	9.6	2.25	5.12
United Fruit	55 1/4	6.25	8.8	4.00	7.24
Union Pacific RR	83 1/4	10.26	8.1	6.00	7.21
Low Price Group:					
General Bronze	14	3.03	4.6	1.00	7.14
Gimbel Bros.	15 3/8	4.16	3.6	1.25	6.83
Nat. Dist. Prod.	22 3/4	3.03	7.3	2.00	8.82

ratios of the low price stocks are much lower. A low price-earnings ratio is an important factor to be considered in the purchase of common stocks, and in this case the low price issues have the advantage. It will also be noted that although the high price stocks paid out a larger dollar amount in dividends in 1949, the low price stocks showed the greater yield. Yield, of course, is of obvious importance in considering any investment.

In referring to Table XI, it should be noted immediately that the relative size of the companies varies greatly, and that the high price shares represent on the average much larger companies. Even within the two groups, this difference in size will be noted, as may be shown by their asset value. For example, in the low price group, General Bronze has an asset value of \$8.4 million, while National Distillers Products has an asset value of \$235.7 million. In the high price group, Union Pacific has an asset value of \$1,177.1 million, while United Fruit has an asset value of \$337.4 million.

The net current assets of the six companies also vary greatly, as do the respective cash positions, as shown in the same table. However, although the cash position of the high price group is much stronger than that of the low price group, the ratio of current assets to current liabilities strongly favors the low price group. It should be realized, of course, that some of the companies, particularly

Table XI

Capital Position of Group Leaders
December 31, 1949

<u>Company</u>	<u>Cur.</u> <u>Assets*</u>	<u>Cur.</u> <u>Liab.*</u>	<u>Net</u> <u>Cur.</u> <u>Assets*</u>	<u>Cash&</u> <u>Gov.*</u>	<u>Cur.</u> <u>Ratio</u>	<u>Asset</u> <u>Value*</u>
High Price Group:						
Sears, Roebuck	605.3	193.7	411.5	190.8	3.16	808.5
United Fruit	97.4	53.3	44.0	77.3	1.83	337.4
Union Pacific	181.1	85.1	96.0	105.2	2.13	1,177.1
Low Price Group:						
General Bronze	5.7	2.8	2.8	1.1	2.04	8.4
Gimbel Bros.	82.8	26.4	56.5	13.7	3.14	139.0
Nat. Dist. Prod.	184.8	30.5	154.3	18.4	6.06	235.7

* Millions of dollars

Table XII

Net Current Assets Per Share
of Group Leaders -- December 31, 1949

<u>Company</u>	<u>Net Cur. Assets (\$ Mil.)</u>	<u>Shares Outstanding (Millions)</u>	<u>N.C.A. Per Share (\$)</u>
High Price Group:			
Sears, Roebuck	411.5	23,647	17.40
United Fruit	44.0	8,775	5.00
Union Pacific RR	96.0	4,446	21.60
Group Average	<u>183.8</u>		<u>14.70</u>
Low Price Group:			
General Bronze	2.8	238	11.80
Gimbel Bros.	56.5	1,955	28.90
Nat. Dist. Prod.	154.3	7,978	19.30
Group Average	<u>71.2</u>		<u>20.00</u>

Sears Roebuck, National Distillers Products and Gimbel Brothers, necessarily carry large inventories, which are naturally shown in current assets. This item should, therefore, be constantly watched by investors under our everchanging economic conditions.

The net current assets of the leaders of the high price group average \$183.8 million compared to an average of only \$71.2 million for the leaders of the low price group, as shown in Table XII. An interesting result develops, however, when these figures are placed on a per share basis. The net current assets per share of the leaders of the low price group average \$20.00, whereas those of the high price group average only \$14.70. Therefore, when one considers the number of shares involved, net current assets, as well as many other items, often show an entirely different picture, as is true of those above.

It would be of little value to compare the long-term debt of the leaders of the two groups, for the large debt of Union Pacific, which is common in the railroad industry, would greatly distort any comparison. Nevertheless, the debt of a company is extremely important in the analysis of its securities.

In Table XIII, price ranges for the six companies are given from 1944 to 1951. Also shown in this table are the closing market prices for the six companies on March 22,

Table XIII

Price History of Group Leaders

(Adjusted for stock splits.)

<u>Company</u>	<u>Market Price 3/22/51</u>	<u>1950-51 Range</u>	<u>1949 Range</u>	<u>1944-48 Range</u>
Low Price Group:				
General Bronze	18	28-13	15-9	28-7
Gimbel Bros.	20	25-14	17-12	44-5
Nat. Dist. Prod.	27	29-20	23-17	32-10
High Price Group:				
Sears, Roebuck	56	58-40	44-34	50-21
United Fruit	70	74-50	56-44	60-18
Union Pacific	100	109-81	89-73	96-47

1951. The writer thought it would be of interest to show what would happen if all six issues again advanced to their 1951 high, or if they again declined to their 1949 low. This was accomplished through the use of material on Table XIII, which partially supplied the information for Table XIV. As shown in Table XIV, an assumed advance to their 1951 high would cause an increase in per share value in the low price shares of 7.4%, 25.0% and 38.9%, which is an average increase of 23.8%. Among the high price shares the advance would result in an increase of 3.6%, 5.7% and 9.0%, or an average increase of only 6.1%. The assumed decline would cause a decrease in value of the low price shares of 37.0%, 40.0%, and 50.0%, or an average decline of 42.3%. The same assumption would decrease the value of the high price shares by 27.0%, 37.2% and 39.3%, or an average decrease of 31.2%. Thus, while the low price shares would advance 23.8%, or almost four times the advance of the high price shares, their decline would be 42.3%, or only one-third greater than that of the high price shares. Therefore, the leading performers representing the low price group definitely hold a more favorable position over the leading performers representing the high price group as tested by this method.

