

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS



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## The Second Great Depression: 1980-?

Not long ago (November 15, 1981, "30/30: A Frightening Prospect") we rated the chances of entering a depression similar to the 30s at 30 per cent. Sadly enough, our handicap was much too generous.

Dating the onset of the second great depression is somewhat difficult, although only significant to historians. Commodity prices peaked in late 1980, but they are likely to have signalled the top too late, given that *inflation* was still accelerating. After-tax corporate profits, a better indicator of *prices and costs*, peaked in the first quarter of 1980. The seasonally adjusted unemployment rate bottomed out in mid-1979 and has since risen over 60 per cent.

Having made as dramatic a statement as is possible in a serious financial publication, it behooves us to consider the possibility of a recovery. It is precisely here that our unconventional view stands out rather prominently: We believe that worldwide recovery will not take place for a *good* number of years, probably extending the depression throughout the entire decade of the 80s.

What do we mean by depression? A lengthy decline or, at best, stagnation of output accompanied by rising unemployment, rising business failures, falling capacity utilization, and declining (real) personal income. If during this depression prices fall, then we are experiencing a deflationary depression. If, on the other hand, prices rise, then we are witnessing an inflationary depression. *Extreme* examples of these two types of depression are respectively the 30s in the US and 1982 in Argentina.

The present worldwide depression has not developed,

and is not likely to ever develop, into a *deflationary* depression and therefore appears to be rather less terrifying than the experience of the thirties. But appearances are deceiving, and if you do not believe that they are, just ask an Argentinian wage earner whose salary has been cut from \$750/month to \$50/month over the last 15 months even while inflation has been reaccelerating from 80 per cent per annum to well over (unofficially) 350 per cent per annum.

Depressions result from excessive credit creation (on the liability side of the ledger) and malinvestments (on the asset side). When poorly conceived investment plans can no longer support debt servicing, liquidation ensues. The cumulative process of liquidation and credit extinction produces inflation. Normally, it is accompanied by some form of monetary discipline that does not allow debt to be rolled over or postponed and consequently forces asset holders to liquidate and raise cash. This description typified the pre-World War II depressions subject to the corset of a gold standard. In more recent years, however, a new type of solution emerged: Credit was not extinguished and malinvestments were not liquidated — they were merely postponed and papered over with new credits.

The 1969-1970 and 1974-1975 episodes were vivid examples of the new solution. Bank credit dipped and then surged to new highs at an accelerating pace. Bank loans to deposit ratios dipped, if ever so slightly, and then rose to new peaks. Government budgetary deficits widened, creating new debt to support consumption. Malinvestments for the most part remained in place and productivity suffered,

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Interest Rates: The scales are tipping again to higher rates . . .

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### Contributors

Albert D. Friedberg

David B. Rothberg

Michael Beech

even during the subsequent recovery. Unemployment began a secular rise, especially in Europe, while utilization of plant capacity dropped to the lowest levels seen in 50 years (Canada is a typical example).

In the last two years, monetary authorities have reaffirmed their adherence to monetary discipline and have been moderately successful in the US, Canada, and a number of other countries. Betraying this resolve is the grim fact that government deficits are becoming too large to be financed out of genuine savings. Since the public believes (rightly) that *it* cannot continue to increase its portfolio allocation to debt paper, it has come to believe that in the long run, monetary discipline will collapse. The same can be said about the function of "lender of last resort" that is the domain of central banks. Corporate and/or sovereign nations' credits cannot default lest they make world commercial banking insolvent.

Recent events in Mexico and Poland support this expectation, although it is not yet clear to what extent central banks will bail out the lenders. If the rescue operation is only half-hearted, debtors will likely bankrupt and bankrupt their creditors. If, on the other hand, the rescue operation is undertaken with gusto, the world will be thrown into an inflationary depression.

The irony of the latter course is that there is no escape from the oppressiveness of debt except through eventual default. The reason is simple: Most debt is short-term and floating. In a generalized round of reflation, nominal interest rates will rise to compensate depositors for the actual and expected loss of purchasing power. As interest rates rise, debtors will be unable to "liquify" their debt and the real burden of debt will remain unchanged. But since the real burden of debt is now too high to propel the next economic recovery, *it follows that it will remain too high regardless of any type of reflationary effort.*

To elaborate the point we must remind the reader that long-term debt with fixed rates of interest was the prevalent form of country and corporate financing in the 50s, 60s, and early 70s. As inflation rose, the real burden of debt decreased, enabling debtors to escape the clutches of debt. In this blissful world (to debtors, of course) reflation was a powerful engine of economic recovery.

The extraordinary sophistication of money markets in recent years has destroyed forever this recovery machine. Depositors demand and receive real rates of interest. The pendulum has swung the other way: Debtors have become enslaved to creditors after 30 years of the latter's captivity.

Faced with a similar and inextricable web, debtors in inflation-ridden Argentina, suffering from the yoke of abnormally high real rates of interest, found a worthwhile ally in the *dirigiste* leadership of Mr. Dagnino Pastore, the present finance minister. Massive reflation, *accompanied by interest rate ceilings*, would reliquify (i.e., extinguish) corporate debt in a short time. Once again, debtors are being raped on the altar of corporate solvency and the elusive goal of more jobs. Genuine capital has vanished in Argenti-

na, hiding in the crevices of the runaway black market, while the government printing press works overtime to replenish withdrawals.

*Clearly, there is only one escape from heavy debt: liquidation of non-earning assets, allowing for an honorable settlement. Partial or total default.*

Worsening the outlook for debt repayment is the sluggishness in world trade that has become apparent in recent years (see Chart 1). Less developed as well as industrialized nations have been erecting a growing number of trade barriers, hampering efforts to generate life-sustaining cash flows. Joining in the protectionist bandwagon, the US Department of Commerce issued preliminary rulings that carbon steel product from five Western European nations and Romania were being sold at unfairly low prices in the US. As a result, importers will be required to post cash or bonds of up to 40 per cent of the import steel's price to cover possible future penalties. And, for the first time, these penalties are being assessed retroactively for 90 days to stem the flood of shipments from France and Belgium in an apparent effort to beat the statutory deadlines.

In another instance of deplorable trade behavior, the Canadian government extracted a Japanese "voluntary" commitment to reduce car exports by about 13 per cent to Canada in the 1982-1983 season and to increase, in coming years, Canadian content in Japanese vehicles.

Protectionism is bound to lower living standards throughout the world, thus contributing directly to the present depression. In a more indirect but no less damaging way, protectionism will shut off possibilities to generate sufficient income even for good debtors, making generalized default all the more likely.

In the months and years ahead a great deal of wealth will be dissipated, a belated recognition of the enormous amounts of debt that went towards consumption and ill-timed and ill-planned capital investments. The sooner the bitter pill is swallowed, the easier will be the pain. On present trends, one cannot be optimistic that the ongoing depression will not degenerate into an inflationary binge and that aside from not solving the present problems, will surely bring about great social upheaval.

