

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.

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### Why some banks must fail . . .

*"My question is, Who is fooling whom?"*

—Dr. Julian Chacel, Brazilian Economist, when discussing the aid program to help Brazil service its \$90 billion debt.

*"The free market view would have us wager the heart of the US banking industry on a questionable point made by ideological extremists."*

—Dr. Henry Kaufman, quoted in the *New York Times*, October 19, 1983.

*"To be sure, the banks will be let off the hook, but this is the price of stability."*

—Dr. Henry Kaufman, addressing the UN Association Economic Policy Council in Washington, October 13, 1983.

*"A certain amount of money — presumably quite a lot — is likely to be lost and will have to be written off by the creditors." Government assistance to help solve the debt situation is unwise "because the banks expose themselves to the danger of becoming government wards."*

—Fritz Leutwiler, President of the BIS, addressing the National Press Club in Washington, September 26, 1983.

No, Dr. Kaufman. The price of stability can never be so cheap as to encourage adventurism on the backs of unconcerned depositors. Would the large money-center banks have had the wherewithal to engage in reckless speculation were it not for the ideological "moderates" who were and are too horrified at the sight of a bank run?

As we enter the era of financial and banking deregulation, will the US authorities forego the opportunity to shock the system into discipline by allowing the insolvent parties to fail? If, in coming weeks and months, ideological extremism does not prevail, banking deregulation will become a nightmare. In the short period of a few years, thousands of banks will close their doors and force the authorities to bail out millions of depositors. The much-dreaded repudiation of currency will have begun.

The Federal Reserve and the FDIC have now only one sensible course of action: They must make it clear that solvent institutions will be showered with liquidity, providing their collateral is good. When the First National Bank of Midland, Texas failed to produce additional security (over and above the Fed's first secured extension of \$600 million), the US Central Bank closed the file, recognizing that the

Midland bank was insolvent. In an attempt to buy time and merge the failing bank, the FDIC pumped in \$100 million. To no avail. The bank has been closed, some of its assets have been sold to another Texan bank, and the FDIC will begin the long process of liquidating whatever assets are salvageable. While it is clear that First National's directors, shareholders, and correspondent banks will be sure losers, it is also possible that large depositors will suffer losses.

The charade of capitalizing interest to basically insolvent debtors is coming to an end; the US authorities must be prepared to allow the impecunious creditors to go the route of the First National Bank of Midland, Texas. The painful surgery must, however, not be allowed to drag on for too long; heavy withdrawals, when they come, as they inevitably will, could weaken the entire banking system and could, furthermore, endanger the conduct of an independent monetary policy.

The Fed and the FDIC must signal to depositors that henceforth, they are entrusted with the proper conduct of the banking industry. Concerned depositors, by their mere threat of withdrawals, will constrain their banks to remain liquid and safe and will demand realistic risk premiums when these principles are compromised. It cannot be otherwise. A small group of regulators cannot possibly supervise the free wheeling-and-dealing activities of the more than 14,000 banks.

For the new, deregulated environment to function properly, the FDIC must change its New Deal philosophy: It should no longer guarantee commercial banks' access to

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unlimited funds behind the shield of a generous insurance scheme. Instead, it should provide consumer protection to the least-fortunate and least-informed members of our society. This philosophical reversal may force it to lower coverage to perhaps between \$5,000 and \$20,000.

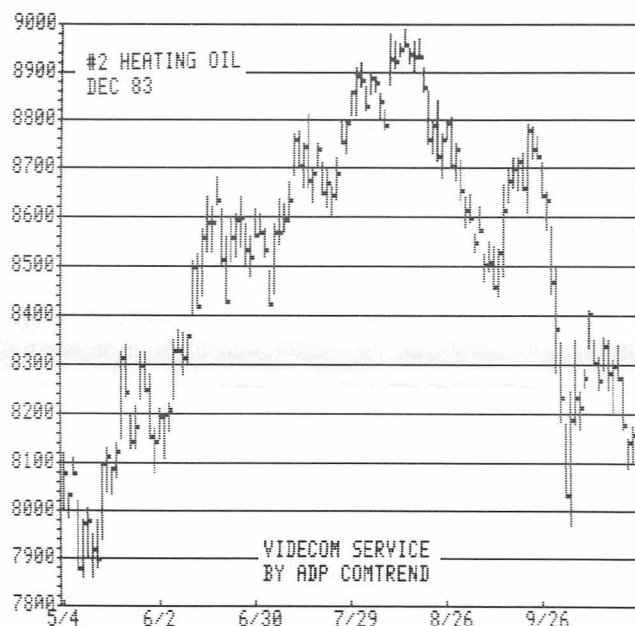
In foreclosing insolvent banks, the FDIC will preside as a trustee over the billions of dollars of loans to the likes of Poland, Yugoslavia, Brazil, and Argentina. If, as, and when

funds are ever returned (and *some* will no doubt be paid), the unlucky uninsured depositors will recoup some of their losses.

In the context of a multi-trillion dollar economy, the recognition of a mere \$50 or \$100 billion of bad loans should not shake its foundations. Should, however, the ideological moderates prevail, Dr. Kaufman, the ultimate costs would be incalculable.

## Energy Futures

Chart 1



The surprising calm with which the oil market accepted the news that Iraq was receiving the five Super Etendards fighter aircraft from France — an event that was supposed to trigger an Iranian blockade of tanker traffic through the Straits of Hormuz — speaks of a heavily-glutted market. In fact, *crude quotes remain 10¢-50¢/barrel below officially-posted prices*; the only exception is Nigeria, whose low differential is totally out of line with market realities.

The French-Iraqi bluff has been woefully ineffective in bringing Iran to the negotiating table, prompting instead Iran's parliamentary speaker, Hashemi Rafsanjani, to say, "if our enemies think that by resorting to provocations . . . they could force us to give up . . . our demand, it is impossible . . . The delivery of the Super Etendard aircraft will have no impact but to prolong the war." Clearly, the Iranians want nothing less than total victory and massive reparation payments. Considering that few military experts in 1979 gave Iran a chance to survive an Iraqi attack for more than a few months — and they have gained a slight military edge after three years — and considering the

Ayatollah's redoubtable will to live and determination to control the Persian Gulf, we would begin placing our chips with Teheran — Super Etendards or not. The Iranian bluff to close the Straits, however, also lost some credibility when Rafsanjani changed the "trigger" from the mere delivery of the aircraft to "as long as it is not possible for our oil to be exported normally." As any good poker player knows, raising in one hand and checking the next is not a sign of strength.

But what of the possibility of such closure? For the past year, we have discussed just such an event with some degree of concern. Our present *lack of concern* — and even irreverence — has surprised a great many of our loyal clients who have patiently dug themselves into a long-term bear position. What has changed? Elementary, Mr. Trader, but first let us restate our *original* argument.

