

QUARTERLY TECHNICAL PERSPECTIVE

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## SUMMARY AND CONCLUSIONS

The market continues highly selective, and the situation does not appear to be improving. The risks created by this condition (and others) are considered to be intermediate-term rather than long-term in scope, since general speculation remains well below past danger levels and because interest rates, though rising, have not moved enough to be bearish based on historic standards.

Due to the intermediate-term risks in the market, the unfavorable environment created by narrow breadth, and the possibility that a shift in market leadership is taking place, slightly below average volatilities are recommended at present on technical grounds.

## BREADTH: AN OVERVIEW

A market analyst uses the concept of "breadth" to measure the normal gradual aging process of a bull market. The NYSE advance-decline line, which is the most popular indicator of market breadth, is probably the best measure of the type of market environment we are in at any particular time--the stronger the A-D line is, the larger the number of stocks participating in the advance.

There are many different types of bull markets. At one extreme is the bull market where virtually all groups and stocks are rising, such as in late 1970 and early 1971. At the other is a bull market that usually, after a substantial advance, has seen a growing number of stocks and groups peak out, one by one, until a majority of stocks are no longer rising. At this point, with a majority of stocks no longer participating, it really isn't a bull market any longer, even though it is too soon to call it a bear market. However, since the general market averages are still rising, or at least going sideways, it persists in keeping the "bull market" label. It is a much more difficult environment for a money manager to operate in, since the best performing stocks are no longer able to offset the worst performing ones, and

performance depends as much on what is weeded from a portfolio--and how quickly--as what is put into it. This is the type of environment that we are in now, and have been for four months: a very selective bull market.

#### MEASURING MARKET BREADTH

There is more to breadth than the advance-decline line, although it does have at least two very commendable features which have made it so popular: it is simple to calculate and has a recorded history going back over fifty years. Sometimes, however, distortions can creep into it, so as a check some other methods of measuring breadth will be looked at as well.

One other way to measure breadth is to take each stock on the NYSE and classify it by "uptrend" or "downtrend". The Trendline Chart Service does this after a fashion for the 672 stocks that they cover by calculating the percentage of these stocks that are above their 200 day (30 week) moving average. (See Exhibit I). This figure shows how many stocks are selling above their average price of the last 30 weeks, and thus in an uptrend condition. At present, slightly more than half of these stocks are below their 200 day moving averages, or in downtrends. An analyst can also look at a chart of each individual NYSE stock each week and derive the same type of information; at present the number of stocks in downtrends is greater than the number in uptrends.

Another way to look at market breadth is on a group basis. The Mansfield weekly chart service includes charts on some 95 sub-groups of the Standard and Poor average. During the past 6 months, 29 of these groups rose, 14 remained unchanged, and 52 fell. Contrast this with March 1971, when it was reported "no group in the market has yet turned down, and very, very few have even begun to go sideways."

The basic measure of market breadth, however, is still the NYSE advance-decline line (see Exhibit II) which, not suprisingly, reflects the same picture as the other measures cited above. Note especially that no rally since March in the general

averages has been "confirmed" by a similar rally above the previous high in the A-D line. These divergences in the past have been ominous warnings of approaching market trouble, although lead times have been erratic.

Perhaps the most dramatic example of the market's loss of breadth took place in the over-the-counter market (See Exhibit III). The NASDAQ Industrial average, consisting of some 1700 issues, soared 47% from its November low to the peak in late May, outperforming all other general market averages. This performance was reflected in the relative performance (top line), which although it slipped slightly during the minor reactions during the spring surged quickly into new high ground when the market recovered. Something changed in July, though--when the market hit bottom and rallied, the NASDAQ Industrials lagged seriously, and the relative performance, as you can see, turned very weak. The best performing market index had suddenly become the worst, which meant that now the NASDAQ Industrials and the Amex price index (See Exhibit II) were both weak--and so was NYSE breadth. It was at that time that my weekly comments began referring to the overall breadth situation as "shockingly weak", and primarily for that reason that slightly below average volatilities were first recommended at that time on technical grounds.

Poor breadth is much more than just a poor technical condition, however. It is the symptom of a basic problem in the equity markets--lack of money.

#### IMPLICATIONS OF POOR BREADTH

A vigorous bull market is marked by large quantities of money flowing into it--so large that it puts stocks up almost across the board. This happened in late 1970 and early 1971 as institutions, especially, poured huge sums of money into common stocks, creating the broad advance in the market. Gradually, however, all bull markets run out of money. As they do fewer and fewer stocks and groups are able to continue participating in the upmove, and one by one they top out. This process is

reflected in breadth statistics, which depict how many stocks are able to keep going.

Poor breadth, therefore, is a warning that the amount of money entering the equity markets has contracted to enough of an extent that it is no longer able to push a majority of stocks higher. Historically, this condition has been followed, sooner or later, by a significant reaction in the general market averages.

#### SUPPLY/DEMAND

Supply/demand factors, with the exception of margin debt, show little change from July. New equity offerings, for example, continued fairly heavy through June (See Exhibit IV)), while institutional net purchases of common stock remained fairly normal by recent standards.

Margin debt (See Exhibit V) has now risen to \$7.8 billion, a very sharp increase since the margin requirements were reduced to 55% last fall. It is noteworthy that the surge of margin money into the equity market has had little effect on stock prices since April, as reflected by the general averages. Since margin debt has almost certainly risen most of the way it is likely to during this cycle, it follows that it is unlikely to have much impact on stock prices generally from now on.

