

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS



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The Mexican Saga

The Past

On February 18 the Mexican government decided to end support of the peso. The currency suffered a 30 per cent market devaluation the same day. The following week the peso dropped another 11 per cent. Currently the Mexican peso is trading at \$.02210, or 40 per cent less than the day prior to the float. The following is a diarized summary of events, analysis, and advice as they appeared in our *COMMENTS* since we first advised being short the peso.

August, 1980. Since last major devaluation in 1976 until mid-1979, Mexican government has maintained peso at 22.85 to 22.87. However since mid-1979, peso allowed to slip by a generally unnoticed 0.6 per cent. Government concedes peso overvalued "a bit" and claims, "some adjustment may be made." Because of country's history of one-shot devaluations, it is unlikely a downward "adjustment" can be made without massive capital flight. Predict balance of payments deficit will worsen due to softening of world oil prices and interest on substantial and expanding public debt. "Mexico's financial condition is critical . . . peso is overvalued by 30 to 40 per cent . . . Before the gradual adjustment process has a chance to restore equilibrium, a speculative run will ensue, forcing the government to take large and unnecessary foreign exchange losses . . . sell September."

January, 1981. Pace of mini devaluation accelerating marginally. Current account deficit during 1980 totals \$4.2 billion. Predict higher world interest rates and consequently further deterioration of Mexican current account due to higher rates applying to Mexico's huge foreign debt, estimated at \$38 billion. ". . . short March '81 . . . potential reward is a devaluation to the 32.00 level."

February, 1981. Spot rate eroding at an accelerating clip, falling by 1.8 per cent since August. Predict growing energy self-sufficiency in the US coupled with world oil glut will impact more directly on Mexican balance of payments. Predict further payments problems due to substantial devaluation of foreign currencies against the dollar and therefore against the peso. Taking into account the greater inflation rate in Mexico vis-a-vis the US since 1976, peso overvalued by 80 per cent. "In view of the more rapid pace of depreciation now taking place in the spot market, we would be better to begin selling deferred contracts. Should devaluation expectations become more widespread, the forward discount may widen considerably".

March 4, 1981 Federal budget deficit estimated by government at 2,332.7 billion pesos. Since 1976, government expenditures have grown from 440 billion to 2.3 trillion pesos, or by 520 per cent; virtually all of it monetized by forcing banking system to purchase government bonds. Inflation running at 4 per cent per month. Manufactured goods not subsidized for export by the government uncompetitive on world markets . . . "Continue to sell aggressively deferred positions such as Dec. '81, March '82 and June '82 . . . The pace of the crawling devaluation has been stepped up from 0.7 per cent in January to 0.8 per cent in February. We fully expect the crawl to turn into a gallop".

March 29, 1981. Government enacts legislation prohibiting importation of luxury items — a feeble gesture that only serves to demonstrate how lost authorities have become. Pemex, the state oil firm, requests increase in its funding facility with Bank of America by \$1 billion. Gross borrowing requests now

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Contributors

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\$13.5 billion. Question: Pemex earnings estimated at \$12 billion . . . Why is it in such need of borrowed money? Answer: the \$12 billion in earnings must be going entirely toward financing other imports. Spot peso falls by just under a full one per cent during March. "The current account deficit is widening and a foreign exchange crisis is looming. The game is not up yet because multi-national banks are either too naive or are trying to protect their massive prior loans. Sell deferred positions with impunity."

May, 1981. Spot peso falls by full one per cent during May. Oil glut causing sales of crude and natural gas to run 4 billion to 5 billion dollars less than projected on an annualized basis. Price of Mayan crude projected to fall to \$26.00 from \$32.00 per barrel. Deferred discounts on peso beginning to widen, "Add to short position on any 100-150 point rallies in '82 position."

July 1, 1981. Spot peso eroded by 1.1 per cent in June. Sr. Serrano Diaz, architect of Mexico's oil boom forced to resign owing to his decision to lower Pemex crude prices by \$4.00 per barrel. His successor announced his decision to raise prices by \$2.00 per barrel. Mexico must suffer reduced revenues resulting from sales at lower prices or drastically reduced sales at higher prices. Current account deficit widens to \$1.42 billion during first quarter, worse by 249 per cent than during comparable period in 1980. If oil and gas revenues comprise 75 per cent of export earnings, it must get worse.

July 26, 1981. In response to disarray in financial markets, President Lopez Portillo announced "unspecified" budget cuts totaling 4 per cent. Action only cosmetic. Portillo told press July 17 he will "fight like a dog" to defend the currency. Growing current account deficit forcing public sector to increase indebtedness. Some banks express concern at size of year-end debt estimated at \$39 billion. "In recent weeks margins on Euro syndicated loans have begun to widen, giving belated recognition to our oft-stated assertion that Mexico is financially bankrupt."

August, 1981. After brief rally attempt during July, peso resumed one per cent rate of monthly decline in August. Payments deficit threatening to engulf entire economy. Government taking steps to limit imports of auto parts. Foolish protectionist measure testifies to emotional and destructive panic beginning to be felt in Mexican financial community.

September, 1981. "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 to scale down a \$500 million loan-hybrid to \$200 million. Three simultaneous financing operations are a sign of desperation . . . In an attempt to forestall the inevitable devaluation, the Mexican government has forced commercial banks to buy 10 billion pesos of government Treasury bills . . . The bank of Mexico . . . thinks little

of monetizing government deficits . . . Mexico will be forced to devalue as soon as oil prices break the Saudi support. Remain heavily short."

October, 1981. Foreign currency outflows — difficult to determine because of lack of current financial information available — calculated by us at \$7.1 billion through June, much higher than the \$3.75 billion deficit on current account admitted by government. Reserves obviously stampeding out of Mexico. Mexican finance minister announced country would launch only two or three more Eurocredits through rest of year. "Mexico's level of international reserves, and therefore ammunition to defend the currency, can be likened to a sink whose drain is open and water pours in from a running tap. As long as the tap runs faster than the water draining out, water accumulates in the sink. The moment water stops coming in at a rapid enough pace, the water level drops. The imminent slowdown in Eurocredits, a result of saturation and prudent(!) debt limits, will begin affecting international reserves as soon as the last quarter of 1981 . . . Remain short."

