

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

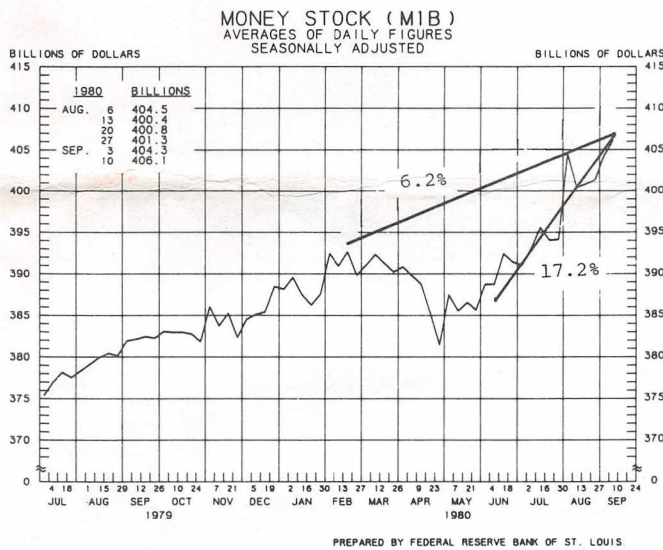
Financial Education Services

September 28, 1980

The Fed's Credibility Problem

With monetary aggregates surging at a 17.0% annual rate of growth, you might think that the Fed has lost all credibility in its anti-inflation course. You might think wrongly.

A look at the accompanying chart should dispel any doubt.



By measuring growth from the May trough, one obtains the much talked about 17% plus but if instead we concentrate on the February/September period, we note a relatively modest annual growth rate of 6.2%. Furthermore, year over year comparisons indicate an intriguing 5.8% annual rate of growth, substantially less than the underlying rate of inflation. The picture brightens somewhat.

Important to realize is that the Fed has *little or no* control over most broad monetary aggregates, at least over the short and intermediate term. The Fed can influence public preferences as between currency, demand and term deposits through its interest rate policy, and it can influence total deposit behavior through its rather imperfect control of bank reserves. As demonstrated in previous issues, the variables most directly under the Fed's control are Holdings of Securities, Float and Member Bank Borrowings, i.e. the items that constitute Federal Reserve Credit. The Fed's Credit behavior has been rather unexceptionally dull, not in keeping with a tight monetary policy but not being too lax either. In all, Credit is and has expanded at a 7.5 — 8.0% annual rate of growth. Depending on commercial banks' and public portfolio preferences, this course should yield an overall money-supply growth of approximately 8%. At times it

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Sterling: it's all right, Jack.

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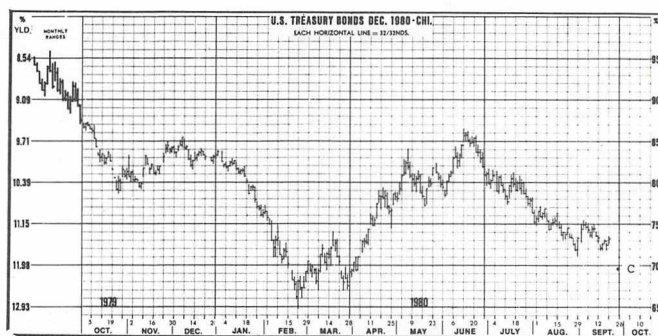
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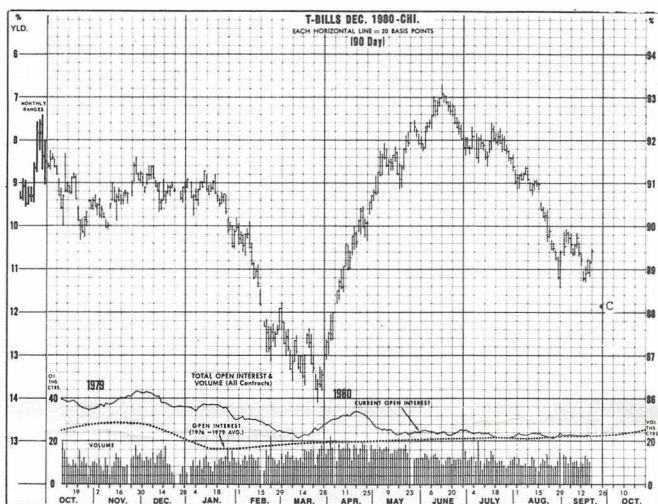
will show a terrifying negative annualized growth rate (i.e. a decline) of 9.1% as in the March/May'80 period and at times, such as now, a scandalous surge of 17%. Neither is a true reflection of monetary policy.

If money supply-watching is out — or at least not meaningful in the context of a steady-as-she goes Federal Reserve Credit policy — what's in? In order to gauge properly whether the Fed is abetting or condoning inflation, one would do well to concentrate on only one critical factor: Are interest rates, the cost of money, positive or negative in real terms? If interest rates are negative as they were between 1975 and 1980, borrowers will demand ever-increasing amounts of money, holders will forever tend to minimize cash balances and savers will repudiate their time-honoured practice. Goods will be continuously preferred over money, the very definition of inflation. Conversely, if interest rates are positive, borrowers will restrain their credit demands to projects with a high rate of return only (minimizing eventual malinvestments), holders will maximize cash balances and savers will defer present day consumption in favor of capital accumulation. Ergo, money will be continuously preferred over goods, the very description of a slightly declining price level.

Are present-day rates positive or negative? Using Euro-dollar deposit rates as proxies for U.S. interest rates in general, a convincing case can be made that rates are positive in real terms. Indeed, 13-13½% rates exceed handily current CPI readings as well as tentative 1980-1981 forecasts. The misconception alluded to before which labels Fed's policy as being too permissive has raised the market's inflationary expectations, and as a result has somewhat removed the edge off present interest rates. We believe that the persistence of present interest-rate levels will create a more favorable inflation environment in months ahead.



