The Italian Stock Market in the Post-war Period

1. This article examines the ups and downs of the Italian stock market from the end of the war to the present time and relates them to the general economic developments, of which the stock market is a part, and in the long run, a measure.

This period must be divided into two sub-periods: the immediate post-war years, which for the purposes of this essay go up to the end of 1947 and perhaps cover even a substantial part of 1948, and the subsequent period. In the first of these sub-periods the stock market was subjected to extremely violent forces from opposite directions, and in consequence oscillated violently in both directions. In the second sub-period, with the disappearance of the exceptional pressures, the market returned to normal, first consolidating its position at the new post-devaluation levels and subsequently resuming its upward movement parallel with the expansion of the economy.

The immediate post-war period

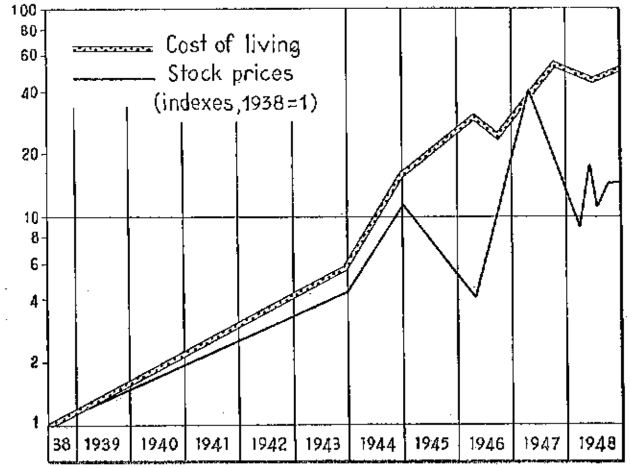
2. In the period between 1944 and 1947, Italy, ravaged by the war, experienced the most disastrous devaluation in its history. In the space of a few years the value of its currency was practically wiped out, falling to less than a fiftieth of the pre-war figure. The price of shares, therefore, tended to rise, since they represented real assets. On the other hand, these very assets were often seriously damaged or even destroyed. Shares, therefore, shot up and down without rhyme or reason.

The general index of stock prices which had shown a moderate upward trend, considering the exceptional circumstances, up to 1943, began to soar in 1944, and, by the end of the year, it had reached

a level 11.4 times that of 1938, as will be seen from Graph No. 1. There were, however, very wide variations as between the component sectors of the general index; the increase was as much as 18.5 times for real estate, while for mining, metals and engineering the figure was only 6.7 (cf. Table A in the Appendix).

At the beginning of 1945, this tendency was abruptly reversed and, in spite of the reduction (in May) of the surtax on stock transactions from 25 per cent to 3 per cent (1), the fall continued until the end of April 1946. That may seem strange, in view of the continuous devaluation of the currency during the whole of 1945 (cf. Graph No. 1); but other, more powerful, factors were acting in the opposite direction.

Graph No. 1



In the first place, there were fears of the socialist tendencies gaining the upper hand in the new government, and hence of the partial or total nationalization of the major industries. In the second place, since the shares were in the names of the holders, the latter were completely at the mercy of any new surtaxes, and these seemed inevitable at the time; but, above all, in my opinion, the decisive

(1) This tax had been introduced in 1941 to act as a brake on speculation. Initially put at 4 per cent, it was later raised, during the war, to as high as 25 per cent. For a chronological account of the various fiscal measures affecting stock exchange and share operations before and during the war, cf. G. Mancini, "Aspects and Problems of the Italian Stock Market", in *Banca Nazionale del Lavoro Quarterly Review*, April 1948.

consideration was that, once the defeat of Italy in the war was certain, many of the holders of large blocks of shares — often pre-eminent figures in the Fascist regime — were absolutely compelled to realize their stocks if they wished to save anything from the wreck.

In April 1946, the index of stocks had fallen to the 1944 level, *i.e.* hardly even four times the pre-war level, whereas the cost of living was 30 times higher. The real value of the shares had thus dropped to a seventh of the pre-war figure. At first sight, an economic explanation of such low prices could also be given by the absurd level to which yields had fallen (0.1-0.2 per cent in the first months of 1946), but it should not have been too difficult to understand that the distribution of insignificant dividends, or even of none at all, by many companies was an absolutely exceptional and temporary phenomenon and that, given the loss of purchasing power of the lira, the prices of shares were bound to adjust themselves to those of other goods. Without a doubt, the factors depressing stock quotations were not so much economic as fiscal and political.

And in fact in May 1946 the stock market underwent a sudden and radical change. Two decrees of 14 May did away with the coupon tax and the remaining surtax on transactions, while the transactions tax on registered stocks (*i.e.* practically all stocks) was reduced by 50 per cent. A decree of 17 May raised the restrictions on the distribution of company dividends, and lastly on May 27 a certain degree of revaluation of fixed assets was approved.

These measures acted like a shot in the arm. They set in motion a fresh wave of confidence in the stock exchange and led to a tremendous recovery. Quotations went up threefold, or almost, in three months. There was a halt in this upward movement in September-October — as a result of the reintroduction of the marginal requirement of 25 per cent on forward deals and of the decree which reserved to the State 25 per cent of the capital profits from revaluation already effected as a result of the decree of the previous May — but the rise at once resumed with renewed vigour and continued till the beginning of May 1947. This whole movement was the most fantastic boom in the history of the Italian stock exchange. In exactly ten months, the general index rose from 413 to 3,922, *i.e.* almost tenfold, and transactions rose to almost the same extent. The index of the textile sector reached a high of 9,700, or 97 times the pre-war figure, while individual stocks in this or other sectors went up even more.

The stock exchange boom of 1946-47 ended at the beginning of May 1947, following the reintroduction of the transactions surtax at the rate of 4 per cent. Immediately after, the new Minister of the Budget, Einaudi, just installed in the fourth De Gasperi Government, announced the programme of currency reorganization which led in the autumn to the stabilization of the lira, and these circumstances, coupled with the difficult technical situation which had been built up in the last months of the preceding dizzy rise, brought about an equally sudden and violent fall in the shares.

In eleven months the index sank from a high of 3,922 to a low of 893, which meant a loss of three quarters. The bulk of the previous speculative gains were gone with the wind, and it was the late comers — occasional buyers or greenhorns in investment matters, attracted by the dazzling prospects of the moment — who suffered more heavily.

One curious aspect of the 1946-47 boom was this. The Milan stock exchange is far and away the most important in Italy. It accounts for about 60 per cent of all operations. But it was Rome that was swept most violently by the frenzy of speculation during these months. Whereas in Milan the volume of transactions remained relatively low even in the first, hectic months of 1947 (being just over thrice that of 1946) the increase in Rome was much sharper — from 3,000 to 40,000 shares and from slightly over a million lire to 85 million a day. This means either that the fever of speculation in this period hit not so much high finance (with its natural centre at Milan) as the man in the street, or that it reached Rome much later and only for that reason did it seem much more violent in comparison with the previous very low level of stock exchange dealings.

3. By the end of 1947, the Italian monetary situation could be regarded as healthy again. And indeed 1948 was a year of great price stability, which appeared miraculous in a country with reconstruction yet unfinished and so soon after the almost total devaluation of the currency.

The same stability was not noticeable in the stock market which registered two further violent (and abnormal) oscillations. Towards the end of March (at the time when the Marshall Plan agreements were concluded) the trend was once again unexpectedly reversed. The index shot up in two months to 1,780, twice the initial figure.

This was followed by a fall of just under 40 per cent in June alone. In the subsequent months, the index seemed at last to be stabilized around 1,400, but in January 1949 there was a final surprise advance of 20 per cent which was completely cancelled in the following months. These two wild fluctuations of 1948-49 may, however, be regarded as the last tremors of the vast earthquake of the preceding years, as Graph No. 1 clearly brings out. In this connection, attention may be drawn to the regularity with which the fluctuation, caused by the end of the war and by the loss of the currency's purchasing power, first expands, acquiring momentum as it goes along, and then declines in a series of increasingly fainter oscillations as if in obedience to the general physical law of oscillatory movement.

In the subsequent period, the market movements became more "normal". That is they were more in line with the general movement of the economy. We will now subject that period to a closer examination.

