FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc. Volume 11, No. 10 November 18, 1990

The end of the third oil shock

Just as suddenly as it appeared, it vanished, leaving behind millions of consumers around the world temporarily inconvenienced, but just that. Thousands of civil servants plotting strategic responses at the requests of frustrated and even panicky, finance ministers and central banks. Zillions of pages (newspapers, subscriptions, journals, monographs, essays, books) full of non-sensical theories, analysis and forecasts, and policy prescriptions — including our good friends at the World Bank (remember the $60/barrel scenario?). Thousands of corporations (such as airlines, truckers, and so on) caught short when they should have been hedging their risks as a routine matter — some to be caught a second time as a result of hedging too late. Billions of hours of TV time (when spread over its audience) wasted, to the detriment of both broadcasters and viewers.

In its inimitable way the market adjusted to the threat. First, it marked up prices sufficiently to equate demand to the diminished *actual* supply — thought to be 2 to 3 million barrels per day (mb/d) in August and September, and slightly less in the winter months, provided large oil producers geared up output to compensate for the loss of Iraq/Kuwait oil. In addition, prices were further marked up to take into account the *potential* loss of supply of Saudi oil — later to be named the "war premium."

At the same time, by moving to backwardation, i.e., an inversion of the term structure of futures prices where nearby contracts command a premium over deferred contracts, the market provided sufficient incentives to users and owners of oil to economize inventories.

Urgent users would have to pay premium prices for spot supplies; those users who could wait would benefit by postponing to the future at rewarding discounts. Similarly, owners of inventories would benefit by selling spot supplies to the market at a premium and repurchasing the inventories in the deferred contract months, "earning" as much as $8/barrel for just six months! (See Chart 1).

All the defensive market mechanisms were in place. High spot prices (as much as 170% higher than they were in mid-summer) would restrain demand. The International Energy Agency in Paris estimated a few weeks ago that worldwide demand for the fourth quarter of this year would be down 300,000 b/d on last year's fourth quarter; US consumption was expected to fall as much as 800,000 b/d for the same period. These IEA figures are far from being final. In our opinion they will be revised upwards a number of times to show declines of as much as 1.2-1.5 mb/d.

High spot prices would also incentivize production — in Opec and non-Opec areas, such as the North Sea and Mexico. By the end of October, Opec had made up about 4 mb/d of the 4.2 mb/d lost as a result of the Iraqi invasion and subsequent embargo. Rising Saudi production, now estimated to surpass 8.2 mb/d and on the way to a sustainable 8.5 mb/d, has by now more than compensated all supply losses.

Finally, higher spot/deferred premiums would rationalize usage and availability, eliminating the prospects of a serious "shortage" or supply interruption (in any case, a zero-probability occurrence in a free market).

How can we be so sure that the peak is behind us? For one thing, the backwardation is narrowing dramatically (see Chart 2). This means that the urgency to own spot supplies is disappearing. It also means that spot supplies are becoming quite plentiful — at rich premiums over deferred months. The peak in the *rate of hoarding* almost coincided with the peak of prices, sometime in early October. Since then, prices and premiums have traced a broad downward correction that

In this issue

Contributions by Albert D. Friedberg, Dr. Steve H. Hanke, Daniel A. Gordon, and Michael D. Hart.

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.

seems set to accelerate, barring an immediate armed conflict.

Also supporting the bearish view is the slow but persistent deterioration of the "crack" (see previous issues for a fuller discussion of the formula and implications of the "crack"); the six-month forward "crack" has declined to $5.20/barrel from $8.10/barrel in mid-August and late September (see Chart 3). In effect, the imbalance of refined products — increased relative supplies — signals a softening ahead for the demand for crude.

But what if war broke out in the Gulf? In our opinion, the question should be rephrased: What happens to crude oil prices *when* war breaks out? Here, the simple and only important factor to bear in mind *vis à vis* oil prices, is the likelihood of damage to *Saudi installations.*

It does not matter that Iraqi and/or Kuwaiti oil fields are bombed, because the world is already living without them, and living well. Besides, underground reservoirs cannot be damaged. Therefore, it is only a matter of time before their wells are operational again.

We are, therefore, back to the question of the potential damage to the Saudi oil installations. Not being military experts, we defer to the assessment of the American military commander of the region, General H. Herman Schwarzkopf. In his view, US and Saudi air defences would make it virtually impossible for Iraqi missiles or the Iraqi Air Force to cause more than marginal damage to Saudi Oil export installations. Neither the tragic loss of life nor the immense loss of material wealth should affect oil prices, *provided Saudi oil facilities are spared.* At the same time, a favorable resolution of the war would psychologically deal a serious blow to the market, collapsing and then more, the built-in war premium related to the anticipated disruptions to Saudi supplies.

Summarizing our view, the market priced oil at a level that would ration diminished actual supplies (the original 4.2 mb/d gap) and diminished potential supplies (damage to Saudi oil installations). In the interim, the gap has been restored via increased production both in and out of Opec, plus falling consumption. The threat to Saudi installations has been reduced substantially, due to the enormous build-up of Allied forces. What remains is the slight, but not nonexistent probability that Saudi oil exports will be curtailed, even if for only a few months, this so-called war premium. Is it worth $14/barrel? Or to phrase the question more dramatically, is it worth a 100% premium? Clearly not.

Reasonable men may argue over a reasonable premium that ranges from 10% to perhaps 25%, $1.50/barrel to about $4/barrel — using the $15/barrel WTI price that prevailed before August 2 as our baseline.

That should bring prices back down to $20 in a hurry.