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CANADIAN FUTURES CONTRACTS									
91-DAY TREASURY BILLS (Combined Montreal - Toronto Trading) \$1 million; multiples of \$0.005					GOVT. OF CANADA BONDS (Combined Montreal - Toronto Trading) 18-Year 9 per cent \$100,000 principal; price is per cent of par value (Fractions are 32nds of 1 per cent)				
High	Low	Settle	Open	Int.	High	Low	Settle	Open	Int.
97.420	97.120	Dec 00	97.130	97.120	97.120	-.060	65		
97.350	97.070	Mar 81	97.070	97.070	97.070	-.070	24		
97.290	97.240	Jun 81							
Total Sales: Friday 10; Thursday 20 Total Open Interest: Thursday 89 + 1 Normal Daily Price Limits: 30.150 above or below prior settlement price.					Season— High Low Price Ch'ge Int. 74-18 45-30 Dec 00 69-20 48-30 69-10 - 6 53 74-18 69-28 Mar 81 - - - 69-15 - 7 31 73-10 70-03 Jun 81 - - - 69-20 - 2 1 Total Sales: Friday 25; Thursday 9 Total Open Interest: Thursday 85 + 1 Normal Daily Price Limits: 64-32				

Globe & Mail, Sep.26th,1980

STRATEGY: Don't bet on a new, generalized upsurge in commodity prices.

Once again we have been stopped out of our long T-Bills and T-Bonds positions. We have consistently underestimated the street's bearish interpretation of Fed policy which has forced us to a premature bullish (& unprofitable) position particularly with regards to the yield curve (short 2 Dec.'80 T-Bonds versus long 7 Dec.'80 T-Bills). With patience, fortitude and a long pocket, this spread will revert to a profit. If you have none of the above, liquidate.

Look to reinstate long Dec'80 T-Bonds at 67.10 OB with stops at 64.17; buy Dec.'80 T-Bills at 89.10 stop, placing stoploss protection, if & when done, at the previous lows.

Precious Metals

Last month we reversed a long standing bearish point-of-view toward GOLD and advised the assumption of long positions in December futures, then trading at 666.00, and addition to those positions on a breakout above 680.00. Such profitable advice was given strictly on the basis of the chart picture and deliberately without strict "fundamental reasons" because at the time of writing "fundamental reasons" did not seem to us to exist. The ensuing move to \$748.00 and subsequent collapse Friday to as low as \$678.50 basis Dec. IMM elicited, as could be

expected, a plethora of reasons for gold's rise. At this point we prefer to consider such reasons as little more than excuses that deserve scrutiny as we seek the direction of the market.

The market's rally was typically explained by 1) heightened anticipation of a further spurt in inflation, and 2) heightened political tension in the Middle East. Dealing with the economic front first, traders' perceptions were unquestionably focussed on the burgeoning money-supply numbers. Over the past four months M_1A and M_1B have mushroomed at annual rates of 14.2% and 17.2% respectively, while, over the past four weeks, the monetary base has increased at a seasonally adjusted yearly rate of 16.2%. If the underlying rate of inflation is solidly rooted at no less than 10% and excess money translates directly into higher prices, a spiral in inflation could be logically argued for. And indeed it was; such an argument has resulted, in addition to the strong move in precious metals, in an appreciable decline in fixed-income securities. The argument is further underscored by the general consensus, best expressed in the alphabet-soup type forecasts- J-shaped, V-shaped, W-shaped-, of an end to the recession as we move, not coincidentally, toward the presidential election.

While we do not take a diametrically opposed position to the explanations noted above we must point out some flaws in the argument and some counter arguments. First of all, as discussed in our introductory comments, the money-supply numbers do not necessarily indicate excessive monetary expansion. To summarize, our view is that the Fed has not proven itself to be either overly partisan or accomodative *yet*, and, given Chairman Volker's background as an academic monetarist banker, we doubt it will become such. We hope it will not.

Secondly, we do not see the recession coming to a quick halt. The inability of Copper to make headway in the face of the strike and the rising precious metals, the bloody decline of Cotton despite the extremely bullish supply situation, and the life-of-contract lows registered in nearby lumber positions all indicate a conspicuous absence of demand and provoke us to add to the soup the letter L. A reading of the history of American business cycles suggests the proper reallocation of credit and resouces which the economy must make before it can get back on track, takes time and has yet to be effected.

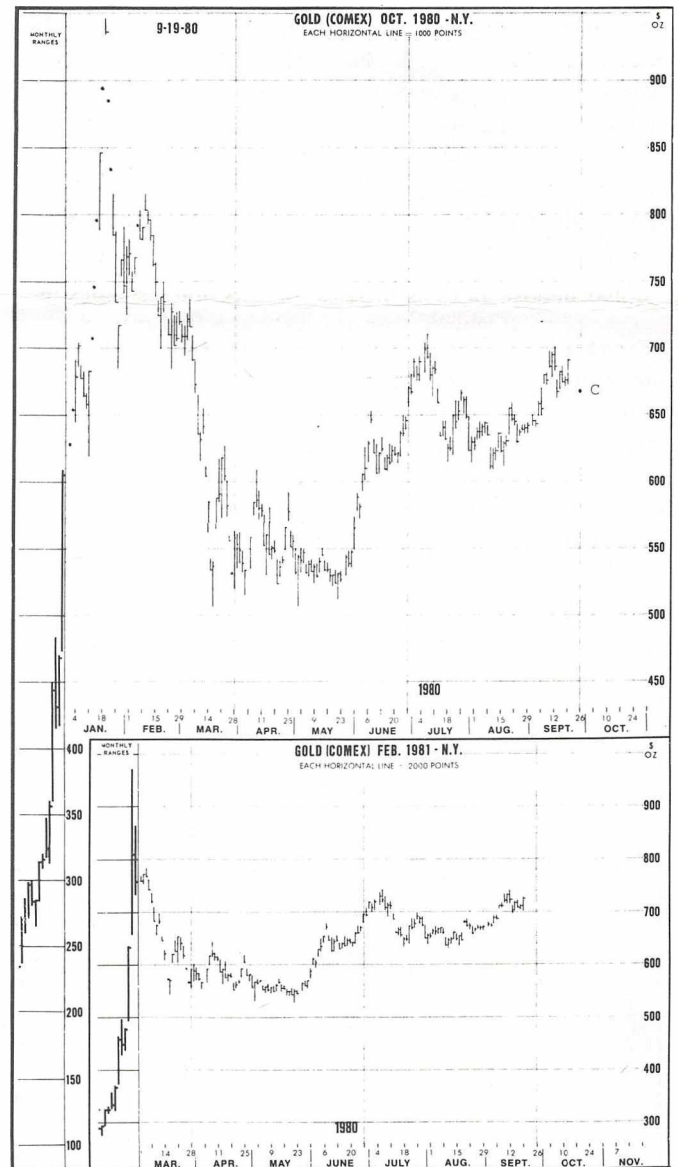
In conclusion, we do not doubt that inflationary expectations have jumped. We do however, doubt that such expectations will be vindicated.