It is apparant to the writer that the above test, inserted as another means of comparing the relative performance and current position of the leaders in each group,

Table XIV

Assumed Advance to 1951 High or Decline
to 1949 Low from March 22, 1951 Price

<u>Company</u>	<u>Market Price 3/22/51</u>	<u>To 1951 High</u>		<u>To 1949 Low</u>	
		<u>Points</u>	<u>Percent</u>	<u>Points</u>	<u>Percent</u>
Low Price Group:					
General Bronze	18	7	38.9	9	50.0
Gimbel Bros.	20	5	25.0	8	40.0
Nat. Dist. Prod.	27	2	7.4	10	37.0
Group Average			<u>23.8</u>		<u>42.3</u>
High Price Group:					
Sears, Roebuck	56	2	3.6	22	39.3
United Fruit	70	4	5.7	26	37.2
Union Pacific	100	9	9.0	27	27.0
Group Average			<u>6.1</u>		<u>31.2</u>

might be assumed to apply to the groups as a whole. Since this might lead to the criticism that the samples would not necessarily portray the resultant market action of the, the entire twenty stocks of each group were tested by the same method. The resultant figures are shown in Table XV. The prices of the individual stocks in each group are not shown, however, the total values from which the average prices were obtained are recorded for both groups.

It will be noted in Table XV that the results for the entire groups are very similar to the results for the leaders of each group which were shown previously. The assumed advance of the shares in the low price group to their respective 1951 high would result in an increase in average per share value of 16.8% compared to 4.5% for the high price group. The assumed decline would result in a decrease in average per share value of the low price group of 43.2% as against 33.1% for the high price group. Thus, as in the case of the leaders of the two groups, the low price group's advance would be approximately four times as great as that of the high price group in the assumed market rise, whereas, its decrease in value would be approximately only one-third greater than that of the high price group in the assumed decline. Thus, it would appear that the low price group has a decided advantage over the high price group when considering the proportional price movements in a rising or falling market.

Table XV

Assumed Advance or Decline of All Stocks
in Each Sample and Current Yield

<u>Sample</u>	<u>Market Price 3/22/51</u>	<u>1951 High</u>	<u>1949 Low</u>	<u>1950 Div.(\$)</u>
Low Price Group:				
Total of 20 Stocks	393	459	223	30.80
Average	19.65	22.95	11.15	1.54
High Price Group:				
Total of 20 Stocks	1458	1524	975	99.33
Average	72.9	76.2	48.75	4.97

Results

Low Price Group:

Percent increase to 1951 High	16.8%
Percent decrease to 1949 Low	43.8%
Yield based on 1950 dividend	7.84%

High Price Group:

Percent increase to 1951 High	4.5%
Percent decrease to 1949 Low	33.1%
Yield based on 1950 dividend	6.82%

D. Affirmative Considerations

1. Average Annual Yield

As stated previously, it is the theory of the writer that any small investor who has the necessary primary financial requirements is interested in common stocks only to "make money", either through a high dividend return or capital appreciation. Although it is agreed that he should keep in mind the relative safety of his investment, the writer believes that the small investor should be willing to accept a slightly greater degree of risk in order to receive a return on his money which would substantiate his slightest interest in common stock investment.

As an example, let us suppose that a small investor, who has sufficiently provided for the necessary primary financial requirements peculiar to his individual situation, has \$5,000 available for investment. Using the statistics which resulted from the previous comparison of high price and low price stocks, let us assume that he invested the money, and at the end of the year the stock prices returned to their original points. Thus, the only factor involved will be the income received on the stocks during the year.

Investment in the high price stocks at the 5.0% average annual yield would result in a sum (stock value plus income) of \$5,250 at the end of the year. In the case of the low price stocks, the resultant sum would be \$5,460 from a

9.2% yield. If he invested in Series E bonds, the resultant sum, using the ten year average yield of 2.9%, would be \$5,145. Thus, by investing in the high price stocks, the investor would gain \$105 over a like investment in Series E bonds. If the investment had been made in low price stocks, the investor would gain \$315 over a like investment in Series E bonds.

In the opinion of the writer, it is very questionable whether the \$105 is adequate compensation for having given up the quality and safety inherent in Series E bonds for common stock investment. The investor would possibly be much wiser to confine all his investing to Series E bonds. On the other hand, if the income over and above that received on Series E bond investment is three times greater than that mentioned above, or \$315, as in the case of the gain by investment in the low price stocks, then the investor might be justified in showing an interest in common stocks. It is recognized that this difference in compensation results from a difference in the estimated risk involved in the two groups of common stocks, however, the writer believes that the small investor should accept the slightly greater risk involved. The largest degree of risk is involved in the small investor's decision to undertake any form of common stock investment, even in shares of the very highest quality, therefore, such a decision should be justified by adequate compensation.

It should be clearly understood that although comparison here has been made with twenty particular low price common stocks, the writer does not wish to imply that any of these issues are necessarily being suggested as stocks for investment. They were chosen at random merely for the purpose of comparison as a group. The writer does believe, however, that there are a great many stocks in the low price field which are suitable for investment on the part of the small investor. It is not the purpose of this work to select such stocks, for that is a decision to be made by the individual investor based upon his own knowledge, experience and judgment.

2. Price Appreciation and Depreciation

Another factor to be taken into consideration concerns the relative effect on high price or low price stocks of price appreciation or depreciation in a rising or falling market. The result of the test previously applied to selected stocks from each of the two groups, and that of each group as a whole, showed that an assumed rise to a particular market level had four times the effect on the stocks from the low price sample, whereas, a similarly assumed decline had only a one-third greater effect on the same stocks. It is obvious that a varying degree of effect would result upon the selection of various stocks under variously assumed market levels. However, it is important to consider that although

low price stocks rise faster in a rising market, and fall faster in a falling market, than do high price stocks, the relative degree of rise and fall as between the two groups favors the low price stocks, as shown by this comparison.

One might argue that such a statement may not always hold true, as might be shown by a comparison of stock prices between 1929 and 1932, or some such similar period. By assuming that such might be the case, it would become necessary for reasons of safety to limit the above consideration to what might be termed normal market fluctuations as differentiated from such as the market crash of 1929. With such a limitation placed upon it, the conclusion reached above would be of little practical value. In the first place, the term "normal market fluctuations" is too general, and could not be safely relied upon. Secondly, even if it should be possible to determine what "normal market fluctuations" are, it would still be impossible to accurately forecast when market fluctuations are going to cease to be "normal", and are going to commence to be "abnormal".

