AMERICAN INSTITUTE for ECONOMIC RESEARCH

GREAT BARRINGTON MASSACHUSETTS

WEEKLY BULLETIN

June 6 1949

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Downward Trend of Stock Prices

The trend of industrial stock prices has long been one of the earliest and most accurate indicators of future business trends. Furthermore, because upward or downward movements of stock prices usually have preceded corresponding changes in business activity, the so-called bull and bear markets are useful guides for those who must attempt to foresee business trends.

On several occasions in the past, the intermediate trends of stock prices have not proved to be good barometers of the business weather. For example, the decline from May to October 1946 (or to May 1947, the date some observers prefer) was classified as a bear market by the Dow Theorists and others. Nevertheless, no substantial decrease in business activity occurred; on the contrary, the extreme phase of the recent boom came after that decline. Nevertheless, nearly all of the cyclical depressions in business activity have been preceded by bear markets, and nearly all of the cyclical revivals of business activity have been preceded or accompanied by bull markets. Certainly, we should not expect a major business depression that was not preceded by a bear market of substantial proportions.

Although the precise reasons for this forecasting ability of the stock market are not known, plausible reasons are easily imagined. For example, business executives and directors presumably have the earliest information on the trends of new orders for the products of industry. Such individuals are also in a position to have preliminary estimates of earnings before such data are available to the general public. In the absence of extreme speculation such as that seen in 1929, one would expect that the sales of securities by those best informed would depress security prices even when the uninformed public was still somewhat optimistic and when most reports of business activity were favorable. Similarly, the early purchase of securities by those in a position to see the earliest evidence of a change for the better in the volume of increasing orders might well initiate an upward trend. In this connection, we assume as a general rule that all information known to even a few individuals will quickly be reflected in stock prices before the information becomes public knowledge.

In view of the record during the past half century, we believe that substantial weight should be given to major changes in security prices. This raises the question, What criterion is used in order to ascertain whether or not a change in security prices is large enough to be classified as a major one? If there were any clear-cut answer to this question, the problem of forecasting business trends (but not, of course, stock-market trends) would be greatly simplified.

Based on fluctuations in the Dow-Jones average of industrial stocks during the past 50 years, the following conclusions appear to be justified:

1. Fluctuations of less than 20 percent are so common that they can not be considered clues to major business changes.
2. Fluctuations of only 20 to 30 percent sometimes have preceded cyclical changes in business.
3. Fluctuations exceeding about 35 percent have been invariably followed by business-cycle changes.

The fluctuations of industrial stock prices since the 25-percent decline in the fall of 1946 were so limited during the nearly 3 years thereafter that they lacked significance in relation to business-cycle changes. In the last few days, however, stock prices have fallen below an earlier low for the year and have nearly broken through the lowest levels of the trading range established during the past 3 years. Whether or not the latter development, if it occurs, will be significant in relation to the future trend of either stock prices or business activity are important questions.

As far as the future trend of stock prices is concerned, such a penetration of either the top or bottom of a long-established resistance level would not necessarily be of great significance. Of seven comparable developments in the past 50 years, four have been followed by major changes in security prices ranging from a decline of 30 percent to a rise of 275 percent, two have been followed by declines of 20 to 25 percent, and one was followed by an insignificant rise in prices. Nevertheless, if past experience provides an indication of the probabilities involved, we should assume that the chances of a further substantial decline were great if prices break through the low level of the 3-year trading range.

As far as the significance of such penetrations in relation to the future trend of business activity is concerned, the four penetrations (two up and two down) followed by major changes in security prices also preceded cyclical changes in business activity. The two breaks that preceded further declines of 20 to 25 percent in stock prices did *not precede* corresponding cyclical changes of business activity; and the one penetration of the

upper limit of trading range that was followed by a negligible change in stock prices preceded a cyclical change of business activity in the *opposite direction.* We therefore conclude that, although a break through the bottom of the trading range is to be expected if a major depression is ahead, such a decline would not be surprising even if only a minor depression is ahead. However, a further decline of industrial stock prices in excess of 25 percent from the 1948 high (that is, a decline of the Dow-Jones industrial average below 145 from the level of 193 reached last June) probably would foreshadow a major depression comparable to those of 1920-21 or 1937-38.