Turning briefly to the Middle East, it is our view that despite the headlines, the conflict between Iran and Iraq is significant only if it can serve to involve the major powers. Entry in any way by the U.S. would be foolish, even though it could serve as a display of strength by President Carter whose major weakness with the electorate has been that he is viewed as a weak Nelly. It is noteworthy that Carter subtly invited Western Allies to

a forum to discuss the possible closure of the straits of Hormuz over the weekend, and that the invitation was immediately refused by West Germany, France and Japan.

Technically gold erupted from a strong base and, with little resistance, barely advanced to a new high since January. The gold market gapped up on the Iran/Iraq situation but showed no follow through and was accompanied by an extremely high consensus of bullish opinion.

The market broke Friday to close as previously mentioned, at \$687.50 in Chicago, a full \$60 from the highs and completing a weekly downside reversal in the process.



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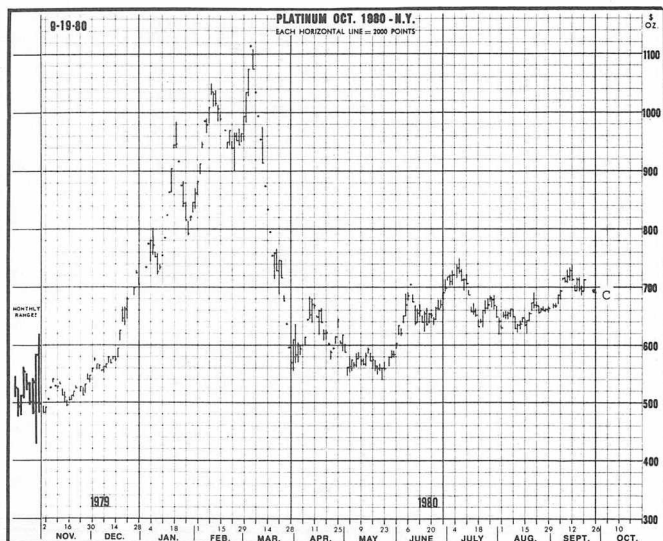
STRATEGY: *It is possible that Friday's shakeout was nothing more than a much-needed cleansing. However, in view of our commentary, we are inclined to believe that, in the absence of some unexpected political development, gold has seen its highs for the current move. Being brokers as well as commentators, we are advising liquidation of long positions on rallies. For the benefit of those having greater faith in the resilience of gold we note the strong support at \$650.00 basis Spot, which is where we would advise them to place stops.*

Platinum

Buoyed by rising gold quotes, platinum prices broke out of their lethargic high-level base of \$620-680/oz basis nearby and managed to climb just above \$750/oz, thus retracing exactly 50% of their spectacular previous decline. The most noteworthy aspect of this rally was the incredible concomitant surge of the open commitment. On July 1, with nearby trading at \$718/oz, open interest stood at the relatively average level of 7666 contracts; by September 25th, with nearby trading at \$730/oz, open interest had risen to 13,983 contracts, an all-time record high. What is more, the total increase came in just 18 trading sessions. In our view, this unsophisticated and urgent buying was being easily accommodated by the trade, a bearish development.

As to the so-called 'facts', we should note that Platinum recovered by refiners in the second quarter of 1980 amounted to 45,048 ounces, 300% more, on the average, than any 1979 quarter and more than double the IQ 1980 recovery. Platinum stocks increased to 319,556 ounces at June 30 from 305,605 at year-end 1979. Finally, second-quarter 1980 usage fell 19% from first quarter led by a decline to the automotive industry.

We are bearish and look for substantially lower levels by year end.

