

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



Volume 5, No. 8 August 19, 1984

What if...?

The US economic boom peaks in the third or fourth quarter of 1984? Some ominous signs are beginning to appear; most important of all, the pronounced weakness in retail sales, which since January of this year, have risen only 0.5% (deflated by the CPI). Industrial production on the other hand has risen 4.5%. Still being driven, in all probability, by the impressive expansion in nonresidential fixed interest.

What is worrisome, however, is that a significant part of the latter "investment" has been quite "speculative": induced by easy credit, by the favorable provisions for capital cost recovery of the US Economic Recovery Tax Act of 1981 and by an inflation psychology that seems every day to be more and more removed from reality. Office construction, as an example, continues unabated despite the fact that the nationwide vacancy rate has reached a new high of 16.5%. Cities like Denver, with a vacancy rate of up to 28%, are described as soft but "worthwhile" to consider for investment purposes and therefore likely to see, over the next 12 months, additions to square footage equal to *twice* the absorption rate.

Easy credit can no longer be relied upon to sustain the boom. In contrast to mid-1982, commercial banks have begun a two-step process of retrenchment. On a liquidity level, bank investments are now being *liquidated* to satisfy loan demand. In the first five months of this year, bank investments *dropped* at an annual rate of 2.4% compared with the double-digit *increases* of mid-'82. Deposit deregulation may "extend" bank liquidity to a certain extent, but there is little doubt that it will come at the expense of sharply escalating interest costs.

The second blade of the scissors in this "squeeze" is the tightening capital requirements being imposed on the US banking system. Assets can no longer be increased unless a proportional (and, in some cases, more than proportional) increase takes place in capital. Given the extremely unfavorable climate existing for bank shares, capital and assets are not likely to expand substantially in coming months. Therefore, loans will become harder to get.

And then there is the great US banking casino. In this giant game of roulette, the casualties, and therefore the level of fear are beginning to rise, if only imperceptibly. Already, 49 banks have closed so far this year, up from 48 in all of 1983; a mere 721 banks are in the Comptroller's watch list. Unfor-

tunately, one bailout generates countless insolvencies, which in turn necessitate more bailouts.

As we've been repeating for the past two years, the government, through its insane insurance schemes and now through its even more insane complete protection plan, has insulated the lifeblood of the economic system from the only discipline that works: market discipline.

Can anyone believe otherwise? Take Financial Corporation of America, the nation's largest savings & loan. Operating as a gambler, Charles Knapp built up his empire by buying, and buying very dearly, short-term deposits to fund his insatiable appetite for speculation. In mid-1982 he committed a substantial portion of his assets — *many times his capital* — to the purchase of long-term securities funded by short-term deposits. In his words, "I thought the country was possibly gone. It was that bad. We were prepared to exist as a company for another year and a half. I could see Pan Am and Ford would be goners and possibly Bank of America, if rates did not fall. *Our theory was that the US government was not going to collapse.*" About this fascinating theory he says, "Everyone says we were really lucky. They never gave any credit for the fact that the *FCA team had really thought these things out (!)*"

Charles Knapp's FCA has continued to gamble in the interest rate market; according to analysts, FCA has the largest interest rate mismatch of any major financial institution — 30% of its assets are repriced every year as against 84% of its liabilities. Charles Knapp knows that FCA had to become huge because if you were big enough, then, in his own words, "the US government was not going to collapse."

And so he set himself to grow at an exponential rate: from approximately \$1 billion in assets in 1979, FCA grew to \$3.7 billion in 1981, \$6.6 billion in 1982, \$22.7 (!) billion in 1983, and \$35 billion in mid-1984, 40% of it funded in the highly-

In this issue

We sell stocks, Eurodollar and T-bond futures, crude oil, precious metals, and foreign currencies — all because of a little game of "what if?" We reprint an interview with Al Friedberg from a recent issue of *Barron's*. We go long soybeans. And we're out of livestock for the moment. Contributions by Albert D. Friedberg and Michael Beech.

volatile, uninsured, and expensive wholesale market with maturities of up to 90 days.

And there is more. Charles Knapp knew that large lending errors and losses in 1980, 1981, and 1982 could be covered up by growing exponentially. He knew that of all the loans made in 1980, 19% (!) had run into problems by September '83; for 1981, some 14% were in trouble, also by September 1983. No matter, 19% of \$1 billion (1980's assets) is a mere half of 1% of \$35 billion, and 14% of \$3.7 billion is only 1.5% of 3.5 billion. Size would cover all vestiges of sin. Quite clever.

But one market, a bit belatedly (but surely before the problem became insurmountable) sniffed and did not like what it smelled. From a high of 32 in mid September 1983, FCA stock traded down to 18 by the end of December 1983 despite overall market strength. A consistent and firm policy of not bailing out industrial and financial corporations regardless of their size would have surely driven away most large institutional depositors in much the same way as the stock market sensed trouble. Were it not for various attempts by Mr. Knapp to halt the slide of FCA (using, of course, depositors' money), including an actual purchase of 4-5 million shares, the stock would have reflected trouble a great deal earlier.

"Charlie" Knapp should have been organizing junkets to Las Vegas, or, at best, should have spent his days in the Chicago pits. Instead, the US government gave him a license to gamble. And he did. To the tune of \$35 billion dollars.

Lurking behind Continental Illinois and FCA there are many, many more financial institutions. Not only mismatched in the term structure of their assets and liabilities but also engaged in reckless speculation and LDC fantasies. Another bailout will encourage the sinners to grow and reach the same privileged status.

The repeated shocks to the financial system will begin to impact the loan market. And while it is true that many skeletons are being kept intact in closets (and even fed!), new ventures will be scrutinized ever more carefully until speculative loans become shut out. Will nonresidential fixed interest prosper in this scenario?

What if . . . retail sales continue to soften (despite booming increases in consumer installment buying), residential and non-residential fixed investment collapses and the US trade deficit widens (a contractive factor in the GNP accounts) as it's likely to do before overvaluation is approached? Will the

US slide into a recession?

Five of our most trustworthy indicators are pointing to just such an occurrence in the very near future (if not already): a) leading indicators (Chart 1) now in a clear downtrend; b) initial unemployment insurance claims (Chart 2) now rising off a bottom; c) the inventory-to-sales ratio (Chart 3) which in our estimate rose to at least 1.34 in July, thus completing a bottom that invariably coincides with an economic peak; d) the lead characteristics of economic momentum (see Chart 4) showing that, on the *average*, we should expect a recession by July '84 and no later than December '84; and e) the continuous flattening of the yield curve (see Chart 5), an indication that the economy is running out of oxygen.

Recessions are extremely unpleasant affairs. They are not talked about, much less forecasted. Soft-landings and slow-downs are "in" because a) they allow for corporate profits to grow; b) they lower interest rates; c) they make the expansion sustainable. In short, they are idyllic. In the overleveraged, overstimulated world of the '70s and '80s, they are unlikely to take place. Rather we are now prone to witness a rapid succession of violent expansions and contractions that are bound to magnify market volatility, bliss and pain, reward and punishment.

