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***Recent Financial Scandals:
A Neo-Luddite Perspective****

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I. Introduction

Cultural change necessarily engenders resistance to that change. The term “neo-Luddite” makes a modern connection to the original Luddite rebellions in England during the early 19th century. As such, neo-Luddite describes a modern philosophy that distrusts or fears the inevitable changes brought about by new technology. This interpretation is based on contemporary historical accounts portraying the original Luddite revolts as an action against the ‘progress’ of technology during the Industrial Revolution. This progress displaced craftsmen in favor of machines in the English textile industry. Today's neo-Luddites continue to raise moral and ethical arguments against the excesses of modern technology. A key theme is that the technological inventions and the technical systems that support those inventions have evolved to control, rather than to facilitate, social interactions. The upshot is that the breadth and depth of technological change in modern society threatens the essence of humanity. To date, the neo-Luddite movement has been largely confined to the fringes of intellectual discourse in the modern era, focusing on ecological, environmental and geo-political concerns.¹

The primary objective of this paper is to apply the neo-Luddite approach to the analyzing the overwhelming technological changes that have impacted security markets in the last two decades. What is the relevance of this for Post Keynesian economics? As illustrated in Poitras (2002), the operation of security markets plays a key role in Keynesian and Post Keynesian economic theory. In this vein, there are still significant unresolved issues between Keynes and Frank Knight about the impact of technological change on the ability of securities markets to handle uncertainty. On this point, Keynes (1936, ch.12) argued that by enhancing market liquidity, destabilizing speculative forces in security markets would be enhanced. Insofar as this increase in liquidity is driven by substantive technological advances, Keynes was clearly in the neo-Luddite camp. This is not to say that Keynes and, by implication, Post Keynesians are neo-Luddites. Rather, the point is that a neo-Luddite interpretation of recent technological changes that have impacted securities markets does have relevance for developing a Post Keynesian interpretation of recent financial scandals.

II. Old Lessons from the Stock Market

The ‘Dean Emeritus’ of Wall Street security analysts, Benjamin Graham, has been quoted as saying: “One thing badly needed by investors – and a quality they rarely seem to have – is a sense of financial history”. In this spirit, it is possible to look at key events in the recent past – the corpus of recent financial scandals – placing this experience within the historical progression of securities markets. In the process, connections can be established to the rich tradition of insightful works on securities markets that were motivated by the desire to educate market participants about the techniques and pitfalls of securities trading and investment analysis, e.g., Mortimer (1762), Graham and Dodd (1934). Recent financial scandals only serve to reinforce the pressing need for investor education to prevent the negative shocks to ‘conventions’ about security prices that play such an important role at both the personal and academic level. While the implications at the personal level are self-evident from a reading of Keynes (1936, ch.12), a germane example at the academic level relates to the role

of ‘conventions’ in determining the Keynesian marginal efficiency of capital.

At the end of the first quarter of 2003 a number of chilling events are still clear on the landscape: the collapse of corporate giants such as Enron, Worldcom and Adelphia induced by unethical and illegal financial management activities; the indictment and conviction – albeit mainly subject to large fines as penalties – of many large investment banking firms for activities that were aimed at the active deception of corporate securities investors; and, the bankruptcy and liquidation of the auditing firm Arthur Anderson induced by the illegal activities of this firm in the Enron debacle.² In addition, the technology-stock led market bubble that burst in early 2000 was characterized by a wave of IPO ‘paper hanging’ exercises in dot.com and other technology-oriented companies that resulted in hundreds of billions of dollars in losses for unsuspecting investors. The severe bear market that followed on the bubble collapse, at the current time, is at three years and counting.³ The toll on the confidence of the small investor has been severe.

With such recent events in mind, the following quotes provides a chilling reminder from days gone by that recent events are echoed in the not so distant past. For example, Philip Fisher (1975, p.1-2), a legend in the annals of security analysts, makes the following observation about conditions in the securities markets of 1974, following the ‘Nifty-Fifty’ market of the late 1960’s:

While these things are hard to measure precisely, indications are overwhelming that only once before in this century has the morale of the American investor been at anything like the low ebb that exists as these words are written the average stock in mid-1974 [is] down 70 percent from its 1968 peak.

