QUARTERLY TECHNICAL PERSPECTIVE

Walter R. Deemer
March 30, 1973

SUMMARY AND CONCLUSION

A considerable amount of long-term technical strength which is present in the market has been more than offset by the extremely viscious downside momentum in the price structure, and the market has earned a "bear market" lable for itself as a result. The disparity between most stocks and high-quality growth stocks is therefore expected to be resolved by eventual declines in the latter, which normally resist a bear market until its' late stages and then join in the general decline. The large number of "cheap" stocks on an historical basis suggests that the eventual bottom should be a better than average long-term buying opportunity, but when the bear market will end and at what level is anybody's guess at this point. The risks from present levels seem to be high enough, especially in institutional-quality growth stocks, that lower than average volatilities are recommended based on technical factors.

NOTE TO READERS

The stock market seems to be unusually controversial at the present time. As a result, points discussed below have been illustrated by chart exhibits wherever possible. This is to let readers follow the reasoning in the discussion as best as possible, and better enable them to agree cr disagree with the conclusions that are made as they so choose. It is hoped that readers will not let the unusually large number of exhibits discourage them from referring to them as they are mentioned in the discussion.

INTRODUCTION

The stock market is so fragmented now that it is virtually impossible to discuss it in general terms. There are at least five separate markets at the present time: institutional quality growth stocks, cyclical stocks, defensive stocks, secondary stocks--and the general market averages themselves, which are a blend of the preceding four areas, but not awfully representative of any particular one of them. (The strength in quality growth stocks, for example, which make up approximately a third of both the S & P 500 and D-J Industrial averages, has tended to hide the weakness elsewhere.) In addition, there is a sharp distinction between the participants in the equity marketplace: institutions dominate trading as never before, and non-institutional players are very much on the sidelines. We shall try in this report to discuss the market both in "general" terms and in terms of each of the major areas whenever possible.

BACKGROUND

The advance from the November 1971 lows petered out early in 1972; since that time the market has been neither a "bull market" nor--until recently--a "bear market." It was not possible to call the early 1972-early 1973 market a "bull market" because even though the general averages were rising more stocks and groups were declining than advancing, especially in the secondary areas. On the other hand, until the major uptrend lines through the 1970 and 1971 lows were penetrated recently it was impossible to call it a "bear market." With the penetration, however, averages join the majority of stocks and groups in a bear market; only institutional-quality growth stocks have reamined immune to the general decline.

SUPPLY-DEMAND

The supply-demand situation improved considerably during the last quarter, highlighted by a reduction in new common stock offerings, an ever-increasing number of companies announcing plans to reacquire their own stock, and a considerable increase in institutional cash reserves.

Figures on new equity offerings are subject to considerable delays. The most recently reported data, through December, show that new equity financing (common stocks, convertible securities, and secondary distributions) was at the low end of its range of the last two years relative to total NYSE market value (See Exhibit I). Additionally, those figures which are available for 1973 so far show a further reduction, especially in the area of secondary distributions, and filings of new equity offerings with the SEC have been relatively modest (except for utilities). The market thus has had less supply to wade through than it had to during 1971 and 1972, and this condition apparently will remain in effect for a few more months at least.

The most dramatic development in the supply-demand picture recently, though, has been the large number of corporations which have announced plans to reacquire their own stock. Some estimates place the dollar amount of this stock as high as $1.5 billion with over 100 separate companies involved, which obviously represents a plus factor of some importance to the market on a longer-term basis.

The amount of institutional cash is another positive factor. Mutual fund cash was 6.2% of total assets in February, compared with 6.2% in late 1971 and 6.5% at the 1972 bottom, but well below the 12.6% reached in mid-1970. Because of their redemption problems, however, mutual funds have been dwarfed as a market factor by other institutions recently, so the cash positions of pension funds, banks and insurance companies--which are not publicly reported--thus take on considerable importance. Leading institutional brokerage firms indicate that these institutions are presently estimated to have 9% to 13% cash positions and that these cash positions are considered "very high". Unfortunately, no direct comparisons are available with previous years to get an idea of just how high these reserves are historically at present. The statistics on institutional trading, although available only through the third quarter, also suggest an increase in available cash at institutions. Exhibit II, which shows this data normalized by taking it as a percentage of NYSE market value, shows that the net buying in the third quarter was the lowest since the third quarter of 1970. The fourth quarter figures should be released sometime next month, and will be important in determining whether this cash buildup continued after September.

One of the key sources of demand for stocks over the last decade has been the ever-increasing percentage of common stocks in pension fund portfolios. Exhibit III shows this trend quite clearly. At the end of 1971 stocks accounted for 67.8% of pension fund portfolios at market value and 59% at book value. The latter series, while not as relevant, is reported quarterly; it shows an additional 3.5% increase through the third quarter of 1972. It thus seems likely that the final 1972 figures of common stock holdings at market value will prove to be in the 71%-72% area. This trend shows no signs so far of abating, but there is obviously a limit somewhere to the expansion. Some have suggested that relatively high interest rates will help to stop it, which is hard to refute.

The two other sources of potential buying power that have been available to the stock market for some time, namely foreigners and the general public, are still present. The public, for example, sold $6.5 billion of common stock on balance on 1971 and another $3.75 billion in 1972. It has been suggested that a resolution of the currency problems of the last few years would encourage foreign buying of American stocks; what would lure the public back is anybody's guess. At any event, there are several important sources of demand now present in the stock market, including institutions, foreigners, and the general public, and corporations buying back their own stocks are also favorable.

On the negative side, the problem of margin calls has surfaced again. As of the end of February, 16% of all margin accounts had less than a 40% equity position, representing approximately $1.3 billion of margin debt, and retail-oriented brokerage house state that the number of margin calls issued recently have increased to peak levels of 1970. Interestingly, these brokerage houses also indicate that their margin customers have not become net sellers as they typically do at important bottoms, implying that people are meeting margin calls by putting up more cash rather than selling stock positions.

INTEREST RATES

Much concern has been voiced recently over rising short-term interest rates, but two technical studies suggest that the concern is a little premature. The first is the "Three Step and Stumble" rule which Edson Gould, one of the great pioneering technicians, many years ago formulated to delienate the point at which rising interest rates cease to merely reflect rising stock prices and expanding economic conditions, but start to increasingly become a cause of the next downturn. The rule states: "Whenever three successive rises occur in any of the three rates set by the monetary authorities (the discount rate, reserve requirements, and/or stock margin requirements, investors should beware--for some time thereafter the market is likely to suffer a substantial set back."

Since 1930 this rule has been triggered seven times (See Exhibit IV): January 1946, August 1948, September 1955, March 1959, December 1965 and April 1968. Afterwards, the market on average rose another 8-10% and 4-5 months, with a minimum lead time of two months before a top. Like most of Gould's work the "Three Steps and Stumble" rule tends to be overly simplistic, but also like most of his work it shows impressive results. Although there have now been two increases in the discount rate, the built-in lead time in the indicator should provide a cushion when the third increase occurs to invoke the rule.

The second technical study is the Monetary Thermometer, which was developed by the Bank Credit Analyst as a consensus indicator of ten measures of credit policy. To quote them, "the purpose of the Thermometer is to provide a conservative indicator (of Federal Reserve policy) with a high degree of reliability." Points are added to the Thermometer as its various components turn negative, with 3 different levels of bearishness for each of the ten components. A total of eight points is required for a bearish condition to be reached (conversely, dropping from above 8 to below it is a bullish indication.) The past history of the Monetary Thermometer is shown in Exhibit V and the lead time for each signal in Exhibit VI. Note that the lead time at market tops ranged from 1 to 8 months with an average of 4.7 months, and that the market has never peaked before a bearish reading was recorded (except for non-monetarily inspired declines). At present, the Thermometer has risen only to 5, which means it is still in bullish territory. The Bank Credit Analyst comments in their February issue that "Since the (Thermometer) has had, historically, a built-in lead time, any effort to anticipate a signal is likely to prove to be a fruitless excerise. The record...has demonstrated that once a signal is given, there (still) is time to reduce or eliminate stock market exposure."

In summary, these admittedly somewhat simplistic approaches to interest rates as they affect the stock market (which nonetheless both have excellent records) suggest that although the recent increases in interest rates is approaching the point where it would have to be considered bearish it has not yet done so. Since both methods have historically reliable lead times to market peaks of 4 to 5 months, one would have to conclude that the increases are still normal and not yet bearish.

SPECULATION

Public stock market speculation remains conspicious by its absence. The Amex/NYSE volume ratio (See Exhibit VII) is at its lowest level in twenty years and the recent action appears remarkably similar to the period following the 1962 decline. However, there seems to be no way to anticipate when it will begin to increase as I tried to do in my last report.

Institutional speculation is quite a different story. P/E ratios on institutional quality growth stocks were pushed up to record levels in January, and the premium of growth multiples to other multiples also reached new all-time highs. This will be discussed further under Growth Stocks; as far as the speculation in them goes, it is still virtually impossible to predict how long the period of exploitation will last or how much more intense it may eventually get. It is only possible to state that based on past standards, the exploitation of institutional-quality growth stocks is at dangerous levels.

SENTIMENT

Sentiment indicators are mixed; those reflecting public sentiment have not turned favorable, but institutional sentiment has. The latter is almost impossible to measure accurately, since timely figures are available only on mutual funds, insurance companies and pension funds. The most recent mutual fund report did show that at the end of February cash was 6.2% and 6.5% respectively, but is way below the 1970 high of 12.6%. This percentage, of course, tends to be the highest at a general market bottom.

No comparable data is available for other institutions, but leading institutional trading firms estimate that banks and insurance companies are presently 9% to 13% in cash against a normal 3% to 4%. This is quite favorable not only from a supply-demand viewpoint (as discussed earlier) but also as a measure of institutional bearishness. While no direct comparison is available with 1970 levels, 9% to 13% certainly appears to be abnormally high for this type of institutional investor, inferring an abnormally high degree of bearishness.

