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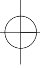
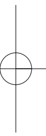
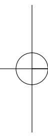
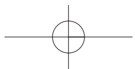






CHAPTER 1

A TALE OF THE PITS



9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 2

The Civil War was a crucible for American attitudes toward life, liberty, and the pursuit of money. The wrenching conflict tore at the very fiber of American life and caused a rapid transformation in views about accumulating wealth. Before the war, in what later would seem like a halcyon period, savings and frugality were heralded as traditional American virtues. During the war, a wave of general speculation in gold and stocks swept the country as the news of bloody battles filled the daily newspapers.

Oddly, the speculation came at the same time that Americans were also doing sensible financial planning. Before the war, only about $5 million of life insurance was outstanding; by 1865, that amount jumped to about $700 million. Clearly, the risk of war, as well as the trend toward increasing urbanization, created a need to pass wealth to the next generation independent of the traditional method of willing land ownership. Americans had always been speculative, but before the war, their speculation had been confined to lottery tickets and real estate transactions. The war brought with it, however, an unprece-

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 3

dented speculative binge in commodities and gold. Bucket shops sprang up around the country, fueling the fire even more. These gambling parlors gave the average citizen the impression that he or she could speculate in stocks and commodities like a professional. The average person on the street was goaded by stories of wealth and fortune created on the exchanges, and professional traders, inspired by even grander notions, believed that they could actually corner the entire supply of grain or gold if they possessed an iron will and enough speculative nerve. Clearly, the United States was on the verge of a great revolution in its attitudes and pastimes.

Lotteries proliferated after the war, especially in the South, where state legislatures were in desperate need of funds. Almost from the beginning, opponents of lotteries lobbied for abolishing them, calling them immoral and capable of debauching the average citizen. The futures markets, however, were on a slightly higher level. Their development during the nineteenth century in the shadow of Wall Street was a mixed blessing. These new markets had the dubious distinction of being equated with the tradition of manipulation and greed for which Wall Street was already well-known. Before the Civil War, dealing with stocks and other intangibles was not considered a respectable vocation; the traders themselves were considered to be on the edge of proper society. When the futures markets were developed, the public naturally looked askance at them and the people who traded them; however, it knew that if these new markets could succeed, their place in American economic life would be assured for generations to come.

Although the markets did succeed, their development was subject to chance. Just as the price of wheat or corn was subject to demand as affected by factors beyond one's control—climate fluctuations and insect infestations, for example—the futures markets were subject to public skepticism, internal dissension, and various external factors, all beyond their control. Unlike

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 4

the stock markets, the futures markets never commanded the widespread respect that the New York Stock Exchange (NYSE) begrudgingly earned over the years. To Easterners, the markets were the places where "hicks" traded agricultural commodities basic to everyday life. Even in their own backyards, the markets were seen as suspect places where predatory "city slicker" speculators took advantage of farmers who were not organized well enough to fight back. There were actually attempts made during the nineteenth century to outlaw futures trading at both the state and national level. The futures markets had crippling legislation passed against them, but they still managed to survive.

The introduction of futures markets in Chicago in the late 1840s certainly witnessed both the highs and lows of financial life. From the beginning, the economic value of futures was never seriously doubted, but those who traded them and their motives were constantly questioned. The nineteenth-century public vaguely understood what took place on the stock exchanges but had little time for the prima donnas who were their best known bulls and bears. Buying and selling railroad shares was a legitimate activity to most observers, but when a trader such as Jacob Little or Daniel Drew cornered stock by buying all of the available supply or plunged it by selling it short (forcing its price down, ruining the "longs" or buyers), the overtly speculative nature of the market rose to the surface. Adding insult to injury, the corners and the plungers both seemed to do quite well financially, while the average investor never seemed to get ahead of the game. The markets appeared rigged in favor of the professional trader.

However shoddy the NYSE's early reputation might have been, the Chicago Board of Trade would suffer an even worse opprobrium; it would endure legal challenges and hostile state legislatures that made the stock exchanges' problems pale by comparison. The futures markets had another unpredictable foe that did not trouble the stock exchanges, located mostly in

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 5

the East. In the Midwest, dealing in futures markets inspired widespread cynicism even among believers because of that region's strong, ingrained Calvinistic work ethic. Profit gained by trading intangibles was considered immoral; only real sweat and labor should be rewarded. How could one claim to be working when that person only shouted orders for buying and selling wheat on an exchange? The one who should be rewarded was the farmer whose sweat and toil brought the wheat to market. There was something inherently wrong in dealing with contracts rather than the real commodity itself. That strong Midwestern ethic would dog the futures markets for years.

The irrepressible force of westward expansion would push futures markets into the spotlight. As the country continued to grow, farms and cities began to develop west of the Mississippi River. Chicago became the gateway to this vast area, almost entirely devoted to agriculture. The railroads made Chicago a central hub, and by the time the Civil War began, the city was the main food supplier for the Union army and, along with St. Louis, a major terminus. The agricultural industry developed quickly, embracing farmers, millers, processors, warehousemen, and the marketers. It was from this last group that the futures markets developed. Trading grain futures on the exchanges was seen as a step in the marketing process of getting grains into the hands of consumers. Like their eastern stock exchange counterparts, futures traders claimed that their trading served a valid economic function. Without it, the farmers would be left with unsold crops and, even worse, potential economic ruin if prices suddenly changed during a crop season.

Experience proved otherwise, at least as far as farmers were concerned. Their crop prices were out of their control because they were in the hands of a small group of professional traders who manipulated prices on the futures exchanges for their own benefit. Making matters worse were the railroads, which forced

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 6

the farmers to pay high charges for getting their harvested crops to the markets. The noble profession of farming was being drained of its vitality by unscrupulous middlemen who capitalized on farmers' isolation and economic ignorance. The whole economic process of farming needed to be returned to its rural origins. City folk, schooled in the ways of speculation and exploitation, had the farmers in a vulnerable position, a situation which only legislation could redress. The country was moving westward too quickly, however, and the argument fell on deaf ears. America was on the move, and the markets were necessary for its economic development. The rural America so fondly recalled by Alexis deTocqueville was rapidly giving way to the new America of the railroad baron and the grain plunger. But even progress could not halt the controversy surrounding the true nature of futures trading. When combined with the stridency of the antimonopolist movement and the reforms suggested by Populists and Grangers, the issue of futures trading proved to be one of the more combustible of the post–Civil War era.

FINE YOUNG CANNIBALS

As Chicago and other Midwest cities began to grow, they developed chambers of commerce and other local organizations to cater to the business community. Locals gathered at these places to dine, share contacts, conduct business, or simply socialize. As early as 1836, in St. Louis a merchants' exchange was developed where all of the sundry commodities that traded on the quay alongside the Mississippi River were organized into a central marketplace. In 1856, Kansas City merchants organized a board of trade to buy and sell commodities in an orderly fashion. In Chicago, a similar sort of meeting place known as the Chicago Board of Trade (CBOT) officially opened in 1848 to less-than-resounding popularity. In the same

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 7

year, railroads and telegraphs reached the city, and the stockyards were opened. Not many in the business community showed much interest in the board; most were too busy contending with the city's explosive growth.

The farming business was in the throes of its own revolution that was quickly changing the face of the city. In the 1830s, Cyrus McCormick developed the reaper, the first device that could cut grain mechanically rather than by hand. After a trip to the Midwest, McCormick realized that his device was more suited to the wide, flat plains of the breadbasket states than it was to the rougher, hilly terrain of western Virginia, where he had been doing sporadic business with his new contraption. In 1848, he relocated his business to Chicago and started producing improved reapers. Within a couple of years, the time needed to harvest an acre of wheat was cut in half. When combined with the constant expansion of farmland, wheat and other grains flowed through Chicago at a rapid pace.

Although local businesspeople initially ignored the CBOT, the increased demand for wheat during the Civil War began to change their opinions about the organization. The CBOT quickly developed into the marketing arm of the wheat industry. Since Chicago was the nexus of this quickly emerging breadbasket, it seemed a natural location for a futures market, and the CBOT seemed the logical place to house it. Futures trading was an old form of arranging crops and other basic commodities for delayed, or future, delivery. It had been used in Japan and England with some degree of success, and the New York markets had traded some commodities futures as well. Originally, the trading was known as *when-arrived* trading, in which a buyer purchased a contract for a farmer's grain crop to be delivered at a date in the near future. The price was agreed to on a specific date, and the contract was binding. If the price subsequently declined, the buyer would still be obligated to make the purchase, and if the crop failed, the farmer

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 8

would remain bound to make delivery of the grain at the agreed-to price even if it had to be purchased elsewhere.

In this simple market, the chain of supply and demand was relatively stable. However, without futures trading, significant price risk was present. Buyers and sellers would have to rely upon the cash (or physicals) market with all of its vagaries and price risk. In the futures markets, uncertainty was removed. Buyers would know the price ahead of time, and sellers could rest more easily than if they had to suffer market conditions at the time of harvest and shipment. But what seemed like an excellent idea for both farmers and users of their products was constantly shrouded in ambiguity and quarrelling about the proper role of futures in everyday American life. How was it possible that such a sound economic idea could invite such heated, disparate opinions?

