Bull Market Prospectors Sound Cautionary Note

Two More Revised Investment Programs, Submitted by Contestants Whose 1935 Selections Fared Well

THIS week's "prospectors" both sound notes of warning in presenting their investment programs. Each, however, believes that the major trend will remain upward for some time to come.

Most specific is Mr. Beers, who, as long ago as June, 1935, forecast that last October would mark a turning point in the market and that the investor should then shift from common stocks into "more stable investments." Although the market continued to rise beyond October, 1936, Mr. Beers does not retract his earlier forecast, on the grounds that the rise since that date consisted of spectacular strength in the typical tail-enders—coppers, steels, and rails. The stocks he recommended in 1935, incidentally, are worth less now than in the middle of last October.

Until later this year the investor should keep his funds in good grade preferred stocks, Mr. Beers holds. During the late summer he should re-invest in common stocks, among which Mr. Beers suggests Electric Bond and Share, Southern Pacific, United States Industrial Alcohol and United Aircraft.

Also foreseeing many reactions and possibly a setback of sizeable proportions during 1937 is Mr. Fell, who, nevertheless, picks five stocks which he considers good investments now.

Again *Barron's* wishes to state that it does not know whether any of the authors of the present series will succeed in doing as well a second time as they did the first. With the investment opinions set forth it expresses neither agreement nor disagreement. Authors in this series were chosen solely on the basis of the market performance of the investments they selected in the 1935 contest, without regard to their other qualifications.

By EDSON BEERS

A MOST important investment principle is that cash (or its equivalent) is sometimes a more attractive holding than stocks.

By this time the prudent investor should have shifted from volatile stocks to stable investments (good grade preferreds) to be prepared to re-enter the speculative markets later this year, probably some time between July and October.

Reasons are lacking for changing the broad financial outlook outlined in June, 1935. These called for:

(1) A bull market (began March, 1935) into October, 1936;

(2) A minor bear swing into October, 1937;

(3) A period of improvement reaching boom proportions in 1939 or 1940;

(4) A panic and depression culminating in 1943.

For five months now we have witnessed the procession of tops in individual stocks and groups so characteristic of the distributive process. Many of the leaders of the 1935-36 bull swing reached their peak last November, but the market was given an appearance of strength during the winter months by rotation of activity in such groups as the coppers, steels and rails—typical tail-enders.

The June, 1935, forecast stated, "The well-advised investor, who held the best stocks from July, 1932, into February, 1934, then shifted into bonds, should by now have shifted into second-grade stocks to hold into the fall of 1936. If the foregoing schedule works out, he should then *shift to more stable investments for a period of seven months to a year*, and then be prepared to shift to thoroughly speculative issues."

Seven months from November, 1936, would be June, 1937; twelve months November, 1937. A buying opportunity some time between June and November appears a reasonable expectation. Duration of the recession will, of course, depend on the rate of decline. A recession to around the 160 level appears a not-unreasonable expectation in view of the 100-point advance since early 1935.

Manifestly the best time for making selections for the next bull swing will be after the market has experienced the major portion of its recession, but it is perhaps not too early to consider likely candidates for purchase.

The next bull market, to begin later this year, should be fully as profitable as the two already witnessed in this recovery cycle (July, 1932—February, 1934 and March, 1935—November 1936) but proper selection will be highly necessary for profitable results. The search for likely issues should be among the more speculative shares, especially among those representative of companies in industries which for one reason or another have not yet joined the prosperity procession.

1935 SELECTION

	Price June 14, 1935	Price Oct. 17, 1936*	Price Apr. 7, 1927	Appreciation
Am. Smelting ...	44	93	90	104%
Chrysler Corp....	49	130	118	141
Johns-Manville .	50	121	131	162
West'house Elec.	52	153	135	160

Average appreciation April 7, 1937, 142%.
Average appreciation Oct. 17, 1936, 154%

*October prices are given because Mr. Beers in 1935 [illegible]ed that the stocks he then recommended should be held only until October, 1936.

Four suitable candidates are the following:

Issue	Recent Price
Electric Bond & Share ..	21
Southern Pacific	56
United Aircraft	28
U. S. Industrial Alcohol	39

Each of these companies is the dominant enterprise in its industry. Electric Bond and Share is the outstanding holding (and investing) company in the utility field; Southern Pacific, measured by first track mileage, the largest transportation system in the country; United Aircraft is one of the world's largest aircraft manufacturers; U. S. Industrial Alcohol is the dominant domestic alcohol producer.

