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Interpreting Chart Action

What do cotton, Swiss francs, T-bills and T-bonds have in common? To the fundamentalist, nothing or, perhaps, very little. To the technician, a great deal.

The most common type of technician is a chartist who is able to draw inferences about future price behavior from past and present price behavior. To a great extent, we are all "chartists." We tend to speak in terms of firming prices or the "recent" firming of prices as an indication that the low point in a decline has been seen. Financial analysts and economists will *extrapolate* trends in sales, production, and even earnings. One need not be an expert chartist to spot a "rising" or "falling" trend; one need, however, be an expert technician to spot a trend reversal *before* it becomes all too obvious. Similarly, one need be an expert technician to expound on the validity of a particular breakout (a move into a recent new high ground), or the strength of a particular uptrend, or the possibility of hidden distribution (goods, shares, or contracts moving from informed to less informed hands) during an unsuspecting top formation.

There are at least two types of professional technicians: those who believe that fundamental economic analysis (sprinkled with psychological and sociological factors) is the main determinant of prices — a sort of value will out — and those who believe that prices are manipulated by big money interests in a total economic vacuum.

The former type of technician believes that there are truly intelligent individuals and/or economic groups with unusual foresight and perhaps privileged information who operate in markets for their benefit but *leave tell-tale marks of their behavior*. These technicians are basically fundamentalists who lack the foresight and the access to privi-

leged information that is available to the most fortunate of human beings. By identifying the actions of the elite, they too can successfully participate in the market.

The latter type of technician is correct only insofar as small secondary markets are concerned. This is the case with thinly traded stocks (i.e., over-the-counter stocks during a boom) and futures contracts that represent small, localized commodity markets (the case of Maine Potatoes in the US, especially before the recent CFTC-imposed delivery specification changes). While technicians of this persuasion are clearly wrong in treating every market as totally devoid of fundamental background, they are, however, correct in one thing: *All markets tend to act as if they were manipulated*; that is, tops tend to attract maximum public interest and buying participation, while bottoms are notorious for their dullness and lack of interest on the part of the public. It is as if "they" (whoever these gnomes are) are able to create enough excitement at will to unload their cheaply bought wares.

We repeat. We maintain a healthy respect for technical analysis, more for the intelligence revelations that it provides regarding flows of sophisticated money than for the simplistic assertion that a market is heading higher (lower) because it is in an uptrend (downtrend). On a more pragmatic level, we subscribe to the notion that markets will act as if they were manipulated so as to excite the average investor into buying at the top or so as to frustrate the average investor into selling at the bottom (and thus always assuring that the majority of investors lose money).

We can now return to our opening question: What do July '82 cotton, July '82 Swiss francs, June '82 T-bills and

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June '82 T-bonds have in common? Well, they all share a common technical characteristic: (failed) breakouts. The July '82 cotton chart, enlarged to show in detail the range and close of the past 90 days, is an excellent example of the dangers of simplistic analysis. Note the extraordinary two-day jump registered in late April, from about 6800 to a high of 7035, following a very tight 23-day range. With this breakout above the January '82 twin highs of 6960, the market was signalling the beginning of a bull trend. Volume and open interest increased very sharply and so did bullish sentiment as expressed in various market publications.

The next four days gave the true technician a clue that all's not well. Despite the clean breakout, the market opened lower the very next day and ranged inside the breakout zone in the subsequent few days, culminating in a sick-looking reversal on April 30. Note how on that day the market closed lower than on the previous three days, after having ranged higher than on any of those days. The advance had stalled; the breakout was invalid. And now a vicious bull trap was sprung, having caught the unsophisticated chart-following crowd right at the top.

A very similar tight range preceded the spectacular 200-point bull run on the June '82 Swiss franc, which managed to close *above* the significant January '82-March '82 downtrend (see Chart 2. January '82 peak not shown). The sharpness of the advance had all the earmarks of a bear market rally. The validity of this conclusion awaited the very next day's action: Instead of following through on this breakout, prices opened *sharply lower*, almost at the low of the previous day's range.

The cotton and Swiss francs charts have already shown us what we may expect to see following a false breakout. The next two charts we present as test cases. First the June '82 T-bill chart. Note the breakout into new recovery high, registered on May 7, having moved above 88.33, the previous recovery high (and, incidentally, our stop loss). Despite the breakout, the market spent the next three days vacillating around the critical level and finally reversing course to close well below the close of the previous four days. Unless June '82 T-bills can regroup once again around the 8835-8840 area for some time, one would have to conclude that the end of the April-May advance is at hand.

We keep the June '82 T-bond chart to the end because it offers, in our opinion, the most fascinating example of persistent technical weakness, likely to degenerate into a very severe bear market.

The first sign of technical weakness is shown by the outside day reversal that capped the spectacular 18-day, six-point advance from the early February '82 lows. A renewed attempt failed to reach the recovery highs, and the market reversed course, *breaking under the two-day support zone* (just below 6116) and *setting up a false downside breakout*. The small bear trap allowed for a renewed attack on the recovery highs, and the challenge was successful.

The advance stalled and was finally reversed but not

before the volume and open interest showed large increases. In the background, the news was bullish: The CPI recorded a negative figure for the first time since 1965, and Congressional leaders were sure to arrive at some budget compromise. The public is kept excited by the move into new high ground. But perhaps the bullish contingent is not loaded up enough, and a third attempt is made in early May. The story repeats itself: a new high close followed by a three-day stalled advance and, finally, a powerful outside day reversal. At Friday's close of 64 10/32 the market was exactly 2/32 higher than the intra-day high recorded on March 8 and just 1/32 higher than our stop loss. In the interim, full rein was given to the bullish sentiment.

Can a bear market be far behind?

The Coming Crunch

Our fundamental view of the financial world has changed little, if at all.

Corporate debt issuance through April '82, in net terms, amounted to less than \$7.7 billion, putting it roughly \$6 billion behind the same time period of 1981 and \$3 billion behind the 1980 stretch. Business loans continue to soar — at a 22 per cent clip since the end of January '82. In the latest reporting week and in the midst of a full fledged recession, US business loans jumped \$2.9 billion and commercial paper outstanding expanded by \$2.9 billion. By any measure, illiquidity is growing.

Monetary policy, as evidenced by the growth in the monetary base (at better than a 9 per cent annual rate) and the low level of non-borrowed reserves speak of temporary ease and eventual tightening.

In the light of a bitter bipartisan struggle, it is unlikely that any compromise will be achieved in the area of the budget deficit. "Untouchable" entitlements coupled with soaring defense spending — up at an annual rate of 47 per cent in the fourth quarter of 1981 — are sure to crowd out the last vestiges of corporate long-term credit demands. Be prepared for a devastating credit crunch.

