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Commodity Comments

November-December Issue

December 16, 1975

COMMODITY OUTLOOK - 1976

Pricewise, 1975 will go down in History as a rather uneventful year. The various commodity indices registered their year lows in the March period, a time when the Western World was quite openly predicting a Great Depression. Based on the behavior of some key industrial commodities, we issued a Commodity Comments entitled "No Depression: a commodity trader's prognosis" on March 10th, followed, on April 8th, by a suggestion that a 'major bull market is in the making (if only for certain commodities) and, therefore, a significant buying opportunity is at hand.' On May 22nd we concluded that 'April 1975 marked the end of the worst post-war recession in the U.S.'

Commodity prices began the one and only upswing of 1975 towards the end of June and rose through the beginning of September by nearly 20% as measured by the Commodity Research Bureau Futures Price Index.

On our August 25th Commodity Comments, in an issue entitled 'Federal Reserve: NSF' we warned that restrictive monetary policy in the U.S. would 'bring to a screeching halt the 1975 commodity mini-boom.' Not only did the Fed not let up but, a pronounced drop in the Base/M₁ multiplier caused M₁ to drop at an annual rate of 1.4% in the August 27-October 29 period, thus assuring us of a new leg in the overall Bear Market and an abortion of the ongoing economic recovery. The CRB index, at this writing, has dropped back to the 190 level, 15% below the year's high and only 9% above the year's low.

In sum, 1975 saw a confirmation of the lateral-downside consolidation in the aggregate indices, which dates back to mid-1973. This mini-deflation in primary goods is expected to continue, with relatively minor exceptions, until the 3rd quarter of 1976. On the CRB Index we project a range of 160 to 210 for the coming year, with the low point reached somewhere between the first and second quarter of 1976. This forecast is based on the assumption that world money supply will begin to reaccelerate during the first quarter of 1976 as central banks move to shore up their sluggish-faltering economies. (see World Money Supply chart in back of issue).

Those attempting to make money in the futures markets will be well advised to ignore long range, macro-economic forecasting and concentrate on the short run (up to 6 months) technical and fundamental picture of each particular commodity.

In order to facilitate portfolio selection, we have adopted the following rating system:

- 6 (*****) very Bullish
- 5 (*****) Bullish
- 4 (****) Neutral-Bullish
- 3 (***) Neutral-Bearish
- 2 (**) Bearish
- 1 (*) Very Bearish

These designations will be found alongside the specific commodity headings.

<u>Cocoa</u> *****	March '76	62.75
	December '76	54.90
	London March '77	641.00

Recent strength has been associated with lower than expected Ghana purchase figures and predictions by an Abidjan dealer that Ivory Coast's outturn will run as much as 50,000 tons below expectations. A very tight nearby position in December London is accentuated by a complete lack of deliveries to date in New York against the December '75 contract, (P.S. December '75 Cocoa expired today at 66.65, exactly on target as per our September 23 issue).

From a statistical point of view, Cocoa offers one of the best bull market bets for 1976: a possible production deficit of as much as 15,000 tons (depending on the accuracy of recent estimates for Ghana and Ivory Coast, and taking into account a strong rise in consumption in the U.S. in recent months) superimposed on worldwide stocks equalling approximately 3.8 months usage. There has been no consumer resistance to present

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prices and we expect very little, if any, so long as Sugar remains below 20¢/lb. and Cocoa remains below 90¢/lb.

The present structure of the market implies a tight supply situation and also provides the investor with an unusually favorable buying opportunity: barring unforeseen events, deferred prices will 'come up' to cash levels, now in the 60-66¢ range. The completion of the Main African harvest at end of January should help lift cash values well into the 80-90¢/lb. mark.

Technically, the recent slow advance has reawakened surprisingly little speculative enthusiasm. Quite the contrary, commission houses have been mostly on the sell side. The present level of open interest is not excessive and has, as yet, not made this market vulnerable to more than normal corrective behavior, i.e. 3-5 cents/lb.

For those interested in obtaining a 'short' play on the British Pound, December '76 and March '77 London Cocoa offer a promising vehicle.

Buy May '76 and forward contracts for a substantial upmove. Stops should be placed at 56.00 basis nearby, on close only.