The foregoing analysis should be considered with the discussions in these bulletins of other indicators of business trends, especially the summary of possibilities and consequences published last week. The latest developments tend to confirm our views (repeated several times in recent months) that the chances of avoiding a business depression are small. However, we still lack conclusive evidence that a major rather than a minor depression is ahead. If the prices of metals and metal products decline about as much again as they have in recent months and prices of industrial stocks decline by more than 25 percent from the 1948 high, we shall have reasonably conclusive evidence that a major depression is under way.

SUPPLY

Industrial Production

Steel-ingot production, scheduled at 91.8 percent of capacity for the week ended June 4, 1949, was 2 percent less than production in the preceding week and was 2 percent less than that in the corresponding week last year. Curtailed production in the plants of the Carnegie-Illinois Steel Corporation was primarily responsible for the rate of operations in the Pittsburgh area falling below 100 percent of capacity for the first time since mid-January.

	1929	*1932*	*1937*	*1938*	*1948*	*1949*
Percent of Capacity†	95*	20	75	26	96	92*p
Weekly Cap. (Million Tons)	1.38	1.52	1.51	1.54	1.80	1.84
Production (Million Tons)	1.31	.30	1.13	.40	1.73	1.69

Automobile and truck production during the week ended May 28, 1949, in the United States and Canada was estimated at 115,001 vehicles, compared with a revised total of 116,878 vehicles reported for the previous week. The return of workers to Ford assembly lines should result in increased output during the next few weeks.

	1929	*1932*	*1937*	*1938*	*1948*	*1949*
Vehicles (000 omitted)†	111	47	131	45	93	115

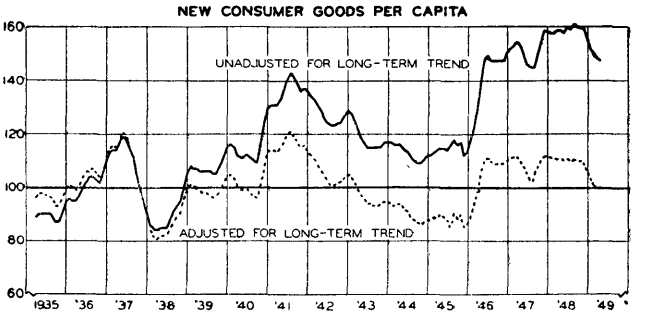
Electric-power production during the week ended May 28, 1949, increased to 5,270,161,000 kilowatt-hours from 5,255,272,000 kilowatt-hours reported for the previous week.

	1929	*1932*	*1937*	*1938*	*1948*	*1949*
Billion Kilowatt-Hours†	1.62	1.43	2.21	1.97	5.08	5.27

Lumber production in the week ended May 21, 1949, increased. *The New York Times* seasonally adjusted index was 2.4 points above the index for the previous week and was 5.3 points above that reported in the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1948*	*1949*
The New York Times Index	113	42	94	79	85	91

†Latest weekly data; corresponding weeks of earlier years
p=preliminary; *holiday week



New Consumer Goods Per Capita

The unadjusted index of new consumer goods per capita decreased nearly 1 percent during April to a point 8 percent below the all-time peak reached last August and to within 2 percent of the postwar low reached in July 1947.

The index adjusted for long-term trend was unchanged during April and remained 10 percent below the level of late 1948, when the current recession in the consumer-goods industries began.

In order to derive our index of new consumer goods per capita, an index of production of the more important types of consumer goods is divided by an index of population. Unimportant month-to-month fluctuations are eliminated by using a 3-month moving average of the production index. The final figure is plotted at the third month on the assumption that this lag approximately equals the time necessary for goods to reach retail markets. Finally, the index is adjusted for long-term trend.