The 1948-1958 period - General picture

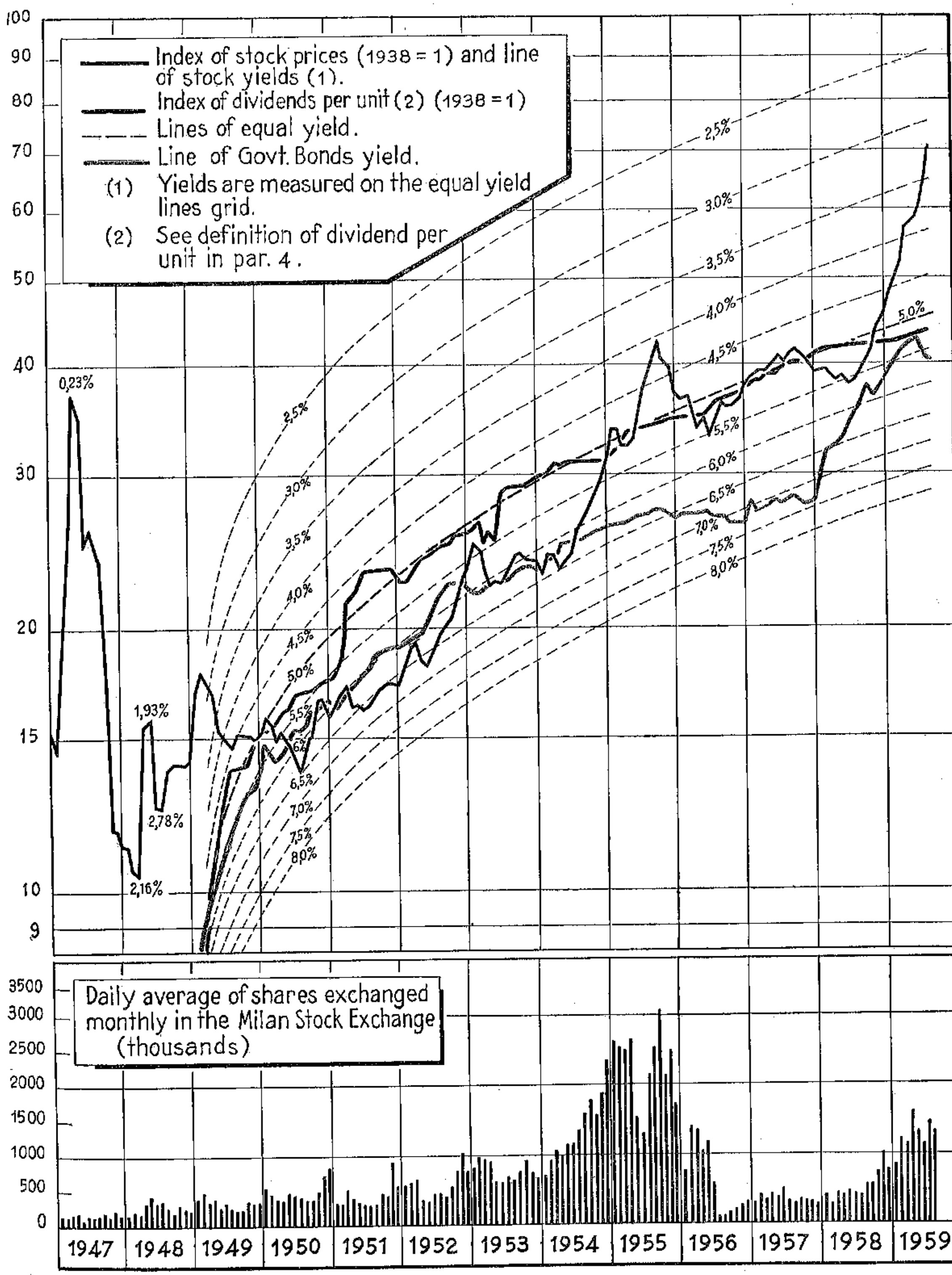
4. Graph No. 2 shows the monthly movements of stock prices (index of prices, ex accrued dividend, of the Banca d'Italia) related — in a new model, which we are submitting to the special attention of stock market analysts — to the two basic factors which in the long run determine the value of the stocks: the yield of the stocks themselves and the yield of Government Bonds.

The black line represents the general index of stock prices. The red line represents the (hypothetical) level of the general index at which the expected yield (*i.e.* the yield based on an expected dividend per share equal to the last one) of the stocks is 5 per cent. This is obtained by multiplying the index by the yield and dividing the product by 0.05. Hence, calling the red line l_o, the index i and the yield r, it is:

$$l_o = \frac{i \cdot r}{0.05}$$

In other words, l_o indicates at any given moment the level of the index of prices needed to give a yield of exactly 5 per cent.

Graph No. 2



The rate of 5 per cent has of course been arbitrarily chosen. But it is fairly close to the average rate of capitalization of Italian stocks in the period under consideration, as is clearly shown by the graph.

If we should repeat the calculation for gradually different reference rates (r_1, r_2, ..r_n, r_{n+1}), we would obtain, in the logarithmic graph, a *series of vertically equidistant curves* (2), each one being given by the formula:

$$l_n = \frac{i \cdot r}{r_n}$$

and representing the " line of yield r_n ", that is, the level which the index must reach to give a yield of r_n.

However, to construct the family of curves of constant yield, instead of considering the actual curves — which, although sufficiently regular, show a few sharp angles due to sudden declarations of changes in dividends, which in reality mature continuously over a period of time — it is convenient to consider the more regular interpolated curves, which at the same time facilitate the material task of the construction of the pattern and form a more reliable guide to the *basic trend* of the stock market. That is precisely what has been done in the graph, in which the interpolated curves of constant yield are indicated by the family of dotted curves. The central curve which is dotted with a heavier type is the curve fitting the unadjusted 5 per cent (red) line and has been taken as a reference base for the plotting of all the others.

As already pointed out, the interpolated curves represent the basic trend of stock prices. *In fact* — the point is worth stressing — *the red line also represents the index of dividends accruing to the " unit " of shares forming the base of the price index.* In other words, it represents the movement in time of the dividends drawn by the hypothetical possessor of a portfolio formed, to start with, of all the shares covered by the index (or proportionate thereto), and then gradually increased and increasing as a result of the immediate reinvestment of all the proceeds accruing to the portfolio (that is, rights to option, bonus shares and so on) except for the dividends.

(2) That is, curves such that the vertical distance between them is constant, at whatever point it is measured.

This index may conveniently be termed the *index of dividends per unit*, and will be so called by us in the rest of this essay. The interpolated curve, therefore, represents the index of dividends per unit, and hence *the basic trend of the stock market.*

Using the lines of reference provided by the curves of constant yield, we can trace on the same graph (green line) the curve of the yield of Government Bonds. It should be noted that the distance between the curve of the general index of prices (which, if related to the lines of yield also represents the yield of the stocks) and the curve of the yield of Government Bonds also measures, in logarithmic scale, the ratio of yields of Government Bonds to yields of shares, that is, what Anglo-Saxon stock market experts call the " curve of confidence " or simply " confidence " or " sentiment " (3).

Finally, at the bottom of the Graph, on a different scale, we show by histogrammes the daily average of stocks dealt in monthly at the Milan stock exchange which, as we have already pointed out, is responsible for over half the transactions on all Italian stock exchanges.

We have thus brought together in a single graph:

— the general index of prices;

— the index of dividends per unit (which in the long run determines the price level);

— the curve of the yield of stocks (represented by the same index of prices, related to the lines of equal yield);

(3) The objective factors which determine the level of stock prices are two in number: the dividends — which are the basic long term factor — and the rate of interest on the money market. In fact, however, in the short run, stock prices diverge, sometimes markedly, from the trend set up by these two factors, which shows that other causal agents exist. These are certainly many and various, but can be lumped together in a single, rather mysterious third factor, which is in the main psychological and is known in most Anglo-Saxon manuals as " confidence ". This can be isolated, by a process of elimination as follows:

$$\text{given:} \quad P_t = \frac{d}{r_{ts}} \quad ; \quad P_e = P_t \cdot c$$

$$\text{then} \quad c = \frac{P_e}{P_t} = P_e \cdot \frac{r_{ts}}{d} = P_e \cdot \frac{r_{ts}}{P_e \cdot r} = \frac{r_{ts}}{r}$$

where P_t is the theoretical price which should capitalize the dividend [d] at the rate yielded by Government Bonds [r_{ts}] the latter having been chosen to represent the rate of interest on the money market; P_e is the actual price, which may be put as equal to the theoretical price multiplied by the unknown factor " confidence " [c]; and $r = d/P_e$ is the yield of shares. In short, confidence, which varies in time, is equal to the ratio of the yield of Government Bonds to that of shares.