November, 1981. Margins on successive borrowings have widened: to 3/8 over US prime, to one half over LIBOR (London Inter-Bank Offering Rate) to 5/8 over deposit rates of US dollar/SDR accounts. A staggering 60 per cent of new financing being used for purposes of refinancing, while only 40 per cent treated as fresh money. "Foreign affairs undersecretary for economic matters stated public sector borrowing requirements during '82 would fall to just \$12 billion from \$16 billion anticipated for 1981. The reason? An expected recovery in manufactured goods. An expected recovery in manufactured goods . . . In the midst of a world recession. With a wildly overvalued peso . . . There is very little risk in shorting deferred positions."

December, 1981. Mexico's finance minister admitted total public foreign debt increased \$14.9 billion during 1981 to \$48.7 billion. Combined with private debt totaling at least \$15 billion, Mexico now the world's largest international debtor. Budget deficit estimated by government at \$27 billion, or 13.4 per cent of GNP . . . "a catastrophic and unsustainable (at least in the context of a fixed exchange) level." Commercial banks estimate Mexico will have to raise \$20 billion more during 1982. ". . . Everyone assumes that international lenders will simply raise lending margins and shut their eyes to a sure case of insolvency. By the end of 1982, if Mexico were capable of borrowing an additional \$11 billion to \$15 billion, (public and private), its total debt would approximate \$80 billion, which at average rates of 15 per cent would require \$12 billion in debt servicing, an amount equal to its entire oil exports . . . remain short distant contracts."

January, 1982. Price of Mayan crude down by \$2.00 per barrel. Margin on most recent international borrowing 7/8 over LIBOR. Banamex estimates spending of foreign tourists went up 4.7 per cent. Mexicans' expenditures

abroad increased 42 per cent. Net tourist balance down by 60.5 per cent. Cheaper now by 8 per cent to vacation at an American resort than at a Mexican resort. "Remain short deferred contracts. A very significant devaluation is in the cards before the year is out."

February, 1982. Even Mexico's heavily subsidized, and therefore reasonably priced, exports having difficulty finding a market in US due to Mexico's failure to sign GATT. Slowdown in exports of manufactured foods affecting unemployment and causing political swing to the left. Reserves fleeing

the country at an accelerating clip. Peso being supported by constant short-term borrowings. If Mexico were unable to roll over these short-term borrowings for even a few months, "its net foreign assets would dissipate almost instantly, making a major devaluation inevitable." Oil prices have broken the Saudi support level. Through the first twelve days of February, the spot peso has depreciated by 1.5 per cent. "Add to previously established short positions . . . the pressure for a maxi-devaluation will become irresistible."

The Present and the Future

Mexico's problems are only beginning.

Just two items alone should add \$6 billion to the 1982 current account deficit compared with the 1981 deficit of \$11 billion: (a) dropping oil prices, estimated to average \$22/barrel for all of 1982, on slightly larger export volume (1.30 million barrels versus 1.10 million barrels); and (b) increased interest payments on the substantially larger public and private debt, estimated to average \$70 billion through 1982.

On the positive side of the scoresheet, increased tourist earnings as well as an expected drop in imports should benefit the current account to the tune of approximately \$3.0 billion.

The capital account, which showed an impressive gain of almost \$15 billion during 1981, a result of massive public and private international borrowing, can be critically affected depending on lenders' perceptions of default. We doubt that Mexico can borrow even half of what it borrowed during 1981. That being the case, Mexico should suffer *ex ante* a balance of payments deficit of close to \$20 billion, far exceeding its availabilities of foreign exchange.

It is always more convenient to speak in *ex ante* terms as opposed to *ex post* terms, since *ex post* Mexico will be able to "balance" its international account. This can be accomplished in either of two ways (or a combination of these two ways): a default or moratorium on international debt and/or a strict control of imports that will match imports to the availability of foreign exchange. Both of these events *will have to* take place in 1982, possibly arranged by an IMF delegation soon after the July 4th election.

At any rate, it is quite clear that the Mexican

Central Bank will be in no position to defend any particular level of the exchange rate. By necessity, the peso will float quite freely over the next few months and, perhaps, years.

How low will it float? The present 40 per cent devaluation will accomplish nothing in terms of improving Mexico's competitiveness if only because prices have already begun to rise by the same magnitude. Fiscal and monetary policies must be sufficiently restrictive to avoid accommodating the subsequent rise in prices. These conditions are not in place now or likely to be in place so long as the budget deficit can equal as much as 11 per cent of GNP. Furthermore, unlike 1976 when Mexico's earnings were on the verge of exploding, thanks to rising oil prices and production, a 1982 austerity program will be faced with sharply declining oil revenues, thus making the inevitable adjustment quite painful.

Short of balancing the budget, Mexico's peso will continue to drift lower. The drop in the rate of exchange should equal, in the long run, the inflation differential vis-a-vis the US, probably in the order of 4 to 5 per cent per month.

In light of the above comments, it is rather puzzling to see deferred contracts trading at a mere 20 to 22 per cent per annum discount. Once more, opportunity knocks on our door . . .

STRATEGY: *Remain firmly short; roll over June '82 and September '82 into December '82 and March '83 contracts, availing yourself of the ridiculously low discounts. March '82 should trade down to .009, or 111 pesos to the dollar.*

