Asset management strategies of British Investment Trusts Companies, 1920-1928.

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Abstract

This dissertation examines the institutional investors' asset management policies in the 1920s in the UK, focusing on the Investment Trust Companies' (ITC) investment strategies. It asks: (1) what are the asset management strategies of the ITCs? (2) what were the main changes in their portfolios and what were the main causes for them? and (3) what was the interaction between the ITCs and societies? It uses a combination of quantitative and qualitative methodology, constructing an appropriate, hand-collected dataset, and it finds that ITCs used a combination of a) passive management, focusing on a naïve diversification and b) an active management top-down approach. Despite seismic changes at the economic, financial and social level, the ITCs maintained diversification as a key tool in their portfolio selection process. They used professional management to secure the clients' savings. The main changes in the ITCs portfolios that this thesis reveals are a) the total withdrawal of the US market, b) its replacement with European and British securities, as well as c) the maintenance of their Latin American assets. Additionally, they transformed their asset allocation applying various financial innovations. These rearrangements cannot be considered in a social and political vacuum. This thesis examines these affairs during the 1920s, arguing that the ITCs were flexible institutions, formidably well informed about anything that could affect their investments; finally, they took full advantage of any financial opportunity that arose. Overall, the ITCs were in the vanguard of financial innovation, offering valuable lessons for the modern tumultuous period.

Keywords: Institutional investors, British Investment Trusts, interwar economic history, diversification, professional management, asset management strategies.

JEL Classification: G23, N20, N22, N24, N26, N84

Acknowledgments

...στους δασκάλους μας το εὖ ζῆν.

[Trans.] ... to our teachers (we are indebted) for living well.

attributed to Alexander III of Macedon (the Great).

I thank them all, from my kindergarten teacher to my supervisors.

ὄλβιος ὅστις τῆς ἱστορίας
ἔσχε μάθησιν,
μήτε πολιτῶν ἐπὶ πημοσύνην
μήτ' εἰς ἀδίκους πράξεις ὁρμῶν,
ἀλλ' ἀθανάτου καθορῶν φύσεως
κόσμον ἀγήρων, πῇ τε συνέστη
καὶ ὅθεν καὶ ὅπως.
τοῖς δὲ τοιούτοις οὐδέποτ' αἰσχρῶν
ἔργων μελέτημα προσίζε

Euripides, Fragmens: Aegeus Meleager. LCL 504: 226-227.

Happy the man who has gained knowledge through inquiry,
not aiming to trouble his fellow citizens,
nor to act unjustly,
but observing eternal nature's ageless order,
the way it was formed, and whence and how.
Such men are never inclined to practise shameful deeds.

[Ed.-Trans.] Collard Ch. and Cropp M. Loeb Classical Library. Harvard University Press.

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1 Introduction

Financial history has become a research field of high importance over recent years. Its significance can be attributed to the dominance of the financial sector of the main economies since the mid-70s and the concomitant instabilities which have emerged (Cassis et al., 2016). Since then, academia has provided us with numerous studies covering various topics; a wide range of books and articles have emerged about topics on financial history (Kindleberger 1984; Neal, 1990; Cassis, 1994; Fergusson, 2008), new journals have appeared[1] and events, associations and dissertations have focused on issues such as financial crises, the evolution of the financial institutions etc. The crisis of 2008 again saw a resurgence of interest in this subject, (Eichengreen, 2016). Synthesizing traditional academic research with the professionals' experience from industry (Cassis & Cottrell, 1994), one can draw important lessons for today.

Financial historians study a vast spectrum of topics. It is an interdisciplinary field with connections in other fields. Political economy, economic history, business history, international economics, sociology and psychology are among the disciplines alongside which financial history coexists. The first significant piece of research in this field was about the banking sector (traditionally it has been the first point for financial history); in particular, the historical appearance and the evolution of these institutions, see Foxwell (1927), and Akrill and Hannah (2001) for the history of Barclays; Wintor (1982) for Lloyds; Andreades (1909), Capie (2010) and Kynaston (2017) for the Bank of England history; Andersen and Cottrell (1975), Moss (1982) and Newton and Cottrell (1998) for provincial banking; Checkland (1975) for Scotland; Ollerenshaw (1987) for N. Ireland.

Goodhart (1986) presented the banks financial structures and Jones (1992) discussed their international character and their interaction with other sectors of the economy (e.g., industry) and their role in the total economic growth paths. Important works for this relationship can be found also in Thomas (1978), Cottrell (1980), Cappie and Collins (1996) and Collins and Barker (2003) among others. Topics about monetary issues, (see Collins, 2012), have been added to these discussions. Finally, political elements and socioeconomic criteria have also

[1] Characteristic paradigms are journals such as *Accounting, Business and Financial History* which was inaugurated in 1990 and the *Financial History Review* in 1994, respectively.

been included in the puzzle, (see Hilferding, 1910; Rubinstein,1981; Harris & Thane, 1984; Johnson, 1985; Cassis & Cottrell, 1994; Way, 2000).

Apart from the banks, other financial institutions have been discussed by financial historians. The capital markets, their origins, evolution and their connection with the rest of the economy have been analysed, in parallel to the banking system. Morgan and Thomas (1962) and Michie (1999) analyse the history and the development of the London Stock Exchange. Kynaston (1994; 1995; 1999; 2001) depicts the City of London including all its financial institutions for two centuries. The works of Thomas (1978) and Cottrell (1980) describe the ways of financing he British economy, pinpointing the role of the stock exchanges in the finance of the real economy.

Kindleberger (1984), Neal (1987) and Cassis (2006) among others scrutinize the role of the international financial centres over time. Van Helten and Cassis (1990) delineate the British financial sector in the late 19th and early 20th century. Overseas investment, still, remains an interesting topic in financial history. In particular, a strong debate remains concerning the connection of British capital export; here the London Stock Exchange has played a dominant role, and it has strong bonds with the international markets through the growth process of the British real economy, especially in the first era of globalization, (see Mc Closkey, 1970; Edelstein, 1976; contra, Kennedy, 1974; Crafts, 1979; Pollard, 1985). Since the end of the 19th century there has been a general awareness of the huge outflows of British capital abroad. However, not all the opinions have agreed about its role in the British internal growth process. The first negative critiques emerged in Hobson (1902), believing that this was the result of the underconsumption of the British population, leading to the lower economic performance of the British economy. A voluminous discourse has arisen; this of Imperialism, see Luxemburg, Lenin etc. Paish (1911) described this tendency of British capital when it reached its apogee; a long tradition of foreign investments emerged, (see Cairncross, 1953; Simon, 1967; among others. Edelstein (1982) argued that this tendency arose because of the better performance of the foreign investment, (see also Goetzmann & Ukov, 2006).[2] Another interesting aspect of the financial markets is the institutional investor, which will be presented now.

[2] For an overview, see Chapter 2.

1.1 Institutional investors

"Institutional investors may be defined as specialized financial institutions that manage savings collectively on behalf of small investors towards a specific objective in terms of acceptable risks, return maximization and maturity of claims" (Davis & Steil, 2004, p. 12). Nowadays, one out of four pounds invested in UK listed equities comes from this type of investors;[3] in the case of the USA, the proportion skyrockets, reaching 67 percent [4] (Rutterford & Hannah, 2016, p. 242; Bebchuk et. al., 2017). The biggest types of institutional investors are pension funds, insurance companies, investment trusts (closed-ended) and unit trusts (open-ended). Their increment is mainly based on the energetic involvement of the pension funds in securities markets and the enlargement of the insurance sector. This has led to significant changes, not only in the financial markets but also in issues such as economic growth (Ruiz 2018), productivity, innovation (Aghion et al., 2013), inequalities and even the range of the socioeconomic regime. Financialization is associated with the role of the financial sector and the significant results in the financial system per se (Epstein, 2005; Toporowski & Michell, 2012; Mader et al., 2020), and affecting the societies themselves e.g., in the provision system (houses, pensions etc.), see Fine and Bayliss (2016).

Despite the great importance of the current position of institutional investments', their old historical evolution and their interconnection with the whole economic system, financial historians pay less attention than they should, especially compared to their considerations of the previous topics. First, insurance companies have attracted, mainly, the historians' interest, (Scott, 2002 and Backer & Collins, 2003). Because of the size and the importance of this type of investment, journals like the *Journal of the Institute of Actuaries* have analysed similar issues since 1886. Rayes (1948) presented the first history of insurance companies. Again, a lot of case studies have appeared in this field, see Dickinson (1960), Supple (1970). Apart from this, many studies have recently focused on pension funds, because of the gradual changes to the pension systems all over the world together with the structural problems in numerous economies. Among others, Hannah (1986; 1988), Thane (2000) and Blake (2003) have discussed the evolution of the institution, focusing on the British case, and depicting the social, political and economic issues regarding the welfare state. Alternative investing institutions

[3] Another interesting clue is the fact that the assets of the institutional investors (insurance companies and pension funds) in 2018 amounted to £ 4.3 trillion (OECD 2019).

[4] The cases of the Anglo-Saxon world are the most popular (UK and the USA). This happens because of the greatest mark on the growth of the institutional investors, the lowest regulation, and the focus of most of the research. However, a similar increment also appears in emerging countries (Davis & Steil, 2004, p. xxiv).

have also been discussed as being important for the UK Building societies (see Hobson, 1953; Ashworth, 1980 and Casu &Gall, 2016). For a similar literature review, see Rutterford (2008).

Investment and Unit Trusts were originally studied by Burton and Corner (1968); additionally, unit trust history has been investigated by Gleeson (1981) and the investment trusts by Cassis (1990). Mc Kendrick & Newlands (1999) present the oldest closed-end investment trust (*Foreign and Colonial Investment Trust*) which was established in 1868. Chambers and Esteves (2013) complete the history for this Investment Trusts Company (ITC, hereafter), developing issues as its asset management, its portfolio diversification and its performance. A major work on ITCs is the study of Burton & Corner (1968), who endeavoured to frame the basic principles of this institution and to depict a first complete historical evolution. A more modern analysis of them can be found in the studies of Sotiropoulos and Rutterford; characteristically as a seminal work it can be mentioned the one of Rutterford et al. (2022).

Very briefly, an ITC is a closed-end financial company that invests its investors' savings in a marketable securities' portfolio, securing their capital and obtaining high returns.[5] ITCs were inaugurated in the last quarter of the 19th century in Britain. They can be summarized as institutions under innovative and professional management, with highly diversified portfolios- both geographically and sectoral- invested in all the main asset classes, fixed interest, and equity, preferred and ordinary shares. Their main scope was: first, to provide absolute security for their investors' capital, second, to earn the highest possible return and, only, third to make any possible capital gain.

For any financial institution to emerge, it is necessary to be based on a solid legal and historical basis; in this case, the limited liability and joint-stock company (see among others Shannon 1931; Hunt 1936; Ireland, 1984; Taylor, 2006) the owing of interests as a legal institution of British society (Anderson, 1975), along with the maturity of the economic system *per se*, can all be seen as a foundation for the emergence of the ITCs. So, chronologically, the mid-19th century is the inauguration point with the evolution of the appropriate economic, legal and institutional foundations, and spatially the centre of gravity was Britain. It is acknowledged for the establishment of both the-then new economic system, namely capitalism and for the ITCs. This is not just a coincidence; of crucial importance was the existence of the appropriate centre where these functions could flourish, namely the City of London (Cassis, 2006).[6]

[5] See Chapter 2 for an overview.
[6] Despite the appearance of this institution in northern European cities and in Scotland, see Swan (2009) and Chapter 2, the basic argument does not change.

In the meanwhile, a mature market of investment trusts was established in the London Stock Exchange (Rutterford, 2009). Guides, books and pamphlets for prospective investors have gradually appeared (Scratchley, 1875; Lowenfeld, 1909). The general climate of the first era of globalization – the first period of huge, open, international capital flows, 1870-1914 (see, O' Rouke & Wiliamson, 1999) - was extremely helpful and it has moulded their character. For the first time, the middle strata had similar opportunities to the traditional financiers. Prudent investment policies, sophisticated management and diversified portfolios indicated the new *ethos* in entrepreneurship (Sotiropoulos et al. 2020). Despite their temporary turmoil because of the Baring crisis in 1890, their incremental growth continued up to the outbreak of WWI (The Economist, 1934).

Recently, a growing interest in portfolio selection of various financial institutions and individual investors has developed (see Baker & Collins, 2003; Chambers et al., 2015; Carlos et al., 2015) which has also incorporated the ITCs (Chambers & Esteves, 2014). These studies followed the already established literature on the benefits of diversification. Although Markowitz (1952) first proved mathematically that diversification is a key component for portfolio selection, this practice has already been applied since the 1870s. Initially, a naïve diversification model was followed, viz. a portfolio composed of equal weights of as many holdings as required to generate a targeted risk. Gradually more sophisticated approaches were implemented, using a top-down approach; the managers targeted a particular level of risk and used uncorrelated securities to reduce risk (Rutterford & Sotiropoulos, 2016, pp. 930-1). Although they followed a more buy-and-hold approach (Chambers & Esteves, 2014) with a low annual turnover, they used professional management selecting a global portfolio.

These discussions cannot be unrelated to research focusing on international financial flows; these also use portfolio theory to interpret the reasons for the British Capital export during the pre-WWI period (Chabot & Kurz, 2003; Goetzmann & Ukhov, 2006) following previous works like Edelstein (1982). Even though these debates are among the longest and most fascinating in economic history, their analyses are at the macro level. Less research has been developed focusing on the micro level, and even less focusing on the interwar period. WWI can be regarded not only as the turning point but also as the end of most of the existing studies. The following period remains as a gap which this thesis will endeavour to close, by investigating the asset management of British ITCs in the period 1914-1928.

1.2 Research questions

The main research question of this dissertation is:

To analyse the British ITCs asset management strategies for the period 1920-1928.

To be answered this question, the basic tool which will be used is the portfolio lists of selected ITCs, continuing the work of Sotiropoulos et al. (2020). A unique database has been constructed containing the main information; three indices are used to answer the main research question: a) the asset allocation of the ITCs' portfolios; b) the geographical allocation and c) the sectoral allocation. This dataset, through the evolution of these three main indices, reveals the portfolio selection ITCs used during the 1920s offering useful information for their asset management strategies.

The main results of this thesis are that British ITCs during the 1920s followed careful but not identical asset management strategies; although they continued selecting conservative portfolio keeping many pre-WWI stable securities, they tested more active top-down approaches to portfolio construction.

WWI caused a seismic shock to their portfolio. ITCs withdrew their well-established US securities (mainly Railways) due to state intervention and devaluation. The capitals received were initially channelled into British War Bonds. Gradually, these investments were directed to the British Colonies and during the second half of the decade ITCs took full advantage of the booming European capital markets (Government Bonds and Industries). Additionally, the post-war renewed British market attracted some British investments. Finally, Latin American securities (Railways and Utilities) remained a stable investment for the whole examining period. Following their main target for security, asset allocation for ITCs remained stable (fixed-income securities' preference) while investing in promising new shares of established companies.

So, constructing the main indices for the British ITCs asset management, (asset, geographical and sectoral allocation) and observing these significant differences in the ITCs portfolios, a second question arose.

What were the causes of all these big changes in their portfolio list, and concomitantly their management strategies?

According to the Modern Portfolio theory (MPT) as pioneered by Markowitz (1952), each investor uses a portfolio which can maximize its return given its risk. This theory is based on

the neoclassical economic approach, making the assumptions that the market clears, and any asset price reflects all the available information. Thus, following this approach a logical answer could be the advantages ITCs could derive from diversification; put differently, a new portfolio could bring higher returns given the risks.

The pre-WWI economies seemed to fit well to this theory. The existing literature focuses on the pre-WWI British financial, economic and social conditions, under which the ITCs acted. During this period, a) the British pound was well covered using the "good housekeeping" practices of the Gold Standard (Bordo & Rockoff, 1996); b) the City was the unequivocal financial centre of the world Cassis (2006) funding both companies and states and c) industry was producing staple products for the domestic economy and was still enjoying imperial dominance; for the British economic history, see indicatively Floud and Johnson (2004). Within this framework, the ITCs could flourish implementing financial innovations.

However, WWI caused seismic changes to the structure and the main functions of global economy, making these assumptions questionable. All these pillars collapsed at the outbreak of WWI. The end of the war four years later revealed a new world.

The main characteristics were the following. First, new states appeared (see Aldcroft, 1977). Second, more financial centres reinforced their positions such as New York and Berlin (Cassis, 2006). Third, the role of the British Industry had gradually changed its character. In the interwar period British manufacturing had been divided into two main sectors. The "old" companies, were mainly companies exporting staple goods such as textiles, coal, shipbuilding etc., and the "new" ones, included electrical engineering, motor vehicles etc. A structural change occurred between these two, the former being curtailed in favour of the later and capital intensity sectors were developed, focused on the domestic market (see Landes, 1969; Aldcroft & Richardson, 1969; Broadberry, 1997; Bowden & Higgings, 2004). Fourth, professional management had been established, (see Hannah, 1983). Fifth, currencies were highly oscillating due to the lack of coverage in gold (see Atkin, 1995; Feinstein, 1995; Einzig, 2012; for the case of the British pound see among others Moggridge, 1972; Wright 1981; Matthews, 1986).

Finally, new social conditions were developing with the gradual militancy of the trade unions, the general political shift of the societies, including Britain, and the outcome of the October Revolution was in progress. Of course, the trade unions as an institution already had a long tradition, (see Musson 1972). Moreover, the socialist thinking had already been established, see the Chartist movement in the UK (Saville, 1990), the Fabians (Pease, 2018), the Owenites

(Harrison, 2009) and other radical voices (Bevir, 2011). In parallel, the Labour Party had already organised in 1900 (Thorpe, 2015).

However, the outbreak of the October revolution galvanised all these social groups into action (see Arnot, 1967; Carr, 1979; Rhodes, 1988). For the first time there was not only a theoretical discussion about a more equal and just world, but a move from theory to praxis occurred. Although, the revolution was not exported, it affected many aspects of different societies. Additionally, many Labour governments appeared in the post-war era; in the UK, the first being in 1923. Gradually, state intervention policies became the norm. All these seriously affected the financial markets, the ITCs included.

This thesis believes that the reason why this pattern has been followed by the ITCs cannot be analysed only by the MPT. ITCs can be seen as institutions which interact with society. Economic rationality is not the only factor that conducts investors to take their decisions. Economic, financial and social conditions determine their main decisions. So, the last question that arises is:

What are the relations of ITCs with societies?

This thesis uses information, mainly collected from financial periodicals and economic and other social indices, to grasp the general financial, economic and social environment of that period. The main answers to this set of questions are the following: ITCs seemed extremely adaptable to the changes in economic, financial and social level. Not only did they react rapidly to the new monetary policies (withdrawal of the Gold standard, devaluation) but also, they implemented a flexible policy against direct state intervention (investment prohibitions, taxation) and above all to the new social environment accepting any political regime that did not harm their financial interests.

Additionally, through this data valuable information for the asset management of the ITCs is released. The articles are mainly from either ITCs' annual meeting reports or relevant articles from financial advisors. In them, opinions were expressed about the general policies implemented by the ITCs directors, as well as their views on possible changes in various sectors of the economy, state and society. Due to the lack of direct archives which could help to examine asset management, this is valuable indirect information for their strategies.

These questions will be analysed in the rest of this dissertation.

1.3 Methods and Contributions

The method this thesis follows is mainly empirical. It builds a dataset using data on annual portfolio lists for 117 ITCs over four non-consecutive years: 1914, 1920, 1924 and 1928. The collection of this dataset is in itself a contribution to financial, business and economic history. This thesis is a first attempt to take full advantage of the asset management strategy of British ITCs during the 1920s. Additionally, it could be used as a baseline for a longer period or to answer questions about the financial flows or the performance (alone or in combination) of various markets or sectors. This analysis is mainly based on a micro level that offers valuable information for decision making even nowadays, especially the various challenges faced by companies during or after crises' episodes.

The second contribution this dissertation makes is the temporal dimension it introduces, namely the move from the pre-WWI period or the first globalization era, to the turbulent interwar period. Despite the existence of research about ITCs in the pre-WWI era, little research has focused on the interwar period.

For as long as an economy, region or sector flourishes, it is logical that the main institutions which participate in this attempt would have a profitable path, pro-rata, while any managerial innovation can be concealed by this environment. Thus, ITCs as a financial institution should have a flourishing perspective, building promising asset management strategies. However, when it is followed by another period, with different characteristics such as financial fragility, social upheaval and economic insecurity, then this financial shield is removed. Practices such as professional management rose to prominence as the appropriate counterbalances to meet these challenges. The ITCs, which were financial pioneers, took full advantage protecting their middle-income investors offering them acceptable yields.

The third contribution of this thesis concerns the development of the literature of financial decision making. This agrees that the role of professional management is crucial to select the appropriate portfolio that could maximize return given the risk. The results of this thesis confirm this approach highlighting the role of diversification even under adverse economic conditions. Additionally, it sheds more light on the asset management strategies of institutional investment focused on the category of the ITCs. By using a representative sample of the ITCs annual portfolio, it extends the one company example (Chambers & Esteeves, 2014) tabulating their investments' decisions completing previous studies (see Burton & Corner, 1968; Cassis, 1990) using primary data.

The other big body in literature in which this thesis intervene is the one about the global financial flows. Although the main research question is not about the export of capital, the rise and evolution of the global financial markets is intertwined with the story of professional management. ITCs can be seen as an institution at the forefront of financial innovations investing in securities from all over the world. Through this study one could derive useful findings about the impact of WWI on global financial markets and how investors dealt with it.

In this context, the last contribution could be incorporated. Methodologically, although a quantitative approach is used – it tests the hypothesis of diversification, there is a need in this thesis to explore these new features revealed after WWI. So, to examine a historically significant phenomenon, the interactions of ITCs with societies, a more historical approach is chosen which helps this thesis to set the changes in the historical context. Thus, a combined method is used in this thesis. Except the main dataset, archives from periodicals and financial newspapers will be used, a combination of quantitative with qualitative methods not only to corroborate the results but also to access trustworthiness to the dataset (Kipping et al. 2014).

Finally, this study believes that history is interesting because it can offer solutions to contemporary problems. "History, as I understand it, is concerned with the study, not of a series of past events, but of the life of society, and with the records of the past as a means to that end" argued Tawney (1933, p. 9), in his inaugural lecture at the London School of Economics.

Nowadays one can discover similarities between the present and the interwar period, economically, socially and financially. Severe economic crises have emerged (1929, 2008), beginning as crashes in the global capital markets; the economic paradigm has shifted from a liberal economy to protectionism- from the globalization to the de-globalization era, impacted by trade wars and poor economic performance losing its previous robustness. Moreover, severe social upheaval and active state intervention have (re)emerged. Businesses have to meet all these challenges using the appropriate professional management.[7]

Of course, the comparisons are not identical. WWI left many countries, mainly European, demolished, with a precipitous fall of the economic activity and serious problems of hyperinflation, and a new socioeconomic paradigm challenging the social and financial status.

[7] See the discussions in the two recent Business History conferences of the EBHA and BHA in 2022. Accidentally (?), both used as their topics: "Business under pressure: Historical lessons for the 2020s" and "Turning Points and Persistent Problems", respectively.

On the other hand, nowadays there is no alternative, at least a living one, or new problems have arisen like the climate change.

This dissertation does not study these phenomena and it is not triggered by the crises' episodes; on the contrary, it is an autonomous study which contributes on the asset management strategies of the ITCs. It brings new evidence to the investors' portfolio selection literature, determining the importance of diversification. However, it cannot ignore either these fundamental characteristics of the examined period, nor the turbulent period nowadays. Hence, the examination of the historic evolution of the ITC could offer valuable advice towards the solution of the economic dead ends which this system constructs, if possible.[8]

1.4 Structure of the dissertation

The rest of this dissertation is structure as follows.

Chapter 2 discusses the already existing literature about the institution of the ITCs. Initially, it presents basic economic and social indices of the UK economy up to the appearance of the ITCs. It adds also the monetary, financial, governmental and entrepreneurial evolution for this country. Furthermore, it exhibits the basic legal and economic origins of the ITCs and, also, the process of British capital exports during the late 19th century; all this frames the environment in which the ITCs have developed. In the last part it scrutinizes the main literature which refers to ITCs, classifying it into three parts, in a chronological order. The first, is related to the discussions which were held in the late 19th - early 20th century. ITCs origins can be traced back to the landed gentry of British society. For the wealthy members of this society in Victorian Britain a problem arose, how to invest their savings, at a time when traditional investments, mainly land and gilts, were underperforming. An alternative solution was given by the existence of the ITCs. This then newly founded institution had not gone unnoticed by the financial advisors of the period. Scratchley (1875) offered one of the earliest references on ITCs as being a promising financial alternative to the then underperforming British gilts. Britain can be seen as a pioneer for this type of investments. The first British ITC was the Foreign and Colonial Government ITC in 1868, (see Mc Kendrick & Newlands, 1999; Chambers & Esteeves, 2004); for the Scottish case, the First Scottish American ITC was established in 1873 in Dundee, (see Swan, 2009; Rutterford et al., 2021). A second discussion,

[8] If an institutional investor with the specific characteristics can beat the competitors (e.g., hedge funds, banks, etc), it is a signal for structural changes in their characteristics. Nevertheless, there is one significant exception, the global crises; in this case no alternative schema is unbeatable. Of course, this goes beyond the scope of this dissertation.

supplementary to the first was concerned the financial novelty of diversification. Various financial advisors such as *Chadwicks' Investment Circular* (1870), Beeton (1870) and Lowenfeld (1909) raised diversification as a risk reduction process, one of the ITCs' bastions. Surprisingly, a third discussion focused, in the early 20th century, on the comparisons between British and American ITCs which had been established later than the former, see Campbell (1924), Robinson (1923; 1930), Chamberlain & Hay (1931).

A resurgence in interest regarding ITCs emerged in the mid-20th century. Burton and Corner (1968) re-examined their historical evolution of the ITCs comparing the British and American case. In Cassis (1990) a new discussion about the main historic diversification techniques of this institution was developed. A new wave of research appeared in the late 20th century, using MPT, re-assessing ITCs. Chambers & Estevees (2004) analysed the oldest ITC, while Hutson (2005) re-examined the 19th century ITCs.

The latest overview of this institution was presented by Sotiropoulos and Rutterford. In their survey, see Sotiropoulos *et al.* (2020), the business history of Victorian ITCs was discussed. Among others, the asset management strategies developed by the directory boards of the ITCs were analysed, along with the asset allocation and the diversification policies which were followed. This dissertation builds the main dataset following a similar analysis. Finally, gaps in the existing literature are identified that this dissertation will address.

Chapter 3 presents the main methodology, namely the data collection process it follows to answer the main research question. For this reason, it collects the annual portfolio lists of the ITCs, which are in the Guildhall Library, London. Existing ITCs are compared with the list of Glasgow (1935), which includes the total number of ITCs operating in that period, adding more information to support the representativeness of this sample. Finally, it concludes to the ITCs which will be used in this database. These lists offer valuable information about the asset allocation, the diversification process and the management techniques which have been used by the ITCs directory boards. Sotiropoulos et al. (2020) offer information about their database, including many of the ITCs which are used in this research too, so, this will be used as a benchmark for its findings.

Chapter 4 investigates the asset allocation of the ITCs. They have maintained their well-diversified portfolios and their value size as in the pre-WWI period. However, this stability does not mean that this sector has remained stagnant. New ITCs have been established by the already existing associations which could take full advantage of local interconnections and test

new asset policies. Despite this misguide, ITCs can be seen as a growing enterprise over time. As for the asset allocation policies, the fixed interest securities have, still, remained the dominant asset type in ITCs portfolios, losing gradually a small portion. Equity, both preferred and ordinary (common) shares, comprise half of the total holdings.

Chapter 5 discusses two main problems for investors, namely inflation and taxation. Because of the outbreak of the war, the British government had to tackle with the problem of funding its excessive needs. Excessive borrowing and the rise of taxation were selected as solutions, affecting completely the ITCs which were forced to release their dollar-based holdings, accepting the War Bonds as "transition" holdings. The inflationary pressures during the war shifted investors' preferences against fixed-income holdings. However, a period of deflation followed the Armistice, along with economic depression. New problems affected not only ITCs but also investors and debenture issuers. ITCs boards had to search for alternatives, these will be discussed in the next chapters.

The rest of the dissertation focuses on the main geographical and sectoral analysis of the ITCs. Chapter 6 overviews the evolution of the geographical and sectoral allocation in the ITCs portfolios in the 1920s. A first discussion arises about the differences between the existing pre-war results and the new findings. Additionally, it introduces in its analysis the economic growth pattern of the various regions and the population growth rates as signs of possible profitability for the ITCs investments in these regions. The results are far from convincing. Thus, it shifts towards institutional indices which could explain the ITCs portfolios' allocation. It extensively uses information from the financial periodicals to capture the climate of the period and to study the various debates regarding the stock exchange, the countries and companies' implementing policies, the social and political conditions. Concomitantly, challenging the mainstream notion of financial unbiasedness to social change, it supports that financial institutions are extremely sensitive to social changes which could unsettle their investments or profitability.

Chapter 7 focuses on the significant market of Latin America, the ITCs financial *El Dorado*. It pinpoints the reasons for the long insist of the British investments in this distant region, focusing on the case of Argentinian Railways. The government's guarantee on both the profitability and the efficiency of the foreign investments, along with the liberal policies were the necessary pillars for the British investments thus, the ITCs successful investments. Both the strength of the links with these countries and the successful management the British ITCs have created, could surpass most external shocks, such as the Mexican revolution in the 1910s. Problems emerged after WWI, when more interventionist policies were implemented, along

with the first shy social riots and the existence of competitors, mainly the USA. However, the 1920s remained a significantly profitable period for investments in Latin America for the ITCs. These established investments reflect the old passive management strategy of a buy-and-hold approach.

Chapter 8 studies an *antithetical* example, that of the USA. A precipitous fall in the ITCs investments was seen in the 1920s in the until then lucrative American, dollar-based holdings. The reasons for this withdrawal were first, the interventionist policy of the UK during WWI in its attempt to collect desperately needed foreign currency to pay for the war. In the meanwhile, the ITCs were taking full advantage of the devaluation of the British currency, gaining from the difference and acquiring risk-free capital with acceptable yields. Second, in the aftermath of the war, a policy in favour of the domestic economy made the issuing of foreign holdings more difficult on the LSE. Finally, the impending gold standard again imposed restrictions on international capital transactions. A second, more interesting question arises. Following the abolition of these barriers, why did the ITCs' sophisticated management not endeavour to re-gain these lucrative investments? The American capital market after WWI was completely different from before. The overvalued holdings offering low yield, were no longer attractive for the ITCs. Additionally, a wave of new holdings has flooded the LSE, thus there were various other safe and promising investments for them. Finally, the long absence had created more information asymmetries that had to be replenished. This is the first case study in which a new management strategy was implemented; ITCs did not follow the market, searching for alternative investments.

And what could replace them? Could this situation have repercussions for ITCs profitability and maybe fame? Could it be, finally, the "end of their game"? An unpredicted alternative from the mid-1920s was Europe, as Chapter 9 displays. Traditionally, the European capital markets were not of vital importance for British investors. The different structure of their financial markets, along with the existence of competitors such as the French and the Germans had created obstacles to their financial penetration. Furthermore, WWI had severely damaged the European economies. In the aftermath, a new continent has emerged with large problems to be solved. New states, financial and economic instability, political upheaval, not to mention the direct challenge of the financial investments as such, were among the main problems. However, the appearance of international organizations, and the (temporary) solution of the German issue aided substantially the European economies. Thus, an abundance of new investments deluged the British market. Additionally, the blooming financial environment shifted the ITCs towards

the European stock markets, where they were dealing with the newly founded national holdings. Questions arise about the political regimes which were established and the possible repercussions they caused for foreign investments. Active and advanced management strategies were mainly applied in the European case to accomplish ITCs' goals.

The motherland of British ITCs is also an interesting case for the examined period (Chapter 10). Despite the international character of the ITCs, Britain has been an important financial destination since the early 20th century. During WWI, Britain has mainly funded the war through issuing debt, see the aforesaid discussion, which was exchanged for American mainly ITCs' holdings. Thus, the ITCs burdened their portfolios with Victory bonds. However, this was not a permanent investment practice. Very soon, they reinvested their capital, keeping much of it inside the UK. In the aftermath of the war, new investments emerged on the LSE. In parallel, the local networks were active enough to influence ITCs' policies. Besides, the already existing tendency to the rationalization of the British industry had attracted the ITCs. This tendency, along with the good economic conditions for a section of British society led to the appearance of a bundle of affordable consumer goods. These promising perspectives for British enterprises did not leave unaffected the ITCs. However, not the whole of the British society could reap the crops of this progress. the non-privileged were pressing for social changes; this could be seen in the first Labour government in the early 20s. The ITCs would for the first time need to deal with the restriction of their activities, a task which has been solved successfully. Finally, Chapter 11 summarizes the main findings of the thesis.

2 Literature Review

2.1 Introduction

This chapter presents the main literature review concerning ITCs. The chapter is split into the following parts. First, it analyses the main elements of the economic and social history of the UK since the Industrial Revolution. The UK was the richest country in the world, and despite the gradual fall of its growth rate, it remained a powerful economy for the whole period. Although it recorded a very strong economic performance, it remained a highly unequal society; this gap was only slightly addressed in the early 20th century.

At the same time, many economic and legal changes occurred, modifying the British economy, finance and society. In the field of law, the origin of trust can be seen in the land law and specifically in the appearance of the type of right regarding interest, which had created the notion of trust, the predecessor of ITCs. As for the sphere of economics, the unlimited liability of a firm was challenged by the emergence of limited liability which together with the development of the joint-stock company, altered the general function of the corporate economy.

Because of the increment of the savings of the upper-class of British society, the question which arose concerned the successful return of these savings. The traditional investments, namely land, consols and railways had not offered sufficient yields. Thus, the export of capital seemed like a prosperous alternative. Of course, this is one exegesis of the increment of the export of British capital. The lack of domestic demand (the underconsumption theory), the concentration of production along with the coalescence of the industrial and banking capital (Imperialism), or the institutional rigidities of the British financial system to fund the local economy were alternative approaches to that issue.

Furthermore, it discusses the main literature of the British ITCs. It classifies the existing one into three parts. The first one is chronologically closer to the period under study and encompasses the period prior to WWII. The authors discuss the establishment, the main characteristics, pinpointing the reasons for the ITCs' success demanding to be transferred to the USA market; all these inside the general professionalization of the investing procedure.

The second part is framed by more modern research. In these, one can find discussions about their main characteristics as their extensive diversification, professional management and total success. For the first time, modern risk and return techniques are used. Another novelty is the

extensive use of the ITCs portfolios to extract the results of their performance and management strategies. Finally, it separates the works of Sotiropoulos and Rutterford as the last part of this review. The reasons for this are: first, their novel way of examining the pre-Markovich diversification policies for the Victorian investors and second, the pioneering techniques of using a micro data approach to the management strategies of the ITCs which they follow. Finally, it concludes.

2.2 Economic and Social History of Britain.

"The starting point for a study in financial or business development must necessarily be the evolution of the economy" (Supple, 1977, p. 9). Thus, this thesis presents some main evidence about the economic performance and the social evolution of the UK in the late 19th - early 20th century to examine the historical evolution of the financial institution of ITCs in the British interwar period.

2.2.1 Economic Growth

First, business and financial analysis do not lie and evolve outside of society, so, beyond the development of its economic forces and its social relations. England, the cradle of the first Industrial Revolution (Mantoux 1964 and Ashton 1968) has been the most advanced economy in the 18th century, it "happened to be at the time the richest land in Christendom" (Postan, 1935, p. 3). In the mid-19th century, it had already built its manufacturing industries on a solid basis (Landes, 1969). Later, in 1870, it maintained its dominant economic position in terms of income per capita (Crafts, 2004). Its GDP pc in 1870 was the highest in the world (3,1919$) while the USA one reached 2,445$. The Netherlands still had a strong economy (2,753$), while Germany (1,913$) and France (1,876$) followed, see Crafts (2004) and Maddison (1995; 2001).

However, gradually, this picture has changed. Although England had the highest GDP pc, its main competitors were growing at a higher rate -for the period 1870-1913, UK annual growth rate was 1 percent while the USA had 1.8 percent, Germany 1.6 percent, and Japan 1.5 percent (Crafts 2004). Matthews et al. (1982, p. 22) counted the same annual growth rate for the UK during the period 1876-1913 at 1.8 percent. However, both agree that after 1870 the UK's rate of growth was persistently below that of its competitors. In 1913 the British GDP pc (4,921$) was ranked second behind the USA (5,301$). Finally, in 1938 UK had a GDP pc of 5,851$, which lay behind the USA (6,126$) and Switzerland (6,390$). However, until the 1950s Britain

was in terms of GDP pc ahead of its European competitors, e.g., France and Germany (Crafts 2004).

Despite the progress of the Industrial Revolution and afterwards, the fruits of this progress were not distributed analogously. Feinstein (1998) argues that the average real benefit for the average working-class family rose by 15 percent for the period 1780 until the 1850s, practically a stagnation period, (see also Allen 2009) who describes this period as an Engels' pause. For a newer revised approach, (see Crafts 2021). The next period can be seen as relatively better, with an annual growth rate of real wages at about 1 percent till the 1930s (Matthews et al., 1982, p. 171). The general picture during the interwar period was vague enough for certain conclusions. Both the supply and the demand sides totally shifted; more frequent oscillations emerged with an unprecedented unemployment rate. The latter which had an average annual rate of 5.8 percent during 1870–1913 doubled in the interwar period to 10.9 percent, with high variations in specific sectors, mainly coal mining and other staple products sectors. In the meantime, earnings generally increased, especially in the middle strata and in the new industries (Hatton, 2004), along with rising productivity and the establishment of new consumer habits among the labour class, see Scott (2017). So, the UK in the late 19th century was already an advanced economy that had amassed its indispensable capital, a prerequisite for the financial institution like the ITC to be established and developed.

2.2.2 Government

Moreover, a new player emerged and galvanized its intervention in the total economic system, assuming a position between the companies and the labour; namely, the government. The UK government before WWI had a *laissez-faire* position which rapidly transformed to pursuing direct intervention in the economy. Before the war, the British state although it had gradually created proper institutions protecting property and reducing transaction costs, thus promoting market (Harris, 2004), it practiced limited intervention and had as its norm the "golden rule", the minimal balanced budget and free trade (Daunton, 1996). Because of the war, the British state totally changed these norms. Before the war, the total public expenditures fluctuated at around 11 percent of GDP while after the war, they rose to 33.2 percent, redistributing now the national income (Middleton, 2004).[9] A similar trend has been followed in the taxation rates. The standard income tax rate following the liberal visions of Glasdon and Peel who have

[9] Characteristically, the social services reached almost 10 percent of the British GDP in 1929, starting from 1.9 percent in 1890.

endeavoured to create a social contract among the social classes (Daunton, 1996) ranged from 2.08 to 3.33 percent for the period 1860-1900. In 1913, the standard rate of income tax raised to 5.8 percent and the highest marginal rate stood at 8.33 percent. The outbreak of WWI changed this situation. In 1920 the standard income tax rate reached 30 percent and the highest marginal rate 52.5 percent. In the interwar period, income taxation has fallen to 20 percent (1929) while the highest marginal rate was stabilized at the same level, both by far higher than the pre-war period (Middleton, 2004). For a first comparison between the pre and post-war taxation, see Jones (1927). The real wages of British labourers had a poor performance. For the period 1856-1873 the annual growth of real wages (per man/hour) was 1.9 percent, while the next period saw it fall to 1.1 percent for 1873-1913 and 0.9 percent for 1924 – 1937 (Matthews et al. 1982, p. 171). Additionally, during the early 20th century a series of laws related to the welfare state were implemented (in national insurance, unemployment, pensions, housing etc.), raising significantly the workers living standards (Boyer, 2004). The necessity of the state to intervene in the economy is not irrelevant to finance, the ITCs included. The direct intervention through taxation, regulation, restrictions on free capital mobility and inflation affected both ITCs' investors who had less disposable income and the ITCs as such, which had to face excessive tax surprises.[10] Finally, they had to prepare for this new, long-lasting *symbiosis*.

2.2.3 Entrepreneurship

Entrepreneurship and economic performance are intertwined and they strongly interact with each other. The growth of large-scale corporations is historically related to the Industrial Revolution; however, this link is neither simple nor direct (Hannah, 1983, p. 8). The typical British production unit was a small one, involving family-based ownership and poor management- initially these two were inseparable, local funding and small technological innovation (Hudson, 2004). Gradually, larger units have appeared, along with greater technological and managerial needs. Through a merger booms in the late 19th century, these newer large-scale enterprises needed a division between ownership and management, advanced financial tools, and professional management (Supple, 1977). A twin revolution occurred from family to professional and from individual to collective management, accepting an institutional structure (Supple, 1977, p. 24). A managerial class emerged together with professional accountants. The introduction of limited liability has also contributed towards this direction (see below). ITCs, as a British institution, operated inside this structural entrepreneurial reform.

[10] See Chapter 4.

Although they had never faced such problems e.g., they had decided to use sophisticated management as an underlying policy, Sotiropoulos et al. (2020), they were affected by this movement; additionally, they contributed to it indirectly, especially in the aftermath of WWI when they decided to invest extensively in newly traded British securities, see Chapter 9.

2.2.4 Monetary Policy

For the period before WWI the dominant monetary policy of the UK government and globally was the Gold Standard, meaning the price for a currency was fixed to the price of gold. One reason for this practice was to prevent inconsistent government policies from raising the amount of money circulating in a market hence, the prevention of inflationary policies (Bordo & Kydland, 1996). Moreover, the governments which chose to follow these policies succeeded a low rate in their debts, so, the adherence to the Gold Standard has "a good housekeeping seal of approval" (Bordo & Rockoff, 1996). This could be seen in the stable and decreasing level of the Bank of England (BoE) interest rate which stood at 5 percent up to 1820 and then fell to 3-4 percent leading up to the outbreak of WWI (Thomas & Dimsdale, 2016). However, the unprecedented shock of WWI made the maintenance of that rule prohibitive. The BoE had to raise the bank notes' circulation and, mainly, to issue a series of debentures to cover the augmented needs of the war; at the same time, the galloping inflation worsened the financial position. At the end of the war, despite the temporary rise in economic activity, the Bank had to face accumulated burdens: the curtailment of the budget deficit and the debt funding; as a response in April 1919 the BoE officially withdrew from the Gold Standard and suffered a concomitant fall of the exchange rate of the pound sterling (Dimsdale, 1981), it also increased its interest rate from 5 in 1917-1918 to 6 in 1919 and 7 percent one year later, along with the Treasury Bills rate, (see Morgan, 1952; Howson, 1974). However, during the next two years, a severe recession hit the British economy causing a precipitous fall in prices along with the fall of the global prices; finally, the uncontrolled exchange rates led to a severe recession. From 1922 a three-year period followed with vigorous debates about the potential new peg of the British currency to the gold. This has finally happened in 1925, in the pre-WWI parity, strengthening the pound and favouring the financial sector in a new short and vulnerable economic boom that lasted the rest of the decade (Dimsdale, 1981; Obsfeld & Taylor, 2003).

The Gold Standard was the ally of international investor, the ITCs included. This was because of first the exchange rate stability and, second the "discipline view", both monetary and fiscal; countries were running balanced budgets and they could prove a "financial probity", (see

Eichengreen & Flandreau, 1997). Thus, little was the chance for an inflationary policy along with the financial dominance of the LSE guaranteed a promising financial return. However, WWI overturned this policy. Withdrawing from the Gold Standard resulted in the appearance of uncontrolled inflation, see the discussion in Chapter 4, which eroded financial income especially of fixed-income holdings' investors. However, for the period under study, both the official policy of the British state which favoured the interests of the City, (see Costigliola, 1977), and the ITCs' management tackled these problems by maintaining their portfolio performance and, especially during the second half of the 1920s, transcending their pre-war profitability. All these will be discussed in the next Chapters.

2.2.5 Finance

The role of finance is fundamental in capitalism. The UK has a long tradition in financial innovations which have underpinned the British economy. Shockwaves finally created the modern system of finance. Beginning with local credit networks, and the use of bills of exchange, multiple revolutions have changed their initial role such as: the Glorious Revolution (1688), the appearance of government finance (Kynaston, 2017),[11] the first financial bubbles (Temin & Voth, 2004),[12] the expansion of credit and the banking system (Neal, 1990), the strengthening of the London securities' market (Michie, 2001; Morecroft, 2017), the Napoleonic wars (1815) which created a second revolution regarding the emergence of foreign securities, the railway mania, new financial panics (Neal, 1998)[13] and the dominance of the joint- stock company since the mid-19th century (Quinn, 2004).

So, in the 19th century the City of London became an international financial centre. Later that century England gradually has served "both as a workshop and as the world's banker" (Cassis, 2006, p. 16). In the meantime, the London Stok Exchange (LSE) became the predominant market, acquiring the role of the world financial capital. A stock exchange is "a market where specialized intermediaries buy and sell securities under a common set of rules and regulations through a closed system dedicated to that purpose" Michie (2001, p. 3). LSE was the main market for the ITCs, both for their securities and for the ones contained in their lists.

The LSE was created in 1693 "when the government, for the first time, borrowed by creating a permanent debt that was transferable" (Michie, 2001, p. 18.) Despite existing since the 17th

[11] The Bank of England was established in 1694.
[12] E.g., the South Sea Bubble, 1720.
[13] Panic of 1825.

century, it was not the dominant European stock exchange. Initially the stock exchange of Amsterdam played this role (17^{th} -18^{th} centuries). Also, the Paris Bourse had a significant role to play; however, the lack of its central organization and regulatory policy along with the French Revolution and Napoleonic Wars saw the European financial centre transfer to London which first prevailed over their rivals and then, absorbed all their know-how and experts. In the meantime, the role of the market had shifted towards exchange. "Thus, on 3 March 1801 a London Stock Exchange formally came into existence that not only provided a market for securities but also incorporated regulations on how business was to be conducted" (Michie, 2001, p. 35). During the next decades, mainly during the 1820s, consecutive changes led the LSE towards abroad and then during the 1840s the "Railway's mania" boosted the LSE functions along with the structural changes in British society which were embedded entirely in the capital market (Postan, 1935). Finally, from 1850 onwards, a third movement occurred from domestic to international. Now, "London is often more concerned with events in Mexico than with what happens in the Midlands" (cited in Cassis, 2006, p. 84). A novelty that emerged was the increment in investments using the collective savings; here is when the ITCs were established.

> "Though the number of individuals directly investing in securities remained but a small proportion of the population, their indirect involvement was greatly widened by the investment of institutions. Joint-stock banks, insurance companies, and *investment trusts* were among the most important of the financial institutions who directed a growing proportion of collective savings into stocks and shares over the 1850–1914 period and did so in an increasingly professional manner" (*emphasis added*, Michie, 2001, p. 74)

Finally, "on the eve of the First World War, the London Stock Exchange was the dominant institution of its kind in the world, whether measured by activity, variety, connections, or sophistication" (Michie, 2001, p. 143)

WWI was a "watershed in Britain's financial history" (174). The direct intervention of the British state not only through the new regulatory rules regarding the LSE's functions, but also with the prohibition of foreign assets (and of brokers), the deluge of government bonds, and the change of monetary policy affected LSE. The increased interest of the British to the stock market can be seen in the participation of broad parts of the British population in the national bond market. This new scenario was completed by the appearance of various industrial and financial companies which diversified the existing market. For the examining period, the ITCs

strategies seem, *ex post*, to have taken full advantage of these movements of the main capital market of the UK, investing in this new sub-market, and raising their yield. The main open question, which cannot be answered in this dissertation, concerns the post-1929 era when the stock market collapsed.

2.3 Legal and Economic Origins of the ITCs

ITCs' establishment was based on specific legal and economic foundations. All the previous discussion can be incorporated into their economic prerequisites. Here this thesis examines the legal and economic origins of the ITCs, namely, the rights on property and the emergence of limited liability and joint-stock company. The core of Neoclassical economics can be seen in the existence of well-defined contracts, property rights and market clearing, (see among others Coase, 1937; Grossman & Hart,1986; Neal, 2014).[14]

2.3.1 Legal Origins on Rights

A basic pillar in the establishment of the ITCs can be found in the legal origins of the land property rights. In Britain, a common practice has gradually developed related to the endowment of property land which was based not on the owning of land but on the owning of interest on land. So, practically, there were two types of landowners in the UK, one who had the total ownership of the land which was a marketable commodity; it could be bought, sold, or bequeathed at any time; and the other, who had the right to receipt only interest generated by the land, as it was not his property, but it was mainly a "family estate" (Anderson, 1975). This meant that the owner of this right on interest could transfer only this right to his offspring. In parallel, the concept of "equitable law", created a separate entity to the legal one of an estate. This can be seen as the archetype of the *trust*, a shield for the ownership and disposition of the property against legal, and economic, disputes. Over time this practice has been consolidated. "Eighteenth century England saw a marvellous proliferation of trusts out of the context of landed property" (Anderson, 1975, p. 102). This trust, based on landed property, has been expanded in sectors beyond land, incorporating commercial interests. Thus, the trust of money succeeded the trust of land. Its basis was not on contract but on a district form of association (trust); this was a British innovation that led to the corporate vehicle, providing safety against bankruptcy. This was the case of the partnership, the predecessor of the ITCs as they appear in

[14] There are long debates and alternative approaches about this topic such as the existence of institutions or the supportive role of the government; nevertheless, all of them originate from and refer to these basic pillars. However, this discussion goes beyond the limits of this dissertation.

the 20th century. One extra step forward needed for this, the appearance of the joint-stock company which is analysed thereupon.

A critical but brief digression follows, before the main topic is addressed. This historical evolution of law and finance is not irrelevant to the institutional evolution of the family in Britain; namely, in the UK married women had no legal identity, meaning that they were subordinated to their husband, however the unmarried women (or widows) were in a better position having the same rights as men. This legal status encouraged the emergence of the trusts and other intermediaries in the UK, see Erickson (2005), invigorating capitalism in this country. Gradually, women participated more actively in finance investing finally in securities, especially after the corresponding laws which also gave property rights to the married women, (see Laurence et al., 2009; Rutterford et al., 2011). The institution of dowry (marriage settlement, jointure) was repealed, and new institutions emerged such as the Victorian trusts which offered income to women; the latter have participated over time in the capital market as investors, (see Maltby & Rutterford, 2006).

The ITCs arose from this tradition as an institutional investor which could secure its clients' (now investors) incomes, overcoming possible difficulties and offering higher yields. Possibly, it can be argued that their focus on prudent management, their support of income from dividends against capital gains, the reserve accounts' existence for absorbing future shocks; all these are developments based on this tradition.

2.3.2 Joint-Stock company and Limited Liability

A mature financial market is a prerequisite for the emergence of the various institutional investors, the ITCs included. A sign of this maturity is the dominance of the *limited liability* and the *joint-stock company*. Although the former is more a legal issue while the latter an economic one (Ireland, 1984), this thesis categorizes it according to the legal origins.[15] Historically, "[t]he earlier companies obtained their legal constitution either by royal charter granted under common law, or by a royal charter granted under statute, or by a special Act of Parliament, and were legal corporations" (Shannon, 1931, p. 267). The main corporate form, however, was a partnership, see the aforesaid discussion. This means that "each partner could then be fairly regarded as the full accredited agent of the others. As a sharer in the profits, each could be regarded as fully liable for the losses. And the rule had been developed for the better

[15] For sure, a different classification is possible. At the end, both economic and legal studies have referred to this and most research on this has been realized by a combination of economists and jurists nowadays.

protection of creditors, that this liability extended to all his private property, 'to his last shilling and acre.'" (Shannon, 1931, p. 271).

The *Chartered companies Act* of 1837 can be regarded as a novelty, inaugurating the notion of limited liability.

> "...and the Members of such Company or Body shall accordingly be individually liable for such Debts, Contracts, Engagements, and Liabilities respectively to such Extent only per Share as in such Letters Patent shall be declared and limited; such Liability nevertheless to be enforced in such Manner and subject to such Provisions as are herein-after contained." (Act 1837, chapter 73, iv).

This was the first step towards a process of appeals and new legislation forging the form of the limited liability company, a process full of contradictions and hot debates reflecting controversial interests (Shannon, 1931). In 1855 the *Limited Liability Act* determined fully this idea as its title declares: "An act for limiting the liability of members of certain joint-stock companies". In its eighth clause it declares that:

> "The members of a joint-stock company which has so obtained a certificate of complete registration with limited liability, after such a certification is granted, notwithstanding... shall not be liable under any Judgment, Decree or Order which shall be obtained against such company, or for any Debt or Engagement of such company, further or otherwise than is herein after provided" (Act 1855, c. 133).

Despite the legal progress, the economic establishment needed more time to be consolidated. Many objections had been raised initially by large investors who had already attained monopoly power; curiously, the first to debate in favour of limited liability in the British Parliament were not tycoons or large investors but middle-class philanthropists and Christian Socialists, see Saville (1956, p. 419). This discussion was older, embracing the classical political economic tradition, (see Henderson, 1986), and correlated with the notions of *laissez faire* and the free trade. Characteristically, one of the first to accept it was Richard Cobden, see Saville (1956, p. 431). Notions such as the free access to economic and legal business privileges were totally unacceptable in the mid-19th century (Taylor, 2006, pp. 10-12). After the first failed endeavours, the limited liability companies have succeeded offering better qualitative characteristics, (see Todd, 1932).

Even in 1880 the limited liability company was in the minority compared to the partnership. Gradually, from 1850 onwards the size of the British enterprise became too big to be covered

by the family of the owners and the local network. Thus, the economic form of joint-stock companies could offer a solution. This, along with the amalgamation tendency since 1880, led to higher capital accumulation and a tendency to monopolize (Hannah, 1983). Limited liability has been of utmost importance up to nowadays. All the conventional theory of the firm is based on the idea of limited liability, (see among others Friedman, 1962; Arrow, 1964; Jensen & Meckling, 1976; Fama & Jensen, 1983; Rajan & Zingales, 1998). Possible advantages can be the limited monitoring costs, more efficient management, optimal investments' decision making; thus, diversification emerges (Ireland, 1984; Easterbrook & Fischel, 1985).

One can argue that these advantages are the main pillars of the ITCs, which took full advantage of their benefits. ITCs were established as trusts and not as companies based on limited liability, an echo of this first period of distrust towards companies, (see Rutterford, 2009). However, this has soon changed, leading to a limited liability company; the form that all the ITCs in this database followed. There were three main differences between Investment Trusts structures as trusts and those structures as companies. First, the existence of capital structure (debt and equity); second, the change from finite life to unlimited life; and third, the existence of corporate governance (Rutterford et al., 2022). Overall, they chose, almost from the beginning, this new type of a company espousing all the then progressive nature it bore viz., indiscriminate participation, shield against default, common rules, finally, reaping all the possible fruits of economic and social progress.

2.4 The Export of British Capital

The growing capital needs of British companies after the Industrial Revolution stimulated the British financial markets in the early 19th century. Furthermore, Britain especially after 1815 dominated, being transformed into the "financial powerhouse of the world" (Morecroft, 2017, p. 41). Innovations in transport and communications propelled the financial markets allowing them to work in a fast and efficient way. The excessive savings of the period of the Industrial Revolution led to huge outflows of British capital abroad. The annual rate of foreign lending for the 1860s reached 3.8 percent of the national product while later to WWI it skyrocketed to 5.2 percent (Edelstein, 1982, p. 3). The ITCs' attempt to achieve high diversification can be interpreted as a part of this procedure of British capital export; three out of four pounds of their portfolios have been invested abroad (Sotiropoulos et al., 2020).

The reasons for this movement have been heavily scrutinized. A first explanation is the very *low domestic rates of returns*. A typical investor, in the UK, may have first invested in a safe

and prestigious investment such as land or government bonds (consols). However, the rate of return from land has gradually declined, working more as a symbol of status (Clark, 1998) which "was losing some of its attraction" (Armstrong, 1990, p. 121), especially in the last quarter of the 19th century (Perry, 1973). Consols were another traditional investment for British investors. However, again, the income which was produced by the government debt diminished offering a yield of less than 3 percent for the period 1882-1902, reaching even 2 percent for the same period, (see Harley, 1976; Armstrong, 1990). A third tradition for the mid-19th century investor namely, the British Railways, were gradually offering limited returns (Mitchell et al., 2011).

A last alternative was the domestic industry. However, the period prior to WWI was a very peculiar one for the finance and the growth of British industry. Although Britain was the workshop of the world because of the Industrial Revolution, up to 1870 most of British companies were labour intensive family businesses with limited need for capital from private and internal sources or local networks without financial intermediates (the banking sector) which were reluctant to support investments (Cottrell, 1980). In the meantime, as has been mentioned, the joint-stock, limited liability company was not yet the dominant form of ownership of British enterprises. However, gradually, old owners of the British firms have realized that it was in their own interests to exchange their position of owning and controlling their companies for diversified portfolios of various holdings; these gains were the new, bigger and more efficient plants which, under professional management and taking full advantage of the scale economies, could, in the long run, raise their profitability (Hannah, 1983). From the previous discussion it can be concluded that the majority of the traditional domestic investment opportunities were unattractive for investors, either offering low returns (in the cases of land, consols and railways) or being in a transition period (domestic industry). This was the first exegesis about the shift of the British investors to abroad, creating in parallel the roots for the emergence of institutions such as the ITCs.[16]

Second, an alternative view of the massive capital outflows was the interpretation of *underconsumption*. In economics, this tradition has deep roots, as a main economic characteristic leading to crises and social turmoil in capitalist economies. Malthus and Sismondi were among the first to have pinpointed that consumption cannot be equalized with investment, proposing as a solution the rise of effective demand. This tendency expanded in

[16] There is a converse for this explanation. See Chapter 9 for more information.

the Victorian period during which the "underworld of economics" developed these theories (Heilbroner, 1972). Hobson supported in his theory that the discrepancy between the low portion of the British national income going to labour incomes and the high propensity for savings by the property owners led to a limited consumption ratio in the UK; this drove their decisions towards capital outflows with serious repercussions. This was the "economic taproot of Imperialism" leading to a third answer to our question, (see Hobson, 1902).

Imperialism was the new reality as a product of the great concentration of production which led to the creation of monopolies, the coalescence of industrial with bank capital (the finance capital) following the export of capital (Lenin, 1917). Many authors incorporated the notion of Imperialism with the underconsumption (and/or underinvestment) theory (Luxemburg, 1913), or focused on the dominant role of the banks (Hilferding, 1910).

The notion of Imperialism was first observed and analysed economies such as Germany where the universal banking system flourished, see the discussion in Chapter 9; thus, paradigms as England need more work towards this direction, which goes beyond the scope of this research. Despite the dominance of the capital-based markets of the British financial system, it "…also leads to monopoly, although somewhat later and perhaps in another form" (Lenin, 1917, p. 17), continuing that "the one-pound share is the basis of British Imperialism" (44).

A final approach involves a bias in favour of foreign investments because of *institutional factors*. "What was inadequate was not the quantity of stored-up wealth, but its behaviour" has aptly been mentioned by Postan (1935, p. 2) challenging any insufficiency of capital in the UK. Saville (1961) discussed the capital markets' rigidities and the investors' unwillingness to fund the domestic economy because, mainly, of London's specialization in foreign investments, the individualism of the managers of the family size British industries and the reluctance of the British banks to long run lending. Landes (1969) reached a similar conclusion about these rigidities of the British capital market. To this institutional approach one can add the high pressure for borrowing from abroad, the "net secular accumulation pressures" (Edelstein, 1982).

These factors can explain the huge capital outflows abroad in the last quarter of the 19th century. Paish (1911) in his seminal paper scrutinized British investments abroad in the first decade of the 20th century. Numerous studies have focused on this upsurge in the export of British capital. Cairncross (1954), Imlah (1958), Thomas (1967), Simon (1967) and Platt (1986) created and compared datasets about the size and the geographical destinations of these movements.

In the meantime, the consequences of this export for the British economy have been discussed in detail. Phelps and Handfield Jones (1952) argued that in the 1890s a fall in British productivity occurred which opened a debate about the "climacteric" conditions of the British economy, see among others Saville (1961) and Aldcroft and Richardson (1969). McCloskey (1970) challenged this argument supporting the notion that the export of British capital was not harmful to British economic growth. This argument, respectively, has been questioned by Kennedy (1974); Crafts (1979) and Pollard (1985) who raised issues of limited and insufficient demand, consumption and finally growth. Edelstein (1982) contradicted these approaches suggesting that foreign investments have yielded higher returns independently of the domestic investment conditions. His ground-breaking research, along with McCloskey (1970), Michie (1988) and Termin (1989) tackled many previous approaches following the rational approach of the optimal use of British funds. Furthermore, he computed the returns of various domestic and foreign returns introducing the basic portfolio theory in history.

As explained in Chapter 1, Markowitz (1952) offered the first explanation based on a mathematical framework (mean-variance model) for what is known today as *modern portfolio theory*. The most studies since then in financial history (Obsfeld & Taylor, 2003; Goetzmann & Ukov, 2006; Chambers & Esteves, 2014; Merli et al., 2019 for France) used this approach extensively. According to the MPT, each investor uses a portfolio which can maximize its return given its risk, see Chapter 1. The dominant approach, the CAPM, assumes that the market clears, and any asset price reflects all the available information.

For the portfolio selection, the next step was the development of the CAPM model which formalises the relationship between risk and return (see Markowitz, 1952; Sharpe, 1964; Lintner,1965 for the CAPM model; Fama, 1970 for the *efficient market hypothesis* [EMH]). According to this theory, asset prices reflect all information; thus, past information cannot predict future prices. Only new information can change prices.

This theory met the economic theories for rationality and efficiency concluding for the economic/financial historians that rational investors preferred the global markets due to financial gains for the pre-WWI period. Goetzman and Ukov (2006, p.297) argued that "diversification played an important role in the decision of British investors to allocate a significant fraction of their portfolio to overseas securities". Chabot and Kurz (2010, p. 1078) argued again that "the real benefit of international investing was the diversification benefit of holding foreign assets that had a low correlation with their domestic counterparts". Rutterford

and Sotiropoulos (2016, p. 942) corroborated these approaches arguing for the "financial technology of dealing with risk in an internationalised economic environment".

Of course, these theories did not go unchallenged. Alternative theories emerged which used behavioural approaches (Benartzi & Thaler, 1995); arbitrage pricing (Ross, 1976); or a combination of these two as the three-factor model by Fama and French (1995). Despite the new approaches and the techniques which have been used, all these models accept the core of the financial analysis, mainly adding on this. These debates are present also in economic history. Despite the exegesis of Edelstein (1982), newer studies raise again the issue of the foreign bias. Edlinger et al. (2013) argued for a British Bias towards the New World. Williamson and O'Rourke (1999) re-established these debates adding new causes for these augmented international capital flows such as demography, growth rates and the frontier thesis.

No matter if the conventional theory of MPT and EMH, extended or not, is correct, it cannot answer to the main research question about the ITCs' asset management strategies. Lack of data also hampers this task. However, a framework closer to the one developed by Wiliamson and O'Rourke (1999) seems more logical, meaning that issue is more multifactorial. In this research, much of these factors will be used.

As the last research question set, financial investors do not live in a social vacuum. This thesis understands ITCs as a part of the general economic base in which numerous actors interact. For this reason, it adds information like, first, certain economic determinants, (economic growth rate); furthermore, demographic data will be used to test for possible causes for sending capitals abroad. Additionally, the theory of Obstfeld and Taylor (2003) and Schularick (2006) for the capital flow pattern from the Old to the new World will be tested for the post-WWI period.

Finally, historical evidence from that period will be extensively used. These articles come, mainly, from either ITCs' annual meeting reports or other articles from financial advisors. Through these articles, the correspondents expressed their opinions and described their experiences regarding the conditions (financial, economic, and social) of the receiving countries for British investments, focusing on the regions with high ITCs investments. Moreover, there are discussions about the management policies which have been followed by the ITCs directors and their attitude toward potential changes in various sectors of the economy, the state, and society. Due to the lack of direct archives which could help to examine asset

management,[17] this is valuable information for indirect information for their strategies. Through this process, the general atmosphere of that period can be encapsulated, which can be used as an explanation for the decision-making of the ITCs directors.

Until now this thesis has presented the economic and social conditions of the UK since the Industrial Revolution. The UK was an advanced economy with a stable but decreasing growth rate and unequal income distribution but with a gradual development of various social indices. Entrepreneurship gradually shifted from small labour-intensive and family-owned companies which were mainly self-financed to larger plants using professional management and financial support from the capital markets. Financial innovations and the Gold Standard transformed the LSE into the dominant capital market of the world. In the meantime, traditional investments either offered lean returns (Consols, land) or faced a transition period (industry). The rapid technological progress, the concentration and centralization of capital and the huge inequalities remoulded capitalism. Thus, investors have focused on foreign investments exporting their capital.

A huge literature has been developed explaining this tendency and searching for the main causes that led British funds abroad. Although this thesis raises different research questions, the high exposure of ITCs portfolios abroad is undoubtedly related to these debates. The existing literature uses mainly the EMH to explain these capital flows. However, there are also different approaches that answer the question extending the framework of this analysis. This thesis addresses the gap in literature in favour of the MPT to explain the international capital flows using also demographic, economic and institutional factors. It believes that all this information can grasp better the environment ITCs were established and evolved.

To synopsize, the ITCs' roots can be sought in the economic, legal and financial foundations of British society with which they were inextricably interwoven. They developed in an advanced economy that had already accumulated a significant amount of capital, taking full advantage of a government which barely intervened in the economy but notably participated in the institutions which were crucial for the stabilization and stimulation of the market. Additionally, they favoured: the mature capital market, the companies' limited liability status, the dominant position of the LSE, a steady monetary policy, and under the auspices of the Gold Standard, the ITCs consolidated as an innovative financial institution. Which is the existing literature for the ITCS? What characteristics have been highlighted? Who was interested in

[17] See Chapter 3 for the financial accounting problems.

them, financial analysts, academics or investors? The next section presents the literature on the ITCs which depicts the general pattern of the research heretofore, before moving on to this analysis.

2.5 ITCs bibliography

The existing literature about ITCs is classified chronologically into three categories. The first one is the literature developed during the late 19th and early 20th century in parallel with the development of the institution of the ITCs. This process reveals the gaps in the existing literature; these gaps are addressed in the rest of the thesis.

Cassis (1990) argued that the first ITC was the *Société Générale des Pays Bas pour favoriser l'industrie Nationale*, founded in 1822 in Brussels, later known as *Société Générale de Belgique* following the financial innovations and the general maturity of capitalism in the Low Countries and the UK, see Carlos and Neal (2011), see also the case of *Mutualité Industrielle* in Belgium in 1836 (Annaert & Verdikt 2020). Since the late 19th-century diversification has been promoted as a risk reduction procedure (Rutterford et al., 2021). Financial advisors in the City, such as the *Chadwicks'* and the *Beatons'*, have directly argued for the advantages which were offered by "a careful selection from the various media of investment", namely, the risk reduction and the return maximation., (see Chadwicks' Investment Circular, 1870, pp. 30-31; Beeton, 1870). Lowenfeld (1909) was one main reference of the early 20th century who is usually discussed in the modern works, e.g., in Goetzmann and Ukhov (2006) or Mitchell et al. (2011). Lowenfeld (1909), as an investors' advisor split the world into various regions which could strengthen the potential investor's security, offer a "systematic method of averaging risks" (p. 88), introducing a first geographical distribution. *Now the existing literature of the ITCs*

2.5.1 Pre-war literature

The literature of the first quarter of the 20th century is composed mainly of two sources; the first was mainly American books/pamphlets written by expert executives who endeavoured to detect the *modus operandi* of the British ITCs reproducing them for the American financial market. The second one, comprises British financial advisors, professionals who wrote books mainly to elucidate the new scientific methods of investments. To put it in other words, academia was absent from this issue, so the scope, style and questions asked were completely different.

