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COMMODITY & CURRENCY COMMENTS

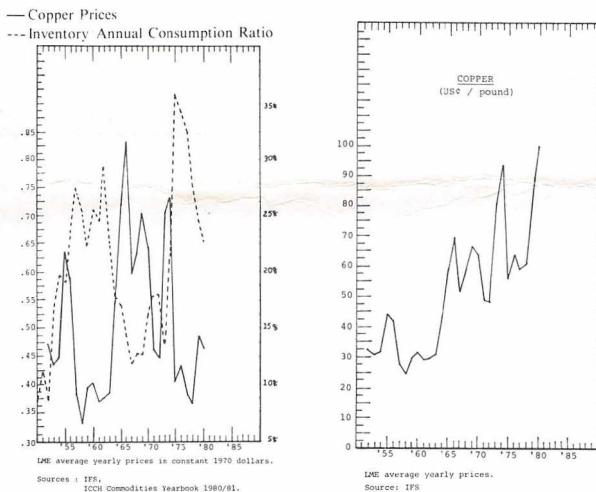
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March 4th, 1981

The Raging Bull

It is not a movie.
Nor an animal.
Not even a jest.
It's Copper.

The red metal has come into its own. Since a picture is worth one thousand words, we thought that the accompanying graphs, would be quite telling.



The graph on the left depicts the price of copper over a period of nearly 30 years in constant 1970 dollars. The graph on the right portrays the path of prices for the same period *in nominal terms*. Upon close examination we note the following: a) Copper prices, in real terms, have been in a pronounced downtrend for almost 15 years, a period long enough to discourage the enormous capital outlays needed to bring a mining and smelter complex into being; b) Real prices will tend to move inversely (with a fairly high degree of correlation) to the inventory/annual consumption ratio (the superimposed dotted line); c) By 1980, the 1975 'hangover' that had such a catastrophic impact on prices, seemed to be over. What is left for us to do is to project 1981-83 supply and demand figures and their respective inventory/consumption ratios.

We started with the assumption that mine, smelter and refining capacities were pre-ordained, given their extremely long lead development. The Bureau of Mines, an unimpeachable a source as any, came to our aid. We followed by making the *conservative* assumption that producers will turn out refined copper at full blast in the 1982-83 period. In the case of copper, that implies a rate of utilization of ninety per cent of capacity, given the extremely volatile state of African, Polish and Peruvian

In this issue

Copper: potential for a major move.
Interest Rates: higher yet.
Coffee: rally imminent.

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politics and the strike-happy nature of Canadian and U.S. copper workers. We further assumed that 1981 would only see a 200,000 tonne production increase due to the present unprofitability of mining copper and its associated by-products. This increase would represent the add on from the lost production in the U.S. as a result of the seven month copper strike, and a slight decrease in output in Zambia and Poland. Presto! Our production estimates can be seen in Table I.

TABLE I
WORLD COPPER BALANCE SHEET
(in thousand of metric tonnes)

	1980	1981	1982	1983
World primary & secondary demand for copper	9,625	10,106	10,611	11,142
	Total world capacity at 90% utilization			
	1980*	1981	1982	1983
Mine	7,785	7,992	9,449	9,657
Smelter	N.A.	N.A.	9,604	9,764
Refinery	9,382	9,590	10,518	10,592
Refined production (deficit) surplus	(243)	(516)	(93)	(550)
Estimated world total ending stocks	2,147	1,631	1,538	988
Inventory/annual consumption Ratio	22.3%	16.13%	14.49%	8.8%

* Estimated actual production

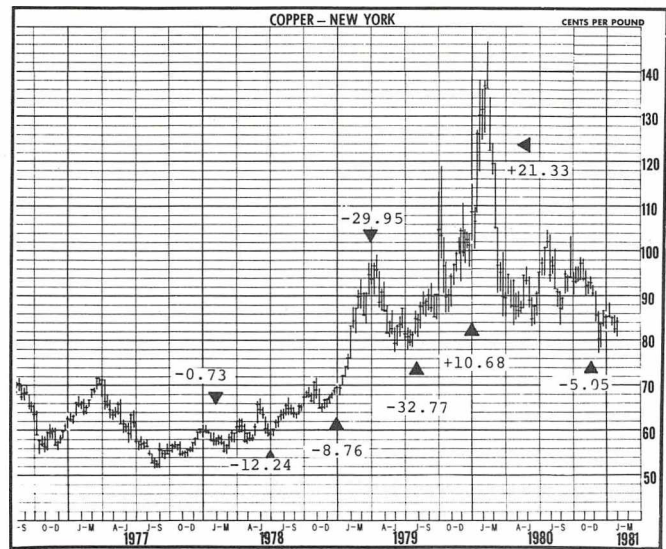
Sources: 1980 Demand Statistics Estimated by World Bureau of Metal Statistics
Bureau of Mines, Minerals commodity Profile Sept. 1979 and FMG Estimates.

We then turned to the demand side. Having examined the historic rate of usage of copper over the past four worldwide recovery phases, we concluded that we could expect a 5% annual growth (half of one per cent lower than the average). The figures were then plugged in to our equation (again shown in Table I).

The results were astounding. We obtained three consecutive years of deficit production which, in turn, caused a decline of world total ending stocks from 2,147,000 tonnes at the end of 1980 to a paltry 988,000 tonnes by the end of 1983. The 1983 carry-out represented an absurdly low inventory/annual consumption ratio of 8.8%. It should be noted that those projections are of an ex-ante nature, i.e. they do not assume the effects that prices will have on demand once it is perceived that, *on unchanged prices*, the carryout drops to less than one million tonnes by the end of 1983, and *disappears entirely by the end of 1984*.