Between 1854 and 1864, the amount of wheat shipped from the Midwest more than quadrupled, and beef and other grains developed rapidly as well, quickly becoming a source of contention among critics of the distributors, whom many labeled war profiteers. As a result, futures trading developed at a fast pace. Problems concerning standard contract size, quality of grains involved, and delivery procedures were ironed out quickly, and acceptable futures contracts, mostly for wheat, became part of the grain marketing system. Farmers could sell their crops at a standard date in the near future; buyers could decide which crops they needed and settle on a price that was made on the exchange—technically in the *pits* where the contracts traded. The CBOT built its first pits, octagonal in shape, after the Civil War to accommodate traders. The pits were slightly concave areas on the CBOT floor where traders congregated and traded, using an open-outcry system to be heard. The system was up and running quickly. One standard feature of the market was not adhered to, however, even from the beginning. To be a true futures market, the seller had to deliver

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 9

the commodity and the buyer had to pay and take delivery. Yet, only a tiny fraction of contracts ever went through the delivery process. Most were traded actively before they expired and were then closed out, meaning that standard contracts were bought back that had been sold or contracts were sold that had been bought. These floor traders were not thinking of delivery; they were thinking only of speculating in the commodity.[1]

The nascent futures markets attracted speculators to the pits, where a seat could be bought quite reasonably in the years prior to the Civil War. These traders wanted no part of a physical commodity; they were interested only in selling at a price higher than that at which they had purchased contracts. Equally, they were also avid short sellers: They would sell contracts and later purchase them back at a lower price, profiting from the price drop. These floor traders became the backbone—and the bane—of the CBOT. Its rules and guidelines were written only for serious hedging purposes. Farmers sold and buyers, usually food processors, purchased grains and produce. The CBOT's bylaws and organization did not admit to speculative traders operating in the pits, although there was no way to actually prohibit their actions. Being recognized by the laws of Illinois as a "board" gave the CBOT the unique ability to set its own regulations and adjudicate its own internal problems, its decisions having the same weight as a court of law. Clearly, the CBOT could have expelled these traders, but what would have been the point? In futures parlance, these traders were the "locals" and added needed liquidity to the exchange floor, but their activities were not officially recognized.

Without the speculators, the exchange would have been a sleepy place. The traders, however, gave it verve and a somewhat tawdry reputation that became an integral part of Chicago folklore. While clearly quick on their feet, the traders were not the most serious-minded businesspeople; in fact, they would not even be regarded as businesspeople in the conven-

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 10

tional sense. They shared a reputation for bloody-mindedness, for conniving, and for a robust sense of humor that matched their counterparts on the NYSE, with whom they were often compared. They clearly were not ambassadors for their profession. In 1875, the CBOT played host to the king of Hawaii, who visited the exchange floor during a tour of the city. As the king was introduced, the traders cheered him wildly, but before he could speak, they broke out with a rendition of "The King of the Cannibals," a popular song of the day. The mayor then attempted to introduce him, but flubbed it when he began the introduction by saying, "I have the honor of escorting into your midst the king of the Can . . ." Obviously, the king did not appreciate the humor and stalked out of the exchange; meanwhile, the traders continued by staging a "native" dance on the floor.[2] Their reputation was already building.

Other exchanges developed in New York as the CBOT was enduring its growing pains. One was the New York Produce Exchange, which opened in 1862 to help supply Union army forces. Another was the New York Cotton Exchange, which opened in 1870 and started taking business away from New Orleans, the traditional home of cotton along with Charleston. As a result, New Orleans opened its own cotton exchange a few years later. New York's exchange attracted many Southern merchants who previously dealt cotton in New Orleans and other cities in the South. Some of these merchants, including Lehman Brothers, later became well-known Wall Street investment banks. New York and New Orleans would compete with Liverpool, in Britain, where a cotton exchange for both physicals and futures had been established in the early 1830s. The exchange played a vital role in Britain's development during the Industrial Revolution and provided jobs in manufacturing and in importing and trading. The Liverpool exchange also was seen as a place where young traders could make a quick killing. Americans were attracted to this exchange, as the mag-

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 11

azine *Harper's* noted, "each keeping a keen eye to the requirements of his own particular mercantile connection." The Liverpool exchange tried to imbue into merchants the long-standing motto of the London Stock Exchange: that a man's word was his bond. "A sense of honor which is derived wholly from social considerations of their common interest will prevent even an individual rogue from breaking his word on the Exchange Flags," the magazine added. "They are unanimous at least in this."[3] The American exchanges were a bit more liberal in their interpretation.

Throughout their early years, all of the exchanges emphasized their economic functions over the speculative. Futures traders tried, unsuccessfully, to contrast themselves favorably with the odious traders whom they claimed inhabited the NYSE—the notorious short sellers and large buyers who arranged corners to capture most of the existing supply of a particular stock. These sharp operators had already become part of American stock market legend; their antics were known to a good part of the reading public through the newspapers and the occasional book chronicling their activities. They and many other traders made their reputations on the floor of the NYSE. They were both admired and hated by commentators, as well as by other traders. It did not take long for the CBOT to develop its own legendary trader, Benjamin P. Hutchinson, who equaled any of the short sellers and large buyers in their techniques and ruthlessness.

Hutchinson, born in Massachusetts in 1829, went to work while in his mid-teens as an apprentice in a shoe store, earning a salary of $20 per year. An ambitious young man who grew to be six-and-a-half-feet tall, he hated his first experience working for someone else and waited for the opportunity to strike out on his own. Within a year, he opened his own shoe store next to his former employer and began to prosper, soon moving his operation to a larger town with better prospects. At the age of 20,

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 12

he appeared poised for reasonable success as a local merchant. He soon married, and in 1857, as he was on his way toward becoming a successful manufacturer and seller of boots and shoes, the financial crisis called the "Western blizzard" struck with full force. The crisis began with Western banks and then blew east; the NYSE suffered badly. The economic depression that soon followed ruined Hutchinson's business, forcing him to reconsider his prospects. At age 28, he made a fateful decision. He packed his wife and his belongings and moved to the Midwest, heeding the traditional Horace Greeley advice. The reputation of the CBOT was about to change, because the migrant brought with him certain skills that the CBOT traders did not possess.

After setting himself up in his adopted city of Chicago, Hutchinson naturally gravitated toward the CBOT and the wheat pits. The heavy war demand for wheat would ensure the future of the pits. Hutchinson, however, was not attracted to the marketing of wheat, only to speculation. In keeping with its original charter, the CBOT itself discouraged speculation, but discouraging frequent buying and selling in the pits was risky for the overall market because it did provide liquidity for true hedgers. As a result, speculators flourished. They bought and sold contracts constantly, attempting to make a few pennies per bushel. This activity became known as *scalping* and was something for which the exchanges became renowned. The floor traders began a cycle of trading patterns that the public could not understand. Instead of marketing wheat, they appeared to be gambling, attempting to anticipate short-term price movements or even to create them. Critics failed to make the distinction that what the buyer of a futures contract did purchase was an asset—albeit a short-term one—that allowed the buyer to take possession of a commodity if desired. Gambling was simply rolling the dice for a potential payout or loss. Ordinarily, hedgers who sold or bought represented the opposite ends of a

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 13

trade; now, however, they were nowhere to be seen. Trading patterns appeared to be going in "rings," disappearing into the ether rather than resulting in a single contract between the two end parties.

Speculation became the bane of the early futures markets. The basic notion of exactly how futures markets were able to help producers and processors was not totally clear in the minds of many in the agrarian Midwest. As far as the agrarians were concerned, anyone other than a real producer or user was a gambler. Cries of speculation and gambling were leveled at the dozens of exchanges—large and small—that were growing up not only in Chicago but in St. Louis, Minneapolis, New Orleans, Milwaukee, New York, and Kansas City. They were not idle cries but set off a wave of antifutures emotions that continued until the end of the nineteenth century. The *Chicago Tribune* lamented that the CBOT was not training young men with useful skills, that "business as at present conducted is training our young men to be gamblers rather than merchants."[4] Most commentators hoped that speculation in the pits would be only a phase in the city's development.

WHISTLING DIXIE

As the CBOT developed, the market for gold futures in New York became the speculator's market of choice. The price of gold reflected the fortunes of the Civil War and became the most speculative market yet witnessed in the nineteenth century. The traders' behavior became so repugnant to politicians and commentators that many began to doubt the patriotism of the marketplace in general. The reaction led to the first futures legislation ever passed.

In late December 1861, New York banks suspended specie payments, eliminating the gold standard in favor of newly created greenbacks. Two weeks later, in January 1862, the Gold

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 14

Room at the NYSE was established. The standard for gold trading was the $20 Double Eagle gold coin, and it was quoted as a premium of its face value. At first glance, the market appeared of be a true commodity market, for gold was the only item traded and was quoted for next-day delivery. Almost immediately, however, a market for *delayed* delivery sprang up. Prices were made either for cash or for a specific time period. For instance, *buyer or seller three* meant the number of days that the trader had to deliver. The organized gold market looked like a legitimate investors' market, but margin trading and delayed deliveries appeared almost immediately, as they had in Chicago. In the event that the exchange could not handle a special order, it could be taken to the Coal Hole at 23 William Street. This was an unofficial exchange, established by traders who did not join the NYSE. True to its name, it was a dark, dingy basement where traders carried out slick deals that even the new exchange would not countenance.

