

TABELL'S MARKET LETTER

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As the market fell prey to a slight sinking spell last Wednesday, we were informed by the New York Times on Thursday morning that one reason was "the debate among money managers whether to continue chasing glamour issues with high-price earnings ratios or to concentrate on other areas in the stock market". There may be some doubt as to whether this is a precise explanation for the market's decline, but the existence of such a debate is undoubtedly a fact of life in the financial community at the moment. It will be recalled that we contributed our own two-cents-worth to the controversy in last week's letter, in which we studied the recent market and earnings history of six leading growth stocks. The conclusions reached were roughly as follows: 1) The bulk of the rise from the 1970 lows was due to a markup in multiples rather than earnings growth. 2) This process had brought those multiples to or close to historic peaks. 3) Therefore, further appreciation opportunities in these issues based on the market's willingness to pay more for earnings might be limited. The further conclusion, of course, was that the aggressive investor was forced, at this stage, to seek above-average upside potential in a more volatile and risky class of securities.

A response to the dilemma on the part of some analysts has been to take another look at cyclical securities. The following table shows the price/earnings ratios, based on 1971 and 1972 estimated earnings, for four typical such issues.

Stock	Current Price	Earnings 1971	Earnings 1972-E	P/1971 Earnings	P/1972 Earnings
Alum. Co. of America	55	\$2.45	\$2.75	22	20
Bethlehem Steel	32	\$3.14	\$4.00	10	8
International Paper	39	\$1.55	\$2.25	25	17
Phelps Dodge	44	\$3.62	\$3.80	12	11

As can be seen, in two cases, at least, the multiples are modest by any standards. International Paper's multiple is not high based on the earnings improvement anticipated for 1972, and the relatively high price being paid for Alcoa can be explained by the fact that the substantial earnings improvement is not expected before the second half of this year. In any case, the multiples are considerably lower than those of the growth issues discussed last week. It is at least plausible to reason, therefore, the economy being in the early stages of a cyclical recovery, that substantial earnings gains in issues of this sort may result in considerably higher prices.

Plausible but not necessarily probable. The last major cyclical recovery the economy has enjoyed ran from 1961 through 1966. The following table shows the earnings of the four issues for the 12 months ended June, 1961 and the 12 months ended December, 1966. As can be seen, the gains were substantial. The percentage increases in earnings for the period compare favorably with the increases for the same period in such growth stocks as IBM (114%), Eastman Kodak (171%) and Sears Roebuck (72%).

Stock	Earnings 6/30/61	Earnings 12/31/66	% Increase
Alum. Co. of America	\$1.70	\$4.83	184
Bethlehem Steel	\$1.50	\$3.72	148
International Paper	\$1.52	\$2.40	57
Phelps Dodge	\$2.00	\$4.05	102

Unfortunately, for the same period, market gains in the stocks were either nominal or non-existent. The following table shows the prices of the four issues in June, 1961 and in December, 1966, together with the price/earnings ratios at the time. The obvious rationality of the market's treatment of cyclical issues is apparent. While it is willing to place a premium multiple on cyclically-depressed earnings, it tends to place a much lower multiple on peak earnings. Thus, the investor who buys cyclical stocks at this point must convince himself, not only that earnings are going to improve, but, that, after the appropriate multiple markdown, there will be room left for price appreciation.

Stock	Price 6/30/61	P/E Ratio	Price 12/31/66	P/E Ratio	% Price Change
Alum. Co. of America	72	42	90	19	+25
Bethlehem Steel	42	28	36	10	-14
International Paper	31	20	29	12	-6
Phelps Dodge	30	15	38	9	+26

Like last week's study, the above is intended to be only a generalization. Quite obviously, we think a number of investment current opportunities can be found in industries which might fall into the "cyclical" classification. We do not think, however, that, if most growth stocks are fully-priced, it is necessarily a corollary that most cyclical issues are relative bargains.

Dow-Jones Industrial (12:00 p.m.) 969.97

S&P (12:00 p.m.) 109.29

AWT:mn

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