The Great Crash of 1929: A Lesson of Caution for All Ages

By Dr. John F. Sase

"Those who cannot remember the past are condemned to repeat it"

-- George Santayana, *The Life of Reason* (1905)

In this article, we look at the Great Crash of 1929, a subject that has particular relevance to our current economic condition. We will address some monumental structural changes in our economic system. These changes led to a new way of life in the Post-Agrarian Age.

Taking into consideration the full breadth and duration of its spillover effect on the economy, the Wall Street Crash of October 1929 has been the most devastating stock market collapse in the history of the United States thus far. This crash marked the beginning of the Great Depression, an event that affected all countries in the industrialized West for the following decade and beyond.

The effects of the Great Crash did not subside fully in the United States until the American mobilization for World War II at the beginning of 1942.

This episode of American Business History remains our most impactful and most studied example of how major market downturns and recoveries occur. However, most of us have only a cursory understanding of this subject.

Given the series of economic events of the past twelve years, which include the Internet Bubble of 1999 and the Real Estate Bubble of 2006, we can find some parallels as well as lessons to learn from the Crash of 1929.

History vs. Mythology—The Best of Two Rounds

The common myths surrounding the Crash, as well as most other economic collapses, tend to oversimplify the reality of the actual events. Without considering the extensive information available, most of us form hopeful though "Pollyanna-ish," assumptions as to how long it takes for markets to recover completely.

Granted, no two major economic disasters are the same.
However, a few general principles seem to be self-evident: First, most downturns and recoveries do not follow a smooth path downward or upward. Second, recoveries take a significantly longer period of time than downturns. Third, the dynamics of these recessions and recoveries, at the very least, are contemporaneous with significant historical events.

Therefore, the lesson of the Crash of 1929 is that, by understanding how these events worked their way through the economic system, we can prepare ourselves to understand, to cope with, and, hopefully, to avoid similar perils and pitfalls in the future.

In order to begin to comprehend the Bubble of 1929, we need to gain some appreciation of how it materialized over the preceding decade. The tracks leading toward this calamity were laid at the end of the first recession that followed World War I. This recession rang the death knell for the traditional small family farm and our rural way of life: Millions of Americans migrated to the growing industrial cities.

This movement changed the emphasis from farming to manufacturing as our country's primary employment sector. Farms failed, and a recession occurred.

This significant recession ended in the summer of 1921. As more jobs became available in the industrial cities, the paradigm shifted from an Agrarian Age to an Urban Age in the United States.

However, this first post-war recession was followed by two shorter and less severe ones in mid-1923 and in the fall of 1927. Apart from these relatively minor interruptions, the stock market generally rose throughout the Roaring Twenties until the bubble finally burst in the fall of 1929.

Following the end of the third post-war recession in late fall of 1928, the market began to soar wildly toward its day of reckoning. After pausing during the first half of 1929, the stock market continued an ascent to its peak. In the fall, the market began its subsequent tumble.

Buying a Stairway to Heaven

The 1920s were marked by events that caused it to be hailed as the "New Era." Prohibition began, the Women's Suffrage Amendment passed, and the first national radio station was launched, along with the mass production of radio receivers for the home. All of these events happened within the first two years of the decade.

As the market escalated to its peak, America witnessed the launch of the first rocket, the first public demonstration of television, Lindbergh's non-stop flight over the Atlantic, talking pictures replacing silent films, the first full-color movies, and the invention of the automatic bread slicer.

The groundwork of Thomas Edison, Nikola Tesla, and other great minds clearly had laid the foundation of this electric New Era.

However, the nefarious side of the Twenties lurked behind the glamour. Sinister activities and corrupting influences drove the economy to its tipping point. It was not the bootleggers, gangsters, and their molls of the Roaring Twenties who caused the calamity.

Instead, it was a handful of malfeasant stockbrokers forming collusive investment pools in order to make illicit trades for the purpose of driving up stock volume and prices artificially. These brokers were accompanied by a small ensemble of CFOs of target companies who were complicit in the pool schemes as well as a few CEOs of major investment banks.

All of these bad eggs participated in the debacle. Later, some were indicted for their efforts, which wiped out the life savings of millions of Americans.

On the other side of the market, we find millions of neophyte investors who did not know the stock market from a hole in the ground. These simple folks wagered their accumulated savings, which were generated by an affluent decade, in the stock market.

In fact, playing the stock market became a National Pastime. All of these investors--butchers, bakers, push-cart operators, hat-check girls, and the cop on the corner--lined up to pour their money into this "hole in the ground." Everyone had their own broker.

The professional sharks in the market smelled blood and went for the kill.

The Stairway to Heaven Leads Straight Down to Hell

The year was 1929 when the fabric of the entire market and the boom economy of the 1920s started to unravel. In July of that year, the market stagnated before its final climax.

Many writers throughout the decades have suggested that the stock market simply responded to the passage of the Smoot-Hawley Tariff Act by the House two months earlier. Many in business had feared that these tariffs imposed on imports would impede international trade.

The market finally peaked on the last trading day before the Labor Day weekend. However, a week earlier, noted Economist Roger Babson (the founder of Babson College in Babson Park, Massachusetts) had predicted that a sixty-to-eighty-point market downturn would occur soon.