Diversification and professional management are two key words for the evolution of this institution. This thesis is based on these two notions. Diversification in finance is a proper capital allocation which minimizes risks coming from the exposure in one particular asset. The proverb "Don't put all your eggs in one basket" can be seen as a naïve explanation of diversification. All the main theories in modern finance are based on this notion.

Professional management is a way to administer an organization. Historically, enterprises had been conducted by their owners. However, the need to separate management and ownership gradually arose (see subsection 2.2.3). Management became a profession. Institutional investors had very early discovered the importance of these professorial bodies that could guide their companies. This thesis uses the notion of professional management interchangeably with scientific and or sophisticated management.

Now this thesis presents these two notions as understood by the first studies of the ITCs.

“The ITC is an organization issuing its own long-term debentures against dependable securities of governments, public utilities, mining, agricultural, shipping, banking, commercial and industrial establishments domestic or foreign” (Thiesing, 1921, p. 3). This was a broad definition for the British ITCs during the examining period. A more comprehensive interpretation can be encompassed in “For what is an ITC except a means of cooperative investment whereby many participants may enjoy the advantages of careful selection and wide distribution of risks?” (Robinson, 1930, p. 282). In this definition, the main characteristics of the ITCs are revealed. So, ITCs were companies that attracted savings by issuing their assets which a professional management team then invested collectively in a diversified portfolio offering finally high yields. So, the main characteristics of the ITCs gathered from the literature are a) diversification and b) professional management. Here, more questions arise but they either originate from, or are interwoven to, these notions. E.g., the discussion about the existence of a reserve account which is a central point highly correlates with the management strategy which has been built.

These characteristics lead to the main scope of the ITCs which was according to the ITCs themselves: “Our company looks in the first place to the security of its investments; in the second place, to yield; and, in the third place only, to possible capital appreciation, and we trust that this conservative policy meets with your approval” (Sterling Trust Annual meeting 1920). This statement includes three main points. The first point is security, the second most important

factor is to achieve the highest possible yield. As for the third element, it is capital appreciation. These elements will be analysed below.

Parkinson (1932), a financial journalist, later the editor of the Financial Times, introduced the notion of *scientific investment* in his self-titled book in which he devotes one chapter for the ITC which is described as an institution that was based on scientific and innovative investment techniques and management. In this chapter he presented ITCs as a solution for the small private individual investor who "according to a certain advanced school of thought…will be slowly but relentlessly compelled to relinquish his initiative in the business of practical investment" (Parkinson, 1932, p. 180). The solution to this judgment was "the building society, the insurance company and the investment trust all claim to secure a high degree of safety of capital for the investor by the 'spreading' of risks" (181). However, he continued adding an extra element concerning the ITCs. While in the case of a building society the main investments are spread in one sector, real estate, and in the case of the insurance company mainly to mortgages, loans and fixed-term issues, an ITCs "goes farther afield and spreads its investments risks among both fixed interest and variable dividend securities in varying proportions" (Parkinson 1932). So, Parkinson described this institution as combining all the advantages which are contained in the other institutional investments.

The second crucial point for an ITC apart from the diversification process was its professional management. By this, he meant that "the composition and modification of the security portfolio of a 'management trust' are left, within wide limits to the discretion of the directors and managers" (181). A summary of crises episodes such as the Baring crisis in the 1890s' and the Great Depression which followed the crash of 1929 have been referred to as indicative of the ITCs' stability, the proof of prudent management and the confidence of their investors, the majority of whom despite the precipitous decline of the securities' market value "refused to part with them, and their market value remained well above zero during the worst phases of both crises" (182). Here there is a strong argument for both the confidence and the successful financial performance of the ITCs during that period in which despite the severe economic crises no bank run episode occurred, nor any other result of panic for the ITCs.

"Experience suggests that the faith of investors in the recuperative powers of the majority of British ITCs, under skilful and conscientious management, has not been misplaced" (Parkinson, 1932). Despite the author highlighting the importance of the investors' faith in the ITCs management, this does not mean that all the attempts of risk reduction were successful. He wondered "why should it be less dangerous to hand over one's resources to a board of

directors to employ as they will than to entrust these directors with capital to be used in a definite way, with specified safeguards after they have made out a *prima facie* case for its employment in a given industry?" (183). This question arises for two reasons; first, to pinpoint the differences with the "fixed" trusts which had been developed mainly in the USA during the 1920s (see Rutterford, 2009) and second to depict the main reasons for this preference: the distribution of their assets and the existence of a reserve account. The last had mainly two sources, one was the undervalued dividends compared to the total earnings and the second was the ITCs' practice of buying for revenue purposes only.

Sturgis (1924), an American expert, in his book referred to the professionalization of the investments' industry. In this procedure, he incorporated the ITCs. Initially he examined thoroughly the-then new scientific method used on investments such as the selection techniques for the most suitable sectors and proper asset allocation. However, "it will be said that such a scientific method of investing as has been outlined in previous chapters is impossible to the small investor who has not enough time or information required to invest in such a manner" (Sturgis, 1924, p. 167). The solution to this was the establishment of the ITC. The author reminds us that this innovation with British roots which could be used, for him, as a paradigm for the USA too, "our English cousins, who have much to teach us in finance…have found a way to meet the problems of the small investor…who would like to have his money handled in the most scientific manner by men trained in security analysis and the investment of money. This is the use of the ITC" (Sturgis, 1924). The author in this sentence summarizes the two main notions of the ITCs, namely, the scientific management, and the role of the small investor. And he continued: "the funds so raised are then invested under the guidance of a staff of experts in the most careful and scientific manner possible".

Furthermore, he analysed the way the ITCs operate through their managers who "buy stocks or bonds in any part of the world after a most careful investigation…They expect to make a business profit in their investments as well as to receive an income" (168). In the end, "the real reason to invest in the securities of an ITC is not only the security thereby obtained, but the prospect of gradually increasing return" (Sturgis, 1924). So, he delineates the two main characteristics of the ITCs, namely safety and a high return. And what exactly was the work of these "experts"?

> "Such a staff will probably contain one man thoroughly familiar with railroad securities, another with public utilities, still another who knows industrial securities. The staff can be rounded out with one bond expert and perhaps one familiar with commercial paper.

> These men would be the ones who would analyse and report on the companies whose securities had been suggested for purchase; they would originate the proposals as to the stocks or bonds to be bought. The final decision would be in the hands of a board of trustees carefully chosen because of their records and financial abilities, men whose names carried exceptional weight" (Sturgis, 1924, p. 169).

Here, he pinpointed the two stages of professional management, the first involving executives who searched and organized future financial investments and the second the trustees who took the final decisions. Both bodies were composed of very experienced professionals and no selection was made by chance. Additionally, each company had experts, each of whom specialized in the main sectors and asset types of their portfolios. These skilful staff worked to promote diversification alongside the companies' regulations which prohibited excessive investments in a unique company or territory (with exceptions such as the USA).

Finally, the main reason for the selection of the diversification policy as a norm for the ITCs was that "it is rare that all parts of the world are at one time in a depression" (170). Again, he touched on a very core issue, the limits which any prudent investor could reach. Diversification seems to beat any challenge, but one, namely the general economic crisis.

Theising, another American government official delineated the ITCs as a channel for American finance to invest abroad. He pinpointed the basic pillar of the ITCs namely, *diversification*:

> "The fundamental principle of the ITC is the distribution of risk by the investment of funds in the securities and bonds of a great number of enterprises, investments in any one security usually being limited to a fraction of capital, say, 10%. Such distribution of risk seems to be one of the most practical forms yet devised of affording the investor a secure channel for profitable investment" (Thiesing, 1921, p. 3).

The advantages of an ITC were the careful selection among various investments using skilful management and a small technical and clerical staff restraining, finally, its costs. Thiesing (1921) referred to the case of speculation because of the significant role of the directors. However, the restrictions on excessive investment in one asset or the issuing of debentures up to the threshold of the issued shares of the company, offered a safety net in these practices.

The USA Trade Commissioner Leland R. Robinson intensively studied the case of the British ITCs reporting the main results to the American Department of Commerce contributing to the then serious American attempt to provide high credits to the world economy. In his report, he listed ITCs as companies that: a) raised capital by issuing ordinary, preferred stock and selling

debentures, b) investing their collected funds in a wide variety of offerings, distributing risk over many industries, countries or types of issue, and c) they appealed to the cautious "middle-class" investor by offering both proprietary and creditor stock of reasonable denomination, and by protecting his interests, whether he held shares or bonds, through conservative management of the capital account (Robinson, 1923, p. 2). Here, apart from the classical recognitions of an ITC, viz., the diversification process and the prudent management he introduced a very interesting element, concerning to who the ITCs policies targeted. It is very important to understand that the principal investor of the ITC was not the typical magnate of British society, but rather a very important and sensitive part of every society the "middle class".

Another issue which he discussed was the size of these companies. Because of their small size, they could invest in only a few experienced directory bodies economizing their costs and achieving better observation of the various securities and offering better and more accurate information to the stockholders of the ITCs. Again, the diversification process was written into the articles of the ITCs prohibiting investment in a specific asset with amounts greater than 5 percent of the paid-up capital. "The investment portfolio of the majority of trusts is truly cosmopolitan" (Robinson, 1923, p. 7). The way the ITCs used to raise capital was through three principal kinds of assets, ordinary, preferred shares, and debentures. What were the main earnings of the ITCs? They came mainly from a) the return on their interest and dividend-bearing securities, b) any fees for trustee, secretarial and registration services, c) underwriting fees and d) profits from selling off their holdings.

An extra advantage of the ITCs was the fact that any participant could raise their capital regardless of the size of her holdings (Robinson, 1930, p. 282). "British ITCs during the entire period of their existence have served mainly as a means of investment diversification among foreign securities" (290). Robinson was an executive whose work vividly portrayed the British ITCs scope, operation, and characteristics. He was renowned among British investors. Characteristically, the Economist spent an article about the then book launch of the author emphasizing the most crucial points of this institution (The Economist, 1926).

2.5.2 Post war literature

The second category in the literature about ITCs historical evolution covers the post-WWII period. The seminal work of Burton and Corner (1968) encapsulated the history, structure, management and characteristics of the ITCs comparing the two main paradigms, the British and the US. They offered an extra definition: "The essence of the investment trust concept is

that the savings of a large number of individuals are collectively invested in a portfolio of marketable securities with the object of obtaining a safety of capital and dividend incomes, normally available only to the very rich investor" (Burton & Corner, 1968, pp. 2-3).

As for the main objectives of these companies, they emphasized the diversification process and the management techniques. Again, they pinpointed the difference of the ITCs to other financial schemas (holding companies etc.) in that they were not focused on rapid profit coming mainly from capital gains but on the income which could be produced by the existing holdings, a description of the buy-and-hold technique. This technique can be found also in the previous discussion about the scope of the ITCs where the Sterling Trust classified capital appreciation gains only in the last place behind security and dividend policies which were thought to be more significant.

The first increasing tendency of this type of financial company occurred in the period before the Baring crisis. Here, the main characteristics of the ITCs were established viz., their performance under the limited liability scheme and the Companies Acts of 1862/1867, their portfolio diversification and the regular capital depreciation through undistributed profits. The next revival of the ITCs occurred after the Baring crisis. Later in the post-WWI period, a wave of new companies flooded the British market increasing their number and capital by more than double. Burton and Corner (1968) also described the ITCs financial contribution during WWI in the attempt of the British government to use their dollar-based holdings. WWI did not have an extremely negative financial imprint on the ITCs which only experienced spontaneous losses and dividend earnings.

Cassis (1990) studied the origins, importance and diversification policies of the British ITCs. He re-examined their geographical, regional distribution, asset allocation and directorships. Finally, he raised questions about the success of this institution (Cassis, 1990, p. 154). Chamber and Esteves (2014) focused their study on the financial evolution of the oldest British ITC, the Foreign and Colonial Investment Trust up to 1914. In this work a discussion arose about this first globalization era, delineating the geographical and sectoral allocation of this ITC. A new characteristic in this work was the detailed research based on the portfolios of this ITC which are used to build their dataset. A complete portfolio diversification emerged. Additionally, they discovered a buy-and-hold practice that has been followed by the managers of this ITC, in terms of a focus on the long-term changes of the prices of the various holdings and thus using a low turnover policy. Finally, they concluded with a better risk and return trade-off. In this period more studies refer to the establishment and historical evolution of the ITCs. Hutson

(2005) examined the early feature of the British ITCs. Apart from them, more projects are focusing on the portfolio selections of other institutional investments, such as the insurance companies, (see Scott 2002; Barker & Collins, 2003). Despite the discussions about the financial benefits the ITCs have gained by diversifying their portfolios, few studies have analysed their strategies in depth. This gap has mainly been bridged by the work of Rutterford and Sotiropoulos.[18]

This marks the third, and final, stage of the existing literature about the historical evolution, performance, and strategies of the ITCs. First, Rutterford (2009) discussed the differences between the British and the USA ITCs and the different performances they had during the 1929 crisis. The high security and the more passive management policies of the British ITCs helped them to surpass the crisis with limited losses compared to the American ITCs catastrophe. Furthermore, Rutterford et al. (2011) investigated the rising share of the participation of the British small investors in the stock market up to 1935, see also the analysis of Rutterford and Sotiropoulos (2017) for the rise of the small investor in the UK and the USA up to 1970. In the meantime, the notion of the diversification process in the pre-Markowitz era is re-examined, see Rutterford and Sotiropoulos (2016a) and Sotiropoulos and Rutterford (2019), concluding that the notion of global diversification was already known to the UK investors of the late 19th century who took full advantage of the benefits of diversification in a simple way (Rutterford and Sotiropoulos 2016b).

Eventually, Sotiropoulos *et al.* (2020) incorporated all the previous studies on a solid basis scrutinizing the management policies of the British ITCs in the pre-WWI era. Their main findings concern professional asset management which has been used in their case combining the buy-and-hold strategy with active management. Furthermore, they argued that the ITCs had presented totally diversified portfolios, investing extensively in the Americas and the UK. Each ITC followed mainly its managerial policy, which was basically stable enough for the whole period, with a limited turnover, and focused on its sample in which overseas investments dominated. Moreover, they were reluctant to invest in European and colonial holdings; they preferred mainly investing in sectors such as the railways, utilities and industrial assets. This strategy, finally, was successful compared to the rest of the financial sector.

[18] These names are mentioned without chronological reference. There is a corpus of research which has been produced the last septennium. This dissertation, although an autonomous and distinct study, it has been inspired by their research, as the reader will find.

Now, what is the difference between active and passive management? Both refer to investment strategies, the principles each investor uses to achieve her goals. Two main strategies are used: passive and active. Passive management maximises returns through the minimise of stock transactions. The investor does not expect to profit from short-term price fluctuations and capital gains. She buys a holding which she then holds, gradually building her wealth. Active management on the contrary, is a strategy in which the investor trades frequently, exploiting every financial opportunity.

As Rutterford and Sotiropoulos (2016) argued since the late 19th century there has been a discussion in the UK about spreading risk across several securities. However, there was not just one way this diversification took place. Chronologically, first came the naïve diversification, in which the investor was "adding as many risky securities as required to generate the targeted yield" (Rutterford & Sotiropoulos, 2016, p. 931).[19] This is more interpreted as passive management.

Financial advisors have gradually developed more sophisticated techniques. "After the turn of the century, diversification recommendations by UK financial analysts took a more sophisticated approach to advising investors of how to achieve a targeted return while reducing overall portfolio risk" (922). This sophisticated top-down approach "targeting a particular level of yield and reducing capital risk through the choice of relatively uncorrelated securities" (931). An advanced edition of this tactic has been practically used throughout the following period up to WWI, see Sotiropoulos *et al*. (2020). These two strategies are discussed throughout this dissertation. Creating a new dataset reveals information to test both the validity of these strategies and their evolution over time.

So, this subsection outlined the main literature for the ITCs. Since the late 19th century, their financial innovations have been discussed in the financial circles of London, mainly the advantages they offered to the middle-income savers and the promising yields of this institution. Their scope was to protect their investors savings and to provide them with high yields focused mainly on significant dividends and less on capital gains. To do this, they based on the diversification process and professional management. This strategy was embedded in the general investments' professionalisation tendency of that period. The American financial advisors very soon understood the importance of this institution and the advantages it offered; hence they started an in-depth analysis of the ITCs characteristics, proposing the transfer of

[19] See also Chapter 1 for the notions of naïve and sophisticated management.

this institution to their country. After WWII, mainly through the research of Burton and Corner (1968) the interest in the ITCs revived, mainly on the side of academics. New studies have focused on the ITCs diversification process applying the modern technique of MPT. Initially, the research focused on a macro level analysis, see Edelstein (1982); gradually, first in one case study and later in a bigger sample, researchers have moved more to the micro level. Sotiropoulos *et al.* (2020) used extensively ITCs' portfolio lists to study their management strategies during the pre-WWI period.

This literature of course sets the basic frameworks of the ITCs asset management. All the studies confirm the strong diversification that the British ITCs followed. They also agreed that the implementation of this process has been achieved through professional management. Chamber and Esteves (2014) move on studying the asset management strategies for Foreign and Colonial Investment Trust using a dataset like what this thesis will build. This approach followed by Sotiropoulos *et al.* (2014) who build a dataset of a sample of ITCs completing the pre-WWI era. However, even these studies do not cover the following: first, they do not discuss the post-WWI period. This thesis analyses the chaotic differences between the pre- and the post-war period. Did these changes affect the ITCs asset management? Although the basic tool this thesis follows is the same with the previous ones, the build of a dataset that contain a sample of portfolios, differences arise. The sector was a profitable one meaning that the sample is growing; additionally, the portfolios changed significantly.

And so, the second main gap in literature appears. Because ITCs changed their portfolios the main indices which are used, viz., the geographical and sectoral allocation changed too. Despite the existence of sources which confirm these changes, Burton and Corner (1968) it is not clear that this led to a different strategy.

All major indices changed significantly. Asset allocation, although it kept its security through the fixed-income assets it shifted towards equity as long-term investments. Additionally, WWI and the direct state regulation forced ITCs to deviate from their main rule, namely diversification. This episode has not been discussed in the existing literature. Thus, this thesis examines this divergence testing its length of time and the ITCs' gradual recovery. Apart from this, ITCs withdrew traditional investments (US Railways) facing the question of replacement. Their answer was the choice of new areas (Europe). New questions arise. Do these movements mean a deviation from security? How had they managed to cover uncertainty? This still remains untouched by the existing literature.

A different question which arises is the following. The existing literature exclusively uses portfolios to study the ITCs strategies. Unequivocally, this offers valuable information- which is why this thesis insists on it too, however, can it extract more information using multiple sources? A second source could be used to validate the final results. Thus, a combined method is used in this thesis. Except the main dataset, sources such as archives from periodicals and financial newspapers are used; thus, this thesis follows a combination of quantitative with qualitative methods which not only verify the results but also access trustworthiness to the dataset (Kipping et al. 2014).

Finally, there is a gap in the existing literature about the interaction of ITCs with society. As the EMH describes, see section 2.4, the market incorporates all the existing information through the price mechanism. However, this approach leaves out a lot of information. Economic, financial and social conditions were completely different after WWI. Thus, ITCs had to be adapted to these new "institutions" - e.g., global financial markets were bounded, affected by monetary and fiscal surprises and the existence of new political regimes changed the rules of the game; ITCs had to accept this new reality. This dissertation is an effort to address this deficit, framing the environment inside which ITCs strategies were evolved and arguing that societies are the main driving forces influencing the moves and the strategies of the financial actors, such as the ITCs.

Last, portfolio selection history of the institutional investors (including the ITCs) and the history of the international capital flows unequivocally share a common ground. Literature surveys the causes for the significant capital flows, during the pre-WWI period. Economic historians offer broader frameworks for their explanations (O'Rourke & Williamson, 1999). However, all these theories collapse for the next period. Existing literature examines the causes for this change and the consequences it had on financial development (Rajan & Zingales, 2003). This thesis intervenes in this dialogue discussing the role of ITCs on this rapid paradigm shift. The adaptation of the ITCs to the new rules of the game is more than important for their profitability. They seem to pass the test of WWI and what followed during the 1920s. They continued to invest abroad by diversifying and remaining at the forefront of financial innovation.

2.6 Conclusion

This Chapter discusses the literature review of the dissertation. First, it studies he economic and social history of Britain from the Industrial Revolution (mid-19th century) to the interwar

period. It is argued that the historical and economic evolution of an economy is a prerequisite for any study in financial or business history. England in the mid-19th century was the workshop of the world, achieving high economic standards in GDP terms. Its economic growth rate has gradually decreased, although it has remained an advanced economy. Rival economies such as the USA and Germany have steadily converged with Britain, achieving higher productivity performances. Despite its flourishing economy, Britain had huge economic inequalities which were evidenced by the low labour wages and an insufficient welfare state. The welfare of the labour class has been improved, although with a delay of a century or more.

In the meantime, financial capital has been modified, reacting to the shocks it suffered. Despite the innovations, its role in financing the British economy remains controversial. British companies were initially family-owned, mainly labour intensive, and the limited capital credits which were necessary were collected by local networks, or the family of the owners; thus, the role of the financial system remained limited.

For a capital market to flourish, it needs to be based on specific prerequisites. In the British case, one can argue about the existence of two great pillars which supported the emergence and which fostered this capital market: first the legal institution of the right to *interest* and second, the establishment of the *limited liability* company. Both created the necessary conditions for the establishment of the joint-stock company and the institution of the trust, cheapening and promoting the participation of broader parts of the population.

In the aftermath of the Industrial Revolution, during the 19th century, there were observed augmented savings in the British economy. Traditionally, savings had been invested in land, the prestigious remnant of the feudal society, and in governmental bonds, the consols. In the mid-19th century, a new investment opportunity appeared, namely, railways. However, firmly, yields began to decrease. So, a question arose, how could an investor exchange these underperforming investments with those with higher yields?

A reaction to this condition was the rising export of British capital. The City of London had been transformed into the leading financial centre of the world in the 19th century, with a cosmopolitan character exporting significant amounts of capital to the international markets. This provoked debates about the causes of this movement and its impact on the growth of the British economy. The ITCs actively participated in this procedure taking full advantage of the various financial opportunities.

The second part of the literature review frames the main literature regarding the establishment, main characteristics, and the historical evolution of the ITCs until nowadays. It classifies the existing literature into three main parts. The first covers the pre-WWII one. Here, numerous mainly American, studies analysed the historical evolution and focused on the main advantages of this British institution integrating it into the then general endeavour of professionalising investments. The main discussions incorporated the characteristics of diversification and professional management, which could be transferred to the US financial market.

The second part included modern approaches to the emergence and evolution of the British ITCs. They focused on case-studies, pinpointing the diversification process working in the ITCs portfolio holdings, adding measures of the ITCs' financial performance. Finally, the works of Sotiropoulos and Rutterford have been presented concluding this review. In their studies they presented a new approach based on the novelty of the micro analysis of the ITCs' portfolios to examine the decision-making procedure concluding with a combination of management policies and globally diversified portfolios which offered higher returns compared to other financial institutions. The last part discusses the gaps in existing literature that are covered in this thesis. The next Chapter analyses the data collection process, and it builds the dataset, the main tool of this dissertation.

3 Data Collection

3.1 Introduction

This Chapter analyses the data collection procedure and the creation of the final sample which comprises the ITCs' portfolio lists. Following Sotiropoulos *et al.* (2020), it constructs a sample, collecting data related to British ITCs portfolio lists which are contained in their annual reports. This process concludes in a dataset for the period 1914-1928, this is the main tool it uses to answer the basic research question which is the study of the ITCs management strategy in the period 1914-1928.

As Chapter 1 mentions, the collection of the database is a contribution. Although it does not offer qualitatively new data from the existing ones, it provides new evidence in financial and business history and specifically in investor portfolio selection. Its methodological innovations are: first, the extension of the period it offers beyond the critical point of 1914 which reveals for first time with this form; and second, its scale which is bigger than the existing one (it includes more companies) offering a better picture for the ITCs portfolios. Mainly, it offers new information for a period in which the dominant financial paradigm changes completely and a new world reveal. The evolution of the British ITCs portfolio selection as it appears through the various regions, sectors and asset types of their holdings (these are the variables this sample offers) are the main factors to test the diversification hypothesis. So, this dataset improves the existing knowledge for the importance of diversification in asset management under adverse conditions. Finally, it is built at the micro level, a new way of studying economic history as opposed to the macro level that has been widely used. This thesis claims to be a first attempt towards this direction. Further research is needed to fill this gap and to fully exploit this dataset.

Initially this Chapter presents the problems which emerge during the creation process of this dataset. First, which companies can be identified as ITCs? It starts from a broader holding companies base. Precluding all the companies which do not meet the criteria being an ITC, it deals with the issue of portfolios' lists publication. Not all ITCs issue a published portfolio; this problem has been solved using the Guildhall Library's archives, which include the annual reports of the ITCs. So, in this Library one can find the annual reports of the ITCs for the period under study offering information about their portfolios. Using sources from that period that contain a full catalogue of the existing ITCs (Glasgow, 1935), and juxtaposing some main

financial variables, this sample is presented. Following this, it checks for any possible bias manipulating the necessary statistical method reaching in the end a representative sample. Apart from this, it faces the "valuation problem". How did the ITCs value their holdings? Did they use their nominal or market values? The way the ITCs had valued their assets was far from clear. A complicated system of book values, time lags in the market value changes' passage in their portfolios' lists, and the existence of reserve accounts was presented. It chooses the nominal values which were provided by their portfolio lists and which offered trustworthy information about the ITCs' portfolio strategies.

After collecting portfolios, this Chapter extracts the necessary information to build the data base. Using the existing details and separating the offered information into several basic variables, this will be the basis for the further analysis in the next Chapters. These variables are mainly: a) the asset allocation, b) geographical and c) sectoral allocation of these portfolios, d) values and currencies of these holdings. The latter are classified into fixed interest holdings (debentures/ bonds) and shares (ordinary and preferred). Furthermore, it creates variables for the main destinations (geographical and sectoral) of their investments. Additionally, it exhibits the values of the ITCs' investments transformed in Great British Pounds. Finally, it concludes.

3.2 The Identification and Representation Process of the ITCs' portfolios

In the pre-WWI period, the definition of *Investment Trusts* was extremely vague, comprising a very broad range of holding companies. So, which of these could be determined to be an ITC? Robinson (1930) discussed this misconception.

> "I refer to the fact that holding companies in the public utility, bank, railroad, and other fields, that finance companies engaged in development or reconstruction usually of small or closely held businesses, and that trading companies plying their energies toward quick market profits regardless of accepted principles of investment or diversification have been all too frequently lumped together as 'investment trusts,' while at the same time this otherwise 'indiscriminate and all-devouring orifice' of a term is not made to cover the uniform trust and incorporated funds now being established by leading banks and trust companies purely for the purpose of performing the true investment trust functions" (Robinson, 1930, pp. 277-278).

Here, he classified three main types of holding companies which were a) holding and operating companies investing mainly in a specific market sector (e.g., minerals, rubber, railways,

utilities); b) finance companies with a wider range of interest but focusing mainly on quick turnover and high commitments and, c) ITCs. He argued that:

> "By the late eighties there could be distinguished in London and Edinburgh (1) holding and operating companies of the kind which proved so active during the half-century preceding the war, in developing such economic re- sources of the Dominions and foreign countries as tea, tin, and other mineral products, rubber, and wool, in building railroads, fostering public utilities, and promoting shipping; (2) finance companies which frequently had a wider range of interest than a holding company controlling, let us say, tea or rubber plantations, but which made no attempt to diversify risk in an adequate investment trust fashion, and strove after promoting and financing profits, acted as traders or dealers, expected quick turnover, and took large commitments in unseasoned undertakings; and (3) investment trusts which in turn differed among themselves, as earlier stated" (Robinson 1930, p. 288).

Rutterford (2009, pp. 162-164) describes this first classification of the various types of trusts presenting the historical evolution and the gradual clearance of the market especially after crises episodes, such as the Baring crisis; finally, ITCs have learnt from their mistakes concluding to the form this thesis examines.

The main identification is that: "… investment trusts should aim merely at the safety which arises from careful selection, wide distribution, and continuous supervision; and the returns to be had from overseas securities bought partly with low-cost capital" (Robinson 1930, p. 289); viz., the characteristics which frame the ITCs' identity, see Chapter 2. Glasgow's argument accorded well with the one of Robinson, adding an extra criterion, the exclusion of capital gains from revenues.

> "A pure ITC is a company which invests funds collectively subscribed, which aims primarily at capital security and at a regular and progressive yield on the capital, and which regards as profit only dividends or interest actually received from investments during the accounting period. The difference between an ITC and a finance company is that an ITC is allowed by its articles of association to include only dividends …" (Glasgow, 1935, p. xix)

He presented a complete list of English and Scottish ITCs; so, Glasgow (1935) is the main source for information for the ITCs. Their names, incorporation date, and origin (English or Scottish) can be identified from his research. Moreover, valuable pieces of information about

their portfolio holdings, annual accounts, their basic principles, comparative analyses etc. emerge.

Identifying ITCs, a second question arises: how many of these published their reports? Corporate financial reporting is a great issue for accounting history and beyond. For the UK, the big debate in accounting history is the role of accounting in management of British enterprises. (Pollard, 1965; Edwards & Newell 1991). Accounting history shows that despite the consecutive Companies Acts during the late 19th – early 20th century, corporate disclosure remained unregulated. Up to 1929 companies were not required to publish reports such as profit and loss accounts or to specify the level of disclosure required in balance sheets (see Arnold, 1991; 1997).

This information complicates the whole process. Glasgow (1935) informs us that only 50 percent of the English ITCs offered information about their portfolios, whereas almost none of the Scottish ones released them. Characteristically, Glasgow posed the international character of the Scottish portfolio as the reason for their directors' aversion to publish their lists, which made it difficult to determine the geographical distribution of the various investments, while in the case of the asset allocation he argued that the ITCs paid little attention to it.

The main reason presented by the Scottish ITCs' representatives in support of their companies' policies on this issue was that: "The Boad has studied to distribute their investments over the principal traders and industries of the world and believe that they have succeeded in spreading the risks inseparable from investments" (cited in Glasgow, 1935, xlvi). Additionally, to dismiss possible fears it was supported that: "A large proportion of our investments is in companies domiciled in Great Britain". As Glasgow (1935, xxiv) argued, it was significant for a proprietor to know "where and how are the companies' funds invested?". A possible solution for the ITCs which refused to publish their lists was to offer this kind of information in their annual meetings. Again, this was not required until 1929. However, this process is present in the majority of the published annual meetings of ITCs; characteristically, the average ITCs' director discussed with the participants during the annual meeting the main changes of their investments and he expressed his thoughts and future perspectives, see among others the minutes of the *Foreign and Colonial, Guardian, London and South American* ITCs' annual meetings. The aversion to publishing reports can be explained for many reasons. The old system of unlimited liability in which ownership and management were not separated had no reasons to disclose internal information. In contrast, for large joint-stock companies with

separate management and ownership the publication of such information was of high importance.

Finally, Glasgow (1935) pinpointed that in normal times, it was not so important for an investor to have access to ITCs' portfolios. However, in abnormal times, this knowledge was of utmost importance because of its relation to potential forthcoming losses. As he continued after the 1929 crisis there was a tendency towards the disclosure of such information, see Glasgow (1935, xlvii).[20] It seems that there was agreement in the literature of the period about the ITCs' aversion publicizing their prospectuses. However, even this situation was much better than the rest of the economy. Arnold (1997) studied the financial disclosures in the UK for the period 1900-24 focusing on Industry. In his research he found that disclosure levels for profit and loses accounts and balance sheets did not exceed 20 percent. Of course, the comparison is not the same, but still, there is a clear tendency in favour of ITCs publicising their reports. A second finding from Arnold (1997) is that disclosure practices reflected to other conditions political, social etc. The examining period can be described as an abnormal one. Due to political upheaval companies were reluctant to provide more information – there was fear of taxation, inflation, other regulations etc. However, this seemed to have the opposite result for ITCs management, who had to publish their lists precisely because of the abnormal conditions. In the end, although the discussion for the level of disclosure is interesting, highlighting the environment of that period, this thesis focuses on a different type of report, the annual portfolio of the ITCs.

The Guildhall Library in London provides all the information about the ITCs; portfolios holdings which are incorporated in the company annual reports. Here, it must be clarified that this list contains all trusts that have already referred to (all the three aforesaid categories). Juxtaposing the ITCs names from Glasgow (1935) to their portfolio lists from the Guildhall Library, the information needed for the construction of this dataset are acquired. This method had already been used to build the ITCs portfolios database for the period 1886-1914 (Sotiropoulos *et al*. 2020). Now, this method has been extended to encompass the ITCs for the period 1914-1928.

In Chapter 1, this thesis discusses the time period which has been chosen as one of its contributions. Now it has to discuss the frequency of its data. As the ITCs published annual portfolio lists one could choose the annual depiction of her data. However, the years 1920,

[20] It was relevant also to the-then new Act law, see above.

1924 and 1928 have been chosen. The reason why not annual but quadrennial observations have been chosen is the following. Sotiropoulos et al. (2020), whose methodology is followed here, shows that ITCs had a low turnover rate for the previous period. This means that it is not necessary to collect information for each year because the results could not offer something completely different. Additionally, the years selected capture the most important events for the analysis of management strategies. First, 1914 is used form the previous work as the link to the pre-WWI portfolios. Then, 1920 as the first observation after WWI, which contains mainly observations for 1919, captures the change of war. Finally, two periods are selected, 1924 and 1928, which can give the information needed for this research. *Ex post*, it seems that the selection of this timeline worked properly. The question of the termination of this dissertation before 1929 which is the critical point of the interwar period is a question which is discussed in the limitations of this thesis, see last Chapter.

What did these reports look like? Figures 3.1 and 3.2, present indicatively two of the hard copy images of a portfolio list and a balance sheet of the *American Investment and General Trust Co* from 1920. The portfolio could provide, to any interested investor, the following details for every security: a) security name (its issuer), b) nominal value held, c) currency, d) security type, e) maturity, and f) yield (coupon or dividend).

Figure 3.1 A snapshot for the list of portfolio holdings of the American Investment and General Trust Co. in 1920

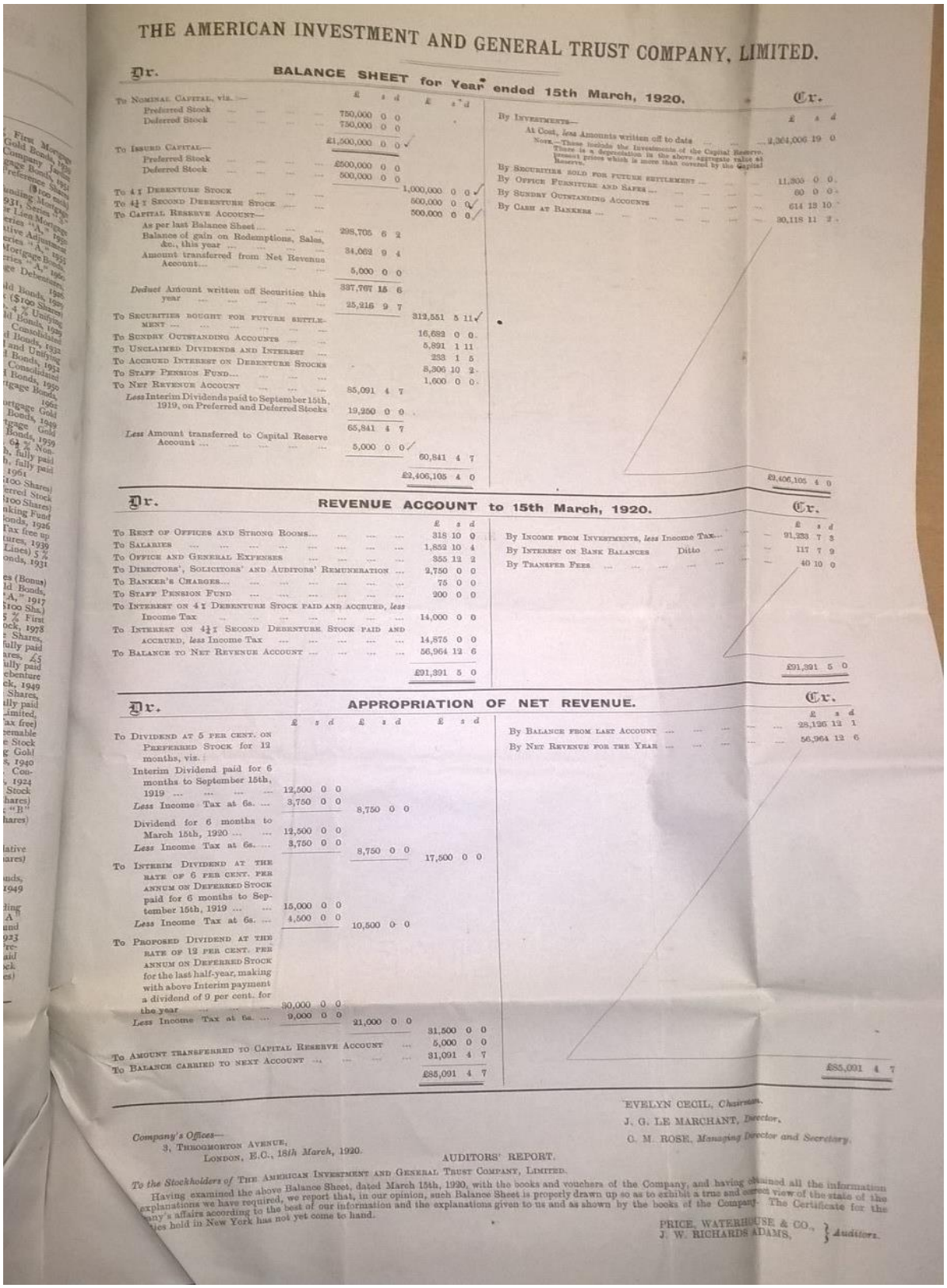
THE AMERICAN INVESTMENT & GENERAL TRUST COMPANY, LIMITED.

A List of the Investments held by the Company on March 15th, 1920,
Excepting those that have been written off.

Nominal Amount, or Number of Shares.	NAME OF SECURITY.	Nominal Amount, or Number of Shares.	NAME OF SECURITY.
$44,600	Advance Rumely Co. 6 % Preferred Stock ($100 Shares)	$21,500	Chicago, Milwaukee and St. Paul Railway Company Common Stock ($100 Shares)
$21,000	Do. Common Stock ($100 Shares)	$125,800	Chicago and North-Western Ry. Co. Common Stock ($100 Shares)
5,000 Shs.	Agricultural and General Engineers, Limited, 8 % Cumulative Preference Shares, £1 each, fully paid	$50,000	Chicago, Peoria and St. Louis Railway Company 4½ % Prior Lien Mortgage Gold Bonds, 1930
4,027 Shs.	Alabama Coal, Iron, Land and Colonization Company, Limited, Shares of 4s. each, fully paid	$100,000	Chicago, Rock Island and Pacific Railway Company 6 % Preferred Stock ($100 Shares)
$50,000	Alabama Great Southern R. R. Co. 6 % "A" Preferred Capital Stock ($50 Shares)	$8,000	Chicago & Western Indiana R. R. Company 6 % General Mortgage Gold Bonds, 1932
$25,000	Do. do. Ordinary Capital Stock ($50 Shs.)	£20,000	Chilian Government 4½ % Gold Loan, 1906
£20,000	Alabama, New Orleans, Texas & Pacific Junction Rys. Co., Ltd., 5 % "B" Debentures, 1940	£9,500	Chilian Northern Railway Company, Limited, 5 % First Mortgage Debentures, 1940
£4,200	Algoma Eastern Railway Co. 5 % First Mtge. Gold Bonds, 1961	£17,240	Chinese Engineering and Mining Company, Limited, 6 % First
£6,600	Algoma Steel Corporation, Limited, 5% First and Refunding Mortgage Sinking Fund Gold Bonds, 1962		Mortgage Debentures, Kailan Bonds, 1962
$15,000	American Cotton Oil Company 6 % Non-Cumulative Pref. Stock ($100 Shares)	£5,000	Chinese Imperial Government 5 % Loan of 1898
		£20,000	Do. 4½ % Loan of 1898
$100,000	American Smelting and Refining Company First Mortgage 5 % Gold Bonds, Series "A," 1947	$50,000	Cincinnati, Hamilton and Dayton R.R. Company 5 % General Mortgage Gold Bonds, 1942
£26,800	Anglo-Argentine Tramways Co., Limited, 5 % Debenture Stock	£20,000	City of Buenos Ayres 5 % Loan of 1914
£2,925	Anglo-Persian Oil Company, Limited, 5 % First Debenture Stock, 1960	$2,000	City Water Company of Shelbyville (Illinois) 5 % First Mortgage Prior Lien Gold Bonds, 1920
£5,000	Antofagasta (Chili) and Bolivia Railway Company, Limited, Deferred Ordinary Stock	$99,000	Colorado Fuel and Iron Company 5 % General Mortgage Sinking Fund Gold Bonds, 1943
		[illegible]	Colorado and Southern Railroad 4 % Non-Cumulative Second

Source: Guildhall Library, Stock Exchange Co. Annual Report

Figure 3.2 A typical balance sheet of an Investment Trust



THE AMERICAN INVESTMENT AND GENERAL TRUST COMPANY, LIMITED.

Dr. BALANCE SHEET for Year ended 15th March, 1920. Cr.

	£ s d	£ s d
To Nominal Capital, viz.—		
Preferred Stock	750,000 0 0	
Deferred Stock	750,000 0 0	
	£1,500,000 0 0	
To Issued Capital—		
Preferred Stock	£500,000 0 0	
Deferred Stock	500,000 0 0	
To 4 % Debenture Stock		1,000,000 0 0
To 4½ % Second Debenture Stock		500,000 0 0
To Capital Reserve Account—		500,000 0 0
As per last Balance Sheet	298,705 6 2	
Balance of gain on Redemptions, Sales, &c., this year	34,062 9 4	
Amount transferred from Net Revenue Account	5,000 0 0	
	337,767 15 6	
Deduct Amount written off Securities this year	25,216 9 7	
To Securities bought for future settlement		312,551 5 11
To Sundry Outstanding Accounts		16,682 0 0
To Unclaimed Dividends and Interest		5,891 1 11
To Accrued Interest on Debenture Stocks		233 1 5
To Staff Pension Fund		8,306 10 2
To Net Revenue Account		1,600 0 0
	85,091 4 7	
Less Interim Dividends paid to September 15th, 1919, on Preferred and Deferred Stocks	19,250 0 0	
	65,841 4 7	
Less Amount transferred to Capital Reserve Account	5,000 0 0	
		60,841 4 7
		£2,406,105 4 0

		£ s d
By Investments—		
At Cost, *less* Amounts written off to date		1,364,006 19 0
Note.—These include the Investments of the Capital Reserve. There is a depreciation in the above aggregate value at present prices which is more than covered by the Capital Reserve.		
By Securities sold for future settlement		11,305 0 0
By Office Furniture and Safes		80 0 0
By Sundry Outstanding Accounts		614 13 10
By Cash at Bankers		30,118 11 2
		£2,406,105 4 0

Dr. REVENUE ACCOUNT to 15th March, 1920. Cr.

	£ s d		£ s d
To Rent of Offices and Strong Rooms	318 10 0	By Income from Investments, *less* Income Tax	91,233 7 3
To Salaries	1,852 10 4	By Interest on Bank Balances Ditto	117 7 9
To Office and General Expenses	355 12 2	By Transfer Fees	40 10 0
To Directors', Solicitors' and Auditors' Remuneration	2,750 0 0		
To Banker's Charges	75 0 0		
To Staff Pension Fund	200 0 0		
To Interest on 4 % Debenture Stock paid and accrued, *less* Income Tax	14,000 0 0		
To Interest on 4½ % Second Debenture Stock paid and accrued, *less* Income Tax	14,875 0 0		
To Balance to Net Revenue Account	56,964 12 6		
	£91,391 5 0		£91,391 5 0

Dr. APPROPRIATION OF NET REVENUE. Cr.

	£ s d	£ s d	£ s d		£ s d
To Dividend at 5 per cent. on Preferred Stock for 12 months, viz.:				By Balance from last Account	28,126 12 1
Interim Dividend paid for 6 months to September 15th, 1919	12,500 0 0			By Net Revenue for the Year	56,964 12 6
Less Income Tax at 6s.	3,750 0 0	8,750 0 0			
Dividend for 6 months to March 15th, 1920	12,500 0 0				
Less Income Tax at 6s.	3,750 0 0	8,750 0 0	17,500 0 0		
To Interim Dividend at the rate of 6 per cent. per annum on Deferred Stock paid for 6 months to September 15th, 1919	15,000 0 0				
Less Income Tax at 6s.	4,500 0 0	10,500 0 0			
To Proposed Dividend at the rate of 12 per cent. per annum on Deferred Stock for the last half-year, making with above Interim payment a dividend of 9 per cent. for the year	30,000 0 0				
Less Income Tax at 6s.	9,000 0 0	21,000 0 0	31,500 0 0		
To Amount transferred to Capital Reserve Account			5,000 0 0		
To Balance carried to next Account			31,091 4 7		
			£85,091 4 7		£85,091 4 7

EVELYN CECIL, *Chairman.*
J. G. LE MARCHANT, *Director.*
C. M. ROSE, *Managing Director and Secretary.*

Company's Offices—
3, Throgmorton Avenue,
London, E.C., *18th March*, 1920.

AUDITORS' REPORT.

To the Stockholders of The American Investment and General Trust Company, Limited.

Having examined the above Balance Sheet, dated March 15th, 1920, with the books and vouchers of the Company, and having obtained all the information explanations we have required, we report that, in our opinion, such Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the any's affairs according to the best of our information and the explanations given to us and as shown by the books of the Company. The Certificate for the ties held in New York has not yet come to hand.

PRICE, WATERHOUSE & CO.,
J. W. RICHARDS ADAMS, } *Auditors.*

Source: Guildhall Library, Stock Exchange Co. Annual Report

Apart from the annual portfolio holdings, this archive features the accounting position of each company in the form of a balance sheet and a revenue account, as shown in Figure 3.2. Besides

these, one can find the annual or other meetings' procedures, speeches of the directors and other important aspects of the company (legal disputes, forms of shares and assets of the company, information for their headquarters and other marketing issues).

The process used is summarized in Figure 3.3. Then, the documents collected went through a digitalization process. The final sample appears in Table 3.1, consisting of 24 ITCs in 1914 growing to 33 in 1928. Overall, 42 companies emerge for this period, all but two were English with the rest being Scottish. Comparing the evolution of the number of ITCs over time it observes that the sample is unbalanced, meaning that the number of companies varies in time. The main difference that appears is prior to and after WWI. 24 companies are appeared in 1914 while in 1920 the number rises to 30 (finally 33 in 1928). Their increase is not irrelevant to the ITCs' financial performance; second this criterion is important for the whole dissertation thereupon. Any comparison over time must consider this rise. An additional factor is the number of holdings that are contained, starting from 8,088 in 1914 reaching 12,650 in 1928 (40,875 holdings appear in the sample). Generally, an amount of 117 portfolio lists is referred to this sample.

Table 3.1 Investment trust portfolios used in this sample by firm and year

	Name of Trust	Registration	Origin	1914	1920	1924	1928	Total	Size (£m)	Ordinary shares (£m)	Preferred shares (£m)	Debentures (£m)
1	Ailsa Investment Trust, Ltd	1927	Scotland				X	1	NA	NA	NA	NA
2	Alliance Trust Co., Ltd	1888	Scotland	X	X	X		3	4.58	0.55	1.25	2.78
3	American Investment and General Trust Co, Ltd	1879	England	X	X	X		3	2.00	0.50	0.50	1.00
4	Anglo-Celtic Trust, Ltd.	1925	England				X	1	NA	NA	NA	NA
5	Army and Navy Investment Trust Co., Ltd	1887	England	X	X	X		3	0.96	0.20	0.36	0.40
6	Bankers Investment Trust, Ltd	1888	England	X	X	X		3	2.70	0.90	0.90	0.90
7	Brewery and Commercial Investment Trust, Ltd.	1890	England	X	X	X	X	4	0.48	0.34	0.13	0.01
8	British Combined Investors Trust, Ltd	1927	England				X	1	NA	NA	NA	NA
9	Colonial Securities Trust Co., Ltd	1889	England	X	X	X	X	4	0.49	0.20	0.30	NA
10	Consolidated Trust, Ltd.	1889	England	X	X	X	X	4	1.23	0.13	0.49	0.62
11	Debenture Securities Investment Co., Ltd	1895	England	X	X	X	X	4	0.55	0.33	0.22	NA
12	Foreign, American and General Investments Trust Co., Ltd.	1883	England	X	X	X		3	2.00	0.75	0.75	0.50
13	Foreign and Colonial Investment Trust Co., Ltd	1879	England	X	X	X		3	2.36	1.11	1.25	NA
14	Friars Investment Trust, Ltd.	1927	England				X	1	NA	NA	NA	NA
15	General and Commercial Investment Trust, Ltd	1888	England	X	X	X	X	4	0.90	0.30	0.30	0.30
16	Government Stock and Other Securities Investment Co., Ltd.	1871	England		X	X	X	3	1.85	0.46	0.46	0.93
17	Grange Trust, Ltd	1926	England				X	1	NA	NA	NA	NA
18	Guardian Investment Trust Co., Ltd.	1888	England	X	X	X	X	4	1.12	0.31	0.31	0.50
19	Imperial Colonial Finance and Agency Corporation, Ltd	1890	England		X	X	X	3	0.18	0.18	NA	NA
20	Indian and General Investment Trust, Ltd.	1889	England			X	X	2	0.50	0.10	0.15	0.25
21	Industrial and General Trust, Ltd	1889	England	X	X	X	X	4	5.00	1.25	1.25	2.50
22	International Investment Trust, Ltd.	1888	England	X	X	X	X	4	1.75	0.40	0.60	0.75
23	Lake View Investment Trust, Ltd.	1920	England			X	X	2	0.41	0.41	NA	NA

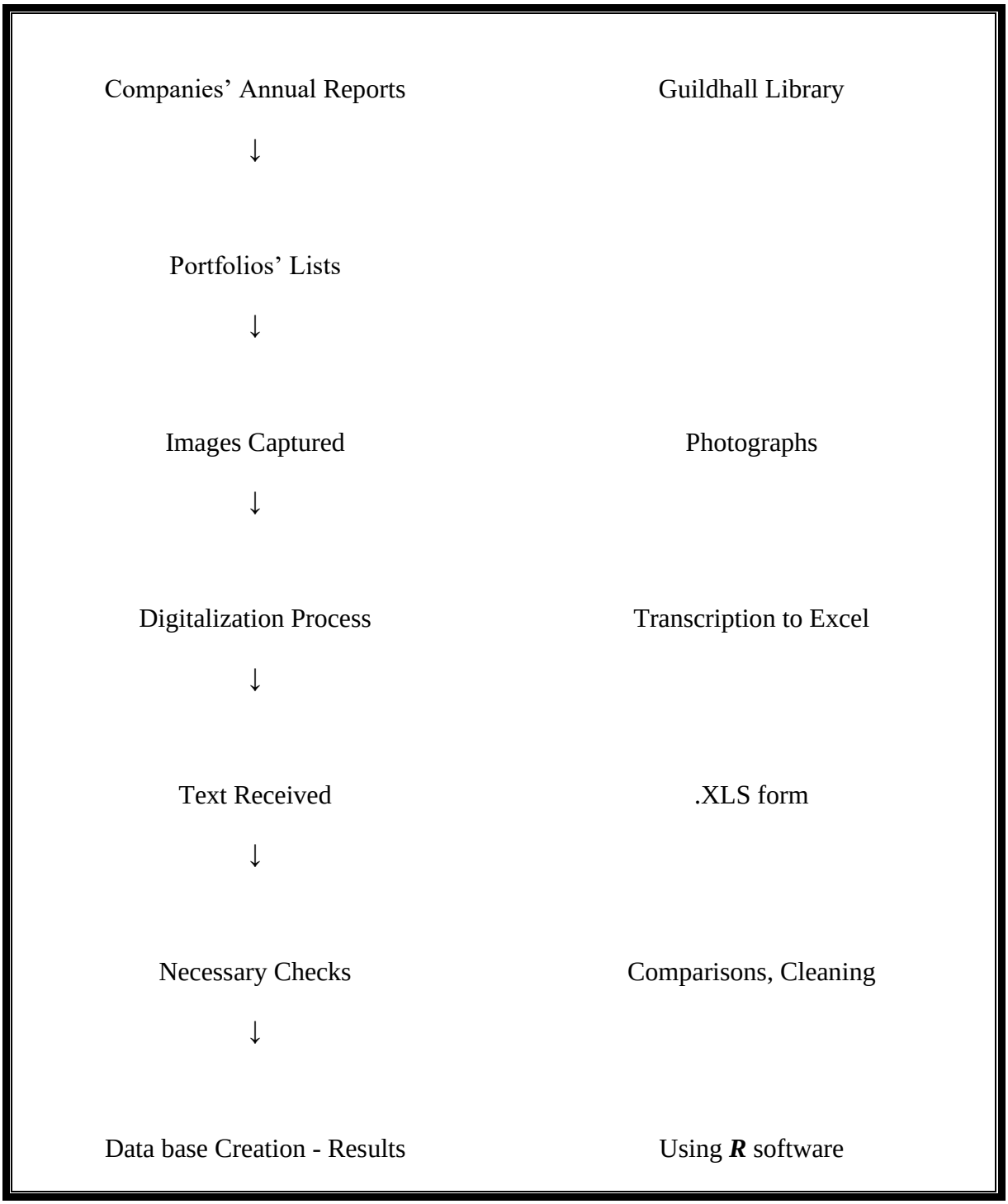
Continued overleaf…

Table 3.1 Investment trust portfolios used in this sample by firm and year (*continued*)

Name of Trust	Registration	Origin	1914	1920	1924	1928	Total	Size (£m)	Ordinary shares (£m)	Preferred shares (£m)	Debentures (£m)	NA
25	London and New York Investment Corporation, Ltd	1889	England	X	X	X	X	4	0.68	0.10	0.43	0.15
26	London General Investment Trust, Ltd	1889	England	X	X	X	X	4	0.48	0.24	0.24	NA
27	London Trust Co., Ltd	1889	England	X	X	X	X	4	1.84	0.38	0.53	0.94
28	Mercantile Investment and General Trust, Co., Ltd	1884	England	X	X	X	X	4	6.00	1.50	1.50	3.00
29	Merchants Trust, Ltd	1889	England	X	X	X	X	4	2.71	0.69	0.69	1.33
30	Municipal Trust, Co., Ltd.	1879	England	X	X	X	X	4	0.75	0.13	0.23	0.38
31	New Investment Co., Ltd	1893	England	X	X	X	X	4	0.20	0.20	NA	NA
32	New York and General Trust, Ltd	1925	England				X	1	NA	NA	NA	NA
33	Omnium Investment Co., Ltd	1887	England		X	X	X	3	1.66	0.41	0.41	0.83
34	Railway Debenture and General Trust Co., Ltd	1873	England	X				1	NA	NA	NA	NA
35	Scottish Investment Trust, Co., Ltd	1887	Scotland		X			1	NA	NA	NA	NA
36	Second Guardian Trust, Ltd	1924	England				X	4	NA	NA	NA	NA
37	Second Industrial Trust, Ltd	1911	England	X	X	X		3	0.64	0.30	0.21	0.13
38	Second Mercantile Trust, Ltd	1923	England				X	1	NA	NA	NA	NA
39	Sterling Trust, Ltd	1917	England		X		X	2	NA	NA	NA	NA
40	Stockholders' Investment Trust, Ltd	1925	England				X	1	NA	NA	NA	NA
41	Trust Union, Ltd	1905	England	X	X	X	X	4	1.00	0.30	0.30	0.40
42	United States and South American Investment Trust Co., Ltd	1886	England		X	X	X	3	1.81	0.50	0.50	0.81
	Number of Trusts			24	30	30	33	117				
	Number of Securities			8,088	9,885	10,252	12,650	40,875				

Source: Guildhall Library, Stock Exchange Co. Annual Reports. Sotiropoulos. et al. (2019) for the data of 1914. The rest is based on the author's calculations.

Figure 3.3 First basic analysis for a typical asset (using Figure 3.1)



The next question concerns the creation of the database. What information can these portfolios offer? Let us take for example Figure 1. In the second column (upper part, right-hand side) the first holding is:

$21,500 Chicago, Milwaukee and St. Paul Railway Company Common Stock ($100 Shares)

The main pieces of information this holding includes are the following.

1) The value and the currency of the specific asset; this one is in US dollars and its total nominal value is $21,500.

2) Origin of this asset; here, the USA.

3) The sector of the holding, railways; and finally,

4) The type of capital; common shares of $100 each.

Extending this for the whole data, a matrix of basic information is built.

Although the process is almost complete, new problems arise.

Speaking for representativeness, the crucial question for this thesis is if this sample follows different policies compared to the ITCs which did not offer information. One way to test this hypothesis, is by applying the *statistical disclosure technique*. This technique detects the possibility of a different strategy according to the publication or not of a list of holdings for an ITC. Thus, there is a division between the ITCs that had decided to publish their assets and the others which had not. Glasgow (1935), along with the annual reports of the ITCs' offer some important variables which could reveal any possible bias based on this differentiation. These variables are: i) the nominal paid-up capital (the amount of money that has been paid to a company from its shareholders for the shares that have been issued), ii) the leverage ratio (the way the borrowed capital has been used; here the sum of preference shares and debenture to the total paid-up capital), iii) the nominal dividend yield (the dividends divided by the face value price of the shares), iv) the market dividend yield (the same as above, with the difference of the usage of the market price in the denominator), v) the rate of return on equity (the price gains of the share plus the dividend divided by the share's price of the previous period), vi) the number of directors, vii) the share premium (the market price of the share to its nominal price), viii) the directors' qualification holdings (the ITCs' capital which is held by the directors of each company) and, ix) the reserves as a ratio to paid-up capital. For these data Sotiropoulos *et al.* (2018) sample is used, choosing the year 1928 for this work.

For all these variables, this thesis constructs the mean and the standard deviation. Then, the t-test is used to find the p-value. The results are summarized in Table 3.2. First, it sets the null hypothesis against the alternative. To reject the null hypothesis, 0.95 is taken as a confidence level. The results of all the variables are greater than the threshold of 0.05, so the null hypothesis is not rejected, meaning that there is no evidence of different strategies, which is a

first proof of a representative sample. During this test, a very interesting finding emerges. If one compares the results of this research with those of Sotiropoulos *et al*. (2020), the only variable which has, relatively, a small p-value is the number of directors. In both cases it appears as a number close or equal to 0.1 (0.11 for the pre-WWI period and 0.1 for the post-WWI respectively), meaning a probability statistically significant in the threshold of 0.1. So, the null hypothesis of the existence of the same policies can be rejected despite the list release or not. However, this fact is insufficient to lead to an alternative result. Possibly, it could be explained by the existence of some big ITCs, meaning a specific number of directors facilitated their operations. Surprisingly, the average number of directors in the disclosing ITCs is smaller than the rest (4.5 versus 4.94 for the non-disclosing portfolios). A logical explanation for this could be the better management techniques implying a smaller and more flexible managerial team, see Robinson (1923; 1930) and Rutterford (2009) for this flexible management.

Table 3.2 Comparison between the firms in our sample in 1928 and the rest of the English Investment Trust sector.

	English ITCs disclosing portfolios' holdings in 1928		English ITCs non-disclosing portfolios' holdings in 1928		
	Mean	s.d.	Mean	s.d.	*p*-value
Nominal paid-up capital (£m)	1.55	1.44	1.37	1.15	0.54
Leverage	0.64	0.21	0.60	0.22	0.36
Nominal dividend yield (%)	0.11	0.04	0.09	0.04	0.13
Dividend yield	0.05	0.01	0.05	0.01	0.83
Rate of return on equity	0.46	1.20	0.33	0.86	0.64
Number of Directors	4.50	1.24	4.94	1.18	0.1
Director Qualification holdings (£K)	1.11	1.69	0.88	0.60	0.47
Reserves as ratio to paid-up capital (%)	0.11	0.09	0.13	0.11	0.22

Source: Sotiropoulos *et al*. (2018); Author's calculations.

Note: This sample contains only English ITCs. As it has been mentioned the Scottish ones in their vast majority had not published their portfolios' holdings.

3.3 Portfolio holdings' prices

As mentioned in the previous section, accounting disclosures were problematic during the pre-WWII period in the UK. Two main problems were the existence of secret reserves and the pricing problems, especially problems with depreciation (Arnold 1997). In this case, a crucial question about the sample is the issue of valuation. In particular, the question is how did the ITCs express the prices of their holdings? Today, investors express the valuation of a company's stock in many ways; however, the two principal indices are the *market value* and the *book value*. The latter is practically the difference between the assets and the liabilities of a company which can be found in the balance sheet while the former depicts the current price

of the company in the market ($share\ price \times number\ of\ shares$). Both have limitations such as a time lag (book value); as Robinson (1923, p. 7) put it "is an ephemeral thing", volatile, so, it was impractical to calculate their current prices only knowing the acquisition cost; as for the market value, it is sensitive to external factors, see Bearley *et al*. (2008), meaning that a shock could temporarily alter the price of a security that generally had a stable and secure position.

In the case of the ITCs, their system of valuation was based neither on the book values nor on the market ones. When an ITC bought a specific holding, it registered this information in its portfolio list using its book value, or its purchase cost. However, the price of this holding did change over time. First, one can understand the disadvantage of registering the market price in this case, the ITCs would have to perpetually change their brochures because of the oscillations of their market prices, "market values are transient values" (Glagow 1935, xxv). On the other hand, using the book value there remains the problem of inflation. Especially for that time, this was of utmost importance, because of the frequent fluctuations in prices, see Chapter 4. ITCs reported the nominal values of their holdings in their portfolio lists, see Sotiropoulos *et al*. (2020), which seemed a reliable way of delimiting the general process of the applying portfolio management strategies.

The main problem this thesis deals with is the peculiar accounting system the ITCs used. In many of them, the prices were not even the acquisition prices. Their common practice was to write down the prices of their holdings. Characteristically, "book values are never written up" (Glagow, 1935, xxviii). The reason for this was the use of "constructive pessimism" as a principle in the ITCs management, which "may be ascribed epigrammatically, but fairly" as "the secret of success" for the ITCs (Glagow, 1935, xxi). This means that a typical ITCs treated each holding as if it had lost a part of its price. So, where could one find the rest of the initial price? ITCs had established a very famous practice, the *inner reserves*. And here the second problem arises with secret reserves. The difference between the prices on the list and the acquired ones "constituted an inner reserve, a substantial margin" (Glagow, 1935, xx). These reserves were either revealed as an augmented capital reserve account, or as a revenue account; thus, they were an unearned profit which should be taxed. No matter which way was chosen, the purpose was the same, to produce additional income.

The combination of the two approaches, viz. the writing down technique of the book values along with an inner account, it was the guarantee of success. "The height of a trust company's prosperity is reached when reserves have been built up and book values written down to such

a pitch that even if the dividend is regularly increased, the company's rate of earning is likely to increase at a still greater rate. The company then begins a progression which the mathematicians call geometric" (Glagow, 1935, xlviii). For this research, the opposite actually mattered. In the case of a fall in the market value (e.g., during an economic crisis, a panic etc.), the companies use these reserves as a "rainy day fund pot" which could guarantee stable dividends.

Finally, in the case of a holding being sold at a profit, "the proceeds are reinvested to produce either an actually or a potentially greater yield" (Glagow, 1935, xlviii). In this case, there is the opportunity to study a mixed situation. Dividing the period under review into two parts, one can observe first, a decreasing market values period, during WWI and in the early 20s, and an increasing one in the second half of the 1920s. To study the real shock, one must also focus on the 1930s which goes beyond the scope of this thesis. Both the annual Investment Trust Companies' Progress in *the Economist* (annual review for 1914-1928) and this thesis can confirm the aforesaid approach. Thus, this otherwise complicated technique, reveals the significance of the notion of security for the ITCs' management strategy, once again. Even the way they depicted their portfolio lists has as the main purpose the provision of security for their investments.

Additionally, the ITCs excluded the holdings which had lost completely their value; an extra distortion which, however, is not significant in the total analysis. Both Sotiropoulos *et al.* (2020) and this analysis estimate these distortions to be less than 1 percent of the total portfolio and they do not impair the sample. Despite these problems, the published portfolios' values can be used in this sample. In the end, as mentioned by Sotiropoulos *et al*. (2020), these were the prices that were provided to investors; thus, this thesis accepts them as reliable. Moreover, chairmen's replies to the question about the breakup value of the deferred stock or the figure of the inner reserve, were identical: "we publish our list of investments", meaning an equal treatment of these (Glasgow, 1935, p. xxvi). And he continued: "theoretically, anybody could go through the list with Stock Exchange lists of quotation prices and calculate the market values for himself", implying that there was no reason for the ITCs to deceive their investors as they had various sources of information.

The example of Glasgow (1935, xx) depicts the whole story. An ITC has held in its list 1,000 ordinary shares of £1 (nominal price) of the company *Shell Transport and Trading Co.*; amounting to £5,000. Gradually, following its write-off technique the company reduced this price which in 1928 was registered at £625, meaning a share price of 2s. 6d. with a

"hypothetical" loss of £4,375. In the meantime, the market value of the share skyrocketed, reaching £15 in 1928, meaning, a short-term total value of £30,000. While its market price had even reached 28s. 1d., it gradually rebounded to 43s. in 1935. Because of the gradual write-off technique, the final loss was not £4,375, but only £625; a negligible loss compared to the total assets of £2 million held by the ITC. This was very important not only for the accounting policy of the company which could present a stable position minimizing losses, but also for its long-run economic performance, maximizing its future dividend growth path or amortizing the losses.

Again Glasgow (1935), described the sale case. Assume an ITC in 1927 had a holding of 1,000 ordinary shares of the *Underground Electric Railways of London*, £1 each (nominal price). Its market value was at 15s. meaning a book value of £758. If this holding were to be sold the next year, in 1928, at a market price of 23s., £1,140 in total, the realised profit would be £382. However, the new amount could be used only as capital profit and not as cash profit. This meant that the company could either credit it to its capital reserve or reinvest it to a new holding, in this case as ordinary shares of the *Meux's Brewery*, £1 each plus bonus, valued at £1,140 while the book value remained at £758.

All in all, the results which can be extracted are the following: first the importance of the inner reserves funds which were working as an additional buffer mechanism against shocks; second, there is a further difficulty for the sample because of the ITCs accounting practices. However, in the end, the registered prices seemed accurate enough for the sample to be built.

3.4 Variables' construction

This section depicts the main variables which appear in the sample. As described above, the data in the ITCs portfolios are enough to create a coherent database for this study. These include sufficient information for the holdings' a) price and currency, b) geographical and c) sectoral destination and d) asset type (asset allocation). For most of this information to emerge, extra research is needed.

The first variable which is created is the type of each holding. The three asset classes which are used are fixed income securities (debentures), and shares (preferred and ordinary).

Bonds and equity are the two main asset classes traded through a variety of markets. The first category (Bonds) is broadly defined as securities (contracts) that give holders future payments by the issuer. There are various types of bonds. For this thesis every fixed-income security can

be defined as a debenture. Hence bonds, debts and loans come under the umbrella of debentures. Equity is divided into two types, preferred and ordinary. Preference shares although they offer a fixed income to the holder is not debt but equity; thus, it pays dividends rather than interest (Rutterford & Davison, 2007, p. 145). Ordinary shares represent a proportionate claim on the residual income of the company. Additionally, they represent a fraction of ownership in the corporation that issues them offering their holders unlimited returns. Investors during the early 20th century used the same classification and they were fully aware about the various advantages and disadvantages each of them offered (see le Maistre, 1926; Parkinson, 1932).

