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THE STOCK MARKET AND THE ECONOMY

Since the beginning of the year, the stock market has been rising at a very impressive rate and sales volume has been record breaking. At the same time, the economic news is increasingly bad. Daily, the newspapers record the closing of plants, the idling of thousands of laborers and indications that the news will get worse before it gets better.

That being the case, the question which is being asked more and more is why is the stock market moving up when the economy is moving down?

Economists are arguing among themselves whether this so-called recession will be V-shaped or U-shaped, that is will the economy tend to decline almost constantly, hit a bottom, and then almost immediately, or shortly thereafter start to climb, or will the economy drop and then coast along the bottom for quite some time before it climbs again.

Regardless, however, whether it turns out to be V-shaped or U-shaped, why is the stock market going up?

No one, of course, has the answer. Probably as good a reason is that the stock market is considered to be one of the so-called "leading indicators". Leading indicators are supposed to indicate how the economy is tending to go. They fortell, in effect, the future. If a lot of these indicators are tending up, presumably the economy will improve, and vice-versa.

Thus, it would appear that the stock market is saying that it expects the economy to improve probably within the next six months. What this means is that investors are gambling that corporations will start to increase their earnings this year, and since stock prices have dropped so drastically within the past year, now is a good time to get into the market again.

Another reason advanced is that as the Federal Reserve has pumped reserves into the monetary system, interest rates have dropped quite rapidly. Investors cannot get 9% or 10% on good short term debt obligations as they could in 1974. But stock prices dropped so much that if corporations are able to continue to pay the present rate of dividends, the yield on them is greater than on short term debt. Thus, a greater return is received. Also there is the possibility of the stocks increasing in price.

Another reason, which may be the most important, is that the realization is growing that the Government is going to intervene in the economy to get it going again. The President's program is evidence that he is taking the lead. The Congress will ateempt to outdo the President by giving the people a greater tax reduction than he has advocated. At the same time, it will not permit him to implement his expensive oil energy program, which would hurt the economy. The more the President and the Congress wrangle the better for the economy for the less they do, the more likely the normal market forces will tend to correct inequities.

And, of course, as previously noted the Federal Reserve System is actively at work to increase the money supply. This means that while temporarily interest rates will fall, in the long run they will rise. Thus, now is a good time to start to sell long term bonds, for as interest rates fall, the price of bonds rises. But long term interest rates will not fall as much as short term rates for lenders will want an increased rate to compensate them for the loss in purchasing power of the dollar in the long term. Holders of long term bonds are thus selling them and probably investing the money in stocks, for it is obvious that the government is going to keep on inflating the money supply year in and year out. So this is a heaven sent opportunity to get out of long term bonds.

Whether the stock market will continue to rise is anyone's guess. If some of the reasons given above are correct, it probably will. But, there is always the possibility that something unforseen as a war will comletely change the situation. That is why you can never be sure what the stock market will do. The only thing you can be certain about is that it will fluctuate.

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