— Friedberg & Co. Ltd. —

347 Bay Street
Toronto, Ontario, Canada M5H 2R7
(416) 864-1195
Cable: Friedco Toronto
Telex: 06-23446

Commodity Comments

May 26, 1976

An Interest Rate Forecast

Interest rates are going up. The bond market is in disarray. The Southern Bell Telephone 8 1/4 s offered at 99 1/2 on April 20th are trading at 94 3/4, a whopping 4 3/4 point drop! Similarly, the Sears Roebuck 8's offered at 99 3/4 are down to 95 1/2 and our GNMA's are down from 97 1/2 to 95 3/8, basis June. In the short end of the market, 3-months Treasury Bills are up to 5.5% from 4.75% in the short span of 5 weeks.

What has happened? First, a brief analytical framework. It must be clearly understood that interest rates are nothing more than a price for money. Since money is a commodity it follows that an excess of demand for loanable funds over a supply of the same causes rates to go higher. Conversely, an excess supply of loanable funds causes rates to go down. Moreover, demand for money is not only a function of immediate 'user' needs but also a function of expectations. Finally, the supply of loanable funds has a 'cost', very much like a commodity, and this cost is in itself a function of present and expected rates of inflation. Since money depreciates in an inflation, the lender wants to protect his purchasing power and therefore offers money at a rate of interest that will at least cover the expected depreciation. It should be clear, however, that in the short run money can trade above or below cost depending on supply/demand conditions. Since the supply of money can arbitrarily be contracted or expanded by the workings of a Central Bank, it follows that money costs in the short run can trade anywhere! Obviously this conclusion if of no practical help. However, if we carry our analogy to commodities further, we will also conclude that money can price itself out if it rises above what final user demand can withstand. And herein lies the key to unlock the puzzle of the 1976 interest rate behaviour.

The Federal Reserve Banks, the agency responsible for the creation of money and credit in the U.S., have become enamored by the simplistic monetarist formula that equates money supply with economic growth and inflation. It has been told by the Friedmanite school of economists that a steady rate of growth of money (preferably 4-5% per annum) guarantees a steady rate of economic growth and a very low rate of inflation. The historical record confirms that there has been a parallel movement between money growth, economic growth and inflation (except for a period in the late 19th Century when we had floating rates!) but does not necessarily prove causation. Be that as it may, and we believe that the monetarists are at least partially right, the Federal Reserve, by focusing on money supply growth does not differentiate between growth induced by loan demand and growth induced by the banking system's purchase of government obligations. The former indicate a strong economy, the latter a relatively weak one. When money supply gains excessively as a result of loan demand, booming business conditions are threatening to cause inflation and the growth in the stock of money must be reined in. In the U.S. loan demand has remained flat from the last quarter of 1974 to April 1976 while bank investments (mostly Treasury obligations) have risen over 18% since the first quarter of 1975. This situation is unprecedented considering that the second quarter of 1975 was the beginning of a fairly strong economic recovery.

A money supply approach to Central Banking suffers from two more deficiencies: a) defining money supply and b) adjusting money supply for seasonal variations. There are seven varieties of 'money supplies' M_1, M_2, M_3, M_4, M_5, M_6 and M_7. The Fed focuses primarily on the first two: M_1 demand deposits plus currency and coin held by the non-bank public and $M_2 = M_1$ + net time deposits but excluding large negotiable CD's. Since both M_1 and M_2 have grown in recent months at rates considerably above target, the Fed has begun to drain reserves from the banking system by selling Treasury obligations. This operation has the effect of raising short term rates. The unusual growth in M_1 and M_2 can be explained away rather easily: a) Treasury balances have been growing considerably (draining deposits away from M_1 and M_2) and CD's have been allowed to run off by large commercial banks who find themselves with large reservoirs of liquidity and no borrowers. Since April 1975, CD's (in denominations of $100,000 or more) have fallen from $88 billion to $68 billion, a $20.0 billion drop that has "spilled" over *into the purchase of stocks, bonds and other financial assets. This 'spill over' causes M_1 and M_2 to grow at an accelerated pace. In reality one kind of money supply has been inflated at the expense of another kind.*

The second problem associated from too close a reading of M figures is associated with seasonal adjustments. In recent testimony before a Senate Banking Committee, Arthur Burns, Chairman of the Fed, pointed out that M_1 growth in February could have ranged from 0%-10.6% instead of the given 6.5% by the mere expedient of using a dozen of different seasonal adjustments (!). Similarly, March could have shown a 4.8%-9.7% range instead of the given 6.1%.

