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Commodity Comments

March 28, 1976

CURRENCIES

Which may be bought and which may be sold?

The European snake is for all particular purposes dead, shattering French hopes for an early return to fixed exchange rates. It has now been established beyond any doubt that fixed exchange rates cannot survive in a world lacking the political will to subordinate employment policies to stabilization policies. The proper tool for combating the heavy speculative onslaught against the Pound and French Franc was a sharp increase in domestic interest rates. Such action, however, ran counter to the Authorities' desire to restore full employment.

Many theories have been advanced to explain exchange rate movements. Money, it is being said, is just another commodity and, as such, it is subject to similar analysis. Simple minds have therefore argued that for any given pair of countries, the one experiencing the highest rate of monetary growth will see its currency depreciate. Very much like more supply than demand. The facts are otherwise. Money supply in Japan grew by 162% in the 1Q/70-3Q/75 period, by 95% in the U.K. The dollar exchange rate for the Yen increased 20.04% while the dollar exchange rate for the U.K. Pound fell 11.49% during that same period...

No, say the 'purchasing-power parity' theorists. Exchange rates are a function of and reflect the differing rates of inflation in consumer prices. A bit closer but...why did the Canadian dollar improve over 4% vis a vis the U.S. dollar in that same period discussed above while consumer prices stood 5% higher? The purchasing power parity theory has gone through some refinements and some of its proponents claim that one must compare export prices, not consumer prices to obtain better results. The Deutsche Bundesbank did just that in its February report. (A shortened version of their table is reproduced below obtained from the London Financial Times, March 9th).

COMPETITIVE SHIFTS IN EXPORT MARKETS
(percentage shifts as against 1972 average)

	Mean export prices in exporter's currency		Exporter's exchange rate*		Overall change of export prices****	
	Jan. June, 1975	July. Sept., 1975	Jan. June, 1975	July. Sept., 1975	Jan. June, 1975	July. Sept., 1975
Britain.....	+70	+85**	-14	-21**	+46	+47**
France.....	+48	+46	+ 6	+ 7	+57	+56
Italy.....	+85	+90	-20	-20	+48	+51
Japan.....	+57	+50	+ 2	+ 1	+60	+51
Netherlands.....	+44	+41	+14	+11	+64	+57
U.S.....	+68	+66	- 4	- 1	+61	+64
West Germany....	+27	+28	+22	+17***	+55	+49

* Weighted relative to all other currencies. ** July-November average. *** July-December. **** The trend is exaggerated since the movements of exchange rates are taken into account twice over, for instance as a revaluation in the exporting country and a devaluation in the country importing. This statistical distortion in the view of the Bundesbank is unlikely to affect greatly the evidence of the third pair of columns.

Britain has been able to offset an 85% export price inflation between 1972 and the third quarter of 1975 with a fall of the exchange rate of 21%. West Germany's 25% price inflation has to be added to the 17% increase in the world value of its currency to obtain an overall figure 'similar' to Britain's. Granted that the Bundesbank's tables look much better today after the further 12% fall in the Lira and the 6% fall in Sterling. Nevertheless, the figures in column 6 leave a great deal unexplained. Furthermore this analysis cannot explain the incredible bull market in Canadian dollars vis a vis U.S. and Europe when our rate of inflation is double our neighbors'. And so, interest rates and short term capital flows enter the picture and a significant departure from common

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quantitative commodity analysis takes place. Indeed, money is a commodity with an extremely short supply cycle. Its production can be cut rather quickly, it can be made expensive quite hurriedly and arbitrarily.

By juggling around with monetary aggregates and rediscount rates, Central Banks can make a nation's sick currency look attractive - at least short term. Very high interest rates relative to other nations, tend to firm up spot exchange and produce a heavy forward discount that discourages bear raids. This is the situation of the Canadian dollar, where the 1 year forward position has gone to an incredible 350 points-discount (3 $\frac{1}{2}$ %). As bearish as one can reasonably get about Canada's latent (and real) inflation and lack of competitiveness, surely 350 points should be a deterrent enough to initiate short positions!

