

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS



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Interest Rates and the Readjustment of Portfolios

During the past four months, rates have vacillated in a range of between 12 per cent and 14 per cent basis yields of cash 90-day US T-bills. Over the period a tremendous battle has taken place between those bullish and those bearish on rates. The argument has been waged in the pages of financial publications, between various factions of the legislature, on Main Street, on Wall Street, and most importantly from our professional orientation, on LaSalle Boulevard, which is where interest rate futures are traded with still-growing enthusiasm on the IMM and the Chicago Board of Trade. Not surprisingly, given the persistent refusal of rates to blossom into mature trends, position-playing speculators of both bullish and bearish orientation have been punished — perhaps not as badly as the economy itself, which has been pulverized by the stubborn insistence of rates to remain at high levels — but punished nonetheless. We must admit that we are amongst those who have been bloodied.

Rates have been an enigma. Those who have argued that they must fall have basically reasoned that their decline must come as a consequence of the recession, which, as traditional thinking would have it, should have served to curtail borrowing. And further, that the relating sizeable premium of rates to inflation can't last forever. Or, as the argument goes, as we approach an election, incumbents will insure that the Fed, theoretically independent but historically sympathetic to the wishes of presidents, will provide ample reserves to the banking system and thus "force" rates down.

Perhaps it's been the obviousness, the simple obvious-

ness, of the bearish argument that has provoked the traditionally more sophisticated analysts to adopt the bullish case. Their argument that rates will rise has basically gone as follows: The Fed will remain firm, and since money supply has over the past seven months tended to grow in the very top of the Fed's stated target ranges of 2½ per cent to 5½ per cent (or, as has been more frequently the case, in excess of them), the Fed would tighten. (Whenever the conventional proxies of money supply — the M series announced Fridays — were not excessive enough, the sophisticated and pessimistic bulls — we're speaking of ourselves here — would resort to scrutiny of the monetary base and justify their position by arguing that it was growing such that even if money supply wasn't big this week, it soon would be.)

Alternatively, the argument goes, the government deficit would be so large — to \$100, \$120, \$140 billion during fiscal 1982 — that its borrowing requirements would crowd out private borrowers and/or put an unsustainable strain on capital and money markets. Moreover, the current recession would instigate a perverse response compared with its predecessors in that borrowers would demand more, not less, credit to compensate for diminished cash flow. This last argument, which has been applied to corporations, municipalities, and financial intermediaries, thus served to lump those institutions in the same category, more or less, as Poland, Mexico, Rumania, et al, i.e., doomed or headed in the direction of doom.

There have even been "apocalyptic" who have argued

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that the Fed, in response to this type of liquidity crisis, would reflate, thus providing both a bullish and a bearish case; bearish in that rates would fall in the short term as credit is made ample; bullish in that rates would rise over the longer term in response to the rekindling of the inflation that will result.

To judge the case of those who have been arguing that rates would rise — and once again, herein we judge ourselves — it must first be noted that the money supply has fallen to within the Fed's target ranges. The compared annual rates of growth of M_1 , taken as an average at four-week intervals dating back to March 3 has been by 3.8 per cent, 3.1 per cent, 5.5 per cent, 4.0 per cent, and 2.5 per cent. That the government deficit will be, to be euphemistic, substantial is undeniable. That it will put an unsustainable strain on capital and money markets is hardly a certainty. After a 50 basis point rise earlier this week in anticipation of the government's announcement made Wednesday, that its refunding, which will be offered next week, will total \$11 billion, T-bill yields have fallen by an equal amount.

There are two pieces of statistical evidence that point to the possibility that the government's financing requirements may be met without undue pressure on interest rates following as a consequence. First, we note that the money multiplier, a chart of which is reprinted courtesy of the Federal Reserve Bank of St. Louis, has on a ratio basis tended to drop rather markedly since the beginning of April. Since the M_1 multiplier is affected by savings leakages, we can deduce that money is not being spent at the same rate as earlier in the year — any vendor of durable goods will woefully attest to such a claim — and is thus available for investment. That this is in fact already happening is corroborated by an entry in the personal income statement for June, which showed that while income increased by 0.3 per cent, spending fell by 0.5 per cent and savings rose by 12 per cent over the month-earlier period.

Indeed, for the period of March, April, and May, American households, which have been one of the few sectors of the economy in relatively respectable financial condition, have saved 6.6 per cent of their disposable income. Such a rate of savings is much higher than it's been for years and comes as a direct consequence either of the inclination of individuals to seek the security of cash for fear of the recession's afflicting them personally — a typical phenomenon in periods of economic slowdown — or of the declining rate of inflation. Should the former reason be the prime motivating factor, the trend could be rapidly reversed should there be a change in the public's perception of the economy's direction, and money supply could easily soar. Should the latter reason prove to be the one dominating the public decisions, and if the Fed remains consistent, then it augers very well for the US economy over the longer term and, from a political point of view, will represent a triumph of President Reagan's initiatives.

Having concluded that for the time being at least, there is a reasonable likelihood that impending government fi-

ancing requirements can be facilitated, one might be tempted to reason that it follows that the third argument of the bulls, i.e., the much-heralded liquidity crisis that looms, is less of a problem than imagined. Unfortunately this is not the case. The compounded annual growth rates of commercial and industrial business loans taken as an average at four-week intervals dating back to mid-January have been huge when compared with either the growth of the money supply or, more importantly, the level of business activity: May 12, 18.8 per cent; April 14, 20.4 per cent; March 17, 20.9 per cent; January 13, 21.6 per cent.

The recent failure of Penn Square testifies to the sorry and frightening shape of financial institutions that has resulted from ill-advised loans made to corporations debilitated by the decline in final demand. And, of course, only the naive or the eternal optimist could argue that Penn Square was and will remain an isolated case. Commercial banks, savings and loans institutions, and private capital and money markets are struggling under the weight of liquidity problems being experienced by many publicly and privately held corporations, municipalities, and of course third-world borrowers such as Poland, Mexico, Rumania, etc. Should more Penn Square-type failures emerge, or worse, should a much feared domino effect develop, it can be safely assumed that the Fed will honor its obligation as lender of last resort and grant the banking industry the reserves it requires to prevent a panic.

Should such an ugly, though unfortunately not unlikely, scenario actually occur, yields would tumble as they did in the wake of Penn Square failure and in the wake of the Drysdale debacle that preceded it. Bearers of government securities would thus not only be secure but better off. Depositors of up to \$100,000 would be insured by the Federal Deposit Insurance Corporation. They would retrieve their investments after the miasma of litigation was sorted out. But the question many investors should be asking is what would happen to deposits of over \$100,000. And what will happen to bearers of privately-issued IOUs such as commercial paper, bank CDs and Eurodeposits, which have nothing backing them except good faith and the perception that it is inconceivable that these instruments could be no more substantial than the belief that Canadians are the best hockey players?