— the curve of the yield of Government Bonds;

— the "curve of confidence" or the ratio between the yield of Government Bonds and the yield of stocks. This curve is not actually traced in the graph but is measured by the gap between the black and the green lines. To make it easier to read, we have reproduced it, together with the curves showing the yields, in Graph No. 3 drawn to normal scale;

— the daily average of transactions every month.

5. A careful study of this Graph enables us to draw a fairly complete picture, in broad outline, of the Italian stock market in the period after 1948.

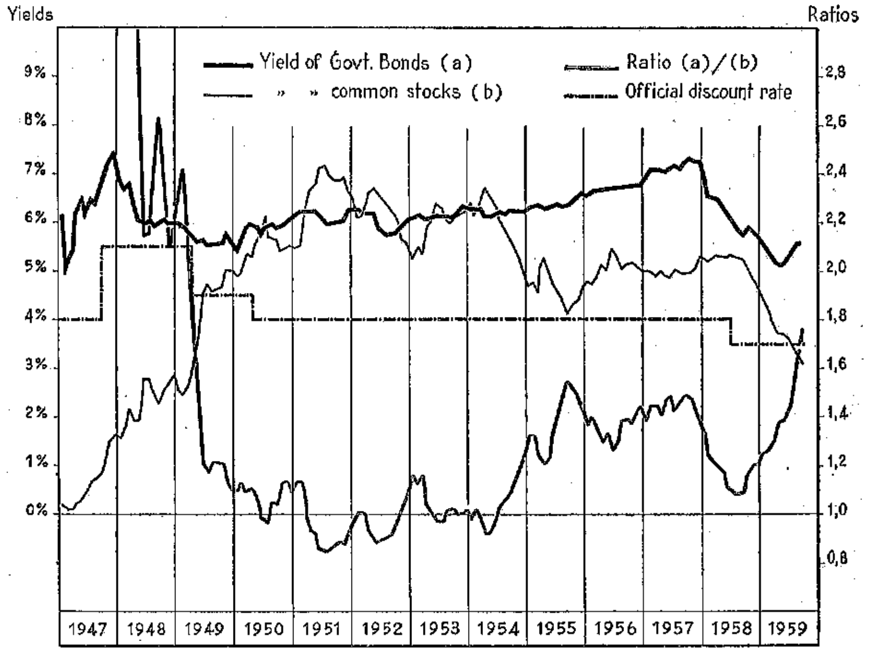
In the two years 1949-50, with the recovery of a stable currency, stock prices may be regarded as having been finally stabilized at about 15 times the pre-war level. The average yield, which was about 2½ per cent at the beginning of 1949, gradually improved, not because prices fell *but because dividends gradually rose*, reflecting the completion of the first phase of reconstruction and the fact that the new plants were beginning to yield profits. At the end of 1949, it was already 5 per cent, and, by the beginning of the second half of 1950, assisted by a sharp but temporary sag in prices, it rose to 6.5 per cent. Thus, for the first time since the end of the war, the yield of shares exceeded that of Government Bonds.

1949 was the year of the first American post-war recession, which so much disturbed economists, because of its sharp, and in a certain sense multiplied, effects of the development on the European economy. This greater concern in Europe, and in this case in Italy, is reflected in the different behaviour of the stock market in these two countries. Whereas in America the fall in stock prices stopped in the summer of 1949, before the recession touched bottom, and a rising phase began which was to last without a break till the outbreak of the Korean war (June 1950), the tendency in Italy was for prices to fluctuate round a stationary level, with the sag, referred to above, in June 1950, just in correspondence to the American highs (cf. Graph No. 4).

In the meantime, the beginning of 1950 saw the start of the upward price movement of goods traded on an international market which, stimulated by the outbreak of the Korean war, was to last — with dizzy peaks for certain Asian and Australian goods — up to the spring of 1951. As a natural reaction, there was a sharp rise

in internal wholesale prices, which was at once passed on, although in attenuated form, to the cost of living. All these were undoubtedly symptoms of the beginning of a new cycle of considerable productive activity which was bound to end with a loss of the currency's purchasing power and with a sharp increase in money profits. In full accordance with the stock exchange paradox, however, stock prices

Graph No. 3



did not rise unduly. Indeed, in Italy, once the reaction from the lows of July 1950 had spent itself, prices again tended downwards in the first half of 1951, while in America the upward impetus gradually weakened, and the indexes tended to stabilize at the high levels reached before.

This is the paradox, whereby the prices of stocks often remain stationary during a recovery or a boom, when there are good prospects for profits, and on the contrary increase during a recession or when business is sluggish. It is explained by the fact that in booms, however brilliant the prospects from investments in shares, the employment of money in direct production is even more attractive, while in depressions the stock market offers an almost inevitable outlet for large supplies of funds which would otherwise lie unused.

6. At the beginning of 1952, however, the yields from stocks had risen to such a degree that their influence on prices was bound to be felt. As early as March 1951, as a consequence of substantial rises in dividends, shares had again become more remunerative than Government Bonds, and the gap between the two rates had reached about 1 per cent in the subsequent weeks.

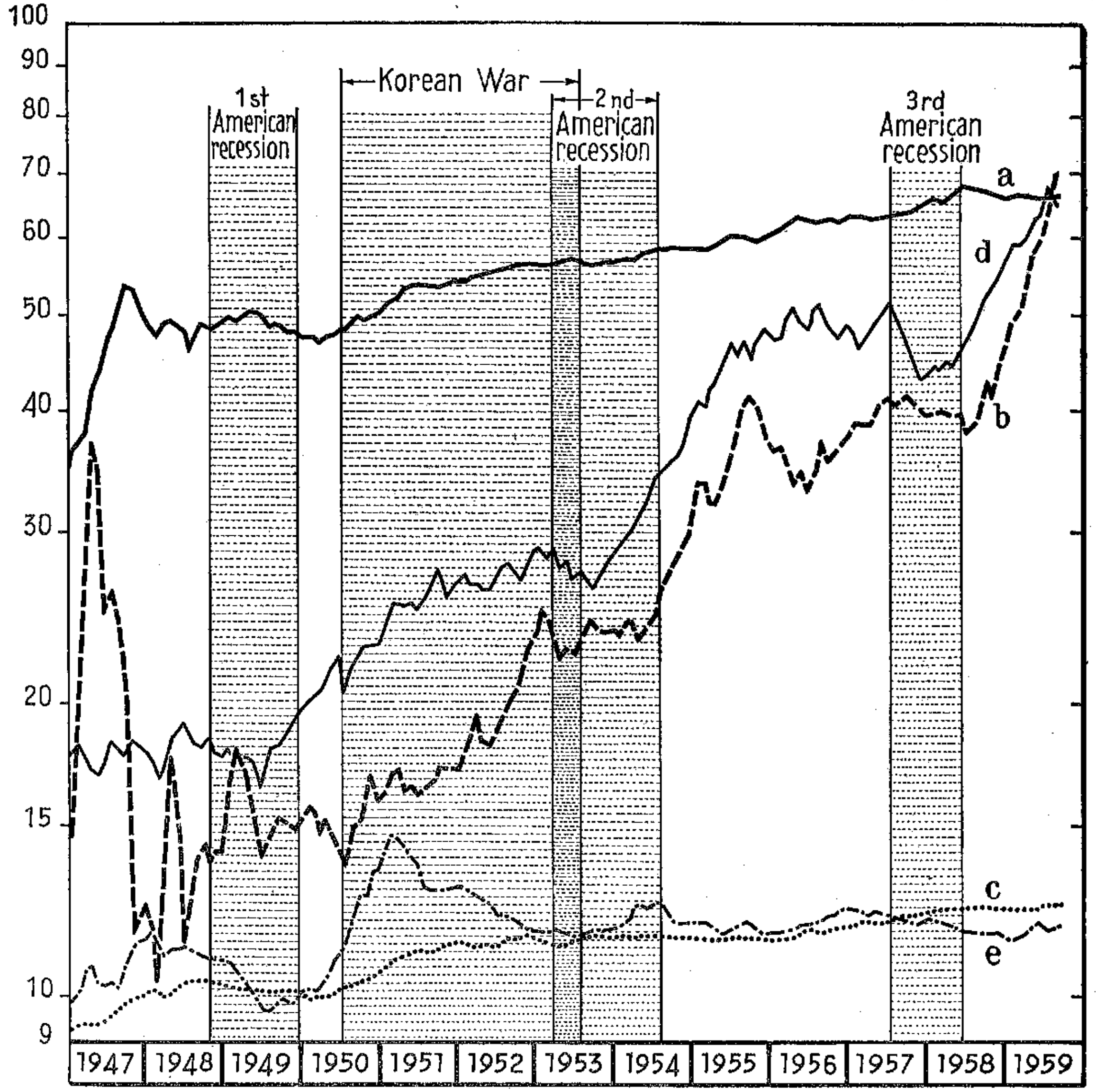
In March 1952, the two curves merged again for a moment but diverged at once in favour of stock rates, the yield from which in May was over 6.5 per cent.

