TRUST INVESTMENTS: THEIR EXTENT AND SOME RELATED ECONOMIC PROBLEMS

N. GILBERT RIDDLE*

A problem confronting all individuals who have accumulated funds is that of investment management. Sound initial selection and careful supervision are essential in order to conserve the principal and gain a satisfactory return. The traditional idea of "permanent investment" has resulted for decades in losses of considerable portions of accumulated funds. We live in a dynamic economic world and investment values may rapidly change.

The question of investment management is not only one of how to do it but also one of who should do it. At one time or another thousands of individuals who have investment funds place them in trust with trust institutions for supervision. While there is a paucity of data on the aggregate amount of individual trust property being administered by trust institutions,[1] there is evidence that the volume totals many billions of dollars. It constitutes a vital part of the investment fund of the nation. The use to which they put it is of major economic significance. The direction they give the huge amount of capital under their supervision will affect the opportunity and progress of enterprises.

It is impossible to obtain more than fragmentary data on personal trust business of trust institutions. With the exception of some data published in a few states, the volume of trust business carried by trust companies and state commercial banks is not reported. Rather adequate information is published relative to personal trust business of national banks. There is also a paucity of statistics on the investment of trust property. These data are reported for a few states. To get an idea how trust institutions invest trust property we have to use the general statistics of national banks, Massachusetts trust institutions, or mere samples of individual institutions. Specific data on the investments of individual trusts are reported to probate courts in some states. The information, however, is hard to obtain and frequently is in such a form as to make it very difficult to assemble or use.

This survey of trust investments is primarily devoted to institutional holdings. This limitation is a matter of expediency because there are far more data on invest-

* A.B., 1922, West Virginia University; A.M., 1926, Ph.D., 1934, Columbia University. Assistant Professor of Finance, The Ohio State University. Author of *The Investment Policy of Trust Institutions* (Business Publications, Inc., Chicago, 1934).

[1] "Trust institution" means any incorporated institution—trust company, national bank, or other corporation—empowered to accept and execute trusts.

ments of personal trust property by trust institutions than on such investments by individual trustees. Nevertheless, it is well known that the individual trustee plays an important role in the management of personal trust property. The search of probate court statistics by the writer convinces him that the volume of personal trust property placed with individual trustees is huge. In a number of areas it was found that individual trustees were supervising a larger number of personal trusts than were being administered by trust institutions. Further data of estates probated and the number of trusts created show that individuals are nominated trustees in a large number of cases, often exceeding the number of appointments of trust institutions.

The laws and conditions governing the investment of trust property by individual trusts are virtually the same as those affecting trust institutions. There are probably no great differences in the status of trusts held by individuals and those held by trust institutions with respect to most of the questions discussed in this article. There are vast differences, however, on certain points. The individual trustee usually administers one or at most only a few trusts. The trust institution, on the other hand, administers scores or even thousands of individual trusts. The individual trustee cannot afford the investment organization and facilities possessed by the average trust institution.

There are no data available for comparing the investments of individual trustees with those of trust institutions. Owing to the dearth of data on individually held trusts it is not feasible to give further consideration to their investments. While the volume of personal trust property being managed by trust institutions is not definitely known, a survey of available data will suffice to show its scope.

Number of Trust Institutions

There are probably 3,000 or more trust institutions in the United States with active personal trust departments. Information from state banking departments warrants the belief that there are more than 1,500 state trust companies. There were 1,913 national banks as of June 30, 1937, that had authority to exercise trust powers, and of this number 1,551 had active trust departments.[2]

Although the number of trust institutions is comparatively small relative to all commercial-banking institutions, their total capitalization aggregates a large proportion of the capital of all commercial banks, and their resources comprise a substantial amount of the total commercial banking resources. This is accounted for by the fact that the capital and resources of the average trust institution are considerably larger than those of the average commercial bank.

The 1,913 national banks having authority to exercise trust powers on June 30, 1937, had a combined capital of $1,301,368,385 and banking resources of $26,205,-955,724. Thus, while only about 36% of the national banks had trust powers, they had over 81% of the total par value of capital, and over 86% of the assets of all banks in the national banking system.

[2] Data in this paper on national banks in the trust field are from the *Annual Reports of the Comptroller of the Currency.*

Number of Individual Trusts

The number of individual trusts being administered by trust institutions is not reported except for those in the national banking system. For the year ending June 30, 1937, national banks were administering 135,772 individual trusts. Of this number 70,665 were living trusts and their assets comprised $7,788,959,078, or 80.7% of the total assets under administration. Court trusts numbered 65,107 with aggregate assets of $1,867,438,062, or 19.3% of the total. The number of individual trusts administered by national banks has increased from about 26,000 in 1927 to 135,772 in 1937. This represents a gain of 109,716, or over 500%. During the past four years there has been a gain of 36.5% in the number of trusts being administered.