Tying in all the above loose ends, one concludes that Wall Street has become overly sensitive to what may turn out to be a misguided monetary policy. Very soon, the M watchers will give up trying to read too closely into weekly movements and concentrate rather on the actual level of loan demand. Furthermore, the Fed, by focusing too narrowly on aggregate money supply figures threatens to price money out of the economy and therefore cause a substantial business slow-down. Assuming a continuation of current rates of inflation (3.5-6.5%), a prime rate of 7 1/2%(which translates into 8 1/2% given fees and compensating balances) may be too stiffling and the recovery could come perilously close to abort.

Our scenario for the next 8 weeks calls for 3 month TB's to hit a maximum of 6-6 1/4, a prime rate of 7 1/4%, and long term rates for triple-A corporates to top at 8.75%, almost precisely where they are trading today. Subsequently, we expect interest rates to turn down once more and possibly hit new lows on the long end of the market.

In view of the above, December '76 TB trading at 92.65 for a yield of 7.35% seem extremely attractive. If by December '76, rates on 3 months bills are no higher than 6 1/4 as we expect, these Decembers will be trading at 93.75, for a $2750 profit potential on a $2000 margin investment. Place stops at 92.00.

September '76 GNMA's (94.05), should have been stopped out at 95.10 as per last month's suggestion (the 96.10 figure was a typographical error and we apologize). New long positions should now be taken at present levels looking for an upswing to 97-98 by year-end. Profit potential is a minimum of $3500 on a margin interest of $2000. Place protective stops at 93.00, on close only.

Technical Trends

Cocoa	******	*September '76*	*85.65*
	*****	*December '76*	*76.70*
	*****	*London March '77*	*956.00*

Cocoa prices have entered into their final and explosive phase.

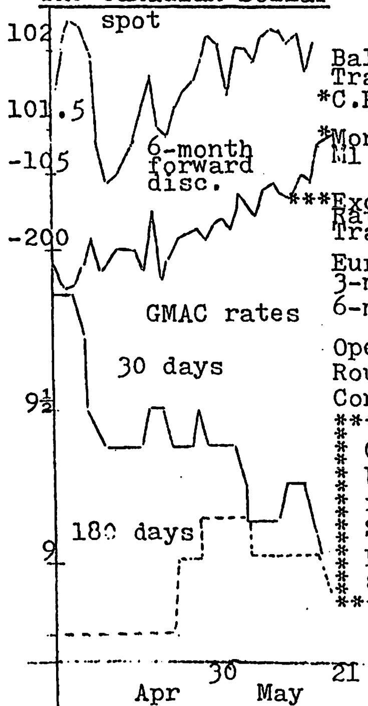
Fuelled by rumours that the Brazilian Temporao crop may not come to 1.6-1.8 million bags as originally anticipated due to a growing incidence of pod-rot and stunned by reports that French Zone Africa had sold out its 1975/76 crop, prices broke through to new contract highs. The July/September/December switches continue to widen presaging a dramatic end of crop year shortage. U.S. consumption seems unaffected, as yet, by rising prices as evidenced by import figures released today, (in lbs).

	COCOA BEANS	COCOA BUTTER
April '76	50,065,546	4,849,430
March '76	64,413,829	5,859,467
April '75	40,035,592	2,335,346
January-April '76	227,161,150	19,853,544
January-April '75	173,374,410	9,136,216
	UNSWEETENED CHOCOLATE	UNSWEETENED COCOA
April '76	2,311,162	12,928,690
March '76	4,168,143	18,664,325
April '75	614,584	8,314,782
January-April '76	14,650,384	68,274,470
January-April '75	4,242,536	43,066,752

How high this market is going is anyone's guess. Consumer resistance can no longer be a moderating factor for the balance of this crop year (to end September 30). Furthermore, usual July/August crop scares emanating from West Africa will give this already hyper-sensitive market more than its normal share of jitters.

Aggressive accounts with steel nerves and strong stomachs can go long at these levels. A close below 75.00 basis September '76 will indicate a trend reversal and should be used as a first stop.

