

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS



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## How high the dollar?

Most major currency cycles tend to move through three stages. Starting at the lowest point, fundamental considerations such as intrinsic "cheapness" become a required, though not necessarily sufficient, condition for improvement. Expectations may still be rampantly bearish, but domestic credit conditions must no longer be expansive. In this first stage, the current account takes a sharp turn for the better aided by the elasticity of its exports and imports, the internal reallocation of resources resulting from a change in relative prices, and the attractiveness of the service sector, usually tourism.

It is important to realize that current account flows are dwarfed by the size and the mobility of capital flows. Therefore, an improvement in the current account alone, unaccompanied by changes in perception about the "cheapness" of the currency, are normally not sufficient to "bull" the exchange rate. Nevertheless, the dramatic change in the external balance of goods and services serves to support changes in perception. We are now ready to enter the second stage: inflows resulting from confidence.

"Confidence" can mean many different things to many different people. In early 1981 we began our bullish case by stating that the US dollar would go higher, "but not necessarily because of interest rates." (May 31, "Western Europe: The Declining Phase") Rather, we perceived that capital would flow away from Europe (in a "declining phase," socially, politically, economically) and towards the US, where a conservative administration was creating a favorable tax and (anti) inflation environment. Similarly, the rise of Sterling in the late '70s was as much a result of *confidence* in the conservative policies of Mrs. Thatcher as

it was of the tangible privilege of being self-sufficient in, and then an exporter of, oil. The confidence factor can even extend to the installations of Pershing Missiles in Europe and increasing friction among the allies, which threatens to break up NATO (a point we made in our November 14, 1982, issue). In its most primitive manifestation, confidence can be bottled up in one word: America!

The interesting feature about this confidence stage is the growing "thinness" of the phenomenon: While initially, confidence is directly related to value and/or economic policy considerations, at some later time, confidence is based on far more ethereal considerations, as is clear from our above paragraph. Ultimately, a "greater fool" effect takes over: confidence on the mere fact that *there is confidence*.

Towards the end of the second stage, the currency is no longer undervalued, and some adverse trade effects can be expected to take place. Analysts and traders, usually possessing short memories, begin to make exaggerated claims about the magnitude of the rise. As now, it is quite common to hear that the US dollar is *overvalued* because, since 1978, it has risen in nominal terms over 38 per cent vis à vis the Deutschmark, over 34 per cent vis à vis the Swiss franc, and almost 30 per cent against the Japanese yen despite the fact that over the same period, US inflation performance has been slightly worse than Germany's, Switzerland's and Japan's (in other words, it has risen even more in real terms!).

Using a lengthier historical perspective, however, we can readily see that on an inflation-adjusted basis, the US dollar is still far from regaining the ground lost in the decade of the '70s. Although purchasing-power parity com-

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### Contributors

- Albert D. Friedberg
- David B. Rothberg
- Michael Beech

parisons are imperfect at best, we demonstrated in past issues that the US dollar is not overvalued. Anecdotal evidence supports this view: Europe and Japan are not ridiculously "cheap."

In stage three, the skeptics begin to believe. But why, we may ask, would they believe that the US dollar at 2.40 DM is overvalued and at, say 3 DM, it is no longer so? Very simply because beliefs in currency valuations are not like religious beliefs where reward and punishment (and the proof of truth) are revealed in the world to come. In currency forecasting, dogmatic beliefs must give way to immediate financial punishment; mounting losses in the here-and-now cannot wait for values to "will out."

Stage three, then, is surrounded by fear and greed and has little to do with value except insofar as the resulting excesses lay the groundwork for a major turn in the current account and a subsequent shift in perceptions. The exact reverse of stage one.

Stage three is characterized by *violent and disorderly* exchange fluctuations accompanied by emergency government measures and official pronouncements that begin to sound a great deal more like threats than forecasts. In the last few weeks and months of the advance, the market gains a momentum of its own. One need only remember that in the four months leading to the all-time high of the Swiss franc (October 1978), it advanced by nearly 40 per cent (!) despite that at 2 SF/\$, the Swiss franc was already absurdly overvalued. Why? Because fearful "shorts" are a great deal more impetuous (and blind) than rational value-pickers.

On July 29 and again on August 1, a number of central banks, including the Federal Reserve, intervened concertedly in the foreign exchange markets in an effort to either resist the powerful advance of the US dollar or, at least, to counter disorderly and nervous trading conditions that ensued upon the US dollar's breaking through the 2.60 DM barrier.

Should we US bulls be concerned? Not at all. In the first place, there is a growing realization that intervention (especially of the sort that is "sterilized" in the money market) is nearly worthless in attempting to accomplish a reversal of trends. Second, Western European countries and Japan do not care, at this time, to supplement intervention with a tighter monetary policy — a necessary condition for a successful stabilization effort. Finally, and most importantly, foreign countries may have begun to view the rise of the US dollar in a far more favorable light, pointing to its stimulative effect on world trade.

We first pointed out the expediency of "suffering" from a rising dollar in our June '82 *Comments* ("The Eye of the Storm") and again in September '82 ("Why the US Dollar Still Reigns Supreme") when we said "... a cyclical approach to the movement of currencies yields basically the same results: a deepening worldwide depression, a desire to reflate by way of an export-led recovery, and more beggar-thy-neighbor competitive devaluations. Again, bullish for the US dollar.

Arguing that the dollar's rise against the mark might aid the German economy by boosting its exports, Karl Otto Poehl, head of the West German Bundesbank, came around to our view that the prescription for *depression is a strong dollar*. Poehl's view was confirmed by Economics Ministry chief economist Otto Schlecht, who further indicated that the Bonn Government didn't expect the strong dollar to cause much harm to the German economy. Significantly, Finance Minister Gerhard Stoltenberg warned against tightening credit in an effort to slow down the dollar's rise because the policy would not affect the dollar's worldwide strength.

Can it be clearer that apart from a few hard-headed, frustrated, sour-faced Frenchmen, who are unhappy regardless of the US dollar's strength or weakness, *the world wants a stronger dollar?*

The gathering strength can be gleaned from Chart 1, where an accelerating pattern of appreciation is evident. We have, however, as yet, not reached the third stage. In fact, we may still be somewhere in the middle of the second stage.