Faced with this kind of loss, large groups of investors have acted in completely predictable ways. One group has pulled out of stocks completely ... There is an even larger group that is of particular interest: people who have decided that “from now on we will act more conservatively”. The usual rationale here is to confine purchases only to the largest companies, the names of which at least are known to almost everyone ... Not only stockholders themselves but also the American economy as a whole cannot afford ever again to have those who *make a sincere effort to understand the rules* suffer the type of bloodbath recently experienced by this generation – a bloodletting exceeded only by that which another generation experienced in the Great Depression some forty years earlier.

This chilling reminder from Fisher reflects the regularity of security market calamities.

This historical viewpoint of Philip Fisher, is expanded in the observations contained in the ‘Bible of Security Analysis’, Graham and Dodd (1934, p.1-3), four decades earlier:

It can hardly be said that the past six years have taught us anything about speculation that was not known before. Even though the last bull and bear markets have been unexampled in recent history as regards both magnitude and duration, at bottom the experience of speculators was no different from that in all previous market cycles. However distinctive was this period in other respects, from the speculator’s standpoint it would justify applying to Wall Street the old French maxim that “the more it changes, the more it’s the same thing”. That enormous profits should have turned into still more colossal losses, that new theories should have been developed and later discredited, that unlimited optimism should have been succeeded by the deepest despair are all in strict accord with age-old tradition. That out of the very intensity of the debacle there will arise new opportunities for large speculative gains appears almost axiomatic; and we seem to be on firm ground in repeating the old aphorisms that in speculation *when* to buy – and sell – is more important than *what* to buy, and also that almost by mathematical law more speculators must lose than can profit.

Graham and Dodd clearly recognized that the speculator’s game is a constant theme in securities markets. The process of speculators winning and losing is as old as markets themselves.

Like Philip Fisher, Graham and Dodd (1934, p.3) were deeply disturbed by the loss of faith from

stockholders and bondholders that had honestly entered the securities markets and were unjustly treated:

in the field of investment, experience since 1927 inspires questions both new and disturbing. Of these the least troublesome arises from the misuse of the term “investment” to cover the crassest and most unrestrained speculation. If that were the only cause of our investment difficulties, it could readily be cured by readopting the old-time, reasonably clean-cut distinctions between speculation and investment. But the real problem goes deeper than that of definition. It is bound up not with the grotesque failure of speculation masquerading as investment but with the scarcely less calamitous failure of investment itself, conducted in accordance with time-honored rules. ... The heavy losses taken by conservative investors ... warrant the serious question, Is there such a thing as sound and satisfactory investment? And also the secondary question, Can the investor rely upon the care and good faith of investment banking houses?

It is difficult to read these words and not see a direct parallel with events in the recent past. Despite numerous regulatory reforms, a revolutionary increase in access to information about securities, and a wealth of legitimate investment opportunities created by an array of technological advances, ‘insiders’ seem, once again, to have captured a lion’s share of the gains that, in properly functioning securities markets, are supposed to flow to legitimate investors and firms seeking investment capital.

These views are supported by the statements of one of the most successful investors in modern times, Warren Buffett. Writing just after the bursting of the technology/dot.com led stock bubble in 2000, Buffett observed about the then recent events in stock markets (Cunningham 2002, p.220):

[T]he huge valuations that market participants were then putting on businesses almost certain to end up being of modest or no value [was irrational]. Yet investors, mesmerized by soaring stock prices and ignoring all else, piled into these enterprises. It was as if some virus, racing wildly among investment professionals as well as amateurs, induced hallucinations in which the values of stocks in certain sectors become decoupled from the values of the businesses that underlay them

What actually occurs in these cases is wealth *transfer*, often on a massive scale. By shamelessly merchandising birdless bushes, promoters have in recent years moved billions of dollars from the pockets of the public to their own purses (and to those of their friends and associates). The fact is that a bubble market has allowed the creation of bubble companies, entities designed more with an eye to making money *off* investors rather than *for* them. Too often an IPO, not profits, was the primary goal of a company’s promoters. At bottom, the “business model” for these companies has been the old-fashioned chain letter, for which many fee-hungry investment bankers acted as eager postmen.

Despite all the layering of regulations and regulators, together with the associated legislative boilerplate, predatory investment banking practices went largely unchecked. Writing this as the Frank Quattrone jury is being sequestered, it still seems that almost all of the ‘paper hangers’ are continuing to enjoy the spoils of the feeding frenzy. Even where penalties have been imposed, there is the lasting impression that ‘the more things change, the more things remain the same’.

