Emotional Investor Series
The Stock Market Crash of 1987
White Paper

The **Emotional Investor Series** explores how current events could lead investors to what we call Emotional Market Timing.

The **Stock Market Crash of 1987** white paper discusses investor's reaction to the S&P 500's drastic drop of 20.47% on "October 19, 1987, commonly known as "Black Monday".

Imagine finding out that today, the S&P 500 lost 20.47%.

This actually happened on October 19, 1987, when the S&P 500 lost 20.47% in a single day.[1]

How would you react? Would you hold firm with your investment or would you employ what we call *Emotional Market Timing* and sell all of your stock investments at a loss?

We define Emotional Market Timing as when an investor, nervous about domestic, world or market events, in essence panics and engages in an almost spontaneous act of selling their investments.

While every market is different, and past performance is never an indication of future results, in our view, Emotional Market Timing may not be the ideal strategy to use when dealing with stock market fear because it centers on alarm rather than conscious rational action.

We believe that the key to grasping the dangers of Emotional Market Timing lies in the understanding that markets will generally rise and fall in cycles, typically moving in large chunks and many times in what we consider to be short time periods.

After a major event like the crash of October 19, 1987, an investor employs Emotional Market Timing and panics out of the market, in essence locking in their losses, and may find themselves sitting on the sidelines as the market is moving back up with nothing but their losses and what is left of their investment.

We have given numerous examples of this in other editions of the Emotional Investor Series of white papers.

In this edition of the Emotional Market Timing Series, we will examine the fear created when the stock market crashed on October 19, 1987.

No single cause could be identified for the –20.47% single day drop of the S&P 500 on what would be called Black Monday. While a number of reasons such as computer trading, overvaluation of the market, trade and budget deficits and illiquidity have been identified, none of these have been viewed as the sole cause.[2]

Anxiety, concern, and even panic ensued as the market closed on Black Monday. Fears and comparisons to the 1929 stock market crash and the Great Depression that followed were prevalent. Remaining an investor in stocks and not employing Emotional Market Timing was certainly difficult.

However, we believe it is important to remember that markets will generally rise and fall in cycles, typically moving in large chunks and many times in what we consider to be short time periods. We suggest that the dangers of Emotional Market Timing may be illustrated by October 19, 1987 crash and the days that followed.

When the market crashed on Black Monday, would you have sold all of your equities? If you had, you would have missed the 5.33% positive return for the S&P 500 the very next day and the additional 9.10% return on October 21, 1987.[1]

After seeing a return for the S&P 500 of over 14% in only two days following Black Monday, would you have invested in equities again?

Well, from October 21, 1987 until December 4, 1987, the S&P 500 lost – (13.34%)(1). Would fear have taken over once more and would Emotional Market Timing led to you selling all of your stocks again?

What is interesting is that one month after the December 4, 1987 low, the S&P 500 returned 14.3%(1). Furthermore, after three months, six months and one year after December 4, 1987, the S&P 500 returned 19.4%, 19.0% and 21.4% respectively (1).

If hypothetically on Friday, October 16, 1987, the trading session before Black Monday, you invested in an investment that was able to generate the returns of the S&P 500, and the very next session the market crashed, you would have recovered all of your losses on a total return basis by June 22, 1988, which is a little over eight months.

In fact, 26 ½ months later, on December 31, 1989, the S&P 500 earn an annual compounded return of 14.74%, despite the punishment it took on Black Monday(1).

It is important for us to stress that each market will be different in severity and length of time of a downtown. However, historic evidence may suggest that employing Emotional Market Timing could lead to poor results.

Clearly, events similar to the Stock Market Crash of 1987 will typically magnify the volatility in the markets.

It is natural for investors to get nervous.

However, because the markets will generally rise and fall in cycles, typically moving in large chunks and many times in what we consider to be short time periods, Emotional Market Timing may not be a prudent strategy to employ.

**For more information on the Emotional Investor Series or
the Bull and Bear white papers or presentations, please call us at (800) 442-4358.**

Disclosures

[1]*Source:* Bloomberg and Dunham & Associates

[2]Facts on File

Investments are subject to risks, including possible loss of principal. Investors should consider the investment objectives, risk factors and expenses of any investment carefully before investing. Diversification does not guarantee profit or ensure against loss.

The S&P 500, or the Standard & Poor's 500, is a stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 Index components and their weightings are determined by S&P Dow Jones Indices. It differs from other U.S. stock market indices, such as the Dow Jones Industrial Average or the Nasdaq Composite index, because of its diverse constituency and weighting methodology. It is one of the most commonly followed equity indices, and many consider it one of the best representations of the U.S. stock market, and a bellwether for the U.S. economy. You cannot invest directly in an index.

All examples are hypothetical and are for illustrative purposes only. We encourage you to seek personalized advice from qualified professionals regarding all personal finance issues. The solution for an investor depends on their and their family's unique circumstances and objectives.

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