THE BEARS SEIZE CONTROL

Revisiting the Devastating Bear Market of 1973–1974 on its 50th Anniversary

By Peter C. Earle

On July 1, 1974, the economic newsletter writer James Dines wrote with a palpable sense of awe. Beginning in January 1973, the Dow Jones Industrial Average (DJIA) had fallen from 1031.68 to 806.24—almost 22%. The United States was in a recession, having emerged from another recession only a few years earlier. In his journal-like account in *The Invisible Crash* (1975), Dines comments:

> You are watching history being made—movies will be made and books written about this era, such as about 1929… As bank failures and record high interest rates prompted a smashing decline below the much vaunted 800 level…we can only shake our heads at our inability to get people out of the stock market before it is too late. Who would believe Polaroid at 23½, down from an all-time high at 149, and McDonald's down 9 points in one day to 38… Add to this the bombed-out favorites of yore, like Levitz, Disney, Combustion Engineering, Damon, and Intel, where prices collapsed suddenly, affording investors no chance to get out in time, and one realizes this is not an ordinary bear market. This is a Crash.

And the worst was yet to come. Between the publication of that missive and December 1974, five months later, the Dow would fall to 577.60. In all, 1974 saw the Dow fall just over 28% and the S&P 500 fall just under 30%. And between 1973 and 1975, those indices fell 56% and 42% of all trading days, respectively, while averaging a decline of less than one-tenth of a percent per day. Fifty years later, the period between January 1973 and December 1974 still recalls one of the most vicious bear markets in history.

Beginnings

The foundation of the deep decline in stock prices was largely laid in the preceding half decade. John Brooks, in *The Go-Go Years*, writes:

> All through the stormy course of 1967 and 1968, when things had been coming apart and it had seemed that the center couldn't hold—the rising national economic crisis culminating in a day when the dollar was unredeemable in Paris, the Martin Luther King and Robert Kennedy assassinations, the shame of the Chicago national convention, the rising tempo of student riots—the silly market had gone its merry way, heedlessly soaring upward as if everything were OK or would surely come out OK as mindlessly euphoric as a Japanese beetle in July. Or as a doomed man enjoying his last meal. One could only ask: Did Wall Street, for all its gutter shrewdness, have the slightest idea what was really going on?

The "Paper Crisis" on Wall Street between 1968 and 1970 was a major operational bottleneck caused by the sheer volume of stock trades overwhelming the manual processing systems used at the time. As the market boomed and trading activity surged, brokerage firms struggled to handle the paperwork involved in settling trades, leading to significant delays, errors and even the collapse of several firms. The crisis exposed the inadequacies of the outdated settlement system and eventually led to the development of automated processes and the creation of the Depository Trust Company (DTC) in 1973 to modernize and centralize trade clearing and settlement. This marked a turning

point in the evolution of financial markets toward greater efficiency and automation.

But before that, the paperwork debacle exposed a handful of vulnerabilities which would prove inflammatory in the upcoming slump. At the dawn of the 1970s, most Wall Street firms were still partnerships, and as such many were essentially run at arm's length. Further, many of those passively managed firms were undercapitalized. As Wyatt Wells notes in his *Certificates and Computers: The Remaking of Wall Street, 1967 to 1971*, "Whereas New York Stock Exchange volume totaled $150 billion in 1968, those members doing business with the public had only $4 billion in capital… As long as prosperity reigned the industry did fine, but its cushion against hard times was thin." The ensuing consolidation, which saw over 100 New York Stock Exchange member firms either liquidate or get acquired, likely contributed to the 1973–1974 bear market by weakening the market's infrastructure and reducing the ability of Wall Street broadly to absorb financial shocks.

The United States was in recession through most of 1970, and a precursor, "mini" bear market occurred in the spring of that year. In the 59 market sessions between March 3, 1970 and May 26, 1970, the S&P 500 only had 16 positive finishes—among the lowest percentage of quarterly positive closes in the pre-1973–1974 bear market period.

The Bears Seize Control

In August 1971, the United States abandoned the Bretton Woods agreement when President Richard Nixon suspended the convertibility of the dollar into gold, effectively dismantling the post-World War II international monetary system. This decision came after years of pressure on US gold reserves, exacerbated by the collapse of the London Gold Pool in 1968, paved the way for the shift to a fiat currency system.

Stock prices rose again and then, throughout much of 1971 and 1972, traded sideways, even when in June 1972 five men were arrested for breaking into the Democratic National Committee headquarters at the Watergate complex in Washington, DC. By late 1972, US stock markets seemed to shrug off the arrival of the fiat currency dollar and the still-unfolding story of the Watergate shenanigans. But by the start of 1973, the US Bureau of Labor Statistics Consumer Price Index (year-over-year) had risen from 2.7% in June 1972 to 3.7%. By the end of the summer of 1973, it was over 7%.

