FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc. Volume 11, No. 7 July 22, 1990

2 + 2 = 5?

The climb of stock prices in recent weeks to new, all-time highs leaves us wondering about the presumed efficiency of markets. Stock prices are neither intrinsically cheap nor do analysts possess some superhuman forecasting talent that can explain the broader indices' defying the laws of gravity.

Let's see. Manufacturing profits as a percentage of sales (see Chart 1) have been downtrending since early 1988; they have been decelerating, on a year-to-year basis since the second quarter of 1988, and they have shown negative year-on-year growth rates since the third quarter of 1988. The factors that have contributed to the profit decline are 1) rising interest rates, a result of the debt build-up of the eighties *and* the tiering of credit quality, 2) rising unit labor costs and strong global competitive pressures that have blocked the pass-through of increased costs to prices, and 3) an economy that is slowing to a grinding halt.

None of these factors is abating nor is likely to abate in the foreseeable future if we adhere to our supply-side spread model (see last month's discussion).

Admittedly, the continuing profit onslaught does have an impact on stock prices. Last week, with the Dow flirting with the magical 3000, after a number of widely-held companies reported disappointing results, their stocks were massacred. In ascending order, Tandem Computers lost 16.5% of its value, Texas Instruments 17.2%, Storage Technologies 21.7%, United Telecommunications 30.4%, and US Shoe 31.2%. These numbers befit a bear market's selling climax.

And yet, despite the localized (but widening) carnage, other "big cap" stocks manage to push higher under the weight of institutional money and carry the indices to new highs. The buying is concentrated in fewer and fewer issues as evidenced by the breadth numbers (see advance/decline line, Chart 2) and the fact that 178 issues made new 52-weeks highs this week (less than 9% of all issues listed on the NYSE), while 150 issues made new lows. What is worse, the concentrated weight of institutional money is driving even mundane companies to stratospheric multiples (see Chart 3 for a sample of market leaders). Could this be 1973 revisited?

Are institutions *that* clairvoyant to anticipate an earnings resurgence, one that we are unable to see, that would explain their love affair with the S&P 500? Hardly. Institutional analysts have incorrectly predicted five of the last five quarterly upturns, and as we have seen in individual situations, their disappointment has led to massive sell-offs.

There is only one answer and that is that good past performance leads to irrational present behavior. The more dramatic the past performance, the more irrational the present behavior. From 1974 to 1989 total returns on common stocks were exceptional: 16.6% compounded annually. Leaving aside the reasons for this phenomenon, it is clear that the *persistence* of the gain and its *magnitude* have created an equity cult that is not easily discarded no matter how rational the arguments.

It is, however, important to consider the following caveats:

1) taking earnings, not dividends, common stocks in the US return less, when risk adjusted, than real yields on high grade corporate bonds;

2) dividend yields, at less than 3%, are as low as they have been prior to every market crash since the turn of the century;

3) price to book value at 2.9 is higher than at any time in recent memory; one could even argue that the takeover and LBO area of the eighties eliminated any serious replacement value/book value discrepancies, so that book values today are a close approximation, plus or minus 10%, of replacement (market) values. If so, the overvaluation is real;

4) the vulnerability of corporate profits to an economic

In this issue

With contributions by Albert D. Friedberg, Dr. Steve H. Hanke, Daniel A. Gordon, Michael D. Hart, and Ricky Zauderer.

downturn is much greater today than at any time in recent history as corporations' net interest costs — interest expenses less interest income — reached a record 52% of profits in 1989's fourth quarter, up from less than 2% a quarter century ago;

5) the banking system is in the throes of a lending trauma (see our previous article on the banking mess and reliquification) that will eventually severely curtail credit to all less-than-triple A credits, forcing asset liquidation and/or painful interest hits;

6) a growing and very uncomfortable fiscal deficit fed by continuing banking failures may not only be impotent to contain a recessionary cascade (as it did in 1974-75 and 1982) but may also become an added drag on an already weak economy if calls for increased taxation are carried out;

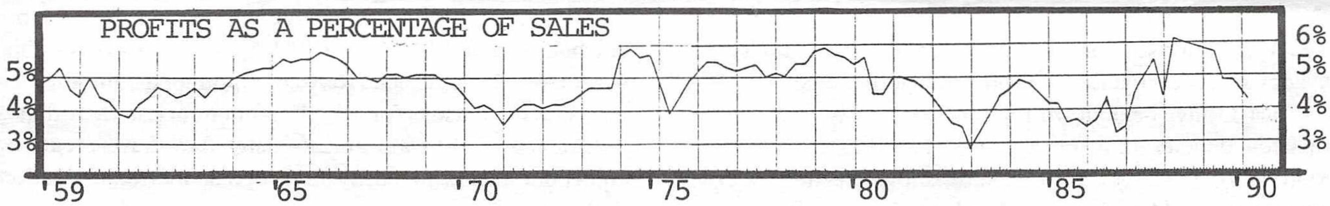
7) the Fed may be unable to "accommodate" the economy via lower interest rates should the dollar tumble, as it will (see currency comments for the US dollar).

Sooner rather than later reason will prevail, and the equity cult will go the way of gold (1980), oil (1986), real estate (1987-199?) and communism (1990). While in the short run, emotions run stronger than logic, in the long run markets are efficient.

The risks of owning common stocks at this time have become too great.

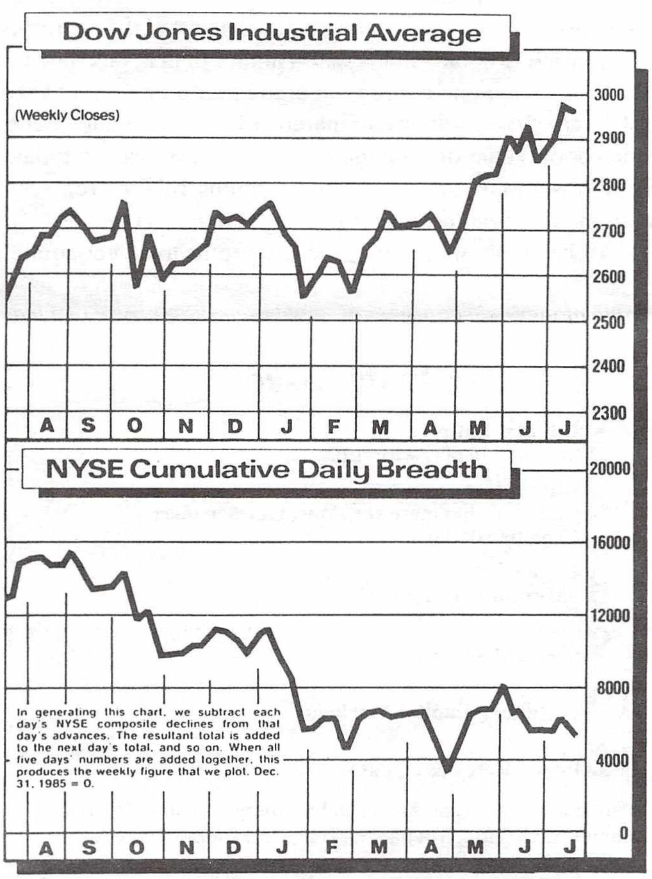
STRATEGY: *Remain short September '90 Value Line; before expiration, roll over to December '90. Maintain to expiration long positions in September '90 S&P 500 puts.*

