

# TABELL'S MARKET LETTER

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MEMBER AMERICAN STOCK EXCHANGE

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After breaking sharply into new lower territory a week ago, the stock market rallied sharply last Friday and, after three days of consolidation, extended the advance with a 22-point rally on Thursday. For the moment, we continue to hold the view expressed in last week's letter that lower prices may well be seen but that said lower prices will be not that much lower than the recent lows and that their aftermath will be, at least, an assault on the old high in the upper 800's on the Dow.

Whatever the near term vicissitudes of the stock market, there are emerging, in our view, a number of grounds to warrant longer-range optimism. Basically, the aggregate of stock prices is determined by two factors, earnings and investor confidence --- expressed in the multiple that the stock market is willing to pay for those earnings. As we all know, that investor confidence reached its all-time nadir last fall at the same time earnings were reaching all-time peaks. The P/E ratio for the Dow was, at that point, the lowest it had ever been since earnings for that Average have been recorded. Since last fall's lows, the Dow multiple has risen noticeably due to the combination of rising prices and lower earnings, but on a cyclical basis, an astounding amount of room remains on the upside.

In addition, we think, there are grounds for optimism as to the future of corporate profits. As the recession bottoms, we think it axiomatic that the Gross National Product will rise in the second half of 1975 and on into 1976, at least in dollar terms. The question, of course, is what percentage will corporate profits constitute of that rising GNP.

Now, corporate profits as a percentage of GNP is a statistic that has behaved similarly in most economic cycles. The percentage has reached a low in each recession in the postwar period and has tended to expand with the succeeding business expansion. Generally, it has tended to peak out well in advance of recessions and has been a pretty fair leading indicator of such recessions. The following table shows the pre-recession high for profits as a percentage of GNP, the number of quarters lead on the beginning of the subsequent recession and the recession lows for each of the five recorded postwar recessions, plus the current one.

	Pre-Recession High		No. of Qtrs Lead	Recession Low	
	Year-Qtr	Profit as % GNP		Year-Qtr	Profit as % GNP
Nov 1948-Oct 1949	1947-3	9.26	6	1949-4	7.10
July 1953-Aug 1954	1950-4	11.00	9	1953-4	4.60
July 1957-Apr 1958	1955-4	6.92	5	1958-1	4.55
May 1960-Feb 1961	1959-3	6.33	3	1961-1	4.85
Nov 1969-Nov 1970	1965-4	6.94	15	1970-4	3.70
??? 1974-??? 1975	1974-3	6.66	0	1975-1	4.40

On their face, the statistics do not present much grounds for optimism. The last four business expansions have produced similar peaks in the series, and most recessions have produced similar lows. We think there are grounds for encouragement for two reasons, however. One is that profits will have probably bottomed out in the current recession at higher levels than the all-time lows reached at the bottom of the 1970 recession, and secondly, that on the expansion into the third quarter of last year profits continued to expand as a percentage of GNP right up until the moment the economy turned down, rather than leading the downturn.

It may well be asked, of course, why the profits percentage should expand from the 4.5% - 6.9% range which has characterized it since the early 1950's. We think a justification can be made on the grounds that profits are undeniably understated, since years of inflation have rendered depreciation charges woefully inadequate. There is no way that current depreciation allowances could cover the replacement cost of current plant. Under these circumstances, we can foresee distinct upward pressure on prices, and we have, indeed, seen an indication of this in the rise in commodity prices despite the obvious recessionary characteristics of the economy during the first half of this year. We think this upward pressure could exert a long-term expansionary force on profit margins and, ultimately, on profits and stock prices.

Dow-Jones Industrials (12:00 p.m.) 832.99

S & P Comp. (12:00 p.m.) 86.70

Cumulative Index (8/28/75) 486.67

AWT/jb

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