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THE STATE OF THE STREET

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BEFORE THE YOUNG PRESIDENTS' ORGANIZATION

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If you have been following the stock market news over the past two weeks, you may be thinking that the view from Wall Street has turned to sunshine and roses after a long, long drought.

The State of the Street is better than it was a few weeks ago -- no doubt about that -- but, unfortunately, it will take much more than a few days of sustained high share volume to clear away the cloud of apprehension hanging over the securities business. Despite the new surge of market activity, the prevailing mood at the New York Stock Exchange is not unrestrained joy.

Just four days ago, our Board of Directors deliberated the possibility of authorizing the Exchange to file suit against an agency of the United States Government -- the Securities and Exchange Commission. The SEC, of course, is the principal

regulatory overseer of the securities industry. The dilemma facing our Board centered on a recent order from the Commission to eliminate fixed rates of commission on all public securities transactions, beginning May 1st.

Despite the urgency of the Board's concerns about the broad impact of that order, our Directors decided against contesting it in the courts. Both the SEC's order and the Exchange's decision not to wage a legal battle over it bear importantly on serious problems facing the managers of many hundreds of United States corporations. Last week's developments provide a natural framework for explaining how those problems look from Wall Street.

The key consideration in the Exchange Board's decision not to sue was our awareness that a court challenge would necessarily focus on narrow legal questions. Thus, even a favorable court ruling would not solve what we regard as the crucial issue: that is, how to maintain a strong, healthy exchange auction market system in an environment of competitive public commission rates.

As a practical matter, the SEC's order, as it now stands, would propel the securities industry into an experiment that no one can guarantee will not seriously impair, if not destroy, the existing equity markets in this country. The potential

consequences to the national economy -- and to hundreds, perhaps thousands, of corporate enterprises -- are very grave indeed.

Why should government be willing to run the risk of dismantling a marketplace that the rest of the world has admired and envied for nearly as long as America has been a free country -- and that many other nations, right now, are striving to emulate?

I do not believe that the SEC or any other government agency really is willing to risk that result.

A bit of background is necessary to fully appreciate just how much is at stake.

Most of you will recall the stock market boom a few years ago that turned to bust virtually overnight -- when an incredible, prolonged upsurge of public trading was followed by a dramatic and even more prolonged downturn that caused near-chaos in the securities industry.

Although the New York Stock Exchange market functioned without interruption, the great volume of orders to buy and sell stocks dangerously strained the facilities of brokerage firms -- creating what was called, in the great understatement of 1968, the "paperwork problem".

Following that, the sudden collapse of market activity and reversal of stock prices badly undermined the financial position of many brokers and dealers -- a large number of whom had recently undertaken huge financial commitments in new computer equipment to help deal with the clerical mess.

Hundreds of securities firms went out of business between 1968 and 1970 -- including some of the best-known brokerage houses. During that period, the New York Stock Exchange and its membership committed some $140 million to protect the interests of public customers of member firms in liquidation. Most of that money was subsequently paid out -- and very little of it will ever be recouped.

That was the background which prompted Congress and the regulatory authorities to begin a sweeping examination of the securities industry. The immediate objective was to guard against any future recurrence of the paperwork and financial debacles. The longer-range goal -- which, by and large, the industry itself supported -- was to determine whether fundamental changes in the structure of the stock market might be desirable or necessary.

Some people concluded from the findings of the various studies that the New York Stock Exchange enjoyed some kind of

special monopoly status. I strongly disagree with that conclusion -- but this is not the time or place to argue the definition of monopoly.

Ironically, however, it is the supposedly monopolistic features of Stock Exchange efficiency that enable it to serve a very necessary and valuable purpose in the economy. But this fact has been consistently ignored by those in Government who would chip away at the foundations of our national economic strength in the name of competition.

Now it is true that most of the trading in the stocks of some 1,550 listed corporations is brought voluntarily to the New York and other registered Stock Exchanges. Each day the market is open, as many as 100,000 individual orders to buy and sell those stocks flow to the continuous two-way auction -- in each stock -- on the various Exchange trading floors. Most of those orders -- and a healthy chunk of the volume -- come from individual investors and smaller financial institutions. They represent most of the public supply and demand for those stocks, and they continue to be the key element in setting stock prices.

