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TABELL'S MARKET LETTER April 30, 1960

Continued weakness prevailed in the stock market most of the week and at its low on Friday, the Dow-Jones Industrial average reached an intra-day bottom of 598.35. Comparable low on the Dow-Jones Rails was 138.87.

This action has been entirely consistent with the thinking expressed in this letter since early January. At that time it was pointed out that the various potential down side projections of the August-January top ranged from 604 to 550. The first of these potential objectives was reached, and subsequently the market held for some time above its March 9th low of 596.20. It was then pointed out that one of two eventualities could take place. Either breadth-of-the-market would improve, leading to the projection of a renewed uptrend, or the old low could be decisively broken with the market showing continued poor vitality. If this were to be the case, the lower limit of the downside objective mentioned above, namely, the 578-550 range, would be the logical stopping place for the Dow. In this connection, it is interesting to note the results of a study of the individual downside objectives of each of the thirty Dow stocks. Taking the upper limits of the downside objectives, in each case, would result in a figure of 550 in terms of the Dow-Jones Industrials. If the lower limits of the downside objectives were used, the figure would be 515. Since all stocks in the Dow could hardly be expected to reach their limits at precisely the same instant in time, it is logical to add some 5% to the figures mentioned above. This results in a possible downside potential of something on the order of 577-540, or very close to the downside potential of the graph of the average itself.

The above downside target also becomes logical when looked at from an earnings point of view. Best available estimates place the 1960 earnings for the Dow somewhere around $41.00. Over the past five years the average has tended to sell at some 13 1/2 times normal earning power (the P/E ratio has gone up sharply when earnings were temporarily affected by a recession, or, as in 1959, by the steel strike). Applying a 13.5 multiple to $41.00 earnings results in a price of 554.

Another method of viewing the earnings picture would be from the point of view of the earnings growth. For the past ten years the Dow earnings have tended to grow at a rate of 4 1/2%, compounded annually. Applying this growth factor to 1960 earnings would mean that 1965 results can be estimated at $51.00. At its early January high, the Dow was selling for 13.5 times these earnings. Comparison to individual situations shows that this was rather high. Polaroid, for example, may well enjoy a growth rate of 35% annually over the next five years. At the same time, the Dow was selling for 685, however, it was available at 188, only 10.4 times projected earnings five years hence. Winn-Dixie Stores, which has enjoyed a 20% growth rate, was then available at 43, some 6.3 times estimated 1965 earnings. Thus, while the average was plumetting from 685 to 600, Polaroid advanced from 188 to 240 and Winn-Dixie from 43 to 54.

Obviously, a large part of the overvaluation in the Dow has already been corrected. At the 550 level, it would be almost 100% corrected. At that price, the Dow would be selling for some 10.8 times anticipated earnings five years hence, a figure not out of line with recent experience and a level equal to the price/1965 earnings ratios of a good many of the popular "super-growth" issues. At this level, the institutional patrons of the Dow blue chips would undoubtedly feel a lot more friendly toward adding to holdings

The above in no way constitutes a projection that the 578-550 level will be reached, although this would become a likelihood if the old lows were decisively broken. It is still possible that the old lows will hold and that breadth-of-the-market will improve, signifying an ultimate advance in prices from around current levels. What does appear apparent, however, is that there is, still, some element of risk in America's leading companies which are the main components of the Dow average, and that many secondary companies still appear attractively priced relative to their long term growth potential. Many individual issues could advance even if the averages decline, and individual stock selection will continue to be the key to investment success.

Dow-Jones Ind. 601.70
~~Dow-Jones Rails 139.83~~

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