

# FRIEDBERG'S

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## The Demise of Opec and Some Investment Implications

The Organization of Petroleum Exporting Countries has been inflicted a mortal wound as a result of the extraordinary drop in oil demand. From a high of just over 60 million barrels per day, world consumption has come down to a present level of just under 44 million barrels per day. At the \$32/barrel price, consumption is likely to erode further regardless of the pace of economic activity.

Due to extremely serious errors in pricing and taxation policies followed by Western nations, both supply and demand curves remained relatively inelastic for more than five years. With the advent of oil decontrol in the US and the maturation of oil production in Mexico, the United Kingdom, Norway and China, common sense economics began to prevail. Consider the following: In August 1981, the US imported 3.9 million barrels/day, down 18 per cent from 4.7 million barrels/day in August 1980, and down 51 per cent from President Carter's limit of 8 million barrels/day in his now well forgotten speech equating energy conservation with the "moral equivalent of war." Also, in August 1981, US crude oil production rose 2.6 per cent from a year earlier, the third consecutive month that US oil production increased, after nearly a decade of declining figures. The energy crisis is clearly

over (as we first pointed out in our *Comments* dated Nov. 26, 1980), now that prices are finally given a free hand to ration out demand and increase production.

In the futile attempt to maintain unrealistic prices, OPEC's share of the world market has shrunk from about 55 per cent in 1973 to a present 38 per cent. Furthermore, OPEC is producing oil at a rate of 58.5 per cent of estimated capacity, a slack that will prove politically and economically intolerable in coming months, especially when its largest member, Saudi Arabia, is producing at a respectable rate of 82.6 per cent of capacity and accounts for almost *half* of OPEC's total output.

If OPEC allowed the free market to price its output so that pre-1973 production levels were regained, it is clear that prices would have to drop rather dramatically from the present \$32-34/barrel. But, by how much? (The question is not merely academic because OPEC may find itself in just such a predicament, like it or not.) In search of an answer, we computed a *very crude* proxy for a free market price of oil. In effect, we assumed that world demand for oil was relatively *static in dollar terms*, (approximated by multiplying production times a com-

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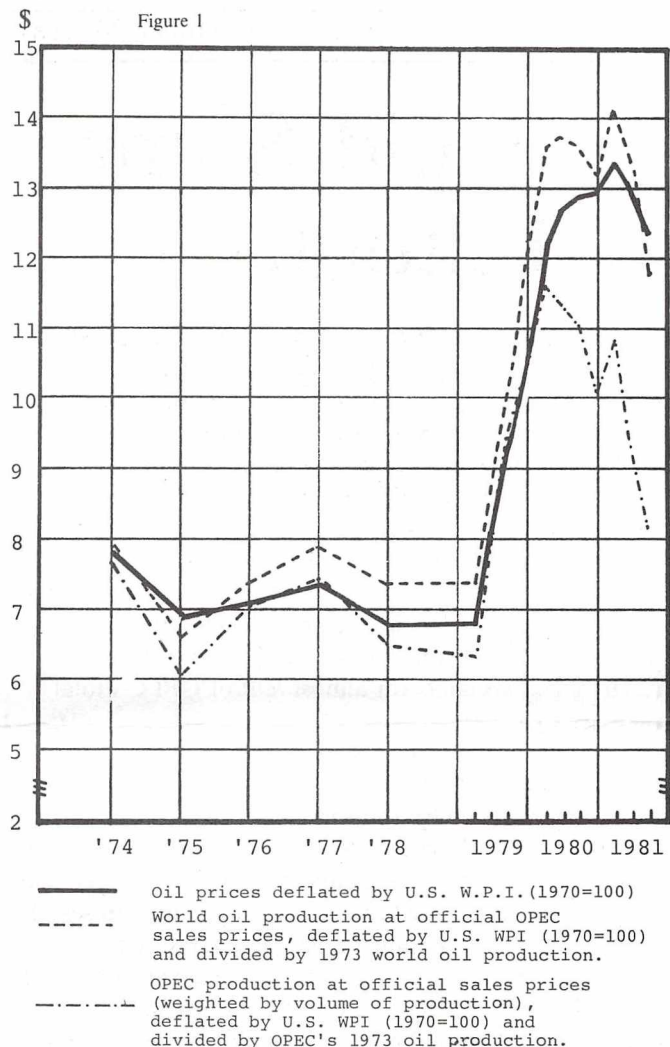
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posite of prices), and divided this dollar value by OPEC's oil production in 1973 (prior to the first quadrupling of prices). We did the same for world production. The results, deflated by US wholesale prices, are presented in Figure 1.



There are a few caveats. First, we have assumed that world demand for oil, in *constant dollar terms*, would remain unchanged, i.e. if real prices are down, more oil would be consumed and vice versa. This simplistic assumption ignores ongoing substitution such as gas, coal and/or nuclear power. In view of present trends, and even assuming perfect price competitiveness, one could easily argue that oil's share of the total energy supply will diminish. In other words, the demand for oil, at declining prices, may not be as perfectly elastic as we have postulated. A second argument against perfect demand elasticity at declining prices is the size and gestation periods associated with investments in oil conservation. Some investments, such as increased gas mileage, are irreversible; others may require extremely lengthy and costly changeovers to accommodate perceptions of cheap and declining oil prices; others yet, for political or military reasons, may never materialize. Mitigating

somewhat the above negatives is the *possibility* that the ratio of energy per unit of output may have bottomed out, thus calling for higher levels of oil consumption as the world economy recovers from its present recessionary phase. This possibility, however, is rather slight in view of the fact that the North American economies are, as yet, a long way off reaching the level of energy economization attained by the European Economic Community and Japan.

There is one more point worth considering. We have assumed that oil producers, in a free and competitive market, will want to sell all the output that they are able to produce. We have therefore used 1973's volume of production for both OPEC and the World (30.9 mb/d and 55.5 mb/d). In the intervening years, however, proven reserves and capacity have increased rather dramatically. As an example, the US Defence Intelligence Agency has just concluded that the Soviet Union is capable of *sustaining* oil production at over 12 mb/d at least until 1985, with production rising gently every year until then, while natural gas exports are expected to double to 100 billion cubic meters annually by 1986. Those new estimates are in strong contrast to recent CIA estimates of just 10-11 mb/d by the middle of the 80's and 8 mb/d by 1990. What's more, the Agency has revealed new estimates of proven oil reserves of 80-85 billion barrels as compared to recent estimates of around 63 billion barrels. The report also says that Soviet natural gas production should rise by 7 per cent to 9 per cent annually, to around 630 million cubic meters per day by 1985. The estimated *increase* over present natural gas production levels is equal, in oil terms, to 36 mb/d, 80 per cent more than OPEC's present oil production!

Another unexpected and important increase in world oil capacity is developing in Tunisia. Oil discoveries by Tenneco and Standard Oil of Indiana are the first solid evidence that Tunisia may have a large scale onshore oil field and further confirms the potential of the Gulf of Gabes, which many geologists think holds billions of barrels of recoverable crude. Although it is far too early to know the extent of the new discoveries, informed sources speculate that Tunisia may be able to increase its proven reserves to as much as 10 billion barrels compared with 2.25 billion barrels as of Jan. 1, 1980. Tunisia currently produces about 110,000 barrels per day of high quality crude, which is comparable to that of its neighbors, Algeria and Libya. In short, our proxy for capacity and desired production levels is becoming rapidly obsolete.