Short selling statistics are disappointing at best, with only odd lot short sales showing any type of a favorable reading to date during the decline. Member firm and specialist short sales have, except for one week, remained at an uncomfortably high percentage of total short sales. Also leading retail brokers report that their trading data has not yet reflected much short selling, indicating that the general public has not been as active on the short side of the market as they usually are after a decline of this magnitude. This lack of short selling is also reflected in this month's short interest ratio (the number of average days volume that the NYSE short interest represents) of 1.11 which, as Exhibit VIII shows, is quite low historically. During recent years, a short interest ratio above 1.80 has been favorable, and a reading below 1.10 has been unfavorable. Active bearishness thus seems not to have yet spread as generally as it normally does during an important decline.

GROWTH STOCKS

It can readily be seen from Exhibits IX and X, which are weekly charts of the Putnam Glamour averages since May 1970, that institutional-quality growth stocks have enjoyed an uninterrupted bull market ever since the 1970 lows. The Appendix contains daily charts of the Putnam Glamour Average for each year since 1966; here too, it can be seen that recent action is still within an orderly uptrend. We have commented previously on the exploitation in the quality growth stocks and the potential vulnerability that results from it. The main question facing us now is whether or not the potential vulnerability will be realized soon, or once again be postponed.

First, the exploitation problem. We have been putting out a weekly study of institutional-quality P/E multiples compared with DJI multiples, based on trailing earnings, for some time now; the most recent one is included as Exhibit XI. Exhibit XII is a graphic summary of the highest and lowest P/E ratios and relative P/E ratios for each quarter since 1962; the dotted line represents peak values each quarter for the Putnam Consumer Glamour Average, which has been consistently selling at higher values recently than the Glamour Average. The arrows indicate the present values for each series.

It can be seen from the top chart that institutional-quality growth stocks have sold at P/E multiples ranging from lows of 25-30 times trailing earnings to peaks of 55-60 times earnings; the all-time record P/E prior to this year was 62.5 times trailing earnings. During the first quarter of 1973, however, the Putnam Consumer Glamour Average sold at a new peak of 64.6 times earnings and the Glamour Average at 56.7 times earnings, and present multiples are still in the 53-56 range.

But P/E multiples alone are only part of the exploitation story. When growth multiples are compared with the DJI multiple the exploitation becomes much more dramatic. This is shown in the bottom part of Exhibit XII. A value of 3.0, for example, would indicate that growth stock multiples are 3.0 times the DJI multiple. The actual P/E ratios using this example might be 14 and 42, or 17 and 51, etc.

As can be seen from the chart, growth stock multiples relative to the DJI multiple have been gradually rising for the last eleven years. The peak level on a historical basis <u>allowing for this gradual increase</u> now seems to be about 4.0 and the trough level about 2.2-2.4. This compares with actual peaks during the last three months of 4.18 times for the Putnam Consumer Glamour Average and 3.92 for the Putnam Glamour Average, and present values are still in the 3.8-4.1 area. By whatever yardstick, then it seems that institutional-quality growth stocks are being very heavily exploited at the present time.

But price trends remain favorable--after all both glamour averages remain in solid uptrends. Is it possible to anticipate a trend reversal before it actually occurs? The answer is yes--if we are in a bear market.

Institutional-quality growth stock averages have made their major highs in the past <u>after</u> broad market averages have. The charts in the Appendix show daily price action of the Putnam Glamour Average for each year since 1965. Important peak and trough values for the DJI have also been indicated. Three separate bull markets tops are included. In 1966, the DJI peaked in February, declined 9½% by March, made a lower high in April, reached a lower low in May, made a further lower high in June, and then declined to the October lows. The Glamour Average resisted the bear market for six months--and then declined 28% in eight weeks, compared with a 14% decline in the DJI during the same eight weeks.

In 1967-68, the DJI peaked in October, declined 12% by November, reached a lower high at year-end, and made its eventual lows in March. Once again the Glamour Average resisted the early phase of the decline in the DJI.

Finally, we come to the classic December 1968-January 1970 period, when growth stocks ignored a bear market for a full 13 months. As you can see from the chart, the Putnam Glamour Average in 1969 completely resisted the sharp drops that took place in the DJI, and did not reach its bull market peak until the third week of January, 1970. It then plunged 41% in seven months--and, for the first time, made its bear market low after the general market did. Fully half of the decline in growth stocks relative action against the general market averages took place <u>after</u> the May 1970 bottom in the latter.

Several conclusions follow. First, the Glamour Average typically shows great resistance during early phases of a bear market, but sooner or later breaks down. During their topping-out process, several higher highs in growth stocks can occur against corresponding lower highs in the DJI. Secondly, growth stocks, once they start down, tend to plunge rather sharply during relatively short periods of time; their betas temporarily skyrocket. Finally, if 1970 is a new precedent, there is now a very real possibility that institutional-quality growth stocks tend to bottom out <u>after</u> the general market does. The general conclusion concerning the present situation is that if we are indeed in a bear market then institutional-quality growth stocks will, sooner or later, join in the general decline, and that such a decline would suggest that the bear market has entered its' late stages.

DEFENSIVE STOCKS

The biggest disappointment in the market during the last few months has been the performance of defensive and moderate-growth stocks. Even the energy group, which had been very strong technically, fell before the general market reaction and their performance turned quite selective as a result. Other moderate growth areas did worse, with growth utilities, to cite one example, giving up most of their late 1972 gains. The attraction that the area appeared to have three months ago technically has largely disappeared as a result, although it could return if--among other things--the dividend ceiling were removed.

CYCLICAL STOCKS

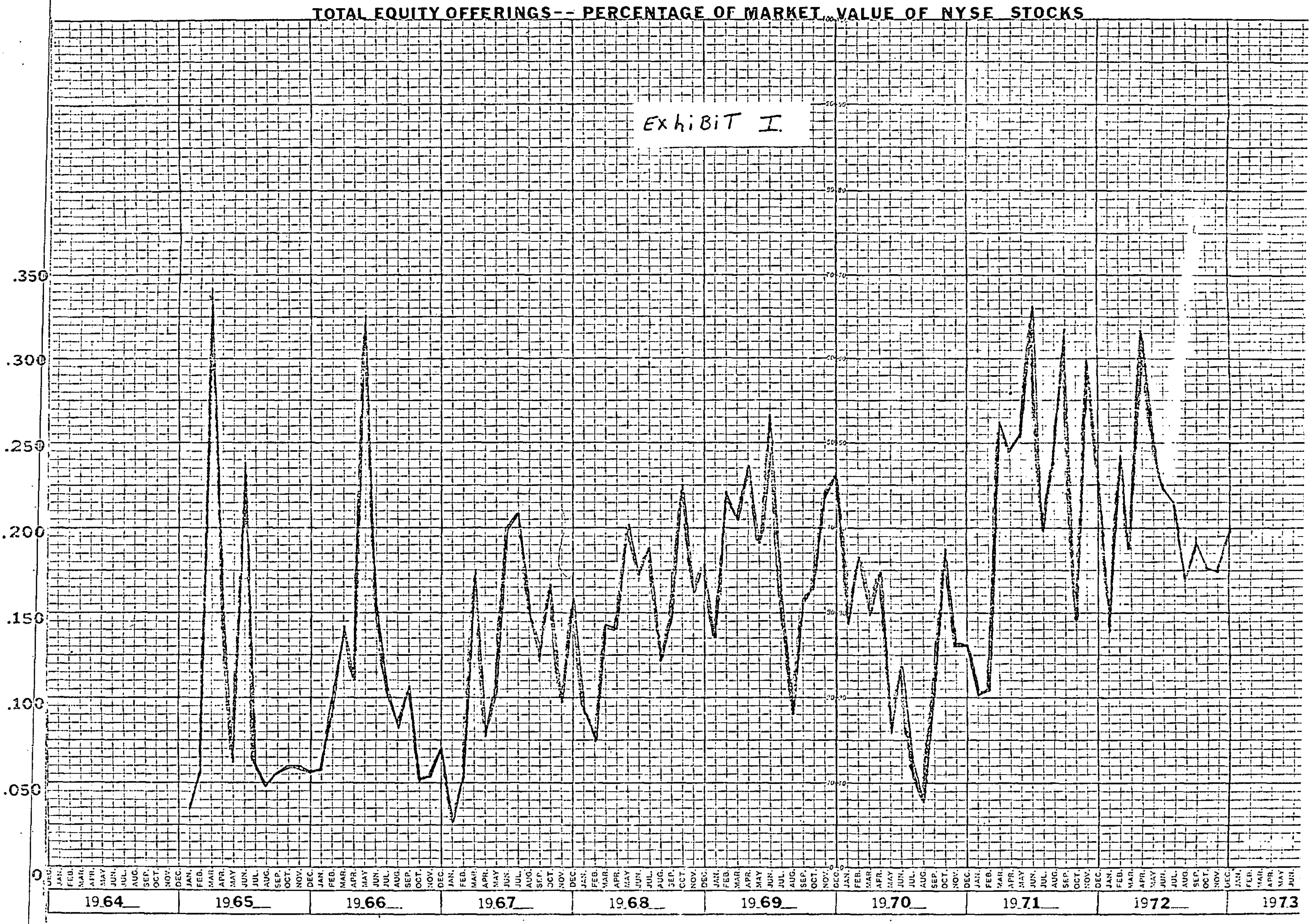
The cyclical area of the market continued to underperform the general averages, and no change is yet apparent technically. As usual, there are exceptions; some mining stocks, especially coppers, displayed good technical action during the past quarter, and specialty steel, fertilizer, and paper stocks also were highlights in this generally drab area. In general, cyclical groups seem content to languish outside of the market's spotlight, and areas of interest within the cyclical area remain highly selective technically. However, any removal of the restrictions on dividend increases would undoubtedly have a positive effect on this area as well.

SECONDARY STOCKS

Secondary stocks continued their poor performance which began last spring; since late December the Amex index and NASDAQ Industrial average have declined 13½% and 18% respectively, compared with a drop of 11% in the NYSE Composite index. Although public speculation, as measured by the Amex/NYSE volume ratio among other things, is at the lowest level in over twenty years, it appears to be impossible to predict when the eventual revival will occur. Although our aggressive money managers can easily compile a list of "very cheap" secondary growth stocks, until general speculation increases the stocks are likely to continue to be disappointing performers in general, although--as always--there will be some exceptions to this rule.

Lest the previous three sections unduly depress people, it should be remembered that when the overall market picture improves breadth will have to strengthen--and the only way it can do so is for one of these weak areas to turn strong. Opportunities are thus present somewhere in these three presently weak areas, even though it is too soon to spot them technically.