In support of an answer to the possible argument that the conclusions reached concerning the relative price movement of high priced and low priced stocks may not always hold true, reference is made to a statistical study by Louis H. Fritzemeler of the relative price behavior of industrial stocks in various price groups from 1926-1935. In this

study, Mr. Fritzeimer stated the following results as concerned high price and low price stocks:

"Unless there are serious uncompensated errors in the statistical work here presented, this investigation would seem to establish the existence of certain relationships between price level and price fluctuations which have hitherto gone unreported by students of stock-market phenomena. These relationships may be briefly stated as follows:

1. Low-price stocks tend to fluctuate relatively more than high-price stocks.

2. In a "bull" market the low-price stocks tend to go up more than high price stocks, and they do not lose these superior gains in the recessions which follow. In other words, the downward movement of low-price stocks is less than proportional to their upward movement, when compared with the upward and downward movement of high-price stocks."*

It will be noted that the period covered by Mr. Fritzeimer's study was from 1926 to 1935 which includes the period from 1929 to 1932. Also, it will be noted that although the method used is not the same as that used by this writer, the results are almost exactly the same. Thus, it is relatively safe to state that the conclusion reached by the writer regarding the price movements of the high price and low price groups applies to "abnormal" as well as "normal" market fluctuations.

As a means of further strengthening the conclusion on price fluctuation, the writer wishes to merely mention a

* 6, p.555

study published in 1931 by J. H. Holmes and Company. This study was devoted to the relative behavior of low-priced and high-priced issues when purchased at or near the bottom of depressions in 1897, 1907, 1914 and 1921. Within its more limited scope, this study led to conclusions similar to those reached later by Louis H. Fritzscheier.

It should be recognized that during any drastic market movement such as 1929, with a few possible exceptions, all securities will tend to suffer in price. The vast majority of financial men believe that the only reasonable protection from such a drastic market movement would be investment in securities of the very highest quality. Such action would automatically eliminate any investment in common stocks, regardless of the price group. Therefore, it might logically be assumed, considering this point of view, that the high price stock group would hold no advantage over the low price stock group under such conditions.

3 . Raising Quality of Investment

The small investor should be constantly on the alert for any situation which might allow him to improve his position. This may, under certain circumstances, involve a switch to a stock in the high price group in order to preserve a gain and improve quality. For example, a stock in the low price group may rise to a point where its price would classify it as being in the high price group. However, it may still

be considered normally a low price stock, and an investor may fear losing a portion or all of a substantial capital gain in a declining market. Under these circumstances, an investor would be wise in attempting to switch to a stock of higher quality and greater price stability, which might even be found at about the same price level. The investor may then hold on to his higher quality stock, or hold it merely until he can buy back into the previously held stock at a safer price level. In other words, a low price stock may rise in price to a point where it would become vulnerable to a rapid price decline in a falling market. Thus, an attempt is made to increase quality and preserve gains. The basis of the principal involved is similar to that employed by formula plans requiring an increasing percentage of bond investment and a decreasing percentage of stock investment in a rising market.

4. Special Situations

Another consideration which warrants the constant attention of the small investor is that of special situations. It might be logically stated that the small investor, if any-one, should be keenly interested in hunting out such securities, for proper diversification of them normally provides better than average chances of success. Undervalued securities offer a higher indicated or appraised value than that suggested by the market price. It is obvious that the price will not

always react to correct this difference in value, however, proper diversification will tend to reduce this element of risk. In those cases in which the price does react favorably, the rewards are usually more than sufficient to offset the unresponsive selections. It should be noted that here, as always, quality is a prime consideration. Since a security of only average quality can become a sound investment opportunity at a sufficiently low price, it is necessary for the small investor to cautiously compare the market price with a conservative estimate of the indicated or appraised value of the security.

5. Impact of Growth

The small investor should also give serious consideration to the selection of a security that will do better than the average over a period of years. A growth stock may be so classified since it is defined as a security which has outperformed the market in the past and is expected to do the same in the future. One can easily ascertain what has happened in the past, but the important factor is to correctly forecast the future. While the past record is important, and may be wisely used as a guide, it does not necessarily indicate what the future trend will be. Another factor to be considered in searching for such stocks is that a security with a good growth record, and with indicated future growth, will sell at a relatively high price. This in itself is not

a bad feature, however, there is a strong tendency for such stocks to be overpriced. In other words, although the growth may continue, investors may be overvaluing such future growth. This appears to be the direct opposite of the previously mentioned special situation. In the case of the special situation, unpopularity may result in the undervaluing of the security, whereas, in the case of growth stocks, popularity may result in overvaluing the security.

The attention of the small investor is here directed at the probable relative degree of appreciation of such stocks in the high and low price groups. It has already been determined that low price stocks will rise proportionately faster than high price stocks in a rising market. Therefore, assuming certain stocks of each group have equal possibilities of growth, and to an equally proportionate degree, it might be logical to further assume that the proportional effect on price would be greater in the low price group. It should be remembered, however, that here, as always, proper diversification is of inestimable value.

6. Effect of Institutional Investment

Institutional investment may have various effects, in number and intensity, on the common stock field of investment. This type of investment has become a major factor in common stocks only in relatively recent years. Its impetus has increased in the last few years because of common stock

investment by insurance companies and pension trust funds. Any explanation as to the effect such investment might have on common stocks would almost necessarily be conjectural. However, it is probably worthwhile to consider some possibilities, and how they might affect the individual investor.

The large majority of those shares which form the basis of institutional common stock investment are of high quality and/or show a good growth potential. These stocks are usually found in the high price group, with the possible exception of numerous public utility issues. Purchase of this class of common stocks by institutions may tend to build up or stabilize their prices when they are in favor. However, individual issues or particular groups may react drastically when, for some reason, they suddenly fall out of favor. Thus, such stocks in the future may not accurately portray general market activity or trends. On the other hand, institutional reaction to financial, economic or political conditions might result in movements by these stocks which in turn would drag other stocks with them, either up or down. This appears to be a logical assumption since many of the so-called "market leaders" are held in favor by institutional investors. Also, many of the stocks which are major holdings by institutions in large part make up the famous "averages" such as the Dow Jones Indexes. Thus, the "averages" may fluctuate as a result of the investment action of institutions, and

due to this fluctuation of the "averages", the overall market may fluctuate likewise. Then again, the overall market may not move in a similar manner, in which case the "averages" will be portraying the trend of a relatively few stocks rather than that of the general market.

