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TABELL'S MARKET LETTER

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We devoted this space last week to a discussion of the uncanny similarity between the stock market's behavior over the past 3½ years and its action during the early 1920's. We pointed out that the 19-month period August, 1921-March, 1923 and the 15 months between August, 1982 and November, 1983 saw almost identical 65% rises in the Dow-Jones Industrial Average. Each of these rises was followed by an interval, 16 months in 1923-1924 and 13 months in 1983-1984, during which no new high was scored, the 1923 experience involving an 18.6% decline and the 1983-1984 instance producing a 15.6% drop. In both cases, these intervening mild corrections were followed by surprising and steady rises to new all-time peaks. By February, 1926, an 87% rise from the October, 1923 low had been posted. As of this week, the Dow had advanced 55% from its bottom of July, 1984.

We thus have two benchmark dates---August 24, 1921 and August 12, 1982---61 years, almost to the day, apart. These dates were followed by long periods of market behavior exhibiting a surprising degree of similarity. What is also interesting is the similarity of the general economic environment on those two dates. An observer looking backward in 1921 would, as in 1982, have observed a quarter-century of rampant inflation having reached or just reaching its peak. He would also have seen an historic peak in interest rates scored a few months before. The following years, both in the 1920's and 1980's, would see interest rates drop sharply from those historic highs.

In 1921, the Wholesale Price Index had peaked a year before, after rising 233% from 1896 to 1920. Between 1955 and 1981, the same Index had advanced 234%. Consumer prices, likewise, rose in both periods, although it must be noted that the rise in the CPI in the years preceding 1982 was twice as great as that in the early part of this century. Despite the fact that the current inflation has been more severe, the price rises leading up to 1920 were probably just as alarming, having accelerated sharply in the latter stages of their advance. The seven years 1913-1920, before, during and after World War I, saw a doubling of consumer prices, something the recent economy has failed to duplicate in so short a time.

In both eras, the stock market's rise was accompanied by a noticeable lessening of inflationary pressures, although that dimunition is a great deal more abrupt in the earlier period. Average consumer-price levels in 1921 were 10% lower than 1920, and the Wholesale Price Index declined an astounding 37%. There ensued eight years of generally stable to decreasing prices. In the present case, we are aware, of course, that price inflation has continued after 1982, but at a considerably more moderate rate. However, by 1985, the Producer Price Index actually showed a mild year-to-year decline, a trend which is likely to continue in 1986.

The levels of interest rates in 1920 and in 1981 were very different, but the historic patterns, although differing in extent, were quite similar. Long-term Government bond yields averaged 5.32% in 1920, and Treasury Bills returned 5.42%. The corresponding figures in 1981 were 12.87% and 14.08%. In both cases, however, interest rates were at cyclical peaks. After falling steadily from the Civil War to 1900, long rates had almost doubled between the turn of the century and 1921. They then fell steadily through the late 1940's, and the rise through 1981 constituted the peak of a 35-year cycle. The rising stock markets that occurred in both instances were accompanied by sharply falling interest rates. Between 1920 and 1926, yields on long Governments dropped by 40%, and Treasury Bill yields were almost cut in half between 1920 and 1924. Currently, long bond yields have dropped some 30% from their 1981 average, and T-Bill yields are just about half of what they averaged five years ago.

In addition to the behavior of inflation and interest rates, other similarities between the two economic environments can be noted. The bull market that started in 1982 has been characterized as a flight of capital from real assets to financial assets, as these assets, both stocks and bonds, began to offer superior returns in a relatively non-inflationary environment, and tangibles which, in the 1970's, had not only kept pace with inflation but left it far behind, became obviously fully priced. The Florida land boom, the lunatic fringe of the real-estate market during the 1920's, began its collapse in 1925, four years into the bull market in stocks and bonds. Not dissimilarly, vacant office buildings are a current feature of many American cities, and the trauma produced by the current adjustment of farmland prices to reality is well known. This has all been taking place, as it did sixty years ago, as the stock and bond markets moved steadily upward.

It is necessary to repeat at this point our caveat of last week. We have been engaged, here, in historical analysis, not in prediction. If we are to pursue our historical analogy all the way, we find ourselves currently at a point in time analogous to late 1925 or early 1926. There is nothing in the analogy to suggest that the unique events of 1926-1929 will be duplicated or that their aftermath, the Great Depression of the 1930's, will be reproduced. We intend, however, to explore those years further in forthcoming letters and to suggest future pitfalls which the 1920s' experience suggests may lay ahead, pitfalls which---it is to be hoped, fortified by historical experience---we may avoid.

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Dow-Jones Industrial Average (12:00 p.m.)	1686.35
S & P Composite (12:00 p.m.)	209.33
Cumulative Index (2/20/86)	2844.09