

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

May 28, 1962

MEMORANDUM FOR THE PRESIDENT

Subject: The Market

We have been talking to a market trader we know who also happens to be a well-trained economist. As background for tomorrow, we pass on his impressions to you, because we think they are well-informed and make a lot of sense.

He attributes the start of present sell-off to four substantive factors. Its continuation he blames on "internal" or technical factors such as momentum and loss of confidence (in stock prices, not the economy). The four substantive factors are:

1. Failure of the recovery to come up to the pattern set by the 1954-55 recovery. The 1959 recovery had been disappointing, but the market fraternity figured that the Democrats would pull out all the stops and take us back to the good old days. Stock prices had gone up accordingly. When it began to look as though even our \$570 billion GNP forecast (modest as that was in terms of full-capacity operations) was too high, the roof started to fall in.
2. Many of the business economists follow a system of forecasting which makes use of "leading indicators." These have been acting in a rather dyspeptic manner recently.
3. The balance of payments and gold outflow have been worrying the market. The men of the Street don't understand it but this doesn't prevent them from believing that devaluation of the dollar may be in the cards. Contrary to common sense and economic theory, they think this would have a bearish impact on the market.
4. Wall Street has been to some extent a victim of its own propaganda about the profit squeeze.

As of now, the funds and institutions are buying. MIT purchased \$8 million of AT&T today, for example. Other large purchases have been noted.

As to what would help the market, our friend believes:

1. A cut in margin requirements would help both psychologically and technically. It would show that Washington gave a damn and it would add buying power. Now is not the time to be punitive to speculators, who are on their knees.

2. For the longer term, a cut in taxes to add vigor to the recovery is the market's main hope. (We have heard this from a dozen sources in finance and business.)

3. He doubts that statements will help much. Wall Street doesn't believe Washington knows anything. Moreover, statements remind the Street of '29.

4. Above all, avoid any word or gesture reminiscent of 1929, such as the organization of highly publicized buying demonstrations.

Walter W. Heller