

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS



Hume Publishing Limited

Volume 3, No. 1 January 17, 1982

A Return to Autarky

With everyone's attention focused on domestic economic problems, the world economy threatens to relapse into the dark ages of autarky, a replay of the 30s. Rising protectionism is the natural political reaction to the economic discontent and financial disorder that afflicts a large number of industrialized and semi-industrialized nations. In its final and most despicable form, protectionism locks normal cyclical fluctuations into permanent declines in production and standards of living; destroys individual liberties and creates the necessary conditions for a rise in totalitarianism.

On January 11, 1982, US Steel and various other US steel producers filed sweeping complaints charging unfair trade practices by European and other foreign steel-makers. If the US courts find injury, countervailing anti-dumping duties will be put on approximately 70 per cent of all carbon steel items imported into the US.

Although a final decision may not be reached for at least 11 months, steel imports will slow down in coming months because importers won't want to take the risks of selling products that later will be found in violation of US trade law and of being slapped with partly retroactive tariffs.

Regardless of whether the dispute is settled out of court, the damage to world trade and to US-European relations will be irreversible. European retaliation will not be long in coming: Agricultural products, particularly soybean, and chemical goods currently being exported by the US to the EEC will become the next pawns in this no-winners trade war.

Furthermore, in the past few weeks, the US government has begun demanding "reciprocity" in trade with Japan, particularly in the area of telecommunication. In this case, free access to Japanese markets may still lay

bare the supremacy of Japanese productivity, leading to further restrictions such as "sales reciprocity".

Bilateral and multi-lateral trade agreements specifying limits in tradeable goods and services can only serve to remove the advantages of a global division of labor with noxious effects on prices and quality. The recent conclusion of the multi-fibers agreement is a deplorable move in that direction. Other examples of a drive to economic nationalism and self-sufficiency abound: the very complicated Common Agricultural Policy adopted by the EEC, which effectively transfers enormous resources from their own industrial sectors (and more industrialized nations) to agricultural sectors (and more agricultural-intensive nations) while shutting out foreign producers by way of stiff tariffs; the negotiated quantitative limits to Japanese automobile exports to the US, Canada and Western Europe, despite clear evidence that domestic automobile industries are not able to satisfy consumers with either price or quality demanded, and so on.

In the above sense, our repeated warnings that the world may be heading for a repetition of the nightmarish 30s should not be taken lightly. Cyclical corrections in an *expanding* world economy are normal occurrences that cleanse excesses and provide a "refreshing pause"; cyclical corrections in a *contracting* world economy are devastating politically, socially and economically.

In two important respects the world economy in the 80s differs from the one in the 30s. In the first place, government activity — everywhere — as a percent of total income is a great deal larger than fifty years ago. Clearly, the effect of this inert octopus on overall economic activity stabilizes the employment effects of an otherwise free-falling economy. That is not to say that

In This Issue

Interest Rates: The trend is surely up . . .

US Dollar: Strong on many counts . . .

Heating Oil: Although the bear market is far from over, you may accept *partial* profits . . .

Precious Metals: It is futile to try to pick bottoms; remain short silver . . .

Tin: For the daring only . . .

1981: The long and short of it . . .

Contributors

Albert D. Friedberg

David B. Rothberg

Michael Beech

unemployment does not rise. Quite the opposite, as recent evidence suggests (see Exhibit 1).

Not only does it mean that unemployment rises *more slowly, less dramatically* but it also means that the economy reaches partial equilibrium at *much higher rates of unemployment*. Simultaneously, productivity gains become exceedingly difficult. Finally, the private sector is choked as a result of the enormous transfer of resources towards the public sector, maiming yet further the nation's productive capacity.

Only in a very narrow sense can it be said that governments' deficits are stabilizing. Rather, they tend to ameliorate an immediate and sharp pain and convert it into a chronic disease. The continuous and long-term rise of unemployment in the US, Canada, and particularly Western Europe are vivid testimony to this fact.

The second important difference between the 30s and the 80s lies in the area of exchange rates. Whereas in the 30s attempts were made to maintain gold parities (i.e., fixed exchange rates) for significant periods of time, later to succumb to deflationary pressures, the world entered the 80s with a generalized regime of floating (albeit managed) exchange rates.

The misguided attempts by the UK to restore pre-WWI parity, the persistent refusal of the gold bloc countries (France, Netherlands, Belgium, Switzerland) to correct their overvaluation in the mid-thirties as well as the German and Italian attempts to maintain a fixed rate of exchange in the context of foreign exchange controls, bilateral clearing arrangements and a multiplicity of blocked domestic currencies, all aggravated the world slump.

Given strong deflationary pressures outside of these countries, any attempt at maintaining fixed rates had to impact, by necessity, employment and industrial activity. Astute currency speculators, knowing fully well the futility of maintaining parities, initiated destabilizing bear raids, hindering the savings process and long-term investments needed to repair productive capacity. In this respect, the 80s are a bit more hopeful.

Floating exchange rates, on one hand, remove fiscal and monetary discipline *on a worldwide basis*. On the other hand, overvaluations are speedily corrected, facilitating world trade to a certain extent. Furthermore, strong deflationary pressures emanating from one region are not necessarily transmitted to other regions, removing partially the danger of synchronized slumps.

It should be pointed out that US monetary policy, with its emphasis on monetary aggregates, has come to resemble somewhat the workings of the gold standard. With one crucial exception. Under the gold standard, deflationary pressures forced the central bank to purchase gold and thus reflate the monetary base and, consequently, the money supply.

A quantitative monetary straightjacket knows of no such pressures. Had one been adopted in the '60s the US would not have experienced the ruinous inflation of the

'70s; interest rates — in the face of continued budgetary deficits — would have remained extremely high in real terms and corporate and individual balance sheets would not have deteriorated to the present state. Adopting a quantitative monetary policy at this late stage of the cycle produces unbearable deflationary pressures, threatening to bring down the whole house of cards; nevertheless, it should be maintained.

The only possible solution to the present impasse is a dramatic reduction in the budget deficit. While such action would remove the "stabilizing" effect of government expenditures on the economy and therefore, as we have seen, accelerate short-term pain, it will free sufficient resources for the private sector to reliquify itself and become, once again, the prime mover of economic activity.

One further note. Supply-side economics is correct in one respect and one respect only. The government's enormous budgetary gap must be alleviated by way of drastic cutbacks on spending rather than increases in taxation.

Assuming that our view of the world is correct — a world that segments itself into large trading blocs, losing the benefits of a liberalism that spanned more than a quarter of a century, a world that stagnates, *at best*, in the economic sense, a world in which governments continue to demand massive transfers of real resources from the private sector, a world partially committed to a monetarist credo — what strategic investment decision can be formulated?

