TABELL'S MARKET LETTER

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A year and a half ago, we published a series of four letters examining some of the implications of the then-popular theory of growth stock investment. On April 19, 1973, we published a summary and conclusion based on those four letters. That summary is reprinted herewith, verbatim and in its entirety.

There is, of course, nothing new under the sun. The following quotation is an appropriate summary of what we have, in our series, indicated was taking place over the past few years. "Selectivity took on a new character by reason of the overshadowing emphasis placed on expected future growth as the prime criterion of an attractive investment. There was nothing wrong with these . . ideas, except that it was almost impossible not to carry them too far. With encouragement from the past and a rosy prospect in the future, the buyers of 'growth stocks' were certain to lose their sense of proportion and to pay excessive prices." The above is not Anthony Tabell writing in 1973 about 1971-72. It is Benjamin Graham writing in 1951 about 1928-29.

As readers may have gathered from our previous letters, we find ourselves, on this issue at least, comfortably in Dr. Graham's camp. But, if mindless projection of growth rates is not the simple key to investment success, what is an alternative philosophy? We offer herewith three principles: 1) Two and two make four. 2) There are no "one-decision" stocks. 3) Investor confidence varies more than earnings. Let us examine some of the implications of these three suggestions.

It was Bernard Baruch who first suggested that in periods of market optimism it was necessary to repeat to oneself that two and two were four. We are, in other words, willing to accept the intuitive conclusion that, when large numbers of buyers are agreed that a given method of investment is a sure road to success, that method cannot prove viable over the long term. The enforcement of this principle is the function of the marketplace, and it is our belief that the market will be no less efficient in this task in the future than it has been in the past.

It should be made clear that what is being said here implies no criticism whatever of the fundamental merits of recognized growth issues, suggests that they should not sell at some premium over other issues or affirms that they cannot under any circumstances be attractive purchase candidates. What we are suggesting, along with Graham, is that the concept that such issues represent appropriate investment vehicles for conservative accounts, regardless of the price being paid, is, to put it mildly, ludicrous.

Secondly, we think the suggestion that there exists a class of "one-decision stocks", where all that is necessary is to buy and hold, constitutes an abdication of the investment manager's responsibility. Were the investment manager perfect, his initial selections for purchase would, of course, be only those stocks which were going to provide the maximum long-term rate of return, and these could be held effectively indefinitely. Investment managers, however, are far from perfect. Each initial purchase memorializes the manager continually to decide whether to hold or not to hold, depending upon whether the original expectations are being fulfilled and to what extent the market price discounts these expectations.

Finally, as we have pointed out, the biggest factor in price change, over relatively long periods of time, tends to be caused not by earnings but by investor confidence in those earnings -- this confidence being most readily expressed by the statistic of the price/earnings ratio for individual stocks. This fact has two implications. The first provides the reason for our conviction, which will surprise no one, that technical analysis is an indispensible factor in the investment decision-making process. It is equally important in evaluating common stocks to have some idea of what the market is likely to pay for future earning power as it is to forecast what that earning power is going to be. Technical work, we think, is a most useful guide in making such a projection.

The second implication of investor confidence variability is that price level, in relation to earnings and in turn to comparable valuation of other stocks, must be a prime criteria in investment selection. It is axiomatic that a stock having a low multiple, thus suggesting low investor confidence, has more potential on the upside should investor confidence increase and less risk on the downside should it continue to deteriorate. Willingness to ignore the price being paid, even in companies of the most pristine quality, involves, in our view, another abdication of the investment manager's responsibility by reason of the assumption of unnecessary risk.

It may be suggested, of course, that recent markets have hardly tended to prove the soundness of these tenets vis-a-vis the simple-minded growth approach and, indeed, may even have suggested the opposite conclusion. We continue to believe, however, that the principles above represent viable guideposts to a successful investment philosophy.

Dow-Jones Industrials (12:00 p.m.) 706.82
S & P Comp. (12:00 p.m.) 73.24
Cumulative Index (8/22/74) 419.19
AWT/jb

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