Chapter 3:
A Century of Stock-Market History: The Level of Stock Prices in Early 1972

Stock-Market History in General – Major stock-Market Swings

In this chapter we shall present the figures, in highly condensed form, with two objects in view.

1. The first is to show the general manner in which stocks have made their underlying advance through the many cycles of the past century.
2. The second is to view the picture in terms of successive ten-year averages, not only of stock prices but of earnings and dividends as well, to bring out the varying relationship between the three important factors.

With this wealth of material as a background we shall pass to a consideration of the level of stock prices at the beginning of 1972.

Stock-Market History in General – Major stock-Market Swings (cont.)

Table 3-1 sets forth the low and high points of nineteen bear- and bull-market cycles in the past 100 years. We have used two indexes here.

TABLE 3-1 Major Stock-Market Swings Between 1871 and 1971

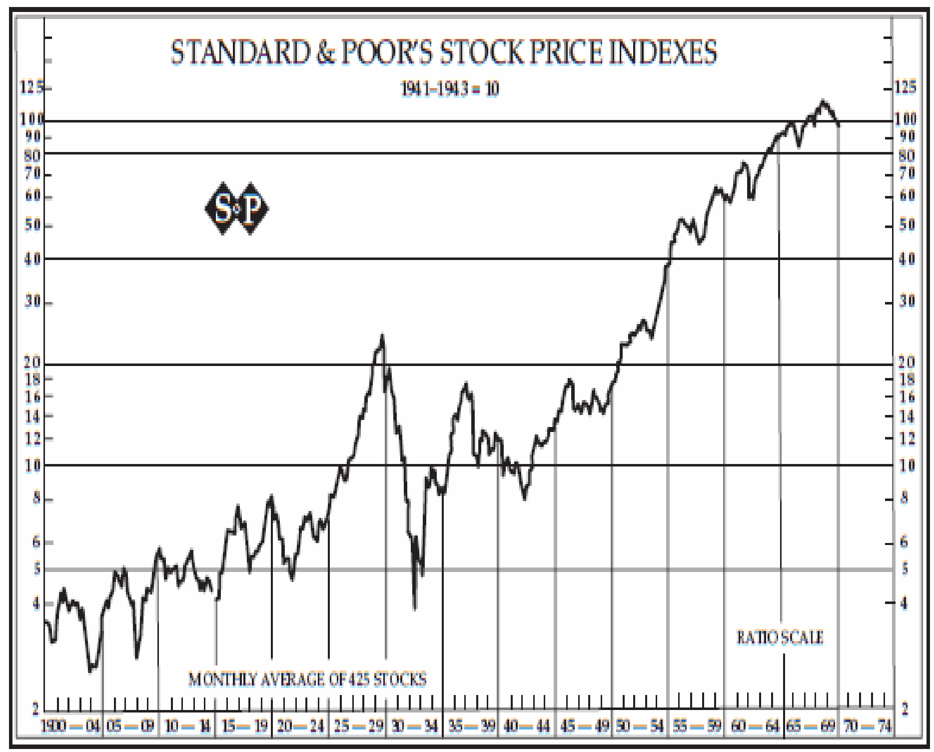
	Cowles-Standard 500 Composite			*Dow-Jones Industrial Average*		
Year	High	Low	Decline	High	Low	Decline
1871		4.64				
1881	6.58					
1885		4.24	28%			
1887	5.90					
1893		4.08	31			
1897					38.85	
1899				77.6		
1900					53.5	31%
1901	8.50			78.3		
1903		6.26	26		43.2	45
1906	10.03			103		
1907		6.25	38		53	48
1909	10.30			100.5		
1914		7.35	29		53.2	47
1916–18	10.21			110.2		
1917		6.80	33		73.4	33
1919	9.51			119.6		
1921		6.45	32		63.9	47
1929	31.92			381		
1932		4.40	86		41.2	89
1937	18.68			197.4		
1938		8.50	55		99	50
1939	13.23			158		
1942		7.47	44		92.9	41
1946	19.25			212.5		
1949		13.55	30		161.2	24
1952	26.6			292		
1952–53		22.7	15		256	13
1956	49.7			521		
1957		39.0	24		420	20
1961	76.7			735		
1962		54.8	29		536	27
1966–68	108.4			995		
1970		69.3	36		631	37
early 1972	100		—	900		—

Stock-Market History in Graph

Three quite distinct patterns, each covering about a third of the 70 years.

1. The first runs from 1900 to 1924, and shows for the most part a series of rather similar market cycles lasting from three to five years. The annual advance in this period averaged just about 3%.
2. We move on to the “New Era” bull market, culminating in 1929, with its terrible aftermath of collapse, followed by quite irregular fluctuations until 1949. Comparing the average level of 1949 with that of 1924, we find the annual rate of advance to be a mere 11/2%; hence the close of our second period found the public with no enthusiasm at all for common stocks. By the rule of opposites the time was ripe for the beginning of the greatest bull market in our history, presented in the last third of our chart.

