"The Buildup to Black Tuesday"

The upward spiral in stock prices throughout the 1920s slowed somewhat during 1929, although this mild recession (a short-lived, minor economic slowdown) was barely noticed by most investors. There were subtle signs of a weakening economy, including a few small breaks in the rise of stock prices and the slowdown in industry and new home construction. But overall, no one questioned the bull market, including some leading economists and respected bankers who preached optimism.

Gradually, however, the occasional reports that over speculation were weakening the market grew more frequent. More and more investors became nervous that perhaps prices had become inflated and they might lose money rather than make more. There were some who predicted a messy end. Shortly after he took office in early 1929, Herbert Hoover attempted to curb the buying frenzy by encouraging financial boards in the government to do what they could to slow it down. He even encouraged newspaper editors to warn their readers about the dangers of over speculation and the inflated prices of stocks. For the most part, Hoover's entreaties were ignored, because no one wanted the "party" of the Roaring Twenties to end.

What Caused the Crash?

As has been stated, the consensus among economists and historians today is that no single issue caused the stock market crash of October 29, 1929. Rather, a combination of events, natural and man-made, along with governmental policies, improvements in manufacturing, and the rise in buying on credit, all contributed to the market's sudden downturn. Despite hard lessons learned from past market collapses, speculators continued to borrow and buy, driving stock prices higher and higher.

Many New York banks could not keep up with the demand to buy stocks on margin and had to borrow money from other banks. Often, they would borrow money at low interest rates from the Federal Reserve Bank and then turn around and loan it out at a higher interest rate. The Federal Reserve bank system was created by the Federal Reserve Act of 1913 to establish a central bank to strengthen the country's financial system. It is made up of a board of governors and 12 regional Federal Reserve banks around the country, as well as other, smaller banks. Some economic experts feel that at the time of the stock market crash, the Federal Reserve should have loosened restrictions on borrowing money instead of tightening them.

After large gains were made in the market in early September 1929, some economists made positive predictions for the final quarter of the year. One of these fortune-tellers was Irving Fisher, an economics professor at Yale University, who said on October 17 that prices had reached "what looks like a permanently high plateau."[2] Fisher had been respected for his writing and teaching about economic theories and his opinion was highly regarded. His mistaken predictions surrounding the market's performance during the days preceding the crash, however, seriously damaged his reputation.

By early October 1929, many utility companies were coming under scrutiny for some of their stock pricing practices. One of these companies, Edison Electric of Boston (which had been cofounded by Samuel Insull before he moved to Chicago), had applied for a stock split, which was denied by the Massachusetts Public Utility Commission. (In a stock split, shareholders are given two shares for every one they presently hold, although the value of the two shares remains the same as the value of the former share.) The *New York Times* reported on October 12 that the reason for the denial involved high electricity rates and the need for the company to drop those rates before raising dividends to investors. This decision caused a drop in Boston Electric's stock price and an investigation by the governor of the commonwealth into the company's operating practices. Massachusetts was not the only state experiencing utility company investigations. The governor of New York at the time, Franklin D. Roosevelt, also instituted an investigation into practices among the utility companies of his state. The stock sell-off the following week began in the public utility sector.

For at least five years prior to the crash, the increase in trading on the stock market was also due in part to the habit of buying stocks with borrowed money. Investors were convinced that prices would continue to go up and they would be able to repay their loans with the sale of the inflated stocks. When stock prices began to fall, speculators became worried, selling off as much stock as they could, causing prices to fall even lower. The ripple effect grew stronger with the passing days, weeks, and months. By the millions, people discovered they were less well-off than they had thought. Their wealth had existed only on paper.