One more thing must be mentioned at this point. As of the end of July, 16% of the margin debt was in accounts with less than 40% equity, or over \$1.2 billion. Margin calls are thus more of a threat now than they have been for many years. The term "margin call" can be an emotionally loaded one, and I do not wish to use it in that way, but the potential danger is considerable at the present time.

If institutions, buying stocks at normal rates, and margin accounts, buying heavily, are not able to push the market up, the remaining hope is foreigners and cash accounts. Net foreign buying, according to preliminary data, has slackened since the surge late last year and early this year (See Exhibit VI), with currency uncertainties undoubtedly a factor. One can only guess at the potential amount of future foreign buying, but it is worth noting that they have never been a major factor in the past.

in the U. S. market (except briefly during the IOS operations of 1968-69).

Cash accounts (public investors) remain by far the biggest potential source of buying power. Unfortunately, they tend to sell on strength and buy on reactions. In July, for example, they bought more heavily than at any time since May-June 1970, but quickly swung back to the sell side as the market rallied. They are thus likely to become a factor on the demand side only during periods of general market weakness.

#### INTEREST RATES

Considerable apprehension has been expressed about rising interest rates. Edson Gould, one of the great pioneering technicians, many years ago formulated the "Three Steps and Stumble" rule to delineate the point at which rising interest rates cease to merely reflect rising stock prices and expanding economic conditions, but start to increasingly become a course 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: May 1937, January 1946, August 1948, and September 1955, March 1959, December 1965 and April 1968. The market on averages, rose another 8-10% and 4-5 months thereafter, with a minimum lead time of two months.

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. With none of the three components-- to date--having had an increase, one must conclude that the concern over the impact of rising interest rates on the stock market is premature.

## SPECULATION

Public speculation remains low by historical standards. The Amex/NYSE volume ratio, for example, has been about 25% for the last few months, well below past danger levels. Margin debt remains in an expanding trend (see Exhibit V and discussion below) but although the level of margin debt is rather high, the activity created by it is not yet high, historically. The fact that so much speculative money is now present in the market does suggest that speculative activity could start to pick up rapidly in the future, but it has not done so yet.

Institutional speculation, on the other hand, is very high in prime growth stocks. Perhaps the only way to measure this speculation is using P/E ratios, which measure what investors are willing to pay for each dollar of reported earnings. The P/E for multiple of the Putnam Glamour Average (based on trailing twelve-month earnings) reached 56.7 in August, while that of The Putnam Consumer Glamour Average reached 63 at the same time. These multiples have swung from a peak of 63.1 to a low of 25.5 during the past eleven years, so the past quarter saw growth stock multiples virtually at the all-time highs. The ratio of the growth average P/E multiple to that of the Dow-Jones Industrial average, which has ranged from a high of 3.82 times to a low of 1.58 times since 1961, reached 3.46 in the case of the Putnam Glamour Average, --and the Putnam Consumer Glamour Average made a new peak in August of 3.84.

It is virtually impossible to predict how long this period of exploitation will last, or how much more intense it may get. It is only possible to state that, based on past standards, the exploitation of high-quality growth stocks is at dangerous levels. The dilemma in the marketplace is that despite this exploitation, no alternative leadership has developed, and the slight faltering of growth stocks in recent weeks (See Exhibits VII & VIII) is--so far--normal considering the magnitude and extent of their previous move.

## CYCLICALS

Some cyclical groups had a flurry of activity in August, causing great excitement and discussion of the market's "new leadership" around the financial community at the time. (Indeed, during the two days that Ford was above 69 no less than 14 people called my attention to the "powerful" technical pattern in the stock!) As in past flare-ups in cyclical since 1970 lows, this one soon faded out, and at present most of these groups have sagged back into limbo.

This, of course, does not mean that all cyclical groups are unattractive--far from it. Selected cyclical groups are quite attractive technically, including broadcasting, chemicals, farm machinery and oil well equipment. Also, cyclical growth stocks in general still look more attractive than consumer growth stocks in general. The cyclical area does not seem to be taking over broad market leadership, but carefully selected groups and stocks within that area should still be able to show superior performance.

## DEFENSIVE STOCKS

The defensive area of the market also showed some signs of life during the past month or two, but--with one important exception--no more than in past flare-ups which eventually aborted. That exception is the energy area (oils, gas utilities, etc.). Strength within the area is selective, but this area is the only one among the several which showed signs recently of taking over market leadership which appears technically to have the sustained strength to do so, and will bear watching very closely during the next few weeks. Other defensive groups have neutral to poor technical patterns at present.

## IS LEADERSHIP CHANGING?

It is too early to tell whether or not the recent faltering of the high-quality growth stocks indicates a shift in market leadership, although when their time

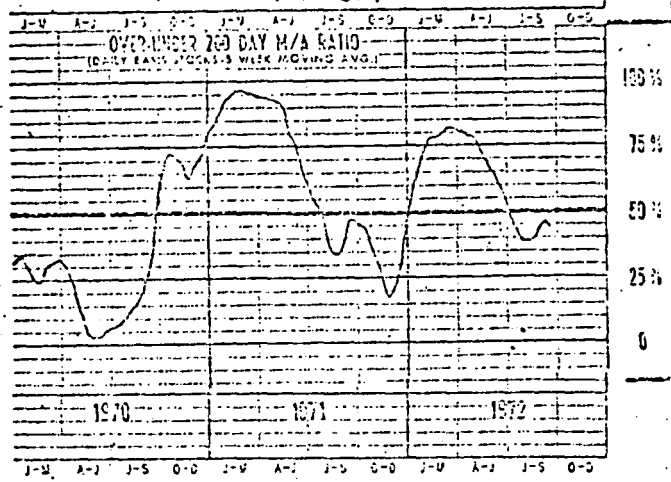


finally comes, they are expected to relinquish their leadership gradually, due to the very large flows of money involved. So far, on technical grounds, the recent flurries of interest in selected cyclical and defensive groups does not appear greater than other such flurries of the past few years which quickly faded out. The big exception, as noted earlier, appears to be the energy area.

