...e Money Men

Warning: It May Be Later Than You Think

PAUL CODMAN CABOT, 70, Boston blue blood and former treasurer of Harvard, chairman of State Street Investing Corp. and director of seven major U.S. corporations, picked up the telephone on his cluttered desk. Sidney Weinberg wants to talk with you, his secretary told him. "Hello Wynie, what's up?" Cabot asked.

What was up was that Chicago dealster Ben Heineman had that morning made a tender offer for B.F. Goodrich, with New York dealster Laurence Tisch acting as a kind of shotgun Myles Standish. Weinberg and Cabot are both Goodrich directors of long standing. As directors, what are we going to do about this takeover, Weinberg asked? What indeed.

Saying goodbye to Weinberg, Cabot swiveled for a minute to gaze at a freighter maneuvering in Boston harbor, 29 stories below. Then he grinned at his visitor and commented:

"It's the same old story in these takeovers. Somebody makes a pass at these girls and they rush out to find a legitimate marriage.

"Either way, the girl loses her virginity—fast."

That's not precisely the way he said it, because for all of Groton and Harvard and Back Bay, Cabot likes to use four-letter words once in a while. But the reader will get the point: Cabot thinks a good many people and a good many companies are being taken in these takeovers.

Becoming serious, he said: "These tender offers and these proliferating conglomerates are wrong. They are dangerous. These takeover guys act as if they have found the secret of perpetual motion. Well, they haven't.

"It's hard enough to run *one* business. How in hell do they expect to run half a dozen?—I know this is a sweeping statement but I'll say it: I know of few mergers that didn't create a mess, and I've been through some big ones.

"And these prices. These old-line companies just are not worth 20, 25 times earnings. I can understand fancy price/earnings ratios for some of these little companies. At least there's a *chance* they could become another IBM or Polaroid. But a cyclical, billion-dollar company? Ridiculous.

"I can see things brewing right now that could be more troublesome than what we had in 1929."

We gulped. Cabot has seen a lot in his time. "Worst than 1929, Mr. Cabot?"

"Look at the parallels. In 1929 money rates were sky-high; John Q. was in heavily, and the brokers were egging him on; people were saying there's going to be a shortage of common stocks."

"But what's *worse* today, Mr. Cabot?"

"I'll tell you. In 1929 the investment trusts were doing wicked and unsound things, things that helped bring on the crash. You didn't know what was in their portfolios. You didn't know where their income was coming from. You had to have faith—in a name.

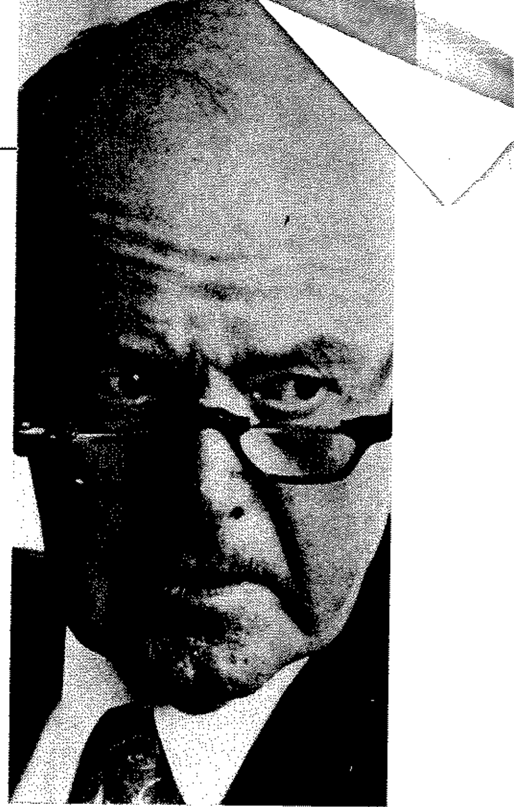
"That kind of role is being played now by the conglomerates and takeover guys. Only they're doing it on a far bigger scale than the investment trusts did: putting up prices, keeping investors in the dark. Why some of the things I see are just crooked."

