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Currency Comments

October 31st, 1977

British Pound

Spot : 184.35 Dec. 77: 183.50 Mar. 78: 184.20 June 78: 184.70
 Sept. 78: 184.52 Dec. 78: 184.30

	May	June	July	Aug.	Sept.
Balance of Trade (mln Stg)					
Jan-Sept. 1976: -2,433					
Jan-Sept. 1977: -1,659	-244	-301	-256	+141	+ 91
Money Supply (Stg M3) %	6.6	2.4	1.0	--	2.2
Reserves (Mln US\$)	9,903	11,570	13,420	14,850	17,170
Retail Sales Index	-2.24	-2.60	-0.74	-1.56	-2.11
Retail Price Index	17.14	17.69	17.59	16.52	15.63
Unemployment Rate	5.60	5.70	6.80	6.90	6.10
*W.P.I.	18.87	20.92	20.93	19.87	19.00
	3rd Qtr 1976	1st Qtr 1977	2nd Qtr 1977	3rd Qtr 1977	
Balance of Payment (mln Stg)					
Current Acct	-637	-327	-241	+526	
Euro Deposit	Sep. 28	Oct. 6	Oct. 14	Oct. 20	Oct. 26
1 Mo.	6 1/2	5 3/4	5.	5 1/8	5.
3 Mo.	7.	5 7/8	5 1/2	6.	5 5/8
6 Mo.	7 1/2	6 5/8	6 1/8	7.	6 1/4
12 Mo.	7 7/16	7 3/16	6 13/16	6 5/8	7 1/8

Open Interest (Oct. 31): 6673	Average Daily Volume : 843
Contract Size : BP 25,000.00 (Approx. US\$ 46,500.)	Daily Limit (Normal) : .05(\$1,250.00)
Minimum Fluctuation : .00050 (\$12.50)	Round Turn Commission: US\$ 60.00
Margin Required : US\$ 2,500.00	Delivery Months : March, June, Sept., Dec.
Trading Hours : 8:45 a.m. - 1:10 p.m. (Chicago Time)	

The UK treasury in its usually understated manner, issued this morning the following statement :

" The Gov't believes that general stability in the external value of Sterling benefits the economy and has been generally welcomed.

" Until July, stability meant in practice a steady U.S. Dollar/Sterling rate. But since the U.S. dollar began to show less stability relative to other currencies in mid-summer, it has been more appropriate to pay regard to the stability of Sterling's effective exchange rate index against the currencies of our main trading partners as a group.

" For this reason the Sterling/Dollar rate has tended to appreciate as the dollar became less strong against currencies generally. Recently the Dollar has fallen sharply, and, with underlying confidence in Sterling strong, the Pound has attracted massive inflows.

" For a long period, it has been possible to offset any effect of these inflows on the domestic money supply, and that effect is in any event complex and to a large extent indirect.

" The growth of Sterling M3 as well as of domestic credit expansion, has remained within the guidelines described by the Chancellor in his April budget.

" However, the Gov't believe that a continuance of these inflows on a large scale could now endanger continued adherence to the domestic monetary targets. In these circumstances, the Bank of England intervention policies will be adjusted accordingly."

The massive \$10 billion inflow (including estimates for October) of the past 6 months resulted in an inevitable bulge in monetary aggregates. The latest 5-weeks period shows an unusual jump of 2.2% in Sterling M3, with further substantial increases a near certainty. The dilemma was belatedly resolved in the best tradition of a system of floating rates. The 700 point jump in Sterling will probably take the edge off speculative buying as it will inject a strong element of risk in outright operations. Additionally, gilts & shares are giving signs of topping out at these levels, removing the premier vehicle for hot money inflows.

All long positions should now be liquidated.

	May	June	July	Aug.	Sept.
Money Supply					
Narrowly Defined	8.35	9.32	8.78	9.60	9.12
More Broadly (M2)	16.06	15.61	15.65	15.31	15.22
M3	15.69	15.14	15.44	13.93	15.01
Balance of Trade (Mln US\$)					
	+ 29	+129	+125	+298	+ 60
General Bank Loans (Percentage Growth)	18.91	18.57	18.07	17.16	15.90
*C.P.I.	7.57	7.67	8.37	8.33	8.40
* Food Price Index	6.11	7.01	9.00	10.18	11.16
Unemployment Rate	7.90	8.00	8.1	8.2	8.3
Euro Deposit					
	Sept. 28	Oct. 6	Oct. 14	Oct. 20	Oct. 26
1 Mo.	6 15/16	7 3/16	7 5/16	7 3/16	7 1/16
3 Mo.	7 3/16	7 5/16	7 9/16	7 9/16	7 5/16
6 Mo.	7 5/16	7 9/16	7 11/16	7 15/16	7 9/16
12 Mo.	7 7/16	2 11/16	7 13/16	8 3/16	7 11/16
Open Interest (Oct. 31) : 1760	Average Daily Volume : 927				
Contract Size : CD\$100,000.00 (Approx. US\$ 90,000.00)					
Minimum Fluctuation : .0001 (\$10.00)	Daily Limit (Normal) : .00750 (\$750.00)				
Margin Required : US\$2,500.00	Round Turn Commission: US\$ 60.00				
Trading Hours : 8:45 a.m. - 1:10 p.m. (Chicago Time)	Delivery Months : March, June, Sept., Dec.				

Last month we stated that " a weak CD\$ is almost an inevitability ". The ensuing decline was spectacular : in a period of 4 weeks, the CD\$ gave up 3.5¢ vis à vis the U.S.\$ (& far more vis à vis Continental currencies), although it managed to stage a modest comeback since last Friday after the Gov't announced a standby credit of \$1.5 bln. The latter deal was obviously effected with the purpose of offsetting the negative implications of a further & substantial drop in reserves. As such, it should merely be viewed as the easiest response the Federal Gov't could take to the increasing calls of 'doing something'.