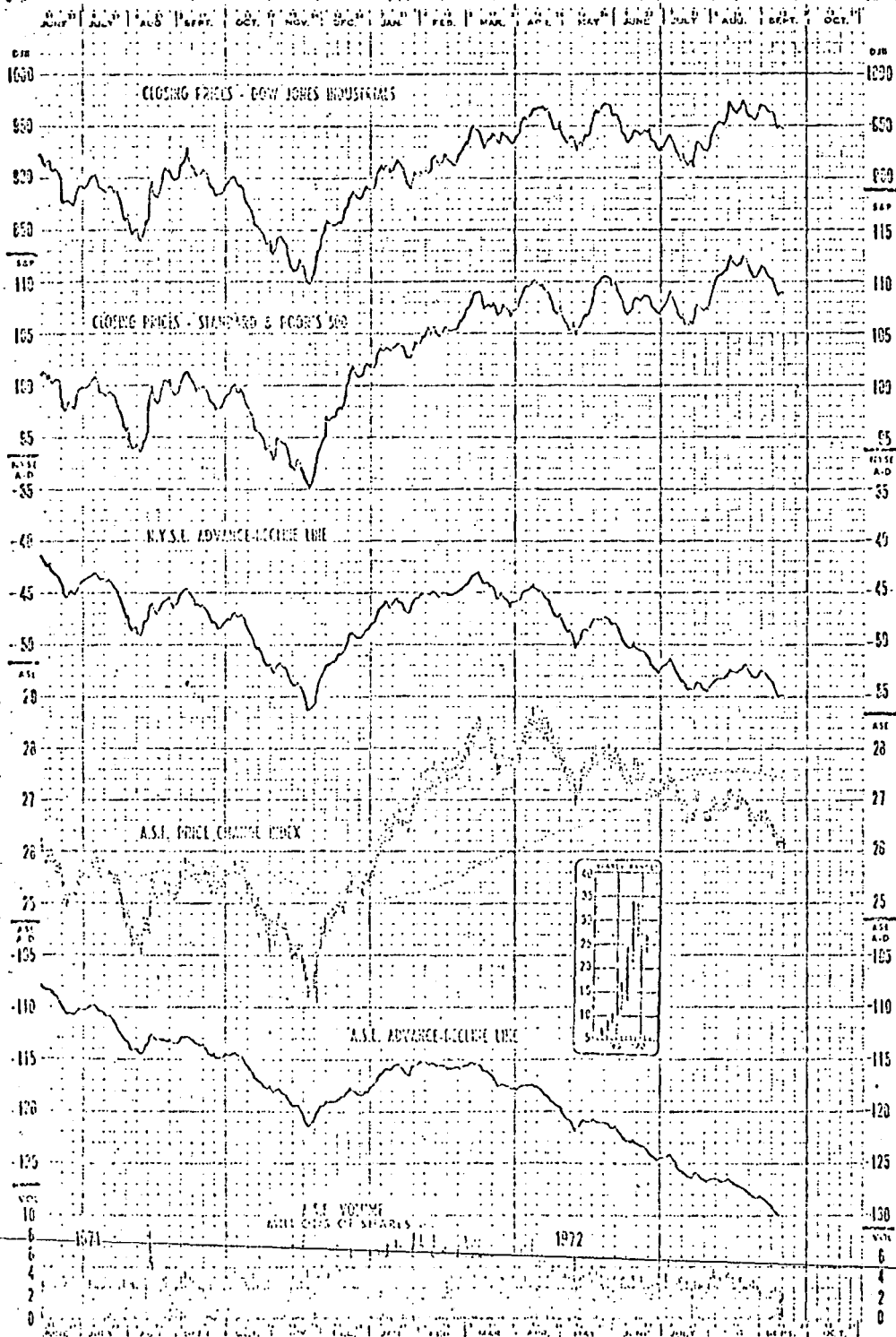
The question concerning continued growth stocks leadership depends to a large extent upon the amount of price declines they have, since they were selling at close to historic high multiple levels in August, giving them limited further upside potential at that time. So far, even though the reactions have been relatively minor, the Putnam Glamour multiple has dropped from 56.7 to 52.2 times trailing twelve month earnings while the Consumer Glamour multiple has fallen from 63.0 to 57.4 times. Quite obviously, the further they decline the further they get from their historic ceilings, and the greater their upside potential.

Historically, leadership usually changes--if it is going to--during and just after a market decline. The market's interest turned from growth to cyclical stocks in 1962, for example, and from cyclical to "performance" stocks in 1965. In 1966 it remained with performance stocks. If market weakness continues, as expected, the question of possible new market leadership will probably be the most important one facing us for the next few months.

