

gone into stocks. In promoting this trend toward a lower cost of capital for business, the growth of mutual funds can claim a share.

The spread of stock ownership through mutual funds has improved the distribution of income and of wealth. It has strengthened the foundations of our private enterprise system, even though we are still far from a true People's Capitalism. These are important achievements.

Mutual funds have been good also to the securities industry. This, too, is grounds for satisfaction. The industry is a valuable part of the American economy. Its welfare is important, as is the personal welfare of the individuals that draw their living from jobs in the industry.

Nevertheless, a reader of some of the literature that is building up around these hearings is bound to feel some concern over the role that consideration of welfare of the securities industry may play in any new legislation. It is in the nature of things that a large part of the literature should be coming from the industry. They must defend their interests, and they are doing so very ably. But this should not obscure the fact that the chief objective is welfare of the mutual fund investor and of the entire economy.

Without implying criticism, it is pertinent to recall what the role of Government has been whenever it has concerned itself with competition in an industry that is not perfectly competitive. It has started out to protect competition, and ended by protecting competitors.

Some such danger seems to loom in the present case. Hopefully, and quite probably, the securities industry will ultimately benefit from an improvement in mutual funds legislation through broadened public acceptance, greater stability, enhanced competitiveness. But the issues cannot be discussed principally from the point of view of how they would affect the industry.

Areas for improvement

If ownership of mutual funds is predominantly good, it is pertinent to ask why changes should be proposed. At least temporarily, these changes could in some cases lead to persons not buying shares they would otherwise have bought. One answer is that investors may believe themselves to be buying something that in fact they are not buying, such as superior market performance. This applies particularly to the advisory fee. A second is that even very desirable results may be bought at too high a price. This applies, I believe, particularly to the sales load or sales charge, and to the front end load. Finally, a desirable activity may produce side effects, that are not desirable. This applies to the heavy trading activity, to the resulting speculative climate accompanied by potential market instability, and possibly the excessive absorption of human and material resources into stock market activity.

I shall take up these matters in the foregoing order.

Advisory fee

The Securities and Exchange Commission believes that the advisory fee paid by mutual funds to their investment advisers is in many cases too high, and recommends that it be subjected to standards of reasonableness. The Commission bases its case partly on comparisons with the cost of other ways of investing in common stocks, and partly upon the failure of economies of scale to be reflected in many of the fees. The industry, through various spokesmen, has replied that the fees actually charged are lower than the Commission thinks, do not compare unfavorably with competing media, and do reflect economies of scale. The difference here is partly one of presentation of statistics, partly of proper choice of comparisons, partly even of semantics. In my view, the Commission's way of summarizing the complex facts is substantially right in terms of what it is proper to compare and what data to use. Neither side, however, seems to have considered the conclusion that seems to emerge from the studies of technicians that the true value of investment advice is on average virtually zero. This follows from the "random walk hypothesis" that has become familiar through numerous academic writings of recent date.

The random walk hypothesis,¹ strictly speaking, has been discussed and empirically tested principally with respect to the influence of past movements of the stock market upon subsequent movements, i.e., with the effect that chartists believe themselves to be exploiting. The evidence strongly suggests that there is

¹ See Paul H. Cootner, editor, *The Random Character of Stock Market Prices*, MIT Press, 1964.