To the rational question, "Who is a wise man?", the Talmud replies: "He who foresees the future." To think *in terms of the present* leads to faulty conclusions. Conventional, run-of-the mill analysts point to the dangers of an economic slowdown. But if the slowdown was here or was imminent, wouldn't copper stocks mount? Facts prove otherwise. A 3-month rate-of-change

of combined LME and COMX warehouse stocks became negative in late 1980 for the first time since January, 1980, a clear indication that a stock drawdown was in the making. This simple, but very sensitive, indicator became negative in early 1973, just prior to the 1973-74 bull market, and once again in early 1978 (see chart), just prior to the long advance from 60¢/lb to \$1.40/lb.



Arrows indicate the 3 months' rate of change of Copper Warehouse Stocks (combined LME and COMEX) at significant junctions.

Again, conventional analysts point to the historically burdensome level of world stocks. But are they really that burdensome? In absolute terms, maybe. In relation to annual usage, not really. Furthermore, given the abysmally low level of investment in copper production facilities, dictated by abnormally low *real* prices, the potential for a massive bottleneck was created as soon as economic activity picked up. Consequently, the so-called burdensome level of stocks is the only source of supply readily available to fill the upcoming production shortfall. Think *in terms of the future*.

How high can prices go? Since *supplies* cannot be increased in the short run, prices will by necessity, have to ration out *demand*. Curiously enough, high 'real' prices of copper in the past have not been able to break the back of copper demand as effectively, and/or as quickly as it may seem. Either prices did not rise high enough, or a worldwide industrial recession came first. On the assumption that one of these two possibilities will kill the raging bull, a price of 62¢-83¢/lb in 1970 dollars is attainable (high range of the past 30 years). Making the further assumption that the CPI will increase by 12% p.a. in 1981, 1982 and 1983, we obtain a target of \$1.85/lb to \$2.47/lb in 1983 dollars.

CONCLUSION AND STRATEGY: Copper is about to enter a bull market of historic proportions. Downside risk is limited both in terms of price, maximum of 5¢/lb, and in terms of time, perhaps 30-60 days. The upside is potentially fabulous: A move to a minimum of \$1.85/lb by 1983 and possibly as high as \$2.50/lb.

The raging bull encompasses all the qualities of a winner. A long period of low real prices. An intractable capacity bottleneck (in the short run) born out of this disastrous price performance. An unquestionable sensitivity to economic cycles, this time, for a change, on the upside. And a 'free play' on political chaos in countries plagued by civil riots and disobedience as well as labor problems.

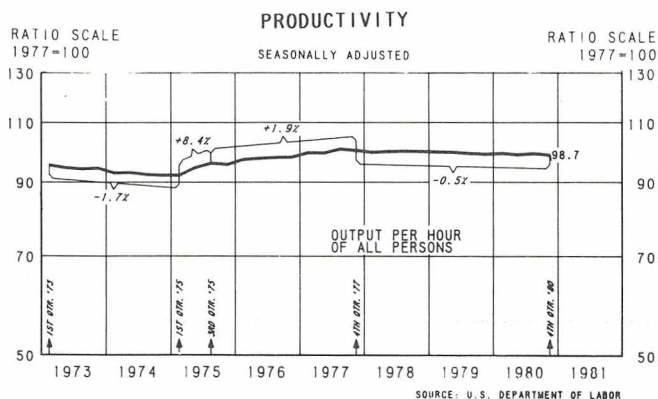
Join the champion. Buy deferred positions at market.

Interest Rates Futures

First a word on Reagan's budget proposals and their impact upon economic activity.

The momentous 30% cut in marginal tax rates along with changes in the tax tables, if fully enacted, should have a profound impact on the U.S. economy's real growth. Much has already been said by various economists (including our own comments) to the effect that present inflation rates have had an extremely deleterious effect on productivity. Among other things, they have pushed nominal personal income up the ladder of progressive tax rates with the effect of cutting real disposable income and forcing an ever larger sector of the economy 'underground.'

Underdepreciation and taxation of illusory inventory profits have substantially decreased corporate cash flow and much needed capital investment. As the accompanying chart shows, output per hour of all persons has declined at an annual rate of .5% over the past three years and has remained practically unchanged since early 1973. The tax-cut proposals should reverse this trend and help achieve a far healthier increase in productivity.



SOURCE: U.S. DEPARTMENT OF LABOR

PREPARED BY FEDERAL RESERVE BANK OF ST. LOUIS

There are, however, two caveats. In the first place, increased social security taxes could offset a meaningful part of the tax-cut bonanza. Secondly, corporate liquidity continues to deteriorate as short term borrowing far outpaces long term funding. Only massive increases in the corporate calendar can remedy this situation, lest capital expansion is cut prematurely short. President Reagan's advisers hope that rising disposable income will add to the savings pool so as to accommodate this increased demand without putting undue pressure on interest rates. Unfortunately, the most effective tax measure available, indexing savings returns so as to maximize investors' after-tax yields, has not been put into place. Therefore, long-term yields must rise high enough to provide the tax-paying community with real rates of income. Assuming a 12% rate of inflation for the coming year and an average tax rate of 33%, risk-free long-term Treasury Bond yields must rise above 18%.

