

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS



Hume Publishing Company

Volume 4, No. 1 January 16, 1983

1982 in Review

*Hope springs eternal from the human breast
Man never is but to be blessed*

— Alexander Pope

Commodity and currency futures — like all varieties of things anticipated — ultimately become, for good or otherwise, commodity and currency presents. Alas, they then immediately become commodity and currency pasts.

Did the deliveries that expired last year requite our anticipations, our hopes? We have two yardsticks by which to judge: First and foremost we have, as traders, our ledger balances and our total equities to attest, most eloquently, to our success or the lack of it. But we fancy ourselves analysts as well as traders. And to review performance strictly from that point of view we have only what we've written over the past 12 months in these *Comments* to look back upon. What follows, then, is our own mini self-review applied, we hope, with only a touch less objectivity we applied to the markets themselves.

Best Recommendation of the Year

The Mexican Peso. (February 15) "Add to previously established short positions . . . The pressure for a maxi-devaluation will become irresistible." Three days later, on February 18, the peso was devalued by 30 per cent. A week later the Mexican unit was allowed to depreciate a further 11 per cent. Total profit: \$20,000 per contract.

Second Best Recommendation

The Mexican Peso. In our first opportunity to discuss the peso after the major devaluations of February, we began, "Mexico's problems are only beginning," and ended, ". . . Once more, opportunity knocks on the door . . . Remain firmly short . . . March '83 should trade down to .009, or 111 pesos to the dollar." This extremely bearish point-of-view was maintained through to our August 2 issue. In mid-August the second maxi-devaluation of the year occurred. We covered our short positions as recommended in our issue of August 22nd, true to our prophecy, at rates in excess of 111 pesos to the dollar. As if the predictions and profits weren't enough, we actually bought the lows.

Worst Advice

Most irritating obdurate, money-losing, opportunity-losing, and generally worst advice of the year: **Bearish on interest rate futures.** Beginning in our January 17 issue and lasting, with only an embarrassed pause here and there, throughout the year, we kept looking vainly to the short side of T-bills and T-bond futures. In January, March bills were trading at 87.50 to yield 12.5 per cent, and March bonds were offered at 60.00. In the ensuing 12 months both instruments staged the biggest bull market advances in their history. The man of common sense deduced that in an economy suffering as badly as ours was, if interest rates did not fall, the social fabric as he knew it would cease to exist. He bought the

In This Issue

The Year 1982 in Review: Some big winners, some embarrassing losers . . .

Precious Metals: Up and away . . .

Sterling: Having reached our first target of \$1.56, we now look to \$1 . . .

Copper: A solid breakout with a big following . . .

Heating Oil: The moment of truth . . .

Grains: A firmer tone . . .

Cocoa: A nascent bull market . . .

Contributors

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instruments and was rewarded amply. We, on the other hand, being analysts of a highly sophisticated persuasion, preferred to examine the subtleties and minutiae of monetary data as though suffering from myopia. January 17: "In this environment, interest rates must surely rise." May 16 (after we had thankfully been stopped out of short positions): "One cannot be impressed with the bearish case . . . Reinstate short sales." June 20: "Short of a decisive and well-advertised move to reflate . . . interest rates . . . may even spike to new highs." Fittingly, in our last issue of 1982 we advised being short the bonds and were stopped out within a week. Enough. And more than enough.

Accordion of the Year Award It Ended on a Sour Note

The T-bill/Eurodollar spread. First advised in August 2, this idea seemed the very essence of logic. A banking crisis was looming — and it hadn't yet become the stuff that makes the cover of *Time* — and as a result, depositors would alter existing portfolios in favor of safety. Yields on Eurodollar CDs would have to widen relative to government paper to compensate. And at first, they did. Originally recommended at 230 points, Euros premium, the spread widened to as much as 375 points in the cash market. Alas, bankers and politicians succeeded — so far — in papering over the crisis. The spread ended 1982 at about 165 points. No, we did not get out with a profit. To be honest, we made matters even worse than they had to be by, in November, recommending substituting the T-bill side of the trade with 40 per cent T-bonds. Interest rate futures again.

Third Best Recommendation

Short the British pound. (January 17) "Given Sterling's high real rate of exchange . . . Sterling must head lower." At the time, the pound was trading at 189.20, basis December '82. February 15: "It is quite possible that sometime during 1982, Sterling will test its all-time low of US \$1.56. It fell to as low as 158.30 in December.

Most Audacious Call of the Year

" . . . we are approaching a low (in copper prices) that will not be seen again during our lifetime." Inasmuch as the author of this little piece of crystal ball-gazing still lives, and copper values have not punctured the lows recorded in the weekly reversal forecast, we are still audaciously accurate. Less importantly, we have been modestly bullish since these remarks were made in June.

Most Embarrassing Forecast

Most embarrassingly-phrased and ill-timed forecast of the year: "We believe that the mystery buyer (of tin) has in fact been able to "corner" this market . . . and expect prices to maintain a very firm tone in weeks ahead. Buyers of three month call options as suggested last month should relax and enjoy the ride." The ride was smooth and straight . . . down. Two weeks after this gem was published in our February issue the mystery buyer turned mystery seller. The mystery was never uncovered. The premiums paid for our call options were never recovered.

Most Poorly-Timed Headline

"Why the US Dollar Still Reigns Supreme." Six weeks after this appeared atop our September 12 issue, major bottoms were made by the Japanese yen, Swiss franc and Deutsche mark. Still, to be fair — for we have been perhaps unduly harsh on ourselves — we had advised the short side of these currencies with but brief apostrophes throughout all of 1982. Those who heeded advice on currency futures all year enjoyed enormous profits. Until the turn in November, the yen, D-Mark and Swiss franc fell by 22, 14.9 and 11.5 per cent respectively. Not to be forgotten was the recommendation to be long Swiss against short the mark. The trade, as indicated, was, is, and will continue to be profitable.

Great Call, No Cigar

In our August 2 issue we admitted without even a trace of pride that all the conditions prescribed in our *Comments* of the previous month determining the end to the two-and-a-half year bear market in precious metals had been fulfilled. The markets had managed weekly upside reversals, had bettered their previous rally peaks, and had advanced by more than 10 per cent off their bottoms. Our conclusion: "Stand aside until the (gold) market crosses 370.00." We more or less adopted this cavalier, "let's watch it" attitude until December when we finally were specific in our advice to be long gold if the market closed above 460.00, basis spot on a Friday. It did — some \$125 per ounce higher than we could have bought it when we first called the turn five months earlier.

