

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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Up and away

The Commodity Research Bureau Index scored a new recovery high and is within striking distance of the 1983 high (see Chart 1).

Skeptics will argue that the move is not significant in that it is the unfortunate result of a devastating drought in the Midwest. But the *Journal of Commerce* Spot Industrial Index, which contains no food, has also recorded a post-1986 recovery high. And while *The Economist's* "All Items Dollar Index" is up 60.5% on one year ago, the Industrial Index is up 74.2%, and the metals sub-index is up 117.4%. No Virginia,

it is not drought but...inflation.

Our remarkably prescient weekly advance-decline line (see Chart 2), a superior indicator of breadth, continues to point to higher levels, and it is fully in gear with the CRB index. Interestingly, only one commodity, cocoa, can be strictly classified as being in a bear market as it records almost daily lows.

The technical evidence is overwhelming. We are in the midst of the third great bull market in 20 years. (The other ones were in 1972-74 and 1978-80.) Enjoy it while it lasts.

Chart 1

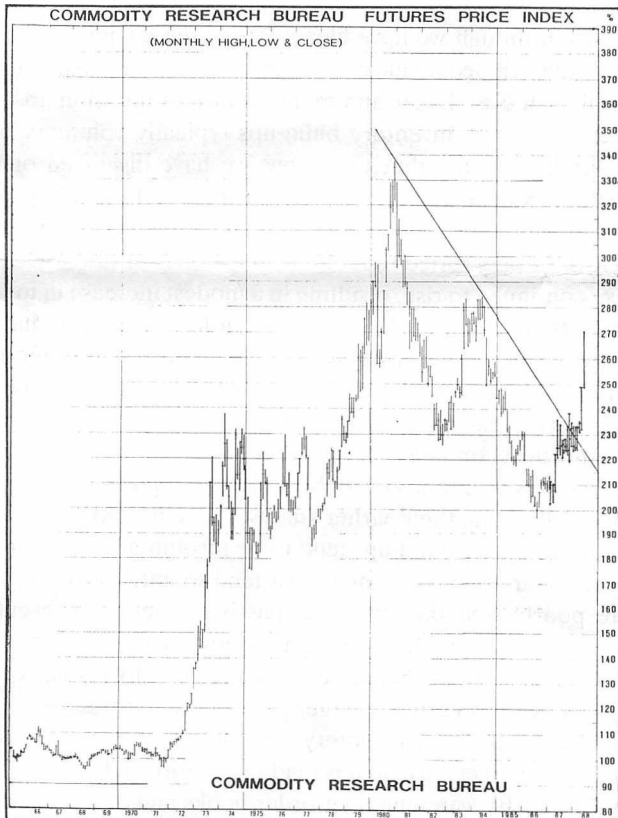


Chart 2



In this issue

The US dollar: undervalued and misunderstood. More gains to come in copper. The end of the stock market rally is near. Gold will break out...eventually. Platinum and the sneak attack. Wheat and live cattle. Friedberg Capital Markets and The Exotics. Contributions by Albert D. Friedberg, Steve H. Hanke, Daniel A. Gordon, William E. Burt, and Michael D. Hart. This issue was prepared June 26, 1988.

THE ECONOMY**Inventories: voluntary versus involuntary**

Inventories represent the proverbial tail that wags the "business cycle dog." For example, last year inventory accumulation amounted to about only 1% of real GNP. However, almost 40% of the variability in real GNP, measured on a quarter-to-quarter basis, is accounted for by changes in inventory levels. In consequence, it shouldn't be too surprising to observe that economists spill a great deal of ink on inventories. What is surprising (well, perhaps not that surprising) is the fact that most economic analyses of inventories are fatally flawed.

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To appreciate the nature of the flawed analyses, consider the recent accumulation of inventories and the standard economic interpretation of it. As inventories began to build up late last year, the economists' pessimistic drumbeat commenced. In a flood of reports, economists argued, as they typically do, that the inventory build-up was involuntary because businesses failed to anticipate sales correctly. As the economists saw it, demand was weaker than sellers had anticipated. Hence, the inventory accumulation was involuntary and the resulting increase in inventories was unwanted.

Economists told us the unwanted inventories would cause a so-called inventory correction. That is, faced with excess inventories, businesses would reduce orders for new goods, so that actual inventories could be worked down (corrected) to desired levels. These reductions in new orders would, of course, cause producers to cut output and ultimately employment. In consequence, the economy would slow, if not dip into a recession.

Well, the inventory correction never occurred. Instead, the economy roared ahead. In the first quarter, GNP posted a respectable 3.6% growth rate. This was 800% higher than the "consensus" forecast.

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Where did the consensus go wrong? As we pointed out in "Inventories: Ps versus Qs" in our February issue, well over half of the build-up in inventories that had occurred was caused by a swing in domestic auto inventories. Moreover, the swing in auto inventories was caused because sales incentive programs were dropped in late 1987. We weren't too concerned about a so-called inventory correction slowing the economy. We argued that incentive programs (lower prices) could be reinstated because supply-side spreads (profit margins) were wide. Moreover, we argued that incentive programs would be reinstated to stimulate auto demand and allow auto inventories to be worked down to more comfortable levels. The evidence has validated our analysis.

The important lesson to be drawn from this episode is

that so-called "unwanted" inventories can be dealt with by either lowering prices to stimulate demand or by lowering orders for new goods (quantities produced). If supply-side spreads are wide (healthy), there is a high probability that prices will be lowered, demand will be stimulated and a rapid inventory adjustment will occur. In this case, the adjustment will not act as a drag on the economy.

Another point, which we did not mention in our earlier analysis of inventories, merits comment, particularly in light of the fact that many economists are still grinding away on their standard inventory correction thesis. Economists tend to ring the alarm bells about inventories much too frequently because they assume that desired stock levels are set at particular points, and that businesses react (adjust) each time that actual stock levels deviate from desired stock levels. In fact, businesses' desired stock levels are represented by a range or interval within which the level of stocks is "comfortable," so that no special measures (either quantity or price changes) are called for. Only if the actual stock level goes outside the desired range, which can be rather wide, will there be either a quantity or price reaction. Hence, there is much less inventory adjusting of any kind than is implied by the frequency with which economists report on this matter.

