The Great War, the NYSE and a Legacy of Strength

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On July 31, 1914, the New York Stock Exchange closed its doors for the longest period in exchange history. It stayed closed until Nov. 28, 1914, when bonds began trading again. Stock trading re-opened Dec. 15, 1914, but shares were not allowed to trade below closing prices of July 30, 1914. By April 1, 1915, all trading was re-established without price limits.

Most would dismiss the closing as a natural response to the beginning of World War I. But no war before or after (including the Civil War), or even the devastating attack on the World Trade Center less than one-half mile from the NYSE in 2001, has shuttered the exchange for more than 10 days in its 222-year history.

I will discuss why it was necessary to close the exchange and what lessons we can draw from the events of 100 years ago.

The ‘longest circuit breaker’

There is abundant historical significance to this story, and Henry George Stebbins Noble, president of the New York Stock Exchange from 1914 to 1919, chronicled it artfully in a 1915 book called *The New York Stock Exchange in the Crisis of 1914*. It is a story of disparate and even competing parties including bankers, brokers, other exchanges and clearing firms that steadfastly remained loyal to the New York Stock Exchange. Even the press cooperated in the closing by refraining from printing articles overly critical of the financial markets and by agreeing not to publish off-market prices in an attempt to calm and bolster the financial markets and forestall a run.

> Noble recounted: “The fundamental reason for closing the Exchange was that America, when the war broke out, was in debt to Europe, and that Europe was sure to enforce the immediate payment of that debt in order to put herself in funds to prosecute this greatest of all wars…There was to be an unexpected run on Uncle Sam’s Bank and the Stock Exchange was the paying teller’s window through which the money was to be drawn out, so the window was closed to gain time.”

What Noble omitted is any reference to government interference, coercion or even influence on the closing or re-opening of the NYSE. In contrast to Noble’s version, a solid case can be built that Washington’s influence, particularly due to Treasury Secretary William G. McAdoo, was substantial. This was persuasively argued by New York University professor William Silber, in his book *When Washington Shut Down Wall Street: The Great Financial Crisis of 1914 and the Origins of America's Monetary Supremacy*.

Silber recently called the exchange closing ‘the longest circuit breaker in American financial history.” War aside, the beginning of the century to 1914 was the worst extended period for stock returns in the 20th century, besides the fateful years to come during the Depression. The Dow Jones Industrial Average (DJIA) was already faltering even before the rumblings that led to war. The DJIA was down almost 20% from Jan. 2, 1913, through July 30, 1914, though most of the drop occurred in the last week. One lesson: It is less disruptive to shut down the exchange in a bad market than in a good market, because of lowered expectations. Further, because of resulting heavy short interest, the stock market would have a built-in stabilizer, as short positions would later have to be covered. “It were well if ill-informed people who deprecate short selling would note this fact,” Noble commented.

America’s rise to prominence

Important themes emerged during this period including globalization, the ascendancy of New York as the capital market of the world, the role of the press, the weakness and durability of paper trading and the exchange itself and the long history of ignorance and resentment of the stock market.

For those of us who think of the “globalization” of markets as being a recent innovation, consider that upon the declaration of war on July 28, 1914, and in the days to follow, most major bourses closed in concert: Montreal, Toronto, Madrid, Vienna, Budapest, Brussels, Antwerp, Berlin, Rome, St. Petersburg, Paris and throughout South America. London, the world financial center, closed on July 31, 1914. Such was the global interconnectivity of interests and property 100 years ago. In the U.S., "Baltimore, Boston, Chicago, Cincinnati, Columbus, Detroit, Indianapolis, Philadelphia, Pittsburgh, St. Louis, San Francisco and Washington, all voted to close along with the NYSE." If the NYSE had not closed, it would have been "the only market in which a world panic could vent itself."

A key vulnerability in the U.S. was the threat that, as Silber wrote, "foreigners owned more than $4 billion U.S. railroad stocks and bonds at the outbreak of the Great War, with $3 billion of that in British hands. These securities were liquid assets and could be sold quickly on the NYSE. Under the gold standard, foreign investors could then use their cash proceeds to acquire the precious metal from the American banking system." They could next ship it all back to London. The Bank of England had just experienced a run on gold and lost $52.5 million. It would be eager to refill its vaults. Further, "fear that the United States would abandon the gold standard pushed the value of the dollar to unprecedented depths on world markets. The magnitude of the problem forced America to defend itself." Closing the NYSE was one of those defenses. Add to this the complication that Europe settled trades every two weeks while the U.S. settled trades daily. The backlog of unknown sells from Europe could have been overwhelming.

