Economic Impact

# Vietnam and Tight Money Are Bogeys In Startling Stock Market Decline

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What's the matter with the stock market?

It's a question that is the basic currency of conversation in Wall Street as well as Main Street.

Just a few weeks ago, President Johnson put the question to an old associate now active in the business world.

He got a frank answer. "It's uncertainty, Mr. President. Uncertainty about interest rates, Vietnam, and whether there will be a tax increase."

During two days of talks with some of the major figures of the financial markets in New York this week, this reporter came away with one overriding impression:

If there is anything "wrong" with the market, it is a blend of Vietnam and tight money. "Vietnam is the imponderable," said one of the Street's most influential men. "It casts a pall over everything."

These are not the sole factors. Many experts think that stocks would have declined sharply regardless of the war. There is a growing belief that with or without Vietnam, the economy will move down in the second half of 1967. Some think the dip will be of recession proportions.

Thus, there are bearish undertones to the market. But the 150-point drop in the Dow-Jones index from a peak near 1000 in February parallels growing U.S. involvement in Vietnam and the rapid leapfrogging of interest rates.

On a single day this week, the Dow index dropped 16 points to 852.13, the widest break since President Kennedy's assassination. It closed Friday at 847.38, off 21.77 points for the week.

In seeking answers to the market's behavior, I talked with the partners and the chief economist of one of the leading brokerage houses in the Nation; the top men in two of the largest underwriting firms;

See IMPACT, A3, Col. 1

**IMPACT—**
***From A1***

the key man and his chief researcher for a major mutuals fund; the head man in an independent research agency, and two of the most distinguished leaders of major U.S. corporations, one a Democrat and one a Republican.

**Near a Consensus**

The points of view varied. But one of the industry men came near a consensus when he observed:

This market is saying that there is a better than even chance we will have many more men in Vietnam next year; that the bill for the war will be sharply higher; that taxes will finally have to be raised to meet the costs; and that by some time in 1967, we will have moved in the direction of Korean-type wage and price controls."

The market also is influenced by the tight money situation and the distortions created by high interest rates. The old Wall Street adage—that tight money is bad for the stock market—apparently is being borne out.

The impact of tight money boils down to one fact: higher yields available to investors in bonds have discouraged investments in stocks.

"Never has it been so profitable to be on the sidelines," one market man observed. "Why, you can take your choice of tax-free municipal bonds at 4 per cent or Federal Government issues at 5 or 5¼ per cent. Or just stick it in the banks at 5½ per cent.

**None of the Risks**

"Hell, you have none of the uncertainties and none of the risks. And when things turn around, there'll be plenty of time and opportunities to buy stocks."

The arithmetic shorthand comes out to this: to get the same return available from investing in a single dollar's worth of bonds at the end of June, one would have had to buy $1.24 worth of stocks.

(These figures are based on the yield of selected high quality stocks in relation to the yield of 30-year prime corporate bonds.)

This means that people buying stocks are paying a premium for anticipated growth in dividends. But at some level, the "spread" becomes too costly. In all probability, it has already driven some investors out of the market.

In 1929, this spread reached a 1.53-to-1 ratio. In 1933, it was 1.45 to 1. In February of this year, it was near the post-depression level at 1.39.

**Carefully Watched**

This factor is being watched carefully. Some encouragement is derived from the fact that the spread at 1.24 to 1 is not so bad as it was earlier in the year.

But as closely as the analysts follow such statistical trends, they keep coming back to the war in Vietnam. There are sharply divergent views in Wall Street about the job the President is doing on this score.

There is no evidence that the drop in the market this year reflects a loss of confidence in the President's leadership, although Mr. Johnson formerly was the

first to relate stock market ebullience with business confidence in his Administration.

Currently, some of Mr. Johnson's strongest supporters in the business community (Democrats as well as Republicans) confess to a feeling of "uneasiness" about the war. Some are disturbed and are sharply critical. Others feel he has no options.

