

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



Volume 9, No. 1 January 24, 1988

1987: Theory and practice

It was the best of times, it was the worst of times. Unlike Sidney Carton in Dickens' *Tale of Two Cities*, though, we didn't lose our heads. In fact, we managed to keep our heads and make a little money on the game — almost in spite of ourselves.

We theorized on a grand scale in 1987, and most of the time, it turns out, theory and reality intersected. The end of the financial mania, the rise in the price of gold, commodity inflation, the falling US dollar, and rising interest rates.

On all of these we had our theories. And mostly, what we predicted would happen, did happen. Mostly. But, of course, pride goeth before the fall. Of the two events we were most convinced of, and which we shouted loudest about, one turned out to be off base, way off, and the other didn't make any money for us.

As you might have guessed, we're referring to our very best efforts on oil and the stock market.

Not even close: We started off 1987 absolutely convinced that the then prevailing backwardation in crude oil futures would bring Opec to the edge of dissolution, and we predicted that "no later than March/April, the \$18 agreement will come apart." We stayed short.

We went on in this way for quite some time, predicting with a certainty the market itself ignored "Act II of the Great Oil Bear Market of the '80s." We finally, reluctantly, admitted defeat in May, allowing that a shift in investor preference to commodities from financial assets had given oil "an unexpected, short-term boost, and forced us to the sidelines." We added, a little plaintively, that "we remain mega-bears" and anticipated getting back into the game when the "commodity market picture... come(s) into better focus."

We thought it came into better focus in July, and we sold oil again, only to be stopped out in October. And, chastened, we've been silent on oil ever since. Still, there's all of 1988 in which to test our theories again.

Close but no cigar: We also did a fair amount of theorizing on the stock market in 1987. And on this one, we were closer to the mark. We started making the appropriate noises back in January, going so far as to say that "a once-in-a-generation short-selling opportunity should present itself shortly." We then entered the fray rather tentatively, going long, then short,

then standing at the sidelines, then going short — until that fateful day 10 months later when we were... left standing at the gate. Yes, we the "expert traders," the players of the volatility game, were left standing at the sidelines as spectators when our best efforts to sell stock index futures foundered on the shoals of volatility in the great October '87 Stock Market Crash.

Humbled once again in a game where theory and reality can meet so perfectly, yet still leave you standing out in the cold, we concluded firmly in our October issue that "the odds are that we have entered a long bear market."

Call of the year: In weighty, well-rounded academic tones we proclaimed the virtues of copper in June, with an exposition on something called "inventory analytics." We bought copper at about 66.00 and sold in August at about 76.70, with handsome profits. They could have been yet more handsome had we not missed copper's subsequent rise to about 84.00. We got back into copper in October around 76.00. As a reward for our patience, December contracts touched 109.00 in November, and exceeded 140.00 in December. May we gloat, just a little?

Call of the wild: After enjoying continuous modest upticks in the price of gold over the year, we form, yes, a theory. In June, we come right out with it: "Gold is in the early stages of a long and powerful bull market that will rise well above the old, historic highs." In October "we are raging bulls." In November we're predicting a minimum upside target of \$850/oz. in the next two years. "There is, at this time," we said, "no downside risk whatever." Our apologies. We do get carried away sometimes. Of course, there's no such thing as an investment with no downside risk. But as of December, we were

In this issue

The Saudis get desperate and thus irrational, so naturally we sell crude oil. We're still bullish on gold but there could be some short-term turbulence. We stand aside on T-bonds and remain firmly long CRB Index. Also, currencies, copper, sugar, and Friedberg Capital Markets. Contributions by Albert D. Friedberg, Steve H. Hanke, Daniel A. Gordon, and Michael D. Hart.

still "firmly" long. Well, whichever way it goes, remember, you heard it here first.

Sweetest trade of the year: Sugar.

Sweetest theory of the year: The decline and fall of the Yankee buck. We talked about soft dollars and hard landing, trade winds, inflation on the march, the banking mess, a time for truth, the trade gap, booms and near booms. The net result of this holistic approach was that we closed 1987 on an upbeat in deutsche marks, yen, Swiss francs, T-bonds, and

Eurodollars. The question is, why on earth did we have to be so verbose about it?

The This-Doesn't-Look-Like-Kansas-Toto Award: The land of Oz was kind to us in 1987 as we rode the Aussie buck up through what we predicted would be its "inevitable revaluation."

Most laboriously explained theory of 1987: backwardation, once at the beginning of the year ("The backwardation, again") and once at the end ("Backwardation revisited").

Enough already! Forward to '88!

CRUDE OIL CRUDE OIL CRUDE OIL CRUDE OIL CRUDE OIL CRUDE OIL CRUDE OIL CRUDE OIL

Desperation breeds irrationality

Question: If your liquid reserves amount to \$25 billion (at most), and you draw them down by \$1.5 billion per month, how long will it take you to empty your cookie jar? Answer: Just over 16 months. That in a nutshell, is Saudi Arabia's current predicament.

What should it do? One or a combination of the following: 1) Increase oil production and exports; 2) devalue the riyal; 3) cut spending; 4) raise income taxes, duties, and tariffs; 5) borrow money.

The last two choices represent, by far, the worst set of policy alternatives. Raising taxes will chase away foreign workers — almost half of the Kingdom's population — stifle business, send taxpayers underground, and shrink disposable income in an economy that has been contracting for five years (last year GDP fell by 3%). Raising tariffs, in the name of revenue creation but cloaked as a measure of protection to local industry, will distort trade patterns, raise the ire and expectations of the "unprotected" members of society, and beg for retaliation. Borrowing money merely postpones the day of reckoning — and adds woes to future fiscal management in the way of increased interest charges. It might even crowd out whatever remains of private credit demands.

Rational policymakers would never consider these choices. And yet, that is precisely what the Saudis announced in early January. Customs duties were to go up to 12% from 7%, except in food and imports from the neighboring Gulf Nations. In some case, such as cement, tariffs were to rise to 20%, thus also providing some local industry protection. Income taxes were to be levied on the four million foreigners at up to 30%. Foreign companies would be facing tax bills of up to 45% of net income. Finally, to bridge the gap further, the Kingdom would borrow approximately \$8 billion, thus ending its 25-year abstinence from borrowing.

In total, tax and tariff measures were to raise almost \$3 billion. Too little, obviously, for so much noise. A few days later, facing strident protests and threats of mass exodus, the Kingdom retracted these revenue-raising moves, leaving everyone wondering about the competence of the authorities. And the new hole-plugging measures.

The authorities need not think too much. A 15% devaluation will generate the missing \$3 billion via higher riyal revenues from an unchanged oil/dollar price — a little more, if a substantial portion of government expenditure is imported (unlikely, since current spending represents at least 85% of planned spending).

