

Extraordinary
Popular Delusions

and **the Madness of Crowds**



JOHN LAW

(See Page 1)

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Popular Delusions
and the Madness of Crowds

Charles Mackay

Reproductions of original illustrations
from the editions of 1841 and 1852

Foreword by

John Marks Templeton

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FOREWORD BY JOHN M. TEMPLETON

Although he wrote in the 1840s about public fiascos that are now distant history, Charles Mackay teaches us some important lessons that apply to investor behavior today. Basing our investment decisions on the actions of the crowd can be a disastrous gamble. And in this case, the “crowd” may well include money managers and analysts well-schooled in investment theory, just as it does the amateur investor.

Today, as in the time of the South Sea Bubble, human nature is drawn like a moth to flame by the speculative fads of the marketplace. The excitement of new glamour issues in electronics or medical technology, the general euphoria over a rising market; these lure even many experienced investors. Their optimism overcomes their better judgment. They abandon critical analysis of the investment’s fundamental value. Like gamblers in a casino they play against the odds, paying inflated prices and dreaming of quick profit.

A contemporary social psychologist uses the term “groupthink” to describe the modern manifestation of crowd madness. Groupthink represents the prevailing beliefs and rationalizations that all too often influence the decisions even of experts. Their investment advice is shaped by the opinions of others, not by the rigors of their own independent analysis.

Since then, the phenomenon has captured the attention of both students of economics and social scientists. Why, they ask in their books and articles, do trained money managers continue to be burned by faulty investment decisions? Ironically enough, they find the same powerful forces at work amid the sophistication of the financial community that Charles Mackay carefully chronicled nearly 150 years ago.

My own philosophy has long been that any individual with God-given intelligence, independence of mind, and patience can avoid the mistakes made by many of those experts who are swayed by the emotions of the crowd. I have always maintained that the best buying opportunities come at what appears to be the worst times. This applies to the general market and to particular securities.

I have often sought out investments that performed poorly in the past, because research showed the phenomenon to be temporary. Usually these securities are out of favor with the investment community, so they are selling for less than their true worth. These may be any type of security, in any industry, in any part of the world. To find such securities and reap their worth, the investor's first and last touchstone must be value.

Successful investing is only common sense. You should resist the temptation to invest in any asset which would have produced the best performance for the previous five years. Instead search worldwide for some type of assets which would have produced the worst performance for the past five years and then select from that list those whose depressed prices were caused not by permanent but by temporary influences.

The popular delusions and madness of crowds described in this book in 1840 have continued to occur in the 20th Century. A few examples during my lifetime have been as follows:

1. In the great Florida land boom of the early 1920s prices of vacant acreage in South Florida increased more than ten-fold and then collapsed within one year almost to the starting point.
2. The great American stock market boom ending in September 1929 caused share prices to increase six-fold and then collapse in less than three years to a point lower than the beginning.
3. In the 1950s, any stocks concerned with uranium became exceedingly popular, often rising more than ten-fold and then later declining more than 90%.
4. In the gold bug boom of 1981 the price of an ounce of gold increased \$35 to \$875 and then declined more than 60%.
5. When the wild speculation in Kuwait stocks not listed on the Kuwait Exchange collapsed in August 1982, many had been bought for later delivery with more than \$94 (U.S.) billion in checks post-dated as much as six months. Some 6000 dealers failed to honor close to 29,000 checks, many of which were later found to be worthless. This amounts is a larger figure than the total market value of all stocks on any European exchange at that time, except London.

In the 20th Century alone more than a hundred other samples of popular delusions can be found among different varieties of assets in different nations. Excesses of crowd emotions occur not only in greed but also in fear.

This human failing can be avoided by an investor in common stocks if he will first investigate the cash dividend yield and market price in comparison with the previous prices for the same stock; the present price in relation to: the sales volume per share, the net asset value per share, the latest earnings per share, the average earnings per share for the latest five years, an estimate by a security analyst for earnings per share per year in the future and the past and probably future annual growth rate of earnings per share. Also beware of any type of asset bought mostly with borrowed money because such debt can lead to forced liquidation at distress prices.