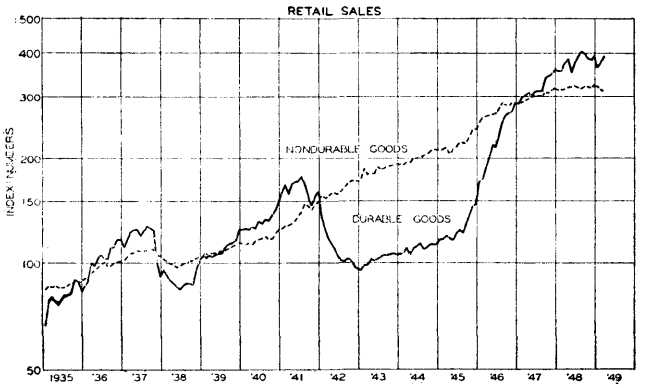
A decrease in textile production that more than counterbalanced increases in automobile production and residential construction was primarily responsible for the slight over-all curtailment of consumer-goods production during April.

Textile production decreased nearly 10 percent during April. Activity in the textile industry has been curtailed more than 28 percent since the postwar peak was reached in February 1948. Much of the recession has occurred during the first 4 months of 1949; a 20-percent decline has been reported since the end of January. Reports of decreasing demand for hosiery suggest that further curtailment of textile production may occur. Although the manufacture of textiles already has decreased more than that of the other consumer goods, there is no evidence that the recession in this industry has ended.

Automobile production, on the other hand, increased 5 percent during April to a postwar high. Not since 1929 has output in any one month exceeded the 543,118 cars produced during April. Strikes during May (especially the Ford strike) hampered operations so much that a substantial decrease in output occurrred. Further curtailment of automobile production is expected in the late summer and early fall as the prewar seasonal pattern is resumed.

The Federal Reserve Board's 3-month moving average of F. W. Dodge residential contract awards increased 5 and 9 percent for March and April respectively. In the 7 months prior to March this index had decreased 34 percent.

No substantial changes occurred in the remaining components of the consumer-goods production index. Food production was unchanged during April. Fluctuations



in this component of the index have been relatively minor throughout the past year. A preliminary estimate (based on cigarette output) of tobacco production indicates that a slight decrease probably occurred during April. Reports of activity in the furniture industry reveal no reversal of the general downward trend that has continued since October 1948. Shoe production, although below that of last year, has been increasing slightly, but the fluctuations are not large enough to affect the over-all index of consumer-goods production substantially.

A continuation of residential construction on a large scale in June together with some increase in automobile production as Ford's operations are resumed in June may cause a moderate upturn in the index. However, we expect the index to be substantially lower this fall, partly because automobile production is almost certain to decrease materially.

DEMAND

Retail Sales

Total retail sales during the first 4 months of 1949 have averaged about the same as total sales in the corresponding period last year. Dollar sales in January and February this year were, on the average, about 1 percent more than the totals for the same 2 months of 1948, but March and April sales averaged about 1 percent less than the totals for the corresponding months last year.[1]

The Department of Commerce's seasonally adjusted index of all retail sales increased nearly 1 percent during April but was 1 percent less than the index for April last year. Since the high reached last December, sales have decreased 3 percent. (The fluctuations in department-store sales have been greater.)

Part of the decrease in the dollar value of sales is attributable to lower prices. The Department of Commerce's index of all retail prices decreased slightly less than 2 percent between December 1948 and last March. Our index of retail prices of commodities usually sold in department stores has decreased 4 percent since December. The weights to be given the prices of items sold in the various types of stores are difficult to determine. However, the two indexes of prices just mentioned presumably provide a satisfactory clue to the extent of the price declines that have occurred recently. We have concluded that unit sales probably are but slightly less than unit sales reported in the peak month, December (after allowing for seasonal changes, of course).

The accompanying chart shows the retail sales of durable and nondurable goods. As was to have been expected, sales of durable goods have increased since the war as more of such items were produced. On the other hand, nondurable-goods sales have increased less rapidly. In 1948 marked fluctuations occurred in the sales of durable items, but the general trend was upward, sales of nondurable goods remained relatively stable.