**STRATEGY:** *Add to new short positions only on significant rallies from current levels (such opportunities may come on good money supply readings).*

*Lower stops to 39.00, basis December '83 DM; to 48.50, basis December '83 SF; to 42.25, basis December '83 yen; to 1.54, basis December '83 BP. Place no stops on the French franc, owing to its thinness of trading on the IMM. We expect the FF to move to the bottom of its European Monetary System intervention level (from near the top now), providing us with a double-barrelled play.*

*Canadian dollar: Stand aside!*

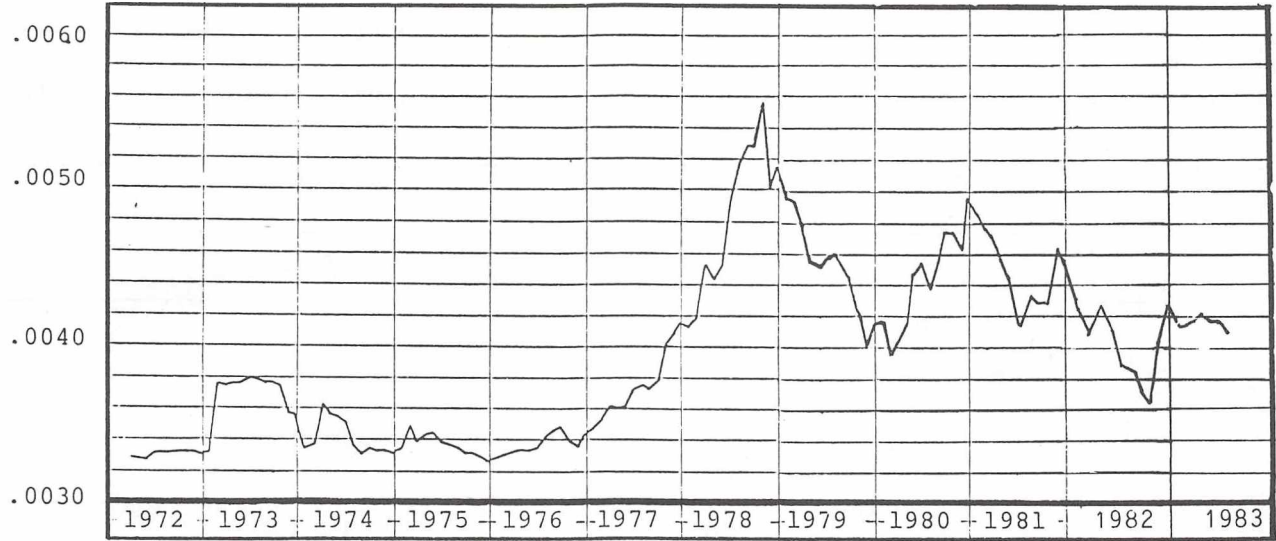
Chart 1

	The U.S.\$ and The World Foreign Exchange Market		
	Aug. 9, 1983/ Aug. 9, 1982	Aug. 9, 1983/ Feb. 9, 1983 Annualized	Aug. 9, 1983/ Jul. 8, 1983 Annualized
Germany	- 6.31%	-19.08%	-48.87%
Japan	+ 7.54%	- 5.99%	-12.56%
France	-13.48%	-29.51%	-51.41%
U.K.	-12.13%	- 6.31%	-37.13%
Italy	-11.66%	-24.44%	-52.59%
Netherlands	- 7.8 %	-21.47%	-47.70%
Canada	+ 1.61%	- 1.46%	- 3.62%
Belgium	-11.13%	-23.29%	-54.92%
Switzerland	- 1.25%	-14.31%	-26.32%
Sweden	-21.35%	-11.62%	-32.39%
Spain	-24.66%	-30.04%	-36.05%
H.K.	-17.22%	-22.05%	-49.27%
Brazil	-70.25%	-110.54%	-134.46%
S.Korea	- 4.86%	- 7.58%	- 5.39%
Singapore	+ 1.21%	- 6.11%	- 8.95%
Australia	- 9.77%	-19.21%	+ 5.08%
Norway	- 9.82%	-10.63%	-30.14%
S.Africa	+ 4.64%	+ 3.16%	-18.40%
Arithmetic Average	-11.48%	-20.02%	-35.84%
Excluding Brazil	- 8.02%	-14.69%	-30.03%
Trade Weighted U.S. \$	+2.80%	+11.4 %	+25.2%