Chart 1



Source: Industry Forecast

Chart 2

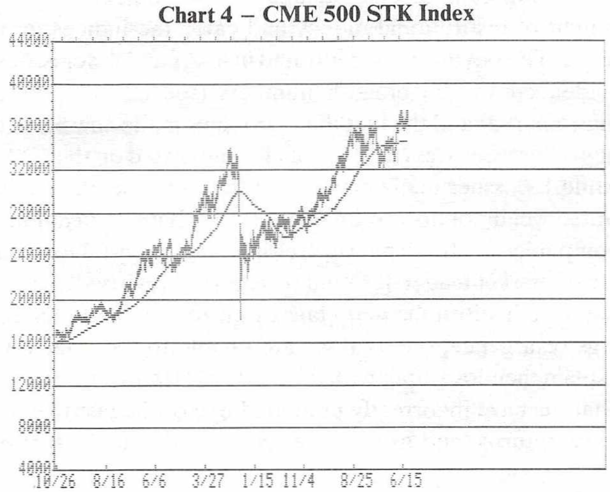


BARRON'S

Chart 3 – Market Leaders

Stocks	P-E multiple
Abbot Laboratories	21x
Baxter International	18
Clorox	19
Coca-Cola	18
Colgate Palmolive	17
Gillette	24
Halliburton	35
Hershey Foods	19
Eli Lilly	24
Merck & Co.	22
Pepsico	23
Schlumberger	33
Syntex	22
Toys R US	30
The Upjohn Co.	24
Wal-Mart	34

Chart 4 – CME 500 STK Index



INTEREST RATES

Tempted to play with fire

Last weekend Federal Reserve Chairman Alan Greenspan testified in connection with the Fed's semi-annual "Monetary Policy Report to Congress." As we have indicated before, that testimony is extremely important (see: "Dr. Greenspan and Interest Rates," *FC&CC,* Feb. 25, 1990).

Chart 5 contains the important elements presented in the report: projections of real GNP, nominal GNP, and the CPI deflator. These projections reflect the Fed's objectives as well as what it anticipates will actually occur. Since 1982, a consistent relationship has existed. When real GNP growth and the CPI deflator were above the Fed's central tendency range, the federal funds rate increased from the end of the previous period. Conversely, the federal funds rate dropped when economic growth and inflation were below the Fed's forecast.

What is interesting at present is the fact that the linkage between the Fed's forecast and federal funds is breaking down. Although we do not yet have GNP data for the first half of 1990, it appears that real growth will be in the Fed's projected range. Given that the first-half inflation was reported last week at an annualized rate of 5.6%, we know that this rate exceeds the Fed's forecast. With real growth within the forecast range and inflation above the range, we would have anticipated that federal funds would have increased. However, the funds rate has fallen from 8.45% in December 1989 to its present 8.0%. The traditional linkages have been broken, and merit comment.

Before we pursue a discussion of that decoupling, however, we must mention that reality has forced Mr. Greenspan to revise his 1990 forecasts. By reducing the projected real GNP growth range and increasing the inflation range, Mr. Greenspan's forecast is more in line with our own views (see: "More Supply Side Problems," *FC&CC,* June 24, 1990).

The decoupling of the traditional relationship between the Fed's forecasts (real GNP and inflation) and changes in federal funds has resulted because a productivity-related squeeze on supply-side spreads has slowed real economic growth. With pressure from the Bush White House, the Fed has become more and more concerned with weak growth and less concerned with inflation (stable money).

What makes this situation so dangerous is that the Fed has eased away from stable money, neo-Wicksellian policy targets. Recall that neo-Wicksellian policy targets require that monetary policy be adjusted so that commodity prices remain stable, the dollar's value remains constant, and the yield curve remains relatively flat.

Since January 1990, the *Economist's* dollar commodity price index for all items has increased by 4.75%, the trade-weighted index for the dollar's value has fallen 3.5%, and not surprising, the yield curve has become steeper, with the government's long-bond yields increasing by about 50 basis points (and federal funds rates falling by 45 basis points).

True neo-Wicksellians would certainly not have lowered the federal funds rate by 45 basis points since January. Indeed, neo-Wicksellian stable money central bankers would probably have kept the funds rate at 8.45%. If that policy would have been pursued, we posit that commodity prices would not have increased, that the dollar would not have depreciated, and long-bond yields would not have increased.

By easing away from neo-Wicksellian targets, the Fed has begun to play with fire. The squeeze on supply-side spreads and the consequent weak real economy have, of course, tempted the Fed to play this dangerous game.

STRATEGY: *Each drop in the federal funds rate since January was accompanied by a roughly one-for-one increase in long-bond yields and a consequent steeper yield curve. Given the weakening economy and the massive political pressure to ease, the Fed will continue to be biased towards lower federal funds rates. The markets, which are very concerned about stable money, will continue to signal their disapproval of a bias towards lower funds rates by demanding higher long-bond yields. Retain T-bond puts.*

See also following comments on the US dollar.

