report found that "[w]ithin these 30 securities, those in which the funds' net purchases accounted for the greatest percentage of the NYSE volume showed, on the average, the largest percentage [price] increase."[35] The Wharton Report also found that during 1953–58 a relatively large portion of mutual fund assets were concentrated in these 30 favored stocks. As of September 1958, investments in these 30 stocks accounted for 19.1 percent of the funds' net assets and for 23.5 percent of the value of their common stock portfolios.[36]

The tendency of mutual funds to concentrate their investments in relatively few securities does not differ from the investment pattern of other institutional investors or, indeed, of the investing public generally.[37] However, investment company portfolio holdings are periodically disclosed to the public whereas most other institutional investors are not subject to disclosure requirements and their portfolio holdings of individual securities generally are not made public. Indeed, although pension funds are more important holders of common stocks than mutual funds and nearly as important as all investment companies (open-end and closed-end), there are no comprehensive data available as to their portfolio holdings in individual securities.

(*b*) *Concentration of investment company portfolios*

Although the investment company industry has tripled its assets since 1958, this growth does not appear to have resulted in a lesser degree of portfolio concentration. A survey of the yearend 1964 common stock holdings of about 425 open-end and closed-end investment companies, with combined assets valued at approximately $40 billion, indicates that about 20 percent of these assets were invested in the 30 common stocks most favored by those companies on that date.

Table VII–7 shows investment company holdings in these 30 securities as a percentage of the number of shares outstanding and the net changes in these holdings during the last half of 1964 as a percent of trading volume in these securities on the NYSE during the same period.[38] The combined holdings of the 425 investment companies in these 30 stocks ranged from 0.5 percent of the outstanding shares of American Telephone & Telegraph Co. to 20.3 percent of the outstanding shares of Columbia Broadcasting System. In 9 of the 30 stocks, investment company holdings amounted to 10 percent or more of the outstanding shares. Trading activity of the investment companies in many of these stocks during the last half of 1964 was particularly significant with *net* purchases amounting to as much as 39.3 percent of NYSE trading volume in the shares of Southern Pacific Co. and 34.9 percent of such volume in the shares of Union Carbide Co. In 13 of the 30 stocks net purchases or sales amounted to 10 percent, or more of NYSE volume during that period, and for 7 of these stocks it exceeded 20 percent or more.

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[35] *Id.* at 387.
[36] *Id.* at 175.
[37] A New York Stock Exchange survey of holdings in NYSE listed common stocks by over 1,800 institutional investors indicates that at year end 1962, five issues accounted for 14.5 percent, and 51 issues accounted for 41.4 percent, of the value of all listed stocks held by these institutions. NYSE Report on Institutional Shareownership (1964) 30.
[38] Net purchase and sale data are used because *gross* data are unavailable.

TABLE VII-7.—*The 50 largest common stock holdings of 425 investment companies as of Dec. 31, 1964*

Name	Market value (millions of dollars)	Number of companies holding	Number of shares held Dec. 31, 1964	Shares held as percent of outstanding stock	Net increase (decrease) in number of shares held June 30 to Dec. 31, 1964	NYSE volume, July 1 to Dec. 31, 1964	Net increase (decrease) in shares held as a percent of NYSE volume, June–December 1964
International Business Machines	837	197	2,043,400	5.8	(17,900)	943,300	(1.90)
Standard Oil Co. (New Jersey)	728	174	8,081,700	3.8	151,600	2,221,000	6.83
General Motors Corp.	676	182	6,902,200	2.4	585,300	[a] 4,474,400	13.08
Texaco, Inc.	653	146	7,488,300	5.5	355,100	1,400,600	25.35
Royal Dutch Petroleum Co.	307	106	6,772,600	7.0	149,000	1,705,900	8.73
Ford Motor Co.	278	103	5,121,000	4.6	(283,300)	4,849,400	(5.84)
Gulf Oil Corp.	268	106	4,579,500	4.4	(49,900)	1,343,300	(3.71)
Mobil Oil Corp.	260	108	2,839,100	5.4	166,800	819,000	20.37
Monsanto Co. [b]	247	111	2,884,700	9.6	153,100	712,600	21.48
General Electric Co.	245	100	2,628,000	2.9	298,400	2,207,900	13.52
International Nickel of Canada	243	109	2,912,200	9.9	64,500	612,300	10.53
Xerox, Inc.	213	79	2,160,000	10.5	(44,500)	4,810,800	(.93)
Eastman Kodak Co.	204	75	1,469,800	3.7	(9,200)	626,700	(1.47)
International Telephone & Telegraph	203	76	3,422,100	17.9	236,100	919,500	25.68
Continental Oil Co.	197	63	2,587,900	12.0	53,300	399,400	13.85
Southern Co.	197	59	3,002,200	12.7	(36,200)	327,300	(11.06)
Amerada Petroleum Corp.	194	50	2,334,000	18.4	46,300	661,000	7.00
Chrysler Corp.	193	63	[illegible]	8.1	718,200	9,935,300	7.23
American Telephone & Telegraph Co.	192	116	[illegible]	.5	(398,100)	[c] 5,908,300	(6.74)
Union Carbide Corp.	181	90	1,422,600	4.7	322,700	924,600	34.90
Columbia Broadcasting System	162	57	3,984,900	20.3	(93,100)	1,861,700	(5.00)
Avon Products, Inc.	161	42	[d] 2,990,900	10.4	[illegible]	[e] [illegible]	4.33
Standard Oil Co. of California	160	61	2,185,900	3.0	[illegible]	[illegible]	(1.69)
General Telephone & Electronics	157	67	4,155,000	4.8	671,900	2,868,700	23.42
Goodyear Tire & Rubber Co.	157	57	3,464,600	9.7	44,800	1,003,900	4.46
Sears, Roebuck & Co.	152	64	1,175,900	1.[illegible]	[illegible]		(6.47)
Southern Pacific Co.	150	74	3,894,300	14.4	[illegible]	[illegible]	39.31
Du Pont (E.I.) de Nemours	149	83	618,800	1.4	(99,700)	522,900	(19.07)
Texas Utilities Co.	149	62	[illegible]	9.6	(13,300)	439,400	(3.03)
Central & South West Corp.	142	56		13.0	(13,500)	332,800	(4.06)

