TRANSACTIONS OF SOCIETY OF ACTUARIES
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than the average. At the same time, their new investments should produce a yield considerably higher than the average. During the past three years the rate of improvement in the average yield was about twelve basis points. Although the annual rate of improvement will decline if my views are anywhere nearly correct, it seems likely, nonetheless, that by 1970 the average net rate of return on life insurance company investments as a whole will exceed $4\frac{3}{4}$ per cent and may actually be closer to 5 per cent.

EQUITIES

HAROLD X. SCHREDER:

Under unprecedented conditions the stock market during the spring of 1962 experienced a shocking and historically severe decline, from which it has made a modest recovery. Moreover, it is now quite generally acknowledged that the leading indicators which most of us watch for clues to the economic outlook are not very encouraging. In fact, at best, they suggest that we may continue our "high-level–slow-growth" economy for some time ahead or, at worst, experience a fairly severe recession.

I was invited here today to "take it from here" for the rest of the decade of the 1960's. I hope I can be even half as good at carrying out this assignment today as our chairman has been in selecting it.

The basic thesis I will attempt to develop today is that, during the tortured early years of this decade, one of the most important stock-market bottoms—buy areas—for many years to come should develop and be taken advantage of by investors, because the long-term outlook for stock prices is extremely favorable, especially for the stocks of the long-depressed basic consumer durable and capital goods industries.

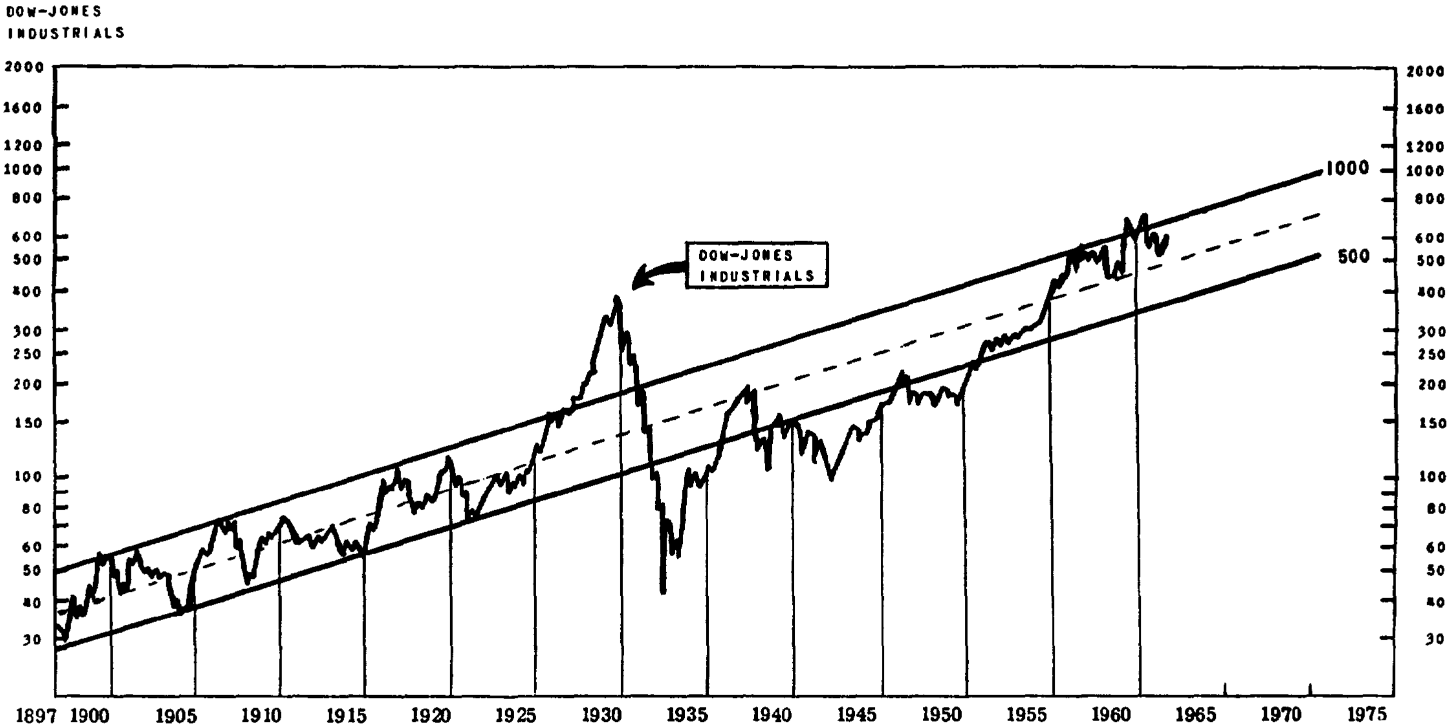
In this connection, while I do not intend to omit some comments on the current stock-market outlook, I understand that my assignment today calls more for the long-term outlook for stock prices—that is, 1970 expectations—because investors of your type, as opposed to speculators, are more interested in either the cyclical or the very long-term outlook for stock prices than in short-term stock-market movements.

Simple Projection of Stock Prices to 1970

What, then, is the outlook for the stock market in 1970? Obviously, there are many ways to make such a judgment, but let us start with the easiest and simplest of all methods of projecting long-term stock prices—projection of their own long-term price trend on a ratio-scale chart. In this connection, I call your attention to Chart I. Note that this chart shows the prices of the Dow-Jones Industrial Average from 1897 to the

CHART I

Long-Term Trend of Stock Prices Projected to 1970 Based upon Long-Term Relationship to Stock Prices



present. On this chart, I have simply drawn the trend lines which best fit the long-term trend of this average of stock prices.

This simple projection device suggests that by 1970 the Dow-Jones Industrial Average should be in a price range of somewhat in excess of 500 to 1,000. Obviously, that is a pretty wide range and as such is not very useful. Clearly, then, while this simple device may suggest a reasonable long-term *uptrend* for stock prices, some exploration of the stock-market *cycle* must be attempted if a reasonably meaningful projection of stock price to 1970 is to be obtained. To do this, one obviously must make some analyses and judgments about the economic outlook, and particularly the earnings and dividends outlook, for the rest of this decade, both by trend and by cycle—a bold undertaking.

Slow Economic Growth since 1956

Gross national output in real terms (constant dollars) has been growing at about a 3 per cent (2.9 per cent) annual rate since the turn of the century and at about a 4 per cent rate since the end of World War II, though since 1956 to date the growth rate has fallen to around 2½ per cent —below the long-term 3 per cent rate. Thus, while the postwar period taken as a whole has shown excellent progress in achieving the goals of the Employment Act of 1946, it was only from 1946 through 1956 that full utilization of our economy's resources was the normal condition. Since 1956 we have been in a prolonged period of economic transition characterized by generally high levels of prosperity and record-breaking national economic statistics, but actually growing at an anemic rate. Moreover, we most likely have another year or more of these slow growth years ahead of us as we gradually continue to digest the built-in changes in our industrial economy that developed during World War II and in the accelerated "catch-up" decade of growth immediately following the war—and as we continue adjusting to the economic developments and competition of our Common Market allies.

Past is prologue, so what has happened to our economy since 1956? Why have we been experiencing sluggish growth? What can we expect for the rest of this decade? Obviously, I cannot answer such huge questions as these in depth in the few minutes I have allotted to me today, but let me at least give you some analyzed summary thoughts and conclusions on these huge and crucial questions.