What does Figure 1 tell us? Note the divergence that begins to emerge in the first quarter of 1980 between crude prices (in constant 1970 dollars) and our proxy for market clearing prices (again in constant 1970 prices). By the third quarter of 1981, crude prices are as much as 51 per cent overvalued, i.e. OPEC would have to lower prices as much as 33 per cent to produce and sell 'at capacity'.

Also, a significant overvaluation begins to emerge if one adjusts world production levels by those prevailing in 1973. Clearly, while non-OPEC sources have satisfied an increasing share of world oil demand, these sources of supply, too, are becoming 'pricey' in relation to world capacity production.

The growing divergence can be resolved in one of two ways. Nominal quotes remain frozen at present levels, approximately \$32/barrel for up to three years, letting inflation 'deflate' the real price by as much as 33 per cent. To accomplish this trick, OPEC and some of the other major non-OPEC producers would have to further curtail production. Given our assumption of unit elasticity, this would require a 33 per cent cutback in present-day production, a difficult operation given the growing number of producers and their budgetary and balance of payments problems. More likely, nominal oil prices will tumble and inflation will take care of the balance. This implies a drop in the light Saudi Arabia marker of about 25 per cent, bringing prices down to the \$24/barrel level. This scenario does not envision an orderly and/or voluntary price-cut. Rather, we are likely to see a growing number of concessionary terms, such as volume discounts from officially posted prices, financing deals, scattered price cuts on the part of the weakest OPEC members and Mexico, followed by renewed efforts to stabilize prices, and so on. The end result is the same: A substantial drop in oil prices that will send shock waves throughout the world.

The net global effect of this drop will be favorable: Favorable to those countries that quickly adopted realistic pricing policies, thus fostering investment changes *early in the game*; unfavorable to countries and industries that became involved in multi-million dollar substitution efforts at prices that bore little resemblance to world oil prices. Synthetic fuel and nuclear schemes ('at any cost') are examples of the latter. The drop will be favorable to countries that built in little protection around rising prices, and unfavorable to countries that are stuck with protective walls around unrealistic pricing schemes or slow administrative decontrol procedures. Finally, the drop will be generally favorable to consumers and consuming nations and unfavorable to producers and producing nations.

The massive negative shift in the terms of trade of producing nations will have serious repercussions on countries such as Mexico, the United Kingdom, Algeria, Venezuela, Nigeria, and Saudi Arabia. Generally speaking, the greatest losers will be the banks, now holding extraordinary amounts of uncollectible debt. In the special case of the UK, renewed budgetary and balance of payments problems will put an effective end to the conservative strategy. Social Democrats and Laborites will be returned to power, lurching Great Britain into Mitterrand's camp, from whence it shall never return. Canada, like other countries, will bemoan its fate, hoping that perhaps its recently concluded Oil Agreement will

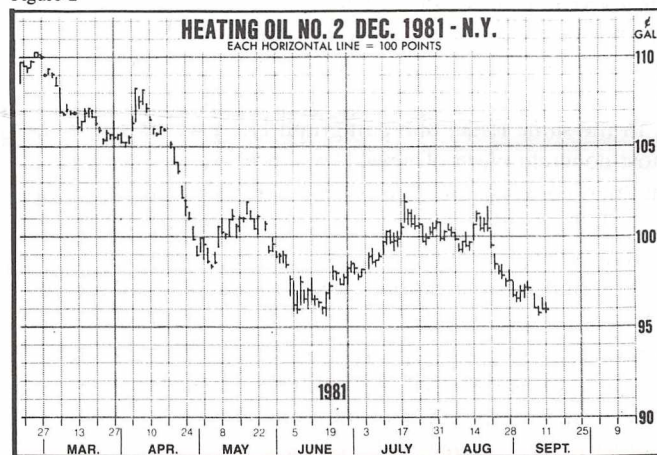
contribute to the welfare of the country, not today, but sometime in the next 30 years.

In the US the windfall-profit tax on oil, hailed by observers as a great boon to Federal revenues, will surely fall far short of expectations, adding woefully to present budgetary problems. On the other hand, the oil glut coupled with the inevitable decontrol of natural gas will remove once and for all America's dependence on foreign sources of energy, a very positive strategic development.

Even though the net global effect will be favorable, the world has won a Pyrrhic victory. Hundreds of billions of dollars were wasted because Western leaders were duped into thinking that the world would run out of oil and therefore, price did not matter. *Sic transit gloria mundi.*

**STRATEGY:** Remain heavily short Heating Oil, British pounds and Mexican pesos. In our previous Comments, we suggested protecting Sterling short positions by way of going long the Swissie; this strategy has proven extremely rewarding and should be continued on a trading basis, should the US dollar show significant signs of further weakening.

Figure 2



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## Precious Metals A time to buy

It is a truism that bear markets create their own bottom with the selfsame factor that, for interminable weeks and months, drives them lower. Let us explain. At first, a bear market is not obvious at all: It looks like just another bull market correction. Once the downtrend is somewhat more mature, reasons begin to emerge, none of which or all of which are reason enough for the decline. Public perception cannot identify accurately enough the reason for the drop. At an even later stage, as demoralization sets in, one or more causes become obvious enough (this is logical, as the market usually foresees what is to come), and traders as well as the media begin their bearish argument with the *one*

incontrovertible fact that *must* result in lower prices. The bearish factor, the X factor, has been discovered and now there is certainty: Prices must go substantially lower. Unbeknown to them, new, and of course not so obvious, factors are beginning to loom on the horizon that will counteract the X factor. The X factor is becoming so well known that nearly everyone has heard of it and nearly everyone has carried its conclusion to the logical end: to sell. The X factor, not being new, becomes worn out. Smart money asks: So what's new? Because the market thrives on something new, unforeseen, mystical, little obvious. And therein lies the secret of bull and bear markets. Stale news marks the turning point, fresh news marks the middle trajectory, expectation of fresh news marks the beginnings . . .

In the July 26th issue of our *Comments*, we stated that "... On a more positive note, both *Business Week* and *Time Magazine* have carried very bearish articles on gold, confidently quoting so-called 'experts' forecasts of \$200 to \$300/oz. The market can hardly be that accommodating to popular beliefs." We made these remarks not realizing how right we were, just two weeks after the BOTTOM. Then, the X factor, the one single identifiable bearish factor was high interest rates. Either it was time for a levelling off of rates (which we did not believe then, nor do we believe now), or it was time that the market began to lose its fascination with high rates: The news was becoming stale; it was a turning point.

In the same issue, one paragraph later, we stated: "The most concrete piece of news in the precious metals area is the final congressional approval to dispose of silver in an 'orderly fashion' over the next 3 years. Starting October 1, and barring any further snags, the GSA will sell 1 million ounces of silver per week. It smacks to us as the END of the bear market." The GSA disposal became the X factor, a powerful depressant when one considers that the silver to be disposed of represents as much as one third of the yearly US consumption. This factor, so bearish to the average trader can actually be construed bullishly: Markets tend to move to where the volume is. In fact, the US auctions will serve two purposes: a) They will accommodate volume buyers of physical material in an otherwise thin market, and b) They will remove, once and for all, the US Government's visible overhang.

