

CHAPTER 1

Fear and Ignorance

Fear always springs from ignorance.

—Ralph Waldo Emerson

Why must people have a fear of investing?
Why did the stock market crash in 1929?
Why was it necessary to become jobless?

Why was it necessary to become penniless?

Why was it necessary for people to leap to their deaths out of fear?

Why was it necessary to forgo the American dream?

Aren't investors by definition fearful? With little training in investing, they tend to do nothing, or they delegate investment responsibilities to stockbrokers, accountants, bank trust officers, insurance agents, relatives, or friends—often with disappointing results. After all, no one will care as much about your financial assets as you do. No one will do the job as well as you can.

It is not an easy job. There are thousands of ways to go wrong. Even the most prudent investment decisions may not work (as we know from personal experience and the tales of countless investors). The job may not be easy, but it is doable. I have learned to invest money successfully, and so can you. It takes some study and considerable personal discipline, but you will be well paid for your efforts. This book will help you get started and guide you toward rewarding accomplishments.

The best opening lesson on fear and investing is illustrated by the largest money-losing event, and worst day of fear ever seen: the stock market crash of 1929.

THE STOCK MARKET CRASH OF 1929

The tragedy of this crash is best illustrated in the many news stories of the time, as reported by the telegraphic services of the Associated Press, *New York Times*, *Chicago Tribune*, *Chicago News*, Universal International News, Consolidated Press, and the United Press.

Tuesday, October 29, 1929

Following Black Monday, October 28, 1929, newspapers ran headlines that screamed "Stocks Drop \$10 to \$70 a Share, Worst Break in Market History," "Billions in Value Are Swept Away by Avalanche of Sales," and "Late Rally Turns Prices Upward, Recovery Small by Comparison; Total Sales Near 16,000,000 Shares."

The greatest break in the history of the New York Stock Exchange (NYSE) continued to slash away billions of dollars in values Tuesday in the most enormous trading day in history.

Prices Seemed to Know No End Positive assurances from the bankers and economists that the bottom had been reached Tuesday brought only a temporary respite; then the market roared downward at wide drops.

Shortly after 1:00 P.M., prices were down 1 to 50 points on both the big board and the curb exchange. New lows for the year or longer were established in many shares. The market value loss was tremendous, totaling more than \$50 billion since the terrific downward movement started a few days earlier.

Rallies Were Short-Lived; Stocks Resumed Their Plunge During the day, slight recoveries set in but these were without support; the stocks that had recovered fell back and joined the general downward rush.

All sorts of bait were dangled before the traders in an effort to revive buying. Bankers were helpless to stem the tide of reaction. They resorted to psychological methods to convince traders they were not worried about the situation.

Influential banks were said to have worked out a plan of attack for Tuesday, but it did not make itself felt in the morning. A group of representative institutions marked down the figures at which stock market loans could be made. One broker reduced commissions, and others were expected to follow. The Federal Reserve was in session, with Secretary Mellon in attendance. He was said to have conferred with President Hoover, but no statement was forthcoming.

All of the World on Selling Spree Engulfed in the greatest selling wave in the history of the NYSE, prices were carried down Tuesday under a torrent of liquidation from every corner of the globe. Monday's losses, huge as they were, were doubled on Tuesday.

More than 13 million shares had changed hands on this record-breaking day. Stocks of all kinds crashed. In mid-afternoon, there was a rally from the lows, which brought prices back from the minimums. It still left them enormously down on the day.

A report that the Federal Reserve Board of Governors was considering closing the exchange was denied semi-officially, and it was announced that various investment trusts and banking interests were buying.

Call money, renewing at 5 percent, was advanced to 6 percent in the last hour, suggesting that the investment trusts were withdrawing funds from the call market to buy stocks. Until mid-day, every attempt to stem the tide met with failure. At the end there was a sharp rally. There has never been anything like it.

Wednesday, October 30, 1929

On Wednesday, the papers ran these headlines: "Stocks Advance \$5 to \$30 a Share" and "Investment Trusts Put Half Billion in Market During Rally."

The bulls staged a great demonstration in the closing minutes.

Prices were whirled up to the highs of the day, a day that had seen prices moving up regularly from the calamitous lows of Tuesday. It was a great climax, and as the closing bell rang traders and brokers shouted, cheered, and threw papers into the air in jubilation at the restoration of confidence in the market.

