EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20506

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MEMORANDUM FOR THE PRESIDENT

Subject: Is the Stock Market Too High?

1. <u>You asked me whether the stock market is too high.</u> Of course, nobody can really predict what the market will do next. It could go down today, next week, or next month. But here are a few facts.

2. <u>Stock prices have risen a lot.</u> Dow-Jones industrials are:

   -- up 20% since November 1963

   -- up 40% since January 1961

   -- up 440% since the end of World War II.

3. <u>But the business earnings which underlie these stock values are up too,</u>

   -- up more than 15% from the fourth quarter of 1963

   -- up 70% from the first quarter of 1961

   -- up 250% since 1946.

4. For the 30 stocks in the Dow-Jones Industrial Index, <u>the price-earnings ratio is now about 19</u>,

   -- <u>up slightly</u> from the 18.6 average for 1963 and the 17.9 average for 1962

   -- <u>but below the 22-24 ratios before the 1962 decline</u> and below the average figures from 1958 through 1961.

5. Here are some important examples of price-earnings ratios of companies that have already reported for the year 1964,

	1961	1964
Alcoa	36	23
Bethlehem Steel	17	12
DuPont	25	26
General Motors	16	17
Procter & Gamble	33	48
Standard Oil, New Jersey	13	18
Westinghouse Electric	40	44

- Defense stocks are generally below their previous peak levels, as would be expected.
- Some individual firms, such as American Motors, Reynolds Tobacco, and cement companies, are not participating in the general rise in earnings and stock prices.

6. The market is sounder than before the 1962 shake-out.

- The "growth stocks" are more realistically priced.
- There is less use of credit to push up values.

7. In the long run, stock prices rise because:

  -- companies plow back earnings.

  -- as incomes rise, more families become investors and have more to invest.

8. But the uptrend of stock values never proceeds smoothly and there are now, as always, many risks.

- A technical correction usually follows a sustained rise of the sort we are in.
- If the economy should slow down, profits could begin to be squeezed, and the present high market is based on the present high profits.
- A tightening of credit always dampens the market.
- Speculation and psychology move prices up and down.

- There are always lots of other uncertainties (the international situation, steel strikes, elections, false rumors, etc.).

Otto Eckstein