Good Advice, Good Cigar

In August, we advised covering short positions in precious metals recommended throughout the year at tremendous profits. Gold had fallen by 14 per cent since the first *Comments* of 1982.

Much Ado About Something

To end as we began, on a literary note, this award goes to the market that was discussed at greatest length, described with the most hyperbole, and forecast with the greatest conviction — heating oil. Of course, we presume readers are by now sufficiently inundated with our views, so that neither a summary of them nor the market's broad movements are warranted. Suffice it to say that ultimately our views were vindicated. Could this be said about our analysis as a whole?

What We Learned

1982 could be characterized, from our point-of-view, as a radical year. Not in recent memory have we been so very right, as in the cases of the peso and the pound, and so very wrong, as in the case of interest rate futures. 1982 also marked, incidentally, the 13th anniversary of the publication

of the Friedberg newsletter; originally called *Commodity Comments* and amended to *Commodity & Currency Comments* in June 1978. Over the preceding 13 years we developed a certain style, consciously or otherwise, of examining futures markets: Rather sophisticated at times, occasionally complex, we've always set out to be honest and original. That this style has proven itself successful allows us to be audacious and make a prediction like we made in copper, or to stick with a position like heating oil, confident, even as the market trends against us, that ultimately we'll be proven correct. But at the same time that style may be responsible for remaining obdurately short interest rate futures. Could it be that in 1982 we forgot some of the basics: to respect a trend, to incorporate common sense, to be bold but at the same time prudent? There is a basic adage in commodity trading that says the trader should cut his losses quickly and let his profits run. If the purpose of this review is in any way critical, what we've learned — relearned, actually — is that adage as applied to analysis. That said, we should all look forward to 1983 with confidence.

What's Up, Doc . . . ?

Commodity and stock prices have continued to recover and stand well off their mid-year lows despite only the barest evidence of a recovery in industrial production. The US dollar began to weaken considerably around mid-November and has since fallen rather spectacularly despite little or no evidence that the Fed was priming the pump. Gold prices penetrated their \$460/oz. lid rather convincingly (*Comments*, December 1982) and are now gearing up to challenge the \$500 level — a far cry from the under-\$300/oz. lows registered in June 1982.

What is going on? We must confess that last month, in a moment of exuberance, we admitted having seen signs of reflation. After all, the foreign exchange markets are highly sensitive to changes in monetary growth and they may have signalled what statistics would perhaps confirm only a few weeks later.

Here we are, a full eight weeks later, and we find no traces of reflation, let alone aggressive ease. Let's review the "numbers": the rate of growth of the adjusted Federal Reserve Credit (basically open market and discount window operations) using three-month comparison bottomed at a very low 3.3 per cent annual rate in September 1982 and improved almost steadily to a December reading of 7.7 per cent. Hardly worth writing home about when you consider that during *all of 1982*, Fed credit grew at a 7.7 per cent annual rate.

In the last post-war depression — the 1974-1975 episode — commodity prices bottomed out in the first quarter of 1975, after Fed credit grew at a very rapid and uninterrupted pace throughout 1974. In other words, reflation preceded the bottom in commodity prices by six to 12 months. Even more important-

ly, industrial production recovered dramatically from a near vertical fall, *coincidentally* with the bottom of commodity prices. Neither of these two conditions has been present in the recent upsurge of commodity prices. It is all the more surprising in view of the Fed's freedom to reflate, especially since it abandoned targetting M1, the narrow money supply.

Again, *what is going on?* Expectations, the perceptions of what the facts are or will be — rather than the actual facts — rule markets. In the August to November stretch, it became clear to market participants that world central banks, particularly the US Federal Reserve, would not allow a foreign international debt crisis to affect its lenders, the commercial banks. Acting firmly, resolutely, and with uncharacteristic speed, the Fed, the Bank of England, the BIS, and the IMF moved to bridge and then coordinate a rescue operation for Mexico, Brazil, and Yugoslavia.

Obviously, reflation is on the way. Why? Because the markets *don't believe* that any of these countries, as well as Poland, Romania, Ecuador, Peru, Venezuela, Indonesia, Nigeria, Cuba, and Zambia will ever be able to pay *even the full interest*. And they are probably right. With some exceptions, international debt repudiation will lead to the destruction of a significant portion of Western banks' assets, *the counterpart of money*.

Reckless lending, then, has impaired the value of money. Money has become worth less, not because its quantity has increased (which, as we have seen, it has not, in any major way) but because its quality has been diminished. Parallels can be found in the ancient world of metallic coinage: When a king debased the pure silver coin, the citizens of his empire required a larger amount of these coins (although almost the

same amount of precious metals) to purchase goods. In a nonmetallic money system, where money has no intrinsic value, the citizen fears that the "debasement" will be made up by the state's increasing the quantity of money. Bad money forces the creation of more money. More money makes each unit of money less valuable.

If, on the other hand, the state does not make up the deficiency and allows its depositors to suffer indeterminate losses, then its more sophisticated citizens will attempt to pass on these bank deposits as soon as they can to the unwary in exchange for real goods or foreign monies that are not as likely to be tampered with. In effect, this increases velocity of circulation.

Under either scenario, prices of real goods rise vis à vis "bad" money. Commodities are real goods. Common stocks represent claims on real goods. Some currencies belong to relatively healthier banking systems whose assets have not, as yet, come under suspicion; they therefore float upwards vis à vis currencies that belong to overextended banking systems.

The demonic nature of fiat money systems has come to the fore. It is not enough for governments to behave responsibly and avoid the temptations of self-finance as might be the

case in the US where the central bank monetizes only an insignificant amount of its fiscal deficit. It must also contend with the folly and greed of its private bankers who, in the reckless pursuit of profit, commit the ultimate sin of becoming insolvent.

It remains for us to prove that, indeed, none of the large "reschedulers" could possibly pay all the interest, let alone principal. In the absence of space, we will devote our attention to the analysis of the most dramatic case of international default: Mexico. Should we be successful at proving this point, we will begin to understand the wisdom of the recent flight from currency (see Chart 1).