A devaluation recognizes that a country has become poorer. It "taxes" in a uniform and nondiscriminatory manner. It helps to diversify non-oil exports, which last year rose by 25% to \$2.5 billion. It provides incentives for import-substitution activities.

A devaluation may have inflationary consequences. So what? Consumer prices *fell* in 1987 and now are 9.2% lower than in 1983. Saudi Arabia could use *some* reflation (especially the insolvent banks and their real estate clients).

A devaluation is a correct short- to medium-term policy response. In the long run, however, Saudi Arabia must increase revenues. And this can be done only by maximizing oil revenues (aside from some gains in non-oil exports helped by a series of real devaluations). This brings us back to our first choice.

Raise oil production; let prices fall where they may. With some lag consumption is elastic. As prices fall, consumption rises. Even more importantly, from Saudi Arabia's perspective, supply is elastic. As prices fall, non-Opec sources of supply diminish and then dry up. At very low prices, even non-Gulf Opec supplies fall. The Saudis gambit to increase market share and force prices lower should result in higher total revenues.

We have made this argument now for the past six years. It has never been proven. Nor can we claim 100% certainty. Nevertheless, it has become clear that *constraining output* to maintain high prices has led to falling total revenue, with only a slight improvement in 1987 as lower oil prices already began to reverse the multi-year consumption downtrend.

In our view, Saudi Arabia could be producing 11 million barrels per day at an average price of \$7-\$8/barrel, for an approximate net gain of 10% in total revenues.

The true gains, however, are far greater. Non-Opec exploration comes to a standstill. Oil retakes some of the mar-

ket share lost and about to be lost to other sources of energy. Iran is brought to its knees by the consequent financial squeeze (losing revenues of up to \$25 million per day) and the debilitating Iran-Iraq conflict comes to an end.

The longer the Saudis wait to implement a genuinely coherent package of economic measures to include devaluation and oil output increases, the more desperate the situation becomes. With their back to the wall, they will become increasingly irrational. Jan. 3 and its aftermath is but a small taste of the chaos to come.

* * * * *

Weak market prices for crude *may* speed up a change in official policy. It did in July-August 1985, and it may be doing so again in January-March 1988.

To measure demand pressure we submit that one must analyze refining margins, commonly called the "crack."

The world consumes products, that is, heating oil and gasoline, not crude oil. If an oversupply of products occurs because of either faltering demand or excess production, product prices weaken. The "crack" narrows. Refining profitability is reduced. Refiners take the cue and reduce crude oil purchases. Crude oil prices fall and refining margins are restored. At times, international events (or manipulative exer-

cises) cause crude oil prices to rise sharply. Should consumers refuse to go along with these rising prices, the crack will narrow and indicate that the higher prices are not *sustainable*.

It is precisely this phenomenon that took place in the weeks preceding the late November '85 top. While crude oil prices were rising to their ultimate peak of \$32/barrel, the crack was falling (see Chart 1), indicating that the bull move was not sustainable. The rest is history.

Once again, in the summer of 1987, buoyed by the Iran-Iraq conflict and the aggravating tanker war, crude prices leaped to \$22.40/barrel (July 17, 1987). During this time the faithful crack revealed some serious cracks in the bull move. As Chart 2 shows, the crack literally collapsed in the May-July period.

Recent weakness in the crack (see Chart 3) may be forecasting serious trouble ahead for crude oil prices. While crude is well down from its Opec-set price (\$17.52/barrel for the Saudi market), product prices have turned even weaker.

The bear is back in command and a challenge of the \$10/barrel lows is in the offering. Ultimately, as we have said for many years, oil prices will fall below \$5/barrel.

STRATEGY: Add to short positions in Saudi riyals. Sell April '88 crude oil at market, risking 18.30, close only.

Chart 1

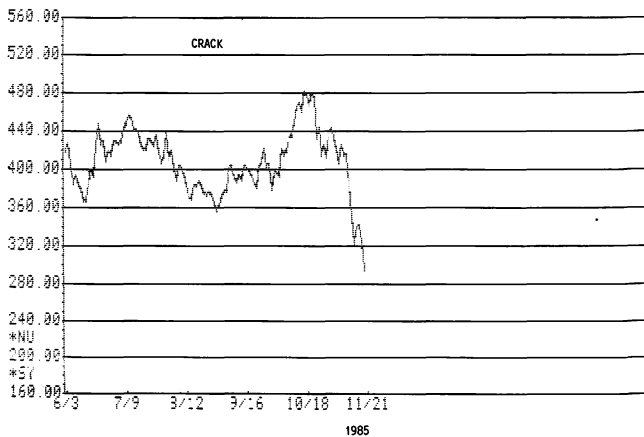


Chart 2

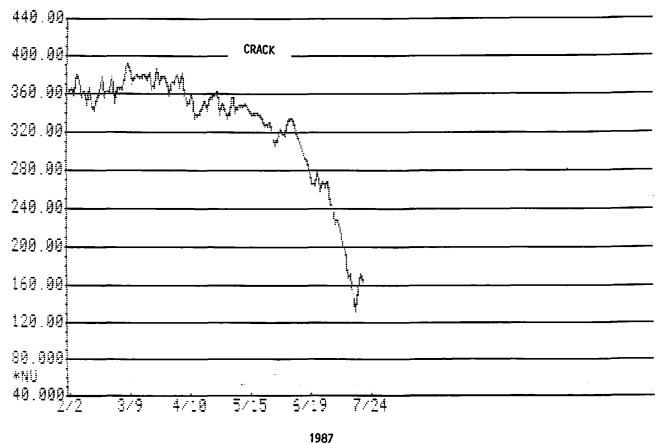


Chart 3

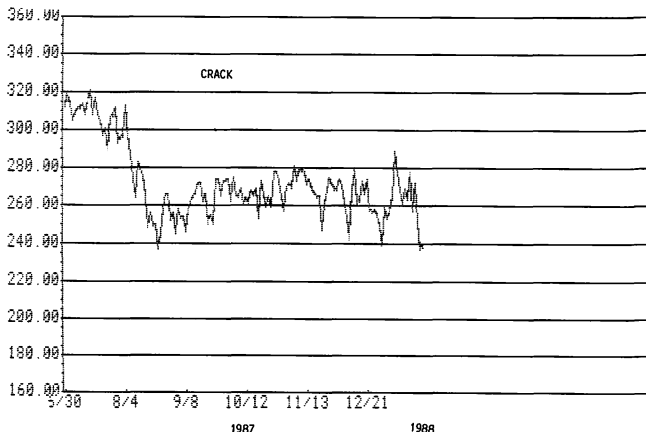
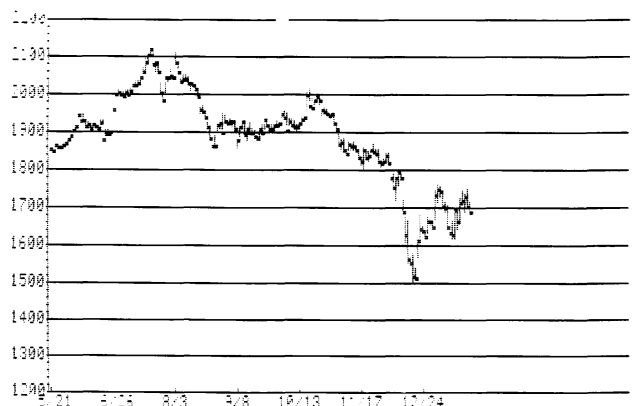


Chart 4 — NYME CRUDE LIGHT APR '88



GOLD GOLD GOLD GOLD GOLD GOLD GOLD GOLD GOLD GOLD GOLD GOLD GOLD GOLD

Bullish, but a little nervous

In recent weeks, gold prices have turned quiet and rather sluggish, after recording a new recovery high at slightly above \$500/oz.