STRATEGY: *Short positions in June '82 T-bills were stopped out at 88.33; lack of follow-through has left the market at 88.17 and at a substantial 45-50 point premium to the cash market. The same is true for T-bonds — stopped out at 64 9/32 and still trading at 64 10/32, after failing to follow through on the breakout.*

Short positions on June '82 Certificates of Deposit and Eurodollars have not been stopped out, as yet.

We cannot but be impressed with the bearish argument, both technical and fundamental. Maintain short positions in CDs and Eurodollars, and reinstate short positions in September '82 T-bills and T-bonds, risking recent highs. This persistent and limited risk approach should be handsomely rewarded in coming weeks.

N.Y. #2 COTTON
JLY 82

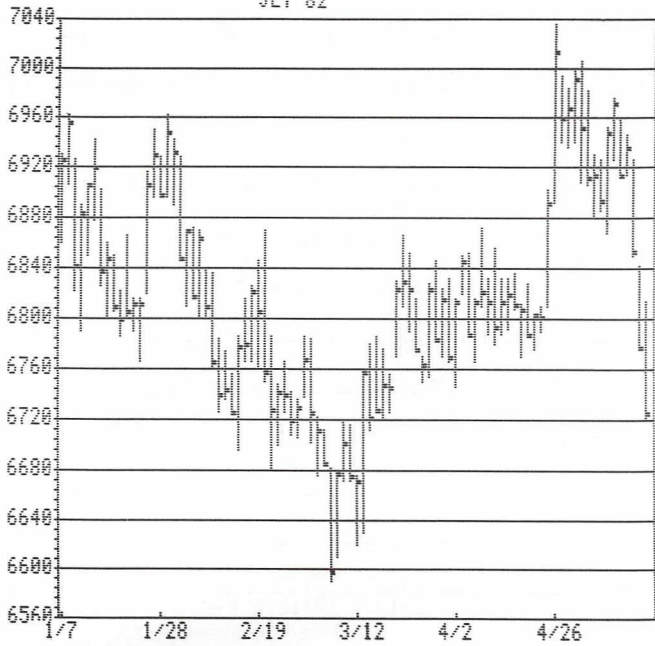


Chart 1

SWISS FRANCS
JUN 82



Chart 2

90 DAY T. BILLS
JUN 82

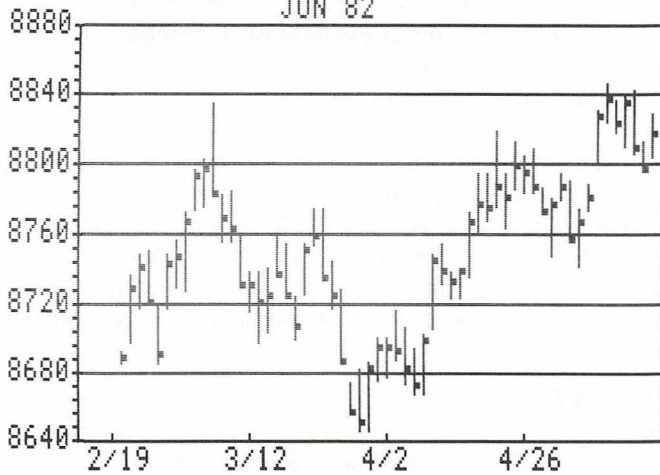


Chart 3

U.S. T. BONDS
JUN 82

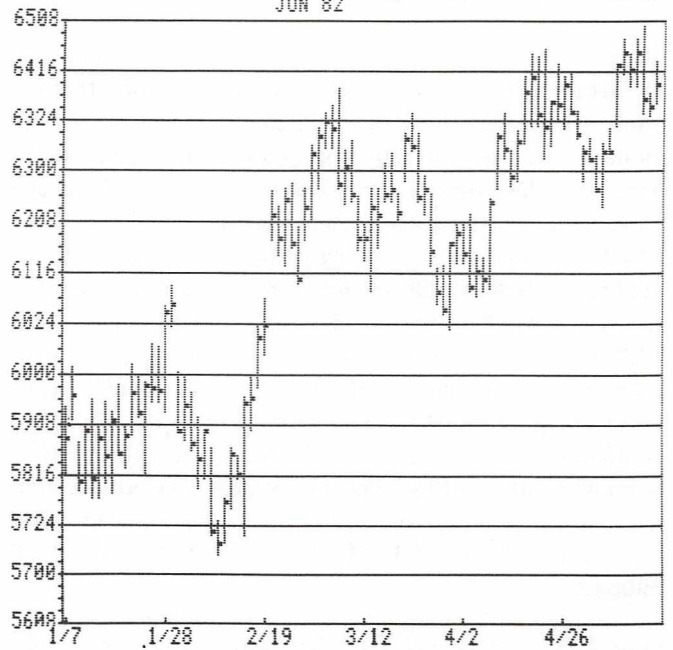


Chart 4

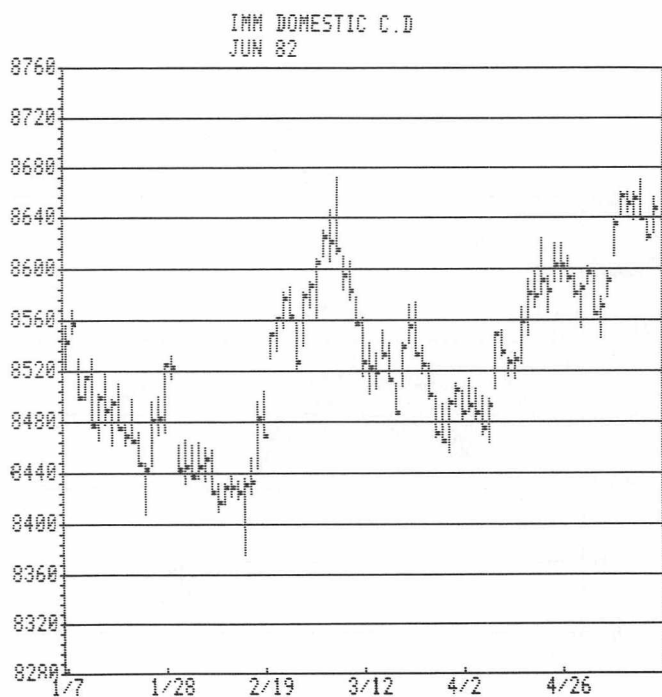


Chart 5

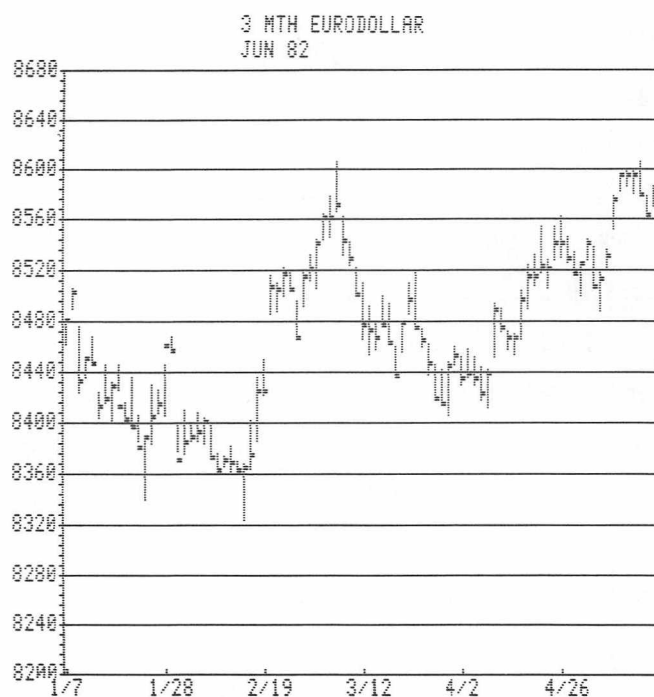


Chart 6

Currencies

Europe and Japan

Sharp bear market rallies in the European currencies as well as the yen have been based on the perception that US interest rates are headed significantly lower in coming months. The two most notable features in recent weeks have been the extraordinary improvement in the Deutsche mark vis à vis the British pound and the Swiss franc (see Charts 7 and 8). This sparkling performance can be attributed to the fact that Germany's current account deficit fell strongly in the first quarter of 1982, to DM1.7 billion from DM9.1 billion in the first quarter of 1981. This improvement reflected a turnaround in the trade account, which registered a surplus of DM11.2 billion in the first quarter of 1982 compared with a deficit of DM200 million in the corresponding quarter of 1981. The government now projects that the current account may be in balance in 1982, after registering deficits of DM17 billion in 1981 and DM30 billion in 1980.

European Monetary System strains should become intolerable, with the French franc and the Italian lire likely to be devalued in the near future by at least 8 to 10 per cent.

STRATEGY: Remain short the British pound; place stops at 190, basis June '82. Reinstate short positions in September '82 yen; place stops at 44.30, close only.

