FRIEDBERG'S
COMMODITY & CURRENCY COMMENTS

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Inflation breaks out

Like a bolt from the clear blue sky, as it were, the Commodity Research Bureau futures index of raw materials made two-year highs this past week. Incredulous, bond traders, economists, and Fed officials (?) shrugged it off as a weather-related scare (dry weather in the grain growing areas of US), likely to be reversed in the very near future. But the sheer *breadth* of the advance was giving the lie to this notion.

The bottom of Chart 1 shows the net weekly cumulative number of advancing commodity futures prices since late 1982 (A-D line)* and compares it with the weekly movement of the CRB index.

One may be able to make three initial observations. First, the extraordinary 23% price decline experienced between early 1984 and mid-1985 was led by a collapsing A-D line, breadth preceding price (by late 1984, the A-D line had dropped below December 1982 levels, well ahead of the performance of the price index, which did not confirm this weakness until six months later).

Second, in mid 1985 the deterioration in breadth came to an end, only a few months after gold bottomed out below $300/oz. and more importantly, *only a few months after the US dollar peaked.* The CRB price index, heavily influenced by the collapse in oil prices, continued to drop until the middle of 1986. Inflation in raw materials was being masked by the devastation in energy prices. Third, breadth was leading the price advance: by May of this year, the A-D line was at its *highest level since the spring of 1984*, when our CRB price index was still trading at approximately 270, or approximately 17% higher than it is now.

The CRB futures price index advance of recent months is no blip. It is an early reflection of the powerful twin inflationary effect of a 30% trade weighted devaluation and a cumulative five-year money supply (M1) expansion of 61%.

An understanding of the dynamics of commodity price fluctuations is in order. How is it that commodity prices can be so volatile as to rise and/or fall in real terms by magnitudes of the order of 30% or more (see Chart 3)? Surely supply conditions, *as a whole*, do not change that drastically over a business cycle to justify such fluctuations; much less does *consumer demand*, which normally keeps a fairly stable relationship with real GNP. While specific commodities may be affected dramatically by marginal changes in supply and/or final demand, this is not likely to happen to a broad and nonrelated sample of commodities.

The answer is *inventory cycles*. Economic units, performing an inventory function, adjust to a desirable inventory level by "speculating" on price outlook, cost of carrying this inventory, and future sales. If inflation is perceived as receding and likely to produce price increases in raw materials below the cost of carrying them, inventory units ("dealers") begin a destocking process. Given a relatively static global supply and relatively inelastic consumer demand function, at least in the short term, dealers pass inventories among themselves like a hot potato in an effort to reduce stocks. Since, on a global basis, stocks *cannot* be reduced, prices must fall. The "deflation" in the prices of raw materials reinforces the desire to destock, prices fall further, and so on.

How does this vicious deflationary cycle come to an end? Very low real prices for commodities begin to affect producer supplies and consumer demand (medium-term elasticity). As a result, total stocks fall and dealers reach *minimum* stock levels. There is not likely to be any further destocking, as the adjustment is complete. Furthermore, even if global stocks do not fall (as, for instance in the case of subsidized production, i.e., grains, sugar, rice, etc.), the *dollar* value of stocks will shrink as a direct result of the price decline. An ex-ante desire to reduce inventories by 50% *can* be accomplished by a price decline of 30% and a drop in physical stocks of 30% (which could come as a consequence of a rise in consumer demand).

Inventory cycles are the single most potent causes of fluctuations in internationally-traded primary commodity

*The A-D line was constructed omitting the Winnipeg grains (too thin and adding too much weight to the grain component of the index; CRB concurs, as it has announced that they will no longer form part of the index as of July 20), the soybean products (oil and meal, preferring to use only beans), and crude oil (using heating oil as a sole proxy for petroleum price). For a description of the 26 commodities included in the index, see Chart 2.

In this issue

prices. A desire to lower inventories from, say, 90 days to 30 days of forward sales can wreack havoc in these markets: From 1980 to 1986 commodity prices fell by 30% in real terms, to their lowest level since the 1930s. By the same token, a perception that inflation is heating up will reverse this process: Dealers will attempt to build up inventories. To the extent that global stocks are, in the near term, relatively static, the dealers' attempt to restock will prove futile *except insofar as they will drive prices higher.* At some point in the future, the dollar value of their stocks, augmented by increased producer supplies, will reach desirable levels and the restocking process will end.

Likewise, the dollar effect on inventory cycles is profound. A dollar revaluation *increases* the value of dealers' inventories (commodity prices are "priced" in dollars) when measured in nondollar currencies. This undesired and unanticipated revaluation leads to inventory liquidation as dealers try to adjust inventories to more "normal" levels. Conversely, a dollar devaluation lowers inventories in nondollar terms, bringing about a destocking effect.

Monetary policy plays a dual role in inventory cycles. Easy money finances, through credit expansion and low real costs, an increase in stocks. At the same time, strong credit expansion (as in the US, especially since early 1985) influences inflationary expectations which cause dealers to adjust upwards their desired inventories. Conversely, tight money cuts the financial ability of dealers to build or even maintain inventories and reinforces their desire to adjust downwards their inventory levels.

The massive six-year decline, in real terms, of commodity prices, the more recent dollar devaluation, some minor supply cutbacks, and rising consumer demand have had the effect of lowering dealers' inventories to *minimum* levels. Inflationary perceptions (the Fed's printing machine) are causing dealers to want to rebuild these inventories. Given near-term relative supply inelasticities, inventory lengthening efforts are futile *except insofar as they raise overall price levels.*

How much are prices likely to rise? At the very least, a 50% rise in overall prices. More, much more, if monetary policy continues to misbehave. Given the cumulative increases in money supply to date, "snugging" won't do. What is required is nothing short of a flattening (or even a slight contraction) in the level of transactional money (M1) for a period of nine to twelve months.

Will the Fed do it? Probably not — until it is too late. The constraints are well known and have been discussed at length in previous issues: fragile economic recovery; fragile banking system; LDC debt situation; and so on. Moreover, the Fed (or at least *some* members of the Board of Governors) do not believe that inflation is fast becoming enemy number one and dismiss the recent strength in prices as merely a speculative, unsustainable blip in prices. They should look again. The breadth of the advance is reminiscent of the 1972-74 commodity explosion when prices doubled!

STRATEGY: *There are three ways to "play" the ongoing bull market in commodities. One is to buy gold (see our comments on gold in this issue). Another is to sell short Eurodollar and T-bond contracts (see our comments later in this issue). And a third is to buy contracts of CRB futures (see contract specifications, Chart 2).*

Chart 1

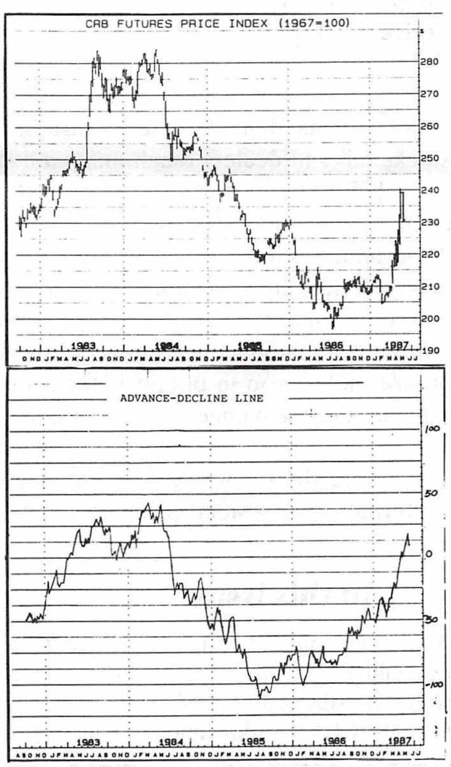


Chart 2

CRB INDEX FUTURES

Components of CRB Index

- Grains: barley, corn, oats, rye, soybean meal, CBT wheat, Minneapolis wheat
- Livestock and Meats: cattle, hogs, pork bellies
- Precious Metals: gold, platinum, silver
- Industrials: cotton, copper, crude oil, lumber, silver, platinum
- Oilseeds: flaxseed, soybean, rapeseed
- Softs (Imported): coffee, cocoa, sugar
- Energy: heating oil, crude oil
- Miscellaneous: orange juice, soybean oil

(Although crude oil, platinum, and silver appear in more than one group, each is used only once in calculating the CRB Futures Price Index.)