Exhibit I



TOTAL EQUITY OFFERINGS-- PERCENTAGE OF MARKET VALUE OF NYSE STOCKS
.350
.300
.250
.200
.150
.100
.050
0
1964
1965
1966
1967
1968
1969
1970
1971
1972
1973

TOTAL INSTITUTIONAL NET COMMON STOCK PURCHASES --- PERCENTAGE OF MARKET VALUE OF NYSE STOCKS

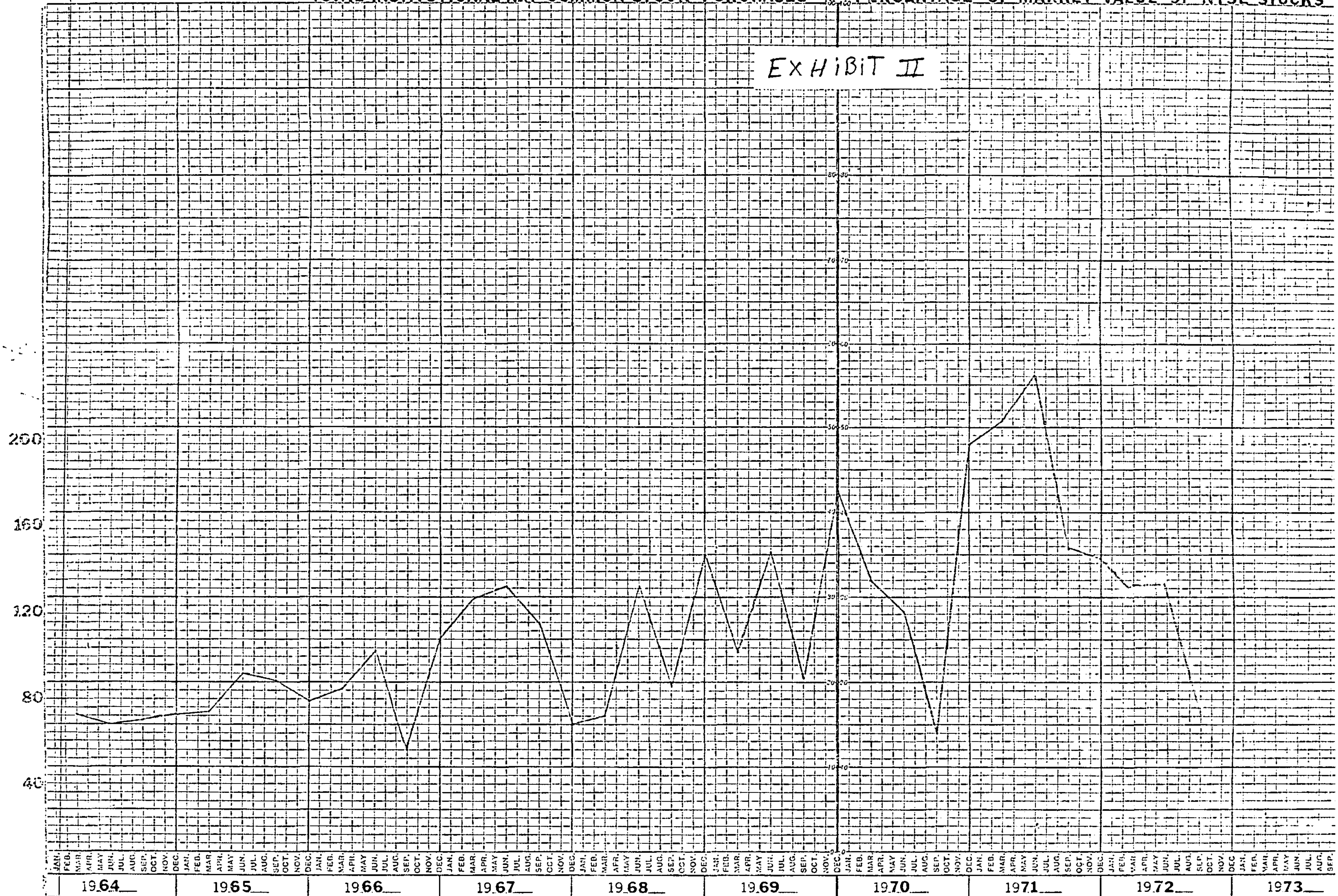
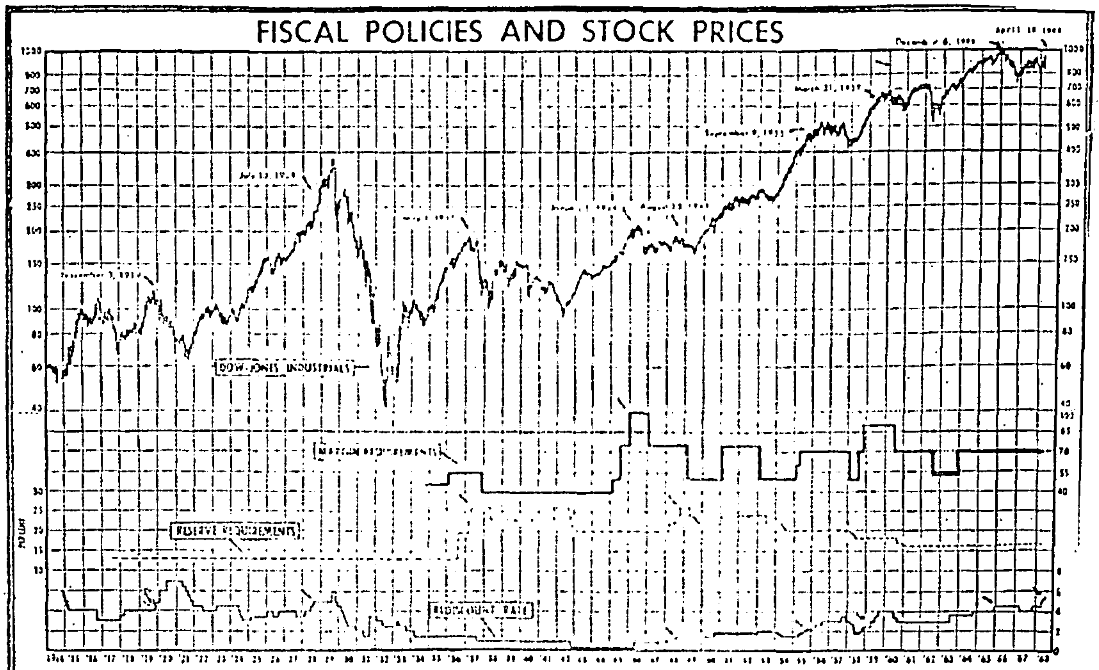


EXHIBIT III

PERCENTAGE OF PENSION FUND ASSETS INVESTED IN COMMON STOCKS

Exhibit IV



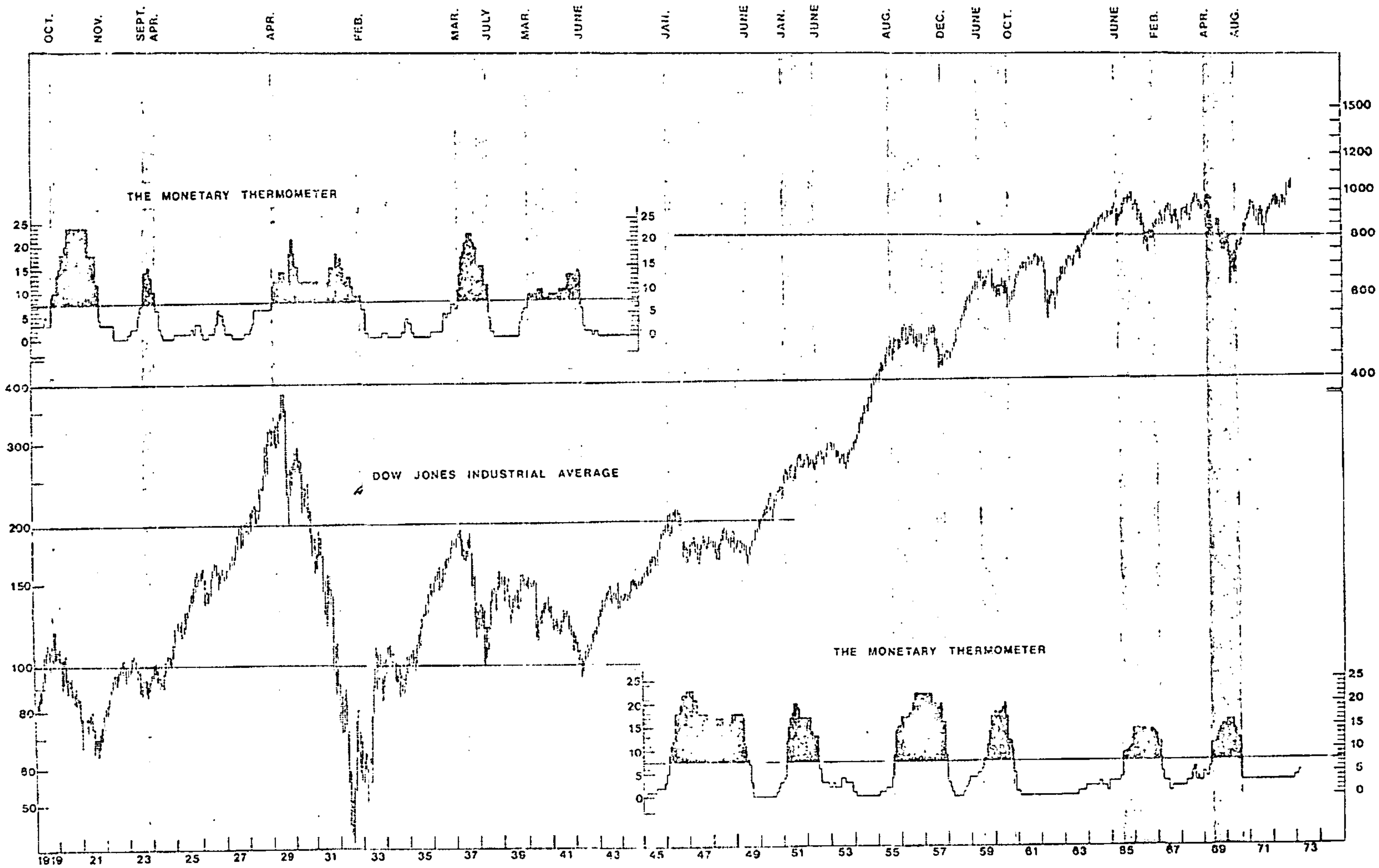
ARROWS INDICATE 3rd SUCCESSIVE MARK-UP OF RESPECTIVE RATES — ALSO CORRESPONDING LEVEL OF STOCK PRICES.