Canada

Press comments that tight fiscal and monetary policies were being seriously questioned in Prime Minister Pierre Trudeau's cabinet, with Minister of Finance Allan MacEachen being the sole holdout, brought about some frenzied selling of the Canadian dollar on the foreign exchange markets. The unit touched 80.40 before recovering to 80.69 by week's end.

The bearish scenario runs as follows: The Bank of Canada is forced to lower interest rates, the Canadian dollar plunges to 75¢, where it is pegged, and wage and price controls are imposed in an effort to invalidate the inflationary consequences of a devaluation. Could be. But it is surely not necessary. And the ultimate effects would be disastrous.

STRATEGY: Having read the 1981 Annual Report of the Bank of Canada, we believe that the monetary authorities are serious in their intention to fight inflation. We cannot oblige by selling Canadian dollar futures at these ridiculous levels. Remain sidelined.

Mexico

The spot rate has begun to deteriorate once again, and it now trades at 47 pesos to the dollar versus a low of 45.71

in mid-March.

In a desperate attempt to steady the collapsing currency, President Lopez Portillo has made an appeal to the nation to stem the conversion of pesos into US dollars, volunteering a piece of valuable advice: The peso is undervalued, as it is "worth" 2.5¢, rather than 2.1¢.

Acting in a far more pragmatic manner, the Bank of Mexico is offering a guaranteed swap back into dollars for those companies seeking foreign credits. This swap will cost 26.5 per cent per annum for three-year transactions, and 28.5 per cent per annum for transactions of up to five years.

Since the one-year forward swap is trading at approximately a 64 per cent premium, it is obvious that the Bank of Mexico is giving away cheap forward facilities, hoping to attract a large inflow of much needed foreign currency. The Bank is in effect running a huge risk, comparable to an insurance company that sells new policies at half the market price to improve cash flow and pay off present claims.

STRATEGY: *The government will try by any conceivable means to hold the peso from crashing through the 2¢ mark before the July 4 election. Après lui, le déluge.*

Remain heavily short deferred contracts.

