

## The Future Trend of Security Prices

*Changes Produced by the War affecting the Price of Capital, Security Prices, Industry and Commerce will, according to the writer, seriously affect Canada as a Borrowing Nation*

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It is of the utmost importance that business men and investors inform themselves on the future trend of interest rates and commodity prices since on the soundness of their knowledge connected therewith their future welfare depends. As a rule business men are impatient of mere theory and demand facts and more fact. Nevertheless, aside from the quite obvious truism that facts are of no value unless interpreted, it remains true that men of affairs, consciously or unconsciously, are the most active of all theorists since they are compelled daily to apply principles to practice. At no time in the industrial world was a knowledge of underlying principles more important than to-day, for business success depends largely upon gauging future market conditions. And in that sphere an understanding of economic theory which explains and accounts for fluctuations in the money and commodity markets is absolutely vital for success. Germany already realizes this and is already preparing feverishly to grapple with and solve the difficult problems that are bound to arise in the new economic world after the war. It is incumbent upon the British Empire and its Allies, therefore, as well as the United States to lay the foundations even now for future industrial and commercial success. In such a programme is of the highest importance to study the probable course of events in the great money markets of the world; for upon the relative abundance of investment capital, as well as upon low interest rates, future prosperity will largely depend.

### Forces Determining Interest Rates.

In this connection what business men will wish to know, above everything, is the probable trend of interest rates or the price of capital. To Canada this problem is of even greater significance than a future labor supply. It is admitted that labor will be required on an increasing scale for the development of this country; but the labor will be available, granted the right opportunities for its employment. These opportunities, apart from social welfare legislation, must be created almost entirely by an uninterrupted flow of capital from the United Kingdom and the United States; and that flow, both as to its volume and rapidity, will depend upon the price we are able and willing to pay for capital. The future rate of interest, therefore, is the question that should give business men in Canada most concern and is, moreover, the problem that needs most careful study.

It is not necessary to go into fine points of economic theory, fortunately, in examining this question. It may be said at once that economists are practically in agreement as to the two main facts in the case — name, that interest rates are the outcome of the functioning of two forces in the money market, the demand for, and the supply of, capital in the sense of an investment fund. This is merely the statement of an elementary proposition that needs no substantiation. The two points that do need elaboration, however, are that interest rates are closely connected with economic productivity and the estimate individuals make of future conditions and their future welfare. These two elements combined determine interest rates. If the rewards of industry are great not only will the demand for investment capital increase, but the motive for saving, in anticipation of higher interest returns, will be intensified. On the other hand, the fear of future want is an equally powerful force making for saving and the accumulation of capital. Any new factor which diminishes apprehension for the future acts as a check upon thrift, and lowers the level of the investment fund. It may be said, therefore, that a diminution of fear for the future tends to raise interest rates. And in this connection, also, it should be observed that anything that tends to remove industrial risk will operate in lowering interest rates. Insurance against risk is not, properly speaking, interest at all, and should be separated from the pure interest rate.

This rather formidable, but simple, proposition may be stated in another and more concrete way. A generation ago if the ordinary family income had been increased from \$1,000 to \$1,200 the additional amount would, in most cases, have been turned into capital. During that period, however, business risks have been diminishing steadily, as have also risks to labor arising through unemployment. In a word, we have less fear of the future, as a rule, than our

forefathers; and as people think less of what tomorrow may bring, the tendency is to save less and spend more. Thus an increasing industrial output makes for an advance in interest rates in two directions — it stimulates the demand for capital on the part of producers and at the same time, through steadier work, higher wages and increased profits, weakens the effective desire for saving. The bearing of all this on security values will be considered later.

### Destruction of Capital Through War.

It is important to investigate, at this point, what effect the destruction of wealth, during the course of this war, will have upon the immediate future of trade and industry. The depressions of the past century, as distinct from financial panics have been occasioned, for the most part, by a failure of the crops whether of wheat in America, cotton in the Southern States, or rice in China and India. Underneath all the elaborate mechanism of credit the world's business is carried on by an exchange of goods for goods — the textiles of Lancashire for the jute and wheat of India, the cutlery of Sheffield for the products of the packing-houses of Chicago and Kansas City, and so on throughout the whole list of the world's labor output. Any considerable failure, therefore, in one of the world's staple crops upon which millions of people depend for their sustenance and purchasing power must inevitably slow down the wheels of industry, although, in point of time, the trade depression may lag considerably behind the crop failure. Crop failures are, in effect, identical with a great and sudden destruction of wealth owing to some natural or other calamity. The European war operates in the same direction, only to a greater degree. A great army of wealth-producers has been withdrawn from industrial pursuits and directed towards the destruction of wealth — of concrete capital goods such as villages and towns, roads and bridges, fields, factories and mines. For the first time in the course of modern wars — that is to say, in the wars of the last hundred years — the annual gains to the nations concerned have not balanced the capital lost and destroyed. Notwithstanding their terrible destructiveness the Napoleonic wars, the Franco-Prussian war of 1870-71, and the American Civil War occurred during years when the belligerents all made a considerable economic advance. This was due, in each case, to expanding national industries and technical economic equipment, but it is doubtful whether, outside of the United Kingdom, any of the Powers engaged in the present struggle are able to hold their own in point of view of national wealth. The final result, therefore, may be easily foreseen. Such an enormous destruction of wealth will, unless the belligerents exercise the greatest care in perfecting their industrial organization and credit equipment, eventuate in one of the severest industrial and commercial depressions that the world has experienced. And for Canada and the United States — countries comparatively undisturbed by the direct ravages of war — the situation will be no less difficult than for Europe. A depression means not only a fall in the value of securities, but of all property — of urban and rural land values, of industrial plants, railways, and wholesale and retail stocks. It should be observed, too, that a decline in the total volume of wealth has more than a corresponding effect upon the market value of goods and securities; that is to say, a failure of ten per cent in the total wheat crop may cause a fall of more than twenty per cent in the market prices of certain goods closely dependent upon agricultural demand. The conclusion to be drawn from this argument is clear. It will avail Canadian and American farmers little to secure fifty cents a bushel more for their wheat now if, at the conclusion of the war, a period of profound industrial depression ensues that will reduce the value of their lands perhaps by twenty per cent. And, as has been remarked, the farmers of this Continent cannot expect to remain outside the zone of industrial depression that will ravage, in all probability, the whole of Europe after the war.