<u>Copper</u>	****	March '76	53.60
	*****	December '76	57.80

Despite stronger than expected auto sales, the copper market is still laboring under heavy supplies. World copper stocks have risen for 17 consecutive months, reaching on October 31 an estimated 1,161,300 tons for the non-communist world, more than double last year's 529,000 tons notwithstanding CIPEC cutbacks. Adjusting for non Communist countries not included in the ABIS statistics, total refined copper stocks were close to 1,500,000 tons, an all-time record high. A grand total of approximately 576,000 tons lie in the visible LME and Comex warehouses.

These burdensome supply statistics should not overwhelm copper investors. In the past 50 years, all bull markets began with a high level of copper stocks. More to the point, they all began with a high level of producer stocks and a low level of end-user (fabricator) stocks. If the recent trend is any indication, fabricator stocks in the U.S. are down to approximately 410,000 tons compared with last year's 473,000 tons, a mere 2 1/3 months' shipments. By any historical yardstick, these are low levels indeed. Assuming that fabricator stocks cannot be reduced much more, a pick up in the re-stocking process will begin as soon as final consumption begins to rise. Our economic scenario calls for a further slowdown economy (witness the recent jump in durable goods inventory/sales ratio) with a flattening trend in industrial production until about March or April '76. We therefore expect copper prices to begin a long upward rise sometime at the end of the first quarter of 1976.

Investors should disregard short term price weakness and concentrate in accumulating deferred 1976 positions.

<u>Cotton</u>	***	March '76	59.70
	*****	December '76	56.38

With a few days left in December, our long standing forecast of 75¢/lb. cotton for year-end has come a cropper. However, considering our initial buy recommendation at 45¢/lb. back on March 10th (... 'King Cotton is stirring up again... buy July and October '75 both at market.'), the market has given us a fair ride for our money.

What went wrong? In the first place, the USDA crop reports of October 12, and November 11th showing a 1975-76 U.S. crop of 9.1 million bales was way off the mark. The last December 10th report, placing it at 3.4 million bales, was much closer to the trade's private guesstimates; in the meantime, however, the damage was done as speculator's interest in the last 2 months was dampened substantially. Secondly, while the USDA's domestic consumption forecast was recently revised upwards to a range of 6.7-7.5 million bales from 6.2-6.7 million earlier estimated (closer to our figure of 7.5-8.5 million bales), the export picture was dimming. Foreign cotton is selling at a substantial 5-8¢/lb. discount as a result of poor business abroad and the 3.5-4.0 million export estimate is no longer realizable. Technically, the market was reflecting such 'weakness' as nearby months (both October '75 and December '75) sagged to unusually wide discounts behind March '76 and May '76. We warned of this happening and advised eliminating long positions at approximately 55.00 basis December '75.

Recent strength is a reaction to the belated U.S.D.A. trimming of crop prospects for this season. We do not foresee, however, an immediate continuation of the uptrend; total 1975-76 disappearance may now only total 10.5 million bales leaving a tight but satisfactory 3.5 million bales carryover at September 30th.

Remain on the sidelines. In the coming weeks we will reassess the market and suggest a new entry point.

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Frozen Concentrated Orange Juice

***** March '76 61.85

***** September '76 65.70

The chart on the back presents a most fascinating picture: a breakout above an 8-year Tong downtrend.

We refuse to discuss FCOJ fundamentals: the 'action' indicates a very large rise, perhaps in the order of 100%.

Technically oriented investors and speculators are advised to 'fill their hats' with FCOJ. A thawing will only produce a 2¢/lb. damage; a freeze on the other hand...

Buy orange juice futures placing stops at 57.50 basis nearby.

<u>Gold **</u>	March '76 IMF	139.40
	December '76 IMF	133.70

Our year-long bearish posture remains intact. The case for lower prices can be summed up in 3 ways: a) monetary; b) conceptual and c) technical.

A. Monetary - The Interim Committee of the IMF at the end of August reached agreement on changing the statutes of the IMF in that they will now embody a 'no gold, no par value' system. The phasing out of gold from the formal monetary system relegates it to a position of just another reserve asset, one which will fluctuate in price and will earn no return. This agreement is a direct corollary of the present system of floating exchange rates, where official monetary reserves are necessary only for 'stabilization' purposes. Gold will no longer have an official price nor will it be accepted by the IMF in exchange for currencies. There will be no new net acquisitions of gold from the market place designed to either augment official reserves or just to support its price on a temporary basis. Fully one third of present IMF gold holdings will be returned to member countries, half of it in exchange for currencies to shore up developing nations (we assume that they will not be dumped on the market).