[a] Includes 55100 shares when distributed.
[b] Formerly Monsanto Chemical Co.
[c] Includes 1,535,500 shares new common.
[d] Adjusted to reflect 3 for 1 split on Oct. 2, 1964.
[e] Includes 326,900 shares new common.

Sources: Guide to Investment Company Portfolios, Vickers Associates Inc. (June 30 to Dec. 31, 1964); Bank and Quotation Record, William B. Dana & Co. (1964).

The stocks listed in table VII–7 represent the largest holdings of the funds in terms of market value. These holdings tended to be concentrated in the securities of the very largest corporations which are widely held and actively traded. Investment company impact on the markets for the less widely held and actively traded securities of smaller companies can be even more important.

(c) *Investment company holdings in particular industries*

Not only do investment company holdings account for a substantial portion of the outstanding stock in particular issues, but their holdings in particular industries can be significant. Table VII–8 shows the holdings of 78 investment companies in selected large aerospace and airline companies at the end of 1965.[39] These 78 companies held over 10 percent of the outstanding stock of five of the 11 aerospace companies listed in this table. In one company—Lockheed Aircraft Corp.—their holdings amounted to 17.3 percent of the outstanding common stock. Their holdings of airline stocks were even more significant, exceeding 10 percent of the outstanding common stock for all but two of the 10 companies. In four airlines, the 78 investment companies held more than 20 percent of the outstanding stock, and in one—Northwest Airlines, Inc.—their holdings amounted to 29 percent of the company's outstanding stock.

TABLE VII–8.—*Holdings of 78 investment companies [a] in 21 selected aerospace and airline issues as of Dec. 31, 1965 [b]*

Issue	Total shares outstanding (thousands)	Number of investment companies holding issue	Shares held by investment companies (thousands)	Percentage of outstanding shares held by investment companies
Aerospace:				
Boeing Co.	8,187	30	1,241.0	15.2
Douglas Aircraft Co., Inc.	4,634	3	165.0	3.6
General Dynamics Corp.	10,153	17	1,351.6	13.3
Grumman Aircraft Engineering Corp.	4,540	11	582.0	12.8
Lockheed Aircraft Corp.	11,078	30	1,915.0	17.3
Martin-Marietta Corp.	19,080	4	1,048.0	5.5
McDonnell Aircraft Corp.	7,993	6	310.7	3.9
North American Aviation, Inc.	8,439	13	534.0	6.3
Thiokol Chemical Corp.	5,625	0	0	0
TRW, Inc.	8,490	6	695.0	8.2
United Aircraft Corp.	11,169	20	1,295.0	11.6
Air transport:				
American Airlines, Inc.	8,966	23	1,969.3	22.0
Continental Airlines, Inc.	3,205	0	0	0
Delta Airlines, Inc.	6,375	17	1,061.1	16.6
Eastern Airlines, Inc.	4,213	19	892.9	21.2
National Airlines, Inc.	4,079	10	719.0	17.6
Northwest Airlines, Inc.	4,575	22	1,328.5	29.0
Pan American World Airways, Inc.	14,754	17	1,766.4	12.0
Trans World Airlines, Inc.	8,759	11	650.0	7.4
United Airlines, Inc.	6,880	20	924.6	13.4
Western Airlines, Inc.	4,292	9	898.5	20.9

[a] The assets of these 78 investment companies represent approximately ⅔ of the assets of I investment companies.

[b] Where an investment company included in the above 78 did not report its holdings as of Dec. 31, 1965, the assumption was made that its yearend 1965 holdings of each issue were equal to those holdings at either the preceding or succeeding reporting period, whichever was lower. Similarly, where an issue appeared at either the preceding or following reporting date but not both, the assumption was made that the transaction occurred following Dec. 31, 1965, in the latter case and prior to Dec. 31, 1965, in the former.

Sources: Guide to Investment Company Portfolios, sec. 3, Vickers Associates, Inc.; Moody's Industrial Manual, June 1966.

[39] These 78 investment companies represented approximately two-thirds of total industry assets as of that date.

The measurement of stockholdings in terms of percentages of stock outstanding tends to understate their significance, since in many issues a large portion of the outstanding stock may be held for control purposes or other long-term investment objectives and would not be part of the floating supply; i.e., the stock available to the trading market in response to price movements in the security. However, even in terms of percentages of outstanding stock, the holdings of these 78 investment companies in the aerospace and airline industries—though not necessarily representative of their holdings in other industries—illustrate their importance as investors in the market for the securities of industry groups. Moreover, as has been noted throughout this report, investment companies represent only a part of institutional holdings. If other institutional investors, particularly noninsured private pension funds, also showed a similar investment pattern, the market for aerospace and airline industry securities would be virtually dominated by the investment decisions of a relatively few managers of institutional portfolios. However, the absence of comprehensive information as to holdings in particular securities by pension funds and other types of large institutional investors precludes evaluation as to the concentration of portfolio holdings among such institutions.