We can see that on relatively conservative assumptions Mexico's debt load is unmanageable. During 1984, assuming that oil prices break to at least \$20/barrel (on OPEC basis) and an average of \$15/barrel for Mexican oil exports while LIBOR rates recover to just 13 per cent, Mexico will default on approximately \$8 billion of interest payments, let alone not having made any principal payments.

The commodity and currency markets are reacting to the abysmal decline in the quality of money. Should we blame the public . . . ?

MEXICO: Projected Balance of Payments 1983-1984

	1983	1984
Export of Good & Services of which Oil	26.0 11.3 ⁽¹⁾	26.4 ⁽⁴⁾ 9.9 ⁽¹⁾
Imports of Goods and Services	18.0 ⁽²⁾	19.8 ⁽⁵⁾
Trade Balance	8.0	6.6
Interest on External Debt	13.0 ⁽³⁾	16.8 ⁽⁶⁾
Current Account Deficit	(5.0)	(10.2)
New Loan Extensions	4.5	0.0
IMF, BIS, etc.	1.8	2.0
Increase in Reserves or Deficiency	1.3	(8.2) ⁽⁷⁾
Total International Debt (end of Year)	105	n.a.

- (1) Assumes 1.55 mb/d at average of \$20 barrel, quite conservative when considering our bearish views for 1983 & 1.8 mb/d and \$15/barrel for 1984.
- (2) Assumes imports of merchandise down to 1979 levels and off 50% from 1981 levels.
- (3) Assumes LIBOR of 10% plus 3% of spreads and fees on total \$100 billion debt.
- (4)(5) Assumes 10% increase in non-oil exports and imports
- (6) Assumes LIBOR of 13% plus 3% fees
- (7) Unable to pay interest unless new credits extended.

Chart 1

Currencies

British Pound

Hopes for price stability are being shattered in the UK as Sterling continues to slump. During December, manufacturers' wholesale prices increased by 1 per cent, the largest rise in 11 months, taking the annual rate of increase to 8 per cent from 7.4 per cent in November, the first such annual increase since July.

Index-linked Gilts have moved to substantial premiums over par, while fixed-rate Gilts have dropped to the lowest levels in months after recording 18-year highs in November 1982. Inflation fever is raging again despite the fact that the UK continues to slide into the longest and deepest depression since the 30s. So much for the excess capacity, no inflation myth and the Philips curve trade-off! Rest of the world: Take note.

The lurch to currency depreciation and inflation as the prescription for depression was foreseen in the *Comments* many months ago (February 8, 1981, May 3, 1981: "... since tax policy is inordinately restrictive, its only weapon is low rates and lower Sterling," July 26, 1981: "... only substantially lower interest rates and the present Sterling depreciation can provide a quick fix to the UK's depression." August 31, 1981 and throughout 1982). Recent figures reveal that corporate liquidity in the UK took a sharp turn for the worse in II Q82 after some progressive improvement from the lows reached III Q80. The illiquidity albatross forces excessive credit expansion, which in turn forces the Bank to keep interest rates too low. Oil and the deteriorating terms of trade will finish off the job.

STRATEGY: One of the best trades of the year: Short Sterling with impunity. Look for the ridiculously low target of \$1 — 1£ by year end 1983.

As we advised last month, long DM or SF positions against the short Sterling will hedge out the US dollar exposure. This strategy has been extremely successful: Not only has Sterling depreciated but the DM and SF have appreciated against the dollar (see charts).

If you're stopped out of the short position in the 20-year Gilts contracts, reinstate at present levels; we still look to cover them at 87.

Deutsche Mark & Swiss Franc

STRATEGY: Remain long; protect profits by raising stops to 42.00 and 50.00 basis close of March '83 DM and March '83 SF respectively. Also, retain the long 4 SF/short 5 DM spread as the SF continues to strengthen.

Yen

STRATEGY: Remain sidelined.

Canadian Dollar

For the Canadian monetary authorities, 1982 represents a milestone. Indeed, the adjusted monetary base stands 2.3 per cent lower at the end of 1982 than at the end of 1981 — the first such drop in recent memory. This compares with increases of 8.4 per cent in 1981-1980 and 5.7 per cent in 1980-1979 — not an insignificant feat in a year that saw a record public sector borrowing requirement.

Undoubtedly, the most severe depression in 50 years produced a collapse in private sector credit demands and facilitated the enormous collection of genuine savings. What will the Bank of Canada do in 1983 as the economy recovers somewhat and Ottawa looks for \$30 billion, not just \$18-\$20 billion? Having abandoned M1, it remains to be seen whether the Bank adopts a new control variable such as the adjusted monetary base, the rate of exchange, or a very broad aggregate, like M2 or M3.

We are at a loss to understand why the Canadian dollar firmed rather unexpectedly towards the last days of December and early January, although we believe that it is more a matter of weakness in the US dollar than strength in the Canadian dollar.

STRATEGY: Remain short, risking a close above 82.20, basis March '83.