These companies have thus far failed to participate in any large way in reviving prosperity, largely because of forces without the control of management, Electric Bond and Share because of political pressure, Southern Pacific because of difficulties common to the railroad industry; United Aircraft because of the infancy of the industry; U. S. Industrial Alcohol because of industry readjustments brought about by prohibition repeal and subsequent competition. These restrictions promise to dissolve in more or less degree over the next several years.

These four stocks well qualify under the 11 "stockholder demands" outlined in the June, 1935, article. All of the companies are in good financial position; all are reasonably well seasoned; number of shares outstanding is in each case reasonable. (Electric Bond and Share with 5,270,000 shares is slightly over the 5,000,000-share maximum.) Each of the stocks has some kind of leverage; none of the companies faces prospects of labor or raw-material difficulties. Consumer resistance to high prices is not a factor in the outlook.

All the stocks are medium-priced. (Southern Pacific is the only one above the 50 maximum.) Earnings in each case have been nominal in recent years. (Southern Pacific, which earned $3.84 last year, is an exception, but this stock, because of the territory served by the road, the substantial capital ahead of the common, and the company's wide interest in lumber, land, coal, steamship, oil, traction, mining and power companies, could show substantially higher earnings over the next several years.) None of the shares pays a dividend except United Aircraft (50 cents last year). All the companies possess good management.

These shares sold several times their recent prices in 1929. Electric Bond and Share sold for the equivalent of 567, Southern Pacific at $157\frac{1}{2}$, U. S. Industrial Alcohol at $243\frac{5}{8}$ and, although comparable figures are not available for the present United Aircraft stock, the parent-company shares, the old United Aircraft, sold as high as 162.

Seldom is a stock worth buying for an extended swing unless it shows prospects of doubling in value. Each of these stocks could easily double or better over the next several years; their average performance should compare favorably with that of the Dow-Jones averages.

In his earlier article Mr. Beers explains his market philosophy from which the forecast, repeated in the foregoing article, was developed, and enumerates the qualifications he requires of specific securities:

Throughout creation there are eternal, everlasting laws of mathematical sequence. Every created thing carries its own mathematics along with it. In other words, all things respond to the laws of their species. The stock market moves in accordance with its own set of laws: business activity responds to its set of laws; credit conditions are governed by their own laws; electrons, atoms, molecules, individuals, families, nations, the world, the solar system, the universe, all are and move because of perfectly definite, in many cases mathematically demonstrable laws.

All motion is the result of force.

The stock market is the resultant of many forces, but there are three dominant: A constant push downward (gravitational), a steady push to the right (time) and a variable force upward (manifestation of the will to buy—psychological). Since the first is a constant the laws governing the second and third forces will suffice—laws of time and laws of mass psychology.

This is logical, too, because these are the two most inflexible and nearly fixed immutable factors entering into any and all economic situations. Men are today dominated in their business actions by the primary emotions of greed and fear just as they have been for many thousands of years (psychology), and a year is only a few seconds different today than it was several thousand years ago (time).

It is vital that the investor have as a foundation a philosophy of investment that will be truly fundamental to his operations, that will not have to be modified with every superficial change in the political, financial and business situation, that will not have to be changed for inflations, wars, earthquakes or dust storms.

Space does not permit of expounding stock-market laws at length, but here are a few:

Law of Post-war Sequences: Developed and expounded by Colonel Ayres, the Law of Post-war Sequences has no exception in modern times. The sequence is a war boom, a sharp, short primary postwar deflation, a long period of reconstruction and urban prosperity, a severe and enduring secondary post-war deflation, a long period of prosperity. Commodity prices attained peak levels of war inflations in 1815, 1864 and 1920. The foregoing sequence was carried out in every case. In 1830, or 15 years after the peak inflation of that time, the nation emerged from the severe and prolonged secondary post-war depression. In 1879, or 15 years after the peak inflation, the nation emerged from the secondary postwar deflation. Fifteen years after the 1920 inflation is the year 1935. The law involves time and mass psychology.

Rule of 7-8 Year Cycles: There is a regular seven to eight year cycle in business and market activity. This is not a law because it cannot be phrased as to eliminate variations. It is a fact though that British business for the past 240 years shows average cycles from top to top and bottom to bottom of eight years. It was seven years from the bottom of 1896 to the panic of 1903; seven years from the panic of 1907 to the panic of 1914; seven years from 1914 to the panic of 1921; eight years to the peak of 1929; seven years from 1929 suggests 1936 as an intermediate peak; seven or eight years from 1932 suggests 1939 or 1940 as the peak of the current inflation.

