

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

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THE PRICE OF GOLD AND ITS ECONOMIC CONSEQUENCES

Feb. 4th, 1980

The insane speculative bubble came to an end in the late morning hours of January 21st. Having reached the incredible price of \$875/oz, spot gold prices began to recede on lack of fresh buying and closed the session on a rather weak note, albeit slightly up on the day. Sensing a faltering market, Far Eastern traders lost no time and began a massive liquidation that spread across space and time. First London, and then New York, witnessed the single most dramatic one-day fluctuation in bullion prices: a net decline of \$144/oz. While financial commentators rushed to label it 'profit-taking', more astute observers knew and understood the meaning of this drop. In technical jargon, a weekly downside reversal had put an end to the great 1976-1980 Gold Bull Market. By the following Friday, the weekly precondition had been fulfilled and a Bear Market of indeterminate time and magnitude was about to take place.

True, the Afghanistan situation was in no better shape. The Russian troops were still only a few hundred miles away from the Gulf and its strategic oil fields. But, by the same token, the Soviets were far from being able to consolidate their territorial gains very easily, had stirred up an enormous unrest in the populous, although admittedly ill-organized and ill-equipped, Islamic World and had challenged the timid U.S. Administration to be called on their bluff. Not the most propitious scenario for a new expansionary drive.

True, the Iran hostage crisis was still not resolved and a potential civil war could erupt any time, shutting off whatever oil was still being exported by the Government of Teheran. But, by the same token, and in spite of the growing unrest, a democratic election was taking place, a sign that some modicum of order and consensus was still ruling in the land. Furthermore, in view of America's reluctance to act forcefully, one could predict the possibility of an ignominious but peaceful settlement of the hostage situation.

The parabolic configuration of the advance - a result of the frantic public participation and the bloodbath taken by veteran and seasoned professionals while covering short positions - was a sign of an important top.

The dust having settled, it behooves us to ask how far down and how much further.

Let us first begin by demonstrating the absurdity of \$650/oz gold (let alone \$875/oz or the mystical \$1000/oz). The adjoining table is instructive in this respect:

Comparative Statistics

	<u>1914</u>	<u>1975</u>	<u>1979</u>	<u>1980*</u>
Gold (\$/oz)	20.67	160.69	190.53	650 (e)
% Inc. from 1914		778.7%	921.7%	3145.0%
W.P.I. (1967=100)	35.2	174.83	234.06	242.25 (e)
% Inc. from 1914		496.68%	664.94%	688.21%
Earnings of U.S. employees	\$639	10,847	14,120	14,473 (e)
% Inc. from 1914		1697 %	2210 %	2264 %

* First quarter.

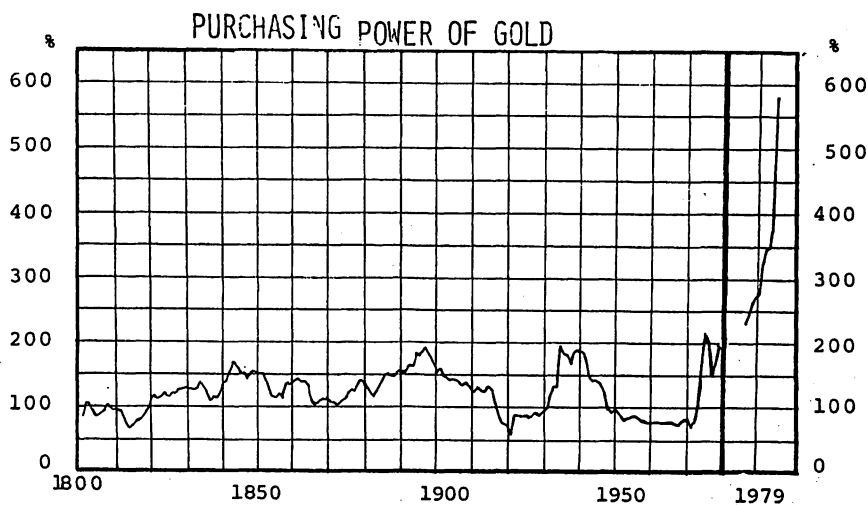
Sources : 1914-1970 from Historical Statistic of The U.S.
1970-1979 from International Financial Statistics.

Prepared by our staff.

We have taken 1914 as the starting base for comparison for the following reasons: a) it marked the end of the worldwide gold standard and, as such, indicated a slight gold overvaluation, b) furthermore, it was the eve of the first WW inflation, an inflation that cheapened gold substantially, then fixed at \$20.67/oz; c) as further proof that 1914 marked the high of gold, in real terms, one should note that gold production, in the ensuing 8 years, dropped as much as 30% from its 1913/1914 peak.

As it can be seen, despite its high starting point, gold has far outpaced either the advance of U.S. wholesale prices or, even more surprising, the nominal rise of salaries and wages in the U.S. Based on the latter, gold would have to be trading at approximately \$475/oz.

A longer term view of gold's present overvaluation can be gleaned from the accompanying chart. The graph, originally presented by Dr. Roy W. Jastram in the Golden Constant, has been updated to reflect the average price of gold prevailing during January 1980. Whereas for almost 2 centuries, gold's purchasing power (price divided by wholesale prices) never exceeded 200 (double the purchasing power ruling in the year 1800), at the present, gold is nearing 600, that is, 6 times the purchasing power it commanded one hundred eighty years ago!



