Mullooly Asset Podcast #200 – Tom's "Black Monday" Story

Tim Mullooly: Welcome back to the podcast. This episode number 200 of the Mullooly Asset Management podcast. This is Tim Mullooly, and with me today, Tom Mullooly. We've been talking about this episode for a while now. This is our 200th episode. That's a lot of podcasts.

Tom Mullooly: I'm really happy that we got past 10. This is terrific.

Tim Mullooly: Yep. Got the ball rolling a few years ago and just kept on going. This is a milestone episode for us and we figured let's talk about another milestone that recently happened in the market. We had the 30 year anniversary of what is now known as Black Monday, or when the market crashed back in 1987.

Tom Mullooly: It's hard to believe that it was 30 years ago, because to me it felt like it was well, not exactly yesterday, but didn't seem all that long ago. It's hard to believe that 30 years have passed.

Tim Mullooly: Yeah, instead of doing our usual where we answer questions from people, I figured today would be a good day to get Tom's perspective from that day and get a hands-on feel as to what happened and what was going on in the market at the time, because you were just starting out your career at that point, right?

Tom Mullooly: I was a baby broker. I was working at Shearson Lehman at the time. I graduated from college in 1983, and I started working right away. Right after graduation, I started at EF Hutton.

To come full circle, I was working in their financial planning department, and I was writing profiles of these clients that we were doing the financial plans for. I would say that my training and education from that time at EF Hutton is equivalent to what a lot of people in the industry now are doing to prepare for the CFP exam. A lot of work.

I was very well prepared when I got into the broker training program at Shearson at the end of '85. In 1986, I started smiling and dialing and looking for business, and I was just starting to open new accounts in 1986 and starting to buy stocks and investments for people. I didn't know that markets could go down.

Tim Mullooly: I was going to say, you were just starting your career. It sounds like you didn't have too much experience in the way markets could really hurt people.

Tom Mullooly: It's funny. The first stock that I ever tracked was part of a course that we had in the eighth grade, and it was Tandy which was the parent company for RadioShack, so that was the first stock symbol, and I used to track it in the newspaper, and I thought it was really, really pretty cool.

That was 1975. I knew that the market really, just from reading the paper, the market really wasn't doing much in the mid '70s. I didn't realize how bad things were.

Prior to that, I had only heard of 1929 and the depression during the '30s, and as naïve and young as I was, I thought, well, 50, 60 years have gone by. They should've gotten a grip on this by now and figured out, so we won't have these really big crashes or long periods of down markets.

Tim Mullooly: Being that long ago, you get the, "Oh, that won't ever happen" mentality. "That was 50 years ago," won't happen to us.

Tom Mullooly: My first year in the business, 1986, the market went up 22% that year. I was like, "This is going to be-"

Tim Mullooly: This is easy.

Tom Mullooly: This is going to be like cream cheese.

Tim Mullooly: We all know what happened that day on Black Monday, but leading up to that in 1987, what was the market like? People, they think of 1987, they think of that one day in October when the market crashed, but the market wasn't as crazy as it was that one day.

Tom Mullooly: This is the part of the story that nobody talks about now, 30 years later, because as amazingly bad October 19th was, the day after and the day after that, the 20th and the 21st, were just as nerve-racking, but also if you go back and look at what happened in 1987 for the year, it was the living definition of volatility.

And let me explain. We had an amazing year in 1986. The market went up 22%. The Dow finished 1986 just under 1,900. It was 1,895. The market went up, and don't quote me, but the market went up almost every day in January 1987. It was crazy. We didn't have a down day until, I think, until the 23rd of the month.

Tim Mullooly: Wow!

Tom Mullooly: Yeah. We hit 1,900 in the first couple of trading days. And then we hit 2,000 a couple of days after that, and now you're clicking off some nice percentages where you're really moving. It was a runaway train. And the market went up, it seemed like every week for a long time.

We did have a little crack on January 23rd. The market went down 6% in about an hour, and everybody blamed program trading, computers. But then it went right back to doing what it had been doing all along, and we got to April and the Dow Jones was at 2,400.

We had put on 500 points in about four months, and this market was not going down. No signs of stopping.

Tim Mullooly: And to keep it in perspective, 500 points, you're listening to this now in 2017, that doesn't sound like much. But when the Dow itself is at 1,900, 500 points is a huge move in just four months.

Tom Mullooly: It was enormous. And a couple of things started happening. We started to see gold come back to life. In April of 1987, we saw interest rates spike up. We started to get some real economic growth numbers, and I think that started to freak people out.