The Euro banking community is the best illustration of the kind of risk that is incurred in this scenario. Of the \$1 trillion outstanding — a second \$1 trillion exists via deposit creation among member banks — approximately half has been lent to third world nations who have used the loans to finance expenditures like airplanes, soccer stadiums, four-lane highways that go nowhere, etc. These expenditures have not and will not result in income sufficient to cover even interest on loans, let alone principal. In short, these loans are assets worth little more than the ink describing them.

Note that half the lenders are comprised of OPEC nations who have enjoyed surpluses so large they've been unable to spend them and by a handful of multinational

corporations. In order to keep the system afloat the banks in the Eurodollar market, who are not restrained by any reserve requirements or by government inspection and are under no tested legal obligation to back their IOUs, must attract deposits every 90 days by issuing paper.

Why, since the insolvency of the borrowers has been recognized for some time, do depositors continue to roll over their investments? The answer can only be that since the number of players is so small they have, like members of a club, come to understand that they have no choice. Were they to refuse to provide their funds, the game would fall to pieces in the same way all banking shell games of this sort have collapsed sooner or later throughout history.

There has been no legal precedent regarding the responsibility of domestic banks to their overseas affiliates. A case regarding Chase's responsibility to a branch in Viet Nam that was nationalized is pending hearing in the Supreme Court. But the implications of the case, no matter what the outcome, are too far removed from the issue at hand to apply. A much more pertinent matter is now unfolding in London where 200 bankers have so far been denied assurance by Italy's central bank that it would underwrite the losses of the non-Italian affiliates of Banco Ambrosiano S.P.A. of Milan, the principal in the Vatican banking scandal.

We believe that in the wake of Penn Square, the members of the club will, somewhat surreptitiously, begin to readjust their portfolios. Likewise, issuers of private paper everywhere will find it necessary to increase incentives to lend by increasing yields as investors seek security.

At the present time, with the money supply under control and a likelihood that government financing needs will be met by increased savings from the household sector, it becomes likely yields will fall. From a technical point of view, the fact that the weekly average of cash bills has broken, on a yield basis, an eight-month trendline, vindicates

such a position. That rates could have a considerable distance to fall is also likely because it is our opinion that the main reason rates have stayed as stubbornly real as they have is that they've commanded a risk premium; the risk being that the Fed could be counted upon to remain consistent. This risk premium should gradually be distilled from the market as the Fed maintains its consistency.

Should a crisis occur or even appear likely, government paper, being of the highest quality, will increase in value while private paper of every sort will be offered at tremendous discounts. The utility of gold increases as investors seek to diversify portfolios away from risk; notably, gold's two-day, \$35 breakout from the lows came immediately in the wake of Penn Square.

STRATEGY: Cover all interest rate futures short positions. Given growing risks in private money market instruments, we recommend spreading CDs and Eurodollars against each other and particularly against T-bills. It is our belief that risk premiums are not measured by absolute numbers (i.e., 100 basis points, 200 basis points, etc.), but by ratios (i.e., a single A credit may have to pay 10 per cent more than double A and 20 per cent more than triple A.) At this time, 3-month Eurodollar deposit rates show a 22 per cent premium over 3 month T-bill rates, while 90-day Certificates of Deposit show a 16.5 per cent premium over corresponding T-bill rates.

We expect these percentage premiums to expand; however, just in case they don't and rates head substantially lower, we face the risk of an absolute narrowing of the spread, thus causing us losses. We must, therefore, weigh our spread and buy 1.22 T-bills for each 1 Eurodollar contract we sell. Similarly, we must buy 1.165 T-bills for every 1 CD contract we sell. We prefer spreading Eurodollars versus T-bills as CDs of \$100,000 carry an implicit US government guarantee, and the risk premium may not show as dramatic a widening.

