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Commodity Comments

One Hundred Percent September 7, 1977.

Regardless of whether one uses the Commodity Research Bureau Index, the Bureau of Labour Statistics, or the Friedberg Commodity Index, commodity prices have advanced approximately 100 percent since 1967. One hundred percent or 2.0 (twice the 1967 level) then is the magic number of parity that we may use in measuring a commodity's relative under or over valuation. The discrepancies occur among various commodities as a result of the uneven and rotational nature of inflation. An excessive creation of purchasing power or, more narrowly, of means of payment (=money), spills over into goods and services and marks them up in rough proportion to the depreciation that has occurred in the unit we call money as the result of increased monetary creation. But money, very much like the flow of a torrential river, will take the path of least resistance. Thus, if obstacles are found on the way of this river, the flowing waters will circumvent it and continue their forward pace. In a monetary environment, obstacles may be either price controls or abundant supplies. In any case, if the obstacles remain for too long, natural forces will overrun them. And so in the case of price controls they will either be removed or supplies will dry up. In the case of abundant supplies, the suppliers will stop production and concentrate on more profitable lines.

By assuming that the monetary depreciation that took place since 1967 is equivalent to our magical 100 percent, commodity laggards may easily be detected. By the same token those goods that have outpaced the general ascent of commodity prices may very soon find obstacles, such as increased supplies, that may slow or retard the advance. The last time we ran through this kind of exercise was in September 1975. At the time we concluded that Broilers, Copper, Lumber, Orange juice, Platinum and Soybean Meal were relatively undervalued. A glance at the enclosed Table will show that prices achieved and, in many cases, vastly exceeded their parity value. Grossly overvalued at the time were Hogs, Pork Bellies, Potatoes, Silver, Sugar and Wheat. Once again, in the interim, prices fell back to their parity value.

While this analysis does not indicate how extreme the degree of under or overvaluation is likely to get before reactions set in nor the timing of such an adjustment, it does, however, help in coordinating a trading strategy that will avoid excessive risk. In this connection it is worthwhile pointing out that at the present time, the following commodities are relatively underpriced: Cattle, Copper, Corn, Platinum, Pork Bellies and Wheat. Still highly over-priced are Cocoa, Coffee, Silver and Sugar while the remaining commodities are more or less in a neutral zone.

chocolate bar line an average of 12.8 percent. On a more positive note, some manufacturers such as Peter Paul favour increasing the price rather than cutting bar size arguing that weight throughout the industry is already "terribly small".

In our opinion, increasing prices rather than reducing weights is a much more effective way to maintain consumption at present levels.

Arrivals in the week ended August 28th from the Bahia zone were disappointing at only 81,456 bags, bringing the total so far this season to 1,536,467 bags. The total for the Temporeo crop ended September 30th will thus hardly exceed 2,000,000 bags as against earlier expectations of 2.4 million to 3.0 million bags. Although the weather in West Africa has improved somewhat, a large degree of uncertainty is still being expressed about the Main Crops, particularly in Ghana. In Cameroon the government raised its producer purchase price for cocoa to 220 CFA francs per kilo (approximately 40 cents U.S. per pound) from 150 CFA (approximately 28 cents per pound) for the 1977/78 season which opens on September 12th. In addition, the government has released credit totalling approximately 10 million dollars to fight crop diseases including brown rot and will subsidize growers to replace old trees. It is fairly obvious that both Ghana and Cameroon, by paying farmers ridiculously low prices, are jeopardizing this important crop and are making a case for continuous shortages in years to come.

It can be stated with a fair amount of certainty that once the September contract has been liquidated the market will follow a jagged downward course. One caveat, however, is the enormous discount on forward positions. As an example, end of 1978 crop is trading at under \$1.50, which represents a 38 percent drop from the July peaks. This by itself argues against establishing any type of aggressive short sales.

Retain previously established (and modest) short positions on New Crop cocoa placing overhead stops at 182.00 basis December 1977 (on close only).