The 'banalization' (as the French call it) or 'demonetization' (as the Americans do) of gold was dictated by the U.S. authorities who accompanied their threats with the disposal of well over 1½ million ounces. Furthermore, the recent strengthening of the U.S. dollar in foreign exchange markets made U.S. dollar denominated financial assets a palatable choice to those countries experiencing balance of payments surpluses.

The movement away from gold in official circles is illustrated by the recent suspension by EEC Countries of the requirement that gold be included along with other reserves for settlements within the 'snake'. Significantly, no time period was specified for reviewing this suspension (from a recent speech given by Dr. Gilbert of the BIS in Atlanta to the Committee for Monetary Research and Education, Inc.)

Henceforth, the international monetary order will be guided by the Rambouillet Agreement, embodying partial and stabilizing intervention and coordination of fiscal and monetary policies within a system of floating exchange rates. The breakdown of such a system will come when paper money, of any origin, will no longer be acceptable as a store of value and/or medium of exchange. Such frightful prospects are not yet visible on the horizon.

B. Conceptual - Purchasing power is preserved, in the long run, by higher market interest rates. Whereas in the 1972-1974 period, inflation consistently exceeded market expectations thus keeping interest rates below returns available from hoarding commodities, the reverse is now true. A positive real rate of return is now available on Eurodollar deposits: 6 months deposits yields at 7½% exceed and probably will exceed the U.S. rate of inflation for the next 6 months. The preservation of purchasing power at current rates of interest makes gold a 'poor' investment, especially in the light of its persistent 'overvaluation' (see Commodity Comments, Sept. 23 where its commodity value is approximated to be \$97/oz).

C. Technical - The violation of the major uptrend going back to 1973 coupled with the inability of prices to overcome the overhead gap at \$155-160/oz. indicates that a test of the recent lows is imminent.

In our September 23, 1975 Comments we foresaw an ultimate bottom in the \$88-120/oz. area, from whence it would react along with the rest of the commodity spectrum. A move through \$160/oz on the upside would invalidate our present thinking and would turn us into bulls.

<u>Grains</u>	***	December '75 Corn	2.55
	*****	December '76 Corn	2.61
	***	December '75 Wheat	3.26
	*****	September '76 Wheat	3.51

On our last issue of October 21, 1975 we said: '...bumper crops and a technically vulnerable market, as witnessed by the inordinately large increase in the open contract,

should see both Corn and Wheat trade back to their long term support areas, \$2.40/bu. and 3.25/bu. respectively...sell March '76 Corn (2.93) and March '76 Wheat (4.10%) at market...'

Our Wheat target was exceeded on the downside by 8¢/bu. while the corn target came to within 7¢/bu of being fulfilled. This proves once again that it takes a good deal of common sense, rather than statistical expertise, to 'score' in the futures markets.

The latest Soviet crop results, coming in a full 23 million tons below the downward revised U.S.D.A. estimate of 160 million tons, was taken rather lightly by the market as the downtrend was first halted, reversed and then resumed leaving the public holding the proverbial bag. The news were shrugged off by repeating an oft cited cliché that Russian logistic and internal transportation facilities can 'only' handle 25-30 million tons annually and, therefore, no new buying was in the making. In the meantime, reports are trickling in that Russian vessels are buying small quantities of Grain in Europe for shipment up the Volga River which by-passes port congestion at exterior facilities.

Extremely low world wheat stocks as a percentage of world consumption, heavy Indian demand, larger Russian purchases in the months ahead and a price structure in line with historical levels (adjusted for inflation—see September 23, issue) make wheat and corn attractive investment situations at these levels.

Buy March '76 and forward corn and wheat futures for a 40-75¢/bu. upside move. Keep in close contact for trading opportunities.

Interest Rates Futures	*****	March '76 Ginnie Mae	94.20
		September '76 Ginnie Mae	93.29

In keeping with our economic scenario of sluggish, and perhaps flat, growth and a continued reduction in the rate of inflation, we foresee a major decline in long term interest rates. Here again our case can be summarized in 3 ways:

1. Balance Sheet
2. Expectational
3. Historical

1. Balance Sheet Approach During the first 3 quarters of 1975, corporate retained earnings were more than 70% larger than in the full year 1974! This excellent cash flow performance allowed the corporate sector to add sizeable amounts to its liquid assets holdings. Indeed, business financing in the capital markets dropped \$48.3 billion, \$14 billion more than the drop in their annual rate of corporate outlays for inventories, plant and equipment.

