FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc. Volume 12, No. 1 January 20, 1991

Back to the futures: 1990 in review

Look around. As the entire world is theatened by the war in the Persian Gulf, listen to the endless batteries of negative economic projections, feel the ultra high frequency paranoia from recession/depression blues, and taste the bitter fruits of easy money.

If this is any indication of what lies ahead, then we would just as soon pause, slowly turn 180 degrees, and count and recount our past trading year. Yes, it's that time again when we employ hindsight evaluating our foresight. Of course, the technical term in doing just this is "back to the futures."

Soft-core cornography

In April we distributed a long corn position, which we sold in May at a substantial profit. This cornography classic for some strange reason got right by the censor's scissors.

Don't bother with the sequels

We traded the yellow metal (that's gold) a total of four times in 1990. The original trade netted us a handsome profit at the box office. However, the sequels were dull, plotless, and generally not worth the price of admission. The obvious moral of the story? Well, let's face it. There is no obvious moral.

Don't try this at home, kids

There are those trades where the profit potential is humungous, but then again the risks are equally as great. Dabbling in this class of trade is definitely not for anyone with nerves softer than a titanium alloy mix. Before discussing our performance in the Nikkei or Japanese yen bond futures contracts, there are three unwritten rules of gaming that should never be breached:

1. Never play poker with anyone whose first name is an American City.

2. Never bet on Caucasian heavyweights.

3. Always follow the directions on the dynamite box.

In keeping with these principles, we proceeded to recommend, with appropriate red flags ("size of contract is 100,000,000 — million — yen, i.e., 7½ times the US T-bond contract. Use extreme caution in entering this market."), a short position in yen bonds, which trade on the LIFFE and the Nikkei, which traded at the time on the SIMEX. The cost per tick in either contract has no equivalent in Chicago or New York, and we entered these markets with very major fundamental supports as well as minor trepidation. To make a (short) long story short, we were to be stopped out twice in the bonds and made a lion's-share profit in the stock market.

(Editor's notes: Aspirin has no effect on titanium.)

Non-recurring short run

We committed ourselves to the long side of the silver market in early November, hoping for a late hit. We ended up taking one just five days later.

Constantly recurring short run

We launched a pilot in sugar futures in February, only to be cancelled in March. The three sequels were met with an equal lack of success. Maybe the moral is to avoid sequels.

An unlikely interest rate play

Einstein to Respondent 1: What's your I.Q.?
Respondent 1: 160

In this issue

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

Einstein: We shall discuss the quantum theory, and the relationship between microphysics and astrophysics.
Einstein to Respondent 2: What's your I.Q.?
Respondent 2: 98.
Einstein: We shall speak of news, weather, and sports.
Einstein to Respondent 3: What's your I.Q.?
Respondent 3: 15.
Einstein: Which way are interest rates headed?

If the truth be known, we profited in September with our T-bond puts, but that's where it ended. Our TED-spread fell apart...literally, as we liquidated the "T" component. We also purchased Eurodollar puts, which at this time look rather doubtful.

Alive and well tribute

Considering the heightened and extreme volatility in the oil markets during 1990 (due to Saddam's turning off Kuwait), we ended up alive, well, and even making some good profits. In March we purchased crude puts, which were held over till May, netting us hefty profits.

In June we had one of the best recommendations of the year, when we were "High on Crack," (see: "Narcotics-related profits" below). The Latin for what happened to us, when Saddam entered Kuwait, is "winning streakus interruptus." As it happened, the puts we purchased in June were, although not widely reported, the first casualties of the Iraqi offensive (or offensive Iraqis, if you prefer).

Our September headline read "Selling on the news," so we were forced to put on a bull spread(?), betting on an Iraqi offensive. This well-meaning trade was liquidated seven days later. We shorted the crude again in September and covered at a loss in October. You can still hear the Iraqi military trainees chanting as they march: "Saddam Hussein is rude to your winning streak in crude...two, three, four.

Best advice of 1990

Cover short positions (in crude) at market and wait to reinstate once military conflict commences — September 1990.

Best advice that was ignored in 1990

Cover short positions (in crude) at market and wait to reinstate once military conflict commences — September 1990.

Narcotic related profits

Submitted for recreational pleasure in June, the crack spread, which involved the sale of crude against the purchase of the future products. This one trade moved like a runaway rocket with a heaven-bound trajectory. When the trade was totally unwound in September, we netted better-than-expected profits per spread. Of course, we were arrested, and can be reached at the Betty Ford clinic in Maryland.

Friedberg's Believe It or Not

We devoted five cover stories of the possible 10 with flawless arguments that had ramifications for stock prices. This was not quite the case. In reality we were short all year the Kansas City Value Line, and when we became short-term bullish, we hedged our position by purchasing S&P futures. In total the Value Line short netted us an outstanding profit. Our two hedges also were profitable, first in March for a small profit, and then in October for a rather large one. After a successful year of trading the stock market, we want to amend a previously recorded conclusion that we made in haste and state categorically for the record that 2+2 is equal to...4.

Best performer (second year running)

Undeniably our best performance of 1990 came from trading currencies. When the year began, we were already in long Swiss (or DM)/short JY, as well as long the Italian lira/short DM. Our long Swiss/short yen was among the most profitable trades in our recent memory. Aside from our intermittent recommendations to add on dips, this trade from beginning to end made an enormous return on margin, and our timing was stellar, liquidating within 1/2% of the high in August.