Investment trusts and trading corporations were heavy buyers of stock over the course of those two days, and purchases were estimated to range from \$350 million to one-half billion dollars. These securities were bought outright.

The wave of hysterical selling, which had clipped more than \$25 billion from the quoted value of listed securities in the New York market during the last week, subsided Wednesday, and prices rallied briskly in response to what appeared to be strong investment demand. Scores of active issues were marked up \$5 to nearly \$30 a share in the first hour of trading.

Developments in the Stock Market Situation Wednesday indicated that a mobilization of the nation's leading financial forces had been undertaken to calm the wave of hysteria and restore confidence in the securities markets. John D. Rockefeller Sr., who rarely spoke for publication, authorized the statement Wednesday that he and his son for some days had been purchasing sound common stocks: "We are continuing and will

continue our purchases in substantial amounts at levels which we believe represent sound investment values," he added.

Philanthropist Pledges to Help Employees Caught in Stock Crash Julius Rosenwald, philanthropist and chairman of the board of Sears Roebuck and Company, "pledged without limit" his personal fortune to guarantee the stock market accounts of the 40,000 employees of his company. John Higgins, vice president of Sears, was delegated the duty of seeing that the employees' accounts were protected.

Higgins immediately looked up the accounts of all employees—not only in Chicago, but everywhere the company had branches. When he found an employee carrying an account in which, in the present bear market, his margin had grown too narrow for safety, Higgins communicated with the broker handling the account. "We simply put up collateral, so that our employees shall be able to weather the storm," Higgins explained. "One of the things I found out was that a great many of employees will have no need for the assistance offered. Some of them, thanks to their thrift and good judgments, are wealthy. The help Mr. Rosenwald is offering is for those who need it."

According to Higgins, Mr. Rosenwald had adopted a similar plan during the financial period depression in 1921. The sum that Mr. Rosenwald pledged was about \$1,600,000, to be used as collateral for employee stock accounts. It was also revealed that Mr. Rosenwald made a gift in 1921 of \$5 million worth of his own stock to the company and pledged \$20 million more of his personal fortune to see the company through. It was explained that Mr. Rosenwald's 1929 offer applied to all employees' stock accounts, no matter what stocks the employees held.

A List of Stocks That Are Safe to Buy The following information was for persons who wished to purchase sound investment issues—it was believed that the stocks named would yield good income.

Kennecot: Provided price of copper metal is held at 18 cents, Kennecot will be in a position to increase its dividend rate by the end of the year. Paying \$5 a share, or better than 7 percent at current prices, Kennecot looms ahead of Anaconda as the favorite of those friendly to the copper group. 1929 range 104⁷/₈–65; Tuesday's close 65³/₄, down 4⁷/₈.

Pullman: Rated an A-1 investment stock, paying \$4 a share, and aided by new car orders, Pullman will earn more than \$5 a share this year. It is no stock to buy for trading turns, but it will do well for the investor who is willing to hold it for the long pull. 1929 range 99¹/₄–75¹/₈ Tuesday's close 75¹/₄, down 3.

American Rolling Mill: Selling at a new low for the year, Rolling Mill is an attractive buy for the long pull. Earnings for the first six months of this year were \$3.26, compared with \$3.07 for the entire twelve months of 1928. Stock pays a dividend of \$2, plus 5 percent in stock. The company owns the valuable exclusive patent for rolling strip steel and is leasing it on a royalty basis to the biggest steel corporations in the world. 1929 range, 144 $\frac{62}{72}$; Tuesday's close 72; down 13.

New York Central: Actually the leader of the seasoned rails, New York Central always has held its place as one of the soundest of investment issues, and has done well in price appreciation. Earnings, estimated at \$16 or more this year, are steadily increasing, and the company is rich in realty. Central will never cost anyone any money in the long run. 1929 range, 256 $\frac{1}{2}$ –175; Tuesday's close 189 $\frac{1}{2}$, up 3 $\frac{1}{2}$.

Pennsylvania: Good management is one of the required attributes of any company to the investor who is buying its stock. Pennsylvania railroad has an excellent management and never has been a market laggard. At current prices, paying a \$4 dividend, it yields a little less than 5 percent. 1929 range, 110–72; Tuesday's price 82, down 8.