It takes patience, discipline and courage to follow the “contrarian” route to investment success: to buy when others are despondently selling, to sell when others are avidly buying. However, based on half a century of experience, I can attest to the rewards at the end of the journey. The best way for an investor to avoid popular delusions is to focus not on outlook but on value.

John M. Templeton, 1989

PREFACE

THE object of the Author in the following pages has been to collect the most remarkable instances of those moral epidemics which have been excited, sometimes by one cause and sometimes by another, and to show how easily the masses have been led astray, and how imitative and gregarious men are, even in their infatuations and crimes.

Some of the subjects introduced may be familiar to the reader; but the Author hopes that sufficient novelty of detail will be found even in these, to render them acceptable, while they could not be wholly omitted in justice to the subject of which it was proposed to treat. The memoirs of the South Sea madness and the Mississippi delusion are more complete and copious than are to be found elsewhere; and the same may be said of the history of the Witch Mania, which contains an account of its terrific progress in Germany, a part of the subject which has been left comparatively untouched by Sir Walter Scott, in his "Letters on Demonology and Witchcraft," the most important that have yet appeared on this fearful but most interesting subject.

Popular delusions began so early, spread so widely, and have lasted so long, that instead of two or three volumes, fifty would scarcely suffice to detail their history. The present may be considered more of a miscellany of delusions than a history,—a chapter only in the great and awful book of human folly which yet remains to be written, and which Porson once jestingly said he would write in five hundred volumes! Interspersed are sketches of some lighter matters,—amusing instances of the imitativeness and wrongheadedness of the people, rather than examples of folly and delusion.

Religious manias have been purposely excluded as incom-

patible with the limits prescribed to the present work;—a mere list of them would alone be sufficient to occupy a volume.

In another volume should these be favourably received, the Author will attempt a complete view of the progress of Alchemy and the philosophical delusions that sprang from it, including the Rosicrucians of a bygone, and the Magnetisers of the present, era.

London, April 23rd, 1841.

PREFACE

TO EDITION OF 1852

IN reading the history of nations, we find that, like individuals, they have their whims and their peculiarities; their seasons of excitement and recklessness, when they care not what they do. We find that whole communities suddenly fix their minds upon one object, and go mad in its pursuit; that millions of people become simultaneously impressed with one delusion, and run after it, till their attention is caught by some new folly more captivating than the first. We see one nation suddenly seized, from its highest to its lowest members, with a fierce desire of military glory; another as suddenly becoming crazed upon a religious scruple; and neither of them recovering its senses until it has shed rivers of blood and sowed a harvest of groans and tears, to be reaped by its posterity. At an early age in the annals of Europe its population lost their wits about the sepulchre of Jesus, and crowded in frenzied multitudes to the Holy Land; another age went mad for fear of the devil, and offered up hundreds of thousands of victims to the delusion of witchcraft. At another time, the many became crazed on the subject of the philosopher's stone, and committed follies till then unheard of in the pursuit. It was once thought a venial offence, in very many countries of Europe, to destroy an enemy by slow poison. Persons who would have revolted at the idea of stabbing a man to the heart, drugged his potage without scruple. Ladies of gentle birth and manners caught the contagion of murder, until poisoning, under their auspices, became quite fashionable. Some delusions, though notorious to all the world, have subsisted for ages, flourishing as widely among civilised and polished nations as among the early barbarians with whom they originated,—that of duelling, for instance, and the belief in omens and divination of the future, which seem

to defy the progress of knowledge to eradicate them entirely from the popular mind. Money, again, has often been a cause of the delusion of multitudes. Sober nations have all at once become desperate gamblers, and risked almost their existence upon the turn of a piece of paper. To trace the history of the most prominent of these delusions is the object of the present pages. Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, and one by one.

Some of the subjects introduced may be familiar to the reader; but the Author hopes that sufficient novelty of detail will be found even in these, to render them acceptable, while they could not be wholly omitted in justice to the subject of which it was proposed to treat. The memoirs of the South-sea madness and the Mississippi delusion are more complete and copious than are to be found elsewhere; and the same may be said of the history of the Witch Mania, which contains an account of its terrific progress in Germany, a part of the subject which has been left comparatively untouched by Sir Walter Scott in his *Letters on Demonology and Witchcraft*, the most important that have yet appeared on this fearful but most interesting subject.

