FRIEDBERG MERCANTILE GROUP

FOURTH QUARTER REPORT 1999

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REPORT
1999

Dear Investor,

We write to you with a rare mixture of feelings: elated for having delivered - in a convincing way - on our promise to turn around the equity hedge fund, energized with the scintillating prospects of the diversified and currency programs and confident that the long wait for above-average returns is at hand for our patient fixed-income investors.

Despite reverses, we have kept a steady hand at the tiller. Instead of abandoning old paradigms, as many value managers have unashamedly done in recent months, we have repeated to ourselves, over and over again, that two plus two still makes four. Thus, we remain convinced that it is not time to revamp and start all over again. Didn't the Greeks of old say that those whom the gods want to destroy they first drive to madness?

To survive, we have cut our losses here and there. Yet we have doggedly maintained an overall posture that reflects our continued concern for a once-in-a-generation economic and financial disturbance that will surely rock the world. With patience, conviction and steadiness, all our funds should be able to repeat the feat of our equity hedge program.

Looking forward to a profitable year,

Albert D. Friedberg

FRIEDBERG MERCANTILE GROUP

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FOREIGN BONDS

FRIEDBERG FOREIGN BOND FUND
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FRIEDBERG TOTAL RETURN FIXED INCOME LP

Losses for the year ran anywhere from 1.4% to 3.9% (in USD). Slightly more than half occurred in the fourth quarter. The overall performance is creditable though far from satisfactory - when the fact that 1999 was the worst year in memory for the bond market is taken into account. The benchmark 30-year US treasury returned a negative 14.2% for the year while the JP Morgan Government Bond Global Index produced an equally negative USD return of 5.08%. While these indices do not necessarily represent a proper benchmark for our portfolios, they do reflect the difficult environment in which we have had to operate throughout the entire year.

Our biggest mistake this year was believing that inflation-linked Treasuries (TIPS) would fully protect us from the rising interest rates that we had anticipated earlier this year. Instead of earning 6.0% to 6.5%, we lost 1.8%. The price decline easily overcame the positive coupon-plus-inflation return. Our investment thesis was based on the assumption that the Fed would raise interest rates as inflation accelerated, leaving real rates steady at around the 3.75%. What actually happened was rather unusual and unexpected: real rates rose further, to an historical 4.35 %, causing TIPS prices to fall. As we suggested at the end of last quarter, this rise in the real rate has been linked to perceptions of a secular shift to much higher rates of economic growth and productivity gains than in modern history. Whether these gains are genuine, and not the temporary effect of the stock market boom or the money and credit explosion witnessed over the past five years, remains to be seen. Without denying the extraordinary strides made in personal computing, telecommunications and the Internet and their contribution to growth, we doubt that their long-term impact on rates of growth will be much more pronounced than the advent of electricity, radio, air travel in the early part of the century.

Going forward, we believe that the likelihood of seeing real rates of interest decline over the next few months is excellent. Most economists forecast an economic slowdown (and the Fed, let us not forget, wants a slowdown to ease strained labor resources), which in turn spells lower real rates. In addition, we have observed that, historically, real rates of interest rise during deflationary/disinflationary periods and decline in periods of accelerating inflation, or at least, in periods when disinflation comes to an end. In recent months, inflation has accelerated somewhat, ending a long period of benign price performance. The implication, therefore, is that real rates of interest should decline.

Our expectation that real rates of interest must begin to decline fairly soon is not trivial to the expected performance of your bond portfolios. As an example, a 50-basis-point decline in rates should lift inflation-linked bonds by a substantial 8.92%; if it occurred by the end of next year and inflation remained at 2.6% (its level of the past 12 months), total return would be 15.15%. If real rates were to decline by 100 basis points, our total return would reach 25.19%. And if US real rates were to fall to their long-term historic average of 2.2%, total returns would skyrocket to 52.62%. Not bad for a staid and boring looking obligation of the US government! Moreover, one should remember that, all along, the indexation feature would protect holders from a genuine revival of inflation, making these bonds a much safer bet than the non-indexed, nominal variety.

The risk is that real rates of interest will continue to rise and that, as a consequence, TIPS will continue to fall. Our response would be to increase the allocation of these bonds in the portfolio. At some point real rates will decline, as they have done repeatedly over the past century of recorded quotes, and substantial capital gains will be earned. For patient investors, there is no better, safer investment than real-rate bonds.

At year end, our combined holdings of TIPS and Canadian-dollar-denominated Canadian Government Real Return Bonds ranged from 52% to 61% of the various portfolios. We would not hesitate, given favorable price conditions, to increase this allocation to as much as 75%.