# EXHIBIT I

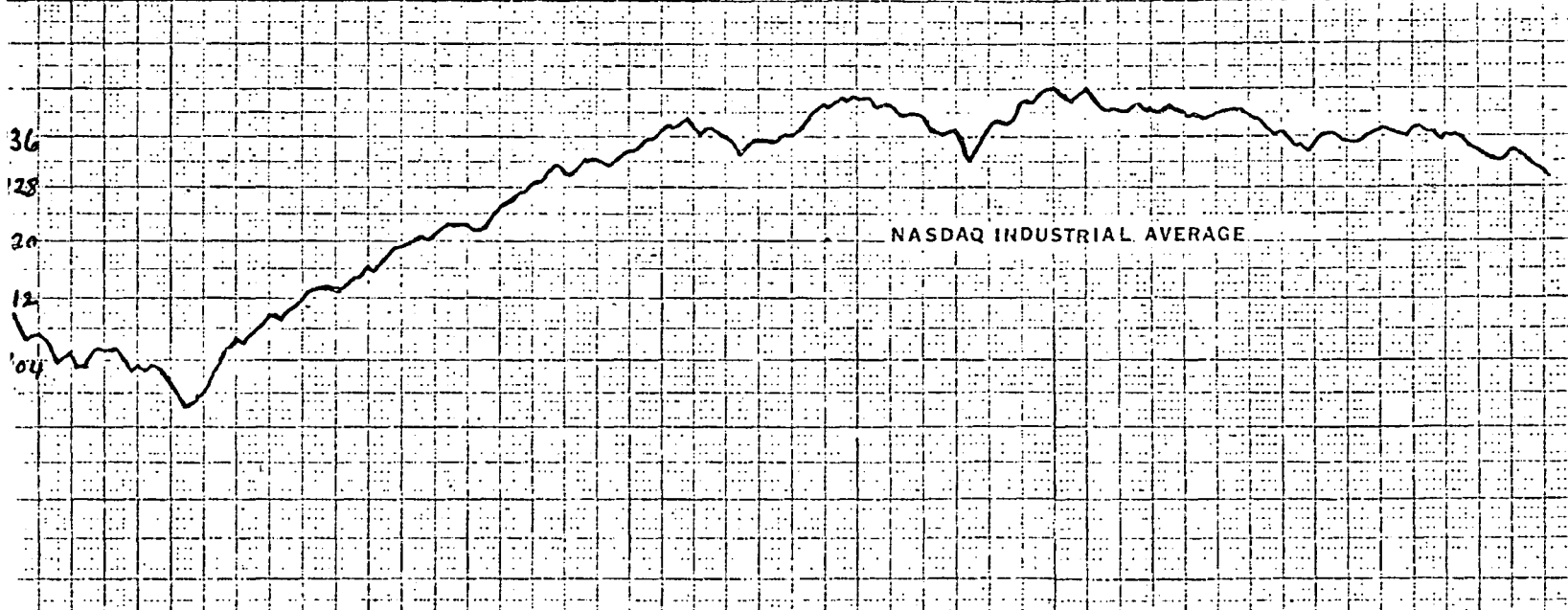
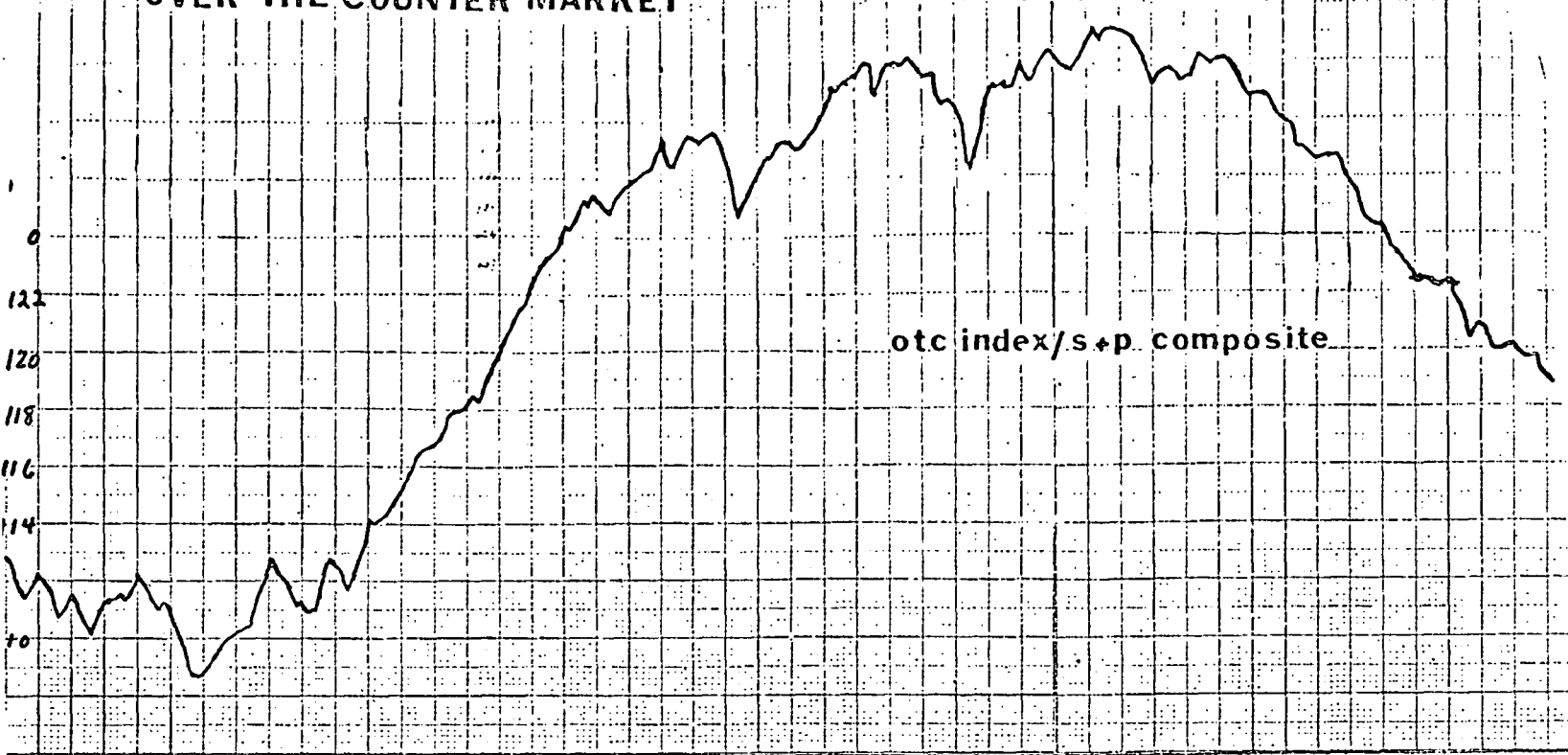