We went on from here to have a string of hits, that started in January and have not run out of steam yet. We took profits in the SF/DM, Greek/DM (SF), Italian/DM, DM, SF, BP, A$, and even the Canadian dollar...twice. Of course, we had some sour trades here too, but they were, under the circumstances, very easy to live with. In conclusion, it was in this area that made the whole of 1990 a solidly good year!

Best one liner at a chart meeting

"All I have ever asked my traders is that they obey my word as they would the will of G-d." (August 27, 1990. Name withheld by request.)

Reprise

In the business of forecasting prices, your words come back like a boomerang, whether you are absolutely correct or whether you are left sitting in a dark room wondering about the presumed "efficiency of markets." When you add to this an industry where, by the virtue or vice of margining, better-than-average timing is essential, you are left in a pressure cooker with a broken valve almost daily. In alternative language, this is to say that the co-efficient of speculators'/traders' emotions is an incredibly large number.

We employ the commonly-known tools, namely fundamentals, technicals, logic, nerves, moxy, etc., and we position ourselves in the market. Some days the market rewards us, reinforces and strengthens us. Other days we watch with a hurt silence as the best laid plans of mice and men go awry.

Let's hope to be as successful in 1991 as we were in 1990.

STOCK INDEXES

Stay short, but cautious

There is little one can add to the economic analysis we made in our last issue. Fundamentals remain bearish despite the recent sharp fall in oil prices, an event we already anticipated last November (see "The end of the third oil shock" and also our strategy section in the "Stock Indexes" column, which concluded "past the rally induced by the decline in oil prices, watch out: The bottom is about to fall out.").

While the banking system may have begun its long-awaited reliquification process (although, note that loans are still growing!), the recession gives no sign of abating. Our latest supply side spreads remain at a very negative -1.7 (see Chart 1), and both the Long Leading Index and the Short Leading Index compiled by the Columbia Business School's Center for International Business Cycle Research (CIBCR) are still in a downtrend. The US economy has as yet not undergone a significant "liquidation" of idle resources, and until it does, it is unlikely the economy will recover.

From a purely technical vantage, an interesting development has taken place. As the S&P 500 fell from 334 to around 312, the number of stocks making new 12-month lows refused to expand beyond 69 issues, a minuscule total when compared to the 700+ issues making yearly lows in the drop to the August/September lows.

Clearly, there has been a serious loss of downside momentum in the broad list. This phenomenon encouraged us to advise covering Value Line contracts, replacing them with S&P 500 contracts as well as entering into outright spread positions.

There is a remarkable historical parallel to the present technical condition: During the 1981-1982 bear market, the maximum number of lows was recorded in September 1981, with the Dow Jones at 807. Six months later, the Dow was to fall to new lows but the list of stocks making new yearly lows fell far short of the September 1981 totals. This non-confirmation was repeated again in June 1982 (Dow Jones at 784), and in the final bear market lows recorded on August 1982 (Dow Jones at 769), each time with a shrinkage of new yearly lows. Significantly, only the rally coming after the final bear market lows saw a dramatic expansion of *highs*. All previous rallies saw a shrinkage of new lows but no new expansion of new highs.

We are willing to draw two conclusions from the above parallels: 1) Bear markets are like gigantic ships — they take time to turn, although the movement and direction are noticeable (so don't rush to pronounce the end of this bear market); and 2) to gauge the extent and potence of this rally, we should pay attention to the number of stocks making new highs. If they don't expand well beyond 80 issues (on a 10-day moving average basis), the rally is suspect.

In conclusion, the recession is taking its course, and it may last a great deal longer than imagined. Monetary conditions are changing for the better, but the banks have as yet to reliquify in earnest. Stocks are still a better deal than bonds (see Chart 2, Switch Model table) for the first quarter of 1991. The model says little beyond March 31. The technicals are saying that the big ship has begun to turn around, but they say little about the magnitude of the coming S&P 500 decline.

STRATEGY: *Stay short S&P 500. Place stops at 340.50, basis cash index, close only. Should the list of new 52-week highs expand beyond 80 on a 10-day moving average basis, cover immediately.*

Chart 1
Supply-side Spreads

PERIOD	SPREADS
89 1	- 0.5
89 2	+0.5
89 3	- 0.7
89 4	- 2.1
90 1	- 1.3
90 2	- 1.7
90 3	- 1.7

For more information, see Dr. S.H. Hanke's "Supply-side spread equations," *FC&CC,* Feb. 25, 1990.

Chart 2
Switch Model

PERIOD	SWITCH VALUE	STOCKS OR BONDS IN NEXT PERIOD
89 1	+2.0	S
89 2	+2.77	S
89 3	+2.74	S
89 4	- 0.63	B
90 1	+0.47	S
90 2	+3.75	S
90 3	- 0.33	B
90 4	+2.98	S

For more information, see Dr. S.H. Hanke's "Stocks vs. Bonds," *FC&CC,* Sept. 16, 1990.

T-BONDS

On Wicksellian price relationships

Over the past two years, we have explained how the work of the Swedish economist, Professor Knut Wicksell, influences various Federal Reserve officials (see *FC&CC* March 1989, October 1989, and May 1990, for example). In consequence of Wicksell's influence, the Fed has tended to pay much less attention to the money supply and more attention to market prices (commodity prices, the yield curve, and the dollar's exchange rate) in setting monetary policy.

Since we began our analysis, which has proven correct, we have engaged in extensive correspondence with monetary scholars who have exchanged research with us. Perhaps the most interesting has been our old friend Dr. David Ranson, President of Wainwright and Co. Economics, Inc. Our correspondence and discussions have focused on the following question: Can Wicksellian price relationships be used as reliable trading guides? Our point of departure has been Professor Wicksell's 1898 paper, "The Influence of the Rate of Interest on Commodity Prices." We now address the results of our correspondence and discussions.