Contract Specifications

CONTRACT UNIT:	CRB FUTURES PRICE INDEX
CONTRACT QUOTE:	INDEX POINTS, i.e., 200.00
CONTRACT VALUE:	$500 × INDEX FUTURES LEVEL (i.e., futures at 200.00 are valued at $100,000: $500 × 200.00)
MINIMUM PRICE FLUCTUATION:	.05 = $25
DAILY PRICE LIMITS:	NONE
TRADING HOURS:	9:00 a.m.–3:30 p.m. (N.Y. TIME)
TRADING CYCLE:	MARCH, MAY, JULY, SEPTEMBER, DECEMBER
FIRST NOTICE DAY:	NONE
LAST TRADING DAY:	THIRD FRIDAY OF THE EXPIRATION MONTH
CONTRACT SETTLEMENT:	SETTLEMENT AT CONTRACT MATURITY IS BY CASH PAYMENT
POSITION LIMITS:	5,000 CONTRACTS NET LONG OR SHORT

MARGINS

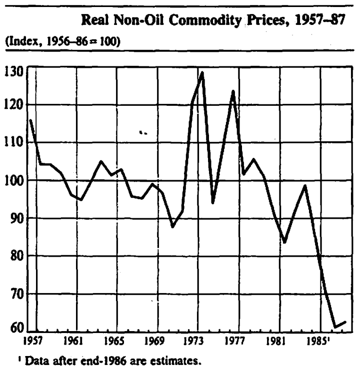
Initial	Maintenance
4500	3750

These contract specifications and margin rates are subject to change without notice.

Important Notice

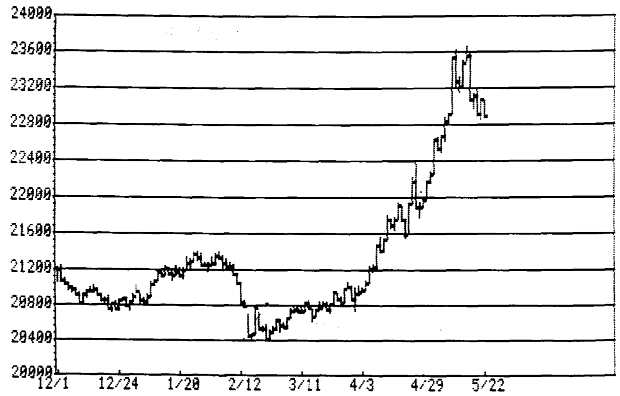
Beginning on July 20, 1987, pending CFTC approval, (i) prices for the Winnipeg Grain Exchange's barley, flaxseed, rapeseed and rye futures contracts and the Minneapolis Grain Exchange's wheat futures contract will no longer be included in the Index; (ii) the arithmetic averaging of individual commodity futures prices will occur over a nine-month period, rather than the current twelve-month period; and (iii) contract months in which open interest is less than 25 contracts will not be included in the Index calculation.

Chart 3



Source: *IMF*

Chart 4 — NYFE CRB PR. IND CASH



Gold

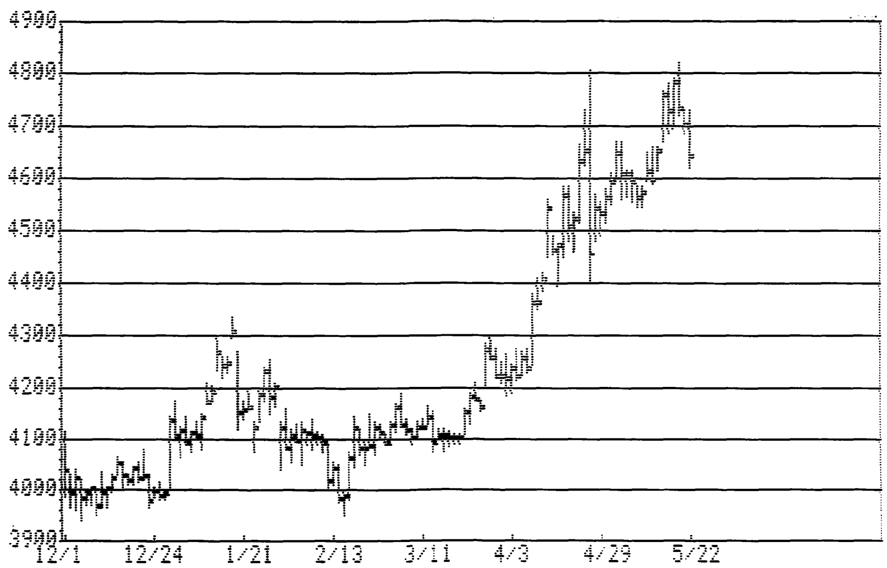
The precious metal's performance is all the more convincing when account is taken of the large supply increases in recent years. According to a report from Consolidated Gold Fields, non-communist world gold mine production rose to 1,281 tonnes in 1986 from 959 tonnes in 1980. Total supply of gold rose 20% last year to 1,967 tonnes thanks to heavy Soviet and Chinese sales, rising mine output outside of South Africa, and scrap sales.

While the Japanese government took 650 tonnes of gold last year, including 182 tonnes used in the Hirohito anniversary coin — and have not purchased any gold so far in 1987 — the market continues to record new recovery highs. Clearly, investor demand, on a global basis, is on the rise. To put it in perspective, the 1986 increase in supplies was less than $5 billion, or one-fifth the amount of money going into mutual funds of all sorts *in the US — on a monthly basis.* A very *slight* shift in investor preference can easily absorb the dramatic increases in production.

Using hockey parlance, one could say that the gold market is "facing off" the Fed. In the medium term, it cares little about defaults (and it should, because defaults are basically deflationary except insofar as they force the Fed to accelerate money growth), less about political/military events (and why should it, they always get "solved" don't they?), and much less about trouble in South Africa (again?). Only tight money and the threat of it can derail this market.

STRATEGY: *Long-term investors should sit out any and all corrections, as this market is heading substantially higher (it will easily surpass historic highs). Traders may wish to protect long positions at 453.00, basis spot Comex, good anytime, with a view towards repurchasing positions at slightly lower levels. The market should find excellent support above $440oz.*

Chart 5 — COMEX GOLD JUN 87



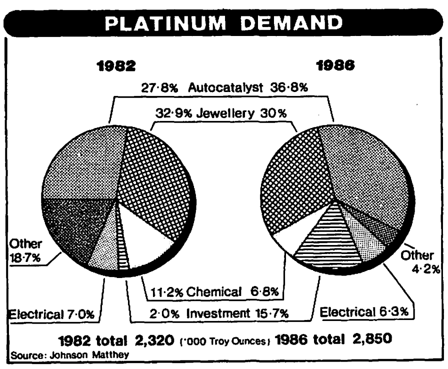
Silver and Platinum

According to Johnson Matthey, one of the world's leading refiners and marketers of precious metals, investment purchases of platinum rose last year by 75%, to 450,000 ounces, representing 16% of all metal sales. The report says that private individuals buying small bars and coins make up the investment market, which is similar in kind to the market for gold coins (rather than to the wholesale bullion market). For a fuller breakdown of demand, consult Chart 6. On the supply side, South Africa supplied 83% of the total, while Soviet sales rose to 290,000 ounces, although still well short of the record 640,000 ounces shipped in 1977. Fundamentals remain generally constructive, especially in view of the growing amount of investment offtake.