Source: Morgan Guaranty Trust Company  
Federal Reserve Board

U.S.\$ JAPANESE YEN

Chart 2



US¢ Deutsche Mark

Chart 3



US¢ Swiss Franc

Chart 4



Chart 5

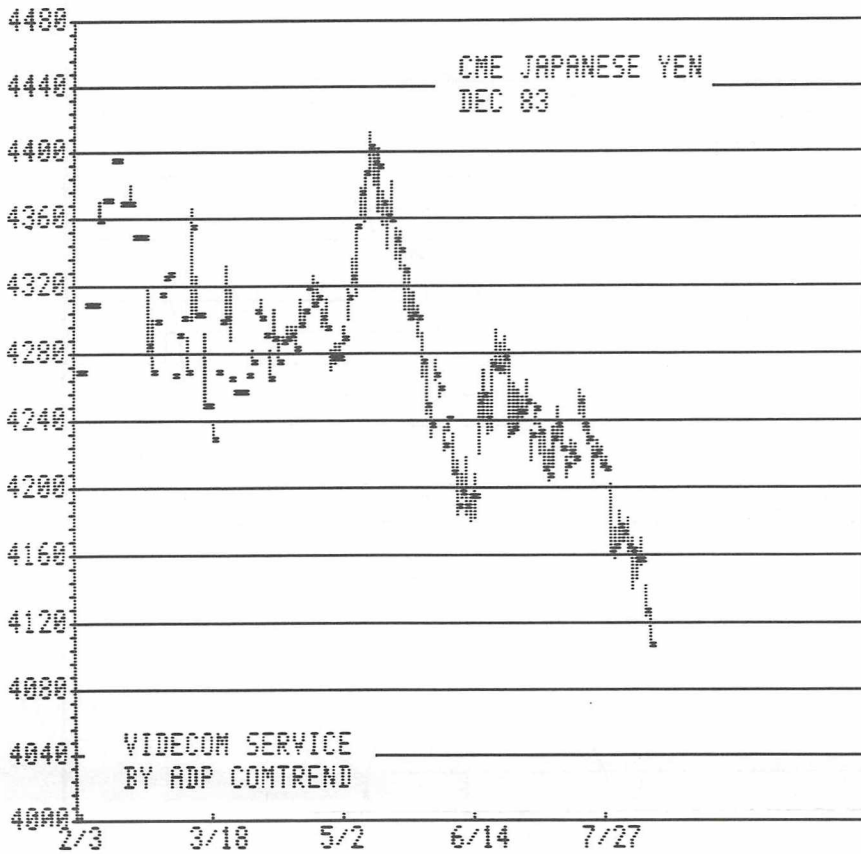


Chart 6

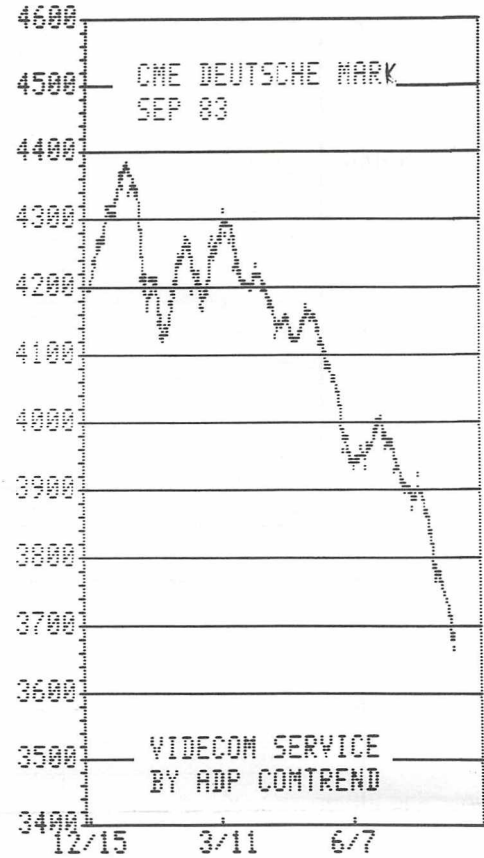


Chart 7

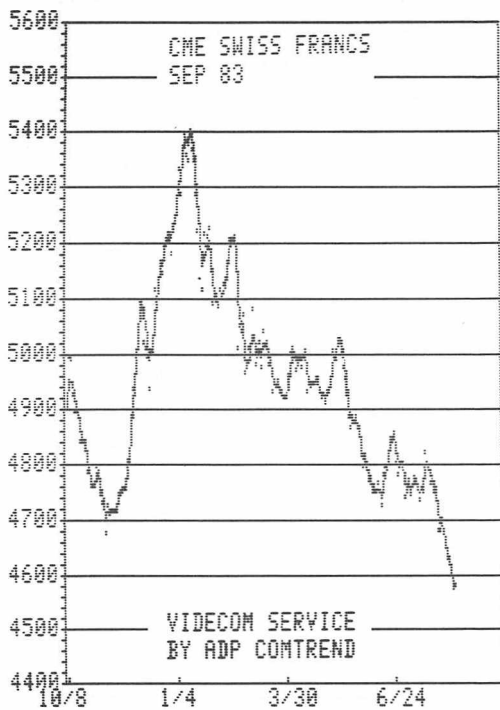


Chart 8

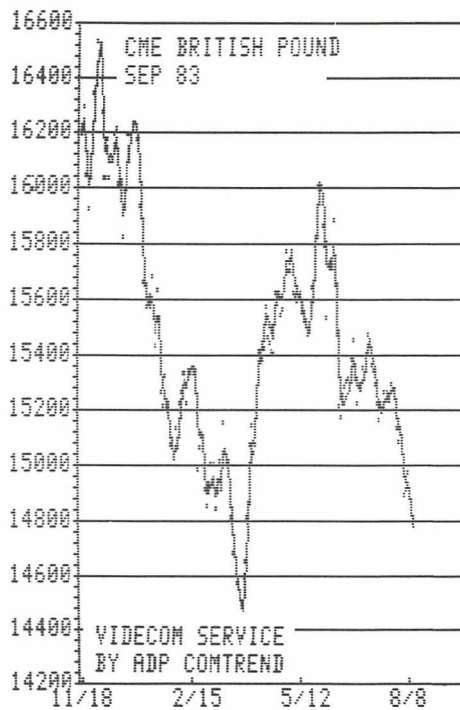
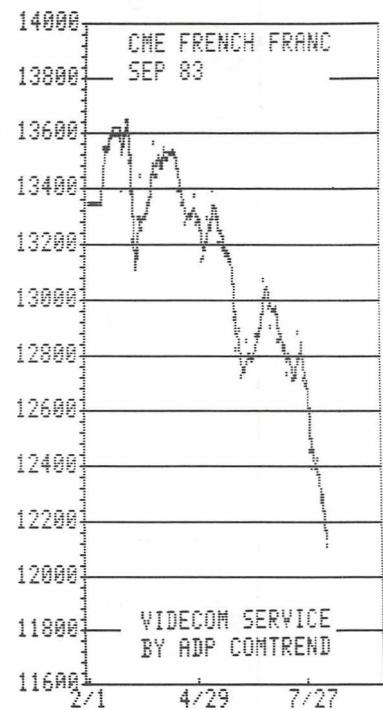


Chart 9



# Interest Rate Futures

The growth of Adjusted Federal Reserve Credit continues to decelerate, with the latest month-over-three months figures showing a slightly immoderate rate of 9.5 per cent per annum. The Fed seems to be firming to a nonborrowed reserve target of \$300-\$400 million, and a top Fed funds level of 9½-9¾ per cent.

Snugging or tightening by the Fed should result in a flattening of the yield curve. Instead, the yield curve has steepened, with most of the steepening taking place in the one- to three-year segment. Almost eight weeks ago, the 20-year-T-bond yielded 140 basis points more than the 90-day T-bill; that spread, too, has widened to 200 basis points. A simple explanation may be that there has been a rekindling of inflationary expectations. Since we "know" that inflation is the least of the economy's problems for the next year, we must offer a better explanation.

There are two aspects to this problem: first, an alarming drop in the US savings rate (see Chart 10) colliding with the voracious appetite of the US government and the growing financing requirements of a still illiquid corporate sector; second, a perceived notion that an enormous amount of capital has been destroyed through loans to developing countries. The gaping hole left behind will have to be "covered" somehow, and either taxpayer and/or depositor will have lost a pound of flesh. To the extent that capital has been dissipated, loanable funds have been reduced, affecting the genuine savings pool — the *long-term bond market* — far more than the transaction-oriented funds pool — money-market deposits, short-term T-bills, commercial paper, and CDs.

Despite inordinately high and attractive real yields, we believe that long-term bonds have entered a severe bear market. The bond trader must come to appreciate the Fed's

dilemma: Massive reflation to reliquify the economy and ease the default pain will bring stratospheric interest rates. No reflation will pit everyone's credit demands against a much-reduced pool of savings. Damned if they do, and damned if they don't.

**STRATEGY:** Last month we advised covering September '83 Eurodollar with a good profit, hoping to reinstate new short positions on rallies. Better money supply readings in late August and early September should provide just such an opportunity. However, at this time we prefer selling T-bonds on rallies to the 73 level, basis nearby.

Retain long T-bill/short Eurodollar spreads (see Charts 12 and 13.)

Chart 10

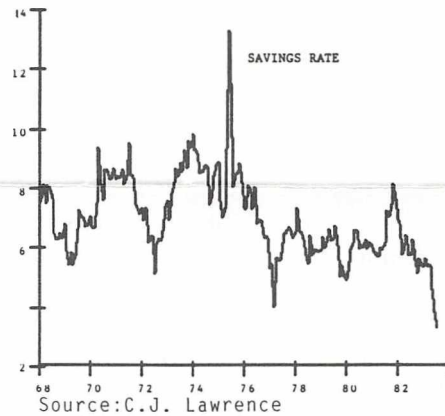


Chart 11



Chart 12

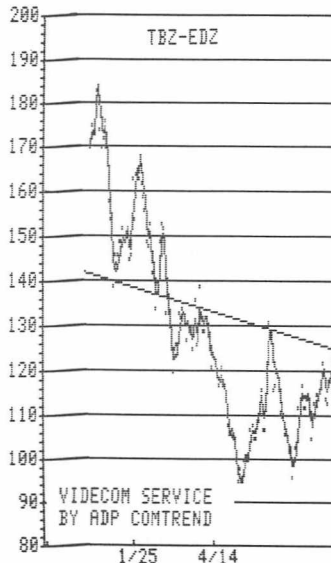
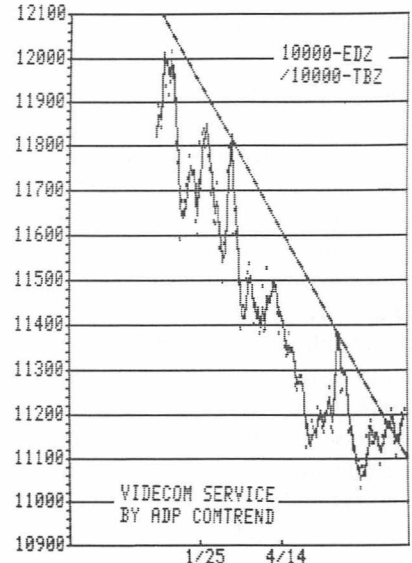