As Keynes (1936) demonstrates, the importance of securities markets in a capitalistic society is difficult to underestimate. Securities markets are essential in life-cycle savings activities, connecting firms requiring capital for production activities with individuals and other firms seeking investment opportunities to grow savings that will be used for future consumption and investment activities. Speculators and financial intermediaries play an essential role in improving the efficiency of this savings-investment process. As agents of the shareholders, corporate management also plays an essential role in ensuring that firms make capital investment decisions that enhance shareholder

returns. However, when the insiders – the corporate managers, financial intermediaries and closely connected large speculators – obtain gains from this process that exceed the net benefits that are being provided, then capitalistic society, as a whole, is worse off. At some point, the rake off becomes so excessive that confidence in the process is threatened. One implication is that savers react by avoiding purchases of financial securities resulting in a mis-allocation of capital resources toward alternative investments such as real property. In all this, the ethical shortcomings of the enhanced consumption activities of unscrupulous insiders are a legitimate concern to neo-Luddites and, hopefully, Post Keynesians.

The perception that ‘insiders’ are able to extract excessive returns – economic rents – from the investment-savings process is not new. For example, in 1940 Schwed produced an interesting effort detailing security market events up to and around that time: Where are the Customers’ Yachts?: Or a Good Hard Look at Wall Street. While there is an apparent desire on the part of regulators and legislators to ‘right the ship’, old problems persist. It is difficult to deny that the power and influence of ‘insiders’ is more than sufficient to avert substantive reforms that would, say, eliminate abuses of executive stock options or criminally penalize those at large securities firms responsible for distributing initial public offerings (IPO’s) that have little chance of economic success. It may even be possible to prevent the ‘investment advisory’ industry from proliferating the number of open-ended mutual funds in order to maximize the ‘take-off’ in fund management fees. Such technology-driven disconnections between the investor advancing the capital (to buy the managed fund) and the actual purchaser of the security (the fund manager) creates a potentially dangerous environment for security valuation.

III. Who Were the Luddites? Are Post Keynesians neo-Luddites?

“The outbreak of the Luddite disturbances in the Midlands in 1811-2 is an episode in the long and varied history of the relations between masters and men in the frame-work knitting trade, and as such can only rightly be understood in connection with what comes before and after ... The main feature of the disturbances in Nottinghamshire and the adjoining counties was the organized destruction of stocking frames by small bands of workmen” (Hammond and Hammond 1919, p.257). To some, the words Luddite and machine-breaker are synonymous. This interpretation has survived into modern times where ‘neo-Luddite’ is usually characterized as representing active resistance to the progress of new technology.⁴ However, as with the Luddite riots, conventional characterizations do not accurately capture the actual state of affairs. Just as Luddites were against the inappropriate application of a specific technology and not against technology, per se, neo-Luddites struggle against the undesirable elements in technological change while seeking to retain the desirable elements..

In the context of the modern securities industry, the ‘new technology’ takes many forms. There has been a revolution in information and securities market access that has been facilitated by the technological advances of the last two decades of the 20th century, particularly the combination of widespread access to high speed personal computers, on-line internet trading and information services, and 24-hour cable television programming largely dedicated to promoting common stock trading. The temptations for individual investors to participate in securities markets, especially common stock markets, have never been so great. In addition, there has been the emergence of investment opportunities in these new technologies that has created challenges for traditional security

analysts and investment strategists. The need for a neo-Luddite interpretation of the situation is understandable.

Like value investing or growth stock, neo-Luddite is another expression that has variable interpretation. This is, at least partly, due to the different possible interpretations that can be given to the original Luddite rebellion. While it is true that the Luddites engaged in machine-breaking, there was much more involved in the Luddite riots of 1811-12. These events in the English Midlands still capture the attention of economic historians, sociologists and philosophers almost two centuries later. Modern observers often highlight the rebellion against technology or technological unemployment that the Luddite riots represent. Some modern historians emphasize the place of the Luddites in the working class struggle against the onslaught of industrialization, e.g., Hobsbawm (1965). Observers closer to that time, such as Lord Byron, identified with the revolutionary elements in the Luddite movement, as reflected in his "Song for the Luddites".⁵ There are many possible themes. There is even a story to be told that is of profound relevance for the issues raised in the recent financial scandals. But, as with recent events, the Luddite riots can only be understood "in connection with what comes before and after".