CHART 1



Stock-Market History in Graph - cont.

3. This phenomenon may have reached its culmination in December 1968 at 118 for Standard & Poor’s 425 industrials (and 108 for its 500-stock composite). Between the low level of 162 for “the Dow” in mid-1949 and the high of 995 in early 1966, the advance had been more than sixfold in 17 years—which is at the average compounded rate of 11% per year, not counting dividends of, say, 3½% per annum.

   These 14% and better returns were documented in 1963, and later, in a much publicized study. It created a natural satisfaction on Wall Street with such fine achievements, and a quite illogical and dangerous conviction that equally marvelous results could be expected for common stocks in the future. Few people seem to have been bothered by the thought that the very extent of the rise might indicate that it had been overdone. The subsequent decline from the 1968 high to the 1970 low was 36% for the Standard & Poor’s composite (and 37% for the DJIA), the largest since the 44% suffered in 1939–1942, which had reflected the perils and uncertainties after Pearl Harbor. In the dramatic manner so characteristic of Wall Street, the low level of May 1970 was followed by a massive and speedy recovery of both averages, and the establishment of a new all-time high for the Standard & Poor’s industrials in early 1972.

Stock-Market History in Earnings and Dividends

The record of price movements should be supplemented by corresponding figures for earnings and dividends, in order to provide an overall view of what has happened to our share economy over the ten decades.

TABLE 3-2 A Picture of Stock-Market Performance, 1871–1970[a]

Period	*Average Price*	*Average Earnings*	*Average P/E Ratio*	*Dividend Average*	*Average Yield*	*Average Payout*	*Annual Growth Rate*[b] Earnings	Dividends
1871–1880	3.58	0.32	11.3	0.21	6.0%	67%	—	—
1881–1890	5.00	0.32	15.6	0.24	4.7	75	− 0.64%	−0.66%
1891–1900	4.65	0.30	15.5	0.19	4.0	64	− 1.04	−2.23
1901–1910	8.32	0.63	13.1	0.35	4.2	58	+ 6.91	+5.33
1911–1920	8.62	0.86	10.0	0.50	5.8	58	+ 3.85	+3.94
1921–1930	13.89	1.05	13.3	0.71	5.1	68	+ 2.84	+2.29
1931–1940	11.55	0.68	17.0	0.78	5.1	85	− 2.15	−0.23
1941–1950	13.90	1.46	9.5	0.87	6.3	60	+10.60	+3.25
1951–1960	39.20	3.00	13.1	1.63	4.2	54	+ 6.74	+5.90
1961–1970	82.50	4.83	17.1	2.68	3.2	55	+ 5.80[c]	+5.40[c]
1954–1956	38.19	2.56	15.1	1.64	4.3	65	+ 2.40[d]	+7.80[d]
1961–1963	66.10	3.66	18.1	2.14	3.2	58	+ 5.15[d]	+4.42[d]
1968–1970	93.25	5.60	16.7	3.13	3.3	56	+ 6.30[d]	+5.60[d]

[a] The following data based largely on figures appearing in N. Molodovsky's article, "Stock Values and Stock Prices," *Financial Analysts Journal*, May 1960. These, in turn, are taken from the Cowles Commission book *Common Stock Indexes* for years before 1926 and from the spliced-on Standard & Poor's 500-stock composite index for 1926 to date.

[b] The annual growth-rate figures are Molodovsky compilations covering successive 21-year periods ending in 1890, 1900, etc.

[c] Growth rate for 1968–1970 vs. 1958–1960.

[d] These growth-rate figures are for 1954–1956 vs. 1947–1949, 1961–1963 vs. 1954–1956, and for 1968–1970 vs. 1958–1960.

Stock-Market History in Earnings and Dividends – cont.

1. The full decade figures smooth out the year-to-year fluctuations and leave a general picture of persistent growth.
2. Only two of the nine decades after the first show a decrease in earnings and average prices (in 1891–1900 and 1931–1940), and no decade after 1900 shows a decrease in average dividends. But the rates of growth in all three categories are quite variable. In general the performance since World War II has been superior to that of earlier decades, but the advance in the 1960s was less pronounced than that of the 1950s.
3. The year 1970 was marked by a definite deterioration in the overall earnings posture of our corporations. The rate of profit on invested capital fell to the lowest percentage since the World War years. Equally striking is the fact that a considerable number of companies reported net losses for the year; many became "financially troubled," and for the first time in three decades there were quite a few important bankruptcy proceedings.

Stock-Market History in Earnings and Dividends – cont.

