

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.

Volume 4, No. 9 September 18, 1983

The day of the bear

Beneath the facade of complacency and euphoria that fronts every major stock market of the world, lurks a big, bad bear. Its ferocious paws have already dented the London bull, perhaps irremediably; Tokyo, Frankfurt, and Amsterdam have come under attack. Its sights are now set on Wall Street, where an exhausted bull can hardly be a match. The tables have turned. It is the Day of the Bear.

It could hardly be otherwise. The much vaunted economic recovery is turning out to be a mere blip in a continuous scenario of stagnation and/or depression. Keynesian props — household reductions in the savings rate and government absorption of whatever savings are still left — can only act as short term “fixes.” Inevitably, the economic patient relapses, and his condition deteriorates even further. What can the interventionists do for an encore? Should Italy's fiscal deficit as a percent of GNP double again, to 33 percent? Will the US and Canada reach Nirvana if the 10 percent threshold is crossed? Have the active fiscal policies of long-time Keynesian practitioners Belgium, Denmark, Brazil and Mexico, which produced deficits nearing 18 percent of GNP, brought them unemployment relief? And what about Portugal and the Netherlands, *struggling* to lower their deficits to 12 percent of GNP? Chart 1 will give us some answers.

There are a number of caveats to Chart 1, which has been compiled from a variety of sources and which, of course, suffers from a number of statistical inconsistencies. At times, we have had to use central government deficits rather than general government deficits; at other times, we have had to use the net increment of the government debt as a proxy for accumulated deficits. Unemployment figures are

calculated differently in almost every country and are thus not comparable across countries. We have therefore chosen to measure *increases* or *decreases* of unemployment in the same country over two periods, 1975-1978 and 1979-1982.

This curious exercise yields some surprising results. In no instance did we find the higher level of budget deficits accompanied by a reduction in unemployment that Keynesians would have expected. In two instances (Italy and Spain) a higher budget deficit merely *slowed* the rate of increase in unemployment. In a number of situations (Canada, South Korea, the Netherlands, and Sweden), a greater deficit was accompanied by an accelerating rate of increase in the level of unemployment (!). In six other cases (Austria, France, Germany, Japan, the UK and the US), small decreases in budget deficits (remaining for the most part, *historically high*) were accompanied by accelerated increases in unemployment. The last three cases are the most interesting ones: In Australia, a *sharp reduction* in the budget deficit was accompanied by a substantial slowdown in the increase of unemployment; in South Africa, the same condition saw a parallel *reduction* in unemployment. Finally, in Singapore, an *increase* in the *budget surplus* was accompanied by a *sharp reduction* in unemployment.

In this less-than-scientific survey, Keynesians' pump-priming is found wanting as a solution to the plague of rising unemployment. On the other hand, substantially more evidence would be required to establish the more obvious conclusion: very substantial reductions in budget deficits (as a percent of GNP), and even surpluses, could restore health to the smothered and pampered economies of the Western World. It is clear, however, that active fiscal policies pur-

Special Note

Effective immediately all editorial and subscription enquiries should be directed to

Friedberg's Commodity & Currency Comments
347 Bay Street, 2nd Floor
Toronto, Ontario, Canada M5H 2R7
(416) 364-1171

In This Issue

US Stock Market: Heading a great deal lower in a hurry . . .

Currencies: The pundits are betting on a drop of the US dollar; they're wrong . . .

Precious Metals: Still lower . . .

Contributors

Albert D. Friedberg

David B. Rothberg

Michael Beech

sued even more aggressively during 1982-1983, do not hold out *proven* promises in the resolution of the worst economic crisis in 50 years.

The mire into which the industrialized world has sunk is doubly dangerous because it will aggravate the twin problems of protectionism and international indebtedness. World trade is certain to stagnate, or decline further, making it impossible for a growing number of debtors to continue servicing their debts. Defaults in turn will wreak havoc in world financial markets, dealing confidence and savings a lethal blow.

Compared with the depression of the thirties, the depression of the eighties perpetuates malinvestments, protects the inefficient, "cushions" and finally impedes the necessary adjustments. Government deficits become a proxy for the degree of maladjustment prevailing in a specific country; the greater the deficit, the greater the imbalances: the less competitive its industries and farmers, the more rigid its pricing structure. By the same token, trade restrictions are symptomatic of serious economic problems. In the words of GATT economists, "Most of the price rigidities making for inefficient resource-allocation and insufficient flows of aggregate investment in national economies *can persist only* because they are shielded by quantitative restrictions from the influence of world-market pricing."

No doubt, these remarks are quite general and long-term. The depression of the eighties, as we pointed out at the end of 1982, will be punctured by cyclical upswings that, from time to time, will cheer the downtrodden spirit of national governments, private soothsayers, and their anxious clientèle. Unfortunately, the greater picture has been lost to them: The liberal and liberalizing world of the fifties and sixties that so well served Western civilization has been exorcised by its own welfarist social democracies. In the end, economist Joseph Shumpeter may well have been right when he predicted the ascendancy of the corporatist state (in the "disciplined" group of nations) and the plague of hyperinflation (in the less disciplined group).

What about the near term? Has the bear already cast its ominous shadow? Sadly enough, the answer is yes.

For almost a year, sovereign debtors, pressed to repay maturing short-term debt, renegotiated the term structure of these loans, offering plump up-front fees and margins, and promising to live by the Bible according to the IMF. Conveniently, banks capitalized interest payments on the assumption that debtors' cash flows would improve. Banks and other disinterested observers pointed to Mexico's fabulous comeback as the mark of success of their approach.

Unfortunately, Mexico's unique example could not be emulated by other less-developed countries (LDCs), particularly Brazil and Argentina. Very simply, Mexico's population at large already had an extremely low standard of living, with rates of underemployment in excess of 50 per cent, *before* the crisis; the austerity plan imposed on the country could hardly have been noticed by the great majority of the population, the political base for the very powerful ruling party. Called upon to make sacrifices (mainly through

draconian import controls) were the *minute* (and politically powerless) middle class (a part of which lives in the free-trading, free-of-controls US border areas) and the corrupt bureaucracy. Import controls, coupled with the favorable impact of devaluation on tourism and Pemex revenues, turned the current account into a \$6.5 billion surplus, giving Mexico some breathing room in the servicing of its debt. It was shown that the great improvements in living standards accomplished during the late seventies devolved first on the ruling class, then on the bureaucracy, then on the middle class, but not at all on the population at large.

It is not quite so in Brazil and Argentina. The strong industrial and agricultural sectors are owned and run by a literate and somewhat sophisticated middle class, which participated fully in the economic advances of the past decade. This large and vociferous middle class, however, came to rely increasingly on government largesse: subsidies; employment; tariff protection. Enter the IMF. Brazilian wage indexation, a question of equity in a country plagued by 150 percent annual inflation, would henceforth be limited to 80 percent of a "purged" cost-of-living index — one that removes exceptional price increases. The sharp drop in living standards that this deindexation causes is too painful. Subsidies are to be cut, again from fairly well-to-do farmers; dollars are to be rationed atop an official rate that slips slightly faster than inflation. Black-market dollar rates make travel abroad impossible except for the wealthiest strata of society. Rio is hit by waves of supermarket looting as 90,000 jobs are lost in the state, so far this year. Unlike Mexico, the holders of those jobs were probably earning an average of \$500/month.