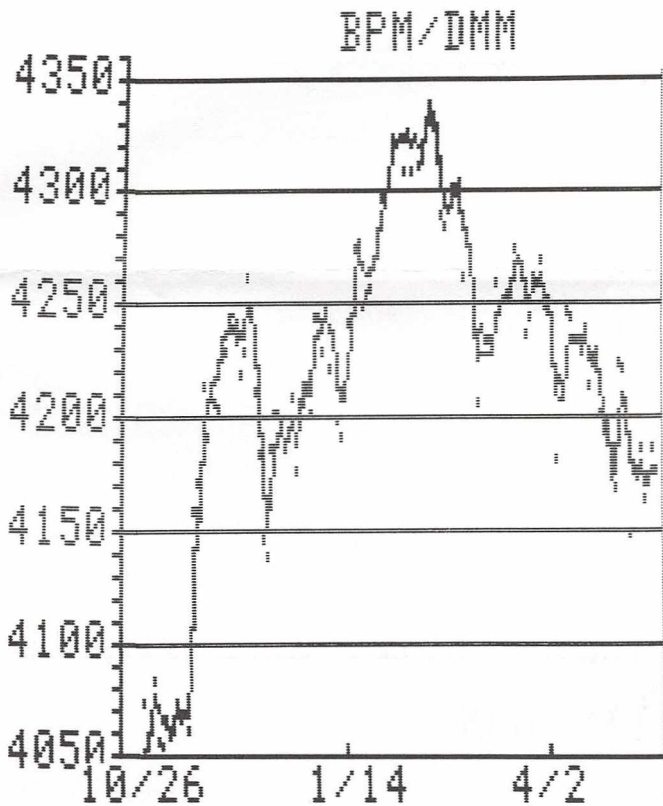


Chart 7

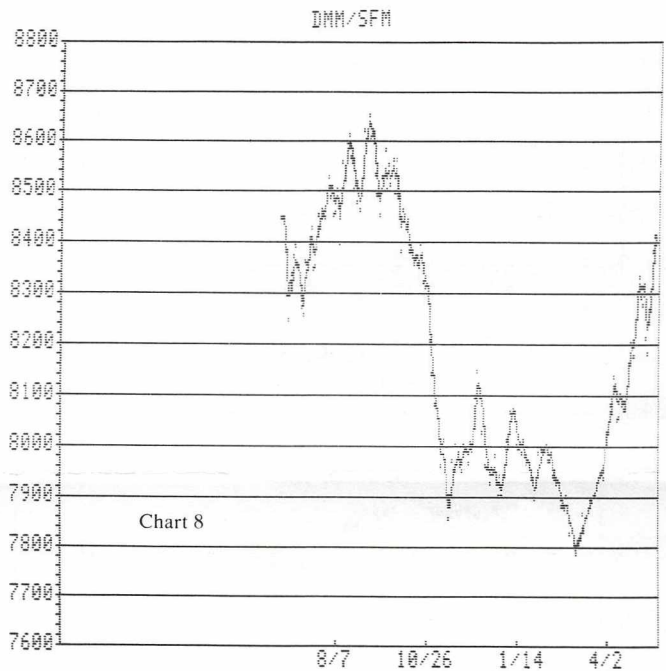


Chart 8

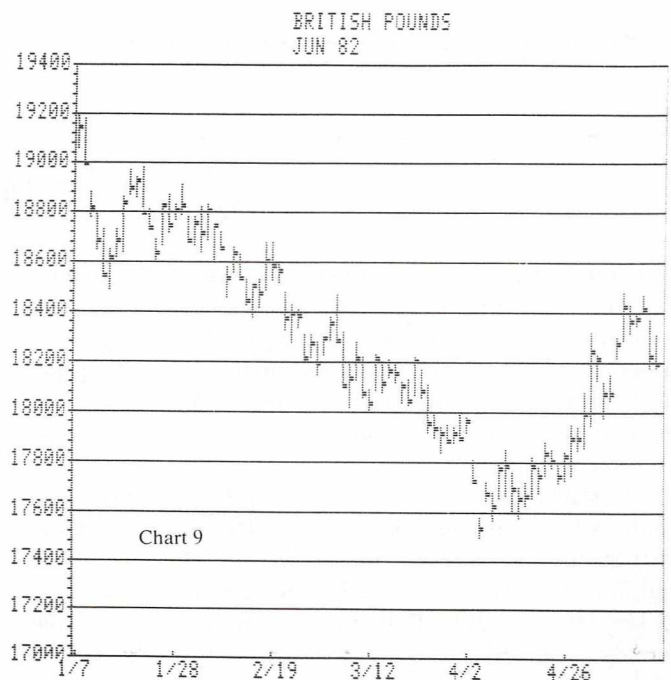
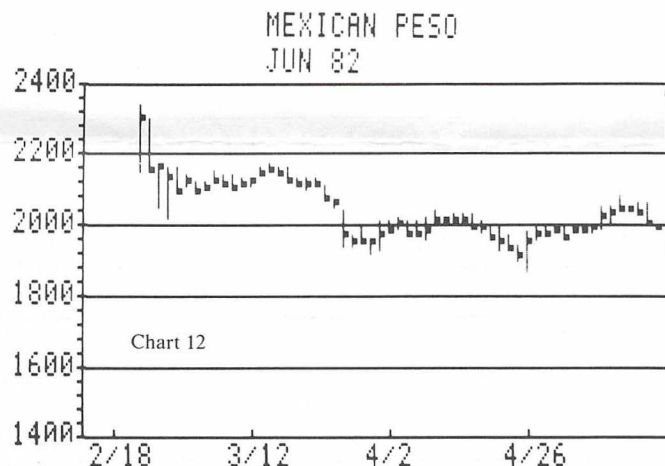
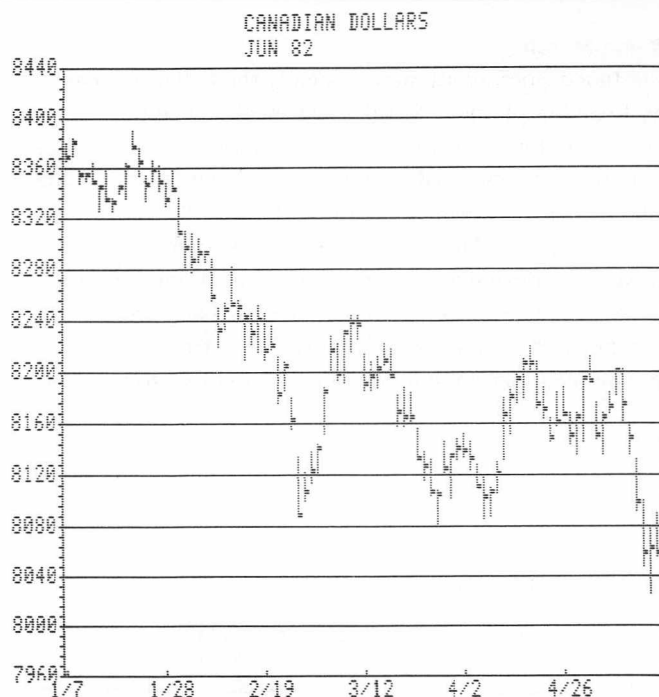
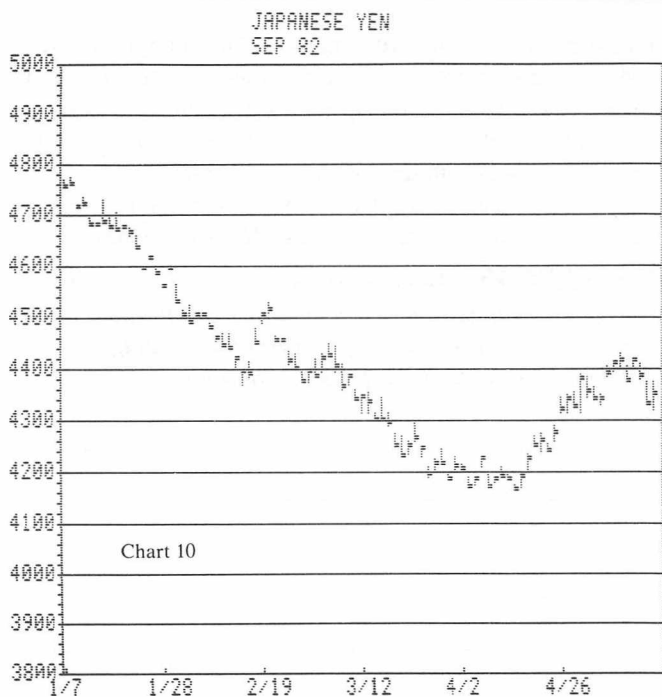


Chart 9



Mexican Peso

Forward Discount Annual Basis %	Sep.82	Dec.82	Mar.83	Jun.83
Jun.82	63.36	61.26	57.84	66.33
Sep.82		57.04	47.55	58.09
Dec.82			39.08	54.67
Mar.83				64.00

Chart 13

Precious Metals

Last month, after due rumination, we arrived at the opinion that the then-current \$55/oz. rally in gold prices was doomed to exhaustion. We were right. The market collapsed to test its lows. Friday's completion of an upside weekly reversal from those lows leaves us in the same boat we were in last month. What is the trend, and can it be captured profitably?

