Are We Days Away From Another Black Monday?

SYNOPSIS

- On October 19, 1987, the S&P 500 dropped over 20% for the single worst day in the history of the U.S. stock market.
- The fear ingrained into the minds of those who lived through Black Monday is a magnet for fear mongers.
- Charts that compare one year to another pop up all the time because they are highly effective weapons for fear mongers.

currie financial group

Black Monday Redux

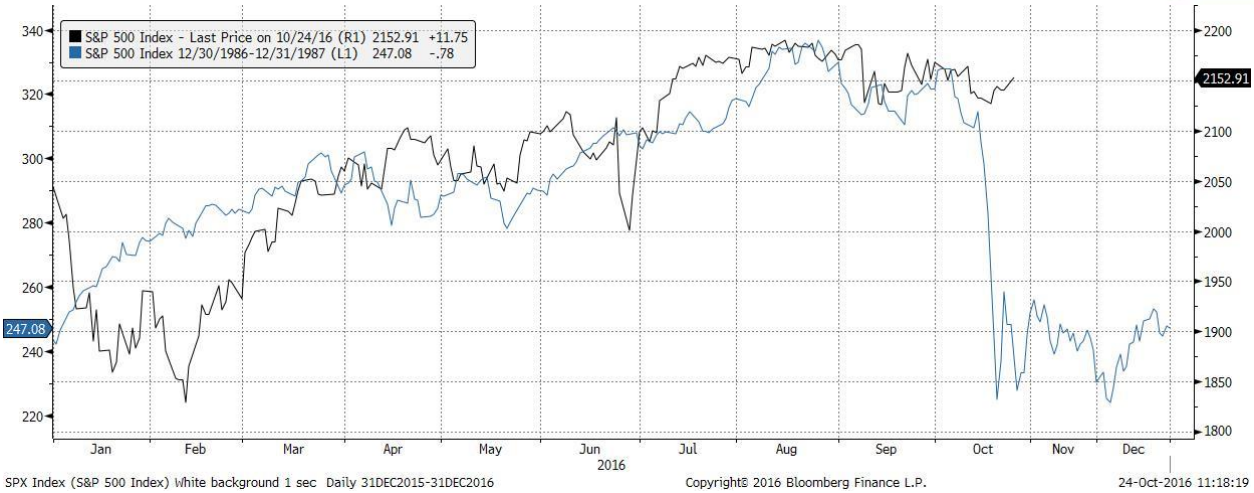
On October 19, 1987, the S&P 500 dropped over 20% for the single worst day in the history of the U.S. stock market. That trading session remains one of the most notorious in financial history, and it has ever since carried the name “Black Monday” for good reason.

The magnitude of this selloff was overwhelming. To put it into context, the index has fallen more than 20% in a year only three times since 1970, so to stomach such a drop in a single day created widespread panic that disseminated throughout global financial markets.

Books have been written, and courses at the best business schools in the country continue to teach future financiers about its impact. It also caused a wave of regulatory changes including trade clearing procedures and the implementation of “circuit breakers,” which are designed to reduce the effects of panic by halting trading if an index falls past a threshold.

The turmoil ingrained into the minds of those who lived through Black Monday is a magnet for fear mongers, and they seem to come up with new and creative ways to compare the events of today against what led the market to fall so much back then.

The chart below is the most recent attempt to elicit fear and has made its way across the internet over the past week or two. The blue line is the price of S&P 500 index during 1987 (it is pretty easy to spot Black Monday), and the black line is the price of S&P 500 index this year. Plotting both years in the same chart allows us to compare the price action month-by-month.



Upon first glance, it appears that 2016 has been tracking 1987 rather closely through early October. Fear mongers are using this pattern to warn investors of an imminent stock market crash, and according to them, we are only a matter of days away.

Dispelling the Fear

A comprehensive understanding of financial history is an integral component of any professional investor's toolkit, but recognizing its limitations is equally important to prevent us from jumping to some very dangerous conclusions.

On its own, the chart above may look scary, but in reality, it is useless. Price movements are completely random and the drivers of the ups and downs back in 1987 are most certainly not what has been driving the stock market this year.

The chart below is all we need to cut the legs out from under the fear monger's case. It plots the performance rather than the actual level of the S&P 500 with the blue line representing 1987 and the black for this year.

This comparison changes the story dramatically. Prior to Black Monday, the stock market saw a near vertical rise of close to 40% going into early September. A move that high in less than ten months is almost as unprecedented as the ensuing selloff.

This year has been quite a different story. For those who may have forgotten, we began the year down over 6% in just the first week. By February, we were down over 10% until the market began its slow recovery.

Said another way, valuations were stretched to the point where they became far more susceptible to a pullback leading into Black Monday, whereas valuations currently are nowhere close to such risky levels.

One more dagger to the heart of the fear monger's case is that nobody, not even the SEC, knows for sure what caused Black Monday. When someone buys or sells a stock, no law requires that person to submit their reasoning for the trade. All we can do is review trading volumes and trust the commentary that came from the large trading desks on Wall Street.

***NOTE**: There are a few catalysts that are widely believed to have caused the panic on Black Monday, but there are also an equal number of theories into the assassination of JFK.*

Simply put, we may never know for sure what ultimately caused the market to lose over 20% in a single trading session, but what is far more certain is that today's economy and stock market look completely different than they did 29 years ago.

Implications for Investors

Anyone who has lived through a traumatic event will tell you that the emotional scars never really heal. Watching a nest egg lose over 20% in less than eight hours certainly qualifies as traumatic, even to the most seasoned investor.

The fear mongers know this to be the case, and it is precisely why they will never let us forget Black Monday because this trauma is an all-access pass to the emotional core of their prey. Once inside, they navigate seamlessly to their final destination, which is a victim's wallet.

Price charts that compare one year to another act a lot like clouds, where the longer you stare at them, the more your brain will convince you that a picture or pattern is emerging. These charts pop up constantly because they are highly effective weapons for fear mongers, when in reality, they provide no value at all.

Lastly, fear mongers and market pundits conveniently leave out the fact that despite such a brutal October, the S&P 500 ended up over 5% in 1987. Those who stuck to their strategy and ignored the handful of volatile days were rewarded.

The bottom line is that I have no idea if the stock market will end the year up or down, but what I am certain about is that it is best to ignore these types of comparisons.

Sincerely,

Mike Sorrentino, CFA
Chief Strategist, Aviance Capital Management
mikeonmarkets.com

This commentary is not intended as investment advice or an investment recommendation. It is solely the opinion of our investment managers at the time of writing. Nothing in the commentary should be construed as a solicitation to buy or sell securities. Past performance is no indication of future performance. Liquid securities, such as those held within DIAS portfolios, can fall in value. Global Financial Private Capital is an SEC Registered Investment Adviser.