Political disintegration in Argentina makes debt negotiations almost impossible. One finds it hard to believe that the IMF has given Buenos Aires a seal of good behavior on their \$1.3 billion standby agreement, considering that government revenues are running at only half of expenditures, the inflation rate is approaching an annual rate of 2,100 percent (yes, two thousand one hundred), and the dollar on the parallel market commands a 70 percent premium over the fast-depreciating official rate. For the upcoming October 30 election, a strongly nationalistic Peronist-military alliance has been forged to stop the Radicalist party headed by a charismatic populist. Their common platform: a dirigistic state where foreign exchange, prices, interest rates, and wages are rigidly controlled and foreign creditors are told to take a walk. Blaming the totally inadequate, incomplete, and ill-administered liberalization experiment of the late seventies, the Argentinian yearns for the paternalistic inward-looking state of the post-Depression and post-war period. Gripped by a Weimar-type hyperinflation, Argentinians are likely to turn to the Soviet Union (which purchases most of its exports) until the debt problem and the world depression are forgotten.

Capitalizing interest payments worked well as long as banks provided funds speedily enough to allow the debtor to meet deadlines. Unfortunately (or perhaps, fortunately), delicate questions of achieving IMF targets began to come into play and the recycling process was slowed down. With

it, arrears began to grow: they now stand at \$2 billion for Brazil; \$300-\$500 million for Argentina; and at least \$400 million for Venezuela.

The arrearages are beginning to affect the financial condition of multinational banks. In recent days, Citicorp disclosed that its nonperforming overseas loans mounted to \$1.7 billion from \$1.4 billion at the end of the first quarter, \$1.1 billion at end of 1982, and \$700 million one year ago. As arrears continue to increase, large banks will be forced to *reverse* accrued interest earnings in the third and fourth quarters of this year. To gain an idea of the magnitude of the sums involved, it should be noted that the top nine US banks have \$13.3 billion of loans to Brazil, \$5.1 billion to Argentina, and \$7.8 billion to Venezuela, probably earning them around \$3.4 billion a year in interest. All three nations are already in arrears; the population of Brazil and Argentina is unlikely to withstand another drop in living standards; and Venezuela is busy telling its creditors that because national elections are being held on December 4, 1983, the world will have to wait (by then, of course, there may be no international reserves left).

The International Monetary Fund (IMF) itself had begun to run into trouble in its quest for an enlargement of its lending facilities. Chances are better than even that the US Congress, deep-down upset by the way the multinational banks are being bailed out by official institutions while collecting "obscene" profits, will fail to approve an \$8.4 billion US contribution to the Fund. If Congress fails to approve the contribution, the IMF could still function for a limited time by relying on its vast gold hoard. However, its days as a banker would be numbered. Perhaps, it's for the better. International lending should never have had the benefit of an official crutch. On the other hand, if Congress passes the contribution, its conditions will certainly not please bankers (see our discussion of reservable loans in the July 14, 1983, issue). Moreover, Congress will then show an extraordinary reluctance to continue to vote for increased official aid.

A second area of *near-term* concern relates to the

noticeable weakening of sensitive industrial commodities. As our section on metals makes abundantly clear, uptrends in aluminum, nickel, zinc, and copper have been reversed, at least temporarily, with ominous implications for continued economic recovery.

Obviously, the investment community isn't perceiving the problem (as it has not made front page news), at least not enough to advocate a bearish stock-market stance. But are there any *technical* signs of deterioration in the US market itself?

In our opinion, the most telling evidence of impending trouble in the equity markets is the increasing narrowness of the advance. While the Dow-Jones Industrial Index records all-time highs, only a very small number of issues has climbed to 52-week highs, in dramatic contrast to the vibrant days of October when as many as half of all stocks listed on the New York Stock Exchange made 52-week highs. Admittedly, it is a great deal easier to achieve new highs in the early part of a sharp advance, especially when the 30 percent advance comes after a long 18-month bear market. Nevertheless, it is the *divergence* of a popular average making new highs unsupported by the rank and file, that intrigues us. Chart 2 speaks of collapsing participation, the normal prelude to a bear market. Chart 3 shows how the 1982 bear market was also preceded by approximately nine months of distribution, characterized by the divergent action of the (rising) popular averages and declining number of stocks making new highs.

The extraordinary levels of volume, margin debt, new issues, high-tech multiples, and insider sales make the US stock market *highly vulnerable to a waterfall decline that could wipe out 30-50 percent of the values* in a short period of time. Stock index futures give traders an excellent opportunity to bet with Cassandra.

STRATEGY: Sell December '83 S & P futures at market; place stops 800 points above entry level.

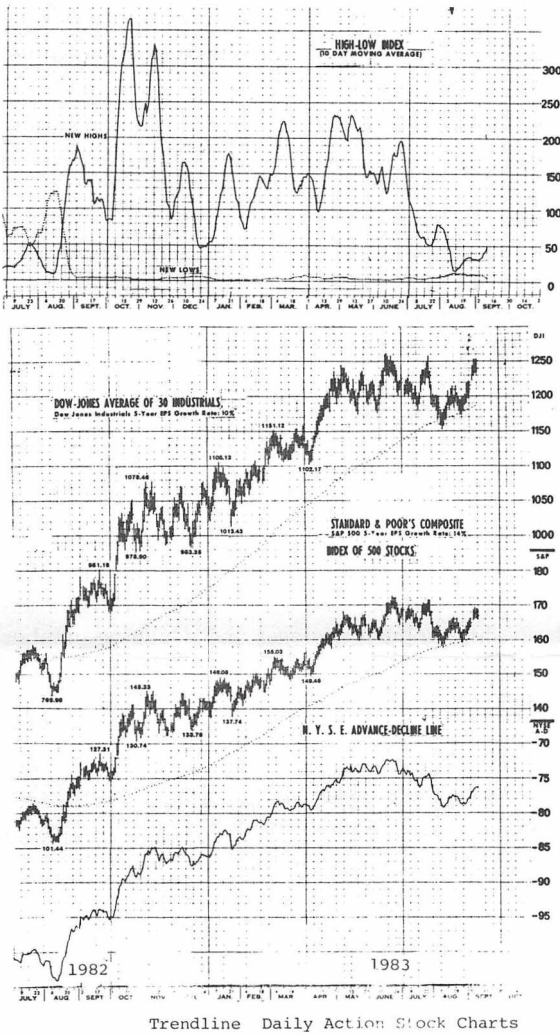
Chart 1

| | 1975-1978 | | 1979-1982 | |
|--------------|----------------------------|--------------------------------|----------------------------|--------------------------------|
| | Government Deficit / GNP % | Increase (+) in Unemployment % | Government Deficit / GNP % | Increase (+) in Unemployment % |
| Italy | 12.67 | 117.14 | 13.09 | 19.48 |
| Spain | 2.39 | 218.98 | 5.34 | 79.93 |
| Canada | 3.87 | 14.29 | 4.29 | 81.42 |
| S. Korea | 1.60 | -21.95 | 2.37 | 15.79 |
| Netherlands | 3.18 | - 3.57 | 5.53 | 182.69 |
| Sweden | 2.51 | 37.5 | 7.94 | 52.38 |
| Austria | 4.33 | 5.0 | 3.29 | 85 |
| France | 1.2 | 38.97 | 0.6 | 48.75 |
| Germany | 2.41 | -16.98 | 2.17 | 139.47 |
| Japan | 5.02 | 5 | 4.62 | 21.05 |
| U.K. | 5.18 | 9.61 | 4.2 | 137.5 |
| U.S. | 3.1 | -24.36 | 2.72 | 87.5 |
| Australia | 4.38 | 43.18 | 1.51 | 14.52 |
| South Africa | 5.9 | 200 | 3.07 | - 13.12 |
| Singapore | (0.79)* | -54.33 | (2.12)* | - 35.78 |