Speculation ran rampant during the Civil War. All sorts of investors began trading in gold, and not all were professionals. Tradespeople, shop clerks, and businesspeople were all buying and selling with great abandon, often for as little as 10 percent down on the full price. Soon, actual users of gold were joined by the speculating public. The game became the same one that was developing in Chicago: "longs" would watch the price rise and then settle with the "shorts" who could not cover their positions for delivery. Vast amounts of cash changed hands; brokers charged $12.50 commission for each $10,000 traded and could easily earn several thousand dollars per day simply by brokering orders. As the war progressed, the price continued to rise.

In 1862, when the Gold Room opened, the price was quoted between 102 and 133 (2 to 33 percent of $20 par, meaning $20.40 to $26.60). By 1864, the price spiraled to 220 from about 157. The price rose and fell on news from the war

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 15

front. Union victories raised the price; Confederate victories drove it down. But it only took about a month for the NYSE to recognize that the Gold Room was so speculative that its traders could be described as lacking patriotism. In a typical display of solidarity with the Union cause, traders would whistle "John Brown's Body" when Union forces scored a victory but switch to "Dixie" when Confederate forces emerged victorious. News of the traders' behavior infuriated Abraham Lincoln, who asked a colleague, "What do you think of those fellows in Wall Street who are gambling in gold at such a time as this? For my part I wish every one of them had his devilish head shot off."[5]

The NYSE obliged by banishing the traders a month later, in February 1862. The outcasts resumed trading at the Coal Hole, where they remained for a year before moving to and occupying Gilpin's News Room at the corner of William Street and Exchange Place. A board was placed outside on the sidewalk so that passersby could see the posted price of gold. For $25, a trader would be admitted to the floor of the exchange, which one contemporary kindly described as pandemonium at its best. Prices ran up and down on a daily basis, and the price of the commodity became even more volatile. Gilpin's News Room became the new Gold Room, and speculation was as rampant as before. Salmon Chase, Lincoln's treasury secretary, visited the room and was so infuriated by what he saw that he urged Congress to pass a new bill in June 1864 called the Gold Bill. This bill made delayed deliveries unlawful; all trades had to be settled within 24 hours. As soon as the bill became law, Gilpin's News Room was closed and the market moved to traders' offices and street corners.

There was the matter of settling claims. Once a trade was done, certificates were transferred from sellers to buyers. Lacking a clearinghouse of any sort, the details of transactions, along with certificates of ownership, were put into large canvas bags

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 16

and carried around town by boys acting as deliverymen. Often, these messengers were attacked and robbed on the street. Running became a more effective way of making deliveries; hence "runner" became a popular nickname for the messengers. More than one of these messengers occasionally disappeared with the bag, for the certificates could be redeemed by anyone. The integrity of the unofficial market was now clearly in doubt.

The reputation of Gilpin's News Room became so bad that traders organized to form the New York Gold Exchange in October 1864. Trading became more orderly and improved over the older system. The Bank of New York lent a hand and its long-established credibility by creating a clearinghouse system in which gold would not have to be delivered against a purchase or sale. Gold certificates, similar to the older, "hotter" variety, were established, each bearing the bank's imprint. By now, the market had clearly become more organized, but its speculative nature shadowed it nevertheless. Congress soon landed a bombshell that for years would reverberate over the markets: It proposed a tax on all sales of gold, leveling half of 1 percent as a form of sales tax. Traders objected vehemently, and the tax was abolished after several years, but its point had been made. Tax on commodities trading proved sobering for the markets.

In summer 1865, the gold certificates of the Bank of New York fell under a cloud when it was discovered that many of them delivered in the months after the Civil War ended were forged. As a result, the exchange established the New York Gold Exchange Bank to act as its clearinghouse, replacing the certificate system and giving the market a new credibility that had been seriously lacking. However, an unforeseen element would surface several years later when Jay Gould and his cohorts began to manipulate the price of gold. With the new markets and clearinghouse system in place, it was now easier to speculate on a large scale because of the relative ease to trade and settle

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 17

gold. Organized attempts to run the price up or down actually were simplified. Even apparent reforms could not cure the exchange's reputation for wild gambling and speculation.

Nevertheless, the Gold Exchange made its debut under the auspices of the NYSE. The gold traders fell under the watchful eye of the gold committee, which oversaw their actions. Several of the committee members were well-known exchange members and had well-established names; among them were Henry Clews, Dunning Duer, and E. B. Ketchum, who traded gold with the young Pierpont Morgan for his family bank's overseas accounts. The organizational changes put the Gold Exchange on a par with the CBOT, which during the Civil War moved ahead rapidly with its own internal developments.

The gold corner mounted by Jay Gould and his cohorts in 1869 became the best known market operation of its day. It also served as a model for others to follow in Chicago. Cornering operations were nothing new on the stock exchange, but an attempt to run up the price of gold, the precious metal serving as the basis of the nation's money, was the most audacious operation ever attempted. At the time, Gould's firm on Wall Street—Smith, Gould & Martin—began to buy gold at increasing prices in an obvious attempt to run its price. Part of the strategy involved the lack of government intervention. If the Treasury released any of the gold stock from Fort Knox, the price would fall immediately. Gould, however, seemed sure that intervention would not take place, and the price rose to almost 160. One of his cohorts in the operation was Abel Corbin, President Ulysses S. Grant's son-in-law. Most insiders assumed that Gould used Corbin to keep Grant from ordering an intervention. Finally, the president was persuaded to intervene, and a selling panic quickly followed. Gould already was in the process of liquidating his positions, however, and when the smoke cleared, he was rumored to have netted over $10 million on the operation.

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 18

The gold corner enhanced Gould's already slick reputation for audacity, but it did little for Grant's developing reputation for venality. In 1870, Congress convened the gold panic investigation, hearing testimony from all the principals involved. In 1871, Charles Francis Adams and his brother Henry also joined the fray with a muckraking book entitled *Chapters of Erie and Other Essays,* which discussed the gold corner and other Gould operations. The Gold Exchange closed in 1879, when the government authorized specie payments to resume. Despite all the publicity and economic repercussions of the gold corner, the technique was still viewed as a legitimate market operation to be employed by anyone with enough nerve and available resources. The Chicago traders proved that they had ample supplies of both.

CURBS AND CORRIDORS

Almost from the beginning, the futures markets did little to actually promote the marketing of commodities. The actual marketing took place among grain elevator operators and warehousemen, who often used the markets to ensure a steady supply of physical commodities for delivery. The markets were instead places where prices could be hedged or speculated. Only 3 percent or less of contracts were actually delivered as stipulated. The number of futures contracts traded as a percentage of actual wheat produced was extremely high. The trading became known as *wind wheat*—contracts that represented nothing but air. Almost all were closed before expiration, ending the buyer's or seller's liability. The "rings" created by the maze of trader activities confused and infuriated many on the outside who were not quite sure what occurred in the pits. Yet another trader activity proved to be the straw that almost broke the proverbial camel's back.

Clearly in violation of board rules, CBOT traders began

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 19

trading options on futures contracts. They would arrange very short term options—as short as one day—with other traders who allowed them to buy or sell depending on the direction in which they thought the commodity price was moving. The option would then give them the right to trade a futures contract. Options to buy, or *calls,* and options to sell, or *puts,* were very common among the traders and had potential to seriously impact exchange prices. Options in Chicago, however, were not referred to as calls or puts, as they were in the stock markets; they were referred to as *privileges,* and traders were engaged in *privilege trading.* The very notion smacked of monopoly and oligopoly. Unfortunately, in a region heavily influenced by the Grange movement with its strong antimonopoly sentiments, the very hint of the term *privilege* as practiced on an exclusive board of trade was almost too much for the Populists who began to use the CBOT as a rallying point for their political platforms.

Pit traders had already developed their reputations by the end of the Civil War. Hutchinson bought a seat on the CBOT for $10 a year before the war began and began actively trading, noting that the price of wheat was affected by the price of gold. So, he studied gold and traded wheat on the trends that he detected in the precious metal. The price of both commodities rose almost uninterruptedly. Hutchinson cornered as many wheat contracts as he could afford and then began selling them quietly as other traders clamored for more. When the price of wheat finally reached its high, Hutchinson had the temerity to sell even more contracts short. When the price of wheat declined, he covered them and made a small fortune. The entire operation had already become familiar, but Hutchinson's reliance on outside economic data was new. When one of the floor traders pursued him on the CBOT floor, imploring him to explain how he knew that prices would fall, the usually taciturn Hutchinson simply turned to him and snapped, "Gold! And war!"

