INVESTMENTS FROM THE VIEWPOINT OF THE PHARMACIST.*

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Investments from the viewpoint of the pharmacist—opportunities classified between (1) investments of a speculative nature in which return is a profit, and in which there is business risk with little or no opportunity to exercise effective control of the capital; and (2) investments by reason of loaning money for a definite time in consideration of a definite interest return, in which risk is minimized and no ownership responsibility or risks are assumed. The latter includes Government bonds, public utility bonds, individual loans, real estate loans, etc.

General suggestions as to choice of securities for various purposes.

Pharmacists, like other successful professional and business men, occasionally have surplus funds for investment. By "surplus funds" I mean money which is not needed to carry on one's business or to meet one's personal expenses. By "investment" I mean the advancement or loan of surplus funds aside from one's business, in consideration of an interest or a profit return.

INVESTMENTS

A person may succeed in a particular business without developing the ability to invest surplus funds in such a way that his principal is safe and the return reasonably ample. We all know of instances of investors whose surplus funds have been lost and whose principal business has been jeopardized or ruined by the exercise of poor judgment in respect to incidental investments. Hence, the investment of surplus funds is a matter to which even the most successful business man may well give serious attention.

With these considerations in mind, I shall proceed to discuss, in a non-technical way, the subject of "Investments from the Viewpoint of the Pharmacist."

Business seeks capital on two distinct bases. First, capital is borrowed, and the particular business or individual promises to repay it at a fixed or determinable time, together with a compensation for the use of the capital which is known as interest.

Second, capital is sought for the permanent needs of the particular business, the compensation for which is contingent upon profits. Advancement of capital in this manner usually carries with it a proprietorship interest and, therefore, proprietorship responsibilities.

The investor thus has two opportunities for the advancement of his surplus funds. He may loan his money for a certain length of time in consideration of an agreed amount of interest, or he may advance it as a co-owner in some business enterprise with the expectation of receiving a profit.

The two fields of investment, although often confused in the mind of the investor, are radically different. It is desirable, therefore, in the first instance, to state the essential facts in relation to each.

The investment field proper, at least from the viewpoint of the incidental investor, is in the loan of funds for an interest return. Thus, $10,000 may be loaned for three years at six percent interest, the return of the principal and the payment of the interest being secured by a bond and mortgage upon real estate. In case

* Read before Section on Commercial Interests, A. Ph. A., New York meeting, 1919.

of default the property mortgaged may be sold for the reimbursement of the lender in the matter of principal, interest and costs. Again, a bond and mortgage may be bought from the investor who originally made the loan, but who is desirous of transferring his rights. Again, a public utility company or an industrial corporation may issue bonds in various denominations—for example, $100, $500, $1000, or any other desired denomination, each bond containing a promise to pay at a future time a certain amount of money, plus interest. Such a bond may be one of a series, all of which are secured by a trust deed or a mortgage covering real estate and, possibly, other property. In somewhat the same manner, the government may issue its bonds, such as the Panama bonds or the Liberty Loan bonds, by the terms of which the government promises to pay at a future time a certain amount, together with interest. In all private business organizations the rights of the bondholders to interest take precedence over the rights of the owners to profits—that is, the interest must be provided for before profits can be taken. There is usually, in addition, the pledge of specific property, aside from the lien that is created upon the general asset fund of the borrower.

A very different situation exists when an investor advances his funds to a business enterprise as a co-owner. There is no contractual obligation for the repayment of the money at a certain time and no agreement as to the amount of compensation. If a partnership in the usual form is created by such an investment, serious responsibilities may attach aside from the risk to which the amount of money advanced is subject. If the partnership fails and its debts are not satisfied by recourse to the partnership assets, each partner will be personally responsible to the creditors. The investor, in such a case, may have little chance to avoid the contingency of unsuccessful business, because in making the investment as an incident to his regular business he would have little or no opportunity to exercise personal supervision and control. Liabilities incurred in this way might even wreck his principal business.

The most common form of investment of this nature consists of the purchase of the stock of corporations. A corporation is merely an artificial person or entity created by law, which may have perpetual succession or life. It is composed of stockholders who receive shares of stock for capital paid in. The shares of stock usually have a par value. In New York the par value of shares may be as low as $5.00 or as high as $100. A corporation is managed by the stockholders, who elect directors, who, in turn, elect officers. Control is exercised by the voting of stock at stockholders' meetings, the holders of a majority in amount of stock being empowered, with few exceptions, to decide matters that arise in the conduct of the affairs of the corporation. A holder of a small proportion of the stock, therefore, often takes no effective part in the management of the corporation. Profits are distributed in the form of dividends, such distribution, granting that profits are available, being usually entirely within the discretion of the board of directors. The minority stockholder, therefore, is often unable to participate in profits, even when they are actually made. The stockholders of a corporation, differing from the partners of a firm, usually have no liability beyond the amount of money paid in for their stock, so that under ordinary conditions no additional liability attaches which may affect the stockholder's personal fortune or business.