Although sales of durable goods decreased in January, gains in February and March offset the decrease. On the other hand, sales of nondurable goods have decreased steadily since December. Apparently, substantial reductions in the prices of many durable items and the greater quantity of automobiles available have contributed to the increase in durable-goods sales in February and March. Preliminary data for April indicate that sales of both durable and nondurable goods may have increased in that month.

Although the downward trend of sales of nondurable goods is similar to the downturn late in 1937, the moderate decrease in sales of durable goods since the peak reached in August 1948 is much less, proportionately, than the decrease in sales of such goods late in 1937. Presumably, retail sales will decrease further during the next few months, but the decline to date has not been serious.

Mail-Order and Chain-Store Retail Sales

For four consecutive months beginning in January 1949 total sales of the Nation's leading mail-order and chain stores were less than those for the corresponding month of the previous year. Sales during April were nearly 5 percent less than those in the corresponding month of 1948. Automotive chains reported the largest percentage decreases in sales followed by the mail-order companies.

Percent Change in Retail Sales for April 1949 vs. April 1948

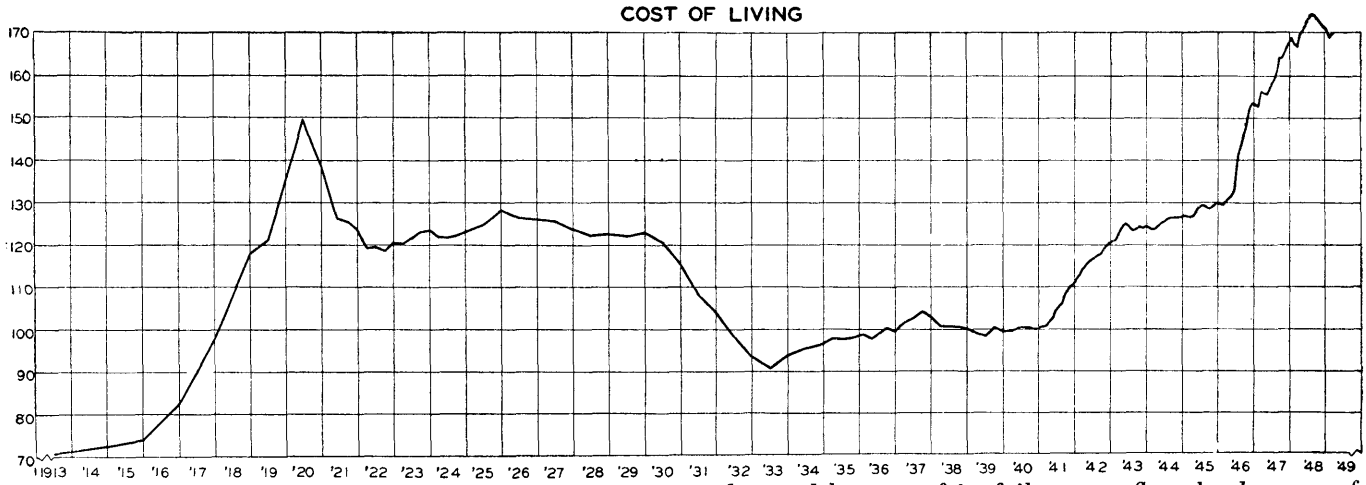
Mail order	− 7
Grocery	− 1
Variety	+24
General Merchandise	+19
Apparel	+34
Shoe	+45
Automotive	−16
Drug	+ 6
Men's Wear	+35

Note: The classes are given in the order of magnitude of dollar sales.

Department-Store Sales

Department-store sales for the week ended May 28, 1949, were 2 percent less than sales for the previous week and were 8 percent less than sales in the corresponding week last year.