For purposes of this discussion, our trading target will be the bond market. To begin our analysis of the bond market, we must shoot down a widely-held belief among bond traders: that there is a clear inverse relationship between real economic growth and total returns on long-term treasuries.

If we divide the past 31 years into the 17 years when real growth exceeded 3% (the average for the period) and 14 years when real growth was less than 3% — we find that there is no significant relationship between economic growth and total returns on long-term treasuries. More specifically, during the 17 years of high growth, treasuries underperformed cash (one-month bills) in eight years, and they outperformed cash in nine years. During the 14 years of slow growth, treasuries underperformed cash in eight years, and they outperformed cash in six years.

The conclusion is obvious: Bond traders can throw away their forecasts of economic growth. Even if these forecasts were perfectly accurate, they don't contain information that is of use in predicting the performance of long bonds relative to cash.

So, what should be the bond boys' (and girls') lodestar? Inflation, measured by the producer price index (all commodities) is the answer. If we look at the last 35 years and identify the 12 highest inflation years and the 12 lowest inflation years, we find that the total return on long-term treasuries underperformed cash (measured by average returns) by 3.5% during the highest inflation years; whereas long-term treasuries outperformed cash by 5% during the lowest inflation years.

The conclusion is obvious: If bond traders can forecast inflation, they will be able to successfully discriminate between bull and bear bond markets.

So how can we successfully forecast changes in inflation? The most reliable, and indeed quite satisfactory, predictor of inflation is the gold market. By using gold prices, we can estimate changes in the producer price index. Chart 3 compares that estimate with the actual change in the producer price index.

Now we have the Wicksellian price relationships that can be used in bond trading: Changes in gold prices predict inflation and changes in inflation accompany changes in bond prices. In consequence, changes in gold prices should predict changes in bond prices. Chart 4 shows that this is indeed the case. With the exception of three years (out of 22), every year that the price of gold changed, the price movement in long-term treasuries changed in the opposite direction one year later. By using this price relationship, we predict that 1991 will be a bull market in bonds because the price of gold declined -2.5% in 1990.

Changes in commodity prices (gold) are only part of the Wicksellian analysis. Another leg of the stool is the yield curve. That price data should also give us information about the bond market.

Since the end of the gold standard, the yield on long-term treasuries has exceed that on three-month bills by 140 basis points on average. Hence, the yield curve has had, on average, a positive slope. The interesting aspect about the slope of the curve is the fact that when the slope deviates from the average, it tends to regress back towards the average. Moreover, most of the "correction" back towards the average slope (+140 basis points) takes place on the long end of the yield curve, with long-term bond yields doing most of the "corrective" work. Chart 5 illustrates that tendency.

When the yield curve has a positive slope that exceeds 140 basis points, we can anticipate a bull market in bonds. Alternatively, a positive yield curve that is less than 140 basis points (or a negative curve) points towards a bear market in bonds. As of Jan. 11, 1991, the yield curve was positive at +196 basis points. Hence, the yield curve (as well as gold) points towards a bull market in bonds. (Note that in 1990, the gold and the yield curve signals were in conflict. Gold signaled a bull market, and the yield curve signaled a bear. The yield curve indicator won the battle of signals — see Chart 4.)

The last leg on the Wicksellian stool is the dollar. A weak (strong) foreign-exchange value of the dollar usually indicates a loose (tight) monetary policy, more (less) inflation, and a bear (bull) market in bonds. However, at times, these relationships can play tricks on the casual observer, because the foreign-exchange value of the dollar is given in relative terms of other fiat monies, not in absolute terms of goods and services. At present, we are in one of those tricky periods.

The dollar's purchasing power is weak relative to other fiat monies. But the dollar's purchasing power is not weak in absolute terms. For example, the price of "all items" (food and industrial commodities) contained in *The Economist's* commodity price index has fallen by 4.4% in dollar terms over the past year. Hence, the dollar's purchasing power of these tradeables has actually increased, and the dollar has become stronger in absolute terms over the past year.

The dollar's weak foreign exchange value is not caused by its absolute purchasing power weakness. Rather, it is caused because the other fiat monies' absolute purchasing power is super strong. For example, *The Economist's* commodity price index for "all items" in SDR terms has fallen -20.2% over the past year. The dollar is strong, but the other fiat monies are even stronger. Even though the dollar's foreign-exchange value is weak, it does not point to increased inflation and a bear market in bonds.

STRATEGY: *Purchase March T-bonds on pullbacks. Specifically, value vultures, who want to sleep well, should purchase in the 92.5 to 93 range.*

– Dr. Steve H. Hanke

Chart 3
Actual Producer Price Changes and Gold-Equation Estimates of Producer Price Changes

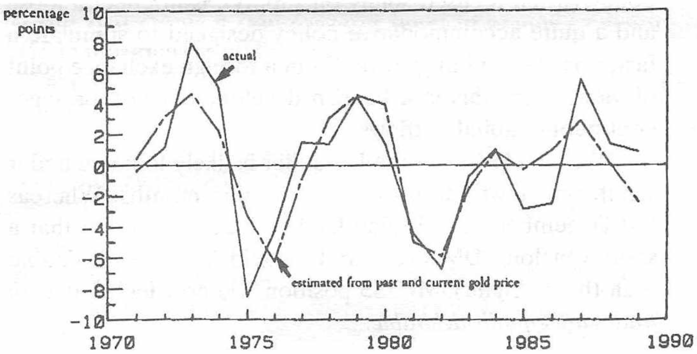


Chart 5
Regression of the Yield Curve to the Average

	Following Year's Change in			
Average For	**Slope of Yield Curve**	**Yield on T-Bills**	**Yield on T-Bonds**	**Slope of Yield Curve**
7 years of greatest slope	244	-3	-28	-25
7 years of least slope	-76	5	79	74

Notes: 1. All numbers in basis points
2. Yield curve = yield on long-term treasuries minus yield on 3-month bills.