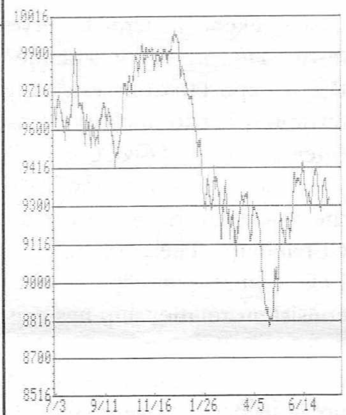
– Dr. Steve H. Hanke

Chart 5
Federal Reserve Projections, Actual Economic Performance, and Interest Rate Trends

	Percentage Change, Fourth Quarter to Fourth Quarter:						Federal Funds Rate	
	Real GNP		Nominal GNP		CPI Deflator		Percentage	
	Fed[a] Projection	Actual	Fed Projection	Actual	Fed Projection	Actual	Levels Dec-Dec	Point Change
1982	½-3	-1.9	8-10½	3.1	6½-7¾	5.1	12.4-9.0	-3.4
1983	3½-4½	6.5	8-9	10.4	4-5	3.6	9.0-9.5	+.5
1984	4-4¾	5.1	9-10	8.6	4½-5	3.4	9.5-8.4	-1.1
Memo:								
1984, 1st half[b]		8.1		12.1		3.6	9.5-11.1	+1.6
1984, 2nd half[c]		2.1		5.3		3.2	11.1-8.4	-2.7
1985	3½-4	3.6	7½-8	6.6	3½-4	2.9	8.4-8.3	-.1
1986	3-3½	2.0	6½-7	4.5	3-4	2.8	8.3-6.25	-2.05
1987	2½-3	5.0	6½-7½	8.3	3-3½	3.1	6.25-6.75	+.5
1988	2-2½	2.7	5¼-6	7.0	3¼-3¾	4.1	6.75-8.75	+2.0
1989	2½-3	2.4	6½-7	6.4	4½-5	3.8	8.75-8.45	-.3
Memo:								
1989, 1st half[d]		3.1		7.5		4.3	8.75-9.5	+.75
1989, 2nd half[e]		1.7		5.3		3.4	9.5-8.45	-1.05
(February Testimony)								
1990	1¾-2[f]		5½-6½		4-4½		8.45-	
(July Testimony)								
1990	1½-2[f]		5½-6½		4½-5	5.6	8.45-8.0	-.45
(July Testimony)								
1990	1¾-2½		5¼-6½		3¾-4½		8.0-	

NOTES:
[a] Federal Reserve projection is central tendency of projections of FOMC members and Federal Reserve Presidents, published each February in the Federal Reserve Board's annual *Monetary Policy Report to Congress* and accompanying Humphrey-Hawkins testimony.
[b] Actual GNP and inflation are annualized growth rates from 1983:IV to 1984:II; interest rates are from December 1983 to June 1984.
[c] Actual GNP and inflation are annualized growth rates from 1984:II to 1984:IV; interest rates are from June 1984 to December 1984.
[d] Actual GNP and inflation are annualized growth rates from 1988:IV to December 1989:II; interest rates are from December 1988 to June 1989.
[e] Actual GNP and inflation are annualized growth rates from 1989:II to 1989:IV; interest rates are from June 1989 to December 1989.
[f] Actual inflation is annualized growth from 1989:IV to 1990:II.

Chart 6
T-bonds Sep 90



CURRENCIES

The US dollar will weaken

Greenspan's gambit, discussed in detail in the foregoing article, makes it all but certain that the US dollar, already trending downward, will enter a period of critical weakness in coming weeks and months.

The bearish factors can be reduced to one: diminishing capital inflows, a result of weakening economic activity, lower interest rates, and the disappearance of the safe-heaven factor (a product of the lessening of tensions in Europe). At the same time, the crumbling banking system (it is only a question of time as to when a major New York city bank closes its doors) is undermining confidence in the US — eventual panic withdrawals may involve some conversions to a safe currency, i.e., Swiss francs.

STRATEGY: *We continue to favor long outright positions in Swiss francs and DM futures.*

Japanese bear still young

The firming of interest rates and the general perception that they will have to go higher yet (despite the cautious tone used by the BOJ) has underpinned the yen in the most recent four weeks, allowing it to advance 4% *vis à vis* the US dollar, but gaining only 1% against the DM.

M2 plus CD growth continues to exceed 12% on a year-to-year basis, well above desirable levels. The BOJ does not see an immediate threat of runaway inflation and is thus reluctant to apply the brakes. Signs of a boom, however, are everywhere: Department store sales rose 12.9% in the year to May versus 10.6% in the fourth quarter; labor markets are tight, as the offer-to-applicants ratio rose in May to a new high in the current upswing, to 1.41 from 1.34 in April. As a result, basic wages are rising: In all industries they rose 5.3% in the year to May, while in the all-important service sector, they rose 6.5% for the same period.

As we mentioned last month, consumer prices, *when viewed over the past three months,* are rising at an annual rate of close to 8%. New figures, available this coming week, should confirm this worrisome development.

For the yen to strengthen, especially *vis à vis* the DM, real interest rates must rise or at least not fall behind those prevailing in West Germany. It is quite clear that nominal rates must rise, as the BOJ has unleashed an inflationary monster over the past few years.

What is not so clear is whether the BOJ will have the courage to lead interest rates higher, i.e., maintain a negative yield curve in the face of collapsing stock, bond, and real

Chart 7
10-Yr. Japanese Gov't Less 3-Mo. Euro-Yen

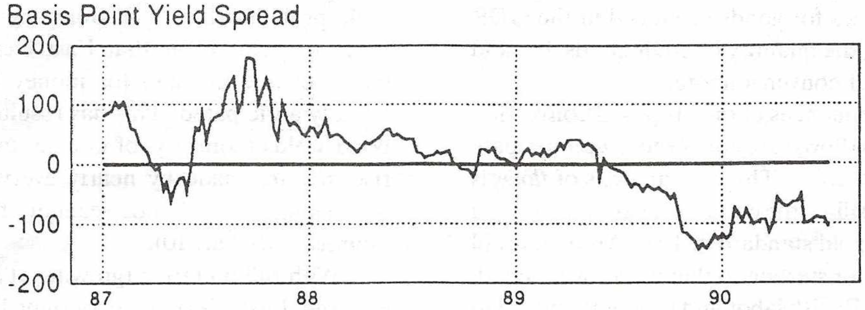
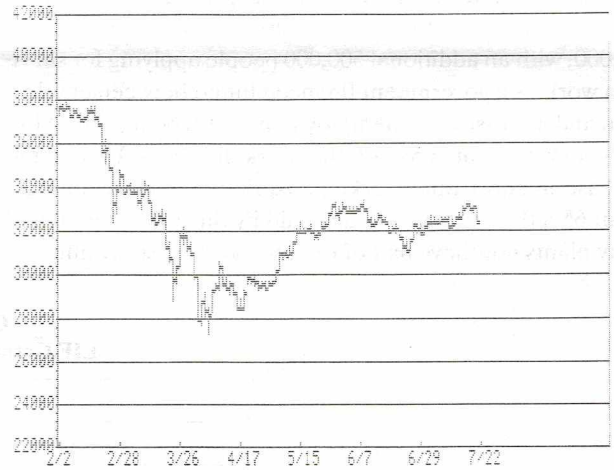


Chart 8 – LIF Japanese Bond Sept 90

Chart 9 – Nikkei 225 Index Spot



estate prices. Although the yield curve is currently gently negative (see Chart 7), further disappointment in consumer prices (as we expect) and the shrinking current account will test the governor's mettle.