First, in connection with our high-level sluggish growth since 1956, it is demonstrably true that what little growth we have had since 1956 has been almost entirely the result of the reasonably normal expansion in consumer nondurable products and services and of the debatable steady increase in government spending. I use the word "debatable," without pursuing it at this time, in connection with rising government spending, because its very substantial rise during the recent "slow-growth" years makes this force very suspect as an economic growth stimulant. The really basic reason that our economic growth has been so anemic since 1956 is simply because of the flat-stagnant rate of corporate profits and spending in this country for consumer durable goods and investment in capital goods.

The sluggishness since 1956 in the major profit-producing, job-producing consumer durable and capital goods industries is due to a combination of six basic conditions:

1. The continuing huge burden of domestic surplus capacity brought about by the capital goods boom of the mid-1950's.
2. The dramatically increased competitive ability by the mid-1950's of our Marshall Plan–resuscitated Western allies in consumer durable and capital goods areas (as well as increased "dumping" activities in raw materials by the Communist nations).
3. The above two "excess" supply conditions met the relative exhaustion by the mid-1950's of the pent-up demand for consumer durables built up during World War II.
4. The latter condition was aggravated by the sharp decline in family formation as an inevitable result of the low birth rate of the early 1930's.
5. The combined deterioration in the supply-demand relation for basic industry's products since 1956 was accompanied by increasing inability to pass on higher product prices as wage-cost pressures increased, all of which combined toward an increasing squeeze on corporate profit margins.
6. Finally, against this background of unbalanced supply-demand cost relationships, our existing tax rates have been draining off too much of business and personal incomes, and growth has automatically been slowed. For example, during the first fifteen months of the current recovery, federal taxes (net of transfers) have taken $12 billion of the $51-billion increase in total incomes, while federal purchases have taken only $7 billion of the $51-billion increase in total output. Obviously, this is a drag on a recovering economy (and taxes *must* be reduced).

Long-Term Economic Growth Outlook Improving

Yet, despite the continued existence of this combined list of slow-growth pressures, is not the bright side of this constellation of economic depressants gradually beginning to show through the economic haze since 1956? I think it is.

In the first place, while manufacturing operating rates have since 1956 been averaging 6 percentage points lower in relation to capacity than in the postwar decade (and of course well below the peak efficiency rates preferred by business men), another year or so of our high-consumption economy versus our prolonged low-capital investment should bring about a utilization of our industrial capacity toward the 90 per cent level, which should (historically) start a round of dynamic capital goods expansion.

Progressively, too, there is growing evidence that we are much more competitive in international markets and that a real improvement in our balance-of-payments problem of the last few years is taking place. While it is true that many of our (export) prices got competitively out of line during the 1955–57 consumer durable–capital goods cost-push boom in this country (and we have been "paying" for it ever since), the degree of overpricing of American exports has been greatly exaggerated for some time. From 1958 through 1961, our balance-of-payments deficit was large, ranging from $2.5 to $3.9 billion annually, and our outflow of gold averaged $1.4 billion annually.

These large deficits, however, were largely the result of large government expenditures abroad (especially for military-troop support), a sharply rising amount of foreign private investment by Americans, and short-term flights of speculative capital especially during 1960–61. In fact, if one excludes these items, United States' net earnings from commercial trade and other current account items is running at a surplus of close to $5 billion per year now, so that our net deficit should be reduced to about $1.5 billion this year versus $2.5 billion last year, and way below the $3.9 billion deficit of 1960.

Moreover, barring a serious recession in 1963 (I do not expect one), our balance-of-payments deficit should practically disappear, and our overall competitive position should improve strikingly over the years ahead. Not only are our foreign aid and military expenditures being reduced and shifted by our own government's actions and by those of our Western allies, but our net private investment income (from our previous high private foreign investments) is in an increasing trend which should continue, and "hot" speculative outflows of short-term funds are sharply lower as the dollar has strengthened.

These favorably developing trends are also being strongly buttressed by our sharply improving wage-price relationship versus Europe. The boom there is producing the same type of cost-push inflation and profit squeeze that we have suffered, especially from 1955 to 1958. With super-employment requiring imported labor, pressures for higher wages in Europe accompanied by strikes have caused wages to rise well above increases in productivity, as much as two times in some countries, notably West Germany. In the meantime, while not entirely satisfactory, wage-rate increases in United States since 1958 have been coming progressively in line with increasing productivity, and these trends should work to our competitive advantage if we can continue to restrain undue increases in our wage-cost-price structure. Since we have the sizable supply of unutilized industrial plant and labor I mentioned earlier, our improved wage-cost-price-structure position has a good chance of being maintained or further improved.

I think, too, that while the Administration squared the circle very crudely in the steel episode in April, 1962, we should not lose sight of the fact that this same Administration is very much aware of the necessity of a sound and highly competitive wage-cost-price structure in this country as is evidenced by its announced attitude against the thirty-five-hour week, its pro-management position on featherbedding, its more realistic depreciation schedules, its 7 per cent investment credit to increase capital goods spending, and its recognition of the need to improve the rate of utilization of our resources and rate of growth of our economy by a tax cut. As President Kennedy stated on June 7, 1962, "our tax structure, as presently weighted, exerts too heavy a drain on a prospering economy. . . . A comprehensive tax reform bill . . . will be offered for action by the next Congress, making effective as of January 1 of next year an across-the-board reduction in personal and corporate income tax rates which will not be wholly offset by other reforms. In other words, it is a net tax reduction."

Other basic conditions which should gradually reverse and turn to a favorable trend are those surrounding new family formation. In contrast to the dragging effect of sharply declining family formation during the last several years, which I mentioned earlier, family formation is beginning an inevitable sharply rising trend into the early 1970's as a natural consequence of the high birth rates during the war and early postwar years. This sharply growing trend of family formation should fundamentally bring about a renewed upsurge in consumer durable goods' spending, with all its attendant favorable economic developments. This "natural" upsurge in the important consumer durable goods should be aided not only by their relatively low production ever since 1955 but by the high level of consumers' incomes, savings, and generally very sizably restored liquidity.

In short, while I am not trying to sweep under the rug the probable existence of another year or so of the same *real* problems we have had since the mid-1950's, especially our balance-of-payments problem (around which so many of our other problems hang), I do submit (1) that a larger perspective of all our admittedly real problems does reveal that we *have been* working on their solution for six years; (2) that we are making very demonstrable and substantial progress; (3) that our prolonged period of convalescence is well advanced; and (4) that practically all our unfavorable trends of the past several years are showing strong signs of gradual reversal to very favorable trends, especially for the latter half of this decade.

1963–1964 Should Begin Dynamic Growth Period

So with the above outline of our "slow-growth" problems since 1956 and their gradually emerging dynamic reversal as a basic background, what kind of an economic growth rate should we expect for the decade to 1970? A review of long-term projections made in 1960 by the National Planning Association, Joint Economic Committee, United States Department of Labor, and *Fortune* magazine reveals a range of projected potential annual growth rates of gross national product from 3.5 to 4.6 per cent. More recently, in November, 1961, the United States joined with the other nineteen members of the Organization for Economic Cooperation and Development in setting as a target the attainment of a 50 per cent, or 4.1 per cent a year, increase in their combined national product during the decade from 1960 to 1970.