The Canadian Dollar



Foreign Exchange Comments

	Jan.76	Feb.76	Mar.76	Apr.76	**1975	**1976
Balance of Trade (mln $)	-309.0	+47.0	-27.0	+62.0	-427.	-227.
*C.P.I.	9.63%	9.14%	9.02%	8.90%		

*Money Supply M1 Apr.28:8.7% May 5:10.6% May 12:11%

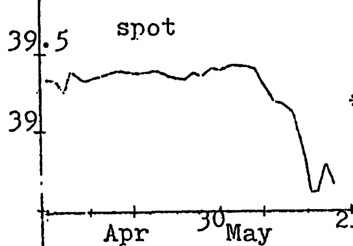
	Apr.23	Apr.30	May 7	May 14	May 21
***Exchange Rate-Trade Weighted	8.29%	8.59%	8.65%	8.79%	8.90%
Euro Deposit 3-month%	9 ½	9 ½	9 ½	9 7/16	9 3/8
6-month%	9 ½	9 ½	9 ½	9 ½	9 ½

Open Interest (May 26): 452 Average Volume (May): 24
Round Turn Commission : 60.00 Margin Required : 2000
Contract Size : 100,000 CD

COMMENTS: The one-year discount has finally dropped below 200 pts thus fulfilling 1 of our selling pre-requisites (see adjacent forward discount chart). Sell long Dec. 76 at market (nailing down a $3,500 profit) & sell Sep.76 short with a 102.4 stop basis spot.

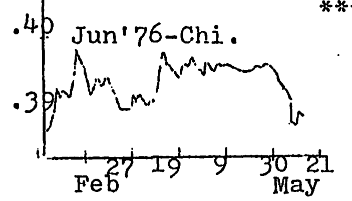
Jun.76: 1.0158 Sep.76: 1.0095 Dec.76: 1.0045

West German Mark



	Jan.76	Feb.76	Mar.76	Apr.76	**1975	**1976
Balance of Trade (mln Marks)	2,495	2,195	3,850	2,238	13,359	10,778
*Cost of Living	5.25%	5.45%	5.35%	5.24%		

	Apr.23	Apr.30	May 7	May 14	May 21
Net Monetary Reserves (mln Marks)	93,400	92,800	91,900	92,000	n/a
***Exchange Rate- Trade Weighted	25.67%	25.87%	25.95%	24.63%	24.18%
Euro Deposit 3-month %	3 3/8	3 6/16	3 10/16	3 ½	3 3/4
6-month %	3 3/4	3 3/4	3 7/8	4	4 1/8

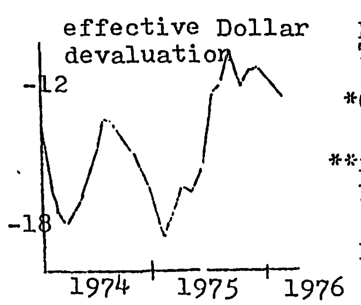


Jun.76 .3871
Sep.76 .3896
Dec.76 .3923

Open Interest (May 26): 845 Average Volume (May): 170
Round Turn Commission : 60.0 Margin Required : 2500
Contract Size : 125,000 DM

COMMENTS : The sharp rise in short term U.S. rates touched off our sell stop at 3950 base Dec.76. Remain sidelined until Eurodollar rates resume downtrend.

U.S. Dollar

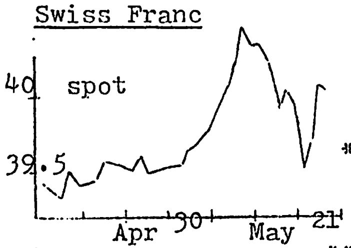


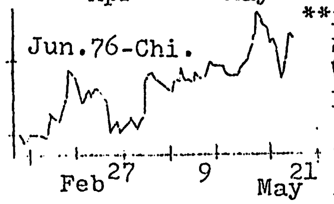
	Jan.76	Feb.76	Mar.76	Apr.76	**1975	**1976
Balance of Trade (in mln $)	-72.6	-140.8	-650.9	-202.1	+2643.6	-1066.4
*C.P.I.	6.79%	6.3%	6.15%	6.05%		