We believe that the BOJ will merely *react* to higher market interest rates: While nominal interest rates will rise, real rates will stay close to negative. It may be attractive enough to US dollar holders (and, as such, the yen may rise *vis à vis* the US dollar), but it will not be sufficient to overcome the generous real rates offered by the EMS currencies and the Swiss franc.

Whether the BOJ takes an active role in curtailing money and credit or merely a passive one, the rise in interest rates will continue to pressure bond and stock prices. The bear market is still in its infancy.

STRATEGY: *We continue to expect the basic yen/DM cross to reach 105-110 in coming months. Because we still favor Swiss franc over DM (see next section), retain the highly profitable long Swiss franc/short yen cross trade.*

Maintain short postions in the September '90 yen bond traded on the LIFFE. Maintain short postions in the September '90 Nikkei, as suggested last month, placing stops at 35,100, close only.

West German mark

In remarks made at a meeting in East Berlin in May on "The New Germany: Consequences for European Corporate Strategies," which was organized by the World Economic Forum of Geneva, Dr. Steve Hanke referred to the upcoming currency unification and some of its problems.

He first pointed out that the 6 Ostmark (OM) to 1 Deutschmark (DM) ratio obtained in the free market in the early part of 1990, although imperfect, was probably the best approximation of the buying power of the OM and the DM. A political decision was made, however, to proceed with a weighted average conversion rate of 1.8 OM to 1 DM.

This conversion of the OM money stock presented the Bundesbank with a potential inflationary problem, one that could be neutralized once the Bundesbank obtained a good "feel" for the demand for money of OM holders.

More serious, however, were the consequences of the 1.8:1 conversion rate on wage and prices (flows). In his words, "If the OM wage rates are converted to DM wage rates at 1.8:1, instead of 6:1, wages in DM terms will be increased by a 6 to 1.8 ratio (or 233.3%). In consequence, wages will be relatively high in the GDR, and unemployment will occur.

"Moreover, as long as labor costs (input prices) remain too high, the GDR will continue to be an unattractive location for private investments. In addition to relatively high input prices, output prices for goods produced in the GDR will be too high. Hence, the quantity of GDR goods demand will be lower than at a 6:1 conversion rate.

"As far as the consequences of the proposed conversion rate on wages and prices (flows) are concerned, we anticipate a severe recession in the GDR. That this analysis of *flows* is correct is revealed by recalling the consequences that followed England's return to the gold standard in 1925. Mr. Churchill fixed the exchange rate for sterling so that it was overvalued. Initially, this overpriced British labor and products and led to a recession."

Eight short weeks later, the preliminary results are in: The East German economy is in deep depression. Unemployment has soared 60% in the first two weeks of July, to 224,000, with an additional 500,000 people applying for short-term work — a government financed limbo between employment and joblessness. Unemployment is still being kept artificially lower — at 2.5% of the work force — by a rapid increase in short time working. Workers on short time get about 65% their previous wage, paid by the government, and many plants now have half of their workers on short time.

Leaving aside the question as to whether the economic collapse of East Germany will present serious or even intractable problems for West Germany in the near to medium term, it seems clear that East Germany's depression has increased the demand for money beyond what had been initially anticipated. This has resulted in a surprising fall in bond yields (contrary, of course, to the widely anticipated rise in rates made by nearly everyone as recently as two months ago) with bonds reaching their highest level in six months (see Chart 10).

With M3 on target (growing at an annual 3.7% to 4.3%) and the East German economy in virtual collapse, the Bundesbank is more likely to ease in coming weeks and months than tighten. As a result, the DM should remain weak in the EMS (next to last-placed French franc) as well as weak *vis à vis* the Swiss franc.

STRATEGY: *Last month we suggested exiting our long SF/short DM cross trade (originally put on at well over 90 centimes) at 83.50, if given the opportunity. The cross touched 84.00 (see Chart 11) and rebounded to 85.50-85.75. Given the new German "fundamentals," we prefer to stay with the Swissie and now set our sights at 82 centimes rather than 83.50.*

