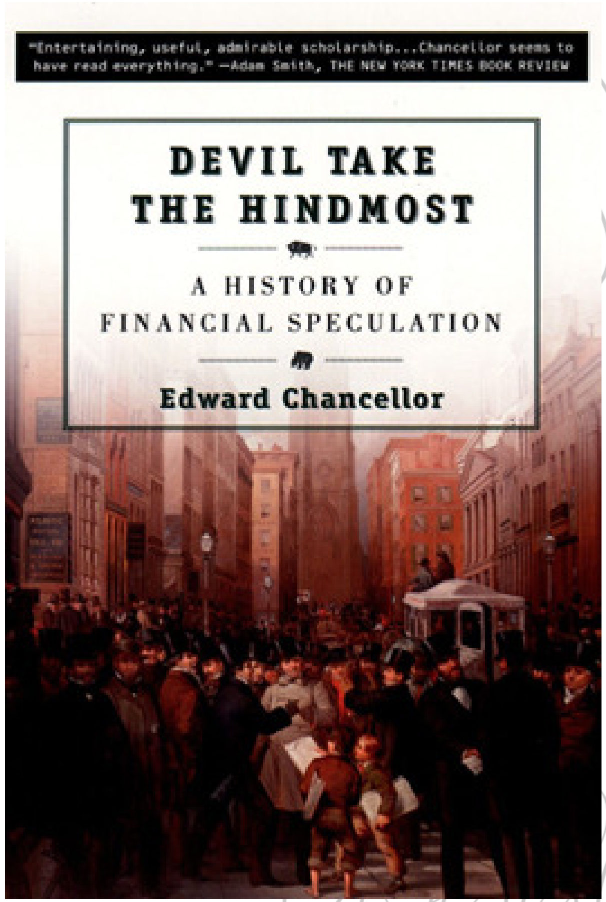
Devil Take the Hindmost

Edward Chancellor © 2000

Chancellor chronicles the history of financial speculation from ancient Rome to the 1998 collapse of the LTCM hedge fund. It covers many famous periods including the ridiculous price rise of tulips in Holland in the 1630s, "investing" in the South Sea Co. in the 1720s, railway booms both in the UK and US, junk bonds and the Japanese property boom of the 1980's. Published just before the dot.com stock collapse, it would have been a good investment for a smart few. Its lessons are timeless which might save you some money one day.

Financial speculation is short-term betting on price rises and has greed at its core. History also show it to be linked with fraud and deception.

"Speculation is an effort, probably unsuccessful, to turn a little money into a lot. Investment is an effort, which should be successful, to prevent a lot of money becoming a little"



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"The greatest hits of financial silliness" *Fortune* magazine review

Speculation is as old as human nature

"When I was young people called me a gambler. As the scale of my operations increased I became known as a speculator. Now I am called a banker. But I have been doing the same thing all the time" - Sir Ernest Cassell, Banker to Edward VII

"There must certainly be a vast Fund of Stupidity in Human Nature, else men would not be caught as they are, a thousand times over by the same snare" - Cato 1721

"Avarice, or desire of gain, is a universal passion which operates at all times, in all places and upon all persons" - David Hume 18th C

"There are two times in a man's life when he should not speculate: when he can't afford it and when he can"; "I was seldom able to see an opportunity until it had ceased to be one"; "A mine is a hole in the ground with a liar standing next to it"
- Mark Twain, famous author and also 1860s Californian gold prospector

"The four most expensive words in the English language are 'this time is different' "
- Sir John Templeton

"Gold rushes tend to encourage impetuous investments. A few will pay off, but when the frenzy is behind us, we will look back incredulously at the wreckage of failed ventures and wonder 'Who funded those companies? What was going on in their minds? Was that just mania at work?" - Bill Gates on dot.com stocks

Common cycle

Commence with a displacement

- **Something new or step-change profit increase in something old**

Followed by positive feedback

- **Rising share prices induce inexperienced investors**

Euphoria spreads

- **New companies floated, credit extended and investors leverage, fraud proliferates, economy enters distress with shift to unproductive capital**