Law of Three Times and Out: It is a psychological law that human nature in mass makes three efforts, can stand only three failures. Result in market is three approaches to top—three approaches to bottom. Three declines remove the timid and fearful, leaving only courageous holders—no one is left to sell. Conversely, three rises use up all the hopeful capital. No buyers are left. In the anticipated rises from 1932 to 1939-40 expect three rises: 1932-1934; 1935-1936; 1937-1939 or 1940.

Law of 30-35 Months: Economic history divides into 30 to 35 month chunks of time. It appears to require two and one-half years to three years for a group of people to become accustomed to a change. No exceptions back to 1860. Recent divisions were:

August, 1921-July, 1924:—35 months. A period of hesitant, rising and declining markets, timid capital, political uncertainty at home and abroad.

July, 1924-March, 1927:—32 months. Return of confidence, rapid expansion of business, universal prosperity and rising markets.

March, 1927-September, 1929:—30 months. Rapidly rising markets, credit inflation resulting from easy money situation created by the Federal

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By PERCY J. FELL

THE "cream," of course, is off the market. Percentage advances cannot in the remaining phases of the bull market compare with the earlier phases which are now history.

I lean to the higher-grade securities, although I believe the greatest percentage gains will lie with some of the lower-grade stocks.

The market will encounter adverse and retardent legislation, perhaps somewhat higher money rates, also labor trouble; nevertheless, due to the increased production of gold, the tendency to inflation, demands for higher standards of living, and the press of economics, I expect materially higher prices in the majority of stocks.

Permit me to qualify the above by stating that stocks will be subject to many reactions and perhaps a considerable setback some time this year, but if no great calamity befalls, the major trend is upward for some time.

I still favor the electrical-supply stocks—"electricity is in the saddle." Public utilities are greatly hampered by legislation and demagogues, but they must expand to keep abreast of the times. Government utility projects must buy electrical apparatus, and the public seems to feel it must have all the home electrical appliances down to the smallest article.

Electrical-supply stocks I particularly favor are Westinghouse Electric & Manufacturing Co. and General Electric Co.

The tremendous pent-up demand for construction, replacements and repairs opens a market for steel that I believe will tax capacity for some time, perhaps several years. I therefore favor United States Steel and Bethlehem Steel.

Lastly, I am a great believer in Chrysler Corp. Walter P. Chrysler is a "wizard."

The arguments on which Mr. Fell based his choice of securities in 1935 also apply to a considerable extent to his present recommendations. The following paragraphs are taken from his earlier manuscript:

The United States is a young, virile giant, convalescing from a temporary illness. Despite the attempts at control and regimentation which we are experiencing, we will continue to have our booms and depressions—overconfidence, overexpansion, overproduction, resulting in a credit strain, a crash and—depression.

All this may be somewhat modified, but it is very questionable as to whether it can be controlled; at least, until we are a much older country. A recovery reaching the proportions of prosperity is always based partially upon inflation, but credit inflation, for which a tremendous base already exists, may not necessarily bring about an abnormal recovery.

1935 SELECTION

	Price June 14, 1935	Price April 7, 1937	Appreciation
West'house Elec. .	52	135	160%
Bethlehem Steel	27	91	237

Average appreciation: 199%

During a long depression replacements, improvements and extensions in many lines of industry are deferred. Activity in both large and small construction lags, and a tremendous accumulation of business is the result. This pent-up demand, once let loose, will restore prosperity more rapidly than most people can visualize—now.

This is especially true of the heavy or capital-goods industries. These have lagged so much that herein I believe speculative investors have greatest opportunities.

Among sound enterprises which are to be held over a period of several years preference must be given to manufacturers of electrical supplies and to the steel companies. Public utilities, whether held by investors or owned by the Government, must keep up their equipment and continually modernize it, so as to cut costs. They must also extend their plants. This benefits electrical-equipment manufacturers. As electricity is cheapened, the use of lighter electrical equipment is increased.

	Net income	Earns. per-share	Divs.	Mkt. range high	low
1936	.. $690,000	$0.89	$1.00	20	9
1935	.. d252,000	d0.33	1.00	17	8
1934	.. 209,000	0.27	1.00	19	8
1933	.. 742,000	0.96	1.00	25	5
1932	.. 361,000	0.45	1.25	15	4
1931	..1,721,000	2.14	3.00	55	10
1930	..4,181,000	5.13	4.00	88	36
1929	..5,652,000	7.02	3.50	148	58
1928	..4,816,000	5.86	2.25	139	75

dDeficit.

debentures of 1948, $3,292,000 subsidiary-company preferred stock, and 805,045 shares of no-par common. Against that capitalization are $17,400,000 in property and $2,081,000 of net quick assets. Deducting the debentures and the subsidiary preferred stock (plus accrued dividends) leaves tangible assets of $9,819,000 for the common stock, giving it a book value of over $12 as of Jan. 2, 1937.

