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TABELL'S MARKET LETTER September 12, 1958

The market continues to forge merrily ahead, and this week it came close to reaching new all-time high ground. The intra-week high of 523.57 on the Dow-Jones Industrial Average came close to penetrating the triple top at 524.37, 523.33 and 523.11 formed in June 1956, August 1956, and July 1957. As has been pointed out regularly by this letter, the market is high. It is high by all statistical yardsticks and this very level makes it vulnerable. As was pointed out last week, earnings are being capitalized at a record rate, and the spread between stock and bond yields is constantly narrowing. An interesting indication of this is that Sears Roebuck last week sold a major debenture issue which was priced to yield considerably more than the company's common stock. There is no particular rule that says that stocks must yield more than bonds. Indeed, there are a number of reasons why they can in many cases yield less than senior securities; among them, inflation and the prospect of increasing income over a period of time. One fact worth noting though, is that many institutions, particularly those with dollar obligations, such as insurance companies, are predominantly yield-oriented. There is, therefore, little reason to expect that buying from this source will provide a further stimulus to equity prices.

The high level of the averages, however, should not deter the investor from seeking value in individual situations. During the whole period from October 1957 to date, while the Dow average was moving ahead some hundred points, a great number of stocks have done little or nothing. Many of the international oils, for example, fall into this class. One of the largest, GULF OIL, has held in a relatively modest trading range between 119 and 101 and, at current levels, is selling only slightly above its two-year low. Ostensibly, this is due to nervousness over the Middle East situation and a fear that Gulf's extensive holdings in the Far East may be expropriated or otherwise disturbed. A hard look at the economic facts of life in the Middle East gives little reason to fear such happenings.

Crude oil by itself is worthless. In order to give it value to the owners, i.e., the Middle East kingdoms, it must first be refined and then marketed. In this connection, it is well to remember the following facts: (1) As proved by the Iranian debacle of 1951, only the international oil companies have the know-how to refine and transport oil, (2) Around half the refining of Middle East crude takes place outside of the Middle East, and the Middle Eastern countries are hardly equipped to build refineries. (3) The only natural volume market for Middle East crude is in Western Europe where marketing facilities are largely controlled by the international oil companies. It would thus seem that, while some rearrangement of the profit split may take place, it is inconceivable that the international companies could be denied access to Middle East oil for any length of time.

Granting the above premises, Gulf Oil appears fairly valued at current levels. Estimated earnings of $8.50 - $9.00 a share for 1958 give the stock a price earnings ratio of around 13. Actual earnings, however, do not give a true picture of Gulf's potential. Depreciation and depletion charges generally run about equal to after-tax earnings and the small pay-out ratio means that a large amount of cash is plowed back annually, thus, sharply increasing the net worth of the company. In this connection it is interesting to note that Gulf has managed to average better than 25% cash earnings on its net worth over the past five years. Thus, while earnings will be off for 1958, there is no reason not to expect longer term growth to continue.

Since the stock has advanced little in the recent bull market, it is strongly possible that the trading shelf in which it has held constitutes an accumulation area. In this connection an upside breakout of the 101-119 range would indicate an upside objective of 150-170. It would appear as more investors realize that Middle East difficulties may be largely transitory that this upside breakout could well take place and the stock is being added to our recommended list for purchase around current levels in long term investment accounts.

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