Since inventory/sales ratios remain still a bit high and large unused capacity precludes a strong capital spending boom, 1976 corporate cash flow should exceed outlays for plant and inventories once again. This rebuilding of liquidity will allow the marketing of large amounts of Treasury debt to cover for next year's well publicized federal deficit.

In the personal sector, public savings promise to remain in the area of 8-9% of income as confidence in the recovery remains fragile. This buildup of savings will provide more than enough financing for the housing sector (In fact, present savings inflows already allow for 25% higher rates of construction).

The January-July '75 period saw corporate bond financing run at an average of 3.6 billion; this rate has declined now to an average of \$1.8 billion for the August-December period. We expect this drop off to continue well into 1976, thus allowing long term interest rates to drop by at least 3/4-1½ percentage points.

2. Expectational Recent studies indicate that long term interest rates embody 1) a risk premium of somewhere between 2.5-3% and 2) an allowance for inflation. The risk premium for Treasuries can today be considered negligible given alternative investment opportunities; the inflation premium should decrease to the lower end of the expected 6-8% rate for next year. Long term Treasuries may appreciate enough to yield just 6½-7%. Since Ginnie Mae's pay approximately 50 basis points more than equivalent Treasuries, a 7-7½% rate for Ginnie Mae could be in the cards. Such an eventuality should move March and September '76 Ginnie Mae to a premium over par.

3. Historical Previous cyclical interest rate declines in the post-war period averaged 22% for corporates, 22% for municipals and 19% for governments. If one assumes that long term interest rates bottomed out in February of this year at 5.70% for new AA utilities, 6.10% prime municipals and 7.85% for U.S. government bonds, the cyclical yield declines would have been only 18% for corporates and 10% for municipals and governments. Also, a February 1975 bottom suffers from delineating the shortest bull market in the post-war period - a mere 4 months for corporates and 7 months for

municipals and governments. This occurrence would be highly unlikely given the severity of the past recession as compared to previous troughs.

Summarizing our argument, we believe that long term interest rates will move significantly lower over the next 6 months. The purchase of March '76, June '76 and September '76 Ginnie Mae's is strongly recommended. Stops should be placed at 92.00 basis March '76.

<u>Livestock Group</u>	*****	February '76 Cattle	41.05
	*****	October '76 Cattle	40.40
		February '76 Hogs	45.42
	****	December '76 Hogs	37.50

In the previous October 21 Commodity Comments, we suggested that 'the turn in hog numbers, fuelled by a very favorable hog-corn ratio, will become quite evident by the middle of 1976, at which time a more normal 35-40¢/lb. level will be reached.' The forward months in hogs are already trading at these 'normal' levels raising the question of whether they have now moved into a buying area.

Conventional thinking (based largely on USDA report on farrowing intentions) places a very large increase in hog numbers during the last half of 1976. This is so given the very high gross hog feeding margins attained during the last quarter of 1975 (reaching a 4-year high in September at \$90.71 per head) and the sagging outlook for corn prices. In our opinion, deferred hog options are already reflecting this sentiment and are negating the full realization of this goal by inhibiting profitable hedging operations.

At this stage a neutral attitude towards hog futures is in order. A cautious scale down buying program should be undertaken in the event August '76-December '76 futures drop to 35.00 or lower.

The sharp rise in feedlot placements has put downward pressure on deferred cattle prices, ignoring the fact that a) a large part of this year's supply came from grass fed cattle (which is now being reduced) and b) breakeven costs for such an operation exceed \$45/cwt even with relatively 'low' corn prices.

Beef prices remain competitive with other meats and a continued rise in demand is practically assured as disposable personal income rises over the next few months. Current purchases of deferred cattle options at 400-500 point discounts from spot are strongly recommended. Our upside target for 1976 is \$50-60/cwt.

<u>Potatoes</u>	*****	May '76	10.08
	****	November '76	6.00

It seems that speculators never learn. While the potatoes fundamentals are quite constructive (world shortage?), it is most improbable to witness extreme supply rationing so early in the season. In fact, anticipating too early could easily damage demand to such an extent as to create a glut in the subsequent months. Fortunately, the bullish hysteria in May '76 futures (which saw it go up to an incredible 19¢/lb.) did not carry cash levels to unacceptable levels: disappearance showed a respectable 2% increase over last year.