Three-Step-And-Stumble Rule in Action

Rule became operative on: (1)	On previous day DJIA had closed at: (2)	Subsequent top registered by DJIA occurred on: (3)	at: (3)	Time lag in months from date in Col. 1 to those in Col. 3 was: (4)	In that period increase in price from those in Col. 2 to Col. 3 was: (5)
11- 3-19	118.63	11- 3-19	119.62	..	1%
7-13-28	206.71	9- 3-29	386.10	14	86
5- 1-37	174.27	8-14-37	190.33	3	10
1- 1-46	192.91	5-29-46	213.36	5	10
8-13-48	179.63	10-26-48	189.83	2	6
9- 9-55	475.06	4- 9-56	524.37	7	10
3-31-59	602.65	8- 3-59	683.90	4	14
12- 6-65	946.10	2- 9-66	1001.11	2	6
4-19-68	909.21	12-2-68	994.65	7	8
			Average	5	18%

Exhibit V

THE MONETARY THERMOMETER AND THE MARKET



February 1973

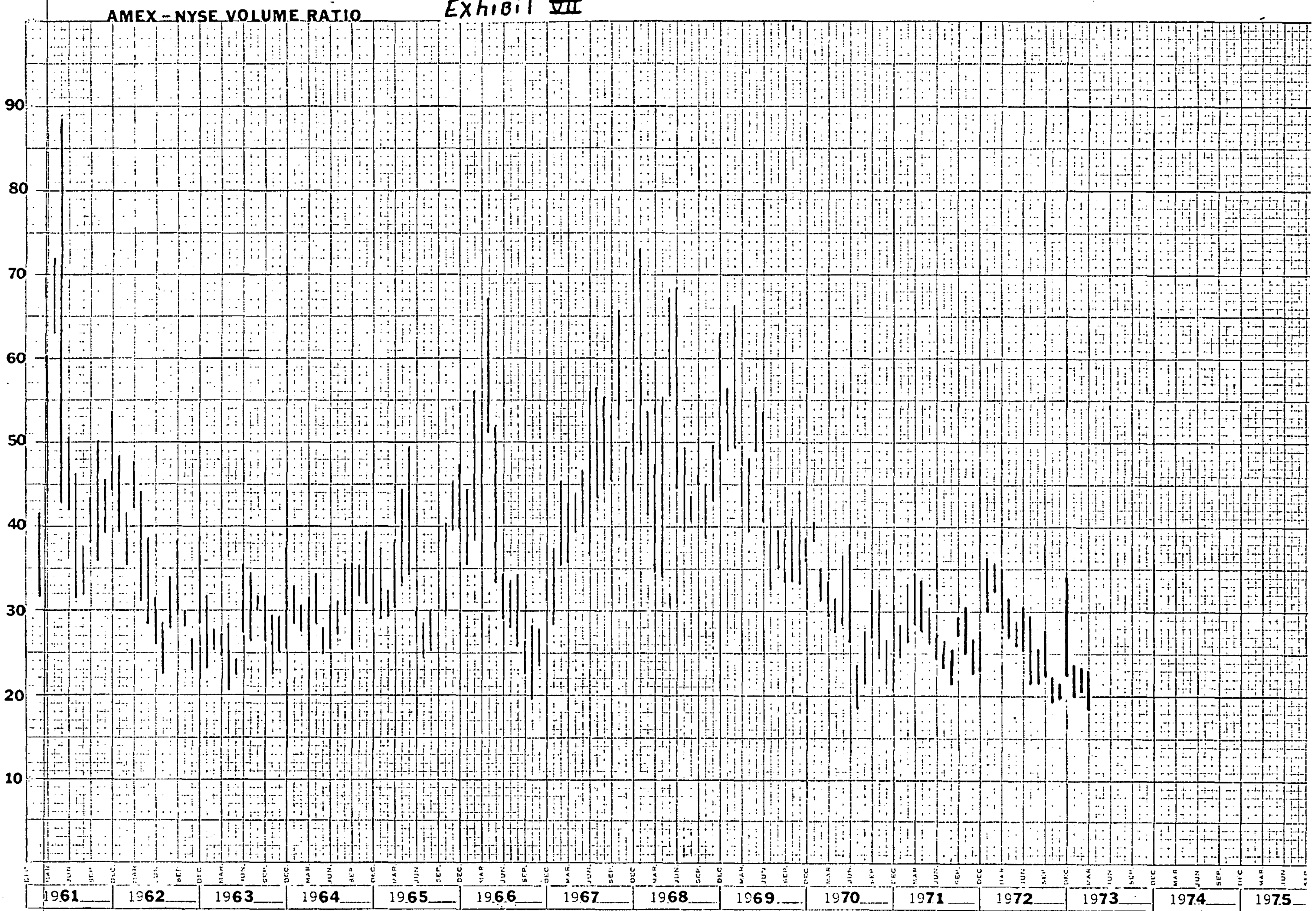
EXHIBIT VI

THE MONETARY THERMOMETER SIGNALS AND THE MARKET

Bearish Signal		Lead Over Final DJ Top	Bullish Signal		Lag After Final DJ Bottom
October	1919	1	November	1921	3
September	1923	*	April	1924	*
April	1929	5	February	1933	6
March	1937	5	July	1938	4
March	1940	1	June	1942	2
January	1946	4	June	1949	0
January	1951	8	June	1952	1
August	1955	8	December	1957	0
June	1959	7	October	1960	0
June	1965	7	February	1967	4
April	1969	1	August	1970	3
	Average	4.7		Average	2.3

* Excluded as there was no major decline in the market.

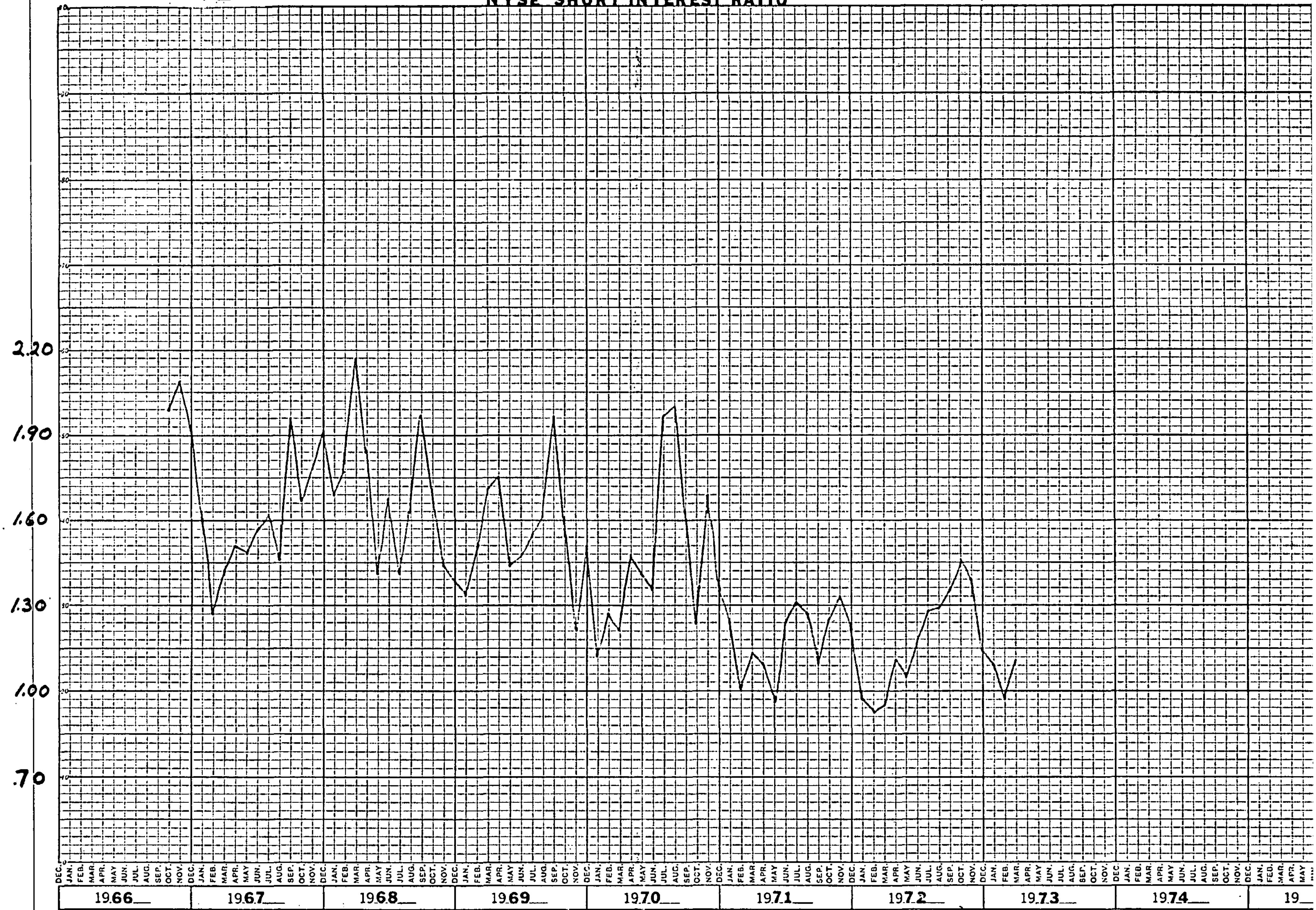
Exhibit VII



AMEX - NYSE VOLUME RATIO
90
80
70
60
50
40
30
20
10
1961
1962
1963
1964
1965
1966
1967
1968
1969
1970
1971
1972
1973
1974
1975

