

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Hume Publishing

November 15, 1981

30/30: A Frightening Prospect

There is a thirty per cent chance, in our opinion, that the world is entering an economic Armageddon similar to the one experienced in the 30s. Every day, and at every step, there are new and tragic developments that sow the seeds of further dislocations.

Consider the following. The US Department of Commerce filed an "unfair competition" complaint against five nations for selling steel at "unfairly" low prices. The items, carbon steel plate, used in bridges and heavy machinery, and hot rolled steel, used in cars, account for about 25 per cent of domestic steel output. This attack comes atop lawsuits initiated by US Steel, asking for widespread anti-dumping and countervailing duty action against 17 foreign producers. Recent press releases have quoted high EEC officials as saying that the US is engaged on a "dangerous course" that could lead to European retaliation against imports of American food, machinery and other products. Japan's car exports have already been effectively restricted or shut out of every major industrialized nation's market. Significantly, these same Japanese automobiles have continued to be extremely successful with Western consumers despite a

worldwide slump in car sales.

Short of a miracle, it is a foregone conclusion that the developed and developing nations will enter a tragic, beggar-thy-neighbor trade confrontation that will reverse the movement towards free trade initiated shortly after WW II. Living standards of even the most puritanical "players" will suffer immensely in years to come.

World commodity prices continue their free fall. The *duration* of the recent decline already exceeds the one experienced during the worldwide recession of 1974-75, although industrial commodities have dropped only 23 per cent to-date (measured by the London *Economist* index of 19 internationally traded raw materials) compared with 41 per cent in 1974-75. Food prices, on the other hand, have exceeded their previous decline by two percentage points (30 per cent vs. 28 per cent). Prospects for an immediate recovery are slim now that the US and Germany have begun strong cyclical contractions. Weakness in raw material prices will certainly add to the extremely onerous debt burden carried by non-oil developing countries (see Figure 1) and force a large number of them into default in coming months.

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Interest Rate Futures: Timing is crucial . . .

Precious Metals: Bearish factors are still at work;
a buy stop is suggested

European Currencies: The Swiss franc reigns supreme;
Sterling breaks out . . .

Grains: Imminent improvements in US export sales

Friedberg's Commodity & Currency Comments is published monthly by Hume Publishing. Make subscription checks payable to Hume Publishing.

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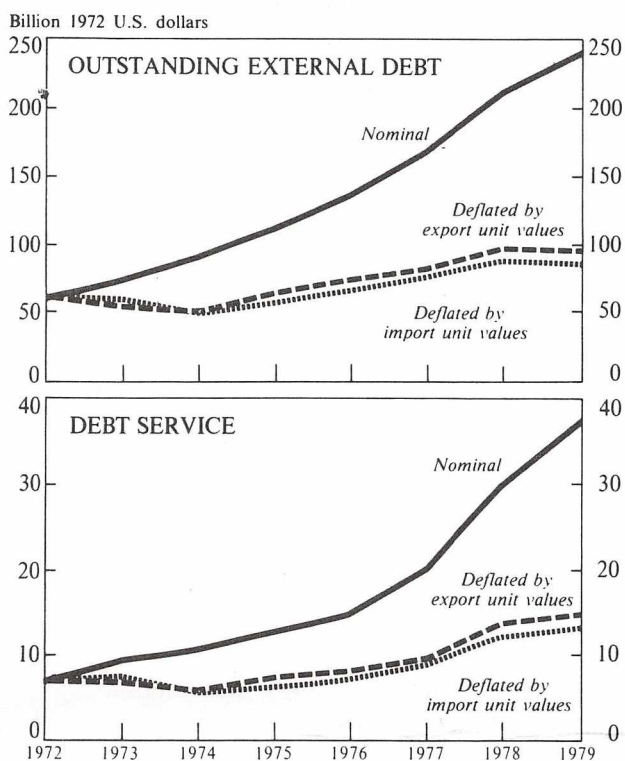
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Content for Friedberg's Commodity & Currency Comments is supplied by Friedberg Commodity Management Inc.

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Figure 1

Public External Debt and Debt Service for 87 Non-Oil Developing Countries, 1972-79



Sources: International Monetary Fund, *World Economic Outlook*; and World Bank, *World Debt Tables*.

Western trade with COMECON countries, financed entirely by naive Western bankers, threatens to slow down significantly in years ahead as a result of recent Polish and Rumanian defaults. While this artificially induced lift to world trade did not represent a very important share of Western business (see Figure 2), its demise will affect quite noticeably the COMECON'S ability to repay, thus putting further strains on banking liquidity. It should be noted that even the Soviet Union, the COMECON'S gilt-edged borrower, has begun to feel the strains of slumping world trade, poor domestic production and imperial adventurism: Its foreign exchange holdings have dropped over \$5 billion since the end of 1980, leaving it with only \$3.6 billion in deposits with Western banks.

Figure 3

Eastern European Countries:
A profile of their Debt

Rate of debt growth 1980 (%)	Short-term debt* to western banks as % of their total claims (December 1980)	Net debt in % of GNP 1980	Debt service as % of non-Communist exports
Bulgaria 8.1	Poland 33.1	Czechoslovakia 4.6	Romania 22
Poland 15.0	Bulgaria 36.3	East Germany 9.2	Czechoslovakia 22
Hungary 15.1	East Germany 38.6	Bulgaria 11.6	Hungary 37
Romania 17.9	Romania 42.7	Poland 17.7	Bulgaria 38
Czechoslovakia 22.6	Hungary 42.9	Hungary 18.4	East Germany 54
East Germany 22.6	Czechoslovakia 43.1	Hungary 20.2	Poland 92

*One year and under
Source: The Vienna Institute for Comparative Economic Studies

Figure 2

WESTERN TRADE WITH COMECON*

Country	Imports from Comecon		Exports to Comecon		Trade balances Exports minus imports ‡ (\$U.S.m)
	Value (\$U.S.m)	Percentage share of country's total imports	Value (\$U.S.m)	Percentage share of country's total exports	
Germany, Fed. Rep. of †	7,986	5	8,695	5	969
Italy	3,866	5	2,633	4	-967
Yugoslavia	3,449	27	2,660	41	-504
France	3,290	3	4,027	4	687
United Kingdom	2,958	3	2,058	2	-574
Finland	2,606	23	1,807	16	-628
Austria	1,773	9	1,992	13	276
Sweden	1,766	6	1,175	4	-468
Netherlands	1,811	3	1,144	2	-574
Belgium	1,059	2	1,059	2	52
Denmark	878	5	377	3	-455
Switzerland	1,134	4	1,068	4	-33
Western Europe (all countries)	35,326	5	30,409	4	-2,826
United States	1,976	1	5,674	3	2,812
Canada	265	0	991	2	734
Japan	2,233	2	3,244	3	1,228
Sub-total	4,474	1	9,909	3	5,774
Grand total	39,800	3	40,318	4	2,948