There are a number of *short-term* concerns in the bullish picture. First, there's the divergence between gold prices and the CRB index (see Chart 7), with the latter eking out a new post-1986 high last week. While the divergence is of very short duration, it *may* be significant nonetheless.

Second, there's the weakness in oil prices (see "Crude Oil" elsewhere in this issue) and our expectations for much lower prices ahead. While gold may not, and will not, parallel oil prices over periods longer than three months, the same cannot be stated for day-to-day reactions. A sharp decline in oil prices could have an important effect on inflationary expectations and cause as much as a 10% correction in bullion prices, especially if during this time the US dollar remains buoyant.

Finally, there's the sharp disinflation in money supply

(see Chart 5) and the clear slowdown in the rate of growth of the Adjusted Monetary Base (see Chart 6), which *could* lead to commodity price deflation, at least as long as it is maintained.

Interestingly, as Chart 8 shows, bullion prices are holding a near-perfect uptrend, commencing in June 1986, containing the early 1987 correction to \$388/oz. as well as the end of the long April 1987 to October 1987 lateral consolidation. This must be construed bullishly, as must the low to moderate open interest level and the *relatively* low bullish consensus (three-week average of 49%).

Our conclusion: *While not highly likely*, gold may enter a period of short-term turbulence. A penetration of the June '86 to April '87 to October 1987 uptrend, now around \$470/oz., basis nearest contract, would signal the onset of just such an occurrence.

STRATEGY: Raise all stops to \$468.00, basis nearest contract, close only.

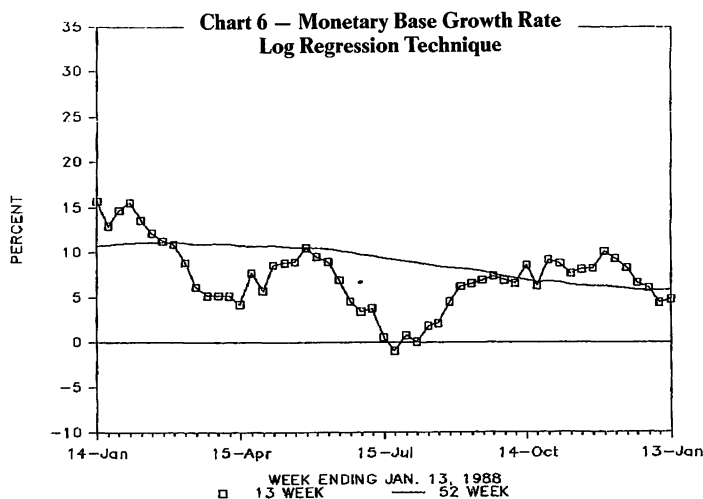
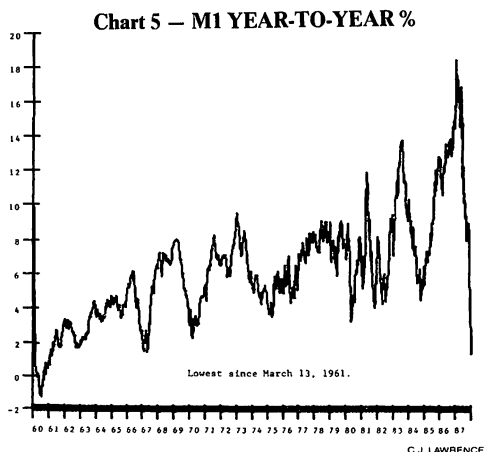


Chart 7

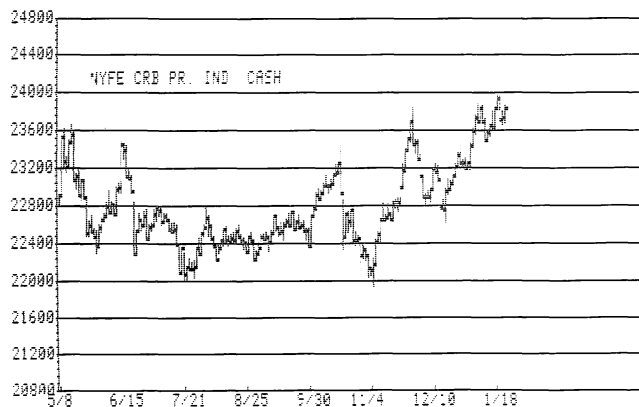
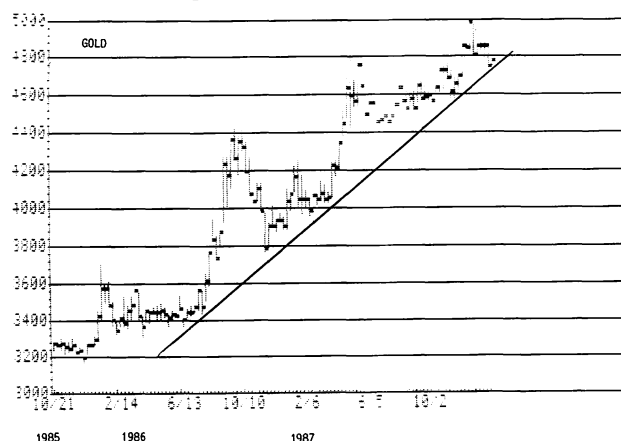


Chart 8 - COMEX GOLD



T-BONDS T-BONDS T-BONDS T-BONDS T-BONDS T-BONDS T-BONDS T-BONDS

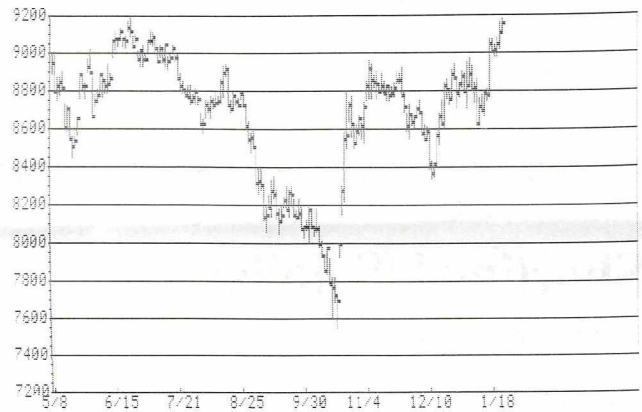
Higher rates stalled for now

Very weak growth in the monetary aggregates (Charts 5 and 6), low CPI figures for December and the slight uptrend in weekly claims for state unemployment, have provided the impetus for this market to record post-crash recovery highs (see Chart 9). Rounding the bullish scenario is ongoing weakness of oil prices and the better tone of the US dollar.