We believe that May '76 potatoes futures are now reasonably priced and look for a steady and orderly advance to the 13-15.00 area by the end of the season.

Buy May '76 at these levels and place stops at 8.00 on close only.

<u>Platinum</u>	****	January '76	143.50
		January '77	155.20

Of the 4 precious metals handled on futures exchange (gold, silver, platinum and palladium) platinum changes hands at the most reasonable price. Selling approximately 10% cheaper than in 1967, it can truly be called undervalued.

Industrial demand for platinum hinges heavily in its continued usage in catalytic converters. General Motors has committed itself to the platinum-based catalytic device at least through 1980. In jewelery, the relative 'cheapness' of platinum vis a vis gold, has created a good market for the former, especially in Japan.

The platinum-gold ratio, now at less than 1-1 has been as high as 9-1 (back in 1968) and should provide good support in the 125-150/oz area even if lower gold prices materialize. Gold bugs are advised to switch to platinum; investors are asked to keep in close contact for a buy recommendation. Traders may purchase deferred futures on or about the middle of January if nearby is trading below \$145/oz.

Silver

* March '76 409.80
 * December '76 439.90

This highly erratic and almost neurotic market continues to zig-zag lower under the weight of distressed long liquidation and fairly heavy spot supplies.

Whatever strength remains in this market is purely speculative and is associated with intraday spurts in the grain pits. Industrial usage in the U.S. and Europe will be down approximately 70 million ounces from 1974 levels. Overall, U.S. stocks should show another fairly sizeable increase over 1974's 337 million ounces and 1973's 321 million ounces.

Recent weakness in demand is affected by the recent Silver Institute's figures estimating an increase in world refined stocks during November of 1,371,000 ounces. This sharp imbalance contrasts with figures to date showing world production of 23.3 million ounces in the first 9 months of 1975 against 23.0 million ounces distribution for the same period.

On an historical basis, adjusted for price inflation, silver remains overvalued and still vulnerable to another wave of speculative liquidation. Our sights remain fixed at the 3.00-3.50 level before any sustainable advance can be resumed. Corrective rallies should be checked at the \$4.40 level basis March '76, where overhead stop position should be placed.

Remain short.

Sugar

* March '76 13.69
 * October '76 13.64

After touching new lows on the present downswing (at about 12.45 basis March '76) Sugar prices recovered to the present 14.00 level raising once again the question of a 'turnaround'.

We continue steadfast in our belief that Sugar prices will erode down to the 6-8¢/lb. mark in coming months barring an unforeseen disaster in the U.S.S.R. beet crop now being harvested.

Rallies in recent months have all had a common denominator: fear that the U.S.S.R. beet crop, now estimated at 8.6 million tons, was as badly damaged as the wheat crop. While we doubt such to be the case, one must always be alert to the 'Russian Connection'. As a result, long standing short positions should only be covered in the event March '76 Sugar moves over 15.50

Consider the falling bearish ingredients:

- 1) Japanese consumption is running at approximately 20% below normal levels of roughly 3 million tons annually (a 'saving' of 600,000 tons). Japan has already asked Australia for a second deferment of part of 390,000 tons to be shipped from Australia in the first half of 1976. The amount includes 90,000 tons postponed from the current half-year period.
- 2) Sugar deliveries in the U.S. are still running to-date 14.6% below 1973 levels (in all, a possible 'saving' of 1.5 million tons).
- 3) The combined U.S. beet and cane sugar crops will easily exceed last year's by 1.5-2.0 million tons.
- 4) The EEC will turn from a net buyer of Sugar during 1974 and part of 1975 to a net seller of 500,000 tons.
- 5) The Phillipines is reportedly stuck with up to 700,000 tons of sugar carried over from last season plus a new crop estimated at 2.5 million tons. Storage facilities are practically unavailable; the Phillipines is hoping for a yet-to-be materialized Russian purchase. In the event this demand does not come through, supplies will be 'dumped' in the world market to make room for the upcoming crop.

Our forecast still calls for an increase in world stocks of the order of 5.0-7.0 million tons, substantial enough to cut present prices in half.

This market is being held up by hope and fond memories; the day of reckoning, however, is just around the corner.

Maintain previously established short positions, with overhead stops at 15.50 basis March '76, on close only.