STRATEGY: *Sell April '91 (and forward) crude oil at market. Add to short position 24 hours after military conflict begins.*

Chart 1 – Crude Oil - Spot

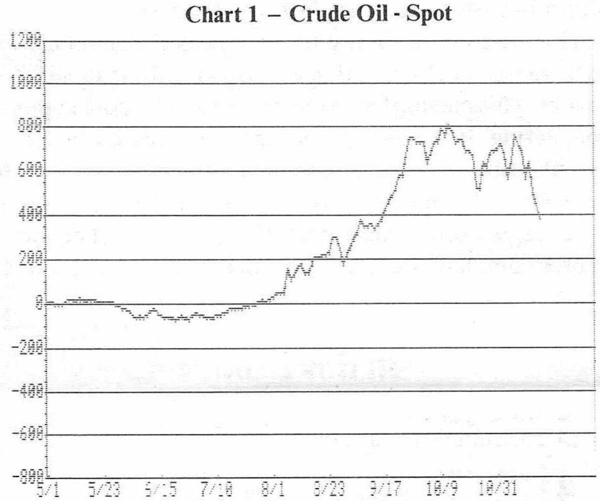


Chart 2 – NYME Crude Light Dec '90

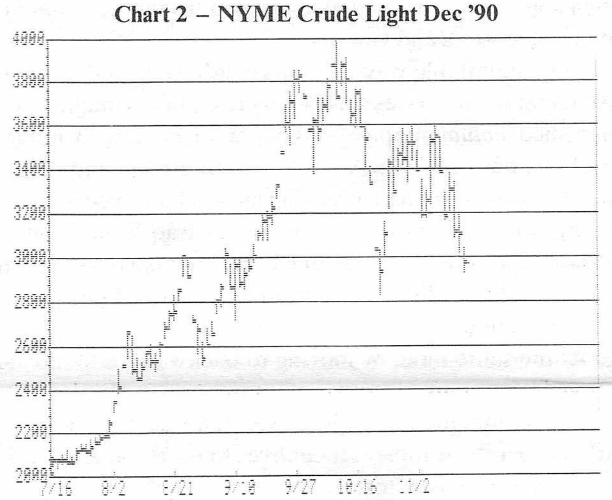
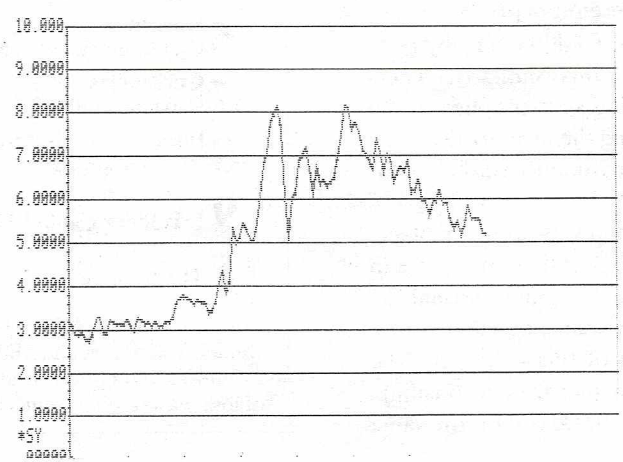


Chart 3 – Crack



STOCK INDEXES

The bottom will fall out

The twin descent of oil prices and interest rates has been instrumental in lifting sentiment in the stock market. The rally that began off the early October lows traced a pattern of rising bottoms and slightly lower tops that was finally penetrated on the upside in the week of Nov. 10. Volume and breadth remained unimpressive.

The rally had all the earmarks of being merely a correction of a deeply oversold condition. Leading the charge were bank and financial stocks, issues that had taken a severe pummelling in the prior weeks.

At week's end the Dow Jones Industrial Average was trading at a reasonable 13.3 times earnings. These numbers helped our Switch Model (see our Sept. 16 issue, "Stock vs. bonds") remain long stocks into the fourth quarter of the year (switch signal was positive to the tune of 0.5, although sharply lower than the previous quarter, which had shown a +3.5 level). The model is *static* and only reflects current earnings, prices, and interest rates.

Few analysts really believe in the likelihood of a severe drop in earnings. The Institutional Broker Estimation System recently released a 1991 earnings projection for the Dow Jones Industrials: Analysts expect 1991 earnings gains for all but three of the 30 Dow stocks. The Dow composite earnings is expected to come in at $258 compared with a latest 52-week trailing figure of $191.52, a whopping 35% gain!

As we have often suggested, bear markets will not bottom until pessimism reigns supreme. It is inconceivable that standing at the doorstep of a recession of undetermined duration and magnitude, analysts should project earnings gains, barely six months later.

Corporate illiquidity (see Chart 4), a persistently wide (and widening) credit quality spread (see Chart 5), mounting bank writeoffs (see Chart 6), bad loan provisions that are only a small fraction of sharply accelerating nonperforming loans (witness Citicorp), a gaping liquidity crunch (see Chart 7), the increasing likelihood that we may experience a synchronized global downturn (see Chart 8 where only Japan and West Germany show some strength) paint a *far* more serious picture than the one happily released by the IBES.

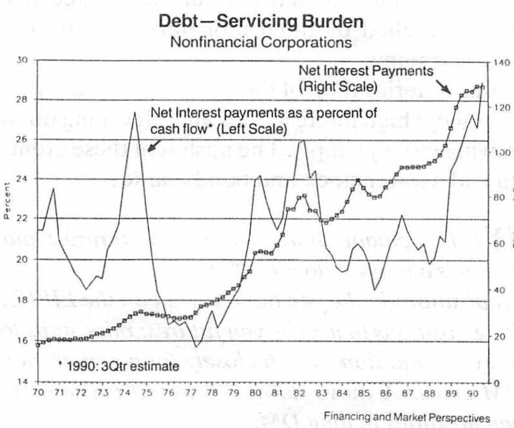
Although the price of oil has declined, itself a result of the pressures of the ongoing debt deflation, it may mask the onset of the worst global economic contraction since the '30s. This could mean the evaporation of corporate earnings. Building analytical models on today's price-earnings ratios may be like building castles on sand. Here today and gone tomorrow.

You do not have to be Wicksellian (see FC&CC May 20, 1990) to realize that the Fed has practically lost all room to ease. Despite appearances of tightness (Chart 9), the steepness of the yield curve (Chart 10) and the weakening dollar (Chart 17) tell us that the Fed's move to lower rates is not credible — and is downright dangerous. It is particularly so in an environment where the public sector deficit is approaching 6% of GNP and the savings ratio has fallen back to 3.5%.

Hit by a global contraction and vanishing earnings, an inability on the part of the Fed to lower real interest rates, and an unwillingness on the part of the Treasury and Congress to allow the fiscal deficit to expand (in a Keynesian sense; see last month's comments), stock prices should disintegrate in the months ahead.