Underwood-Elliott-Fisher: This company has further merger possibilities, in addition to enjoying the position of the largest company in the business machine and office equipment industry. 1929 range, 181 $\frac{3}{4}$ –91; Tuesday's close 97, down 13.

American Radiator: Mergers have often been forecast for this company, and undoubtedly they will occur in the course of time. At present, the company is a powerful unit in the industry. Dividend is \$1.50 or 4.3 percent at current price. 1929 range, 55 $\frac{3}{8}$ –28; Tuesday's close 32, up.

Thursday, October 31, 1929

"Big Buying Wave Sends Stocks Higher," "Profit Taking Fails to Wipe Out Gains Made in Early Hour," "Orders Pour In from Everywhere; Volume of Trade Heavy" were headlines that ran in the major dailies on Thursday, October 31.

The three-hour stock exchange sessions Thursday saw traders push the market forward at such a pace that \$10 billion was added to the market's valuation of stock. The trading was terrific. In the short session, thousands upon thousands of shares, bargains as described by such financiers as John D. Rockefeller, were bought. The first half-hour alone was at a rate of more than 24 million shares for a full-day session.

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THE STOCK OPTION INCOME GENERATOR

Tickers ran an hour behind, but floor quotations just at closing time showed that stocks were up from 1 to 40 points. Buying was as frenzied Thursday as selling had been the previous Tuesday. Values came back with the vigor of the old bull market that Wall Street had declared dead just days before.

The desire of knowledge, like the thirst of riches, increases ever with the acquisition of it.

—Laurence Sterne

**INVESTMENT KNOWLEDGE + STOCK
MARKET = PROFITS**

You can make money no matter what direction the stock market is going. You have just seen a brief insight into the 1929 crash and its aftermath. On the day of the crash, stocks were rebounding by the end of the trading day. On the following two days, the numbers were even better:

- October 29, 1929, -30.57 Dow Jones -11.73 percent
- October 30, 1929, +28.40 Dow Jones +12.34 percent

This illustrates that a lot of money can be made as a result of a market crash.

You can now see that financial hell or financial heaven may be just around the corner. I differ from many of my colleagues in my sincere belief that the prepared investor can profit when the market goes up or down. Let us emulate investors like John D. Rockefeller Sr. and Julius Rosenwald.

They say a fool and his money are soon parted. What I want to know is how he got it in the first place.

UNDERSTANDING INVESTOR BEHAVIOR

Behavioral finance attempts to provide a structure for understanding the behavior of investors and the stock markets in which they invest. This framework is complementary to the standard theory of finance, also known as the *efficient market* theory. In this latter view, investors are totally rational beings. In making decisions, they consider all available information and accurately assess its meaning. They determine the probable outcomes associated with various decisions and only take actions likely to maximize their overall wealth and minimize risk.

Under the standard theory, securities markets quickly—almost instantaneously—incorporate all known information. Market movements are based on changes in that information and reflect the collective reactions of rational investors to the new information. Securities are always accurately priced.

Behavioral finance, in contrast, holds that investors are actually not completely rational beings. They sometimes act based on imperfect or incomplete information, and they may misinterpret information or react to it in inappropriate ways. However, behaviorists believe investor behavior is not purely random or totally irrational, either. They believe that even the nonrational behavior of investors falls into patterns and may be somewhat predictable.

Mind over Matter

Market declines are a natural part of the investment process. There have always been momentous events that dampened the markets. But history has shown that markets eventually rebound. Maintaining a long-term perspective through challenging economic times isn't easy, but it can be rewarding. Throughout the history of the market, the ups generally have outweighed the downs, resulting in strong long-term growth opportunities.

The best way to predict your future is to create it.

—Abraham Lincoln

THE CRASH OF 2008

Official confirmation of the painfully obvious, that the United States entered a recession in December 2007, came from the National Bureau of Economic Research. In reflecting on the calendar year 2008, the sad state of the economy is obvious.

We saw gasoline costs go through the roof and then plummet. The Dow Jones turned into a daily roller coaster, and the \$700 billion bailout took shape but did not seem to have any impact on market stability. Terms such as “mortgage meltdown” and “credit freeze” became part of the everyday financial language, and the unemployment rate rose dramatically.

