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Twenty years on from the great stockmarket collapse of 1987 . . .

Will we crash again?

Erica Thompson

THE 1987 stockmarket crash wiped a staggering 25 per cent off the value of Australian shares in a single day.

Some believe there's worrying parallels between what happened then and what's happening now — four and a half years of extraordinary gains combined with an increasingly volatile investment environment.

But as the 20th anniversary of Black Monday approaches, analysts say there's no need to start fire-selling.

"History is unlikely to repeat in this instance because the fundamentals supporting our market remain strong, valuations remain reasonable and the magnitude of gains seen in the current bull run are relatively modest," says Wise-Owl.com analyst Tim Morris.

By the end of October in 1987 the local market had lost more than 40 per cent and didn't bounce back to its pre-crash highs until February 1994.

Mr Morris says an equivalent one-day crash today would see the ASX 200 Index drop from its current level above 6700 to about 5000.

But AMP chief economist Shane Oliver says while you can never rule out another plunge "given the fickleness of investor confidence", there are several factors working in our favour this time round.

"The increase in share prices . . . has been nowhere near comparable to the surge into the 1987 sharemarket top," he says.

The Australian market has risen by almost 150 per cent from its lows in 2003, while the rally that preceded the 1987 crash saw shares rise by a whopping 420 per cent. Dr Oliver says market gains have also been less than profit growth, meaning valuations are still a long way from bubble extremes.

"Prior to the 1987 crash share prices surged relative to profits, whereas in recent years share prices have been catching up to profits."

He says the late '80s were also associated with rapid growth in corporate debt and gearing, asset churning and highly speculative developments by entrepreneurial stocks such as Bond Corp and Qintex.

"By contrast, corporate gearing is now relatively low and the huge profit growth being generated by resources companies is real," he says.

Mr Morris says shareholders should also take comfort in the fact the two big drivers of the current resources boom — China and India — account for more than a third of the world's population.

"Judging by these numbers, there is clearly the potential for many more years of solid gains," he says.

But not everyone is convinced it's smooth sailing ahead, with global markets continuing to behave irrationally.

Dr Oliver believes after rising sharply from its August fall, the Australian market is due for a pull-back and weak US economic data may be a trigger.

Wealth Within chief analyst Dale Gillham is also taking a wait-and-see approach.

"To say that the rise in the Australian sharemarket over the past few weeks has been interesting would be an understatement," he says. "The current market has risen two-thirds of the distance in price in around half the time (compared to 1987).

"What is concerning is that I cannot find one period in the last 25 years in which the market has moved this fast in price."

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MEDIA MONITORS
INCISIVE INSIGHT

Money&You

Will we crash again?

Mortgage broking industry grows

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AUSTRALIAN SHARES

	Sept '87 peak	Now
Prior 12mth share price gain %	88.4	29.6
Prior 4yr price gain % pa	34.0	20.1
Prior 12mth profit growth %	24.5	14.7
Prior 4yr profit growth % pa	15.5	25.0

ALL ORDINARIES MONTHLY CHART

20-year anniversary
Mining boom
1987 crash
7000
6000
5000
4000
3000
2000
1000
Dec29 1989
Dec31 1999
Dec31 2009

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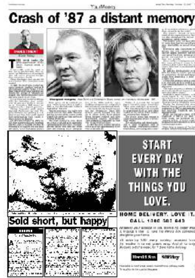
MEDIA MONITORS
INCISIVE INSIGHT



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Brief: WISEOWL

Grin and bear it: rather than growling, the savvy investor can make money from a bear market.

Sold short, but happy

SHARES

Simon Guzowski

AN AGE-OLD market adage has been to buy low and sell high.

Buying something at a low price which you can then sell to someone else at a high price sounds like a great way of making money.

This is the approach most people use to make money in the market.

But, have you ever considered doing the opposite of this? That is, selling a stock at a high price and then buying it back at a lower price. This is called "going short" and allows you to profit when a share price falls.