Chart 10
LIF German Bond Sept 90

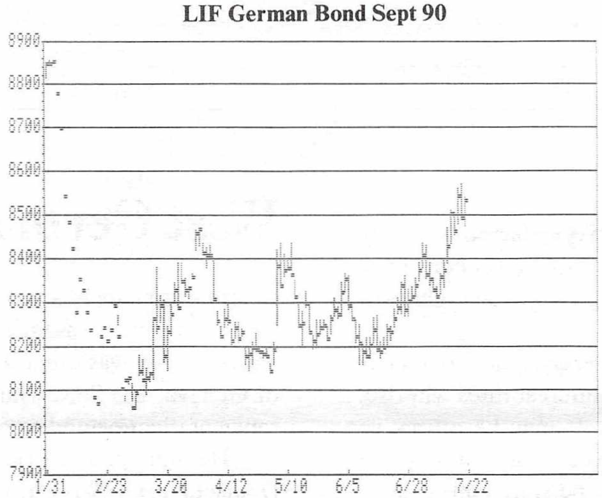


Chart 11 – DM/SF

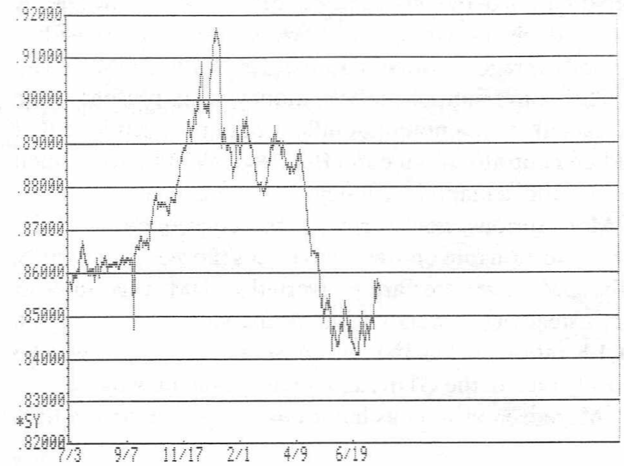
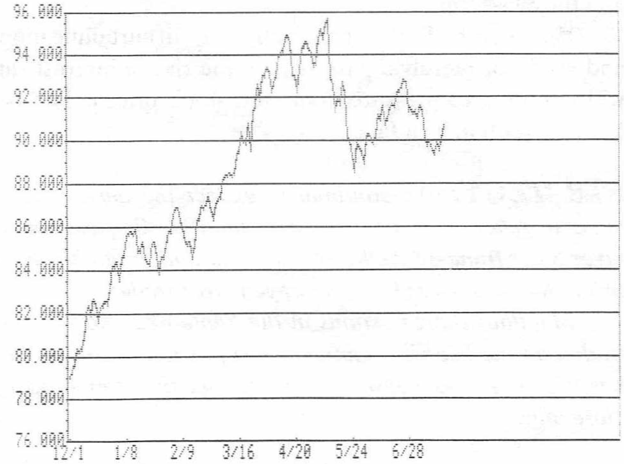


Chart 12 – DM/JY



Canuck buck's moment of truth

The Canadian dollar may be approaching the moment of truth. A firm monetary policy designed to rein in an exploding M2 is beginning to bear fruit. Year over year, growth has slowed to 10.5% from 14.5% (see Chart 13), and what is more significant, there has been practically no M2 increase since February of this year.

It would appear that the Bank of Canada has re-embraced monetarism and may be targeting a 5% to 6% annual growth rate in M2, compatible with a near-zero inflation rate (as indicated by some recent staff comments). If so, the bank may be nearing its objective. On the other hand, it is known that the bank is interested in fostering a strong and relatively high Canadian dollar (in Mr. Crow's words, "...it is worth noting that this acceleration (in inflation) has taken place despite the price-dampening effects from a significant appreciation of the Canadian dollar") as an anti-inflation tool.

Since it is impossible to control simultaneously money supply and the exchange rate, one wonders which policy will be pursued and which one will be abandoned. Even if the bank gives money supply control a higher priority (likely, if the economy continues to slump) and, as a result, begins to ease interest rates (as soon as year-over-year growth hits 5% to 6%), it is not likely to do so in such a manner as to allow a freefall of the Canadian dollar.

The sensitivity of the exchange rate to changes in interest rate differentials is extremely large, especially when external financing requirements are still growing (see Chart 14, depicting a widening current account deficit). From past behavior, it would not be unreasonable to believe that a 100 basis point narrowing of the interest rates differential could initially produce a Canadian dollar drop of 2.5% to 3.5%, perhaps the outer limit of the bank's tolerance range. As such, the easing will have to be pianissimo.

STRATEGY: *Given present interest rate difficulties and forward discounts, shorting Canadian dollar futures is and has been an unfavorable game (in the game theory sense) — unless, of course, one's timing is exquisite. Because we are still unsure as to the timing of the easing, we prefer passing up the opportunity to catch a rapid fall. For those who insist, put options are the way.*

Chart 13

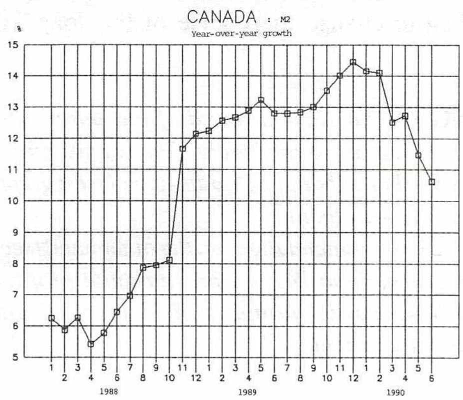


Chart 14

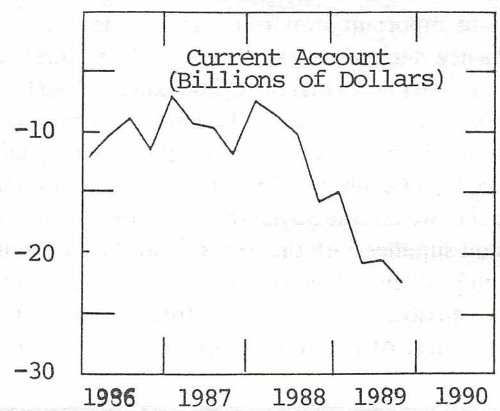
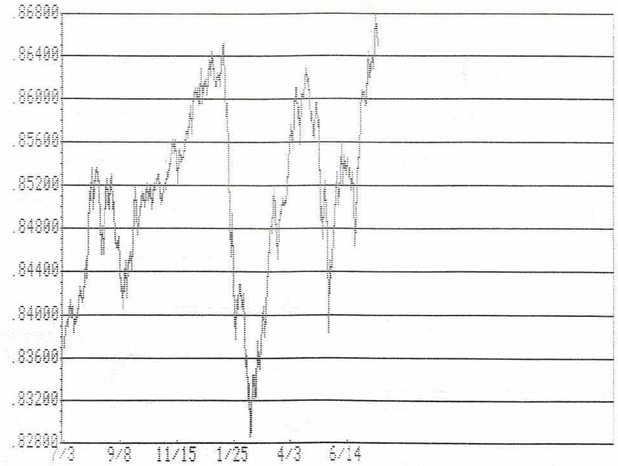


Chart 15
Canadian dollar



CRUDE OIL

Saber-rattling and the bear

To say that crude oil prices are notoriously influenced by political events is both an understatement and an exaggeration.

Saddam Hussein's veiled threat to Kuwait and UAE that they have been responsible for the drop in prices and may have to pay the consequences if they insist in overproducing is merely a recognition of the relatively new geopolitical balance in the region: After the cessation of the Iraq/Iran war, Iraq has become the military leader of the Arab world.

