

TABELL'S MARKET LETTER

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We noted last week that the advocate of growth stock investment could produce a highly impressive record of results over the past two decades. An investor of \$15,000 in IBM in 1949 would be a millionaire today, and the investor who placed a like amount in Xerox in 1958 would now be worth \$3 million. It is difficult to argue with such numbers.

Yet it is perhaps worthwhile to take a hard look at the record, using as an example the most immaculate of vestal virgins (as one analyst called growth favorites this week), International Business Machines.

	%	Comp. Annual		%	Comp. Annual	
	Price	Change	Growth Rate	Earnings	Change	Growth Rate
1949	6.25	-	-	.33	-	-
1961	150	+1564%	26.5%	1.96	+494%	16.0%
1972	400	+ 167%	9.4%	11.03	+462%	17.0%

The table above compares IBM's price and its earnings for three years, 1949, 1961, and 1972. What is worthy of note is the compound annual growth rate of earnings. It was better for the period 1961-1972 than for 1949-1961. Yet, for the first period, IBM increased 1564% at a compound annual rate of over 26%, whereas since 1961 it has appreciated at an above-average but hardly astonishing rate, 9.4%.

I. B. M.	D. J. I. A.	Ratio					
Price	Earnings	P/E	Price	Earnings	P/E	of P/E's	
1949	6.25	.33	18.9	200.13	23.54	8.5	2.22
1961	150	1.96	76.5	731.14	31.91	22.9	3.34
1972	400	11.03	36.2	1020.02	65.00	15.7	2.30

The statistics above document some of the reasons for this performance disparity. In 1949 IBM was selling for 18.9 times earnings, and the Dow-Jones Industrial Average was selling at 8.5 times. Thus, IBM's multiple was 2.22 times that of the Dow. By 1961 the Dow multiple had almost tripled, to 22.9, and IBM, by then everyone's darling, was selling at 3.34 times the Dow multiple, producing a p/e ratio of 76.5. Since that time the market forces have been working in the opposite direction. The Dow p/e has declined to 15.7 and IBM has retreated to almost the same multiple in relation to the Dow that it had in 1949.

POINTS CHANGE DUE TO	1949 - 1961	1961 - 1972
Earnings Change	+30.75	+694
Improvement in DJIA P/E	+62.75	-266
Change IBM P/E as % of Dow P/E	+50.25	-178
Total Points Gain	143.75	250

If we break the price changes for IBM over the two periods into those due to earnings growth, changes due to a shift in the Dow p/e, and changes due to shifts in IBM's p/e relative to that of the Dow, some interesting numbers emerge. Only 30 points of IBM of the 143 point gain from 1949 to 1961 was due to earnings improvement and, had it not been for the other factors, the stock would have sold at 37 not 150. Almost half the 1949-61 gain came from a change in the general-market price/earnings ratio and more than a third from a change in IBM's relative position. By contrast, for the 1961-72 period, had IBM retained its 1961 multiple, it would have tacked on 694 points to sell for 844. However, the drop in the Dow knocked off 266 points of this gain and the change in relative position another 178 points thus making the total gain only 250 points.

The only point that these figures underscore is that the truly spectacular gains in growth stock investment come from purchase early in the growth curve—not later. IBM, in 1949, it will be recalled, had yet to produce its first computer and in 1958 Xerox was a tiny over-the-counter company with a few patents on a largely untested process. By the time the growth process is finally recognized and companies achieve the size of IBM, now a \$9 billion operation, it becomes less and less logical to project the growth curve infinitely into the future, and thus a logical process of multiple erosion occurs. There is moreover scant evidence that the process of general erosion of multiples, as shown by the decline of the Dow p/e since 1961, is not a continuing process. With this factor working against the investor, rather than in his favor as it did over the 1961-71 period, it becomes all the more important to select stocks early on the growth curve. This, however, is a process which poses problems, some of which we hope to discuss next week.

Dow-Jones Industrial (12:00 p.m.) 966.44
S & P (12:00 p.m.) 113.96

AWT:rk

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