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The Over-Valuation of Some Blue Chip Stocks

"To pay too much for future earnings can be expensive," warns one observer of the Wall Street scene. Here he uses four stocks to show why he thinks some high quality issues are vulnerable to a market decline.

By Walter J. Schloss

WITH THE DOW-JONES Industrial Average selling over 500 and new highs being made every day, it is interesting to see where some of our better known stocks are selling in relation to other stocks and to their own previous prices.

While it is undoubtedly true that what happened yesterday is no proof of what will happen tomorrow, still one cannot completely disregard past prices, earnings and dividends. To pay too much for future earnings can be expensive.

Public demand for blue chips is based on many things: factors such as large size, past growth records, dividend records, the tendency for the largest corporations to grow

larger through reinvestment of profits, and acquisitions through mergers. In addition, most investment trust managers, brokers and financial services tend to concentrate on these issues. The recent monthly stock investment plans have also followed this policy. Other factors, such as the reluctance of investors to sell their holdings at a profit and pay the capital gains tax, also keep some stock out of the market.

People have made a great deal of money lately investing in the high grade common stock field, but the question in many minds is whether or not these paper profits can be transferred into realized capital gains before a substantial decline sets in.

There are other kinds of common stocks one can buy besides the "blue chips." Care has to be exercised in the selection of off-beat securities, but the results can be very gratifying. For some investors, it might be better to build up savings bank accounts or invest in tax exempts.

Below are listed four blue chip common stocks all selling at their all-time highs. While the Dow Jones Industrial Average has gone up 137% from its 1946 high of 212, these securities have made increases of 270% (General Electric) to 790% (Minnesota Mining).

Are these securities vulnerable to a market decline? It would appear that they are, based on past market history.

In Table I, a comparison is made of the earnings, dividends, market

record, price/earnings ratios, yields and percent paid out in dividends of the four blue chips. Take a look at the figures in the price/earnings ratio column.

Certainly these figures today are on the high side compared with previous years. For example, Dow Chemical, based on its current price, is selling at 49 times its earnings for the past 10 years. Similarly, Minnesota Mining is presently selling at 61 times its last 10 years earnings, 51 times its last 5 year earnings and 32 times its 1955 earnings.

One of the four companies is distributing nearly all of its current earnings and still only yields 3.1%.

It might be pointed out at this time that there are other blue chips just as well known that should be placed in the same category as the

TABLE I

	Earnings per share	Average High-Low	Price Earn. Ratio	Yield	% Paid Out in Divds.
Dow Chemical					
Current	\$2.14	71	33	1.4%	47%
1955	2.14	51 1/2	24	1.9*	47%*
5 Yr. Average	1.76	40	23	2.2	50
10 Yr. Average	1.45	28	19	2.3	44
				*plus 2% stock	
General Electric					
Current	\$2.32	65	28	3.1%	87%
1955	2.32	52	22	3.1	69
5 Yr. Average	2.02	31	15	4.1%	63
10 Yr. Average	1.70	22	13	4.5	59%
Minnesota Mining					
Current	\$4.14	134	32	1.35%	44%
1955	4.14	97 1/2	24	1.7	40
5 Yr. Average	2.62	62	24	1.9	45
10 Yr. Average	2.19	41	19	2.1	21%
Minneapolis Honeywell					
Current	\$2.98	76	25	2.0%	50%
1955	2.98	59	20	2.0%	50%
5 Yr. Average	2.03	37	18	3.3	61%
10 Yr. Average	1.74	26	15	3.7	55%

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TABLE II

All figures adjusted to present capitalization per share.

	Dow Chemical	General Electric	Minnesota Mining	Minneapolis Honeywell
March 14, 1956 Market	71	65	134	3-13-56 76
1946 High	16	17 1/2	15	17
1948-49 Low	11	10 1/2	13 1/2	10 1/2
% decline from 1946 high	31%	40%	10%	38%
1937 High	13	21 1/2	5	15
1938 Low	7	9	3	6
% decline from 1937 high	46%	58%	40%	60%

securities mentioned here. For simplicity's sake, and because these companies seemed typical of a certain group of blue chips, these four are used as illustrations.

Table II compares the present market prices with previous high-low periods. It can be seen that these securities have risen spectacularly in the past seven years. From an historical point of view, it is hard to believe this appreciation will continue without some lengthy interruption.

In Table III, an attempt was made to relate previous market highs with the company's book value. The four stocks are selling higher today in relation to their

book values than they did at their high in 1946.

The companies under study are representative of a group of blue chips which are selling on their future expectations. Certainly the people in 1929 who bought stocks because of the future growth potential of a particular industry were correct in that they saw a long term growth to our economy. Unfortunately, these investors had to wait, in many cases, 25 years before the stock market gave them a decent profit on their 1929 cost. And many of the 1929 blue chips are no longer with us.

Mr. Schloss is a general partner in Walter J. Schloss Assoc., a partnership which invests for capital gains.

TABLE III

	Dow Chemical	General Electric	Minnesota Mining	Minneapolis Honeywell
Book Value 12-55	\$13.86	\$12.19	\$18.38	\$14.46
Current Market	71	65	134	76
Number of times stock selling over book value	5.1 Times	5.3 Times	7.3 Times	5.3 Times
Book Value 12-45	\$4.91	\$4.19	\$3.60	\$3.81
Market High 1946	16	17 1/2	20	17
Number of times stock selling over book value	3.3 Times	4.2 Times	5.6 Times	4.5 Times
Book Value 12-36	\$1.86	\$3.86	\$1.03	\$1.33
Market High 1937	13	21 1/2	5	15
Number of times stock selling over book value	7.0 Times	5.6 Times	4.9 Times	11.3 Times

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