4. A striking feature of Table 3-2 is the change in the price/earnings ratios since World War II.† In June 1949 the S & P composite index sold at only 6.3 times the applicable earnings of the past 12 months; in March 1961 the ratio was 22.9 times. Similarly, the dividend yield on the S & P index had fallen from over 7% in 1949 to only 3.0% in 1961, a contrast heightened by the fact that interest rates on high-grade bonds had meanwhile risen from 2.60% to 4.50%.

5. To people of long experience and innate caution the passage from one extreme to another carried a strong warning of trouble ahead. They could not help thinking apprehensively of the 1926–1929 bull market and its tragic aftermath. But these fears have not been confirmed by the event. nothing has happened either to business or to stock prices that can compare with the bear market and depression of 1929–1932.

The Stock-Market Level in Early 1972

The work of a financial analyst falls somewhere in the middle between that of a mathematician and of an orator.

TABLE 3-3 Data Relating to Standard & Poor's Composite Index in Various Years

Year[a]	*1948*	*1953*	*1958*	*1963*	*1968*	*1971*
Closing price	15.20	24.81	55.21	75.02	103.9	100[d]
Earned in current year	2.24	2.51	2.89	4.02	5.76	5.23
Average earnings of last 3 years	1.65	2.44	2.22	3.63	5.37	5.53
Dividend in current year	.93	1.48	1.75	2.28	2.99	3.10
High-grade bond interest[a]	2.77%	3.08%	4.12%	4.36%	6.51%	7.57%
Wholesale-price index	87.9	92.7	100.4	105.0	108.7	114.3
Ratios:						
Price/last year's earnings	6.3 ×	9.9 ×	18.4 ×	18.6 ×	18.0 ×	19.2 ×
Price/3-years' earnings	9.2 ×	10.2 ×	17.6 ×	20.7 ×	19.5 ×	18.1 ×
3-Years' "earnings yield"[c]	10.9 %	9.8 %	5.8 %	4.8 %	5.15%	5.53%
Dividend yield	5.6 %	5.5 %	3.3 %	3.04%	2.87%	3.11%
Stock-earnings yield/bond yield	3.96×	3.20×	1.41×	1.10×	.80×	.72×
Dividend yield/bond yield	2.1 ×	1.8 ×	.80×	.70×	.44×	.41×
Earnings/book value[e]	11.2 %	11.8 %	12.8 %	10.5 %	11.5 %	11.5 %

The Stock-Market Level in Early 1972 – cont.

1. The 3-year price/earnings ratio for the market was lower in October 1971 than at year-end 1963 and 1968. It was about the same as in 1958, but much higher than in the early years of the long bull market. This important indicator, taken by itself, could not be construed to indicate that the market was especially high in January 1972.
2. The reader will note from our table that the ratio of stock returns (earnings/ price) to bond returns has grown worse during the entire period, so that the January 1972 figure was less favorable to stocks, by this criterion, than in any of the previous years examined.
3. When dividend yields are compared with bond yields we find that the relationship was completely reversed between 1948 and 1972. In the early year stocks yielded twice as much as bonds; now bonds yield twice as much, and more, than stocks.
4. Our final judgment is that the adverse change in the bondyield/stock-yield ratio fully offsets the better price/earnings ratio for late 1971, based on the 3-year earnings figures. Hence our view of the early 1972 market level would tend to be the same as it was some 7 years ago—i.e., that it is an unattractive one from the standpoint of conservative investment.

The Stock-Market Level in Early 1972 – cont.

5. In terms of historical market swings the 1971 picture would still appear to be one of irregular recovery from the bad setback suffered in 1969–1970. In the past such recoveries have ushered in a new stage of the recurrent and persistent bull market that began in 1949. (This was the expectation of Wall Street generally during 1971.) After the terrible experience suffered by the public buyers of low-grade common-stock offerings in the 1968–1970 cycle, it is too early (in 1971) for another twirl of the new-issue merry-go-round.
6. We think the investor must be prepared for difficult times ahead—perhaps in the form of a fairly quick replay of the the 1969–1970 decline, or perhaps in the form of another bull market fling, to be followed by a more catastrophic collapse.

What Course to Follow

The principles of investment, as set forth herein, would call for the following policy under 1971 conditions (as 1964), in order of urgency:

1. No borrowing to buy or hold securities.
2. No increase in the proportion of funds held in common stocks.
3. A reduction in common-stock holdings where needed to bring it down to a maximum of 50 per cent of the total portfolio. The capital-gains tax must be paid with as good grace as possible, and the proceeds invested in first-quality bonds or held as a savings deposit.
4. Investors who for some time have been following a bona fide dollar-cost averaging plan can in logic elect either to continue their periodic purchases unchanged or to suspend them until they feel the market level is no longer dangerous. We should advise rather strongly against the initiation of a new dollar-averaging plan at the 1971 levels (as that of late 1964).