Chapter 3

The "Silent" Crash

The whole situation is most mysterious; undoubtedly many men who were very rich have become much poorer, but as there seems to be no one breaking, perhaps we shall get off with the fright only.[1]

—J. P. "Jack" Morgan Jr.
March 14, 1907

By early 1907, it seemed that the steady progressive tightening of money, which had been accelerated by the massive capital demands of San Francisco's earthquake, had precipitated a slow and steady decline in equity prices—considered by some contemporaries to be a "silent" crash in the U.S. financial markets.

Between its peak in September 1906 and the end of February 1907, the index of all listed stocks fell 7.7 percent, a five-month change in value unremarkable in view of the long history of the market, but pertinent as the beginning of a trend. Indeed, on March 6, 1907, telegraph correspondence between Jack Morgan and his partner in J. P. Morgan & Company's London affiliate, Teddy Grenfell, reflected the deepening anxiety between the world's financial centers:

Grenfell: Can you give us any information and what is your opinion of the immediate future of your market?[2]

Morgan: Do not get any information showing real trouble our market although of course continued liquidation must hurt some people and may do severe damage in places. From what I can make out do not think stocks are in weak hands. Shall be surprised if immediate future brings much more liquidation, although of course impossible form opinion.[3]

In the coming days, Teddy and Jack exchanged more anxious telegrams about rumors of gold shipments. Grenfell thought that at the "first indication [of] considerable withdrawals of gold," the Bank of England would raise its interest rate. He wondered whether the U.S. Treasury would relieve the situation by releasing gold from its vaults into the financial system. On March 13 Jack wired back that he could discover no intentions to ship gold from London *this* week, though there might be attempts to buy gold next week.[4]

By mid-March the "silent" crash had become audible as equity prices turned decidedly and sharply for the worse. Declining over a series of days (March 9 to 13 and 23 to 26) rather than on a single day, the index of all listed stocks fell 9.8 percent. Especially damaged were shares in shipping (off 16.6 percent), mining (down 14.5 percent), steel and iron (down 14.8 percent), and street railways (off 13.8 percent). The *Commercial and Financial Chronicle*, the principal financial periodical at the time, observed, "The liquidation going on in Wall Street . . . is phenomenal. Stock sales . . . are among the high records in the Stock Exchange history."[5]

J. Pierpont Morgan was absent from New York during these disturbances in the market; he had sailed for Europe at midnight on March 13, the day of the sharp market break. There, Pierpont met old friends, toured the art markets for possible acquisitions for his collection, and relaxed at various spas and villas. Meanwhile, Jack Morgan in New York grappled with the confusion and chaos in the financial system, writing in a letter to his partners in London on March 14:

> Here we are, still alive in spite of the most unpleasant panic which we are going through. The whole trouble lies, in my mind, in the mystery of the conditions; no one seems to be in any trouble, there is money at a price for anyone who wants it, and in our loans, and in those of all the Banks I have talked to, there has been no trouble whatever of keeping the margins perfectly good, except the physical difficulty of

> getting the certificates round quickly enough. . . . I could not yesterday finish this letter owing to the panic and general trouble, there being so much to see to with Father and Perkins both away. Today, things seem to be so much quieter that I am in hopes that most of the trouble is over, certainly for the present. . . . The whole situation is most mysterious; undoubtedly many men who were very rich have become much poorer, but as there seems to be no one breaking, perhaps we shall get off with the fright only.[6]

As the price declines continued during the next week, rumors of the failure of financial institutions began to circulate. The London partners of J. P. Morgan & Company cabled to Jack: "*London Daily Telegraph* today states that house of international prominence has been helped in New York. Is there any truth in this? Who is it? Do you expect much further liquidation?"[7] Jack replied, "As far as we know there is no truth in rumor international house having been helped. Newspaper reports here is that various stock exchange houses in London are in difficulties. Cable any information you can obtain. Urgent liquidation seems to be pretty well done but as many parties heavily hit look for depressed markets for some time."[8]

Indeed, conditions remained unsettled as the unrest spread to other financial markets. On March 23, 1907, the *Commercial and Financial Chronicle* noted, "Lack of confidence [among investors] is never reflected more unerringly than in the money market; and the seriousness of the situation in that regard is shown in the inability of the railroads for over a year past to finance their new capital needs."[9] Both the municipalities of Philadelphia and St. Louis made bond offerings, and in neither case was the underwriting successful. "Money is commanding such high rates that it is impossible to float even gilt-edged securities at the low figures offered by Philadelphia and St. Louis," the *Chronicle* reported.