The economies of the oil market have been cast, so to speak, ever since the laws of supply and demand were allowed to function relatively freely — that is, since about the late '70s. For whereas non-OPEC supply began to respond to the spectacular multiplication of the price sometime in 1974-75, demand was allowed free rein by shortsighted and politically-conscious governments in North America. Not until oil deregulation brought the news of price increases to the American consumer (who heretofore had a penchant for wearing sweaters in the spring) did the insane increases in consumption come to a halt. And so it was that OPEC, in an attempt to hold up prices, became the residual petroleum supplier to the world. This "swing" position forced it to cut back production from 34 million barrels per day (mbd) to as low as 14 mbd in the winter of 1983 — and include a modest \$5/barrel readjustment in its \$34/barrel price to boot.

We won't bore you with the intricacies of the new price support pact, except to reiterate that it too will collapse as OPEC is forced to accept a *continuous* drop in production despite the financial frailty of much of its membership. Chart 2 shows the remarkable downtrend in OPEC production necessary to maintain an unrealistic price for oil. This downtrend will not reverse until (a) all OPEC nations are bankrupt or (b) Iran wins the multiyear conflict and begins producing oil from Iraqi fields or (c) the price of oil reaches

an "equilibrium price." It has been our opinion, and still remains, that the latter means a spot price of \$8-\$10/barrel.

The inevitability of a price collapse left us no alternative but to advocate short positions in heating oil, gasoil and, more recently, crude oil futures. And so we did for two years, patiently, persistently, and tenaciously. What could have upset these calculations? Nothing. But the highly-leveraged world of futures is not well-suited to "temporary setbacks."

What would have happened if suddenly, without warning, the Iranians, in a desperate attempt to blackmail the Persian Gulf members who had been supporting Iraq, blockaded the Straits? Well, of course, the oil market would have been "thrown into confusion" (to borrow a favorite press understatement), and oil prices would have skyrocketed. Somebody in that think-tank called the US State Department had figured that the price would have risen to... nothing less than \$96/barrel(!); his chilling hour-by-hour, blow-by-blow account would have frayed even the steeliest nerves. Admittedly, after a number of weeks or months (time enough for consultations and, perhaps, some action) the US, with or without its dependable allies, would have reopened the Straits, and the market would have returned back to orbit. In the interim, however, our margin accounts would have been devastated by this "temporary setback."

This scenario would have been true until very recently — until in fact, Iran announced publicly its intention to close the Straits any time it was provoked. The various announcements were given enough publicity to elicit firm US response: It resolved to keep the Straits open to traffic, and to that purpose it directed part of its Mediterranean fleet to the Gulf of Oman. In fact, the usually reliable military strategists at the London International Institute of Strategic Studies estimated that Iran's navy, consisting of three destroyers, four frigates, and 10 fast patrol boats, was no match for the formidable armada of US, French, and British navy ships and was therefore incapable of effectively blocking access to the Gulf for longer than a few days. Nor would the Iranians be able to keep the Straits of Hormuz mined in the presence of US minesweepers and helicopters.

The response time has effectively been shortened from a devastating few weeks (or months?) to a few days, hardly a disaster. Furthermore, the mere presence of US forces in the area, ready to move at a moment's notice, may be enough of a deterrent. Finally, the Iranians would have to first lose their exporting capability before they'd attempt to close off everyone's (including their own) shipments.

The possibility still remains that Exocet missiles would be used to sink foreign tankers lifting Iranian oil. This would cause insurance costs to skyrocket and would effectively stop further Iranian oil exports. This scenario, suggested by our good friend and noted oil analyst, Charles T. Maxwell, would also carry the added risk of Iran's retaliating by cutting off the Iraqi pipeline to the Mediterranean, which runs through Turkey. In all, 2.8 mbd could be cut off. This is still a far cry from the potential 8 mbd that would be cut in a

blockade of the Straits.

More importantly, we believe that the market has already taken this risk into account: During the third quarter, oil companies increased their land stocks by over 1 mbd in spite of bulging inventories, which now equal 93 days of forward supplies. Governments increased their land stocks by 300,000 barrels per day, and there are reports that total stocks on sea have increased by as much as 1 mbd. The puzzling strength of crude prices during August and September and OPEC's very comfortable 18-18.5 mbd selling rate is thus resolved: The market has been preparing itself for a reduced flow of oil from the Gulf.

But why our lack of concern at the military situation surrounding the Straits of Hormuz? *Since the element of surprise is gone*, the market is not likely to react too strongly nor for too long should the Straits be blocked. This in turn would allow us to retain our long-term short positions without having to run undue risks.

An interesting development in recent weeks has been the relative weakening of the New York heating oil contract vis à vis London gasoil (see Chart 3). From an average \$8/tonne premium and a peak \$11/tonne premium, heating oil has weakened to a \$4.50/tonne premium over gasoil. Understandably, Iranian shipment difficulties would affect London much more adversely, as it relies heavily on Iranian product. Moreover, emergency releases from the US oil stockpile would tend to keep a lid on US heating oil prices should trouble arise in the Gulf. For this reason we still recommend temporarily switching short positions of gasoil into heating oil. Note that the December '82 positions saw the heating oil variety sell at a *discount* of as much as \$13/tonne, a situation that could easily be repeated this year.

**STRATEGY:** *Remain heavily short, resting assured that with the element of surprise gone, the closure of the Straits has become more of a nuisance than a danger to the market. Where feasible, switch gasoil futures into heating oil, looking for the latter to move to a discount from the present premium.*

Chart 2

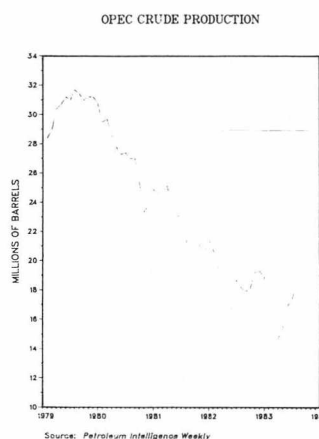


Chart 3

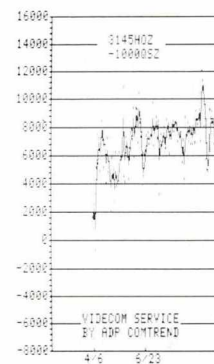
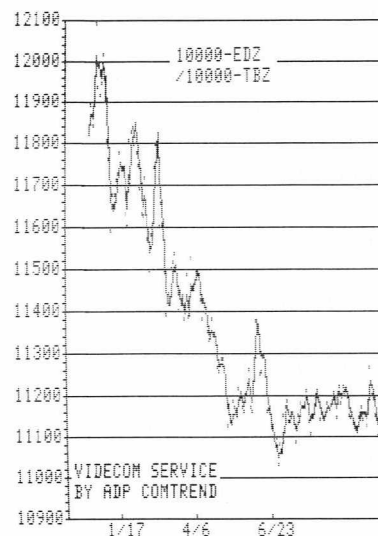


Chart 4



## Interest Rate Futures

**STRATEGY:** Our lone recommendation in this sector, the long T-Bill/short Eurodollar spread, seems poised to widen (see Chart 4). Add to this spread, preferably in the March position.

## Currencies

Our bullish views on the US dollar had been underpinned by our contrarian leanings: After all, informed opinion thought that the dollar was overvalued. Think of our disappointment when we found out that the US dollar had made the cover of *Time Magazine* in the October 10 issue. Its title: "Superdollar: dominating the world's currencies" sent shivers through our spine: Could it be that unknowingly we had been *part* of the bullish consensus? As good contrarians, we dreaded nothing more (especially *Time Magazine!*).

