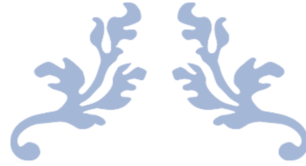

Investors Guide to Stock Market Crashes

Everything You Need to Know About Stock Market Crashes & Their Long-Term Impact on Your Investments

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Introduction

It is absolutely normal to worry about the next stock market crash. You probably have a portion of your life savings wrapped up in your retirement fund, which is tied to the success of the stock market.

I will show you the impact of every major stock market crash over the last.

The big question is should you fear a crash, and what can you do to avoid it? This analysis will help you decide.

What is a Stock Market Crash?

A stock market crash is a correction or realignment of the value of stocks. A correction means that the stocks that form the basis of a stock index are deemed to be over-valued, and a sell-off begins. Stock market crashes can be extremely volatile and fall quickly due to the level of psychological fear in the market.

Why Do Stock Markets Crash?

A stock market crashes because stock market investors lose confidence in the value of the equities they own. If you believe that the future earnings potential of stocks you own will be diminished, you will seek to sell the stock before it decreases in price; when many investors start selling simultaneously, this causes a crash.

Why Do Stock Markets Go Up?

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If you observe any long-term chart of any major stock index, you will see that it increases in value. There has never been a 20 year period in history when the stock market has not increased in value.

Stock markets go up because the companies that issue stock continually seek to improve their business, create better products and services, become more efficient, and generate more revenue and profits. These activities add value to a company, and it is this continue value increase that increases the value of the stock and, therefore, the value of the stock market.

When Did The Stock Market Crash?

There have been six major stock market crashes since 1929. In 1929 the DJIA lost 89% in 3 years, in 1973, the market lost 46% in 2 years, and in 1987 stocks dropped 35% in 4 weeks. More recently, in 2000, the Nasdaq crashed by 83%, and in 2008 the DJIA lost 54% in 16 months. Finally, in 2020 due to the COVID pandemic, the markets dropped by 38% in 5 weeks.

How Long Until Stock Markets Recover From A Crash?

If we analyze the 6 major US stock market crashes of the last 100 years, we see that the average peak loss was 57%. Also, the average duration of the recovery is 9.8 years. This can be somewhat misleading, though. The 1929 crash was exceptional in its size and duration. Additionally, governments and central banks have realized that they can manage inflation and stimulate the economy to speed economic and stock market crash recovery.

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Over the last 20 years, we have had three major crashes, with an average loss of 62%, but with an average recovery time of 7 years.

Stock Market Crash (Year)	Size of Crash %	# Years to Recover
1929	-89%	23
1973	-46%	10
1987	-35%	2
2000	-83%	16
2008	-54%	5
2020	-38%	1
Average	**-57%**	**9.8**

Table 1: Stock Market Crashes & Their Impact

Stock Market Crashes In History: A Timeline

Chart: 100 Years of Stock Market Crashes

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The Stock Market Crash of 1929

A breakdown in investor confidence caused the 1929 stock market crash. The Dow had risen by over 503% in the previous 9 years, led by the general public's unrestricted access to credit, which they used to buy stocks on margin. High unemployment and an unregulated, unsustainably high stock market led to a collapse in confidence, which caused the stock market crash.

The 1929 Stock Market Crash in Numbers

The 1929 stock market crash and subsequent depression was the longest recession in history, lasting 23 years. The Dow Jones Industrial Average lost 89% of its value in 3 years, causing widespread poverty, debt, and homelessness.

Chart: The 1929 Stock Market Crash Lost 89% in 3 Years & Took 23 Years to Recover.

The increase in production output due to world war II provided economists with valuable lessons in stimulating economies out of recessions.

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What Caused the Stock Market Crash of 1929?

Ultimately the cause of the 1929 stock market crash was an **asset and equity bubble** driven by the general public's unrestricted access to **credit**. Easy access to credit fueled a wave of highly speculative and **risky investments** in the stock market. Eventually, prices were unsustainably high, and the overheated stock market crashed.