Chart 1

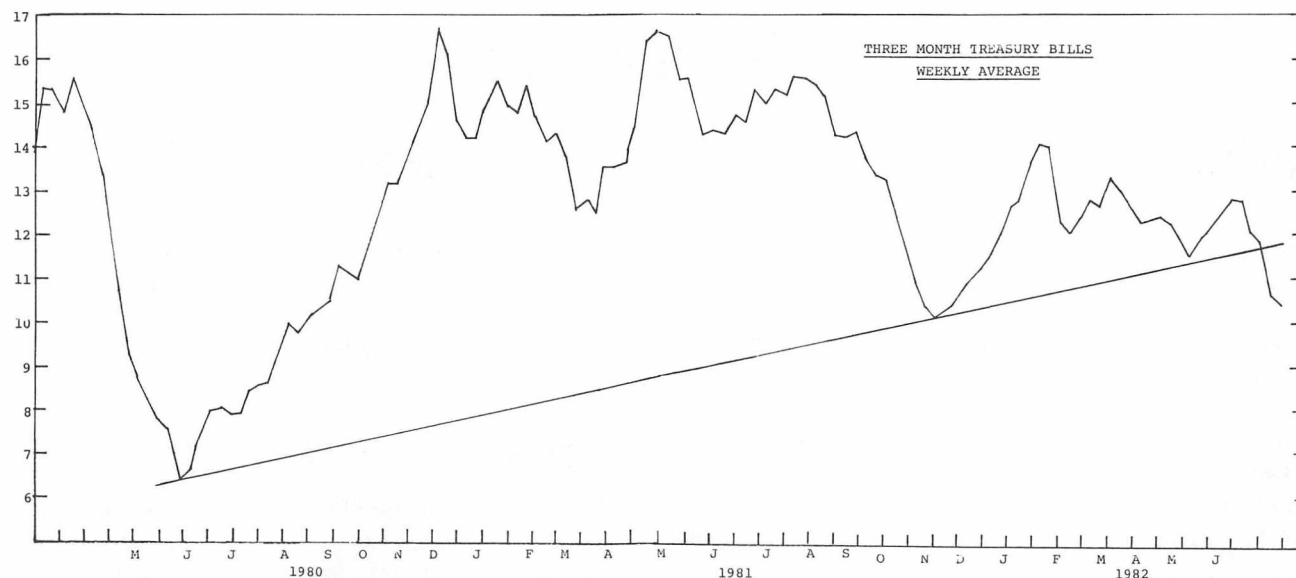


Chart 2

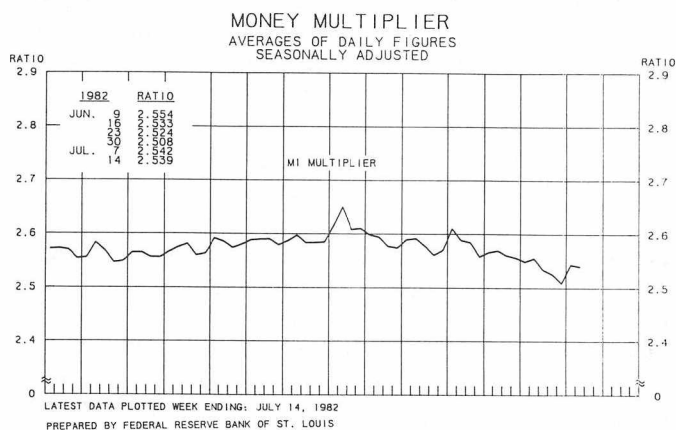


Chart 4

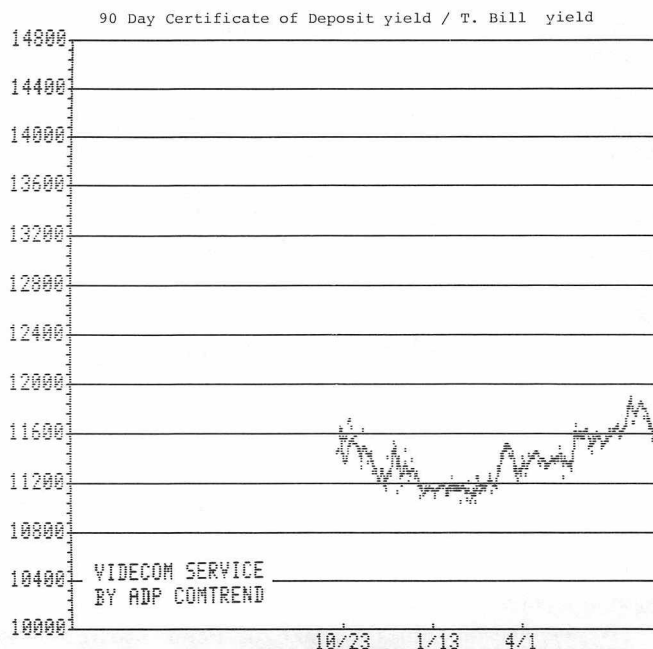
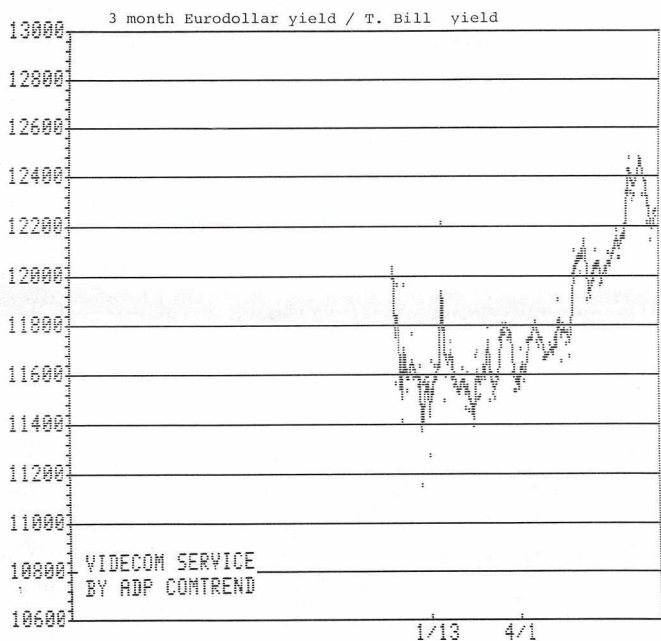


Chart 3



Currencies

Sterling

Britain's current account surplus disappeared in May as exports fell £106 million and imports jumped £205 million from April. This development makes the UK's first deficit since January of this year and deals a heavy blow to government forecasts of a £4 billion surplus for the full year.

In the meantime, economic activity remains stagnant and unemployment continues to climb, making life politically unbearable for Mrs. Thatcher. Reflation is becoming a necessity and the easiest way to go about it is to allow money market rates to collapse and carry Sterling along.

STRATEGY: Remain short, leaving stops at 1.8250 basis September '82.

Deutschemark/Swiss Franc

Our long SF/short DM spread has become profitable as the DM has fallen from 86 to 84.50 centimes.

STRATEGY: We advise retaining spread, although recommend that it be "equalized" (given contract size differences) by selling 6 DM for every 5 SF contracts held long.

Japanese Yen

The extraordinary productivity of the Japanese economy has blinded economists to the strong and latent inflationist undercurrent built into Japanese public finances. After all,

budgeted tax revenues are always planned to cover between 60 per cent and 80 per cent of spending, and the gap, in absolute numbers, increases prodigiously (see charts). Government debt, financed thus far by the well known Japanese high propensity to save, has soared in recent years: from 15 trillion yen in 1975 to an estimated 80 trillion yen in 1981. What is worse, when the National Tax Agency finally closed its books last month on the 1981 fiscal year, it was found that the amount of tax collected was 2.9 trillion yen less than expected, a direct result of the ongoing (and unanticipated) economic slump.

Regardless of savings patterns, it is hardly likely that government debt can be financed at such an astronomic rate. The normal demand for government paper arising out of portfolio considerations must not only be satisfied but, most probably, saturated.

STRATEGY: *Expectations of inflationary financing must be the principal force driving capital out of Japan, be it to purchase US-denominated zero-coupon bonds, Krugerrand, or antiques. Do not cover, as suggested last month, at 38.50 basis September. Roll over to December '82, and remain short.*

Canadian Dollar

Not surprisingly, the Canadian dollar has managed to bounce up rather smartly from its panic-stricken lows recorded just six weeks ago. As we said on June 20th, "... the Canadian dollar, in real terms, is substantially undervalued. Secondly, it is strong on a relative basis (to other currencies). Finally, if the Bank of Canada persists in its monetary squeeze, the currency is likely to bounce back to the 80¢ mark as soon as the Fed relents — as it must, sooner or later."

The monetary squeeze put on by the Bank of Canada began in June and reached full strength in July. The narrow money supply slowed its growth from a 21.6 per cent annual rate in May '82 (over six months prior) to a mere 0.15 per cent rate in June, while figures not seasonally adjusted show a year-over-year drop of 4 per cent in July, after a nearly 3 per cent annual year-over-year increase recorded in May '82 and June '82.