Country	Comecon Exports to the West		Comecon Imports from the West		Western trade balance Exports minus imports ‡ (\$U.S.m)
	Value (\$U.S.m)	Percentage share of country's total exports	Value (\$U.S.m)	Percentage share of country's total imports	
Soviet Union	21,892	38	20,037	31	-478
Poland	5,424	31	6,231	38	1,120
German Dem. Rep. †	4,475	28	5,276	35	1,017
German Dem. Rep. ‡	1,965	12	2,656	18	826
Czechoslovakia	3,213	23	3,067	24	37
Hungary	2,784	32	3,137	40	502
Romania	3,472	32	3,882	40	613
Bulgaria	1,050	12	1,309	15	325
Total †	42,310	32	42,939	32	3,140
Total ‡	39,800	30	40,319	30	2,949

* Figures refer to seven East European members of Comecon: Soviet Union, Poland, East Germany, Czechoslovakia, Hungary, Romania and Bulgaria.

† Including trade between East Germany and West Germany.

‡ Excluding trade between East Germany and West Germany.

Source: UN Economic Commission for Europe.

Commodity price-support schemes are becoming increasingly popular, threatening to defer long-run supply-demand adjustments indefinitely. International buffer-stock operations/cartels in cocoa and natural rubber have been added to tin, coffee, sugar, and crude oil. Price supports and income subsidies in dairy products, peanuts, rice, sugar, wheat, and corn remain the darlings of US House & Senate conferees.

Little remains to be said about the EEC's monstrous price-support schemes for its own agricultural products except to note, in a rather understated manner, that they run contrary to optimal resource allocation, and thus, economic efficiency. Here again, as in the above points, there is little relief in sight. World trade is bound to suffer.

The inability of Western countries to form strong, decisive, and rational governments is highlighted by recent political stalemates in Denmark, Belgium, Netherlands, and Portugal and narrow majorities in West Germany, Italy, Sweden, and Israel. Where clear

majorities have been obtained, the movement has been invariably to the left, witness France and Greece. Right-wing and well intentioned majorities, as in the UK (and the US?) have seen their support eroded owing to their inability to deal with budgetary looseness and bureaucratic entanglements. And now, the main advocate for US budgetary discipline, Mr. David Stockman, freely admits that hopes for a balanced budget in 1984 are chimerical because no headway has been made in defense and entitlement programs.

Finally, worldwide liquidity constraints — outlined in these pages in great detail over the past few months — are so pervasive as to abort any worthwhile recovery effort that can possibly be staged in coming months and years.

In all probability and in due time, industrialized nations will resort once again to Keynesian pump-priming measures to revive their dying economies. "Stabilizing" budgetary deficits and inordinate bank credit expansions, similar to the ones taken in the 1976-78 period but on an even grander scale, will be undertaken in the hope of inflating our way out of the deepening slump. To the extent that most of the people can be "fooled" into believing in restraint while the printing presses work overtime (concededly, a major effort if one believes in semi-rational expectations), the effort will be successful . . . at an eventual cost of a new and high inflationary plateau and a subsequent depression.

A second and even less pleasing alternative may be for most Western Governments to move more heavily in the direction of state control and nationalization of the means of production in a silly effort to save jobs. Such is the present course of action designed by the Government of Canada, the Province of Quebec and France.

In the third and improbable alternative governments react to a world depression by allowing free market forces to "cleanse" the system and lay the foundations for a renewal of the 1945-70 episode.

In all cases, near term prospects are frightening.

Interest Rate Futures

Paradoxically enough, the Fed has been tighter in recent months than at any time in recent memory. Bank reserves, adjusted by reserve requirement ratio changes, have *dropped* at an annual rate of 9.3 per cent in the two months ended Oct. 28, 1981, while year-over-year growth has slowed to the remarkable pace of only 2.8 per cent. Similarly, the adjusted monetary base in the same two-month span, has dropped at an annual rate of 1 per cent, while year-over-year growth has been moderate, at just 4.6 per cent per annum.

While credit demands remain extremely buoyant, inflationary expectations have been demolished in recent weeks with the consequent collapse of short- and long-term rates. Last month we warned that such a departure from secular trends was in the making, although we noted that it may only be temporary. Our concern still lies with the ravaged nature of corporate (and household) balance sheets.

A recent study released by Chemical Bank shows that the debt service ratio (interest on debt divided by cash flow) of US corporations stood at 0.44 in the second quarter of 1981, just barely lower than the 0.45 peak reading in 1974.

In the interim, interest costs have dropped somewhat from the second quarter average, and cash flow has certainly plunged with the advent of the business contraction, spelling certain trouble in the months ahead. Similarly, growth in bank investments, a good measure of bank liquidity, has slowed down to the lowest pace in eighteen months, while the strength of bank loans remains unabated.

Similarities drawn between the rallies that occurred in 1980 and late 1981 are superficial. In the first place, the drop in rates that began in April 1980 was accompanied just one month later by the largest issuance of corporate debt in years. The May and June 1980 totals of \$6.7 billion and \$7.3 billion were more than double the levels achieved early in the year, thus relieving some corporate liquidity constraints and accelerating bank loan repayments.

Significantly, rates *bottomed* during June, a sign that the credit markets could not be carried by expectations alone. The present peak in yields was registered in mid-May '81 (for 3-month T-Bills) and the first week in August 1981 (for 3-month Eurodollars).

As at the end of October, a full 3 months after the zenith of private short-term paper rates, the pace of corporate debt issuance remains absolutely lethargic, a mere \$3.1 billion. The rally, based on expectations of a drop in credit demands, has as yet not dented the enormous short-term indebtedness of US corporations. On present indications, offerings in the month of November are building up to a respectable showing, although far short of the levels achieved in May and June 1980.

Will the market accommodate the latecomers? Or will it, as is more likely, back away from the present overbought condition and begin a new upward cycle in interest rates? We think the latter. There are also innumerable other *dissimilarities*: credit demands remain much stronger than in the second quarter of 1980; the rate of decline in industrial production is much less severe; Treasury and agency borrowings are projected to reach \$44 billion this quarter compared with a mere \$14 billion in the second quarter of 1980, etc.

STRATEGY: Reinstating short positions in T-Bills and T-Bonds requires an exquisite sense of timing, one too difficult to transmit (even if correctly anticipated) in a monthly newsletter.