One does not have to search very far to find another similar auction that preceded, accompanied and perhaps was responsible for one of history's greatest bull markets: gold, from 1976 to 1979. Our *Comments* of November 4, 1976 (a mere eight weeks after the BOTTOM), regarding the IMF auctions and their likely impact on prices can be considered a classic of market psychology and we therefore permit ourselves to reproduce it in its entirety:

*"The single most potent depressant on the gold market was the IMF's decision to dispose of 50 million ounces (split evenly between outright sales and return to members). However, and here is the catch, it is axiomatic*

*that a market will always move defensively in anticipation of an unfavorable development but will never discount that same development twice, i.e. while it is actually taking place.*

*Let us now examine, in chronological order, the market's reaction to the IMF's words and deeds.*

*On September 1, 1975, the IMF announced that it will sell 25 million ounces subject to ratification by its members. The P.M. fixing on the day of the announcement was \$154.60, down \$7.31 from the previous close.*

*By April 15th, 1976, date on which the IMF was said to be nearing final agreement on terms governing the sale, the P.M. fixing was \$127.75. Participants had had seven and one-half months to consider the negatives and concluded that the \$127.75 level would 'clear the market'.*

*On May 6th, 1976, the IMF announced the auction of 780,000 ounces to be offered on June 2nd, the first of eight auctions to be held every six weeks for four years. The actual setting of the date (it now was to become reality) had practically no effect on the market: The P.M. fixing was \$126.90.*

*It was obvious that the market was 'comfortable' with that level and fully believed that nearly 800 tons (almost a full year of South African production) could be disposed of in just four years, in addition to the additional potential supply arising out of the return of an extra 25 million ounces to member countries. This market conclusion was arrived at after a full eight months of 'deliberations'.*

#### IMF Auction Boxscore

	Date	Ozs. Sold	High Bid	Low Bid	Average	Total Bids (oz)
First	June 2, 1976	780,000	134.00	126.00	126.98	2,368,000
Second	July 15, 1976	780,000	126.50	122.05	123.02	2,114,000
Third	Sept. 16, 1976	780,000	114.00	108.76	109.40	3,662,400
Fourth	Oct. 27, 1976	779,200	119.05	116.80	117.71	4,200,000

*Why, then, did the auctions take place at prices below \$126-128/oz? Most probably because of the extreme weakness showed by the general commodity price level which went into a tailspin on or about the first week of July (coinciding with gold's breakdown below the initial \$122-124 support). Quite probably because of South Africa's well publicized payments difficulties and the bearish marketing implications it created. Least probable, but not to be dismissed lightly, the possibility that the market was 'allowed' to drift down by the BIS (and its members) after the 2nd auction to: a) test the Central Bank demand and thus, marketability of gold, as an asset, de facto b) accumulate bullion at the lowest possible price.*

*Prices have now returned to the 'old' equilibrium level set in April-May 1976. If our theory is correct, the forthcoming auctions will take place at prices which will average, at least, \$126.-128./oz."*

The rest is history.

The important chronological events regarding the GSA disposal are as follows: On March 17th, the Senate Budget Committee approved President Reagan's recommendation that the US sell silver, tin and other excess materials from the strategic stockpile as a way to save federal money. The March '81 contract closed that day at \$12.76/oz up 42¢/oz, reflecting hopes that the final approval will be blocked by silver interests. On April 8th, the GSA announced plans to sell approximately 140 million ounces of silver from the US stockpile over the next four years. Final congressional approval as to timing and amount was still lacking: Silver prices closed that day at \$11.60/oz, down over 21 cents and they were to close lower again in subsequent days. On June 15th, the Administration formally requested authorization to sell 52 million ounces in the 1982 fiscal year, beginning October 1, 1981. The amount and the timing were much more concrete and Silver closed at \$10.20/oz, down 29 cents. Final congressional approval is obtained through compromise on July 24th to dispose of 109 million ounces over three years. On Monday, July 27th, Spot Silver closes at \$8.38/oz, barely above its July 6th low of \$8.27/oz. In early August, Silver records a new bear market closing low: \$8.265 but prices hold steady and subsequently move higher.

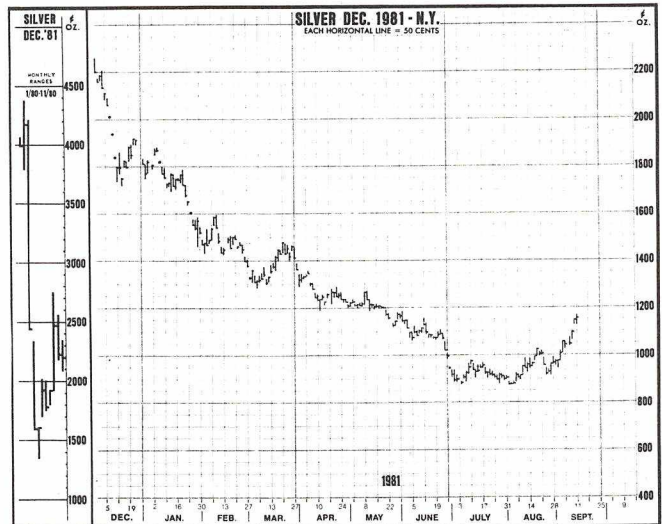
Clearly, the market has adjusted itself to this bearish factor by moving down, in a classical defensive manner, from \$12.76/oz to \$ 8.265/oz. Since a market does not discount twice the same news, we are forced to conclude that: a) No new lows will result as a consequence of this auction, although, as we have seen in the gold market of 1976, other factors may affect prices adversely, such as a renewed tightness of money or a deflationary collapse of commodity prices, and b) Auction prices will average substantially above \$ 8.38/oz.

It is perhaps more than a passing coincidence that both gold and silver bottomed out on or about the same time as the Fed began to ease its reins on bank reserves, i.e. in early July. The sensitivity of precious metals to monetary policy is well-known. It remains to be seen whether the Fed will, once again, take an active role in making money more expensive (bearish for precious metals), or become a passive participant in rising interest rates (bullish for precious metals).

**STRATEGY:** Silver should be bought on a scale down from 9.60 basis Spot (Friday's close 9.90 basis Spot) by accounts willing to risk closes below \$ 8/oz. Buying of very deferred contracts is recommended on the assumption that interest rates will resume to rise and, therefore, widen the switch.

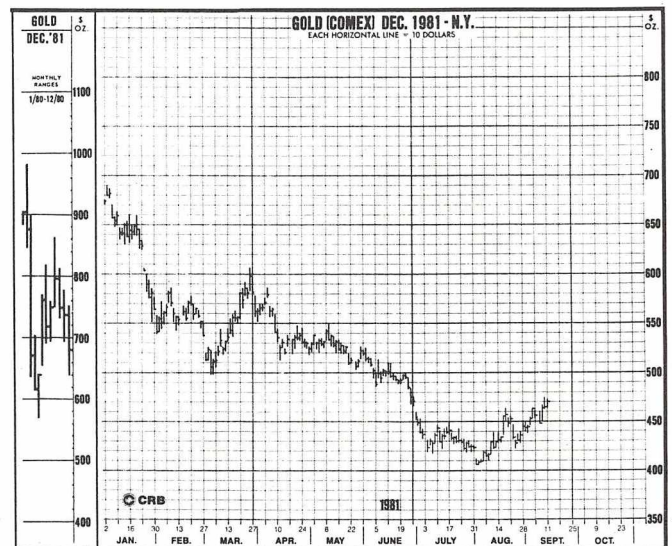
A limited buying program of deferred gold contracts is also recommended, on a scale down from 453 basis December '81 (Friday's close 465), risking contract lows.