**STRATEGY:** *1. All great bull markets in debt instruments have been accompanied by debt liquidation. The disparities between Charts 2 and 3 indicate that the present euphoria is not justified. Having advised the covering of all interest rates futures last month, we now feel that the scales have once again tipped to the bear side. Begin a scale up program of selling T-bills and more particularly Eurodollar and T-bonds futures. For specific levels, refer to Chart 5. For those worried enough to trade with the trend rather than against the trend, concentrate on either a weekly downside reversal or the first upturn in rates shown on Chart 4 (weekly average of 3-month T-bills).*

*2. Retain spread, long 5 December T-bills versus the*

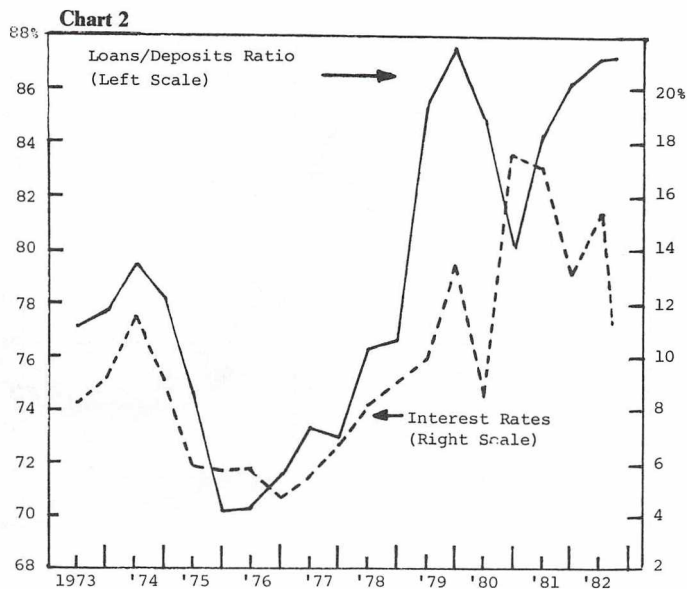
E R R A T A

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should read : produces deflation

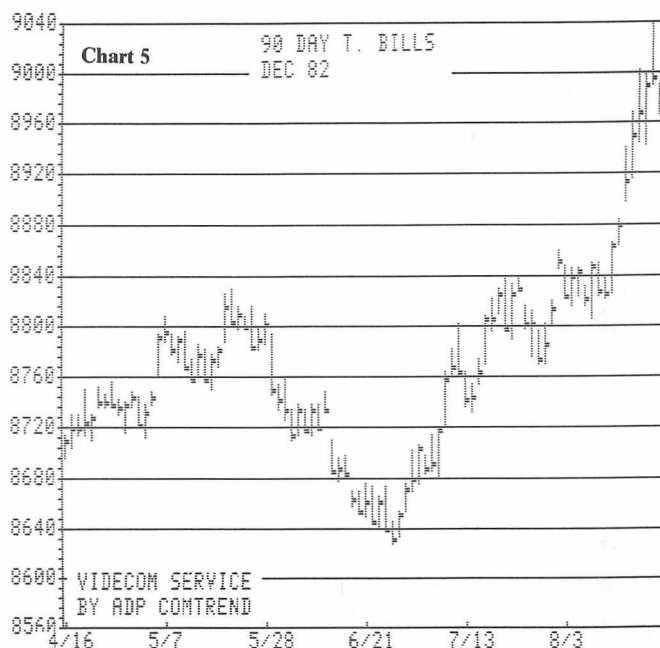
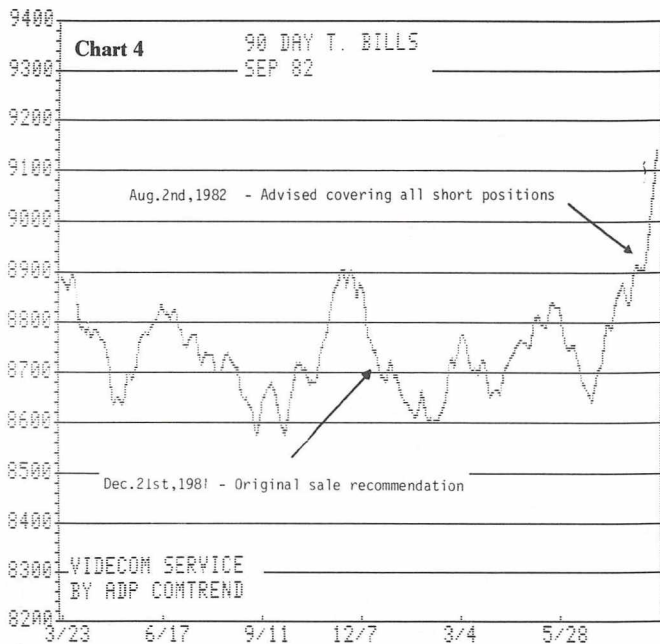
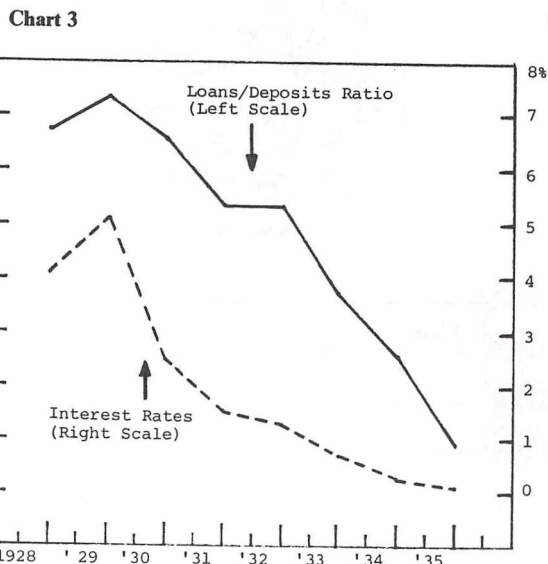
sale of 4 December Eurodollars. Spread is widening quite profitably (see chart 7).

3. As per last month's advice, we are long gold, after it closed conclusively above \$370/oz. There is little doubt that the growing possibility of an inflationary depression will be extremely bullish for gold. We doubt, however, that the time has already come. Nevertheless, public expectations very

often run ahead of actual events, making it increasingly likely that the all-time lows have already been made. Be prepared to sell into strength with spot in the area of \$430-\$450/oz. Should deflation come sooner than we expect, there will be many more good opportunities to capitalize on the next bull market.

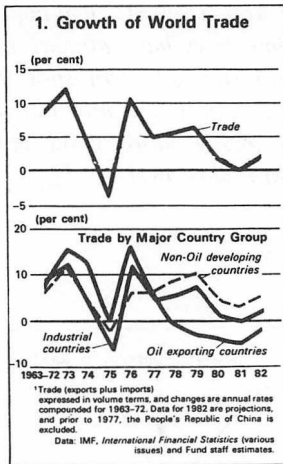


Notice how loan/deposit ratios move in the same direction as interest rates — except in the 1981-1982 period where rates head lower while the loan/deposit ratio remains stubbornly perched at the highest level in history. Clearly, the lower trend in rates is not supported by fundamentals.