Cabot paused and reached into his desk. Out came the annual report of one of the better known conglomerates. We had to promise not to print its name before he guided us through its income report. No question about it. It was downright misleading; the earnings weren't what the report seemed to say they were.

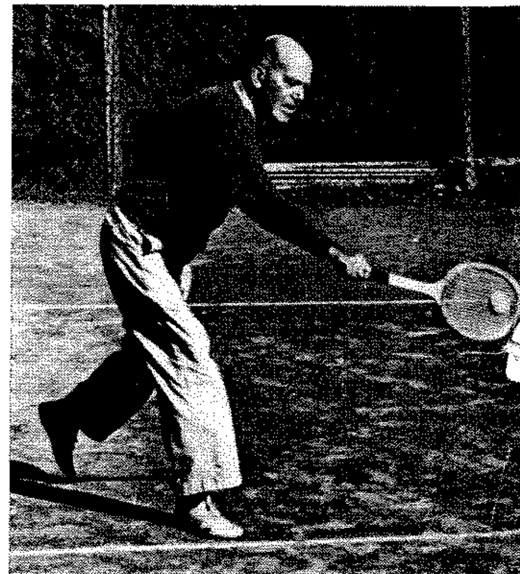
Said Cabot: "I brought this to the attention of a mutual friend who asked the company. His friend in the company said he hadn't been aware of the way earnings had been reported. The hell he hadn't! I persuaded my partners to sell the stock."

"But Mr. Cabot," we interrupted, "you conservative types have been worrying for quite a while now. Yet nothing's happened. When do you think the bottom is going to drop out?"

"Now you've got me," he conceded. "I don't know the answer. I do know that these excesses always last longer than makes any bloody sense. I remember the Florida land boom of the Twenties. They were even selling land under lakes. My partners and I knew prices were too high, but we figured we'd sell to the next guy. But it's risky trying to play that game. We were too late and we took a mild hosing. It was the best thing that ever happened to us.



Paul Cabot



"What will break the camel's back this time, I don't know. But I can see the poor beast starting to buckle.

"It shocks me that so many of the investment companies are playing the game too. It works like this: A takeover guy comes to them and says, 'I'm going to take

over such-and-such at such a price, 50% over the current market price. Why don't you buy 5% of the stock and tender it to me when my offer comes out?' So the takeover guy gets a block of stock in friendly hands and the investment company gets an assured, easy profit. Even if the takeover fails, the raped company marries someone else and the investment company still makes out.

"This is a game that's going to give the whole investment company business a bad name.

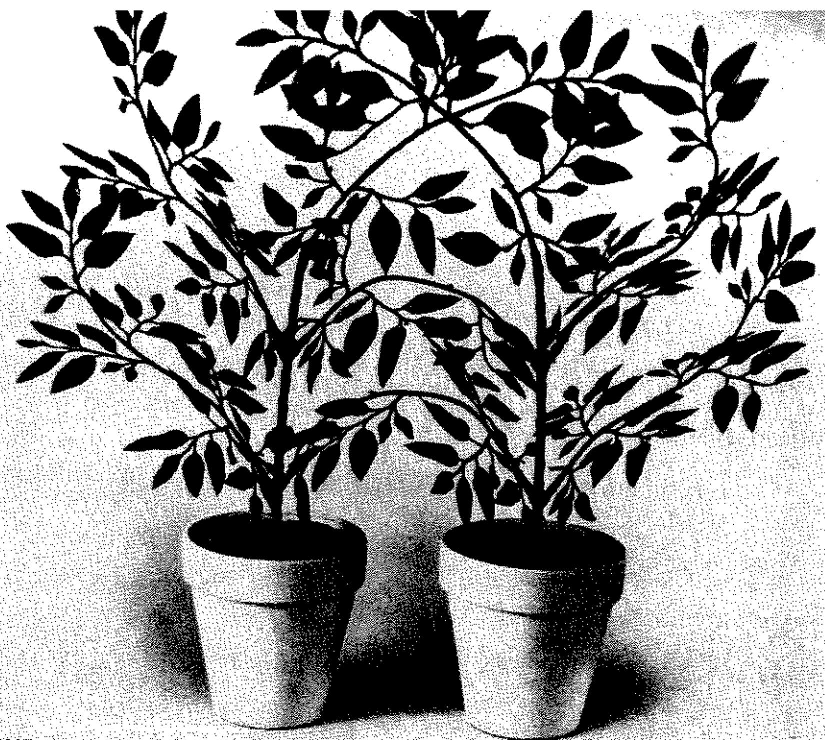
"Don't get me wrong. I don't argue with investing for performance. I'm for it. But investing for short-range performance like this is wrong. It's poor policy. It can actually lead to bad long-range performance. At State Street we're willing to take risks, but not the kind where we're going to be blown right out of the window if something goes wrong."