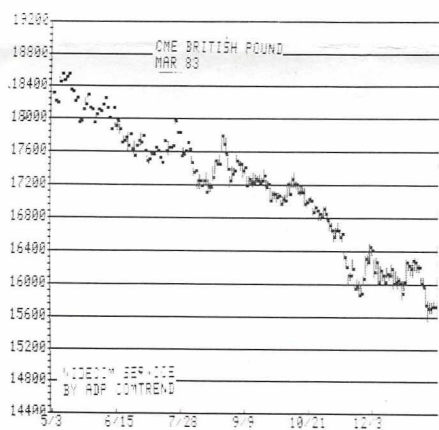


Chart 2

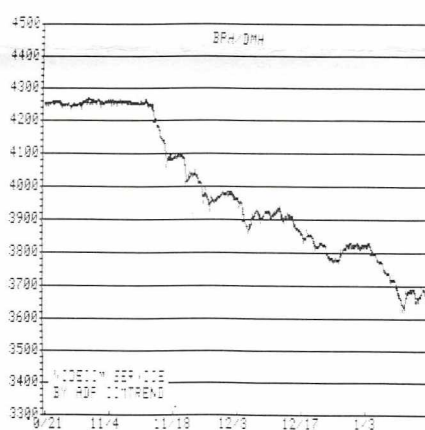


Chart 3

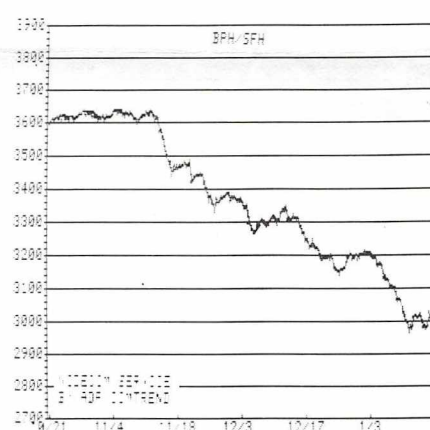


Chart 4

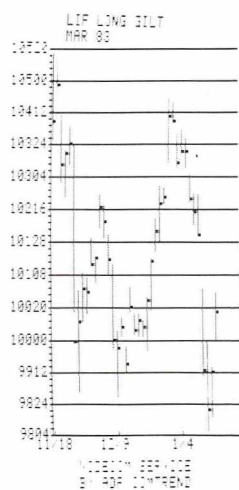


Chart 5

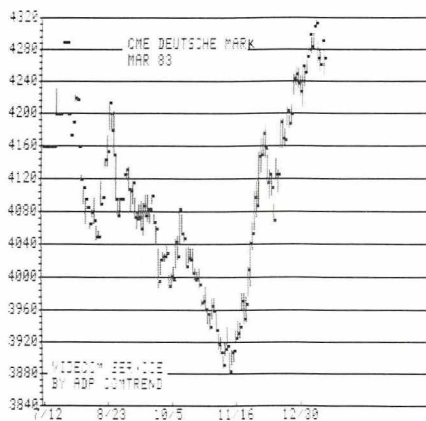


Chart 6

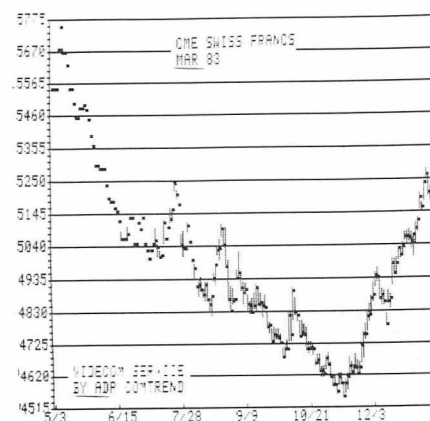
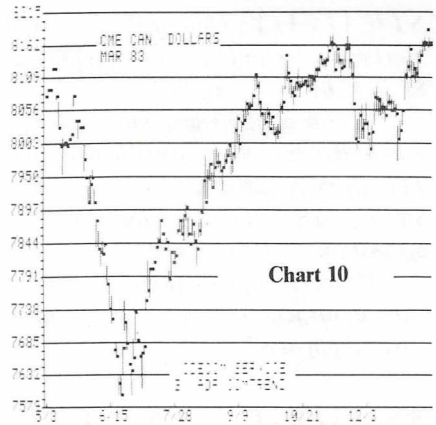
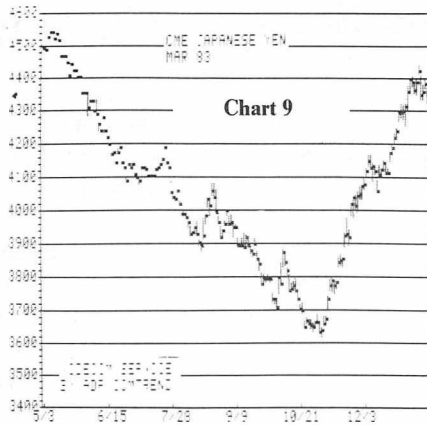
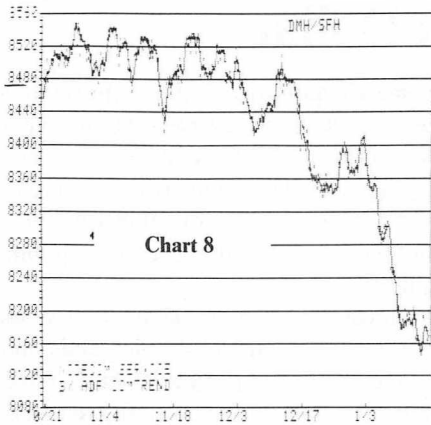


Chart 7



Precious Metals

The bullish consensus has become intolerably high, making a substantial correction inevitable. The question that remains is, from which level? Nevertheless, as argued last month, the trend has turned up rather decisively, and at some point in the next few weeks and months, gold should trade above \$600/oz., a normal and "readable" technical objective.

Interestingly, gold prices, expressed in Swiss francs, have finally been able to confirm an uptrend (see chart) lending strength to the argument that the move in bullion is a flight

from all currency, not just the US dollar.

STRATEGY: Although we are sympathetic to silver, platinum, and palladium, we remain nonetheless more secure in our long gold position. It possesses more "monetary" attributes, it is more liquid, and it is not likely to be derailed by a single source of supply.

Add to long positions, but only on good-sized reactions. Place protective stops at 434.00, basis February '83, close only.