* Budget Surplus

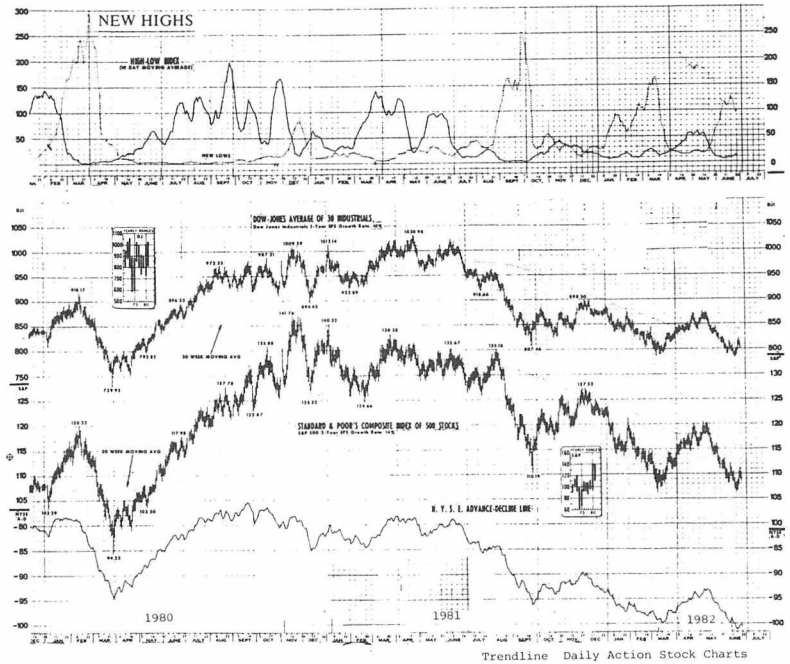
Sources: UN Monthly Bulletin of Statistics, International Financial Statistics

Chart 2



Trendline Daily Action Stock Charts

Chart 3



Trendline Daily Action Stock Charts

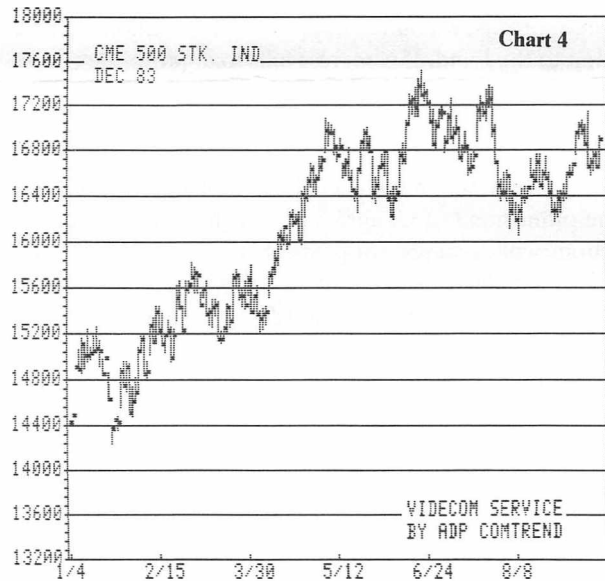


Chart 4

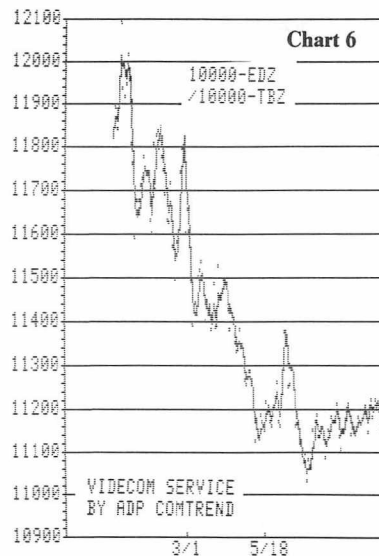
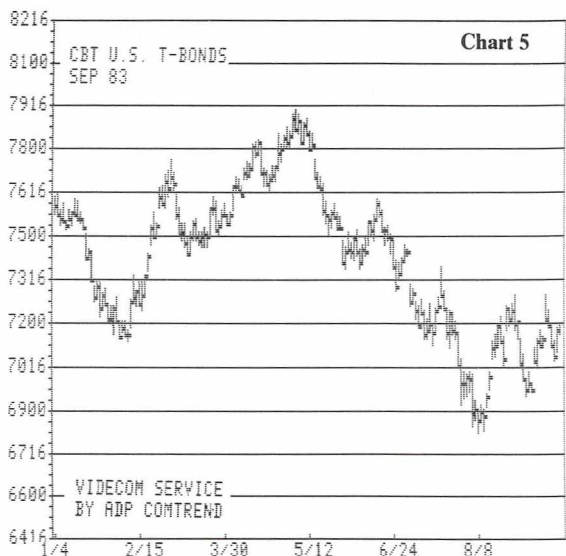
Interest Rate Futures

Last month we stated that "better money supply readings in late August and early September" should provide good short-selling opportunities, and we suggested selling September '83 T-bonds on rallies to 73. On Monday September 12 the high of the September '83 T-bonds was 72.30; the market then retreated to close at 72.03. During the week, T-bonds traded as low as 70.23 and closed the week at 71.24. The relatively high \$5.5 billion increase in money supply on Friday, September 16

should force a lower opening on Monday September 19, which we would use as an opportunity to cover.

A weakening economy and a money supply under better control are providing, temporarily at least, a constructive backdrop to the bond market.

STRATEGY: Move to the sidelines. Retain long T-bill/short Eurodollar spread; roll forward to March '84.



Currencies

In a recently-released study, the US International Trade Commission concluded that exchange-rate fluctuations cannot always be presumed to be the predominant factor determining changes in trade balances. It noted that the trade-weighted value of the US dollar had appreciated 31.7 percent during 1980-1982 and that the US nonpetroleum merchandise trade surplus dropped from \$54.1 billion to \$27 billion. Nevertheless, it found that "there is often little direct correlation between the percentage change in the value of the US dollar against specific currencies and trade balances." As an example, it pointed out that although the dollar appreciated 21 percent against the French franc from 1981-1982, the bilateral trade balance improved slightly for the US, whereas a 7 percent appreciation of the US dollar against the West German Deutschemark accompanied a considerable worsening of the US-West German trade deficit.

This observation conforms to the one we made a number of months ago when we pointed out that US exports to Canada had dropped significantly in spite of the fact that the US\$/C\$ relationship had remained absolutely steady.

In all probability, the deterioration of the US trade balance can be attributed principally to the relative *openness* of its borders and the strength of its cyclical recovery. As stated on many prior occasions, this trade deficit comes as a blessing to the world economy, as it sustains employment and production in the rest of the world.

By betting on further dollar strength, are we still betting against the pundits? Chart 13 is reassuring. Not one single expert believes that the dollar will go higher than 2.75 DM, roughly the parity at the time of the survey.