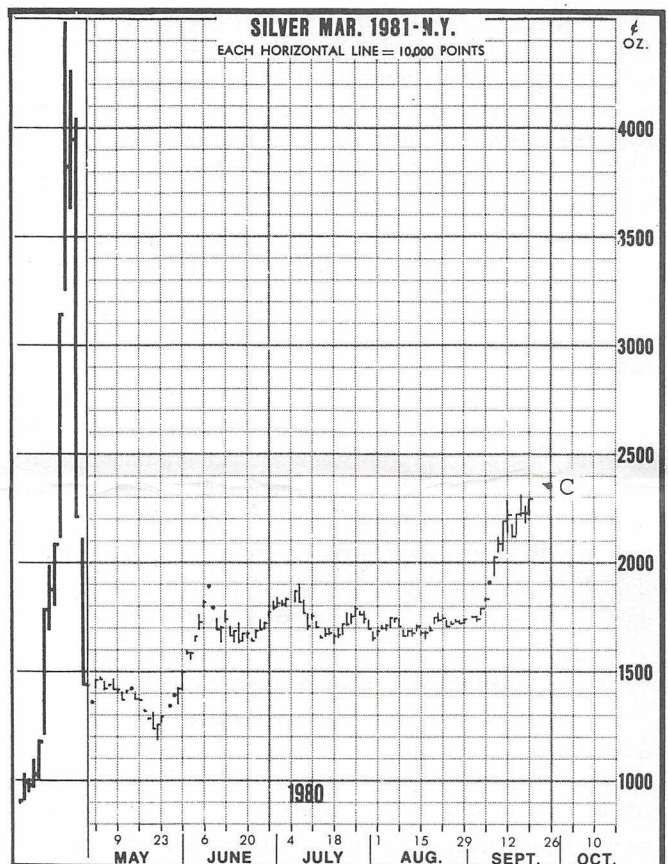


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Silver

The great June-September'80 coil resolved itself on the upside, vindicating the interpretation we put forth last month. The meteoric rise found resistance at the \$24/oz level (£10/oz) last seen in early March; the key reversal of this Friday assumed credence as it completed a downside weekly reversal.

Liquidate long March'80 position at market (by moving through the spot, if necessary) and stand aside.



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Grains and Oilseeds

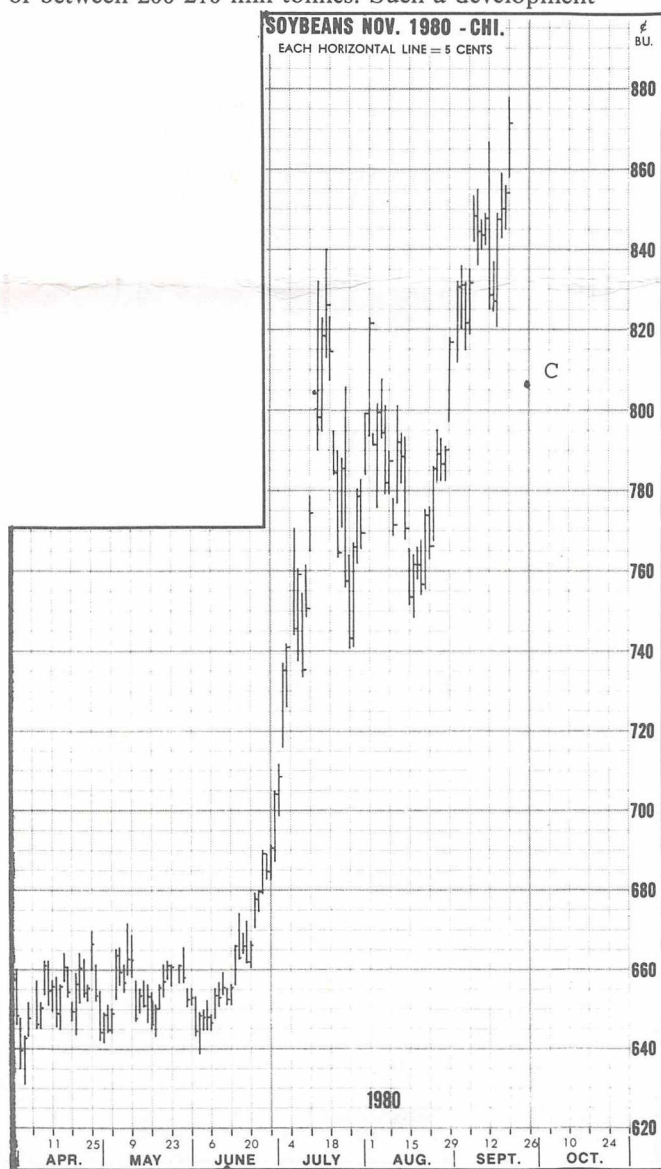
The recent softness in grains is attributable to seasonal-hedge pressure not being adequately met by speculative buying. Our views are 1) a bull market needs a consistent influx of bullish news to keep it on track; while the USDA September 11th production forecast of 6.5 bln. bales of corn and 1.8 bln. bushels of beans represent marked reductions over last year's production and modest downward revisions from August's projections, (see August's Comments) the numbers were generally greater than expected by traders; and 2) Bull markets

governed by supply considerations are generally more suspect than those motivated by demand because the former can be much more easily quantified than the latter; production numbers are generally known by everyone by harvest time, whereas offtake is virtually impossible to gauge until after the crop year is over, at which time its too late. Thus far the grains and oils have been supply-oriented markets with attention focussed squarely on the weather-reduced U.S. crop. Looking ahead to demand, and by that we mean past the harvest, we note the likelihood of new Soviet buying either directly from the U.S. should the embargo be relaxed — the Senate introduced a motion Friday, albeit having little chance of success, to abandon the embargo altogether — or indirectly through countries which in turn will have to go to the U.S. for supplies. It is believed the Soviets will need to import as much as 30 mln tonnes of grains next calendar year to supplement their harvest of between 200-210 mln tonnes. Such a development

would serve to reinstate the thread of bullish news while at the same time refocus the market's perceptions to the demand side of the equation. However, when and indeed, if such will occur, at this point, remains conjectural.

Technically, the weekly reversal and sharp drop in beans have damaged the market. Corn has broken our stop of 346/bush. but has not yet conclusively violated the bottom of the support at 343 basis December. Wheat remains in an uptrend as does Soybean meal. Soy-Oil has broken decisively.