Yearly figures for 1800-1978

Monthly figures for 1979 (Apr. 79-Jan. 80)

Sources: The Golden Constant by Roy W. Jastram
Updated by our staff

In his superbly detailed study, Dr. Jastram discusses a curious phenomenon which he calls the "Retrieval Phenomenon". In his words, "... the commodity price level may move away higher or lower, but it tends to return repeatedly to the level of gold the amazing aspect of this conclusion is that this is not because gold eventually moves toward commodity prices but because commodity prices return to gold." The period covered by Dr. Jastram, however, had two distinguishing characteristics: a) a monetary system tied to gold, in which a loss of official gold forced an automatic contraction and, conversely, a gain in official gold forced an automatic expansion and b) by necessity, a relatively fixed price of gold, making our yardstick highly sensitive to deflations/inflations. Both conditions can be said to have existed prior to 1971, although, admittedly, the post-WW II monetary system was only tenuously linked to gold. From 1971 to the present, however, the discipline of gold no longer was effective. One may legitimately ask whether the so-called 'Retrieval Phenomenon' would still be operative. If the answer is positive, would commodities 'chase' gold, as the sugar bulls contend, or would gold obligingly drop in value to meet the present level of wholesale prices.

Before we proceed, it should be noted that despite its attempted de-monetization, gold remains the single largest component of international reserves, amounting to well over 65% of the total. As such it will begin to play a rather important role in the economic policies of countries enjoying this golden 'windfall'. To be more specific we have selected a very substantial group of countries classed by the IMF as Other Less developed, and analyzed their collective international trade balance vis à vis their international reserves, taking gold at market values prevailing at end December 1979 (\$524/oz):

Other Less Devel. Areas :

	<u>Total Reserves</u> <u>(Gold at Market Value)</u> (Mln of U.S. \$)	<u>Balance of Trade</u> (Mln of U.S. \$)	<u>Reserves/</u> <u>Balance of Trade</u>
1952	7,324	-4,100	1.7863
1960	6,639	-5,040	1.3173
1970	13,896	-10,150	1.3690
1975	35,769.99	-44,596	0.8021
1979	104,445.4	-44,918 e	2.325

Source: International Financial Statistics

Clearly, this selected group of 'citizens' comprising no less than 85 countries and including such giants as Argentina, Brazil, Mexico, Taiwan, Korea, is, collectively, in a substantially more comfortable position today than at any time in the past 30 years. Since external constraints on growth policies are not particularly serious it follows that: a) their spending policies will continue to exert inflationary pressures on a world scale and b) their main exports, primary raw materials, will not be necessarily dumped on world markets to obtain foreign exchange.

A narrower focus on a select group of countries supports the view that gold may become an extremely useful reserve asset in months and years to come

	<u>Brazil</u> (MLN US\$)	<u>Mexico</u> (MLN US\$)	<u>Turkey</u> (MLN US\$)	<u>Canada</u> (MLN US\$)
Int'l Currency Reserves	9,720.77	1,933	900.5	2,933
Gold (At Market Value)	1,112.51	1,306	2,577	15,181
Total Reserves	10,833.28	3,239	3,477.5	18,114
Current Account (1979)	-9,000	-3,400	-1,350	-6,000
Total Reserves/Current Acct. 1.20		.95	2.57	3.0

Source: International Financial Statistics.

Prepared by our Staff.

Using gold as an international life belt implies also a potential overhang of gold supplies so long as its price remains high in real terms. A particularly noteworthy example is Canada who has expressed a strong interest in disposing of at least one million ounces at current levels 'so as to obtain diversification into earning assets'. Bull markets, by necessity in expansionary phases of economic activity, have a tendency to absorb almost unlimited amounts of supply. Bear markets, on the other hand, do not take to excess supplies very kindly and some indigestion problems may appear.

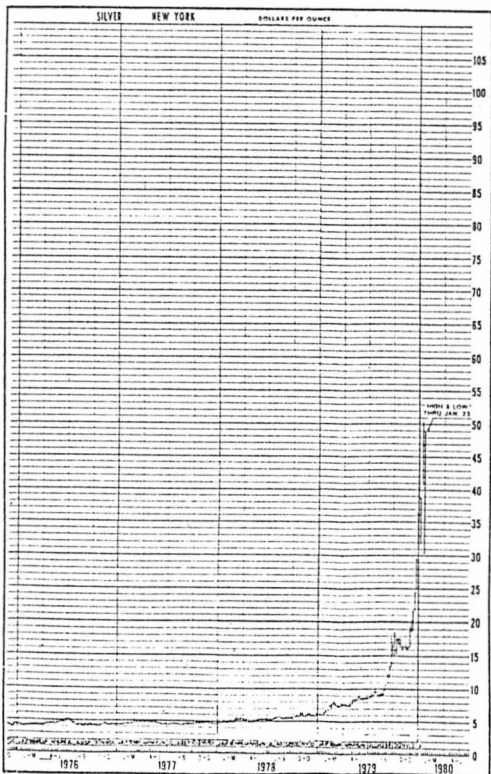
In all, a Retrieval Phenomenon of some sort is certain to take place. Given gold's extremely high relative price, one could argue that gold and wholesale prices are likely to meet somewhere in the middle. Certainly, it would be difficult to foresee a near term rise in wholesale prices of 580%. Furthermore, the active use of gold as an international asset would tend to put some gentle downward pressure (in real terms if not in nominal terms) in months and years to come.