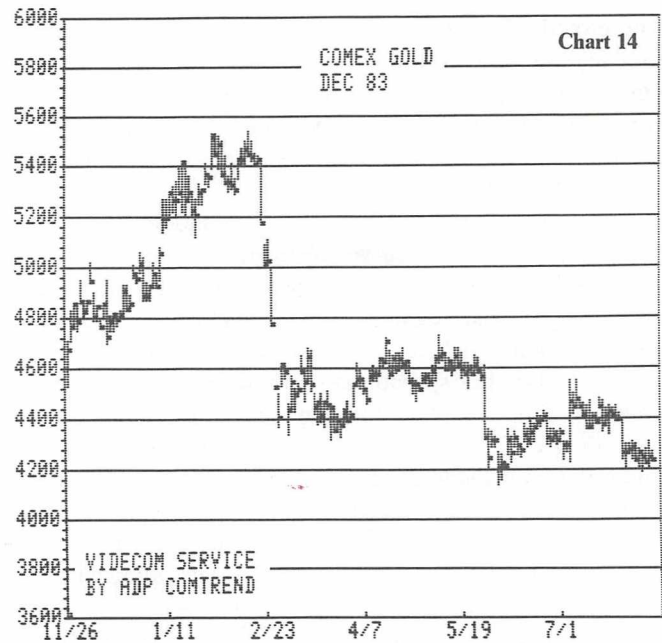
Chart 13



# Gold

Gold appears ever more vulnerable with every passing day. Strength in the US dollar as well as the prospects for a continued disinflation, make the bearish case quite potent. Furthermore, our valuation studies (May '83 *Comments*, Gold: Not Fairly Valued) continue to point to equilibrium levels as low as \$200/oz. Finally, the need for central banks to sell gold was recently highlighted by Portugal: In the predicament of having to repay a \$400 million loan to the Bank for International Settlements, Lisbon chose to part with 975,000 ounces. Obviously, cash-earning (or costing) Eurodeposit rates were more attractive (or costly) than bullion at \$410/oz!

**STRATEGY:** Remain short, placing new stops at 456, basis December '83 Comex gold, close only. Long-term bullion investors and gold mining companies should note that the risk/reward ratio is sufficiently attractive to permit serious hedging operations.



# Energy Futures

Tuberculosis has been described — particularly in the nineteenth century — as producing symptoms giving the appearance not just of good health, but indeed of truly superior health. Beneath the tragically robust appearance however, the intractable bacillus eats at its victim, and the demeanor of death is not apparent until the very end. Then, too late, do the patient, friends, and family realize that earlier liveliness came from enervation, that rosy cheeks had been the result of fever, and that late upsurges in vitality were the signs of approaching death.

Tuberculosis, which in the nineteenth century was termed consumption, seems a particularly apt metaphor to describe the current state of the oil market. Firm (and in some cases Russian Urals and Egyptian, recently raised) crude quotes, and the hale uptrend in product-futures prices, lend the appearance of vigorous health to a market that beneath the surface is being consistently ravaged by the economic realities of supply and demand.

This diagnosis is most eloquently described in Chart 15, which shows that US demand for all product supplied was lagging last year's pace by 3.7 per cent through the end of July, while domestic was registering a 0.4 per cent increase. Despite the much heralded growth in economic activity, there is only little indication that the secular trend toward increased conservation is being threatened as the most significant factor of influence upon the market.

Over the most recent four-week period, industry data show total products supplied up by 1.2 per cent over last

year's pace. The majority of the aggregate increase was made by the distillate component, which was up 15.4 per cent. At this time of year, distillate fuel would be purchased by jobbers in order to restock ahead of the winter heating season, which begins in October, and by the trucking industry, which uses it for diesel fuel. We doubt fuel consumption has increased by greater than the economy's 8.7 per cent second-quarter rate of growth. We therefore conclude that a goodly part of the amount of product is going into secondary nonreportable inventory. That being the case, American Petroleum Institute (API) data showing primary or reportable stocks at 128.944 million barrels, 85.5 per cent of what they were at this time last year, are probably misleading.

The oil malady is, one must remember, even more virulent in Europe and Asia, which do not enjoy the benefits of expanding business conditions and are forced to pay for oil in ever more expensive dollars. Oil consumption in all OECD countries (which includes the US) registered a 7.4 per cent decline to 364 million tonnes in the first quarter. Since US usage was down by a lesser amount, and because, since the end of the first quarter, the dollar has firmed considerably, we can safely assume foreign demand is especially pallid.

Under present circumstances OPEC can be linked to a tubercular patient before the discovery of antibiotics. It maintains itself as a result of the idiotic largesse of Saudi Arabia, which allowed its production to dry up to a 12-year

low of an average 3.867 million barrels per day through the first half. In doing so, it has permitted Iran, its avowed enemy, to earn enough to wage a prolonged war against Iraq, which Saudi Arabia must, perforce, finance to the tune of over \$1 billion per month. Despite Saudi Arabian policy, individual OPEC members are ever prone to contagion. The perils of Venezuela, Nigeria, and Algeria are well documented. The following news items force us to add the UAR, hardly viewed as a weak sister, to the danger list:

**Emirates' budget gap to widen sharply in 1983**

ABU DHABI, United Arab Emirates (AP) — The United Arab Emirates released its 1983 budget more than eight months into the year, saying it had needed the delay to decide how to deal with a sharply wider deficit. But it didn't say how it would do so.

Government spending for this year was set at the equivalent of \$5.08 billion. State revenue is expected to fall 28 per cent from 1982, to \$3.5 billion, leaving a deficit of \$1.58 billion.

The gap is wider than 1982's \$627 million deficit, converting the dirham at its current rate, and in contrast to 1981's surplus of \$1.6 billion.

The Emirates' official news agency quoted the minister of state for financial affairs, Ahmed al-Tayer, as saying that sales of oil and natural gas account for 95 per cent of state revenue and that "oil exports have dropped by 50 per cent this year, compared with figures for the end of the 1970s."

Ultimately, of course, like all cartels throughout history, OPEC will fall, as the selfish interests of the desperate members supersede the common good. How far in the future can such an event be? When will the true nature of the disease affecting the oil market manifest itself?

Although accurate timing is nearly impossible to forecast, we do feel comfortable in predicting that the highs in deferred heating and gas-oil futures prices are very close at hand. Charts 16, 17, 18 show that for the past two years, heating oil prices peaked toward the end of the year. Last year's high was 105, achieved in October. Also in the last two years, the premium of forward deliveries to cash has tended to shrink during the summer months. This year it has widened. The other distinguishing feature of this year's

activity is the considerably higher open position. We feel the price firmness is attributable to secondary inventory accumulation and trend-following speculators who, abetted by the price history of the past two years, have elected to bid up the December options in London and New York and have thus discounted the seasonality. A trend as firmly entrenched as this one has a momentum that shorts trade against at their peril.

