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On Borrowed Money, On Borrowed Time . . .

Business and banking confidence continues to deteriorate. Central banks around the world, well aware of the catastrophic effects that credit withdrawals can wreak on failing nations and corporations, are coaxing, and in the process underwriting, financial institutions to do what they are naturally loath to do: throw good money after bad money.

In her inimitable style, the Lady of Threadneedle warns that debts threaten world recovery to the point that "*financing constraints* (our emphasis) might be more severe than allowed for in the forecast" of a 2½ per cent growth next year for six industrialized countries (excluding the UK). After having played a successful role in arranging (on behalf of the UK banks) a rescheduling of some of Mexico's debts and a modest extension of new credit, the Lady adds, rather elegantly, "it is particularly hard to assess the effects of such financing difficulties, which are novel on their present scale and likely to be discontinuous in their effects."

In truth, banks must begin making substantial write-offs on their developing countries' debts. It is rather clear that monetary authorities and banks alike have given up hopes of ever being repaid, at least as far as *principal* is concerned. What makes the present situation so intractable is that a very substantial portion of present international indebtedness is of a floating rate nature: *even interest payments are at stake*. The negative interest cost of the 60s and 70s (principally on long-term, fixed-rate indebtedness) has given way to positive interest costs that in real terms range from as "little" as 5 per cent to as much as 15-20 per cent. These interest costs are being aggravated by widening risk spreads as well as falling export prices.

Furthermore, as paradoxical as it may seem, reflation (in the monetary and price sense rather than in the real sense) may in some cases be even more damaging: Interest costs will rise to reflect heightened inflationary expectations, terms of trade will remain essentially unchanged (and therefore net current account proceeds will also remain unchanged), and the debt burden will climb.

There are many who argue that the way out of this depression is simply to resort to the printing press. And so one finds that a group of 26 distinguished economists and bankers, including former cabinet ministers and senior officials in US, Japanese, German, and French governments, advocate more expansionary economic policies if a breakdown is to be averted. For countries like the US and Canada, the group recommends monetary expansion and a further reduction of the discount rate by at least two percentage points.

Fed chairman Paul Volcker has already hinted that the supply of money should be expanded at a slightly faster rate than originally targeted in order to offset falling velocity. In remarks prepared for delivery at a congressional Joint Economic Committee hearing he noted that the "velocity decline in M1 from the fourth quarter of 1981 to the fourth quarter of 1982 is likely to amount to 3 per cent, the first significant velocity decline in about 30 years . . . M2 and M3 velocities — which had been relatively trendless earlier — have also declined significantly."

In This Issue

Contributors

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Volcker went on to explain that the decline in velocity indicated a strong tendency to hold more liquid assets relative to current income.. And, *in the same breath*, he added that the issue of whether the monetary targets should be changed will be discussed over the next few months and announced in February. Can the implications be any clearer?

The reflationists forget that it is not the amount of money but the structure of (banking) balance sheets that direct the real flow of wealth. Illiquidity in the face of massive central bank monetization is a well-known phenomenon to students of inflations and hyperinflations. A cursory look at the crucial loan/deposit ratio (Chart 1) for all US banks indicates that illiquidity, even at this late stage, has as yet not been recomposed. It also indicates that the *banking system* in the US does not have a great deal of extra real resources from which to fuel the coming recovery.

Reflationists also forget that markets cannot be fooled for very long. Excessive monetary ease has already toppled Sterling and is now weakening the US and Canadian dollars (see "Currencies"). Furthermore, the extremely sensitive long end of the bond market in both the UK and the US has already begun to retreat from euphoric highs, uncomfortable at the prospects of rising inflation (see "Interest Rate Futures").

There are now a number of strong indications that the US economy reached a *cyclical* low during November. In the first place, a four-week moving average of Initial Unemployment Insurance Claims (Chart 2) has begun a hopeful descent from the mid-October highs. In particular, the 590,000 figure for the week of December 4 was the lowest reading since mid-September. Housing starts have shown unusual vigor and were up last month by 25 per cent, no doubt helped by falling interest rates.

Further proof that US consumers are loosening their purse strings a bit is that at November 30, car inventories were at the lowest level in 12 years. Finally Chart 3 indicates that the consumer and corporate sectors have undergone a *considerable process of reliquification*, very similar to the one experienced in 1975, which preceded the last economic expansion. The similarities are particularly striking in the government and private short-term credit sectors where, like 1975, the increased demand for funds by the former was accommodated, to a great extent, by a drop in the demand for funds of the latter.

Unlike 1975, the cyclical recovery that began in late 1982 will have little oxygen. Rising protectionism will cut a permanent and substantial slice off the world's standard of living and make it nigh impossible for developing nations to generate life-saving cash flow. Rising fear on the part of international and domestic lenders superimposed upon their meager (much more meager than seven years ago) real resources will do little to sustain purchasing power. Outright debt repudiation and painful debt liquidation will occur in the months ahead, straining even further whatever resources banks are counting upon. Finally, either as a result of this process or in an effort to reactivate the slumping world economy, the printing presses will begin to work overtime. The only result will be accelerating price inflation and skyrocketing interest rates.

Disinflation gives way to inflation. The recession is dead. The depression lives on.

