

Oh How the Mighty Have Fallen: the Failures that Ignited America's Financial panics

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Reviving an old way of looking at financial panics

John Stuart Mill

“It [a panic] occurs when a succession of unexpected failures has created in the mercantile, and sometimes also in the non-mercantile public a general distrust in each other's solvency; disposing every one not only to refuse fresh credit, except on very onerous terms, but to call in, if possible all credit which he has already given. Deposits are withdrawn from banks; notes are returned on the issuers in exchange for specie; bankers raise their rate of discount, and withhold their customary advances; merchants refuse to renew mercantile bills.”

Walter Bagehot

“Such accidental events are of the most various nature: a bad harvest, an apprehension of foreign invasion, the sudden failure of a great firm which everybody trusted, and many other similar events, have all caused a sudden demand for cash.”

Methodology

- What do the famous failures have in common?
- Case studies, surveys of case studies, time series
- *Financial Stability Oversight Council* designates “systemically important Financial Institutions”

Some generalizations about the failures that started America's Panics

Typically

- succession of failures that cross regional and institutional boundaries
- Shadow banks
- Eggs in one basket
- Real estate
- Run by trustworthy geniuses – before they failed

A few examples

- 1837, 1873, 1884 = ? 2008
- Real Estate
- Trustworthy Geniuses

1837 Key failure: J.L. and S. Joseph

- ☑ Succession of failures that cross regional and institutional boundaries
- ☑ a shadow bank – private investment bank
- ☑ most of their eggs one basket
- ☑ Real estate
- ☑ trustworthy financial geniuses -- before they failed

Problems for the Josephs

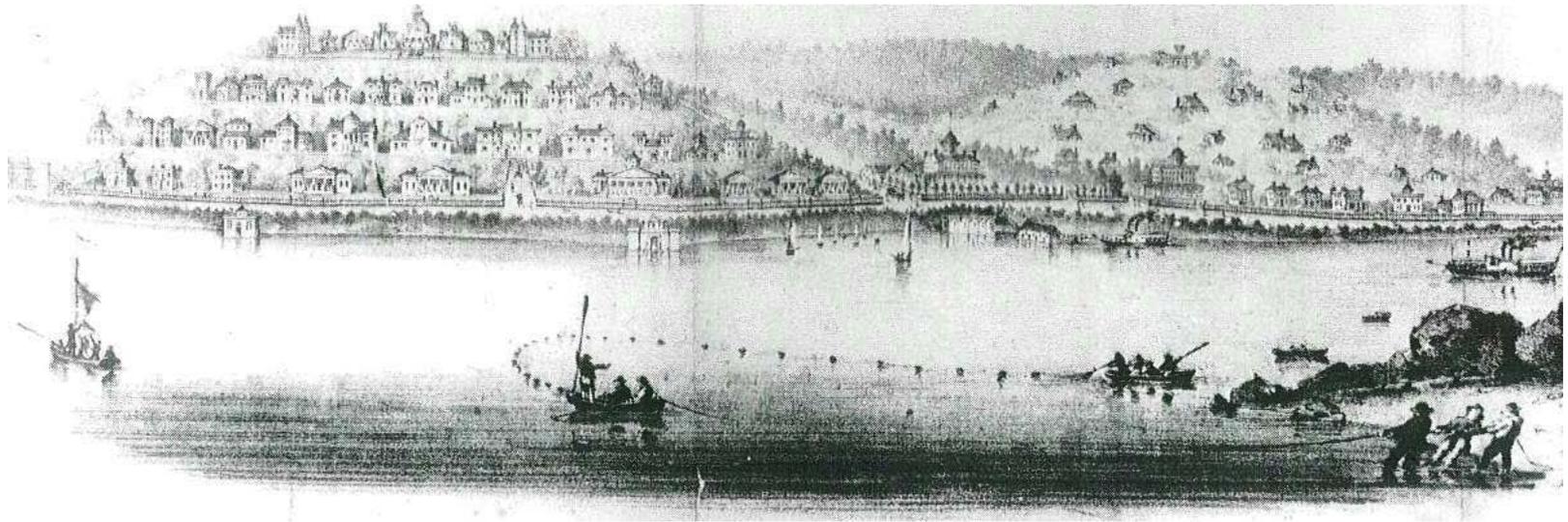
- Loans to cotton brokers in Louisiana go bad
- marble-clad office building under construction collapses
- Rothschilds want some of their money back
- Real estate investments fail