The New York Stock Exchange

The New York Stock Exchange (NYSE), the largest stock exchange in the world, was founded in 1792 in the area of Lower Manhattan that is now Wall Street, when a group of 24 brokers (people who buy and sell shares of stock) agreed to deal only with each other. The exchange was formally established in 1817. By the 1920s, the inner sanctum of the NYSE was like another world. Trading began at 10 A.M. and ended at 3 P.M., both times signaled by the banging of a loud gong. Within the massive, 15,000-square-foot room, floors were padded to reduce noise. Seventeen semicircular trading posts were set up, each handling a different type of stock. Ticker-tape machines recorded current stock prices on huge ribbons of paper as the price reports came in from around the country. The machines were kept under glass and were connected via telegraph to thousands of other stock exchanges and brokers' offices nationwide. For every 100 million shares traded, 500 miles of tape swirled through the machines.

Stock transactions, including sale prices, were tracked telegraphically through these machines. Today, giant digital readouts announce the latest prices as quickly as transactions are made. In the 1920s, the tickers spewed out printed numbers that were then transcribed onto chalkboards. These tickers were relatively slow, and if transactions took place too rapidly, the tracking mechanisms would fall behind. On Monday, October 21, 1929, the week before the big crash, the ticker ran a full 100 minutes behind actual sales by the end of the day. That delay worsened during the following week. When the ticker fell behind, people were not aware of the actual price of any given stock, and they were not aware of just how much they had lost. Those who tried to get information by phone were equally frustrated, because phone lines were continuously jammed. Lack of adequate communication likely played a large role in the severity of the panic.

The Stock Market Craze

Most experts and investors alike believed that rising stock prices reflected a healthy economy. The government had no policies in place to regulate the market, although the Federal Reserve Board did try to keep investments in balance by occasionally raising interest rates to discourage rampant borrowing. People would think twice before borrowing money, because higher interest rates meant that the borrower would have to pay back much more money than he/she borrowed. In fact, that February, the Federal Bank of New York raised interest rates by one point, from 5 to 6 percent, to discourage "reckless behavior" by speculators who continued to borrow.

The following month, the Federal Reserve Board met secretly, leading to rumors that interest rates would be raised again; consequently, investors began to sell. Rising interest rates are often believed to have a braking effect on the economy. Stock values are tracked each day by the industrial average—the average value of the price of the top 30 companies trading in the stock exchange. This average is a good indicator of the market's overall performance. One point equals $1.

Charles E. Mitchell, president of the country's largest bank, National City Bank, promised to keep interest rates low and to continue to lend money. The Federal Reserve Board and some of the more influential bankers could have requested congressional approval to set limits on buying on margin, but none of these men wanted to be associated with having ended the boom.

By 1929, it seemed as though everyone, in all walks of life, and not just businessmen, was interested in the stock market. People took out second mortgages on their homes and housewives sneaked money from household expenses to play the market. Some people invested everything they had in the market in the belief that there was no way they could *not* become rich.

Investment trusts, which were relatively new at the time, raised investors' confidence even more. These trusts combined stocks of many companies in one grouping, so buying shares in an investment trust actually meant purchasing stock in many different companies. Because these funds were managed by professional financial advisors and were diversified (made up of a variety of companies), people felt more secure buying stock this way. Using a professional took the guesswork out of investing. High levels of speculation in some stocks pushed prices well above what companies were actually worth. Most investors did not worry about these inflated prices, however, believing that they represented the future worth of the companies—the companies' potential, not the present reality. Unfortunately, diversification of stocks within a trust or fund did not help investors at the time of the crash because of the universal drop in prices in all categories.

Heading Toward A Crash

Stock prices reached their high point on September 3, 1929. Two days later, economist Roger Babson said in a speech to the National Business Conference, "Sooner or later a crash is coming and it may be terrific. Factories will shut down and men will be thrown out of work. The vicious circle will get in full swing and the result will be a serious business depression." The industrial average dropped as the market responded to his prediction, but it recovered the next day. This dip became known as the Babson Break.[3] He was one of the few who accurately predicted the coming crash publicly.

