TABELL'S MARKET LETTER

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The second quarter of 1985 has come to an end, and the event was duly celebrated by the release, in Wednesday's newspapers, of mutual-fund performance for that quarter. On average, the published results were somewhat less spectacular than July 4th fireworks. Although the mean fund performance was plus 6% for the three months ended June 30th, this figure was slightly under comparably measured returns for both the S & P 500-Stock Index and the Dow-Jones Industrial Average. It was, moreover, as the press stories noted, the eighth consecutive quarter in which funds, on average, underperformed the S & P.

The record of the past two years will undoubtedly please that minority, mostly in the academic community, which still basically believes in the strong form of the random-walk hypothesis. This hypothesis essentially states that it is impossible for professional investment management consistently to outperform broad unmanaged portfolios for which the S & P 500 may be considered a proxy. Needless to say, as market technicians, we find ourselves in total opposition to this theory. Nonetheless, we think the figures indicate some of the practical difficulties which have faced the investment manager over the past couple of years. They are, in addition, we think, indicative of the changing nature of the market since the beginning of the current upward cycle in August, 1982.

It is no accident, in our view, that performance difficulties for professional managers go back *exactly two years, to the end of the second quarter of 1983. It is also interesting to note that,* for the year previous to this, managed funds in general tended to outperform the averages by significant amounts, this despite the fact that, during that prior year, the averages in general put on one of their best performances of all time, the S & P 500 rising 53% from June 30, 1982 to June 30, 1983. It is worthwhile recalling just precisely what was going on during that happy period.

What was taking place, of course, was the initial liftoff of the present bull market, and, as technicians are aware, such periods have a number of normal characteristics. One such characteristic is above-average market breadth which means, quite simply, not only that the averages are moving ahead spectacularly, but that most stocks are also doing so, and that, more importantly, almost no stocks whatever are moving downward. From a management point of view, it is this breadth which makes it easy to avoid the sorts of portfolio mistakes which penalize overall performance.

Another characteristic of the 1982-1983 period was that it constituted the last hurrah for the Over-the-Counter market. While the S & P 500 was up 53%, the OTC industrials almost exactly doubled. This suggests that it was a particularly easy period in which to improve portfolio performance by juicing up portfolio beta or volatility. There exist essentially two reasons why an individual stock will, at any point in time, outperform the market averages. One is superior relative strength characteristics, the often-ignored alpha in the equation which measures a stock's performance relative to the market. The second reason for outperformance is beta or volatility. High-beta stocks will, by definition, magnify moves in the averages in whatever direction. OTC performance during 1982-1983 suggests that there were large numbers of such stocks available for selection.

In contrast to this sort of atmosphere, the market environment of the past two years has altered radically. The period subsequent to June, 1983 saw the complete collapse of a large portion of the high-beta segment of the market. The same stocks that had done so much to bolster portfolio performance during the bull market's early stages were now producing precisely the opposite effect, and it became necessary dramatically to reduce exposure to these issues. This was particularly true in view of the fact that the mid-1983-mid-1984 period saw stock prices generally enter a declining phase. Whereas portfolio volatility constituted a major tool for outperforming the averages in 1982-1983, defensive quality constituted the proper medicine for 1983-1984.

As mid-1984 approached and the second phase of the bull-market rise began, the market, predictably became more selective. As we noted last week, large segments of the market, OTC issues once again and capital-goods issues in general, tended to fail to participate in the advance. The same was true, to a large degree, of the important energy sector. Above-average performance tended to be concentrated in consumer-goods and interest-sensitive stocks, areas not generally considered as appropriate components for an aggressive portfolio.

What we are saying here, of course, reflects our own technician's bias in favor of the thesis that markets possess identifiable characteristics and that a study of these characteristics is important. We think that technical work can, in general, identify the sorts of broad shifts in market sentiment discussed above and can therefore constitute an indispensable tool in the overall portfolio management process.

AWT:rs

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Dow-Jones Industrials (12:00 p.m.)	1334.45
S & P Composite (12:00 p.m.)	192.33
Cumulative Index (7/3/85)	2568.72