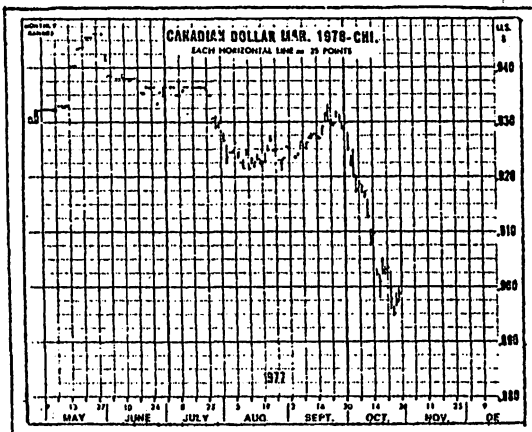
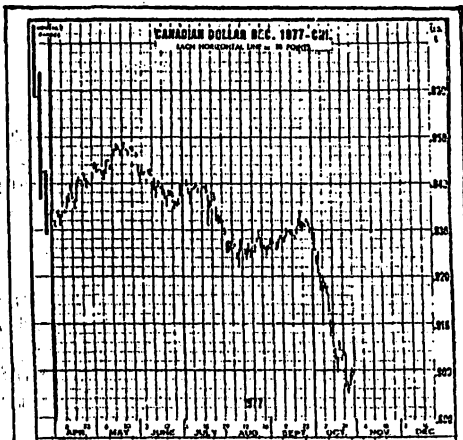
The fundamental picture remains unchanged. Interest rate differentials are almost non-existent, the trade balance has & will not improved from the devaluation either in the short run (the "J" curve) or in the long run (more inflation) & debt burdens continue to climb. Furthermore, the prices for Canada's exportable raw materials are set in the world market & cannot be affected appreciably by a local currency depreciation. The only area to 'benefit' from the devaluation will be the tourist gap; undoubtedly, this could improve.

Cumulative trade figures show that the 10%-plus drop in the CD\$ since late last year has not brought Canada any gains. This was our contention last November 30th: " We strongly disagree with those members of the press & other academic thinkers that believe in the necessity of depreciating the external value of the CD\$. Since the end of World War II, many countries have tried to devalue 'once & for all' and discovered that such a course of action was highly detrimental to their balance of trade (contrary to conventional wisdom) & highly inflationary.

"The 'overvaluation' of the CD\$ over the past year was highly successful in checking inflationary domestic pressures and, contrary to orthodox expectations, reversed the balance of trade deficit that prevailed during the time of the cheap CD\$, early & mid-1975. Figures provided below indicate that Canada had a trade surplus during 1976 compared with a deficit in 1975. Furthermore, by enjoying a 'strong' dollar, Canada was able to borrow huge amounts of money abroad, easily covering a growing deficit on its current account. "

The damage has already been done, & it is irreversible - huge layers of 'supply' lie in the 91-94 area & it will require an economic transformation before a sustained upside move can be successfully accomplished.

Remain short; cover on close above 90.80 basis Dec. 77.



Spot : 44.58 Dec. 77: 44.81 Mar. 78: 45.18 June 78: 45.55
 Sept. 78: 45.40 Dec. 78: 45.70 Mar. 79: 36.05

		May	June	July	Aug.	Sept.
Balance of Trade (Mln Marks)						
Jan-Sept. 1976 :						
Jan-Sept. 1977 :	+26,240	3,620	2,890	1,760	2,520	3,600
Balance of Payment (mln Marks)						
Jan-Sept. 1976:	4.19 Bln					
Jan-Sept. 1977:	0.50 Bln.	1,650	779	-1,990	-1,680	-1,500
Money Supply						
M1		6.89	5.66	8.23	7.83	9.11
M2		9.00	6.74	9.11	7.62	8.19
M3		9.14	7.75	9.90	8.96	9.37
* W.P.I.		0.62	0.81	-0.03	-1.24	-1.11
Cost of Living		3.83	4.0	4.33	3.89	3.96
Unemployment Rate		4.1	4.1	4.3	4.3	4.0
Net Monetary Reserves (Mln Marks)						
		Sept. 28	Oct. 7	Oct. 14	Oct. 20	Oct. 26
		84,900	86,300	86,800	87,400	
Euro Deposit						
1 Mo.		3 15/16	3 3/4	3 11/16	3 13/16	3 15/16
3 Mo.		3 15/16	3 7/8	3 15/16	3 15/16	4 1/16
6 Mo.		4 1/16	3 15/16	3 15/16	3 15/16	4 1/16
12 Mo.		4 3/16	4 1/16	4 1/16	4 1/16	4 1/16

Open Interest (Oct. 31) : 2952 Average Daily Volume : 710
 Contract Size : DM 125,000.00 (Approx. U.S.\$ 56,500)
 Minimum Fluctuation : .0001 (\$12.50) Daily Limit (Normal) : .0060 (\$750.00)
 Margin Required : US\$ 2,500.00 Round Turn Commission: US\$ 60.00
 Trading Hours : 8:45 a.m. - 1:10 p.m. Delivery Months : March, June, Sept., Dec.

Fundamentally, a bearish case can finally be made. The strength in the external trade sector has been dissipating while the current account now shows hardly any gains since the beginning of the year as against a healthy DM 4 billion gain in the corresponding period last year. Growth in the monetary aggregates has consistently exceeded target levels & the pace is due to accelerate as industrial activity remains extremely sluggish. In recent days, arbitrageurs (& Central Bank operations) have helped pull up the DM to the runaway SF.

We do not care to follow the advance & look to establish short positions as soon as the SF falters (see SF).

French Franc

Spot : 20.72 Dec. 77: 20.47 Mar. 78: 20.42

		May	June	July	Aug.	Sept.
Balance of Trade (mln FFr)						
Jan-Sept. 1976:	-11,839					
Jan-Sept. 1977:	-10,510	-441	-2,320	-797	-1,850	+421
*Money Supply						
M1		8.04	5.94	9.78	---	---
M2		11.30	10.05	11.20		
M3		12.90	11.80	14.08		
Net Change of Foreign Exchange Assets						
		5.69	19.0	18.80	19.59	19.52
*Retail Price Index						
		9.82	10.20	10.10	9.91	9.69
Unemployment Rate						
			5.2	5.4	5.5	5.3
Weekly Reserves (mln FFr)						
		Sept. 28	Oct. 6	Oct. 13	Oct. 20	Oct. 26
		94,422	94,611	94,662	94,704	
Euro Deposit						
1 Mo.		8 7/8	8 7/8	8 3/4	9.	9 1/4
3 Mo.		9 1/4	9 3/4	9 3/8	9 1/4	9 3/4
6 Mo.		10 3/8	10 1/8	10 1/8	10 1/4	10 1/2
12 Mo.		10 3/8	10 3/4	10 3/4	10 3/4	11.