The Iraqi's saber-rattling will not lead to lower Gulf production: either Iraq annexes these two puny nations and pumps *their* oil or there is no annexation and Kuwait and UAE cut production back to their assigned quotas — and accommodate Iraq's overproduction. Either way, the Gulf states will continue to target prices rather than maximize production, exposing themselves to long-run declines in real total revenues.

Assuming a tight near-term Opec agreement around 22.0-22.3 million barrels per day (b/d), the problem of excess inventories has still not been addressed. What is worse, the economic slowdown in the US is reducing consumption, removing an important prop from under the market.

And a new demand-shock has entered the picture: Eastern Europe. It is well known that the USSR exports close to 80 million tonnes/year of oil to Eastern Europe. The perverse terms of trade prevailing in Comecon countries makes it certain that oil is priced too cheaply, thus incentivizing overconsumption.

In recent weeks, the Soviets have decided to cut Eastern Europe's oil supplies with the excuse that they are suffering production problems. The true reason, of course, is that the Soviets are anxious to sell oil in the free market, thus maximizing revenues. At this time, it appears that the cutbacks will be of the order of 30%. More likely the Soviets will impose a sufficiently large cutback so as to force a renegotiation of the terms of the deal.

The combined effects of rising oil prices and the sharp drop in industrial production will have an almost immediate impact on Eastern European oil consumption. We estimate the "net saving" for Eastern Europe alone at around 500,000 b/d by late this year. Total savings, if we include the Soviet Union, could be a multiple thereof.

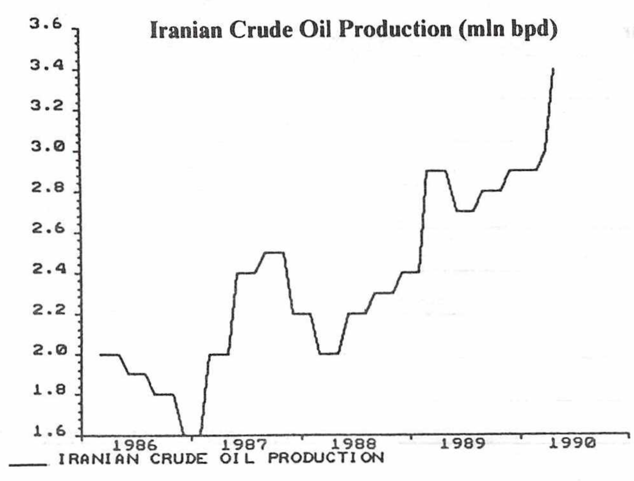
On the supply side, the Iranians have made significant strides since the end of the war. Chart 16 shows how production has recovered to more than 3.4 mb/d, surpassing Iraq as the second largest Gulf producer. Their silence regarding pricing may be due to the fact that they have become financially indifferent between $18/barrel and 3.14 mb/d production and a lower price with a higher level of production, *provided* they are able to continue increasing production. Their negotiating posture, next week, will bear watching for a clue to future output.

With the world drowning in oil, it will take more than just saber-rattling to change the course of this long-term bear market.

STRATEGY: *Our second round of put purchases, begun on May 21, did not prove profitable. The August puts expired, and the September $18 and $19 puts have lost a great deal of their value. Stay with them.*

Our crack recommendation, on the other hand (see Hotline Update on crack, June 24) has proven quite profitable (see Chart 17). Take partial profits at 4.25/barrel if and when available and retain balance.

Chart 16



Source : Datastream

Chart 17 – Crack

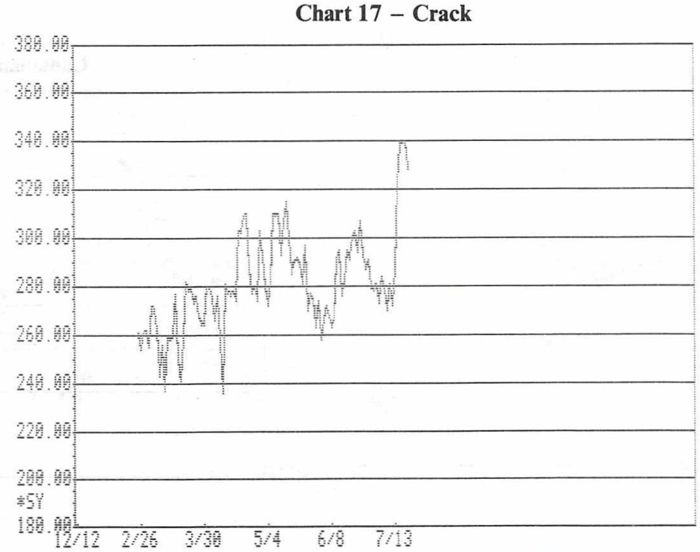
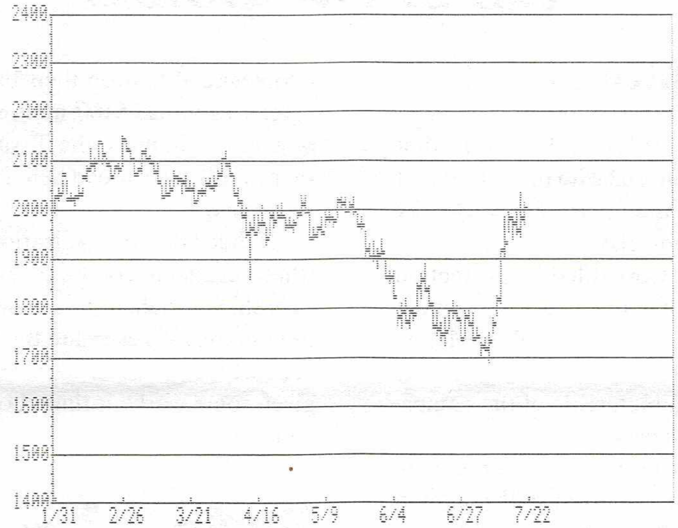


Chart 18
NYME Crude Light Sep 90

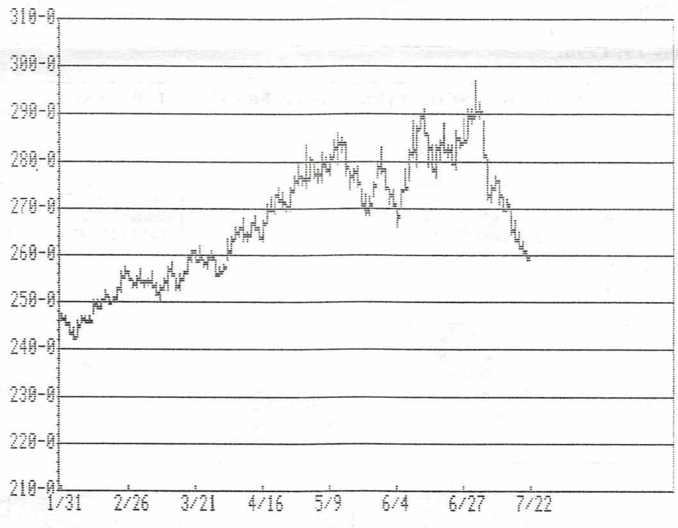


CONCEPT TRADES

With these trades, there is no defined risk/reward target, no defined timing. They are useful when used in conjunction with technical tools.