Regarding the latter, the following quotation from the column of Edson B. Smith, financial writer for The Boston Herald, may be of interest:

"One of the unusual characteristics of the bull market which started in June, 1949, has been the comparative lack of interest in low priced issues. Generally, in protracted bull swings, speculation spills over into stocks selling for a few dollars a share.

This week's Barron's (January 7, 1952) has an interesting study of this situation. It made a list of 48 low-priced stocks which was designed to include all of the more actively traded listed stocks that dipped to five or below at any time between 1942 and 1949. At their best 1951 prices these stocks on the average were 48 per cent below their 1946 tops.

The whole market as measured by any of the accepted averages was substantially higher in 1951 than in 1946. The Dow-Jones industrials, for example, were 212 at their 1946 high and 276 at their 1951 high. Both the utility and rail averages were substantially higher in 1951 than in 1946.

All this perhaps is indirect evidence of the importance in the market during the last year of what may properly be described as informed buying. The concentration of investment demand in the better class of stocks and the relative neglect of what sometimes have been referred to uncharitably as 'cats and dogs', shows the important part that investment trusts, pension funds and others of similar stature

have played on the recent market."*

It is probably appropriate to make two specific comments concerning the above quotation. The first is in regard to the statement that "The whole market as measured by any of the accepted averages was substantially higher in 1951 than in 1946." It will be noted that Mr. Smith then cited the Dow-Jones industrial average as a specific example, and the Barron's article also referred to this average. However, at the other extreme, had the average market price of all issues listed on the New York Stock Exchange been used instead, the result would have been entirely different. The latter average market price at its 1946 high was \$50.45, whereas, its 1951 high was only \$42.20. It is apparent from this that the Dow-Jones industrial average is not a measure of the "whole market".

The second comment concerns the fact that the 48 low priced stocks in the sample used in the Barron's article (Low-Priced Shares by Roger W. Bridwell) were, at their best 1951 levels, 48% below their 1946 top. Also, reference was made in Mr. Bridwell's article in Barron's to "a well-known index of low-priced stocks" which at its 1951 high was 20% below its 1946 peak. In regard to the former, the 48 low-priced stocks were subject to two conditions according to the article. They had to be among the more actively traded, listed stocks that dipped to five or below at the trough of

the bear-to-bull reversals of 1942 and 1949, and also, omitted from the list were many issues usually included in such a tabulation, which might reflect special influences of a non-recurring nature, rather than the speculative sentiment of the investing public.

It is not known whether the "well-known index of low-priced stocks" referred to in Mr. Bridwell's article in Barron's was the Barron's Low-Priced Stock Index. However, there is some similarity in method of selection as regards the stocks included in this latter index and Mr. Bridwell's sample of 48 low-priced stocks. The two limiting conditions of selection that Mr. Bridwell mentioned using are exactly the same as two, among others, used by Barron's in selecting the 20 stocks used in its low-priced stock index. Whether the other limiting conditions of selection used by Barron's were also used, it is only fair to point out that one of these requires that the stocks selected must have dropped 50% or more since their bull market peak of 1946. Thus, any stocks selected, among other things, had to have a market price below 5 in 1942, had to drop at least 50% from their 1946 high, and had to also have a market price below 5 in 1949. Any low-priced stocks not meeting these requirements were automatically eliminated. No such limiting conditions on price are required of the stocks making up the Dow-Jones industrial

index.

Therefore, the writer questions whether one can rightfully compare the two groups as regards their price action since 1946, especially as to whether, since 1949, they have reached or passed their 1946 peak. The requirement that the low-priced stocks must have fallen at least 50% in the interim places them at a great disadvantage, for during the same period the Dow-Jones Industrial Index fell only 24%. If the required depreciation of the low-priced stocks since 1946 had been only 24%, instead of 50%, the results of the comparison might have been entirely different.

At this point, the writer would like to bring to the attention of the reader another viewpoint regarding the possible effect of institutional investment on common stocks. The following quotations appeared in The Commercial And Financial Chronical in an article by Roger F. Murray, Vice President of Bankers Trust Company in New York, entitled "Investment Impact of Pension Fund Accumulations":

"Thus, we can observe the natural tendency for new money to be put to work where the values seem most attractive for long-term investment. Does this mean that there will be greater stability in the prices of common stocks? My answer is affirmative for a term of years but not necessarily for short periods of time."

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"It is sometimes asserted that concentrated buying of seasoned equities by

pension trusts will gradually drive up prices to a point where they will no longer provide adequate yields. Furthermore, it is argued, the new issue market will become favorable only to these well established companies. Such statements, it seems to me, result from an incomplete analysis, ignoring what may happen to the funds received by those who sell stocks to pension trusts. Presumably, the former holders, on balance, invest in other equities of lesser quality or personal businesses of one kind or another. It should be borne in mind that it is immaterial at what point an addition is made to the stream of equity capital insofar as measurement of the aggregate supply is concerned. If that stream is free to flow in all directions, it is not too important whether the funds are added with a 'venture capital' or a 'prudent man' label."*

E. Negative Considerations

1. Patience

This section has been set aside in order to mention briefly what might be termed "warnings" in regard to a few phases of the investment process which will confront the small investor. It is not intended that these "warnings" be considered rules that must be strictly followed in order to achieve investment success. However, they might wisely be taken as a few of the considerations which the small investor should keep constantly in mind in order to avoid some of the many pitfalls on the route to investment success.

One of the foremost of these "warnings", in the writer's mind, is the exercise of patience on the part of the investor. Patience in investment, especially in common stocks,

can often not only make the investor a lot of money, but also, can often save him a lot of money. Frequently the small investor, for one reason or another, may become interested in a particular stock, and cursory examination or analysis may intensify this interest. However, a more detailed examination or a truer analysis might show up factors which would completely alter the situation of the stocks. Had the investor "leaped" after his superficial exploration of the facts, he might very well have regretted it later. The position of the investor might well have been reversed, however, wherein an initial lack of interest might, after better analysis, prove to have been the wrong attitude concerning the stock involved. Complete analysis, of course, was the enlightening feature involved in this example. However, the exercise of patience on the part of the investor, which in this example led to further analysis, was the characteristic which determined the final result.