STRATEGY: *If you are in doubt (and we aren't), bet against the pundits.*

Remain short currencies, lower stops to 38.75, basis

December '83 DM; to 47.75, basis December '83 SF; to 42.00, basis December '83 yen; to 1.54 (unchanged from last month), basis December '83 BP.

The French franc/DM cross-rate has moved above 3.02 as the Belgian Franc comes under some pressure. Retain short position in French franc, even if DM short position is topped out.

Canadian Dollar

In recent months, Canadian monetary authorities have begun to accumulate reserves rather consistently, indicating that there is upside pressure on the currency.

This view is supported by the fact that Canada's adjusted monetary base has remained *unchanged* since December 1981, a full 22 months, and probably the longest period of monetary restraint in recent memory.

Our neutral-friendly attitude is solidifying. We now expect a *upside breakout* to occur in the months ahead.

STRATEGY: *Begin accumulating long positions at present levels; add on a breakout above 8160, basis December '83.*

Chart 7

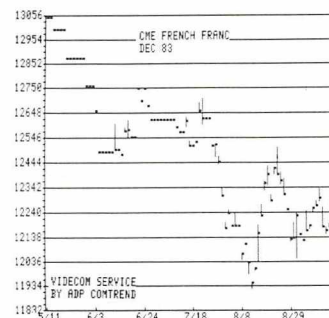


Chart 8

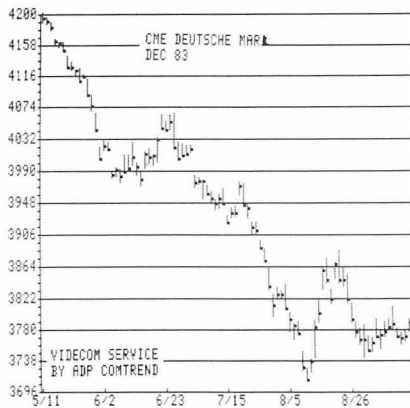


Chart 9

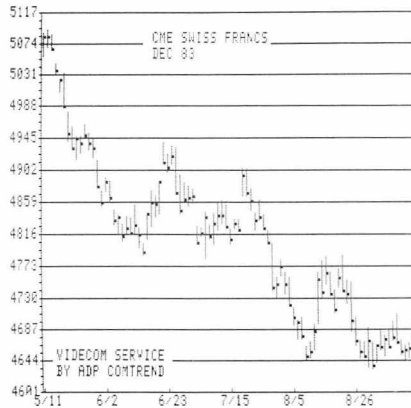


Chart 10

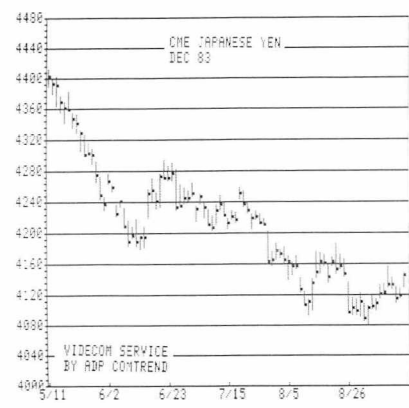


Chart 11

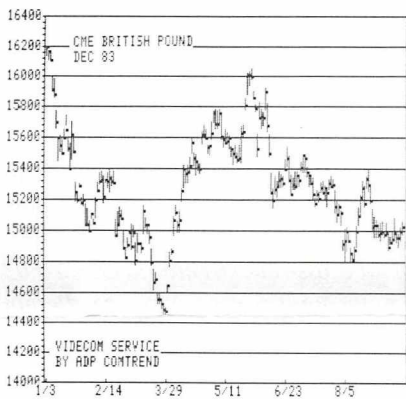


Chart 12

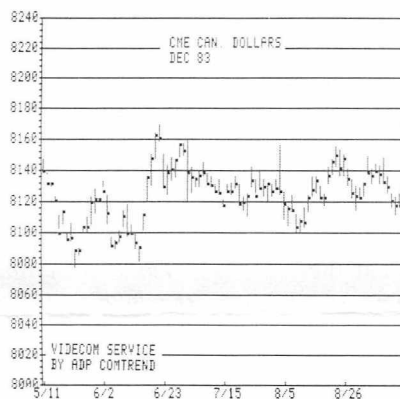


Chart 13

AT THE END OF THE YEAR,
ONE U.S. DOLLAR WILL BE WORTH...

| | Japanese Yen | German Mark | French Franc | Swiss Franc | British Pound Sterling |
|--|--------------|-------------|--------------|-------------|------------------------|
| Dr. Michael Rosenberg Prudential-Bache | 250 | 2.75 | 8.25 | 2.22 | 1.45 |
| Merrill Lynch Economics | 245 | 2.53 | 7.63 | NA | 1.52 |
| Elliott Riordan Wharton Econometrics | 230 | 2.55 | NA | 2.04 | 1.58 |
| David Wyss Data Resources | 235 | 2.50 | 7.65 | 2.18 | 1.52 |
| Ram Bhagavatula Citibank | 235 | 2.40 | 7.44 | 2.05 | 1.60 |
| Paul Koerner Worldwide Investment Research | 225 | 2.20 | 9.00 | 1.96 | 1.51 |
| Andre Sharon Drexel Burnham Lambert | 196 | 2.40 | 7.60 | 2.00 | 1.51 |

FINANCIAL WORLD

Gold

News that Portugal would be selling a fair quantity of gold to help it repay an outstanding BIS loan as well as the disclosure before the House Banking Committee that Brazil was being asked to sell \$500 million of gold in both 1983 and 1984, sent bullion prices to their lowest levels in four months.

For the time being, gold and silver prices should follow the weakness of other industrial commodities, particularly

base metals. As well, an easing of interest rates would appear to represent lower inflationary expectations and less possibilities of LDC default, which, of course, would be bearish for gold.

STRATEGY: Remain short; lower protective stops to \$445, basis December '83, close only.

Chart 14

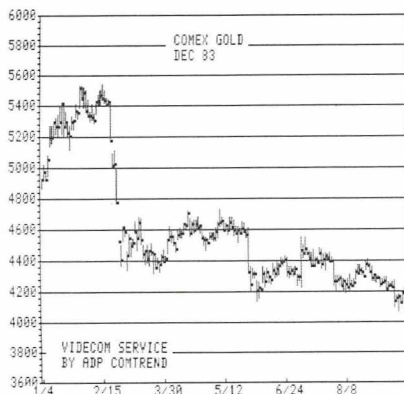
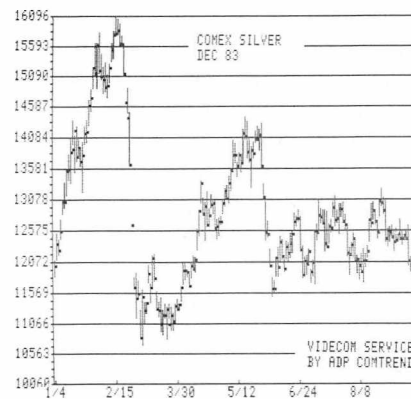


Chart 15



Base Metals

Our economic universe is an extremely arid one. The normal recovery cycle of consumer spending leading to increased capacity utilization, restocking, and finally to fresh investment in new plant and equipment is of necessity aborted before the third stage — often even before the second, as private sector borrowing needs collide with public borrowing in a reduced pool of savings. The mechanics of the business cycle in this type of environment was described by Milton Friedman some years ago as “a stop-and-go economy.”

