The Great Depression, Sector by Sector

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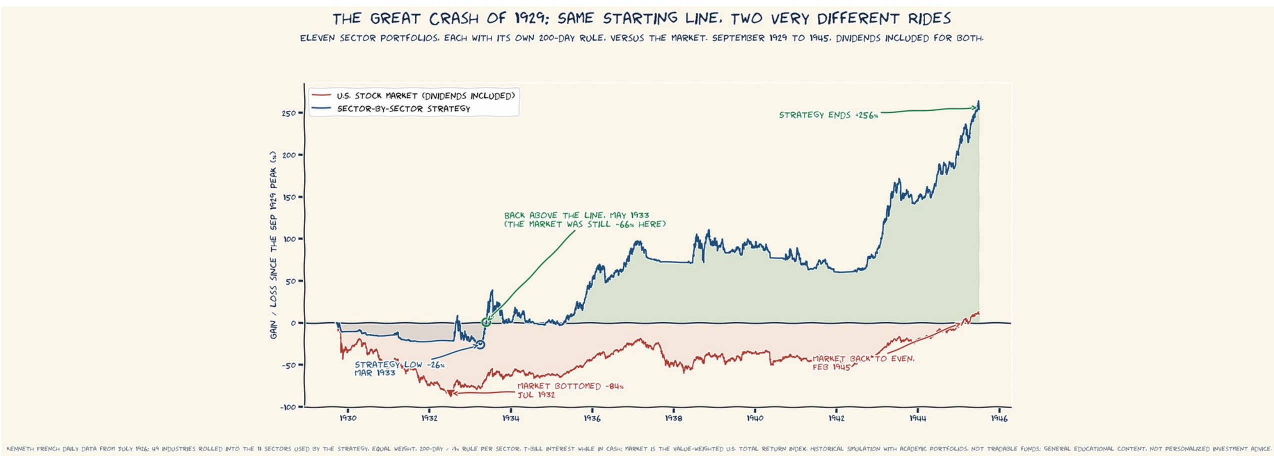
Our 1929 crash study has always carried a quiet asterisk. Sector funds did not exist in 1929, so that study applies the 200-day rule to the market index as a whole, one signal for everything. The real strategy watches eleven sectors separately, and each one steps aside on its own schedule. I finally ran the real thing through the worst decade in American market history, using Kenneth French’s daily record of 49 American industries, which begins in July 1926. I grouped those industries into the eleven sectors we trade today, gave each sector its own 200-day rule with the 1 percent band, moved each slice to Treasury bills when its trend broke, and kept everything equally weighted, dividends included.

The market peaked in September 1929. The U.S. market, dividends included, lost 84 percent by July 1932 and did not reclaim its 1929 level until February 1945. The sector-by-sector strategy never fell more than about 26 percent below its starting point (about 32 percent measured peak to trough), crossed back above its starting line in May 1933 while buy-and-hold was still down 59 percent, and finished 1939 up 92 percent while buy-and-hold was still underwater.



Why eleven signals beat one

Sectors broke trend at different times, so the portfolio walked to safety in steps rather than waiting for the whole market to confirm. And whipsaws diversify: when one sector’s signal gets faked out, the others usually do not, so the individual mistakes average into something much gentler than any one of them alone. Add the interest Treasury bills actually paid in those years and the arithmetic compounds quietly in the right direction.

The honest caveats

These are academic portfolios, not funds anyone could have bought in 1929, and my grouping of 49 industries into eleven modern sectors is an approximation, with real estate, telephone, and utilities each resting on a single industry series. What this test shows is not that anyone could have done this then. It shows that the discipline itself, applied mechanically to the data that existed, held up in the single worst market environment on record.

John

Sources: Kenneth R. French Data Library, 49 Industry Portfolios (daily, value weighted) and daily risk-free rate, July 1926 through 1954. Historical simulation; general market commentary and educational content only, not personalised investment advice.