In economic efficiency, the US has *relatively* less to lose from a loss in the specialization of trade than Western Europe or Japan simply because its trade with the outside world is relatively smaller in relation to GNP than the EEC and/or Japan. Furthermore, the US government's burden on the private sector, expressed as the relationship between budgetary deficits to GNP or government's expenditures to GNP, is considerably lower than its counterparts. It also follows that economic conditions in the US will be more favorable to capital than those prevailing in the EEC or Japan. Therefore, persistent capital inflows should sustain a relatively strong US dollar.

Currency adjustments are likely to become even more pronounced and dramatic. Nations plagued by high unemployment will resort to allowing their currencies to depreciate in their efforts to reflate the domestic economies. It is quite likely that the real rates of exchange of the European Monetary System (EMS) participants will decline to the point of producing substantial current account balances — a visible and potentially expedient method of providing employment relief (see Exhibit 3).

Strains within the EMS will become untenable. The French franc, the Italian lire and the Belgian franc will either cut loose from the EMS or re-enter the EMS at various intervals and after strong devaluations.

US interest rates will continue to rise, to perhaps unimaginable levels, provided the Fed maintains its monetarist stance and budget deficits are not curtailed. Gold and silver are unlikely to perform well in this type of environment. Similarly, commodity prices are unlikely to sustain strong advances.

The magnificent edifice of liberalism and prosperity built soon after WWII has, unfortunately, come to an end. First, the collapse of the Bretton Woods agreement and now, the substantial erosion, in both letter and spirit, of the General Agreement on Trade and Tariffs (GATT) will be regretted.

Exhibit 1 Rates of Growth of Employment and Government Deficit

	1960 - 1970			1970 - 1981		
	Employment		Accumulated Gov't Deficit / Average GNP	Employment		Accumulated Gov't Deficit / Average GNP
	Compounded Annual Rates of Change			Compounded Annual Rates of Change		
	%	*	%	%	*	%
Belgium	-0.2	*	26.5	-2.9	*	-45.82
Canada	2.0	*	-10.6	0.7	*	-34.41
France	0.7	**	-2.8 (1)	-0.4	**	-15.67 (1)
W. Germany	0.6	**	-5.8	-1.62	**	-13.53
Italy	1.8	**	-38.0	+0.2	**	-111.01
Japan	4.6	*	-11.08	-1.04	*	-41.07
Netherlands	0.0	*	-16.38	-2.9	*	-28.11
Switzerland	0.9	*	+12.36	-1.9	*	-0.67
U.K.	0.3	***	-6.8	-0.5	***	-46.75
U.S.	2.7	****	-7.8	+2.4	****	-22.47

* Manufacturing employment.

** Industrial employment.

*** Employed Labour Force.

**** Payroll employment.

(1) Increased Government Debt/GNP

Sources : Federal Reserve Bank of St. Louis
International Financial Statistics

Exhibit 3 Real Rates of Exchange and Current Accounts

	Belgium			France			W. Germany			Italy			Japan			Netherlands			Switzerland			U.K.		
	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)	Exch. Rate (US ¢)	Real Rate	Current Account (Bln US\$)
1971	2.05	2.27	-1.204	18.04	18.93	+0.524	28.65	33.88	+0.69	.1613	.1329	+2.041	.2863	.2779	+5.82	28.55	33.33	-0.110	24.19	28.49	+0.082	2.4344	2.2029	+2.629
1972	2.27	2.51	-0.648	19.82	20.84	+0.282	31.36	36.38	+0.88	.1715	.1407	+2.796	.3298	.3090	+6.66	31.16	36.60	+1.348	26.18	30.60	+0.221	2.5018	2.2814	+0.497
1973	2.57	2.82	-1.491	22.45	23.94	-0.585	37.42	40.92	+4.64	.1715	.1459	-2.233	.3680	.3532	-0.11	35.77	39.72	+2.420	31.58	36.13	+0.279	2.4522	2.1242	-2.556
1974	2.57	2.77	-2.858	20.79	24.09	-5.845	38.64	40.37	+10.09	.1538	.1549	-8.046	.3423	.3633	-4.72	37.20	38.09	+2.218	33.56	37.56	+0.173	2.3390	2.0910	-7.908
1975	2.72	2.72	+0.268	23.33	23.33	-0.006	40.65	40.65	+3.8	.1532	.1532	-0.570	.3369	.3369	-0.69	39.54	39.54	+2.001	38.74	38.74	+2.590	2.2218	2.2218	-3.808
1976	2.59	2.65	-0.003	20.92	21.48	-5.886	39.71	37.37	+3.65	.1202	.1422	-2.851	.3372	.3385	+3.74	37.82	38.98	+2.734	40.01	37.98	+3.500	1.8062	2.0255	-1.890
1977	2.79	2.76	-0.716	20.35	20.79	-2.982	43.06	41.32	+3.82	.1133	.1473	+2.467	.3724	.3590	+10.89	40.74	41.88	+0.621	41.61	37.33	+3.775	1.7455	2.4583	-0.306
1978	3.18	2.85	-0.951	22.16	21.90	+3.790	49.79	44.84	+9.04	.1178	.1540	+6.234	.4752	.4141	+17.59	46.22	44.64	-1.410	55.93	44.95	+4.436	1.9195	2.7091	+1.496
1979	3.41	2.90	-3.273	23.50	23.38	+1.119	54.56	45.77	-6.06	.1204	.1615	+5.092	.4563	.3791	-8.74	49.85	43.93	-2.269	60.14	44.61	+2.433	2.1216	3.0290	-2.903
1980	3.42	2.69	-5.866	23.66	22.46	-7.810	55.01	43.52	-15.89	.1168	.1650	-9.785	.4410	.3784	-10.71	50.30	42.05	-2.786	59.71	40.85	-0.533	2.3263	2.5595	+6.063
1981	2.59 ¹	2.05		16.72 ²	16.28		44.83 ³	35.49	-6.48 ⁴	.0839 ⁵	.1304		.4476 ³	.3562	-0.53 ⁴	35.98 ²	30.22	+0.993 ⁴	55.90 ³	37.06		1.8992 ³		

(1) Sep. 1981.

(2) Aug. 1981

(3) Nov. 1981

(4) Data thru 2nd Qtr 1981.

(5) Oct. 1981

Source: International Financial Statistics

— Interest Rate Futures —

As pointed out last month, the market has commenced to take notice of the Fed's reflationary moves, anticipating a renewed tightening in the not-too-distant future. As a result, interest rates have begun to climb in earnest.

