The Stock Market Situation

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Mr. Graham analyses the present level of stock prices based on relationship between price and value, and causes of the market's rise; and suggests methods of controlling excessive speculation. Maintains that while stocks are not as high as they look, nevertheless on the basis of various quantitative criteria the prudent investor should lighten his holdings. Asserts the fundamental reason for the market rise since September 1953, was the swing from doubt to confidence, with public's emphasis concentrated on opportunities rather than risks in common stocks. Contends that net result of possible abolition of capital gains tax cannot be foretold, suggests President might be given power to make changes in effective rate, within specified limits.

This statement will address itself mainly to three points:  
(A) The present level of stock prices from the standpoint of the relationship between price and value.  
(B) Causes of the rise in the market since September 1953.  
(C) Feasible methods of controlling excessive speculation in the future.

(A) The Present Level of Stock Prices

Common stocks look high and are high, but they are not as high as they look. The market level of industrials stock is far above the 1929 high as shown by the Standard & Poor's Index of 450. The Dow-Jones Industrials are now at a lower ratio to their average earnings in the past than they were at their highs in 1929, 1937 and 1943. The same applies to General Electric as an individual stock. It is clear that the issues referred to—which may be considered as reasonably representative of the larger industrials as a whole—have a considerable way to go before reaching the ratios shown at their former tops. It should be pointed out also that high-grade interest rates are now definitely lower than in previous bull markets except for 1946. Lower basic interest rates presumably justify a higher value for each dollar of dividends or earnings.

Much has been made of these relationships as indicating that the market is still on safe ground. However, such comparisons fail to take into account the extent of the subsequent declines from 10 years ending in 1958 and the average earnings held to during any period of depression. In a sense the soundness of this Central Value is borne out our ability to escape a new depression in that we have in the recessions probably fair to a market is not too high we have really made the business cycle.

Although such a view would involve a complete break with the past, prepared to deny its validity. There is some reason for concluding that in the future the depressions will be by the natural American business, terminal deflationary sible inflationary r above analysis is by unfavorable to the s of stock prices. For reaching my own al on the subject, I am
Benjamin Graham

(The present figure is above 300 as compared with the 1929 high of 185.) The Dow-Jones Industrials Average at about 410 is now only moderately above its 1929 high of 382, but the difference would be much larger except for the substitutions made in the Average. However, the railroad and utility issues as a whole are well below their 1929 highs.

The true measure of common stocks values, of course, is not found by reference to price movements alone, but by price in relation to earnings, dividends, future prospects and, to a small extent, asset values.

Present concepts of common stock valuation turn largely on estimating average future earnings and dividends and applying thereto a suitable capitalization rate or multiplier. Since these elements are all matters of prediction or judgment, there is room for a wide difference of informed opinion as to the proper value for a single stock or group of stocks at any time. Uninformed or speculative opinion will, of course, cover an even wider range as the market swings from the depth of pessimism to the heights of optimism.

As a guide to identifying the present level of stock prices in the light of past experience, I have made two sets of comparisons—one relating to the Dow-Jones Industrial Average, the other to General Electric, a component of that Average and an outstanding "blue chip" issue. I have related the present prices and the high prices in 1929, 1937 and 1946 to earnings of the preceding year, the preceding five years and the preceding 10 years. This information, together with certain other data, appears on the appended table.

*Mr. Graham's statement at the Hearings on the Stock Market Study before the Committee on Banking and Currency, U. S. Senate, March 11, 1935.

Frozen-Food Deliveries, 1937-1946

A Reassuring Measure

This mechanical method applied to the situation in the beginning of 1935 yields a Central Value for the Dow-Jones Industrials of 396, or only slightly under their present value. Such a figure, if reliable, would have to be regarded as rather reassuring. It would indicate that the market in terms of value is no higher now than it was in early 1927, or in early 1933, or late 1945. However, the validity of this Central Value figure may be open to question if we observe that the...
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March 25, 1953

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hark back to the analysis I made of the stock market in October, 1954, at a time when the Dow-Jones Average stood at 185. This my analysis appeared in “The Commercial and Financial Chronicle,” Oct. 18, 1945. I should like to point to the fact that it expresses my view with respect to the stock market today.

The three different approaches used in the present analysis of stock prices have yielded diverse indications. From the first, the market appears distinctly on the high side and vulnerable to a substantial setback. Contrariwise, our second category—that of appraisal based on figures and formula—about supports the present level, and suggests that the familiar bull market enthusiasm might

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