Since October 19, 1987, when the Dow-Jones Industrial stock price index declined by 508 points in one day, stock market volatility has competed with inflation and unemployment for the status of economic demon of our society. It has become fashionable to talk about an increase in stock market volatility and its real and imagined dangers. As we struggle to cope with our new obsession, we might keep a few points in mind.

Volatility of stock prices consists of two parts – increases and decreases. All that happened last October was that most of the increases since January 1987 were wiped out. Tripling of the Dow-Jones Industrial stock price index over the past five years represented an unprecedented run-up of prices. But few of those who worry about the volatility of stock prices today raised their voices until prices peaked. Perhaps it is not unreasonable to wonder if many concerns raised about stock market volatility have to do with loss of wealth and not with volatility per se.

After we have isolated our concerns over the decrease in stock prices from our concerns over the decrease in stock prices from our concerns about the increase in stock market volatility, we might as well concede that there has, indeed, been an increase in the volatility of stock prices during the 80s. Before we decide whether it is good or bad, and who is to blame, let’s try to understand what factors determine this volatility.