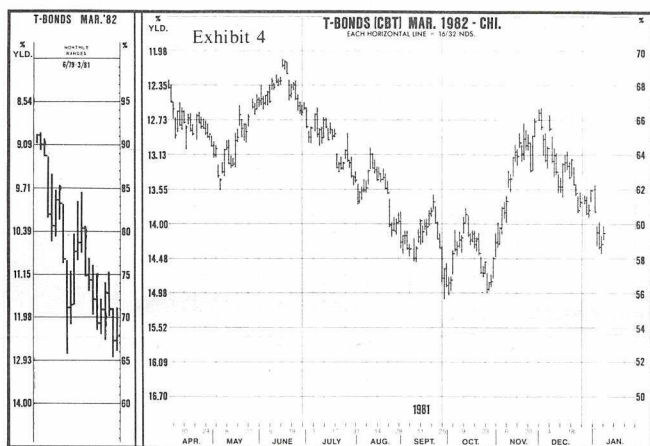
After the release of Friday's massive \$9.8 billion increase in M₁, three-month Treasury bills moved to a new recovery high in yields of 12.50 per cent, while long-term Treasuries dropped a full point, coming within a hairbreadth of matching the record yields of 15 per cent first reached in September and October 1981.

Corporate debt issuance in December 1981 fell back to approximately \$4 billion, a pitiful level when one considers the extraordinary urgency to reliquify corporate balance sheets.

Velocity (see Exhibit 6) continues to rise exponentially, an indication that the economy is tapping all and every pocket of liquidity available. In this environment, interest rates must surely rise as well.

STRATEGY: Remain short Interest rate futures. Stops on March '82 T-bills, March '82 CDs and March '82 Eurodollars should be placed at 88.00, 86.25 and 85.50 respectively. Stops on march '82 T-bonds may be placed at 61.00, all basis close only.

Since the Fed has not as yet begun to tighten, we are not able to provide reasonable downside targets. We believe, however, that the reward/risk ratio of being short interest rate futures is still quite favorable.



Reprinted from Commodity Research Bureau, Inc.



Reprinted from Commodity Research Bureau, Inc.

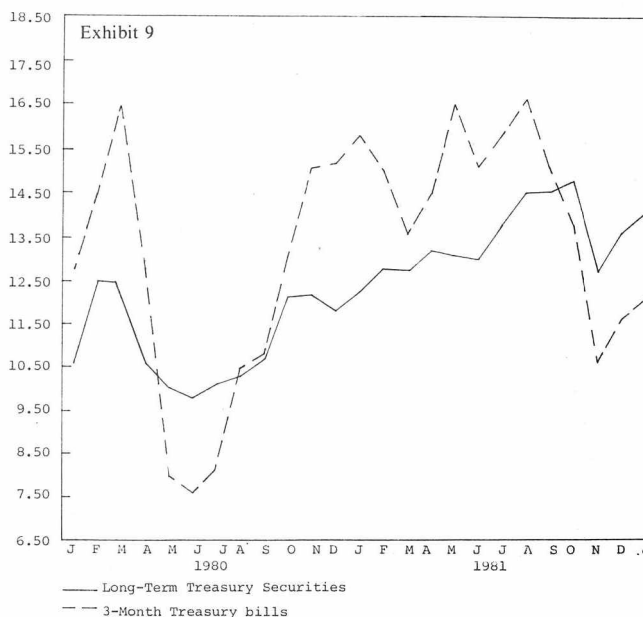
Exhibit 6	Debits to Demand Deposits (billions of US\$)	Annual Change %	Demand Deposit Turnover	Annual Change %
1960	2,839		35.5	
1961	3,111	9.58	38.2	7.61
1962	3,346	10.45	41.5	8.64
1963	3,755	9.28	44.3	6.75
1964*	4,141	10.28	47.7	7.67
1964**	4,631		44.8	
1965	5,162	11.47	48.1	7.37
1966	5,923	14.74	52.8	9.77
1967	6,662	12.48	56.7	7.39
1968	8,010	20.23	62.0	9.35
1969	9,223	15.14	68.0	9.68
1970	10,904	18.22	77.0	13.24
1971	12,383	13.57	83.7	8.70
1972	16,438	32.75	76.7	-8.36
1973	20,904	27.16	91.3	19.04
1974	22,938	9.73	99.0	8.43
1975	25,028	9.12	105.3	6.36
1976	29,180	16.59	116.8	10.92
1977	34,322	17.62	129.2	10.62
1978	40,298	17.41	139.4	7.89
1979	49,775	23.52	163.5	17.29
1980	63,013	26.60	201.6	23.30
1981 Oct.	85,705	30.56***	303.4	50.65***

* Comparable with earlier years

** Comparable with later years.

*** Oct.81 over Oct.80

Sources: Federal Reserve Bulletin
Historical Statistics of the United States.



Currencies

The after-effects of the Polish debacle on Western European financial institutions, as well as rising US interest rates, are once again determining the course of foreign currencies. Concern with unemployment has taken the edge off a more restrictive monetary policy on the part of the Bundesbank and has, once again, widened differentials in favor of US money market rates.

After having undergone a massive monetary squeeze in the past 12 months, with M_1 dropping at an annual rate of 7.4 per cent, the Swiss National Bank announced that it would relax its stance so as to allow a small depreciation of the Swissie vis à vis the Deutsche mark. At this writing, the effect on the SF/DM parity has been almost negligible.

With short-term rates remaining at or above 15 per cent, Sterling continues relatively strong vis à vis continental currencies. The ever-so-slight upturn in

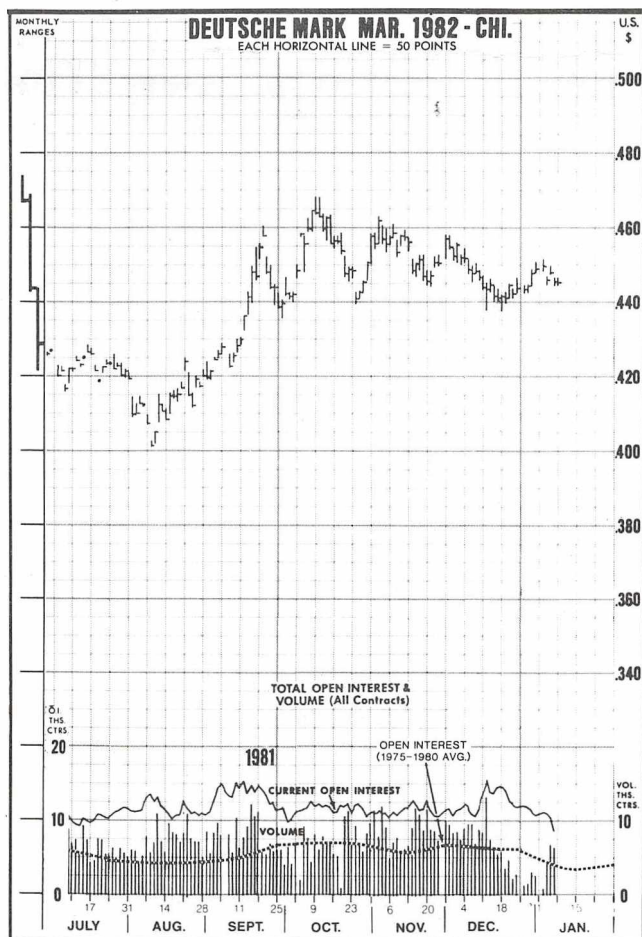
economic activity is being accompanied by outsized increases in bank lending, an indication that pervasive illiquidity is still not being corrected. Unemployment continues to rise and now stands at almost 2.8 million, seasonally adjusted. Given Sterling's high real rate of exchange, monetary authorities retain considerable leeway as to further easing maneuvers. Short-term interest rates and Sterling should head lower by Spring.