As any reader of Charles Dickens knows, the early 19th century in England was a bleak time for the poor and destitute. Social injustice is hardly descriptive of the general situation. As for the working poor, conditions in the textile mills and putting-out shops were hostile to the many children who were compelled, of economic necessity, to work there. There were few mechanisms for adult workers to express discontent. One method was general riot, but this was used only in extreme situations, such as when food was intolerably scarce and prices for food were high. In response to conditions in a specific industry, machine-breaking was a more common and effective tool for workers to express discontent. Instances of organized machine breaking were not original to the Luddite riots. Such actions had occurred at least since the early 18th century. Yet, as evidenced by the army of 12,000 soldiers that was used to suppress the uprising at the height of the Luddite riots, there was something different involved. As Thomis (1970, p.145) observes:

... the army of 12,000 required for domestic use to suppress the Luddites was a greater force than Wellington had taken to Portugal in 1808 ... The army against the Luddites might have been six times as large as any needed previously for domestic disputes ... Luddism was something new ... There were civil wars, religious riots, food riots and industrial riots in the previous two centuries, but there had never been such wide-scale industrial riots occurring simultaneously with food riots in an industrial revolution context, where the problems of three major industries reached crisis point. And all this was happening during the greatest war that the country had ever waged, with an economy now dependent on overseas trade which could not be sustained.

One interesting aspect of the riots was the absence of any Parliamentary action on the riots until after the peak of the rioting had passed.

The Luddite riots were situated in a particular historical context, just as the technology boom of the last two decades of the 20th century is situated in a particular historical context. Certain elements carried forward from previous times are echoed while new elements are also introduced. The specifics of the situation cause individuals to react in a collective fashion that creates "something new". Yet, even with a long period for reflection, there is still misunderstanding about the Luddite riots, just as there is and will be misunderstanding about the events in securities markets in the last few years of the 20th century. For example, in contrast to the riots in the woolen district of Yorkshire in 1796, the Luddite riots did not involve mobs attacking factories where new and improved

machinery was in use,: “in truth, there was no new machinery in use, although, among other grievances, there was a new and, as it seemed to the men, an illegitimate adaptation of an old machine” (Hammond and Hammond 1919, p.257). Rather, the Luddite movement was aimed at specific manufacturers known for harsh treatment of workers that had, in most instances, rapidly achieved a high level of wealth. The economic situation created by the war with France, and the associated disruption of trade, had raised the cost of food at a time of reduced working opportunities. In turn, the degree of organized reaction against those seen to be benefitting at a time of hardship for the lower working classes was, in a sense, revolutionary.

A neo-Luddite examination of recent financial scandals does not have to call for a revolt against the progress of technology in the securities industry. Rather, the illegitimate adaption of technology can be the issue. In the recent past, securities markets have seen advances in information and trading technologies that have extended the scope of security trading to include unsophisticated individual traders not previously involved in securities markets. Even more sophisticated traders now have access to information about securities that was not possible as recently as two decades ago. Yet, this enhanced access to trading and information has not been matched by increases in the ability to analyze securities. This creates a market environment where unscrupulous operators can thrive. For example, unsophisticated investors, wanting to enter the game but unable to make accurate security selection decisions, are encouraged to purchase managed investment funds. This permits securities firms to proliferate the number of funds to include a range of sector funds that are mandated to purchase a relatively narrow range stocks. The result is a disconnection between the purchaser of the security – the mutual fund investor – and the analysis of the specific securities being purchased.

In addition to fund product proliferation, unsophisticated investors are enticed into unsound trading practices that are rationalized using ‘advances(?)’ in security analysis that are reminiscent of the “new era theory” of Graham and Dodd (1934) (e.g., Poitras 2004). This situation has been complicated by the wave of advances in internet, telecom and other high technology applications that has spawned a range of new investment opportunities that are not readily analyzed using traditional valuation methods. The combination of these and other technological advances in securities markets created an environment that produced a speculative bubble in common stocks, particularly in the technology related sector. The use of inadequate valuation methods for these stocks contributed to the boom in new technology issues. The overwhelming success that many of these IPO’s had for issuers presented the temptation of easy money that, ultimately, proved irresistible to many investment bankers. Success in the technology IPO segment contributed to a market environment of ‘good news’ where financial shenanigans by the likes of Enron, Worldcom, Tyco and others were received without sufficient skepticism and inspection by investors, regulators and academics.