STRATEGY: *We are inclined to believe these markets will remain in primary uptrends. Given the technical weakness of beans and oil however, we opine such with less certainty than last month. Allowing for that a correction can be ruthless, we advise the following: Raise stops in beans to 7.95 basis November. Remain sidelined in Corn for now but in close contact.*



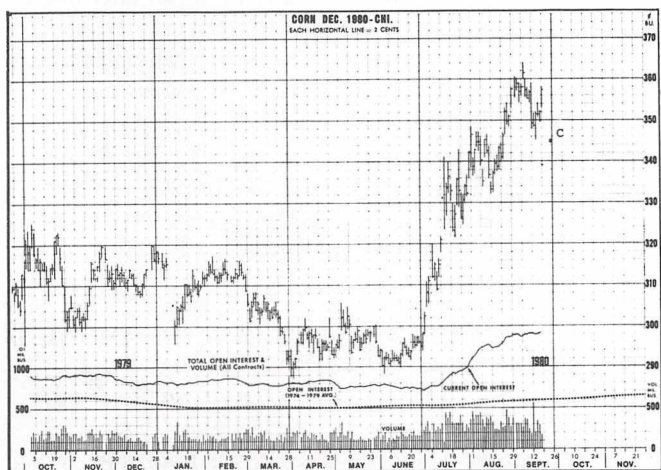
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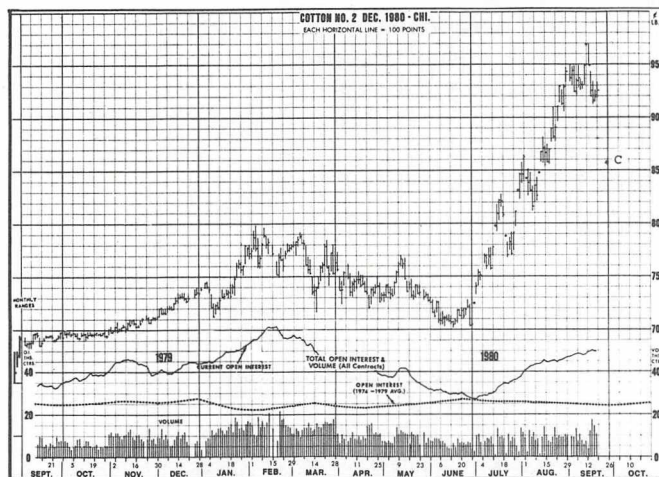
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Cotton

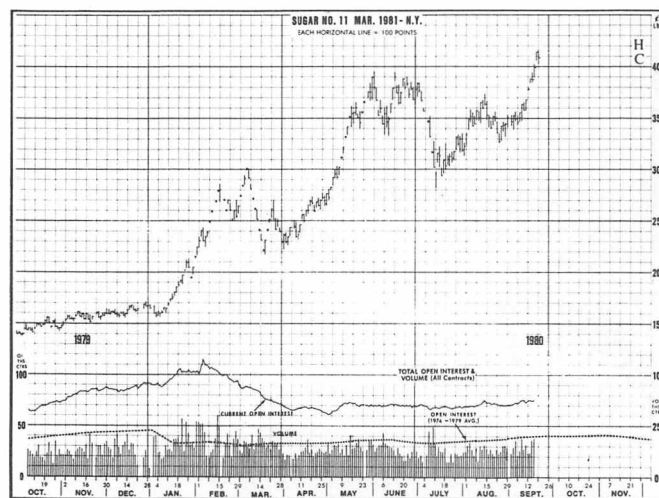
The September USDA report revised production downward from its August estimate of 12.7 mln bales by an extremely bullish 1.0 mln bales. In response the market rose the limit the next day and then declined over the next two weeks, by a full 13 cents, basis December. As in the case of grains and oils, it would seem clear that hedge pressure has failed to meet buyers. However, in the case of Cotton, the fact that the market has moved from a once-distinctive backwardation into contango suggests that the missing buyers are not so much speculators as professionals. The technical picture looks extremely bleak at this point with the primary uptrend having been violated some 800 basis points ago.

STRATEGY: Having been stopped out of this market at 87.00 basis December as per last month's comments (& based on the uptrend on Sept. 1), we are sidelined. However, given the raw numbers we would not be averse to re-entering this market from the long side. Remember, if production is only 11.7 mln. bales then in order for there not to be a zero carryover next year, consumption would have to be reduced by a not insignificant 4%. In order for there not to be a production deficit and a consequent erosion of the already small 2.7 mln bale carry-into 1980/81, consumption would have to be reduced by an enormous 22%. In 1974 total offtake fell, compared to the previous year by 30%; however, at that time, Cotton's share of the overall textile market was eroding, whereas currently Cotton's share has tended to increase. Stay posted; it is possible Cotton may develop into a major bull market yet.

Sugar

Last month we described the fundamental scenario and advised long positions or the purchase of March call options in London (see August's comments). Revisions to last month's scenario now call for a deficit of 3.5 mln tonnes versus 4.5 mln. This coupled with an inordinate buildup in the open commitment which, we assume, taking into account the high degree of prevailing bullish sentiment, is too-largely composed of small speculators, and the weak chart pattern, (note the weekly reversal on the accompanying chart), dissuade us from maintaining our profitable positions, right to the end as it were.

STRATEGY: Liquidate outright long positions and go short against March calls, thereby locking in the cost of the premium plus profit.