Coffee

* December 1977	180.00
* March 1978	165.05
* November London:	£2,472

Brazil continues to maintain its export tax at \$3.20 per lb. thereby withholding for yet another month green beans from the free market. Colombia's minimum tax stands at \$2.03 per lb. With total roastings so far in 1977 being 29 percent, (as of August 27th) in the U.S., 22.4 percent (as of July 21st) in Holland, 5 percent (as of July 31st) in West Germany less than 1976 a rather heady game of chess has developed. The major producer refuses to sell and the major consumers are refusing to buy. Which side will be the first to surrender its position?

The FAS has released its second estimate of world production; 69.9 mln. bags versus 70.5 mln. bags estimated in mid June. Exportable production is forecast at 52.6 mln. bags versus 52.8 mln. The Brazilians estimate consumer demand will total 58 mln. bags and, claiming they have no stocks whatsoever, feel that ultimately roasters will be forced to come to them and pay their price.

We disagree. First, our estimate of 1977/78 world demand remains unchanged from our April 22nd estimate of 52.7 mln. bags. Second, given that the better part of the current crop has been harvested in Brazil and exporters are still being forced to sit on coffee they purchased at prices now 55 percent above current free market offerings (see last month's comments) allegations that there is no inventory being held anywhere in Brazil are fatuous to the point of being condescending. Third, inventories held by retail outlets in the U.S. are so burdensome that discount coupons are being honoured at as much as 300 percent their stated value in order to spur demand. Retailers are content to break even or take a small loss, and obviously will be buyers in the months ahead, on a hand to mouth basis only. Finally, the financial crisis in Brazil is still in effect as described last month. We believe that only blind stubbornness or blind stupidity will force the IBC to hold out much longer.

Remain committedly short. We maintain a target range of \$1.25-\$1.50 per lb. basis the December contract.

We note that Robustas coffee in London is presently trading at a premium to N.Y. Given that Robustas is an inferior grade coffee we previously computed its value at 75 percent of the New York contract. In addition, London does not face the possibility of a dock strike. As such, we favour adding to short November positions in London.

<u>Copper</u>	****	September 1977	55.50
	****	December 1977	56.50

After having failed to follow through on a move to new season's lows, the key December 1977 position rallied and closed 30 points above these lows. Subsequently, the downtrending triangle, normally a bearish formation, was broken through on the upside with unusual vigour giving the charts a constructive look.

To fundamentalists, the recent rally remains as puzzling as ever. Copper production in Chile continues to increase over year-ago levels while Peru is expected to double present exports in the coming year. Recent mine closures for domestic U.S. producers are not expected to dent present burdensome supplies for yet many months. At the same time, the recent economic slowdown in O.E.C.D. countries augurs poorly for copper consumption. U.S. housing and automobile production, on the other hand, remain extremely strong and may yet be the key to the present market.

Technically, the market looks capable of advancing further. Resistance should initially be found at the major downtrend connecting the March and May peaks, which stands today at approximately 59.00 basis December 1977.

It is advisable to initiate some long positions at these levels with stops at 5500 on close only basis December 1977, and adding on a move above the aforesaid downtrend.

<u>Cotton</u>	**	December 1977	52.92
	***	March 1978	54.00

The bear trend continues.

The USDA's first estimate of the 1977-78 crop which began August 1st can be described as neutral to bearish. The USDA expects farmers to harvest 12,828.7 thousand acres of 13,354 thousand acres planted. Yield is expected at 506 lbs/acre and production is expected to total 13,523.6 thousand bales, up 28 percent from last year and 10 percent above our "most bearish" estimate made just following the prospective plantings report April 22nd.

On the world front, the ICAC has raised its estimate of world production to 64.6 mln. bales; .6 mln. bales higher than its July estimate and 6.5 mln. bales higher than last year's crop.

Domestic demand (U.S.) during July, the final month of crop year 1976/77, was the poorest since March 1974. Only 397,047 bales were used giving a daily rate of usage of 19,852 bales. June's daily rate was 30,293 bales, last July's was 22,230 bales. The prospects for 1977/78 are generally described only as being "very slightly better". Worldwide, the ICAC forecasts world consumption at 61.6 mln. bales, down slightly from '76/77.

Exports from the U.S. have tentatively been estimated at between 4 and 5 mln. bales, or generally speaking, lower than 1976/77's 5.0 mln. bale total. Given the overall world picture we feel the lower end of that continuum is most likely.

