Sifting through the economic rubble after the CRASH

PSU experts link 1929 and 1987

By RICK WOODWARD
Collegian Staff Writer

Because of continuing falls in stock prices on Wall Street, many economists are asking themselves: "Is this 1929 all over again?"

A stock market crash in late October 1929 similar to the one experienced in the last week and a half heralded the Great Depression of the 1930s.

Monday's *Wall Street Journal* compared last week's crash to the crash of 1929 and found the "Dow's movements last week mirrored market 58 years ago."

Another *Journal* story examined the similarities and the differences — and found that the most striking differences were that in 1929 the United States had surpluses in trade and the federal budget, an advantage over today's economy.

The Dow-Jones industrial average — a weighted average of 30 major U.S. companies' stock prices — rose about 2,000 points since 1982, but lost almost a half of that total gain in the last week and a half.

There was a similar bull market in the years before the 1929 crash, said Randall Woolridge, a University finance professor.

The pattern of a bull market for a few years followed by a huge crash is similar in the two cases, he said, noting that the market did not reach its lowest point of the Depression until 1932.

But "that's all paper wealth," and does not mean the country will necessary go into a recession, said University economics professor James Herendeen.

Administration officials in 1929 also called the losses suffered in the crash "paper losses," according to *The New York Times*.

Belief that the dropping dollar and international factors "were going to come back and haunt us with higher interest rates and higher inflation" caused the initial market drop last week, and computerized program trading probably amplified that tendency and caused the magnitude of the drop, Herendeen said.

In 1929, administration officials quoted in the *Times* also blamed "the unsound technical condition of the market" for the crash, corresponding to the blame placed on today's use of computers to predict patterns on the market, which are then used by traders in their buying and selling decisions.

Some have pointed to the fact that brokers are not free to extend credit to investors as they were in 1929 as an indication that the catastrophic results of the 1929 crash cannot be duplicated this time.

However, Herendeen said he did not believe that was a correct assessment.

The amount of borrowed money invested in the market is probably not significantly different from the 1929 amount, he said, because although the margins — percentages of one's investment that one must "have down" for the broker — are higher now, "there are all kinds of ways to get around it."

One of those ways is simply to borrow the money from a bank, he said.

But Woolridge said he does not believe there is as much borrowed money in the market as there was in the 1920s.

"I don't think people could get the loans to lever themselves up (as much as in the 1920s)," he said, even if they are investing money obtained from bank loans and home equity loans.

Although inflation is currently about 4 percent, a level it has maintained fairly consistently for the last four years, fear that inflation would result from the U.S. international trade deficit and federal budget deficit was one of the causes of last week's fall, said University economics professor Dean Croushore.

But University finance professor James Miles said "deficits have nothing to do with this."

Instead, he attributed it to the fact that President Reagan, who has opposed tax increases, has lost control of the federal government to liberal Democrats, who have talked about raising corporate taxes and the personal taxes of people with high incomes.

This tendency scares wealthy investors, Miles said, and therefore triggered the fall.

Other reasons for the fall include the overvaluation of stocks compared to bonds and the significantly falling exchange rate of the dollar in the last week, Herendeen said.

Herendeen said he expects the Federal Reserve Board to say the economy is stable.

"The Fed is the most powerful maker of (U.S.) economic policy," he said.

But it remains to be seen whether new Fed chairman Alan Greenspan will be as credible on Wall Street as was his predecessor Paul Volcker, he said.

On the brink of the Depression, officials of the Hoover administration in 1929 also said the economy was sound.

A look at then and now in print

Some analysts say last week's stock market crash cannot be compared to the crash of 1929 which heralded the Great Depression. But a comparison of articles about that crash and stories printed last week in *The New York Times* shows startlingly similar patterns in market behavior and the reactions of administration officials and business leaders.

—by Rick Woodward

1929

• "Prices of stocks crash in heavy liquidation. Total drop of billions." — headline, *The New York Times*, Oct. 24, p.1. "The fundamental business of the country, that is production and distribution of commodities, is on a sound and prosperous basis." — Republican President Herbert Hoover, on Oct. 25, 1929.

• " Break was unexpected." — *NYT*, Oct. 24, p. 2.

