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What Time Is It on the Stock Market Clock?

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Expert market analyst sees D-J Industrial Average topping out in 1960 to 1961 at around 780 to 800, compared to last August's high of 683, before declining to 750-525 range in next five years. In revealing investor confidence is currently extremely high and makes for a more vulnerable market, Mr. Tabell doubts, however, that we are in a major downtrend. The analyst explains the factors influencing price diversity of one stock to another; examines market wave theories; observes new emerging pattern of a narrower range for stocks and a wider one for bonds; and envisages an advancing market wave over the next ten years. Investors are advised to be selective and not solve their investment problems by remaining static and owning the "Favorite Fifty."

Many investors are confused by the seemingly irrational behavior of the stock market. They find it difficult to understand why one stock will sell at 40 or 50 times earnings and another at 10 times. They become confused when the price of one stock advances while its earnings are declining and another declines while its earnings are in an uptrend. Part of this seeming irrationality is explained by the fact that the stock market should act as a barometer rather than a thermometer, attempting to discount trends in advance rather than reflect the immediate situation.

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To a larger extent, however, the seemingly irrational behavior of stock prices is explained by the fact that the price of a stock depends, not on one single yardstick but on many elements. These many elements can probably be narrowed down to four main influences on stock prices. Three of these factors are tangible: (1) earnings, (2) dividends, and (3) money rates or bond yields. But there is a fourth factor that is not tangible, that cannot be expressed in terms of numbers and that is not easy to measure. This fourth factor is investor confidence. In-

vestor confidence is that element that makes a stock earning $10 a share sell at $75, or only seven and a half times earnings at one time and will make the same stock with the same earnings sell at $200 or 20 times earnings at another time. This intangible factor of investor confidence, or lack of it can, for long periods of time, be much more important in its influence on prices than the other three fundamental factors.

Investor confidence is difficult to measure. The best but far from perfect method is by a study of the technical factors in price movements. Breadth-of-the-market action as portrayed by volume, advances and declines and new highs and new lows is sometimes quite helpful and I maintain a large library of graphs and charts of this nature. Even more important is the action of individual issues and groups. Continued study of the price action of some 1,500 individual companies listed on the New York Stock Exchange and American Stock Exchange and their relative strength as compared to the rest of the market is a partial answer to the evaluation of investor confidence. What do these various technical indicators show at the moment? What time is it on the stock market clock?

Highs and Lows of Investors' Confidence

Perhaps the best approach to the question is to examine the two extremes of high and low in investor confidence. Interestingly enough, the highest confidence point in recorded financial history, and also the lowest point, both occurred in the last 30 years

1929 was a peak of investor confidence—or more truly, a peak in speculative confidence. It is not necessary to go into detail on the speculative excesses that occurred during that period. The story has been told many times before. It was the result of a combination of factors that will, in my opinion, never occur again in our lifetime. 1929 was the end of an era It was the end of an upward trend of prices that started way back in 1850. Perhaps we can call this 80-year period the Era of Private Capitalism where a comparatively small number of individuals reaped the rewards of the development of the country and the many new inventions of the period. 1929 signaled the end of concentrated wealth.

The next 20 years were a period of change during which time a great many of our former beliefs and concepts altered quite radically. World War II added to the change. By 1949 we were ready to embark on a new era. The investor, however, did not believe it. The fear of 1929 still hung over the stock market.

In 1949, investor confidence was extremely low. In fact, the stock market was more drastically undervalued in 1949 than at any time in our financial history. Blue chips stocks like General Electric were selling at six to seven times earnings to yield 6½% to 7½%. The undervaluation was even greater than in 1932 because earnings in 1949 were already in an uptrend that started after the end of World War II, while in 1932 there were still several years of almost ten million unemployed and many uncertainties ahead. The reason for the undervaluation was the inability of investors to believe the earnings of 1949 would continue. Fears of a postwar depression, seven million unemployed and another 1929 were in the offing.

The set of factors that caused the undervaluation of 1949 were most unusual. The investor who is waiting for them to return is doomed to disappointment. Like 1929, the 1949 undervaluation will not occur again in the lifetime of today's investors. 1949 was probably the start of a new era which we might call, to use Keith Funston's term, an Era of Peoples' Capitalism. This era, like 1850 to 1929, will be an era of great growth, new inventions and products of even greater magnitude than the previous period. Its rewards will be gained by the many rather than the few. *In timing, it* should be similar to 1850 to 1929.

However, to temper the rosy enthusiasm of this pattern, the growth and advance will not be in straight line. There will be many interruptions. There were many in the 1850-1929 pattern. FIGURE I portrays the 1850-1929 period.