# EXHIBIT II



# OVER THE COUNTER MARKET

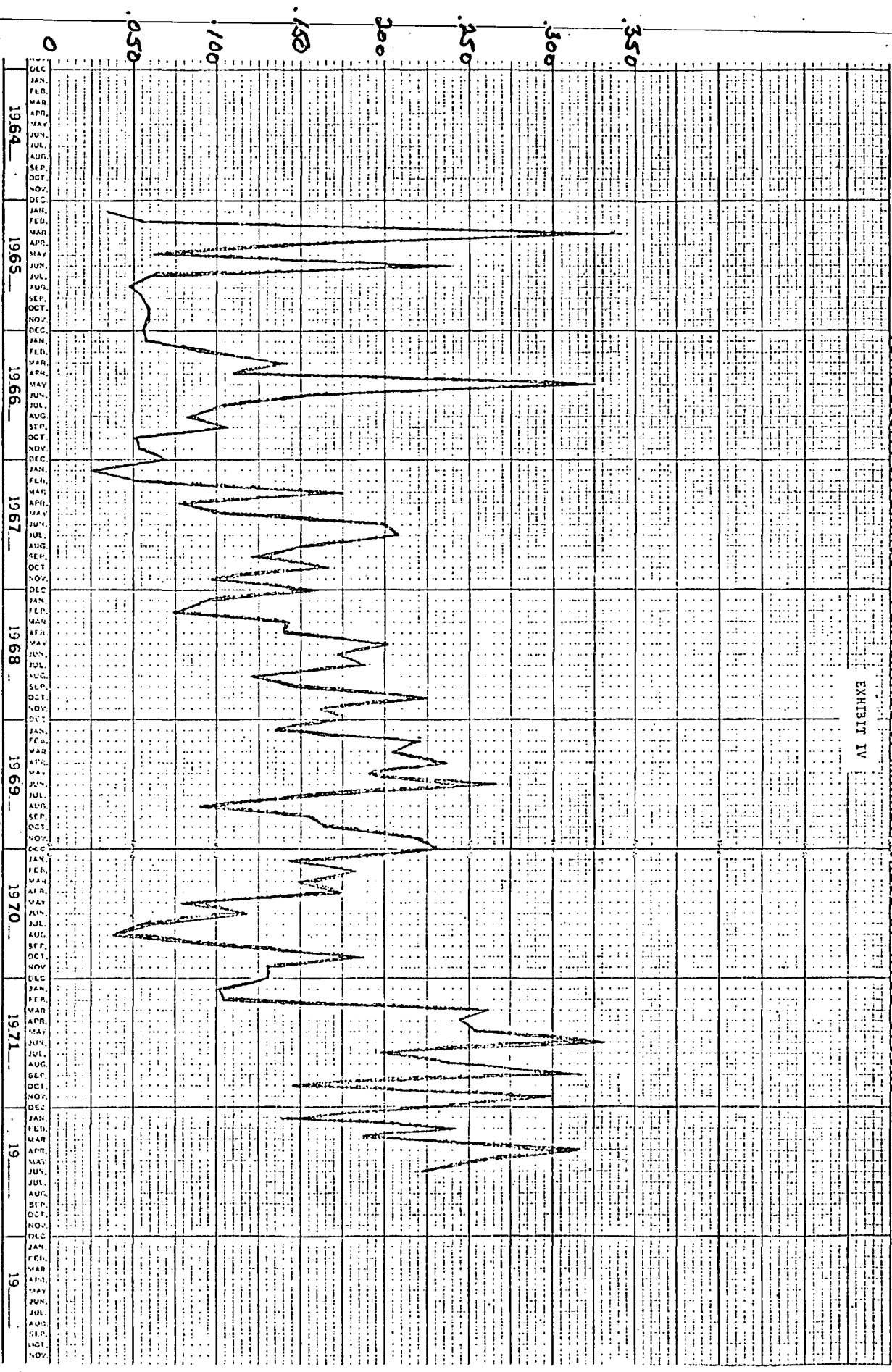
EXHIBIT #III



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NOV DEC 1972 JAN FEB MAR APR MAY JUNE JULY AUGUST SEP

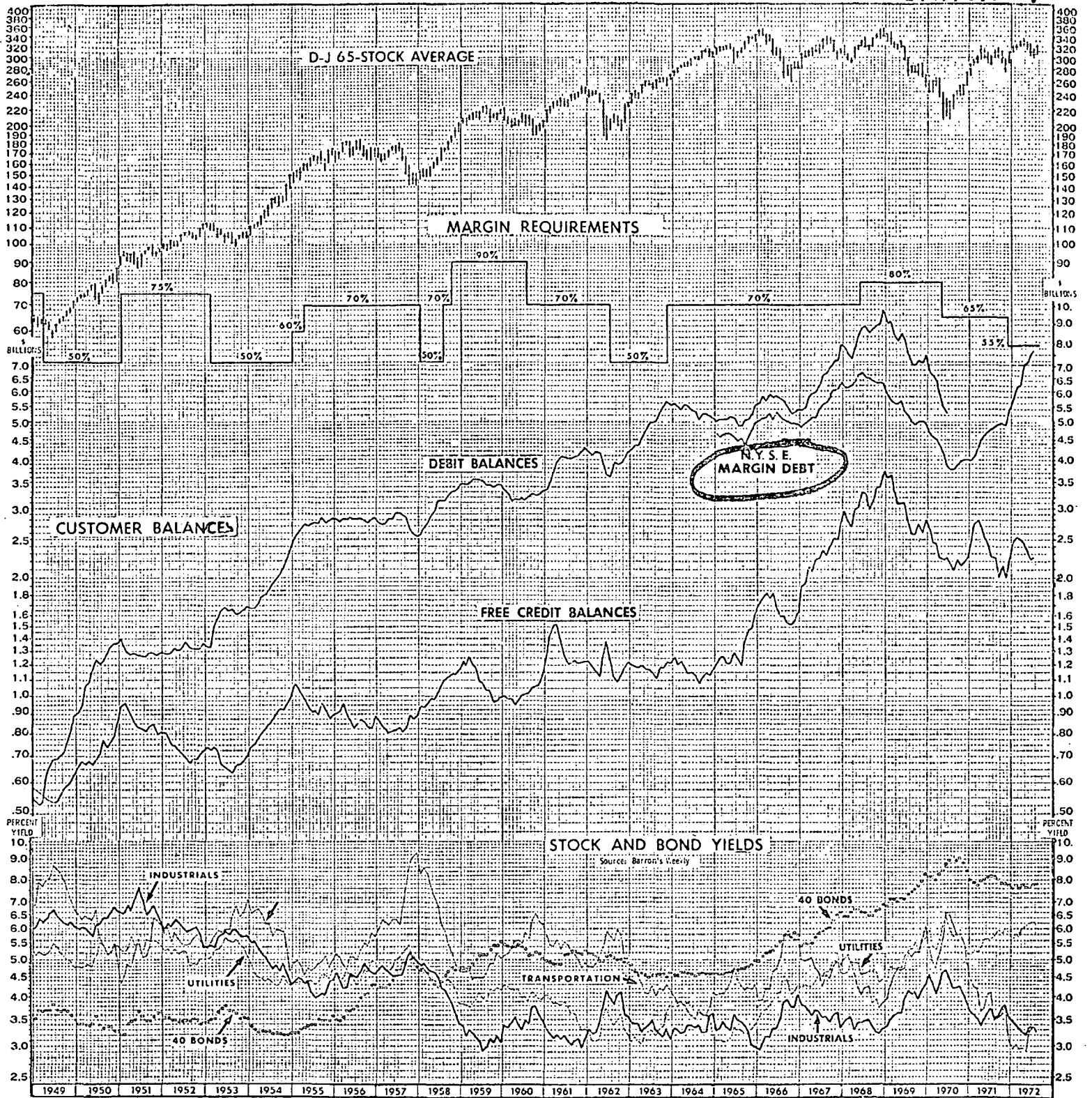
TOTAL EQUITY OFFERINGS - PERCENTAGE OF MARKET VALUE OF NYSE STOCKS

EXHIBIT IV