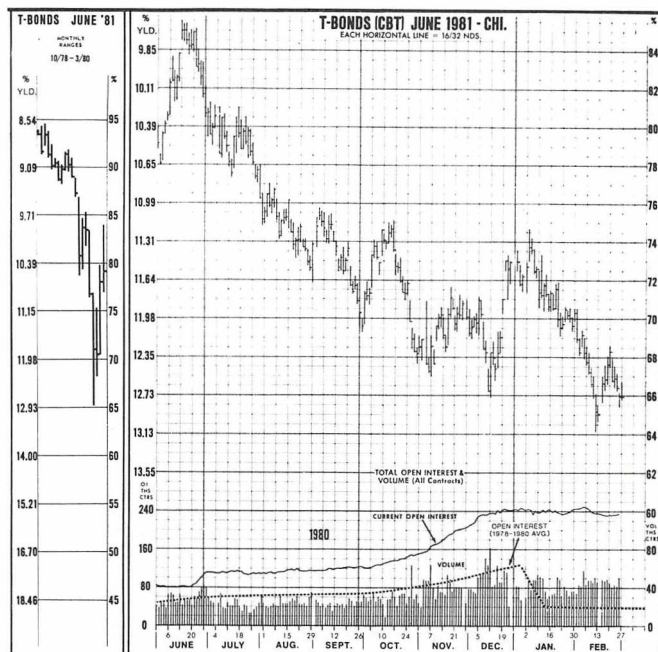
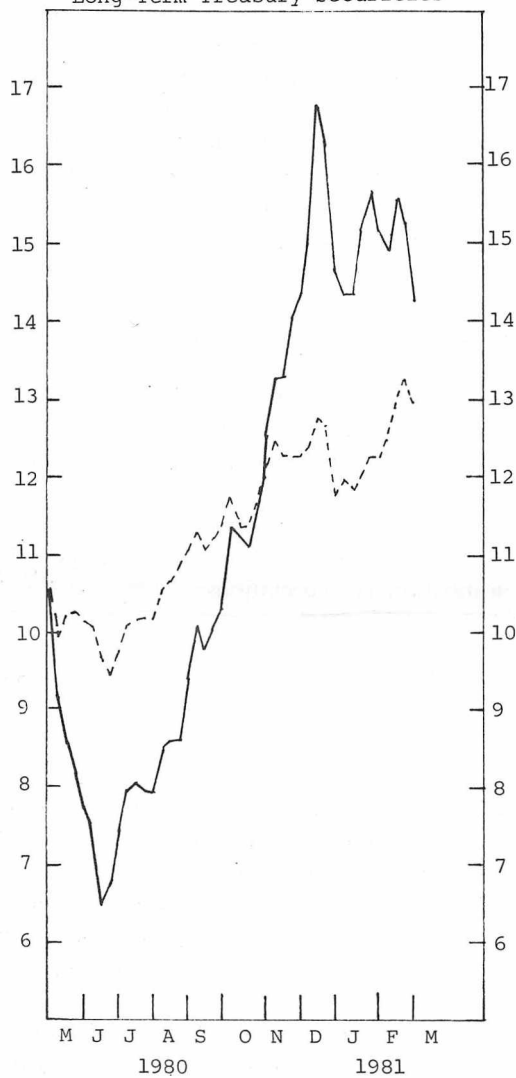
Bank credit continues to expand at a very rapid clip. The most recent six-month span shows a 16.3% annualized rate of growth, making hash of those who feel that the Fed is regaining control of the supply of money. It is clear that credit is ample, and in no way is about to threaten the nascent economic recovery. Moreover, it is too ample to have any disinflationary impact on prices. As a result, long-term interest rates must continue to reflect high inflationary expectations.

STRATEGY: We continue with the view that interest rates are heading irregularly higher. However, as noted in our previous Comments, the yield curve is showing signs of flattening, not as a prelude to a fall in general rates, but rather as a recognition that, in the short run, credit is amply available, and in the long run, inflation is still a double-digit affair.

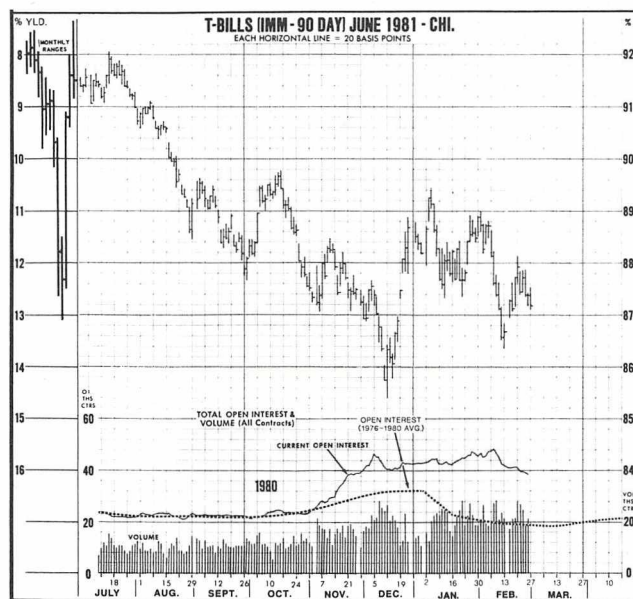
Cover March '81 T-Bills sold at 86.79 (as of January 11th) at present levels showing a 110 point profit. Our short March '81 T-Bills, Long June '81 T-Bill spread put on at around 80-100 points did not reach the expected 250 differential, but nevertheless, should be cleared out now with a 40-60 point profit.

Concentrate on adding to short T-Bond positions, lowering stops to 69.10 basis December '81, close only.

