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TABELL'S MARKET LETTER

June 24, 1960

At Wednesday's intra-day low of 639.22, the Dow-Jones Industrials had reacted twenty-four points from early June high of 663.64. This is approximately a one-third correction of the sixty-seven point advance from the May low of 596.61, which is normal technical action in an advancing phase. Furthermore, the retracement has carried back to near the top of the three-month 637-596 range which should furnish a good support level. So far, the technical action of the averages has been normal, but there has as yet been no confirming signal by my breadth-of-the-market studies. The index has so far failed to better the March high and is way below the high level reached in April, 1959. However, it has declined very little in the past two weeks and is only a short distance from the March high.

Regardless of what the stock market does over the next few weeks, or few months, the general outlook for the long term, i.e., the next five to ten years, remains the same. An understanding of this outlook is obviously important to the intermediate term trader or speculator since, to a great extent, the general market outlook will determine the type of security he wishes to own. For this reason, a few obvious truths about the long range prospects for the stock market bear restating at this time.

The easiest way to view the prospects for the equity market over the next ten years is in contrast to the past ten. The last decade started at a time when stocks, in general, were more undervalued than they had ever been in previous history. It was only logical that this undervaluation should be corrected and a large part of the 1950's was spent correcting it. Thus, from 1947-49 to 1957-59, the Dow-Jones Industrial average increased some 200%, based on its mean price for the two periods. Earnings, however, increased only 53%, an average annual rate of growth of something under 4 1/2% compounded. This was a delightful process and proved extremely rewarding to those who were perceptive enough to recognize the terrific undervaluation which prevailed in the equity market ten years ago. The only trouble is that it cannot be expected to go on indefinitely.

The realization that the prices of many blue chip stocks had gotten rather out of line when measured against their growth prospects has slowly crept into the thinking of investment managers during the second half of the last decade. This realization accounts in large part for the rather desultory performance of such former favorites as DuPont, General Motors, International Paper and Standard Oil of New Jersey over the past few years. The new favorites became the "super-growth" stocks, which, it is reasoned, are going to exhibit earnings growth far outstripping that of the economy over the next decade. The growth prospects in these issues, it is argued, warrant the payment of an extraordinary premium over their value based on current earnings. There is absolutely nothing wrong with this theory when applied to, say, Texas Instruments, where a lead in development and research assures terrific expansion in earnings over the long term. It becomes a little ridiculous, however, to start applying the same multiples to every operation that starts out with an M.I.T. graduate and a few coils of wire and puts the magic word "electronics" in its name.

All of the above allows us to draw a few conclusions as to the general climate of the equity market over the next few years. (1) In conspicuous contrast to the last decade, it will not be easy for the unsophisticated investor to amass large capital gains. (2) It will not be possible to follow the old saw "buy good stocks and hold them". This policy worked wonderfully between 1949 and 1956. Its recent results have been disappointing and will continue to be so. The Dow-Jones Industrial average, composed largely of blue chip companies, will, five years from now, probably be within 20% of where it is at this moment. (3) Investment success will be attained by continued seeking for companies which will grow faster than the economy as a whole. For those companies where growth is assured, the payment of a premium is undoubtedly justified. However, in many cases, equally good opportunities will be found in companies where no premium need be paid and where growth prospects have not yet been recognized by the market.

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Dow-Jones Ind. 647.01
Dow-Jones Rails 123.60