Real Estate Investments

- American Land Company
 - to purchase cotton lands in the Southwest
 - 400,000 acres
- New Brighton Association
 - Luxury development on Staten Island

New Brighton Association

Staten Island Development



Highlights of the New Brighton Development

- Homes will be “castles”
- “Village of Fountains”
- Fresh water will be pumped to an artificial lake two miles long
- 14 fountains, running day and night all year
“fountains were to be copies or superior to those of old Europe”
 - Versailles, Berlin, Constantinople, etc.

Surviving Examples of New Brighton mansions on Staten Island



Reputation of J.L. and S. Joseph

- Representatives of the Rothschilds
 - Succeeded by August Belmont

- *The New York Herald*

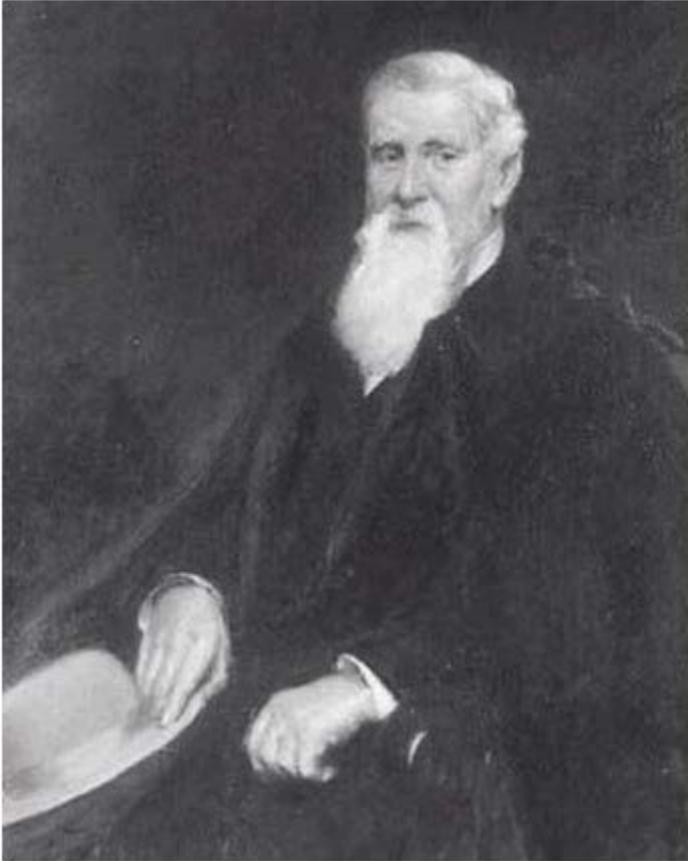
The Josephs and their partners were the favorites of the merchants of New York – their liberality – their aptitude for business – their gentlemanly behavior and their honorable conduct – their frank, unassuming manners – have made for them, in their days of prosperity, ‘troops of friends.’

Second Bank of the United States as lender of last resort?

- March 17, Josephs suspend.
- March 18 , meeting in New York.
 - Second Bank of United States offers \$1 million if other New York Banks offer enough to keep Josephs afloat.
 - No deal
- March 29. Biddle in NY announces plan for \$8 million in post notes and in one year bonds
- April 1. Notes and bonds go on sale

September 1873

Key Failure: Jay Cooke



- ☑ Succession of failures that cross regional and institutional boundaries
- ☑ a shadow bank – private bank and state bank
- ☑ most of his eggs in one basket
 - ☑ Real estate
 - ☑ trustworthy financial genius -- before he failed

Northern Pacific Railroad

- Cooke is financed partly by small deposits
- Real Estate Play
- Must sell bonds of the Northern Pacific to raise cash
- Bonds are valuable because of land grants to the Northern Pacific