Silver's massive downside recorded on April 24 had a sobering impact on speculative interest. Open positions have since declined about 28,000 contracts, bringing the open interest level back to below 100,000 contracts — a time when silver was still trading below $6/oz. A lengthy high level consolidation in this range (750-950) seems unlikely given the "washed-out" appearance of its open position. Nevertheless, one should ask whether present levels are sustainable in the absence of especially noteworthy consumption statistics (or a drawdown of hefty warehouse stocks). Were prices "put up"? And if so, will they begin to erode in the absence of good offtake? Or did the price rise signal a shift in genuine investor preference at the bullion level or, at the very least, a desire to lengthen inventories by dealers (see our first article)? A breakout above 9.50, basis July '87, will confirm the latter, whereas a close below 7.50 will confirm the view that prices were merely "put up."

STRATEGY: *The flash update of May 12 reinstated long positions in July '87 platinum and July '87 silver. On Friday, May 22, July '87 platinum triggered our sell stop by closing just under 598.00. July '87 silver managed to close just above the 825 stop, close only. If stopped out, stand aside and await further instructions.*

Chart 6



Financial Times Tuesday May 19 1987

Chart 7 — COMEX SILVER JLY 87

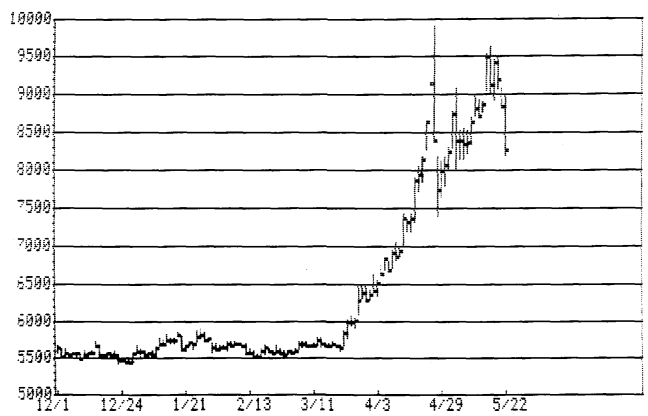


Chart 8 — NYME PLATINUM JLY 87

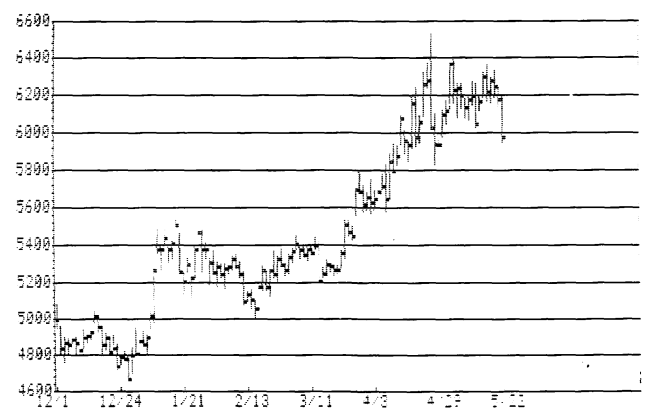
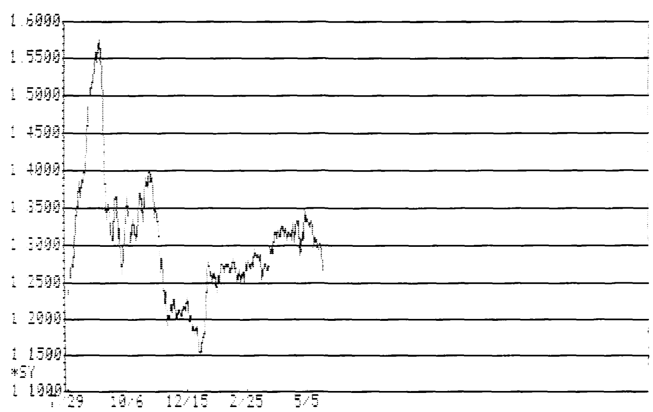


Chart 9 — PLV87/GCV87



On Oil Price Stability

Most observers are now firmly wedded to the notion that the oil market has entered a new era of stability, one in which prices will move upward in an orderly fashion. What a difference a year makes!

We continue to hold a contrary view: The oil market will become unstable and oil prices will ratchet downward over time.

The leverage effect — Opec operates as a residual supplier. Given the price of oil, non-Opec producers supply the market. Any remaining unsatisfied demand is supplied by Opec. In consequence, changes in the total market demand for oil or non-Opec supply have a magnified effect on Opec production. To understand the implications of this leverage effect, we build on some insights provided to us by Professor M. A. Adelman and his colleague at the Massachusetts Institute of Technology's Energy Laboratory, Mr. Michael C. Lynch.

Opec's output is about 40% of the total non-communist production. In consequence, if non-Opec production changes by 1% of the total market production or the total market demand for oil changes by 1%, then Opec must alter its output by 2.5%, if it wishes to maintain a target price. This is the Opec leverage effect.

There is also a Saudi leverage effect because changes in the demand for Opec oil tend to be met by the Saudis. With the Saudis operating as the residual supplier within Opec, any changes in the demand for Opec oil have a magnified effect on the Saudis' production. For example, the Saudis have about a 25% share of Opec production and Opec has about a 40% share of the non-communist production. Hence, if non-Opec production changes by 1% of the total market production or the total market demand for oil changes by 1%, then the Saudis must alter their production by 10%, if they wish to maintain a target price.

Chart 10 shows the Saudi leverage effect in action. The plunge in Saudi production was created by a combination of modest reductions in the total demand for oil and increased production by non-Opec suppliers. That the Saudis started a price war in 1985 shouldn't be too surprising. Faced with the undesirable consequences of the leverage effect, the Saudis had to convince other Opec members that encroachment on the Saudis' share of Opec production had its limits. In addition, the Saudis had to make the leverage effect work in favor of Opec: low prices stimulated total market demand and reduced non-Opec production, and this leveraged into increased demand for Opec (and Saudi) oil.

Stability: the Saudis' enemy — Although the Saudis' price war strategy produced its intended consequences, the Saudis abandoned it. The Saudis now are attempting to create a new era for the oil market, one which is marked by stability. To date, this message has taken hold as virtually everyone believes that we now have stability. Paradoxically, it is the expectation of market stability that will turn against the Saudis and cause them to initiate another price war.

To create the expectation of market stability, the Saudis have had to once again become the residual supplier within Opec. In consequence, the Saudis' oil revenues fell by 9% in the first quarter of 1987 (compared with the last quarter of 1986).

Here's how the dynamics of the expectations about market stability have begun to work against the Saudis. Firstly, the expectations of stable and gradually rising oil prices have stimulated the trend toward fuel-switching from oil to natural gas (see *FC&CC*, April 27, 1987). This has tended to weaken the total market demand for oil. Secondly, the expectations about stability have worked toward stabilizing non-Opec production. For example, contrary to claims that production in the United States would fall by 5% annually, US production has leveled off during the last nine months (see Chart 11). Both of these factors are weakening the demand for Opec oil, in particular the Saudis' oil.

If this weren't enough, the "carrot" of "high" prices and/or the "stick" of financial imperatives continue to generate cheating within Opec. This, of course, leaves even a smaller residual share of Opec's demand for the Saudis.