Another detour on the long way to much higher interest rates seems to be shaping up. Near-term strength can only be derailed by a decisive breakout of the CRB index (quite likely) or a new powerful, attack on the US dollar (less likely, at least near term).

STRATEGY: *New short positions recommended in the Hotline Update of Jan. 4 at 89.00 were stopped out at 91.00. We stand aside.*

Chart 9 — T-BONDS (DAY) MAR 88



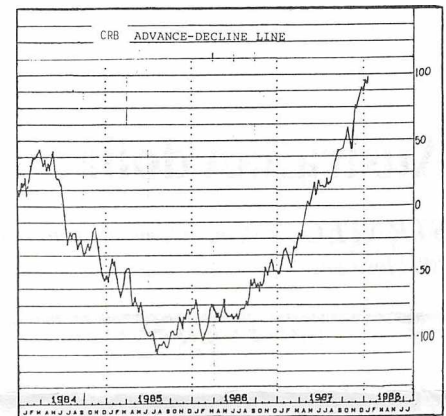
CRB INDEX CRB INDEX CRB INDEX CRB INDEX CRB INDEX CRB INDEX CRB INDEX CRB INDEX

The bull charges on

Healthy rotation, typical of a commodity bull market, has propelled our advance/decline line to new highs (see Chart 10). The index, however, is still unable to break out decisively above 240. A significant backwardation has developed in the forward months, paralleling the inversions in a growing number of commodities.

STRATEGY: *Remain firmly long; raise stops to 23150, basis cash index, close only.*

Chart 10



COPPER COPPER COPPER COPPER COPPER COPPER COPPER COPPER COPPER COPPER

Correction just a lull in bull

Last month we anticipated that "a correction may occur once spot December is liquidated." It did. March '88 copper peaked short of \$1.30/lb. and subsequently sold down to \$1.03/lb. before recovering Friday to \$1.0810.

There have been no major negative developments in recent weeks. LME stocks did increase by over 13,000 tonnes over the New Year and the subsequent week, but thus far there has been no follow-through, especially in Comex. The

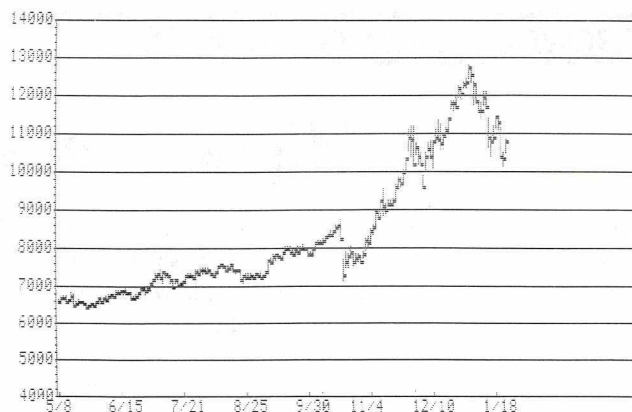
reaction can be attributed to the fact that users overanticipated their first quarter needs in November-December, creating a slight vacuum in demand thus far in January.

The 20% to 22% reaction from the peak qualifies as a medium-sized correction in a continuing bull market. Supporting our correction "thesis" is the fact that the backwardation has narrowed only "somewhat," remaining at an eye-popping 1,000 points-plus for spot-March, March-May, and

May-July. Those who need immediate-delivery copper must still pay up for it.

STRATEGY: We exited extremely profitable long March '88 positions at around 11700 as per Hotline Update of Jan. 5. Reenter the long side if and when March '88 breaks out above 11490, good anytime.

Chart 11 — COMEX COPPER MAR 88

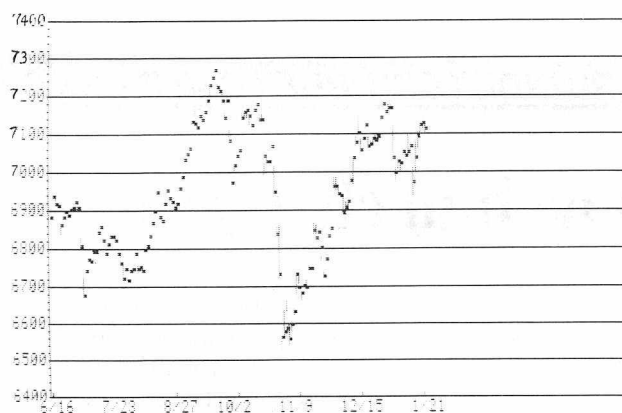


CURRENCIES CURRENCIES CURRENCIES CURRENCIES CURRENCIES CURRENCIES

Shorting US dollar still *too* popular

STRATEGY: We repeat almost verbatim last month's advice: The short side of the US dollar — while extremely logical — is (still) much too popular. We prefer, at this time, to stand aside and wait for a good entry opportunity. Keep in touch via the Hotline.

Chart 12 — CME AUSTRALIAN DOLLAR MARCH 88



Australian dollar

STRATEGY: Remain long; raise stops to 69.75, basis March '88, close only.

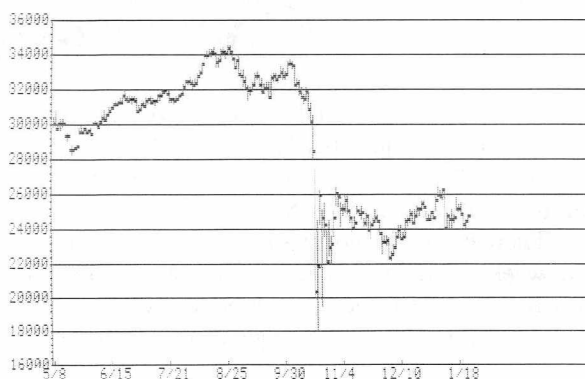
STOCK INDEXES STOCK INDEXES STOCK INDEXES STOCK INDEXES STOCK INDEXES

New York and Tokyo: the long and short

New York: Good support around 240, basis spot index. Breadth figures are unimpressive, too few new highs.