Finally, during the week of March 25, cables between Morgan's partners suggested that the worst was past. New York investors took courage from the announcement that the U.S. Treasury would deposit at least $12 million with national banks to ease the money situation. On March 29, 1907, Jack Morgan reflected on the change in mood to his London partners:

> The two panics within the last ten days have given people a big scare, and the losses of course are frightful. The fact that no one has failed is

> more of the nature of a miracle than of ordinary business, but it simply shows, as far as I can see, that practically no one was overtrading. . . . My own belief, however, is that the panic is over, and the fact that the Treasury is putting out money rather fast and that that action has really been the cause of the restoration of confidence makes me feel that it was at bottom a money panic. Not a money panic such as we have heretofore had, but an apprehension that, in view of enormous calls being made upon huge stock issues during the next few months the market might be so far drained of money that those who were obliged to pay the calls would have difficulty in arranging to get the necessary fund. The whole thing has been an interesting experience, although an extremely painful one and I shall be greatly relieved when matters finally drift—as they seem to be doing—into a state of dullness and cheaper money. . . . From all this long screed you may see that I am tired but hopeful, hopeful because of the simple fact that there is a tremendous productive capacity in this country, and that this productive capacity has not been one whit reduced by the colic we have all been having.[10]

Almost as suddenly as it had begun, there was a sense that the mounting crisis had been stopped. The source of optimism in the market was the prospect of Americans buying £4 million in gold in London for shipment to New York; the U.S. Secretary of the Treasury, George B. Cortelyou, also ordered that $15 million be placed on deposit with New York City banks, thus giving much-needed liquidity to the capital markets. The *Commercial and Financial Chronicle* concluded that this "made a material change on Tuesday in the financial sentiment, the panicky tendency being arrested and a general advance in stock values taking place."[11] Within a few weeks, the disturbance in the markets seemed to have subsided.

Reflecting the financial anxieties caused by the March crash in equity prices, call money interest rates had spiked upward during this period, but they subsided when the flush of cash and gold into the New York money markets produced lower interest rates and a modest recovery in equity prices (see Figure 3.1).* On April 13, the *Commercial*

* *Call money* consisted of loans from banks to brokers that had to be repaid upon demand and were secured by bonds or shares of stock. The interest rates on call loans were the leading barometer of money market conditions. The variability of those rates in March and July 1907 reflected the deep-seated anxieties of investors.

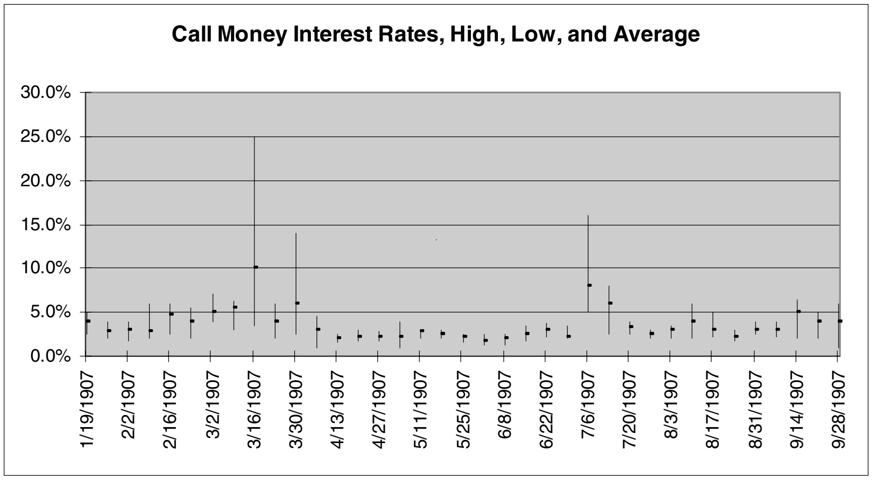

Figure 3.1 Call money interest rates.