Technically the \$560-600/oz level should act as an excellent near term support for the following reasons: 1) the first major selling wave terminated at that level finding solid support and 2) \$560 represents a 2/3 retracement of the November/January advance. Once the lower end of this range is attained, gold will do either of the following: a) form a bullish but rather boring high level base for a considerable period of time, perhaps as much as 3 years or b) sink quickly and decisively below \$560/oz and perhaps retrace 50% to 66% of the entire 1976-1980 advance, taking it to as low as \$ 360/oz.

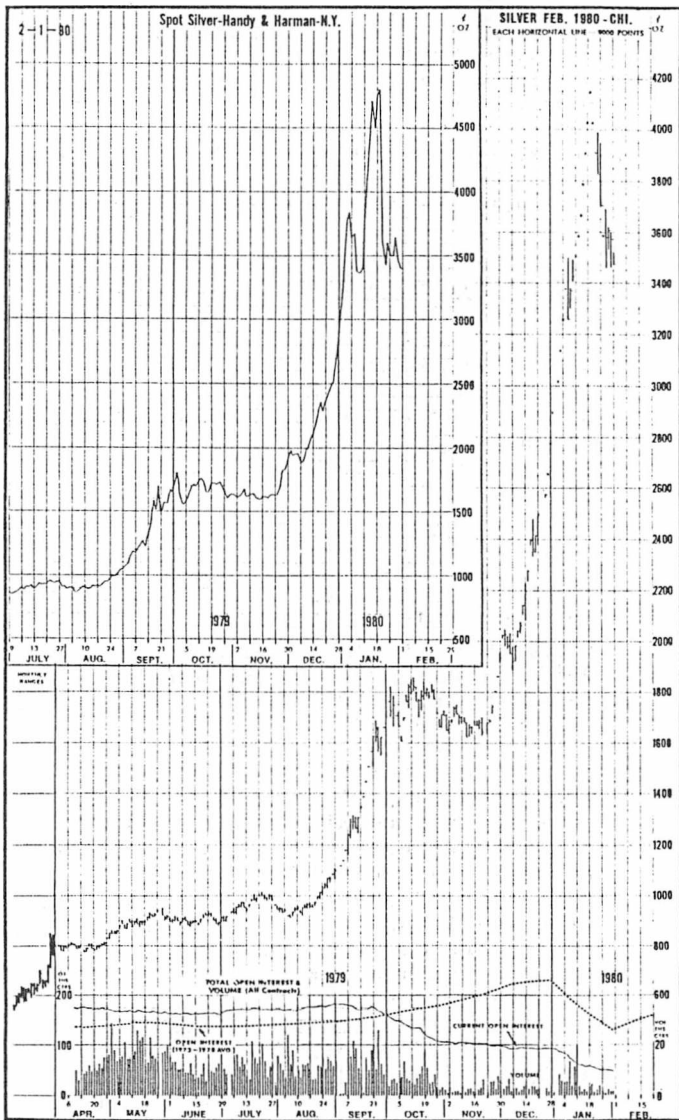
On either count, speculative long positions are not warranted, particularly in view of the holding cost of gold now exceeding \$10/oz per month!



SILVER



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Silver

A major top has been formed in the manner described in our last issue, i.e. a weekly downside reversal.

The sorrowful closure of the market to new positions has been the work of sore professional losers, suffering devastating variation margin calls. By the same token, it was their desperate short covering that 'blew the top off' this market.

Well financed speculators would be well advised to establish short positions at these levels, risking the 41.00 mark basis Spot. Note: at the present time, only the CBOT permits new positions in the April '80 and forward positions.

Alternatively, well financed spreaders (require about \$460,000 per spread) may sell 5 contracts of June Chicago Silver at 3500 and buy 13 March Chicago Gold at 670. The present gold/silver ratio of 20-1 should widen to at least 30-1 with each point representing approximately \$45,000 profit.

PLATINUM

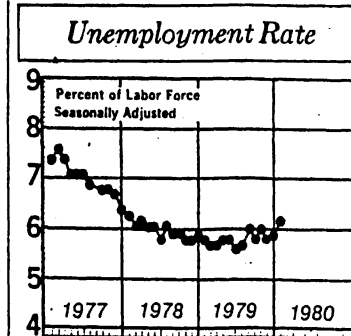
Remain sidelined.

INTEREST RATES FUTURES

Our well thought-out recessionary scenario (see January issue) did not anticipate a belated recognition of real yields on the part of the bond market.

Our conviction of a moderately severe recession grows stronger in inverse proportion to the timid and almost apologetic consensus forecast of a mild recession. As the stimulus of unanticipated accelerated inflation wears off, the U.S. economy will fall back to a low, stagnating and sub-optimal level of economic activity.