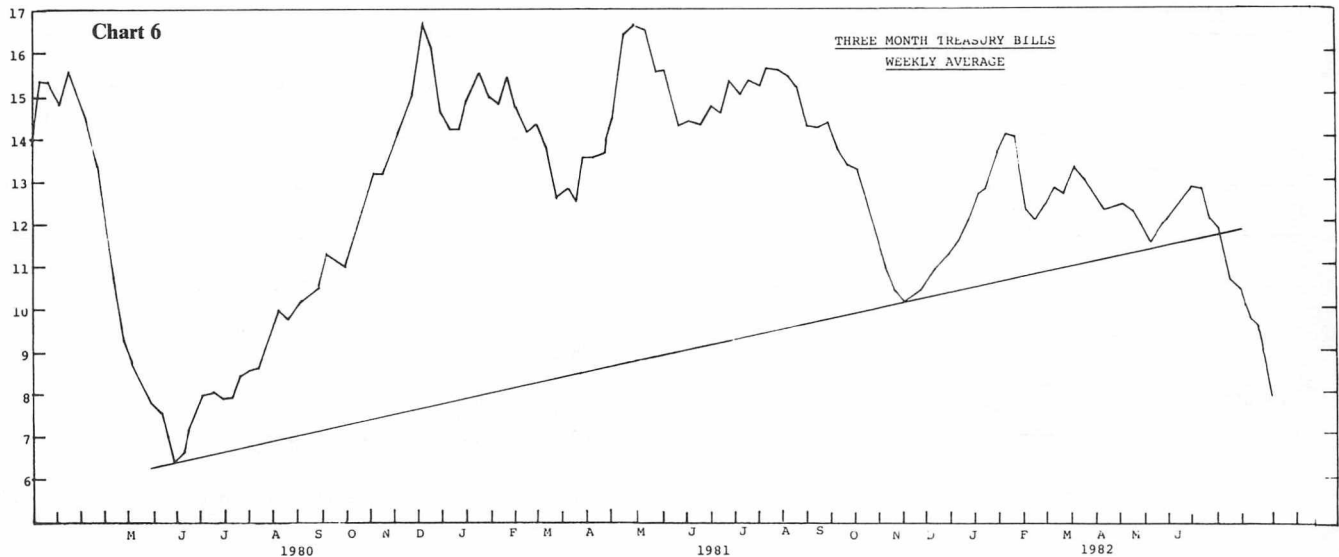
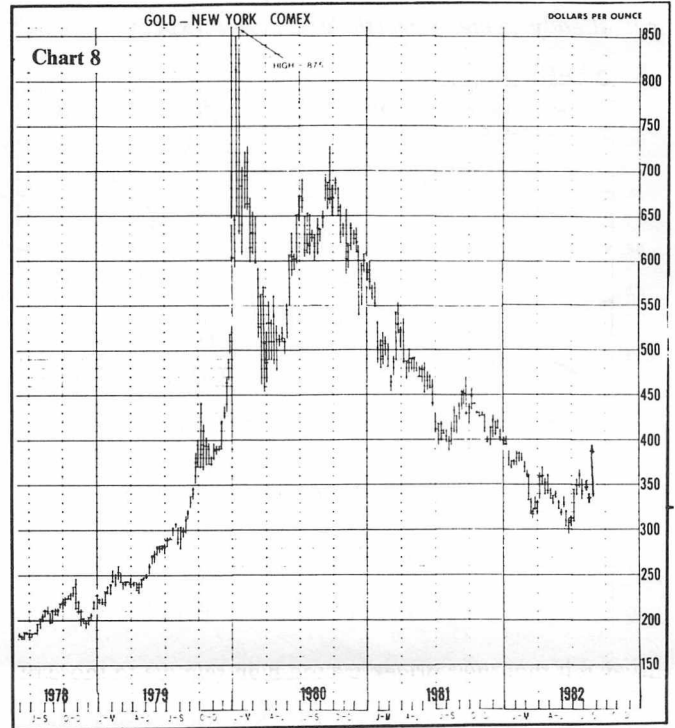
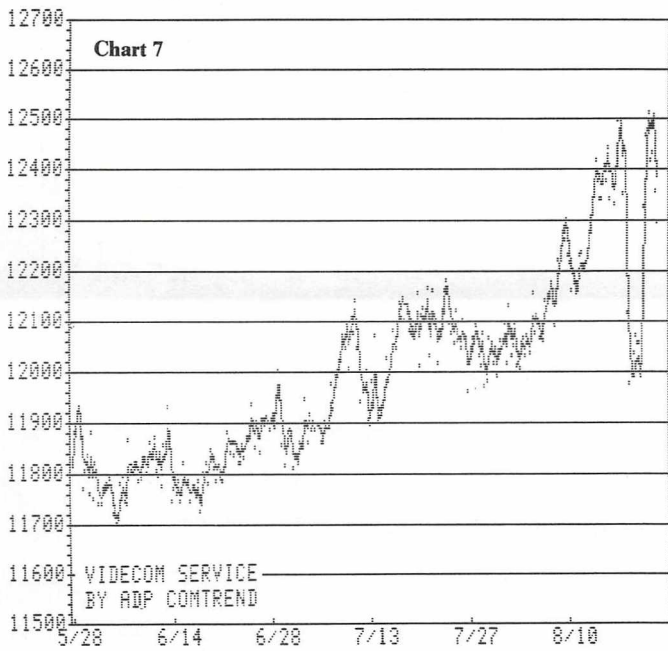
It is hard selling at present levels given the discount to cash. Wait at least until 91.50.

Chart 1



IMF Survey

Euro Dollar Dec.82 Yield / Tr.Bill Dec.82 Yield



# Currencies

## British Pound

A roaring bull market in gilts (see Chart 10) has been the most interesting feature in the dull British capital. Typifying the irrationality of the herd instinct, the Transports 3 per cent of 1987-1988 have traded up to yield a mere 7.9 per cent, which on an after-tax basis assumes that the five-year inflation outlook centers around 3.5 per cent per annum. On the other hand, index-linked gilts are showing a superb 2.5 per cent real yield!

As we have been predicting for well over a year, the British economic depression shows no signs of bottoming, despite repeated optimistic pronouncements. Manufacturing output took a sharp turn for the worse in June, bringing production to its lowest level in 15 years and some 14 per cent lower than it had been when Mrs. Thatcher took office. Seasonal unemployment continues its uninterrupted rise, pushing close to the 3 million mark. Interestingly enough, nearly 70 per cent of the respondents to a CBI survey felt that their prices are too high relative to those of their overseas competitors. The CBI is after a competitive devaluation.

The government has precious little room to maneuver. The volume of imports is running 10 per cent above the average of 1980 and 1981 and is 3.5 per cent above the level at the last peak of economic activity in 1979. This huge shift in the propensity to import has been paid by oil sales, a commodity that very soon will begin a violent shakeout (see Heating Oil). Clearly reflation will throw Britain's balance of trade into the red, bringing back the old headache of the Wilson and Heath days. Furthermore, corporate liquidity has, as yet, not recovered to the early 1979 levels, despite one of the most excruciating economic contractions on record. Reflation will surely bring along an explosion of bank lending to the private sector, as it has already begun to do, negating any effort to control broad monetary aggregates.