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 20

That operation alone earned Hutchinson the familiar nickname "Old Hutch." He quickly became a legend in his own time, assuming a hallowed reputation like that of Jay Gould or Daniel Drew. In 1866, another physical corner only enhanced his stature. Again running counter to popular traders' opinion, Hutchinson bought all of the physical wheat in the Chicago warehouses and then all of the call options that other traders would sell him. The shortage in wheat began to make itself apparent as the delivery day for the contracts approached, and all the traders who were short had to bow before him as he settled their contracts at great profit to himself. He made well over a million dollars on the corner. But Hutchinson saw himself in a different light. As far as he was concerned, he was just an old country boy in the right place at the right time.

When confronted with the idea that his actions in the pits might be unethical, Hutchinson had a simple reply. "Ethics, the word has a curious rattle," he responded. "Its meaning is hardly known in business today. Yet no one has accused me of violating any laws . . . what I have done may likewise be tried by anyone who wishes to risk his fortune. The field is open to all." Then, in a clear shot at Wall Street stock manipulators, he continued by saying, "I have issued no spurious stock certificates, stolen no railroads, joined in no gold conspiracy. For a study of such type ethics, I would respectfully invite your attention to the gentlemen of Wall Street."[6]

Farmers who suffered through the highs and lows of fluctuating wheat prices did not see the distinction quite so clearly. Speculation in the CBOT pits coincided with a larger problem brewing in the Midwest that challenged the practices of pit trading in futures contracts. Investors in the East may have fretted over losing money in bad stock deals, but their losses did not necessarily challenge their very way of life. Farmers claimed that speculation was responsible for unstable wheat prices that could spell ruin for their livelihoods. Great fortunes were being

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 21

made—and lost—in the Chicago pits, but the price of wheat on the open market began a steady decline once the Civil War ended. Naturally, the farmers blamed the pit traders for rampant speculation that was hurting their incomes. The pit traders responded, somewhat crudely, but to the point.

After the Civil War, the Grange movement began speaking for farmers throughout the Midwest. From the agrarian point of view, farmers were constantly at the mercy of others—railroads, pit traders, Wall Street bankers, and unscrupulous warehouse operators who charged too much to store farmers' crops. Their argument was simple. When the Civil War ended, the price of wheat began its long, steady decline. In 1866, for example, the price of a bushel of wheat was about $2.06 per bushel, and within 10 years, it had declined to $1.03. The decline did not stop. By the end of the century, the price stood around 50 cents per bushel. During that period, corners and bear raids were netting speculators millions in the Chicago pits while the average wheat farmer was becoming impoverished. Was that not enough proof that the CBOT and other futures exchanges were nothing more than gambling pits where immoral men toyed with the price of wheat for their own gain?

Adding insult to injury were the activities of grain transporters and warehouse workers. Railroads charged high rates to small farmers while granting rebates to large businesses, which could afford to negotiate with them. Silo operators did the same, usually working in concert with the railroads. By the time farmers sold their crops, they often already had recorded losses for the year. The noble profession of working the land was being degraded by these city slickers who cared little for the plight of the farmers.

When asked about cornering wheat in the pits, Hutchinson remarked that no man could stand in the way of the crop, which metaphorically rushed to market like a great wind. Standing in its way was useless. Wheat was the basic crop of the

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 22

Midwest, and there was too much supply of it to manipulate. In this respect, Hutchinson was perfectly correct. Since the time when McCormick introduced the reaper, the number of labor hours needed to bring in the crop had declined by 50 percent. Between 1850 and 1880, the number of farms in existence nearly quadrupled and wheat production doubled.[7] The decline in real prices was explained by a doubling in capacity and efficiency. No wonder the plight of the wheat farmer was becoming a matter of regional and national concern. The prices of many other agricultural commodities managed to register small gains during the post–Civil War period, but no major crop witnessed serious price increases. The economics of the situation did not favor the farmer, but how did the speculators manage to make small fortunes from declining crop prices?

Speculation was the culprit as far as the agrarians were concerned. Futures trading was attacked on two levels. First, there were the exchanges themselves, where less than 3 percent of all contracts were actually delivered. If the pits were not satisfying their original objective of hedging, what possible justification could there be for their continued use? Second, the matter of options, or privilege trading, became a hotly contested issue because it was widespread and had no basis in exchange rules. Traders would arrange options between themselves, usually for short periods of a day to a week. Since exchange rules actually prohibited any form of trading other than futures contracts in the pits, options deals were usually struck on the curb of the street outside the CBOT or in the corridors of the exchange itself.

Little-known outside the futures or stock exchanges, options had the distinction of being the first financial vehicle in American history to be labeled "immoral." In general, the Grange movement thought little of futures trading activities. In a familiar Grange song of the period, the lyrics were not very subtle:

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 23

> There are speculators all about, you know,
> Who are sure to help each other roll the ball,
> As the people they can fleece, and then take so much apiece,
> While the farmer is the man that feeds them all.[8]

The distinction made between options and futures was very simple. Essentially, futures were tolerable as long as delivery was accomplished in accordance with the contracts involved, whereas options were useless gambling instruments because they could not be used to make or take delivery of an actual commodity, only a contract on it. In today's parlance, these options were actually options *on futures contracts*, not on the actual commodities themselves. Traders liked them because they offered flexibility to buy or sell more contracts within one day or one week of the day in which a price was established. However, farmers and their representatives regarded them as useless gambling vehicles. Despite the rapidly growing economy in the 1870s and 1880s, farmers would win a temporary victory when antifutures and antioptions legislation appeared both in state legislatures and in Washington.

PIT WARS

After Hutchinson's notable corners in the late 1860s, activities among pit traders intensified. Farming wheat was not a particularly profitable adventure, but traders were making more money in one cornering or plunging operation than most farmers made in a lifetime. The Chicago pits quickly began turning out as many famous bulls and bears as the NYSE. Occasionally, Easterners would venture to the Midwest to try their hand at cornering an agricultural commodity. Attracted to the pits were stock speculators who saw them as simple, unregulated gambling arenas with fewer rules than the stock markets.

As time passed, futures exchanges became symbols of civic

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 24

pride. St. Louis built its new Merchants Exchange in its downtown, not far from the levee, in 1874. The new edifice quickly became the most important building in the city. Developers were quick to point out that the costs incurred were neither exorbitant nor met with borrowed money. "St. Louis is emphatically not a mortgaged city," declared the local newspaper at the time of the building's inauguration, "the great pile now rising slowly from its foundations, covering two thirds of an entire block, was not undertaken at a venture, or 'trust to luck' style of business. Money, ready cash to pay for it, was in sight before a brick was removed from the old building."[9] Ironically, supporters of the exchange wanted to point out that while activity inside the building may have been speculative, the building itself was based upon sound financing. Chicago had a similar civic point of view. Activity at the CBOT was interrupted by the Chicago fire of 1871, which destroyed the CBOT's headquarters at LaSalle and Washington. All of its records were lost. After operating in temporary quarters for almost four years, a new building was opened at Jackson Boulevard and LaSalle in 1875. It, too, became a symbol of the city's capitalist ethic. The new digs inspired traders. Within several months, some of the most spectacular corners yet attempted in the markets would be attempted.

While agricultural production increased in general, the supply of wheat through Chicago vacillated during the 1870s, giving the corners an opportunity. In 1871 and again in 1876, the amount of wheat flowing through Chicago actually dropped, and the speculators who were quick enough to detect the trend made a killing. Hutchinson had already taught them the virtues of examining economic data from outside the region before speculating, but even he could not have anticipated the extent of the grandiose plans that were being hatched. In 1874, William Sturges, a CBOT trader, attempted a corner in corn futures, and in 1878, Philip D. Armour

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 25

attempted a spectacular corner in wheat, as did James R. Keene, a Wall Street stock speculator who traveled to the Midwest to try his luck in the pits. These men all met with mixed results, but their operations drew the scrutiny of state legislatures, especially in Illinois.

Conservative sentiments prompted the Illinois Legislature to pass an anticornering and antioptions bill in spring 1874. However, what passed in the legislature and what occurred on the CBOT were two entirely different matters. Since the CBOT rules had the effect of law, its members did not give much notice to what occurred outside the exchange. Beginning in the summer of 1874, William "King Jack" Sturges mounted an ambitious corner in corn. He forced the prices up and sold short in an obvious attempt to convince other traders that he had failed. He then forced the prices up again, putting a classic squeeze on his fellow traders who were forced to capitulate and settle. The other traders returned the compliment and caught Sturges in a corner, but unlike them, he was unwilling to settle. The case eventually wound its way through the courts and was settled nearly five years later, after which Sturges resumed his place on the exchange. His past actions, however, cast the CBOT in a bad light. When his other corners, along with Hutchinson's corners, were considered, it was clear that the Illinois Legislature had reacted to real abuses in the market. But the issue was far from settled.

During the 1870s, another well-known speculator, who would also become one of the most notorious meat packers in the country, was also active on the futures exchanges. Philip D., or "Peedy," Armour was both a friend and foe of Hutchinson in the pits, where the two often matched wits, and fortunes, in elaborate market operations. Armour's reputation from an early age was substantial, although he was not quite the master trader that Hutchinson was. Born in Stockbridge, New York, in 1832, Armour had only a rudimentary education when he set

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 26

out for California during the Gold Rush with three friends, one of whom died en route. Rather than search for gold, he decided to start his own small construction company, and he began digging trenches used by miners in their search for gold, making almost $10,000 from his efforts. He then traveled back east to visit his home in New York State, but he stopped in Milwaukee on the way, where he entered the hog-packing business. From Milwaukee, he was lured to Chicago, where he founded Armour & Co. and brought in his brothers from New York State to help operate it.