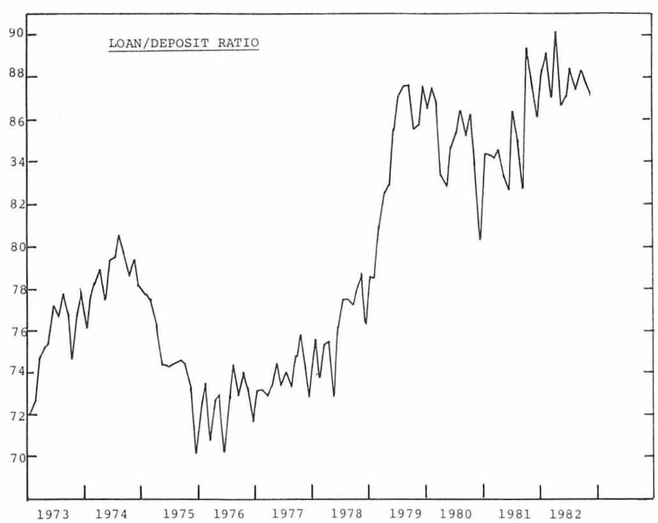


Chart 1

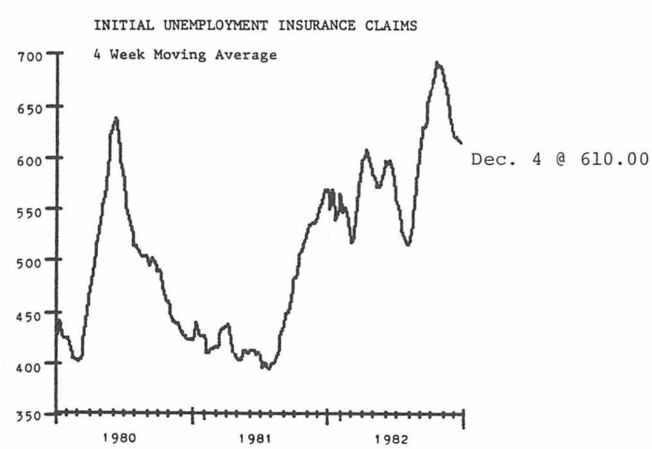


Chart 2

Funds Raised in Credit Markets

	1974	1975	Year-over-year change Bln $	%	1981	1982 III Qtr.*	Year-over-year change Bln $	%
	bln$	bln $			bln$	bln$		
Total	233.4	224.0	-9.4	-4.03%	465.6	549.3	83.7	17.89%
U.S. Gov't Sec. State+Local Obligations	48.4	111.0	62.4	129.34	165.5	343.0	177.5	107.25
Corp. & Foreign Bonds	24.9	36.7	11.8	47.39	28.5	63.0	34.5	121.05
Mortgages	63.1	59.8	-3.3	-5.23	115.2	79.4	-35.8	-31.08
Consumer Credit, Bank Loans N.E.C. Open-market paper Other Loans	91.4	6.0	-85.4	-93.44	190	35.9	-154.1	-81.10

*Annualized

Source : U.S. Flow of Funds Accounts

Chart 3

Interest Rate Futures

The bearish case for long term bonds is gaining strength.

The Fed has become visibly concerned with the external debt of the likes of Brazil and Mexico, realizing that a drop-off in the cost of credit may be beneficial to debtors and creditors alike. The most recent ½-point reduction in the discount rate is *qualitatively* different than the previous reductions — it came at a time when funds were trading at around 9 per cent (in effect, the Fed led rather than followed the market) and when monetary aggregates were generously overshooting their stated targets.

While short-term rates can be manipulated by the Fed at convenience (i.e., interest rate targeting), long-term rates cannot. Thus, one would expect the yield curve to widen, as it has for the past few weeks (see Chart 4).

STRATEGY: *The time has come to initiate short positions in T-bonds in a serious way. Risking 76.20, basis March '83, we look for an initial target of 69. We believe that during the course of 1983, T-bonds will give up the entire gain achieved in the second half of 1982, and then some.*

The switch out of long T-bills to long T-bonds in the T-bill/Eurodollar spread was particularly ill-timed. We suggest eliminating the entire spread, foregoing the possibility of earning money on a widening of the risk premium.

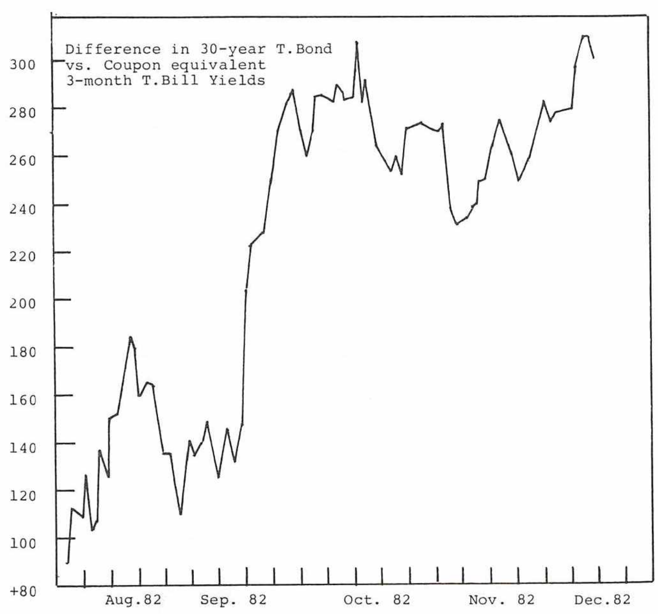


Chart 4

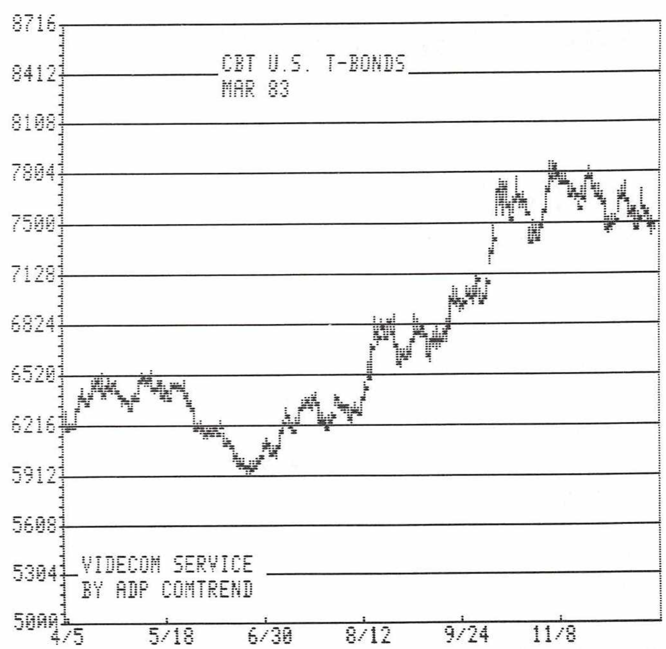


Chart 5

Euro Dollar Deposit March 83 Yields/

T.Bills March 83 Yields

Chart 6

Currencies

Swiss Franc, Deutsche Mark

Last month we painstakingly demonstrated that the US dollar was not overvalued on a pure statistical basis. In fact, we found the opposite to be true; namely, that the Deutsche mark and the yen were overvalued approximately 13 per cent and 7 per cent respectively in real terms, while Sterling was overvalued as much as 30 per cent. We cautioned that purchasing power parities calculations are known to be imprecise. Nevertheless, we drew the conclusion that the US dollar was likely to remain firm and even go higher in coming months as it was not "too expensive."