Quite clearly, such a high rate of growth of potential output will not be reached immediately, because of the "short fall" we have been experiencing during recent years and because, as I have outlined earlier, many of these "short-fall" growth problems will very likely be with us for another year or more. As the second half of this decade approaches, however, with the broad help from all the emerging dynamic forces from the in-between years since 1956, combined with a rapidly growing labor force, it should be possible—even likely—to exceed a growth rate of 4.5 per cent annually and thereby achieve an average rate of growth of around 4 per cent for the decade for the 1960's. In fact, if the confluence of dynamic growth forces develop as I expect, and if 1970 is, therefore, a year of full employment (around 4 per cent unemployment rate), actual GNP should grow at an average annual rate of nearly 5 per cent.

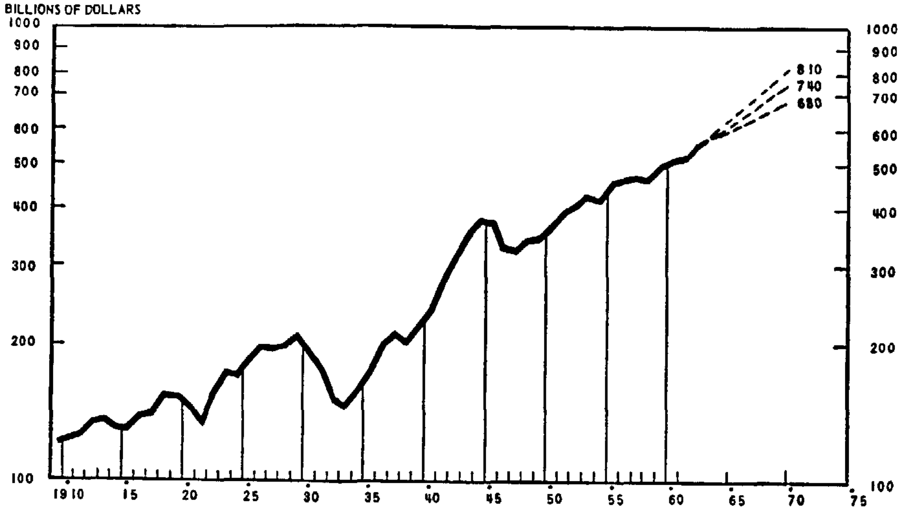
It is with these thoughts in mind that I call your attention to Chart II. On it, you will notice that I have made three projections of gross national output in 1961 dollars to 1970—a 3 per cent annual growth rate to $680 billion, a 4 per cent annual growth rate to $740 billions, and a full-employment annual growth rate of nearly 5 per cent to $810 billions of GNP. What should this range of GNP possibilities mean for stock prices both per se and as a result of correlated earnings and dividend prospects?

Stock Prices versus GNP Outlook

A long-term analysis of Dow-Jones Industrial stock prices and their relationship to GNP shows that there is a crude relationship of stock prices to GNP of about 1¼ to 1. With this crude projection measure as a guide, I call your attention to Chart III, which shows where the Dow-Jones Industrial Average would be in 1970 on the basis of the three GNP projections described above and shown on Chart II. From the basically favorable economic outlook I have outlined, especially for the last half

CHART II

GROSS NATIONAL OUTPUT
(In 1961 Prices)



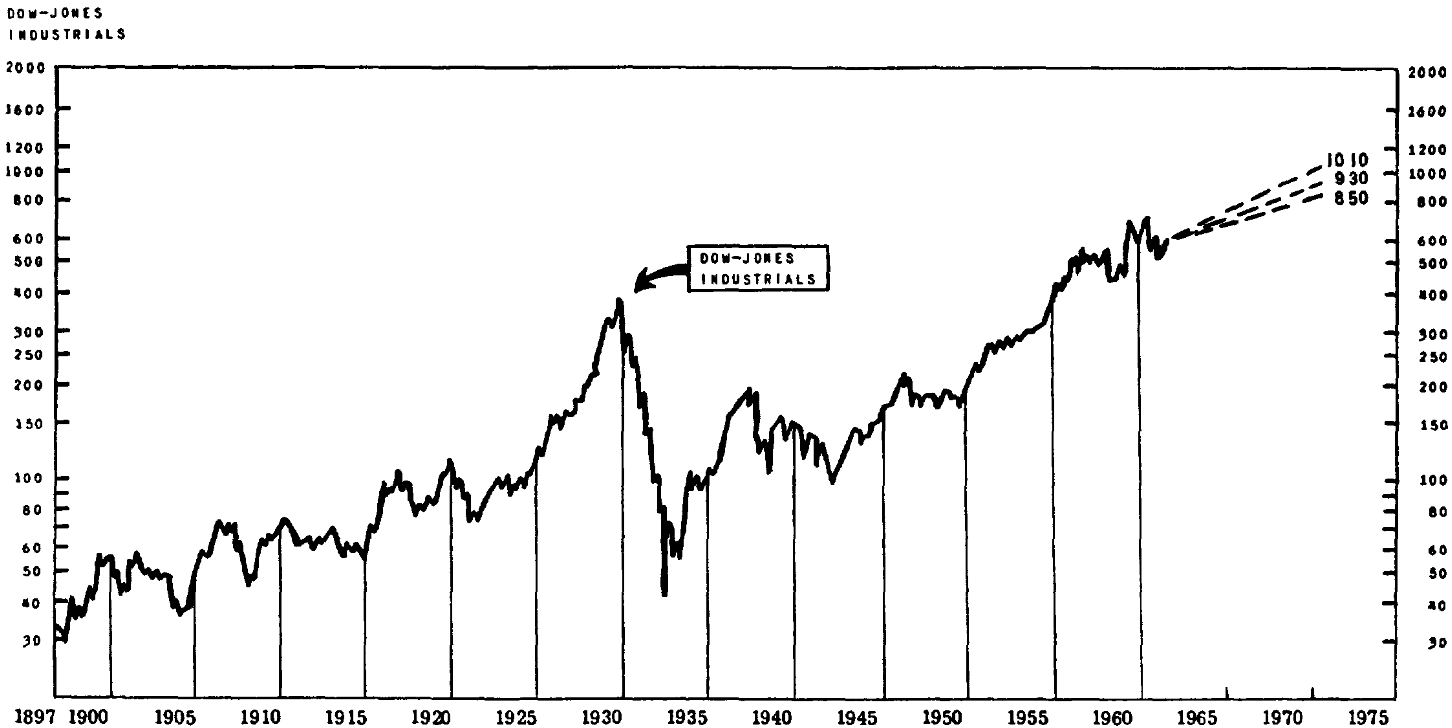
of this decade, I think it is fair to conclude that the Dow-Jones Industrial stock index should easily be in the 900–1,000 range by 1970, and, if full-employment conditions prevailed, with an attendant buoyant feeling that this stock index could well be in the 1,100–1,200 area on its historical relationship to gross national product.

1970 Earnings and Dividends Outlook

Obviously, a more sophisticated approach to the stock-market outlook is to project some future earnings and dividends estimates for the rest of this decade, because, after all is said and done, earnings and dividends are the basis of stock values, and over the long term stock values do determine stock prices. What should we expect in the way of Dow-Jones Industrial earnings and dividends by 1970?

CHART III

LONG-TERM TREND OF STOCK PRICES PROJECTED TO 1970 BASED UPON LONG-TERM RELATIONSHIP TO 3–4–5 PER CENT GNP GROWTH



In this connection, we in our organization use a great variety of approaches for estimating earnings and dividends. These include, as I have already mentioned, economic "model" approaches, that is, estimates of gross national product by various assumptions revolving around population growth, labor force, hours worked, productivity rates, etc. Then, of course, the normal relationship of these various economic "models" must be translated to corporate profits and dividends in periods of expanding and contracting business. Then these estimated total corporate profits and dividends have to be converted to the Dow-Jones Industrial Average or Standard and Poor's 500 by fairly well-established relationships.

