Speculation and the Stock Market

Buying shares

The confidence that came with the boom cycle and boosted it, led to a new development – ordinary people began to buy and sell shares.

What are shares?

Shares are just that, a 'share' in a company. If a person needs money to set up a company, or money to expand an existing company, the owner can raise that money by selling shares in the company. When the owner does this, he or she no longer owns all the company – the shareholders, the people who buy the shares, do. What they get in return for their shares is a yearly dividend. Each year, if it has made a profit, that profit is divided up between the shareholders. The amount they get is calculated according to the number of shares they have. Before the 1920s, only wealthy people or banks bought shares. They bought shares in companies they thought would be successful and would pay a good dividend, and they usually kept the shares for a long time. If shareholders needed money, they could sell their shares. Shares were not sold from person to person. For most companies they could only be bought and sold at a stock exchange – the most important was the New York Stock Exchange in Wall Street.

How the stock market worked

The **stock market** is the general name for buying and selling shares. Shares had no set value. They were worth whatever someone was prepared to pay for them. If you bought a share in a company for $10 one week, it could be worth $10 the next week, or $100 or $1. It all depended on the demand for the shares. The people who traded shares were called 'brokers'. If trading was 'slow', the prices of shares could stay the same for days, weeks or months. But, if there was a lot of buying and selling in the stock market, prices could go up and down several times a day.

In the 1920s, because new companies made such big profits, the prices of their shares went up and up. More and more people bought shares. People started to buy shares not for the dividend, but to sell them again at a profit.

In 1929, Samuel Crowther interviewed John J Raskob [from the finance section of General Motors] about how an ordinary person could get rich by investing in stocks. Crowther published Raskob's ideas in a *Ladies' Home Journal* article, 'Everybody Ought to be Rich'. In the interview, Raskob claimed that putting just $15 a month into shares would make investors $80,000 over the next 20 years. The prospect of building such a great fortune seemed possible in the atmosphere of the 1920s market. Shares excited investors; millions put their savings into the market hoping for a quick profit.

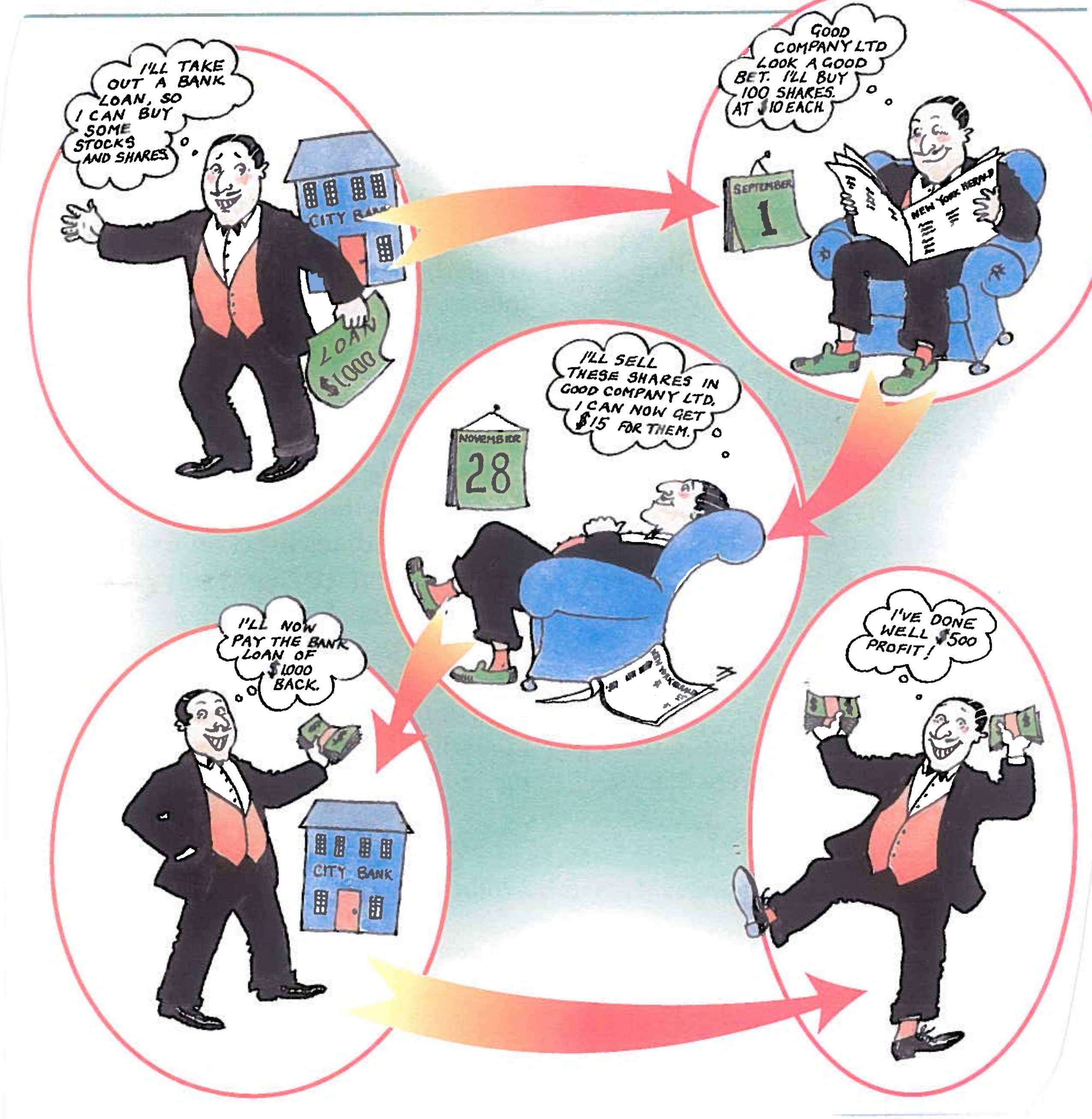
Source D: *From* Stocks for the Long Run, *written by Jeremy J Siege in 2008.*