Fewer new homes were constructed during the fall, adding to lower production across all industries, which caused the recession to deepen. On October 19, more than 3 million shares were traded and the industrial average fell yet again. Five days later, on October 24 (often called Black Thursday), the industrial average fell to that previous June's level, erasing any profits stockholders had made in the four months in between. The heavy trading and fall of the industrial average caused the day to begin on a sour note at the New York Stock Exchange, with General Motors' company stock selling well below its previous market price.

Throughout that day, Richard Whitney, vice president of the NYSE, placed buy orders at each trading station on the floor of the exchange. And at noon, top bankers set up a $50 million fund in the hope of bolstering falling stock prices. These measures helped restore some calm and order, and the market closed 12 points down from the day before. In total, 12,894,650 shares were traded on Black Thursday, a new record. The previous record for trading activity had been set about 18 months before, on March 12, 1928, when 3,875,910 shares were traded. On the day after Black Thursday, a *New York Times* headline stated, "Worst Stock Crash Stemmed by Banks: 12,894,650-share Day Swamps Market: Leaders Confer, Find Conditions Sound."[4]

That Friday and Saturday, October 25 and 26, trading remained heavy, but prices were fairly steady. In 1929, the stock market was open for trading six days a week. But Sunday, October 27, 1929, was no normal day off for those who worked there. From bankers and brokers to clerks, offices were full of people trying to recover from the never-before experienced highs and lows of the week before. It seemed that all of New

York was reacting to the unprecedented events of that day. Restaurants normally closed on Sundays opened their doors for tourists who flocked to the district to see for themselves where all the excitement had taken place; perhaps some wanted to take home souvenirs of the ticker tape that littered the streets.

Monday's opening gong started a selling frenzy and the industrial average fell 38 points that day, representing the largest drop in prices ever. The bankers did not rescue investors this time. In fact, that evening, they released a statement saying their goal was to maintain order within the market, not to protect anyone's profit or keep prices at a certain level. Everyone was preparing for what might happen the next day.

From Black Thursday to Black Tuesday, stocks lost more than $26 billion in value and over 30 million shares traded. After that dismal week, prices continued to fall, wiping out an estimated $30 billion in stock value by mid-November 1929.

Black Tuesday is often associated with stories of investors and traders jumping out of windows after losing everything. Black Tuesday and the days surrounding were especially painful for investors who had borrowed money to purchase stocks that had become worthless or close to it.

The situation influenced what became a major turning point for the U.S. economy, because many of these borrowers, who had leveraged themselves considerably in an effort to participate in the bull market, were ruined financially. They had to sell everything to pay back their debts, and many couldn't pay them back at all. Thousands of banks failed as a result. Businesses closed, as they were unable to get credit, and the nation's disposable income fell precipitously.

Why It Matters:

Historians often cite Black Tuesday as the beginning of the Great Depression because it marked not only the end of one of the nation's greatest bull markets, but the end of widespread optimism and confidence in the U.S. economy. Many investors had equated the health of the stock market with the health of the economy, but Black Tuesday challenged this premise.

As with many market reversals, the causes are numerous, intertwined, and controversial. For example, many cite the September 1929 passage of the Smoot-Hawley Tariff Act, which placed high taxes on many imported items, as a major contributor to the market's instability. Others note the huge amount of leverage investors had used to buy stocks, and some cite the scandal-ridden recall of British funds invested in the U.S. and the September 26 spike in the Bank of England's discount rate.

Besides the dramatic effect on investor psychology, the events of Black Tuesday contributed to the creation of a variety of new laws, organizations, and programs designed to improve the country's infrastructure, further social welfare, and prevent corporate fraud and abuses. These included the establishment of the Federal Depository Insurance Corporation (FDIC) and the passage of the Securities Act of 1933, the Glass-Steagall Act of 1933, the Securities and Exchange Act of 1934, and the Public Utility Holding Act of 1935. The panic caused by information delays also spawned faster ticker systems that could handle heavy trading days.