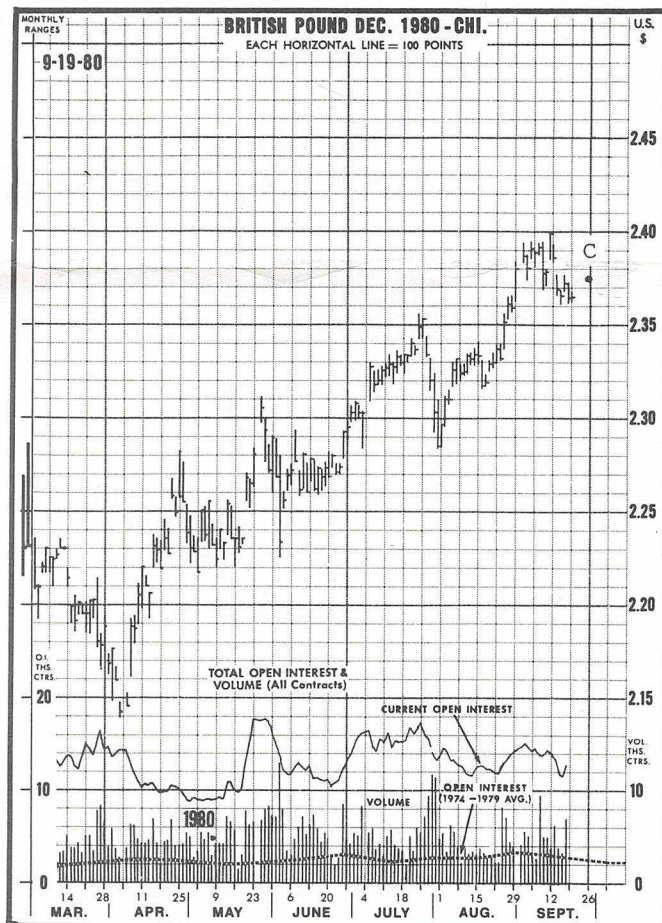


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Currencies

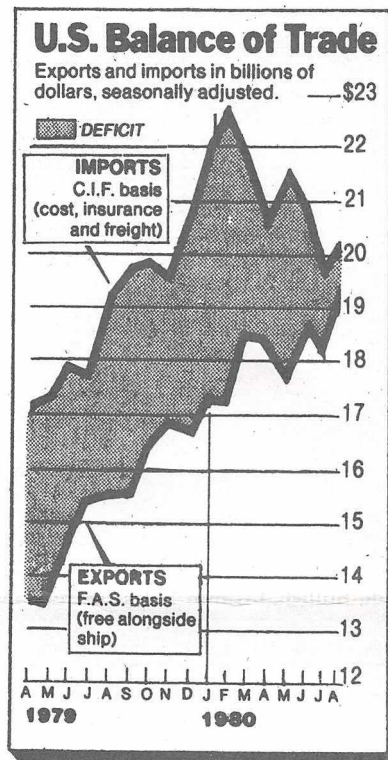
UK — The convergence of US & UK interest rates has narrowed dramatically the forward discounts and they now stand at little more than 300 points for 12 months. This fluctuating differential serves to underscore the basic policy differences between the Bank of England and the Federal Reserve. Whereas the latter reacts to bank reserves and money-supply development by manipulating interest rates, the former fixes interest rates at a high enough nominal level (and thus a very high positive level), to ensure a deflationary path. The results are for all to see. British CPI figures have trended down month by month and are now *running well below* a 10% annual rate; the U.S. is still struggling with on and off double-digit music.

Remain long Sterling; raise stops to 2.35 basis Spot.



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U.S. dollar — Strong and strengthening; the trade deficit continues to narrow (see chart) and should ensure a healthy current-account surplus for 1980/81.



The New York Times / Sept. 27, 1980

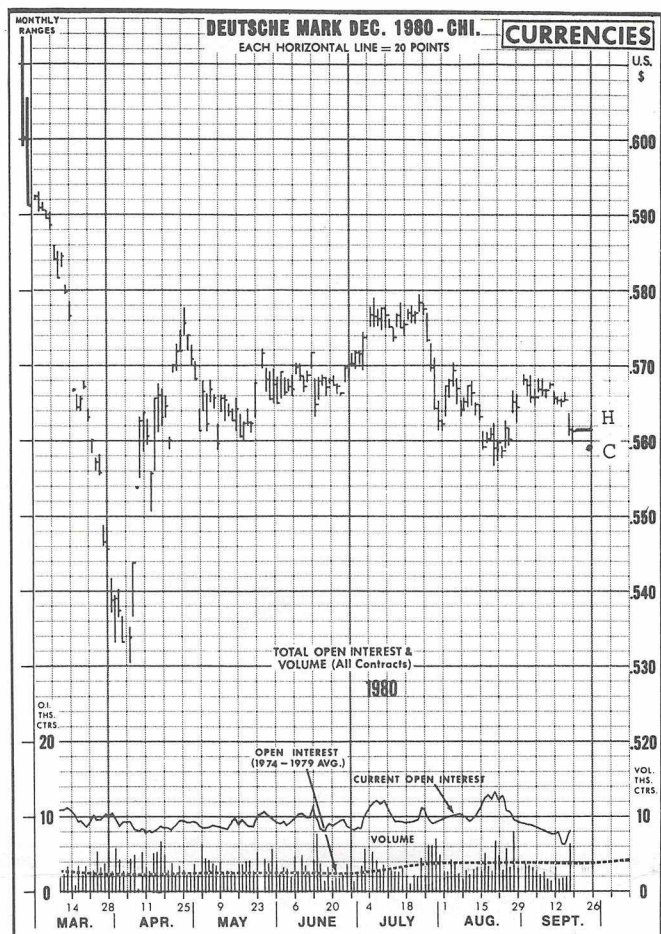
STRATEGY: Remain short Dec.'80 DM and Dec. 81 Sf as per last month's recommendation; lower stops to 57.10 and 63.00 respectively. Middle-Eastern investment buying of Japanese Securities is supporting an increasingly overvalued Japanese Yen. Do not stand in the way; wait for a good selling opportunity.