	Apr.23	Apr.30	May 7	May 14	May 21
***Exchange rate - Trade Weighted	-12.25	-12.28	-12.43	-12.61	-12.13%
Euro Deposit 3-month%	5 6/16	5 8/16	5 10/16	6 1/16	
6-month%	5 15/16	6	6 4/16	6 11/16	

* over year ago same month
** cumulative figures for the period Jan.-Apr.
*** Appreciation or depreciation(-) from 18/12/71

Swiss Franc





	Jan.76	Feb.76	Mar.76	Apr.76	** 1975	** 1976
Balance of Trade (mln SFR)	-110.5	33.5	Bal.	176.6	-1346.3	99.6
*C.P.I.	3.43%	3.05%	2.5%	2.22%		

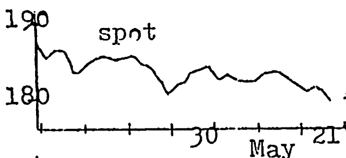
	Apr.23	Apr.30	May 7	May 14	May 21
Reserves (mln SFR)	11,874	12,290	12,716	12,356	n/a
***Exchange rate Trade Weighted	42.68%	43.07%	44.53%	43.92%	44.18%
Euro Deposit 3-month%	1 1/4	1 5/16	1 1/4	1 7/16	1 1/2
6-month%	1 7/8	2	1 15/16	2 3/16	2 9/16

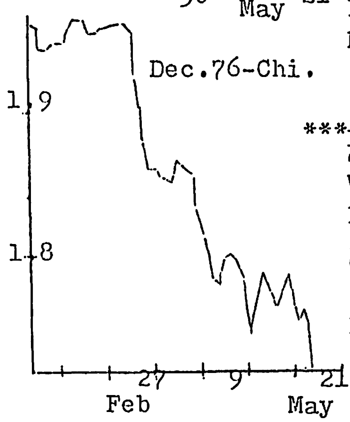
Open Interest (May 26): 1,110 Average Volume(May): 230
Round Turn Commission : 60.00 Margin Required :2500
Contract Size : 125,000 SFR

Jun.76 .4064
Sep.76 .4118
Dec.76 .4158

COMMENTS : The SF/DM ratio continues to widen, probably a result of Italian flight capital. The May 17th dip to 40.66 did not activate our sell stop(at 40.20). Remain long & move stop up to 40.50 base Dec.76.

British Pound





	Jan.76	Feb.76	Mar.76	Apr.76	** 1975	** 1976
Balance of trade (mln Stg)	-173.0	-246.0	-19.0	-255.0	-974.0	-693.0
*W.P.I.	19.1%	18.4%	15.6%	11.0%		
*Wage Index	27 %	27.7%	23.8%	24 %		
Reserves (mln U.S.)	6,785	7,024	5,905	4,848		

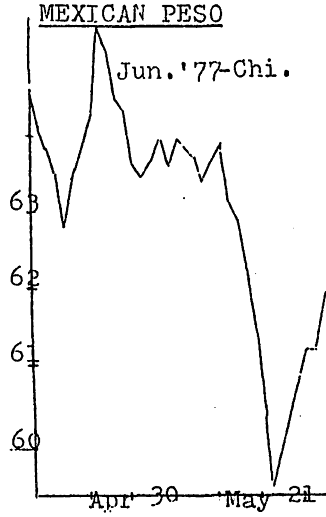
	Apr.23	Apr.30	May 7	May 14	May 21
***Exchange Rate Trade Weighted	-47.30%	-47.78%	-48.35%	-48.06%	-49.18%
Euro Deposit 3-month%	11 3/4	11	11 3/8	11 1/8	11 5/8
6-month%	11 5/8	11 1/8	11 1/2	11 5/8	12 1/8

Open Interest (May 26): 806 Average Volume(May): 109
Round Turn Commission : 60.0 Margin Required : 3000
Contract Size : 25,000 BP

Jun.76: 1.7700
Sep.76: 1.7490
Dec.76: 1.7200
Mar.77: 1.7000

COMMENTS : A sharply deteriorating trade balance despite the massive drop in Sterling confirm our earlier views on the futility of devaluations. The Bank of England has now begun to make interest rate more attractive and a breathing space can be won. Wait on sideline for a buy recommendation.

