Richard Cluver Predicts

In our 30th year of service to the investing public of South Africa

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How short are investors' memories! Back in 1987 the world's share markets experienced the greatest short-term decline since the Wall Street Crash of 1929. But few people today seem aware of it and how it began.

On October 19 1987, subsequently referred to as Black Monday, the crash began in Hong Kong and spread west to Europe, hitting the United States after other markets had already declined by a significant margin. The Dow Jones Industrial Average (DJIA) fell exactly 508 points to 1,738.74 (22.61%). By the end of October, stock markets in Hong Kong, Australia, Spain, the United Kingdom, the United States and Canada had fallen 45.5%, 41.8%, 31%, 26.45%, 22.68% and 22.5% respectively. New Zealand's market was hit especially hard, falling about 60% from its 1987 peak, and taking several years to recover.
It is quite hard to see the event in my graph below which reflects the closing value of the JSE Overall Index for the past 32 years. Due to the exponential nature of markets (the doubling effect which I mentioned in my article in last week's issue of ***The Investor***) the declines of 1998, 2002, 2008 and 2015 appear to have been of much greater magnitude:

US columnist Jared Dillian this week reminded his readers that " the proximate cause of the Crash of '87 (apart from the geopolitical concerns at the time) was portfolio insurance, a hedging technique marketed to real money accounts. This compelled you to sell futures on the way down (to hedge) and buy them on the way up (to get exposure).

"A key point to understand about certain strategies in finance: **Nothing bad happens if some people do it, but all hell breaks loose if *everyone* does it**.

"You don't have to be a brain surgeon to realize that everyone selling *at the same time* could cause problems.`

“That is what happened. The market declined, which caused portfolio insurance selling to kick in. That made futures cheap to fair value, which caused index arbitrage to kick in, selling a bunch of stock at the same time.

“The Dow falling 22.61% in one day was a “25-standard deviation event.” That is an occurrence so rare that if the stock market had been open every single day since the Big Bang… it *still* shouldn’t happen. And yet it did.

Dillian then added the fact that:

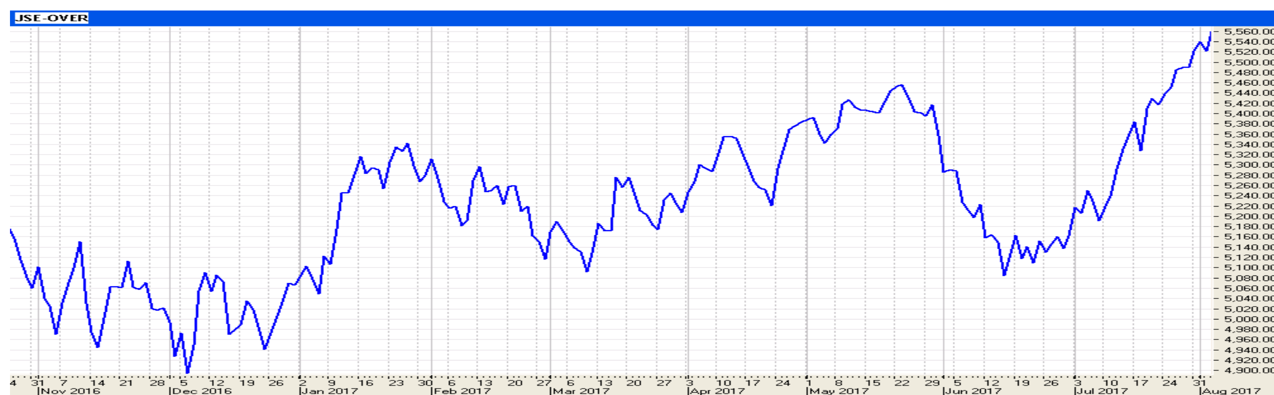
- People are short VXX…
- And short VIX futures…
- And playing roll-down with the term structure.
- People are selling variance outright…
- And buying inverse vol ETFs…
- And also selling upside VIX and VXX calls for income…
- Along with massive overwriting and put selling programs.

