Technical Market Action

Predictions of a falling off in business at some time in the not far distant future continue to make headline news. True, these dire predictions have been prevalent since VJ Day when government economists predicted vast unemployment by early 1946 and the President advocated a higher wage scale and a holding or reduction in prices to maintain the purchasing power of the nation. Subsequent events have proven the fallacy of that prediction. However, since that time, prophesies of deflation, then inflation, then deflation, then inflation have followed each other in rapid succession. True, the date of the business recession has been advanced from early 1946 to the fall of 1946 to the early part of 1947 to the latter part of 1947. So far, these fears have been unfounded. While individual industries have been going through a period of readjustment and lower earnings, an equal or greater number have shown record earnings. National income is at a high level and more people are employed than at any time in our country's history. Commodity prices have failed to follow the exact pattern of World War I and are still at or near peak levels. Some of the early prophets of gloom have reversed their predictions and expect "a catastrophe boom". The date for the recession has now been advanced to sometime in 1948, with "after the mid-year" being the majority opinion.

The writer of this letter does not pretend to be an economist. Any opinions expressed have been based entirely on the technical action of the market and the supply and demand patterns of the averages and of individual issues. This letter turned bearish on the market in mid-1946 when the 199 level in the Dow-Jones industrial average was penetrated. Since September 1946, we have indicated that the 170-160 area of the same average was a long term buying area. Since that time, events have strengthened our convictions. For the past year, the averages have built up, in the approximately 160-187 area, a strong potential base area that indicates, together with other patterns, an eventual upside penetration of this base area followed by successive rises to 210-215 followed by an eventual 275-350 in the Dow-Jones industrial average. Obviously, this pattern will require considerable time before its ultimate consummation and will be interrupted by sharp and deep technical corrections. It will be extremely selective with present indications favoring the heavy goods industries over the soft goods industries. Also, obviously, the ultimate objective of 275-350 is a wide target and will be subject to further refinement as the pattern develops.

In a nutshell, the market, to us, appears to be on the verge of an important rise with selectivity of prime importance. Individual stocks are in one of three positions: 1. They indicate higher prices. 2. They indicate a further period of backing and filling before a rise is indicated, and, 3, they indicate lower prices. In our opinion, the vast majority of individual issues are in the first two categories. The number of issues in the third classification is small. An attempt to guess the allocations would be 50% in the first category, 40% in the second category and 10% in the third category. Obviously, the selection and timing of purchases will mean the difference between large gains and small profits.

How does this technical pattern jibe with the predictions of a recession in 1948? This question is of particular importance at the moment. The writer concedes that an increasing number of astute, sound, conservative and able economists and counselors have predicted a decline of varying depths at some time in 1948. Can this technical pattern still hold true in the face of such convincing opinions to the contrary?

I believe it can. I believe that it is possible that the predictions of these able gentlemen could, to a certain extent, be correct and also that the market can move higher. I base my opinions on the fact that, at present prices, the market has failed, by a wide margin, to even start to discount the present earnings. Even earnings 25% below the present rate, would, if valued at past ratios, result in a price-level at least 50% higher than present prices.

For the last seventeen months, the market has moved contrary to the trend of business and earnings. If on May 29th, 1946, when the averages hit their high of 213, one could have visualized the tremendous increase in earnings for the year of 1947, it would have certainly seemed the logical thing to buy rather than sell. Yet, marketwise, it would have been the wrong thing to do. Five months later, the market was selling 52 points below the high of 1946. Prognostications of a moderate decline in profits may be correct, but a market that has failed by a wide margin to discount the present earnings could very well continue to move against the trend and work sharply higher. What of course is needed is a definite change in public psychology. It makes quite a difference, marketwise, if earnings are valued at a ratio of 5 times or 15 times. On $5 it means a difference between 25 or 75.

Without attempting to assign a reason but speaking purely from a technical viewpoint, believe the market indicates substantially higher levels over the longer term. Continue to advocate the purchase of recommended issues during periods of minor price adjustment.

EDMUND W. TABELL
SHIELDS & COMPANY

October 30, 1947