Corn: Record low stocks as a percentage of consumption. Overly wet planting conditions, initial pollination period still to come, and now the supposedly bumper Soviet crop is well behind last year (up to July 16, 13.5 million hectares has been harvested compared with 20.3 million hectares last year). The bullish side looks very attractive.

Chart 19
CBT Corn Sep 90



FRIEDBERG CAPITAL MARKETS

A tail of two bonds

Southmark update

Southmark's senior debentures 10⅞% of 1989 was first recommended in April 1989 at around 62 with the caveat that Chapter 11 was likely and that it thus represented a very risky investment. Little did we suspect *how* risky!

Just one year after Southmark Corp. filed for protection under Chapter 11, the company has reached a settlement with its creditors in federal bankruptcy court. This week, the creditors adopted a reorganiztion plan that will most likely end the volatility that has been characteristic of the company's shares and debentures over the past year.

The reorganization plan includes payment by the company of cash, secured notes, and preferred and common shares in order to settle approximatley $2 billion in debts.

Under the plan, there will be a vast liquidation of all real estate assets, except for the Texas-based San Jacinto Savings and Loan, in order to come up with $227 million in cash over a two-and-a-half-year period. Of this total amount, $75 million will be available immediately for disbursements. The lion's share (85%) will go to the senior bondholders of record on August 10, 1990.

Southmark has struck an independent deal on the San Jacinto S&L with the Office of Thrift Supervision. The regulators agreed to drop their bankruptcy claims if Southmark agreed to infuse $100 million in San Jacinto. The infusion of capital will make the Texas thrift marginally solvent. But there's still widespread belief that the feds will seize the thrift regardless.

Under the reorganization plan, the senior bondholders (that's us, thank goodness) will receive a package consisting of cash, new debentures, new preferred stock, and new common shares. We estimate the final value of the package to be somewhere between $250 and $300 per $1,000 debenture, given some workout time. Losses on the original investment will run to 60%.

Bonex '82 – a sterling investment

First recommended in our LDC Debt Comments of Dec. 26, 1989. Recommended again Jan. 26, 1990. Return to date on a hypothetical purchase made Dec. 26, 1989: 53.6%; return to date on a purchase made Jan. 26, 1990: 70.13%. These returns assume reinvestment of interest and amortization (see Chart 22).

Chart 20
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. **Rates as of July 19, 1990.**

	U.S. $	NEW ZEALAND $	AUSTRALIAN $	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE	BRITISH POUND
2 year	8.16%	CIBC 14% 27/7/92, yields 12.51% (.548 NZ/US)					1 yr. US 7.89% Stockholm 10⅝% 10/11/91 yields 9.46% (6.335 US/Dkr.)	
3 year	8.25%		World Bank 12¾% 15/3/93 yields 13.14% (.6867 A$/US)	Euro Inv. Bk. 5½% 9/8/93, yields 8.24% (1.641 US/DM)		Canada 5⅝% 23/7/93, yields 6.84% (142.15 US/JY)		Sweden 9⅜% 14/4/93, yields 12.88% (1.602 BP/US)
4 year	8.31%		CBA 14% 1/7/94, yields 13.64% (.6469 A$/US)					
6 year	8.38%			Bk. of Nova Scotia 5⅝% 7/5/96, yields 8.56% (1.658 US/DM)				
8 year	8.49%				Australia 5% 30/10/98, yields 6.93% (1.252 US/SF)			
Spot Exchange Rate	N/A	.5938	.784	1.6412	1.4055	147.85	6.245	1.8165

*For example, since a US$-based investor would receive 435 basis points (1251-816) by holding the CIBC NZ$ bond, the NZ$ can depreciate to .548 NZ/US from the present spot exchange rate of .5938 NZ/US over the next 2 years 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 21