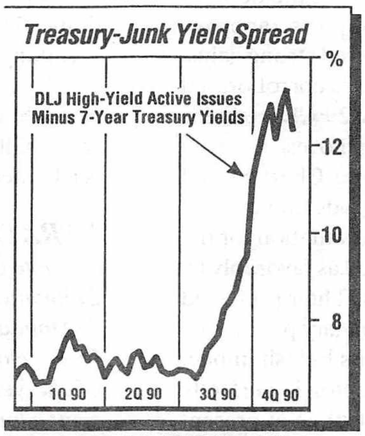
STRATEGY: *Past the rally induced by the decline in oil prices, watch out: The bottom is about to fall out. Remain short Value Line futures contracts.*

Chart 4
Corp. Illiquidity



Financing and Market Perspectives
Merrill Lynch & Co.

Chart 5
Credit Quality Spread



Barron's / Donaldson, Lufkin & Jenrette

Chart 6
Bank Write-offs

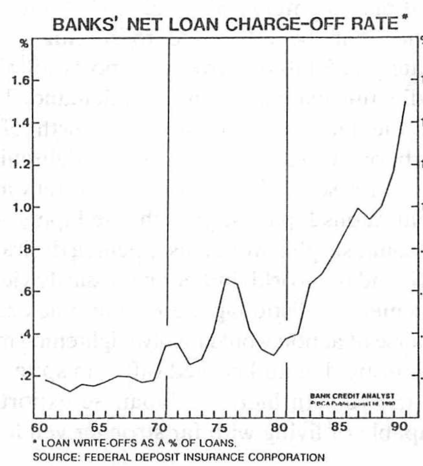


Chart 7 – Gaping Liquidity Crunch

RISING DEBT AND DECLINING LIQUIDITY: NOW VS. 1930s

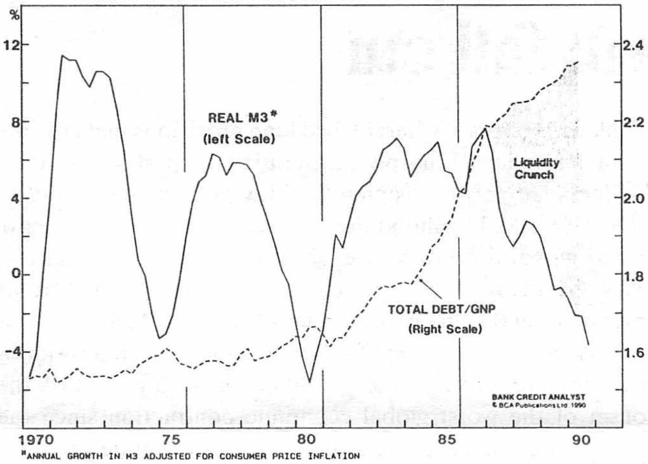
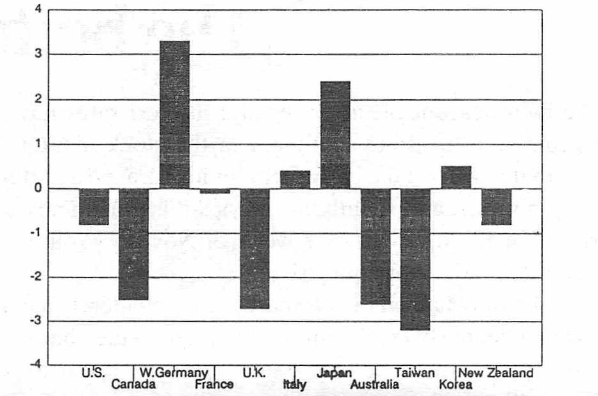


Chart 8 – A Synchronized Global Downturn?

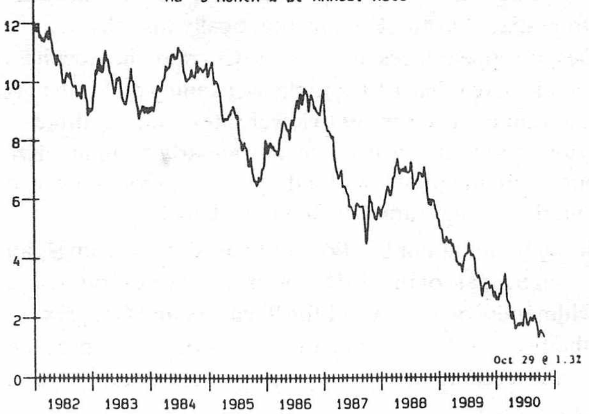
LATEST LEADING INDEXES, GROWTH RATES (%),11 COUNTRIES



CENTER FOR INTERNATIONAL BUSINESS CYCLE RESEARCH, COLUMBIA UNIVERSITY BUSINESS SCHOOL

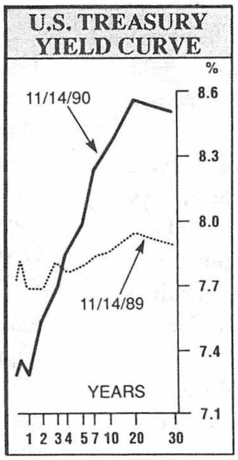
Chart 9
Appearances of Tightness

M3 9 Month % at Annual Rate



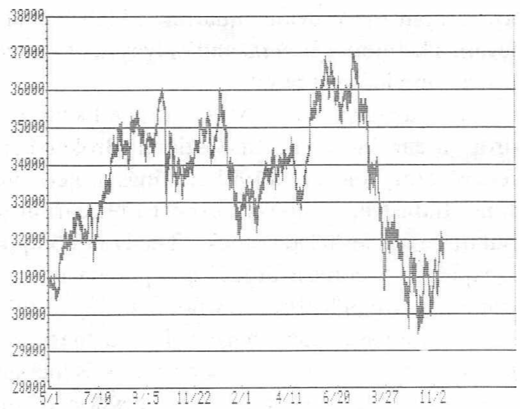
C.J. LAWRENCE.

Chart 10
Yield Curve



Barron's / Knight-Ridder Tradecenter.

Chart 11 – S&P 500



CURRENCIES

Japanese yen, Nikkei-Dow and bonds

The Japanese trade surplus continues to shrink. After seasonal adjustments, October's surplus fell to $2.53 billion, or half of September's $5.17 billion. While some of the deterioration can be attributed to surging oil imports (approximately $1.8 billion), overall imports still showed strong gains, indicating excessive domestic demand. This is corroborated by the fact that the rate of growth of M2+CD remains stubbornly high despite repeated tightening moves.