The Bank's main tightening tool has been its foreign exchange intervention. Official monetary movements were negative to the tune of almost C\$1 billion in May and C\$2.2 billion in June, reflecting the Bank's frantic attempt to shore up the declining buck. What is truly surprising is the mildness of the overall monetary contraction that resulted from such a massive propping operation. The Bank of Canada has purposely been offsetting the contractionary pull of its foreign exchange arm lest interest rates soar well beyond last summer's highs. The cost of maintaining a relatively strong Canadian dollar in the face of a strongly expansionary fiscal policy as well as a relatively expansionary monetary policy is staggering: a loss, thus far in 1982, of

C\$4.3 billion. The July level of international reserves will be enormously instructive to the market: Has the Bank managed to recover, say, one third of its recent losses? If not, a renewed attack on the dollar is imminent.

STRATEGY: *Monetary policy in Canada remains extremely tight. Bearishness on the dollar has been based primarily on expectations that the government will have to resort to inflationary (i.e., printing money) financing of the monstrous budget deficit now seen to exceed 7 per cent of GNP. So long as that is not the case, we will retain a friendly attitude to the currency. Stand aside.*

Mexican Peso

In a truly desperate bid for foreign funds, Mexico drew on its \$700 million swap line with the US, requested and obtained a \$1 billion "bridging" loan for the time that it took 27 lead managers to put together a \$2.5 billion jumbo loan, instructed Merrill Lynch to sell up to \$175 million of 15-year securities at 18.5 per cent with three-year redemption options (giving Eurobanks an opportunity to make a net 3 percentage points by matching three-year Eurodeposits to these so-called long-term securities) and mortgaged over \$1.2 billion future oil sales, thus relying on the credit of the oil buyers, as its own credit is nearly exhausted.

The patient is drowning but is still putting up a brave face. And with some good reason. Western banks are not able to bite such a big bullet, as the Polish (virtual) default shows. They rather continue to book loans at ever increasing margins, knowing fully well that they will never be repaid, rather than face the music. That not all bankers are of course that foolish can be seen from the fact that only \$400 million was raised from over 500 bankers contacted by the lead managers of the \$2.5 billion jumbo loan. The only foolish bankers were those that were already into Mexico for sums equal to a very substantial part of their own capital and reserves or even exceeding them. It would not be surprising if the list of the latter matches name for name the list of the 27 lead managers who ended up buying \$78.9 million each of worthless Mexican paper — about 70 per cent more than they hoped to be left holding.

Since Mexico *must* raise \$2.5 billion each and every month, one must assume that it will resort, increasingly, to mortgaging future sales of crude oil and petroleum products. The problem, however, is that (a) not all buyers enjoy better credit ratings than Mexico (Argentina, Brazil, Cuba, Costa Rica, Italy, Spain) and (b) there must be a willingness on the part of buyers to commit for oil (now and for the foreseeable future in a buyer's market) for long periods ahead, a situation that will become necessary for Mexico lest it face a vacuum of receipts in the period subsequent to the "mortgage" operation.

Clearly, Mexico is bidding for time, hoping first for a resurgence of the oil boom, second for a substantial in-

crease in exports of oil and products, and third, as any bankrupt will tell you, for a miracle.

The competitive gains of devaluation have already been eroded by enormous price increases. The Mexican trade balance has swung modestly to the black (a swing worth \$1.75 billion) in the first six months of 1982, only

because imports have been savagely suppressed — mostly by the federal government just prior to the elections.

STRATEGY: We remain extremely confident of another Mexi-devaluation before the year is out. Remain short December '82 and March '83. And by selling June '83 at present levels.

Chart 5

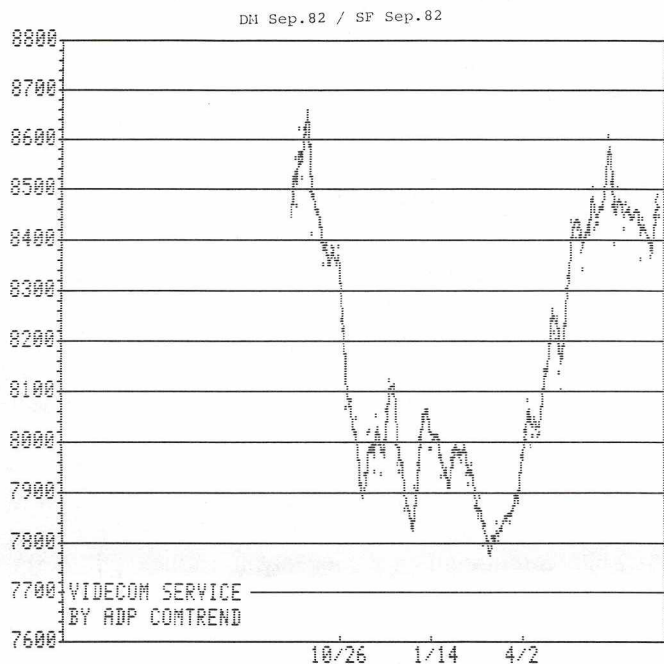


Chart 7

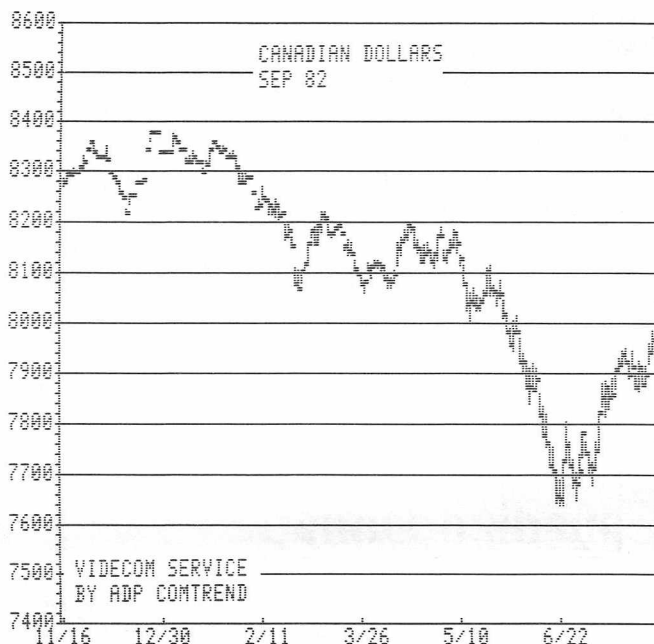
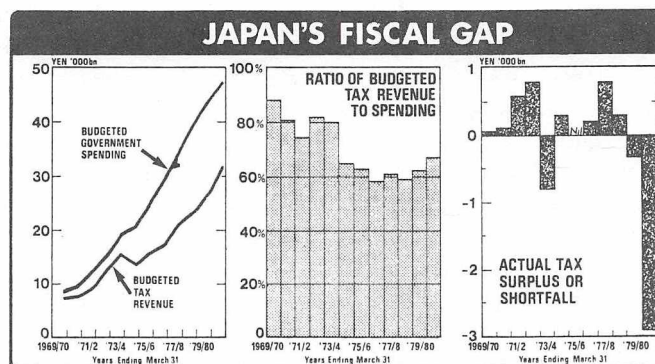