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MONEY MANIA.—THE MISSISSIPPI SCHEME

Some in clandestine companies combine;
Erect new stocks to trade beyond the line;
With air and empty names beguile the town,
And raise new credits first, then cry 'em down;
Divide the empty nothing into shares,
And set the crowd together by the ears.—*Defoe.*

THE personal character and career of one man are so intimately connected with the great scheme of the years 1719 and 1720, that a history of the Mississippi madness can have no fitter introduction than a sketch of the life of its great author John Law. Historians are divided in opinion as to whether they should designate him a knave or a madman. Both epithets were unsparingly applied to him in his lifetime, and while the unhappy consequences of his projects were still deeply felt. Posterity, however, has found reason to doubt the justice of the accusation, and to confess that John Law was neither knave nor madman, but one more deceived than deceiving, more sinned against than sinning. He was thoroughly acquainted with the philosophy and true principles of credit. He understood the monetary question better than any man of his day; and if his system fell with a crash so tremendous, it was not so much his fault as that of the people amongst whom he had erected it. He did not calculate upon the avaricious frenzy of a whole nation; he did not see that confidence, like mistrust, could be increased almost *ad infinitum*, and that hope was as extravagant as fear. How was he to foretell that the French people, like the man in the fable, would kill, in their frantic eagerness, the fine goose he had brought to lay them so many golden eggs? His fate was like that which may be supposed to have overtaken the first adventurous boatman who rowed

from Erie to Ontario. Broad and smooth was the river on which he embarked; rapid and pleasant was his progress; and who was to stay him in his career? Alas for him! the cataract was nigh. He saw, when it was too late, that the tide which wafted him so joyously along was a tide of destruction; and when he endeavoured to retrace his way, he found that the current was too strong for his weak efforts to stem, and that he drew nearer every instant to the tremendous falls. Down he went over the sharp rocks, and the waters with him. *He* dashed to pieces with his bark; but the waters, maddened and turned to foam by the rough descent, only boiled and bubbled for a time, and then flowed on again as smoothly as ever. Just so it was with Law and the French people. He was the boatman, and they were the waters.

John Law was born at Edinburgh in the year 1671. His father was the younger son of an ancient family in Fife, and carried on the business of a goldsmith and banker. He amassed considerable wealth in his trade, sufficient to enable him to gratify the wish, so common among his countrymen, of adding a territorial designation to his name. He purchased with this view the estates of Lauriston and Randleston, on the Firth of Forth, on the borders of West and Mid Lothian, and was thenceforth known as Law of Lauriston. The subject of our memoir, being the eldest son, was received into his father's counting-house at the age of fourteen, and for three years laboured hard to acquire an insight into the principles of banking as then carried on in Scotland. He had always manifested great love for the study of numbers, and his proficiency in the mathematics was considered extraordinary in one of his tender years. At the age of seventeen he was tall, strong, and well made; and his face, although deeply scarred with the small-pox, was agreeable in its expression, and full of intelligence. At this time he began to neglect his business, and becoming vain of his person, indulged in considerable extravagance of attire. He was a great favourite with the ladies, by whom he was called Beau Law; while the other sex, despising his foppery, nicknamed him Jessamy John. At the death of his father, which happened in 1688, he withdrew entirely from

the desk, which had become so irksome, and being possessed of the revenues of the paternal estate of Lauriston, he proceeded to London, to see the world.