Open Interest (Oct. 31) : 157 Average Daily Volume: 6
 Contract Size : FFR 250,000.00 (US\$ 51,500.00 Approx.)
 Minimum Fluctuation : .00005 (\$12.50) Daily Limit (Normal): .00500 (\$1,250.00)
 Margin Required : US\$ 4,000.00 Round Turn Commission: US\$ 60.00
 Trading Hours : 8:45 am - 1:10 p.m. (Chicago Time) Delivery Months : March, June, Sept. Dec.

Last months advice to hedge short FFr with a long JY or SFr has paid off handsomely.

Retain hedge; if flat, sell March '78 FFr if SFr falters below 44.70 basis December '77.

Spot : 40.19 Dec. 77: 40.37 Mar. 78: 40.62 June 78: 40.90

	May	June	July	Aug.	Sept.
Balance of Trade (Mln U.S.\$)					
Jan-Sept. 1976: + 6,632					
Jan-Sept. 1977: +10,840	640	1,490	2,050	1,150	1,690
Balance of Payment (Mln US\$)					
Jan-Sept. 1976: +2,757					
Jan-Sept. 1977: +3,738	390	699	937	300	511
Money Supply					
M1	3.80	5.10	6.20	---	---
M2	11.20	11.00	11.20	---	---
Reserves (Mln US\$)	17,250	17,390	17,630	17,770	17,870
*C.P.I.	9.27	8.52	7.88	8.55	7.61
*W.P.I.	3.35	2.61	1.08	0.78	0.50
Unemployment Rate	2.03	2.09	2.13	1.9	2.11

Open Interest (Oct. 31):	3562	Average Daily volume :	1352
Contract Size :	Yen 12,500,000.00 (Approx. U.S.\$ 51,500.00)		
Minimum Fluctuation :	.000010(\$12.50)	Daily Limit (Normal) :	.00060 (\$750.00)
Margin Required :	US\$ 3,000.00	Round Turn Commission :	\$60.00
Trading Hours :	8:45 a.m. - 1:10 pm (Chicago Time)	Delivery Months :	Mar., June, Sept. Dec.

Moved out prematurely.

Remain sidelined.

Mexican Peso

 Spot : 44.10 Dec. 77: 43.75 Mar. 78: 42.60 June 78: 41.10
 Sept. 78: 40.15 Dec. 78: 39.30 Mar. 79: 38.30

Mexican Gov't Spending - The Finance Secretariat said the Mexican government's spending deficit in the first five months of this year amounted to 5.89 bln pesos compared to 13.50 mln in Jan-May 1976. Government revenue totalled 78,01 bln pesos and spending 83.90 bln.

Balance of Payment & Trade - The Bank of Mexico said Mexico had an overall balance of payments surplus of 16.2 mln dlrs in the 2nd qtr of 1977 against a deficit of 24 mln dlrs in the 2nd qtr 1976. The banks figures showed a trade deficit of 339.5 mln dlrs with exports totalling 1.98 bln dlrs and imports 2.32 bln.

CPI & WPI - In September, retail prices rose 1.8%, the central bank in Mexico City said. The increase compares with a 2.1% rise in August and 3.4% increase in Sept. 1976 following the Government's decision to devalue the peso. The most recent rise was attributed to higher retail prices for food and household appliances and furnishings. The bank also reported that the wholesale price index rose by 0.5% from 2.8% in Aug. and 6/2% in Sept. 1976.

Forward Disc.	Dec.77	Mar. 78	June 78	Sept.78	Dec. 78	Mar. 79
Spot	9.52	10.2	11.66	10.75	10.05	9.86
Dec.77		10.51	12.11	10.97	10.17	9.96
Mar.78			14.08	11.50	10.33	10.09
June 78				9.24	8.75	9.08
Sept.78					8.46	9.22
Dec. 78						10.18

Open Interest (Oct. 31) :	2080	Average Daily Volume:	103
Contract Size :	MP 1,000,000.00 (APPROX. US.\$ 43,000.00)		
Minimum Fluctuation :	.00001(\$10.00)	Daily Limit (Normal):	.00150(\$1,500.00)
Margin Required :	US\$ 4,000.00	Round Turn Commission:	US\$ 60.00
Trading Hours :	8:45 am - 1:10 pm	Delivery Months:	March, June, Sept, Dec.

Forward discounts continue to shrink. An oil boom psychology has taken hold of speculators in spite of : a). strong reacceleration of monetary growth b). deterioration in fiscal performance & c). the meager near term prospects for extracting its fabulous energy resources.

Heavy importation of energy related equipment plus the softening trend in agricultural prices including grains, cotton & coffee bode ill for the artificially restrained trade deficit.

Longs are hoping for a repetition of the BP performance. Any such comparisons are not only childish but highly dangerous.

Remain short deferred options; be prepared to see the discount vanish but cover if spot moves above 44.30.

Spot : 44.84 Dec. 77: 45.37 Mar. 78: 45.69 June 78: 46.30
 Sept. 78: 46.98 Dec. 78: 47.41 Mar. 79: 47.15

	May	June	July	Aug.	Sept
Balance of Trade (Mln Sfr)					
Jan-Sept. 1976: -114					
Jan-Sept. 1977: -1575	-125	-146	+5.4	-615	-30
* C.P.I.	1.27	1.75	1.70	1.26	1.60
Unemployment Rate	0.40	0.30	0.30	0.30	n/a

