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TABELL'S MARKET LETTER January 18, 1963

The market continues its impressive show of strength.

At Tuesday's high of 680.80, the Dow-Jones Industrials had almost reached the lower part of the 685-700 objective this letter has constantly suggested was the upside potential. Our feelings concerning the equity market at the moment can be summed up in three statements.

(1) - It is difficult to read, from the base formed between May 1962 and October 1962, an upside potential of much higher than 685-700 on the Dow. This figure, moreover, coincides with the heavy overhead supply that exists between 680 and 740, the original 1961-62 top which produced the sharp decline in the early part of last year.

(2) - It would, therefore, be illogical to expect an advance substantially above the 685-700 level without some correction or consolidation. Such a correction or consolidation would enlarge the base and make a higher reading possible. It is impossible at this point to predict what form this sort of action may take. Certainly, no distributional top has been formed and the market does not appear immediately vulnerable.

(3) - The most important thing to remember, however, is that all of this is part of the process of forming a long-term base for a new major advance. Here again, it is impossible to predict, at this early stage, the timing of such an advance, and it is probable that its beginning is months, or possibly years, away. It should, however, ultimately carry the market into new high territory.

If this indeed is the shape of things to come, it behooves the analyst, even at this early stage, to examine the factors which might lead to the start of the next bull market. At this week's high, the Dow-Jones Industrials were selling at 19.2 times their latest twelve months earnings, a level which, interestingly enough, has been exceeded only in 1961, just before the 215-point break in the averages. It is almost axiomatic that before any major upside move takes place, there must be a substantial increase in the earning ability of common stocks and a move out of the earnings plateau that has been in existence since 1955.

It is in this connection, as we have noted in the past few weeks, that we feel the pending tax legislation is of major importance. Much has been made of the Administration's tax program in the business press. It has been called a reversal of the economic thinking of the past thirty years and a repudiation of the theories of the late Lord Keynes. This is a bit strong. Indeed, the philosophy behind the tax cut, both implied and stated, seems largely Keynesian in its assumption. A strong case can be made, however, that the President's tax program, if enacted, and combined with those measures already enacted, would reverse a trend in tax policy that has largely prevailed since 1935 and start the return swing of a pendulum which had almost certainly moved too far in one direction.

What the Administration has proposed includes an eventual reduction in the corporate income tax to 47% (a move which, by itself, would add 10% to the post-tax earnings of corporations). Already, depreciation schedules and investment credits have been enacted allowing business to invest in the capital equipment necessary to increase profits, and the proposed reduction in the top tax bracket to 65% would free a large portion of the income of the upper bracket tax payer who is in a position to invest new funds in business enterprise.

As noted above, the recent history of taxation in the United States may be viewed as a pendulum. Throughout the 1920's, under Treasury Secretary Andrew Mellon, gradual reductions were made in corporate and high bracket taxes, and these taxes reached a nadir in the late 1920's. Beginning with the Revenue Act of 1935, the emphasis shifted heavily to raising surtaxes and corporation income taxes, and these revenue sources increased in importance with very little interruption, spurred on by the demands of World War II and the Korean War. We are, in other words, on the threshold of the first major lightening of the business tax burden since the 1920's. It may be left to analysts of varying political and economic persuasion to argue about the effects of this move on the economy as a whole over the long term. It seems difficult to doubt, however, that the result for the business community over the next few years could be a move out of the eight-year profits stagnation which has hobbled it to date. Just such a move will be needed before any major advance in common stock prices can take place.

Dow-Jones Ind. 672.52
Dow-Jones Rails 146.25

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