TABELL'S MARKET LETTER

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December 28, 1984

In reviewing the stock market year 1984, we alluded last week to the fact that it was extremely difficult, even with the complete history of that year behind us, to place it in the framework of a cyclical pattern. This, we suggested, made the formulation of a 1985 forecast somewhat difficult. This can be illustrated by indicating that the only thing that cycle theory suggests about 1985 is that it is unlikely to be like last year, one which saw a change in the Dow of less than 5%. It seems probable, in other words, that 1985 will close with the averages at a figure significantly different from current levels. It is, however, difficult to decide whether that figure will be higher or lower.

Let us hasten to say that we are fully aware of the total uselessness of the above statement. Nonetheless, an examination of how we arrived at it may be of some help in formulating a more coherent forecast for 1985, or at least --- and this should be the product of a forecast --- a rational investment policy to be followed as we enter that year.

In reviewing 1984 last week, we suggested that it could be interpreted in terms of three possible market scenarios: (1) a bear market which began in late 1983-early 1984 coincident with the highs in most popular averages; (2) a bear market which began last month when those highs were tested; and (3) a continuing bull market. Let us start out by affirming that the first of these seems inconsistent with the present evidence. We think the fact that, at its November high, the Dow was only a bit more than 40 points, some 3½%, below its year-earlier peak, plus the fact that large segments of the market moved on to new highs in the latter part of 1984, make the late-1983 and late-1984 peaks technically equivalent. Thus the 1984 experience can be viewed in one of two ways, as an interruption in an ongoing bull market or as a broad top formation preceding a bear market whose most vicious effects will be felt in 1985. Now the only thing we know for certain about the present cycle is its starting date, August, 1982. If it topped in November, its advancing phase will have lasted for 27 months. If a top is reached sometime in 1985 the advancing phase will have lasted between 29 and 40 months, and a continued 1985 market rise with a top in 1986 will result in an advancing phase in excess of 40 months.

Since the Dow was first computed in 1897, we have the history of 23 past major cycles to guide us. On the face of it, the argument that the market is currently in the process of topping out looks fairly strong. Thirteen of the previous 23 cycles have had advancing phases of 27 months or less. Closer examination reveals, however, that 10 of those 13 occurred prior to 1942 and thus may be less than reliable guides in the current case. The opposite reasoning is true for the ongoing bull-market theory. Only 6 of the 23 cycles have advanced longer than 40 months. However, five of these six were in the post-war period, and they constituted half of the 10 cycles recorded within that period. The least likely scenario seems to be that of a market topping within the year 1985. Only four of 23 cycles have advanced for a period between 28 and 40 months. Again, however, two of the three most recent cycles did in fact fall into that category, the 32-month advance from May, 1970 to January, 1973 and the 37-month advance from March, 1978 to April, 1981.

All this helps explain, we trust, our arrival at the dilemma outlined in the first paragraph of this letter. The one redeeming feature of this dilemma is that it should be resolved fairly shortly, in all probability within the first couple of months of the new year. We have, in effect, as we have noted in the past, a breadth divergence which is now a full 18 months old, dating back, on our daily breadth work, to June, 1983. On the other hand, the entire second half of 1984 has seen a notable improvement in breadth. Basically market breadth, along with a great many indicators of underlying momentum has shown a distinct upward bias ever since last August. Further strength would likely erase the entire divergence and thus suggest the alternative possibility mentioned above, a bull market extension through just about all of 1985. Failure to mount a meaningful rally, however, would turn the breadth divergence and the potential double top formation into overwhelming evidence that 1985 is likely to constitute a bear-market year. In this connection we think analysis of the year-end rally, which we will discuss next week, will be of importance. The extent of this rally into the new year, generally a good indicator, should go a long way toward resolving the present impasse.

Meanwhile, if a 1985 forecast is difficult, an appropriate investment policy is more easily arrived at. That policy should be one of remaining, albeit highly wary, fully invested. There exists a sufficient number of individual issues showing little technical vulnerability to suggest that holding them at least into the early part of the upcoming year is unlikely to be costly, even under the worst case scenario. There even exists a recent case (1976-1978) during which large numbers of individual stocks were able to maintain major uptrends throughout an ongoing full-scale bear market. Such might well be the case with any downward pressure that might develop over the next year. Meanwhile a fully-invested position will afford participation in what, admittedly, is the less-likely scenario, a major extension of the upswing postponing the ultimate cycle top into sometime in 1986.

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AWT:rs

Dow-Jones Industrials (12·00 p.m.)	1200.86
S & P Composite (12 00 p.m.)	165.73
Cumulative Index (12/27/84)	2092.73

WE WISH YOU ALL A VERY HAPPY NEW YEAR