What if . . . the scenario we see unfolding (and here we allow our imagination to mix freely with our "gut" feeling) is a recession before the end of 1984 that turns quite severe in 1985 as banking problems compound the crisis? The yield curve becomes extremely negative as short-term rates skyrocket (yes, in a recession before a final blast of liquidation), stock prices collapse, oil prices collapse, bankruptcies multiply, the US dollar spikes and then returns back to earth, and politicians begin to engineer the next major financial and monetary push. As Cassandra's crystal ball clouds over, we wonder why we cannot join the chorus of optimists. Are they really so naive?

STRATEGY: Sell stocks. Sell Eurodollar and T-bond futures, but particularly Eurodollars. Maintain the much-maligned Ted spread, now coming back with a vengeance. Sell crude oil. Stay away from precious metals. Sell foreign currencies.

A more detailed (and technical) look at the above follows these comments.

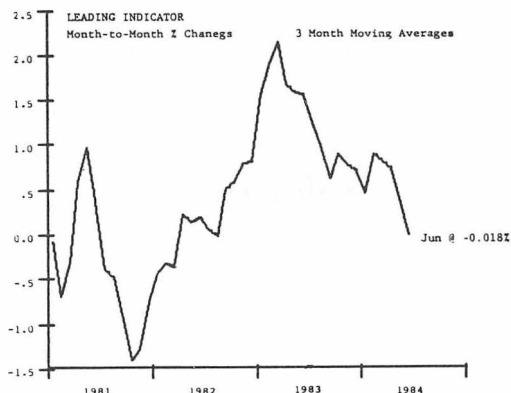


Chart 1

LEADING INDICATOR		
	Month-to-Month % Changes	3 Month Moving Averages
1983:1	3.1	1.568
1983:2	1.5	1.881
1983:3	1.9	2.156
1983:4	1.5	1.849
1983:5	1.2	1.559
1983:6	1.9	1.552
1983:7	0.6	1.232
1983:8	0.4	0.964
1983:9	0.8	0.611
1983:10	1.4	0.899
1983:11	0.1	0.772
1983:12	0.6	0.684
1984:1	0.7	0.450
1984:2	1.4	0.895
1984:3	0.3	0.810
1984:4	0.5	0.724
1984:5	0.4	0.378
1984:6	-0.9	-0.018

Reprinted from Weekly Economic Data, Cyrus J. Lawrence Incorporated

Chart 2

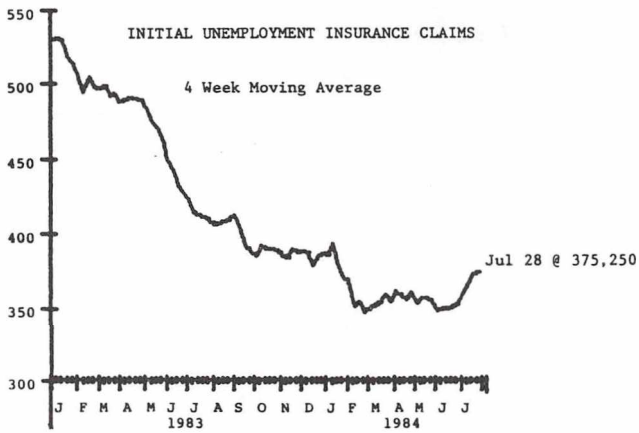


Chart 4

Level and Changes in Economic Activity

Date of Peak in Year-over-Year Change in Economy (a)	Date of Peak in Economy (b)	No. of Months Peak Change Led Peak Level
Nov 1952	Jul 1953	8
Sept 1956	Feb 1957	5
May 1959	Jan 1960	8
Oct 1965	Oct 1966	12
Jul 1968	Mar 1969	8
Oct 1972	Nov 1973	13
Feb 1981	Aug 1981	6
Average		8
Nov 1983	?	?

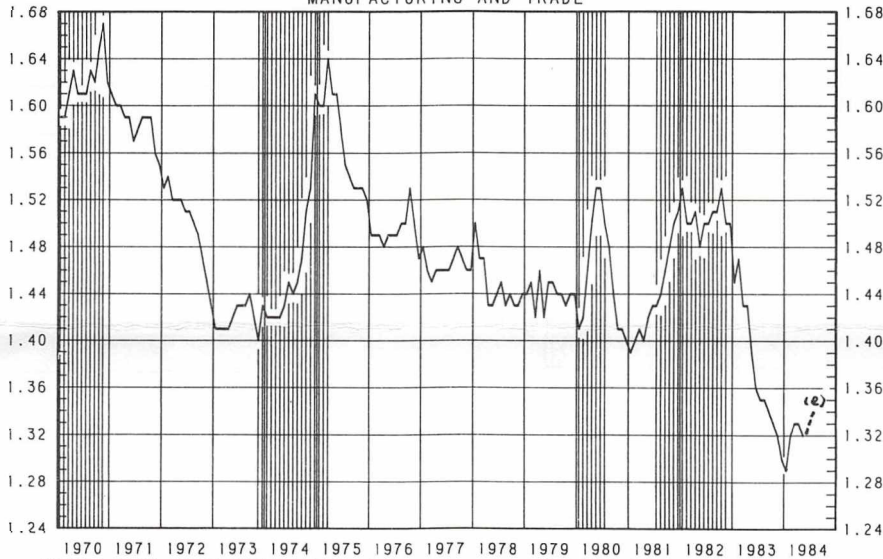
(a) Peak in year-over-year change in spread between growth in industrial production and growth in employment.
(b) Peak in year-over-year change in industrial production.

From Goldman Sachs Research (except ?'s)

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Chart 3

INVENTORIES COMPARED WITH MONTHLY SALES*
MANUFACTURING AND TRADE



1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984
*RATIOS BASED ON SEASONALLY ADJUSTED DATA. SOURCE: U.S. DEPARTMENT OF COMMERCE
SHADED AREAS REPRESENT PERIODS OF BUSINESS RECESSIONS.
LATEST DATA PLOTTED: MAY PRELIMINARY

PREPARED BY FEDERAL RESERVE BANK OF ST. LOUIS

Chart 5

Three Yield Comparisons

	(A) 30-day Commercial Paper	(B) Corporate AAA Bonds	(B)/(A)	(C) 3-month Treasury Bill	(D) 1-year Treasury Bill	(D)/(C)	(E) 5-year Treasury Securities	(F) Long-Term Treasury Securities	(F)/(E)
1983									
Mar. 25	8.68	11.76	1.3548	8.55	8.55	1.000	10.26	10.70	1.043
Apr. 29	8.36	11.43	1.3672	8.11	8.16	1.006	9.95	10.44	1.049
May 27	8.49	11.67	1.3746	8.48	8.51	1.004	10.32	10.75	1.042
Jun. 24	9.15	11.71	1.28	8.97	9.02	1.006	10.71	10.95	1.022
Jul. 29	9.17	12.31	1.342	9.13	9.44	1.034	11.39	11.62	1.020
Aug. 26	9.20	12.32	1.339	9.15	9.37	1.024	11.34	11.54	1.018
Sep. 30	8.97	12.22	1.362	8.75	9.04	1.033	11.22	11.43	1.019
Oct. 28	9.04	12.34	1.365	8.66	9.02	1.042	11.39	11.69	1.026
Nov. 25	9.06	12.36	1.364	8.79	9.07	1.032	11.35	11.59	1.021
Dec. 30	9.66	12.56	1.300	8.96	9.22	1.029	11.54	11.78	1.021
1984									
Jan. 27	9.20	11.98	1.302	8.93	9.04	1.012	11.31	11.59	1.025
Feb. 24	9.42	12.22	1.297	9.18	9.35	1.019	11.67	11.94	1.023
Mar. 30	10.04	12.71	1.266	9.72	9.86	1.014	12.20	12.40	1.016
Apr. 27	10.16	12.95	1.275	9.64	10.00	1.037	12.47	12.69	1.018
May 25	10.19	13.42	1.317	9.79	10.73	1.096	13.35	13.49	1.010
Jun. 29	11.07	13.71	1.238	9.81	11.09	1.130	13.72	13.62	0.992
Jul. 27	10.98	13.31	1.213	10.25	10.79	1.052	13.03	13.02	0.999
Aug. 10 (p)	11.09	12.92	1.165	10.51	10.72	1.020	12.65	12.65	1.000

