TABELL'S MARKET LETTER

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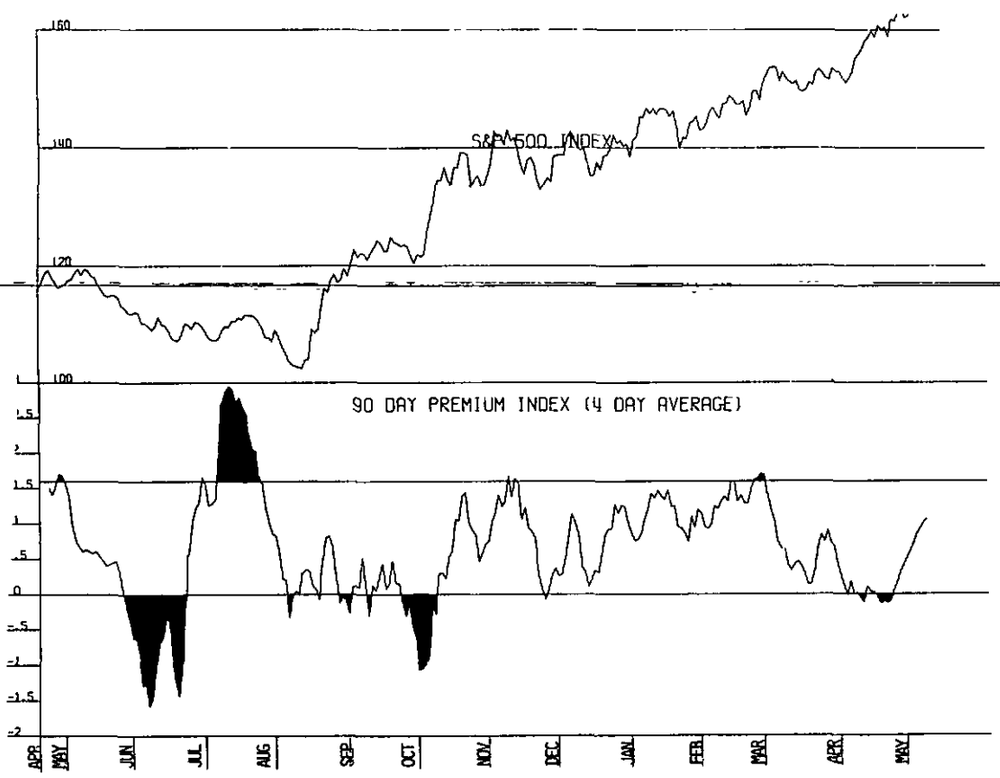
When the history of Wall Street for the past decade or so is finally written it may come to be known for the proliferation of new financial instruments. Taking only equity-related devices, we have witnessed, first, the birth of options followed by interest-rate futures, stock index futures, and finally options on futures.

Insofar as the technican is concerned, these instruments represent newly available numbers, and it is his job to analyze any and all numbers relating to the stock market. In this connection, we were asked to give a talk last week before the annual seminar of the Market Technicans Association on the relationship of stock-index-futures prices indices to the indices themselves. We will try here to summarize some of the conclusions reached.

It is easy to theorize where a stock-index-futures contract should sell, given the current interest-rate structure. Basically, it should sell for a premium over the actual index, depending on expiration date and gradually eroding to zero as expiration approaches. Historical analysis of the data, however, suggests that it does not, in fact, do so. By contrast, index-future prices seem to behave as a sentiment indicator and, apparently, as an indicator of uninformed sentiment. They tend, in other words, to sell at excessive premiums at short-term market highs and at low premiums or, often, at discounts at market lows.



The above graph shows the S & P 500 over the past year, together with an invention of ours called the 90-day premium index, which is simply an average of the percentage premium or discount on the two nearest futures contracts for that index, weighted according to their time to expiration. The periods of discount and of excessive premium are shaded. It is interesting to compare the extreme values on this index with the short-term peaks and troughs of the S & P 500 itself. Note, for example, the period, August-October, 1982. A few days prior to the August low, index-future premiums moved to discounts and continued to remain at generally low values all the way through the steepest part of the rise. Premiums did not become excessive until mid-November, coincident with the first short-term top of any significance in the current bull market.

Both the tops and the bottoms of the trading-range swings between November and January tended to be signaled by extreme values for premiums, and the final extreme high value was reached in late February, just before the market flattened out prior to its recent rise. Interestingly, just prior to that rise, futures again began selling at a discount, signaling the most recent upward leg. Their current value is now neutral.

Whether this relationship will remain, as investors become more used to interest futures, is a point which will remain moot. However, for the time being, at least, the technician would appear to have gained a new short-term indicator of some value.

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AWT:rs

Dow-Jones Industrials (12:00 p.m.) 1187.40
S & P Composite (12:00 p.m.) 161.55
Cumulative Index (5/19/83) 190.27