Certainly the market is not responsive to events in the South Atlantic. It could, however, tender support from the uncharacteristic persistence (as opposed to the general ebb and flow) of hostilities on the Israeli/Lebanese border. Still looking at the Middle East, the market may perceive the firming of oil prices as a bullish omen. If this is so, the buying input generated by such perceptions should be

looked upon as no more than a supply of sell orders soon to be executed (see also "Heating Oil").

Other bullish arguments may be engendered by the perception that rates are headed lower. Since we are of the opinion that the contrary is likely, we find ourselves again at odds with the market. It could be that the market fears deflation. The growth in the monetary base lends credence to such a view, and the declaration, even in minority, by our finance minister at last week's Organization for Economic Cooperation and Development conference, that attention should be refocused toward unemployment, gives the view some vindication.

To conclude, we cannot find an argument or a sum of arguments that cogently supports a bullish point of view. We

therefore believe that buying at around current levels represents bottom picking only. Although we cannot recommend a position, we view gold as still in a bear market

and we doubt our views would change as long as the yellow metal remained beneath the downtrend noted on the accompanying chart.

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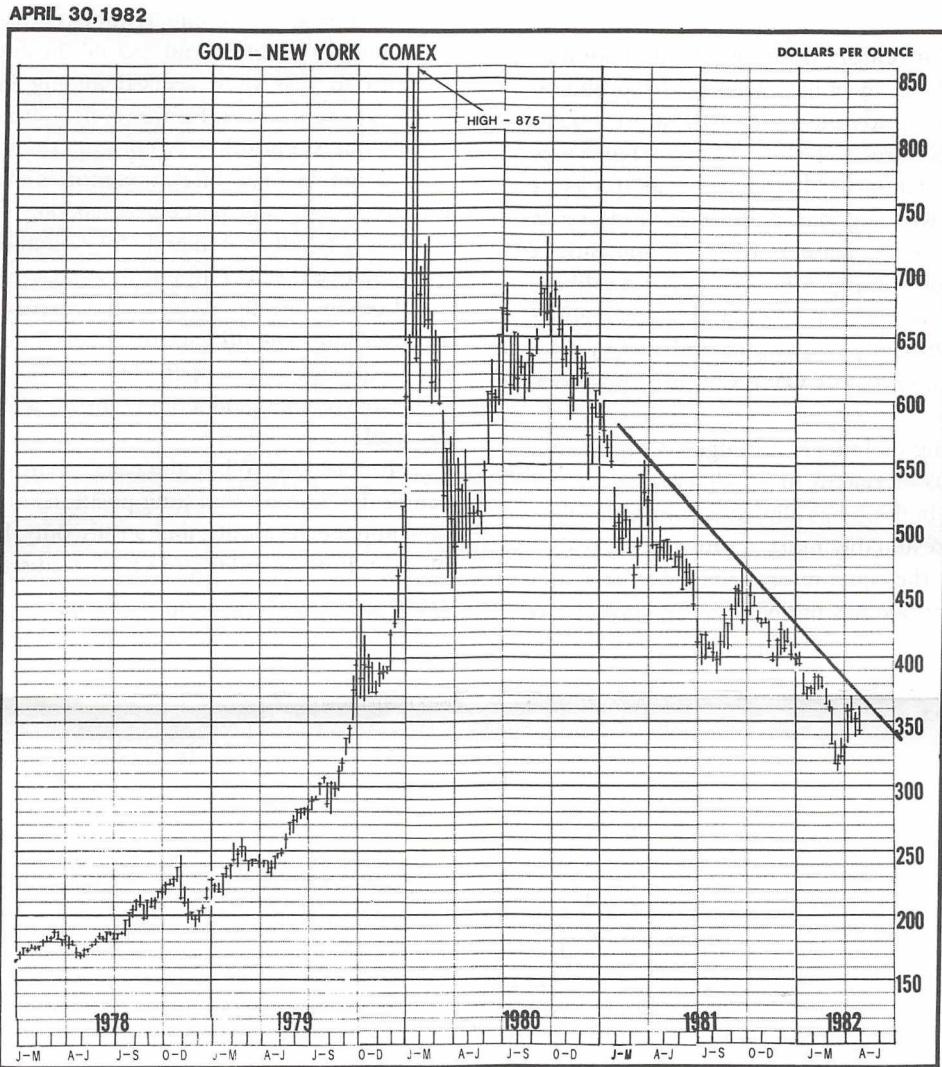


Chart 14

Copper

We find ourselves attracted to the long side for the first time in fifteen months. Despite that it is difficult, at the present time, to argue that the much anticipated major advance is in the offing, a bullish posture is warranted. What currently only looks like a (substantial) bear market rally may develop into something more full-blown inasmuch as the clouded economic environment may clear by the time the rally has run its course.

Current fundamentals are, to say the least, iffy. It is possible to suggest that the uptick in car sales registered since last writing indicates that the depressed auto industry may be bottoming out. The same may be true of construc-

tion. Nonetheless, the US Federal Reserve Board's report that industrial production fell 0.6 per cent during April, the eighth decline in the past nine months, militates against predicting a sharp turnaround in either of those industries that are copper's biggest sources of demand.

Copper inventories as indicated by stocks in exchange warehouses in London and New York are still increasing but at a reduced pace from the rate registered during the first quarter. The smoothed, 12-week rate of increase of combined London Metal Exchange (LME) and COMEX stocks has shown growth of 5.1 per cent, 3.12 per cent, 6.79 per cent, and 7.15 per cent over the previous four weeks

compared with an average of 12 per cent during the January to March period. Standing at 318,759 metric tons, warehouse stocks, while up 13 per cent over last year's level, are hardly burdensome by comparison to the 1974-1975 downturn. At that time LME stocks alone stood above 400,000 metric tons.

Any discussion of inventory positions should take into account the copper held by mills. There is a problem, however, of obtaining up-to-date data. The most recent report issued by the US Bureau of Mines (April 28) provides statistics only through January. These show that stocks of refined copper held at wire rod mills were 30,227 tons, or 28 per cent, less than last year's amount at 78,944 tons. Stocks at brass mills were up only marginally. We believe it is likely that mill stocks have fallen since January: The ongoing spate of production cutbacks suggests it; and so too does the increase in open interest in COMEX futures positions over the past months.

From the beginning of January through to Thursday's close, open interest has increased to 73,328 contracts from 51,298 contracts. This buildup has almost certainly discouraged the larger, and presumably more sophisticated, trader who would look upon the open interest increase as a sign that the over-zealous public has jumped on the market too soon. We believe the open interest has increased largely

because producers have elected to sell as much cash copper as they've been able to — thus the drawdown in mill inventories — and to hedge themselves by buying deferred futures positions. This strategy would be atypical but certainly advantageous from the producers' point-of-view. First of all, the producer is able to improve his tight cash position by selling spot metal. And second, he can "borrow" copper forward at less than bank-financing costs. The current one-year premium on futures contracts is 13.8 per cent.