Legend had it that in 1852, as a young man, Armour walked from New York State to Chicago because he did not have enough money for trainfare. Although false, such stories were characteristic of traders who liked to surround themselves with myth and heroic deeds. At age 20, Armour was already in California digging ditches. Like Hutchinson, however, he suffered adversity before becoming a well-known pit trader. His greatest financial coup came in 1865 in a market maneuver that rivaled any of the previous 50 years. Sensing that Grant's march on Richmond would mark the end of the Civil War and, with it, the high price of provisions (pork), Armour began selling provisions short in New York at $40 per barrel. When news of Lee's surrender did come, Armour covered at $18, earning over $2 million and an instant reputation. Unlike Hutchinson, Armour put the money to work into a useful business by starting the Milwaukee hog-packing company that bore his name. "I like to turn bristles, blood, and the inside and outside of pigs and bullocks into revenue," Armour often remarked.

Armour & Co. became known as embodying the worst abuses of the meat-packing industry. Although Armour was already dead when Upton Sinclair published *The Jungle* in 1906, his name would forever be linked with the meat-packing industry in Chicago. And like many industries of the day, the meat-packing industry was concentrated in several firms that

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 27

dominated it greatly, causing a Wharton School professor to remark that the five big Chicago and other Midwestern meatpacking firms were controlled mostly by New York bankers who recognized their monopoly on the industry and, as a result, sought financial alliances with the meat packers. The monopoly was so tight that "not only [do] they have a monopolistic control over the American meat industry, but have secured control, similar in purpose if not yet in extent, over the principal substitutes for meat, such as eggs, cheese, and vegetable oil products and are rapidly extending their power to cover fish and nearly every kind of foodstuff."[10] The meat trust, as it quickly became known, was by 1880 in total control of the meat-packing market. The trust was so tight that only the representatives of the five companies bothered to attend the daily livestock and meat auctions in Chicago, and the price that they agreed upon was the only price of the day. Usually, it was low. "No conspiracy is perceptible," wrote a contemporary commentator. "There is only an accidental harmony of minds."[11]

During the 1870s and 1880s, Armour was active on the futures markets, periodically arranging huge corners. In 1878, he cornered a high grade of wheat in Chicago and Milwaukee, sending the price soaring by over 10 cents per bushel. Then, he switched to corn and other grains before he again switched, this time to livestock. He cornered pork futures in the 1880s, raising the price by over 50 percent in two months before cashing out for a reputed profit of $4 million in four months.

The effect that this market activity had on farmers was staggering. The worst results were on those farmers who were in the process of delivering their crops when a speculator mounted a pit operation. One 1872 operation in oat futures was combined with manipulation at the warehouses, catching the attention of the *Chicago Tribune,* which described the situation: "A man in Illinois sold 15,000 bushels of his own oats on the Chicago market before the corner started, at 38 cents a

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 28

bushel to be delivered in June. A blockade of the railroad and warehouse facilities made it impossible for him to make the actual delivery, and he was forced to buy from the manipulators at 43 cents to settle his contract. When his oats reached market, after the corner ended, they sold for 31 cents a bushel. So, he lost 12 cents a bushel on his own oats."[12] After the affair, the newspaper suggested that the CBOT dedicate a new building that it was about to open to the "suppression of gambling."

Operations of that sort not only helped to strengthen farmers' fears about the markets but also continued to attract speculators, not all of whom were locals. James R. Keene, a well-known New York speculator, eyed Chicago with envy and decided that he could make a killing on the faraway exchange, much as he had done on the NYSE by operating manipulative pools. Keene was an established speculator and organizer of stock market pools who decided to become king of the wheat pits after hearing of Hutchinson's reputation. Keene was born in England but raised in California, where he tried his hand at all of the traditional Western occupations while he was still in his teens. He had been a muleskinner, a cowboy, and newspaper editor before he bought a seat on the San Francisco Mining Exchange, where he had already dabbled in gold. His intention was to corner wheat in the same fashion that Jay Gould had attempted to corner gold in 1869. He began wheat dealing in fall 1878 with money raised from a pool of New York investors. With a $5 million war chest, Keene began buying up wheat and was close to cornering the market within a few months. Then, suddenly, his brokers received sell orders via telegram and sold many of his positions before he could apply the final squeeze to the opposition pit traders. The brokers dumped 3 million bushels before Keene intervened, claiming that it was not he who sent the sell order. Perplexed, the brokers bought the positions back and continued buying another 11

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 29

million bushels on his orders. It then became apparent that Hutchinson had been selling him all the wheat he wanted, because there was actually a surplus of wheat in the area. However, the origin of the sell order remained a mystery.

Keene, among others, suspected Hutchinson of sending the telegram, but the source was to be found in New York, in the likeliest of places. One of Keene's major past antagonists had been the redoubtable Jay Gould, master speculator and perhaps the most hated man in America, for his involvement in the gold corner had caused a recession in 1873. Gould had diversified from railroads, where he earned his unenviable reputation, and was now a major investor in Western Union, which he had seized in a spectacular bear raid shortly before. A colleague of Gould informed him that Keene was overextended in the Chicago wheat market and that the time was ripe to destroy him. Gould was in an advantageous position to send an anonymous telegram, and before long, the wave of selling in Chicago made Keene's creditors and bankers nervous. By the time his creditors had finished with him, Keene was in the words of Matthew Josephson, "shorn, like the veriest lamb, of seven millions and turned adrift, a bankrupt. It was a grievous lesson."[13] Undaunted, Keene's attention again turned to New York, where he concentrated on NYSE stocks and later became the master market maker in U.S. Steel at J. P. Morgan's request. Even in his later years, his sharp reputation followed him. Bernard Baruch said in the 1930s that "under the SEC's regulations, Keene's methods in making a market are no loner permitted."

Like Hutchinson, Gould recognized the link between gold and commodities prices. A year after his famous gold corner, he was called to testify before a Congressional hearing investigating the corner and its effect on gold. When asked about his ramping of gold, Gould replied in terms that the wheat

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 30

traders well understood: "I went in with a view of putting gold up. At the time, the fact was established that we had an immense harvest and that there was going to be a large surplus of breadstuffs, either to rot or be exported . . . I found that with gold at [a premium of one hundred] 40 or 45, Americans would supply the English market with breadstuffs; but that it would require gold to be at that price to equalize our high price labor . . . with gold below 40 we could not export but with gold above 45 we would get the trade."[14] Arguing that he was helping exports did not necessarily convince Congress that his motives were patriotic, but it did illustrate that Gould, like Hutchinson, was aware of the factors that made the prices of commodities and precious metals move in tandem.

Keene returned to New York, where he soon resumed speculating in stocks—all the wiser for having dealt with Gould and Hutchinson. He became known as the "Silver Fox" of Wall Street and participated in many pools later organized by J. P. Morgan to prop up the price of stocks in which the legendary banker had an interest. However, his interest in Chicago futures demonstrated the reputation and vulnerability of the futures markets during the first three decades of their existence. The general reputation of the markets for creating wildly vacillating prices only made the Grangers and other critics skeptical about their usefulness. Moreover, the markets were not the only culprit in the cross hairs of the reform movement.

Chicago became the center of the country's breadbasket, and almost all wheat and corn passed through the city on its way to market. The warehousemen also made a fast killing by charging a couple of cents per bushel in storage charges regardless of whether they actually stored the grain. This served to increase prices, although farmers were left with the bill, cutting into their already meager profit margins. This rapacious attitude did little to help the grain marketing system.

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 31

Redress for the beleaguered farmers was left to the courts. One Illinois warehouseman named Munn was charged with violating a state law for operating a warehouse without a license. At issue was the matter of excess charges plus the fact that much of the wheat stored in his warehouses came from out of state and was in transit. The Grange movement contended that the railroads and the operators were interfering in interstate commerce and that Illinois had the right to fine Munn in the absence of any meaningful federal laws regulating interstate commerce. The Illinois courts agreed. Munn appealed his conviction to the Supreme Court, which in 1877 found against him in the celebrated case *Munn v. Illinois.* The decision was the first meaningful one made by the court in years concerning interstate commerce. The *Chicago Tribune* put the warehousemen into perspective when it stated that "the name of a Chicago warehouseman has become a synonym with that of a pirate in the agricultural districts and there has been ample justification thereof."[15]

The Grange movement would have little to sing about in the years that followed. The Munn decision effectively was rolled back in 1886 by another Supreme Court case, *Wabash Railway Co. v. Illinois,* which stated that states could not regulate railways that simply passed through their jurisdiction. The uproar caused by that decision prompted Congress to pass the Interstate Commerce Act the following year, establishing the Interstate Commerce Commission as the regulator of the railroads. The battle against the railroads and the warehousemen became detached from the separate but equally compelling case against the futures exchanges as time wore on. From the farmers' point of view, however, they were being held hostage by enemies on several fronts—Eastern speculators who ran the railroads, warehouses, and exchange pits. The result was a combination of wildly fluctuating prices and additional charges, adding to their woes. The legislatures were the only

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 32

recourse available, so the battle against the exchanges was pursued in state capitals and, eventually, in Washington.