The situation was thus ripe for a considerable rise, and this was set in motion by the decree promulgated at that time which raised the coefficients of revaluation of plants 18 to 40 times, thus giving rise to well founded hopes of bonus shares distributions and windfall increases in capital values. From May 1952 to January 1953, prices rose continuously, bringing the general index up to a level about 25 times above pre-war. From June 1951, which may be regarded as the take off platform for the complete upward cycle, the average increase was 54 per cent, with marked variations from one sector to another as is shown by the following summary. While real estate values rose by 120 per cent and financial and others by just under 100 per cent, the textile sector began to go through a difficult period. The sector index increased by only 7 per cent, while some items in it even fell. The other industrial sectors remained almost perfectly in line with the general index.

JUNE 1951-JANUARY 1953 RISE
INDEXES OF PRICES (June 1951=100) AND YIELDS

	June 1951		January 1953	
	prices	% yields	prices	% yields
Finance and insurance	100	5.34	191	4.27
Textiles	100	5.94	107	6.91
Mining, metallurgy and engineering	100	9.19	153	5.75
Electricity and related branches	100	7.43	152	5.45
Sugar and chemical	100	6.19	155	4.38
Real estate	100	6.62	220	3.76
Miscellaneous	100	6.15	197	4.00
Total	*100*	*7.12*	*154*	*5.25*

Graph No. 4



a - Index of cost of living in Italy *(1938=1)*;

b - Index of stock prices in Italy *(1938=1)*;

c - Consumer price index in U.S.A. *(1947-49=10)*;

d - Index of stock prices in U.S.A. *(Dow Jones averages: 10)*;

e - Index of prices of raw materials traded on an international market. *(Confindustria index 1949=10)*.

The yield from shares was, of course, declining in the meantime; in November 1952 it was again below that of Government Bonds and in January 1953 sank to a low of just over 5 per cent.

7. At the beginning of 1953 the Korean war was drawing to a close, and was ushering in the second American recession which was immediately reflected in a drop in Wall Street prices — the first one of any magnitude since 1949. The Italian market reacted — perhaps independently of international events — to the previous rapid upward movement, by losing about 10 per cent of its maximum figure, and the yield went up again to over 6 per cent — almost equal to that of Government Bonds.

All this happened in the first months of 1953. For all the rest of the year and for the first half of 1954, the level of prices remained fairly stable, with slight hesitant oscillations up and down. On the one hand, it was still feared that the American recession might spread to Europe, as the 1949 one had done, with all the negative consequences on profits flowing therefrom; on the other hand, the yields which had again risen to 6 and then to 6½ per cent stood in the way of further drops in prices.

Yet, as time went by, the negative effects feared from the American recession were slow in appearing, and it was realized more and more clearly, almost with a feeling of welcome surprise, that this time these effects would not make themselves felt; that is, that the largely reconstructed European economy had become less dependent on the American economy and hence less vulnerable to its fluctuations. And thus, when it was clear, halfway through 1954, that the economic outturn of 1953 had been fairly satisfactory, that the dividends of the preceding year had been generally maintained at the same level and often increased, and that the American recession had touched bottom, a new upward cycle began which, except for a brief interruption of two months in the spring of 1955, was to last for about a year and a half bringing the general index up to over 40 times the pre-war level, with an increase of as much as 80 per cent over April 1954.

This time the most favoured sector was that of the metals, steel and engineering, followed by real estate, finance and others, while the textile industry, still in a bad way, increased by a modest 12 per cent — thanks above all to some old and extremely sound firms

whose traditional skill and resources took the edge off the difficulties of many of their problems.

APRIL 1954-SEPTEMBER 1955 RISE
INDEXES OF PRICES (April 1954=100) AND YIELDS

	April 1954		September 1955	
	prices	% yields	prices	% yields
Finance and insurance	100	6.19	172	3.81
Textiles	100	4.85	112	4.87
Mining metallurgy and engineering	100	8.27	240	3.74
Electricity and related branches	100	7.10	163	4.99
Sugar and chemical	100	4.69	152	3.27
Real estate	100	5.78	178	2.71
Miscellaneous	100	5.57	183	3.35
Total	*100*	*6.64*	*178*	*4.11*

It is a pity that the indexes of the Banca d'Italia are not broken down in greater detail as between sectors. It is quite probable that insurance and finance securities do not move parallel, and it is even more probable that sugar (food) stocks and chemical stocks, lumped together in the same heading, do not move in concert. Nor is even the division "mining, metals and engineering" very homogeneous. The comparison between different variations registered by the various sectors in different stock exchange phases might well prove more instructive if more detailed sectorial indexes were available.

As a result of the sharp rise, the yield for stocks declined gradually to a low of 4 per cent — a most unusual level for the Italian market. Not only so. In the 1951-52 rise, the fall in the yield of stocks had been linked to a fall, a very slight one though, in the rate of yield of fixed interest securities. In 1954-55 on the contrary, while the former dropped sharply, the latter continued to rise, so that the gap between the two gradually widened.

This is brought out clearly by Graph No. 3, in which the two yield curves, linked to each other up to mid-1954, diverge from then on more and more markedly. In the autumn of 1955, the gap was to rise to 2½ points, and the ratio (the red curve in Graph No. 3) between the yield of Government Bonds and that of stocks was over 1.5.

8. It is obvious from Graphs 2 and 3 that in September 1955 the prices of stocks were extremely high, and the technical situation, on account of the previous increase, was bound to be extremely strained. That being so, a strong reaction was clearly to be expected. All that was lacking was something to set the ball rolling.

This something was the now famous article 17 of the new tax law. As readers will be aware, the aim of this article, which was more and more frequently discussed in the press in the autumn of 1955, was to eliminate certain fictitious transfers — which practically made it possible to own shares without registering them, as is required by law, and hence without the income tax authorities being able to control income derived from them. The article also aimed at facilitating the assessment of speculative gains from short term operations, by making it compulsory to report to a central office all transactions carried out each day.

This measure, it must be said at once, is extremely complicated from a technical point of view and indeed is not entirely justifiable in essence. However, this did not alter by one jot the situation as to the effective purchase of stocks, transfers of which already had to be reported to the general register. If for no other reason that that, the article hardly deserved all the outcry it stirred up in the financial, and even in the daily press. As it happened, the picture of the consequences of the act was so sombre as not to encourage investors to take advantage of the attractive prices in the first half of 1956 and in the subsequent phases of the depression, and even led to a large number of sales at low levels. Only when the market was fairly far on in the present upward swing did article 17 suddenly disappear from the scene and no more was heard of it on the press.

9. The downward phase which followed the peaks of September 1955 lasted for nine months, lowering the index by over 20 per cent. In June 1956, the trend went the other way, but the recovery was slow, and there was a very much reduced volume of transactions. As appears clearly from Graph No. 2, the volume of transactions at the Milan stock exchange crashed from 2-3 million shares a day in 1955 to almost nothing in July-August 1956, and then rose again very slowly. The yield, which had gone up to 5.5 per cent in June 1956, went down gradually to 4.80 per cent in September 1957, when the trend was again reversed for another nine months. In this phase, too, the decline was slow and the transactions few. In essence, during all this period (from the middle of 1956 to the middle of 1958) the level remained on the whole stable, consolidating the previous increases.