If our supposition is correct, then we can draw two bullish conclusions: First, inventories may be considerably less than generally perceived; second, existing long positions may result in demands for actual delivery. The latter instance could effect an unexpected squeeze.

Looking briefly at the technical picture, we note Chart 15 describing a healthy uptrend. It is noteworthy that during the past week the copper chart, unlike the chart of many other currencies and commodities, showed no sign of a reversal.

To reiterate: While the case is hardly cut and dried, we are of the opinion that long positions are warranted. What now appears as a rally, and a rally only, has the potential to blossom into something of greater substance.

STRATEGY: Buy July, risking the 70.00 level. Our target is 85.00.

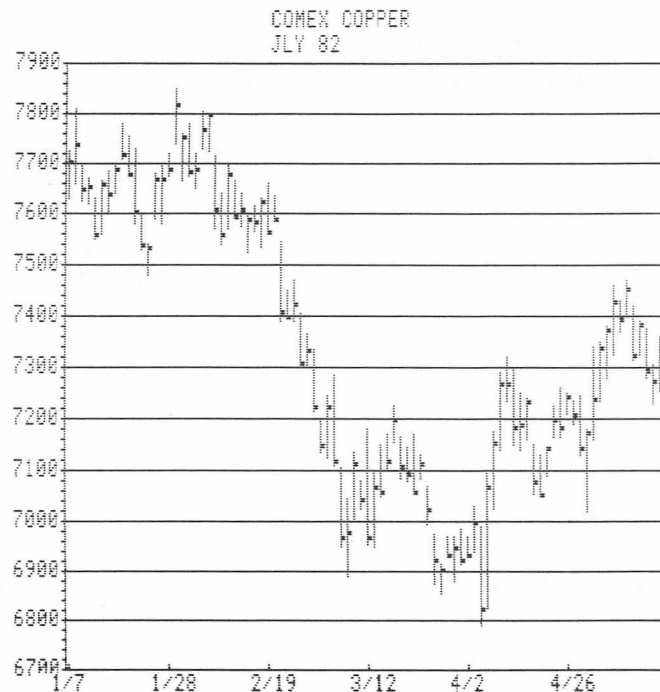


Chart 15

Heating Oil

The strong upturn in recent weeks is as much due to an improvement in crude prices as it is to a widening of profit margins in distillate production.

Saudi Arabia's marker has traded up to \$34-\$34.25/barrel this past week, considerably above the March lows of \$27.50/barrel. Temporary success has not come easily. In the first place, Saudi Arabia has bought Nigeria's allegiance to the cartel with promises of a \$1 billion loan at concessionary rates of interest.

Secondly, rumors persist to the effect that the Saudis have lowered production below their self-imposed limit of 7 million barrels per day (mbd) and may be producing at as little as 5.5 mbd — an unsustainable medium-term objective.

Finally, OPEC has been talking up the market by adducing statistics that show that the glut in excess inventories is coming to an end.

Assuming generously, in view of worldwide deflationary pressures and a sticky \$34/barrel price, that world demand for oil remains at the present level of 42-43 mbd, and assuming further that closing inventory levels for 1981 amounted to 4.6 billion barrels and that industry would be satisfied with a 75-day supply on hand versus a more traditional 90-day supply in the heyday of rising oil prices,

industry stocks would be drawn down almost 1.5 billion barrels during 1982, or at a rate of 4 mbd. With non-OPEC sources supplying about 23 mbd, OPEC would be forced to produce at just a 15 mbd rate, bankrupting 10 of the 13 member states and severely damaging the remaining three. More likely, OPEC members will begin to cheat on their allocations, making a price collapse inevitable.

While timing the onslaught is difficult — admittedly it may be months away — waiting for it to happen may not involve too much risk, *provided one assumes that \$34/barrel is also a ceiling*. Allowing for slightly expanded profit margins, heating oil should not trade above 94¢ through August and 102¢ through December '82, the seasonal peak. If, on the other hand, oil prices did indeed collapse in the next few months, December '82 heating oil could trade down to 60¢.

STRATEGY: Short positions in December '82 heating oil have been stopped twice, once at 90.00 and once at 95.00. For those speculators with a strong stomach, we recommend reinstating short positions at these levels once again. More conservative traders would prefer to sell into weakness, perhaps following a downside weekly reversal.

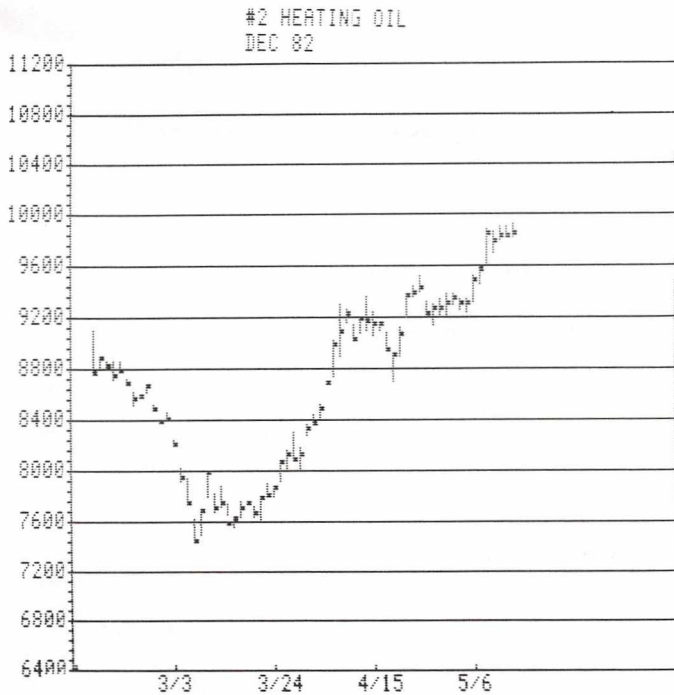
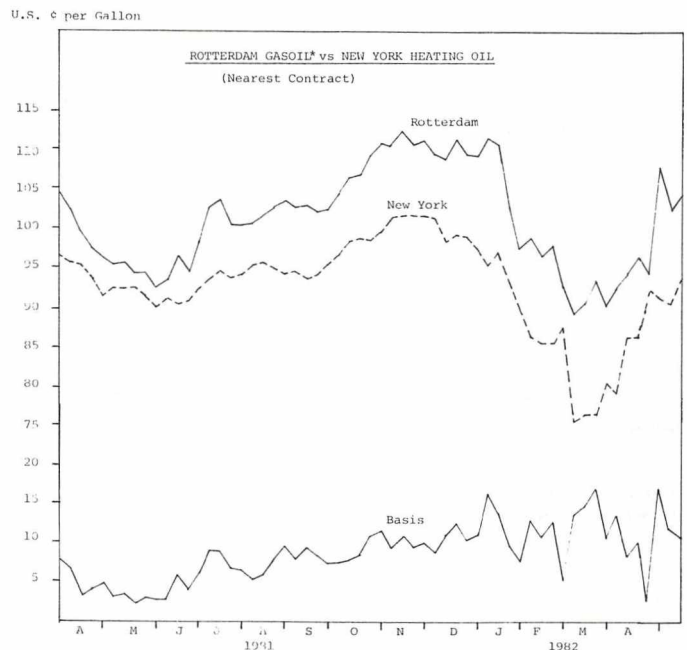


Chart 16



*London Gas Oil price converted from US\$/tonne to US¢/gallon and adjusted by freights, insurance and financial costs.