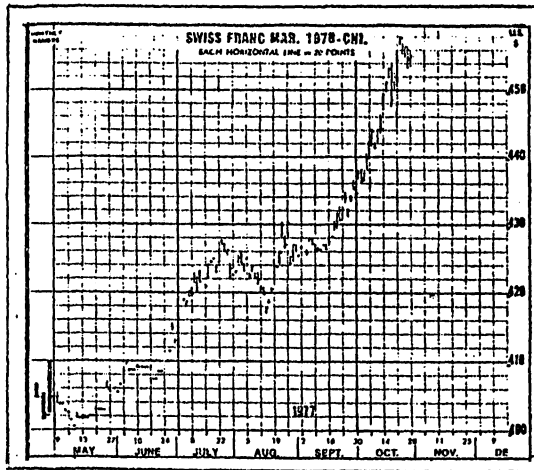
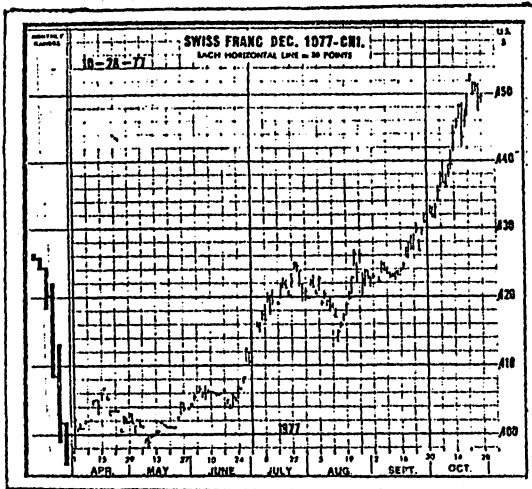
	Sept. 28	Oct. 7	Oct. 14	Oct. 20	Oct. 26
Reserves (Weekly) Mln Sfr	14,750	13,070	12,690	13,190	
Euro Deposit					
1 Mo.	2.	1 7/8	1 3/8	1 3/16	1 1/4
3 Mo.	2 5/16	2 9/16	2 3/8	2.	2.
6 Mo.	2 13/16	2 13/16	2 5/8	2 5/16	2 5/16
12 Mo.	3 3/16	3.	2 15/16	2 5/8	2 11/16

Open Interest (Oct. 31) : 3107 Average Daily Volume: 714
 Contract Size : SFR 125,000.00 (Approx. US\$ 56,500)
 Minimum Fluctuation : .0001 (\$12.50) Daily Limit (Normal): .0060 (\$750.00)
 Margin Required : US\$ 2,500.00 Round Turn Commission: US\$ 60.00
 Trading Hours : 8:45 a.m. - 1:10 p.m. Delivery Months : Mar., June, Sept., Dec.
 (Chicago Time)

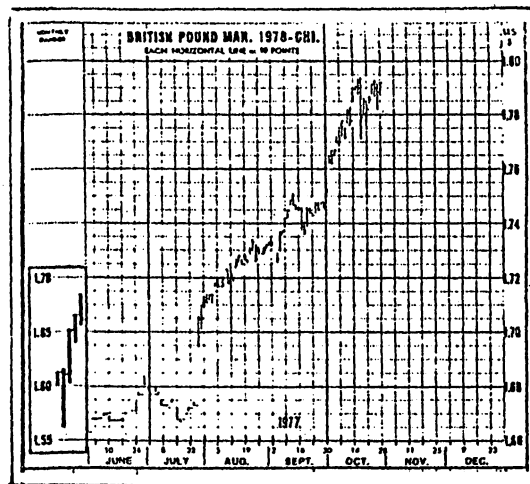
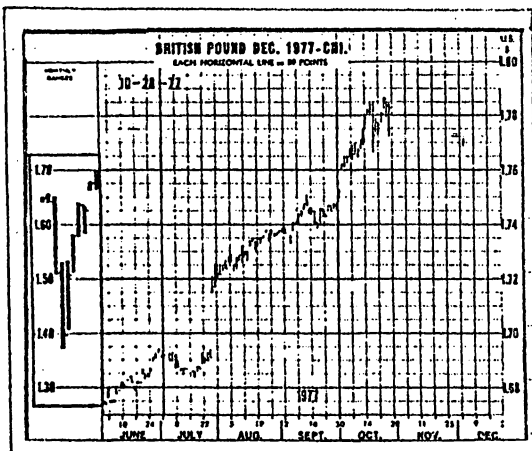
DM/SF Ratio : Spot 0.994

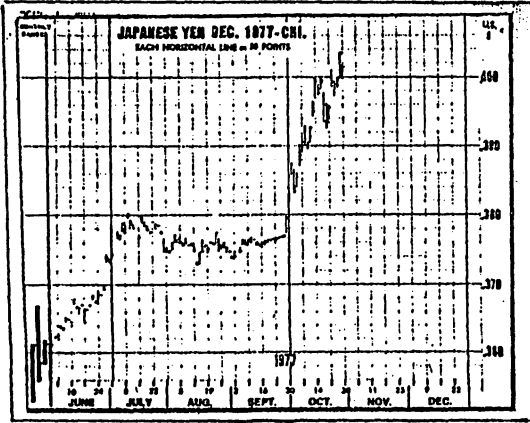
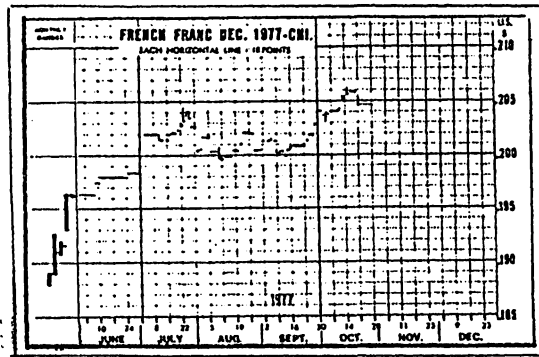
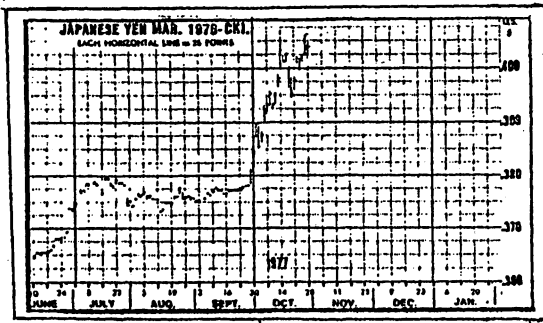
The SF is becoming dangerously overvalued. The balance of trade has already swung deeply into the red while 'hot money' inflows can only be described as highly speculative given the extreme interest rate differentials vis a vis Eurodollar deposits.

Hang on to the joyride but be prepared to liquidate long positions on a break below 44.70 basis nearby December 1977.