STRATEGY: Add to previously established short positions in the Deutsche mark, tightening protective stops to 45.25 basis March '82.

Sell March '82 British pound and March '82 Swiss franc at present levels, risking 191.00 and 55.40 respectively. We expect these currencies to lose at least 10 per cent in coming weeks.

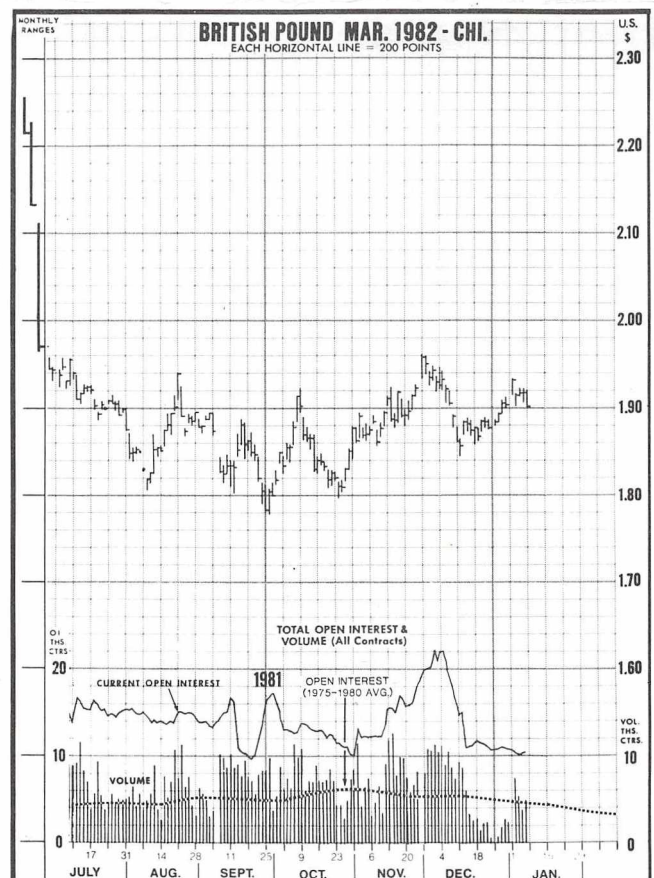
Remain sidelined in Japanese yen.

Exhibit 10

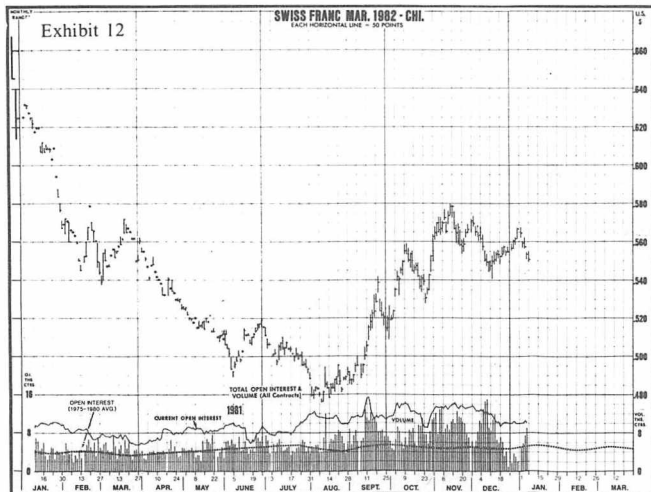


Reprinted from Commodity Research Bureau, Inc.

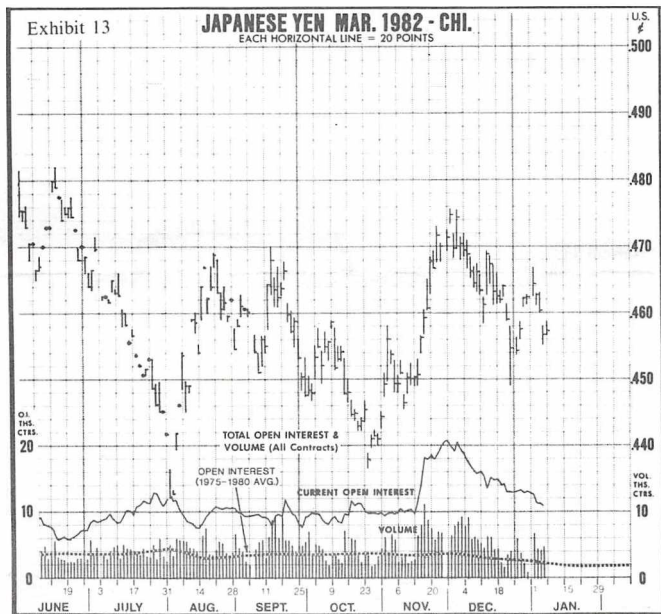
Exhibit 11



Reprinted from Commodity Research Bureau, Inc.



Reprinted from Commodity Research Bureau, Inc.



Reprinted from Commodity Research Bureau, Inc.

Mexican Peso

The screws are beginning to tighten. First, Mexico is forced to lower its Maya Oil by \$2/barrel, thus lowering the overall selling price by \$1/barrel (50/50 mixture). Second, Banrural, a government-owned bank, borrows \$400 million in the Eurodollar market at 7/8 over London Interbank Offering Rate (LIBOR), a significant increase in margins, indicating that creditors are beginning to reevaluate their Mexican portfolio.