* * * * *

Even though we have cleared away the analytic underbrush that tripped up most economists earlier this year, there remains an even larger and more important question about inventories: Are inventory build-ups typically voluntary or involuntary? (Note that until now, we have discussed only involuntary changes in inventory.) We must address this question because, although auto stocks have been brought under control through price reductions, the stocks of other goods have continued to rise, resulting in a modest increase in total business inventories. For example, total inventories have increased by four-tenths, three-tenths, and five-tenths of one percent in the last three reported months (February, March, and April, respectively). This has set off another wave of pessimistic economic reports that warn of an impending inventory correction. The authors of these reports, of course, fail to tell us that their earlier analyses were invalid.

If inventory build-ups tend to be involuntary, then businesses (market participants) must tend to anticipate the future poorly, and they must be passive, reacting to events rather than leading them. With this view, involuntary inventory accumulations that are outside the "comfort zone" can be dealt with by reducing either prices or quantities.

Alternatively, if inventory build-ups tend to be voluntary, then market participants tend to be rational, foresighted, and active. By watching their order books and other leading

indicators, businesses can anticipate future sales a few months ahead, and will adjust their inventories in accordance to what they believe the future holds. With this view, voluntary inventory accumulations that are outside the "comfort zone" can signal strong future production and sales.

Most economists believe that inventory build-ups are involuntary and that the only way to adjust is to cut back new orders, output, and employment. (They fail to acknowledge that involuntary stock build-ups can be dealt with through price reductions that stimulate demand.) This is rather curious because the old fashioned business cycle literature, as well as the newer rational expectations literature, holds that inventory changes are voluntary. Hence, when inventories grow (decline), they signal future growth (sluggishness). Which theory is correct? The answer to this question represents an important empirical issue. Fortunately, our supply-side friends at H.C. Wainwright & Co., Economics have completed an important study that yields answers.

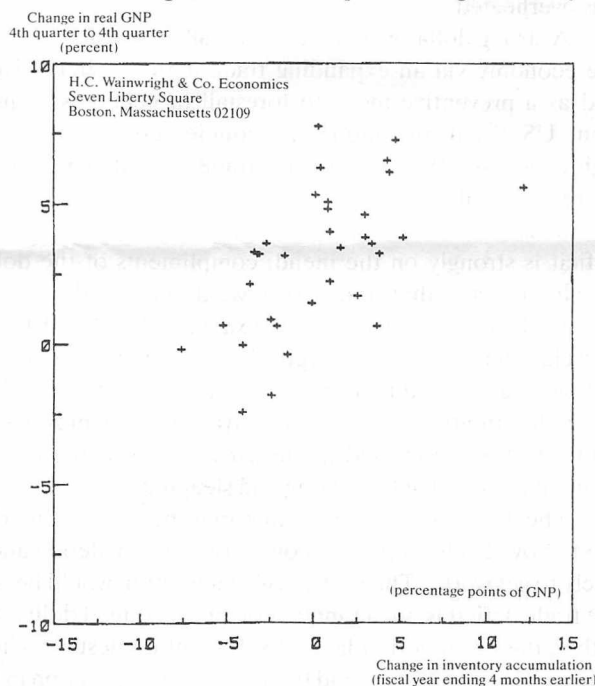
The H.C. Wainwright study, by employing data from 1954 to 1987, found statistically significant relationships between changes in inventories and economic activity. First, inventory changes are positively correlated with movements in the economy. Hence, inventory build-ups are bullish for production and final sales. Second, inventory changes lead production and sales by between four and six months (see Chart 3). For any doubters, please note that these findings are consistent with the fact that changes in inventories are one of the pro-cyclical components in the government's monthly Index of Leading Indicators.

The picture is clear: Changes in inventories tend to be voluntary, not involuntary. Hence, inventory building tends to signal a boom, not a recession.

Implications: For the time being, economic growth is in the "inventory cards." This growth will continue to put upward pressure on commodity prices and interest rates.

— Steve H. Hanke

Chart 3 – Rising Inventories Anticipate a Stronger Economy



CURRENCIES

US\$: Undervalued and misunderstood

We pointed out last month that a possible change in trend was in the offing, particularly with respect to the DM, Swiss franc, and other EMS currencies. We were a little less convinced with the yen and Sterling, as we thought their cross rate would improve. Improve they did, but, nevertheless, dollar strength carried them dramatically lower in recent weeks. Fortunately, reversal points were triggered early in the move, that is, DM1.74, 1.8390 in the September '88 IMM Sterling, and 79.80 in the September '88 IMM yen.

While trade figures have shown an improved trend, the currency account moves deeper into the red, at approximately a \$160 billion annual rate. Yet the dollar has given every indication that it has, in fact, bottomed out. What goes on here?

At issue is the following theorem: In a free market (one that is not "manipulated" via active intervention or government pronouncements), a currency may never be considered overvalued or undervalued. If the current account is in deficit, it simply means that the country in question is a net buyer of goods and services and a net seller of investments (stocks,

bonds, real estate, factories, etc.).

If, at the same time, the currency is rising, as was the case for the US dollar from 1980 to 1985, it means that non-residents are far more eager to "invest" in this country than they are to sell its goods and services. In other words, capital movements "overwhelm" the current account. While in the end, both accounts must balance, it is clear that causation, at least in the US case, ran strongly from capital inflows to current account outflows.

From that perspective, the dollar was never overvalued. Nevertheless, the G-7, in their infinite wisdom, declared the dollar overvalued and pressed (with words and action) its decline. Such was the "intellectual" power of their arguments (supported by the likes of Martin Feldstein) that private capital movements ceased to move to the US in fear of experiencing heavy exchange losses.

The post-facto equality of the capital and current account was made up by increased central bank intervention. It was as if a healthy person were incorrectly diagnosed about, say, a pimple on his nose and persuaded that he was gravely

ill. He was therefore told that he could no longer eat, drink, sleep, or exercise routinely. Naturally, this healthy person *became* sick, at which point the persuaders had to administer medicine. If the indoctrination process can be reversed, the patient will return to his normal routine and will regain his health.

Central banks and economists issued an incorrect diagnosis: The dollar was not overvalued; rather, the economy was overheated.