Fortunately, we had little to be concerned about. Sputtering out inconsistencies and much nonsense, always delicately quoted from a so-called expert, the article hesitated somewhat from taking a strong stance as to near- and medium-term direction. Although it clearly "sympathized" with those who foresaw a mild or violent drop, the article never hesitated to describe the dollar matter-of-factly as overvalued.

We have consistently refused to believe that the US dollar is overvalued. In the first place, we demonstrated that the growing US trade deficit was due to a dis-synchronized pattern of growth — much stronger and earlier recovery than its trading partners and a dollar scarcity in some less-developed countries, particularly Mexico. Secondly, using *bilateral* trade flows, we demonstrated that currency movements did a remarkably poor job of explaining trade surpluses and deficits. Hence, the improvement in the US surplus vis à vis France (against whose currency the US unit appreciated), the massive deterioration vis à vis Canada (against whose currency the US unit remained unchanged), and now the massive Swiss trade deficit, 74 percent above the one recorded in 1982 for the first eight months and second only to the record deficit set in 1980, when its unit

was a great deal more "overvalued" than today. Thirdly, we pointed out that the trade figures were incapable of capturing the total movement of goods and services and that the inclusion of all or part of \$42 billion of net errors and omissions in the current category would definitely change the trend. Finally, while it is true that the dollar had risen a great deal from the lows reached in 1978-80, it is also true that its previous decline had been quite exaggerated and that in real terms a good case could be made that the US dollar was still undervalued in relation to the Swiss franc, the deutschemark, the Japanese yen, and the British pound by between 8 and 15 percent if the base year was moved to 1958, a year of relative external equilibrium.

**STRATEGY:** Despite our fundamental belief in the continuing strength of the US dollar, technical considerations forced us last month to abandon short positions in Japanese yen, DM, and Swiss franc. As a result, our stops at 42.00, basis December '83 yen, 47.75, basis December '83 Swiss franc, and 38.75, basis December '83 DM reasonably protected paper profits. On the other hand, cover stops were not triggered on the British pound and the French franc.

Bottom pickers were only too glad to jump on the currencies bandwagon, producing a stronger-than-expected rally. Nevertheless, there is as yet no tangible evidence that the US dollar has topped out. We prefer to remain long the dollar via short positions in French francs and British pounds.

Reinstate short positions in December '83 DM, December '83 SF, and December '83 yen should these markets close below 38.25, 47.35, and 42.80 respectively.