There were, of course, many other ups and downs during this period, but the five main waves *are noted above. The present* pattern will probably correspond roughly to the graph, with 1949 corresponding to 1850.

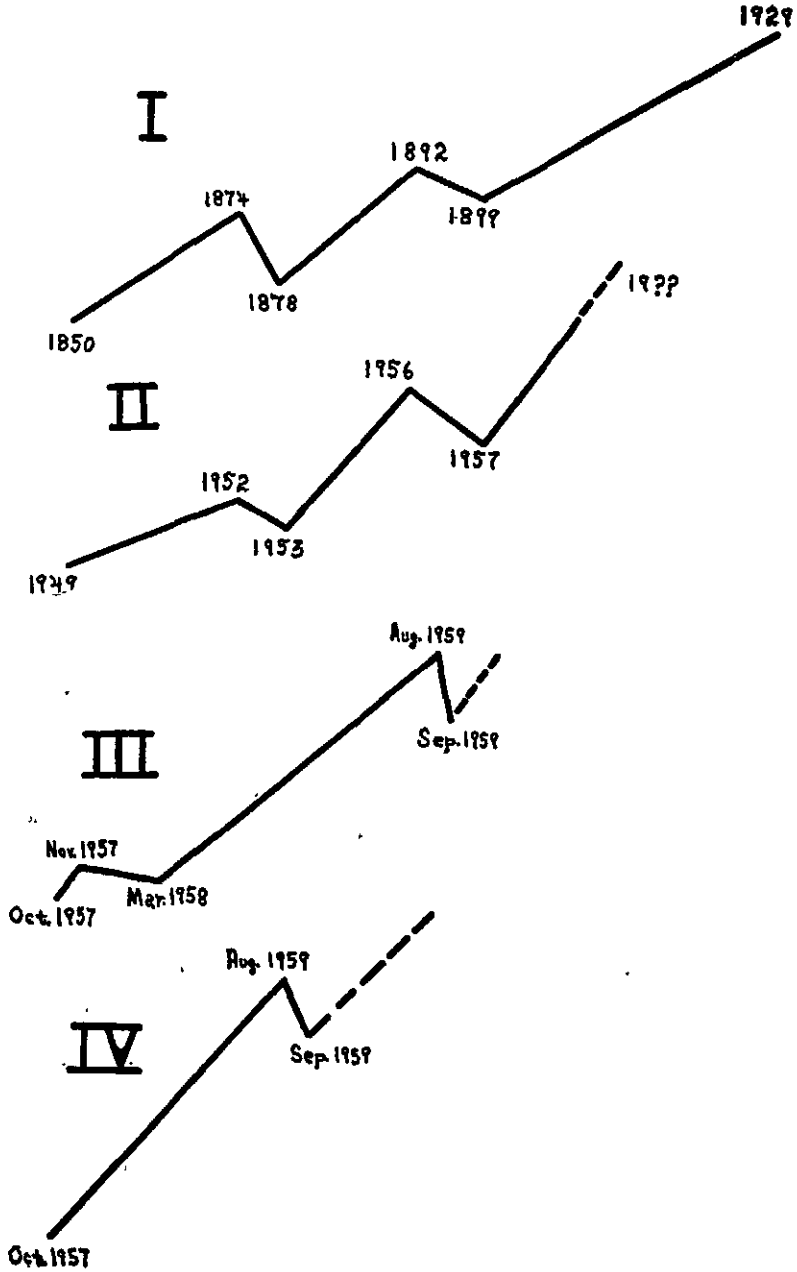
This five-wave pattern is the usual one and I would expect the present major advance to have a similar movement before it culminates early in the 2000's. The present market is still in the first wave of this upward movement. The question is how far are we from the top of the first wave and *the start of the second.*

Present Market Vulnerability to Change

The market, in terms of the Dow-Jones Industrial average has advanced over 300% from the June 1949 low of 160 to the August 1959 high of roughly 680. This ten-year advance was partially *due to increased earnings and partially* due to a correction of the drastic undervaluation that existed in 1949. It is unrealistic to expect a similar advance in the next ten years. The earnings improvement over the next decade could easily be comparable to that of the past ten years, but the undervaluation caused by low investor confidence *in 1949 does not exist today.* Investor confidence is, currently, extremely high. It is higher than at any time since the 1920's. Many of today's prices reflect a belief in the continuation of the upward earnings trend well into the 1960's. The market is obviously more vulnerable to a temporary change in confidence than it has been for quite some time.