STRATEGY: We are short against long March 240 calls. Thus far, the latter maintained their huge premiums because of growing volatility. Time, however, will erode this premium. Short position must, therefore, produce quick results. Keep in close contact with Hotline service.

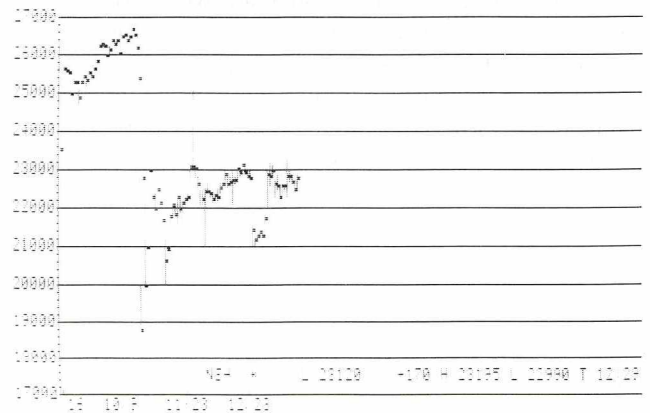
Chart 13 — CME 500 STOCK INDEX MARCH 88



Tokyo: Showing increasing signs of exhaustion. Bullish economic news is being offset by falling real estate prices in Tokyo. Outright government manipulation saved the day two weeks ago, just as the Nikkei Index was readying to pierce the October lows. There has been no follow-through apart from the one-day 800-point surge.

STRATEGY: *This market is ready to collapse. Rarely has a gutsy trader had such an outstanding trade: selling futures at these levels (as advised in our Hotline Update of Jan. 5) and risking a close above 23500, basis the cash index. The rewards could be enormous. Our target is 13500.*

Chart 14 — NIKKEI 225 FUTURES MARCH 88



SUGAR SUGAR SUGAR SUGAR SUGAR SUGAR SUGAR SUGAR SUGAR SUGAR SUGAR SUGAR

Sweet music: sugar prices climbing

Since the last issue of *FC&CC* (Dec. 20, 1987), sugar prices have moved up smartly (see Chart 15). This continuation of the price trend that began in the dog days of summer was motivated, in large part, by recent downward adjustments in projected production for the 1987-88 season by the major forecasting services. For example, London's E.D.&F. Man knocked its January estimate of world output for 1987-88 down to 102.789 million tons.

That the so-called market for sugar has strengthened during the past month is obvious. After all, prices have risen. What is not so obvious is that the loan market for sugar has also strengthened. Recall that we argued in "Backwardation revisited" (*FC&CC*: Dec. 20, 1987) that an array of futures contracts creates the possibility for an implicit loan market for commodities, one in which participants can borrow commodities (take a loan) by purchasing near-term contracts and simultaneously selling more distant contracts. The costs of taking these commodity loans are determined by commodity interest rates. Like any other loan market, when a commodity loan market is weak, commodity interest rates are low.

Charts 16 and 17 not only display sugar prices but also commodity interest rates for sugar. It is clear that sugar's market prices, as well as sugar interest rates, have risen during the past few weeks. Hence, both the so-called sugar market and the implicit sugar loan market have displayed parallel strength. This market behavior represents a very strong bull market signal.

So much for the constructive developments of the past month. Let's turn our attention to future prospects for the sugar market and, more particularly, prices.

Our most recent forecast for the world demand-supply balance is presented in Chart 18. In addition, Chart 18 contains demand-supply balances that we presented in May and

July 1987. On the demand side, it is important to note that moving from the May 1987 to the current forecast, disappearance figures have been consistently revised upward. Low prices have stimulated use. On the supply side, production for the current market year (1987-88) has been revised downward since the July 1987 forecast but is still above the estimates made in May 1987.

The combination of reducing our production and increasing our consumption estimates for 1987-88 affect the all-important ending stocks figures favorably. Currently, we anticipate that the ending stocks, as a percent of disappearance, will fall to 31.47%. A number this low has not been recorded since the 1980-81 market year, a year that marked the peak of the last bull market in sugar: The average closing price (Oct. 1 to Dec. 31, 1981) for the March contract was 38.05 cents per pound.

What do these fundamentals hold for sugar prices? First, and foremost, they indicate that the direction of prices is unambiguously upward. The bull market in sugar is for real. In terms of the price level, the fundamentals suggest that the average closing price for the March '89 contract, during the period Oct. 1 to Dec. 31, 1988, should be about 14¢ per pound. Moreover, these fundamentals and the associated average closing price imply that with normal market "overshooting," the March '89 contract highs could reach 18¢ to 20¢ by the end of 1988.

What does the short-term hold for prices? Since the bull market in sugar is in its infancy, many potential purchasers of the physicals have believed, and some still believe, that the sugar price run-up and higher prices are not sustainable. In consequence, these potential purchasers have waited to buy. For example, importing countries — such as Egypt, Algeria, and Nigeria — which have historically bought on a hand-to-

mouth basis, have, of late, been absent from the markets. In consequence, these countries, and others who have deferred purchases, have drawn down their stocks and accumulated a pent-up demand for new stocks. These potential purchasers will soon enter the market for physicals because their stocks are dangerously low (the hand-to-mouth group), and/or they will come to realize that the bull market is for real and that

their hopes to finesse the price at which they can enter the market have evaporated. The entry of this deferred demand for physicals should give the futures market an extra bit of stimulation in the near future.

STRATEGY: Raise stops on long positions to 8.95, basis March '88, close only.

— Steve H. Hanke

Chart 15 — N.Y. #11 SUGAR MAR 88

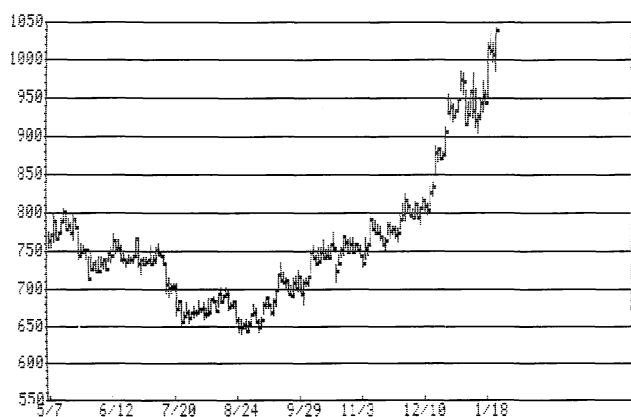


Chart 16
World Sugar: Interest Rates

	Def'd Month	Def'd Close	Near Month	Near Close	C.I.R. % per annum
21 Jan. 1988	May	9.85	Mar	10.07	13.40
	Jul	9.73	May	9.85	7.40
15 Jan. 1988	May	9.40	Mar	9.55	9.57
	Jul	9.39	May	9.40	0.64
8 Jan. 1988	May	9.54	Mar	9.59	3.14
	Jul	9.56	May	9.54	-1.26
31 Dec. 1987	May	9.41	Mar	9.49	5.10
	Jul	9.39	May	9.41	1.28
24 Dec. 1987	May	9.33	Mar	9.32	-0.64
	Jul	9.30	May	9.33	1.94