It should be borne in mind, however, that the colossal destruction of wealth that is now taking place in Europe will not affect to the same extent or degree all industries alike, but that some will suffer more than others. It is certain that the losses

will be unevenly distributed throughout the field of industry, and some interests will suffer more than others. Moreover, it is obvious that the sum total of the world's resources will be as great as before; and that in time wealth will be piled up as never before and values reach new high levels. Nevertheless, it is risky to hold for investment industrial stocks, as these are bound to be affected by the decline of industry at the close of the war. It is a quite different risk that one must incur by holding bonds, for they depend for their value not so much upon the output of economic goods as upon the prevailing interest rates. Stocks—at least common and participating preferred stocks—depend upon two factors for the maintenance of their value—the rate of interest and the extent of the profits. Bonds, on the other hand, are affected, so far as their price is concerned, less by the general state of industry and the level of profits and more by market rates of interest on long and short-time loans. It is obvious that a high rate of interest will lower the value of bonds and such stocks as carry a fixed rate of return, while a decline in interest rates will bring about precisely opposite effects. Now, if the belligerent nations—as well as Holland, the United States and other neutral countries—are saving less while at the same time the demand for capital increases, interest rates must inevitably advance. It is likely that England alone of all the belligerent Powers is saving something out of the national income, and this despite the war. Sir George Paish estimates that the earnings of labor and capital have increased by some \$3,000,000,000 annually since the outbreak of hostilities; and from this estimate it is evident that the war is not laying a crushing burden on the British people. At the same time it is to be observed that the wealthy classes are being taxed heavily for non-productive purposes, and the loan fund is to that extent diminished. In the United States, Canada and England the middle classes—those with incomes ranging between \$2,000 and \$5,000—have largely ceased to save except through insurance; while the laboring classes who place their surplus funds in postal and other savings banks are probably accumulating as much as before. If taxation for the wealthy classes, therefore, is relatively heavy in Europe after the war, and if the United States enters upon an ambitious programme of "preparedness" the level of the reservoir of loanable capital will be lowered, and the demand remaining the same or being increased interest rates will rise.

It may take some years to work out the results, but long-time bonds, under rising rates for money, are bound to fall in value. This is made clear by the phenomenal fall in the price of the Consolidated Stocks of the United Kingdom during the years 1900-1914. It was not that Consols were not good from the point of view of security — they were the safest investment in the world — but they could not hold their own in a rising money market. It is necessary to go but a step further in considering the effect of rising interest rates on stocks. It is obvious that if a corporation must pay a higher rate on its bonded indebtedness a smaller share of the gross income will be left for payment of dividends. And if in addition to that smaller net income the average rate of profit has risen, say, from six to eight per cent, it is obvious that stocks will be hammered down by a double force. At the same time it may be observed that the new conditions will be more rapidly met in the stock than in the bond market.

### Who Will Pay for the War?

One thing further may be said by way of conclusion. If a great industrial depression does follow the close of this struggle the United States will lose far more than it has gained through its transactions with the European belligerents. American exports to the United Kingdom, France and Russia have been paid for, not by the importation of goods or gold, but to a great extent by securities. A considerable fall in the price of securities and the value of agricultural land may mean that the United States will have lost more than it has gained in war profits. This in itself should provide food for thought to those American journalists who insist that New York will displace London as a world centre of finance at the close of the present struggle. Americans are only too likely to realize suddenly that their golden hopes have gone glimmering, and that expected increases in national wealth through war contracts are but a delusion and a snare. War, in itself, can bring no permanent gain in wealth either to those directly concerned or to those who seek to profit at the expense of the nations engaged in the conflict. It is a universal curse that must inevitably work havoc to the trade, industry and commerce of the entire world.