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DIGEST OF INFORMAL DISCUSSION

INVESTMENTS

A. What is the outlook for interest earnings on the following types of investments for the balance of 1961? for the succeeding three years?
   (i) Industrial securities,
   (ii) Residential mortgages,
   (iii) Farm mortgages,
   (iv) Investment real estate.
   Are companies and pension funds changing the relative proportion of their investments among these categories? Are there any new types of investments arising in these categories?
B. Are companies investing in common stocks to the extent permitted? What types of equity investment programs have companies set up? Are pension funds continuing to look to common stocks to the same extent as in the recent past?

New York Regional Meeting

MR. CHARLES A. SPOERL: I asked five Hartford companies to give their opinion on the outlook for interest earnings. The first question I asked was if they thought interest rates are at or past the peak or if the peak is still to come. Four companies thought the peak was passed, and two thought the peak was still to come (one company expressing a divided opinion in its investment department by casting one vote on each side). On the four specified classes of securities, the general idea was that industrial bonds had higher rates ahead, and in the case of residential mortgages a declining trend would be evident. Farm mortgages were expected to show a slightly declining trend, but would be a little more steady than residential mortgages. As to real estate investment, two companies were optimistic, quoting rates of close to 6% or $6\frac{1}{2}$% to 7% over the next few years, while another company said that there is a tax cloud in investment real estate which must be straightened out before it would be too much interested in this direction.

As to the proportions of investments, everyone seemed to think the thing to do is to sell governments, reinvesting in a varied list with industrial bonds the most popular choice. Two companies thought the thing to do is to buy tax exempt bonds, I suppose because they are more nearly tax exempt than other companies find them. One company thought there would not be very much change.

In reply to the question about whether there were any new types of investment arising that would be of interest, four of the companies said no, and one said, "Yes, indeed, but we can't reveal it."

I have a few remarks on investing in common stocks. Most of the Hartford companies have modest programs or no programs at all. One company thought that they were pretty well bought up, but most did not. In the case of the two multiple line companies, the casualty affiliate is buying stocks so there is sort of an indirect investment in stocks, which can be quite potent.

MR. EARL F. BUCKNELL: Interest rates in the long term area have been in a general decline since the end of 1960, continuing the trend that started first in the short term sector fairly early in the year. The total decline in long term rates since late 1959 has been from $\frac{3}{4}\%$ to 1% on corporate bonds.

This has been affected recently by the attempt to lower long term rates to encourage home building and other capital expenditures, while holding short term rates up as one barrier against the outflow of gold. Whether this attempt to influence the money markets in the opposite direction could survive a substantial increase in demands for long term funds is questionable, and even now there is some evidence that the attempt to nudge long term rates downward is meeting resistance.

Basically it appears the economy will be forced to rely on real savings for long term credit. Consequently, the prospective rate structure seems likely to depend largely on the prospects for the level of business activity. Most economists anticipate some increase in this level in the second half of the year, but it seems probable that, barring a substantial change in the international climate or fears of inflation, the improvement in 1961 may be rather mild. Any increase in long term rates would also be rather modest, but there should be some increase from current levels by the end of the year.

The amount of federal government financing and the maturity range may be an important factor. It seems very likely that some deficit financing will appear, but it is more difficult to judge whether this will bring with it an increase in private borrowing, resulting from uncertainties about the future value of the dollar. If there should be such a development, the Federal Reserve would probably tighten credit aggressively, and rates would rise rather sharply.

Interest rates on the various types of investment will act in the same way as rates as a whole, with some typical differences:

1. Industrial securities should show some increase from current levels. There seems to be a fairly good backlog of demand for funds, most of which comes

from a desire to improve efficiency or to finance receivables in one way or another.

2. On residential mortgages interest rates tend to lag behind the rates of securities markets, and they seem likely to continue to decline for some time yet.
3. Farm mortgage rates behave somewhat like residential mortgage rates and are influenced very heavily by the activity of Federal Land Banks. Their cost of money is going down at present, and, consequently, they are reducing rates. This probably will continue for some period of time, perhaps through the balance of the year.
4. Investment real estate rates have moved below mortgage rates on similar properties and credits for the past year or so. Some investors are willing to pay a premium for the possible gain arising from the residual equities in real estate. Consequently, rates on this type of investment may not rise as much as on comparable mortgage investments if fears about dollar obligations develop.

Insurance companies are increasing their investments more rapidly in industrial securities, including commercial and industrial mortgages; residential mortgages are increasing also, but investment in farm mortgages has not kept pace because of the rather small supply and competition from the Federal Land Banks. Pension funds are mostly in public utilities and industrial securities, including some commercial and industrial mortgages, and common stocks.

The most important type of new investment which has arisen recently is the mortgage backed up by a lease of a substantial lessee, which is being increasingly applied to real estate and also to personal property. It now extends to fleets of cars, trucks, machinery, fixtures, and recently to the financing of jet planes by one of the airlines.

Relating to section B, policies of common stock investment vary widely. Most companies are not investing the maximum permitted. Perhaps the most common program is some type of dollar averaging with the view of approaching the legal limit over a period of years. Many companies do not follow such a program, however, and some have even sold positions to take profits.

MR. DAVID G. SCOTT: In the case of one Illinois company, the most important limit on the amount that can be invested in common stocks is the one which comes up to be one half of your surplus, including the security valuation reserve. Under that kind of system, if you are operating at the limit available, when the prices of stocks are up the amount that you can invest in stocks is automatically reduced, and when stocks are down you automatically have a bigger margin to invest. So theoretically, you will invest the highest amount in stocks when they are low.