Chart 4
Gold and Bonds
Since the end of the Gold Standard

Calendar year	Change in average price of long-term Treasuries	Previous year change in average price of gold
1969	- 10%	10%
1970	- 6	7
1971	9	- 16
1972	3	10
1973	5	41
1974	- 5	70
1975	- 3	64
1976	4	1
1977	2	- 22
1978	8	18
1979	- 8	31
1980	- 17	59
1981	- 17	98
1982	7	- 24
1983	13	- 18
1984	11	12
1985	16	- 15
1986	30	- 12
1987	- 6	16
1988	- 4	21
1989	+ 5	- 3
1990	- 2	- 13

Source of bond price data: Standard & Poor's, with adjustment for discontinuity at the end of 1974. Note: Until 1968, the market price of gold was pegged at $35/oz. by the U.S. government.

CURRENCIES

DM/US$: Long term fundamentals begin to reassert themselves

Safe haven demand for US dollars had only a short, albeit dramatic, impact on the US currency. It all began with the resignation of Soviet Foreign Minister Eduard Schevardnaze and the geopolitical (bearish) implications, particularly for West Germany.

Cooler heads prevailed, and the dollar fell back to the pre-resignation levels. But once again, the imminent Persian conflict highlighted the desirability of owning US dollars. And once again, the dollar rallied to the late December lows. In all, the dollar gained approximately 6% against the deutschemark (see Chart 6) in each of the two rallying attempts and slightly more versus the Japanese yen (see Chart 7).

"Political" fundamentals had reinforced, temporarily, the prevalent view that the dollar had been viewed as "cheap." Indeed, widely circulated calculations of purchasing power parities (see Kenichi Ohno, "Estimating Yen/dollar and March/dollar Purchasing Power Parities," IMF Staff Papers, Vol. 37, No. 3, September 1990) came up with a DM/US$ equilibrium PPP level close to 2.00. Using, on the other hand, the OECD benchmark approach, one would arrive at an even higher dollar level, namely 2.20. In addition, anecdotal evidence supported the notion that Western Europe was expensive *vis à vis* the US.

Except for the shortest of trends, measured in minutes, hours, and maybe days, or the longest of trends, measured in years, neither "political" fundamentals (the so called safe-haven demand factor) nor PPPs can be relied upon to profit from foreign exchange fluctuations. What is relevant, instead, is being able to anticipate persistent capital flows. These capital flows will respond, among other things, to a) relative GNP growth differentials and/or b) real interest rates differentials, and/or c) monetary accommodation. (In our November '90 issue we discussed Germany's impending capital shortage resulting from the absorption of East Germany and the consequent fall in the capital/labor ratio.)

In each one of these areas, the EMS currencies, and more particularly the DM, enjoy a clear advantage over the US unit, drawing the inescapable conclusion that capital flows will continue to move away from dollars and into the DM bloc.

Chart 8 shows a satisfactory relationship between relative rates of growth and the DM/US$ exchange rate. As pointed out earlier, being able to forecast differential rates of growth should prove helpful in anticipating capital flows. Chart 9 indicates that West Germany's economic growth will continue to exceed US growth for the foreseeable future.

On the interest rate front, DM yields have widened their differentials *vis à vis* Eurodollar rates. They now range from 200 basis points for three months to 216 basis points for 12 months, 162 basis points for two years and 62 basis points for 10 years. Since the inflation rate in West Germany is running 2½ percentage points lower than in the US, real interest rate differentials are even wider than those suggested by the nominal figures. These differentials should prove extremely supportive for capital movements into DM in the months ahead.

Finally, there is the matter of monetary accommodation. In the US, the yield curve has steepened considerably in recent months. Thirty-year government bonds are now trading 160 basis points higher than three-month Treasury bills, indicating an excessive degree of ease on the part of the Fed.

What's more, Fed funds in recent weeks have tended to fall well below the 7¼% target rate, denoting a worrisome surplus of bank reserves and perhaps a still-excessive pace of money supply *despite the extremely low rates of growth of M1* (0.8% at an annual rate over the past two months) and M2 (-0.8% at an annual rate over the same period).

What appears on the surface to be a tight monetary policy (when focused solely on supply), is in effect a loose and a quite accommodative policy designed to stimulate a faster pace of credit growth. From a foreign exchange point of view, then, this is a bearish development and presages continuous capital outflows.