Figure 3



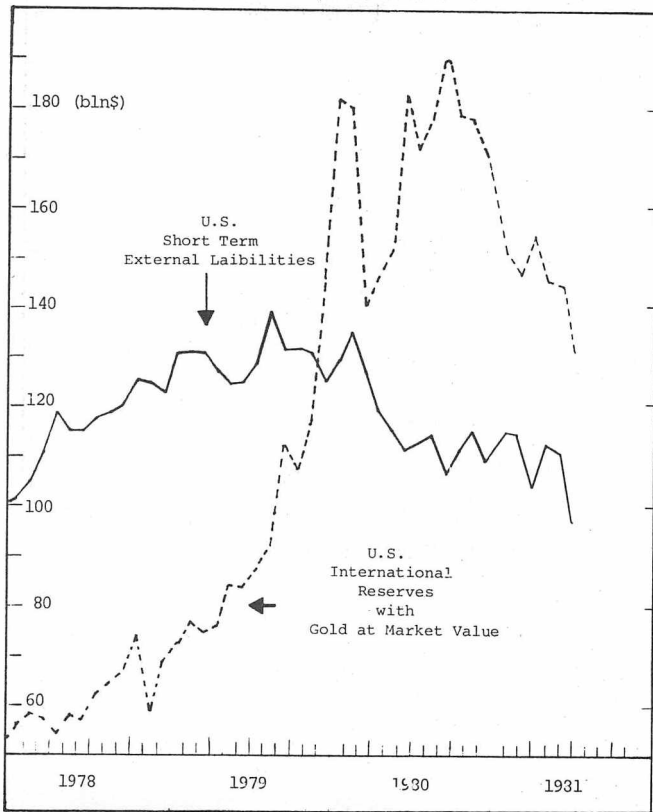
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Figure 4



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Figure 5



Sources : Federal Reserve Bulletin  
International Monetary Fund

Figure 6

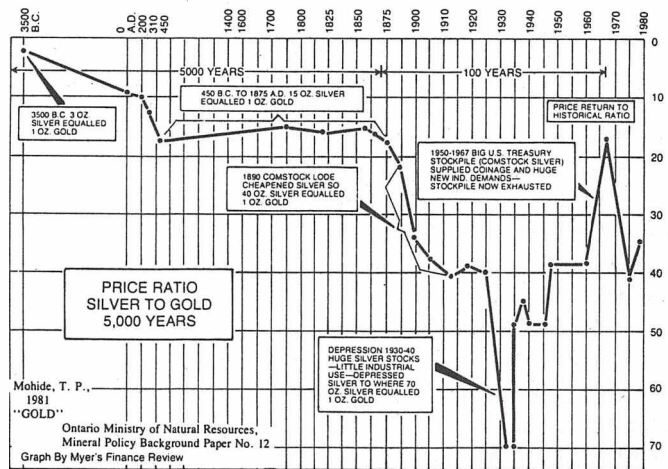


Figure 7

Silver in The United States (thousand troy ounces)		1978				1979				1980				1981
		1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr
Stocks, beginning of period														
Industry stocks		35,935	33,010	28,966	24,577	28,790	33,482	27,747	21,500	16,102	31,044	23,915	20,246	19,500
Defense Dept.		6,710	6,080	6,840	6,970	6,450	5,940	5,810	5,240	5,670	5,400	4,860	3,820	4,510
Treasury Bullion		39,360	39,266	39,217	39,208	39,157	39,149	39,129	39,064	38,990	38,958	38,958	38,937	38,890
Commodity Exchange		68,363	74,149	72,752	67,755	58,227	49,592	54,114	51,465	74,809	83,615	81,982	82,134	86,648
Chicago Board of Trade		61,040	62,510	63,955	62,240	59,885	55,325	56,845	65,290	58,320	57,515	45,750	46,115	34,150
<b>Total</b>		<b>211,413</b>	<b>215,015</b>	<b>211,730</b>	<b>200,750</b>	<b>192,509</b>	<b>183,488</b>	<b>183,645</b>	<b>182,559</b>	<b>193,891</b>	<b>216,532</b>	<b>195,465</b>	<b>191,252</b>	<b>183,698</b>
Plus:														
Production														
Mine		10,172	9,610	9,094	10,509	9,415	9,604	9,365	8,688	9,140	8,760	5,078	6,819	8,638
Refinery		24,482	23,847	22,120	20,993	21,952	22,822	20,641	25,715	31,799	27,250	13,246	17,696	24,802
Imports		23,275	21,827	20,643	9,896	24,756	18,071	18,570	30,981	21,971	17,481	18,814	20,431	24,412
<b>Total</b>		<b>57,929</b>	<b>55,284</b>	<b>51,857</b>	<b>41,398</b>	<b>56,123</b>	<b>50,497</b>	<b>48,576</b>	<b>65,384</b>	<b>62,910</b>	<b>53,491</b>	<b>37,138</b>	<b>44,946</b>	<b>57,852</b>
Minus:														
Consumption														
Net Industrial		38,192	43,155	37,284	41,534	51,779	43,040	30,916	31,515	31,482	36,118	25,016	32,585	33,796
Coinage		8	11	11	15	5	13	76	74	4	0	27	40	74
Exports		5,655	5,000	7,235	4,510	5,197	4,208	5,239	20,919	24,580	38,744	9,179	8,348	9,763
<b>Total</b>		<b>43,855</b>	<b>48,166</b>	<b>44,530</b>	<b>46,059</b>	<b>56,981</b>	<b>47,261</b>	<b>36,231</b>	<b>52,508</b>	<b>56,066</b>	<b>74,862</b>	<b>34,222</b>	<b>40,973</b>	<b>43,633</b>
Stocks, end of period														
Industry		33,010	28,966	24,577	28,790	33,482	27,747	21,500	16,102	31,044	23,915	20,246	19,500	22,565
Defense Dept.		6,080	6,840	6,970	6,450	5,940	5,810	5,240	5,670	5,400	4,860	3,820	4,510	4,240
Treasury Bullion		39,266	39,217	39,208	39,157	39,149	39,129	39,064	38,990	38,958	38,958	38,937	38,890	38,797
Commodity Exchange		74,149	72,752	67,755	58,227	49,592	54,114	51,465	74,809	83,615	81,982	82,134	86,648	85,352
Chicago Board of Trade		62,510	63,955	62,240	59,885	55,325	56,845	65,290	58,320	57,515	45,750	46,115	34,150	18,952
<b>Total</b>		<b>215,015</b>	<b>211,730</b>	<b>200,750</b>	<b>192,509</b>	<b>183,488</b>	<b>183,645</b>	<b>182,559</b>	<b>193,891</b>	<b>216,532</b>	<b>195,465</b>	<b>191,252</b>	<b>183,698</b>	<b>169,906</b>
Apparent increased (decreased) in Private Vaults		10,472	10,403	18,307	3,580	8,163	3,079	13,431	1,544	-15,797	-304	7,129	11,527	28,011

# Interest Rate Futures

The Fed continues to ease rather significantly in recent weeks. Non-borrowed reserves have grown at a 28.9 per cent rate in the past thirteen weeks while average borrowed reserves have fallen to \$ 617 million in the week ended September 16th. Also for the past week, Fed funds have averaged less than 16 per cent, trading at times down to 15 per cent without Fed intervention.