During the quarter we increased our allocation to Turkish Treasury Bills to as much as 25% (a maximum 10% for the Canadian fund, because of regulatory constraints). The severe earthquakes that hit Turkey in recent months forced a faster-than-anticipated devaluation schedule for the Turkish Lira, decreasing significantly our expected returns. Nevertheless, returns remained positive. In recent weeks, Turkey has entered into an important economic agreement with the IMF that will speed the country's liberalization, privatization and deregulation efforts. As part of the package, Turkey has adopted a declining crawling peg devaluation schedule that will have the effect of increasing our dollar returns, in line with earlier expectations. For anyone wishing to understand our interest in Turkey, Dr. Steve Hanke provided an in-depth study in the November 1999 issue of Friedberg's Commodity and Currency. This article is available free of charge.

Finally, we have continued to reduce our overall exposure to the New Zealand dollar sector, which now ranges from 13.5% to 18.2%. At 11.59% and 16.77%, expected yields to maturity on the two holdings remain relatively attractive, despite our more reserved outlook for the country's economy and currency. Over time, and given favorable conditions and suitable alternatives, we will further reduce exposure in this area. We continue to emphasize credit quality (overall credit quality of A, A+), short duration (around three years, assuming a one-quarter beta adjusted modified duration for the TIPS) and a mix of US dollars and Canadian dollars (more of the latter in the Canadian fund, less in the US and Cayman funds). During the quarter we temporarily moved to a 35% foreign currency exposure, principally yen, euro and swiss francs, in the belief that a US dollar reversal was imminent. These positions were subsequently abandoned, with only slight overall losses. Retaining this non-dollar exposure would have meant considerably higher costs at year end. Nevertheless, it is a fact that we remain flexibly committed to moving away from US dollar exposure when and if the time comes.

For the past year, our defensive posture produced a relatively meritorious performance. This same posture, in our opinion, carries the potential for an above-average, positive performance that will greatly reward the loyal, and patient, investor.

DIVERSIFIED TRADING PROGRAM

FRIEDBERG DIVERSIFIED FUND
FRIEDBERG DIVERSIFIED POOL

The good news is that we stood in the way of the stock market herd and survived. The bad news is that we logged another losing quarter, down between 10.4% and 12.9%, to cap a particularly disappointing year. Yet we remain extremely optimistic with regard to achieving a home run in any one of the markets we keep under close scrutiny.

For the quarter, our overall commodities operations produced flat results while losses were sustained in three separate S&P 500 short sales. These accounted for the entire drawdown for the period. Subsequent to our last losing foray on the short side of the stock market index, we reasoned that the Fed would have to be ‘punished’ for allowing monetary conditions to become so loose as to cause the most extended financial bubble in modern history. The bubble itself, contrary to our earlier thesis, was not sufficient reason for the Fed to apply the brakes. For one thing, price inflation remained relatively subdued and the Fed could continue to espouse the belief that we had entered a new paradigm of sustained and accelerating (!) gains in productivity. More important, the Fed had heeded the lessons of history: the previous two major bubbles in this century, the US in 1928-29 and Japan in 1988-89, were burst by anxious central banks. What followed, they observed, was years of slumping economic activity and deflationary conditions. Ergo, central banks ought not to pay too much attention to bubbles, much less burst them. Little thought is given to laying the blame for the resulting depression on the excesses of the previous boom years. Our conclusion was that the Fed would not bring the party to an end until it saw inflation accelerate. Clearly, our betting on a bear market was a bit premature; house prices and commodity prices would have to lift off from their multi-year slumber to trigger an adequate monetary response.

This, then, is the background to our renewed strategy. In terms of a trading plan, this strategy tells us that we need to find liquid and active commodities that will signal the onset of a faster pace of inflation. Once we have identified them (and we believe that gold must be one of them), our strategy is to establish aggressive long positions, always keeping one eye tuned to the yield curve (still positive, for now) and the ‘break-evens’ of the inflation-linked Treasuries for signs that the Fed is still behind the curve. As soon as meaningful signs appear that the Fed is getting serious, we will establish short positions in financial futures.

Our overall outlook has not changed much, if at all, from last year, when we concluded that the major themes for the coming year continue to be the insane valuation of stock markets around the globe, the still-too-low interest rate on long-term Japanese securities, and the approaching bottom in commodity prices. The insane valuations have gotten more insane, Japanese long-term interest rates have become even more of an anomaly in the context of exploding fiscal deficits and debt, and commodity prices have certainly reached bottom.