[1]As we have pointed out from time to time, department-store sales usually reflect the trend of sales in all retail stores. Department-store sales have in general reflected the pattern of all sales during the first 4 months of 1949. However, total retail sales, seasonally adjusted, in March increased, whereas the Federal Reserve Board's seasonally adjusted index of department-store sales decreased during the month. In this connection, the Federal Reserve Board's statisticians have delayed publication of the April department-store-sales index while revisions are made in their seasonal-adjustment factors. In the May 2 bulletin we mentioned that the seasonal adjustment for March would be especially difficult. Perhaps the revised seasonal adjustments will change the final Federal Reserve data so that department-store sales will more accurately reflect the trend of all retail sales.



PRICES

Cost of Living

For the second consecutive month the index of consumers' prices increased slightly during the month ended April 15. A further increase in food prices together with additional increases in rents and the prices of miscellaneous goods and services more than counterbalanced decreases in the prices of apparel, housefurnishings, fuel, electricity, and refrigeration. Nevertheless, the index remained 3 percent below the all-time high reached during August and September 1948.

Food prices, which are heavily weighted in the computation of the index, rose 0.6 percent during the month. Prices of eggs, meats, fresh fruits, and vegetables were higher. The April increase in food prices was slightly less than that of March, when prices rose 1 percent. Prior to March, food prices had decreased for six consecutive months and had been responsible for much of the decrease in the over-all index since September.

Residential rents continued to increase during April. The rent component of the index has risen approximately 0.2 percent in each of the last 4 months. Rents have not decreased since June 1942, when they were artificially lowered by the Government as part of the general price-control program. However, in view of Government restrictions on rent increases since the war, there is little reason to believe that the current trend of the rent component is of major significance as an indicator of the general trend of consumers' prices. In 1929 and 1937, decreases in rents occurred simultaneously with decreases in the cost of living, but in the early twenties the decline in rents did not begin until a year after the over-all cost of living began to decline.

A second component that has not decreased since the cost of living turned downward in October is that of miscellaneous goods and services (which includes such costs as those of medical care, personal services, household operation, automobiles and the items necessary for their operation, and upkeep, other transportation, tobacco products, and motion pictures). However, the increases in this component have not been more than 0.2 of 1 percent during any one month since October. Presumably, the recent decrease in prices of General Motors cars will tend to lower the index of miscellaneous goods and services prices. We have mentioned in previous bulletins that this index (which uses the official prices of passenger cars in its computation) has been distorted because of its failure to reflect the decrease of dealer bonuses.

Apparel prices decreased nearly 1 percent during the month ended April 15. In six consecutive months of decreasing prices, apparel prices have fallen 4.5 percent. Housefurnishings prices, which declined 1 percent during April and also have declined for six consecutive months, have fallen 3.5 percent since October.

The third component of the consumers' price index to decrease during the month ended April 15 was that of fuel, electricity, and refrigeration. The decrease, which was slightly more than 1 percent, was only the second monthly decline since October but was the largest decrease reported for any of the components of the consumers' price index during the last 2 months.

We have frequently pointed out the difficulties involved in lowering the cost of living when the Government engages in such practices as the farmers' price-support program. Government interference with free market prices was brought out even more clearly last week in New Jersey. The Attorney General of that State was instrumental in having a milk company rescind an announced price cut. The excuse for not permitting the lowered price was that the decrease would be harmful to the milk industry. Apparently, the company was given the alternative of rescinding the price reduction or losing its license to sell milk.

Although prices of food increased during April, the increase was less than that of the preceding month. Furthermore, the other increases in components of the cost-of-living index were relatively small. Finally, there was no slackening in the rate of decline of apparel and housefurnishings prices, and the decrease in the cost of fuel, electricity, and refrigeration was relatively large. The recent reversal of the downward movement of the cost of living apparently is only a temporary development. Food prices, especially, are expected to be lower this fall. However, a substantial decline of the consumers' price index is hardly to be expected until there has been much more deflation than that thus far this year.

Commodities at Wholesale

	1948	*1949*	
(August 1949=100)	*June 2*	*May 26*	*June 2*
Spot-Market Prices (28 basic raw materials)	327	242	236
Commodity Futures Prices (Dow-Jones Daily Index)	311	262	259