Clearly, the Fed has backed away from its tight grip on the banking system, concerned perhaps by the softness shown in real economic activity and encouraged by the subnormal growth of M<sub>1</sub>B. Broader monetary aggregates, however, have continued to exceed the Fed's upper target providing a potential limit to the amount of easing up that can be carried out without rekindling inflationary expectations.

We stand firmly committed to the view that interest rates are heading a great deal higher. The budget is out of control, corporate liquidity continues to erode, the Fed is unable to properly identify *money*, the Discount Window is now potentially open to one thousand thrift institutions. The only question is whether the Fed will engineer a necessary credit crunch or whether it will duplicate its 1976 - 1980 policy of following the rates up, too little and too late. Damned if it does and damned if it doesn't.

**STRATEGY:** Remain short December '81 T-Bills, leaving stops at 87.00, close only. December '81 T-Bonds can be sold at present levels, placing protective stops at 63½, close only. We maintain a target of 79.00 for December '81 T-Bills and 52 for December '81 T-Bonds.

Figure 9

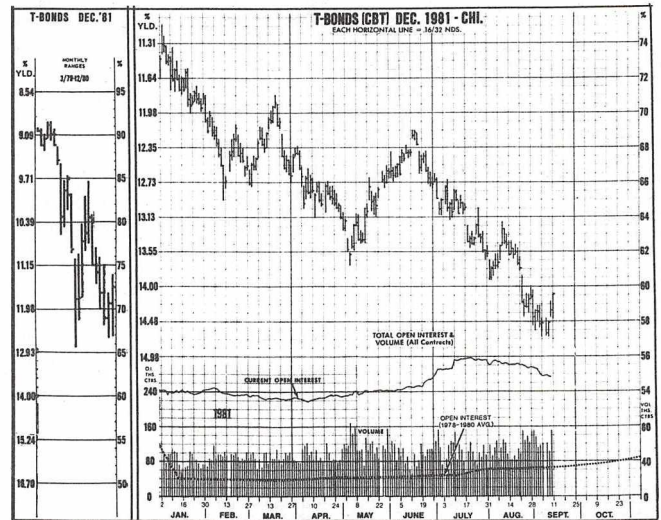


Figure 10

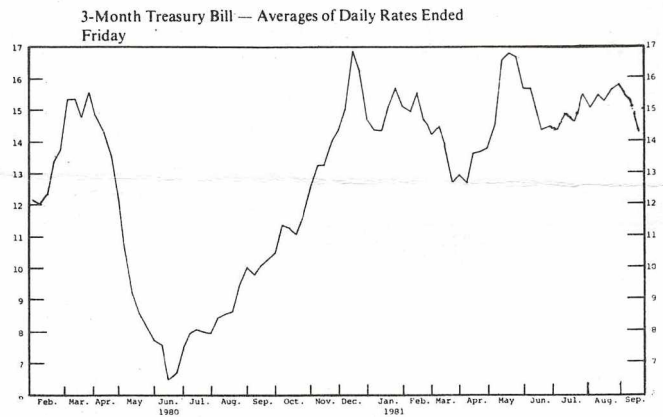


Figure 8

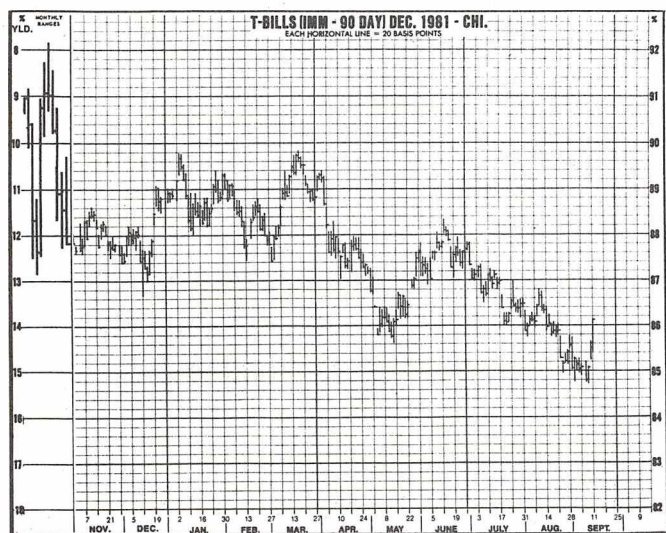
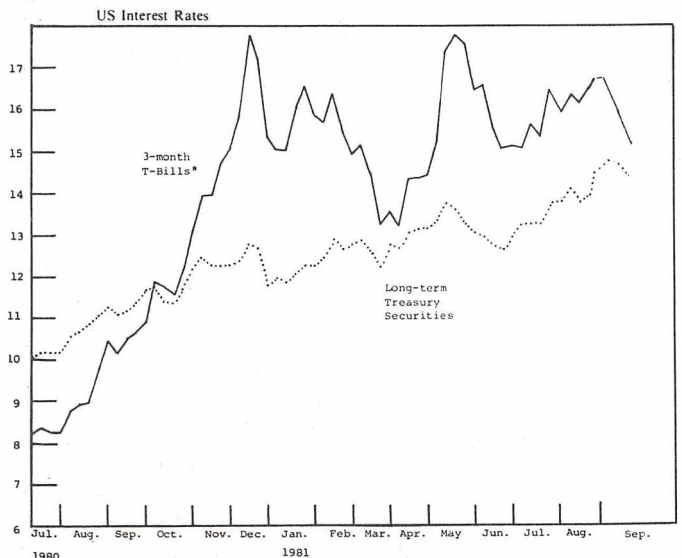


Figure 11



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\* Adjusted to a true yield basis from a discount basis

Source: Federal Reserve Bank of St. Louis

Figure 12

**TREASURY BILLS (1MM) - \$1 mil.; pts. of 100%**

	Open	High	Low	Settle	Chg	Settle	Chg	Open
Sep1	85.79	85.82	85.72	85.73	-.02	14.27	+.02	3.964
Dec	86.35	86.42	86.28	86.32	-.04	13.68	+.04	19.181
Mar82	86.53	86.58	86.46	86.52	-.04	13.48	+.04	6.919
June	86.67	86.74	86.64	86.66	-.08	13.43	+.08	3.719
Sep1	86.70	86.72	86.66	86.66	-.08	13.34	-.08	1.625
Dec	86.71	86.73	86.66	86.67	-.06	13.23	+.06	1.355
Mar83	86.72	86.72	86.66	86.66	-.07	13.34	+.07	1.305
June*	86.70	86.72	86.66	86.66	-.07	13.34	+.07	476

Est vol 15,739; vol Thu 23,007; open int 38,544, -705.