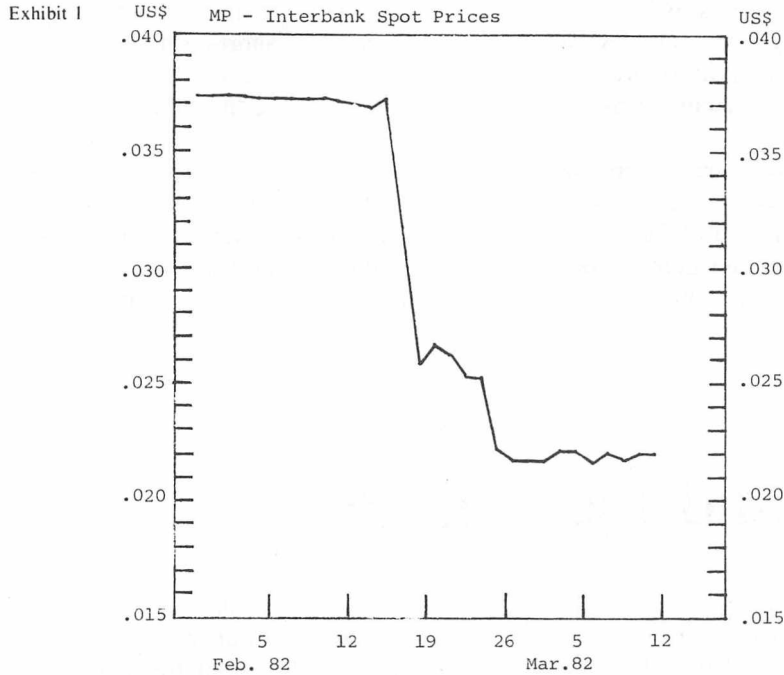


Exhibit 2 MP

Forward Discount Annual Basis %	Jun.82	Sep.82	Dec.82	Mar.83	Jun.83
Mar.82	15.04	19.75	21.32	21.20	20.51
Jun.82		25.41	25.41	24.16	22.73
Sep.82			27.14	25.13	23.32
Dec.82				24.80	22.96
Mar.83					22.53

Interest Rates Futures

Prudence is the better part of valor.

Our short position in interest rates futures was stopped out on February 18th, when March '82 T-bonds closed above 59.20, and February 22nd, when short-term instruments like T-bills, CDs and Eurodollars closed above our recommended stops of 87.25, 85.30 and 84.60 respectively. In all cases, the market continued to rally, showing gains of as much as 4 points in the T-bonds (\$4,000 per contract) and 100 points for T-bills (\$2,500 per contract).

What happened? In retrospect, the market had become too "negative" about the US federal government's prospective fiscal deficit, attracting relatively unsophisticated selling. Short covering on the part of these weak sellers was triggered in response to an updated version of first quarter fiscal borrowing requirements: Accelerated collections and slow disbursements pushed estimates of total borrowings for the first quarter down to \$31 billion from as much as \$42 billion anticipated in January. While the drop represents merely a shift of borrowing for the first quarter to the second and third quarters, it marked a sufficient change in sentiment to force bears

out of hibernation in a hurry! Aiding this shift in sentiment were two relatively favorable weekly readings in money supply and renewed fears that the recession was deepening once more.

Leaving aside this temporary aberration, *it is clear that the case for higher yields is compelling.* In the first place, the Fed continues to accommodate the high demand for money, keeping the banking system and the non-bank public well supplied with reserves and currency. Chart 3 shows the extraordinary increase in the monetary base in the first quarter of 1982 to date. From an annualized rate of growth of 2.9 per cent in the third to fourth quarter of 1981, the base growth has jumped 1,131 per cent, to an annualized rate of growth of 11.1 per cent. Since the market reacts perversely to Fed action — it increases yields when the Fed is easy because it expects a renewed tightening and/or because of heightened inflationary expectations — one can only conclude that interest rates are certain to rise. It should be noted that while the average Fed funds rate has, so far into this quarter, risen only 3 basis points (13.78 per cent to 13.81 per cent), Fed funds stand today at 14.5 to 15 per cent

and are likely to show a confirmed uptrend for the quarter, once we come to the end of March.

Furthermore, the unusual weakness displayed by the economy in the first two months of 1982 can be explained away by the very severe winter that affected the US over that period. The recent statistics showing a rise of 1.6 per cent in retail sales for February vindicate the view that the economy may have already hit bottom, with consequent increases in production still to come. Assuming, however, that the economy is still heading south, it is unlikely that credit demands will abate. The reason is the pervasive degree of illiquidity running through the corporate and banking sectors.

Chart 4 shows that corporate illiquidity, measured by the quick ratio (current assets divided by current liabilities) reached, in the third quarter of 1981, the lowest point in the post-war period — down to 79.9 per cent — a dismal showing even with respect to the nadir of the 1974-75 recession. *Clearly, demand for funds is becoming relatively inelastic regardless of economic conditions, and perhaps aggravated by the slump in profits.*

Corporations have been unable and/or unwilling to fund their liabilities in the long end of the market. Even such a blue-chip debtor as IBM has had to issue relatively short dated paper, extendible at the option of the holder in 1985, 1988 or 1991 despite the posted maturity of 1994. As a further concession, IBM will adjust the coupon in 1985, 1988 and 1993 to a level roughly in line with the yield on three-year Treasury notes. The bond market is dead. Only continuous liquidation of assets and/or massive monetary reflation (an unlikely prospect, at least for the foreseeable few months) will redress run down corporate balance sheets.

Equally ominous is the terrifying drop of banking liquidity. Chart 5 compares the loan/deposit ratio (inverted, a rise in the ratio is shown as a drop) with the movement of industrial production. What stands out is the fact that a drop in economic activity can no longer be associated with a rebuilding of banking liquidity, as was the case in 1974 and 1980, when both measures showed a logical correlation. We must now assume that banks are keeping afloat a great deal of dead beats, i.e., insolvent

individuals, corporations and the likes of Poland, who have no means of ever repaying their debts. Writing off these loans now has become too embarrassing and too painful. It can certainly be said that when the day of reckoning arrives, the embarrassment and the pain will be multiplied many times over.

The common thread running through these remarks is that the demand for money will continue to run at least as high as the rate of interest, with the extension of new credits papering over the inevitable accumulation of interest payments. Has the market perceived, as yet, these risks? Possibly. Last week, three months Certificates of Deposit widened their premium over three months Treasury bills by 14 basis points in the spot March position and by 30 basis points in the June position, breaking out of a fairly long and steady band (see Chart 6).

At last, private money market paper is being downgraded more in line with perceived risks. The late February, early March rally was accompanied by a movement from negative to positive in the yield curve (see Chart 7). This too was a short-term aberration. The unabated demand for short-term credit will inevitably show up in a steepening negative yield curve. This movement will be reinforced towards the very end of March when savings institutions begin to withdraw funds obtained via tax-exempt certificates from short-term bank deposits and begin redeploying them in the long end of the market, as required by law.

