TABELL'S MARKET LETTER

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April 30, 1982

Studying stock market history has, to us, always been fascinating because it has always constituted a blend of the new and the old. It is, essentially of course, a product of the collective action of human investors subject to the same emotions that have afflicted humans, presumably, since Adam. Yet simple-minded analysis of historical data often comes to grief because peculiar circumstances produce trading patterns that have previously never -- or only rarely-- occurred.

An instance is 1976-1978, a conventional bear market fitting neatly into the major four-year-cycle pattern which had prevailed back to the inception of the Republic and also into the order of swing magnitude that has existed for the past eight years. However, 1976-78 also produced a phenomenon that was historically unique, that of secondary issues rising in the face of a sharply falling market, something that a close study of market history revealed had not occurred previously in this century.

It is at least conceivable that such a relatively unique pattern is tracing itself out at the present time. 1981-82 has seen what, like 1976-78, was a conventional bear market in the averages, running at least through last September. There followed a six-month period of sideways action, an event unusual if not entirely unprecedented, followed by a new low early last month. That decline, however, failed to follow through and has been superseded, at least through midweek this week, by a burst of market strength. It remains, of course, possible that this constitutes only another interruption preceding a test and/or penetration of the March lows. We have felt for some time that this interpretation was appropriate, and we are, at this stage, still not ready to abandon it. At the same time, it cannot be denied that the lack of any substantive and continuing downside pressure since last September has caused improving technical patterns to manifest themselves in large numbers of stocks.

1976-1978 was dubbed, at the time, the two-tier market, and it is just such a pattern which may once again be emerging -- with the components of the two tiers in question unsurprisingly quite different. The tier showing superior strength, with most components having manifested sharp rises since last Fall, consists of a diverse group of issues such as Banks, Insurance Companies, Utilities, Foods, Drugs, etc. Conversely, the bear market over the past year-and-a-half has been led by Energy and Commodity issues. It is not hard to find a common denominator unifying each of the two tiers. The latter are the classic inflation hedges; the former, uniformly, are those issues which may benefit, in one way or another, from the abatement of inflation.

It can hadly be accidental that this phenomenon is becoming evident at a time when the Consumer Price Index has just fallen, on a month-to-month basis, for the first time in 17 years. Quite obviously this event is dramatic. It is also, in our opinion, not a fluke. It is, in fact, part of an ongoing pattern of a reduced rate-of-increase in the CPI going back to last October. Adminstration forecasters were accused of wide-eyed optimism at the beginning of the year for suggesting that 1982 inflation might be under 6%. Three months later, something on this order has now become the consensus forecast, and it is probably far too high. If the average inflation rate of the past six months prevails for the remainder of 1982, the year's rise in the CPI will be on the order of 2½%. We would suggest that a rate even closer to zero would not be a bad long-shot bet.

Stock prices, and the prices of financial assets in general are, in our view, just beginning their adjustment to this drastic change in economic circumstances. This adjustment, we suspect, is far from over. It is difficult to accumulate long-range data on shifts in market preference between inflation and disinflation issues specifically. However, similar shifts in preference between broad general market areas have generally tended to persist over long cycles, on average four to six years. We may, in other words, be living with the two tiers that have developed in 1981-82 for quite some time.

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AWT:rs

Dow-Jones Industrials (12:00 p.m.) 846.56
S & P Composite (12:00 p.m.) 116.42
Cumulative Index (4/29/82) 1132.18