Yet, even with yields of between 5 and 5.5 per cent, the level of prices of stocks was not low if we look at the extremely high yield of Government Bonds at that time. For this yield, after September 1955, went on increasing, so that the two yield curves continued to remain far apart (cf. Graph No. 3). In the final months of 1956, the yield of Government Bonds was over 7 per cent and stayed at that level throughout 1957. The ratio between the two yields never went below 1.3, and throughout 1957 it stayed as high as between 1.4 and 1.5. In these circumstances — due to the great investment boom in that period and to the resulting credit tightness — the stock market could not really be said to be depressed.

At the beginning of 1958, the money market rather unexpectedly went from a state of tightness to one of marked liquidity, and the yield of Government Bonds began to fall rapidly, thus approaching that of stocks. The ratio between the two declined steadily and in June reached 1.1. The upward impetus on prices then extended to the stocks, and a new, vast and intense movement was set in motion which has now been going on for well over a year, bringing prices to new record levels.

At the end of June 1959, the general index had risen to a level 60 times over pre-war, with an increase of 59 per cent above June 1958. The greatest increases this time were in textiles, which had finally awakened from their lethargy, immediately followed by financial and insurance stocks, while all the other sectors had risen slightly less than the average. The yield fell from 5.53 per cent to 3.62 per cent — an extremely low level for Italian stocks and never before known in normal times. For textiles and finance, the yield fell below 3 per cent and for some shares to as low as 1.0 per cent. The volume of transactions, although still far from the maxima of autumn 1955, often went back up to above a million shares a day (5).

(5) At the end of August the general index had risen to a peak of over 70 times the pre-war level and the yield had come down to around 3%.

JUNE 1958-JUNE 1959 RISE
INDEXES OF PRICES (June 1958=100) AND YIELDS

	June 1958		June 1959	
	prices	% yields	prices	% yields
Finance and insurance	100	5.20	196	2.77
Textiles	100	4.67	204	2.54
Mining metallurgy and engineering	100	6.37	153	4.12
Electricity and related branches	100	5.79	151	4.02
Sugar and chemical	100	4.97	137	4.06
Real estate	100	4.56	148	3.13
Miscellaneous	100	4.00	142	2.95
Total	*100*	*5.53*	*159*	*3.62*

We will return to the question of prices at a later stage, when we formulate some conclusions on market prospects in the immediate and more distant future. First, however, we must briefly examine the other basic aspect of the stock market — the issues of new stocks for cash.

The remuneration of share capital and new issues for cash

10. So far we have studied the broad movement of the stock market with reference only to the prices of stocks and volume of transactions. We must now consider another, no less important, aspect of the market, which is the raising of fresh share capital through the stock exchange. It seemed to us worth trying to relate that factor to the total dividends paid out on existing share capital.

It does not appear that this comparison has ever been made, nor do we know exactly what importance to attribute to it. It is certain, however, that, if we take on one hand companies, as self-contained entities, and on the other hand shareholders as a group, we can distinguish clearly between two flows of money from each body to the other. There are the dividends paid out every year to the shareholders by the companies as a reward for the capital already invested, and the sums paid by the shareholders to the companies for new investments through issues of new shares. The balance between these two opposite flows constitutes the net flow from the companies to the shareholders or vice versa. And, if the shareholders are regarded as a single unit, this balance is *in practice* the net income derived by them from their investment in shares.

Naturally, the shareholders cannot be regarded as a single unit, and their number and the possibility of exchanging their shares — and the rights connected therewith — on the stock exchange render the proposition invalid for the individual. Nevertheless, from the point of view of the firms, it has a certain curious interest. It is no doubt true that the new capital invested will give larger future profits, but if *over a sufficiently long period*, the firms regularly receive from the shareholders more than they pay them on their existing capital, can it really be said that share capital is remunerated? This is a question which rather puzzles me and to which I am unable to give a specific reply; and yet it does not seem to me entirely irrelevant. I will therefore leave it unsolved and will confine myself to setting out the results of this inquiry, which in any case bring out a number of very interesting points.

These finding are set forth in detail in Table C (Appendix) and are summed up in the table on the next page. Before starting to illustrate them, we must issue a warning that the figures both of dividends and of share issues contain duplications for fairly considerable amounts, because a substantial part of the shares of the companies under consideration is owned by other companies in the group. That does not, however, affect proportions, because the duplications in the dividends and the new capital obviously cancel out in the ratio between the two totals, and for our purposes it is precisely the ratios that count.

11. In the ten years covered by the inquiry (1949-1958) the Italian companies quoted on the stock exchange distributed dividends of 865 billion lire ($ 1,380 million). In the same period, they received from the shareholders for issues of new shares 874 billion lire ($ 1,395 million), so that during these ten years there was a net flow of just under 9 billion lire ($ 15 million) from the shareholders to the companies. The almost complete coincidence of the totals is striking. If, on the contrary, we consider the flows year by year, it will be seen that the excess of the intake over the dividends was particularly marked in 1949, 1953, and in the last two years, whereas in 1952 and in the three years from 1954 to 1956 dividends were well above the sums asked for.

DIVIDENDS DISTRIBUTED AND NEW ISSUES OF SHARES
FOR CASH BY ITALIAN COMPANIES QUOTED ON THE STOCK EXCHANGE,
IN THE TEN YEARS 1949-1958
(in billions of lire)

Sectors	Dividends		Payment of shareholders		Difference (a)—(b)	Ratio (a)/(b)
	value (a)	% of total	value (b)	% of total		
Finance	115.9	(13.4)	247.2	(28.3)	− 131.3	0.46
Insurance	13.0	(1.5)	1.1	(0.1)	+ 11.9	11.8
Transports	6.7	(0.8)	1.5	(0.2)	+ 5.2	4.5
Textiles	64.6	(7.5)	19.9	(2.3)	+ 44.7	3.2
Mining and metallurgy	123.4	(14.4)	87.5	(10.0)	+ 35.9	1.4
Engineering and motors	69.5	(8.0)	116.9	(13.4)	− 47.4	0.6
Electricity	308.6	(35.6)	307.9	(35.2)	− 0.7	1.0
Sugar and food	26.1	(3.0)	20.9	(2.4)	+ 5.2	1.25
Chemicals	47.7	(5.5)	33.7	(3.8)	+ 14.0	1.4
Real estate	19.5	(2.2)	16.0	(1.8)	+ 3.5	1.2
Miscellaneous	79.1	(9.1)	21.5	(2.5)	+ 57.6	3.7
Total	865.1	(100.0)	874.2	(100.0)	− 9.1	1.0

Of the 865 billion lire of dividends distributed, as many as 309, or over a third, are from the electric sector, followed by mining and metallurgy with 123 (14 per cent), finance with 116 (13 per cent), miscellaneous with 79 (9 per cent), engineering with 70 (8 per cent), textiles with 65 (7.5 per cent) and the others thereafter. Broadly speaking, these percentages reflect the importance of the various sectors in terms of the stock exchange value of their capital.

The new capital was drawn again for over 1/3 by the electric sector, but the financial sector now comes second with 247 billion lire or 28 per cent of the total. Next follows engineering, with 117 billion lire (or 13 per cent), mining and metallurgy with 88 billion lire (10 per cent) and — a long way behind — the others.

The situation is quite different if we examine the net money flows. Of the eleven sectors into which the list (6) has been split up, nine show a more or less marked surplus of dividends distributed over new payments requested of the shareholders, while in the other two sectors the latter are well above the former.

(6) It is perhaps superfluous to point out that the subdivision into sectors, in this table, based almost entirely on the data published by the paper "24 Ore" in its special end-of-year numbers, is different from that adopted by the Banca d'Italia in calculating its indexes.

The two sectors where the inflow regularly exceeds the dividends are finance and engineering. In the former, the new issues for cash over the whole period were well above twice the dividends paid out. In only one year out of ten, *i.e.* 1954, did finance companies distribute to shareholders more than they asked of them. At bottom, this corresponds to the specific function of these institutes, which is precisely that of collecting funds from the public and employing them in industry. The other sector in which the new issues (177 billion lire) were well above the dividends (70 billion lire) was engineering. It should be noted that in this sector one single firm (Fiat) completely dominates the picture (accounting for about 90 per cent). The heavier destruction during the war, the need for drastic reconversion, and above all the great prospects of expansion, entailed particularly heavy investments in this sector. It is worth noting, however, that while in the first half of the period under consideration dividends were almost always lower than the sums needed, the position was reversed in 1954 and 1955. In recent years there were balances alternately in either direction.