Obviously, too, instead of starting with the composite economic "whole" and working down to "model" Dow-Jones Industrial Average earnings and dividends, we naturally work up to average earnings and dividends by estimating individual company's earnings and dividends by all kinds of assumptions revolving around established relationships to sales, profit margins, book values, undistributed earnings, depreciation rates, new products, etc.

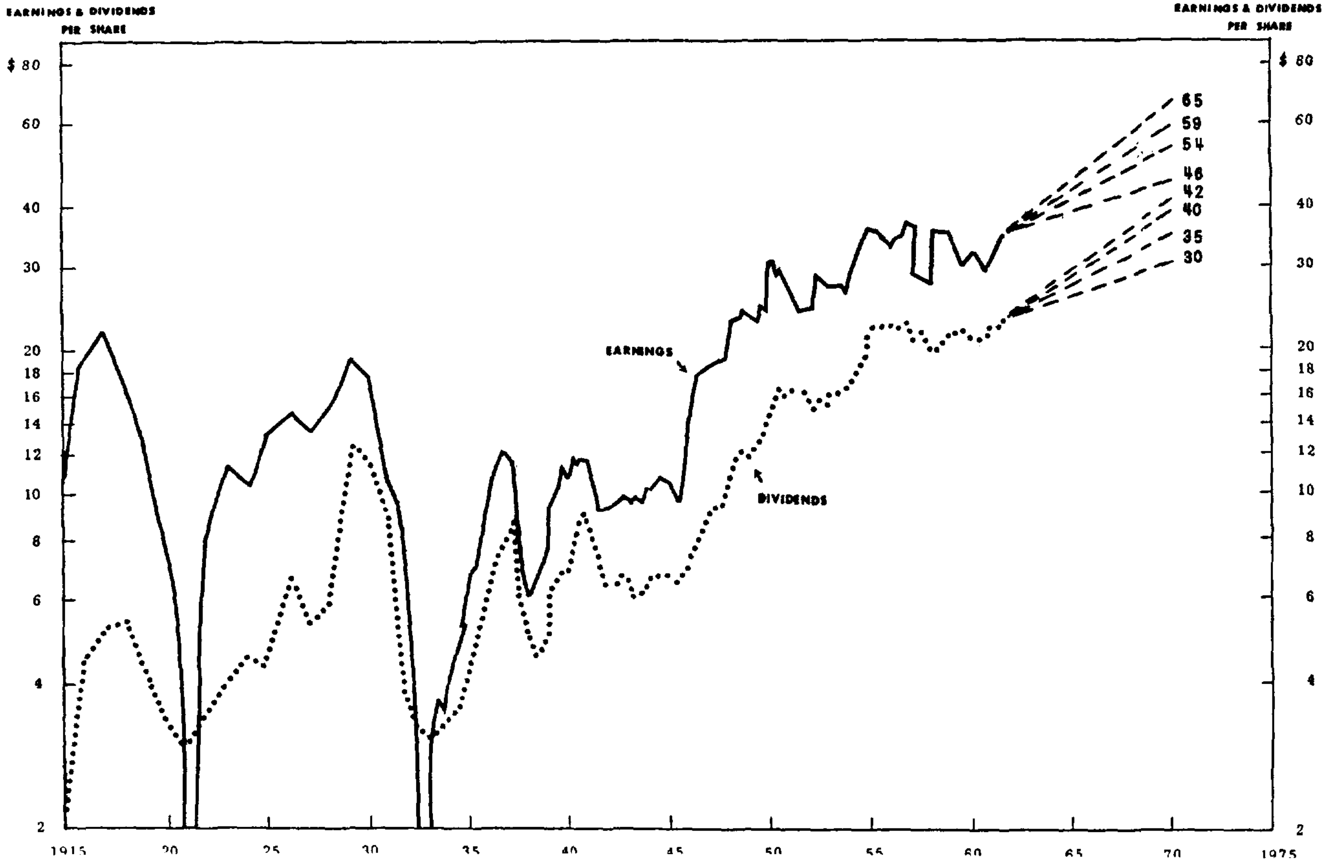
By all these various methods of estimating earnings and dividends for the Dow-Jones Industrial stocks, we have arrived at the range for 1970 shown on Chart IV. The four estimates of earnings and dividends, reflecting our various economic assumptions, range on the (conservative) high side from a "full" employment year to a "poor" year in 1970. Among these estimated ranges, I have picked my estimate of earnings as around $57–$59 and dividends as around $37–$38 per Dow-Jones Industrial share for 1970. I regard these estimates as normally attainable and as actually conservative on the basis of my very favorable economic expectations for the latter half of this decade and on the basis of a reasonably good intervening tax cut on corporate earnings (and for individuals). In this connection, I think it is well to keep in mind that every 1 per cent cut in present corporate tax rates means about a 2 per cent increase in reported profits after taxes.

1970 Earnings and Dividend Capitalizers?

Of course, what the estimated earnings and dividends will be in 1970 is only half the stock-market projection. The other half is how they will be capitalized—what will the price-earnings multiplier be? What will the dividend capitalizer be at that time? There is no question but what a judgment about future price-earnings multipliers or dividend capitalizers is a far more difficult one to make than one about future earnings and dividends. This is simply because, in addition to the long-term trend of

CHART IV

EARNINGS AND DIVIDENDS PER SHARE OF THE THIRTY DOW-JONES INDUSTRIAL STOCKS
(Projected to 1970 by Various Methods and Assumptions)



earnings and dividends, investors' psychology, or what investors ***think*** earnings and dividends are worth, plays such an important part in determining the price level of stocks individually or as an index such as the Dow-Jones Industrials.

In this connection of investor psychology and varying appraisals of given levels of earnings and dividends, however, there are some fairly good long-term guides. Specifically, if you will take a look at the middle panel chart of Appendix Chart B,[1] you will discover very quickly that the "normal" long-term (1871–1962) price-earnings ratio is about 15*x* (it got there last June at the 525 Dow-Jones Industrial level) and that anything below 12*x* is quite rare, as is anything above 18–20*x* earnings. It is with

TABLE 1

If Average Price-earning Ratios Are:	If 1970 Per-Share DJI Earnings Are . . .			
	$65 ("Full"-Employment Prosperity)	$59 (Prosperity)	$54 (Good Times)	$46 (Poor Times)
	. . . the Average Price of Dow-Jones Industrials Would Be:			
Enthusiastic (20*x*)........	1,300	1,180	1,080	920
Confident (18*x*)..........	1,170	1,060	970	828
Average (15*x*)...........	975	885	810	690
Subdued (12*x*)...........	780	710	650	550

these historical capitalizers of earnings in mind that I call your attention to Table 1. You will notice that I have combined in this table the range of various combinations of "possible" earnings and capitalizers thereof that are most likely to occur by 1970 based upon a multiple combination of historical relationships.

Similarly, if you will take a look at the middle panel chart of Appendix Chart C, you will also discover very quickly that the "normal" long-term (1871–1962) price-dividend ratio is about 20*x* (5 per cent yield) and that any price below 15–17*x* dividends (6–7 per cent yield) is historically "low," whereas a price-dividend ratio of over 30*x* (around a 3 per cent yield) is historically high. Again, with these historical capitalizers of dividends in mind I call your attention to Table 2. As in Table 1, you will notice that

[1] The two basic long-term price and earnings variables and reciprocal earnings yields are also presented as of documentary interest. The relationships are practically interchangeable with the Dow-Jones Industrial Average.