Note: Commodity interest rates represent the cost of holding a commodity from the near month until the deferred month, on an annualized percentage basis.
It is calculated with the following formula:

$$\frac{(\text{near month} - \text{deferred month})}{\text{deferred month}} \times \frac{12}{\text{\# mos. between contracts}}$$

Chart 17
World Sugar: Interest Rates

Period from 12/21/87 to 1/21/88:
 — Day of highest closing price: 19 January 1988
 — Day of lowest closing price: 21 December 1987

	Def'd Month	Def'd Close	Near Month	Near Close	C.I.R. % per annum
19 January 1988	May	9.94	Mar	10.18	14.49
	Jul	9.77	May	9.94	10.44
21 December 1987	May	8.76	Mar	8.73	-2.05
	July	8.77	May	8.76	-0.68

Note: Commodity interest rates represent the cost of holding a commodity from the near month until the deferred month, on an annualized percentage basis.
It is calculated with the following formula:

$$\frac{(\text{near month} - \text{deferred month})}{\text{deferred month}} \times \frac{12}{\text{\# mos. between contracts}}$$

Chart 18
World Sugar: Production, Disappearance, Stocks

Mkt. Year	Current FC&CC		Ending Stocks	
	Production	Disappearance	Quantity	% of Disap.
86/87	104.0	104.0	36.56	35.15%
87/88	102.4	105.7	33.26	31.47%
<u>July 26, 1987 FC&CC</u>				
86/87	103.9	103.5	38.1	36.80%
87/88	103.0	105.4	35.7	33.87%
<u>May 24, 1987 FC&CC</u>				
86/87	101.8	103.2	36.0	34.88%
87/88	101.0	105.0	32.0	30.48%

Note: All figures in millions of tons, unless otherwise specified.

NOTEBOOK NOTEBOOK NOTEBOOK NOTEBOOK NOTEBOOK NOTEBOOK NOTE

Brokers: In their own words

We asked the brokers of Friedberg Mercantile Group to give us their own short stories about 1987. Beefs, bouquets, anecdotes — anything that they found memorable in 1987. Here's what they wrote:

Words to the wise

I've been with Friedberg since 1978. A big part of my job is talking to customers. It has not always been easy. In 1984 and 1985 we did badly. It was a nightmare for me. I found myself either defending Friedberg constantly to people who, at best, would just pretend to sound civil, or playing cards because it occasionally got so bad customers did not call at all. But 1987 was a great year. Fantastic. I bet, on average, our accounts tripled during the past year. Looking back, I would have thought that with those kinds of profits, the part of my job that involved talking to customers would have been easy; everyone would be happy, it would be fun. Now I know better. When it comes to money and markets, people spew out the same clichés to their brokers no matter how poorly or how well they're doing. The only thing that might change is the tone in their voices. Here is a sampling of some of them applied to 1987:

"Did you know that..."

A well-respected client who runs a company with \$500,000,000 a year in sales said to me, "Did you know that if *we* weren't stopped out of our short position of S&P at 330.00, *we* would have made over \$60,000."

"Yes but..."

With one of my favorite clients, who turned \$3,000 to over \$60,000 in less than two years, I had the following conversation: Broker: Didn't we do well in copper? I think it was our best trade of 1987.

Client: Yeah, but we had only two contracts. If we had had four, we would have made an extra \$25,000."

"What a bad day."

A senior partner in a prestigious law firm told me recently: "I thought Friday was a bad day. But I didn't realize how bad. I gave you a cheque yesterday for \$100,000, and when I asked for my equity, it was unchanged."

"How come..."

Even my associates had to rub salt on the wound by saying that after being short the S&P at 105.00 in 1982, "how come we were not short the S&P last Oct. 19?"

"If only I had..."

Not to be outdone, my own personal fantasy was "if only I had bought 20 S&P put options for less than \$2,000 I could have been a millionaire, and you wouldn't have to read all this."

— **Danny**

His word was his bond

We started trading foreign currency bonds in April 1986. I was given the responsibility of running the bond desk. It was my first big opportunity. One day soon after I started I got a telephone call from a curt, sharp-tongued guy who asked me about our New Zealand bonds, which were then advertised at 16%-20%. He told me that he "would not put a dime in a country with more sheep than people." He said the currency would devalue and told me that he must have misread the ad because he thought that the 16%-20% was in Canadian dollar investment. I suggested that if he did not like the risk of soft currencies, he might consider the yen or deutsche mark bonds, which we were strongly recommending at the time. His retort was "those currencies have topped out and the low nominal yields make them doubly unattractive." The exchange rates at the time were at around 2.15 DM/US\$ and 151 JY/US\$.

I took the man's name and address and sent him some information, hoping that despite our rocky start, I would still get his business. I never heard from him. The man's name was hard to forget. In December when the financial press was exploding with the story of the collapsing US dollar, I happened to be checking the bonds sales tickets. I noticed his name on a Swiss franc bond purchased when the Swiss franc was trading above the Canadian dollar. Good luck.

— **Michael**

What kind of son-in-law

In mid September, a client of mine bought a deeply out-of-the-money S&P 500 put option, paying a premium of about \$500. Last Oct. 19, he cashed in the option, taking a \$40,000 profit. It was one of the most profitable trades I ever brokered in my life. A few days later, the client met my mother-in-law. The good woman had listened to me about losing money often. It hurts me and I know it hurts her to see me unhappy. Anyhow, the client told her that her son-in-law made him a

\$40,000 profit on a \$500 investment.

The next day, my mother-in-law called me and told me she'd heard the news. I could hear the excitement in her voice. I was happy, assuming she was happy for me. "Thanks for calling," I said. She said, "What kind of son-in-law are you, when you make those kinds of profits for strangers and not for me?!"

— Abe

He let his losses run

In early 1985 it cost 3.5 deutsche marks to buy one US dollar. It now costs only 1.67 DM to do the same. This weakness in the "greenback" attracted many a trader to speculate on a recovery in the dollar. Throughout 1987, one such client of mine — well, ex-client actually — built up a large short position in the DM. As the DM kept rising, undaunted, he kept adding to his losing position.

Finally, on Dec. 31, with a 105-point rally in the DM, his account went below margin. I tried to locate him, but his office said that he was overseas and couldn't be reached. Minutes before the markets were to close for New Year's, the phone rang. It was the raging dollar bull. He said he had no way of meeting his margin call and instructed me to cover his entire position. And, yes you guessed it, his order was filled at .6426, the current contract high for Mar '88 DM. In the next two weeks the DM dropped to trade as low as .5955. Of all the good things that happened in '87, it's funny how this bad one stays with me.