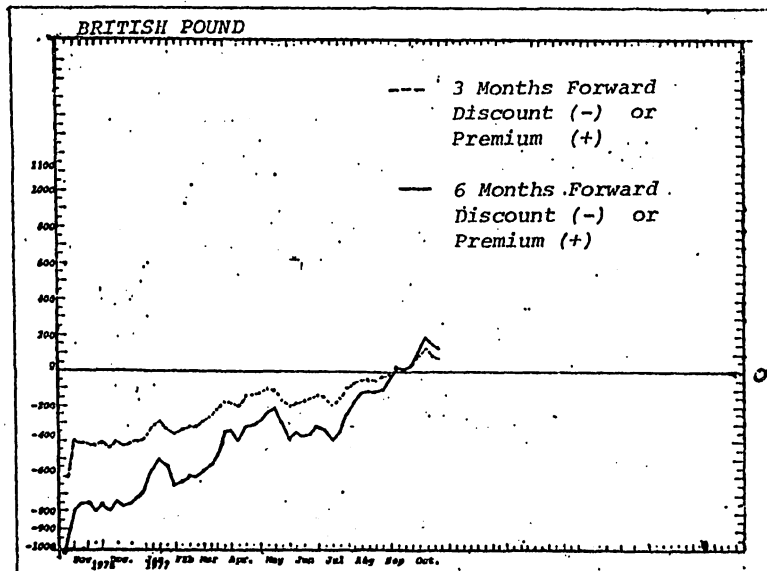
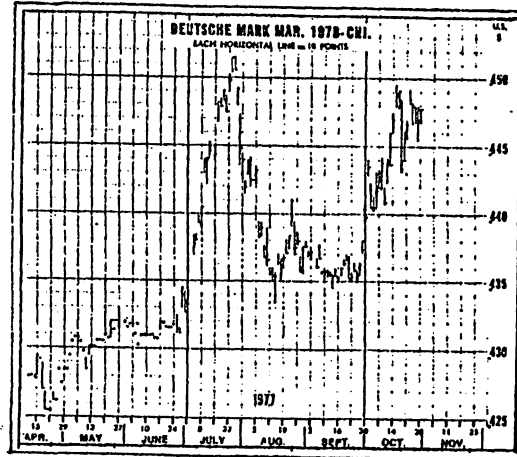
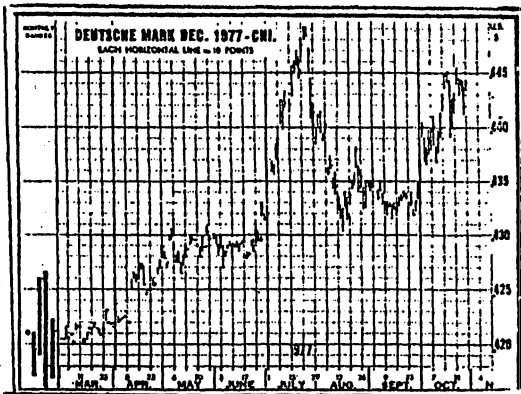


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Commodity Comments

The following is an explanation of our ranking system:

- ***** Very Bullish
- **** Bullish
- *** Bullish Neutral
- ** Neutral Bearish
- * Bearish
- * Very Bearish

Copper : A Long Term Bear Market?

November 1, 1977.

**** Dec. 77 : 54.76

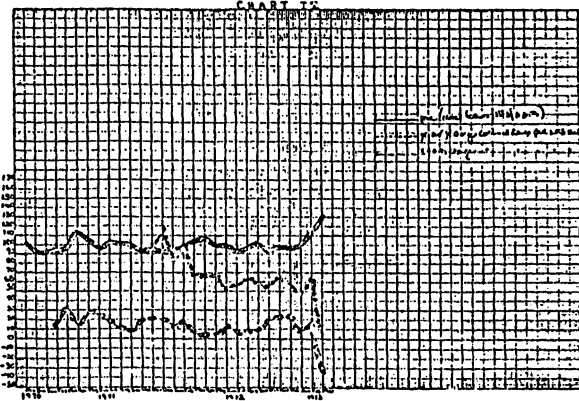
**** Mar. 78 : 56.10

Chart I presents a fascinating picture. Copper prices, in real terms, peaked out in 1967 and are now trading at the lowest levels since 1963. Furthermore, prices have become increasingly less responsive to gains in industrial production and increasingly more responsive to drops in economic activity. The inevitable conclusion is that over the past 10 years, we have required increasingly less copper per incremental unit of output. The long term picture is bleak. What about the near term prospects?



--- weighted index of industrial production of 10 industrial countries
 — price nearest futures contract in constant 1967 dollars
 ... year over year change in price nearest futures contract in constant 1967 dollars.

Chart II compares the year over year change and the month over previous 3 months' change in combined Comex and LME warehouse stocks compared to copper prices for the period 1970 -- early 1973, just prior to the onset of the great 1973 - 1974 bull move. As it can be gleaned from the chart, the bull move began and was accompanied by a drop of the sensitive month over previous 3 months' below the zero reference line. In fact, prices remained fairly stable throughout 1971 and 1972 as accretion of stocks proceeded.

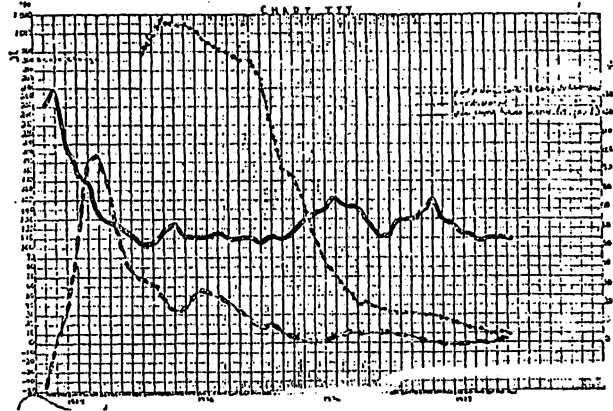


— price nearest futures contract.
 ... year over year change combined Comex plus LME stocks
 --- 3 months change combined Comex plus LME stocks

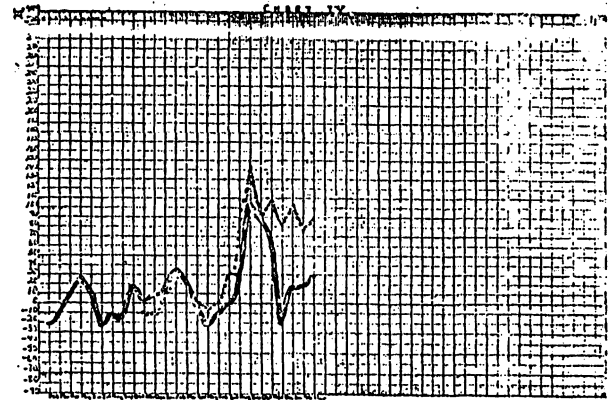
We now come to a theoretical point, and it is this: the absolute level of stocks at any one time is irrelevant. Ex post, all "surplus" copper is "sold" -- either by producers and users wishing to hold stocks at a particular price level or by a shift to investors and speculators. The latter occurs mostly as producers and users hedge their ex ante unwanted stocks on the futures market. Since all the copper has already been "sold", our only interest in trying to determine whether a) no new stocks are building up, which, ex ante, may develop selling pressure and b) whether hedge pressure is not continuing on already existing and unhedged stocks, i.e., those held willingly by the Trade at that particular price level.