In a scenario of global contraction (see Chart 8) and continuous Japanese growth, the Japanese trade and current account surplus would disappear, a desirable situation for the US (and the world) but not necessarily viewed as favorably by the mercantilistic Japanese economic czars. Their preferred course of action would involve tightening monetary policy until domestic demand cooled off — in spite of its bullish impact in the yen. In fact, the Japanese export sector is perfectly capable of living with far stronger yen levels than at present (witness the surprisingly strong 10.7% increases in export volume for October despite a currency appreciation of 6.75%).

This argument, then, summarizes our view: Excessive domestic demand, fuelled by rapid monetary growth, in a shrinking global economy.

The resulting deterioration of the trade surplus, calls for a "cooling off" policy: high interest rates and a levelling off of the rapidly growing money supply. The upshot of these events is a higher yen and a lower stock and bond market.

STRATEGY: *1) Remain short Nikkei-Dow futures; our ultimate objective is a move below 15,000.*
2) Retain short positions in the yen bond traded on the LIFFE.
3) Maintain long positions in nearby yen futures; raise stops to 75.00, close only. In addition, watch closely for a penetration of the yen/DM cross: A move above 89 would cause us to switch long yen positions to long DM.

Chart 12 – Nikkei 225 Index Spot

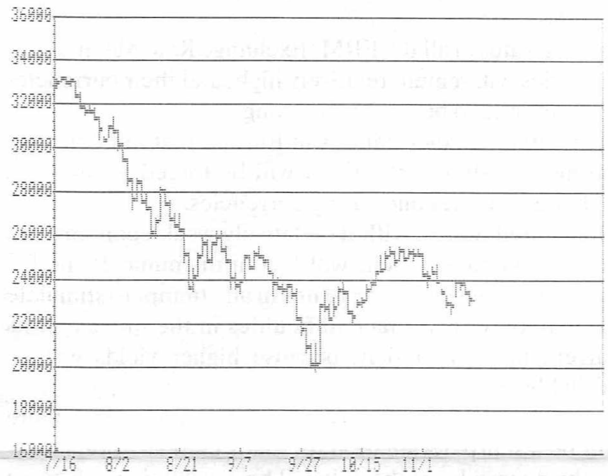


Chart 13 – CME Japanese Yen Dec '90

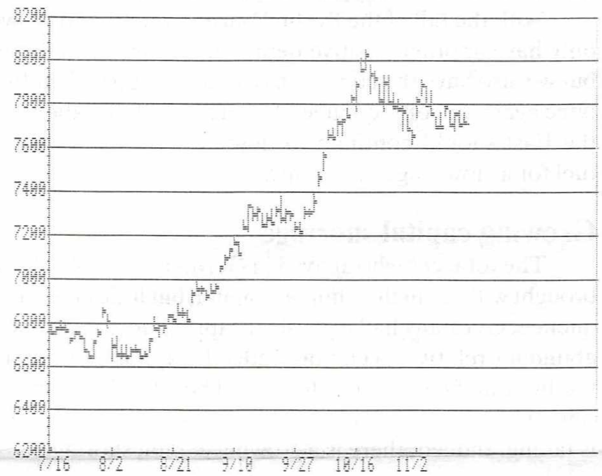
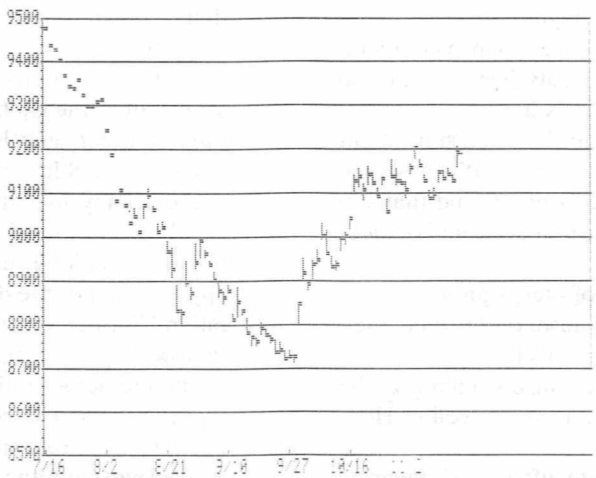


Chart 14 – LIF Japanese Bond Dec '90



CURRENCIES

On Germany's impending capital shortage

In 1990, Germany has witnessed a major demographic shock. With reunification, Germany's population increased by 18 million, or 29%. In addition, and beyond the view of most observers, another 1.5 million so-called "ethnic Germans" have poured in from the Soviet Union, Poland, Bulgaria, and other parts of Eastern Europe.

The 1990 demographic shock in Germany is similar to the one that occurred in 1945-48, when a surge of refugees from the East arrived in West Germany. The economic consequences of both demographic shocks are significant and often overlooked. For example, despite the losses inflicted during World War II, West Germany had an ample supply of human capital (labor). Indeed, the supply laid the demographic foundation for a sudden rise in that nation's post-War long-run potential. The demographic shock of 1990 will, of course, lay the same type of growth-promoting foundation.

A continuous flow

If the 1990 shock weren't enough, we anticipate a continuous flow of labor into the unified Germany. To appreciate this, we must recall that ever since the industrialization of the Rhine-Ruhr Valley, real wages have declined along a gradient from West to East. This real wage gradient results because the quantity and quality of capital per worker declines as we move from West to East. In addition, transport costs increase as we move East.

In consequence of the real wage gradient, there is a tendency for mobile human capital (the "cream" of the labor force) to migrate from East to West. Before World War II, this natural labor flow tended to make Germany a "low wage" country. Assisted by the demographic shock of 1945-48, this "low wage" advantage was particularly true in the early years of reconstruction. Of course, with the advent of the Cold War and the Iron Curtain, the East-to-West labor flow was artificially curtailed, and Germany gradually lost its "low wage" advantage.

With the fall of the Berlin Wall and reunification, we not only have another positive demographic shock in Germany, but we also have the conditions for the wage gradient to work once again. In consequence, the "cream" of the labor force in the East should continue to flow into Germany, providing fuel for a "low wage" economy.

Growing capital shortage

The refugees who arrived in Germany after World War II brought with them their human capital, but little else. In consequence, Germany had a physical capital shortage: Labor was abundant relative to capital. Indeed, capital, not labor, was the limiting factor of production. The situation is much the same today. In consequence, Germany's capital/labor ratio is falling. Indeed, there is a growing capital shortage.