The accompanying charts of the industrial commodities (lumber, copper, cotton, and aluminum) depict the effect this stop-and-go type economy will have on price volatility. The dramatic rises that began last year were all from depressed levels and, unusual in the early stages of true bull markets, nearly all straight up. The recent vertiginous drops in prices have baffled observers who point to what should be the still immature stage of the recovery. In fact,

what has happened has been a speculative washout as those stages failed to mature beyond the first of consumer spending.

Of the four commodities depicted, the best speculative opportunity exists in aluminum. Twenty-five percent of aluminum demand comes from the housing sector, which will continue to suffer under the weight of exorbitant prices for mortgages. From a technical point of view, the market has just broken down, leaving the speculator with ample opportunity yet.

STRATEGY: We would advise purchasing three-month put options on the LME. The premiums of about US \$1,500 are about equal to the contango — that there is a contango indicates there is no shortage of aluminum — and the profit potential is as much as \$7,500.

Remain sidelined copper, which, though affected by the same fundamentals, is trading at a price already too low to warrant speculation.

Chart 16

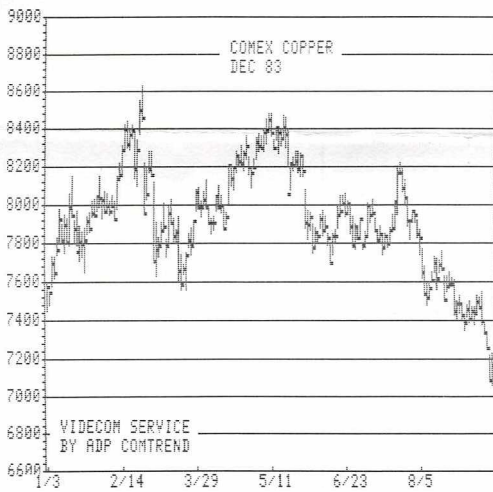


Chart 17

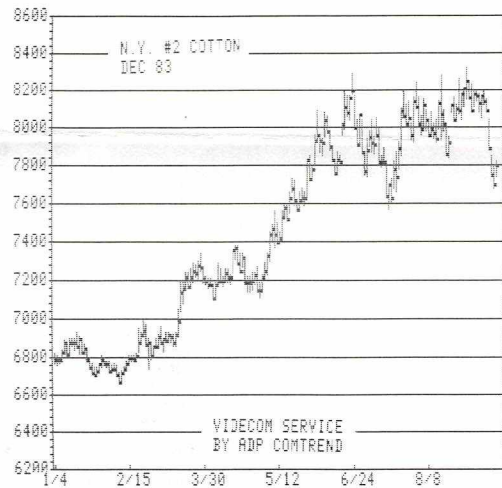
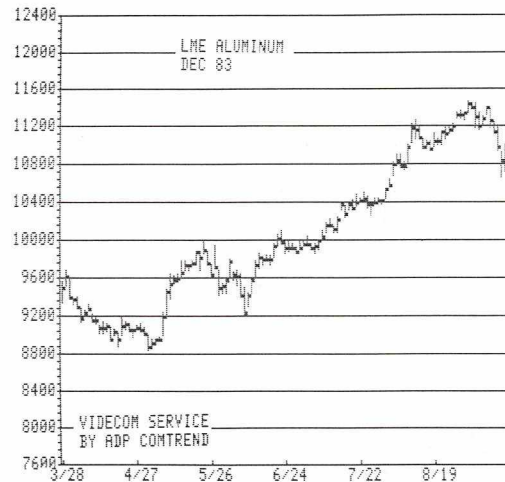


Chart 18



Chart 19



Energy Futures

OPEC output in excess of its self-imposed ceiling of 17.5 million barrels per day (mbd) during this year's third quarter was a direct result of a new build-up in stock. So states the well-informed International Energy Agency, which concludes that oil stocks rose by 2.3 mbd (see Chart 20). As the restocking process came to an end, North Sea oil fell to \$30.30/barrel from a high of \$31.30/barrel, Nigerian Bonny light to \$30.70/barrel from \$31.12, and Arabian light to \$28.65/barrel from \$29/barrel.

There is no economic justification for this large increase in stocks unless we accept the view that the Gulf is about to witness a dramatic expansion of the Iran-Iraq war and that the renewed hostilities would somehow disrupt the traffic through the Straits of Hormuz. Why now? Because the French are in the process of shipping to Iraq five Super Etendards fighter planes, which, when equipped with Exocet missiles can destroy Iran's Kharg Island terminal and thus widen the conflict.

A direct Iraqi attack on Iranian oil installations is an act of desperation; it seems reasonable to believe that Iran

could win this war of attrition because it generates four times as much oil revenues as Iraq. The introduction of the deadly Exocet missiles, however, could delay this outcome, although it is unlikely to change it. For now, we will bet on any of the following: a) the Iraqis don't get their planes because the Israelis blow them up (or capture them); b) the Iraqis get them but are unable to fly them; c) the Saudis (with their Awacs) spot them and use Piper Cubs to bring them down; d) the Iraqis manage to use \$40 million worth of Exocets (at a million a piece) and miss their target; e) the Iranians lose their terminal but are stopped by the heroic US marines at the gates of the Straits; f) the Iranians are scared enough to sit down and negotiate.

While the economics of oil are *very bearish*, the politics of oil are rather hazy. Need we say more?

STRATEGY: *Remain short; roll positions as far out as possible, thus taking protection in case of an unexpected interruption to supplies.*

Chart 20

| WORLD OIL SUPPLY AND DEMAND IN 1983 (millions of barrels a day) | | | | | |
|--|----------------|----------------|----------------|----------------|---------------|
| 1983: | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter | Total 1983 |
| Demand | 44.9 | 43.0 | 42.3 | 45.7 | 44.0 |
| Non-Opec oil supply | 24.9 | 25.5 | 25.7 | 25.7 | 25.5 |
| Additional requirements | 20.0 | 17.5 | 16.6 | 20.0 | 18.5 |
| Opec production: | | | | | |
| Crude | 15.3 | 16.5 | 18.0 | | |
| NGL | 0.8 | 0.8 | 0.9 | | |
| Total | 16.1 | 17.3 | 18.9 | | |
| Supply/demand balance | - 3.9 | - 0.2 | + 2.3 | | |
| Total oil supply | 41.0 | 42.8 | 44.6 | | |

Source: International Energy Agency

Financial Times

Chart 21

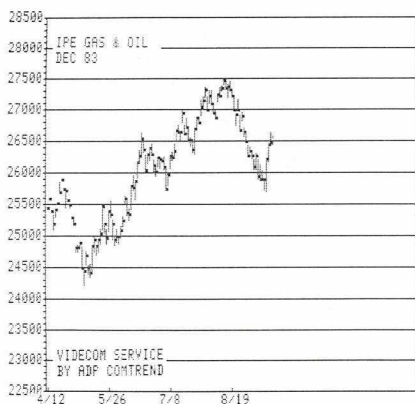


Chart 22

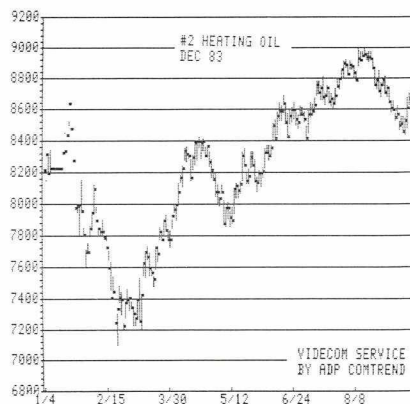
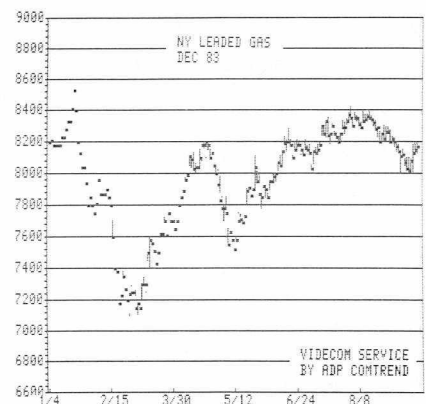


Chart 23



Cocoa

An accurate assessment has still not been made of the size of forthcoming West African crops. Presumably, the recent collapse in prices can be at least partly accounted for by trade houses whose knowledge of conditions in the field exceeds our own. That being the case, one could conclude the most bearish of scenarios — an Ivory Coast crop of 400,000 tonnes — has already been discounted.