Stocks are less attractive for strictly investment purposes than are bonds, which will later be considered in more detail. The subject of stock investments, however, is important and a fuller consideration of the subject will now be undertaken.

Distinction should be made between:

(1) Large utility and industrial corporations, whose stocks are listed and dealt in on the stock exchanges and whose managements are dependent very much upon an appeal to widely scattered stockholders for their support; and

(2) Closely held corporations in which the incidental investor has no general market in which to sell his stock in case he desires to do so, and in which he is largely dependent upon the fairness of the stockholders who are in control as to the matter of compensation to officers, declaration of dividends, and the like. It is the latter type of corporation which is usually brought to the attention of the incidental investor. The dangers of this type of small investment are many, to which brief attention will be given.

First of all, the ownership of minority stock in a closely held corporation, that is, the ownership of less than a majority of the shares, shares conferring proprietorship rights, may give no effective voice in the control of the affairs of the corporation. Thus, the stockholders who own or control a majority of the shares have the power to elect directors and, through the directors, to elect themselves officers of the corporation. In the absence of fraud, the compensation of the officers is within the discretion of the directors; therefore, the persons in control may take by means of liberal salaries what would otherwise be available for dividend distribution purposes. A case comes to mind in which the officers, who were the controlling stockholders of a closely held but successful corporation, paid to each officer a salary of $100,000 a year, presumably in order to absorb profits to the exclusion of minority stockholders. The matter came to light in a court action in which the minority holders were unable to have the action of the directors abrogated.

The declaration and payment of dividends, moreover, is within the discretion of the board of directors; hence, such net earnings as may be left over may not find their way to the stockholders. An instance of this kind is found in the case of a leading railway company, certain minority stockholders of which attempted to make the board of directors pay dividends instead of using millions of dollars of profits to build up and improve the properties of the company. It was held that the directors could not, under the circumstances, be required to declare dividends. In the same way, in a small and closely held corporation, the majority interests may retain the profits indefinitely for the use of the corporation.

There have been innumerable instances of holders of minority interests in corporations who have considered themselves unfairly treated and who have, therefore, resorted to the courts for relief. Unless there is a gross mismanagement or fraud, the courts will seldom interfere on behalf of minority stockholders. It follows, therefore, that the holder of a small amount of stock in a closely held corporation is very often dependent upon the liberality and the fairness of the controlling interests. There is no agreement for the repayment of the investor's advances; he is assured of no definite return; and, in the fortunate case that substantial profits are earned, he may be without power to force a distribution which will enable him to realize a profit return. Even though the parties in control are known to be men of fairness and integrity, there is always a possibility that their interests will be sold and transferred, and that new interests will be in control. Altogether too much control is surrendered by the investor to bring such an advancement of funds within the range of true investment.

In the small and closely held corporation there is likely to be little market for the stock, once it is acquired. For example, two men who held the outstanding stock of a small corporation, amounting to $30,000, which was promoting and manufacturing a new machine, induced a man to subscribe for $10,000 of additional stock of the corporation. His money was used in the business, and the two men in control were able to pay themselves liberal salaries, although they were paid against the protest of the incoming stockholder. Such surplus profits as were made for several years were used up in adding to the plant and in extending the business. The minority holder repeatedly sought to sell his stock interest, but found no one who was willing to purchase it under the conditions. He finally sold the stock, the book value of which was 150, at 50—one-half of its original cost and one-third of its book value. Even though the outcome had been satisfactory and a dividend received, a sale and transfer could have been made only by a private negotiation with some one willing to take the risks of minority stock ownership.

Aside from the foregoing, there is always the risk that the particular enterprise will not make any profits but will incur losses that will entirely extinguish the capital. The investment is thus subject to business risks and, notwithstanding the risk, the minority stockholder is usually unable to secure any effective control of the situation that would lead to the prevention of losses. He may be entirely dependent upon the controlling interests for the protection of his advance.