Interest Rate Futures

An interesting trade is suggested by the flattening of the yield curve: Buy December '84 T-bills and sell September '84 T-bills. Alternatively, one may buy March '85 and sell December '84 and/or September '84. Furthermore, a yield curve play on the Ted spread (short Euro's against long T-bills) suggests replacing long September '84 T-bills with December '84 or March '85, leaving the short side in September '84 Euro's, producing a "whammy."

The shaping of a negative yield curve, as well as the Treasury's plan to tap "hot money" in Europe by way of bearer or semi-bearer bonds, do *not* favor the sale of T-bonds. While they *should* decline, odds are vastly superior in the short sale of Euros.

STRATEGY: *Keep a stop on short September Euros at 88.25, close only. Maintain Ted spreads, or even better, roll them into a whammy. Place stops (as per Hotline update of Friday August 17) on short December '84 T-bonds at 66.04, close only, but we prefer selling short-dated instruments.*

Chart 6

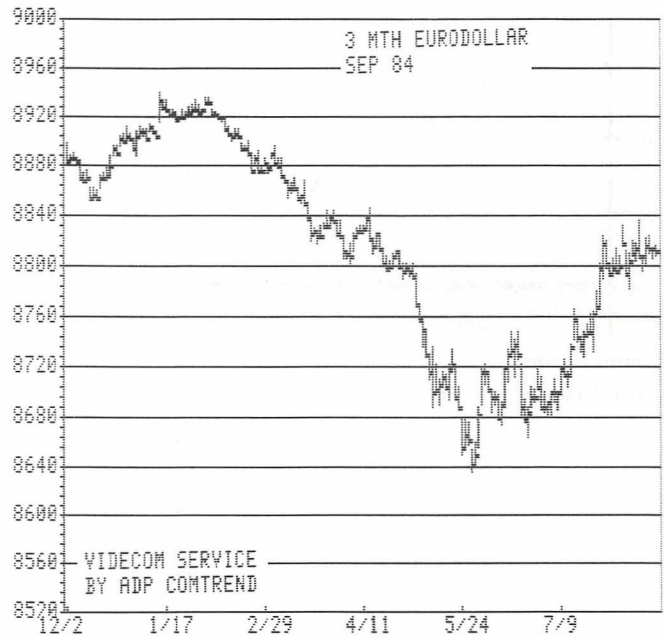


Chart 7

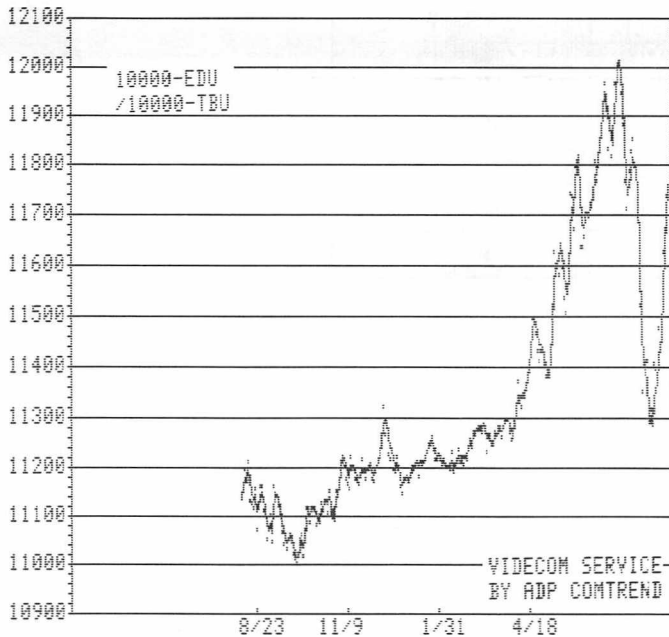
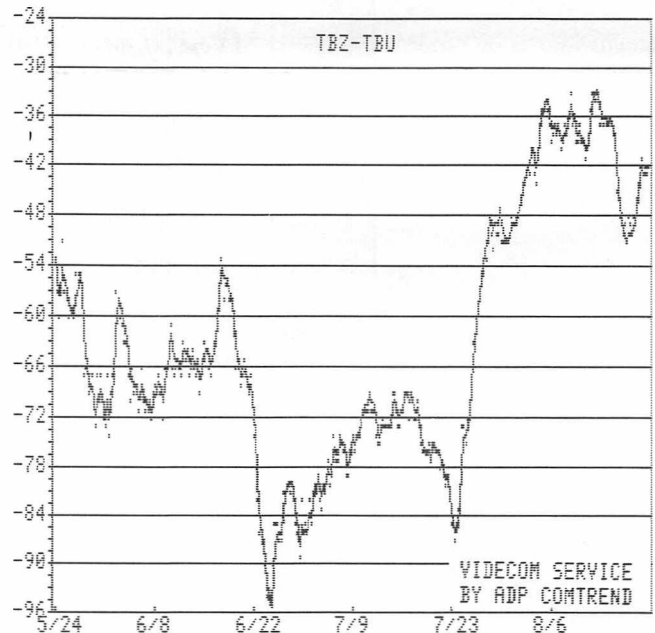


Chart 8



Stock Index Futures

As Vesuvius erupted, we, the inhabitants of Pompeii, could barely utter sounds of wonder . . . and terror.

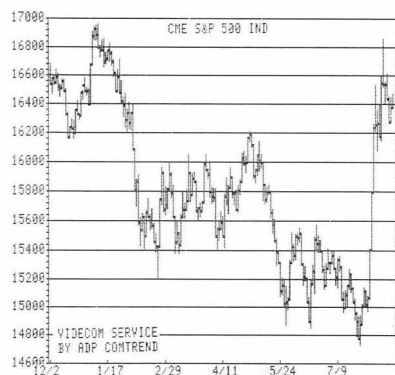
Those who miraculously survived and still have the wherewithal to continue living, take stock of the situation. It is merely a powerful, very powerful, bear market rally — one that managed to retrace almost exactly two-thirds of the previous de-

cline and therefore still within the parameters of a downtrend. One that managed to turn nearly every skeptic into a believer, subjecting the bear to the double humiliation of a financial loss and an intellectual chastisement.