From Cooke's add in the New York Times, Feb. 29, 1871

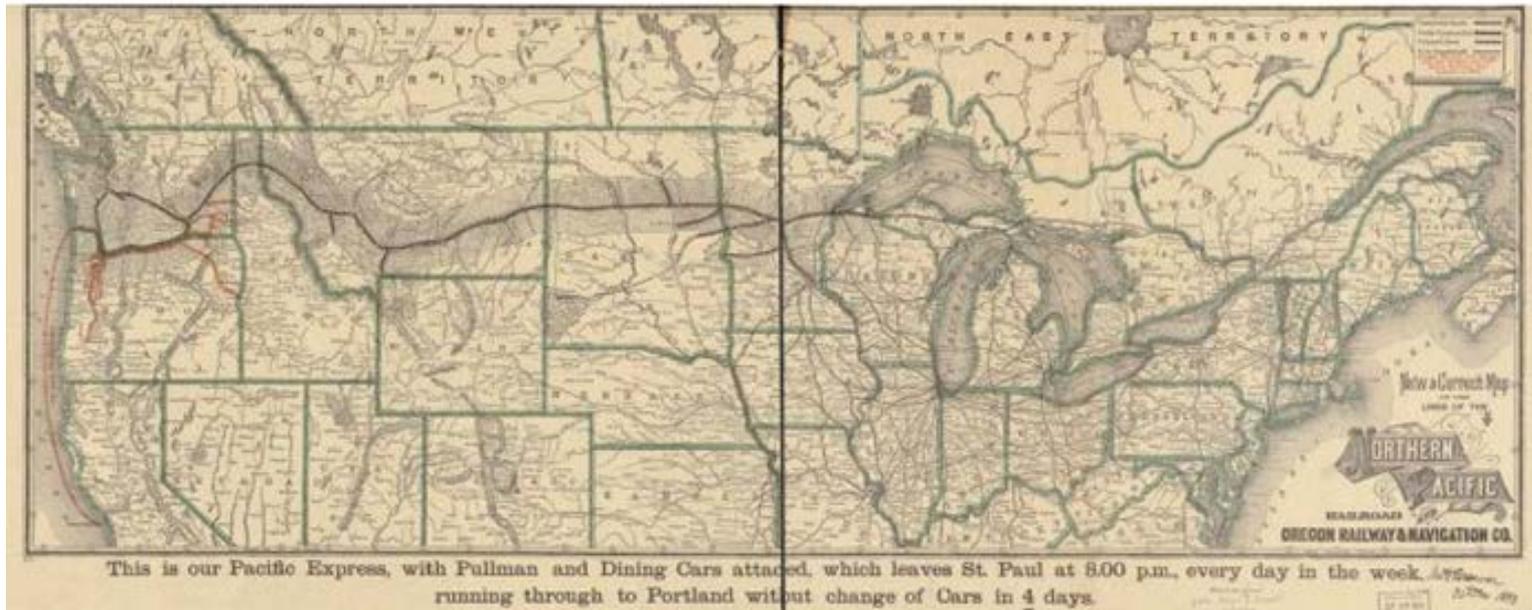
NEW 7.30 GOLD LOAN
OF THE
NORTHERN PACIFIC RAILROAD COMPANY,
SECURED BY FIRST MORTGAGE ON RAIL-
ROAD AND LAND GRANT.

SAFE ! PROFITABLE ! PERMANENT !

We offer for sale, at par and accrued interest, the First Mortgage Land Grant Gold Bonds of the Northern Pacific Railroad Company. They are free from United States tax, and are issued of the following denominations : Coupons \$100, \$500 and \$1,000 ; Registered \$100, \$500, \$1,000, \$5,000 and \$10,000.

With the same entire confidence with which we commended Government bonds to capitalists and people, we now, after the fullest investigation, recommend these Northern Pacific Railroad Bonds to our friends and the general public.

Cooke's "Banana Belt"