In retrospect, the US dollar hit its trade-weighted high on November 8 and has since weakened by almost four percentage points (see Chart 7). The US dollar has declined against the yen, Swiss franc, Deutsche mark, and other European monetary system (EMS) currencies more than four per cent, while it has appreciated against Sterling and the Canadian dollar. Since foreign exchange markets are a great deal more sensitive than commodity markets to monetary inflation, one must conclude that the Fed is a great deal more accommodative than initially estimated. This is true if the demand for money has begun to drop significantly and the supply of money is growing too fast both in absolute terms and relative to demand. Should this trend persist, accelerating price inflation will reappear in the US in the not-too-distant future.

STRATEGY: *We advise reversing course in the DM-SF; cover all short positions (showing very substantial profits) and move to the long side. We prefer the SF over the DM and advise* ***retaining*** *a previously established long SF/short DM spread.*

On outright long positions, risk 40.50 and 47.60 for the March '83 DM and March '83 SF and look for advances to 44.40 and 57.00 respectively.

Sterling

Sterling remains a very special case.

Economic activity continues to stagnate at extremely low levels, unemployment grows, the balance of trade deteriorates, the terms of trade are about to swing adversely in a major way. The Bank of England has precious little room to maneuver to try to reactivate the slumping economy. That is because a) Sterling has begun to fall rather precipitously and b) private loan demand has been extremely brisk; both threaten price stability.

Demonstrating the fragility of investor expectations, long-term Gilts have given way to index-linked Treasuries as the most popular girls in town. It does not pay to bet on further gains on the inflationary front. In fact, the hard won progress achieved to date (year-on-year rise of 6.5 per cent) will be lost in a matter of months. Moreover, reflation is not likely to give business more than a temporary shot-in-the-arm.

Britons remain as oppressed as ever by the State, regardless of party in power.

STRATEGY: *Calls for monetary easing and a lower Sterling are heard all over the land. Good-looking inflation numbers are providing the excuse. We feel that between now and the election, Sterling will lose at least 20 per cent. This forecast gains a great deal more certainty if and when couched in trade-weighted terms or, at least, in a cross-rate, basis the DM and/or the SF. We are therefore advising short sellers of Sterling to protect their US dollar exposure by purchasing an equivalent amount of Deutsche mark (4 contracts to every 5 BP contracts) or Swiss francs (2 contracts for every 3 BP contracts).*

The long 20-year Gilts contract, traded on the London International Financial Futures Exchange, presents an excellent selling opportunity. Risking 103.00 basis March '83, we look for an initial target of 87. Each point represents £500. Margin is £3,000. (See Chart 13.)

Canadian Dollar

From a purely monetary view there have been three significant developments during the past month. In the first place, the Bank bowed to the inevitable and abandoned M1 targeting after seven frustrating years. In our annual Spring inflation reports, we have long advocated replacing M1 with either Domestic Credit or Adjusted Monetary Base. Unfortunately, the Bank has *not* announced a replacement yardstick, heightening expectations of a "secret" move to reflate. Second, the adjusted monetary base, as calculated by our firm, has up-ticked again as of early December (the fourth consecutive *monthly* increase) to the highest level since February 1982. Third, and most important, net inflows in the month of November slowed down to a trickle, $49.2 million, and represent the smallest increase in official reserves since July of this year. Clearly, domestic monetary balances, at the much reduced level of activity, are satisfactory and do not require external assistance.

Fiscally, Ottawa is growing progressively more irresponsible. Atop a $25 billion deficit, it is proposing to increase spending in housing and transportation in order to stimulate economic recovery. It is nearly impossible to see how the federal government plans to finance this deficit without crowding out the private sector further or destroying the bond market through inflation.

STRATEGY: *We believe that the Canadian dollar is ripe for a severe decline in weeks ahead. Sell March '83 at present levels (80.70), risking 82.20, and look for a move to 75.50.*

