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**TABELL'S MARKET LETTER** February 21, 1963

The Dow-Jones Industrials scored another new high this week, reaching an intra-day peak of 694.27 on Monday. The averages were not, however, able to hold their gains and by Friday had reacted to a low of 675.87.

As pointed out last week, one of the most interesting facets of recent market action has been the action of the rails. Although the industrials at this week's top were well below their 1961 peak, the rails had moved slightly above their '61 high. This, to an extent, is a misleading statistic since the rails are still below their 1959 high, a level bettered by the industrials at this week's top and, moreover, far below the peak made in 1956 when the industrials were selling for 525. Nonetheless, it is worthy of note that the rails have advanced 36% from their October lows, versus a rise of 26% for the industrials. This constitutes the first time the rails have outperformed the industrials on a major move since 1958-59.

From a technical point of view, most rail stocks, in common with the great majority of their industrial brethren, are at or close to their short-term upside objectives. However, it should also be noted that, since 1959, many carriers have been building up base formations which, when ultimately penetrated on the upside, could indicate substantially higher levels - in some cases as much as 100% above current prices.

This is not to suggest that any such move is imminent, for the favorable developments which affect the industry are essentially long-term ones. Nonetheless, these developments are of sufficient importance, we believe, to warrant the inclusion of rail stocks in investment accounts which might not have considered them heretofore.

There are four basic factors which seem to be creating a change for the better in the railroad picture.

(1) Favorable tax treatment in the form of liberalized depreciation and investment credits has improved the earnings and cash flow picture of many roads. The increased cash flow will enable roads to invest in new equipment which will allow them to compete for traffic. One obvious example of such equipment is the new automobile hauling car which is enabling the railroads to reclaim a large percentage of the automobile-carrying business from trucks.

(2) Some initial signs of progress in solving the present labor problems are being seen. The recent report of the Presidential Commission was essentially constructive. Railroads have estimated that they could save $200 million annually with even a few changes in archaic labor laws, and as much as $600 million if all desired changes were enacted. This latter amount is more than total income of Class I roads.

(3) The President's transportation message, and recent ICC decisions, show a tendency toward liberalization of the regulatory climate. Strangely enough, the railroad rate picture will be best improved by allowing roads to decrease rates on bulk commodities, rather than increase them. Through such decreases they can regain a large part of the shipping lost to other forms of transportation and thus obtain the volume necessary to produce higher earnings.

(4) The Interstate Commerce Commission is, on the evidence, favorably disposed toward the majority of pending mergers. The importance of mergers can fully be realized only by examining the basic nature of the railroad business. The business is one which requires heavy fixed expenses for maintenance of way and equipment. Essentially, railroad mileage in the United States is largely under-utilized. In fact, it was recently estimated that half the industry's tonnage is hauled on 10% of the track. Mergers will, of course, allow elimination of wasteful duplicating facilities and eventually allow merged roads to produce the same number of ton miles with a considerably reduced plant.

All of the above factors are admittedly long-term, but as they slowly work out, the effect could be dynamic. The average railroad is one of the most highly leveraged businesses in America today, both in terms of capital structure and in ratio of fixed to variable operating expenses. Any minor improvement could produce truly dramatic effects on railroad earnings.

A number of carriers on our recommended list include Atchison, Topeka & Santa Fe (26 1/2) and Seaboard Air Line R.R. (37). Other rails which appear relatively attractive at the moment include, Kansas City Southern (43), Southern Railway (59), and Union Pacific (35). These, and other quality railroads, would appear to be purchases on market weakness in longer-term capital growth accounts.

Dow-Jones Ind. 681.64
Dow-Jones Rails 153.12

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