What Has Been Done To Avoid The 1929 Crash in the Future?

The introduction of market regulators and legislation to ensure transparency of accounting and the limitation of credit risk were the major steps taken to avoid another great depression.

The Stock Market Crash of 1973 (Oil Shock)

In October 1973, OPEC (Organization of Arab Petroleum Exporting Countries) declared an oil embargo on countries supporting Israel during the Arab-Israel Yom Kippur war. This was an attempt to exert political influence on Western nations, who were highly dependent on middle eastern oil. This led to a global economic shock wave.

The 1973 Stock Market Crash In Numbers

The 1973 Oil Crisis caused a crash that wiped out 46% of the Dow Jones Industrial Average in 2 years, and it took 10 years for the index to recover the loss.

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Chart: The 1973 Stock Market Oil Crisis Crash Caused a 46% Loss in 2 Years, Which Took 10 Years to Recover.

What Caused the Stock Market Crash of 1973?

The cause of the 1972 stock market crash was **geopolitics and market disruption**. The Oil embargo severely disrupted western economic output and caused a massive correction in the valuation of companies dependent on oil, which was essentially most of the economy.

What Has Been Done To Avoid The 1973 Crash in the Future?

Western governments invested heavily in decreasing dependence on imported oil; for example, Henry Kissenger unveiled the “Project Independence” program, which by 1981 meant that reliance on OPEC was diminished.

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The Stock Market Crash of 1987 (Black Monday)

The 1987 Stock Market Crash In Numbers

The 1987 Black Monday Crash was extremely aggressive, dropping 35% in 4 weeks, but it recovered relatively quickly in 2 years.

Chart: 1987 Stock Market Crash (Black Monday) Dropped 35% in 4 weeks and recovered in 2 years.

What Caused the Stock Market Crash of 1987?

There is no definitive answer as to what actually caused the 1987 crash. Most experts agree that investors saw the market as being overvalued, trading at a PE Ratio of 23. After a strong bull market in the 1980s, there was already considerable fear in the market. This is why understanding market sentiment, fear and greed, and psychology is important when investing in the stock market. When confidence is lost, it can produce a cascading effect of extreme panic selling.

What Has Been Done To Avoid The 1987 Crash in the Future?

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The lessons learned from the 1987 crash led to the introduction of trading curbs. These are essentially circuit breakers that halt trading when there is exceptional volatility and losses in markets. These have been used many times in future crashes and help mitigate extensive losses by introducing a cooling-off period to help dissipate the fear emotions in the market.

The Stock Market Crash of 2000 (DotCom)

The DotCom Nasdaq 100 Crash in 2000 In Numbers

The internet bubble was a big crash for the NASDAQ, with an 83% loss over 3 years. The NASDAQ took over 16 years to recover from the crash.

Chart: Stock Market Crash 2000 – DotCom Crash Nasdaq 100 Chart

In comparison, the Dow Jones Industrial Average only dropped 37% over 34 months and took 6.6 years to recover. This was very much an "Internet Stocks" crisis, but it still impacted the broader market.

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Chart: Stock Market Crash 2000 – DotCom Crash DJ-30 Chart

What Caused the Stock Market Crash of 2000?

From 1993 to 2000, modern web browsers and the worldwide web-enabled new ways of doing business primarily bypassing traditional retail business models and cutting costs. This disrupted the established business models of "Bricks and Mortar" businesses. The aggressive push of new internet businesses to claim market share resulted in companies that were run at huge losses in order to dominate the web.

Investors rushed to buy stocks of internet-related companies, regardless of the company valuation. With a huge wave of investment, stock prices soared to unsustainable levels. The NASDAQ 100 rose 400% and reached a Price-Earnings Multiple of 200, which has never been seen before. With investment banks such as Citigroup and Merrill Lynch pumping the market and analysts were proclaiming "Bricks & Mortar companies are dead," the bubble was complete.

