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Commodity Comments

January 20, 1976

INTEREST RATES

GOLD

SUGAR

LOWER, Lower...

The vigorous pace of economic recovery is now slowly grinding to a halt. While GNP figures for the last quarter of 1975 showed a 5.4% rate of real growth (down substantially from the 12% gain achieved in the third quarter), the first 3 months of 1976 will do well to show a 1-2% annualized increment. At worst, it may even show a slight decline...

Indications of this slowdown abound: loan demand has dropped off rather sharply in the past 8 weeks, wholesale prices receded 0.4% in December, housing permits issued were down on a seasonally adjusted basis by 2½% from November's sluggish pace, new orders for manufactured goods slid in November at a seasonally adjusted 0.5% following October's 1.1% gain (note the 2.6% drop in durable goods, sharpest in 8 months), manufacturer's inventories dropped by less than final sales (indicating unwanted accumulation), and so on.

The alert commodity trader does not require a PHD in Economics to discern economic trends—he feels them. The CRB Industrial Index, at 152.6, was unable to better the August highs of 160.50 and seems now headed lower (particularly with the recent drop in Cotton, Silver and Platinum). The Imported group, despite a meteoric rise in Coffee prices, has also been unable to better the August highs. Considering the recent sloppy action of Sugar and Cocoa, it is unlikely that it will do so in the near future. Wholesale beef prices in Chicago, generally a good proxy for consumer demand, are hovering at nine-months lows. Gold prices the premier barometer of inflationary expectations, are down to a two-year low.

Expansionary forces in the economy will not be rekindled for yet another 3 to 6 months. The interim period will be painful for the bulls as the path of least resistance is downwards. Exceptionally, some commodities will buck the trend: mostly, they will be benefitting from very special circumstances such as true supply shortages or a widely oversold (technically) condition.

We will continue to adopt a numerical rating system which will be placed alongside the specific commodity heading.

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

A split rating will indicate our opinion for each particular month as to its expiring value.

<u>Cocoa</u>	***	March '76	63.65
	*****	December '76	55.30
	*****	London March '77	645.00

On December 23 Gill & Duffus estimated that world 1975/76 Cocoa production will exceed consumption by 24,000 tons. Three weeks later, the Commonwealth Secretariat issued a similar forecast, pointing to a 1975/76 surplus of 35,000 tons. In the interim, U.S. grinding figures for the first quarter of 1976 showed a 21% jump over last year, well within earlier trade guesstimates. Similarly, there were few surprises in the U. K., Netherlands, and West Germany.

The rather abrupt tapering off in Ghana main crop purchases encouraged a lively and optimistic trade participation, the first sign that the market was becoming vulnerable to a good-sized correction. Having risen nearly 70% from its June lows, Cocoa prices gave signs of exhaustion and were looking for new stimulus before moving

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significantly higher. An aggressive hedge buying program on the part of some U.S. manufacturers was nearly completed while Origins remained close to the market. The inevitable correction ensued.

How far will the correction carry? The market is technically overbought and a distinct Head & Shoulder chart pattern is apparent. A major 7-month uptrend line at 58¢ and a strong support area at 53-54¢/lb. all basis March, seem to offer the most likely terminal points for the present retracement. We have therefore downgraded our rating for March '76 to Neutral-Bearish and expect to reinstate long positions in the deferred months on a pull back of 500-1000 points.

Liquidate long positions at these levels (short positions are not warranted given the overall bullish outlook) and look to buy September 1976 at approximately 53.00.

<u>Copper</u>	***	March '76	56.20
	*****	December '76	59.70

World refined copper stocks rose 17,700 short tons during November 1975, to 1,179,000 tons from 1,161,000 in October. The pace of the November increase was about 1/3 of October's rise. Rumors circulating on the LME indicate a 50,000 tons increase in LME warehouse stocks in the near future, mostly from CIPEC origin. In light of the serious foreign exchange problems experienced by CIPEC countries, such an eventuality cannot be ruled out. If fulfilled, LME warehouses will bulge with over 560,000 tons, tempering fabricator's urge to replenish depleted inventories.

Despite repeated bullish pronouncements by U.S. & U.K. Commissions houses, prices basis nearby March have been unable to overcome trade selling in the 57.50 area. Thirty-day momentum figures have turned down twice from the 105% level in recent weeks and presage an early return to the lower end of the trading range. Open commitment has continued to skyrocket paralleling warehouse movements and indicating heavy producer hedging.

