TABELL'S MARKET LETTER

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We remarked in this space a couple of weeks ago on the recent fashion of explaining each and every gyration of the stock market in terms of interest rates. Current conventional wisdom seems to be assuming that there exists a positive correlation between interest rates and the stock market. We began, therefore, an examination of that hypothesis, and we continue it herewith.

The first thing we noted was the obvious, but often ignored, fact of evident very-long-term interest-rate cycles, the most recent examples having been a bond bear market from the 1940's to 1981 and a major bull market since.
We also made an attempt to identify bull and bear bond-market swings within that context by applying a 10% filter to bond-yield data. The figures in this letter apply the same filter to bond yields from 1950 to date using daily prices.

We have been able in this fashion to identify eleven bond market bottoms since 1953 along with ten tops. (The present trend, obviously, is up.) The table at right gives the dates of those eleven bottoms. The present fascination of equity analysts with bond prices may stem from the fact that it is possible to identify no fewer than ten of those bottoms with major bottoms in stocks. (The one most difficult to tie to a stock low is, ironically, the bond market's major long term low in 1981, when yields reached 15%.) The bond bottoms, furthermore, appear in most cases to lead the stock market!

BOND AND STOCK MARKET BOTTOMS - 1953 - 1990

Bond Bottoms	Stock Bottoms	Days Lead	Bond Bottoms	Stock Bottoms	Days Lead
Jun 16 1953	Sept 14 1953	63	Oct 1 1981	-	-
Aug 15 1957	Oct 22 1957	47	Feb 9 1982	Aug 12 1982	128
Jan 28 1960	Oct 25 1960	188	July 2 1984	July 24 1984	15
July 2 1970	May 26 1970	-27	Oct 20 1987	Oct 19 1987	-1
Sept 20 1974	Dec 6 1974	54	Mar 29 1989	Oct 11 1990	390
Mar 7 1980	April 21 1980	30			

Taking the opposite point of view, seven of the nine equity-market bottoms which we identify in the period under study have been associated, usually with a lead, with lows in bond prices. Only the collapses of 1962 and 1966 appear to have no bond-market counterpart. In addition, bond bottoms were associated with important intermediate-term drops in 1960, 1980, and 1984.

When we try to make practical use of this information, however, we encounter a number of difficulties. The first is that the lead times tend to be short, thus making it necessary for the stock-market analyst to identify bond- market lows with precision. This is not all that easy to do. In all but two of the cases (1980 and 1982) the bond market had rallied less than 50 basis points off its low by the time of the stock-market bottom.

BOND AND STOCK MARKET TOPS - 1954 - 1990

Bond Top	DJIA	Days Lead	Stock Top	DJIA	%Chg
Oct 27 1954	355.73	681	Jan 12 1957	520.77	+46
June 17 1958	478 97	879	Dec 13 1961	734.91	+53
March 27 1963	684 73	724	Feb 9 1966	995.15	+45
Feb 16 1971	890.06	685	Nov 1 1973	948.53	+7
Jan 5 1977	978 06	424	Sep 11 1978	907.54	-7
June 17 1980	879.27	216	April 27 1981	1024.05	+16
Nov 30 1981	-	-	-	-	-
May 11 1983	1219 72	55	Nov 29 1983	1287 20	+5
Jan 22 1987	2145.67	149	Aug 25 1987	2722.42	+27
Feb 3 1988	1924 57	799	July 17 1990	2909.75	+55

Even if it is conceded that bond-market action may have some value for forecasting purposes at bottoms, its usefulness at equity market tops appears to be close to non-existent. The table at left lists the ten bond peaks that a 10% filter identifies along with the subsequent highs in the equity marts. Here precisely the opposite problem from the one encountered with bottoms occurs. In the case of tops the lead time is unconscionably long! Up until 1980 at least, the bond market topped out well in excess of a year before the stock market, and in one case (1958-1961) the lead was over three years. Needless to say, in these cases equities still had the bulk of their bull-market advances ahead of them at the time of the interest-rate peaks. To illustrate this we have also shown in the table the comparative levels of the Dow Jones Industrials at the bond and stock peaks and have listed the percentage advances in the right-hand column.

A couple of the more recent signals may be said to have had some value. Bonds turned downward on May 11, 1983, six months before stocks did so and without too much of a "missed" advance in the DJIA. The January 1987 bond market top also can be credited with presaging the October 1987 collapse, although at the time of the bond market high stocks were 600 points below their ultimate August peaks. Since investor memories often tend to be short, these two recent successes may have contributed to some degree to the reputation of bond prices as a forecasting tool.

In summary then the trend of the bond market may be a marginally useful harbinger of stock market bottoms, but it is of little use at tops. This comment is presently relevant since, with the Dow standing, as of a month ago, some 30% above its year-ago levels, it is, at the moment, a top we are trying to identify, not a bottom. There are many indicators we expect to be using to look for an upcoming peak, but a correction of the bond advance will not be one of them, despite the furor it will undoubtedly elicit.

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Dow Jones Industrials (12·00) 2893.34
Standard & Poors 500 (12:00) 375.14
Cumulative Index (11/27/91) 6418.11