"The collapse of the Internet bubble, perhaps one of the largest financial fiascoes in US history, came after a three-year period, starting in January 1997, when investors would buy almost anything even vaguely associated with the Internet, regardless of valuation. Investors ignored huge current

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losses and were willing to pay 100 times the expected earnings in fiscal 2002. They were goaded by bullish reports from sell-side securities analysts and market forecasts from IT research firms, such as IDC, Gartner, and Forrester Research." Source CNN Money November 2001

In 2000, it became clear that many internet companies were burning cash fast, and bankruptcies began. This coincided with the Federal Reserve increasing interest rates to help to cool an overheating economy. With interest rate hikes and high bankruptcies, confidence collapsed, and so did the NASDAQ 100, which lost 83% in 2 years and took 10 years to recover.

Interestingly the Brick & Mortar companies listed on the NYSE also suffered from the crash, with the DJ-30 losing 34% in 34 months and took 6.5 years to recover.

What Has Been Done To Avoid The 2000 Crash in the Future?

Laws and regulations regarding the full disclosure of risk and tightened rules on conflict of interest declaration have impacted the market. There was also a string of litigation against executives of companies involved in the string of high-profile scandals, including Enron, Worldcom, and Andersen Consulting.

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The Stock Market Crash of 2008 (Global Financial Crisis)

The 2008 Financial Crisis Crash In Numbers

The financial crisis was an aggressive crash lasting just 16 months but managing to wipe out 54% of the value of stocks. Due to the decisive central bank and government action, the recovery took 5 years and was not prolonged more than necessary.

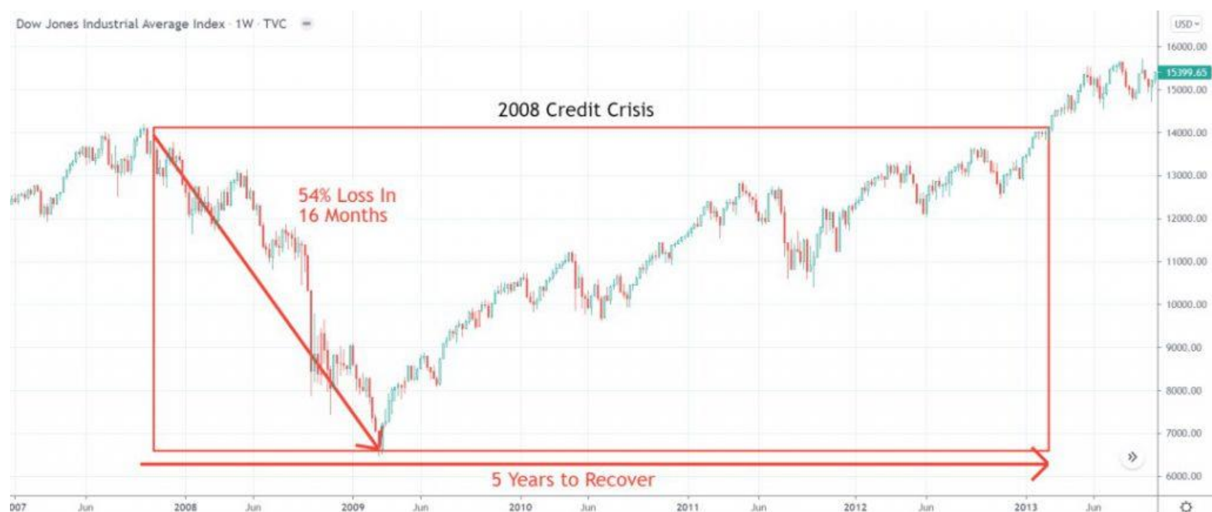

Chart: Stock Market Crash 2008 – Financial Crisis

What Caused the Stock Market Crash of 2008?