The accompanying chart is quite expressive. Technicians



The Wall Street Journal

will recognize it as a superb 'saucer bottom', spelling sharply higher unemployment. Employment figures also speak of a momentum coming to a screeching halt: the economy generated 3.4 million new jobs in 1977, 2.9 million in 1978 and only 1.9 million in 1979. The very important adult male jobless rate (not a male chauvinist remark!) climbed dramatically from 4.2% in December to 4.7% in January. Admittedly auto layoffs are principally responsible for this rise. The loss of purchasing power of one sector, however, can have wide spreading effect on the overall economy.

While credit demands continue at a high pace, it is quite likely that they are related to maintaining excessive inventories (still rising versus stagnant real sales), ambitious expansion plans and some merger activity. If so, they will begin to moderate in the months ahead.

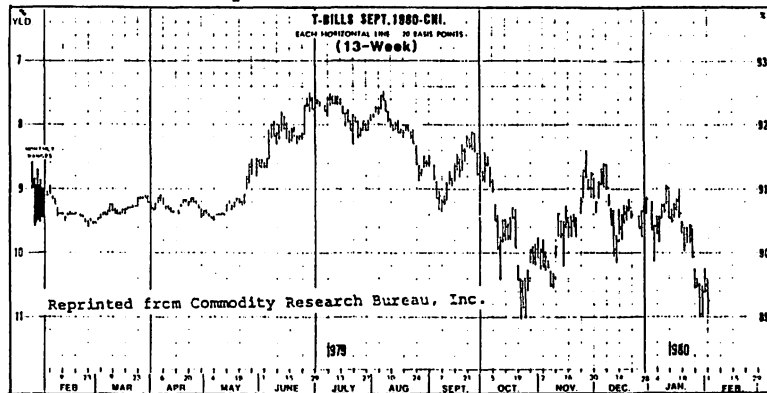
At the present time, there are no external constraints on the U.S. economy as the U.S. dollar has continued to firm vis à vis its main trading partners. As a result, and, in view of experimental games being played by the Fed in re-defining & controlling aggregates, we do not foresee a drastic upward change in administered rates.

Interest Rates Futures ...

September T-Bills may become a buy if and when they approach the 88.00 level. Scale down purchase, starting at 88.50, should prove rewarding.

GNMA	Settle	Yield	Treasury Bonds	Treasury Bills		
Mar.	73-02	12.482	Mar. 73-01	11.465	Mar. 88.01	11.99
Jun.	72-27	12.528	Jun. 73-21	11.362	Jun. 88.62	11.38
Sept.	73-08	12.442	Sept. 74-12	11.246	Sept. 89.33	10.67
Dec.	73-27	12.319	Dec. 74-30	11.156	Dec. 89.78	10.22
Mar'81	74-10	12.222	Mar'81 75-11	11.092	Mar'81 90.04	9.96
Jun.	74-14	12.196	Jun 75-16	11.067	Jun. 90.10	9.90
Sept.	74-09	12.229	Sept. 75-14	11.077	Sept. 90.15	9.85
Dec.	74-04	12.261	Dec. 75-12	11.087	Dec. 90.19	9.81
Mar'82	74-00	12.286	Mar'82 75-10	11.097		
Jun.	73-28	12.312	Jun. 75-08	11.106		
Sept.	73-24	12.338	Sept. 75-06	11.116		

As of Feb. 4, 1980



THE RISE (of the British Pound) AND THE FALL (of the Deutsche Mark).