The amazing thing that happened was we saw the bond market ... we saw yields start to spike higher because we were starting to get real growth. The funny thing is, everybody talks about the rip roaring '80s. How great they were for the economy.

In 1985, the economy grew, the gross domestic product ... at that time it used to be called GNP, gross national product ... went up 2.9%. That's good growth.

Tim Mullooly: But nothing crazy, though.

Tom Mullooly: Great. In 1986, the economy grew less, 2.3%. But we were getting 22% returns in the market. We started to see some real economic growth in the beginning of 1987 and yields started spiking up. When yields spike up, bond prices crater. What very few people talk about is the bond market had its own crash, so to speak, in April and May.

We had clients at my branch that had some money in the stock market, but they had more money in bonds, and they were furious, because they were hearing about all their friends making money in the stock market, and they were actually losing money in bonds.

They were not happy campers.

A lot of people in the ... I don't say a lot of people ... but I saw people, many people in our branch move out of bonds, because they were losing money in May, June, and July, into stocks at what was essentially the height of the market. You're making this face that-

Tim Mullooly: I was going to say I wish you guys could see my face, because as Tom was explaining that, I'm thinking oh, no. Oh, no.

Tom Mullooly: And it was terrible in hindsight to see this, but there were a lot of folks in the branches and a lot of brokers in the branches who were beside themselves. They didn't know what to do.

They didn't know how to explain it to clients, how they were losing money in bonds and all their friends were making money in the stock market, so they made the switch into more equities. It was really pretty bad.

Tim Mullooly: At the time, the way that the year had gone and the way the last couple years had gone in the stock market, it's not like you could see the crash coming, so when one asset class at the time, like bonds, isn't doing well, people want to change it up.

You see the stock market doing well, it makes sense, but in hindsight, that was the worst idea.

Tom Mullooly: Yeah.

Tim Mullooly: Selling your bonds after you lose your money. You lost money on your bonds, putting them into stocks right before they crash.

Tom Mullooly: Yeah.

Tim Mullooly: Yikes.

Tom Mullooly: It was really-

Tim Mullooly: That's the big sigh of the episode.

Tom Mullooly: That is the big sigh in this one, right. It was really pretty nutty now in hindsight to see it, but it was just the theory of crowds, and that crowd mentality where people say, "All my friends are making money in stocks, so we have to have more money in stocks."

And I saw that happen every day all summer. At the time, it looked like the right thing to do.

Tim Mullooly: It might be hard to pinpoint one thing that happened necessarily to make the crash happen, but were there certain things that started happening throughout the months leading up to the crash that brought this on?

Tom Mullooly: We had a situation where the markets had gone up. Other than a couple of breaks in April when rates started moving up, we saw the market went straight up in May, June, July, so most months we had huge net gains.

Then we got to August and we had a new Fed chairman installed, Alan Greenspan, and he took the place of Paul Volcker. Now Volcker had let interest rates rise in the early '80s to try and break the back of inflation and it was working, because now they're on the downside of the mountain where they're actually lowering rates.

Greenspan pumped the brakes on the whole rate cutting thing and said we're actually going to tighten to try and put some speed bumps on the economy if it's growing as fast as it appears to be.

That was really one of the first cracks that we saw. That month, the market hit a high of 2,700. It was at 2,722.

Tim Mullooly: Wow!

Tom Mullooly: Yeah, August 25th.

Tim Mullooly: Think back to the number he said earlier in the episode. The Dow ended 1986 at 1,895. And just said in August, the Dow Jones hit a high of 2,700.

Tom Mullooly: It's like 30% higher or something like that? It's just out of control.

Tim Mullooly: It's crazy.

Tom Mullooly: It really is. But that was the high point and things started going down. We started seeing a lot of different news headlines, and so when we talk to our clients today about what could go wrong with the markets, one of the things that I always like to throw in is it can be some kind of compilation of news events or one external event that just changes people's short term psychology, and it just turns them around.

We had a lot of different things that started happening in September. We started to see some earnings reports come out that weren't very strong.

We started to see companies talk about their forecast for 1988, where they were tempering expectations. And so people started to talk in September openly about how much further ahead the market was than where it ought to be.

We actually started seeing daily volatility in September, where we started seeing down days mixed in with up days, and there were actually more down days in September than there were in any other month that year, and it was unsettling.

Tim Mullooly: People were starting to do the freak out a little bit.

Tom Mullooly: They were.

Tim Mullooly: They were used to higher and higher prices every day.

