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Round-Lot Traders Called Key to Market's Rebound

Wall Street Consensus Indicates Buying by Individuals, Not Institutions, Ended the Stock Slide

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By EILEEN SHANAHAN

Well-to-do individuals, those who generally buy stocks in 100-share "round lots," appear to have been responsible for halting the great stock-slide of April and May.

It seems they turned the market around at the end of May (whether permanently or temporarily, nobody knows) despite the fact that the big financial institutions whose activities may have helped trigger the downturn—the mutual funds, the banks and the insurance companies—were still sitting on the sidelines or, in some cases, actively selling stocks.

This is the consensus that emerges from interviews, during the last week, with nearly two dozen of the most respected men in Wall Street, men who were chosen for their reputations for insight and also to represent a cross-section of the securities industry.

Most of those interviewed insisted on anonymity.

One who did not, and who added some significant details to the consensus, was Donald T. Regan, the president of Merrill Lynch, Pierce, Fenner & Smith, Inc., the nation's largest brokerage house.

Mr. Regan said his company's records disclosed striking differences in the investment patterns of his customers in different parts of the country.

"Heartland America was buying all the way down," he said. Merrill Lynch offices in such places as Louisville, Ky., Tulsa, Okla., and Albuquerque, N.M., never showed a decline in buy orders, he said.

But in the concern's offices on both coasts—from Boston to Miami in the East, emphatically including New York City, and also in Los Angeles—buy orders dried up from early April or mid-April on, he said.

Trading Pattern

When the turnaround came in the last week of May, Mr. Regan said, it was because round-lot buyers on both coasts—not the little "Aunt Janes" who buy a few shares at a time but business executives and professional men—came back into the market. They did so, apparently, simply because they thought the price declines had reached the point where stocks were a good buy.

The big financial institutions were still either selling or sitting on the sidelines with their cash at that time, according to the consensus.

Apparently, they still are.

Stan West, director of research for the New York Stock Exchange, observed that with the heavy volume of stock trading that took place last week, with 14 million to 16 million shares changing hands most days, "you would have expected to see 100 or more big blocks traded, as happened during the up phase of the market. But it has run around 70."

More Statistics

Institutional investors are generally the buyers and sellers of the big blocks—10,000 shares or larger.

Some other statistics from Mr. West's department, though he expresses doubts about their validity, reinforce the view of many of those interviewed that it was the actions of institutions that touched off the steep drop in stock prices in April.

The figures, which are not normally published and which are based on reports from a small number of major brokerage firms, show that institutions became net sellers of stock in April while individuals were still net buyers.

The net sales of institutions

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amounted to only about 500,000 shares, according to the data reported to the stock exchange. But the real figure could be much larger because, Mr. West points out, a defect in his sample is that it underreports institutional business.

Figures for May are not yet available.

Among those interviewed, a large majority believe in retrospect that the April-May break was not fundamentally an outgrowth of the expansion of the war into Cambodia, student unrest, loss of confidence in the Nixon Administration and other external factors that were generally cited at the time.

The majority feels, on the contrary, that internal factors in the stock markets themselves and the financial community were more to blame.

This group divides the market decline into two distinct phases.

The first, lasting from the time that stock prices peaked in December, 1968, until some time in April was, they believe, an entirely rational drop based on the expectation of a decline in business activity and profits as the intended result of the Nixon Administration's anti-inflation policies.

Following Phase

The second phase, beginning around mid-April, saw the slide become less rational—so far as any relationship to basic economic factors was concerned or to the outlook for business profits. This part of the decline, where the downturn begun to feed on itself, was based largely on weaknesses that the earlier, more rational, part of the decline, had exposed.

Among these weaknesses was one that most Wall Streeters were reluctant to discuss: the financial distress in which a significant number of brokerage houses found themselves because they had invested much of their working capital in stocks, some of them quite speculative stocks.

While the shaky financial condition of some major brokerage houses has been widely rumored in the last two months, their condition has generally been attributed, publicly, to low or outright losses profitability on their operations.

Policies of Firms

The real cause, according to many of those interviewed, is that these firms followed less than prudent policies in investing their working capital during the years of speculative fervor, 1965-68. When the prices of the speculative securities declined, these firms were caught with stock that was literally unmarketable, in the worst cases, or salable only at significant losses, in others.

Some sales of investment-quality stocks probably had to be made, the consensus holds, to keep these brokers' working capital up to the levels required by the rules of the Securities and Exchange Commission and New York Stock Exchange. The sale of stock increases working capital because, under the rules, only a certain percentage of the capital invested in stock is counted as working capital. When the stock is converted to cash, it is all counted.

Some mutual funds, similarly, were caught with a lot of speculative stock in their portfolios that was hard to get fever abated. If a fund itself was faced with more redemptions than new sales of fund shares—as many were, even though mutual funds as a whole still had a net inflow of investment in April—they were forced to sell investment-quality stocks to raise the cash to meet redemptions.

Banks, too, were selling stock at this time and in May, according to the consensus. In their case, it may have been not so much that they had lost money in extremely speculative stocks as that they were foreclosing business loans, as businesses went sour, against which they held stock as collateral.

Among the other events in April, to turn a rational decline into a snowballing one, were the following:

¶The reorganization and possible collapse of Investors Overseas Services, Inc., the big foreign mutual fund complex, contributed to worries and probably, also, to the amount of American stock that was suddenly being sold.

¶A widespread belief arose that the Federal Reserve System was tightening the money supply again—a belief that is still held in some quarters despite statements and statistics to the contrary from the system iself.

¶The long decline was beginning to cause distress selling. By the end of April, Mr. Regan disclosed, the daily calls for more margin—that is, cash to cover the original sale prices of stocks that had been bought partly on credit—had risen to three times the rate of the end of March.

Those who hold that it was such internal factors that turned the long 1969-70 downturn into a crash, rather than external news, note that the period of very sharp downturn in April began 10 days before the Cambodian invasion and, in fact, right after President Nixon announced his plans to pull 150,000 troops out of Vietnam in the next 12 months.

On the other side of this argument is the fact that daily headlines proclaimed hard fighting in Cambodia and the possibility of American involvement.

Members of the consensus who believe individual investors finally turned the market up on Wednesday, May 27, say that it happened primarily because, in the words of a trader for one of the big institutional brokerage firms, "the public began to see Telephone and duPont at a price they liked."

A minority holds strongly to the view that President Nixon's dinner with 45 leading business executives, many from the securities industry, was responsible for the turnaround.

The dinner was held the evening of the day of the big upturn but had been widely publicized on television the night before and in morning newspapers.