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Op-Ed Contributor

Everyman's Financial Meltdown

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FOR connoisseurs of financial mayhem, the stock market crash of October 1929, which started 80 years ago this week, still holds pride of place. Like a tautly directed drama, it unfolded with graphic horror at the corner of Broad and Wall Streets, captured in grainy black-and-white newsreels. It capped a stylish era in which well-tailored men and chic flappers set a racy tone for stock investing. To the delight of historians, it possessed clear-cut villains, a riveting story line and plenty of palpable abuses for reformers to correct.

In retrospect, the evils of the 1920s seem almost quaint in their simplicity. Finance today is far more esoteric, marked by complex securities sure to baffle reformers as they seek solutions to the problems exposed by last year's crash.

Before the '20s, common stocks were deemed unsuitable for ordinary investors. That stigma began to fade during World War I, when Liberty Loan drives encouraged Americans to own government bonds, feeding a taste for securities that persisted into the '20s. To capitalize on this trend, commercial banks on Wall Street created securities affiliates and hired thousands of young stockbrokers who were untroubled by memories of past panics. Charles Mitchell, the head of National City Bank, prodded his recruits with pep talks and office contests to sell stocks with razzmatazz. The stock market quickly grew fashionable, with brokerage offices installed

even on trans-Atlantic liners.

It is tempting to deride the bull market of the '20s as a case study in mass delusion. There was a widespread belief that history had turned a corner, that a New Era of permanent prosperity had dawned. Long an importer of capital from Europe, the United States had emerged from World War I as the world's leading creditor, and governments from around the globe flocked to Wall Street for loans.

The stock market of the 1920s was dazzled by the technological innovations of its day. As in every boom, irrational exuberance was merely rational exuberance run amok. Charles Lindbergh's solo flight to Paris fostered a perfect mania for aircraft stocks, while the invention of "talkies" spurred film company shares to new heights. The decade witnessed an explosion in sales of cars and radios, refrigerators and washing machines, all made affordable by installment plans. Art Deco skyscrapers soared in Manhattan. The infectious excitement obscured the economy's dangerous lopsidedness, with oil, agriculture and other "sick sectors" undercutting the general prosperity. Long before the crash, community banks were failing at the rate of one per day.

Every stock market spree is sustained by soothing illusions. Investors in the '20s took comfort from the creation of the Federal Reserve System in 1913. Now buttressed by a central bank, Wall Street believed that the business cycle had been repealed, and the presumed safety net encouraged investors to buy the dips and ride out the most turbulent fluctuations. Three consecutive Republican presidents — Warren Harding, Calvin Coolidge and Herbert Hoover — cut taxes, weakened antitrust laws and promised not to meddle with Wall Street.

The stock exchange was a rigged market that made no claims to fairness. Speculators operated more than a hundred "pools" that openly manipulated individual stocks and sometimes bribed

financial journalists. Their flamboyant managers — William Crago Durant, Michael Meehan, Joseph P. Kennedy and Jesse Livermore — became folk heroes, their raffish exploits reported in gossip columns, giving Wall Street a louche glamour. Hot stock tips, circulated by waiters and bootblacks, made old-fashioned research superfluous. For many participants, a whiff of sin only enhanced the stock market's seduction. Small investors imagined that the large speculators who dominated the exchange could, if necessary, levitate the market and prevent unpleasant crack-ups.

Even as the stock boom captured the national imagination, most Americans sat safely on the sidelines. In a population of 125 million, fewer than two million took a flier in stocks, but their impact was magnified by half a million margin accounts. Under the lax standards in effect, investors could plunk down a small fraction of a stock's value and borrow the rest. Banks showered this brokers' loan market with funds, and many corporations channeled spare cash there as well. Since much of this money was raised on the stock exchange in the first place, it created a self-perpetuating speculative machine. Margin loans equivalent to one-fifth the value of listed stocks poised the market on a tall but shaky scaffolding.

Compounding the leverage problem was the vogue for mutual funds, known then as investment trusts. Their managers were supposed to shelter small investors from speculative swings, but these professionals proved as faddish as everyone else. Pumped up with borrowed money, they invested in other highly indebted trusts in a never-ending chain of speculation.

Those who questioned the New Era gospel were ostracized as knaves or fools. The most persistent spoilsport was the economist Roger Babson, whose gloomy forecasts were mocked even as the economy stagnated in the sweltering summer of 1929. On Sept. 5, 1929, Babson reiterated his doomsday cry: "Sooner or later a crash is coming, and it may be terrific." This

time, instead of yawning, the market sold off sharply in what was dubbed the “Babson Break” — the first sign of market fragility. President Hoover turned to Thomas W. Lamont, the senior partner of J. P. Morgan & Co., for reassurance. Five days before Black Thursday, Lamont obliged him with this stunning bromide: “The future appears brilliant.”