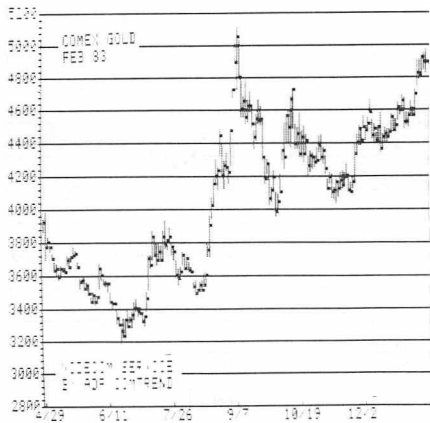


Chart 11

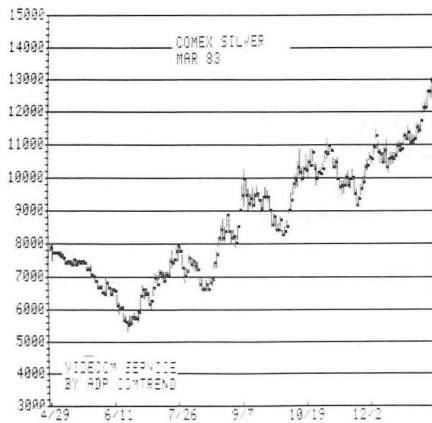


Chart 12

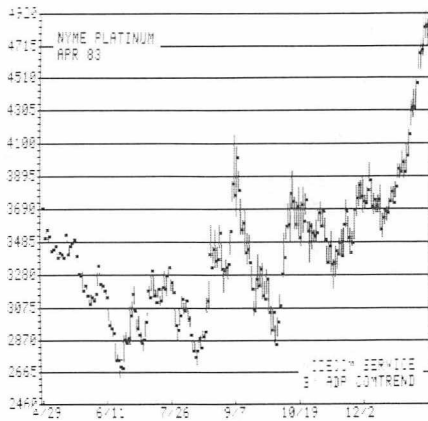


Chart 13

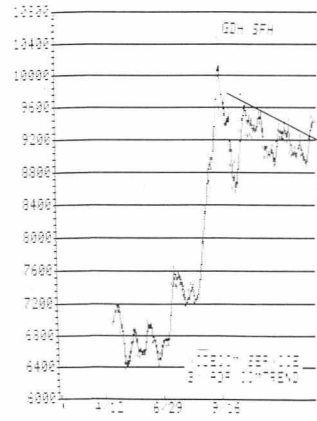


Chart 14

Copper

Technical indicators are split dramatically: On the one hand, copper prices have broken out on the upside of a seven-month long base with prices clearing decisively the high point of the base, the July 1982 highs; on the other hand, the open interest has exploded over 25,000 contracts since mid-December, the date of the market's initial thrust, indicating an enormous *speculative* following. Supporting the "unreal" nature of the advance is the bullish consensus opinion of professional writers, which has exceeded 85 per cent, a highly vulnerable level to contrarians. Finally, the switches have failed to narrow, once again demonstrating that trade demand for copper remains soft. To confuse the issue even further, scrap cash copper Number 2 has been *uptrending* ever since the June lows; in speculative markets, futures tend to outperform scrap prices, not vice versa as now.

How are we to resolve this dilemma? It is fairly obvious that the flight from money has a lot more to do with copper at

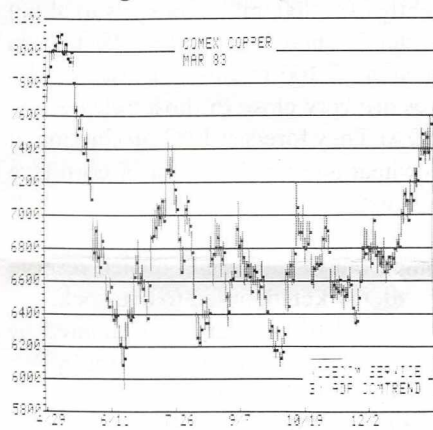


Chart 15

the present time than industrial demand for copper. If the value of money were to be cut in half, copper prices would have to double *regardless* of industrial demand. Therefore, since we are not able to estimate the real drop of the value of money except by looking at commodity prices themselves, we will have to take for granted that (a) it is happening, (b) it will be overdone from time to time (as no one is able to estimate exactly the loss by "debasement"), (c) it can only end when a resolution of the money problem is achieved, if ever, or (d) it can be quantified and a new equilibrium reached.

STRATEGY: *In line with (b) above, we believe that the advance has gotten ahead of itself if only because of our expectational indicators (high open interest and high bullish consensus). Nevertheless, we would rather be with it than without it.*

Traders (we emphasize traders) could take partial profits on 33 per cent of their long positions, to be reinstated on setbacks. Investors are advised to stay long.

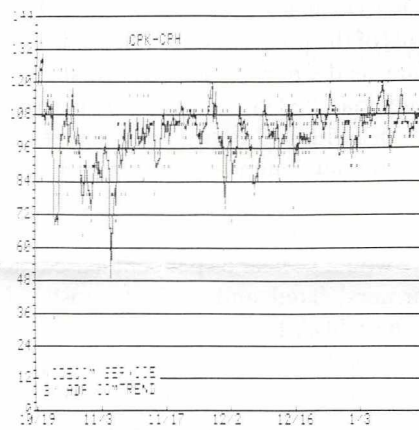


Chart 16

Heating Oil

Last month we suggested that the Saudis may be as indifferent to selling 6 mbd (million barrels per day) at \$34/barrel as they are to selling 10.5-11.0 mbd (that is, full capacity) at \$20/barrel — except that it would carry the implicit recognition that prices would no longer rise, at least for many years to come.

In the interim, it has become clear that Saudi Arabia is only selling slightly above 5 mbd, in effect accommodating the recent increases of Iran, Libya, and Venezuela. With the Iranians threatening to go to 3.2 mbd and every other OPEC nation sneaking into full production ranges, Saudi Arabia finds itself at the edge of losing its market share entirely by this spring. Furthermore, the Saudis realize that by cutting back unilaterally, they are in effect financing Iran and allowing it to prolong its war with Iraq indefinitely.

Losses of up to \$4/barrel have prompted the Aramco Group to press for Saudi discounts or production cutbacks. Discounts make little if any sense at this juncture, as other market participants are likely to undersell the new, lower price. Production cutback from these levels, on the other hand, would be suicidal. And so, short of a near-unanimous

agreement to cut back production to 18-18.5 mbd for the duration of the winter and less than 15 mbd for the spring, the Saudis may have to resort to a substantial price cut. This will enable them to regain lost market share while threatening the cheaters in OPEC with financial destruction unless they fall into line.

The long decline in prices is at hand. We still believe that oil prices will slump to the \$20/barrel level by the end of the first quarter of 1983 and to as low as \$8-\$10/barrel by the end of the year.

STRATEGY: *Last month we advised covering short positions in heating oil with substantial profits and purchasing put options in London Gasoil — a limited-loss bear market play. The limited-loss feature of the put option gives us protection in the eventuality of an Iranian offensive across the Straits of Hormuz — an extremely slim but ever-present possibility in the volatile Middle East — undertaken to punish the Gulf States for their support of Iraq or their oil policies.*

If you're unable to purchase puts, sell May or June '83 heating oil at market.