5. Importance of individual funds and fund complexes

Tendencies to favor certain stocks and industries are sometimes observable within the mutual fund industry as a whole but, since the investment decisions of fund managers vary, the market impact of their decisions to buy and sell particular securities may be substantially mitigated by these differences. In some respects a more important aspect of the market influence of mutual funds is the number and extent of sizable holdings in individual stocks contained in the portfolios of large mutual funds and fund complexes. Such large holdings empower single advisory organizations to affect significantly the market in particular securities by their decisions to buy or sell on behalf of the funds they manage.

(a) Mutual fund growth and sizable holdings

The Wharton Report found that between yearend 1952 and September 30, 1958, the number of sizable holdings by individual mutual funds and funds complexes had increased significantly. At the end of 1952, the mutual funds surveyed in the Wharton Report had a total of 882 portfolio holdings amounting to one percent or more of the issuer's outstanding voting stock and 53 holdings of five percent or more. By September 30, 1958, the number of one percent holdings had nearly doubled to 1,611, and the number of five percent holdings had more than tripled to 165.[40]

The rise in the number and importance of large holdings by mutual fund complexes was also significant. Holdings of one percent or more of the issuer's outstanding voting stock by fund complexes rose from 752 at yearend 1952 to 1,503 at September 30, 1958, and holdings of five percent or more, which numbered 74 at the end of 1952, had increased to 183 by September 30, 1958.[41]

[40] Wharton Report 406.
[41] *Id.* at 408.

The Wharton Report found that the number of large portfolio holdings tended to increase with the size of individual funds and fund complexes.[42] Its findings as to the increase in the number of large holdings between **1952** and **1958** suggested that the growth of the mutual fund industry during that period had not been accompanied by a degree of portfolio diversification commensurate with the substantial amounts of net money inflow to the funds during those years.

Although a comprehensive industry-wide study of mutual fund portfolio concentration since **1958** has not been made, the available evidence suggests that this was also true of this later period. Table VII–9 shows for **10** of the largest funds in **1964** the changes in the number of common stock issues held at the end of fiscal years **1958** and **1964** and the amount of their net capital inflow during that period. All of these funds, except The Dreyfus Fund, Inc. and National Investors **Corp.,** were identified in the Wharton Report as having more than **40** holdings of one percent or more of the outstanding voting stock of portfolio companies on September **30,** 1958.[43] The number of such holdings on that date ranged from **120** in the case of Investors Mutual, Inc. to **41** in the case of Fundamental Investors, Inc.

TABLE VII–9.—*Net capital inflow and common stock issues held in 1958 and 1964 by 10 large mutual funds* [a]

Fund	Net assets, fiscal yearend		Net inflow of new money, 1958–64		Number of common stock issues held, fiscal yearend		
	1958 (millions)	1964 (millions)	Amount (millions)	Percent of fiscal yearend 1958 net assets	1958	1964	Percent of increase (decrease)
1. Investors Mutual, Inc.	$1,217.9	$2,620.5	$1,071.4	88.0	[b] 208	[b] 131	(37.0)
2. Massachusetts Investors Trust	1,432.8	2,101.1	301.3	21.0	123	105	(14.6)
3. Wellington Fund, Inc.	858.0	1,878.6	1,029.7	120.0	[b] 138	[b] 117	(15.2)
4. Insurance Securities Trust Fund	356.9	1,333.2	605.7	141.7	88	97	10.2
5. Affiliated Fund, Inc.	477.8	1,117.8	429.4	89.8	142	156	9.9
6. United Accumulative Fund	241.3	980.4	658.2	272.8	158	139	(12.0)
7. Fundamental Investors, Inc.	515.0	907.6	287.5	55.8	[b] 99	[b] 107	8.1
8. The Dreyfus Fund, Inc.	36.6	800.2	607.0	1,657.4	70	[b] 151	115.7
9. Fidelity Fund, Inc.	357.1	545.7	152.3	42.7	165	[b] 92	(44.2)
10. National Investors Corp.	94.0	429.5	262.4	279.2	70	139	98.6

[a] Represents the 10 largest mutual funds as of their fiscal yearends 1964, managed by different external or internal advisory organizations.
[b] In some instances annual reports group an unspecified number of small holdings in a single industry into an "other" eategory. Where this occurred each such category was counted as one common stock holding.

Since stock prices had risen considerably during the period **1958–64,** new money inflow could not be expected to have led to a proportionate increase in the number of common stock issues held. However, at the end of their fiscal year **1964,** despite substantial net capital inflow between **1958** and **1964,** half of the **10** funds had reduced the number of common stock issues held by them from the number held at their fiscal yearends **1958.** The largest fund, Investors Mutual, Inc., reduced its holdings by **37** percent from **208** to **131** issues. The largest

[42] *Id.* at 406.
[43] *Id.* at 405.

reduction was 44 percent—from 165 to 92—for Fidelity Fund, Inc. The smallest reduction was 12 percent—from 158 to 139—in the case of United Accumulative Fund. However, the 139 common stock issues held by United Accumulative at yearend 1964 accounted for 92.4 percent of its assets, while the 158 issues in its 1958 common stock portfolio accounted for only 83 percent of its assets.

