Exchange Gets Facelift and Extends Focus
By Exchange Staff

After a recent upheaval in The Exchange's staff, due to the graduation (recent and upcoming) of its core members, new, enthusiastic staff members have joined the newspaper, assisting in both fine-tuning the paper's quality and in expanding the paper's focus. Heading the staff are new Editors-in-Chief: Yair Oppenheim and Jeffrey Spolansky, both of whom have risen quickly through the ranks with the common point of boosting the quality of the paper.

Through the course of the past few years, The Exchange has acted as the sole student-publication of the Sy Syms School of Business of Yeshiva University. "The Exchange has been great in raising SS58's profile in the New York business community," says David Anziska. "It has been instrumental in enabling students to acquaint themselves with today's changing marketplace." Beginning with a conventional focus circling student news and career paths, The Exchange soon branched out to handling current events and in-depth looks at areas in business. Set with that goal, The Exchange managed to pique the interest of Sy Syms students, providing comprehensive coverage of investment opportunities, financial news, and accounting standards. As Associate Editor Ilan Scharf puts it, "While we were proud of the past achievements of The Exchange, we have decided to pursue a fresh perspective in its future production."

The Exchange was given the facelift it needed as it shifted its target to being a "Barron's-type publication." Though this did improve the quality of the paper, as noted by the SS58 student body and faculty members, it seemed to alienate readers by seemingly regurgitating New York Times and Wall Street Journal articles. Editor-in-Chief Yair Oppenheim said, "The Exchange needed a shot in the arm because of a lack of creativity in last semester's edition."

The staff of The Exchange would like to inform its readers about the changes that will make the paper more user-friendly.

Increased inter-campus coordination: It is exceedingly difficult to coordinate the publication of a single newspaper between two distant campuses such as the Uptown and Midtown campuses of SS58. Efforts are being made to ensure that both student bodies are being sufficiently represented within The Exchange. Furthermore, we are finding new ways to increase communication and participation between the two campuses and integrate them into the new and improved Exchange.

Real business personalities: The business world is comprised of individuals, the "Movers and Shakers" who every day are faced with decisions that will effect thousands of people. One can only imagine the pressure a CEO must face at the workplace when formulating a corporate vision necessary to avoid the usual market troubles. The Exchange hopes to introduce an innovative series of various corporate executive profiles. This series should provide the readers with a better sense of how practical decisions are made today in global economy.

Sy Syms School course evaluations: Courses will be showcased each issue via an interview with each offering's respective instructor. The instructors will provide descriptions of the classes along with their methods of teaching. This is to establish student interest in these electives and obtain feedback from readers.

Opinions and Editorials: As any seasoned journalist can tell you, the most important and most telling aspect of a newspaper is its opinion pieces and editorials. The Exchange hopes to provide piercing commentary on various issues ranging from ease of registration at the Sy Syms School of Business to general events in the business world that affects the student body. As a result, all students and alumni are encouraged to submit their own originality on issues relating to business.
Dear fellow students,

Three years ago, a few students at the Sy Syms School of Business of Baruch College decided that the school needed its own newspaper. The idea was that the school would compete with The Wharton undergraduate business school, The Stein—NYU under­graduate business school, and the like, and publish its own newspaper. Students were encouraged to participate in this endeavor initiated by Jayson Buskin.

We have come a long way from the original format and focus of The Exchange. In fact, this article is being written by the people who bring this newspaper to you; we are researching issues of international concern that will affect the business world in the future. We will inform the students about international culture, and we hope that it will fill us in on your education.

However, I feel that a brief confession from the editor's desk is necessary. Several of you are wondering why it took so long to publish the second issue of The Exchange. Well, we have had difficulties that prevented us from operating any quicker. After receiving information earlier this academic year that The Exchange had closed its own computers, the reality was that we have neither the computers nor the money to publish computers and the newspaper and some university faculty, as well. We appreciate the staff of The Commentator for continuing to allow us to use their office to publish The Exchange. However, we regret the fact that our schedules often run concurrently and, therefore, we are incapable of publishing on a consistent monthly basis. The Exchange would like to thank the Sy Syms School of Business Student Council on both campuses for covering our publishing expenses. We would not be here without you.

Sincerely,

Jeffrey Garness
Editor-in-chief

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From the Editor's Desk

Dear Students,

With the Spring 1998 semester beginning, we find much excitement in the Sy Syms School of Business. Recruitment continues to grow with it, a large number of new and exciting courses are being offered. Dr. Charles Snow is teaching FIN 2505—Entrepreneurial Finance as part of the Stern Entrepreneurial Institute. Dr. Arieh Lichtenstein is teaching ENG 2505—Internet for Business. Dr. Moshe Pava, MAA 447, Seminar in Business Ethics, will discuss the impact of computer technology on research and practice. Prof. Laura Zaino, MAA 447, International Expert Promotion, will present a case study of the computer industry, and will we present a career services analysis for business. All courses are being offered to meet the changing needs of the business community. The Contemp­orary Problems in the Business Semester is again being offered on Fridays with an impressive list of CEOs and corporate executives.

The Office of Placement & Career Services has already launched its Spring activities. The on-campus recruiting schedule is one of the largest in years. Workshops on recruiting for permanent, summer, and internship positions have been offered. A large number of graduating seniors have already received offers. With a very strong job market the coming years, this looks like an excellent placement year. The Office of Placement & Career Services has also seen some new staff additions and promotions. Naomi Kapp has been promoted to Associate Director, and Jennifer Berman and Robert Borenstein have joined us as Assistant Directors. Laura Steinin is the new administrative assistant for the The Office of Placement & Career Services. Those seniors who are interested in applying for graduate schools should meet with Naomi Kapp to plan the application process. Last year we had a near-perfect acceptance rate, and this year looks even better.

Field trips to the New York Stock Exchange, and Cooper & Lybrand, LLP, were held with more to follow. Speaker events in Finance, International Business, and Finance/Accounting Career in Israel will be held this semester. We invite students to join the excitement that exists in the Sy Syms School of Business.

Sincerely,

Ira L. Jaskoll
Associate Dean

SSSBBA Presidents' Messages

I am quite pleased to once again address you all through the forum of The Exchange. Congratulations to the editors for their persistence and dedication in bringing this issue to fruition. With the spring semester upon us, there has been a great deal of activity at the Sy Syms School of Business. The Joint Business School recently organized a very successful trip to the New York Stock Exchange, and the Max Investment Club has met on February 17 with the hopes of hosting alumni speakers in the near future. Please keep an eye on the signs around campus, and also provide the Student Council with your feedback and recommendations. While I have your attention, I'd really like to stress to all Sy Syms students that we truly care with students from any other university in any arena. Our school days are less than three of any other college in the country, while many of our classes and exams are truly challenging. Many of us have often been intimidated because our school is only ten years old, and don't we receive the recognition that some of the nation's more established universities do. However, while we have fewer alumni to turn to for guidance and support, our alumni have been very successful in a multitude of fields. Their success is indicative of what we can achieve through hard work and drive in our roots.

To fully prepare for both the technical and time management challenges that we will encounter upon our entrance into the business world, we must begin utilizing those very skills during our time at Yeshiva University. We must take full advantage of both our morning and afternoon classes, and provide ourselves with capabilities that will last a lifetime.

Sincerely,

Simcha Ginsinger
President, SSSB

During November 23-25, 1997, I and three other SSSB students, Rachelle Baur (for the Business Society President), Jonathan Teitelbaum (SSSB Treasurer), and Michael Gewirtz (SSSB Secretary) had the opportunity to attend an international conference given by the Foundation for Student Communication of Princeton University on the topic of "Corporate Public Responsibility." At this conference, we had the chance to listen to Presidents and CEOs of fortune 500 corporations, as well as smaller companies discuss their companies' business philosophies and views of communal altruism. The conference was quite intriguing and gave us a chance to learn in a different forum other than a typical classroom setting. What was most fascinating during these three days of seminars, lectures and public ruminations was the way we students, yet at the same time, representatives of Modern Orthodox Jewry interacted with other college students.

Predictably, there were times when I felt the differences between the world of up with respect to the other 300 students. During the long group discussions where we interacted with panelists and speakers, I realized that as opposed to some Jews views of charity from corporations or individuals somewhat differently than the non-Jews. Many students felt that it is the company's obligation to "save the world" at any and all costs. On the other hand, took a more modest approach. Basing on my Jewish background, I disagreed because I felt that charity starts within the immediate community. Only once corporations reach out to the direct communities should they go on to more ambitious altruistic endeavors. Aside from these few trivial

Sincerely,

Cheri Ochs
President, SSSB

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The Exchange is brought to you with the cooperation of the American Marketing Association chapter at Yeshiva University.
Exactly What Is A "Leveraged Buyout" Anyway?

By Avi Goldin

The Leveraged Buyout craze of the late 80's created a frenzy in the financial community unparalleled in history. Billion or multi-billion dollar transactions were announced on a near-weekly basis. In 1988, almost everyone has heard of an LBO at sometime in their collegiate career, or has had to bluff his/her way through a conversation on their evils and merits, few actually know how one works and what it accomplishes. Although the trend has subsided it is an important one to learn. What is an LBO?