While we have shed 27% of our equity over the past year, we have managed to stay alive (thanks to effective risk management), refined our strategy and developed a more focused trading plan. We are positively excited.

CURRENCY PROGRAM

FRIEDBERG CURRENCY FUND
FRIEDBERG CURRENCY FUND LTD.
FRIEDBERG FOREX LP

Difficult trading conditions have persisted. Markets have been extremely choppy and volatile for short time periods, as well as totally lacking in direction. Some of this may be due to the fact that intervention, including verbal intervention, has become more frequent. It's an almost daily occurrence in some markets. In addition, stock markets have begun taking an ever more important role in international capital flows, easily overshadowing the classical impact of interest rate differentials. They are transmitting a great deal of their erratic behavior and volatility to the currency markets.

Be that as it may, risks continue to increase for any given level of reward, a phenomenon that we have alluded to in previous communications. The effects on our performance are there for you to see (and feel). We were down between 6% and 8% for the quarter, whittling down our erstwhile handsome gain for the year to between 5.5% and 12.7% (all in USD). Two thirds of our loss was incurred in a spread trade, long Mexico/short Brazil. We first lifted the long Mexican peso, hardly at a felicitous moment we might add, and later covered the Brazilian real. Our only consolation is that the trade looked much worse at year end.

You might reasonably ask why we trade at all, if conditions, by our own admissions, are so difficult. Why not wait for conditions to change? For one thing, we erred in not taking our theses more seriously when challenged by some of our colleagues who resisted the notion that a change had taken place in the market. For another, it is not unnatural to believe that 'this time is different' and that conditions have returned to normal. Only a lengthy period of losses and disappointments, not rational evaluations, can firmly change longstanding beliefs. The past few months have been helpful in this respect.

When will conditions change sufficiently for us to trade with more confidence? Perhaps when the link adjoining stock markets, capital flows, and currencies begins to lose some of its potency and/or when the ugly ducklings, namely Euroland and Japan, begin to adopt more positive pro-secular growth and more balanced fiscal and monetary policies respectively. This change could begin as soon as next month or as late as the end of the year. Or, horror of horrors, never.

There is still an excellent rationale, however, for maintaining a leveraged forex account. Major trend changes are bound to take place in the next time period in the USD-Yen-Euro axis and in the less important but still active currencies such as sterling, the Swiss franc, and the Canadian and Australian dollars. These currencies are severely mis-aligned with their fundamentals. The potential payoff from positioning ourselves correctly while they regain long-term equilibrium is enormous. The challenge will be to avoid the 'noises' and in general the conditions that have caused fundamentalists such as ourselves (as well as trend-following systems) to suffer a maddening erosion of equity.

FRIEDBERG FUTURES FUND

The Futures Fund combines the Currency and Diversified programs in approximately equal weights. Please refer to our earlier comments regarding these programs.

FRIEDBERG GLOBAL OPPORTUNITIES FUND LTD.

FRIEDBERG INTERNATIONAL FUND

The Global Opportunities Fund comprises the Diversified Trading Program and the International Fund. Comments in this section will cover the International Fund only.

For the first time in more than five quarters, the International Fund posted a quarterly gain. It was a mere 2.7%, but a sign nonetheless that our persistence has begun to pay off. Most gratifying of all were the gains made on the short side of the Japanese secondary banks even as the Nikkei 225 rose 7.5% during the same period. We have few doubts that these secondary banks are 'walking dead,' ready to be closed by the regulatory authorities once their true net worth is computed. Deflationary forces continue to erode land values and thus the banks' collateral security. Monetary policy would have to turn massively inflationary before one could speak of a genuine bailout of these banks. In short, while the race against time is on, we believe that these banks will be considered insolvent long before monetary reflation can work its magic on collateral values. As at year end, our short exposure to these banks represented 51% of the total portfolio.

A relatively small investment in the Turkish stock market, via the NYSE-listed Turkish Investment Fund, was a large winner (up 330%) and served to offset losses on our short position in South Korean equities. Unfortunately, we have been unable to short local Korean banks and some overextended chaebols, where we believe downside potential is substantial. Instead, we had to concentrate our selling on three ADRs, one of which, The Korea Fund, was covered before year end. Though economic gains have been spectacular, *financial* improvement in South Korea has been largely cosmetic. Outside of telecom and internet issues, its stock market looks ‘heavy’ and is due for a substantial setback.

A fair-sized four-country arbitrage rounds out the Fund’s largest positions. We are long Dutch and Finnish and short Italian and Spanish banks, as a proxy for economic performance in these countries and our relative outlook for them. So far, the position is approximately flat.