Although five of the 10 funds listed in table VII–9 had increased the number of common stock issues held in their portfolios between 1958 and 1964; for only two funds—National Investors Corp. and The Dreyfus Fund, Inc.—were the increases substantial. The Dreyfus Fund, Inc., had the largest increase in the number of common stock issues. It held 70 such issues at yearend 1958 and 151 issues at yearend 1964. During this period, however, net capital inflow into The Dreyfus Fund, Inc. amounted to $607 million or over 16 times its yearend 1958 net asset value.

The fact that the substantial new capital inflow of the 10 funds between yearends 1958 to 1964 generally was not accompanied by commensurate increases in the diversification of their portfolios does not necessarily indicate that there was an increase in the number of their large portfolio holdings. The funds could have shifted their portfolio holdings into the more actively traded and widely held securities. A more complete evaluation of the number and extent of large holdings and of the relationship between mutual fund growth through net capital inflow and increases in large holdings can only be obtained by a detailed examination of individual funds and fund complexes.

(b) The IDS complex

The largest mutual fund complex both in 1958 and 1964 consisted of the five funds managed by Investors Diversified Services, Inc. (IDS). The portfolios of four of these funds—Investors Mutual, Inc., Investors Stock Fund, Inc., Investors Variable Payment Fund, Inc., and Investors Inter-Continental Fund, Inc.—consisted mainly of common stocks.[44]

At the end of their 1958 fiscal years [45] these four funds had combined net assets valued at approximately $1.8 billion and common stock holdings of domestic issuers valued at slightly less than $1.2 billion.[46] The funds' annual reports identify 289 separate holdings of domestic common stocks as of their fiscal yearends 1958.[47] One hundred and eighty-three of these holdings, or 63.3 percent, represented one percent or more of the outstanding shares of the issue. Thirty holdings, or 10.4 percent of the total, amounted to more than five percent of the outstanding shares of the issue.

By their fiscal yearends 1964, the combined net asset value of the four IDS funds had increased to almost $4.5 billion and the market value of their common stocks of domestic issuers to approximately $3.3 billion. The number of separate common stock holdings

[44] The portfolio of the fifth fund—Investors Selective Fund, Inc.—consisted primarily of bonds and preferred stock and did not contain common stocks.

[45] The four funds each had different fiscal years, ending on the last day of September, October, November, and December

[46] In 1958, Investors Inter-Continental Fund's portfolio was limited to securities issued by Canadian and other foreign issuers. By its yearend 1964, its investment policy had been changed to permit investment in domestic issues and investments in domestic common stocks then constituted approximately 29 percent of the market value of its common stock portfolio. In May 1966 it was merged into Investors Variable Payment Fund, Ino.

[47] The annual reports of the funds identified several small holdings only by industry group. The actual number of common stock issues is therefore somewhat larger.

in the combined portfolios of the four funds, as to which the issuer is identified in the funds' annual reports, however, had been reduced from **289** at their **1958** fiscal yearends to **216.** Although the proportion of common stock issues representing five percent or more of the outstanding stock had decreased slightly since yearend **1958** (from 10.4 percent to **9.3** percent), approximately **76.9** percent **(166** out of **216** holdings) represented one percent or more of the outstanding stock at yearend **3964,** as compared with **63.3** percent **(183** of **289** holdings) in 1958.

These figures suggest that even though the growth of the IDS funds during the period **1958** to **1964** was accompanied by substantially less rather than greater diversification of their common stock portfolios: the **1964** portfolios contained more actively traded and widely held seburities than did the **1958** portfolios. The reduction from **1958** in the five percent holdings, both in nubmers and as a percent of the total common stock portfolios, also suggests the possibility of a deliberate management decision to avoid very large holdings in individual stocks. Nevertheless, as noted in the preceding paragraph, the portfolios of the IDS funds still contain a substantial number **of** large holdings.

The above analysis reflects the number **of** sizable holdings by the IDS funds as against the amount of outstanding shares of each issue. As noted previously, the measurement of stockholdings in terms of outstanding shares tends to understate their importance, since a substantial portion of the outstanding stock often is not available to the trading markets as part of the floating supply.[48] Viewed in terms of percentage of trading volume–a more appropriate measure of potential market impact than percentage of putstanding shares—the increase in the sizable common stock holdings of the IDS. funds between their fiscal yearends **1958** and **1964** is even more significant, both in absolute numbers and as a percentage **of** their combined common stock portfolios. At the end of their fiscal year **1958, 229** of the **289** different domestic issues held by the IDS funds were listed on either the NYSE or the Amex.

An examination of the trading volume on all exchanges for these stocks shows that the **1958** holdings of the IDS funds in **136** of these stocks—almost **60** percent of the total number of issues—was equivalent to **10** percent or more of each stock's annual trading volume during that year. Holdings in **60** stocks—over **26** percent of the total number of stocks held—was equivalent to **25** percent or more of the annual trading volume, and holdings in **15** stocks—or over **6** percent of the total number of stocks held—was equivalent to **50** percent **or** more of annual trading volume.

By fiscal yearend **1964,** portfolio share concentration relative to trading volume had increased appreciably. Holdings in **141** stocks—over **77** percent of the **182** holdings in common stocks listed on the NYSE and the Amex—represented **10** percent or more of **1964** trading volume in these stocks. Seventy-two holdings—almost **40** percent of the total—represented **25** percent or more of annual trading volume, and holdings of **26** stocks—14 percent **of** the total—represented **50** percent or more of annual trading volume.

