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SUPPLEMENT TO REPORT DATED DECEMBER 16, 1976

Developments that took place over the past month have forced us to modify, somewhat, our thinking on the cotton situation. So as not to appear, in any way, misleading, we are sending this supplement to all our clients and subscribers who asked for our original report.

Supply:

Rumours which began last week that the USDA would announce a production figure significantly higher than they did in December were confirmed January 10th. The latest, and final, USDA report calls for production during the current crop year, beginning August 1st, of 10,560,000 bales. This is 280,000 bales more than their last prediction and has consequently been a considerable depressant on the market. Prices have declined a full 10¢, basis March and July.

We still feel the actual figure will be lower than the USDA estimate for the reasons stated on page 2 of our report.

Production is centered largely in the Southwest. Texas will produce a full million bales more than last year. Texas produces largely shorter staple lengths of cotton. Our analysis of shorter staple lengths - page 3 of original report - is especially noteworthy.

Demand:

1. Domestic Consumption;

We remain bullish on the economy and are consistent in our thinking that domestic consumption will be, at least, 6.9 million bales.

The present ratio of the inventory positions of the mills to domestic consumption - page 6 of original - is statistically even more bullish than it was October 30th. Perhaps the mills were more accurate than most speculators in estimating final production and have held off purchasing because they anticipated declining prices. In this case they will enter the market soon. Perhaps the mills are speculating that domestic consumption will be less than we do. Their present position suggests they are anticipating less than 6 million bales usage. Only the most famished bear would agree with that figure, and so, if this latter argument is true, I would suggest again that the mills will enter the market soon. Finally, perhaps the mills have already purchased - in August or September - and have "hidden" their inventories in the warehouses of friendly companies in an attempt to provide better bank financing, lower carrying charges generally, and what only appears to be bullish news - i.e. low inventory positions.

This latter argument is, to a certain degree, precluded by the recently fallen interest rates. Our opinion is that the first supposition is correct. The mills anticipated an increase in supply and a consequent fall in price. Their refrain will end soon.

2. Exports;

The FAS reports export commitments as of December 26th, totaled 3.96 million bales. With a full six months remaining in the current crop year, only .5 million bales need to be registered to achieve the departments last projected figure: 4.45 million bales.

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2. Exports (continued);

We have taken a second look at the export market since our report. Our conclusion now is only slightly different. While there doesn't appear to be much international demand still unsatisfied - Korea and Taiwan are possible exceptions - there is no doubt in our mind that 4.5 million bale figure is far too low and will be revised upward. Our feeling is that the new revision will be of an amount large enough to absorb the production increase.

We stand by the suggestion made on page 7 of the report that as American Cotton becomes more competitive unexpected purchasers may enter the market. Rumours of an agreement with China persist. (There would be a thin irony implicit in China making a large purchase of American cotton. Undoubtedly such a purchase would initiate a bull market. Russia, the only other country with enough cotton available for export has as its national symbol the bear).

Our revised supply-demand forecast calls for a carryover into next year of 3 million bales. This is 200,000 bales more than we estimated last month.

Over the Long Term:

There has been no change in the 6.8% increase in prospective plantings suggested last month by the USDA - page 3. However, tomorrow, Friday, the USDA offers its preliminary seed crop report, and on the 21st, its prospective plantings report. These should be watched closely by the trade.

It is noteworthy that, during the recent price slide, the October contract, which is the first contract traded in the 1977 crop year, has held its own relative to the July contract, which is the last contract traded in the current crop year.

Conclusion and Recommendation:

The bearish news - ie. the production figures - is: 1) a surprise, 2) dramatic, and 3) arrived. The bullish news - ie. the consumption and export data - is: 1) probably going to be less dramatic 2) probably going to be as influential, and 3) still to come.

As stated, the purpose of this supplement is to acquaint you with our "modified" thinking. Our thinking is modified only to a small degree, and certainly not in kind. We are no longer strident bulls. But we are still bullish. Cotton has declined from a ***** rating to *****. Its still a bright light.

In the final analysis, fundamentals have not proportionately altered the situation significantly. If we were long at almost 80¢ we're definitely long at less than 70¢.

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

David Rothberg
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