Instability: the Saudis' friend — To avoid being squeezed out of the market again, the Saudis must move toward establishing a ceiling, rather than a floor, for oil prices. Recent statements by Saudi King Fahd indicate that the Kingdom might be moving in the direction of an oil price ceiling. If low enough, this ceiling would act to slow fuel-switching. It would also terminate some marginal non-Opec production and development. In consequence, a low ceiling could put the leverage effect to work for Opec and increase the demand for its oil. But, to protect its "fair" share of the Opec demand, the Saudis will ultimately be forced into another price war. This will be required to insure that there isn't too much cheating within Opec. Moreover, periodic price wars will complement the price ceiling because they will tilt long-term price expectations toward the bearish end of the spectrum. This will further retard fuel-switching and non-Opec production and development.

STRATEGY: *Although we detect signs that the Saudis have begun to slowly inch toward the inevitable (a "low" price ceiling, coupled with periodic price wars), they are not there yet. In the meantime, investor preferences have begun to swing from financial assets toward commodities. This has given oil an unexpected, short-term boost, and forced us to the sidelines. We remain mega-bears, and anticipate reselling oil when the commodity market picture, as well as the timing of the Saudis' game plan, come into better focus.*

— Steve H. Hanke

Chart 10
SAUDI EXPORTS OF PETROLEUM

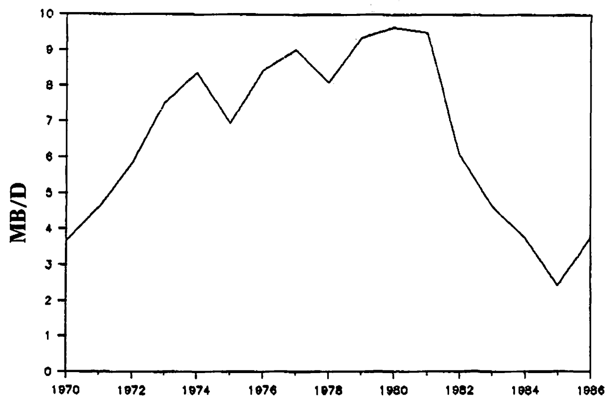
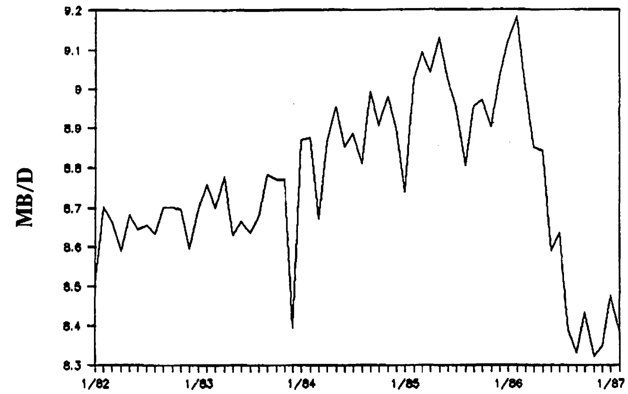


Chart 11
US CRUDE OIL PRODUCTION



Interest Rate Futures

It looked like the Fed was serious about "snugging." For one reporting two-week period, free reserves became negative, and the adjusted monetary base "flattened" to a 2.5% annual rate of growth for the two months ending in early April. By mid-May, the Fed had reverted to supply enough reserves so that banks enjoyed, once more, free reserves. It appears that the snugging episode was no more than a miscalculation of Treasury balances, and with that out of the way, bank borrowings have dropped and reserves availability remains ample. At the same time, the St. Louis measure of the monetary base is showing signs of reacceleration, moving recently to an annual growth rate of 7.2% for the latest eight-week period (and, note, a 9.1% year-over-year rate of growth).

Admittedly, the better-looking US dollar (holding steady at the lower levels, as pit traders are fond of saying) has removed an important reason to tighten as the Fed pays less attention to gold and the CRB than to the dollar. What is happening, in effect, is a restructuring and readjustment of assets: nondollar assets (i.e., DM, yen bonds) have become less attractive than gold and commodities due to their ridiculously low yields. The attack on the dollar is coming through a different flank, via rising inflation. The Fed's soldiers have as yet not caught the enemy's strategic redeployment.

Either way, it spells much higher interest rates.

STRATEGY: *Remain short T-bonds and Eurodollars (the one half that was covered on April 16, was reinstated on the Hotline update of May 16). While sentiment remains slightly negative, it is also true that even the bears don't have an inkling of how much higher interest rates will have to go to a) choke off the coming inflation and b) to reduce domestic demand sufficiently to reverse the current account deficit.*

Moreover, the market's technical *condition remains highly vulnerable as* weak *holders of bond mutual funds (they increased $250 billion in five years and are still increasing at* $15-$20 billion more per month*) begin to redeem shares that were supposed to yield 20%-25% per annum (total return, in the rising bond markets of 1985-1986) and now show 10% losses — in one month! As this phenomenon will tend to widen the yield curve, we prefer to move expiring June '87 Eurodollar contracts over to the T-bond market.*

Place stops at 91.16 and 92.30, basis September T-bonds and September '87 Eurodollars, close only.

Chart 12 — CBT U.S. T-BONDS SEP 87

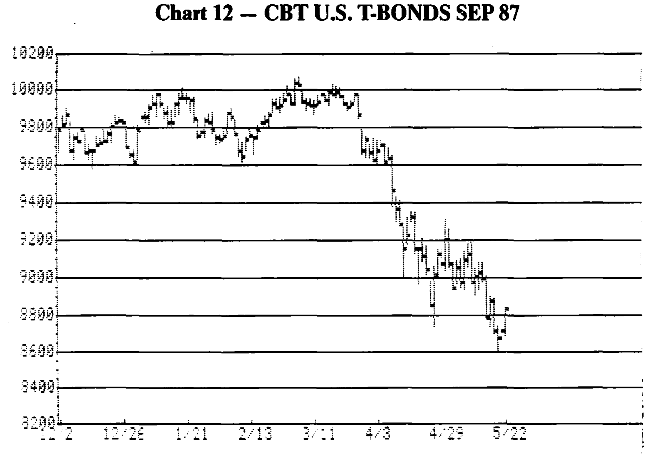
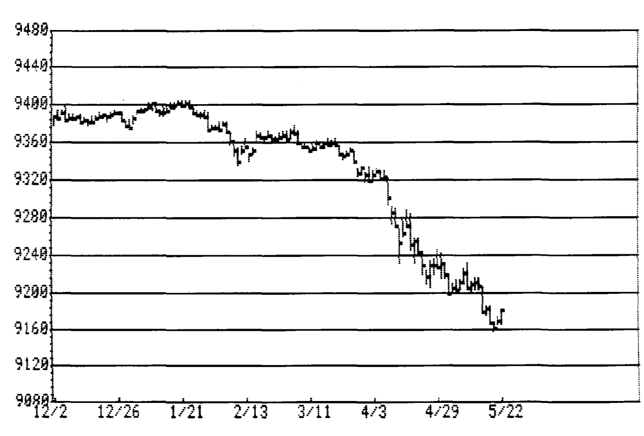


Chart 13 — 3 MTH EURODOLLAR SEP 87



Stock Indexes

The market has continued to weaken in the face of rising interest rates and despite substantially improved corporate earnings. Clearly, the p-e ratio expansion has peaked; whatever strength remains in this market will have to come from the earnings side.

There are a number of especially noteworthy technical problems. First, breadth has collapsed (see Chart 14). Second, new lows have been consistently outpacing new highs, although admittedly the list of new lows has not expanded significantly. Third, odd-lot short sales have been minuscule; it seems that odd-lotters have not as yet been made aware of the interest rate problems. Finally, specialist short sales remain high, a sure sign that professionals expect the market to fall further.

