Book Reviews

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NEW LEVELS IN THE STOCK MARKET, by CHARLES AMOS DICE. *McGraw-Hill Book Company*, New York. 264 pages.

New Levels in the Stock Market is a book dealing with economics rather than accounting: an accountant feels a certain shyness in offering critical comment on it.

Its purpose is "to describe the revolution that has come upon us unheralded and largely unnoticed and to state the significance of recent developments for the stock market and for business."

It does describe the changes in the stock market since 1900, vividly and clearly, and so far as this reviewer can judge, correctly. The book is the result of wide reading and unprejudiced judgment, but how did the author come to the conclusion that the changes in the stock market had been largely unnoticed? Columbus, Ohio, is not a backwoods village but a wide-awake progressive city, so it is hard to believe that the changes referred to have not been closely followed there just as they have been in New York.

This does not mean that all those who have watched the developments during the great stock boom have seen all that this author has seen and described. On the contrary there will be few who read the book without gaining some fresh and valuable viewpoint.

There is no attempt to account for the great rise in stock prices by means of any new and strange theory, the author harping from beginning to end on the superior methods, business enterprise and courage of the American people; he is emphatically a bull, although he does not allow his optimism to color his facts.

He does follow the idea of American superiority into strange fields, as in the instance where he pokes a little fun at the poor British for wearing an obsolete pattern of shirt, to don which it is necessary to climb through the tails, whereas the progressive American wears a coat shirt, which can be put on and taken off without mussing the hair or even taking off the hat.

The field covered is almost too wide for one book, including the federal-reserve system, customer ownership, Henry Ford, mass production, English bath tubs—or the lack of them—investment trusts, brokers' loans and a hundred other matters.

In speaking of brokers' loans the author has followed the common notion that loans to brokers, in effect loans to marginal stock purchasers, are just so much money taken out of the supply available for credit purposes. Catchings has dealt effectively with this error. The notion might be expected in a member of congress, or a senator, but hardly in the writer of such a generally thoughtful book as this is.

Many paragraphs close with a question mark; the author does not think that he has found out everything about everything, but points out many things that need elucidation. The book closes with a declaration that "it is this sublime faith" (of Americans in the soundness of their business structure) "that furnishes the pillars for the new levels in the stock market and business situation of our time."

Those who have not made a study of the developments in the stock market will find in this book the condensed observations of a capable observer extending over many years; for them it is a short cut to knowledge, reliable as to facts, tinged with optimism as to opinions. And the bullish author will take no hurt from study of the October, 1929, stock market.

F. W. THORNTON.

INVESTMENT TRUST ORGANIZATION AND MANAGEMENT (revised edition), by LELAND REX ROBINSON. *Ronald Press, Co.*, New York. 608 pages.

The revised edition of *Investment-trust Organization and Management* is practically a new treatise on the interesting subject of investment trusts rather than a revision of Dr. Robinson's book published in 1926. This is due largely to the growth of the investment-trust idea in the United States, which offers a comparison with British trusts which was not hitherto available. The author points out that the reason for their creation is due in part to the fact that investment problems are becoming increasingly complicated and that the advantage to the shareholders is the ownership of an interest in a diversified portfolio and, for inheritance-tax purposes, the saving of money as well as annoyance.

The various types of investment trusts are defined and a distinction is made between true investment trusts along the lines of the British type and other investment organizations which are commonly called investment trusts. American investments are divided into two general types—the contractual and the direct. Their set-up, operation and relation to shareholders are explained at length.

CONTRACTUAL TRUSTS

The various phases of the contractual type of company, which is sometimes used to split up the ownership of high-priced securities and also for the issuance of "American shares" in foreign securities, are outlined as follows:

(1) Trusteeship; (2) fixed portfolio with limited powers of substitution; (3) certificate holders like beneficiaries under any trust agreement; (4) restrictions on borrowing; (5) trustee custodian and at times nominal owner of the securities in the portfolio; (6) trustee receives a fee and the management group may also make a spread in the purchase of investments for the trust; (7) no reserves built up out of income, distribution merely being restricted so that corpus is not impaired; (8) certificates usually registered and not easily marketed; (9) income in most instances taxable for federal and New York state income-tax purposes, directly to beneficiaries; (10) additional certificates issued if they can be absorbed by the market provided the underlying investments are not too high.

Benefits of contractual trusts are said to be (1) investor knows composition of underlying securities; (2) reduction of error in judgment of reinvestments; (3) investment in leading corporations which will keep abreast of the times and will participate in expanding economic development; (4) value of investments should increase despite market fluctuations.

