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TABELL'S MARKET LETTER October 6, 1961

The stock market, in the latter part of the week, turned in a fairly impressive performance. On increased volume, the Dow-Jones Industrials reached an intra-day high of 714.07 on Friday. Even more significant was the action of our shorter-term breadth index which, for the first time in a long while, managed to match the action of the averages, bettering its levels of two weeks ago. If this continues, and longer-term breadth also improves, it will be possible to become more optimistic on the immediate outlook.

However, insofar as the industrial sector of the list is concerned, it is not yet possible to let bullish enthusiasm become rampant. The Dow has just about run out the upside count of the tiny base formed in the 692-697 area, and is just under the heavy overhead supply existing at 715. The most bullish possible pattern would be continued backing and filling at present levels before an attempt at penetration of this supply is made. Until this happens, it is best to reserve judgment as to the intermediate trend.

As has been noted in many places, however, the action of the rails over the past few weeks has been a good bit more encouraging than that of the industrials. As most investors are aware, the Dow-Jones Rails this week bettered their August peak, reaching an intra-day high of 152.24 on Thursday. While various counts are possible on both the Dow-Jones Rail average and the Standard & Poor Rail Index, ability to follow through on this high would indicate a move of at least fairly substantial proportions.-- possibly to the 160-180 range on the Dow and to the 45-49 range on the S & P Index.

Many investors tend to shy away from rail securities, becoming somewhat confused by the mystique of ICC accounting and the highly technical jargon about carloadings, maintenance ratios, etc. which usually accompanies most rail analysis. Actually, the rails appear attractive at this juncture in comparison with their industrial cousins for a number of very simple reasons.

1. They are measurably cheaper than industrials on the basis of both earnings and dividends. Yields on the four better-grade U.S. rails in our recommended list -- Atchison, Topeka & Santa Fe, Northern Pacific, Seaboard Airline and Southern Railway -- range from 4.7% to 5.2% on dividends whose continuance appears virtually assured. This compares with a present yield of 3.09% on the Dow-Jones Industrial average. The price earnings ratios for the four stocks are between ten and fifteen times depressed 1960 earnings, and between six and ten times peak 1955-59 earnings. The current P/E ratio for the Dow Industrials is 24.

2. Contrary to the impression held by many investors, earnings of the better-grade rails have shown some measure of growth. It is quite true that a railroad, by the very nature of its operation, will have its revenues adversely affected by the business cycle. However, almost all of the better southern and western roads, including the four on our list, have tended to show substantial earnings improvement from cyclical peak to cyclical peak. There is no reason to suspect that this action will not continue.

3. 1962 earnings for the higher quality equities should show marked improvement over both 1960 and 1961 results. Excellent earnings comparisons are already beginning to show up as carloadings and revenues, and, above all, operating earnings, reported each month, show impressive gains over year-ago figures.

4. The above factors apply largely to better-grade rail securities. However, the more speculative equities have an attraction of their own, based largely on the fantastic leverage contained in both their capital structure and their operating ratios. For example, Chicago, Milwaukee, St. Paul & Pacific had operating revenues in 1960 of $108 per share. The comparable figure for Chicago, Northwestern was $187. The earnings improvement which even a small change in profit margins can generate in roads of this type is, of course, tremendous.

5. A final point in favor of the rails must be noted in the huge savings which will occur through mergers now in the preliminary stages. In this connection, it must be emphasized that the regulatory authorities tend to move at a ponderous pace and many mergers now being discussed will not be consummated for a number of years. Nonetheless, the move toward merger has gained impetus and will continue to do so.

For all of the above reasons, in today's uncertain market, the conservatively priced high-quality rail equities deserve representation in every investment portfolio.

Dow-Jones Ind. 708.25
Dow-Jones Rails 150.74

ANTHONY W. TABELL
WALSTON & CO. INC.