The man with funds to invest will often be approached by promoters, either through salesmen or the mails, with propositions for the purchase of stock. The corporation whose stock is offered may be developing any kind of business—oil, mining, real estate, manufacturing, orange raising, pecan raising, motor car production. The use of intensive methods of selling such stock is usually, although not necessarily, evidence of the fact that it cannot be disposed of by ordinary means. Attractive prospectuses are issued, estimates of profits to be earned are made, engineers' and geologists' reports are secured, sales organizations are created and compensated by commissions—all these things are done in order to sell to the incidental investor stocks of highly speculative companies.

If analyses were made of the losses suffered by business men by reason of advances for the purpose of investment, it would be found that nearly all of them arise by reason of the purchase of minority stocks in highly speculative enterprises. Many a business man, prudent and successful in his own enterprise, has tucked away a sheaf of handsomely engraved stock certificates which he keeps as a reminder of his own schooling in the art of investment. Strange as it may seem, some of the men who are most thrifty and successful in their own businesses go the farthest afield in such matters. I have a man in mind who for years conducted a successful business and by steady and persistent saving accumulated a comfortable competence. He seldom had a bad account on his books, and he never wasted a dollar in riotous living; yet he was induced to buy $5,000 of stock in an oil company and $10,000 of stock in a mining company, all of which to-day is not worth a postage stamp. He has, as mementos of his faith in prospectuses, pieces of paper representing a loss equivalent to twenty-five percent of his entire savings. Instances of this kind can be cited by the score in every community; and, while no type of business man seems to be exempt from luckless speculation of this kind, it is safe to say that pharmacists and physicians are fully represented.

We have quite a different condition in stocks that are listed and dealt in on the New York Stock Exchange. Certain safeguards are taken by the Stock Exchange which insure to the public that only stocks of reputable companies are listed, although, of course, there is no assurance or guarantee as to the matter of dividends. These stocks consist, generally speaking, of two classes, *viz.*,

(1) Preferred stock, which is a stock with preferences over one or more classes of other stock—usually a single class of stock known as "common stock." A preferred stock is usually entitled to a certain rate of dividend, in many cases seven percent, which must be paid to the holders of preferred stock before any dividends are paid to the holders of common stock of the same company; and

(2) Common stock, the holders of which are entitled to all dividend distribution other than those made to "preferred" stockholders.

Thus, the United States Steel Corporation has a seven percent preferred stock upon which dividends have been paid regularly for many years, and common stock upon which the rate of dividends has fluctuated. In the same way, the American Woolen Company has a preferred stock and a common stock; the Atchison, Topeka & Santa Fe Railway has preferred stock and common stock; the International Paper Company has preferred stock and common stock, and so on. The preferred stock is not likely to fluctuate as violently in price as the common stock and, of course, is not so speculative.

In the case of a listed stock in a large company, the owner, even though he owns but a small interest in the company, always has a market available. Moreover, the persons in control of such a corporation often do not own enough stock actually to control it, but depend upon securing from the stockholders who own small lots proxies to vote their stock in stockholders' meetings. In such a case, there is always greater safety to the small stockholder than there is in the small and closely held corporations in which control is exercised by virtue of stock actually owned. From the viewpoint of investment, stocks in large companies whose securities are listed on the stock exchanges are much to be preferred over minority stocks in small corporations.

The purchase of stocks in the market on margin is, of course, speculative and cannot properly be considered investment. The procedure is for the speculator to advance a margin, say twenty percent, of the amount of the purchase. The balance of the money is borrowed by the broker handling the transaction from a bank or a trust company, and the stocks are pledged as collateral security to secure the loan. If the price goes down, additional margin must be forthcoming from the speculator, or the stocks are sold to satisfy the loan. If the price goes up, the stocks may be sold by the broker, at the direction of the speculator, in order that a profit may be realized. A person speculating on margin with incidental funds is necessarily dependent upon the advice and judgment of brokers or other specialists. The purchase of stocks and other securities on margin is not true investment, because the attempt is made to make the funds available cover a wider range of securities than is possible by outright investment purchase.

The purchase of stocks on the market for investment purposes, therefore, should be made outright, and the securities acquired should be held primarily for their income-producing features. If the securities advance in price, the investor of course may sell them and realize a profit. If the prices go down, the investor is unaffected, provided he holds his investment, and his dividends remain constant.

If the investor should consider stock or other security purchases, the best method for him to pursue is to select a thoroughly well-known and reliable firm of investment bankers. There are many such firms in New York, Boston, Philadelphia, Chicago and other cities. The advice of investment bankers, which is almost certain to be honest and based on a knowledge of facts and conditions, can be had without cost. Extreme care should be taken in selecting a firm of investment bankers—elaborate printed matter does not necessarily indicate a firm of standing. Many of the largest banks and trust companies maintain departments for the advice of their depositors, and such advice is usually sound. In case of doubt about a firm, reliable information can be secured from one's banker.

