TABELL'S MARKET LETTER

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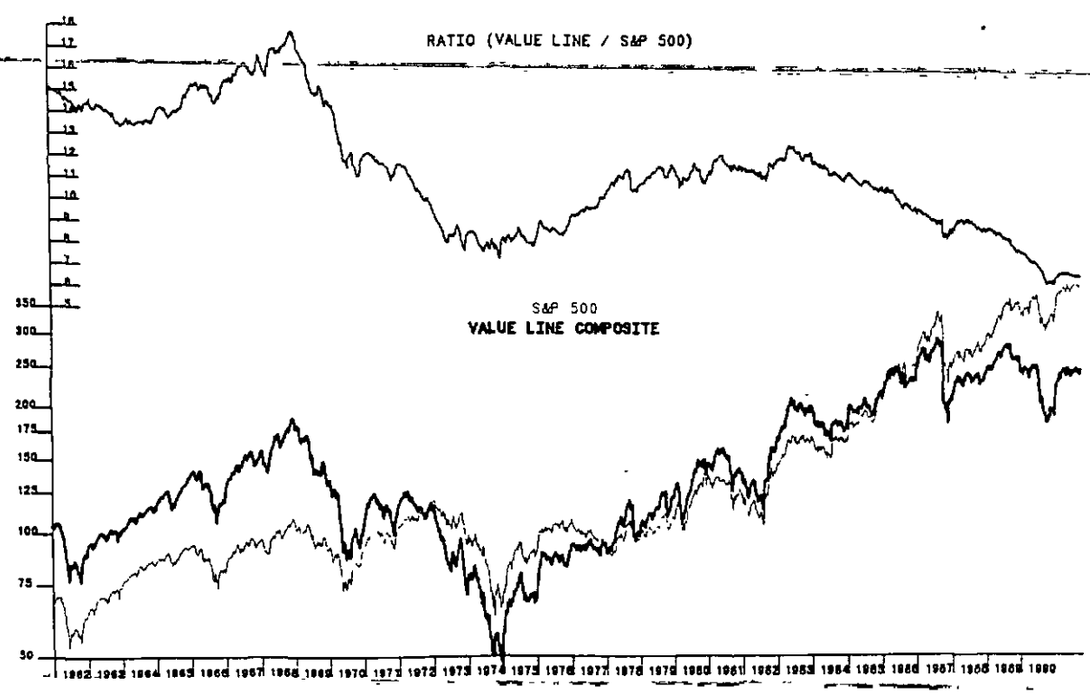
If one is to believe the recent market stories in the financial press, it could be concluded that "Small is Beautiful" has become the stock market's new slogan. The renaissance of the small-stock---particularly the over-the-counter small stock---is, by now, a widely accepted fact.

There is some justification for this. The most recent spate of stories has noted the fact that the OTC Industrials and Composite have, along with the Dow, been posting new all-time highs, this while the S & P 500, presumably representative of larger companies, has continued to languish below its peak close of 396.64 on August 28th. Likewise it cannot be denied that, since the pre-gulf-war lows of a year ago, the OTC indices have outperformed their large-cap counterparts. The NASDAQ Composite and Industrial indicators have moved ahead 64.4% and 76.4% respectively since that bottom of just over a year ago while their S & P counterparts could do no better than similar 33% advances.

We need, however, to recall a basic fact---the fact that smaller stocks inherently display more stock-market volatility than do larger ones, that they regularly move ahead more in a bull market and conversely decline more sharply in bull markets. If we are to accept market action since last October as being part of a conventional bear market, then the better performance of the OTC indicators is a perfectly normal phenomenon. There will, we should remind ourselves, eventually ensue a cycle-length market decline, and, when this occurs, we should expect small stocks to decline more than their senior brethren. Only after this has occurred will we have tangible evidence of better small-stock performance.

The best to gauge the relative action of small versus large stocks is to compute a ratio, in the chart below, which has appeared before in this space, the ratio of the S & P 500 to the Value Line Composite. (Using either of the NASDAQ averages would have produced essentially the same recent picture.) The action of the two averages themselves is shown by the thick and thin lines at the bottom of the page, while the upper line plots the ratio.



The most important fact revealed by the chart is that the relative performance of small vs. large stocks is basically a long-term phenomenon. One did significantly better owning small stocks in the early 1960's and from the 1974 low through mid-1983. Since that time the sort of issues which dominate the 500 have been the place to be. Cycles do not, of course, go on forever, and it is possible that the tiny blip at the end of the chart may represent the start of the kind of reversal that took place in 1972-76. That reversal, it should be remembered, though, required almost four years to complete.

Thus the case for small stocks at the moment rests largely on their greater volatility and the assumption of an ongoing bull market. Investors willing to make that assumption and to accept the risks involved may well be justified in opting for owning smaller issues. Whether supra-cycle outperformance has begun, though, is a point which still remains moot.

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Dow-Jones Industrials (12:00 noon) 3019.45
Standard & Poors 500 (12.00) noon) 385.45
Cumulative Index (October 24) 6410.47