[48] See **p. 294, supra.**

(c) Insurance Securities Trust Fund

The investment policies of the funds in the IDS complex call for and permit diversified portfolios of securities issued by companies operating in virtually every segment of the domestic and foreign economies. However, a number of large funds are so-called specialty funds, which operate under investment policies that limit their investments to particular industries or segments of the economy. The Wharton Report found that in 1958 the pattern of large holdings in the mutual fund industry was dominated by one large specialty fund, Insurance Securities Trust Fund. In 1958, this fund, with assets of $299 million on September 30 of that year, was limited by its articles of trust to acquiring not more than 10 percent of the voting securities of 104 specified fire, casualty, and life insurance companies. On September 30, 1958, the Fund held between 5 and 9.9 percent of the voting stock of 32 of these companies, and 10 percent of the voting stock of 21 additional insurance companies.[49]

By yearend 1964, Insurance Securities Trust Fund's net assets had grown to $1.3 billion, virtually all invested in the common stocks of 97 insurance companies.[50] It held more than one percent of the outstanding common stock of all 97 companies, five percent or more of the stock of 67 companies, eight percent or more of the stock of 40 companies and 9.9 to 10 percent of the stock of 25 companies.

Since almost all insurance company stocks are traded only in the over-the-counter market, there are no data available as to trading volume in the stocks held by Insurance Securities Trust Fund. However, the stocks which the Fund may hold are specifically designated in its Articles of Trust and known throughout the financial community. The Fund itself seldom seeks out sellers of securities it wishes to buy, since sellers of substantial blocks of these securities usually offer them to the Fund before attempting to dispose of them through the ordinary channels of the marketplace. There seems little question that the Fund is a dominant factor in the market for many of these stocks.

(d) Other funds and fund complexes

The combined portfolios of the IDS funds contain the largest common stock holdings under the management of a single adviser in the mutual fund industry. Similarly, Insurance Securities Trust Fund is by far the largest specialty fund within the industry. Thus, the number and extent of the large common stock holdings in the 1964 portfolios of these funds may not be representative of other funds and fund complexes in the industry. However, even in 1958 the $1.2 billion common stock portfolio of the IDS funds and the $299 million portfolio of Insurance Securities Trust Fund had significant numbers of sizable holdings. More than a dozen other funds and fund complexes now have common stock portfolios approaching the size of, or even larger than that of, the IDS funds in 1958.

[49] Wharton Report 409.
[50] In 1964, the Fund's Articles of Trust were amended to permit the investment of up to 20 percent of its assets in bank stocks.

D. REGULATORY IMPLICATIONS OF INSTITUTIONAL INVESTOR GROWTH

1. *Impact on the market generally*

By channeling significant amounts of capital to the equity markets that would not otherwise have been placed there, mutual funds and other institutional investors have contributed substantially to the generally upward trend of stock prices during the post-World War II period. And, as previously noted, the potential market impact of the mutual funds is greater than that of other institutional investors. This is so because of the two unique characteristics of the funds—their continuing drive to sell new fund shares and the ever-present right of redemption. In a bull market, the continuously operating distribution systems of the mutual fund industry are well positioned to take advantage of sharp upswings in stock prices so as to stimulate the sale of new fund shares. To some extent, these new fund shares are sold to persons who would be reluctant to buy equity securities directly and who in relatively stationary or declining markets would not be inclined to acquire indirect interests in such securities through the mutual fund medium. Because mutual funds add to the number of investors who are willing to commit their resources to equity securities in rising markets, they can accentuate the sharp market upswings that often set the stage for subsequent market declines. While the efforts of the mutual funds' distributors have continued to make additional capital available for equity investment in times of decline, understandably, this additional capital has not been fully committed to the market during declines. Indeed, despite a substantial net sales position with respect to their shares, mutual funds were net sellers of common stock during the third quarter of 1966, a period of generally declining prices.

The redeemable character of mutual fund shares creates the possibility that during market declines fund managers might be compelled to liquidate portfolio securities on an extensive scale to meet the demands of large numbers of redeeming shareholders. The ensuing destabilizing pressure could conceivably create a vicious circle of sharp market declines leading to further increases in redemptions and hence to even sharper market declines.

Not until recent years have mutual funds become substantial factors in the markets. Hence experience as to the behavior of mutual fund investors in market crises is still too meager to serve as a basis for reliable conclusions as to the full force of the potential market impact of mutual fund redemption pressures. However, a market crisis in which redemptions by mutual fund shareholders have added crucial pressures on the market has not occurred. During the market declines of 1962 and 1966 mutual fund share sales fell to some extent. But in neither of those declines did redemptions rise significantly. In 1962 and in 1966 new share sales continued to exceed redemptions by substantial amounts. Hence it is clear that forced liquidation by the funds to meet redemption pressures was not a signscant factor in either the 1962 or the 1966 decline.

2. Emergency powers

The Commission has power to deal with extreme market emergencies. The Exchange Act provides that if "in its opinion the public interest so requires," the Commission can "with the approval of the President, summarily * * * suspend all trading on any national securities exchange."[51] This power is a reserve power to be used only in the gravest crises and has never been exercised. When market crises required a suspension of trading, the exchanges have on occasion used their powers to halt all activity on their floors. The NYSE did so when heavy foreign selling of American securities seemed to be about to engender a panic at the outset of World War I. This suspension of trading lasted for 4 months, from July 31, 1914, to November 28, 1914.[52] The NYSE also closed for 2 days during the 1929 decline, and more recently all exchanges voluntarily suspended activity on November 22, 1963, within minutes after receipt of the news of President Kennedy's assassination.