Chart 17

Grains

The United States Department of Agriculture (USDA) forecasts of 1982-1983 US grain production are shown in Chart 18. Winter wheat production is now forecast at 2,063 million bushels versus 2,128 million forecast December 1, 1981. Private forecaster Conrad Leslie estimates 1982-1983 winter wheat production at 2,148 million bushels. He assumes higher yields and lower participation in the acreage set-aside in his forecasts.

In the most recent USDA supply and demand report for grains, soybean exports in 1981-1982 were forecast at 890 million bushels, up from 870 million previously. Ending stocks are correspondingly forecast at 315 million bushels compared with 335 million previously.

Soybean exports to May 6 amounted to 739 million bushels. Commitments account for another 170 million bushels. This total (909 million) already exceeds the USDA's forecast. Soybean exports will likely be much higher than currently indicated with ending stocks correspondingly tighter.

The Brazil soybean crop is forecast now at 12.8 million metric tons (MMT), compared with 13.5 MMT earlier, and 15.5 MMT in 1981. This, the Falkland Islands situation,

which may divert sales away from Brazil to the USA, and corn plantings, which are proceeding well (and may cause acreage to be reduced) will lend support to soybean prices. The USDA's estimate of production, consumption, and imports by the USSR and China are shown in Chart 19.

The final tally of enrollment in the acreage set aside program is as follows: corn, 75.24 per cent; wheat, 84.85 per cent. Final participation rates depend on prices at the certification deadlines (corn, late July; wheat, late May) and expected prices at harvest-time.

STRATEGY: *Close spread position of long KC/short CBT wheat as record-large Kansas (hard red winter) production projections are weighing on KC prices. In view of the very large wheat carryover and another huge crop in the making, we expect wheat futures to trend lower until the harvest nears completion. Sell July wheat, risking closes above 3.70, with an objective of 3.40.*

Corn is in a sideways pattern; stand aside. Buy September soybeans with a target 7.00, risking 6.60. We still recommend short July/long September or November soybean spreads. Risk prices at par, with an objective of 10¢-15¢ premium the new crop months.

U.S. GRAIN PRODUCTION - forecasts, 1982/83, compared to estimates, 1981/82.
(million bushels)

	1982/83		1981/82
		5/1/82	12/1/81
corn	7,685		8,201
all wheat	2,648		2,793
<u>winter wheat</u>			
HRW	1,211	1,256	1,115
SRW	590	616	673
white	263	256	310
total winter wheat*	2,063	2,128	2,099
<u>spring wheat</u>	585		694
soybeans	2,100		2,030

SOURCE: U.S.D.A.

* -may not add due to rounding

Chart 18

SOVIET AND CHINESE GRAIN PRODUCTION, CONSUMPTION, AND IMPORT FORECASTS.

	U.S.S.R.		CHINA	
	1982/83	1981/82	1982/83	1981/82
<u>wheat</u> - production	95.0	88.0	56.5	57.5
consumption	102.0	106.2	71.0	71.2
imports	16.0	19.0	14.5	13.0
<u>coarse grains</u> -production	95.0	77.0	84.0	82.5
consumption	111.0	101.0	85.0	83.7
imports	21.0	24.0	1.0	1.2
<u>other</u> - production	10.0	10.0	NA	NA
consumption	NA	NA	NA	NA
imports	1.0	1.0	NA	NA
<u>total</u> - production	200.0	175.0	140.5	140.0
consumption	213.0	207.2	156.0	154.9
imports	38.0	44.0	15.5	13.9

SOURCE: U.S.D.A.

Chart 19

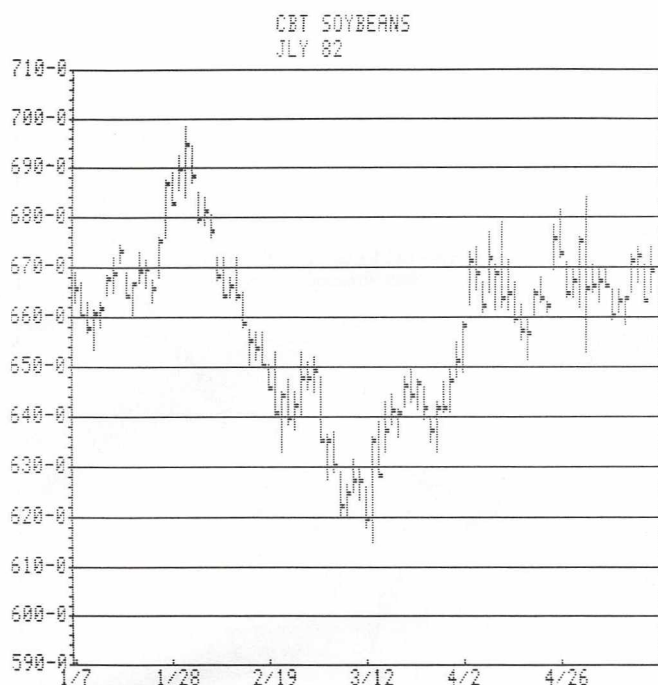


Chart 20

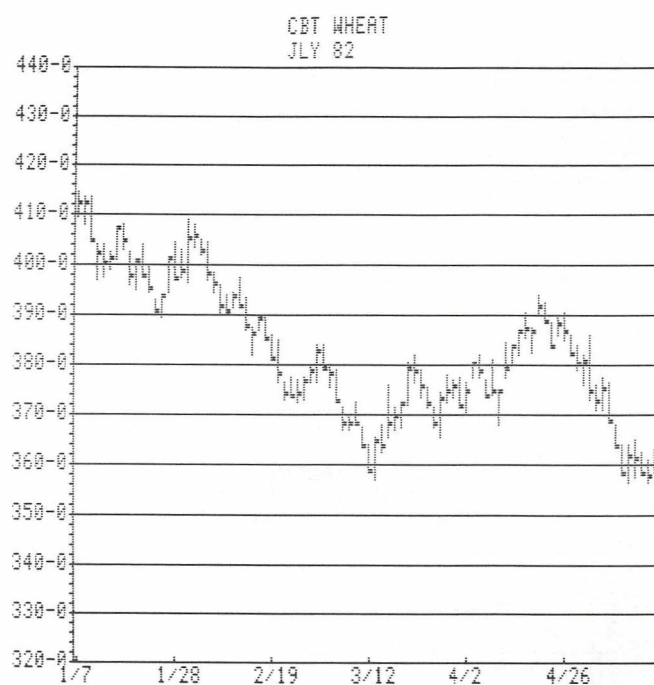


Chart 21

Livestock

The seven-state Cattle on Feed report was released by the USDA on May 13. Figures were much in line with what was anticipated, as shown in Chart 22, which also compares 1982 with 1981 figures. We expect an upcoming price reaction in cattle futures as marketings increase and higher beef prices are passed on to the consumer, who may substitute pork. Demand for cattle would thus suffer.