Technically, this market has not given sufficient reason to believe that a firm bottom has been seen. Short term traders should buy on a breakout above 58.00 basis March '76. Investors will do well to accumulate December '76 on weakness, preferably on a scale down.

<u>Cotton</u>	***	March '76	59.59
	*****	December '76	57.85

The USDA's latest estimate of Cotton production for the 1975 season showed a further reduction of approximately 150,000 bales from the December forecast. It now places total outturn at slightly above 8.3 million bales. As the January estimate was slightly above trade expectations of 8.2 million bales, the market reacted negatively and has since retreated almost 4¢/lb. As of January 1, a total of 7.6 MM running bales had been ginned prior to January 1, according to Census Bureau figures, lending credence to the USDA's estimate.

The latest drop in prices brings American growths down to a 'mere' 8¢/lb premium over foreign growths. A spate of delivery cancellations on the part of countries such as Mexico and Turkey, underscores the need to pay up for American cotton. Nonetheless, in view of the extremely sluggish export business being booked at the present time, the domestic economic slowdown and the possibility of a bumper 1976 crop, we believe the premium is still 3-4¢/lb too high.

The March-May spread, having widened to 105 points from less than 40 points a few weeks ago, belies any tightening of nearby supplies.

We are inclined to remain on the sidelines until such time as the nearby month can be purchased for under 55¢/lb. Spreaders should purchase December '76 and sell March '76 at present levels looking for a slight premium on the deferred.

<u>Frozen Concentrated Orange Juice</u>	*****	March '76	61.70
	*****	September '76	66.40

The first week of January witnessed a sharp two day rise amounting to over 400 points in anticipation of an overnight frost in Florida. Frenzied buying turned into disappointing long liquidation the very next 2 days and the market collapsed to two consecutive limit downs. The bullish power of a frost was well documented; the converse was not fully proven as the market declined to pre-scare levels and no lower. Heavy declining volume was well absorbed by the trade-who, in turn, began to have second thoughts about frost damage. Yield damage may indeed have been far more significant than suspected.

The fact remains that: a) the frost season is not over yet; b) Orange Juice prices are extremely reasonable (lower than 7 years ago!); c) long liquidation has been extremely well absorbed and d) the breakout of a 7-year downtrend is still intact.

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Pessimistic economic prospects for the next few months have not tempered our bullish enthusiasm and we remain firmly committed to the long side. Stops should be raised to 58.00 basis nearby March, on close only.

<u>Gold</u>	**	March '76	124.60
	**	December '76	129.40

Our year long bearish posture is now paying off handsomely. Our last Commodity Comments made a convincing 3 point case for lower prices.

To recapitulate previous arguments; a) gold has been de facto demonetized (thus removing an enormous prop from under the market); b) with inflation continuing to abate in the U.S., short term money market instruments and Eurodollar deposits provide a 'real' and positive rate of return and thus guarantee purchasing power (i.e. the need for 'hard' money has been obviated for the present time) and c) the violation of the major uptrend going back to 1973 remains intact.

Since last month's comments, a few new developments have strengthened the bearish case. To wit,

a) The IMF has scheduled the first auction of bullion by March of this year - approximately 7½ MM ounces. This amount is a great deal larger than the U.S. auctions held last year. Should prices drop below \$110-\$120/oz (which we fully expect), the auction will probably be postponed to a later date and a sharp rally may follow.

b) Portugal has indicated that they sold a small amount of gold a few months ago, both to 'test' the market (presumably to acquaint themselves with gold's qualities as a liquidity cushion of last resort) and to raise badly needed foreign exchange reserves. Portugal's hoard, well in excess of \$3.5 billion at current prices, may hang over the market like the proverbial sword of Damocles, especially in view of the deteriorating economics situation. A run in the lira in the past few days, may reflect growing apprehension over Italy's 2 billion gold collateral with West Germany. The pledging of gold at \$120/oz will inevitably force Germany to call Rome for additional margin. Given Italy's low currency reserves, it is unlikely that the call will be met with additional money - either Germany sells the gold or it is forced to move it onto its own books. The critical decision will further unnerve agonizing bulls. Not to be sneered at, is the possibility of large LDC sales in the weeks ahead (we suspect some countries have already begun to sell).

c) The recent penetration of prices below the sacred \$128.75/oz support level represents a breakdown from a massive 1½ year head & shoulder pattern; such a violation can hardly be ignored. Technical yardsticks point to an absurd target of \$60/oz. Long before then, value conscious investors and countries will pick up the pieces. Redistribution of income is being accomplished on a global scale without any fiscal measures.