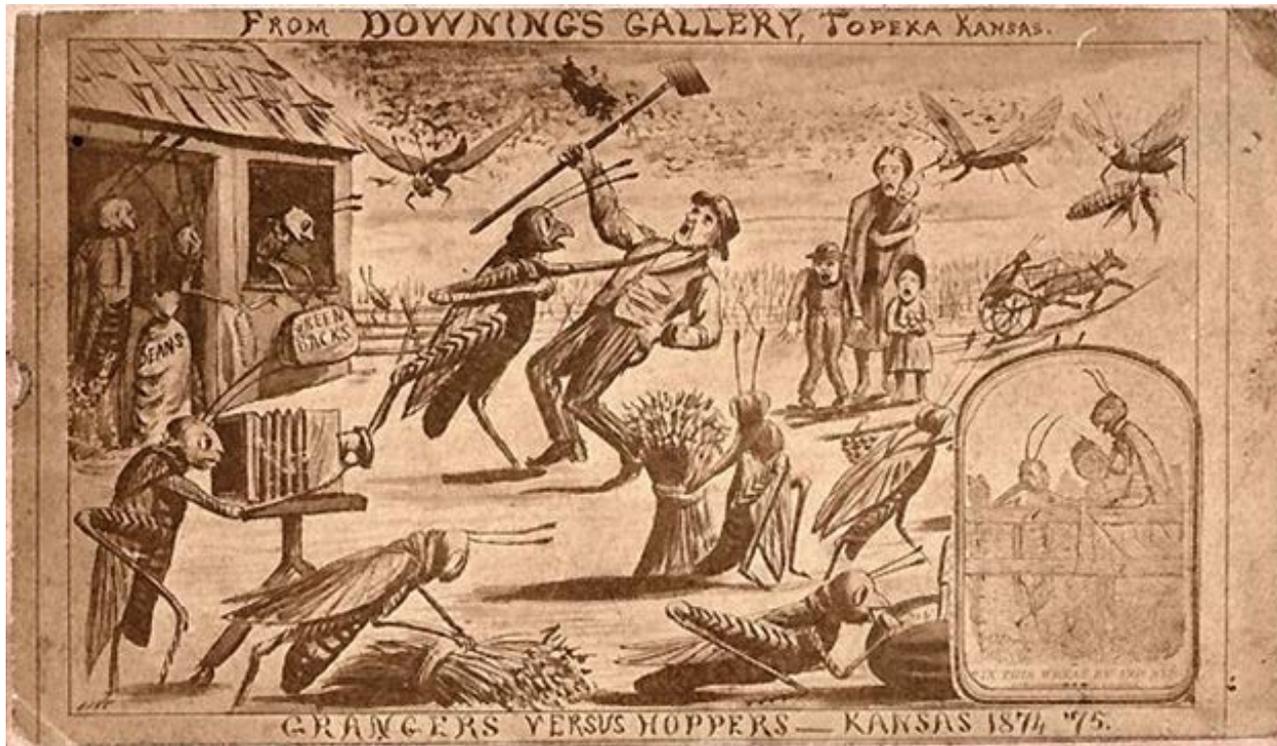
- 40 million acres (Florida = 37)