We conclude that the US dollar is likely to come under significant downside pressure in coming months. Whereas last December (see Hotline Update Dec. 19) we felt that a short yen/long DM cross trade would be more profitable than the outright DM/US$ position, we now feel that *both trades are equally desirable.*

STRATEGY: *Maintain long DM/short yen cross trade (see also our discussion of the yen in the September '90 issue). Institute new long positions in outright DM; place initial stops at 64.00, close only, basis March '91.*

Chart 6
CME Deutsche Mark Mar '91

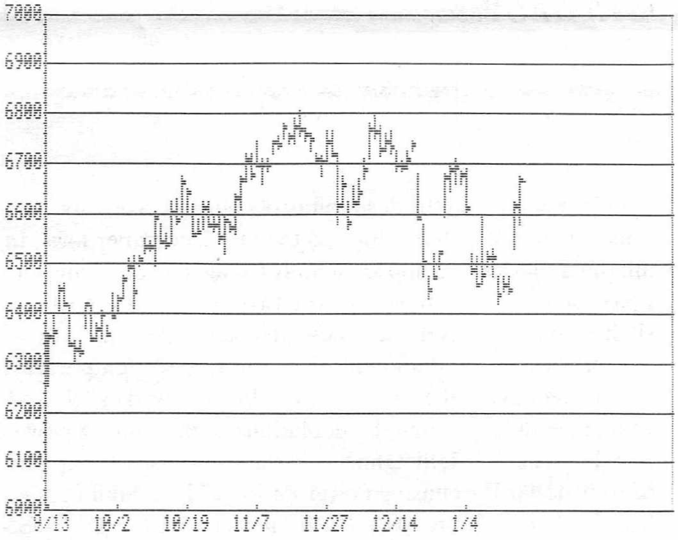


Chart 7
CME Japanese Yen Mar '91

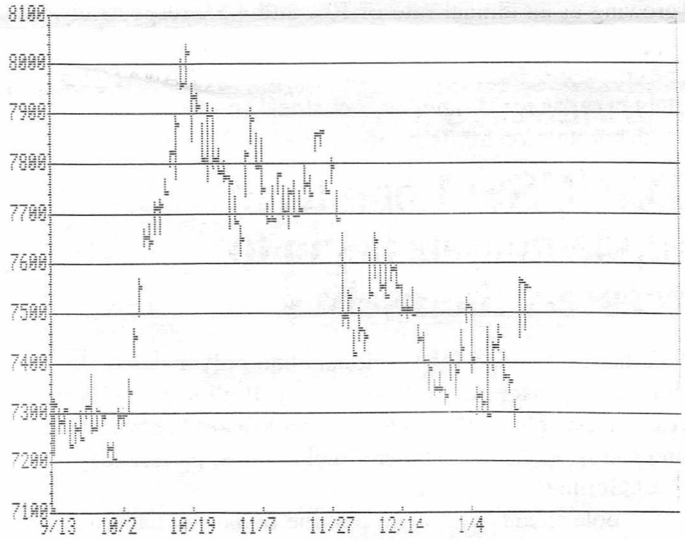


Chart 8

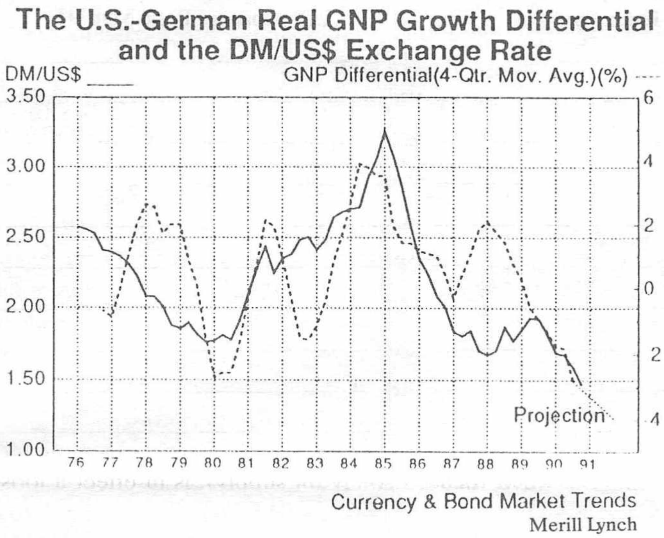
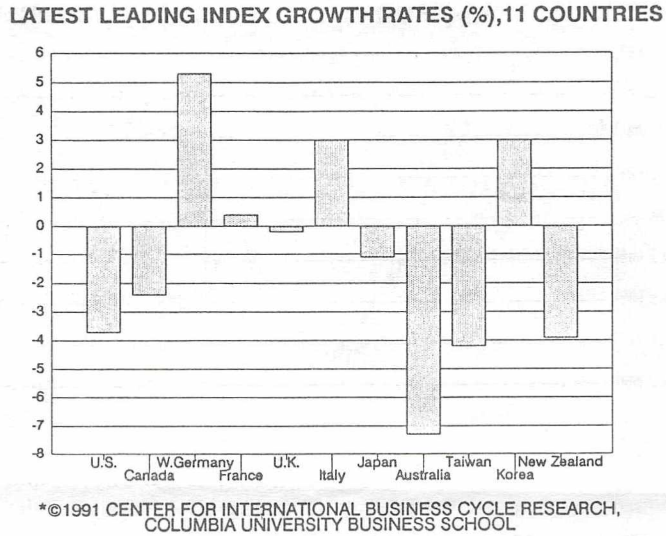


Chart 9



Yen, Japanese bonds, Nikkei index

Japan's underlying rate of inflation continues to climb to multi-year highs. National CPI in November '90 was up 4.2% year-over-year, the largest rise since a 4.3% rise in December 1981. Excluding perishables, the year-over-year rise was a still-too-high 3.2%. In another sign of accelerating inflation, tight labor markets are forcing wages higher, with awards averaging 5% in the year to November 1990 (see Chart 10).

Finally, the current account balance continues to narrow. Were it not for the collapse of oil prices in recent days, the C/A balance might have shrunk to barely a surplus for the first half of 1991.

Clearly, the Bank of Japan (BOJ) has not as yet been able to rein in domestic demand. Monetary "restraint" remains timid, at best, with the result that M2+CD and M1 are growing at an annual rate of 10% and 4.5% respectively. It appears that the BOJ has been intimidated by the rising pace of corporate bankruptcies: Just Thursday, NANATOMI, a Japanese resort developer and stock speculator, filed for court protection for debts of about $2.19 billion.