Because those orders all flow to a central auction among buyers and sellers, investors can be reasonably certain that they will get the best price available at any time they

decide to buy or sell a listed stock themselves. And in most cases, that price is no more than a quarter-point -- that is, 25¢ a share -- more or less than was paid in the immediately preceding trade in the same stock. When market conditions cause wider spreads to open between successive bids and offers, the auction market mechanism -- uniquely -- provides that a stock specialist charged with maintaining an orderly market in each stock assigned to him must -- not may, but must -- step in and, using his own inventory of shares, offer the public investor a better price than is available at that moment in the auction because of the temporary imbalance of supply and demand.

Critics of this system ignore the fact that a specialist in a particular stock on one Stock Exchange competes with other specialists in the same stock on other Stock Exchanges. They claim, instead, that the specialist on any Stock Exchange has what amounts to a monopoly franchise. Again, that is certainly not my idea of monopoly -- especially when you consider that the franchise says to the specialist that because no one else has the resources, the expertise or the inclination to take the extraordinary financial risks necessary to assure that the public is fairly treated, he must do it.

Critics who question that propriety of that franchise

have sometimes appeared to believe it would be better to let the public fend for itself. The result, they say, would be competition -- and competition is better than any form of real or imagined monopoly. The SEC's commission-rate order, in its present form, would implement that concept.

But what are some of the predictable results of the kind of competition now in prospect?

Leaving aside the complex technical details -- which I'll be glad to discuss later with anyone who wants to-- the changeover to unfixed or so-called competitive rates will make it possible, profitable, and perhaps necessary, for many brokers to give up their Stock Exchange memberships and set themselves up as dealers in one or many of the 1,550 listed stocks now traded chiefly on the various Exchanges. Instead of bringing their customers' orders to Exchange auctions in those stocks, they would sell directly to their customers or buy directly from them -- simply marking the price of each stock up or down enough to assure themselves a satisfactory profit on each deal.

From the standpoint of customers, instead of paying a predetermined, government-sanctioned commission rate to a broker for handling their business at the Exchange auction,

they will pay a dealer whatever premium he thinks the traffic will bear. Of course, that assumes the dealer handles the stock the customers want to buy or sell, and that he is willing to do business with them in the first place.

Predictably, there will be at least three different price levels: one for the biggest and best institutional customers; another, rather less advantageous set of prices for other favored buyers and sellers; and a third set for everyone else.

Will the "competitive" cost to the typical investor be more than the present "monopolistic" fixed commission rates? I believe it will, in most cases. Most of the critics disagree. If they are wrong, competition will bring handsome profits to the dealers who survive the demise of the Stock Exchanges -- and disaster to the majority.

IMPACT ON CORPORATIONS

Meanwhile, the fallout elsewhere in the economy -- on some of your businesses, for example -- could do a great deal more damage.

The restructured securities markets fostered by fully competitive public commission rates will consist of reasonably efficient dealer markets catering to the special interests of large institutions in perhaps 200 to 300 active stocks --

plus a small group of regional broker-dealers handling the stocks of a few prominent companies in their own areas. And not, I am afraid, very much else.

What of the 1,250 or more smaller and medium-sized listed companies whose stocks are ignored by the big institutions? It is a safe bet that they won't be of much interest to the dealers, either.

Today, nearly all of those companies rely on the Stock Exchanges to provide the only continuous national market available to individuals and smaller institutions who want to buy and sell their stocks. If any of you ladies and gentlemen happen to preside over such listed companies, you know that in normal times, you can obtain capital for growth and expansion -- by issuing new stocks or bonds, or even by going to your bankers -- because the existing auction markets provide a clear continuous evaluation of what the investing public thinks of your operations and prospects. You may not always be pleased with the market's judgement -- but at least you know where your company stands.

If your companies are frozen out of a new market system -- or if investors have to shop around to find a dealer willing to buy and sell your issues, even at prices he can set unilaterally -- what will happen to the resale value of investors' present holdings in your companies' stocks? And

what impact do you suppose that will have on your ability to raise capital in the future? I believe you can answer those questions better than I can.

In terms of the national economy, those prospects raise many grave questions about thousands of jobs that won't materialize if hundreds of well-managed companies cannot finance growth and expansion. Not to mention public confidence in an economy that, in the name of "competition", could become more and more heavily concentrated in the hands of a few hundred corporate and institutional giants.

ROOM FOR IMPROVEMENT

Now, I certainly do not mean to suggest, in any of this discussion, that the New York Stock Exchange thinks it has been -- or is today -- free from fault or error. We have made our share of mistakes. We actively support -- and we are implementing -- many proposals that have been advanced for improving the efficiency of the existing auction market system. The smooth handling of transactions involving more than a quarter-billion shares of stock over the past two weeks suggests that we have a much more efficient operation today than we had just a few years ago. There is room for further improvement, and we are working on that. We also believe the existing system can be made more competitive without tearing down the auction markets and endangering the

legitimate interests of hundreds of corporations and millions of stockholders and jobseekers. And we will be working toward that goal with Congress and the SEC in the months ahead. But we are going to need a good deal more support from the corporate community and from the public than we have received in the past.