STRATEGY: *Once more, aggressive short positions in interest rates futures are warranted. Our views on illiquidity, private risks and the expected move in the yield curve force us to consider selling Certificates of Deposit and Eurodollars first, followed by Treasury bills and Treasury bonds. Considerations related to contract liquidity suggest the use of Treasury bills exclusively, unless, of course, small positions are undertaken.*

Place stops at recent high, i.e., June '82 CDs at 86.72, June '82 Eurodollars at 86.07, June '82 Treasury-bills at 88.33 and June '82 T-bonds at 64.9/32, all close only.

Exhibit 3

	Adjusted Monetary Base (Compounded Annual Rates of Change)	Variation from Previous Quarter Annualized	Adjusted Reserves (Compounded Annual Rates of Change)	Fed Funds Rates	
	%	%	%	From	To
4Q 79 - 1Q 80	7.1		0		
1Q 80 - 2Q 80	6.5	-33.8	+2.8	15.05	12.69
2Q 80 - 3Q 80	9.9	+209	+7.4	12.69	9.83
3Q 80 - 4Q 80	10.0	+ 4	+12.1	9.83	15.85
4Q 80 - 1Q 81	3.8	-248	0	15.85	16.57
1Q 81 - 2Q 81	7.8	+421	7.1	16.57	17.78
2Q 81 - 3Q 81	4.1	-190	3.4	17.78	17.58
3Q 81 - 4Q 81	2.9	-117	-1.7	17.58	13.78
4Q 81 - Feb. 82	11.1	+1,131	9.2	13.78	13.81

Exhibit 4

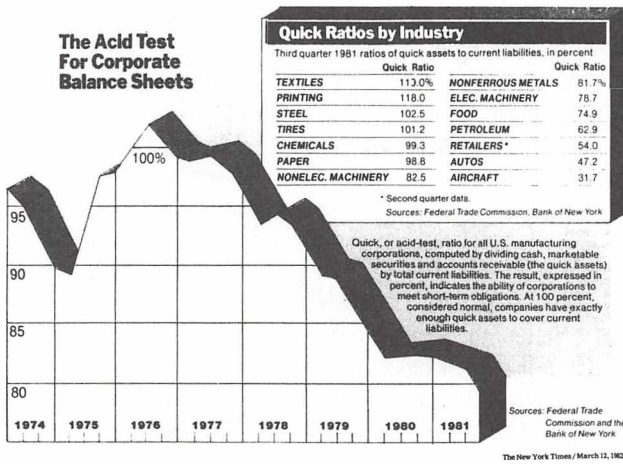


Exhibit 5

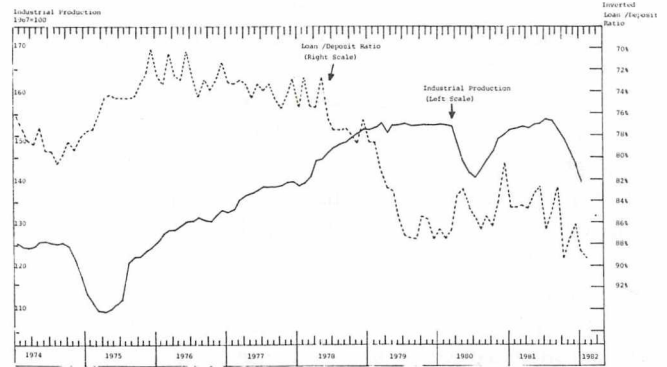


Exhibit 7

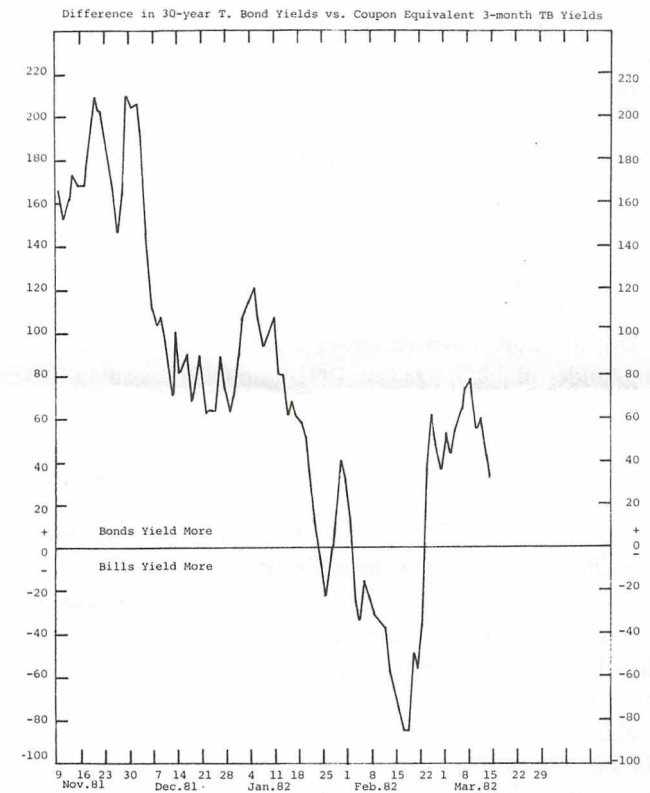


Exhibit 6

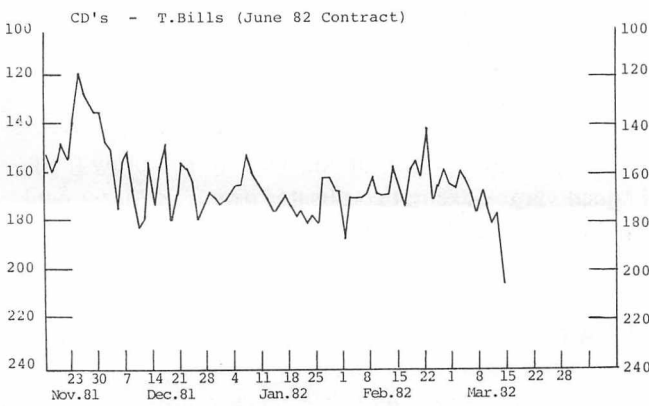
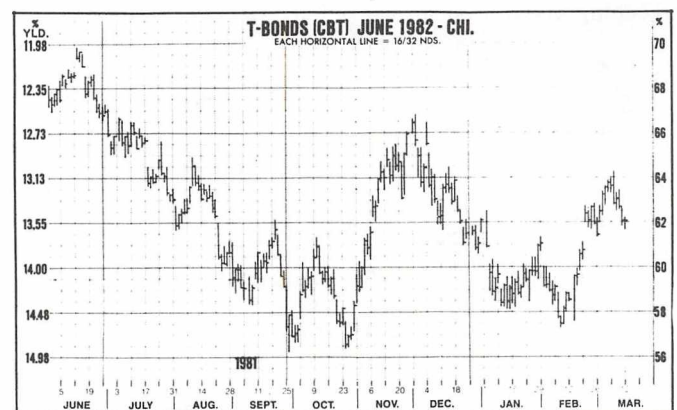