Short selling isn't as complicated as it sounds.

Let's compare it to Australia's other favourite investment, property.

Just say you were lucky enough (or should we say smart enough?) to pick the top of Australia's property market in early 2003.

Expecting property prices to fall, you sold a house for $500,000. If you were to then buy this property back a couple of years later for $400,000 you would become $100,000 better off.

On the stock market this process works only slightly differently in that you sell someone else's shares.

You first borrow shares from someone, usually your broker, and sell these shares into the market.

If you've judged correctly and these shares go on to fall in value you'll be able to buy them back at a cheaper price than what you've sold them for. You then pocket the difference.

For example, if you were to sell one hundred shares in company XYZ for $10 each, and then buy these back a month later when their price had fallen to $8.50, you will have made a profit of $1.50 per share or $150 (assuming no transaction costs).

Short selling can be a bit of a mind bender at first, but once mastered, allows an investor to make money from stocks that fall in value.

This is a great tool to keep on the belt because from time to time bear markets do happen, and when they do, more stocks will fall in value than those that rise in value.

Simon Guzowski is a senior equities analyst at independent investment research house, wise-owl.com

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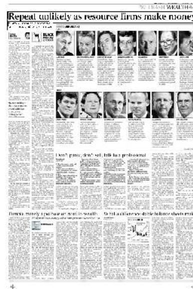
MEDIA MONITORS
INCISIVE INSIGHT



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Repeat unlikely as resource firms make money

It's different this time but there are still lessons to be learned from the 1987 crash

ANNA FENECH
WEALTH EDITOR

BLACK MONDAY
20 YEARS ON

ANOTHER week, another market high — and another record high for BHP. It seems nothing can stop the onward march of the resources boom in what are extraordinary days for the market. Or can it?

With the 20-year anniversary of the 1987 share market crash fast approaching, a few investors are skittish about the parallels between then and now — particularly the length of the current boom and the huge share price gains in the lead-up.

During the tech boom it was described as "irrational exuberance" by Robert J Shiller, who wrote a book of the same name.

Most say "it's different this time" because the resources companies driving the boom actually make money, but investors can still learn lessons from previous wealth-destroying episodes.

While nobody has a crystal ball, these lessons may include understanding what conditions prompt a crash, how to cushion your portfolio against one, judging whether a crash is as bad as it looks, and how to react if there is one.

The Australian share market fell a staggering 41.8 per cent between October 19, 1987 and the end of that month. An equivalent crash today would see the S&P/ASX 200 fall from its current level of 6600 to around 4000 — "a scary proposition, indeed" says Tim Morris, a share market analyst at wise-owl.com (see graph).

> 'By responding to short-term market events with fear, investors can destroy wealth'
> John Owen, MLC senior analyst

"However, we believe there's no need to panic this October because the fundamentals supporting our market remain strong, valuations remain reasonable and the magnitude of gains seen in the current bull run are relatively modest," he says.

The current boom, underpinned by large resources stocks supplying an industrialising China, is now four years old.

Taking into account the length of the boom and recent volatility inspired by the sub-prime crisis, some investors are wondering whether we are "due" for another fall.

Mark Dutton, chief investment officer for fund manager giant Axa, says the answer is "no".

"It's a spurious argument to say today that the Australian share market is up by a large amount since 2003 and that therefore it has to come down.

"It's not true on a stand-alone basis. It is only true if it is driven by overvaluation of the stocks in the market.

"In 1987 there was no doubt in anybody's mind that it was a run based on overvaluation."

So, investors must know how to distinguish between a strong market rally driven by fundamentals and one driven by overvaluation and speculation.

"Until quite recently, valuations actually lagged corporate profit growth and, overall, the market has not overextended this time," Dutton says.

A common valuation tool is the price to earnings ratio of the market.