It was nearly impossible to open a newspaper, turn on the television, or surf the Web without coming across a doom-and-gloom story about the economy and the financial markets. While there is no doubt that these are

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difficult times, this is an ideal time for investors to position themselves for long-term success.

Against the backdrop of the problems in the subprime mortgage sector, the ensuing credit crunch, and the unsteady influence on markets, investors have been challenged to revalidate their ideas about how best to invest in a rollercoaster market. In the interest of providing context, it is important that the reader understand my investment philosophy. It is based on the tenets of broad stock portfolio diversification and linked alternative investments. We don't engage in tactical or market-timing efforts. Instead, we attempt to execute a strategic asset allocation, with targets adjusted periodically over a long time horizon.

It appears that the United States has plunged into its worst financial crisis since the 1930s. The leadership of Treasury Secretary Henry Paulson and Federal Reserve Chief Ben S. Bernanke in fighting it has been sluggish and inconsistent. The intensity of the crash will surely earn a place in financial history.

U.S. consumer bankruptcy filings jumped nearly 33 percent in 2008 amid a recession that's expected to keep filings rising in 2009.

Overall consumer filings reached over 1.5 million last year. The 2008 rate of increase fell short of the 40 percent rise recorded in 2007, and the annual total in both of those years is still short of the more than two million recorded in 2005 alone. A law that took effect in October 2005 made personal bankruptcy filings more difficult and sharply curtailed filings in 2006 to about 573,000, the lowest level since 1998.

President Obama and his Congress took the reins of the country in January 2009, but it will take time for them to develop policies to stimulate the economy and promote liquidity. What's an investor to do? Understand that when the market changes, people tend to get nervous, apprehensive, and downright uneasy.

Neither the entrepreneurs nor the farmers nor the capitalists determine what has to be produced. The consumers do that.

—Ludwig Von Mises

WHAT TO DO FIRST

First, do not dump the market by selling your quality stocks. Yes, it is the worst bear market since 2000–2002 and stocks are trading at valuations not

seen in decades, but equities will come back. Panics invariably provoke investors to make the wrong moves. So resist the panicky calls from some so-called experts and many of your friends to move cash while you still have some savings left.

If you have uninvested cash, there is an almost endless choice of quality businesses trading at or near liquidation prices. The stock market is on a fire sale. Take advantage.

How patient do you have to be? How long will you have to wait? Some economists argue that it will take years to recover from the worldwide collapse we are facing. I do not agree. The United States and every other economic power know only too well the lessons of the Great Depression. Nobody will try to fight the recession by raising interest rates, or by closing the door to imports, as we did in 1930 with the Smoot-Hawley Tariff Act. We are already seeing global cooperation to prevent real disaster, such as the coordinated rate cuts made in early October 2008 by the Federal Reserve, the European Central Bank, the Bank of England, and the central banks of Canada, Sweden, and Switzerland.

It's okay, change makes everybody nervous. After all, it's more comfortable to stick with what you've always known. The truth is, a change in the market is a positive action. With the knowledge gained from this book, you will not only get the good comfortable feeling of knowing what to do, but also know how to react to anything that happens. People instantly get apprehensive if they think the changes are too big. Actually, as you will see, big changes work to your advantage. Of course, until you prove these facts to yourself, some of you are going to be just plain uneasy. I know no matter how much I tell you, the proof is going to be in the doing.

This book will show you how to prepare—not by hiding in a bomb shelter waiting for adversity to go away, but by arming yourself for battle in the financial marketplace. Take that money out of your mattress. If you do not, you will miss one of the greatest buying opportunities of your life. Times like these, when many U.S. companies are looking cheap, are the times to take action and buy.

Alarming? Not at all. The risk is surprisingly small. The rewards are great. You will learn how to use the psychology of the mob, and how to turn “nervous” into profits. You will be alerted to what it can cost you if you still believe in Santa Claus, the tooth fairy, or the good sense of brokers and bureaucrats.

Regardless of where you see the best value, most money managers agree that it's nearly impossible to predict when the markets will hit rock bottom. They recommend that investors dollar cost average into their chosen investments, regularly depositing money, so they will catch the bottom without resorting to a crystal ball.