U.S. Interest Rates
3-month Treasury Bill
Long-Term Treasury Securities

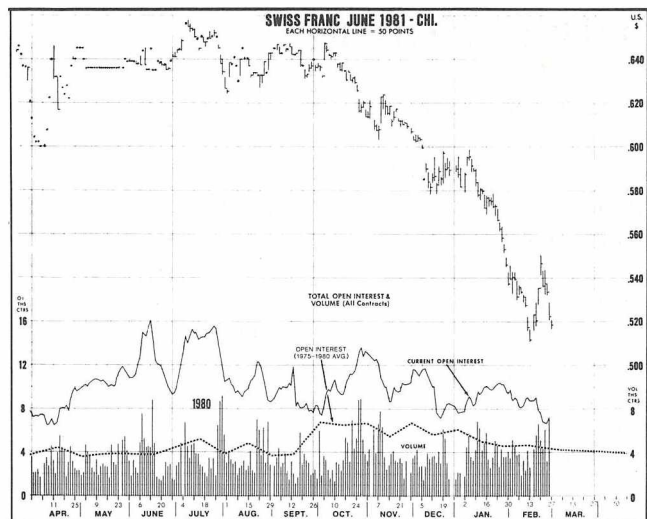


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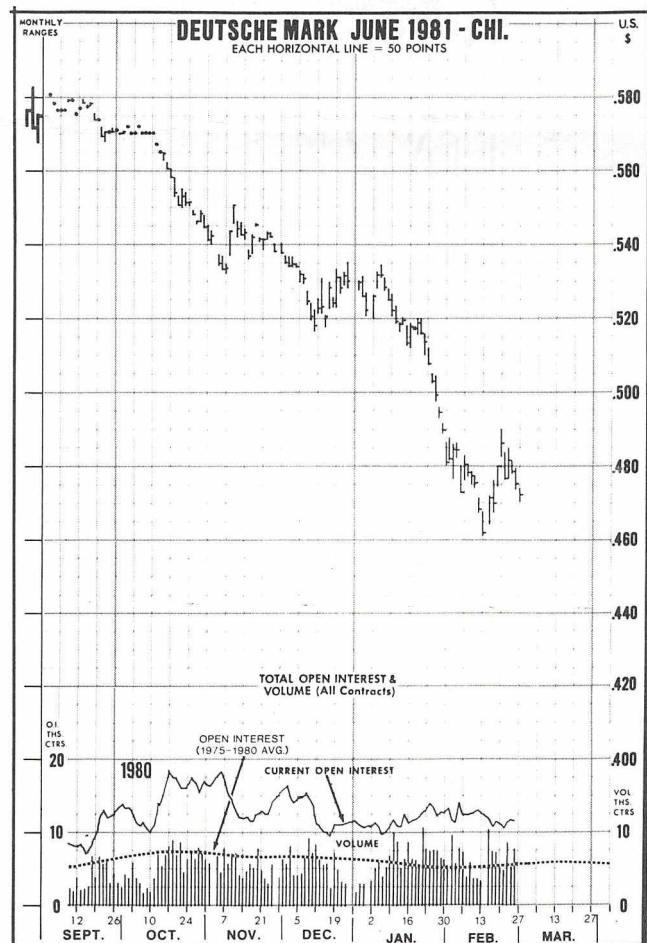


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GNMA 8% (CBT) - \$100,000 princpl; pts., 32nds of 100%										
	Open	High	Low	Settle	Chg	Settle	Yield	Chg	Open	Interest
Mar	66-12	66-16	66-01	66-04	+ 3	14.049	-.023		3,126	
June	66-30	67-04	66-11	66-17	- 3	13.951	+.038		11,453	
Sept.	67-14	67-17	66-26	67-00	- 3	13.839	+.023		8,279	
Dec	67-21	67-23	67-06	67-08	- 3	13.779	+.022		8,366	
Mar82	67-30	67-30	67-14	67-14	- 2	13.735	+.015		12,151	
June	67-27	67-27	67-12	67-15	- 2	13.727	+.014		15,958	
Sept	67-17	67-17	67-15	67-15	- 2	13.727	+.014		16,296	
Dec	67-24	67-24	67-14	67-14	- 2	13.735	+.015		10,185	
Mar83	67-24	67-22	67-13	67-13	- 2	13.742	+.015		5,103	
June	67-21	67-21	67-12	67-12	- 2	13.750	+.015		2,671	
Sept	67-20	67-20	67-11	67-11	- 2	13.757	+.015		1,824	
Est vol 6,500; vol Tue 11,126; open int 95,412, -327.										
TREASURY BONDS (CBT) - \$100,000; pts. 32nds of 100%										
Mar	65-10	65-15	64-20	64-27	- 4	12.958	+.025		10,901	
June	66-08	66-15	65-18	65-25	- 6	12.771	+.036		49,340	
Sept	66-30	67-04	66-10	66-15	- 5	12.637	+.030		24,535	
Dec	67-11	67-18	66-25	66-30	- 3	12.547	+.024		22,129	
Mar82	67-22	67-29	67-06	67-10	- 3	12.476	+.018		23,345	
June	67-30	68-03	67-16	67-18	- 3	12.429	+.018		28,136	
Sept	68-06	68-06	67-23	67-23	- 3	12.399	+.017		23,931	
Dec	68-11	68-11	67-27	67-27	- 3	12.376	+.018		26,155	
Mar83	68-12	68-13	67-31	67-31	- 3	12.353	+.018		13,935	
June	68-16	68-16	68-03	68-03	- 3	12.329	+.017		7,259	
Sept	68-10	68-10	68-07	68-07	- 3	12.306	+.017		2,785	
Dec	68-22	68-22	68-11	68-11	- 3	12.283	+.017		24	
Est vol 45,000; vol Tue 50,144; open int 232,475, +1,679.										
TREASURY BONDS (NYFE) - \$100,000; pts. 32nds of 100										
May	72-22	72-29	72-02	72-07	- 8	12.905	+.045		572	
Aug	73-08	73-08	72-26	72-25	- 7	12.803	+.040		292	
Nov	73-21	73-21	73-04	73-06	- 6	12.729	+.034		328	
Feb82	73-14	73-14	73-14	73-14	- 7	12.684	+.039		436	
May	73-17	73-17	73-17	73-17	- 7	12.667	+.039		782	
Aug	73-20	73-20	73-20	73-20	- 7	12.651	+.039		563	
Nov	73-23	73-23	73-23	73-23	- 7	12.634	+.039		290	
Feb83	73-26	73-26	73-26	73-26	- 7	12.617	+.039		1	
Est vol 827; vol Tue 842; open int 3,264, -35.										
TREASURY BILLS (IMM) - \$1 mil.; pts. of 100%										
	Open	High	Low	Settle	Chg	Settle	Discount	Chg	Open	Interest
Mar	85.91	85.94	85.66	85.67	-.14	14.33	+.14		8,787	
June	87.32	87.41	87.07	87.13	-.09	12.87	+.09		16,139	
Sept	87.79	88.00	87.60	87.67	-.07	12.33	+.07		5,709	
Dec	87.94	88.18	87.88	87.90	-.04	12.10	+.04		3,540	
Mar82	88.06	88.22	88.00	88.01	-.04	11.99	+.04		2,037	
June	88.20	88.24	88.01	88.01	-.03	11.99	+.03		833	
Sept	88.24	88.24	88.03	88.03	+.06	11.97	-.06		398	
Dec	88.18	88.18	88.05	88.05	+.12	11.95	-.12		41	
Est vol 16,784; vol Tue 20,023; open int 37,484, -45.										