The Investment Company Act also provides for suspension of the redemption rights of mutual fund shareholders and of other holders of redeemable investment company securities. Section 22(e) of the act[53] permits redemption rights to be suspended when: (1) The New York Stock Exchange is closed for reasons other than "customary weekend and holiday closings;[54] (2) trading on the New York Stock Exchange is restricted;[55] (3) because of an emergency, disposal of an investment company's securities is not reasonably practicable;[56] (4) emergencies impede an investment company from fairly determining the value of its net assets;[57] and (5) the Commission permits such suspension "for the protection of securities holders of the company."[58]

Apart from these limited emergency powers, the Commission does not have and does not seek responsibility for controlling price fluctuations—even extreme ones—in the securities markets. The growing institutionalization of the stock market does not appear at this time to require that the Commission's responsibilities in this area be broadened.

3. *Impact on the market for individual issues*

Some of the principal regulatory implications of the growth of institutional investment stem from the large numbers of sizable blocks of individual securities that institutional investors hold. These holdings may have been purchased with the funds of a multitude of small investors, but they are under the effective control of a relatively few professional managers. The decisions of these managers to buy, sell, or hold particular securities have significant effects on the markets for those securities.

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[51] Sec. 19(a)(4).

[52] When it reopened, the NYSE imposed severe restrictions on trading which were not removed until Apr. 1, 1915.

[33] The section also provides that except in the unusual situations therein enumerated "No registered investment company shall suspend the right of redemption or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such secnrity to the company or its agent designated for that purpose for redemption * * *."

[54] Sec. 22(e)(1)(A).

[55] Sec. 22(e)(1)(B). Sec. 22(e)(i) empowers the Commission to determine the conditions under which "trading shall be deemed to be restricted."

[56] Sec. 22(e)(2)(A).

[37] See. 22(e)(2)(B).

[58] Sec. 22(e)(3).

In the mutual fund industry this decision-making power is highly concentrated. Eight advisory organizations control about half of the industry's assets.[59] The growth of the funds has been accompanied by increases in the number and *size* of large holdings by individual funds and fund complexes. Indeed, as previously noted, despite substantial amounts of new money inflow, some of the largest funds have reduced the number of common stock holdings in their portfolios.[60] And nom the markets for many securities can be significantly influenced by the decisions of **a** single fund manager.

The accumulation of large numbers of sizable holdings of individual issues is not unique to investment companies. Other institutional investors, among them the private noninsured pension funds which hold more corporate stock than do mutual funds and almost as much as the entire investment company industry, also accumulate very substantial positions in individual issues. Moreover, the investment decision-making power of private noninsured pension funds is also marked by a high degree of concentration. **A** survey by the Commission's staff indicates that 20 large banks manage almost half of all noninsured private pension fund assets: In addition, banking institutions manage substantial amounts of assets for other institutional investors and for personal trusts, estates, guardianships, and common trust funds. Thus, the decisions of these banks to buy and sell particular securities can have as signscant a market impact as the decisions of the principal mutual fund managers.

The growing institutionalization of the securities markets tends to make the markets for the issues in which institutional holdings are significant more susceptible to sharp, sudden, and erratic price fluctuations. **As** the irregular and relatively infrequent transactions of institutional investors in sizable blocks of securities become more and more significant and the relative importance of broad streams of smaller 100-share orders from individual investors dwindles, the auction markets find it increasingly difficult to maintain the high degree of depth, liquidity, end continuity which they have traditionally sought to achieve. Even when a large institutional investor makes a conscious effort to avoid upsetting the market by adhering to gradual programs of accumulation or disposition, its activities tend to have a marked effect on the prices of the securities involved.

In some respects the market impact of mutual fund activity is even more significant than that of other institutional investors. **As** noted previously, the funds' portfolio turnover rates are significantly higher than those of other institutional investors. This means that the funds account for a greater share of aggregate market activity than the value of their holdings would indicate. Illustrative is the fact that pension funds, which hold even-more stock than mutual funds do, have been much less prominent as sellers of securities than mutual funds have been.

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[59] The eight advisory organizations that managed the largest amounts of mutual fund assets on June 30. 1966, managed 52.2 percent of total mutual fund assets on that date. Since the corresponding figure on September 30, 1958—almost 8 years earlier—was 52.2 percent (Wharton Report 43), it is clear that the degree of concentration has not been lessened significantly by the growth of the industry. In mid-1966 the assets managed by the three largest advisers constituted 28.5 percent of all mutual fund assets. The corresponding figure on Sept. 30, 1958, was 30.8 percent. The 55.2 billion in mutual fund assets that IDS managed oh June 30,1966, constituted 13.5 percent of the assets of the entire industry on that date, a slight decline from the corresponding figure for Sept. 30,1958, which was 14.7 percent.

[60] See pp. 294–298, supra.

Moreover, much of the mutual funds' capital comes to them from people who—but for the funds—would have invested in securities directly for their own account. Hence, the growth of the funds has resulted in substituting the decisions of a few professional managers with respect to massive blocks of securities for the decisions of large numbers of individual investors.