Chart 5

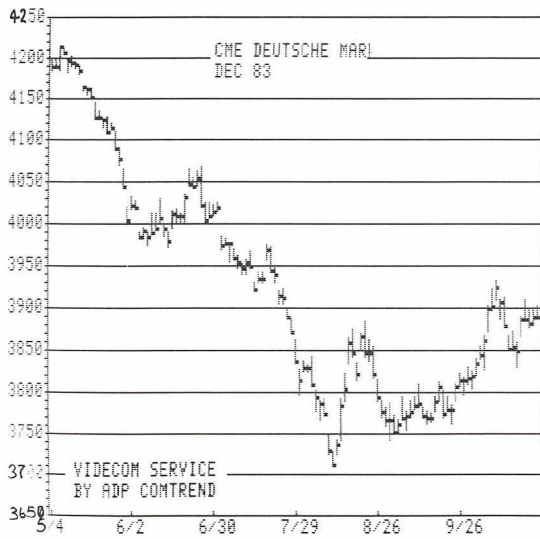


Chart 6

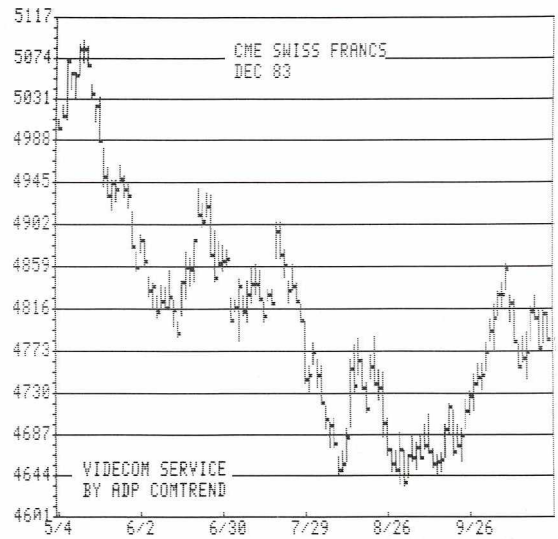


Chart 7

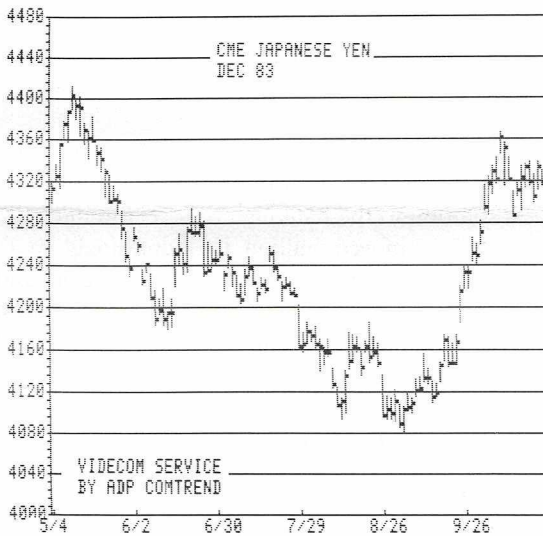


Chart 8

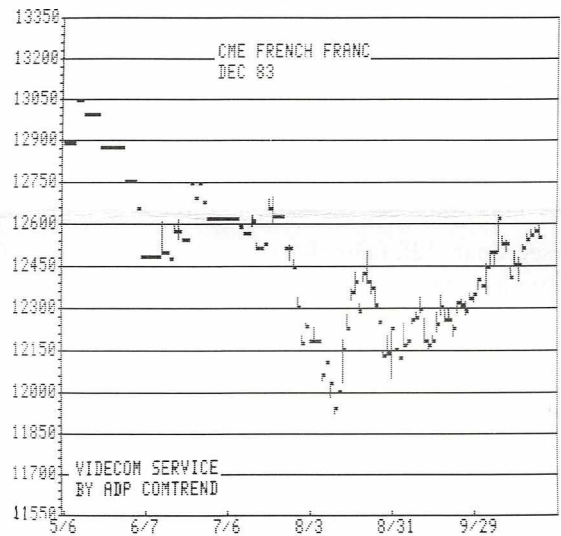


Chart 9

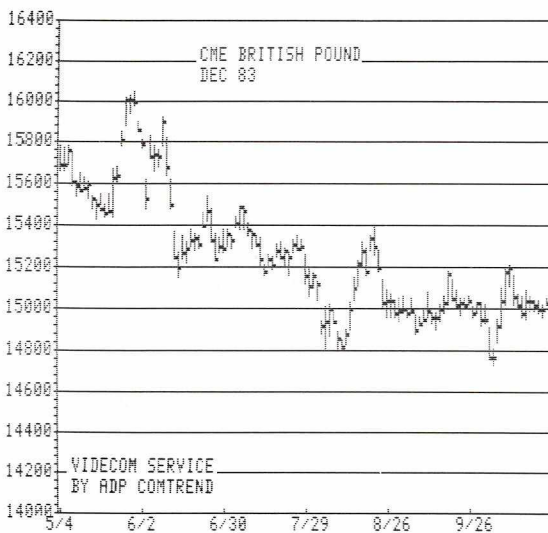
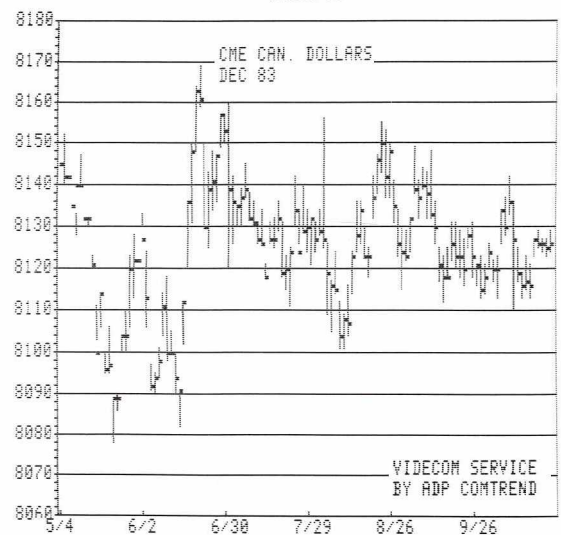


Chart 10



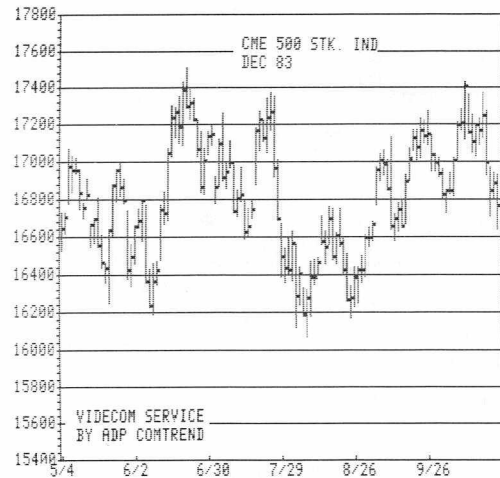
# Stock Market Indexes

As suggested last month, a severe shakeout is brewing, likely to lop off as much as 30 percent of recent highs.

Total disenchantment with technology and brokerage issues, and the first stirrings of concern regarding money-center banks are leading the decline. It should be noted that while on the NYSE, new lows exceeded new highs for the first time since the 1982 lows, on October 19, new lows exceeded new highs on the AMEX and NASDAQ on every trading day of the past week — a sign that the “rank and file” is exhausted. Furthermore, 17 out of the 20 most active issues this past week closed with a minus sign — an indication that negative sentiment is rubbing off on the large holders.

**STRATEGY:** Remain short; add aggressively on close below 166.00 and 158.00, basis December '83 S&P futures.

Chart 11



# Precious Metals

Prices continued to decline, apparently responding to a number of bearish factors, among them the enormous buildup in combined Comex-LME silver warehouse stocks (see Chart 12), fears that central banks would be forced to dump gold in an effort to raise much needed cash, fears that the IMF may also be forced to sell its large gold hoard should the US Congress not approve further funding, etc.

The simple truth is that precious metal prices are dropping because they are still in a bear market that began in early 1980. Their (downward) path of least resistance, dictated by price considerations (i.e., gold is overvalued in terms of purchasing power) and/or convertibility considerations (i.e., the net external liabilities of the US can be paid

off at almost half current bullion prices) has been continuously interrupted by fears of war or fears of a massive reflation as a solution to the banking crisis. These interruptions have in effect moved bullion to increasingly weak hands. Recent increases in the open interest of gold and silver are typical of price declines of such magnitudes, presaging perhaps that the stale bull liquidation phase is still ahead.

**STRATEGY:** Remain short December '83 Comex gold, lower stops to 420.00, close only. Silver prices should test last August's lows of \$6/oz; place protective stops at \$11.60, basis Comex December '83, close only.

Chart 12

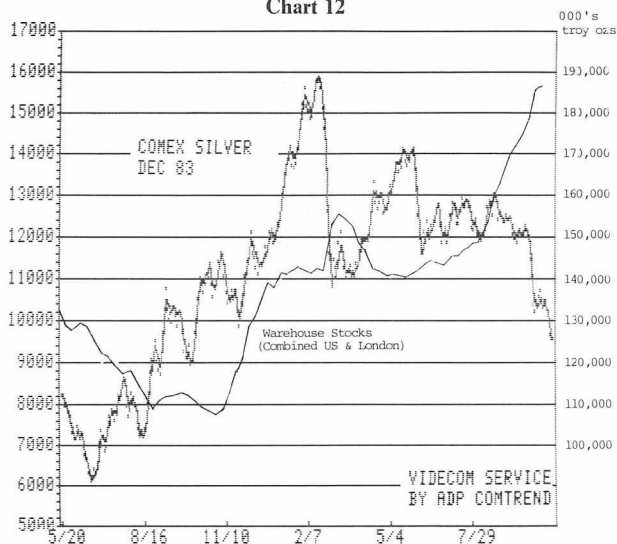
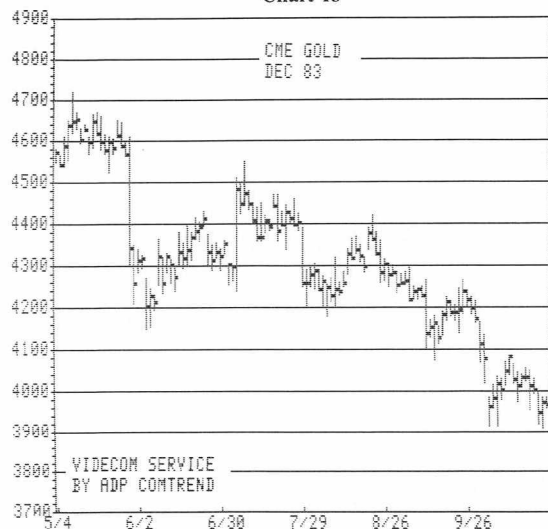