A leveraged buyout refers to the transaction that takes place when an investor group, over the decision making process of a company by acquiring enough shares of the target company to assume control. The term refers to the fact that most of the capital used to acquire the company is financed through debt. LBO’s most commonly occur when the market undervalues a company in terms of its equity. In layman’s terms it means that the price of the company’s stock is worth less than the value of all the assets of the company. The most common type of LBO is where an existing company will buy the company for the purpose of selling off all or some of its assets. Many times, the group will sell off what it feels is the weaker divisions of the company and keep the one or two parts that they feel can keep up a positive cash flow.

For example: suppose a company has 10 million shares outstanding, trading at $20 a share. This places the market value of the company at $200 million. Suppose that the company was found to be worth $250 million. This could theoretically result in a profit of $50 million for anyone selling the company. Of course nothing is as simple as that. In order to get the shareholders to sell their shares, the raider typically is forced to offer a slight premium over the current stock price, say $22 a share. This is called a take over bid, can rise to $30 million — still quite a tidy sum. In addition, speculation about the takeover will drive up the share price, forcing the raider to pay even more for the company.

Who makes an LBO?

There are three types of groups that attempt LBO’s. In the first type of group, the management of the company is part of the takeover group. In effect, the managers, along with any other major shareholder, take the company from its shareholders replacing equity (stock) with debt (loans and bonds). Having management as part of the group allows them to gain some control of the company and work to increase its profitability. For example: suppose a company is bought for $25 million and its major shareholder purchased 10 million shares at $2.50 each. If the raider wants to sell them at $22 a share, he can make a net profit of $30 million — a hefty gain. Of course everything is relative. The key is that the raider typically is forced to make a offer of $22 a share or more, or they will lose control of the company. This lowers his profits to $30 million to $40 million instead of the $30 million to $40 million which he could theoretically result in a profit of $50 million just by buying and then selling off what he feels are the company’s weakest divisions. The first type of leveraged buyout is where a company is part of the take over winner.

The second type of leveraged buyout is when the transaction that takes place when the company’s board of directors, and perhaps the company itself, is forced to make the company a successful business. This type of leveraged buyout is where a financial institution, buy the company in terms of the company’s equity. This-inform­ation is critical in knowing how high its scope and impact. Billions of dollars in commissions were earned, and huge companies changed ownership in one of the most exciting times in history. Most likely, almost everyone has heard of an LBO at sometime in their collegiate career, or has had to bluff his/her way through a conversation on their evils and merits, few actually know how one works and what it accomplishes. Although the trend has subsided it is an important one to learn. What is an LBO?

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Morningstar’s Rating System for Dummies
by Jonathan Teitelbaum

Morningstar is an independent mutual fund rating and analysis service based in Chicago. Morningstar has created a simple, catchy signature of its own - the star system for indicating value in a mutual fund - that's very much like the signature "thumbs up" or "thumbs down" ratings made popular by movie critics Siskel and Ebert. Both ratings offer an endorsement, but neither claims that the choice is right for you.

For example, before deciding to watch a movie, you may want to inquire as to whether it is an action/adventure or a love story, an actor you enjoy, and if there dazzling special effects. Correspondingly, before deciding to invest in a mutual fund you may want to inquire whether the fund manager has a solid record, and if it relies on cash reserves or whether it will take on a roller coaster price ride, whether the fund manager has a high turnover rate, and if it relies on economic theory, etc.

For instance, a fund that you enjoy, has created a simple, catchy signature of its own - the star system for indicating value in a mutual fund - that's very much like the signature "thumbs up" or "thumbs down" ratings made popular by movie critics Siskel and Ebert. Both ratings offer an endorsement, but neither claims that the choice is right for you.

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Morningstar, however, was ahead of the curve when it came to the development of its star system. In 1982, Morningstar began its mutual fund ratings, and over the years, its system has become the most widely used method of evaluating mutual funds.

Morningstar's ratings are based on a combination of factors, including the fund's performance, risk, and expenses. The system uses a five-star rating scale, with five stars being the highest rating and one star being the lowest. Funds are rated for one-year, three-year, and five-year periods, and a fund's overall rating is a combination of its ratings for those periods.

The one-year rating is based on the fund's total return for the most recent year. The three-year rating is based on the fund's total return for the most recent three years, and the five-year rating is based on the fund's total return for the most recent five years. The overall rating is a combination of the one-, three-, and five-year ratings, with each rating weighted equally.

Morningstar's ratings are widely used by investors, financial advisors, and mutual fund companies. They are also used by financial news organizations and other organizations for their own research purposes.

Course Spotlight: Organizational Behavior
by Dr. Stephen Reschke

Since receiving my doctorate in industrial psychology, I have spent over 30 years as an internal and external consultant for a variety of organizations. I have worked with companies in the United States, Israel, and Iran. I have held positions ranging from Director of Human Resource Development for the Israeli Military Industries to Vice President for Organizational Effectiveness in the Citibank Mastercard/Visa Division.

In the years of the mid-seventies, I was on the faculty of Tel Aviv University, in addition to teaching a number of courses at the Technion and at the Shenkar College of Textile and Design. For about five years, I returned to the academic environment as a member of the adjunct faculty at Sy Syms.

Concurrent with my position at the Sy Syms School, I am also serving as Director at Corporate Performance, Inc., a company specializing in performance management and productivity improvement. We have developed a computerized algorithm model for the objective management and evaluation of performance in organizations. The model is applicable for all types of organizations.

These varied experiences in applied as well as academic settings have allowed me to reflect on the challenge of designing an undergraduate business school course in organizational behavior which is relevant to the needs of our students. The course must serve the purpose of being an overview for students who plan to enter the work force upon graduation as well as being an overview for those who intend to pursue graduate study.

A course in Organizational Behavior has the added challenge of conveying information beyond what we consider to be common sense. Information does not go beyond common sense, the students will rightfully claim that the material is "fluff" and should certainly not be required for Management and Marketing majors. If the course contradicts common sense, it creates a serious credibility gap between what students already know and what they are being told. Information contains both the familiar and the unfamiliar, and if students are told what they already know, they will not be motivated to learn.

Unfortunately, many of the so-called experts bombard us with management homilies which either contradict each other or contradict the anecdotal body of knowledge in organizational behavior. For example, ever since our students were allowed to understand concepts, it's been drilled into their brains that people are created equally or that they have equal opportunities. The one advantage which often comes upon in our class discussions is the conflict between providing superior customer service at any cost, a philosophy of Quality Management, and the need to be competitive in order to survive.

One of the most important considerations in designing a course in organizational behavior for business school students is arriving at the proper balance between theoretical and applied content. Clearly, a course which emphasizes the theoretical will not be perceived as being practical. On the other hand, a course which emphasizes the applied aspects will not be perceived as having much conceptual content. The lack of a conceptual framework severely restricts our ability to generalize from one situation to another. Furthermore, it would be almost impossible to understand, manage, or predict the behavior of individuals in an organizational setting.

Since organizational behavior is affected by a multitude of variables, some readily identifiable and others unknown to us, we need a formal structure to help us sort out perceptions, motivations, peer pressure, leadership styles, and other antecedents of behavior. While we may be tempted to question predictions of individual and organizational behavior with the proverbial "it depends," we really need to make specific recommendations if at all possible, if we are to have an impact on improving organizational performance.

The course in an undergraduate business school course in organizational behavior must be defined in terms of content which enables the student to identify and understand those variables which will determine individual and organizational behavior.
The Crux of Computer Consulting

By Yair Oppenheim

Q: What specific tasks do Computer Consultants do on the job? What areas do they focus on?
A: Well, there are several areas where consultants can work. Some of them will design as well as write entire applications if needed be. In other words, they have a person sent to a company to carry out a project for them. It can be a one-time assignment. The consultant will do the project and once he's finished with the project, he may maintain it for the organization, or the organization may decide to run the project on its own. Consultants may also be used for training applications software because some companies consider training to be a one-time assignment. Some consultants will also set up networks for organizations. Again, we're talking about small organizations. You're not going to find consultants regularly getting involved in major organizations unless they work for a consulting company where their main job is just doing consulting.

Q: What makes a consultant more needed or unique than a company's own technical help department?
A: Again, when dealing with a small company, it may not even have a technical help department. They may just have someone who learns the new software once they know how to use the software, or even someone who knows how to use it once a consultant has set up the hardware.

Q: Would there be a case where a company would have a help desk and still require a consultant?
A: You're talking about a medium or large-scale company. In that case, the company could have one. It would basically be an area that they want to look at as a new area and it's not sure if it should delve into it and needs someone who is totally unbiased so that he could give his opinions for what is needed in that situation.

Q: How involved or objective do consultants have to be when they work for a company? Do they need to know the inner workings of the business or just do what they're told?
A: Well, they must have some kind of idea of how the business performs. Unless they have the background of what the business does, they won't be able to make the decisions in terms of regarding the appropriate applications as well as the hardware for that business. If they're not involved, they may have to have a background relating to how it functions.