Due to the weakening of the securities and exchange commission (SEC) and lax financial regulation, banks took excessive risks in mortgage lending practices. The introduction of predatory lending practices, such as sub-prime mortgages, allowed people to buy houses with low initial repayments, but large delayed repayments led to a huge property bubble.

These high-risk loans were hidden in Collateralized Debt Obligations (CDOs) by Citigroup and Merrill Lynch and sold on as investment to banks and funds globally. When the mortgages began to default, there were a

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string of bankruptcies in the financial sector, including the collapse of Lehman Brothers, which kicked off the worldwide panic and breakdown in confidence.

- **For a great movie that covers the Financial Crisis, watch Inside Job**

What Has Been Done To Avoid The 2008 Crash in the Future?

The main response to avoid a repeat of the 2008 Financial Crisis was introducing the Dodd-Frank Act in 2010. It created large-scale reform and regulatory improvements, including introducing the Financial Stability Oversight Council (FSOC) and better regulation for derivatives and shadow banking.

The Stock Market Crash of 2020 (Covid Crash)

The 2020 Stock Market Crash in Numbers

The Corona Crash was the most aggressive and shocking crash of all, losing 38% in just 5 weeks. Luckily due to government stimulus and support, the market recovered in record time, taking just 10 months, to recoup the losses.

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Chart: The 2020 CoronaVirus Crash Lost 38% in 5 Weeks, But Only Took 10 Months to Recover.

What Caused the Stock Market Crash of 2020?

The Covid Crash of 2020 differed from all previous crashes because a worldwide virus pandemic, SARS-COV-2/COVID-19, caused it. The measures introduced to fight the virus, especially lockdowns and social distancing, created a surge in unemployment and retail bankruptcies.

The stock market reacted quickly, with a 38% loss occurring in only 5 weeks, devastating the travel, leisure, and retail industries. Interestingly the market had recovered within 10 months due to the rapid reaction of governments and central banks, who supported the unemployed and the industries with massive cash stimulus policies. The US issued $1.9 trillion or 26% of their GDP in stimulus and the EU 11% or €750 billion.

What Has Been Done To Avoid The 2020 Crash in the Future?

Avoiding this type of crash will be difficult as the cause is not financial corruption, lack of legislation, or systemic. This crisis highlighted the problems with the globalization of supply chains and the world's reliance on China. Governments are looking to diversify out of China and create

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increased self-sufficiency, especially in semiconductor production and vaccine production.

The Causes of Stock Market Crashes

Crash	Cause	Cause	Cause
1929	Equity Bubble	Easy Access to Credit	Poor Institutional Risk Management
1973	Geopolitics	Oil Market Disruption	
1987	Equity Bubble		
2000	Equity Bubble	Easy Access to Capital	Poor Institutional Risk Management
2008	Asset Bubble	Easy Access to Credit	Poor Institutional Risk Management
2020	Global Pandemic	Lockdowns	

5 Biggest Causes of Stock Market Crashes

The analysis shows that 66% of stock market crashes are caused by asset and equity bubbles. In fact, in 3 of the 6 crashes, ease of access to investment capital or credit was used to fuel the asset and equity bubbles. The unrestricted access to capital was caused by poor institutional risk management. It is a cycle; low interest rates, deregulation of finance, access to cheap capital lead to equity and asset bubbles.

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Only 2 stock market crashes were not related to bubbles, the disruption of the oil market by OPEC in 1973 caused a deep correction, and the SARS-COV-2 pandemic caused a massive drop in global demand and employment.

So, if you want to be on the lookout for the next crash, watch for these 5 factors.

1. Equity & Asset Bubbles

The stock market crashes of 1929, 1987, 2000, and 2008 were caused by equity and asset bubbles. One could actually assert that the real cause of the bubbles was poor institutional risk management and easy access to credit, the effect of which was risky speculation. Economist Robert J. Schiller highlights this in his Nobel Prize-winning book, Irrational Exuberance.