As a response to either an accurate forecast or a self-fulfilling prophecy, the market produced what has become known as the Babson Break. During this break in the market over the next month, the Dow Jones Industrial Average slipped 15%. It went from its high of 380 down to 320 before regaining half of its previous composure at 350 points.

This initial drop wiped out the equity of the players who had invested after the last week of June of that year.

For those of us who have seen James Cameron's film *Titanic,* we may envision the market as the stern of the ship as it bobbed helplessly before going under. The bobbing ceased on Black Thursday—24 October.

The plunge to the depths of financial despair hesitated over the following weekend as bankers and brokers scrambled to keep the market afloat. However, the bottom fell out on Black Tuesday—29 October—as the market collapsed to two thirds of its pre-Labor Day pinnacle.

Over the next two weeks, it recovered modestly before sinking to
slightly more than half of its peak. Nevertheless, this brief crash obliterated the equity of anyone who had invested after February 1928.

Why? Prices fell to below the level of winter 1928.

This episode started the downward rollercoaster ride that would last until 1932. These next two years displayed a series of step-downs, each marked by a mild upward trend followed by a severe decline.

Some investors profited by these upturns if they exited soon enough. However, anyone who continued to hold their stocks saw their equity vanish. By early December 1929, the market had recovered past the two-third mark before taking a mild drop during the Holiday Season. As the New Year commenced, the Dow regained 80% of its strength.

However, the recovery did not last beyond April. This movement heralded the beginning of a stair-step decline in which each modest recovery was followed by a larger drop.

Hope/Despair/Hope/Despair/Hope/Despair…

The manically depressive market drifted downward into the abyss. By November 1931, the investors who had entered and held in the market as early as May 1924 found their equity completely evaporated.

During this long decline, the rallies averaged forty days in length, though they varied from two weeks to two and a half months. This pattern of rally and rescission occurred eight times over the next two years until the market bottomed out in July of the 1932 election year.

In the midsummer heat, the market laid comatose, having lost ninety percent of its value.

Franklin Delano Roosevelt won the Presidential Election of 1932. However, here is a historical fact from this year that slipped under the political rug: The market had begun to recover from its lowest point during the months preceding the election (well, sort of).

Following modest gains during the election season, the rising Dow reversed course and slowly drifted back downward until late winter of 1933 as the nation experienced widespread runs on its banks. Notably, the Bank Holiday of March 1933 that successfully ended the bank runs marked the turnaround of the stock market as well as the economy at large.

Nevertheless, the subsequent recovery was largely a matter of a modest quarterly gain followed by more than a year of economic stagnation. Unemployment lingered for years to come. It took concerted New Deal efforts until 1937 to reduce the unemployment rate to half of its highpoint in 1933.

Americans watched for two and a half years, from late 1929 to early 1932, until the market bottomed out. Over this period of time, its value dropped 90%.

After reaching the depths of economic despair in 1932, the market took five years to recover. However, it only reached half of its previous value in this recovery.

Compounding the problem, a significant recession during 1937 and 1938 saw most of the gains made since the New Deal plateau of 1933 and 1934 evaporate over the course of nine months. Though offset by various Federal Recovery Programs, unemployment continued to linger.

Finally, it was the boom economy of World War II that drove American unemployment downward to virtually nothing. The labor force worked double- and triple-shifts to support the War Effort.

However, the stock market did not fare as well.

When German forces marched into Paris in early 1940, the stock market dropped once again. In the wake of the attack on Pearl Harbor at the end of 1941, the market succumbed to further depression.

It did not regain its composure until D-Day and the Bretton Woods Conference. In summer 1944, 730 delegates from all forty-four Allied nations met in Bretton Woods, New Hampshire to regulate the international monetary and financial order after the War.

Fast Forward to the Present Day

Today, American life is somewhat different than it was in 1929. The labor force has grown more widely educated and highly skilled.

We still have some of the financial market regulations and institutions in place that were created by the New Deal in the 1930s. However, we must remain on guard against economic disasters similar to the Great Crash of 1929 that continue to occur into the Twenty-first Century.

We still can learn lessons of great value in order to protect ourselves in these difficult economic times.

Regardless of the state of human development, certain economic principles continue to apply. These principles include the facts that most downturns and upturns do not follow a smooth path; economic recoveries take significantly longer than their preceding downturns; and the dynamics of these recessions and recoveries usually are correlated with specific historical events, both small and large.

What particular relevance do these lessons have for us? Perhaps most simply, individual small professional practices and businesses as well as larger firms rely upon various financial markets to hold and increase their cash reserves.

For example, many attorneys depend upon this reservoir of funds to finance their practices between settlements and lump-sum payments. These days, being a skilled attorney is not enough. Law firms also must master the tools that enable them to manage and protect their working capital and to avoid the pitfalls of nefarious market actions.

By heeding historical events such as the Great Crash of 1929, all potential investors may find themselves in a more secure financial position as they move forward into the future. Even if one does not buy the proverbial Stairway to Heaven, s/he still may be able to obtain a good strong rope and life-preserver.

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