On a more positive note, relatively low p-e ratio stocks, cyclical companies (particularly aluminum, copper, steel, and even computer manufacturers, and autos) have been performing rather well in this late stage of the business recovery. It is therefore likely that market leadership on the next rally will change to the low p-e and cyclical group. That a significant rally is still in the cards (and perhaps one that would score new highs) is guaranteed by the Fed's accommodative posture. Lack of credit rather than its high cost is the market killer. For proof, just look at Australia.

STRATEGY: *We are continuing to trade this market, looking for intermediate-size moves. We are now short as per Flash update of May 12 with stops at 288.20, basis June '87, good anytime.*

Chart 14

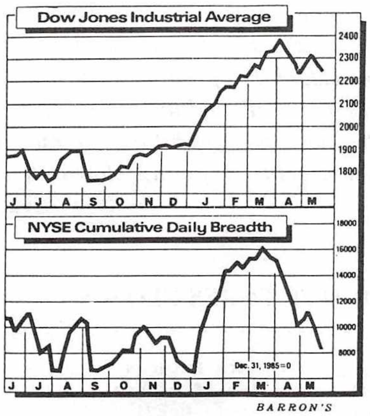


Chart 15 — CME S&P 500 INDEX

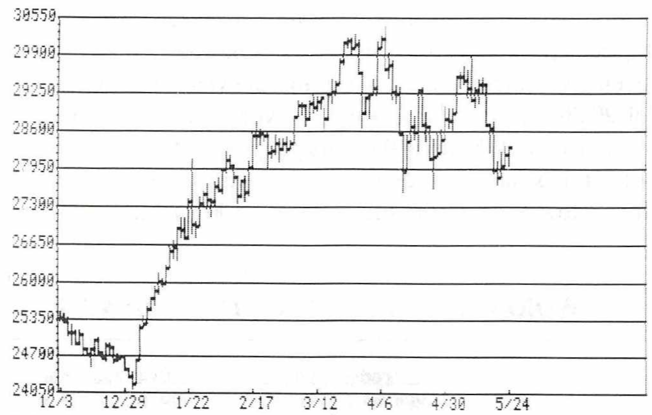


Chart 16 S&P

DATE	BOT	SOLD	Realized P/L	Unrealized P/L	Total P/L
May 1	290.00				
May 8		294.65	+2,325.00		
		294.65			
May 12	297.00		-1,175.00		
		294.45		+6,325.00	
		(Friday May 22nd, Settlement:281.80)			+7,475.00

Lord Keynes and Sugar

Although John Maynard Keynes is one of the most well known figures in economics, few would associate his name with sugar or any other commodity. This is curious because Lord Keynes spent a considerable amount of his energies analyzing commodity markets. He speculated heavily in these markets, with great success.

To set the stage for our analysis of sugar, we quote from the April 1923 Special Memorandum No. 1, which was prepared by Lord Keynes and published by the London and Cambridge Economic Service: "Accurate information as to the volume from time to time of surplus stocks of staple commodities is of utmost interest both to businessmen and to economists. For reasons, which do not concern us in detail in this statistical enquiry, movements in the volumes of stocks have an immense influence on the course of price changes. In many commodities, for example, a reduction of stocks from three months' to one month's consumption or an increase from three months' to six months' is capable of affecting current prices to an extent which may seem disproportionate. But stocks, failing special explanations in particular cases, are the best index to impending instability of the price level... To the economist a statistical inquiry into fluctuations of stocks may, if it can be carried on over a long enough period, throw much light on the hidden mechanism lying behind cyclical movements...."

Chart 17 contains the type of data that Lord Keynes used in his analyses of commodities. The key variables for world sugar (production, disappearance, stocks and prices) are displayed for the past 25 years. By examining the last two columns, a clear pattern between stocks and prices can be observed. For example, prices for the average of March futures closes in October through December first peaked in 1963 at 10.11 cents per pound. Not surprisingly, stocks as a percent of disappearance declined to a low of only 18.94% at the end of the September 1962/August 1963 market year and were only 20.64% at the end of the 1963/1964 market year. In 1974, prices peaked again at 46.49 cents per pound. Stocks had been declining in the four prior market years, reaching a low of 20.35% in the 1973-74 market year. The next price peak occurred in 1980 at 38.05 cents per pound. In a classical fashion, stocks had been declining prior to the price peak, reaching a low of 27.97% in the 1980-81 market year.

Although stocks are currently high, they are in a declining trend. Moreover, they are projected to continue their decline. To understand the projected declines, first look at the production column. The three-year (1987-88 to 1989-90) projected production growth is based on the assumption that production will grow at about the same rate as it did in the four market years 1983-84 to 1986-87. Next look at the disappearance column. It is assumed that consumption growth rate for the three years projected will be slightly lower than that in the four market years 1983-84 to 1986-87. Given these trends in production and consumption, stocks will continue to fall substantially during the next three market years.

Given that lower stocks result in higher prices, we anticipate a bull market in sugar. The average price for March 1988 futures contract, during the October-December 1987 period, should be 9.50 cents per pound or about 22% higher than the current price for that contract. We anticipate that the bull market will peak as early as the calendar year 1989 (which is projected at 30.00 cents per pound, see Chart 17) or perhaps in 1990.

STRATEGY: *Given our general view of commodities and the underlying fundamentals for sugar, we recommend that long-term investors establish a position in sugar at this time. The downside risks are small, and the rewards promise to be most attractive. Purchase the March 1988 contract at the market; place stops at 6.85 cents per pound, close only.*

— Steve H. Hanke

Chart 17

WORLD SUGAR: PRODUCTION, DISAPPEARANCE, STOCKS, MCH FUTURES CLOSES

	Production		Disappearance		Ending Stocks		Mch Futures
	000 MT	% of 3-yr-ave	000 MT	% of 3-yr-ave	000 MT	% of disapp	Ave of closes Oct1-Dec31
61/62	52351	100.2	55968	112.3	13463	24.05	2.57 cents/lbs.
62/63	51172	97.2	54342	103.0	10293	18.94	3.87
63/64	54745	102.9	53909	98.6	11129	20.64	10.11
64/65	66831	126.7	59191	108.1	18769	31.71	3.17
65/66	62328	108.2	62105	111.3	18992	30.58	2.29
66/67	64765	105.7	64850	111.0	18907	29.15	1.57
67/68	65626	101.5	64897	104.6	19636	30.26	2.54
68/69	66828	104.0	67307	105.2	19157	28.46	2.72
69/70	72981	111.0	71014	108.1	21124	29.75	3.22
70/71	71030	103.7	73403	108.4	18751	25.55	4.10
71/72	72309	102.9	73206	103.7	17854	24.39	5.33
72/73	75550	104.8	77005	106.2	16399	21.30	8.15
73/74	78932	108.2	79209	106.3	16122	20.35	10.24
74/75	78263	103.5	76915	100.6	17470	22.71	46.49
75/76	81581	105.2	78573	101.1	20478	26.06	13.72
76/77	86950	109.2	82222	105.1	25206	30.66	8.46
77/78	91033	110.7	85747	108.2	30492	35.56	8.89
78/79	90965	105.1	90250	109.8	31207	34.58	8.92
79/80	84857	94.7	90271	104.9	25793	28.57	14.89
80/81	88213	99.2	89091	100.4	24915	27.97	38.05
81/82	100732	114.5	92387	102.8	33260	36.00	12.68
82/83	100452	110.1	94705	104.6	39007	41.19	7.33
83/84	98011	101.6	97148	105.5	39870	41.04	9.69
84/85	100433	100.7	100047	105.6	40256	40.24	5.38
85/86	98497	98.9	101393	104.2	37360	36.85	5.90
86/87es	101845	102.9	103205	103.7	36000	34.88	6.64
87/88pj	101000	100.7	105000	103.4	32000	30.48	9.50pj
88/89pj	102000	101.5	107000	103.7	27000	25.23	15.00pj
89/90pj	103000	101.4	109000	103.7	21000	19.27	30.00pj

Source: *Commodity Associates*

Currencies

Widening interest rate diffferentials in favor of the US in both the long- and short-term areas has temporarily halted the rout. At the same time, US trade, in volume terms, has begun to show a very *small* improvement, encouraging market participants to believe that the dollar has reached an equilibrium point.