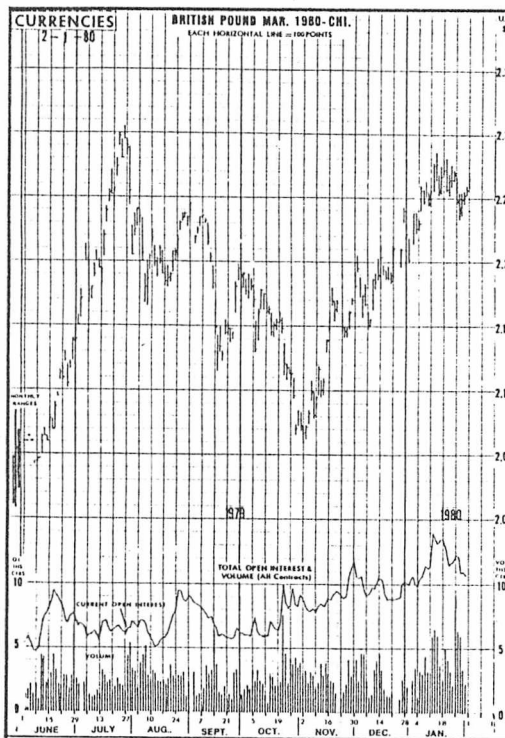
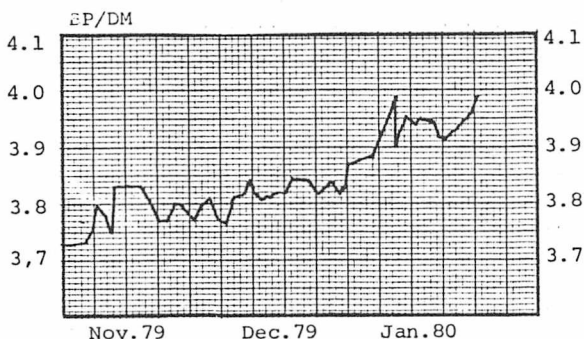
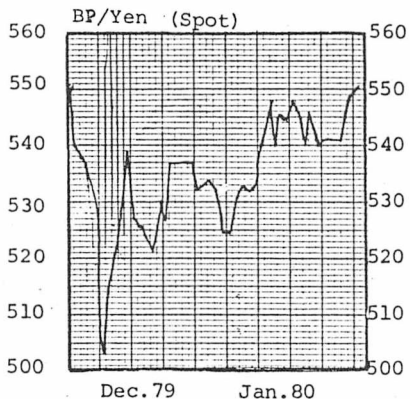
Rarely, if ever, are economic events perceived as they really are by participants. Perhaps, economists and finance experts, like generals, are always fighting the last war. Perhaps, reality is too bitter to swallow and too unpopular to divulge. Be that as it may, Otto Poehl, newly-elected President of the Bundesbank, gave us a living proof of the above stated truism. He discusses the 'Mark's role as the world's second investment and reserve currency and concludes that it should be accepted as a fact of life because W. Germany dislikes and always will oppose capital controls. Mr. Poehl does not, as yet, sense a major shift from the DM to Sterling. He conveniently ignores Germany's first current account deficit in 15 years, this time just DM 9 billion and a prospective current account deficit of DM 20 billion for 1980. A structuralist argument is being espoused: ballooning oil imports, especially now that the DM has not risen to offset the rise in dollar prices! But why did it rise sufficiently to offset the quadrupling of prices in 1973-74 and why hasn't it risen now? Isn't possible that Germans have 'grown fat', that monetary policy has been too lax? The sharp fall of stock prices (to 3 year lows) despite relatively good economic statistics may be indicating another very subtle change. The proximity of Warsaw Pact troops to West Germany, in the light of an unmistakable expansionist trend of Soviet might, may be frightening away long term capital, already put off by rising, and well in excess of productivity, wage demands. Capital controls may not be necessary. But for the wrong reasons.

Britain, on the other hand, has begun an earnest re-appraisal of thirty years of mismanagement. With a strong laissez-faire orientation at the top it has already earned some significant accomplishments. It has reduced the real size of Public Spending and the PSBR, with more to come in the Spring Budget. It has introduced an incentive-oriented tax structure. It has freed Sterling from exchange controls, thus causing capital to flow in rather than flow out (an apparent paradox). It has imposed and maintained positive rates of return in the money and bond markets. It has managed its exchange rate with a view towards obtaining the best domestic control of money supply i.e., almost not interfering with the market. It has shocked industry and labor into renewed competitiveness by allowing Sterling to rise.

Will British Steel derail the Conservative strategy? We do not think so. Nor do we fear excessive wage demands, as they will be moderated by the onset of a recession. Sterling may, once again, become an important reserve currency.

Add to previously established long positions at these levels. Add again on a move above 2.33 basis Spot. Our near term target of \$2.40/£ is in sight. Our longer term objective of \$ 2.75/£ should be achieved during 1980.

Sell stops were triggered in DM and SF. Remain sidelined. Long positions in JY should be stopped at 41.70 basis March '80.



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U.K. Economic Indicators :

	Visible Balance	Current Balance	Oil Balance	DCE	Reserves	M1*	M3*	RPI	Foods
	(£ bln)	(£ bln)	(£ mln)	(£ mln)	(US\$ bln)	%	%	(1974=100)	
1978 :									
3rd Qtr.	-0.367	+0.299	- 501	+ 572	16.55	17.2	8.1	199.2	206.2
4th Qtr.	-0.039	+0.614	- 480	+1,774	15.77	14.9	11.9	202.6	208.0
1979 :									
1st Qtr.	-1.1610	-1.238	- 234	+1,524	16.78	7.6	9.3	208.9	218.8
2nd Qtr.	-0.682	-0.575	- 227	+2,705	21.69	9.7	17.2	216.5	225.2
3rd Qtr.	-0.406	-0.220	- 166	+2,414	23.18	11.5	9.9	231.1	231.9
4th Qtr.	-0.535	-0.385	- 177						
Aug.	-0.194	-0.132	- 130	+1,057	22.30	6.1	12.4	230.9	231.8
Sept.	-0.185	-0.123	+ 8	+ 925	22.75	11.5	9.9	233.2	232.6
Oct.	-0.418	-0.368	- 85	+1,550	22.49	15.7	15.1	235.6	234.8
Nov.	-0.045	+0.005	- 12	+1,257	22.42	6.3	13.1	237.7	237.0
Dec.	-0.072	-0.022	- 104	+ 253	22.72	4.6	12.1	239.4	239.9

Source: Financial Times.