To determine a), we analyze the rate of change of combined stocks similar to the exercise carried out in Chart II. The accompanying Chart III reveals that while we are approaching a sort of equilibrium, we have, as yet, not arrived at the 'take off' stage. In trying to determine b), we assume that the rate of change of the open interest will provide us with some clues as to whether hedge selling persists (on an aggregate basis) or is lifting. A decline in open interest may mean that the 'sold' or hedged copper is being repurchased by a more optimistic Trade. Unfortunately, LME open interest figures are unavailable as it does not follow a Clearing House system. Chart IV depicts the year over year and the month over previous 3 months' change in the Comex open interest for the 1971--early 1973 period. While in this case, the year over year change in open interest does not fall below the zero reference line, its rate of increase decelerates rather sharply just prior to the bull move. In our opinion, speculative short selling masked a net lifting of trade hedges and thus obscured a most important observation. In Chart V, covering the present period, we note that hedge selling is no longer a predominant force. On a year over year basis, a certain amount of hedge lifting has already developed; on the more sensitive month over previous 3 months' change, a slightly unfavourable reversal has just taken place.

We conclude that: a) Copper is in a long term bear market; b) a semblance of equilibrium has been achieved, but



— price nearest futures contract
... year over year change combined Comex plus LME stocks
--- 3 months' change combined Comex plus LME stocks.



— 3 month change Comex open interest
... year over year change Comex open interest



— 3 month change Comex open interest
... year over year change Comex open interest

c) we have not as yet reached the take-off point.

Remain sidelined (after having stopped out longs at 5500 basis December 77).
Keep in close contact as the above figures will be monitored rather closely.

* The sensitive month over previous 3 months' change, however, drops rather sharply below the zero reference line. Obviously, the Trade was aggressively repurchasing its hedged positions.

Cocoa

***** December 1977 : 181.70

***** March 1978 : 158.20

The bearish case for cocoa is just too pat. The argument runs as follows: world production will increase by approximately 8% while consumption will decrease by up to 10% making for a surplus of over 100,000 tons. These projections translate into a \$1.00 to \$1.20 a pound level based on the March and May contracts.

Since reports coming from West Africa, at this moment, are highly tentative, we are not in a position to quarrel with the production figures. Suffice it to say that early returns from Ghana's Main Crop are not in as yet in spite of the official commencement of the season on October 14th. Heavy rain may have delayed and perhaps may even have damaged the arrival of beans. Also, whereas a great deal of hope had been pinned on a higher Ivory Coast crop, the official forecast for the 1977-1978 crop is now being put at 225,000 tons, 2,000 tons less than the 1976-77 figures. Prices being asked for origins reflect the possibility that all is not well with current crops -- as an example, Ghana has recently been asking for \$1.85 a pound for January-March delivery, Nigeria has rejected bids for December-February Cocoa at slightly under \$1.82 per pound and Brazil recently sold 15,000 bags overseas at about \$2.00 a pound for November.

On the demand side, the greatest imponderable is the Eastern European Bloc and the USSR. For the past two years they have sharply reduced the importation of Cocoa beans in an effort to save precious foreign exchange and, at the same time, influence a lower market. USSR grindings have recently been put at just 85,000 tons for 1976-77 which is anywhere between 55 and 65 thousand tons lower than the average of the previous few years and the lowest since 1967. Given that a) prices have remained extremely high despite a sizeable drop in Eastern European consumption; b) sharp discounts are available for forward delivery; and c) chocolate has become a symbol of a high standard of living, particularly for undeveloped and socialist countries, it would not be hard to imagine an actual increase in Eastern European and Russian buying for the 1977-78 crop year. Looking at the U.S.A., third-quarter grinding figures showed a sharp 25.6% drop from the corresponding period in 1976. Our calculations, based on imports of Cocoa beans and products, indicate that usage may not have dropped nearly as much. Following are the figures for U.S. imports of Cocoa and chocolate products during September as given by the Census Bureau:

U.S. SEPTEMBER COCOA-CHOCOLATE PRODUCT IMPORTS (in pounds)

	<u>COCOA BEANS</u>	<u>COCOA BUTTER</u>
Sept. 77	13,937,002	2,975,152
Aug. 77	24,187,388	3,290,571
Sept. 76	44,007,136	4,218,513
Jan.-Sept. 77	344,567,817	31,173,158
Jan.-Sept. 76	446,021,760	40,787,619

	<u>UNSWEETENED CHOCOLATE</u>	<u>UNSWEETENED COCOA</u>
Sept. 77	9,371,637	12,539,267
Aug. 77	7,722,163	8,663,661
Sept. 76	6,535,234	15,613,698
Jan.-Sept. 77	52,927,323	122,678,267
Jan.-Sept. 76	34,573,904	124,420,308

Converting the above product figures into Cocoa bean equivalents, shows an approximate drop of 66 million pounds from last year's 860 million pound total, or roughly 7.7%. The U.K. grind was down just 8.4% for the third-

quarter of 1976 and the West German grind was down only .9%, both of these figures well below expectations.

In sum, there is a strong probability or at least a strong possibility, that 1977-78 Cocoa consumption may not show any substantial fall-off and, in fact, may even better 1976-77 when considering that the Eastern European bloc (including the USSR) will try to make up for lost ground. We feel that the ICCO's recent forecast of a 33,000 ton deficit for 1977-78 will turn out to be much closer to the actual outcome than popular forecasts of a 100,000 ton plus surplus.

Technically, the major December uptrend line has held well in spite of increased bearish pronouncements while switches have widened enormously, a thorn in the bearish case. Speculators have built up very large short positions, particularly in the distant contracts with a conviction that once near term supplies are relieved the market will collapse. Since nearby supplies are still trading at fancy premiums over terminal values, the selling of distant months based on flimsy production expectations can only be called reckless.