In the sectors where the dividends exceed the inflow of new capital, the largest differences are to be found, in order, in miscellaneous, textiles, mining and metallurgy, with 58, 45 and 36 billion lire respectively in the ten years.

If, however, we wish to find out which are the sectors which distribute more to the shareholders than they ask from them, or vice versa, we must consider the ratio between dividends distributed and new issues for cash. We then find that insurance is far ahead of the rest, with a ratio of about 12. The net remuneration of capital in this sector has been constantly on the increase over the whole period, while requests for new payments from the shareholders have been negligible. This may explain why insurance shares rate so high in the stock exchange. The yield is therefore extremely low. The second place is, somewhat unexpectedly, taken by transport, with a ratio of over 5. The distribution of dividends, however, in this case shows substantial irregularities — with a marked decline in 1952 from the 1951 peak, and with further, if slighter, falls in 1954 and 1958 below the preceding years. At the present time, some firms in this sector are going through a difficult time.

Equally surprising is the high ratio between dividends distributed and new capital raised in the textile sector, which only now appears to be emerging from a crisis which has lasted for several years. The surplus of distributions over new issues has been constant over the whole period, in spite of the fact that in recent years numerous companies have had to suspend payment of dividends. It must be concluded that either the sector has an exceptionally sound basis (as is probably the case) or that it is the crisis itself which has brought about this situation by discouraging new investments and hence avoiding requests to the shareholder for new capital.

In the "miscellaneous" sector, the ratio is also high. This sector includes several of the most thriving and best run firms in Italian industry. Over the whole period in question, dividends are constantly higher than new issues for cash, and the excess is the highest in absolute value, although the sector comes only fourth in terms of the amount of capital quoted.

Ratios of over unity, but to a much smaller extent, occur in the mining and metallurgical sector (the main company in the sector, accounting for about 60 per cent, is Montecatini) where a prevalence of payments by the shareholders in the first half of the period is followed by a definite prevalence of the sums distributed by the companies in the subsequent years — and in the food, chemical and real estate sectors.

Lastly, the electric sector, by far the most important in the list, shows dividends and increases in capital for cash in almost perfect equilibrium, reproducing the situation of the list as a whole. In the ten years, the dividends have exceeded the fresh capital on six occasions, and on the other four the opposite has happened. The sums raised were particularly high as compared with the dividends in 1949 and 1953.

Prospects

12. A review such as the above cannot terminate without some reference, however brief and summary, to market prospects.

In the long run, stock prices are indissolubly linked to dividends. This is clearly demonstrated either by Graph No. 2, which relates the general index of stock prices to the general index of dividends, or by Graph No. 5, which repeats the comparison for each of the sectors composing the Banca d'Italia index; and lastly by Graph No. 6 which relates prices and dividends of American industrial stocks in the periods following the two world wars. For this graph, I have used for the period from 1918 to 1934 the Cowles Commission's indexes of industrial stocks (base year 1926 = 100) to which I have linked for the following period Moody's index of 125 industrial stocks.

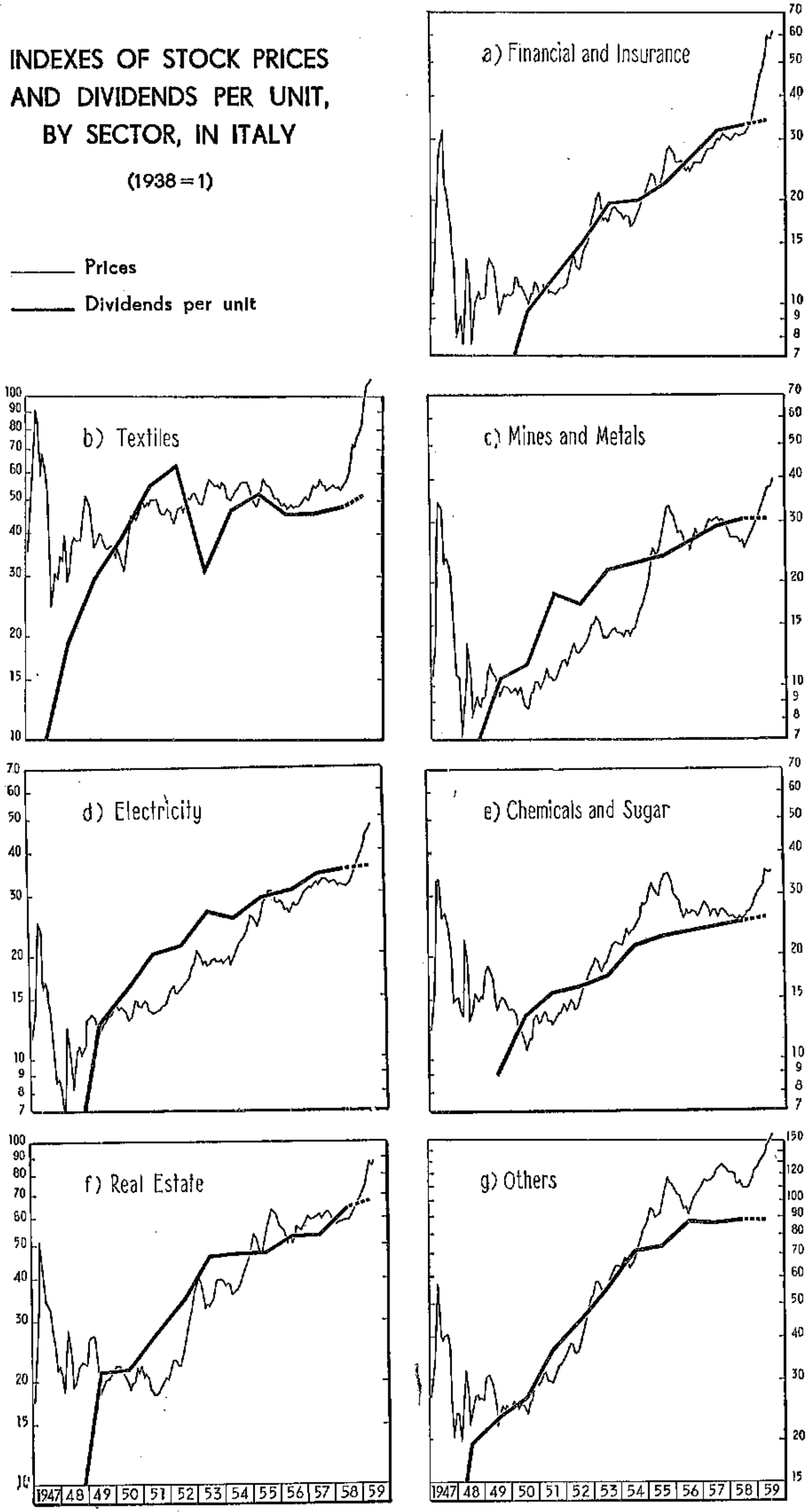
Three traits common to these graphs strike the reader. In the first place, measured over a sufficiently long period, the price index grows at a rate exactly proportionate to the dividend per unit. In the second place — and it must be remembered that the graphs cover periods after world wars which rocked the western economies to their foundations — the dividend per unit increases very rapidly in the reconstruction period after the war, but then the pace slows down, and lastly — in the case of the first post-war period — even falls. In the third place, the index of stock prices — which to start with, though increasing fairly rapidly, lags behind the index of dividends per unit — increases at a faster rate at the very time when the rate for dividends per unit is beginning to slow down, advancing well above the equilibrium level and thus creating the preconditions of a brusque reversal of the trend.