and Financial Chronicle observed, "The monetary situation has reversed its character for call money, from abnormally high to abnormally low rates—the relief in New York communicating a like tendency elsewhere. This change has opened the stock market here to more venturesome buying, and consequently speculative operators have again been in evidence."[12]

While an optimistic mood may have returned, robust buying behavior had not. The *Chronicle* noted an eerie slackening of trading and persistently low stock prices, which suggested an absence of investors from the exchange. During April and May, the index of all stocks fell 3 percent, with large declines in shipping (down 12 percent), household goods (off 12 percent), machinery (off 10 percent), and copper (down 10 percent). On April 20, the *Chronicle* remained gloomy, saying, "no refuge from the old instability has been found. . . . A harsher and deeper economic irregularity is what the doctors have to deal with before real recovery will be under way."[13]

Business fundamentals also looked bleak. For the month of April, the value of claims in bankruptcy had grown 38 percent over the same month a year earlier, with the sharpest growth in the manufacturing sector.[14] On May 2, Teddy Grenfell in London queried Jack Morgan in a telegram about the stock market and when the banks in San Francisco might reopen.* Morgan replied, "Think further demand for gold is probable but impossible estimate amount. Stock market—believe decline largely speculative. Do not hear of any serious trouble any where though market vaguely apprehensive of difficulty arising largely from varied activities President USA."[15] For financiers and investors in 1907, the "varied activities President USA" were an overriding concern.

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Despite his patrician mien and pedigree, President Theodore Roosevelt was masterful at giving voice to the nation's popular will. By 1907, Americans had become increasingly disturbed by the tumultuous changes that had accompanied the country's impressive industrial growth. They were worried about the number and type of immigrants entering the country; the size, noise, and frenzy of the nation's large cities; the effectiveness of their elected representatives; the consequences of old age, illness, and injury on the job; the day-to-day hazards of urban life; and even the quality of their food and water. Yet most of all they reacted with alarm to the rise of big business and the corporate merger movement. Some Americans, calling themselves "progressives," argued vociferously for the right of a community to protect itself against those who pursued their economic self-interest without concern for the common good.[16] President Theodore Roosevelt became their most outspoken proponent.

Progressives especially looked at J. P. Morgan and Wall Street with fear, some of it well founded. Since the Civil War, the history of corporate finance had been punctuated by instances of looting and self-dealing by the financial promoters. It seemed that the very intimate engagement of financiers as both insiders and outside investors opened conflicts of interest against which the public would not be able to guard. Moreover, many of the combinations these investors organized resulted in oligopolies and monopolies that sacrificed the welfare of consumers

* The main reason why San Francisco's banks remained closed for several weeks after the earthquake and fire was to allow time for the vaults to cool. The fire was so hot in the financial district that if banks had reopened their vaults immediately after the fire had ended, the residual heat would have caused paper inside the vaults to burst into flame. This need to wait stilted economic recovery and made the city dependent on outside cash to pay for labor needed for the city's intense rebuilding effort.

for the benefit of investors. The sheer scale of the new corporate trusts raised concerns about the possible abuse of economic power to achieve political ends. Standard Oil, for instance, had the power to extract rebates from railroads for shipping their products that were not given to its competitors. Muckraking writers such as Sinclair Lewis famously focused attention on unsanitary conditions in meatpacking. Lincoln Steffens exposed unsafe compounds used in pharmaceuticals. In this context, the rather closed world of high corporation finance seemed highly suspicious.