**Is Blunt About It**

One who has known the President well said bluntly: "Things are in a hell of a shape." A Wall Street executive (and a Democrat) said he would vote for a Republican "if there is a good one running against Johnson (in 1968)".

On the other hand, an important industrialist well-positioned to know the views of upper-echelon corporate policymakers thinks the business community is solidly behind the President and his Vietnam policy.

He feels the commitment in Vietnam holds no threat to the economy, and that "Johnson is just a fellow trying to do a job, although he may have made some miscalculations."

A man who played an important role in lining up Republican support for LBJ in industry and in Wall Street in 1964 confesses that he is "worried" about Vietnam and "like all thoughtful people, I am uneasy." But he sees no alternatives, and would be equally worried by an abrupt pullout from Vietnam.

Whatever their views on Mr. Johnson, these men agree that Vietnam constitutes a bearish influence on the market.

Popular mythology held that war is good for business. Wall Street and businessmen agree it is not (barring a few exceptions) because war breeds higher taxes, shortages of manpower and materials, and—most undesirable of all—a controlled economy.

Businessmen want to make their own decisions on prices and wages, and they are less free to do so in time of war than in any other situation.

**Unpopular in Street**

For all of these reasons—but especially because the future is so clouded with uncertainty—the war in Vietnam is unpopular in Wall Street, apart from humanitarian considerations relating to the brutality and waste of war.

"Sure, the market is jumpy," said a vice president of one of the big commission houses. "How much farther does the war get escalated? How far do we go before we exhaust our resources? What we have here is an uncertainty we can assess."

The more sophisticated in the Street are assuming that a land force of 500,000 men or slightly more will be committed to Vietnam by 1967, and that the President will ask for a major supplemental appropriation in January. One man with a good pipeline to Washington thinks the supplemental appropriation may be in the $12 to $15 billion range.

But no one knows.

"You know," said the head of a major research operation, "the only 'market letter' worth a damn would be written in Washington. All we know is that we wake up in the morning, and there it is — Vietnam. Day after day, and it looms larger. But you tell me how big it will get!"

**Searches for News**

Almost painfully, Wall Street searches for news on which to base buy-sell judgments. To the Washington visitor, it is apparent that information considered "good", or "hot news" is often sketchy and out of date, if not wrong.

One advantage the "pros" in Wall Street enjoy is an ability to take the swings in the market with a fair amount of equanimity. Most are not surprised by the 15 per cent drop in the Dow-Jones index this year. In fact, they would view calmly a further drop to about the 800 level. Some already predict it.

Their reasoning is simple: in the 3½ years since the Cuban missile crisis, the market had risen almost perpendicularly, by 500 points, to hit 1000 early in 1966.

"It would have been naive," says the manager of a multi-million-dollar mutuals fund, "not to assume after a rise like that, that a 200-point drop was in the cards."

The stock market, in this view, was vulnerable ("the fire was laid") and just waiting for something to put it on the skids.

"Anything could have done it", says the mutuals fund man, "even good news. Take good news: it comes along, and if the market is ready for a drop, then the market says: 'Not as good as expected' or 'This news has already been discounted.' If it's bad news, okay, that's easy."

**Trigger Points**

There have been several such trigger points, apart from Vietnam. The chief ones I found were these:

- The somewhat less dynamic economy in the second quarter. Auto sales are considered disappointing, and housing starts "dreadful." Say the experts: "The weak factors have been well-advertised."
- Worries about the pound and the dollar. Many of the analysts think this has been overdone. But international concerns trouble the individual investor. A consensus in Wall Street is that investors fear devaluation of the pound and believe it might lead to devaluation of the dollar. "Everybody becomes extrasensitive to news from abroad when there's a basic concern about the domestic economy," one man said.
- Worries about 1967 profit levels. They reason that wages will increase faster in 1967, the guideposts will be useless and business volume will be reduced. They see little relief from other cost factors, including high interest.
- Fear of political concessions to labor. A prevalent view in Wall Street is that the Administration cracked down on molybdenum prices recently as a sop to union leaders. Some believe the Administration ultimately may ask for a tax increase, not to raise revenues, but "for the purpose of controlling the demand of the top AFL-CIO hierarchy for wage increases above true productivity levels."

