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Brent Sheather's RESEARCH

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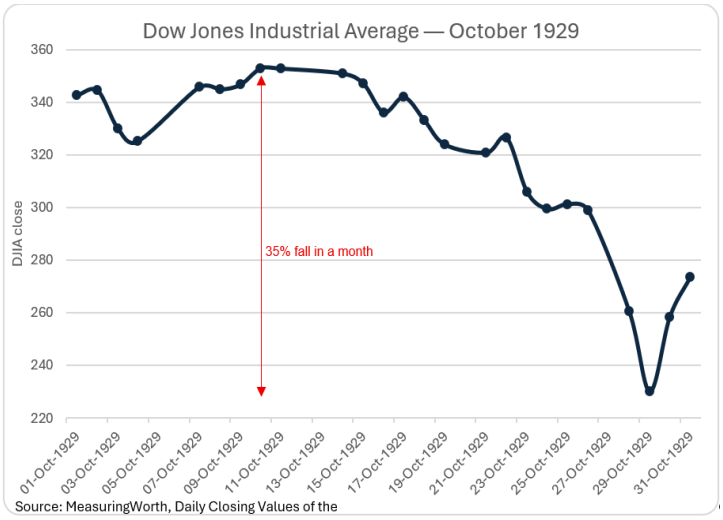
Brent Sheather is a Financial Advice Provider and a personal finance and investments writer.

1929: INSIDE THE GREATEST CRASH IN WALL STREET'S HISTORY – AND HOW IT SHATTERED A NATION PART 4: THE EVENTS OF OCTOBER 24, 1929 TO OCTOBER 29 1929

In this, the final episode in our series on Andrew Ross Sorkin's book 1929, we will look at the worst days of the 29 crash through the eyes of some of the big players of the time. In the Authors Note he comments: "after writing Too Big to Fail, about the financial crisis of 2008, I wanted to explore the most infamous crash in history with the same level of depth, granular detail, and human emotion. The narrative that follows is the product of more than eight years of reporting and thousands of hours of research: an account built on private letters, diaries, memos, notes, oral histories, court records, board transcripts, depositions, and law suits – some of which have never been published or closely examined". He finishes with a cryptic comment that the arc of 1929 is a bit like the response to Ernest Hemmingway's famous line: "How did you go bankrupt?" Hemmingway's character replies: "Two ways, gradually, then suddenly."

As the graph adjacent illustrates the 29 crash really kicked off in October with the US stock market losing more than 1/3rd of its value in just 19 days. From its high point on 10 October 1929 to its low point on 8 July 1932 the US stockmarket fell by a very scary 88.3%.

The graph above records a number of times when investors "bought the dip" in October of 1929, only to lose money. The same false dawns beguiled NZ investors in 1987 – one day the phones would be silent as institutional selling overwhelmed the buyers then the next day waves of retail investors would return to "buy the dip" and the phones would all ring at once. Having read about 1929 and being of a naturally nervous disposition I often tried to warn clients that just because Brierley was $3.00 lower than its price a week earlier that didn't mean that it was necessarily good value. Ever since then I have been very wary of "buying the dip" on the basis that it is difficult to differentiate between a "dip" which occurs due to a deterioration of economic fundamentals (lower earnings or a higher discount rate) or "dips" which result from irrational panic selling. The strong form of the EMH argues for the first scenario but behavioural economics acknowledges the latter. A third scenario is that with equities so widely owned panic selling can actually translate into a deterioration in fundamentals.

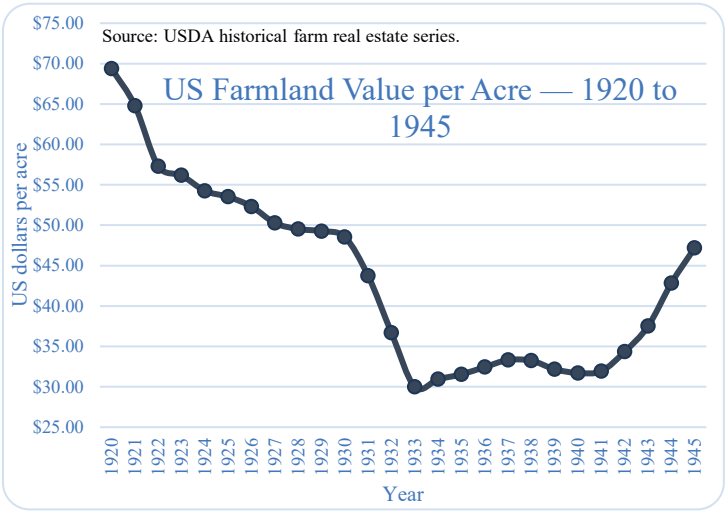


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George Soros popularised this school of thought which he calls "reflexivity". In the 1987 crash, in the month of October, the NZ stock market fell by 28.2% from its high point on 18 September 1987. It went on to finally bottom on 15 January 1991, some 65.3% lower than its high point.