— Sholom

Hot tip make a cold hand

"Inside information" that can be used to trade profitably is hard to come by in futures. Having been a broker for more than 10 years now, I know that rumors tend to be either untrue, or if accurate, already in the market by the time they are heard.

I have a customer who claimed to have a close personal friend who was working with Shiekh Yamani, the former Saudi oil minister, on an authorized biography. Yamani prophesied, said my customer, that July '87 crude oil, then at about 1825, would drop a lot, and soon. The customer directed me to liquidate all positions in his managed account, and employ the funds to short crude oil.

The story was fun to tell, so I spread it around a bit, and put on some shorts myself. Oil dropped a bit. I felt nervous and protected these positions with a break-even stop, which

was subsequently hit and was stopped out in a couple of weeks. The customer, sure of his source, got out later with a loss of \$1.25 per barrel, asked for a cheque, and has not traded since.

Skepticism is a necessity to trade successfully. It is cheapest to already own some when entering this game.

— Bill

Behind the times

In commodities, timing is essential. Never was this more clearly illustrated than Dec. 31. On this day, most traders are either in the pubs by 10 a.m. celebrating their 1987 trades, or doing some last-minute shopping to buy a pair of suspenders to hold up their proverbial pants.

At our firm, the mood was jovial and the trading light. We passed the time betting on how the markets were going to close. But some clients never rest. As the volume wore down and the last crossword puzzle was almost completed, the phone rang. It was Joe, a client, asking me to put a cyclical bean spread that was guaranteed to bring him a profit on Jan. 1. He promised he'd call by the close to put the spread on.

The day wore on. At 1:00 p.m. soybeans closed. Joe called at 1:03 p.m. How do you tell a client on New Year's Eve that his sure thing will have to wait another year? You tell him that in commodities, timing is essential. And to get a new wristwatch for next Christmas.

— Ricky

Saved by the salad

For the past three years, a client of mine has managed a small fund that he trades here. One gruelling Thursday a once-highly-profitable short position he had in T-bonds turned into a nightmare as the market rallied to heights never dreamed of — the dreaded stop-loss began to kick in, hard. One by one we brokers all covered. It was a terrible loss. But lo — had the worm turned?

At the end of the day, I was searching through a waste paper basket for a number and spotted my client's stop-loss order, unplaced and unexecuted, stuck to the remains of a chicken salad plate. Normally, this would be an unforgivable sin. But on this day, the market had in fact closed 15 points lower than the stop. A bunch of sheepish brokers had to call a bunch of irritable clients that day. But at least one client of mine was spared — saved by a chicken salad.

— Gari

Oz bonds an excellent inflation hedge

The Australian dollar appreciated by approximately 10% against the US dollar in 1987, even though the Reserve Bank actively defended both ends of the currency's trading range. The high end of the range was defended so that Australia's export sector could remain price competitive. Conversely the Reserve Bank intervened at the low end of the range to lower the cost of servicing Australia's foreign debt, as well as to stem importing inflation to Australia.

After the global collapse in the equity markets, the A\$ traded as low as .665 US/A\$ (the same level as January 1987). The perception was that a world-wide recession was imminent and that Australia's commodity-based export-dependent economy would suffer severely in that kind of economic en-

vironment. The concern was that commodity prices would begin to erode from their recent appreciation and that this would be extremely detrimental to Australia's export revenues. However, in December the Australian dollar steadily rebounded to its trading range.

The A\$ yield curve is positively sloped, and interest rate differentials between US\$ and A\$ are approximately 400-500 basis points in favor of the A\$. In any event, A\$-denominated bond issues still are an excellent hedge against inflation while offering a yield pick-up over comparable C\$ or US\$ securities. We offer for your well diversified investment portfolio: **Canadian Imperial Bank of Commerce 13% 13/3/91 A\$ bond**, currently priced to yield 12.36%. This is RRSP eligible.

Chart 19
Foreign Currency Bond Investment Yearly Performance
December 31, 1986 - December 31, 1987
for a US\$-based investor

Had you invested on Dec. 31/86 in:	% appreciation/depreciation due to currency fluctuation	% appreciation/depreciation due to price of bond (interest rate fluctuation) X currency appreciation	Nominal Coupon X currency appreciation	Total Gain in US\$*
Wells Fargo 16 1/8% 5/12/84 NZ\$	+23.9	+ .94	+19.98	+44.82%
Quebec Hydro 5 1/2% 1/5/96 DM	+22.5	+ .97	+ 6.74	+30.21%
Canada 5 5/8% 23/7/93 JY	+30.8	+4.39	+ 7.36	+42.55%
Australia 5% 30/10/98 SF	+26.8	+ .94	+ 6.34	+34.08%

* Assumes that all coupons were reinvested fully.

Chart 20
Foreign Currency Bond Investment Yearly Performance
December 31, 1986 - December 31, 1987
for a C\$-based investor

Had you invested on Dec. 31/86 in:	% appreciation/depreciation due to currency fluctuation	% appreciation/depreciation due to price of bond (interest rate fluctuation) X currency appreciation	Nominal Coupon X currency appreciation	Total Gain in Cdn.\$*
Wells Fargo 16 1/8% 5/12/84 NZ\$	+16.5	+ .89	+18.8	36.29%
Quebec Hydro 5 1/2% 1/5/96 DM	+15.2	+ .91	+ 6.34	22.45%
Canada 5 5/8% 23/7/93 JY	+23.1	+4.14	+ 6.92	34.16%
Australia 5% 30/10/98 SF	+19.3	+ .88	+ 5.96	+26.14%

* Assumes that all coupons were reinvested fully.