The US exit from Vietnam in 1973 contributed to uncertainty in the economy and financial markets, as war-related spending began to wind down, adding to inflationary pressures and straining fiscal resources. On top of that, a sense of malaise and disillusionment grew over the realization that the war effort, not least of which the human toll, had essentially been futile.

On October 6, 1973, Egyptian and Syrian forces launched a surprise attack on Israeli positions in the Sinai and Golan Heights, seeking to reclaim territory lost in the 1967 war. The attack, timed to coincide with Yom Kippur, caught Israeli forces off guard due to intelligence failures, allowing Egypt to breach Israeli defenses across the Suez Canal and Syria to make significant gains in the Golan Heights. Israeli forces initially struggled, particularly in the Golan, but by October 9, they shifted to a counteroffensive. With US military aid arriving on October 10, Israel regained much of the territory it lost early on. A ceasefire was announced on October 22, 1973, but not before Arab

National Archives and Records Administration

Gas station in Oregon with "Pumps Closed" sign in October 1973, due to the gasoline shortage that occurred during the 1973–1974 bear market.

OPEC members (dubbed "OAPEC") retaliated by imposing an oil embargo on the United States. Contributing to the spike in oil prices was the devaluation of the US dollar in the wake of the collapse of the Bretton Woods agreement two years earlier.

The impact reverberated through the US economy, with the second recession in three years starting in November 1973. Arthur Burns, chairman of the Federal Reserve, noted that the timing of the oil crisis was particularly damaging. At the time, wholesale prices for industrial commodities were already rising at over 10% annually, and industrial capacity was stretched thin. Additionally, the domestic oil industry lacked the capacity to ramp up production to meet the demand caused by the embargo, leading to severe price increases. Energy costs soared, leading the federal government to implement energy conservation measures, including speed limits and rationing programs. (The crisis led to the creation of the Strategic Petroleum Reserve and among the inaugural efforts by the government to investigate alternative energy sources to reduce reliance on foreign oil.)

From 1973 through 1974, a mix of persistent and emerging bearish factors kept surfacing, leaving little incentive to hold stocks beyond their declining prices—yet even those continued to drop. It was a macabre time for investors.

Trading on the floor of the New York Stock Exchange, 1973.

Images Press

Bulls Resurgent

The first half of 1974 was grim. US Gross Domestic Product (GDP) fell by 3.4% in the first quarter, with inflation surpassing 10%. The second quarter was not much better: although GDP rose a meager 1%, inflation reached 11%. By August 1974, the average US stock had fallen 70% since 1968, but more downside was en route. Facing imminent impeachment, Nixon resigned from the presidency on August 8, 1974. The S&P 500 closed that day at 81.57 and fell to 63.39 by October 1. Around that time, a *New York Times* reporter bore witness to one of what must have been an increasingly common scene during the fall of 1974.

> After the close on the New York Stock Exchange…a vice president of a Wall Street brokerage firm stopped by to check on the Dow Jones ticker that was humming with gentle, cricket-like chirps. "Good Lord!" he exclaimed. "The Dow is Down another 16½ points!" The blue-chip average limped in that day with a finish at 671.54, rounding out a decline of 126 points within 14 trading sessions, a period that encompassed President Ford's ascendancy to the White House. [He] took a sip of cold coffee and grunted. "You know the trouble with this market?" he said. "The grinding away of prices. Every time you think it's going to improve, you raise your head—and it gets handed back to you on a platter."

On Friday, December 6, 1974, Carl Douglas's "Kung Fu Fighting" was at the top of the music charts. *All in the Family*, *M*A*S*H* and *Kojak* were among the most watched television programs. And on that day, the US Bureau of Labor Statistics announced that the unemployment rate had reached 6.5%. The DJIA dropped to 577.60, its lowest close since the Cuban Missile Crisis 12 years earlier. And this—not that anyone would have bet at that point—was the lowest trough in the 1973–1974 bear market. The deepest and most agonizing bear market since the Great Depression had finally come to an end. Even at that point, though, things would not improve for nearly a decade; the 1973 to 1974 bear market was the nastiest part of a trough for the US economy. Between December 1969 and November 1982, the economy contracted for 49 months.

The DJIA crossed the 1,000 level for the first time just before Thanksgiving in November 1972, and then declined by essentially half over the next two years. But even after climbing off the December 1974 lows, the 1,000 level would only be decisively reclaimed in October 1982: a full decade, and two severe economic recessions, later.