So much for investment in stocks. My advice sums up to the effect that minority stocks in closely held corporations, particularly those of a highly speculative nature, should be avoided; that investments in listed stocks, both preferred and common, with well-established dividend records, are entirely legitimate, provided purchases are made outright upon the basis of advice from reliable investment bankers. From the conservative investment viewpoint, however, the purchase of stocks is seldom, if ever, as desirable as the purchase of bonds.

We come now to the investment field proper, which consists of the loaning of money for an interest return. The most convenient method of making an investment in this field is through the purchase of listed bonds, as heretofore explained. Brief mention will be made of the characteristics of bonds and the details of purchase and interest payments.

BONDS.

Bonds may be considered in three distinct divisions, *viz.*:

(1) Government bonds, including the obligations of the Federal government and of the various states and their subdivisions such as counties, cities, villages, school districts.

(2) Bonds of public service companies, such as the railroads, the traction companies, and the gas and electric light companies.

(3) Bonds of industrial corporations, such as those engaged in the steel, lumber, textile, and electrical industries.

Bonds of the United States Government, usually known as "Government" bonds, are recognized as the highest-grade investment obtainable. In the normal times preceding the Great War the price of government bonds was so high that the interest yield was as low as two percent. The highest rate at which such bonds were issued during the war when the credit of the entire financial world was strained to the breaking point, was four and three-quarters percent. Bonds of this nature, while returning a comparatively low rate of interest, are marketable at any time in any commercial center and afford the maximum of security.

Closely associated with government bonds in the estimation of conservative investors are the obligations of the various states and municipalities. These securities at the present time return to the investor a yield of from four and one-quarter to five percent, depending upon their desirability. They are dealt in by investment bankers, some of whom specialize in state and municipal issues. The market, while good, is not as broad and as immediate as that available for the bonds of the Federal government.

Railroad bonds, which are included in the second classification, constitute the larger part of the bonds listed on the stock exchanges. In normal times the interest return on high-grade railroad bonds is about four percent. The present yield is from five to six percent.

Industrial corporations, usually those of a manufacturing nature, often find it convenient to raise funds by the issuance of bonds, secured by trust deed or mortgage on real estate and other property. The interest yield at the present time is likely to be as high as seven or eight percent. Because of conditions growing out of the war, many commercial concerns are financing their affairs by the sale of short-term notes running from one to three years, which are issued instead of long-time bonds or special stock. Such notes often afford a desirable investment but should be bought only upon the advice of investment bankers who have studied the legal status of the notes as well as the financial standing and business prospects of the firms that issue them.

Practically all railroad bonds and many industrial bonds are listed on the stock exchange and can be bought through investment bankers or stock brokers. Railroad and industrial issues are usually in the denomination of $1,000 a bond. The government Liberty bonds, on the other hand, can be bought in denominations as low as $50, which makes them more convenient for the small investor. Any investment banker or stock broker can purchase the bonds of the government or of any reputable business organization, provided they are offered in the securities markets, whether the particular issue is listed on the stock exchange or not.

Investors should bear in mind that the nominal interest rate received may be different from the actual interest. If a five-percent bond for $1,000 is purchased at 95, the nominal interest return collected each year will be 5 percent of $1,000, or $50. Inasmuch as $50 a year is being received upon an investment of $950, the actual interest return on the investment, leaving out of consideration the appreciation to par that will take place by the time the bond matures to be paid, is 5.26 percent.

If the bond is payable at par in five years, there will be a five-percent increment which will take place during the five years; this increment will be an additional return to the investor if he holds the bond until maturity and payment. In speaking of the "yield" of the bond, an investment banker usually takes into account such a factor of increment. For example, a bond of the Fourth Liberty issue now selling at about 93.25 will mature in a certain number of years to be paid at its par value, and the investment banker calculates that the "yield" to the person who holds such a bond to maturity includes the increment in the manner that has been pointed out.

On the other hand, if a bond is bought at a premium, that is, if a $1,000 bond should be bought at 105, the cost would be $1,050. If such a bond were due to be paid in five years, and if the investor held the bond until maturity, there would be a decrement in his investment over the term of five years of $50. This decrement decreases the net yield, so that the interest return would not be as large as would otherwise be the case.

It will thus be seen that the investor is often concerned with the nominal interest that is collected, the actual immediate interest return on the investment, and the ultimate "yield."