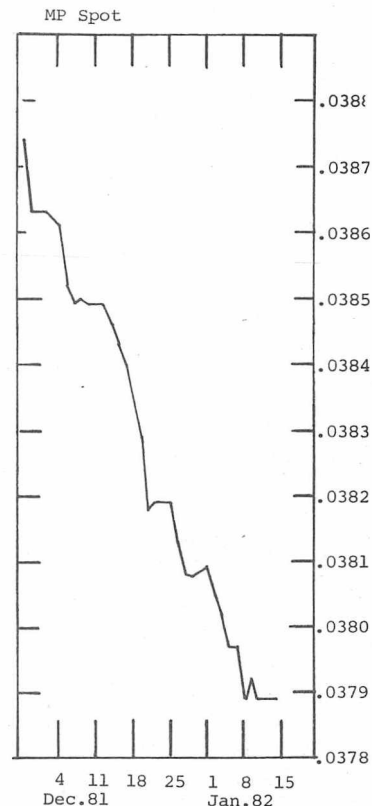
The extensive overvaluation of the peso is having a predictable effect on tourism. Banamex estimates that spending of foreign tourists in Mexico went up by a mere 4.7 per cent, to \$1.75 billion. Mexico's expenditures abroad increased by a massive 42 per cent, to almost \$1.5

billion. This brought Mexico's net tourist balance down 60.5 per cent, to \$260 million. When short border crossings are included, Mexico's net balance falls by 65.8 per cent, to \$430 million. Banamex carried out a survey earlier this year in 12 Mexican resorts and 57 in the US, and found that Mexican prices for a basket of tourist services (hotel, food and car rental) were 8 per cent higher than in the US, a significant reversal from 1977 and 1979, which showed positive differentials in favor of Mexico of 45 and 28 per cent respectively.

During 1981, the National Rural Credit Bank, an arm of the government, invested \$2.5 billion in agriculture in order to bring Mexico closer to its target of food self-sufficiency. In all, Mexico harvested 4.3 million tonnes more than in 1980, which, at free market prices, is the equivalent of approximately \$600 million. Since most of the \$2.5 billion investment was in highly subsidized credits and grants for seeds and fertilizers and in support prices rather than in infrastructure, one can see that such admirable goals as self-sufficiency run counter to economic and common sense. So much for statism.

STRATEGY: Remain short deferred contracts. Roll over March '82 into September or December '82 positions. A very significant devaluation is in the cards before the year is out.

Exhibit 15

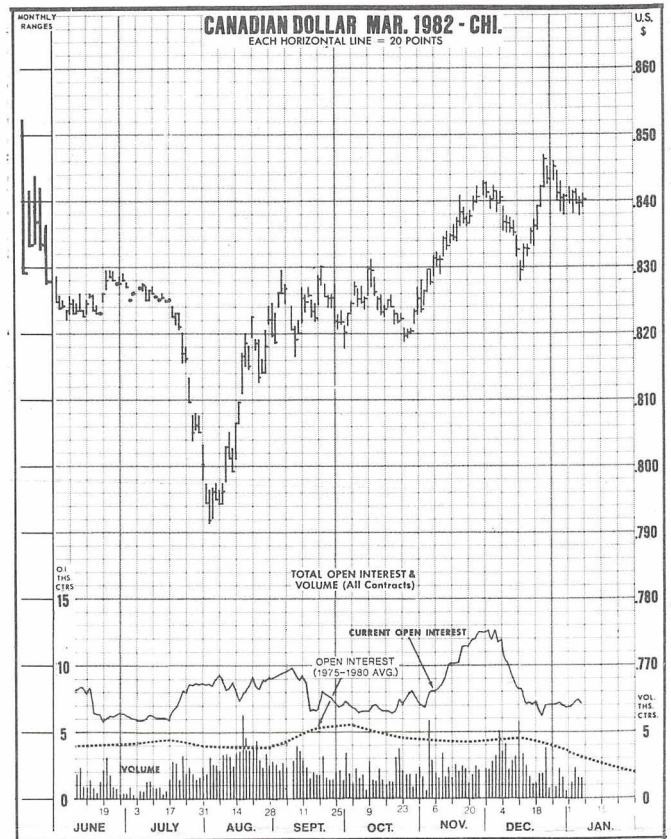


Canadian Dollar

The Bank of Canada has maintained a relatively relaxed monetary policy in view of the recent strength of the Canadian dollar. In fact, monetary policy — despite appearances to the contrary — has been targeted to a relatively fixed rate of exchange vis à vis the US dollar (in a range of 81¢-85¢).

STRATEGY: Sell March '82 Canadian dollar at market. It remains to be seen what level of exchange rate will prompt the Bank of Canada to raise its Bank Rate and widen the interest rate differential in its favor. Place stops at 84.50 basis March '82, close only.

Exhibit 16



Reprinted from Commodity Research Bureau, Inc.

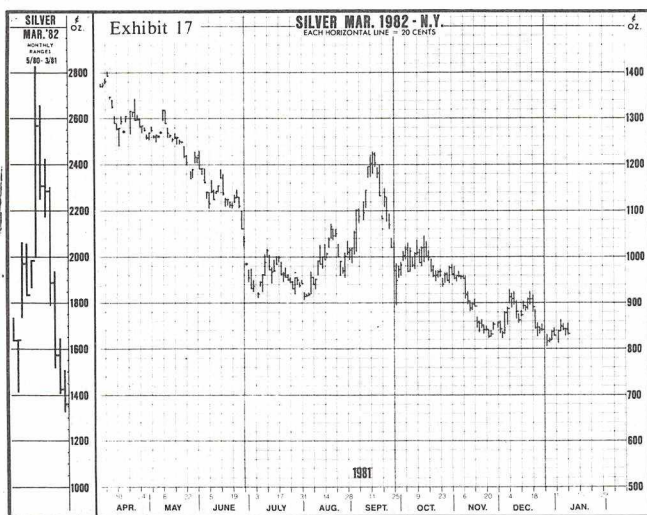
Precious Metals

The bear market continues in full force.

STRATEGY: Remain short silver.

Last month we stated that the gold market was "readying for a sizeable move... on the downside." Events have vindicated us. Possible support exists at the

\$360/oz. level; otherwise, the long-term 1976-1979 up-trend — intersecting at \$330/oz. — should provide meaningful resistance to further erosion. Regardless of where gold finds a resting place, we doubt that it will turn on a dime. Do not try to pick bottoms.



Reprinted from Commodity Research Bureau, Inc.



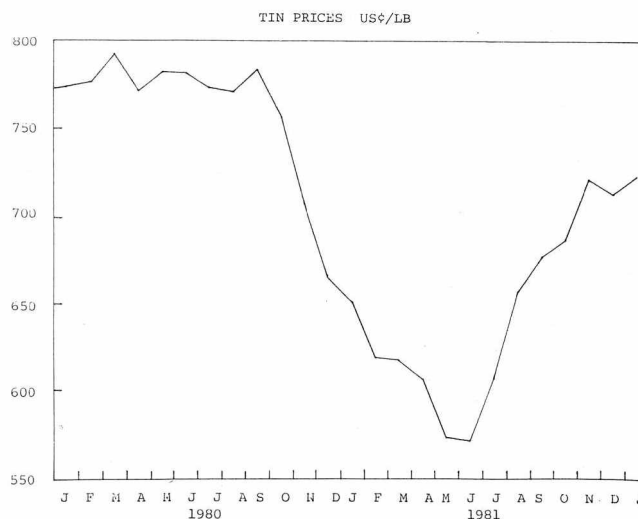
Reprinted from Commodity Research Bureau, Inc.