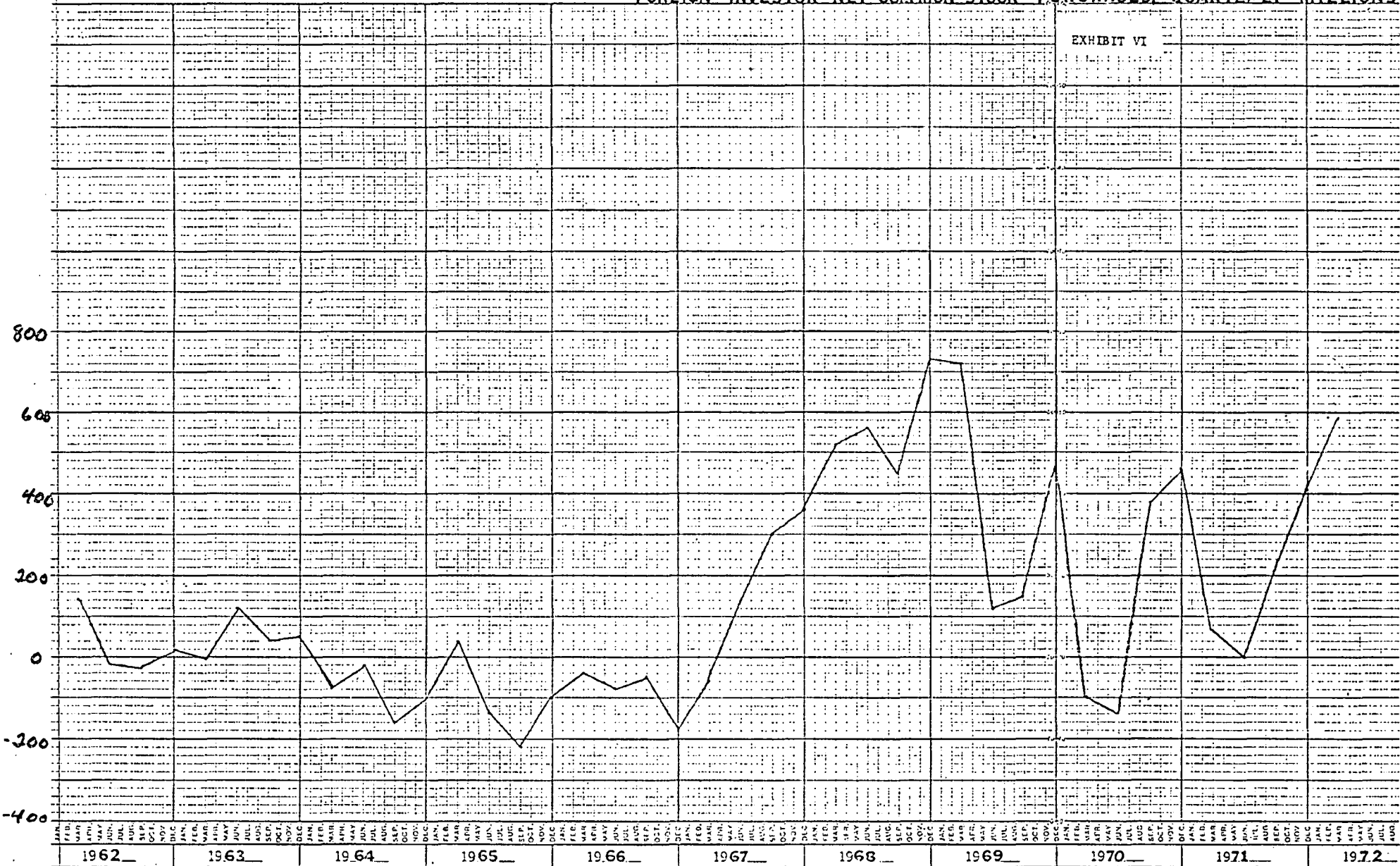
MARGIN REQUIREMENTS, CUSTOMERS BALANCES, AND STOCK AND BOND YIELDS

EXHIBIT V



FOREIGN INVESTOR NET COMMON STOCK PURCHASES, QUARTERLY - MILLIONS

EXHIBIT VI



**THE PUTNAM CONSUMER GLAMOUR AVERAGE - WEEKLY**

EXHIBIT 7

ratio to S&P

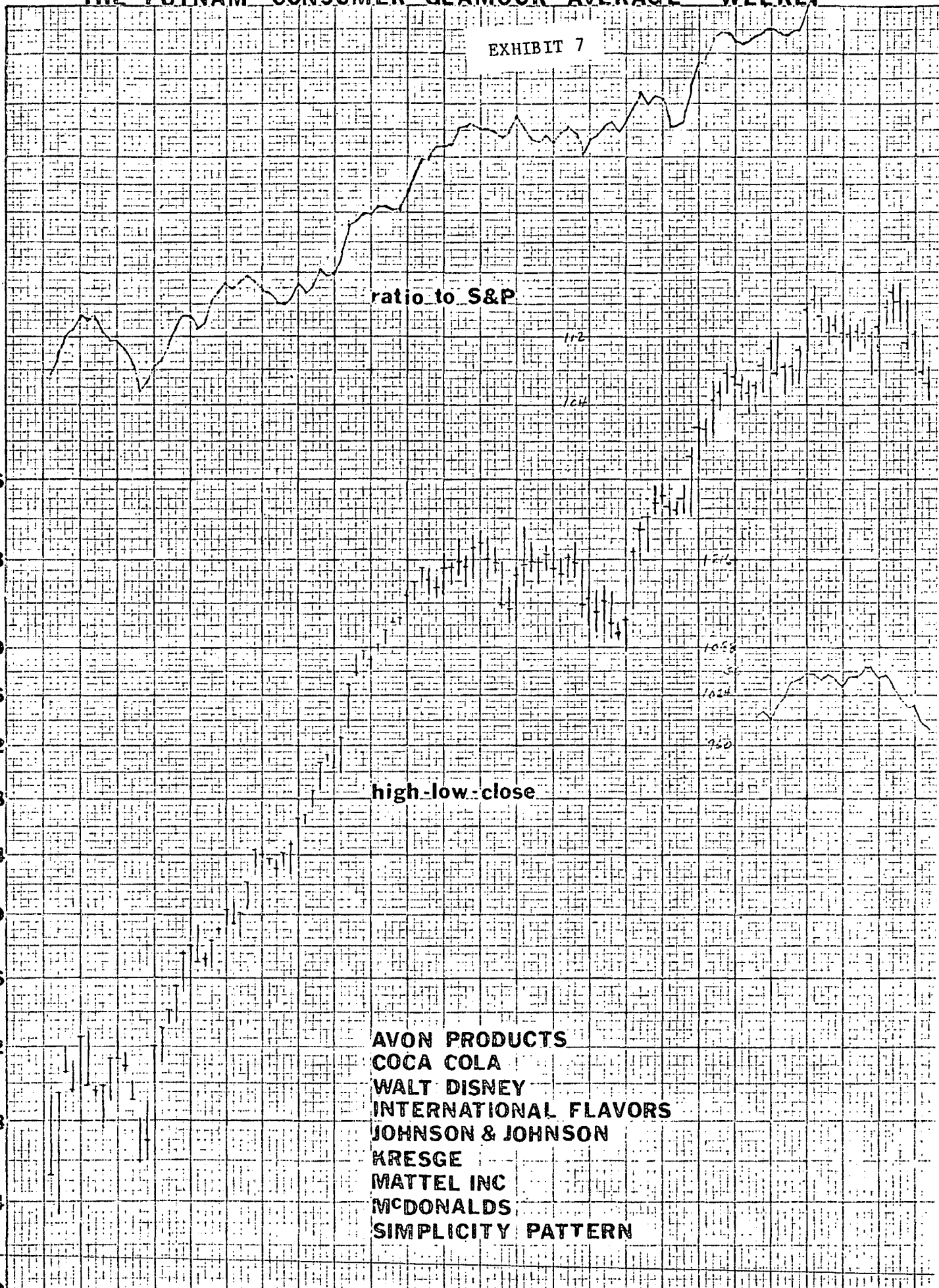
high-low-close