All this speaks to an important, if unresolved, discrepancy between Frank Knight and Keynes about the impact that growth in the breadth and depth of securities markets has on the resolution of pricing uncertainty in those markets. Knight (1921, p.239) recognizes four methods of dealing with uncertainty: consolidation; specialization; control of the future; and increased power of prediction. It is not difficult to see how Knight would argue that recent technological advances would contribute to a reduction in the uncertainty inherent in security valuation. In contrast, Keynes (1936, p.158) observes:

If I may be allowed to appropriate the term *speculation* for the activity of forecasting the psychology of the market, and the term *enterprise* for the activity of forecasting the prospective yield of assets over their whole

life, it is by no means always the case that speculation predominates over enterprise. As the organization of investment markets improves, the risk of the predominance of speculation does, however, increase.

By substantively enhancing the overall liquidity of securities markets, recent technological changes have contributed to the predominance of speculation over enterprise. Given that Keynes recommends that the “social objective of skilled investment should be to defeat the dark forces of time and ignorance which envelop our future”, it is sensible to interpret this aspect of Keynesian macroeconomics as being consistent with the tenor of neo-Luddism.

IV. The Information Revolution, High Tech Stocks and Gorilla Finance

The Luddites provide a rich source of historical lessons for modern observers. One useful lesson is that the same event can be interpreted in a number of different ways. These various interpretations may, or may not, be seen as consistent with actual events. A specific event can be given an interpretation that, while comforting to the proponent, may unhelpfully stretch or assemble facts. In writing about current events such as corporate deceit and corruption associated with the collapse of firms such as Enron and Worldcom or the indictment and conviction of major securities firms for unethically touting stocks in investment research reports, financial market observers are not unlike historians writing about the Luddites (Thomis 1970, p.30-1)

Historians ... are repeatedly warned that by and large they find in the past what they want to find there, and the factors that influence them in their search are too numerous and complex to warrant discussion here. Yet these factors are particularly important where a subject such as the Luddites is concerned, for it is on this sort of subject that the historian has had a particular difficulty in achieving not objectivity, for this is beyond him, but a recognition of the subjectivity which pervades his work. And so the Luddites have usually been presented as the people we want them to have been and at the same time we have believed that this is what they really were.

And so it is with the corporate collapses, stock market bubbles and unethical activities of major securities firms in the late 20th and early 21st century. There are those who would point to events such as the Enron collapse and the prosecution of Arthur Anderson as evidence in support of the effectiveness of SEC enforcement and the FASB-inspired auditor oversight rules. There are also those who would argue the opposite position, that serious corporate collapses such as those at Enron and Worldcom are evidence of the ineffectiveness of prevailing regulatory and oversight structures.

This all relates to another deeper lesson from Luddite history: the power of the state is often biased in favour of ‘economic progress’ and the well-connected special interests that benefit from this progress. The bias is claimed to be justified by the social benefits of achieving economic progress, though the power is often applied selectively and the gains distributed disproportionately to degree of influence that special interests can have. The Luddites have long since receded from the stage of history and the immediate issues that concerned them have also disappeared, along with the archaic laws and social practices that characterized early 19th century England. Yet, the Luddites still remain relevant in modern times, if only as a symbol for those seeking a fair distribution of the gains resulting from the relentless development of modern technology.

In securities markets, due to the technological revolution brought on by the internet, cable television, satellite communication and the like, investors have rapid access to a range of information sources that was inconceivable even two decades ago. This information access has been coupled with

the ability to execute trades with speed, precision and low expense. This has contributed to an unparalleled degree of interest in trading securities, particularly common stocks, by the general public. Recent events have revealed the ability of certain large securities firms to use this heightened interest and technological environment to extract unwarranted intermediation profits.

Is the present regulatory structure sufficient to deal with securities markets of the 21st century? Though an acceptable answer to this question has to ultimately prove elusive, it is possible to make some general observations. Events surrounding the collapse of stock market prices that began in early 2000 produced a number of reforms aimed at ‘cleaning up’ the securities industry. Recognizing that the scope of the reforms pales in comparison to the changes introduced in the mid-1930's, key legislation such as Sarbanes-Oxley does incrementally improve the enforcement structure. Yet, the desire and ability to prosecute available laws can in many cases be more effective than introducing new laws. The prosecution of a number of high profile individuals – investment analysts, corporate executives and professional auditors – gives the appearance of a concerted effort by regulators to deal with recent wrongdoings. However, there is still considerable evidence that immense gains derived from unethical and, in some cases, illegal security market activities still remain in the hands of unscrupulous “stock market operators”.