2. Easy Access to Credit

Low-interest rates and easy access to credit allow economies to expand rapidly and increase demand and wealth generation. But there is a point at which, if not properly managed, all the capital sloshing around an economy needs to be invested somewhere. We know from market sentiment and fear and greed that money usually finds a home in the latest hot technologies or industries. In 2008 subprime lending caused a housing asset bubble; in 2000, greed and expectation in internet stocks, and in 1929 high-risk speculation in stocks using margin cause the collapse.

3. Poor Institutional Risk Management

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In half of the stock market crashes, poor management of risk by institutions was a major cause. In 1929 provision of loans for margin trading in stocks fueled the bubble. In 2000 investment banks were responsible for pumping internet stocks and IPOs, which, combined with a lack of government regulatory oversight, caused the bubble. Finally, in 2007/8, irresponsible risk management from investment banks caused asset-backed securities to default because of sub-prime mortgage lending, causing a global financial crisis and complete loss of confidence.

4. Geopolitics & Market Disruption

Wars, tariffs, and trade embargos contribute to the destruction of wealth, but they only contributed to one major stock market crash in the western world. However, in developing nations, these continue to be major issues that hold back wealth creation, unemployment, and much-needed improvements in quality of life.

5. Pandemic

The latest crash in 2020 introduced us all to a brand new threat to our way of life, pandemic, and disease. While we have paid the price in both lives and economically for our abuse of animals, this problem is only just beginning.

3 Biggest Effects of Stock Market Crashes

We have looked at the causes of stock market crashes, but what about the effects.

1. Financial Loss

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Financial losses are usually painful and quick when the market goes through a major correction. Trillions of dollars get wiped off the value of stocks, companies, pension funds, and property. It is like the value simply disappears, and it is at this point we realize that our economies and wealth are simply based on a foundation of confidence. When that confidence erodes, so does our society and our standard of living.

2. Inflation/Deflation

Since 2007 interest rates have been reduced to almost zero, this has helped fuel the recovery needed to restore wealth and boost confidence in the global economy. Low interest rates and vibrant global competition has helped to keep inflation low. In fact, we're at a point of price deflation in 2019, and in 2021 we are now facing negative interest rate charges on our money held in private bank accounts.

Inflation has been declared dead by economists, but due to the pandemic and the huge decrease in global production, inflation is rising. High inflation over 4% is bad for wealth creation and stock markets. Central banks' main tool for fighting inflation is to increase interest rates, increase interest rates too much, and cause asset and equity bubbles to burst.

3. High Unemployment

An unfortunate effect of stock market crashes is high unemployment and large increases in homelessness. This can take years to recover fully and causes huge amounts of mental and physical anguish to large swathes of the population.

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Is The Stock Market Crashing?

A simple way to assess if the stock market is crashing is to use technical analysis of the stock market indices. Using a long-term chart of a broad market index like the S&P 500 and overlaying a moving average 9 indicator over the price line can give us a simple indication. Make sure the chart is set to 1 week per bar. When the price drops significantly below the 9 week moving average, the market is in a significant correction.

Is the Stock Market Going to Crash?

Yes, I can confirm that the stock market is going to crash. Crashes and corrections are an unfortunate side effect of global capital, equity, and commodity markets. Maintaining a perfectly regulated, fair, smooth-running economic system seems to be beyond normal human and governmental control. History tells us that over the last 90 years, we have had 6 major stock market crashes, which is an average of one crash every 15 years.

Next Stock Market Crash Prediction

No one can truly predict exactly when the next stock market crash will occur. But using the research built up over the last 100-years, it is possible to spot the conditions that make a stock market crash more likely.

The primary cause of stock market crashes is a lack of institutional regulation and risk management and the low cost of money, which causes bubbles to occur. In 2021 we have 4 major risks that could cause a future stock market crash.