Q: Thus the more long-term they work with a company...
A: The more involved they'll be.

Q: How would you begin a career in consulting— are there any requirements to learn and can information be self-taught?
A: You have to work for other companies before you can do consulting. You have to be employed as a regular employee before you'll be able to do any consulting.

Q: Is it a prospective company?
A: If any company, in other words, you have to get your feet wet. You need experience with computers. You can just walk in and say that you want to be a consultant even though there are plenty of people today that attempt to do this. There are the fly by night. Some people try to pretend to be a consultant when they're really not consultants.

Q: Is it so easy to get started—is there some way to transport yourself from here to there?
A: You have to be experienced in the business so that people have heard of you before. In other words, you used to be with such-and-such a company doing this, and now you've decided to go out on your own to do the work.

Q: How does one get to work to begin with?
A: It is similar to working for an agency and then developing a private practice.

Q: Well, it is developing a private practice. You get recommended from one company to another, and sometimes you'll take a work with a consulting company where they'll just farm you out. It may be a full-time or part-time job...
A: You can make it both. As a part-time job, you'll also have to do it with other people. You can't leave the company hanging, as in the case that you're doing another kind of job as a full-time job and you suddenly decide to move to consulting as a part-time job. You can't come back to it in two or three days. You have to be working with other people on a part time basis to do that kind of consulting, because there always has to be someone to cover you.

Q: How creative is the work? Do consultants get to apply solutions to situations themselves, or do they partially rely on programmers as a crutch? For example, when they're doing the work, do they get to design the application from their head or do they just make a database in say, Microsoft Access?
A: It depends on a few factors. If it's something in the area of design, the company might tell you to design it and someone else will implement it. If no one can implement it, the consultant might have to design the implementation on it, he might be doing it from start to finish.

Q: So there's a distinction between the two? Someone will be preparing the application and somebody will think it out beforehand?
A: Correct. Perhaps one person may be doing both, depending on what has to be done. For example, when I worked for a company at one time I had a person working for me and I gave her a job to do. I gave her exact specifications on what should be done. I could have done it in a few hours, but it took her a long time to do it. I gave her two weeks and she didn't finish it, so I had to take a few hours to do it before the deadline.

Q: What are the pros and cons of consulting? Why do people enter consulting?
A: It can be famine or feast. It can be constant at times, as MIS is a strong market to begin with, while at other times, it can be lean time—you might not be able to find anything.

Q: Can I assume right now that more people need it?
A: Due to the year 2002 problem, people are looking for consultants to solve that right.

Q: Can you advertise yourself or even go further and just look for work?
A: You can advertise yourself in the local yellow pages or newspaper. I've seen people advertise in newspapers. As an advertisement, you could advertise for computer advertisements for hardware, software, training, or consulting, but this is looking towards small companies—very small companies. You can also advertise in magazines such as Newsday, you're going to find that a lot of people once a consultant has set up some of the work done. Sometimes the consultants even wind up with a full-time job after advertising.

Q: Once you work for an agency and decide to develop a practice on your own, is it possible to take their clients with you?
A: Their clients are now your clients, because they'll call you directly without going through the agency. The agency was just doing their job at that time. Additionally, an agency only gets a fee for that time; it's one service project. The agency will also ask for compensation for the services if the company that placed you at hires you. The company that picks you up afterwards owes them, not you.

Suspended Accounts... continued from front page

were nevertheless allowed immediate use of the EIN by the IRS at any bank for deposit purposes. However, the organizations can no longer maintain their former federal tax-exempt status.

After much deliberation within the IRS, Yeshiva University will not be charged with tax fraud. When asked if there will be charges filed against Yeshiva University, the spokesperson for the IRS said, "Because they never filed in the past, there is no penalty. Had one of the organizations taken part in TEFRA with YU's number, there would have been more serious complications." Mrs. Marion Jabin of the IRS commented, "It's not problematic that there's no penalty for the EIN.

The reason why the University required the organizations to get their own EINs is because had there been any tax liability, the University would have been required to pay the tax.

One can find an exempt organization package from the Internet at http://www.irs.gov. Mr. McLaughlin of the IRS Exempt Organization Division suggests that student leaders file Form 9918: User Fee for Exempt Organization Determination Letter Request, and Package 1023: Application for Recognition of Exemption. Package 1023 is primarily for organizations that qualify under section 501(c)(3) of the Internal Revenue Code. The required User Fee is $357. A document download Publication 557 is off the Internet as well. A copy of the organizations' consultations must accompany the applications. It must contain basic information which is regularly considered by the organization and which is not substantially related to the performance by the organization of its exempt purpose or is not a program to which the organization needs the profits derived from this activity; Any organization that expects its unrelated tax to be $500 or more is required to file Form 9917.

One example that the IRS provides of this kind of income would be yearbook advertising. Income of a tax-exempt organization that comes from the sale of advertising in a yearbook is considered unrelated business taxable income if the nature of the advertising meets certain conditions. Another example would be advertising for products and services used by the legal profession, and legal notices, the commercial advertising does not advance the exempt purposes of the association. Therefore, it is taxable as unrelated taxable income.

Analogous to the previous situation is the sale of commercial advertisement to the Observer and The Commentator. Presumably, the advertisements do not fall under the auspices of exempt practices. Therefore, it is safe to assume that the revenues are taxable as unrelated business income, which happens to be the same rate as corporate tax.
Show Me (Anywhere Between 5 to 6 Percent of the Money!!)
by David Rappaport

Leasing vs. Purchasing
by Kovi Smolack

Financial managers, without a doubt, will at some point be faced with the decision of whether to purchase an asset or lease it. When making this important decision, one must understand both the different types of leases available and the financial ramifications of those leases.

Firstly, it is important to distinguish between the different types of leases. Operating leases are those where the financial manager will not receive title of the asset and are therefore not a purchase. On the other hand, when a person enters into a financial lease, he or she will acquire title to the asset in question. The financial manager will then be responsible for maintaining and insuring the asset, and unlike an operating lease, is not cancelable.

An important fact is that the only time a financial lease is cancelable is when the company files for bankruptcy, which is not considered a normal business decision. If the company is in a situation where it is considering whether to purchase or lease an asset, in all likelihood it will not be able to purchase it.

One of the biggest differences between the two types of leases is that operating leases are not considered an acquisition of assets by the company. The lease payment may be deducted from the company’s taxes. In the case of a financial lease, the maintenance of the asset is also deductible as is the maintenance cost if the asset is purchased. Knowing these facts, the financial manager must work out the numbers and determine which lease suits the company best.

As an illustration of this choice, one can analyze the decision process of Company X, which is deciding whether to lease or to purchase a given asset for $1,000,000. The company has the option of a financial lease for five years, with payments totaling $268,177 per year or the company may also choose the alternative of purchasing the asset and financing it with 10% annual interest, for payments totaling $263,783 per year. In the case of leasing, the lease payment is multiplied by (1-Tax Rate) to obtain the tax savings, and then subtracted from the lease payment to obtain the net outflow to the company. Assuming a 40% tax rate and a discount rate equal to the cost of the debt to the firm (10%), the present value of net outflows over the five-year period is $609,839. In the case of purchasing, both the interest expense and the depreciation is multiplied by (1-Tax Rate) to obtain the tax savings and this number is then subtracted from the loan payment to obtain the net outflow. Taking the present value of the net outflows over the five-year period, we obtain a total cost of $594,372. In this example, purchasing the asset is the less costly option. Additionally, because the lease would be classified as a financial lease, it must be reflected on the balance sheet just as a loan must be. Therefore, the financial manager clearly should choose to purchase the asset.

The question of whether to buy or lease does not have an empirical answer. The financial manager must analyze each asset acquisition on a case by case basis. Only after examining the numbers involved as well as the company’s overall financial health will the manager be able to decide on the better option.

The REIT market is shedding its bad rep and is attracting new investors. The REIT allows someone like our little Jimmy to have ownership in a portion of that $3 trillion commercial real estate market. The National Association of Real Estate Investment Trusts (NAREIT) returned 35.8%, including dividends, compared with 20% for the Standard & Poor’s 500-stock index. Not only did REITs outpace most stocks, but they also offered better yields than a lot of bonds.

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New Capital Gains Tax Laws

by Jeffrey Gams

The recently enacted Taxpayer Relief Act of 1997 (Public Law 105-34) carries a variety of important amendments to the Internal Revenue Code that impact all aspects of the complex tax laws in recent memory that affects individuals, families, investors, and businesses. A proper understanding of the new law is essential if one is to benefit from it. This article will focus on the capital gains element of the new law.

As under the prior law, short-term capital gains are taxable at ordinary income rates (15% - 39.6%). Short-term capital gains continue to be defined as gains from the sale or exchange of a capital asset held for one year or less. The complication comes with long-term capital gains. Possible capital gains rates of eight, ten, sixteen, twenty-five, and twenty-eight percent are now applicable.

An eight month holding period will come into effect. Therefore, if a taxpayer sells assets for eighteen months, Between the twenty-fourth month or shorter term, and the eighteen month, long-term, period, holdings fall into a new category dubbed "intermediate" and are subject to a twenty-eight percent maximum tax if sold.