Year	$ millions spent on share trading
1926	450.8
1927	576.6
1928	919.7
1929	1,125.0

Source E: *From* A History of the Federal Reserve, *written by Allan Meltzer and Alan Greenspan in 2003.*

Company	3 March 1928	3 Sept 1929
Woolworths	$1.81	$2.51
Radio	$0.94	$5.05
AT & T (telephone company)	$0.77	$3.04
Westinghouse (electrical goods)	$0.92	$3.13
General Motors (cars)	$1.40	$1.82

Source F: *The price of a share in selected companies in 1928 and 1929.*



Buying shares 'on the margin'.

Buying and selling shares

Ordinary Americans had more money than ever before. Some of them began investing in American companies. They bought **shares** in whatever company they chose. Every year the **shareholders** were paid a share of that company's profits. This is called a **dividend**. If a company was doing well, the dividends would be high.

Shareholders could make money in another way. If a company's dividends were high, more and more people would want to buy shares in that company. Then shareholders could sell their shares for more than they paid for them. So that way they would make a profit.

Buying on the margin

Some Americans borrowed money from banks so that they could buy shares. These people paid the banks back from the profits they made. This is called buying **on the margin**.

Buying on the margin only worked when profits, and therefore dividends, were high. If profits were low and there was no dividend, shareholders could not pay back their bank loan.

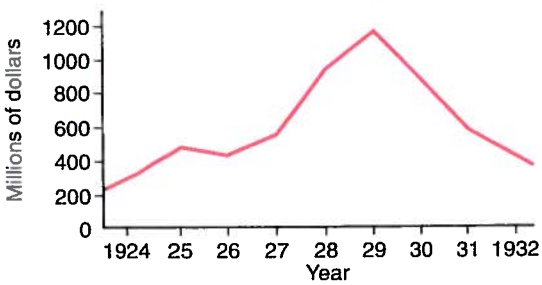
Why was there a boom in the stock market?