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5 Systemic Risks That Might Cause the Next Stock Market Crash

1. Low Interest Rates
2. Government Cash Stimulus
3. Property & Equity Bubbles
4. Inflation
5. The Pandemic

12 years of **low interest rates** mean that the yields on government bonds are close to zero. This means that the extra capital available through **government stimulus** needs to be invested somewhere, that somewhere is equities and property. The **Nasdaq 100 is up 122%** since the bottom of the crash in March 2020 and **up 53% from the previous all-time high** in February 2020. That can be seen as an incredible recovery or the signs of an equity bubble. **Median House Price Sales in the US (MPUS) have increased by 60%** in the last 10 years. Add to this that the pandemic is not over, and it has caused a serious decline in output which has **boosted inflation**. **Inflation causes stock market declines,** and **increasing interest rates battles inflation but causes stock market crashes**.

Considering that all these risk factors are real and present right now, it is not hard to imagine that the next stock market crash is coming soon.

Governments Are Managing Stock Market Crashes Better

The positive side to this history lesson of stock market crashes is that governments and central banks are genuinely getting better at managing an economic crisis. The Obama response to the 2008 financial crisis was

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good and saved the financial system as we know it using stimulus, bailouts, and lowering interest rates. While most governments failed to lockdown and react quickly enough to the COVID-19 virus, they did enact enough stimulus to stop massive and widespread poverty through unemployment, which resulted in a quick end to the Corona crash in 2020.

How To Avoid A Stock Market Crash

The total protection of your money from a market crash is impossible. However, you can minimize your risks and protect most of your investments with a few precautions. Thus, keeping most of the assets in your 401K safe in a bear market is possible. However, you must be careful not to sacrifice your portfolio's ability to grow to avoid risks.

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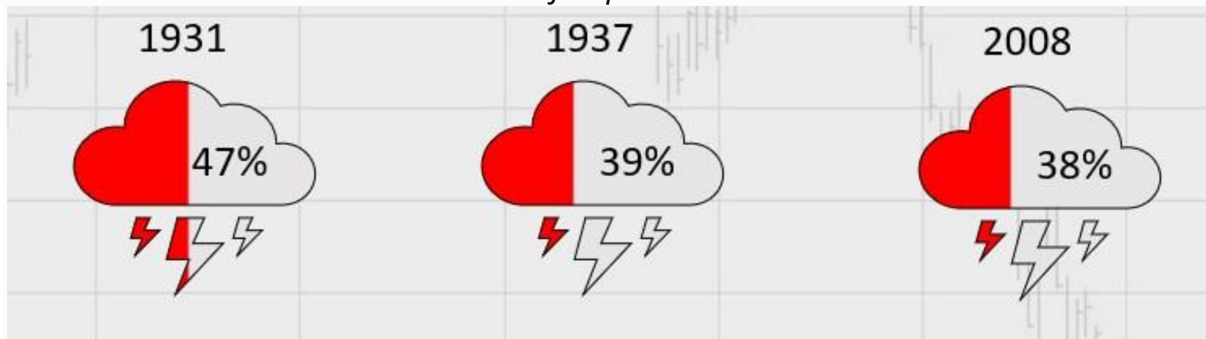
Move to Cash in a Crash

Generally, stocks fall in value twice as quickly as they gain value. The best price gains are longer-term uptrends over multiple years. Crashes happen quickly and violently due to the panic and fear in the market. However, a real crash can be devastating to your wealth; luckily, they are fairly infrequent.



Worst Stock Market Crash Years

The three worst crashes of all time were the great depression of 1929, the worst year being 1931 with a 47% drop, followed by 1937 with a 39% drop. The next worse was in 2008, with a 38% drop in one year.

The simple truth is that when there is a real stock market crash, most, if not all, stocks fall. So diversification in safe stocks will not help you. The best course of action is moving your portfolio to cash or government bonds. This means total protection from falling stocks.

However, there is one problem with moving to cash; it is the timing.

If you move to cash too early and the market recovers quickly, then you may miss out on stock market gains.