Since July 28, in order to qualify for long-term treatment, one has to hold assets for eighteen months. Between the twelve-month, or shorter term, and the eighteen month, long-term, period, holdings fall into a new category dubbed "long-term" and are subject to a twenty-eight percent maximum tax if sold.

In May 1997, a proposal was submitted to the US Senate by Senator William Roth the Senate Finance Chairman, to repeal the newly established eighteen month period.

On August 1, 1997 Roberto Rizzo, an eight-percent or eighteen-percent tax bracket investor, sold 1000 shares of Coca-Cola Co. for a market price of $20,000. On January 1, 2001, the stock is worth $30,000. Gary thinks the stock will increase in price rapidly so he makes a deemed sale, paying a 20% tax on the $10,000 gain. If he holds the stock for more than 5 years after January 1, 2001, he can use the 18% rate.

One might want to make the election for their beneficiary. A business owner that encounters widely fluctuates in income should time investment sales so that he meets the eighteen-month holding period while he is in the fifteen-percent tax bracket.

The net capital gain is $10,000 taxable at 20%. The Taxpayer Relief Act of 1997 does not allow for such a technicality; as long as it would raise the tax-payers bills.

To illustrate, Michael Enzer has a net capital gain of $30,000 in the 28% tax bracket. He has also unencrapted section 1250 gains of $10,000, and long-term capital gain of $30,000 in the 20% bracket. The net capital gain is $100,000 ($30,000 + $10,000 + $30,000). Under the old capital gains classification, $10,000 of the loss in the 28% group would be used to offset the gain in the 25% group, and the remaining loss of $20,000 ($30,000 - $10,000) in the 20% group would offset $20,000 of the $30,000 gain in the 20% tax-rate group. Net capital gains tax is $10,000 taxable at 20%.

Without the technical correction, the $30,000 loss would have first reduced the $30,000 gain of the 20% group leaving the 25% tax-rate group untouched. The net capital gain is $10,000, taxable at 25%.

Morningstar Funds

Continued from page 4

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds

Morningstar Funds
THE SEVEN DEADLY MYTHS OF ACCOUNTING

by Moses L. Pava

S everal myths are taught to students as fact. Some are more reprehensible than others. Yet, in my opinion, the most damaging to the career of accounting is that which holds that accounting is not a real science. The following seven myths are widely accepted and taught to students as fact. They are common, but they are wrong. They are the result of misunderstanding or ignorance of important facts about accounting. These myths are like convoluted cookbooks with the number and difficulty of recipes growing exponentially from year to year. If academic disciplines were to be evaluated solely on the basis of the sheer weight of textbooks, accounting would still be the heaviest. What would students do if they were told to read, write, and talk in a foreign country, overladen with unnecessary baggage? Worse yet, the baggage may not only prove useless, but in the end it may prove harmful-just as these students' prejudices against "the seven deadly accounting myths." The best way to combat the seven deadly myths is to develop precise teaching goals specifically designed to counter them. Are you susceptible to any of these myths?

Myth 1: Learning accounting is like learning the rules of a game. The most common question, Is this material going to be on the exam?, reveals a deeply held and primitive belief prevalent among students. Students assume that the only thing that really matters is memorization. Some will say: Accounting is a technical field and I can learn the technical details by rote. Accounting students, like tourists visiting a foreign country, seem confused and overwhelmed with unnecessary baggage. Worse still, the baggage may not only prove useless, but in the end it may prove harmful — just as these students' prejudices against "the seven deadly accounting myths." The best way to combat the seven deadly myths is to develop precise teaching goals specifically designed to counter them. Are you susceptible to any of these myths?

Myth 2: I'm good at math, so I'll be good at accounting. Students are often puzzled when I tell them that the final examination will include a number of essay questions. Further, they seem to resent our school's graduation requirement of a substantial and substantial research project to be completed during the senior year. Students' responses seem to be based on the idea that accounting exams should be merely one more opportunity for students to rehearse the mechanical steps involved in solving homework problems. If an exam question is presented in a manner different from homework problems, I invariably hear the complaint, That's not fair. This wasn't in the homework. Many accounting students enjoy the fact that there are obvious right and wrong answers in accounting: If they wanted ambiguity, they would have chosen English literature or philosophy as majors instead of accounting. Accounting problems often are thought of as interesting mathematical puzzles.

As with all of the accounting myths, there is a kernel of truth here. However, preparing a statement of cash flows from balance sheet and income statement information certainly has this "brain teaser" quality. When I see a student yelping Aha! during a midterm examination, I know (even without checking her paper) she has solved the cash-flow problem. Answering a highly stylized textbook question on make or buy requires math proficiency and confidence. Quantitative skills are important. Being able to add up numbers quickly, being sensitive to the magnitude of numbers, understanding the concept of the time value of money are bedrock requirements. But they miss the essential educational point.

Myth 3: There is such a thing as a "bottom line." If it is true that accounting is like math, then accounting should always yield one right answer; we call it right or wrong. Thus, the third deadly accounting myth is born. For the past few years, I have asked hundreds of intermediate accounting students to arrive for the following question as part of their final examination: What are the benefits and limitations of net income as a measure of corporate performance? The answers I receive are often not very clear, but even the very best students are deep in perplexity. Given the students' own accounting theory, the question makes little sense to them. It is almost as meaningless as asking them to evaluate the benefits and limitations of subtraction as a mathematical operation. Just as students take subtraction for granted, students have inherited a view where net income is a granite-like status. Net income simply is. These robust results are obtained in spite of the fact that a complete picture of the financial performance of corporate accounting and managerial compensation already have been in the headlines and will continue to stay there until satisfactory yardsticks have been developed to gauge them. Investors want more disaggregated data concerning segments and products. Students who conceptualize corporate performance as a single measure will be uncertain as to what is being asked of them.

Myth 4: Accounting is a "thing apart." Understanding other disciplines is a waste of time. The students constantly need to be reminded that the quality of net income is a relevant measure of corporate performance is only as good as what finally goes into creating the number. Consider the following examples. On the exam, the question is often the choice of the depreciation methods, estimation of useful lives, and future salvage values. It is based on historical costs and tells us nothing about current market values. Research and development costs and advertising outlays are expenses immediately and lower reported net income regardless of the future earnings potential created as a result of these activities. The pension expense can be altered drastically by changing crucial assumptions about interest rates, expected future salaries, and numerous actuarial assumptions. Similarly, reported revenues can be altered significantly with small changes in estimates of the timing of future revenue flows.

As the external demands for corporate accountability and responsibility increase, corporate stakeholders begin to question whether the corporation is independent of its major competitors. A stakeholder view of the corporation is becoming increasingly popular. As a result of this enlarged view, investors and other interested parties are asking for better-quality information about environmental effects of corporate actions. There is a growing demand for accountants to measure precisely the cost and benefits associated with environmental impacts. Similarly, society is beginning to demand more information about product quality and safety. Issues related to measuring employee and managerial compensation are no longer in the headlines and will continue to stay there until satisfac-

The use of case materials and newspaper articles enhances reading comprehension. Asking you to present answers to homework problems gives you a chance to make informal and low-risk oral presentations. Group projects emphasize communication skills and better prepare you for real-world work environments. Exam questions on exams and more writing projects to see that students' compensation will increase. The assumption that students are mastering these skills elsewhere in the university and can incorporate them to the study of accounting is proving increasingly naive.

Myth 5: If you are the most zealous student who is the most zealous student who is the most zealous student and the most zealous student to rehearse the mechanical steps involved in solving homework problems, you will be preposterous to accept the idea of learning accounting is like learning a new language. It would be erroneous to accept the idea that students of language who simply memorize the meanings of long lists of foreign vocabulary words actually have learned a new language. Obviously, students need to be able to read, write, and talk in the new language. Meaningful communication is the only acceptable proof of mastery of a language. Accounting also is primarily about communication. The ultimate educational goal is not to focus on an ever-increasing list of rules but to create an environment where students learn how to communicate financial information to interested parties in an effective way.

Many of the best textbooks begin with this insight in Chapter 1 only to neglect it in the chapters that follow. Good accountants are experts at selecting, organizing, presenting, and auditing huge amounts of data in ways that will be useful to decision makers. It is an enormous task that, when done efficiently, does improve the material well-being of society. If the final products — financial statements, managerial reports, and oral presentations — are the facts the student understands and irrelevant, accountants — even if all rules have been applied correctly — have failed. Accountants are valuable as communications experts. They are society's specialists in the language of business.

Myth 6: Good accountants are experts and auditing huge amounts of data. Unfortunately, these students' prejudices against "the seven deadly accounting myths." The best way to combat the seven deadly myths is to develop precise teaching goals specifically designed to counter them. Are you susceptible to any of these myths?