Northern Pacific runs into trouble

attacked by the Sioux war parties led by
Gall, Sitting Bull, and Crazy Horse



And Swarms of Rocky Mountain Locusts. July 1873

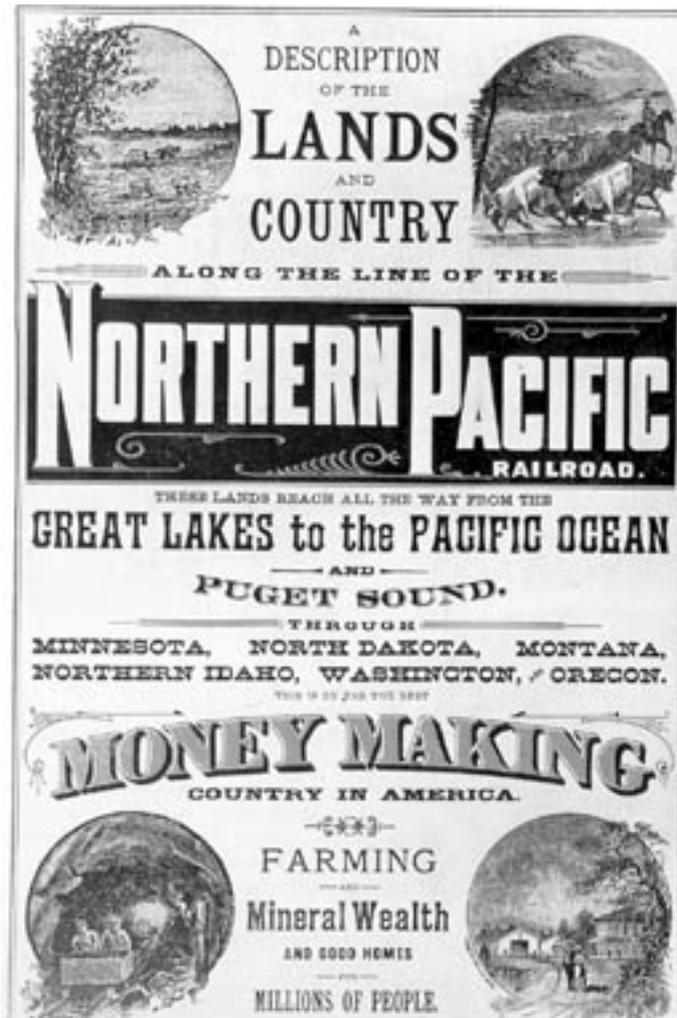


According to the *Guinness Book of World Records* the greatest concentration of insects ever observed was the 1874 swarm that covered 200,000 square miles.

Finished in 1883



Description of the Land



A
DESCRIPTION
OF THE
LANDS
AND
COUNTRY

ALONG THE LINE OF THE

NORTHERN PACIFIC
RAILROAD.

THESE LANDS REACH ALL THE WAY FROM THE
GREAT LAKES to the PACIFIC OCEAN
— AND —
PUGET SOUND.

THROUGH
MINNESOTA, NORTH DAKOTA, MONTANA,
NORTHERN IDAHO, WASHINGTON, OREGON.

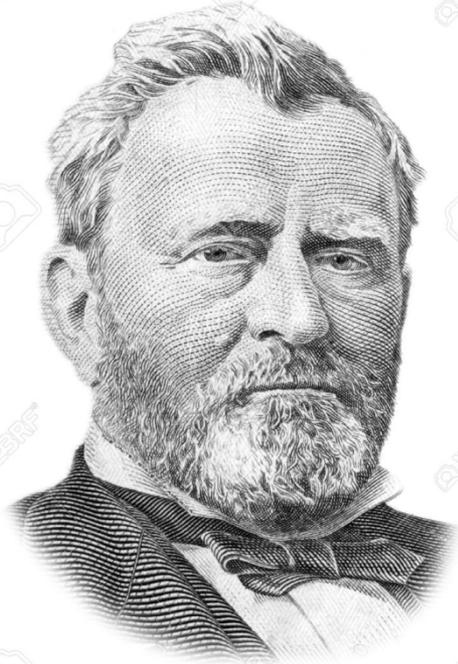
THIS IS AS FAR AS THE WEST

MONEY MAKING
COUNTRY IN AMERICA.

FARMING
— AND —
Mineral Wealth
AND GOOD HOMES
— FOR —
MILLIONS OF PEOPLE.

1884 Key failure: Grant and Ward

Ulysses S. Grant



Ferdinand Ward “The Young Napoleon of Wall Street”



Grant and Ward,

- Succession of failures that cross ~~regional and~~ institutional boundaries
- a shadow bank – private investment bank
- most of the eggs in one basket
- Real estate
- financial genius before he failed