In previous comments we have indicated a maximum downside target of \$88/oz, this representing the outer limit of a 2½ retracement of the 1971-1974 advance.

We still consider \$97/oz the 'central value' for gold as a commodity (adjusted for inflation since 1914) and therefore believe that a scale down purchase program should be initiated at \$100/oz. Covering of previously established short positions should certainly be considered in the \$100-\$90/oz area.

<u>Grains</u>	****	December '76 Corn	271 ¼
	****	September '76 Wheat	374

In our last issue we recommended the purchase of December '76 Corn (then at \$2.61/bu) and September '76 Wheat (\$3.51/bu) looking for a 40-75¢/bu upside move.

We have now downgraded our rating from bullish to neutral but prefer to remain long previously established positions.

Place stops at \$3.62/bu on the Wheat and \$2.64 on the Corn for a no-loss trade if stopped out.

<u>Interest Rates Futures</u>	*****	March '76	92.25
	*****	September '76	94.30

In our previous issue, we made a 3 point case for lower long term interest rates. Recent economic statistics, such as the abnormally slow growth of money supply, declining loan demand, the possibility of renewed inventory liquidation and lower commodity prices reinforce our bullish posture in the Ginnie Mae futures.

Since last month's buy recommendation, Ginnie Maes have risen well over 200 points representing a profit in excess of \$2000 per contract on margin of \$2500.

The Corporate Calendar is building up, but at a moderate pace so far. The \$437 million on tap this past week is still far below the 1975 weekly average of \$683 MM. The 'Money Manager' 30-day visible supply at \$1.8 billion is also well below the 1975 monthly average of \$2.96 billion.

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Naturally, the recent drop in long term rates has attracted more corporate treasurers to the market and the market has developed a slight degree of indigestion. An oversupply condition has developed in the government market where the dealer community was forced to absorb at least 50% of the \$4.5 billion in two new issues. The degree of dealer overstocking was reflected in the total lack of positive response to the Fed's cut in the Discount Rate.

Near term we feel the market may move to the high 94-low 95 area at which point, nearby March will yield approximately 8.65-8.70%.

Long term positions should not be disturbed; new buying should be done on a further 3/4 point drop and concentrated on the deferred December position where yields are about 15/20 basis points higher.

<u>Livestock Complex</u>	*****	February '76 Cattle	39.00
	*****	October '76 Cattle	41.82
	*****	February '76 Hogs	47.95
	*****	December '76 Hogs	41.60

Today's 23-State Cattle and Calves on feed report revealed very few surprises. Numbers in feed at 12,296 MH head, were 128 percent of a year ago and in line with trade ideas of 126.7%. Placements on feed at 8.317 million head were 127% of a year ago and on the low end of trade estimates. Marketing were slightly lower than trade expectations but well within their range of estimates.

Present high production costs militate against a large movement to feed lots, and, at any rate, any such increases will diminish the large flow of grass fed cattle. Weights should continue to diminish for yet another few months. The market's present malaise can be attributed to falling demand as the consumer continues uncertain about future economic prospects. However, beef prices are now down almost 30% from August highs and will shortly begin to stimulate consumption.

Technically, cattle is highly oversold as falling open interest figures show. Maintain long positions; we expect a sharp advance in the next few weeks.

Hog prices, after breaking out of a 3 months' downtrend, are forming a reverse head & shoulder pattern. This formation is being accompanied by a sharp reduction in trader's commitments. The market 'feels' ready for a sharp advance.

Buy June '76 and forward hogs at market. Place stops 500 points lower.

<u>Potatoes</u>	****	May '76	16.25
	***	November '76	6.40

With May '76 Potatoes trading at 10.08, we said "...May '76 potatoes are now reasonably priced and look for a steady and orderly advance to the 13-15.00 area by the end of the season" (Commodity Comments, December 16, 1975).