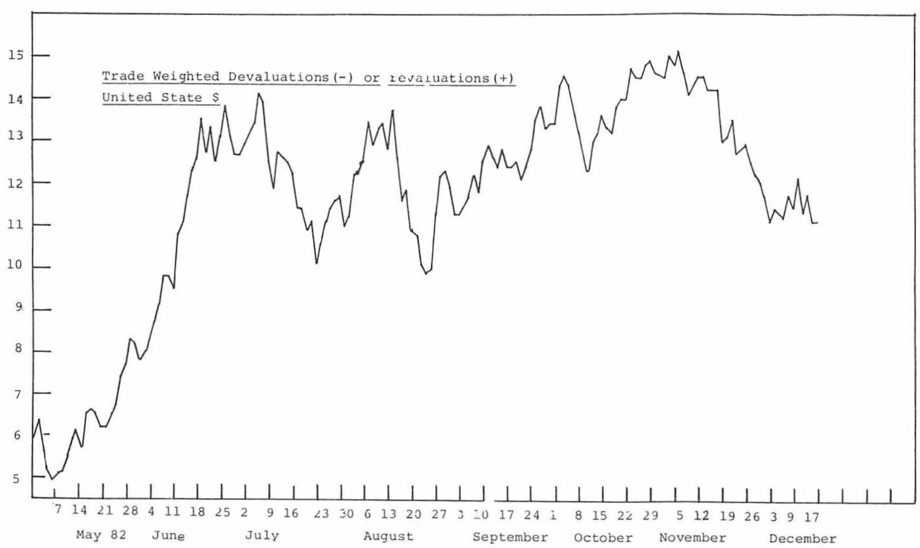


Chart 7

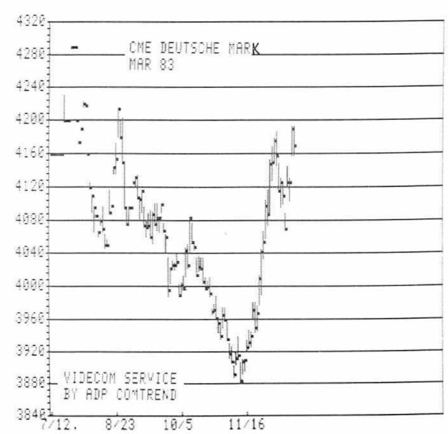


Chart 8

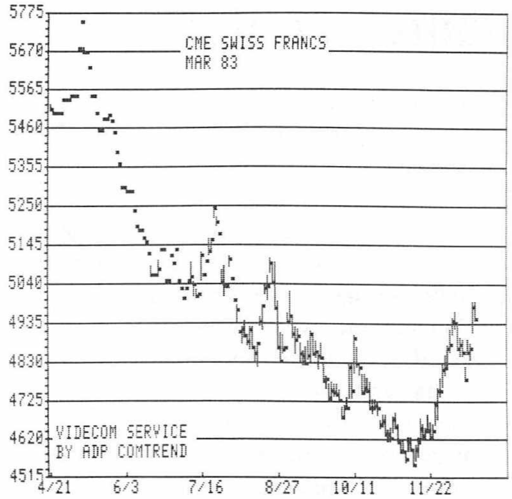


Chart 9

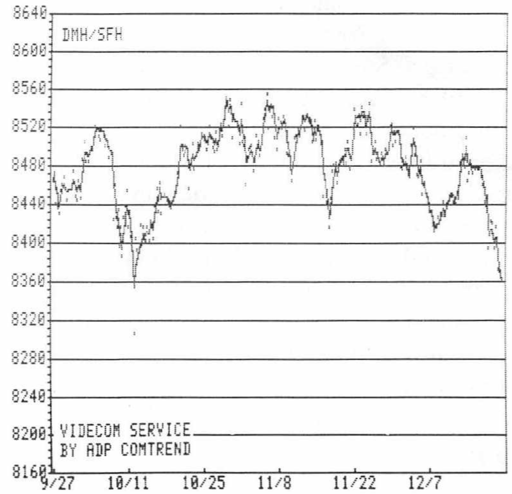
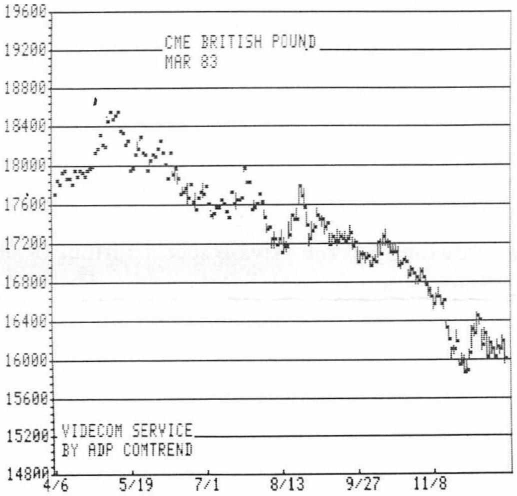


Chart 10



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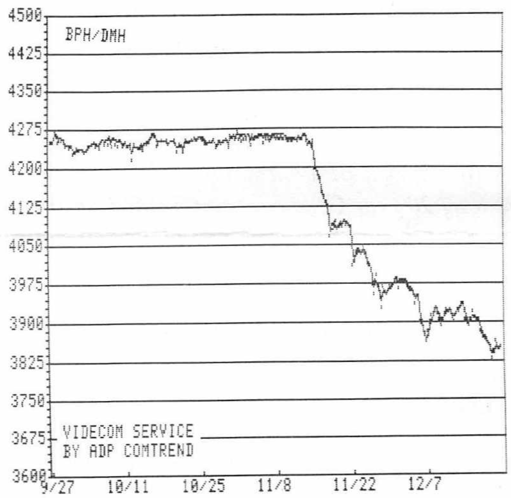

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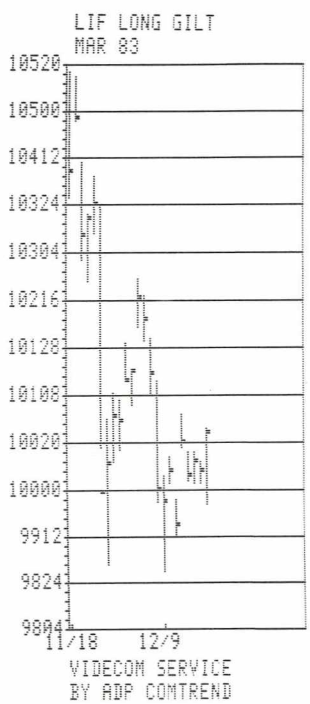

Chart 13

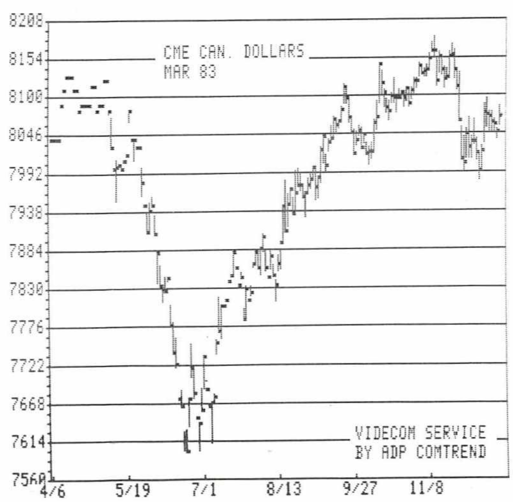

Chart 14

Precious Metals

The initial stirrings of inflation in the US have lifted the precious metals market well above its long-term price equilibrium. Moreover, substantial IMF quota increases now being contemplated will swell the supply of reserve paper by perhaps as much as \$40-\$45 billion, approximately \$40/\$50 per every ounce of gold in central bank coffers, validating part of the June/December rise.

Technically, the market seems to be "chipping" away at the \$450-\$460/oz. resistance level, an area that represented good support through the 1980 and 1981 bear market. It is interesting to note that gold has been unable to close (on a weekly basis) above this level since mid-1981, lending great significance to weekly closes above \$460/oz. By way of comparison, we have reproduced the chart of silver for the 1967-1973 period (Chart 16). The similarities in behavior and formation are remarkable.

Note how throughout the 1968-1971 bear market, the \$1.50-\$1.60/oz. level acted as good support, later to give way to the ultimate lows of \$1.25 recorded in late 1971. In the ensuing recovery, silver stopped "dead" at the \$1.50-\$1.60 level, churning for a number of months and "chipping" away at what had become a formidable resistance level. To the unsophisticated observer, silver "looked" like it could go no higher. When the breakout finally occurred, silver prices accelerated to the top of the descending top formation (\$1.90), reacted to slightly above the breakout, and then launched one of the most extraordinary bull moves in commodity history.