A DROP IN THE BUCKET

Adding to the exchanges' woes were the infamous bucket shops of the nineteenth century. Already well-known in the New York stock and gold markets, bucket shop operators naturally took to LaSalle Street as they did to Wall Street. The first bucket shops appeared in Chicago in the mid-1870s. For only a few dollars, the small investor could play the market like Keene and Hutchinson. The bucket shop was nothing more than a betting parlor where a few dollars would allow the average man in the street to assume a "position" in stocks or futures.

Bucket shops charged their investors only a small fraction of the price of a stock or futures contract. The futures markets themselves required only a small fraction of the value of a contract to be deposited in cash for a trader to open a position. Naturally, that trader was responsible for the entire amount of gain or loss that followed, but the enormous leverage offered by the small margins was very appealing. Bucket shop customers were under the impression that they were offered the same sort of leverage when, in fact, they were only making a bet on the market's direction. Bucket shop operators were neither members of the exchanges nor qualified brokers; they simply ran betting shops where money was taken and (sometimes) paid back when there was a profit.

Bucket shop operators were nettlesome pests. The CBOT finally had to ban them from the exchange floor, where they would wander about to check out the price action before taking bets. Since only pit traders were allowed on the exchange floor, the CBOT thought that the bucket shop operators would sully its reputation. The streets adjoining LaSalle were adorned with bucket shops, and there were many more spread around the

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 33

country. Oddly, they formed the first retail body of brokers, although they were independent and could assume a variety of forms and levels of sophistication. Nevertheless, they were all bogus, and more than one was known to disappear if the bets moved against it. Returning customer money on a net basis was not part of their "service." In the absence of what are known today as retail brokers, bucket shop operators did a brisk business despite the risks and the shadowy figures among them.

By the latter part of the nineteenth century, the CBOT and the bucket shop operators were at war. Many operators witnessed the success of pit traders and decided to follow in their footsteps, taking a few shortcuts along the way. One of the most notorious was William Rodman Hennig, a bucket shop operator who in 1894 appeared in Chicago from places unknown with a few thousand dollars in his pocket. Within a year of his arrival, he opened a bucket shop under the grand name of the Equitable Produce and Stock Exchange, located in the basement of the Grand Pacific Hotel. He leased private telephone and telegraph wires and set himself up into what appeared to be a miniature exchange with all the trappings. He was soon doing a brisk business and moved his exchange to more spacious quarters, changing its name to the Consolidated Produce and Stock Exchange of Chicago.

Having established a headquarters, he then produced official-looking literature to announce his business. Advertising appeared, announcing the purpose of the new business. "The Consolidated Produce and Stock Exchange," it began, "is so organized that stocks, securities of all kinds, and grain and provisions may be dealt in and handled on the floor of its exchange hall by and between members under rules, regulations, and bylaws of the most approved character." The new expanded operation opened for business in late May 1896; however, the last part of the ad's sentence attracted attention because several months earlier Hennig and his partners, as well as all of their

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 34

employees, had been indicted by a Chicago grand jury for operating a bucket shop and violating gambling laws.

Legal distractions did not bother bucket shop operators in the least. Hennig hired a dozen young men to act as traders and shout orders among themselves on his exchange's floor. Visitors to his offices were given the impression that they were in a legitimate broker's office when, in fact, the entire operation was a well-designed fraud. Hennig, though, did not lack for customers, either before or after his indictment. The straw that broke the camel's back was a letter that he sent to a CBOT official in July 1896 pledging $1,000 for the CBOT's bucket shop fund so that the legitimate exchange would succeed in its effort "to break up the bucket shop element in this city, as well as to suppress the illegal traffic in privileges."[16] The CBOT official to whom Hennig adressed the letter was the same official who had brought charges against him on behalf of the CBOT several months before.

Infuriated, the official, John Hill, again began a drive that eventually saw Hennig and his accomplices indicted and successfully prosecuted in 1898 after several police raids to gather evidence. Bucket shop operators were encouraged by some of the divided court decisions made in the past and constantly flew in the face of the CBOT until they were challenged. As a result of the Hennig prosecution, the number of bucket shops began to decline and would decline even more after the turn of the new century. But the damage they did to small, uneducated speculators was considerable. A Chicago newspaper succinctly summed up the plight of the bucket shop investor when it stated that "the bucket shop victim is a hopeful wretch. He pursues his hollow object with the devotion an opium eater has for his drug. But he rarely gains it. Sometimes he wins a small sum, and the proprietor always knows he will come back with it. When he wins a large amount the keeper evades settlement . . . in the long run, practically speaking, it is impossible

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 35

to win because the keeper won't allow it." The paper concluded that bucket shop operators were "among the most heartless, rapacious and cruel harpies that prey upon the deluded poor."[17]

The exchanges wanted rid of them and muckrakers ranted against them, but somehow the bucket shops managed to find a place in the odd ideological battle that waged in the nineteenth century between Populists and the business community. The world of the Populists was one of rhetoric and appeals to emotions. Policy positions often were not based on fact and often played to a very basic regional instinct that consciously sought to set agrarian interests in the South and Midwest against those in the East. Conspiracy was often at the center of their arguments. An extremely popular book that circulated in the Midwest during the late 1880s was *Seven Financial Conspiracies That Have Enslaved the American People,* written by S. (Sarah) E. V. Emery. In its discussion of conspiracies, many based on the manipulation of gold by Eastern bankers, the book attempted to show how the average agrarian was at the mercy of the Wall Street crowd that cared only for money, not products. The subtitle of the book rang especially true in criticisms of futures, but the refrain became standard in Populist rhetoric: *How the Producers Have Been Robbed by the Non-Producers Through Evil Legislation.* Facts and figures were of little use in these sorts of attacks. Implying that Easterners were at the heart of the problem played well in the heartland.[18]

Bucket shops benefited from this general sort of public relations because they were seen as a challenge to the futures market monopoly in the distribution system. The fact that they were nothing more than gambling casinos did not seem to matter; as far as Populists were concerned, bucket shops provided alternatives to the predatory pit traders and gave the little person a chance to make a buck. Adding insult to injury, some CBOT members often took orders from individuals on behalf

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 36

of bucket shops, moonlighting for a few extra dollars. As far as the person on the street was concerned, bucket shops looked legitimate, and there were times when the small bettor actually won. Bucket shops posted securities and commodities prices on blackboards in their windows, usually showing prices on fictitious trades. The more sophisticated shops actually employed ticker tapes and telegraphs, or at least led their customers to believe that they did. The telegraph became the shops' battleground with the CBOT in its attempt to reassert its authority over the markets.

The CBOT asserted that any telegraph company holding space on its trading floor should be prohibited from supplying information to bucket shop operators. Such a task was not easy, for bucket shop operators constantly infiltrated the floor of the exchange, seeking tips and prices. The bucket shops responded by going to court. Unfortunately, the courts were never of the same mind, often confusing the operations of the CBOT with those of the shops. Finally, the issue wound its way to an Illinois legislative committee, which sent a delegation to the CBOT. After some extremely conflicting and confusing testimony, the committee concluded that when comparing the CBOT with the bucket shops, "one is legitimate as the other, and the business of one as honorable as the other." Even worse for the exchange, the *Chicago Tribune* concluded that by attacking the shops, the CBOT was attempting "to do away with its rivals."[19] After 35 years of existence, the CBOT was looked upon as little more than a betting parlor, serving manipulators. Because it was deemed a necessary evil, it was felt that no reason existed for the person on the street to not be allowed in on the action as well.

Liked or not, bucket shops remained on both LaSalle Street and Wall Street. They were a problem that state governments were not able to control. Controlling the activities of traders on exchanges and bucket brokers was not something that could be effectively controlled by the government during the nineteenth

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 37

century. The best that states could do was pass local laws and hope that traders and exchanges would fall in line. Even after 1874, the Illinois antioption law remained vague and rarely enforced. But on the federal level, prospects were better for fighting the sorts of injustices that agrarians felt they had suffered. Futures exchanges and options trading became part of a larger issue that began to boil over after 1890. Antifutures and antioptions laws became integrally intertwined with the larger economic issue of the day. They were included in the silver question that dominated political discussions, especially during the presidential election of 1896.