While commendable, the goal of a security market where individual investors are insulated by regulations and regulators from unscrupulous stock market operators is unrealistic. The history of security markets is an almost continuous record of ‘fleecing the lambs’. For example, the first significant study of English stock market practices, Everyman his own Broker (1761) by Thomas Mortimer was aimed at educating individual investors on how to avoid the schemes and machinations of stock market intermediaries operating in London’s Exchange Alley, e.g., Poitras (2000, ch.8). In the 19th century, the activities of Drew, Gould and Fisk are symbolic of the market manipulations of that era (Poitras 2004, ch.2). The stock market machinations of the last few years of the 20th century are only the most recent in the long history of relations between unscrupulous market insiders and the individual investors that, in the end, are the source of the unconscionable rake-offs that accrue to those insiders. In a society that measures success in terms of material accomplishments, it is commendable to become a millionaire by marketing pieces of paper, such as IPO stock certificates, based on some idea that is appealing to investment bankers. Success is measured in terms of wealth accumulation and not by whether the underlying venture becomes a profitable business or produces socially beneficial products.

The problems appearing in security markets are systemic, transcending the ‘greed is good’ ethos of modern financial activities. As Keynes (1936, p.157) observes: “There is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable”. Keynes (1936, p.155-7) argued forcefully against a securities market that is dominated by considerations of liquidity: “We have reached the third degree where we devote our intelligence to anticipating what average opinion expects average opinion to be.” In such an environment, investors making decisions based on “the best genuine long-term expectations he can frame” face prospects that are “so difficult to-day as to be scarcely practicable.” In contrast to those trading on “the anticipation of impending changes, in the news or in the atmosphere ... by which experience shows that the mass psychology of the market is most influenced”, those investing on the basis of long-term value “run greater risks than he who tries to guess better than the crowd how the crowd will behave”. Ultimately, “given equal intelligence, [the long-term value investor] may make more

disastrous mistakes”.

V. The Continuing and Pressing Need for Investor Education

It is not possible in a brief paper to deal in a substantive fashion with specifying a road map for reform of securities markets that would be consistent with all neo-Luddite concerns or, for that matter, Post Keynesian concerns. Logical identification of such reforms would make sense only by accurately identifying the complex interactions between security market participants that take place within the context of modern technology-driven society. The objective here is much less ambitious: to identify with one key aspect required to achieve a personal line of defense against the relentless development of technology in the securities industry. That key is the education of investors, particularly unsophisticated investors, about the valuation techniques involved in making “the best genuine long-term expectations” about future security values. Though there was an element of fraud in a number of the recent financial scandals, e.g., the Enron collapse, the general absence of criminal prosecutions arising from the scandals indicates that investor ignorance likely played a larger role in the market manipulations than the criminal intent of the market insiders.

As Keynes (1936, p.156) observes: “it makes a vast difference to an investment market whether or not [skilled individuals who purchase investments based on genuine long-term expectations] predominate in their influence over game players.” Such investors face numerous obstacles, including human nature – “life is not long enough ... there is a peculiar zest for making money quickly” – and the need “for greater resources for safety” to weather the possibly long periods until prices accurately reflect genuine long-term expectations. Unlike areas such as medicine and the law where rigid requirements are imposed on practitioners and, by implication, teachers, there are relatively few requirements imposed on those dispensing investment advice. The market is guided by self-regulation and *caveat emptor*. Finance academics have been largely content to approach the subject from the philosophical perspective of logical positivism, engaging in the ‘scientific’ search for absolute truths that mimics the approach of the natural sciences.

Casual inspection of the market for investment advice reveals the need for a neo-Luddite perspective on views that are widely disseminated in the practitioner community. A useful example is “gorilla game finance”, a concept promoted in the most successful investment book featured on Amazon.com during 1998. This approach to security analysis and investment strategy has certain elements in common with, say, Philip Fisher: “Ours is deliberately a *hyperselective investment strategy* which calls for investing in as few companies as possible” (Moore et al. 1999, p.xxiv). For Moore et al. (1999, p.19-20), the gorilla game is a form of growth investing: “Like growth investors, gorilla gamers value the forward looking dynamics of a company’s market as a better indicator of its future stock performance than its current price/earnings ratio ... It focuses exclusively on high tech, and specifically on product oriented companies that sell into mass markets undergoing hypergrowth ... It uses consolidation, not diversification, as its primary risk-reduction strategy for long-term holds.”