If our technical comparison is valid, a breakout above \$460/oz. (on a weekly closing basis) would take prices to the \$600/oz. area and, eventually, to new highs.

STRATEGY: *Here, too, deflation or disinflation is no longer in the cards. Timid long positions may be taken in gold at present levels. Stops should be placed at 410, basis Spot. In line with our technical comments, we advise becoming aggressive buyers of gold, should it manage to record a Friday close above \$460/oz.*

Chart 15

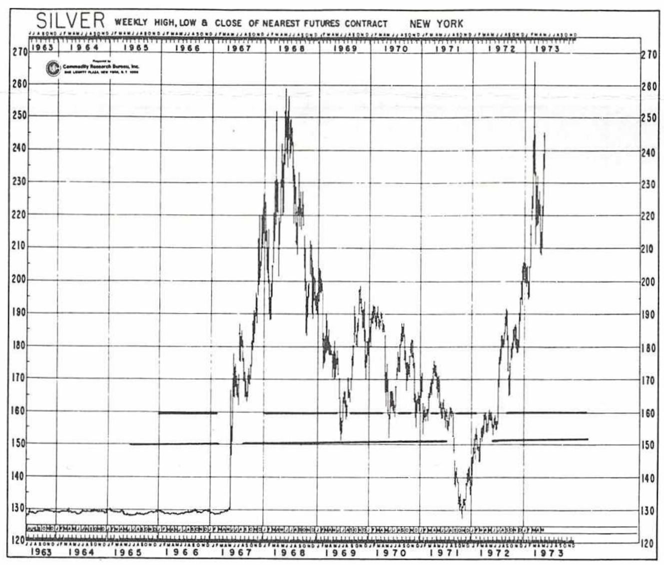

Chart 16

Heating Oil

At this writing, the OPEC ministers are holding a meeting in Vienna, and the outcome is, as yet, unknown. Oil-producing nations have expressed in recent days a willingness to maintain the benchmark price at \$34/barrel, although in practice only Saudi Arabia, Kuwait, and the United Arab Emirates (UAE) have kept their output below their self-imposed quotas and are pledging to continue such a policy.

The two most flagrant violators, Iran and Libya, have insisted on being allocated substantially larger quotas than the ones agreed upon last March. The question of differentials is quite vexing, because it is at the margin where volume is sold, allowing countries such as Nigeria, Libya, and Iran to capture a substantial part of the market away from the Arabian light producers.

With the *significant* exception of war-torn Iraq and Saudi Arabia, most OPEC nations are producing at full, or close to full, capacity in an operational sense. This implies that a substantial price decline in the price of oil would translate into catastrophic reductions in total income for all but Saudi Arabia, to a lesser extent Kuwait and UAE, and Iraq if the war ends on a favorable note. As an example, the Saudis could drop prices to $20/barrel and sell 11 million barrels per day (mbd) (full capacity), generating the same amount of income or slightly more than currently, with 6 mbd being sold at $34/barrel.

This, in effect, is the Saudi *leverage*. Should Saudi sales, however, fall back to 3-4 mbd, as is quite likely by the end of the winter, it would be left with little choice but to cut prices to a level that *could* absorb a tripling of production.

It now appears likely that the Saudis will stay the course, despite flagrant cheating, for three reasons: a) cutting prices at this time will not increase total revenues; b) Iraq is into Saudi Arabia for a very considerable amount of money and cutting oil prices may force Iraq to default — at least as long as production stays below 1 mbd; and c) the world economy, led by the US, may be on the verge of recovery, or so Saudi economists think.

The collapse in oil prices is inevitable — short of a Gulf war. The end of the winter season — April — will be OPEC's most vulnerable moment, as it may leave the Saudis no choice but to cut prices in order to increase total revenues.

STRATEGY: *We are inclined to take profits at these levels and with the proceeds purchase London gas-oil put options, trading around $20/ton for June/July delivery. At a small cost, the put options provide a risk-free (Gulf-war?) play on the inevitable break in prices.*