Open Interest (Jan.31/80) : 10,613
 Contract Size : BP 25,000.00 (Approx. US\$ 55,000)
 Daily Limit (normal) .05 (\$1,250.00)
 Commission : US 55.00
 Trading Hours : 8:23 am - 1:23 pm Chicago Time

Daily Volume (Jan.31/80) : 2,250
 Minimum Fluctuation : .00050 (\$12.50)
 Margin Required : US\$3,500.00
 Delivery Months : March, June, Sept., December

*** Mar.80 : 228.60 Jun.80 : 227.50 Sep.80 : 226.60 Dec.80 : 224.50 ***

SF

1979 ---	Balance of Trade (Mln SF)	W.P.I. %	Unemployment	Open Interest (Jan.31/80) : 11,463
Aug.	- 667	4.9	0.3	Daily Volume (Jan.31/80) : 4,064
Sep.	- 445	6.9	0.3	Contract Size : SF 125,000.00 (Approx. US\$80,000)
Oct.	- 593	6.75	0.3	Minimum Fluctuation : .00010 (\$12.50)
Nov.	- 386	6.83	0.3	Daily Limit (Normal) : .0150 (\$1,875.00)
Dec.	- 417	6.90	0.3	Margin Required : US\$5,000.00
				Commission : US\$ 55.00
				Trading Hours : 8:15 am - 1.15 pm
				Delivery Months : Mar., June., Sept., Dec.

*** Mar.80 : 62.08 Jun.80 : 63.35 Sep.80 : 64.53 Dec.80 : 65.52 ***

YEN

1979 ---	Balance of Trade	Balance of Overall Account	Balance of Current Account	Reserves	W.P.I.	Unemployment
Aug.	- 669	- 387	-1,530	25,170	10.94	2.23
Sept.	+ 147	-2,330	- 792	25,330	12.61	2.03
Oct.	- 350	-3,470	-1,120	23,270	14.54	2.15
Nov.	-1,220	-1,560	-2,220	20,170	16.07	2.17
Dec.	+ 731	- 512	-2,470	20,330	17.52	2.07

Open Interest (Jan.31/80) : 3,999 Daily Volume (Jan.31/80) : 519
 Contract Size : Yen 12,500,000.00 (Approx US\$ 52,500)
 Minimum Fluctuation : .0000010 (\$12.50) Margin Req'd : US\$ 3,750.00
 Daily Limit (Normal) : .0001 (\$1,250.00) Commission : US\$ 55.00
 Trading Hours : 8:25 am - 1:25 pm Chicago Time
 Delivery Months : March, June, September, December.

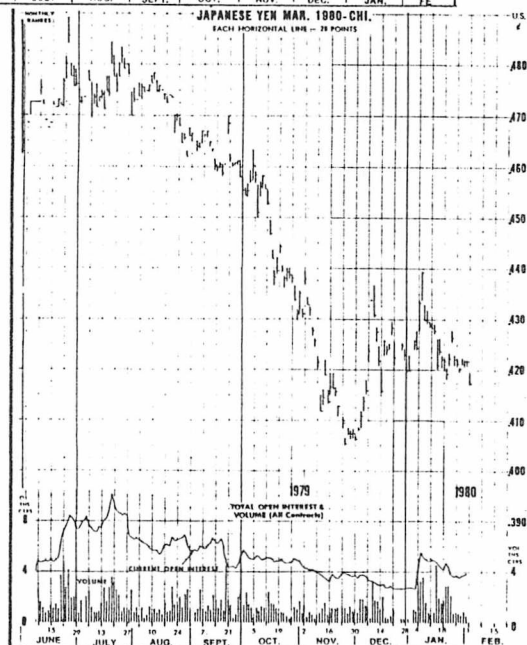
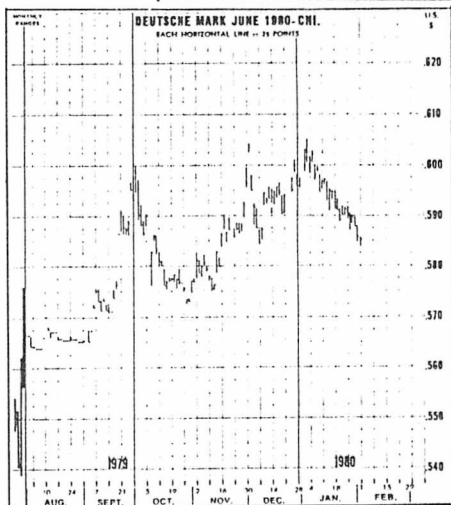
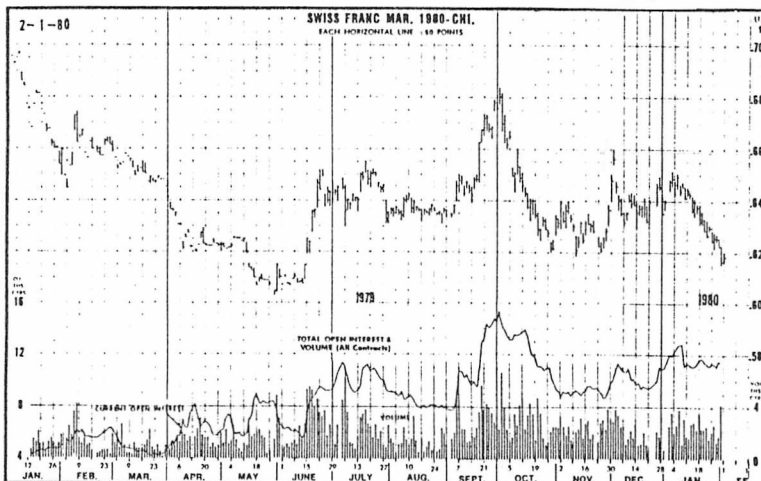
*** Mar.80 : 41.96 Jun.80 : 42.55 Sep.80 : 43.15 Dec.80 : 43.50 ***