A strong dollar would, automatically, have slowed down the economy via an expanding trade deficit. Alternatively, and as a preventive move to forestall protectionist legislation, US fiscal and monetary policies could have been tightened and the "excessive" trade deficit would have corrected itself.

So far, we have obtained a G-7 declaration that the trade deficit is strongly on the mend, compliments of the dollar devaluation and that, thank you, we do not need a further decline. It is akin to saying, in our example, that the 50 lb. loss of weight has been quite helpful in reducing the size of the pimple and we need no further dieting or loss of sleep. With the indoctrination phase over, private capital movements return to US shores, and the dollar recovers as the patient would if he went back to eating and sleeping.

The danger in this approach is that the original "fear" is not removed: The current account continues in deficit and is likely to get worse. The proper G-7 declaration would be that the trade deficit is *not* a function of an overvalued dollar, but rather, the product of a lack of sufficient domestic savings. The correct medicine would then be a strong reduction in the fiscal deficit and a much tighter monetary policy.

We thus find ourselves at an interesting juncture: the dollar, having been "manipulated" downwards is strongly undervalued. The trade deficit shows some temporary improvement (probably a result of strong foreign economic growth) and the powers-that-be are reassured that their medicine has worked. The immediate threat of a further dollar devaluation is removed, confidence in the US dollar is restored, and of course, the dollar's path of least resistance is

upwards (that is, the capital account is as strong as ever).

But because we have not exorcised the myth that the trade deficit is a product of an "overvalued" dollar, we run the ever-present risk that a reversal or a slowing down of the trade improvement will bring back "dollar bashing."

What is a speculator to do? Allow the trade euphoria to run its course and look for signs of a slowing down in the pace of the improvement. It should come a great deal sooner than expected, simply because the US is operating at near-full capacity and will be unable to expand exports at the same rate as it has done thus far. The speculator needs to "test" the market's response to disappointing trade news: A small and short correction is a sign that the market is still hopeful that central banks will *not* resort to renewed dollar-bashing. It implies further strength.

In sum, convinced that the trade figures are likely to prove disappointing once more in the not-too-distant future, we cannot buy dollars *prior* to such an occurrence. Instead, we will limit ourselves to gauging the market's reaction *after* the bit of bad news: On relative strength, we will buy (at least for a trade), and on weakness, we will sell.

Despite strong dollar undervaluation, there are only two instances that will lead us to take a strong, *unequivocal* long dollar position: Either the G-7 abandons their dogma of equating trade deficits with currency overvaluation *or* alternatively, the US economy undergoes a true adjustment, sinks into recession, and generates a lasting and substantial trade improvement.

STRATEGY: *Stand aside on the US dollar.*

Cross traders may wish to purchase DM and sell yen on the assumption that central bank intervention will likely slow DM depreciation as it approaches the lower end of the possible Louvre range, while the yen has still further to go to reach the lower intervention point. While this cross trade carries an implicit dollar view (that is, that the dollar will continue rising), it is probably a little less risky than an outright dollar position. Risk recent lows.

Chart 4 -

CME SWISS FRANC 8/27/84 to 6/24/88

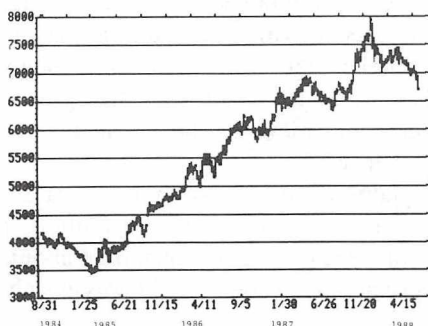


Chart 5 -

CME DEUTSCHE MARK 8/27/84 to 6/24/88

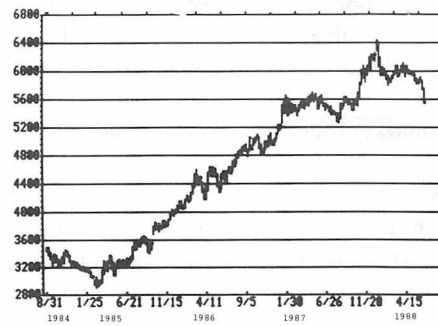


Chart 6 -

CME JAPANESE YEN 8/27/84 to 6/24/88

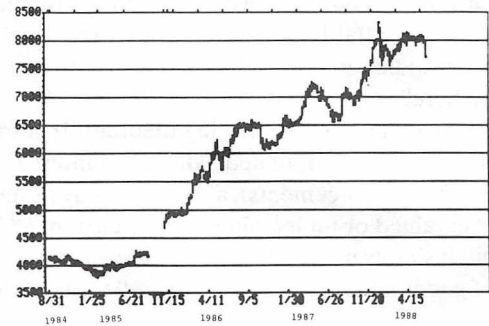


Chart 7 - CME BRITISH POUND 8/27/84 to 6/24/88

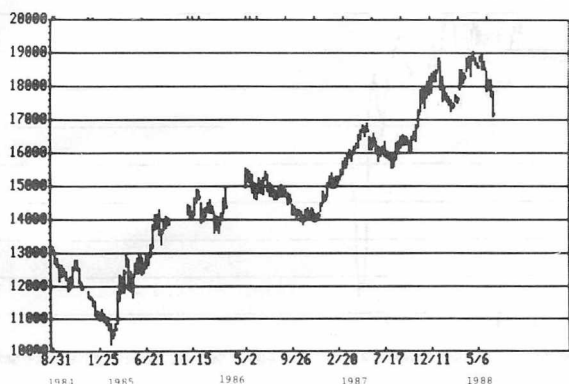


Chart 7A

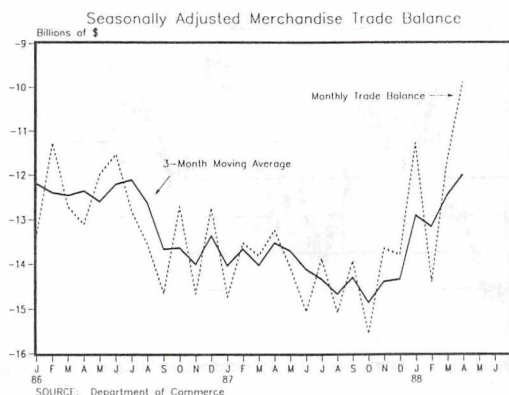


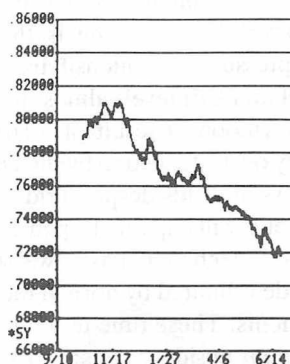
Chart 8

Table 21. Four Phases in Depreciation of U.S. Dollar, February 1985-February 1988

