TABELL'S MARKET LETTER

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We commented in last week's letter on the astounding lack of participation in the bull market to date on the part of the individual investor -- citing a few figures suggesting that the impetus for the market rise had come almost totally from the institutional sector. In one sense, of course, it is unfair to separate institutional and so-called public trading, since the institution is, in reality, nothing more than a financial intermediary providing a conduit through which public investment funds can be channeled. The behavior of the institutional investor, therefore, is -- in the long run, at least -- dictated by the behavior of the individuals who entrust their funds to him.

This is particularly true of the mutual fund industry. Open-end investment companies are, by their very definition, continuously selling and redeeming shares, i.e., receiving funds from and paying funds out to the investing public. It is, thus, the behavior of that public which must eventually determine the action taken by the mutual fund industry in the market. Recently the behavior of the mutual fund share holder has been a wee bit disquieting, and we suggest that his future actions are worth keeping an eye on.

Since 1954, when the figures first became available, total mutual fund assets have increased from $5 billion to a peak of $54 billion in November, 1968. With the market rise, this figure is again being approached. A goodly portion of this increase has come from the continuous influx of new funds for investment. Never, since 1954, have mutual fund redemptions exceeded mutual fund sales in any one month so that the industry, as a whole, has been in a position of continuously having new cash available for new purchases. In the short run, of course, it can and occasionally has sterilized this cash inflow by building up cash reserves rather than investing the new money. In the long run, however, the industry has been virtually forced to be a net buyer of stocks, a circumstance which has something, at least, to do with the rising trend of prices over the past 15 years.

Over the shorter term, the behavior of the mutual fund public has fallen into a discernable pattern based on stages of the stock market cycle. Historically, that behavior can be divided into three phases, running roughly as follows:

(1) During bear markets, sales generally tend to decline as the public becomes fearful of declining prices. But, as a counterbalance to this, redemptions slough off also, due, apparently, to public reluctance to redeem shares at a loss. Thus, sales declined from $361 million to $133 million in January-September, 1962 but redemptions which had been over $100 million in early 1961 dropped to $73 million at the bear market bottom. In 1966, sales dropped by $200 million, but redemptions again paralleled this decline. The same thing happened in the recent bear market where new sales declined from $875 million in January, 1969 to $303 million in May, 1970. Redemptions, however, also fell, dropping from $396 million to a low of $167 million last summer.

(2) As the market recovers, sales tend to improve rather sluggishly but redemptions increase sharply reflecting, evidently, the willingness of the fund investor to sell when he "gets even". In the first 18 months of the 1962-1966 upswing, redemptions rose from $51 million to $110 million and during the comparable period of 1966- 1967, they increased from $132 million to over $300 million. This is paralleled by the recent experience. Fund redemptions last August were $167 million. From that point, they have risen to an all-time high of $424 million last month.

(3) During the latter part of bull markets, redemptions continue to rise but generally sales begin to advance at a faster rate, increasing the cash inflow of the industry and providing an impetus for continuation on the upswing. This stage has not yet occurred in the present case.

As suggested above, the public's behavior to date has been absolutely normal -- but with a difference. In 1963 and 1967, when redemptions increased as the market advanced, they tended to average around 60% of sales. In the 11 months since May, 1970, they have averaged 75%, and in three months have been in excess of 90%, including the last two months reported -- February and March. The fund industry, therefore, for the past two months, has been in a position where virtually no new cash has been coming in. It has been able, in the short run, to ignore this lack of new money and has been a heavy net buyer, having invested $2.5 billion since August despite a cash inflow of barely $1 billion. This has been done by drawing down on cash reserves which had reached a peak of $4.8 billion last July and are now down to $3.3 billion.

Now these reserves are still at a relatively high level and, based on past experience, the industry can probably draw on almost another $1 billion of this cash. Moreover, at some point, we should enter the third phase referred to above. Thus, sales should pick up and cash inflow should again increase. Until evidence that this is occurring takes place, however, we think the behavior of the mutual fund investor should be watched carefully. If recent tendencies persist, this behavior could well force a change in the historic stance of the fund industry in the market place.

Dow-Jones Ind. (11:00 a.m.) 938.31
S&P (11:00 a.m.) 103.33
AWT:mn

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