President Theodore Roosevelt was the personification of this progressive movement, and he applied his executive power to challenge the influence of large corporations and to mediate between labor and capital. He was a pragmatist in a time of great political ferment, and he carefully navigated between opposing attitudes. Most relevant for the events of 1907 were his attitudes and policies toward large corporations. On the one hand, Roosevelt accepted industrialization and the large scale of firms that it brought.[17] He believed that large corporations were here to stay, and that the stance of government should not be to eradicate the large firms, but rather to identify and eliminate the types of combinations that were dangerous.* "I believe in corporations," Roosevelt said early in his presidency. "They are indispensable instruments of our modern civilization; but I believe that they should be so supervised and so regulated that they shall act for the interest of the community as a whole."[18]

However, to deal with the perceived ills of large corporations, Roosevelt also implemented a policy of aggressive enforcement of the antitrust laws, mediation, and regulation. In 1902, for example, Roosevelt initiated a series of important antitrust actions, beginning with a suit against the Northern Securities Company, a railroad trust organized by J. P. Morgan, James J. Hill, John D. Rockefeller, and E. H. Harriman in 1901 just five weeks after Roosevelt took office. Two years later, the Supreme Court ordered the company dissolved. Roosevelt also filed suit

* Just weeks after the Panic, Roosevelt said, "It is unfortunate that our present laws should forbid all combinations instead of sharply discriminating between those combinations which do good and those combinations which do evil. . .The antitrust law should not prohibit combinations that do no injustice to the public, still less those the existence of which is on the whole of benefit to the public." Quoted from a public speech by Theodore Roosevelt, "Sherman Antitrust Law" dated Dec. 3, 1907. Used with permission of Columbia University Rare Book and Manuscript library.

against the unpopular "beef trust," an action that the Court upheld in 1905. When states began filing state antitrust suits against Standard Oil between 1904 and 1907, Roosevelt directed the Justice Department to assume leadership of the campaign against the oil monopoly.[19] By 1907, the Roosevelt administration had sued nearly 40 corporations under the Sherman Antitrust Act.

In that same spirit, Roosevelt revitalized the Interstate Commerce Commission, which had been created in 1887, by signing the Elkins Act of 1903 and the Hepburn Act of 1906, which gave the Commission the power to set maximum shipping rates for railroads. He also reenergized the presidency and asserted executive powers to protect particular social groups and supervise the economy in ways not seen since Reconstruction. In a Memorial Day speech at Indianapolis, President Theodore Roosevelt railed that the "predatory man of wealth" was the primary threat to private property in the United States:

> One great problem that we have before us is to preserve the rights of property, and these can only be preserved if we remember that they are in less jeopardy from the Socialist and the Anarchist than from the predatory man of wealth. There can be no halt in the course we have deliberately elected to pursue, the policy of asserting the right of the nation, so far as it has the power, to supervise and control the business use of wealth, especially in the corporate form.[20]

Progressive activism was reflected at the state level as well; various states passed legislation sharply limiting the prices railroads could charge passengers. Business analysts believed these prices yielded revenues below the costs necessary to provide the services, thus inducing downward pressures on stock prices.[21] The *Chronicle* opined, "What is ailing the railroads and the stock market? . . . The underlying cause is the same as it was at the time of the collapse in March, the same, indeed, as it has been for about a year and a half, during all of which period a shrinkage in values has been in progress. Owing to the assaults of those high in authority and adverse legislation both by Congress and the State legislatures, confidence is almost completely gone. No one is willing to buy at what appear like ridiculously low prices because no one can tell what the future may bring forth."[22]

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The initial judgment of knowledgeable observers was that the break in stock prices in March 1907 had been sparked by investor fears arising from the Roosevelt administration's aggressive attitude toward railroads and industrial corporations. "For a year we have been foretelling this catastrophe, an assured result of the trials railroad property, railroad men and other large capitalists have been forced to suffer," the *Commercial and Financial Chronicle* said, commenting on a newly launched investigation of E. H. Harriman's Union Pacific railroad. "What has just taken place is not the final scene. Hereafter, if the irritant is continued, as we presume it will be, it will not be so exclusively securities and security-holders that will suffer; all sorts of industrial affairs are sure to get involved."[23] That irritant, of course, was the president of the United States.