Phase		Average Monthly Nominal Depreciation ¹ (In percent)	Cumulative Real Depreciation to Last Month ² (In percent)	Average Monthly Increase in Reserves of Group of Seven, excluding U.S. ³ (In billions of U.S. dollars)	Intervention by U.S. Authorities	Typical Relationship Between Exchange Rate and Interest Differentials
Pre-Plaza Agreement	February-September 1985	1.3	9	1.3	\$565 million purchases of foreign currency, February-March.	Positive
Post-Plaza Agreement	September 1985-May 1986	2.3	25	2.0	\$3,301 million purchases of foreign currency, September-November.	Positive
Pre-Louvre Accord	May 1986-February 1987	1.1	34	5.4	\$50 million sales of foreign currency, January 1987.	Positive
Post-Louvre Accord	February 1987-February 1988	0.8	40	7.1 ⁴	Purchases of foreign currency: \$30 million in March, \$631 million in August. Sales of foreign currency: \$4,870 million, April-June; \$5,040 million, August-January. (Data for February not currently available.)	Negative

Chart 9

DEUTSCHE MARKS SEP. 88/JAPANESE YEN SEP. 88



COPPER

Still more gains ahead

Virtually uninterrupted week-to-week increases in combined Comex and LME warehouse stock have had little impact on prices and/or spreads. July '88 copper reached a contract high of 110.50 this past week before easing to close at 104.20, a breathtaking gain of more than 16¢/lb. since our last comments. The July/September backwardation has widened to 750 points, well above the 500 to 550 points resistance in effect since late last year (see our last issue).

While it would appear (from recent warehouse movements) that copper supplies are catching up to consumption, little attention has been paid to classical inventory cycles: Since spot inventories command a premium, market participants are attempting to rebuild inventories. Current supply flows are not large enough to accommodate consumption and demand for inventories, thus creating upward price pres-

ures. Eventually, a combination of higher prices and a steady increase in excess production will satisfy demand for inventories. At that point, prices will begin to recede.

It is nearly impossible to determine which level (inventory/sales) is "satisfactory," especially in view of the fact that rising prices, per se, create their own speculative demand. The existing backwardation, which extends well into 1989, however, reveals an urgent need to own spot inventories. We must assume, therefore, that demand for "restocking" will continue into the indefinite future.

STRATEGY: Roll July '88 long positions into September '88, taking advantage of the large backwardation; move stops on September '88 to 87.00, close only.

Chart 10 – COMEX COPPER JULY 88

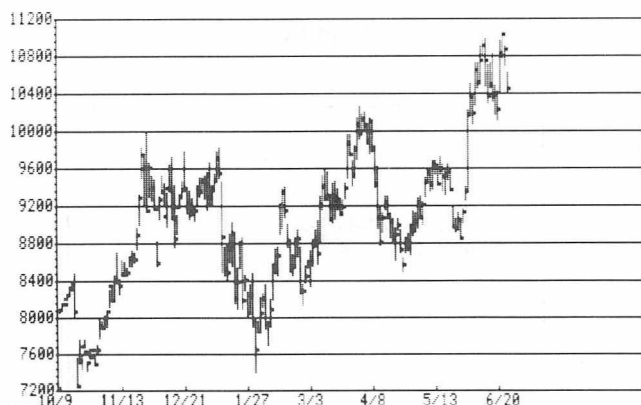
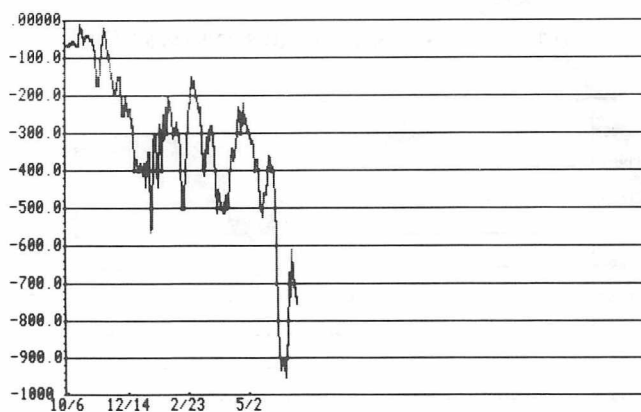


Chart 11 – COPPER (SEP. 88-JUL. 88)



STOCK INDEXES

The rally: the end is near

The (short-term) bullish factors enumerated last month prevailed a great deal sooner than we had anticipated, forcing us to cover bear positions prematurely (short June 270 calls as well as long 270 September puts), at least temporarily.

How powerful and lasting is this rally likely to be? Inflationary pressures are intensifying and will become visible at the PPI and CPI levels almost immediately. The bond market's honeymoon, a result of a strong dollar, is consequently nearly over, attested to by the fact that it has failed to reach new lows in yields despite Friday's dollar surge. Once more bond yields will cap the drop in earning yields.

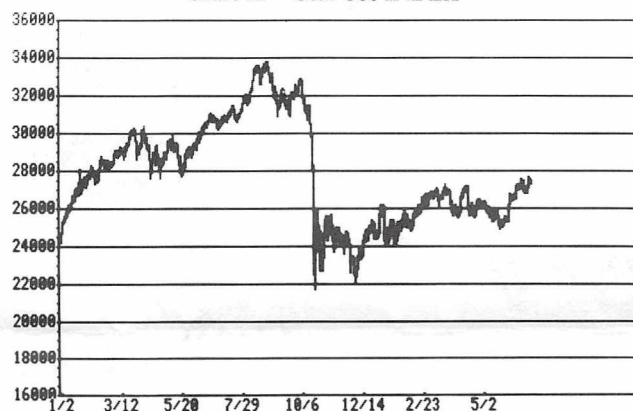
On a more technical basis, we should note that the market's upside is limited by normal recovery rules: 50% and 67% retracements. These time-tested tenets point to the following *maximum* upside targets: DJIA 2182 and 2371, S&P 500 277 and 297.50. Furthermore, our own projections (see last month's Chart 6, "Probable bear market path") indicate that while the S&P has exceeded the lower and more rapid path (now at 250), it is still *below* our upper path (now at 280).