The number of individual trusts in state trust institutions will undoubtedly exceed those in national banks. From time to time there are made available data of individual state trust institutions. A number of these institutions administer eight thousand or more individual trusts each. There are many more supervising from one thousand to five or six thousand accounts.

There were 299 national banks, for the year ending June 30, 1937, acting as trustees under 1,213 insurance trust agreements. On the same date 702 national banks held under trust agreements 16,259 insurance policies not yet matured or operative.

Trust institutions are named to act as individual trustees in thousands of agreements yearly. Between June 30, 1936 and June 30, 1937, 873 national banks were named as individual trustees in 6,250 agreements. In the preceding year they were named in 8,012 agreements. It is likely that other types of trust institutions are as an aggregate appointed trustees in more than ten thousand agreements yearly. Some individual trust institutions in large centers like New York, Philadelphia, and Chicago are named trustees in 300 to 500 agreements yearly.

Volume of Property in Individual Trusts

The large number of individual trusts administered by trust institutions represents huge sums of trust property. Data are very incomplete regarding the aggregate individual trust property of all trust institutions. National banks were administering $9,656,397,140 in individual trust property as of June 30, 1937. Trust institutions in New York City manage many billions in individual trust property. The writer has every reason to believe that there are at least six trust institutions in New York City administering from one to three billions of individual trust property. In the State of New York there are probably ten to fifteen billion dollars in such property. In Pennsylvania, trust institutions administer over five billion dollars of personal trust property. In Illinois, there is nearly as much. There is probably an aggregate of a billion dollars or more of personal trust property being administered in a number of other states, including Massachusetts, New Jersey, Maryland, Ohio, Michigan, Missouri, and California. Connecticut, Wisconsin, Minnesota, and a number of other states also contain hundreds of millions of personal trust property.

New individual trust accounts placed on the books of national banks between June 30, 1936 and June 30, 1937 aggregate $345,634,961 of trust property. The preceding year it included $317,090,906. For all trust institutions, new appointments will likely exceed a billion dollars yearly.

The amount of life insurance trusteed by all trust institutions is estimated to exceed four billion dollars. Insurance trusts administered by national banks aggregated $55,706,000 in 1937. For the same date insurance policies held under trust agreements not yet operative totaled $639,827,000.

Concentration of Personal Trust Business

A distinctive feature of the personal trust business is its concentration in a comparatively small number of trust institutions in the large cities. This is to be expected, however, because capital has been accumulated primarily by a small percentage of the population; the vast majority of the people do not have much. Fully 80% of the people spend all they get, or lose most of what they save in unsound business adventures and in speculation. While a relatively small percentage of the people accumulate capital, Federal Estate Tax Reports, probate court records, and other records of information show that hundreds of thousands of individuals have accumulated substantial estates. These funds are widely distributed throughout the country but most of them are found in the cities. The bulk of the accumulated capital, the big estates especially, is found in the large financial and commercial centers of the nation.

This fact, undoubtedly, accounts for the bulk of individual trust property being administered by the large trust institutions in the large cities. In the five largest cities, those having a population of 1,000,000 or over, forty-one national banks as of June 30, 1937, were supervising 32,118 individual trusts with aggregate assets of $4,817,206,888. Thus less than 3% of the national banks with active trust departments administer nearly 25% of the personal trusts, and about 50% of the trust property held by national banks. Over 80% of the trust business of national banks is confined to cities having a population of 250,000 or over. It is likely that one or two per cent of the national banks engaged in trust business, located in the twelve or fifteen largest cities, administer the great bulk of the trust property in the national banking system.

There is just as great a concentration of individual trust property in state trust institutions. There is ample evidence to support the belief that a few leading trust institutions in the cities of 400,000 or over administer a large percentage of the personal trust property of all such institutions.

What we have in reality is the mobilizing of the capital of a few hundred thousand or more individuals in the hands of comparatively few huge trust institutions. We now have relatively permanent specialized institutions as the investment managers of these billions of dollars of property.

Problems Affecting Investment

The problems of trust institutions as investment managers differ considerably from most institutional investors, such as life insurance companies, savings banks, commercial banks, and investment trusts. The latter institutions receive only cash to invest, they have only one portfolio to supervise, and they have only one set of laws, if any, to comply with in managing their investments.

On the other hand trust institutions are perplexed by innumerable problems in the performance of their investment functions. Each trust institution has a variety of individual trusts, the number varying from a few in the smallest trust institutions to ten or fifteen thousand in the largest ones. Each trust is a separate account, requires a separate portfolio and must be administered according to varying circumstances, such as legal requirements, type of property contained in the inventory, duration, the needs of beneficiaries, and economic conditions.