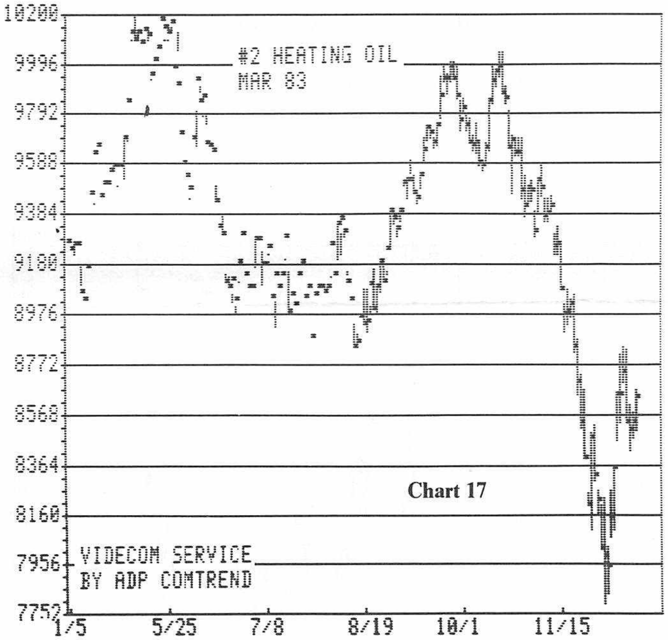

Chart 17

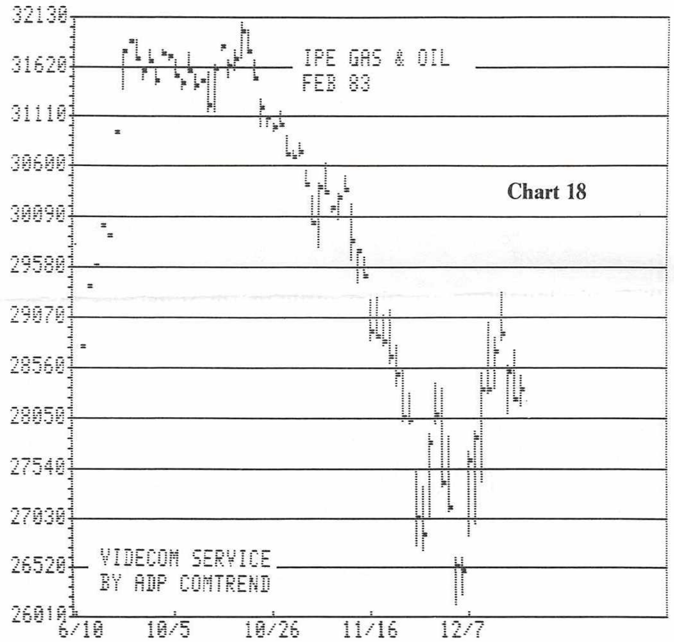

Chart 18

Copper

STRATEGY: *Remain long, risking 59.00, basis Spot.*

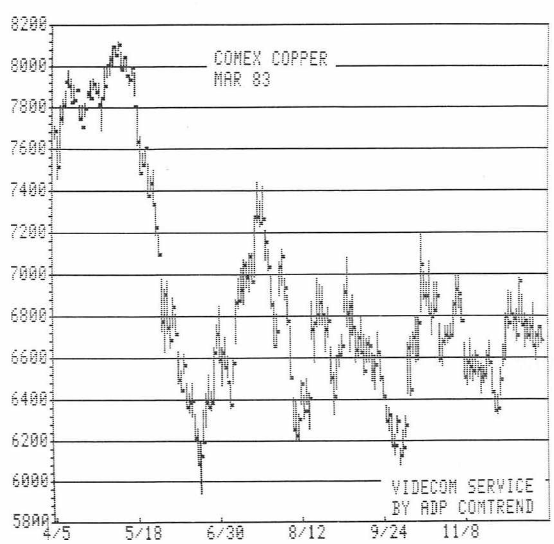

Chart 19

Grains

Two issues dominated the market for grains during the past month. The first was a proposed "payment in-kind" (PIK) program for US crops; the second was the GATT meeting in Geneva during the last week of November. The results of both have bearish implications for grain prices in the near-term (1983 at least), and likely bullish implications in the longer term (past 1983-end).

There are three alternatives for farmers who elect to participate in the US acreage set-aside programs, assuming the PIK program is legislated in time for plantings of 1983 crops:

(1) Participate in the already-announced regular acreage reduction program (15 per cent for wheat; 20 per cent for corn, including 5 per cent paid diversion for wheat and 10 for corn), thus qualifying for regular nine-month loans and reserve loans if the PIK program is not legislated in time for 1983 crops;

(2) Participate in the regular acreage reduction program *plus* withdraw an additional 10 to 30 per cent base acreage from production in return for a certain number of bushels per acre of the crop not produced, to be received from Commodity Credit Corporation (CCC) — owned stocks defaulted through lapsed farmer-owned reserve loans;

(3) If insufficient acreage is set-aside, in the government's eyes, through these programs, farmers who otherwise would choose not to participate in the first programs (1 and 2) could submit bids detailing how many bushels of "in-kind commodity" would be required to get them to participate. The lowest bids (bushels per acre) would be accepted first if additional acreage were to be set-aside by USDA policy. Those whose bids were accepted would be entitled to zero production, to be rewarded with payment-in-kind.

It appears that a farmer must first decide whether to participate in the regular loan program. To qualify, there is a 15 per cent set-aside for wheat; 20 per cent for corn. To decide *not* to participate, then, a farmer's expected price for the cash grain he is to produce and sell must be more than roughly 85 and 80 per cent of the regular loan rate for wheat and corn respectively.

The farmer then has a second decision, which influences his first; i.e., whether to set aside more than the minimum amount of land from production if he decides to participate. This decision must be based on the gross margin he earns on production of the crop, which necessitates a projection of the harvest price for the commodity.

If the farmer's total cost of production divided by this projected price exceeds the percentage of yield that the USDA decides upon for the payment-in-kind program, the farmer should direct additional acreage, up to the maximum 45 per cent for wheat and 50 per cent for corn. He would then receive CCC-owned grain on the basis of that percentage multiplied by the USDA's yield per acre figure.

The result of this complicated process is that farmers will probably choose to divert about 15 to 20 per cent of total acreage of grains from production. This compares with 48.3 per cent of wheat land certified, on which actual harvestings were 80 per cent of base acreage, resulting in an estimated 9.7 per cent drop in base wheat acreage. Compare also with corn certification of 28.8 per cent and actual set-aside of a certified acreage of 24.5 per cent, resulting in an estimated 7.1 per cent drop in base corn acreage.

In April 1982 we estimated the total reduction in respective acreage at 9 per cent for wheat and 5.5 per cent for corn. The problem is that farmers planted more acres than would have been left unplanted without the program, while certifying the required percentage of base acreage; actual harvest acreage fell only 2.4 per cent for both wheat and corn from 1981 levels.

The hitch is that 1982/1983 crop winter wheat, which comprises two-thirds of the US wheat crop, was planted before the program was proposed. Thus, wheat acreage will fall by a smaller percentage in 1983 than corn acreage, relative to 1981 acreage.

Under the PIK program, farmers would not receive loans on PIK grain, but would be required to sell it for cash or use it for feed. If the USDA sets the percentage of yield to be received by farmers diverting an additional 10 to 30 per cent of their acreage from production at say, 65 per cent, then we would estimate that 30 per cent of farmers would choose to divert an average 20 per cent additional land from production. With a base yield of 35 bushels per acre for wheat and 110 bushels for corn, we estimate that if the PIK program is legislated, 125 million bushels of wheat and 350 million bushels of corn will be released from the CCC-owned stocks generated from the farmer-owned reserve.

Compliance in the wheat program may be significantly less, however, because the 1983 winter crop is already planted, which would result in a smaller drawdown of CCC owned stocks. If our forecast of total acreage diverted from production at 15 to 20 per cent proves correct, and assuming yields of 35 bushels per acre for wheat and 110 for corn, total production of wheat may fall by slightly over 400 million bushels to about 2,400 million; corn production may fall roughly 1,250 million bushels to somewhat under 7,100 million.

These levels of production, assuming disappearance in 1983/1984 at the same level as currently forecast for 1982/1983, would result in only negligible reduction of ending stocks. At the same time, more grain would be forced onto the market by a change that will be tantamount to eliminating the three-year reserve loan program if the PIK program is legislated.