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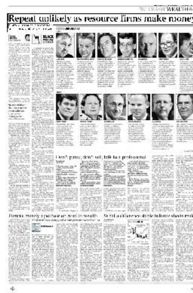

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In Australia, the sum of inflation plus the PE is about 18.1, versus 24.3 in 1987, according to Shane Oliver, head of investment strategy at AMP.

Oliver says that from 1982 to mid-August/September 1987, global and Australian markets experienced a strong bull market on the back of recovery from the early 1980s recession, the economic deregulation and reforms of the 1980s, and a re-rating of shares due to lower inflation.

"By 1987, this had become very speculative and debt-fuelled, with Australian shares almost doubling over the year to their September high on the back of strong gains in so-called entrepreneurial stocks."

There was rapid growth in corporate debt and gearing, asset churning and highly speculative developments by a group of entrepreneurial stocks including Bond Corp and Qintex — "In fact, entrepreneurs had their own market sector," Oliver says.

"And, over the four years to 1987, US and Australian share price gains were way in excess of profit growth."

John Owen, a senior investment analyst at MLC who remembers the crash well, says the crash was devastating but also shows the value of "time in the market" versus "trying to time markets".

He says it also shows the value of perspective — because, to his mind, the 1987 crash was not as bad as it looked.

While the crash was large on October 19 and during November 1987, the Australian share market still finished the backwards year down by just -7.9 per cent.

And, people who had invested for the three or four years before the crash "would have still come out substantially ahead because of the returns for the previous few years", Owen says.

Look at the market returns for the previous four years before 1987: in 1983, the All Ords rose 66.8 per cent in one calendar year; in 1984 it fell -2.3 per cent; in 1985 the return was +44.1 per cent; and in 1986, a staggering +52.2 per cent.

It all supports the view that it is time in the market that counts, not market timing.

This is a get-rich slow philosophy of buying quality stocks or other investments, reinvesting dividends, and giving yourself time to ride market humps and bumps — in order to increase your average.

"If there is a crash, maintain your investment discipline by using it as an opportunity to acquire stock at cheaper prices," Owen says.

"Numerous studies show that by responding to short-term market events with fear, investors can destroy wealth."

He uses the example of someone who invested $100,000 in Australian shares at the end of 1982 and then left it completely alone — they would have $3.1 million by May 2006.

If they had sold their investment after the 1987 crash and gone to cash for the five negative months after the crash, before re-entering the market, their investment value would only be $2.09 million.

"By capitulating to fear they would have lost $1 million."

Paul Betti, a financial adviser who specialises in margin lending, says investors should understand that if companies are increasing their income via profit growth and dividends, then regardless of any short-term capital appreciation or depreciation (which occurs due to market sentiment, not individual company fundamentals), the share price will steadily rise over time.

"If there's a crash, stay put in your existing investments and consider putting more money in," he suggests.

"If property prices dropped by 20 per cent overnight, would you sell or buy property? I'd suggest most people would use the opportunity to buy quality property — it's the same thing."

However, to maintain flexibility and liquidity, Betti advises investors to keep investments in both property and shares, bearing in mind the advantages of both.

"Property prices are not as volatile and are unlikely to drop by that much overnight — but you can't reinvest the rent as such

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and get a growing income stream from dividends like you can from shares." A key difference between 1987 and now is that today, most Australians have exposure to the sharemarket.

There is $1 trillion in super savings, of which about 40 per cent or more would be invested in the Australian equities market (as per the asset allocation for the average balanced default super fund).

In 1987, there was some super, but mandatory and universal super coverage was five years away. That's the indirect exposure.

Today, many Australians also routinely invest in the share market directly by using online brokers.

"What it means is people should be more aware of share market fundamentals because they have far greater exposure to Australian shares — indirectly through their super and directly through their own share holdings," Owen says.

Another key lesson Owen learned from the crash was the importance of portfolio liquidity.