Exhibit 8



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Exhibit 9



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Exhibit 10

TREASURY BILLS (IMM) - \$1 mil.; pts. of 100%									
	Open	High	Low	Settle	Chg	Settle	Chg	Discount	Open Interest
Mar	87.38	87.44	87.23	87.28	-.11	12.72	+.11		4,294
June	87.25	87.38	87.16	87.32	....	12.68	....		20,783
Sept	87.08	87.13	86.93	87.03	-.07	12.97	+.07		6,621
Dec	86.97	86.98	86.79	86.89	-.11	13.11	+.11		3,060
Mr83	86.92	86.94	86.80	86.88	-.09	13.12	+.09		1,856
June	86.88	86.93	86.82	86.90	-.07	13.10	+.07		999
Sept	86.95	86.95	86.88	86.91	-.08	13.09	+.08		159
Dec	87.00	87.00	86.94	86.95	-.07	13.05	+.07		45
Est vol 28,462; vol Thu 30,979; open int 37,817, -2,183.									
BANKS CDs (IMM) - \$1 mil.; pts. of 100%									
Mar	85.50	85.62	85.40	85.49	-.15	14.51	+.15		731
June	85.42	85.60	85.15	85.27	-.30	14.73	+.30		5,470
Sept	85.43	85.59	85.18	85.28	-.29	14.72	+.29		776
Dec	85.61	85.61	85.36	85.36	-.24	14.64	+.24		97
Est vol 6,692; vol Thu 7,587; open int 7,074, +132.									
TREASURY BONDS (CBT) - \$100,000; pts. 32nds of 100%									
Mar	61-20	61-30	61-15	61-23	- 2	13.615	+.014		8,313
June	61-30	62-07	61-22	62-01	....	13.547	....		66,598
Sept	62-05	62-17	61-31	62-11	....	13.479	....		20,921
Dec	62-18	62-27	62-11	62-22	+ 1	13.405	-.007		17,223
Mar83	62-27	63-06	62-25	63-01	+ 2	13.352	-.014		13,724
June	63-00	63-13	63-00	63-11	+ 3	13.266	-.020		11,310
Sept	63-14	63-20	63-14	63-20	+ 4	13.208	-.026		14,122
Dec	63-26	63-29	63-18	63-29	+ 5	13.149	-.033		12,408
Mar84	64-04	64-05	63-29	64-05	+ 6	13.098	-.038		10,293
June	64-07	64-13	64-07	64-13	+ 7	13.047	-.044		5,166
Sept	....	....	....	64-21	+ 8	12.996	-.045		1,818
Dec	64-18	64-29	64-17	64-29	+ 9	12.945	-.057		908
Est vol 50,000; vol Thu 69,353; open int 182,804, -2,825.									

Currencies

British Pound

A hardly inspiring budget, but with one novel and progressive innovation: the indexation of capital gains and the announcement that the Exchequer will issue cost-of-living indexed bonds, available to all investors (including nonresidents) and exempt from taxes on the gains arising from indexation. Little consolation is offered in the area of general government expenditures: they are slated to increase 9.5 per cent in 1982-83 and to decrease as a percentage of GDP, from 45 per cent in 1981-82 to 44.5 per cent in 1982-83.

The UK is likely to stagnate as long as (a) government expenditures do not fall significantly from present levels, (b) Sterling remains "too high" in real terms (probably overvalued by anywhere between 10 per cent and 20 per cent) and (c) corporate liquidity remains abysmally low (see Chart 12). On the last score, it is clear that the company sector will face a shortage of cash to finance rebuilding stocks and increasing investments when and if the economy recovers.

STRATEGY: remain short, risking 1.87 basis June '82 and looking for 1.72.

Deutsche Mark and Swiss Franc

The recent rally stopped us out (profitably) of the March '82 Swiss franc but it kept us in the short Deutsche mark position.

STRATEGY: Remain short Deutsche mark but begin shifting positions to the short side of the British pound (see above comments).

Japanese Yen

Growing budget deficits are beginning to undermine Japan's financial stability. From fiscal year 1974 to fiscal year 1980, the annual deficit increased sevenfold, to \$60 billion, representing as much as 6 per cent of GNP. Low domestic interest rates will make it difficult for the Japanese government to fund its growing budget gaps out of genuine savings. Furthermore, the recent drop in fourth quarter GNP (the first in six years) will accelerate the drop in government revenues.

The expansive fiscal/monetary stance is already having some effects on Japan's balance of payments. Despite a massive current account surplus, international reserves have begun a gentle but noticeable drop. In view of rising protectionism, it is likely that Japan's current account will deteriorate, aiding the already very negative movement on capital account.

The Yen should depreciate significantly in months ahead.

STRATEGY: Sell June '82 yen at market, risking 44.60, close only.

Canadian Dollar

The Canadian dollar rallied sharply from the 81.25 level as US interest rates fell nearly 200 basis points, while Canadian interest rates remained relatively steady. In the past few days, renewed pressure has appeared on the foreign exchange markets, once again the result of US interest rates' reversing course.

