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TABELL'S MARKET LETTER

December 2, 1966

Last week's market was a desultory affair. The Dow-Jones Industrial Average moved lower on each of the five days of the week. Although declines were small, the biggest drop in price being a 5.90 point decline on Tuesday, the closing low of 789.47 reached on Friday was moderately below the previous week's low close of 794.98 and brought the Dow for the second time, to around the 790 level previously mentioned by this letter as an important downside target.

Of interest is the fact that on this second approach to the 790 support level, most of our shorter term market indicators had reached, or were close to, oversold territory. As we have noted before, the historical pattern favors market irregularity in the early part of December, but any such irregularity should probably be viewed as an opportunity to establish positions prior to the start of the December-January rally.

One of the most interesting features of the recent market has been the behavior of short interest on the New York Stock Exchange, a figure which is released by the Exchange shortly after the 15th of every month. As of November 15th, the total number of shares in short position increased to a record level of 14.1 million, which was an advance from 12.6 million shares in the previous month. The 14.1-million-share figure represented the peak of a rather steady rise in short interest which had been going on for the past six months, ever since May of this year.

It is, at least theoretically, true that a high short interest tends to be a supportive factor for the market in that shares sold short must, eventually, be repurchased. Certainly, this reasoning cannot be faulted. It has, however, recently become fashionable to minimize the significance of the current high short interest level. Justification for this usually takes two forms. On the one hand, it is argued that a great deal of the high short interest represents short sales against the box, or short sales made as part of an arbitrage situation. This reasoning seems spurious. In a year such as the present when most investors have losses, short sales against the box in an effort to postpone profits should be relatively low. There is, moreover, no reason to suspect that the level of arbitrage shorts should be any different presently than it has been in prior years. The second reason for discounting high short interest is based on the fact that it has been rising throughout the year and so far has proved of little help to the stock market. Of this, more later.

In general, most analysts concerned with the short interest do not look at the raw short interest figure itself, but rather at something called the short interest ratio, a number arrived at by dividing the short interest by the average daily volume for the previous month. A study of this ratio going back to the time it was first computed in the early 1930's, is interesting. Throughout most of the 1930's and early 1940's, it fluctuated in a range between .4 and 1.5 -- in other words, a short interest of between 1/2 and 1 1/2 times daily volume. During the 1950's it tended to be generally higher, remaining for the most part between just under one and two times trading volume. For the month ended November 15, 1966, average daily trading volume was 6.77 million shares. Thus the short interest ratio was 2.09 or more than two day's volume of trading.

Since 1933, a short interest ratio of over 2 has occurred only four times, early 1933, Spring, 1938, Summer and Fall, 1949, and Spring, 1958. The reader will immediately recognize these previous periods as major market turning points. Of even more interest, however, is the behavior of the short interest ratio in relation to the trend of the market. The low in the short interest ratio this year was in May when a ratio of 1.10 was reached. At that time the Dow was hovering just underneath the 900 level. Since then, while the market has been moving sharply downward, the short interest ratio has been increasing. In other words, the short sellers have been selling -- not on a rally, as is the usual case -- but into the teeth of one of the sharpest market declines in years. This also, is a rare phenomenon. A sustained rise in short interest in the face of a falling market has again occurred on only a few occasions since the early 1930's. These occasions are: Fall, 1932, Spring, 1938, Spring, 1942, Spring, 1949 and Summer, 1953. Each of these points also constituted a major stock market low.

It is, of course, possible that economic events in 1967 will bear out the negative expectations of those who have sold short. However, the historical implication of the recent behavior of the short interest ratio cannot, it would seem, be ignored.

Dow-Jones Ind. 789.47
Dow-Jones Rails 201.50

ANTHONY W. TABELL
WALSTON & CO. INC.