The amount of saleable grain will be greater than production. The reserve program currently guarantees a farmer the $4.00 reserve loan rate for 1982 crop wheat, and $2.90 for corn, while the "in-kind" program would be subject to market prices. The US has resorted to a more free-market oriented pricing structure, which in the near-term (until 1983-end) we consider bearish, barring severe crop problems, and bullish in the longer term, owing to a drawdown in currently excessive government-held stocks.

The GATT meeting resulted in no agreements in agricultural trade or any other sector. However, despite the EEC's adamance about US requests to cut subsidization of exports, it appears that there may have been some covert attempt by the EEC to avoid exacerbating the conflict with the US. In fact, the monetary compensatory amount (MCA) for grain export (the EEC subsidies) have been dropping gradually, owing to a combination of rising wheat prices (from the lows several weeks ago) and EEC policy considerations. In addition, EEC authorities are planning a price increase for grain prices paid to farmers of between only 0 and 5 per cent, compared with over 10 per cent in 1981/1982. A trade war, which would have had incredibly bearish implications for grain prices, will probably be averted. However, the trend towards reduced subsidies is slightly bearish for grain prices. The EEC is the US' number one competitor in the wheat export market in terms of current exportable stocks.

Again, the USDA has lowered its forecast of Soviet coarse grain imports relative to wheat imports in 1982/1983, this time to 17 million metric tons (MMT) (19 previously) and 17 MMT (17 previously) for coarse grains and wheat respectively. The total import forecast was reduced commensurately to 35 MMT from 37, including 1.0 MMT of miscellaneous grains and pulses, compared with 1981/1982 Soviet imports of 46 MMT. In the past two weeks the USSR has made its first 1982/1983 purchases of US hard red winter (HRW) wheat, basis Kansas City, amounting to a total of 1.25 MMT. Corn sales to the USSR so far amount to roughly 3.0 MMT. We expect further significant purchases by the USSR to support US wheat prices, with a direct effect on Kansas City prices and an indirect supportive effect on Chicago soft red winter (SRW) wheat prices.

In the USDA's latest supply and demand projections, wheat exports were projected at 1,600 million bushels (1,650 before, and 1,773 in 1981/1982) and corn exports at 2,100 (2,150 before, and 1,967 in 1981/1982). Respective ending stocks projections were raised to 1,511 million bushels and 3,497 million for wheat and corn.

Seasonally, soybean meal demand rises during the winter livestock feeding season. At the same time, the USDA forecast 1982/1983 soybean meal exports at 8,050 million short-term versus 7,850 last month and 6,908 in 1981/1982. Soybean oil exports are forecast at levels in line with 1981/1982 exports of 2,075 million pounds.

Meanwhile, South American fishmeal supplies are threatened owing to a "nïno" off the coast of Peru that may also affect Chile. This phenomenon is a very warm ocean current that occurs once every several years in the locale and that kills anchovies, which are the source of high protein fishmeal. Fishmeal prices in Japan have risen 30 per cent in yen denomination in the past few weeks, partly in response to lower supplies in South America as well as off the Japanese coast.

In a "joint product" market, such as that for soybeans crushed into meal and oil, increasing demand relative to supply for one component (meal in this case) tends to depress the price of the other component because of a forced build-up in the stocks of the second component (oil in this case). Rising prices and lower supplies for fishmeal should direct demand to soybean meal as an alternative in some industries. We therefore recommend buying 1 soybean meal and selling 2 soybean oil as a spread.

STRATEGY: *Retain long wheat/short corn spreads of long 1 March CBT wheat/long 1 March KC wheat and short 3 March corn with stops on one-third of corn positions at $2.60. Also retain any of the above as outright positions. Buy orders recommended last month at $3.40 and $3.30 respectively in March CBT wheat would have been filled following the sharp correction we foresaw. Buy 1 March soybean meal/sell 2 March soybean oil at present levels. The best new outright position to be instated at these levels is long March soybean meal with stops at $160 per short ton and a target of $200.*

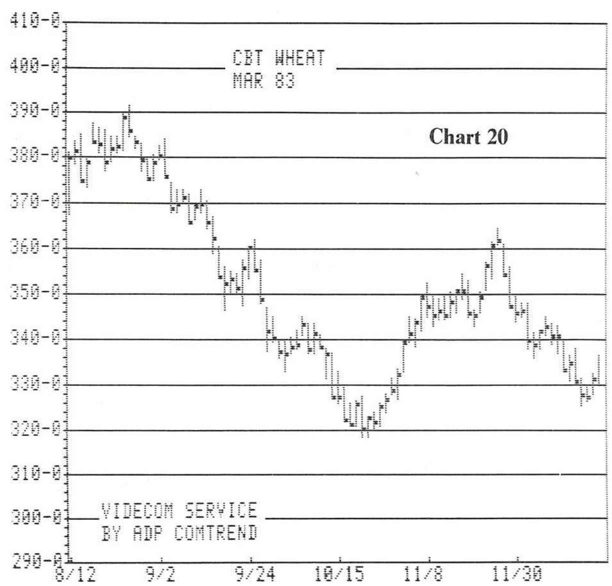

Chart 20

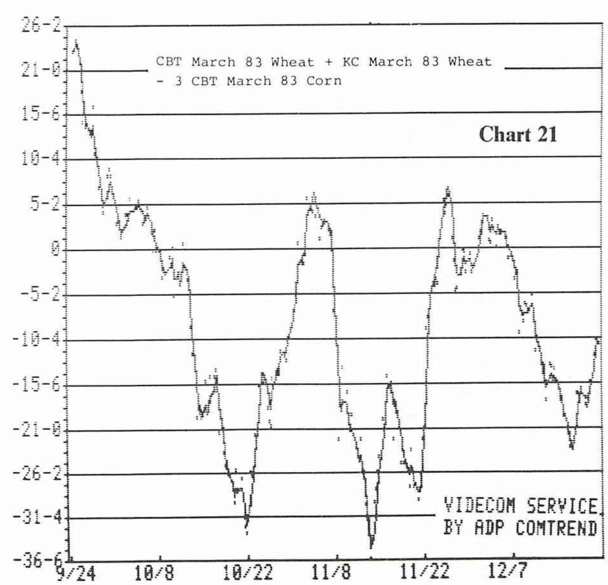

Chart 21

Livestock

Cattle producers continued to place cattle on feedlots in a range of between 10 and 20 per cent above 1981 levels during the final few months of 1982. This has tended to hold live cattle futures in all months in a very moderate downward tending channel, with a recent bias towards lower levels. However, marketings of cattle in November, as reported in the December 14 USDA Cattle and Calves on Feed Report (Chart 24) were much heavier than expected. Seasonally, range-fed ("nonfed") cattle are moved off pastures in the late fall and early winter. It appears that a large number of these nonfed cattle were marketed rather than moved to feed lots. This has resulted in some near-term tightness in live cattle supplies. November cash cattle prices held up remarkably well in view of the heavy marketings.

