

Chapter 4

Rise and Crash

The period between March 1928 and September 1929 is famous in America's economic history. It was the time of the Great Bull (rising) Market. During that time Americans were obsessed with the idea of buying stocks. Some stocks went up by as much as 700%. People invested their life's savings in the stock market. Others borrowed huge sums of money in the hopes of getting rich quick, and many thought it a sin not to. Average people – cab drivers, housewives, construction workers, and waiters, as well as millionaires and brokers, were totally invested in the stock market.

What got people so interested in buying and selling stocks? Why did the stock market rise so rapidly during that period of time? And what caused it to collapse so suddenly 18 months later? These are some of the questions which are at least partially answered in this chapter.

March 3, 1928

The Great Bull Market started on a particular day, March 3, 1928. That was the day Michael J. Meehan and a group of friends decided to make some money by fooling a lot of people. They formed a plan to buy and sell large numbers of shares of RCA (Radio) stock to each other. This arrangement is called a pool. The idea behind their scheme was to cause the price of the stock to rise, unload it on people who did not know what they were doing, and emerge with a great profit. Here is how it worked:

At the start of the business day, Meehan sold 200 shares of Radio stock at its opening price of \$94.50 (94 1/2). His friend sold the same 200 shares to another friend at \$95 a share. The next sale of the same stocks was at \$96.00, followed by \$97.50, before Meehan bought back his original shares at \$98.25 each.

For those following the ticker tape, the sales just described were recorded as follows:

R.2.941/2; R.2.95; R.2.96; R.2.971/2; R.2.981/4.
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Even people who read the ticker did not know that all the buying and selling was done by a couple of friends planning to fool the public. But that is exactly what Meehan and his confederates were doing. And they succeeded. People interested in getting rich quickly saw the price of RCA going up and began to buy large amounts of this stock. On March 12, 1928, Radio went up by \$12.00 a share. The next day the price jumped up \$18.00. By the end of March, RCA was selling for \$195.00 -- a gain of \$100 from the opening price of March 3rd. Now, Meehan and his friends sold their shares of RCA and split a profit of \$10 million between them. Had they held on to their shares of Radio, they would have realized far more profit. Before the Great Crash of 1929 ended the Bull Market, Radio was selling for 505 dollars a share.

Michael Meehan and his friends got people interested in the stock market. The stock market became front page news, and a speculative fever swept the country. Radio stock, of course, was not the only game in town. Other popular stocks at the time included GM, U.S. Steel, and Goldman Sachs. Some performed as well as Radio – others did even better. All attracted people because they thought they could get rich quickly.

Buying on Margin

Once people became interested in buying stocks, they wanted to invest as much money as possible. They wanted to invest money they did not even have!

Smart money managers came up with a plan to help people borrow money to invest in the market. Buy the stock on credit! In those days it was called margin. You put a certain amount of money down – usually about 25% of the price of the stock, sometimes even less. That was the margin. The rest you borrow from a bank. Since the money you borrowed could be called in by the bank at any time it was referred to as, "call money". Using this plan could increase the money you invested and your profits if the market went up.

Suppose you bought a share of Radio stock for \$100 in March 1928. Your margin requirement of 25% would mean you invested \$25.00 of your own money and borrowed \$75.00. If you kept this stock until September of 1929, you could sell it for \$500. Your profit would be \$400.00. Since you only invested \$25.00 of your own money – your profit would be 16 times your original investment, or 1600%!

Paid for stock	Sold stock for	Profit after interest paid
\$94.00	\$505	\$ \$400
Money borrowed	Money Paid back	
\$75	\$75.00	
Own Money invested	Profit made	% profit:
\$25	\$400	1,600%

Margin in Reverse

While margin worked its magic when the market went up, it could do a great deal of damage when the market went down. People who bought stocks during the high point of the stock market, would be forced to sell their stocks when the market started going down. The reason is that bankers and brokers would want more money to cover their loans.

As margin encouraged people to buy stocks while the market was rising it would also force people to sell their stocks when the market was falling. And when people sell their stocks, prices come down. Declining prices cause more people to sell their stocks to cover their loans, and this in turn causes prices to go down even further. Thus margin was a time bomb in the stock market ready to go off if something started the stock market on a downward course.