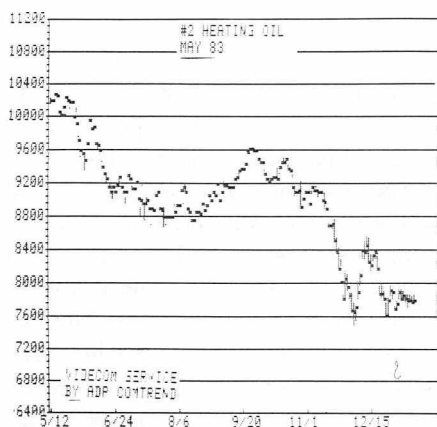


Chart 17

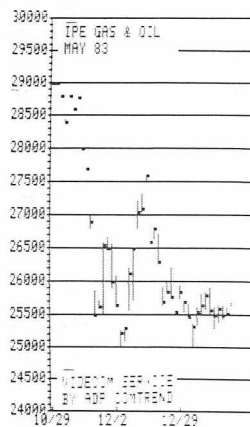


Chart 18

Grains

Last month we discussed the possible effects of the payment-in-kind (PIK) program for wheat and corn farmers in the US. On January 11 the details of the program were released. The main factor in question was the percentage of normal crop yield in a farmer's county that the USDA would pay in grain to a farmer who diverts an additional 10 to 30 per cent of his acreage over and above the minimum required 15 per cent level for wheat and 20 per cent for corn (including 5 per cent paid diversion for wheat and 10 per cent for corn). We supposed that the figure would be near 65 per cent, based on our perception of farmers' fixed and variable costs of production. However, the USDA has chosen to pay 95 per cent of normal yield for winter wheat "in kind" (which comprises 2/3 of US production) and 80 per cent for corn and other eligible crops. *This is very attractive to US farmers.* The extra 15 per cent grain payment for winter wheat to farmers will offset the already incurred expenses of grain planted in fall 1982.

As of January 5, farmers had enrolled 24.4 million acres of wheat (26.9 per cent of base acreage) and 21.4 million of feed grains, including corn (26.4 per cent of base) in the 15 per cent wheat and 20 per cent corn acreage reduction program. While this land still must be certified later in the growing season, the trend is towards a high level of compliance. A Pioneer Company survey of corn farmers in seven Mid-Western states in November showed that 62 per cent of them were planning to participate in the *regular* acreage set aside program, 20 per cent were not planning to take part, and 18 per cent were undecided. Meanwhile, a top USDA official, Dawson Ahalt, believes that about 40 per cent of US corn farmers will participate in the PIK program, which, of course, necessitates compliance in the regular program too.

We would agree with the consensus that *the bidding process for taking entire farms out of production could be a bureaucratic nightmare*, along with the difficulties inherent in distributing grain efficiently to participating producers. Some of our readers may, in fact, have had nightmares trying to decipher the complicated process outlined in the *Grains* section of last month's *Comments*.

We came to the conclusion that "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" in last month's analysis. Our estimates are very close to those released on January 11 by the USDA: They forecast 1983 production at 2,380 million bushels wheat and 6,876 million of corn (see Chart 19). The USDA estimates that 210 million bushels wheat and 360 million of corn will be "paid-in-kind"; that is, this grain will be brought out of the farmer-owned reserve and must be either stored, marketed, or fed to livestock.

As Chart 19 shows, the PIK program, as estimated by the USDA, should reduce 1983 production of wheat by 265 million bushels, and corn by 783 million. Because the amount forced onto the market by the PIK program is smaller than the amount that would otherwise have been produced, we view the program as being bullish in the longer term. However, the fact that this grain may come to the market all at once produces a situation that may be bearish in the post-harvest season (when five months of paid storage by the USDA run out) and that may weaken the basis (farm price minus futures price) substantially. Clearly, the effect of the PIK program depends on farmers' participation rates.

A number of other factors came to pass since our last *Comments*.

(1) The EEC agreed to raise grain prices paid to farmers by only 4.4 per cent, alleviating to some degree severe tensions with the US over subsidies and possibly helping to avoid a farm trade war, which would send dairy product and grain prices plummeting (particularly wheat, which, owing to lost market share, is raising the ire of the US more than other crops).

(2) The USDA raised its final preliminary estimate of 1982 corn production by 0.8 per cent to 8,397 million bushels from 8,330 estimated before and versus 8,202 in 1981 (see Chart 20).

(3) For the third time since we pointed out in October that Soviet wheat import estimates should be raised relative to coarse grain import projections (at that time, the USDA

estimated Soviet imports at 16 MMT (million metric tons) of wheat and 23 MMT of coarse grains), USDA estimates have risen. Soviet imports are now estimated at 19 MMT of wheat and 16 MMT of coarse grains.

(4) 1982-1983 export sales to the USSR are currently at 2.9 MMT of US wheat as of January 6 and 3.05 MMT of US corn.

(5) This winter's heavy rainfall and mild weather has been detrimental to portions of the winter wheat crop, but prospects for corn and soybean production have conversely been improved by added subsoil moisture.

(6) Argentina's wheat crop in 1983, soon to be harvested, is estimated at a record 14.5 MMT, up from the earlier estimate of 13.65, and as compared with last year's output of 8.1 MMT. About 9 MMT of the 1982-1983 wheat crop will be available for export, compared with 3.8 in 1981-1982. Of this exportable surplus in 1982-1983, 5.5 MMT have already been sold. The 5.2 MMT increase in available Argentine exportable wheat is offset, though, by a drop of about 8 MMT in the available Australian exportable surplus from 14 MMT to 16 MMT.

(7) Winter wheat plantings as estimated by the USDA on

December 22 were 3.3 million acres (5.1 per cent) below 1981-1982 levels, compared with expectations of a drop of only 1.8 to 2.3 million acres from 87.2 million acres in 1981-1982.

STRATEGY: Retain long wheat/short corn spreads, but cover 1 short position in corn and remain long 1 March CBT wheat, long 1 March KC wheat, and short 2 March corn. Farmer reluctance to sell corn at farm prices below 2.30 is strongly supporting the market; someday, farmers will have to sell this corn, however, rather than storing it for eternity.

We recommend selling corn outright if it reaches 2.70, basis March, with stops on a close above 2.82, and a target of 2.40.

Long positions in CBT or KC wheat are still highly satisfactory.