I have combined in Table 2 the range of various combinations of "possible" dividends and capitalizers thereof that are most likely to occur by 1970 based upon a multiple combination of historical relationships.

These two tables can be used as sort of do-it-yourself devices for quantitative thinking about 1970 stock prices. Before I draw my 1970 price-probable conclusions from these two basic tables, however, I would be completely remiss in my assignment today, especially for this distinguished audience of actuaries, if I did not discuss briefly the most basic and sophisticated method of determining stock prices—the discount or present-worth method of determining stock prices.

This practical method of stock-price computation is derived from the principle that, as I am sure all of you understand, the value of a common

TABLE 2

If Average Price-Dividend Ratios Are:	If 1970 Per-Share DJI Dividends Are . . .			
	$42 ("Full"-Employment Prosperity)	$38 (Prosperity)	$35 (Good Times)	$30 (Poor Times)
	. . . the Average Price of Dow-Jones Industrials Would Be:			
Enthusiastic ($30x$)........	1,260	1,140	1,050	900
Confident ($25x$)..........	1,050	950	875	750
Average ($20x$)...........	840	760	700	600
Subdued ($16x$)...........	700	630	580	500

stock (as with a bond) is the present worth of all future dividends. Obviously, this is not so easy a valuation as it is with a bond, because a stock has no fixed dividend (interest) rate, nor does a stock have a stated maturity date. In the case of the stock the dividend rate can be derived from the rate of earnings growth, and maturity can be established by historical observation. Equally obviously, therefore, since earnings are the source of dividends, and dividend payout relationships can be and are quite well established, present worth of a stock or average such as the Dow-Jones Industrial can be expressed in terms of capitalization of earnings.

In this basic connection, earnings figures as far back as they go have been exposed to and are the result of practically all possible economic conditions of war and peace, political developments, and inflationary and deflationary problems; but if a trend line is fitted into the fluctuating curve of earnings of the Dow-Jones Industrial Average or Standard and Poor's 500 (see first panel of Appendix Chart B), the long-term earnings trend has been growing at an annual rate of about 4 per cent (despite the flat earnings trend of the past few years). As for the future earnings trend, one may argue for many different assumptions, but the least arbitrary of all future estimates of earnings is a simple projection of the long-term 4 per cent growth rate into the future, with obviously expected cyclical deviations around the trend.

With these summary thoughts and historical figures in mind, if one assumes the logical and basic variables of a historical 4 per cent long-term earnings growth rate, 60 per cent dividend payout, an "average" eight-year investment period, and historical discount rates ranging from 6 to 8 per cent, and my best "conservative" estimate of $57 per share of Dow-Jones Industrial earnings in 1970, then a 6 per cent discount rate should produce around a 1,100 Dow-Jones Industrial level by 1970, a 6½ per cent discount rate should produce over a 1,000 Dow-Jones Industrial level, a 7 per cent rate should produce over a 900 Dow-Jones Industrial level, a 7½ per cent rate should produce over an 840 Dow-Jones Industrial level, and an 8 per cent discount rate should produce a 1970 Dow-Jones Industrial level of around 770.

1970 Most Probable Stock Prices

While from these basic valuation approaches, based upon various methods and historical relationships, a potentially wide range of stock-market projections are indicated, I believe that a combined-probable projection for 1970 has the merit of a specific set of numbers to work with and at the same time can better be related to a rational cyclical deviation from historical trend. I, therefore, on Chart V show my "best-judgment" range projected at this time for the Dow-Jones Industrial Average by 1970.

Actually, I will further refine my summarized "best-judgment" price range of the Dow-Jones Industrial Average for 1970 from 850 to 1,100-plus toward the higher estimate not only because of my expectation of very favorable economic activity during the latter half of this decade but because of the demonstrated cyclical pattern of stock prices themselves as they move through each decade.

In this connection, I call your attention to Chart VI, which shows that stock prices over the decades have shown a strong tendency to repeat their pattern of movement every decade. You will note that the 1950's stock market traced the long ten-year pattern for the seven decades 1881–1950 quite closely. The typical ten-year stock-price pattern reveals a declining first year (1961, 1951, 1941, etc.), a declining and rising market in the

CHART V

Long-Term Trend of Stock Prices Projected to 1970 Based upon Long-Term Relationship to Historical Probability