There is no painless or "orderly" way to prick the asset bubble (see Chart 11). Increasingly, however, the BOJ will be forced to concentrate its attention on excessive domestic demand and inflation. This will mean a tighter monetary policy, higher interest rates, and sharply lower real estate and stock prices. Unfortunately, the timing of this new round of tightening is uncertain, especially in view of the very recent favorable developments on the energy front. It hardly needs to be said that overt monetary easing in response to more bankruptcies and/or the fall in oil prices will be highly inflationary, postponing only temporarily the asset market's day of reckoning.

Conclusion: Monetary policy is still too timid, and as a result, money supply is still growing too rapidly. Asset prices are crumbling, only too slowly. Inflation is accelerating. The yen is likely to ease *vis à vis* the DM until such time as the BOJ retakes the initiative.

STRATEGY: *Stay short yen* vis à vis *long DM (see Chart 12). We expect the cross to challenge and better the 95 yen/DM rate.*

Retain short positions in LIFFE yen bonds. Retain short positions in Nikkei futures; lower stops to 26,000, basis cash index, close only.

Chart 10

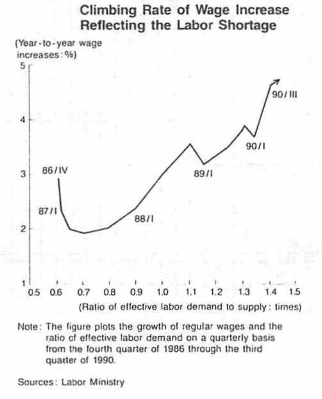


Chart 11

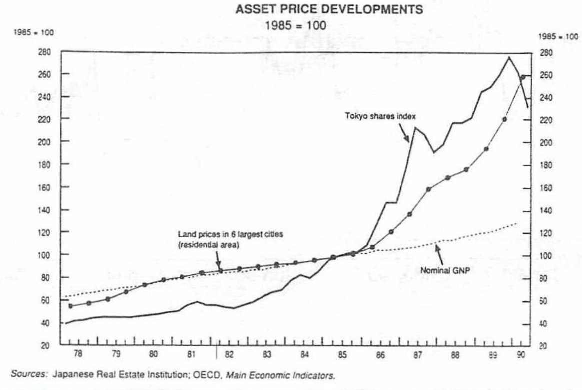


Chart 12
Yen per DM

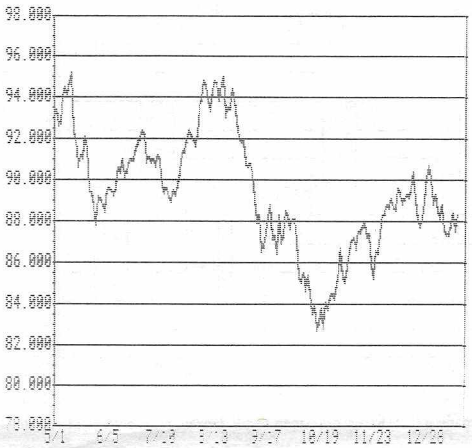
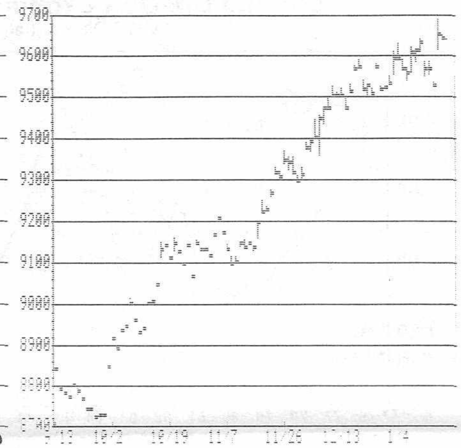


Chart 13
Nikkei 225 Index Spot

Chart 14
LIF Japanese Bond Mar '91



Canadian dollar: The Bank's stable policy

The Bank of Canada has been extremely skillful at encouraging lower interest rates without negatively affecting the exchange rate (see Chart 15) while achieving a gradual slowdown in the year-over-year rate of growth of M2 (see Chart 16). Three-month rates have fallen over 250 basis points from their 1990 highs. The slope of the yield curve has flattened considerably in recent weeks: 20-year governments relative to three-month Euro-Canadian dollars have moved from a peak 290 basis points' discount to an 80 basis points' discount. They key to the Bank's success lies in "following" market rates down, not leading them.

We see little danger to the Canadian dollar for so long as the Bank follows this policy. Nevertheless, we still believe that the Bank has an M2 target around 5% to 6% per year. A slowdown below these levels may be taken as a cue for the Bank to ease more aggressively and allow the currency to depreciate to the 1.17 to 1.19 area. It should be pointed out that throughout 1990 the Canadian dollar traded in an increasingly stable range, probably meeting official approval if not the result of outright design. If true, the Bank's monetary policy may give priority to exchange rate developments even before the Canadian dollar falls to the 1.17 to 1.19 area, as posited.