Chart 6



Financial Times

Precious Metals

Both gold and silver markets ended their most recent declines by recording weekly upside reversals, a development that we anticipated last month as being the precursor for a better than temporary bottom. Since then, silver soared as much as 50 per cent, while gold, trailing slightly behind, gained a still respectable 25 per cent.

While on fundamental grounds the rally is suspect — US monetary policy turned *accommodative but not easy*

and total US external liabilities continued to shrink, at least until April of this year — technically the market is quite eloquent. In gold's case, it has broken through an 18-month-long downtrend, and it has recorded a better dollar and percentage gain than the last rally from new lows. Should gold better \$370/oz. basis the nearby contract, it will achieve a milestone: breaking through a previous rally top (a rally is defined as an up move equal to *at least 10 per cent*

from any new low), the first such occurrence in the two-and-a-half-year-old bear market.

STRATEGY: At the present time, we do not care to follow the advance, at least until spot gold closes conclusively above \$370/oz.

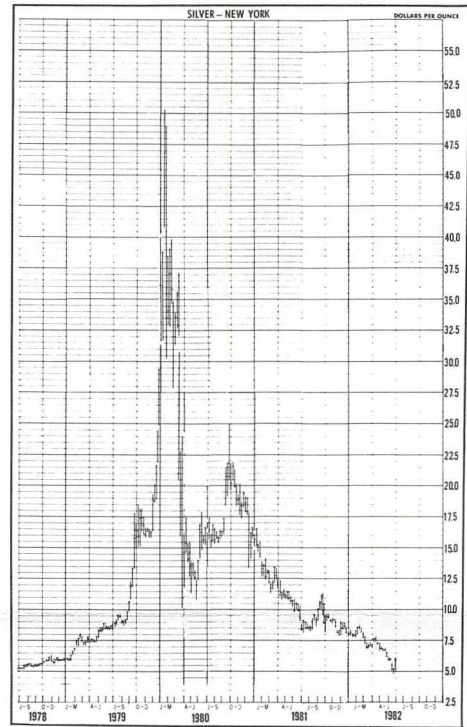
Chart 8



Reprinted from Commodity Research Bureau

Silver's bull move has been punctured by last week's downside reversal as well as the well-advertised reason for its sensational recovery: a drop of nearly 16 million ounces in the combined New York, Chicago, and London warehouses. Stand aside.

Chart 9



Reprinted from Commodity Research Bureau

Copper

At the time of our last report, copper was trading at 57.00 basis September and was in the midst of a pronounced downturn. We adopted the view that a sell-off to such levels defied not only fundamental analysis but common sense itself and thus concluded that a buying opportunity would present itself to the nimble speculator. Although we couldn't predict either a time-frame or a price level we did feel that technical analysis would reveal the turn; we predicted the market's bloom would be made either in the form of a weekly reversal or an island reversal, both of which were illustrated. We predicted a sharp rally would ensue accompanied by a pronounced decline in open interest. We then, rather brazenly, predicted that the turn would be from a level that would probably not be seen again.

The weekly reversal, as can be seen on the accompanying chart, occurred the next week. Prices rallied from their lows of 54.60, and as they did, open interest dropped from 68,921 lots to as low as 63,905 lots — at the time, September was trading at 64.25 — and then rose again to 68,129 lots at the peak of the rally, which was 69.70. Prices have since

fallen back and currently, (July 30th), hold at 63.15.

To predict the future course of copper prices, some appreciation of the fundamentals must now be taken into account. It is generally believed that mined copper output in the US will drop by up to 500,000 tonnes during 1982 from 1.5 million tonnes in 1981. This is occurring because of the spate of mine slowdowns and closures. At the same time, however, with the construction and auto industries still suffering, demand has hardly been robust. That this is so is best indicated by the high levels of inventory in COMEX warehouses and at primary smelting and refining plants. COMEX stocks, for example, have climbed almost without interruption from 167,627 tonnes at the beginning of the year to 187,929 tonnes as of last Monday.

We can deduce that (1) the full effects of the drop in mine production have not been felt yet, (2) that demand is being met from inventory, and (3) that the pipeline will eventually run thin. The question is when. Although, intuitively, we believe the recession has seen its lows, we can't predict a sharp turnaround. And we certainly can't

predict a sharp turnaround in the specific sectors of construction or automobile manufacturing.

We must also take into account supplies from countries other than the US. As was the case during the last bear market in copper which occurred during 1974, Third World countries have not responded to depressed prices by reducing production. Although at current levels it is doubtful if any major producing nation can, on average, mine profitably, many nations haven't a choice to curtail output. Zambia and Iran, to name but two, have recently reported increases in production. Given the states of their economies, especially their desperate needs for foreign exchange, this should come as no surprise.

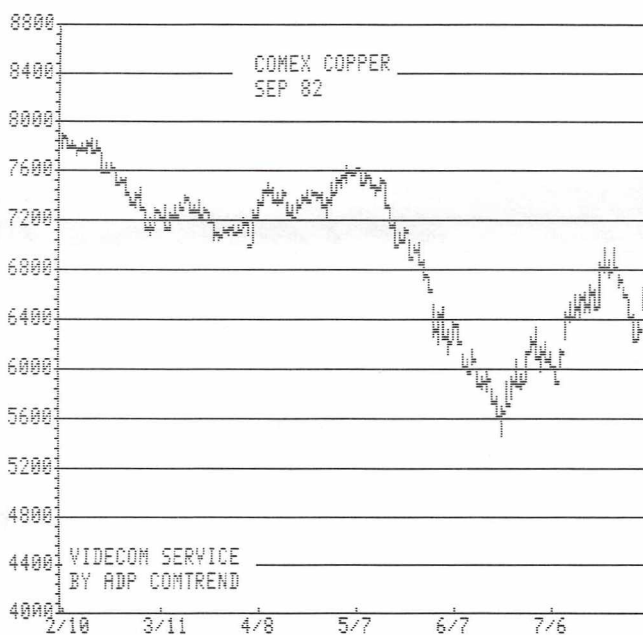
On a more positive note one must take into account the recent meeting of CIPEC, the organization comprised of five of the largest copper producers, most of whom are in, to varying degrees, the same boat as Iran and Zambia. They effected a resolution to come to terms with the depressed state of the industry by either intervening on a limited scale on futures markets and/or altering marketing methods. We've been accustomed to scoffing at pronouncements of this sort in the past; however, the modesty of the CIPEC announcement and the very fact that they could agree to make it — Peru and Chile have traditionally disagreed — suggest reason for optimism.