As reflected by the portfolio’s low turnover, we are feeling comfortable with all our positions. Last quarter’s favorable change of momentum is a sign that these positions have not become stale and should be a harbinger, we hope, of much better times ahead.

EQUITY HEDGE PROGRAM

FRIEDBERG EQUITY HEDGE FUND LTD.
FRIEDBERG EQUITY HEDGE FUND

We are pleased to report gains ranging from 29% to 31.5% for the quarter and 15% to 19% for the year. The tactical changes implemented (and explained) at the end of the second quarter of the year have borne fruit and earned us a total return of as much as 44% in the last two quarters.

Though the sizzling performance might make it appear otherwise, at no time did the program depart from its customary and stated market neutral parameters. The long-to-short ratios (on a dollar basis) for end of month were: 54.8/45.2 (September 30); 53.8/46.2 (October 31); 56/44 (November 30); and 57.7/43.3 (end of December). As explained in previous letters, the beta of particular stocks causes the portfolio to move away from an intuitively balanced 50/50 ratio; this phenomenon is well understood by all practitioners of market-neutral strategies. The only difference among managers is the method of measuring beta and the method of dealing with stocks that have a beta greater than one. Our ratios are adjusted on a weekly basis based on a proprietary formula that indicates to us the degree of long or short ‘tilt’ or bias of the overall portfolio. Extremes are corrected immediately by selling/shorting or buying/covering additional stock. Regardless of tilt, the portfolio never exceeds a ratio of 58 to 42 long or short.

Breaking out our results, we found that the short positions contributed a negative 6.7% of the beginning quarter’s equity while the long positions contributed a positive 34.5%. These results are particularly encouraging. Our long selection outperformed the S&P 500 (up 14.5% for the quarter) and our short selection underperformed the benchmark (by rising *less*) - a perfect score.

Our largest losses on the short side were E-Trade Group, Providian Financial, Cap One Financial and American Online; our largest gains on the short side were all bank shares (which represented a steady 20% exposure throughout the quarter) and the ubiquitous Revlon. Down an additional 56.5% from September 30, at $7.93 Revlon is a mere shadow of its old self. On the long side, the top-performing group was our old biotech favorites - up a spectacular 40.8% in the quarter. Moreover, biotech holdings contributed 42.7% of the fund's total gains for the quarter even though they represented slightly less than 20% of the long position at all times. The largest four individual gains were also in biotech stocks: PE Celera (+270%), Vical (+116.7%), Dusa Pharmaceutical (+103.5%) and Cephalon (+92.3%). The Russell 2000 Index (futures) constituted on average more than 60% of the fund's total long position. We spoke of this anticipated buildup in our second-quarter communication to shareholders. The index's performance lead, on a total return basis, the S&P 500 index by a wide margin: + 4.78%. We remain friendly to the Russell 2000 index for the reasons outlined in the second-quarter letter.

Our confidence in the program was built over years of successful experience - and so we communicated it to you. Still, months of disappointing results tested your trust and our confidence to the limit. The results are certainly gratifying. Most of all, we are grateful for having had the opportunity to earn your trust, and for having grasped that opportunity. We look forward to another good year.

NEW ZEALAND

FRIEDBERG NEW ZEALAND FUND LTD.
NEW ZEALAND EQUITIES FUND
FCMI KIWI EQUITIES INVESTORS
TORONTO NZ EQUITY TRUST

One of the biggest disappointments of our professional career.

The 1984 economic revolution, one of the most dramatic transformations in the history of capitalism, had only a very minor impact on capital values. Stock prices rose 173% from 1984 to 1987, crashed and never truly recovered. From the pre-crash highs to the close of 1999, the NZ40 recorded an annualized total return of *minus* 1.5%, compared with the S&P 500's annualized positive total return of 18.69% . What held down share prices? Was the crash of '87 more traumatic than the one suffered abroad, thus chasing away investors for so many years? Why? Did the market smell the non-sustainability of the economic reforms? Did the years of tight and austere Reserve Bank monetary policy stand in the way of the asset and credit boom that swept almost every industrialized nation in the '90s? Unfortunately, we may never know the answer.

In recent weeks Labour has formed a new center-left government with the assistance of two radical left parties. This has been a fitting electoral response, we admit, to nine years of political stagnation, lack of creativity and lack of courage on the part of the ruling right-wing National Party. National's coalition agreement three years ago with a small, vocal and Big Government party was the straw that broke the camel's back - and so we noted it in our monthly economic comments. The new center-left government, more aptly called left-ultra left, will raise marginal taxes, raise spending, cancel the Employment Act and introduce once again dis-incentives to employment, put an end to even small scale privatizations, and pass an unending number of initiatives and regulations that will destroy wealth and incentive. It is doubtful that the present economic landscape will be recognizable three years from now.