We have mixed feelings of the direction of prices from here. Technically, the market's penetration of our stop of 2000, basis December, in New York violated important support. On the other hand, the price action of last week described a weekly reversal, one of the more reliable

indicators of trend reversals. Looking at things from a most general perspective, we are bearish on prices generally in this depressed economic climate. And yet cocoa has entered into a new cyclical phase up and is still extremely cheap when considering retail prices of confectionary items.

STRATEGY: *The lightest of investment-type long positions may be reestablished with stops at recent lows.*

(This issue marks the last in which David Rothberg will make a regular contribution for six to nine months. Mr. Rothberg will be taking a belated sabbatical, during which he will write and travel, to return sometime in 1984.)

Sugar

The flames of the bull market have been doused for this season. In spite of European beet test weights substantially below a year ago and a projected deficit of 2.1 million metric tons (mmt) in the world production/consumption balance calculated by Gill and Duffus, the October and March contracts have decidedly broken down through technical support. In fact, with the last of the longs' technical stops having been executed, the widening October-March spread, and the prospect of buying by major consumer nations as the cane and beet crops are harvested, we recommend covering short positions in October.

The International Sugar Agreement (ISA) is currently being debated in the annual meeting of this weak cartel. Unless the EEC agrees to cooperate, sugar futures could stay low indefinitely. As a non-member, the EEC has simply supplied the product that members of the ISA have withheld from the market.

STRATEGY: *Cover short positions at 8.80 cents or 10.00 cents on stop, or before the end of September, locking in profits of at least \$1,250 per contract. Sell March sugar at 12.20 cents if the opportunity arises, with stops at 13.50 cents.*

Grains

In 1983 the US has suffered the worst drought since the Dust Bowl era of the 1930s, coincident with huge drops in planted acreage owing to the USDA's payment-in-kind acreage reduction program. That the US can even come close to meeting the domestic and export demand for grain in the face of these challenges says much of US supply capabilities.

The prospective corn and soybean crops estimated by the USDA on September 12, were almost exactly on target with forecaster Conrad Leslie's estimates and the expectations for the USDA report (see Chart 24). However, traders were anticipating something more (that is, *less* in terms of production), as prices sold off sharply for the next three days. A report quoting a panel of Chicago Board of Trade traders immediately after the report calling for record prices seemed to sound the death knell for the grain markets.

The 1983 US corn crop is currently expected to be 4,390 million bushels, a tremendous 47.7 percent below the record 8,397 million in 1982. The soybean crop, too, is estimated at 1,535 million bushels, an amazing 40.7 percent

below the 2,277 million last year. The supply and demand projections on September 13 for corn and soybean were tailored around the tremendous drop in supply. Demand merely had to be estimated at a level that would leave a reasonable carryover; excess supplies of corn and soybean have been eliminated in one momentous year. For corn, carryover is now estimated at 900 million bushels, roughly 12 percent of an average year's total supplies. Soybean carryover, however, was estimated at a minimal 150 million bushels, an amount considered to be only "pipeline" supplies.

It now remains for prices to seek out a level at which demand will be restrained so that a reasonable carryover of corn and soybeans will remain. But what price will this be? As it is, demand must fall by at least 7 percent in the case of corn and 13 percent in the case of soybeans from 1982-1983 levels.

If demand is weak enough that the existing contract highs have sufficiently reduced potential demand already in line with supplies, then prices will likely gradually erode until early 1984, when southern hemisphere crops can be

accurately forecast and US plantings prospects in 1984 can be anticipated. *Foreign and domestic farmers can be expected to plant full out in 1984 to take advantage of profitable prices.* It is our belief that December and March corn prices would have a great deal of difficulty remaining above \$3.75/bushel, if they indeed retrace to that level, under any circumstances. Wheat is still in tremendous oversupply. Even with the 30 percent 1984 acreage reduction program and 20 percent payment-in-kind (PIK) option, the oversupply will continue in 1984. Wheat prices over 4.00, basis Chicago, and 4.25, basis Kansas City, should prove unsustainable, basis December.

The situation with soybeans may prove different, though. With US supplies comprising a much larger proportion of world production and exports, it is conceivable that a late

fall resurgence in demand could cause a new peak in soybean futures around \$11.00/bushel. In this situation, the soybean/corn price ratio would advance to a near record 3:1.