The above example can also be applied to timing and price as well as selection. Analysis may prove a stock to be a particularly interesting situation. However, the investor may feel that the present price is a little high, and that the stock might well be purchased at a future date at a more reasonable price. Under such circumstances, the investor would be wise to exercise patience and withhold his purchase of the stock until it is felt that the price is down

to a reasonable level.

There is probably an endless number of examples which could be mentioned that would tend to stress the importance of patience. Only two fairly obvious examples have been mentioned here. However, the small investor should be cautious not to interpret "wishful thinking" as patience. For instance, suppose that a stock held by an investor steadily declines in price for some specific reason, or reasons, and truthful analysis shows no facts substantiating a change in the trend. It would be wise for the investor to be honest with himself and recognize this situation, rather than deceive himself and hopefully believe that, as far as the stock in question is concerned, "prosperity is just around the corner". In such a case, the investor should be willing to sell and take a loss, or, if a profit should still be present, he should sell and save what is left of it. It is obvious that to continue to hold the stock would merely be "wishful thinking".

2. Diversification

It was stated previously that the writer adheres to the opinion that it is possible for the small investor to adequately diversify his funds in common stocks. However, it is recognized that a tempting pitfall for the small investor is the tendency to over-diversify his funds. Proper diversification is entirely dependent upon the particular

situation peculiar to the individual investor. The writer strongly believes that over-diversification is almost as bad as no diversification. This is probably especially true as regards the small investor. In the first place, it is necessary that the small investor place his common stock funds in those issues where his money will work to his best possible advantage. Secondly, the small investor is usually fairly limited in the amount of time he has available to devote to the attention of his stocks. Thus, by over-diversifying his common stock funds, the small investor not only holds some securities which are not of maximum benefit to him, but also, he has insufficient time to adequately analyse his holdings so that he might eliminate such securities. This can lead to a vicious spiral in which he constantly becomes more deeply involved. So much of his limited time is spent trying to attend to the stocks of his over-diversified portfolio, he has too little time available to devote to possible new selections. Therefore, more stocks are probably purchased which are not of maximum benefit to him. Thus, his funds are spread further over an even weaker list, and he becomes more entangled in a dangerous situation.

It is important to remember that a good analysis of a security merely lessens the probability of loss, and that no analysis, even the most complete and most exact, entirely eliminates this probability. However, adequate diversification

supplementing good analysis, affords the investor the opportunity of a favorable aggregate result despite individual setbacks.

3. Purchase of Common Stocks

There are some "negative considerations" which the small investor should meditate upon before purchasing common stocks. This thesis has been based upon the assumption that the small investor, having sufficiently provided for the necessary primary financial requirements peculiar to his individual situation, was interested in common stock investment. Previously, the writer mentioned briefly the attitude of many financial men who firmly believe that common stocks are not suitable for the small investor. On the other hand, the writer holds to the opposite viewpoint, assuming that primary financial requirements are adequately satisfied. Nevertheless, the writer is of the opinion that the small investor should weigh the former viewpoint and consider other possible avenues of investment.

One of the most prominent types of investment often compared with common stocks is bonds. Much has been written of the relative merits of these two, and many statistical comparisons have been made. It would be wise for the small investor to acquaint himself with some of this material, and familiarize himself with the relative advantages and disadvantages of each. It should be recognized, however, that in

any statistical comparison between bonds and stocks, the date on which the comparison starts is of utmost importance in affecting the results. In fact, this is probably true of most statistical comparisons. The comparison between the two samples of stocks used in this thesis, for example, might have produced much different results had a different date been chosen for the assumed purchase of the stocks. In the comparison used here, the writer wanted to compare the performance of the two samples over the last ten years. This period was, in fact, one of growth and rising market prices. One might argue from this that it would be logical for the low price sample to show a better performance than the high price sample. However, the writer was most interested in finding the relative degree of performance. Also, it was intended that the results of the comparison would then be used in conjunction with a test of the price action of the two samples.

Another medium of investment that the small investor should consider is that of mutual fund shares. These shares claim the advantages of diversification and management for the investor of limited means. They offer him a chance to place his funds under the supervision of investment specialists, and thus, relieve the small investor of much of the time and worry involved in handling his own investment funds. It must be remembered, however, that the investor still faces the problem of selection, for these funds are large in number

and varied in purpose.

The above-mentioned types of investment are only two of many that are available to the small investor, other than common stock investment. If, after considering these other mediums of investment, the small investor decides in favor of common stock investment, he is advised to make his purchases cautiously. He should constantly keep in mind that although many people have made money in common stocks, probably a great many more people have lost money. Once the small investor purchases a stock, he stands to either win or lose. Seldom, if ever, will he just break even.

4 Switching

The small investor may use the process of switching from one stock to another as a means of improving his position. However, he should realize that this type of transaction may also lead to disaster. While the idea of switching stocks in order to attain an improved position is a good one, it easily leads to attempts to take advantage of short-term swings, and finally, to wild attempts to outguess the market. There is probably no surer way to lose money than this.

Dr. John H. Prime, Professor of Finance at New York University, made the following concise statement on switching:

"Switching can lead to mere trading. It is justified only when definite improvement in portfolio is achieved."*

* 9, p.184

Only a few of many possible "warnings" have been mentioned here. The writer did not intend to mention all of them nor to discuss any of them in great detail, but rather, to bring to the attention of the small investor the fact that there are many pitfalls which exist in the various phases of investment. All investors are subject to these pitfalls, but the small investor is especially so, for he often loses his bearings in an attempt to achieve quick profits. It is one thing to dream of a "quick killing" in the stock market, but to realize the same is something entirely different. The former very often takes place; the latter very seldom takes place.

IV. Conclusion

The writer adheres to the theory that any small investor who has satisfied his necessary primary financial requirements is interested in common stocks only to "make money", either through a high dividend return or capital appreciation. The writer also believes that the small investor's decision to undertake any form of common stock investment in preference to Series E bonds involves a far greater risk than a decision to invest in the low price stock group in preference to the high price stock group. The return on investment in the low price stock group as compared with the yield of Series E bonds was proportionately much greater than the return on investment in the high

price stock group. It is the opinion of the writer that the small investor should be willing to accept the slightly greater risk involved in order to receive a return on his money which would substantiate his slightest interest in common stock investment.