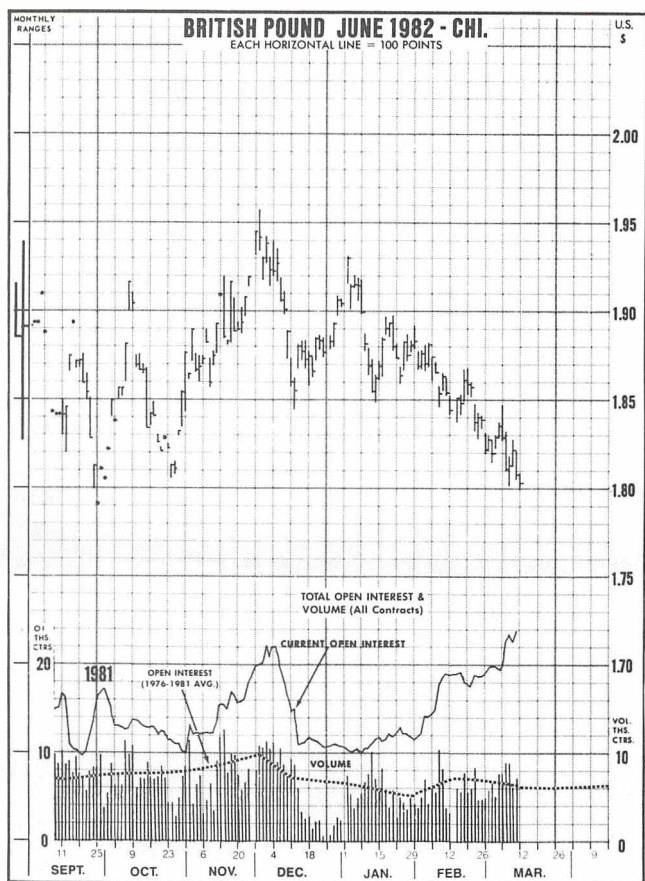
The Canadian dollar is likely to drop into new low ground in the weeks ahead.

STRATEGY: Remain short Canadian dollar futures. Place stops at 83.00, basis June '82.

Another interesting spreading opportunity has developed. The interest rates differential between long-term US and Canadian bonds has narrowed to a mere 140 basis points. Given currency pressures and the likelihood that the US government will not issue a new

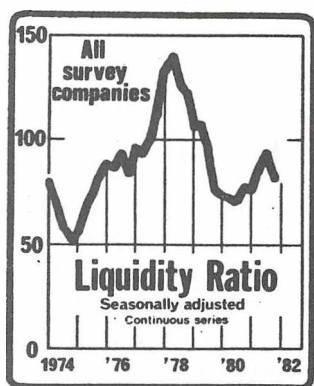
long-term bond for some time, it would appear quite profitable to sell long-term Canada bonds (on the TSE) versus the purchase of long-term US bonds (on the CBOT). Ratio analysis suggests selling 41 June '82 Canada versus buying 30 June '82 US bonds. Look for the spread to widen to at least 240 basis points.

Exhibit 11

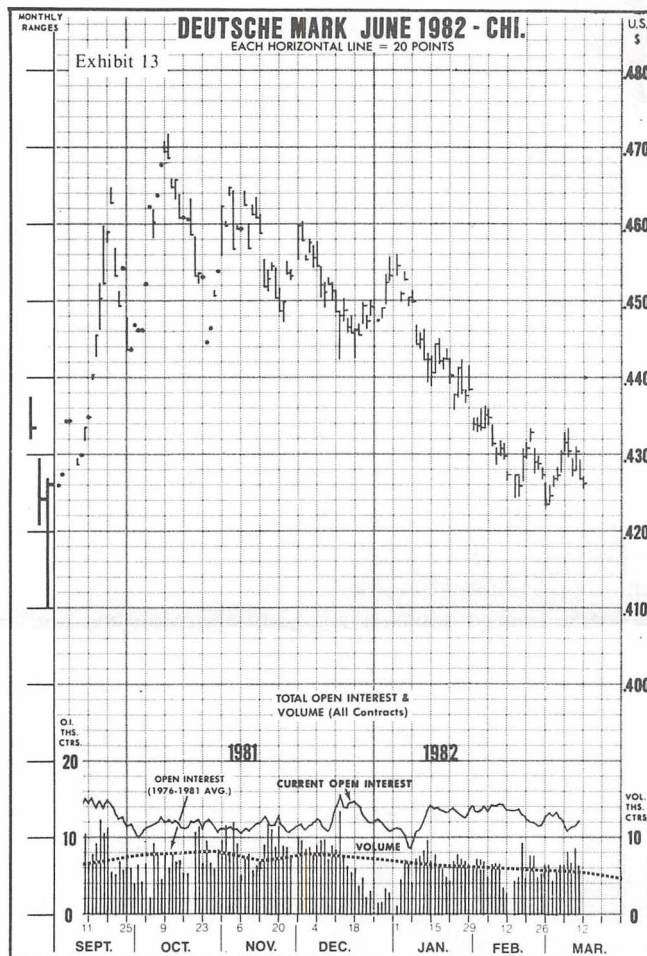


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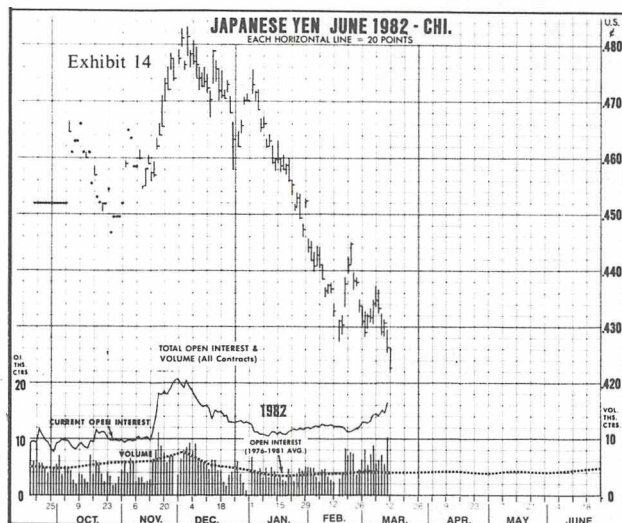
Exhibit 12