MEXICAN PESO



	1st Qtr75	4th Qtr75	Total/75	1st Qtr76
Current Account Deficit (mln U.S.$)	751	1,093	3,643	641

COMMENTS : The momentum of the pro-devaluation forces has begun to peter out due to incredibly strong official opposition. Those who have continued to hold the short Jun'76/long Sep.77 straddle despite massive erosion (our worst recommendation in years), should now wait until Jun.15, cover June'76 (presumable at par) & remain long uncovered the Sep '77 position which at these levels offers extraordinary protection. Should the Gov't float the Peso, sell Sep.76 immediately at market - otherwise wait until it reaches 7875 before you reinstate straddle.

<u>Copper</u>	*****	September '76	70.90
	*****	December '76	72.30

What at first looked like a normal consolidation in the 68.50-75.00 area basis July '76 developed into a more prolonged shakeout. Prices fell back from an aborted rally @ 73.00 to 67.30 before a new sustained recovery got underway. At no time did volume and/or open interest indicate that distribution was takine place.

Long positions that were stopped out at 70.40 on close basis December '76 can now confidently re-enter market at these levels. Sell stops should be placed at 69.60 on close. Upside target reads 83-85¢ basis nearby.

<u>Cotton</u>	****	July '76	67.70
	****	December '76	66.28

Industry sources now believe that the USDA's April 1 survey on planting intentions for Cotton of 11.25 million acres may have been underestimated by at least a half million acres. Given favorable weather conditions, outturn may go over 10.0 million bales compared to last year's 8.3 million bales.

U.S. Cotton exports will have to rise by an average of 85,000 bales weekly if the projected export target of 3.4 million bales is to be reached by July 31. Recent weekly shipment figures lend much credence to these estimates.

Chart readings point to an important upside move terminating in the 74-76¢ range. Other technical factors, namely high speculative interest on the long side and lack of strength in the July/October switch, continues to disturb us.

We prefer to remain on the sidelines.

<u>Frozen Concentrated Orange Juice</u>	******	July '76	58.05
	******	September '76	58.80
	******	January '77	60.60

The market has thus far paid scant attention to the normally favorable seasonal pattern that develops between May and January and to the relative 'cheapness' of the product. Instead, a bearish public has emphasized the 7.5% increase in processors' stocks of concentrate and the 6.4% increase in the net pack to May 1, 1976 vs the corresponding year-ago period. Imports of foreign concentrate already exceed the total for the 1974-75 season and are being construed bearishly despite their evidence of good demand.

On a more favorable note, May '76 expired strong, rising 95 points to 58.95 on the last trading day. Thus far, nearby has not violated the very important 58.00 long term support. Extrapolation of present consumption trends point to the first drawdown in carryover since 1972.

We expect the market to stabilize at current levels and begin a sustained advance well into late 1976-early 1977. Place stops at 57.50 basis nearby July, on close only.

<u>Grains</u>	***	December '76 Corn	2.72 1/2
	****	September '76 Wheat	3.62

Amidst cries of worldwide food shortages and crisis, grain stocks have begun to improve rather dramatically. Barring a much anticipated summer drought in the U.S., a 6.4 billion bushels crop is in sight which should put carryover stocks at the end of the 1976/77 season at almost 1.0 billion bushels, 17% of that year's expected disappearance and the highest since 1971/72. Similarly, Wheat carrover stocks at the end of the 1976/77 season has been revised upwards to 760 million bushels, a very comfortable level. On a worldwide basis, countries such as Brazil and India will require substantially less feedgrain imports in view of excellent crop prospects. As usual, the U.S.S.R. remains single biggest imponderable in the world picture.

Long wheat positions should be closed out at 3.75 basis July, if given the opportunity. Raise stops to 3.40. We continue neutral on Corn although would begin a scale up selling program at $2.80/bu basis March '77.

<u>Livestock Complex</u>	***	October '76 Cattle	46.32
	***	December '76 Hogs	42.40

Long positions were stopped at 45.00 basis new June Cattle and 49.00 basis June Hogs.

Move to the sidelines.