The Exchange has been characterized as being adamantly opposed to competitive public commission rates. That simply is not so. We have been -- and we continue to be -- adamantly opposed to changes that would choke off the flow of orders in listed stocks to the auction markets. Our position -- from the very beginning of the debate on this issue has been that we would be willing to give up the authority to set public commission rates, if government would act to assure that the bulk of public orders in listed stocks continues to flow to the New York, American, Pacific, Midwest and other Stock Exchanges.

Although the SEC's order to eliminate miniumum rates does not provide the necessary assurances, the Commission has clearly indicated its awareness that unintended adverse consequences could develop before or after May 1st. The Commission says it will position itself to take prompt corrective action based on the findings of a monitoring program

that will collect data on the financial and other activities of brokers. More specifically, they have said that -- and I am quoting now from the Commission's formal announcement of its adoption of the rule eliminating fixed rates -- "if it should appear that member firms are proposing to leave the Exchanges in order to execute customers' transactions by making markets off the Exchange, various steps could be taken to restrict this practice to the extent necessary or appropriate in the public interest or for the protection of investors".

Unfortunately, the Commission has not yet spelled out what kind of restrictions it might consider or how promptly they might be put into effect. However, our Board of Directors -- in rejecting the alternative of contesting this issue in the courts -- decided to accept these assurances of the Commission's good faith.

We are, after all, dealing with reasonable people whose convictions are genuine and whose motives are beyond question. We have never doubted that. It follows then that if the SEC's monitoring activities bear out the Exchange's fears, the Commission will act promptly and effectively to avoid the consequences we have been warning about.

Accordingly, we believe that the Exchange's efforts

can be most productive in working with the SEC to develop specific suitable techniques for strengthening and improving the auction market system within a framework of competitive public rates -- rather than in pursuing a long, costly and necessarily inconclusive court contest. Moreover, if the Exchange and the SEC can agree on appropriate measures, we would assume that the Commission would want to incorporate them into its rules. We would expect, further, that -- if need be -- the Commission would join us in recommending that such measures be included in any future national securities legislation.

CAPITAL AND JOBS

It scarcely seems necessary to point out to an audience of corporate chief executives that public confidence in the national economy today is at a critical juncture. Most major industries face an uphill struggle to raise enormous amounts of capital to finance the kind of growth and expansion that can be translated into tens of thousands of new jobs. For smaller businesses, the problems are even greater. The demands on the nation's equity markets in the years ahead will be more severe than ever before.

I am unwilling to believe that as government tries to bolster public confidence and cope with the grim

statistics of rising unemployment, it would also mandate a securities pricing experiment without providing any assurance that we will continue to have strong equity markets and that American business will retain the ability to generate new job opportunities.

AFL-CIO President George Meany made what I believe was a very relevant and very telling statement at one of the economic summit meetings held in Washington last fall. Commenting on the prospect of WPA-type jobs as an offset to job layoffs in private industry, Mr. Meany told the meeting: the goal of this Administration should be to create real employment -- real, full employment -- in the private sector.

I couldn't agree more. And I believe most of us in business management share that goal and want to help achieve it. I believe labor and capital should -- and must-- join forces to demand national economic policies that will enable American business to tap billions of dollars of private savings that can, in fact, help create real, full employment in the private sector.

If Congress and the Administration really expect to bring down living costs without throwing millions of Americans out of work and demeaning the quality of life in our country, they must do everything they can to encourage a massive flow of private savings into productive

business investment.

Government must avoid policies and experiments that can only deflect, discourage or hinder millions of Americans from putting their savings to work in the mainstream of the economy.

Government must recognize that without an adequate supply of investment capital, business stagnates, efficiency declines, costs rise, jobs vanish -- and inflation swirls upward.

Government must recognize that without strong equity markets in which everyone can participate fairly and equally, we will not have an adequate supply of investment capital.

And government must recognize that without a vigorous Stock Exchange auction market system, there will be no strong equity capital markets in this country.

Government must begin facing up to the truth that, in our American system of capitalism, there are no inherent discrepancies between the legitimate interests of the people and the legitimate interests of the businesses that serve and employ them, and in which they invest a significant part of their personal savings. I can think of no better starting point than the rules, regulations and legislation governing the strength and health of our national securities markets.