MARKET LETTER OF MAY 20, 1966

Reprinted from Thursday Issue, April 21, 1966

The COMMERCIAL and FINANCIAL
CHRONICLE
25 PARK PLACE, NEW YORK, N. Y. 10007

Basis for New Market Advance Is Now Under Way

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Mr. Tabell re-examines his father's famous prediction of six years ago and sees little need to change it today. Similarly relying on the "Elliot Wave" theory, analyst Tabell disagrees with those who say we have had one bull market since 1949 which still remains uncorrected. If so, he adds, "we should run for the hills." Actually, he claims, once the 1962-1966 Dow Index advance is corrected in P/E terms the upswing almost entirely disappears. Thus, in predicting a not too bullish market over the year ahead, Mr. Tabell advises taking advantage of any weaknesses. They provide, he says, an excellent buying opportunity and he bases this view on the premise that we are now completing a base formation for a new advance to begin in the latter part of this decade.

Some six years ago, my father, the late Edmund W. Tabell, delivered a speech in Phoenix, Arizona (reprinted in the **Commercial & Financial Chronicle** of November 19, 1959) entitled "What Time is It on The Stock Market Clock?" The purpose of the speech was to make some observations on long range cycles in the stock market and to offer some observations as to what the 1960's might have in store


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It was an important question at that point. The time was two years prior to the 1962 break in stock prices, the sharpest decline in twenty-five years Already a great many stocks had begun declining from highs they were not again to achieve for as much as five years and which, indeed, some stocks have not again achieved to this day.

The question of what time is it or the stock market clock is equally important today. We have recently completed a forty-two-month rise in the leading market indices, the longest such rise in post-war history. The length of this rise,

coupled with the obvious signs of deterioration being seen in market leadership, have caused many pessimistic voices to be raised.

The burden of my paper today will be two-fold. It will be to prove, first of all, that the analysis made in 1959 was essentially correct and that since that time the stock market clock has simply advanced In other words, the outlines of the pattern then foreseen have, in large part, materialized — with, as could be expected, some "surprises" which could not be foreseen until a later date. Secondly, it is likely that the pattern then foreseen for the latter half of the 1960's will also materialize — again with the appropriate adjustment for changing conditions.

In order to prove this contention it is necessary to outline the 1959 analysis. This can best be done in terms of the Elliott Wave Principle, a useful stock market theory often employed by the writer and regularly used by Hamilton Bolton of Bolton, Tremblay & Company of Montreal, the leading authority on the subject. In highly simplified form, the Elliott Principle holds that stock market upswings generally take place in five phases, the first, third and fifth phases or "waves" being upward moves and the second and fourth being downward moves, correctionary in nature. Likewise, downswings generally take place in three phases, the first and third being downward moves and the second phase, an upswing

The main point made by the Elliott Wave Principle is that each one of these waves is infinitely divisible. In other words, each one of the three upward waves comprising a major upswing can be sub-divided into five minor waves, and each one of the downswings (since then are corrections running counter to the main trend) subdivides into three waves. In a 3-wave downward swing the first and third downward waves sub-divide into fives, and the upward wave divides into three minor waves.

Upswing Started in 1949

Without going into a great deal of detail, it is sufficient to say that the Elliott Principle has been fairly descriptive of stock market history as we know it. For example, it is possible to take the entire 72-year period from 1857 to 1929 and divide it into a major upward cycle of five distinct waves. Each one of the waves within this cycle can, likewise, be subdivided according to the rules of the theory It is also possible in Elliott terms to view the entire period from 1929 to 1949 as a correction, the theory being that the 72-year upswing in stock prices was entirely corrected by the war and depression-torn markets of the 1930's and 1940's. If the theory is correct, therefore, 1949 saw the start of a new major stock price upswing similar to the one that began more than 100 years ago in 1857 and was culminated only by the 1929 debacle.

In retrospect, 1949 is a logical starting place for such an upswing. It was a period when security prices generally were as depressed as they have been at any time during the century. As we all remember, "blue chips" of the quality of Standard Oil of New Jersey, General Motors and General Electric, were then available at price-earnings ratios of six to seven and yields of better than 6%.

In retrospect, then, in 1959 it was easy to look back and see

that a major rise in security prices had begun ten years earlier and that the first wave of that advance should be fairly close to a conclusion. If the Elliott Principle were correct, it would be possible, therefore, to divide this first wave into a typical five-wave upswing. This could quite logically be done. The first wave apparently had lasted from 1949 to 1952, with a correction in 1952-53. The third wave began from the 1953 bottom and lasted to the 1956 top, and the correction from 1956-57 completed the fourth wave Therefore, in 1959, it was quite possible to visualize the long advance from 1949 very shortly coming to an end with all the attendant phenomena historically associated with a major stock market top.

Thus, the 1959 speech said "My conclusion is that the August, 1959 high of 683 is not the top of the bull market. I believe it probable that the stock market will have a typical fifth wave climax with sharply higher volume and speculation in secondary issues. The high to be reached in 1960 or 1961 will be somewhere around 750-800. What will follow after the market reaches a high in 1960 or 1961? I believe the market will probably have a decline somewhat greater than we have witnessed in quite some time. I would expect a decline to around 550-525, or about 28% to 32%."

ACCURATE PREDICTION

This prediction, of course, proved quite accurate. Just two years after it was made the Dow-Jones Industrials reached a high of 741.30 and seven months later in June, 1962, it reached a low of 524.55. The top was, of course, a typical speculative climax with a great deal of activity in third and fourth rate issues.