But there are other important lessons in the exchange rate game. As we have stated countless times in the past, devaluations do nothing or very little to redress a nation's competitiveness. West Germany has continued to pile up surpluses despite its 45% revaluation vis a vis the U.S. dollar since the first quarter of 1970. The U.K., on the other hand, has suffered a 20% devaluation in the same period of time, but its trade deficits grow larger. The repeated U.S. devaluations of 1970-1973 did not produce any visible results. It took an extraordinarily severe recession starting in 1974 (far greater than Europe's) to reverse the balance of trade in favor of the United States. In 1975 the U.S. experienced a sharp cutback in imports (a result of the worst depression since the 30's) and a rise in exports, mostly agricultural due to severe crop failures abroad. In fact, a strong case can be made that devaluations cause further inflation.

It then follows that exchange rate movements are a function of: a) long term costs and price inflation, especially in the export products; b) relative rates of return, particularly on short term investments and c) relative rates of growth. Furthermore, devaluations are inflationary in as much as they are quickly reflected in the domestic price level and, as a result, provide little international competitive advantage. Conversely, revaluations are anti-inflationary in that they are responsible for greater efficiency and productivity, while they halt the rise of the domestic price level.

Applying the above notions to the Canadian dollar, it seems obvious that both (B) and (C) are favorable at this moment while (A) is unfavorable. A rising exchange rate will inhibit the export sector thus further retarding domestic growth and reinforcing the upward march of the exchange. The reversal of this bull market will come when the Bank of Canada decides that it no longer can afford a high level of unemployment and a relatively stagnant economy and begins to ease its reins on the already tight banking sector. It seems likely that this will not happen yet for another few months. Coincidentally, when the propitious time arrives, the backwardation in a self-serving fashion will narrow rather sharply.

The U.S. dollar, on the other hand, may begin to weaken vis a vis the Deutsche Mark, the Swiss Franc and the Dutch Guilder. As the expansion gathers momentum, and the relative growth rates vis a vis Germany, the Netherlands and Switzerland widen, imports begin to rise far faster than exports. Interest rates differential should not change drastically while price inflation performance will still favor Germany and Switzerland, albeit slightly.

The British Pound should continue to deteriorate given its extremely low interest rate structure (in real Pounds), a restocking process (as the economy recovers) with a high import content and a relatively much higher rate of inflation reinforced by the vicious cycle of constant devaluations.

Buy December '76 Deutsche Mark and December '76 Swiss Franc at market risking 50 points, maintain long December '76 Canadian Dollar and sell December '76 British Pound at 188.50 risking 195.00.

A note on the Mexican Peso - With the passage of time, the Mexican Peso has become increasingly overvalued, especially in relation to most European currencies. This is so as it has steadfastly remained anchored to the U.S. dollar since 1954 despite repeated devaluations of the British Pound, Italian Lira and Spanish Peseta. Heavy Capital inflows, mostly of a short term nature, have for years covered an unfavorable trade balance. The country's capacity to borrow and service the present staggering debt has begun to come under scrutiny (1) and it is now a foregone conclusion that a 15-25% devaluations is in the cards.

Forward positions trade at extreme discounts compensating for a) much higher relative interest rates in Mexico and b) devaluation fears. Barring a devaluation, the discount will narrow over time making it extremely costly to undertake bear operations.

As an alternative, we suggest a relatively 'small risk' devaluation play: sell June '76 and buy September '77 at approximately 1100 points. Should the expected devaluation take place before June '76 the full spread will be earned (1100 points=\$11,000).

Otherwise, June '76 will move up to 8000 (loss = 225 points = \$2250) but the September '77 position is also expected to gain part of the 'discount' - perhaps as much as 100-150 points (= \$1,000-1,500) making the risk-reward ratio an extraordinarily attractive 10-1. Spread margin \$1,000.

(1)

(In Millions of Dollars)

<u>Trade balance</u>		<u>net payment of profits and interest</u>		<u>Balance of Current account</u>		<u>Movement of Capital</u>	
<u>1974</u>	<u>1975</u>	<u>1974</u>	<u>1975</u>	<u>1974</u>	<u>1975</u>	<u>1974</u>	<u>1975</u>
-1,390	-1,463	-1,619	-1,921	-2,910	-3,314	+2,940	+3,214