All of these things are fine when *some* people do them—not when *everyone* does them.

If—make that *when*—all of these strategies unwind simultaneously, it has the potential to take down the entire financial system.”

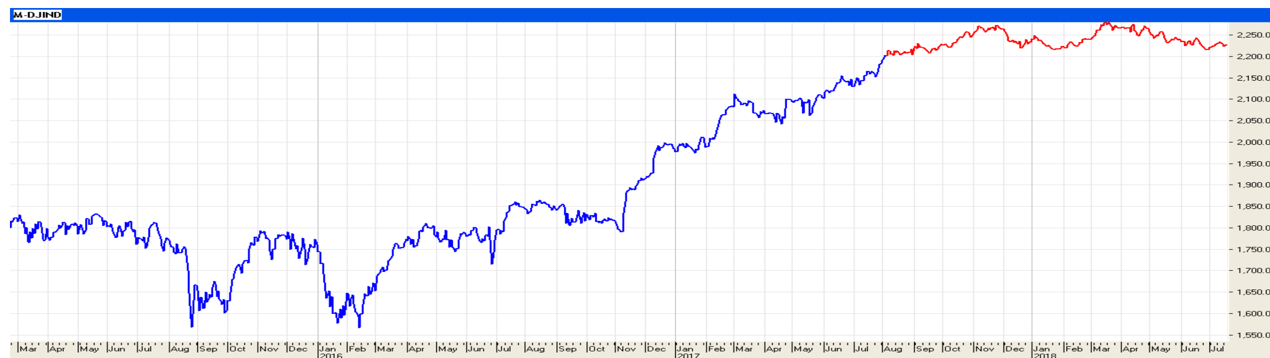
So, in the graph below I have reproduced the JSE Overall Index for that period to illustrate how that crash unfolded here in South Africa:

And to compare it with what has been happening here lately:



As you can see it came out of a clear blue sky with nothing locally to offer a warning. However, on Wall Street, as the graph of the Dow Jones Index on the right makes clear, it was already obvious that a minor decline was under way. All that was needed was a stampede when everyone…or here read algorithms….acted in panic mode.

So lets turn to the Dow as it appears today, noting that it has been powering upwards to ever new highs on a wave of super optimism. Only ShareFinder's projection system senses weakness, briefly in September and then in a more pronounced fashion beginning in November…that is if nobody panics….or rather if an ever-growing number of investors take out insurance against the inevitability of a share market downturn when the US Federal Reserve starts raising interest rates…which is its stated objective in the very near future!



I don't want to be seen as promoting panic, but I would urge readers to consider taking out some insurance. You need to recognise that a downward correction is inevitable. Only the magnitude and the timing are currently in question.

The next month:

New York's SP500: I correctly predicted a down phase which I expect to last until around the 17th before the next recovery trend sets in.

London's Footsie: I correctly forecast a new recovery. Now I see it lasting until between the 18th and the 22nd.

JSE Industrial Index: I correctly predicted a brief recovery which I expect to be over by the middle of the week followed by a short down-trend and then a sideways trend while investors wait for guidance from Wall Street.

Top 40 Index: I correctly predicted that the recovery would continue into August. Now I see an imminent topping out, and then a brief downturn until between the 14th and the 21st.

The ShareFinder Blue Chip Index: I correctly predicted that the recovery would end this week. Now I see a down-phase lasting until between August 8 and 11th.

Golds: I correctly predicted a continued upward reaction which looks likely to continue until around the 15th when a brief retraction is due.

The Rand: I correctly predicted fresh weakness and foresaw a recovery beginning around August 7.I expect the gains to last until between the 25th and 28th.

The Predicts accuracy rate on a running average basis over the past 627 weeks has been 84.19%. For the past 12 months it has been 90.71%.

Richard Cluver