The phenomenon illustrated by the three graphs is easily explicable in terms of theory. After a great war, the economy is being rapidly reconstructed. Goods are in short supply, demand is strong, prices are high, and all industrial activities highly profitable. Hence, businesses thrive and profits increase rapidly. The price of stocks, too, moves upwards, but less rapidly — since in periods of great and profitable economic activity liquidity is scarce and, however profitable the purchase of stocks, the direct employment of capital in industry is still more so. Gradually, as reconstruction progresses and productive capacity increases, the shortage of goods disappears little by little, and the transition is effected from a producer's market to a consumer's market. In these conditions, the prices of products tend to be stabilized or even to fall. Competition becomes keener, and profit margins narrower. As an inevitable consequence, therefore, dividends tend to rise at a slower rate, and logically share prices should do the same. But at this point irrational as well as powerfull psychological factors intervene to give an entirely different twist to events. When goods are in abundant supply and there is a buyer's market, there is also a marked monetary liquidity which finds it difficult to obtain an outlet, or at least a sufficiently profitable one, in trade and industry. This liquidity, as it builds up, consequently turns more and more to the finance market, and especially towards stocks which were relatively neglected in the preceding period. Thus, *for purely monetary reasons*, because of the growing liquidity of the market and the falling interest rates, *the increase in prices of stocks acquires a momentum of its own at the very moment when the profits of the firms which they represent begin to slow down their pace.*

The picture of the subsequent stage is familiar. As prices rise, so do speculative gains. The stock exchange comes into fashion, and increasing quantities of new funds are channelled towards it. This naturally pushes up prices still further, and finally a vicious circle is created which rapidly goes from strength to strength, till to assume gigantic proportions. More and more frequently, new investors and speculators resort to the stock exchange, and new investment companies sprout like mushrooms. It seems as if nothing can stop the boom. Yields no longer count. The stocks are so to speak dissociated from the firms they represent, and acquire a sort of mysterious value of their own, of which no one knows the origin but which everyone accepts. In this way, a chain of commitments is forged, of credits and debts, of heavy interest on increasingly exposed positions — a chain which is bound to break when the " spree " goes beyond a certain limit. In fact, the income on which the flow of growing funds into the stock exchange is based is always the same one, and one only — and that is the industrial income of the firms represented by the stocks. This income not only cannot keep pace with the dizzy increase in prices of shares in the last stages of a boom but even tends in these very phases to increase at an ever slower pace or to be stabilized and even to fall.

13. It now seems clear from Graphs Nos. 2, 5 and 6 that, both in Italy and in the United States (and, we may add, also in the other western countries) the stock exchange is at present passing through the last phase of a boom of the type described. And it may confidently be asserted that, if the government monetary policies were today to repeat the errors of 1928-29, there would be bound to be a repetition of the fall in stock prices too and, what is more

Graph No. 5



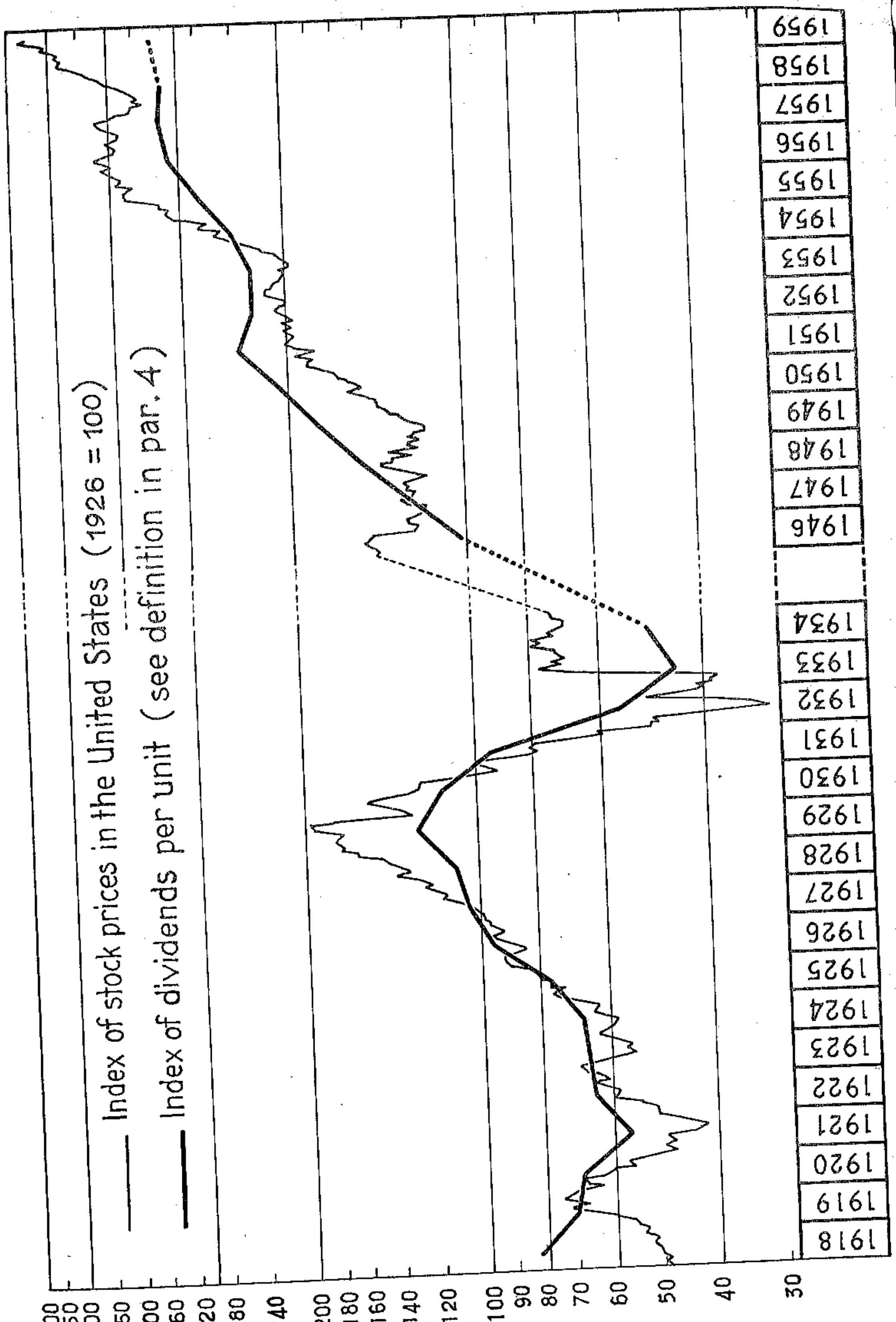
important, a more serious depression than the two or three recessions of the post-war period.

Fortunately, since 1930 economics have made, thanks to Keynes, at least one gigantic stride. It is now realized that the crises of overproduction (and the recessions flowing from them) can be fought not by tightening one's belt and cutting expenditure, but by adopting precisely the opposite policy, that is, by increasing expenditure in order to give the community a chance to consume and enjoy the goods being produced in greater abundance. Unless, therefore, this lesson is forgotten at the last moment, a 1929 type of crisis should be ruled out at the present time.

From the point of view of this essay, this means that average business profits — and hence average dividends per unit — should not today run any risk of being slashed as in 1929, but should at least maintain their present levels. This depends largely on the measure and acumen with which governments apply the Keynesian theories. It is clear in fact that a deflationist policy would lead to a crisis as it did in 1929, but it is equally clear that a policy of excessive deficit financing would produce a certain degree of price inflation which would artificially inflate industrial incomes and hence the dividends per unit, and in the last resort the prices of stocks. The ideal would be for the anti-cyclical monetary policy to be graduated in such a way as to keep the price level stable on the whole. It is extremely hard, however, to ensure this. And, since we believe that — under the constant pressure of trade union demands and the constant, more or less laudable, concern of governments not to alienate the sympathies of the masses by unpopular measures — even the most prudent monetary policy (as the Italian policy over the last decade can undoubtedly claim to be) will be unable to avoid a constant if slight inflationary process (see Graph No. 4), we feel confident to conclude that dividends per unit will continue to rise in the long run — though certainly not at a rate comparable to that of the last few years — and therefore that the general index of stock prices will continue to go up in the same measure.

14. If, therefore, the long run prospects of the stock market seem on the whole favorable, the same cannot be said of the short term prospects. During the last few months, the price curve has diverged too sharply from that of divedends per unit, both in Italy (cf. Graph No. 2) and in the United States (cf. Graph No. 6) and

Graph No. 6



in the other major western countries. The two curves are bound to come closer somewhat in the next months. If we exclude the possibility of the dividends per unit curve jumping to the level of prices — which would only be possible in the case (which fortunately appears rather improbable) of a sudden serious inflation — it must be the price curve to come closer to the dividend curve. The further the present speculative rise proceeds, the more severe will be the necessary adjustment.