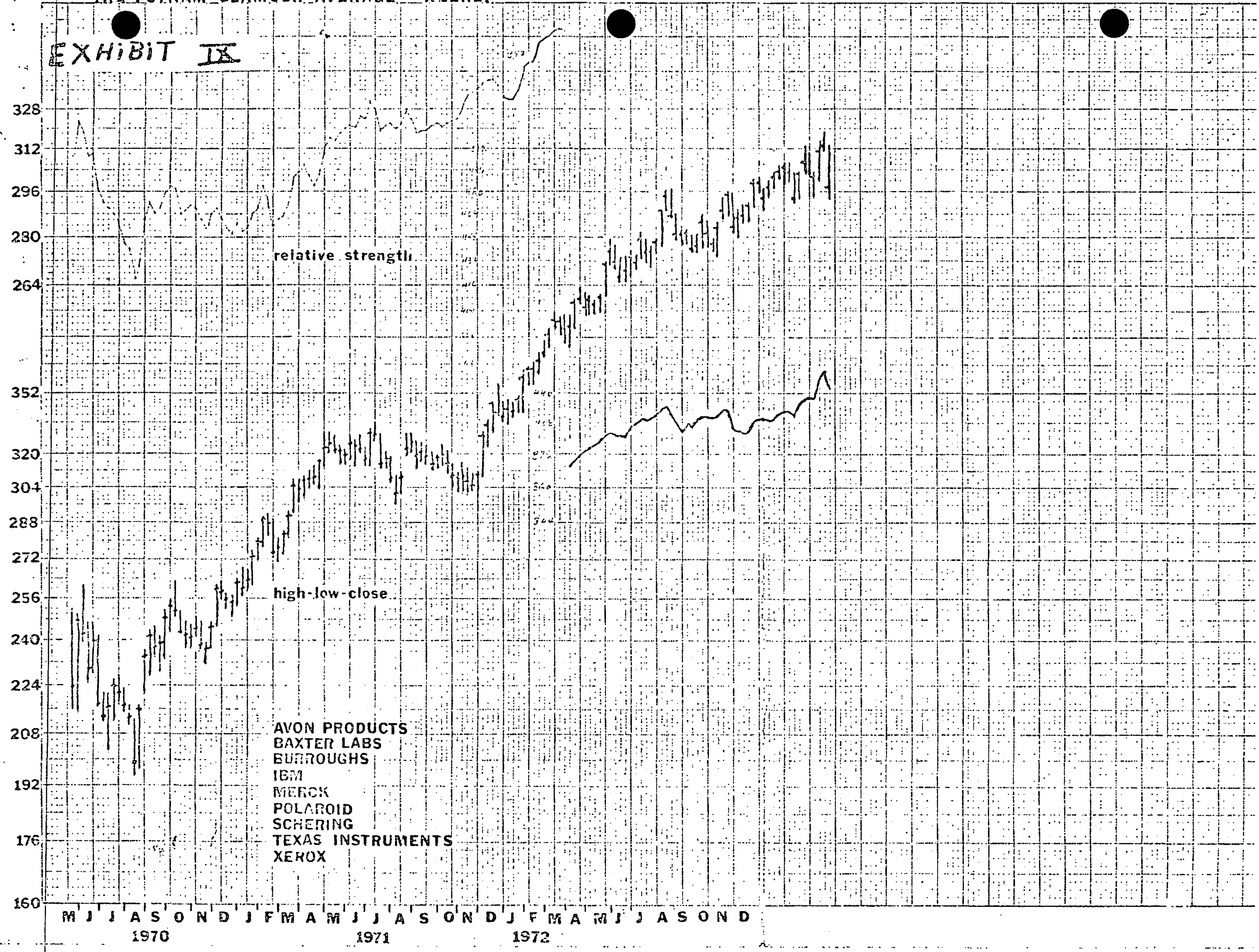
EXHIBIT VIII

NYSE SHORT INTEREST RATIO

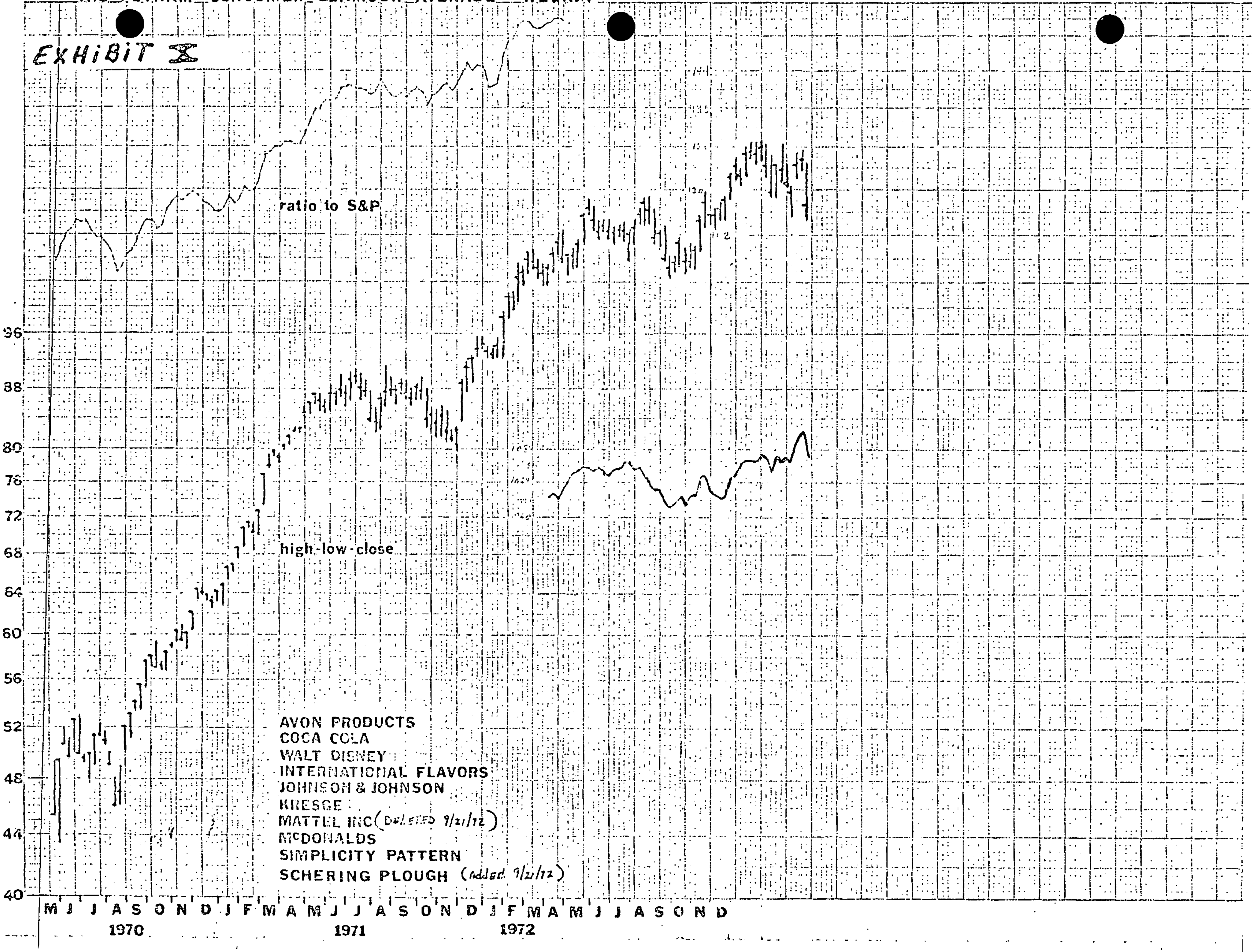


THE PUTNAM GLAMOUR AVERAGE - WEEKLY

EXHIBIT IX



THE PUTNAM CONSUMER GLAMOUR AVERAGE - WEEKLY



March 26, 1973

EXHIBIT XI

The most recent statistics in our study of price/earnings ratios are as follows:

WEEK ENDED	DJI EPS.	DJI P/E	GLAMOUR P/E (1)	RATIO (2)	CONSUMER GLAMOUR P/E (1)	RATIO (2)
Mar. 16	$66.63	14.5	56.7	392	60.1	416
Mar.23	$66.85	13.8	53.3	386	56.0	406

DJI earnings for 1972 were $66.73.

(1) Historic range prior to 1972 was 25.5 to 62.5 (both averages); 1973 peak is 64.6.

(2) Ratio of Glamour P/E to DJI P/E; historical range prior to 1972 was 158 to 382, (both averages); 1973 peak is 418.

