TABELL'S MARKET LETTER

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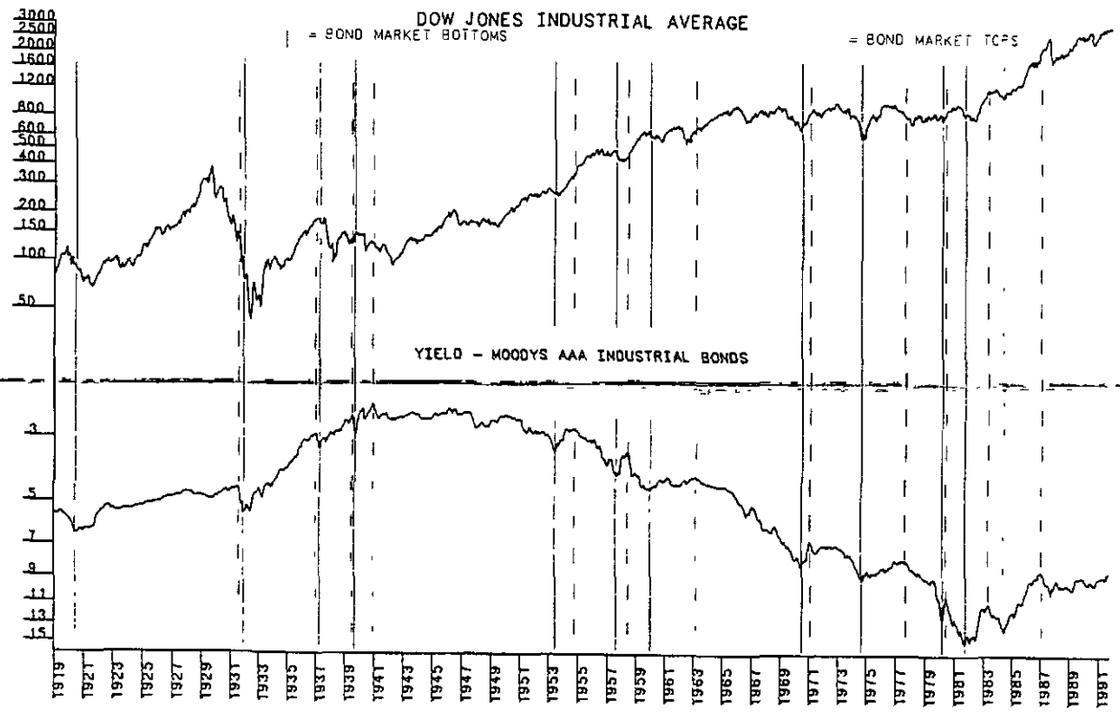
We noted last week that, "there can be little doubt. . that we have . . an interest-rate-driven market." This may have seemed less than apparent when, on Wednesday, the market responded to the fifth consecutive cut in the rediscount rate with little more than a yawn We think, however, that it can be taken as given that conventional wisdom has, for quite some time now, tended to regard the directions of the stock and bond markets as being positively correlated. We remain skeptical regarding this supposed correlation, and we intend, therefore, to spend a few of these letters examining it In such examinations, it is well to begin by taking a long-term view, and the chart below does that, tracing the monthly history of the DJIA and the yield for Moody's AAA Industrial Bonds since January, 1919. The yield, as inspection will reveal, is plotted on an inverted, logarithmic scale so that the series shown effectively traces the history of long-term bond prices.



The first and most obvious characteristic of interest rates is, as Sidney Homer noted long ago, the existence of extremely long and persistent cycles Thus the entire period from 1920, when bonds returned 6.47%, to 1940 (2.28%), can be viewed as a long bull market, and the 41 years to 1981, when the yield reached just under 15%, as an ongoing bear market. For the record, we believe that decade-old low to have been the start of a long-term upward cycle in bond prices which has, obviously, a number of years yet to run

These long cycles seem to have little correlation with the stock market. The 1920-1940 bull market included the upswing of the 1920's but also the bear market of the 1930's. At its end stock prices were just about where they had been twenty years before. And the 41-year bond bear market saw some of the best stock markets in recorded history.

What about the correlation of the shorter cycles shown on the chart by solid vertical lines at bond-market bottoms and dotted lines at tops? Here the recent record is good. Since 1981, bond-market turns have accurately mirrored stock-market ones This may well account for the current fascination with interest rates as an explanation for stock-market behavior. However, as a glance at the chart will show, the record over time has been less impressive. Throughout the 1940's, 1950's and 1960's, the bond market regularly turned down so long before the equity market that it was effectively useless as an indicator.

If we regard major turns in the bond market (we use a 10% filter to define major turns) as stock-market "signals", there have been 24 such signals in the period shown. Fifteen were "correct", but the strategy of buying and selling stocks at bond-market turns would not have bettered the return from simply buying and holding equities. Looked at another way, if one uses hindsight to define bull and bear movements in the bond and stock markets, it turns out that, of 850 market months since 1920, the stock and bond markets were moving in the same direction in 430 months and in opposite directions in 420 months. Obviously, the supposed correlation between the stock market and interest rates deserves further examination.

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Dow Jones Industrials (12 noon)	3062 16
S & P 500 (12 noon)	394 84
Cumulative Index (Nov 7, 1991)	6525.24