Exhibit 19



Reprinted from Commodity Research Bureau, Inc.

Exhibit 20



— Tin —

An intriguing power play.

A "mystery buyer," thought to be the Malaysian government, has succeeded in reversing a sharp drop in tin prices and, in fact, has taken tin to a new 15-month high (see Exhibit 20). Interestingly enough, this mystery buyer has stimulated a boom in tin sales from the US strategic material stockpile. While the General Services Administration (GSA) was authorized to sell up to 10,000 tonnes per year for three years, it only managed to sell 3,170 tonnes in the previous 15 months. Since December 14, the date on which the GSA removed its restrictions on exports, sales have climbed 3,140 tonnes. Most of the buyers are New York traders with affiliates in London, who claim that they can buy GSA tin cheaper than what it cost to produce (Associated Metals).

At any rate, this market is in the throes of a good old-fashioned squeeze. Cash tin now trades at a significant £500-£550 premium to three-month metal, principally a result of heavy dealer "hedge" selling.

STRATEGY: *Aggressive accounts may be interested in purchasing three-month call options at around £480-£550/tonne. The cost of the option is covered by the backwardation; in effect, should cash tin remain at £8600/tonne, the buyer of the option will have recouped his investment. In the interim, cash tin may yet reach new highs and a significant profit may be achieved.*

— Heating Oil —

We have been theoretically short this market since November of 1980, when in our *Comments* of that month we projected that the exorbitant prices charged by OPEC had finally impacted upon market forces; strict conservation methods and alternate sources of supply would create, if they hadn't already, a major cyclical turn in the oil market. These views were elaborated in our May 31, 1981, and July 1, 1981, *Comments* when we established the bulk of our short position.

From May until November 1981, the heating oil market paid scant attention to our arguments. Prices worked in a narrow range between 98.00 and 102.00 basis May. Since the market itself told us nothing, our position was essentially an investment in our own logic. Finally, in November prices broke and the market told us we were right. One of the most vicious bear markets of the year has yielded us profits of nearly \$6,000 per contract in the past two and a half months.

Still OPEC remains intact. In fact, although obvious chinks have developed as a result of what is very obviously now a buyers' market for crude, crude prices themselves are still higher now than they were twelve months ago.

Every time a trader takes a position in a market, he is essentially saying that the market's estimation of the value of what he's trading is wrong. In the case of heating oil, prices have not fallen because of the impending disembodiment of OPEC. Speculators who have come to recognize what we predicted more than a year ago have been in part responsible. But prices have also fallen because of the recession, which has been unexpectedly swift and severe and because of the winter,

which up until ten days ago was relatively mild.

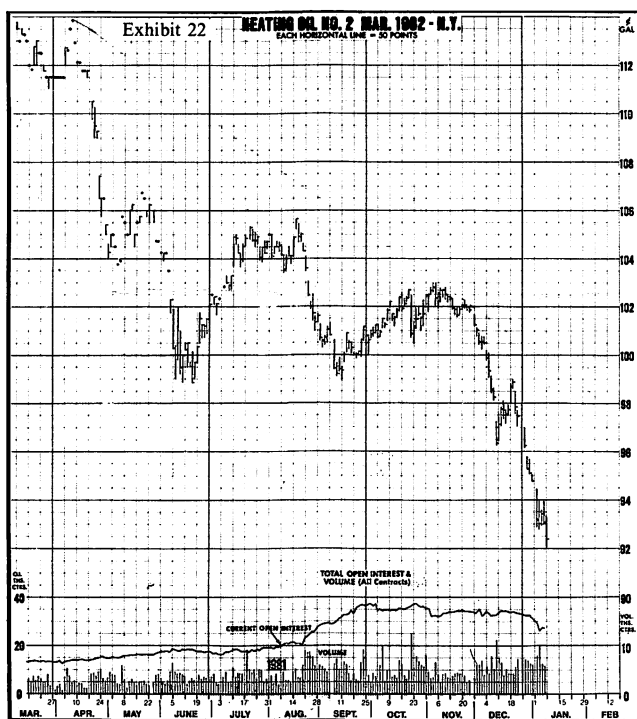
Last May, when crude quotes were slightly higher than they are now, and after another relatively mild winter, May heating oil was trading in the 90¢ range. We believe 90¢ represents a fair value, or "right" level, for heating oil given *current fundamentals*. Current fundamentals, not *projected fundamentals*.

We remain of the opinion that the oil market has suffered a critical shift and that that shift has hardly begun to impact upon prices of related products. The argument we have proffered since November of 1980 and tracked, if you will, since July is still sound. The latest pieces of evidence to support it are the lowering quotes by Mexico and Venezuela, news that OPEC production fell 13.9 per cent in November, and that there is growing momentum in the movement to decontrol gas prices in the US (the latter, predicted to occur within the next three years, could very well prove to be the final nail in

the coffin).

In sum, what we are saying at present is that while heating oil remains a secular bear market, short positions at current levels are once again investments in long-term projected fundamentals. That the market has fallen to a value range and, in the process, yielded handsome profits and that the technical picture has deteriorated from the point-of-view of the bears forces us, as traders, to recommend assuming partial profits.

STRATEGY: We advise covering one third to one half of all short positions. Place stops at 96.50 basis March for the remaining half. Despite what may appear as a defensive attitude, we want to emphasize again that heating oil represents an opportunity to participate in a bear market that could prove to be of historic dimension in months ahead. We therefore advise maintaining close contact for re-establishment of short positions.



Reprinted from Commodity Research Bureau, Inc.

Grains

Large grains and oilseed crops are expected in the US again in 1982, following record or near record 1981 crops. A 15 per cent wheat set-aside for 1982 is in effect. However, participation is expected to be only about 37 per cent, resulting in a 5 per cent area reduction, overall.

Winter wheat seedlings for 1982 were a record 66.25 million acres in the US. Actual harvested acreage is forecast to be slightly below that in 1981 due to abandonment, but a record yield target makes the USDA's 1982 winter wheat forecast a new record 2,128 million bushels, up 1 per cent from the previous record of 2,099 million in 1981.

Indications are that plantings of corn in the US in 1982 will be slightly below that of 1981, while soybean plantings will be about the same. The odds are against a repeat of the tremendous 1981 corn yields, so the 1982 corn crop may be of a more manageable size. The 1982 soybean crop is still indefinite, however, as the January prospective plantings report has been delayed one month.