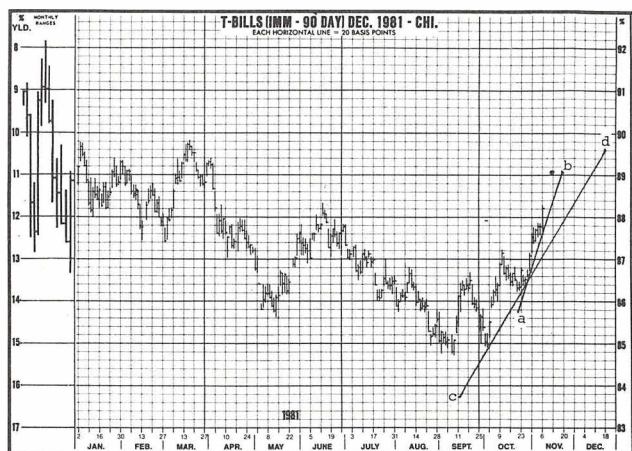
We will make an attempt using what, in our opinion, are the two best technical tools signalling a reversal: making a weekly reversal and breaking a trendline.

Focusing on the first signal, a close on any Friday (preferably based on the cash or spot market) lower than the previous Friday's close, with a new high being recorded in the interim, is a weekly downside reversal. It will force us to probe the short side until such time as either (a) the market makes a new high or (b) the market records an upside weekly reversal in the following week or weeks. In either one of these two cases, you should run for cover.

The second signal is simpler and independent of the first one (although if both signals are available, it would be all the more significant). Refer to the chart of December '81 T-Bills (Figure 4). A downside penetration of the a-b uptrend would provide the first sign that the upside momentum has been lost. Probe the short side, risking recovery highs. A downside penetration of the c-d uptrend would be even more meaningful and of course would call for adding to previously established short positions. A more conservative and more reliable approach to this strategy would involve the use of a cash T-Bill weekly average chart and the penetration of its a-b downtrend (yields up, bills down).

Liquidity consideration would dictate a stronger reversal in T-Bills and Certificates of Deposit than in T-Bonds. Act accordingly.

Figure 4



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Figure 5

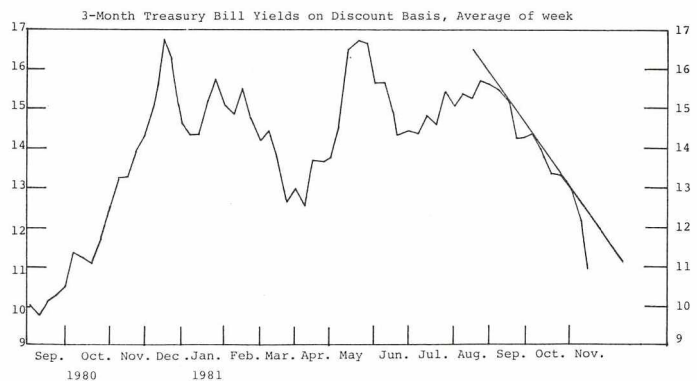
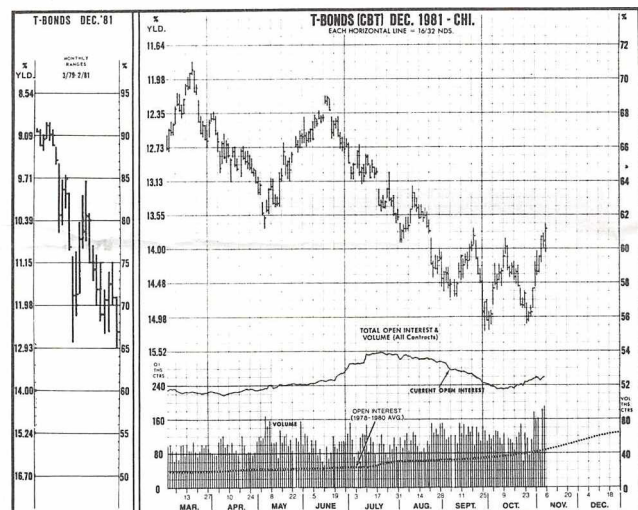


Figure 6



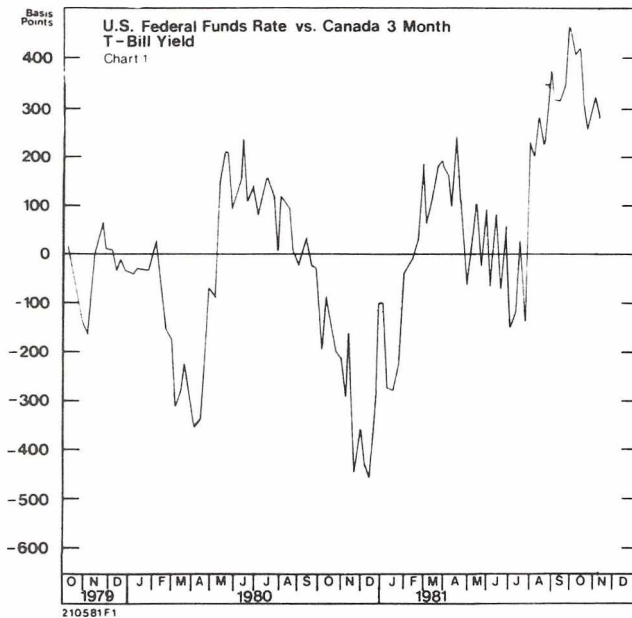
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Canadian Interest Rate Futures

Our spread strategy of buying 27 Dec. '81 Canadian T-Bonds and selling 20 Dec. '81 US T-Bonds has been handsomely rewarded. Using closing prices as of October 16 and closing prices of Friday November 13, the transaction shows a profit of US \$40,000.

STRATEGY: Close out the spread, and accept profits.

Figure 9



Fixed Income, Wood Gundy

Figure 10



Fixed Income, Wood Gundy

Currencies

British Pound

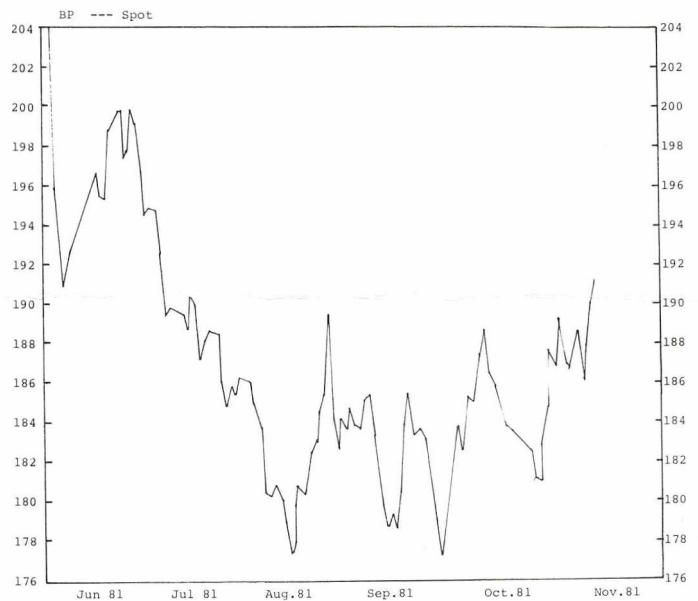
While the British index for manufacturing industries for the third quarter rose 1.5 per cent compared with the second quarter, the September index of production for all industries rose only slightly compared with the August figure, and the three-month index edged upwards by a modest 0.5 per cent. This "grasping at straws" has nonetheless firmed up the UK's money market where one-month Sterling CDs have fetched over 15 1/8 per cent. This phenomenon validates our view that liquidity preferences have come to overwhelm recessionary influences and will easily "choke" any full-fledged recovery.