Implications

1. The *natural* rate of interest (real rate) in Germany will shift upward and remain relatively high.
2. Real rates of interest will remain relatively high in Germany.
3. The foreign-exchange value of the deutschemark will continue to increase and remain relatively high.

   Some might question our bullish conclusion about the deutschemark. They argue that the relatively strong mark will reduce German competitiveness, and that surpluses on Germany's trade and current account balances will continue to shrink.

   In consequence, the supply of marks on foreign exchange markets will increase, because, on balance, Germans will need to make more payments for foreign goods and services than in the past. If nothing else changed, the mark's foreign exchange value would indeed decline. However, other things will change.

   With widening real interest rate differentials favoring Germany, the demand for marks will incrase, because foreigners will wish to purchase German assets. As was the case in the US during the early 1980s, the increase in the demand for marks, which is motivated by shifting interest rate differentials, will dominate the increase in the supply of marks, which is generated by a deteriorating German current account. Hence, the mark will continue to appreciate.
4. Interest rates in all the ERM (Exchange Rate Mechanism) countries will remain relatively high, and their currencies will continue to be relatively strong.
5. Many other smaller nations in Europe that are considering membership in the ERM will be forced to maintain high interest rates and strong currencies.
6. The United States, with its relatively weak economy and current account deficit, will face a dilemma: If the US continues to lower interest rates in an attempt to stimulate the economy, it will face difficulties in the finance of its current account deficit, because higher yields will be available overseas.

Under the condition of lower US interest rates, there will be a sharp devaluation (perhaps even an "overshoot" on the downside) of the dollar. The devaluation will cease when investors in dollar-denominated assets can secure an overall rate of return (interest plus appreciation of the dollar) equal to that which can be obtained in Germany and elsewhere.

In order to provide this expected appreciation, the sharp fall in the exchange rate must be sufficient to take the dollar *below* its long-run equilibrium value. Then all dollar asset holders can look forward to an appreciation of that currency *up to* its long-run equilibrium.

In short, the dollar's spot exchange rate must fall below its new long-run equilibrium path, so that the future appreciation of the dollar will compensate for the initial fall in US interest rates. Alternatively, if the Fed tempers its lowering of interest rates because of dollar worries, economic deterioration in the US will accelerate. Given that the White House favors the former and the Fed the latter interest rate (monetary) policy, we anticipate that the Fed will continue to split the difference. We can expect grudgingly lower interest rates and a steadily falling dollar.

STRATEGY: *Retain long positions in the deutschemark and other EMS currencies.*

– Dr. Steve H. Hanke

Chart 15 – CME Deutsche Mark Dec '90

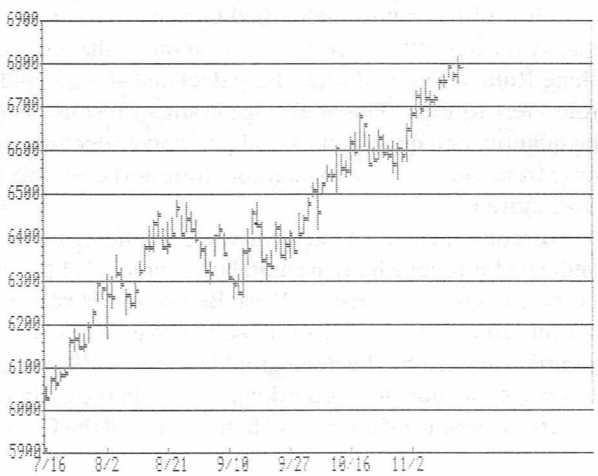


Chart 16 – DM/JY

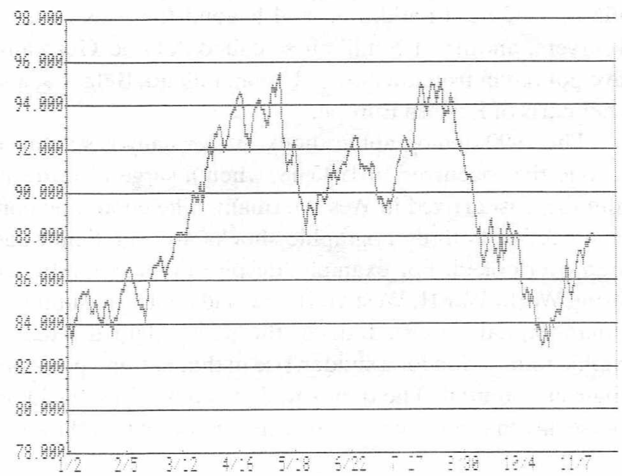
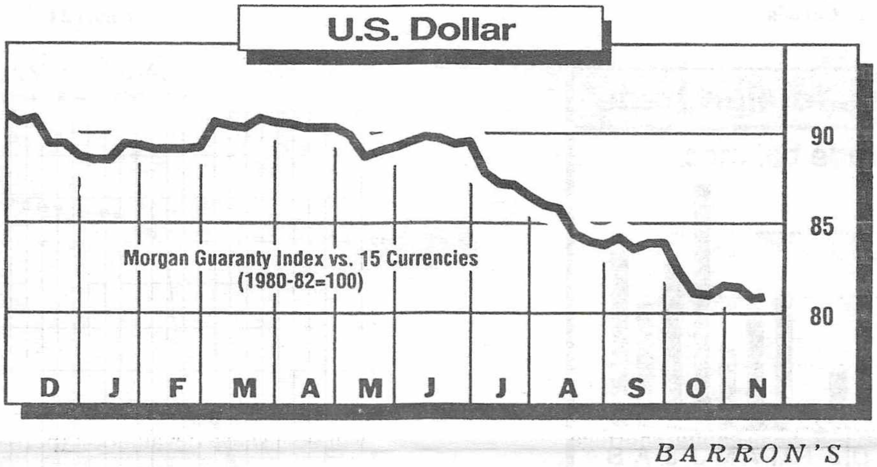


Chart 17 – US Dollar



CURRENCIES

Canadian dollar

Gathering economic weakness in Canada — with GDP expected to fall between 1.5% and 2% on an annualized basis for the fourth quarter of the year — is putting considerable political pressure on the Bank of Canada to accelerate its move towards ease.

Since early August, before the Kuwait invasion, short-term rates have fallen by over 100 basis points, bringing them to the lowest levels in 15 months. Long-term rates, however, have refused to back down over the same period, demonstrating a fair degree of resistance to further easing and a potential limit to what the Bank of Canada can do.