U.K. Economic Indicators:

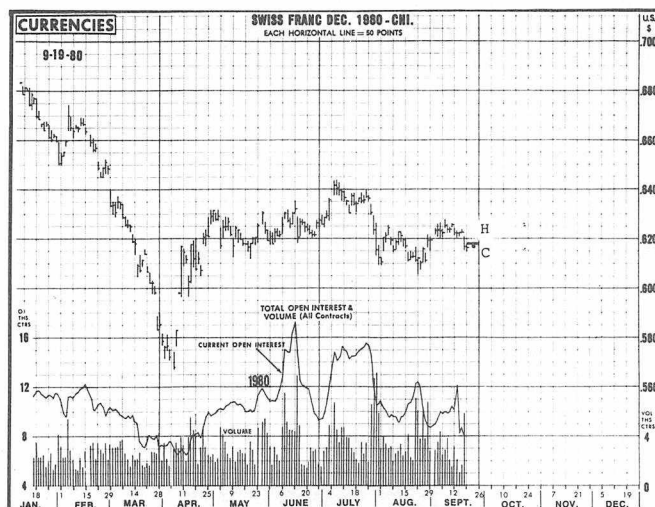
	Visible Balance	Current Balance	Oil	DCE	Reserves	M1	M3	M/R	EPI	F.T. Comdty.	Foods
Apr. 80	-303	-255	+24	702	28.01	-4.0	5.9	17	260.8	275.7	254.1
May 80	-1	+77	-25	1,147	28.28	4.0	12.6	17	263.2	268.2	255.7
Jun. 80	+3	+80	-30	1,369	28.17	-4.9	13.7	17	265.7	267.5	257.9
Jul. 80	+261	+336	+102	3,382	28.27	11.7	36.5	16	267.9	273.6	259.9
Aug. 80	+63	+138	+10	2,016	28.29	11.2	40.8	16	268.5	275.4	259.0

Source: Financial Times

Quotes : Dec.80: 2.3745 Mar.81: 2.3720 Jun.81: 2.3660



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SF	Aug. 80	Jul. 80	Jun. 80	May. 80
Balance of Trade (mln SFr)	-1,030	-992	-742	-669
C.P.I.**	4.18	3.32	3.33	4.34
W.P.I.**	4.70	4.83	4.23	
Unemployment	0.2	0.2	0.2	0.2

Reserves (bln SFr): Sep. 20 : 20.20 Sep. 10: 20.77 Aug. 30: 19.91

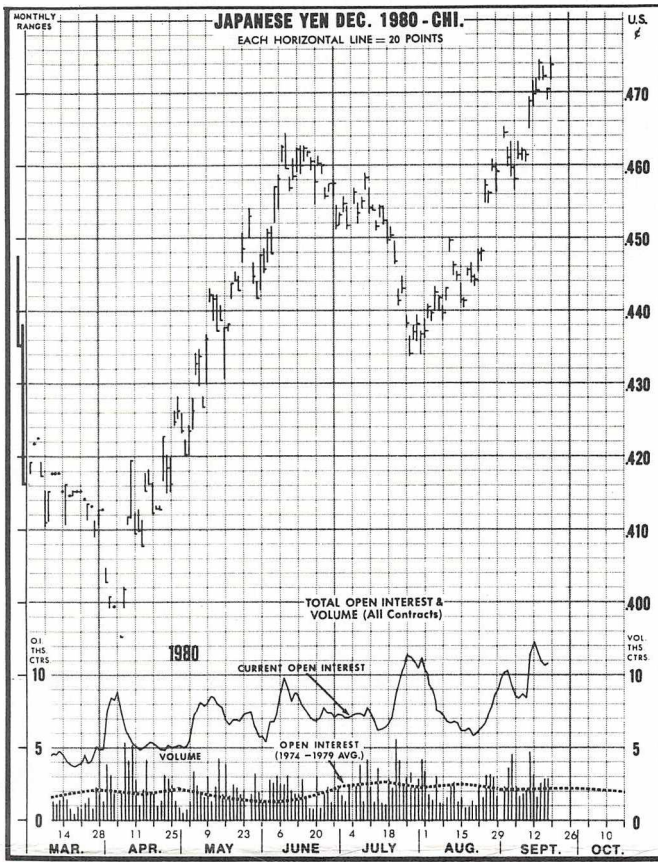
Euro Deposits %	Sep. 26	Sep. 19	Sep. 12	Sep. 5
1 Mo.	6 1/16	5 9/16	5 11/16	5 -/8
3 Mo.	6 1/16	5 5/8	5 11/16	5 3/8
6 Mo.	6 1/8	5 7/8	5 13/16	5 1/2
12 Mo.	5 5/16	5 11/16	5 9/16	5 5/16

Quotes: Dec. 80 : 61.65 Mar. 81 : 62.70 Jun. 81 : 64.00

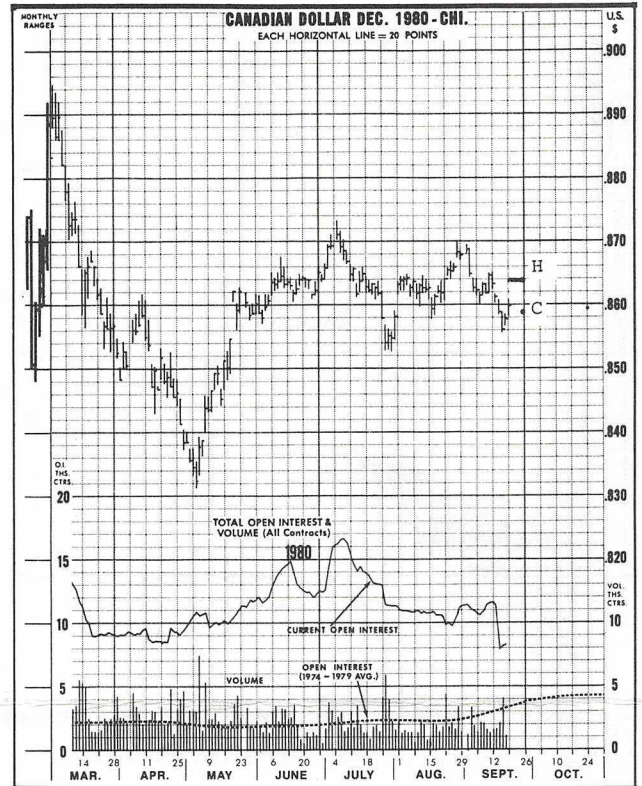
** year-over-year % change.