Financial Times

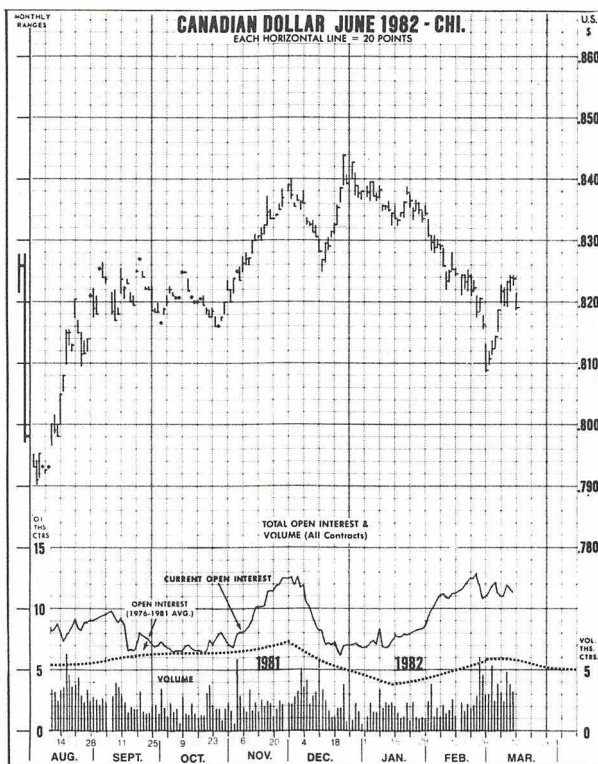


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Exhibit 15



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Precious Metals

As we've been suggesting for the past few months, the downtrend continues in full force. Significantly, gold prices, having broken through the \$360/oz. level, have retraced more than 2/3 of the 1976-80 advance, a prediction that we made on February 4, 1980. Moreover, prices have also eased through the long 1976-80 uptrend,

at \$330/oz., indicating that the decline will get a great deal bloodier.

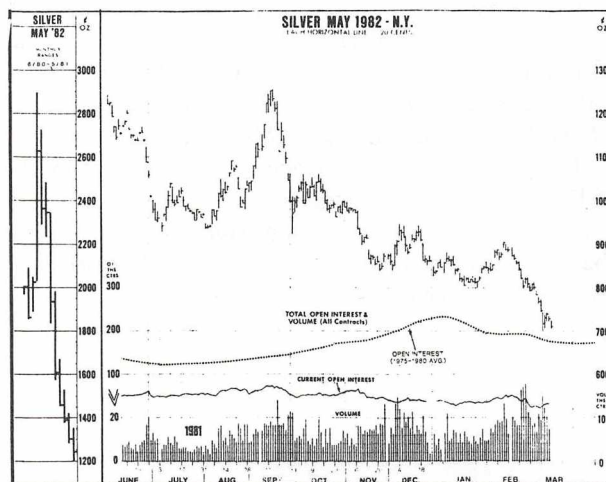
STRATEGY: Remain short silver, with stops at 7.75, basis July '82, close only. Remain sidelined in gold, awaiting an important bottom.

Exhibit 16



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Exhibit 17



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Grains

At this point in the season it becomes necessary to analyze two dominant market factors. The first is ending stocks forecasts and the proportion that "free" stocks (those not under government control through loan or reserve programs) comprise of this total. The second factor is preliminary expectations with regard to the new crops, as indicated by plantings and planting intentions.

In Chart 18 we have calculated "free" stocks as a percentage of the total for corn and wheat for the period 1960 to 1981-82, and have compared these with relevant prices. There is a definite inverse correlation between free stocks and prices. In 1981-82 free stocks appear significantly less than previous years in recent history in proportion to the total carryover.

The low proportion of free stocks is indicative of massive government involvement in the marketplace (as everywhere else) and the high cost of this support. In the unlikely case of free stocks being used up in the near future, trigger release prices will come into play in determining the future course of market prices. It should be noted that only three months are left in the current wheat season, while six months are left in the current corn crop season. Thus, there is more room for change in corn stocks data.

Chart 19 shows the continuous downtrend revision in the past few months of the USDA's (US Dept. of Agriculture) export forecasts for corn and wheat for 1981-82. The most recent revisions were for 50 million-bushel reductions in both corn and wheat report projections as of March 11. If one compares this trend with the trend in prices over the same period, there is an obvious connection. The reduction in the corn export forecast was made despite an upward revision of US corn exports in 1981-82 to the USSR.

This revision to USSR corn import projections resulted from a surge in sales of about 2.3 MMT (million metric tons) in a buying spree that began February 10. Total grain sales to the USSR are now over 13 MMT (7.16 MMT of corn and 5.86 MMT of wheat).

The positive impact of recent corn purchases by the USSR has been limited, and may continue to be, by the size of stocks and by competition from Argentine corn, to be harvested starting in April (although Argentine corn is higher-priced than US corn).

Recent buying of soft red winter (SRW) wheat, mainly by China, may exert an upward influence on May wheat futures on the CBT, largely because of tightness in free stocks of SRW wheat, a projected 20 million bushels or less as some observers believe. This would tend to work against both our long May corn short May wheat spread on CBT, and our long Kansas City short CBT May wheat spread, causing us to re-evaluate these positions.

Participation in the acreage set-aside programs is a factor in prospects for the new season's crops. Participation is expected to be small according to recent estimates, weighing heavily on deferred contracts in wheat and corn. Particularly low participation is expected in SRW wheat and should depress July CBT wheat futures. This low participation rate is expected, as crop prospects are good for winter wheat to be harvested in the eastern states in July and participation would necessitate grazing or plowing some of this crop under. The loss from the existing investment would be prohibitive.

Coupled with downward export revisions are higher carryover projections. Carryover of all wheat, but of SRW in particular, is expected to be higher than even now projected by the USDA. An important factor is how the market will react to large total SRW stocks but record-low "free" stocks. Sales of hard red winter (HRW) wheat to the USSR have tapered off recently. This also works against our long position in May KC wheat/short May CBT wheat. Thus, there are several pros and cons in the evaluation of this spread. We still expect the spread to widen in our favor. However, conditions would warrant that we are better off in the new season, for the several reasons already discussed.

Last month's *Comments* advised that 80¢ is likely a resistance level in our May corn-wheat spread on the CBT. However, being at that level now, we would not prevent further potential profits if this level were broken, by closing out all our spread positions. Heavy sales of corn to the USSR may continue to hold corn prices up relative to wheat.

STRATEGY: *Roll forward the long corn/short wheat spreads and long KC wheat/short CBT wheat to the July position.*

Remain long corn and short wheat, provided that you respect stops (as per last month's suggestions).