Buy March 1978 at market; place protective stop at 145 close only. Look for a sharp upmove of anywhere between 20 and 60 cents a pound over the next 8-12 weeks.

Coffee

* N.Y. December : 180.43
* N.Y. March : 148.63
* Ldn. January : £1,737

On Halloween eve, the U.S. general accounting office, the investigative accounting arm of Congress, issued a report commissioned last spring which states that government actions in producer nations viz. Brazil's "understating" of supplies by 5.1 million bags between March 76 and January 77 (see March's Comments), and Brazil's purchase of coffee from other exporters in excess of its needs, were instrumental in causing higher prices. The latest round of trick-or-treating follows.

The IBC announced in early October that the support price paid to farmers would be raised to 2,500 Cruzeiros (roughly \$100.00) per bag from 2,000 Cruzeiros and that the export quota was raised to \$220.00 per bag from \$160.00 for delivery through December. Cold sales, i.e., sales registered, but without buyers, were suspended as of October 14th, and all sales from Trieste and Hong Kong have been cancelled. In addition, Interbras, the trading arm of the IBC, shipped home the Robustas coffee it purchased last month in London. All of this was done for the stated purpose of improving what IBC Prez Calazans refers to as an inadequate supply situation. Let us not confuse farce with drama. Before suspending our healthy sense of disbelief we refer you to the usually authoritative newspaper O Estado De Sao Paulo whose headline October 25th read "IBC Confirms Special Contracts With Importers" ... i.e., under the official minima of \$3.20 a pound.

At the same time Brazil shipped its Robustas coffee other mild producers Costa Rica, Dominican Republic, El Salvador, Ecuador, Guatemala, Honduras, Mexico, Nicaragua, Panama and Venezuela got in on the act by suspending sales altogether.

The effects of all this bluffing are best exemplified by action in the physicals market where Colombian beans, now virtually the only ones being traded, were offered at \$2.00 for November shipment; up almost .20¢. But bids ranged only as high as \$1.85. Obviously roasters remained reluctant buyers; on a hand-to-mouth basis only.

With consumption roughly 28% below last year the demand side of the equation will continue to render all attempts by producers to bolster prices ineffectual.

U.S. SEPTEMBER COFFEE IMPORTS (in pounds)

	<u>CRUDE</u>	<u>ROASTED</u>
Sept. 77	89,695,758	3,030,809
Aug. 77	91,935,673	3,021,192
Sept. 76	126,508,528	3,007,814
Jan.-Sept.77	1,567,923,957	40,216,944
Jan.-Sept.66	2,019,596,814	30,769,311

SOLUBLE COFFEE IMPORTS (in pounds)

	<u>U.S. TOTAL</u>	<u>FROM BRAZIL</u>
Sept. 77	2,595,175	1,782,348
Aug. 77	2,767,190	1,756,745
Sept. 76	5,225,675	4,778,283
Jan.-Sept.77	52,354,342	34,949,897
Jan.-Sept.76	52,591,444	40,067,356

Add to previously established short positions by selling March contract in N.Y.

Cotton

*** December : 50.64
*** March : 51.53

The USDA's October estimate of U.S. supply called for production of 13.32 million bales. This compares with actual production of 10.56 million bales last year and its September estimate of 13.20 million. On the world front the ICAC now projects this season's production at 64.4 million bales vs. 58.2 million last year.

The really bleak news has concerned demand. September's data shows a daily rate of usage of only 23,943 bales vs. August's already paltry 24,687 bales. Despite a cash price more competitive than last year by roughly 25¢ per pound or 33%, cumulative consumption through the first two months of 1977-78 trailed last year's pace by 58,049 bales or 5%. In addition, export sales, which started off with such a flourish, have not only slowed to a crawl, but declined as several foreign purchasers reneged on their intentions.

All the above combined were surely responsible for pushing prices below the critical 51.90 support level basis December. However, before recommending a short position we note a single bright light on an otherwise dismal stage: i.e., the 6.8% boost in constant dollar expenditures for clothing and footwear during the third-quarter.

All told, we believe cotton is attractive by virtue of its being so cheap. However, we would recommend resisting temptation until prices closed firmly above 51.90 and then placing protective stops at that level.

Interest Rate Futures

**** December 1977 GNMA : 97.01
**** June 1978 T Bill : 93.02

Our mid-month Special Bulletin noted the very large drop in Federal Reserve Bank Credit that had occurred for the week ended October 12, 1977, and we remarked that the Fed may have finally found the proper Funds level. The most recent Federal Reserve Bank of St. Louis publication, however, does not support the above interpretation as it shows Adjusted Federal Reserve Credit still expanding at an unhealthy pace of 11.9% per annum. Portfolio operations, commonly called Open Market operations or presently being negated by member bank borrowings at Federal Reserve Banks, still running at a hefty 1.5 billion dollars. The increase in the Discount Rate to 6% was a timid move on the part of the Fed to plug this hole and was no doubt influenced by recent

White House criticism and the continuing exodus of member banks from the Federal Reserve system. Short of penalizing borrowings from the Discount Window with extremely high rates, the Fed may attempt some moral suasion on its member banks and/or aggressive selling of Bills and other securities. This may have just been the case yesterday when the Fed took the unusual step of selling Bills for its own account during a refunding operation. In sum, the monetary aggregates are still basically out of control.

On the demand side, total loans by the banking system continue to increase at a fast clip with September showing an annualized gain of 14.3%. To accommodate the growing credit demands the banking system has been liquidating securities. This process accelerated during September which showed an annualized drop in the holdings of securities of slightly over 4%. Holdings of CD's by Commercial Banks have continued to increase in the most recent four weeks and indicate a growing need for liability management on the part of the large New York and Chicago banks.

The economic expansion is proceeding faster than what most observers are willing to concede, but still under the torrid pace of the early part of 1977. We remain convinced that the economy will continue to expand and that credit demand, when added to enormous treasury and federal agency borrowing, will outstrip loanable supplies and cause interest rates to move higher. The short June 1978 Treasury Bill position was covered as per our mid-month bulletin, while a light purchase program in December 1977 of GNMA's was commenced at the 97.06 level. In view of the above comments, however, we prefer to flatten out old positions and remain sidelined.

