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The Wisdom of a Wall Streeter

By Daniel R Wessels

An out-of-town visitor was being shown the wonders of the New York financial district. When the party arrived at the Battery, one of his guides indicated some handsome ships riding at anchor: "Look, those are the bankers' and brokers' yachts." Where are the customers' yachts?" asked the naïve visitor.

Fred Schwed Jr (Where Are the Customers' Yachts? 1940, 1955, 1995, 2006)

Jason Zweig, editor of *Money Magazine* and author of *Your Money and Your Brain* – an introduction to "neuroeconomics" which explains how our brains often trick us and invariably cause suboptimal behaviour and financial decision-making – tells the story of a bizarre incident in the beginning of 2000 that at first did not seem too significant, but the more he thought about it, convinced him that somehow market valuations and that the worth of money lost touch with reality at the time.

Late one evening in January of that year Zweig left his office and got into a taxi in Manhattan – the heart of New York's financial district. While they were waiting for the traffic light to change four arrogant young men (whizz kids) smartly and powerfully dressed came up to the taxi. One of the men knocked at the driver's window and asked whether the driver could take them to an address merely four blocks away. The driver responded that he could not since he already had a passenger, but the men were adamant and waived $100 in front of the driver to throw Zweig out of the taxi. Luckily for Zweig the driver turned away the offer and drove off.

Most people will forget these kinds of incidents after a day or two, but somehow it stuck with Zweig. This episode vaguely reminded him of something he read in a book about driving around in Manhattan, bull markets and money. Then, a week later it clicked. Zweig remembered the story he read in Fred Schwed Jr's *Where Are the Customers' Yachts*. In 1929 a luxurious club car was commuting every business day to the station and inside the car was a silver bowl with nickels in it. Passengers who needed a nickel (5c) for the subway ride downtown could take one but were not expected to put anything back in exchange. Alas, a nickel at *that* time was not considered money – a minor convenience like a toothpick for which nothing is charged. But then October 1929 happened and the financial structure of the United States collapsed and the bowl with free nickels disappeared forever.

Zweig's taxi incident reminded him that like in 1929, the bull market of 2000 had roared so far up and fast that money once again decayed into a minor convenience. Young men were willing to waive $100 bills like Kleenex tissues rather than walking four blocks. There and then Zweig concluded, reminded by Schwed's anecdote of the bowl with free nickels and other acumens that the bull market of 2000, and specifically the rage about IT stocks at the time, was coming to an abrupt end, perhaps sooner than later. A mere six weeks later the NASDAQ index (technology stocks) began crashing and went on to lose 75% of its value over the next two and a half years!

Who was Fred Schwed Jr? He was the son of a short-seller (a person selling stock without physically owning the stock in the hope that those stock prices somewhere in the future will trade at lower prices than today) who went bankrupt in the bull market of the 1920's. Like his dad, Schwed Jr joined Wall Street in the 1920s as a professional trader, and like his dad he lost a bundle and had to leave the game, but unlike his dad he lost it because of the dreadful bear market that followed the 1929 stock market crash.

Although Schwed Jr did not survive the markets, he never lost his wit and sharp observations and became an author with a bestselling children's book *Wacky, the Small Boy*. Years later (1940) he wrote *Where Are the Customers' Yachts?* – A satirical view of Wall Street's mentality and how the different role players – brokers, bankers and customers – interacted with each other. At the time it was basically a reflection on the folly of the bull market leading up to the crash of 1929. Fifteen years later (1955) the second edition of this book was published but by then the stock markets truly shrugged off the bear market of the 1930s, but Schwed Jr soon realised he could not add or change anything from the first edition since Wall Street remained the same as before, despite new reforms and regulations that have been introduced since the 1930s.

Today the markets operate vastly different from those days; in fact, it is fair to say it is unrecognizable from those markets many decades ago with even tighter regulations, reforms and many new technological advances, but the human spirit of financial markets never changed. That is why this book, despite (or maybe because of) its modest volume (170 pages), humoristic and non-academic approach, stood the test of time as opposed to the often lengthy, serious and complex discussions of financial matters. Therefore, the book is as relevant today as it was then.

I will endeavour to share some of the best acumens from the book, but by no means will it be a complete or even a fair reflection on Schwed's work. The reader will note that many of Schwed's observations hinge on a deep understanding of human behaviour and decision-making in financial matters, long before academics formally developed the field of behavioural finance (investment psychology) as we know it today.

