What If You Bought Right Before the Market Correction of 1987?

The New York stock market crash of 1987 happened 30 years ago when, on October 19, the Dow Jones Industrial Average (DJIA or the Dow) plunged by a then-record 508 points—a 22% decline in the index.

That wasn't the largest down day in percentage terms in U.S. stock market history. That indignity belongs to December 12, 1914, when the Dow saw a decline of 24%. The stock exchange was shut in July of 1914 as World War I began—and it did not reopen until December 12 that year. By comparison, the notorious Black Tuesday crash of October 24, 1929, that preceded the Great Depression, saw stocks fall by only 13%.

What were the reasons given to the American public to explain the stock market crash?

1. **A weak dollar:** Secretary of Treasury James Baker's strategy of dollar devaluation was viewed as a gamble and not favorably received by the Germans and Japanese. Baker believed that "we are engaged in a life-or-death struggle here to preserve the world economy."
2. **Inflation:** Following 59 months of economic expansion, a steep and prolonged decline in the consumer price index, and persistent dollar weakness, inflation began to rise by the beginning of 1987. Many investors believed that the stagflation of the 1970s was coming back.
3. **Trade deficit:** The deficit, despite the sharp decline in the dollar, had not been noticeably reduced. The United States was said to be losing the future to the Japanese.
4. **Conflict in the Middle East:** On that October morning of the market crash, U.S. warships attacked an Iranian oil production platform in the Persian Gulf in response to a missile that had hit an American tanker off the coast of Kuwait the prior week. In an example of historical irony, the fear then was that America was now fighting Iraq's battle against Iran.
5. **Computer trading:** The exchange's computer systems were deemed ill-equipped to handle the increased trading volume and were viewed as an ominous sign for the future of the U.S. stock market.

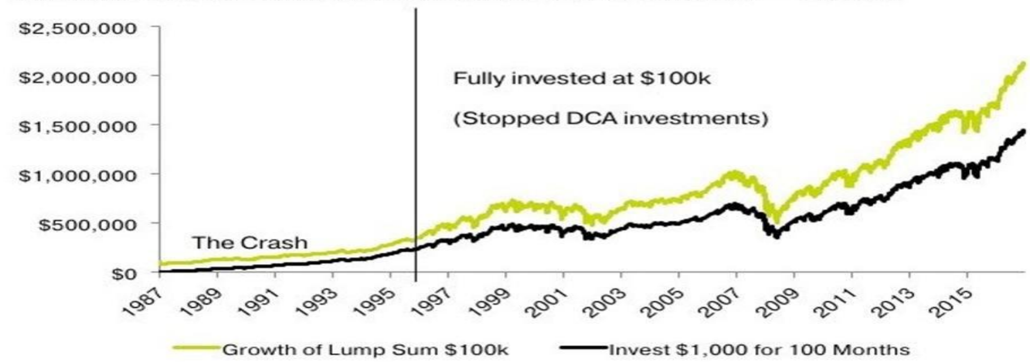
Does it all sound a bit familiar?

Investors who woke up on October 20, 1987, would have been hard-pressed to envision the U.S. stock market not only posting positive returns for the year (the Dow had been up by as much as 40% year-to-date, prior to the crash) but also returning 371% over the next decade—and 617% by the end of the secular bull market in 1999.

Imagine receiving an inheritance of $100,000 on Friday, October 16, 1987—the eve of the famous Black Monday crash. If you had put your money that day in the Dow, then by the following Monday it would have been worth $77,420. Ouch. However, by the following October 20th of 1988, your investment would have once again surpassed $100,000 and 30 years later, would be worth more than $2.1 million today, around $700,000 more than if you had slowly dollar-cost averaged your inheritance into the market over a long period of time (Exhibit 1).

Exhibit 1: Dollar Cost Averaging Is Okay, but Time in the Market is Typically Better

"Time in the Market is more important than timing the market." – Unkown



Source: Factset, as of 9/30/2017.

Past Performance does not guarantee future results

I recently asked one of our long-time clients how he responded to the crash of 1987. He said, "I didn't do anything. I was a young man, and I was in it for the long term."

Coincidentally, the Number One song on America's pop charts on the day of the crash was "Lost In Emotion" by Lisa Lisa and Cult Jam. What song ended the year at number 1? "Faith," by George Michael. How apropos.