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Currencies DM/SF

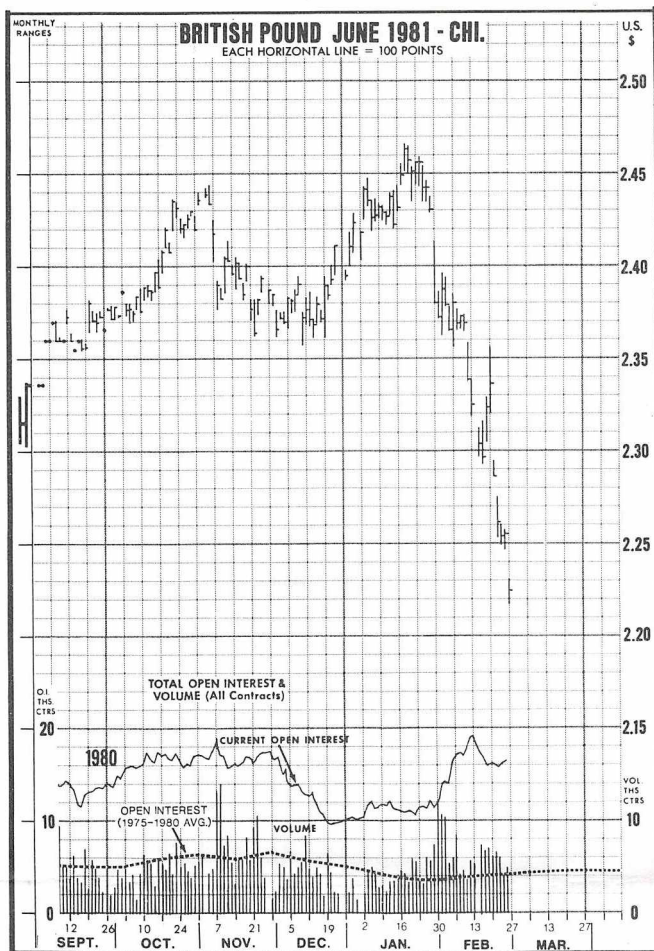
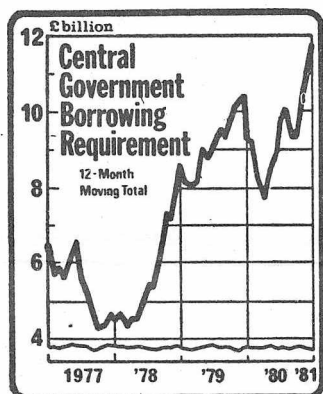
An atmosphere of crisis has engulfed the German and Swiss money markets. Jerky reactions to spontaneous, at times unplanned, and always inconsistent Central Banks' moves, have maintained extremely disorderly conditions where no direction or trend is clearly discernible.

STRATEGY: Having taken substantial profits on earlier short positions, we prefer to remain sidelined unless June '81 DM and June '81 SF break recent lows, in which case short positions may be reinstated.

British Pound

Last month's suggestion that Sterling was due, *at the very least*, for a substantial correction came true in very short order. We underestimated the extent of the first downleg by projecting a possible target of 2.27 basis Spot, although we clearly reserved judgement on the likelihood that a bear market would begin, until we got a glimpse of the March 10th budget.

The bearish case rests on the gargantuan size of the continuously upward revised PSBR, now estimated at £13 billion (see chart for trend), and its significant impact on Domestic Credit Expansion running well above £14.9 billion for 1980 compared to its 1977 (healthy) low of £1.1.



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STRATEGY: Sterling could be sold on rallies to the 224-225 area basis Spot with stops at 2.35.

