TABELL'S MARKET LETTER

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The baby calf spawned last May 26 is beginning to grow horns and display some highly masculine characteristics. In a dramatic burst of strength last week, the stock market, which had been consolidating in a narrow trading range since the end of August, burst ahead on a broad front. The advance, this time, was more apparent in the S&P 500 Stock Index than in the Dow as the S&P reached a new recovery high at 84.31 on Friday whereas the blue-chip index still remained below its September 8 peak of 773.14.

In the course of the advance, the market showed the typical bull-market characteristic of ignoring bad news and concentrating on good. The flames of war fanned the Middle East, yet the market's only response to the conflict was to beat an orderly retreat within the confines of the aforementioned trading range. Then, in response to favorable business news and a less-than-expected rise in the cost-of-living index for August, prices took off on a broad front.

The character of the rally since last May has been good. The present upswing is the fifth minor advance within the context of the intermediate-term uptrend, a factor in itself an indication of strength. (Weak rallies have only one or two "legs".) The corrections following these advances have generally been minuscule. The Dow declined 4% from June 3 - 12 and 7% between June 19 and July 7. A 3.8% drop took place in early August, and the recent decline was only 3.3%. None of these drops have lasted longer than two weeks. The vitality, indeed, has been impressive.

Meanwhile, the market's underpinnings have been strengthened. Our unwillingness over the past month to forecast substantially higher prices (i.e., above the low-to-middle 800's) was based on the fact that only a small minority of stocks possessed worthwhile long-term base patterns. That aspect has been slowly improving over the past few months. A great many stocks still have patterns inconsistent with much higher prices, but the extent of accumulation that has taken place in recent weeks is impressive, and probably, at the moment, somewhere from one-third to one-half of the list shows base formations indicating, at least, worthwhile intermediate moves. We are still, however, inclined to view the intermediate term with some caution. This is based, not only on technical factors, but on the business-and-earnings picture as well. Part of the rally, as we indicated above, was in response to improving business news. But, in this connection, it is well to remember the adage about the stock market's never discounting the same thing twice.

At the end of June, the Dow-Jones Industrial Average had earned $53.43 for the prior 12 months and was selling for 12.8 times those earnings. As September ends, it has moved up some 80 points in the face of the fact that 12-month earnings for the third quarter are likely to be down, perhaps in the area of $52.50. Thus, the Dow p/e has increased from 12.8 to around 14.8.

This sort of action is totally consistent with historical experience. In 46 quarters since 1953 when earnings have declined, the earnings-multiple has moved ahead in 35 of them. The average advance in the p/e in those quarters was almost 12%. The market, historically, recognizes earnings declines as temporary phenomena and is willing to place a premium multiple on lower levels of earnings.

As earnings advance, however, the response tends to be the opposite. Dow earnings have moved ahead in 96 calendar quarters since 1935, and in 65 cases, the multiple declined, the average drop being 7.3%. Even in the minority of cases where the multiple has advanced along with earnings, the average advance, 4%, has been small.

This has some applicability in the present case, since, barring a protracted automobile strike, earnings are likely to bottom out in the fourth quarter and should certainly advance somewhat in the first quarter of 1971. In view of the past record, it is difficult to foresee a Dow multiple at the end of the year of much more than, say, 16 which, assuming earnings of $53, would result in a price of around 850, not too far away from the objectives indicated by our technical work. Further improvement will, it seems to us, require an accelerating rate of business improvement during 1971, and, with the recovery still in its early stages, it is difficult to forecast how fast such improvement may take place.

Dow-Jones Ind. (11:00 a.m.) 761.02
S&P (11:00 a.m.) 84.31
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