At the same time, the annualized rate of growth of M2 remains uncomfortably high at 9%, especially in view of a) recent average wage gains of 6.5% and b) the upcoming Goods and Services Tax (GST), a type of value added tax that is certain to add a few points to the CPI. On a year-over-year basis, however, M2 is likely to slow down sharply in coming months, giving the Bank *some* room to ease. That may not, however, be until well past the implementation of the GST.

Belying those who believe that the C$ is grossly overvalued, Canada recorded a dramatic increase in September's trade surplus. At $1.48 billion, it was more than double the August surplus of $679 million, while the third-quarter surplus, $3.2 billion, is substantially better than last year's third-quarter surplus of $1.3 billion.

Favorable interest rate differentials *vis à vis* the US are expected to continue propping up the C$ for some time yet.

STRATEGY: *We remain comfortably long, for now.*

Chart 18 – CME Can. Dollars Dec '90

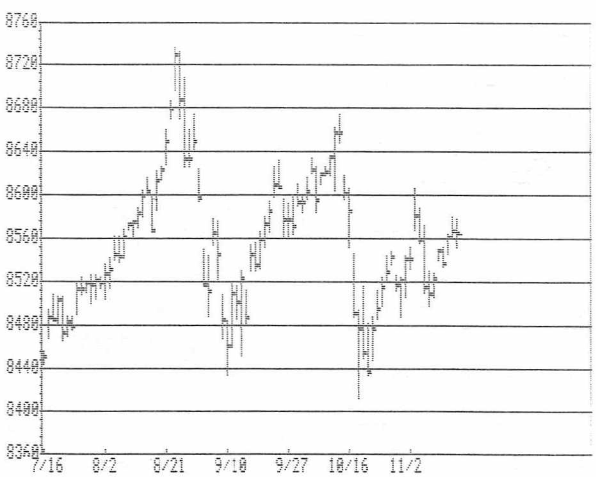


Chart 19 – Can $

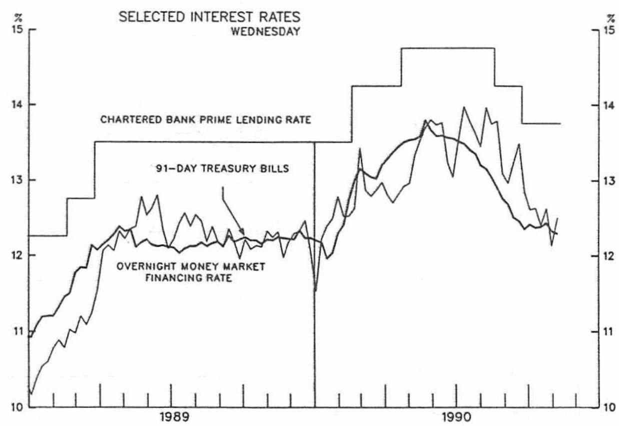
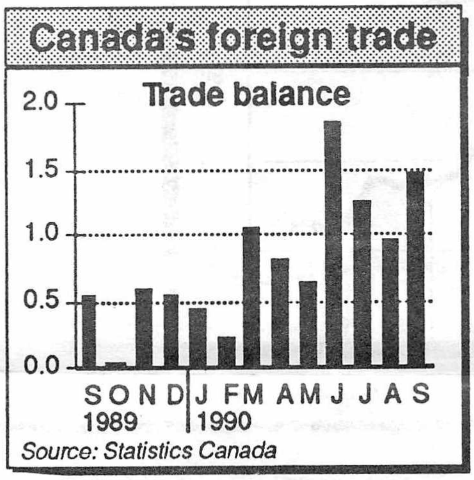
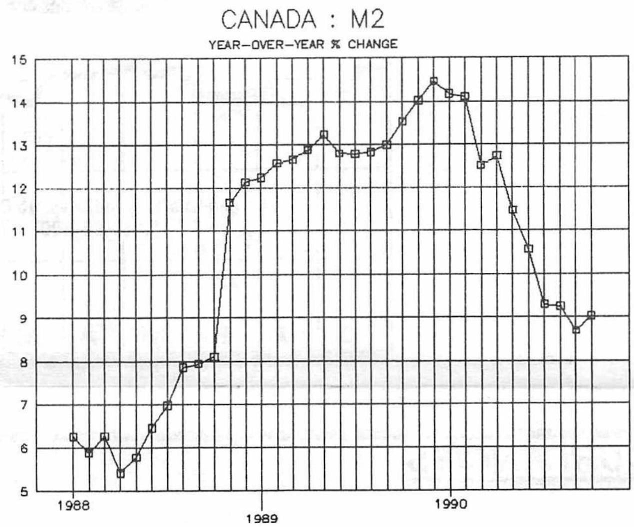


Chart 20
Canada



The Globe and Mail,

Chart 21



INTEREST RATE FUTURES

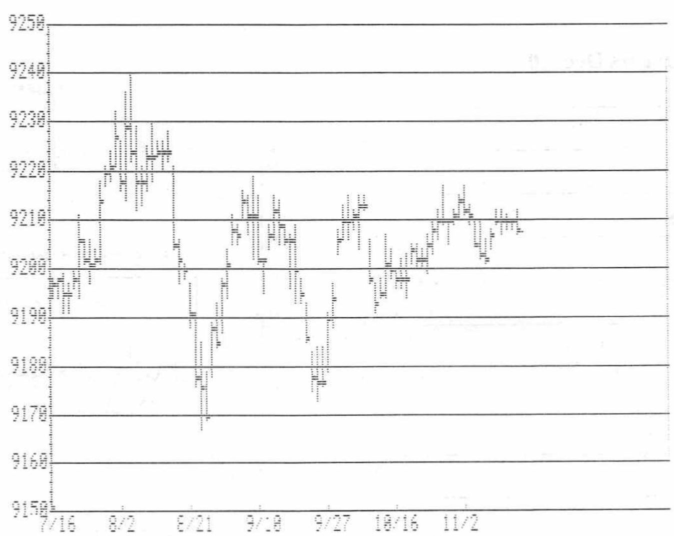
The Ted spread

The substantial decline in interest rates built into T-bill futures forced us to abandon the "T" side of the Ted spread.