However, before unequivocally calling for lower prices it behooves us to discuss several potential exceptions to the bear case. First of all, the ratio of planted acreage to harvested acreage as estimated by the USDA suggests an unusually low abandonment, (the amount of cotton land to waste due to a variety of weather related, mechanical, etc. factors). A comparison with recent years illustrates the point.

<u>Year</u>	<u>Planted acreage</u>	<u>Harvested acreage</u>	<u>Ratio</u>
1977/78	13,354	12,829	1.040
1976/77	11,684	10,899	1.072
1975/76	9,493	8,796	1.079
1974/75	13,699	12,567	1.090
1973/74	12,480	11,970	1.042
1972/73	14,001	12,984	1.078

The second point to consider is the yield figure of 506 lbs per acre. Not only is it the highest since 1973 (520 lbs. per acre) but, in addition, it belies the overall trend towards gently decreasing yields.

Such extreme optimism leaves the cotton crop in a somewhat vulnerable position. The supply data offered by the USDA was based on conditions as of August 1st. While there have been no noticeably adverse developments since that date and while most of the crop has already been harvested, we would still not be surprised if subsequent USDA reports called for less cotton.

Taking all factors into consideration we would respect the bear trend and remain short, even adding modestly to our position on rallies. However risk no more than 56¢ (basis March). Should prices break above these upper levels, recommend assuming modest long positions placing stops at recent lows.

Interest Rate Futures

*****	September 1977 GNMA	99.10
*****	December 1977 GNMA	98.23
*****	December 1977 Long Term U.S.	
	Treasury Bonds	103.14
****	December 1977 U.S. Treasury	
	Bills	94.15

Having driven the Federal Funds rate to the 6 percent mark the FED has stepped back to study the response of monetary aggregates. Recent M1 and M2 figures show a slight flattening whereas the monetary base is still increasing at an above average pace due mostly to the increase in member bank borrowings at the Discount window. The latter was made more expensive by the recent increase in the Discount rate to 5 3/4 percent, a move unanimously expected for the past few weeks.

While short and intermediate term rates are sharply higher than their May/July levels, long term rates have eased. The 7 5/8 percent government bonds of the year 2007 eased to 7.6 percent from a late July high of 7.71 percent. Similarly, in the corporate bond market, a 25 million dollar Iowa Public Service bond was priced to yield 8.15 percent compared to the early August high of 8.35 percent for similar quality issues. As we postulated last month, long term rates can move inversely to short term rates because a) the short to long rates have been unusually wide and b) the bond market has been encouraged by the FED's resolve to slow the money supply growth, and its implied effects on inflation and economic growth. On the latter score there is a general feeling that a significant slowdown, if not outright recession, is in the cards. This market perception, whether a true forecast or not, aided by the sharply lower commodity prices of the last few months, should continue to fuel the recent advance of the long term end of the bond market.

Once again we present our rate of change (on a 12 months basis) of the Friedberg Commodity Index checked against the annualized yield of three month Treasury Bills. The correlation to date has been rather remarkable and presages not only lower long term rates but perhaps also a small drop in

the short end of the market. It should be noted, however, that large commercial banks have begun to increase their holdings of CD's and the long term downtrend in these deposit liabilities seems to have come to an end. This indicates that a) loan demand may not be as weak as generally conceded, and b) M1 and M2 growth may taper off in favour of a more inclusive definition of money. While this may be good news in the near term, it opens up a Pandora's box: bank loan financing in the future may be extremely difficult to control in a boom-type situation.

In summary short run considerations favour holding long positions in GNMA's and long-term U.S. Treasury Bonds. The

perceptual fallacy by most market participants about the economic conditions will not become obvious to all for at least another sixty days and this very fact will be known to us, commodity traders, well in advance.

Remain long December 1977 GNMA, still looking for a move to between 100 and 102.

Orange Juice

***** November 1977 193.90
 ***** January 1978 96.05

Still a major bull market.

Despite the volatile corrective swings which saw the September uptrend touched but never broken (on close) we are left with a 5¢ profit since last writing.

