

## Commodity Comments



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### Commodity Comments

November 26, 1974

#### Foreign Currency Futures: for hedgers and speculators

In the past four weeks gold soared over \$25/oz while the U.S. dollar declined as much as 7½% vis a vis the Swiss Franc and the Deutsche Mark. These two events were correctly forecast in our Commodity Comments of October 22. A brief follow-up to this situation is now in order.

The Federal Reserve Board is now pursuing an increasingly accomodating credit policy in response to the worsening economic slump. Cuts in reserve requirements on long term deposits have released approximately \$760 million in reserves while it has further tried to encourage a lengthening of maturities of the banking system's deposit liabilities. The Fed's target range for Federal Funds trading has apparently dropped another notch last week to 9%-9½%. For the time being however this could represent the 'low' in short term rates. Proof to this contention lies in the fact that CD's for the 12 reporting N. Y. banks dropped \$441 million last week forcing them to boost rates once again over the 9 1/8% area. Also, our Eurodollar interest rates graphs point to a termination of the early September-late October decline at about 9 3/4-10% and a possible rally to the 11 3/4-12% area. Bear in mind that this is taking place despite layoffs in the automotive industry and an already protracted coal industry strike. In other words, the stubborn inflation at hand provides a minimum floor to prime interest rates-somewhere between 9%-10%. There is little question that a move to lower interest rates will have to wait for substantially lower rates of inflation.

The Fed's aggressive move to ease is now running against one more obstacle and a major one at that: namely, a reverse floor of short term funds out of the U.S. dollar. On examining rates paid on Eurocurrency deposits in London, one finds that Swiss Francs command a 7 3/4% and 8 1/4% rate for 3 and 6 months respectively against 9 7/8% for U.S. dollars. Similarly, for Deutsche Marks, the rate hovers about 8%-8 5/8%. In effect, the differential has narrowed now to approximately 1 3/4% and 1 1/4%. We contend (and did so more than one month ago) that these differentials are not large enough to induce Swiss Franc and Deutsche Marks holders to switch to U.S. dollars (or conversely, it induces a movement out of the U.S. and into these two currencies). The reason is simply the fact that both Switzerland and Germany are running inflation rates as much as 10 percentage points lower than the U.S.

Basically, short term capital movements and not trade considerations play the most important role in determining exchange rate movements. Over the past few years we've hammered this point countless times. In essence, a currency preference phenomenon is taking place, one that requires a large (2-2 1/2 percentage points) or very large (3-4% percentage points) interest rate differential in favor of a 'soft' currency such as the U.S. dollar.

Repeated intervention in the foreign exchange markets by the Fed. and the Bundesbank to halt the steady erosion of the U.S. dollar and artificial constraints on Swiss based deposits on the part of the Swiss National Bank have done little more than slowing down the inevitable consequences of easy money. The trend for lower U.S. dollars vis a vis the strong currencies will continue unabated, regardless of official intervention, until the basic issue of interest rate differential is resolved. Since we can foresee little easing in Germany and Swiss interest rates (due to their earnest attempt at bringing inflation under control), the Fed must see to a resumption of higher interest rates in the U.S. This course of action is politically unacceptable in an economic climate such as today's.

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We conclude therefore that long positions in Swiss Franc and Deutsche Mark should be maintained and even increased on favorable opportunities. Similarly a bull run in Dutch Guilders and Japanese Yen may be expected, if only sympathetically. Following is a list of facts on Currency Futures traded in the International Monetary Market in Chicago with some pertinent data on open interest and liquidity.

<u>Contract</u>	<u>Latest Quote March</u>	<u>\$/Point</u>	<u>Limit Margin/ Points</u>	<u>Limit Move In \$</u>	<u>Open Interest as of Nov. 22</u>	<u>Liquidity</u>	<u>Margin Requirements</u>	<u>Round Turn Commission</u>
25,000 British Pounds	22750	\$2.50	500	\$1250	700	Fair	3,000	50.00
100,000 Canadian dollar	101290	\$1.00	750	\$ 750	378	Poor	3,000	50.00
125,000 Dutch Guilder	39420	\$1.25	600	\$750	182	Poor	3,000	50.00
250,000 Deutsche Mark	40685	\$2.50	500	\$1250	3383	Excellent	5,000	60.00
12,500,000 Japanese Yen	33300	\$1.25	600	\$ 750	170	Poor	3,000	50.00
1,000,000 Mexican Pesos	7935	\$10.00	75	\$ 750	11305	Excellent	3,000	60.00
250,000 Swiss Franc	37280	\$2.50	500	\$1250	1631	Excellent	5,000	60.00

- (1) All currencies are traded against U.S. dollars.
- (2) Limit moves are flexible, after 3 consecutive limit moves, limit goes up 150%, then 200%, finally it is limitless.
- (3) 9:45-2:20 p.m. Toronto Time.
- (4) Major delivery months are March, June, September, December.

Continue to hold long positions in Deutsche Mark and Swiss Franc but be in constant contact for possible reversal.

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<u>Cocoa</u>	December '74	77.85
	March '75	71.00

A promising break out of a massive two months triangle, stalled too long giving the bears a golden chance to break this market. Manufacturers, well short of physical inventory, were able to talk this market down by first issuing spot arrival warnings in London and then, a leading bearish article in the Wall Street Journal. Strangely enough, the steep December-March-May backwardation, both in London and New York never collapsed indicating that a speculative drop was occurring in the face of a continuing shortage. A recession-depression mentality engulfed this market and expectations of a sharp drop in consumption pushed the forward deliveries as well as the nearby down a gigantic 1500 points.

