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
MEMBER AMERICAN STOCK EXCHANGE

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In the hope that it may be useful in today's market environment, we offer, herewith, a discourse on elementary financial mathematics.

The stock market has been rallying of late in response to lower short-term interest rates, albeit the unprecedented bond-market rally of this spring appears now to be entering a correctionary phase. Much of the bond-market strength, however, has been concentrated in short-term instruments, and long-term bonds are still priced to yield relatively generous returns on an historical basis. A reasonable working estimate of yields currently available from taxable bonds of high quality would be 12%. Stocks, by contrast, provide current returns nowhere nearly so generous. How, then, to justify the purchase of stocks at current levels and, by extension, the sharp rally in the stock market since last March, at a time when the prospect for dividend improvement is hazy at best?

The obvious justification is that bond income remains fixed while stock dividends presumably will grow. This argument can, of course, be pushed to excess, as it was, for example, in the early 1970's. In considering the purchase of a low-yielding stock versus a higher yielding bond, two key questions need to be asked. The first is how many years of dividend growth will be required before the yield for the common based on purchase price is equal to the presently available bond yield. The second is how many years will be required before the total return from the equity investment will equal that which would have been available from purchase of the bond.

Growth Rate/ Current Yld.	2%	4%	6%	8%	10%	12%	14%	16%	18%	20%
1%	126/200	64/101	43/69	33/52	27/42	22/36	19/31	17/28	16/25	14/23
2%	91/151	46/ 77	31/52	24/40	19/32	16/27	14/24	13/21	11/19	10/17
3%	71/121	36/ 62	24/42	19/32	15/26	13/22	11/19	10/17	9/16	8/14
4%	56/ 99	29/ 50	19/34	15/26	12/22	10/18	9/16	8/14	7/13	7/12
5%	45/ 81	23/ 41	16/28	12/22	10/18	8/15	7/13	6/12	6/11	5/10
6%	36/ 65	18/ 34	12/23	10/18	8/15	7/13	6/11	5/10	5/ 9	4/ 8
7%	28/ 52	14/ 27	10/19	8/14	6/12	5/10	5/ 9	4/ 8	4/ 7	3/ 7
8%	21/ 40	11/ 21	7/15	6/11	5/ 9	4/ 8	4/ 7	3/ 7	3/ 6	3/ 6
9%	15/ 29	8/ 16	5/11	4/ 9	4/ 7	3/ 6	3/ 6	2/ 5	2/ 5	2/ 4
10%	10/ 19	5/ 11	4/ 8	3/ 6	2/ 5	2/ 5	2/ 4	2/ 4	2/ 4	1/ 3

The table above attempts to answer these questions. The column headings show various hypothetical dividend-growth rates and the row headings show various assumed current stock yields. For each junction point, the figure to the left of the slash shows the number of years required until dividends grow so that the yield on purchase price for a stock purchased at the current yield shown is equal to 12%. The figure to the right of the slash shows the number of years required for the total return on the stock (assuming reinvestment of dividends) to equal that of a 12% bond (assuming reinvestment of interest). To cite an example, a stock currently yielding 5%, with an anticipated dividend growth rate of 10% annually, would begin to yield 12% on cost after 10 years. After 18 years, the total return would be equal to that of a 12% bond purchased at the same time.

How does this all work out in terms of actual yields available today? As the most simple-minded possible example of available stock yields, we examined the dividend figures for the 20 largest companies on the New York Stock Exchange, taken in terms of market value, with no more than one representative of any single industry allowed in the sample. The average current yield for those 20 companies is 5.14% with a range between 1.1% and 9.5%. The average historical dividend growth rate has been 11.075% measured from the final quarter of 1969 through the first quarter of 1980. The range of growth rates has been from 2.5% to 23%. A theoretical portfolio constructed using those parameters would, after nine years, provide a yield on cost in excess of 12%. After 16 years, the total return would exceed that of a 12% bond assuming reinvestment of income in both cases.

It should go without saying, of course, that the growth rates cited above are historical, and future projection is, at best, hypothetical. It should also be noted, however, that the above example considers income only and not potential capital gains from stocks, which presumably would accrue over the long term along with dividend growth. It is interesting, however, that if historical dividend growth rates can be projected into the future, over a reasonable period, the income from high-quality stocks might well exceed that of first quality bonds even at current near-record interest rates.

ANTHONY W. TABELL
DELAFIELD, HARVEY, TABELL

Dow-Jones Industrials (12:00 PM)	886.01
S & P Composite (12:00 PM)	117.11
Cumulative Index (7/10/80)	885.00

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