

Introduction

That Passion for Reality

[He felt] hatred of all shams, scorn of all mummeries, a bitter merciless pleasure in the hard facts. And that passion for reality was beautiful in him. . . . He was a millionaire, and yet scrupulously simple . . .

—GEORGE SANTAYANA, *THE LAST PURITAN*

How can I write objectively about someone I liked and admired? In the case of Paul Cabot, this question almost answers itself. He wouldn't have had it any other way. Paul is often associated with the phrase, "First, you've got to get the facts. Then you've got to face the facts," the quintessential expression of hardheaded rationalism, applied to the investment business. He faced the facts about stocks, business associates, and himself.

Why am I writing about Paul Cabot? To explain this I must go back to 1978. In that year I completed my PhD in history without prospects for a good academic job. So I entered a six-week program that prepared humanities scholars for positions in business, and I went to work at Paul Cabot's State Street Research & Management Company. Six years later, in 1984, the program sponsors asked me to contribute an essay for a book chronicling the experiences of its graduates. The essay traces the path that led to this work.

In that essay I compared the values of successful scholars and successful investors by drawing parallels between the thinking of historian Oscar Handlin and that of Paul Cabot. The former was the dissertation advisor to my dissertation advisor, Bernard Bailyn; the latter founded the company I was then working for and hired, trained, and influenced the men who had hired, trained, and influenced me.

I defined a scholar as someone who studies evidence and develops “an insight into its significance that contributes to the understanding of a broader range of issues.” The scholar “discovers value that others have missed, either by uncovering fresh evidence, or by looking with fresh insight into material previously studied by others. [He] sees something no one else has seen, understands its value, and knows how to make use of it.” Similarly, the investor either uncovers fresh evidence about a company, perhaps from its customers, or studies publicly available information with fresh insight. The key skills these searches share are the intellectual honesty to see the facts (rather than what confirms one’s preconceived notions) and the creativity to understand their significance. Handlin identifies the key event as the discovery of facts in conflict with the scholar’s original thesis, when this “encounter with the evidence” pushes him toward a new version of the thesis. I concluded, “Encountering evidence in the world of scholarship and facing the facts of the investment world are very similar intellectual and emotional experiences.”¹

During his long and productive life, Paul Cabot (1898–1994) founded the first mutual fund and compiled an extraordinary investment record with it. He championed high standards of fiduciary responsibility at a time when mutual funds were new and helped shape crucial legislation when the mutual fund industry was under attack in the 1930s. He also shifted the bulk of the Harvard endowment from preferred stocks and bonds to common stocks just in time for the post-World War II bull market, thereby setting an example for other colleges and universities to follow. But I have written this book as much to capture who Paul Cabot was— his character, personality, and intellect—as to chronicle what he did.

Handlin uses the analogy of the puzzle to describe the work of the historian, a person who struggles to put the pieces in place but frequently comes upon “unexpected fragments,” those stubborn facts in conflict with his original thesis.² While the facts of Paul’s life are clear, how they fit together and contributed to the development of his personality is a puzzle, which this book depicts but only partially solves. The pieces are these.

First of all, family. Paul saw his father as “the epitome of complete honesty and frankness” who instilled in his children “the necessity of trying to make something worthwhile of [their] lives and have regard for the well being” of others.³ He was also equally appreciative of his mother, who took responsibility for his religious education. Paul’s children remember that their grandmother supervised even their own religious education—“with a vengeance,” according to one of them. While Paul was known more for

his cigar smoking, whiskey drinking, and coarse language than for his religious faith, he adopted the rhetoric and the mindset of a Massachusetts preacher, some might say the prophet Jeremiah, when he railed against the abuses of the investment trusts in the 1920s and 1930s.

Second, the milieu of upper-class Boston. Behind the conventions of Brahmin society lay a culture of rationalism and realism dating back to when the Puritan settlers, with their rigorous intellectualism, encountered the harsh conditions of the New England wilderness. Their experience, as related by twentieth-century historians, transformed their culture over the course of more than a century into one that valued independence, shrewdness, and philanthropy—qualities that today are identified more as Yankee than as Puritan. This culture, along with commercial success and certain legal developments in Massachusetts, created the conditions for the growth of the money management profession in Boston in the nineteenth century. Paul possessed that independence and shrewdness. Years before his birth, his family had achieved commercial success, social position, and the mastery of legal and financial affairs required of the Boston trustees. When Yale University honored Paul with a doctor of laws degree in 1965, the citation praised “the bluntness of your speech and the soundness of your cold-roast Boston eye for the Yankee dollar.” Paul was a product of place as well as of family.