Rome PIETRO MANES

STATISTICAL APPENDIX

TABLE A

MAXIMUM AND MINIMUM PRICES OF STOCKS IN THE PERIOD 1944-1948
(1938 = 100)

	Finance and insurance	Textiles	Mining metallurgy and engineering	Electricity	Sugar and chemical	Real estate	Miscellaneous	Total: Index	Total: Yield
1938	100	100	100	100	100	100	100	100	5.10
1943, end of year	355	455	288	562	359	588	552	449	1.35
1944, end of year	921	1,629	672	1,247	1,082	1,828	1,274	1,136	0.52
1946, April . .	302	811	286	375	436	591	671	413	0.69
1947, April: average . . .	3,184	9,167	3,410	2,563	3,372	4,932	5,646	3,700	0.23
(max.) . . .	(3,380)	(9,700)	(3,600)	(2,720)	(3,580)	(5,200)	(6,000)	(3,922)	(0.22)
1948, March: average . . .	772	2,875	692	693	1,345	1,847	1,966	1,035	2.16
(min.) . . .	(735)	(2,517)	(573)	(583)	(1,165)	(1,593)	(1,722)	(893)	(2.51)
1948, May: average . . .	1,208	3,967	1,149	1,113	2,001	2,538	2,873	1,581	1.93
(max.) . . .	(1,392)	(4,387)	(1,326)	(1,280)	(2,257)	(3,088)	(3,299)	(1,787)	(1.71)
1948, July: average . . .	920	3,082	887	931	1,368	1,968	2,432	1,249	2.78
(min.) . . .	(830)	(2,800)	(800)	(840)	(1,240)	(1,780)	(2,200)	(1,130)	(3.07)
1948, September	1,058	3,747	901	1,052	1,519	2,255	2,659	1,400	2.27

INDEXES OF DIVIDENDS PER UNIT IN ITALY, 1938-1958 TABLE B
(1938 = 100)

	Finance and insurance	Textiles	Mining metallurgy and engineering	Electricity	Sugar and chemical	Real estate	Miscellaneous	Total
1938	100	100	100	100	100	100	100	100
1947	220	869	487	165	211	396	546	346
1948	460	1,939	666	371	436	617	1,945	682
1949	670	3,004	1.052	1,256	918	2,146	2,327	1,349
1950	960	3,967	1,152	1,577	1,341	2,174	2,652	1,662
1951	1,190	5,513	1,845	2,021	1,570	2,759	3,657	2,240
1952	1,500	6,307	1,744	2,143	1,634	3,448	4,442	2,446
1953	1,960	3,148	2,186	2,686	1,752	4,629	5,555	2,854
1954	2,000	4,729	2,282	2,581	2,156	4,721	7,171	3,036
1955	2,230	5,290	2,397	2,949	2,286	4,774	7,901	3,362
1956	2,690	4,603	2,636	3,057	2,350	5,340	8,784	3,590
1957	3,220	4,610	2,918	3,429	2,441	5,367	8,671	3,947
1958	3,320	4,829	3,080	3,533	2,527	6,463	8,845	4,126

TABLE C

DIVIDENDS DISTRIBUTED AND NEW ISSUES OF SHARES FOR CASH BY ITALIAN COMPANIES QUOTED ON STOCK EXCHANGE IN THE TEN YEARS 1949-1958

(million lire)

		1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	Total 1949-58
Finance	(a)	1,290	2,163	3,875	7,397	9,509	12,840	15,270	17,022	21,116	25,463	115,945
	(b)	19,937	5,440	4,306	7,845	29,700	3,135	39,332	19,500	60,731	57,265	247,191
	(c)	− 18,647	− 3,277	− 431	− 448	− 20,191	+ 9,705	− 24,062	− 2,478	− 39,615	− 31,802	− 131,246
Insurance	(a)	327	496	679	920	1,153	1,374	1,594	1,956	2,151	2,372	13,022
	(b)	860	—	—	70	—	140	—	—	—	—	1,070
	(c)	− 533	+ 496	+ 679	+ 850	+ 1,153	+ 1,234	+ 1,594	+ 1,956	+ 2,151	+ 2,372	+ 11,952
Transport	(a)	164	1,276	1,354	413	533	502	473	651	708	674	6,748
	(b)	1,404	—	100	—	—	—	—	—	—	—	1,504
	(c)	− 1,240	+ 1,276	+ 1,254	+ 413	+ 533	+ 502	+ 473	+ 651	+ 708	+ 674	+ 5,244
Textiles and clothing	(a)	3,928	5,468	8,059	9,100	5,214	6,251	6,707	6,538	6,618	6,741	64,624
	(b)	1,504	2,146	5,160	255	170	250	2,885	5,400	120	2,000	19,890
	(c)	+ 2,424	+ 3,322	+ 2,899	— 8,845	+ 5,044	+ 6,001	+ 3,822	+ 1,138	+ 6,498	+ 4,741	+ 44,734
Mining and metallurgy	(a)	4,719	5,825	8,000	10,389	11,251	14,737	15,404	15,963	17,653	19,509	123,450
	(b)	6,300	7,500	10,016	5,709	23,000	—	2,000	7,060	24,120	1,800	87,505
	(c)	− 1,581	− 1,675	− 2,016	+ 4,680	− 11,749	+ 14,737	+ 13,404	+ 8,903	− 6,467	+ 17,709	+ 35,945
Engineering and motors	(a)	1,116	1,902	3,271	3,885	9,460	7,656	8,408	8,206	12,780	12,810	69,494
	(b)	2,049	2,290	26,716	2,094	18,172	3,000	706	19,200	12,102	30,600	116,929
	(c)	− 933	− 388	− 23,445	+ 1,791	− 8,712	+ 4,656	+ 7,702	+ 10,994	+ 678	− 17,790	− 47,435
Electricity	(a)	8,060	15,325	19,874	22,819	25,000	32,154	37,128	42,060	51,029	55,111	308,560
	(b)	15,944	13,032	8,876	10,336	56,924	30,950	26,492	21,850	59,323	64,181	307,908
	(c)	− 7,884	+ 2,293	+ 10,998	+ 12,483	− 31,924	+ 1,204	+ 10,636	+ 20,210	− 8,294	− 9,070	+ 652
Food	(a)	773	1,203	1,640	1,859	2,292	3,099	3,543	3,863	3,751	4,041	26,064
	(b)	402	156	—	—	420	—	870	8,250	288	10,563	20,949
	(c)	+ 371	+ 1,047	+ 1,640	1,859	+ 1,872	+ 3,099	+ 2,673	+ 4,387	+ 3,463	− 6,522	+ 5,115
Chemical	(a)	1,065	2,570	3,179	3,780	4,283	5,752	6,311	5,267	4,860	6,612	43,679
	(b)	2,380	5,925	280	3,632	1,280	4,365	4,508	3,284	7,840	198	33,692
	(c)	− 1,315	− 3,355	+ 2,899	+ 148	+ 3,003	+ 1,387	+ 1,803	+ 1,983	− 2,980	+ 6,414	+ 9,987
Real estate	(a)	946	829	1,226	1,482	1,712	2,211	2,148	2,417	3,182	3,311	19,464
	(b)	631	216	1,067	432	2,102	—	475	4,237	608	6,257	16,025
	(c)	+ 315	+ 613	+ 159	+ 1,050	− 390	+ 2,211	+ 1,673	− 1,820	+ 2,574	− 2,946	+ 3,439
Miscellaneous	(a)	2,243	3,751	4,483	5,728	7,168	9,081	10,793	11,508	12,103	12,300	79,158
	(b)	1,055	283	220	1,092	607	5,118	2,076	2,295	800	7,979	21,525
	(c)	+ 1,188	+ 3,468	+ 4,263	+ 4,636	+ 6,561	+ 3,963	+ 8,717	+ 9,213	+ 11,303	+ 4,321	+ 57,633
Total	(a)	23,932	40,808	55,539	67,772	73,075	95,657	107,981	115,451	135,952	148,945	865,112
	(b)	52,466	36,988	56,642	31,466	132,376	46,688	79,615	91,076	166,034	180,853	874,204
	(c)	− 28,534	+ 3,820	− 1,103	+ 36,306	− 59,301	+ 48,969	+ 28,366	+ 24,375	− 30,082	− 31,908	− 9,092

(a) dividends distributed; (b) new issues for cash; (c) differences.