Chart 13



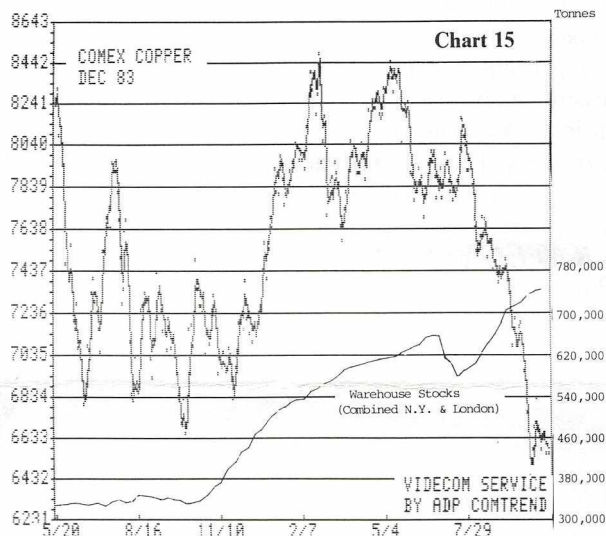
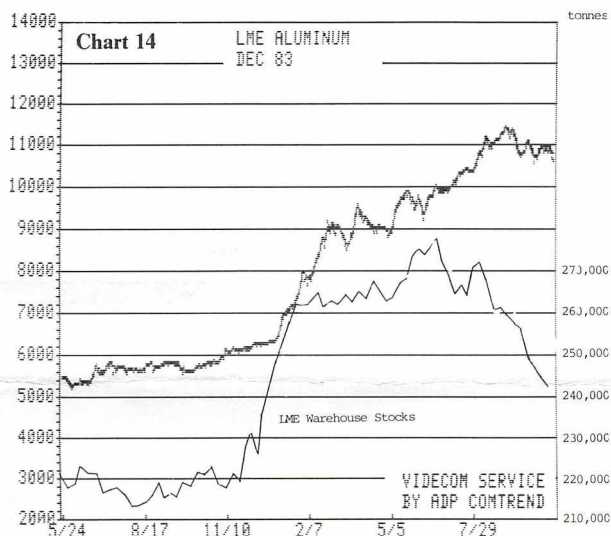
# Base Metals

Last month we chose to trade aluminum from the short side as "copper, though affected by the same fundamentals, is trading at a price already too low to warrant speculation." This was said with December '83 copper trading at 71.80. Friday's close of 65.60 made hash of our value judgments, although it confirmed the presence of powerful deflationary forces — a situation we have been alluding to for many months. The urge to sell, forced by the need for cash, recognizes no values. Strangely enough, aluminum prices have only declined marginally (about £15/tonne) although sufficiently to defray half the cost of a put option without

even counting the benefits of earning the contango. At Friday's close, aluminum commanded a 5¢/lb. premium over copper, a rare occurrence.

The accelerated increases in copper warehouse stocks (see charts) are not being accompanied by commensurate increases in forward hedge selling as open interest remains static or falls marginally at best. This indicates that there is still a considerable amount of unfilled selling pressure.

**STRATEGY:** Remain short LME aluminum via three-month put options.



# Cotton

We've changed our mind. (It's not the first time, and it won't be the last.) It has been our impression through the summer of 1983 that the negative world-wide supply situation for cotton would restrict substantial domestic price increases; however, a combination of fundamental and technical factors has changed our outlook.

Much of the 37.5 percent drop in cotton production in the US in 1983 has been made up world-wide by foreign production increases. World production in 1983-84 is forecast at 65.7 million bales, only 2 million below 1982-83. In fact, world year-end stocks on July 31, 1984, are projected to fall only 2.9 million bales, from 27.8 on July 31, 1983, to 24.9 million bales.

World-wide cotton consumption is expected to rise to 68.5 million bales in 1983-84 from 66.8 in the previous season. This will be led by increases in China to 16.7 million bales from 16.1 in 1982-83, along with increases in India, the USSR, Egypt, and South Korea. These countries are expected to have large, even record, crops this year, though. The

world trade situation is thus somewhat slack, with US exports forecast at 5.3 million bales. The 1983-84 crop is currently estimated at 7.55 million bales.

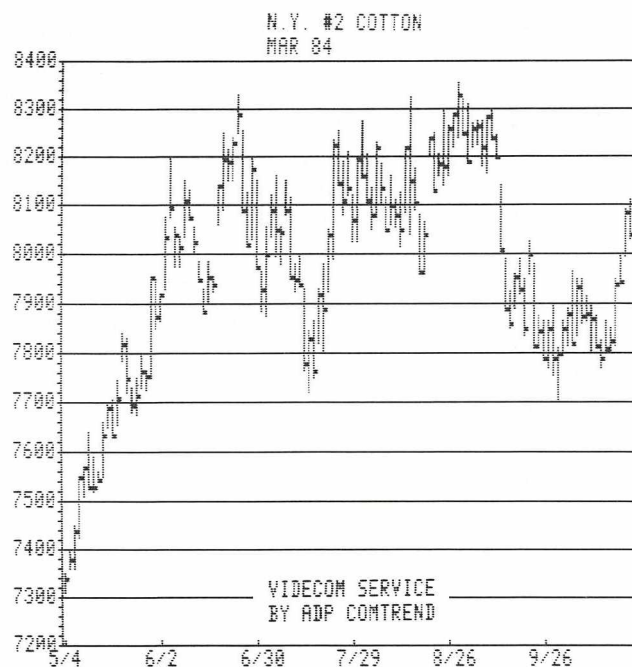
Carryout in 1983-84 is now forecast at 4.4 million bales, down from 7.9 last season. (Optimum carryover is considered 3.5-4.0 million.) This may be further reduced if additional damage occurs to the crop before harvest completion. A cold snap in Texas on September 19 and 20 was reported to have ruined as much as 300,000 bales of cotton. Later, on October 1 and 2, torrential rains in Arizona were reported to have reduced crop prospects by almost 100,000 bales, while reducing the quality of much more of the state's usually high-quality crop. The initial response to these reports was subdued, but recent technical factors have set the stage for a possible move to 90¢ in nearby contracts. Prices have broken out from an extensive consolidation phase in the mid-to-upper 70 cent range. At the same time, open interest has fallen to levels well below that prevailing through most of 1983.

The most recent report of US cotton consumption indicated use of 453,708 bales in the four-week period July 31 to August 27. This compares with 368,884 bales in the previous four-week period and 385,918 in the year-earlier four-week period. Average daily consumption in August 1983 was 22,685 bales, up 23 percent from the previous month and up 18 percent from the year-ago period.

The 1984 USDA cotton price-support program is due to be released before November 1. No payment-in-kind program is expected, and the prospect of a target price freeze at 76¢ has been dismissed. Instead, the target price will rise to 81¢ in 1984, attracting a higher level of participation in the set-aside program. Set-aside is mandatory in order to receive loan-rate (55¢ basic support price) and target-price protection. With a set-aside rate of 20 percent or lower, we feel 70 percent of producers would be inclined to participate in average reductions. (A higher required set-aside would lower participation rates, as it would reduce gross returns per acre, on average.) With a prospective 15 percent reduction in 1984 acreage from base (average of 1982 and 1983 cotton area, planted and certified set-aside) acreage, the price outlook for 1984 could be quite constructive.

**STRATEGY:** Buy March cotton at the market, placing sell stops at 77.80, stop close only.

Chart 16



## Sugar

**STRATEGY:** Short positions recommended last month should have been covered at 10¢ or lower; sugar having failed to reach the 8.80 target by a slim margin. Positions

were covered with profits in excess of \$1,250 per contract. Sales recommended at 12.20, basis March, failed to be filled by 26 points. Stand aside.

## Grains

Who in their right mind buys more of a product when the price rises? Obviously, no one, unless he is merely speculating. Still, many analysts argue that 1983-84 export sales commitments for soybeans at 67 percent above those at this time last year is *bullish*; in fact, this is a *bearish* argument.