No matter. Even though the volume was extraordinary, individual action left quite a bit to be desired. Specifically,

the biggest gains were the stocks that had previously lost the most (i.e., the weakest) such as money center banks — an indication that it was primarily a rally of a very overvalued market rather than a new upward leg led by a dynamic group of new companies or new industries. In short, leadership is still lacking, new highs have not expanded as they should, if it is to be a new bull move (see Chart 10), and the A/D line is still miles away from a meaningful recovery in contrast to the indices.

Chart 9

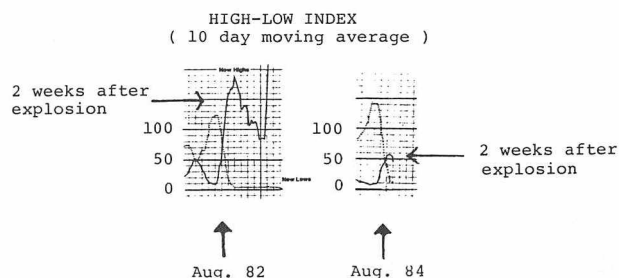


In markets one must never say never. Therefore, we will allow for the possibility of institutions' turning completely mad and driving the indices to higher levels. Closes above the highs of August 10 will force us to move to the sidelines.

STRATEGY: Think bearishly. Once the train switches to reverse, the huge volume traded between July 26 and now will turn into liquidation waves that should take the market down as much as 30%.

Traders keep stops on one half the position at 168.50, basis September '84, good anytime, and 170.50, close only, on the balance.

Chart 10



Currencies

Recent studies by Professor S. Hanke of Johns Hopkins University and William C. Freund, chief economist of the NYSE, continue to buttress our long-held view that the US dollar is not overvalued in a trade sense. Instead, the merchandising trade deficits are highly correlated with differential rates of economic growth. A look at some export figures leaves little doubt of the continuing competitiveness of US products: consider that in 1983 (the first full recovery year for the US economy), agricultural exports increased about 18%, while nonagricultural exports rose almost 6%.

When broken down by industries, one notes the extraordinary breadth of this overall achievement: foods, feeds and beverages (18.6% increase), autos (40.6%), industrial supplies and materials (1.4%), capital goods, export autos (2.2%), consumer goods (1.4%), and other (25%). And the first quarter of 1984 saw a 6.3% export increase on an annualized basis over 1983 despite the fact that the dollar continued to appreciate.

What is more, nearly half of 40 US industry groups had a larger share of world export in 1982 than in 1972; 23 groups had the largest or second-largest share of world exports in 1982 against 22 in 1972. At the same time, imports fell as a share of the American market in 12 groups, with the increase in import penetration three percentage points or less in an additional 15 of the 40 industry groups. Such widespread trade competitiveness speaks rather conclusively against the theory of overvaluation. Let us emphasize the point. We are not denying that a *continued* real appreciation of the US dollar, *in due course*, will overvalue the dollar. We *are* denying that the time has come now.

A practical model for understanding the fluctuations in

a foreign exchange market must include three essential ingredients: a) capital flows, not trade flows, are primarily responsible for extended bull or bear moves; b) capital flows possess a certain inertia and therefore require massive perceptual changes to reverse them; and c) powerful capital flows anticipate and quickly discount *trade changes* or will ignore them for a considerable period of time if (1) asset values in the country experiencing an inflow are attractively priced and/or (2) interest rate incentives are strong enough to overcome fears of future exchange losses.

In the US, attractively priced assets (shares, real estate, etc.) acted as a magnet for foreign capital, which in turn helped to "race" the boom, causing the current account to turn negative. Given their extraordinary *inertia*, capital flows persist, ignoring the relatively minuscule current account negative (probably 2% of GNP by the end of 1984). Since the second half of 1983, deposits and debt securities rather than "cheap" assets have been the repositories of these inflows.

What perceptual change *must* take place before these inflows reverse direction? For one thing, the dollar must be *tangibly*, not statistically, *overvalued*. Investors, merchants, and tourists must *feel* that the US dollar is expensive and that, therefore, the current account imbalance will not be corrected merely by a cyclical drop in the value of US currency. For these participants to *feel* an overvaluation, the overvaluation must be quite obvious. So obvious, in fact, that the public will begin to dishoard dollars on a grand scale (just as the forex departments of the big banks throw in their towels and begin to cover their painful dollar short positions).

What is clear is that the dollar will *not* roll over and die

as in the neat forecasting models used by corporate treasurers and forex traders. Instead, the short covering spike will be dramatic and totally unpredictable. As to its timing: months after the US enters the next recession.

STRATEGY: *The slow and orderly ascent of the US dollar is proof that the end is not in sight. It is therefore possible for currencies to rally from present levels on a number of pretexts. Chief among these may be foreign depositor mistrust of the creaky (collapsing?) US banking system. Weekly upside reversals in the DM, SF, and BP indicate that one such rally is in progress. Nimble traders may want to cover these positions and use rallies to resell them. Long-term traders should ignore all intervening rallies and concentrate on the ultimate spike.*

Lower stops on September yen to 42.10, close only.

Canadian Dollar

Stopped out of the (very) profitable long-term short positions at 75.92 on July 24, we reinstated the position and again stopped ourselves out at 76.17. Fundamentals, as we said last month, favor a slightly stronger Canadian dollar, but it was not until the last few weeks that the market acted as if it wanted to stop going down.

STRATEGY: *Remain sidelined.*

Chart 11

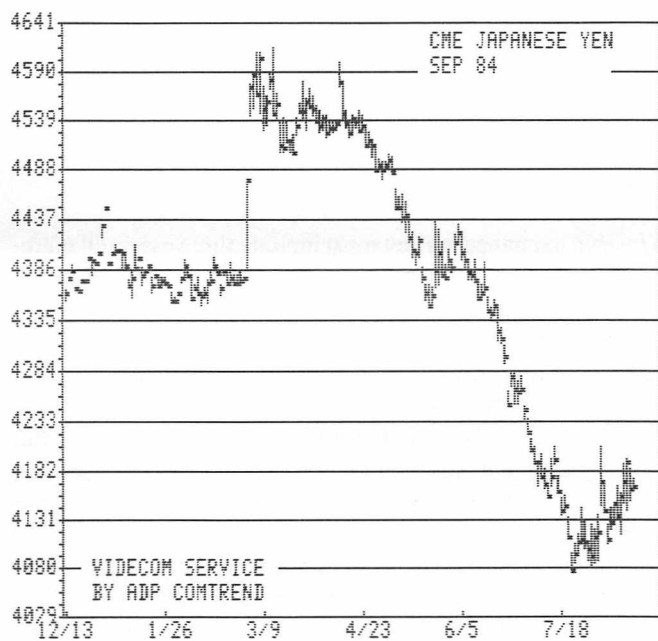
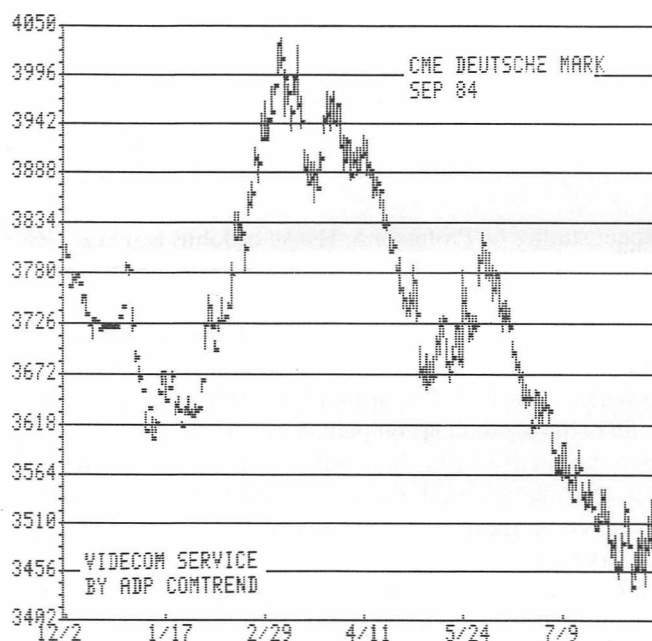


Chart 12



Reprinted from Barron's

Right on the money

Al Friedberg has been a lonely bull on the dollar

(Another in our continuing series of reprints from major financial periodicals. This one's from the August 13 Barron's.)