Inevitably, the conversation in Wall Street comes back to the subtle ramifications of war costs and the

higher interest rates that have developed in the past six months.

Corporations as well as individuals have been moving money out of the market, or borrowing it, to take advantage of rates up to 5½ per cent being paid by banks in certificates of deposit (CDS).

Two examples:

- The president of a New York company showed me the tally of money moved out of securities since Jan. 1 into bank CD's paying 5½ per cent. The total: $90 million.
- Individuals have been quietly borrowing on their insurance policies at guaranteed rates (usually 4 or 5 per cent) and putting the money into banks or bonds. A quick survey of key insurance companies in New York suggests that the insurance companies' loan volume has expanded 5 to 6 times in the past six months.

**Pressed For Funds**

This means that insurance companies have been pressed to find the liquid funds to make loans to policy-holders. Some have been selling stocks, which is another form of pressure on the market. One of the largest insurance companies found it necessary to borrow $300 million in short-terms funds from New York banks in the past several months.

Wall Streeters also suspect that tight money has played a role in the market's problems in this way: the average individual or small businessman goes to his bank for a loan, but because money is scarce, he is turned down. His next line of secondary reserves is his stock holdings.

The suspicion is that pressed for cash, many persons sell off some of their stock holdings — especially when the market is said to be weak.

"What it amounts to," says a man who has researched the subject, "is that the tighter the Federal Reserve tries to make money, the greater the pressure they put on the money markets."

Another man points out that the entire experience of operating in such tight money markets is virtually new to most businessmen in this country. "They're groping for the answers," this observer said.

The usual amount of uncertainty exists about who is doing the principal buying and selling. But many experts think that after a period of unloading or being on the sidelines, most mutual funds and pension funds have made cautious additional purchases in the market in the past several days. Some are waiting for lower points.

One of these experts believes mutual funds are in the midst of a great "switching" movement — from the glamor stocks back to the blue chips.

**Market Was Ripe**

Nearly everyone on Wall Street — especially those who would take a further drop in stride — points out that prices today are at safer or more reasonable levels than they were some months back. Almost everybody thinks that at a Dow Jones index of 1000, the market was ripe for a drop.

Now, they think there is more realism in a market where the average price is 14.5 times anticipated 1966 earnings. In 1962, when the market suffered a major drop, the price-earnings ratio was an outlandish 24-1.

Nobody has ever devised a "proper" price-earnings ratio. But in 1949, when stocks were selling at only 10 times earnings, the market was clearly depressed. "You didn't need to be selective," explains one broker. "You could be dumb and blind, and pick up almost anything."

In recent months, the ratio had been creeping upwards of 17 to 1—and of course some stocks, purchased for their long-term potential or plain glamor, were selling at vastly higher relative prices.

"At the present level, 14.5 to 1, or 15 to 1," said a cautious man in his comfortable Park Avenue lookout, "stocks are not palpably cheap by historic yardsticks, but neither are they in a dangerous area." The experts on the Street can hand-carry a visitor though a long list, including blue chips, which even now sell at only 9 or 10 times earnings.

In a street where unanimity is hard to come by, I found one proposition on which most agreed: Wall Street, for all of its unhappiness with high interest rates, feels the President has been right in avoiding a tax hike.

The rationale is that taxes affect profits, and that the economy may be cooling off by itself. But there also is the conviction in Wall Street that the President may not be able to avoid a tax increase much longer.

If Vietnam spending goes up, Wall Street would be resigned to a tax boost. Once announced, the feeling is that there would be a sigh of relief. It's the other economic unpleasantness—the wage and price crunch—that sends chills up the backs of traders.