TABELL'S MARKET LETTER

Delafield, Harvey, Tabell

909 STATE ROAD, PRINCETON, NEW JERSEY 08540

DIVISION OF

Janney Montgomery Scott Inc.

MEMBER NEW YORK STOCK EXCHANGE, INC
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Those who seek out news events as an explanation for the behavior of the stock market have been having a hard time of it lately. Paradoxically, the culprit in the present instance has not been a shortage of news events. Indeed, there have been plenty of those. We have had, among other things, the declining dollar, the coal strike, Mideast hostilities, etc. The problem has been, rather, the market's response to these events or, more precisely, its lack of response. The market, as those of us who make a living following it are painfully aware, has done, in the past few weeks, practically nothing. There has, in other words, been a total lack of response on the market's part to events which, in other times and at other places, might have jarred it into violent movement.

In this sort of atmosphere, the upward move of some eight points, which took place in the Dow on Tuesday and Wednesday, was perhaps of more than passing interest. We were assured by various pundits that this strength was due to the Department of Commerce's release on that day of the Consumer Price Index for February, which stood at 188.3% of its 1967 average, a rise of 0.6% from the January figure before seasonal adjustments. This rise was reputed to have been of a lesser magnitude than the financial community was expecting, thus triggering the minor rally in the stock market.

The conventional chain of reasoning, which suggests that moderation in inflation is bullish for stock prices, is complex and a bit tenuous. It posits that renewed inflation will cause a response on the part of monetary authorities in the form of tighter money or slowed-down monetary growth. This, in turn, is supposed to produce higher interest rates which are then supposed to affect stock prices in a negative direction. Presumably, an abatement of inflationary pressures makes the Fed less inclined to act in this pernicious fashion and is, therefore, stimulative of equity prices. Never mind that all the links in the foregoing chain can be criticized both theoretically and empirically. It has, over the past year or so, provided a reasonably good explanation of the market's short-term behavior.

If it is, indeed, fear of inflationary pressures which is currently depressing the market, it may be that we have a feature built into the current price structure which is more apparent than real. In contrast to what seems to be a widely-prevailing impression, it is, at least, an arguable premise that a) the economy's recent progress in combatting inflation has not been all that bad and b) that the prospects for the immediate future, at least, may be somewhat better than the conventional wisdom envisions. Let us examine first of all the recent record.

One plausable view of the Consumer Price Index is as an annualized six-month rate of change. Using a change rate suggests the pace at which prices are actually growing, and a six-month period tends to smooth out shorter term fluctuations. On this basis, the most recent record has been rather good. The rate of change for the six-month period ended June, 1977 was an annualized 9.0%. This figure declined sharply throughout the latter half of last year, reaching an annual rate of 4.4% in December. For the past two months, it has increased, but not seriously, and the February figure represents a 5.4% annual rate of change. This is not terribly out of line with the level which prevailed throughout all of 1976 and, indeed, is a considerably lower rate of increase than tended to prevail in the post-recession period. Indeed, at no time since the early part of the 1960's have we seen long periods of a better performance on the part of growth in consumer prices.

If recent action is not that unsatisfactory, what are the prospects for the future? We have, in the past, confessed our own bias in the direction of the belief that money-supply growth is the most important determinant of price change. As an outgrowth of this thinking, we have stated our belief in the efficacy of a "neutral" monetary policy, one in which short-term changes in the money supply are held within as narrow a range as possible. Strangely enough, for six years now, there has been some evidence at least that this sort of policy is being followed. The month-to-month change in the six-month average of the broadly defined money supply (M2) has been fluctuating for the most part in a narrow band on either side of 0.8% per month, the only exception being a protracted period of slower growth during the 1974 recession. Now it is arguable that this rate is perhaps too high and, indeed, is suggestive of price increases at approximately a 5% annual rate. Strangely enough, it is just this sort of behavior, for the most part, that we have been having.

The point is that there have recently been none of the wide swings in monetary change which characterized the early 1970's, and which may have been responsible for inflation in the double-digit range. Indeed, the steady rate of monetary growth could, given time, continue to moderate the rate of inflation as it was apparently doing throughout the latter half of last year. Under these conditions, anticipated inflationary pressures, which may be built into current stock-market levels, might very well be illusory.

Dow-Jones Industrials (12:00 p.m.)	756.54	ANTHONY W. TABELL
S & P Composite (12:00 p.m.)	89.08	DELAFIELD, HARVEY, TABELL
Cumulative Index (3/30/78)	681.424	

AWT/jt