Advised and protected by all the ideas and techniques explained to you in the following pages, you can proceed on your way and come home richer than when you started out.

Therefore, do not repress your spirits or lose your courage. All things work according to law, and all things can be made to manifest this law.

—Anonymous

MY INVESTMENT HISTORY

I just returned from a mutual fund seminar where I learned that if I had put my money with the company 56 years ago, my \$10,000 would now be \$10,338,589. (Total value includes reinvested dividends and capital gain distribution totaling \$3,924,771 taken in shares.)

If I had participated in that scenario, I can tell you where I would really be now: I would be dead from old age. Besides, who had \$10,000 56 years ago? How much would taxes have reduced the \$10 million end result?

Both beginners and long-time participants dream of—and are unrealistic about—making fantastic gains in a short time. The stock market can make you a fortune, if you are willing to get rich slowly. The stock market is the place to be if your goals are to make money.

Norman, the first stockbroker I ever met socially, said to me many years ago, “Harvey, I can make you a small fortune and guarantee it.” *Wow!* I thought. “Just come to me with a large fortune,” he continued.

My experience in the stock market is not unique. I grew up in a poor working-class environment, where I received an appreciation for the lifestyle commonly described as the American dream.

When we are very young, we are possessors of a splendid gift—a mind that knows no limits. Faced with a new experience, our minds allow us to make discoveries, gain insights, and with time, learn something more of the world around us. If we are truly fortunate, we’ll never completely let go of that early innocence that keeps us forever open to new ideas and permits us to dream.

In the United States, you have to realize that the only real limits to learning and dreaming are the ones we make for ourselves. In the United States, someone with humble beginnings can learn to earn and become a capitalist or even a tycoon.

I’ve been rich and I’ve been poor. Rich is better.

—Sophie Tucker

For many families today, simple economic survival is a problem. If you are able to invest, you must operate as a businessperson to be successful.

Intelligent businesspeople must have the ability to learn or understand from their own and others' experiences. They need to know how to buy and sell products and services with a profit motive, in an efficient and methodical manner. Using the knowledge thus gained, one can become a successful investor.

No one I knew as a child . . . family or extended family . . . owned stocks. The first time the notion of fear of stocks expressed itself was when I was warned never to buy any stock, *ever*, because some people had jumped from rooftops when the market crashed in 1929. I was afraid, but I thought, *Didn't all rich people have stock?* "If I ever buy stock I will never go on a roof," I decided.

I never worked for a bank or brokerage house, nor did I take any stock investment courses in school. I happened upon the stock market in 1957 because of my business as a commercial photographer. I dealt with companies and corporations, and began to see what American business and industry were all about.

On assignments, I visited factories where I took pictures of the manufacturing process, from raw materials to the finished products. I was working with sales managers, advertising directors, and chief executive officers (CEOs) to create photographs for annual reports and advertising.

Many of these executives would tell me about their companies and suggest that I buy some stock. I was working with my hobby, photography, doing what I loved to do, and getting paid at the same time. I enjoyed my work and made a living, but I never made any real money.

My First Stock Purchase

My first buy in 1962, with the few hundred dollars that I'd managed to accumulate, was in a major theme park to be built outside Denver. This was a new issue, and the broker even said I would not have to pay a commission. What a deal! I did not do any research, just looked at some pretty photographs (which I had produced) and turned over my money. I did not know Denver was starting a fledgling industry in penny stocks, and I was an early customer. I bought my first stock . . . and lost it all. Boy, did I learn a lesson.

Insider Trading

A short time later, I had a friend who was a principal in a company that wanted to expand its business. I bought in with the understanding that whenever he was selling his shares, he would let me know, allowing me

to get out also. About two years later, I received my first communication, which stated that the company had failed and was bankrupt. I called my friend and he told me he forgot to tell me he was getting out so that I could sell! Then and there, I decided this was my first and last time to use insider trading. I had lost again, but I resolved that I would become an informed investor in the future.

Experience is not what happens to a man; it is what a man does with what happens to him.