STRATEGY: *Remain long.*

Chart 15

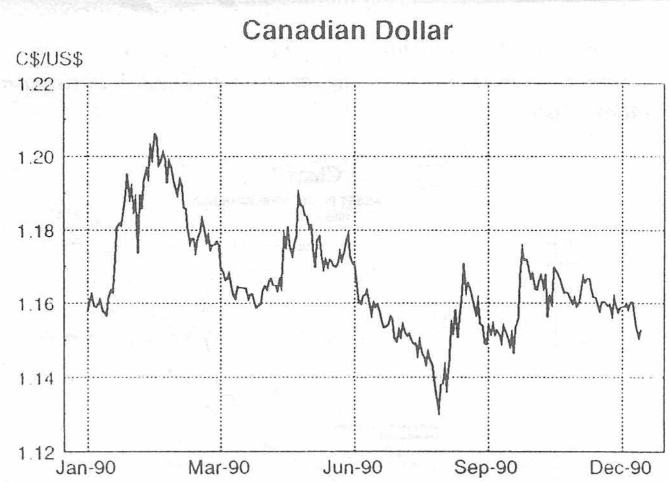
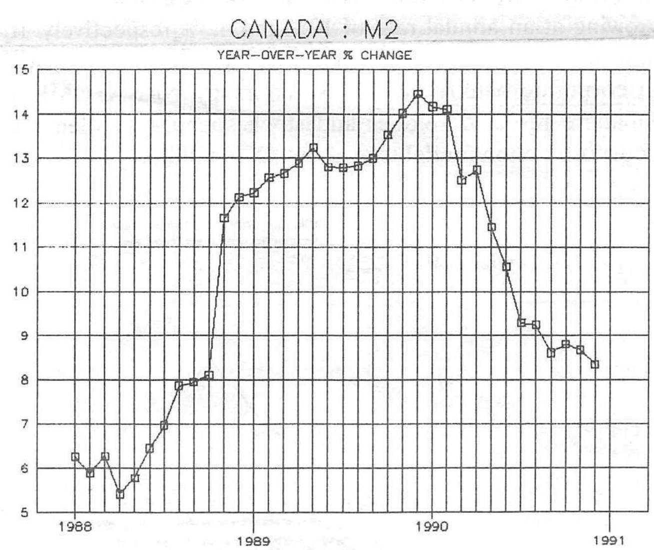


Chart 16



CRUDE OIL

Despite everything, stay short

In our last issue (November 18, 1990, "The end of the third oil shock" we made a strong case for low oil prices, regardless of the outcome of the Gulf crisis. We argued strongly that supplies had been fully made up and that Saudi oil installations were in no danger, thanks to the US buildup. We concluded by saying that "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."

Our strategy was flawless: "Sell April '91 (and forward) crude oil at market. Add to short positions 24 hours after military conflict begins."

Sometimes, however, we get too cute and end up outsmarting ourselves. Embarrassingly, we advised (over the Hotline, December 19) straddling the short positions via a long nearby contract, in the belief that the crisis leading to the final outbreak of war would widen the spread (it did, widening approximately 450 points) and that we would be able to sell the nearby contract — on a big spike as soon as the hostilities began (the spike took place during the night of the attack, recording $40/barrel in the Far East but collapsing well before New York opened, leaving us high and dry...and humiliated), leaving us short the deferred contract.

Since the eruption of war, the spreads have collapsed, leaving February '91 with a 90 cent/barrel premium to August '91. In fact, short of a highly unlikely hit on a Saudi Oil installations, oil prices are likely to fall to new post-1974 lows, buffeted by the global recession, huge inventories, and the need for Kuwait and Iraq to eventually maximize production for reconstruction and, possibly, reparation payments.

It was indeed the end of the third oil shock...

STRATEGY: *Liquidate long February '91 long and remain short deferred contracts.*

Chart 17
Feb. Crude Oil

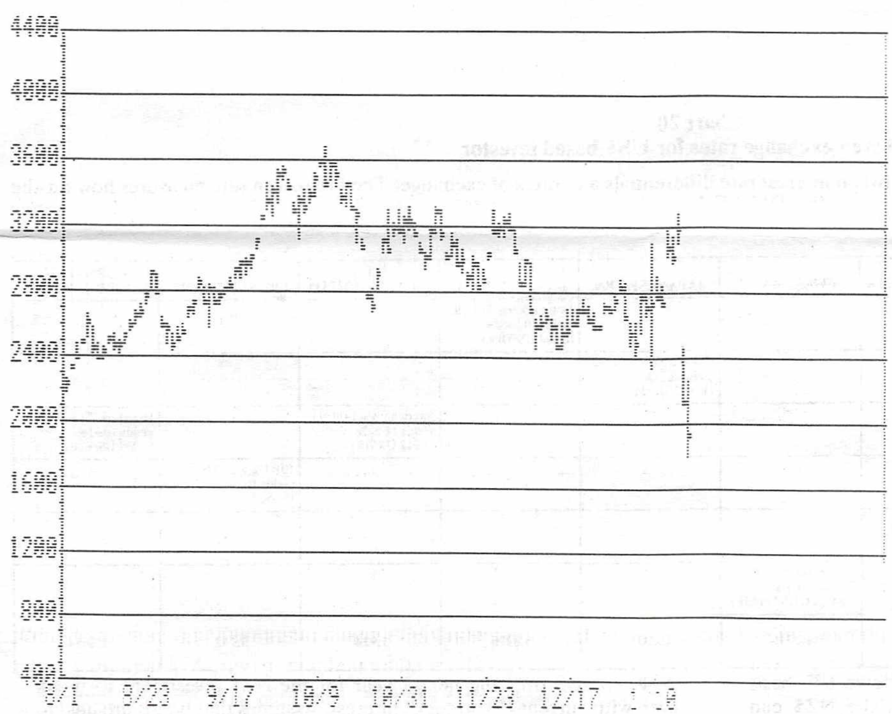
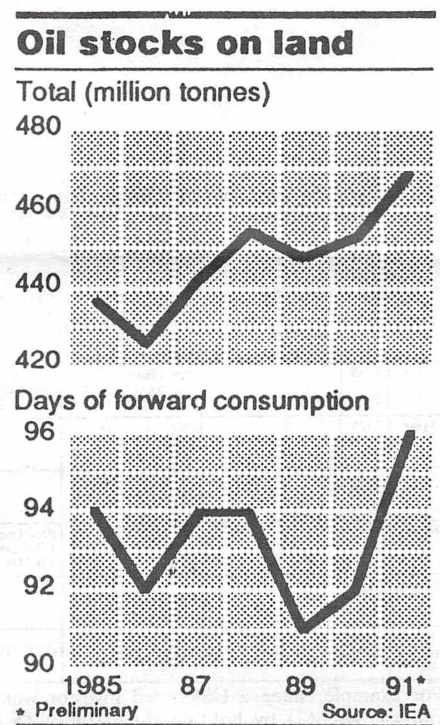