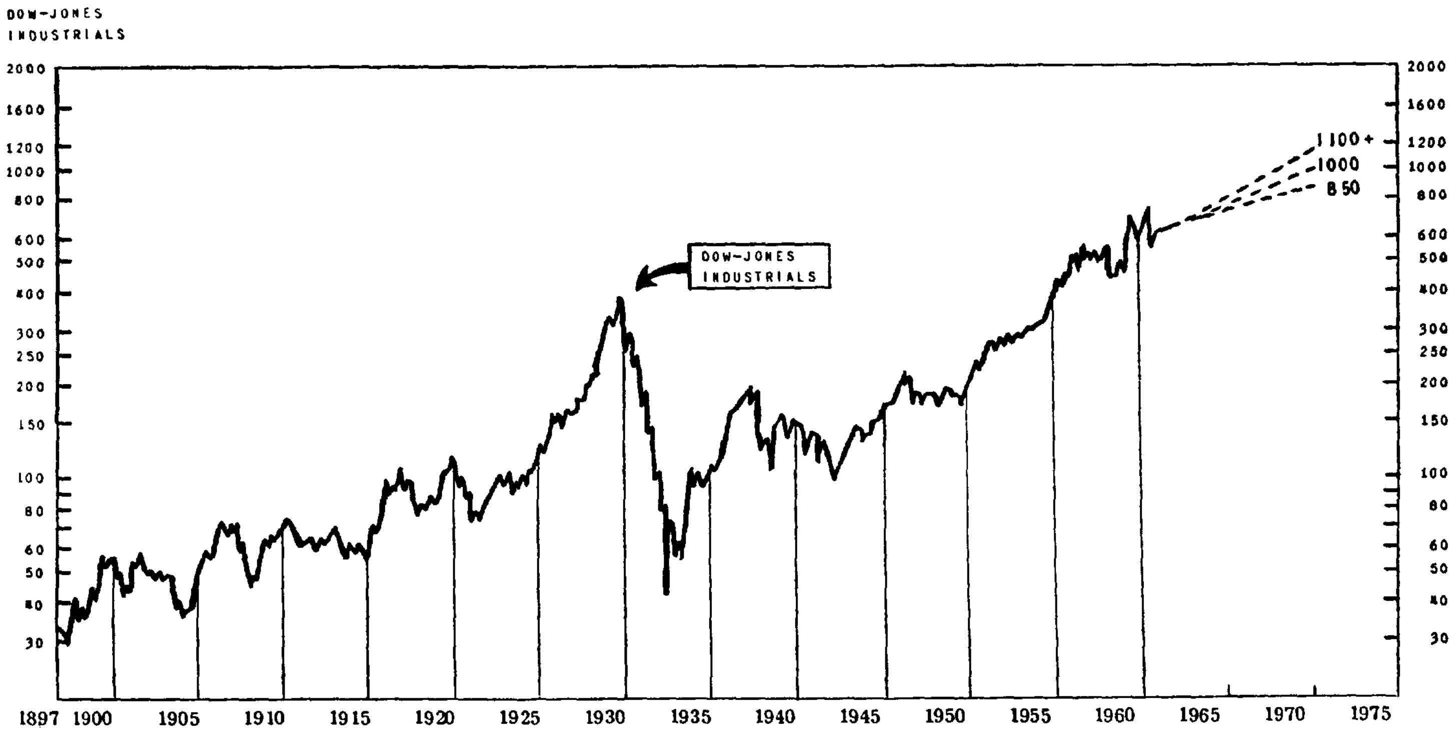
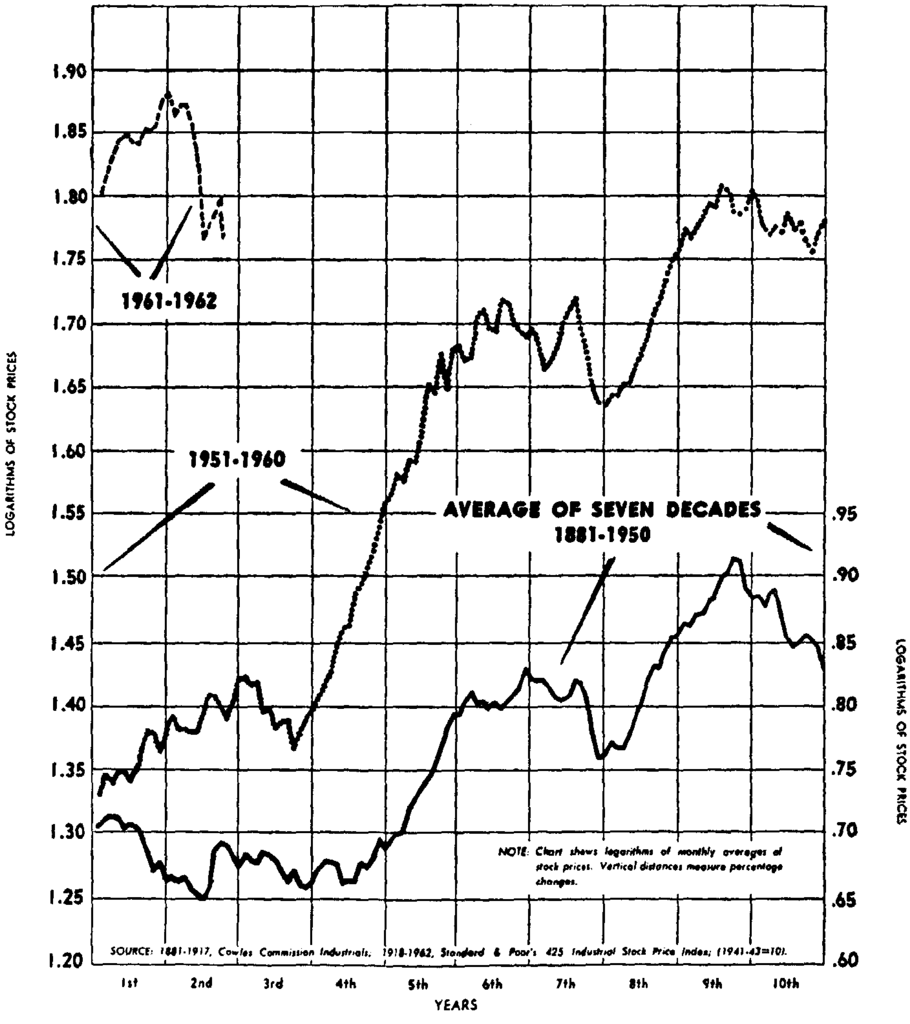


CHART VI

TEN-YEAR PATTERNS OF INDUSTRIAL STOCK PRICES
(1950's and 1960's versus Average for Seven Decades)



second year (1962, etc.), a slide in the third year (but not to a new low), a rally in the fourth year, a very strong fifth year, a leveling-off in the sixth year, a decline in the seventh year, a strong eighth and ninth year, and a declining tenth year.[2]

Thus, while this "normal decade" stock-price pattern is, of course, entirely empirical, its repeated pattern of low stock prices in the second (1962) and third (1963) year and of high stock prices toward the end of each decade does strongly tend to confirm the logic both of the current concern and of my very favorable cyclical economic and stock-market expectations for this decade as it progresses.

The stock-investment benefits of the anticipated gradual renewal of a very vigorous economy are tremendous. Not only, as I have tried to point out here today, is the long-term outlook excellent for over-all earnings, dividends, and stock-price growth, but as the rest of this decade unfolds—instead of basic earnings growth being confined to a small group of industries (foods, utilities, etc.), as has been the case for the last five or six years of generally "high-level stagnant" earnings growth—virtually all the major and more basic industry group's earnings should dramatically grow again! This means that after some additional intermediate months of adjustment, well-balanced economic conditions should gradually develop, which will bring with them a broad, across-the-board stock-market advance—the type we have not seen in this country since 1956. In sum, the long-term outlook for business and the stock market is excellent. From recent prices, the general level of stock prices should approximately double over the rest of this decade!

The Next Several Months?

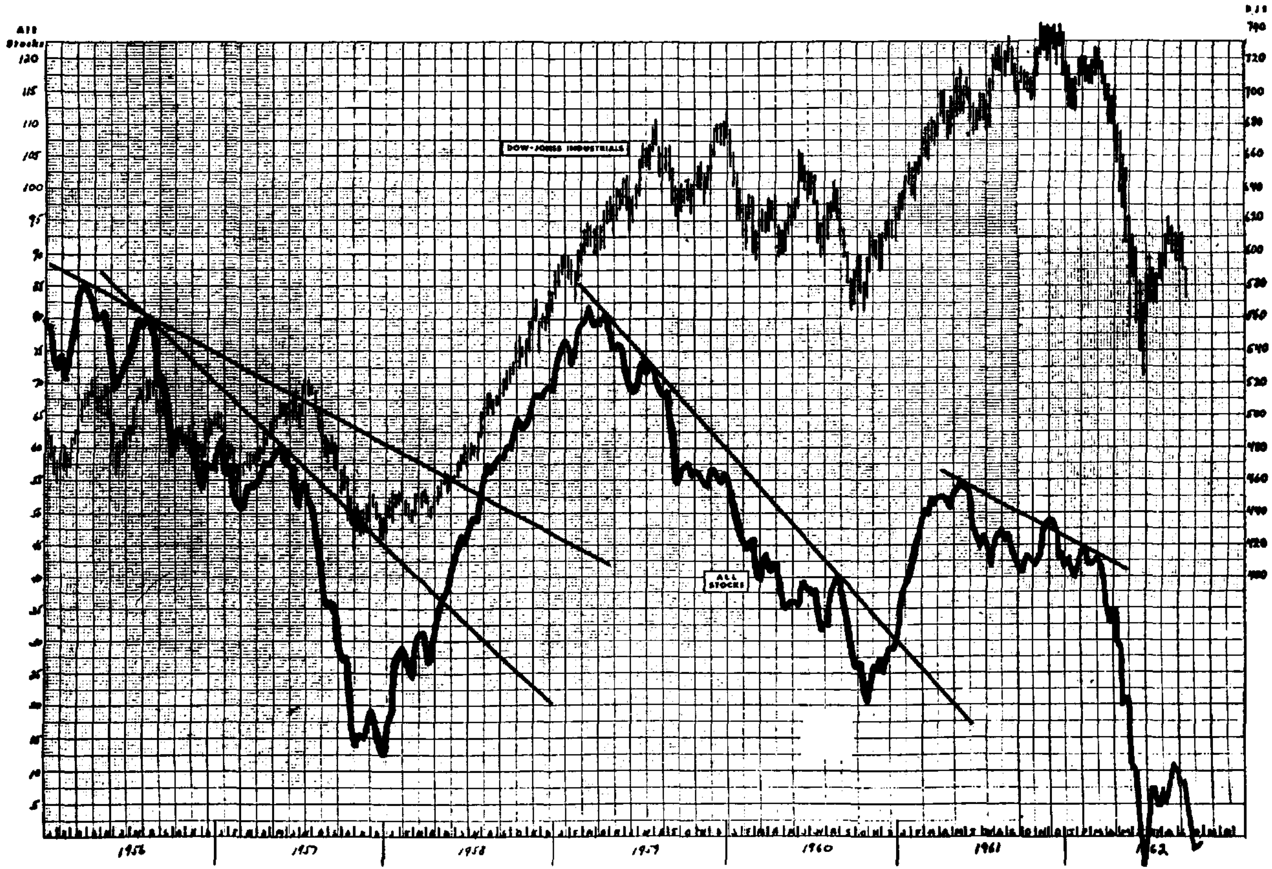
This should complete my assignment today, and, naturally, this is where I should like to quit; but I know you will not let me off the *current* stock-market "hook" in the question-and-answer period, so I will give you a few thoughts on this vital area before I sit down.

