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Commodity Comments

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Federal Reserve: NSF

The recent NSF policy of the Federal Reserve Board threatens to bring to a screeching halt the 1975 commodity mini-boom. Chairman Burns seems quite content with the latest money supply targets given to Congressionel members. The unusual 14% jump in M_1, for May and June is attributed to the Federal Government tax rebates but is, nonetheless, incorporated into the 2nd quarter's average money stock and provides the base for the 5-7½% growth rate target established for the second quarter of 1975 through the second quarter of 1976. Chairman Burns is trying to allow for greater monetary expansion but is boxed in by his previous protestations of moderation and Congressional 'expertise' in basic monetary economics. Chairman Burns knows that inflation cannot run below 8% for 1975 (as we predicted 2 months ago) and that velocity is still not moving up. In fact, demand deposit velocity at large commercial banks and other centers (excluding New York) is still falling. Chairman Burns must know that real M_1 is now negative.

Other monetary aggregates are just as foreboding. The adjusted credit proxy for the last 12 months has grown only 3.6%; since mid-June it has actually declined at an annual rate of 1.1%! Bank credit (total loans and investments) is now running at a paltry 3.6% annual rate since January 1975. All these rates are negative when adjusted for inflation. The present 'rebound' in economic activity requires little financing as economic units, on the average, are still well stocked (and in fact, still liquidating inventories) while consumer spending is far more respondent to movements in disposable income than to aggregate credit policies. The crunch will undoubtedly arrive when private and public credit demands begin to mount-no later than the fourth quarter of the year. Our feeling is that Federal Reserve even keeling in front of heavy Treasury offerings in the next few months and possibly a bail-out of New York city will force monetary aggregates to grow at a much more rapid clip. Chairman Burns will bow to the inevitable either voluntarily or involuntarily and the avowed targets will be abandoned. Should the NSF policy of the Fed continue, however, commodity prices will begin crumbling down no later than October. At that time such staples as Grains and Sugar will find bumper harvests.

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A little anecdote illustrates very well the recent rising trend in commodity prices:

> *Dr. Gareth Nelson, associate curator in the Department of Ichthyology at the American Museum of Natural History in New York City, as quoted in a UPI story, explaining that the most common species of sharks don't really deserve the bad reputation of the great white shark depicted in "Jaws":*

They're not interested in eating people. Sharks don't make a living eating people. They're looking to eat what they always eat.

Sharks tend to investigate people and one way they do is to bite. But generally they take a bite or two bites and then they go away.

Just one or two shakeouts can be as deadly as a bear market...

Technical Trends

Cocoa	*September '75*	*56.05*
	December '75	*50.85*

The constructive effect of improving grinding figures reported last month and nearby paucity of supplies helped this market gain an additional 600 points before running out of steam. Heavy chart selling in the vicinity of 63-64.00 basis September '75 repelled the exploding bull market and triggered heavy long liquidation. The open commitment, seasonally low already, dropped an additional one thousand contracts in 4 of the liveliest trading days on the New York Cocoa Exchange.

Trade sentiment continues to lean on the bearish side as it points to a robust Bahia crop and an as yet healthy West African outturn. Total Bahia arrivals to date are still quite high but they seem to be gradually reducing and a further drop is generally *being expected towards the end of the Temporao. The trade expectations of 2.4 million bags will most probably be attained.*

Most of our earlier price expectations have been reached with July expiring in the vicinity of 67.00 and September reaching slightly over 64.00/lb. The market is now acting defensively although it cannot afford to drop substantially from the below-50 area in the deferreds. Crop scares in the August-September period will tend to firm up this market and a good upside reaction from the presently oversold condition is expected.

Remain long December '75 Cocoa risking 49.25 on close; lighten up positions as December approaches 55.00-57.00.

Coffee		*September '75*	*82.10*
		March '76	*83.70*
London (Robustas)		*September '75*	*771.00*
		March '76	*790.50*

The USDA has confirmed the extensive damage to the Brazilian crop and now it remains to be seen whether manufacturers, when replenishing their inventories, will await a dip in the market or will proceed to buy at these levels.