Let's take off our rose-colored glasses and look at the supply-demand situation as it really is. To date, the mid-August contract highs in wheat, corn, soybeans, and soybean meal, and the late-September high of soybean oil, have held. Demand has slackened substantially since the fretful days of July and August when domestic and foreign buyers scrambled to book forward commitments. Japan, for example, has covered import commitments to the end of March (about three months ahead of schedule) and has determined to await lower prices before arranging April to June needs.

The greater level of soybean bookings is the result of buyers' completing purchase obligations to alleviate the

possibility of having to buy later at even higher prices. A larger-than-normal proportion of purchases have been booked; a smaller proportion remains. That higher prices than those in late August have not yet transpired is something even the buyers could not predict. Such prices may yet come about, but the longer prices remain high without making new highs, the lower the probability of such an event.

In the short period from October 1 to 13, corn export sales commitments were 4.53 times what they were for the same period in the 1982-83 season; again not a *bullish* case, but a *bearish* one. Wheat export commitments for July 1 to October 13 are running high for the same reason, at 2.61 times those for the same time in 1982-83.

Actual exports, that is, export inspections, to October 14 are 19.3 percent behind 1982-83 figures for wheat, 6.6 percent behind last year for soybeans, and 50.7 percent behind last year for corn (in the short period of October 1 to 6).

With export commitments subject to cancellation, and export inspections already lagging last season's rates, the bearish case is clearly more logical.

Total 1982-83 exports for commodities with marketing year ending September 30 were reported October 14: Total corn exports for the marketing year were 1,887.1 million bushels, compared with the USDA's forecast the day before of 1,850; soybean oil and meal exports for the season were much lower than the October 13 USDA estimates (in brackets) at 1,784.4 million pounds (1,900) and 6,431.5 thousand tons (7,050) respectively. These figures represent shortfalls in exports of 6.1 percent for soybean oil and 8.8 percent for soybean meal, compared with the USDA estimates. The USDA's 1983-84 export forecasts of 1,450 million pounds for soybean oil, 5,700 thousand tons for soybean meal, and 720 million bushels for soybeans are probably still too high in view of current prices for these commodities. These estimates represent reductions of less than 20 percent from final 1982-83 export figures, when prices are currently more than 50 percent above 1982 prices at this time. The 1983-84 corn export forecast of 1,925 is ridiculously high in view of corn prices to date in the 1983-84 season.

Buyers of all these grains and oilseeds have already been forced to turn to other sources and other supplies. Wheat and barley feed use, skim milk powder for feed, tapioca pellet feed, and citrus pulp pellet feed will all increase substantially in place of corn and soymeal. Thailand has taken corn sales from the US; its prices are much lower, it has a large export surplus, and transportation to continental Eurasia is much cheaper. The USSR has booked one or two cargoes of Thai corn of 100,000 metric tons (mt) each.

Wheat is being supplied, at lower prices than the already low US wheat prices, by the EEC and Argentina, and possibly Canada, while Australia's soon-to-be-harvested new crop could be offered at prices as much as \$20/mt lower than US prices. Soybean prices will face a potential fall when South American crops become a certainty and come to market at competitive prices. In circumstances such as these, with high prices for nearby contracts, Brazil has been known to deliver all possible corn and soybean supplies from the new crops to be harvested (spring 1984) and, if necessary, replace these with imports later in the season. Such an event would be very bearish for corn and soybeans.

The October 12 production estimates placed soybeans at 1,517 million bushels, compared with expectations of 1,515, the September estimate of 1,535, and 1982 record production of the revised 2,229 noted above. The respective figures for corn were 4,259, expectations of 4,274, and 4,390 in the September estimate, and record 1982 output of 8,397 million bushels.

End of season (August 30) soybean stocks reported on September 20 were substantially below expectations at 387 million bushels versus the USDA estimate, several days

before, of 455 million bushels. However, it had been known for some time that the 1982 US soybean crop was overestimated by about 2 percent. Thus, only about 20 to 25 million bushels of soybean usage in excess of expectations could be accounted for by a higher level of disappearance in July and August for domestic feed use and export. The October 12 crop report reduced the 1982 US soybean crop estimate commensurately to 2,229 million bushels from 2,277. Neither the lower reported stocks, nor the 308 million bushel reduction in USDA soybean production estimates between August and September could provide the fuel necessary to power soybean prices to new highs.

Corn prices have similarly failed to rise to new highs in the past two months, while wheat prices have been substantially weaker. The bearishness of the world wheat supply situation in view of current estimates of 1983-84 wheat production, with comparative 1982-83 figures, for the following countries, has finally permeated the bullish facade created in view of the summer rise in corn and soybean prices: China — record 78.0 million metric tons (mmt) (68.4 in 1982-83); India — record 42.5 (37.8); Australia — record 19.0 (8.8 for the 1982-83 drought-devastated crop); Argentina — 13.0 (14.5) — recently estimated, and second only to the record 1982-83 crop. Total 1983-84 world wheat production is estimated now at a *new record* 484.3 mmt compared with the previous 1982-83 record of 479.5 mmt.

**STRATEGY:** *Remain short December corn, having sold virtually at the top of the market, around 3.68, with a target of 3.25. Lower stops to 3.50. Our recommendation to sell December wheat at 4.00 was missed on September 21 by only 3¢, when the high was 3.97. Alas, since then, December wheat has retreated to around 3.60. Sell December soybean oil at the market, and again at 32¢ with stops, close only, at 35¢, and a target at 24¢.*

## Spread opportunities in grains and oilseeds

We have made a bearish case for the grain complex as a whole. However, the bearish case in wheat may be exhausted; this suggests the opportunity for profitably spreading wheat versus corn. The overwhelming bearish news in the wheat market has pressured it to trade barely (cash basis) above the 3.30 loan rate for 1984 production. While prices may briefly trade below this level, participation rates in the order of 25 percent in the 1984 USDA wheat acreage reduction programs (30 percent mandatory diversion in order to participate in regular and reserve loan programs, plus optional 20 percent additional diversion with payment-in-kind at the rate of 75 per cent) and a target price of 4.45 (maximum deficiency payments of 1.15 — the difference between the loan rate of 3.30 and the 4.45 planned target price) should begin to offer support to the wheat market.

Concern at the end of September that China would not fulfill its minimum 6.0 mmt purchase obligations have been largely alleviated. Until September 26, only half that required minimum had been purchased by the Chinese. US pressure that they meet the minimum requirements have generated sales of a total of 640,000 mt of US wheat since then. A continuation of such sales should help to raise wheat prices. Chinese wheat commitments now total 2.255 mmt, with the potential for as much as an additional 2.3 mmt before the end of December.

Turning to the soybean complex, Chart 20 provides figures based on the October 13 USDA supply and demand projections that support the hypothesis that a spread of long 1 March soybean meal/short 2 March soybean oil should be undertaken. Ending stocks in terms of potential soybean meal equivalent (existing meal stocks plus the potential meal production from soybean carryover stocks) will be much smaller than ending stocks in terms of potential soybean oil equivalent. The comparison is even more strongly in favor of the meal when only forecast, *existing* (crushed) stocks on September 30, 1984, are compared as a proportion of annual usage.