The validity of financial predictions

Imagine you have had the opportunity to consider two predictions, one from a young broker trainee, named Joe, chewing gum and leaning against the wall, and another from a Mr S. Hugo Big – a Harvard graduate sitting behind a grandiose desk in a very smart office. Joe predicted the following: "Looks like there will be a little rally after lunch". S. Hugo Big issued the following press release: "…therefore it becomes clear that over the period of the next fifteen years the investment demand for…will find such deserved popularity…"

Instead of asking whose statement seems to be the most credible, one should ask which of these statements is the sillier? Both statements could be correct of course. Moreover, statements like these have sold billion dollars' worth of securities. Maybe the honours should go to S. Hugo Big – at least he has the educational advantage over Joe to make any statement sound sillier. But, since neither of them has any factual or casual basis for saying either of these things, the honours should be even. Of course, both men would deny that their

predictions are just based on “gut feel” or that they are fakers or liars; but that their predictions are solely based on intensive research and studying of price patterns.

Yet, the sad truth is that very few experts have ever known for two years (much less fifteen) what was going to happen to any class of securities – and that the majority are usually spectacularly wrong in a much shorter time than that.

It seems that the mind has a regrettable tendency to believe, as actually true, that which it only hopes to be true. The notion that the financial future is not predictable is just too unpleasant to be given any room at all in the Wall Streeter’s consciousness. They continue to dream of conquests, coups, and power, for themselves or for the people they advise.

Some Wall Street men manage to shed these dreams, given sufficient years, but the ultimate dream they almost never shed: that there is a secret, meaningful and predictable, in the rise and fall of enterprises – that a close study of this and that will prove something.

The passion for prophecy

The croupier at the roulette table does not claim that he knows something about the order in which the numbers will come up. He just sees to it that the bets are properly paid off. But it is hard for a Wall Street man to be just a croupier. This causes a great deal of anguish in the long run, and the reasons for it are both human and economic.

Customers have an unfortunate habit of asking about the financial future. Now if you do someone the honour of asking him a difficult question, you may be assured that you will get a detailed answer. Rarely will it be the most difficult of all answers – “I don’t know.”

The average male likes to sit at breakfast and tell his wife and children what Adolf Hitler [present day Muammar Gaddafi perhaps] is going to do month after next. This is harmless vanity, but from this it is an easy step for him to tell people what the share price of Company X is going to do month after next.

On the economic side there is no denying that the more financial predictions you make, the more business you do and the more commissions you get. However, Wall Streeters do not sit down and think: “Now let’s see. What cock-and-bull story shall I invent and tell them today?” The usual thought process is far more innocent. The broker influences the customer with his knowledge of the future, but only after he has convinced himself. The worst that should be said of him is that he wants to convince himself badly and that he therefore succeeds in convincing himself – generally badly.

Wall Street Semantics

"What is the market doing?" The answering phrases are – "It is going up", or, "It is going down." It is a fair thing to say of a piston, elevator or golf ball at a certain moment. This suggests not only that it has been going up, but that it will probably continue to go on up, for a little while at least, because whatever impulse started it is still operating to some extent. But it is not a fair thing to say of the stock market, which, not being a physical thing, is not subject to Newton's laws of propulsion or inertia. Unfortunately most of us credit this false analogy. Thus, we are not tempted to buy unless they are "going up" or to sell unless they are "going down." But when the market is "going up", there is no reason to believe that the very next move is more likely to be up than down.

Chartists and Technical Analysis

There have always been a considerable number of people who busy themselves examining the last thousand numbers which have appeared on a roulette wheel, in search of some repeating pattern. Sadly enough, they have usually found it.

As a science I should say that chart reading shares a pedestal with astrology; but most chart readers are educated men and have too much mental discipline to take astrology seriously. The subject seems to suffer from a lack of causation. That one can, by examining the line already drawn, makes a useful guess at the line not yet drawn, must be predicated on the hypothesis that "history repeats itself". History does in a vague way repeat itself, but it does it ponderously, and with an infinite number of surprising variations.

Accounting

Accounting, some say, is not a science but an art. Consider the old gentleman who owned a sizeable department store that was annoyed by his sons and auditors, who were trying to convince him that while business seemed to be good, the store was actually losing money. Finally, the old man spoke: "The pushcart that I pushed into this town forty years ago we still have. It is in the storeroom on the sixth floor. Go up, check it off. Then everything else you see is profit."