West German	Aug. 80	Jul. 80	Jun. 80	May 80
(mln DM)				
Balance of Trade	-100	+107	+279	+297
Balance of Payments				
Overall		1,215	2,214	829
Current	-3,900	-5,104	-3,156	-1,460
Unemployment Rate	3.7	3.7	3.4	3.3
Cost of Living**	5.56	5.47	5.96	6.09
W.P.I.**	6.68	7.78	8.11	9.03
Monetary Reserves (bln DM)				
	Sep. 23 : 77.8	Sep. 15: 80.6	Sep. 7: 75.9	
Euro Deposits %	Sep. 26	Sep. 19	Sep. 12	Sep. 5
1 Mo.	9.	8 11/16	8 3/4	8 7/8
3 Mo.	9.	8 5/8	8 5/8	8 11/16
6 Mo.	8 15/16	8 1/2	8 1/2	8 7/16
12 Mo.	8 5/8	8 5/16	8 1/4	8 3/16
Quotes :	Dec. 80 : 55.93	Mar. 81 : 56.61	Jun. 81 : 57.10	

** Year-over-year % change.



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Yen

	Aug. 80	Jul. 80	Jun. 80	May. 80
(bln US\$)				
Balance of Trade	+ .330	+ .130	+ .127	- .664
Balance of Payments				
Overall	+ .880	+ .322	Eal.	- .247
Current	- .820	- 1.030	- .929	- 1.77
W.P.I.**	17.12	18.46	20.25	21.89
Unemployment Rate	n/a	2.09	1.89	1.98
Reserves (bln US\$)	23.05	22.79	22.64	21.40
Euro Deposits %	Sep. 26	Sep. 19	Sep. 12	Sep. 5
1 Mo.	13 3/16	12 7/8	12 7/8	12 1/4
3 Mo.	12 3/4	11 13/16	12 1/8	11 3/4
6 Mo.	11 1/8	10 13/16	10 1/4	10 1/2
12 Mo.	10 1/8	9 11/16	9 1/2	9 5/8

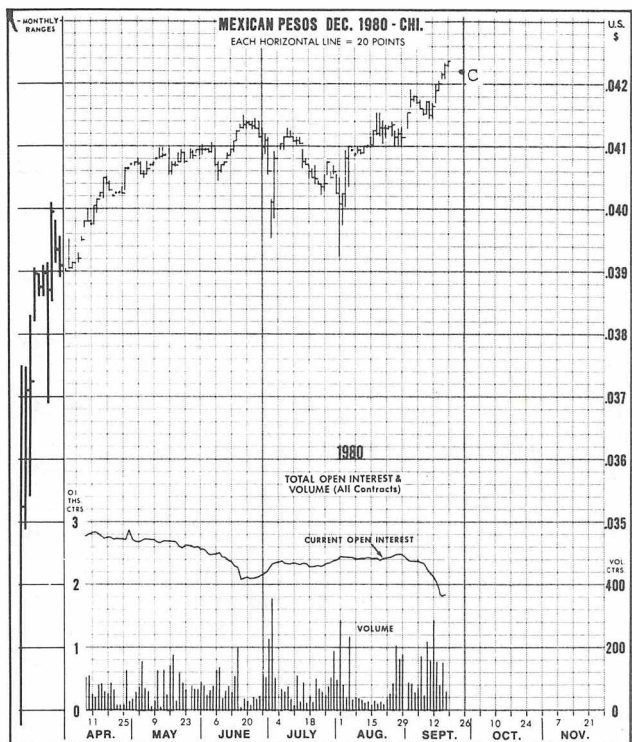
Quotes: Dec. 80: 47.47 Mar. 81: 47.77 Jun. 81: 48.00

** year-over-year % change.

CD\$	Aug. 80	Jul. 80	Jun. 80	May. 80
(mln CD\$)				
Balance of Trade		+351	+892	+579
General Loans **	17.50	20.01	22.16	20.54
M1 **	5.0	3.78	1.28	3.91
M1B **	2.88	1.62	-0.31	1.65
M2 **	17.32	18.21	17.76	18.86
M3 **	13.00	15.73	15.06	15.61
Int'l Reserves (bln US\$)	4.27	4.2	4.31	4.2?
Total Money **	10.74	15.55	15.83	16.61
C.P.I.**	10.74	10.10	10.13	9.44
Food only**	10.63	9.08	12.26	8.09
Unemployment Rate	7.7	7.5	7.8	7.8
Euro Deposits %	Sep. 26	Sep. 19	Sep. 12	Sep. 5
1 Mo.	10 3/8	10 7/8	10.	10 3/8
3 Mo.	11 3/8	11 3/8	10 5/8	10 1/2
6 Mo.	12	12 1/8	11 3/8	11 1/8
12 Mo.	12 1/2	12 1/2	11 7/8	11 5/8

Quotes: Dec. 80: 85.86 Mar. 81: 86.10 Jun. 81 : 86.05

** Year-over-year % change.



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Canadian dollar — Continues to drift aimlessly; stand aside.

Mexican Peso — Despite earlier noble statements that Mexico could not afford to increase oil production beyond the nation's orderly capacity to digest its petro wealth, output has already reached 2.5 million barrels daily, a level not to have been achieved until late 1982. Clearly Mexico needs these Petro-Dollars more than for just orderly economic growth; it needs them to pay interest and food. Remain short.

*Albert D. Friedberg
David B. Rothberg*

Notes:

Notes:

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