We’ve Learnt Nothing From the 1987 Financial Market Crash

Retrieved Monday 16th of October 2017 09:22:06 PM

‘Man the phones. It’s going to be a busy day.’

Never a truer word was spoken.

The day was Tuesday, 20 October 1987.

The Dow Jones had plunged 22% in value and the shocks were being felt around the world.

The fledgling investment advisory industry was facing its first baptism of fire.

Clients rang wanting reassurance, wanting to know the next step to take, or simply wanting to sell.

The lessons learnt from that period have never left me.

Exuberance mixed with excessive debt and overconfidence is a toxic mix. A cocktail of excess that’s potentially fatal to your financia

In the 1980s, the entrepreneurial sector drank heavily from the punch bowl of excess. ‘Greed is good’ sums up the mantra of that pe

The difference between then and now is that the cocktail of excess is no longer isolated to one sector of the community…it has intox

In the mid-1980s, global debt was around US$20 trillion. Today it’s in excess of US$220 trillion.

As a society, we’ve learnt nothing from the events of 1987.

The past 30 years has taken greed from being merely good to an object of idolisation.

Reading *The Weekend Australian* made me smile.

There on the front page was this line:

‘Property downturn a “threat” says RBA’

You can see why those economic academics in Martin Place get paid the big bucks. They’re as sharp as tacks…

According to the article:

> ‘*The property boom has lured hundreds of thousands of low income Australians into negatively geared investments that the Res*
>
> *In a warning that rising household debts are the biggest domestic risk to the Australian economy, the Reserve Bank is conductir*

What do you think lured hundreds of thousands of low-income Australians to put their s into the debt noose?

The RBA’s low interest policy, that’s what.

The stupidity of those who are supposed to be responsible and prudent is beyond galling.

It's reprehensible. It's infuriating. It borders on the criminal.

In recent memory, we've 'been there and done this' far too often for their actions to be an 'error of judgement'.

It was deliberate.

The RBA's low interest rate policy was purposefully designed to entice people to borrow more and more to keep the economy 'growing'.

When this bubble finds its pin, the cost — in both financial and human terms — will be catastrophic.

If a medical practitioner inflicted this much pain and suffering, they'd be disbarred for life.

But if you're a central banker, you're rewarded with a well-paid board position. Go figure.

On the 30-year anniversary of Black Tuesday, as a society, we've learnt nothing. Which means history is doomed to repeat itself. But this time the message is going to be delivered so powerfully that it'll be heard for a generation or more.

The lessons of 1987 have long been forgotten by the investment industry. Most of today's planners were in school back then.

It was wry amusement that I read an article in *Weekend Wealth* titled 'How super comfortable will you be?'

Here are some extracts from the article:

> '*The Association of Australian Super Funds of Australia…calculate that if you're single you'll need an annual income* [for a good

> '*If you have $824,000 at age 65, assuming you can get 7 per cent investment return, that's enough to get a couple through a co*

Pray tell, where do you get 7% per annum each and every year for 20 years in an investment environment where the 'risk-free' rate of return is less than 3%?

Once you invest outside the security of the banking system, you accept there is risk to your capital. That extra 4% of return does **not** come without risk to your capital, and most certainly won't come with monotonous regularity for two decades (unless of course you invest with Bernie Madoff).

But wait, it gets better…

> '*On a simplistic level, if one were to invest their whole super in National Australia Bank shares, which pay a grossed-up dividend*

Why stop the exercise at 9%? Why not find an even higher-yielding stock on the ASX and use that for 'simplistic' purposes?

On one hand we have the RBA 'stress testing' banks to see how they'll cope with a property downturn; on the other, we have a 'simplistic' example of investing your entire retirement capital in one bank.

If (or when) there is a property downturn, do you think the banks may incur some pain to the bottom line? Probably.

Will the banks be able to maintain the same dividend payout? Probably not.

The industry's 'beautiful projections' ignore the ugly truth. Markets never deliver such neatly packaged outcomes.