The USDA expects that the inventory of cattle and calves on January 1, 1983, is likely to be unchanged or down 1 per cent from the 115.7 million head at the beginning of 1982. This would be positive for cattle prices; to add to this positive fundamental, nonfed cattle numbers are very low on a historical basis owing to low feed prices and poor fall pasture this year. As a result, there may be fewer cattle around than expected.

The USDA expects the December 22 quarterly Hog and Pig Report to be bullish, with little increase in building hog inventories; so it appears, does everybody else. The market has been very strong in the past week, particularly in the deferred months, which were trading at relatively large discounts. In Chart 25 we show the early expectations of the hog report in terms of numbers relative to a year ago, with our expectations included. We expect that hog producers, contrary to the consensus, *will* have begun to increase hog breeding levels, and that results of the report will be at least in the upper range, if not above, relative to the expectations. If indeed hog purchases have reversed the trend in production levels, deferred hog prices should fall considerably.

Based on the September hog report, final quarter 1982 hog slaughter was slated to fall between 15 and 20 per cent. Recent slaughter rates appear to have averaged roughly 14 per cent below 1981 levels. This, and limited data on sow slaughter rates, compared with 1981, indicate to us that hog producers have at least begun to retain gilts for breeding, and breed sows rather than slaughter them. This results from very profitable feeding margins for hogs, which currently can be locked in on the futures market by buying corn (as a proxy for feed) and selling hogs in the month they are to be ready for market.

STRATEGY: *Cattle are likely to remain in the trading range established by the moderate downward trending channel. Long positions in April cattle, after taking profits on the short side and going long, were stopped out on December 4 at 56.5¢, stop close only. Aggressive traders could trade April cattle within the range shown in Chart 23, with stops 50 points above or below the range.*

Maintain existing short positions in April hogs established between 54.5¢ and 55.5¢. The target is 48¢ between now and April. Sell October hogs at any levels possible; positions recommended last month would have been stopped out above 49¢ in the past week. Our target for October hogs is 40¢. Please keep in close contact following the December 22 hog report, as these positions are highly sensitive to the results of the report.

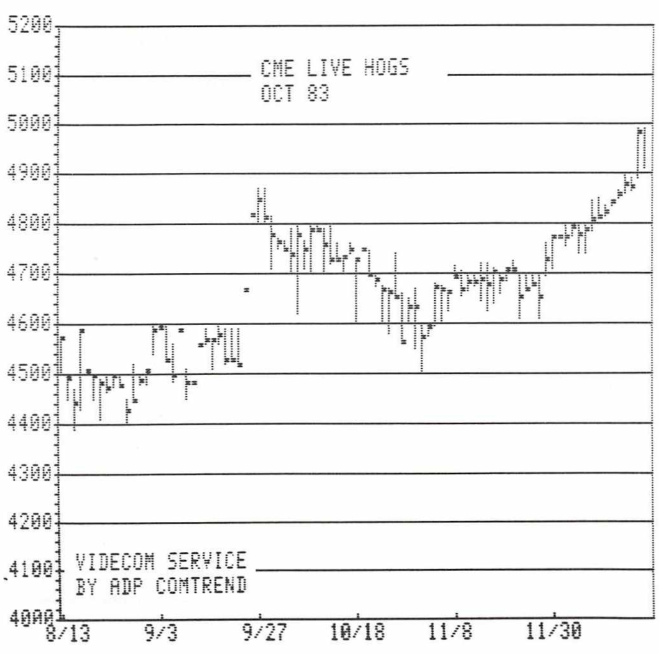

Chart 22

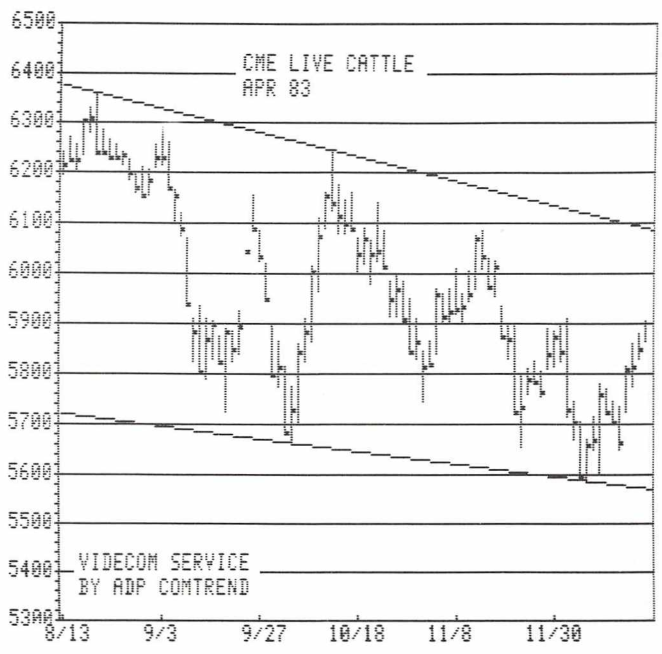

Chart 23

December 14 USDA seven-state cattle and calves on feed report.

(thousand head)	1982	1981	1982/1981 %	expected
on feed-Nov.1	8,123	7,113	114.2	
placements-Nov.	1,785	1,617	110.4	110.6
marketings-Nov.	1,485	1,295	114.7	107.3
other disappearance	119	107	111.2	
on feed-Dec.1	8,304	7,328	113.3	113.8

Source: U.S.D.A.

Chart 24

Early expectations of December 22 USDA hog and pig report.

	1982/1981 %	Friedberg's
all hogs on farms	86-95	95
market hogs (within 2-3 months)	86-96	96
breeding inventory	91-95	97

Chart 25

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