He says that on the day of the crash, the fund manager he then worked for decided to convert 20 per cent of what were fully invested portfolios into cash.

"The only stocks we could move (sell) on that day (of the crash) were the BHPs, Brambles, Coles — big companies that were extremely liquid.

"There are parts of the market today that have forgotten market liquidity. Some smaller companies or stocks that had interesting ideas in an overheated market then did not have strong fundamentals like profit and cashflow."

So, invest in large liquid companies — because if conditions change dramatically, investors may find they can't get out of those stocks.

Another lesson is not to pick a fund manager based on last year's winner — no matter how long a boom has lasted.

In the year to September 30, 1987, the best performing managers were delivering returns of over 80 per cent for the year. For example, the No 1 pooled fund manager return was +91.7 per cent for the year to September 30, 1987 (Source: Mercer).

The "worst" performer returned +31.4 per cent.

Looking at the returns for the year to the end of December (that is, post-crash), the No 1 manager in the year to 30/09/87 recorded a return of -11.6 per cent and its performance ranking fell to 35th out of 40 managers surveyed.

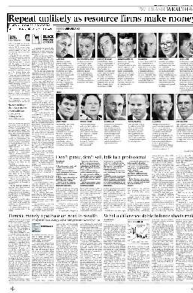
That is, it went from No 1 to No 35 in the space of a quarter.

Axa's Dutton says the main lesson for investors is to protect against "the inevitable correction of overvaluation" such as was seen in 1999-2000 when the tech bubble burst.

"That was an overvaluation rally.

"The trouble is, you can be right so early you miss out on an extended rally — and that's a difficult tradeoff."

Consequently, a lot of fund manager evaluations now not only consider valuation criteria but also consider how likely it is that there will be a catalyst to change market sentiment.



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HEROES AND VILLAINS
1987

ALAN BOND

Skilful investing in Perth property and beer set the former house painter on the road to fortune, making him the country's most successful entrepreneur. But by 1988, with huge liabilities of $14 billion, Bondy was vulnerable to creative accounting. Accused of removing as much as $3 billion from Bell Resources, he was declared bankrupt in April 1992. After a brief spell in jail, he has been living mostly in London.

ROBERT HOLMES A COURT

Our biggest corporate raider shook Australia's biggest company, BHP, to the core with a threatened takeover that ultimately failed. The WA government was a firm supporter. He was raising funds for a tilt at the Fairfax media empire when he died suddenly in 1990. Janet Holmes a Court continued the business and rationalised it.

CHRISTOPHER SKASE

Built his $3 billion Qintex media and property empire in the 1980s while enjoying a life of flamboyant excess. Qintex's collapse in November 1989, owing more than $1 billion, was triggered by a tilt at the MGM film studio eight months earlier. He declared himself bankrupt and chose to live in exile on the Spanish island resort of Majorca, where he died of stomach cancer in 2001.

WARWICK FAIRFAX JNR

Moved to protect the family media dynasty from "invaders" by privatising John Fairfax in August 1987 – in the process, disastrously loading up on debt weeks before the crash. The family split, a cousin moved off to form Rural Press and the company was forced to sell interests in TV, radio and magazines. Warwick Jnr and his family live quietly in the US.

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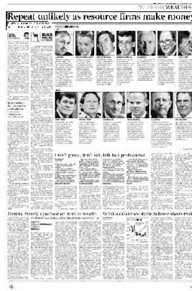

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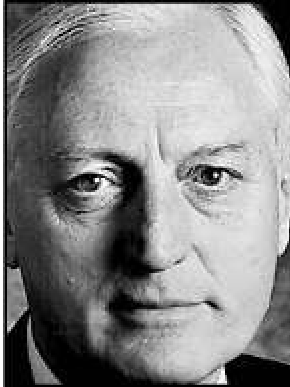
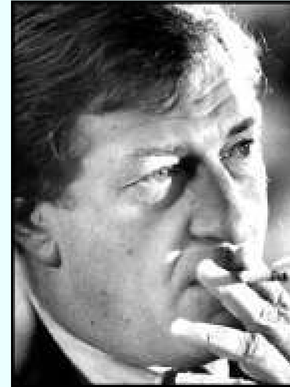