**STRATEGY:** Retain long July wheat/short July corn spread, risking at par. These spreads should have been initiated last month at about 25 cents premium wheat. Buy 1

March soybean meal/sell 2 March soybean oil, at the market, risking \$3,000 per spread. Double the position if March soybean oil trades to above 32¢ regardless of where March soybean meal is trading. Risk \$3,000 on the additional amount as well.

## Protectionism on wane?

The suspension of certain European Economic Community (EEC) subsidies on September 28 holds promise for the ultimate breakdown of world protectionism. The EEC move was necessary to prevent its own bankruptcy, which was developing and is still possible as long as the EEC attempts to subsidize domestic production to prevent competition from external (and more competitive) supplies. Current EEC plans include an imposition of a tax on animal fats and vegetable oil imports to protect the EEC oilseed industry. There is tremendous opposition outside the EEC (and even within, as it would harm the German and Dutch soy product re-export industries) to such taxes. The sooner the EEC becomes bankrupt as a result of its restrictive agricultural policies, the better. That will be a major step towards freer trade and lower consumer taxes (which currently fund government-subsidized inefficiencies).

Chart 17

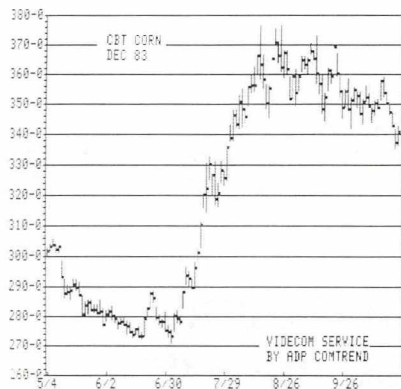


Chart 18

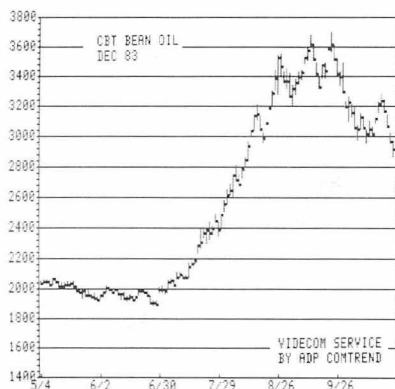


Chart 19

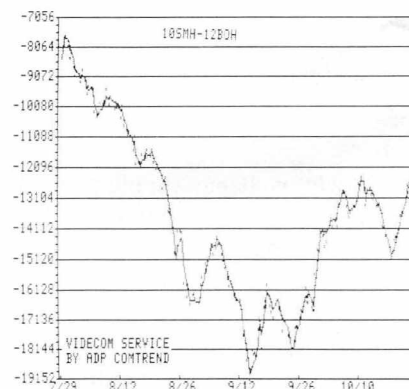


Chart 20

October 13 USDA Supply and Demand Projections - October 1 data.

-soybean meal and soybean oil carryover - combined crushed and uncrushed equivalent.

		1983/84 Sept. 30/84	1982/83 Sept. 30/83
<b>soybean meal equivalent ('000 short tons)</b>			
UNCRUSHED	1983/84	48 lb./bu. x 2000 lb./ton x 120 mln.bu.	2,880
	1982/83	387 "	9,288
CRUSHED	1983/84	forecast carryover 180 thousand short tons	180*
	1982/83	375 "	375*
<b>TOTAL CARRYOVER</b>			
		3,060	9,663
<b>ANNUAL USAGE</b>			
	1983/84	23,450	26,500
	1982/83	13.1% (0.8%)	36.5% (14.2%)
<b>soybean oil equivalent (million pounds)</b>			
UNCRUSHED	1983/84	11 lb./bu. x 120 mln.bu.	1,320
	1982/83	387 "	4,257
CRUSHED	1983/84	forecast carryover 795 mln.lb.	795*
	1982/83	1,370 "	1,370*
<b>TOTAL CARRYOVER</b>			
		2,115	5,627
<b>ANNUAL USAGE</b>			
	1983/84	11,200	11,750
	1982/83	18.9% (7.1%)	47.9% (11.7%)

# Livestock

A bull market in meats initiated by a combination of cyclically low product prices and high feed prices is gradually developing. However, the livestock market (especially cattle) will have to survive both seasonal price weakness between now and the end of the year, and the heavy pace of slaughter. For cattle, this heavy pace of slaughter will be caused by passage of dairy legislation, reducing milk price-support levels, thus generating dairy herd liquidation; for hogs, the high slaughter rates (up to 27 percent above 1982 on a day-to-day basis), far in excess of those forecast based on the June and September hog reports (estimating fourth quarter marketings up 15 percent from 1982), are the result of delayed weight gains during the very hot summer months in 1983.

In retrospect our analysis of hog breeding herd retention in last month's report was very accurate, looking at the September 20 USDA hogs and pigs report (see Chart 21). We anticipated that breeding inventory would have to be at least 3 or 4 percent above the respective level on September 1 last year. In fact, the figure was reported at 5.0 percent above 1982 levels, resulting in a bearish interpretation of the hog report when compared with anticipated breeding inventory increases of only 2.7 percent (average) from a year earlier.

Retail beef movement has remained good for this time of year in the face of cattle slaughter rates about 1.5 percent above 1982 in recent weeks. The October 18 USDA quarterly 13-state and monthly 7-state report generated a bullish reaction the following day. Traders took more interest in the 13-state report, which indicated that marketings were higher than anticipated in July through September, leaving fewer heavyweight cattle for slaughter in the next month or so. Less consideration was given to the negative implications of 7-state placements at 100 percent of 1982 levels during

September at the top of the expected range, compared with average expectations of 96.4 percent. Lighter-weight steer and heifer numbers are substantially below a year ago, supporting our bullish case for June 1984 cattle. These figures would lead us to believe that prospective higher slaughter cattle prices in the summer of 1984 coupled with grain prices we currently expect to be lower in summer 1984 than the drought-plagued summer 1983, would create a tremendously bullish situation for August feeder cattle. As we reported last month, feeder cattle prices are low at present, given break-even prices for slaughter cattle at around 60¢ per pound. Feeders are currently trading at about 2¢ premium to live cattle, and in a bull market, premiums of up to 10 cents or more are not uncommon.

