

selections rich in material that are always completely unrepresentative of the mine as a whole, while samples are those materials taken with great care and intelligence for the purpose of reflecting an accurate picture of the mine as a whole, of what can be expected in the course of more penetrating work. Specimens are easy to select. Samples are of a much more difficult order. Specimens are always misleading; well taken samples provide a basis of reliance.

What you have been listening to for the past 2 weeks, gentlemen, in my opinion is an analysis of a few specimens, and you have not heard anything about the average sampling of the ore. Of course, in a mine the specimens are examples of the best, and in an investigation we all now know that the specimens are examples of the worst. I do not believe that it would be any wiser to write a law based upon specimens than it would be to buy a mine based upon specimens. The latter, I know, is fatal.

Now this business of selecting specimens may be interesting but it is not very instructive. For example, if it fell to my lot to argue the other side of the case, I would produce specimens having as much virtue as the ones you have listened to had vice. To illustrate, it was necessary 3 years ago for my company to report on the state of its affairs before the S. E. C. (I cite this particular example because the S. E. C. is officially in possession of the same data.) It was able to state that for those stockholders who had paid \$104 on the date of formation of the company, namely September 25, 1929, there were available for each share of stock on November 7, 1936, assets of a net value of \$134.34; and that, further, in the meantime each share had received during that period of 7 years \$19.35 in dividends. In other words, over the period of the world's greatest financial disaster, it was possible for my company to render to every original shareholder, for the \$104 which he had paid in 1929, an accounting of almost \$154 in 1936. The record of this operation is as extraordinarily good as the records of the ones you have listened to were disastrous.

Senator DOWNEY. What range of security companies are you covering?

Mr. BUNKER. This is my own company. I am saying that if I had to pick specimens to argue the other side of the case I could find them in numerous companies. Among a few are General American Investors and National Bond and Share. Strangely enough, these which I have mentioned, and which have such excellent records, have been operated under banker-manager sponsorship which you have been informed is one of the most evil relationships that can exist in this industry.

But neither these specimens, on the one hand, nor the other specimens to which you have listened, on the other, are in any sense representative of a true and average story of the industry. They are interesting but they are not very useful in determining what the totality of the situation really is.

I have touched on the evidence that has been presented to you by the S. E. C. and I have told you where I stand on legislation and regulations that would, in my opinion, adequately and effectively cure the malpractice which has been brought to light. Now, before we go on to a discussion of the details of the bill that is before you, I feel that it is essential that I bring to your attention certain im-

portant facts with respect to the constructive side of this industry, which have been thus far overlooked in these hearings. I am sure that you will wish to hear them so that both sides of the picture may be clearly on record.

There are in the studies of the S. E. C. which have been presented to the Congress, thousands of pages of findings and conclusions relating to the general experience and performance of the industry. It is too much to expect that any great number of people should have taken the days or weeks of time which would be required to make a careful study of such voluminous material. My own opinion is derived from not only a minute and careful examination of all of this material as it has been made available to the public, but also from daily operating experience as senior executive officer of one of the largest investment companies, which position I have held from the time this company was founded until the present day, as its senior executive officer.

To begin with, as you have already heard, ours is a very large industry. Its assets are above \$4,000,000,000. It is estimated that there are 1,500,000 stockholders of investment companies as against from 10 to 12,000,000 stockholders of all other American industries. There are thus possibly more Americans owning stock in investment trusts than in any other single American industry. Legislation affecting investment trusts will affect the fortunes of these million and a half stockholders. Our companies in their turn hold securities in virtually every important publicly owned American enterprise. Consequently, legislation if destructive of our industry would have direct and indirect effects throughout the American economy. I emphasize these facts to support my belief that the question of regulation of the investment company industry is one of major importance, with wide ramifications.

Next, as to the historical background. On January 1, 1927, the industry was of negligible size. At that time it had received total contributions of capital in the neighborhood of \$700,000,000. Ninety percent of the entire growth of the industry took place in the next 3 years. By the close of 1929 the \$700,000,000 figure had been increased to approximately \$7,000,000,000. In fact, substantially more than \$3,000,000,000 was raised for this industry in the single year of 1929 and a good part of this in the several months preceding the stock market collapse of October 1929.

We may wonder that the world was not wiser than to form these companies at such a time. But the very fact that it was not was responsible for many of the problems that developed in the succeeding years.

It is really necessary to reproduce the sentiments of that era in order to understand the problems of this industry in the days of its infancy.