The classification of these three types of investments is referred to either explicitly; see the example above where there is a direct notation *common shares*, so this is a strict clarification about its type; it is an ordinary share, or, in other cases, implicitly. Here, the features in the description which indicate each type (e.g., the existence or not of standard coupon, the shares' number or any amount expressed in monetary term etc.) are important. In the case of a share, (both ordinary and preferred) there is a common practice of describing only their number, e.g., *Taltal Railway Co. ordinary shares, fully paid, £5,* 2000 shares. So, there is a transformation of this type of entry into a price value; this can be used by multiplying the number of shares by the value per share. In the case of US companies, more specifically, the notion of the share of no-par value emerges, see Noke (2000). In any case any deviation is negligible because this type remains below 1 percent of the total sample. These are transformed as $1 per share or they are excluded if there is limited information about them. Finally, in both cases, the problem of the foreign currencies has to be resolved. The basic non-pound currency present in the sample is the US dollar. This thesis selects the exchange rate of £1 to 4.86$, see Thomas and Dimsdale (2016).[21] As for the other currencies, for the years 1920 and 1924 there were only a few of them, so they are excluded from the sample.[22] Regarding 1928, because of the rebound of foreign currencies, especially the European ones, it is necessary to include them in the sample. For 1928, the periodical *Investors' Monthly Manual* (1929) was used as the main source for the exchange rates; the Federal Reserve Bulletin (1929) and Einzig (1937) were also used as they offered crucial information.

[21] During WWI the Gold Standard ceased to exist. Afterwards, there was a period of high fluctuations, see next chapter, while in 1925 pound was pegged again to Gold Standard. To avoid misunderstandings, for the whole period it is used the fixed rate £1 to 4.86$. Despite the existence of high inflation, and deflation afterwards, the use of nominal or par values in the portfolio lists solved this problem; thus, there is no need to adjust the securities' prices.

[22] This exclusion does not distort the sample. For the period prior to 1928 the rate of foreign currencies holdings per trust, excluding USD was less than 2 percent, see next Chapter.

The next variable is the geographical allocation of the ITCs portfolio lists. The main goal here is to construct a variable related to the countries of origin of the various holdings. The basic practice which is followed for the countries' classification is to use as a benchmark the territory where the company's basic economic operation took place.

The construction of this variable is not a simple procedure. First, there is not always clear evidence in every holding about its geographical origin. The easiest cases are where a direct and clear notion of the country appears. E.g., the *Argentine Railway Company* 6%, *Notes 1920* or the *Brazil Government 5% Loan of 1913* are simple cases. In these, the descriptions are unquestionable; there is one Argentinian and one Brazilian holding, respectively. However, this was not everywhere the norm. In ambiguous cases, there is a search for a reliable source either online, or in the case of the British companies, to use the webpage of the *Grace Guide to British Industrial* history[23] which is rich in information. Of course, there are cases which could not be resolved. Again, a safe guide for this procedure was the already existing base for the pre-1914 area.

Another problem was country classification. Reminding that the period under study was 1914-1928, the geographical distribution of the globe was quite different from nowadays. Not only this, but also, during that period the uninterrupted formation of new states was in progress. E.g., in the aftermath of WWI three empires were dissolved on European territory and the borders were redrawn more than once; not to mention the vast British Empire which extended over two continents. As a main rule, the countries' classification is based mainly on their current status (borders, name) – if any. Certainly, there are gaps in this dynamic process, which, in some cases, were impossible for this thesis to address. Exceptions to the previous rule, can be mainly seen either in the cases of regions that, today, are divided between more than one country or, in the cases of government bonds, especially referred to colonies and other non-independent states. As for the classification which has been followed by the LSE, see the *Stock Exchange Official Intelligence*, there is only sectoral allocation, so any type of information regarding the country can be extracted only indirectly through companies' descriptions.

Now, a new problem arises for multinational companies, or for companies extending their activities in more than one country. The 19th century indeed was a period of prodigious international capital transfers, favouring these types of corporations. Maybe, in the case of a company producing one commodity (e.g., tea) or rendering specific services (e.g., electricity)

[23] See, https://www.gracesguide.co.uk/Main_Page

the decision is clear, but what about an enterprise with an international presence or a company that uses multiple stages for its final production? Lowenfeld (1907) used in his description these types of companies with international activities such as telegraph or shipping. However, this thesis takes consider the fact that because of the diachronic change of the enterprises, the classification varies too, meaning that a classification of company in the late 19th century is possibly not suitable for the 1920s. In the same category it also adds companies for which it was not clear their main country.

Nowadays, there are different classifications regarding the legal corporate headquarter. The head of the company has been chosen according to its main activity, its board, the stock exchange where it trades its stocks, etc. This question has been solved using the territory of the basic economic operation in the sample. The two main exemptions from this rule are: a) the trusts, which are considered only in England or Scotland, while other similar enterprises are placed in the sector of land, mortgage and finance; and b) the banking sector, which is mainly reported as British, unless there is a clear explanation of the enterprise's country origin.

At the end of this process, a basis of 119 countries (and regions) is created, see Table 3.3 for the list, basically more than half of the current UN members; 195 were the countries in 2019; see UN (2019). Because geographical allocation is crucial information there are no exclusions. Each country that appeared at least once in the dataset has been added in the final sample.

Table 3.3 List of countries in the database

(1) Africa	(41) Germany	(81) Norway
(2) Argentina	(42) Ghana	(82) Pakistan
(3) Australia	(43) Gibraltar	(83) Palestine
(4) Austria	(44) Greece	(84) Panama
(5) Azerbaijan	(45) Guatemala	(85) Paraguay
(6) Bangladesh	(46) Guyana	(86) Peru
(7) Barbados	(47) Hong Kong	(87) Philippines
(8) Belgium	(48) Hungary	(88) Poland
(9) Belize	(49) Iceland	(89) Portugal
(10) Bolivia	(50) India	(90) Prussia
(11) Borneo	(51) Indonesia	(91) Puerto Rico
(12) Botswana	(52) Iran	(92) Romania
(13) Brazil	(53) Ireland	(93) Russia
(14) Bulgaria	(54) Italy	(94) Salvador
(15) Burma	(55) Japan	(95) Scandinavia/Russia
(16) Canada	(56) Java	(96) Scotland
(17) Central Africa	(57) Kenya	(97) Serbia
(18) Central America	(58) Laos	(98) Siam
(19) Central and South America	(59) Latin America	(99) Singapore
(20) Chile	(60) Latvia	(100) South Africa
(21) China	(61) Lithuania	(101) South America
(22) Colombia	(62) Luxemburg	(102) South Wales
(23) Congo	(63) Madagascar	(103) Spain
(24) Costa Rica	(64) Malaysia	(104) Sri Lanka
(25) Croatia	(65) Malta	(105) Sudan
(26) Cuba	(66) Marshall Islands	(106) Sweden
(27) Cyprus	(67) Mauritius	(107) Switzerland
(28) Czech Republic	(68) Mexico	(108) Thailand
(29) Denmark	(69) Middle East	(109) Trinidad and Tobago
(30) Dominican Republic	(70) Mongolia	(110) Turkey
(31) Dutch East Indies	(71) Morocco	(111) Uganda
(32) East Africa	(72) Myanmar	(112) Ukraine
(33) Ecuador	(73) Mozambique	(113) Uruguay
(34) Egypt	(74) Netherlands	(114) USA
(35) El Salvador	(75) New South Wales	(115) Venezuela
(36) England	(76) New Zealand	(116) Vietnam
(37) Estonia	(77) Nicaragua	(117) Wales
(38) Europe	(78) Nigeria	(118) West Africa
(39) Finland	(79) North Borneo	(119) Zimbabwe
(40) France	(80) Northern Ireland	

Notes: Because of the hand-collected dataset, there are cases of overlaps. In cases of limited information, this thesis has selected the closest country/ region; in case of no data, it has chosen the N/A (it is not included in the table).

Source: Author's calculations.

The third fundamental variable concerns the sector in which each company was activated. Here, again the previous paradigm is used. Using this, one can detect a railway company in Argentina and a debt from Brazil. So, the title of each holding is indicative of sector each company was operating in. In more complex cases, again, as in the previous case of geographical allocation, a variety of sources are consulted, mainly internet ones. For the British securities, especially in the industrial sector, the *Grace Guide to British Industrial history* is of utmost importance. Moreover, the *Stock Exchange Official Intelligence*, the official annual account of the LSE,

classified the various securities it traded giving information about them. However, the classification it offers is not clear enough, i.e., there are detailed descriptions for sovereign debts or railways but insufficient descriptions for the private companies mainly industries.[24] Additionally, the sites of the companies which are still active are useful as well, and the names of the companies in a more broaden frame. Again, because of the existence of many defunct companies and the absence of a central source for their existence, great effort was required to be created a consistent base as close to reality as possible.

In general, this variable is composed of a wide range of sectors. This thesis follows a classification as the Stock Exchange Yearbook presents. However, it includes also parts of the modern classification and the structure of the Input-Output analysis. On the one hand it follows the then classification to avoid possible anachronisms. On the other hand, the 1920s can be seen as the predecessor of how modern economies understand and classify their main activities. Thus, a combination of these two approaches provides the maximum of information one can obtain.

Additionally, because of the exposure of the trusts, a convenient classification is sought for further analysis. For instance, a more detailed classification occurs in the secondary sector, focusing on subcategories such as machinery, chemicals, or automobile. The same is followed in the utilities which are divided in electricity, railways and tramways- which were mainly offered by the same (mainly British) contractor. See Table 3.4 for more information. Also, raw materials (rubber, tea and coffee), the *bulwark* of the imperial investments have been classified together. Besides these, especially in the UK many new sectors have appeared such as the cinema, which proves the mobility among the various sectors along with deeper structural economic and social factors. Finally, 72 sectors are identified; note, the US economy nowadays uses mainly the Input-Output Tables of 15 or 71 industries, see BEA (2019).

[24] See e.g., the number of companies which were classified as *Investment, Trust and Finance* or the *Miscellaneous* ones Stock Exchange Official Intelligence (1928).

Table 3.4 List of sectors in the database

(1) Agriculture	(25) Manufacturing (mineral water)	(49) Other (paper mill)
(2) Automobile	(26) Manufacturing (railway cars)	(50) Other (photography)
(3) Banking & Discount	(27) Manufacturing (steam pump machinery)	(51) Other (printing)
(4) Brewery and Distillery	(28) Manufacturing (sugar production)	(52) Other (publishing)
(5) British Corporation & County Stocks	(29) Manufacturing (Tractor machinery)	(53) Other (restaurant)
(6) Canals, Docks & Harbours	(30) Mining	(54) Other (retail)
(7) Electric, Lighting and Power	(31) Nitrate	(55) Other (salt production)
(8) Foreign Corporation Stocks	(32) Oil	(56) Other (sugar)
(9) Government	(33) Other	(57) Other (textile)
(10) Insurance	(34) Other (asphalt)	(58) Other (timber)
(11) Iron, Coal and Steel	(35) Other (cinema)	(59) Other (theatre)
(12) Land, Mortgage and Financial	(36) Other (clothing)	(60) Other (trade)
(13) Manufacturing	(37) Other (construction)	(61) Other (warehouse)
(14) Manufacturing (ammunition)	(38) Other (copper works)	(62) Railway
(15) Manufacturing (canning)	(39) Other (cotton gin)	(63) Railways/Electric Lighting and Power
(16) Manufacturing (cement)	(40) Other (dept store)	(64) Shipping
(17) Manufacturing (chemical)	(41) Other (gas)	(65) Tea, Coffee and Rubber
(18) Manufacturing (cigar and tobacco)	(42) Other (grocer)	(66) Telegraph and telephone
(19) Manufacturing (cotton)	(43) Other (hotel)	(67) Tramway & Omnibus
(20) Manufacturing (dry goods)	(44) Other (jute)	(68) Tramway/Electric Lighting and Power
(21) Manufacturing (engines)	(45) Other (meat industry)	(69) Trust
(22) Manufacturing (farm machinery)	(46) Other (metal works)	(70) Vineyard
(23) Manufacturing (food/butter)	(47) Other (newspaper)	(71) Waterworks
(24) Manufacturing (machinery)	(48) Other (paper and pulp)	

Notes: Because of the hand-collected dataset, there are cases of overlaps.

Source: Author's calculation.

In the aforementioned presentation, the basic variables of the data construction are introduced. So, using the information regarding the portfolios' lists for the years 1920-1924-1928 and combining these with the existing one (1914) this thesis builds a first basic dataset comprising of the securities' names, their book value, asset types, geographical and regional diversifications. The information collected must also be taxonomized in a compact way. The approach of Sotiropoulos *et al.* (2020) is used, based on Lowenfeld (1907). According to the latter, more concentrated groups were created. It groups the various countries for the geographic variable in a table composed of six regions:

1) Africa,
2) UK,
3) Europe,
4) South America,
5) North America,
6) Asia/Pacific.

Lowenfeld (1907) was based on a 10-region description with further subdivision (Central America, North Europe, Empire, and South Europe). However, for research reasons, in Sotiropoulos *et. al*. (2020) and here a slightly different classification has been developed involving the criterion of the proximity of the regions which are used by the ITCs; analytically, the globe has been taxonomized on a country basis.

Some clarifications here for the classification followed. North America comprises two states, namely the USA and Canada. Both were extremely important for the UK as ex-colonies (or still then under British control). Latin America (LA) is used as the group of countries in which Roman languages are spoken, see *The Encyclopaedia of Latin American History and Culture* (2008). So, all the Americas except the two countries as it mentioned before. Asia/Pacific contains both Asia (Turkey included) and Oceania. Various approaches can be followed. This thesis is not for a department of Geography. Rather, this classification is consistent with the existing literature and logic. Finally, it is practical, leading to useful results for the portfolio analysis of the ITCs.

Moreover, the various countries' data are classified into three basic subgroups: a) the British Empire countries – colonies, under a broad definition; b) foreign ones; and c) the UK itself. The reason for this further classification is to present the data in a more coherent and manageable form. Of course, a different way could be used. Finally, the Trusts themselves used a similar classification for their portfolio's lists (see Sotiropoulos *et al.* 2020).

For the sectoral analysis, the various sectors are grouped into the following general categories:

1) industrial,
2) commercial and agriculture,
3) finance,
4) utilities,
5) government,
6) railways,
7) trusts.

Trusts contain only the ITCs which included in the portfolios as a separate category. The reason for this is a further research for cross-investments among the various ITCs. Finance includes mainly banking, insurance and land, mortgage and finance. Utilities summarizes sectors such as electric, lighting and power, trams and telephone. Railways because of its importance are separated. Industrial, commercial and agriculture is a huge sector including all the secondary department, trade and agricultural activities.

3.5 Conclusion

This chapter presents the methodology which has been followed for the data collection and the construction of the sample. The sample is a contribution. It offers new data from a non-examined period; the indices created will be used in this thesis to be answered its research question, the asset management strategies of the British ITCs adding value to portfolio selection. The first problem emerges in the identification procedure for the ITCs. Using information from Glasgow (1935) it classifies the holding companies into three categories, companies investing in a specific market, finance companies focusing mainly on a quick turnover, and ITCs.

A second issue that is tackled is the representation of the dataset. More specifically, not all the ITCs had published their portfolios. The problem is not unknown for the accounting and business historians. ITCs were in a better condition than the rest of the enterprises. The Guildhall Library offers a full catalogue of annual reports of holding companies. Thereafter, it uses the descriptions of the ITCs' portfolios to construct the main variables for the dataset. A new problem arose, the representativeness of the dataset. To solve it, it is used both a statistical methodology and a historical explanation which conclude that no bias existed. An additional question arose, the holdings' valuation. For this study, the nominal values of the ITCs' portfolio lists are used to provide a reliable picture of the management strategies the ITCs follow.

Having dealt with these problems, this thesis is ready to create the database. The three main variables which are constructed are the asset allocation, the geographical and sectoral distribution of the various holdings. Finally, it creates the dataset which is composed of three different asset types (debentures, preferred and ordinary shares), a list of the countries and the sectors of the various holdings. The two last variables are accompanied by more compact forms including a smaller and more coherent bundle of regions (close to continents) and a small group of sectors. These details, in toto, are systemized in a database which will be used in the next chapter, in which the descriptive statistics will be analysed.

4 Main Results

4.1 Introduction

The previous Chapter delineated the data collection process presenting the various challenges it faced. This Chapter presents the main results of the data analysis. Specifically, it examines the evolution of the ITCs' asset allocation for the period 1914-1928. The existing literature argues about highly sophisticated institutions, which followed a very advanced asset management strategy. ITCs' priority was to offer the highest yields to their investors maintaining the maximum security; this was achieved thanks to the diversification process in their portfolios that reduced the risk, offering in parallel competitive yields. The existence of the City as a financial *Mecca* has offered their portfolios the advantage of access to various types of assets, well distributed all over the world and in numerous industries. The ITCs had taken full advantage of the opportunity, investing heavily in many parts of the world, contributing to the phenomenon of the export of capital, in sectors that satisfied their initial goals (Sotiropoulos *et al.*, 2020).

As already explained, this model was successful under specific conditions. The supremacy of the City, the stability of the monetary and the tax regime, and the existence of social peace were, among others, the essential conditions for their success (Bordo & Rockoff, 1996; Eichengreen & Flandreau, 1997). However, the post war era was a *terra incognita* for the whole system. Most countries, including the UK, had already abandoned the Gold Standard;[25] new rivals emerged offering dynamic financial centres; the fiscal position of the British state had been severely affected by the war; the old economic model was unstable, and huge social polarization had appeared.

All the preceding conditions called into question the continuation of the pre-war diversified portfolio policy of the ITCs. To put it in other words, how did these new socio-economic conditions affect these management techniques? Would these structural changes alter their scope or their implementing strategies? This thesis constructs a dataset that shed light on the (new) applied policies of ITCs' asset management.

[25] The UK withdrew from the Gold Standard in April 1919, inaugurating a period of wide monetary fluctuations, deep currency devaluation and, concomitantly, losing the absolute advantage of an anchor currency ideal for investments, see Chapter 2.

First, it presents the main results which emanate from the dataset. Issues such as the magnitude of the average ITC portfolio, the number of assets, and their allocation will be discussed. Moreover, it will be sketched the evolution of these issues over time for the examined period. A discussion about the ITCs' diversification policies and the existence of any outliers will also be developed. Besides, a comparison will be drawn between the ITCs and all listed companies of the LSE. This will be the first set of questions that will be answered.

4.2 Main Descriptive statistics

Table 4.1 summarises all the basic information from the data set. It starts depicting the ITC archetype in the 1920s. A typical trust comprised a 349 holdings portfolio; 168 were in fixed interest holdings, 100 ordinary and 81 preferred shares, each of them costed £6,024 on average; finally, the total trust's value was around £2.15 million (with 0.3 percent of its portfolio, as an average holding's value). This information is a first strong element for this thesis to argue that ITCs have built an unequivocally diversified portfolio for the period under study.

Furthermore, it uses summary statistics to detect the level of diversification, and the dispersion of this sample. Despite the existence of outliers (121 holdings for the minimum list and 943 correspondingly for the maximum), it is balanced enough (see the median 320); additionally, the third quartile of the sample (the observation in the 88th position) consists of 413 holdings. Additionally, the typical portfolio can easily be compared with a modern ITC one century later.[26] Apart from this, a totally different policy, compared to the current one, is visible. Today, the conventional discussion in financial economics is that a small investor's carefully selected portfolio can succeed in diversification with a number no more than 10 shares, see indicatively the textbooks of Rutterford and Davison (2007, p. 214), or Brealey *et al.* (2008, p. 187).

Much discussion has been developed on this issue, (see Evans & Archer, 1968; Johnson & Shannon, 1974; Domian et. al., 2007; Goetzmann & Kumar, 2008; Alexeev & Tapon, 2014). Although this information is not sufficient to answer completely the question,[27] it is indicative of the way the ITCs have designed their policy, believing in a more naïve approach.

[26] An easy way to prove this is to receive information directly from modern ITCs portfolios. E.g., in the case of Witan Investment Trust, its portfolio is composed of almost 300 holdings (Witan Investment Trust 2020), while the oldest ITC, the Foreign and Colonial Trust has almost 500 holdings (Foreign and Colonial Investment Trust 2020); thus, it is obvious that they are of comparable size despite the time distance of a century.

[27] An institutional investor (ITC) can hardly be compared to an individual investor, as textbooks or many studies describe. However, the general point, *mutatis mutandis*, exists.

The fourth variable, the value of the portfolio, is of high importance because it shows the size of the ITC. As a result, the average portfolio was worth £2.15 mil., and the value of the third quartile of the sample is, basically, of the same amount (£2.6 mil.). Here the outliers are larger (the minimum stands at 85 percent less value whereas the maximum is 3.5 times bigger), although they seem not to distort the distribution. Now, the last variable of the first subset, the holding's value, offers again a crucial variable for the diversification of the ITCs' portfolio. So, the average nominal value held by the individual security is £6,024. Adding to this the fact that the ¾ of our holdings cost less than £7,400, (at the level of list) is a significant indication of the complete diversification. The outliers are again present, there were values of more than £40,000, see the Table below, but without affecting the total sample.

The second, third and fourth variables of Table 4.1 depict the basic asset allocation among the fixed interest securities (debts, debentures, loans), and the shares. The latter is subdivided into preferred and ordinary ones. The first general picture is that the debentures represent the biggest part of the sample for the whole period (55 percent of the nominal value at the level of the portfolio) followed by the ordinary shares (24 percent), and preferred ones (20 percent). This predilection for the fixed interest holdings is strongly connected with security which was a *sine qua non* for their management strategies, see Chapter 2.

Table 4.1 Descriptive Statistics of the Investment Trusts' portfolios (1914-1928)

	Obs	min	quart_1	median	mean	st.dev	quart_3	max
Number of holdings per portfolio	117	121	247	320	349	149	413	943
Debentures	117	58	115	152	168	71	208	427
Preference shares	117	6	53	68	81	43	95	208
Ordinary shares	117	12	58	81	100	77	127	442
Portfolio value (£ mil)	117	0.31	0.83	1.54	2.15	1.96	2.60	9.92
% Ordinary shares	117	1.49	18.52	23.52	24.07	10.67	29.52	50.65
% Preference shares	117	0.68	15.14	20.26	20.41	7.49	24.32	43.46
% Debentures	117	23.81	48.24	54.73	55.52	13.15	61.02	97.83
Value of the individual security in £	117	1,271	2,999	4,803	6,024	5,080	7,385	41,515
Weight of the individual security as % port. value	40,875	0.00	0.09	0.19	0.29	0.47	0.35	26.02
Debentures	19,708	0.00	0.13	0.23	0.33	0.54	0.39	26.02
Preference shares	9,510	0.00	0.09	0.17	0.25	0.35	0.32	14.94
Ordinary shares	11,646	0.00	0.05	0.12	0.24	0.41	0.28	14.03
UK	15,725	0.00	0.08	0.15	0.25	0.49	0.29	21.06
Foreign	19,120	0.00	0.12	0.24	0.34	0.49	0.42	26.02
Empire	5,539	0.00	0.06	0.13	0.20	0.28	0.25	8.00

Notes: These data refer to the period 1914-1928; this thesis calculates the years 1914,1920,1924 and 1928, see Chapter 3. For the first panel it aggregates all the variables at the level of the portfolios before it calculates the descriptive statistics; finally, 117 firms appear totally in the sample (24 for 1914 30 for 1920 and 1924 and 33 for 1928). For the second panel, it measures the weight of the average individual security, and then, it separates it into the various categories (type and geographical allocation).

Source: For 1914 it uses the data of Sotiropoulos *et al.* (2020). The rest belongs to this dataset.

This distribution of the asset allocations confirms that ITCs generally invest greater amounts in debentures than in shares. This can be proven from the second subset of the Table in which there is no aggregation in the level of the trust. From the total number of holdings in the sample (40,875) 19,078 are debentures, less than 50 percent of the total and they are spread across 117 portfolios. Moreover, besides the higher average weight, the dispersion is greater, see both the third quartile and the maxima. The rest are divided into preferred shares (9,510) and ordinary (common) ones (11,646).

The next set of variables in the second subset delineate the other main diversification type which is the geographical one. The 50 percent of the sample are referred to investments abroad (19,120); for the remaining ones, 15,725 are domestic investments and 5,539 (the ⅐ of the sample) are assigned to the British Empire. Again, in this case the diversification is absolute as the weight of the average holding ranges between 0.2- 0.35 percent. Surprisingly the average weight of the foreign holdings is slightly higher than the rest; however, in absolute terms, the differences are negligible, being less than 1 percent and confirming complete diversification.

While Table 4.1 presents the descriptive statistics for the dataset, a logical question that arises is the possibility of any significant change during the 14-year period covered by the sample. Consequently, a new Table must be constructed, encapsulating this information. Table 4.2 summarizes the ITCs' behaviour for each of the four years of this dataset, 1914;1920; 1924 and 1928. The variables which are used are the same as in the first subset of Table 1. The first variable, which is the number of holdings of the ITCs, seems to be stable from 1914 to 1924 covering a range of 330-340 holdings (on average), with a significant increment for the last observation in 1928, when the average number of holdings reaches 383. Studying the median, (the second observation in each cell) there is a close relationship between the average and the median with a slightly positive skew, declaring a normal distribution.

From the average total number of portfolios' holdings (330-380), there are 170 debentures held in the average ITC portfolio, (starting from 177 in 1914 and reducing slightly to 170 in 1928). This proves a dominant but gradually decreasing tendency for fixed interest holdings. This gap is bridged by the reverse tendency of the other two assets' categories (ordinary and preferred shares) which is clearly increasing. Starting from 70 preferred and 90 ordinary shares, prior to the war, in the final year (1928) there were 95 and 117 shares correspondingly. Thus, there is a general increase in the number of holdings per portfolio while the number of debentures reduces. This gap has been addressed by the rise in the number of shares and even at a higher

level, more than 20 percent each. So, there is a decrease of the average holding's value, see row 9 of this Table.

The fifth variable illustrates the average ITC's portfolio value, its assets' size. The range of the average portfolio was about £2.1 million. For the pre-war period (1914), the average portfolio was £ million 2.05 which has gradually increased after the war reaching £2.29 million in 1920, while for the next year there is a reduction to £2.2 million (1924) and finally, £2.06 million in 1928 because of the introduction of new smaller trusts.

Here, nominal values appear. Thus, it can be argued that ITCs had a stable portfolio list value. However, the examining period is characterised by regular and persistent price oscillations (inflation).

Prices in the UK doubled during the war up to 1920, while in 1922 they were 2.5 times higher, accumulatively. Hence, the phenomenal rise in 1920 (from 2.05 to 2.29 in 1920) is not real if one counts the galloping inflation. Additionally, the gradual replacement of debentures by shares and the normal turnover of the ITCs' portfolio perplexes more the final answer. Below, this thesis discusses the two countervailing tendencies, the increasing prices of the shares and the decreasing ones of the debentures. Furthermore, the next period, 1921-1924, there was an opposite tendency, deep deflationary pressures hit the British economy; prices fell by 30 percent; finally, they remained well above the pre-war level (40 percent more in 1926), (Feinstein et al., 1995; O' Donoghue et al., 2004). Overall, inflation eroded ITCs' old holdings, mainly debentures; thus, they strived to enrich their portfolio with newer products, a movement which has been developed *pari-passu* with the issue of new securities by companies which had been seriously affected by this situation.

The next three variables (rows 6 to 8 in Table 4.2) show the proportions of the three types of asset allocation. The debentures' value rate decreased during the 20s from 58 percent at the outbreak of the war to 52 percent in 1928 remaining the dominant asset type. The other two types increased slightly to 25 percent for the ordinary shares and for the preferred ones. Despite this high increment as for the number of the holdings this difference is not so visible in terms of value. Examining variables 6 to 8 (the value of the average asset allocation holdings group) one can see that the preferred shares rose by 20 percent (from 19 percent in 1914 to 23 percent in 1928) while the ordinary share proportions increased from 22 percent to 24 percent, an even lower difference.

Table 4.2 Descriptive Statistics of the Investment Trusts' portfolios by sample year.

	1914	**1920**	**1924**	**1928**
Number of holdings per portfolio	337; 317; 128.13	329.50; 318.50; 134.81	341.73; 317.50; 150.18	383.33; 331; 173.46
Debentures	177.17; 156; 63.08	156; 137.50; 59.90	170.83; 154; 70.74	171.24; 148; 87.09
Preference shares	69.63; 61; 40.25	77.70; 65; 37.11	79; 66.5; 37.11	95.09; 87; 49.44
Ordinary shares	89.79; 70.5; 65.8	95.77; 80.5; 70.86	91.9; 80.5; 75.2	117; 94; 91.93
Portfolio value (£ mil)	2.05; 1.48; 1.67	2.29; 1.77; 1.91	2.20 ;1.61; 2.04	2.06; 1.33; 2.19
% Debentures	58.48; 56.81; 15.36	55.32; 56.09; 12.89	56.88; 53.95; 13.32	52.31; 51.79; 11.27
% Preference shares	18.96; 19.70; 8.10	20.52; 18.51; 8,20	18,79; 18,61; 7,07	22,84; 22,74; 6,29
% Ordinary shares	22.57; 23.54; 10.50	24,15; 23,95; 9,26	24,33; 23,20; 11,61	24,85; 22,98; 11,46
Value of the individual security in £	5,758.93; 4,623.18; 3,344.76	7,346.11; 5,763.44; 7,494.21	6,304.17; 5,083.73; 5,035.40	4,760.38; 4,459.98; 2,866.84

Notes: These data refer to the period 1914-1928. The variables are the same as the first panel of the previous Table (**Table 1**); they have again been aggregated all the variables at the level of the portfolios before the descriptive statistics calculations. Values are expressed as mean, median and standard deviation respectively.

Source: For 1914 it uses the data of Sotiropoulos *et al.* (2020). The rest belongs to this dataset.

The last variable (row 9) of the sample is the individual security's value. The evolution of the average asset value is very interesting. Starting from the pre-war level of £5,600 it reached £7,300 in 1920 exhibiting a 30 percent increment. This can be interpreted by the then new burden of the national debt, in high values, imposed on the ITCs, altering the mean value. This can be proved observing the two next observations for the years 1924 and 1928, with values at £6,300 and £4,800 respectively. Also, part of the reduction can be also attributed to the gradual acquirement of more ordinary shares, which were, generally, denominated in smaller values.

To summarise, only these two Tables are enough to offer the first representative picture for the British ITCs, at least the ones which are contained in this sample, for the period 1914-1928. A sample of 40,000 observations of 117 firms is displayed, well-diversified into 350 assets per portfolio list, evenly distributed. Half of the sample has been invested in fixed interest assets while the rest has been divided into ordinary and preferred shares. These results confirm at a first level that a ITCs had diversified portfolios, holding a wide variety of almost equal value holdings. Despite the outbreak of WWI and the necessary changes they had to follow, they maintained a sophisticated management leaving their priorities untouched. The significant dispersion, which will be clearer below, is a sign against a "one size fits all" management policy, this means that each company was following, more or less, an autonomous path. Although the high diversification policy they applied about the asset allocation policy, which included both fixed interest holdings and equity, there was a significant predilection towards the former type of holdings. That period can be characterized as the first endeavour towards the shift of the paradigm, viz. the exclusive usage of the fixed interest holdings as a long-term investment which is challenged by the equal participation of the equity for a higher yield, (see Smith, 1926); for the UK case during the interwar period, (see Scott, 2002). This debate will be examined scrupulously in this chapter.

Now this thesis scrutinizes the existence of the extrema of these holdings, by studying which could potentially distort the diversification process, viz. which holdings were of much different (mainly higher) value than the average, and which was the reason for this distortion of an otherwise perfectly diversified portfolio. It also examines the size of the ITCs, in particular, it discusses the size of their portfolios which seems to be inconsistent with their successful financial performance.

4.1.1 Alternative controls for outliers

To explore the degree of the diversification of the sample, this thesis creates additionally Table 4.3, in which it estimates the percentiles of the holdings' values to identify their minima and maxima.[28] The holdings that are in the highest 0.1 percent (41 observations) cost more than £139,540 and the highest 1 percent is worth more than £45,000. In the same way, the upper 10 percent includes holdings of greater value than £13,000; while, in the lowest section there are, correspondingly, values less than £832 for the lowest 10 percent of the sample. Concluding, it is evidence of the existence of outliers in the sample, however, this does not alter the main argument about a well-distributed sample, indicated by ITCs with many and low valued investments.

Table 4.3 The highest and lowest percentiles of the sample's values per asset

Percentile	**99.9%**	**99%**	**95%**	**90%**	**10%**	**5%**	**1%**	**0.1%**
£	139,537.54	45,033.26	20,000	12,898	832,55	500	102.88	12.85

Source: For the 1914 it uses the basis of Sotiropoulos *et.al.* (2020). The rest belongs to this dataset.

Moreover, it separates from the sample the upper 1 percent to scrutinize the main holding's types that compose it. It offers additional information about the asset allocation policies that were being followed. This is summarised in Table 4.4, in which from the top 421 assets (the highest 1 percent), the 80 highest value assets (the highest 2‰ of the sample) have 6-digit values. Moreover, the majority of the highest 1 percent can be found in the sectors: railways (almost 50 percent), the government (lower number than the railways but much higher in value) and finally, services as electricity and tramways. Here this study separates two tendencies. The first concerns a non-economic factor, the external shock of WWI. The direct intervention of the British government, as this thesis supports in the next chapters, compelled the ITCs to shift their strategies incorporating the high value of governmental bonds as an exchange for their American ones.

However, this episode was temporary not affecting the ITCs portfolio in the long run; the notion of diversification remained dominant as an idea and practice. The second tendency concerns all the other securities (bonds) which were connected to sectors and countries with long-term financial relations, see the next Chapters. E.g, there were well-established American Railways or other Utilities. In these sectors and countries, the ITCs had in any case significant investments. Finally, internal information and /or preferences cannot be excluded.

[28] This is a cross section analysis.

Table 4.4 Information about the holdings with the highest values of our sample

In the upper 1%
421 observations with values ≥ £45,000 *of which:*
Railways: 194
Government: 82
Electricity, Lightning and Power: 27
Tramways: 26
80 assets > £100.000

Source: For the 1914 it uses the basis of Sotiropoulos *et.al.* (2020). The rest belongs to this dataset.

Additional information is presented to be explored the ITCs' holdings with the highest values. Table 4.6 specifies, indicatively, the 50 holdings with the highest value (the highest 1‰ of the holdings). The results are supplementary to the previous Tables. More than 50 percent of the observations (27) are government bonds which have mainly appeared during the WWI. Extremely interesting is the fact that no but one observation is for 1914. The second sector was railways with 20 observations. Out of 50 assets, half were from 1920. This information is indicative of the cause of these outliers. It is a deviation from the ITCs' norm about diversification because mainly of increased state intervention.[29] During the 1920s, this situation gradually normalized.

Finally, it has not prepared a table for the holdings with the lowest values. As Table 3 highlights, the lowest 1 percent (421 holdings) contains holdings that cost less than £103. The reason why it does not depict these data across a table is that these holdings are distributed in an extremely wide area. Some interesting facts are: first, the vast majority of these holdings are shares (few bonds of low value), second, there are two main destinations, namely the UK and the USA (here the notion of no-par value is present); finally, despite the wide sectoral dispersion, the position of Industry is dominant (50 percent); sectors as trusts, breweries and railways observed more frequently.

[29] Regarding Railways, they belong to the second case as mentioned above. ITCs persistently kept in their portfolio holdings like these for the whole period; however, their prices were generally much lower e.g., almost 1,000 Latin American railways holdings bigger than £20,000 existed, comprising 40 percent of the observations of the upper 5 percent of the sample; nevertheless, their average amount is £33,000 which is much lower than values dealt with now, overall, it did not affect the general diversification process.

Table 4.5 The 50 highest value assets

ITC	Year	Value (£)	Country	Sector	Asset
Mercantile Investment and General Trust	1920	1,000,000	UK	Government	War Loan 5% 1929-1947
Sterling Trust	1920	780,464,5	USA	Railway	Vicksburg Shreveport and Pacific RR common stock
Mercantile Investment and General Trust	1924	700,000	UK	Government	War Loan, 5 per Cent. 1929-1947
Sterling Trust	1924	627,488.7	USA	Railway	Common Stock (out of a total issue of $2,856,500).
Consolidated Trust	1920	625,000	France	Government	National Defence loan of the govt of the French republic 4% rentes "British Issue"
Sterling Trust	1920	585,464.5	USA	Railway	Vicksburg Shreveport and Pacific RR Pref Mort 5% stock non cum
Sterling Trust	1920	573,770.5	USA	Railway	Alabama and Vicksburg RR Stock
Sterling Trust	1920	525,136.6	USA	Railway	Vicksburg Shreveport and Pacific RR General Mort 5% bonds
Mercantile Investment and General Trust	1924	519,000	UK	Government	Conversion 3½ per Cent. Loan, 1961
Foreign and Colonial IT	1920	481,100	UK	Government	5% War Loan 1929-1947
Sterling Trust	1924	470,610.9	USA	Railway	Preferred 5% Stock (out of a total issue of $2,142,800).
Sterling Trust	1924	350,900	UK	Government	3½% Conversion Loan.
Sterling Trust	1920	313,000	UK	Government	4% Funding Loan 1960/1990
USA and South America IT	1920	300,000	UK	Government	5% War Loan 1929-1947
USA and South America IT	1924	300,000	UK	Government	5 per Cent. War Loan, 1929-1947
Mercantile Investment and General Trust	1928	300,000	UK	Government	Conversion 3½ per Cent. Loan, 1961
Sterling Trust	1920	295,000	UK	Government	4% Victory Bonds
Foreign and Colonial IT	1924	290,000	UK	Government	5 per cent. War Loan, 1929-1947.
Industrial and General Trust	1928	266,375	UK	Government	British Government, 3½ per Cent. Conversion Loan.
Sterling Trust	1924	264,253.4	USA	Railway	Stock (out of a total issue of $2,100,000).
Sterling Trust	1924	258,000	UK	Government	4% Funding Loan, 1960-1990.
Sterling Trust	1920	255,000	UK	Government	4% National War Bonds 1927
Sterling Trust	1924	255,000	UK	Government	4% National War Bonds, 1927.

Continued Overleaf…

Table 4.5 The 50 highest value assets (*continued*).

ITC	Year	Value (£)	Country	Sector	Asset
Alliance Trust	1920	250,000	UK	Government	French National Loan 4% Rentes
Sterling Trust	1920	244,000	UK	Government	5% War Loan 1929-1947
Sterling Trust	1924	244,000	UK	Government	5% War Loan, 1929-1947.
Sterling Trust	1924	226,244.3	USA	Railway	Refunding and Improvement Mortgage 6% Gold Bonds.
General and Commercial IT	1924	200,000	Brazil	Railway	Leopoldina Railway Company, Ld. (Ordinary Stock.) £10 each, fully paid.
Industrial and General Trust	1924	200,000	UK	Government	British Government, 3½ per Cent. Conversion Loan.
Scottish IT	1920	196,000	UK	Government	National War Bonds 5% 1922
Mercantile Investment and General Trust	1928	182,000	Italy	Shipping	Loan (Societa Anonima per Azioni Lloyd Sabaudo) Guaranteed under the Trade Facilities
Bankers Investment Trusts	1920	175,800	UK	Government	British Government 5% War Loan 1929-1947
Bankers Investment Trusts	1924	175,800	UK	Government	British Government 5% War Loan, 1929-1947
Sterling Trust	1920	158,688.5	USA	Railway	Alabama and Vicksburg RR Consolidated 5% mort bonds
Sterling Trust	1928	150,160	UK	Trust	"C" Debentures of this Trust.
Industrial and General Trust	1924	150,000	Argentina	Railway	Cordoba Central Railway Company, Limited, 5 per Cent. Second Debenture Stock.
Industrial and General Trust	1924	150,000	Chile	Railway	Antofagasta (Chili) and Bolivia Railway Company, Limited, Consolidated Ordinary Stock.
Industrial and General Trust	1928	150,000	Argentina	Railway	Cordoba Central Railway Company, Limited, 5 per Cent. Second Debenture Stock.
Industrial and General Trust	1928	150,000	Chile	Railway	Antofagasta (Chili) and Bolivia Railway Company, Limited, Consolidated Ordinary Stock.
Sterling Trust	1920	140,000	UK	Government	6% Exchequer Bonds 1920
American Investment and General Trust	1920	139,289.6	UK	Government	War Loan 5% 1929-1947
Mercantile Investment and General Trust	1920	139,071	USA	Railway	Missouri Pacific Ry. Co., 5% conv cum pref stock $100 fy pd
Sterling Trust	1924	138,460	USA	Railway	"C" Debentures of this Company.
Bankers Investment Trusts	1924	132,450	China	Government	Chinese Imperial Government, 4½% Gold Loan of 1898
Foreign, American and General Trust	1920	127,300	UK	Government	War Loan 5% 1929-1947
Bankers Investment Trusts	1914	123,250	USA	Railway	Alabama Great Southern Railroad Co., Ordinary Shares, $50 each, fully paid
Bankers Investment Trusts	1920	123,250	USA	Railway	Alabama Great Southern Railroad Co., Ordinary Shares, $50 each, fully paid
Industrial and General Trust	1920	120,000	Argentina	Railway	Cordoba Central Railway Company, Limited, 4% Second Debenture Stock
Sterling Trust	1920	113,688.5	USA	Railway	Alabama and Vicksburg RR Second mort 5% bonds

Source: For the 1914 it uses the basis of Sotiropoulos *et.al.* (2020). The rest belongs to this dataset.

4.1.2 Historical evolution of the size of the ITCs

An important piece of information for every company, sector or economy at all is its size, a significant index for its robustness and its future. The ITCs cannot be excluded from this canon. Sotiropoulos *et al.* (2020) presented an average paid-up capital of £1.2 million for 1914. Chapter 3, Table 3.1 for 1928 finds an average paid-up capital of £1.37 million for the English ITCs non- disclosing portfolios' holdings and £1.55 million for the disclosing ones correspondingly. For this period an annual growth rate of 1 percent emerges. Thus, for a period of 14 years this thesis cannot see a significant size change. So, where exactly can it detect their growth pattern? Did they represent a stagnant sector? If this is correct, it is a first sign for a decaying sector, thus, rapid change in its policies is required, for a potential future revival. This research supports that is not true for the ITCs. A peculiar characteristic they mainly used was the establishment of new companies, which bore the same name using a serial number (e.g., *Second* Mercantile Trust, *Third* Scottish American Trust etc.), used the same directory teams, belonged to the same interests and followed the same managerial policies. ITCs managerial teams were crystal clear about the implementation of this policy.

A characteristic example was the speech of the Chairman of the Mercantile Investment and General Trust who referred to the annual meeting of the Trust in 1927, one of the most profitable years of the period. "in the interval [period of one year] this company has issued no additional capital. The capital of the company in 1918 was 6£ million. It is 6£ million today, so that this large increase in revenue has been secured by the employment of the same resources." (Financial Times, 23 February 1927, p. 2).[30] Two important facts can be extracted from this quotation. First, the ITCs' policy against the frequent issue of new shares, hence, hardly new capital was raised. Second, the indeed strange and non-economic logic, they followed; a policy of initial growth up to a threshold, beyond which no growth path existed.

During the 1920s, there was a financial boom which along with structural changes of the UK economy, see Chapter 9, led to a mountainous wave of companies' entries into the financial market, mainly into the LSE. Following this wave, many new ITCs were inaugurated.[31] A significant observation about these newer ITCs was that many belonged to the already existing ones, bearing smaller portfolios (including second third etc. in their names); so, this is not an

[30] FT hereafter.
[31] See, *The Economist* (1934).

indication of a problematic situation, rather it supports the opposite opinion about the development of the sector.

The inauguration of these new ITCs was not unknown to the financial advisors of the period. Robinson (1923) referred to various reasons why these new ITCs were established. Some of them were: a) the interconnections between the directors and the managers, meaning that a small number of people could direct a lot of companies; to put it differently "several Trusts can be run with the economy of the one", b) the complete control over all the aspects of the business; and, mainly, c) "the desire to obtain new articles of association, benefiting by the experience of the parent company without altering its traditional policy" (Robinson 1923, p. 6). In the last case, the management's endeavour to experiment with new "conditions of investments" was characteristic.

In the case of the *Scottish Investment Trust,* for example, in its Second Trust a new asset allocation had occurred, with 60 percent of its issued capital in preferred stock and the rest in deferred one (for the First Trust the corresponding split was 50/50) while the borrowing power had augmented to 100 percent of the share capital (from 50 percent). This practice, viz. the higher leverage offer, verified the existence of a well-established company (Rutterford et al., 2021). All in all, the limitation of the size of the ITCs, is not an index for a problematic situation, rather, it supports the opposite opinion about the development of the sector. It is only a phenomenological rejection of the laws of the concentration and centralization process. This is a very fundamental notion, "the immanent laws of capitalist production" according to Marx. Through the process of accumulation, competition and credit, there is a tendency toward fewer and stronger companies in the market. See among others Marx (1867), Sweezy (1942), Shaikh (1991). The ITCs *de facto* expanded just using an abnormal way, unique in economic history.

A similar question that arises is the relationship between the ITCs' paid- up capital compared and the general paid-up capitals of the British listed companies in the LSE. Examining the data for 1915 in Essex-Crosby (1937), depicted in Table 4.6, from a total of 5,333 registered companies (both in England and Scotland) almost 1,000 (18 percent of the total number of companies) had paid-up capitals of more than £0.5 mil. Comparing this with the Investment Trusts, it is observed that, for 1915, the latter were smaller companies which had a much lower spread (there was no company with capital greater than £10 million and 44 percent of them had capital between £0.5 and 10 mil); at the same time, 405 of the total companies had as a paid-up capital an amount greater than £0.5 million. Here, many problems arise. First, this study included a broader definition for the Investment Trusts, *Financial Trusts* for Essex-Crosby

(1937) in 1915. Second, various polices which were followed to raise up capital. Despite these, the main point remains, a significant difference between the Trusts and the total sample.

In 1935, 20 years later, the concentration and centralization process of capital was present; the remaining companies after WWI and the economic crisis of 1929 were fewer, with a total number of 3,949, while the sizes were higher (118 companies had paid-up capital greater than £5 million compared to 53, 20 years earlier); now, three out of ten companies had capital greater than £0.5 million. The total registered capital was £1 billion more than in 1915 reaching £3.7 billion. At the same time, the picture for Investment Trusts was more complicated. The total number of the ITCs had risen by 55 percent, reaching 228 Trusts; moreover, its paid-up capital had risen too by 1.64 times. The ITCs with capital greater than £ 0.5 million now represented 77 percent of their total number. So, comparing the Investment Trusts with the general picture of British registered companies, which had become less and stronger, also following the rationalization process of the British Industry (see Hannah, 1983), Trusts had not only become stronger, but also numerically more, with no great capital discrepancies among themselves. The last evidence conceals the coexistence of many ITCs which originated from the same parent company, as discussed in the previous paragraph, so the real number was overestimated. Further research is needed to bridge the gap of the unusual raising capital techniques of the ITCs and their contribution to the establishment of financial markets as they are known nowadays.

Table 4.6 Paid-up capital and Number of Companies for the years 1915 and 1935

Companies Registered in England and Scotland for the year 1915		
	Total Number: 5,337	*(of which)* **Investment Trusts**: 147
Total Paid up capital and fixed loans (£ mil)	**Companies' Number**	**Companies' Number**
>10	19	-
5-10	34	2
2-5	143	13
1-2	273	21
0.5-1	497	29
Total	***966***	***65***
	(18% of the total number)	(44% of the total number)
	Total Subscribed amount	
	2,735,205 (thousands £) *(of which)* ≈ **2,400,000 (thousands £) paid up**	**122,639 (thousands £)** *(of which)* ≈ **120,000 (thousands £) paid up**
Companies Registered in England and Scotland for the year 1935		
	Total Number: 3,949	*(of which)* **Investment Trusts:** 228
Total Paid up capital and fixed loans (£ mil)	**Companies' Number**	**Companies' Number**
> 10	41	-
5-10	77	7
2-5	222	43
1-2	346	64
0.5-1	513	63
Total	***1199***	***177***
	(30% of the total number)	(77% of the total number)
	Total Subscribed amount	
	3,728,230 (thousands £) *(of which)* ≈ **3,410,000 (thousands £) paid up**	**324,315 (thousands £)** *Almost all of them* **paid up**

Notes: The reference for ITCs in 1915 is *Financial Trusts* whereas for 1935 is *Investment Trusts*.
Source: Essex-Crosby (1937); Table III p. 222; Table IV p.223; Table XI p. 230; Table XI.

4.3 Conclusion

This Chapter discusses the main results of the ITCs' dataset. Descriptive statistics reveal an ITC which on average was a 350-holdings' trust, with a slight temporal increment, but with a stable total value portfolio of approximately £2 million. This were the main results form a sample with 40878 observations. The determinants are a) the existence of a highly diversified portfolio lists for the whole period; b) the continuing amplification of an already sophisticated management strategy which had beaten the financial predicament of WWI and its aftermath. A diachronic superiority of the fixed income assets was presented, which gradually led to a parallel curtailment and an analogous augmentation of equity. Half of the assets of this sample were foreign, while only the minority were invested in the Empire. It is evidence for global investments superiority for the examining period.

Second, this Chapter examines the evolution of the size that British ITCs followed. A controversial route appears as compared with the LSE registered companies. Despite the capital growth and the shrinkage of the total registered companies, the ITCs seem to follow an *unorthodox* path, growing in number and remaining more stable in registered capital. This abnormality can be explained by the inauguration of new ITCs with close relations among each other. All indices that are used outline the main purpose of ITCs; an institution which follows a very diversified portfolio that is the basis for a successful management strategy.

5 Asset Allocation of the ITCs

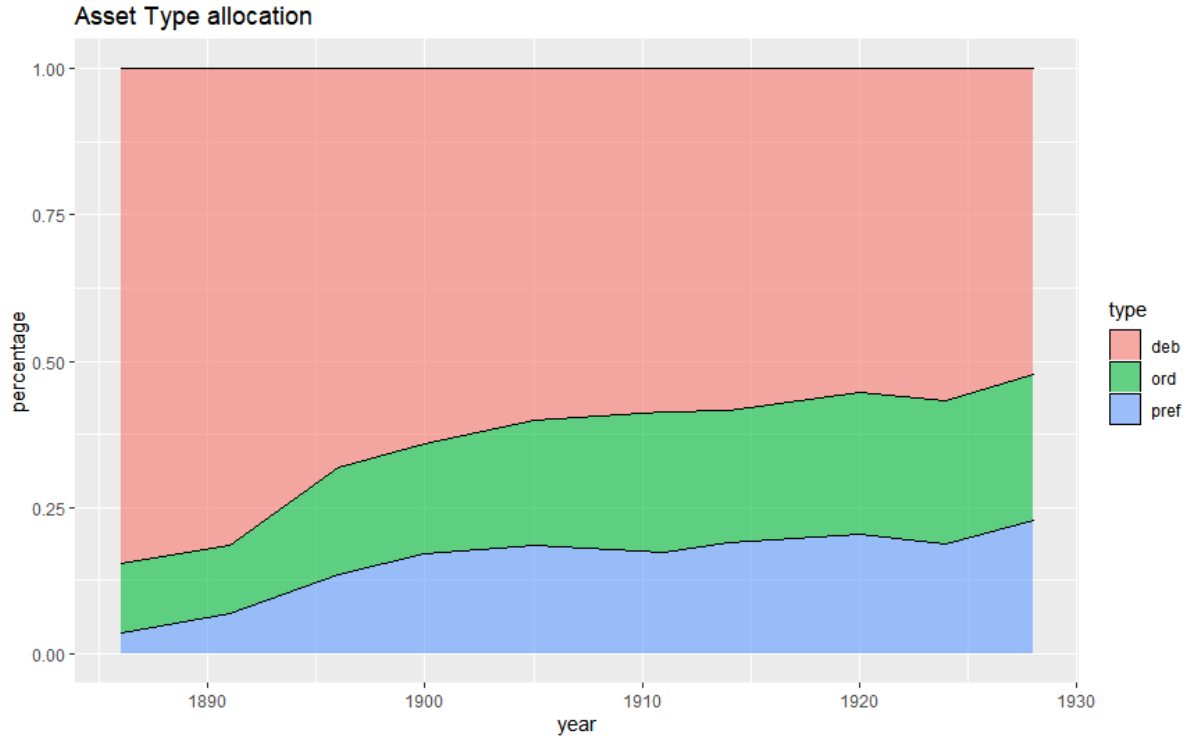
5.1 Introduction

Asset allocation is the first of the main variables that dataset contains; this will answer the main research question, the asset management strategies of the British ITCs. This Chapter focuses on issues about the asset allocation of ITCs portfolios during the 1920s. It starts debating the main problems arising for a war economy, namely inflation and taxation. Could the ITCs tackle these difficulties? Was their management efficient enough to challenge this situation? Additionally, it depicts the cataclysmic results of WWI in the ITCs portfolio lists. The emphatic state intervention in the capital market led the ITCs to curb their diversified portfolio, the holy grail of this financial institution. Could they react to this non-economic shock? Finally, it compares the ITCs' asset allocation in parallel to the general evolution of the British financial market.

Results confirm the superiority of the ITC management strategy. Their commitment to long term and well diversified investments was significant in facing these external shocks. Despite the challenges to the various holding types because of the monetary imbalances which had led many investors to change their portfolio, the ITCs remained consolidated in their initial scope. This strategy did not mean a disengagement from the financial market. Studying the market closely, they participated in all the promising novelties, especially in a period of a financial increment. They gradually, expanded their lists to include more ordinary shares, that had flooded the LSE, maintaining their management foundations.

Figure 5.1 analyses the diachronic flow of the various types of asset allocation in the portfolios. It presents the average percentage of each type and there is an initial aggregation at the level of portfolios. The reason why it decides to visualize the whole period since the late 19th century merging the data of Sotiropoulos *et al.* (2020) with this base is because it gives us a more explicit and panoramic view of the evolution of the asset allocation and of the criteria according to which specific investment policies were made.

Figure 5.1 ITCs asset type allocation 1886-1928 (percent average portfolio nominal value)



Source: Sotiropoulos *et al.* (2020) for the period up to 1914. The rest belongs to this dataset.
Notes: The sample contains the whole period since ITCs appearance.

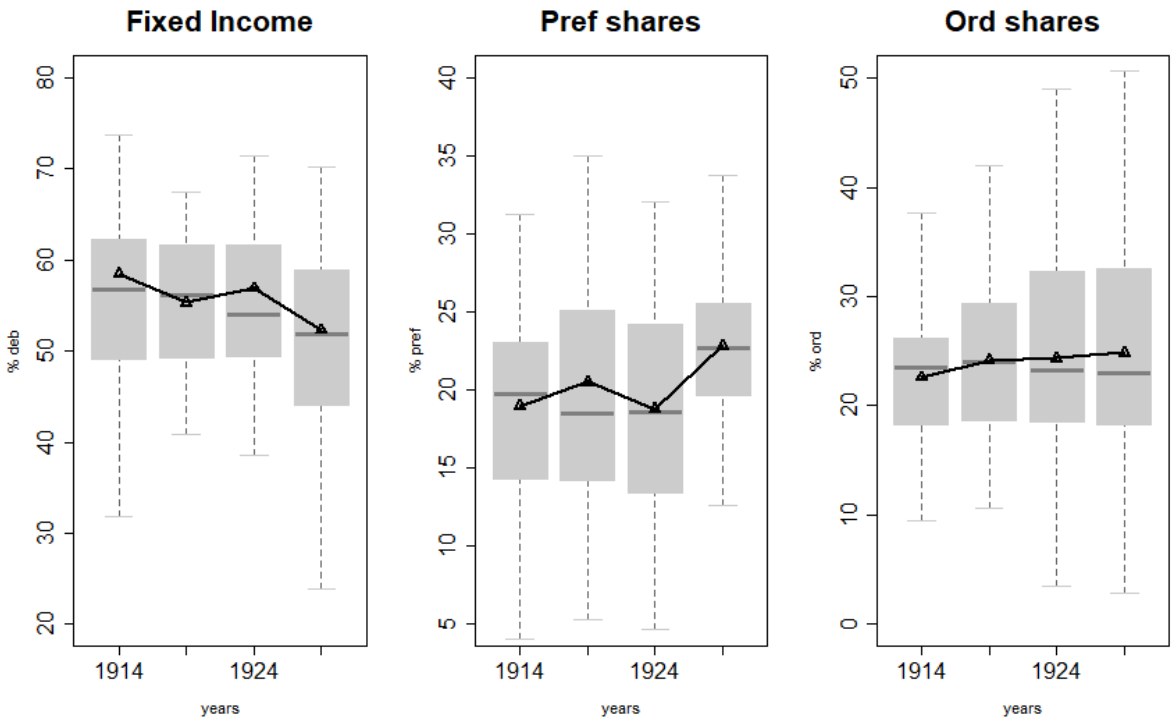
As Figure 5.1 depicts, see also Figure 5.2**,** the fixed income securities dominated throughout the whole period, being the absolute majority without exceptions. The main tendency was a gradual and moderate shift towards shares[32] (both the ordinary and the preferred ones). Figure 5.2 presents the same variables as the previous one in a boxplot form. The most interesting point is the high dispersion which appears. This dispersion, mainly of the ordinary shares, depicts the huge differences among the various portfolio lists. Especially in the last two observations (1924 and 1928) this distance increases; there are portfolios with negligible portions of ordinary shares whereas there are others that invested almost half of their portfolio in ordinary shares.

An interesting question which arises is what does this tendency symbolize? Initially, this change can be interpreted as an active management strategy, viz. that the ITCs boards had foreseen a better performance of the ordinary shares modifying the asset allocation of their portfolio. Besides, because the post-WWI period was a period of a massive entry of new companies into the British financial markets, they just followed the market. In the meanwhile,

[32] Excluding the period up to 1890 because of lack of data, a moderate shift towards a higher investment in shares appears; nevertheless, the presence of debentures remains dominant.

the monetary conditions of the period (high inflation) pressed the lenders to withdraw the fixed income securities from their portfolio, see the discussion below. A combination of all these can explain this tendency. Finally, during the interwar period, in economic history the argument about the "cult of equity" has been supported, meaning a shift towards the extensive usage of equity as a new philosophy in investment theory, see Scott (2002). Smith (1925) introduced the investment of common stock as a long-term investment supporting the more promising yields they could offer and proposing the wise investment management which should be followed. This study attracted publicity, especially after the review written by Keynes (1925), see also Smith (1926). As for the ITCs, the data does not support this practice entirely. Such a structural change was extremely risky for the cautious ITCs' management, without preventing the new chances of well-established enterprises' securities.

Figure 5.2 Asset allocation by type (percent of portfolio nominal value)



Source: For the 1914 it uses the basis of Sotiropoulos *et al.* (2020). The rest belongs to this dataset.

The rest of this Chapter is divided in three parts. Initially, it describes the two main problems for the investors, taxation and inflation, which emerge during and in the aftermath of WWI in the British economy, and globally. Although ITCs faced no severe problems with them, they had to learn to live with them. Next, it explains the main consequence of WWI for the ITCs, viz. the direct state intervention which purchased the dollar-based securities leading to the search for alternatives. Finally, it delineates the financial atmosphere of that period describing

the main dangers of the asset allocation on the ITCs performance. Because of the frequent and deep fluctuations in the monetary policy in the aftermath of WWI, the securities' values were seriously but temporarily affected. Fixed income and equities followed opposite roads; however, the ITCs suffered no serious damage because of their long term and secure investments. Nevertheless, they were affected, shifting gradually, but lesser, their portfolio towards the ordinary shares. Since 1923, they scored great success because of the financial boom; participating also in the then financial innovations through their own issued equity. All in all, the changes in the asset allocation were not significant; the cautious asset management again proved beneficial; nevertheless, they interacted well with the market taking full advantage of the opportunities that arose.

5.2 Taxation-Inflation: two problems of the war economy and beyond.

The examining period of this study includes WWI. War generally is a period of turbulence in economics. Besides, it occurred after a long period of peace which the French characterise as a *belle époque*, (see Palmer *et al*., 2013).[33] In the UK, the Edwardian period had started in 1901, following the Victorian one; here one can argue that, at least, financially speaking, there was general *euphoria* caused by the financial predominance of the City whose "pulse beat to the rhythm of its markets" (Cassis, 2006, p. 83). WWI was a disruption to this atmosphere. War finance was one of the main and unprecedented problems, especially for a liberal state such as the UK. Which were the main ways to finance a war? The alternatives are few, namely: a) raising taxation, b) raising debts, and c) raising the money supply (inflation). Obviously, combinations of these ways are also effective. For this discussion of the period of WWI see among others Keynes (1914a & b), Fisher (1918) and Pigou (1918, 1920). These discussions were, unavoidably, enriched during WWII. Any of these alternatives creates serious economic problems. In the case of the investors both tax increase and the emergence of inflation changes their preferences about investments. For the ITCs the problem exists too. Higher taxation meant a financial predicament for the share or bondholders to raise or even to maintain their assets and the monetary oscillations changed rapidly the values of the various holdings. Finally, the BoE interest rate functioned as a benchmark for these movements, see Chapter 3.

In the case of Britain, the issue of war bonds was the norm; however, the other two measures were employed too, (see Morgan, 1952); Ellison et al., 2019). For instance, the taxation system

[33] This happened for all Europe, its first golden age, living in peace, economic prosperity, colonial expansion, and technological innovations and arts.

was reformed because of the emergent situation; income taxation was raised. Since 1909, a system of two income tax rates had existed, a regular one and a supertax, known as a "surtax", with the parallel existence of a tax-free level. The political implications of taxation are a huge debate even nowadays. Daunton (1996), refers to the endeavours of Peel and Glasdon to implement a taxation system "as a social contract between classes and interests" dealing with issues of fairness and equitability.

A threshold of £150 tax-free annual amount was present, and the pre-war tax was 7d in the £ (2.9 percent approximately). During the war, both the tax-free threshold has lowered, and the super tax was increased. Characteristically, an income of £5,000 in 1913 was taxed by 8.3percent, while in 1918 an income of £10,000 reached to pay 52.5 percent (Cheffins, 2008, p. 259)! At the same time, a debate arose, emerging the contradictory interests mainly between the City and the Industry, in which also the labour class was participating (Daunton, 1996). The question was how the excess exposure to borrowing would be repaid. The imposition of a capital (or wealth) levy, or higher taxation (on capital or on income) were the main solutions of course through the prism of political and social interests.[34] Prominent economists of that period participated in the debate, see Pigou (1918; 1920); contra Stamp (1919). The proposed solution was the implementation of an Excess Profit Duty (EPD) on all companies on profits which exceeded 20 percent of the corresponding pre-war profitability, starting from 40 percent and reaching 80 percent in 1917 (Cheffins, 2008, p. 257). All these variations in taxation had implicit effects in the ITCs because their share/bondholders were simultaneously taxpayers with significant incomes. Thus, when an investor faced serious tax burden, a common practice was (still is) either to postpone any new investment or even to liquidate the existing ones to redeem their tax debts.

Additionally, there was an extra explicit burden of taxation in ITCs, namely, the dividend taxation. Dividends in the interwar period were taxed not only in a standard rate, as already mentioned, but also through supertax. So, only for the regular tax rate, there was an increase as follows: from 7d. in the £ in 1913 (2.9 percent) to 3s. 6d. in 1915 (17.5 percent) and finally to 6s. in 1918 (30 percent). Additionally, the company for the UK tax authorities was not regarded as a separate taxable entity (Rutterford, 2004). As a result,

[34] Labour were voting in favour of a huge capital levy as a weapon against the capitalists. The Conservative government was in favour of a wealth levy. Businessmen were against any type of excess taxation. See Pigou (1920).

> "taxation of company profits in England is part of the general system of taxing personal income. Although the government collects the levy on dividends and earnings at the corporate source, adjustment thereof is subsequently made on the individual's net tax bill in accordance with his respective bracket. The recipient is in effect liable for the tax on his dividends as for that on his salary and other receipts, with the sole difference that the company making the distribution acts as the tax collector for the state" (May, 1939, p. 736).

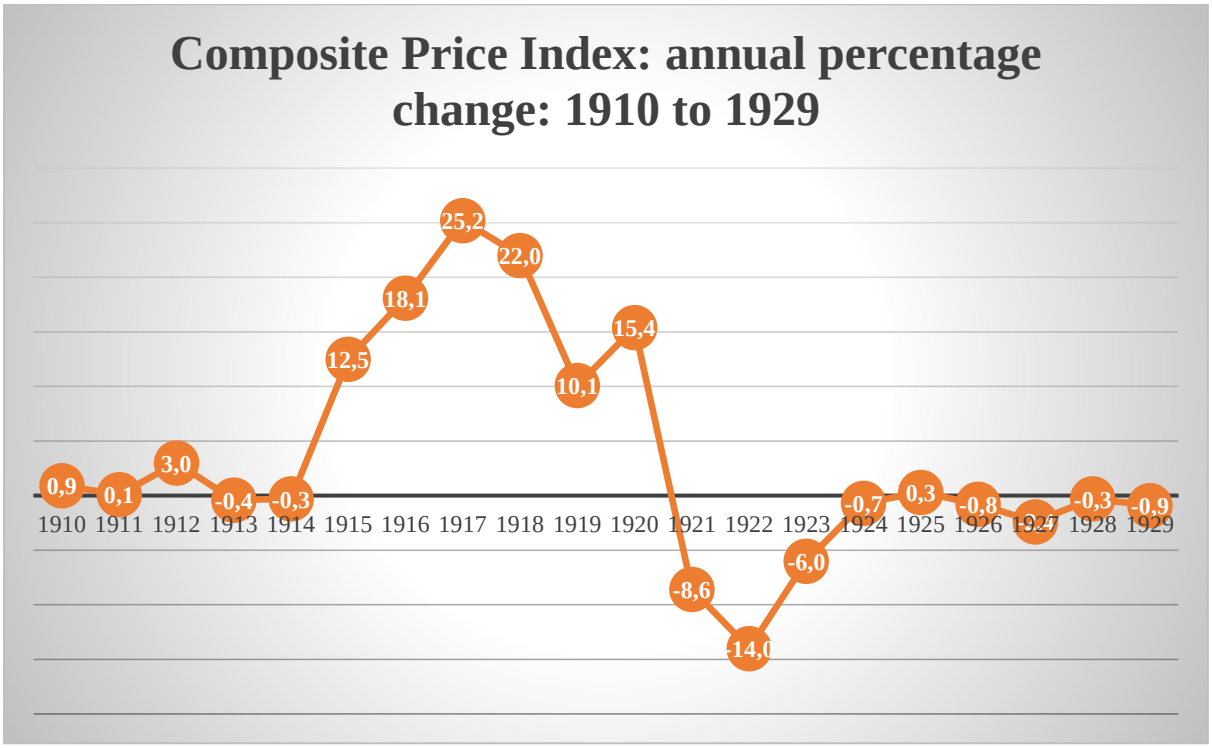
This technique created problems because it was practically unable for the ITC to accurately pledge their final net earnings. "This made it difficult to estimate income tax after 'company' tax but before 'investor' tax" (Rutterford, 2004, p. 131). A common practice for the British ITCs was to guarantee a specific dividend (let us say 5 percent) after tax to the potential investor. However, under "surprise taxation" it was difficult enough to achieve the initial pledge.

The problem of the inner reserves, as discussed in Chapter 2, is directly related to taxation. A significant reason why British companies selected to keep secret reserves was high taxation (Arnold 1997). This tactic was followed also in financial sector (see Cappie & Billings, 2001).

At the same time, because of the outbreak of the war, government expenditure increased, Morgan (1952). As a solution to this problem, drastic restrictions were placed on assets in foreign currencies (see Atkin, 1970) as it will be analysed below.

