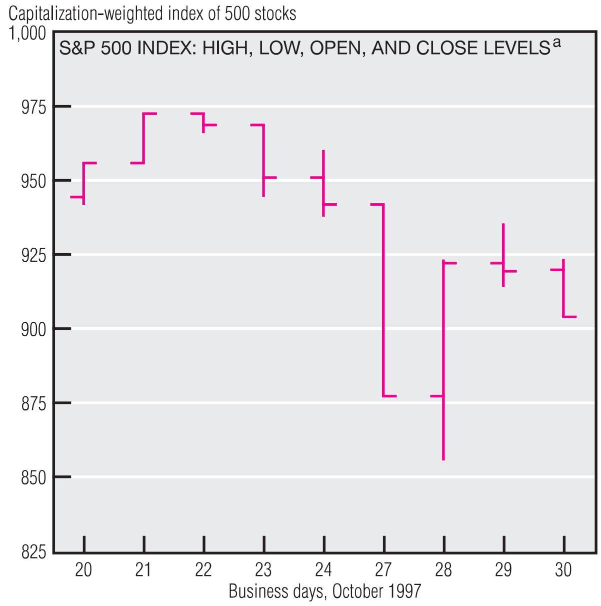
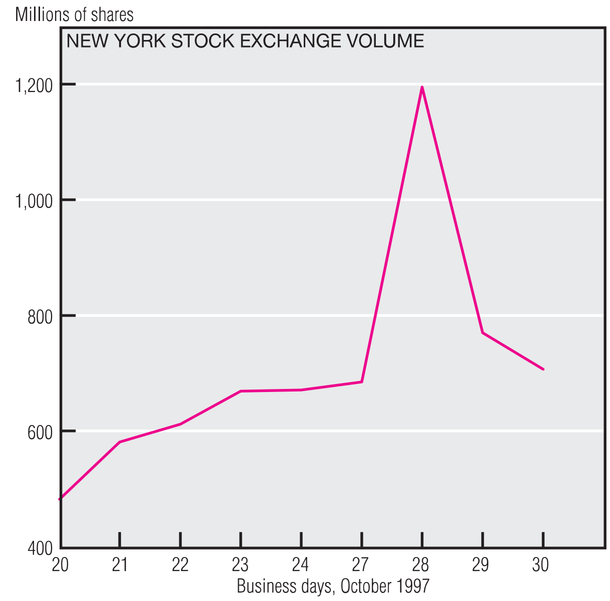
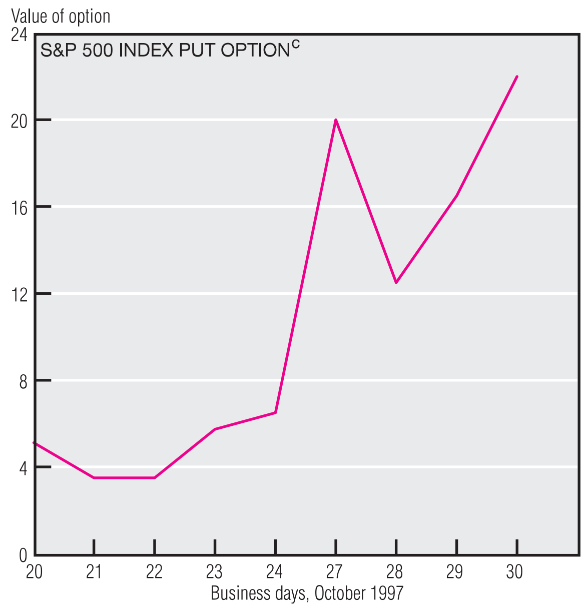
The Stock Market Correction





S&P 500 Index Largest Percent Drops[b]

Rank	Date	Point drop	Percent change
1	October 19,1987	57.86	–20.47
2	October 28, 1929	3.38	–12.94
3	October 29, 1929	2.31	–10.16
4	November 6, 1929	2.27	–9.92
5	October 18, 1937	1.08	–9.12
6	October 5, 1931	0.88	–9.07
7	July 20, 1933	1.03	–8.88
8	July 21, 1933	0.92	–8.70
9	October 10, 1932	0.60	–8.55
10	October 26, 1987	20.55	–8.28
17	October 27, 1997	64.62	–6.86



a. Vertical lines show highs and lows for the day. Horizontal lines to the left and right show open and close levels, respectively.
b. Ranked by percent change.
c. For December 1997 at a strike price of 850.
SOURCES: Bloomberg Information Service; DRI/McGraw–Hill; and *The Wall Street Journal,* various issues.

On October 27, the S&P 500 index plummeted 64.62 points, a percentage loss of 6.86%. This was the largest point drop in a single day, and the seventeenth largest percentage drop since the S&P index started in 1926. The chart showing the high, low, open, and close levels of the index reveals that the market dropped for three business days prior to October 27. The date of the correction also stands out because, in contrast to the ups and downs of the usual day, the high point was at the opening bell and the low point was insignificantly different from the close. The following day showed a large gain, despite early losses.

Daily volume on the New York Stock Exchange was high leading up to the correction; thus, October 27 does not stand out in the week, although its volume of 685 million shares exceeded both the 1987 crash and the average for 1996 (412 million). On October 28, trading volume exceeded a billion shares for the first time.

One reaction of investors was an attempt to preserve the gains built up over the past two years by entering into options. The most popular of these was the December 1997 put, with a strike price of 850. A put option gives its holders the right to sell their stock at the agreed-upon strike (or exercise price). In this case, the option would pay off only if the S&P 500 index dropped below 850. On October 27, demand for these options soared, and their price rose accordingly. More significantly, option prices remained high, partly because of increased uncertainty over stock prices, which makes the protective floor of the put more valuable.