Albert D. Friedberg speaks with a slight accent, acquired in his earliest years. He was born in Lyon, France, in 1946; moved with his family to Uruguay, where his father engaged in inter-

national currency trading, then on to the US where he graduated from Johns Hopkins University and later from Columbia University with an M.B.A. in international banking. But his accent doesn't cloak his bent for speaking forthrightly and clearly about markets — particularly, currencies, petroleum and precious metals. He was an emphatic bull on the US dollar

when nearly no one else was, and, of course (a bit easier), he's been bearish on oil and the precious metals. Much of what he's predicted has come to pass. What's next, Al?

— Richard A. Donnelly

Barron's: Al, how long have you been in the commodities business?

Friedberg: Since 1971. I started a company called Friedberg & Co. and it later changed its name to Friedberg Mercantile Group, as it separated into two functions: a retail foreign exchange business, which my father continued managing, and a commodities futures business, which I took over.

Q: This was in Toronto?

A: This was in Toronto. My interest in commodities was awakened in the late 'Sixties when a friend of mine got involved in the silver certificates business and thought it would be proper for him to hedge. We visited a commodities firm and learned the silver business, the silver futures business. At that time we made a few dollars trading, in addition to the hedging part.

Q: Your timing, of course, was superb.

A: I started trading seriously in May of 1971, with about \$1,900 altogether. My first big hit was silver coins. Then one of the biggest scores our firm made — it sort of put us on the map — was sugar. Where we bought for our clients nearly a thousand contracts, which was nearly 10% of the open interest in sugar. And we bought it at around 7½ cents to 8 cents and sold out at about 22 cents. After a long year — we waited a whole year with it.

Q: Now you trade everything?

A: Now we trade everything. Hard commodities, soft commodities, everything. And currency futures have become our main business. Currency futures are about 50%-60% of the total.

Q: You trade for both your clients and your own account?

A: Yes. We are a commodities brokerage firm, but we're also a management firm. Our clients give us discretionary power to trade for them and that's what we do. I would say that 90% of our business is managed. We operate with very few people. In the trading area, I have three assistants.

Q: You must have felt a little lonely this spring when the consensus was very bearish on the US dollar. What made you so firm in the face of such pressure?

A: What the others were doing wrong was about the same thing they were doing wrong for two years. Which was looking at the value of the US dollar as a function of the balance of trade. Just focusing narrowly on the balance of trade, and saying the US's trade deficit is getting worse and worse. And that it was eventually going to reverse the course of the US dollar.

The second mistake they made was that the dollar had

risen quite a bit from the lows of 1978-80 and a lot of people said the dollar was overvalued, without giving due consideration to how far the dollar had gone down before that. By 1978 the dollar was very, very low, at least in relation to 1972-73.

Q: Are you still as bullish on the dollar today as you were?

A: Yes, I'm still as bullish, but I think the picture has changed now. I just want to come back to one more thing. Most observers are saying that high interest rates are supporting the dollar, and that situation is untenable.

Q: You disagree?

A: Over the past few years, if you look closely enough, you will see there have been periods in which the US interest rates were coming down and the dollar was very, very strong. So interest rates alone haven't made the dollar strong. What we've been saying for the past three or four years is that there is a major capital flow into the US.

Q: Why's that?

A: We don't know why this is, but we think it has to do with the disintegration of the European economic systems. Plus, the tremendous profit opportunities in the US, with its markets that are so large and liquid. Where else can you buy large amounts of stock; buy very big pieces of property, park money — large amounts of money?

Q: But Al, all of this was really true in '78, '79 and '80.

A: True.

Q: The US markets didn't suddenly acquire this wonderful allure —

A: Here's the point. First, you always have to start from an undervalued situation. The base is an undervalued currency. In other words, your basic pattern of trade has to change, as a result of a very low currency. But more than that, your assets have to be extremely well-priced. If you look at the prices of buildings, the prices of real estate, the prices of corporate ownership in 1978, in relation to other currencies, you see that you were buying something very, very cheaply. So, you had a very low currency, and that's the beginning.

Q: What else?

A: The second thing is that the low level of the US currency and the relative cheapness of its assets, was not well perceived until Reagan came in. Reagan was very much of a catalyst for people to begin perceiving the cheapness of the dollar. So from late '82 to early '83, you had a massive capital flow into the US that had little to do with interest rates, but a lot to do with profit opportunity, with the fact that it's good to be in the US because there's a good Republican Administration.

Q: Then by definition the currency has to be a little more precarious than it was a couple of years ago.

A: Much more, much more precarious . . .

Q: Are the shorts on the dollar being forced to cover?

A: It's happening, and I think that, as in every bull market in commodities and currencies that you have studied for the past 40 or 50 or 100 years, if it's a long enough bull market, it will end in a spike. The reason it does is that so many people buck the trend for so long until finally, when they give up, they go into panic-type buying.

Q: *A lot of people thought that happened in January and February.*

A: Yes, but if you look at the rate of acceleration of the move, it wasn't any different than it was in '82 or '81. So the dollar basically has been going up in orderly fashion, without a spike. A recent example of a spike was in 1978, when the dollar itself went the other way, and the Swiss franc rose 30% in a few months. The thing about spikes is that you really don't know how far they can go. They're extreme, they're quick, and they're emotional.

Q: *So this thing isn't going to end without a spike. But you said people have been wrong about the dollar because they've been focusing on the trade balance?*

A: It's true that every currency, before it tops in real terms, will have a very large balance-of-trade deficit or current accounts deficits, one of the two — current account being more encompassing. But the US current account deficit for this year won't be larger, even under the worst assumptions, than 1½% of GNP. And that's not so terrible.

Q: *When will the dollar weaken?*

A: It's very hard to say. But what we have found is that a currency does not begin to depreciate in real terms until after an economic contraction takes place. So we probably have to look first for the next recession, and then look forward and say, okay, three months from now, or possibly eight months from now, or 10 months from now. It probably happens that way because capital, having an inertia of some sort, keeps coming in and the speculative bubble bursts only after business conditions begin to deteriorate rapidly. But the key is still capital flows.

Q: *What if the US's interest rate advantage were to disappear, or ease up a lot? What would the dollar look like?*

A: Without a corresponding decrease in other countries?