Perhaps accounting is not even an art, but just a state of mind. [Like the accounting scandals of Enron and WorldCom in the 2000s, there were corporations in Schwed's time too that were fabricating results rather than reporting the truth]: …for some time the corporations had flourished, chiefly on assets that simply weren't there, but which everyone thought were there. Everyone, that is, save one man in each case, who had created the assets all by himself, using only a pen, some ink, and a lot of skilful dishonesty.

Wall Street as a career

Wall Street has always been burdened by having in its personnel a good many estimable people who don't know anything about the laws of probability and risk, and not too much about arithmetic. Of course, if you have a persuasive and forceful character you can always make a big splash in the Street.

Probabilities

There is a mathematical demonstration of what would happen, what *must* happen, if a large number of men were set to playing a game of pure chance, like coin flipping, against each other.

Let us have 400,000 players (market speculators) engage at one time. After the first game there will be 200,000 winners. Then the second game is played; again there will be 200,000 winners of which half would have won both rounds and an equal amount of players that lost both rounds. After the third game there will be 50,000 players that won every time, and so forth.

Number of players that won the game each and every time

Round	400,000
1	200,000
2	100,000
3	50,000
4	25,000
5	12,500
6	6,250
7	3,125
8	1,563
9	781
10	391
11	195
12	98
13	49
14	24
15	12

Eventually, only a dozen players will be left that have won every single time for fifteen games. These players are regarded as the experts, the greatest coin flippers, the men who never lose, and perhaps they have their biographies written.

Admittedly, it is preposterous to suggest that stock speculation is like coin flipping. I know that there is more skill to stock speculation. What I have never been able to determine is – how much more?

Investment and Speculation

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

[The above definitions are probably some of the most powerful phrases ever written on investment matters. Any investor, short-term and long-term, should know the vast difference in the likelihood that each strategy will succeed. Too often, however, ordinary investors are confusing the matters. For example, expecting unrealistic investment returns from a strategy that is very unlikely to succeed (and not understanding the potential downside) or being too pessimistic about investing when the odds should be in your favour].

The Best Investment Advice

For no fee at all I am prepared to offer any wealthy person an investment program which will last a lifetime and will not only preserve the estate but greatly increase it: When there is a stock market boom, and everyone is scrambling for stocks, sell them. Take the proceeds and buy conservative bonds. No doubt the stocks you sold will go higher. Pay no attention to this – just wait for the depression which will come sooner or later. When this depression (panic) becomes a national catastrophe, sell out the bonds and buy back the stocks. No doubt the stocks will go still lower. Again pay no attention. Wait for the next boom. Continue to repeat this operation as long as you live, and you'll have the pleasure of dying rich.

But it distresses me to report that I have never enjoyed the social acquaintance of anyone who managed to do it. The chief difficulties, of course, are psychological. It requires buying bonds when bonds are unpopular, and buying stocks when stocks are universally detested.

I suspect that there are actually a few people who do something like this, even though I have never had the pleasure of meeting them. I suspect it because someone must buy the stocks that the suckers sell at those awful prices – a fact usually outside the consciousness of the public and of financial reporters.

Media reporting and hype

> "Large selling was in evidence at the opening bell and gained steadily in volume throughout the morning session…and during the final hour equities were thrown overboard in huge lots, without regard for price or value."

The public reads the papers, and reading the foregoing, it gets the impression that on a catastrophic day everyone sold and nobody bought. Of course, there is just no truth in that at all. If on that day “selling” amounted to 7,365,000 shares, the volume of buying can also be calculated. In this case it was 7,365,000 shares.

Why a professional writer on financial matters, who clearly knows so much about money, is not rich?

In my case I have not only written airily on financial matters, but I have actually been fiddling around with common stocks most of my mature life. And as of this writing (1955) the stock market has been going up for fifteen years and is at new high. Yet I haven’t got a Cadillac to my name.

My tendency has been to buy stocks. Then when they show a profit I sell them. It seems to me at these moments that I have achieved life’s loveliest guerdon (reward) – making some money without doing any work. Then a long time later it turns out that I should have just bought them, and thereafter I should have just sat on them like a fat, stupid peasant. A peasant, however, who is rich beyond his limited dreams of avarice…