TABELL'S MARKET LETTER

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Regular readers of this letter will no doubt be aware that we, as market technicians, have always been more than a little dubious about the applicability of economic forecasting to stock market forecasting. Thus, in recent months, while not denying the great technical strength shown by the market itself, we have remained skeptical about some of the recent economic forecasts which have been offered as a rationale for the market rise. Nonetheless, it is always desirable, we think, to keep an eye on the economic background as it develops and to try to guess what surprises could be in store for us. In terms of potential uncertainties, the present situation is especially interesting.

Economic writers (just as, we suppose, stock market writers) often appear to be frustrated authors of fiction. There is a tendency to create heroes and villians, good guys and bad guys, and, if, later, the good guys fall from grace, why, this is the stuff of which great fiction is made. In much of the writing about the economy in 1968 and 1969, the good guys were unquestionably the so-called monetarist economists, those who tended to emphasize the importance of fluctuations in monetary aggregates as being important to the course of the economy. Their academic dean, Dr. Milton Friedman, was assumed to have the ear of the Nixon administration and George Schultz, one of their number, was firmly implanted in that administration's inner circle. Such bastons of monetary theory as the Federal Reserve Bank of St. Louis and the First National City Bank of New York were widely quoted, and weekly money-supply figures regularly supplied lead stories for financial pages.

All this was not without reason. It was the monetarists who had first forecast that the sharp expansion of monetary aggregates throughout 1967 and 1968 suggested the dangers of a record-setting inflation. The subsequent contraction in the money supply in 1969 also correctly forecast the 1969-1970 recession. Moreover, the monetarists assured us, this contraction would help to bring about a slowdown in the inflation which plagued the economy in the late 1960's.

As 1971 emerged, however, disenchantment set in. The recession -- which the monetarists had correctly forecast and a great many others had not -- had arrived on schedule. But the slowdown in inflation, by early 1971, had totally failed to materialize, and the administration was severely taken to task, especially by non-monetarist critics, for being in the uncomfortable position of presiding over a recession and an inflation at one and the same time. Thus the imposition of the Phase 1 wage-price freeze in August and the Phase 2 price controls in November were widely interpreted as the formal casting out of the monetarists from the administration temple. By the end of 1971, John K. Galbraith, mirabile dictu, was saying kind words about Richard Nixon, and conventional economists were emerging from the woodwork armed with rosy forecasts for 1972.

Meanwhile, back in the banking system, there continues to be a money supply, and its action during 1971 has been interesting. For the first seven months of 1971, demand deposits and currency increased at the annual rate of 11.6%, just about the most rapid increase for such a period in modern times. Since that time, the increase in monetary aggregates has been just about nil. All this has received scant attention from a financial community busily concerning itself with Phase 2.

What it all means, of course, is subject to varying interpretations. If we simply measure the money-supply increase for the entire year 1971, it turns out to be a more-or-less normal 6%. Very recent behavior of the monetary figures indicates mild expansion, suggesting that the 6% rate might continue.

Yet the slowdown of late 1971 at least raises some questions. Comparable slowdowns have occurred seven times in the past since 1947 and five of the seven, with lead times generally running around a year, have led to recessions. Yet that ugly word would certainly be the last to occur to us as we listen to the deluge of optimistic 1972 forecasting.

Now lead times, as monetarists learned in their erroneous forecasts of slowed inflation for 1971, are notoriously imprecise, and we have no way of knowing whether the erratic growth of money supply in 1971 will have any effect at all or, assuming an effect, how long it will take to become manifest. We think it would be folly, however, to proceed on the assumption that the imposition of price controls has ushered in some sort of new era and that fluctuations in monetary aggregates can simply be ignored.

Dow-Jones Industrial (12:00 p.m.) 904.80
S&P(12:00 p.m.) 104.68
AWT:mn

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