TABELL'S MARKET LETTER

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Portfolio management, and, perforce, technical analysis, which is its servant, divides naturally into two general disciplines. The first such discipline involves assessment of the overall market environment. This assumes importance because it has been repeatedly demonstrated that common stocks possess a high degree of covariance. Indeed, studies have shown that as much as 70% of the variation in stock prices can be attributed to movements in the general market. It therefore becomes folly to construct a portfolio with heavy equity exposure, however attractive those equities may be on an individual basis, if one feels strongly that the market in general is highly vulnerable.

Once a decision on asset mix has been made, however, the second discipline, that of analysis of individual stocks, comes into play. To the extent that common stocks are included in that asset mix --- and they almost always will be --- an attempt obviously should be made to select those individual stocks likely to outperform the general market.

The trouble with the above neat categorization, though, is that the two disciplines tend to intertwine and fold back upon each other. From the technician's point of view, regardless of the number of macro-market indicators he may follow, his analysis of individual stocks will feed back into his analysis of the market environment. When large numbers of stocks appear technically attractive on an individual basis, the analyst's market opinion will presumably be more bullish then when the opposite is the case. The same dilemma confronts the portfolio manager. Stocks present differing degrees of volatility, expressed by the concept, borrowed from statistics, of "beta", and a pessimistic market opinion presumably can create a bias in favor of less volatile stocks.

Life is not easy, and, at the present time, the interaction of general market analysis and individual-stock analysis is producing an unusual number of conflicting signals and unresolved dilemmas. To begin with, our own analysis of general-market indicators, does not allow us to become excessively bearish at this juncture. Three weeks ago we noted that the market had moved to a new high coupled with a breadth confirmation as recently as July 19. The normal lead time of breadth on market highs, we tried to suggest, indicates that an imminent decline, before an attempt on new highs, is an historically unlikely occurrence. On the other hand, we have the question of the current cycle's evident maturity. Readers are aware of our oft-argued opinion that the four-year cycle phenomenon is a real one and are equally aware of the fact that conventional analysis of that cycle makes it now three years plus one month old. This is decidedly long in the tooth and suggests that a decline commencing at a point not too far removed from the present and ending sometime in 1986 is a real possibility.

Now let us superimpose our analysis of individual stock patterns on this picture. To some degree, such analysis must confirm the caution engendered by an examination of the four-year cycle, if one compares the sorts of patterns that exist today with those of, say, the summer of 1982. Three years ago, we saw hosts of stocks starting moves off bases that went back many years, bases which were the end product of long years of still earlier decline. Today we see, in many cases, the upside objectives of those bases having been reached, and we see precious few instances of stocks which have declined sharply, formed new major bases and now seem to be on the verge of major upside moves.

Yet, individual-stock work does not lend itself to an excessively bearish bias either. We have been pointing out, indeed, we hope, while the game was underway, that last summer's trading essentially consisted of a shift in leadership. Disinflation-hedge issues, which had been upside leaders for a year, suddenly relinquished that position, formed small tops and began to move lower. Meanwhile, a number of cyclical issues found new short-term relative strength and moved precisely in the opposite direction.

It is, in general, possible to place these two contrary movements in a general context. The downward move in disinflation-hedge stocks was preceded only by short-term distribution, and the objectives of that distribution are close to being reached, meaning that much of the technical damage is largely repaired. Cyclical issues, on the other hand, are among the minority that possess the sort of attractive long-range base formations we discussed above. The upswings, by and large, were moves from the bottom to the top of these long-term trading areas. There is, thus, both a bullish and bearish scenario for the two classes of stocks. The bullish one would call for the former leaders, having completed necessary corrections, to resume long-term upward trends and for the cyclicals to continue their recent moves by breaking out of their long-range bases. A bearish scenario would call for broadening tops in consumer-related stocks and the return to the bottom of their trading ranges and resumption of their slumber by cyclical issues. None of this, however, would produce a great deal of fireworks on the downside.

The purpose of this exercise, quite obviously, has been to pose questions rather than give answers, and we think it part of wisdom to recognize that the stock market occasionally presents us with environments when the former exercise is the appropriate one. Our own view, repeatedly stated, is that substantial downside risk, while conceivably lurking somewhere out there in the nebulous future, is not currently staring us in the face. The twin disciplines of market analysis and stock selection may, in the future, call for drastic action, the former toward reduction of equity exposure, the latter toward massive portfolio-shifting away from disinflation-hedge issues. We do not feel, however, that it is necessary to embark aggressively on either course at the present time.

Dow-Jones Industrials (12:00 p.m.)	1304.88
S & P Composite (12:00 p.m.)	183.36
Cumulative Index (9/12/85)	2429.81

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