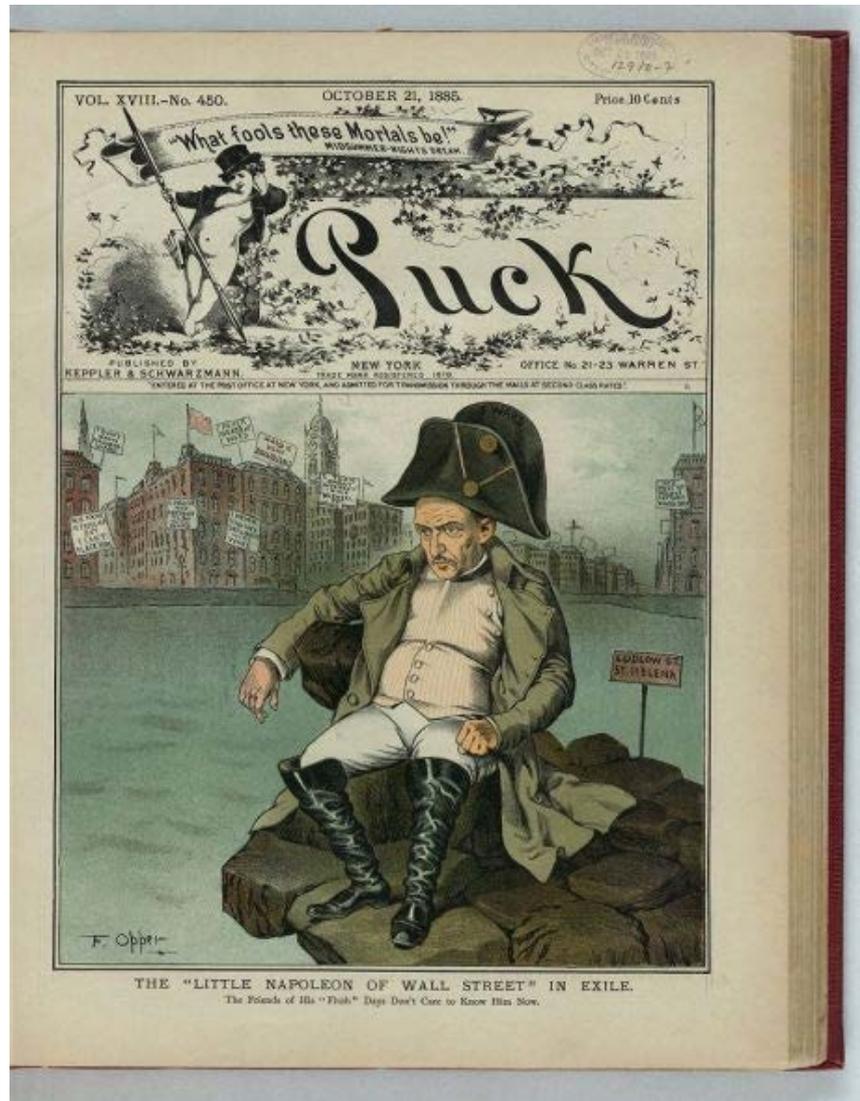
Ward's Ponzi Game

- I am winning profitable government contracts
 - Flour, horses, blankets, etc.
- Because General Grant is a partner
- Promises of 10 to 20 percent per month.
- But there are no contracts
- Pure Ponzi game

Ward's reputation

- “Young Napoleon” of Wall Street
- Partner is Ulysses S. Grant who saved the union
- Within days – Ward a crook on the run; Grant a dupe
- Ward in Sing Sing
- Grant broke