Why was gold important? Gold was the world currency up to World War I. Later, the pound sterling would replace gold. Still later, the dollar would assume its place. In an email interview, Dr. Silber wrote me, "McAdoo needed to keep gold in the country to insure a healthy opening of the Federal Reserve system." The Federal Reserve grew out of the panic of 1907 with the charge to create reserve or elastic currency to attempt to avoid bank runs. The Federal Reserve is not entirely dependent on its precious metals store, as the U.S. Treasury was at the time. Therefore, its lending power became nearly instantly infinite. Its backing was now a nation, instead of only a nation's treasure. Silber concluded in his book: "In January 1915 the New York capital market replaced London as money lender to the world."

A relief valve

Amid this turmoil, not surprisingly, after the NYSE closed, a second market called New Street was informally created in which certain types of transactions could occur, above a specific price floor, without reporting prices back to the NYSE and without the media publishing trade activities. This secondary market – sometimes called derisively the "outside," "outlaw" or "gutter" market – was first resisted by the NYSE. The fear was that execution of orders below the last prices set on July 30 could undo the very purpose of closing the Exchanges. But this informal alternative market was quickly tolerated by the NYSE's "committee of five" as a necessary relief valve for desperate sellers. (The committee of five included Noble and four of his senior associates and made virtually every decision regarding the operation of the exchange.)

Silber stated disapprovingly that there was a "campaign by the New York Stock Exchange during the trading suspension to suppress New Street prices." Noble would disagree with this tone and would claim instead that the press willingly cooperated with the NYSE for the sake of stopping a possible run on the market from massive London and U.S. sellers. "If declining prices were made through media of this description, and the press felt called upon to furnish them to the public, the closing of the exchange might not suffice to prevent panic and disaster." One could reasonably argue for transparency at all costs. But Noble believed that the cost would be catastrophic. Could this have been one of the early acts of fiduciary to client duty?

Other lessons for today

The markets of 100 years ago also remind us of the relative merit of electronic records. Today, all trading is done electronically. We cannot imagine any way to hold or to trade securities in a more efficient manner. And certainly we smile at descriptions like those found in Noble's book of steamer ships with quaint names like *Olympic* and *Mauretania* filled with stock certificates *en route* from London to settle trades for cash or gold in the U.S. However, upon what ships would our stocks sail if the power grid collapsed after an electromagnetic pulse attack and our book entry positions are now merely blank computer screens? I think we all are a bit uneasy with our 100% reliance on computer records. For example, speaking of quaint names, Mt. Gox, as we have discovered, is certainly no Mt. Olympus. Reminders of the events of 100 years ago should be refresher courses on the potentially precarious state of our virtual financial world.

Finally, there is a lesson for today's Occupy Wall Street crowd. Noble wrote:

> The World crisis of 1914 forced upon us an object lesson on the question of speculative exchanges in general which ought to be of lasting profit. For years agitators had been hard at work all over the country urging the suppression of the Cotton Exchanges, and claiming that they contained gamblers who depressed the price of the cotton growers' product. In the summer of 1914 the dreams of these agitators were realized. The Cotton Exchanges were all closed and the cotton grower was given an opportunity of testing the benefits of a situation where there was no reliable agency to appraise the value of cotton. The result may be summed up in the statement that the reopening of the Cotton Exchanges met with no opposition. A similar object lesson was furnished in the case of the Stock Exchanges.

> They were all closed, and for a few weeks some profound thinkers in the radical press stated that the country was showing its ability to dispense with them. When the time for their reopening came, however, there was no agitation to prevent it.

With a few word replacements, the above could be written about today's agitators. No one has created a more reliable method for forming, valuing and transferring wealth than the stock exchanges. This will likely be the story in another hundred years.

Conclusions

The judicious closing of the NYSE under watch of five committed individuals is a remarkable story of cooperation, sacrifice, shared purpose and loyalty. Perhaps this is an alliance that only war can forge. There was only one argument, according to Noble, among the committee of five:

> On one of the first few days of their career a rather positive and aggressive member, arguing with a colleague, said *you must remember that you are only one of this Committee*. The Committeeman thus addressed responded with calm determination, *and you must not forget that you are not the other four*. This encounter excited much amusement among the remaining members and was the one and only occasion where anything resembling a serious difference appeared.

With poetic fanfare, Noble ended his historic account accordingly:

> It can be stated with confidence that the intelligent resourcefulness of the Stock Exchange, in conjunction with the splendid public spirited work of the New York banks and the press, warded off a calamity the possible magnitude of which it would be difficult to measure. The success of this undertaking should be a source of pride and emulation to those future generations of brokers who will have to solve the problems of the great financial market when in the words of Tyndall, "you and I, like streaks of morning cloud, shall have melted into the infinite azure of the past."

Did it work? Was it prudent to close the NYSE for four and a half months? Probably. From the market re-opening (without restrictions) April 1, 1915, through the Treaty of Versailles on June 28, 1919, the official end of the war, the DJIA rose 75%. The stock market certainly can climb a wall of worry. Moreover, I believe it brings a certain comfort to us that while shells fly, countries fight and attacks rain down – even right outside the door – the exchange marches on. The Great War broke many things, but not the financial markets.

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