Chart 21
Foreign Currency Bonds

Date: January 21, 1988

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

ISSUER MTY DATE/COUPON	BID	OFFER	CURRENT ANNUAL YIELD TO MTY.	LAST PAY DATE	NEXT PAY DATE	
NEW ZEALAND DOLLAR DENOMINATED BONDS						
COCA COLA 16/6/89 18%	102 1/4	- 103	15.18	16/6/87	- 16/6/88	
HONDA INT'L 20/9/89 16 3/8%	100 1/2	- 101 1/4	15.26	20/9/87	- 20/9/88	
HONDA INT'L 28/5/90 16%	100	- 100 3/4	15.45	28/11/86	- 28/5/88	
TOURIST HOTEL CORP. (N.Z.) 4/6/93 zero coupon	46	- 47 1/2	14.93	matures 4/6/93		
BANK OF NOVA SCOTIA 15/9/89 18% RRSP eligible	103 1/4	- 104	15.32	15/9/87	- 15/9/88	
WELLS FARGO (semi-ann.) 12/5/89 16 1/8%	100 5/8	- 101 3/8	15.40	12/11/87	- 12/5/88	
KODAK (semi-ann.) 15/2/89 17%	101 1/2	- 102 1/4	15.11	15/8/87	- 15/2/88	
TRONTO DOMINION 2/4/90 18% RRSP eligible	103 1/2	- 104 1/4	15.45	2/4/87	- 2/4/88	
AUSTRALIAN DOLLAR DENOMINATED BONDS						
CAN.IMP.BANK OF COMMERCE 13/3/91 13% RRSP eligible	100 3/4	- 101 1/2	12.36	13/3/87	- 13/3/88	
DANISH KRONE DENOMINATED BONDS						
WORLD BANK 20/11/92 9 3/4% RRSP eligible	98 3/4	- 99 1/2	9.87	20/11/87	- 20/11/88	
STOCKHOLM 10/11/91 10 5/8%	100 3/4	- 101 1/2	10.10	10/11/87	- 10/11/88	
DEUTSCHE MARK DENOMINATED BONDS						
GOVT. OF BELGIUM 29/4/96 5 1/2%	94.05	- 94.80	6.32	29/4/87	- 29/4/88	
QUEBEC HYDRO 1/5/96 5 1/2% RRSP eligible	96 3/4	- 97 1/2	5.89	1/5/87	- 1/5/88	
SWISS FRANC DENOMINATED BONDS						
GOVT. OF AUSTRALIA 30/10/98 5%	102	- 102 3/4	4.67	30/10/87	- 30/10/88	
JAPANESE YEN DENOMINATED BONDS						
GOVT. OF CANADA 23/7/93 5 5/8% RRSP eligible	104 1/8	- 104 7/8	4.59	23/7/87	- 23/7/88	
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES						
ISSUER	MAT. DATE	COUPON	BID	OFFER	CURRENT COUPON	NEXT COUPON DATE:
UNITED KINGDOM	7/10/92	3mo.LIBID (quarterly)	99.90	- 100.20	7 1/16%	7/4/88
UNITED KINGDOM	24/9/96	3 mo.LIBID-1/8 (quarterly)	99.61	- 99.91	7 11/16%	24/3/88

For further information and current prices please call: FRIEDBERG CAPITAL MARKETS (415) 364-2700

FOREX RATES & UPDATE FOREX RATES & UPDATE FOREX RATES & UPDATE FOREX

<u>Currency</u>	<u>Spot</u>	<u>3-Month</u>	<u>12-Month</u>	<u>Comments vis à vis US\$</u>	<u>Comments vis à vis DM (Spot DM: 167.25)</u>
Belgian franc	34.96-34.99	34.85-34.85	34.56-34.79	Neutral	Neutral
Danish krone	6.43-6.44	6.46-6.48	6.53-6.56	Neutral	Neutral
Dutch guilder	1.8806-1.8816	1.8670-1.8683	1.8231-1.8256	Neutral	Remain short
Greek drachma	133.50-133.56	137.40-139.25	148.50-157.15	Remain short	Remain short
Hong Kong dollar	7.7920-7.7930	7.7045-7.7155	7.5420-7.6430	Remain short	Neutral
Italian lira	1227-1232	1237-1245	1267-1277	Neutral	Remain short
Kuwaiti dinar	.27425-.27455	.27262-.27335	.26743-.26933	Neutral	Remain short
Malaysian ringgit	2.5475-2.5485	2.5245-2.5275	2.4625-2.4835	Neutral	Neutral
New Zealand dollar	.6655-.6665	.6495-.6525	.6125-.6185	Remain long	Neutral
Norwegian krone	6.37-6.38	6.48-6.50	6.79-6.82	Neutral	Neutral
Portuguese escudo	136.25-137.25	138.50-141.00	143.25-149.25	Neutral	Neutral
Saudi Arabian riyal	3.7500-3.7510	3.7550-3.7590	3.7600-3.7685	Remain short	Remain short
Singapore dollar	2.0245-2.0255	2.0055-2.0070	1.9595-1.9655	Neutral	Neutral
Spanish peseta	113.10-113.30	114.60-115.20	117.85-119.05	Neutral	Neutral
Swedish krona	6.01-6.02	6.04-6.06	6.14-6.17	Neutral	Neutral
Venezuelan bolivar	31.05-31.31	Not available	Not available	Commercial hedgers remain short	

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 HOTLINE UPDATE HOTLINE UPDATE HOTLINE UPDATE HOTLINE

Tuesday, December 22: There are no changes or new recommendations.

Thursday, December 24:

1. We are concerned that the open interest on the S&P 500 dropped over 22,000 contracts to 108,000 on the expiration of the December position. This may have removed support from the market. Therefore, should cash S&P close below 246.00, we advise liquidating call options. Alternatively, traders could sell March contracts against the long call position.
2. Raise stops on long March sugar positions to 830, close only.

Tuesday, December 29: Substantial support has been withdrawn from the market in the most recent week, as open interest has fallen to 109,000 contracts, from over 140,000 contracts. This may have been a result of the bullish consensus rising too quickly. The market has broken our revised stop of 246.00, basis spot S&P, and we are now short futures against the long March 240 calls, as recommended in the update of Thursday, December 24. There are no other changes and recommendations. Should there be no further changes or recommendations in the next few days, this message will be repeated in our next recording Thursday, December 31.

Flash update, Monday, January 4, 1988, 11:45 a.m.: Sell March T-bonds (now trading at 89.00) at the market, placing stops at 91.00, good anytime.

Tuesday, January 5: Raise stops on copper to 11720, basis March, good anytime. Also one new recommendation: Establish short positions on the March Nikkei Dow contract traded on the SIMEX, risking 23,500, basis spot index, good anytime.

Friday, January 8: The following is a recap of recommendations made during this past week.

1. You are short March bonds at approximately 8900, with a stop at 9100, good anytime as per our flash update of January 4.
2. You have been stopped out of long March copper at 117.20, as per our Hotline Update of January 5.
3. You are short the Nikkei Dow at 22100, risking 23,500, basis spot index, good anytime, as per our Hotline Update of January 5.
4. We are reminding you that you have liquidated your S&P call options or alternatively sold futures against the calls, as per our update of December 29.

There are no other changes or new recommendations.

Tuesday, January 12: There are no changes or new recommendations.

Friday, January 15: No changes or new recommendations.

Flash update, Friday, January 22, 9:15 a.m.: Sell April crude oil at market. Place initial stops at 18.30, close only.

Friday, January 22: As of this morning's flash update, we are now short crude oil with stops at 1830, close only.

Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published monthly by Friedberg Commodity Management Inc., 347 Bay Street, Toronto, Ontario, M5H 2R7. Contents copyright © 1988 by Friedberg Commodity Management Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement.

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

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

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