BRIAN LOTON

As head of the venerable BHP, Brian Loton fended off a determined takeover bid from Robert Holmes a Court. It was a close-run thing, and Holmes a Court was recognised for revealing BHP's vulnerability and under-performance. Many thought Loton would have lost if not for an astute defence by advisers Mike Tilley, John Elliott and Graeme Samuel.

KERRY PACKER

Australia's second-richest man saw the market was overblown and pulled back his share market investments. It barely slowed his business growth. Best known for selling Sydney's channel Nine to Alan Bond for $1 billion and later buying it back for less than half that figure. Packer's "you only get one Alan Bond in your life" was the corporate quote of the 1980s.



JOHN ELLIOTT

Presided over the biggest failed takeover in Australia. Impressed with his style and rhetoric, some of the world's biggest banks backed his Harlin Holdings for a $5.6 billion management buyout of Elders IXL, the rural and brewing business, in August 1989. It flopped. A turbulent life followed for the business supremo and one-time Liberal Party kingpin. In July he emerged from a ban on being a director, and he is now free to pursue any business interests he likes.

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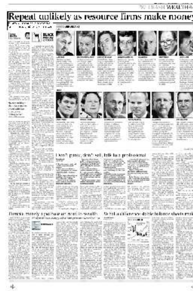

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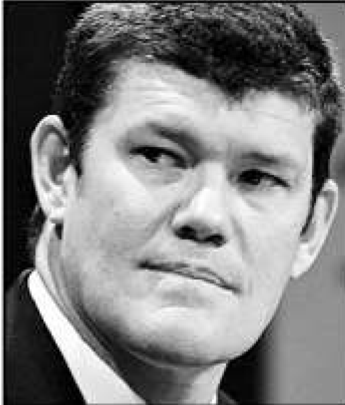

JAMES PACKER

Inherited the $7 billion family empire on the death of his father on Boxing Day, 2005. Like his dad, he sold his media interests at the top of the market – this time to private equity. While Packer Snr loved gambling, it has been James who has ramped up the family's business interests towards gaming at home, Macau and in Canada.

ANDREW FORREST

One-time stockbroker now worth more than $5 billion on the promise of riches from Fortescue Metals' iron ore mines at Christmas Creek and Cloud Break in the Chichester Ranges of northwest Australia. Yet to dig any iron ore out of the ground, but has the security of long-term contracts from hungry Chinese steel mills.

KERR NEILSON

Worth more than $3 billion on the listing of his Platinum Asset Management empire earlier this year. The group's value-style funds are being overshadowed by extraordinary growth in the equities market, but his supporters know his time will come. A symbol of the baby boomers' superannuation boom.

MARIUS KLOPPERS

South African set to expand the global mega-miner BHP Billiton on the insatiable growth of China and India. Whatever the mineral in demand, BHP Billiton can supply it. No other company today so well symbolises the "stronger for longer" hopes of the noughties' boom.

ALLAN MOSS

A key figure at Macquarie Bank, which emerged barely troubled from the 1987 crash. It had already begun to diversify into more exotic forms of investment banking and commercial lending. With a philosophy of wanting to be No.1 in each of its business sectors, it has grown into a substantial worldwide business. Australia's "milionaire's factory" is a global pioneer of financial engineering and infrastructure funding – but is its debt model vulnerable to market shocks?

JOHN KINGHORN

Swept hundreds of millions off the table into his pockets with the float of the RAMS Home Loan business. He and his backers' shareholders have since been hit by the US sub-prime lending crisis that has seen borrowing costs escalate and cast a pall over business. Westpac has flagged it will buy the name and distribution assets.

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