TABELL'S MARKET LETTER

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We have regularly commented in this space on what seems to us the amazing amount of effort devoted by the financial community to forecasting the outlook for the economy with the intent to say something meaningful about the stock market. We say 'we are amazed' at this effort since there exists abundant evidence to suggest that it is essentially futile. The unspoken assumption behind much of Wall Street's economic forecasting is that changes in the economy are a major cause of changes in share prices. If this were the case, trends in economic activity would lead changes in stock-market indices, whereas the true relationship is exactly the other way around. Indeed, the Standard and Poor's 500 is used by the National Bureau of Economic Research as a component of its index of leading economic indicators.

The thrust of this letter, then, will be an attempt to reverse the usual process. We will try to review the stock market scenario as it has unfolded over the past few months, give our interpretation of that scenario and try to ascertain whether there is implicit therein an economic forecast.

The essential elements of the market outlook at this point can, we think, be divided into two parts. The first part is the outlook for the market as a whole, which, our readers are aware, we see as ranging from neutral to bearish. The second part is a shift in relative price action, irrespective of the general market direction, away from the leadership of the past two years and in the direction of cyclical, capital-goods, manufacturing companies.

The less-than-sanguine overall market outlook is based, in our view, on the trading range which has contained the popular market indices since March. The best-case interpretation of this trading range is as a loss of momentum which is likely to remain in effect for some time. The worst-case interpretation of the range, of course, is as a major-cycle top. If it is true that the market leads the economy, this sort of action would seem, at first glance, to be suggesting some sort of economic slowdown. However, let us recall, the change in stock-market behavior dates back to early Spring. It is quite possible that this weakness was, in fact, leading the slowed rate of economic growth which emerged in the most recent quarter.

Moreover, when we look at the apparent shift in stock-market leadership, an interesting story emerges. Among those groups showing recently improved relative action, are such industries as aluminium, automobiles, chemicals, coppers, forest products, oil, paper and steel. Indeed, the best technical action at the moment is being shown almost uniformly by the most cyclical of market sectors, the basic industries of smokestack America. These industries, moreover, appear to be wresting leadership from the disinflation-hedge, interest-sensitive areas.

If our interpretation is the correct one, the stock market is, then, telling a rather interesting story. It is suggesting, first of all, the likelihood of an economic expansion a good deal more vigorous then conventional wisdom would have us believe. How else to explain the improving price action of cyclical stocks in the face of essentially disappointing recent earnings?

It is, furthermore, suggesting that that expansion may well be strong enough to exert an upward pressure on interest rates. Thus, the recent weakness in interest-sensitive stocks and the apparent loss of momentum in the bond market which is, like the equity market, close to its high, but essentially at the same general level as last Spring.

What the market also seems to be anticipating is, if not the resumption of mild inflation, at least the temporary cessation of deflationary pressures which have accompanied the bull market since 1984. This would appear to be confirmed by the essential flattening of the downtrend in most commodity prices over the past few months.

Vigorous expansion, higher interest rates, and modestly renewed inflation, in other words, seem to be implicit in the story being told by recent stock price action. It would be interesting to see if, in this case, the stock market proves as accurate an economic forecaster as it has been in the past.

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AWT:cg

Dow Jones Industrial Average (12:00 Noon)	1867.27
S & P 500 (12:00 Noon)	243.37
Cumulative Index (11/13/86)	3196.52