TABELL'S MARKET LETTER

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George J. W. Goodman, in an early novel prior to his incarnation as 'Adam Smith', had one of his characters utter an immortal piece of stock market advice. To his offspring who had been bragging about his cleverness in amassing a stock-market fortune, a wise old father rejoined, "Son, never confuse brains with bull markets".

There is, unfortunately, a tendency in many segments of the financial community, not only to equate investment sagacity with the normal bull market process, but also to confuse a number of sacred cows such as earnings growth with that process. A hypothetical example will illustrate.

Suppose an investor, on June 30, 1970, had decided to construct himself a portfolio consisting of six of the widely-recognized growth stocks, Avon Products, Eastman Kodak, IBM, Polaroid, Sears Roebuck and Xerox. He would have every reason to be pleased with his investment results to date. His portfolio value would be up 96%, the first three columns of the table below showing the details.

	Price 6/30/70	Current Price	% Advance	Earnings 6/30/70	Earnings 12/31/71	%Change
AVP	70	124	+77	1.55	1.89	+22
EK	64	120	+88	2.50	2.60	+4
IBM	250	398	+60	8.51	9.38	+10
S	56	115	+105	2.85	3.56	+25
PRD	53	133	+151	2.10	1.86	-11
XRX	73	145	+99	2.26	2.71	+20

The crucial questions is "Why ?", and, unfortunately, most investors with similar portfolios would tend to utter pious declamations about the merits of growth stocks. As the table indicates, however, market gains ranging from 60% to 151% were achieved on earnings gains ranging from -11% to +25%. The bulk of the portfolio gain was achieved, not through earnings growth, but through the normal bull-market process of marking up the price paid for a dollar of earnings.

That this process has advanced to a fairly mature stage is suggested by the table below which compares the current p/e ratio of each stock to its peak p/e ratio for the 1968-1969 period. As can be seen, three of the six stocks are above that peak and the others are close.

	Current Price	Earnings 1971	P/E	Peak P/E 1968-1969
AVP	124	1.89	66	63
EK	120	2.60	46	40
IBM	398	9.38	42	47
S	115	3.56	32	26
PRD	133	1.86	72	76
XRX	145	2.71	54	56

The implication, of course, is that further gains based on the market's willingness to pay a higher price for earnings may be limited. The following table takes 1972 estimated earnings for each of the six stocks, applies the highest multiple from the above table and indicates the price at which each stock would sell based on that multiple. As can be seen, the percentage advances from current levels on this basis are limited.

	Current Price	Est. 1972 Earnings	Peak P/E	Potential Price	% Change
AVP	124	2.10	66	139	+12
EK	120	3.00	46	138	+15
IBM	398	10.50	47	494	+24
S	115	3.90	32	125	+9
PRD	133	1.75	76	133	-
XRX	145	3.10	56	174	+20

Now it should be made clear what the above study is not intended to do. Most importantly, it is not intended to make any judgment, pro or con, as to the current investment merits of the six companies. It is also not meant to suggest that the target prices mentioned in the last table posses any practical value for investment purposes. It is meant, rather, to reiterate a fact of which we should all remind ourselves as the market makes new highs in a two-year-old bull move, i.e., that the purpose of bull markets is to discount rosy futures. It is also meant to suggest that, in the case of such easily-selectable issues as the ones above, the process of discounting may be reasonably well-advanced. The investor's dilemma at this point is that further substantial multiple plays can probably be found only by recourse to less conventional stocks. Such recourse, quite obviously, entails the acceptance of a higher degree of risk.

Dow-Jones Industrial (12:00 p.m.) 965.98
S&P (12:00 p.m.) 109.88
AWT:mn

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