Here are the views of a justly respected financial agency published on September 30, 1929, a date just past the peak of investment trust flotations:

We have made a careful survey of general economic conditions and find no logical basis for anticipating a prolonged reaction in the stock market. The continued high rate of activity in industry, with excellent earning power in prospect for the leading corporations makes us believe that the present technical recession in the market offers investors an opportunity to acquire selected stocks for long-pull investment purposes.

Obviously, investment companies could not have been founded in such volume at that time unless practically everyone in the United States had agreed with the above opinion. There had to be willing buyers of the issues that were offered in such profusion. Based upon such optimistic psychology, this \$7,000,000 industry was born. But no sooner had it been born than it had to meet the gravest problems of all financial history.

From September 1929 to June 1932, the value of American stocks shrank by at least \$125,000,000,000, an amount approximately equal to a third of all the wealth ascribed to the United States in 1929. All fields of our economy were affected.

Senator DOWNEY. What year did you say?

Mr. BUNKER. From September 1929 to June 1932, the value of American stocks shrank by at least \$125,000,000,000, an amount approximately equal to a third of all the wealth ascribed to the United States in 1929.

Senator HERRING. Can we not have copies of this statement? If we had copies of it we could follow it along.

(Copies of the statement referred to were distributed to the members of the subcommittee.)

Mr. BUNKER. Probably 40 percent of the 1929 wealth vanished. Conservatively speaking, at least one-fifth of American estates were wiped out. I am sure no one here wants any more extended review of this painful period. But nonetheless, it must be borne in mind that this was the period of the infancy of this industry.

During the depression, the dramatic shrinkage of value of all securities in the United States naturally included those held by investment companies.

When the blow struck, this industry was just passing through the promotional and inflationary stage which seems to be characteristic of the period of birth of any dynamic new American enterprise.

The founders of this industry had not anticipated the most devastating and precipitous collapse in the history of world markets. Many, if not most of the investment trusts that were formed at this period were founded upon the expectation of being able to make large and legitimate profits from investments in special situations, from participation in private ventures, undertaking new ventures, underwriting, etc. It was everyone's hope and belief that the large profit possibilities of the late 1920's would continue indefinitely, and it was the purpose of the organizers and managers of the majority of investment trusts at that time to take advantage of these opportunities rather than to engage solely or primarily in the everyday routine of the management of diversified portfolios. The last thing in the world that they were prepared to do was to establish a defensive investment position and maintain it for the next 3 years, although this definitely was what the times required. Men give up their hopes reluctantly. Here they needed to trade hope for despair and do it quickly.

Certainly, an objective study of any industry's operations during this period should have taken into account primarily the abnormal setting in which the operations had taken place. The S. E. C.'s study does not seem to me to have taken this background into consideration.

But, the S. E. C. did undertake to measure the performance of our industry. It certainly did not do so by reviewing the general situation and establishing our appropriate place in the economic setting of the times. The conclusions at which it arrived are, in my opinion, unrealistic and give no true picture whatever of the actual comparative performance achieved. I am referring of course to the voluminous statistical study prepared by the S. E. C.

This study has suggested again and again that the result the managements of investment companies achieved was exactly nothing, that one would have done just as well had he bought a package of securities as represented in well known indexes and carried them throughout this trying period. In most instances the tests of performance have been measured against the alleged behavior of 90 stocks which composed one of the index averages maintained by the Standard Statistics Co. The S. E. C. statisticians found that the performance of such a theoretical fund and the actual performance of the portfolios of the investment companies were approximately the same, and they conclude that the investor would have done as well to buy such a group of stocks and to avoid all the bother and expense of management. And he would have done even better to buy only Government bonds.

We have examined with care these studies of performance. We knew, of course, that the Standard Statistics Index was primarily a mathematical concept. It never pretended to be a recommendation for an investment fund or to parallel in any sense the operation of an investment fund. On the other hand, the S. E. C. statisticians used this as a basis of measurement, apparently because it was their understanding, as far as one can gather from the voluminous studies, that one could have invested in the group of stocks that composed the index, and remaining so invested over a given period of years, would have had to make only nine changes, occasioned by eliminations and substitutions.