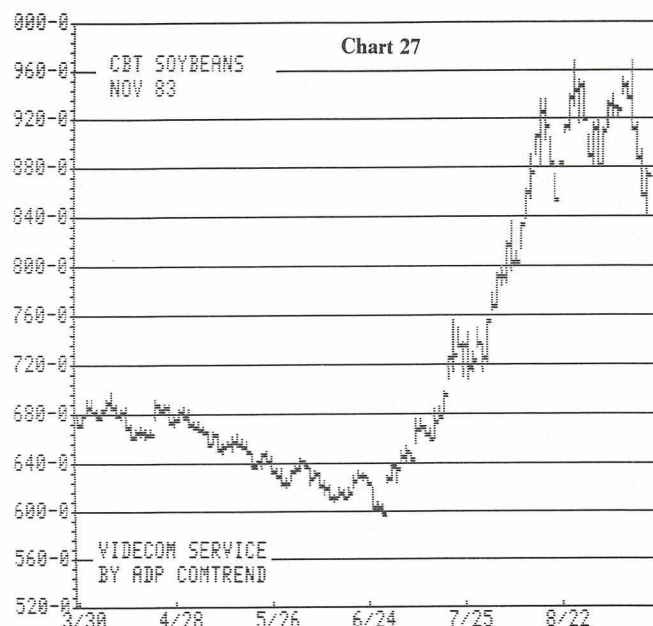
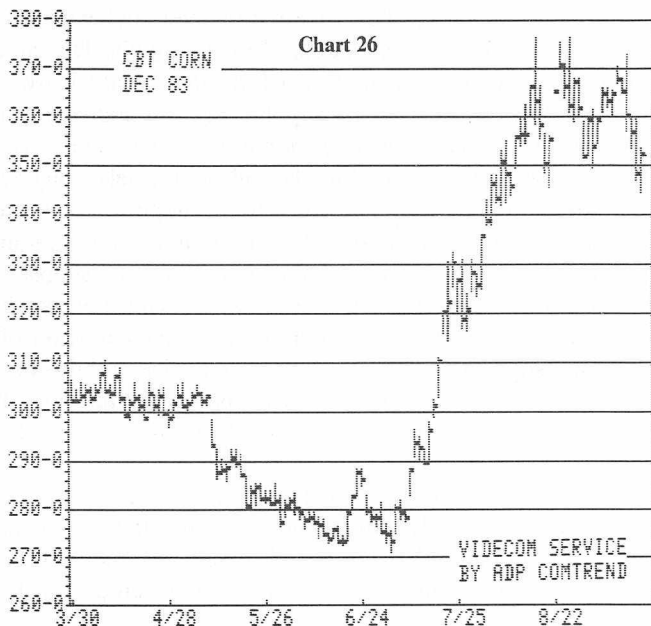
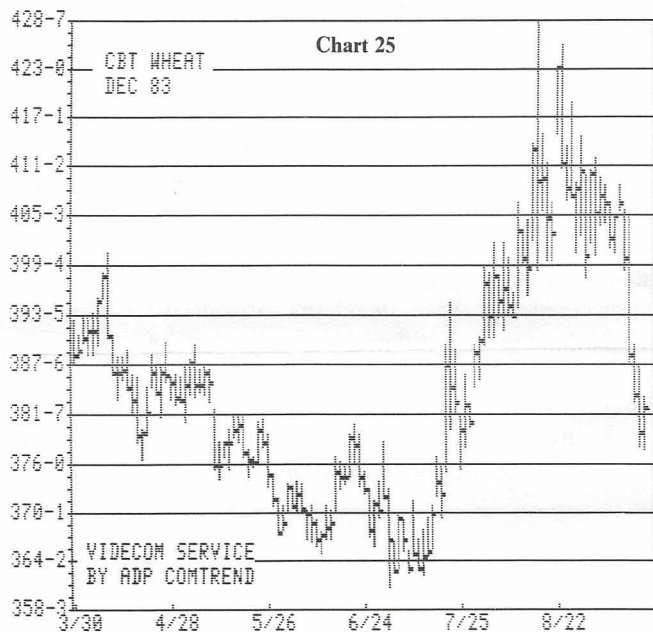
STRATEGY: *The long soybean/short soybean oil was stopped out last month with losses of \$2,000. We were too early in recommending short positions in oil; stand aside for the moment. Sell December wheat at 4.00 with stops at 4.30. Sell December corn at the market and again at 3.60, placing stops at 3.71, stop close only. For spread traders, we believe the July wheat/corn spread provides excellent value at around 30 cents. Buy July wheat/sell July corn at the market, and treat this as a long-term trade, risking 20 cents on the spread.*

Chart 24

Sept. 13 USDA Supply and Demand Projection - Sept. 1 data. -- million bushels.

| | 1983/84 9/13/83 | 8/12/83 | 1982/83 9/13/83 | 1981/84 1982/83 | expected | lexise 9/8/83 |
|---|--------------------|---------|--------------------|--------------------|----------|---------------------|
| WHEAT - supply | | | | | | |
| starting stocks | 1,541 | 1,541 | 1,104 | 132.4 | | |
| production | 2,408 | 2,424 | 2,809 | 87.7 | | |
| average yield | 39.5 | 39.8 | 35.6 | 111.0 | | |
| total supply | 3,952 | 3,965 | 3,900 | 95.3 | | |
| - usage | | | | | | |
| feed | 300 | 280 | 216 | 138.9 | | |
| other | 725 | 725 | 714 | 101.0 | | |
| total domestic | 1,025 | 1,005 | 928 | 110.5 | | |
| exports | 1,400 | 1,400 | 1,511 | 92.7 | | |
| total usage | 2,425 | 2,405 | 2,439 | 99.4 | | |
| ending stocks | 1,527 | 1,563 | 1,541 | 99.1 | | |
| CORN - supply | | | | | | |
| starting stocks | 3,434 | 3,434 | 2,206 | 150.7 | | |
| production | 4,390 | 5,237 | 8,197 | 52.1 | 4,420 | (4,500-4,630) 4,390 |
| average yield | 85.1 | 79.9 | 114.8 | 74.1 | | |
| total supply | 7,825 | 8,672 | 10,684 | 73.2 | | |
| - usage | | | | | | |
| feed | 4,050 | 4,250 | 4,500 | 99.0 | | |
| other | 950 | 960 | 900 | 105.6 | | |
| total domestic | 5,000 | 5,210 | 5,400 | 92.6 | | |
| exports | 1,925 | 2,000 | 1,850 | 104.1 | | |
| total usage | 6,925 | 7,210 | 7,250 | 99.3 | | |
| ending stocks | 900 | 1,462 | 3,434 | 76.2 | | |
| SOYBEANS - supply | | | | | | |
| starting stocks | 455 | 455 | 265 | 171.1 | | |
| production | 1,535 | 1,843 | 2,277 | 67.4 | 1,540 | (1,440-1,720) 1,501 |
| average yield | 24.9 | 29.7 | 32.2 | 77.1 | | |
| total supply | 1,990 | 2,298 | 2,542 | 78.3 | | |
| - usage | | | | | | |
| crushings | 1,010 | 1,105 | 1,100 | 91.8 | | |
| exports | 740 | 830 | 900 | 82.2 | | |
| seed, feed, residual | 90 | 88 | 88 | 102.3 | | |
| total usage | 1,840 | 2,023 | 2,088 | 86.1 | | |
| ending stocks | 150 | 275 | 455 | 33.0 | | |
| COTTON - supply (million pounds) | | | | | | |
| starting stocks | 7.9 | 8.0 | 6.6 | 120.0 | | |
| production | 7.8 | 7.8 | 12.0 | 65.0 | 7.55 | (7.25-8.0) |
| average yield | 501.0 | 503.0 | 500.0 | 84.9 | | |
| total supply | 15.7 | 15.8 | 18.6 | 84.4 | | |
| - usage | | | | | | |
| domestic | 5.9 | 5.9 | 5.5 | 107.3 | | |
| exports | 5.2 | 5.3 | 5.2 | 100.0 | | |
| total usage | 11.1 | 11.2 | 10.7 | 103.7 | | |
| ending stocks | 4.7 | 4.7 | 7.9 | 95.5 | | |

Source: USDA



Livestock

The heavy pace of slaughter in late August suppressed the bullish effects of high grain prices and resulted in unprofitably low hog/corn and steer/corn ratios.

Beef production in the week ended September 3 was 467.3 million pounds, the largest for any week since the second week of January 1979. However, better-than-anticipated retail beef movement in the face of heavy supplies caused the market to rebound furiously from the lows. By late September, it is hypothesized that well-fed slaughter steer supplies will tighten. In October, the bullish implications of such tightness will be erased, however, with nonfed slaughter picking up, owing to heavy cow slaughter and cattle moving off fall pastures.

Hog marketings will soon increase from a combination of cooler weather, allowing faster weight gains, and heavy October marketings of hogs. These hogs were farrowed *before* sows began to be slaughtered as a result of a very high rate of breeding-herd expansion, coincident with unprofitably low market hog-prices. Hog slaughter at times should reach 15 percent or more above 1982 levels on a weekly basis.

Long-term price projections, of course, depend tremendously on the rate of contraction or expansion in the rate of production. For cattle, this rate of change can be measured as placements on feed in the monthly seven-state and quarterly 13-state cattle-on-feed reports. For hogs, the rate of change can be measured directly from the primary effect of breeding rates rather than the secondary effect of placement rates in the case of cattle. The primary effect of cattle-breeding rates fails to account for veal-calf slaughter, nonfed pastured cattle, heifers retained for milk production, etcetera.