**INTERNATIONAL MONETARY MARKET**  
Division of Chicago Mercantile Exchange

September 18, 1981  
3 MONTH DOMESTIC CERTIFICATE OF DEPOSIT FUTURES  
(\$ 1 million; pts of 100 pct, adri m)

	Open	High	Low	Settle	Pt Chg	Yield	Add On
Sep181	83.70	83.72b	83.62	83.64	-	16.36	-
Dec81	83.55	83.69	83.54	83.61	+ 2	16.39	-
Mar82	83.73	83.77	83.71b	83.77	+ 7	16.23	-
June82	83.90b	83.90b	83.90	83.90	+ 10	16.10	-

Est. Vol: 1,520; Vol.: Thursday 2,870; Open Int: Thursday 3,385, -56.

**Chicago Board of Trade**  
LaSalle at Jackson, Chicago 60604  
90-DAY DOMESTIC CERTIFICATES OF DEPOSIT  
(\$1 million; pts of 100%)

September 18, 1981

	Open	High	Low	Settle	Net Yield	Chg	Open
Dec81	83.61	83.65	83.52	83.55	16.45	....	641
Mar82	83.74	83.75	83.72	83.73	+ 01	16.27	- 700
June82	83.90	83.90	83.89	83.89	+ 01	16.11	- 418
Sep82	84.00	84.00	84.00	84.00	+ 03	16.00	- 228

Est. Sales: 2,000; Volume: Thursday 1,953; Open Interest: 1,987, +111.

Figure 13

**CANADIAN FUTURES CONTRACTS**

**91-DAY TREASURY BILLS**  
(Combined Toronto-Montreal trading)  
\$1 million; multiples of \$0.005

	Open	High	Low	Settle	Open
Sep 81	95.380	95.380	95.380	95.380	6
Dec 81	95.575	95.575	95.575	95.575	24
Mar 82	95.625	95.625	95.625	95.625	24
Jun 82	95.775	95.775	95.775	95.775	10

Sales: Friday 0; Thursday 4  
Total Open Interest: Thursday 64 - 3  
Normal Daily Price Limits 50.150 above or below prior settlement price.  
(Winnipeg trading)  
91-day Canada treasury bills  
\$200,000; points of 100 per cent

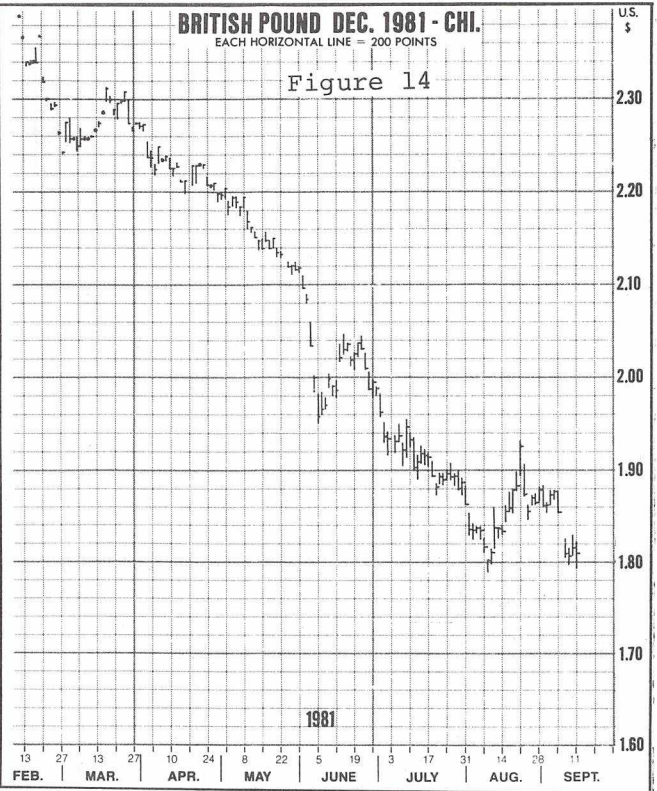
	Open	High	Low	Settle	Open
Sep 81	80.65	80.65	80.65	80.65	15
Dec 81	81.00	81.00	81.00	81.00	25
Mar 82	82.00	82.00	82.00	82.00	9

Total Sales: Thursday nil.

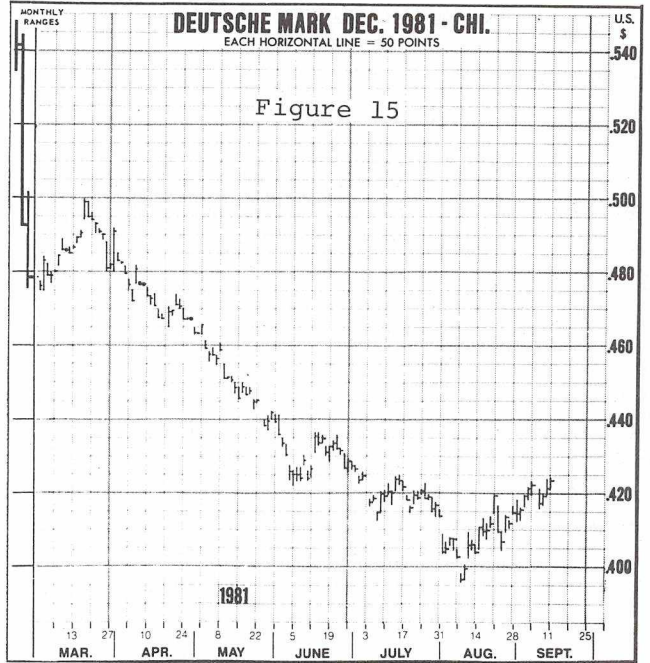
**MID-TERM GOVERNMENT OF CANADA BONDS**  
(Combined Toronto-Montreal trading)  
5 Year 9% \$50,000 princ.; Price is % of Par Value  
(Fractions are 32nds of 1%)

	Open	High	Low	Settle	Open
Sep 81	61.00	61.00	61.00	61.00	...
Dec 81	61.00	61.00	61.00	61.00	...
Mar 82	62.02	62.02	62.02	62.02	...

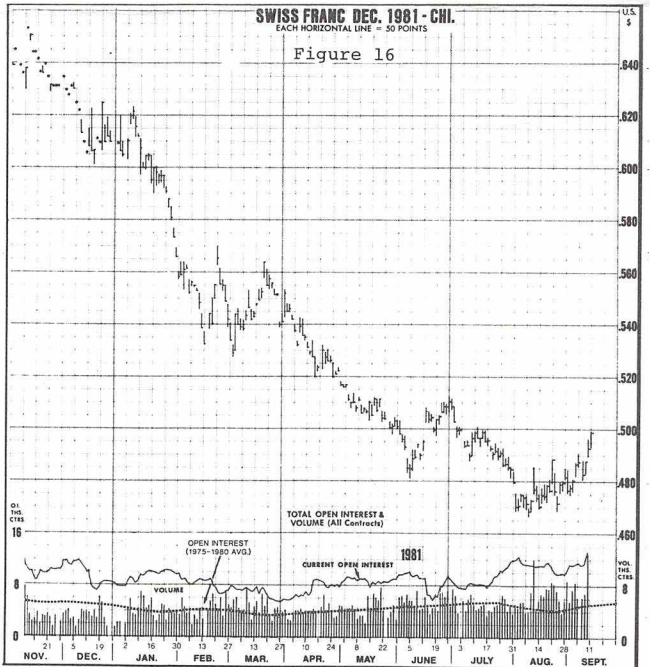
Total Sales: Thursday nil.