In the late nineteenth century, the argument about the nature of futures exchanges was still as heated as it was during the Civil War. The old pit traders maintained that what they did was risky but still refused to recognize a larger role for the markets. Hutchinson's son Charles followed his father to the CBOT and was elected president in 1888. He made a speech on the occasion in which he claimed that the CBOT was a significant benefit for the farmer, even going as far as claiming that the institution was philanthropic. When he had heard his son's remarks, Hutchinson turned to a fellow board member on the floor and said, "Did you hear what Charlie said? Charlie said we were philanthropists! Why bless my buttons, we're gamblers. You're a gambler and I'm a gambler." But he later added a note of realism: "Even farmers can say a good word for a speculator, if he happens to be working in their favor."[20]

Despite the fact that the newer breed of CBOT member saw a wider role for the exchanges, the old guard was still up to its customary tricks. In 1888, the CBOT received a shock when rumor reached the floor that Old Hutch was dead. Traders paused in shock, wondering what to do. Shortly, they began selling wheat in droves, driving down the price. Hutchinson had been the central figure in wheat selling, and holding long positions was quickly determined to be imprudent. It was time

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 38

to sell before the entire market collapsed. True to form, the reports of his demise proved premature: Hutchinson was very much alive but hospitalized after falling down a flight of stairs. Many sellers were quick to react to the rumor, however, and lost in the process. Most traders wished that he had not recovered so soon, for within a year he mounted another spectacular wheat corner, driving the price up temporarily by almost 50 cents per bushel.

LEGISLATE AND SPECULATE

By the 1890s, Populists began to unite to formally oppose futures exchanges. A move was made to pass an antioption and antifutures market law in Washington for rescuing farmers from the clutches of speculators. To extirpate speculators was a difficult matter, however; the exchanges were now well established, so legislating them out of existence was probably impossible. At the center of the exchanges was scalping. It was felt that if scalping could be reduced, the exchanges would return to the purpose for which they were created—to provide buyers and sellers with guaranteed prices.

To reduce the amount of speculation, a proposal was devised that would tax the sale of grains or cotton futures contracts when the seller did not actually own the commodity. The proposal got its impetus from the sales tax on gold passed during the Civil War. It was acknowledged that the tax would quickly reduce the amount of short selling in the markets. But after 40 years of trading, it was not universally clear whether it was a good idea. All speculation led to increased liquidity on the pit floors, and while that may have helped the plungers and the corners, it also aided hedging real positions. More specific laws, such as the antioption law of Illinois, had proved fruitless in the battle, so taxation appeared to be a viable alternative to reduce pit gambling.

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 39

By the early 1890s, several minor antifutures bills had already reached Congress, but they had never gotten out of committee conferences. Then, in 1892, a bill sponsored by Representative William H. Hatch of Missouri and Senator William Washburn of Minnesota crystallized many of the earlier attempts. The Hatch bill began making the rounds of various Congressional committees and stirred heated debate on both sides of the issue. A 10 percent tax was its centerpiece, eliciting comments from farmers, food processors, and futures traders. Testimony poured in from both detractors and supporters, and the bill managed to touch every sensitive nerve. Charles A. Pillsbury, the nation's largest miller of wheat and other grains, supported the bill, knowing that it would hinder the pit traders whom he blamed for erratic prices and economic uncertainty. Others were not as certain. During the Civil War, gold speculation had been rampant in New York before Secretary of the Treasury Salmon Chase banned gold futures trading by speculators in 1864. The prohibition was ephemeral, however, and trading resumed shortly thereafter. What was the point in banning a practice if market forces would unite to defeat the ban in short order?

A clever defense of the futures exchanges came from those who waved the specter of the British in the face of the opposition. These individuals claimed that if futures trading dried up as a result of the Hatch bill, the markets would shift to Britain. Liverpool already had the world's largest grain futures market, and it would take decades for Chicago to supersede Liverpool's market in size and importance. Did antifutures forces want to give the British a backdoor entry to one of America's vital markets? This was clever; the British were in favor of the gold standard, whereas Midwesterners and Populists favored a dual-metal standard of gold and silver. Because the British were the largest foreign investors in America at the time, they had created some enmity in agrarian regions by being absentee land-

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 40

lords. Claiming that the Hatch bill might actually help line their pockets even more seemed appealing.

The bill went for a vote in 1893. It passed the House by 167 votes to 46 and the Senate by 40 votes to 29. The geographical breakdown of the voting followed what was expected of the various regions. It was opposed only in the House and the Senate by the Middle Atlantic states and southern New England—and then only by the narrowest of margins. The rest of the country favored it by a resounding "yea" vote in both houses. The final vote revealed that over 80 percent of Congress had voted for the bill.[21]

Yet, the Hatch bill never became law. Proposed amendments were never added, and the bill died a slow death after Congress adjourned. The issue was, in fact, never raised again after Congress recessed. It became apparent that agrarian opposition to futures trading was still as strong as ever but the legislation would not see the light of day. Then, a severe recession followed a stock market panic, leading to J. P. Morgan's famous rescue of the U.S. Treasury by helping to sell it a gold-backed bond. In 1893, Congress repealed the Sherman Silver Act of 1890, and the country returned to a gold-only standard. These two events were much more momentous than anti-futures legislation, eclipsing the Hatch bill. Also, the Populist influence began to wane even before the presidential campaign of William Jennings Bryan against William McKinley in 1896. Against this political backdrop, pit traders had little to restrain them in their dreams of corners and manipulation.

The Hatch bill did contain several lessons for posterity. One futures market would be regulated during World War I, and the failure of the bill proved an invaluable lesson to future regulators. It did underscore the fear of short selling, however. The process was vital to the markets, but it ran against the grain of conservative thought throughout most of the nineteenth century. How could someone sell something he did not own with

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 41

the intent of buying it back at a later time for a profit? As far as critics were concerned, it was only an excuse for forcing prices down to make a profit. There had been several vain attempts to curtail the practice, dating as far back as the War of 1812 in New York, but all proved futile. The Hatch bill was nothing more than an anti–short selling bill in disguise, with its proposed 10 percent tax a warning to traders not to sell something that they did not own.

Lotteries, the one popular form of gambling, were also in legislative trouble at the end of the nineteenth century. The many state lotteries that had begun since the Civil War were constantly attacked by critics on grounds of being immoral, leading to their gradual abolition during the 1880s and 1890s. The one exception was the Louisiana lottery, the most successful in the country in the latter half of the nineteenth century. A private company was granted the right to operate in Louisiana, and its lottery was enormously successful. When it first began operation in 1868, the lottery held lavish ceremonies whenever drawings were made. The lottery's organizers hired Confederate General P. G. Beauregard to preside over the drawings and they managed to pay handsome dividends in many years to the lottery's investors. Its tickets were sold nationwide, becoming even more popular as many states banned their own lotteries. In 1899, however, the national antilottery movement finally ensnared it. Congress passed a law that prohibited the use of public mail service for selling lottery tickets, effectively putting an end to Louisiana's lottery operation. By the time the law was passed, 42 of the existing 44 states at the time had already banned lotteries, and the ban effectively ended the practice of selling tickets via the mail.[22]

The ingenuity of lottery operators continued, however. Many of the tickets sold in the United States were from foreign lotteries and their operators simply avoided the public mail by using private courier services to deliver the tickets across state

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 42

lines. Then, finally, Congress put an end to that practice as well, and the issue wound its way to the Supreme Court. In *Champion v. Ames* (1903), the court ruled that Congress indeed had the right to prohibit the transport of lottery tickets by means other than that of the U.S. mail. The *New York Times,* taking note of the decision, queried whether "the right to 'regulate' includes the right to prohibit commerce in articles deemed prejudicial to the public health or morals."[23] The court apparently thought it did. Moreover, supporters of national securities legislation thought that the law would help them in their quest to impose regulations on the stock exchanges, but the law was not applied to securities dealings.

Much of the furor surrounding lotteries was as practical as it was moral. Besides believing that gambling was unconstructive, leading to idleness and debauchery, many were opposed to them simply because they were ripe with fraud. Often, ticket holders were defrauded when too many tickets were sold or when the potential payout was exaggerated. State legislators frequently were bribed so that the lotteries could obtain favorable legislation and were continued to be bribed so that the lotteries could continue operating. The Louisiana Legislature became as well-known for corruption as the New York Legislature had been during the Tammany Hall days, and the bill introduced during Benjamin Harrison's presidency to deny the use of public mail service to lotteries was meant to be an effective antidote to the fraud. In many ways, the opposition to lotteries was framed in a similar fashion to the opposition to futures markets, and it certainly was more successful.

While Washington was busy with economic affairs, the traders again were having their way in the pits. Another massive corner was organized in 1897 by Joseph Leiter, a newcomer to pit trading. Leiter was one of the new breed of floor traders who saw opportunity in the Chicago pits. Born in Chicago in 1868 to real estate magnate Levi Z. Leiter, he

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 43

attended Harvard before returning home to Chicago. His father entrusted him with a million dollars, hoping that the young man would manage his real estate holdings. But Leiter had other ideas and headed straight for the CBOT, where he had already decided he would make his own fortune. He was a bit of a fish out of water, because the pits were not accustomed to college-educated traders.