High inflation is generally harmful to the economy, (see characteristically Burda & Wyplosz 1997; Barro, 1997; Blancard *et al.,* 2017). Especially during a war, shocks in the economy causes increases in price levels. The most indicative index for inflation is the Consumer Price Index. As Figure 3 features**,** for the period 1915-1919 there was an average annual rise of 18 percent. The picture was the same for all the economies, neutral countries included, because of the unprecedented rise in the demand side of the economy with a parallel disruption on the supply side. This situation continued for one additional year (1920) with a boom in the British economy. However, the situation was totally inverted in the succeeding years. In 1920s there is a persistent curtailment of the prices index reflecting a less than idyllic picture for the British economy. As already mentioned, the goal of the British authorities was to surpass the deflated value of the British pound; an explicit support for the interests of the City compared to British industry.

Figure 5.3 Composite Price Index: annual percentage change: 1910 to 1929



Source: O' Donoghue *et al*. 2004, p. 44.

The best description of that atmosphere can be displayed by the following speech by the Governor of the BoE in 1920:

> "The first and most urgent task before the Country is to get back to the gold standard by getting rid of this specific depreciation of the currency. This end can only be achieved by a reversal of the process by which the specific depreciation was produced, the artificial creation of currency and credit, and for this the appropriate instrument is the rate of interest. The process of deflation of prices which may be expected to follow on the check to the expansion of credit must necessarily be a painful one to some classes of the community, but this is unavoidable" (quoted in Feinstein *et al.*, 1995, p. 17).

High inflation is generally problematic for the fixed income securities' investors, who lose part of their income. So, as a common practice, inflation is in favour of the issuer of the debt.[35] Thus, the existence of inflation of 100 percent cumulatively for the period 1914-1918 meant great losses for the owners of British debentures, the ITCs included. In this case, the situation was more perplexing because of the high intervention of the British government in the capital market, offering gigantic amounts of Gilts. These war bonds were issued under good

[35] Always for the same currency. Now, the ITCs were simultaneously bondholders and bond issuers. Thus, they had the advantage of using the same tactic for themselves, mitigating the consequences.

conditions, see Morgan (1952, p. 108*ff*),[36] working as a substitute for corporate bonds. To solve the problems of servicing its expensive debt and covering the governmental deficit, it withdrew from the Gold Standard. This led, automatically, to inflation, affecting the sterling dollar exchange. Concomitantly, the BoE used the tool of the interest rate in an endeavour to attract capitals ($5 \rightarrow 6 \rightarrow 7$ percent), see Morgan (1952). The next period, 1920-1922, a severe depression hit also the British economy compelling the BoE towards a subsequent curtailment of its rate to release new capital onto the market. However, this movement was too late to dispel the concern of a disruption in the capital market, also affecting the ITCs. The prices' stabilization following 1924, see Figure 4.3, gave a green light to the investors for higher economic activity along with the rumours about the return to the Gold Standard, which finally occurred the next year; the stabilization of this period was a positive sign for the capital and money market.

Now the role of inflation in shares is analysed. Inflation has a negative effect in shares returns, (see Nelson, 1976; Fama & Schwert, 1977; Erb et al., 1995; Barnes et al., 1999). However, it is very interesting to note that in high inflationary cases, this negative correlation to inflation ceased (Erb et al., 1995; Boyd et al., 2001) which is mainly unrelated or after a threshold positive.[37] Modigliani and Cohn (1977) argued for a neutral effect of inflation in shares returns. Surely, in the long run, the high inflation distorts the financial sector and the economic activity.

Here a crucial comment must be added. So far, this thesis has explained inflation in terms of the sterling-based holdings. This means that it covers mainly the British securities and the securities of foreign countries but expressed in pounds, e.g., the Latin American ones. However, the position of foreign currencies was not stable. The main difference here concerns the US dollar-based holdings (one-third of the total sample). US inflation followed a similar path after 1916, it entered the war one year later, following five years of significant inflation (raising the prices 100 percent cumulatively up to 1920); later, it experienced two deflationary years finishing in a stable environment until the crisis, see Chapter 7. The end of the war left the US economy as the great winner, overtaking the British financial market, galvanizing its economy and ruling its own global financial empire. However, the story of these (dollar based) securities is more complex as it will support both in the next section and in Chapter 7. Finally, inflation was crucial for the European securities that the ITCs had acquired since the mid-

[36] [N.B.] for the investors.
[37] These studies focus more on emerging economies after the 1980s, so the examples are not identical. However, the empirical research exists challenging the main idea of a completely negative relationship.

1920s, see Chapter 8. In this new environment of the post-WWI period with higher inflation, the investors searched for extra protection either through an (inter)national pledge, a higher nominal yield, or a combination of the two. In any case, the ITCs learnt to live under this new condition, hedging their portfolio through diversification or extra protection.

Overall, both excessive taxation and inflation distort investments. War periods, like the examining one, can be characterized as special cases during which both problems arise. Additionally, for the post-WWI period, these problems remained. ITCs could neither ignore nor abate them. Their only solution was to learn to live with them. Of course, prudent and sophisticated management had some degrees of freedom, thus it can mitigate potential consequences; however, the ITCs had to seek a symbiosis between them and their purpose. The next subsection delineates the basic evolution of the various security's types during and after WWI, comparing the effects of these problems and pinpointing their outcomes for the ITCs' portfolio. The main analysis of this study does not conclude with any serious problem in their portfolio performance emanating from these two phenomena. The next subsection examines how the ITCs faced financial consequences of WWI.

5.3 WWI and foreign assets. The catalyst.

"It is perhaps a truism to say that the invested wealth of the United Kingdom is one of the strongest weapons of the Allies in the present war…it is not generally understood to what an extent the peculiar character of our national investments has helped to strengthen our position" (*FT* 15/05/1916, p. 2). The explanation for this comparative advantage was that UK investments, in contrast with the other European countries, such as France, had no investments in Europe. "It is our good fortune at the present crisis that so large a proportion of the regular stream of surplus capital available for investment in time of peace has flowed towards America" (*FT* 15/05/1916, p. 2.). "Our European investments are from a national standpoint practically of no avail, for the simple reason that there is no market for them in the countries from which we draw our principal supplies". On the other hand, "[t]he only class of investments for which a really good market obtains is that of United States dollars securities, and the fact that we are drawing so much material assistance from that country renders it all the easier to make the best use of the portion of our national assets". It concluded: "it was, of course, for this reason that this scheme for the Government purchase of American securities was launched in January last" (*FT* 15/05/1916, p. 2) Here, the author described two main issues which are crucial in this analysis; first, the better financial position of the US securities, implying a

potential profit from their exchange and second, the urgent need for obtaining US dollars, not only in cash but also in securities. Indeed, the UK during WWI needed huge amounts of both products and ammunitions, the majority of which was traded from the USA; thus, huge amounts of USD were required, (see Morgan 1952, Ch. 9; Broadberry & Howlett, 2005).

More specifically, "on 24 December 1914 a temporary regulation was passed prohibiting dealings in securities that had not been physically held in Britain since September 1914" (Atkin, 2004, p. 33). At the beginning of the new year, state intervention became stricter; in particular, on 15 January 1915 the Treasury demanded its own approval in advance of issuing fresh capital. In July of the same year, the BoE intervened in the LSE, or by private treaty, buying dollar securities which had been forwarded to New York for sale. They finally acquired securities to the nominal value of $233 million by the end of the year (May, 1922). Because this process had been characterized as "haphazard", in December 1915, the *American Dollars Security Committee* was founded. Its purpose was clear; to obtain securities denominated in dollars, to sell for dollars or to keep for collateral. The first step towards this goal was to investigate the amount of such assets. To get a clear picture of the number of assets held in dollars, they wrote a letter to the institutional investors of the period, viz. to insurance companies, banks and trusts (ITCs included), "asking them to submit lists of American dollar securities held by them, with a view to a possible sale or loan to the Treasury" (May 1922). In parallel, the committee endeavoured to communicate this new situation using extensively the financial newspapers, a hub for investors, as is shown in Figure 4.4.

The role of this procedure was to persuade the investors to support this action. In Figure 4.4, one can see this endeavour. Specifically, the Committee gave the reason for this financial action. It called "the attention of the public to the importance from a national point of view", so, focusing initially on the national emotions of the British, and then it turned to rationality offering the economic argument "of utilizing to the full the resources of the country in the shape of American securities". In the next paragraph, after promoting its already "extremely satisfactory" operations, it analysed the new reality: "In view, however, of the large sums required in America for the purchase of munitions of war and to safeguard the stability of exchanges it is very important that there should be no falling off in the volume of sales and deposits". Here, it explicitly mentions the two main problems which the UK government faced, a) the huge military expenditures in dollars and b) the serious monetary problems of the BoE namely, the storage of huge foreign exchange deposits in the BoE and concomitantly the maintenance of the value of the pound (see Morgan, 1952; Moggridge, 1972). Finally, the

necessary details for no concern, “full particulars for the arrangements both for sale and for deposit can be obtained”, about the process were provided.

In January 1916, at the National Debt Office in Old Jewry, active operations were inaugurated, based on 54 main American securities (which were all bonds). “The prices offered were based on the current New York closing quotations of the previous evening, the New York percentage price being converted into the London sterling price at the existing rate of exchange with accrued interest”. To communicate the event in a better way, the official prices were shared telephonically to all provincial stock exchanges on a daily basis. Table 4.8 presents a characteristic picture of the US dollars-based assets which were bought by the Treasury through this schema. As it is obvious, most of the assets were negotiated at par or even above, meaning that the whole process could be characterised as successful for all the participants.

Therefore, the success of the programme was notable, accumulating £40 million during its first 10 weeks. In March 1916, a deposit scheme was established, in which the securities were deposited for a two-year period, with the lender received dividends plus an additional ½ to 1 percent in annual basis; in parallel he was entitled to sell his assets in New York or to release them for purchase by the Treasury. This scheme was modified in August and prolonged the period to 5 years and, also, it included other bonds in foreign currency. These deposits were mainly used for issuing a loan on behalf of the UK in the USA *UNITED KINGDOM 3-5-year 5½% Notes Dated November 1, 1916* amounted to $300 million using bonds of $360 million as collateral, (see May, 1922).

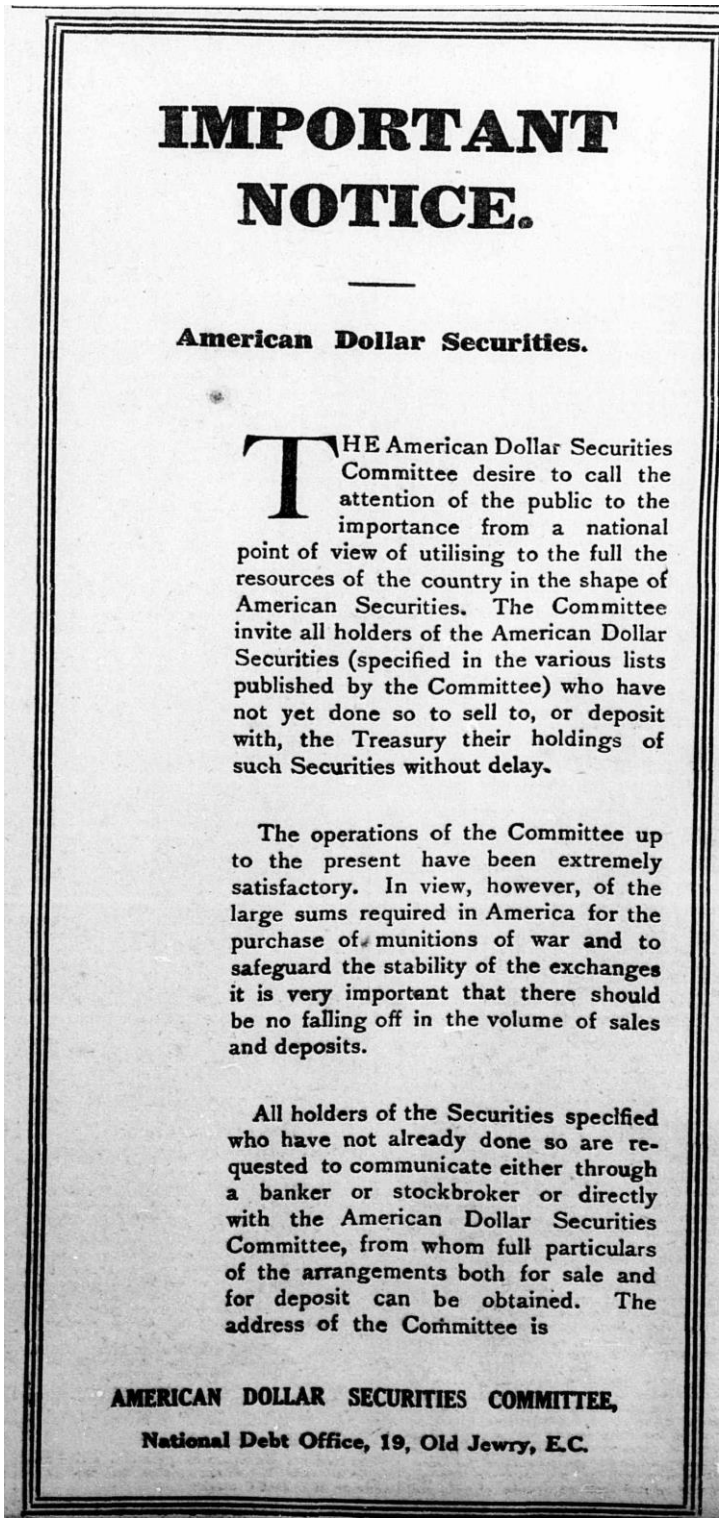
A more interventionist policy was implemented later that year. The government imposed an additional tax on the income of all the securities in the selling lists, excluding taxation only for those which would be sold to the Treasury. The imposition of this taxation -even its announcement- shocked the market which reacted rapidly by selling off the aforementioned securities. “It is evident that the publicity given to the proposed increased tax of 2s. in the £ on the income derived from dollar securities which come within the scope of the Treasury’s scheme for purchase or borrowing has had a marked effect in including private holders to come in” (*FT*, 30 May 1916, p. 2).

This is a description of the reaction of the investors to the announcement: “Just before the announcement of the 2s. surtax the flow of the dollar securities to the National Debt Office, to be dealt with the mobilization scheme, has slackened to a trickle; it has since increased to a torrent. [Ed. N.] This “penal tax” had been imposed in the Budget of 1916, Morgan (1952, p.

327). The Treasury Committee and their staff have been coping manfully with the masses of securities that have been hurled at them in the last few days…" (*FT*, 3 Jun 1916, p. 2). Here, a new problem emerged, which was the clarification of this measure. Because of the existence of lists with the participating assets, there was a serious problem with the remainders.

Moreover, the refusal to accept securities valued at less than $5,000 created additional ambiguities. The National Debt Office hastened to solve the problem, announcing that only the assets which were officially included in the Treasury daily lists would be affected by the taxation and the imposed restrictions. And all this took place in a polemical atmosphere with accusations of "unpatriotic" regarding alternative investing behaviours. Mammoth lists of dollar-based assets were listed for tax imposition, (see *FT,* 3 Jul 1916, p. 5). The final, and more drastic measure was the imposition of the *Defence of the Realm Regulation* (November 1917) which "explicitly prohibited the purchase of securities issued abroad" (Atkin, 1970, p. 325); this happened, not by chance, in the final phase of the war when the needs had dramatically increased. After 1918, this Regulation was relaxed until it ceased in 1919. Morgan (1952, pp. 326-331) estimated the sales of USD securities through this committee between £250-300 mil. In this amount, he did not count the private sales, which were estimated at £500 mil.

Figure 5.4 Notice for the of American Dollars Securities' sale



IMPORTANT NOTICE.

American Dollar Securities.

THE American Dollar Securities Committee desire to call the attention of the public to the importance from a national point of view of utilising to the full the resources of the country in the shape of American Securities. The Committee invite all holders of the American Dollar Securities (specified in the various lists published by the Committee) who have not yet done so to sell to, or deposit with, the Treasury their holdings of such Securities without delay.

The operations of the Committee up to the present have been extremely satisfactory. In view, however, of the large sums required in America for the purchase of munitions of war and to safeguard the stability of the exchanges it is very important that there should be no falling off in the volume of sales and deposits.

All holders of the Securities specified who have not already done so are requested to communicate either through a banker or stockbroker or directly with the American Dollar Securities Committee, from whom full particulars of the arrangements both for sale and for deposit can be obtained. The address of the Committee is

AMERICAN DOLLAR SECURITIES COMMITTEE,

National Debt Office, 19, Old Jewry, E.C.

Source: *Financial Times*, 15 May 1916, p.

Table 5.1 Treasuries Buying Prices of American Securities, Jan 1916

Stock	Price Offered
American Telephone and Telegraph	
4% Coll Trust, 1929	95 ⅕
4% Convertible, 1933	106 ½
4 ½ % Convertible, 1936	114
Atchison, Topeka and Santa Fe	
General Mortgage 4%, 1995	99 ½
Adjustment 4%, 1995	91 ¾
Convertible 4%, 1965	112 ¼
Convertible 4%, 1960	112 ¼
Baltimore and Ohio	
Prior Lien Mortgage 3 ½ %, 1925	97 ⅜
First Mortgage 4 %, 1948	97 ¼
S.W. Division First Mort. 3 ½ %, 1925	96 ⅛
Convertible 4 ½ %, 1933	104 ¼
P.L.E. and W. Virginia System Refunding 4%, 1941	94
Canadian Pacific	
6% Notes, 1924	107 xd
Central Pacific	
First Refunding 4%, 1949	94 ½ xd
Central of New Jersey	
General Mortgage 5%, 1987	121 ⅞
Chesapeake and Ohio	
First Consolidated Mort. 5%, 1939	111 ⅛
General Mortgage 4 ½ %, 1992	97 ¾
Convertible 4 ½ %, 1930	92 ¼ xd
Chicago Milwaukee and St. Paul	
General Mortgage 4%, 1989	96 ⅞
25- Year Debenture 4%, 1934	96 ⅛
Convertible 4 ½ %, 1932	108
Chicago, St. Lewis and New Orleans	
Consolidated 5%, 1951	114 ⅜
Erie	
First Consolidated Prior Lien 4%, 1996	89 ⅜
Consolidated General Lien 4%, 1996	80 ¼
General Electric of New York	
5% Debenture, 1952	109 ⅞
Illinois Central	
Collateral Trust 4%, 1952	93 ½
Collateral Trust 4%, 1953	90
Kansas City Terminal	
First Mortgage 4%, 1960	91 ¾
Lake Shore and Michigan Southern	
25- Year Debenture 4%, 1928	100 ⅝
25- Year Debenture 4%, 1931	99 ⅛
Long Island	
Refunding Mortgage 4%, 1949	92 ⅞
Louisville and Nashville	
Unified Mortgage 4%, 1940	98 ¾
Minneapolis, St. Paul and Sault Ste. Marie	
Consolidated Mortgage 4%, 1938	97 ⅜
Minneapolis Sault Ste. Marie and Atlantic	
First Mortgage 4%, 1926	102

Continued overleaf…

Table 5.1 Treasuries Buying Prices of American Securities, Jan 1916 (*continued*)

Stock	Price Offered
New York Central and Hudson River	
Refunding 3 ½ %, 1997	87 ⅛
Debenture 4%, 1934	97 ⅝
New York Telephone	
First and General Mortgage, 4 ½ %, 1939	89 ¾
Northern Pacific	
Prior Lien Mortgage 4%, 1997	97 ½
General Lien Mortgage 3%, 2047	68 ⅝ xd
Great Northern G. and C.B. and Q. Col. 4%, 1921	102 ⅞
Oregon Short Line	
Refunding Mortgage 4%, 1929	97 ¾
Oregon Washington RR and Navigation	
4%, 1961	89 ¾
Pennsylvania RR and Allegheny Valley	
General Mortgage 4%, 1942	101 ¾
Pennsylvania Company	
Guaranteed 4 ½ %, 1921	105 ½
Reading	
General Mortgage 4%, 1997	99 ⅜
Southern	
First Consolidated Mortgage 5%, 1994	107 ⅝
Southern Pacific Company	
Collateral Trust 4%, 1949	91 ⅜
Convertible 4%, 1929	94 ½
Convertible 5%, 1934	113
Southern Pacific RR	
First Refunding and Mortgage 4%, 1955	94 ⅞
United States Steel Corporation	
S.F. Collateral Trust Second 5%, 1963	109 ⅝
Union Pacific	
First Mortgage RR and Land Grant 4%, 1947	101 ⅜
First Lien and Refunding Mortgage 4%, 2008	95 ¾
Convertible 4%, 1927	97 ⅝

Source: *Financial Times*, 18 Jan 1916, p. 5.

The main reasons for these restrictions were: a) "to protect the British government's position in the London capital market; and b) "to protect the pound when it was under pressure from abroad (Morgan, 1952, p. 331). In March 1919, the pound ceased to be fixed at the exchange rate of $4.77 per £1, so the reasons for the continuation of the Committee were diminished.

The imposition of capital controls will now be discussed. The harshest implementation of this policy occurred in November 1917 with the passage of Regulation 41D, which forbade any British resident to send money for or to subscribe to any issue of capital outside of the UK without permission from the Treasury. As a result, "Dealings in dollar securities turned into a one-way flow as British holders were forced to disinvest" (Atkin, 2004, p. 36). Extremely interesting is also the following: "…the use of the Regulation 41D to prevent them from using foreign currency in order to acquire foreign securities still marked *the earliest use of legal powers by a British govt to restrict the freedom of the individuals*…" (33), which bears

fundamental rearrangements in the fields of philosophical monism, political liberalism and the economic doctrine of *laissez faire*, and historical ones as for the role of the British state.

The period after WWI cannot be characterized as a period of absolute freedom for overseas transactions. Some restrictions remained in a flexible way. The two main players of these movements were the Treasury and the BoE who guarded the whole process. From time to time the regulations were focused more on a) supporting the domestic economy; b) relieving the burden of the excess war borrowing of the state; and c) correcting the currency oscillations. In 1925, the UK officially re-joined the Gold Standard, so the period 1926-1928 was a relatively unregulated period (Atkin, 1970).

ITCs, willy-nilly, participated in this process. Along with the rest of the financial trusts, banks and insurance companies, they were impelled to obtain, either by selling or granted, their US dollar-based railways, mainly, debentures. This movement along with their private foreign sales, for reasons which will be explained in Chapter 7, left them with a much lower rate of American securities in their portfolio. As a counterbalance, they acquired a substantial volume of British government bonds. All this process, for sure, did not damage them financially. Now, the ITCs were clearly at the crossroads. Would they continue with these new conditions? If they did, they would lose their basic financial innovation namely, diversification. They had to take a momentous decision in a period in which serious problems emerged in the British and international economy and society.

5.4 The ITCs Asset Allocation vis-à-vis the British financial market evolution

This section describes the ITCs asset allocation during the 1920s. The *Economist* offered annual surveys about their financial conditions and the main challenges they faced. Although WWI affected the ITCs' portfolio, the basic idea about fixed-income assets- this of security and good performance- seems to be dominant for the whole period. The discussion was extremely lively in the economic press of the period.

Already during the war, because of the high cost of living, a lot of investments had been sold for income or replaced by others with higher returns (mainly dividends). High inflation had led to a speculative bubble: "the flotation of new companies, the of old ones and the issue of new shares became almost a daily event in 1919" (cited in Howson, 1974, p. 89). As a result,

ordinary shares' prices had increased in the aftermath of the war[38] (Gardner 1919, p. 414), while fixed-income securities had lost part of their value, see Table 4.9. For sure, the previous discussion was not the case with the ITCs, which used a more sophisticated management, but because it had affected a lot of investors, implicitly was of high importance to them.

Although ITCs were extremely cautious, being based on long-term debentures, they were able to avoid such an inflationary surprise. As a tendency they maintained a secure portfolio away from these oscillations (as a rate of the average total portfolio, preferred shares rose by 1 percent). At the same time, the greatest loser was debentures, which decreased by 12 percent (from 177 to 156), losing also 3 percent of their rate in the ITCs portfolio.

The ITCs' movements, although correlated to the market's changes, they maintained their character and their basic principles. 1920 "will be always remembered by investors for the severe depreciation which took place in security values, cannot have been without anxiety to the directors of the ITCs" (*The Economist,* 1921, p. 864). However, ITCs' reports made further progress increasing their revenues for the whole previous period from their sophisticated management. This means that despite the falling prices, their previous "steady expansion" during the war period, resulted in the maintenance of their position, with "no serious effects on the companies' incomes, the bulk of which is derived from high class fixed interest-bearing securities" (*The Economist,* 1921, p. 864). Furthermore, "some of the investments of the companies, it may be added, are of the industrial type usually in the form of debentures or preference stocks" (*The Economist,* 1921, p. 864); here, there is a note for holdings beyond the bonds, taking full advantage of the high prices even from the ordinary shares which had not yet been affected by the economic and trade depression.

1921, was a period of severe economic depression and trade imbalances; now the dividends were curtailed, however, the shares' prices improved and the ITCs maintained or even improved their dividends (*The Economist,* 1922, p. 572). Additionally, they were deeply involved in these monetary oscillations. In 1922, the monetary conditions were radically different; now the policy was in favour of cheap money. The advantages of this policy to the ITCs were: a) higher prices for their own shares, which were "sensibly higher" than one year ago (1920), and b) the lower Bank rate which boosted new borrowings. Indicatively, the director of the *Mercantile and General Investment Trust* argued in a company meeting that

[38] From a list comparing prices of 14 representative assets (Table 8) during and immediately after the war, the picture is clearly negative for the fixed income assets and irregular for the shares, with some great rises of some well-defined ones.

"The opportunity created by fluctuations in the value of money are the most useful raw material available for improving the property of a trust company, and the reason that almost every trust company has come through the recent troubles strengthen rather than injured by the ordeal is that the various boards have been ready to grasp these opportunities" (cited in *The Economist,* 1922, p. 574). This is an implicit but accurate admission that the ITCs had obtained an advantage through this period. So, once more, they tackled the problems of this unstable period. In 1922 they received lower revenues, but experienced a capital appreciation, compared to the previous year, maintaining, or even increasing the dividend they offered (*The Economist,* 1923, p. 675).

This tumultuous monetary period had as a result the multiple changes in the various securities for both their issuers and their holders. Gradually more investors, the ITCs included, selected some preferred shares with better perspectives: *Imperial Tobacco Co. (Gt Britain and Ireland) 5 ½ "A" Cumulative Pref shs.*, *Mond Nickel 7 ½ % Cum. Pref.*, *J. Lyons and Co. Ltd 5% Cum pref. shs*., *Bells United Asbestos 6% Cum Pref shs*. (Fleming 1923). The reason why they are quoted is that all of them were contained in the sampled portfolios, proof, at least theoretically, of prudent and professional management.

Debates about the various types of asset allocation, their risk and return relationship are embodied in the general discussion towards a scientific management of the companies, which is extensively discussed in all the studies about the ITCs, see Chapter 2. Especially the works of Smith (1925, 1926) offer the first scientific proof using a long data time series for the US market about the higher yield of shares comparing to fixed income holdings. This aspect was far from being dominant in that period. Keynes (1925) reviewing Smith's book, he concludes raising doubts about any possible predilection in favour of ordinary shares in the UK. The main reasons for him were first, the lower developmental process of British enterprises compared with corresponding US ones and second, because of the different attitude of British industries which were less conservative regarding the "division of profits". Although Scott (2002) argued for the "cult of equity" supporting the equities' rise of the institutional investors (insurance) during the interwar period, it seems that this did not happen in the case of ITCs. Weak investor protection, listing requirements and underwriting practices led to IPO under-pricing, (see Chambers & Dimson, 2009). Overall, the roots of this tendency can be detected during this period; however, it seems that ITCs were still unready for this challenge. It would take time for this process to be consolidated.

1923 was, generally, a better year than the previous one for the ITCs. For the first time, they had the full benefit of both capital appreciation and interest rates, increasing their revenues. Dividends were, for the first time, higher than the corresponding ones in 1913, before WWI (*The Economist,* 1924, p. 620). In the next year, 1924, which is the second year of this sample the earnings were higher than the previous year overcoming the pre-war period; at the same time, their share prices reached the same level as in 1914 (*The Economist,* 1925a, p. 702). The boom of the LSE in 1924 boosted this increasing performance (*The Economist,* 1924b, p. 723).[39] The changes in the sample regarding the asset allocation had not changed notably. The fixed interest holdings increased slightly (55 percent in 1920 → 57 percent in 1924), despite the huge disposal of the US railways bonds. It also seemed that Victory bonds represented a smaller part of their portfolios. The new bond editions of UK enterprises of this period replaced gilts, while the Latin American investments remained stable, see the next Chapters. As for preference shares, they lost only 2 percent (21 → 19 percent) probably, but not only, because of the insecure position they were in. In this discussion, the role of the issuers of these holdings is significant, meaning that various companies took full advantage of the new policies, devaluing their financing needs and removing voting rights Finally, the ordinary shares remained in the same position (about 24 percent).

Gradually, after 1925 and the stabilization of the currency, a new boom of investments began. These new sectors of investment in the UK issued large amounts of stocks which flooded the market, being accepted by the ITCs, which followed the increasing profitability of the industrial sectors in these years (*The Economist,* 1926, pp. 88-89). New issues of shares deluged the market. *The Economist,* while initially offering annual reviews of the new issues, gradually added semi-annual presentations, which later became quarterly or even more frequent, see *The Economist* (1925; 1927). Although these new shares were in the ITCs portfolios, caution remained, and more specifically, about their speculation. These arguments were based on their uncertainty on dividend returns, which was understood as a sign of speculation (Fleming 1926). ITCs' portfolios were gradually being replenished by new companies or older ones which, until then, had been underestimated by their managerial teams. E.g., the colonial securities of the mammoth Empire, which had almost been excluded from their holdings until then, ITCs invested on average 6 percent in Asia/Pacific and less than 2 percent in Africa (see Sotiropoulos

[39] Here the reference is to the British investments which were almost ¼ of the total sample, see next Chapter; however, it was indicative of the trend of that period. Also, it can explain the shift of the ITCs portfolios towards British investments. Finally, there was a correlation among the shares in the same capital market.

et al., 2020)[40], gradually backed by government aid became more attractive. Moreover, Europe which had been totally absent, seemed to shrug off its lethargic economic conditions finding a position, at least briefly, in the ITCs' portfolios, see Chapter 8.

At the same time (1926-1927), because of the circumstances, the approach towards shares had changed; some voices more positive towards them emerged, (see Taylor -Smith, 1927). This more positive approach was not ephemeral. In 1925 ordinary shares of the industrial sectors in the LSE offered 10.3 percent while the same debentures and preference shares offered almost half, 5.11 and 5.5 percent respectively, (see *The Economist*, 1926, p. 89; Hammond, 1927).

The good performance of the stock market of these years created more opportunities, improving the already positive attitude towards ordinary shares. A new discovery, that ameliorated the environment for them was the practice of bonus shares. Many companies were using, as an attraction, the issue of new, bonus, or at a discount to the market price, shares which were distributed to the existing shareholders. Conservative advisors were sceptical about this new fashion. In the case of a free distribution of shares, companies which decided a movement like this, were accruing their liabilities, meaning that the future obligations of the company would be greater. Concomitantly, such companies should either increase their profitability to accomplish the goal of maintaining the dividend per share or reducing the dividends per share. In the case of issuing new shares at a lower price, the company had to raise new rights pro rata to existing holdings, because of the price difference. Cautious voices argued the possible *watering* of the companies' capital, and consequent fall of the dividends and prices of the shares, "…their ultimate effect when the reverse conditions obtain is to hasten the inevitable shrinkage in dividends as well as in share prices" (Fleming, 1927).

The ITCs were involved in this process. Despite being careful, they participated in this process using their own shares. A characteristic case was that of the *Omnium Trust* which, in 1927, distributed the excess of its profitability in three different ways. Initially, it raised its dividend on its ordinary shares from 8 to 10 percent; second it distributed an amount by capitalising its reserve fund and transforming it into preferred shares, which were distributed to the deferred shareholders. Finally, the shareholders had the right to subscribe at par for new ordinary shares and debentures at a rate of 10-20 percent of the face value of their holdings (*FT*, 14 Jan 1927, p. 6). So, although the ITCs were conservative regarding easy acceptance of the risky trends of

[40] See also Chapter 5.

the capital market, they had no problem in applying them in case in which they had experienced their efficiency.

Continuing this promising tendency, assisted by the attractions they were used to, in parallel with a rising phase of the financial sector, there was the view that: "ordinary shares are admittedly more interesting than most investments; they are more active, more mercurial and they possess a certain elusive quality that fascinates the average holder. Compared with them preference shares that have no participation rights and good class bonds and debentures seem dull and inanimate" (Whorlow, 1927 pp. 49-50).

As already mentioned, in these years (1926-1928) a wave of new issues deluged the stock market. Companies were offering various packages to attract prospective investors such as free bonus shares or offering packages to overcome possible objection for specific assets. Characteristic is the example of offering packages of ordinary and preference shares (Fleming, 1928, p. 47). In these cases, especially in the case of new issues the danger of speculation was high. Very often, institutions such as banks, insurance companies and investment companies were enabling the process of allowing these securities onto the market. ITCs were included among these institutions; this implies support for institutions such as the ITCs.

In the final year of the sample (1928), the picture for asset allocation showed that a small reduction in holdings of fixed income occurring (1924: 57 → 1928: 52 percent), with a concomitant shift in the ITCs' portfolios towards shares. More specifically, preference shares increased by 4 percent (1924: 19 → 1928: 23 percent) and the common ones remained practically static (1924: 24 → 1928: 25 percent). However, their number changed the most in all sample. They total number grew by 27 percent compared to the previous observation (1924). This mean a value abatement, also, the newly acquired ordinary shares were of lower value. Specifically, the average ordinary value in 1924 in this sample was £ 6,100 while in 1928 it had fallen to £4,894. A second interesting element here is the fact that this number was almost equal to the average individual holding, meaning a significant diminution of the rest of the holding's types. This shift is indicative of the prudent management they implemented, with careful and not cursory movements towards the new "fashionable" assets. This picture is characterized as successful for the ITCs, which improved their financial performance. In 1927, "all the big ITCs had a satisfactory experience…" (*The Economist,* 1928, p. 524). *The Economist* used a list of 17 characteristic ITCs, all had higher revenues, some even higher than the two previous years, and that, also, offered high dividends which "have again been on a generous scale", of more than 13 percent, on average.

This new phenomenon was the "talk of the market". *Ex post*, there were studies which, especially after the crisis of 1929 (for the UK economy, mainly in 1931), have focused on the ambiguous role of this movement. The crucial factor to be judged the success of this measure was the age of the firms. Old companies were generally in a better position, whereas many newly issued companies (in 1928) had suffered from the calamitous devaluation of the crisis years (Harris, 1933). The main tendency of these newer companies was to issue shares not for the acquisition of a new company, but to retain their position, keeping the issued shares for themselves; the key points in these cases were the proportion between the ordinary and preferred shares, the attractions of the initially generous interest rates but lower future participation, the price discrepancies and finally, that "the promoters relied far more upon attractive potentialities than on past results" (Harris, 1933, p. 456). One interesting observation in this article was the deviation of the then new ITCs. The latter had been invested in "long standing securities, these companies were new ventures only in a very limited sense, and they are therefore separated for the more truly new ventures" (457). This argument confirms: first, their unequivocally prudent management, despite their age; and second, the close relationship among the various companies of the sector. Another observation is that this tendency was not irrelevant to the tax policy. Because of the focus of the taxation system on the dividend and not on the capital gains (Cheffins, 2008, see above), there was an advantage, especially for prosperous companies, to surpass the taxation issues issuing new shares or just selling the already overvalued ones and receiving a tax-free profit. All the aforesaid events were able to assimilate the movements of the stock market and, in a way, the wider economic and social transformation of the society in the first decade of the interwar period, maintaining at the same time its unique character. This will be more visible in the next Chapter (Chapter 5).

This section (4.3.3) discusses the evolution of the ITCs portfolio's asset allocation for the period 1914-1928. Presenting evidence from primary sources such as the financial press of the period, it correlates the evolution of the asset allocation with the fluctuations and the potential dangers of the British financial market of that period. WWI acted as a catalyst for the composition of the ITCs' portfolios. The ITCs obliged to fundamentally change their portfolio lists because of state directives during WWI. Additionally, they had to tackle the main issue of excessive taxation and consecutive waves of price fluctuations, affecting differently the various holding' s types. The ITCs succeeded mainly because of their investments in long-term and well-established securities; although, they missed no financial opportunity to test new types and securities in their portfolio interacting with the financial markets' evolution. There was a

dynamic discussion in financial circles about the new role of equity as an alternative investment in the long run, in which affected the ITCs management. 1923 can be seen as the turning point, a flourishing financial market emerged afterwards, leading the ITCs to take full advantage of investing in ordinary shares. Although it remained practically stable, using a common for them asset allocation for the whole period, viz. the fixed income holdings dominance followed by equity (ordinary and preferred shares), there was a gradual tendency towards the latter ones, especially appearing in this sample last temporal observation (1928). The ITCs participated in the new paradigm of the blooming British financial market (bonus shares' issue, newly emerging shares' investments); however, they left their management core strategies untouched.

5.5 Conclusion

This Chapter focuses on the evolution of the ITCs' asset allocation. Initially, it refers to taxation and inflation, as two problems that proliferated during the war, affecting unquestionably the ITCs' portfolio. Moreover, state intervention on the US dollar-based securities created a turmoil in the ITCs' portfolio which had accumulated huge bulks of mainly American securities, see also Chapter 8. The gap was replenished by the war bonds, curbing, temporarily, ITCs' diversification. The monetary policy during and, mainly, after WWI shocked the financial market; the frequent changes altered the values and expectations of the capital market. ITCs portfolio was founded on the solid basis of prudent management which could amortize temporary monetary shocks.

This situation led to a serious discussion about the shift towards financial alternatives, mainly the replacement of fixed income stock with equity. The ITCs were entangled to these discussions. The success of the British financial market in the mid-1920s dominated, leading to a shift in favour of equity as a significant investment. The ITCs were well-informed about these movements, taking full advantage of the opportunities which emerged without jeopardizing their priorities. All in all, the evolution of the ITCs' asset allocation by type during the 1920s was not quantitatively significant, testing the prudent ITCs' management and their well-studied movements; however, qualitative changes appeared, reflecting the shift in financial, business, economic and - at the end- in social terms. *Ex post*, these movements can be characterized as successful because their financial performance both during WWI and in the next period prospered. Inevitably, all these changes had a crucial impact on the geographical and sectoral allocation of the ITCs; this will be discussed in the next Chapter.

6 Geographical and Sectoral Allocation

6.1 Introduction

This Chapter studies the geographical and sectoral allocation of the portfolios of the British ITCs during the 1920s. The main research question for this dissertation concerns the asset management strategies of the British ITCs in the period 1914-1928. For the ITCs to accomplish their goal, they had to reduce their investments' risks, see Chapter 2. For this reason, diversification techniques were applied. A crucial way for a company to achieve diversification is through the spread of its portfolio in different uncorrelated markets and sectors. So, the main purpose of this Chapter is twofold. First, it examines how geographical and sectoral allocation affected ITCs asset management during the 1920s; and second it discusses the international financial flows during the 1920s.

Sotiropoulos et al. (2020) and Chambers and Esteves (2014), among others, concluded that during the pre-WWI period ITCs had globally diversified their portfolio. Both argued that ITCs invested in specific geographic destinations and sectors. A typical pre-WWI ITC invested mainly in North and South American securities (railways' debentures and other utilities' equity) and in British industrial holdings. The economic and financial conditions, viz. the dominance of the City, the Gold Standard and the government absence had created a perfect financial environment for the ITCs to work, choosing among numerous financial alternatives spread in all over the world and in all the sectors participating in the capital market. Can the same be said about the post-war period? The outbreak of WWI distorted the global status quo; the impending changes forced everyone, the ITCs included, to follow the new conditions. Could the ITCs manged to cope with these new difficulties without losing their principles? These will be the core discussions in the following chapters. This Chapter summarizes the basic knowledge about the geographical and sectoral allocation of the ITCs, in1920s. Both are of outstanding importance in political economy and finance, with broader political and social implications.

Furthermore, this Chapter incorporates into recent research regarding the international financial flows during the "first globalization era" the ITCs' contribution as a vehicle for the international transfers of capital. A huge literature has studied the historical reasons for this process. Underconsumption, higher returns, the evolution of capitalism, the crucial role of banking and institutional factors were the main explanations (Hobson, 1902; Hilferding, 1910;

Lenin, 1917). These debates continued until today (Mac Closkey, 1971; Kennedy, 1974; Platt, 1977; 1986; Cain & Hopkins, 1987; Cassis & Cottrell, 1994). After the 1980s, economic historians extensively used the new concept of MPT and EMH theories[41] to study these movements. The most of these argued that investors selected investing abroad due to the higher returns these markets offered given the risk, (see Edelstein, 1976; 1982; Chabot & Kurz, 2003; Goetzmann & Ukov, 2006; Chambers & Esteves, 2014, for the ITCs case). Obsfeld and Taylor (2002) developed their theory for the rich-poor theory. However, other discussions described a broader framework which could answer this question, (see O'Rourke & Williamson, 1999). Can this broader framework be tested for the case of the ITCs? More importantly, has the post-WWI period affected their pattern?

The main findings are the following. ITCs continued their pre-WWI strategy. They focused on the geographical and sectoral allocation of their portfolio lists. Despite the unprecedented shocks they had suffered, they endeavoured to modify their lists in a way that could leave unaffected their main determinants. Second, this Chapter finds a capital flow pattern relevant to the existing one, viz. the "one-way asset shifts" of Obstfeld and Taylor (2002) from the Old to the New world during the pre-WWI period, but this was distorted in the post-war era, not only in general, but also for the ITCs'.

Geographical and sectoral allocation answers basically, the main question about the asset management of the ITCs during the 1920s. Two parallel practices emerge. On the one hand, ITCs maintained their secure markets (LA) or sectors (Railways) that support their passive strategies; on the other hand, the new sectors (new British Industries) or regions (Europe) can be interpreted as an attempt for more modern active management of uncorrelated assets, a "top-down approach". Finally, the last question about the interaction between ITCs and societies is answered. This happens through the participation of more actors in the environment of that period who could affect the investment decisions. This Chapter uses significant socioeconomic indices (annual product and population), then, it discusses mainly the context behind the decision-making of the ITCs' asset management. For this, it collects mainly information from financial newspapers to shed light on the financial environment of the period. Moreover, it adds factors as the Government and the international climate, which are important for the decision-making process, as well as the main social and or political events, which could explicitly

[41] See Chapter 2.

modify the whole society playing a motivating role to the final investments. This practice will be analysed in detail in the next Chapters of this dissertation.

6.2 The Determinants of Geography and Sectors in Investments

Why do we care about the geographical and sectoral distribution? Are they important for an asset management strategy? Distance, first, matter in investments; this notion has been thoroughly studied both in economics, in finance and beyond. Historically, the *export of capital* has been a controversial subject since the late 19th - early 20th century, and it still remains debatable. However, not always has the argument been in favour of them. Since the establishment of the classical political economy, (see Backhouse, 2002, Ch. 7; Screpanti & Zamagni, 2005), there have been discussions about the "home bias" of the investors, viz. the preference for home assets against foreign ones. Ricardo (1817) argued in favour of this. Marx (1894) spoke about the tendency of trade abroad as a *counteracting influence* on the tendency of the falling rate of profit (Ch. 14), an implicit argument against foreign investments. However, the prodigious increment of the *export of capital* since the end of the 19th century has modified these approaches.[42] Homeric debates have arisen concerning the causes and the effects of the export of capital. ITCs have participated willy-nilly as institutions, mainly focused on the export of capital through their portfolio management. All these arguments work perfectly for the pre-WWI conditions. This study is a first attempt to scrutinize the evolution of this phenomenon afterwards, under adverse economic, financial and political conditions.

Apart from its historical evolution, the role of distance in investments has also recently been examined by financial economists, under, different conditions. Petersen and Rajan (2002) studied mainly the appearance of technology in this relationship; Seasholes and Zhu (2010) detected an inverse relation between distance and investor sophistication. Rutterford *et al.* (2017) demonstrated the local bias in the UK and emphasized the positive relationship between British investors and local firms. ITCs managers could not use the tools that technology offers today; however, as it supports in the next chapters, the strategies which have been followed can be described as pioneering, establishing the foundations of the MPT and the way scientific community understands finance even nowadays.

Along with this historical and theoretical evolution of the notion of distance, the notion of geographical allocation emerges. Geographical allocation is embedded in the general field of

[42] The two main forms of the export of capital are: a) the direct investments and b) the portfolio theory. ITCs are classified as a subcategory of the second.

diversification, as a portfolio selection technique.[43] Global diversification has been extensively used. Lowenfeld (1907) published maps through which the global financial geography emerged.

Although the notion of distance and the geographical allocation is unequivocally important for investments, the notion of sectors and sectoral allocation does not present such an interest. Historically, the export of capital can be mainly connected to trade relations; the control of the basic raw materials has been mentioned as a significant reason for this process, see all the classics of Imperialism. Thus, an examination of these sectors framed this discussion. Nevertheless, other types of international economic relations, mainly foreign direct investments and portfolio theory, have been included in this process; hence, the "first globalization era" emerged leading to investments in specific sectors of foreign economies. Feis (1930) presented the various foreign sectors of the main British investments. Cairncross (1953), discussed foreign investments presenting implicitly the various investing sectors. Edelstein (1982), studying the rates on returns on overseas portfolio investments, exhibited the main foreign sectors: "With few exceptions, the realized returns to the debentures of overseas governments, municipalities, railways, and social-overhead enterprises surpassed their domestic counterparts" (Edelstein, 1976, p. 291).

Financial economists today are interested in sectoral analysis, incorporating it in the portfolio selection process, (see Heston & Rouwenhorst, 1995), who compared industry effects on portfolio selection. Carrieri et al. (2012), studied both the sectoral and geographical outcomes on the value of firms, (see also Denis et al., 2002). Although the results are not as direct as before, there is a relationship to the financial performance of the investments.

Since the late 19th century, British capital has been extensively exposed globally and sectoral[44]. This has been extensively argued in economic history. Both older, (see Paish, 1911; Simon, 1967; Cairncross, 1953), and more contemporary works (characteristically, Goetzmann & Ukhov, 2006), focused mainly on the regional allocation, especially of the pre-WWI era. Rutterford and Sotiropoulos (2016) have studied the first attempts of geographical and sectoral diversification since 1870s. A significant corpus of financial advisors have focused on these practices as it is known from the pamphlets, prospectuses and books they have published. Additionally, the financial press like the *Financial Times*, and periodicals like *The Financial*

[43] See Chapter 2 for the discussion.
[44] See session 2.4.

Review of Reviews, the *Investors' Monthly Manual*[45] and *the Economist,* have devoted a part of their analyses on these, see Chapter 2. This strategy tended to become the norm in the pre-WWI period.

ITCs were at the forefront of this process, as Sotiropoulos *et al.* (2020) observed. In their study, they pinpointed the pre-WWI geographical and sectoral diversification of the ITCs. In their portfolio lists, one can find investments coming from almost every sector of the economy and from all over the world. Of course, there were preferences throughout the period under study. Characteristically, the lion's share of a typical ITC's portfolio was mainly concentrated in two continents: both, in the American territory. One-third of the average portfolio has been invested in North America and 30 percent in Latin America. Their sectoral preferences were included railways, and various utilities.[46] The well-established USD-based American railways, and the GBP-based Latin American investments, which were listed in the LSE, were the typical picture for the pre-WWI average ITC.

Speaking for the rest of the world, the UK, the homeland of the ITCs, at the beginning of the 20th century absorbed 20 percent of the total investments, maintaining this amount for the next decade. Industry was mainly preferrable for the UK case, with mainly local networks in the various British peripheral stock exchanges and, mainly, the LSE being used. Finally, Europe received a small part of the total investments (8 percent in 1891 which has declined to 5 percent in 1914); as for Africa and Asia, the two great colonial territories, only a few investments for the ITCs were observed in these areas with 6 percent and less than 2 percent respectively. Sotiropoulos *et al.* (2020) argued that the ITCs' global portfolios of the pre-war period had beneficial results regarding their returns.[47]

Comparing the sector diversification with the total paid-up capital in LSE, differences emerge. The ITCs were more reluctant to indulge in government bonds acquisition. On the other hand, there was an inclination towards social-overhead enterprises (utilities). Characteristically, in 1914 the utilities' part of the LSE paid-up capital was less than 5 percent, while the corresponding percentage for the ITCs' portfolios was more than 20 percent. As a replacement, government investments represented 5 percent of the ITCs portfolios; the same sector for the LSE exceeded 40 percent. Additionally, the ITCs performed better than the rest of the financial

[45] FT, FRoR, IMM thereafter respectively.
[46] For the sector definitions, see Chapter 3.
[47] Again, all the values in the chapter are nominal and they are referred to average sizes, unless stated otherwise.

sector. Thus, it can be supported the fact that the ITCs' sectoral allocation could have led to better financial results because of these strategies they followed.

This Chapter extends this discussion for the 1920-1928 period. As already argued, see previous Chapters, the economic and financial conditions in the post-WWI period were totally different. Many of the pre-WWI determinants ceased during this period, as the supremacy of the LSE, the Gold Standard and free capital mobility. What was the impact of these changes in the already developed strategy of the sectoral and geographical diversification of the ITCs? So far, state intervention during the war forcing a withdrawal from the American market and the forced investment in British war bonds has been discussed. Which was the evolution of this change? Theis thesis answers to all these thereupon.

6.3 The general picture of the geographical and sectoral allocation

Figures 6.1 and 6.2 and Tables 6.1 and 6.2 summarize the general asset allocation of the ITCs in the aftermath of WWI period. Before the war, a wide sectoral and geographical spread of ITCs' investments has been presented. Simon (1967, p. 54) in a study about the British portfolio Foreign Investments argued that: "The fifty-year totals for our major components confirm the extent of the sharply unequal distribution of new British portfolio foreign investment. A relatively small proportion was absorbed by the colonial and non- colonial tropics, while the regions of recent settlement – especially independent countries such as the US- received more substantial amounts to foster the growth of their social overhead capital". This picture is almost the same for the ITCs in 1914, (see also Paish, 1911). Their portfolios contained investments of every kind, from US railways and Latin American government bonds to raw materials (e.g., South African gold, Chilian nitrate, Asian tea) and from land and mortgage companies' equities to British engineering ones.[48] In general, there were specific preferences for a global rather than a local diversification strategy. These preferences were contained in their portfolio lists. All the studies agree about the unequal geographical allocation in the ITCs portfolios, (see Corner & Burton 1963; Cassis, 1990; Chambers & Esteves, 2014; Sotiropoulos et al., 2020), arguing that the pre-WWI ITCs were "heavily overweight" in the Americas (both North and South ones), (Chambers & Esteves, 2014, p. 8).

[48] For the definitions and acronyms about regions and sectors, see Chapter 4.

Table 6.1 Average Investment Trust portfolio regional allocation (% of portfolio nominal values).

		1914	1920	1924	1928
Europe	Observations	23	28	30	33
	Average	2.33	3.92	3.90	12.50
UK	Observations	24	30	30	33
	Average	24.29	34.37	36.48	38.26
North America	Observations	24	30	30	33
	Average	33.66	20.22	9.86	4.97
South America	Observations	24	30	30	33
	Average	31.34	32.45	36.02	30.43
Africa	Observations	23	29	30	33
	Average	1.89	1.89	2.55	2.64
Asia/Pacific	Observations	24	30	30	33
	Average	6.07	6.79	10.83	10.99
Unspecific	Observations	22	27	23	21
	Average	0.65	0.77	0.48	0.33

Notes: The variables have been aggregated at the level of the portfolios. The observations count the number of ITCs which appear for each year; the averages count the % nominal value of the ITCs portfolio lists which has been invested in the specific region.
Source: For 1914 it uses the data of Sotiropoulos *et al.* (2020). The rest belongs to this dataset.

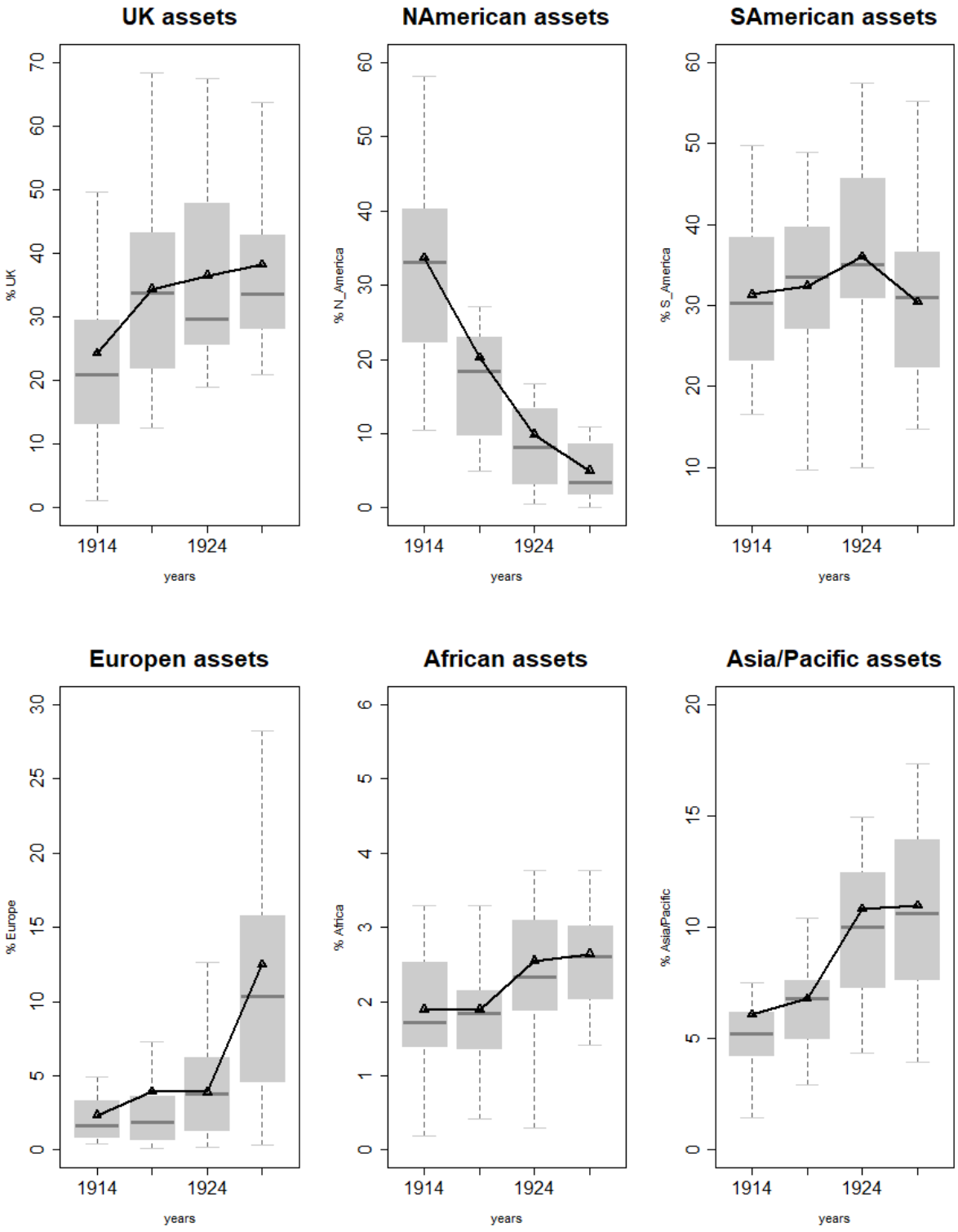
Table 6.2 Average Investment Trust portfolio sectoral allocation (% of portfolio nominal values)

Sectors		1914	1920	1924	1928
Government	Observations	24	30	30	33
	Average	5.76	13.42	12.79	12.88
Finance	Observations	24	30	30	33
	Average	5.25	4.50	4.36	7.75
ICA	Observations	24	30	30	33
	Average	28.16	20.87	25.14	31.16
RR	Observations	24	30	30	33
	Average	35.12	36.05	32.05	24.63
Trusts	Observations	22	29	29	32
	Average	4.99	6.93	7.21	6.29
Utilities	Observations	24	30	30	33
	Average	20.00	17.02	18.35	17.11

Notes: The variables have been aggregated at the level of the portfolios. The observations count the number of ITCs which appear for each year; the averages count the % nominal value of the ITCs portfolio lists which has been invested in the specific sector. ICA is used for the industrial, commercial, and agricultural sectors; Finance includes the financial sector except the category of the ITCs.

Source: For 1914 it uses the data of Sotiropoulos *et al.* (2020). The rest belongs to this dataset.

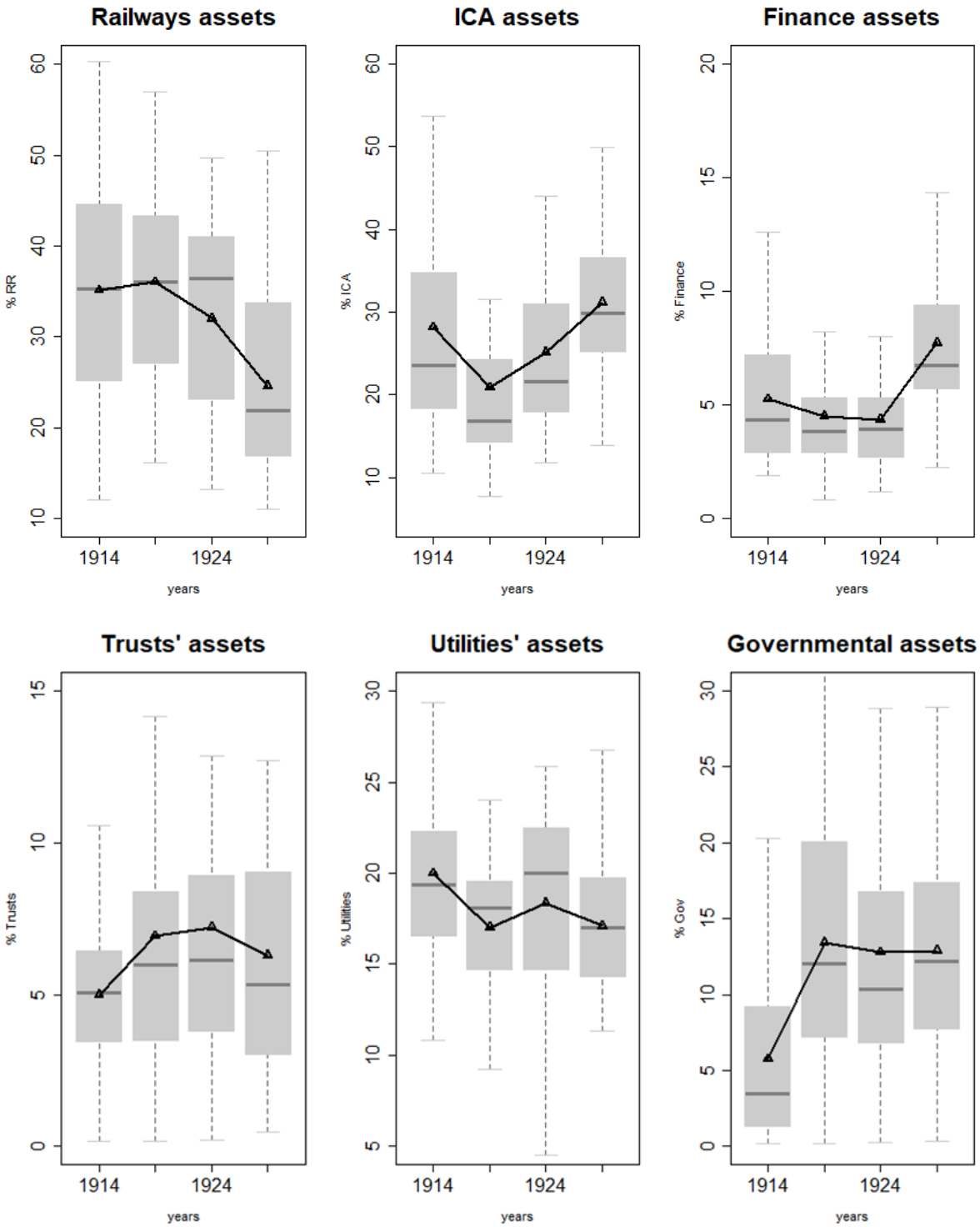
Figure 6.1 ITCs geographical allocation (percent portfolio nominal value)



Notes: These calculations are based on the reported nominal values. NA and SA are acronyms for North and South America respectively, see Chapter 3 for more information. The variables have been aggregated at the level of the portfolios.

Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

Figure 6.2 ITCs sectoral allocation (percent of portfolio nominal value)



Notes: These calculations are based on the reported nominal values. NA and SA are acronyms for North and South America respectively, se Chapter 3. ICA is used for the industrial, commercial, and agricultural sectors; Finance includes the financial sector except the category of the ITCs. The variables have been aggregated at the level of the portfolios.

Source: Author' s computations. For 1914 it uses Sotiropoulos *et.al*. (2020).

These "overweight" preferences are presented also in Figures 5.1 and 5.2 Three main categories attracted ITCs' investments at the outbreak of WWI both geographically and sectoral. Two-

thirds of the investments were invested in the American continents, mainly in railways and other utilities. The UK followed with one quarter of their investments; here, industry was the dominant sector. The remaining investments were diversified across the rest of the world (9 percent): Asia/Pacific 6.7 percent, Africa 1.9 percent and, Europe 2.3 percent. Besides this, the ITCs portfolios were completed by holdings of British financial companies, other ITCs, some colonial raw materials, and foreign governments. Chambers and Esteves (2014), who examined the portfolio of one ITCs, drew to a similar picture, obviously with differences because of the nature of that ITC (*foreign* and *colonial*).

Government bonds were not included extensively in the ITCs portfolio. Regarding the British ones, as already discussed, their anaemic returns did not offer many financial opportunities, see Chapter 2. In the end, this underperformance was a reason for the establishment of the ITCs. Surprisingly, the same aversion was observed in the case of the foreign governments' ones. Only one out of 20 pounds of ITCs holdings were government ones, almost all of them coming from foreign governments. Although the LSE was the financial centre for government bonds for the pre-war period (Michie, 2001), the ITCs seemed not to share this predilection for the government bonds.

There were exceptions as in the case of the Latin American holdings which, despite their troubled background (Taylor, 2006), attracted British investors. In contrast, utilities could be considered as "the most striking example", Sotiropoulos et al. (2020, p. 803). ITCs were extremely exposed to that sector, investing one out of five pounds on average. Another interesting finding concerned the financial sector which was not their number one priority. The sector with the name Finance (mainly banking) absorbed 5 percent of the total sample. A different category is the ITC (it is presented as a separate field from the ITCs because of the proximity to them); thus, a case of internal information emerged. Indicatively, these companies shared common headquarters or even common directors on their boards; hence, a special interest appeared. Nevertheless, there were no excessive investments in the sector; only 5 percent of the total sample was invested in other ITCs.

The situation was totally different after the end of the war. Significant changes can be observed in this sample. The USA gradually vanished from the ITCs investment map during the 1920s. North America, which was the dominant pre-war destination absorbing one out of three pounds of the ITCs investments (33.66 percent in 1914) lost one-third of its investments (20 percent in 1920). This 'leakage' continued; the next observation four years later described a 50 percent further removal. Finally, in 1928, American holdings amounted to less than 5 percent (4.97

percent). In absolute terms, the greatest fall occurred during WWI as described in the previous Chapter. However, an additionally significant decline happened the next four years whereby the ITCs withdrew 10 percent of their total investments from the USA. The dominant US sector in which they invested was the railways, see Chapter 8. Despite the calamitous fall of the US investments, the impact on the railways sector, separately, was by far milder. In 1920, 36 percent of their investments were in the railways, marginally higher than in 1914. Combining these two facts, the result, in parallel with the withdrawal of the US railways, is that there was an extensive re investment of these amounts in the same sector, but in different countries.

In the meanwhile, the dominance of the UK position was consolidated, see Chapter 9, with a rebound for the Empire trading mainly governmental bonds and industrial equity to cover the gap. Figure 6.1 (lower group) depicts three clear rebounds; two of them were within the Empire (Asia, Africa and Pacific); the first reaction occurred between 1920 and 1924. Although this change was tiny in absolute terms, there was a distinct preference for these regions. Finally, in 1928, the rise of Europe was perceptible.[49] Surprisingly, the continent, the form and the sectors were chosen for first time for the ITCs portfolio; Europe was far from the British ITCs first priorities during the whole pre-WWI period. On the contrary, industrial shares, European government bonds but not railways were the main European investments from the mid-1920s, see Chapter 9.

Latin America, the great investment option for British capital remained a dominant, safe and prosperous destination for the ITCs, see the next Chapter. Railways and other Utilities across the region were mainly a British affair. In addition, Latin American government bonds had a long tradition in British financial circles. Although Latin America was composed of mainly unstable economies focused on the trade of raw materials, it offered strong investment opportunities. However, as Figure 6.1 shows, during that time (1914-1928) Latin American holdings reached a level of saturation, beyond which their main criterion, diversification, would be violated.

Besides, Tables 6.1 and 6.2 offer more information about the geographical and sectoral allocation of the ITCs portfolios. The aforesaid percentages were the average values which are depicted in the Figures below. The main results of the descriptive statistics, Figures 1 and 2, are presented in the form of boxplots offering basic piece of information for the geographical and sectoral allocation. All the values are nominal, and they have been aggregated in the level

[49] Europe increased by more than two times compared to 1920 (3.9 percent → 13 percent) and more than fourfold compared to 1914.

of the portfolio. The existence of a significant dispersion is further confirmation of the separate strategies each ITC followed. As Figures 6.1 and 6.2 delineate, there were differences in all the geographical and sectoral allocation models. E.g., in 1928, there was one ITC invested more than 50 percent of its portfolio in Latin America, while another invested less than 20 percent. As for sectoral allocation, again in 1928 one ITC had half of its portfolio invested in railways, while another invested less than 10 percent. This means that despite the existence of a general tendency, each ITC board had its own tactic as for the allocation of its portfolio which would have been followed.

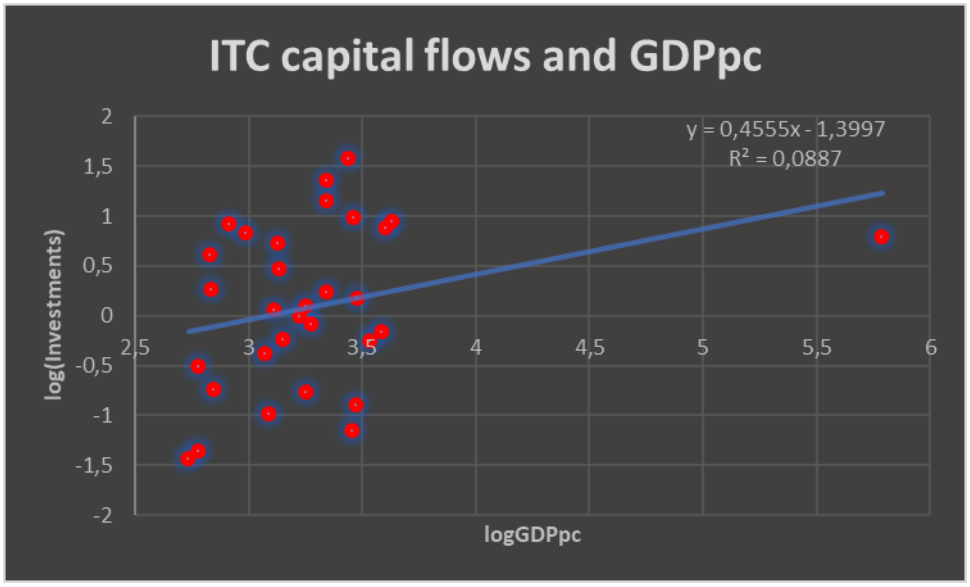
6.4 Economic and Population growth rates, Institutional characteristics.