Studies have indicated that feedlot operators, who operate on narrow profit margins in feeding cattle and hogs for slaughter, tend to bid feeder cattle and weaner pig prices to a level such that they eliminate any "excess" profits. We believe this is the case at present prices, and that producers will hedge their inventories at these levels, pressuring the market.

Currently, indications are that cattle slaughter will be 1 to 2 per cent higher for the remainder of 1982 than the relevant period in 1981. The mean number of marketings of cattle as a proportion of the number on feed over the past 12 years is 61.2 per cent. If this proportion of marketings is reached, given current on-feed statistics, marketings will be 5.6 per cent above April-June 1981 in the similar 1982 quarter.

First quarter pork output was down 9 per cent from 1981. Second quarter slaughter output is likely to be off 10 per cent from 1981, with third and fourth quarter production expected to be 12 per cent below 1981. 1982 pork output is expected to be 11 per cent lower than 1981 overall.

When one compares expected producer hedge-selling levels (a function of number on feed) with processor demand (a derived function of consumer demand, as affected by disposable income and substitution), the fundamentals appear stronger for hogs than for cattle.

STRATEGY: *Maintain long positions in hogs, as they have broken through the barrier of all-time previous highs. In view of lower expected third quarter output of pork, combined with the possibility of a rebound in the economy, we would look for greater demand for pork in the fall with respect to supplies. Take advantage of growing weakness in cattle futures advances by spreading long four August hogs/short three August cattle with an objective of prices at par. October hogs and October cattle could be similarly traded as a spread. Place stops at 8¢, basis August and 9¢, basis October.*

Cattle and calves on feed - seven states*

	1982	1981	1982, 1981	1982 report expectations
on feed - March 1	6,869	7,126	96	
placed on feed - during March	1,793	1,383	130	
marketings - during March	1,542	1,553	99	
other disappearance**				
- during March	96	119	81	
on feed - April 1	7,024	6,837	103	
placed on feed - during April	1,565	1,721	91	92.3
marketings - during April	1,414	1,386	102	101.6
other disappearance**				
- during April	109	142	77	
on feed - May 1	7,066	7,030	101	100.8

* -Arizona, California, Colorado, Iowa, Kansas, Nebraska, Texas.
 ** -includes death loss and feedlot movements.
 Source : U.S.D.A.

Chart 22

PRICE DIFFERENTIAL:
 LIVE CATTLE AUGUST '82
 MINUS LIVE HOGS AUGUST '82

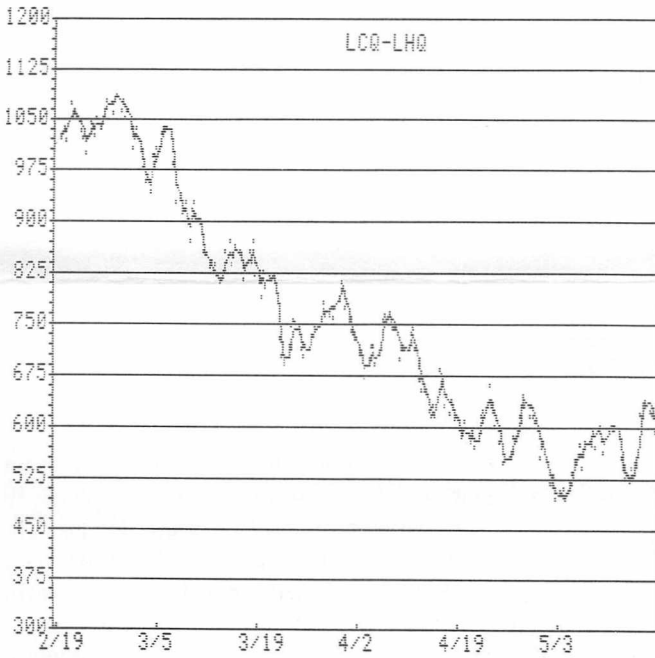


Chart 23

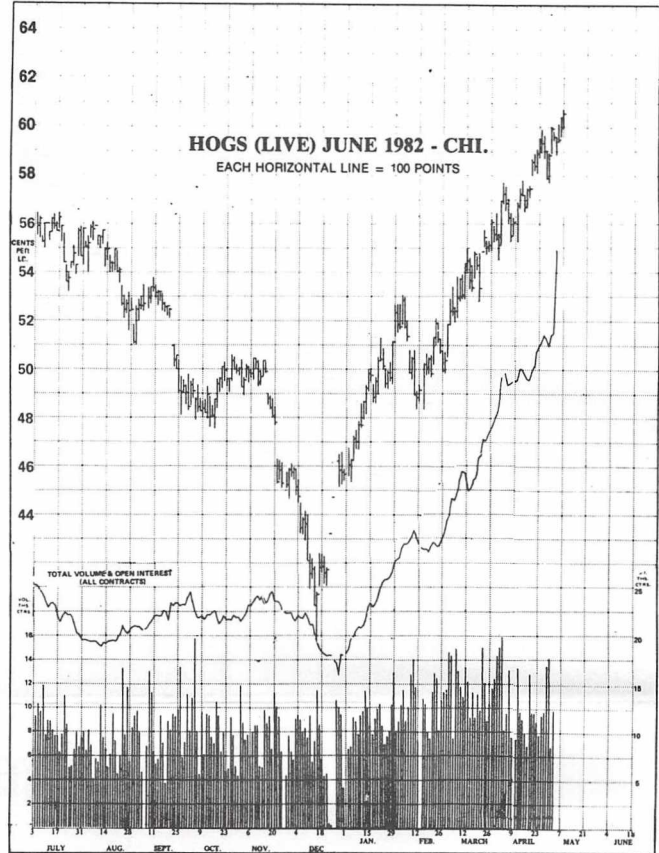


Chart 24

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Trading Accounts

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