Time is running out for the Conservative government still resting on the temporary laurels of the Falklands victory. Any increase in government spending will signal the end of restraint. It will not revive the economy (as the French have found out), but it will set the UK on the last leg of its voyage: an inflationary depression.

**STRATEGY:** *Take advantage of the strength in gilts, and nail down profits. Sterling is ready to tumble. Our minimum downside target is \$1.55; by mid 1983 Sterling may trade close to parity with the US dollar.*

## Canadian Dollar

The adjusted monetary base has begun to recover, if ever so slightly, and now stands at C\$17.2 billion up from C\$17.03 billion in July and C\$16.12 billion in March, its lowest point for the year. Nevertheless, the adjusted monetary base is still lower than the C\$17.5 billion recorded in November 1981. Basis 3-month Treasury-bills, the interest rate spread remains in favor of Canada by a phenomenal 600 basis points.

Clearly, monetary considerations dictate a much higher level for the Canadian dollar. Rational calculations aside, the market does not *believe* that the Bank of Canada can maintain a continued tight posture in view of the extraordinary budgetary deficit, equal to nearly 8 per cent of GNP.

Since Mr. Trudeau does not come for reelection for yet a number of years, it would appear foolish to bet against the determined resolve of the Bank of Canada. Foolish, that is, unless things change. . . .

**STRATEGY:** *We are not prepared, as yet, to abandon the bull side of the Canadian dollar, a side that we defended against many odds and nonbelievers. We caution, however, to begin selling once the deep-discounted deferred contracts narrow the spread (i.e., when Canadian interest rates narrow their differential to perhaps 300 basis points on T-bills).*

## Japanese Yen

Our views remain unaltered. We expect the Yen to trade down to ¥300 to the dollar. Place stops at 41.50 basis December '82.

## Swiss Franc and Deutsche Mark

Our spread, short 6 DM contracts versus the purchase of 5 SF contracts has returned to the positive and we remain confident that the DM/SF will trade down to the 80-82 level.

## Mexican Peso

"If they can steal my dollars, they can steal my jewelry"

— *A Mexican housewife emptying her safe-box*

"I will take every centavo I have out of this country"

— *The same woman, by a WSJ reporter in Mexico.*

It is admittedly rather gauche to applaud one's own triumph to an audience. More so if the personal success in question should be the flip side of someone else's tragedy — and there can be no doubt that the devaluation of the Mexican peso represents a very real tragedy for the citizens of Mexico as well as a potential tragedy for the financial institutions that lent Mexico unconscionable amounts of money over the past several years. But being speculators who, like all others who refer to themselves by that moniker and know all too well the agonies of market strategies that go awry, it's difficult not to be immodest. To capture a devaluation is from the point-of-view of the speculator the most elegant of coups. He endures the interminable wait as economic forces move, like glaciers, to impact upon markets the way he foresaw . . . it seems so very long ago. The reward comes as suddenly and with as much warning as . . . tragedy.

And the reward is not simply the money won. Neither, we can safely assume, is the tragedy for the Mexican citizen a matter that can be quantified solely in terms of money lost. For him the tragedy encompasses the despair of realizing the folly of trusting an irresponsible and lying government. Conversely, the speculator's reward encompasses the pleasure of seeing through the obfuscations and backing his judgment — in other words, of being right. To paraphrase Jesse Livermore, the great American speculator of the early century, concentrate upon looking at the market the right way and profits will accrue naturally. In our *Comments* of March we summarized some of the ways we looked at the Mexican peso market leading up to the devaluation of February 18. Following is a briefer summary of our views since then:

*March 14:* "Mexico's problems are only beginning." Current account deficit expected to increase due to oil glut and increased interest payments on substantially larger public and private debt. Capital account will show deterioration as lenders come to perceive risk of default. ". . . 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 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 4 election. By necessity the peso will float quite freely over the next few months and, perhaps, years. Remain firmly short. March '83 should trade down to .009, or 111 pesos to the dollar."

*June 20:* "A second devaluation, as devastating as the

first is due . . . A large \$2.5 billion syndicated loan has fallen apart . . . Mexico has finally come to the end of the line . . . problems are now being compounded by the failure of Grupo Alfa . . . At this point there is no 'spread' or 'margin' over LIBOR that will entice the foolish banking community into throwing some more good money after bad . . . Soon after the election a full default and moratorium will be put in place and the IMF will be called to implement an austerity plan, which of course will be preceded by a massive devaluation and a continuing monthly 'crawling' peg . . . Hyperinflation and revolution . . . may yet destroy whatever hopes the lending banks ever had of recouping their principal — let alone the interest — over the next 20 years."

*August 2:* Mexico scrambling for funds desperately, mortgaging \$1.2 billion of future oil sales and shifting the onus of creditworthiness onto the purchasers. Only \$400 million raised from 500 bankers contracted in an effort to borrow \$2.5 billion. "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 . . . We remain extremely confident of another Mexi-devaluation before the year is out. Remain short December '82 and March '83. Add by selling June '83 at present levels."

*Once again, the future:* The IMF, the Bank of International Settlements, the US government, the Federal Reserve, and more than 100 commercial banks gathered this week to attempt a most difficult task: how to help Mexico avoid formal default.

It is hard to believe that anything less than outright default is in the cards. Nevertheless, some time has been gained; time enough to prepare the foolish banking community for the massive write-offs that are yet to come. Mexico will not be able to repay its debts, if only because the terms of trade are about to shift massively against her: Oil prices will not be able to sustain the extraordinary burden of the debt, which in real terms promises to stubbornly remain at \$80 billion in 1982 currency.