One of the strengths of Sorkin's account is that he tells the story through the people who were actually there, and few characters illustrate the extraordinary events of October 1929 better than Richard Whitney and Jesse Livermore. Whitney, vice-president of the New York Stock Exchange and the very embodiment of the Wall Street establishment, found himself at the centre of the panic on Black Thursday, 24 October. With selling overwhelming the market, ticker tapes running hours behind and confidence evaporating, a group of leading bankers decided that a very public show of support was required. Acting on their behalf, Whitney walked onto the floor of the Exchange and bid for 10,000 shares of U.S. Steel at a price above the prevailing market. For a time it worked. Selling slowed, prices recovered and Whitney was hailed as Wall Street's "White Knight". But it proved to be only a temporary respite. By Black Monday and Black Tuesday the selling had returned with such force that neither Whitney nor the banking syndicate behind him had the resources to stop it. His intervention is therefore remembered less as the moment the crash was halted than as one of its many false dawns. There is an unhappy postscript to Whitney's story: the man celebrated as a hero in 1929 was later exposed as an embezzler, having stolen from clients and institutions to meet his own debts, and in 1938 he was sent to prison. Jesse Livermore stood on the opposite side of the market. While Whitney was trying to arrest the decline, Livermore had spent much of 1929 positioning himself for it, convinced that speculation had carried share prices far beyond anything justified by the underlying fundamentals. As Wall Street descended into panic, every new wave of selling increased the value of his short positions. By Black Tuesday he had reportedly made around US$100 million, an almost unimaginable fortune at the time. His subsequent story provides another warning against assuming that success in markets is permanent. Despite his extraordinary trading ability, Livermore later lost much of his fortune through further speculation and, in 1940, died by suicide in New York.



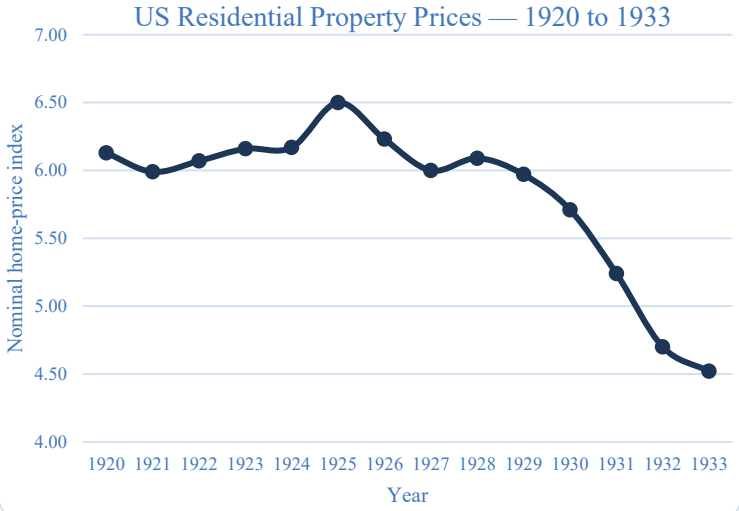
Whilst the post 1929 period is popularly known as a "stockmarket crash" the "crash" wasn't just confined to shares – numerous other investment classes nosedived too. In these other asset classes include a number which are popularly considered to be less risky than shares. So another lesson of 1929 is that, when you have a debt deflation, all bets are off. In an NBER working paper published in April 2012, The Anatomy of a Credit Crisis: The Boom and Bust in Farmland Prices in the USA in the 1920s, the authors, commenting on the 57% fall in farmland value per acre from 1920 to 1933, write that "credit availability directly inflated land prices. Credit also amplified the relationship between positive fundamentals and land prices, leading to greater indebtedness. When fundamentals soured areas with higher credit availability suffered a greater fall in land prices. Land prices and credit availability remained low for decades in these areas suggesting that leverage might render temporary credit induced booms and busts persistent".

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A popular heuristic amongst property investors is that residential property prices keep up with inflation. That belief was seriously challenged in the 1920 – 33 period as illustrated in the graph opposite which shows that from their peak in 1925 the average US residential property fell in value by 31%. However the general price level fell by approximately 35% in that period so house prices actually went up in real terms by about 6%. By the way it took until 1944 for prices to get back, in nominal terms, to where they were in 1925.

Source: Robert Shiller historical US home-price series.



Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.

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