Q: *Right.*

A: Well, obviously that would put some pressure on the dollar.

Q: *But it wouldn't throw it into a bear market?*

A: I don't think that the reversal will come in that fashion. I think that when the reversal comes in the dollar, interest rates will continue to rise. Most probably what we'll see is dollar interest rates continue to rise, the differentials begin to narrow, a recession sets in, and then US interest rates continue to go up because then they'll have to; they'll have this inflationary problem as the dollar starts coming down.

Q: *But you don't see that now?*

A: I think the earliest it can come is in the next three or four months, but not before the dollar rises at least another 20% in spikes.

Q: *That's all?*

A: At least another 20%, and maybe 40%.

Q: *What would that mean to other currencies?*

A: The British pound most probably will fluctuate in a range to the Deutschemerk. In other words, I think the Bank of England is keeping what they call a trade-weighted level. And I don't think they'll let it go below 3.40-3.50 to the Deutschemerk, nor will it go up above 3.80 Deutschemarks. So it's really the Deutschemerk, when it comes to analyzing the pound.

Q: *In dollar terms, what would that work out to?*

A: If I can estimate where the Deutschemerk is going, you can easily estimate the pound. I'm assuming the Deutschemerk will go to a minimum of 3.20 to the dollar.

Q: *It's now what, about 2.85?*

A: It's 2.90 today, 2.89-2.90. A minimum of 3.20. I think it would not be inconceivable to see 3.50-3.60, and I think it might reach the nominal level of 1960-65, which was four to the dollar, in an emotional type of market environment.

Q: *How about the Japanese yen?*

A: I'm very, very bearish on the Japanese yen. Maybe because of my contrarian leanings. The whole world has been bullish on it. If anybody wanted to be bearish on the dollar, they would look at the yen. And every time the dollar had a little dip, the yen is the one that had a big rise. Again, I think, a mistaken perception. Everybody looks at the balance of trade; the Japanese balance of trade is a colossal surplus. What they don't perceive is that the capital outflows from Japan are larger. In fact Japan is running, overall, a balance-of-payments deficit right now. If you look at the total consolidated banking system, the loss of dollars continues month by month.

Q: *Where's gold going? Is it nearing a buy opportunity, or is there significant room on the downside?*

A: Down. But, I think this is definitely the beginning of a value range for gold, so that from \$350 down — and I can't tell how low it will go because that depends on the strength of the dollar, conceivably the Deutschemerk, too — but from \$350 down, gold has entered a value region.

Q: *So longer-term, you would have no quarrel with anyone buying gold?*

A: Longer-term, I don't have any quarrel. But I do warn that emotionally, when the dollar peaks is probably when gold will bottom, and that could have an unsettling effect on the long-term position, unless it's well-financed.

Q: *Let's talk briefly about silver. It really took a beating recently, more than gold, even though it's an industrial metal, as you know.*

A: I have mixed feeling about silver. I still remember trading silver at \$1.30-\$1.40 an ounce, in 1970. I would just say that if you assume that silver should maintain its value in real terms, it should be, today, more than three times that — \$5-\$6 an ounce.

Q: *That's all?*

A: Yes. There's been a large increase in supplies because prices were very high for a considerable length of time. In real terms, the price of silver has been well above the equilibrium level for many years. So the increased supplies should have glutted the market, and we should have cheaper silver. I don't think silver at \$8 is a bargain, in today's environment.

Q: *You've been dead right on oil, as I seem to recall. Are you still bearish?*

A: Very bearish, and getting increasingly more so as the dollar rises.

Q: *You called for \$20 a barrel.*

A: Before the end of the year. I'll have to eat my typewriter if it's higher by the end of the year.

Q: *Still think that?*

A: It's going to do that. Whether it's exactly before the end of the year or early next year, I think we're going to see a major collapse. The dollar is making oil extremely expensive in most countries. OPEC production has to decline in order to adjust to the lower foreign demand, and in order to accommodate the non-OPEC supplies. But there is a level which it can't go below, because then Nigeria will break away and Saudi Arabia is the only country at the moment able financially to cut production and capable of making a dent in what's produced. Kuwait is capable financially, but it's not capable of making a dent in output because its production is down to 600,000-800,000 barrels a day. I'm convinced that we will have oil prices, sometime in the very near future, at \$10 a barrel.

Q: *What's the near future?*

A: I think that inside of 18 months we'll have a major drop in prices. And I think before the end of next year we should be close to \$10.

Q: *What does this do to the companies that have been acquiring reserves at so-called "cheap" prices of \$6 a barrel in the ground?*

A: Knowing the protectionism that is around now, we will probably apply a tariff of some sort, which incidentally will be even more bearish for world prices. If the US applies a \$5 tariff, then the world price will have to go down another \$5. But Canada and the US will probably protect their domestic interests, I don't know at what level, maybe not \$25, maybe \$20 — but at some level.

Q: *And the price of natural gas will be cut in half?*

A: Yes. There's nothing sacred about that. Everybody who trades in commodities knows that gold was \$800 and today it's \$300; that a very large drop. We've kept natural gas so long at that artificial level. And the longer you keep a commodity at an artificial level, the more it falls.

Q: *That would be catastrophic for the pound.*

A: Yes. It might create another outflow of capital that could come at the wrong time for sterling. I'd think the Bank of England, with \$18 billion in reserves, could probably maintain it for a long period, at 3.40-3.50 Deutschmarks. But you'll see tremendous pressure on the bank.

Q: *Are you looking for further weakness in all commodities?*

A: No. I don't think we're going to see the commodity price level go down much more from here, both from a sentiment point of view, and from a value point of view.

Q: *You mean these things have intrinsic value?*

A: From a value point of view, copper, cocoa and cotton, for instance — cotton especially. I would think that we're very close to the turning point in commodity prices.

Q: *Thanks, Al.*

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Energy Futures

As we hoped last month, the market served us with a good-sized rally, 100 points from the closing price in our last month's issue but 200 points from the subsequent low.

With the help of Mr. Alick Buchanan-Smith, the energy minister, BNOC, Opec's other member (as the *Financial Times* of London called it), was able to convince its main customers that despite the North Sea Brent's \$3.50/barrel discount to official price, the glut was only temporary. Oil companies cooperated and the North Sea Brent rose to \$28.50, a much less threatening discount. An official break in the North Sea oil

could have precipitated a breakdown, with Nigeria leading into a full-scale price war. Strong hints dropped by the Saudis to the effect that its own production had dropped to the 4.0-4.5 mb/d range helped to stabilize the market further, although the danger of breakdown is ever more near.