At least since Graham and Dodd (1934), traditional security analysis has emphasized the need for diversification. Even Philip Fisher, an analyst with an aversion to holding large numbers of securities, emphasized the importance of not concentrating all investments in the same sector. Some diversification across industries is an essential component of any plausible investment strategy. Yet

this is precisely what the gorilla game recommends. The Luddites were not against the progress of technology but rather the illegitimate application of technology. Similarly, a neo-Luddite perspective on ‘progressions’ in security analysis such as the gorilla game argues against the illegitimate application of traditional valuation techniques to investment in technology companies. Approaches to security analysis such as the gorilla game are comforting to unsophisticated investors that are unwilling or unable to analyze the securities of a sizable number of firms across a wide range of industries. Itching to take advantage of the dramatically enhanced ability to trade common stocks provided by the developments in technology, the unsophisticated investor is massaged into believing that all that is required for successful investing is to stick to technology and pick the gorillas.

Heuristically, a gorilla is a high tech superpower that dominates its area of business. Companies such as Microsoft, Intel, Cisco and Oracle are identified as gorillas. The primary objective of the gorilla game is to identify the gorillas of the future. According to Moore et al. (1999, p.13-4), the essence of the gorilla game can be captured in a few points: *“Find markets transitioning into hypergrowth ... Buy a basket of stocks that represent all the companies that have a clear shot at being the gorilla ... As the gorilla emerges, sell off the rest of the basket and consolidate your holdings in the gorilla ... Plan to hold the gorilla for the long-term ... Sell the gorilla only when a new category, based on alternative technology, threatens to eradicate its power.”* Moore et al. (1999, p.87) explicitly recognize that the price of a gorilla “looks like a very hot company in a very hot category, and its price gets bid up.” Yet, it is claimed that despite the seemingly high price “the market undervalues just how hot this gorilla is ... we have to say at the outset that the stock will not look undervalued – it would certainly not attract a value investor.” All this is vaguely reminiscent of the Graham and Dodd (1934) “new era theory” of stock investing.

The gorilla game is not proposed without a detailed rationalization. There is a reference to the stock price being the present value of future anticipated earnings, but the analysis is not structured around this notion in the same fashion as for value investing. Instead there is a focus on explaining the success of gorillas. There is discussion of value chains: “The power of a gorilla is based on its control over a value chain” (p.52). This is supplemented by the technology adoption life cycle: “systems plateau and resist change until enough stress builds up to break the old system and bring in the new” (p.11). There is even a connection to Porter’s competitive advantage: “whereas Porter is typically looking at substitutions of one mature category for another – say, beer for wine or wine for liquor – high tech is based on discontinuous innovation” (p.43). Despite the reference to conventional theorizing, the gorilla game is predicated on the assumption that high tech gorillas are systemically undervalued and that consolidating investment portfolios into a small number of such stocks is an optimal strategy. While the gorilla game may have had a successful track record up to and shortly following the time Moore et al. (1999) book appeared, the abject failure of this strategy since that time is not difficult to document.

The gorilla game calls out for a neo-Luddite perspective regarding the illegitimate application of easy to digest security analysis and investment strategy techniques. A central theme of security analysis going back at least to Graham and Dodd (1934) is the need to make a distinction between speculation and investment. Though Moore et al. are able to describe high tech stocks in terms of analytical techniques that are associated with investment opportunities, recall the essential features of the new era theory (Graham and Dodd 1934, p.307): “That the dividend yield should have slight bearing upon the value ... That since no relationship apparently exist[s] between assets and earning

power, the asset value [is] entirely devoid of importance ... That past earnings [are] significant only to the extent that they indicated what *changes* in the earnings were likely to take place in the future". The essential features of the gorilla game are narrowly focused on exploiting the speculative valuation of a segment of the high tech stock sector. Where the theory does not fit, as with bio-technology stocks, such opportunities are ignored. It is explicitly recognized that extension of the theory to, say, internet stocks requires considerably tinkering with the underlying notions. While the desire to identify and capture the next Microsoft or Intel long before it emerges as a gorilla is commendable, it is inappropriate to pass such musings off as sound investment strategy.

The widespread propagation and acceptance of strategies such as the gorilla game is only one of a wide range of issues in modern securities markets that require a neo-Luddite perspective. Though academics are well situated to undertake arms length examination, only a limited amount of such analysis has been forthcoming. The self-regulatory aspect of modern securities markets provides an avenue for practitioners to be the source of many schemes that require inspection. In addition, regulators are typically biased toward maintaining the status quo and act to plug holes in the dike, instead of redesigning the flood control system. Yet, the general reluctance on the part of academics to actively challenge a range of ill-conceived practitioner and regulator dictums and policies is both understandable and unfortunate. Among academics concerned with these issues, there is still a lack of widespread agreement on the appropriate approach to key aspects of security selection. The central propositions of modern Finance, such as the efficient market hypothesis and two fund separation, have a philosophical basis and practical implications that are contrary to the views of many practitioners. The recent questioning of these propositions within modern Finance only serves to complicate matters further.