4. *Conclusions*

While the nation's securities markets on the whole have responded well to the changes wrought by increased institutional investor participation, there are increasing signs of strain on the mechanisms of the auction markets. In a number of instances, the sudden and simultaneous appearance of sell orders for large blocks of the same security has resulted in a marked drop in its price. In a few instances, the strain on the auction market caused a temporary suspension of trading in the security involved. In some instances, the selling pressures appear to have been accentuated—perhaps unduly so—because of the manner in which the orders were executed.

The nature of the securities markets has been greatly changed by their institutionalization. Hence practices and procedures that may have worked well in the pre-institutional era must now be reappraised. This reappraisal is one of the primary tasks of the Commission, the securities industry, and the institutional investors themselves. The Commission has already taken some steps in this direction. To meet the need for fuller information as to trading in the third market, the Commission in 1964 adopted reporting requirements for broker-dealers who make nonexchange markets in exchange-traded securities.[61] These reports provide the Commission and the securities industry for the first time with a periodic flow of information concerning the most actively traded securities in the third market.

More recently, at the request of the Commission, the NYSE modified its Rule 394. That rule, with limited exceptions requires all NYSE member firms to execute all of their transactions in NYSE listed stocks on the Exchange. As modified, it now makes clear that NYSE members may solicit nonmember marketmakers off the Exchange floor in certain situations when such solicitation would facilitate the execution of an order.[62] The Commission believes that this change will enhance the efficiency of the market mechanisms in coping with the large block transactions of institutional investors.

The evidence available at this time with respect to the consequences of the institutionalixation of the investment process does not point to a need for major new legislation. But the reexamination of existing market mechanisms and rules necessitated by these changes requires fuller data concerning the security holdings and trading patterns of institutional investors than has heretofore been available. Some of this information with respect to investment companies is available to the Commission through the disclosure and reporting requirements of the Investment Company Act and other Federal securities laws. Recently, the Commission has made arrangements with the Investment Company Institute and the Association of Closed-End Investment Companies to obtain monthly data collected by them as to

[61] Rule 17a-9 under the Exchange Act (17 C.F.R. sec. 240.17a-9), promulgated by Securities Exchange Act Release No. 7474 (Dec. 1,1964).

[62] *See* Securities Exchange Act Release No. 7981 (Oct. 20, 1966).

common stock purchases and sales by investment companies. In very active markets this data will be obtained from a large sample of investment companies on a weekly or perhaps on a more frequent basis.

But there is a lack of reliable and comprehensive data concerning the securities holdings and trading activities of other institutional investors. For example, even though noninsured pension funds own more corporate stock than mutual funds do, there is no information generally available—even on an annual basis—as to the size of the pension funds' holdings of specific securities. Pension funds are regulated under the Welfare and Pension Fund Disclosure Act of 1958,[63] which is administered by the Department of Labor. Closing the informational gap with respect to pension fund holdings and holdings of other institutional investors through amendments to existing Federal regulatory statutes and through other appropriate means is an indispensable preliminary step to adequate analysis to the problems raised by the institutionalization of the securities markets.

E. MUTUAL FUNDS AND SPECULATIVE ACTIVITY

1. Speculative activity by mutual funds

Although Federal securities regulation is neither designed to prevent all speculative activity in the securities markets nor to guard against fluctuations — even extreme ones — the Congress recognized that excessive speculation accompanied by considerable price gyrations can be detrimental to the national interest. A concern over excessive speculation and sudden and unreasonable fluctuations in the prices of securities is clearly articulated in the Exchange Act, which establishes certain controls on security speculation.[64]

The Investment Company Act also expresses concern over the possible detrimental effects of investment company use of bank credit and short sales. It prohibits investment companies from purchasing securities on margin and from effecting short sales in contravention of such rules as the Commission may prescribe.[65]

Recently, several new mutual funds, organized for the purpose of following highly speculative investment policies and proposing to rely upon speculative devices such as buying securities on margin, using put and call options, utilizing debt obligations, and short selling, have sought to register under the Act. These funds apparently are attempting to emulate the activities of a number of unregistered speculative trading funds, the so-called "hedge funds," which have been operating in the markets of the 1960's with money obtained from less than 100 investors.[66] In addition, some mutual funds registered under the Act have grown and operated successfully without reliance on specialized speculative techniques, but, nevertheless, pursuing investment policies which favor rapid turnover of portfolio securities in the light of short-term market trends.

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[63] 29 U.S.C., sec. 301 et seq., 72 Stat. 997.

[64] Among these controls is the power vested in the Board of Governors of the Federal Reserve System to regulate the amount of credit that may be initially extended on any security registered on a national securities exchange, Exchange Act, sec. 7. By adjusting the amount of bank credit available for securities transactions, that agency can attempt to moderate the tempo of price fluctuations in the securities markets. In addition, sec. 10(a) of the Exchange Act empowers the Commission to prohibit or limit short sales of securities or the use of stop-loss orders in connection with securities transactions.

[65] Sec. 12(a).

[66] Investment companies that have no more than 100 security holders and are neither making nor presently proposing to make public offerings of their securities are not required to register under the Act (sec. 3(c)(1)). See pp. 34-35, supra.