We remain short Eurodollar contracts, on an outright basis, betting on 1) the inability of the Fed to effectively lower rates in the face of a dollar debacle, and 2) the anticipated jump in private, uninsured deposit rates due to "credit quality" concerns (an elegant way of saying that we expect a significant number of banks, participating in the Eurodollar market, to fail in the not-too-distant future.

STRATEGY: *Remain short December '90 Eurodollars; roll over to March '91 prior to expiration.*

Chart 22
3 Mth. Eurodollar Dec '90



FRIEDBERG CAPITAL MARKETS

Cooper Companies

Third-quarter results

At the end of August, Cooper Companies reported its fourth successive quarterly profit on sales of $11.5 million. As mentioned in previous issues, the Cooper Companies is continuing with its three-phase plan for reorganization.

Phase I, begun in May 1988, called for the retirement of excessive corporate debt through the divestiture of several business dispositions that ultimately raised nearly $900 million, most of which was used to retire that debt.

Phase II, which began in September 1988, called for the consolidation of the remaining operating businesses and reassignment of senior management. During the last seven quarters, the company successfully relocated its San Jose operations to Rochester where it added 100 new employees and a second shift.

Product offerings, including daily wear, extended wear, and flexible wear, were enhanced by the addition of three new products.

Phase III, calls for the company to use its cash and cash equivalents to acquire profitable businesses and commence rebuilding a health-care conglomerate of companies.

Cooper Cos. has a large tax-loss carryforward, which will best be employed by purchasing profitable entities and matching them in an effort to shelter profits.

A comforting feature for bondholders of Cooper Cos. is the extraordinary gain this quarter of $2.6 million, which is as a result of the company's *repurchasing* its own bonds in open market operations.

Alliant Computer

Third-quarter results

For the recently-released third quarter, Alliant Computer Systems Corp. took a nonrecurring charge of more than $20 million and reported a loss from operations of $6 million, or about $0.40 per share.

Revenues continue to be affected by the continuing product transition to the FX-2800 supercomputer in addition to an adverse business climate. The company is confident that the obstacles that have led to negative growth in two consecutive quarters is soon to be worked out.

However, Alliant has more than $23 million in cash or near-cash and about $39 million face value in outstanding bonds, which at market value translates into $6.7 million. Therefore, the company has ample cash to support its debt. Despite this, its convertible bond is currently trading at only 17.

Recommended bond portfolio allocation

DM fixed-rate bonds	35%
US dollar high-yield and convertible bonds	25%
British pound fixed-rate bonds	12.5%
Danish krone fixed-rate bonds	17.5%
Japanese yen bonds	10%

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Chart 23
Foreign Currency Bonds

Date: November 15, 1990
We offer the following Bonds subject to change without prior notice: Minimum amount US$5000 (Cdn.$7,000)

ISSUER/MTY.DATE/COUPON	BID		OFFER	CURRENT ANN. YIELD TO MTY	NEXT INTEREST PAYMENT DATE
CANADIAN DOLLAR DENOMINATED BONDS					
GOVERNMENT OF CANADA (semi annual) 05/12/90 10 1/4%	99.83	-			05-12/90
NEW ZEALAND DOLLAR DENOMINATED BONDS					
CAN.IMP.BANK OF COMMERCE 27/07/92 14% RRSP eligible	100	-	100 3/4	13.34%	27/07/91
AUSTRALIAN DOLLAR DENOMINATED BONDS					
General Electric 11/07/92 14 1/4% (semi)	102 3/4	-	103 3/8	12.25%	11/01/91
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	102 7/8	-	103 5/8	12.62%	01/07/91
WORLD BANK 15/03/93 12 3/4% RRSP eligible	101 1/4	-	102	11.64%	15/03/91
DANISH KRONE DENOMINATED BONDS					
KINGDOM OF DENMARK 9% 20/11/92	97 1/8	-	97 7/8	10.23%	20/11/91
STOCKHOLM 10/11/91 10 5/8%	100	-	100 3/4	9.75%	10/11/91
BRITISH POUND DENOMINATED BONDS					
KGDM of SWEDEN 14/4/93 9 3/8%	94 1/4	-	95	11.83%	14/04/91
FRENCH FRANC DENOMINATED BONDS					
EUROPEAN INV.BANK 8 3/4% 12/7/95	94 5/8	-	95 3/8	10.81%	12/07/91
DEUTSCHE MARK DENOMINATED BONDS					
QUEBEC HYDRO 5 1/2% 1/5/96 RRSP eligible	84 3/4	-	85 1/2	8.97%	01/05/91
PROVINCE OF QUEBEC 6% 1/4/97 RRSP eligible	84 3/4	-	85 1/2	9.08%	01/04/91
EUROPEAN INV. BANK 5 1/2% 9/8/93	92 3/4	-	93 1/2	8.25%	09/08/91
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	85	-	86	8.96%	07/05/91
WORLD BANK 5 7/8% 4/2/97 RRSP eligible	84 1/2	-	85 1/4	9.08%	04/02/91
SWISS FRANC DENOMINATED BONDS					
GOVT.OF AUSTRALIA 30/10/98 5%	85	-	87	7.21%	30/10/91
JAPANESE YEN DENOMINATED BONDS					
GOVT.OF CANADA 23/7/93 5 5/8% RRSP eligible	95	-	96.40	7.13%	23/07/91
U.S.DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS					
PACIFIC SCIENTIFIC 7 3/4% 15/06/03(semi) CV @$38 p/sh	70	-	71 1/2	12.63%	15/12/90
SUNRISE MEDICAL INC.7.25% 26/6/96 CV @$17 5/8 p/sh	97	-	101 1/2	6.91%	26/06/91
ALLIANT COMPUTER 7.25% 15/05/12(semi) CV @$39.75 p/sh	12 1/2	-	17	47.22%	15/11/90
COOPER CO'S. 10 5/8% 01/03/05(semi) CV @$27.45 p/sh call in 1995 @100	69 1/2	-	73	15.91%	01/03/91
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @$39.50 p/sh	23	-	28 1/2	21.15%	01/03/91
U.S.DOLLAR DENOMINATED FIXED RATE BONDS					
ALBERTA 7 3/8% 9/12/91 RRSP eligible	99	-	99 3/4	7.62%	09/12/90
SOUTHMARK 12% 10/8/97 (semi)	56	-	60	24.69%	10/02/91

U.S.DOLLAR DENOMINATED FLOATING RATE NOTES	Bid		Offer	Current Coupon	
UNITED KINGDOM 24/9/96 3 mo.LIBID-1/8 (qtly)	99.90	-	100.20	8 1/4%	28/09/90
REPUBLIC OF ITALY 30/4/93 3 mo Limean(qtly)	99.30	-	99.70	7 15/16%	31/01/91

Although we monitor these issues specifically, we also can fill any order in any foreign currency bond.