Orange Juice

***** November : 126.65
***** January : 125.85
***** March : 124.35

Most significant developments since our special bulletin of October 17th have been a) prices are now 14¢ higher basis March and b) Minute Maid's raising card prices yesterday by 20¢ per dozen 6-ounce cans and by 36¢ per case of 12 1-quart containers of chilled juice on the east coast and 30¢ on the west coast and in the mid-west. Both were predicted. This bull market is still very much intact.

Movement continued to perform at a hot 3.4 million gallon clip last week. The trend of especially strong bulk movement continued and we expect any resistance to retail movement to be assuaged by this sector.

Two interesting notes on supply: a) the forecasting firm that predicted last January's big freeze (WSC of Bedford, Mass.) says the odds of a freeze this year are better than last year and b) the Florida citrus industry announced it would exert its full (and considerable) influence in Washington to prevent any foreign grown citrus from entering the U.S. duty free. Bullish.

Latest available data indicates increasing participation on the long side by the trade and increasing participation on the short side by the public. It is doubtful the former would be sellers before the threat of another freeze is assuredly passed.

Remain firmly long, adding on dips. Raise stops to 112.00 basis January.

Precious Metals

**** December 1977 Comex Gold : 163.70
***** January 1978 Platinum : 173.20
***** March 1978 Palladium : 47.00

Interest in gold has reached hysteric proportions in recent weeks. Speculative long positions on Comex and the IMM have built up to record levels and represent an increase of no less than 3 million ounces over the past eight weeks. Aside from the futures market, the speculative public has had to absorb an enormous supply of physical gold. Recent reports confirm the sale of some 1½ million ounces of gold earlier this year by Portugal and, despite rumours to the contrary, South Africa has not withheld gold for the past four months as its holdings have remained vitually unchanged at 286 million rand. Assuming

that OPEC Central Banks are not hiding their gold portion of monetary reserves, we must conclude that a very large amount of bullion and forward commitments have been absorbed by speculators encouraged by the spectacular weakness of the U.S. dollar. It should be noted that on a relative strength basis gold prices have begun to decline vis a vis the strongest European currencies and the Japanese Yen; i.e., in Swiss Francs or Japanese Yen gold prices are actually down over the past three weeks. This weakness has not yet hit the speculative longs, but might trigger, at any time, a heavy bout of liquidation. As suggested in our September Comments trading long positions should be out of this market on the run up to \$160. per ounce. Remain sidelined.

After briefly touching parity with gold, Platinum prices raced ahead and now have, once again, reestablished a small premium. Enthusiasm for platinum has been caused by renewed racial unrest in South Africa, a weak U.S. dollar, a slight drop in expected Canadian supplies as a result of INCO's closures and the common sense view that platinum prices are very depressed in real terms, as outlined in these Comments just a few months ago. Recent Bureau of Mines figures for the second-quarter of 1977 show a 22% drop in platinum sales to consuming industries in the United States and an 18% drop in palladium sales against the corresponding period in 1976. Stocks of platinum dipped to 475,610 ounces from 512,000 at the end of the first quarter of 1977, but were up substantially over the 420,464 ounces shown on June 30th, 1976. Stocks of palladium increased to 391,914 ounces and were up over 100,000 ounces over last year's level. As of last week, warehouse stocks at the New York Mercantile Exchange amounted to 145,200 ounces, a 26,000 ounce drop from the July 1st levels. It can be assumed that a large part of the 984 deliveries made against the expired October '77 contract has been withdrawn and this may indicate a pick up in industrial demand. Warehouse stocks of palladium stand at 22,200 ounces, approximately 10,000 ounces lower than on July 1st, 1977.

The recent run up in platinum prices has little fundamental support and should find increasing resistance at the 172-176 level basis January '78. Nevertheless, given its extremely low price, in real terms, we continue to prefer platinum and palladium over gold and silver and recommend keeping at least a small long exposure in these two markets.

Sugar

* March 1978 : 8.60

On October 25th, F.O. Licht raised 1976-77 initial stocks to 20,567 million tons compared with 20,441 million tons in its second estimate. Licht put final stocks at 25,460 million tons, up from 23,330 million tons in its earlier estimates. Production was forecast at 88,256 million tons from 86,077 million tons and consumption at 83,070 million tons compared with 82,961 million tons in its earlier estimates. Principally responsible for the upward revisions were larger than expected increases in Brazilian and Cuban output and slower than expected offtake.

Given the present harvest in some areas and growing conditions in others, outturn for 1977-78 should surpass the previous season while demand may not, once again, increase by more than a million tons, given powerful inroads made by corn sweeteners and the artificially high sugar prices being maintained in many countries. It is our contention that final stocks for the 1977-78 season will exceed 30 million tons or roughly 35.7% of annual consumption. This overhang will become unmanageable even with the recent ISA agreement. Cheating by the poorest members of the cartel will lead to heavy dumping.

The artificially high price level built into the 1978 contracts make it an ideal and almost riskless short sale. We expect March 1978 to trade down to at least 7¢ per pound. Should the U.S. impose restrictive import quotas or should the I.S.A. agreement break up, we have no doubt the March 1978 will trade down to as low as 5¢ per pound. Remain firmly short.

Wood Complex

**** January Lumber : 180.60
**** January Plywood : 191.10

September's housing starts figures are as follows: construction during the month was started at a seasonally adjusted 2,040,000 annual rate versus

August's revised 2,034,000 clip. Starts of single family homes ran at 1,492,000 units, up 2% from August, while multi-family housing fell 4.6% to 548,000 units. Permits, the indicators of future construction, fell 7% to a seasonally adjusted annual rate of 1,696,000 units.

Most noteworthy is the decline in the issuance of permits. The recent rise in interest rates caused the flow of savings into federally insured savings and loan associations to reach the lowest level of the year during September. The excess of new deposits over withdrawals was \$1.65 billion, down 37% from August's admittedly large \$2.63 billion. Commitments to make home loans in the future declined to \$21.39 billion from \$21.67 billion in August. Obviously builders must fear a pinch.

Our technical indicators, however, do not reflect this somewhat longer term pessimism, leaving us to conclude that while the overall bias of the wood markets is to the downside, they may be traded the other way over the short term.

Buy January Lumber and Plywood at present levels, placing protective stops at 175.00 and 184.00 respectively. Look to sell on a \$10 - \$15 rally.

FRIEDBERG COMMODITY INDEX

SEPTEMBER 1977 : 198.20
OCTOBER 1977 : 207.85
NET CHANGE : +4.87%

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

Albert D. Friedberg

David B. Rothberg