Sterling quotes have shown a remarkable resilience of late, refusing to break below the 1.84-1.85 level and, in

fact, broke out, on Friday, above the technically important barrier of 1.90, no doubt influenced by favorable interest rate differentials vis-à-vis Eurodollar rates. Also, more significantly, domestic money market tightness has firmed the BP/DM cross-rate, which now stands at 4.24, up from a recent low of 4.10. In recent weeks, only the Swiss franc has outperformed the British pound as we have been anticipating for quite some time (see Figure 13).

STRATEGY: Despite our profitable hedged position (short BP, long SF), we would prefer to temporarily cover outright all our BP short positions. Remain sidelined.

Figure 12

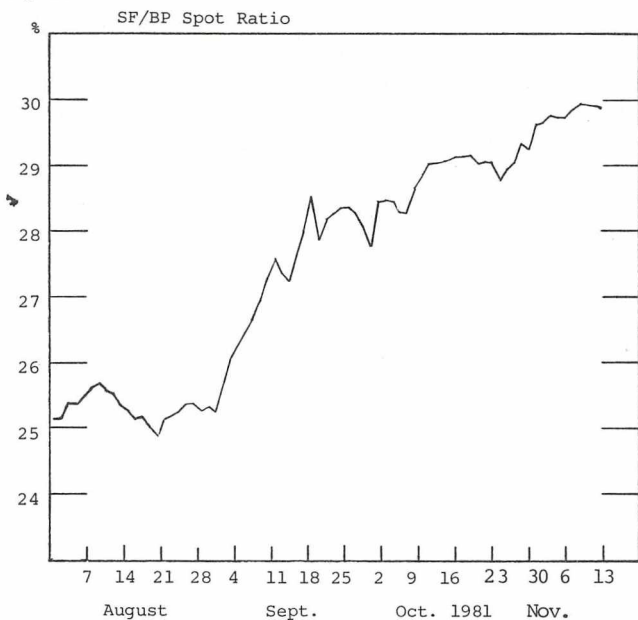


Swiss Franc

For the first time in nearly three years, the Deutsche mark broke the .80 Swiss franc barrier. As a result, the Swiss National Bank was prompted to do short term swaps at 6 3/4 per cent, substantially below money market rates. Nonetheless, the operation was only moderately successful as tightness persisted. 3-month Swiss deposit rates still exceed 12-month rates by 0.5 per cent and long-term bond rates by as much as 300 basis points.

STRATEGY: The Swiss franc still remains our favorite foreign currency. Long positions should be retained, risking 54.00 basis Spot. Our next upside target is 59.00 basis Spot; ultimately, it would not surprise us to see the March '81 Swiss franc at 65.00-66.00.

Figure 13



movements. Domestic credit, however, continues to surge, oblivious to the fact that Rome is burning. Consider the following; M_2 , M_3 , and general loans have grown at annual rates of 16.2 per cent, 21.7 per cent, and 30.2 per cent over the past three months.

What does the foregoing have to do with the Canadian dollar? Very little . . . for now. Either Canada maintains an extraordinarily high interest rate structure (measured in terms of a favorable differential vis-à-vis the US rates) or the Canadian buck sinks. And if it does, inflation soars.

STRATEGY: Cover (temporarily) short positions as forward discounts remain too steep. Reinstate short March '82 Canadian dollar if and when the discount to Spot narrows to 20 points.

Figure 14



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Canadian Dollar

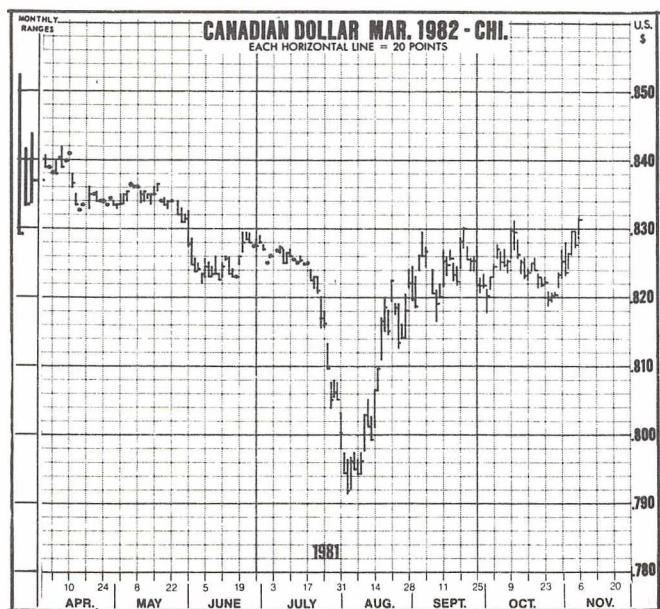
A light touch of supply-side economics, a heavy rhetoric of Statism, and a remarkable penchant for changing rules in mid-stream — a situation that does wonders for investor confidence. Thus, the new Canadian budget.

Lurking in the background is a frightening collapse of the current account (running at an annual deficit of almost C\$10 billion) and long-term capital account (deficit, in the second quarter, of C\$2.5 billion) compensated by a surplus of extremely volatile short-term capital flows and a draw-down of net official monetary