The facts are extraordinarily different. In the first instance, the fund would have had to have the ability to make retroactive changes in its portfolio. But that matter is of only minor moment. We have tried to create such a fund on paper and trace through its theoretical existence in order to see what practical problems might have been encountered. We have been able to work out three methods of handling an actual fund to effect transactions in a fashion somewhat parallel to those effected by the index. In the simplest case, it was necessary to make 333 investment changes in 14 years, but in this case one must have had available at all times an uninvested fund with which to take up the issue of new stock offerings. The behavior of such a fund composed of cash and securities would in no sense have paralleled the index, because of the amounts of uninvested cash.

In another case, it would have been necessary to sell portions of 90 of the securities every time one of the 90 companies offered an issue of new stock. While the result of such a process would have come out exactly the same as the index, it would have occasioned over the period a minimum number of 29,970 transactions. This clearly ruled out this type of operation as wholly impracticable and completely outside of the category described by the S. E. C. as an "unmanaged" fund.

There seemed to be only one method left which was in any way fair and reasonable. This was to have invested a fund in all of the stocks

included in the index in the same proportion in which they were originally represented. And then, upon each of the 333 occasions on which it was necessary to take up rights to purchase stock as offered, to sell that percentage of the rights which would produce cash to purchase the remainder. This would have occasioned innumerable transactions also, but at least would not have required an inexhaustible supply of money. But the interesting thing is that if one had conscientiously pursued such a course, which seems the only one possible, the behavior of the fund so treated would have fallen behind the behavior of the index by over 18 percent for the period from 1927 through 1937. But the assets of the investment companies did not fall behind this index. They exceeded the behavior of such a fund as I have described by over 20 percent—and 20 percent when one is talking in billions is a large sum of money. I realize that this is complicated but, at least in our opinion, it invalidates the statistical premises used by the S. E. C. in assaying the performance records of the investment company industry. In fairness to the S. E. C. I should like to file herewith an extensive study which we have prepared on this subject.

Senator WAGNER. It will be placed in the record at the end of your testimony.

Mr. BUNKER. Now it is true that the S. E. C. has suggested that this comparison is not the only possible one, but it is nonetheless the only one that has been made; further, the S. E. C. has taken no steps whatever and made no effort to throw any more light upon this almost controlling subject. We believe it is appropriate to do so, since it is so very important to view this entire business in some realistic setting. In my opinion, it is essential to analyze the behavior of comparable and related situations which tend to show much better whether the performance has been good or bad. I have prepared a number of these comparisons which I hope will be interesting to the members of this committee. I can assure you, gentlemen, they are not specimens. I do think they will surprise you.

On page 195 of House Document No. 70 there appears a table which furnishes information with respect to the years in which securities of various types of investment companies were issued to the public. It is significant that in this table—representing over \$4 billion—approximately \$2.7 billion of investment company securities were issued in the year 1929 alone, or, in other words, 65 percent of this large cross section of such issues was sold in 1 single year out of the 9-year period which is incorporated in the table. In other words, 1929 stands out as the year of maximum importance in the formation and issue of investment company securities. Since such was the case, it seemed to be particularly fitting to make a study of all issues, other than investment companies, which were offered and sold in the year 1929 and to trace through their behavior in comparison with the behavior of the portfolios of investment companies.

So far as we have been able, we have therefore made a very careful study of the issues sold in 1929 of industrial, utility, and rail securities—grouping separately common stocks, preferred stocks, and bonds. I should like to submit this study to support the statements I am about to make.

Now the results of this are extremely interesting. The study was large and representative, and traced the 6-year history of over \$5.5 billion of 1929 issues. It was inclusive and played no favorites.

The performance of investment companies, according to the study of the S. E. C., was that from the end of 1929 to the end of 1935 they preserved 69 percent of their assets. It was necessary for us to make an adjustment in this figure because the comparison had to be made with the average date of issue in 1929 rather than with the year end. The result of the adjustment established that 56 percent of the assets of investment company portfolios was preserved over the period of this comparative study. It is quite striking, therefore, to discover that compared with such a performance the aggregate value of all other common stocks issued in 1929 was only 33 percent of their issue price at the end of 1935. In other words, investment company portfolios maintained a performance over this period about 60 percent better than these common stocks issued in 1929. Those common stock issues, I might add, included securities of many of the leading industrial companies in the country.

Now as to the behavior of preferred stocks. All of those issued in 1929, together, preserved only 47 percent of their value to the year end of 1935. That is, the assets of the investment companies were preserved over the same period almost 20 percent better than if they had consisted entirely of this group of senior securities.