". . . there is considerable mystery about why such an avalanche of stock should hit the market at the same time." — *NYT*, Oct. 24, p. 1.

• "The president of one of the largest groups of investment trusts . . . predicted that any period of depression would be of comparatively short duration, and next year many issues would sweep to new high marks." — *NYT*, Oct. 24, p. 1.

• "The break in stock market values on the New York Stock Exchange (Oct. 23) came as a surprise to administration officials who, with the stiffening of security values at the opening of the market, had believed that the recession was checked. Officials declined to comment on the situation except to say that there was nothing in the condition of the Federal Reserve System or in general business conditions which could be held responsible for the recent reaction." —*NYT*, Oct. 24, p. 2.

• "Worst crash stemmed by banks . . . leaders confer, find conditions sound" — *NYT*, Oct. 25, p. 1 headline.

"Confidence in the soundness of the stock market structure, notwithstanding the upheaval of the last few days, was voiced last night by bankers and other financial leaders . . . the feeling was general that the worst had been seen. Wall Street ended the day in an optimistic frame of mind." — *NYT*, Oct. 25, p. 1.

• "Stocks collapse . . . but rally at close cheers brokers; bankers optimistic" — *NYT*, Oct. 30, p. 1.

1987

• "This is purely a stock market thing, and there are no indicators of a recession out there." — Reagan on Oct. 22.

• "Fall Stuns Corporate Leaders" — headline, *NYT*, Oct. 20, p. D32.

"Leaders of major America companies were shaken by the stock market plunge yesterday . . . (which) caught them as much by surprise as it did most investors." — *NYT*, Oct. 20, p. D32.

"Analysts scrambled for explanations." — *NYT*, Oct. 20, p. 1.

• "Some experts see the fall as a long-needed comedown, which took the Dow to a more rational level after an unrealistically fast climb. They believe that after a rest, Wall Street will rally again. Says Robert Prechter, the Georgia-based stock guru: 'The bull market remains intact.' " — *Time*, Oct. 26, p. 33.

• "Our citizens should not panic. . . . There is nothing in what has happened here that should result in a recession." — President Reagan on Oct. 20.

• "These consultations (between administration officials and chairmen of the Federal Reserve Board, the Securities Exchange Commission, and the New York Stock Exchange) confirm our view that the underlying economy remains sound. We are in the strongest peacetime expansion in history. Employment is at the highest level ever. Manufacturing output is up." — White House spokesman Marlin Fitzwater in a written statement on Oct. 19.

• "Wall Street rebound widens with gains for most stocks . . . Buyers aggressive . . . Analysts show cautious optimism" — headlines, *NYT*, Oct. 22, p. 1.

• "Stocks fall, but avert plunge" — *NYT*, Oct. 23, p. 1.

"Market is steady and tension eases" — *NYT*, Oct. 24, p. 1.

"And hope began to build that the crisis might be over." — *NYT*, Oct. 24, p. 1.

Market closes mostly lower Wednesday

NEW YORK (AP) — The stock market vacillated again yesterday but closed mostly lower as the dollar and bond markets resurfaced as factors influencing its course.

The Dow Jones industrial average finished up a scant 0.33 points at 1,846.82 following a 52.56-point gain Tuesday. The value of all stocks lost $12 billion.

In a day punctuated by erratic swings, the average fell 63 points in the first half hour, then rebounded sharply, being up as high as 35 points above Tuesday's close.

The dollar fell sharply in European trading — hitting a seven-year low against the West German mark and a five-year low against the British pound.

Despite the slight rise in the Dow, two stocks lost money for every one that advanced, while more than 279 million shares were traded in another abbreviated session on the New York Stock Exchange.

"This is a very treacherous market," said Alfred E. Goldman, a vice president at A.G. Edwards & Sons Inc. in St. Louis. "The best thing to have is a sense of humor and cash on the sidelines."

Markets have been closing two hours early to allow people to catch up on paperwork. The shortened hours will continue through Friday.

Although there was more panic selling yesterday, "each wave puts less pressure on the market," indicating signs of a turnaround, said Michael Metz, an analyst with Oppenheimer & Co.

While the market tossed and turned, workers on Wall Street and in brokerage firms struggled to keep a positive outlook.

"The strain is just unbelieveable, the tension and the anxiety," Metz said. "It's really a very difficult environment."