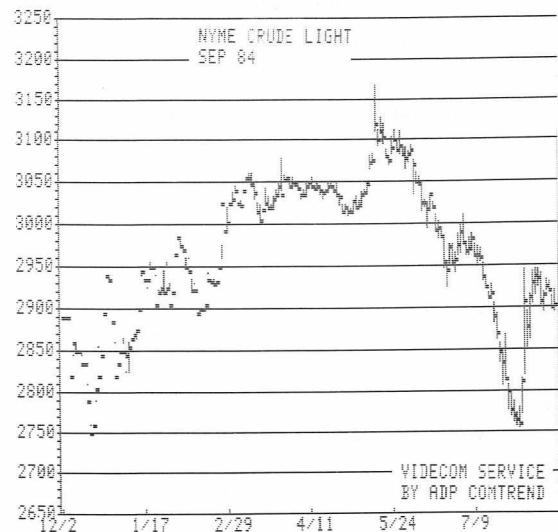
What it boils down to is this: Saudi Arabia is the only producer able to restrict output sufficiently to restore some semblance of equilibrium — and capable of doing so. On the other hand, the oil-for-planes barter deal, which threw as much as 34 million barrels into an already weakened market, shows

that the Kingdom — as represented by the King and princes — may be tiring of playing the discipline game — at an exorbitant cost to themselves! As we've demonstrated in past issues, Saudi Arabia's own long range interest would be better served at \$12/barrel and full production (12 mb/d) than at \$29/barrel and an average output of 4.5 mb/d. Should this recognition set in (as well as the side benefits of financially destroying Iran), Sheikh Yamani will be ousted and prices will drop.

STRATEGY: *One cannot afford to be out of the short side of crude oil. The war risk and its impact on traffic and production has demonstrably been shown to be minimal. Seasonal weakness sets in between August and the end of September; the glut is enormous, as shown by the full contango of 68 points between September '84 and December '84 crude.*

Sell December '84 crude at market; place stops at 31.20, close only.

Chart 13



Grains & Oilseeds

This month, the big story has to be soybeans. Prices have been positively buoyant as the July-August rains remained spotty. In fact, some soybean areas have been extremely dry. Why all the fuss? Soybeans, you see, need those refreshing, periodic showers in late July and early August. Continued dryness would reduce pollination and thus reduce the number of pods per plant. The fewer the pods per plant, the smaller the yield. And, of course, the higher the prices.

Let's not overlook the other grains either. Prices have rebounded all around in recent weeks, especially in corn. There's much concern that the lack of rain and above-normal temperatures will reduce the kernel filling of corn ears — also reducing yields.

On August 10, the USDA released its first production estimates for corn and soybeans based on actual yield surveys (see Chart 14). Private forecaster Conrad Leslie's August 8 soybean production estimate of 2,069.4 million bushels (mbu.) had been viewed somewhat negatively. However, after some initial weakness, prices ended the next day on a positive note. Then, August 10 heralded the USDA's lower production estimate of 2,035.4 mbu. Relief flooded the market, prices turned higher still. Corn production, too, was lower than anticipated in the USDA report, and corn prices advanced promisingly for several days.

Average corn yields were forecast by the USDA at 107.9 bushels per acre compared with the drought-devastated 81.0 bushels in 1983 and the past five-year average of 100.7 bushels. Soybean yields were forecast at a nationwide average of 30.5 bushels per acre, versus the drastically reduced 25.3 bushels last year and the past five-year average yield of 29.1 bushels.

A small reduction in soybean yields, though — even as little as one bushel per acre — could mean the difference between a 6.00 or 7.00 soybean price, as it could lower 1984-85

carryover stocks on August 31, 1985, to 175 mbu. from the current USDA forecast of 250 mbu.

The USDA followed up on its August 10 crop production report with a new supply and demand report on August 13. There were several important changes. For corn, the 1983-84 export forecast was reduced to 1,850 mbu. from 1,900 mbu., as corn export sales dropped considerably in late June and early July. At present, however, the USSR has been a big buyer of US corn, mostly for the 1984-85 season beginning October. Since late July, the USSR has bought 0.55 million metric tons (mmt) (21.7 mbu.) of US corn for delivery before October. In addition, since late July, the Soviets had contract for over 2.5 mmt (98.4 mbu.) of corn for delivery in the second agreement year beginning October. This has caused the USDA to raise its forecast of 1984-85 corn exports to 2,050 mbu. from 1,975 previously.

The USDA now forecasts Soviet grain imports in 1984-85 at a near record 43.0 mmt, up from 38.0 forecast only last month. This is comprised of 24.0 mmt (882 mbu.) of wheat (23.0 mmt previously and above last year's record wheat imports of 20.5 mmt, or 753 mbu.) and 18.0 mmt (709 mbu.) of corn (14.0 previously) and the highest in three years.

On August 10, the USDA finally lowered its 1984 Soviet grain production forecast to 180 mmt from 190 previously. If these late sales of corn to the USSR for 1983-84 delivery keep up, though, it is conceivable that the current forecast of 1,850 mbu. will be exceeded. At present, the US domestic use projection has been lowered to 4,850 mbu., placing the corn carryover forecast for September 30 at 587 mbu. (estimated August 13), up from 512 mbu. in the previous report. However, with the increased 1984-85 export forecast and lower forecast 1984 corn production, carryover on September 30, 1985, is now expected to be 1,056 mbu. against 1,173 mbu. previously.

The 1983-84 domestic crush for soybeans is now forecast at 980 mbu., up from 970 estimated last month, lowering the August 31 carryover forecast to 95 mbu. (5.0% of 1983-84 supplies) from 105 mbu. That is the lowest level since 1973-74 when carryover was 59.6 mbu., or 3.7% of 1973-74 total supplies.

The 1984-85 wheat export forecast has been raised to 1,475 mbu. from 1,400 previously versus 1,429 mbu. exported in 1983-84, owing partly to early 1984-85 Soviet purchases of 0.325 mmt (11.9 mbu.) of hard red winter wheat, and partly to 1984-85 forecast Pakistani imports of 0.96 mmt (35.3 mbu.), up from only 0.32 mmt (11.8 mbu.) in 1983-84.

On August 16, China cancelled 0.274 mmt (10.1 mbu.) of wheat that it had contracted to import from the US in 1984-85. This quickly renewed fears that China will not fulfill its obligation to import 8.2 mmt (301.4 mbu.) of US wheat in 1984-85. Last year, China failed to buy the agreed 6.0 mmt (22.5 mbu.) of US wheat, but said it would add the 2.2 mmt (80.9 mbu.) difference to 1984-85 imports. This appears questionable now, as China harvested its fourth successive record grain harvest, estimated by the USDA at 296 versus 292.6 mmt in 1983. Last year, China's total grain imports (almost all wheat) fell 16.2% to 13.5 mmt.

In other developments, the USDA reduced its estimate of 1984-85 Canadian wheat production a sharp 5.3 mmt to 20.2 mmt (742.4 mbu.) from 25.5 (937.1 mbu.) because of drought in Southern Alberta and Saskatchewan. At the same time, the USDA raised its forecast of 1984-85 Australian wheat production to 16.5 mmt (606.4 mbu.) from 15.0 mmt (551.3 mbu.), owing to needed rainfall in some producing areas.

The West German publication *Oil World* said recently that world market import demand for soybeans is switching from South American origins back to US soybeans after Ar-

gentine farmers marketed their bumper crops of 6.1 mmt (224.2 mbu.) at an unprecedented pace this season. At the beginning of July, only 0.4 mmt (14.7 mbu.) remained in farmers' bins. Almost 90% of total 1984-85 (April to March) soybean exports are likely to have been shipped in the first five months of the season. As a result, with Brazilian commitments already completed for a large part of its 1984-85 crops, buyers will turn to the US as the only major supplier.

