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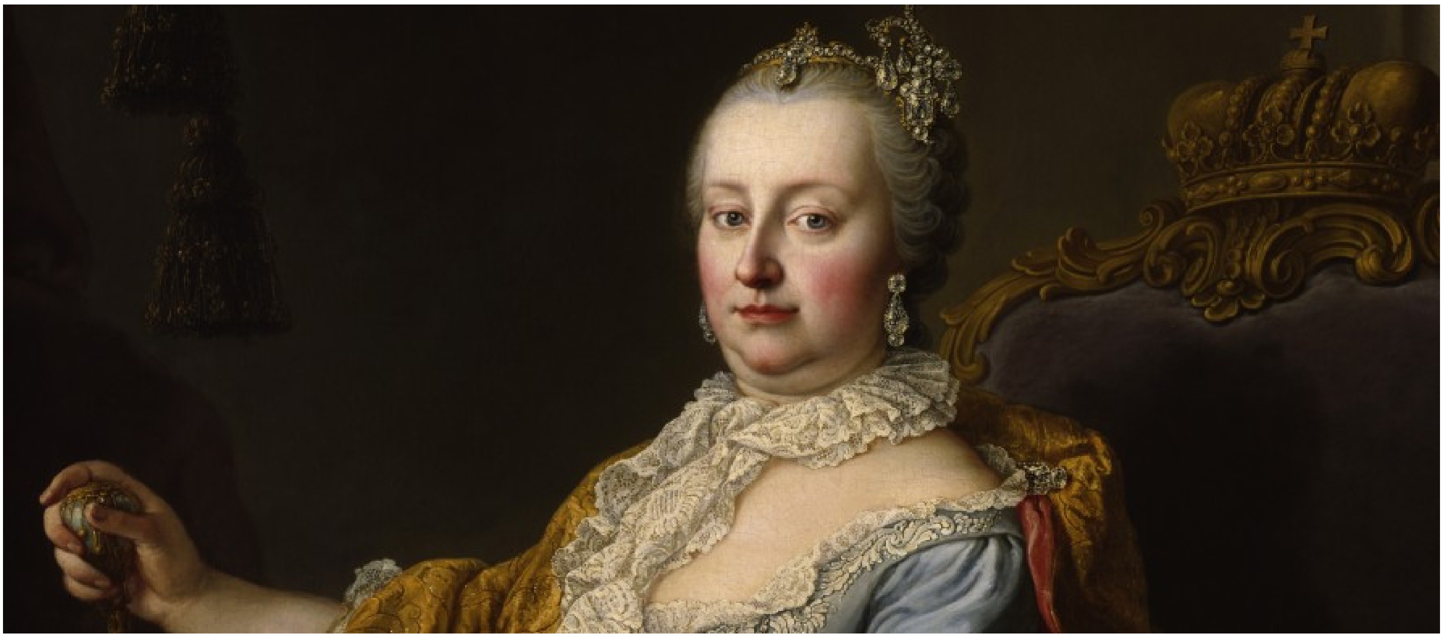
What investors can learn from Maria Theresia and the Vienna stock exchange

Paul Severin



Austria celebrates the 300th birthday of Maria Theresa. She was born on 13 May 1717 in Vienna. It was her who founded the Vienna stock exchange in 1771 on the basis of an imperial patent (see image), after an earlier, failed attempt in 1761. Even though a lot has changed politically, economically, and technically since then, the eventful history of the Vienna stock exchange is still very instructive for every investor.

1. Securities trading has to be regulated and supervised

The reason for the establishment of the Vienna stock exchange in 1771 was the attempt to finance the numerous wars the Empire was and had been involved in. The War of the Austrian Succession and the Napoleonic wars had cost a lot of money. At that time, securities in the form of obligations (today: government bonds) already existed, but there was no regulated market where they would have been traded. Founding a stock exchange in order to finance the rising budget debt in an orderly way was therefore a strategic question.

