Rational human behaviour for corporate survival: Black Monday Review

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A story of mass ignorance inculcating a powerful lesson on the significance of information transparency in a trading economics; insofar technology can make markets less transparent, the crucial role of free press stand out (Casey, 2018).

This critique on the Black Monday phenomenon pronounces behavioural anomaly in economics as a result of rational human behaviour for corporate survival. Three dimensions are reviewed: Policy and political undertones, highfaluting financial vehicles as well as technology and social responsibility.

Key words: Black Monday. Economic Futures, Stock Market, Corporate Social Responsibility, Financial vehicles, Behavioural Anomaly

Black Monday 1987 is the undisputed notorious day in financial history that witnessed a single trading day slump of 508.32 points in the Dow Jones Industrial Average[1] and over 500 billion dollars gone (Kenton, 1999). In a robust trade setting foremost American financial firms registered all-time highs in August. By September, investors started dumping shares —and then rather hastily come October (Cheetham, 2017). The wave swept east into Tokyo and then London with everybody crazy to liquidate (Carnero, 2018). Then since, Black Monday October 17, 1987 is known as the day that reversed years of stable stock trade (McKeon, 2009).

Figure 1: Dow Jones 1987-06-19 through 1988-01-19 (Saggi, 2000)

Trading stock is all about minimising losses, and it is not simply a matter of maximising profit (Carnero, 2018). An Equity Market conducts the trade of financial assets, which comprise of a primary and a secondary market. The primary market recognises Governments and companies selling fractions of ownership through investment banks; while the secondary market forms the trading platform of these fractions of ownership commonly known as stock (Huang, 2007). As an example, the New York Stock Exchange that completes roughly 1.46 billion stocks traded each hour out of 2668 companies (ADVFN Plc, 2016).

Stock trade impacts on the growth of the overall world economy, whereby financial instruments are typically utilised to dilute risk; many times through public offerings (Stowell,

[1] A stock market index that indicates the value of 30 large, publicly owned companies based in the United States, and how they have traded in the stock market during various periods of time. These 30 companies are also included in the S&P 500 Index

2010). The danger of stock volatility is that it has become more difficult to decipher with HFT, otherwise high-frequency trading algorithms that move enormous volume in a split of a second (Kenton, 1999).

POLICY AND POLITICAL UNDERTONES

The American legislation delimiting tax benefits in respect to corporate takeovers that was introduced a week before Black Monday by the Committee of House Ways and Means: intends to abolishes debt interest deductions on corporate restructurings, which definitely made these candidate firms extremely volatile in the equity market (Brady, 1989).

Referring to the Brady Commission Report, stock prices of these key candidates company takeovers, fell sharply that same week before Black Monday, even when these firms outperformed the equity market twelve months in previous (Mitchell, 1989). Note eight takeover candidates index had risen 70 percent, concurrent 25 percent with Standard and Poor, between December 1986 and October 1987 (Harris, 1989).