Myth 7: Accountants are valuable as communications experts. In the business school replaced a pre-existing accounting program. Even today, the school would still prefer to choose the accounting program and eliminate the additional requirements the business school is placing on the accounting content and should be learned as a "thing apart." Students complain about the "soft" nature of management and marketing. While they tolerate finance courses, organizational behavior is a "complete waste of time." When I recently suggested to...
an accounting major that he consider taking a psychology course as one of his electives. I told him I was joking. (After his reaction, I didn’t have the heart to tell him that I had majored in psychology as an undergraduate and never regretted the decision.)

Fact: Accounting is embedded in an economic and political system. Accounting students have good reasons to be proud of the rigorous and highly logical nature of their discipline. Accounting is correctly thought of as nonpolitical. But just as “bottom-line” thinking is fast becoming a thing of the past, it is now more evident to accounting educators and researchers that accounting cannot stand alone. The following questions—critical to the accounting profession—are not answered in isolation: What is it that we are accounting for? What is the ultimate purpose of the corporation? To whom are managers ultimately accountable? Do auditors maintain independence? How will technological breakthroughs affect and ultimately alter the traditional accounting cycle? Will accounting standards need to be more (or less) flexible as business becomes increasingly international? Accounting students need to think about these and similar questions as early as possible in their careers.

Successful accounting students will be able to explain what they learn in nonaccounting courses, including other business courses and liberal arts with their accounting lessons. There can be no such thing as accounting Robinson Crusoe. Teachers need to emphasize the economic effects of alternative accounting standards and analyze the nonfinancial effects of alternative accounting standards on employees and others, compare U.S. standards to international standards, discuss the effects of increasing disclosure of nonfinancial information, and isolate the political assumptions underlying the accounting standards in increasing proclivity.

Myth 5: All decisions are based on the cost-benefit criterion. If not, they should be.

Indeed, many decisions are best thought of in terms of the cost-benefit calculus. A favorite example from my accounting introductory accounting literature will help clarify.

Suppose Dan Smith, the proprietor of a small ice cream shop, has just purchased a new ice cream maker for $20,000. He expects the machine will last 10 years with no future salvage value. Maintenance and operating costs on the machine are expected to be about $1,000 per year. Smith is happy with his new machine. Its capacity is more than adequate to meet the demand of his modest clientele, and he is delighted to be rid of the old machine.

Three days after the purchase, supersalesman Buck Starr meets Smith at a local chamber of commerce meeting. Smith, still excited about his recent purchase, brag to Starr about it. Starr turns to Smith, “You should have talked to me first.” Smith says, “Well, the effects of alternative accounting standards somehow might be improved, students simply cannot fathom why the standards are not altered immediately. After all, if accounting students understand that there is a third—environmentalists may conflict with consumer demands.

Ultimately, accounting, like all institutions, is constructed by human beings. The standard-setting process thus requires compromise, ingenuity, creativity, and trade-offs.

Myth 7: I’ll learn what I really need to know when I get to my first job.

The title of an enormously popular book suggests All I Really Need to Know I Learned in Kindergarten (Robert Fulghum, New York: Villard Books, 1988): Accounting students have the opposite view: “All I really need to know I’ll learn when I get to my first job.” The myth holds that the sole purpose of the undergraduate accounting degree is job placement. The university is a vocational school (if not completely honest) employment agency, and faculty are glorified headhunters. This final myth is nurtured by the reality that, if accounting were truly only about memorizing a list of rules, if accounting were indeed a “thing apart,” if all decisions were based on a cost-benefit calculus, perhaps there would be no role for university accounting programs. Such a world does not exist.

Fact: The goals of a university education are not necessarily the same as the goals of major accounting firms. The six facts discussed above cannot be duplicated easily by for-profit organizations. Accounting educators, at best, take a long-term perspective. Accounting firms, as my former students justifiably complain to me, are notorious for choosing the short-term perspective. The turnover rate has increased, and the emphasis on long-range planning. Accounting education is designed to provide students with a foundation to build on.

The early years at accounting firms rarely provide “the big picture” nor prepare students for careers in industry where most accountants will finish out their careers. Accounting education is designed not just with survival in mind. Each of the “truths” described above is designed to provide you with the tools to thrive and blossom. All seven emphasize language and communication, verbal skills, an enlarged view of the “truths” described above is designed to provide you with the tools to thrive and blossom. All seven emphasize language and communication, verbal skills, an enlarged view of the business environment, and emotional intelligence. Accounting is a dynamic, exciting, important, controversial, and challenging discipline. It’s time we let our students in on the secret.
The New Real Estate Investment
by Isaac Galena

Young Jimmy Yeagers was a Monopoly prodigy. By the age of seven, he had mastered the intricacies of the Parker Brothers Board game. He knew all the game strategies, as well as the mortgage payments on each color-coded property. His parents recognized his God-given talents; when it came time for young Jimmy to join the work force, his parents directed him into real estate. Jimmy was quite successful; however his dreams of owning a million-dollar property never came to fruition with his mere professional golf course caretaker’s salary. He would never have that chance to own the real “Boardwalk” or “Park Place” properties.

Today there is a way to own not only real estate, but instead invest in mortgages, or more likely buys, income-producing property. The source of the income is rent, paid by college kids and workers don’t sharply rise or drop. The remaining REITs are more diversified within real estate by location, economic region and property type. REITs are even sometimes referred to as the “mutual funds of real estate.”

Another major reason to invest in REITs is due to the related tax laws. REITs pay no federal corporate income tax. However the tax regulations also require that a REIT distribute at least 95 percent of its net income to shareholders as dividends. That sharply limits the REIT’s options for growth.

Within the equity sector there are ten or 43 REITs, is residential: apartment buildings, office complexes, golf courses, shopping malls, industrial parks, and office buildings, all depending on the trust. On the market today, there are about 195 publicly traded REITs. The market capitalization of these 195 is approximately $94 billion, which means the entire publicly traded component of the industry is a minuscule piece of the investment world. The field is relatively new and surprisingly small. It was only in 1960; it would be 30 years before REITs could be considered respectable, mainstream investment vehicles. The market capitalization of REITs has increased from approximately $10 Billion in 1986 to over $90 Billion today. “The REIT craze is far from over,” writes Peter Lynch, vice-chairman of Fidelity Management and Research.

How do REITs Work? The process begins with an initial public offering, let’s say the management group of a new REIT sells ten million shares for $10 each. With that $100 million it builds, or more likely buys, income-producing property. The source of the income is rent, paid by college kids and families in residential complexes, companies in office towers, or stores in extravagant shopping malls. This type of REIT is called an equity REIT. Equity REITs constitute about 89 percent of the REIT industry in terms of market capitalization. Basically, if you’re a shareholder in an equity REIT, you’re a landlord.

The other category of real estate investment trusts is mortgage REITs, which make up half of the remaining market capitalization. These trusts do not buy property, but instead invest in mortgages taken out by builders and property owners. Mortgage REITs succeed only if borrowers don’t default and interest rates don’t sharply rise or drop. That can be quite risky. The remaining REITs are so-called hybrids, which both own property and loan money.

The primary reasons to invest in real estate are high returns and low correlations with other major asset classes, which can make real estate a valuable diversifier. Investors can also diversify within real estate by location, economic region and property type. REITs are even sometimes referred to as the “mutual funds of real estate.”

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Within the equity sector there are ten or so subsectors. The largest, with 43 REITs and about $21 billion in market capitalization, is retail. REITs that own shopping complexes of various sorts. Next, with 36 REITs, is residential: apartment buildings and complexes. Third is industrial: office, containing industrial parks and office buildings. There’s also much money invested in self-storage and health-care facilities. These REITs tend to own not hospitals and clinics but the ground beneath them.

So how does a REIT grow? One way is to sell property from its portfolio at a profit; another is to issue more stock. It can also borrow money and pay the smallest dividend allowable by law and acceptable to shareholders. The best combination for a REIT is the market that is turning up with leases that are turning over. In that environment, a new lease is seen as an opportunity to raise prices. Kenneth Heebner, portfolio manager of FCM Realty Mutual Fund, has nearly 50 percent of his portfolio in hotel REITs, including FelCor Suite Hotels. FelCor, owner of the premium brand Embassy Suites, acquires undermanaged hotels, upgrades them, and raises room rates under the Embassy Suites name. It’s expected to return 20% in 1997.

In order to attract institutional investors, REITs are in a race to get bigger, in a short time. Institutional investors are starting to forsake direct investment in real estate to focus on buying and swapping properties into REITs. REIT mutual funds are proliferating too. There are now 58 REIT funds, and 19 of them are sold without front-end loads. Several pension funds have announced recently that they will also shift assets from private real estate to REITs. However, investors are still hesitant to vest into this emerging venture. Charac- continued on page 6
I t is often seen that Israeli politics is a whirlwind of unique, unsolvable problems: peace process, terrorism, immigration, and determining who is a Jew. Now, one of Israel’s major political debates, threatening the stability of its economy and exports, is not at all unique, but in fact, faced by every other industrial nation: how much power to assign the central bank of a country with regard to controlling inflation and unemployment.