Maintain long 1 March soybean meal/short 2 March soybean oil spread, with stops on one-half the short positions in soybean oil on a close above 17.20. Raise stops on long positions in March soybean meal to 176 from 160, with a target of \$200 per ton.

USDA ESTIMATED EFFECTS OF PAYMENT-IN-KIND PROGRAM

		With program 1983/84	Without program 1983/84	1982/83	IMPACT OF PROGRAM		
					Absolute vs. without PIK program	absolute vs. 1982	Percent
Wheat	acreaage	65.6	75.5	78.8	-9.9	-13.2	-16.8
	production	2380	2645	2809	-265	-429	-15.3
	ending stocks	1506	1771	1509	-265	-3	-0.2
	farmer-owned reserve	765	1310	975	-545	-210	-21.5
Corn	acreaage	60.0	69.0	72.8	-9.0	-12.8	-17.6
	production	6876	7659	8330	-783	-1454	-17.5
	ending stocks	2884	3647	3497	-763	-613	-17.5
	farmer-owned reserve	1940	2515	2300	-575	-360	-15.7

Chart 19

FINAL ESTIMATES FOR 1982 US CROPS Dec. 22 and Jan. 13 Reports

(Million bushels)	Final 1982	Previous estimate	Final 1981
All wheat	2,808.7	2,810.5	2,798.7
Winter wheat	2,108.2	2,106.1	2,103.5
Grain corn	8,397.3	8,329.8	8,201.6
Soybean	2,277.0	2,299.5	2,000.1

CURRENTLY FORECAST 1982/83 ENDING STOCKS

	1982/83-Jan.	1982/83- Dec.	1981/82
Wheat (May.31)	1,516	1,511	1,163
Corn (Sept.30)	3,564	3,497	2,366
Soybean (Aug.31)	390	430	268

Chart 20

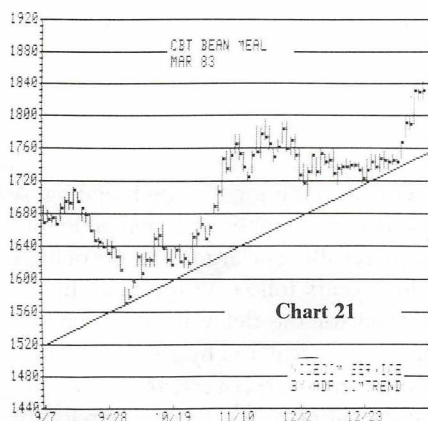


Chart 21

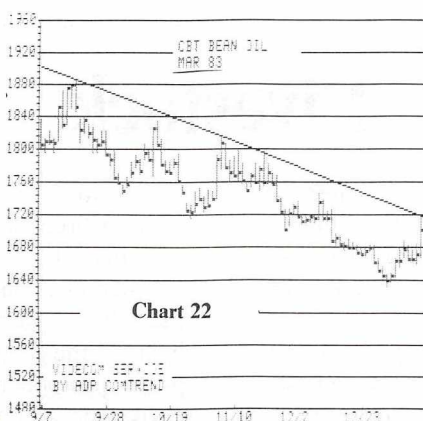


Chart 22

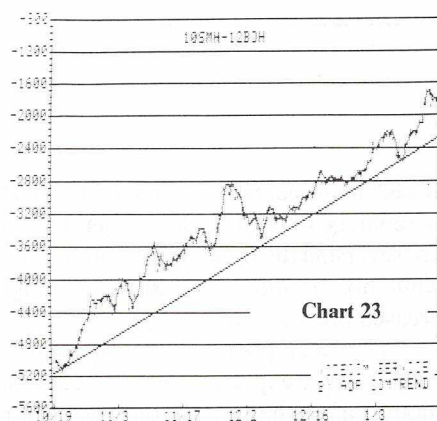


Chart 23

Cocoa

In the November 1980 *Comments*, we forecast that cocoa prices would bottom towards the end of 1982, at levels not much below \$1,350 per metric ton (MT). In fact, cocoa having reached a low, basis March, of \$1,310 (on a closing basis) now appears set for a significant bull move.

Five consecutive years of surplus production have brought cocoa to the lowest prices since 1975. However, recent developments lead one to believe that 1982-1983 will mark the first year in six that a drawdown in stocks occurs. The production deficit could run to as high as 30,000 MT in some views. Fairly strong buffer stock purchases and control by the International Cocoa Organization (ICCO) could aid in the firming of prices in 1983, even though the industry has the largest available stocks since the 1964-1965 season.

Production in the Ivory Coast, Ghana, and Nigeria is expected to be lower, owing to a combination of some dryness during the season, and a reduction in the intensity of cultivation of the cacao trees in the environment of falling prices. The Brazilian cocoa-producing state of Bahia has felt the effects of a drought, which, while relieved some-

what by rain in the past two weeks, may have already destroyed 20 per cent of the 1982-1983 crop. Conversely, Ecuador's production may fall because of *overly heavy rains*.

Recent rumors and price activity on the London market suggest that Ivory Coast producers may have oversold their 1982-1983 production. Supplies smuggled from Ghana have, in the past, added substantially to the availability of Ivory Coast cocoa. However, much lower smuggled supplies are evident this season, and Ghanaian supplies are holding out for higher prices than those currently offered.

A recent US report indicating that cocoa grindings were up 7.7 per cent over a year ago suggests that lower prices have stimulated demand, which would be an important contributing cause of a change in trend; that is, towards higher cocoa prices.