However, last year's high of 105.00 was achieved when crude oil was posted at \$34.00 per barrel, just before what was assumed at the time to be the coldest winter in a century (it turned out to be the warmest). With posted prices currently at \$29.00, one assumes the ratio equivalent of last year's high cannot be breached by much or for long. Taking 29/34 of 105.00 leaves us with 89.60, basis, of course, December. The gas-oil equivalent is 274.75.

At current levels, short positions in the distillates have the advantages of having a small risk — leaving aside the unlikely, though ever present, possibility of armed conflict engulfing the entire gulf region — while offering enormous reward-potential. Oil remains the single most overvalued commodity in the world and can fall in value by 50 per cent while in the process yielding futures traders as much as \$15,000 per contract.

**STRATEGY:** *Stay short, short, and ever short.*

Chart 15

EIA WEEKLY REPORT

YR. TO DATE US. OIL DEMAND ( 209 DAYS - 1000 BPD )

	1983	1982	%
GASOLINE	6,517	6,541	-0.4
DISTILLATE FUEL	2,628	2,785	-5.6
RESIDUAL FUEL	1,426	1,851	-23.0
JET FUEL	1,024	1,009	+1.5
OTHER OILS	3,312	3,301	+0.3
TOTAL PRODUCTION SUPPLIED	14,907	15,487	-3.7
DOMESTIC CRUDE OUTPUT	8,666	8,635	+0.4
CRUDE IMPORTS (EXC SPR)	2,818	3,234	-12.9
REFINERY RUNS	11,513	11,745	-2.0

Chart 16

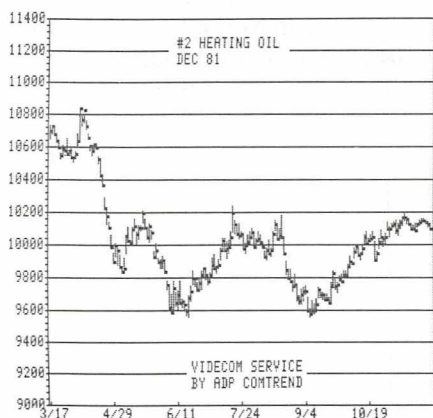


Chart 17

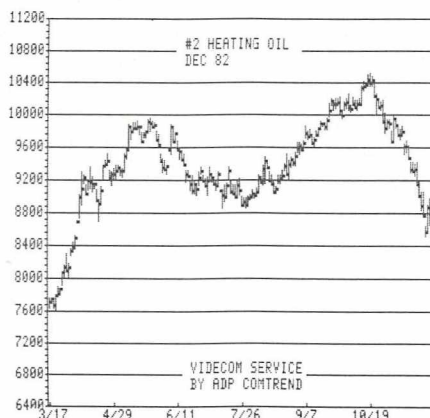


Chart 18

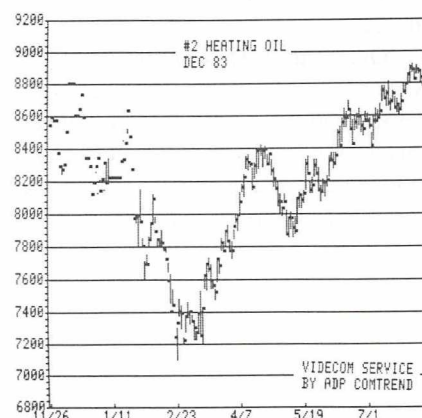


Chart 19

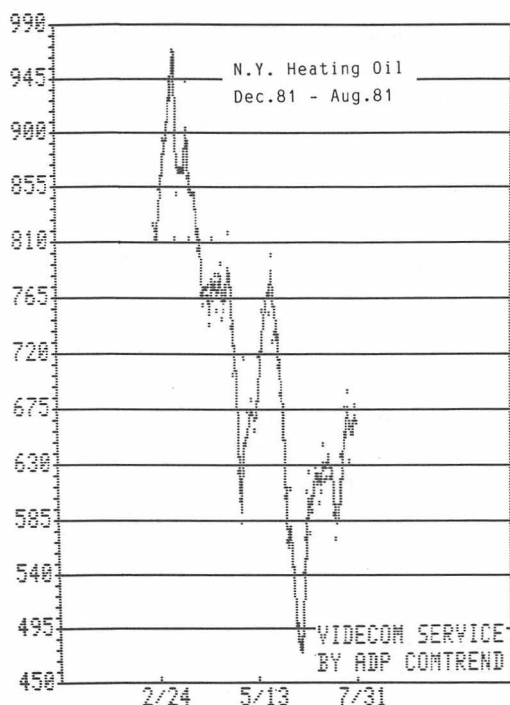


Chart 20

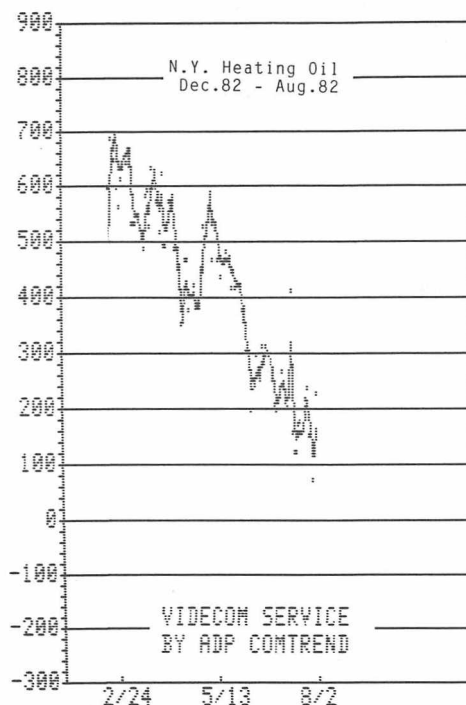
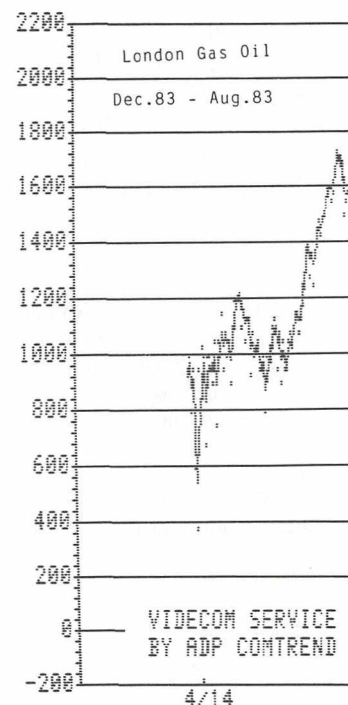


Chart 21



## Cocoa

Data reported since last writing are consistent with our view that we are in the throes of a long-term bull market. Gill and Duffus, the most respected of industry reporters, has belatedly raised its estimate of the 1982-83 deficit to 105,000 tonnes from 60,000 tonnes estimated in May. The deficit of the current year, which ends September 30, follows a surplus during 1981-82 of 100,000 tonnes.