In addition, the recent buying by China of (it is rumored) as much as 150,000 tonnes on the LME at around the £700 level should serve to remind us that the price of copper, like that of any other commodity, does affect elasticity and that there are buyers who will creep out of the woodwork, so to speak, to provide a floor for values. Although the foregoing is a less-than-comprehensive overview of copper fundamentals, we can draw several conclusions: First, there is little to suggest that copper, at present, is about to begin a major move that will lift prices to the \$1.40 plus levels predicted by some analysts, including ourselves, in the spring of last year; second, since demand is being fed by inventory in the US and since that inventory,

though burdensome, is not by historical standards — a fact not mentioned above — high either in the US or elsewhere, the long-term outlook remains bright; third, there is reason to believe that a change in policy by some producing and consuming nations will serve to defend prices.

STRATEGY: *In sum, we will still be bold and maintain that while the 15 cent rally from the lows was overdone — such is natural coming in response to a market so grossly oversold — copper is unlikely to see those lows a second time. Speculators intent on participating in fast, trending-type markets should either liquidate their long positions on strength or consider trading the market from the long side, i.e., buying dips and selling rallies. More patient investor-types should maintain a constant exposure on the long side as part of an overall portfolio. Place stops at 59.00 basis September on close only.*

Chart 10



Heating Oil

The strains on the so-called OPEC cartel are becoming impossible to reconcile. Iran's output has been recovering a great deal faster than anticipated and may be now approaching 2¾ mbd (million barrels per day). Exports at close to 2 mbd are well above the March quotas, a ceiling that Iran has no intention of heeding. In an apparent bid for Gulf supremacy, politically, militarily, and economically, Iran will export as much as it can pump and may yet reach the unthinkable 4.5-5.0 mbd. Long before then, other Gulf producers will realize that their exercise in self-abstention is merely playing into Iran's hands and will begin to raise their own depressed output levels.

Indonesia, which as recently as last year pumped 1.6

mbd, was given a 1.3 mbd ceiling in March, woefully inadequate considering that its current account deficit at that rate will probably increase to \$7 billion and its overall balance of payments deficit to upward of \$4 billion. These figures, in turn, show a sharp deterioration from the \$2.5 billion and \$980 million deficit respectively recorded in 1980-82. Clearly, full scale production equal to the 1.7 mbd capacity will become necessary lest Indonesia exhaust its meager \$5 billion foreign exchange reserve in a matter of a few months.

The above examples represent most-feasible case scenarios of breaking ranks. There has already been, however, a clear case of violation: Venezuela, under the pretext that

the self-imposed ceilings accorded in March are not being followed, announced that it too would seek to increase production from the permissible 1.5 mbd to 1.8 mbd.

It does not take a great deal of imagination to see that the OPEC production ceiling of 17.5 mbd is totally unsustainable. Desperation out of economic necessity, greed, and mere chiseling will tear to shreds the semblance of any production agreement with the most likely output scenario showing a 20-21 mbd rate by the middle of the third quarter of 1982 and a 22-25 mbd rate by the end of the year. We predict that ultimately even Saudi Arabia will join in the

free-for-all and attempt to pump its way into faltering or disappearing markets with as much as 9-10 mbd.

STRATEGY: Short sales of December '82 heating oil represent the #1 investment idea of the year (along with short sales of Mexican peso futures). Risk is thought to be minimal, although conservatively one would have to allow (in case of, say, a revolution or war in Saudi Arabia) for as much as \$4,000 per contract. Reward is anywhere between \$12,000-\$15,000 per contract. Recently, (see chart), the London Gasoil premium narrowed to a mere 2¢/gallon (from 15.6¢/gallon when first suggested) over New York. At these levels, it would pay to switch back sales to New York.

Chart 11

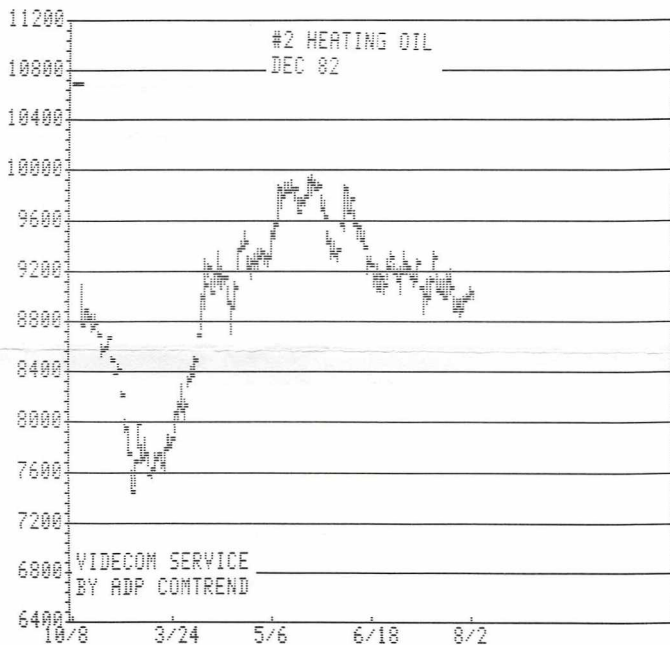
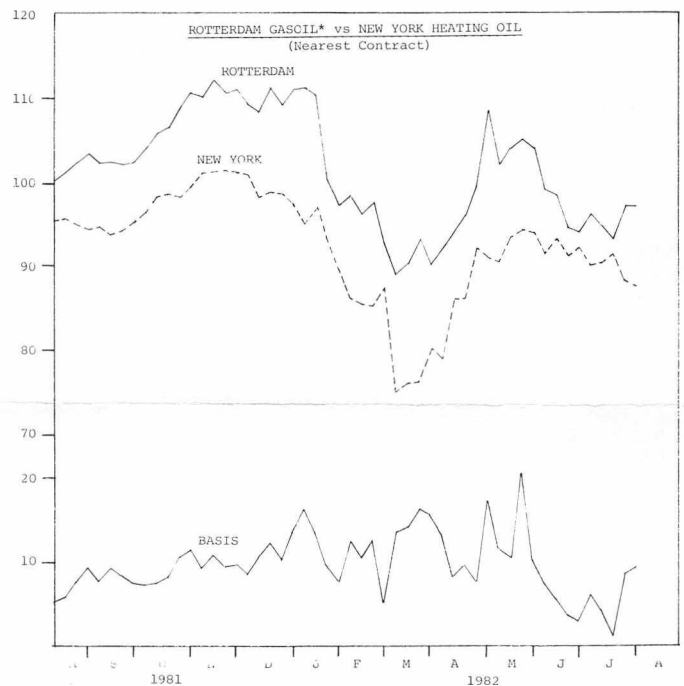