ON the morning of Thursday, Oct. 24, 1929, the stock market imploded from the sheer weight of its own excesses. Stocks suffered such precipitous drops that there were tearful scenes on the exchange floor and the visitors’ gallery was cleared. Wall Street was thronged by distraught investors, who emitted a haunting moan as their life savings evaporated.

At noon, the crowd thrilled to the sight of Wall Street titans hurrying up the steps of the House of Morgan. Led by Lamont, the emergency meeting included Charles Mitchell and Albert Wiggin of Chase National Bank. Conspicuously missing were any government figures; it was a throwback to earlier panics, when financiers orchestrated their own rescues. The bankers pledged \$240 million to stabilize the market. At 1:30, Dick Whitney, acting president of the stock exchange, strode ostentatiously to the United States Steel trading post and barked out a bid for 10,000 shares at a price several points higher than the previous trade. To cheers, he re-enacted this inspirational scene with other stocks. Such was the residual mystique of Wall Street bankers that the market rallied vigorously and closed only marginally lower. The next day, The Wall Street Journal ran a hopeful headline: “Bankers Halt Stock Debacle.”

This first act of the 1929 crash suggested that the smart money was powerful enough to tame an unruly market. Heavy selling on Monday, however, convinced investors that Thursday’s turbulence hadn’t been a fluke, but the first tremor of an earthquake. At Tuesday’s opening, tremendous waves of selling set off pandemonium on the trading floor. The overloaded ticker tape lagged two and a half hours behind trading as 16.5 million shares changed hands. When

the final numbers were in, stocks had lost a quarter of their value in two days. The shock and pain were manifest in photos of ruined men standing on Wall Street. This time, the notion that somebody would save them — the bankers, the Fed, the big-time speculators — had proven a cruel mirage.

On farms and in small towns, the crash was greeted with puritanical glee: the city slickers had gotten their comeuppance. Exaggerated accounts of investors taking fancy dives from upper-story ledges underscored the urban nature of stock investing in the '20s. Unlike the 2009 crash, the 1929 debacle didn't topple major banks or corporations. It simply wiped out a generation of speculators.

In retrospect, the 1929 crash stands as the dark gateway to the Great Depression, though not its direct cause. In its aftermath, government moved with unwonted vigor to shore up the economy. George Harrison, head of the New York Fed, bought large amounts of government bonds and slashed the rediscount rate. President Hoover pleaded with business to preserve wage levels, and some major companies increased their dividends. In mid-November, a tremendous rally drove stocks up 25 percent in a few days. By February 1930, The New York Times editorialized that “the patient” was now headed for a complete recovery. The next month, Hoover predicted that the “worst effects of the crash” would soon be over, and by April the stock market had recouped almost half of its October losses.

The cheerleading proved premature. In the fall of 1930, cascading bank failures signaled a full-blown economic disaster. The stock market began to sink, not with huge selling bursts, but in an unrelenting slide that whittled stock prices daily, shaving almost 90 percent of the Dow's value from its September 1929 peak to the summer of 1932. Aside from those bankrupted by margin calls, the worst calamities occurred not among investors who sold in panic after the

crash, but among bargain-hunters who swooped down afterward in what had seemed a once-in-a-lifetime buying opportunity.

Starting in 1933, a secret history of the crash was unearthed by Ferdinand Pecora, the chief counsel of the Senate Banking Committee, who interrogated witnesses in sensational hearings. He revealed that Charles Mitchell and other National City executives had cushioned their stock losses by tapping interest-free loans from a special bank fund, while Albert Wiggin made millions selling short his own bank's shares. Such revelations dashed forever the notion that Wall Street could effectively police itself. With Pecora's help, the Roosevelt administration created a transparent regulatory framework that has shaped financial markets to the present day.

New Deal financial reformers were fortunate that the crash had followed the satisfying script of a morality play, with sin and repentance followed by redemption. The wicked ways of Wall Street in the '20s could be comfortably told in a fireside chat. Franklin Roosevelt had a bunch of rich rascals to chastise — unscrupulous individuals rather than irresponsible institutions, as in our own recent decline. The blatant stock market abuses were comprehensible to ordinary citizens, quite unlike the exotic credit derivatives and mortgage-backed securities that baffle us today. And the Great Depression that followed the 1929 crash fostered a climate for reform that has proven hard to replicate.

However severe, our current predicament seems mild compared to the calamitous unemployment of the early 1930s. Hence, average Americans, mystified by the complexities of finance today, still await a new season of financial reform.

Ron Chernow is the author of "The House of Morgan" and "Alexander Hamilton."

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