The raised estimate is largely attributed to the failure of West Africa's crops. However, world demand is also on the upswing, albeit, given the generally depressed economies of almost all major consumers other than the US, by only a marginal amount.

In the US, imports of beans and semi-processed goods continue to outpace last year by a sizeable amount (see Chart 23).

Over the past months, the futures market has been extraordinarily volatile, with ranges of \$1,000/tonne plus, and limit moves up and down being rather commonplace. This is so because the market's attention has been focused upon the upcoming 1983-84 crop, specifically the size of the West African outturn, which has been plagued by two stages

of drought. The true effect of this continues to be the subject of wide speculation.

Rain following the first period of drought allowed for healthy formation of cherelles. However, beginning June 6, a second stage of dry weather inhibited development, leaving the industry with a delayed crop. Because of the delay, the final development of beans has been difficult to assess. As a result, estimates of the size of the Ivory Coast's production, the world's largest, now varied from a bullish 280,000 tonnes to a bearish 400,000 tonnes. The 1981-83 crop is put at 330,000 tonnes.

We use the terms "bullish" and "bearish" in reference to the size of the crop advisedly. Basically we have been long cocoa as a common sense investment in a commodity that began a long-term bull cycle in November of last year. We believe the cycle market, though it may suffer a sag in the face of a healthy Ivorian crop, will not be derailed.

**STRATEGY:** Remain long with stops in December N. Y. at 2,000. We believe a move to between 2,700 to 3,000 is possible.

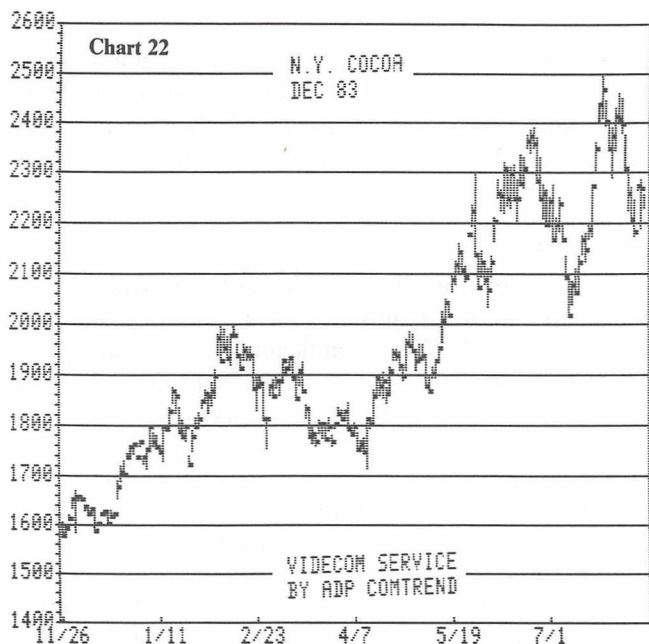


Chart 23

U.S. Cocoa-Chocolate product imports Washington, July 29 - U.S. Imports of cocoa and Chocolate products during June were as following, with comparison, according to Census Bureau figures in LBS --

	COCOA BEANS	COCOA BUTTER
June 83	24,867,137	7,315,997
May 83	32,168,138	5,250,053
Jun 82	26,567,730	4,015,404
Jan-Jun 83	380,069,011	57,835,228
Jan-Jun 82	225,033,323	36,225,812

	UNSWEETENED CHOCOLATE	UNSWEETENED COCOA
Jun 83	619,676	406,714
May 83	7,422,381	13,834,762
Jun 82	2,664,650	9,345,289
Jan-Jun 83	48,214,704	82,990,167
Jan-Jun 82	33,209,759	63,255,250

## Sugar

The internationally respected analysts, Gill and Duffus, recently estimated world sugar production in 1983-84 at 94.7 million metric tons (mmt) raw value, down from 95.4 mmt estimated in early July and compared with 99.3 mmt in 1982-83. Consumption is forecast at 95.7 mmt versus 93.7 in 1982-83. World stocks are forecast to fall to 36.7 mmt at the end of 1983-84, representing 38 per cent of consumption,

from 38.3 mmt, or 41 per cent of consumption at 1982-83 year-end. Ending stocks of over 30 per cent are considered bearish.

**STRATEGY:** Last month it appears we got caught in a bear trap! Try selling October sugar again, above 11 cents, with stops at 12.50, close only, and an objective of 8 cents.

## Grains

Let's start right off with a weather report. Soon after we published last month's *Comments*, it became apparent that weather conditions were not going to improve. Rain had been expected, but not enough fell. And the resulting damage to corn and soybean crops has been tremendous.

On August 11, the USDA released estimates of 1983 production based on August 1 conditions (see Chart 24). But the market, being ever wise, will tend to ignore these figures, as damage has been significant since August 1. Corn pollinates in the US corn belt during the second and third weeks of July. But lack of moisture reduced kernel formation and thus, prospective yields. Although more damage to the corn crop can certainly occur, it would result more in harvesting delays than simply yield reduction. Later harvest, however, can lead to crop losses owing to frost damage.

The same situation does not apply to soybeans. Soybeans grown in the cornbelt pollinate mostly in the second week of August. If soil moisture is insufficient, pollination

may fail to occur, resulting in pod formation with no beans. As a result, soybean prices are now more responsive to weather factors than corn prices.

The carryover of 1982-83 crop corn was last estimated by the USDA on July 13 at 3,384 million bushels. Given the July 13 figures and the August 11 USDA corn crop estimate of 5,237 million bushels, 1983-84 carryover stocks could fall to well below 1,100 million bushels. This would be a reasonable stocks-to-use ratio of about 15 per cent.

The 1982-83 soybean ending stocks are forecast at 455 million bushels. Combining the July 13 USDA supply and demand projections with the August 11 USDA soybean crop estimate of 1,843 million bushels indicates ending stocks of roughly 175 million bushels. This level would be inadequate at well below 10 per cent of normal annual disappearance. For this reason, soybean prices have up till now displayed significantly more strength than corn prices; the effect on 1983-84 ending stocks is more profound. While higher

prices will certainly ration supplies, corn and soybean production and prospective ending stocks have been reduced sharply by the combination of the payment-in-kind program and drought.

Wheat prices have benefitted substantially from corn and soybean price strength. Much of the rise can be attributed to speculative activity, although wheat certainly would be used as a substitute for corn in livestock feed rations if it remained at a sizeable discount to rising corn prices. But the kicker is the USDA forecast of a record Canadian wheat crop of 30.0 mmt, compared with 28.0 estimated in July and 27.6 harvested in 1982 — definitely a depressant for wheat prices.

The new five-year US-Soviet grain trade agreement announced July 28 provides for minimum Soviet purchases of 4.0 mmt each of wheat and corn, plus 1.0 mmt of wheat or corn or 0.5 mmt of soybeans or products. Also, the USSR could take up to 3.0 mmt of US wheat and/or corn without prior consultations. This agreement brings Soviet commitments to 20 mmt annually from outside suppliers: 5.0 mmt from Canada; 4.5 mmt from Argentina; and about 1.0 mmt from each of Hungary and Brazil. All this, of course, in

addition to the new US commitment.