STRATEGY: *Treat this market as a nascent bull market. Buy at these levels lightly and more aggressively on setbacks of \$40-\$80/ton from any highs.*

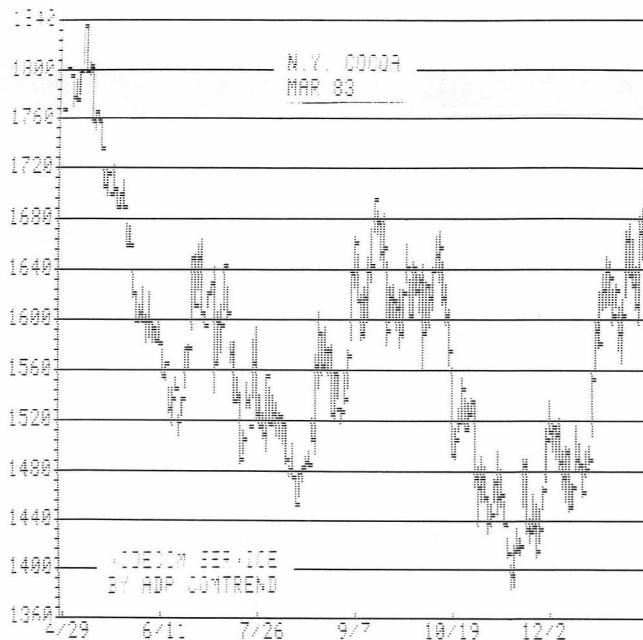


Chart 24

Livestock

Based on biweekly breakdowns of cow and sow slaughter as a percentage of total cattle and pig slaughter, cattle producers are reversing the trend towards increased breeding inventory while hog producers are just beginning a trend towards increased breeding stock.

The December 22 USDA hogs and pigs report was not bearish as we expected (see Chart 25). Normally, three to six months after the peak in the hog-corn ratio (August 1982),

there is major evidence of gilt retention for hog breeding. A peak in breeding stock occurs roughly one year after the peak in the hog-corn ratio, resulting in large numbers of hogs for market about 1.5 to 2 years following the peak in the ratio. The apparent reason for the delay in hog breeding includes the general pessimism triggered by low commodity prices, postponements of economic recovery, and uncertainty over pork consumption patterns. These have tended to

lengthen the period leading to expansion of the hog cycle.

However, a number of factors the market appears to have ignored would support a belief that hog breeding inventory is beginning to expand faster than expected. In the September report, September to November farrowing intentions were 10.5 per cent below the year before. However, the actual number of farrowings in this period was only 3 per cent below 1981. Also, the number of lightweight market hogs exceeded expectations in the December report, and the number of heavyweight market hogs was lower than expected, which would be consistent with gilt retention. The December 1982 to May 1983 pig crop is estimated by the USDA to be down 3 per cent from 1981-1982, versus expectations of about a 7 per cent drop.

Technically, cattle prices have broken out of some down-trend lines, but heavy placements last summer and fall and high cow slaughter levels as cattle feeders apparently abandon attempts to increase their breeding herd inventory should weigh on prices in the early part of 1983. The recent trading range of 56¢ to 63¢ in April cattle remains intact, although the long-term trend appears to have flattened out. January 18 cattle on feed statistics should slow continued heavy placements 10 to 20 per cent above 1981-1982. Watch the January

28 semi-annual cattle inventory report; most expectations are for about a 1 per cent drop in cattle numbers from 115.7 million head at the start of 1982, but lower than expected non-fed cattle numbers could be a factor in price direction.

STRATEGY: Sell April cattle at 61.5¢ to 62¢ with stops above 63.5¢, close only, and a target of 57¢.

Remain short April hogs with stops on a close above 58¢. Orders placed at 54.5, 55.0, 55.5, 56.0 and 56.5 are all filled now. Last April, live hog futures finished at about 54¢; this year, with only 5 or 6 per cent fewer hogs and many more cattle available around April, prices appear to be getting overly high. Our short position in October hogs is taking a good beating; much as we would like to ride out this upswing in the belief that by October hog numbers for market should be at least 10 per cent above 1982, we must recommend covering short positions and reselling when the strong up-trend is broken. In October 1982, hog futures finished trading around 57¢ — 6¢ or 7¢ above current levels. Hence, owing to greater visibility in the near term (April) compared with the longer term (October), we choose to retain the April positions while stepping out of October positions in the interim.

USDA HOGS & PIGS REPORT Dec. 22 - Dec. 1 data - 50 States					
	1982	1981	1982 1981	%	expected
all hogs and pigs on farms	53,230	58,688	90.7		89.1
kept for breeding	7,310	7,843	93.2		93.5
kept for market	45,919	50,845	90.3		88.6
under 60 lb	18,355	19,487	94.2		90.2
60-119 lb	11,648	12,923	90.1		88.2
120-179 lb.	9,182	10,437	88.0		87.2
over 180 lb.	6,735	7,998	84.2		86.0
Sept - Nov 82	2,953	3,062	96.4		86-93
pig crop Sept. - Nov. '82	21,927	22,636	96.9		88-91
1982 pig crop	84,092	93,776	89.7		
- 10 States					
	1982	1981	1982 1981	%	expected
all hogs and pigs on farms	41,940	45,970	91.2		
kept for breeding	5,593	6,021	92.9		
for market	36,347	39,949	91.0		
farrowing intentions Dec. '82-					
Feb. '83	1,956	1,977	98.9		94.7
Mar - May	2,341	2,391	97.9		97.1
Dec. '82 - May '83	4,297	4,368	98.4		

Source:USDA

Chart 25

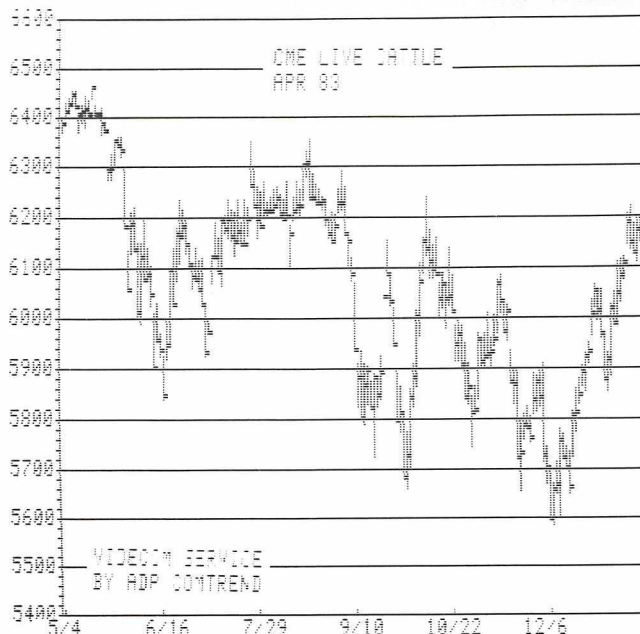


Chart 26

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In Canada and all other countries except the US: Hume Publishing Company, 4141 Yonge Street, Willowdale, Ontario M2P 2A7, Telephone (416) 221-4596.

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