The 19th century was a period of intense international capital flows, see O'Rourke and Williamson (1999). Economic historians and economists have tried to explain the cycles, trends, destinations of this capital mobility comparing it to the recent globalization era since the 1970s following the liberalization of the markets, (see among others Edelstein, 1982; Lucas, 1990; Taylor & Williamson, 1994; Bordo et al., 2003; Flandreau & Zumer, 2004; Schularick, 2006; Schularick & Steger, 2010). Among the basic results are the high capital and labour outflows towards poor countries, (see Obsfeld & Taylor, 2002; Taylor & Williamson, 1994).

Thus, both the economic growth rate and the population (immigration) growth rate are two issues closely related to capital flows. This study adds extra information to this story. ITCs can be recognised as important international capital flows transfer vehicles. They were financial institutions with significant capital outflows, as this study proves. Figures 6.3 and 6.4 tabulate this picture.

Following Schularick (2006), these figures display the relationship between the initial GDP pc of the various countries (Figure 6.3 counts the GDP pc for the year 1900 while Figure 6.4 counts it for 1920) and capital inflows (the amounts the ITCs invested in these countries for the years 1914 and 1928 respectively), both transformed into logarithms. Figure 6.3 describes a weak but positive relationship between the GDP and ITCs investments for the pre-war period. However, excluding the USA as an outlier (having a much higher GDP pc) the ITCs followed a path close to what the literature describes, viz. capital export to poorer economies, creating permanent debtors/ creditors. This correlation became vaguer for the 1920s. The result became less positive following a disruption of the pre-WWI pattern.

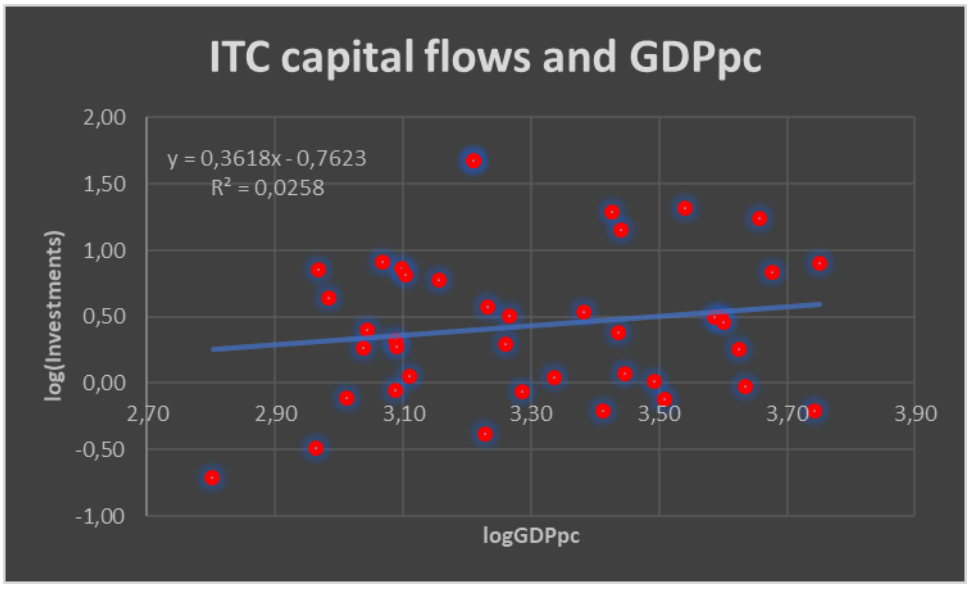
Figure 6.3 ITCs capital flows and initial GDP pc, pre-WWI period



Note: log (GDP pc) is for 1900 and log (Investments) for 1914. The latter variable has been estimated as a per capita level.

Source: For the data, see Maddison (2010). For the methodology Schularick (2006). Author's estimations.

Figure 6.4 ITCs capital flows and initial GDP pc, 1920s



Note: log (GDP pc) is for 1920 and log (Investments) for 1928. The latter variable has been estimated as a per capita level.

Source: For the data, see Maddison (2010). For the methodology Schularick (2006). Author's estimations.

This discussion argues for a closer examination of variables such as the GDP, which are important for global finance. Starting from this, this study examines further the effect of variables like the annual product in the asset allocation of the ITCs. Furthermore, it adds the notion of population, already used implicitly in the previous process in this analysis. Overall,

both the size and the growth rate of these two variables, the annual product and the population, matter for the capital markets. This Chapter systemize them in the Tables 6.3-6.5 in which the main evolution of these is presented for the examining period.

Table 6.3 Gross Domestic Product per capita for 1913, population growth rate and growth rate for the period 1901-1913

	GDP pc 1913 ($)	Population growth rate (%)	Economic growth rate (%)
Latin America	1,494	1.8	2.29
Western Offshoots	5,233	1.97	2.19
UK	4,921	0.80	0.73
Western Europe_30	3,457	0.85	1.40
Africa	637	0.97	0.45
Asia	695	0.88	0.67
World Average	1,524	1,06	1.47

Notes: Both the population growth rate and the economic growth rate (3rd and 4th rows correspondingly) are annual rates of change, thus it has been used the type $ROC = \frac{P_B - P_A}{P_A} * 100$, where P_A and P_B are the starting and the ending price. Because of lack of data, for the population rate for the regions of Africa, Asia, and the world average; and for the economic growth rate of Latin America, Western Europe, Asia, Africa and the world, correspondingly it have been used the rule of roots; viz $ROC = \left[\left({P_B}/{P_A}\right)^{\left(\frac{1}{N}\right)} - 1\right] * 100$, where N are the time periods. For Western Europe it has been used 30 Western European countries, included UK; for Latin America all the countries of the region; and for Western Offshoots the USA, Canada, Australia and New Zealand. For the amounts in $ there have been used the 1990 International Geary-Khamis dollars.

Source: Maddison (2010). Author's estimations.

Table 6.4 Average Gross Domestic Product per capita and average growth rate for the war period, 1914-1918

	Average GDP pc 1914-1918 ($)	Economic growth rates 1914-1918 (%)
Latin America_8	1,516	-0.69
Western Offshoots	5,134	1.33
UK	5,296	2.13
Western Europe	3,293	-1.32
Africa	NA	NA
India	683	0.20
Japan	1,544	3.96
World Average 1913-1920:	0.55	

Notes: For both of the two variables of Latin America it has been used the index of 8 countries of the region; for Western Europe 12 big countries; because of lack of information about Asia, it has been used as proxies two characteristic countries, namely India and Japan; for Africa there are no information; for the world average it has been used the type of roots for years 1913-1920. For the rest of the regions annual growth rates have been used. For the amounts in $ there have been used the 1990 International Geary-Khamis dollars.

Source: Maddison (2010). Author's estimations.

Table 6.5 Gross Domestic Product per capita for 1920, 1928, average population growth rate and average growth rate for the 1920s, 1920-1928

Country	GDP pc 1920 ($)	GDP pc 1928 ($)	population growth rate 1920-1928 (%)	growth rates 1920-1928 (%)
Latin America_8	1,644	2,039	1.93	2.89
Western Offshoots	5,397	6,402	1.60	1.75
UK	4,548	5,357	-0.21	1.16
Western Europe	3,125	4,017	0.71	3.13
Africa	NA	NA	NA	NA
India	635	706	0.86	0.34
Japan	1,696	1,992	1.35	1.07

Notes: For all the variables of Latin America it has been used the index of 8 countries of the region; for Western Europe 30 countries; because of lack of information about Asia, again, it has been used as proxies two characteristic countries, namely India and Japan; for Africa and the world, there are no information, correspondingly. For all the regions annual growth rates have been used. For the amounts in $ there have been used the 1990 International Geary-Khamis dollars.

Source: Maddison (2010). Author's estimations.

Initially, the economic performance of each country is an important factor that affects the investors' decisions to invest in this area, (see indicatively Rousseau & Sylla, 2003). These Tables present both the GDP pc and the economic growth rate[50] of the period for the main ITCs geographical destinations, endeavouring to capture both the economic robustness of the various countries and their progress, for the notion of economic growth see Barro and Sala-I-Martin (2004), all data are from Maddison (2010). This can be used also as a proxy of the attraction of foreign capital in the form of portfolio investment, a proxy for the investor's future profitability.

The existing literature uses the GDP- weighted benchmark, (see Chambers & Esteves, 2014, p. 8; Sotiropoulos et al., 2020), in which the GDP share of each region as a portion of the global GDP is examined. So, a picture of advanced versus emerging economies appeared, in comparison to the ITCs investments in the specific destination. This thesis does not use this approach because of the limited information this renders to the question about the causes of the selected asset allocation strategies of the ITCs. Although GDP measures the economic performance of a country/region, it is difficult to compare regions with different populations, thus the notion of the GDP pc emerges. Moreover, freezing GDP for a specific year, either the same or the final one of the period one studies, it distorts the results first because of the loss of changes over time and second, for an investor, the previous (weighted) economic performance

[50] This dissertation uses the notions of GDP pc and the growth rate as the annual rate of return of the GDP pc expressed in 1990 International Geary-Khamis dollars; thus, it can tackle the important problem of inflation, see Chapter 4. For the formulas, see the Tables' notes.

possibly matters. Besides, various questions arise about the notion of an emerging economy etc., this goes beyond the scope of this study.

This thesis uses both the GDP, presenting the level of economic activity inside country, also adding the growth rate capturing changes over time; finally, the p*er capita* index is used comparing countries with different populations. At the end, it is known that these indices have only *ex post*, theoretical importance, because the notion of GDP was unknown to the economists of this period, it only appeared in the 1930s for the first time.[51]

Additionally, the whole 19th century can be characterized as a mass migration flow period especially from Europe to the New World (Ferrie & Hatton, 2015). During the period 1870-1930 almost 60 million Europeans migrated in the New World (Shanchez-Alonso, 2019). Up to WWI, the trend was increasing, reaching 800,000 for Latin America (Argentina, Brazil, Cuba, Uruguay) and 1.8 million for the USA and Canada per year (many of them British citizens, see Chapter 2). However, after WWI, the migration flows shrank to less than 50 percent (Shanchez-Alonso, 2019, p. 5) of the pre-war level, remaining significant in absolute terms. These movements instigated big debates about the incentives of the migration flows and the results for the economies and financial markets of both the sending and the receiving nations.

A question also about the neoclassical theory of convergence arose (Taylor & Williamson, 1997). Convergence theory has a significant role in neoclassical macroeconomics. Its main idea is that poorer countries incomes are increasing faster than the richer ones, because of the accumulation of capital and the diminishing returns until reaching a steady state, (see Solow, 1956 and the vast literature thereafter). Should one accept the convergence hypothesis, and using migration as a proxy for this, he can conclude in a similar approach as the previous viz. the higher financial expectations for these economies. Thus, the population growth rate is used as an alternative index for the ITCs decisions to invest in a specific region/ country. Theoretically, there are objections to this approach. Economic history is a much more complicated topic, that needs deeper explanations focusing on the structural characteristics of each economy and society. O'Rourke and Williamson (1997, pp. 184-5) argue characteristically for the case of the European periphery: "…it might be of some value to think a little less like an economist and a little more like an historian. That is, it would be a mistake

[51] It could be interesting for a further study to be used indices as the Trade balance, the Industrial production, defaults, the degree of penetration of a foreign country etc.

to try to force that experience into one tidy explanation whether it comes from the fertile mind of Heckscher, Ohlin…".

The first results from economic and population indices are the following.

First, Table 6.3 displays the pre-WWI picture. The New World (mainly the Western offshoots) had high scores in both indices. Latin America, despite the low GDP presented dynamic development. On the contrary, both the UK and Western Europe, both rich regions, seemed to grow at a much slower rate. The rest of the world, despite the lack of data, did not follow a significantly evolutionary path. A combination of these data with this dataset can shed light on the reasons for the capital flows of the ITCs. Specifically, the high exposure of ITCs portfolio in Latin America can be interpreted, following the paradigm of Taylor and Williamson (1994) who argued that the high immigration outflows from the Old World, mainly England, during the 19th century, resulted in the pressure for high investment rate in the countries of the New World, which led, concomitantly, to augmented capital outflows. In this category, one can also add the case of the USA, but not that of Canada or Australia. This means that these indices are not sufficient to entirely explain the investing decisions of the ITCs. This is the reason for this thesis to incorporate new players, broadening the existing narrow frame.

Then, Table 6.4 focuses on WWI. The short period is insufficient to yield information for any financial pattern; however, it can offer two valuable pieces of evidence. First, most of the regions suffered from bad economic results, obviously because of the war and second, that the main loser was the European territory, paying the price of the war.

Finally, Table 6.5 captures the post-war picture. Europe now was the great surprise growing at a high rate; this may explain the shift of the ITCs' interest in that region. Not only did the Western offshoots, although they scored high for both their GDP and their growth path, refuse to accept more ITCs investments, but they also saw a withdrawal of the British ITCs investments. For the case of the USA, further questions arise concerning the inversion of the British investors to return. Although they maintained their investments in Latin America, the global pre-war pattern seems to have been disrupted, leading to a new financial flow one. In the end, despite the reckless and tempestuous new financial pattern, the ITCs managed, up to 1928, to conduct their investments maintaining their asset management strategy.

6.5 Conclusion

This Chapter presents the basic results of geographical and sectoral allocation of the ITCs for the period 1914-1928. Both aspects have long been important, from the discussions of the classical political economists up to modern financial studies. Nowadays, most of the researchers argue that geographical diversification raises the financial performance of portfolios however, home bias is not absent from various cases. The main pre-WWI geographical destinations for the ITCs were the Americas, followed by the UK, while the rest of the world was underrepresented in this sample. The railways, together with the rest of the utilities and the industrial sectors, were preferred in the ITCs portfolio while the government bonds and the financial sectors played a minor role. WWI partially changed this allocation. The ITCs withdrew their US investments shifting temporarily to the UK gilts as a government obligation. Additionally, they hedged their risks in the safety of the British Empire, to a lesser extent. Finally, they took full advantage of the European 'spring' of the mid-1920s. Overall, the evolution of the role of Latin America remained dominant. The ITCs maintained their investments in railways and the other utilities, both in Latin America, investing in parallel in new markets to which they moved their previous investments in the USA. The new European government bonds along with the British industrial holdings, comprised their alternative investments.

Recently, a discussion has resurfaced about the "first globalization era" combining the financial development approach and the "finance growth nexus". This thesis follows this pattern by contributing to the debate on international capital flows and the paradigm shift during the interwar period. Moreover, it uses basic variables from this discussion to explain the decision-making process of the ITCs management strategy. Thus, it examines the economic growth rate as an index for the economic performance which could attract foreign investors into this market, as a profitability index. Additionally, it reckons the population growth rate assuming it correlates with the immigration rates, again as an index for higher economic and financial performance. The geographical and sectoral allocation of the ITCs can answer the main research question of this thesis, the asset management strategies of the ITCs. ITCs used a combination of passive and active strategies. The maintenance of safe holdings in their portfolios, despite the economics and financial changes, features the more passive part of their strategies, a buy-and-hold approach they used to apply. However, the new acquisitions, especially in areas and sectors that were unknown to them indicate a shift towards a more active strategy where their directors applied a more top-down approach, added uncorrelated markets

to increase their returns decreasing their risks. Finally, this thesis uses, as before, a multidimensional approach importing more agents into the general plan such as the government, the various discussions of the financial actors and social factors. These issues will be scrutinized in the next Chapters.

7 Persistence in Latin American holdings

7.1 Introduction

This thesis to answer its research question, the asset management of the ITCs, builds a dataset constructing mainly three indices: the asset, geographical and sectoral allocation of the ITCs portfolio. The previous Chapter tabulates the main results of the geographical and sectoral allocation. Latin America was one of the most preferred regions for the ITCs investments for the whole period not only before WWI but also afterwards. Moreover, specific sectors can be found in the ITCs portfolio such as Railways, Utilities and to a lesser extent Government bonds. So, the question that arises in this Chapter is, what were the determinant factors of this persistence of the LA holdings in the ITCs portfolios? Additionally, this Chapter tries to answer the other question of this thesis, the interaction of the ITCs with the local societies. What were the reasons for the ITCs to remain investing in this region despite the huge changes? What can be argued about the management strategies they followed?

Latin America (LA)[52] had diachronically 'special' economic and political relations with the European continent. Since its Spanish occupation in the 15th century, the Europeans have played a determining role in the internal affairs of the region. Following a wave of national revolutions during the early 19th century the Europeans, especially the British, seized the opportunity to develop close economic and political relationships with the countries of that region, Pendle (1963).[53] Paish (1911) argued that LA was the third biggest foreign destination for UK capital investments' abroad, behind the USA and Canada. The ITCs have shown intense interest for Latin American holdings since the late 19th century, (Chambers & Esteves, 2014; Sotiropoulos et al., 2020). They seemed to follow the financially promising climate of that period about the LA holdings. Practically one out of three pounds of the pre-WWI British ITCs was invested in LA. The same picture remained during the period after the war (1914-1928).

LA was generally a privileged area for British investments. The long roots of the British capital in the area had created a safe environment for their business opportunities which offered security and high returns. The first financial British attempts in LA started during the 1820s from the government bonds market, followed later by railways, other municipal mainly public

[52] Latin America comprises in this sample all Americas apart from the USA and Canada, see Chapter 3.
[53] European rivalries for Latin America have been presented since the Spanish occupation. However, the emancipation movements together with the Monroe Doctrine inaugurated the British economic penetration into Latin American territory.

utilities, telegraph services and commercial banking operations reaching to industrial ventures and retail, (see Rippy, 1977; Platt, 1986). During the 1880s, the ITCs entered this market dynamically. However, the next decade was not financially successful. British investments in LA precipitously fell due to the Baring Crisis in 1890-1. Notwithstanding, the next decade fully compensated the British investors, (Rippy, 1977). Despite the sharp and frequent economic fluctuations, British investments remained intact in the area, focused on the country with the highest performance, namely Argentina. Additionally, the British ITCs did not hesitate to invest even in the backward countries of the region with an intense sovereign defaults' history.

The first part of this Chapter studies LA economic and population growth rates for the first three decades of the 20th century. Although it scored high economic and population growth rates, LA has practically never ceased to accept significant immigration flows throughout the period, offering a measure of economic prosperity, or better a land of *great expectations*; this can be partially correlated to the ITCs exposure in this region. The king of the British investments in the area was railways, following by utilities and government bonds. In the case of Argentina (subsection 6.3.2), foreign, mainly British owners of this investment had built a sufficient legal basis (the Mitre Law) to pledge promising returns. An extra advantage for the British investors which affected the ITCs was the widespread use of the GBP as a currency in most of the LA holdings, overcoming the unreliable local currencies. Even in problematic cases such as Mexico (subsection 6.3.5), the gold peg of the railways investments along with the patience of the ITCs policies led to a maintenance of the returns of their investments.

Overall, ITCs have invested in LA Railways (15 percent of the total portfolio) taking full advantage of a combination of high returns and secure investments. The management strategy that followed was the typical passive approach using a buy-and-hold technique. The main financial periodicals of the period under study were highly concerned about the evolution of the Latin American economies. E.g., periodicals such as the FRoR and the IMM devoted at least one article related to this region in each issue, supporting the strong British financial interests in the region. However, this picture began to fade. State intervention and labour upheaval has emerged giving the British investors, the ITCs included concern. Gradually, the British financial superiority in the area was challenged by the economic penetration of the USA and Germany. But all these will occur in a next period.

7.2 Economic and population growth rates of Latin America.

As mentioned above, LA was a territory composed of vulnerable economies focused mainly on the export of one or more raw materials (e. g. agricultural products, minerals), see Bulmer -Thomas et al., (2006); this meant high and regular economic oscillations because of the international prices of the products exported. It was a poor region compared to the advanced economies of the Western Offshoots. GDP pc for eight selected LA countries in 1920 was $1,600, extremely low compared to the $4,500 of the UK or the $5,500 of the USA. So, observing this significant difference one could easily raise the question, why an investor to trust their capital to such backward economies? The first rough conclusion is not because of their economic prosperity. As argued in Chapter 5, there is considerable literature about the pre-WWI capital outflows from the rich to mainly poor countries, a pattern which was curbed thereafter. Specifically, during the pre-WWI period a one-way asset shift was observed, meaning an investing preference towards the poorer economies (Obsfeld & Taylor, 2002), creating persistent creditors (Britain) and debtors (LA). A second significant variable correlated to the international investments is migration. Theoretically, Taylor and Williamson (1994) argued that the high immigration outflows from the Old World, mainly England, during the 19th century, had, as a result created the pressure for high investments rates investments in the countries of the New World, LA included, which led to augmented capital outflows. Thus, population rates and foreign investments -in this case the British ITCs- are correlated. Overall, both economic and population growth rates are related, at least up to 1914, to the expansion of foreign investments, the ITCs in this case. However, the post WWI period completely changed this picture.

Starting from the presence of the growth variable, the results are summarized in Figure 7.1. See also Table 7.1, Table 7.2, Table 7.3 for the evolution of these variables. Initially, this thesis add evidence from the Maddison database (2010) regarding the GDP pc for eight selected countries of Latin America for the pre, inter and post-war period, correspondingly, see Chapter 5. Now it uses countries' data; especially for the post-war period it adds smaller countries because these data are available (not only in Maddison (2010) but also in this database). Economic and population growth rates are also included in this research. Briefly, sizeable discrepancies were present among the various countries; a clear outlier, namely Argentina emerged, which attracted high investments, despite its mild growth rate.

Table 7.1 Gross Domestic Product per capita for 1913, population growth rate and growth rate for the period 1901-1913 for 8 selected countries of Latin America

Country	GDP pc 1913 ($)	Population growth rate (%)	Economic growth rates (%)
Argentina	3,797	3.83	2.60
Brazil	811	2.13	1.46
Mexico	1,732	0.74	1.95
Chile	2,988	1.14	2.52
Uruguay	3,310	1.96	3.45
Colombia	1,236	2.04	1.87
Peru	1,032	1.26	3.22
Venezuela	962	0.95	2.45
Total	1,618	1.77	2.31

Notes: For the amounts in $ there have been used the 1990 International Geary-Khamis dollars. The growth rates have been calculated as the average annual rate of change (ROC) for the period under study as $\rho = (\Omega - \mathrm{A})/\mathrm{A}$, where Ω is the final observation and A the initial one. See the previous Chapter for more information.
Source: Maddison Database (2010); Author's calculations.

Table 7.2 Average Gross Domestic Product per capita and average growth rate for the war period for Latin America 8 countries, 1914-1918

Country	Average GDP pc 1914-1918 ($)	Economic growth rates 1914-1918 (%)
Argentina	3,135	-2.57
Brazil	806	-0.02
Mexico	1,770	0.74
Chile	2,726	0.30
Uruguay	2,636	-2.56
Colombia	683	0.41
Peru	1,140	3.23
Venezuela	997	-0.38
Total	1,516	-0.69

Notes: For the amounts in $ there have been used the 1990 International Geary-Khamis dollars. For the growth rate see above.
Source: Maddison Database (2010); Author's calculations.

Table 7.3 Gross Domestic Product per capita for 1920, 1928, average population growth rate and average growth rate for the 1920s, 1920-1928 for selective countries of Latin America

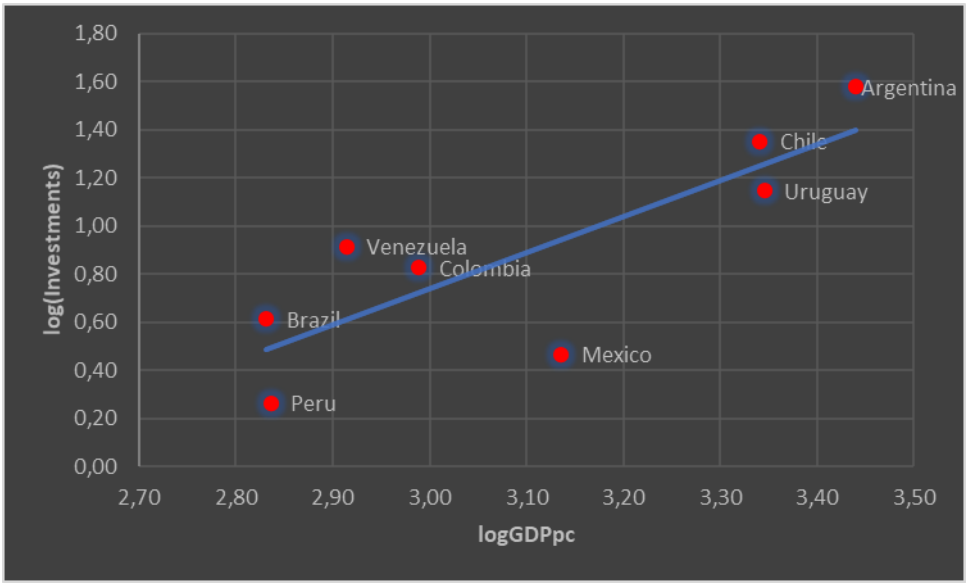
	GDP pc 1920 ($)	GDP pc 1928 ($)	Population growth rate 1920-1928 (%)	Economic growth rates 1920-1928 (%)
Argentina	3,473	4,291	2.97	2.98
Brazil	963	1,158	2.06	2.97
Mexico	1,823	1,857	1.21	0.33
Chile	2,768	3,332	1.33	3.95
Uruguay	2,674	3,906	2.30	2.81
Colombia	1,255	1,304	2.59	1.98
Peru	1,226	1,754	1.54	4.08
Venezuela	1,173	3,057	0.89	13.96
Total	1,644	2,039	1.94	2.89
Costa Rica	1,624	1,685	1.50	0.77
El Salvador	932	1,055	2.18	1.99
Guatemala	1,272	1,557	1.04	2.70
Honduras	1,274	1,547	2.79	2.77
Nicaragua	1,264	1,590	0.67	3.56

Notes: For the amounts in $ there have been used the 1990 International Geary-Khamis dollars. For the last 5 countries the growth rate is for the period 1921-1928.For the growth rates, see above.
Source: Maddison Database (2010); Author's calculations.

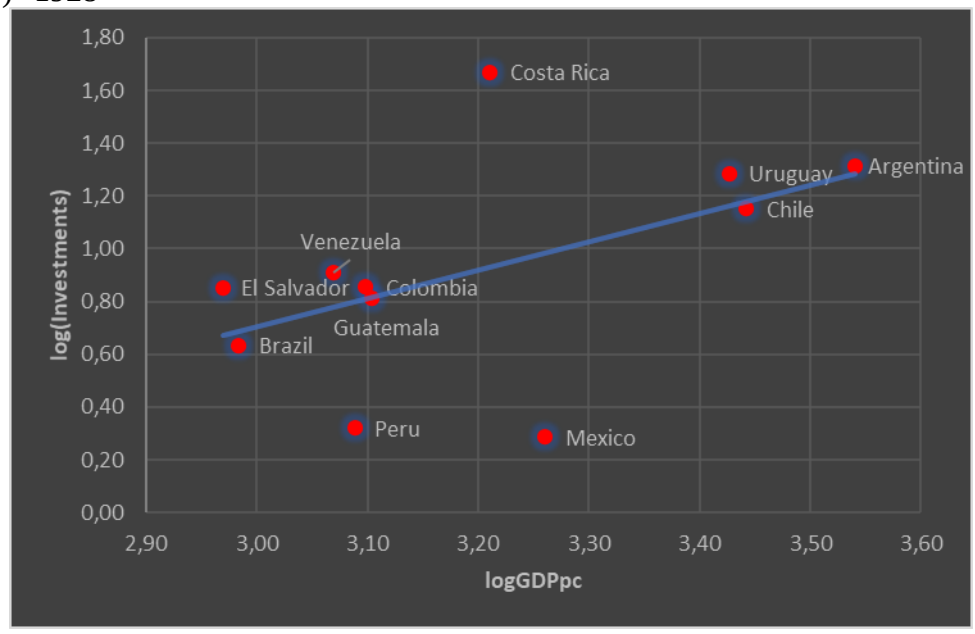
Figure 6.1 follows, again, Schularick (2006) and it features the correlation between the GDP pc in the initial period and the ITCs capital outflows, both in logarithmic form. Although the samples are different the main tendency is confirmed. For the pre-WWI period, the positive relation is stronger (steeper slope) than afterwards. Argentina in both cases is a positive outlier meaning that with a GDP pc almost $3,500 it converged with the advanced economies' ones. Adding to this the fact that the Argentinian economy had grown satisfactorily well, scoring an average of 2.6 – 3 percent for the period after 1900, apart from WWI, it seemed a positive sign for a foreign investor.

Figure 7.1 Economic growth rate-ITC investments' share scatterplot for Latin American countries

a) 1914



b) 1928



Note: log (GDP pc) is for 1900 and log (Investments) for 1914. The latter variable has been estimated as a per capita level.

Source: For the data, see Maddison (2010). For the methodology Schularick (2006). Author's estimations.

During the interwar period, the LA economies suffered from the limited demand from the European and North American economies. However, this friction did not seem enough to change the ITCs policy for the region. Indeed, the picture of the post-war era can justify their decisions; again, a stable growth rate for most of the economies is visible. "[T]he main security of the investor in Argentine stocks is the *exceedingly rapid growth* during recent years" (IMM;

May, 1929, p. 237), so it seems that investors had a similar opinion about the growth rate as a factor of their financial engagement with the specific country, for the economic growth in Latin America during the 1920s, (see Taylor, 1992; Thorp, 1998). The robust economic position for this country could be taken as a positive sign for the ITCs to maintain their investments. Here, the study of each country will enlighten us about the reasons behind the significant British ITCs' investments in this area.

Furthermore, it studies the population rate. LA can be described as the *Promised Land* for the European immigrants who flocked there during the 19th century. Despite WWI, the case of free movements and some initial mitigation measures, see among others Shanchez-Alonso (2019), the inflows were never suspended.[54] Tables 3-4-5 in Chapter 4 show that LA remained together with the rest of the New World as the main population increasing regions, implying high immigration rates. Considering the population growth, a clear positive relationship with ITCs' investments can be found; this trend is because of the critical role of Argentina. Removing this country, the relation becomes more moderate.

Argentina again is a special case. It had the highest population growth rate for the whole period following 1900, higher than 3 percent on an annual basis. Combining this with the previously high economic growth rate, this thesis can argue that an economy with both robust demographics (immigration and fertility rates), (see Taylor & Williamson, 1994), and economic performance was an ideal investing choice for the foreign investments of the ITCs. As for the post war period, now the picture is again different: the relationship between population growth rate and ITCs investments is still positive, but weaker. Possibly, the immigration constraints caused by the war and the period afterwards can explain this difference. Finally, apart from Argentina, another interesting case, namely Brazil, seems to score higher population rates and a significant economic growth rate during the 1920s, leading to increased British investments. All in all, the ITCs seem to follow a similar path to what the general economic theory refers to as the international capital flows during the "first globalization era", despite any peculiarities. This picture changed during the post-war period. Although the ITCs continued to invest dynamically in the area, the first changes from the pre-war paradigm are visible.

[54] In absolute terms, the population of Argentina in 1920 amounted to 8.9 mil, in Brazil it was 27 mil, in Mexico it was close to 15 million and in Chile 3.7; the same period the British population stood at 47 million and the US one reached 107 million.

This Chapter also broadens the strict financial frame, with more actors being added, to explicate the main reasons for the asset management strategies of the British ITCs in the period 1914-1928. Now it starts adding these alternative indices to enhance the big picture of the economic penetration of Britain in Latin American territory, focusing on the case of the ITCs. A mixture of economic and non-economic factors is needed to delineate the environment in which the ITCs acted in LA. The British government, a crucial actor, although imbued with liberal ideas was diachronically active in economic cases in this area. It has been argued that this policy was implemented after the emancipation movements in the early 19th century. Canning took full advantage, planning a new status quo in which the UK would be the leader, see Pendle (1963, p. 114); also, the discussion in the FroR was indicative of this approach; finally see the notion of the *informal imperialism* in the works of Ferns (1953) and Winn (1976). Also, there is a similar theoretical discussion in Gallaher and Robinson (1953).

The situation regarding the trade and monetary issues in LA was not ideal the first year after the end of WWI. The huge oscillations following the abandonment of the Gold Standard were, also, reflected in the economics of LA (Martin, 1923). The abandonment of the Gold Standard has also affected the LA currencies, characteristically, Argentina withdrew from the Gold Standard in 1913 which had been established since 1899, see Rock (1986). However, first because of the long distance from the epicentre of the war and, also, because of the preferential position of the foreign share/bond holders and the guaranteed returns, the "contagion" was less than in the European economies, (Albert & Henderson, 1981).[55]

A first possible general explanation about the dominance of the British ITCs in Latin America could be the lack of traditional banking alternative even before WWI. Since the emancipation of LA, the capital accumulation and the economic growth remained unquestionable. Because of the lack of national capital, along with an insufficient and immature banking and financial markets, the foreign capital addressed this gap. Despite "the fact that foreigners and their capital arrived in quantity [Ed. N. in LA] is indisputable" (Platt, 1979, p. 3), there are heroic debates about its role in the economic development of the region, (see Furtado, 1970; Thorp, 1998; Taylor, 2006); the notions of underdevelopment and dependency arise here, see below. The first alternative could be the foreign banks. However, in the case of the British bankers, they could not provide the LA traders with long-term credits without asking for higher coverage

[55] The removal of the Gold standard and the concomitant trade and government budgets imbalances reawakened the fears of massive national defaults and economic problems. However, the ITCs, as mentioned, were not overexposed to LA national debt. The private debts, especially in foreign-owned enterprises such as in Railways rarely defaulted and were secured, see next section.

(e.g., collateral); this gap was gradually covered by the rival German system which provided long-term credits (Martin, 1921). He regarded it as a factor which affected the economic crisis in the area (e.g., the case of Mexico); see also the analysis of Capie and Collins (1996) for the problems of the British banking system lending the real economy. Thus, the British financial market, espousing a more international character (Cassis, 2006) would take the risk investing in a foreign market, anticipating higher returns. Banks are diachronically more reluctant to finance foreign investments. However, the universal banking system which has been developed in economies such as Germany seemed more inclusive, also joining these practices. For the case of the British Banks in LA, see Jones (1992).

Furthermore, one of the knottiest problems of the funding process of the LA economies involved the monetary imbalances. Because of the weakness of the LA economies, their dependency on raw materials exports and the consecutive defaults for the whole of the 19th century, their currencies were weak too, with frequent fluctuations, see for the case of Argentina Rock (1986), for Mexico Womack (1986), for Chile Blackmore (1986). The high oscillations in the monetary systems of the LA currencies had made the development of the local financial system impossible. These twin problems, namely the monetary instability and the banking underdevelopment were tackled by the emergence of the British financial markets and the British currency; using these two stable anchors, the British pound and the LSE they could prevent the devastating financial oscillations.

As Feis (1930, p. 30) argued: “In the regions where the technique of trade financing was little developed, and the means therefore small, or where the necessary business experience and probity were lacking, or where the fluctuations of the local currency gave special space to the stable English pound, they found their greatest opportunity… and throughout Latin America”. Thus, in LA the British investors succeeded in transforming the disadvantages such as the weak financial markets, the lack of entrepreneurship, or the monetary weakness into opportunities, improving their profits. The ITCs led in this process. These interventions could not stabilize the problems arising in the type of economies, focusing mainly on the exports of agricultural products. This can be seen in the growth rates of the LA economies (Maddison, 2010) and it is also present in the discussions of the period. However, these policies could guarantee the profitability of British investors in the region.

Another example which is used, describes the complexity of the whole discussion about the geographical allocation in the region and beyond. Also, it introduces a question about the interaction between the financial investors, the state, and society. As a characteristic example,

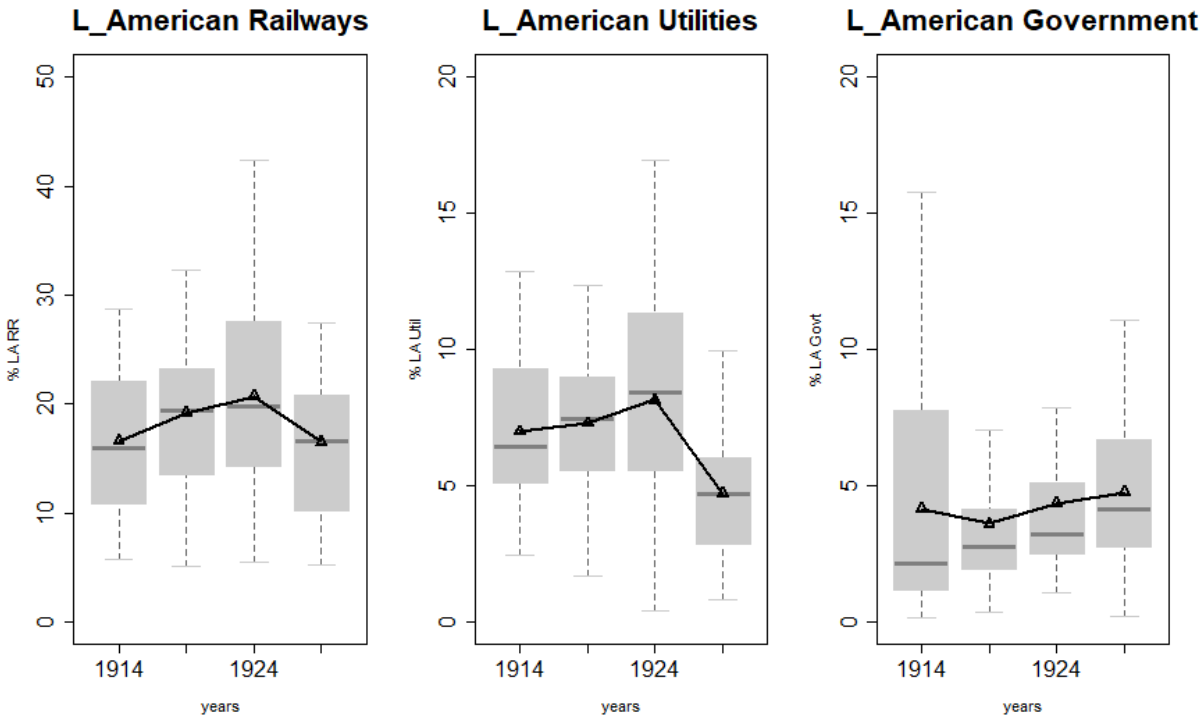
one of the most prominent British industrialists, Sir Mac Gowan, the Chairman and Managing director of *Nobel* industries, visited the major Latin American countries in 1918 searching for any possible business activity. In his report, he mentioned explicitly "the support which should be given by our Government to their Ministers and commercial Attaches to assist British commercial firms". (Mac Gowan, 1922, p. 5). In many cases below, indirectly, or not, endeavours from the British government to support (or to intervene in) these economies assisting their domestic economic interests, can be seen. Numerous advisory bodies and other supportive committees participated in both the Latin American public finance and private economies. This is a first evidence about political bias that has been used by various economic interests, affecting obviously the ITCs' decisions. Similarly, Martin (1922) proposed a greater diplomatic intervention in the region; in parallel he introduced a more political aspect, the notion of classical liberalism; believing that the Latin American governments would guarantee the British because of their liberating past against the "Spanish tyranny" (Martin, 1922). To these examples one could add also alternative explanations about the British financial penetration in the continent. For instance, there was the *exegesis* which combined the significant presence of the British investors in the region to the privileged politico-economic relations and which had created an unequal economic relationship, this is the theory of informal imperialism, see above.

Finally, problems for the investors seemed to appear later because of political and social changes. LA had a very peculiar political and social history originating in the colonial period (Bethell, 1986) and affecting structurally its economy (Cardoso & Faletto, 1979). In the early 20th century, numerous oligarchic regimes emerged in the region (Kaltwasser, 2018). In addition, political pressure from socialist parties arose (Walter, 1974). This pressure increased, also, because of the October Revolution, which had crossed the Atlantic Ocean in the interwar area. As a result, stronger demands for more energetic state intervention and acute labour demands appeared, diminishing the profitability, and influencing the financial market.

These paradigms sketch the multidisciplinary approach towards the geographical allocation which will be followed. Despite the difficulties, the ITCs and generally British interest in the investment in Latin America remained stable for the whole period. The British long term economic, political and social relations were forged throughout the 19th century, offering a solid base for their investments in LA. Despite the distance and the weak and vulnerable economic performance, ITCs along with the rest of the British investors created an indispensable environment using their own currency and their own financial market along with

the thorough economic investigation of these economies to secure their investments and raise their returns. But, what about the preferred sectors in LA? Did they offer any analogous safety and profitability criteria? How did the ITCs management manage to reduce the risk of their investments?

Figure 7.2 ITCs portfolio main sectoral allocation in Latin America (percent of portfolio nominal value)



Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

In Figure 6.2, the main sectoral analysis of Latin American region is presented. The three dominant fields of the ITCs investments in Latin America were a) railways, b) utilities, and c) government bonds. By far the most preferred holdings were the railways. Comparing with the general exposure of the ITCs portfolios in railways (35 percent in 1914 and 36 percent in 1920) it seems that a significant part of these holdings came from LA (the other significant destination was the USA, see Chapter 7) At the outbreak of WWI, both LA and North America railways had almost 15 percent each share of the total portfolios, 30 percent aggregated. However, the route of the railways investments on behalf of the ITCs in these two regions during the next decade was not the same at all. As have argued in Chapter 5, although the US holdings vanished from the ITCs portfolios, sweeping the Railways away too, the picture for the LA railways was far different. For the whole of the period, 1914-1928, more than 10 percent of the general value of ITCs holdings were invested in LA Railways, see also Table 6.4.

Table 7.4 Geographical allocation in selected countries of Latin America (percent of portfolio nominal values).

Country		1914	1920	1924	1928
Argentina	Observations	24	30	30	33
	Average	14.07	14.58	15.54	11.23
Brazil	Observations	24	30	30	33
	Average	4.84	5.34	6.25	6.74
Chile	Observations	24	29	30	33
	Average	1.62	1.74	2.51	2.65
Costa Rica	Observations	17	22	23	20
	Average	0.74	0.83	0.89	1.09
Cuba	Observations	23	30	30	27
	Average	2.25	1.95	1.88	1.37
Mexico	Observations	24	29	29	29
	Average	4.22	3.82	4.45	2.86
Uruguay	Observations	24	30	30	30
	Average	1.96	2.13	1.94	1.56
Paraguay	Observations	16	20	21	18
	Average	0.54	0.73	0.80	1.09
El Salvador	Observations	3	4	6	6
	Average	0.14	0.16	0.22	0.48
Guatemala	Observations	1	4	3	5
	Average	0.54	0.32	0.64	0.55
Trinidad	Observations	9	7	4	8
	Average	0.22	0.27	0.17	0.07
Venezuela	Observations	15	21	22	25
	Average	0.95	1.16	1.40	1.27
Peru	Observations	12	15	19	27
	Average	0.73	0.84	0.85	1.54
Colombia	Observations	14	16	17	23
	Average	0.42	0.39	0.38	0.54
Central America	Observations	3	11	14	27
	Average	0.28	0.45	0.54	0.79

Source: For 1914 it uses the data of Sotiropoulos *et.al.* (2020). For the rest of the data, it uses this sample.

Apart from that, for the whole period 5-7 percent of the total portfolio value was invested in LA Utilities, usually municipal ones,[56] while the revelation of this research is the third subcategory, namely government bonds. As have mentioned in the previous Chapter, following Sotiropoulos et al. (2020, p. 801): "ITCs were relatively less keen on government securities than was the LSE as a whole". Especially in 1914, almost all the government bonds they held in their portfolios were from LA. Despite the shift towards the British government bonds during WWI, see Chapters 5 and 9, the one-third of their investments in government securities remained in LA. So, there were three main sectors which presented a significant interest for the ITCs. Now, what were the reasons behind this preference? This thesis studies the reasons which have led the British ITCs investing in a safe and flourishing sector, namely railways.

[56] Electrical, water, transportation or other economic infrastructure companies were based on a municipality level.

7.3 Railway's investments in Latin America

7.3.1 Railways - Introduction

> "The railways sprang first up as the '*couronnement de l'oeuvre'* in those countries where *modern industry was most developed*, England, United States, Belgium, France, etc. I call them the *'couronnement de l'oeuvre'* not only in the sense, that they were at last (together with steamships for oceanic intercourse and the telegraphs) the *means of communication* adequate to the modern means of production, but also in so far as they were the basis of immense joint-stock companies, forming at the same time a new starting point for all *other sorts* of joint-stock companies, to commence by banking companies. They gave in one word an impetus never before suspected to the *concentration of capital* and also to the accelerated and immensely enlarged *cosmopolitan* activity of *loanable capital*, thus embracing the whole world in a network of financial swindling and mutual *indebtedness*, the capitalistic form of 'international' brotherhood" (Marx, 1879, p. 356, italics for emphasis).

The railways were an industrial innovation of the Victorian period, the mid-1820s, and were considered "a *considerable* addition to the industrial structure" (Gourvish, 1980, p. 9, italics for emphasis). Railways have a significant role in the *evolution* of capitalism, contributing to the accumulation process, as a means of transportation, and exporting capital universally. "They represented the prime example of large-scale free-enterprise capitalism in 19th century Britain", with unquestionable participation in the main macroeconomic indices; namely, in fixed capital formation, revenues and employment (Gourvish, 1980). Besides, the railways sector had undergone a concentration process during the 19th century. Finally, to tackle the various financial challenges, they had developed pioneer manager structures; the joint-stock and the limited liability companies were mainly used. These institutional changes were "a social base to the capital market of the mid-century [Ed. N. the 19th century] was provided by the new class of 'pure' investors, the people who had learned to put their money into profitable use, and to decide that use by the sole criterion of interest, and whose expectations of income were very largely a matter of yields and quotations" (Postan, 1935, p. 7). Railways were the pioneering sector in this process.

By the 1870s, almost all the railways system in the UK had been constructed (Gourvish, 1980). In parallel, the British had taken full advantage of this invention, exporting their know-how, experience and methods all over the world. The ITCs had got into a close relationship with the

development of Railways abroad from the beginning with one-third of their assets invested in this sector. What were the main reasons for this affair? This 'eternal love' goes beyond financial reasons. Unequivocally, it is based on the profit motive; however, that these relationships which had been forged by the British investors and this sector, concealed a long-term conception about the "benevolent impulse to uplift colonials and other economically retarded peoples", see Rippy (1977, p. 198). Furthermore, as Marx noted in the aforesaid quote, especially in the second part, a view which was supported by Postan 50 years later, the railways were the pioneers of the joint-stock company, creating a *cosmopolitan* character for the capital. The ITCs, in parallel, focused mainly on stock exchange schemas and investing in joint stock companies globally; thus, they shared common values and it seems logical for the ITCs to support institutions that espoused the same principles as them.

So far, this thesis presents an institution that ran in the British investors' blood, with both embracing a common philosophy and through railways they could infuse their civilization in the indigenous. All these offered in the end a prosperous and safe, long-run investment. And why had LA been selected as the ITCs railways *El Dorado*? The best way to answer this question is to focus on one of the places where the British ITCs were heavily invested in Railways, namely in Argentina.

7.3.2 The case of Argentina

> "On the eve on WWI British investment in Argentina were, with the exception of the British investments in the USA, the largest group of investments made by British investors in any country outside the British Empire. The estimated British investments of £316 mil. was 8.5% of all British external investments in the spring before Sarajevo. At the beginning of the depression of 1929 the proportionate quantity of British investments in Argentina was even greater: 12.8%" (Ferns, 1952, p. 341).

Looking at the sample for 1928, out of a total of almost £73 mil., Argentina absorbed £8 mil. or 11 percent of the sample, which is a number very close to what Ferns supported above. Argentina absorbed 4,400 holdings out of the total sample of 40,875. Half of them were in railways, while the next big investments were in utility companies such as tramways and electricity, 900 collectively. Of course, investments in public debt and the raised municipalities bonds were attractive too with more than 300 holdings (Figure 7.3).

From now on, this thesis uses as an index for the evolution of a specific sector or region the number of holdings it finds in the ITCs portfolios. The basic problem with this approach is the

following: the number of holdings does not offer specific information about the value of these holdings. E.g., one ITC could have shares of several tea companies in Asia, however, their average value would be much lower than the overall average- here, the average value of a *Tea, Coffee and Rubber* holding, see Chapter 3, was almost £2,800 while the average value of an individual holding was £6,000, see Chapter 4. Additionally, because most of the companies issued many different types of holdings this meant that more than one holding in a portfolio could refer to the same company. E.g., if ITC x holds one ordinary share, one preferred share and one bond form the same company, then this number is not entirely identical for the relationship of this ITC to the examining sector or region. The results therefore need to be interpreted with caution. Nevertheless, the holdings' number in absolute terms can offer information for the trend of the management strategies and the evolution of the geographical and sectoral allocation. Of course, one must see these indices in combination with the portfolios' value and the general discussion to have a solid overview.

Argentina can be defined as an outlier in LA's economic performance. In 1913 its GDP pc was $3,797, the highest in the region with a 2.6 percent annual average growth rate for the period 1901-1913. The average Latin American GDP pc was only 43 percent of the Argentinian one, indicating the distance of the latter. During WWI, LA product decreased annually by almost 1 percent, for Argentina there was 2.5 percent fall. The total exports have fallen dramatically, because of the limited demand from Europe. However, the situation changed in the aftermath of the war. For the period 1920- 1928, the Argentinian growth rate was 3 percent on average, similar to the average LA rate. Additionally, Argentina had a 3 percent population growth rate which was the highest in the region, implying a significant rise in the immigration rate.

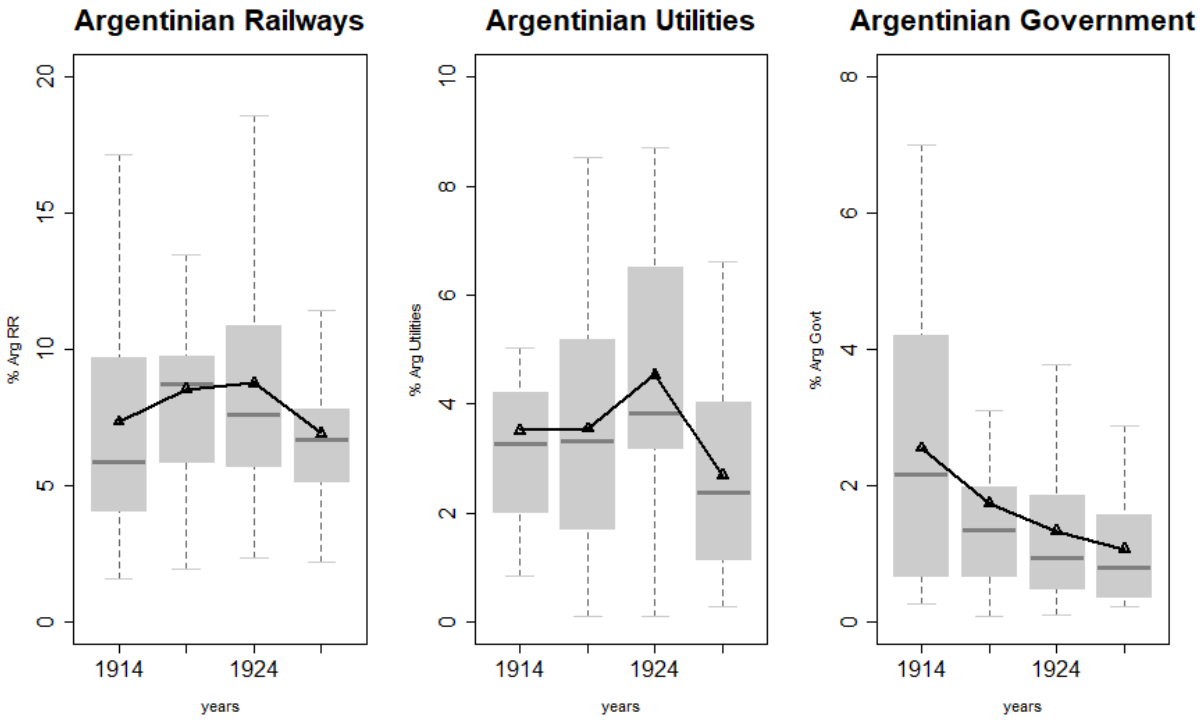
There are also other qualitative data for immigration flows: "The Argentine is becoming rapidly Italianized. There is a steady flow of thrifty, sober and industrious workers from Italy who are better adapted to the climate and conditions than the Northern Europeans and who are helping to build up a nation which is wealth are resources may someday rival the USA" (Lee, 1925, p. 55). This tendency continued even after the war at 2.97 percent per year. So, it seems that the specific immigrant inflows are determined to be as a positive sign by the British investments in the area. Immigration is discussed even nowadays in economics combined with long run economic growth patterns, the role of institutions etc. (Acemoglu et al., 2000).

In 1928, the last year of this sample its GDP pc reached $4,291 (Tables 6.2 and 6.3). Argentina was one of the few Latin American countries which could be compared to the then advanced world of the Western Offshoots or the British one ($5,300). Just to mention that the average

Western European GPD pc for 1928, a period after the European recovery from WWI, was lower reaching $4,017. This situation seemed to be ideal for British investments, pleased that they have been investing in a country with a robust and long-run economic growth, reaching the western levels. Automatically, this performance affected the domestic demand, offering more opportunities for the ITCs.

"There is probably no field in which the function of British capital to encourage and foster the development of commerce and enterprise in the distant part of the globe has been more in evidence than it has been in connection with the Railways of the Argentine Republic" (Fleming, 1925, p. 51).

Figure 7.3 ITCs portfolio main sectoral allocation in Argentina (percent of portfolio nominal value)



Source: Author' s computations. For 1914, it uses Sotiropoulos et al. (2020).

Figure 7.3 focuses on the main Argentinian investments of the ITCs of the sample. Indeed, Argentine was a favourite destination for British capital. Almost 40 percent of the total investments in Latin America were focused on Argentine. And the investments' king was undoubtedly the Railways. According to Grossman (2017) 70 percent of the paid-up capital of Argentina for the period 1869-1929 was on railways. The conditions were similar for the whole continent with 56 percent. In his analysis, Argentine equities had an annual growth dividend policy of 5-6 percent for the period 1899-1928 and annual capital gains of the same

percentages. In the same period Latin American Railways equities had an annual growth of 5 -6 percent and 5 percent respectively (Grossman, 2017). The only exception was the second decade of the century (1909-1918) with no capital gains; all measures are weighted in paid up capital. The same happened also with the ITCs portfolios which were filled by 4,500 holdings from this country, the 2,000 of them in railways. The climate was ideal for the whole period in the railways sector. The pre-war legislation (the Mitre Law) and the guarantees for the continuation of future profitability were the necessary and sufficient conditions for investment in that sector (see Lewis, 1983).

7.3.3 The Mitre Law

So, this thesis needs to detect the reason behind this preference towards the Railways in LA. In Chapter 2, it has already been described that *safety* was a cornerstone in the ITCs asset management strategy. This means that it needs to find a returns' safety net for the LA Railways, in particular Argentina. This net would perfectly be offered by the coverage of the government.

"The most significant single step in the relationship between British Railways and Argentina was the passage of the Mitre Law in 1907" (Duncan, 1937, p. 559). The law was mainly an attempt by the Argentine government to re-codify all the previous legislation about the concession laws and regulation of the Argentinian railways. It offered a simple and unified basis upon which the companies could be established and operate. It "put the relationship of all the foreign companies with the government on the same basis" (Duncan, 1937, p. 559). It solved issues of safety regulations, land expropriation, concessions, duties' exemption, government regulations on tariffs, profits, rights, compensations, legislations, taxation (Lewis, 1983, p. 194). It lasted for 40 years.

For the sector of railways to be developed, there was a serious barrier that impeded the general developmental process of the area, the long distances. Railways were not only a solution to this problem but also a trigger point for the growth route of the country. "Railways must be established to drive the countries ahead, or they will recede into a state of semi barbarism" (cited in Lewis, 1983, p. 7). Although the first investments in most of the sectors historically were private, "Railways conquer distance: they work wonders better than any ruler of the land. The railway innovates, reforms and modifies – without official decrees and commotions" (6-7). This discussion can be linked to the introductory note for the railways and their connection to development.

Additionally, in the total economic transformation of the then-newcomer independent LA countries, Argentina included, high quantities of foreign capital were used; a part of these was, as these Tables show, the ITCs' one. The first sector this capital was invested in, excluding sovereign bonds, was the railways. Paradoxically, the Argentinian government recognised this chance very early; with the Argentinian Constitution of 1853 encouraging railway construction. The early investors (often British) were related to the interests of land and merchandise. "The archetypal large-scale investor was a merchant or landowner domestic or foreign, with extensive commitments in Argentina" (Ferns, 1960 p. 333). The government to support this initial attempt, intervened, assuring profitability through a guarantee of an annual rate of return of 7 percent.

Although it referred to the ordinary shares, it has worked as an anchor for all the foreign companies' securities declaring a compromise between the government and the state. ITCs which had a ratio of 50 percent of their total Argentinian Railways securities in bonds, while the other half was in preferred and ordinary shares for the period up to 1914, (see Sotiropoulos et al., 2020), had both a direct and an indirect effect, gaining for their ordinary shares directly and also using the rest as a "safety mark-up". Grants for land purchase were given generously. "This was the basic factor which made it necessary in the beginning to offer generous bounties to foreign capital, because the process of capital formation proceeds at a much slower rate in countries which do not have iron and steel industries" (Duncan, 1937, p. 560).

Under these initiatives, "British savers look to Argentine railways stocks, especially debentures, as means of providing a secure and remunerative return on their own account" (Lewis 1983, p. 21). This phrase would seem to match the ITCs perfectly, they then seized the opportunity for safe investments in a diversified portfolio accepting high returns. After the railway mania in 1883-1884, the Baring crisis rectified the maladministration and over borrowing problems of the sector (79). In the aftermath of the Baring crisis a discussion about ending the guarantees of the Argentine Government took place. The Argentine government decided in 1891 to suspend this scheme. However, the powerful foreign (namely British) investors reacted obviously negatively, establishing a Railway Committee which sought to persuade, or demand from, the government to alter its decision; finally, a modification to the "anachronistic character of the existing system" occurred (118).

The next decade was a decade of privatizations in the railways system. The previous supportive governmental policy had led to the establishment of a system of railways in the country. Moreover, it had worked beneficially for the structural change of the economy of the country,

which had been transformed into a giant exporter of agricultural products. So, "the crisis had a *cathartic* effect" (192). Now a reorganizational schema was needed, a *railway rationalization* (148), see Chapter 9, to become technologically efficient, boosting its productivity and raising its profitability. The Mitre Law promoted these initiatives, changing the form of protection (the guarantee of a 7 percent interest rate), which was dysfunctional for both the government, which could not predict the absolute subsidy; thus, it had difficulty budgeting for it, and for the companies which, having already secured their income, had no incentive to practice any technological progress or economic efficiency. The new scheme allowed the government to regulate companies' profitability and efficiency, using as indices the income to capital ratio and the expenditures to receipts one, (see Duncan, 1937).

An amalgamation process followed, constructing along four big lines: a) the Pacific group, b) the Rosario/Central Argentina, c) the Great Southern and Western and, d) the Cordoba Central, (see Lewis, 1983). The *emblematic* legislation that authorized the positive transition to a new system was the *Mitre Law*, which endeavoured to balance between the foreign investors (through the reaffirmation of land expropriation, freedom from taxation etc.) and the Argentine state (regulations on tariffs, profits, routes, labour rights etc.). Indeed, the following years saw the sector prospering, extending its functions, its routes, enlarging its capacity, and restraining its working expenses (Lewis, 1983).

This section has shed light on the reasons of the high and persistent interest of the ITCs in the Argentinian railways and beyond. The state guarantee and the British know-how in the specific sector were, unequivocally, serious reasons behind the insistence of the ITCs in this sector. Furthermore, in the aforesaid discussion about evolution of the Mitre Law, there is a crucial development in a) the entrepreneurial theory and b) in the State business relations. As for the former, the gradual Law's revision resulted in a review of the enterprise's goals which shifted towards a functional and innovative scheme, regulating the huge monopolies' profits; as for the latter, there was an endeavour, at least as a declarative goal, to create a more collaborative environment between the government and the main foreign companies. Finally, the whole process has further implications. The ITCs had not invested in such an extensive way in the Argentinian railways by chance. Surely, the government's pledge for their investments was of crucial importance and, in the end, their returns were guaranteed. However, the ITCs were aware of this evolution. In the meantime, they had already implemented pioneer managerial strategies. So, it seems that their views accorded well with those of the Argentinian railways,

shaping the notion of *innovation and entrepreneurship* as it exists nowadays, (see Bessant & Tidd, 2015).

Thus, the ITCs had not hesitated in investing extensively in Argentina. The examined period offered all the advantages for an investor to decide to invest his money. Here is an indicative explanation for this investing *paradise* from the *Mercantile Investment Trust*:

> "This company, as other Trust companies has large sums invested in Argentina, mainly in the Railway companies, but also in important industrial concerns in the Argentine. Well, the last nine years have been on the whole a period of steady progress in the Argentine. Under the wise administration of President Alvear politics have of late given little trouble, labour has been reasonable, the currency has been maintained in a healthy condition, and in consequence trade- has gone ahead and we are receiving a considerable better return upon our large Argentine investment" (*FT*, 23/02/1927, p. 2).

All this period has been characterised as positive for British investments in Argentine; the same happened with the ITCs which had focused a lot on this economy. Even in 1928, there was an ongoing developmental process in various sectors as the Railways, the port works etc. (*FT*, 19/03/1928, p. 29).

7.3.4 State intervention- social turmoil as a bad sign for the investors.

At has been argued above, in the 1920s, governments tried to intervene more actively in almost every economy, Latin America included. Moreover, the labour class had awakened ideologically making economic and political demands. This obviously could not be characterised as positive for the investment interests in this region. In the case of Argentina:

> "The rise of the cost of commodities during the last few years has pronounced great unrest among the labouring classes in the Argentine as in other countries and reasonable demands for increased wages which have mingled with other demands which are unreasonable in many respects. The Argentine government in its desire to placate labour, has certainly adopted a very complaisant attitudes towards these unreasonable demands of the men, and it was only after some delay that it authorised a rise in the railways rates which the companies had been obliged to ask for in view of the heavier cost of working the lines" (*FT*, 21/08/1918b, p. 2).

A first comment on the previous quote is that it was not irrelevant to what followed. The serious social polarization along with political upheaval had as a result the Tragic Week (Semana

Tragica) in January 1919, with a massacre of Argentinian strikers taking place (Hebert, 1972; Rock, 1975). The previous ideal environment for investments in Argentina was disrupted when the Argentinian government applied a more energetic interference in the national economy, and, especially, in sectors of strategic importance e.g., in oil production and in land redistribution, (see Rock, 1975), [57] facing also with labour militancy, as in other cases in Latin America.

For both regulatory plans, namely oil and land, there were categorical objections on behalf of the British investors. As for the former, a discussion on whether state intervention in the oil market a synonym for the retardation in the development of the sector was, arose. The way this retardation worked, was as follows:

> "The government policy of refusing large concessions and of letting private capital carry the load of the wildcatting, coupled with the fact that the nearest approach to a petroleum law in the country is an old mining law that is not sufficiently definite or adapted to the needs of oil development to warrant foreign capital making the expenditures necessary for exploration has retarded active development to a large degree" (*FT* 07/08/1928, p. 5).

As for the latter case of the redistribution policies of the agricultural lands (Martin, 1928), these dangers were a reality for British foreign companies such as the *Forestal Land, Timber and Railway Co.* This British company had suffered a lot in Argentine since 1918. The massive waves of strikes also hit this company, with demands for higher wages and shorter working hours. The strikers succeeded in achieving most of their demands at the cost of the profits of the company, *ex hypothesi*. Also, this company had problems with Argentinian governments concerning its rights to deforest public terrains (Cowen, 1990). All of them, necessarily, had a negative impact on the investors, the ITCs included, which had in their portfolios 70 holdings from the specific company which in the last two years had been curtailed.

Railways were not far away from a similar situation. "The social and political effectiveness effervescence which culminated in the *semana tragica* (Ed. N. Tragic week) of 1919 did not leave the railways unscratched" (Lewis, 1977, p. 416). The persistent labour economic and social demands, e.g., for better wages which "have never been high", pension legislation etc, and their militant character, calling for frequent strikes and stoppages, along with the

[57] The main economic policy of the then Argentinian government under the presidency of the interventionist Yrigoyen has been summarized as the "Petroleum and Land Plan".

government intervention, see above, "was viewed with growing apprehension by the British – owned lines" (417). Because of the impact of these movements in their issued debentures, they decided to create selective alliances, with vague results for their companies' positions in the long run. So, a new environment emerged with significant changes for British investments in LA. These changes would mainly unravel during the following period, which goes beyond the scope of this dissertation; however, the first episodes unfolded during this period.

To summarize, Argentine seemed an ideal place for ITCs investments during 1914-1928. The basic criteria were fulfilled, guaranteed investments with attractive yields. The country's growth rate was diachronic, as was the whole continent. However, it remains open to see how state intervention, labour demands, and the growth of curtailment could affect their policy.

From the discussion so far, it can be summarized that railways were a very strong holding in LA for the ITCs. This preference goes beyond the current investor's rationality, obtaining cultural and political characteristics. However, as it will support thereupon, even in not so promising cases, such as with Mexico, the ITCs took the risk and invested in a country which "turned out to be less profitable than that in any other major Latin American country…" (Rippy, 1977, p. 97). In the end, it seems that their patience, in other words the low turnover under the generally professional and cautious management, was by no means damaging for their interests.

7.3.5 Mexican Railways. Exploiting the *Treasury house of the Word*.

Mexico defaulted for the last time in the period 1913-1914,[58] having already previously defaulted in the 19th century. In fact, "during its full history of independence…4/5 of Mexico's one hundred years of existence may have witnessed the country in a state of default upon its public debt…" (Martin, 1922, p. 22). At the same period, the GDP pc for Mexico was $1,732, less than half that of Argentina, while the population growth was negligible (0.74 percent) and the growth rate was at 1.95 percent, both among the lowest in LA.

However, in 1920, the first year of the sample, 4 percent of the total investments were invested in this country (see Table 9). The default which had happened just occurred six years earlier, did not left unaffected the Mexican railways.

> "For many months Carranza and Villa have operated the northern sections of two lines, together with the principal branches, for their own personal account. Private advices

[58] Up to the 1920s.

> received here recently state that in addition to much of the physical property being destroyed, what formerly constituted the lines of *National Railways of Mexico* are being operated for no less than live [N.B. possibly typographical error] generals of the army…This means a virtual dismemberment of what was left of the property…" (*FT*, 10/10/1914, p. 3).

This problem remained for a long time. In 1918, an outlook for the Mexican economy mentioned the lack of information (Lawson 1918). The new Mexican government had intended to establish a Committee to solve the problem of "claims for damages during the revolution" (Lawson 1918). The specific asset was a fundamental one for the ITCs portfolios. This can be understood by the fact that the total sample contains some 150 holdings of the *National Railways of Mexico*.

The situation during of the next period did not improve; for the period 1920-1928 there was economic stagnation (0.33 percent) and in 1928 the GDP stood at $1,857 GDP pc. So, why would a sophisticated management group such those of the ITCs, maintain their Mexican holdings? The reason behind this was because of a kind of hedge they had created for these holdings. Mexico, as it is known, had enormous gold mines; as a result, this raw material was used as the perfect peg for the British investments. This *gold connection* was based on such a solid basis that even the inconsistency of the coupon's payment was acceptable. In a publication of the *Financial Times* one can read: "The announcement made by the directors of the National Railways of Mexico that they have not been able to arrange for the payment of the interest obligations due on 1st October…The coupon passed covers a very considerable sum" (*FT*, 10/10/1914, p. 3).