Last month's settlement of the textile dispute between the US and the People's Republic of China should result in China's taking the minimum amount of US grain under the bilateral agreement. To this date, though, they have made no purchases.

Forward sales of old and new crop corn remain very good. But forward sales of new crop soft red winter wheat remain terrible; sales of new crop hard red winter wheat, though, are satisfactory in spite of a lack of Soviet purchases to this point. However, significant sales may take place during the next month, and if the weather improves, these sales could be the last of the bullish news for several weeks.

**STRATEGY:** Short positions were stopped out in September wheat and November soybeans for those who heeded our untimely advice. Remain sidelined from any outright positions in grains at this time, but institute the spread long 2 December soybean meal/short 3 December soybean oil at present levels, risking \$2,000 per spread. Soybean oil, with its many substitutes, appears overpriced at these levels.

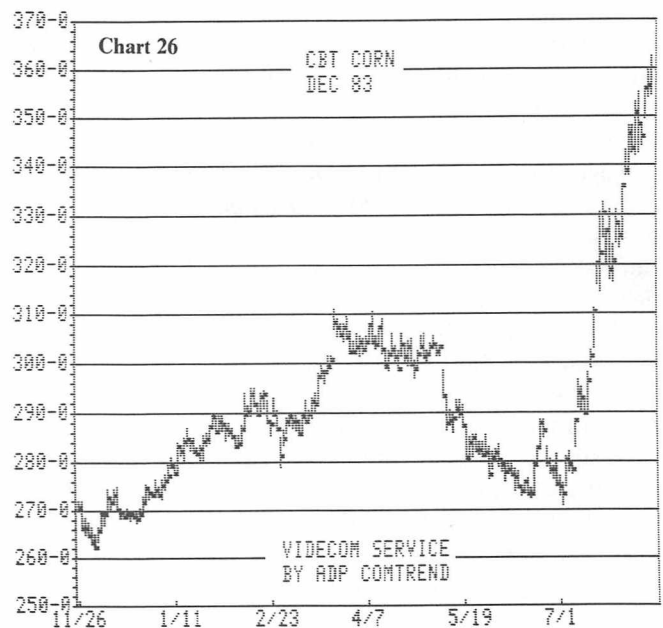
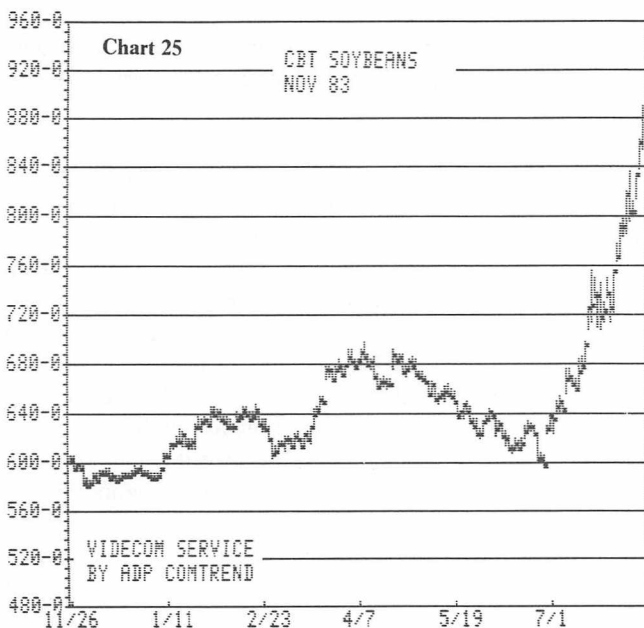
August 11 USDA crop production and acreage report - August 1 data.

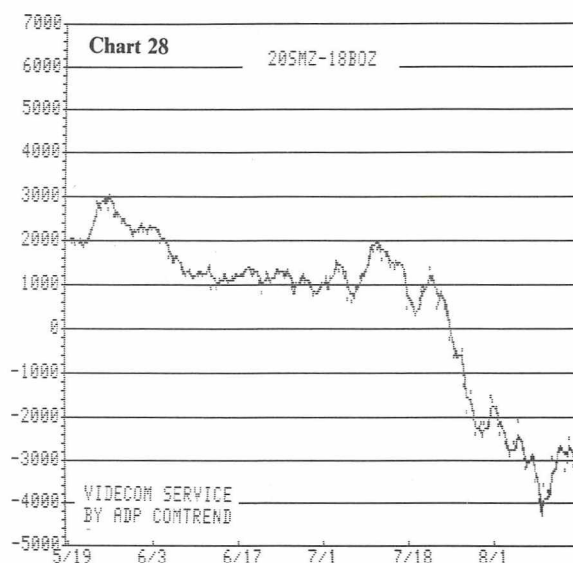
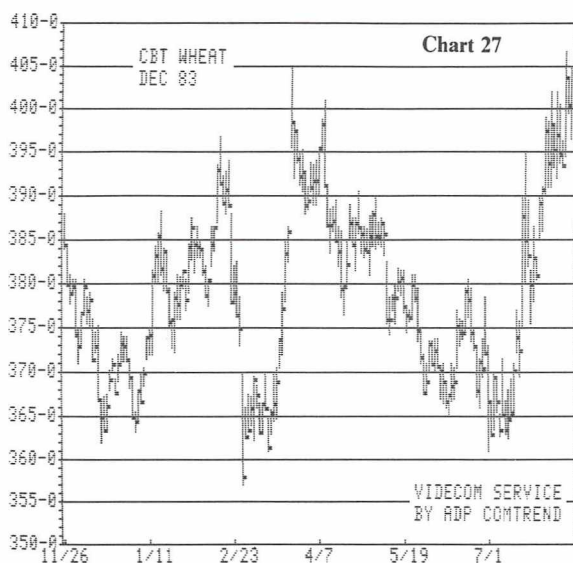
Chart 24

	acreage for harvest('000 acres)			yield			production				1983 1982%
	8/1/83	7/1/83	1982	8/1/83	7/1/83*	1982	8/1/83	expected	7/1/83	1982	
corn	52,414	52,464	73,152	99.9	118.2	114.8	5,236.6	5,180	6,200	8,397.3	62.4
soybeans	62,108	62,183	70,783	29.7	32.0	32.2	1,843.5	1,820	1,990	2,277.0	81.0
all wheat	60,969	61,394	78,841	39.8	39.7	35.6	2,423.9		2,437	2,808.7	86.3
-winter wheat	47,242	47,667	58,347	41.6	40.6	36.1	1,963.2		1,937	2,108.0	93.1
cotton	7,451.4	-	9,728.5	503**	-	582	7,809.5***	7,800	8,000	11,962.6	65.3

\* - not estimated by USDA.  
 \*\* - pounds per acre.  
 \*\*\* - thousand 480-pound bales.

Source: USDA





## Livestock

We were right. Prices have displayed an unusual late summer advance as we predicted last month. Hog slaughter rates in the first two weeks of August fell to 6 per cent above 1982 levels from 10 per cent above previous-year levels in the first half of July. At the same time, hog producers have moved lighter-weight hogs to market as excessively hot midsummer weather restricted weight gains. Average slaughter weights fell about 7 pounds from end-of-June to end-of-July.