Although mutual funds that emphasize speculative trading policies do not represent a large segment of the industry, there has been a tendency for managers of other funds to emphasize more active trading in order to capitalize on short-term market movements. This tendency is reflected in a rise in aggregate mutual fund portfolio turnover rates in late 1965 and the first half of 1966.[67]

Despite these tendencies for increased trading activities, short selling and margin trading thus far have not been widespread within the investment company industry, and the Commission has not had occasion to issue rules with respect to these practices. However, the Commission has revised its annual reporting form for management investment companies to require that such companies furnish the Commission with information as to such transactions, thereby enabling the Commission to gauge the amount of such activity and any tendencies toward increases in it.[68] Management investment companies are also required to report annually to the Commission the amount of their purchases and sales of the same securities within any 6-month period.[69] An examination of these reports does not indicate that margin trading, short sales and short-swing trading by investment companies are extensive problems at the present time.

Since investment companies have been required to furnish the Commission with this sort of information only since the adoption of the revised annual reporting form in 1965, the Commission does not have a basis for measuring with any precision whether investment companies have increased their use of these speculative techniques. It has, however, directed its staff to analyze this information on a continuing basis in order to keep a close watch on any tendencies for widespread use of such speculative techniques. Should further evidence indicate the existence of widespread problems in this area, the Commission will act within the ambit of its existing authority to deal with them and present such legislative recommendations to Congress as may be necessary.

2. Speculative activity by mutual fund investors—Withdrawal privileges

In recent years there appears to be a growing use by speculatively oriented investors of withdrawal and reinvestment privileges in connection with single payment plan certificates issued by contractual plan companies. Since such plans generally provide the holders with an unlimited withdrawal and reinvestment privilege with respect to 90 percent of their investment, they furnish a means whereby investors redeem and reinvest in mutual fund shares without payment of an additional sales charge. In 1960, sales of single payment plan certificates amounted to $37.3 million, approximately 15 percent of

67 Mutual fund annual portfolio turnover rates for 1964 through the 1st half of 1966 were:

	1964	1965	1966
	Percent	*Percent*	*Percent*
First quarter	21.1	18.4	27.8
Second quarter	18.0	17.1	32.0
Third quarter	14.2	18.2	
Fourth quarter	13.1	23.0	

Formula used is lesser of purchases or sales divided by the average of the market value of stockholdings at the beginning and end of period. The results were then annualized.

68 Item 1.26 of Form N-1R.

69 Item 2.02 of Form N-1R.

the value of all fund shares acquired by contractual plan companies and 1.5 percent of the value of all new mutual fund shares issued in that year. In 1965 they amounted to $150.4 million, representing 30 percent of the value of all fund shares acquired through such payments and 2.9 percent of the value of all new mutual fund shares issued. During the first three months of 1966 sales of single payment plan certificates averaged over $35 million per month.[70]

These figures may have included single payment plan purchases by the Fund of Funds, Ltd., a foreign-based investment company which invests primarily in other investment companies and which has never made use of the withdrawal and reinvestment privilege.[71] However, other investors apparently have made extensive use of this privilege. One fund, with net assets of over $500 million as of April 30, 1966, reported that during the 6 month period ending on that date almost $145 million of assets previously withdrawn from single payment plans—more than a quarter of its net assets—had been reinvested.

Until very recently the dominant concern of most fund managers centered on long-term investment results. The orientation of fund shareholders has been similar. Generally, mutual fund shareholders have been—and for the most part still are—concerned with long-run investment results rather than with short-run speculation; and substantial industry-wide increases in redemptions during relatively short-term market declines have not occurred. For these reasons, fund managers have been free to carry out large scale programs of accumulation and disposition on a gradual basis with a view toward avoiding drastic market upsets.

However, the extensive use of single payment plan withdrawal and reinvestment privileges by a relatively few speculatively minded investors could seriously circumscribe at critical times the exercise of managerial discretion in the interest of the large majority of shareholders who have long-term investment objectives. It creates substantial questions of fairness to the large majority of mutual fund shareholders who make their investments and pay a continuing fee to obtain the unencumbered investment judgments of professional management, not of fellow shareholders interested in speculation. Moreover, it is the entire body of shareholders in a fund, rather than these speculators alone, who bear the increased brokerage costs that are incurred.

The widespread use of withdrawal and reinvestment privileges for speculative purposes has serious adverse implications for mutual fund investors. Both the NASD and individual funds recently have taken steps to discourage these practices.[72] The Commission is also exploring the possibility of adopting rules under its existing authority to prevent the use of withdrawal and reinvestment privileges for speculative

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[70] Source: Investment Company Institute.

[71] See pp. 311–324, infra

[72] The NASD has adopted an interpretation of its Rules of Fair Practice which, among other things, prohibits its members from suggesting encouraging or assisting planholders in making repeated or excessive use of the withdrawal privilege. Ordinarily use of the privilege by a planholder more than once a year would constitute repeated or excessive use. Members are also specifically prohibited from assisting reinvestments by planholders within 90 days after withdrawals by them. In addition, various mutual funds offering plans featuring the withdrawal privilege have stated in their prospectuses that they are revising their plan certificates to accord with the NASD interpretation.

purposes. Should its existing authority be insufficient to deal with the practices, the Commission will recommend appropriate legislation.

The Commission recognizes that the privilege of withdrawal and reinvestment without the payment of additional sales loads or of redemption fees can be a benefit to shareholders—particularly to shareholders of modest means confronted with a sudden and temporary need to liquidate their mutual fund holdings—and at present does not envisage any need for an outright ban of this privilege. Any steps taken by the Commission in this area, therefore, would be limited to preventing the abuse of this reinvestment privilege for speculative or other purposes adverse to the interests of the funds and their shareholders.