

accumulation is slower than that of liquidation—the price of the stock rises on heavy volume. Strong tape action may attract many individual investors and, when the funds stop buying and their purchases are disclosed and publicized, still other investors will buy, reasoning that fund managers' judgement is superior. By this time the fund managers may decide that the stock has no more potential for near-term appreciation and that other stocks are more promising. They sell. If other institutions agree that the stock is overpriced, the funds may dump the stock or a substantial part of it. Now the stock's price may be down to where it was when the funds began to accumulate it. But many individuals will have bought the stock and have losses because of the short-term trading activities of the funds. The fund managers, moreover, may again repeat the process in the same stock or different stocks.

Whether or not such increased trading activity by the funds is properly labeled "speculative," the impact of their increased emphasis on short-term movements has had, as previously noted, and may increasingly have an unsettling impact on the continuity, liquidity and orderliness of the markets in particular stocks. Since some medium-size and a few large funds are engaging in this type of trading, and since they may hold a substantial portion of the floating supply of even the popular and widely held securities, the market impact of this type of trading can be even greater than that of the clearly speculative activities of a small number of unregistered hedge funds and of a few registered funds, whose assets are relatively small, whose disclosed investment methods emphasize speculation.

Hedge funds generally are partnerships of affluent persons which (i) claim an exemption from registration under Section 3(c)(1) of the Investment Company Act based upon the contention that they have no more than 100 securities holders and make no public offerings of their securities, and (ii) use speculative devices such as buying securities on margin, using put and call options, utilizing debt obligations, and short selling.

Numerous reports have been published in the news media of the concern of many in the securities industry, including leaders of its investment company sector, and of others about the impact of short-term trading and speculative activities by certain institutions and, particularly, by investment companies. Some, including the American Institute of Management and Chairman William McChesney Martin, Jr., of the Board of Governors of the Federal Reserve System, have compared such activities and the effects of such activities to the pool operations of the 1920s. Mr. Martin in a recent speech found "disquieting" the trend of certain mutual fund and other institutional managers to measure their success in terms of relatively short-term market performance. He stated:

"Given the large buying power of their institutions, there is an obvious risk that speculative in-and-out trading of this type may virtually corner the market in individual stocks. And in any event, activity of this kind tends to create undesirably volatile price fluctuations."

Mr. Martin concluded:

"The specific responsibilities of the securities industry to those who use its market place may be covered rather well by what used to be called the pursuit of long-run, enlightened self-interest. Customers * * * must not suffer as a result of inside trading or massive institutional speculation * * *. It is the responsibility of the Exchanges and other market organizations to have proper rules and requirements and to see that these standards are scrupulously observed."

If I seem to have zeroed in on investment company managers, let me assure you that we are aware of quickened interest of other institutional managers in the profits to be realized from short-term trading.

The new wrinkle is that today's speculation and short-term trading is being done by professionals—the managers of the so-called "Go-Go" funds and of other institutions. The manager of one of the newer "Go-Go" funds has explained this approach by stating that investment managers are much more technically oriented and that news moves faster. "What used to take two or three years to happen can now take place in a matter of months * * *. [M]arket developments have become so tremendously compressed in time * * *. The values are the same, but the realization of them is much more rapid. This is a much higher risk game than it was two years ago and there is a greater premium on being right."¹ To me, this appears to mean that such professional managers are most

¹ A. Theodore Lyman, Jr., Senior Vice President of Putnam Management Company, the adviser to Putnam Equities Fund, quoted in *Financial World*, September 27, 1967, p. 25.