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History is more or less bunk.

Henry Ford, quoted in the Chicago Tribune, May 25, 1916

Back in October, 1987 we experienced the worst stock market crash since I started working in the business. Fortunately I had the foresight to record the reporting of the event on video tape. Last weekend, while cleaning out a drawer, I found the old tape along with a few others and decided to watch them. Seeing history played as a live event, particularly when it relates to money, gives you the same feeling in your stomach as the one you get when you see red and blue flashing lights in your rear view mirror.

Washington Week in Review is still shown on PBS on Friday nights. My tape leads off with Friday, October 16, 1987. Moderator Paul Duke opens with:

> Good evening. This may go down as the year the cheering stopped at the White House with this week symbolizing President Reagan's growing catalog of troubles. Topping everything, the plummeting stock market and the rapid rise in interest rates. There's also the Persian Gulf where the threat of increased conflict is mounting. Mr. Reagan's Supreme Court nominee, Robert Bork, still seems headed for defeat and the President is losing another Cabinet member, Labor Secretary William Brock . . . [and there were questions] whether George Bush can overcome the wimp factor in his presidential campaign.

He then handed the commentary over to *Washington Post* reporter Hobart Rowan who added meat to Mr. Duke's teaser. In the next few sentences, we hear the phrases "economic jitters," "economic crisis," "wild day on the stock market," "prices gyrated," "collapse," and "fears a recession." Investors also worried about the huge trade and budget deficits, high and rising interest rates, inflation and a troubled economy, the weak dollar, lack of US cooperation with Germany and Japan, the appearance of the loss of American power internationally along with a weak and/or ineffective Congressional leadership. If that wasn't enough, US warships were hit with Iranian missiles in the Persian Gulf.

This show appeared the Friday <u>before</u> the Crash of 1987 hit on Monday, October 19. The market was primed to fall because of the action on the prior Thursday and Friday. When the bell rang at 9:30, program trading began with a vengeance. The so-called "portfolio insurance" was a mindless computerized system that sold more and more the lower the market went. That "Black Monday" the Dow Jones Industrial Average finished down 508 points to 1738. IBM lost $32, Procter & Gamble $23, and Merck $24. In only two months, the market was down by more than a third.

Tuesday, October 20, was even tougher on investors. Traders hit the floor selling. More than one hundred stocks could not open on the New York Stock Exchange including big ones like Merck, Sears, Eastman Kodak and Dow Chemical. There were no buyers at any price. Early Monday Alan Greenspan, Chairman of the Federal Reserve, said the Fed would act as lender of last resort to banks that were willing (ordered?) to make loans to a brokerage industry that was threatened with bankruptcy. At the time, I was watching events on a Telerate machine in the bank's trading room. Until the Fed announcement I thought the market rout would reverse itself once investors came to their senses so the market advance could resume. If the brokers needed the banks to guarantee loans and the banks needed the Fed, there was more to this drop than I suspected. I felt paralyzed. All I could do was watch the market drop another 156 points, 8% lower than the day before. While it recovered a little the rest of the week, the following Monday was "Black Monday II." Down another 157 points to 1794 on the Dow. It took almost two years to recover the losses and move to new highs.

There were other tapes in my drawer too, one recorded ten years after the 1987 Crash. On October 27, 1997 we watched a global meltdown that started in the puny Hong Kong market where the Hang Seng index dropped almost 14% in a day. This set off a chain reaction world-wide that lead to a 554 point drop in New York. That was only 7% but may have been much more if trading on the NYSE hadn't been halted twice in the afternoon. The reason for the drop? Fear of a global recession. Interestingly, the six largest losses on Nasdaq took place in a ten month period between October 27, 1997 and August 31, 1998. Think about that for a second. We have a foreign market meltdown and a true crash on Nasdaq during the final two years of the Clinton Administration. Most investors remember only that the Nasdaq went nuts in 1999 and 2000, climbing from roughly 1500 to a little over 5000 before crashing again in 2000 and 2001.

My tape of Dow crossing 8000, 9000, 10000, and 11000 is fun to watch. The higher the market went, the more excited the reporters and analysts got. Some of the anchors on CNBC today were there for the 1987 Crash and for the subsequent rise. They provide continuity to the drama although a few of them have less hair.

The similarity of 1987 to today's circumstances are spooky. Deficits, rising interest rates, a threat of a slowing economy, talk of recession, Persian Gulf problems, supposedly overpriced markets and political gridlock sound all too familiar. Toss in the possibility of a Supreme Court nominee or two and we have a match. The wild cards are oil (it was $20 in 1987, $60 now), hedge funds (portfolio insurance?) and China's bid for Unocal. Other market debacles have started from less. I'm not forecasting a crash any time soon. What I am forecasting is that the next decline, when it comes, will be fast and ugly, not like the three year torture we went through from 2000 to 2002. The important thing to remember during the drop is that not one of the rent-a-pundits on TV will be able to tell you what is going on until it is all over. It was that way in both 1987 and in 1997 and it will be again.

Henry Ford was right about many things but he was wrong about history. Investing is all about controlling your financial emotions during times of stress. If you can remember how you felt the last time there was a big, seemingly uncontrolled drop in the market, you are less likely to do something irrational with your portfolio. And there will be a next time.

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I see that legendary investor Warren Buffet is buying a utility. That means he now owns two. When I was training in Detroit many years ago, I was given the phone number of "Utilities Anonymous." Whenever I had the urge to buy a utility stock, I was to call that number and the guy on the other end of the line would talk me out of it. Frankly, I can't understand the economics of utilities. Yes, growth is consistent but generally slow. Regulators establish the prices the companies can charge customers but utility suppliers of natural gas and coal and the other resources necessary to run the business are not regulated. When costs increase faster than revenue established by regulators, earnings can get squeezed. Utilities have high debt to equity ratios which makes them vulnerable to rising interest rates. Many utilities have energy and real estate subsidiaries, businesses that grow faster than the basic business. (Buying a utility for the non-utility exposure seems perverse to me.) Earnings and profits from non-utility businesses are used by the utility to add to capacity or to support existing debt. When utilities do add new capacity, finances can get stretched until the new facilities produce enough revenue to pay down debt.

Utilities have been strong performers since the end of 2002, recovering most of the ground lost in 2000 and 2001. A high dividend yield makes them an attractive alternative to bonds when bond yields are low. The good news is that utilities occasionally raise the dividend. The bad news is that utilities can eliminate the dividend as Allegheny Energy did in 2002. I doubt investors are buying utilities for growth. If this really is a quest for yield, buyers need to be cautious. There's an old rule "More money has been lost chasing yields than at the point of a gun." Don't reach. You will regret it if you do.

Have a great July 4 weekend!

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