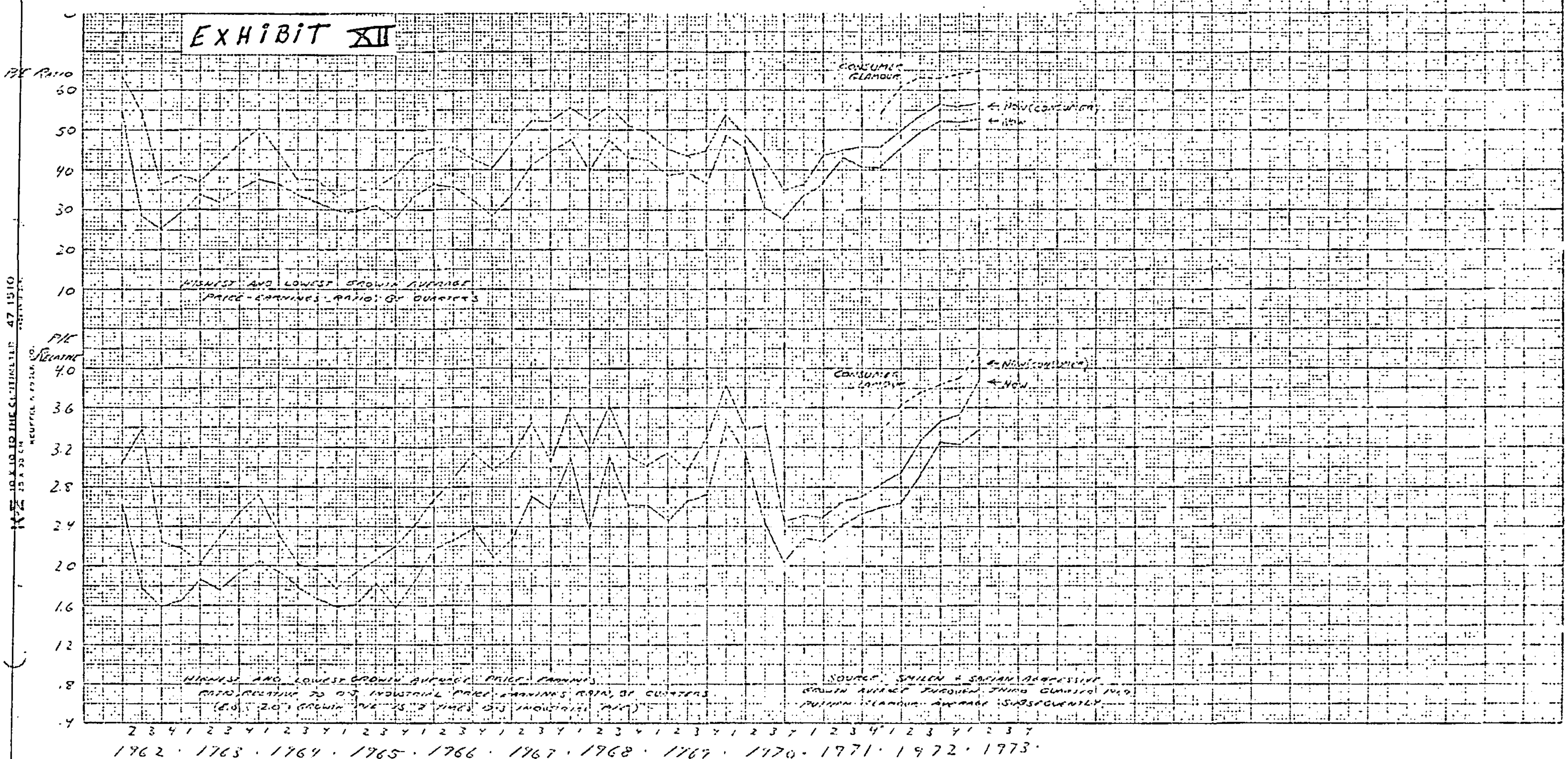


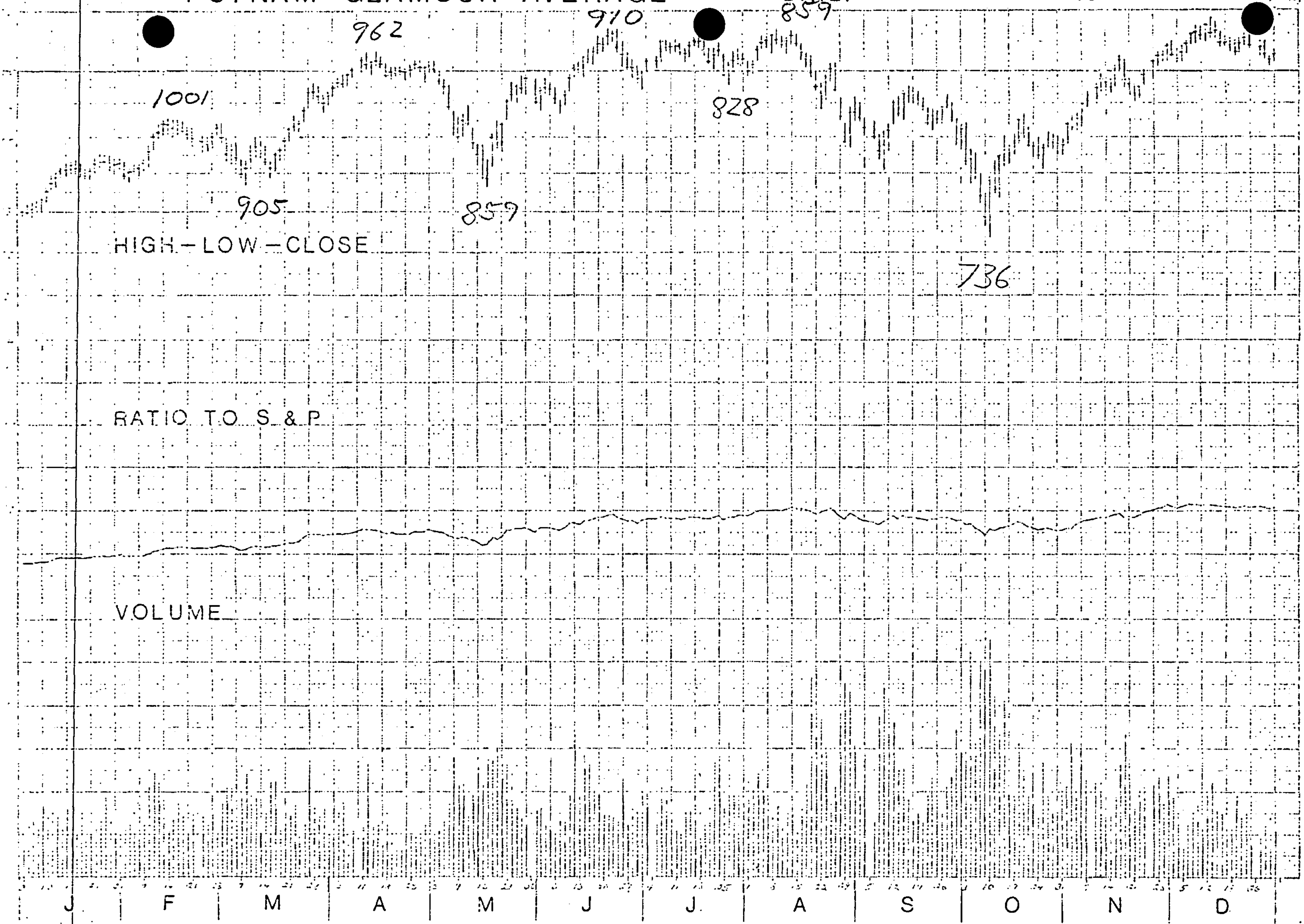
EXHIBIT XII
P/E Ratio
60
50
40
30
20
10
P/E Relative
4.0
3.6
3.2
2.8
2.4
2.0
1.6
1.2
.8
.4
Consumer Glamour
Now
1962 · 1963 · 1964 · 1965 · 1966 · 1967 · 1968 · 1969 · 1970 · 1971 · 1972 · 1973 ·