As we already mentioned in our interest rate section, all that has *really* happened is that investors have been reshuffling their portfolios away from low-yielding nondollar assets, particularly SF, yen, and DM, and into gold and various other commodities. It is as if one breach on the dyke has been repaired and another one has just opened up in a different location. The dyke is fundamentally weak, and cracks will appear continuously. In a monetary sense, credit creation in the US is excessive: At times it attacks the external value of the dollar, and at other times it attacks the (internal) purchasing power of the dollar. Two sides of the same coin.

STRATEGY: *Raise stops on long yen and DM positions to 71.30 and 5600 respectively, basis Sept. '87, close only.*

Canadian dollar

The Bank of Canada has returned to its more traditional role: that of supporting the Canadian dollar. As interest rate differentials have narrowed vis à vis US rates, downward pressure has reappeared, the natural consequence of a twin deficit operating on Canada's external front: current account and long-term investment capital. Interest rates will have to rise much more in Canada before the bearish pressure subsides.

STRATEGY: *Roll June '87 short positions to September and place stops at 74.85, close only.*

Chart 18 — CME SWISS FRANCS SEP 87

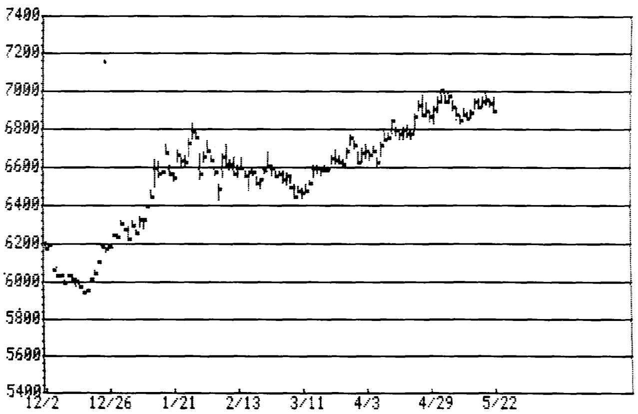


Chart 19 — CME DEUTSCHE MARK SEP 87

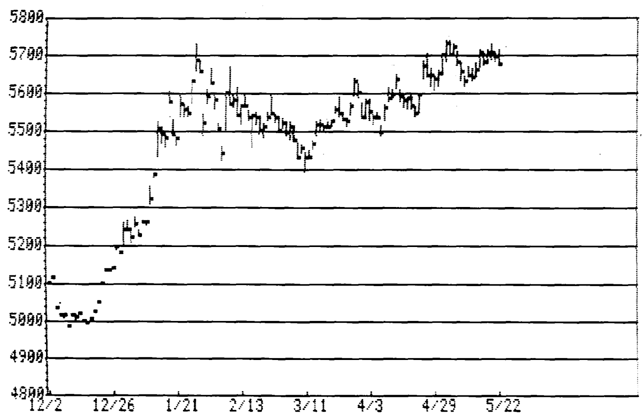


Chart 20 — CME BRITISH POUNDS SEP 87

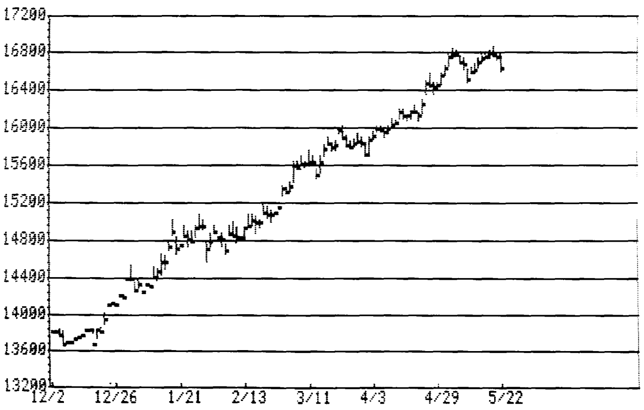
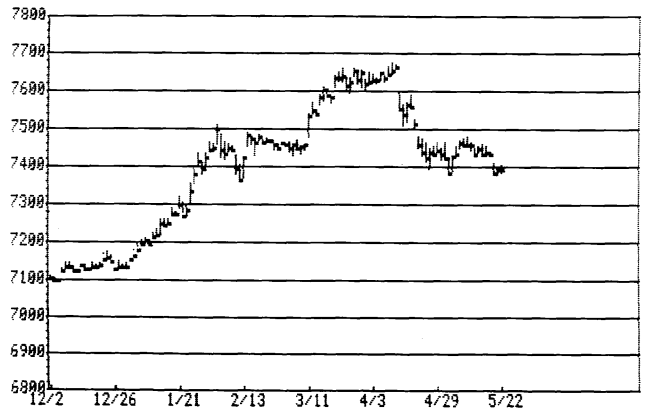


Chart 21 — CME CAN. DOLLARS SEP 87



Friedberg Capital Markets

There is little difficulty in explaining the abundance of newly-issued Australian-dollar denominated bonds. Basically, people like double-digit coupon paper. The proverbial "Belgium dentists" earn 2%-3% on their savings accounts and 6%, at best, on domestic bonds. It is therefore no wonder that Australian dollar Eurobonds have had a warm reception in continental Europe. This is also true for US dollar and Canadian dollar-based investors. New issue volume in A$ bonds in 1987 (A$7 billion) has already outpaced the whole of 1986 by A$1.9 billion (see Chart 22).

Issuers are only too pleased to denominate their bonds in Australian dollars, since they have been able to swap the currency for more attractive funding in other currencies.

Buyers of A$ bonds have placed their faith in the Labour government's ability to put Australia's economy on track in spite of the budget deficit, slow export growth, and close to double digit inflation. More recently Finance Minister Keating introduced substantial budget cuts that should bring the budget deficit down to less than 2% of Gross Domestic Product (GDP), encouraging investors in their belief that Australian interest rates are heading lower.

The Canadian Imperial Bank of Commerce A$13% coupon of 13/3/91 trading to yield 13.62% is RRSP eligible and made available through Friedberg Capital Markets.