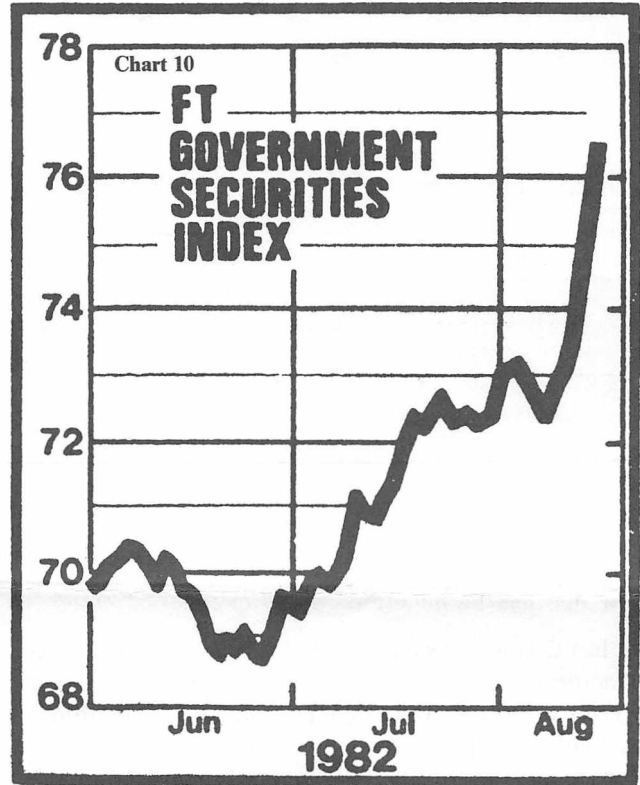
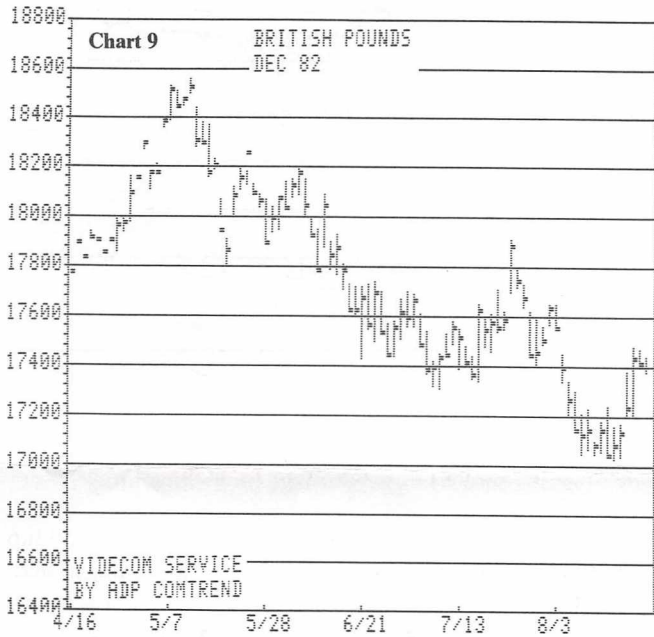
But what is more incredible is that distinguished gentlemen can sit together with a group of "bandidos" who have literally stolen billions of dollars from residents and nonresidents by forcing conversions of due dollars at the artificial and unrealistic 69.50 pesos/dollar parity when the free market straddles 100 pesos/dollar. Obviously, morality plays no role in either banking or governmental circles. It would be easy to say that these gentlemen deserve to lose their investment if it were not for the fact that, ultimately, it is the American depositor and taxpayer who will pay the bill.

The forced conversion of dollars at 69.50 pesos will accelerate a massive flight of capital (especially since there will be newly printed banknotes). Foreign banks and governments will be advancing funds now that will be used to

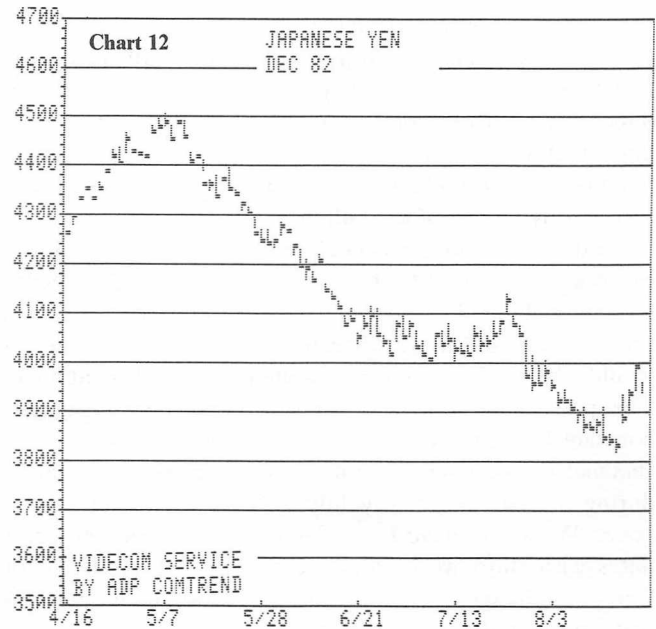
repay them in six months' time. In the interim, however, a good portion of those new credits will be frittered away to contain the avalanche of capital outflows and the gaping hole in the current account — one that will become intolerable once oil prices begin to crumble.

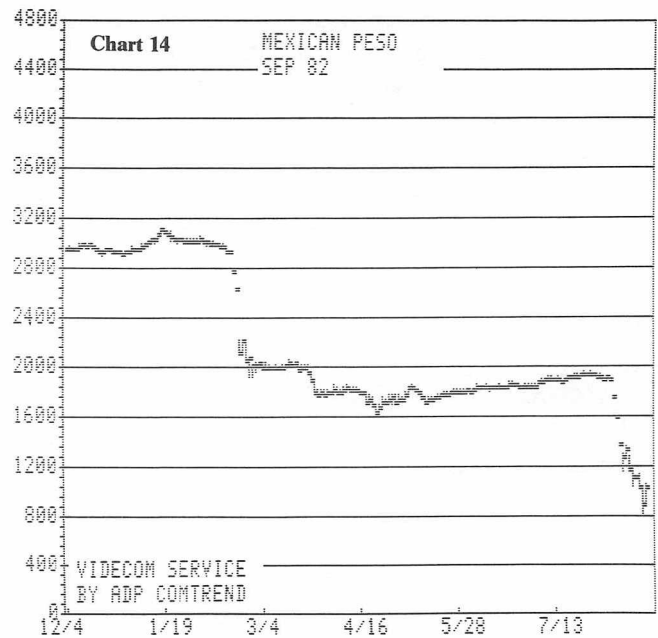
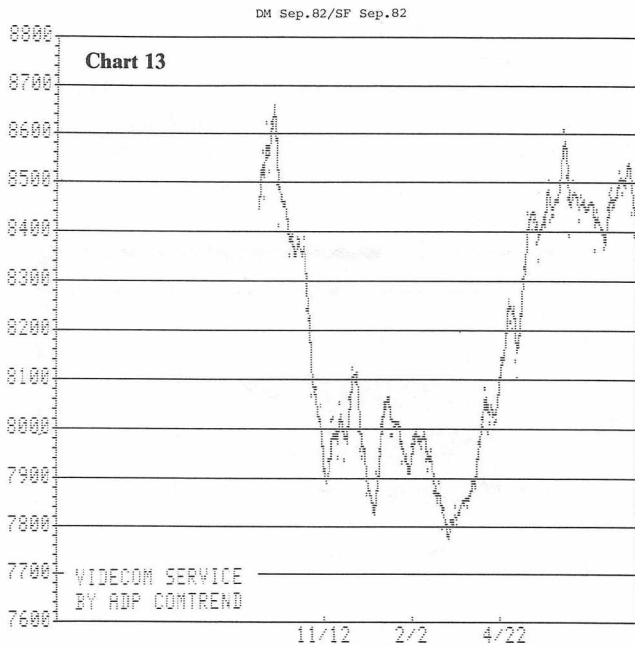
**STRATEGY:** Near September '82 should be covered at these levels, as the currency is likely to stabilize, at least for a few weeks. Unfortunately, the size of the contract has

shrunk enormously, and margin requirements equal or exceed the full value of the contracts, thus considerably diminishing leverage. Furthermore, there is always a possibility (stronger now) that eventual foreign exchange controls will rob the "shorts" from their much deserved gain. On balance, however, we recommend maintaining short positions on deferred contracts. The Mexican peso will become worthless.