<u>Contract</u>	<u>Latest Quote Dec.</u>	<u>Contract \$/Point</u>	<u>Limit Margin/Points</u>	<u>Limit Move In \$</u>	<u>Open Interest as of Mar. 26</u>	<u>Liquidity</u>	<u>Margin Requirements</u>	<u>Round Turn Commission</u>
25,000	18650	\$ 2.50	500	\$1250	664	Fair	3,000	60.00
British Pounds								
100,000	9870	\$ 1.00	750	\$ 750	173	Poor	2,000	60.00
Canadian Dollar								
125,000	3998	\$ 1.25	600	\$1250	1278	Excellent	2,500	60.00
Deutsche Mark								
12,500,000	(Sept)	\$ 1.25	600	\$ 750	201	Poor	2,500	60.00
Japanese Yen								
1,000,000	7215	\$10.00	75	\$ 750	2321	Excellent	5,000	60.00
Mexican Pesos								
125,000	4040	\$ 1.25	600	\$1250	1312	Excellent	2,500	60.00
Swiss Franc								
125,000	20450	\$ 1.25	500	\$ 625	278	Poor	2,500	60.00
French Francs								

(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) 9:45-2:10 P.m. Toronto Time.

(4) Major delivery months are March, June, September, December.

Technical Trends

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 (expired)	71.20
*****	December '76	59.90
*****	London March '77	720.00

A spate of supply and demand forecasts for the 1975/76 season did little to encourage fresh activity in the market, which turned extremely quiet and traded (on a closing basis) over a range of only 100 points for over 2 weeks. In London, on the other hand, during that same period prices advanced over £ 35/ton to reflect £'s 5% devaluation. The latter event has vindicated our long standing position in London March '77 Cocoa.

On March 15th, the Statistics Committee of the International Cocoa Organization (ICCO) revised its earlier estimate of a 10,000 tons surplus for 1975/76 to a forecast deficit of 18,000 tons. Simultaneously, it revised downwards the 1974/75 surplus to 81,300 from 82,500 tons. The most significant aspect of the 1974/75 revision lies in the Soviet usage figures which are now thought to amount to 154,000 tons. Soon thereafter the market broke out on the upside from its 7 week consolidation range, scoring new season highs today.

The advance continues to proceed in an orderly fashion. Speculative participation remains subdued, Origin selling is disciplined and trade buying is done mostly on good setbacks.

Add to previously established long positions but retain the old protective stop at 63.20 basis May (close only). Our long term target still remains 90¢/lb.

<u>Copper</u>	March '76	62.40
*****	December '76	65.50

The dynamic advance begun in early February gave some signs of tiring this week. The pause took place amidst pronounced weakness in the precious metals and a corrective trend in other base metals such as Tin and Zinc.

Deliveries of refined copper to U.S. fabricators during January were reported at 136,500 short tons up from 116,200 in December and, except for last September, the highest since October '74. Outside the U.S., deliveries in January increased 8,500 tons over December to 229,600 tons, highest since last June. The American Bureau of Metal Statistics further reported, however, that production more than kept pace with shipments. As a result, refined stocks (industry and non-industry) in January rose for the 20th consecutive month, reaching 1,236,900 tons, up 10,600 from December 31 and sharply above the year earlier level of 737,900 tons. Total refined copper stocks in the non-communist world are indicated at around 1,500,000 tons if one includes 250,000 to 300,000 tons of refined metal in countries not covered by the survey.

At the outset of the last bull market in Copper (December '72), stocks totalled approximately 1,050,000 tons without taking into consideration the relatively large U.S. Government stockpile, since disposed. On a comparative basis, present stocks may not be as excessive as they seem. Furthermore, as pointed out in our last Comments, the contango structure of the market can accommodate practically all the so called 'surplus' tonnage that exists at any one time. That this is taking place can be corroborated by seeing that the New York open position alone represents almost 500,000 tons of copper (the LME presumably even more). The bullish argument is further supported by the political and military unrest in Africa that may cause serious disruptions in the flow of Zambia and Zaire copper.

Technically, the recent move has been significant for it penetrated a 1½ year long downtrend basis Spot at 59.00¢/lb and bettered the 2 largest rallies of the past year. On a negative note, speculative participation and commission houses' bullishness seem a bit on the high side.

We feel it is prudent to accept profits at these levels. Sell at market but reinstate long position if market betters recent highs by more than 100 points, on close only.

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<u>Cotton</u>	*****	July '76	58.49
	*****	December '76	57.75

In spite of the fact that in 1975/76 total supply will total just 14.1 million bales - the smallest since 1923-24, anxiety remains in the trade over: a) increasing imports of cotton textile products which may be posing a real threat to the domestic mill industry (December imports totalled the equivalent of 136,100 bales of raw Cotton, more than double the year earlier levels) and b) the prospects for a relatively large 1976/77 crop as the planting season approaches and cotton still commands a relatively more profitable price than soybeans.