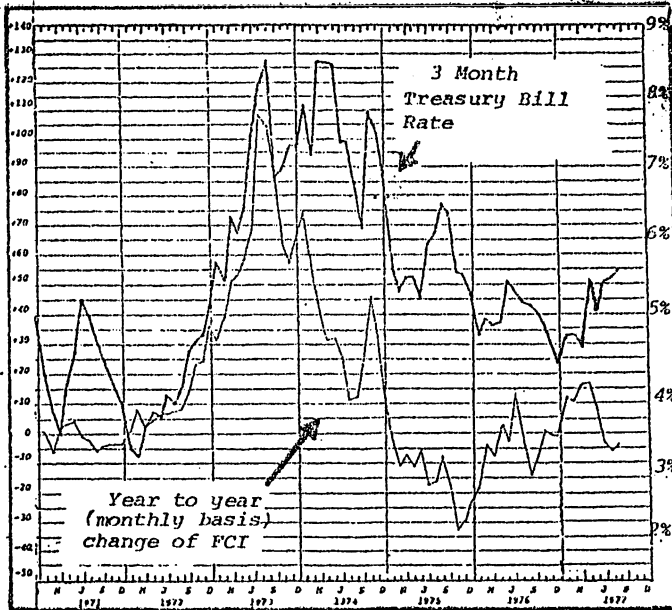
Last Thursday's movement, 4,010 thousand gallons, brings cumulative movement so far the year to 152,755 thousand gallons, 10 percent above last year's record pace and 8.8 percent above the pace required to meet our objective of 193.0 mln. gallons by the end of November. Carry-over could be as low 20 mln. gallons.

As stated last month, we await the USDA's first official estimate of next year's crop, due October 12th, although we note that the consensus is that orange production will not exceed 165 million boxes while our most pessimistic estimate called for production of 190 mln. boxes.

As yet there is no evidence of slackening consumer interest. Latest data indicates that declines in consumption of F.C.O.J. are being compensated for by increases in demand for chilled juice. Price has not yet been a significant factor having risen only 5.9¢ or 20 percent to an average 28.3¢ per six ounce tin.

With the exception of official confirmation of the size of next year's crop, all the fundamental conditions for another explosive phase of this bull market exist. Our technical indicators suggest the market is in good hands.

Remain firmly long the November contract but respect the present uptrend line currently around 105.00. We look for prices to achieve the 1.60/lb. level.



Precious Metals

***** December 1977 COMEX gold 149.30
***** October 1977 Platinum 149.10
***** September 1977 Platinum 42.40
***** December 1977 Silver 453.50

After having consolidated for almost two months under the 145/146 level basis Spot, gold prices broke out on the upside as the December 1977 Comex contract hit a 15 week high at 150.90. The recent show of strength, particularly in the last few days, has been attributed to the buying of one floor trader who reportedly acquired 2500 contracts on behalf of an unspecified source. As a result some concern is being voiced about deliverable supplies for that particular month should delivery be requested. While information of this kind is almost always useless (for the buying was rather visible) it should be noted that it has come atop a fairly bullish technical configuration which holds the promise of sharply higher prices ahead.

In spite of the fact that the currency turmoil has abated somewhat, a general feeling of distrust of currencies still pervades, particularly in view of very large budget deficits being planned in countries such as France, Japan and West Germany and the already sorry state of fiscal affairs in the U.S., U.K., Canada and Italy. With little of substance to follow, we will trust our bullish looking chart and advise remaining firmly long with stops raised to 143.50 basis December 1977 Comex, on close only.

For the first time in recent memory, platinum prices are trading exactly on par with gold. This indicates a huge undervaluation of platinum which, in months to come, will reward very handsomely the patient investor. Remain long the platinum group of metals.

Sugar

* October 1977 7.74
* March 1978 8.87

Sugar prices continue to mark time after an eventful expiration of the September contract at 7.56.

E.D. and F. Man estimates, provisionally, World Sugar production for the 1977/78 season at 89.39 million tons raw value against a revised 85.95 million tons in 1976/77. The bountiful new crops should exceed consumption by over 4 million tons, thus putting extremely heavy downward pressure on prices.

The market is holding at these levels in expectation of a new International Sugar Agreement to be negotiated in Geneva this month. Should little or no progress develop we expect prices to break this 7-cent mark and ultimately achieve out 5¢/lb objective.

Remain short.