The Bank of Israel is the Israeli counterpart to the U.S. Federal Reserve, it essentially dictates how much money will be circulated in the economy at any given time. Like the Federal Reserve and the German Bundesbank, the Bank of Israel operates independent of government control; economic conditions dictate how much money is circulated and decisions about money circulation by the rate of inflation and interest rates.

The principle behind this separation of Bank and State is that decisions about money circulation are too important to allow popular influence on the decision. Politicians might not be willing to make unpopular but necessary changes in monetary policy if they threatened their re-election, thus, the decision is put into the hands of appointed, unelected officials who do not have much threat of losing their jobs. (The same mentality is illustrated in many facets of the government, including the selection of judges and military leaders.)

What is this monetary policy and its responsibilities as follows: “Maintaining the internal value of the local currency (i.e., its purchasing power) and its external value (against other currencies). Keep inflation low, and achieve high levels of production, employment, national income, and capital investment in Israel.”

Thus, growth of the economy and reduction in unemployment often occurs at the expense of high inflation. Inflation is detrimental to any economy because it makes money’s value unpredictable and thus less useful. As a result, loans become harder to secure as lenders take on increased risk.

The Bank of Israel defines inflation as follows: “Past experience shows that inflation has a distorting effect on the economy – affecting production, consumption, foreign trade, labor, and the financial markets – and also creates problems for the execution of fiscal and monetary policy. Hence the importance which the ‘Bank of Israel’ (like central banks all over the world) attaches to maintaining the value of the local currency, and combating inflation.”

In a small economy such as Israel’s, which is open to the movement of capital, over-expansion could also affect the balance of payments and lead to a fall in foreign-exchange reserves. For this reason, as well as the effects that changes in exchange rates have on domestic prices, exchange-rate policy constitutes an important aspect of the Bank of Israel’s policy.

‘The importance of monetary policy in a nation’s economy, it is little wonder that Alan Greenspan, who heads the U.S. Federal Reserve, has been described as the second most powerful man in the United States. Jacob Frenkel has similar power over Israel’s economy as he is the head of the Bank of Israel and determines the country’s discount rate, effectively controlling the rate of money flow. However, recent economic problems in Israel have prompted requests by Israeli business men such as Dan Propper, head of Osram, to call for a limiting of Frenkel’s power due to his tight control of the money supply in the face of slow growth and high unemployment.

Israel’s unemployment rate has climbed to 7.6% recently, (well above the natural unemployment of 5-6%), and growth has slowed to 2% (for a small country, this is a low figure). Despite these figures indicating poor growth, Frenkel wants to raise interest rates, which may slow things down even further. Frenkel has promised to do this by the country’s current 10% inflation rate, which is the ceiling for the government’s targeted healthy inflation.

Thus, Israel is faced with a classic problem in Macroeconomics: How much interest rate to raise will affect the flow of money in the economy, counteracting inflation but threatening to increase unemployment?

Frenkel favors the former; business leaders favor the latter. This division of opinion is understandable. Frenkel is a macroeconomist who understands the dangers should Israel’s currency become devalued due to high inflation: hard to import goods, hard to attract investors willing to accept shekels, lack of confidence by the population in its money’s worth, and so on. Business leaders however, see things in terms of a microeconomic perspective: they care about their particular business’s health as well as the employment of the population more than the reputation of Israel’s shekels in the International Monetary Fund.

The Knesset meets to vote on the Business leaders proposal to have a committee made up of bank employees as well as outsiders to make decisions about Interest rates, inflation, and growth. This decision would take from Frenkel sole power over monetary policy. No matter how the situation resolves, one thing about it makes it typical for Israeli politics: there is no solution. 
The Russian Economy: Order or Chaos
by Ilan Scharf

American investors seem to be enamored with the Russian economy. Indeed, its stock market has risen a dramatic 60% since April, and is up 156% since 1996. American investors are currently pouring money into the country like never before. Forty-one debt and equity funds now exist, controlled solely by foreign investors, accounting for $1.4 billion dollars in foreign investment. The news only gets better: Wall street pundits predict foreign investment is going to increase even greater. This can be attributed to the stabilizing political situation. Boris Yeltsin, although still suffering from lingering health problems, appointed competent advisors well versed in modern economics. New legislation, aimed at patching up the loopholes that allowed $10 billion dollars of investment to be lost to pyramid schemes, has lent a sense of security to a perpetually embattled financial system. But beware: do not blindly throw your American dollars to the Russian stock market just yet; for all is not quiet on the Russian front. Even the most sanguine Wall Street wizard and portfolio manager bares grave concern about what lies ahead in the 21st century.

There are a number of problems inherent in the Russian economic-political system that make investing there a risky proposition. Flagrant fraud and violent crime are endemic in Russia. It is a common place for the infamous Russian mafia to engage in brutal, if not deadly shake downs of businessmen, aimed at extracting large "protection" payments. Indeed, serious crime is up 70% since 1990; a murder is committed in Moscow, the Russian crown jewel and capital, every five hours. International businessmen are fearful for their lives when traveling there. Financial fraud, pyramid schemes and costly kickbacks has risen two-fold since 1996. Whether trying to take out a loan from the bank or splurging on the family in a nice restaurant, one feels the effects of these unsavory activities. Nevertheless, the corruption in the business sector is much in comparison to that of the private sector. The government is mired in corruption from head to toe. Politicians, hailed as those "servants" of the people, are more corrupt than Russia. Moreover, a large proportion of financial crimes go unreported. This stems from a vastly corrupt police force - one plagued by staggering incompetence and corruption. Either out of laziness or incompetence, the police force fails to properly investigate the reported crimes, arresting families and "good citizens." The "thieves" then simply steal or kill potential state witnesses. Nearly six percent of the police force were disciplined last year.

But stealing crime and shameless political manipulation are only the tip of the iceberg. The tax system, the most fundamental service a country can provide, is in complete disarray. Multidisciplinary companies and corporations have used ingenious American style lobbying to cloak the government into granting them sweeping tax exemptions. These tax breaks create a financial burden that small businesses must make up. Thus, this predatory system has restricted mobility for hungry entrepreneurs and nascent small businesses trying to make it big. Indeed, small businesses estimate that they pay up to 80% of their profits to Uncle Boris. One firm estimated that even by doubling revenues it would still exact only a two percent profit after taxes and inflation. While stiff penalties are placed on those who are convicted of tax fraud, the conviction rate is miniscule at best. Tax authorities do not have the necessary capacities and resources to seriously combat tax evasion. Of greater importance, it is not uncommon for individuals and corporations either out of confusion or a desire to raise skimp profits, to simply not pay their taxes. Corrupt tax collectors have facilitated this practice, making themselves readily available for bribes and political favors.

Still, what frightens potential investors the most is the Russian mentality. Indeed, our Russian counterparts fail to grasp basic capitalist ideas and principles. Monolithic corporations demand deals to be done their way or no way. Attempts by foreign investors to breach this "false rule to communicate," by teaching Russian businessmen how business is done in the West, are met with defiance and dogmatism. For example, when General Motors attempted to open a plant in Moscow, they stipulated for the project to produce 50,000 units a year. The Russians, on the other hand, wanted a unit that would produce 500,000 units. This desire to do things on a enormous scale is not comprehended by their Russian counterparts. The Russian plutocracy does comprehend the idea that what is good for the country as a whole will also be good for themselves in the long run.

It is a shame: Russia has all of the necessary tools: an educated workforce, limitless natural resources - to thrive in the next century. Yet, Russians, whether lowly peasants or wealthy fat cats, still do not comprehend that remaining entrenched in their Bolshevik ways will do little to improve an already depressing situation. A free market economy does not mean that government officials should bestow early Christmas presents to political cronies; it does not mean that a select few should get rich while the rest of the populace starves. If Russians are really serious about becoming a prime investment center, another Asian Tiger, then they should join the capitalist boat, by realizing that there is never an easy way out: difficult problems call for equally difficult solutions.

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Before describing different mutual fund categories, a reason needs to be given as to why many people ignore a large part of the investment universe. Often, people invest in bond funds is that they are considered safer because of the availability of information and its immediate effect on price.

International funds come in many forms: some are general diversified international funds, and it is these specialized funds that have the greatest volatility (both in their price and the fund's performance). Last year, the Asian funds (and the broad emerging market funds which include Asian holdings) were dragged down by the collapse of the Thai stock market, which precipitated a fall in other local currencies and markets. Since the Mexican peso's collapse a few years ago, Thailand's troubles serve either as a reminder that what shoots up can just as easily come down, providing a good opportunity to buy low. For the short term, the former has certainly proven true, as the phenomenon of rising prices and falling exchange rates spread through the region, even affecting stronger markets like Hong Kong. Originally, this caused many back-end load funds to invest in speculative trading companies that have not yet established productive mines took a big hit, mostly because of their share price to skyrocket. When an independent geological survey was finally released a year and a half later, it found that the gold was imaginary, causing the stock's price to tumble from nearly $20 to the current low of about $10. The story is still ongoing as the chief geologist is being sued in the Cayman Islands. The lesson of this story is that some sector funds can be risky, especially in those sectors of the market that seem especially prone to fraud.