Chart 12



Grains

The major news in the grain markets since our report on June 20 was that damage of this year's USSR crop, for the third year in succession, has been greater than first estimated. The Soviet crop is now estimated at 170 MMT (million metric tons), compared with 185 MMT estimated in June, and a USDA figure of 175 MMT for the 1981-1982 crop. Imports are forecast at 46 MMT, compared with 42 MMT in June, and 46 MMT in 1981-1982.

Meanwhile, the bear market has continued. The June 23 report of grains stocks as of June 1 was bearish for wheat and corn, and constructive for soybeans. (See Chart 13.) Despite constructiveness, beans have trended lower. We recommended that September soybeans should have been bought if stocks were below 650 million bushels. Our

estimate was close, but stocks were in fact over our contingent level, at 658 million.

The USDA preliminarily projected 1982 soybean production in the US at 2155 million bushels versus the June estimate of 2100 million and 1981 production of a revised 2.003 million bushels (2.033 previously). The June 29 plantings report is given in Chart 14. The report was very bearish for soybeans and corn.

STRATEGY: Our trading strategy remains essentially the same in view of the fact that events have progressed much as we anticipated. The 1982 corn crop will be large at around 6,785 million bushels estimated by the USDA. This will weigh on December futures. However, farmer market-

ings have been reluctant, significant amounts of corn remain under loan, and free stocks promise to be tight. Our recommendation last month to buy September/sell December corn risking 6 cents premium December was stopped out on July 29 due to an unexpected USDA requirement that existing 1981 grain under loan be replaced with 1982 crops. This necessitates farmer selling of 1981 crop grain under loan. However, we would reinstate the spread at 5¢ to 6¢ premium December. While only one month remains before the September contract becomes deliverable, at that time we would wish to be short December corn outright if weather has been reasonably favorable during the critical growing month of August. Due to low (30 to 40 per cent) participation in the 10 per cent corn acreage set aside to date, few farmers will qualify for 1982-crop price-support

loans, and the effectiveness of the \$2.55 loan rate will be largely negated.

We expect soybeans to trend lower in expectation of a large 1982 crop. This is a change in opinion; we would sell November soybeans with a target of \$5.80, risking 10¢ from entry point. Upon reaching this level in the next month or more, we would be buyers, as very good soymeal use in the January to June period of 1982 will likely be repeated in 1983. From levels in the high \$5 range, the plausibility of our "\$7.00 per bushel case" may begin to look favorable.

The carrying charge in September to December wheat futures is at an annual rate of about 26 per cent. In light of falling interest rates, we would buy September/sell December wheat, as farmers will hold wheat in storage to earn these carrying charges. This spread has done well seasonally in August in recent years.

Chart 13

US Grain/Soybean stocks as of June 1/82 (million bushels)

	June 1	Expected
Corn	3853.7	3808
Wheat	1159.0	1137
Soybeans	657.8	670

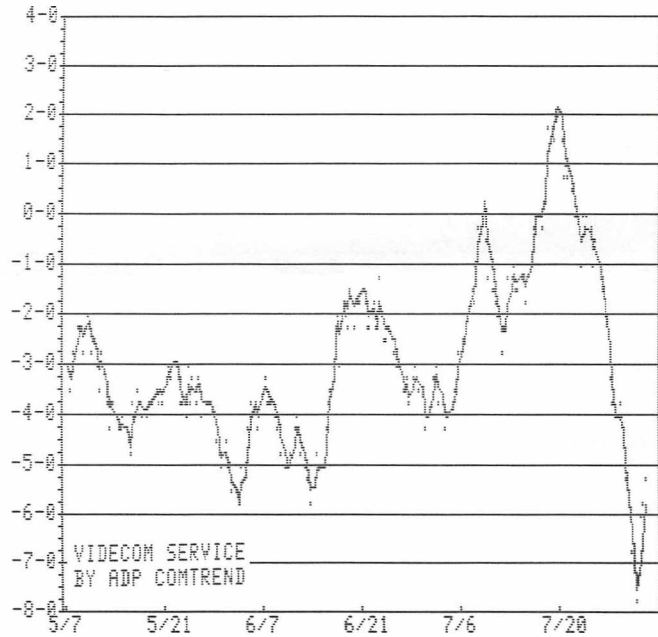
Chart 14

US Planted acreage released June 29/82

	1982	1981	Expected
Corn	82,129,000	84,153,000	87,710,000
Soybeans	72,157,000	68,000,000	70,100,000

Chart 15

Corn Sep.82 - Corn Dec.82



Livestock

Our spread recommended in the past two months has done tremendously well — long August or October hogs/short the respective month in cattle. August spreads instituted at 6¢ or more premium cattle were offset at 2¢ to 3¢ premium cattle in late July. October spreads are more volatile; on several occasions this position could have been instituted at 6¢ premium cattle, with the spread now at about 3¢.

The quarterly hogs and pigs report released June 22 is given in Chart 16. Most hog numbers are slightly bearish compared with expectations, but the market reacted favorably. Hog slaughter failed to drop seasonally as projected and in line with USDA data on hog numbers, during July. However, the week July 26 to 30, slaughter may have dropped sharply, into line with expectations. This was much later than

expected, and much later than most years if, in fact, it was the case that hog slaughter did fall sharply. With low grain prices, producers may have been feeding hogs at a faster rate to take advantage of summer prices, which are generally better than later in the year. If actual hog numbers are relatively close to the USDA data, hog production could fall 10 to 14 per cent in the third quarter relative to 1981, and up to 20 per cent in the fourth quarter compared with 1981.