We've disposed of half our long positions and prefer to raise protective stops on the balance to £750 basis November Robustas. Long September-short December '75 spreads put on at 100 points December '75 premium were unwound at premiums ranging from 150 to 300 points premium the nearby in early August. The gains, although not as spectacular as our net long positions, were substantial in view of the lower margin requirements.

Copper	*December '75*	*63.30*
	3 mos London Wirebars	*650.00*

Showing increasing resistance to weakness in the precious metals area, copper prices consolidated in the 58.50-61.00 area basis December '75 and proceeded to break out into new recovery highs. Its last major resistance lies in the 63¢ basis Spot, the producer price, and we suspect that this attempt will easily penetrate the overhead obstacle. The market has been making good upside progress despite repeated bearish talk and heavy open interest figures. The burden of proof lies now with the staggering 28,000 plus short position built up in Comex.

In the background, world refined copper stocks rose in Jun 21,200 short tons, less than half the May increase of 51,000 tons, giving a good indication that production cutbacks have finally equalized outturn with demand. We fully expect that July and August figures will show the first absolute drop in stocks in over one year. Highly significant was the fact that refined copper stocks of U.S. fabricators (as reported by the ABMS) fell 4,000 short tons in June to 448,100 short tons and to some 13,000 tons below the June 1974 stock figure of 461,300 tons, the first such year to year drop. These figures lend credence to our contention that most of the so-called copper overhang is not where it is needed, i.e. end users, but rather in the strong hand of producers and investors. The last two groups will not sell large quantities of the metal unless it reaches much higher levels.

Sometime in the next 60 days the world will wake up to a 'copper shortage' much like the one that saw it take off to $1.40/lb back in 1973-74.

Add to previously established long position, our first objective remains 85¢/lb for December '75.

Cotton	*Phase II*	*October 1975*	*52.81*
		December 1975	*53.19*

Cotton prices broke out rather decisively out of its 47.50-49.50 area basis October 1975 where a good deal of base building took place. The breakout was attributed to the August 11 USDA first 1975-1976 crop estimate which showed that U.S. cotton production this year will fall to 9.4 million net weight bales of 480 lbs, down 18% from the 11.5 million bales last year. This crop estimate was also 400,000 to 800,000 bales lower than previous trade expectations and, as such, were considered highly bullish. Since that first estimate, worm damage in the Mississipi area will have lowered the crop estimates even further leaving us perhaps with the possibility of seeing a 1976 carryover stock level of 2.5-3.0 million bales-a post war low.

The market has begun to accelerate on the upside and we feel that the second phase of this explosive bull market is about to take place. Last month we had raised our target to 60¢/lb. for late Summer 1975 and an average price of 75¢/lb for year end. We are now raising our sights once more, this time by 500 points. If the second USDA crop report however, to be issued the second week of September, is lower than 9,000,000 bales this market may attain the $1/lb mark by year end.

Currencies	September '75 Deutsche Mark	3865
	September '75 Swiss Frank	3720
	September '75 British Pound	21965

The Eurodeposit differentials widened again this past month as the Bundesbank tried to relieve the heavy money market pressures occuring in West Germany. Large federal and municipal governments' borrowing needs coupled with foreign borrowings in the local market (now halted by decree) tended to raise interest rates above levels compatible with current reflationary efforts. With the West German economy still limping along the bottom we do not envision yet a narrowing of Eurodollar-Euro Deutsche Mark deposit rates for yet another 4-8 weeks. At that point, the present 'bottoming out' process of the Deutsche Mark (as well as the Swiss Franc) will gain strength and a new upward leg will have started. Keep in close contact.

British unemployement continued to rise providing a more credible base on which wage controls will operate. The British economy is now on a counter cyclical phase with the rest of the OECD countries, and stands a better than even chance of maintaining a sterling rate of 2.10-2.20 for the next few months. Avoid long commitments in sterling, however, as it is still a long term bear market.