First, regardless of how favorably I view the long-term outlook, there are several (indicator) reasons to expect a softness of some sorts in business activity by early next year or even before. On the other hand, the current business recovery, which began in the first quarter of 1961, does not appear to have built up any of the usual economic "excesses" (i.e., inventories, huge new capacity, credit and other abuses, etc.). Thus, while

[2] This typical ten-year pattern was presented and discussed by Edgar Lawrence Smith in *Tides in the Affairs of Men* (New York: Macmillan Co., 1939), and Smith's theories were updated in his more recent book *Common Stocks and Business Cycles* (New York: William-Frederick Press, 1959).

CHART VII

Major Trend—All Stocks



(as I have taken pains to discuss today) our economy is still basically adjusting to the imbalances inherited from the postwar period preceding the mid-1950's, it is very encouraging to me that no additional excesses have been piled up during the past eighteen months which could further complicate and delay the convalescence in basic business conditions that has been going on ever since the 1955–57 period. It is very possible, therefore, that the "coming recession" will be so mild that it will be only a "technical" recession, with the Federal Reserve Board industrial production index ranging somewhere between the present 119–120 level and a 1963 low point of 112. Similarly, it is very possible that the 525 Dow-Jones Industrial level of last June has already discounted this type of mild recession.

Stock Indexes Up—Stock Prices Down

Let's face it though. If the excesses in the current recovery of the economy have been small to nonexistent, stock prices—as measured by the familiar Dow-Jones Industrial index—had developed by late 1961 the "excesses" of selling at the historically high level of 24*x* earnings and on less than a 3 per cent yield basis. By last June, however, this familiar stock index had dropped by 30 per cent to a more "normal" 15*x* earnings and a "reasonable" 4 per cent yield basis—not too far from present relationships. Whether this is enough "correction" of the big 1949–61 stock-market (index) rise is problematical, but one thing is certain: *the Dow-Jones Industrial Average is not telling the real story behind the stock market since 1956.*

In this connection, I call your attention to Chart VII, which shows the weekly high and low of the Dow-Jones Industrial Average since 1956 and the major trend of all stocks. This major trend line is usually referred to by stock-market technicians as the "Breadth Index," because it measures the continuous relationship of the total number of stocks that trade every day on the New York Stock Exchange with the number of stocks which advance and decline each day. Obviously, regardless of what the Dow-Jones Industrial index may indicate, the majority of all stock traded on the big board since 1956 has been in a major three-phase downtrend which *may* very well have culminated last June.

Even the individual price action of the thirty stocks which make up the Dow-Jones Industrial Average reflects the declining trend of stocks since the 1955–57 period. For example, when the Dow-Jones Industrial Average recorded its all-time high of 734.91 last December 13, or over 40 per cent above its mid-1950's high of 525, fifteen of the thirty stocks were *lower* than their own individual highs of that period by an average of 21 per cent! And, a few days ago, with the Dow-Jones Industrial Average still over 10 per cent above its mid-1950's high, twenty-one of the individual thirty Dow-Jones Industrial stocks were selling *lower* than their own individual highs of the mid-1950's by 30 per cent!

In thinking about the current stock market, therefore, one must constantly keep in mind the *differences* between the underlying pattern of the 1949–61 bull market, especially since 1956, from other bull markets and especially from the one of the 1920's. While there are a great number of differences between the conditions of 1929 and the current market, notably in money and credit areas, the stock-market differences are unique.

For example, whereas there is normally a market-top distribution area of a year or so as in 1928–29, as the Breadth Index (Chart VII) and the individual price action of the thirty Dow-Jones Industrial stocks clearly reveal, the current market's position is the result of a *six*-year distribution period. Specifically, the motors, chemicals, nonferrous metals, and rails topped out during 1955–56; oils in 1957; steels in 1959; electronics and glamour issues in 1960; food and utilities in 1961. As a result, by the time of the 1962 spring collapse, a large number of stocks were so well liquidated that they not only outperformed the Dow-Jones Industrial Average in the decline but have outperformed it in the recovery period (i.e., oils, motors, etc.).

In short, when one (really) looks at the current stock market, it is obvious that a tremendous amount of stock-market correction has been taking place for the past several years (rather than just in 1962, as it may appear to the uninitiated) and that many stocks are quite thoroughly liquidated, even if the Dow-Jones Industrial stock average may "back and fill" in a 100-point trendless 525–550 to 625–650 band for some time, or even record a moderate new low. The main point to keep in mind about the stock market for the next several months is that, while it will require keen analysis and vicious selectivity, it should provide a major buy area for the rest of the decade.

Summary and Conclusions

It seems to me that from the above facts, figures, and discussion the following summary conclusions are in order:

1. The mild business recovery of the past eighteen months very likely will be followed by another six months to a year of "softness"—representing the "ending" of the prolonged "in-between" economic adjustment years since the mid-1950's.

2. Earnings on the Dow-Jones Industrial stocks, therefore, are likely to remain in the \$30–\$36 per share range which has prevailed since the