Tom Mullooly: Well, we talk about volatility a lot, and I think folks think about volatility in terms of, well, the market's up 100 today on Monday, and then it's down 100 points on Tuesday, and then it's up 75 points on Wednesday. They think volatility is a daily event.

Tim Mullooly: Swinging back and forth on a day-to-day basis.

Tom Mullooly: I think 1987 showed a lot of people that volatility can happen in long periods of time. And so we say 1987 was a volatile year, but it was volatile in one direction for a long time. From January through August, the market was very volatile in one direction, up.

Then right before we turned on the microphones, I said then it was volatile in another direction, vertical. In a vertical direction, down.

Tim Mullooly: Straight down.

Tom Mullooly: Straight down. And then it started rebuilding from there. If you were Rip Van Winkle and you just slept through 1987 and it looked like the year returned 2% or something like that, it looked like a nothing year. Far from it. Far from it.

Tim Mullooly: Sitting through that from an emotional standpoint was a rollercoaster. But like you said, from January 1 to December 31st, you zoom out, doesn't look too bad. But strap in for that day in October.

Tom Mullooly: It was really tough because the market started growing more and more unsettled and we had, like I just mentioned, much more daily volatility. The week that we had going into ... the week before the crash, that week, the market was down 9%. Think about that.

Tim Mullooly: In one week.

Tom Mullooly: In one week.

Tim Mullooly: Wow!

Tom Mullooly: On Friday, October 16th, which was option expiration day, the market was down 4%. That day, October 16th, it was a Friday afternoon, I remember, it was ... we're recording this around the same time ... it was the first cold day of the year, and it was a summer kind of like what we've had in 2017, where we had Indian summer. It's been really nice, but it was the first cold day where I really wanted to wear a jacket. And it was option expiration, and the market finished down 106 points. It was the first time ever that the Dow had finished down 100 points. Triple digits. It had never done that before.

And I went home that night, Friday night, worried. I had no idea what was going to happen with this market. Over the weekend, we started to see headlines about how overseas markets were selling off following what happened in New York.

There were headlines about moving destroyers and aircraft carriers into the Persian Gulf. Talking about oil. There was a comment from Treasury Secretary, James Baker, who told the Germans, either you inflate the Mark ... remember, they didn't have the Euro back then. Every country had their own currency.

His comment was, "Either you inflate the Mark, or we'll devalue the dollar." Yeah, devaluing the dollar. Not cool.

Going into Monday morning, we had overseas markets, Hong Kong, all of those overseas markets sold off big. European markets were down big. Then we have this business in the Persian Gulf. We had Baker's comment. Stock futures way down in the morning.

Tim Mullooly: Sounds like the perfect storm-

Tom Mullooly: Pretty much.

Tim Mullooly: For a crazy day.

Tom Mullooly: So the day begins, October 19th, and it's just straight down selling. Everybody is selling. Most individual clients didn't even know what was going on until the afternoon. At that point, we had already blown through down 100. We were down 200 at some point. I started getting phone calls around lunchtime from clients, "What do you think we should do?"

I had a client who called and said, "I want you to just sell everything." And I said, "Gee, I think that's ... I wouldn't do that." And I remember her saying to me, "I don't care what you say anymore. We are never going back into the stock market again." And she was paying for her three kids' college educations. And she never went back.

This is what started to happen. As the afternoon wore on, my phone started ringing with more velocity. Clients calling, saying, "Get me out. I don't care. Just sell it." Now here's the problem, is that we used to sit there with ... there were two types of screens.

There were Bunker Ramo's and there were Quotrons. I had a Quotron, and it was basically a useless box on my desk that day because all the prices were wrong.

Tim Mullooly: There was so much activity going on that nothing you were getting was accurate.

Tom Mullooly: Right. The tape was over two hours delayed most of the day. I couldn't even begin to tell you what the prices were. We started to basically tell clients, "Hey, we don't even know what price we're going to get out."

We also had clients who had limit orders to sell at prices far away from the current market that were getting filled at higher prices. That should never have happened.

And we had trades that were getting corrected weeks later, in November, that we didn't know if they were real or not. It rattled everybody's confidence in terms of retail investors.

The problem was that we also had some real institutional fear, as well. Some banks stopped extending credit to market makers, to mid-tier firms, brokerage firms, and so we had real problems that night about whether companies had enough margin, if they had enough buying power, if they were able to pay for their trades.

Remember, the market makers, they had to be the buyer of last resort, so they were buying all day Monday.

The specialists were in a lot of hot water, and everybody went home that night. I worried whether I was going to have a job.