DM

1979 ---	Balance of Trade (Mln Marks)	Balance of Payments	Unemployment Rate
Aug.	976	-2,900	3.5
Sept.	1,900	-2,400	3.2
Oct.	1,800	- 800	3.3
Nov.	1,510	- 900	3.5
Dec.	800	- 500	3.8

Open Interest (Jan.31/80) : 12,235
 Daily Volume (Jan.31/80) : 4,175
 Contract Size : DM 125,000.00 (Approx. US\$ 73,750.00)
 Minimum Fluctuation : .00010 (\$12.50)
 Daily Limit (Normal) : .010 (\$1,250.00)
 Margin Required : US\$3,500.00
 Commission : US\$55.00
 Trading Hours : 8:19am - 1:19 pm (Chicago Time)
 Delivery Months : Mar., Jun., Sep., Dec.

*** Mar.80 : 57.82 Jun.80 : 58.66 Sep.80 : 59.33 Dec.80 : 60.05 ***



CANADIAN DOLLAR

A puzzling and firming trend continues to prevail in the CD\$.

A continued tight rein on bank resources has succeeded, at least temporarily, to slow down the growth of broad monetary aggregates while, at the same time, it has brought a decline of 6.6% on an annualized basis in M1, lowering year over year growth rates to a modest 6.5%. While the growth of the broad money supply and general loans remains excessive, it is clearly moving in the right direction and it is probably the main reason for the CD\$ good recent performance.

Modest long positions are warranted at present levels. Technical targets are 88¢ and 92¢. Move stops to 85.4 basis March'80.

A note on the upcoming election. While over the years we have concentrated solely on economic matters, it behooves us to endorse a political party that will carry out an economic policy consistent with our resources and potential.

Sadly, none of the existing major parties in Canada comes close to satisfying this requirement. And this is because Canadians do best when left alone to do their 'own thing'. We do not need Big Brother to protect us by curtailing production and raising prices through Marketing Boards. Nor do we need Him to cheapen resources that are bountifully produced in this country, such as oil and gas, confiscating the just earnings of millions of small shareholders. And misdirecting our productive efforts to plants and equipment that will, with time, as inexorably as night follows day, become obsolete regardless of false subsidies. Surely, we should not have to pay taxes on non-existent interest and/or dividends and/or capital gains. If we continue to do so, we will become serfs to the State. Controlled, Manipulated, Intimidated.

If we are to exercise our civic duty, let us do it with our conscience. Let your 'practical' neighbour decide which major political party will bankrupt us over the next few years. Let the politicians of this country understand our yearning for Non-Interference.

Canada's fourth major party (outside of Quebec) is our only choice. We fervently endorse the Libertarian Party.

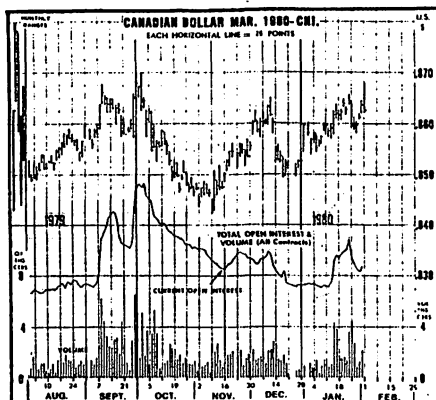
1979 -	Balance of Trade	General Bank Loans *	M1	M1B	M2	M3	Total Liabilities*	Int'l Reserves	C.P.I.†	Food Index*	Unemployment S.A.	N.S.A.
	(Mln \$)							(bln US)				
Aug.	+ 98	21.44	8.61	6.81	16.98	20.63	18.66	4.27	8.44	10.01	7.2	6.6
Sep.	764	21.81	7.44	5.57	17.00	19.07	17.45	4.51	9.58	12.85	7.1	6.4
Oct.	327	22.28	6.01	4.08	17.49	19.44	16.71	3.92	9.26	12.28	7.4	6.6
Nov.	587	23.51	3.16	0.75	16.59	18.15	15.3	3.97	9.40	12.20	7.3	6.8
Dec.	727	25.2	2.3	0.99	17.41	18.1		3.87	9.76	13.10	7.1	7.0

* Year-over-year % Change.

Open Interest (Jan.31/80) : 8,781
 Contract Size : CD 100,000.00 (Approx. US\$ 86,000.00)
 Daily Limit (Normal) : 0.0075 (\$750.00)
 Commission : US\$ 55.00
 Trading Hours : 8:21 am - 1:21 pm Chicago Time.