Trusts range in size from a few hundred dollars to millions. Their composition when received by the trust institution may be all cash or a single type of investment, but more commonly there is a variety of bonds, stocks, mortgages, real estate, and some cash.

In the management of the portfolio the trustee can only retain investments or make new commitments in accordance with the terms of the instrument creating the trust, the statutes of the state, or the law as set forth in decisions of the courts. In general, the trustee is obligated to invest trust property in such a manner that it will be safe and yield the largest return, consistent with safety, to the beneficiary. The trust property must not be allowed to remain idle. It should be kept invested in sound income producing assets, which are marketable. Investments should be made with a consideration of the nature and object of the trust. Speculation is prohibited. The trustee is required to perform his duty properly, which entails the highest degree of diligence, care, and honesty. Investments improperly made make the trustee liable for losses resulting from the act.

Statutes and Their Effects

The investments of trust institutions are greatly affected by the statutes of the state concerned. Personal trusts are regarded in a special way by the law; the law is organized to give special protection to the property of these trusts. The law imposes definite rules and standards designed to promote the selection of sound investments and to disqualify unsuitable issues, thereby protecting beneficiaries against losses.

Unless otherwise provided by the trust instrument, trustees must in many states invest trust property in investments authorized by statute. Statutes usually sanction the selection of issues in the following categories: United States government, state and municipal bonds; railroad, electric, telephone, and gas bonds; real estate mortgage bonds, and real estate mortgages. Industrial bonds are eligible in some states. Other types of securities are sanctioned in some jurisdictions. There are specific requirements imposed for the selection of individual issues, such as the terms of the issue, size of the enterprise, solvency record, earnings record, relation of the value of the property to the funded debt, ratio of debt to assessed valuation (for municipals), and stock capitalization to the funded debt.

The standards imposed by statute in various states are not uniform; some are poor and antiquated; none are entirely satisfactory. The best are marred by defects. Nevertheless such regulations have been desirable. The principles and standards set forth in the law are believed to have promoted in some cases the selection of sounder investments than would otherwise have been made.

The writer has seen sufficient evidence of trust institution investment practice to appreciate the fact that the standards laid down by the law have been instrumental in improving the investment quality of trust portfolios.

The statutes governing investments in New York, Massachusetts, Pennsylvania, and many other states serve as very good guides for the selection of investments and if followed will undoubtedly produce fairly satisfactory results. Institutions such as the mutual savings banks, etc., which have been guided by these statutory requirements have had good investment records; probably superior to most institutions with broad investment powers.

Until comparatively recently many trust institutions were rather poorly organized for trust investment work. This is still true of most small trust institutions, and of some large ones. About 75% of all trust institutions administering trust funds have under-million-dollar trust departments. Further, each individual trust as an average is very small. How can such institutions give proper supervision to their trust investments? Surely the statutes are of some help in promoting the selection of sound investments by these institutions.

Trust Investments

While there are very few up-to-date statistics on the investment of trust property by trust institutions, we have sample data which will suffice to give a fairly adequate idea of the investments of these institutions which administer thousands of accounts and personal trust property aggregating billions of dollars.

The study of the investment of trust property may be approached first by an analysis of the portfolios of national banks. The investment of property handled by national banks may be seen from the following table:

COMBINED TRUST INVESTMENT PORTFOLIOS OF NATIONAL BANKS
(In millions of dollars)

	BONDS		STOCKS		REAL ESTATE MORTGAGES		REAL ESTATE		MISCELLANEOUS	
	Amt.	*Per cent of Total*	*Amt.*	*Per cent of Total*	*Amt.*	*Per cent of Total*	*Amt.*	*Per cent of Total*	*Amt.*	*Per cent of Total*
1931	1,266	26.5	1,260	26.4	675	14.1	...	...	1,573	33.0
1932	1,563	37.6	1,285	30.9	672	16.1	...	...	642	15.4
1934	3,602	47.1	2,421	31.7	735	9.6	532	7.0	357	4.7
1936	4,129	51.0	2,436	30.1	605	7.5	585	7.2	340	4.2
1937	3,982	49.0	2,555	31.4	580	7.1	596	7.3	421	5.2

An analysis of the $8,135,313,923 of invested trust property as of June 30, 1937 revealed that 49% was in bonds; 31.4% in stocks; 7.1% in real estate mortgages; 7.3% in real estate; and 5.2% consisted of miscellaneous material. The bulk of the investments is in bonds which has been considerably increased relatively since 1931. Stocks are also a very important item, the largest next to bonds. Each of the remaining classes of investments are relatively small. There is no subdivision of these major groups of investments so the data afford us only limited information.