At 23 months, the 1973–1974 bear market is the second longest in the post-war period (bested by the 31-month slump between March 2000 and October 2002) and the third deepest in terms of percentage decline, bested only by the Great Financial Crisis slide (a 56% drop from October 2007 to March 2009) and the aforementioned Dot Com bust/September 11 attacks period (a 49% slide). Of particular note is the nature of the 1973–1974 bear market where volatility is concerned: none of the top 20 largest one-day percent changes (up or down), largest one-day index point changes (up or down), largest intraday index point swings or largest intraday point changes with turnovers (positive to negative or vice versa) occurred within that time period. Stock prices just slowly, incessantly, melted away.

Interim Archives

1970s trading desk at Merrill Lynch, New York City.

Aftermath

In January 1975, with the DJIA just over the 600 level and the S&P 500 creeping back toward 80, *New York Magazine* featured a cover story entitled "Wall Street Refugees: Survivors of the Crash and How They're Making Out." Chronicled were 10 former analysts, traders and partners of securities firms that either downsized, were acquired or liquidated beneath the grinding, nearly two-year stock decline. For most, the next act involved entrepreneurship: a bicycle shop and a steakhouse, among others. For one, a $1,500 investment in a screenplay resulted in the seven Academy Award-winning film *The Sting*; another went back to school to pursue a medical degree. (A quick internet search of one endeavor, a delicatessen in Brooklyn, suggests strongly that five decades later the eatery endures, at least in name.)

Decades later, Wall Street veterans recall the period with exasperation and disgust. From January 2001 to September 2002, US equities were in the midst of another bear market, drifting down 27% during the period. In January 2002, Martin D. Sass of MD Sass, LLC recalled:

> Believe me, having started my firm—as an equities-only special situations manager—right at the top, in March 1972, with the Dow at 1000 heading to 577 in October '74, I really know what a bear market is like. It was gruesome, it didn't matter how much work you did or how cheap an equity looked, it got cheaper… Try coming in every day for 18 months, like I did from March '72 to Oct '74, and watching the market fall practically every day. It seemed to me that it did drop every single day; it was brutal. Even being in cash, it was horrible, and the one-third of the portfolio that was invested—because you had to have something on the table—got beaten up daily. It was tough. Even the people who are lionized now as the era's greatest investors, people like [Warren] Buffett, were having bad problems. There just weren't a lot of places to hide.

In May 1973, small cap trailblazer Chuck Royce took over management of Pennsylvania Mutual Fund, which lost 48.5% of its value in 1973 and 46% in 1974. In 2016, he recalled, "For me, it was like the Great Depression. Everything we owned went down. It seemed as if the world was coming to an end."

Contrary to James Dines's forecast, few books were written and no films produced about the early 1970s bear market, but accounts have carried forward in other ways. The economic crises of the 1970s left indelible marks on cultural landmarks, manifesting in various forms of artistic expression echoing the anxieties and uncertainties of the time. The era's pervasive sense of economic instability gave rise to dystopian science fiction, epitomized by films like *Mad Max*, depicting a world spiraling into chaos following the exhaustion of oil in a direct reflection of the 1973 embargo. The rise of punk rock amid stagflation (high unemployment, rising prices and falling standards of living) channeled the visceral hardships and disillusionment faced by the working class into a raw, unfiltered commentary on social problems. Moreover, the period saw a resurgence of interest in speculative fiction, with works like John Brunner's *The Sheep Look Up* exploring malaise and environmental degradation as consequences of an allegedly unchecked capitalism. Even in architecture, stagflation contributed to the spread of Brutalism, a style characterized by stark, unadorned concrete structures that mirrored the austerity and alienation felt by many during this turbulent decade.

With "buying the dip" and bargain-hunting now deeply ingrained in the ethos of investing and trading, future declines may be shorter-lived as market participants swiftly capitalize on opportunities. Another bear market undoubtedly lurks somewhere over the horizon, but it seems likely that lessons learned over the past 50 years will lead to more tempered downturns ahead. $

Dr. Peter C. Earle is a senior economist at the American Institute for Economic Research (AIER). His research focuses on financial markets, financial market history, monetary policy, cryptocurrencies, the economics of games and problems in economic measurement. He has been a member of the Financial History *editorial board since 2022.*

Sources

"Alternative Investment Guru." *Traders Magazine*. January 2002.

Brooks, John. *The Go-Go Years: The Drama and Crashing Finale of Wall Street's Bullish 60s*. John Wiley & Sons. 1999.

Vartan, Vartanig G. "Why This Bear Market Is Different." *The New York Times*. September 1974.

"Wall Street Refugees: Survivors of the Crash and How They're Making Out." *New York Magazine*. January 27, 1975.

Wells, Wyatt. "Certificates and Computers: The Remaking of Wall Street, 1967 to 1971." *Business History Review*. Volume 74, Issue 2. 2000.

Zweig, Jason. "Learning from the Bear Market of 1973–1974." December 11, 2016. https://jasonzweig.com/learning-from-the-bear-market-of-1973-1974/