The rise of the stock market

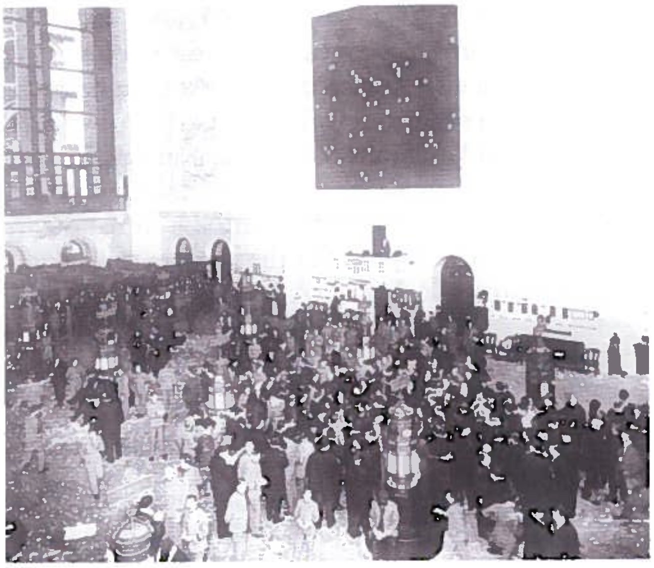
In the 1920s the stock market seemed to be the key to the prosperity of the USA. The value of stocks and shares rose steadily throughout the decade until 1928 and 1929, when they rose dramatically. The amount of buying and selling of shares grew substantially until it was a common occurrence for ordinary working people to become involved. The accepted image of the 1920s is that 'even the shoeshine boy' was dealing in shares.

Since shares in most companies seemed to rise in value, people were prepared to risk their money on buying shares. The USA began to speculate. Even if people did not have enough money to pay the full amount, they would make a deposit, borrow to pay the rest and then sell the shares in a couple of weeks when their value had risen and a profit had been made. The speculator would then pay off his debt and still have made money on the deal. (This process was called 'buying on the margin'.)

The number of shares traded in 1926 was about 451 million. The figure increased to 577 million the following year. By 1928, with share prices rising fast, there was a **bull market** on the Wall Street Stock Exchange, and in 1929, more than 1.1 billion shares were sold. Up to 25 million Americans became involved in the frenzy of share dealing in the last years of the decade. The graph below illustrates how quickly sales in shares grew.



Graph showing sales of stocks and shares at the Wall Street Stock Exchange, 1923–32.



Inside the New York Stock Exchange on Wall Street, 1925.

Source A: John J Raskob, a leading Democratic Party politician, speaking about the benefit of buying shares in 1928

If a man saves $15 a week, and invests in good shares . . . at the end of twenty years [he] will have at least $80,000 and an income from investments of around $400 a month.

Source B: From *After the Crash* by J Rublowsky, 1970, describing the share buying frenzy

Almost any share was gobbled up in the hope of striking it rich but many of these were worthless. The Seaboard Airline was actually a railroad and had nothing to do with aviation, yet it attracted thousands of investors because aviation shares were the glamour issue of the day.

Source C: A view of speculation from *The Lawless Decade* by P Sann, 1957

Speculation wasn't gambling, it was an investment in the glorious American future, an expression of faith in the endless wondrous prosperity that blessed the land.

Source D: Shares being bought in a stockbroker's office on Wall Street in 1929

Speculation

Advice like that offered in Source A encouraged many Americans to invest in the stock market. Banks at the time were usually paying an annual interest rate of 7 per cent on savings accounts. The difference between the return on savings and the profit that could be made from speculation made the stock market an attractive gamble. The possibility of buying shares 'on the margin' fuelled speculation further.

Many investors borrowed money to buy shares. As long as share prices continued to rise, there was nothing to worry about. People were so confident about the market that by the summer of 1929, investors had borrowed a total of $8.5 billion to buy on the margin – a figure that had risen from $3.2 billion in 1926. The table below shows how consumer confidence increased the value of shares between 1928 and 1929.

Company	31 August 1928	3 September 1929	29 October 1929
American and Foreign Power	$38.00	$167.75	$73.00
AT and T	$182.00	$304.00	$230.00
Hershey Chocolate	$53.25	$128.00	$108.00
IBM	$130.86	$241.75	–
People's Gas, Chicago	$182.86	$182.86	–
Detroit Edison	$205.00	$350.00	–

Selected share prices, 1927–29. Why would these figures encourage people to buy shares *before* September 1929?