In Massachusetts more information is published regarding trust investments than in any other state. Data on the investment of trust property there are significant not only because the volume of such investments is large but also because of the "Massachusetts rule" which accords greater latitude to the trustee's discretion than do the rules prevailing in many states. The proportion of trust property invested in stocks is very large, amounting to nearly 50% at the present time.[3] Stocks have averaged over 40% of the aggregate trust property in Massachusetts trust institutions during the past two decades. For the past eight years the average has exceeded 45%. This is a considerably higher percentage than is contained in any other sample of trust institution investments.

Massachusetts trust institutions are also large investors in bonds. For several decades bonds have constituted over 35% of the total investments. Corporate bonds have played a noticeably more important part than have government, state, and municipal issues. There has been a comparatively small division of trust property into the real estate field by Massachusetts trust institutions.

If we combine as an aggregate corporate bonds and the stocks it will show that personal trust property invested by Massachusetts trust institutions has largely been in the corporate field.

Additional light on the investments of trust institutions is revealed in the data obtained from "100 of the largest and best known trust institutions in the country."[4] Information was asked as to how "they were investing trust funds under moderate size discretionary living trusts." The percentage distribution of such investments appears as follows:

United States government bonds	21%
State and municipal bonds	12%
Corporate bonds	37%
Real estate mortgages	12%
Preferred stocks	5%
Common stocks	13%

Bonds comprise 70% of the total, a substantially larger proportion than was so invested by national banks or Massachusetts trust institutions. Eighty-eight per cent of the investments are allocated to stocks and bonds. The general policy indicated is one of purchasing bonds primarily. Governmental issues of all types comprise 33%

[3] MASS. COMM'R OF BANKS, ANNUAL REPORTS.

[4] Lewis, *Present Day Trust Investments* (1937) 65 TRUST COMPANIES 148.

of the aggregate. High favor is shown for United States government bonds as they account for "more than one-fifth of the average living trust fund." When one considers that these figures are for discretionary living trusts there is a surprisingly small percentage in common stocks, only 13% of the aggregate. This is a very much smaller amount than is shown for trust investments of national banks or Massachusetts trust institutions.

While corporate bonds constitute the largest proportion, 37% of the aggregate investments of these living trusts, there is no information regarding the proportion in railroad bonds, public utility bonds, or industrial bonds. Thus their policy in this respect is unknown.

Further information on the amount of trust institution investments is contained in the trust activities of a selected group of trust institutions. The analysis of investments contained in 196 testamentary trusts is based on statistics obtained by the writer from nineteen trust institutions located in New York, Boston, Cleveland, Chicago, and St. Louis.[5] The investigation covered the years 1919 to 1932. One hundred ten of the trusts were discretionary while 86 restricted the trustee's power in some manner. The trusts varied in size from approximately $10,000 to more than $3,000,000.

How was the property distributed when it was received in trust? How was it reinvested by the trust institutions? This information is shown in the following table:

DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS
(In percentages of total)

Type of Investment	*Inventory*	*1919*	*1921*	*1925*	*1929*	*1932*	*1919-1932 average*
United States Bonds	2.9	3.0	5.7	4.0	1.6	3.1	3.4
State and Municipal Bonds	3.5	5.9	9.8	10.4	10.9	14.1	10.4
Railroad Bonds	6.6	9.1	8.4	8.0	6.0	5.1	7.5
Utility Bonds	2.8	2.8	2.9	4.3	6.9	8.6	4.9
Industrial Bonds	0.8	1.6	1.8	2.1	2.2	2.9	2.1
Foreign Bonds	0.5	0.5	1.0	0.9	0.7	0.5	0.7
Railroad Preferred Stock	1.5	2.7	2.6	2.1	1.3	0.7	1.9
Utility Preferred Stock	0.8	0.7	0.7	0.9	0.9	0.7	0.8
Industrial Preferred Stock	4.5	4.5	4.5	4.4	3.7	3.0	4.0
Railroad Common Stock	10.3	10.1	8.5	6.7	2.7	1.7	6.0
Utility Common Stock	8.2	8.1	7.0	4.2	3.7	3.2	4.9
Industrial Common Stock	14.0	12.4	14.0	17.0	22.8	23.4	18.1
Bank and Finance Stock	6.0	4.4	4.3	4.0	5.0	4.1	4.2
Land Bank Bonds	0.1	0.0	0.1	2.4	3.0	2.0	1.8
Real Estate Obligations	9.8	16.5	13.5	16.3	21.5	22.3	17.4
Real Estate	18.0	17.0	14.8	11.8	6.2	3.0	10.5
Miscellaneous	9.7	0.7	0.4	0.5	0.9	1.6	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

A survey of the investments made by the nineteen trust institutions warrants the conclusion that they were widely different from those in the preceding studies. The

[5] RIDDLE, THE INVESTMENT POLICY OF TRUST INSTITUTIONS (1934), containing an analysis of the investment management of these trusts.

nineteen trust institutions in the five large cities invested about one-third of the aggregate property in bonds, about one-third in common stocks, and about one-fourth in real estate obligations. Real estate obligations were decidedly a larger element than was shown in the trust investments of national banks or Massachusetts trust institutions.