While we believe that plantings will eventually turn out to be up to 10% larger than previously estimated in January, the growing strength of the U.S. and Western European economies should absorb the two-year combined supply with little difficulty (including cheap Far East imports).

Remain long July and December '76 Cotton. Look for a move to 70-75¢/lb by early July.

<u>Frozen Concentrated Orange Juice</u>	*****	May '76	61.50
	*****	September '76	64.35

The market has tended to drift over the past few weeks lacking any fresh incentives.

Cumulative movement so far this season is 55,940,538 gallons compared with 55,517,751 gallons last season.

The uptrend remains intact. Stay long with protective stops at 58.50 basis nearby (close only).

<u>Grains</u>	***	December Corn	2.62 3/4
	***	September Wheat	3.66

Last month, with September Wheat trading at \$3.99/bu. and December Corn at \$2.74/bu we stated that 'the weather scare, in our view, has been overdone and prices have now become vulnerable to further setbacks.'

A further reason for our near term bearishness at the time was the inability of prices to break through a two-year long downtrend that extends from the \$6.50/bu. level attained in early 1974.

At this writing, nearby Wheat has good support in the \$3.30-3.40 region and we'd be prepared to buy at these levels risking a close below \$3.20/bu. We'd still keep on the sidelines regarding Corn.

<u>Interest Rates Futures</u>		March '76 (expired) Ginnie Mae	96.18
	*****	September '76 Ginnie Mae	95.19
	*****	December '76 T.B.	93.10

The Ginnie Mae market spent the balance of February and most of March consolidating just under the significant January-February downtrend. In late March, spurred by the good news of a rise in February's CPI of just one tenth of one percent, a slackening in the rate of growth of M_1 and a steady Fed Fund rate (straddling 4 7/8%), Ginnie Mae futures along with the most of the U.S. bond market broke out of the downtrend and is now challenging the January highs.

A potentially important and favorable fundamental factor for the CNMA market is the continuing high level of savings inflows into thrift institutions. In January, the Savings and Loan industry experienced a record monthly inflow of \$5.8 billion seasonally adjusted. Preliminary indications for February and March suggest continued record inflows. Since all these funds cannot be committed immediately to direct construction lending (as the economy does not as yet warrant such a high level of activity), it is quite probable that we shall be witnessing a strong retail demand by these institutions.

Concluding our bullish remarks, we believe that the 60-70 point spread between GNMA and intermediate governments will narrow to possibly 25 points as investors roll down the quality ladder in search for higher yields. This is typical behaviour in a bond bull market.

Remain heavily long. Over the next two months June and September GNMA's should attain par. Possible risk \$1,000 - possible reward \$5,000 - margin \$2,500.

<u>Livestock Complex</u>	*****	April '76 Cattle	38.67
	*****	October '76 Cattle	43.97
	*****	April '76 Hogs	45.72
	*****	December '76 Hogs	40.75

The livestock complex has been trendless for the past few weeks, backing and filling within a 200 point range.

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An upside breakout in the livestock complex seems imminent. Crucial breakouts are as follows: old April cattle 39.30, old June Cattle 44.20 and old April Hogs 46.00, all on close only.

New contracts may be bought when crossing above levels.

<u>Potatoes</u>	*****	May '76	14.85
		November '76	5.60

After dipping twice to the 11.00 cent mark (but never closing there, thus not activating protective stops), the market has moved within striking distance of its January highs. A significant downtrend (from the contract highs) lies in the 15.50-16.20 area while overhead supply is clearly visible all the way up to 17.00.

According to Census Bureau Statistics released by the Commerce Dept., February exports of Fresh Potatoes rose to 55,904,287 lbs from 39,605,104 lbs exported the previous month and were sharply above the 18.92 million in the same period last year. The 95.51 million lbs exported in the first 2 months of this year was sharply above the 33.55 million in the same period last year.

For those who are unable to keep in close contact, we advise to remain long and raise protective stops to 12.70, on close only.

<u>Precious Metals</u>	*	December '76 IMM Gold	131.90
	*	March '76 Silver (expired)	407.80
	*	December '76 Silver	427.70
	****	April '76 Platinum	136.70
	****	January '77 Platinum	143.20

Trading quietly within a relatively narrow \$4/oz. band, gold prices have given signs of basing. Relative action, however has been disappointing especially in view of the European currency turmoil and the unstable African political situation. This 'relative' weakness in the face of potentially bullish news may presage a continuation of the bear trend begun in late 1974.