The case of Mexico was a hot topic for the ITCs of that time. In the Annual General Meetings of the *Mercantile Investment and General Trust* in 1914 and 1915 there was apparent concern about the situation in Mexico. Initially, the concern was limited "It may interest some of you to learn that of the purchases made during the year, *in spite of some serious loss on two or three Mexican investments…after deducting any depreciation on some Mexican and American stocks*…" (The Economist 1914, p. 541, italics for emphasis). However, during the next year's meeting the situation became more volatile. "At the present time Mexico is a country where we can see no daylight at all, and I am afraid we shall have to wait until some settled order of government is evolved" (The Economist 1915, p. 445). And he continued: "I do not myself think it will be very long before we see a change in the outlook for the securities which we have go in this country" (445). In any case, it was a discussion of crucial importance because

of the weight it had in the total investments – for this ITC it was 5 percent of the investments. All these examples highlight the transience of this phenomenon and the patience the investors needed so as not to lose.

Judging empirically, the ITCs seem not to be losers in these investments. Their persistence has somehow been rewarded. The real damages in the railways were not catastrophic (Lawson 1918). Moreover, Mexico had invested in the stabilization of its national banking system, creating a more modern law protecting the rights of the shareholder (Martin, 1922), as La Porta *et al.* (2008) described. Besides, the long and stable British Mexican relationship made it more difficult for the British investors to withdraw from the country (Lawson, 1918; Martin, 1920a). Finally, the ITCs management did not remain passive during this process. In 1928, a representative of the *Mercantile Investment and General Trust* argued that: "the prosperity in South America has had a double effect as regards the old established Trust Company. It has enabled large sums of new money to be invested upon favourable terms, and at the same time it has brought back into interest bearing some securities which had gone into default and in similar cases had been wholly written off as lost" (*FT*, 24/02/1928, p. 3). It seems to reflect the case of Mexico. So, here, there is a reference about the support of the energetic management of the ITCs' managerial policy (Rutterford *et al*., 2021). Thay were ready to use their networks in these markets to counterbalance any possible loses and to rapidly return a positive result. Here, the role of the bondholders' associations emerges, (see Flandreau, 201; Rutterford *et al.*, 2022). Finally, the fact that the situation in this country was not ideal can be proved by the ITCs' reluctance to invest in new holdings restricting the exposure to the country to almost 50 percent, see Table 6.4.

7.4 Rest of the LA countries

Argentina and Mexio are two case studies this thesis has decided to study. The reasons for this choice are for the first case, the size of the ITCs investments in the country, focusing on the railways, while the second case works as a counterexample. However, as Table 6.4 depicts almost all the LA territory was present in the ITC portfolio lists. If the 12-13 percent of the ITCs investments were in Argentina a similar rate was invested in the rest of the region.

This database is full of LA railways, apart from the Argentinian ones, meaning that a similar logic has been followed in many other cases. According to Grossman (2017) in some cases this was the only significant type of investments in the country. E.g., in Cuba 93 percent, in Uruguay 73 percent and in Venezuela 63 percent. All the above are presented in this database.

"The railroad investment was by far the most important British investment in Latin America at the close of 1913" (Rippy, 1977, p. 68), representing nearly half of the nominal capital and two-thirds of the economic enterprises (excluding governments). There were investments in more than 118 railroads while, in some cases, there were monopolistic conditions (Rippy, 1977). Of course, all the cases were not the same. There were many cases that offered lower returns with limited or no dividends or irregular other payments. E.g., in the case of the *Dorada Railways* (Colombia), "Few, if any, dividends were paid before 1911. For the decade beginning in that year the annual nominal average for the ordinary shares was only 3.75 percent; and it rose in 6.8 percent the next decade…So far, the record does not suggest a profitable enterprise; but note the following facts: debentures with 6 percent and 8 percent coupons sometimes amounted to more than the share capital …a stock bonus of 50 percent was paid in 1926" (118). This holding appears in the dataset 40 times, almost all after 1914, with a noteworthy change from debentures to ordinary shares for the last year (1928). The first interpretation is that ITCs had closely followed the changes in the paid-in capital searching for higher returns. Second, although the case is different, more unstable, and thus, with fewer holdings in the sample than the Argentinian one, in the end, it seems that the British investors had not suffered financially. Therefore, this sector remained steadily above 15 percent in the whole region.

Financial advisors advertised in favour of this investment: "Recent developments are certainly such as to afford encouragement to those who have been interested in railways for years and have been following its progress…" (Fleming, 1925, p. 57). However, they did not avoid the warning of possible difficulties, meaning the attractive character of these assets activated the law of demand and supply, so, their prices gradually rose, making the asset less attractive. "…but the prices of the interest stocks seem too high now to justify any recommendation for purchase" (57).

A country with a significant presence in this dataset is Brazil coming third in the country rankings in 1928, with 6 percent of the total after the UK and Argentina. Again railways, other infrastructure and governmental bonds were the main securities. Chile, another interesting case, with vast nitrate ores, the only sector correlated directly to a raw material in the ITCs lists, (see Lee, 1925; Rippy, 1977; Greenhill (1977) for the Chilian case); second in the list comes the petroleum corporations (Peru, Mexico). The case of the rest of the utilities, electricity, waterworks and tramways is again interesting. Power production is a *sine qua non* for a developing region, a sign of progress and modernization, (Rubio et al., 2010). Promising returns led foreign capital to invest in this industry; however, the high degree of government

and municipality intervention played an ambiguous role of these ventures, (see Jones et al., 1977). The ITCs invested a lot in these sectors in LA; perhaps, for them, this intervention and the consolidated monopoly conditions had positive results. Further work could address this gap examining the ITCs investments in the whole region.

7.5 Conclusion

In this Chapter, a panoramic view of British investments in LA has been presented. The dataset includes a large number of Latin American holdings. What does it mean for the main research question, the asset management? Keeping so many LA holdings in the ITCs portfolio for so long could be interpreted as the most passive part of their management strategy. A more buy-and-hold mentality is present in this case. Here, ITCs apply a more naïve management in which the investor basically "follows" the market. As for the reasons for this stay, one could see the historical characteristics of these economies, markets and societies. LA was a region with long-standing relationships, economically and politically, with the UK. Additionally, the economic performances of LA presented huge inequalities. Although they scored high economic growth rates and by far the most dynamic population growth rates compared with the other regions of the world, their starting point was limited, their markets were weak and there was not explicit correlation with the ITCs investment in the region. The fundamental investment of the ITCs in LA was railways. So, what were the reasons for this type of investments over time?

The case of Argentina is indicative for this. Initially, it was a paradigm for their investments as a mature economy compared with the rest of the region offering promising financial opportunities. Furthermore, railways, an industry deeply rooted in the British society with long-term experience in the whole spectrum of its business, was the perfect investment in a foreign country such as Argentina. Adding to this a profit guaranteed by the state and a low taxation as indispensable prerequisites, this Chapter argues that this was an ideal investment. ITCs massively invested in Argentinian railways maximising their profits by maintaining their principle of security.

The additional pledge would be asked in the case of second thoughts, as in Mexico. Despite the political turmoil in there in the early 20th century, the use of gold as a peg for their investments minimised any possible uncertainty. This was a common practice for many backward economies in this region. The two main pillars of security for any investment in Latin America were the British currency and the use of the LSE as the main stock exchange.

During the examined period (1914-1928), new problems emerged related to the British investments in LA, raising questions about the ITCs' strategies in this region; these were mainly about state intervention and social unrest. These problems do not seem to have been strong enough to affect the ITCs policies, at that time. During the 1930s, it could be extremely interesting regarding the further consequences of these new phenomena. Will they be temporary or manageable, and so of no concern for British investors, or would they prove to be dangerous to the ITCs profitability. Further research can answer this question.

8 American holdings

8.1 Introduction

This Chapter continues the geographical and sectoral allocations as two main indices in this dataset which answer the main question of this thesis, the asset management of the ITCs during the 1920s focusing on North America. The main questions that arise can be summarized as follows. First, were there any changes in the ITCs asset management that can be found in the case of North America, and if so, in what direction? What were the reasons that led to the investors' withdrawal; and second, knowing that external factors led to this decision, see Chapter 4, why did they not return to such a known and promising market as the one of the Roaring twenties, when the restrictions released or even ceased to exist.

As Chapter 6 presents, the other important destination for the ITCs' investments remaining in the landmass of the Americas was North America[59]. As has already been mentioned in Chapter 6, North America in this sample comprises two states, namely the USA and Canada. Both were extremely important for the UK as ex-colonies (or still then under British control).

As Tables 8.1-8.2-8.3 show, these two countries were cases of advanced economies.[60] Especially for Canada, this thesis classifies it as an advanced economy considering both population and its main economic indices, (see Watkins & Grant, 1993; Green, 2000).[61] The GDP pc for 1913 were $5,031 and $4,447 for the USA and Canada, respectively. Both countries had a gentle economic growth rate (2 -3 percent) and population growth (mainly for Canada). They were positively affected by WWI, in contrast to Europe, see Table 8.2 and Chapter 9. Especially in the case of the USA, a significant economic growth rate was present. After the post-war recession, the growth rate increased; for the period 1922-1929 it reached the annual rate of 4.7 percent, (see among others White, 1990; Maddison, 1995; Abramovitz & David, 2000). In the aftermath of the war, the indisputable winner was the USA, as it became the financial and economic centre of the world, (see Abramovitz & David, 2000; Cassis, 2006). Finally, in 1928 the *Roaring Twenties* were experienced in the US GDP pc which reached $6,569, the highest in the world. Both countries' GDP increased in the period 1920-1928 as Table 8.3 demonstrates. In the case of Canada, the growth rate exceeded 3 percent.

[59] North America in the sample comprises two states, namely the USA and Canada, see Chapter 3. Both were extremely important for the UK as ex-colonies (or still then under British control).
[60] See also Chapter 2.
[61] Despite the intense economic and political intervention of both the USA and the UK, Canada has evolved into an economic and political power.

Table 8.1 Gross Domestic Product per capita for 1913, population growth rate and growth rate for the period 1901-1913 for North America

Country	GDP pc 1913 ($)	Population growth rate (%)	Economic growth rate (%)
USA	5,301	1.90	2.16
Canada	4,447	2.84	3.42

Notes: For the amounts in $ there have been used the 1990 International Geary-Khamis dollars. The growth rates have been calculated as the average annual rate of change (ROC) for the period under study as $\rho = (\Omega - \mathrm{A})/\mathrm{A}$, where Ω is the final observation and A the initial one. See above for more information.

Source: Maddison Database (2010); Author's calculations.

Table 8.2 Average Gross Domestic Product per capita and average growth rate for the war period for North America, 1914-1918

Country	Average GDP pc 1914-1918 ($)	growth rates 1914-1918 (%)
USA	5,206	1.62
Canada	4,429	0.25

Notes: For the amounts in $ there have been used the 1990 International Geary-Khamis dollars.

Source: Maddison Database (2010); Author's calculations.

Table 8.3 Gross Domestic Product per capita for 1920, 1928, average population growth rate and average growth rate for the 1920s, 1920-1928 for selective countries of North America

Country	GDP pc 1920 ($)	GDP pc 1928 ($)	population growth rate 1920-1928 (%)	growth rates 1920-1928 (%)
USA	5,552	6,569	1.54	1.72
Canada	3,861	5,172	1.88	3.12

Notes: For the amounts in $ there have been used the 1990 International Geary-Khamis dollars.
Source: Maddison Database (2010); Author's calculations.

Historically, these two countries were an attractive destination for foreign British investments. The USA was by far the first foreign destination, a country that received the greatest amount of British capital since the early 19th century (Paish, 1911, p.175). "Excluding the USA to which however we are also attached by ties of blood and language- Great Britain has provided more capital to Canada than to any other country, and the rate at which the British people are now increasing their investments in Canada is so rapid as to be phenomenal" (177). Similar were the results of Thomas (1967) and Feis (1930), who concluded that of the total British overseas investments in 1913, participation in Canada reached 13.7 percent and in the US 20 percent.

As for the case of the USA, all the existing literature, (see Burton and Corner, 1968; Cassis, 1990; Chambers & Esteves, 2014; Sotiropoulos *et al*., 2020), emphasize the high ITCs' investments in American holdings. The average ITC invested 29.86 percent of its portfolio (nominal values) in the USA in 1914. This means that three out of 10 pounds were invested in

the USA, mainly in the American railways and other utilities, ranking the USA as the number one destination of ITCs' investments.

Whereas the ITCs, in the case of the USA, have followed broadly the general pattern of high exports of British capital, they seemed to be indifferent to Canadian holdings. Only 3.8 percent of the total investments can be found in Canadian holdings in 1914. In the same period, much higher amounts can be found in Latin American countries, see Chapter 6, placing Canada in 6th position in the geographical distribution ranking. So, what was the reason for this huge divergence? Did the ITCs management have any internal information which could justify their unwillingness to invest in these holdings? The reason for this different behaviour could be the following. In the case of Canada, the attitude and performance of the direct investments were distinguishable, compared to other cases of British direct investments (e.g., Argentina); in Canada, investments bypassed the stock exchange. The role of the British settlers was crucial as they transferred their own capital there, investing it in activities such as farming (Platt, 1985, p. 85), especially in wheat farming (Green, 2000).

An interesting discussion here is the role of US capital which had been invested in Canada. The USA have invested mainly in the industrial sector of Canada. So, the growing US vertically integrated companies invested extensively in Canadian firms, (see Naylor, 1993). The sources of this financing must be sought in the promising US stock market, (see, also, Cassis, 2006) for the role of the government and the domestic market. Thus, there was little room for portfolio investments, the ITCs included, to get involved. Additionally, during the late 19th century when the period of huge exports of capital occurred, there were alternative destinations for the British investors such as Argentine which offered, if not better, equally profitable returns plus the safety of investing "inside the empire, formal and informal" (Naylor, 1993, p. 135); see, also, Ferns (1953) etc. So, despite the relations of Canada with the British metropolis, the New World offered an abundance of financial alternatives with which the Canadian holdings could not compete. This phenomenon is observed in this sample (English case). The Scottish ITCs followed a different path, (see Swan, 2009).

So far, there are two paradigms; a successful one for the USA which, as a powerful economy with a mature financial market, absorbed significant foreign investment from the British ITCs, while Canada which also had strong bonds with the UK, and a rapidly growing economy could not attract the British ITCs mainly because of the different way its own market had evolved. WWI has dramatically changed the already existing image. A calamitous collapse occurred in the North American assets which in 1928 did not amount to more than 6 percent of the total

sample, see Table 7.4. Canada also lost 50 percent of its pre-war position, while the US assets totally exhausted.

Table 8.4 Geographical allocation in North America (percent of portfolio nominal values)

Countries		1914	1920	1924	1928
USA	Observations	24	30	29	32
	Average	29.86	17.54	8.63	3.60
Canada	Observations	24	30	30	32
	Average	3.80	2.69	1.51	1.53

Source: Author's computations; For 1914 it uses Sotiropoulos *et.al.* (2020).

So, this Chapter searches about this paradigm shift, viz. the entire withdrawal from that region, especially from the USA. It shows that North America is used for the application of the new active management. Managers abandoned the buy-and-hold approach (see previous Chapter) intervening drastically in ITCs portfolios and withdrawing holdings with low returns and high risks. Although the US market was a traditional one for the British ITCs (section 7.1), WWI destroyed these bonds. The findings show that the main reasons for the removal of British investments from the USA market was first, British state intervention because of the funding of the war expenditures and second the high capital gains caused by the high devaluation of the British currency because of withdrawal from the Gold Standard (section 8.2). Although the economic, financial and monetary conditions of the USA blossomed in the aftermath of the war, especially during the 1920s, the British ITCs did not return to this market. This was the result of the poor performance of, mainly, the American railways and the appearance of promising alternative markets for them (section 8.3). Gradually, the US stock market completely changes its character to a new unattractive one for the British ITCs (section 8.4). Finally, it concludes.

8.2 USA. The complete ITCs' withdrawal and their reluctance to recover.

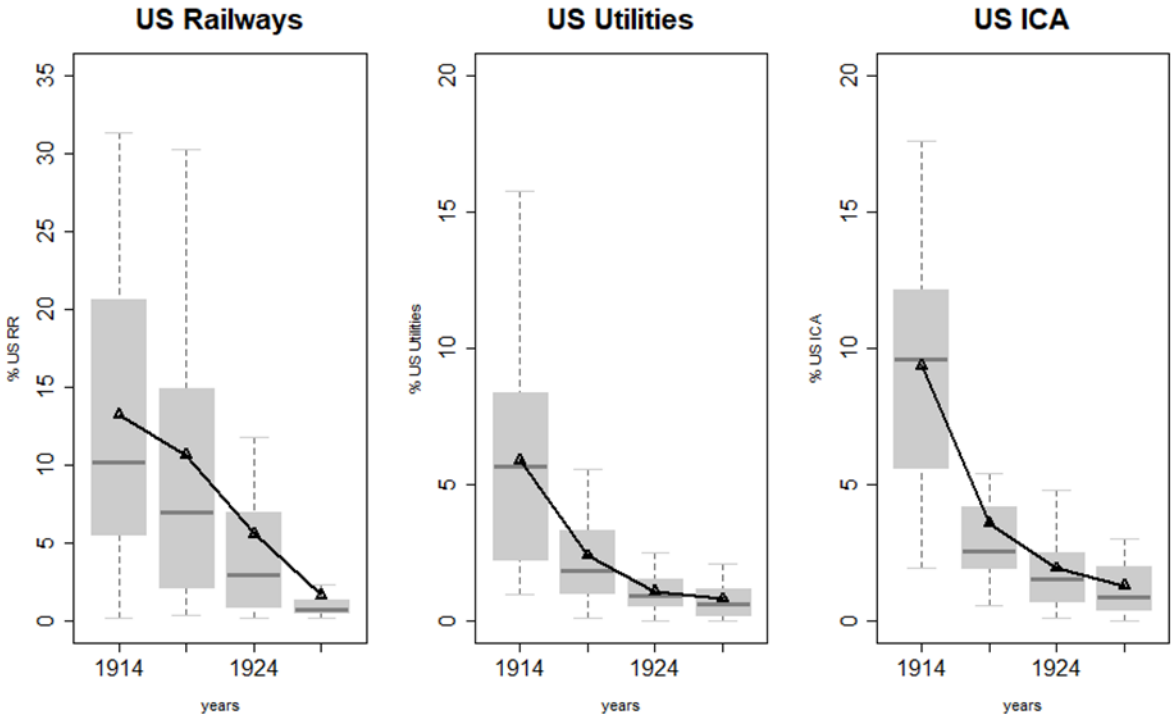
8.2.1 The pre-war conditions

The USA, at the outbreak of WWI, was the biggest foreign importer of British capital (Paish, 1911; Thomas, 1967; Edelstein, 1982); despite being an industrial giant by the turn of the century, it remained a net debtor in international accounts (Wilkins, 2004, pp. 4-5). This was not a new picture, "the international migration of capital has played an important part in the economic history of the United States since colonial times" (Lewis, 1938, p. 1). Initially, funding was needed to pay all the government obligations for the establishment of the new nation and, second, for trade purposes; after the 1840s, the borrowing was mainly for the railways' expansion in the US territory (Lewis, 1938). Edelstein (1982) reckoned the US

Railways generated a higher rate of return than many alternative investments for the pre-WWI period. Apart from their profitability, see Chapter 6, railways were a 'special' investment for the British who, using their know-how, networks and inventiveness, had expanded this enterprise worldwide and realized their *oecumenical* imperial perspectives. The USA served as a significant example in this process. "By and large, British investors were the ones who for more than three -quarters of a century furnished American railways the principal market for their securities" (Lewis, 1938, p. 36).

The same picture can be observed in the case of the ITCs (Sotiropoulos *et al*., 2020). In 1914, the one-third of the total investments were directed to the USA. US railways led with 13 percent, followed by utilities (9 percent) and finally, the industrial sector (6 percent), see Figure 7.1. These assets were mainly in dollars (24 percent on average, viz. 80 percent of total USA investments), a currency universally accepted and safe. Most of the bonds were expressed in gold as extra security. The remaining 20 percent were in British pounds. Most of the non-USD American holdings were from sectors other than railways. Possibly, they were closely connected to British interests (e.g., Breweries); additionally, this is an evidence of the dominance of the British financial market. Finally, due to the role of the LSE as the global, pre-WWI financial centre, many US railways used this market to trade their securities, (see Chambers *et al*., 2018).

Figure 8.1 ITCs portfolio main sectoral allocation in the USA (percent of portfolio nominal value)



Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

US railways was one of the dominant holdings of the ITCs. The British had introduced the railway system to US territory, investing considerable sums of money, (see Ripley, 1934; Lewis, 1938; Jenks, 1951); Adler, 1971; Wilkins, 2004). What was the reason for this selection? The first obvious one was the high financial returns which the British investors acquired. Edelstein (1982, p. 94) compared the various foreign investments of the British, pinpointing significant differences in rates of returns for the period up to 1914. In particular, he argued that the American Railroads offered persistently higher yields than the British ones, which were among the highest of the sample. Furthermore, the results of Goetzman and Ukov (2006, pp. 289-290) are also consistent with the previous work, presenting optimal portfolios from British listed assets sets in 1913 which included various US Railways bonds, practically half of their portfolio. Another reason about the disproportionately large share of American railways securities, generally, in foreign investment portfolios, and in our case in British ITCs', can be attributed to information asymmetries (Bordo et. al., 1999) who argued:

> "But the manufacturing, financial and commercial sectors of the economy were growing every bit as fast as transportation, and foreign investment in these sectors was less; information asymmetries explain this fact. It was relatively easy to monitor the actions of a railway company's management: investors could verify how much track

had been laid, where it had been laid, and how much traffic it carried more easily than they could verify and evaluate the investment decisions of managers of concerns in these other sectors" (pp. 33-34).

Possibly, in the same category can be added also the utilities which offered again interesting returns, (see Edelstein, 1982).

The third important sector with significant ITCs' participation was the industrial and commercial sector (broadly defined, see Chapter 3). The USA in the late 19th – early 20th century created big enterprises based on electricity and the internal combustion engines which were funded by the American financial markets (Chandler, 1959). This was helped by the strong protectionist policies of the infant business of the country (Bairoch, 1993), suggesting another reason for the acquisition of these holdings from the British ITCs. The problems faced by companies exporting their products because of trade barriers can be solved through direct investments (FDI or portfolio theory). E.g., the breweries which are extensively contained in this sample. In this process, the ITCs indirectly appear investing in these UK-connected enterprises. "The Report of the American Dollar Securities Committee indicates that about 13 percent of the value of American securities held by the British before the war was represented by the issues of industrial companies, this group being interpreted broadly enough to include all American -controlled companies except railways and utilities" (Lewis 1938, p. 77). The corresponding rate for the sample is close to the previous one for 1914, almost 10 percent, using a broad definition; mainly, the British ITCs seemed to include in their portfolios mining/iron companies, chemicals and/or breweries. However, the dominance of the Railways and the rest of the Utilities was unquestionable.

Two main findings emerge from the sample are: first, the preference of the ITCs was more for bonds than for other types of asset allocation. In this sample, the USA debentures (fixed income holdings) represented 20 percent, on average, in 1914, viz. the two-thirds of the USA investments. "Portfolio investors from abroad held more bonds than stock" (Wilkins, 2004, p. 6). This finding agrees with Chambers *et al.* (2018) who supported empirically this result, studying the US railways bonds listed in New York and London. As for the ITCs, the findings of both Chambers and Esteves (2014) and Sotiropoulos *et al.* (2020) are consistent with the previous research. The foreign investors mainly selected this type of investment backed by gold and/or secured on assets to reduce their risk against default. Hannah (2015) highlighted this higher default possibility for the NYSE compared to the other big capital markets. These findings support this analysis for the preference of bonds as a safety net for the, especially,

foreign investors. In this process, the intervention of the investors in the railway's committees or the peg of their investments in gold, securing their money could be added. As Wilkins (1991) argued:

> "Because American railroad finance was unregulated, haphazard, and frequently subject to abuse and because the contributions of foreign investors were so immense, when there were defaults, as often occurred, foreign investors through directors and protective committees exercised influence. Thus, even while the investments were portfolio ones, foreign investors, or their representatives watched to see that their monies did not evaporate. Prudent investors were, appropriately, wary" (p. 15).

Second, is the fact that these types of investments, mainly Railways, were issued not only in New York but also in the stock exchanges of London, mainly, and less so in Amsterdam (Wilkins, 1991; Chambers et al., 2018). Especially for the LSE, the American Railroads were so substantial, that it devoted a special section to them (Wilkins, 2004, pp. 82-83), see also any issue of the IMM.

The role of the US stock market in the late 19th early 20th century in controversial in economic history, (see among others, Davis, 1966; Michie, 1986; Rajan & Zingales, 2003; Syla, 2006); O'Sullivan, 2007). In any case, this thesis accepts the argument that the US stock market had a "dramatic expansion" up to 1930 (O'Sullivan, 2007, p. 491), so during the period under study it was already a mature, diversified and dynamic market, notwithstanding the problems. So, for the British investors, having a group of securities in a sector that had been constructed, conducted and generally affected by themselves, totally secured by type, currency and with extra hedge (gold-based) was ideal. Additionally, not only was the initial (financial and economic) market of these securities rapidly growing, but also, they could be traded inside the LSE; thus, US railways were the security every British ITCs would prefer to have in its portfolio.

8.2.2 WWI and the mass *exodus* of the ITCs from the USA stock market.

WWI was a catalyst for foreign investments in the USA, the ITCs included. In the first year after the war that is included in this sample, 1920, the picture was not the same. That more than 700 holdings had disappeared from the portfolios of the ITCs, which now invested only18 percent of their holdings in American assets, a fall of 40, was totally unexpected for an institution such as the ITC with such a conservative strategy. This fall had spread to all the sectors of the sample, see Figure 7.1. What were the reasons for this aversion of the ITCs to

the until then solid assets? Was there any noticeable problem in the fiscal policy of the country, any revolution, or other social disturbance? Or, more obviously, can any problem be identified concerning their profitability?

Table 7.5 tabulates the growth rate of the main US sectors during the period under study. Chronologically, three sectoral path changes emerge. First, the 1914-1920 change appeared in the sectors other than railways. During the second change, nevertheless, in 1920-1924, the loss was equally spread across the various sectors. Finally, a greater fall in US railways occurred in the 1924-1928 period. Thus, there was a time lag between the withdrawal from railways and the remaining US holdings, of course, counting much smaller investments. Practically, the ITCs first sold, to a greater extent, their utilities and industrial US securities and later their US railways ones.

Table 8.5 USA ITCs sectoral analysis. The main growth rates, 1914-1928

	year	**Average (%)**	**Growth rates**
USA Railways	1914	13,25	
	1920	10,68	-0,19
	1924	5,60	-0,48
	1928	1,68	-0,70
USA Utilities	1914	5,90	
	1920	2,41	-0,59
	1924	1,09	-0,55
	1928	0,83	-0,24
USA Industries	1914	9,38	
	1920	3,60	-0,62
	1924	1,94	-0,46
	1928	1,29	-0,33

Notes: The growth rates have been calculated as the average rate of change (ROC) for the period under study as $\rho = (\Omega - \mathrm{A})/\mathrm{A}$, where Ω is the final observation and A the initial one.

Source: Author's computations. For 1914 it uses Sotiropoulos *et al.* (2020).

WWI left the US economy in a much better condition than they had entered it, having surpassed the European economies like the UK, France, and Germany. The dynamism of the American economy had been present even before the war (Abramovitz & David, 2000; Galambos, 2000); now it could be added to this the comparative advantage of less expenditure during the war, exploiting its geographical position and their initial neutrality. Finally, the USA left the war as a lender nation (Wilkins, 2004). The already high income – $5,301 in 1913- increased despite the war, reaching $5,552 in 1920.

The 1920s was a period not only of high economic growth rates, which for the period 1922-1929, surpassed 3 percent annually, but also of a mature banking and finance system (White, 1990). In 1928, the US GDP pc climbed to $6,569, leaving in second position Switzerland, with $6,100 and much further back the UK with $5,357, (see Maddison, 2010). So, there was

a flourishing economy that could attract rather than repel foreign investments. An additional reason could be the monetary policy. As already mentioned namely, monetary policy, could affect investors, see Chapter 4. Thus, not only during wartime but also in the aftermath, this could have been a problem, leading to divestment. However, the Federal Reserve maintained the Gold Standard for the whole period, until it withdrew in 1933 (Crabbe, 1989). Comparing this stability to the economic and monetary problems faced by both the UK, see Chapter 4 and below, and Europe, see Chapter 8, in the same period, the USD strengthened during the post-WWI period, up to the crisis in 1929.

If the problem was not the US economic stagnation in the 1920s, the next question which arises concerns about the US securities' market. Could one argue about the inefficiency of the US stock exchanges or any financial imbalance? Apart from the economic progress of a region, the development of the financial market plays an equally, if not more, important role for portfolio investments. Lavington (1921), analysing the British capital market, offered a first study of the main factors which determine a capital market, the supply and the demand side for investments. As mentioned, there was wide discussion about the role of the American capital market. To these debates, which delineate the main problems which the American financial market faced especially during the late 19th - early 20th century, one can add the numerous exegeses of the crash in the USA in 1929, emanating from the various methodological, social and philosophical doctrines.

The American stock exchange expansion during the post-WWI period, was based mainly on the "economic euphoria" propelling the unprecedented rise in capital demand of the thriving US corporations, (see White, 1990). Within this framework, there were financial approaches arguing for the emergence of a stock bubble during the 1920s, (see Galbraith, 1954; Kindelberger, 1978), because of this financial boom or approaching crisis based on monetary imbalances (contraction) (Friedman & Schwartz, 1963). However, even these approaches did not recognize any financial problem in the 1920s, accepting the 'inherent instability' of the financial markets, (Galbraith, 1954; Kindelberger, 1978), or the synchronism among the various markets.

> "The twenties were, in the main, a period of high prosperity and stable economic growth. An enormous construction boom rebuilt American cities. The automobile reshaped American life. The bull market in stocks mirrored soaring American optimism about the future. From 1921 to 1929, two recessions interrupted economic development, but both were so mild that many if not most of those who lived and

> worked at the time were unaware that they had occurred. The recessions were clearly registered only on the delicate seismographs economists and statisticians were developing.
>
> On the monetary side, the most notable feature was the close connection in timing between the movements in economic activity and the explicit policy measures taken by the Federal Reserve System. Moderate restraint in early 1923, exercised by sales of government securities and a rise in discount rates, was followed closely by a peak in business and the onset of the 1923-24 recession. A reversal of policy in late 1923 and early 1924 in the direction of ease was followed by a trough in business in July 1924 and a vigorous cyclical revival. Moderate restraint in the third quarter of 1926 was followed by a peak in October, and easing measures in 1927, by a cyclical trough in November". (Friedman & Schwartz, 1936, p. 305).

Despite the critiques or the alternative approaches to the economic crisis of the period, there was no reason for the British investors of the ITCs to believe that there was any kind of anomaly in the American stock market, rather the opposite. Thus, so far, there would appear no economic, monetary or financial reason which can explain the ITCs withdrawing their investments from a flourishing market with well-established securities.

However, as Figure 8.1 and Table 8.4 and 8.5 depict, throughout the period, there was a continuous decline in the ITCs' USA holdings. In the first year of observation after WWI, 1920, there was a 40 percent decline; the ITCs now invested only 18 percent of their portfolio in USA holdings. The following years in the dataset present a similar practice. In 1924, fewer than 9 percent of the ITCs' investments were in American securities, while in 1928, an anaemic 4 percent were left. Thus, the whole process is divided into two parts. The first focuses on the reasons which led to the removal of these assets during or in the aftermath of WWI. So, an important cause which can explain the precipitous fall of American assets between 1914 and 1924 was the British state intervention during the war, see Chapter 4. Specifically, because of the urgent need for dollars for trade purposes and credits during the war, the British economy intervened in the capital market. The steps which followed can be summarized in Table 8.6; for this analysis *cf.* subsection 4.3.2.

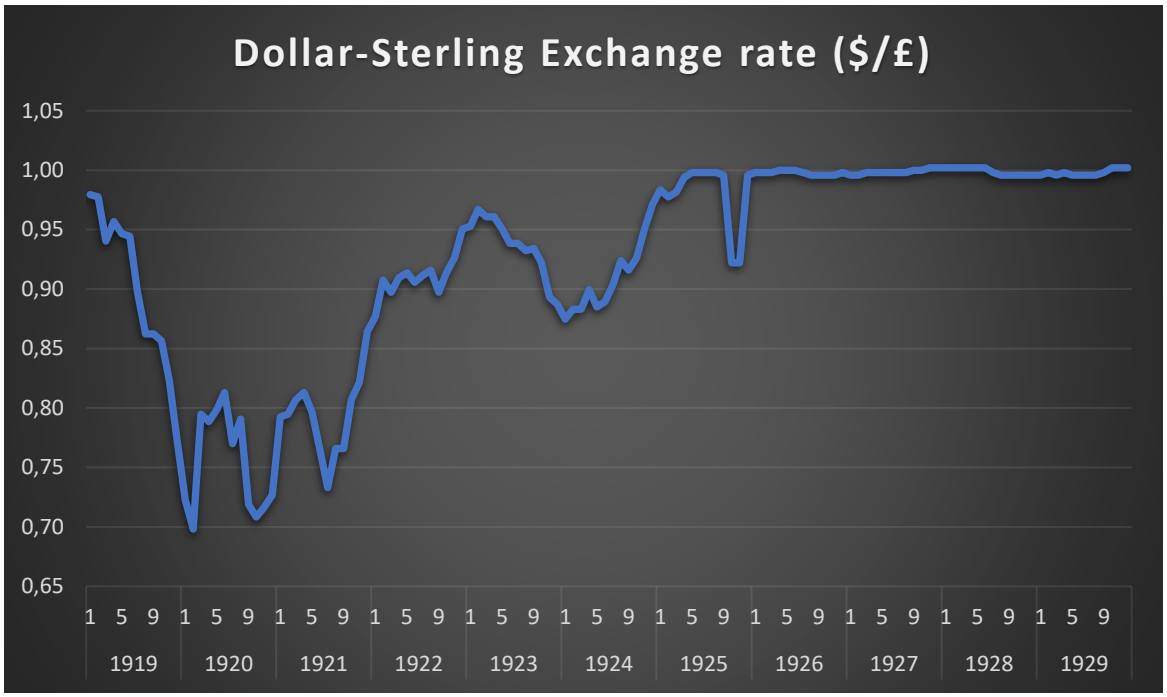
Table 8.6 British State's interventions in the foreign currencies during WWI.

Date	Action
December 1914	No deal with securities physically held in the UK
January 1915	Treasury's approval for issuing of new capital
July 1915	BoE intervention in the LSE buying $ securities
December 1915	American Dollar Security Committee
January 1916	National Debt Office → active operations in 54 $ bonds
March 1916	Deposit scheme
1616	Tax imposed on income from the $ list securities
November 1917	Prohibition of purchases of assets issued abroad (Defence of the Realm Regulation 41D)
March 1919	Capital Issues Committee
Panel B	
April 1919	Withdrawal of 41D
April - November 1919	Defence of the Realm Regulation 30F
1920	Limitation of issue of overseas loans
1922-1923	Embargo against foreign public authorities (less than 20 years)
January 1924	Embargo's Withdrawn
November 1924 - April 1925	Foreign Loans' Exclusion from LSE

Source: May (1922); Atkin (1978).

To further explain the fall of the US holdings from the British ITCs portfolios, this thesis has to examine also the evolution of the US monetary fluctuations *vis-à-vis* the British ones. During the war, an action that shocked not only British investors but all the then world *status quo* regarding the monetary sphere, was the abolition of the Gold Standard, (see Morgan, 1952; Moggridge, 1972; Eichengreen & Flandreau, 1997). Because of the gigantic indebtedness and the instability of the British economy, the unlinking of sterling from gold resulted in the fall of its value against the USD. Studying the monthly exchange rate between the British pound and the American dollar in Table 7.7 (the data it used are monthly from the IMM exchange rates Table on its first page for the period 1919-1928) it is observed that the GBP suffered heavy losses on its value against the USD for the period 1919-1921. It started at $4.77 per £, in January 1919, but by December of the same year it had reached 3.76 $ per £ (having lost 15 percent of its value); by the following February, it has dropped further, reaching $3.40, whereas in December 1920 it exchanged at $ 3.54 (30 percent loss). For two years, steadily, the British currency stood at a price lower than $4, only finally reaching 90 percent of the pre-war rate in February 1922, an exchange value which was held until 1925 when the pre-war parity restored (see also Morgan, 1952, Ch. IX), see Figure 7.2 for a visual presentation of the evolution of the monthly exchange rate of the GBP to USD.

Figure 8.2 Current exchange rate (£/4.87$)



Notes: Current exchange rate (4.87$/£), monthly basis, January 1919- December 1929.
Sources: Investors' Money Monthly (IMM) 1919-1928; Author's calculations.

Table 8.7 The United States Dollar - Pound Sterling Monthly Exchange Rate, 1919-1928

		January	February	March	April	May	June	July	August	September	October	November	December
1919	a	0.98	0.98	0.94	0.96	0.95	0.94	0.90	0.86	0.86	0.86	0.82	0.77
	b	0	0	-0.04	0.02	-0.01	0	-0.05	-0.04	0	-0.01	-0.04	-0.06
	c	4.77	4.76	4.58	4.66	4.61	4.60	4.37	4.20	4,20	4.17	4.01	3.76
1920	a	0.72	0.70	0.79	0,79	0.80	0.81	0.77	0.79	0.72	0.71	0.72	0.73
	b	-0.06	-0.03	0.14	-0.01	0.01	0.02	-0.05	0.03	-0.09	-0.01	0.01	0.01
	c	3.52	3.40	3.87	3.84	3.89	3.96	3.75	3.85	3.50	3.45	3.49	3.54
1921	a	0.79	0.79	0.81	0.81	0.80	0.77	0.73	0.77	0.77	0.81	0.82	0.86
	b	0.09	0	0.02	0.01	-0.02	-0,04	-0.04	0.04	0	0.05	0.02	0.05
	c	3.86	3.87	3.93	3.96	3.88	3.73	3.57	3.73	3.73	3.93	4.00	4.21
1922	a	0.88	0.91	0.90	0.91	0.91	0.91	0.91	0.92	0.90	0.91	0.93	0.95
	b	0.01	0.04	-0.01	0.01	0	-0.01	0.01	0	-0.02	0.02	0.01	0.03
	c	4.27	4.42	4.37	4.43	4.45	4.41	4.44	4.46	4,37	4.45	4.51	4.63
1923	a	0.95	0.97	0.96	NA	0.95	0.94	0.94	0.93	0.93	0.92	0.89	0.89
	b	0	0.02	-0.01	NA	NA	-0.01	0	-0.01	0	-0.01	-0.03	-0.01
	c	4.64	4.71	4.68	NA	4.63	4.57	4.57	4.54	4.55	4.49	4.35	4.32
1924	a	0.87	0.88	0.88	0.90	0.89	0.89	0.90	0.92	0.92	0.93	0.95	0.97
	b	-0.01	0.01	0	0.02	-0.02	0	0.02	0.02	-0.01	0.01	0.03	0.02
	c	4.26	4.30	4.30	4.38	4.31	4.33	4.40	4.50	4.46	4.51	4.63	4.73
1925	a	0.98	0.98	0.98	0.99	1	1	1	1	1	0.92	0.92	1.00
	b	0.01	-0.01	0	0.01	0	0	0	0	0	-0.07	0	0.08
	c	4.79	4.76	4.78	4.84	4.86	4.86	4.86	4.86	4.85	4.49	4.49	4.85
1926	a	1	1	1	1	1	1	1	1	1	1	1	1
	b	0	0	0	0	0	0	0	0	0	0	0	0
	c	4.86	4.86	4.86	4.87	4.87	4.87	4.86	4.85	4.85	4.85	4.85	4.86
1927	a	1	1	1	1	1	1	1	1	1	1	1	1
	b	0	0	0	0	0	0	0	0	0	0	0	0
	c	4.85	4.85	4.86	4.86	4.86	4.86	4.86	4.86	4.87	4.87	4.88	4.88
1928	a	1	1	1	1	1	1	1	1	1	1	1	1
	b	0	0	0	0	0	0	0	0	0	0	0	0
	c	4.88	4.88	4.88	4.88	4.88	4.88	4.86	4.85	4.85	4.85	4.85	4.85

Notes: The notations of the second row are: (a) the current exchange rate/par value [4.87 $/£]; (b) the monthly rate of change of the current exchange rate $Monthly\ currency\ rate\ of\ change = (Curr_t - Curr_{t-1})/Curr_{t-1}$; (c) the current exchange rate.
Source: Investors' Money Monthly (IMM) 1919-1928; Author's calculations.

Another interesting point here is to compare the inflation between the two economies, namely the UK and the USA. Chapter 4 presented the price index of the UK economy. The story can be expanded also for the USA case. Knowing that the US securities of the ITCs were mainly in USD, any price index change had a direct effect on the ITCs portfolio, not to mention that it affected the 30 percent of their total investments plus the overexposure in debentures, which were the main losers of an inflationary surprise. For the period 1914-1920, there was high inflation, 150 percent cumulatively, succeeded by high deflation over the next three years, leading finally to higher price level, almost 80 percent higher than at the initial point. Although the picture in the USA was not the same, the tendency seemed to remain the same. The wholesale prices were constant up to the first quarter of 1915 while they rose dramatically for the next period up to the 1920 climbing to two and a half times their level in 1914. Nevertheless, because of the Federal Reserve's intervention, inflation was curbed. A decrease of 50 percent occurred in the period 1920-1921, followed by price stability for the next period up to 1929 (Friedman & Schwartz, 1963).

So, both characteristics for the period between 1919 and 1922 argue that huge capital gains could be achieved by the British holders of American securities because of the British monetary conditions, especially the withdrawal from the Gold Standard. See the following example defending this argument. Assuming a typical British investor; specifically, a manager in an ITC, in which portfolio there was a US holding e. g the *Atchison, Topeka and Santa Fé Ry. Co., 4% Convertible Gold Bonds, 1960* (it is included in the *Mercantile Investment Trust* portfolio) with a book value of $100,000 in 1914. In February 1919 with an exchange rate of 4.76 $ / £, this meant its value was approximately £21,000. The same holding one year later with a new exchange rate of 3.4 $ / £ would be valued at £29,400. This means a 40 percent rise solely because of this difference. What a wiser reaction of a sale with a gain of £8,400 which could be reinvested in different holdings? Doing a simple extrapolation, accepting that the average ITC had 30 percent of its portfolio in US investments and with an average value of each ITC at £2 million, by selling on average one-third its American securities (£ 200,000 or 1 million $), there would be collective capital gains of £84,000. Hence, a representative British ITC could gain almost 5 percent of its total portfolio because of this movement. This was a great opportunity for quick and high gains, that no one could lose, and sure not the already experienced management of the ITCs.

Again, the problem with the values presented in the ITCs portfolios emerges, see Chapter 3. The ITCs never increased their list values, preferring to transfer the difference to their reserve

accounts, one can argue for these gains. Was there any information about this argument from the real actors, the ITCs executives? Well, in March 1919, the *Economist* in its annual article about the ITCs' progress mentioned that "the heavy decline in the value of many assets … [because of the result *Eds. N*.] of change in money values…and from which in many other ways we reap compensatory advantages" (The *Economist,* 1919, p. 686). This was the quote of the chairman of the *Mercantile and General Investment Trust* who was far from anxious about the final financial results, concluding that: "This class of depreciation means no loss of stability to your enterprise". This phrase encompasses once more the basic managerial strategy the ITCs had been following throughout the examined period, viz. that price changes in their holdings because of monetary issues was not a reason for anxiety. The main income for the ITCs was the revenues from the dividends/coupons and, only secondary, the capital gains. What could these 'many other ways', see the quotation above, of reaping advantages be? The author of the article mentioned one: "Advantage has been taken by some of the companies of the present position of the American exchange to realize American securities at a handsome profit on the book values, the profits so obtained being placed to reserve or utilised in writing down the book value of other securities" (The *Economist,* 1919, p. 686). So, here it has presented the second reason beyond that of state intervention which led the British ITCs to remove their US holdings, namely, the acquisition of significant capital gains from the extensive exchange rates for a period of up to five consecutive years, see Table 7.6.

As this thesis will mention below, there were two ways for a divestment of foreign-owned American holdings during the war. The one it has just displayed, focused on a private sale which, in contrast to the public one, led by the British state, (see Wilkins, 2004). According to her, "[p]rivate sales took place for a number of reasons, including the poor financial performance of American railroad securities, the possibilities of higher returns in Europe [*Ed. N.* see also Chapter 8], and, as some American securities rose in value with the "war boom," the desire to take advantage of the capital gains" (Wilkins, 2004, p. 37). Characteristically, she mentioned the visit of an experienced dealer of American Railroads who, on behalf of some British trusts- possibly including the ITCs- tried to sell instead of buy American bonds. So, during the war and in the aftermath, there was a tendency of the British investors to reduce their US holdings because of poor performance, better alternatives, and important capital gains.

In the meanwhile, although the war was over, the BoE continued implementing various types of regulations adding a further burden for holding a foreign currency asset (see Table 7.5, Panel B). As described in Chapter 4, during the war various restrictions had been imposed related to

the exchange and acquisition of foreign assets, the climax of which was Realm Regulation 41D. This was a draconian law prohibiting the purchase of any asset which had been issued abroad. This legislation was withdrawn the next year (1919) because of the end of the war. However, completely free capital mobility did not return, (Moggridge, 1972). Instead, a new regulation was imposed (Realm Regulation 30F). The reasons for this new legislation were not war based but domestic. "The main need now is to protect the foreign exchanges and to conserve capital for development within the UK" (cited in Atkin, 1970, p. 325). This regulation was imposed in April 1919. The British government had already planned to issue some new sovereign debt in June (4 percent victory bonds and 4 percent funding bonds) collecting £ 570 mil. Thus, there was an attempt to exclude possible competition from foreign borrowers. In December this regulation, finally, ceased to exist. Checking Table 7.5, one can observe that after 1920, the restrictions were focused, mainly, on the foreign government refunding bonds. The reason behind this was that the Treasury, 'working harmoniously' with the BoE, has considered these holdings as substitutes for gilts, challenging the attempt of the British State to repay its massive debt (Atkin, 1970). For the period 1920-1921, because of the high-interest rates -The BoE raised its interest rate to 6 percent in 1919 and to 7 percent in the next two years, reducing it consecutively from 6 ½ to 4 ½ in 1922, (see Morgan, 1952, Ch. IV) - another danger arose for the UK government. It was not the foreign assets as such, but mainly the dimension of time. So, the collaboration of the BoE and the Treasury focused on the restriction on the short-term (less than 20 years) foreign loans.[62]

In the next years (1922-1923), the conditions were relaxed (from 20 to 10 years) and finally in 1924 they were totally withdrawn. The next form of embargo emerged in 1924 lasting for one year. This time the embargo of foreign loans related to the preparation to return of the Gold Standard (Atkin, 1970). All of these had to do with new editions of foreign (mainly government) bonds. Was there any problem with the already acquired corporate US bonds held by the ITCs? The reasons why this thesis refers to this are first, that it can comprehensively disturb the free capital mobility; this can explain partially the further shrinkage of the American assets placed in the ITCs portfolios, which had endeavoured to take full advantage of the difference between the currencies. Second, it can delineate the temporary lack of foreign holdings (especially loans) in the LSE which had led the investors to possible alternatives, either in domestic holdings or in alternative destinations (a flood of colonial loans had appeared

[62] Meaning that these governments could not issue bonds maturing in less than 20 years; this, practically, ceased this market, especially for the emerging economies, colonies and the other dominions.

bypassing the law). In the end, during this period a significant decrease of, mainly, US railways took place, see Table 8.1.

Overall, the direct state intervention during the war against the dollar-based assets, monetary uncertainty, the economic crisis (1920-1922) along with the continuation of a new type of capital controls for foreign investments, plus a capital gain for the US holdings sales certainly affected the British investors, the ITCs included. All these interactions are reflected in the database.

8.2.3 ITCs' reluctance to regain their American holdings

Until now the two main reasons for the curtailment of the US assets in the ITCs portfolios can be synopsised as a) state intervention and b) depreciation. These can explain adequately the investors' withdrawal from these types of investments. However, a next question arises. Why did they not return to them when the situation normalized? In the end, this was their flagship, as these holdings represented 30 percent of their total portfolios' values and symbolized the ITCs' trust and international presence. Not only had they reduced their exposure to US assets because of the war but also, they continued this policy during the 1920s. The editor of the Financial Times seemed to raise the same question writing in February 1925: "Will the London market in American Railroad securities regain its old popularity with the restoration of the sterling to dollar parity?" (*FT*, 13/02/1925, p. 4). In 1924, fewer than 10 percent of the ITCs' American holdings remained in their portfolios, see Table 7.4 (The reduction rate had fallen from 19 to 9 percent). 850 American holdings were still present in 1924 in the ITCs portfolios. Now, the loss was practically equal among the main sectors, see Table 7.1 Both railways, utilities and industrial had lost 50 percent. "All American Rails seem at present very fully valued and they have little attraction for the British investor who wants to make the most of his money (Whorlow, 1926 p. 73).

So, despite the existence of an embargo, the situation was different from during WWI. As a result, the reasons behind this continued ITCs' withdrawal could be a possible explanation not only for the total withdrawal from the US market, but also for their reluctance to reinvest in it; in particular, it could be because of the very high prices, some of the railways were overvalued, and also the "watering" of many of the ordinary shares, meaning that the shares were issued with no real value behind them (73) raising speculative phenomena. The Financial Times argued that "[i]f dollar securities are bought in the future it will be simply because they are desirable investments- or speculations - on merits and not on account of any temporary benefits

arising from a gold premium" (*FT*, 13/02/1925, p. 4), implying that any possible financial perspective for American holdings would not be based on monetary but on financial factors, real and long term.

Additionally, a further danger for the acquisition of these overvalued holdings was the redemption that the bonds were at due for repayment. Redemption always occurs at par, meaning that a debenture which is sold over this price will cause a final loss to the investor (Gardner, 1924, p. 51). Hence, the biggest problem was that the average yield of the average American railways bond was *ridiculously low* (50). The maximum yield it could reach was 4 ½ %, a yield[63] even lower than the British Government War Loan which offered 5 percent, under the sovereign guarantee of the British government. And what is the problem under these circumstances?

> "The question of capital stability is, of course, largely affected by the yield which is returned. Obviously, securities returning low rates of interest are more liable to be adversely affected in price by unfavourable financial or economic conditions than investments affording a more adequate return. For this reason alone, it would appear that investors who hold or purchase dollar securities at their present unremunerative levels are exposing their capital to a very considerable danger of risk" (Gardner, 1924, p. 51).

Here, is the third reason for the unattractiveness of US bonds, their low yield. The previous quote explains in a comprehensible way the relationship between yield and volatility. This example presents in a simple way the notions of duration and volatility, which usually is given in an extremely obscure way (see the case of Brealey *et al.*, 2008, Ch. 4; Rutterford & Davison, 2007).[64] Apart from these reasons, another supplementary one can be identified. Even if there were suitable holdings that could meet the financial standards, the general financial environment was not the same.

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[63] The author uses market values for his example. However, this thesis refers to it because of the comparison between the two yields in which the gilt precedes while the USA railway follows. Additionally, assuming that the article was written in early 1924 -it was published in March 1924, declaring that the then exchange rate was at 4.30$ / £. Indeed, Table 8.6 highlights that this period the rate was at the range of 4.30$ / £. Furthermore, the author notes that with a rate at 4.87$ / £ the yields shrink at exchange leading to the range of 4%. Possibly, he had a very broad and accurate understanding of the markets, because in the immediately following period the rate escalated to this amount, see Table 8.6.

[64] Volatility (V) measures the dispersion of returns for a given security; duration (D) measures the sensitivity of the price of an asset to interest rate (r). The relation among them is depicted as $V = \frac{D}{(1+r)}$ thus, for a smaller denomination (low yield) the ration increases (large volatility). Overall, lower coupons (yields) have longer duration and the volatility is higher.

> "Within the past ten years striking changes have occurred in investment conditions…the supply of home securities have been enormously extended, both in volume and variety. The would- be investor of today can satisfy his requirements, however exacting, without looking further afield than the home market, whether in gilt edged securities, Railway stocks or industrial shares." (*FT*, 13/02/1925 p. 4)

And this correspondent continued, "If he is to be attracted again to a market in which he formerly played from day to day a prominent part, he will have to go through the somewhat tedious task of acquainting himself with a mass of geographical and financial detail long forgotten" (4). So, a fourth obstacle for the non-return tendency can be seen in the existence of alternatives inside the domestic market. Of course, this was not the norm in the case of the ITCs which had built their fame as international investors, but this reference is indicative of the climate among the British investors of the mid- 20s, urging the ITCs directors towards a specific route. However, extending this argument and including all the alternative markets it could support a similar position. This means that the ITCs found themselves in a period in the aftermath of WWI, with free capital, or temporarily invested in British victory bonds; at the same time, a plethora of new holdings deluged the capital market (initially the British one) offering promising returns, (see Campbell et al., 2021).[65] So, there was a match between the forces of demand and supply of capital, which led to the ITCs to leave the US market which was not an attractive market for them. As Table 7.1 presents, a significant abatement of the US railways occurred after 1920; thus, these explanations did not pass unnoticed by the ITCs.

Moreover, the last reference highlights the importance of persistent engagement with a specific market for investors to reap any financial benefits from it. Any absence for a long period would have created a gap that would be difficult to bridge. This topic is not irrelevant today. The passage of time has preoccupied not only researchers in accounting and finance, but also neuroscientists and psychologists. See, characteristically, the discussion in Ding *et al* (2017). Again, the problem of straight connection is problematic because of the then lack of technology-based applications "refreshing" managers' memory and supporting many advisors' processes such as data manipulation, building portfolios, fintech etc. See Turner (2016) for these 'dangers' in interpreting financial history using uncritically modern financial theories. Consequently, the New York Stock Exchange (NYSE) ended up being *terra incognita* for the ITCs, whose directors needed to re-examine carefully the US market before re-joining.

[65] The average annual returns for the UK equities for the decade 1919-1929 were 5.4%.

Nevertheless, the NYSE (and the US economy generally) mushroomed during the roaring twenties. So, why did the ITCs directors not capitalize on these favourable circumstances? The answer could have been that "If interest in American Rails revives, it will probably be directed to those securities which are included in the speculative rather than the investment class" (*ibid*.). This approach could outline the ITCs reluctance to reinvest in the US Railroads market. Security, as already mentioned, was a cornerstone for the ITCs managerial policy which seems to be incompatible with the speculation criterion which has just been described.

8.3 The transformation of the US stock market.

Until now, this thesis has presented the reaction of the ITCs towards their US securities form their own point of view. However, the other side, namely the American stock market, has not remained dormant. As it mentioned above, WWI transformed the USA from a debtor nation into a credit nation. Characteristically:

> "…between 1896 and 1914, 'interest payments on total foreign capital invested in the United States' had been five times 'the interest payments on American capital invested abroad'; by contrast, in the period between July 1, 1914, and December 31, 1918, the 'interest on American capital abroad' equalled 2.8 times that paid on foreign capital in the United States. Servicing America's foreign obligations had not been a major strain before 1914; now it was no burden at all. In fact, the nation was already reaping the returns on its creditor position" cited in Wilkins (2004, p. 65).

The war played the main role in this shift. Lewis (1938, p. 114) noted that: "During the four and a half years of World War One, the creditor countries of Europe disposed of a large part of the American investments they had accumulated during the preceding century. In this way the principal belligerents were able to supply part of their wartime needs for American wheat, cotton, oil, munitions, and other commodities". Wilkins (2004, p. 35) recognized that "[b]y far the most significant change in the pattern of foreign investment in America, 1915-1917, was the dramatic reduction in what had been the huge European portfolio holdings- a liquidation begun in 1914; this decline greatly offset the net rise in foreign direct investments". Wilkins (2004) referred to two means of achieving for this reduction of the foreign portfolios a) private and b) government sells. Britain was by far the biggest holder of American securities and

mainly used the second way to repatriate American securities through the American Dollars Security Committee, (see Table 7.5; Chapter 4; May, 1922; Lewis, 1938; Atkin, 1970; 2004).[66]

Up to 1915, a total number of $1.6 billion of American holdings had been sold by Europeans, with $950 million having been sold by the British (Wilkins, 2004, p. 38). The next two years, 1.5 more than 1$ billion of American Railroads held abroad had been sold. At the end of the war, more than half of the foreign investments in the USA had been repatriated (Wilkins, 2004, p. 64). The next period was entirely new for the whole world, the stock markets included, which moved into *uncharted waters*. The US economy had lived through seismic changes. As for its foreign investments, portfolio investments had overcome the FDI. Now, the role of foreign investments was totally different; the USA as the dominant creditor, attracted various foreign investments in bonds and stock

> "With the FPI in stocks and bonds, foreign investments in American issued securities did not necessarily represent investments in the United States. As the country became a creditor nation, as New York became a significant international securities market, and as securities were issued for U.S. outward foreign investments, investors from abroad frequently bought these securities in America. A 'recycling' of foreign moneys occurred, as foreigners acquired such U.S.-issued 'foreign' securities" (Wilkins, 2004, pp. 68-69).

The next qualitative change of the US stock market was the gradual shift of the foreign investors towards common shares: "When the 1934 portfolio is compared with that for 1914 it indicates that foreigners have lost their pre -war predilection for American bonds and have greatly increased their purchases of common stocks" (Lewis, 1938, p. 134). This meant that:

> "Railway bonds, in particular, have lost favour with foreign investors. The sharp liquidation of railway bonds that began in 1914 did not come to an end with the signing of the peace treaty. On the contrary, it has continued throughout the post-war period, so that in 1934 foreign holdings of rail bonds amounted to only 254 $ million, or 9 % of the portfolio, as compared with approximately 2.8 billion, or 50 %, in 1914" (Lewis, 1938, p. 134)

The ITCs were affected by this environment of divestment of American railways bonds. These had suffered from poor performance. Moreover, as supported in the previous Chapters, the interwar period was a period of high state intervention in every country, the USA included. So,

[66] Not surprisingly, ITCs used both ways, maintaining their management strategy.

the railways, as a crucial transportation industry, were taken over by the state during the war. When they were returned to their private owners, they were "in a sorry condition of under-maintenance and with the efficiency of railroad labour impaired" (cited in Wilkins 2004, p. 82); this is a common response for the *zealots* of the *laissez-fair* doctrine even nowadays, in the case of a profit loss. Hence, the foundation of a regulatory committee after WWI, see Acworth (1920) for the discussion of that period, did not receive an enthusiastic welcome from the foreign investors.

Overall, it seems that the ITCs chose to invest in other regions, such as the colonies and later, in Europe, not to mention the UK itself and the already preferable Latin America, see the discussions in the corresponding Chapters and their general findings about the geographical allocation in Chapter 5. During the 1920s, instead, many European investors chose to move their investments to the USA because of the hyperinflation and the dangers of political upheavals (Wilkins, 2004). It is very surprising that Wilkins (2004) estimated that the British Investment Trusts had 23 percent of their investments in the USA in 1923 and 10 percent in 1929, a fall that is much greater than these findings. Of course, our measurements are uneven. Wilkins (2004) findings are coming from Cassis (1990) who referred to the Economist as it cited in Burton and Corner (1968); their reference was based on a different sample than the one here, but all studies agree that there was a tendency of the British trusts to withdraw from the US market, focusing on different, safer and more promising markets.

Finally, in 1928, fewer than 5 percent of the US holdings were active in ITCs' portfolios. A qualitative element must be mentioned here. From the fewer than 700 existing holdings, only 130 (20 percent) were from the railways sector. The rest were newly founded companies in the industrial sector, again focused on new technology and enterprises in consumer durables (see below the case of the UK, chapter 9) possibly representing a new, gradually autarkic economy. Wilkins (2004, p. 210) argued that many new trusts were established in the post 1925 period which "… concentrated on industrial securities, unlike many of the earlier ones that had invested heavily in railroads".

This sample does not support a huge shift towards the US market; possibly, she added more trusts which are not included in the definition this thesis follows for the ITCs, see Chapter 3 which newer companies were, maybe, less risk averse; thus, they could invest in the flourishing US stock market of the late 1920s. See e.g., the case of life insurance companies which "became more adventurous in their portfolio management and in some respects 'discovered' the New York market" (Moggridge, 1972, p. 215). Although the British investors, especially after the

stabilization of the pound in 1925, shifted again towards the American market which offered promising returns, this did not happen in the case of the ITCs. “For most old and new British investment trusts, it seems evident that the United States was not the primary locale for their investments in the late 1920s” (Wilkins, 2004, p. 210). This qualitative criterion has further interpretations; deeper questions could arise about the role of financial capital as a bearer of technological progress, invigorating finally the whole economic system. A different paradigm of the interaction between the financial capital and the economic dynamism arises; but this goes beyond the scope of this dissertation. The sophisticated management of the ITCs seemed sceptical about acquiring new securities from the US stock market. *Ex post,* (1929 economic crisis) it seems like a wise choice.

To summarize, a total withdrawal of the British ITCs from the US securities can be seen during the examined period. The reasons for this withdrawal, can be divided into two sets. The first was related to the war itself. Because of the state intervention, the investors were forced to exchange their foreign (mainly US assets). Additionally, the huge depreciation which followed the abandonment of the Gold Standard offered great opportunities for capital gains. The second set of causes that led to the total withdrawal from the US market was categorically financial. The American (mainly railways holdings) were considered to be overpriced, offering low yield, raising their risk. In parallel, the LSE was offered many alternative investments. Finally, the long absence of UK ITCs investors from the NYSE had created information asymmetries. All of these created a prohibitive climate for British investors who needed to search for alternative investments.

8.4 Conclusion

Since the ITCs’ establishment, North America was a geographical destination of crucial importance, attracting significant capital for investment. However, the picture for the ITCs became more complicated in the late 19th - early 20th century. Although both Canda and USA had a significant economic growth rate and a high immigration inflow, including British immigrants, the ITCs chose to invest largely in the USA and not in Canda, because of the structure of the financial markets and the developmental pattern each country followed. In the case of the USA, the ITCs did not hesitate to invest in Railways’ debentures, other utilities and industrial sector holdings which were being offered in abundance. Especially the Railways bonds offered the unquestionable safety the ITCs were demanding and the promising returns

they desired. Thus, the average ITC had invested 30 percent of its portfolio in US holdings in 1914.

However, the outcome of WWI brought this dynamic evolution to an end. The reasons for the following steep fall were based: a) on the British state interventions in the foreign currencies financial market; and b) the devaluation of the British currency in the years after the war until the new peg in 1925. These reasons are behind the total movement of the ITCs out of the US market which remained robust, with their economy flourishing and their currency stable.

British ITCs management strategies followed an active approach choosing the right time to sell their holdings making significant profits. The next big question concerned their refusal to re-invest in this market. Among the reasons for this unwillingness were a) the extremely high prices of typical American stocks, b) their low yields which could create a high sensitivity in interest changes; which could lead to, c) the appearance of financial bubbles; d) the existence of numerous alternatives; and e) the lack of information which had been created because of the prolonged (decennial) absence from this market. These can only partially answer to the question posed; further research could clarify alternative answers about the assets' returns and their concomitant profitability issues. In the meanwhile, the US stock market soared, while its character was changing. Following the shift of the American economy to a creditor nation, its stable economic growth and the technological transformation which had already occurred, the market moved from being focused on American railways bonds, to an openly diversified and equity-based market. The ITCs, at least those of this sample, did not follow its pattern, preferring alternative markets like the British and the European ones. These will be presented forthwith.

9 Europe

9.1 Introduction

This Chapter presents the new management strategies that were followed by the ITCs during the 1920s focusing on Europe. Europe was the big surprise of the dataset, showing the biggest change in the ITCs portfolio. They multiplied their entries to European holdings bringing this region from the background to the foreground, for the British capital market. The first question which will be answered is the main research question of this dissertation, viz., the asset management strategy they followed. Second, this Chapter discusses the research question on the interaction between investors and society. The new conditions experienced by Europe in the aftermath of the war are used to test any possible reaction of the managers with the new reality. How did they deal with the new political regimes? Could inflation be a hindrance to their investments? How did ITCs deal with issues such as the new stock markets or trading in new currencies?

Europe, in toto, had been used as a new financial workshop for the ITCs. First, the inseparable bond between the investors and the society is clearly seen in this Chapter. Answering the final research question of this thesis, market is not the only factor which leads the markets decisions. The choice of the best strategies for managers was the result of a wider process considering several factors. WWI changed fundamentally the European economies, societies and financial markets (section 9.2). Not only did the war completely devastate the European infrastructure, shrinking its economies and decimating its working force, but it also had graved repercussions (certainly for the investors) for the following period, namely hyperinflation, the German reparations and finally, the social revolution. Thus, for a foreign investor, in this case the British ITCs, these problems had to be solved as a prerequisite for them to invest in this region. The inauguration of an international organization, the League of Nations (LoN, hereafter) imposed the necessary conditions for the countries to manage their monetary imbalances. Additionally, the exigent financial demands for the states to reconstruct their economies along with the, temporary, solution of the German reparation led to a deluge of new financial assets (section 9.3). Finally, the political turmoil of many countries played an ambiguous role for British investors (section 9.4).

In Europe, the ITCs found a promising alternative for their idle capital taken from the USA, see Chapter 8, and testing new practices, such as investing in foreign stock markets, currencies

and sectors; through these novelties a new road was carved out by the ITCs, which applied new and active management strategies targeting their main purpose (section 9.5). Taking full advantage of the occasion, their managers chose holdings of high returns and low risk improving their portfolio yields and launching all these financial novelties. Thus, Europe was the region where ITCs applied the most active management strategy of all the other cases. They tested new policies improving their portfolios and increasing their returns adding new uncorrelated holdings.

9.2 European economic growth path

Europe, as Sotiropoulos *et al.* (2020) highlighted, had been a *terra incognita* for the ITCs investments, since the 19th century.[67] The average ITC portfolio had initially invested in Europe 15 percent in 1886; finally, in 1914, it fell to less than 5 percent. In his major study, Feis (1930) examined the European capital outflows in the pre -WWI period; in this, he argued that the long-term British investments abroad for 1913 amounted to £3.8 billion, of which only £219 million were invested in Europe.[68] Instead, the main foreign investors in Europe were the French. "…unfortunately, the tendency of the Frenchman has been to invest either in his own or in neighbouring European countries" (*FT*, 15/5/1916, p. 2). The first approach for this different strategy was mainly political. "The political designs of the French Government resulted in the equivalent of £500 million being invested in Russian bonds…Similar ill-fated loans were wade to Turkey, Austria-Hungary, the Balkan States…Nearly all the loans were ultimately repudiated" (Thomas, 1967, p. 12). For a different approach, see Parent and Rault (2004). Apart from France, other European countries were mainly invested in Europe, see characteristically Germany which, using a totally different financial paradigm invested the 60 percent of its total foreign investments in Europe (Feis, 1930, p. 74).

No matter what the reasons for the European (French) portfolios' selection techniques, the discussions of that time agreed on the lack of diversification as a significant element. *"France*, another great credit nation, was not so fortunate" (Rossi, 1923, p. 55). The reason for this condition, at least for this author, was the lack of geographical diversification.

> "France endeavoured, to some extent, to guide the flow of French capital into channels approved by French political aspirations and an enormous proportion of the French

[67] For this research, Europe does not include the UK, and countries as Turkey and Russia. Especially for the UK, it is included for reasons of comparison.
[68] The corresponding investments in Latin America were £757 million and almost the same for the USA.

