TABELL'S MARKET LETTER

Delafield, Harvey, Tabell Inc.

5 VAUGHN DRIVE, CN 5209, PRINCETON, NEW JERSEY 08543-5209

MEMBER NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC
(609) 987-2300

June 21, 1991

"It Ain't Necessarily So"
Ira Gershwin, Porgy and Bess

We headed this letter with the above quotation 16 years ago, in February, 1975. We were reminded, this week, by the market reactions to unfavorable earnings news from Columbia Gas and IBM, of the difficulty in forecasting quarterly results. Our study of 16 years ago advanced the thesis that --- even if such results could be perfectly predicted --- the usefulness of such predictions for a price forecast was, at best, limited. Wall Street's conventional wisdom, in other words, "ain't necessarily so."

Earnings for the Dow Jones Industrial Average were first measured on a quarterly basis starting in 1929. Thus we are able to measure percentage changes in 12-month earnings starting with the first quarter of 1930, running through the first quarter of 1941, a total of 245 quarters. For five of these quarters, in 1932-33, earnings were negative and comparisons are thus distorted. This leaves us with 240 quarters which can be studied.

Of those 240 quarters, 12-month earnings for the Dow declined in 90 of them. Was this bearish for stock prices? Hardly, and indeed, the scale is tilted slightly in the opposite direction. In more than half of those quarters, 49 of 90, prices rose rather than fell. Thus, paradoxically, a forecast of declining earnings is, however marginally, bullish for stock prices. (A bit of the same tendency is manifested on the upside. Of the 150 quarters in which earnings rose, 56, or more than a third, saw declining prices).

The reason for all this, of course, is that the market anticipates rather than follows. It is, sensibly, willing to pay higher prices for recessionary, below-normal earnings and is less willing to place a premium on rising, above-normal earnings. Thus, Dow Jones earnings peaked two years ago and have declined in 7 of the past 8 quarters, falling some 33%. Yet in 6 of the 8 quarters, the price paid for those earnings has risen, producing, in the process, a 600-point rise for the Dow. This is a fairly graphic example of the fact that multiples tend to move in a direction opposite to earnings.

This is amply borne out by the record. In the 240 quarters since 1930, the quarter-to-quarter change in the P/E ratio has been in a direction opposite to the change in earnings in 171 of those quarters. In the 90 quarters in which earnings were down, the multiple increased 67 times and decreased in 23. The most recent two quarters, the last quarter of 1990 and the first of 1991, are typical. In both, earnings were down sharply, yet the average posted a sharp advance in both periods. The same may well turn out to be true for the current quarter.

It can be shown, moreover, that the multiple is a great deal more important in determining the course of prices than are earnings. As noted above, falling earnings produced falling prices less than half the time and rising earnings, rising prices only about two-thirds of the time. Yet, in 174 out of 240 quarters, multiples and prices have moved in the same direction.

To forecast multiples, as we have noted in the past, it is necessary to turn to technical work, and that work does not, at this point at least, suggest serious weakness. The market's recent willingness to place a higher valuation on the below-normal earning power during a recession is a phenomenon totally consistent with the historical record.

ANTHONY W. TABELL
DELAFIELD, HARVEY, TABELL INC.

Dow Jones Industrials (12:00)	2957.74
S & P 500 (12:00)	376.78
Cumulative Index (6/20/91)	6111.76

AWT:jb