Imagine buying a stock for \$500, with 25% of the cost paid out of pocket, and a loan of \$375. Should the stock go down to \$25, the buyer would have lost \$475, over 300% of his original investment.

The Market Heads Down

By September 1929 the stock market was like a sponge full of water. It could not soak up any more stocks. People were no longer buying new stocks – investors were a little jittery. Prices were too high. No new money was coming into the market.

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The stock market started going down when British investors began selling their stocks. They were having problems in England and needed the money at home.

In October 1929, the banks began to get worried. Too much money had been lent out on margin. They began to call in loans. This forced people to sell their stocks to cover their loans. Prices began to fall – people were getting jittery. Maybe it was time to sell. Good times could not last forever.

October 23, 1929. That was the worse day to date in the history of the stock market. So many people were trying to sell their stocks that the ticker tape ran 2 hours late. This caused even more panic sales. The brokers spent long hours in the morning trying to balance their books. In account after account, their clients had used up their margin and needed to raise more money.

The next day, October 24th, was even worse than the 23rd. Investors were forced to put blocks of stocks on sale sometimes totaling 10,000 shares at a time. There was absolute chaos on the New York Stock Exchange. Goldman Sachs lost \$30. in 2 hours. Other stocks seemed headed for even greater losses.

At this point, a pool of bankers got together to temporarily save the stock market. They bought up thousands of shares of stocks to stop the fall in prices, and restore people's confidence. But all they did was to call a short-lived halt to the collapse in stock prices, and quietly sell their stock before the market collapsed completely. Too many margin accounts had been exhausted by the fall in prices on October 24th, and people had to sell. The huge volume of sales orders came crashing down on the stock market on October 29th. Here is what one writer said about the collapse of the stock market that day:

Tuesday, October 29th, was "Black Tuesday" -- the day of the big crash. Tens of thousands of shares of stock were put on sale for whatever they could bring. But there were no buyers! Prices fell, fell, wiping out millionaires and just plain small time speculators alike. Stocks that once sold for \$48 a share were now offered for one dollar. Even the best stocks dropped as much as \$60.00 a share.

As to the cause of the collapse, another observer speculated:

It seems probable that the principle cause of the break in prices . . . was not fear. Nor was it short selling. It was forced selling. It was the dumping on the market of hundreds of thousands shares of stock held in the name of miserable traders whose margins were exhausted or about to be exhausted. The gigantic edifice of prices was honeycombed with speculative credit and was now breaking down under its own weight.

All in all, stocks lost 40 billion of their value. [An equal loss today would be more than 1 trillion dollars]

October 29th was a nightmare that is still remembered today. Fortunes were lost. People who were rich in the morning were broke or worse that night. Life savings were gone. Dreams and hopes died. Millionaires became beggars. Some jumped out of their office windows; went home and put their heads in their ovens.

October 29th was also the end of an era. The stock market crash took the bloom off the prosperity of the 1920's. In the following years, unemployment jumped from one to thirteen million. Industrial production was practically cut in half. Millions lost their businesses, their homes, and their farms. America entered into the greatest peace-time economic crisis it faced before or since.

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Just as the stock market had climbed during the prosperity of the 1920's, it fell during the depression that followed. The accompanying charts show just how far prices collapsed. Note in particular the average for the 50 leading stocks – which tells the story of the stocks in the stock market game.

Dow Jones Industrial Average, March, 1927 – July, 1932

Stock	Dividends	Price of Stock on:			
		1927	3/3/28	1/3/29	9/3/29
U.S. Steel	7	140	200	260	21
Goldman Sacks	0	40	185	180	4
American Can	2	77	130	180	31
Am Tel & Tel.	9	180	240	300	71
Radio (RCA)	0	94	300	505	17
Avg. 50 Leaders	5	176	240	310	34

Suggested student exercises:

1. Account for the rise and fall of the stock market. Assess the part played by Michael Meehan, margin, uneven distribution of wealth, undue optimism, forced selling, fear, and economic conditions.
2. Make as many comparisons as you can with the stock market of the 1920's and early 1930's to the stock market of the 1990's and the early 2000's.? Do they seem to be more similarities than differences?