The other important segment of the fund universe that must be mentioned is bond funds. Most bond funds are steady dividend-bands because of the interest rates of the bonds in their portfolios, making their returns much more predictable than those of stock funds. Aside from collecting interest on their bonds, they also profit when declining interest rates raise the prices of their holdings. Treasury bonds are usually considered to be the safest funds because there is no risk of a default by the U.S. Treasury. However, when Treasury funds enter into derivative trading (where they can potentially) can boost a fund's yield, they assume all of the risks that are typically associated with that sector. Furthermore, bond funds are categorized by their average debt rate, while corporate and municipal bond funds are also linked by the credit ratings of their bonds' issuers. Bonds with decent credit ratings are known as investment grade, while those with low credit ratings are referred to euphemistically as high-yield securities and colloquially as junk bonds. Lower credit ratings and longer terms increase bond yields, and of course the risks of both declining prices and default. Of late, bond funds have seen a comeback before the collapse. At the same time, a number of factors have caused them to appreciate noticeably. Specifically, rates have declined with the Federal Reserve official's recommendation that the budget deficit has decreased in the supply of Treasury bonds. The trend is likely to continue: both the President and Congress support a balanced budget, and decreasing supply, when coupled with steady or increasing demand, will result in higher prices. The related note, the fact that inflation has been dormant for the last few years has kept interest rates down even though the future of interest rates and inflation is unknown.

Also worth noting is the appearance of many emerging market bond funds. The risks of these funds are similar to those of emerging market stock funds; if a developing country's government decides to pay its debts (or if its currency collapses making such payments worthless), investors will get stuck with worthless investments. This is especially unfair, however, to mention the risks without mentioning the rewards, which have been phenomenal.

Generally, diversified U.S. stock funds are categorized by the market capitalizations (total value of all outstanding shares) of the companies in their holdings and by whether they are growth or value oriented. Some common categories include blue chip, mid-cap, small-cap, and micro-cap. The exact size of a micro-cap stock is difficult to define, but small-cap stocks are usually those whose total value is less than $1 billion, with micro-caps being a lot smaller. Aside from the usual risks associated with investing in the stock market, micro-caps are often thinly traded, making selling a position difficult, something that is unheard of on the New York Stock Exchange. While these smaller firms do not yet have an established product, which makes for shaky earnings. Another risk is that, traditionally, this category of stocks is the one that attracts the most fraud, partly due to lack of general interest on the part of investors, and profit margins may be quite high. While outstanding, serious price manipulation is accomplished with less difficulty than with bigger stocks. Although micro-caps are usually negotiable through mutual funds, a fund does protect against these risks, the large amounts of money invested by these funds make them especially difficult to sell when stocks whose total capitalization can be less than that of the fund (given that funds often want to keep their portfolios diversified, they may own as little as 5% of the 5% of the total shares outstanding). This problem is compounded as the price of a fund's holdings rise, raising their potential stocks out of the micro-cap classification.

One respectable fund in this category, the Robertson Stephens Micro-Cap Growth Fund, simply focuses on the least efficient market segment. While many funds have high fees, and local assistance must often be enlisted, which is not true of domestic funds. Funds that are worth noting are sector funds. Each of these funds concentrates on a specific industry, such as banks, biotechnology, or software, to name just a few. The advantage (or disadvantage) of these funds is that by concentrating on a specific part of the market, their managers can take advantage of that industry's growth or profitability, and they often experience large fluctuations as their industry rises in and out of the market's favor. The gold funds, for instance, have generally been down the last few years because of their poor short-term return, something which will often not be done after the fund has gained recognition.
written history. The earthy cause of the Egyptian Bondage was ups and downs in the price of grain, something that caused friction between every agricultural society and its nomadic neighbors. Athens experienced the Great Land Crash of 333 B.C.E. (that is, Tullipomania) halted Holland in 1636 and the 18th Century witnessed the twin calamities of the Mississippi Scheme in France and the South Sea Bubble in England. But the first fully-modern crash was the Great Cotton Crash of 1817. In 1835 a fire had destroyed much of Wall Street. Out of the ashes a new breed of speculator arose, yelling on the names of the Josephs Brothers. They invested their new-found wealth in construction of a magnificent new bank building near Hanover Street.

On March 14, 1817, cracks appeared in the almost-completed building. The cracks grow until the entire building suddenly collapsed, shattering the foundations of every Wall Street building. Three days later, on March 17, a packet ship arrived from New Orleans. The cotton market had collapsed leaving $200 million in worthless debts, and the Cotton Panic of 1817 began. Within two months, Bowlings Green would be filled with troops and the mayor of New York would be storing ammunition in his office against a starving, violent mob. This is a classic crash contradiction: people starve while food prices are so low that bank fails. Not only agricultural markets but the stock market and real estate would fall, and keep falling for three years. The historian Reginald McGrane, writing in 1924, called it “one of the most disastrous periods this country has ever experienced.”

**International Aspects**

The crash was not limited to Wall Street, or even to the United States. The origin can be traced either to the United States in 1835 or England in 1836. It spread (or returned) to the United States in 1837 and from there to continental Europe (this makes sense financially, if not geographically). From Europe it reinfected England in 1839, provoking one last calamity in the United States in 1840. This is another classic crash pattern; a decline in one place ripples out to cause declines in other places, which spread back to abort recovery in the original place.

A third element of a modern crash is the series of ups and downs over a period of years. Like all crashes, this one began with a rally. Expansion of the British Empire and improvements in textile technology led to a cotton boom from 1826 to 1831. The cotton boom drew investment into cotton, of course, but also into spinning mills, land to grow the cotton and railroads to transport it. At the same time, American states were borrowing money to build canals and other public works.

This created a tremendous demand for capital. In England it was met by laws authorizing joint stock banks in 1826 and 1833. The United States used soft-money banks and began switching from silver to gold. The increase in capital fueled the expansion that created the need for more capital. Also all this capital was making people rich so demand for luxury goods soared.

In the summer of 1836, the Bank of England cut off credit to the “W Banks.” Wiggins, Wilde and Wilkie were three of only seven United States banks operating in England. This action, and the resulting failure of these banks, caused capital to evaporate. At approximately the same time, hardly any Democrats in the United States pushed the Specie Circular that required payment for public lands to be paid in gold. This further reduced available capital and weakened banks. By early 1837, the price of cotton had plummeted and dragged down all associated investments with it.

**Bank Failures**

In New York, dozens of banks failed (including J. E. & S. Josephs & Company, collapsed building and all) on Friday, March 17, 1837. New York turned to the great Nicholas Biddle. Biddle ran the United States National Bank until 1833 when President Andrew Jackson refused to renew its charter. He was still president of the most successful bank in the country.

Biddle agreed to ship $1,000,000 of gold and silver to London and New York banks did the same. This failed to restore American credit so the bank run continued. As Charles Collman told it in 1833, “These bank runs of ’37 were different from the ones with which our day is familiar. They consisted of a frantic rush of the poorer people, who demanded cash for the paper money which had been issued by the banks.”

Biddle, Integrated to M. Collman in 1833 but rare today, was that troops were called out to quell the mob and silver and gold disappeared from circulation.

The next blow came when the solid and respected Mechanics’ Bank failed and its president, John Fleming, committed suicide. Next the august Dry Dock Bank failed. By the middle of April 352 banks had failed. All of the South and most of the West was bankrupt. The losses caused a recession throughout Europe and North America.

**Blood in the Streets**

Great investors know that the time to buy is when there is blood in the streets. The streets were literally littered with this money this time. Millions of dollars of assets could be had for thousands of dollars of cash. Slowly the gold and silver that had been hoarded throughout the crisis came out to snap up land, companies and factories. Moreover the cheap cotton (and tobacco as well) made the factories profitable, factories opened and expanded throughout the American South and in Europe as well.

Nicholas Biddle had a bold plan. He decided to corner cotton. With cotton so cheap, he could buy the entire available supply. Then he could name his price. He arranged credit through several European banks, most prominently Maison Hottenruein of Paris, and bought cotton throughout the growing season.

By the summer of 1838, the price of cotton had soared. The people who had bought land and built mills after the 1837 crash were ruined. European spinning mills refused to buy American cotton and the entire world textile industry ground to a halt for six months. But the boycott succeeded and Biddle’s corner failed. Cotton prices fell to new lows and caused another round of bankruptcies and bank failures.

This cycle, rally, crash, new Investment, new rally and new crash was repeated at least two other times before the United States emerged from depression in 1844. And more crashes were to come. As Charles Collman, “the currency embouriments of [1837]; the wild October 1839 twenty years later, with its moths and the hysterias of September, ’73 the wrack of the great adventur of ’84; the terrors of ’93, when all the fat of the monopolies was in the market, the railroad operations of ’01; the black year of ’07, when the very devil was to pay with copper and the banks.”

On October 19, 1837, I started writing this in the early morning hours of October 24, 1837. Yes, the stock market fell the limit and I have to make a lot of trading decisions for tomorrow. I have been up all night, watching the Asian markets, overnight futures trading and analyses from various parties. Europe will open soon and give more clues.