London Financial Times





# Copper

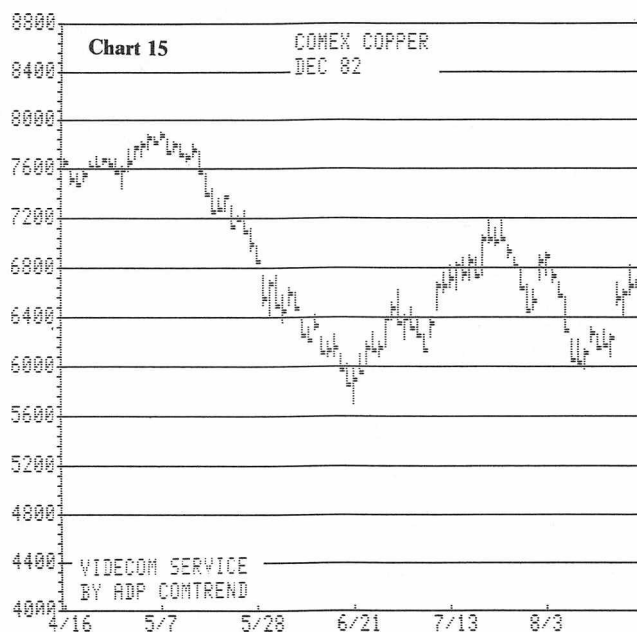
In our last *Comments* we concluded fundamental and technical factors did not paint a picture clear enough to warrant an aggressive posture in the copper market. We therefore advised either liquidating long positions recommended the previous month on strength — we enjoyed a good rally in the week immediately following publication — or maintaining a modest, investment-type exposure with stops at 59.00 basis September on close. The stop was executed August 9 when the September option closed at 58.55.

The fact that the stop was touched indicates basic technical weakness. In falling to such a level the market punctures both the correction low of 62.50 and the more important correction low of 59.00 — our stop. Such a reaction — so broad and so disrespectful of support levels — is hardly typical of the bull market.

Equally damning has been the tendency of open interest to increase: from 66,487 lots as of last writing to 68,941 lots as of Thursday. As we noted in our last *Comments*, open interest did not evaporate as much as we thought it would when in June we forecast the turn was close at hand. The persistent “stickiness” of the open interest suggests constant hedge pressure — had the selling been essentially speculative, we would presumably have seen it drop sharply during the late June/early July rally as the public ran for cover. We would have to conclude that the hedging originates with third world producers who, in their need for foreign exchange, are selling into the market no matter how soft, and regardless of the cost.

That this is so is best indicated by the ongoing buildup of warehouse stocks in London and New York. Combined, they total 343,574 tonnes and are increasing, on a 12-week rate-of-change basis, at 5.15 per cent through last week, only slightly lower than the average for all of 1982. Despite the spate of domestic mine closures and slowdowns, supply remains excessive. This is certainly disappointing but hardly a surprise given the extremely depressed level of demand. The auto industry is laying off employees as its busiest season approaches; auto output is currently just under 50 per cent below last year's depressed rate. And the construction component of offtake is equally sorry: Very little of the 30 per cent increase in housing starts reported last week for the month of July comprised single family homes, which are the largest users of industrial commodities; almost the entire increase was made up of government-subsidized multiple dwellings. Advance planning of construction projects through August 19 was reported at \$1.8 billion as opposed to \$2.8 billion at this time last year. We cannot envisage a sharp change in the demand pattern in the foreseeable future.

**STRATEGY:** *In light of the above comments we advise remaining sidelined for now. Short sales are not recommended because, despite all the negative views, copper is extremely cheap at present levels.*



## Heating Oil

Saudi Arabia's much touted OPEC leadership is vanishing rapidly as its production begins to drop to nearly expendable levels. August production is set at 5.5 mbd (million barrels per day), the lowest in a decade and just a shade higher than Iran's maximum potential capacity. Furthermore, oil revenues, at these production levels, no longer cover current expenditures, forcing the Saudis to dip into their investment income. Since accumulated reserves can be considered the personal property of the ruling family, it is unlikely that they will be allowed to run down significantly for the benefit of the Kingdom.

In recent weeks, both Iran and Nigeria have seen their crude oil sales drop between 10 per cent and 20 per cent, despite Saudi restraint. At \$30.80/barrel, the free market price for the Saudi marker is beginning to put intolerable pressures on the so-called cartel. Hence rumors that Saudi Arabia is considering a \$2-\$4 per barrel cut in the official price.

In the fundamental background, oil consumption among major industrialized countries fell 7 per cent in the first quarter of 1982 from the year earlier. According to the International Energy Agency, net imports dropped by 16 per cent from a year earlier, a greater drop than consumption, owing to the increased production of Norway (+4.1 per cent) and Britain (+7.4 per cent). Interestingly enough, stocks of crude oil and products declined only 5.3 per cent to 3.14 billion barrels, indicating that major oil companies, governments, and dealers have still not been able to adjust to the permanent downward shift in demand. Inventories

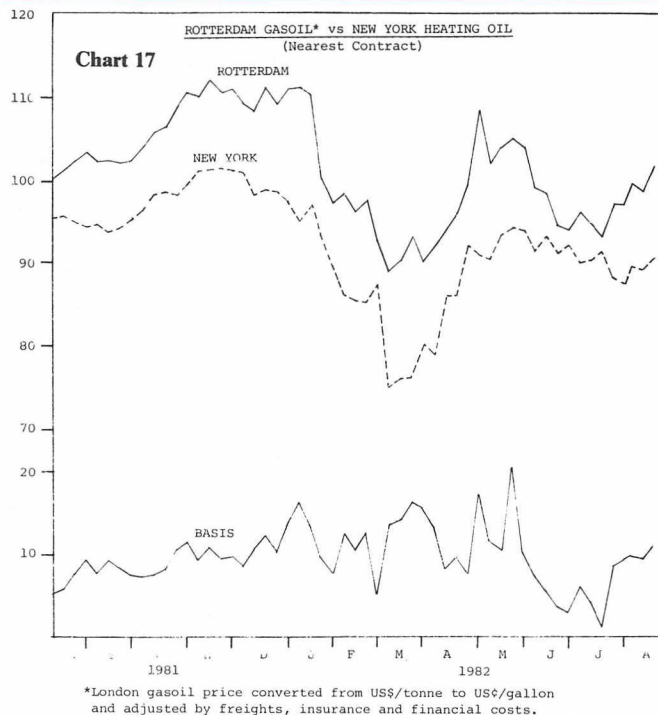
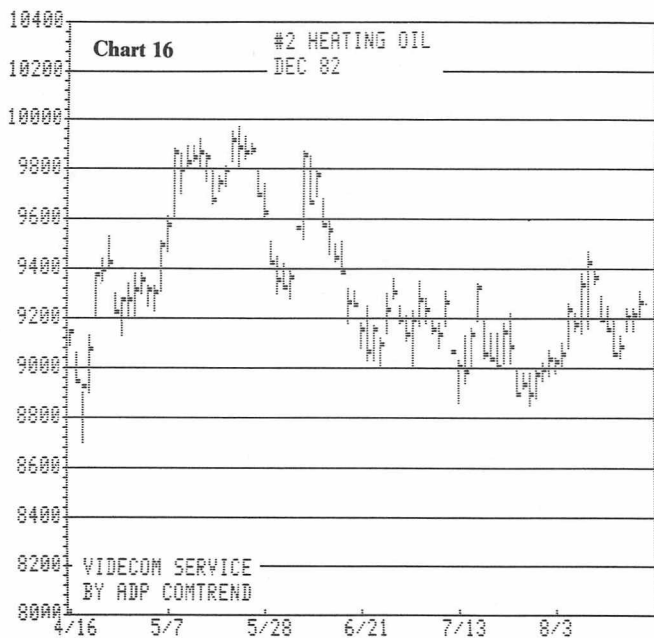
remain at an extremely high level, equal to 104 days of consumption. Should a sudden bearish perception take hold, dealers and other users will likely try to reduce inventory levels to a more normal 60-day usage, precipitating 1.3 billion barrels on the market, equal to no less than 75 days of OPEC production!

