TABELL'S MARKET LETTER

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We suggested last week that, paradoxically, it would be constructive for the market to pull back and test its earlier lows. This, indeed, it did in this week's trading, and the apparent reasons for this weakness were interesting and deserve comment.

The spur to the market decline was, of course, plunging oil prices, as it became apparent that OPEC was willing to embark on a full-scale price war. The prospect of dramatically lower petroleum pricing, obviously, has implications not only for the oil industry itself, but also for the economy as a whole---witness the renewed worry this week regarding the banking system and Mexican debt.

As far as the oil price itself is concerned, a few observations can be made. First, it is not an oversimplification to say that there exists, at some level, an equilibrium price for oil in today's economy. That price is undoubtedly lower than the $30 plus per barrel that OPEC was extorting a few years ago and, certainly, higher than the $3 or so a barrel which prevailed before the Arabs discovered the supposed virtues of oligopoly. Beyond this, it is difficult to be specific, since the sort of free market for oil which would allow rapid adjustment to the equilibrium price has almost never prevailed. The past decade has seen an attempt at cartel pricing, which collapsed for the classic reason---inability to maintain production discipline. OPEC cannot agree on a means to shut off the tap; therefore, this incremental volume has resulted in lower prices. The apparent current strategy is now to drive non-OPEC producers out of the market. This is theoretically possible, since Middle East crude possesses the lowest lift cost. However, since alternative production facilities are already in place---North Sea oil derricks, for example---implementation of such a strategy would suggest that the price of oil over the next few years might remain as far below the normal equilibrium price as it was, recently, above it. We are, thus, unwilling to argue with even the most dire price projections made by some analysts.

Under these conditions, one might expect the price action of oil stocks, a major market component, to indicate impending doom, and, indeed, sell recommendations on the industry have been a conspicuous feature for the last few weeks. Interestingly, however, oil-stock price patterns suggest that, while the stocks are not without substantive risk at the present time, they are something considerably short of potential disasters. Currently, the majority of oil issues are close to downside breakouts, which would suggest further short-term price weakness in early 1986. Support, however, exists not too far under current levels, and the distribution patterns are hardly major in scope.

The implication seems to be, in other words, that, as far as oil issues are concerned, much of the anticipated product-price weakness has already been discounted in the stock market. This statement would appear to be equally true as far as some of the consequent broader implications of low-priced oil are concerned.

A major factor in the recent economic environment, possibly the most salient factor as far as stock prices are concerned, has been disinflation. In terms of the overall price level, the past two years have been almost unique in recent history, with the producer price index currently below its figure of spring, 1984. A sharp short-term rise in the last quarter has caused some worries that this trend might be reversing. As lower oil prices become fully felt, further weakness in wholesale prices is highly likely to manifest itself. Also, the Fed may be given more incentive to ease monetary policy. In other words, the disinflation trend of 1984-1985, expected by many analysts to end in 1986, now appears more likely to continue.

Again, however, this is a development which seems to have been largely discounted in the marketplace. Disinflation-hedge stocks have been market leaders now for at least a year and a half, and our readers are familiar with our thesis that they are currently fully priced. Technical patterns would suggest, therefore, that most of this week's news concerning oil prices themselves and disinflation in general was long before efficiently reflected in the marketplace.

It is important to recall, however, that eras of disinflation have been abundantly proved to have favorable implications for stock prices. This relationship was emphatically demonstrated by the bull market of the past 3½ years. Regardless of short-term swings, it seems to us that lower oil prices, insofar as they contribute to mitigation of inflationary pressures, will, over the long term, produce a background favorable for common stocks.

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AWT:lt

Dow-Jones Industrials (12:00 p.m.)	1520.17
S & P Composite (12:00 p.m.)	204.70
Cumulative Index (1/23/86)	2687.32