Is the composition of trust portfolios of national banks and Massachusetts trust institutions determined by the investment policies of these houses or is it largely a reflection of the contents of the trusts when they were received by these institutions? If the study of the 196 trusts administered by nineteen trust institutions[6] is a fair indication, the answer is that both factors are important. This study shows that bonds constituted 17.1% of the aggregate property in the inventory of the trusts and over 30% at the end. Stocks were 45.3% in the inventory but less than 40% at the end. Real estate obligations totaled 9.9% in the inventory but were increased to about 25% at the end. Real estate was decreased from 18% in the inventory to less than 5% at the end. From 1922 to 1929 there was practically no change in the proportion invested in bonds or common stocks. Preferred stocks and real estate were decreased and real estate obligations increased.

Tendency to Select Sounder Investments

There is a definite tendency for trust institutions to improve the quality of investments in their portfolios and thereby control the flow of capital into safer and probably more desirable enterprises. Statutes and court decisions emphasize safety and experience and oppose new or speculative business. Often the property received from the creator of the trust does not qualify as to quality for a trust portfolio. Thus, unless the trustee is empowered to continue such investments, they must be converted into authorized securities. In this way weaker or less desirable investments are sold and higher grade issues selected in their place. Securities so selected are frequently drawn from the approved list, which is merely the names of issues approved by an investment committee of the trust institution as being suitable for trust investments. This results in the process of financing the larger and sounder corporations. This is definitely true because the larger trust institutions in the great cities are not restricted or concerned with local and smaller enterprises.

These same trust institutions are also big buyers of municipals. While there are normally few restrictions on the selection of municipals within the state where the trust institution is located, nevertheless, such institutions are more careful in their choice of such bonds than is the average individual. Thus, they purchase principally the best municipals. In selecting out-of-state municipals, trust institutions are sometimes limited by specific standards which tend to make eligible only the highest grade bonds.

The process of selecting high grade investments is also applied to the real estate field. Undoubtedly trust institutions have selected many undesirable mortgages and

[6] *Ibid.*

real estate bonds. The misleading appraisals of real estate followed so widely in the twenties caused losses to practically all investors. Today, however, the procedure has been considerably improved, specific standards are laid down and followed. The legal restrictions prevented, to a large extent, the placing of trust funds in the weaker securities. The study of many individual trusts during the twenties showed that among the hundreds of commitments made by trust institutions, the vast majority were sound investments, judged by the standards then prevailing. It is doubtful if the investment orgies of the twenties can be attributed to the policies followed in investing individual trust funds by trust institutions.

Criticism of Trust Investments

There is ample ground, however, for criticizing the individual trust investments of trust institutions. In the study of 196 individual trust portfolios the investments were rated for the period 1930 to 1932. The ratings were given effect before the full impact of the depression had been appreciated. The ratings included United States government bonds, state and municipal bonds, corporate securities—bonds, preferred stocks, and common stocks. There were several thousand different investments rated for all the trusts. The investment quality of the aggregate of stocks and bonds is shown in the following table:

INVESTMENT QUALITY OF BONDS, PREFERRED AND COMMON STOCKS OF 196 TRUSTS
(Based on ratings in period 1930-1932)

	AAA	*AA*	*A*	*BBB*	*BB*	*Lower*	*Unrated*	*Total*
All Securities	17.4%	14.0%	12.1%	18.1%	10.8%	17.7%	9.9%	100%
All Bonds	35.8	21.8	19.0	13.5	3.0	1.7	5.2	100
All Preferred Stocks	4.3	14.2	15.0	37.9	11.4	5.1	12.1	100
All Common Stocks	1.1	3.2	6.7	20.8	18.9	35.2	14.1	100
Governmentals:								
U. S. Gov. Bonds	100.0							
State and Mun. Bonds	40.1	21.8	16.5	12.3	3.2	1.9	4.2	100
Railroads:								
Bonds	24.2	20.7	31.8	15.3	3.9	2.0	2.1	100
Preferred Stocks	5.5	11.3	10.1	30.3	19.2	10.7	12.9	100
Common Stocks	0.0	0.2	0.8	8.3	18.9	66.5	5.3	100
Utilities:								
Bonds	40.4	27.1	18.3	8.2	1.9	0.6	3.5	100
Preferred Stocks	6.0	20.7	23.6	19.4	9.8	5.4	15.1	100
Common Stocks	2.1	6.4	16.8	30.3	20.7	17.6	6.1	100
Industrials:								
Bonds	18.5	17.8	20.0	18.4	3.4	1.6	20.3	100
Preferred Stocks	3.4	10.4	14.8	44.5	11.7	4.2	11.0	100
Common Stocks	0.2	1.2	5.2	16.4	16.1	43.0	17.9	100

One is justified in saying that there was entirely too large an amount of individual trust investments of inferior quality. Since all of these accounts had been under the supervision of trust institutions throughout the period of the twenties, there seems little excuse for holding so many weak issues. A considerable number of the corporate stocks, both common and preferred, as well as many bonds, suffered substantial losses. Likewise, some of the municipals had difficulty. There is no data on how the real estate fared.