- AVON PRODUCTS
- COCA COLA
- WALT DISNEY
- INTERNATIONAL FLAVORS
- JOHNSON & JOHNSON
- KRESGE
- MATTEL INC
- MCDONALDS
- SIMPLICITY PATTERN

96  
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80  
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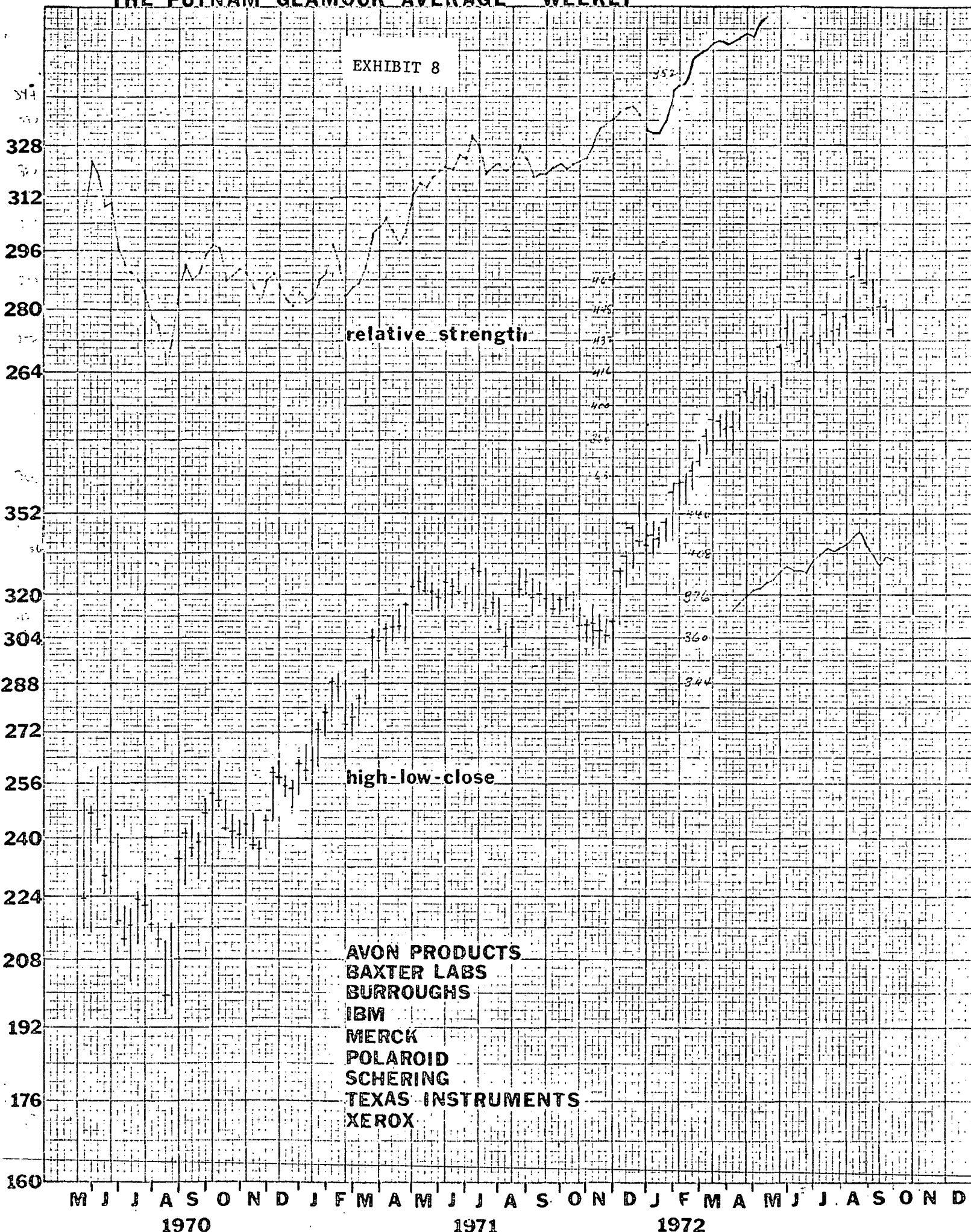
M J J A S O N D J F M A M J J A S O N D J F M A M J J A S

SECURITY PRICES 1960 47 6490  
53 WEEKS OF 5 DAYS X 2 LOG CYCLES  
MADE IN U.S.A.  
KEUFEL & ESSER CO.



# THE PUTNAM GLAMOUR AVERAGE - WEEKLY

EXHIBIT 8



relative strength

high-low-close

- AVON PRODUCTS
- BAXTER LABS
- BURROUGHS
- IBM
- MERCK
- POLAROID
- SCHERING
- TEXAS INSTRUMENTS
- XEROX

1970

1971

1972