Bonds issued in 1929, as would be expected, did better and preserved 74 percent; but here one must admit the comparison is almost unrelated, because never at any time was it anticipated by investment trust stockholders that their companies' funds would be substantially invested in high-grade bonds.

All of these 1929 security issues together—common stocks, preferred stocks, and bonds—preserved only 49 percent of their issue value to the end of 1935. In other words, the investment companies preserved 10 percent more of their assets than the average of all these other securities. This seems a much fairer and more realistic test than any which has been applied by the S. E. C. It does look as if management deserves a kind word from someone.

Another statistical comparison seems particularly appropriate. One of the best known investment rating services has for many years rightly enjoyed the reputation of a conservative investment counsel to institutional and individual investors. Its ratings of bonds are officially recognized by governmental agencies. It is fair to say that the recommendations of this established agency may be regarded at any given time as representative of sound and experienced judgment at that time. On September 30, 1929, this organization submitted to its clients a list of about 50 stocks with a recommendation of their purchase for investment. Of these stocks, 37 were given specific ratings—half of them a rating of A or better (Aa in stocks corresponding to Aaa in bonds). We have taken the list of rated stocks, and to give full emphasis to investment standing, we have weighted the list in accordance with the rating, giving A issues a triple weight, the Baa and Ba a double weight, and everything below a single weight.

We believe that the performance of this sophisticated list of rated stocks, weighted as above, and with adjustments for rights and capital changes, is fairly representative of the performance of a first-class "unmanaged" portfolio.

This portfolio, recommended in 1929, had at the end of 1935 a value of 47.9 percent of its 1929 year-end value. Against this figure, the

average of investment trust portfolio valuations at the end of 1935, as we have said, was 69 percent. In other words, investment company portfolios preserved 44 percent more of their assets than if they had been composed entirely of these recommended and leading stocks. Again it would seem that management gave a fair account of itself.

Now, I have not meant to suggest that the investment policy of this highly rated service was ever to buy such stocks and hold them for 6 years, nor could it be sound investment management for anyone to ignore changes in conditions, particularly as they occurred with such overwhelming force at that time. But the point is that the difference between that kind of inaction and actual performance must go to the credit of management of this young industry. And 44 percent is quite a lot of credit.

If we have labored the foregoing facts, our purpose was definitely to lift the investment trust problem out of the unreal setting in which the S. E. C. chose to consider it, and to place it in its proper perspective to the financial happenings of the actual world. Otherwise it would be impossible to view the problem with any clarity and to distinguish from those elements characteristic of the times those which were solely peculiar to the industry. Up to this point they have all been lumped together.

If I had been asked to guess what the performance results of all of these investment companies collectively had been throughout the period of great disaster between 1929 and 1935, I am sure that, bearing in mind that these companies were in their infancy when the great collapse came, I should have guessed a figure far below the performance which was realized, far below the average of other issues of going concerns brought out at the same time, and far below the highly recommended list of investment stocks. Certainly I never should have dared to guess that these new organizations would have far exceeded the average of such other situations.

Possibly, I should have had in mind that they were the only financial institutions of which I could think which did not receive the aid and support of the Government in this critical period. Possibly, when I reflected that aid had been rushed from every source to the commercial banks, savings banks, insurance companies, building and loan companies; when I thought of the \$4,000,000,000 worth of mortgages, urban and agricultural, which had been taken over by the Government; of the permission to carry securities at conventional quotations; of the direct aid from the R. F. C. by purchase of preferred stocks and notes—I might have believed that these investment companies would have done well to have survived at all, totally without any aid of this sort.

Also, if my knowledge had been derived only from sitting here these past 2 weeks and hearing of the abuses and frauds, I am sure I should have been convinced that little or nothing could possibly have been left. But when one considers all of the facts, the record of these companies over the depression period has been little short of remarkable.

Another important aspect of our industry should be mentioned. The funds of investment companies have been and should be largely invested in equity securities. We want to emphasize the importance to the continuation of American recovery and industrial expansion that lies in this availability for equity investment of the great fund

of capital represented by the investment-trust industry. We believe that the relative importance of this fund at the present time has not been fully appreciated. It seems to us that we have only to take a casual glance at what is happening to available investment funds to see that more and more of them are being precluded from the purchase of dynamic junior securities which, after all, are those securities which provide the money to start new businesses and to expand existing ones. Life-insurance companies, savings banks, legally restricted trust funds of widows and orphans, and added to these in the last few years, various pension funds, Government social-security funds, and so forth—these are growing in size annually, and are largely restricted to investment in the very highest grade bonds. Men of wealth, who previously were by all odds the largest buyers of equity securities, are more and more preoccupied today with the preservation of their fortunes rather than with their augmentation, or with high yields either in dividends or capital appreciation, to say nothing of the fact that pools of personal wealth are diminishing.