Despite exceedingly favorable valuations, the new economic background is hardly conducive to a bull market in shares. In fact, the shift to the left in economic policy will at some point collide with the inflation-targeting policies of the Reserve Bank (as in, for example, a currency crisis induced by a flight to capital) and will exacerbate bearish pressures. As a result, we have raised additional cash. It now represents almost 44% of the portfolio. We have retained long positions in only five stocks. Their common denominator is good to excellent management, a competitive edge, fair liquidity, good growth prospects and reasonable valuations. The following table presents our current holdings:

Friedberg NZ Fund Ltd.

6 Largest Stock Holdings in the Fund

		Price 31-Dec-99	Price /Sales	Price /Earnings Forecast	Price /Cashflow	Price /NTA	Gross Dividend Yield Forecast
BRIERLEYINVESTMENTS	BRY.NZ	0.40	0.56	3.37	6.23	0.43	7.50%
CARTERHOLT	CAH.NZ	2.50	1.56	27.17	14.19	0.97	2.40%
FISHER & PAYKEL	FAP.NZ	7.30	1.11	17.06	9.89	2.16	4.91%
HALLENSTEINGLASSON	HLG.NZ	2.40	0.89	13.01	10.48	4.23	10.57%
KIWIINCOMEPROPERTY	KIP.NZ	0.94	N.A.*	9.80	11.61	0.83	11.69%
ST LUKES	STL.NZ	1.60	N.A.*	11.19	15.90	1.10	7.19%

***N.A. (Not applicable for property trust)**

Weighted gross dividend yield 7.78%

While we believe that we can squeeze additional upside from this select group of stocks, we are intent on reducing or even eliminating positions at any sign of operational weakness and/or share price underperformance. In short, we are keeping them on the proverbial short leash.

FRIEDBERG SKILL/BASED MANAGERS FUND

The Skill-Based Managers Fund earned returns of -2.12% in October, +1.13% in November, and +2.35% in December 1999. The Fund started August 1 with the following objectives: to earning annual returns between 12% and 15%; and to have those returns show insignificant correlation with the stock market; and to be no more volatile than the stock market.

Although we fell short of our return objective, we nonetheless ended the year in the black. Furthermore, we managed to do so while actually showing negative correlation to the S&P, and volatility that was much lower than the S&P. Not bad for a start.

Our current portfolio includes convertible arbitrage, risk arbitrage, long/short value investing, market-neutral strategies, and our own futures fund - itself a composite of FMG's currency and diversified programs. All seem well-positioned to avail themselves of opportunities in the present benign environment. At the same time, their strategies appear able to stand steady or even profit should the environment turn malign.

In all alternative strategies - save, perhaps, forex - liquidity is always a critical issue. Ever mindful of this, we are considering an allocation to a particular interest rate arbitrage specialist. Timing depends more than anything else upon the flow of assets into the fund which, at this point, is relatively small.

FRIEDBERG ALLOCATION FUND LTD.

Allocation as at December 31,1999

Cash	5.18%
Fixed Income	57.17%
Currency	7.91%
Equity Hedge	12.85%
NZ	8.84%
Global Opp	8.05%

Neal Rackoff comments:

The Friedberg Allocation Fund returned -.16% for the fourth quarter and a -5.22% for the year.

When the Friedberg Allocation Fund was first created its mandate was to approximate the manager's allocation of capital across the various assets and strategies in which he participates. Its objective was to provide and demonstrate that a balanced purchase of the manager will, in fact, provide steadier returns, softening the down years and enhancing the up years on a risk reward basis.

In the last year and a half, we have accomplished those goals. Furthermore, the fund allows investors to track where the manager is committing his money and what he is most excited about. This information is critical when evaluating any trader because the point of investing with a trader is his ability to be ahead of the curve; to see over the horizon today, not as a celebration of his past accomplishments. As such, it behooves investors to 'follow the money' and to play the game the way the manager sees it now. Advice that continues to be true.

Although we will no longer make available as of December 31, 1999 a separate vehicle that will track this allocation, we will continue to provide these insights for you in the future on a quarterly basis.

Recommended allocation going forward:

Fixed Income - 65%
Equity Hedge - 15%
Currency - 10%
Global Opp - 10%

Benjamin Disraeli: "The secret of success is constancy of purpose."

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