To show you what can happen in real-life based on only needing a 5% return, this is an edited extract from my book, *How Much Bull Can Investors Bear?*

***

'*Let me show you what would have happened if you'd retired in June 2007 (when share markets were still going strong) and i*

'*You place your trust in a responsible planner. They recognise the market's looking a bit toppy in 2007. To offset the prospect*

'*The textbook says to place four years' worth of drawdowns in cash, and the balance in "growth" assets. This way, you can dr*

'*Here's our example based on $500,000 to invest and a $25,000 per annum drawdown.*

'*For the purpose of the exercise, I've used performance data supplied by Super Ratings.*

'*Below is the median annual return for balanced funds over the past nine financial years and a projected return for this financi*

1. *2007/2008 financial year: –4% (loss)*
2. *2008/2009 financial year: –7% (loss)*
3. *2009/2010 financial year: 9.8% (gain)*
4. *2010/2011 financial year: 8.7% (gain)*
5. *2011/2012 financial year: 0.4% (gain)*
6. *2012/2013 financial year: 14.7% (gain)*
7. *2013/2014 financial year: 12.7% (gain)*
8. *2014/2015 financial year: 9.7% (gain)*
9. *2015/2016 financial year: 3.0% gain)*
10. *2016/2017 financial year: 8.1% (gain)*

'*The table below shows the outcome if we apply the above performance figures to our $500,000 investment — $100,000 in ca*

'*(Note the $100,000 cash buffer plus interest earned exhausts the cash buffer after 4.5 years. Therefore, halfway through yea*

Year	Start Amount of Balanced Fund	Performance	Balance	Less Annual Drawdown	End of year balance of Balanced Fund
07/08	$400,000	Minus 6.4%	$374,400	Nil	$374,400
08/09	$374,400	Minus 12.7%	$326,850	Nil	$326,850
09/10	$326,850	Plus 9.8%	$358,880	Nil	$358,880
10/11	$358,880	Plus 8.7%	$390,100	Nil	$390,100
11/12	$390,100	Plus 0.4%	$391,600	$12,500	$379,160
12/13	$379,160	Plus 14.7%	$434,900	$25,000	$409,900
13/14	$409,900	Plus 12.7%	$461,960	$25,000	$436,960
14/15	$436,960	Plus 9.7%	$479,345	$25,000	$454,345
15/16	$454,345	Plus 3.0%	$467,975	$25,000	$442,975
16/17	$442,975	Plus 8.1%	$478,856	$25,000	$453,856

[Click to enlarge]

'*After ten years, our starting $500,000 is now worth $453,856 (the cash buffer expired in early 2012).*

'*The account balance would be much lower if the drawdown had been indexed (which happens in reality). In addition, if a plan*

'*The fact is that if your account–based pension (with a focus on growth) gets hit early by negative returns, it's unlikely you'll e*

‘*As you can see, the impact of two negative years has not been offset by eight positive years. And in the context of negative r*

‘*Even though six of the eight positive years produced very respectable returns, the retiree is still behind. There goes the theor*

‘*The temporary halt in debt accumulation in 2008/09 put our hypothetical retiree on this slippery slope.*

‘*In theory (there’s that word again), the four–year cash buffer is the solution to the volatility problem. However, from the bitter*

‘*To demonstrate just how slippery the slope can become, let’s hypothetically say the run of eight positive years are now follow*

17/18	$453,856	Minus 6.4%	$424,809	$25,000	$399,809
18/19	$399,809	Minus 12.7%	$349,033	$25,000	$324,033

[Click to enlarge]

‘*Twelve years later, your capital is 35% less than when you started.*

‘*Here’s the other really bad news…global share markets are ripe for a major fall.*

‘*A fall that has all the potential to make 2008/09 look like a mere hiccup.*

‘*Minus 6.4% and Minus 12.7% might be numbers that people wish they had achieved.*

‘*Given that the majority of Australians have their superannuation assets — by default — in balanced funds, they are highly ex*

‘*Once you are on that slippery slope, there is no way back.*’

This Friday is the 30th anniversary of the 1987 crash.

I’ll raise a glass in thanks to what that period taught me about respecting markets, the value of humility, and the long-term benefit of investing with cautious optimism.

Unfortunately, these are lessons that far too many people are going to learn the hard way in the not-too-distant future.

If you’d like to know how to protect your capital from a repeat of 1987, please go here.

Regards,

Vern Gowdie,

Editor, *The Gowdie Letter*

- Author
- Latest Posts

Vern GowdieEditor at Markets %26 Money

Vern Gowdie has been involved in financial planning in Australia since 1986. In 1999, Personal Investor magazine ranked Vern as o

His previous firm, Gowdie Financial Planning, was recognized in 2004, 2005, 2006 %26 2007, by Independent Financial Adviser ma

He is a feature editor to Markets and Money and is Founder and Chairman of the Gowdie Family Wealth and the Gowdie Letter adv

Latest posts by Vern Gowdie (see all)

- We've Learnt Nothing From the 1987 Financial Market Crash - October 16, 2017
- A Challenging Guarantee - October 13, 2017
- Why Warren Buffett Is Wrong - October 9, 2017
- The IMF Has Read 'The End of Australia' - October 6, 2017