Leiter's plan was to corner the supply of wheat, emulating Hutchinson in the process. He did not keep his ambition a secret. "Mind you, he is a bright boy," remarked the old trader, "but it can't be done again. The market is too big, too immense." Nonetheless, Leiter proceeded with abandon, and after several false starts, he finally made some money in the pits and began to mount his corner—the largest operation of its sort to date. The syndicate that he formed to pursue the operation cornered nearly 16 million bushels at a time when world reserves of the grain were running low. In addition, he planned to corner wheat in December, when the supply was naturally short because of the winter season. It appeared that Leiter had successfully cornered December wheat, but then the plot thickened.[24]

While Leiter's syndicate was buying all of the contracts available, Philip D. Armour and his agents had been selling. Suddenly, traders were not sure that the market had been cornered successfully, especially if Armour was involved. In a classic confrontation of liar's poker, Armour asked Leiter face to face what he had in mind. Leiter laughed at him, telling him that he would force him to settle the contracts at a great loss. Armour became so infuriated by the upstart that he went away and devised a method to break the arrogant young man rather than capitulate to him. He ordered his agents to send all available wheat through Duluth, Minnesota, to be forwarded to Chicago. He then hired adventurous sailors who were willing to sail the Great Lakes in the dead of winter to deliver the wheat.

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 44

He even hired tugboats to break the ice on the lakes so that the boats would arrive before the delivery date of his contracts. To the astonishment of all, he delivered his wheat on time, breaking Leiter's corner in the process. Leiter profited but not by the amount originally hoped for.

As a result of the corner, the price of wheat rose 24 cents a bushel to $1.09. Leiter then cornered May wheat with the profits he made from the Armour deal, and the price shot up to $1.85 per bushel. But Leiter became too greedy. Not knowing enough about agriculture, he continued his new corner into the summer months, when a record crop followed. A surfeit of wheat flowed into Chicago, and his positions collapsed. What had been a $7 million paper profit in May disintegrated into a $9 million loss, absorbed by his father. Ever the gentleman, Armour sent Leiter a photograph of himself, inscribed "with best regards," after the escapade ended.

Leiter learned a lesson from the affair, and the family fortune was reduced about 9 percent. He went on to become a typical heir to a family fortune of the period, dabbling in horse racing, philanthropy, and other acceptable sporting and social pastimes. He maintained a liquor vault at his Washington, D.C., home, which robbers once raided of $300,000 worth of liquor and wines. When he died in 1931, a local newspaper eulogized him as "cut in the pattern of the daring visionaries who built a titanic Chicago out of a mud flat pioneer village."[25] He was best remembered, though, for the attempted wheat corner, perhaps a lesson that getting out early with a smaller-than-anticipated profit is better than no profit at all.

Leiter did have one success, but probably not of the sort that he envisaged. Farmers were elated over the increase in the price of wheat caused by his corners, and many made handsome profits by supplying Armour. In this case, the wild speculation worked in their favor. Criticism of the speculators was nowhere to be found, but the quiet would not last for long. The

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 45

Progressive movement was gaining strength and would prove to be a more significant adversary than the Populists. Conspiracy theories would give way to more cogent arguments about what ailed America, although a clear break with the Populist past was not possible. The idea that speculators and rapacious Easterners dominated the futures markets would continue. Old notions died hard in the heartland, where anyone who was not a farmer was viewed with suspicion.

Armour did not confine his speculation to the futures pits in the 1890s. He also was active on Wall Street, where his tips were known to move the prices of railroad stocks, especially those operating around Chicago. Speculating in more than one market was relatively common before the turn of the century as communications improved and were faster than ever before. In late 1893, Armour was talking up the price of the St. Paul & Duluth Railroad, which, like many other railroad shares, was not faring well in the market. A local Wall Street newspaper reported that "he declares he is as firm a believer in the stock as he ever was and has been buying it on the way down." The stock retreated from a high of $80 per share and was currently around $27 when he started bulling it. "He swears that there is no human power that can prevent it from advancing again to the high prices at which it sold years ago," the newspaper added.[26] As it turned out, the opposite was true, and Armour lost a sizable amount on the trades.

The days of the megalomaniac corners and massive bear raids appeared to be waning but still managed to survive the nineteenth century. Ironically, Hutchinson's career came to an end with another ambitious corner. In 1889, he was lured into believing that a massive corner in wheat and corn could still be accomplished, and he ventured millions to prove himself once again. However, after reading the markets correctly for years, he overestimated the demand for the two commodities and paid a heavy price. The prices did not respond to his massive

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 46

buying efforts, as international financial developments began to take their toll on commodities prices. In 1890, the British banking house Baring Brothers failed, putting a serious damper on foreign—especially British—investment and speculation in the American markets. As gold began to flow out of the United States, depressing the price of wheat and corn, Hutchinson refused to read the market signals and continued to purchase contracts. Hutchinson was the same trader who, years before, had unraveled the connection between gold and grain prices, but he misread the situation in 1890 and suffered heavy losses as a result.

Within a year, Hutchinson's fortune and reputation were broken. The last attempt at a corner lost him $2 million in July corn, causing him to retreat from the pits permanently. After his personal debacle, Hutchinson secretly decamped to a small office near Wall Street, living anonymously for months before being accidentally discovered by a visiting Chicago businessman. Although he eschewed the pits, he still needed to be near the action, and Wall Street seemed like a natural place to hide. But he had lost his market touch and was growing too old to influence the markets. Although he occasionally was seen in the galleries of the CBOT following his retirement, he never again traded on the floor of the CBOT. He spent his last years alone at a retirement home in rural Wisconsin but not forgotten in the pits where his legend lived on.

Hutchinson died in 1899, marking the end of a half-century of grandiose speculation. Younger traders were eager to take his place as the king of the wheat pit on the CBOT. These larger-than-life characters immediately stepped forward to assume his mantle. The idea of cornering the entire wheat supply of the United States held its allure, although agricultural production continued to increase and the supply of most agricultural commodities appeared too large to corner. That would not, however, stop speculation on the exchanges. In the

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 47

years preceding World War I, different exchanges would begin to regulate themselves with greater efficiency and integrity. The Supreme Court helped define the markets' role in several important rulings early in the new century. For better or worse, the futures markets did leave their mark on society. In the late 1890s, a play called *Other People's Money* started a run in New York, starring Hennessy Leroyle, a well-known period comic actor. Leroyle played the role of the king of the wheat pit, who just happened to bear a strong likeness to Joseph Leiter. Louis Brandeis would later use the same title in a book that he wrote to excoriate those bankers who exploited the public during the heyday of the Progressive Era.

NOTES

1. *Standard* meant that the contracts did not vary on the exchanges listing them. It did not imply a nationwide standard by any means. Contracts in Chicago could not be mixed with contracts in St. Louis or Kansas City. If a contract had been bought on an exchange, it needed to be sold on that exchange only, and vice versa.
2. Jonathan Lurie, *The Chicago Board of Trade 1859–1905* (Urbana: University of Illinois Press, 1979), pp. 30–31.
3. *Harper's Weekly,* September 5, 1874.
4. *Chicago Tribune,* September 15, 1865.
5. Kinahan Cornwallis, *The Gold Room* (New York: A. S. Barnes & Co., 1879), p. 7.
6. Edward J. Dies, *The Plunger: A Tale of the Wheat Pit* (New York: Covici-Fried, 1929), p. 50.
7. U.S. Department of Commerce, *Historical Statistics of the United States: Colonial Times to 1957,* pp. 278–297.
8. James L. Orr, ed., *Grange Melodies* (Philadelphia: Geo. S. Ferguson Co., 1912), p. 193.
9. *St. Louis Republican,* June 7, 1874.
10. Theodore J. Grayson, *Leaders and Periods of American Finance* (New York: John Wiley & Sons, 1932), p. 396.

9394_Geisst_01.b.qxd 8/13/02 1:36 PM Page 48

11. C.E. Russell, *The Greatest Trust in the World* (Chicago: Ridgway-Thayer, 1905), p. 286.
12. Lurie, *Chicago Board of Trade,* p. 55.
13. Matthew Josephson, *The Robber Barons* (New York: Harcourt Brace, 1934), p. 208.
14. Report of the Committee on Banking and Currency. *Gold Panic Investigation,* 41st Cong., 2nd sess., Feb. 28, 1870, Rept. 32, p. 132.
15. Lurie, *Chicago Board of Trade,* p. 53.
16. John Hill, Jr., *Gold Bricks of Speculation* (Chicago: Lincoln Book Concern, 1904), p. 80.
17. *Chicago Journal,* July 16, 1898.
18. Certainly not everyone in the Midwest subscribed to the conspiracy theories. A congressman from Wisconsin, Joseph W. Babcock, refuted the assumptions made in the book as bogus before Congress seven years later. He then published a pamphlet entitled "A Populist Humbug Exposed," which outlined his position.
19. Lurie, *Chicago Board of Trade,* p. 87.
20. Dies, *The Plunger,* p. 138.
21. Cedric B. Cowing, *Populists, Plungers, and Progressives: A Social History of Stock and Commodity Speculation 1890–1936* (Princeton, NJ: Princeton University Press, 1965), p. 22.
22. George Sullivan, *By Chance a Winner: The History of Lotteries* (New York: Dodd, Mead, 1972), p. 57.
23. *New York Times,* February 24, 1903.
24. December wheat means that contracts were due for December delivery, expiring on a specific day in that month. Futures contracts traded on a quarterly basis so that a contract would become due at every season of every year, namely, December, March, June, and September.
25. *Wisconsin State Journal,* April 12, 1931.
26. *Wall Street Daily News,* December 23, 1893.