Just how far we are toward the end of the advance that started in 1949 might be gathered from an *examination of the price pattern* of that advance. It has not been in a straight line, as shown in FIGURE II.

It will be noted that the advance has been in five waves like the advance shown for the major 1850-1929 advance in FIGURE I. This is a characteristic price movement and is shown as Elliot's Wave Principal. Quite a bit of study has been done on this interesting theory. Hamilton Bolton of Bolton-Tremblay, Montreal, President of the National Federation of Financial Analysts Societies, is the leading authority on this subject, as well as on money supply and demand. The conclusions drawn from Elliot's work have been quite accurate over a period of time. In very simplified form, the principle is that price movements *usually consist of five waves.* Three are in the direction of the move and two in an opposite direction. This pattern occurs in both major and minor moves. The minor moves are, of course, much more difficult to recognize. A glance at FIGURE II would indicate that the stock market is in the fifth or final phase of the *advance that started in 1949.* The first wave was the advance from the 1949 low to near the end of the Korean war in 1952. The second wave was a mild correction or consolidation until September 1953. At that point the market was still greatly undervalued and a broad advance to 525 in the averages occurred from 1953 to 1956. This was the third wave and was followed by a 20% correction to about 420 that ended in October 1957 This was the



fourth wave. The fifth wave started from the October 1957 low.

Doubts We Are in Major Downtrend

Was the long-term advance from 1949 completed at the August 1959 high of 683 and are we now in a major downtrend? It is possible, but I doubt it. There are several technical reasons for this The advance that started in October 1957 while a part of the broad 1949 advance to date, must be considered a bull market of its own. A study of 14 bull markets since 1884 indicates that if the present bull market ended in August 1959, it is well below average in terms of both time and percentage advance. The average time duration of the 14 bull markets has been 30 months. The present bull market lasted only 21 months if August was the top. The average percentage advance of previous bull markets was 105%. The present advance to August is only 63%. In addition, volume indications on the decline since August have not been of the type usually associated with important phases. The heaviest volume of trading occurred in the first week of the decline from 683 to 640. While the decline continued to a low of 613 in September, volume failed to increase. In an important downtrend, volume increases as each new low is attained.

From the viewpoint of the business cycle, the odds favor a continued upturn in business well into 1960 and maybe beyond. The average time duration of a business cycle is 27 months to three years. The present upward business cycle started in April 1958 and is only 19 months old. The steel strike shortages will probably extend the cycle through 1960 and into 1961. Earnings in the first half of 1960 could well surpass the rate of $11 earned in the second quarter of 1959. Dividend payouts have been below average and some dividend increases and extras are to be expected. This is hardly the background for a market decline. Furthermore, the fifth and final phase of a long-term advance is usually the most dynamic with heavy volume and overspeculation. The present advance does not yet fit into this category.

If we use Elliot's wave principal on the advance from the October 1957 lows, we have a number of alternative interpretations. On shorter term moves, the various waves are difficult to recognize while they are taking place. One possibility is shown in FIGURE III.

This would indicate that we are now in the fifth or final wave. An equally valid possibility, in my opinion, is the one shown in FIGURE IV.

This would indicate we are only in the third wave, and the culmination of the advance from October 1957 will be in 1961 or possibly as late as 1962.

My conclusion is that the August, 1959 high of 683 is not the top of the bull market. I believe it probable that the stock market will have a typical fifth wave climax with sharply higher volume and speculation in secondary issues. The high to be reached in 1960 or 1961 will be somewhere around 750-800. Percentagewise, this is an advance only about 20% from present levels—as compared with a rise of 300% from the 1949 lows.

Might Reach 550-525 at Most

What will follow after the market reaches a high in 1960 or 1961? I believe the market will probably have a decline somewhat greater than we have witnessed in quite some time. This is not as ominous as it sounds. The market has not had a really severe decline in recent years. The 1957 decline was 20%. The 1946 decline was 25%. If the averages reach 750-800 on the

Dow-Jones industrials, I would expect a decline to around 550-525, or about 28% to 32%. The averages were at 550 about a year ago so a return to that level would be no great catastrophe.

Going back to Elliot's Wave Principle, the second wave of a major price advance, as depicted in FIGURE I is usually a broad, consolidating phase rather than a steep decline. This consolidation or resting period is needed to allow earnings to catch up with first overenthusiastic appraisal of the years ahead. Therefore, after the market tops out in 1960 or 1961, I would expect a broad consolidating period for several years. During that period, the Industrial average might hold in an area bounded roughly by 750 and 550. At present levels, the market is about half way between these extremes. This trading range could last as long as five years. While this is the pattern indicated for the averages, it does not necessarily apply to individual stocks. I would expect extreme selectivity during this period in individual issues.

