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Commodity Comments

October 22, 1974

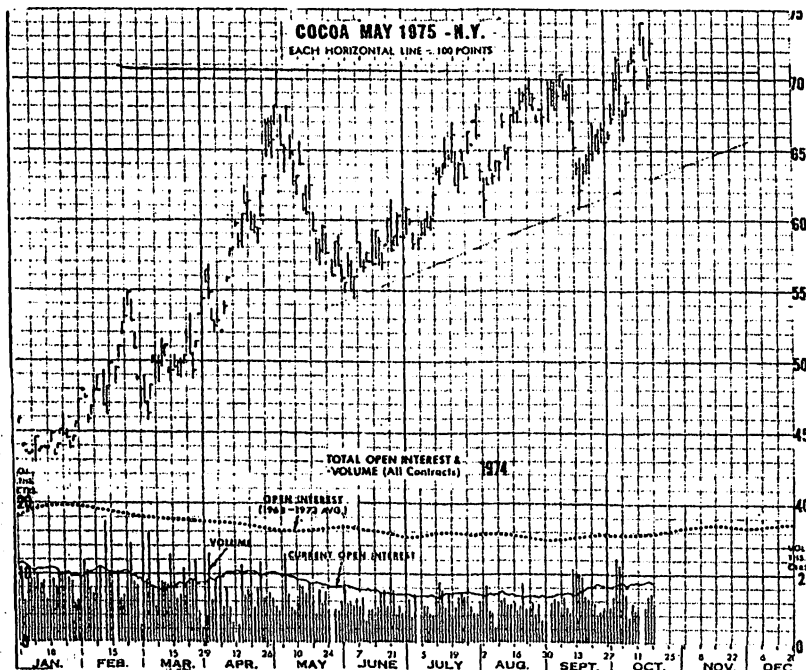
On Triangles, Head & Shoulders & just plain cheap . . .

For the past few years we have been injecting comments of a fundamental nature into our basically technical approach to markets. We have done so simply to assure non-believers of the 'soundness' of our recommendations. At times, one's own conscience is also put at ease; for the most part, however, fundamental information is usually too late to be of any real use. Trend analysis, within the framework of mass behavioral psychology, is never late. It can however, suffer from (a) faulty interpretation and/or (b) lack of discipline, especially if contrary to prevalent conventional wisdom.

Trend analysis is not the study of lines, points or figures as they pertain to past patterns and their probable repetition. It is rather a study of when and where buying or selling pressure is likely to occur, of when and where a market equilibrium is likely to be upset. It assumes that a trend set in motion does not reverse easily and when it does it is because all the eager buyers or sellers have been satisfied. In turn, eagerness is as much a function of necessity as it is a function of human nature such as greed or fear.

Technical formations, because of their patterns, tell us something about the present supply and demand equation. A triangle (with a flat or declining top and a rising bottom) occurring during an advance is a pause in the uptrend. This pause however, is notable by the fact that sellers are unable to turn down buyers; in fact reaction lows are nearly always made at progressively higher levels indicating that buyers are advancing their price ideas. Always keep in mind the axiom that a trend set in motion requires an overpowering reason to reverse.

Below you will find a chart of May '75 Cocoa-note the 'flat' top at 70-71¢/lb in existence for 6½ months, the 3 consecutively higher lows at 55, 60½ and 61¢/lb. The long bull market, started in late 1971, was still in force and a concerted effort by sellers to hold prices down below 70-71¢/lb did not deter buyers who kept advancing their bids to finally nibble away and overcome the last source of supply.



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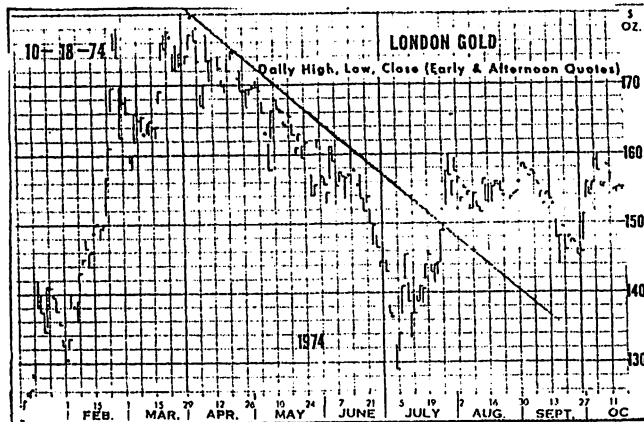
The massive overhead supply was finally absorbed in mid-October and now cocoa prices have embarked on one more upside leg (the final one?) that should carry it at least 30¢ and probably 50¢ higher. The extent of the upmove is roughly proportional to the duration of the accumulation period.

Built into the present price structure is the fact that demand, as evidenced by grindings, is down between 9 and 12% from last year. Since prices maintained a basically lateral movement, selling pressure could not have been all that strong. We then conclude that either (a) resistance at 70-71¢ was more illusory than real (i.e. manipulated) or (b) supply is also roughly 9-12% lower. The upside penetration then would signal that accumulation has been completed and/or that supplies may be even more than 9-12% lower. Since manufacturers' demand can be based on discounted prices (March through September '75 are substantially lower than cash), grindings are expected to hold in at least the same range as last year.

Our first target of 90¢ basis December was accomplished today but the market looks healthy enough for an attack on the \$1.10 area basis spot.

Add to additional long positions and raise stops to 81¢ (basis December '74).

Below we reproduce a gold chart. Some of the most notable features are: (a) the April-July downtrend was decisively broken in early August, (b) a nearly perfect resistance area has developed around the \$160 mark and (c) a reverse head and shoulder pattern seems to have evolved.



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In spite of a concerted selling effort at the \$160/oz level and warnings that the price may settle at the much lower \$115-130/oz area (see Citibank's latest publication), prices don't fall away as they should if we were merely in a bear market rally. The overall bull trend remains intact and the persistent nibbling away at the resistance area will eventually eat through the supply.

Given that reverse head and shoulder formations have a tendency to be symmetrical, one could venture a guess that prices will break on the upside within 10 days. A period longer than 10 days would cause us to temper our bullish stance.

A strong fundamental consideration for a bullish posture is the large decline in short term Eurodollar rates (see last month's Comments) now hovering between 9 1/8 and 10 3/4 %. At these subnormal rates of return, considering present inflation, speculative money can be counted upon to move into gold. Furthermore, the U.S. dollar has begun to weaken considerably and that, too, is bullish for gold.

Plywood and lumber do not require chart reading - they are just plainly too cheap. With mills in the U.S. and Canada cutting back as much as 20% of their production, it is only a matter of time before a genuine shortage takes place. Housing-starts watchers would be better off looking at production costs than at new construction figures.

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Liquidate all long positions. Courageous traders may probe the short side with mental stops at around 44¢ basis March '75.

Wheat December 5.28

In much the same way as Corn, Wheat prices are poised for a spectacular upside run. The major 4 months' base confined in the \$4.20-4.80 area can support a move well past the old high of \$6.40/bushel.

Buy at market.

Zinc 3 months £ 343.0 - 345.0
Tin 3 months £ 2980 - 2990

The covering of the zinc short position proved a bit premature but rewarding nonetheless.

The suggestion to go long tin @ £3400 to capture the £600 backwardation caught us on the wrong side of the market as Cash tin fell nearly £1000 in 4 weeks' time. Take the £400 loss on the 3 months' position and move to the sidelines.

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All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.

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