Grain	September '75 Corn	319 3/4
	September '75 Soymeal	149.2

We advised selling previously established long position in grains rather prematurely, missing out a good portion of the recent advance. In spite of heavy Russian buying, we can't help but think that the U.S. Wheat, Corn, and Soybean crops will be substantial enough to accomodate present needs even at slightly lower levels. Technically, the powerful wheat action may indicate an ultimate level of 5.00-5.25 basis March '76 Wheat, 3.50-3.75 March '76 Corn and 6.75-7.25 March '76 Soybean.

We prefer, however, to remain on the sidelines, until a better risk/reward ratio reappears.

Livestock	August '75 Broilers	51.50
	November '75 Broilers	41.72
	October '75 Cattle	45.42
	October '75 Hogs	55.07

The bull market continues fuelled by extremely low hog receipts and light weight cattle slaughter.

Our long positions in October '75 Cattle suggested last month at around 41.85 was stopped out 300 points lower; the long position in hogs, however, still remains open showing us now a 600 point profit.

Remain long and raise stops to 53.00 basis October '75.

In view of high and still rising Soymeal prices, November '75 broilers remain an undervalued meat play. It should be noted that it is selling as much as 1200 points below August '75

Buy at market with stops at 39.00.

Orange Juice	September '75	60.00
	January '76	64.00

Chart actions almost 'convinces' us that a devastating frost will occur this year in Florida, sometime between November '75 and January '76.

The breakout of the 7-year long triangle has been accomplished without much fanfare and headlines. We now raise our sights to prices well over $1.00/lb for January '76 Orange Juice. Ramain long and raise protective stops to 59.50 basis January '76.

Precious Metals	September '75 Silver	488.30
	October '75 Platinum	176.00
	October '75 Gold	163.00

As suggested last month, part of the long silver position was sold between 4.90-5.20 basis September '75 with a view towards reinstating longs at lower levels. The 4.75-4,80 level is providing good support giving us an opportunity to cautiously re-enter the market here with protective stops at 4.75 on close only. This stop should be watched closely as open interest figures are revealing a certain amount of distribution in the 500-530 area.

We are long October '75 Platinum at 165.50 as per last month's suggestion but we prefer to raise the stop to 167.00 for a no-loss trade. Gold prices continue to trade in the no-man's zone of 160-165 basis Spot. Relative to other commodity prices, gold remains overvalued. It will require a much greater inflationary binge to embark this market on a bull trend capable of piercing through the $200 level. Technically, a sharp upside move in Silver may trigger a quick $10-15/oz. rise but, nevertheless, we would be disinclined to follow the advance. Remain sidelined.

<u>Rubber</u>	October/December '75	37.20
	January/March '76	38.30

Partial profits in the long January/March '76 positions at around the 38-38.50 mark were advised last month. The market is correcting laterally its large May-July advance and should signal a resumption of the move if January/March '76 can move above 40.00 points.

Remain long placing stops in the balance of position at 37.00 basis January/March '76.

<u>Wood Complex</u> November '75 Plywood 128.50

A move below the strategic February-May-June uptrend in Plywood, triggered a renewed wave of liquidation that eventually took prices to 118.50 basis September '75. The sell off was accompanied once again by a dropping open interest, falling to slightly under 5700 contracts, a full 4400 contracts below the 1975 high. Our bullishness persevered and found consolation in the two-week base established between 118.50 and 125.00, despite the ongoing erosion of values in the lumber pit.

Less than one week ago, a shockingly bullish housing starts report, showing a 14% rise in starts and a 6% jump in permits for July 1975, lifted the market out of its trading range moving it even closer to the April-June-July downtrend. The upside penetration (Circa 132 basis September '75), it accomplished will have left behind a huge bear trap of more than 6 weeks duration.

The composition of last month's housing starts was quite encouraging as it showed a remarkable 51% jump in multifamily starts, to 300,000 units. Peak levels for these accomodations in the early 70's were 1.1 million units. It is this sector that showed the largest drop as a result of a) overbuilding on the part of REITS during the 1971-73 heydays and b) present reluctance on the part of apartment developers to launch new projects since rentals are too low to provide adequate profitability. We are becoming even more confident in seeing 2 MM plus housing starts for the U.S. around the second quarter of 1976. This tempo should practically guarantee a $180-$230 per 1000 board feet price for plywood.

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