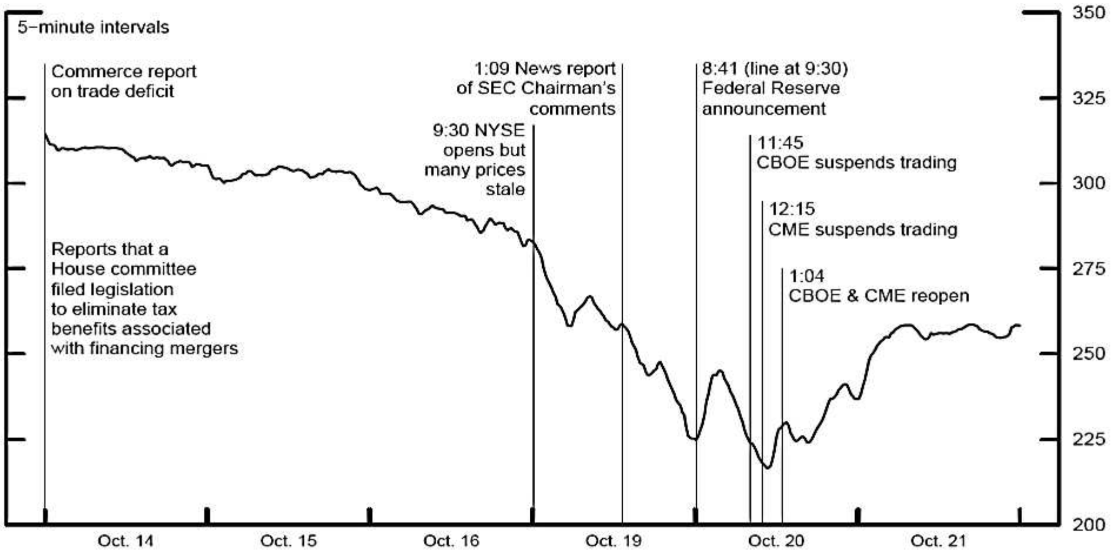

Figure 2: Standard & Poor 500 index 1987-10-14 through 1987-10-21 (Carnero, 2018)

Despite the poor international trade report, Treasury bond yield continued to escalate far above the average at under 9 percent; closing on October 16 at 10.24 percent (French, 1986).

HIGHFALUTING FINANCIAL VEHICLES

This very sharp short-term decline in a span of 24 hours reflects the discounts on futures, otherwise portfolio insurance financial vehicles, to be unrealistic statistical illusions, if not smaller than or nonexistent—and therefore overvalued (Kleidon, 1992).

Studies show a backwardation induced the cash prices to fall further, prompting institutions and traders to dispose stocks to skirt losses (Roll, 1988). Furthermore, the backwardation put down an incentive for index arbitragers to over sell shorts, eventually stressing the stock market toward the slump (O'Brien, 1988). This is thought as the most unusual feature of the Black Monday phenomenon.

TECHNOLOGY AND CORPORATE SOCIAL RESPONSIBILITY

People easily access to information these days, but not in a way that they understand it. With bond markets more volatile when compared to the 1970s (Black, 1973), algorithms forecast are based on historical trends that cannot foresee phenomenon of human behaviour (Weisenthal, 2019).

Computer trading by large institutions with systems automated to take up huge stock movements in bull market trend; suggest systemic failure (Derher, 1988). Nonetheless, technology is not at fault as it is developed as a tool for the user; and thus the user is fully responsible for such choice, whether ignorance of such mechanisms (Lynch, 2007).

Figure 43: The Black Monday effect on the FTSE 100 (BBC Bloomberg index)

In contrast the Brady Commission Report, Robert Shiller of New York Times concludes massive investor panic to be completely accountable for Black Monday (Oyedele, 2017). These investors set out to trade stock utilised technology to systematically sell equity futures as stock prices fell—and stand to gain from high-frequency trading (Casey, 2018)

Black Monday sits the classic example of corporate social responsibility, when profit is weighed up against considerable social cost, when a downward market movement is significant and unexpected (Fortune, 1989). Thus Governments and international organisations respond with policy measures to ensure a financial system resilient to economic shocks (Hardevoulis, 1990). The BBC index in Figure 3 states comparatives of the 1987 ultra-high trading indexes against the stable constant trend of 2017.

As the Bertrand Model points out, it can be assumed that the price competition generates volume. In this case, stock investors had the incentive of reducing losses below rivals through diversification in the futures markets. More importantly, these investors can conspire or collude, and decide to charge a uniform price that optimises profits, rather than competition (Bertrand, 1883).

CONCLUSION

Corporate Social Responsibility is not about funding a small remote primary school: CSR would mean the culpability of corporations who stand to gain at a huge social cost—*such as Black Monday.*

Whatever else, this discourse is incomplete without the theory homo economicus, which surfaces in all rational economic models, and is defined as behavioural anomalies (Camerer, 2006). Suboptimal decisions are drawn to satisfy certain aspiration levels by human beings. Inevitably, behavioural anomalies that are encountered in economic practice in the real world are often too significant to be ignored such not to increasingly influence the evolution of economic theory.

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