Generally, August to October hog slaughter has been greater than May to July slaughter. However, it may be that 1982 marks the first year recorded that the reverse is true. In years when third quarter production is less than 112 per cent of second quarter production, October hog futures tend to rise in August and September. The quarterly USDA

13-state cattle feed report released July 19 was much in line with expectations, as shown in Chart 17. The semi-annual cattle inventory as of July 1 is shown in Chart 18. It was quite bullish, although the market discounted most of it.

STRATEGY: Buy October or December hogs, sell the

Chart 16

QUARTERLY USDA HOGS AND PIGS REPORT - Released June 22, June 1 Data

('000 head)	June 1/82	June 1/82	1982 T98T %	Expected
Total pigs on farms	51,990	59,740	87.0	85.8
Kept for breeding	7,389	8,378	88.2	87.0
For market	44,601	51,382	86.8	85.7
under 60 lb	18,941	23,069	82.1	84.1
60-119 lb	10,954	12,204	89.8	84.1
120-179 lb	8,200	9,041	90.7	86.0
over 180 lb	6,506	7,068	92.0	87.5

Chart 17

QUARTERLY USDA 13-STATE CATTLE ON FEED REPORT - Released July 19, July 1 Data

('000 head)	July 1/82	July 1/82	1982 T98T %	Expected
Placements April-June	5,766	5,590	103.1	105.9
Marketings April-June	5,194	5,113	101.6	102.4
On feed July 1	8,981	8,646	103.9	103.7

Chart 19

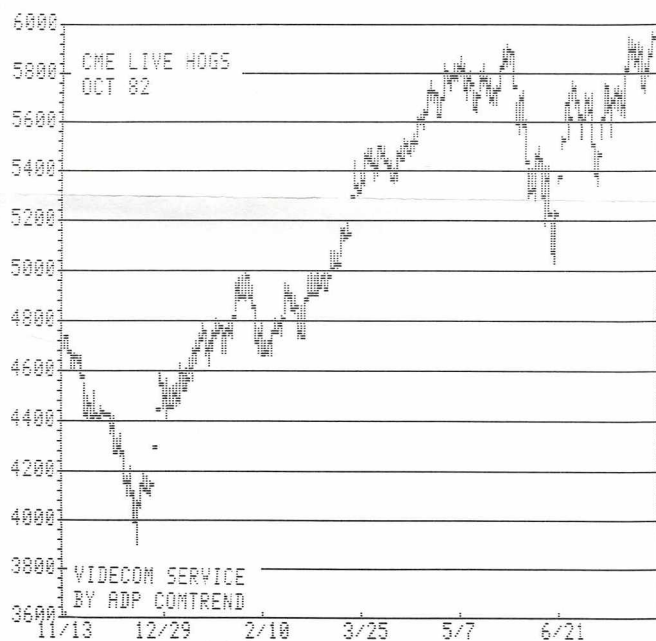
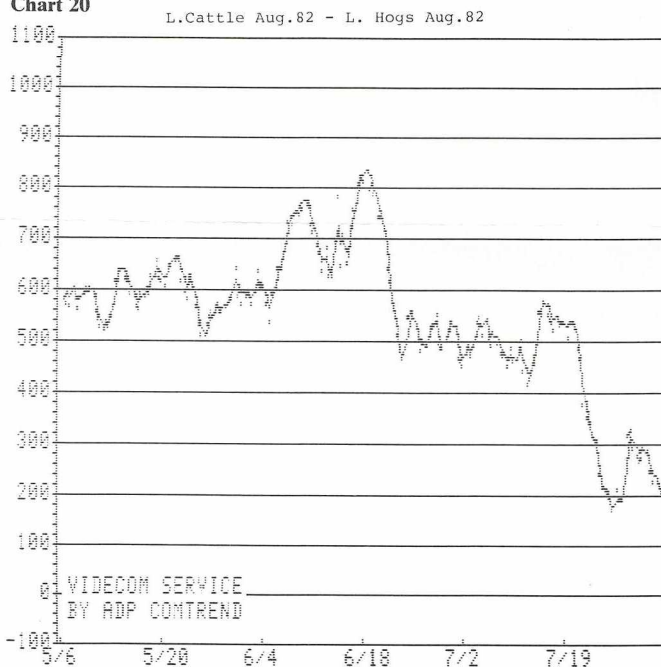


Chart 18

SEMI-ANNUAL USDA CATTLE INVENTORY - Released July 26; July 1 Data

('000 head)	July 1/82	July 1/82	1982 T98T %	Expected
All cattle & Calves	123,740	124,800	99.2	100.8
Slaughter heifers 500 lb plus	7,650	7,495	102.1	101.9
Slaughter steers 500 lb plus	16,340	16,253	100.5	101.2
Heif., steers, bulls, 500 lb & under	36,650	36,549	100.3	101.9
Cow inventory	49,590	51,004	97.2	101.4
1982 & 1981	43,600	44,700	97.5	102.6

Chart 20



Cotton

"Rapid: adjective; moving, or capable of moving, with great speed; swiftly, very quick." The foregoing definition from the Oxford dictionary was a fitting description of the move in cotton prices we have seen in the past month. Last month we projected that "cotton could rapidly retrace to 75¢." Even we were surprised by the extent of the rapidity; in fact, the December contract retraced to 74.88¢ from which point it consolidated in a classic flag formation. Were it not for open interest signals, we could not have forecast that it would break on the downside rather than the upside from this consolidation phase. For those who reacted to our buy

recommendation, and have maintained their positions through the past week's 2¢ to 3¢ correction, you are likely showing profit from positions entered between 69¢ and 72¢ in December futures.

Roughly 2.75 million acres of cotton were damaged severely by storms in the states of Oklahoma and Texas in late June and early July. Over 4 million acres of the 11.57 million reported planted on June 29 appears to have been affected. Considerable controversy remains to be calmed as to the net effect on production. At present, the 1982-1983 crop may be estimated at only 9.5-10.0 million bales, with

losses of 2.3 to 2.4 million bales likely to have been suffered. Some feel the losses may have been up to 3.0 million bales. Ending 1982-1983 season carryover is now projected to 4.5 million bales versus 6.2 earlier. The drop of only 1.7 million bales reflects reduced consumption and export forecasts for the season by the USDA.

STRATEGY: *Accept profits at these levels. Should the August 11th USDA acreage and production estimate confirm the worst case damage scenario, it remains to be seen whether a carryover of 4.5 million bales is not sufficient for the still poor level of final demand.*

We would only reenter long side if December '82 breaks 75¢.

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