He was now very young, very vain, good-looking, tolerably rich, and quite uncontrolled. It is no wonder that, on his arrival in the capital, he should launch out into extravagance. He soon became a regular frequenter of the gaming-houses, and by pursuing a certain plan, based upon some abstruse calculation of chances, he contrived to gain considerable sums. All the gamblers envied him his luck, and many made it a point to watch his play, and stake their money on the same chances. In affairs of gallantry he was equally fortunate; ladies of the first rank smiled graciously upon the handsome Scotchman—the young, the rich, the witty, and the obliging. But all these successes only paved the way for reverses. After he had been for nine years exposed to the dangerous attractions of the gay life he was leading, he became an irrecoverable gambler. As his love of play increased in violence, it diminished in prudence. Great losses were only to be repaired by still greater ventures, and one unhappy day he lost more than he could repay without mortgaging his family estate. To that step he was driven at last. At the same time his gallantry brought him into trouble. A love affair, or slight flirtation, with a lady of the name of Villiers,* exposed him to the resentment of a Mr. Wilson, by whom he was challenged to fight a duel. Law accepted, and had the ill fortune to shoot his antagonist dead upon the spot. He was arrested the same day, and brought to trial for murder by the relatives of Mr. Wilson. He was afterwards found guilty, and sentenced to death. The sentence was commuted to a fine, upon the ground that the offence only amounted to manslaughter. An appeal being lodged by a brother of the deceased, Law was detained in the King's Bench, whence, by some means or other, which he never explained, he contrived to escape; and an action being instituted against the sheriffs, he was advertised in the Gazette, and a reward offered for his apprehension. He was described as "Captain John Law, a

*Miss Elizabeth Villiers, afterwards Countess of Orkney.

Scotchman, aged twenty-six; a very tall, black, lean man; well shaped, above six feet high, with large pock-holes in his face; big nosed, and speaking broad and loud." As this was rather a caricature than a description of him, it has been supposed that it was drawn up with a view to favour his escape. He succeeded in reaching the Continent, where he travelled for three years, and devoted much of his attention to the monetary and banking affairs of the countries through which he passed. He stayed a few months in Amsterdam, and speculated to some extent in the funds. His mornings were devoted to the study of finance and the principles of trade, and his evenings to the gaming-house. It is generally believed that he returned to Edinburgh in the year 1700. It is certain that he published in that city his *Proposals and Reasons for constituting a Council of Trade*. This pamphlet did not excite much attention.

In a short time afterwards he published a project for establishing what he called a Land-Bank,* the notes issued by which were never to exceed the value of the entire lands of the state, upon ordinary interest, or were to be equal in value to the land, with the right to enter into possession at a certain time. The project excited a good deal of discussion in the Scottish Parliament, and a motion for the establishment of such a bank was brought forward by a neutral party, called the Squadrone, whom Law had interested in his favour. The Parliament ultimately passed a resolution to the effect, that, to establish any kind of paper credit, so as to force it to pass, was an improper expedient for the nation.

Upon the failure of this project, and of his efforts to procure a pardon for the murder of Mr. Wilson, Law withdrew to the Continent, and resumed his old habits of gaming. For fourteen years he continued to roam about, in Flanders, Holland, Germany, Hungary, Italy, and France. He soon became intimately acquainted with the extent of the trade and resources of each, and daily more confirmed in his opinion that no country could prosper without a paper currency. During the whole of this time he appears to have chiefly supported himself by success-

* The wits of the day called it a *sand-bank*, which would wreck the vessel of the state.

ful play. At every gambling-house of note in the capitals of Europe he was known and appreciated as one better skilled in the intricacies of chance than any other man of the day. It is stated in the *Biographie Universelle* that he was expelled, first from Venice, and afterwards from Genoa, by the magistrates, who thought him a visitor too dangerous for the youth of those cities. During his residence in Paris he rendered himself obnoxious to D'Argenson, the lieutenant-general of the police, by whom he was ordered to quit the capital. This did not take place, however, before he had made the acquaintance, in the saloons, of the Duke de Vendôme, the Prince de Conti, and of the gay Duke of Orleans, the latter of whom was destined afterwards to exercise so much influence over his fate. The Duke of Orleans was pleased with the vivacity and good sense of the Scottish adventurer, while the latter was no less pleased with the wit and amiability of a prince who promised to become his patron. They were often thrown into each other's society, and Law seized every opportunity to instil his financial doctrines into the mind of one whose proximity to the throne pointed him out as destined, at no very distant date, to play an important part in the government.