This is not a new development. We have long experienced selectivity in advancing markets. For example, the market has advanced 63% from the October, 1957 lows. The buyer of U. S. Steel at the 1957 low of 50 would have had a better-then-average 100% advance. The buyer of another blue chip issue, Standard Oil of New Jersey, would have a loss at today's prices if he bought at the 1957 low. But in the new pattern of recent markets, this selectivity is extending into declining markets also. In 1957, for the first time in market history, it would have been possible to have been 100% long of stocks and have shown a profit despite the fact that the averages declined 20% A broad list of issues advanced from June 1957 to the end of the year, including utilities, grocery chains, drugs, tobaccos, finance companies and foods With institutional investors continually investing in the equity market on a dollar averaging plan, certain types of companies will run counter to the downtrend.

All of this is part of a new pattern resulting from the Federal government's attempt to stabilize the economy. These various built-in stabilizers of social security, unemployment insurance, government spending, money rates and many others, result in a narrower range for stocks and a wider range for bonds. In the 10 years prior to World War II, the average yearly fluctuation from high to low in stocks was 44%, and in bonds 8%. In the 10 years after World War II, the average yearly fluctuation in the stock market had dropped to 18%, and bond fluctuations had increased to 12%. The spread is probably narrower in the past five years. The question, "What is the stock market going to do?" is becoming more and more outmoded. The market is no longer like the Western movies, either a "good guy" or a "bad guy," or either bull or bear. The market of the next five years will probably be neither bull nor bear, but rather a combination of up and down markets in individual issues The events of the next few years will have varying effects on various individual stocks and groups.

Foresees Consolidating Market

A consolidating market for a long period of time fits into the probable economic background for the foreseeable future. Mr. Krushchev's recent visit has brought home to us the fact that the war with Russia will be fought on the economic front rather than with hydrogen bombs and missiles. This will require some drastic changes in thinking, not only at the government level, but from labor and business. In order to meet the challenge of a dynamic nation, we will have to drop our

complacent attitude toward a great many of our problems.

We must realize, for example, that a great many of our tax laws are archaic and were enacted under conditions that no longer exist. They are in need of a thorough revision. We must realize that we cannot afford much of the needless government spending like the billions we are pouring down a rathole on farm subsidies We must realize that inflation must be halted or we will price ourselves out of world markets. We must realize that costs must be stabilized and productivity increased if we are to create enough exports to pay for the raw materials we will have to import in increasing amounts as our own raw materials dwindle. We must realize that outmoded "make-work" programs and "featherbedding" are outmoded and a terrific drag on our economy. We must realize that research expenditures must be increased sharply in order to keep our place in the competitive race. We must realize that government spending must be streamlined and taxes reduced in order to help create the capital needed for more efficient plant and for the public needs such as roads, hospitals, schools and low-cost housing.

These and many other problems will need time for their solution Enactment of such a program will have disturbing effects at times on certain segments of our economy, while at the same time it will be constructive toward other segments. It will probably result in the highly selective market that I envision for the next several years.

Conclusion

In conclusion, I believe the stock market will top out in 1960 or 1961 at around 750 to 800 and then hold in a range bounded by roughly 750 and 525 for the next five years. The Dow-Jones Industrial average on Nov. 12, 1959, sold at 648.52. It is entirely possible that on Nov. 12, 1964 the average will still be at 648.52. During the next five years, we will have to drop the outmoded concept of bull and bear markets and concentrate on the outlook for individual industries and issues. We will probably have to change our opinions on the outlook for many individual issues. We will not be able to solve the investment problems of the next five years by remaining static and owning the "Favorite Fifty." That investment program worked very well in the past 10 years, but will not meet the probable changes of the next five years.

If the picture is somewhat obscure for the next five years, it is much clearer for the next 10 years. This is a growth country and we are still in the early stages of our new era of a "People's Capitalism." After the first wave is ended and the needed consolidating phase of the second wave completed, the economy and the stock market will again embark upon another advancing phase. I do not expect that in the next 10 years the market will duplicate the 300% rise of the past 10 years. It could, however, be 100% higher by 1969 or somewhere around 1250 and 1500 in the Dow-Jones Industrials.

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*An address by Mr. Tabell before the Arizona Bankers Assn.'s 56th Annual Convention, Phoenix, Ariz., Nov. 13, 1959.