Crash

- **Various triggers cause a buyers strike with panic selling ensuing**

From Kindlegerger *Manias, Panics and Crashes*

Speculation tied also to development and invention

1600 — 1700 — 1800 — 1900 — 2000

1630
“Tulipomania”
Holland

1690
Stock jobbing in
(ex)change Alley
London

1720
South Sea Co.
London

1770
Canals
UK

1820s
Emerging Markets
Eg. South America,

1845
Railways
UK

1860s-70s
Mining,
Petroleum,
Railways
US

1930
“The Crash”
US

1970
“Nifty Fifty”
US

1980s
Junk bonds
1987 crash
US

1990
Stock and land prices
Japan

Late 1990s
Hedge funds (LTCM)
US

2000s
.com

“Columbus himself was a speculator and North America the greatest prize of all. The first American colonies were established as joint-stock ventures”

George Washington, Benjamin Franklin, Thomas Jefferson were land speculators or “land jobbers

The boom in leveraged buyouts (funded by junk bonds) became the driving force behind the bull market of the 1980s

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Highlights from the 1600s – 1800s …

Tulips	South Sea Co.	Canals and Railways (an early Internet)
First tulip introduced into prosperous 1620s Holland from Turkey ("tulipan" meaning turban) Tulips initially were a speculative alternative to high stock prices Tulip prices rose from 20 guilders to 1000-6000 depending on variety (vs. average annual wage and home price of 300 guilders) "little attempt to justify prices – most intended to sell quickly" "most t/x were for bulbs that could never be delivered because they didn't exist and were paid with credit notes that could never be honoured because the money wasn't there" On 3rd Feb 1637 market crashed for lack of new buyers	Company formed to take over UK government debt obligations (annuities) South Sea manipulated a rise in its share price by bribing officials and encouraged the annuitants (eg. pensioners) to take shares instead of regular payments 20% down terms were also used to encourage demand and prop up share price Euphoria spread to other float companies including to: • "Trade to and settle Terra Australis" (50 yrs before Cook discovered Australia) • extract silver from lead, saltpetre from lavatories, cure VD, trade in human hair, perpetual motion, "undertaking of great advantage but no one to know what it is", …	Returns from 1st built canals in 1767 generated genuine profits but stimulated a boom that extended to 1793 and included 50 parliamentary acts and 1000 miles of canals Unregulated railroads were seen as attractive monopolies 50% of factory employment went into building. Laissez-faire planning saw city pairs connected with 2-3 private lines; 8000 miles of track laid, 7x that of France and Germany Crash after interest rates rose from 2 to 10%; stocks lost 85% of value "mania represented a transfer of wealth from middle class speculators to needy labourers"

… and the 1900s

1929 crash	1987 crash	Japanese bubble economy
"Stock prices have reached a permanently high plateau" 1929 Yale economist Irving Fisher By July 1932 DJI was down 90% (from a P/E high of only 28; GDP collapsed by 60%) Relaxation of anti-trust rules, compliant labour, modern management methods, new Federal Reserve (allure of safety), free trade, declining inflation, "cult of the common stock", tax cuts, "instalment purchases" (consumer credit), women's emancipation (35% of stock-holders), corporate re-engineering, new investment trusts and rise of margin loans (incl. by invested corporations) all contributed to the runaway stock market	During Reagan's deregulation era, Michael Milliken introduced junk bonds. These were later used to finance hostile takeovers of American public companies allowing the "small to go after the big". This drove the stock market to new heights. In 1987 the market was nervous owing to fears of US inflation, Japanese investors repatriating funds for an NTT listing, a falling US dollar, Persian gulf missile attack and lastly a CNN story about "imminent market collapse" On Monday 19 October 1987 stock markets from the East started falling ending with the US market down 23%. Losses were accentuated by computerised selling designed to stop losses.	"Was foremost a property boom" during the back drop of stimulative credit by the BOJ and deregulation of postal savings 1956-1986 land increased 50x vs 2x cpi creating belief "property prices would never fall" Policies restricted land sales and credit was based on land value "as property prices climbed, lifetime earnings were insufficient to buy a small Tokyo apt creating multi-generational loans" Companies were valued on land content not business. Value of golf course memberships rose to $200b ($2.7m pp) Nikkei peaked at P/E 90 declining later by 60% as did Tokyo land prices

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