Other than dividends, the small investor must consider possible capital appreciation in his attempt to "make money". It is commonly believed that low price stocks rise and fall faster than high price stocks in a rising or falling market. However, it is also widely believed of low price stocks that the decline in a falling market is of a proportionate intensity at least equal to, if not greater than, the rise in a rising market. An example of this widespread belief is expressed in the following excerpt taken from John Durand's booklet entitled "Your Opportunities for Investment in 1951":

"Investors seeking speculative gains often prefer low priced stocks on the theory that the lower the price, the greater the profit potential. There is some logic to that, in a rising market; but it must also be considered that there is at least equal downward risk when markets decline."

It is not the intention of the writer to criticize Mr. Durand's work nor to criticize, in particular, his ideas on the subject being discussed. Mr. Durand's statement is quoted here merely to give the reader a specific example of the prevalent theory regarding the price action of low price

stocks in a fluctuating market.

From the resultant figures of a comparison of the two stock groups in this thesis, along with substantiating evidence of previous studies by Louis H. Fritzscheier, and also by J.H.Holmes and Company, it can be concluded that the existing theory on the price action of low price stocks is incorrect. It is true that low price stocks rise and fall faster than high price stocks in a rising and falling market. However, in comparison with high price stocks, low price stocks rise proportionately more in a rising market than their proportionate fall in a falling market.

Assuming the above conclusion to be correct, it is logical for one to also consider the possible added impact of special situations and growth situations when found among low price common stocks as against high price common stocks. In other words, assuming one of these situations exists in two stocks, and other conditions are relatively equal, then the stock with the lower market price should be selected.

Although institutional investment might result in some important effects upon the common stock market, there is probably as yet insufficient evidence to indicate conclusively what these effects might be. Nevertheless, the small investor might consider the possible building up or stabilizing of a stock price when the stock is held in favor by institutions. There is also the possibility that some of the famous

"averages" or "indexes", which might be composed largely of stocks considered to be of higher quality and held in favor by institutional investors, will tend to indicate the trend of the groups of which they are composed rather than of the general market.

As mentioned previously, many financial writers believe that the small investor should confine his common stock investments to the so-called "blue chips". For example, John Emmett Kirshman in his book entitled "Principles of Investment" said:

"Only one principle of great importance needs be stressed. Since the small investor cannot afford to lose, he should confine his investments to only the trusted and tried issues."*

However, the writer believes that the small investor can find stocks of sufficient quality in the low price group as well as the high price group in which the so-called "blue chips" are normally found. It might be safely concluded that the comparison of the leading performers of the two groups bears out the writer's theory.

The probability that the advantages of low price stocks might work in the small investor's favor is highly dependent upon adequate diversification. The small investor should remember that proper diversification is entirely dependent upon the particular situation peculiar to the

* 8, p.847

individual investor. Of course, basic rules of diversification should be followed such as spreading the risk over various types of industries and various types of companies within industries. However, such advantages may be lost by over-diversification. These advantages may also be lost by numerous other "pitfalls". Should the small investor wander into these "pitfalls", he would not only lose the possible advantages, but also, would place himself on the road to financial failure.

Even though the small investor weighs the advantages and disadvantages discussed in this thesis, and decides to place his common stock investments in the low price group, he is still faced with the problem of selection. The writer would like to stress again that the small investor should be willing to spend as much time as is reasonably possible on his investments---both in the selection of his stocks and in handling his portfolio. He must acquaint himself with all factors, and have the capacity to give some kind of interpretation to them. The small investor should constantly keep in mind that his selections must be based upon his own knowledge, experience and judgement.

The writer would like to advise any small investor, who is preparing himself for common stock investment, of the numerous publications which are available to him. A number of them are listed in the bibliography of this thesis. Two

of these, which the writer believes would be of inestimable value are: "How to Invest", a booklet published by Merrill Lynch, Pierce, Fenner & Beane; and "The Intelligent Investor" by Benjamin Graham.

There are two final statements of advice which the small investor should heed:

1. Once you have arrived at a decision on a particular stock, have the courage of your convictions and follow through, despite what others may think or say.

2. Although your portfolio is well-chosen and apparently sound, review it continually in the light of changing conditions as they might affect your securities or your personal requirements.

Appendix A

Stocks Included in Low Price Group Sample

1. American Locomotive Company
2. Armour & Company
3. The Bath Iron Works Corporation
4. The Budd Company
5. The bullard Company
6. Commercial Solvents Corporation
7. Electric Boat Company
8. The Florsheim Shoe Company
9. General Baking Company
10. General Bronze Corporation
11. Gimbel Brothers, Incorporated
12. Gulf, Mobile & Ohio Railroad Company
13. International Telephone & Telegraph Corporation
14. Lerner Stores Corporation
15. Nash-Kelvinator Corporation
16. National Distillers Products Corporation.
17. The Pennsylvania Railroad Company
18. Radio Corporation of America
19. Socony-Vacuum Oil Company, Inc.
20. St. Regis Paper Company

Appendix B

Stocks Included in High Price Group Sample

1. American Can Company
2. American Telephone & Telegraph Company
3. Armstrong Cork Company
4. Chrysler Corporation
5. Dow Chemical Company
6. E. I. duPont de Nemours & Company
7. Eastmen Kodak Company
8. General Electric Company
9. General Mills, Incorporated
10. General Motors Corporation
11. Monsanto Chemical Company
12. Norfolk & Western Railway Company
13. Pittsburgh Plate Glass Company
14. The Proctor & Gamble Company
15. Sears, Roebuck and Company
16. Standard Oil Company of New Jersey
17. Union Pacific Railroad Company
18. Union Carbide and Carbon Corporation
19. United Fruit Company
20. United Shoe Machinery Corporation

Appendix C

Low-Priced Shares*

By Roger W. Bridwell

(Table accompanying article not included here.)

The action of low-priced shares in this bull market has been a source of no little disappointment to speculatively inclined investors. While every major market average exceeded its 1946 high by a goodly margin in 1951--- 20% as measured by the Dow-Jones Industrial Average--- low-priced shares remained well below their best 1946 levels.

One well-known index of low-priced stocks registered a new high for the bull market in February, 1951, 20% below its 1946 peak. Probably a more accurate picture of this backward group is afforded by the representative list of 48 low-priced stocks shown in the accompanying table. At their best 1951 levels these issues lagged 48% below their 1946 top.