Chart 22

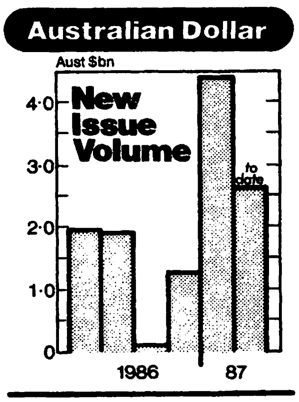


Chart 23 — TA.C*TD.C

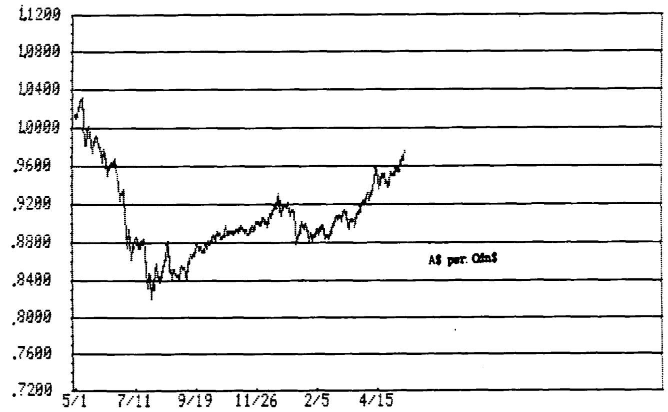


Chart 24 — MIDLAND BANK AUD CASH

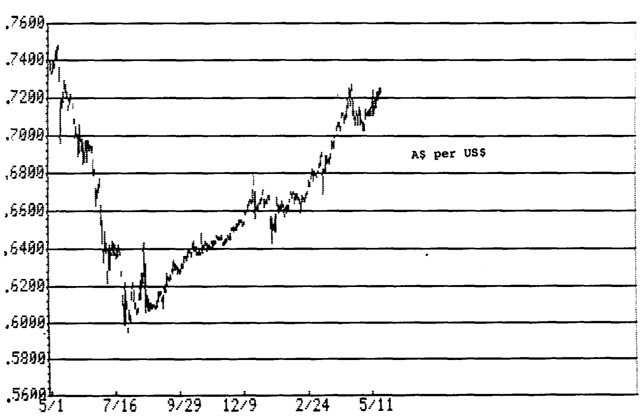


Chart 25

Foreign Currency Bonds

DATE: May 22, 1987

We offer the following Bonds subject to change without prior notice:
Minimum amount U.S.$5,000 (Cdn.$7,000).

ISSUER MTY. DATE/COUPON	BID	OFFER	CURRENT ANNUAL YIELD TO.MTY.	CURRENT COUPON PERIOD
NEW ZEALAND DOLLAR DENOMINATED BONDS				
COCA COLA FIN. CORP. 16/6/89 18%	100 1/8 -	100 7/8	17.41	16/6/86-16/6/87
HONDA INT'L 20/9/89 16 3/8%	95½ -	96¼	18.14	20/6/86-20/9/87
HONDA INT'L 28/5/90 16%	94½ -	95¼	17.82	28/11/86-28/5/88
TOURIST HOTEL CORP.(N.Z.) 4/6/93 zero coupon	42 3/4 -	43½	14.84	matures 4/6/93
BANK OF NOVA SCOTIA 15/9/89 18¼% RRSP eligible	101¼ -	102	17.00	15/5/86-15/9/87
WELLS FARGO (semi-ann.) 12/5/89 16 1/8%	94 3/4 -	95½	19.87	12/5/87-12/11/87
KODAK (semi-ann.) 15/2/89 17%	98 -	98 3/4	18.61	12/2/87-15/8/87
TORONTO DOMINION 2/4/90 18% RRSP eligible	101½ -	102¼	17.32	2/4/87-2/4/88
AUSTRALIAN DOLLAR DENOMINATED BONDS				
CAN. IMP.BANK OF COMMERCE 13/3/91 13% RRSP eligible	97¼ -	98	13.66	13/3/87-13/3/88
DEUTSCHE MARK DENOMINATED BONDS				
REPUBLIC OF PORTUGAL 19/6/94 6 5/8%	102¼ -	103	6.09	19/6/87-19/6/88
GOVT. OF BELGIUM 29/4/96 5¼%	95½ -	96¼	6.05	29/4/87-29/4/88
QUEBEC HYDRO 1/5/96 5¼% RRSP eligible	96 3/8 -	97 1/8	5.92	1/5/87-1/5/88
SWISS FRANC DENOMINATED BONDS				
GOVT. OF AUSTRALIA 30/10/98 5%	102 5/8 -	103 3/8	4.61	30/10/86-30/10/87
JAPANESE YEN DENOMINATED BONDS				
GOVT. OF CANADA 23/7/93 5 5/8% RRSP eligible	105 3/8 -	106 1/8	4.46	23/7/86-23/7/87

U.S. DOLLAR DENOMINATED FLOATING RATE NOTES

ISSUER	MAT.	BID	OFFER	CURRENT COUPON	NEXT COUPON DATE:
SANTA BARBARA SAVINGS & LOAN (fully collateralized)	18/12/95 pays 1/8% over 3 months LIBOR (quarterly)	99.75-	100.05	6 5/8%	18/6/87
LINFIN SAVINGS & LOAN (fully collateralized)	14/11/95 pays 1/8% over 3 months LIBOR (quarterly)	99.79-	100.09	7 3/8%	18/8/87
UNITED KINGDOM	7/10/92 3 month LIBID	99.85-	100.05	6 9/16%	7/7/87

For further information and current prices please call: FRIEDBERG CAPITAL MARKETS (416) 364-2700

The Exotics

Swedish krona

Sweden continues to make major progress on its fiscal front. The 1987 budget deficit is now put at Kr32 billion for the fiscal year beginning July 1, 1987, down from Kr37 billion for the year ending June 30, 1987. As a percentage of GDP, the deficit now hovers at around 3.5% compared with a peak of 13% in 1982-83. Real GNP growth is growing at 2% per annum, which is sufficient to keep Sweden's open unemployment rate at 2.5%, the lowest in the OECD. On a more negative note, the relatively tight labor market sustained a severe wage push, which has seen labor cost in Sweden rise at double that of Germany. This has necessitated a subtle depreciation of the krona so as to restore competitiveness. Sweden's double weighting of the US dollar in its currency basket has in effect provided it with a 9% depreciation against the DM on a year-over-year basis.

For 1986, the current account surplus was Kr6.7 billion but is expected to narrow to Kr1 billion during the course of 1987. Terms of trade, which have been relatively helpful to Sweden during the course of 1986, are likely to remain helpful during the course of 1987, as forest products, pulp, and newsprint continue to firm in the world's commodity market. Thus, there is little danger of a sudden and severe devaluation. Nevertheless, Sweden's explosive wage push will force the Central Bank to allow a gentle downward float vis à vis the strongest European currencies.

STRATEGY: *We have been neutral on the SKr for quite some time. After profiting from the crown's strength against the dollar as recommended in FC&CC April 20, 1986, currently we prefer to remain neutral vis à vis the US dollar and DM.*

Chart 26

BASKET

U.S.	16%	Denmark	12%
Norway	13%	U.K.	19%
Germany	23%	Finland	10%

YEAR	SWEDISH KRONOR PER U.S. DOLLAR (PERIOD)	U.S. 1970 =1.00	U.S. 1978 =1.00	BASKET 1970 =1.00	BASKET 1978 =1.00
1967	5.16	0.9577	1.2947	1.0217	1.0889
1968	5.16	0.9805	1.3256	0.9725	1.0364
1969	5.17	1.0076	1.3622	0.9957	1.0612
1970	5.18	1.0000	1.3520	1.0000	1.0658
1971	5.10	0.9552	1.2914	0.9984	1.0641
1972	4.76	0.8706	1.1770	0.9593	1.0224
1973	4.36	0.7932	1.0723	0.9154	0.9756
1974	4.43	0.8136	1.1000	0.9377	0.9994
1975	4.15	0.7571	1.0235	0.9151	0.9753
1976	4.35	0.7625	1.0309	0.8662	0.9232
1977	4.48	0.7494	1.0131	0.8837	0.9418
1978	4.51	0.7397	1.0000	0.9383	1.0000
1979	4.28	0.7283	0.9846	0.9880	1.0529
1980	4.22	0.7169	0.9692	1.0304	1.0982
1981	5.06	0.8452	1.1426	1.0783	1.1492
1982	5.28	1.0246	1.3852	1.2003	1.2792
1983	7.66	1.1848	1.6018	1.2806	1.3649
1984	8.27	1.2345	1.6690	1.2249	1.3055
1985	8.60	1.2373	1.6728	1.2272	1.3079
1986 (1Q)	7.40	1.0477	1.4165	1.1419	1.2170
1986 (2Q)	7.20	1.0186	1.3771	1.1439	1.2191
1986 (3Q)	6.96	0.9866	1.3338	1.0988	1.1710