Potatoes An Afterthought

Our high expectations for the May 1976 position came to nought. It was not, however, a miscalculation. Maine potatoes were indeed in extremely short supply on May 7th, day on which the May '76 contract expired. An aggressive short seller identified as Mr. Simplot, a multimillionaire Idaho farmer, kept prices artificially low all through the closing days (and weeks?) of the focal month with little or no intention to deliver. And so, today, Richard B. Levine, N. Y. Mercantile Exchange President, on announcing that 997 contracts remained undelivered, termed the massive default 'unprecedented' in the history of futures trading. As he very aptly put it 'the integrity of commodity futures is at stake.' If these 50 million lbs of Maine potatoes cannot be bought in and delivered in N.Y., a settling price for the defaulted contracts will have to be imposed and penalties will be levied on the 3 clearing house members carrying the short positions.

Whereas most probably the interest of the remaining longs will be protected (by arriving at a fairly high valuation), another question still remains: if there truly was manipulation, shouldn't the longs that had to liquidate prior to the closing bell of May 7, also be compensated? Weren't they forced to sell at artificially low prices throughout the last weeks, days, hours and minutes of the now infamous May '76 contract?

Injured parties, take stock!

Precious Metals	***	December '76 IMM Gold	131.10
	****	December '76 Silver	481.60
	*****	January '77 Platinum	167.50
	******	December '76 Palladium	45.50

New short positions in December '76 Gold may have been activated on May 25th when it closed at 127.90, 10 points below our sell stop. On Comex, however, December '76 managed to close 128.10, 10 points above the crucial level. We prefer to keep neutral until such time as a definite breakout of the 128.00-139.00 box is achieved.

A fairly constructive chart pattern has evolved in Silver. As we said last month, however, upside potential remains vague and rather limited. We therefore don't care to follow the upside.

Platinum relatively 'low' price still holds an appeal. Add to previously established long positions looking to nail down profits at 180-182 basis January '77. Raise stops to 160.50 basis January '77, on close only.

Palladium continues to look attractive at these levels. Remain long.

Sugar	*	July '76	14.07
	*	October '76	14.45

No OPEC-type cartel is possible in Sugar. This sad lesson was learned by the Dominican Republic and the Philippines who, unsuccessfully, tried to hold off considerable quantities of raws from the market. During this holding period, other exporters were able to unload surplus Sugar in a fairly orderly manner. Subsequently, these 2 nations entered into direct selling agreements with U.S. refineries for upwards of 1.5 million tons.

In the last few days, drought conditions have been broken over much of the beet growing areas in Europe. The national area under sugar beet in the UK will be a record 510,000 acres compared to last year's 488,000 acres. France expects to have a record exportable surplus of 2 million tons in 1976/77 after an estimated production of 3.5 million tons (v.s 2.98 million in 1975/76). The USDA has estimated Australia's 1976/77 output at 3.3 million tons v.s. a revised 1974/75 outturn of 2.93 million tons. They also report that India's 1976/77 sugarcane crop took place under favorable weather conditions and expect Indian exports of Sugar to be vigorously promoted. This list could be extended to practically all the major producing areas in the world.

Our previous projections are slowly being vindicated. F. O. Licht's second World Sugar Balance estimates for 1975/76 to August 31 indicate production at 82,047 million tons, consumption at 79,858 million tons, and final stocks at 19,317 million tons compared to last year's 17,074 million tons. Dr. Helmut Ahlfeld, managing director of F. O. Licht told a meeting of sweetener users that world sugar stocks may be 'comfortable' in the 1976/77 crop year. Based on preliminary estimates for next year, final stocks may increase by as much as 1.5-4.5 million tons. In our view, the longer prices remain above 13¢/lb, the greater will be the eventual glut.

We continue to take a very dim view of this market and expect prices to reach our long standing target of 6-8¢/lb within the next 12 months.

Short positions may be taken at current levels placing protective stops at 16.50 basis July '76 and September '76.

Wood Complex	*****	July Plywood	147.50
	*****	September Plywood	150.00
	****	July Lumber	148.70
	*****	September Lumber	158.80

A lacklustre housing report showing a drop in starts of 4% and a drop in permits of 3% from March set this market back one more time. It had already been on the defensive in response to rising interest rates.

Multi-family starts, the key to the 1976/77 housing market, remained virtually static at a 235,000 rate. Within the next 2 or 3 months this sector will begin to improve rather dramatically in response to a tightening in apartment vacancies and a consequent rise in rents and builder/owner returns.

Remain long.

Albert D. Friedberg
Vice-President
Commodity Futures

*** *** *** *** *** *** *** *** *** *** *** *** *** *** *** *** *** ***