Figure 17

	Oct. 81	Sep. 81	Aug. 81	July 81
Balance of Trade				
U.K. (bln Sterling)		+0.013		
C.D. (bln CD\$)		+0.065	+3.372	+3.346
D.M. (bln Marks)		+3.48	-0.055	+3.7
J.Y. (bln U.S.\$)		+3.26	+1.74	+2.36
SFr. (bln Francs)	-0.442	-0.942	-0.991	-0.507
Current Account				
U.K. (bln Sterling)		+0.147		
D.M. (bln Marks)			-6.1	-3.1
J.Y. (bln US\$)		+2.12	+3.93	+8.71
Overall Account				
D.M. (bln Marks)			-4.49	+1.3
J.Y. (bln US\$)		+1.55	+6.01	-7.81
Reserves				
U.K. (bln US\$)	23.32	23.70	24.51	24.58
C.D. (bln US\$)	2.80	2.99	3.29	2.31
D.M. (bln Marks)	62.6	69.50	71.10	75.20
J.Y. (bln US\$)	28.45	27.98	27.66	27.51
SFr. (bln Francs)	17.81	20.78	19.20	19.35
Cost of Living or C.P.I.				
U.K. (1974 base)		301.0	299.3	297.1
C.D. (1971 base)	244.8	242.4	240.6	238.9
D.M. (1976 base)	125.8	125.4	124.7	124.4
J.Y. (1980 base)		106.1	104.4	105.0
SFr. (1977 base)	117.5	117.9	117.8	116.0
W.P.I.				
U.S. (1975 base)	227.9	225.9	223.8	222.1
C.D. (1971 base)		276.9	275.2	272.9
D.M. (1976 base)			127.7	126.0
J.Y. (1975 base)	135.5	135.7	135.7	135.0
SFr. (1963 base)	167.8	166.6	166.6	164.4
Unemployment Rate				
U.K.	11.3	11.1	10.9	10.7
C.D.	8.3	8.2	7.0	7.2
D.M.	5.9	5.4	5.5	5.3
J.Y.		2.1	2.0	2.1
SFr.	0.2	0.2	0.2	0.1

Figure 16



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Mexican Peso

In the first of a series of major corporate bail-outs, Banobras, the public works bank and an arm of the Mexican government, has signed a letter of intent to lend 17 billion pesos (\$680 million) to Grupo Industrial Alfa, the country's largest private sector holding company. This peso loan, at a concessional 40 per cent per annum (when free money market rates are running in excess of 55 per cent per annum) has created a political storm. The government, however, has had little choice, simply because a default would have extremely serious international repercussions. The Grupo has been a heavy user of Eurodollar syndicated credits.

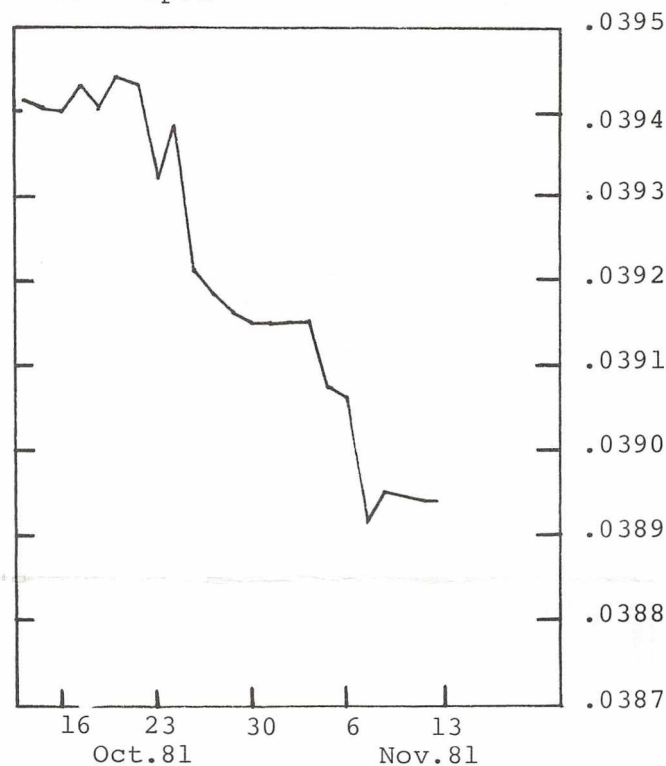
Recent Mexican borrowings reveal that the margins have begun to widen. A \$500 million eight-year credit being arranged for the state financing agency, Nacional Financiera (half of the amount in SDRs and the balance in US dollars) carries a margin of $\frac{5}{8}$ per cent over the relevant deposit rates. This is a higher margin than the most recent deals done at $\frac{1}{2}$ over LIBOR or $\frac{3}{8}$ over US prime.

The going is getting rougher, which of course, prompted the Foreign Affairs Undersecretary for Economic Matters, Mr. Jorge Navarrete, to state that public sector borrowings in 1982 would decrease to just \$12 billion from the \$16 billion anticipated for 1981. The reason? (Don't laugh.) An expected recovery in manufactured good exports. In the midst of a world recession. With a wildly overvalued peso. Incidentally, 60 per cent of the new financing will go towards refinancing (an acute case of borrowing from Peter to pay Paul), and 40 per cent will be new cash.

STRATEGY: There is very little risk in shorting deferred positions, as the peso is being devalued steadily by 1 per cent per month. We anticipate a faster rate of depreciation before the final collapse.

Figure 18

MP - Spot



Japanese Yen Deutsche Mark

STRATEGY: Remain sidelined.

Precious Metals

Recent action has vindicated our recent bearish scenario.

Reportedly, the gold market has been pressured by some heavy Russian selling, although, perhaps, the fact that it has already occurred allows for the possibility of a technical rally.

GSA silver sales have been rather disappointing. On November 12 (see Figure 19) no silver was awarded despite the fact that bids totalled 3.4 million ounces. As we stated last month, a bullish GSA makes us bearish . . .

STRATEGY: Bullion's insensitivity to lower US interest rates and a weaker US dollar denote uncharacteristic weakness. Nevertheless, in the present world environment, one can only put faith in the Creator and in gold, the latter only if and when it begins an uptrend.

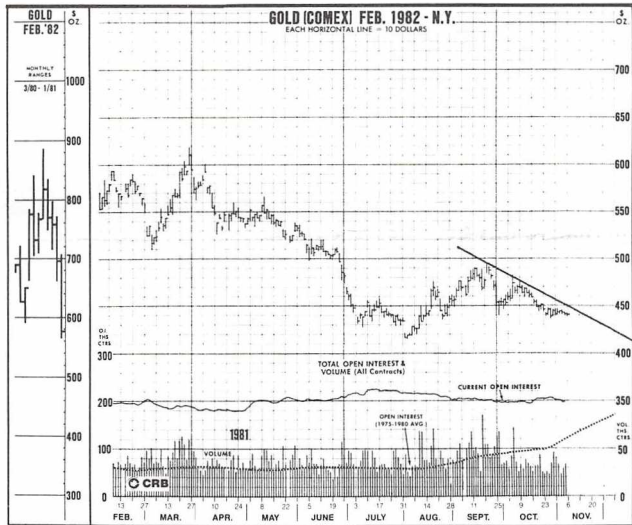
Be prepared to buy Feb. '82 gold if it closes above 440. Otherwise, stand aside.

As for silver, we believe that the gold/silver ratio will widen to perhaps 60 to 1; therefore, we would sell silver on bulges against the purchase of gold on dips, always doing the selling first.