The most recent cattle-on-feed report on September 14 (see Chart 28) indicated that cattle feedlot operators have reacted slightly more strongly than expected to higher feed prices. Placements were only 90.5 percent of 1982 levels, compared with expectations of 97.7 percent. The cattle industry continues, however, to operate quite stably, with commercial beef production in a fairly narrow range over the past five years of 21.3 billion pounds (1979) to 22.9 billion (forecast 1983.) Placements figures and numbers on feed augur for a continuation of this stability through 1984.

An important figure to consider in the hunt for a long-term bullish case for live cattle futures is indicated in the July cattle inventory report: heifers retained for beef cow replacement. In the July report, this figure was 5.2 percent below the 1982 figure. A continuation of this trend, coupled with lower placements of cattle into feedlots, as in the September 14 report, could generate a very bullish case for June 1984 live cattle futures.

The reduction in the hog breeding inventory has been more profound in the past few months, but will not be as quantifiable until the September 20 hogs and pigs report (see Expectations, Chart 29). Hog producers have apparently been in a liquidation phase since May; however, only four months of liquidation have been experienced following eight months of rapid expansion. Sow slaughter in June through August has been about 35 percent above 1982. About 10 to 15 percent of this is accounted for by higher total slaughter this summer. With some degree of gilt retention, albeit low, breeding inventory on September 1, 1983, still can be expected to be at least 3 or 4 percent above September 1, 1982.

In this situation, we are bearish for hogs through the second quarter of 1984. We are especially bearish on April hogs, in light of its unusual premium to the February contract.

Note that even with high current feed prices, low feeder cattle prices at present still allow cattle feeders to break even just above 60 cents per pound. Similarly, deferred hog futures around 55 cents would allow a hog-corn ratio sufficient to generate small returns. With this in mind, we would recommend full-scale expansion of hog and cattle breeding programs at present, particularly the former.

STRATEGY: *Short positions in October cattle should have been covered on one of the three days they traded below 60 cents, for profits of at least 4.5 cents. April hogs were sold at 48 cents and again at above 50 cents on August 15 or 16. Our objective is 43.5 cents. Lower stops to 48.5 cents.*

We recommend you buy June cattle at 64 cents and again at 63 cents with stops at 61.5 cents with stops at 61.5 cents for a longer-term trade.

Chart 28 USDA CATTLE + CALVES ON FEED REPORT - 7-STATE MONTHLY

| Sept. 14 | 1983 | 1982 | 83/82% | Exp. |
|-----------------|-------|-------|--------|-------|
| On Feed Aug. 1 | 6,873 | 6,836 | 100.5 | |
| Placements-Aug. | 1,566 | 1,731 | 90.5 | 97.7 |
| Marketings-Aug. | 1,659 | 1,689 | 98.2 | 101.0 |
| On Feed Sept. 1 | 6,691 | 6,817 | 98.2 | 99.8 |

Chart 29

Expectations of Sept. 20 USDA Quarterly Hogs & Pigs Report

| | |
|-------------------|-----------------------|
| | $\frac{1983}{1982}\%$ |
| all hogs and pigs | 107-111 |
| kept for breeding | 98-105 |
| kept for market | 108-113 |

Chart 30

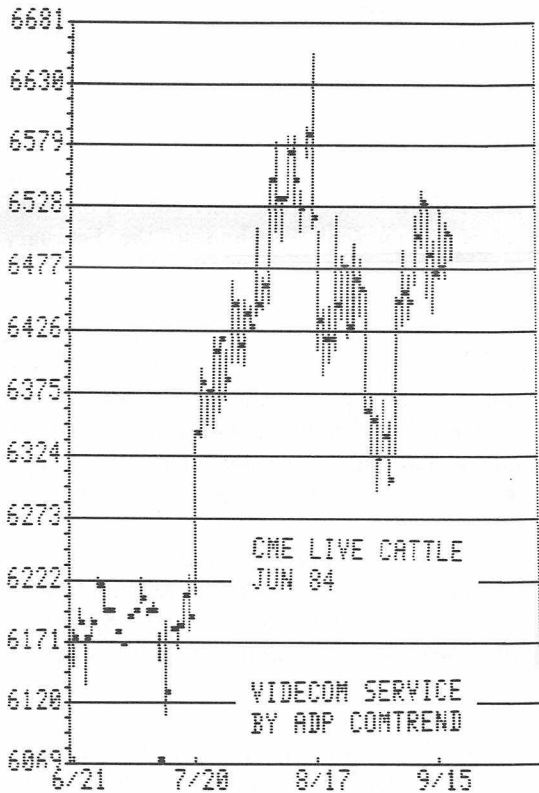
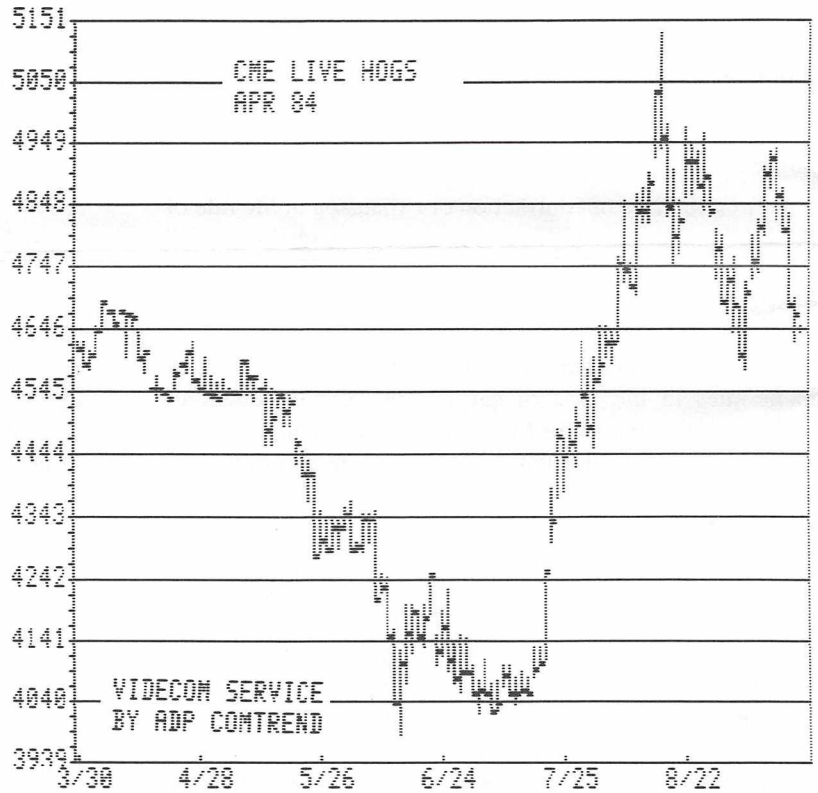


Chart 31



Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published monthly by Friedberg Commodity Management Inc., 347 Bay Street, Toronto, Ontario, M5H 2R7. Contents copyright © 1983 by Friedberg's Commodity Management Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement.

Subscription Enquiries
Friedberg's Commodity & Currency Comments
347 Bay Street
2nd Floor
Toronto, Ontario, Canada
M5H 2R7
(416) 364-1171

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

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