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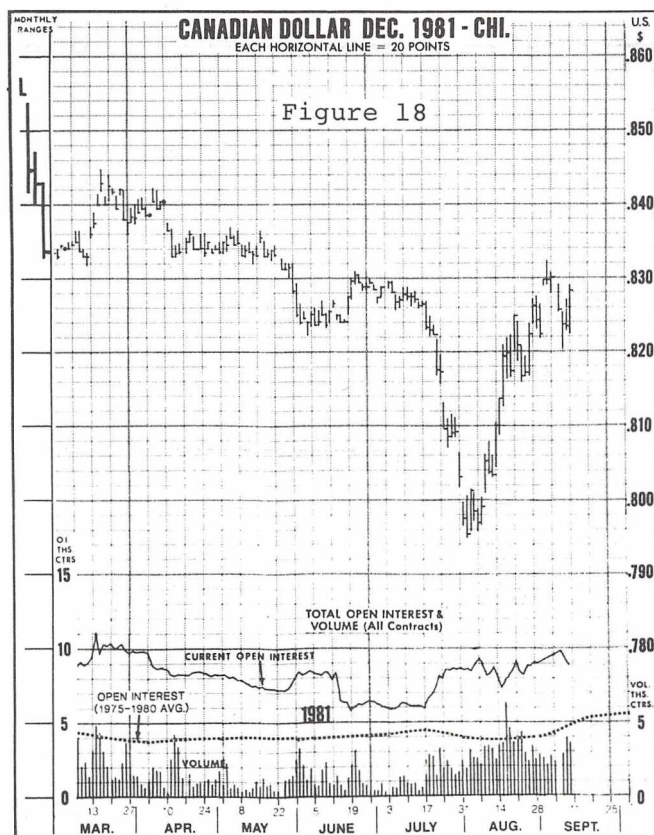
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# Currencies

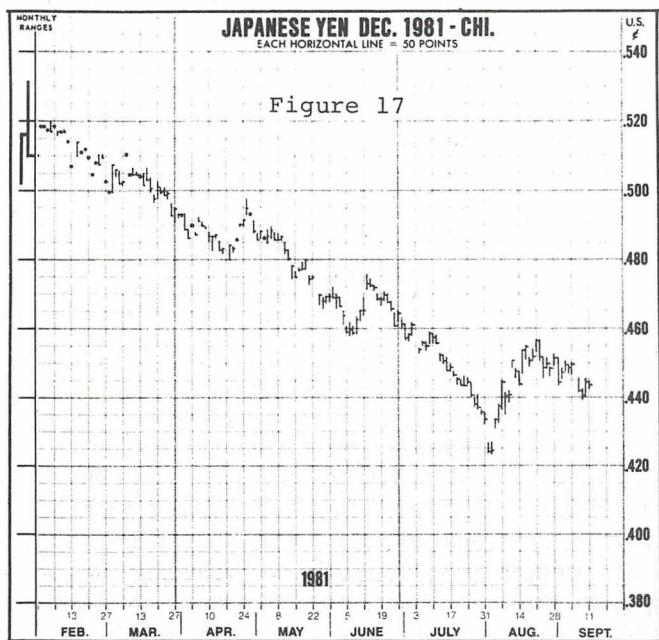
The Swiss franc, Deutsche mark and Japanese yen continue to benefit from the recent easing in US monetary policy and a favorable shift in their respective current accounts.

As the accompanying chart shows (Figure 19), the British pound continues to lose ground *vis à vis* the DM (and the Swissie too), and for reasons outlined in our opening remarks, we expect it to depreciate further.

**STRATEGY:** Remain sidelined on the Deutsche mark. Long positions in Swiss francs as a hedge to Sterling short positions may be retained. Cover short positions in Japanese yen. The announcement of an oil agreement between the Federal Government and Alberta gave us an opportunity to sell the Canadian dollar; remain short.



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Figure 19

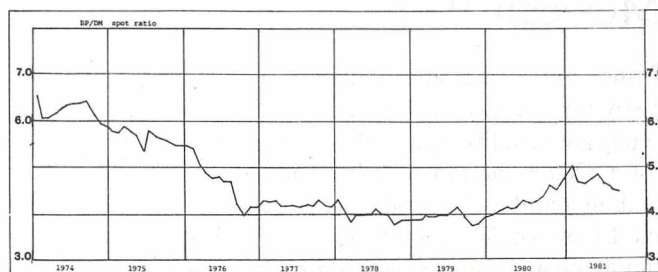


Figure 20

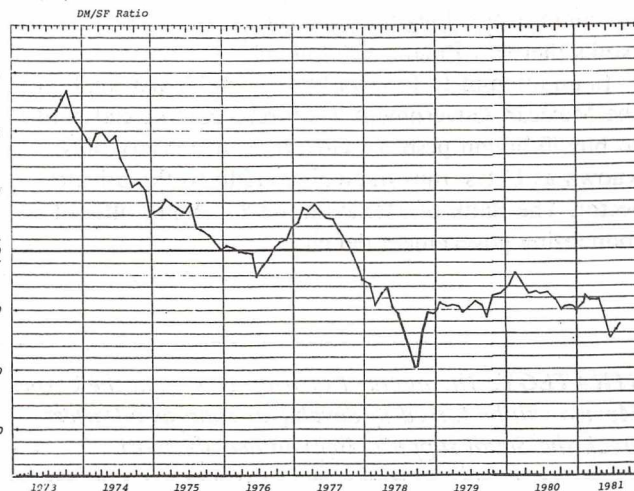
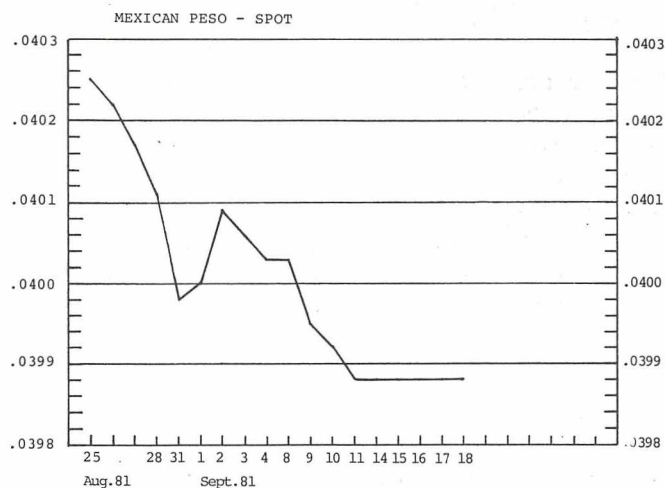