An additional bearish element was introduced this week as Mexico reached an agreement to supply the US government with crude oil for its stockpile program. The agreement specifies that current sales of 50,000 b/d will gradually increase to 130,000 b/d by mid-1983. Increased light oil sales at very favorable prices are likely to put additional strains on OPEC, making it a certainty that prices will plunge.

*We are only weeks from a major oil price collapse. It will probably be initiated by Saudi Arabia as it tries to regain lost markets and attempt a soft and quiet reduction in the official price. No sooner than prices are cut, a price war will develop led by Iran, Nigeria, Libya, and Venezuela, and free market prices will head towards the low \$20s.*

**STRATEGY:** *The imminence of a major price drop makes heating oil and gasoil futures an ideal way to play the current depression. The recent widening of the Rotterdam/New York spread should direct our selling efforts to London.*

*Add new shorts in the deferred months with impunity. Avoid trading the two nearby contract months in New York or London.*



## Grains

The bear market continues. The August 11 USDA crop report shown in Chart 18 was devastating for corn and soybean prices. On August 12, corn closed down the limit of 10¢; soybeans closed down about 20¢. Those who sold November soybeans as we suggested last month would have profited from positions instituted at about \$6.10, and now trading around \$5.65. The size of the 1982 crop report was highly unexpected, at 13 per cent above 1981 and 5 per cent above pre-report expectations. The size of the estimate negates our recommendation to look to buy soybeans in the \$5.80 region.

Soybean ending stocks in 1981-1982 (August 31) are estimated at 270 million bushels. Over the course of the 1982-1983 season they are now slated to rise to 420 million (on August 31, 1983) compared with the July projection of 345 million for that date. This is a 22 per cent increase, resulting from a 6.4 per cent increase in the 1982 crop estimate.

Corn ending stock in 1981-1982 (September 30) are forecast now at 2,076 million bushels. They are forecast at 2,791 million on September 30, 1983 versus 2,047 million estimated earlier, a 36 per cent rise, resulting from an 8.2 per cent rise in the 1982 crop estimate. Ending stocks of 2,791 million bushels would be a 34.4 per cent increase from 1981 ending stocks currently forecast.

Given current projections, ending stocks as a percentage of annual disappearance would be as follows: for soybeans, 13.0 per cent in 1981-1982, 19.6 per cent in 1982-1983; for corn, 30.0 per cent in 1981-1982, 36.7 per cent in 1982-1983. Owing to the much more burdensome

stocks of corn as a proportion of annual disappearance, we would be more willing sellers of corn than soybeans. In view of low participation rates in the 10 per cent acreage set-aside for corn (last given August 20 at 34.5 per cent of enrollment — with enrollment of 75 per cent of the base, participation is 25.9 per cent overall), the \$2.55 loan support level will be ineffective, and will simply act as a reward to those farmers who participated.

Wheat ending stocks are forecast to rise only 13.5 per cent from June 30, 1982, to June 30, 1983, and up only 5.5 per cent from July indications. These numbers compare with 34.4 per cent and 36.0 per cent respectively for corn statistics. On a world scale, the build-up is similar. The rise in stocks is, of course, in the exporting countries. Thus, it remains a buyer's market for coarse grains. We expect corn prices to be depressed substantially further relative to wheat from current levels.

**STRATEGY:** Sell December corn, risking the bottom of the gap at \$2.37, with a target of \$2.00. Buy December wheat, sell December corn for a spread that could go to \$1.60 premium with a 6¢ trailing stop. Maintain short positions in November soybeans with stops lowered to \$5.72. Carrying charges are out of line in soybeans; sell May '83, buy November '82 soybeans, risking 42¢ premium May with an objective of 28¢. The premium is now 38 to 39 cents. Interest rates are the prime variable in these spreads; if at any time T-bill rates rise to over 17 per cent in the nearby month, this recommendation should be voided.

The long September/short December corn spread has

been very volatile; those who initiated new positions after old positions were stopped out at 6¢ premium December are now profiting from levels initiated at 5¢ or more premium December, with the spread currently at 2¢ premium December.

Maintain these spreads until the very end of August, as

the previous highs of 2¢ premium September may be realized. Use a trailing stop 1¢ below the present level. The long September/short December wheat spread has begun to move in our favor and should be retained until the end of August using a 1¢ trailing stop.

Chart 18

U.S.D.A. CROP PRODUCTION ESTIMATES - Aug. 1 conditions - Aug. 11 Report

	1982	1981	$\frac{1982}{1981}$ %	Laslie -Aug.6	expected
Corn	8315.1	8201.	101.4	7968.	7817.
Soybeans	2293.4	2031.	112.9	2236.	2188.
All Wheat	2769.3	2793.4	99.1	2737.2	
Winter wheat	2095.6	2098.7	99.9	2094.8	
All Cotton	11.14	15.65	71.2		10.6