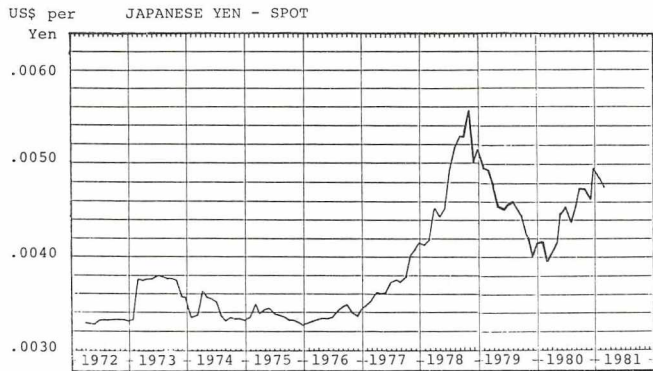
Domestic Credit Expansion Seasonally Adj. (£mIn)	
1975	4,530
1976	7,474
1977	1,132
1978	8,065
1979	10,284
1980	14,960

Yen

The relative 'cheapening' of the DM and SF may cause a shift away from the Yen and towards these currencies.

Technically, the market looks vulnerable to a substantial decline and we favor the short side.

STRATEGY: Sell June '81 Yen at present levels, placing protective stops at 50.25, close only.



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CANADIAN FUTURES CONTRACTS

91-DAY TREASURY BILLS (Combined Toronto-Montreal trading) \$1 millions; multiples of \$0.005					Total Open Interest: Tuesday 20 N-C Normal Daily Price Limits: 64-32 above or below prior settlement price.				
-- Season -- High Low High Low Price Ch'ge Int. 97.350 95.930 Mar 81 -- -- 95.955 -- 17 97.290 96.125 Jun 81 -- -- % .285 -- 9 % 270 % 200 Sep 81 -- -- -- -- --					-- Season -- High Low High Low Price Ch'ge Int. 75-08 67-00 Mar 81 68-10 68-04 68-04 - 02 105 74-15 67-12 Jun 81 68-24 68-12 68-13 - 03 204 69-16 68-24 Sep 81 -- -- 68-24 -- 1				
Sales: Wednesday 0; Tuesday 2 Total Open Interest: Tuesday 25 - 2 Normal Daily Price Limits: \$0.150 above or below prior settlement price. (Winnipeg trading) 91-day Canada treasury bills \$200,000; points of 100 per cent					-- Season -- High Low High Low Price Ch'ge Int. 79-20 74-70 Jun 81 -- -- 74-22 + 03 36 79-20 74-22 Sep 81 -- -- 75-09 - 01 9 79-15 75-15 Dec 81 -- -- 76-09 - 01 - 85-10 82-21 Jun 81 -- -- 83-08 + 02 20 Sales: Wednesday 0; Tuesday 2				
-- Season -- High Low High Low Price Ch'ge Int. 84-20 80-20 Jun 81 -- -- 85.13 + 12 16 84-25 85-00 Sep 81 -- -- 85.62 + 16 5 84-45 85-41 Dec 81 -- -- 86.37 + 20 4 86-43 85-87 Mar 82 -- -- 86.19 -- - Total Sales: Tuesday 0					-- Season -- High Low High Low Price Ch'ge Int. 79-20 74-70 Jun 81 -- -- 74-22 + 03 36 79-20 74-22 Sep 81 -- -- 75-09 - 01 9 79-15 75-15 Dec 81 -- -- 76-09 - 01 - 79-20 75-28 Mar 82 -- -- 76-15 -- - Total Sales: Tuesday 0				

CDS

Our strategy of selling three month T-Bills at 96.150 has been rewarded handsomely as the market is now trading at 95.950.

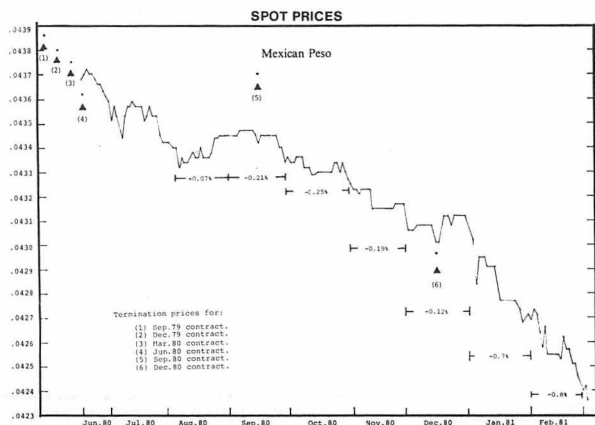
STRATEGY: Remain sidelined on the CD\$. Roll over short March '81 T-Bill into June '81 on the continuing assumption that the Bank of Canada will need to maintain wide interest rate differentials, via à vis the U.S., to keep the beleaguered CD\$ above 82.80 — 83.00.

Mexican Peso

President Lopez Portillo recently announced that for 1981, the Federal Budget will be 2,332.7 billion Pesos, an increase of 31.2% over the probable (it is usually revised upwards several times) 1980 figures. It should be noted that since 1976, total Government Expenditures have grown from a planned 440 billion Pesos to the contemplated 2.3 trillion Pesos, a truly sensational 520% increase. Moreover, this ridiculous extravaganza was monetized almost in its entirety by forcing the banking system to purchase Government bonds as reserve requirements.

Despite price controls, inflation continues to run at more than 4% per month, thus widening almost daily the differentials vis à vis the U.S. Dollar.

STRATEGY: Continue to sell aggressively deferred positions such as Dec. '81, March '82 and June '82. The pace of the crawling devaluation has been stepped up from a -0.7% in January '81 to a -0.8% in February '81, and we fully expect the crawl to turn into a gallop.