Senator DOWNEY. I regret very much that I have to withdraw.
(Senator Downey withdrew from the hearing room.)

Mr. BUNKER. This state of affairs is a result of existing tax laws and we cite it only as a fact, without criticism or comment. It seems to us self-evident that the sources from which is to come money for the purchase of equities are contracting. The investment-trust industry remains perhaps the most important organized reservoir of such capital. Our plea, therefore, is that nothing should be done in the name of regulation and control that will immobilize this great dynamic pool of capital or which will impair its ability to invest intelligently in American industry.

We do not subscribe to the theory that, because the history of our investment companies has been not to invest directly to any great extent in new issues, they do not therefore contribute to the supply of money for enterprise. Our economic links are more interwoven than that. Our economy is rapidly changing. We believe rather that these companies receive funds from a large class of people heretofore not given to purchasing equity securities, and that these funds, when used for equity investment, represent an irreplaceable source of the kind of capital most needed in our economy today.

Just one more word about the industry. I am struck with the fact, in perusing the long studies of the S. E. C., that there is no description of or any comment upon the question of organization or personnel of these companies, or any statement about their equipment and machinery for handling investments. My own observations are that in all of the instances with which I am familiar, the last 10 years have been devoted to selecting and training personnel, toward creating a more competent and specialized organization to deal with the many exacting problems that are inherent in this business, problems which in their wide range require not only the ability to make careful analyses of hundreds of special securities and industries, but to deal with and interpret the significance of such large and continuing questions as the purchasing power of agriculture and labor, the supply of money and credit, the changing value of gold and its ensuing implications on the entire commodity price structure, the effects of international affairs, of economic isolation, and of the complete social change from a laissez-faire economy for which most of the old school analysts

and economists were trained. It is my sincere belief that the investment trust management personnel today is of a far better order of ability and competence than it was in 1929.

All of these facts make me feel it proper to raise the question whether the past 10 years should not be regarded as the years of infancy of a new industry and, therefore, whether one has not a duty to look forward to, and plan constructively for, the next decade, rather than continue looking backward.

I have given a general picture of the importance and size and performance of the industry and I have also given our views on the problem of regulation.

I would like, therefore, to come back again for a moment to a general discussion preliminary to the bill.

I happen to think that in order to fashion a bill based upon the real needs for correction, after impartial consideration of all the facts, a high degree of general cooperation between the industry and the Commission must be established. It is my opinion that such a spirit of cooperation has existed on the part of the industry for the past 4 years. The committee which I represent has earnestly desired the chance to cooperate in the development of a bill. You may have obtained a different impression from the remarks of Commissioner Healy in his opening statement, when he expressed disappointment that representatives of the industry's major elements had not accepted the Commission's suggestion of conferences on the bill during the period intervening between the bill's introduction and the beginning of these hearings.

I can assure you that any suggestion that an effective opportunity for cooperation existed after the introduction of the bill is unrealistic. The full time between the introduction of the bill on March 14 and the commencement of hearings on April 2 was required for preparation. I do not mean to say that it would not have been possible to consult with the Commission for 2 or 3 hours but, on the other hand, I am sure no one would suggest that the development of a bill of this length and complexity would possibly be advanced by such a type of discussion.

My group is not only willing, but anxious, to cooperate; anxious to develop a bill dedicated to the principles which I have announced and to the general principle that we favor regulation adequate to prevent the gross forms of abuse which have occurred and which are not prevented by existing statutes. After all, the section of the industry which I represent has suffered for 4 years under the cloud of these investigations, and under discriminatory and unfair tax treatment, and it is anxious to bring the matter to a close. It will subscribe to any plan of good workmanship and genuine cooperation.

It is for that reason we have been so anxious to come before this body with the hope that after hearing all sides of the case, your committee will lay down principles and instructions as a basis for further developing a proper bill. The present bill, in our opinion, is neither livable nor workable as now written. We believe that it goes far beyond the necessities of the case and that, if it became law in substantially its present form, it might operate to cause the retirement from the industry of desirable elements in it, whose records have been more than creditable and those who have shown scrupulous regard for the interests of stockholders. We do not believe this destructive