

ELVIS AND THE STOCK MARKET  
COMMON STOCK THEORY OF INVESTING

(1921 TO 1929 NEW ERA) APRIL 10, 2001

Every New Era, such as ours, has dramatically enhanced the common stock theory of investment. The problem is that this has suffered a severe setback during the severe contraction that has followed each speculative climax.

During the last New Era, Barron's ran contests for performance from portfolios designed for a businessman or a widow.

Within the former class, Hazel Freeman won the contest in 1927. It is not known if she reached guru status, but her advice was mentioned a number of times.

For a new contest beginning in 1927, Freeman set up a \$100,000 portfolio with a 70% weighting in "attractive common stocks" with the balance in short-term bonds. In October, 1928, equities were increased to 80% and by September, 1929 the portfolio had increased to over \$220,000.

However, with the subsequent reversal, the valuation had declined to \$204,000 on October 21. But Ms. Freeman recommended no reduction in the 88% exposure to equities. She was not unaware of growing signs of risk and rationalized them. Her review included concerns about soaring brokers' loans as well as "frenzied financings and watering of issues".

Despite these warnings, her confidence rested upon "remembering that the world is today making tradition, not following it. The business man who has placed his \$204,000 in the [stocks] above listed can remain abroad for another year in a peaceful state of mind. On his return, he will find his funds to have been soundly and profitably invested."

We have added the emphasis and a year later, in October, 1930, the Dow was at 185, down 51% from its high of 381 in September, 1929. The subsequent low was 41 in 1932.

#### The Culture Of A Boom:

As with New Eras before and since, the culture of prosperity (although based upon inflated asset prices) finds it impossible to change and understandably fights the consequent contraction.

The defence by proponents of the common share theories was mainly through valuations. A representative widow's portfolio had doubled in value and income from 1925 to 1929. Then, so long as this showed a gain, the theory was justified and intensely defended. The rapid decline in wealth was shunned in favour of moral relativism. All the gains evaporated and finally the last obstinate proponent admitted that the "widow" should have kept her funds in bank deposits.

Barron's provided a continuous record of the change from confidence to dismay. The Trader's column was competent and the following quotations provide the appropriate comment on the theory, in real time:

July 7, 1930 (DJIA 218):

"A [weakening] commodity market that is increasing the purchasing power of the dollar by leaps and bounds offers the greatest attractions to a bond buyer in many years. Were it not for the losses that would have to be taken and the impairment of confidence that would be created by the abandonment by the powerful interests of the common stock theories, bonds would be coming into their own more rapidly.

August 11, 1930 (DJIA 224):

"Apparently only hard times and more widespread dividend revisions will cure the unreasonable belief in the unvarying superiority of common shares.

September 5, 1930 (DJIA 240):

"Until earnings power becomes more assertive, the long-pull outlook must remain highly dubious, with the short-pull as much of a gamble as ever.

September 12, 1930 (DJIA 241):

"Investing For A Widow: Results a vindication of common stock theory.

Portfolio at: July 13, 1930 = \$113,000

Portfolio at: August, 1925 = \$50,000

October 20, 1930 (DJIA 193):

"The common stock theory has been pretty well demolished.

November 24, 1930 (DJIA 188):

"A very eminent banker bluntly states that this is a period more akin to 1873, not 1907 or 1921 [1873 climaxed the fourth New Era and was followed by a 5-year bear market].

February 2, 1931 (DJIA 169):

"But mere faith in American equities based upon their 20-year records is insufficient basis for [their] hasty acquisition in the midst of a protracted depression.

May 4, 1931 (DJIA 151):

"The defeatism of thousands of speculators, business men, bankers and politicians is spreading the theory that not until 1936 can the U.S. emerge from this depression. The theory is just the reverse of 1929, when the New Era exponents were shouting five more years of fat and plenty.

September 21, 1931 (DJIA 111):

"It is easy enough for high pressure advisory services to talk of "foundations being laid for new fortunes". Such talk is simply an echo of the common stock theory, which is proving the greatest financial curse this country has ever experienced.

By July, 1932, the Dow had completed its full decline from 381 to 41. The index did not exceed the record high until 1955. By that date, many of the high performers were gone, or suffered stock rollbacks, or their businesses had changed materially.

For example, RCA took radio from little commercial value in 1920 to a fully saturated new technology in 1929. The attractions then were network broadcasting, gramophones, and talking pictures. Earnings peaked at \$3.33 in 1928. This was not regained until 1957 when the main surge was from the Elvis Presley contract, an event obviously beyond even the wild discounting process of 1929.

## Observations:

There are two ways of looking at the notorious 1929-1933 contraction. One is to read mainstream textbooks written to defend interventionist economics well after the event. The other is to do your own due diligence and read financial newspapers of the day. Unfortunately, the equity theory was accompanied by beguiling notions from academic utopians, of which the Harvard Economic Society made a tedious number of claims that appropriate manipulations for price stability or of interest rates would immediately restore prosperity.

Barron's weekly format was thorough and provides continuity, in real time, on 4 different approaches to the contraction. We have adjudicated their success and rank them as follows:

	<b>GRADE</b>
Street Sense (The Trader Column)	B+
Charting	C+
Common Stock Theory	F
Harvard Economic Society	F

Proponents of the Common Stock Theory and the Harvard economists capitulated near the stock market bottom (DJIA: -89%) in 1932. The Trader did a creditable job through the bottoming process and merits a B+.

## Conclusions:

The point to be made is that New Eras and their climaxes are methodical and can be analyzed. So are their financial contractions, which made the common stock theory a failure from 1929 until 1932.

Bob Hoye  
Editor & Chief Investment Strategist  
[www.InstitutionalAdvisors.com](http://www.InstitutionalAdvisors.com)