<u>Wood Complex</u>	****	March '76 Plywood	152.30
	*****	September '76 Plywood	153.00
	****	March '76 Lumber	161.10
	*****	September '76 Lumber	165.00

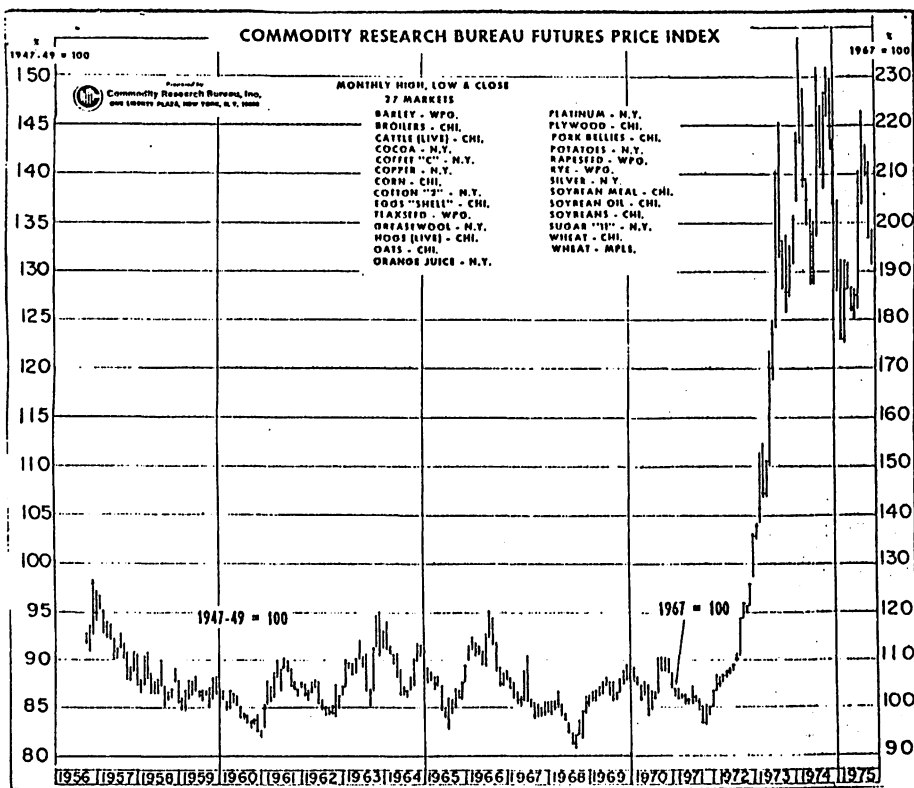
Housing starts figures were issued today after the close of the market which match almost exactly our October 21 forecast of 1,350,000 units for the end of 1975. Specifically, starts at 1,375,000 units were down 5.6% from November '75 and fell more in line with the underlying level of 1,115,000 permits issued. The significant category of 5-or-more family units rose to 287,000 from 250,000 in October while permits increased to 264,000 from 233,000 units. As reported almost 2 months ago '...the long awaited turnaround in multifamily starts may have begun...'. With rental rates beginning to tighten in many urban centres of the U.S., apartment construction should begin to pick up significantly in the months ahead. This sector should provide the single most significant stimulus to housing starts in the next 4 quarters. Our forecast still calls for 1,550,000 at end of the first quarter of 1976, 1,750,000 at mid-to late 1976 and 2,000,000 at end of 1976-beginning of 1977. The very high personal savings rate is flooding savings institutions with funds which in turn will provide readily accessible mortgage financing to builders.

The long term bull market still remains in force. In the last 10 days, however, prices have moved sharply ahead of what current conditions warrant. Technically, a sharp increase in lumber's open interest and a broadening top formation in the plywood signal a possible correction of roughly 10%. We therefore advise liquidating established long positions with a view to reentering market at lower levels.