Move too late, and you will have lost too much money; in this case, you should employ a dollar-cost averaging strategy. The problem of timing your move to cash is covered with our Stock Market Crash Detector System.

[Related Article: Avoid The Crash Move To Cash]

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What Can You Do During a Stock Market Crash?

Dollar-cost Averaging (DCA) in stock investing is a great way for long-term investors to maximize profits and lower risk while staying fully invested in the market.

Dollar-cost Averaging is a method of investing whereby an investor scales into a long-term investment with a fixed amount regularly (e.g., monthly). When the price of the investment goes down, they receive more shares for their money, and when it increases, they get less. This averages down the cost per share, promoting a successful outcome.

Dollar-Cost Averaging is an investing strategy commonly used by investors. If you regularly contribute to a retirement fund or your investment portfolio, you automatically use dollar-cost averaging. This regular contribution averages out the overall cost of the investment.

If the stock price decreases over time, the investor will receive more shares for their money, meaning the asset's average price decreases. This averages down the cost per share, promoting a successful investing outcome. If the stock price increases, they get fewer stocks, which increases the overall average cost.

Related Article: [Dollar Cost Averaging In Stocks [8 Top Investing Strategies]

How To Protect Your IRA/401K Retirement Fund During a Crash

There is no foolproof strategy that will keep your portfolio safe. However, you can mitigate your risks with basic moves like diversification. The first

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strategy for protecting your nest egg is diversification. To explain, put your money in several places, so you do not lose everything.

For instance, invest in different stocks and US Treasury Bonds. An example of basic diversification is 20% tech stocks, 20% finance stocks, and 20% energy stocks. In addition, invest in several good dividend stocks so you will have money coming in. A great rule to follow is to have at least 50% of your 401K funds in dividend stocks.

Finally, having part of your funds outside of stocks will keep part of your money from a crash. Simply, having 20% of your funds in CDs or Bonds can ensure you will have cash.

Good diversification can be provided by using the Portfolio Correlation Functionality in Stock Rover.

Related Article: How to Protect Your Retirement Fund During a Crash

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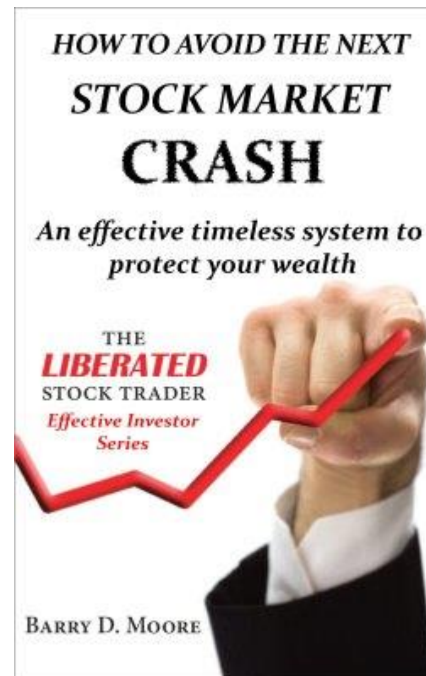
Stock Market Crashes: Final Thoughts

Researching and writing this analysis has helped me clarify my approach to handling stock market crashes. Firstly we can try to avoid the crash by moving to cash, but that is difficult to do because stock market collapses move fast. Ultimately, if you are caught in a crash, a great way to manage it is to use Dollar Cost Averaging and keep investing through to correction; this lowers your average cost per share and means you pick up bargains along the way.



In our entire history, we have recovered from 6 major crashes; our first crash in 1029 took 23 years to recover, 2008 took 5 years, and 2020 took 10 months.

Crash recovery can take time, so if you are close to retirement, make sure to be diversified into Bond and secure assets to ensure you do not lose too much.

If you are interested in a systematic approach to avoiding stock market crashes, I would highly recommend my book:

[How to Avoid the Next Stock Market Crash – eBook & Video Training]

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