The final 1981 wheat crop estimate in the US was made December 22, at 2,793 million bushels, up 43 million from the previous estimate. The final preliminary estimates for corn and soybeans were given January 15 at 8,201 million bushels (revised from 8,097) and 2,030

million bushels (revised from 2,077) respectively.

Citing relatively high carryover stocks of grains at the end of the 1981/82 marketing year, particularly for corn, and large expected 1982 crops, the price support loans and grain reserve could prove particularly important again in 1982. We have maintained the view that support levels could be tested for wheat as well as corn. Entry of grain into loan and reserve programs thus continues to be a major factor in market activity. There were 1,563 million bushels of 1981 crop corn under price support loans as of January 13, compared with 1,417 million a week earlier. The total includes 936 million bushels of 1980 and 1981 crops of corn in the farmer-owned grain reserve compared with 831 million bushels a week earlier.

The minimum price support loan rates (essentially a floor on market prices) for 1982-85 will be at least \$3.55 per bushel for wheat and \$2.55 per bushel for corn. Discussions this past week propose that the wheat support price may be raised to \$3.85-\$4.00. In 1981 the loan rates were \$3.20 for wheat and \$2.40 for corn. Price support loan rates for soybeans in 1982-85 will be 75 per cent of the national five-year average price to farmers, but no lower than \$5.02 per bushel.

Price support loan rates are the amount farmers meeting eligibility requirements can borrow from the Commodity Credit Corporation (CCC) using their crop as collateral for the loan. Loans generally mature in nine months. If it is advantageous to the farmer, he can default on the loan repayment; in this case, the collateral is taken as full payment of the loan and interest charges (now 12.25 per cent, down from 14.5 per cent). In 1982, acreage reductions for wheat and possibly for corn will be required for eligibility to receive loans.

The farmer-owned grain reserve is an alternative to the price support loans. This three-year set-aside allows farmers to have received \$2.55 per bushel for corn in 1981, versus the \$2.40 for regular CCC loans. They also receive 26.5 cents per bushel annually for storage payments. Interest is charged at the cost to the CCC in the first year, but is waived in the second and third year.

Farmers agree to keep their grain in reserve until the national five-day moving average market price (trigger-release) is \$3.15 per bushel for corn. At prices above this farmers may sell their stored crop without penalty, and repay the loan. The Secretary of Agriculture may limit the size of the reserve, but not to less than 700 million

bushels of wheat and 1 billion bushels feedgrains. When a reserve is in effect, the USDA cannot sell any government-owned grain for less than 110 per cent of the existing trigger-release price.

In addition to these programs, farmers receive deficiency payments for the amount that the national average market price received by farmers in the first five months of the marketing year falls below the "target" price. These target prices are set independently of support prices through loan and reserve programs.

The government will pay deficiency payments to a maximum of the difference between the target price and the reserve loan level; any market movement below the support price level is made up to farmers only by placing their crop under loan or reserve and not by deficiency payments. Thus, by raising the loan level, the government reduces the margin of maximum deficiency payment levels. This budgetary gimmick places more burden on farmers to out-wait market depressions rather than sell their crop and receive deficiency payments.

The key reversal, mentioned last month, in the corn market on December 16, has been respected. We may see a rally of 15¢-20¢ in this market if export sales reach a more normal ratio of 2:1, corn over wheat. The wheat and soybean markets did not quite make key reversals on this date; technical weakness in wheat, in particular, came about as a result. Soybeans have exhibited some strength consistent with overseas meal demand.

European soybean purchases have been relatively high in recent weeks as a safeguard against the possible placement of tariffs by the US.

STRATEGY: *Maintain long May corn/short May wheat spread on CBT, aiming for \$1.00 premium wheat over corn. Maintain long KC/short CBT wheat spread, placing stops at 5¢ or 6¢ premium KC.*

Present indication of tightness in hard wheat at the end of the season is being discounted by record use of soft wheat for feed and export, particularly to China, by problems in Poland and implications for the USSR, and by expectations of a smaller soft wheat crop (basis Chicago) in 1982.

Soybean could be approached from the long side, risking contract lows of \$184.00 basis July.

1981: The Long and Mostly the Short of It

It's come that time of year when humankind, it seems, feels obliged to review the past twelve months that have just evaporated into history. Whatever was well or poorly — or more frequently best or worst — designed, built, advertised, photographed, filmed, performed, written, composed, thrown, run or hit is summarized and then either applauded or derided. Even predictions of currency

and commodity prices are taken stock of; we review our past so as to improve our future.

Since we are traders as well as authors, our endeavors over the past twelve months are subject to two types of reviews. As traders, our arena is the market, a place where there is no need to offer a subjective evaluation of failure or success. We either made money for customers

or we didn't. Thankfully we did. The *average* customer of the Friedberg Mercantile Group made many times more than the record rates of interest that were predicted in these *Comments* throughout the year. As authors of these commodity comments, however, it's a bit more difficult to judge, since we didn't trade some of the predictions as emphatically as we did others.

The tone of our *Comments* for all of 1981 was established in the year's first issue, January 11. The title, "Varieties of Monetarist Experiments," heralded the focus we would maintain on interest rates and their consequences all year long. We pointed out then that simple proxies for money — the M series — were inadequate for measuring supply, that the best proxy was the broadest (i.e., federal reserve credit), and that because it was growing at an alarmingly high rate, rates themselves were doomed for a roller coaster ride higher.

Note: Strategies then were as follows: "Short March '81 T-bills with a generous stop at 89.00 (close only), looking for a move down to 81-82 . . . Commodity prices should suffer from high carrying charges. Our favorite shorts: platinum; copper; tin; lumber."

We stated that the trend for precious metals was unmistakably lower. "The renewed widening of the gold/silver ratio leads the way in the vicious bear market. In our opinion a test of the \$10.80 lows (in silver) recorded in early 1980 is not out of the cards."

US dollar strength was broadly based and well sustained. We advised remaining firmly short Swiss franc and D-Mark.

The fundamental scenario of copper was bearish. Our view for the year was that copper would not better \$1.05/lb. and would likely drop as low as 70¢.

Both in terms of the amount of money invested in the market and space devoted in our *Comments*, interest rates, foreign currencies, precious metals, copper, and heating oil, which was first advised as a bear market vehicle in the last letter of 1980, were our biggest preoccupations.

Lumber was not mentioned again during the year, nor was it traded beyond more than a modest scale by us. Had the reader taken a short position in lumber on January 11 and liquidated it December 31, he would have seen the market fall from 225.00 to 149.90 basis January 1982 and enjoyed a profit of \$9,750 per contract.