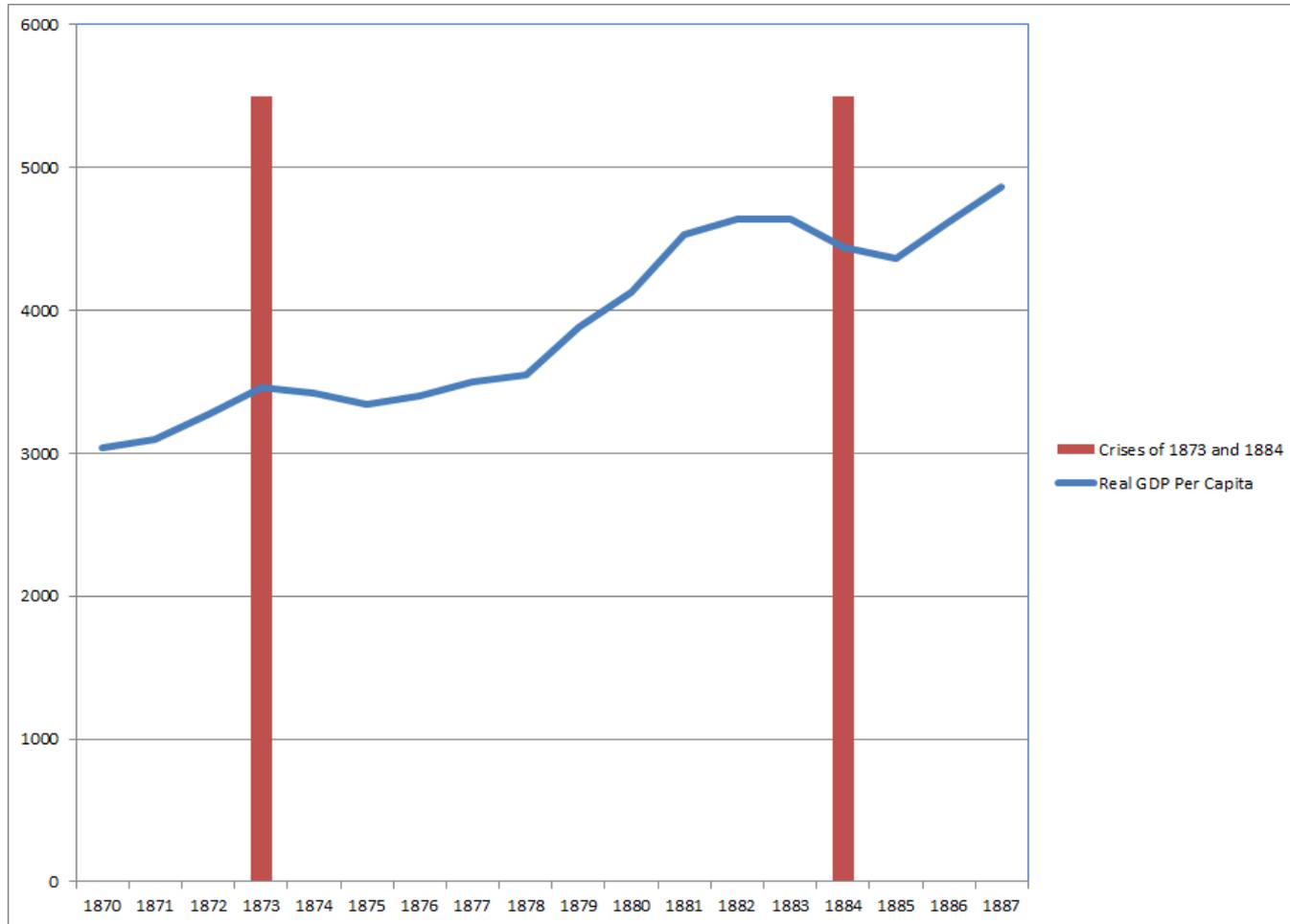
Ward after the fall



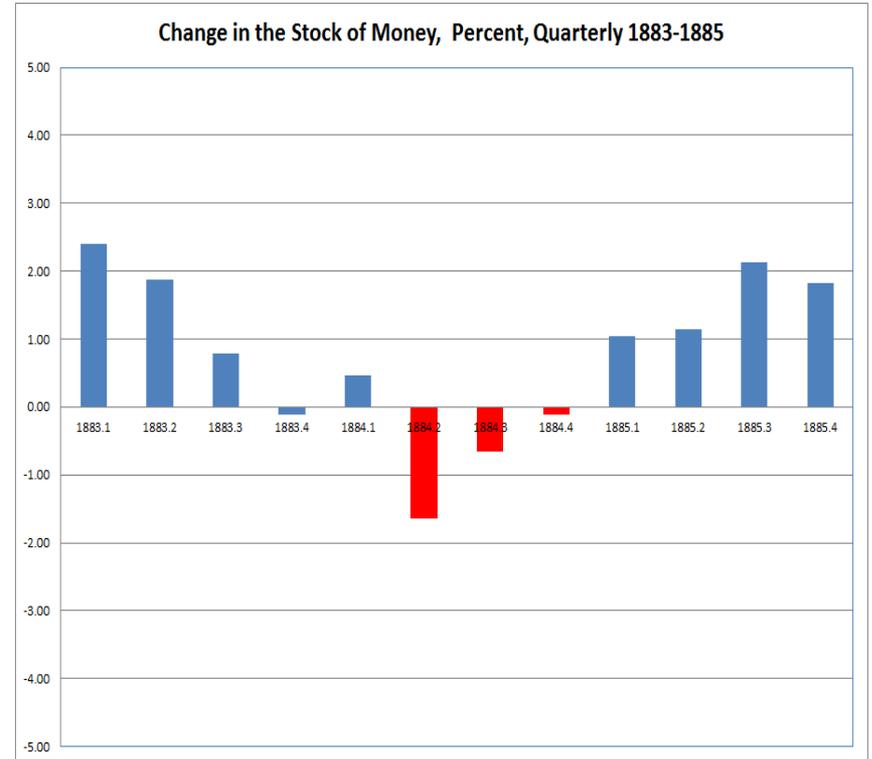
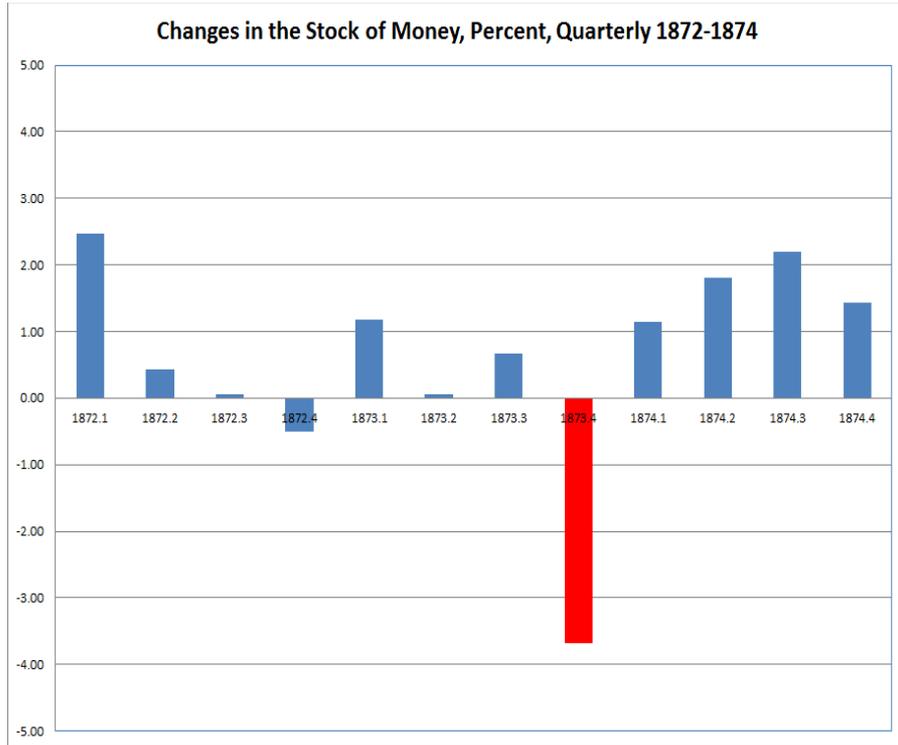
A minor panic