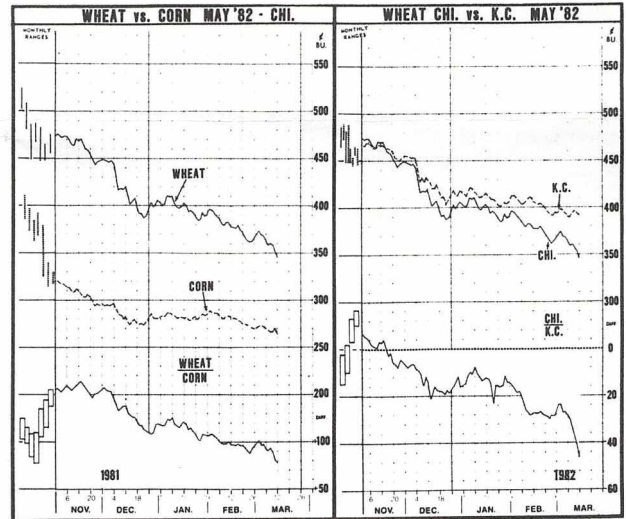
Exhibit 18

GOVERNMENT PRICE SUPPORT PROGRAMS FOR WHEAT & CORN

WHEAT				CORN				
annual average Chicago price (US\$ per bushel)	ending carryover (June 30) (Million bushels)	"free" stocks	free as % of total	annual average Chicago price (US\$ per bushel)	ending carryover (Sept. 30) (Million bushels)	"free stocks"	free as % of total	
1960	2.02	1,411.0	43.0	3.0	1.10	2,016.0	126.0	6.3
1961	2.09	1,322.0	130.0	9.8	1.11	1,653.0	118.0	7.1
1962	2.17	1,195.0	16.0	1.3	1.19	1,365.0	90.0	6.6
1963	2.06	901.0	10.0	1.1	1.20	1,537.0	237.0	15.4
1964-65	1.58	817.0	135.0	16.5	1.28	1,147.0	223.0	19.4
1965-66	1.64	535.0	195.0	36.4	1.27	840.0	403.0	48.0
1966-67	1.79	425.0	224.0	52.7	1.36	823.0	449.0	54.6
1967-68	1.53	539.0	216.0	40.1	1.12	1,162.0	448.0	38.6
1968-69	1.30	904.0	268.5	29.7	1.17	1,118.4	381.2	34.1
1969-70	1.43	982.6	226.7	23.1	1.25	1,005.2	404.1	40.2
1970-71	1.67	822.8	230.9	28.1	1.44	666.7	324.1	48.6
1971-72	1.58	983.4	249.1	25.3	1.18	1,126.9	430.1	38.2
1972-73	2.31	597.1	465.1	77.9	1.91	707.9	539.0	76.1
1973-74	4.93	340.1	339.0	99.7	2.95	483.9	471.3	97.4
1974-75	4.09	435.0	430.7	99.0	3.12	361.4	360.9	99.8
1975-76	3.54	665.3	643.9	96.8	2.75	399.7	376.2	94.1
1976-77	2.81	1,113.2	1,113.2	100.0	2.30	885.9	737.7	83.3
1977-78	2.56	1,178.0	1,132.1	96.1	2.26	1,111.4	367.5	33.1
1978-79	3.57	924.1	873.9	94.6	2.54	1,303.9	538.6	41.3
1979-80	4.24	902.0	760.3	84.3	2.81	1,617.5	642.2	39.7
1980-81	4.39 ¹	989.0	433.0	43.8	3.49 ³	1,034.0	610.0	59.0
1981-82		1,117.0 ²	353.0 ²	31.6		2,076.0 ²	417.0	20.1

1 Jan.-Nov. 3 Oct.-Mar.
2 forecast by USDA

Exhibit 20



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Exhibit 19

EXPORT FORECASTS -- USDA (million bushels)

Month of Forecast	Wheat	Corn
Nov 81	1,900	2,500
Dec 81	1,900	2,375
Jan 82	1,850	2,250
Feb 82	1,850	2,175
Mar 82	1,800	2,125

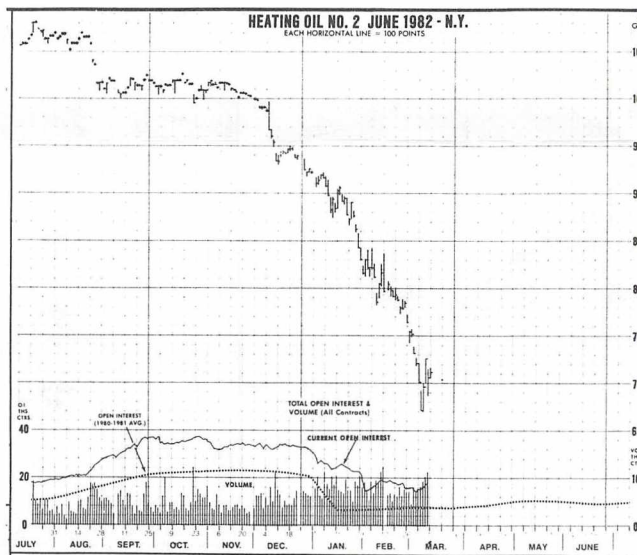
Potpourri

Coffee . . . Tin . . . Heating Oil

When taking into account the overall bearish environment plus the release of an additional 672,000 bags for 1981-82 export owing to the ICO's 15-day moving average's rising above the 135¢/lb. trigger in late February, coffee has held its own quite well. We remain favorably disposed to the long side via September London call options . . . Tin prices have collapsed as mystery buyer turns mystery seller. Options will probably have to be abandoned at full loss of premium . . . Heating oil this week completed an

upside weekly reversal, and remaining shorts should cover as per last month's advice and accept profits in the neighborhood of \$12,000 per contract. We remain bearish. Despite the publicity, OPEC has no escape from the secular shift that's taken place. Their most probable, and most foolish, tactic will be to cut production, thereby inhibiting the market mechanism from improving demand and reducing non-OPEC supply. Look to reestablish shorts in December '82 at between 82¢ and 85¢, placing stops at 90.00, on close. Our target for that delivery is 62.00.

Exhibit 21



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