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Every Market Collapse Is Different

By NICHOLAS F. BRADY

WASHINGTON — This is an extraordinary period for American investors. Caution should be their compass. It would be an error to expect a speedy correction like the one that followed the last major stock market implosion.

Fifteen years ago President Ronald Reagan asked me to head the commission to examine the market crash of October 1987. From the close of trading on Oct. 13, 1987, to the close of trading on Oct. 19, 1987, the Dow Jones industrial average fell 769 points, or 31 percent. In those four days of trading, the value of all outstanding United States stocks decreased by almost $1 trillion. On Oct. 19 alone, the Dow fell by 508 points, or 22.6 percent. Only the Crash of 1929 approaches the 1987 decline in magnitude.

The conclusion we reached in the fall of 1987 was that the market was not equipped to handle the volume that arose so suddenly. The recommendations of our report — improved clearance and settlement procedures, the adoption of circuit breakers and an increase in capacity — were put into place. The crash was the result of a structural problem. Valuations were not the culprit.

The present market collapse is different; it was caused by vastly overblown valuations. The stock market has been in a colossal bubble, a delusion born in the late 1990's that reached its zenith in 2000. While not common, bubbles have always been a fact of market life, a byproduct of runaway human emotions. They arise when people congregate and talk — and today market commentary is constant on cable TV and the Internet. Unfortunately, investors are finding that the breathless talking heads and brokers are hardly objective.

We are now experiencing the bursting of a bubble. But there is no textbook that explains how an economy recovers from a bubble. It is clear only that we must work down the excesses in the system in capacity, consumption and debt that were created in the late 90's.

Meanwhile, Americans' investment habits have changed. Now they are as likely to have their assets in the market as in a savings account or invested in their home. But markets change rapidly, and the public is discovering much of their wealth is in someone else's hands. In times like these, assigning blame becomes popular; politicians, especially, are adept at identifying somebody else's mistakes. This is conversation, not wisdom. Take it with a grain of salt.

Now what to do? I have always believed that people make money betting against the end of the world. Certainly anyone who bet against an investment in the United States in the last 50 years has been on the wrong side of the wager. Still, it was easy, even in the 90's, to realize that the market was drastically overpriced. It's difficult to know now where the bottom is. Markets overrun on the downside just as they do on the upside.

There is an old Bahamian expression: "Never mind the noise in the market, pay attention to the price of the fish." But how will we know what the right price is or, perhaps more important, the quality of the fish? Real progress has come from the sorry events of the last year. Accountants and corporate executives must now produce accurate figures that are consistent and clear. Investors will have more reliable information. Our economic and political system has a marvelous capacity for improvement.

But in contrast to 1987, this correction will take time; the president and Congress have already enacted the necessary reforms. Meanwhile, the nerve-racking swings in the market will continue. But the confusion will eventually clear, as it always has, and the market — and the economy — will start to make sense again.

Nicholas F. Brady was secretary of the Treasury from 1988 to 1993.