Figure 19

CSA Silver Auctions								
Date	Amount Bid (million ounces)	Amount Offered (million ounces)	Amount Sold (ounces)	Average Sale Price (\$/oz.)	Net Sales (\$)	No. of Bids	No. of Bids Accepted	High/Low Bids
Oct. 14, '81	5.85	1.25	160,000	9.38/oz.	\$ 1,500,800			
Oct. 21	4.5	1.25	224,000	8.97	2,009,280	25	13	9.028/7.80
Oct. 28	2.728	1.25	448,000	9.023	4,043,300	11	10	9.075/8.60
Nov. 4	2.700	1.25	1,128,000	9.050	10,208,400	10	6	9.105/8.45
Nov. 12	3.400	1.25	Nil	Nil	Nil	11	Nil	8.451/8.11

Figure 20



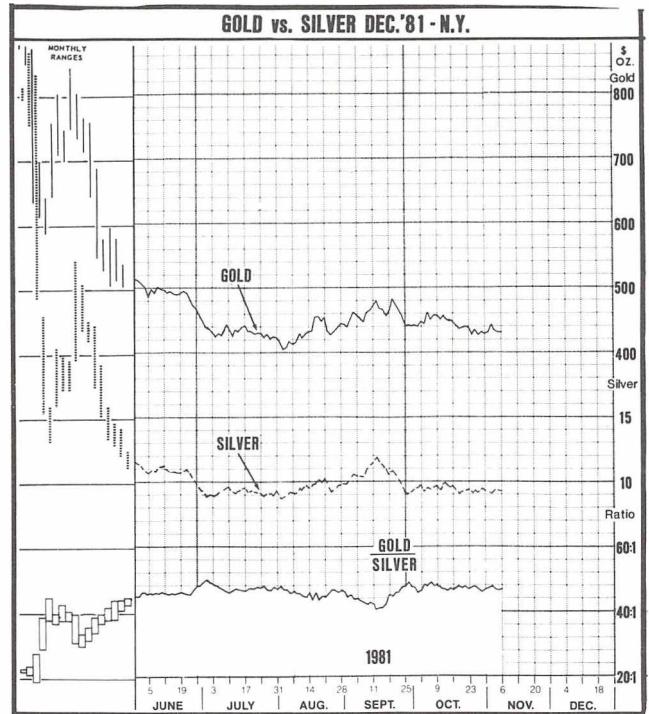
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Figure 21



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Figure 22



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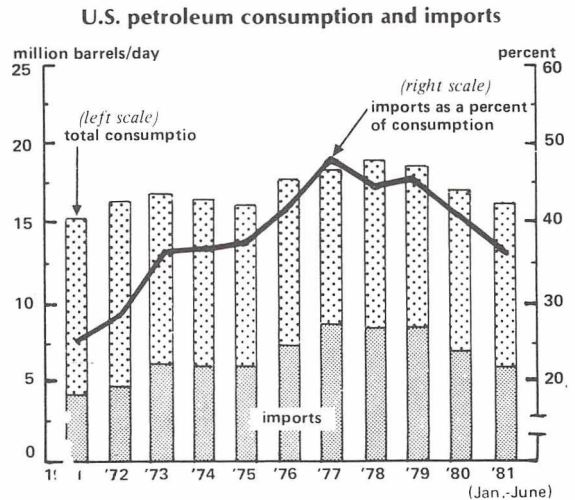
Heating Oil

One picture is worth a thousand words. We have therefore provided three fascinating pictures.

Sustained analysis of these charts will no doubt enlighten the few remaining bulls.

STRATEGY: Remain heavily short. Place stops at the equivalent of 105.00 basis December '81.

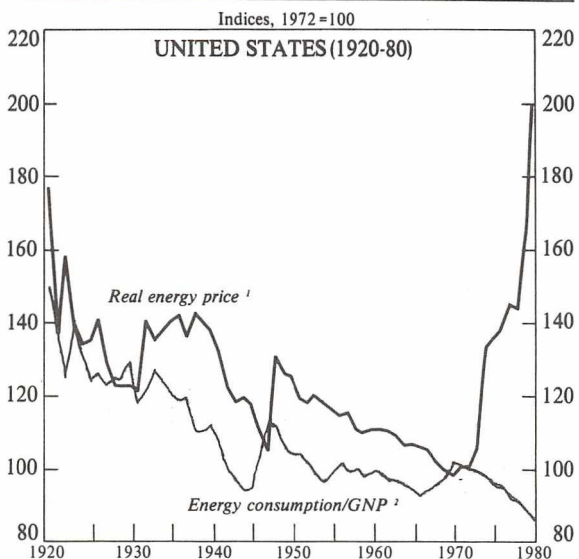
Figure 23



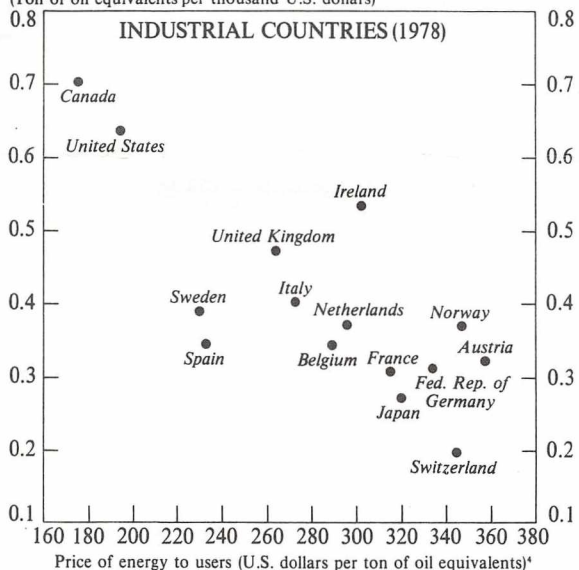
INTERNATIONAL LETTER
FEDERAL RESERVE BANK
OF CHICAGO

Figure 24

Industrial Countries: Energy Price and Energy Consumption Per Unit of GNP



Energy consumption per GNP³
(Ton of oil equivalents per thousand U.S. dollars)



¹ Average of producer prices for fuels, related products and power, and the consumer price index for energy, deflated by overall producer and consumer price indices, respectively. Prior to 1957, energy consumer prices were formed from fuel, utilities, and transportation indices.

² Ratio to GNP at constant prices.

³ GNPs have been converted to U.S. dollars at market rates; consumption is at the final user level and is in terms of metric tons of oil equivalents.

⁴ Prices described in footnote 1 to Chart 16, converted into U.S. dollars at 1978 exchange rates.

World Economic Outlook: A Survey by the Staff of the International Monetary Fund

Grains

Despite a continuing trend towards a weaker US dollar, which should boost US exports, grain sales by the US have been weak over the past month in view of the record crops of wheat and corn and near-record crops of

soybeans and feedgrains. Recent major declines in US interest rates have added to the slide of the dollar.