The London tin market enjoyed cartel-like price buttressing — we are currently long via three-month call options — rose to £8,300 from £6,300 during the year. We luckily covered as per recommendations in our March letter at a modest profit.

Money markets were scrutinized in depth in every issue. In February we advised adding short positions in December bonds to our existing T-bill shorts, looking for a move down to as low as 55.00. They were trading at 68.18 at the time.

Our attention during the month shifted from federal reserve credit to bank credit, which was also growing at a

rapid clip. By March we found ourselves stopped out of our short bond position at 69.10 (loss of \$750.00). Undaunted, we pointed to the continued rise in federal reserve and bank credit and recommended reestablishing the same short position with the same target of 55.00. We confirmed our worst suspicions of inflation coupled with stagnating output and bravely suggested, at the same time, to add to previously established short positions in bills.

By the time we wrote our May 3 *Comments*, December bonds had traded down to 60.00 and September bills were at 85.00. We were ahead of the game by \$8,000 and \$7,500 per contract respectively. By July 1 the recession was beginning to be felt and there was a developing consensus that rates were due to tumble. We were still bullish on rates, however, and headlined our *Comments* that month with the title "Betty Against the Pundits." Our conclusion, which of course was to remain short the instruments (with targets of 80.50 for September bills and still 55.00 for December bonds) is worth repeating inasmuch as it expresses a difficult but cardinal lesson for the would-be successful speculator: He must be a loner, ready to be ridiculed by the conventional bankers and theorists. And he must be visionary.

By the time of our next letter, August 30, "Taxes, Liquidity, and the Great Puzzle," which again focused on rates, December bonds had traded down to 58.00 and September bills were at 85.60. We rolled bills into the December options and lowered our target to 79.00.

The interest rate game of 1981 came to an end for us in early October. We covered our bills at 85.15, 25 basis points from the lows of the year, and our bonds at 57.15; the low was 56.00. Those who followed our thinking sweated through the highly irregular bull market in rates that we predicted right at the beginning of the year and were ultimately rewarded by profit well in excess of \$10,000 per contract.

As we implied at the outset, interest rates dominated all markets during 1981. Indeed, they dominated public consciousness, stepping regularly from the business section to the front page in much the same way gold did in 1979 to early 1980. Currencies and precious metals reacted to the ever increasing rates and fell as forecast. We added the pound to our line of currency shorts in February. By March it was our only foreign currency short. We covered our Deutsche marks and Swiss francs at around the 47.00 and 51.50 levels respectively basis March. Because they were trading at 51.33 and 56.85 respectively as of our January *Comments*, our profits were a handsome \$5,400 in Deutsche marks and \$6,800 in Swiss francs. At the same time we advised reestablishing the same short positions in deferred deliveries if new lows were made.

New lows were made in the period between our April and May *Comments*. We added to short positions in May and covered them in October at the same time that we covered our short positions in financial instruments,

this time suffering losses of approximately \$1,000 in Deutsche marks and \$2,500 in Swiss francs.

The British pound proved one of the year's biggest winners. When we first advised being short in February, December '81 was trading at the 240.00 level. By the time we advised covering in mid-November, the market had fallen to 189.00. Readers who followed our advice literally enjoyed a win of \$12,750 per unit. In addition, when we covered our short positions in rate futures in October, we advised not only liquidating shorts in Swiss francs but going long as a hedge against the existing short position in pounds. If one treated the hedge as part of the trade and liquidated both positions simultaneously, the market made a further contribution of \$2,500 to the trader.

Although we were bearish throughout the year in all precious metals, we were not as committed, either as traders or as authors, as we were to currencies or financial futures. Twice we abandoned our short position; in May and in October. The bear market was sluggish, difficult to "play." Just as precious metals themselves lost their glitter in terms of values, the markets lost their glamor as trading vehicles. Weeks of narrow trading ranges were followed by breaks in prices and subsequent retracements. To have remained short gold, silver, and platinum throughout 1981 was essentially to have adopted an investment posture in disinflation and continuing high rates. Being more traders than investors we found this difficult to do. Being short the rate instruments themselves gave us more action and more profit.

Interestingly enough, the biggest faux pas of the year was made in the only market in which we reversed our posture from our January 11 *Comments*. Readers and customers alike will have no difficulty in remembering

the copper debacle. In March we completely abandoned our bearish views, and in the most hyperbolic prose style of the entire year wrote: "Copper is about to enter a bull market of historic proportions. Downside risk is limited both in terms of price, maximum of 5¢ per pound and in terms of time, perhaps thirty to sixty days. A move to \$1.85 per pound by 1983 and possibly as high as \$2.50 per pound. Join the champion, buy deferred contracts."

In subsequent issues we scaled down our optimism, lowered our targets, grew more defensive, but the red metal hung around our egos and our equities like an albatross. We finally admitted defeat in July; July Copper had fallen 8¢ by then. But as though the \$2,000 loss and dashed hopes were not enough punishment to inflict upon ourselves, our customers, and our readers, we advised re-entry again in late July and promptly lost another \$1,500.

Copper typified the folly of being long virtually anything during '81. After ten years of virtually uninterrupted bull markets, the Commodity Research Bureau Index fell consistently throughout the year, declining by more than 30 per cent from its peak reached in November 1981. Attempts to pick bottoms in sugar, corn, wheat, cotton, and soybean oil all resulted in losses, albeit small ones. Conversely the modest short positions we advised assuming in sugar and cocoa resulted in compensating profits. The only long position that was liquidated in the black was one we took in coffee in the spring. The market fell from the moment we put it on until a frost in July redeemed us.

Which leaves us with the only major position we've not yet mentioned — the Mexican peso. Can we review our performance in the dynamic unit south of the Rio Grande? Like 1982, the jury is still out.

Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published monthly by Hume Publishing Limited, 4141 Yonge Street, Willowdale, Ontario M2P 2A7. Telephone (416) 221-4596. Contents copyright © 1982 Hume Publishing Limited. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement. Opinions expressed are not necessarily those of the publisher. Content for Friedberg's Commodity & Currency Comments is supplied by Friedberg Commodity Management Inc.

Subscription Enquiries

In Canada and all other countries except the US: Hume Publishing Limited, 4141 Yonge Street, Willowdale, Ontario M2P 2A7. Telephone (416) 221-4596.
In the US: Hume Publishing Inc., 120 Interstate N. Parkway E., Box 723188, Atlanta, Georgia 30339. Telephone (404) 952-5740.

Trading Accounts

All enquiries concerning trading accounts should be directed to Friedberg Mercantile Group, 347 Bay Street, Suite 207, Toronto, Ontario M5A 2R7. Telephone (416) 364-2700. Cable: Friedco Toronto. Telex: 06-23446.