Poor breadth figures (weekly A-D line has yet to confirm new recovery highs in DJ and S&P 500), an incredibly low

plurality of new high over new lows, the quick snap back in sentiment (attested to by *Indicator's Digest* poll, *Market Vane* consensus, and low put/call ratios) all point to a rapidly approaching end to this rally.

STRATEGY: *Remain sidelined. Keep posted for reentry to short side via put options.*

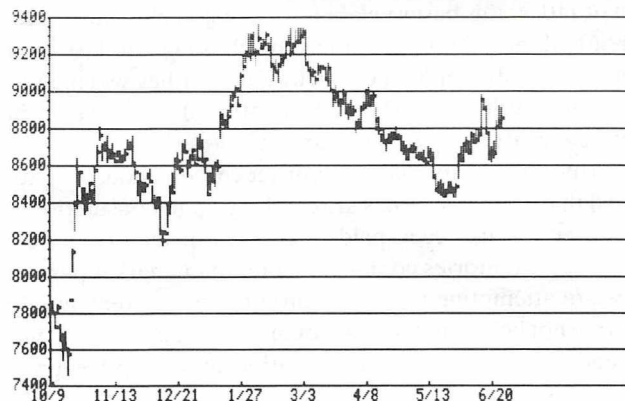
Chart 12 – S&P 500 INDEX



T-BONDS

STRATEGY: *Remain short via September 84 and September 86 put options.*

Chart 13 – CBT T-BOND (DAY) SEP. 88



GOLD

Stay tuned for the breakout

Our thesis that bull markets in gold are accompanied by central bank selling (see *FC&CC*, Dec. 20, 1987) received an important boost this month. The Bank for International Settlements announced that official gold stocks fell by 90 tonnes in 1987, the first fall since 1984. In Latin America, Colombia and Peru were the largest sellers with 41 tonnes and 20 tonnes respectively. In Eastern Europe, Romania and Hungary reduced their holdings by 28 tonnes and 22 tonnes, while among industrial nations, Canada disposed of 37 tonnes. The most prominent buyer was Taiwan, with its acquisition of 65 tonnes.

Technically, gold continues to act very sluggishly de-

spite the formidable advance in commodity prices.

The most logical explanation is that there has not been, as yet, a strong public perception of inflation (despite the rise in raw material), and thus important amounts of recently mined gold and future supplies (via gold loans) have held prices in a very broad but steady range.

We foresee an eventual breakout on the upside.

STRATEGY: *In the interim, we still favor the runaway long 1 CRB/short 2.5 gold (see Chart 15) and the long platinum/short gold spreads. Protect outright long gold positions with stops at 442, basis nearest contract, close only.*

Chart 14 – COMEX GOLD AUG. 88

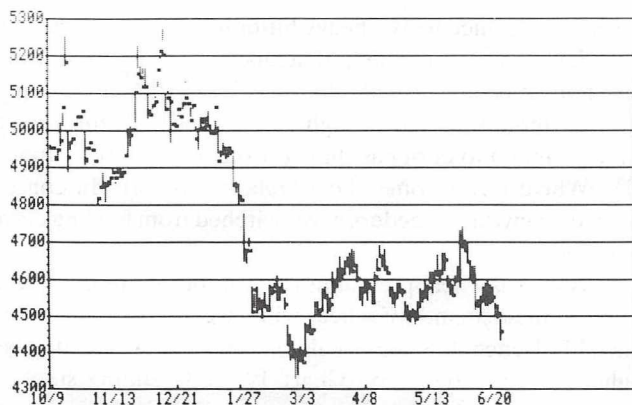


Chart 15 – CRB/Gold

**PLATINUM**

A sneak attack

Although the fundamentals for platinum remain unchanged, several points merit attention. The first concerns the Japanese market. The Tokyo Commodity Exchange for Industry (TCOM) is four times larger than the NYMEX. Of note is the fact that the Nipponese have altered their trading habits in this large platinum market. Instead of offsetting their long positions on futures contracts, they have increasingly taken delivery of the physicals. For example, delivery was made on 43,730 ounces for the April contract, and expectations are that even more deliveries will be taken on the June contract. This suggests that the Japanese are increasingly looking to platinum as a buy-and-hold investment. To the extent that this observation is correct, it will take a much larger price run-up to induce the physicals to come back into the spot

market than it once did. This should be bullish.

Second, the stocks on the NYMEX continue to drift downward (Chart 16). This is constructive.

Third, the US economy, as well as other OECD economies, continue to perform well. If this trend holds for much longer, it will deplete commercial stocks to uncomfortably low levels, and induce new industrial demand. This could hit the market like an unanticipated sneak attack.

STRATEGY: *Retain long October platinum (2)/short October gold (1) spread. Maintain stops at \$70/oz. platinum premium, on close only.*

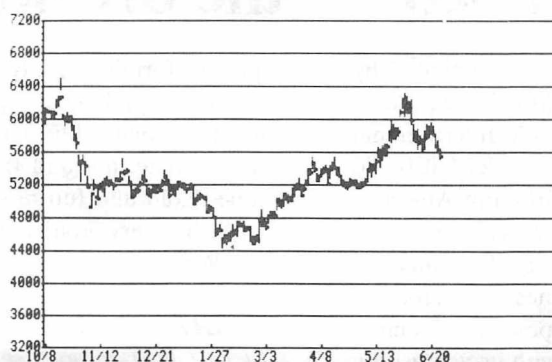
– Steve H. Hanke

Chart 16
Platinum Stocks
(New York
Mercantile Exchange)

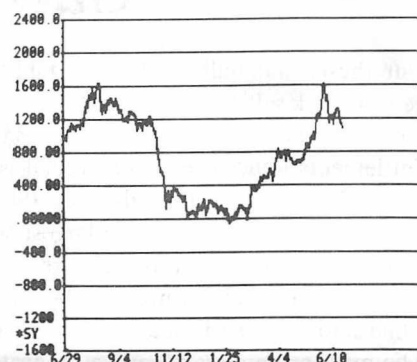
Date	Ounces
April 22	213,100
29	213,100
May 6	213,100
13	213,050
20	208,250
27	205,400
June 3	200,450
10	199,050
17	199,050

For more historical data, see
FC&C, April 24, 1988 (Chart 10).