In spite of the relative cheapness of US products, foreign demand for US grain has failed to materialize at projected rates. Much of this can be attributed to the centrally-planned economies' diversification of supplies since the embargo. However, grain prices at present are a steal.

Very high levels of world trade have not supported grain and oilseed prices. Corn set new contract lows in the past week. The Federal Feedgrain Reserves Program loan rate is \$2.40, which has stopped corn prices from falling any lower; it is unlikely that corn prices can fall further. In addition, on-farm stocks are likely to be large following the harvest because lower interest rates don't provide as much of an incentive to sell corn immediately. Wheat prices have displayed a moderate seasonal uptrend since September, and corn should begin such a rise now that the harvest is almost completed.

Oat prices set a contract high recently, which is very near the all-time high price for oats on the CBT. The reason for high oat prices is a severe shortage of stocks — 1,446 million bushels of deliverable grade stocks in Minneapolis in 1981 compared with 7,422 million bushels last year. The soybean complex has exhibited very poor prices owing to competition from South American producers and declining world demand for soybean oil as alternative oils become very competitive or preferable.

Last week the US Senate began plans to set price support levels for corn and wheat for 1982-85. The minimum support level proposed is \$2.55 for corn and \$3.50 for wheat, with provisions for increases in the cost of production. Target prices suggested range from a minimum of \$2.70-\$3.15 for corn and \$4.00-\$4.75 for wheat. Soybean support prices have not yet been given consideration.

If world trade levels in grains and oilseeds decline while record or near record world production levels are maintained, these price supports could become very important for developments in world markets. Soybean complex price support levels are very low relative to costs of production; if support levels for grains are tested, soybean prices may fall sharply, while grain prices are supported.

In the meantime, exports of corn and wheat from the US should strengthen between now and January. Soviet imports generally peak during this period. The delay in commitments for grain purchases is cause for concern. Expectations that the value of the US dollar may continue to fall is a possible answer, but the fact that importers have 30 to 60 days to pay for goods and that they can borrow US dollars to be repaid at lower future dollar values tend to negate this argument. The Soviets, for example, may be feeling the financial crunch from their ventures in Afghanistan and Poland, as displayed by their depletion of international currency reserves in European banks and large sales of gold, estimated at

over 200 tonnes in 1981, to date. There is no doubt that large grain imports of 43 MMT are costly to the Soviets, although this situation should not cause import cancellations.

Corn and wheat are buys at present prices. Soybeans have displayed a steep downtrend in recent months, but cutbacks in crushings by processors in the Americas and Europe provide support at present. Developments in the near future should give a better indication of a new direction for prices in the soybean complex. Oats will likely show some resistance at their all time record high, but could conceivably break through this level.

STRATEGY: Corn has little to do but rise with seasonal advances. We suggest long outright positions. Soviet import developments would provide an excellent reason for price advances.

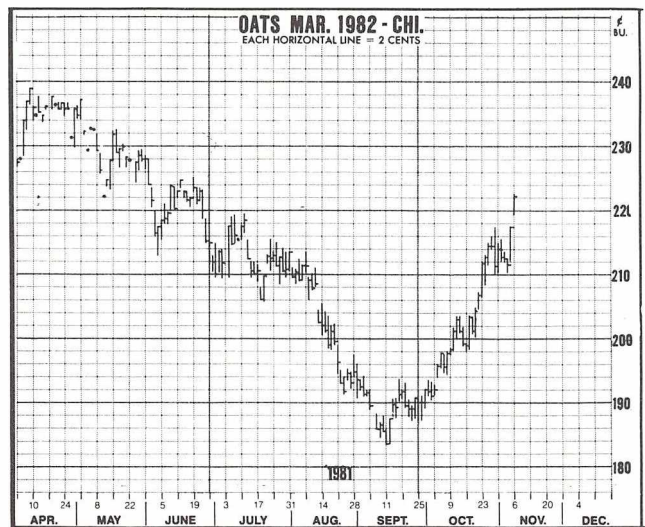
Maintain long wheat positions. We see no reason to abandon at this time the long May '82 corn/short May 82 wheat.

Figure 25



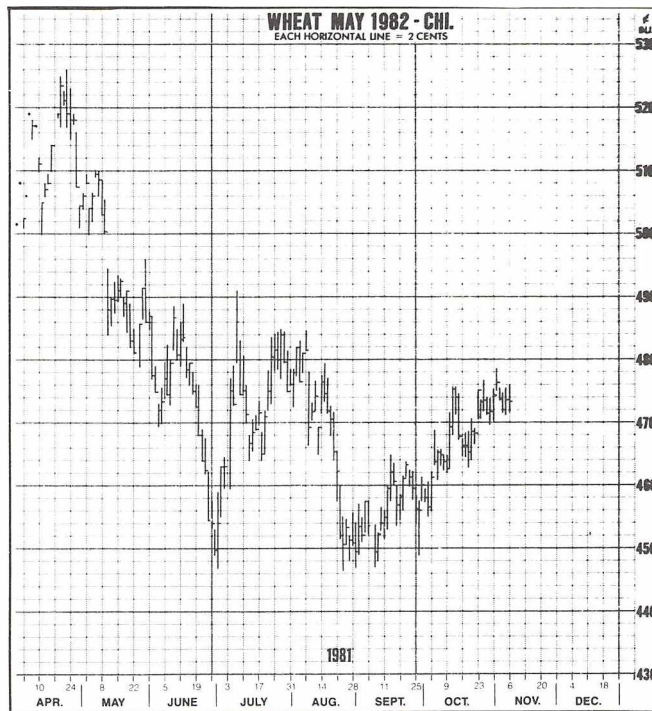
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Figure 27



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Figure 26



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Cocoa

We maintain the bearish posture initiated nearly a year ago when, in our November 26, 1980, issue entitled "On Supply, Demand and Common Sense," we projected a bear market that would last until late 1982. Our reasoning then was, briefly, that the high price of 1974-75 had affected elasticity; following the three years it takes to bring a tree into full production, surplus would ensue and weigh on prices. The cycle is roughly 7½ years.

Most recent estimates of the 1981-82 crop year are in keeping with our long-term view. This year's surplus, the fifth in a row, is currently put at 96,000 tonnes, up from last year's, as production estimated at 1.68 mln. tonnes is up 3.7 per cent, while consumption estimated at 1.59 mln. tonnes would be up only 3.25 per cent.

Such fundamentals however, are currently obscured by the working of the ICCO, a consortium of producing and consuming nations. Indeed, it is because such bearish fundamentals have depressed values to the extent they have that the ICCO established a fund to buffer prices. Originally budgeted at \$220 mln. the fund had as its goal the establishment of a price of \$1.10 per pound.