Another point of criticism regarding investment practices of trust institutions is that of holding unsuitable securities received from the creator of the trust for an unduly long time. In the portfolios of 196 trusts there were a number of such investments held for five to ten years or longer. A considerable number of undesirable investments received in trust prior to 1922 were still being held when the depression came. Trust institutions were shown to be rather slow in making changes. Perhaps this is due to their conservative and cautious policies. It was also due to the lack of an adequate investment organization on the part of some institutions.

Do Legal Requirements Foster Liquidation?

Do the special standards and rules to which the trustee is subject foster liquidation appreciably in periods of depression? The specific requirements imposed by the New York statutes upon trust investments may be cited as an example. The statute specified that railroad mortgage bonds, collateral trust bonds, and railroad equipment obligations were eligible if the company had earned its fixed charges one and one-half times in five of the six years immediately preceding, and also in the last year. If dividends have not been as specified, then the period is set at nine out of the ten preceding years. In the case of debenture bonds, income obligations, etc., the fixed charges must be earned twice both in the latest year and in five out of the six preceding years. These standards seemed high and were thought to be ample for gilt-edge securities. So they were for normal times. But we failed to appreciate that such standards must be high enough to enable an investment to withstand adversity. Railroads proved to be vulnerable to an unusual degree to the hazards of a depression. Although the bonds of scores of Class I railroads met the test during the period of the twenties, they soon failed to qualify when the depression got under way. Less than a dozen Class I roads were earning their fixed charges one and one-half times in 1931. Thus the bonds of scores of roads lost their legal status. The situation created a problem for the trust institutions of retaining or disposing of these investments. There were two elements in the problem: one legal, the other economic. Court decisions are clear that "trustees should have such time as good sound judgment may require to protect the estate against the sale of sound securities in a market that is of common knowledge depressed."[7] To prevent possible wholesale dumping of legals that had become ineligible, a moratorium was declared in the law, thereby extending the legality of an investment if it were on the legal list as of January 1, 1931. While the legal aspect was quickly cared for there was still the economic problem of deciding whether to sell or hold the railroad investments in view of the condition and outlook for the railroads. Undoubtedly the trust institutions took the wiser course in some cases and disposed of some railroad bonds. There is no proof, however, that such bonds were sold in any unusual amounts. The analysis of the 196 testamentary trusts showed no appreciable change in the holdings of railroad bonds during 1930, 1931, and 1932. In fact there is nothing revealed in these

[7] *In re* Watson's Estate, 145 Misc. 425, 261 N. Y. Supp. 327 (1931).

accounts to indicate that there were any abrupt changes in the investments during the depression from 1929 to 1932.

The data of the 196 individual trusts might lead one to believe that trust institutions were slow to change trust investments rather than to follow a liquidation policy when there was a change in the market. This seems to have been true even though many securities they held were greatly affected by changes in business and market conditions. Thus, we are probably justified in saying that the huge volume of individual trust funds administered by trust institutions were somewhat of a stabilizing force in the capital market.

Trust Income, Investment Yields, Prices

While there has been a substantial increase in the volume of individual trust business of trust institutions, the trustees' income at the present time is far less satisfactory. This is particularly true in those states where fees are based largely or wholly on trust income. There is a paucity of data on the earnings of trust investments. Market yields of specific investments do not necessarily indicate the yield being received by an individual trust. For instance a high grade security bought in 1926 or 1929 to yield 5¼% and held to the present time has continued to yield this rate although its price has varied during the intervening years. However, since trust portfolios are varied from time to time because of bond calls, maturities, and other reasons, there has no doubt been a considerable decrease in trust earnings. The average yield on high grade corporate bonds was about 5% for the period 1926-1929. The yield on municipal bonds was less. Today high grade bonds yield about 30% less than in 1926-1929.

There has also been a decrease in the yield of high grade real estate loans. Real estate commitments are now made at 4% to 6%, the yield averaging fully 20% to 35% less than during the twenties.

There has been a reduction in income during the depression resulting from defaults on some bonds and mortgages and omission of dividends on some stocks. There are practically no data on this question. The writer has seen some evidence on this point from his study of individual trusts.