Above 1.00 = Undervalued
Under 1.00 = Overvalued

Chart 27

Year	Foreign Assets (Mln US$)	CURRENT ACCOUNT As % of GNP %	CUMULATIVE 12 QTR. Current Account (Mln US$)
1970	916	-0.8	-578
1971	1286	0.9	-110
1972	1950	1.3	654
1973	3267	2.7	2348
1974	3261	-0.9	1444
1975	4072	-0.4	535
1976	3443	-2.1	-2542
1977	3553	-2.6	-4171
1978	3263	-0.2	-4080
1979	369	-2.2	-4846
1980	-1221	-3.5	-7069
1981	-3119	-2.5	-9665
1982	-3748	-3.4	-10777
1983	-3717	-1.0	-7296
1984	-4705	0.4	-4080
1985	-4332	-1.2	-1704
1986	-4540	0.8	159

Chart 28

HARD CURRENCY COVER (In millions of U.S. Dollars)

Reserves * + Previous 12-months curren Account ***= 10,168

(Reserves + 12-months C/A)/ Broad Money ** = 10168/72,610= 14.0%

*As at Feb. 1987** Feb. 1987 *** 1987 Estimated

Figures in millions of U.S. Dollars

	Broad Money (Converted to U.S. Dollars)
1977	42,060
1987 Feb.	72,610
% Increase (decrease)	72.6%
Corresponding % increase in the United States	110.4%

(a) 1986 Imports as percentage of GNP 25.68%
(b) 1977 - 1986 Imports as percentage of GNP 25.97%
1986 /1977 - 1986 average) = (a)/(b) = 98.8%

Source: IFS

RATES

Chart 29

SPOT	1 - Month	3 - Month	6 - Month	12 - Month
6.2275-6.2325	6.2375-6.2455	6.2495 6.2580	6.2600-6.2690	6.3525-6.3675

Forex Rates & Update

Currency	*Spot*	*3-Month*	*12-Month*	*Comments vis à vis US$*	*Comments vis à vis DM (Spot DM: 1.7800)*
Australian dollar	.7210-.7215	.7106-.7114	.6860-.6875	Remain long	Remain long
Belgian franc	36.90-36.95	36.81-36.91	36.52-36.72	Neutral	Remain long
Danish krone	6.70-6.71	6.73-6.74	6.81-6.84	Neutral	Remain short
Dutch guilder	2.0075-2.0085	1.9950-1.9965	1.9440-1.9975	Neutral	Remain long
Greek drachma	132.50-133.00	135.50-138.00	148.50-159.00	Neutral	Remain short
Italian lira	1289-1290	1289-1291	1292-1294	Neutral	Neutral
Kuwaiti dinar	.27400-.27440	.27215-.27289	.26595-.26762	Neutral	Remain short
Malaysian ringgit	2.4710-2.4720	2.4470-2.4510	2.4110-2.4520	Neutral	Neutral
Hong Kong dollar	7.8050-7.8060	7.7725-7.7765	7.7105-7.7365	Sell 12 months at 7.65 to US$ if available	
New Zealand dollar	.5778-.5788	.5576-.5596	.5163-.5223	Remain long	Remain long
Norwegian krone	6.61-6.62	6.72-6.74	6.99-7.02	Neutral	Neutral
Portugese escudo	138.50-139.00	141.00-143.00	146.00-157.00	Neutral	Neutral
Saudi Arabian riyal	3.7500-3.7510	3.7450-3.7470	3.7360-3.7410	Remain short	Remain short
Singapore dollar	2.1120-2.1130	2.1010-2.1040	2.0620-2.0730	Neutral	Neutral
Spanish peseta	124.65-124.85	126.75-127.45	130.90-133.10	Neutral	Neutral
Venezuelan bolivar	27.70-27.90	28.30-28.70	29.20-30.80	Neutral	Neutral

Explanatory Notes

*Indicates change in recommendation from last issue

Currency expected to firm against both currencies.	Buy	Buy
Currency expected to strengthen against US $ and weaken against DM.	Buy	Sell
Currency expected to weaken against both major currencies.	Sell	Sell
Currency expected to weaken against US $, but strengthen against DM.	Sell	Buy
Term used to liquidate short position but does not imply a new buy recommendation	Cover	
Term used to indicate sale advice of previous long position, but does not imply a new short sale recommendation.	Liquidate	

Hotline Update

Tuesday, April 28: The market letter was mailed today. One new recommendation: Tighten stops on long currency positions. Raise stops on June DM to 5505, on June SF to 6700, and on June Japanese yen to 7050 stop, all good anytime.

Flash update, Friday, May 1, 11:50 a.m.: Buy June S&P at market (now trading at approximately 290.00). Place initial stops at 283.50, basis June, good anytime.

Friday, May 1: A review of the week's activities and recommendations: 1) As of Tuesday's update, we raised our stops on long currency positions to 5505 on June DM, 6700 on June SF, and 7050 on June Japanese yen, all good anytime. 2) As of today's flash update at 11:50 a.m., you are now long the June S&P with stops at 283.50, good anytime.

Tuesday, May 5: There are no new recommendations. As of Friday's flash, we are now long the June S&P. Raise stops to 286.00, basis June, good anytime.

Flash update, Friday, May 8, 10:20 a.m.: Liquidate all long S&P positions at the market, accepting profits. You may now sell short June S&P at market, risking 297.00 good anytime. If no other changes or new recommendations, this will replace the regular Friday update.

Flash update, Tuesday, May 12, 9:22 a.m.: A number of new recommendations: 1) Reinstate long positions in silver and platinum at the market. Stop recommendations will follow on the next broadcast. 2) Traders who may have sold gold should reinstate positions at market. New stops should be placed at 453.00, basis June, good anytime. 3) Last Friday, May 8, we advised liquidating long S&P positions and putting on an initial short position. This short position was unfortunately stopped out Monday, May 11 at approximately 297.00 with a small loss. We now advise reentering the short trade. Sell June S&P at market, placing initial stops at 301.00, good anytime. If there are no other changes or new recommendations, this flash update will replace the regular Tuesday update.

Friday, May 16: A review of the weeks' activities with some revised stop recommendations: 1) As per our Tuesday a.m. May 12 flash update, you reinstated long silver and platinum positions. Place stops at 825.00 and 599.00, respectively, basis July, close only. 2) As per the same update, traders were advised to reinstate long gold positions with stops at 453.00, basis June, good anytime. 3) As per the same update, we advised selling June S&P at market with stops at 301.00, good anytime. Lower stops to 296.00, close only. 4) Barring a discount rate cut over this weekend, reinstate the second half of short T-bond and Eurodollar positions originally covered on April 16, selling September contracts and placing initial stops at 9116 for the bonds and 9230 for the Euros.

Tuesday, May 18: First a new recommendation: Believe it or not, we are advising to cover all short positions in crude oil at market. We believe that while the oil fundamentals remain extremely bearish, the ongoing bull market in commodities has changed overall sentiment. As a result, middlemen restocking will help Opec raise production or alternatively, raise prices, while leaving production unchanged. Second, lower June S&P stop on our short positions to 28820, good anytime.

Friday, May 22: A recap of the week's recommendations: As of Tuesday, we have covered our short crude oil positions. Remain sidelined pending a weakening of general commodity prices. Maintain stops on short June S&P positions of 28820, good anytime.

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