- Sprague – It will not be necessary to devote much space to the panic of 1884, inasmuch as the financial disturbance was wholly confined to New York, and its banking aspects was of an unusually simple and definite nature.
- Wicker – “banker’s unrest”

Real GDP per capita 1870-1887, 2009 prices



1873 vs. 1884



Ponzi

- His story I can buy International Reply Coupons at the prewar Lira Price
 - But the Lira has depreciated
 - So I can buy U.S. stamps cheaply and sell them in bulk at a small discount
- Promises of 50% in 45 days
- He doesn't do it
- Robs Peter to pay Paul

Ward and Ponzi

On top



Trying to flee



A minor bank panic in Boston in 1920-1921

- Banks or Trust Companies thought to be connected to Ponzi
- Hanover Trust Company
- Cosmopolitan Trust Company
- Fidelity Trust Company
- Lawrence Trust Company
- Tremont Trust Company

Richard S. Fuld, Jr. CEO of Lehman Brothers.



Conclusion:

Lehman Brothers is an old story

- ☑ After a succession of failures that cross regional and institutional boundaries
- ☑ shadow bank
- ☑ eggs in one basket
- ☑ Real estate
- ☑ trustworthy geniuses – before they failed

Fortune Magazine's list of America's most admired securities firms

Rank	March 2006	March 2007	March 2008
1	Merrill Lynch	Lehman Brothers Holdings	Goldman Sachs Group
2	Lehman Brothers Holdings	Bear Stearns	Morgan Stanley
3	Bear Stearns	Goldman Sachs Group	Lehman Brothers Holdings
4	Goldman Sachs Group	Legg Mason	Charles Schwab
5	Franklin Resources	Morgan Stanley	Legg Mason
6	A.G. Edwards	A.G. Edwards	Franklin Resources
7	Legg Mason	Merrill Lynch	AXA Financial
8	AXA Financial	Franklin Resources	Bear Stearns
9	Charles Schwab	AXA Financial	Merrill Lynch
10	Morgan Stanley	E*TRADE Financial	E*TRADE Financial

The last word

“All of this has happened before, and it will all happen again.”

(Peter Pan)