Precious Metals

We are inclined to gloss over the precious metals sector, preferring to direct metal bulls toward copper. Nevertheless, a word is in order. Firstly, gold prices have entered a 'value' range but are likely to remain there for quite some time yet unless panic selling creates a downside blowoff. We have as yet to see this action as the decline remains quite orderly, and stubborn bulls remain affixed to the inevitable long-term rise.

The bearish case for silver remains intact so long as the Hunt Brothers manage to hold on to their hoard. A margin call is inevitable; the vultures will be ready to absorb the Hunt block at a discount from the market of perhaps \$4-\$5/oz. Who might they be? The Central Banks of Mexico and Peru, or a consortium of bullion dealers, or some other oil tycoon...

Wait for the day.

STRATEGY: Remain short gold and silver. Should a violent downside spike occur on either we would be inclined to nibble on the long side.

Remain short Platinum. Our downside target is \$350/oz.

Coffee

The very-promising-looking base that's been formed over the past six months has induced us to examine the coffee market. It's the first time we've given it anything more than a cursory glance since we wrote an in-depth study of the market in February of 1977.

In early 1977, coffee was in the final and most spectacular phase of the famous bull market that began with the July, 1975 frost. In the six week period from the end of February until mid-April, coffee prices rose more than a dollar per pound or, from a trader's point-of-view, by \$37,500 per contract. In February, as the market was advancing by historic leaps, we concluded: "Our feeling is that the end will come... sometime around late July or August, (or) should wholesale prices average ... \$2.40/lb. Once the top is reached, prices could decline to 80¢ within eighteen months."

In mid April, 1977 the wholesale price of coffee did come to average \$2.48/lb. The market 'topped' at \$3.40/lb at the same time, and one of our most profitable positions was assumed on the short side of the bear market that ensued. In fourteen months coffee prices fell to \$1.05/lb basis the nearest futures contract.

	Jan.81	Dec.80	Nov.80	1980	1979	Jan.80
Balance of Trade						
U.K. (bln Stg.)	+0.757	+2.246	+4.455	+1.04	- 3.4	-0.320
C.D. (bln CDS)		.497	1.49	+7.96	+ 3.99	+0.317
D.M. (bln Marks)	-9	1.01	.377	9.14	22.43	+0.342
J.Y. (bln US\$)	-1.47	2.39	.560	2.364	2.03	-2.36
SFr. (bln Francs)	-0.391	-0.880	-0.510	-11.24	-4.718	-0.920
Current Account						
U.K. (bln Stg.)	.957	.346	.555	2.281	- 1.67	-0.296
D.M. (bln Marks)	-5.0	-7	-1.6	-28.2	-10.1	-2.41
J.Y. (bln US\$)	-2.88	1.18	-0.610	-10.829	- 8.75	-3.37
Overall Account						
D.M. (bln Marks)		-0.675	-2.52	-27.89	- 4.95	-3.88
J.Y. (bln US\$)	- 0.048	+4	+1.35	- 8.4	-16.62	-2.22
Reserves						
U.K. (bln US\$)	28.39	27.48	28.19			
C.D. (bln US\$)	3.436	4.03	3.47			
D.M. (bln Marks)	67.1	67.4	69.4			
J.Y. (bln US\$)	26.5	25.23	24.94			
SFr. (bln Francs)	21.72	27.36	20.82			
Cost of Living/CPI				Jan. 81/Jan. 80	Dec. 80/Dec. 79	
U.K. (1974 base)	277.3	275.6	274.1	13.05	15.12	
C.D. (1971 base)	224.1	221.3	220.0	11.99	11.21	
D.M. (1976 base)	120.5	119.3	118.6	5.98	5.48	
J.Y. (1975 base)	141.3	139.6	140.5	7.37	7.06	
SFr. (1977 base)	112.0	110.9	110.5	5.16	4.62	
W.P.I.						
U.K. (1975 base)	209.6	206.6	206.1	11.19	12.71	
C.D. (1971 base)		257.5	256.9		11.81	
D.M. (1976 base)	120.3	119.2	117.5	5.71	6.71	
J.Y. (1975 base)	132.3	133.0	133.2	6.69	9.56	
SFr. (1963 base)	160.6	158.9	153.3	4.97	4.61	
Unemployment Rate						
U.K.	9.3	9.3	8.9			
C.D.	7.3	7.4	7.3			
D.M.	5.6	4.3	4.2			
J.Y.	2.2	2.1	2.1			
SFr.	0.3	0.2	0.2			

From the time the lows were seen in mid 1978, prices rallied to \$1.60/lb then fell back to \$1.20/lb by the end of 1978. They then worked their way back to the \$1.60/lb mark by mid 1979, before advancing sharply on a mini-frost scare in July of that year to \$2.30/lb. The market subsequently fell back to the \$1.60/lb level, advanced on frost-insurance buying to \$2.00 in mid summer of last year, and since, has fallen without interruption to the \$1.20/lb — 1.30/lb plateau that you see on the accompanying chart.



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As we stated by way of introduction, the chart does look promising. The question is whether or not such promise is supported by fundamentals.