Lower yields have meant that on an individual trust, say, of $100,000, the fee of a trust company on the annual income would be around 20% to 30% less in 1937 or 1938 than in 1926 or in 1929. The volume of individual trust property administered by national banks was $4,642,000,000 in 1932 and $9,656,000,000 in 1937, or a gain of over 100%. The average volume of trust assets in each national bank more than doubled from 1932 to 1937. On the other hand average gross earnings for trust departments were $15,390 in 1932 and only $23,952 in 1937, or an increase of about 64%.

The writer found a gross return of 5.8% on the composite investments of 196 individual trusts which had been in operation ten to thirty odd years. These trusts had been created in the period 1893 to 1919 and were in operation till 1930-1932.

Needless to say there were wide variations among various trusts. There was no positive relationship between the size of the trust and gross income.

Reports from trust institutions indicate that average gross yield today is about 3.75%. For individual institutions the yield ranged from 2.75% to 5.50%. These figures are for moderate sized discretionary living trusts.[7a]

Not only has there been a reduction in income for trust institutions but the income for the beneficiaries has also been reduced.

In consequence of these factors, trust institutions have been caught between the dilemma of conservative investing and the urge to gain a larger return. The desire for conservative investing is greatly prompted by depression conditions because of risks of loss of principal. Legal requirements and standards set up for the selection of gilt-edge investments, the collapse of values, and the inactivity of the capital market have brought about a possible shortage of desirable investment outlets. While government and municipal issues constitute a satisfactory outlet, affording a wide range of maturities, tax advantages, etc., their prices are high and their yields low. Corporate issues of prime quality are comparatively scarce today. One trust institution official writes that there are only 63 issues on their list of approved bonds, eleven being railroad bonds, eleven industrial bonds, and 41 public utility bonds.[8] Suitable corporate bonds are also high priced and the yields low. High grade real estate mortgages are also very scarce. Trust institutions are seeking prime mortgages at 4, 4½, and 5 %.

It is very likely that for gilt-edge bonds, prices will remain high and yields low for many months to come. It will be so until business picks up and the capital market revives. There seems to be no immediate prospects for relief in the dearth of gilt-edge corporate bonds and real estate obligations, from high bond prices and low yields. Long term maturities will increase the income of a portfolio, but, of course, if and when interest rates increase there will be a drop in prices. Thus, many trust institutions are buying only a limited amount of long-term low-interest bearing bonds. They are selecting more short-term material, buying government and municipal bonds, and maintaining more cash funds in the form of deposits and United States savings bonds.

During the past few years a large proportion of the high-coupon obligations of corporations have been refunded into low-coupon obligations. There has been a decided concentration of maturities of these refunding issues in the sixties. There has been a ready market for these new issues and trust institutions have made extensive purchases. These 30-year bonds yield approximately 3¼%. Forecasts by bankers of average interest yield of gilt-edge bonds for the next few decades indicates that it will be about 4¼%. There seems to be a definite belief that long-term bond yields will be higher than the current return on high grade issues. In view of these factors what investment policy should trust institutions follow? If yields increase,

[7a] Lewis, *supra* note 4.

[8] Blunt, *Trust Investments* (Feb. 1938) 66 TRUST COMPANIES 174.

bonds are sure to fall in price. But when will yields increase and how much? If yields should increase to about 4% in the next three or four years, or possibly five, wouldn't it pay to buy short-term issues for that period and then make the long-term commitment at 4%? This of course depends upon a number of factors, such as short-term yields, the present income needs of the trust, and its maturity.

Investing in Common Stocks

In view of the many difficulties confronting trust institutions in investing personal trust property, such as high investment risks, limitations of desirable investment outlets, high security prices, and low yields, many trust officials are advocating selecting stocks. In addition, trust institutions are confronted with the problem of the purchasing power of the trust income. The fear of inflation has also given further impetus to buying common stocks.

In most states the purchase of common stocks for trust funds has not been permitted. Massachusetts is a notable exception; there the purchase of common stocks has been sanctioned by law and practiced for some time. In other jurisdictions, discretionary trusts have permitted their selection; or the terms of the trust instrument have authorized the retention of common stocks received from the creator of the trust. Under such conditions, certain trust funds have been invested in common stocks in substantial amounts and the practice has been carried on for a number of years.[9]

While common stocks have played an important role in trust investments, they have been included largely under the conditions indicated above. Today there is an unusual urge among trust people to invest in common stocks.[10] They desire to have the trustee authorized and permitted to buy them on the basis that common stocks are a satisfactory type of investment for trust funds. To accomplish this to a satisfactory degree most state laws will have to be broadened. If trust institutions are granted such permission will their investment problems be less rigorous? Will it enable them to preserve the principal with more certainty and to obtain a larger income for the beneficiaries? Does this type of security make it possible for the trust institution to build a portfolio more in accordance with their problems and the needs and requirements of the beneficiaries?

