

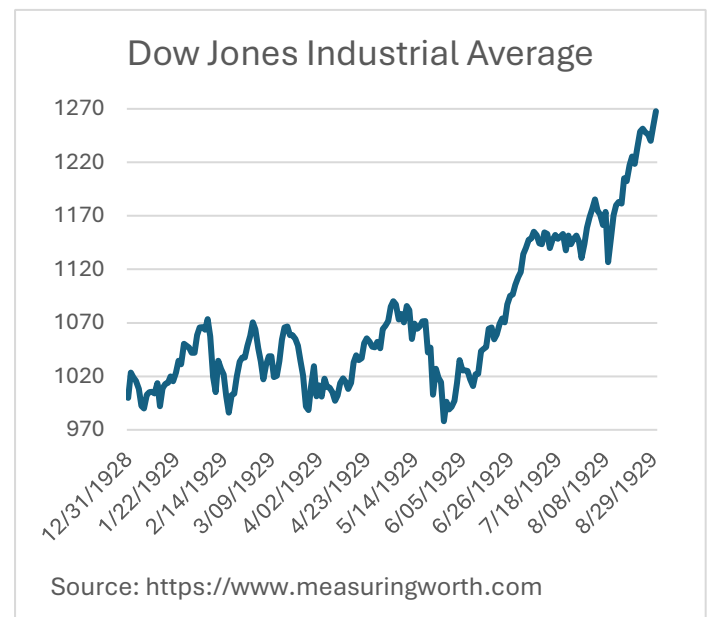
Brent Sheather is a Financial Advice Provider and a personal finance and investments writer.

1929: INSIDE THE GREATEST CRASH IN WALL STREET'S HISTORY – AND HOW IT SHATTERED A NATION PART 3: SUNSHINE CHARLIE'S LUCK RUNS OUT

In this, the third part of our series on the 1929 crash we will look how at that period impacted the life of one of the biggest players: Charles Mitchell of National City Bank. Early in the book Sorkin recounts the travails of Mr Mitchell, the 52 year old Chairman and CEO of the biggest bank in America, National City Bank (later to become Citibank). Mitchell, popularly known as Sunshine Charlie given his optimistic disposition, got the top job at National City Bank in 1921 and, until the crash ruined everything including his reputation, it appeared he was the right person, in the right place, at the right time. In the constructive economic environment of the Roaring Twenties his strategy of bringing Wall Street to Main Street by installing equity salesman in each of National City's 36 NYC branches (with its securities affiliate having offices in a further 50 leading American cities), together with the provision of margin facilities enabling individuals to buy shares with just a 10% deposit, supercharged National City's profitability. Prior to Sunshine Charlie's initiative the stock market and margin lending had a relatively narrow base of the rich and famous. "Across America, National City's depositors could walk into a bank branch to cash a cheque, discuss a loan, and leave owning shares in the bank itself. The country's largest bank had turned its branch system into a securities distribution network, helping to draw thousands of ordinary savers into the stock-market boom. By 1929, National City Bank stock was changing hands at more than eight times its book value, and salesmen were still finding eager buyers". Source: US Senate Investigation Into Stock Exchange Practices, June 1934.

Early in February 1929, eight months before the crash, the Federal Reserve issued a warning to banks that margin lending was excessive: margin

loans outstanding had grown from US\$1.0 bn in 1920 to US\$6.0 bn in 1929. At the time a Federal Reserve Governor said privately "that it was better that the stock market fell out of the 10th storey today rather than the 20th storey later on". As the graph below illustrates the market fell in February as



a result of the Fed's warning. However in March Mitchell called a press conference where he commented with words to the effect that National City Bank will continue to provide investors with margin loans "no matter what the Federal Reserve thinks". The market reacted immediately, recouping all its losses of the previous week, and went on to rise by a further 19% to its peak just before the crash. Mitchell's move to "save the market" made him a celebrity however at subsequent post crash Senate enquiries Mitchell's action to continue "pumping" the market with margin loans was harshly criticised, particularly

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given that he was on the Board of the Fed at the time

By researching hither to private documents Sorkin describes the situation that confronted Sunshine Charlie late in the afternoon of Monday October 28 1929: the market had earlier that day closed down 13%, the largest fall in a series of convulsions that had seen shares fall by 20% in the last six trading days. Sorkin writes *"Charles Mitchell strode up the steps of 55 Wall Street, determined to project his usual sense of confidence and certitude. It had been a crushing afternoon. As he returned to his office he knew that the eyes of Wall Street were on him – in his gray three piece suit, shoulders back, Mitchell kept up his smile as he passed through the glass domed central hall of his National City Bank, with its 83 foot ceiling and two solid bronze doors protecting a safe weighing some 300 tons, it was the largest in the country."* Mitchell's problem was as follows: he had arranged for National City to take over the National Bank of Commerce and the merger terms allowed National Bank of Commerce shareholders to take either US\$360 in cash or 0.8 shares of National City Bank stock. When the deal was structured National City's share price was around \$496 per share making the cash option unattractive. But with the recent fall in the market the cash option was now looking much better. One small problem: National City didn't have enough cash if everyone opted for the cash option. Mitchell was thus naturally trying to keep National City's share price high by buying stock in the market but on that Monday selling pressure built such that the bank had had to buy 71,000 shares of its own stock at a cost of US\$32m. Banking rules prevented the bank from borrowing to buy its own shares so the only option Mitchell had was to buy the shares himself. He did this by borrowing US\$12m from JP Morgan, a large sum given his net worth at the time was around \$US6m. Unfortunately for Sunshine Charlie the next day, Black Tuesday, markets crashed even further. Ultimately the takeover failed and Mitchell lost much of his own fortune that had been accumulated up to that point. Mitchell was subsequently vilified by leading members of government and the Federal Reserve.

This story reminds me of one of the scariest moments I had back in the late '80s: A company with no earnings history floated on the New Zealand Stock Exchange and subsequently the price was pushed up to 3x the IPO price within

about six months. My guess is that, like Sunshine Charlie, the directors of that company were supporting its share price as they were going to use the shares as "currency" to buy other companies, with genuine earnings. The NZ sharemarket crash made supporting a share price rather difficult, like Sunshine Charlie's experience, and around the time that the price was at its highest point I got a call from a very wealthy person who wanted to sell, from memory, about 350,000 shares. Back in 1987 an order for around \$1m worth of shares was a big deal. We started selling on market and within an hour or two I got a call from an individual connected with that company asking me how many shares we had to sell and offering to buy them himself. I could have got brokerage on both sides of the deal if I had sold them to him however post the crash I was a bit paranoid re counterparty risk and had even instructed our dealers on the trading floor to only sell big parcels of shares to brokers that were backed by banks. So I told that person that we could only sell them on market. We did this and one broking firm, presumably the broking firm used by that individual, bought most of the shares. A few months later heard that that person didn't pay the broker for the shares. Of course, the broker had to pay us, which they did, and we were able to pay the client. It dawned on me that if I had crossed the shares to the individual he may not have paid us but we would have had to pay the client which would have meant a loss for our firm of over \$1m, real money back in 1987.

In three weeks' time we will finish off this series by looking at how Sorkin chronicles the events on the worst days of the 1929 Crash – October 24 to October 29 1929 through the personal accounts of some of the big players of the time.

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.