Purity had a splendid record through 1930 and in the depression, and there has only been one year of its career—1935—in which a deficit

... profits have declined steadily from 1930, and whose working capital must be bolstered.

from a rising market. In addition to that underlying influence, Purity—which has a heavier stake in the semi-luxury cake lines—should feel the stimulus of sharply rising mass purchasing power, the more so because it is heavily entrenched in the industrial centers of the East and West, while Cushman's Sons, Inc. is in such popular centers as New York, Chicago and Philadelphia.

For speculation in an industry which has been, for the most part, in an eclipse since the last boom and on improvement in the buying power of industrial and urban centers, Purity is a logical candidate. The management, which was so successful in its earlier days of rapid expansion, has had time to assimilate growth and has once more begun to expand, as evidenced by the $1,100,000 capital expenditure for improvements and extensions last year.

stout benefits from the intense activities in and rising wage scales of such big industrial centers as Detroit, Chicago, Kansas City, Akron, Cleveland, Cincinnati, Toledo and Pittsburgh, but the rash of strikes must make for unevenness of wage payments. Moreover, Purity would suffer sharply, as it did during the depression, from any serious business recession.

Most discouraging phase of Purity's latter-day record has been with its big retail subsidiary, Cushman's Sons, Inc. After its acquisition in 1928, Cushman's Inc. was a big source of revenue to Purity, and in 1930 its net profit increased nearly 50% over the preceding year whereas the consolidated net income of Purity in the same period was declining by 26%. From that 1930 peak Cushman's profits steadily tobogganed to nominal proportions in 1934, ran into a big loss in 1935—because

	Operating profit	Net profit	Working capital
1936	..... d$68,000	d$376,000	$527,000
1935	..... d400,000	d689,000	379,000
1934	 386,000	73,000	857,000
1933	 797,000	409,000	1,170,000
1932	1,092,000	663,000	*1,119,000
1931	1,700,000	1,194,000	160,000
1930	2,084,000	1,467,000	463,000
1929	1,513,000	993,000	449,000

d Deficit. *Increase caused by liquidation of nearly $1,000,000 "due from associated companies."

recovery of the wholesale or retail divisions has not been particularly impressive. As repercussions of the Cushman's Sons, Inc. strike in 1935 were far-reaching and continued into 1936, measure of recovery of what used to be the strong right arm of the Purity enterprise may be detected in character of earnings figures appearing through the current year. To offset the implications of the general 1930-1936 trend, recovery by Cushman must needs be emphatic.

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Reserve Board in its efforts to return Europe to the gold standard.

September, 1929-July, 1932:—34 months. Steady liquidation and deflation.

Thirty months from July, 1932, was January, 1935; and 35 months June 1935. The past three years have been characterized by timid capital, lack of confidence, vacillating markets. A change was to be expected in the period January-June, 1935. The market turned in March, 1935. The background changed in May with the Supreme Court decisions. Expect two and one-half to three years expanding business, increasing prosperity, higher markets.

Several dozen laws of measurement of time and psychology as they apply to the stock market are in back of the forecast at the beginning of this article. Application of the laws as we move into 1939-40 may justify minor changes in expectations, but the odds, mathematically calculated, are heavily in favor of the forecast.

The stock buyer becomes a partner in the enterprise into which he buys. What should he demand of this partnership?

1—Strong financial position.
2—A seasoned company.
3—A reasonable number of shares outstanding. (under 5,000,000).
4—Prior capital (leverage).
5—No potential labor difficulties.
6—No raw-material problems.
7—No consumer resistance to a high-priced product.
8—A reasonable price (50 or under).
9—A favorable outlook for the industry—beware of companies with several years of profit behind them.
10—A low or no dividend.
11—*GOOD MANAGEMENT.*

Speculation—Members on the New York Stock Exchange during the week of March 13 traded 6,874,405 shares for their own account, or 21.25% of total Exchange transactions, according to compilations of the SEC. In week of March 6 members traded 7,066,373 shares for their own account, or 21.39%, against 19.70% in the previous week.