When compiling the list an effort was made to include all of the more actively traded, listed stocks that dipped to five or below at the trough of the bear-to-bull reversals of 1942 and 1949. A few of the lows were established as early as 1941 and 1948, some late in 1942 and 1949.

* 12, p.11-12

Omitted from the list were many issues usually included in such a tabulation, which might reflect special influences of a non-recurring nature, rather than the speculative sentiment of the investing public.

Illustrative of the lack of enthusiasm for low-priced shares is the fact that only two of the 48 stocks managed to better their 1946 tops during 1950 or 1951. The popular pair, Butte Copper and Consolidated Copper Mines, both reflected the insistent rearmament demand for scarce non-ferrous metals. Several other issues approached the record levels of five years ago only to back away before making the grade. Especially noteworthy in this regard has been the action of Lehigh Valley R.R., National Container, Barium Steel and Missouri-Kansas-Texas R.R.

Even more striking is a comparison of the total appreciation enjoyed by the 48 stocks during each primary stock market upswing. During the 1942-1946 bull market, gains ranged up to the astronomical figure of 10,550% chalked up to Burry Biscuit. No less than fifteen of these fast movers gained 2,000% or more. Investing an equal dollar amount in each of the 48 issues at the 1942 bottom would have produced a gratifying paper profit of 1,048% at the highest quotation for each stock in 1946

As holders of these shares will agree, results have been far less spectacular during the last 28 months of

general market advance. Largest markup has been the 570% turned in by Butte Copper, while total price appreciation figured on the peak price for each of the 48 stocks has amounted to a modest 199%. Since the individual stocks actually registered their highs (and lows) several months apart, appreciation for the 48 stocks when considered as an average mounted to only slightly more than 100%. Before drawing conclusions from the performance record just cited, investors who have patiently been holding low-priced shares would do well to review their action during previous bull markets.

The record reveals a pattern of two well-defined moves, one early in the bull market and the other during the next-to-the-last stage. In between comes a period of consolidation during which the low-priced group lags behind the rest of the market and forms a base from which the second phase of the advance begins.

A study of the three bull markets of the last thirty years- 1923-1929, 1932-1937, and 1942-1946---reveals that the first important advance by low-priced stocks runs to between 100% and 200% and averages about 18 months in duration. The "resting" period retraces only a fraction of the gained and is apt to endure about a year. The second (and final) important move is likely to carry even further percentagewise than the first move, averages about 18 months in duration, and then

culminates before the final top of the bull market is registered by the market averages. In every instance the gain in low-priced indexes more than doubled the corresponding gain in broader market averages.

Turning to the 1951 situation we find that low-priced shares moved up 110% on the average between the June, 1949, low and February, 1951, high, but managed to outstrip the rest of the market by only a subnormal 80%---another indication of the low esteem in which these shares are currently held. The remaining ten months of 1951 produced a side-wise consolidation movement, with losses characteristically holding to a small fraction of earlier gains. By year-end 1951, low-priced indexes were within easy striking distance of their highs for the bull market.

Especially significant are the time intervals involved. Both the initial advance of 20 months and the subsequent resting period of ten months parallel almost to the month the average duration of the corresponding phases in previous bull markets.

On the basis of historical precedent alone, there is ample reason to anticipate the usual second move which could be expected to carry as far and probably further than the recent rise from the June 1949, lows. Such a move could start at any time and last between a year and two years. Nevertheless, it is always dangerous to assume that history

will repeat and especially that stock market pattern will unfold in exactly the same manner. Many developments can arise to upset the anticipated sequence.

It can be argued that drastically higher income taxes and higher brokerage commissions tended to make speculation in low-priced shares less attractive in the year 1951 than during previous periods when speculative fever ran high. Or again, that "the public" whose traditionally unbridled appetite for the "cats and dogs" presumably causes them to soar far beyond intrinsic values during the final markup stage may be funneling their funds into the relatively safe haven offered by the mutual funds. Mutual funds in turn display an exclusive appetite for blue chips, raising the question: Might not the shares of marginal companies be losing out all around this time?

While it is true that low-cost shares have lagged relative to high-cost investments, they are no longer on the bargain counter, and new purchases obviously entail much greater risk than in 1942 or 1949. Because a majority of the issues listed in the table are chiefly of interest as speculative vehicles rather than as conservative long-range investments, knowledge of their price action is probably of greater practical assistance in making selections than earning power and other fundamental considerations.

Since the 1949-51 appreciation shown is based on

the high for the year, many issues are actually much closer to their 1949 lows than the table indicates. For example, in December, Alleghany Corp. had slipped 30% below the year's high. Curtis Publishing, another stellar performer in 1946, was 35% under its 1951 high by the end of December. Even at the high for the year, both had appreciated less than one-fiftieth as much as in the 1943-1946 market. Other issues lagging by a similar amount include American & Foreign Power Co., Burry Biscuit, and National Bellas Hess.

Whether or not history will repeat and cheap stocks will again turn in sensational gains at the last minute, it cannot be gainsaid that low-priced shares are suffering from a bad case of comparative neglect based on past performance standards.

Appendix D

The Essential Ingredient*

By George E. Shea, Jr.

The two most famous lines in the lore of speculation and investment are also the most irritatingly vague.

When Nathan Rothschild, founder in the time of Napoleon of the London branch of the famous banking family, was asked how he managed to make money so regularly in securities, he replied:

"I buy cheap and sell dear."

And on the question of what the stock market was going to do, the elder J. P. Morgan is reputed to have said:

"It will fluctuate."

Clearly, Rothschild's answer begs the question of how one is to determine when securities are cheap and when they are dear. And Morgan's is merely a statement of the obvious. Hence these trite sayings are often taken as the mere evasions of purse-proud men who did not wish to give away their secrets.

But there is more to them than that. What Morgan obviously implied was that he didn't know, and he didn't think anyone else knew, what the market was going to do.

* 15, p.5-6

And what Rothschild evidently had in mind was the next logical step. Since no one knows what the market is going to do, it is necessary to think in terms of individual securities. The safe course is to buy only those which are offered at prices which seem cheap. And the profitable course is to sell them if and when they are bid for dearly.

Which still leaves open the question of how to decide what's cheap and what's dear. That is our subject here today---assuming it is at all possible to dissect in print the subtleties of an exercise in judgement.