**STRATEGY:** *For all intents and purposes, we will consider that our target was reached at 43.5¢ in April hogs. While the low was 43.52, we covered positions when it became apparent that prices were bottoming; we hope you, too, covered short positions in April hogs at close to 43.5, for profits of about \$1,650 per contract, on average, in only two months. We now recommend spreads long December hogs/short April hogs at 300 points premium April, risking 150 points. The brunt of the heavy fourth quarter marketings are discounted, while seasonally weak April is trading at an excessive premium to nearby contracts.*

*Long positions in June '84 cattle have been filled as per last month's recommendations, between 63.50 and 64¢. Maintain these positions with stops at 61.5¢. In addition, buy August feeder cattle at the market and again at 64¢ with stops at 62.5¢. Those preferring spreads should buy August feeder cattle and sell August live cattle at the market, risking 200 points, with a long-term objective of 10¢ premium the feeder cattle.*

Chart 21

SEPTEMBER 20 USDA QUARTERLY HOGS AND PIGS REPORT - SEPTEMBER 1 DATA

	1983	1982	$\frac{1983}{1982}$ %	Expected
All hogs and pigs on farms	45,880	41,670	110.1	109.4 (106-112)
Kept for breeding	5,829	5,553	105.0	102.7 (100-106)
Kept for market	40,051	36,117	110.9	110.5 (107-115)
under 60 lbs	15,804	14,562	108.5	108.1 (105-112)
60-119 lbs.	10,169	9,000	113.0	111.4 (107-116)
120-179 lbs.	8,303	7,277	114.1	112.3 (110-114)
over 180 lbs.	5,775	5,278	109.4	111.1 (107-114)
Farrowing intentions -Dec. '83-Feb. '84	2,069	2,090	99.0	95.3 ( 91-101)
Sept.-Nov. '83	2,464	2,363	104.3	98.3 ( 92-104)
Pig crop-June-Aug. '83	17,675	16,254	108.7	110.6 (107-113)

Chart 22

OCTOBER 18 USDA CATTLE AND CALVES ON FEED REPORT - OCTOBER 1 DATA.

	13-state quarterly		1983 1982	1983 1982	% expected		
	1983	1982					
on feed July 1	9,067	8,981	101.0	Sept. 1	6,691	6,817	98.1
placements-July-Sept	5,586	5,846	95.6	Sept. 2,003	2,004	100.0	96.4
marketings-July-Sept	5,890	5,773	102.0	( 92-104)			( 90-100)
on feed Oct. 1	8,465	8,800	96.2	Oct. 1	1,672	1,585	105.5
				( 98-105)			(100-105)
				( 95- 99)			( 94- 99)
kinds on feed							
-steers and calves	5,450	5,600	97.3				
under 500 lb.	232	265	87.5				
500-699 lb.	740	843	87.8				
700-899 lb.	1,932	1,893	102.1				
900-1099 lb.	1,922	1,988	96.7				
over 1100 lb.	624	611	102.1				
-heifers and calves	2,989	3,175	94.1				
under 500 lb.	81	168	48.2				
500-699 lb.	642	794	80.9				
700-899 lb.	1,414	1,292	109.4				
over 900 lb.	852	921	92.5				
-cows and others	26	25	104.0				
intended marketings	5,323	5,384	98.9				
Oct.-Dec. 83							

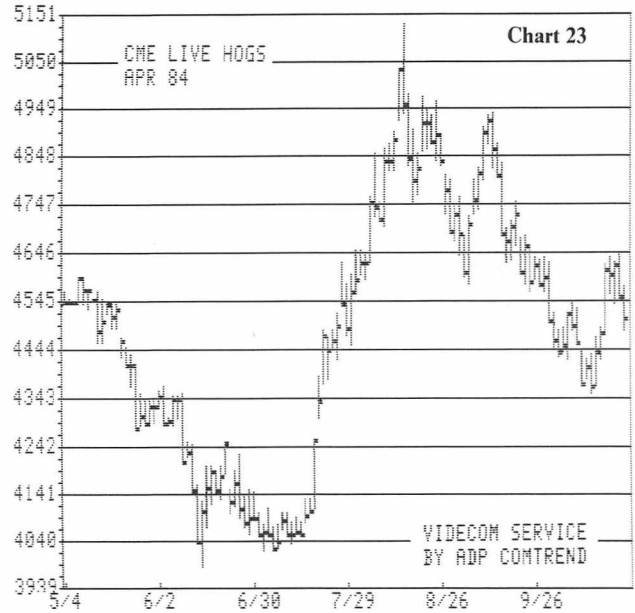


Chart 24

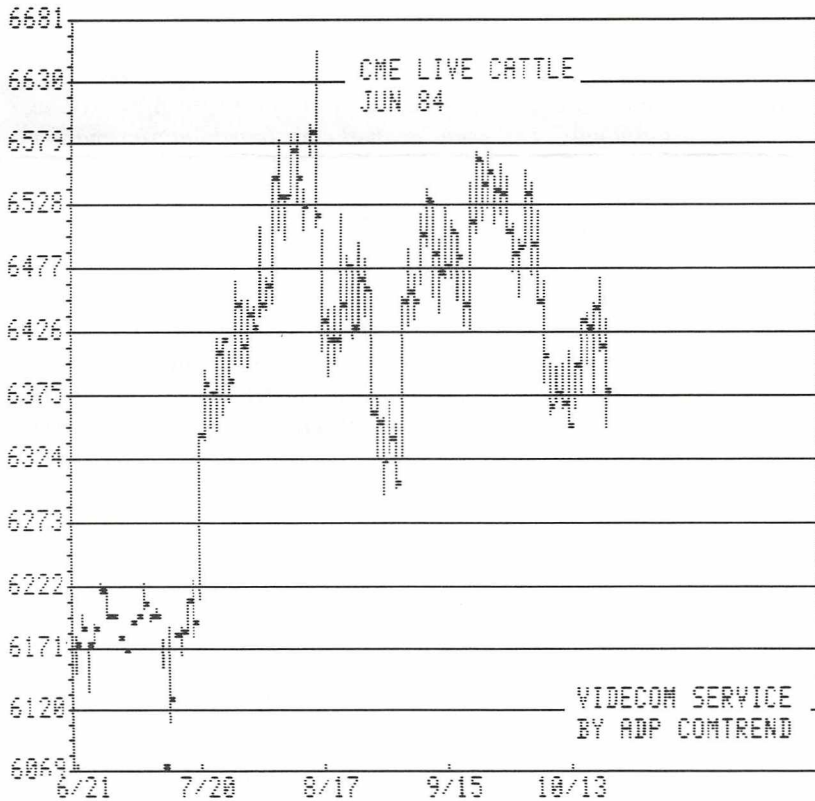
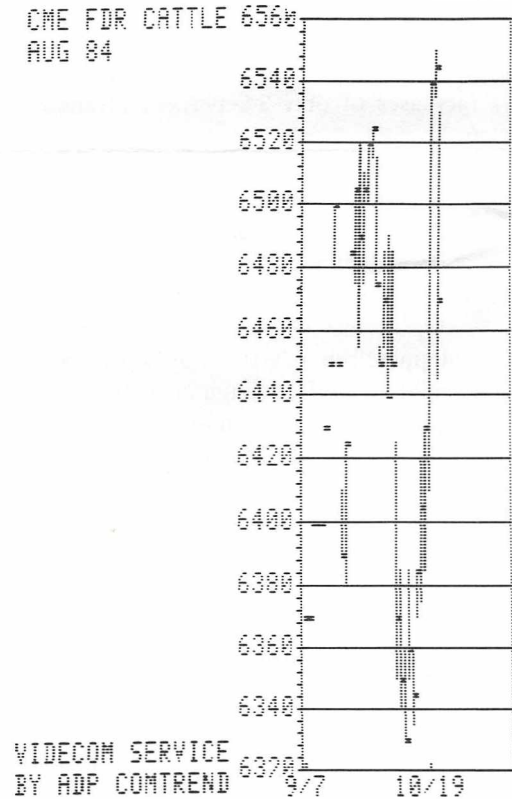


Chart 25



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