World production during the current 1980/81 crop year, (which began in July), is forecast at 80.2 mln. bags, only 200,000 bags less than last year's near-record crop. Exportable production, the amount of coffee not consumed domestically by producing nations, is put at around 60.0 mln. bags, as compared with last year's 60.4 mln. bags. World imports, or demand by consuming nations, is forecast at 61 mln. bags. The resulting deficit should draw down stocks held by producers to ... what? As was the case when we wrote our study in 1977, discrepancies by reporting agencies representing producing and consuming nations make it impossible to know. The USDA, which is consumer oriented, estimates year-end stocks at 22.9 mln. bags. The ICCH, an association representing the London clearing house, used PANCAFÉ, a producer nation organization, to arrive at a base year figure in 1975. Working forward from that year, one arrives at the astounding year-end number of 10.3 mln. bags. Another reason for the discrepancy, in addition to the obvious motives for playing with the numbers, is the likelihood that consumption in producing nations which do not have the same fetish we have for statistics, is subject to genuine error in calculations.

In any case, year-end inventories held in producing nations are not as significant as they would be for other crops since coffee is a perennial crop. Trees take five years to reach maturity and then yield fruit for as long as twenty years; once there is a set number of yielding trees, future or expectational inventory is, within broad limits, implicitly known. As a result, it is already predicted that the Brazilian 1981 crop, which will not be fully harvested until July of 1982, will be around a record 30 mln. bags. This year's crop is put at 20 mln. bags; the average over the previous six years is 19.6 mln. bags. That so burdensome a supply is probable, is the result of the maturation of new trees planted in 1976, the year after the killing 1975 frost.

Thus, year-end production stocks are incalculable, and under normal circumstances, not crucial. By normal circumstances we mean non-frost years. If a frost were to occur and year-end producer stocks tally toward the lower end of the 10.3 to 22.9 mln. bag range, then there is no insurance against prices rising to astronomic heights to ration demand.

Within the broad context of world production and consumption estimates, we can particularize fundamentals to see if we can find a clue in a specific area which may serve to alter the broader picture. In the U.S. we notice that through the better part of 1980 imports and roastings declined, compared with 1979, by about 6%. But recent figures show that fourth quarter roastings showed sudden and unexpected gains of approximately 12% compared with the previous year. Weekly roasting figures through the first eight weeks of 1981 put roastings at plus 7% over the comparable 1980 figures. The average retail price of coffee in New York, taking into account loss-leader and coupon merchandizing, has fallen to around \$1.60/lb. Although we do not have comprehensive figures by which to compare coffee prices to a basket of competing beverages, it seems to us, as everyday consumers, that at the retail and counter level, coffee is at least fairly priced. Thus, continuation of the bulge in roastings that began in the fourth quarter of last year would not surprise us. By extension, an upward revision in world demand estimates for the current year would not surprise us either.

Incidentals

In addition to the foregoing, two unrelated observations are worth mentioning:

1) As mentioned, it is generally perceived that Brazil will produce around 30 mln. bags in 1981/82. That so much coffee is expected hence, obviously serves as a depressant on the market. As we said in reference to year-end stocks, producer nations have their reasons for playing with numbers. In 1977 Brazil swore that they held no inventory. They did so, even to representatives of consuming nations who actually toured the country to

vindicate statistical evidence which they felt would prove that Brazil really did hold inventory. Now Brazil concurs with the USDA that it will have a huge crop in 1981. Why? We would offer as a possible explanation that Brazil, hungry as it is for foreign exchange, is either attempting to cow rival producers into a less-than-aggressive producing strategy, or is attempting to gain an advantageous share of the quotas which are divided up amongst producers according to the current international coffee agreement. Therefore, 30 mln. bags may prove an overly optimistic projection

2) A respected meteorologist, who has forecast commodity-related weather over the past five years with as reasonable a degree of accuracy as one could hope for, has opined that the rather unusual weather experienced in North America over the past year would be seen in South America during our summer, their winter. In short, he suggests a likelihood of a freeze. We wouldn't mortgage our home, but we would take his view, and the effects his view will have on the trade, into consideration.

Conclusion

We started out to see whether or not fundamentals were in keeping with the promising looking chart picture. Given (1) the estimated production deficit, (2) the recent upturn in U.S. usage and the possibility that it will serve to augment the deficit, (3) the possibility that it will serve insurance stocks do not exist in producing nations, and (4) our incidentals, we conclude that the fundamentals and the chart confirm that long positions are warranted.

Caveat

If there is not a frost, an advance should not be considered a bull market. The accompanying table of deflated deliverable Colombian prices shows that, at present, the price of coffee is too high in real terms by comparison to other pre-frost periods (note*), to warrant a major move. We would anticipate a 40¢ move to around the \$1.60/lb level only.

COFFEE	—	COLOMBIA	Coffee @ 1970 prices
1952		57.01	83.35
3*		59.92	86.97
4		79.93	115.50
5		64.38	93.30
6		73.97	105.67
7		63.94	88.31
8		52.34	70.35
9		45.22	60.21
1960		44.89	58.83
1		43.62	56.65
2		40.77	52.34
3*		39.55	50.19
4		48.80	61.08
5		48.49	59.72
6		47.43	56.67
7		41.94	48.77
8		42.60	47.54
9*		44.97	47.61
1970		56.66	56.66
1		49.01	46.99
2		55.71	51.72
3		72.66	63.51
4		77.86	61.31
5*		81.71	58.95
6		157.74	107.60
7		240.21	153.78
8		185.20	110.25
9*		183.40	98.09
1980		178.85	84.34

STRATEGY: Buy Sept. '81 call options in London. If there is a frost, the profit is obvious. If there is no frost, margin-free short positions will be established once the frost season passes.

Present quotes of Sept. calls (March 5), are £1051 striking, premium £128; which means one is paying and risking \$1408 for the privilege of buying the underlying 5 tonne futures contract at a total value of \$11,561.



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Notes

Notes

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