At latest count approximately 65,000 tonnes, calculated at about 68 per cent of the budget, had been bought, and the initial price floor has not been achieved. ICCO policy appears to have changed recently. The buffer manager is instructed to buy cocoa when the price falls below a price determined by a complicated formula. Today's price calculates at 93.28¢/pound. The emphasis thus appears now to be a defensive one of preventing further price

slides rather than on aggressively bidding prices higher.

OPEC notwithstanding, attempts of producers to establish protective cartels (which is what, in effect, the ICCO buffer stock is) have a high failure rate.

The main reason, of course, is that artificially maintained prices inhibit markets' elasticities and, by extension, the natural tendency of markets to allocate resources properly. In the case of cocoa the major threat is to consumption, which in the US has increased handsomely in recent years to a per capita average of 3.7 pounds.

Continuing on the theme of consumption, it is noteworthy that through the first nine months of this year, imports of beans into the US have exceeded last year's imports over the same period by 86 per cent — 456.0 mln. lbs. versus 245.3 mln. lbs. Combined imports of chocolate products are currently exceeding last year's rate by 13 per cent. Interestingly, however, grindings of beans over the same period have totaled 315.5 mln. lbs., or only 69 per cent of imports. This is to say a full 140 mln. lbs. of beans have been put in warehouses. Despite that inventories were low, and that per capita usage (a factor more of long-term significance) has increased, stockpiling beans, especially given the high financing costs that prevailed until the beginning of this month, was and probably is being conducted ahead of buffer stock buying.

This Monday, unfortunately the day after writing, the ICCO will meet to decide whether to add to the buffer fund budget. Rumor has it that the budget may be increased to the extent that the buffer manager will be able to purchase a total of 250,000 tonnes, or nearly four times what has already been bought. The current technical aspect of the market indicates that a rally is in the offing; thus, it would not be unwise to conclude that the budget will be augmented to a substantial degree.

The fundamentals are bearish. And, since we believe the attempt to artificially maintain prices can only be temporarily successful and ultimately will cause the very bear market the cartel seeks to avoid, and more importantly, since there now exist substantial inventories (both the buffer stock, which is storable for 18 months to 2 years and those in US warehouses, which are only storable for 1 year), it is our opinion that a strong rally should be used as an opportunity to be set short.

STRATEGY: Cover existing profitable shorts, recommended in the potpourri section of our August 30th Comments and look to sell March in the neighborhood of 2150 on a scale-up, risking 2450.

Figure 28



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Sugar

We are of the opinion the long-term bear market is still intact and that worthwhile profits remain to be taken from the short side.

The USDA's recent estimate of the 1981-82 world sugar crop called for production of 95.8 million tonnes, which is a record. The 9 million tonnes, or 10.40 per cent increase over last year's crop, is the highest season to season jump in outturn in 17 years. Consumption is put at 91.6 million tonnes versus 88.7 million tonnes last year. The resultant surplus is 4.2 million tonnes.

As recently as September, the market was expecting a surplus of only slightly more than half the current estimate. Given that corn prices are relatively even more depressed than sugar prices, fructose is expected to make further inroads into the sweetener market over the coming year. This trend was noted by the USDA to have been in effect during October. In sum, an estimated surplus of 4.2 million tonnes may be conservative; some unofficial trade sources have projected a surplus of as high as 5.0 million tonnes.

Focusing on specific variables that may either upset the bearish supply/demand balance or induce a temporary reversal in the downtrend, we must look at activity within the EEC and rumors of Soviet buying. There is a distinct possibility the EEC may join the ISA and consequently restrain sales and establish quotas. Were this to happen, a rally could be expected. Of greater, though longer-term, significance would be the bearish fact of stockpiles overhanging the market. Recently, EEC sales have picked up, following a lull in activity.

The Russian beet crop is one of the few in the world this year that is coming in beneath initial expectations. Soviet sugar output has thus suffered for the second consecutive year. As a result, there were rumors of Russia's purchasing as much as 0.7 million tonnes. So far, although the Soviets have entered the world market, such presumed optimism on the part of bulls has not

come close to being fulfilled. Given that the Soviets suffer from a currency shortage — extensive selling of gold from the USSR is known to have taken place — and that, once again, they will harvest a dismal grain crop we would expect sugar purchases to be a low-priority element of policy.

Technically, sugar has seen two rally attempts foiled in weekly downside reversals. The substantial buildup in open interest suggests public buying in hope of picking a bottom.

STRATEGY: Sell March at current levels. Stop of 13.50 on close. Profit potential is in the \$3,000 per contract range.

Figure 29



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Figure 15 refers to Swiss francs (Page 5).

Figure 15

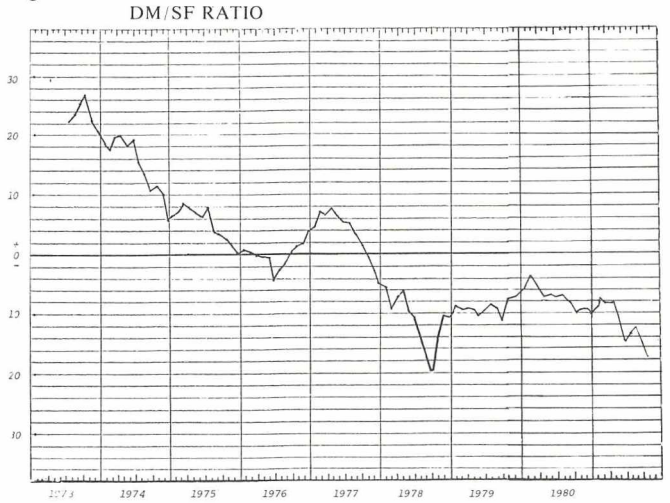
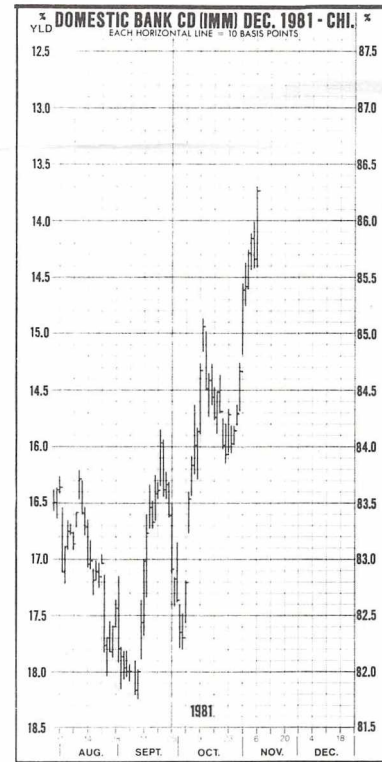


Figure 7 refers to Interest Rate Futures (Page 3).

Figure 7



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Michael Beech

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