Third, liberal education. Paul downplayed and underestimated the importance of all but the most practical, business-oriented portion of his schooling. He showed little overt interest in the study of literature, the core of an upper-class Boston education, but beneath the surface he absorbed certain values of classical and some modern writers, such as simplicity, clarity, and intellectual honesty. His choice of an undergraduate major, mathematics, reflected a penchant for analytical rigor, which was most evident later on in business school and in his career.

Fourth, professional education. In business school he explored questions that really fascinated him. He became a top student and a scholar, doing research that, while never culminating in a completed doctoral dissertation, had an important impact on the history of American finance. Paul’s hardheaded rationalism complemented the German Enlightenment empiricism of his advisor, Arthur Stone Dewing, who had begun his academic career studying philosophy.⁴

These four pieces of the puzzle all played important roles in Paul’s business career and later life. While it is difficult, perhaps even arbitrary, to separate them, a story about a decision he had to make shows them

coming together. In 1932, Paul's company, State Street Research & Management, had the opportunity to purchase Lee, Higginson & Co., which went into liquidation after the suicide of Ivar Kreuger and the collapse of his Swedish Match Company. Paul wanted to consult his partner and cousin, Richard Paine, on the matter, but Paine was extremely ill and could not be disturbed. Because of his respect for his uncle and because father and son thought so much alike, he decided to consult Dick's father, Robert Treat Paine II, instead: "I remember trying to give him all the pros and cons of taking it over, . . . all the facts, . . . answering any questions he had. . . . And then I ended by asking him, have you any knowledge, Uncle Bob, of whether it is my judgment that we should or should not buy this company, because I wanted to try and just give you the facts without putting my personal opinion in them." Bob said that he did not know where Paul stood on the matter and proceeded to give him unbiased advice.⁵

In "Truth and Politics," Hannah Arendt identifies the deliberate confusion of fact and opinion as a form of lying. She then traces the disinterested pursuit of truth back to Homer.⁶ Paul did not consciously trace intellectual honesty back to the ancient Greeks, but he grew up with writers like Homer and Thucydides. While literature never captured his imagination, what Thucydides called "the simple way of looking at things, which is so much the mark of a noble nature" had an impact on his careers as mathematics major, business student, scholar, and investor.

All of this still does not explain Paul Cabot. As rich as his background was, it was not unique. Hundreds of his contemporaries had similar advantages and grew up more like John P. Marquand's fictional George Apley than Paul Cabot; that is, they lacked the insight to question things and the force to change them. But Paul stands in sharp contrast to Marquand characters like Apley, who said, "I am the sort of man I am because environment prevented my being anything else."⁷ Paul adopted the highest ideals of Boston society—learning, leadership, service, honesty—but fused them onto a pragmatic, sometimes iconoclastic, personality. Marquand did not give Apley the courage or perspective to break through the limitations of his time and place the way Paul did. Instead, he relied on Apley's "biographer," Mr. Willing, to face the facts that Apley suppressed during his lifetime, though Marquand makes it clear that Apley shared some of Paul's honesty and would have lived more authentically had not the bonds of family and the conventions of society discouraged it.

Marquand wrote *The Late George Apley* in the form of a biography. George Santayana called *The Last Puritan* "a memoir in the form of a

novel.” They both created fictional characters and biographers to present their views on Boston culture and society, among other subjects. But Paul’s personality was much more powerful than those of Marquand’s and Santayana’s protagonists. He was born with a mental and emotional confidence that developed in the unique culture of Boston to produce an extraordinarily independent, forceful, and productive individual—more American than Bostonian or New Englander. To understand Paul and what he represented we must look to the specific, in his words, the realities and facts.

PASSION FOR REALITY

1

Family, Education, and Army Service

Dear Ma,

I just received your letter advising me to quit. *Nothing doing*. I have been through half of this course & I'm going to finish it. It will take a stick of dynamite to get me out of here. . . . I hate this life. . . so much that it makes me obstinate and pig-headed & come what may I'm going thru with it.

—PAUL CABOT, IN A LETTER FROM THE ARMY, 1918¹

That got me into studying these common stocks—other people must have been doing the same thing but I wasn't aware of it. At any rate I used to study the earnings and I still believe that the single most important fact, other than the honesty of the management, is the amount and direction of your earnings. So it got to me, and that's what I think started me in this sort of business—got me studying. . . the companies and trying to determine what is the real value.

—PAUL CABOT, REFLECTING ON HIS 1922 HARVARD
BUSINESS SCHOOL SUMMER JOB IN 1971²

C-R-A-C-K!

Paul Cabot fired, pulled his ROTC rifle in from the window of Persis Smith Hall, and gleefully surveyed the damage. Students were holding a dance in the quadrangle below, and the shot “had a terrific effect. All the little girls thought the Germans were out for them. They all rushed for shelter and there was terrible excitement.”

It was a beautiful warm spring evening, May 29, 1918, at the end of Paul's freshman year. The next day he would leave Harvard for ROTC