Is consumption really dropping off? Figures released in Washington today show that imports of Cocoa beans for October were 13,100,000 lbs well ahead of September's 10,600,000 lbs and October '73's 6,200,000 lbs. Similarly, Cocoa butter imports of 5,700,000 lbs were substantially ahead of September's 2,180,000 lbs and last year's strike-depressed 990,000 lbs. These figures should lay to rest the depression mentality.

There is little doubt that high (incredibly high) sugar prices are and will affect Cocoa products—perhaps this was the major bear argument. A substantial drop in Sugar prices, such as we are about to witness, should improve somewhat the situation, if permanent damage has not already been done.

Technically, prices broke through major uptrend lines both in New York and London, while Spot Cocoa prices in New York find themselves well under major support levels of \$1/lb established during June, July and September of this year. A minor uptrend basis March and May '75 checked the decline yesterday indicating that at worst a small rally could develop and, at best, the beginning of some form of consolidation will occur at these levels.

Our long positions have now been closed, either @81¢ basis December (as suggested in last month's Comments) or when March '75 broke through the major uptrend @71.30.

We do not like selling this market short due to the deep forward discounts now prevailing. We would, however, re-establish long positions should March '75 move over 7600 on close. Alternatively, a relatively extended consolidation at these levels accompanied by a constructive open interest development could signal a good-sized rally ahead. Please stay in close contact.

<u>Coffee</u>	March '75	60.37
	Robustas (London) Jan. '75	8473

Long positions taken in the low 50's should now be sold, both in New York and London as market will most likely ease off into a 52-60¢ trading range.

Sell long position and move to the sidelines.

<u>Corn</u>	December '74 Corn	355 3/4
	March '75 Corn	367 1/4

An inordinate build-up in the open interest figures alerted us to a possible change in trend and sell recommendations were issued to our clients in the 3.77-3.79 area.

The large build up continues in the face of extremely bullish news and we prefer to leave this market aside for the moment.

Re-enter market on the long side only if March closes above \$3.92/bu.

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<u>Copper</u>	December '74	57.00
	December '75	65.00

Long term value conscious investors will be well rewarded by accumulating new December '75 positions @ 65.00

Maintain present long positions and add to them on setbacks.

<u>Livestock Complex</u>	April '75 Cattle	41.60
	April '75 Hogs	43.15
	April '75 Pork Bellies	65.60

A great deal has happened since our last comments in which we suggested to remain long these positions.

While the tide may have turned we still prefer the long side. However, stop loss orders should be entered @38.75, 38.25 and 60.00 respectively, on close only.

<u>Precious Metals</u>	Gold January '75	190.50
	Silver March '75	467.60
	Platinum April '75	184.50

Having broken out on the upside from the 160.00/oz area exactly on target (as forecast by our last comments), gold prices hit some resistance at \$190.50 basis the London Fix and eased off to the \$180.00. The setback has been substantially completed and with a weakening U.S. dollar, we now expect an assault on the major \$200/oz. A move through the \$200/oz mark should trigger enough buying interest to achieve a target of \$220-230/oz. Place protective stops @175 basis London's second fixing.

Silver prices churned heavily in the \$480-520 area and finally gave way going through our long term stop loss of \$4.50/oz. Attentive traders would have stepped out @4.75 seeing the massive increase in the open commitment. Having gone down to an important support area @\$4.20/oz, prices rebounded and are now in gear with rising gold prices. This kind of sympathetic behavior, while bullish in the short run, may be masking a substantial process of distribution that could surface on any gold weakness.

P. S. Silver bulls are better off being long gold.

Platinum prices eased off and found good dealer support in the now familiar \$165/\$170/oz. basis Spot and are headed for a \$20-\$30 rise. Continue to trade (trade only) from the long side.

<u>Sugar #11</u>	March '75	57.20
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After a frenzied run to 65.60, Sugar prices collapsed and are now trading around \$140/ton below recent high in the unrestricted December position in London. The market has been heavily offered down the limit, with 1,000-2,000 contracts unfilled and less than 1,000 contracts traded. In view of the huge open interest (almost 24,000 contracts) and the small volume absorbed on the way down, we suspect that the decline has still a long way to go.

The death knell to the great Sugar Bull Market has been given and any intervening piece of bullish news will only slow down the inevitable decline. Our premature short positions @40-41¢/lb were stopped out as advised at 44¢/lb. Only very well heeled dealers and speculators should take short positions now as the market is 'super volatile'. A more conservative approach would involve the sale of May '75 positions vs the purchase of March '76 @ anywhere between 1600 and 1800 points premium nearby. Any short positions should naturally be stopped out at season's highs.

<u>Wheat</u>	December '74	4.93
	March '75	5.12 ½

The same comment applies to Wheat as in Corn (see Corn). The open interest in Wheat, however, is more constructive and a resumption of the uptrend is now an even proposition.

Buy March '75 Wheat on a move above 5.50/bu. on close only; otherwise remain on the sidelines.

Wood Complex

March '75 Lumber	123.50
March '75 Plywood	112.10

The long bull market has begun; it will now require a great deal of patience.  
Long positions should be maintained and additions made on any good setbacks.

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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.