STRATEGY: Remain long November soybeans, raising stops to 6.18, good anytime, to insure at least a small profit. Long positions in December corn were stopped out below 2.80, on the close of July 25; stand aside.

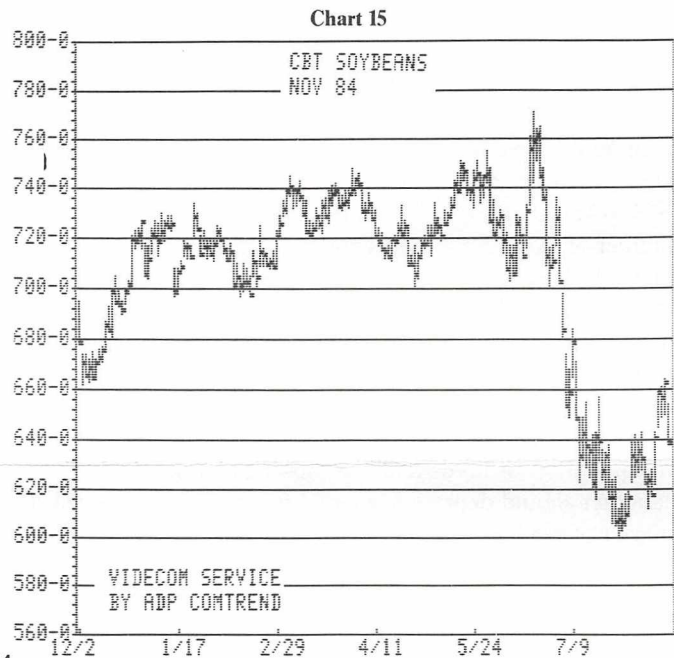


Chart 14

August 10 USDA Crop Production Report - August 1 data.

CROP PRODUCTION (million bushels)	1984-Aug 8/10/84	Expected (range)	Leslie 8/8/84	1984-July 7/10/84	1983	1982	Record -year
corn	7,667.7	7759.8 (7630-8060)	7,643.6	7,810.0	4,166.1	8,235.1	8,235.1-1982
soybeans	2,035.4	2041.5 (1960-2088)	2,069.4	2,025.0	1,566.7	2,190.3	2,260.7-1979
all wheat	2,527.8			2,524.0	2,419.8	2,765.0	2,785.4-1981
-winter wheat	2,045.1			2,021.9	1,988.3	2,073.6	2,097.1-1981
-spring wheat*	385.6		346.9	not given	358.5	545.5	545.5-1982
cotton (mln 480-lb bales)	12.57	(12.0-12.4)		11.80	7.77	11.96	15.65-1981

ACREAGE FOR HARVEST
(million acres)

corn	71.064			51.443	72.719	74.524-1981
soybeans	66.833			61.815	69.442	70.343-1979
all wheat	66.194			61.390	77.937	80.642-1981
-winter wheat	51.009			47.584	57.633	58.476-1981
-spring wheat*	11.991			11.314	16.127	16.511-1981
cotton	10.353			7.368	9.734	13.841-1981

* - not including durum wheat.

Source: U.S.D.A.

Livestock

Livestock prices remain weak in the face of what are considered ample supplies, and despite three factors: 1) hog slaughter to date in August is about 6.3% below 1983 and only 1.4% above the respective 1982 period; 2) cattle slaughter to date in August is only 3.6% above 1983; 3) respectable out-movement of frozen pork-belly stocks of about 41 million pounds nationwide in the past two months, based on expectations of 85.7 million pounds on August 1 in the August 20 report.

We hypothesize that much of the current weakness in livestock prices is attributable to liquidation of breeding herds, particularly in the case of cattle. Beef cow inventories at 38.1 million on July 1, 1984, are higher than 1979 and 1980 in the 13 years since 1972. More importantly, heifers over 500 pounds being kept in inventory for beef cow replacement, 5.6 million head, are lower than every year since the early 1960s, except 1979, when there were 5.5 million head in inventory. The number of steers 500 pounds and over on July 1, 1984, is still relatively high historically, but by the fourth quarter 1984, after these supplies are worked off, the number of replacement cattle from calves under 500 pounds of July 1, 1984, will be historically low.

The 1984 calf crop is expected to be 2% below 1983, marking the fourth consecutive year of decline. The current level of liquidation of herds and the present high level of cattle slaughter should depress live cattle prices through the third quarter of 1984 but will set the stage for excellent buying opportunities then.

Similarly, hog slaughter shows roughly 6% sow slaughter as a proportion of total slaughter, which implies not expansion, but *liquidation* of hog breeding inventories, and the likelihood of higher hog prices in 1985.

On August 1, the USDA estimated that beef production in the second half of 1984 will be about 5% less than 1983 while pork output could be down 10% or more. Those declines will only be partially offset by a 5% increase in broiler production from the second half of 1983 level. For the year, red meat output is estimated at 38,199 million pounds, 2% below 1983, while poultry production in 1984 will total about 2% more than 1983.

For 1985, the USDA sees red meat production falling about 3% to 37.180 million pounds, while total meat output, including poultry, is expected to fall only 1% to 53,700 million pounds.

The August 14 monthly seven-state cattle-on-feed report was considered somewhat negative, owing to the higher-than-expected placements in July and lower-than-expected marketings, which both contributed to more cattle on feed as of August 1 than was expected.

STRATEGY: *Long positions in August hogs were stopped out below 53¢ in the week July 23 to 27. Long positions in December cattle were stopped out below 64.5¢, with small profits the same week, following the negative cattle inventory report on July 20. Remain sidelined in livestock futures, awaiting buying opportunities in cattle.*

Hotline Updates

Friday, July 27: 1. Reinstate short September Euro positions, which were stopped out at 8766 as per our recommendation of July 16. Use a stop of 8825, close only, basis September. Please note one discrepancy — Our latest market letter recommended a stop of 8765. 2. You were stopped out of the September C\$ at 7592 on July 24, as per our advice of placing a stop close at 7580. We now advise reinstating short positions at these levels, risking 7617, basis September, good anytime.

Thursday, August 9, 9:35 a.m.: As per our last market letter, dated July 22, you were stopped out of the September S & P short position on the close of Thursday August 2 at approximately 158.25. We now recommend that you reinstate immediately, and at the market, short positions in the September contract, risking this week's high of 165.27, basis the Cash Index, close only.

Friday, August 10: Here is a summary and recap in line with recent changes: 1. You are short September Eurodollars as of our July 27 update, with stops at 88.25, close only. 2. You are flat the September Canadian dollar. 3. You are flat September '84 S & P's after having been stopped out yesterday, August 9, at the close at about 167.650. Please note that this followed a resale recommendation put out on the same day. Over the next one or two trading days, but perhaps as early as Monday morning, August 13, we will be issuing some new trading suggestions, particularly with respect to the Canadian dollar, treasury bonds, and S & P futures. Please keep in close contact regarding these recommendations.

Wednesday, August 15: As we pointed out on Friday, August 10, important developments have taken place in the past few days. In the first place, long-term bonds have in all probability topped out and are likely to carry with them the stock market. Therefore, we recommend selling December T-bonds at these levels, risking recent highs of 6604, close only. Secondly, reinstate the full line in the short S & P position, at market. Place stops on one half the position at 16850, good anytime, and on the second half at 17050, close only.

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