South Africa's weakening external position may be forcing her into an accelerated selling program. The recent gold swap operation conducted with Switzerland's Big Three Banks may be the first indication that additional gold 'sales' may be underway.

Recent reports indicate that IMF sales will begin in May spaced out over 6 week periods and offering as much as 600,000 ounces at a clip. The desultory pace of trading in the futures market make it highly unlikely that such sales will find firm buyers. Central Bank support (via the BIS) is also highly unlikely given France's recent loss of over 70% of its net currency reserves in last month's vain attempt at holding the 1.76 Franc-Deutsche Mark parity. Finally U.S., Germany, Saudi Arabia and Kuwait, have all given clear indications that they will not be buyers of bullion, at least not at these levels. That leaves the Swiss National Bank as the only willing and able buyer of last resort. Our guess is that the auction will be postponed. The surrounding uncertainty, will in this short run, however, create serious downside pressure.

Technically, a close below 129.00 basis IMM June will bring a test of the 123.00 lows and, quite probably, new lows will be seen. Support will be uncovered at \$115/oz, \$100/oz and finally \$88-90/oz.

Long standing short positions should be maintained for such an eventuality. Protective stops, however, should be lowered to \$138/oz basis nearby, on close only.

Responding to strength in the grain and base metals pit, Silver managed to mount a formidable rally, threatening at one time our overhead stop of 4.45 basis nearby. Resistance, however, at the 435-440 area has been just as formidable in this otherwise professional market and the inevitable return to the bear trend ensued.

Another test of the 3.50-3.80 /oz support area is now envisaged and with every passing day (and passing rally) the chances of it holding that level grow dimmer.

Maintain short position; lower protective stop to 441, close only, basis July.

Retain stop on long April '76 Platinum at 135.00 close only.

<u>Sugar</u>	*	May '76	14.71
	*	Oct. '76	14.52

Our feeling that there was something amiss in the world Sugar market was confirmed in early March when rumours of Soviet buying gave way to a confirmation by the Soviet Prodtorg Import and Export Organization that it had in effect bought 200,000 tons raws from Philippines \$200,000 raw from Western Europe. Strangely enough,

the total quantity purchased by the Russian (equivalent to 8000 contracts) is the amount that the open position on the New York Sugar Exchange dropped prior to the 180 point jump. As pointed out in our last Comments, technical consideration were forcing us to reverse, at least temporarily, our long standing bearish position. Once again, fundamentals confirmed what technical tools had predicted.

With the news out of the way, we have allowed our latent bearishness to re-surface. The Soviets' 3.15 million ton shortfall (which should take them back to 1974 consumption levels) has been made good by Cuba (a bit over 2.5 million tons) & the recent 400,000 tons purchases. On the supply side, Philippine and the Dominican Republic still remain awash with Sugar. Between both, a surplus of over 2,000,000 tons is available to the market. India and the EEC continue to hold formidable supplies while South Africa and other non-traditional exporters such as Greece and Uruguay are readying to enter the market.

Sell May and July '76 short and place protective stops at 15.50, close only.

<u>Wood Complex</u>	*****	May '76 Plywood	154.00
	*****	September '76 Plywood	158.20
	****	May '76 Lumber	158.00
	*****	July '76 Lumber	165.30

Exactly as anticipated last month, the market entered into a corrective phase that saw plywood and lumber prices fall roughly \$19/1000 board feet, the first severe shakeout since last September.

Figures reported a few weeks ago revealed that the overall trend in housing gathered speed in February. Starts jumped to a 1.56 million seasonally adjusted annual rate, up 27% from the previous month. Once again, the strength remained concentrated in the single family sector which was up 37% to 1.3 million units. Both the 2-4 family and multifamily (5 or more units) structures declined from January extending their flat performance since the first half of 1975. As vacancy rates continue to drop, mortgage money becomes ever more plentiful (see 'Interest Rates Futures' above) and REIT problems are worked out, apartment construction will begin to soar. Taken together, starts will surely exceed 2,000,000 units by end 1976.

Last month we suggested the purchase of September '76 Plywood at 155-160 and July '76 Lumber at 165-170. We presume you are now long.

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Commodity Futures

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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.