Wood Complex:

***** January 1978 Lumber: 189.30
***** January 1978 Plywood: 205.50

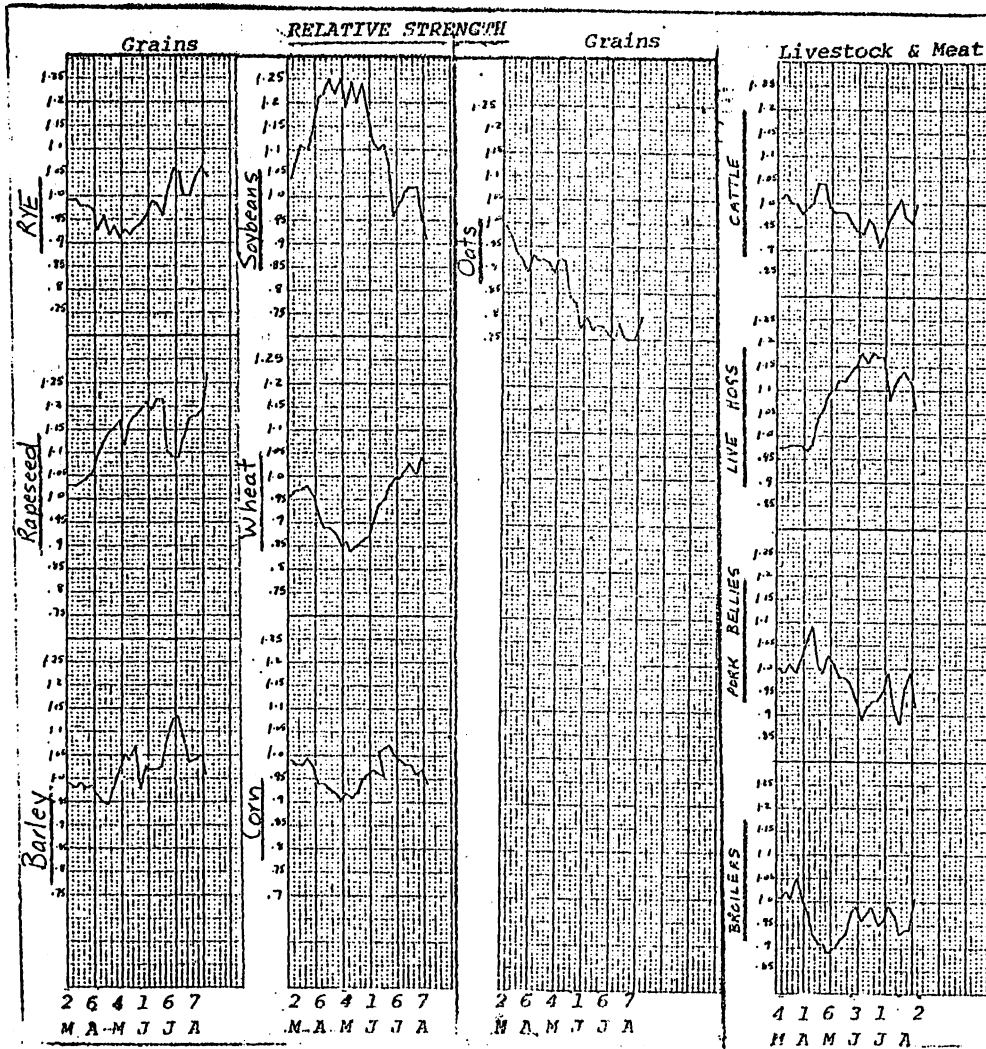
The correction which followed the explosive bull move that occurred early in July has washed out most of the weak longs. We now expect another advance though perhaps of a less dynamic nature.

Supplies are tight as evidenced by the backwardation structure of the market. Demand from the construction industry, the strongest of all U.S. economic sectors, remains strong. July starts totalled 2,064,000, units up 8 percent from June. Singles totalled 1,462,000 units up 6 percent and 1,630,000 permits were issued, down 3 percent. Sales of both existing and new homes continue at a healthy pace and inflows into savings and loans institutions, though slowing, remain adequate.

We favour a modest long posture in both January Lumber and Plywood and, given the recent volatility of this market, recommend you stay in close contact.

FRIEDBERG COMMODITY INDEX

AUGUST 1977: 202.35
 JULY 1977: 201.00
 NET CHANGE: +0.67%



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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