Investigation of 1929 stock market crash

Introduction

The 1929 stock market crash was a significant event (1949). Not only was it the first major crash of a stock exchange in history, but it also led to major economical influences/events such as the Great Depression and introduction of regulations through the Securities and Exchange Commission (other countries also adopted their own regulation services). But what caused such disarray and havoc that culminated into a Great Depression and caused the Government to form a whole new regulation commission? That is what this essay focuses on. Through scrutinized research and prudency, a question was formulated as to whether it was overconfidence in the market and economy that was the cause. Overconfidence seemed to be the sneaky devil that stole that sum of over 40 billion dollars from Uncle Sam. The sources indicated allude, to some extent, the danger that almost all Americans were indulged in, overconfidence.

Thus the investigation will be focused on both the relevance and importance of this topic. Google's definition of overconfidence is as follows, "The definition of overconfidence is when someone has more confidence than they should have based on the situation and they misjudge their ability or opinion." (2015) Based on this definition we can already see the mistakes that [almost all] Americans were engaged in, they misjudged their ability and opinion. They bought stock on margin borrowing from banks that gave money away because they were also overconfident in their market and clients. They used this borrowed money to buy stock from 'hot tips' in deluded hope that another fool would buy the same stock for a higher price, completely ignoring the underlying business fundamentals, like is the company even making money? Or are the companies' earnings growing enough, which would justify someone else to buy the stock back at a higher price? Blinded by unwavering optimism, they ignored these questions and when they ran out of fools to keep buying the stock at higher prices (and when they realized the fundamentals of the companies) they went on a selling spree that drove the stock price to the unimaginable lows that it reached.

However, it was overconfidence from all Americans that is to blame, the overconfidence from the banks and brokers that lent margin money with no justification, the overconfidence from the Government who thought that all would sought itself out and that the economic prosperity would last forever, and of course the overconfidence from everyday Americans who thought they could make a quick buck from the market.

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Investigation

Of course, the importance and relevance of such an investigation is to understand why the financial world is the way it is today, why the government regulates the way it does and of course to prevent the same misjudgment from occurring in the future. It also establishes an understanding of how confidence can affect investment and investors [thus stock prices and economy] and by learning the emotions and misjudgments of the past economists, investors, governments and the like are better equipped for handling the events of the future.

A famous book on investing was written in 1949 by a famous and esteemed investor, Benjamin Graham. Graham is seen as the father of the 'value investing'. (1949) Successful investors today such as Warren Buffet have been partisans to this method. So, Graham knows his stuff. Value investing focuses on the fundamentals of a company (what the 1929 investors ignored, as mentioned above), throughout his book (which purpose is to help investors make money) he keeps preaching that one must never be optimistic in selecting stocks, and that in fact you must be pessimistic during economic booms and optimistic during times of repression. If only his book was written in 1929 instead of 1949, perhaps the Great Depression could have been avoided. This illustrates indeed that overconfidence was a cause of the crash, Graham believes that if investors were more pessimistic, the stock prices would not have been unreasonable overvalued and that a crash would have been avoided.

Source 2 lists the number one reason for the crash was overpriced stocks. This means that the shares were priced unreasonably high and that only a crash could bring them back to normal levels. The only thing that will cause a stock to be selling at a high level is confidence that the price of the stock will be continue to rise in the future and/or that the earnings will continue to grow (in other words if the economy continues to prosper) (1950). Common sense states that the economy (if anything) can continue to prosper forever, eventually balancing will occur and there is bound to be set backs. But this was not as obvious to the Americans, Banks and Governments of 1929. They were adamant that stocks were to continue growing forever, and when the balancing did finally come (in the form of decreased earnings, slowed business and setbacks) it was such a shock that it unfortunately set in stone a frenzy of selling that in reverse fashion lowered prices to historic lows and ironically, created an under confidence in the American market that culminated in the Great Depression.

One might wonder where the Government/authority was during all of this. They were there, but like the average American, were blinded by unwavering confidence in the American prosperity. Source 3 gives a very important suggestion for this; it states that the fiscal government had a clear signal to raise the interest rates. Increased interest rates, which are associated with loans, would have made it harder for everyday Americans to borrow on margin. However, the government chose not raise the interest rates, confident that the economy will continue to

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prosper and that Americans will be more than able to pay their huge culmination of debt indefinitely. So when the economy did hinder and the stock prices fell, average Americans were found wanting, unable to pay debts. Banks were left bankrupt, unable to repay savings, rendering millions of Americans with nothing.

This links to source 4 (a documentary), hearing the stories of Great Depression victims, its clear the banking system had a major role in the hardships experienced. So many Americans, even those immune from the stock speculation, had all their savings held in these banks (that were carelessly loaning money, over confident in putting their clients money into speculating hands). This documentary further reiterates the importance of confidence in the economy by illustrating how the radio was used during the depression to restore confidence to Americans in what became known as 'fireside chats'. (1935) It seems the government had gone from hands off approach where they thought the prospering economy would sought itself out, to a much more hands on approach where they had to utilize everything they could to restore a lost confidence to the consuming American.

A speech is one of these radio addresses, spoken by the controversial President – Herbert Hoover – at the time. It's a speech regarding Unemployment Relief. The greater part of the speech focuses on unemployment problems and the government's attempts to make amends to these problems but the underlying theme is the attempt to restore faith and hope (or confidence) in the American public. Confidence was extremely important to the governments at the time. This recurring theme of confidence eludes its influence in determining economic conditions and thus ultimately strengthening the argument that it was indeed the over confidence that caused the Great Depression.

Oral accounts from the everyday Americans/victims of the Great Depression state that, "business in the 1920s was worshipped like religion". Their friends were becoming rich overnight, stock returns were doubling if not tripling and that it was hard not to believe that the prosperity would last forever. One can almost hear the blind sense of optimism when hearing the romanticized accounts of the roaring twenties. In some of the victims' cases, the optimism was too great and caused some to put all their money, money meant for their children and families, into stock options in blind hope of becoming rich even though it is evident that they have/had absolutely no knowledge of investing or the exchange for that matter. And just as one could hear the optimism, so could one hear the pain and heartache of the depression that followed.

Speculation in any era is evidently a dangerous game and just as the cartoon in source 7 suggests, people were so confident in the market that they were willing to put their heads on the line just for a hot tip. Even with repeated warnings from prudent investors such as Benjamin Graham, the public ignored it just like water off a ducks back and unfortunately it was those

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overconfident individuals who put all their money/savings into an overvalued market that caused the Great Depression.

Conclusion

Ultimately, the evidence is overwhelmingly alluding to investor confidence (or investor sentiment if you will) as the major cause of the depression. Many argue that it was the banking system or the government that caused the depression, but this too can be linked to over confidence (as done above). And even if it isn't the major cause, then it is definitely at least one of the causes. It took American stock market over 25 years to return to the 1929 levels (1950) and as a result, we now have stricter regulations and fiscal policies to protect individuals from their own over confidence, and thus themselves.

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