Tim Mullooly: After hearing comments like that one client, “I'm never coming back into the market again”, and such a crazy day. It's got to get you scared.

Tom Mullooly: Well, you think about, okay, well I have to start over now.

Tim Mullooly: And you have to pitch people to get them to want to go back into the stock market after they just watched what happened earlier that day or last week.

Tom Mullooly: People just didn't want to do that. It was really tough, because I know all around me there were other young brokers like myself, and they started in the weeks after the stock market crashed, they started pitching CDs to clients. What a turnaround. Just really, really amazing.

We all came into work Tuesday morning, not really knowing what to expect. We had heard stories where there were problems with orders. There was real talk on Tuesday, the 20th, which I think is a more important day personally, because they again were swamped with sell orders at the open.

The market started going down again, and there was real talk of closing the New York Stock Exchange. They were afraid of doing that because they felt that it was important that they show confidence and strength and they open the next day for trading.

There was a time in the '60s where the stock market was closed on Wednesdays, just to process the paper trades.

Then they went to half days at times, but they didn't want to close after that. It was very important that they stay open. In fact, President Reagan came out around 12:30 that next day and said do whatever you need to do to keep the market open.

In fact, Tuesday was the day where we got a very important quote from the Fed Chairman, Alan Greenspan. We got a one line comment from Greenspan on Tuesday morning after the crash, and he said, "The Federal Reserve, consistent with its responsibilities as the nation's central bank, affirm today its readiness to serve as a source of liquidity to support the economic and financial system."

The Fed had never said anything like that, that it was going to backstop the financial system.

When they've been asked ... after Greenspan, then it was Bernanke, now it's Yellen ... they've all pretty much denied this, that this means what we think it means.

This was the first time that we ever saw someone from the Fed come out and say this, that they were going to do whatever it took to backstop the economy, and that helped the selling subside.

Then it was, how do we get all these order imbalances fixed? This was a minute by minute event that was happening on Tuesday, the 20th.

Some people refer to it as trickery. Some people call it market manipulation. James Stewart, who wrote Liar's Poker, at the time, he was a writer for the Wall Street Journal, he came out with a great article.

We should link to it in the show notes.

Tim Mullooly: Yep, definitely will.

Tom Mullooly: And he described what happened in the Chicago pits and how they were able to turn things around.

Tim Mullooly: Is that referring to the Major Market Index?

Tom Mullooly: That's right. The MMI. You don't hear about that anymore. The Major Market Index used to be this index of the most liquid stocks out there. It was only 17 stocks. It wasn't an ETF, but it worked like an ETF.

Very few people traded the MMI, even though you'd hear Larry Wachtel from Bache Securities, Bache Halsey Stuart Shields on the radio every morning talking about the Major Market Index. But this was a tool that they could use in the Chicago pits as a way to show activity again in the stocks.

The 17 stocks that made up the Major Market Index, most of them were Dow stocks. The way to get the market moving again ... because they were closing it ... trading had stopped.

There were no buyers, and everybody had just been selling, selling, selling through the morning on the 20th. They noticed that the gap between the actual price of the 17 stocks and the last trade of the Major Market Index had such a huge gap.

The Major Market Index, MMI, was higher. They actually started buying the Major Market Index.

What happens is, when you start to see the spread widen between the futures and the actual price, the arbitragers say, "Okay, if the price of the futures is higher, we're going to go in and buy stocks and we'll sell the Major Market Index," so that actually got people buying stocks.

The 17 components of the Major Market Index, most of them were Dow stocks. That kick started things.

Tim Mullooly: Got the ball rolling back in the right direction.

Tom Mullooly: We finished the day, Tuesday, the 20th ... we were down in the morning. We finished the day up 102 points, and that really helped get things back on positive footing. The market didn't come back right away.

A lot of people didn't want to invest. They didn't want to hear from a stockbroker for a long, long time. But a good lesson for all of us in so many different things. It was scary on the way up. It was even more scarier on the way down, because of the velocity. That's the first time that I heard some of these old Wall Street guys uses phrases like, "The market takes the staircase up, but it takes the elevator down."

Tim Mullooly: Just picture that in your head.

Tom Mullooly: That's what happens. There's a bigger fear of losing money than there is the fear of missing out. Well, thanks for listening to episode number 200 of the Mullooly Asset Management podcast. It's been terrific, and Tim, let's try and do 200 more of these.

Tim Mullooly: Yeah, we're going to keep on going.

Tom Mullooly: Great.

Tim Mullooly: We'll see you next week for episode 201.