At the moment, it seems as if the market will open lower, drop under 7,000 briefly, then rally. Why do I say that? Because the overnight futures are trading at levels that will force the initial drop, but orders to buy stock are high. I am putting together orders to pick up certain stocks that I thought were good val­ues two weeks ago and should be great values tomorrow. But “value” is relative, I hope they will do better than the average stock, and the companies are solid despite economic propositions. But if the market heads further south, my stocks will not look like bargains.

Even if I am right in the short-term, what will the rally mean? Will it be a brief hiatus in a major crash? Or will it be the first step on the road to new stock market records? Personally, I am confident about the medium-term based on the behavior of interest rates and commodities. Long-term is a problem, in the long run the stock market has always outperformed alternative investments.

Late nights and dramatic events conjure up the ghosts of history. I imagine a distant ancestor herding livestock in the Sinai: A drought has made it difficult for him to feed his flock. He has driven up the price of food in Egyptian cities. Does it make sense to bring the animals to the city for slaughter? The price is good, and the alternative is difficult.

If the rains return in the next few years, the price of livestock will fall. My great-great-grandfather can purchase a large herd with the profits from the sale; he will hold high and bought low. But if the drought persists, all the profits will be spent on expensive food and he will be impoverished, forced to labor in cities to survive.

Perhaps a distant cousin owned land in Athens or tills in Holland. No doubt various relatives were caught up in the financial panic of the following centuries. I know my grandparents were touched by the Great Depression.

I doubt that October 1997 will go down in history as these events should be forgotten in November 1997. But on the eve of a crash, you never know.
As any person in today's predatory business climate can tell you, the most important ingredient to success is good personal service. In this post-modern society where computers seem to be displacing humans in all areas, a nice, friendly face can go a long way in improving one's day. Indeed, sometimes a nice, friendly face behind the counter can be the sole reason why someone buys a product.

Located on 186th Street and Amsterdam Avenue, there are two businesses - Grandma's Cookie Jar, a first rate bakery whose delicious muffins have achieved folklore status, and The Collegiate Book Store, a third rate establishment whose claims to fame are exorbitant prices and a paltry selection of books - where one can see how pivotal of a role service can play in making a pleasant business environment. When first entering The Collegiate Book Store, one is struck by the clerks' apathy and unreadiness in helping. They respond to simple to simple questions, like a book's location or cost, with snide facial expressions and abrupt shouts of disbelief. When a professor requests more books, one becomes common witness to fiery diatribes about how a book's shortage is not their fault and how they should not order more books in order to teach the professor a lesson. Crude behavior is the local dialect.

Grandma's Cookie Jar, on the other hand, is a business establishment that realizes the importance of efficient service. Taking a cue from the Yeshiva University's Cafeteria, "Grandpa", Grandma's cuddly owner, hired two cute Hispanic women to serve consumers. With their sweet smiles and friendly demeanor, "Lorraine" and "Wanda" have made buying pastries a whole new experience. When they are around, muffins taste more scrumptious than usual, and bagels are miraculously softer, while the decadent aroma of hot cookies and chocolate brownies smells better than ever.

However, what intrigues us most are the reactions many a Yeshiva student has to these women. Instead of acting like normal consumers buying products (i.e., paying their bills and leaving), many students deem it necessary to forgo the traditional pleasantries of "Have a nice day!" and "How is your life going?" for more meaningful conversations. Indeed, it is not an uncommon sight to see a Yeshiva student swapping family stories or a newly heard joke with these two women. Often after finishing his conversation with one of them, a student will punctuate the moment with an awkward smile or laugh. Although we are sure that "Grandpa" did not hire "Lorraine" and "Wanda" with the intent of boosting business by having them flirt with the student body, we are equally sure that "Grandpa" is dismayed with the results - added sales and fatter profit margins. Unfortunately, in rare occasions these long conversations can hinder business as well, when annoyed consumers not interested in seeing students make fools of themselves in awkward conversation, walk out of the store upset at the slow service.

Managing a successful business is a tricky game. On a daily basis, businessmen, whether wealthy or rich, strive to get an upper hand on their competition. The Collegiate Book Store and Grandma's are two stores that show how service can alter a business environment. While students do everything in their power not to go through the hellish experience of buying a book in The Collegiate Book Store, people go out of their way to buy muffins and shamelessly hit on the "Grandma Girls". But we feel the need to inform The Collegiate Book Store that all hope is not lost: if they want to see what good service means then they should take out their wallet, and prepare to hire people of the opposite sex.

Appreciates letters, commentary, and responses from all of its readers.

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Personal Investment Strategy

DISASTER

by Professor Aaron Brown

The deadliest volcanic eruption in history was the 1815 explosion of Tambora, just west of Sumbawa. The resulting tsunami flooded the low-lying areas of hundreds of nearby islands and killed 10,000 people. Most of the victims were islanders living in low-lying areas who supported themselves by fishing or trading.

The disaster caused a profound cultural shift among the surviving islanders. It seemed apparent that beach dwellers were sinful and dangerous, that fishing and trading were suspect occupations. The ancient ocean gods who united society among thousands of islands were neglected in favor of religion tied to ancestral sites on land. The lonely-knit society of Micronesia gave way to economies firmly rooted to one island.

As the years passed, some people began to question these changes. Not the people who had actually witnessed the Tamboran tsunami, of course, but by the 1840s most residents had only heard about this event from their parents. There was attractive land available near the ocean and it seemed silly for sailors and fishermen to climb to highland every night. People longed for the old free-roaming boxways. Mountain life seemed stifled and over-regulated, the beach promised adventure and freedom. But 10,000 dead are hard to forget, even if you have only heard about it second-hand.

By the 1880's, second-hand had changed to third-hand. The only living witnesses to Tambora had been 15-18 years old in 1815; even most of the people whose parents had witnessed the event were dead. The grandchildren began to move back down to the undersupplied shore. The old beach subculture was resurrected in a manner not unlike the contemporaneous settling of the American West.

In May 1861, rumblings began on an uninhabited island a few hundred miles northwest of Tambora, its central volcano, and had been dormant for over 200 years. A series of small explosions were heard on neighboring islands. Then, in August, Krakatoa blew.

This was the second-deadliest volcano in history. Although Krakatoa killed fewer people than Tambora, its cultural consequences in the western Samoan islands was many times greater. The first disaster molded the island societies, the second, confirming disaster, was the kind that forced those changes into glass-hard permanence.

The Great Crash of 1929

What is this story doing in a personal finance column? If you can forgive the impunity of comparing losses of money to mass deaths, consider the analogy to the market crash of 1929. This was not an event of October 29, 1929, when the stock market fell 13% in one day. It was not the three months of sharp negative returns from September to November 1929. It was a three-year disaster from 1929 to 1931 with seven distinct crashes separated by record-breaking rallies.

From September to November 1929, the stock market declined 37%. Stock prices were near the level of the beginning of 1928. Now the smart money started flowing in; the people who had been waiting on the sidelines because they knew the market had been overvalued. "The Great Bear," Jesse Livermore, who had been short it, i.e., had bet that stock prices would go down since May 1929, began to snap up bargains left and right. Over the next six months the market rewarded these brave souls with a 20% return, undoing more than half of the Crash. Then, in June 1930, the entire 20% was taken away in three days of frantic trading and the market was back to the lows of November 1929. By the end of 1930 the market was 25% below these levels.

Now the really smart money appeared. "The Great Bear" was now "The Breakout Bear," having lost all his and his investors' money by getting in too soon. But there were others who had realized that 1929 had not squeezed all the excess out of the stock market. To these careful investors, after further reductions of 25% by December 1930, the market looked cheap.

These investors received 20% returns in January and February 1931. Then they gave back 30% in the next three months. These cycles continued until by December the market was down 43% from the 25% below the post-crash values in November 1929.

Now the worst had to be over. First there was a 37% crash in 1929, then a further 25% reduction in 1930, then another 43% decline in 1932. Now even the most cautious investors had to admit the market was cheap. February 1932 seemed to be the turning point with a solid 6% return for the month. But the next three months were springtime only for the calendar. The stock market fell another 6%. 1932 ended up just as bad as 1929.

Crash Theory

A one-time decline in prices, no matter how severe, does not test the financial markets. There is always money on the sidelines, waiting to repair the damage. But a constant cycle of rally followed by deeper decline leaves a lasting imprint. Four of the six years after 1932 saw stock market returns better than +30%, including +43% and +48% years. By the end of 1936, every stock market investor who had stayed in the market was showing a profit, whenever they had bought. But by this time, there were very few investors who had not had their faith shaken by the crash/rally/bigger crash cycle.

This is why the 13% sink market crash in 1929 changed the financial system in fundamental ways while the 23% 1987 crash caused only minor technical adjustments. 1929 is still the "Great Crash"; 1987 is already forgotten.

A simple decline in stock prices that stabilizes at a new, lower level, should not have a lasting economic impact. It does not destroy any real assets. It does not withdraw any capital from productive use. The defining characteristic of a true crash is an extended period of negative returns, it takes time for the economic damage to occur.

A Brief History of Crashes - Cotton Crash of 1817

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