Talks to reduce the budget deficit resumed in Washington.

AP Laserphoto

An example of the frenzied activity on the New York Stock Exchange.

University portfolio loses less than 10%

By TERRY MUTCHLER
Collegian Staff Writer

With the recent stock market turbulence, Penn State lost less than 10 percent of its $130 million endowment, but the loss will not have any material impact on program fundings, the senior vice president of financial operations said.

"I wouldn't want to express it in dollars but I would say its between five and 10 percent in market value," Steve Garban said.

"It's not going to be dramatic," he continued. "We will still be able to fund all programs."

Garban said endowment money is primarily used for scholarships and student aid.

Of the University's total portfolio, which includes investments and endowments, Garban said, only 35 percent was invested in stocks. He stressed that the amount lost was strictly in endowments, not investments.

The difference, he said, is that endowments are funds people give to the University with the stipulation that the principle not be spent.

Investments, on the other hand, include all of the University's funds, such as funds from tuition and the state, he said.

"We lost some," he added. "But we did position ourselves not just in stocks. Whereas we lost in stocks we had gains in bonds."

Marcus Schneck from the University's Office of Public Information said University President Bryce Jordan did not release a statement on the issue.

Jordan, who is out of town, could not be reached for comment.

In its worst trading session since the crash of 1929, which led to the Great Depression, the stock market plummeted last week more than 500 points draining more than $500 billion out of the value of stocks.

"And," Garban added, "I don't think this market's done."

The Dow's plunge to 1,738.74 left it 22.6 percent down, a one-day loss far larger than the 12.8 percent drop on Oct. 28, 1929, known as Black Monday. It also beat the Oct. 29 1929 record when it fell an additional 11.7 percent.

Garban said over the last five years, Penn State has gained about 22 percent each year, adding that the market is not a simple matter with which to deal.

"When this year's all said and done, I'm not sure where we will be," he said. "But, it won't have a material impact."

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— Steve Garban, senior vice president of financial operations

Some say recession can be avoided

By CHET CURRIER
AP Business Writer

NEW YORK — The calamitous drop in the stock market doesn't have to result in a severe recession, many analysts say.

But keeping the damage contained will require wise decisions by political and business leaders, and some good luck as well.

In its traditional role as a forecasting mechanism for the business and economic outlook, the market would seem to be sending a truly frightening signal. And market moves as dramatic as the current ones can take on some characteristics of a self-fulfilling prophecy.

At the moment, however, "in speaking out, the market is not simply forecasting," said Albert Sommers, economist at the Conference Board, a business research organization. "It is taking on some of the burden of adjustment and some of the pain.

"The sustained decline in the market is not just an anguished announcement that it is unhappy with ominous conditions for which no one any longer has a painless solution.

"It suggests at least one element of the solution: Increased caution, a weakening trend in consumption, a slower growth rate, a decline in import demand, and a freeing of productive resources to seek export markets."

Most economists agree that attitudes and expectations — not only of policymakers but also of consumers, workers and managers of businesses large or small — are an important driving force behind economic trends.

The market collapse, analysts say, may already have altered those expectations in a constructive way.

"In one sense, heightened consumer caution would be a most welcome development," observed David Resler, economist at Nomura Securities International in New York.

"Greater caution would lead to less spending and more consumer saving. Increased household savings would reduce America's reliance on foreign funds while simultaneously reducing imports and the trade deficit."

Resler added: "It is far more desirable that this needed adjustment occur over a protracted period of time than to happen quickly, because consumers lose confidence."

That last caveat comes close to the crux of the problem. Even if they can be found, quick fixes for the nation's trade and budget deficits might themselves have recessionary consequences for the economy.

Tax increases, cuts in government spending, reduced demand for imported goods all effectively take money out of circulation.

Thus, a key role falls to the Federal Reserve in its management of the nation's money supply. On Oct. 20, the day after the Dow Jones industrial average took a 508-point drop, the Fed pledged to prime the economy's pump with enough funds to keep it from sputtering.

One of the challenges facing the Fed is to live up to that promise without raising fears of increased future inflation.

Optimists on the economy like to point to events of 1962, when the market went through a sharp break in the springtime and more rough going in the fall.