Similarly, cattle slaughter rates have fallen to about 2.5 per cent above 1982 levels in the first two weeks of August, from levels 3.5 percent above 1982. Hot weather in cattle-feeding states has also reduced cattle weight gains, causing lighter steers and heifers to be marketed. This has reduced available fully-finished cattle somewhat, pushing prices higher.

Hog and steer prices have worked higher in spite of increased sow and cattle slaughter. The tremendous upturn in feed prices, coupled with low hog prices, have stimulated some abandonment of hog production plans, resulting in sow slaughter over 20 per cent higher than at this time in 1982, while total hog slaughter is 6 per cent above 1982. Higher feed costs and deteriorating pasture conditions, both results of the drought, have also caused more cattle to be sent to market.

The July 18 Cattle-on-Feed Report, shown in Chart 29, was interpreted as negative, based on both the quarterly 13-state report and the monthly 7-state report (to a greater degree). The July 21 semi-annual cattle inventory report was interpreted as mostly negative, although heifers slated for beef cow replacement were well below the range of estimates, which is positive for late 1984 and 1985 cattle prices. Cattle futures shrugged off the negative connotations of these reports, however, and concentrated on the bullish effects of

the heat wave and rapidly rising feed prices.

The July 21 Cold Storage Report showed frozen pork belly supplies at 63.4 million pounds on July 1, compared with 64.7 on June 1 and 72.6 million pounds on July 1, 1982. This was interpreted as neutral.

At present, livestock futures prices will probably continue to rest on weather factors, which will also affect the cost of feed inputs. However, improvements in the weather, while not necessarily inducing lower *grain* prices, should bring about increased steer and hog runs before the middle of September, causing prices to retreat somewhat. We believe the rise in April hog futures has been overdone — sell this seasonally weak month.

The heavy-weight steers and heavy-weight heifers reported in the July 19 Cattle-on-Feed report indicated levels 34 per cent and 42 per cent higher than on July 1, 1982, respectively. Marketing of these cattle and the lagged effect of heavy June seven-state placements should help to suppress prices. In addition, proposed dairy legislation would reduce US milk prices and induce substantial milk cow slaughter after October. In the fall of 1980, similar circumstances caused beef prices to plummet.

**STRATEGY:** August pork bellies should have been bought at 48 to 50 cents and sold at 57 cents or higher based on last month's advice. Similarly, long positions in February pork bellies instituted around 56 cents should have been liquidated at 65 cents. Long positions in October cattle purchased in the 57 to 58 cent range should have been sold at 61.5.

This month, sell October cattle at 60 cents or better with stops at 63 cents, close only, and a target of 56 cents. Sell April hogs at the market, and again at 50 cents, if reached, with close only stops at 52 cents and an objective of 43.50 cents.

Chart 29

July 18 USDA cattle on feed report - July 1 data - '000 head.

	13 state quarterly			7-state monthly					
	1983	1982	$\frac{1983}{1982}$ expected	1983	1982	$\frac{1983}{1982}$ expected			
on feed - April 1	9,153	8,818	103.8	June 1	7,331	7,363	99.6		
placements - Apr. - June	5,886	5,781	101.8	102.5	June	1,582	1,420	111.4	106.1
marketings - Apr. - June	5,522	5,209	106.0	107.7	June	1,560	1,515	103.0	107.0
on feed - July 1	9,067	8,981	101.0	99.9	July 1	7,275	7,181	101.3	99.5
--steers and calves	5,659	5,643	100.3						
- 500 lb.	170	162	104.9						
500 - 699 lb.	643	167	96.4						
700 - 899 lb.	2,083	2,283	91.2						
900 -1099 lb.	2,298	2,185	105.2						
-1100 lb.	465	346	134.4						
--heifers and calves	3,379	3,306	102.2						
- 500 lb.	73	117	62.4						
500 - 699 lb.	667	811	82.2						
700 - 899 lb.	1,694	1,711	99.0						
- 900 lb.	945	667	141.7						
intended marketings									
- July - Sept.	5,842	5,773	101.2						

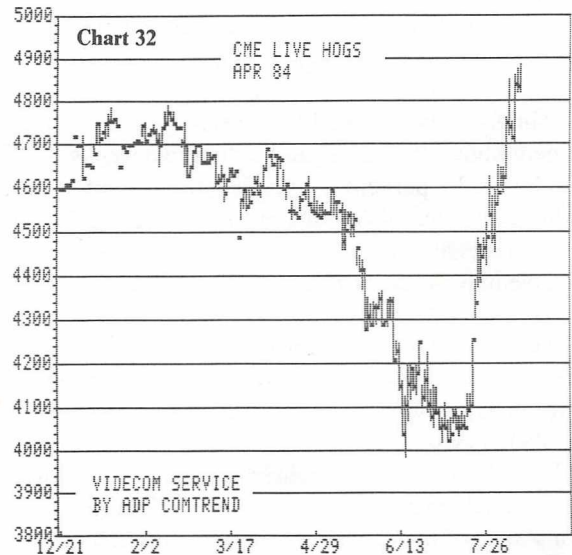
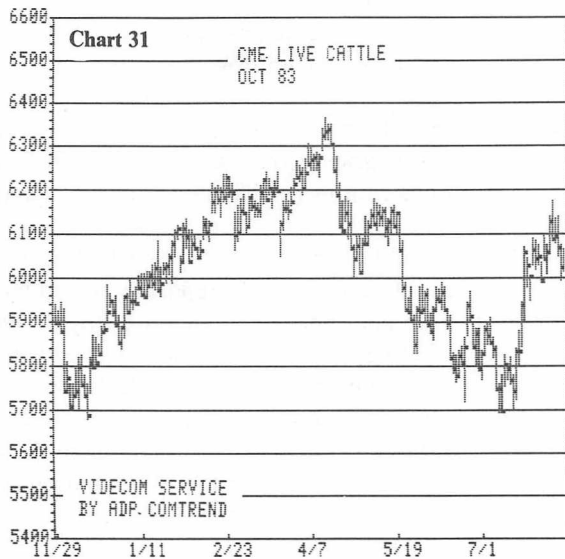
Chart 30

July 21 USDA semi-annual cattle inventory report - July 1 data. -'000 head.

	1983	1982	$\frac{1983}{1982}$ expected	
all cattle and calves	123,540	124,140	99.5	99.1
cows and heifers with calves	49,600	49,900	99.4	98.2
- beef cows	38,520	38,970	98.8	97.6
- milk cows	11,080	11,020	100.5	101.2
heifers -- 500 lb.	18,570	18,550	100.1	101.2
-for beef cow replacement	5,800	6,120	94.8	98.0
-for milk cow replacement	4,880	4,780	102.1	100.4
all other heifers	7,890	7,650	103.1	105.6
steers - 500 lb.	16,840	16,340	103.1	103.5
bulls - 500 lb.	2,560	2,610	98.1	99.5
heifers, steers, bulls - 500lb	35,970	36,650	98.1	98.2
1983 calf crop	44,200	44,645*	99.0	98.5

\*estimate

Source: USDA



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