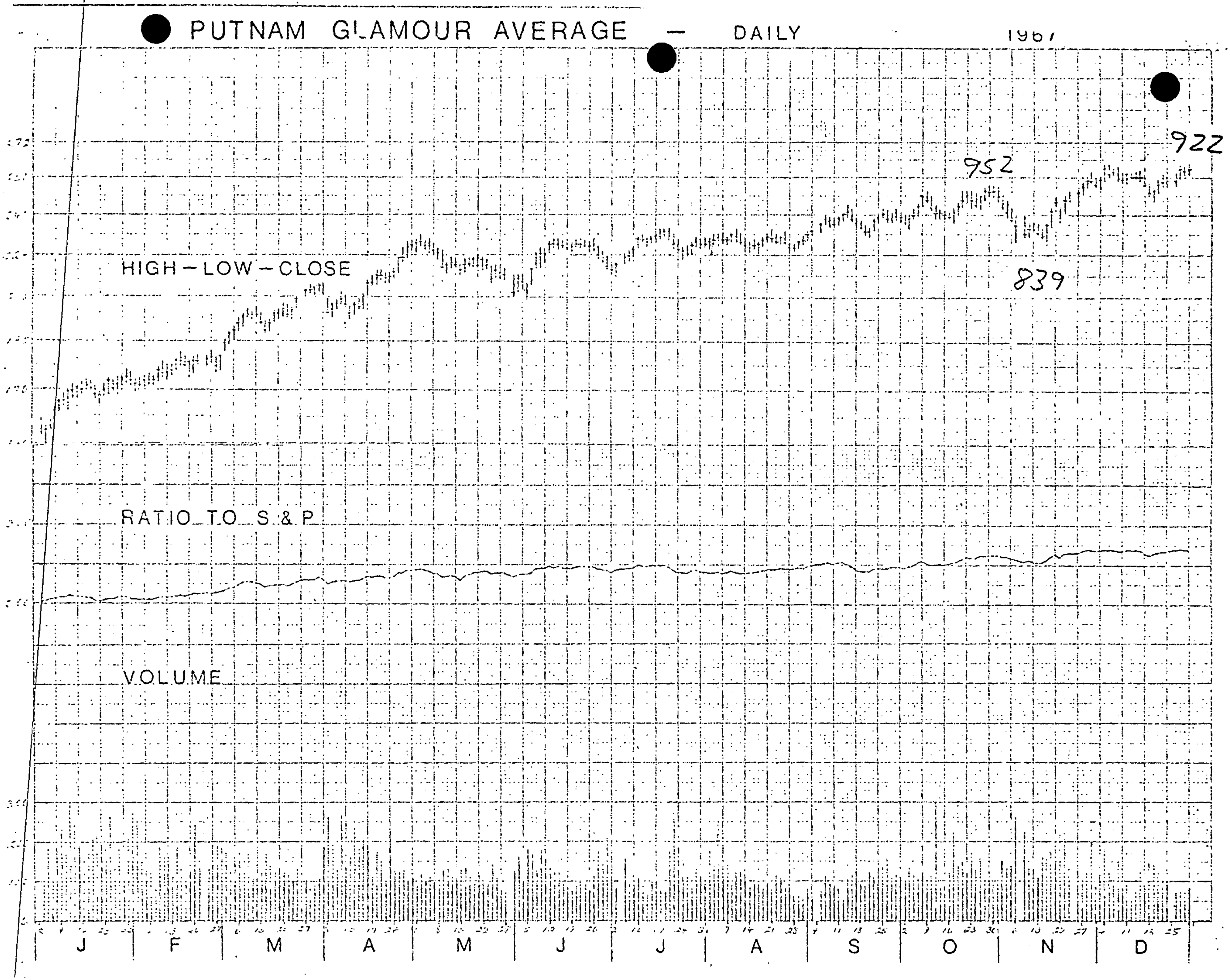
A P P E N D I X

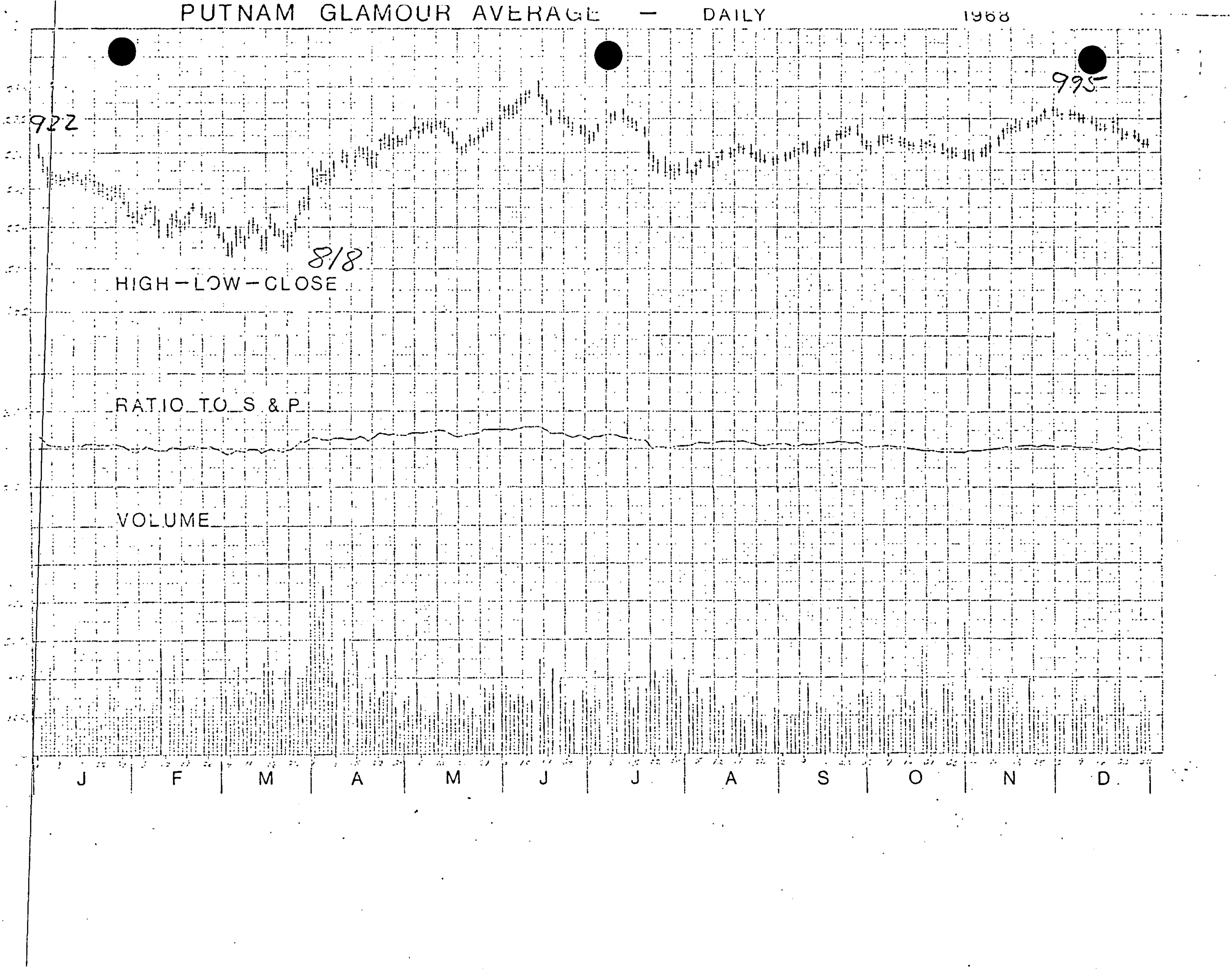
The Putnam Glamour Average--

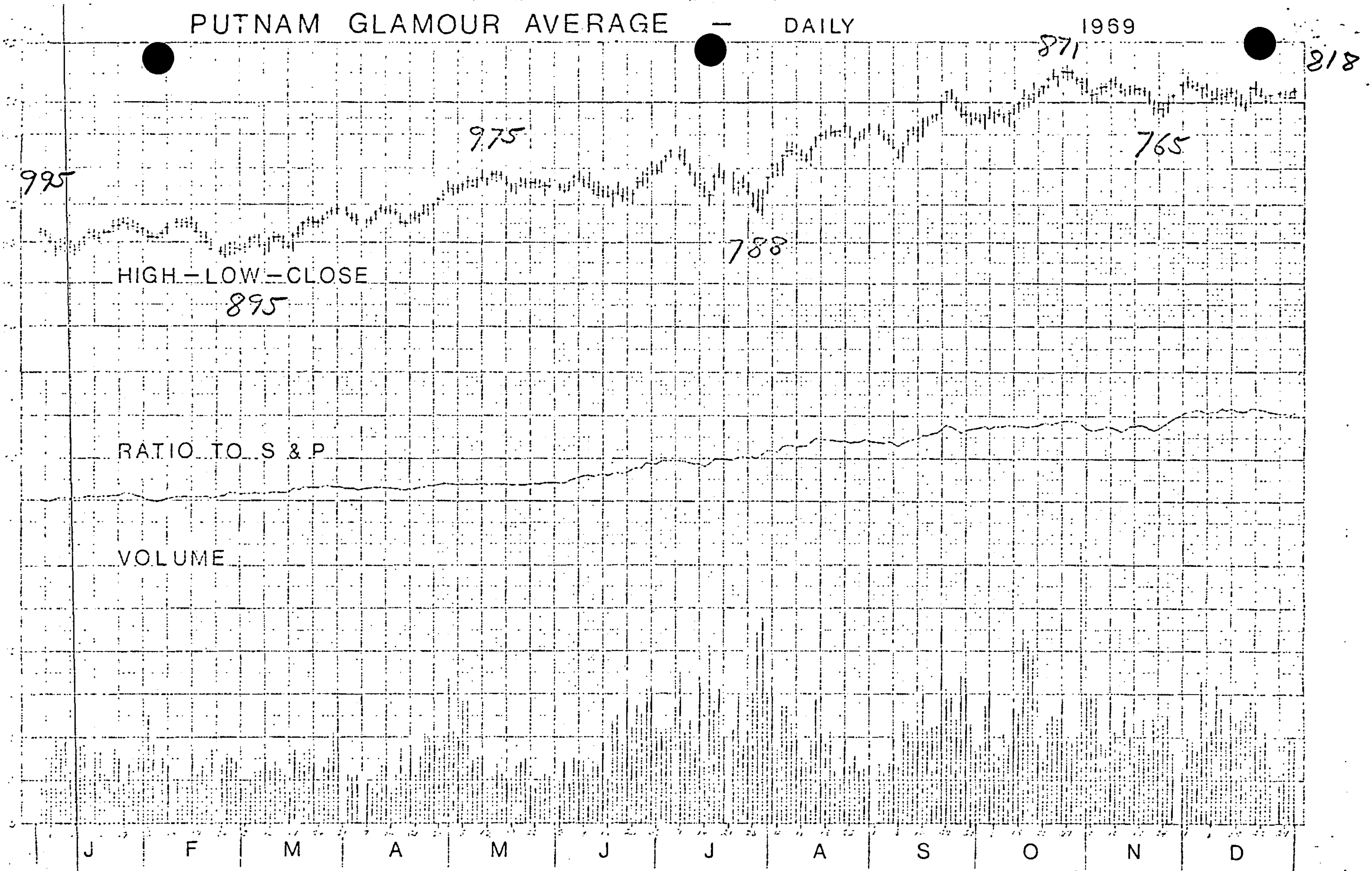
Daily, 1966-1973

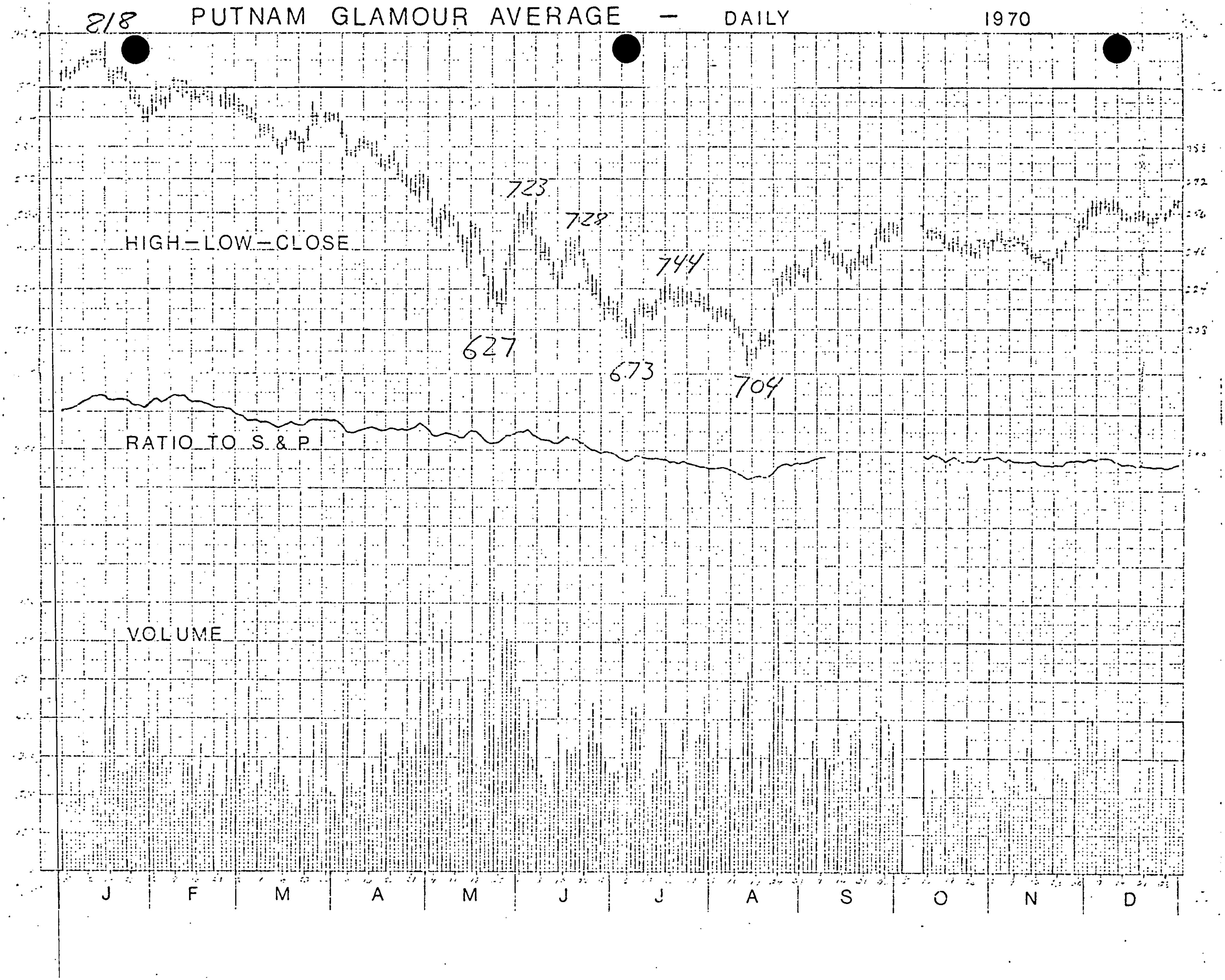
PUTNAM GLAMOUR AVERAGE — DAILY 1966

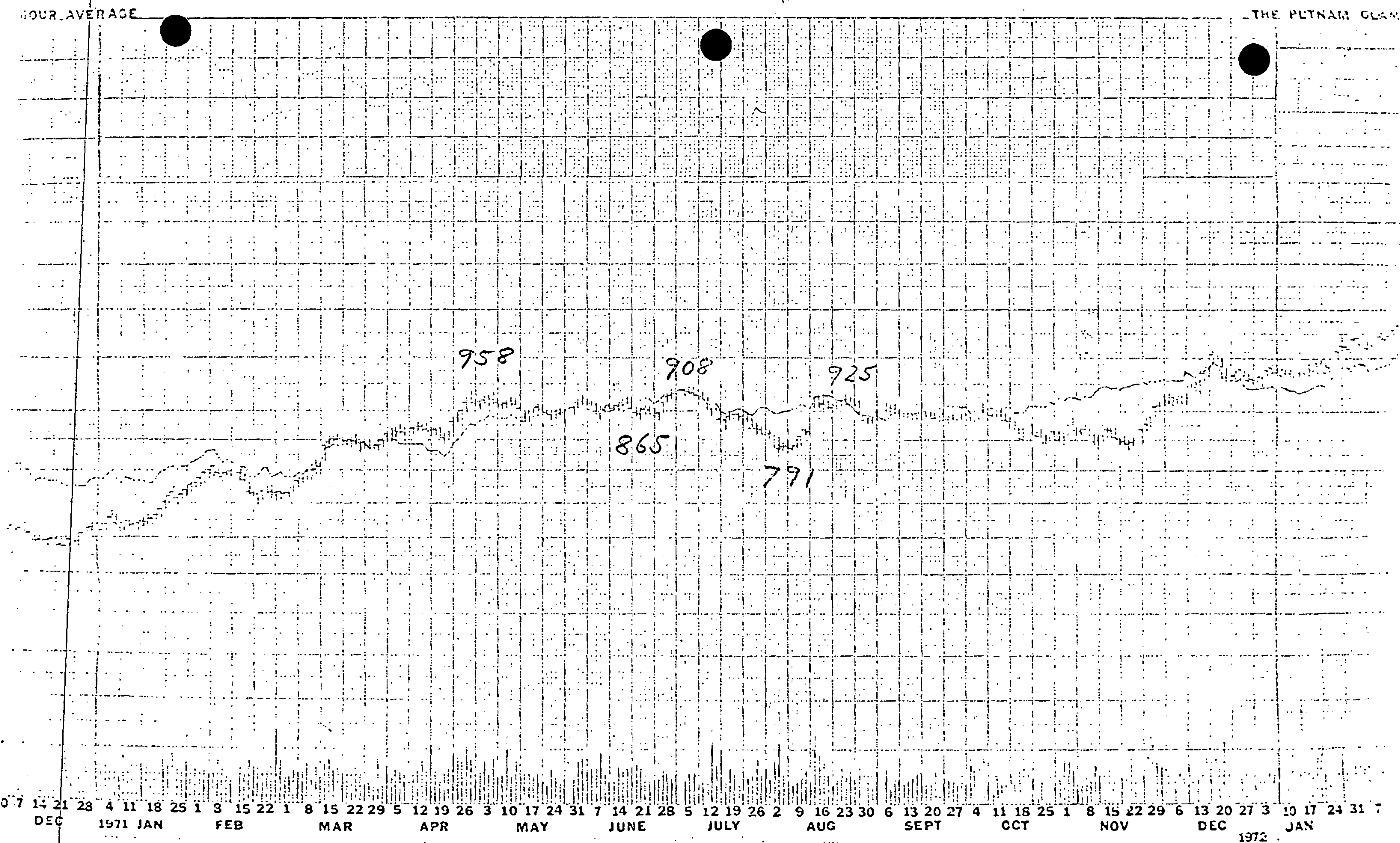



PUTNAM GLAMOUR AVERAGE — DAILY
1967
HIGH – LOW – CLOSE
952
922
839
RATIO TO S & P
VOLUME
J
F
M
A
M
J
J
A
S
O
N
D


PUTNAM GLAMOUR AVERAGE — DAILY 1968
922
995
818
HIGH – LOW – CLOSE