Chart 17 – NYME PLATINUM JULY 88



**Chart 18 –
PLATINUM OCT. 88-GOLD OCT. 88**



WHEAT

An undervalued commodity

In last month's wheat article, we noted that "we are currently trading in a very tricky weather market." Who said that we weren't the masters of understatement?

We weren't able to purchase December wheat at \$3.40/bu. on dips created by rains, because there was no rain. However, we did purchase September \$3.90/bu. calls (per the Hotline).

As we pointed out last month, the supply-demand picture looked most promising. Well, it even looks more promising now (compare Chart 17 from our May issue with Chart 19). The USDA has reduced the estimate for total supply and use for the 1988-89 crop year. The net effect is projected to further reduce what were already projected to be very low "ending stocks" and "ending stocks as a percent of use."

So far, so good, but there is more bullish news, which is not yet fully reflected in the market. One of our most sagacious friends keeps an eye on both the futures markets and

the feed lots, since he is a heavy hitter in each. He alerted us to the following developments that, upon checking, we learned have not yet been factored into the USDA estimates. During the past month, as the drought has intensified, the wheat price premium to corn has slipped from about 55% to about 13%. Wheat has become cheap, relative to corn. In consequence, many cattle feeders have switched from feeding corn to wheat.

As long as wheat premiums to corn stay at present levels or lower, the demand for wheat will have an extra, unanticipated lift. Hence, 1988-89 "total domestic use" will tend to be higher than the figure on Chart 19, and "ending stocks" lower. This is bullish for wheat.

STRATEGY: Retain September calls.

– Steve H. Hanke

Chart 19
Wheat Supply/Demand
(millions of bushels)

	1981/ 82	1982/ 83	1983/ 84	1984/ 85	1985/ 86	1986/ 87	June 9, 1988 USDA Estimate 1987/ 88	June 9, 1988 USDA Estimate 1988/ 89
Beginning Stocks	989	1,159	1,515	1,399	1,425	1,905	1,821	1,236
Production	2,785	2,765	2,420	2,585	2,425	2,092	2,105	2,120
Total Supply	3,777	3,932	3,939	4,003	3,866	4,018	3,941	3,371
Total Domestic Use	847	908	1,112	1,154	1,046	1,193	1,105	1,090
Exports	1,771	1,509	1,429	1,424	915	1,004	1,600	1,500
Total Use	2,618	2,417	2,540	2,578	1,961	2,197	2,705	2,590
Ending Stocks	1,159	1,515	1,399	1,425	1,905	1,821	1,236	781
Ending Stocks as % of Use	44.3%	62.7%	55.1%	55.3%	97.1%	82.8%	45.7%	30.2%

Chart 20 – CBT WHEAT SEP 88



LIVE CATTLE**Low-risk drought trade**

The grain crop outlook has been deteriorating by the day. A few more weeks of drought will mean not just a reduced crop of corn and soybeans, but for many farmers no crop at all. It is thus obvious why long grain futures is a popular trade right now. However, should the high-pressure system parked over the center of North America move on, grain crops could still recover dramatically. Long the grains is a very exciting place to be, but also very risky.

If the grain crop fails, then commodity prices will adjust to curb demand and ration available supplies. Most corn and soybean meal is fed to livestock. At present feed prices, hog and poultry production and cattle feedlots are unprofitable. Thus, down the road, meat supplies will fail.

When producers retrench, it is obviously bullish in the cattle markets longer term, but paradoxically, bearish in the near term. Heifers that would have been bred are instead slaughtered, and light-weight cattle coming off the parched pastures are slaughtered straight away instead of going into feedlots. Six months or more in the future, the animals that should have been placed on feed this summer, but weren't, because of the unprofitability of feedlot operations, won't be there. We expect sharply higher fed cattle prices in 1989.

STRATEGY: Buy February 89 live cattle at market. Risk 67.50, on close — the low of the pre-drought period. We prefer February over the later 1989 months, because we expect backwardation to set in. Hotline long positions in June 1989 should be switched into February to capture the discount, which should later become a premium.

— William E. Burt

FRIEDBERG CAPITAL MARKETS**Danish high yields**

For the last 18 months, the lure of high nominal yields has proven to be extremely enticing to investors. Countries such as New Zealand, Australia, Canada, etc. have attracted huge pools of capital searching for higher yields than those available in US dollars. Investors are generally attracted towards high nominal yields on foreign currency bonds because of the cushion offered, which may make up for a possible devaluation in the currency of the bond.

Conversely, currencies that offer low nominal yields, such as the Japanese yen, West German deutschemark, and Swiss franc are psychologically displeasing because in order to outperform US dollar investments these currencies *must* appreciate. Demand for the hard currencies has generally remained strong, while demand for the soft currencies has

accelerated.

The strength in the New Zealand, Australian, and Canadian dollars is generally attributed to the recent explosion in commodity prices, coupled with investors' indiscriminately buying the high-yielding currencies.

One currency that offers investors high nominal yield is the Danish krone. Danish krone bonds actually offer investors the best of both worlds, because of high rates of interest, and its close alignment with the EMS currencies.

We offer the following issues denominated in Danish krone:

World Bank 9 $\frac{3}{4}$ %, 20/11/92, yields 10.01%

City of Stockholm 10 $\frac{5}{8}$ %, 10/11/91, yields 9.63%.