Daily Volume (Jan.31/80) : 2,123
 Minimum Fluctuation : 0.00010 (\$10.00)
 Margin Required : US\$ 2,000.00
 Delivery Months : March, June, September, December

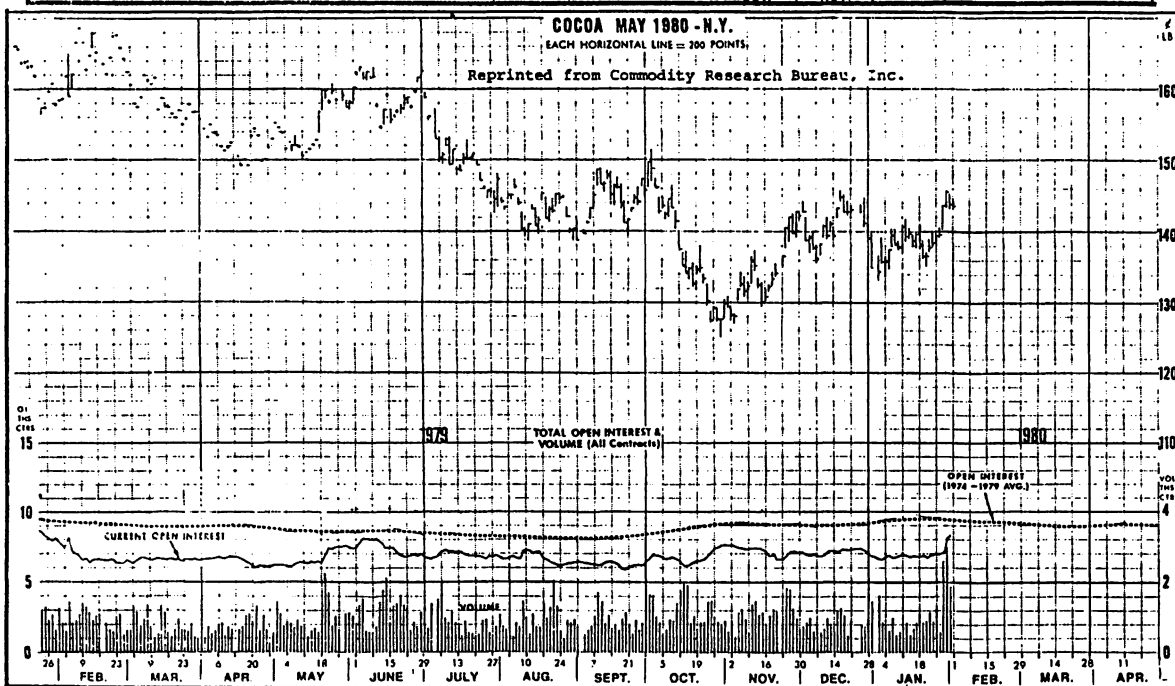
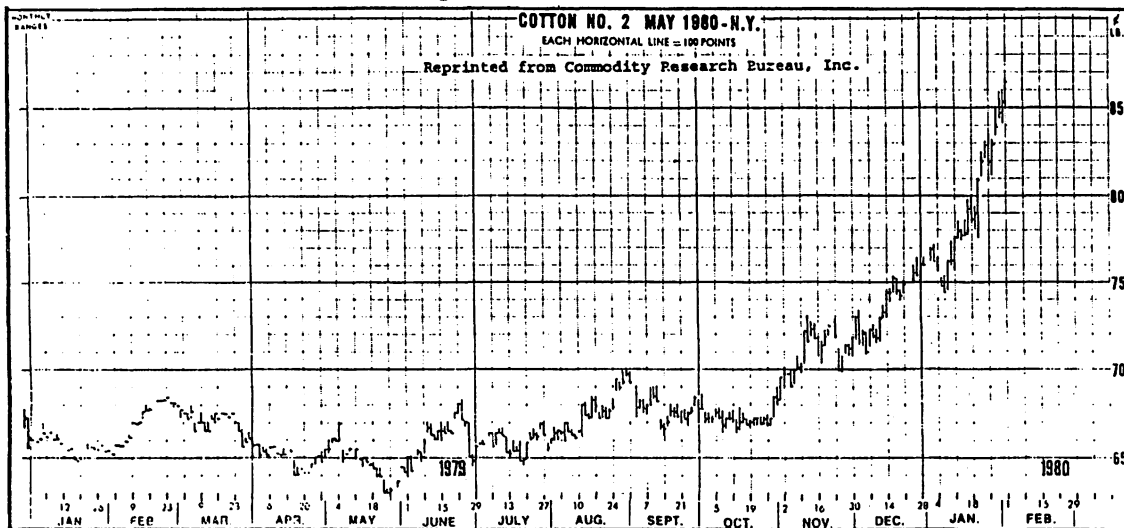
*** Mar. 80 : 86.27 June 80 : 86.45 Sep. 80 : 86.74 Dec. 80 : 86.85 Mar. 81 : 87.00 ***



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POTPOURRI

We don't care to follow Copper's present advance; remain sidelined...
COTTON reached today our target; take profits
COCOA being groomed for a "bull move"; modest long positions are warranted
 One of these days, Sugar will hit the fan....
 Remain long the Livestock complex.....



F.C.I.

Jan. 31/80 297.63
 Dec. 31/79 285.89
 Jan. 31/79 250.83
 +4.11% from prev. month.
 +18.7% from year ago.



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

Albert D. Friedberg