It is likely that trust institutions are expecting to derive too much from common stock investments. The writer thinks it is a hazardous adventure for trust institu-

[9] For data, see pp. 344-347, *supra*.

[10] The question of inflation is an important factor influencing the thinking of trust people on common stocks as trust investments. More and more attention is given to the idea that a trustee should attempt to maintain the purchasing power of an individual trust. This demand is more pronounced today in view of the threat of inflation.

How can the investor escape? Buy common stocks is the usual policy advocated. They are expected to rise in the market and the increase in dollar value will compensate for a loss in purchasing power. Yet it is quite certain that stock speculation in a period of inflation will be exceedingly difficult and hazardous; vastly more so than during ordinary times. The economic aspects of the question are sufficiently complex and hazardous as to warn the trust institution that it is a problem to be approached with great care.

tions. Their quality is more difficult to determine than is that of gilt-edge bonds. Their income in general is far less certain than is the interest on high grade bonds. Their prices fluctuate frequently and over a much wider range than do sound bonds. Common stocks are affected to a considerable extent by market speculation and trading. Except at depressed levels, the common stocks of many of the soundest companies sell at such high prices that their cash dividend yield is low.

If trust institutions invest more extensively in common stocks, the effects in the security market cannot be definitely foretold. The increased flow of funds into common stocks will probably tend to enhance the prices of stocks and thereby reduce the average return on them.

If common stocks were selected in accordance with the best investment judgment as to their suitability for investment of trust funds, it is possible that such a policy would have a stabilizing influence. Common stocks would be chosen more on the basis of their intrinsic value and price would be more of a factor in their purchase. They would constitute more of a long-term program. "Switching," trading, and speculative activities would be greatly reduced if trust institutions followed some such policy on investing substantial sums in common stocks.

On the other hand, if trustees become "stock-minded," and insist on investing with a rising market and attempt to sell with the down movements, market swings may be accentuated. Selecting common stocks chiefly on the basis of market analysis is apt to be very unsatisfactory.

If trust investments are liberalized to permit the purchase of common stocks, it might have a salutary effect upon corporate financing. Many corporations would be able to obtain more capital through issuance of stocks instead of bonds. It is too early to more than surmise what might be the outcome of such a movement.

The Control of Enterprise

The control of enterprise by trust institutions is a factor of considerable significance. We have already noted the immense volume of personal trust property concentrated in the hands of a relatively few large trust institutions in the large cities. A number of institutions administer as much as a billion dollars of such property and there are many such institutions administering more than one hundred million dollars. The control of these huge funds may lead to a good deal of influence over business enterprise.

It is true that the trustee does not have complete control over the property trusteed with him since it is subject to certain legal restrictions. For all practicable purposes, however, the trustee has sufficient control to direct the flow of substantial proportions or all of these funds. Further, he may have considerable option as to the type of financial instrument—mortgages, bonds, or stocks—which he will hold as representing these invested funds.

An important factor in the control of a corporation is the possession of stocks with voting rights. Trust institutions are large holders of stocks. National banks administering individual trusts hold $2,255,000,000 in stocks. The forty-one national banks in cities of 1,000,000 or over have $1,228,000,000 in stocks. Other types of trust institutions also have large investments in stocks. Sample studies show that trust institutions have invested in stocks from roughly 20% to 50% of the trust property.

These figures may be increased owing to the concentrated drive to broaden the scope of trust investments to include common stocks. At any rate stocks are apt to continue to be a very important element of trust investments. Statistics of estates show that stocks constitute 30 odd per cent of the gross value of the smaller estates and 70 odd per cent of the larger ones. The estates trusteed will, of course, contain these stocks.

With these large amounts of stocks in trust portfolios it is only natural that the trust institution would be in possession of enough votes to be influential in the management of companies. It does not necessarily follow that trust institutions are exercising a managerial control over enterprises. However, the fact remains that they have great potential power in this respect.

Trust Institutions as Investment Supervisors

It is a sad commentary upon our investment system when we appraise it in terms of misdirected capital, losses in disastrous business adventures, or in speculation. Investment losses in this country reach staggering sums yearly. It means insecurity for much of our accumulated capital.

Our economic system is organized on the basis of placing the responsibility upon the individual for getting ahead financially. But after the individual has earned and saved, his capital is often lost through unwise investments. For the most part the individual has been his own investment manager with the inevitable result of incurring great losses. The average individual neither has the time nor training to be a successful investor.

On the other hand our financial system has been filled with incompetent investment supervisors. While there are a few good investment organizations which are rendering satisfactory investment service, they are not always known. Perhaps a large proportion of the investors who seek advisors never find good ones.

The larger trust institutions are undoubtedly among our best investment houses. There is ample evidence to show that they have accomplished a great deal in conserving and directing accumulated capital.