Date: July 19, 1990

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

PAY ISSUER/MTY.DATE/COUPON	BID	OFFER	CURRENT ANN. YIELD TO MTY	LAST PAY NEXT DATE
CANADIAN DOLLAR DENOMINATED BONDS				
GOVERNMENT OF CANADA (semi annual) 05/12/90 10 1/4%	98.88	99.18	Money Market	05/06/90-05/12/90
NEW ZEALAND DOLLAR DENOMINATED BONDS				
CAN.IMP.BANK OF COMMERCE 27/07/92 14% RRSP eligible	101 3/4	102 1/2	12.51%	27/07/89-27/07/90
AUSTRALIAN DOLLAR DENOMINATED BONDS				
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	100 1/4	101	13.64%	01/07/89-01/07/90
WORLD BANK 15/03/93 12 3/4% RRSP eligible	98 1/4	99	13.14%	15/03/90-15/03/91
CAN.IMP.BANK OF COMMERCE 13/03/91 13% RRSP eligible	97 3/4	99 1/4	13.64%	13/03/90-13/03/91
DANISH KRONE DENOMINATED BONDS				
STOCKHOLM 10/11/91 10 5/8%	100 1/4	101 1/4	9.46%	10/11/90-10/11/91
BRITISH POUND DENOMINATED BONDS				
KGDM of SWEDEN 14/4/93 9 3/8%	91 1/4	92 1/4	12.88%	14/04/90-14/04/91
DEUTSCHE MARK DENOMINATED BONDS				
QUEBEC HYDRO 5 1/2% 1/5/96 RRSP eligible	86	87	8.43%	01/05/90-01/05/91
PROVINCE OF QUEBEC 6% 1/4/97 RRSP eligible	86	86 3/4	8.69%	01/04/90-01/04/91
EUROPEAN INV. BANK 5 1/2% 9/8/93	92 1/8	92 7/8	8.24%	09/08/89-09/08/90
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	86	87	8.56%	07/05/90-07/05/91
WORLD BANK 5 7/8% 4/2/97 RRSP eligible	86 1/8	87 1/8	8.51%	04/02/90-04/02/91
SWISS FRANC DENOMINATED BONDS				
GOVT.OF AUSTRALIA 30/10/98 5%	86 1/8	88 1/8	6.93%	30/10/89-30/10/90
JAPANESE YEN DENOMINATED BONDS				
GOVT.OF CANADA 23/7/93 5 5/8% RRSP eligible	96.05	96.80	6.84%	23/07/89-23/07/90
U.S.DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03(semi) CV @$38 p/sh	75 3/8	77 3/8	11.40%	15/06/90-15/12/90
SUNRISE MEDICAL INC.7.25% 26/6/96 CV @$17 5/8 p/sh	98	102 1/2	6.72%	26/06/90-26/06/91
ALLIANT COMPUTER 7.25% 15/05/12(semi) CV @$39.75 p/sh	47 1/4	49 1/4	15.95%	15/05/90-15/11/90
COOPER CO'S. 10 5/8% 01/03/05(semi) CV @$27.45 p/sh call in 1995 @100	72 1/2	74 1/2	15.52%	01/03/90-01/09/90
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @$39.50 p/sh	35	40	15.36%	01/03/90-01/09/90
U.S.DOLLAR DENOMINATED FIXED RATE BONDS				
ALBERTA 7 3/8% 9/12/91 RRSP eligible	98 3/8	99 1/8	8.02%	09/12/89-09/12/90
U.S.DOLLAR DENOMINATED FLOATING RATE NOTES	Bid	Offer	Current Coupon	
UNITED KINGDOM 24/9/96 3 mo.LIBID-1/8 (qtly)	99.60	99.90	8 1/8%	28/06/90-28/09/90
REPUBLIC OF ITALY 30/4/93	99.05	99.45	8 5/8%	30/04/90-31/07/90
LDC US$ DENOMINATED BONDS				
ARGENTINA BONEX series 82 6 MO LIBOR (semi) ammort. 1/12 of princ./year	91 1/4	92 3/4	8.4375	15/02/90-15/08/90 * 21.70

*IRR

Chart 22

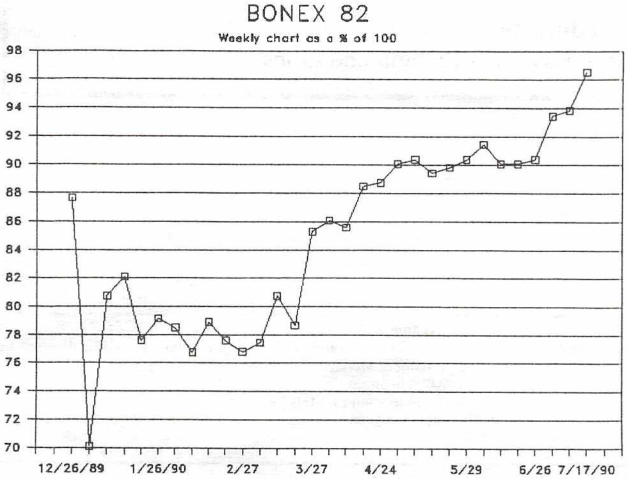


Chart 23

Recommended bond portfolio allocation

Swiss franc and/or DM denominated bonds	35%
US dollar high-yield convertible bonds	20%
Argentina Bonex	10%
British pound fixed-rate bonds	17.5%
Danish krone fixed-rate bonds	17.5%

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FOREX RATES & UPDATE

Currency	*Spot*	*3-Month*	*12-Month*	*Comments vis à vis US$*	*Comments vis à vis DM (Spot DM: 1.6425)*
Australian dollar	.7830-.7840	.7710-.7725	.7400-.7430	Remain long	Neutral
Belgian franc	33.81-33.86	33.85-34.00	33.89-34.34	Remain long	Neutral
*Danish krone	6.2275-6.2325	6.2570-6.2690	6.3325-6.3550	Remain long	Liquidate
Dutch guilder	1.8490-1.8500	1.8493-1.8508	1.8538-1.8568	Remain long	Neutral
Greek drachma	160.70-160.80	164.20-167.80	174.20-189.30	Neutral	Neutral
Hong Kong dollar	7.7655-7.7665	7.7750-7.7800	7.8100-7.8200	Neutral	Neutral
Irish punt	1.6320-1.6335	1.6240-1.6270	1.6010-1.6120	Remain long	Neutral
Italian lira	1201-1202	1210-1212	1238-1231	Remain long	Neutral
Kuwaiti dinar	.29025-.29035	.29035-.29070	.29040-.29150	Neutral	Neutral
Malaysian ringgit	2.7065-2.7075	2.7050-2.7090	2.7000-2.7100	Neutral	Neutral
New Zealand dollar	.5920-.5930	.5840-.5850	.5610-.5640	Neutral	Neutral
Norwegian krone	6.2875-6.2925	6.3315-6.3415	6.4585-6.4810	Remain long	Neutral
Portugese escudo	143.95-144.05	145.35-146.05	152.75-156.55	Neutral	Neutral
Saudi Arabian riyal	3.7500-3.7510	3.7475-3.7500	3.7440-3.7470	Remain short	Remain short
Singapore dollar	1.8165-1.8175	1.8165-1.8190	1.8125-1.8225	Neutral	Neutral
Spanish peseta	100.40-100.50	102.00-102.20	106.13-106.53	Neutral	Neutral
Swedish krona	5.9350-5.9400	5.9955-6.0000	6.2030-6.2330	Remain long	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

Friday, June 29:
One new change: On Monday, June 25, at 1:05 a.m., we liquidated long October sugar positions at the market.

Tuesday, July 3:
No changes or new recommendations.

Friday, July 6:
No changes or new recommendations.

Tuesday, July 10:
No changes or new recommendations.

Flash Update, Thursday, July 12, 1:15 p.m.:
Buy October sugar at market, risking 1160, close only.

Friday, July 13:
Buy October sugar at market, risking, 1160 close only.

Tuesday, July 17:
No changes or new recommendation.

Friday, July 20:
No changes or new recommendations.

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