STATUTORY OR DIRECT TRUSTS

From a legal viewpoint statutory trusts take the form of Massachusetts or common-law trusts, while corporations organized under the laws of the various states comply with the economic use of the term "investment trusts." Both forms of organization, which are taxed alike under the federal income-tax law, can be used for the same purposes and with similar limitation of personal liability. While common-law trusts, in the states which permit them, are less formal and subject to fewer restrictions, all things being equal the corporate form is preferable and the stock of a corporation is more easily marketed.

A recent practice is to issue allotment certificates or units of preferred and common stock so that those who contribute to the fixed capital also receive the benefits of proprietorship implicit in common stock. The management group often subscribes to all the junior shares of preferred and common stock. When the preferred shares have a par value, the amount received for each unit in excess of the par value of the preferred shares is considered as the amount paid in for the common shares. Sometimes the no-par common stock is given a stated value and any excess received is carried to capital surplus, against which the cost of financing is charged. Since there is usually an excess of assets over the subscription price of the preferred shares, and the dividend on preference shares is in effect a fixed charge, the relation of the various classes of stock to be issued is a matter of vital importance. The type of investments purchased is governed somewhat by the nature of the capital structure.

In order to obtain additional capital at a fixed charge which is less than dividends paid on preferred shares (in Great Britain a very low rate of interest prevails), American investment trusts issue collateral bonds or debentures. The rate of interest depends on the money market and on such special features as the covenant to pay not in excess of 2 per cent. of the federal income taxes and the refund of the personal-property tax imposed by several states. Temporary borrowing should be restricted and be resorted to only in such instances as the anticipation of the issuance of capital or when favorable investment opportunities occur.

Under the topic of taxation the author illustrates the federal income taxes borne by the certificate holders according to the kind of income received by the investment trust and whether or not it is taxed as a corporation or passes the tax to the beneficiaries of the trust. Income taxes imposed by the more important foreign countries are listed and attention is called to the credit allowed by the United States to corporations, but no mention is made of the effect on trusts whose income is taxable directly to the beneficiaries. The taxable status of the various forms of investment trusts under New York state franchise taxes and original issue and transfer taxes receives attention.

Investment problems and policies are fully set forth. Diversification either through prescribed limitation or adopted policy of the management is obtained through investment in several industries, various countries and also in different types of securities. A sufficient number of investments should be in securities listed on the several exchanges and no single investment should constitute a substantial minority ownership of any company, except perhaps allied investment companies. Dr. Robinson wisely emphasizes the fact that investment for quick turnover, marginal trading and short selling are, in general, illegitimate for organizations whose shares are widely held. With the personnel and resources at the command of an investment trust, profitable investments can be made in both "bull" and "bear" markets. The author states that the greatest opportunities for constructive effort lie in following the position which British trusts hold in their association with underwriting groups. In the final analysis the main element of safety for the shareholders is in the ability of the managers properly to administer the funds and make such a report as will maintain the confidence placed in them. Protection of the securities owned is either through complete internal supervision or partly or entirely through an independent custodian, together with proper insurance.

Typical balance-sheet and income statements are used as a basis for the discussion of accounting policies and methods. Four methods of valuation of securities are described. The statement is made that investments are purchased for their yield, and sentimental fluctuations in market values are not of particular interest to investment trusts unless there is a real falling off of earning power, as a forced liquidation of investments should not be necessary. Along the lines of the British practice of using profits realized from sale of securities as a hidden valuation reserve (such profits are not considered as income and are not taxed as such) any unrealized profits or losses should be properly reflected and designated and not merged with realized gains or losses. The writer stresses the use of sound accounting practice (regardless of the lack of legal restrictions) of not declaring dividends when capital funds are impaired. For the benefit of the management, periodical valuations are made using the quotation at the middle point of the day (?) for listed securities and a conservative estimate for over-the-counter securities.

While no detailed procedure of accounting is discussed, the various kinds of transactions of an investment trust which must be recorded on the accounting records are listed. After enumerating those items which are definitely to be taken into income from interest and dividends, the treatment of stock dividends, scrip and rights is outlined in detail. As to these last three sources of possible income, the procedure approved by the treasury department is recommended except, perhaps, when the right to subscribe is exercised: in that case the author says the original cost plus subscription price should be considered the total cost of the increased number of shares. The average cost of each investment is the generally accepted method of calculating profits on securities sold.

Dr. Robinson states that repurchase agreements, which should avoid the characteristics of "wash sales," are conceivably permissible when the seller wishes to establish profits but is anxious to regain his position in the security in question, such agreements to be a basis of mutual advantage between the two principals. As a corollary would it not also be conceivably permissible to use the convenience of repurchase agreements to establish losses as well as profits?

Another source of income is from participation in underwriting of securities, whether or not the investment trust purchases the securities, provided such profits result from actually assuming an underwriter's liability. However, any concession received from participation in a selling group ordinarily should not be taken into income but should be credited to cost of security acquired, as investment trusts are not in the business of distributing securities.