He went over to a filing cabinet and took out a reprint of an article he wrote for *The Atlantic Monthly*. It warned against investment company abuses and speculation. The key sentence: "*Almost anyone can make money during a period of rising prices, but it will take real skill to curtail losses when things are moving in the opposite direction.*" The date of the article: March 1929. In the years thereafter, Cabot proved his point; State Street's customers survived the Great Crash and, perhaps more impressive, avoided being trapped in the False Rally of 1930-31.

As we got ready to leave, Cabot hedged, but only a little bit, on his warning of impending trouble. "Of course, we've got more built-in correctives today. A sharp stock market probably would not turn into a depression. But it could still be a beautiful decline. A beautiful one."

So that, in no uncertain terms, is what Paul Cabot thinks the conglomerate and takeover trends are leading to. You can discount him, if you wish, as an aging patrician who resents new money and new tactics. You can say that his Puritan heritage rebels at easy money; that he's mad because the Establishment is being challenged.

But, frankly, we were impressed by his warning. And a little scared. ■



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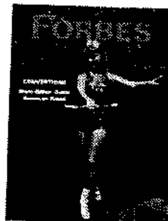

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treble its price when it *doubles* its earnings; the market, assuming the rising trend will continue, puts a premium on the stock. In Graham's view, the market should regard the gain rather more skeptically: At most the stock should double—or maybe not even that until such time as the earnings gains look reasonably permanent. "The market's viewpoint in these things can be quite volatile," he says.

Indeed it can. Recently Wm. Wrigley stock dropped some $60 million, or 19%, in one day, when Wall Street chose to be disappointed with a 20% *gain* in earnings.

In spite of the rough bear markets of recent years, Graham is by no means convinced that the worst is over. It won't be, he says, until "price movements are justified by objective views of some kind and not simply by pure enthusiasm or obstinacy. The extraordinary recovery the market made from its 1970 low indicates that there has been no real impairment in the public's enthusiasm for stocks that seem to be moving best."

But the old game of premiums-for-growth isn't producing results, he says, and so, its days are numbered. "I don't think traders, and that includes the institutions, will maintain forever a stock market psychology that turns out to be relatively unprofitable.

"Take IBM again. It sold at 350 in 1968 and now is about 335. With a dividend return of under 2%, that means its shareholders got virtually no net return on their money. They become dependent on a market advance to justify the price they paid—but it should be the other way around."

In all this, Graham is not predicting "another 1929" or "500 on the Dow" or anything rash like that. But he does see ahead a repetition of the wild swings of the past few years.

There it is, Ben Graham updated, and it's not a very optimistic message. But it's sober and hard-headed and realistic and maybe more in tune with the new mood in America. When you think about it, a really rip-roaring stock market would seem terribly out of place in a nation which is questioning its basic values and in a world where the once almighty dollar cowers before the once-despised yen. ■