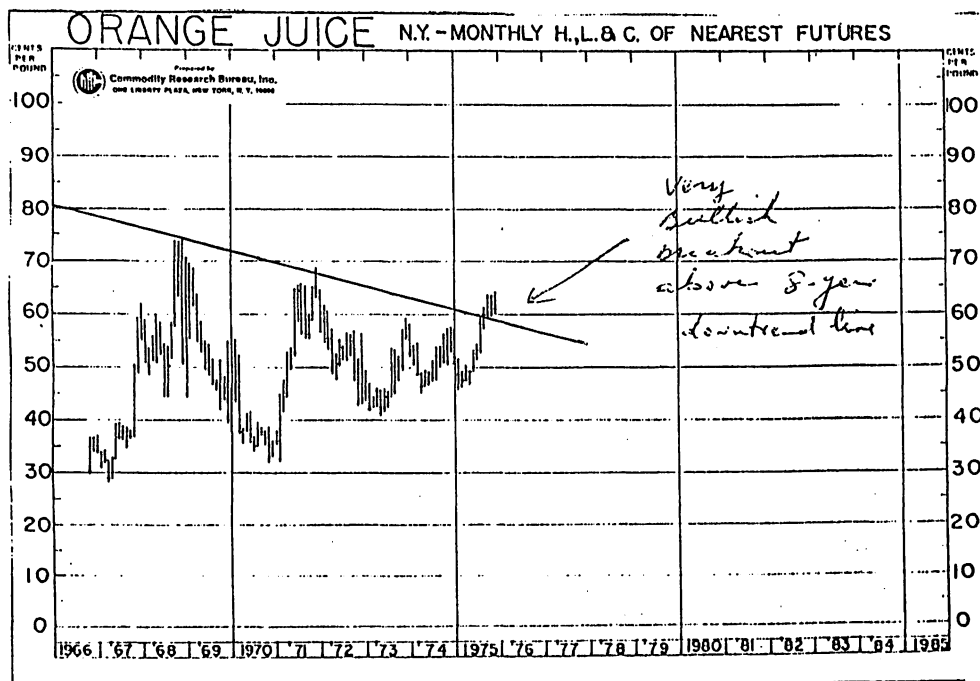
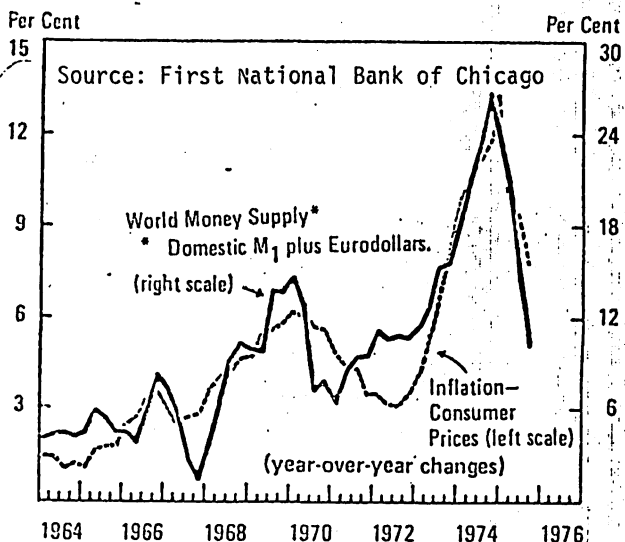
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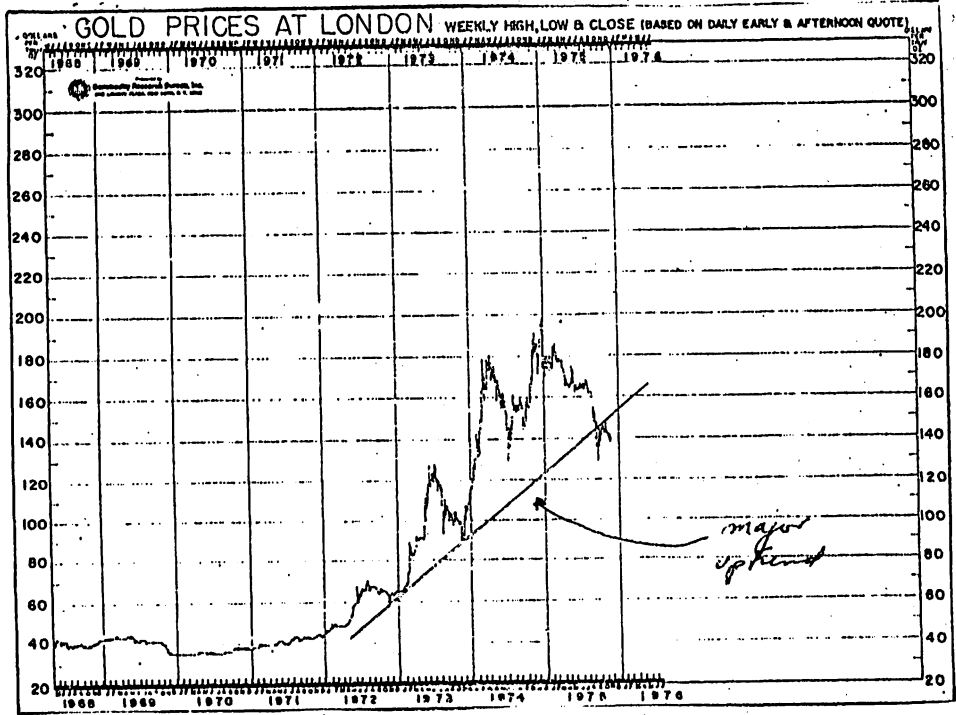
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All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.