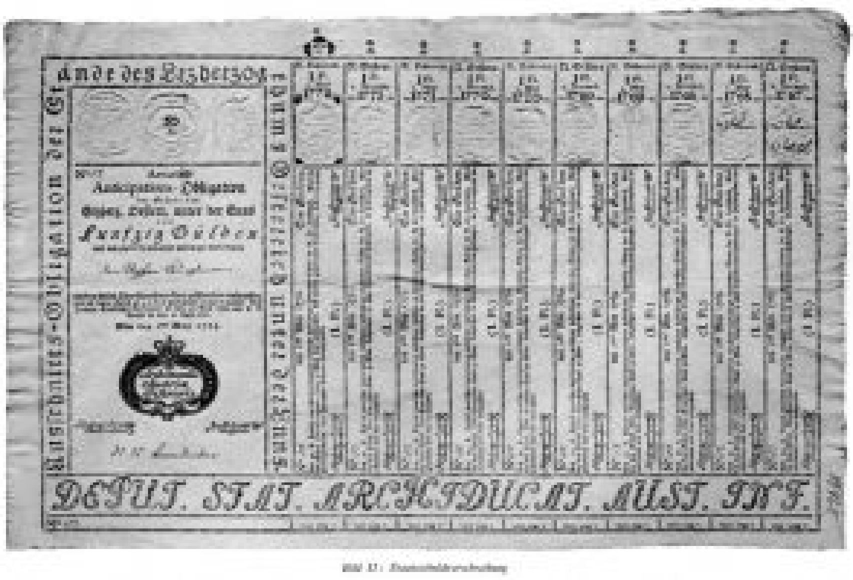
The patent from 1771 mentions possible damages that not only the owner but also the issuer could suffer as a result of uncontrolled trading in securities. “Bucket-shops” were subject to particularly stringent criticism. Those were traders who acted unofficially and without licence. Plans were to do away with this lack of transparency. The goal was a regulated market.

The advantages of a regulated market are often forgotten if the capital market is painted with the broad stroke of speculation. Actually, it is the regulated and supervised processes of securities trading that characterise a stock exchange.

Image: The old Vienna trading floor fell victim to a fire in 1956 Source: Vienna stock exchange

2. Stock exchange histories and cycles repeat themselves

The costly Napoleonic wars came with disastrous consequences for Austria. In 1811, they even caused a national bankruptcy. The prices of government bonds fell to 12% of their nominal value.



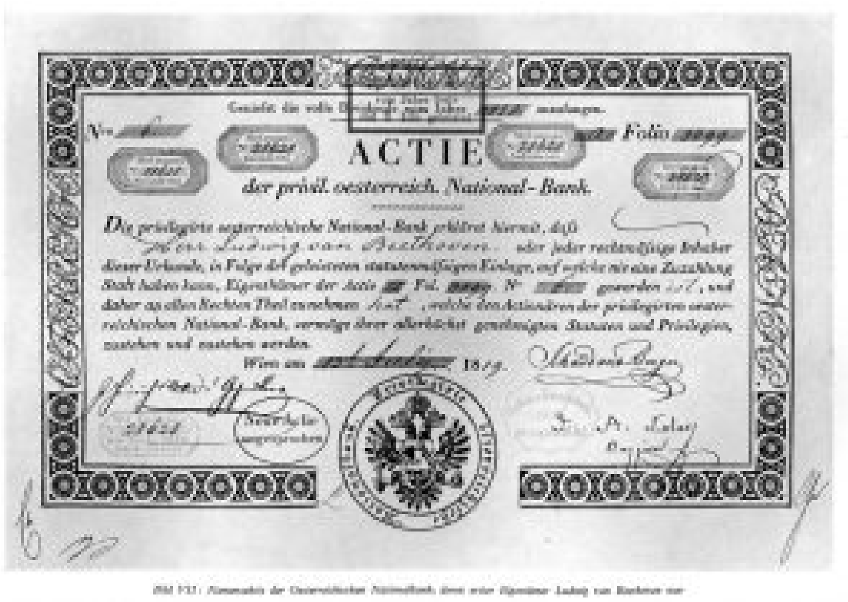
Government obligation, 1 May 1767 Source: Vienna stock exchange

The industrial rise in the second half of the 19th century caused numerous companies to float their capital on the stock exchange. The increased supply convinced an increasing part of the population to invest their savings in equities. These were largely speculative funds that pushed share prices up. This in turn attracted companies that were unstable but were still floated. The climax of the bubble arrived in 1873 at the same time as the World Exposition 1873 Vienna. On the one hand, the expectations from the Exposition were excessive, and on the other hand it cost a lot of money that was allocated badly. Many retail investors bought shares on credit. When people started realising that the economic success of the World Exposition was not going to happen and the general economic situation was falling short of expectations, the institutes called on the speculators for fresh money due to the falling prices. Many were unable to produce the required funds, which accelerated the downward spiral. It took years for trust to come back.

This scenario reminds us of the speculative bubble of the former stock exchange segment “Neuer Markt” in Germany at the end of 1999/2000. This segment was founded in 1997 as a result of the euphoria around the new economy to emulate the American technology exchange NASDAQ. Here, expectations, fuelled by the turning millennium, were also beyond reach. Many companies floated on the stock exchange were selling the hope of future success but were otherwise built on shaky grounds. A stock exchange adage describes this phenomenon: “No price is too high for a bull, and no price is too low for a bear.” Phases of overshooting are nothing new on the stock exchange, and they will always exist.

3. The stock exchange is a copy of the economy

In 1816, “Privilegierte österreichische Nationalbank” (privileged Austrian central bank) was founded, with its shares listed as of 1 April 1816 at the Vienna stock exchange. For a long time, the shares of Österreichische Nationalbank were the only ones traded there. Fun fact: Ludwig van Beethoven was one of the shareholders.