RATIO TO S & P
VOLUME
J F M A M J J A S O N D


PUTNAM GLAMOUR AVERAGE — DAILY 1969
HIGH—LOW—CLOSE
RATIO TO S & P
VOLUME
995
895
975
788
871
765
818
J
F
M
A
M
J
J
A
S
O
N
D

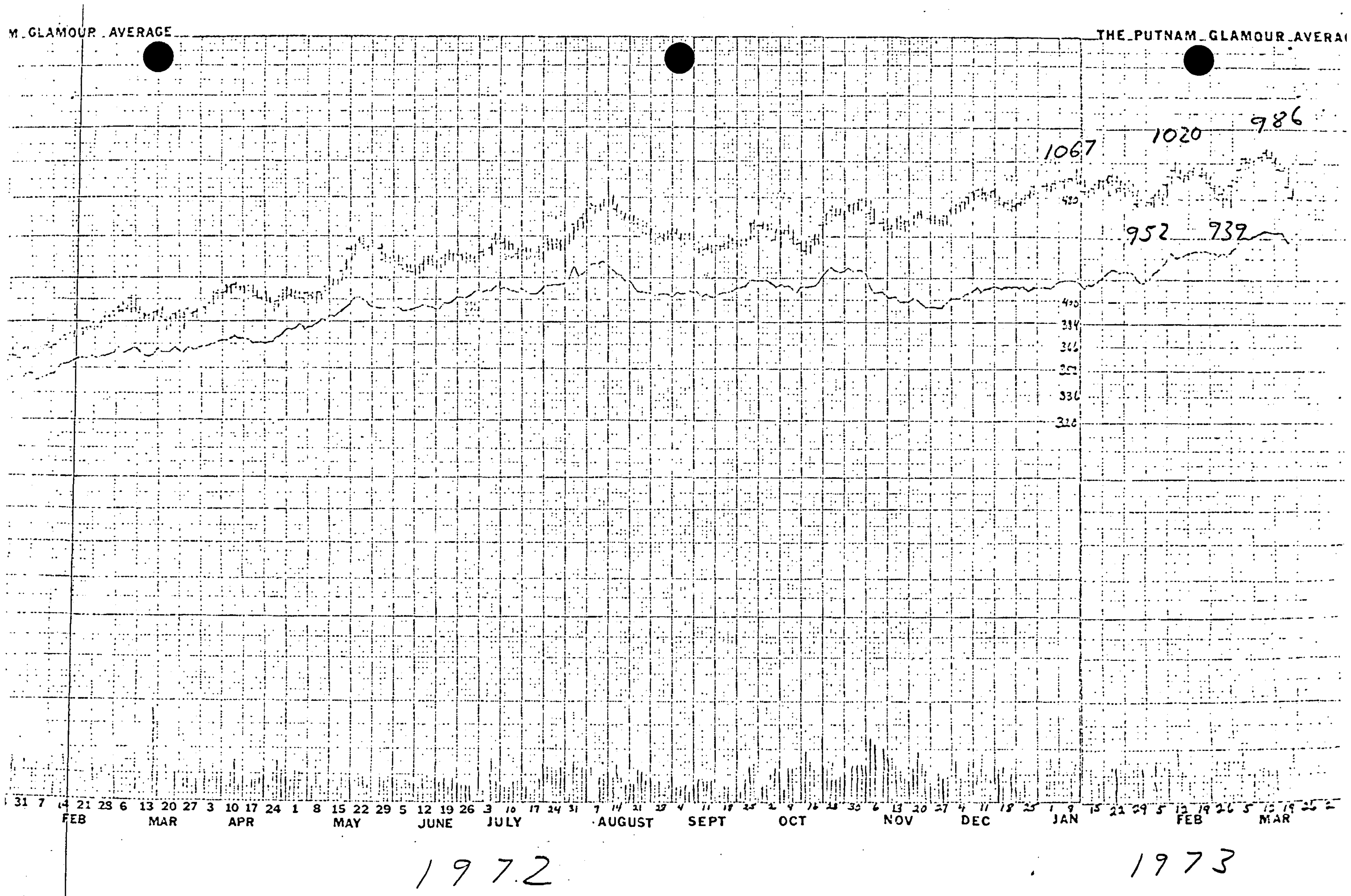

818
PUTNAM GLAMOUR AVERAGE - DAILY
1970
723
728
HIGH-LOW-CLOSE
744
627
673
704
RATIO TO S & P
VOLUME
J
F
M
A
M
J
J
A
S
O
N
D



1970.

1971

1972


M GLAMOUR AVERAGE
THE PUTNAM GLAMOUR AVERA
1067
1020
986
952
939
FEB
MAR
APR
MAY
JUNE
JULY
AUGUST
SEPT
OCT
NOV
DEC
JAN
FEB
MAR
1972
1973