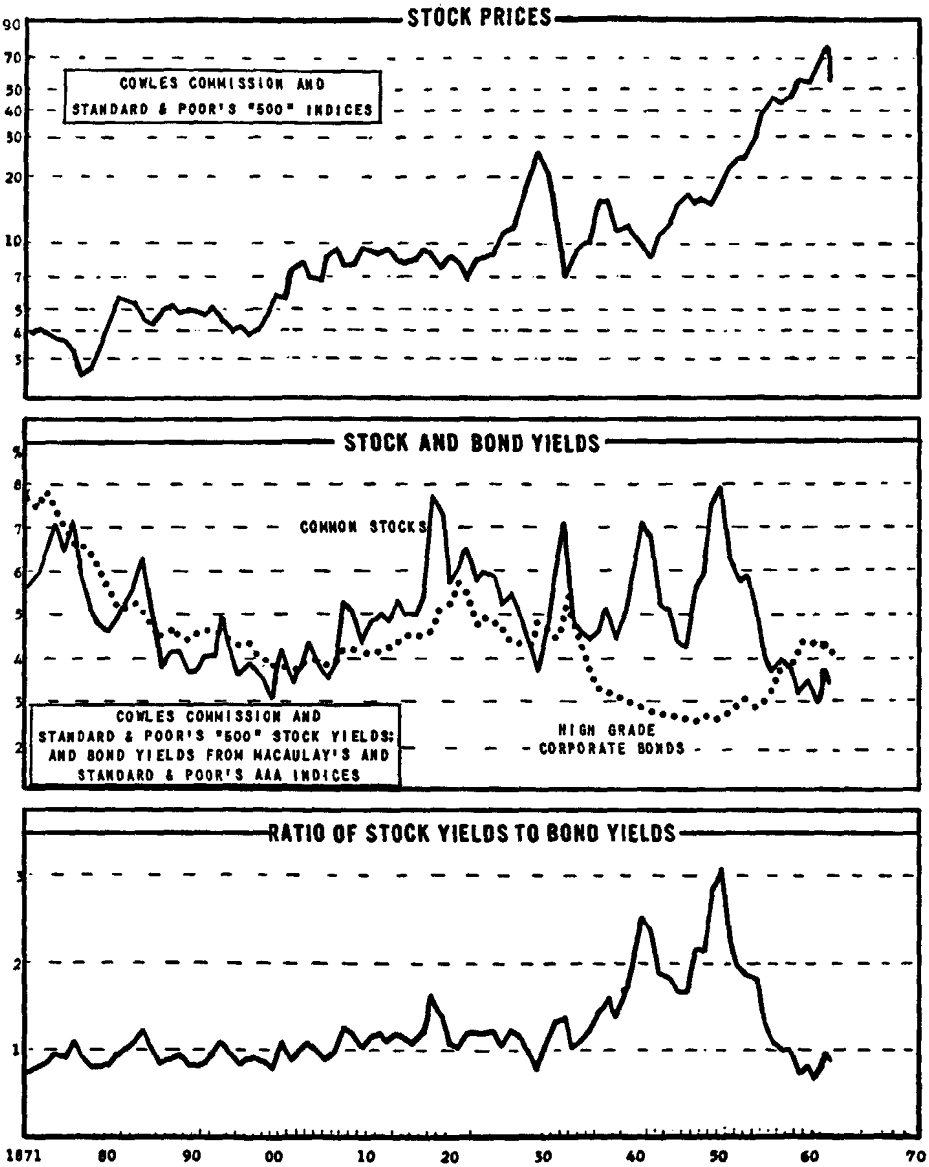
mid-1950's for another year or so. While this background certainly does not suggest the likelihood of a broad stock-market advance, neither does it suggest a further steep emotional decline after a 30 per cent drop in the Dow-Jones Industrial Average earlier this year and a much larger decline in the majority of stocks which has been taking place progressively ever since 1955. Actually, the average decline from the individual high to low price of the thirty Dow-Jones Industrial stocks has been 43 per cent during the 1955–62 period. Thus, while it is obvious that a major Dow-Jones Industrial stock-market top was made last December at the 735 level, it is also very possible that the Dow-Jones Industrial approximated a major bottom last June at the average 525 level.

3. The most likely prospect for the intermediate term, therefore, is a wide trading range for quite a prolonged time—a year or so—between 525 to 650 as measured by the Dow-Jones Industrial. This trading range, however, will undoubtedly mask some striking internal market changes and require vicious selectivity as many of the still overvalued former favorites are knocked down and as many of the sold-out stocks, representing our long-depressed basic industries which have large recovery potentials, begin to move up.

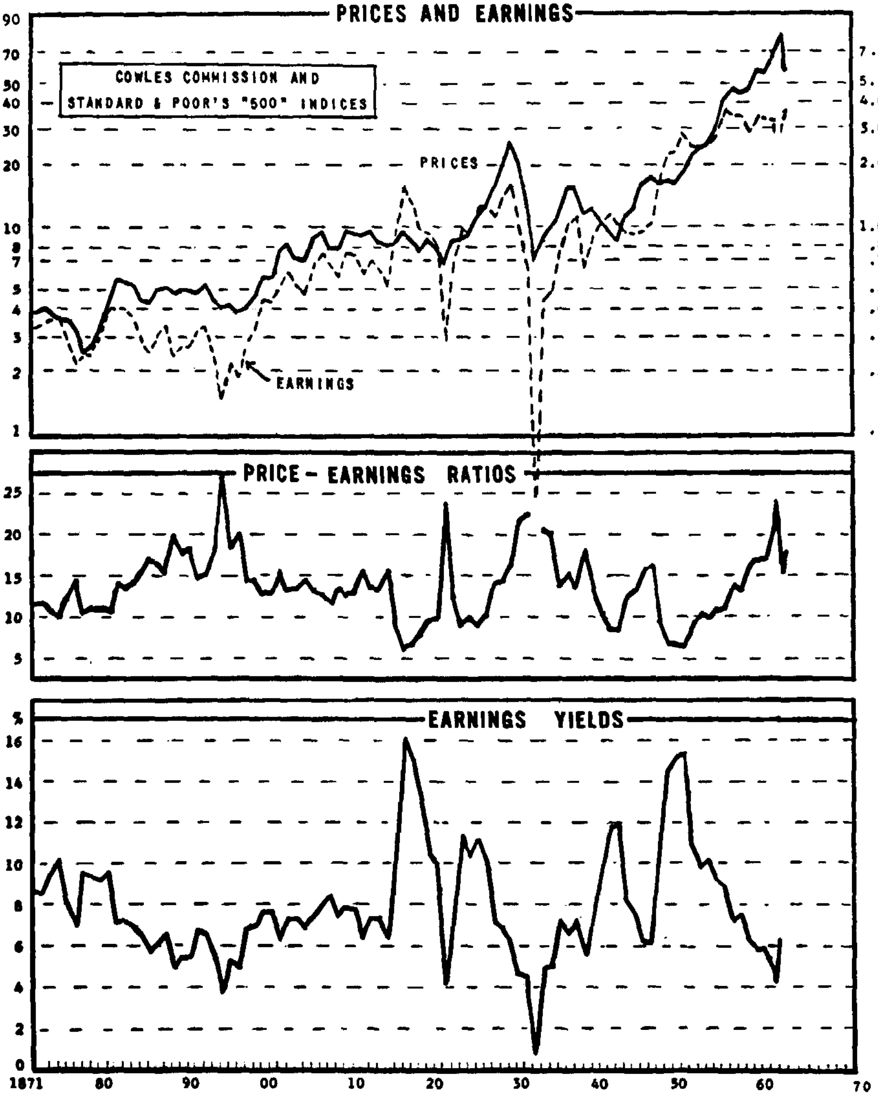
4. While this indicated that prolonged trading range can be a very irritating period, one must remember that investment opportunity and problems go hand in hand and that pessimism and gloom are the natural companions of long-term accumulation patterns during which stocks gradually pass from weaker, speculative holders to stronger, investment holders. This indicated trading range should, therefore, develop into an accumulation base which should eventually take the stock market as measured by the Dow-Jones Industrial way above the 1961 highs—very likely double recent market prices as the basically favorable and vigorous business conditions develop over the latter half of this decade.

5. Finally, we should all remember that, despite our periodic ups and downs, it has never really paid to sell America short and that well-selected common stocks are the best method of capitalizing on the long-term growth of the American economy. The 1871–1962 stock prices chart and accompanying tabulation shown in the upper panel of Appendix Chart A clearly reveal the value and strong odds in favor of long-term investing in common stocks.

APPENDIX CHART A



APPENDIX CHART B



APPENDIX CHART C