TABELL'S MARKET LETTER

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We indicated in last week's letter the fact that we were becoming somewhat less than enchanted about the technical performance of the stock market, citing at some length the evidence of technical deterioration which had been manifesting itself since approximately last March. We confess, looking back at it, that we were somewhat surprised when this weakness began to emerge and yet, probably, we should not have been, for the occurrence of weakness as the Dow moved above the 920 level in March of this year was totally consistent with the hypothesis as to long-term market behavior which this letter has held for the past two years.

We have repeatedly suggested that the single, most significant technical occurrence of the post-war period was the violation, in 1969-1970, of the secular uptrend channel which had contained the major market averages since 1942. As we said in this space almost a year and a half ago, on January 15, 1971, "the equity market from 1942 until 1966 was buoyed by a secular uptrend advancing at the rate of about 9% a year on the Dow. Sure, there were bull markets and bear markets within the framework of that uptrend, but the bull markets were long and dynamic and the bear markets, although painful, short and quickly recovered. There is real evidence, at the moment however, that the secular uptrend is no longer with us. Indeed, computed from 1966, the slope of the DJIA has been virtually zero. The most statistically accurate description of the market on average for the past five years is that it is a wide, flat trading channel." Absolutely nothing has happened in the past 18 months to challenge the accuracy of that description.

Let us examine the action of the major averages since 1966 a bit more closely. For the Dow-Jones Industrial Average, the major secular trend can be described by a line which has been declining at the rate of approximately .017 points per trading day since January 1, 1966. At that time, the central value was 879, and the slight downward slope since then now makes the central or normal value for the Dow approximately 852. The expected fluctuation about this central value can also be computed, using a device which statisticians call the standard error. In the case of the Dow, this is about 69 points which means that, during 1966-1972, the Dow spent approximately two-thirds of its time within a range of 69 points plus or minus the normal value and 95% of its time within 138 points (twice the standard error) either way of its normal value. Looked at another way, the Dow moved above its range of normal value at approximately 920 and would reach a range of extreme overevaluation at about 990. Conversely it would become undervalued at 783 and extremely undervalued at about the 714 level.

For the S&P 500, the picture is a bit more bullish. Unlike the Dow, its action since 1966 can be described by an upward-sloping channel rising at the rate of .007 points per day. Thus, while its central value in 1966 was 87.77, it has increased, at the moment, to 98.84. The standard error is approximately 7.18 points so that the index becomes overvalued at about 106 and extremely overvalued at 114. The range of undervaluation begins at 91 and reaches extreme undervaluation at 83.

Viewed in this light, the fact that the market remained in a state of almost perfect health through March, 1971, at which point it began first to show deterioration, is hardly surprising. The Dow first closed above the 920 level during the last week in February, and it was shortly after that that the weakness we referred to last week began to manifest itself. The S&P 500, likewise, moved above the 106 level at precisely the same time.

Now all of the above is nothing more than a description of what has taken place in the past. If we choose to believe that the underlying process determining stock prices has changed dramatically from that of 1966-1972, it is totally worthless. However, as we stated above, we are willing to proceed, until confronted with evidence to the contrary, on the hypothesis that seven years of statistical evidence cannot be ignored in a future projection.

We have said in the past that all too many investors are, consciously or unconsciously, basing their behavior on the market pattern which prevailed between 1942 and 1966 rather than the one which has obtained from 1966 to date. We intend to discuss the market-strategy implications of our hypothesis more fully in future issues of this letter.

Dow-Jones Industrial (12:00 p.m.) 935.73
S&P (12:00 p.m.) 106.92
AWT:mn

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