TABELL'S MARKET LETTER

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May 7, 1971

Well it finally happened. The crisis, nay, the catastrophe, about which a whole generation of Cassandras has been prating for, lo, these many years, finally took place during the first week of May, 1971. We had, in short, a real live run on the U.S. dollar. In the corridors of Whitehall and the Quai d'Orsay and on the banks of the Rhine, lamps were burning far into the night. In Zurich the gnomes were dancing nervously about their cauldrons. For as the European central banks this week ceased their support of the U.S. dollar, that ultimate horror against which we have long been warned -- devaluation of the dollar in terms of foreign currencies -- came a step closer to reality.

And yet, the average perennial bear of the international money market must have felt, at week's end, much like a member of one of those religious sects who are periodically predicting the end of the world on a specific date, when he awakes on the morning of the Final Judgement to find everything pretty much as before. The Dow-Jones Industrial Average wound up the week modestly lower than it had begun. At last reports from Washington, the dome was still on the Capitol, and on Nassau Street, Princeton, New Jersey, at least, bread lines appeared to be totally absent.

What we are saying, of course, is that the stock market's response in shrugging off the events of the week was probably the correct one. The result of this week's activity in European money markets will undoubtedly be upward revaluation of key European currencies, whatever technical device for accomplishing this is finally chosen. This, in one sense, at least, will constitute the long-heralded dollar devaluation. And yet, the effect of all this on an economy where net exports constitute less than 1/2% of total GNP will probably be something close to nil. A rise in the price of Volkswagens, after all, is hardly calculated to send American Capitalism into a tailspin. There was, however, we think, a message buried in the events of the week and, herewith, our attempt to ferret it out.

We suspect that it is no coincidence that the run on the dollar took place at exactly this point in time, and we think that the trigger for that run was a pronounced swing in U.S. monetary policy which has become increasingly evident in the available statistics for the first four months of 1971. That this policy set off a certain sequence of events in the international money markets is a matter, to us, of little consequence. The implications of the change for the health of the domestic economy could, however, be serious indeed.

Far and away the best short summary of this prospect is posited by Milton Friedman in the May 3 issue of Newsweek. Dr. Friedman begins by pointing out that the rate of growth in monetary aggregates from January to March was the greatest for any two-month period in the past quarter century. This money explosion comes at the end of what had, in our view, been a period of highly rational and successful monetary policy in 1970, during which year monetary aggregates rose at a rate roughly compatible with the physical abilities of the economic system to expand. This rate of monetary growth contributed to an end of the slump in real GNP, a gradually declining rate of inflation, improved profits in the first quarter of 1971 and a recovering stock market. The effects of 1970 policy will undoubtedly continue through 1971, and further economic recovery along with reduced inflation should result, together with stabilized and ultimately reduced unemployment.

And yet, while the essential rightness of last year's policy should have been apparent, there were and still are those, in our political society, who are continuously crying for more. To what extent recent federal policy constitutes acquiescence to these elements we cannot say. But if the trend continues, and we stress the word "if", it can have, it seems to us, only two results, renewed inflation beginning in 1972, and/or another period of monetary restraint in order to undo the damage already done.

Neither of these two effects bode any good for the stock market. Contrary to superstition, above-average inflation, in the short run at least, has tended to produce declining stock prices. And, as we learned all too painfully in 1969-1970, one of the conduits through which monetary catharsis reaches the economic main stream is the stock market. Dr. Friedman points out, and we agree, that two months do not make a trend and that it is entirely feasible for the Federal Reserve to return to the eminently sensible policy of 1970. With the warning of recent months already having been issued, however, future growth of monetary aggregates will bear even more than the usual close watching.

Dow-Jones Industrials (11:00 a.m.) 932.69
S&P (11:00 a.m.) 102.59
AWT:mn

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