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

Chart 24
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 November 15, 1990.**

	U.S. $	NEW ZEALAND $	AUSTRALIAN $	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE	BRITISH POUND	FRENCH FRANC
2 year	7.58%	CIBC 14% 27/7/92, yields 13.34% (.550 AZ/US)	General Electric 14¼% 11/7/92, yields 12.25% (.709 A$/US)				Denmark 9% 20/11/92, yields 10.23% (5.965 US/Dkr.)		
3 year	7.70%					Canada 5⅝% 23/7/93, yields 7.13% (127.3 US/JY)		Sweden 9⅜% 14/4/93, yields 11.83% (1.749 US/DM)	
5 year	7.98%								Euro. Inv. Bnk. 8¾% 12/7/95, yields 10.81% (5.679 US/FFr)
6 year	8.11%			Prov. Quebec 6% 1/4/97, yields 9.08% 1.405 US/DM					
8 year	8.29%				Australia 5% 30/10/98, yields 7.21% (1.156 US/SF)				
Spot Exchange Rate	N/A	.6112	.772	1.478	1.2525	129.43	5.682	1.9585	4.9905

*For example, since a US$-based investor would receive 576 basis points (1334-758) by holding the CIBC NZ$ bond, the NZ$ can depreciate to .550 NZ/US from the present spot exchange rate of .612 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.

THE EXOTICS

Saudi Arabian riyal

Saudi Arabia's cultural mores have remarkably strong influence, so it appears, on financial reporting. Since the budget statement of early January 1990, there has been practically no statistical information forthcoming.

The last entry in the IFS shows that quasi-money was growing at an 8.8% annualized rate in the year to May 1990, while CPI was barely unchanged in the year to July 1990. It is noteworthy that inflation has been negative since 1981, when an IFS index stood at 105.8, while the latest reading for July 1990 is 97.3. The upshot is that the Saudi riyal has depreciated in real terms *vis à vis* the US dollar and *vis à vis* a trade-weighted basket, without necessitating a formal nominal devaluation.

The January 1990 budget indicated an increase in spending of 1.4% to SAR143 billion, while revenue has expected to rise 1.7% to SAR118 billion, leaving a budget deficit of SAR25 billion to be covered by issuing domestic bonds. These figures have become totally obsolete ever since August 2, as oil production and exports have risen by more than 60% from the budgeted levels, while prices have soared as much as 170%. On the other hand, military spending is thought to have risen dramatically, both in terms of operations and in terms of expenditures for new weapons.

Be that as it may, the existing devaluation story that we advanced in past years — based on falling real revenues and the inability to lower expenditures any further over the past five years — will have to be postponed for a much later date. Fortunately, the bear speculation has *averaged* a nil cost, as the forward rates straddled spot rates by minor variations.

STRATEGY: *Allow short positions to run off as they come due.*

Chart 26 – Rates

Spot	1 Month	3 Month	6 Month	12 Month
3.7495 - 3.7500	3.7475 - 3.7495	3.7470- 3.7495	3.7465- 3.7495	3.7465- 3.7495

FOREX RATES & UPDATE

Currency	*Spot*	*3-Month*	*12-Month*	*Comments vis à vis US$*	*Comments vis à vis DM (Spot DM: 1.4700)*
Australian dollar	.7700-.7710	.7620-.7635	.7400-.7430	Remain long	Neutral
Belgian franc	30.45-30.50	30.51-30.60	30.84-31.02	Remain long	Neutral
Danish krone	5.6540-5.6590	5.6855-5.6965	5.7890-5.8140	Remain long	Neutral
Dutch guilder	1.6603-1.6613	1.6638-1.6652	1.6788-1.6818	Remain long	Neutral
Greek drachma	152.15-152.45	155.65-161.45	162.15-182.45	Neutral	Neutral
Hong Kong dollar	7.7925-7.7935	7.7905-7.7930	7.7975-7.8075	Neutral	Neutral
Irish punt	1.8220-1.8235	1.8095-1.8130	1.7720-1.7800	Remain long	Neutral
Italian lira	1110-1111	1121-1123	1149-1153	Remain long	Neutral
Malaysian ringgit	2.6947-2.6957	2.7012-2.7092	2.7147-2.7457	Neutral	Neutral
New Zealand dollar	.6097-.7707	.6011-.6625	.5767-.5797	Neutral	Neutral
Norwegian krone	5.7550-5.7600	5.7995-5.8095	5.9300-5.9505	Remain long	Neutral
Portugese escudo	130.30-130.50	132.50-134.20	138.30-144.00	Neutral	Neutral
Singapore dollar	1.7100-1.7110	1.7080-1.7100	1.7020-1.7110	Neutral	Neutral
Spanish peseta	93.90-94.00	95.40-95.58	99.50-99.80	Remain long	Neutral
Swedish krona	5.5250-5.5300	5.6170-6.6295	5.8700-5.9000	Neutral	Remain Short

Explanatory Notes

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, October 23:
No changes or new recommendations. One note: As of Oct. 29, there will be a new hotline number as indicated to subscribers in the October letter.

Flash update, Friday, October 26:
Liquidate long S&P positions. This will leave you outright short Value Line once again. One note: As of Oct. 29, there will be a new hotline number as indicated to subscribers in the October letter.

Flash update, Wednesday, October 31, 11:00 a.m.:
Liquidate the long December T-bill side of the Ted spread, remaining short December Eurodollars. Place stops at 9245, close only, basis December.

Friday, November 2:
Repeat of flash as above.

Tuesday, November 5:
No changes or new recommendations.

Flash update, Friday, November 8, 8:30 a.m.:
Buy March silver at market, risking 420.00, close only.

Friday, November 8:
One change as per our flash of this morning: Buy March silver at market, risking 420.00, close only.

Tuesday, November 13:
No changes or new recommendations.

Flash update, Thursday, November 15, 12:30 p.m.:
Liquidate long silver positions at market and stand aside.

Friday, November 16:
One change this week as per our flash yesterday at 12:30 p.m.: Liquidate long silver positions at market and stand aside.

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