Chart 21 — CME LIVE CATTLE FEB 89

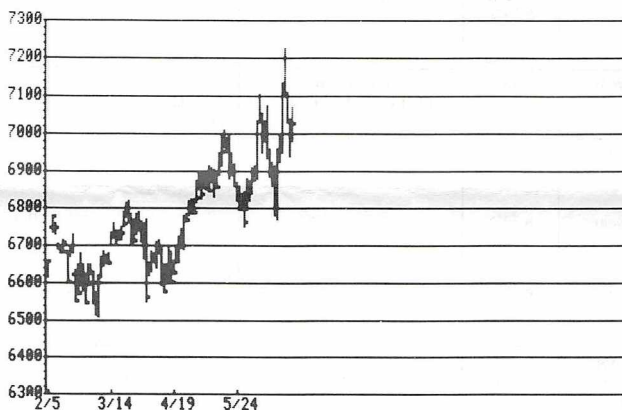


Chart 22
Breakeven exchange rates for US\$ – based investor

This analysis shows a "snapshot" of the relationship between interest rate differentials and rates of exchange. The breakeven rate measures how far the foreign currency has to devalue (for NZ\$, A\$, DKr) or revalue (for DM, SF, JY) before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation.

	U.S. \$	NEW ZEALAND \$	AUSTRALIAN \$	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE
1 year	7.44%	Wells Fargo 16½ 12/5/89 Yields 15.33% (.660 NZ/US\$)					
2 year	8.02%	Toronto Dom. Bk. 18% 2/4/90 yields 14.75% (.628 NZ/US)					
4 year	8.34%						World Bank 9¾ 20/11/92 yields 10.08% (7.21 US/DKr.)
5 year	8.48%	Tourist Hotel 0 4/6/93 yields 14.58% (.539 NZ/US)	World Bank 12¾ 15/3/93 yields 12.41 (.686 A/US)			Canada 5% 23/7/93 yields 4.86% (108.4 US/JY)	
6 year	8.59%		Com. Bk. of Aus. 14% 1/7/94 yields 13.06% (.671 A/US)				
8 year	8.72%			Belgian 5½ 1/5/96 yields 5.99% (1.45 US/DM)			
10 year	8.86%				Australia 5% 30/10/98 yields 4.66% (.994 US/SF)		
Spot Exchange Rate	N/A	.7087	.8198	1.7803	1.473	128.43	6.7675

**For example, in parentheses, since a US\$ based investor would receive 789 basis points 1533-744 by holding the Wells Fargo 16½ bond NZ\$ can depreciate to (.660 NZ/US from the present spot exchange rate of .7087

NZ/US over the next 1 year for the NZ\$ investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

Chart 23
Foreign currency bond investment yearly performance
May 29/87-May 31/88
For a Cdn\$ Based Investor

Had you invested on May 29/87 in:	% appreciation/depreciation due to currency fluctuation	% appreciation/depreciation due to price of bond interest rate fluctuation X currency appreciation	Nominal Coupon X currency	Total Return in Cdn.\$ *
Wells Fargo 16½% 5/12/89 NZ\$	+10.9	+2	+17.9	30.8%
Quebec Hydro 5½% 1/5/96 DM	-2.5	-1.5	+5.4	1.4%
Canada 5% 23/7/93 JY	+6.1	-2.1	+6.0	10.0%
Australia 5% 30/10/98 SF	+6.0	-1.5	+5.3	9.7%
C.I.B.C. 13% 13/3/91 A\$	+4.2	-1.0	+13.5	16.7%

*Assumes that all coupons were reinvested fully.

Chart 24
Foreign currency bond investment yearly performance
May 29/87-May 31/88
For a US\$ Based Investor

Had you invested on May 29/87 in:	% appreciation/depreciation due to currency fluctuation	% appreciation/depreciation due to price of bond interest rate fluctuation X currency appreciation	Nominal Coupon X currency	Total Return in US\$ *
Wells Fargo 16½% 5/12/89 NZ\$	+20.1	+6.6	+19.4	46.1%
Quebec Hydro 5½% 1/5/96 DM	+5.5	-1.4	+5.8	9.9%
Canada 5% 23/7/93 JY	+14.9	-1.9	+6.5	19.5%
Australia 5% 30/10/98 SF	+4.9	-1.6	+5.2	8.5%
C.I.B.C. 13% 13/3/91 A\$	+12.8	-.9	+14.7	26.6%

*Assumes that all coupons were reinvested fully.

THE EXOTICS

Belgian franc

Last year saw some progress on the fiscal front, as the public sector deficit fell to 8.1% of GNP from 11% the previous year. The new centre left government led by veteran Prime Minister Wolfried Martens has pledged to preserve economic austerity and bring the deficit down to 7% of GNP in 1989. Monstrous deficits along with the accumulated weight of the public sector debt and its continued appearance on the nation's capital money markets when refundings take place are sapping the strength of the private sector. Unemployment remains a high 10.5%.

Not surprisingly, Belgium enjoys a current account surplus, a result of excellent price performance and subdued economic growth. The franc/DM parity is quite realistic and not suspect in any kind of future realignment. Nevertheless, economic efficiency dictates that the deficit be brought back under control at a much faster rate.

STRATEGY: Remain neutral against both the US dollar and the deutschemark.

Chart 25

YEAR	BELGIAN FRANC PER U.S. DOLLAR (PERIOD END)	U.S.		BASKET	
		1970 =1.00	1977 =1.00	1970 =1.00	1977 =1.00
1967	49.62	0.9500	1.6039	1.0055	1.3122
1968	50.14	0.9738	1.6441	0.9732	1.2701
1969	49.66	0.9806	1.6556	0.9745	1.2718
1970	49.67	1.0000	1.6884	1.0000	1.3051
1971	44.75	0.8989	1.5177	0.9440	1.2320
1972	44.06	0.8683	1.4660	0.9855	1.2861
1973	41.32	0.8086	1.3653	1.0028	1.3087
1974	36.12	0.6953	1.1739	0.8598	1.1221
1975	39.52	0.7370	1.2443	0.9650	1.2593
1976	35.98	0.6506	1.0985	0.8055	1.0513
1977	32.94	0.5923	1.0000	0.7662	1.0000
1978	28.88	0.5345	0.9025	0.7540	0.9841
1979	28.04	0.5528	0.9334	0.8238	1.0751
1980	31.52	0.6615	1.1169	1.0080	1.3156
1981	38.46	0.8281	1.3982	1.0634	1.3879
1982	46.92	0.9855	1.6639	1.1570	1.5100
1983	55.46	1.1168	1.8855	1.2102	1.5794
1984	63.08	1.2457	2.1033	1.2184	1.5901
1985	50.36	0.9816	1.6572	0.9408	1.2278
1986	40.41	0.7932	1.3392	0.9139	1.1927
1987	33.15	0.6640	1.1210	0.8611	1.1239
1988 (1Q)	34.72	0.7081	1.1955	0.9749	1.2723

