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TABELL'S MARKET LETTER February 12, 1960

There appears to be little change in the market picture from that outlined in last week's letter. A new intra-day low of 610.17 on the Dow-Jones Industrials was reached on Monday, and a new closing low of 618.57 was attained on Thursday. As of this writing, breadth-of-the-market indicators have given no indication of improving action. Short term indicators are approaching oversold territory and a technical rally remains a possibility. On an intermediate term basis, nevertheless, the trend is still neutral to unfavorable.

However, as was pointed out last week, the market is fairly close to the bottom of the range we envision for the next two-three years. Further weakness, therefore, would seem to provide an opportunity to make well-selected purchases on a long range basis.

Recent action of the various market averages has provoked much discussion of the Dow Theory and its interpretation of the current market. This Theory is probably the oldest and best known of all technical tools. It was first advanced by the late Charles H. Dow at the turn of the century, and has since been enlarged upon by many market students, particularly William P. Hamilton and Robert Rhea. In highly simplified form, the following conditions are necessary for the Dow theorist to predict a change in a longer term uptrend.

(1) The market must make a clearly-defined top.
(2) The top must be followed by a clearly-defined decline.
(3) A subsequent rally must fail to penetrate the previous top made in (1).
(4) A new low must be made under the low made in (2).

Obviously, action, the reverse of the above, indicates a change from a bear to a bull market. Such action must take place not only in the Industrial average, but must be "confirmed" by the action of the Rail average. Failure of the action of one average to confirm the other usually indicates an uncertain or sideways market. Serious students of the Theory have added many other factors to modify and improve upon the above rules.

We have recently made a study of the performance of the Dow Theory from 1929 to date. The conclusions reached were rather interesting. Under our interpretation, which may, of course, differ from that of other analysts, 24 signals were given in the period under study. Nine of the signals resulted in a gain of 10% or more from one signal to the next opposite signal. The other fifteen signals were whipsaw signals, i.e. bull market signals given at a level above a previous bear market signal, or vice versa. However, the gains on the valid signals were extensive enough to wipe out occasional small losses on whipsaw signals. The largest loss incurred was one of 15%, based on the average. On the other hand, gains of close to 70% were recorded on two occasions, the 1930-32 bear market and the 1953-56 bull upsurge.

It will be noted that the Theory, as is the case with all technical devices, is prone to "whipsaws". It has, however, successfully pointed out all major turning points in the market beginning with 1929 and including 1932, 1937, 1942 and 1949. It has been particularly ineffective in a sideways and trendless market, as exemplified by the periods 1938 to 1942 and 1946 to 1949. Occasionally, valid bull and bear market signals were interrupted by whipsaw signals. This occurred in 1929-1930 and in 1952-1953.

The current standing of the market in the light of the Theory is somewhat questionable. Using the Dow averages, the fact that the Industrials made a new high in January cancelled out any immediate signal under the Theory. Even had the Industrials not made a new high, any signal given at the recent lows would have been disregarded as the Rails failed to confirm it. Using Standard & Poor indices on the other hand, a Dow Theory bear market signal was given as both the Industrials and Rails failed to make new highs in January and posted a new low in the early part of this week.

Even were a signal to be given, however, its value by itself as a tool in determining investment policy would be somewhat in doubt. As has been noted above, the Theory is prone to giving whipsaw signals in essentially sideways markets. This is, of course, the type of market we look for in the early 1960s. Thus, the obvious conclusion is that while the Theory is an extremely helpful technical tool, it must be taken in conjunction with other indicators, such as breadth-of-the-market, volume indicators, point and figure counts, etc., in order accurately to gauge market probabilities.

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EDMUND W. TABELL
WALSTON & CO. INC.

Dow-Jones Industrials 622.23
Dow-Jones Rails 130.

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