WILL THERE BE ANOTHER BLACK MONDAY?

Global Financial Private Capital

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 can easily distort the reality of a situation.

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."

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.

"Price charts that compare one year to another act a lot like clouds..."

The turmoil ingrained into the minds of those who lived through Black Monday is a magnet for fear mongers, particularly this time of year. One of the more common fear tactics is to publicize a chart like the one below.

The red line tracks the index level of the S&P 500 in 1987 (it is pretty easy to spot Black Monday), and the black line tracks the S&P 500 this year through October 5. Upon first glance, it appears that 2017 has been tracking 1987 rather closely through early October.

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

Fear mongers use charts like this one, along with the fact that this year is the 30th anniversary of Black Monday, to warn investors of an imminent stock market crash.

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.

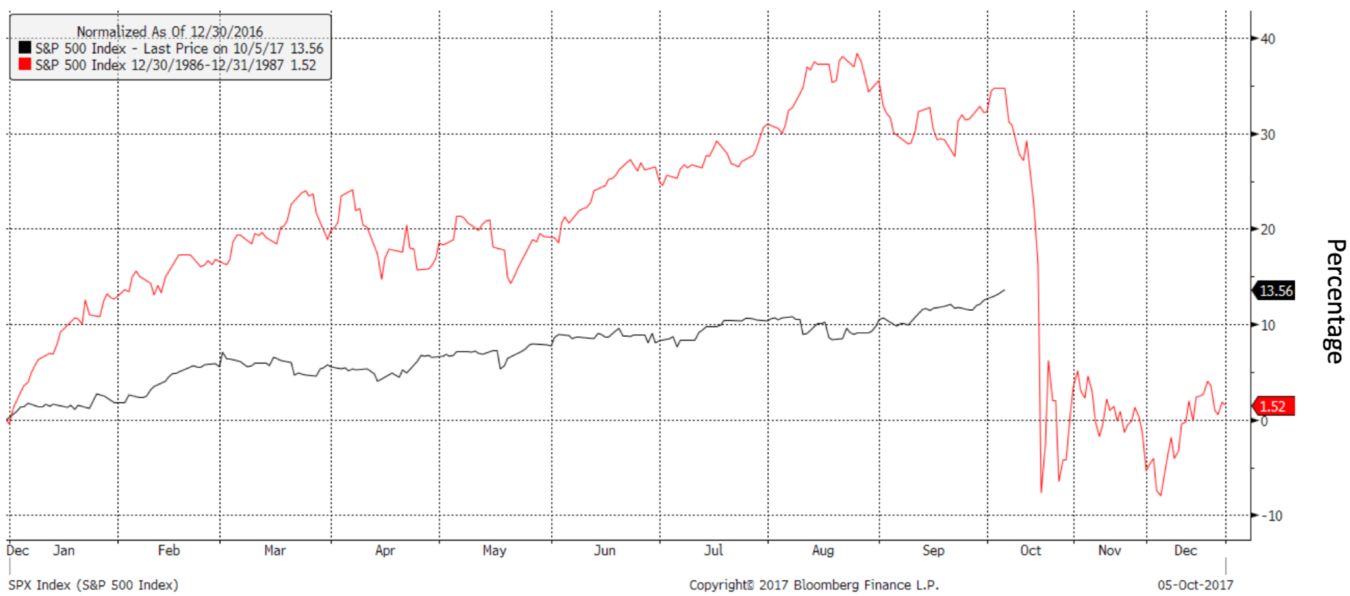
On its own, the previous chart may look scary, but in reality, it is useless. Index movements are completely random over such a short time period, and the chart below is all we need to cut the legs out from under the fear monger's case. It plots the performance on a percentage basis rather than the actual level of the S&P 500 with the red line representing 1987 and the black for this year.

caused the panic on Black Monday, but there are also a similar number of theories into the assassination of JFK.

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.

Simply put, we may never know for sure what caused the stock market to lose over 20% in a single trading session,

S&P 500 Index Performance



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 a completely different story. Sure, the S&P 500 is up an impressive 13% through October 5, 2017, but that is nowhere close to the run experienced back in 1987. Interest rates are also a fraction of where they stood back in October 1987, which creates a completely different investment environment. It's apples and oranges.

Another very important point to note is that nobody, not even the SEC, knows for sure what caused Black Monday. There are a few catalysts that are widely believed to have

but what is far more certain is that today's economy and stock market look quite different than they did 30 years ago.

IMPLICATIONS FOR INVESTORS

Traumatic events leave emotional scars that 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.

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

THOUGHT FOR THE WEEK
WILL THERE BE ANOTHER BLACK MONDAY?

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 very little value.

Furthermore, any time an investor hears the word “anniversary” applied to any trend, price movement, catastrophe, or other characteristic of an investment return, it is best to approach whatever is being discussed and/or analyzed with extreme skepticism.

Markets do not run on calendars, so an anniversary to a good or bad event provides zero value to an investment process used to estimate future returns. Instead, markets are event-driven, and the events that led to Black Monday are most likely not the events that have driven the market higher in 2017.

Lastly, fear mongers and market pundits conveniently leave out the fact that despite such a brutal October, the S&P 500 ended up 2.03% and delivered 3.22% in dividends for a total return of 5.25% in 1987[1]. 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,

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[1]*Source: Bloomberg*

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