> foreign investments were represented by Russian securities. We, as it happened, had a better-balanced investment list than France in our list and we were more fortunate in our selections. *We gained, France suffered, which proves nothing except that geographical distribution for a nation is economically sound, providing a sufficiently wide field is covered, the proportions are well balanced and the selection good"* (Rossi, 1923, p. 55, emphasis added).

The previous comment is indicative, supporting the argument for the importance of the geographic diversification process for every kind of investment, followed by the ITCs. In 1914 the French investments in Russia were at 11.3 bl francs (out of a total of 27.5 bl FRF in Europe), while outside Europe 17.5 bl francs have been invested. Comparatively, the British investments in Russia were half of the total European ones, see Feis (1930, p. 51). Besides, despite the British interest in the European continent, its trade relationships, and the existence of the London Stock exchange which "for generations has been the *Mecca* of foreign governments and municipalities bend on raising money" (Whorlow, 1926, p. 68), it seems there was no general interest in the continental securities.[69]

Additionally, unwillingness to invest in the big European economies such as Germany and France was present even before the war. "In the closing decades of the nineteenth century, the British holdings of continental securities declined rather than the contrary" Feis (1930, p. 18). Feis (1930) argued that the reasons for this contraction of British investments since the late 19th century were because of a) the consecutive defaults of European sovereign debts, and b) the acceleration of the domestic capital accumulation creating more self-sufficient economies leading to peripheral European markets, Feis (1930, pp. 18-20).

Hence, European economies could be characterized as closed economies, at least financially: "Manufactures and traders who were able to obtain accommodation from their bankers on most reasonable terms, and those who wanted long dated debentures loans could get them quite easily and cheaply from investors in their countries" (Taylor Smith, 1923, p. 36; Feis, 1930). Especially for Central European countries, e.g., Germany, their banking sectors could provide their industries with low-cost finance (Calomiris, 1993; Benston, 1994) conducting also the whole credit process and determining the issuance, distribution and pricing of shares

[69] Newer works have challenged this point. Edlinger et al., (2013) argued that the Paris stock market had become gradually international, increasing its financial efficiency; besides, they estimated a world portfolio which could accelerate its performance concluding that this ideal portfolio should have focused more on European holdings; thus, the British investors could have scored higher optimal portfolios. Furthermore, a similar literature supports the first diversification approaches of the French financial market (Merli et al., 2019).

(Hilferding, 1910). So, these more advanced bank-based systems could fund their economies more efficiently than through the conditions set by the more sophisticated financial markets, such as the UK system.[70]

To summarise, the ITCs had excluded European holdings from their portfolio lists since the late 19th century. The main reasons for this decision were institutional. The different financial paradigm, the basis and the kind of securities offered, along with the high financial (and political) penetration of the European investors had left the British investors on the margins. All these concluded to an anaemic 2.33 percent (average of the portfolio nominal values) being invested in Europe at the outbreak of WWI.

Europe was not a poor region for the early 20th century. The average European (Britain included) GDP pc in 1913 was $3,457, an amount much higher than the corresponding Latin American GDP which had only half of it. Nevertheless, European income levels ranged widely, from $4,000 for Belgium and Netherlands to $1,500 for Greece and $1,200 for Portugal. The European economic growth rate was 1.4 percent for the first decade of the 20th century, much lower than the corresponding ones of the New World. Besides, the European population growth rate for the same period was moderate (0.85 percent). Europe was still considered as a main migrant outflow region; moreover, the war made it a non-desirable place for settlement All these points are summarized in Tables 8.1 and 8.2.

[70] The debate of market versus banking finance, along with the role of the financial system in economic growth is voluminous and long. Despite the older arguments being in favour of banking one, see above, recent ones have challenged this approach, espousing a more conciliatory paradigm, see Fohlin (2007) for Germany; La Porta *et al.* (2008) for the correlation of the legal foundations to the economic growth; Hannah (2015) for the re-examination of US-Europe corporate finance, among others. This topic, overall, exceeds the scope of this dissertation. The different structures in the European markets encompass wider social characteristics. E.g. in the case of France, the structure of the French economy was based not so much on mass production and the mechanization process rather, on labour intensive, family-owned small plants; these social relations have led to the foundation of a *rentier* who was "the head of the family who planned for the closing years of life, secure in the income of these accumulations… enjoying the limited but steady receipts of his collections of slowly acquired bonds" Feis (1930, pp. 34-35). Concomitantly, this has created a tight, national financial market focused more on their domestic government and railways bonds; the peripheral European states and the French dominions supplemented the Paris stock market, offering little room for the British investors.

Table 9.1 Annual Average Economic Growth rates of European countries for the first three decades of the 20th century

Country	1901-1913 (%)	1914-1918 (%)	1920-1928 (%)
Austria	1.45	-5.7	5.57
Belgium	0.95	-7.07	4.84
Denmark	2.03	-2.29	2.52
Finland	1.85	-8.08	5.64
France	1.57	-6.74	5.43
Germany	1.57	-3.7	5.65
Italy	2.9	5.86	0.76
Netherlands	1.31	-3.62	3.72
Norway	2.08	-1.59	2.13
Sweden	2.62	-1.59	3.29
Switzerland	0.87	-2.19	4.81
United Kingdom	0.73	-1.32	1.16
Total 12 Western Europe	1.44	NA	3.2
Ireland	NA	NA	NA
Greece	NA	2.27	6.87
Portugal	-0.3	-1.64	2.82
Spain	1.14	-0.08	2.68
Total 14 small west European countries	NA	-1.36	3.29

Notes: The growth rates have been calculated as the average annual rate of change (ROC) for the period under study as $\rho = (\Omega - \mathrm{A})/\mathrm{A}$, where Ω is the final observation and A the initial one. See above for more information.

Source: Maddison Database (2010); Author's calculations.

Table 9.2 Gross Domestic Product per capita of European countries for the years 1913, 1920,1928

	GDP pc 1913 ($)	GDP pc 1920 ($)	GDP pc 1928 ($)
Austria	3,465	2,412	3,657
Belgium	4,220	3,962	5,139
Denmark	3,912	3,992	4,785
Finland	2,111	1,846	2,707
France	3,485	3,227	4,431
Germany	3,648	2,796	4,090
Italy	2,564	2,587	3,016
Netherlands	4,049	4,220	5,720
Norway	2,447	2,739	3,106
Sweden	3,073	3,111	3,885
Switzerland	4,266	4,314	6,171
United Kingdom	4,921	4,548	5,357
Total 12 Western Europe	3,687	3,313	4,298
Ireland	2,736	NA	2,737
Greece	1,592	1,433	2,234
Portugal	1,250	1,229	1,470
Spain	2,056	2,177	2,584
Total 14 small west European countries	2,830	2,536	3,294
Bulgaria	1,534	NA	1,219
Czechoslovakia	2,096	1,933	2,977
Hungary	2,098	1,709	2,415
Poland	1,739	NA	NA
Romania	1,741	NA	1,225
Yugoslavia	1,057	1,031	1,314

Source: Maddison Database (2010); Author's calculations.
Notes: For the amounts in $ there have been used the 1990 International Geary-Khamis dollars.

Of course, WWI was catalytic for this continent, first because its epicentre was the European terrain, and second because of its unprecedented repercussions on its states, economies, societies. The European product had an average annual curtailment of 1.32 percent during wartime, the worst among the world's regions, see Chapter 5. "The richest industrial provinces of France have been devastated by war, and the greatest part of her accumulated resources abroad being locked up in Belgium, Germany and Russia, are for the present practically unavailable" (*FT*, 15/5/16, p. 2). Let's keep in mind that after the war, three Empires had vanished, namely the Russian, the Austro-Hungarian and the Ottoman and, in their place, new States emerged with different territories, populations and cultures; Also, for the first time, new socio-economic systems appeared. The shocks in the economic sphere were rapid. The first market which was motivated was, obviously, the monetary one. The destruction of these three Empires and the establishment of new states had, as a result, the "introduction of a batch of exotic currencies…" (Atkin, 2004, p. 42), which flooded into the London market.

However, the ITCs' managers did not react to this huge speculative bubble.[71] At the same time, the owners of the old European holdings, coming especially from the former Empires, were seriously damaged. "Indeed, one of the real tragedies behind the figures shown in the exchange tables in the daily newspapers, is that the intellectual classes in many parts of Europe are being blotted out, more slowly, but just as completely as they have been wiped out in Russia" (Marlow, 1921, p. 51). The first reasonable reaction to this was for the bondholder to eliminate them; "[T]hese facts must be admitted, and we may feel a good deal of sympathy with the first impulse of the British bond holder, viz. to throw the scrip into the waste paper basket…". However, the suggestion for the bond holder in these cases was not to sell off "…but such a deed would be an act of utter folly" (51). The reason for this was simple, namely, to keep them, and to even expand the investment buying a large quantity of disastrously undervalued assets to maintain them for some years, in anticipation of an appreciation by then. The author emphasized mainly the fixed interest assets because of the established rights they obtained and especially in the railways sector or other stable investments; they would not cease to exist; "You can't destroy a Railway" (53). This tactic can be seen in the sample, because the

[71] Much in the current literature pays particular attention in two basic issues; first the transition problems with a new currency, see Lotz and Rocheteau (2002); and second, the fact that weaker and, mainly, peripheral economies have usually volatile currencies which could affect the already vulnerable economy against an external shock, Calvo *et al*. (1993). Thus, the emergence of an optimum currency area, Mundel (1961), the attempt to peg local currencies or to adopt a stronger one, Calvo (2002), and finally, the extensive debate over the monetary unions as the EU, see Begg *et al*. (1998) and de Grauwe (2000). For an overview, see Krugman and Obstfeld (2008).

observations of these states (especially of Central Europe) were kept in 1920. See e.g., the Railways *Lemberg Czernowitz Jassy*, or the *Hungarian Railways*. Similarities can be observed with cases as those in Lain America (Mexico etc.) which have been mentioned above, see Chapter 6.

Now, comparing the aforementioned picture with the same region just eight years later, in 1928, a completely different view appears. Tables 9.1 and 9.2 present evidence of a considerable economic expansion (3.2 percent), transforming the region into the growth leader of the world. The ITCs during the same period, as proved from the sample, see Table 8.3, totally reoriented their geographical destinations, quadrupled their European holdings.

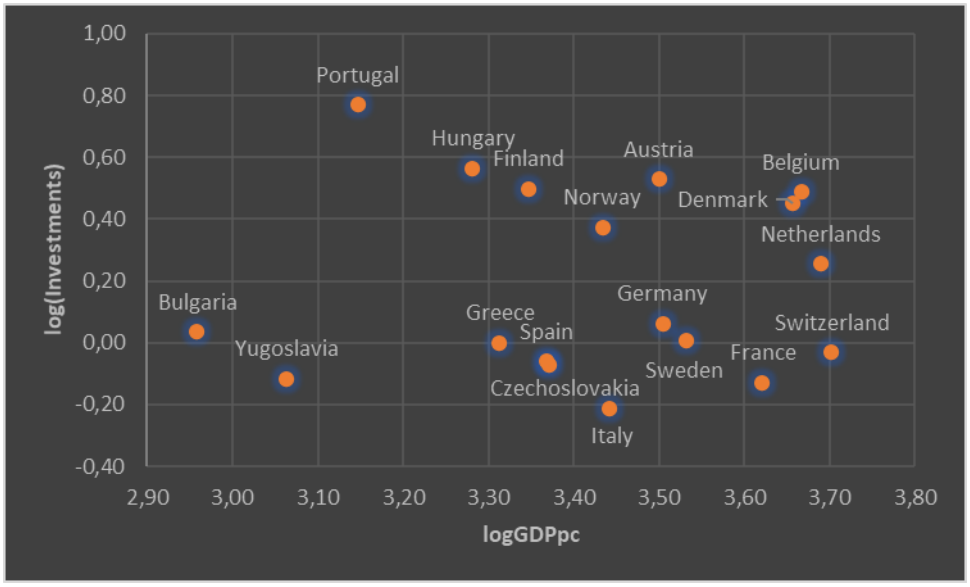
Table 9.3 Geographical allocation in selected countries of Europe (percent of portfolio nominal values)

Country		1914	1920	1924	1928
Austria	Observations	0	2	17	15
	Average	0	0,52	0,43	1,09
Belgium	Observations	0	7	8	24
	Average	0	0,29	0,26	1,19
Denmark	Observations	2	1	14	7
	Average	0,22	2,24	0,32	0,48
Netherlands	Observations	6	4	14	20
	Average	0,17	0,10	0,12	0,67
Germany	Observations	8	9	3	27
	Average	0,41	0,20	0,23	3,61
France	Observations	7	19	23	29
	Average	0,14	2,19	0,66	1,48
Italy	Observations	2	1	2	24
	Average	0,31	0,44	0,38	1,19
Greece	Observations	11	12	14	27
	Average	1,42	1,15	1,50	1,78
Hungary	Observations	6	4	8	30
	Average	0,37	0,96	0,68	1,52
Spain	Observations	20	23	21	19
	Average	1,23	1,60	1,60	1,21
Sweden	Observations	4	0	7	18
	Average	0,47	0	0	0,32
Switzerland	Observations	1	1	2	10
	Average	0,13	0,05	0,14	0,18
Portugal	Observations	1	9	10	15
	Average	0,33	0,27	0,84	0,28
Finland	Observations	0	0	11	19
	Average	0	0	0,30	0,52
Norway	Observations	2	2	6	9
	Average	0,10	0,38	0,45	0,30
Czechoslovakia	Observations	0	0	18	21
	Average	0	0	0,41	0,57
Bulgaria	Observations	0	0	0	8
	Average	0	0	0	0,30
Latvia	Observations	0	1	1	1
	Average	0	0,21	0,18	0,24
Estonia	Observations	0	0	0	4
	Average	0	0	0	0,34
Poland	Observations	0	0	0	24
	Average	0	0	0	0,50
Serbia	Observations	0	0	0	14
	Average	0	0	0	0,52
Ukraine	Observations	1	5	4	1
	Average	0,12	0,43	0,20	0,24
Azerbaijan	Observations	7	11	8	2
	Average	0,26	0,26	0,17	0,14
Romania	Observations	4	1	5	12
	Average	0,35	0,56	0,24	0,42
Russia	Observations	18	15	14	4
	Average	0,77	0,67	0,87	1,33
Europe (Total)	Observations	23	28	30	33
	Average	2.33	3.92	3.90	12.50

Notes: Russia does not include in Europe. It has been added for reasons of comparison.

Source: For the 1914 it uses the basis of Sotiropoulos *et.al.* (2020). The rest belongs to this dataset.

Figure 9.1 ITCs capital flows in Europe and initial Gross Domestic Product per capita, 1920s



Note: log (GDP pc) is for 1924 and log (Investments) for 1928. The latter variable has been estimated as a per capita level.

Source: For the data, see Maddison (2010). For the methodology Schularick (2006). Author's estimations.

Figure 8.1 features the correlation between the ITCs investments in various European countries and their annual production in 1920. The results here confirm the existing study about the shift of the investment paradigm for the interwar period, (see Obstfeld & Taylor, 2003; Schularick, 2006) among others. No clear tendency exists between the GDP and international (here European) investments. This leads to two interpretations. First, despite any ambiguity, it is clear enough that Europe had become an alternative destination for ITCs investments. The rapid economic growth rate can be one reason for the shift of the ITCs' policy towards Europe, but not the only one. Thus, the second one arises. If not for economic reasons, then what was the reason/s for the shift of the ITCs towards this collapsed and economically problematic region, without any previous experience? Why would such well organized and frugal institutions navigate these *uncharted waters*? And, finally, what was their reaction to this *social workshop*, called Europe? These will be analysed below.

9.3 The main post-WWI problems Europe faced.

WWI bequeathed terrible economic problems to Europe; first, was the number one enemy for investors, hyperinflation. Almost all the countries in Europe had been hit severely by this. This was the first problem that should have been solved before the investors approached Europe. Other economic problems included the fiscal imbalances, currency collapses; and of course, wider problems such as the appearance of persistent and rising unemployment rates and social

instability; shifting back to "the gears of peace" was "neither an automatic nor a fingertip operation, (see for this analysis Clough & Cole 1967; Kindleberger, 1973; 1984; Aldcroft, 1977; Maddison, 1977; Eichengreen, 1993; Feinstein, 1995; Feinstein et al., 2008). And this Chapter keeps in mind that all these problems were intertwined. All these socioeconomic problems were related to the question raised above, viz., the ITCs choice to invest in Europe. These problems are a red flag for every investor, let alone a foreign one who focuses on security, such as the ITCs. So, the solution to these problems was a *sine qua non* for the British ITCs to invest in this region.

As for the first problem, the European territory had suffered severely from inflation but not in the same way. During the war, inflation had escalated, while a short period of deflation followed the Armistice period (spring 1919 to summer 1920). This was succeeded by a world-wide slump (mid-1920 to 1921). The European countries could be divided into three groups; first, "Five countries proved totally unable to contain the war and post-war pressures and were ravaged by hyperinflation. These were Austria, Hungary, Poland, Russia, and Germany" (Feinstein et al., 1995). Apart from this, a second group was left with high inflation after the end of the war, comprising France, Belgium, Finland, and Italy, and smaller countries such as the Balkans. A third group gradually endeavoured to control it including Sweden, the Netherlands, and the UK. This classification was related, certainly, to the intervention policies of the central banks (where they existed) and the governments. All the countries were at a price level much higher than the one in 1914, (see Feinstein et al., 1995; Table 9.4).[72]

Because the hyperinflation, could not be solved by each country separately, the contribution of an international organization was of utmost importance. This was the then newly founded LoN, an organization founded in 1920 following the Paris Peace Conference, (see Pedersen, 2007; Clavin, 2013; Henig, 2019). Among its main goals was collective security and disarmament. To succeed in these goals, it needed global economic stabilization. For this reason, the First Assembly at Geneva established an Economic and Financial Advisory Committee to provide information to the conference. In 1923, an Economic and Financial Organization came into being (Hill, 1946, Endres & Fleming, 2002). This organization provided the European states with assistance in stabilizing their inflation through a central bank autonomy which could guarantee a) price stability through the return to a gold exchange standard scheme (differentiated from the pre-war one preventing deflationary movements), b) full employment,

[72] E. g in 1918 the country with the lowest deviation from the pre-war price index was the Netherlands with a rise of 62 percent. In 1920 the condition was worse for the total of the European countries.

and c) prudent fiscal policy not affecting inflation (Endres & Fleming, 2002). Several, especially peripheral, European countries namely, Austria, Greece, Bulgaria and Hungary progressively asked the LoN for its advice (or they have been obliged by the international financial lenders to use the organization as a pledge), to follow this route. Gradually, one after the other all the European countries pegged again their currencies to gold through exchange schemes, as is presented in Table 8.4. The aforesaid role of the international organizations has been affirmed by the financial advisors of the period. "Great results have been achieved by international financial action, the work of the League of Nations in this respect having proved of immense value to the economic recovery of Europe" (Rossi, 1925b, p. 35).

Table 9.4 Stabilization of European Currencies (1922-1929)

Country	Year	New Parity (as % of the pre-war)
Austria	1922	0.00007
Sweden	1922	100
Germany	1923	0.0000000001
Czechoslovakia	1923	14.6
Hungary	1924	0.0069
Bulgaria	1924	3.8
Finland	1924	13
Netherlands	1924	100
Switzerland	1924	100
UK	1925	100
Yugoslavia	1925	8.9
Denmark	1926	100
Italy	1926	27.3
France	1926	20.3
Belgium	1926	14.5
Poland	1926	0.000026
Greece	1927	6.7
Romania	1927	3.1
Norway	1928	100
Portugal	1929	4.1

Source: Feinstein et al. (1995, Table 1.2)

The question of pegging to gold raised new issues. The 1920s was a period of a great monetary rivalry between the USA and the UK, (see Costigliola, 1977), regarding the way the new global financial structure should be built. The UK, knowing that superiority of the USA was in favour of a regulated financial return to gold which could use as an anchor BoE and the pound. Although this plan failed, many peripheral European countries accepted it, e.g., Greece, Hungary etc. Thus, a new informal financial empire emerged in which the ITCs were involved, see Chapter 7.

Concerning Germany, this brings us to the second main problem, the economic reconstruction process. Between the end of 1918 and the beginning of 1919, the German Reich was established. However, as recently have being defeated in WWI, a peace treaty remained

unresolved. A few months later, in June 1919, in Paris the *Treaty of Versailles* officially ended the war, including a) territorial issues, b) disarmament demands, c) economic reparations, and d) the assignment of guilt. As for the reparations' issues, which relates more to this research, they agreed[73] in London two years later the following: the total amount of reparations should be divided into three tranches, a) an indemnity of 12 bl in gold marks (this was called A bonds); b) a compensation of 38 bl gold marks for inter-allied war debts (B bonds); and c) a notional charge of 82 bl gold marks (C bonds) (Ritschl, 2012, p. 4). Because of the theoretical (basically political) notion of the third part, the first two bonds amounted to 100 percent of the German GDP of 1913.[74] The reluctance of the Germans to meet their tax obligations worsened the economic conditions, leading to hyperinflation and a significant breakdown of the German economy in 1923.

Faced with deadlock, the Western allies (mainly the USA and the UK) agreed to assist the German economy to overcome the problems designing and implementing the *Dawes Plan*, a plan which, among others, included the return of the Ruhr area to Germany, a loan agreement to the country, with a parallel rescheduling of the reparations, applying a low initial annual amount in ascending order over time. Because of the conditions of the loan, there was debt relief, together with the stabilization of the currency and the increment of the economic production, and transfer protection was constructed (Aldcroft, 1977). These were sufficient conditions for a huge inflow of foreign credit. A further important agreement was the *Locarno Pact*, which was signed in 1925 and meant to solve territorial differences, destructing the colonial empires and the forty-year-old "megalomaniac ideas" of Germany to "have got a place in the sun" and establishing political stability in Europe for the next 5 years, (see Hardin, 1926). "The hatchet is buried, and an atmosphere of peace and friendship prevails in Europe" (Hardin, 1926, pp. 10-11). These solutions to the German reparations problem seemed to unravel the biggest European issue, which goes beyond the financial framework. This discussion is not irrelevant to the ITCs' decision to invest, especially in Germany, 3.6 percent of their average portfolio value, ranking the country fourth in the list only behind the UK, Argentina and Brazil, see Table 8.3. So, the ITCs took full advantage of the solution to the German problem, investing a lot in the country; they were part of this flood of foreign capitals participating with £2 mil, a significant investment for their size (almost £ 70 million for 1928).

[73] The notion of agreement is symbolic; many economists and politicians had raised serious objections to the unrealistic and mainly punitive character of the Treaty, which was rather a lion's share agreement. See Keynes (1919).
[74] With the third one the amount was equal to the 260 percent!

Now the third problem (at least for the investors) emerges; namely revolution. The evolution of the then-already existed socialist ideas and the gradual development of the labour movements, especially in Europe and in North America, had been practised in Russia. WWI was the trigger point for the revolutionary policies; Russia, being the weaker link of the Imperialist chain, constituted a different economic and political paradigm for the examined period. The October Revolution dissolved the Russian Empire and the government of Kerensky, establishing a new economic system. The new regime was a shock for the whole world, especially for the backbones of the already well-established (even rotten for the Marxists) economic system, which were the investors; for the October revolution, (see among others Carr, 1979; Hobsbawm, 1994). For the first time, not just theoretically but also practically, a system that evangelized the end of exploitation of man by man, rejecting the individual possession of the means of production, had been introduced. The joint-stock company, the bulwark of capitalism, together with the capitalist state were the first victims. All the banks and the main industries were confiscated, the national debt was repudiated. In 1922, the British agent in Moscow sent a letter to the council of the national economy asking for information about the condition of the Russian securities in British hands. The reply was that: "…in accordance with the law March 4, 1919 shares, stock and debentures and other loans of nationalized undertakings are cancelled and cannot be due for payment" (Keating, 1923, p. 22), leaving no ambiguities about the purposes of the new government.

The revolution had initially spread in more countries such as Hungary (1919), Finland (1918) and Germany (1918-1919), with other smaller social uprisings in Italy, the Baltic, Ireland etc. However, these were soon defeated. This turmoil affected the investors' decisions, at least in the beginning. For the investors, all these events, even the conditions in Russia seemed temporary in character. "[T]he temporary elimination of Russia as a field of investment and the undoubted fact that whatever may happen in the near future towards the rehabilitation of that unhappy country, the confidence of the general public in Russian credit and integrity must remain shaken to the depths for at least another generation" (Taylor Smith, 1923, p. 36). This text is indicative of what the investors had in their minds concerning this case. The problem for them, at least initially, was mainly in terms of confidence, implying that that regime would be a short political *parenthesis* for the country (and, obviously, for their investments). For the other countries of Central and Eastern Europe (Hungary, Romania) there was belief in a shorter timeline, believing that the *Bolshevik menace* was just a bad dream, leaving, as a defect, only the phenomenon of currency imbalances (Marlow, 1921).

This new situation affected rapidly the whole world (Hobsbawm, 1994). In the case of Europe, structural changes shook the European political order (see Wrigley, 1993) for the impact of the October revolution on Europe; Doumanis (2016) of an overview of Interwar Europe. "Political liberalism was in full retreat" for the whole period, see Hobsbawm (1994, Ch 4). The classical pre-war liberal political regimes were pressed both by the militant labour movements and by the newly fascist regimes, (see Luebbert, 1991).[75] although the political situations in the various European countries have already been systematically discussed, the question remains. Why should the financial circles (in which the ITCs were involved) participate in this discussion? Additionally, how did the ITCs react to these changes? A further interesting question which arises here concerns the relationship between the various political systems (regime, polities) and investment.

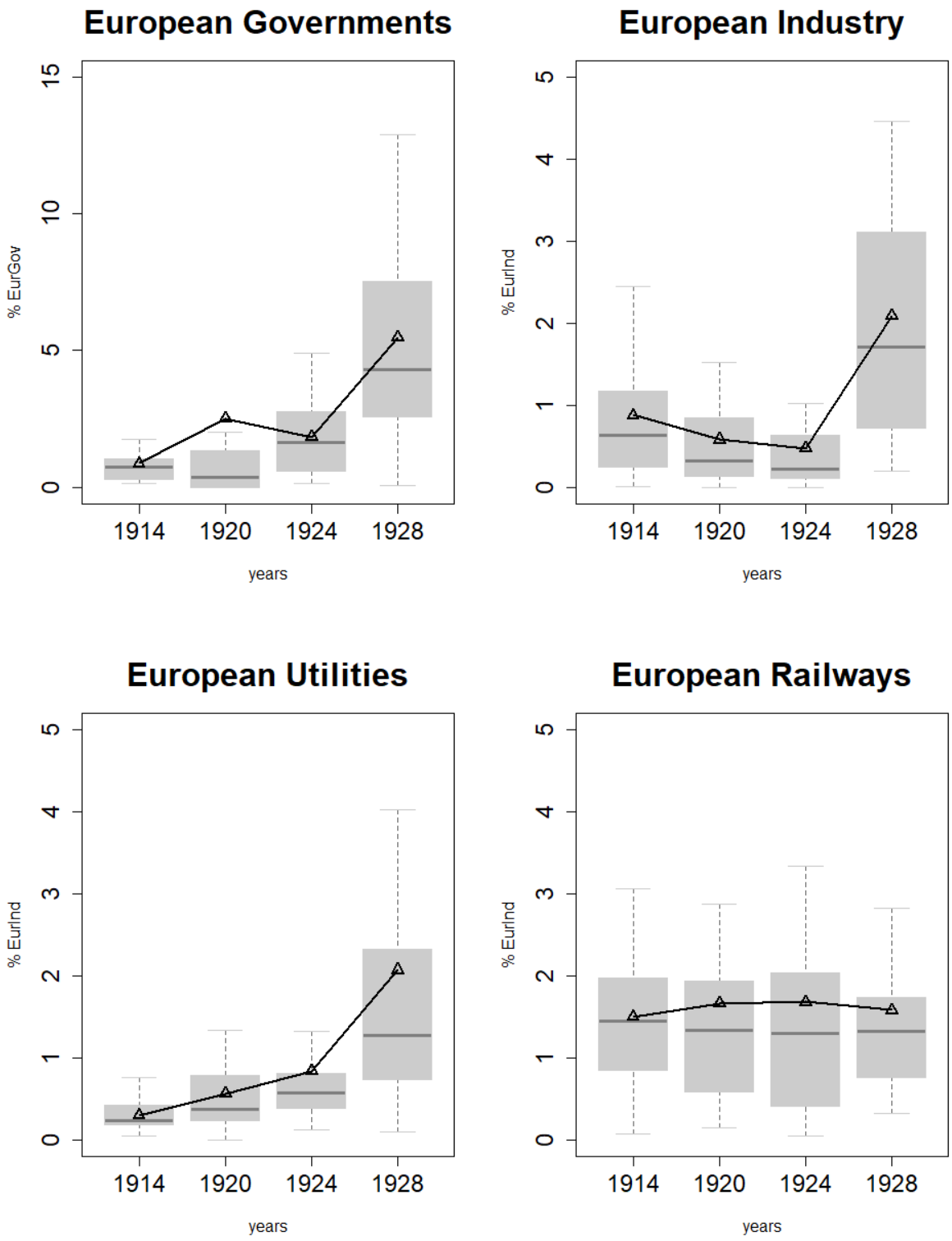
Here, there is a highly debatable question about the relation between the political regime of a country and the borrowing results. E.g., North and Weingast (1989) supported the positive relationship between advanced institutions and cheap borrowing. Flandreau and Zumer (2004) and Ferguson and Schularick (2006) altered the question, arguing the importance of the supply side (creditor) to be relaxed from borrowing constraints. Finally, Tunçer and Weller (2020) discussed the notion of stability as a prerequisite for the foreign creditor. For a financial perspective, common are the results of Delis *et al.* (2020), who, using a contemporary dataset, argued that democratization reduces the cost of credit. However, there are different approaches, which do not confirm this paradigm, see *The Economist* (11/07/1964) and Weller (2021) for historical counter examples. This thesis would like to broaden the question by adding any asset class, apart from national debts. Is democracy an anchor for foreign investors? During the interwar period, it was not a certainty. The most characteristic case was, arguably, that of Italy.

These big problems, in addition to the existing pre-war ones, left no room for the foreign investors to invest in Europe. Table 8.3 and Figure 8.2 confirm this aversion between 1920 and 1924. Thus, the ITCs, up to the mid-1920s, had no reasons to invest in Europe. Comparing this picture to the next studied period (1928), there is a completely different position, meaning that somehow these obstacles had been overcome. The first, namely, hyperinflation, together with the general reconstructive policy was solved through the assistance of the LoN and the implementation of several financial, trade and monetary rules. The second difficulty, Germany, was overcome in an ambiguous, at least, way through the direct intervention of the great

[75] E.g., the establishment of the fascist regime in Italy in 1922.

powers, mainly the USA. As for the third impediment, the collapse of the traditional liberal democracy, it seemed that investors as a class endeavoured to take full advantage of the new opportunity, without crossing the red line of their profits *per se*; this will be discussed further below.

Figure 9.2 ITCs European main sectoral analysis (percent of portfolio nominal value)



Source: Author' s computations. For 1914, it uses Sotiropoulos et al. (2020).

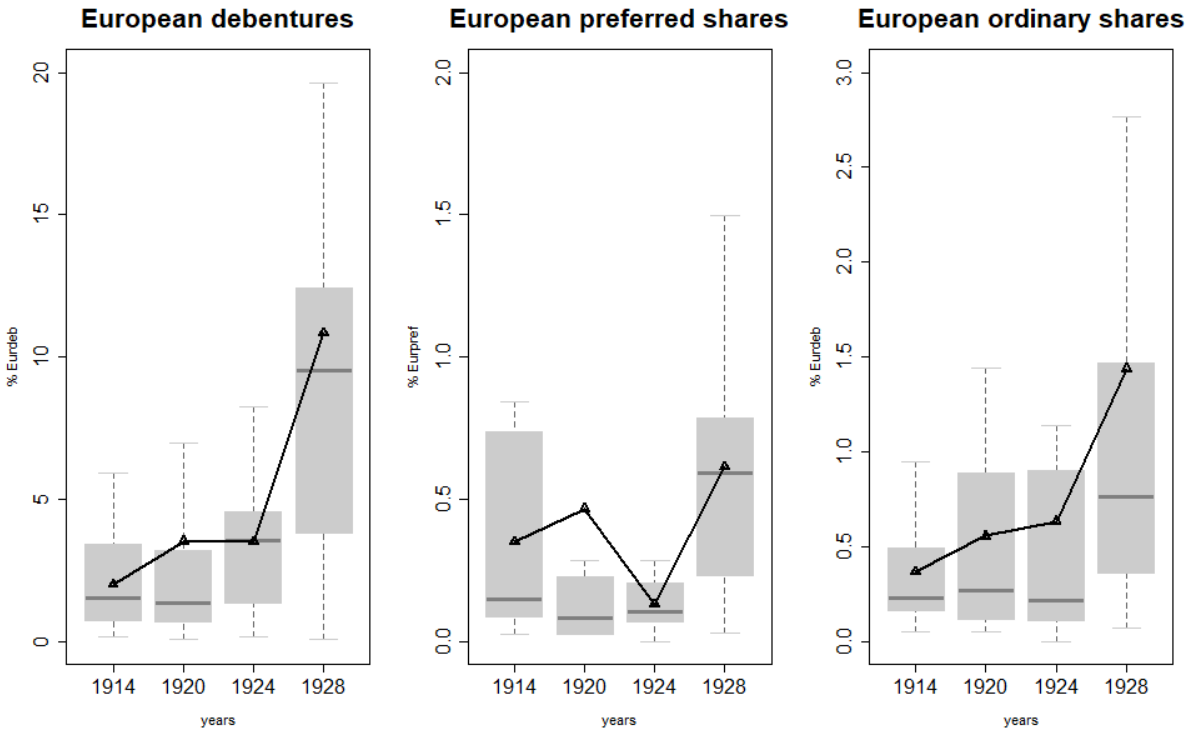
Table 8.4 and Figure 8.2 summarize the national and sectoral analysis of the European assets of the ITCs in the 1920s. Three main sectors emerged in the European holdings of the ITCs; namely governmental bonds, industrial securities and utilities. Figure 9.2 adds the railways

sector. As this figure presents, the latter sector followed a different route, remaining practically stable (1 - 2 percent) for the whole period. Thus, the ITCs although having invested much in this sector -see the case of Latin America, the USA, even Asia etc.- they have not invested in this sector in Europe. Possibly, the lack of available equities and the dominance of continental economies in the sector (mainly France, Germany and Russia) left no space for the British investors, see above. Surprisingly, the picture remained the same even during the second half of the 1920s, despite the general European economic euphoria. Reasons for extensive state intervention could have been concealed behind this unwillingness. As for the other three sectors, although their absolute size cannot be compared to the one of Latin American or British investments, the difference between 1924 and 1928 is noteworthy. Specifically, the ITCs' investments increased dramatically from 4-5 percent in 1920 and 1924, in 12.5 percent in 1928, an increment of more than three times. The ITCs, accepting the prerequisites as for the security of their investments and the promising financial performances of the newly established European holdings seized the opportunity to invest in this new, for them, market using novel practices which this thesis will describe thereupon.

A final interesting finding is the asset allocation of the ITCs European holdings. As Figure 8.3 shows, debentures were the dominant European type of holdings. As for the other two types of ITCs holdings namely, preferred and ordinary shares, they all but vanished from their portfolio. Protection was the main explanation for this. Additionally, the preferred sectors (government) could explain this choice, which is very different from the general picture (one would expect at least double rates from these two types, see Chapter 4).

Now, it will focus on three main cases which encompass the main challenges the ITCs faced in Europe during this short "spring" of the mid-1920s. The first was the opportunity, which appeared in the European periphery related to the urgent need for capital issuing debentures to stabilize and reconstruct their economies. Then this thesis discusses the monetary and political problems which emerged in Europe; specifically, it presents the cases of Italy and France. Finally, it pinpoints the novelty of the strengthening of the national stock exchanges which issued extensively new holdings, a new opportunity for the ITCs. In all these, it provides European countries as indicative case studies, exhibiting the various challenges, the different financial paradigms, and the institutional barriers which had to be overcome by the ITCs, delineating, in parallel, the financial innovations which were used, thus, framing active asset management strategies.

Figure 9.3 Asset allocation of the ITCs European holdings (percent of portfolio nominal value)



Notes: Debentures contain all the fixed- income securities (sovereign bonds etc.).

Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

9.4 European sovereign bonds. The cases of Greece and Hungary

The bonds issued by the European Governments were the unquestionable champion of the ITCs investments. This change was visible in 1928, practically occurred over the period 1924-1928. European governments' bonds almost trebled between 1924 (1.8 percent) and 1928 (5.4 percent). In some cases, this rate exceeded 10! Thus, there were big differences among the various countries. Bonds issued by Germany were on average 1.7 percent of the sample, by French 0.7 percent and by Italy 0.5 percent. Nevertheless, the peripheral countries seemed more attractive to the ITCs managers. Greece, already an established destination for British investors, had 1.2 percent (stable for the whole period); then, Belgium and Hungary (1 percent), Austria and Italy (0.5 percent), and last the Czech Republic (0.35 percent).[76]

This movement is perfectly connected with the gradual reconstruction policy which happened in the mid-20s, leading to a shift of the ITCs strategy. Through the assistance of the LoN one after another European country (and various municipalities) raised bonds under its aegis, which

[76] Although the numbers could seem low, cumulatively, they surpassed 5 percent; now if one adds the elements of a) newcomer and b) the aversion of the ITCs to the government securities, see Sotiropoulos *et al.* (2020), then the result becomes more interesting. Only LA overcame these numbers.

was a perfect solution for British investors. The *Financial Times* welcomed in the New Year (1925) with a resume for the stock markets of the previous year:

> "The market in foreign government securities has been more than usually interesting…some progress has undoubtedly been made in the matter of post war reconstruction, as so far as Europe is concerned the year closes with the outlook for the restoration of settled conditions more encouraging than at any time since the Armistice" (*FT*, 2/1/1925, p. 1).

The same article mentioned the issuing of new government bonds for Austria, Hungary, and Greece, together with new issues for Germany through the *Daws plans*.

The reason it uses this example is to compare the parallel movement between the evidence offered by the financial press and the policy of the ITCs. The foregoing article explicitly mentioned the four previous foreign bonds' cases (Austrian 6%, Hungarian 7 ½ %, Greek 7% [it was the Refugee Loan] and Czechoslovakian 8%). This is also a test of the similarities between the ITCs strategies and the general financial discussions of the period. Indeed, by checking this sample, it can find the aforesaid holdings in the portfolios. More than 15 observations can be found for the Austrian loan, 40 for the Hungarian, 20 for the Greek and 10 for the Czechoslovakian. This demonstrates a reaction of the ITCs asset management policies to these new promising holdings. Here it has to mention again that many of these countries had already decided to peg their currencies (e. g. the Greek drachma, Hungarian crown) to the British pound and, finally, to gold (Aldcroft, 2006); thus, offering an extra security for the British ITCs to invest in them.

The nominal yields (coupons) of these securities were extremely high, especially compared to the American or the LA railways, see Chapters 7 and 8. This difference could be a mark- up because of the country's financial history, the issuer's age, or the high inflationary pressures. Table 8.5 summarises the currencies in which the European securities were issued. Half of them were issued in GBP, meaning that the issuers aimed at lower rates and access to the international markets. The rest were issued either in USD or in national currencies, again with high nominal yields. The main findings here are first, the denomination in USD, for the first time, was a sign of the strength of the NYSE and the international role it played during that period, see Chapter 7, and second, was the appearance of national currencies which can be interpreted both as a sign of rise of financial nationalism and, also, as an evidence of the growth of these economies which could now negotiate in the international market.

Table 9.5 Currency exposure of European holdings in the ITCs portfolio (percent of portfolio nominal values)

Year	Observations	Average	Median	st. dev.
securities issued in local currencies				
1914	11	0.17	0.10	0.27
1920	16	0.93	0.00	3.53
1924	19	0.00	0.00	0.00
1928	27	3.01	1.85	3.02
securities issued in GBP				
1914	23	2.21	1.29	2.05
1920	28	3.38	1.83	5.45
1924	30	3.80	3.49	3.11
1928	33	6.97	6.49	4.25
securities issued in USD				
1914	6	0.14	0.10	0.12
1920	1	0.03	0.03	NA
1924	9	0.30	0.27	0.36
1928	28	3.62	1.87	4.20

Source: For the 1914 it uses the basis of Sotiropoulos *et.al.* (2020). The rest belongs to this dataset.

9.4.1 Greece

Greece could be the most characteristic case for a peripheral country. Here, despite the limited territory and the unstable economy (almost $1500 GDP pc in 1920), the ITCs acquired diachronically more than 300 assets (almost 2 percent of the whole sample overtaking countries like France, coming second in Europe after Germany!). However, the establishment of the Bank of Greece in 1927 was a precondition for entering in the International credit systems unhindered after WWI and the Minor Asia catastrophe (1922). In 1928, more than 80 holdings were in government bonds, the majority in GBP, but also some were in USD and, surprisingly, in the local currency, drachma, which was pegged in the GBP.[77] The case of Greece was extremely interesting for the financial advisors. Several articles in the financial press of the mid-1920s were devoted to Greece. Their focus, mainly, was on the issue of the Greek public finance and its currency because both were problematic.[78] In 1927, Greece pegged its currency to gold through the GBP, but in a parity much lower than the pre-war one, see Table 9.4. This thesis mentions characteristically the case of the *Greek Government 7% Refugee Loan*; that was a Loan issued as follows: "The purpose of the Loan is to provide funds for establishing on the land or in industry Greeks who were living in Turkey and who in accordance with the

[77] This happened with the *Greek Government, 8 %. Internal Forced Loan, 1926*.
[78] See e.g., the article with title "Greek Revenue" in *Financial Times* (01/09/1925, p. 4) discussing the positive public finance conditions of that period in the country.

Treaty of Peace with that country, were transferred to Greece" (Fox, 1926b, p. 35). The specific one had a significant presence in the sample with more than 50 holdings (both in 1924 and 1928), indicating the importance it had for the ITCs portfolios. In 1928, the first attempts to import substitution policies were observed in the Balkans, with a parallel attempt at land redistribution, events which were commented upon by the advisors of the period (Fells, 1928).

9.4.2 Hungary

Hungary was the second case of a peripheral country, a former member of the Austro-Hungarian Empire. Its GDP pc was $2,098 in 1913 and after a fall to $1,709, returned to $2,415 in 1928, so it could be classified as a middle-income economy. As has been mentioned, after the October revolution, a similar revolution occurred in the country, lasting a short period of time. This meant, of course, there was a relevant financial mistrust towards the country for some time. Because of the reconstruction period which followed, the country's securities, finally, were accepted by the investors, the ITCs included. Until 1924, only 30 holdings were present, but by 1928 a sharp increase to 150 new securities occurred (1.5 percent of the total sample spread in 30 out of 34 ITCs). It should be noted that the Hungarian growth rate rose to about 20 percent in 1925. The country had followed a similar route as that of Greece, meaning that the *LoN* demanded an independent central bank, a balanced budget, and a fixed exchange rate system (Macher, 2019). This was welcomed by the financial press of the time. "The greatest step taken since the war towards the European restoration through the agency of international cooperation… seems likely in the very near future by a similarly [*Ed. N.* to Austria] successful operation affecting Hungary" (*FT*, 5/1/1924, p. 2).

These two characteristic examples, exhibit the assistance provided by the LoN in stabilization policies, in conjunction with a national construction policy, resulted in arousing the interest of the ITCs in the then newly issued national bonds, which, again, offered them security and interesting returns.

9.5 Inflation and political turmoil. The cases of France and Italy.

Inflation was a new canon for the post-WWI period in Europe, striking the whole continent. Not all countries were affected in the same way. France and Italy were two cases in which inflation did not destroy their economies, (see Feinstein et al., 1995). On the contrary, there were sectors of the real economy that were revitalized (Asselain & Plessis, 1995; Cerretano, 2004). Their post-WWI period until 1926 was inflationary. In 1926, there was an attempt in

both cases to recover from this high inflation. Eventually, this restoration period was consolidated by the return of the Gold Standard in 1927 (for Italy) and 1928 (for France). The ITCs reactions to these oscillations were contradictory. On the one hand, they were extremely sceptical about investing in highly depreciated conditions; on the other hand, they had anticipated possible profits in the real sectors of these economies. The evolution of their actions, as it can be seen through the ITCs portfolios, portrayed this ambiguity. However, all these processes had intense political upheavals. Both countries, but more so Italy, suffered during and in the aftermath of the war. The massive unemployment rate and the falling wages led to general social unrest, (Mayer, 2016; Gabbuti, 2020). The discussions of the financial advisors which it presents are extremely interesting. Specifically, they participated actively in discussions, expressing openly their preference about the alternative political options. Moreover, it is concluded that they had no problem concerning the political regime a country would follow. Their only concern was the stability of their investments.

9.5.1 France

In France, the bad economic condition was translated into huge deflationary pressures on its currency after abandoning the Gold Standard. Characteristically, £1 was equal to 25 FRF in July 1918 while in July 1923 to 75-78 FF (IMM 07/1918, 07/1923; Marlow 1923), this, in itself, was an adverse criterion for keeping assets denominated in FF, as there were "obvious dangers ahead" (Marlow, 1923, p. 16). Despite the currency problems, the economic situation of the country had gradually improved in the aftermath of the war. After a calamitous fall in the French growth rate (-6.74 percent) during wartime, a period of high expectations emerged, with an annual growth rate of 5.43 percent for the period 1920-1928. The French GDP pc was among the highest, standing at $3,485 in 1913, falling to $3,272 in 1920 and surpassing the pre-war period reaching the amount of $4,431 in 1928.

Nevertheless, the evolution of the political situation affected the developmental and financial sphere. Often changes of governments altered the mixture of implementing policies. In 1924 the conservative government lost the elections because of the burden of taxation and the franc's collapse; the labour government (Herriot) which succeeded raised the government's expenditures, which was covered mainly by the accelerated use of the printing machine, while simultaneously issuing new credits, (Adamthwaite, 1995). The economists and the investors were suspicious of these fluctuations; for the description of both the political and the economic evidence, see Davis (1924). This was then followed by a conservative government in 1926,

implementing restrictive fiscal policy. "A single false step would plunge the country into the abyss, and no one could haul it out again. We are like a sick person who to be cured must follow a strict and prolong regime and avoid the slightest form of excess" (Poincare, cited in de Bilinski, 1928, pp. 39-40); for Poincare reform see Eichengreen and Wyplosz (1990). This explained the emergent character of the implementation of fiscal and monetary measures, and of course echoed specific ideological norms. The situation was not so easy because of the strong social polarization, but the situation, at least for the advisor was not worrying.

> "[F]or the first time, a considerable number of Socialists were elected last year in the Senate, which had up to then been the stronghold of the moderate elements of the country. The various sections of the Socialists also constitute a formidable body in the Chamber. As it not of the Marxian brand, however, except among a section of the artisan and the city labourer classes, Socialism as such holds no menace to the existing order of things in France…" (de Bilinski, 1928, p. 41), unveiling the real *demons* of the investors.

"France would one day offer a field of golden opportunities…the problem offered by their financial difficulties were, indeed, *far more of a political than a financial nature. All that was to make all classes contribute to the Budget in proportion to their means*" (*FT*, 10/02/1926, p. 2, emphasis added). Despite the slower stabilization process and the various social disputes which had emerged, again, the interest of the investors of that country's assets increased gently. Presumably, in their choice measured the fact that a new attempt of stabilization occurred (125 FF per GBP) in October 1926, (see Cassiers, 1995).[79] In the sample, France is underrepresented with fewer than 250 holdings, divided mainly between the government sector and the various railways in 1928 (70 holdings each).[80] The reason for these preferences was mainly the excessive reconstructive programme of the French infrastructure that had been demolished by the war.

And what were the characteristics of the French securities which had been preferred by the ITCs? Their promising yields were one of the reasons, see the case of the railways in which they had invested. The same securities were included in the lists of the financial advisors of that time. E.g., the *Midi Railways* which costed £89 and yielded at 6 ½ % (Rossi, 1925b).

[79] For the Belgian Franc a similar process happened (175 BEF per GBP). Various assets in this currency from Belgium in this sample following this process, too.

[80] Possibly the only European country in which such a high number of railways exists. High yields together with internal information could have explained this movement. Another country with railways investments in the ITCs portfolios was Greece.

Another example came from the municipality sector, see the case of the *Department of Seine* at 7% with more than 10 observations in the sample (both in 1924 and 1928). This was an attractive investment "regarded as no wit inferior in security to a British Corporation Loan" (Rossi, 1925b, p. 37). Interesting is also the fact that most of the assets were not denominated in FRF but in GBP and USD, declaring the investors' reluctance to take inflationary risks. Characteristically, fewer than 10 holdings were in FRF; a fact unambiguously connected with currency insecurity. This is one more piece of evidence regarding the significance the ITCs' management ascribed to the notion of security in their investments. Currency rigidities seem to play a significant role, together with political choices in the decision of the ITCs to abstain from the French capital market.

9.5.2 Italy

Italy is a case study of outstanding importance, concerning the social and political conception of the investors and their real danger for their business. Italy, indeed, had suffered a lot from WWI. Its economy and its currency had collapsed, and serious political uprisings took place.

For the economic (and non-economic) problems of Italy, see the interesting presentation of Kahn (1921).

> "The most serious difficulties to overcome, however, are non-financial. Irresponsible and vindictive conduct of labour in the industrial centres may continue for many years, for the doctrine of the class struggle has been deeply implanted, the resentment aroused by the recent riots has been bitter, and habits of irregularity and negligence have been confirmed. The moderate majority of organized labour accepts the principle of Giolitti's plan of labour participation in industrial management, but the employers are opposed, and the numerous radical elements will refuse any kind of cooperation, at least as long as there is a de facto Communist government in Russia. Industrial development must wait upon satisfactory labour conditions, credits with which to purchase raw materials, and recovery from the general depression" (Kahn, 1921, p. 91).

The Italian GDP pc descended to about $2,500 in 1920-1921, from $3,400 the previous year; finally, it reached $3,016 in 1928. The Italian growth rate lagged compared to the other European countries. Its pre-war score was 2.9 percent, which rose during the war. However, the big difference was present in the first post-war years with a huge curtailment (-9.15 percent for the years 1919-1921 on average). Finally, it presented a positive sign in the mid-20s. Because of Italy's severe economic problems during the first post-war period, it remained an

extremely unattractive destination for foreign investors. The most characteristic example to describe the magnitude of the destruction for the prospective investor, is the *Italian 5% Rente* of £1000 nominal value which was worth only £232 in 1922, falling from £956 in 1914 (Rossi, 1923, p. 58).

Thus, Italy could be characterized financially as a lost cause. To be attractive again for both the local and the foreign investors, a positive shock was needed urgently. "Italy, until one year ago appeared to be following the same disastrous road as Central Europe…" (Marlow, 1923, p. 15). The critical point here is the word *until*. Did something suddenly change the chaotic economic conditions? The author continued: "but the rise in power of the Fascisti has certainly stopped the disintegration which has taken place in her political and industrial life. At the same time, she is by no means 'out of the woods' and investors would be well advised to adopt a waiting attitude for a little longer" (15). Why should the investors to be patient? Was there a possible barrier that should be overcome? Evidently, not all economic problems could be solved automatically. However, the crucial question was focused on something else: "Can the Fascisti keep down the corruption which at one time was sapping the life blood of Italy? Is the Communist menace dead or it is only 'scotched' and waiting for an outbreak of trouble in Central Europe to rise one more and reproduce the political and industrial chaos from which the Fascisti saved Italy?" (Marlow, 1923, p. 15)

It seems that, gradually, a lot of discussions were held about the issue of Italy. "As long as she presumes a peaceful policy, Italy has nothing to fear for foreign aggression, and she has recently shown in a remarkable way that anarchism and Bolshevism will not be tolerated. Thanks to the advent of a strong man at a critical period, but apparently possessed of Napoleonic determination and great administrative ability, Italy is rapidly putting her house in order" (Rossi, 1923b, p. 23). And what were the *Herculean tasks* of this "strong" man? Among others: i) a large-scale reduction of all administrative departments, ii) simplified and improved income tax collection, iii) exemption from taxation for foreign capital invested in Italian industrial enterprises, and v) the denationalization of state undertakings (Rossi, 1923b). If this cannot be described as an *investor's heaven*, then what can?

To summarize, the foreign investors' reactions to the change of the regime in Italy were unanimously supportive. The *paean*s for Mussolini were because he symbolized stability (economically, but mainly socially) which was required for their impending investments.

Nevertheless, the ITCs, through their portfolios seemed to maintain a cautious optimism. 80 holdings appeared in the sample, the vast majority in 1928 (0.75- 1.2 percent of the sample). The main securities which had been kept were the then newly founded Italian, state-supported and managed, manufacturing consortia in the sectors of armaments, engineering, and chemicals. These were extremely big industrial monopolies as *SNIA Viscosa* the second-largest rayon producer in the world, *Terni Societa per l'Industria e l'Elettricita*, the greatest hydroelectric company etc. Especially the first company is a very interesting example because it was acquired by Courtaulds in 1927; 1920s was an extremely productive decade for the company, (see Cerretano, 2004; 2012; Varian, 2020). Indeed, in the sample, there are 11 holdings of this Italian firm, all of them in 1928 and 30 more for Courtaulds. Discussions about the investment prospects in these industries arose in discussions later in the 20s (Mercer, 1926). Again, in 1926, there were attempts at stabilizing the Italian lira and regulation in the banking sector (Toniolo, 1995); this stabilization process was an additional pledge to secure for the ITCs' interests. Furthermore, to strengthen their Italian securities, ITCs preferred especially those denominated not in the local currency, obviously because of the fear of the steep and sudden oscillations of the Italian currency.

These examples of European industry reveal also concealed opportunities for the ITCs. The European industries had to tackle high inflationary pressures as part of their national economies. Thus, problems for their funding and imports emerged. However, this inflation revealed opportunities, such as the debt forgiveness and the curtailment of their values. This was a good time for British finance to intervene and fund the European industries and for the British manufacturing to merge or acquire these companies. This could be a win-win solution, increasing their production and seizing the competitive prices' advantage, according to *The Economist* (1925). The ITCs seemed to be involved indirectly, investing in these holdings of merged European enterprises.

All in all, high inflation was not always a barrier for British investors to invest in holdings (eventually in economies) with monetary imbalances. Besides, the endeavour of the governments to balance prices and production levels was a high-risk venture. On the other side, the managerial policies of the ITCs were wise enough to foresee emerging holdings under these policies. As for the political unrest at that time, there were concerned about future financial problems that could be provoked. It seems from the discussions of the period that any political solution which could pledge the security of their investments was welcomed. In the end, social peace together with interesting financial returns was the solid basis for their incentives to enter

the specific markets. A few ITCs did risk including holdings from these countries in their portfolios but covered them under the safety of the anchor currencies (GBP or USD).

9.6 Local Stock Exchanges improvement

During the mid-1920s a monetary stabilization process was being followed across all the European countries. High inflation was moderated, central banks were inaugurated, fiscal deficits were abated, and huge amounts of capital flowed into many peripheral countries, (see Kindleberger, 1973; Aldcroft, 1977). This, together with the reconstruction policies resulted in the invigoration of the European Stock Exchanges. Here, it presents several cases of European stock markets that had attracted British investors, delineating the new circumstances which had to be solved by the ITCs to continue and protect their investments. These cases are Sweden, Italy, Czechoslovakia, and Hungary. Among them, they were mainly peripheral European countries which did not have robust economies and suffered many problems in the past, for the European periphery, (see Aldcroft, 2006). However, the promising growth rates, the technological development and the laborious efforts they made to balance their fiscal and monetary economics resulted in an expression of interest on behalf of the ITCs. This paradigm shift for the ITCs led to new challenges. These markets did not have identical rules, they did not follow the same norms as the LSE plus the existence of the exchange foreign risk. Despite the problems they faced, it seems that the ITCs took the risk to invest in these markets, carving a new strategic path in their asset management.

The first case is Sweden. Generally speaking, Scandinavia, which had been composed of less developed economies, was gradually transformed into a promising field of investments. Characteristically, it was argued that: “Sweden is a European country which can be regarded as thoroughly sound it every way. Not only does it possess a stable Government and an appreciated currency- a thing rare in these days- but she has considerable industrial wealth” (Marlow, 1923). This picture described not only a good financial choice, but also a flourishing economy. The country’s GDP pc had started at $3,077 before the war, finished at $3,885, with a growth rate of 3.29 percent for the post-war period.

Whereas the exposure of the ITCs portfolios in these countries was insignificant in 1920, it expanded in the next observation (1924), moving from one-digit number to almost 50 holdings in governmental stocks and, in Sweden, in manufacturing). By 1928, the figure was almost double! Sweden was the first country to peg its currency, see Table 8.4, which can be

considered as a guarantee of financial stability. Despite the overall improvement there, the ITCs' interest was monopolized by one leading industry, namely the *Swedish Match Co.*

Again, another interesting example of a company's evolution in time. In 1925, the company had such a success with the British investors, that a meeting was arranged with the company's managing director in London. In this event, this company had existed and been developed in an extensive merger with previous smaller Swedish match companies, creating a monopoly in 1913. This sector, also, was peculiar in that several countries had raised huge tariff barriers. Thus, for the company to tackle this problem, it had to establish an international network through FDI. This process required funding; hence, the raising of new capital through new shares in the foreign markets. Again, new problems arose because the company had to be kept under Swedish control. So, new financial products needed to be introduced; "B" shares were the result. Indeed, more than 50 percent of the holdings of this sample are this type of share (*FT*, 21/05/1925, p. 2).

Behind these developments, of crucial importance was the attempt of many Swedish industrial shares to be traded in other countries' stock exchanges, among them, obviously, London (Lofgren, 1928, p. 13; see also the *London Stock Exchange Yearbook 1928* which mentioned the parallel stock market trading). However, not all investors embraced this positive position, i.e., it was argued that "to suggest that they should, at any rate, not be overlooked when the investor feels that the time has come to broaden his field of selection" (Taylor Smith, 1926, p. 63).

Italy was a second characteristic example. In the case of Italian shares, the acquisition process was different from the UK paradigm. First, in a peripheral economy like Italy, internal information asymmetry was the norm. This drawback could be outstripped using the necessary internal information (knowing someone from Italy) or the usage of a notary. Second,

> "The ways of the Italian stockbrokers are not our ways; the official bourses - even under their new and much abbreviated methods – afford no sufficient protection to investors, as does for example the London Stock Exchange; while the involved and tedious procedure of Italian civil courts whenever there is before them a case involving the holding, buying, selling, registering, transfer or forfeiture of securities- and particularly if the suitor be a foreigner – are a constant open trap for the unwary. Compliance- to the best of one's ability – with the numerous and sometimes

> contradictory regulations laid down may be perfectly well intended; and yet the result may fall far below the point of perfection" (Caractacus, 1927, p. 31).

This is a very important comment. It elucidates how the Italian Stock Exchange operated. It also delineates the difficulties a prospective investor may face in the case of selecting an Italian asset, implying, in parallel, the ITCs' connections with Italian financial advisors or their expeditions to Italy to register for these transactions. Finally, and most importantly, as has already been mentioned, the law plays a significant role in the evolution of financial institutions.

Czechoslovakia was a Central European country, which seemed to have gained its good economic position earlier than its neighbours.

> "Czechoslovakia is almost the only new state in Central Europe worth considering from the point of view of the investor. This country has from its creation followed out a consistently sound and honest financial policy. Whereas its neighbours have continued to inflate their currencies and pile up debt, Czechoslovakia has steadily avoided these pitfalls and her population had settled down to hard work and economy. The country itself has valuable mineral resources, and considerable industrial development; it is possessed of a stable and honest government, and its progress has been most striking. Today it is certainly the healthiest, financially, country in Central Europe" (Marlow, 1923, p. 10).

Its GDP pc was $2,096 in 1913 and then it fell to $1,933 in 1920, finishing at $2,977 in 1928; despite the lack of information, the average annual growth rate for the period 1921-1928 was approximately 5.68 percent. The then new government bond *Czechoslovakia Sterling bond 8%* (1922) with a price at 95 has been discussed in financial press. Looking carefully at the sample, 30 securities from this country appeared in 1924, eight of them concerned that sovereign bond. Another 30 observations were presented in 1928 divided between the government bonds and the company-*symbol* of the country, *Skoda Works*. The development of the local stock exchange was also remarkable (in 1926 the total turnover for the year was half a billion crowns that proliferated reaching 15 bl crowns one year later (Bark, 1928, p. 45).

Another interesting case is Hungary. Apart from the Hungarian government bonds, which have already been mentioned, numerous manufacturing companies were added, many of them issuing shares in the local currency, the pengo, only recently established in 1927. The Hungarian stock exchange also played a significant role. "A good sign is the steady working

of the Hungarian Stock Exchange which has attracted the notice of the foreign capitalists. Efforts are being made to have the principal standards stocks quoted to the large European exchanges and, if they are successful, it will be another indication of confidence in the position of the country" (Mercer, 1927, p. 90). This, combined with the situation in Czechoslovakia, presented a clear trend of improving the functioning of exchange stocks in peripheral European countries, reflecting an indication of their financial maturity, something noticeable to the ITCs management.

To conclude, in the mid-1920s many peripheral European stock markets seemed to be strengthened, as a result of the general economic boom. These new markets soon attracted foreign capital by offering great financial choices. Moreover, different networks appeared offering relationships with the main European markets, mainly London. The ITCs actively participated in this process. However, the new markets did not follow the basic principles of the LSE. Many national institutions (legal systems, governments) systematically intervened, using different socio-economic norms. This was a completely new financial channel, introduced by the ITCs. A new active management policy emerged for them, framing a financial novelty, without uprooting the basic principles of their management policies.

9.7 Conclusion

This Chapter is indicative not only for the main research question of this thesis, but also for the one about the interaction of the ITCs with the society. Europe was a multifaceted *Janus* for the whole interwar period, economically, socially and politically. Economically and infrastructurally destroyed, socially impoverished, financially indebted, politically divided by WWI, Europe remained an unattractive option for the extremely careful ITCs which focused on the security of their holdings by the early 1920s. The main problems that emerged; namely, hyperinflation, economic destruction, and social upheaval had to be overcome before the foreign investors would become more positive towards the European capital markets.

WWI bequeathed all the European countries with extremely high price levels. Sober fiscal and monetary policies were needed to cooperatively restrain the inflationary tendencies. International organizations were established, providing the states with monetary and fiscal advice and supervising their implementations. So, gradually many peripheral countries, such as Greece, Hungary, Czechoslovakia etc. tried to manage, under *draconian measures*, their fiscal positions and under the auspices of the international community (LoN), they became, again, attractive. Evidently, different deflationary policies were performed, intertwined, also,

with the political cycles. Additionally, reconstruction programmes were inaugurated, to rectify the economic problems, the characteristic example here is Germany which, under the Treaties and the Dawes Plan had, at least temporarily, succeeded in attracting the inflow of significant amounts of money, boosting its production, and becoming an attractive destination for investment. Europe's share in the ITCs portfolios sextupled; in 1914 one out of 50 pounds was invested in Europe while in 1928, ⅛ of the total investments were in this continent.

Interwar investors were highly interested in the political dimension of their investments. Numerous discussions about the political conditions in Europe and beyond appeared in the financial press commenting and declaring explicitly their preferences regarding various foreign affairs. Liberal democracy seemed not to be a prerequisite for sound investments. Investors were desperately interested in the stability they needed to continue their financial transactions. The crucial question was, who would do the job? Any regime which would pledge not to jeopardize their claims, either democratically elected or autocratically imposed, was *praised with the timbrel and dance*. Only one dictatorship was abhorrent, the dictatorship of the proletariat.

This has led the ITCs to follow active management strategies, the main research question of this thesis, changing their asset allocation with new holdings and reacting to the dramatic changes in the European market. They did not hesitate to implement two radical policies as this sample shows. First, it signifies the emergence of holdings in local currencies. Second, the stabilization programmes and the appearance of a group of peripheral stock exchanges shifted ITCs boards towards these markets appears. A climate of euphoria was felt in London's capital markets. Despite the differences in these stock exchanges and the impartial protection the offered to the investor, they attracted foreign investors, the ITCs included. This was "nothing less than a miracle" according to the former British Chancellor of the Exchequer, Phillip Snowden (Snowden, 1927, p. 10) in *Financial Times*.

10 UK investments in the 1920s. The ITCs' reply to the social and economic challenges of a New Era.

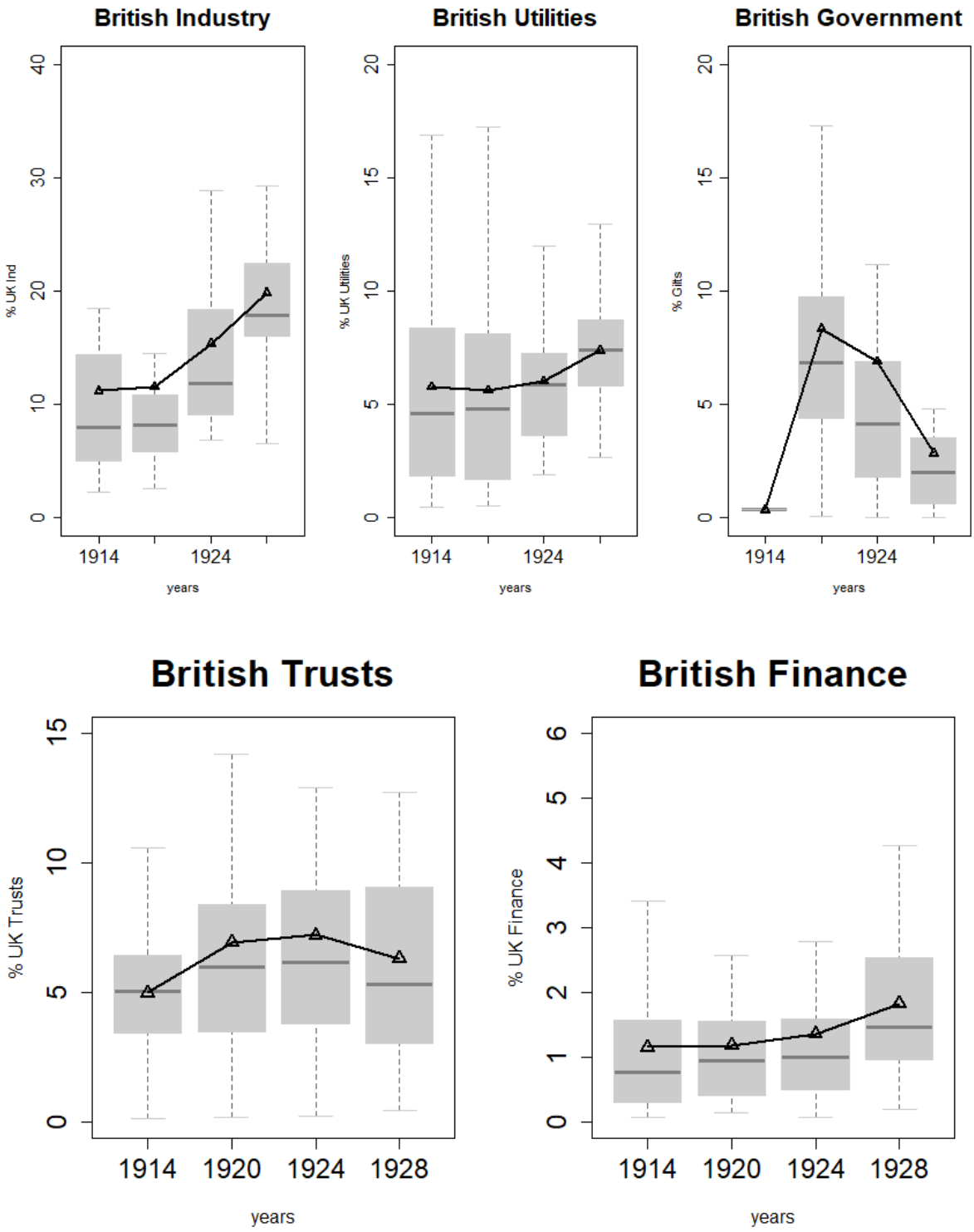
10.1 Introduction

This Chapter discusses the British investments of the ITCs in the period 1914-1928. British ITCs followed a global diversification process, as already mentioned by all the previous literature, this research included. However, rarely has the role of their domestic investments been discussed. Despite the significant number of British securities, they contained in their portfolio -one out of five pounds has been invested inside the UK since the early 20th century, according to the literature, (see Burton & Corner, 1968; Cassis, 1990; Sotiropoulos et al., 2020), it would seem as if the British ITCs had no interest in British investment. In this Chapter, this gap in the literature will be bridged by examining the domestic investments of the ITCs during 1914-1928. The first question which will be answered is the asset management of the ITCs as interpreted in their domestic market exposure and second the qualitatively new data in the British financial market discovering the reasons for the Industrial sector's dominance in the ITCs portfolios and the emergence of new industries, especially in consumer durables and in other newly founded industries like the film industry.