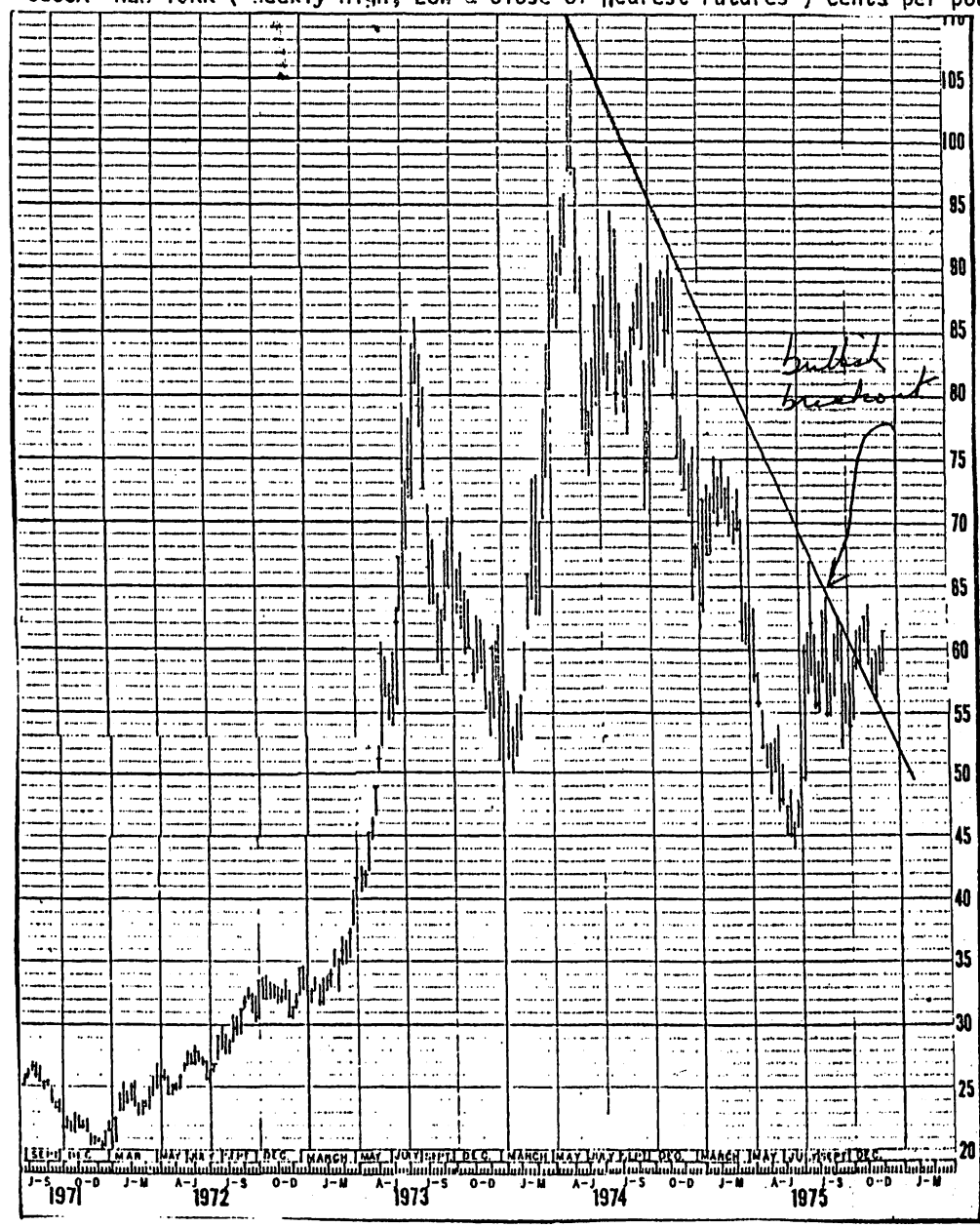


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