Shortly before the death of Louis XIV., or, as some say, in 1780, Law proposed a scheme of finance to Desmarests, the comptroller. Louis is reported to have inquired whether the projector were a Catholic, and on being answered in the negative, to have declined having any thing to do with him.*

It was after this repulse that he visited Italy. His mind being still occupied with schemes of finance, he proposed to Victor Amadeus, Duke of Savoy, to establish his land-bank in that country. The duke replied that his dominions were too circumscribed for the execution of so great a project, and that he was by far too poor a potentate to be ruined. He advised

*This anecdote, which is related in the correspondence of Madame de Bavière, Duchess of Orleans and mother of the Regent, is discredited by Lord John Russell in his *History of the principal States of Europe from the Peace of Utrecht*; for what reason he does not inform us. There is no doubt that Law proposed his scheme to Desmarests, and that Louis refused to hear it. The reason given for the refusal is quite consistent with the character of that bigoted and tyrannical monarch.

him, however, to try the king of France once more; for he was sure, if he knew any thing of the French character, that the people would be delighted with a plan, not only so new, but so plausible.

Louis XIV. died in 1715, and the heir to the throne being an infant only seven years of age, the Duke of Orleans assumed the reins of government, as regent, during his minority. Law now found himself in a more favourable position. The tide in his affairs had come, which, taken at the flood, was to waft him on to fortune. The regent was his friend, already acquainted with his theory and pretensions, and inclined, moreover, to aid him in any efforts to restore the wounded credit of France, bowed down to the earth by the extravagance of the long reign of Louis XIV.

Hardly was that monarch laid in his grave ere the popular hatred, suppressed so long, burst forth against his memory. He who, during his life, had been flattered with an excess of adulation, to which history scarcely offers a parallel, was now cursed as a tyrant, a bigot, and a plunderer. His statues were pelted and disfigured; his effigies torn down, amid the execrations of the populace, and his name rendered synonymous with selfishness and oppression. The glory of his arms was forgotten, and nothing was remembered but his reverses, his extravagance, and his cruelty.

The finances of the country were in a state of the utmost disorder. A profuse and corrupt monarch, whose profuseness and corruption were imitated by almost every functionary, from the highest to the lowest grade, had brought France to the verge of ruin. The national debt amounted to 3000 millions of livres, the revenue to 145 millions, and the expenses of government to 142 millions per annum; leaving only three millions to pay the interest upon 3000 millions. The first care of the regent was to discover a remedy for an evil of such magnitude, and a council was early summoned to take the matter into consideration. The Duke de St. Simon was of opinion that nothing could save the country from revolution but a remedy at once bold and dangerous. He advised the regent to convoke the states-general, and declare a national bankruptcy. The Duke

de Noailles, a man of accommodating principles, an accomplished courtier, and totally averse from giving himself any trouble or annoyance that ingenuity could escape from, opposed the project of St. Simon with all his influence. He represented the expedient as alike dishonest and ruinous. The regent was of the same opinion, and this desperate remedy fell to the ground.

The measures ultimately adopted, though they promised fair, only aggravated the evil. The first and most dishonest measure was of no advantage to the state. A recoinage was ordered, by which the currency was depreciated one-fifth; those who took a thousand pieces of gold or silver to the mint received back an amount of coin of the same nominal value, but only four-fifths of the weight of metal. By this contrivance the treasury gained seventy-two millions of livres, and all the commercial operations of the country were disordered. A trifling diminution of the taxes silenced the clamours of the people, and for the slight present advantage the great prospective evil was forgotten.

A Chamber of Justice was next instituted to inquire into the malversations of the loan-contractors and the farmers of the revenues. Tax-collectors are never very popular in any country, but those of France at this period deserved all the odium with which they were loaded. As soon as these farmers-general, with all their hosts of subordinate agents, called *maltôtiers*,* were called to account for their misdeeds, the most extravagant joy took possession of the nation. The Chamber of Justice, instituted chiefly for this purpose, was endowed with very extensive powers. It was composed of the presidents and councils of the parliament, the judges of the Courts of Aid and of Requests, and the officers of the Chamber of Account, under the general presidency of the minister of finance. Informers were encouraged to give evidence against the offenders by the promise of one-fifth part of the fines and confiscations. A tenth of all concealed effects belonging to the guilty was promised to such as should furnish the means of discovering them.

* From *maltôte*, an oppressive tax.