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TABELL'S MARKET LETTER January 13, 1967

There is often, if we would but realize it, a certain ironic humor to the stock market.

On Tuesday night, President Johnson announced, in his State-of-the Union message, that he would ask the Congress to impose a 6% surcharge on both corporate and personal income taxes. This surcharge will mean, among other things, that all of us will have less money to spend and, presumably, invest in stocks during 1967. It means that corporations will earn, probably, some 3% less than they otherwise would have earned. And, on a more sophisticated level, at least in terms of conventional wisdom, the tax increase will provide a braking force on economic activity.

The stock market's response was as follows. On Wednesday, after an initial drop which lasted for one hour, the Dow advanced 8 points on the third highest volume in the history of the Stock Exchange; on Thursday, it advanced another 7 points with volume just barely under Wednesday's figure; and on Friday early profit-taking stalled a 5-point decline and the Dow advanced another 5 points. On all three days advancing stocks led declining issues by a wide margin, and, in the process, all of the popular averages broke out sharply on the upside of trading ranges in which they had been confined for the past 5 months. The whole thing constitutes a superb example of why we use the technical approach to the stock market.

Since the week's action was intimately tied to the tax increase, it is worthwhile to examine the evident economic reasoning behind it. Quite obviously, Mr. Johnson's economic advisers are able to see, as well as the rest of us, the obvious signs of a slowdown in economic activity. However, they seem to feel, in the face of these signs, that the slowdown will be of short duration, perhaps reaching a bottom by the second or third quarter of 1967, and that, at that point, the economy could turn upward again of its own momentum, thus preventing the increase from having any deleterious effect.

The counter-argument would, of course, say that business activity has turned down and we do not, at this early stage, have the wisdom to know how far a downturn may extend. It is, therefore, opponents would say, playing with fire to take any action at this time which might accelerate a downturn.

All of the above, of course, constitutes an interesting discussion for an economic seminar, but it bears little relationship to the day-to-day activity of the stock market. What is important in this case, we think, is not so much the ultimate economic effect of the tax cut, but the cold hard fact of the market's response to it. What the stock market is, in fact, saying by its sharp advance last week, is that it is willing to adhere, at least for the time being, to the Johnsonian idea that the 1967 contraction will be both mild and short. It is also recognizing the fact, both implicit and explicit in the President's speech, that tight money is a thing of the past and that the pressure on common stock prices due to much higher yields available elsewhere will very shortly be eased substantially.

Whether the market will have to reverse these views at a later date is, of course, anybody's guess. From a technical point of view, all of the popular averages have now broken out on the upside of trading ranges in which they have held since August. As noted last week, the upside objectives vary widely for various indices, but for the present let us discuss the market in terms of the Dow. The most conservative upside projections center around the 860-870 range, while more liberal targets vary from 900 to 950. Overhead supply exists in the 870-900 area where the Dow traded repeatedly in late 1964, Summer 1965, and May and June of 1966. It is this supply area that constitutes, really, the next important test for the market. Ability to penetrate this supply would indicate, if not a major extension of the upswing, at least the entrance of the market into a new phase in which the base for a new advance would be laid. Inability to gain much headway at the 870-900 level would raise some rather serious questions. We prefer to think at the moment that the risk of not owning common stocks at this point is at least equal to the risk of owning them. If it appears necessary to take another look at this policy at a future date, we will, obviously, do so.

ANTHONY W. TABELL
WALSTON & CO. INC.

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