These intricacies need not confuse the main features of bond investment in the mind of the investor. The investment banker is always willing to make the calculations and to give the investor full information as to the net return upon any investment under consideration.

There are two distinct classes of bonds as to form—registered bonds and coupon bonds. A registered bond is one which can be registered, in the name of the holder, with the government or with the concern issuing the bond. Interest on registered bonds is usually paid, when it falls due, by check. The interest term may be a year, or, as more often happens, six months. If the bond is lost or destroyed, provision is made by which a new one may be issued upon compliance with certain formalities. This form of bond is more desirable than the coupon bond because of this protection against loss.

The coupon bond is so called because coupons are attached to cover the payment of interest. Thus, in the case of a five-percent $1,000 bond, interest payable semi-annually, there is a coupon attached for each six-months' period during the life of the bond. When the time for the collection of each six months' interest arrives, the coupon is detached and presented for payment. The usual procedure is to deposit the coupon in a regular bank account for collection.

A coupon bond is usually made to bearer, as are the attached coupons. In case the bond is lost and falls into the hands of an innocent purchaser for value, the real owner of the bond will not be able to recover his loss. Coupon bonds, therefore, require extreme care and should always be kept in a safe deposit box or left with a bank or trust company that has proper facilities for safeguarding valuable papers.

Savings banks afford a safe and convenient method of investing surplus funds. It should be remembered that bonds, certain classes of high-grade stocks, and real estate loans are the basis of savings bank investments. Savings banks are strictly limited as to the things in which their funds may be invested. It follows that, if a depositor places money in a savings bank his funds are safeguarded by conservative investment. There are many advantages in the matter of convenience, moreover, that make the deposit of funds in such an institution desirable from an investment viewpoint. There is only a small margin between the interest paid upon a savings bank account and the interest that may be obtained by conservative investment. For the investment of an amount up to a few thousand dollars, therefore, nothing better is available than the deposit of money in savings banks. There is, of course, no chance of an increment in value, such as exists when bonds are carefully selected. However, this feature is of small importance if the amounts to be invested are small.

The advancement of money the repayment of which is secured by bond and mortgage upon real estate has already been mentioned. When the security is ample, the rate of interest satisfactory, and precautions are taken in the matter of all legal formalities, this type of investment is highly satisfactory. The market for the security, however, is limited, and there is little or no chance for an increase in the value of the security. Loans of this kind are usually held by the person who makes them until maturity, when they are paid off or renewed. If the incidental investor loans his money in this fashion, he should turn over the details to some reliable lawyer or financial institution. The small fee that is required for the service is amply justified by the safety secured. Investment, it must be remembered, is a technical matter, and the investor should always secure the aid and advice of those persons or concerns that make it their business to study investment conditions.

There are certain matters in respect to income taxation that have a bearing upon the net return upon investments. For example, interest upon a limited amount of Liberty bonds is free from income tax. The investment banker can give reliable information upon this subject.

Finally, one word as to the best procedure in setting aside funds for the upbuilding of your private competence or fortune. Remember the hardest dollar to save is the first dollar. Each succeeding dollar comes with somewhat less effort than its predecessor. Therefore, no risk whatever should be taken with the first dollar, and, if you please, a somewhat increased risk, for the sake of increasing the return on investment, may be taken with each succeeding dollar as the dollars build one upon another.

The foregoing principle, for example, may be applied as follows: Incidental savings may be placed in the savings bank. Later, these incidental savings may be converted into Liberty bonds, and this procedure may be followed until the amount of $5,000 or $10,000 is reached. The next step may be to invest $5,000 or $10,000 in high-grade railroad bonds, the next $5,000 or $10,000 in high-grade industrial bonds, and the next $5,000 or $10,000 in preferred stocks of industrial corporations. Succeeding investments may be made in the common stocks of successful and well-established industrial concerns. If the proportion of such stocks becomes too large, further investments in the various grades of bonds will re-establish the soundness of the ratio.

In a general way, the foregoing shows a line of progress from the highest grade of investment, with a limited return, to high-grade investments of a more speculative nature in respect to income. The principle of progression is sound because, as the ability to take risks without hazarding the entire fund is established, the range and profitableness of the investments are increased. A procedure of this kind, too rarely found in actual practice, is sound to the core, and assures to the business man the great objective of sound investment—the employment of surplus funds with security of principal and an interest return proportionate to the ability of the investor to take financial risk.

May each of you, in this day of social and economic unrest, become a stabilizing factor by the accumulation of surplus funds sufficient to protect the future of yourself and of those dependent upon your industry and foresight!