Dallas Regional Meeting

MR. SAM HOUSTON HUFFMAN: Six major banks in Dallas, Houston, Fort Worth and Oklahoma City have pooled funds for approved pension and profit sharing plans, setting up both a stock or equity fund and a bond or fixed income fund. Many of the Wyatt Company's clients have some one of these participating banks acting as corporate trustee, with a substantial portion of the trust funds invested in these pooled funds.

About eighteen months ago, one of these banks which has done an excellent job for our clients had about 60% of its trust funds invested in the stock fund; then it began to reverse the position until only 30% was in stocks as the stock market approached the bottom of its slide.[1] Then it again started to acquire stocks until the percentage is now about 50% in the stock fund. The yield for the bond fund for the last year for this particular bank has been slightly under 5% and there has been a capital gain of about 3%. The nearly 5% yield is assured for at least the next four years, as few of the bonds are callable within that period. Also during the past year the income on the stock fund has been about 3% but there has been a capital appreciation of nearly 20%.

One large bank in the Midwest with a pooled pension fund recently added a third category for approved pension and profit sharing plans, namely an all mortgage fund, and within 30 days after its pension and profit sharing accounts had been notified it had about $6½ million of FHA insured mortgages with a return of 5¼%.

We have several clients with pension funds invested in second mortgages in shopping centers, with excellent yields. Also we have several clients where the trustee has built an office or other building and leased it to the client at a rental which results in a net return of about 9% on the investment, and in most cases there has already been a substantial increase in the market value of the property.

As you are all aware, the investment situation during the last two years has been somewhat erratic and has represented an economic reversal. During this period and in the future it is very important that the corporate trustees of large pension funds maintain a very watchful and aggressive attitude in order to properly protect the huge funds en-

[1] In response to an inquiry from MR. WALTER W. STEFFEN as to how the change in ratio from predominantly stocks to predominantly bonds was accomplished, whether all new money on a rapidly growing fund was placed in the investment that looked attractive at the time or investments were terminated and switched from one type of security to another, MR. HUFFMAN replied that there was some selling done before the ratio got down and also the new money was going mostly into bonds.

trusted to their care and also obtain the maximum yield consistent with safety of the funds.

MR. JOSEPH W. HAHN: As to the outlook for interest rates, it may seem quite old-fashioned to speak about the law of supply and demand, but I suggest that the law is going to operate with respect to interest rates.

As to residential mortgages, at the present cost of building there is not likely to be a heavy increase in the demand for mortgage money and consequently the current softening will probably continue for the remainder of the year.

In connection with industrial securities, the supply is probably at a two-year low here, with the result that the yield on those securities currently being issued is fairly low. However, many of the economic indicators would suggest that we have reached the bottom of the current recession and possibly we are in a period of upturn. If true, then it seems likely there will be greater demand for funds by industrial enterprises and there will be an upturn of the yield or interest rate on those securities.

Now, the Federal Reserve Board certainly exercises a great deal of control over interest rates. There has been recently a fairly well publicized program by the Board to nudge the price of long-term governments upward by purchasing long-term government bonds. This is simply a nudge, it is not any attempt to drive down the long-term interest rate and it has been curiously unsuccessful because yields have actually increased during the period that this program has been in effect. This is not so much a measure of the inability of the Federal Reserve Board to control interest rates as it is a measure of their interest in lowering the long-term rate. Concurrently with that program they have tried to raise the yield on short-term securities and this has been fairly successful. It would seem then that the Federal Reserve Board is not overly interested in lowering the long-term interest rate.

We are invited to discuss the outlook for the three years after 1961. Well, I do not know why this period was chosen; possibly it represents the remaining term of Mr. Kennedy. I suggest that maybe the picture is clearer for the next two years, which represent the remaining term of Mr. Martin, who is the chairman of the Federal Reserve Board.

MR. WILMER A. JENKINS: I am associated with an unusual fund, which is declining in size and recently faced the necessity of raising three or four million dollars within the next year. The question was when to sell long-term bonds. I consulted three groups of experts, and their opinions may interest you. One expert was the trust department of a

large New York bank, one was our own TIAA investment staff, and the third was the investment department of a large ministers' pension fund. All three said, "Don't hold off selling more than six months. Sell between now and fall."

Their thinking was that, with a business pick-up later in the year, the demand for money would rise, so that security prices would be likely to decline, with an accompanying rise in the interest rate. These three groups of experts thought that the law of supply and demand would be the reason for their anticipated result, although they didn't overlook the strong desire of the administration, and the perhaps not so strong desire of the Federal Reserve Board, to lower long-term interest rates.

MR. FREDERICK P. SLOAT: On section A, we observe in our New York area that there is a trend to get into mortgages and even into real estate in some of the pension funds.

On section B, as to whether pension funds are continuing to look to common stocks to the same extent as in the past, I think the answer is "Yes," unless you want to say it's "No" because they are possibly investing in common stocks to a greater extent than in the past. We still observe pension trusts that are changing the proportion of stocks or going into stocks for the first time. I am not aware of any that have decreased the proportion in stocks. Of course, this does not mean that they have not temporarily changed the emphasis of their investment program. It is true that, in the last year, quite a few have slowed down their investments in equities. Even a big bank that may be investing on a dollar-averaging basis may have a tendency to slow down purchases because the market is going down and then not start to speed up again until it goes up; as a result, they do miss some opportunities by not adhering to dollar averaging.

MR. MORTON D. MILLER: In the case of my own company, the Equitable of New York, approximately two years ago we embarked upon a dollar-averaging common stock program. It is set up so that we will reach our maximum reasonable participation in stock investments over a period of ten years. Of course, it is too early for us to know quite how we will come out on the program, but as far as I know our people are reasonably satisfied with results to date.