Britain was an advanced economy since the 19th century, see Chapter 2. Although the dynamism of the economy declined after the late 19th century, it remained a robust economy, technologically advanced and financially dominant. The annual average economic growth rate of the British economy for the first two decades of the 20th century was 0.73 percent. Its GDP pc reached $4,921 in 1913; however, the outbreak of the war curtailed the British national product at $4,548. In the aftermath of the war, there were initial signs of recovery (1919-1920); however, the worldwide slump led the British economy into depression. Its growth rate increased again after 1922 (it had lost almost 20 percent of its income for the period 1919-1921) and reached a peak at $5,357 in 1928, see Table 9.1. For the same period, its population grew at a moderate pace, starting at 0.8 percent for the pre-war period, falling to 0.4 percent during the war and finished by falling further to 0.2 percent for the next period, see also Feinstein (1995). For the British economy during the interwar period, (see Aldcroft & Richardson, 1969; Boadberry, 1986; O'Brien, 1987; Floud & Jonson, 2004).

Since the early 20th century British investments have totalled one-fifth of ITCs portfolios. In 1914, the third biggest geographical destination of the British ITCs portfolios was the UK (24.3 percent). Table 9.2 and Figure 9.1 depict the British asset allocation for the period 1914-1928.

Figure 10.1 ITCs portfolio main sectoral allocation in the UK (percent of portfolio nominal value)



Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

At the outbreak of WWI, 11 percent of the total portfolio lists (on average in nominal values) were in British Industrial and commercial assets, followed by utilities and trusts, which aggregated 5 percent each. The financial sector together with railways and government bonds, were underrepresented, with less than 2 percent. Characteristically, the latter[81] represented only 0.3 percent of the total. Their yields were too low for the ITCs. Also, their falling prices and interest rates, which had been presented since the Great Depression, continued to discourage professional managers from investing in these holdings. Indeed, a consol with a yield of 2.5 percent was quite unattractive, compared to a 4.5 percent bond of an Argentinian railway or a well-established American Railroad.

For a discussion about the pre-war UK National Debt, see among others, Harley (1976); also, for a comparison between the British and the foreign investments (see Edelstein, 1982; Sotiropoulos & Rutterford, 2018). About the risk of foreign investments, (see Flandreau, 2013). Moreover, a not so prolific investment was the British railway. Here the fixed interest payments were at a higher level (4-5 percent) but they offered a very low or even negative yield. The profitability of the British railways has been thoroughly discussed, (Aldcroft, 1968; Irving, 1978; Gourvish, 1980; Crafts et al., 2008; Mitchell et al., 2011). No matter the exact return and management of the sector, they unanimously agreed about the gradual decline of their profitability in time and the concomitant consequences it had in their equity. During WWI, the British railways were nationalised, and their re-privatized in 1921 but remaining under national regulation. In the meantime, they had to compete with road haulage, (see Scott, 2002b).

Table 10.1 Economic and social indices for the UK, for the period 1901-1928

	1901-1913	**1914-1918**	**1920-1928**
Economic growth rate (%)	0.73	-1.32	1.16
	1913	**1920**	**1928**
GDP pc ($)	4,921	4,548	5,357
Population growth rate (%)	0.8	-	-0.21

Notes: The growth rates have been calculated as the average annual rate of change (ROC) for the period under study as $\rho = (\Omega - \mathrm{A})/\mathrm{A}$, where Ω is the final observation and A the initial one.

Source: Author' s computations. Maddison Database (2010).

[81] Gilts are the government bonds of the UK, broadly defined.

Table 10.2 British allocation (percent of portfolio nominal values)

		1914	1920	1924	1928
UK	Observations	24	30	30	33
	Average (%)	24.29	34.37	36.48	38.26

Notes: The observations count the number of ITCs which appear for each year; the averages count the % nominal value of the ITCs portfolio lists which has been invested in the UK. The average value has been aggregated at the level of the portfolios.

Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

The British ICA attracted the ITCs most. Across the timeline (1914- 1928), more than 10 percent of the total holdings came from the British ICA, coming third in the ranking system behind the Latin American and the US railways. Additionally, investments in this sector gradually increased during the next period, especially after 1924. Two other sectors which had a persistent and significant presence were utilities and trusts, with approximately 5 percent each, for the period under study. As for the British sovereign debt, its low level was disrupted by the outcome of WWI, with a spike appearing in 1920, although the ITCs returned gradually to their pre-war levels, as shown in the following observations (1924, 1928). Finally, the financial sector was underrepresented for the whole period.

What were the reasons behind this evolution? This Chapter argues that they were multidimensional; not only political (e.g., the state intervention during the war, see Chapter 7) but also financial, economic, and social. "In the UK the first world war marked a watershed in economic and business development as well as a political and social life" (Hannah, 1983, p. 26). At the end of the war, Britain was a different country economically, financially and socially; of course, it was not the only one, as has already been described. Financially speaking, the country had been transformed into a net borrower. The British market had been glutted with *victory bonds*, (see Chapter 4; Morgan, 1954). This issuance of this plethora of bonds, because of the law of supply and demand, resulted in a fall in the prices of the fixed-income securities. For this reason, the Treasury had imposed restrictions in the foreign debentures (Atkin, 1970), see also Chapter 5. All these temporary changes had little effect on the ITCs, whose managers were extremely careful and frugal in their portfolio changes. This is the reason behind the soaring government bonds in 1920, which was only a temporary spike, which vanished in the mid-1920s. According to the data, the ITCs directors quickly chose to withdraw from this sector. First, these securities had not been acquired in the free market but through direct state intervention and second, the market after WWI was much more open with more financial opportunities, (see Levington, 1921; Campbell et al., 2021). Thus, the ITCs could find alternative investments with higher prospects both domestically and internationally. In the

British market, they took full advantage of the various ICA securities which were abundant in the LSE, gaining from the high demand for consumer durables. In parallel, the developed local networks of regional markets like the breweries along with the internal information offered satisfactory alternatives for their capital.

So, this Chapter shows the following. First the appearance of the Government bonds in the ITCs portfolios (section 10.2) due to the direct state intervention during WWI which temporarily deviated from their "diversification rule". Second, the Industrial sector's dominance in British ITCs due to the opportunities that arose in the new "rational" British economy focusing on the case of the British Breweries (section 10.3). Finally, it scrutinizes the emergence of new industries, especially in consumer durables and in other newly founded industries like the film industry (section 10.4). All these delineates the general asset management strategies ITCs have followed, viz., the combination of active and passive management without changing their main purpose for diversification.

10.2 The rise and fall of the British Government Bonds

Both historically and theoretically, government bonds offer the safest financial alternative for a typical investor. For the whole of the 19th century and the pre-WWI period, the British government bonds were the largest part of the British financial market of that period, (see Klovland, 1994; Odlyzko, 2017). However, it has been unanimously supported, that during the late 19th century, their returns decreased, see Chapter 2. Thus, the ITCs were reluctant to acquire these holdings, as it seems clear from their portfolios. Indeed, in 1914, just at the outbreak of WWI only one subscription to a British government bond appears in the ITCs portfolio.

WWI affected on an unprecedented scale this financial market, having an inevitable impact on the ITCs' strategies. They followed the mobilization securities' project which had been imposed by the British government, see Chapter 4 and 7, exchanging their foreign currency's holdings, mainly dollar based, for government bonds, (see Atkin, 1970).

Nevertheless, the situation was temporary as Figure 9.1 depicts. This sample is composed of only 194 holdings of gilts, see Table 9.4. In 1914, all but one of them were absent from the list. In 1920, 106 were present. Additionally, these securities were included in 24 out of 30 ITCs which compose the sample. Thus, 80 percent of the firms in it seemed to have followed the

rules of the government, replacing their US holdings with British government bonds.[82] Moreover, this was one of the few cases in which the canon of high diversification process was suspended. More specifically, as already mentioned in Chapter 4, these 100 holdings were large compared to the rest of the sample. Tables 9.3 and 9.4 describe this situation. The average gilt value was tenfold more than the average holding of the total portfolios (£61,000 versus £6,000, see Table 9.4). Besides, the average ITC in 1920 held 8 percent of its portfolio in British government bonds, expressed as an amount of £260,000 as Figure 7.1 shows, see also Table 9.4.[83]

Table 10.3 British Government Bonds allocation

A. British Government bonds' value (expressed in £ 100,000)								
Year	**Observations**	**Mean**	**Median**	**St. Dev.**	**Min**	**Q_1**	**Q_3**	**Max**
1914	1	0.20	0.20	NA	0.20	0.20	0.20	0.20
1920	24	2.59	1.48	3.61	0.01	0.45	2.76	13.48
1924	22	2.12	0.57	3.68	0.01	0.15	2.12	13.40
1928	10	1.10	0.45	1.46	0.01	0.06	1.84	4.00
B. British Government bonds' weight (% of portfolio nominal value)								
Year	**Observations**	**Mean**	**Median**	**St. Dev**	**Min**	**Q_1**	**Q_3**	**Max**
1914	1	0.34	0.34	NA	0.34	0.34	0.34	0.34
1920	24	8.33	6.84	6.20	0.08	4.50	9.23	23.76
1924	22	6.89	4.16	8.19	0.03	1.83	6.89	29.81
1928	10	3.10	2.39	3.35	0.03	0.90	3.76	11.61

Notes: The upper subset measures the descriptive statistics of the British government bonds' value as a portfolio's ratio expressed in hundreds of thousands of pounds. The lower subset measures the descriptive statistics of the British government bonds' weight in the portfolio's level.
Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

Table 10.4 British Government Bonds allocation (in pounds per holding)

	Observations	**Mean**	**Median**	**St. Dev**	**Min**	**Q_1**	**Q_3**	**Max**
Gilts	194	61,794	20,000	119,295	140	5,000	50,000	1,000,000
Total	40,875	6,198	3,100	14,900	10.28	1,500	6,500	1,000,000

Notes: In this Table no aggregation has taken place, so these are unweighted descriptive statistics. In the case of the total holdings the minimum price has been set as higher than 10 £. 24 observations have been removed.
Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

This situation, as Figure 9.1 shows, was temporary; The number of Government bonds fell in the following year (1924), reaching 70 holdings, indicating a tendency of the ITCs to be absolved from them. Furthermore, their values' size gradually moderated, falling from the £260,000 to £210,0000, a significant curtailment of 20 percent. This tendency was reflected on

[82] Of course, this was the first reason; there was a second one, namely the trade of American holdings taking full advantage of the high devaluation of the GBP, see Chapter 7.
[83] To give just one characteristic example of this anomaly, in 1920, the ITCs held, cumulatively, 100 holdings of British government bonds which represented 8 percent of their nominal value on average, while in the same year, they held more than 1,000 Argentinian holdings, representing the15 percent (double that of the British securities) of the nominal value of the average portfolio.

the broader process among the various types of holdings. In the meanwhile, the government bond market did not remain static. This market reacted to various other markets like the monetary (interest rate) and the other financial markets as well as the applied economic policy in general. In 1922, the attempt by the BoE to reduce its interest rate was successful. By then, because of the increased demand for money, the investors were reluctant to hold their old bonds, shifting to newer fixed interest rate assets which were being issued with high interest rates to appear more attractive (Morgan, 1952).[84] Furthermore, the high inflation of the years, 1915-1920, had resulted in the poor performance of these fixed-income assets, see Chapter 4. After the short boom in the aftermath of the war, 1919-1920, a period of depression followed during 1920-1922. The -maybe lagged- reaction of BoE was to reduce the central bank interest rate consecutively, from 5 percent in 1921 to 3 percent the next year (Morgan, 1952; Thomas & Dimsdale, 2016). This shocked all the participants, both the issuers of debentures, and the financial investors, leading to the former to reduce the interest rates of their own holdings, exercising, mainly, their right on their redeemable bonds to exchange them with newer ones, gaining from the new competitive conditions. As a result, the latter were in a dilemma; should they keep their stocks, knowing that in a possible redemption they would lose because of their above par bonds, or should they change their stocks to shares and other debentures, even at a loss, anticipating a prospective better yield (Taylor Smith, 1922)? There were various reactions to this. The immediate one was to move towards preference shares. Some big investors, following the market, shifted towards short-run notes or preferred to leave their money idle, waiting for better conditions. However, these were extremely risky actions, highly criticized by advisors (Taylor Smith, 1922; 1923b), for this see the extensive discussion in Chapter 4.

The ITCs actively participated in this process. The Chairman of the *Mercantile Investment and General Trust* was extremely cautious in his announcement:

> "if the resources of a company at the end of the war were already locked up in pre-war securities … to take advantage of post war rates by bringing in new money or by selling existing pre-war investments. The latter was not an easy operation. The causes which had created higher post war rates depreciated the value of existing securities, so that if you sold the latter the reduced price you obtained, reinvested at the higher rates, might leave pretty much the same as you were" (*FT*, 23/02/1927, p. 2).

[84] The central bank interest rate works as a benchmark for the economy. For the period 1919- 1920 the BoE raised the interest rate to the range of 6 to 7 percent. Thus, the new bonds which had been issued at that time had to offer competitive yields to attract potential investors.

He continued, referring to the ITC's tactics for success, which were a) the existence of cash which had been properly invested in the aftermath of the war; b) the gains of the US denominated investment sales; c) the gains from the Argentinian and Mexican investments; and d) the gains from the securities of other ITCs. This is an explanation based on a highly sophisticated management. As Table 7.3 depicts, one of the main type of securities which the ITCs tried to remove from their portfolio were the British government bonds which were gradually sold off.

And what were the main alternative solutions for the money which had been released from the British government bonds? Certainly, one can support many solutions, as all the previous Chapters describe, however, one of them was the newly established British securities which flooded the LSE during the same period. This sparked long discussions about the preferable asset allocation in the British (and global) financial markets of the time, as Chapter 4 presents.

The last year of the sample (1928), although the UK holdings seemed slightly strengthened, accounting for the 38 percent of the sample, British government bonds had vanished from the sample. One out of three ITCs had held these holdings in their portfolios (only 20 have remained, an 80 percent loss) which had a much lower value (the average value was £110,000, lower than half of 1920, but much higher than the average holding of the total sample). As has been argued, the previous years had witnessed many events at both the international and the domestic level. In the financial sector, a lot of new issues of shares had appeared in the LSE.

New companies had been trying to lure prospective investors to prefer their assets. Part of the enterprise profits was distributed with new bonus issues of shares. More than 170 holdings in the food industry were present, indicating the shift towards the mass consumption practiced by British society. Chemicals were positive, with slightly fewer than 300 holdings, while engineering secured its position. Automobiles reached 100, and the printing sector doubled. A new addition to the picture was the appearance of the new means of entertainment, namely *cinema*. 70 new holdings worthily represented the seventh art production and distribution process as a promising new sector; a sign that the ITCs were extremely familiar with the idea of grasping opportunities for investing in pioneering sectors. Following the boom of the financial sector, the ITCs shifted towards the shares (the ordinary shares had been raised by 1.5 percent, the preferred ones by 4 percent while debentures were curtailed by 4 percent. These main tendencies will be analysed below.

10.3 The case of the British industrial sector

The industrial sector, as mentioned, was steadily of great interest to the ITCs. The reasons for this are various; among others were the existence of a mature stock market which could offer alternatives to any potential investor- here the LSE- and the development of enterprises, this goes back to the Industrial Revolution, see Chapter 2, which now used extensively the stock market for their funding purposes and for making financial profits (capital gains and dividend growth). Nevertheless, at the same time, the structural changes inside the British economy started to modify the ITCs' preferences. The rationalization process of the British industry, see Hannah (1983), was met by the already sophisticated managerial process of the ITCs.

Traditionally, the British industries were small, usually under family control, with advanced local networks, working as their financiers and focused on the production of staple materials for the colonies, see Chapter 2. During the war, many of these companies worked for the war economy. However, the conditions changed after the Armistice. Processes that had already started at the end of the previous century were completed now. The owners, members of the same family, could probably manage a small local and practically monopolized firm in a good way, but this was completely dysfunctional in the new era. Here, the debate of the "divorce" of the ownership from control arises. See, for a first approach Payne (1967), who analysed the managerial, organizational and sociological problems which had been caused by the growth process of the British enterprises.

A similar process occurred that period, broadly speaking, also in the USA, which had maintained their own characteristics. See the pioneering work of Berle and Means (1932). This opened a huge debate about the comparisons between the UK and the USA paradigm, (see Davis, 1966; Cheffins & Bank, 2009). The latter was a reply to the work of Hannah (2007) about the superiority of British corporate governance. It seems that it is an ongoing debate; however, this goes beyond the scope of this research, see also Foreman-Peck and Hannah (2013). Hannah (1983; 2007) replied, arguing for the early transformation of British corporate governance. According to him, the already established tendency of the owning families to sell their part of the company to the stock market than preserve it, meant a shift towards a divorce of the ownership of the company from management. The industrialists preferred to become *rentiers* and through owning a diversified portfolio sought to raise their profitability, and reduce taxation (Hannah, 1983, p. 57; Cheffins, 2003). In the aftermath of WWI: "there was a tax bias in favour of retained earnings and to address the discrepancy the government introduced corrective measures that created incentives for private companies to obtain a stock

exchange listing, a steppingstone to ownership dispersion" Cheffins (2008, p. 259). Moreover, the dominant doctrine of *laissez-faire* left little room for government intervention (which had been implemented during the war). To all these, must be added the problem (at least for the companies) of the radicalization of the working class, and the problem of high and persistent, for the first time, unemployment, (see Tomlinson, 1981; Pelling, 1992; Hatton (2004).

The only response to the new conditions for the companies if they wished to stay alive was to cooperate, to merge, to create larger-scale enterprises and to diversify their products; plus, the need for professional management. This is known as the *rationalization* movement, "a defensive reaction to the challenge to the existing structure of power and ownership in industry" (Hannah, 1983, p. 33).

Although there are various approaches concerning the evolutionary process of this "divorce", including the managerial problems, the corporate governance, the nature, size and timeline of the British enterprises, British industry practically adopted a model already embedded in the ITCs, rationalization. In other words, this was the basic philosophy behind these institutions. Discussions like these were common inside the ITCs' circles. See, among others, a discussion in an annual meeting of the *Investment Trust Corporation,* reflecting its vision of the country's economic future. "But even lower wages and greater production are not enough unless combined with the highest efficiency from the capital and managerial end" (*FT*, 7/6/1921, p. 2). Issues such as technological innovation, pioneer management, and competitive wages were mentioned.

Focusing on the results of our sample, all these changes in the British manufacture, were realized by the ITCs, which gradually took the risk to invest in them. In 1920 this evolution was in progress. The first difference can be confirmed from the ITCs sample, at least qualitatively. Companies such as *Armstrong (Sir W.G.) Whitworth & Co., Ld*. or *Dunlop Rubber Co. Ltd or Birmingham Small Arms Company, Ld.* increased their presence. Equally important was the fact that almost 40 holdings in the automobile sector emerged. Finally, the chemical and cement companies increased from 35 to 80, more than double.

The ITCs seem to have participated in a way in the transformation process of British industry. An example was the *Imperial Chemical Companies* (ICI). ICI was a part of the preceding process of the reorganization of the old-fashioned, family-owned British companies. This process had matured through the merger of previous companies in the chemical sector. More specifically, four companies - *British Dyestuffs Corporation, United Alkali Co, Nobel*

industries and *Brunner Mond and Co.* had participated in this merger in 1926. In 1924, the last year before the merger, more than 70 assets from these four companies were in this sample. The next year (1928), the first following the merger, there are more than 120 holdings of ICI, indicating the dynamics of this process.[85] Another case was the company *Sir W.G. Armstrong Whitworth and Co.*, an important British engineering company with 120 holdings in the sample. Their historic evolution was more complex than it might seem. The end of the war had led to excessive optimism. It was argued that: "a New Industrial Revolution which is likely to have far greater results for good than the introduction of machinery 130 years ago" (cited in Hannah, 1983 p. 29) was to be expected. The evolutionary process of the British industry was present in various financial fora. The headline of Financial Times in 1925 presented the situation as: "Industry future. Old Methods must be discarded" (*FT*, 1/9/1925), in which two issues were argued to be of utmost importance, namely the standardization and the simplification processes for British industry.

However, the conditions of the industrial enterprises were far from rosy. In the period under study, new problems emerged not only because of oscillations in trade, but also because of the difficulties in adaptation in the new post-war area. These problems affected the balance sheets of the companies and their stock valuation. *Vickers* e. g. decided to write down a large part of their balance sheet assets (Fleming, 1925). It should be noted that this company is included in the sample, having more than 100 holdings.

Another problem for them for the period after 1925 was the restoration of the Gold Standard in the old parity, leading to revaluation and making the final product more expensive to sell abroad. This affected *Armstrong*[86] in same period. "All in chaos and the future in the hands of gods" (Gluckstein, 1926 p. 51) described, with a tone of pessimism, the situation for the shareholders. And he continued, wondering: "Will the reorganization of the capital be necessary?" (51), giving an affirmative answer saying that "New blood on the directorate, and a guarantee of efficiency in the future management are the common accompaniment corporate bodies in extremis…It is in the interest of everyone that there should be a steady flow of capital

[85] The difference becomes more important knowing that the sample comprised 30 firms in 1924 and 33 firms in 1928. The firms' number was practically the same, while the new firms were smaller in portfolio value, see Chapters 3 and 4.

[86] Indeed, checking these two companies for four years the impact in the stock prices is crucial: *Armstrong* Ordinary Share (£1): 1925 [11/6]; 1926 [1/4]; 1927 [3/16]; 1928 [5/32]; 3rd preference share 6 ½% non-cumulative (£1): 1925 [23/32]; 1926 [9/32]; 1927 [3/16]; 1928 [1/8]. For *Vickers*: Ordinary Share (£1): 1925 [18/32]; 1926 (6/8 from now on) [7/16]; 1927 [19/32]; 1928 [15/16]; preference share 5% cumulative (£1): 1925 [11/16]; 1926 [12/16]; 1927 [7/8]; 1928 [5/8]. In both cases the debentures are costing higher prices (almost 52 for the former and 95 for the latter. (IMM, 1925-1928, October).

into the joint-stock enterprise" (54). All in all, his answer covered the two main axes of the whole discussion namely management and financing through the stock market. The solution to these problems was the following: "The most hopeful strategy for large firms in the staple industries was to diversify into alternative products for which demand was growing and in which their existing financial, technical and managerial skills gave them a comparative advantage" (Hannah, 1983, p. 109). These policies led to the achievement of economies of scale, the reduction of competition, combination of synergies between complementarities, amelioration of R & D, the improvement of exports etc. (109-119). It seems from the result that the ITCs reserved their stocks in most cases being patient enough and participating, in parallel, in the process of the reorganization of the British economy.

The ITCs were already pioneers and could gain from these changes in the British economy. As the *Guardian Investment Trust* has explained:

> "but the investment art as applied by trust companies, has been developed so scientifically that I feel hopeful that we may in the forthcoming year be able still further to improve our position both as to revenue and as to capital value. The success of the trust investment companies depends largely on the experience and judgement of the management…the members of the Board have first-hand knowledge of all technical detail relating to the investments, as well as of the general principles on which the successful conduct of the business must be founded. *(FT,* 15/02/1924, p. 2*)*

Additionally, the ITCs were not passive observers of the financial markets, calculating a risk and return trade-off for their portfolios. They were directed by active managerial teams which had expressed publicly their opinion about not only financial but also economic, political, and social issues. This was the canon, as it has been shown in the previous chapters on the cases of Latin America, Europe, mainly, and this one, as this thesis describes further below. Thus, the ITCs were not only interested in the developments of the structure of British enterprises, but also, they advocated for these policies. The *London and South American Investment Trust* annual meeting argued that: "For the moment the most urgent need is for increased and cheaper production, which can alone be secured by loyal cooperation between capitalist and labour interests." (*FT*, 28/04/1926, p. 4). So, it seems that during the period concerned, the ITCs and the British industrial companies' views converged regarding the processes which should be followed, technologically, efficiently, and managerially.

10.3.1 British Breweries

Figure 10.2 ITCs portfolio main sectoral allocation in the UK (percent of portfolio nominal value)

Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

An industry that was strongly represented in the sample was the breweries and distilleries, see Figure 9.2. The total sample for the period 1914-1928 consists of 41,000 observations, of which more than 3,000 were invested in breweries. From these holdings, the vast majority were held in the UK (2,500); for the whole period under study, the average ITC invested 5 percent of its portfolio's value in British breweries. Breweries have a long tradition in British society (see Gourvish & Wilson, 1994). This type of company, until the end of the 19th century was based on numerous family businesses, working on a regional basis supported by local networks. Despite going public in the 1880s, they maintained these characteristics. This means that the paid-up capital which had been issued was distributed predominantly among local stock exchanges or even privately. "Historians of brewing have tended to represent its management as conservative and secretive, one in which the drive to go public introduced virtually no change in ownership, structure and management" (Gourvish & Wilson, 1985, p. 156). This process was extremely risky, especially under poor management. However, it could provide alternative advantages, E.g., the conservative management possibly suited perfectly to the ITCs policies.

Searching in the whole sample in the specific sector, many British breweries emerge. Indicatively, there are companies such as *Wolverhampton & Dudley Breweries Ltd* with 50 holdings, which was a product of amalgamation in the early 1900s, *Rochdale & Manor Brewery Ltd* had another 40 holdings; this company had been registered in 1895. Then, *Samuel Allsopp & Sons Ltd* with another 50 holdings, which went bankrupt at the beginning of the 20th century and was restructured later (1911) and *Ind Coop and Co. Ltd* with 50 holdings which re-registered in 1912; these two companies finally merged in 1935. *Benskin's Watford Brewery Ltd* with 40 holdings moved on with multiple mergers, which was the same situation with *Marston, Thompson & Evershed Ltd* with 40 more holdings .[87] Thus, a reorganization trend was common from the beginning of the century. Such breweries were present in the ITCs lists, despite often being in the process of merging and acquisition. The existence of internal information seems to be unequivocal for the acquisition of their issued equity.

Both the LSE yearbook and the IMM containing long catalogues of Breweries verify this tendency.[88] Many Breweries have used provincial stock exchanges and others have issued non-public holdings which have been contained in the ITCs portfolios. So, the reasons why the ITCs maintained such a significant number of breweries holdings were, first, the existence of prudent management which they deeply appreciated and second, the existence of extensive local networks between the directors of the ITCs and the breweries sector executives, which were enough to shift their attention to these holdings.

Here, this thesis opens a parenthesis referring to a very fascinating episode which is extremely educative to modern finance, viz. the operation of the of the law of *laissez faire* in financial markets. As it is known, the main theories about financial markets have been built on the assumption that markets clear. However, this, in practice, has been disputed. Historically, there are episodes that confirm these disputes; one will be now presented. The sector which it studies can be used as an indicative example. The British breweries, despite their official listing in the LSE, and the rest of provincial stock exchanges, in practice, as it has been just mentioned, they were semi-private holdings. This was mainly based on the then common-sense that a) all the quoted stocks were negotiable, b) all it was always possible to deal based on quotations, c) the unquoted stocks were unsaleable and, d) the hallmark stocks were sound (Whorlow, 1922, pp. 46-47). However, "Innumerable instances could be of quoted securities which cannot be

[87] The majority of these are coming from the *Brewerypedia*, the database of the Brewery History Society. Available at: http://breweryhistory.com/wiki/index.php?title=Main_Page

[88] E.g., a typical volume of the IMM (05/1925) contained a three-page list registering Breweries, a list composed of more than 250 holdings.

bought", he continued, giving the example of an investor who wished to buy a brewery debenture. "He knew the brewery, its record and its price and yield on the stock being satisfactory, he gave a buying offer only to find that the debentures were unobtainable; they had not been dealt in for over two years, although they were religiously quoted in the official List day after day" (48). Rough research into the breweries can show that the notably lower prices of the holdings of these companies, was the first element to prove the difference between a selected and a non-selected category of assets (see IMM, 03/1914). Additionally, he referred to the case of the British corporations, among which, from the more than 200 holdings in the list, 50 percent were not negotiable. These are very good examples supporting the argument that the financial market, as any kind of market, must be considered to have realistic dimensions, which, many times, are more perplexing and multifactorial than the abstract models present. The final comment which correlates to the ITCs is that one must be extremely cautious with the bases she constructs, as in this case, because she knows which irregularities emerge in the calculation of these portfolios' nominal values.

10.4 The entrance of new industries into the ITCs' portfolios.

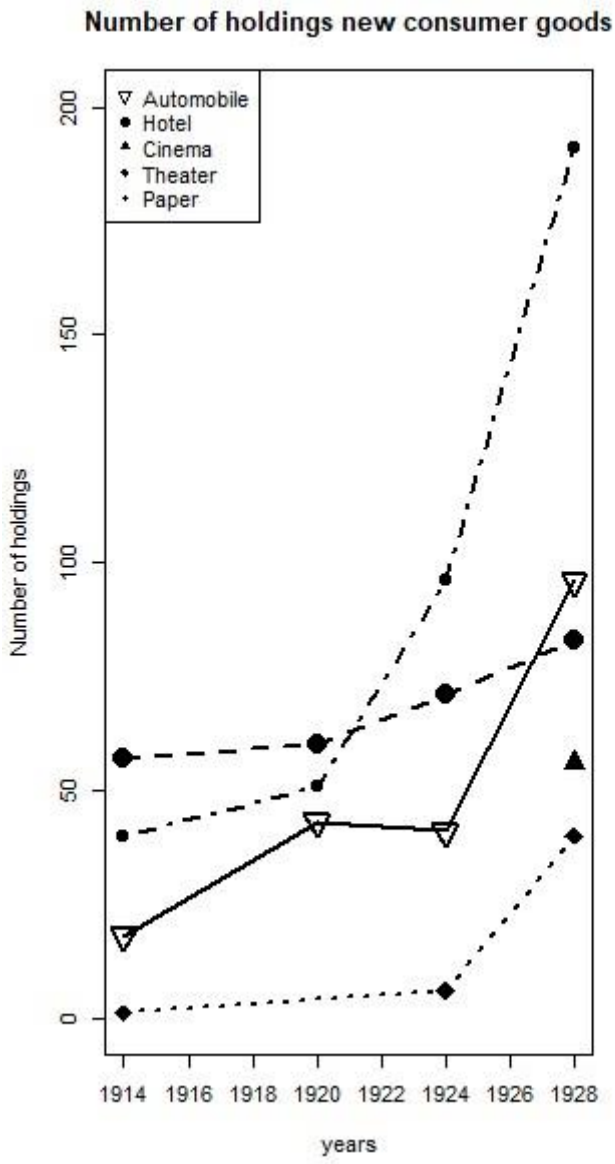
It has been mentioned that the changes in British society could be observed in the new kinds of companies that were being established. During the interwar period, a significant shift of British industry from the old model, based on the export of staple products, to a new paradigm of new, mainly domestic, capital intensive industries was observed, (see Aldcroft & Richardson, 1969; Magee, 2004; Bowden & Higgins, 2004).

Many new companies which produced consumer durables (mass produced manufactured goods, e.g., cars, electrical appliances, other consumer goods were visible in the sample), followed a tendency of augmenting lower-class consumption in both durable and consumable goods which had been produced more rationally, reducing their prices and making them affordable (Scott, 2017). The first household appliances were discreetly introduced, (see Bowden & Offer, 1994), changing completely the working conditions and the habits of wider social groups of British society, see e.g., the appearance of the radio industry, (Scott, 2012); all these changes affected the British family's working time at home and the development of mass leisure activities, (see Jones, 1986). The ITCs seemed to foresee a financial prospect in these new industries. Figure 9.3 depicts this tendency in the British economy. Here, it presents the

sectors of a) automobiles, b) hotels, c) cinema, d) theatre and e) paper.[89] As with any index, this cannot offer the whole range of information concerning the ITCs. Again, here this thesis prefers the representation of the number of observations instead of the sectoral allocation as a ratio of the total nominal value per trust. The reason for this is that this shift towards these sectors was a novel idea for that period. It would like more to focus on the qualitative change which was still negligible of the whole sample (50-100 observations in a sample of 10,000); however, there was a distinct tendency which implied a broad change of the whole society. Despite the disadvantages which arise from an unbalanced sample, it is indicative of the ascending tendency of these new, mass consumption products/services.

[89] Paper is used as an indication of many similar sub sectors; it is a combination of the sectors of printing, photography, publishing, newspapers, and paper and pulp production.

Figure 10.3 New British consumer goods' holdings (number per year for the total sample)



Source: Author' s computations. For 1914, it uses Sotiropoulos *et al.* (2020).

10.4.1 The case of the Film Industry.

One of these new industries was the Film industry. This sector appeared in the sample in 1928, see Figure 9.3, with 56 observations spread across 26 ITCs. The sector was a new one, focused on the general climate of mass consumption of consumer goods and services for extended sections of the British population. Even though the film industry was a British innovation, it confronted a serious competitor, the USA (for the huge expansion of the US cinema, (see Thompson, 1985; Sedgwick & Pokorny, 1998). "Perhaps the saddest reflection is that we were the pioneers of the moving picture. That it was something more than an attractive novelty which

would share the fate of all such innovations neither the showman nor the capitalist could be persuaded to believe. The rest of the story does not matter, because it is futile to hark back…Can the Film Industry in Great Britain be secured from its parlous plight?" (Martin, 1927, p. 39). So, what was the misguided part of the story, which goes beyond the intuition of the animal spirit, the *capitalist*? He replied: "As I previously remarked, if the economic aspect is of weight, there are other urgent considerations. Nothing can disguise that kinematography is the most powerful instrument of propaganda yet discovered".[90]

So, it seems that this British industry could not compete with the US one. Some reasons for this backwardness were: the magnitude of the market, the dearth of resource and the lack of capital: "Where we spend hundred for a single picture, they spend thousands…[t]he important consideration still remains, that there is the keenest competition from the super producer and that Hollywood enjoys the heaviest purchasing power…our productions are few and far between…the enormous American home market enables the latter to be sold here at a price with which the English production cannot compete" (Martin, 1927, pp. 40-41). Another problem for the British film industry was its inability to export to the US, see Sedgwick and Pokorny (2005); an exemption from this was the attempt of big companies like the Gaumont British which appears in the sample which controlled half of the film industrySo, why did the ITCs invest in such a market?

The first reason was that the sector remained a profitable one, being "by far, the most popular form of mass public entertainment" (Miskell, 2005, p. 433). Additionally, according to the conventional wisdom, when the private sector faces difficulties when investing in a particular industry necessary for society, the usual *Deus ex Machina* is direct intervention from the side of the state; in this case quotas were imposed in the number of the films which could be shown in the British cinemas. Despite the problems in the sphere of the production of films, the ITCs did not hesitate to invest both in the production and in the distribution of this industry. It has been argued that the state protection was beneficial for the sector creating new financial prospects. Even the earliest government intentions to impose protective legislation for the sector created financial expectations. "The measure of protection given to the British Film Industry [*Ed. N.* not the homonym organization that was established later] by the Bill which is shortly to pass into law has encouraged the formation of quite a number of companies engaged, or proposing to engage, in the actual production of cinematograph films within Great

[90] The first attempts at regulation in this sector can be seen during the interwar period, see Miskell (2005).

Britain…" (Fleming, 1928, p. 46)[91]. Because these were new types of companies, they used extensively financial attractions to get the public to invest in them. Specifically, they offered packages of preferred together with ordinary shares (usually at a lower price) "each entitled to the surplus of distributed profits and representing what is commonly known as 'the equity of the business'" (46-47). In the end, this practice has been characterised as extremely high risk. In research concerning the years of crisis (1931 and hereafter for the British case) these "new ventures" suffered severely, depreciating as much as 83 percent (Harris, 1933). The ITCs invested in the cinema industry and in theatre, respectively with 50 holdings each (usually indistinguishable, almost all in 1928). The question remains unsolved as to the consequences of the crisis on the ITCs investments related to these new sectors using such high-risk policies. For the American case it has been supported a similar trend, an upward movement up to the crash, then a fall and a rebound; however, the fall was not so dramatic as the rest of the economy (Sedgwick & Pokorny, 1998).

10.5 Conclusion

Britain had been a significant destination for ITCs investments since the beginning of their existence in the early 20th century. On the eve of WWI, one out of four pounds of ITCs investments was held inside the UK. WWI was a catalyst for the British economy *per se*. In the financial sector, the British government intervened heavily, absorbing the foreign currencies, mainly dollars, as securities for funding the huge war expenditures. The end of the war inaugurated a new period for the country. In the case of the ITCs, it left them with funds coming from the US market, raising the question about its new investing destination.

In the industrial sector, the conditions had already matured for a rationalization process of production. This forged the British companies' position, offering a new alternative for ITCs' investments. A flourishing financially period followed, of which they took full advantage. New industries emerged which raised many new equities for their funding process. The ITCs soon followed, with caution, this tendency to shift towards the more promising shares and leave old, fixed-income assets, gilts included behind. New sectors of durable consumer goods, mass production commodities and many newly founded plants were added to the ITCs' portfolios. Moreover, the ITCs' participated in the local financial networks, having invested generously in regional enterprises like the breweries. The UK, at this time, became the leading

[91] He speaks for the Cinematograph Films Act 1927, see Miskell (2005).

geographical destination of the ITCs. The UK is indicative for the asset management of the ITCs during the 1920s.

This case encompasses the general strategy ITCs followed. There is a combination of active and passive management. ITCs mangers acquired new holdings which could be found both in the LSE and in the local networks. However, they were extremely cautious picking more fixed income assets from established and reliable companies. For the whole period, it was clear, that, despite the financially blooming environment abroad, the national economy would always be a stable anchor for investments; the resemblance to our days is more than noticeable.

11 Conclusions

11.1 Synopsis

Portfolio selection is of great importance in modern financial theory and practice. Based on modern portfolio theory, it is widely used for maximising financial returns given the risk. Although its role is crucial for any investor, institutional investors exclusively base their strategies on this. And as the weight of institutional investors increases over time, asset management strategies play a much more significant role for international financial markets. Diversification is the key for a successful asset management. Although the proper mathematical techniques to prove it did not appear until the 1950s, the notion was already known since the end of the 19th century. Among the various institutional investors which applied this was the ITC.

Recently an increasing interest has been developing about the portfolio selection of institutional investors during the pre-WWI period. A much smaller debate has arisen about the ITCs asset management strategies. This debate argues that ITCs were at the forefront of the financial innovation. They applied professional management to secure their clients' funds maximising their returns. Diversification was of course of high importance, as their portfolios show. Their investments were global taking full advantage of the financial momentum, open markets, gold standard, limited state intervention, financial dominance among others.

The ITC as an innovative financial institution is perfectly intertwined with capitalism. It emanated from this economic system and, inevitably, it has interacted with it over time. The most crucial turning points in the history of capitalism can be seen in the ITCs evolutionary process. Even the fact that the UK was the cradle both of this institution and capitalism per se signifies the importance the former has to the passage of the system to a new stage. Since the late 19th century, a second much larger debate has arisen, the expansion of capital in an unprecedented way, surpassing national borders and occupying the greatest part of the globe. Huge global financial flows emerged. ITCs reaped the benefits of the economic, social and political conditions of this "first globalization era" maturing institutionally, applying advanced management strategies and maximizing their profitability in the long run through diversified portfolios and risk averse tactics.

According to the existing literature, ITCs followed mainly passive asset management which targeted established assets and markets following the market and focusing on a buy-and-hold

approach. At the same time the use of more active strategies has been tested; management has chosen uncorrelated assets to maximise their returns. However, WWI led to a rapid paradigm shift. A new world revealed at the aftermath of the war.

In the aftermath of the war, a New World arose. The previous Belle Époque became just a reminiscence, despite the agonized attempts to restore it. Now, the global economy, politics and society sailed in murky waters. The determinants of investments, viz., state non-intervention, stable monetary and fiscal regimes, social tranquillity, and uninterrupted international investments had been destroyed. How did the ITCs interact in this new Âge sombre? Have they followed the pre-WWI strategies? Was diversification still central for their policies? Existing literature has not discussed yet these topics.

This thesis endeavours to address the gap setting the following questions as raised in Chapter 1:

What were the asset management strategies for the British ITCs during the 1920s?

What were the main changes in their portfolios, and concomitantly their management strategies and what were the main causes for these?

What were the interaction of ITCs with societies?

To answer the first question, Chapter 3 builds a proper dataset including information from the ITCs portfolios for the period 1914-1928. It offers new data from the first decade after WWI. The Guildhall Library offers a full catalogue of annual reports of holding companies; this is the main archive which is used in this dataset. This Chapter deals with the various problems encountered during its construction: a) the identification procedure for the ITCs, b) the problem of representativeness and c) the holdings' valuation. It deals with issues as the recognition of the ITCs and it raise questions as the validity and credibility of the sample; finally, it tackles with the determination of the value of these holdings. To solve these problems, this Chapter uses both a statistical methodology and a historical explanation which conclude that no bias existed. ITCs portfolios contain the most information the researcher can find today, also these facts could be easily proven by all concerned during the examining period.

Then, from the existing material it constructs the three main variables which are used in this dissertation: a) the asset allocation, b) the geographical and c) the sectoral distribution of the various holdings. Again, various problems emerge. Finally, a representative and trustworthy dataset is ready to answer the main research question.

The average ITC was a company composed of a large portfolio list (350 holdings) which was worth about £2 million, totally diversified, with the average security costing £6,000, see Chapter 4. The ITCs' asset allocation was spread across the three dominant security types (fixed income, preferred and ordinary shares). During the examining period, debentures were the dominant security type which amounted to half of the total ITCs' value. Despite the managerial conservatism and the phenomenal stagnation in the size of the ITCs, ITCs were a promising enterprise. Although their average size has remained practically stable at a level of £ 1.7- 2 million for the period since the late 19th century, this institution was a successful one which had flourished using alternative paths like the usage of subsidiaries

The main determinants of the asset allocation evolution seem to have been the economic and political conditions in the UK and beyond. Because of WWI, the tax and inflationary shocks affected all the investors, the ITCs included as Chapter 5 describes. The latter were forced to contribute more to the unprecedented fiscal needs, making their effort for guaranteed interest payments extremely difficult. Additionally, the high inflationary pressures created problems regarding the redemption reactions and the issuance of new securities modifying qualitatively the ITCs portfolio lists. During the same period, a great debate arose about the usage of ordinary shares as a long-term investment. The ITCs seemed not to participate fully in this tendency; however, there was gradually a slight shift towards the acquisition of these security types.

So, examining the asset allocation Chapters 5 conclude that ITCs followed a more buy-and-hold strategy, they focused on their conservative debentures which offered security; at the same time, they seemed to experiment with the then newcomer shares which reflected the financial boom of the British market of the mid-1920s. This is interpreted as an active management strategy targeting new promising assets with higher, controversial risks.

One of the innovations the ITCs applied was the broad diversification of geographical and sectoral terms as Chapter 6 argues. The existing literature agrees over the basic destinations of the ITCs in the pre-WWI period. The main investments were distributed in, mainly, London-listed companies expressed in GBP, the majority of which were in the US and Latin American railways and other utilities; also, there was a large number of UK companies (mainly industrials) and to a lesser degree, foreign government debentures. Europe and the British Empire were underrepresented in the sample. This dataset reveals a great reclassification in this picture, as this Chapter summarises. The main body of this dissertation depicts the most interesting cases in this change. Historical data regarding the economic, social, political,

institutional factors are principally used to explain the second research question, the reasons which led ITCs to follow these paths.

This Chapter also discusses the huge debate in economic history literature, the evolution of the international financial flows during the examining period. ITCs seemed to follow the "rich-poor" theory of Obstfeld and Taylor (2002) for the capital flows during the pre-WWI period, while the post-war data distort the pre-war pattern, introducing a new era. Moreover, economic historians examine factors such as economic and population growth rates to explain these flows. This analysis test extensively these hypotheses, however, the results are not fully convincing. Hence, it moves beyond these indices adding factors such as population flows, monetary policies, sources for political and social evolution and other institutional adjustments, all these are included in the current interpretive scheme. This thesis argues that these offer a more convincing answer to the second and third question, the reasons for the management strategies followed and their interaction between the ITCs and societies.

Chapter 7 presents perhaps the most stable of all the ITCs' financial destinations, Latin America. Overall, Latin America has remained since the late 19th century a lucrative destination for British investments. The two main prerequisites that led the ITCs to focus on this region were a) security and b) high return, an ideal combination even for investors nowadays. To a greater or a lesser degree, securities from all the Latin American countries appeared in the ITCs' lists, regardless of the level of their economies. Among all, Argentina received the lion's share of the ITCs investments. The sound economic climate, the government's pledge to cover the foreign investments in the railways industry and the limited state intervention created the ideal environment for the British ITCs which took full advantage of this situation investing one out of 10 pounds of their portfolio in Argentinian railways.

This situation was similar in other Latin American countries, even where the economic situations were not ideal. Even in extreme cases, i.e., in Mexico which was a problematic case with consecutive defaults and social upheaval among others, the ITCs seemed to properly hedge their investments covering them in gold; finally, the results did not seem to be catastrophic for them. Although Britain had forged suitable political and economic bonds which could guarantee a prosperous financial environment, the first problems emerged during the late 1920s with the arrival of rival capital (mainly American) and the implementation of the first interventionist policies to regulate foreign capital. The last point remains open to a further study on the next decade of the 1930s. LA, overall was the region in which ITCs applied the most passive management strategy following the buy-and-hold approach they used to apply

during the previous period. Long established economic and political interests interpreted the persistence of British ITCs in the area.

The next chapters focus on the changes, the big surprises of that period concerning the geographical and sectoral allocation of the ITCs. Chapter 8 refers to the main withdrawal of the ITCs from the USA. The USA was a significant destination for the ITCs during the pre-WWI period. Again, their number one investment was railways, a crucial industry for the British who were closely connected to it, economically, politically and financially. During the pre-war period this market, which was traded also in the European, mainly the London stock exchange market, attracted the ITCs, which already had the know-how and anticipated security and stable and high returns, (see Edelstein, 1982). These dollar-based securities were maybe the only exception to the canon of GBP sovereignty in the total investments.

WWI changed entirely this picture. The urgent need of the British state for foreign currency to face the colossal fiscal expenditures led to direct intervention in the financial market gradually prohibiting the trade of securities in foreign currencies, mainly the dollar. The ITCs abided by the state rules and granted them their securities in US dollars. Additionally, the monetary policy of the British state caused severe inflationary pressure which resulted in the devaluation of the British currency. This created great opportunities for the holders of securities of foreign, overvalued currencies, mainly USD, allowing them to sell them and profit from capital gains. These were the two main reasons for the huge withdrawal of the British ITCs from the US market. However, these explanations cannot answer the next question; why did British investors, specifically the ITC, remain passive, ignoring the lucrative US market for the whole 1920s? USA was the big winner following WWI; its economy flourished, and it became a net global creditor. This euphoria affected the American stock market the securities of which had been overvalued, reducing their yields and worsening the position of the ITCs to acquire them. Besides, absence from the American market for a long period had created extra problems for the ITCs to re-join the market and build the internal networks they needed. As for the American railways, the dominant American holding, during the war it was brought under government control; significant regulatory policies were implemented afterwards, diminishing its profitability for the foreign investors. Here, the strategy followed was diametrically opposed to the previous Chapter. Active management was applied taking full advantage of the right moment for a profitable outcome.

So far, there is a total withdrawal from the American holdings. The subsequent question is where did these funds go? The temporal analysis of the dataset exhibit that Europe now

attracted, mainly, the British ITCs capital. Chapter 9 explains the reasons for this conversion focusing on the question on the interaction between ITCs and society. During the pre-WWI period, Europe, despite its robust economy, remained non-preferable for the ITCs. WWI ruined the European economy. Furthermore, structural changes at the political and social level transformed the whole continent. In the aftermath of WWI, the old European Empires collapsed, the European infrastructure was seriously damaged, inflation was rampant, the traditional liberal democracy was not the canon anymore, and the newly established alternative economic Soviet paradigm shocked the investors, who would be among the main losers.

However, the establishment of an international organization, the League of Nations, provided support to the various economies to curb hyperinflation by implementing a package of fiscal and monetary policies. Additionally, the winners of WWI, mainly the USA, sought to solve the big issue of the German reparations funding. One after another, the European countries, searching desperately for funds to reconstruct their economies, issued government (and later corporate) bonds.

In this process the British investors were actively involved, the ITCs included, by investing in the European government bonds, the first deviation from their practice of not heavily investing in foreign governmental bonds. Furthermore, ITCs seemed to face this new political and economic environment critically, but they were not categorically opposed to it. Persistent inflation was not an investor's ally, so they preferred to abstain from these markets, or to hedge, acquiring holdings expressed in GBP. As for the political turmoil, they acted cautiously. First, they received the indispensable political pledges not to jeopardise the (foreign) investments; concomitantly, they took the risk to invest in the new financial opportunities. Finally, they followed the boom of the European capital markets investing in newly established but secured industrial holdings, many of them in national currencies.

A new paradigm was established for the ITCs, who left the "security" of the LSE-traded holdings in GBP and USD or pegged to gold and shifted towards more attractive ones. This novelty was not without risk. The ITCs had to face new challenges investing in markets operating under a different legal system, not unquestionably supporting the minority shareholders' rights, necessitating strong local networks to avoid asymmetric information, and trading in foreign currencies. Thus, an active asset management strategy emerged for the ITCs which endeavoured to maximise their returns, maintaining their security prerequisite as steadily as possible. The tool of diversification was again guarded jealously; various European countries and regions' securities were added to the ITCs portfolio, testing their relationship with this

practice. In Europe the most active management strategies were applied demonstrating why ITCs were at the forefront of financial innovation. Additionally, the third question is mainly answered, ITCs had to seriously react to the social turmoil of the first interwar period carefully selecting the areas where their investments could be accepted.

Chapter 10 discusses the British financial rebound of the ITCs portfolio lists. Despite the global diversification, the ITCs followed and their role in the general tendency of the export of British capital since the late quarter of the 19th century, their portfolio lists contained significant numbers of British securities, one-fifth of their total investments. WWI was a catalyst for British financial, economic and social life. The British state, for the first time in its history, had directly intervened in the market because of its urgent need to fulfill its financial duties in foreign currencies, mainly USD, by limiting the trade of foreign securities. Gradually, this limitation reached full prohibition, demanding the delivery of the dollar securities in a special mobilization security project, exchanging them for British government bonds. These were included in the ITCs lists; for the first time, the ITCs diverged temporarily from their common practice of diversification, amassing in their portfolio substantial victory bonds values, all of them belonging to the same country and sector. Although this was provisional and mandatory, it was not necessarily uneconomical; gradually, they were removed, and the system stabilized.

In the meanwhile, the British economy had been transformed; structural changes led to a rationalization process in British industry which now consisted of large enterprises, diversified product, professional management and the frequent use of the capital market for funding among others. This tendency led to a deluge of new securities, appearing either in the LSE or among the local markets and networks; the ITCs, whose increased capital supply coincided with the outbreak of the companies' funding demand, seized the opportunity. Moreover, the paradigm shift of the British industry from exporting staple goods to a focus on domestic, capital intensive or consumer durables released new securities onto the market. The ITCs took full advantage, investing in new industrial sectors like automobiles or entertainment (film industry). Additionally, they invested in local markets as the breweries which offered many opportunities. In this case, a combination of active and passive management was applied that reflects the great plane of the ITCs asset management during the 1920s.

11.2 Synthesis of findings and contributions.

This dissertation discusses the asset management strategies of the British ITCs for the period 1914-1928. There is a rich literature for the historical evolution and the main characteristics of

the British ITCs. They were at the forefront of financial innovation using sophisticated asset management and extensive portfolio diversification (see Chapter 2). They took full advantage of the financial, economic and social environment. However, this discussion is mainly stopping with the outbreak of WWI. Literature offers little evidence for the next period. So, crucial questions arise: Did the changes affect ITCs strategies? Could their management follow the pre-war practices? And finally, what was their interaction with the then new world? This dissertation endeavours to address these gaps. The main contributions are a) the dataset it generates, offering valuable information for the main research question; b) the temporal dimension that it examines, expanding the research timeline from the pre-WWI period, or the "first globalization era", to the interwar one and c) the development of the literature of financial decision making.

The main methodology this thesis uses is empirical. It builds a dataset using data on annual portfolio lists for 117 ITCs over four non-consecutive years: 1914, 1920, 1924 and 1928. Thus, as any empirical methodology does, this thesis tests the hypothesis of diversification as an instrument for professional asset management. It follows numerous studies which, from the end of the 19th century, analysed the evolution of this institution, focusing on the main advantages (diversification and professional management) of this British institution. All the existing studies confirm the strong diversification that the British ITCs (see Chapter 2); this is accompanied by the recent discussion about professional management (see Rutterford & Sotiropoulos, 2016 and Chamber & Esteves, 2014) as the *raisons d'être* of this institution.

The second contribution of this thesis is the temporal dimension. Most of the existing literature discusses the institutions of the ITC for the period before WWI. The goal is obvious: the period bears similarities to the post-1980s (e.g., the globalization of capital markets, free trade and monetary stability). However, little evidence exists for the interwar period. This study bridges this gap. The sample used sheds light on the question of the asset management strategies followed by ITCs in the 1920s under the new circumstances of financial fragility, social upheaval and economic insecurity. This thesis finds that professional management never neglected during this period. Instead, ITCs rapidly adapted to the new conditions, taking full advantage of the new opportunities (markets, assets, states).

This thesis highlights the main asset management which ITCs followed to achieve their goals during the 1920s. These management strategies consist of two parts. First, they followed passive asset management. This was a legacy of the pre-WWI period; initially, investors

followed a naïve diversification strategy, investing in unbalanced portfolios, using the tactic of buy as you go and hold, meaning that they were keeping their acquired securities perpetually.

This dissertation discusses many cases which prove this approach. Initially, the way the ITCs chose to price their holdings is indicative of the significant importance they attached to preserving their holdings values; endeavouring, finally, not to jeopardize their initial pledge to their investors. Consequently, they insisted on investing in areas which they were sure that they would secure returns over a long period, in areas where they had all the possible information required for doing business seamlessly.

Additionally, the Latin American case is a perfect example for this practice, see Chapter 7. Even in cases where there was not the necessary security, at least in the short run, ITCs invented, pegging the security to gold, see the case of Mexico. Within this practice, there was the main selection of holdings traded on the LSE or other British stock markets, see the characteristic example of the US railways for the pre-WWI period, see Chapter 8; in this case, they accepted the USD because it was another stable currency, as well as they knew the specific sector in depth and could control the securities, which were also inside the British "financial terrain".

The notion of security was so crucial for them that they could forego the potential yield. This could be the reason for them not to invest in more risky markets, such as the foreign exchange or commodities, see the case in the aftermath of WWI, or Keynes' interaction (Moggridge, 2013). The acquisition of so many debentures in their portfolios indicates their preference for this approach despite the discussions that time about common shares as long-term investments, see Smith (1925) and the same tendency in the late 1920s in the US market in Chapter 8; the ITCs strategy was against the "cult of equity" that had been argued for the period, see Scott (2002). Even in the cases of temporary losses, the ITCs' policies were extremely cautious; they were based on patience, believing that in the long run their result would be positive, solving the problem of returns. Finally, as for the potential capital gains, by construction, they were of lesser importance; their gains were deposited in a different account which was held for a rainy day, see Chapter 3.

In this strategy has gradually been added a second, active portfolio management. In this case they intervened in their portfolios choosing uncorrelated assets to reduce their risk. The post-WWI period was ideal for testing this approach. The first signs for an advanced management were visible even before WWI. If they had followed the market, applying a completely passive

management, they would have preferred investments such as government bonds, both British and colonial, and not in utilities, industrial securities, see the discussions in the various financial journals of the period under study. Second, and mainly, even in the case of the forced purchase of the national government bonds, they quickly sought alternative investments to accomplish their purpose. This change indicates both a strategy towards a diversified portfolio and an active and entirely professional management. Although security was a sine qua non for the typical ITC, any prosperous financial return did not go unnoticed, see Chapter 8, especially in the massive selling of the US railways because of the devaluation of the British currency. This is neither a sign of passive, or even bad management, nor a departure from the diversification process. Rather, it is a sign of wise and professional management which first, takes full advantage of the economic conditions; so, it disputes any late reaction, and second, anticipates alternative and future profitable opportunities.

Europe can be seen as the characteristic example. Despite the reluctance of the British investors, the ITCs included, to invest in pre-WWI Europe, it came very much to the fore since the scenery had completely changed in the aftermath of the war. Especially in the second half of the 1920s, given the economic conditions in Europe, the British investors became active enough to identify potential profitable financial opportunities. The British ITCs participated in this market to secure their investments. The European markets were mostly shielded by international organizations (LoN) which imposed the necessary monetary and fiscal commitments on the various countries, creating finally a safe and favourable financial environment. Thus, the yields of these securities were promising.

This proves the creation of a new secured and profitable portfolio list using the diversification procedure extensively, with which the ITCs were already familiar. The qualitatively sophisticated and active management they applied was the perfect "managerial metamorphosis" achieved through a) selecting holdings based on foreign, non-USD, currencies; b) participating dynamically in the national stock markets surmounting any institutional barrier; and c) accepting the new political regimes, not necessarily advocates of liberal democracy, insofar as they could do business properly.

Finally, the boundaries between the passive and active management were not always clear. The case for this combination between the buy-and-hold portfolio strategy along with an active policy was the UK. ITCs retained their pre-war assets based on local networks and they added new assets of companies which had recently listed on the LSE. Gradually, they seemed to

bolster their active part of this strategy which became qualitatively superior applying brand new practices without reforming their basic scope and the tools they used to accomplish it.

Hence, the management strategy of the ITCs continued with its pre-WWI naïve buy-and-hold basis along with an active policy. Gradually, they seemed to bolster their active part of this strategy which became qualitatively superior applying brand new practices without reforming their basic scope and the tools they used to accomplish it.

Although the empirical method used can provide satisfactory answers to the first question, it is insufficient to answer the other two questions. This thesis argues that the exclusive use of MPT cannot answer why investors followed these assets compared to alternative. The basic prerequisites for this, free markets, no state intervention, currency stabilization had been violated, if not ceased to exist. Thus, much more criteria have been checked to answer this question.

This dissertation introduces a second methodological historical approach. Besides the use of the dataset, this thesis employs archives from periodicals and financial newspapers to verify its results answering the remaining two questions (second) about the causes which led to the main changes of the ITCs' portfolios and (third) strategies and their interaction with societies.

So, to examine these multifactorial phenomena, the interactions of ITCs with both economies and societies, a more historical approach is chosen which helps this thesis to set the changes in the historical context. So, to answer the last two questions this thesis shifts from a testable hypothesis to a historical approach that uses multiple sources (triangular research) which have bounded use, create methodological challenges and are open to criticism (Kipping et al. 2014). Finally, this is the third contribution of this thesis.

So, in the aforementioned cases, (LA, Europe and Britain) the general economic and political conditions are examined. In all of them, it seems that their decisions matter for ITC policies. In LA, this thesis observes that government guarantees played a crucial role for the maintenance of the ITCs in the region. Additionally, the role of the USA, the then-new leading economic power was significant in the European case. Their financial support in Europe shifted ITCs to invest too. Finally, there was the indispensable political supervision of the British Empire which envisioned the creation of a new Pax Britannica in Europe. It is not just a coincidence that many of these countries pegged their currency not automatically to the Gold Standard but, implicitly through the peg, to the GBP, see the cases of Hungary or Greece

(Costigliola 1977). This proves in turn the creation of a new secured and profitable portfolio list using the diversification procedure extensively, with which the ITCs were already familiar. The non-democratic regimes established in Europe again offer new evidence for investors policies.

Any possible social change did not go unnoticed for the ITCs management which theoretically remains passive to these changes. The example of LA is indicative. Signs of gradual state intervention policies have shaken British investors policies, ITCs included. Additionally, indices for the economic robustness of these cases are examined. The GDP for the main regions is used because economy is not unrelated to financial decisions. This thesis revises previous works for the use of a GDP-weighted benchmark, presenting a new approach of the diachronic evolution of the GDP. Other economic indices like the currency stability are studied due to their importance on foreign investments. An important tool for this approach is the use of financial newspapers, articles and other indices which conveys the reader the environment of that period. This approach also improves the answer to the main question. The financial press offers speeches, discussions and debates of the main actors, the ITCs managers and directors testing qualitatively the dataset results. These sources have been used as signs with limited but indicative application; they need to engage with each other to offer a reliable answer to the research questions.

This analysis is mainly based on a micro level that offers valuable information for decision making even nowadays, especially the various challenges faced by companies during or after crises' episodes.

This thesis also enhances the literature regarding the global financial flows. Despite not being its main question, it is not at all irrelevant to this study. ITCs held a global portfolio being at the forefront of financial innovations. For this reason, this study examines various indices as economic history proposes. It adds the economic and population growth rates to test the convergence hypothesis. Although the pre-WWI period confirmed a rich-poor theory, viz. high financial outflows to poor countries (Chapter 6)- this confirmation exists for the ITCs case too, the war blurs this view. ITCs invested heavily in other – non necessarily poor- areas like Europe or even in British colonies in Asia. They showed incredible adaptability while maintaining diversification. Although new barriers were placed in their way, they proved that even during the interwar period, at lease its first decade, financial markets functioned satisfactorily producing positive results under conditions.

All in all, ITCs were a financial innovation not only during the first globalization era (pre-WWI period) but also afterwards. During the first post-war period (1920-1928), the ITCs basically followed the same route. Their main purpose, which had remained unchangeable for the whole period, was to obtain a satisfactory income for their investors' savings. This thesis focuses on the asset management strategies during the 1920s. Diversification, even under adverse economic conditions, remained a basic approach they applied. This institution was inextricably intertwined with the socioeconomic environment of that period developing a direct adaptation to the new conditions.

11.3 Limitations and further research

Before completing this dissertation, it would be interesting to devote some space to discuss its limitations. The first can be seen as the incomplete period it covers. Although the 1920s reveals new and interesting information about the ITCs asset management, one would expect the investigation of both the previous period and the next decade, to have an overview for the whole period. Sotiropoulos *et al.* (2021) and other similar works scrutinize the pre-WWI period (basically before the outbreak of WWI in 1914). The next period, i.e., the war period has rarely been discussed. Due to the unprecedented conditions and the frequency of changes of the main variables, a detailed research will shed more light on these years. On the same line of reasoning, 1929 was again a crucial period, the Great Crash, which along with the 1931, the sterling crisis for the UK, should have been thoroughly studied. And of course, the rest of the 1930s is of great interest. However, both time and budget constraints have made such an approach impossible. Thus, future research will cover this incomplete part.

Second, the type of information this thesis use, creates gaps in the total research. This is a common problem for economic historians. The further one moves back chronologically, the lower the quality of the data becomes, or their form differs from what it is recognised now as normal. E.g., the fact that the ITCs were not required to publish their annual portfolio lists raises questions for the representativeness of the sample and the data that remains unused. Or the lack of information regarding the accurate identification and classification of the various securities is a problem that certainly distorts the dataset, see Chapter 2.

Third, the lack of formal texts such as the annual meetings minutes create additional problems to this thesis. Although financial press is used to cover this gap and to present indirectly the asset management the ITCs followed, this information is partial. Detailed official texts could offer valuable information to this research.

Another crucial issue this thesis deals with is the valuation of the various securities. The examining period includes high inflationary oscillations. Thus, accuracy in depicting their lists was a very difficult task. Moreover, the way ITCs used their inner reserves, as well as the time lags and irregularity in publishing their annual lists again create problems in the final data.

For the latter group of problems, this thesis constructs a dataset, it analyses the results and creates some case studies knowing that these constraints exist. Its goal is to minimise their impacts and make them manageable. Obviously, future and detailed research will cover some of these shortcomings as it suggests thereupon.

To synopsize, UK Investment Trusts Companies were a special financial institution, an outcome of the economic and legal evolutionary process of British society. Since its emergence in Victorian Britain, it has stood in the vanguard of financial innovation. It swiftly developed a globally diversified portfolio to offer secured and high-return financial services to individual middle-class investors in a similar way to business magnates. Professional management was used extensively to create a sober, long-term investing policy. Their dominant asset management strategy was mainly a mixture of *buy-and-hold* and *active* portfolio management. After the first period of 20-30 years, during which any crisis or other financial episode had been tackled successfully, their reputation was built on a solid basis, ready to be exported to other advanced economies, like the USA. WWI was a catalyst with unprecedented repercussions in financial, economic and social terms. The ITCs, unavoidably, participated in this cataclysm. However, they endeavoured to successfully use their sophisticated management, their diversified portfolio along with the pioneer tactics, rearranging their portfolios and shielding themselves from potential financial dangers. Overall, the ITCs' progress in active management could be seen as a dynamic path in the financial sector. The ground-breaking practices they followed were the main determinant for their evolution.

Now the 1920s can be seen as a prelude to the Great Depression of the 1930s. The crucial question is: how did the ITCs react to all this? Could their implemented policy of a totally diversified portfolio list, focused on secured holdings and the use of a professional management, surpass the economic collapse? So far, it seems that they have survived all the *hard times* (the Baring crisis, WWI); however, could they transcend the boundaries of capitalism *per se*? This is the first question which may only be answered through future research.

The second research question which arises, is the following. Even if the ITCs fail to yield promising returns during a crisis period, which is something every researcher expects, it is known that they have survived to the present day. So, what asset management strategies have they used? Have they followed a similar procedure, or have they adapted to changing circumstances? Finally, compared to the rest of the financial sector, is there any better performance which could be a preference to the ITCs as an influential investing vehicle, especially for the middle incomes.

Nowadays capitalism faces similar problems to those of the interwar period, which this thesis examines. Anaemic growth rates, chaotic inequalities, Homeric political quarrels, violent social turmoil, and persistent trade wars are some of these problems. Of course, there are differences, e.g., the greatest difference is the lack of alternative or the emergence of the climate change problem. Yet, both academically and empirically, there is intense concern about these anomalies in a way not very different as in the past, see indicatively the financial press of the 1920s. Proposals for qualitatively better political power (Zingales 2017), fairer wealth distribution (Piketty 2013), changes of enterprise principles (Business Roundtable 2019; *The Economist* 2019) are among the major debates which either enrich the most prestigious academic journals or capture the headlines. In both cases, the shock of the non-participation (even hostility, in some cases) of most of the population in the fundamental *raison d'être* of capitalism is more than manifest. From the phrase "in fact, we are all communists" of the British businessman Lord Inchcape in 1920 (*The Financial Times* 1920) to "from each according to their abilities" of *the Economist* (2019), the bulwark of economic liberalism, despite its centennial, the distance is not so far. In this environment, the ITCs seems to offer the first alternative against threats. The existence of financial participation of broader parts of the British population was, during the 1920s, an embankment to the alternative; nowadays, would a broader collaboration be an alternative to scepticism or ignorance? The threshold of this alternative limit approaches the frame of capitalism *per se*.

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