----- BASKET -----
 U.S. 7% Italy 7%
 U.K. 11% France 24%
 Germany 29% Netherland 22%

Above 1.00 = undervalued
 Below 1.00 = overvalued

Chart 26

Year	Foreign Assets (Mln US\$)	CURRENT ACCOUNT As % of GNP	CUMULATIVE 12 QTR. Current Account (Mln US\$)
1970	2110	2.75	987
1971	2950	2.22	1605
1972	3540	3.60	2659
1973	3680	2.99	3319
1974	3530	1.43	3447
1975	3960	0.28	2352
1976	3810	0.63	1390
1977	3420	-0.69	62
1978	2240	-0.84	-936
1979	-1610	-2.79	-4448
1980	-1900	-4.14	-8839
1981	-6120	-4.28	-12196
1982	-7490	-3.00	-11711
1983	-9000	-0.60	-7261
1984	-9505	0.00	-3134
1985	-14293	0.82	+ 119
1986	-18948	3.13	+ 4220
1987	-21926	2.13	+ 7310

Chart 28

Spot	1 Month	3 Month	6 Month	12 Month
37.68-	37.62-	37.52-	37.36-	36.99-
37.75	37.70	37.58	37.45	37.13

Chart 27

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

Reserves * + Previous 12-months curren Account ***= 15887
 (Reserves + 12-months C/A) / M1 ** = 15887/28402 = 55%
 (Reserves + 12-months C/A) / Broad Money ** = 15887/65674 = 24%
 *As at March 1988 ** Sept.1988 *** 1987 = (1)-(4)

Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1977	22,495	40,616
1987 (Sept.)	28,402	65,674
% Increase (decrease)	26%	61%

Corresponding % increase in the United States 116% 115%

(a) 1987 Imports as percentage of GNP 48.7%
 (b) 1978 - 1987 Imports as percentage of GNP =52.5%
 1987 /1978 - 1987 average) = (a)/(b) = 92.7%

Source: IFS

FOREX RATES & UPDATE

<i>Currency</i>	<i>Spot</i>	<i>3-Month</i>	<i>12-Month</i>	<i>Comments vis à vis US\$</i>	<i>Comments vis à vis DM (Spot DM: 181.70)</i>
Australian dollar	.8245-.8255	.8140-.8148	.7850-.7870	Remain long, raising stops to .7950, basis cash, good anytime	Neutral
Belgian franc	37.68-37.73	37.52-37.58	36.99-37.13	Liquidated**	Neutral
Danish krone	6.8500-6.8550	6.8600-6.8700	6.8800-6.9000	Liquidated**	Remain long
Dutch guilder	2.0235-2.0245	2.0055-2.0070	1.9565-1.9590	Liquidated**	Remain short
Greek drachma	143.65-143.75	145.00-147.50	152.75-161.65	Remain short	Remain short
*Hong Kong dollar	7.8000-7.8010	7.7885-7.8010	7.7850-7.8060	Cover	Neutral
Italian lira	1335-1336	1344-1346	1371-1375	Liquidated**	Remain short
Kuwaiti dinar	.27905-.27925	.27785-.27850	.27360-.27525	Neutral	Neutral
Malaysian ringgit	2.5905-2.5915	2.5675-2.5705	2.5005-2.5215	Neutral	Neutral
New Zealand dollar	.7095-.7105	.6950-.6975	.6645-.6705	Neutral	Neutral
Norwegian krone	6.5075-6.5125	6.5895-6.5975	6.7800-6.7925	Liquidated**	Neutral
Portugese escudo	146.90-147.30	147.90-148.30	150.90-154.20	Liquidated**	Remain long
Saudi Arabian riyal	3.7500-3.7510	3.7520-3.7530	3.7530-3.7555	Remain short	Remain short
Singapore dollar	2.0345-2.0355	2.0187-2.0203	1.9705-1.9765	Neutral	Neutral
Spanish pesetas	119.10-119.30	119.60-120.00	120.00-120.60	Liquidated**	Neutral
Swedish krona	6.2150-6.2200	6.2450-6.2610	6.3335-6.3460	Liquidated**	Neutral
Irish punt	1.4885-1.4900	1.4910-1.4940	1.4950-1.5100	Neutral	Neutral

Explanatory Notes

*Indicates change in recommendation from last issue.

**These positions were liquidated when the \$/DM rate moved above 1.7400 in New York on May 31.

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, May 31: No changes or new recommendations. The market letter is in the mail.

Friday, June 3: No changes or new recommendations.

Tuesday, June 7: No changes or new recommendations.

Friday, June 10: Two new recommendations:

Raise stops in October sugar to 950, close only.

Buy September 390 wheat call options at 23¢ (or better).

Tuesday, June 14: Raise stops in July copper to 9500, close only.

Flash update, Thursday, June 16: Liquidate October sugar at market. Remain sidelined until further notice.

Friday, June 17: One flash update on Thursday to liquidate long sugar positions at market.

Flash update, Tuesday, June 21, 11:20 a.m.:

First: Recent stock market action, particularly its resilience to poor inflation news, makes us believe that the bullish arguments we predicted in our last issue will, after all, be vindicated. Thus, we now believe that a substantial bear market rally has begun and is likely to carry on for some time yet.

We advise liquidating September 270 puts at market, and moving to the sidelines.

Second: Drought conditions are forcing heavy herd liquidation. Consequently, 1989 positions should benefit. Buy June '89 cattle at market. Risk 7120, close only.

Friday, June 24: On Tuesday morning's flash update we advised liquidating September 270 S&P options. We also advised going long June cattle with a risk of 7120, close only.

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