Figure 21

	Aug. 81	Jul. 81	Jun. 81	May 81
<b>Balance of Trade</b>				
C.D. (bln CD\$)		+ .439	+ .500	+ .461
D.M. (bln Marks)		+3.37	+1.67	+1.57
J.Y. (bln US\$)		+2.36	+2.58	+ .856
SFr. (bln Francs)	-.991	-.507	-.708	-.482
<b>Current Account</b>				
D.M. (bln Marks)		-3.1	-3.8	-1.5
J.Y. (bln US\$)		+ .871	+1.31	+ .277
<b>Overall Account</b>				
D.M. (bln Marks)		+1.3	-1.46	+2.83
J.Y. (bln US\$)		-.781	-.954	-1.17
<b>Reserves</b>				
U.K. (bln US\$)	24.51	24.58	25.63	26.49
C.D. (bln US\$)	3.29	2.31	3.05	3.18
D.M. (bln Marks)	71.10	75.20	74.3	75.6
J.Y. (bln US\$)	27.66	27.51	27.84	27.7
SFr. (bln Francs)	19.20	19.35	23.04	19.3
<b>Cost of Living or C.P.I.</b>				
U.K. (1974 base)		297.1	295.8	294.1
C.D. (1971 base)	240.6	238.9	236.8	233.2
D.M. (1976 base)	124.7	124.4	123.9	123.3
J.Y. (1980 base)		105.0	105.3	105.3
SFr. (1977 base)	117.8	116.0	115.4	114.6
<b>W.P.I.</b>				
U.K. (1975 base)	223.8	222.1	221.0	219.0
C.D. (1971 base)		272.9	271.9	269.6
D.M. (1976 base)	127.7	126.0	125.1	124.9
J.Y. (1975 base)		135.0	134.4	133.8
SFr. (1963 base)	166.6	164.4	164.4	164.4
<b>Unemployment rate</b>				
U.K.	10.9	10.7	10.6	10.4
C.D.	7.0	7.2	7.3	7.1
D.M.	5.5	5.3	5.3	4.8
J.Y.		2.1	2.2	2.3
SFr.	0.2	0.1	0.1	0.2

Figure 22



## Copper

It's been said that one of the occupational hazards of being a commodities trader comes from the stress of trying to remain objective in the face of repeated losses. The truth of the adage is by now very clear to us. Having been stopped out of long positions in copper every time we assumed them since April, we suffer the despair of money lost and, in addition, the ignominy of having to accept that all one would have had to do to make money would have been to take the other side of our trades. Trying still . . .

We note that Comex stocks in New York have remained relatively flat at around 151,500 tonnes since last writing. LME stocks however, have registered their first decline of any substance — by 5,000 tonnes to 111,750 tonnes — so that the twelve week moving average of warehouse stocks in London and New York is showing a rate of decline of 3.9 per cent. The drop in inventories, unaccompanied by an uptrend in prices, indicates a continued unwillingness of dealers to assume them as well as a certain level of demand not being adequately met by supply. The latter presages higher prices over the long term but, once again, the question is when will the long term begin.

The technical picture is (colored) semi-bullish. Not trusting ourselves, we have sought the advice of a customer who has pointed out that the five-day moving average has crossed the twenty-day average at a time when the one-day close — Tuesday's — was at 83.30, above the twenty-day average and the highest close in the previous fifteen days. This signals the beginning of an uptrend. The same technician points out that on balance volume, which is an attempt to provide information on the quality of price movements by yielding a volume curve that can be compared with the price curve, turned bullish for the first time in ten months when the low of 78.40 registered September 8, was not confirmed. This also signals a trend reversal. The chart picture and open interest offer neutral signs.

## Mexican Peso

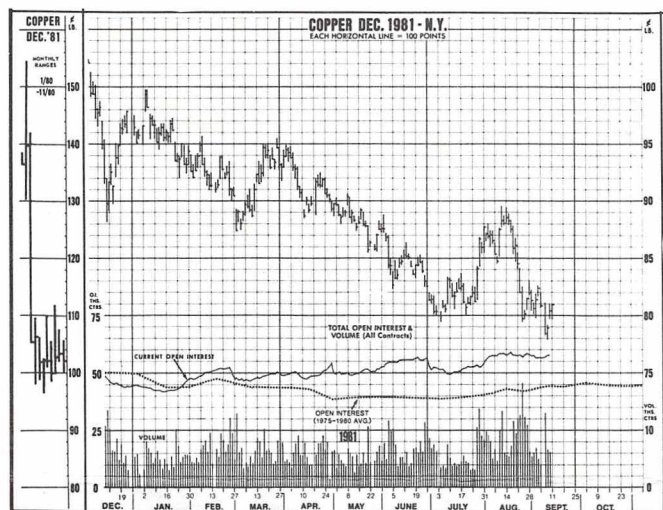
Pemex borrowings are running into some resistance. Early this week, Pemex had to cancel one of three large syndicated credits: that with the Bank of Nova Scotia for a \$200 million loan. It has had to scale down a \$500 million loan-bond hybrid (financing being arranged by the European Banking company) to \$200 million. Three simultaneous financing operations are a sign of desperation. The underwriters however, have oversubscribed the third issue showing an incredibly small 1.5 per cent premium over a long term UK bond. Are these the same banks that lent Poland \$26 billion?

In an attempt to forestall the inevitable devaluation, the Mexican Government has forced commercial banks to buy 10 billion pesos of Government treasury bills, known as Cetes, thus tightening credit to the private sector. The Bank of Mexico however, thinks little of monetizing government deficits.

**STRATEGY:** *The moment of truth is around the corner. Mexico will be forced to devalue as soon as oil prices break the Saudi support. Remain heavily short.*

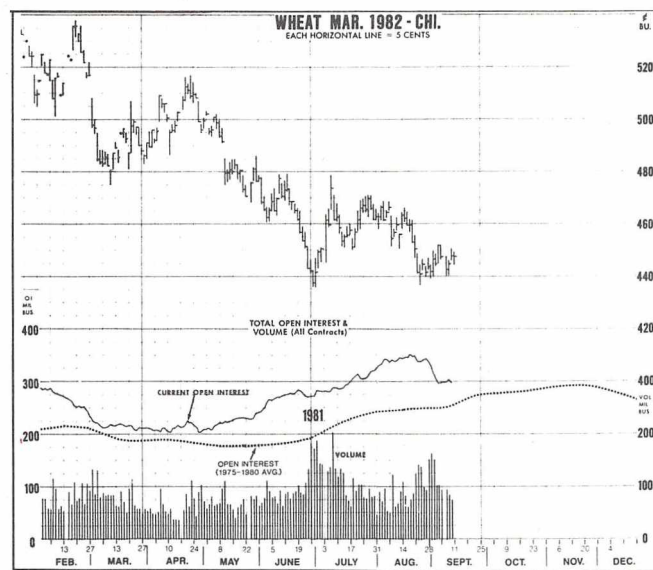
**STRATEGY:** Copper is worth probing from the long side, again with stops at recent lows. For those who understandably will temper their enthusiasm for such advice, we offer a second adage to the one provided in our introduction to this epistle: A bull market always provides ample opportunity to climb aboard. We don't hold it against anyone who will elect to be patient.

Figure 23



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Figure 24



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Albert D. Friedberg  
David B. Rothberg

## Grains

Briefly: The bearish crop reports have all been published. Everyone knows them. In other words, all the bad news is in. Given the steep price drop, one can be reasonably tempted to speculate that a bottom is close at hand. Of beans, corn and wheat, we prefer the latter because the seasonal hedge pressure does not burden it; the main part of the crop has been harvested.

**STRATEGY:** Buy March wheat on stop at 460 close only.

Notes:

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

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