For that is what it comes down to --- a matter of judgement. And that judgement can be acquired only by experience, including the experience of making errors.

Any one who buys or sells anything at all learns to judge values by some form of comparison. We would all snap up an offer of \$100 for a rickety kitchen table made of unpainted pine. We would know without thinking twice that, with that much money, we could buy something far better in any department store.

Likewise, we would quickly cry "sold" if offered a sturdy, neatly finished dining-room table, made of cherry-wood or maple, for only one dollar. Even if it were not just the right size for us, we know we could sell it to somebody for far more.

Now, unbelievable as it may seem, prices of

securities do sometimes get as far out of line as the ridiculous figures just cited. The writer can remember when, within three years, New York Central common fell from $256\frac{1}{2}$ to under 9. And he can also remember when Chrysler Corp. stock rose in an almost equally short period from 5 to $138\frac{3}{4}$.

It is clear that at one extreme or the other the public appraisal of these shares must have been incorrect, and anyone who took a calm view of what they were likely to be worth in the long run had an opportunity to sell, or to buy, them profitably at very little risk. Their subsequent long-term price histories show that N. Y. Central was close to its proper range around 9 rather than above 200, while Chrysler (since split two-for-one) was not much too high above 130.

Most of the time, of course, the great body of securities stay a lot closer than did those two at their wild extremes to what might be called their enduring values. But there are always some groups, or some individual stocks, selling at prices which, later on, can be seen by hindsight to have been justified---either much too low or much too high.

We are not concerned here with transformations as complete as that which produces a pearl of great price from the lowly oyster. Such a metamorphosis occurred when the discovery and development of wonder drugs like penicillin brought new companies and their shares to the speculative

forefront. Another, unfavorable instead of favorable, was the blow struck at moving picture theatres in some parts of the country by television. Still a third is the current conversion of Northern Pacific from a railroad stock to an oil stock. The discovery of petroleum deep under lands which it owns has added a completely new element of value to its shares.

This kind of change generally cannot be guessed in advance, and even when it is, the problem of measuring its potential effect, and thus estimating its value, is usually beyond human capability. What we are discussing here is the humanly possible function of gauging the lasting worth of securities which are temporarily depressed, or overvalued. Is Chrysler, to take just one example, selling at a price which is somewhere within the range of its probable value, or is it above or below that? This is the question to which every investor considering the purchase of a security should direct his attention.

It can be answered only by collecting figures on earning power and dividend-paying power. The dividend currently being paid is of minor importance, even though that is what most people ask first about a stock. The stock is often a better purchase when it pays nothing than after it becomes known as a dividend payer. By that time buyers have begun competing with each other for it, and the price is no

longer attractive:

If there is a dividend, can it be continued? Can it be raised? What is the stock likely to be able to pay, on the average, over a substantial period of years? These are the important questions, and the only way to answer them is to estimate what the stock can earn, on the average, over the years.

In the case of Chrysler, earnings of the past ten years, including a rough estimate for 1951, averaged \$7 a share on the present stock. But since results for the first four of those years were held below prewar figures by the wartime excess profits tax, it may be fairer to judge the stock's earning power by only the latest six years. That average turns out to be close to \$10 a share. Thus the stock's present price just under 70 is only about seven times proven earning power, which is a rather conservative ratio.

Furthermore, a glimpse of how high the earning power might be in really favorable period was given when the net profits reached \$7.55 a share for a mere three months, in the third quarter of 1950. That's a rate of \$30 a share a year. Though restrictions on automobile production make this year's outlook unpromising, and though generally poor business conditions could have a further adverse effect, it looks as if Chrysler ought to be able to pay dividends averaging \$4 a share or more over the years. That's almost 6% on the present

price. On that basis, the stock does not seem extraordinarily cheap, but its price may be near the bottom of its current range of value.

Let's look at another, entirely different, stock. Dow Chemical Co. also suffered from the excess profits tax in World War II. Its earnings for the six years since then have averaged \$4.50 a share, including a guess of \$5.50 for the fiscal year ending May 31, 1952. However, two factors make this figure look too low as a guide to the stock's earning power. One is that, except for the World War II years, the earnings have grown annually with few exceptions. The second is that the company has entered upon an expansion program which will double its assets in three or four years. Thus, taking an optimistic view, the stock might be earning \$10 a share four years hence, or even more if corporate taxes come down, and might be able to pay \$5 or \$6 a share in dividends annually. Hence at 114 it is already selling at ten times the best probable earnings four years away, and the dividend return obtainable from it, if the stock is bought at present prices, can hardly reach more than 5% for four years.

Shares of the dynamically growing chemical companies sell deservedly at far higher ratios to earnings than most other stocks. Dow Chemical sells at 20 times the current year's rate of earnings, and if it sold at 20 times the best probable earnings of the next four years, it would go above

200 in that time. Much more than that can hardly be expected of it, and adverse conditions might hold earnings, or the price, to a good deal less. While perhaps not priced outlandishly high, it is certainly well within its proper current range of value, and may already have reached the upper portion of that range.

From the conclusions reached about these stocks it will be clear to the reader that they were not picked as examples of great buying or selling opportunities. These brief and incomplete appraisals merely provide illustrations of some of the varying factors to be taken into account in such work.

The present stock market is a difficult one in which to find special opportunities. The rise in common stock prices since the middle of 1949 has not gone, in general, to extremes of over-valuation, but it has eliminated most under-valuations. Some doubtless still exist of which the writer is not aware. A few may be available among railroad and steel stocks, to pick two industries which are still badly out of fashion among investors.

The difficulty in appraising these two groups is that the figures at hand are not conclusive. Like all other industries, these have benefited hugely from the industrial boom of the past ten years. The financial solidity and earnings stability of steel and rail companies, on the whole,

are probably much greater than when they were facing, in all unawareness, the bad years of the 'thirties. But their new strength has not been tested in the business recession, or even depression, which is sure to hit us some day.

However, as Morgan suggested, no one knows what the future holds, for business or for stocks. The boom might go on another five years, or it might collapse tomorrow.

The only possible road to investment success is to try always to buy cheap enough to leave a big margin for error. In the pursuit of that aim, a cold and skeptical eye for values is the essential ingredient.

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