—Aldous Huxley

Mutual Funds

Next, I decided that when it comes to investing, you should let someone who knows do it for you. “Yes, certainly!” shouts the mutual fund industry, and its success in getting that message across has been one of the last decade’s most remarkable marketing stories. I picked a no-load growth stock mutual fund with a long track record and invested . . . and lost my growth (although I kept my principal).

Mutual funds are the third-biggest financial industry in America, behind only the banks and insurance companies. As recently as 1980, there were fewer than 600 funds. Today, the country has more than 10,000. This explosive growth is not justified, if you judge by the ability of the average fund to beat the market. None were up in 2008. None were down less than 10 percent, and the average performance was –43 percent. I didn’t know that the unmanaged Dow Jones Industrial Average advanced more than half again as much as the typical stock mutual fund.

Why did I go with a mutual fund? First, because I was frightened and baffled by the volatility of the markets, I had become convinced that a fund portfolio manager could handle my money better than I could. Second, slick advertising dazzled me with claims that were extravagant and deceptive to an innocent, novice investor.

Self-Management: A Better Way

Realizing that I was going nowhere with the fund, I decided to manage a small portfolio myself. I divided my investment money, leaving one part in a “growth mutual fund.” The second part I supervised. Then I watched which of my investments did better. My portfolio won handily. It was not only good for my pocketbook; it was good for my ego. Besides, I thought,

why should someone else have all the fun with my money? I withdrew all my money from the fund and have since managed it myself.

Why did I win? My holdings outperformed the heavily advertised “professional management” of the mutual fund, because I stuck with a diversified portfolio of quality stocks, and they didn’t.

The best of prophets of the future is the past.

—George Gordon, Lord Byron

SUMMARY

Today, a growing number of people are entranced with the subject of investing without having any basic know-how. Within these growing numbers, most become amateur investors; many find themselves caught in a poor deal and are afraid to invest again. Only a few become successful.

Making the leap from serious investor to successful investor to a professional registered investment advisor (RIA), while seemingly a simple and evolutionary step, is quite complex. In my case, I got into it by sheer drive, the sort of urge that starts in the soles of one’s feet and grows into a burning desire until it becomes an all-consuming way of life. As in professional photography, this competitiveness becomes more evident when you compare the number of amateurs to the number of pros. The success of the professional in any competitive environment is due to this burning desire, and a certain amount of glamour and romance is associated with it.

The proliferation of stockbrokers, investment counselors, and salespeople (along with their advice) induces many to invest with inadequate knowledge. This results in creating fear in many investors and leaves the opportunity for profit purely up to luck and chance.

Many make investment decisions influenced by prejudice, social injustice, pollution, or anything else that is real to them. When investing, the only thing on your mind should be making a profit. If you don’t want money, don’t invest. Making a political statement does not belong in the investment arena, and should not be any part of your investment decisions. If a company offends you, write letters, make a placard, and go picket the social injustices that you see happening. Emotions that make you boycott a stock do not hurt the company.

Then there are the engineers and technical people, who spend their days producing charts and graphs. They do not read their financial media or the Internet to select stocks. They look at patterns from the

past and expect to see them duplicated today. Many of them do it very successfully.

Astrologers have entered the stock market arena, gazing at stars and the planets' alignment to foretell the future. No doubt a few crystal balls are in use today. You would do as well to put your "lucky" pet on the financial pages and use its first dropping to mark the pick of the day.

Regardless of what you paid for a stock, you will find, as I have, that the only realism is the ticker tape. It tells you what a stock is selling for right now, not what you wish it was or what it will be. Trying to apply reason, logic, or any other sane intelligent thought process is meaningless. Why? Because the market is irrational!

The desire to become a successful investor can be strong. With it comes the task of developing an investment strategy. What you do to support your interest usually sparks the jump from casual to successful investor. Even if you are not going to become a professional investor, you have to think and invest like one. When you learn this, you are on your way.

With this book, I intend to provoke your thoughts and challenge your beliefs; my goal is for you to understand and know how to invest. I have worked hard, sifting my experiences to offer you accurate, meaningful, and vital information that you will need. I wish to prepare you, as simply and completely as I can, to face the main investment challenges that await you.

Take fast hold of instruction; let her not go; keep her; for she is thy life.

—Proverbs 4:13

Education does not mean teaching people to know what they do not know;
it means teaching them to behave as they do not behave.

—John Ruskin