If 1949-1961 was indeed a bull market in Elliott terms, it would have been logical to expect its aftermath to follow the typical Elliott 3-wave pattern— a correction followed by an upswing and then a third corrective wave which would complete the base for a new advance. Thus, the "pure" Elliott formation would have called for the decline from 741 to 524, to be followed by a rally, perhaps to a point under 741, and then a decline back to around the 524 level. Thus, the 1959 speech said — "Therefore, after the market tops out in 1960 or 1961, I would expect a broad consolidating period for several years. During that period, the Industrial Average might hold in an area bounded roughly by 750 and 550 . . . This trading range could last as long as five years. While this is the pattern indicated for the averages, it does not necessarily apply to individual stocks. I would expect extreme selectivity during this period in individual issues."

This has not quite happened, at least insofar as the averages are concerned. Instead of a mild rally following the first-wave decline, there ensued a 42-month rise to a new high which exceeded the old high in the Dow by some 34%.

At this point there are only two rational alternatives. The first one is to discard the entire analysis, and this a great many theoreticians have done. According to this line of reasoning, everything that has taken place from between 1949 and the Dow-Jones Industrial high of 1001.11 last February, constitutes one bull market which as yet remains uncorrected. If this is true, we had best run for the hills

I, for one, do not believe it is true. Anyone close to the stock market in 1961 is aware that this period had all of the characteristics of a major stock market top to a degree not remotely approached by today's market. I do not think it is possible, as so many are doing, conveniently to ignore 1961-62 as a mere technical interruption of a long advance. I think, in other words, that the analysis made six years ago is essentially correct and that, in 1961, the bull market ended and the stock market moved into a new phase.

If this is the case, the sharp rise in the Dow to new high territory over the past three and one-half years, coupled with a much sharper rise in individual issues, needs to be fitted into the pattern then outlined I believe that this can be done.

First of all, we have been talking to date purely in terms of the averages. For the past decade, as most analysts are aware, this has been misleading For example, many stocks in the 1949-1961 rise made their highs as early as 1956, and a great many more made their highs in 1959. A great many of those stocks which made their highs long before the market had already completed base formations for a substantial new advance by June of 1962. As these stocks moved into major bull markets of their own, the rise in the Dow-Jones Industrial Average was extended to a point far beyond what would have been expected if all stocks had topped out as the averages did in 1961. Much more important, however, is the fact that the market of the past five years has moved against a rather unusual economic background For the twelve months ended September, 1961, just before the market reached its peak, the Dow-Jones Industrial Average earned $29.03. Since then we have seen more than four years of continuous earnings expansion to the point where the Dow probably earned just under $54.00 for the year 1965 and, probably, will earn $60 00 in 1966. At its recent low of 905, therefore, the Dow was selling for 16.9 times earnings, a figure not too much different than the P-E **at the 1962 low.**

Put in terms of P-E ratios, rather than prices, the entire 1962-66 upswing almost entirely disappears. The Index corrected itself from a P-E of 24.2 in the third quarter of 1961 to one of 16.2 in the second quarter of 1962. Since that time the P-E has never moved much above 19. This sort of pattern is far more consistent with the analysis offered in 1959 than is the conventional pattern of prices. And, this is, in a sense, as it should be. When we talk in terms of long stock market cycles we are usually talking in terms of swings in investor confidence. It is at least an arguable premise that investor confidence in the overall market has improved very little in the past four years.

Indeed, it is possible that investor confidence as expressed by the Dow-Jones P-E may ultimately wind up with a classical three-wave Elliott-type downswing. If this is the case, we might see a decline in the Dow-Jones P-E to around 14, the level which characterized it during 1956-57. This would hardly be a major disaster. Again, assuming $60 00 earnings for 1966, this would produce a Dow-Jones Average level of 840, not too different from the June 1965 low

Outlook Over the Next Year

If this is the case, the outlook for the stock market over the next year is not a terribly bullish one, and the immediate signs of market deterioration we are seeing at this late stage warn us against unreserved optimism at this point The last high in the Dow-Jones Industrials was, for example, not confirmed by our breadth index, indicating some deterioration of leadership It is quite possible that longer term volume indices are just now beginning to top out, a phenomenon which has led all major stock market peaks in the post-war period. In other words, it is quite possible that a year from now the popular market averages could be somewhat lower than they are today.

Yet, the important thing is how we view this anticipated stock market weakness. If we subscribe to the theory that the entire 1949-1966 period constitutes one single advance, we should certainly view any impending downturn with a great deal of alarm. If, on the other hand, as I do, we believe that the present market is in the process of completing a base formation for a new advance to begin in the latter part of this decade, then any weakness will provide one of the most important buying opportunities for common stocks in recent years In other words, I believe that in later years, by hindsight, we will be able to view the 1965, 1966 or 1967 period as a wide trading range which completed the base for a new upswing

In 1959, in the analysis of time on the stock market clock, the conclusion was as follows—"In conclusion, I believe the stock market will top out in 1960 or 1961 at around 750 to 800 . . During the next five years, we will have to drop the outmoded concept of bull and bear markets and concentrate on the outlook for individual industries and issues. We will probably have to change our opinions on the outlook for many individual issues. We will not be able to solve the investment problems of the next five years by remaining static and owning the 'Favorite Fifty.' That investment program worked very well in the past ten years, but will not meet the probable changes of the next five years. If the picture is somewhat obscure for the next five years, it is much clearer for the next ten years. This is a growth country and we are still in the early stages of the advance. After the first wave is ended and the needed consolidating phase of the second wave completed, the economy and the stock market will again embark upon another advancing phase. I do not expect that in the next ten years the market will duplicate the 300% rise of the past ten years. It could, however, be 100% higher by 1969 or somewhere around 1250 and 1500 in the Dow-Jones Industrials."

Although the time might have to be pushed forward to the early 1970's, there appears little reason to change this prediction today.

*An address by Mr Tabell to the Boston Investment Club, Boston, Mass April 6, 1966