In the tradition of educational materials on security trading going back to Mortimer (1761), the education of students, small individual investors, practitioners and other academics about the appropriate techniques of security analysis and investment strategy is an effective first line of defense in the struggle against the market interests seeking 'fleecing' opportunities in modern securities markets. Ultimately, education can be an effective defense against, not only the unscrupulous stock market operators, but also the broader *caveat emptor* environment that is pervasive in securities markets. Mortimer claimed to have lost a "genteel fortune" to the stockjobbers of Exchange Alley prompting him to refer to himself as "a bastard of the alley". The memorable comment from Groucho Marx about the financial losses he suffered during the market collapse that started in Oct. 1929 captures a sentiment eerily similar to Mortimer almost 200 years later: "I only lost \$250,000 ... it wasn't much, but it was all the money I had". From a neo-Luddite perspective, the recent scandals in financial markets demonstrate that recent developments in information and trading technologies have exacerbated, rather than alleviated, the abilities of unscrupulous market operators to 'fleece the lambs'.

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NOTES

1. The neo-Luddite movement is a fluid and loosely knit grouping of thinkers that share some common threads. In particular, neo-Luddites argue that technological development is not necessarily equivalent to technological progress. More generally, neo-Luddites question the position that technology has assumed in interpreting the human condition. Though violent fringe elements, such as the Una-bomber, share these concerns, there have also been thoughtful intellectual contributions originating from the movement, such as Glendenning (1990), Roszak (1994) and Sale (1995). Some neo-Luddites claim the French philosopher Jacques Ellul (Ellul 1964) as a precursor. Bailey (2001) and Frobish (2002) are recent discussions of the movement.

2. There are numerous sources that chronicle the recent financial scandals, though the details of some stories in more recent scandals still remain to be told completely because events have not as yet arrived at a completion. Many of the currently available sources on specific financial scandals are written in the tradition of Stewart (1991), Lewis (1989) and Burrough and Helyar (1990). For example, Schwartz and Watkins (2003) chronicles the rise and fall of the Enron corporation while Toffler and Reingold (2003) examines the collapse of Arthur Anderson. Partnoy (2003) provides a more general overview of the scandals.

3. Precise estimates of investor losses due to the collapse of the stock market bubble are difficult to determine, if only because a significant fraction of the losses were only losses on paper. In other words, it is possible to calculate the loss as the change in aggregate stock market capitalization from the market peak in early 2000 to, say, the market capitalization two years later. Such methods of estimation can produce values as high as \$10 trillion. Yet, this assumes that investors actually purchased stocks at the inflated prices. A more accurate estimate of the losses would involve determining the size of the net capital losses – book value minus market value adjusted for an adequate level of return over the holding period – over the period of the bubble. Given the large number of investors and wide range of book values, this type of calculation is not possible to determine. However, the value of the losses used here of ‘hundreds of billions’ is not difficult to justify and, if anything, is overly conservative.

4. Though there is some disagreement on the point, it is generally accepted (e.g., Thomis 1970, p.11) that the term Luddite originates from the use of the name ‘Ned Ludd’ as a signature on threatening letters sent to employers in Dec. 1811. This resulted in the local *Nottingham Review* referring to the stocking-frame breakers as Luddites, a term that was adopted and continues to this day. According to John Blackner, a local historian of the time, the reference to Ned Ludd can be traced as follows: “the framebreakers assumed this appellation from the circumstances of an ignorant youth, in Leicestershire, of the name Ludlam, who, when ordered by his father, a framework-knitter, to square his needles, took a hammer and beat them into a heap’.

5. The poem by Bryon goes:

As the Liberty lads over the sea

Brought their freedom, and cheaply, with blood
 So we, boys, we
 Will die fighting, or live free,
And down with all kings but King Ludd.

When the web that we weave is complete,
And the shuttle exchanged for the sword,
 We will fling the winding sheet
 O'er the despot at our feet,
And dye it deep in the gore he has poured.

 Though black as his heart its hue,
 Since his veins are corrupted to mud,
 Yet this is the dew
 Which the tree shall renew
 Of liberty, planted by Ludd!