The various bases of compensation used are stock-subscription rights or a straight fee and should safely permit of average earnings from all sources of not less than 7½ per cent. or 8 per cent. on total investment capital. The author discusses and illustrates by tables the relation of dividend distribution to earnings and quotes from the report of the attorney-general of New York state on the advisability of building up reserves in order to meet such contingencies as may arise.

Dr. Robinson concludes his authoritative book by citing examples of specialized investment trusts and of other investment organizations which operate along similar lines. As a sample of a managerial investment trust he mentions the American Founders Corporation and explains its relationship with its affiliated trusts. While the early beginnings of the investment-trust idea were as early as 1893, the International Securities Trust of America, organized in 1921, was the first one organized along the lines of British trusts.

The author gives as the indispensable ingredients for growth of the investment-trust idea (1) stable currency; (2) well organized banking system; (3) preponderance of corporate enterprises in business; (4) wide and trustworthy market for securities; (5) large class of investors and an abundance of investment capital; (6) greater regard for accuracy and honesty in financial statements. He specifically points out the value of financial statements to individual and also institutional buyers. The dangers of arbitrary regulations are mentioned and it is suggested that like the British surveillance, which is exercised at the inception of the company, proper approach to any regulation is through strengthening and clarifying existing state laws.

Finally, the opinion is expressed that even as the British trusts came through the trying periods of the '90's and the world war, so properly managed American trusts should prove to be ever successful and be "an important instrumentality in setting to work along economically sound lines the capital of the masses of investors."

EDWARD A. BENSON.

INTEREST, ANNUITIES AND BONDS, by HERBERT TATE. *Sir Isaac Pitman & Sons, Ltd.*, Toronto. 104 pages.

The scope of *Interest, Annuities and Bonds* is so well defined by the author himself that it seems hardly necessary to amplify his statements. He offers: "A text on the principles of compound interest and annuities, comprising a course of lectures delivered to second-year students in the school of commerce of McGill University, Montreal, and to an evening class of students for the final examinations of the Society of Chartered Accountants of the Province of Quebec." For this and similar purposes, when it can be amply supplemented by the spoken word, the book will no doubt be very useful for the very reason which limits its use to that of a classroom textbook, namely, its compactness.

A great deal of information is crowded by the author into very small space. He is evidently a mathematician by inclination, whose natural medium of expression is the formula, and he therefore is loath to use words when an appropriate combination of a few symbols will express his thoughts so much more concisely. The one exception seems to be the word "clearly," which is freely used because the subject matter is indeed clear to him. It is true that with the exception of the appendix "the material is well within the compass of those having a sound knowledge of elementary algebra as far as exponential or logarithmic series," but how many general practitioners have? The mere fact of having passed an examination in algebra many years ago will not place the average accountant in this favored class, unless he has chosen the mathematics of finance for his hobby or specialty and thus kept himself in training. All others intending to acquire a working knowledge of the subject without the aid of supplementary oral instruction will need much more explanation and less symbols, if they are not to be frightened away. It is regrettable that the wealth of material contained in the well graduated exercises is not made more accessible to this larger group, because the problems, although not new, are presented in such attractive form as to challenge the ingenuity and interest of even casual readers.

The appendix is devoted to a discussion of the force of interest (limit of effective rate), the continuous annuity, etc., which, according to Mr. Tate, are easily grasped after preceding chapters have been assimilated. As a matter of fact, no convincing explanation is given at all, because that would require a knowledge of the theory of limits or the elements of differential calculus. With a set of standard tables, the book closes, promising to be a valuable manual for college instructors and even students. Its usefulness to the practising accountant, however, must be considered somewhat limited. But then, no one claimed that it would be especially suitable for the practising accountant, and, after all, the best that may be said of any book is that it is everything the author intended it to be.

GABRIEL A. D. PREINREICH.

MATHEMATICS PREPARATORY TO STATISTICS AND FINANCE, by GEORGE N. BAUER. *The Macmillan Company.* 337 pages. $2.00.

The word "preparatory" in the title, *Mathematics Preparatory to Statistics and Finance*, should be noted. The purpose of the book, as stated in the preface, was to bridge the gap that often exists between what a high-school student knows of mathematics and what he is expected to know on entering a college business course. It does not deal either with statistics as such or with the mathematics of finance as such.

The chapter on logarithms is unusually clear, as is that on the simpler forms of annuities, but graphs of quadratic equations and functions, while perhaps interesting to some classes of engineers, hardly enter the business life of an accountant.

As this review is intended mainly for the edification of public accountants, it may be stated briefly that this well written little volume would be of little use to them.

EDWARD FRASER.