That the advance was steady and orderly was rather a gross understatement-it was explosive! Prices skyrocketed today to a new recovery high of 16.25 on news that the EEC, faced with a 20% reduction in its crop, was suspending import duties on potatoes in an attempt to satisfy local demand. A world shortage is threatening to carry potato prices beyond the old time high of 19.00 reached last October.

Our long positions were closed out between 13.00 & 15.00 basis May '76. From the sidelines we watch in awe the giant bear squeeze and hesitate to initiate short positions as there has been little signs of distribution.

Keep in close contact.

<u>Platinum</u>	****	April '76	141.00
		January '77	148.60

Last month's advice to goldbugs to switch to platinum was indeed quite timely. The drop in platinum prices was \$7/oz v.s. gold's \$15/oz. From here on, the ratio should continue to favor platinum.

Traders are assumed to be long at 141-142 basis April '76 in keeping with last month's advice to buy deferred futures on or about the middle of January should nearby trade below \$145/oz. Investors should continue to watch this market from the sidelines with an eye on gold's eventual bottom.

<u>Silver</u>	*	March '76	386.00
	*	December '76	410.10

After staging a spectacular (illogical and manipulated, to boot) rally to the \$4.40 area basis March '76 (exactly as anticipated last month), silver prices resumed their long two-year downtrend. Today's close represented contract lows on all outstanding options, although spot silver has yet to break the 370-380 area of support established in October 1974.

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As stated last month, silver remains overvalued and still vulnerable to another wave of speculative liquidation. The ongoing price collapse has all the looks of being the 'real thing'. Maintain short positions, looking to cover as a scale down from 3.25 to just under \$3.00/oz.

<u>Wood Complex</u>	***	March '76 Plywood	151.70
	*****	September '76 Plywood	156.10
	**	March '76 Lumber	154.90
	***	September '76 Lumber	170.00

One of the leading indicators foreshadowing an unexpected flattening of economic activity, has been the recent trend of housing permits. Permits, at a seasonally adjusted rate of 1,058,000 units, were down from November's pace of 1,085,000. The critical multi family sector was a fraction lower (217,000 from 221,000 in November) and still lags the overall recovery. As previously stated, we expect this sector to contribute the largest share of gain in years to come.

Be that as it may, our sell recommendation last month was quite timely. Whereas Plywood prices have only reacted marginally since that time, lumber prices have dropped as much as \$7/1000 board feet and are now as much as \$15/1000 board feet below contract highs.

Prices are expected to find support at close to their major uptrends, somewhere between 200 & 400 points lower. Should the technical picture improve somewhat, particularly with regards to the open interest and volume patterns, we would consider reentering the market from the long side despite 'gloomy' fundamentals.

Keep in very close contact.

<u>Sugar</u>	*	March '76	13.62
	*	October '76	13.63

The 'Russian connection' alluded to in last month's comments, came to the fore in late December with a USDA estimate of Russian Sugar crop damage. The release stated that the Soviet Union will only produce 7.5 MM tons in 1975-76, a 1.0 to 1.5 MM ton decrease from the previously expected figure. On those news, the market rallied to the 14.60 area basis March '76 but fell widely short of reaching the danger point of 15.50.

Taking advantage of bullish speculators' gullibility, the Dominican Republic, Bolivia, and Peru sold outstanding quantities of raws, while India and the EEC did the same in the White Sugar sector.

The burden of enormous supplies is slowly breaking the back of the bull. We would not be at all surprised to see March '76 make new contract lows before its expiration. Stop-loss selling in a market heavily overbought by speculators will put the final nail on the coffin.

Remain firmly short, looking for market to break to the 6-8\$/lb area sometime during 1976. Lower protective stops to 15.00 basis March '76, on close only.

<u>Currencies</u>		Spot Cdn. Dollar	99.70
	****	December '76	
		Canadian Dollar	97.32

Despite our deep misgivings about future economic prospects for Canada, we believe that the purchase of the deferred December '76 position, trading at roughly 2½% discount from spot, represents a sound investment value.

Canadian investors who have converted Canadian funds into U.S. dollars for the purpose of purchasing U.S. money market instruments or shares will do well in covering the eventual re-entry to the Canadian Dollar by way of purchasing the forward months. The same holds true for Canadian exporters to the U.S. who expect to receive a future flow of U.S. dollars.

Contract calls for \$100,000 CF, margin required is \$2,500 and round turn commission amounts to \$60.

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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.