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Duke prof: Recession likely to follow crash

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What caused "Black Monday," when the stock market fell 508 points on Oct. 19, and long-range effects that may appear was discussed yesterday by professors at Duke University's Fuqua School of Business.

Some disagree over whether the 25 percent drop in the value of the stocks was really a market crash or just a violent correction and a bad day for Wall Street.

"I offer no apology for calling it a 'crash.' It was worthy of the term," said Douglas T. Breeden, associate professor of business administration at Fuqua.

He said that "movements this big in the stock markets are not insignificant events," and that this is more than an overdue correction. A recession will likely follow the roller-coaster activity, he added.

"The supply and demand equilibria are fragile," Breeden said. "The market is built on expectation, but when expectations turn and fall, production is cut, people are laid off, income drops and people buy less."

The drop of 508 points in the Dow Jones Industrial Average "wasn't unfounded," but was due because prices on stock were too high, Breeden said.

"They're not at a cheap level now, but it's a reasonable level. The only amazing thing is why did it drop so quickly and in one shot."

Another Fuqua instructor, Campbell Harvey, took a more relaxed view of the market's dive.

"I don't see the situation as serious as people make it out to be. It's not that it (the market) went down, but that it went up (during August) so many points," he said. "I think the anomaly is the market going up so fast and not coming down."

When a stock market becomes as volatile as it had been during recent weeks, Harvey said, stock prices must drop to guarantee that investors can keep their earnings.

As further evidence that the market may be regaining its footing quickly, Wall Street posted its 7th-largest point gain in his-

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tory yesterday.

However, the stock market remains down $856 billion from its peak of Aug. 25, and officials have curtailed trading hours for another week to catch up paperwork that has piled up since the flurry of trading Oct. 19.

A 55.2-point gain yesterday in the Dow Jones industrial average of 30 blue-chip stocks put that widely watched barometer up 42 points for the week at 1,993.53. Still, the Dow is 27 percent and 730 points below its high-water mark in August.

Students at Duke's Fuqua School may consider themselves lucky that Black Monday did not happen in January, when job openings would have been affected, Harvey said.

The effects of the fall may be more nervousness on the part of employers who will be interviewing Fuqua graduates later this year, but Harvey said he did not believe it indicates a strong downturn in the economy.

"Stock market trading is often viewed as a leading indicator for the economy ... but there's no strong correlation. It's been wrong so many times since the 70s."

The bond market gives a much clearer indication of what's happening with the United States' economy, Harvey said, adding it currently shows no strong signals.

Portfolio insurance has been pointed at as increasing the volatility of the market, and some blame it for the market fall. Stock prices are believed to have tumbled because they hit a "trigger point" for portfolio insurance.

The insurance lets investors hedge their market risk by diversifying, and gives them the right to sell in the future at a price agreed on ahead of time.

Kalman Cohen, a bank-research professor, said he sees "a flurry of activity to come in the methods of exchange.

"The question arising is: Is there something in the nature of the market that will contribute to a dynamic instability?" he said. "It's worth looking at the sources of instability and how you can change regulations to overcome them."

Among traders, behavior that may be rational on an individual basis becomes irrational when followed by many traders.

Cohen compared Black Monday to a fire in a theater. As prices dropped on stocks, everyone rushed to get out of the market, escalating the seriousness of the drop.

The aftershocks of the $500 billion collapse of Wall Street may follow patterns of earlier years, with cutbacks in spending by corporations and consumers similar to those seen in 1929 at the outset of the Great Depression, Breeden said.

As consumer consumption falls, production will be cut back, workers laid off and consumer borrowing will either stop or remain unchanged.

"There's no reason to believe this won't be a normal recession," Breeden said.