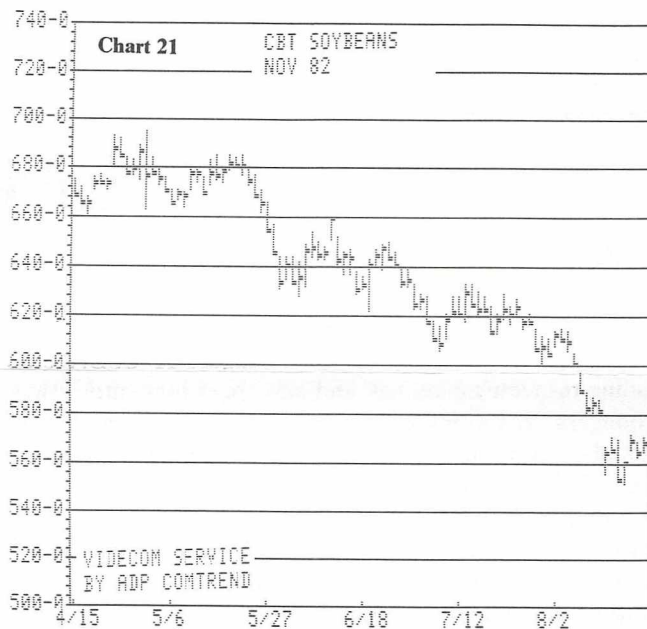
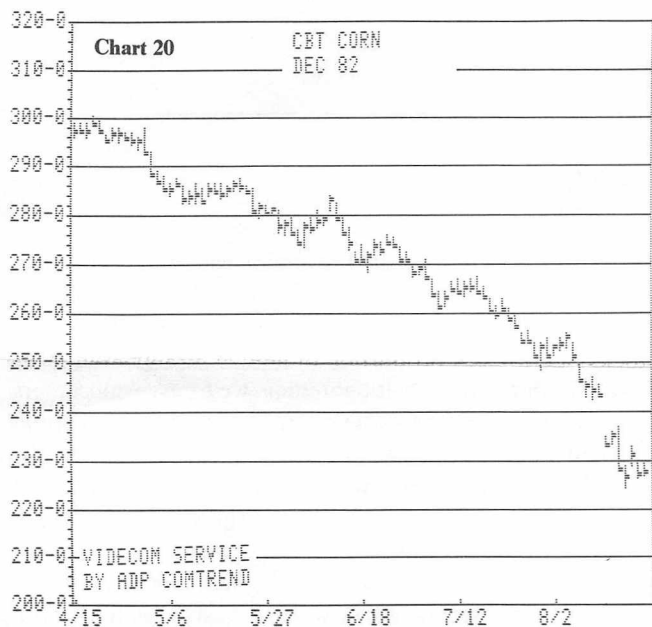
(million bushels, except cotton, million bales).

Chart 19

U.S.D.A. CATTLE AND CALVES ON FEED - August 13 Report

	( '000 head)	1982	1983	$\frac{1982}{1981}$ %	expected
On feed July 1		7,181	6,846		
Placements -July		1,205	1,082	111.4	112.1
marketings -July		1,482	1,412	105.0	104.7
On feed Aug. 1		6,836	6,451	106.0	106.1

Source: USDA



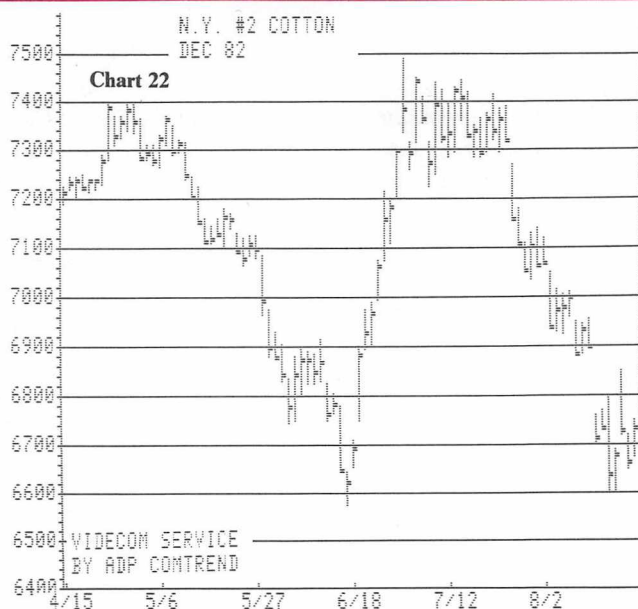
# Cotton

Cotton prices have returned to the low levels set in mid-June. When we forecast the upswing in cotton prices at that time, we were unaware that major crop damage would act in our favor. The storm damage resulted in about 1.5 million acres of cotton being damaged to the extent that it will not be harvested. Yields on the balance, however, will be higher than last year by about 3.7 per cent on the harvested acreage. As a result, the August 12 USDA crop report estimated 1982 cotton production at 11.1 million bales compared with 10.0 million indicated on July 13. This has sent cotton prices back to near the June 17 lows of 65.75¢ basis December.

Nondurable goods sales have, of course, been much less affected by the economic downturn than have durable

goods sales. In fact, retail sales have increased compared with three months ago on a seasonally-adjusted basis. With the August cotton crop forecast of 11.1 million bales versus 12.5 million in June, and 1982-1983 ending stocks now forecast at an albeit sufficient level of 5.6 million bales compared with 6.2 indicated in June, combined with a similar technical picture, we must again recommend buying December cotton as we did June 20.

**STRATEGY:** Buy December cotton with a target of 72¢. Risk from these levels is very low, given the very strong technical support at 65.75¢. Should this level be broken on the downside, we would bail out.



## Livestock

On the last day of trading in the August contracts, hog prices reached our target — at par with cattle! In the coming months, we believe this will take place again, in the October and December contracts. These are currently trading respectively at 3.5¢ and 5.5¢, premium cattle. Hog producers, in the midst of economic slowdown and high capital costs, have been reluctant to enter an expansionary phase. In fact, they cut back breeding inventories in the first part of 1982 to such a level that hog production will be down about 14 per cent from 1981 in October, and as much as 20 per cent from 1981 in December. At the same time cattle production is up about 2 per cent from 1981.

Cattle producers too have cut back in light of the recession; if the current trend over the past month or two continues, the cattle inventory build-up in 1981 and 1982 will have been the shortest phase ever. Cattle producers are liquidating, causing slaughter levels to be as much as 4 or 5 per cent higher than 1981. This is expected to continue for the remainder of 1982. The 1982 calf crop is expected now to be 2.5 per cent lower than 1981 versus an earlier expectation of 2.5 per cent above 1981.

Some analysts argue that meat prices cannot rise during a recession. However, the all-time previous high in hog prices

was set in the period of the last major economic downturn in 1975. Since then, disposable income in real terms has increased greatly; consumers have more to spend on food whether one considers the poor, the wealthy, or the unemployed. Under current belt-tightening, we foresee consumers not eliminating meat from their diets, but more likely switching to cheaper alternatives within the meat group; namely, pork. When analyzing live-weight prices at par for hogs and cattle and adjusting to a dressed weight basis, it is discovered that pork is still 16.2 per cent cheaper than beef.

To substantiate our scenario of higher meat prices in the midst of a severe economic downturn, cash hogs sold at all-time highs of up to 67.5¢ on August 13, breaking previous records set October 7, 1965. The August 13 highs were again surpassed on August 16 and 17. Pork is thus underpriced not only in nominal terms but in real terms as well.

**STRATEGY:** Buy October or December hogs, sell the respective month cattle. Objective is par; risk 5¢ October, 6¢ December, premium cattle. If necessary, reinstate spreads at higher levels as they are quite volatile. Also, buy October or December hogs outright, risking 58¢ and 56¢, respectively. Our first target is 65¢.

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#### Subscription Enquiries

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#### Trading Accounts

All enquiries concerning trading accounts should be directed to Friedberg Mercantile Group, 347 Bay Street, Suite 207, Toronto, Ontario M5H 2R7. Telephone (416) 364-2700. Cable: Friedco Toronto. Telex: 06-23446.

All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.