Registered share: Ludwig van Beethoven Source: Wiener Börse (Vienna stock exchange)

It was 1842 before additional shares were floated: Kaiser-Ferdinands-Nordbahn, Budweis-Linz-Gmundner Eisenbahn, and Donau-Dampfschiffahrtsgesellschaft. None of these companies have remained listed on the stock exchange.

The stock exchange is a scale model of the economy. Companies float their stock on the stock exchange, are taken over, or take over other companies. Some companies go bankrupt, others change their business model, their name, or delist their capital again. All that is totally normal. Economic activity means change. Equity investors invest in the economy and also benefit from its changes.

4. Shares as protection from inflation

At the beginning of WWI, the Vienna stock exchange ceased operations and only resumed them at the end of 1919. In the following period of political and sociological change and the so-called “crown inflation”, which wiped out the savings of countless families, the stock exchange registered a large influx of investors and a rise of share prices driven largely by inflation. After the introduction of the Austrian schilling and upon consolidation of the economic and currency situation, the Vienna stock exchange also entered calmer waters.[1)]

That period bore the stock exchange wisdom according to which equities are a good protection against inflation. Savers often get a raw deal at times of high inflation, especially with inflation rates below the interest rates. Today’s situation is similar, even though at 2% the extent of inflation is significantly smaller. But the real devaluation of money supports stock exchanges today as well.

5. Closing stock exchanges is no good idea

The beginning of WWI in 1914 caused the Vienna stock exchange to shut temporarily. But soon it became obvious that a closed stock exchange did not stop people from trading – except now they were doing so outside of the supervision by authorities, with all the negative consequences one might imagine. [1)]. In WWII, or more precisely from 1938 to 28 March 1945, the Vienna stock exchange was open for trading. On 28 March, the last session took place at the stock exchange. On 15 November 1948, the Vienna stock exchange was re-opened ceremonially and has held its prominent spot in the Austrian economy ever since.

Interestingly, the holders of securities would generally come out of years of war in better shape than the owners of cash or savings accounts. The interest in securities has therefore been on a continuous rise since the re-opening of the stock exchange in 1954.

A closed stock exchange comes with the risk of prices being established outside of the regulated market. Nowadays, securities are often suspended from trading in case of extreme price fluctuations. A lot has been said about whether or not this makes sense. History teaches us that trading should remain in place also during difficult times. Transactions outside the stock exchange lack transparency.

6. A stock exchange is a basic requirement for wealth and employment

Providing the economy and the government with capital, either equity in the form of shares or debt in the form of bonds, is the most important function of an exchange. If companies can persuade investors to invest in their business models, jobs are created, governments can finance their household at economical rates and transparently and ensure the liquidity for their projects.

The term "stock exchange" often conjures up the image of Silicon Valley. Young companies require venture capital in order to try something new. They often do not receive the funds from traditional sources such as loans. This also applies to existing companies.

7. Share prices contain important information for all participants in the economy

It is important to interpret the share prices as signal for the business sector. The transparent establishment of prices holds an important function for the business and the public sector.

The current price contains information that is publically available and thus speaks to the future assessment of the asset. The price thus reflects the expectations of the future. This is the democracy of the stock exchange. It is where different market opinions meet. Only if someone is willing to buy or sell at a certain price is a price established. It is the optimal reflection of the company value.

[1)] Vienna Stock Exchange: 1771 bis 1959; Wiener Börsekammer
Festschrift 200 Jahre Wiener Börse, Dr. Harald Eichler

- Photos/Pictures: kindly made available by Vienna Stock Exchange:
  * State obligation from the time of founding the Vienna Stock Exchange
  * Die stocks of the Austrian National Bank owned by Ludwig van Beethoven. The National Bank-Shares were introduced on 1.4.1816, the first official trade was on 27.5.1818. It was the first stock that was traded on the Vienna Stock Exchange. The price was 510 ½ Gulden C.M.
  * Trading floor of the Stock Exchange Building; Ringstraße, 19the Century.

The author likes to thank the Vienna Stock Exchange for the valuable input and pictures.

Paul Severin

Paul Severin has worked at Erste Asset Management since April 2008. Until 2012 he was responsible for the company's product management; he has directed communications and PR activities since April 2012. From 1992 to 2008, he was director of equity fund management and deputy director for institutional funds at Pioneer Investments Austria in Vienna.

His career in the securities business began in 1992 at Constantia Privatbank as a portfolio manager and analyst. He worked as primary analyst at Creditanstalt Investmentbank in Vienna from 1994 to 1999.

He studied international business at Innsbruck University and Marquette University in Milwaukee, WI, USA. Before his university studies, he worked at Dornbirner Sparkasse in letters of credit and export financing.

Paul Severin is a member of the board at ÖVFA (Austrian Association for Financial Analysis and Asset Management) and a CEFA charter holder.