Could the NYSE Drop 5,750 Points in a Day?

Remembering the October 1987 Crash

Remember Black Monday – that fateful day on October 19, 1987 – when the stock market plummeted a stunning 22.6% in one day? And it should not be lost on investors that 31 years later, the NYSE was trading real close to its all-time high within what many consider to be a long-in-the-tooth bull market of 10 years.

Most of the recent articles reflecting on Black Monday start with headlines about why “this time is different.” And for the most part, that makes sense. But ask someone who actually experienced Black Monday firsthand and they will tell you that thinking about it happening again gives them the chills.

Comparing 1987 to 2018

First off, everyone knows that the market is dramatically higher today than it was 31 years ago. On Black Monday, the Dow Jones Industrial Average fell exactly 508 points to 1,738.74.

If the NYSE dropped 508 points today, that would amount to less than 2%. So, for comparison purposes, the market would have to drop over 5,750 points in today’s terms to equate to that devastating day back in October 1987.

And the last time the market traded 5,750 points lower than it does today? That would be January of 2017, right before it crested 20,000. Really.

October is A Unique Month

Generally speaking, October is a nice month. We transition into fall, it’s real football weather and kids (and adults) are encouraged to dress up and go trick-or-treating.

But it’s also one of the most worrisome months for financial advisors. Not because it is the worst month for the stock market – that is reserved for September. But because there have been some pretty ugly stock market crashes in October, including:

- The Panic of 1907 – October 1907 – Also known as the 1907 Banker’s Panic, the NYSE dropped almost 50%.
- Black Tuesday, Thursday and Monday – October 1929 – The Crash of 1929 was historic, leading to the 12-year Great Depression.
- Friday the 13th – October 13, 1989 – referred to by some as “Black Friday,” the DJIA fell 5.26% on the 13th and another 7.26% on the following Monday. And the major indices had closed at all-time highs just four days before too.
- Asian Crisis – October 27, 1997 – often considered a “mini-crash” it was still the eighth biggest point loss and 15th biggest percentage loss in 100 years.
- Bear Market of 2007 - 2009 – From October 2007 through June 2009, the DJIA, NASDAQ and the S&P 500 all experienced declines of more than 20%
- Black Monday – October 1987

Is This Time Different?

Most of what is being written by the press talks about why "this time really is different." That thinking is scary. Market cycles happen and we are 10 years into an almost unprecedented bull market run.

Should you worry that another crash is imminent? Probably not. But a little skepticism, a dash of worry and healthy reflection provide perspective that at a very high level, this time is not different.

So, let's examine the 1987 and the 2018 stock markets:

Valuations

1987: The price-to-earnings ratio (P/E based on forward 12-month earnings) was 23.0 times near the market's peak.

2018: The forward 12-month P/E ratio is 15.7 times. This P/E ratio is below the 5-year average (16.3) but above the 10-year average (14.5). Note that at the market's peak in 2000, stocks had a P/E of 27.3.

Economic growth

1987: GDP growth averaged a solid 3.6% in the two years prior to the peak driven by rising household spending.

2018: GDP growth has been very strong, averaging at an annual rate of 4.2%.

Interest Rates/Monetary Policy

1987: Monetary policy was being tightened, with the fed funds rate rising by nearly 1.5% in the year preceding the peak, reaching 7.25% in late 1987. 10-year rates were at 9.6%, having jumped from about 7% a year earlier.

2018: The Federal Reserve has increased the fed funds rate three times in 2018 and it currently stands at 2.0%. Most expect the Fed to continue its approach of slowly raising rates, but 10-year rates are just north of 3.0%.

Conclusions from An Advisor

Let's be crystal clear: very few will suggest that a market crash of October 1987 proportions is imminent. At all.

But four of the most dangerous words for investors are: "This Time Is Different."

And so, remember the paraphrased words from philosopher George Santayana:

Those Who Don't Learn from Market Crashes
are Doomed to Repeat Them.

Call if you want to discuss more.