Chart 18



FRIEDBERG CAPITAL MARKETS

Chart 19

Date: January 17, 1991
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) 01/09/91 9%	98.90	- 99.40	10.27%	01/03/91
NEW ZEALAND DOLLAR DENOMINATED BONDS				
CAN.IMP.BANK OF COMMERCE 27/07/92 14% RRSP eligible	99 3/4	- 100 1/2	13.44%	27/07/91
AUSTRALIAN DOLLAR DENOMINATED BONDS				
General Electric 11/07/92 14 1/4% (semi)	102 3/8	- 103 1/8	12.20%	11/01/91
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	102 1/8	- 102 7/8	12.83%	01/07/91
WORLD BANK 15/03/93 12 3/4% RRSP eligible	100 3/8	- 101 1/8	12.07%	15/03/91
DANISH KRONE DENOMINATED BONDS				
KINGDOM OF DENMARK 9% 20/11/92	97.02	- 97.77	10.37%	20/11/91
ECU DENOMINATED BONDS				
KINGDOM OF DENMARK 7 7/8% 20/01/94	93 1/4	- 94	10.31%	20/01/91
BRITISH POUND DENOMINATED BONDS				
KGDM of SWEDEN 14/4/93 9 3/8%	94 7/8	- 95 5/8	11.67%	14/04/91
FRENCH FRANC DENOMINATED BONDS				
EUROPEAN INV.BANK 8 3/4% 12/7/95	95	- 95 3/4	10.17%	12/07/91
DEUTSCHE MARK DENOMINATED BONDS				
QUEBEC HYDRO 5 1/2% 1/5/96 RRSP eligible	85 1/4	-		01/05/91
PROVINCE OF QUEBEC 6% 1/4/97 RRSP eligible	86	- 86 3/4	8.87%	01/04/91
EUROPEAN INV. BANK 5 1/2% 9/8/93	92 3/4	- 93 1/2	8.42%	09/08/91
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	85 1/2	-		07/05/91
WORLD BANK 5 7/8% 4/2/97 RRSP eligible	85 1/4	- 86	8.98%	04/02/91

ISSUER/MTY.DATE/COUPON	BID	OFFER	CURRENT ANN. YIELD TO MTY	NEXT INTEREST PAYMENT DATE
SWISS FRANC DENOMINATED BONDS				
GOVT.OF AUSTRALIA 30/10/98 5%	85	- 87	7.24%	30/10/91
JAPANESE YEN DENOMINATED BONDS				
GOVT.OF CANADA 23/7/93 5 5/8% RRSP eligible	96 3/4	- 97 1/2	6.73%	23/07/91
U.S.DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03(semi) CV @$38 p/sh	70 3/4	- 71 1/2	12.66%	15/06/91
SUNRISE MEDICAL INC.7.25% 26/6/96 CV @$17 5/8 p/sh	108	- 115 3/8	4.03%	26/06/91
ALLIANT COMPUTER 7.25% 15/05/12(semi) CV @$39.75 p/sh	15	- 19 1/4	41.16%	15/05/91
COOPER CO'S. 10 5/8% 01/03/05(semi) CV @$27.45 p/sh call in 1995 @100	71 1/2	- 73 1/4	15.88%	01/03/91
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @$39.50 p/sh	24 1/2	- 29 1/2	20.52%	01/03/91
U.S.DOLLAR DENOMINATED FIXED RATE BONDS				
ALBERTA 7 3/8% 9/12/91 RRSP eligible	99 3/8	- 100 1/4	7.01%	09/12/91
SOUTHMARK 12% 10/8/97 (semi)	32	- 42	14.17%	10/08/91

U.S.DOLLAR DENOMINATED FLOATING RATE NOTES	Bid	Offer	Current Coupon	
UNITED KINGDOM 24/9/96 3 mo.LIBID-1/8 (qtly)	100	- 100.30	7 15/16%	28/03/91
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 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 January 17, 1991.**

	U.S. $	NEW ZEALAND $	AUSTRALIAN $	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE	BRITISH POUND	FRENCH FRANC	EUROPEAN CURRENCY UNIT
1 year	6.67%	CIBC 14% 27/7/92, yields 13.44% (.558 NZ/US)	General Electric 14¼% 11/7/92, yields 12.2% (.744 A$/US)				Denmark 9% 20/11/92, yields 10.37% (6.024 US/Dkr.)			
2 year	7.19%		World Bank 12¾% 15/3/93, yields 12.07% (.7158 A/US)	EIB 5½% 9/8/93, yields 8.42% (1.550 US/DM)		Canada 5⅝% 23/7/93, yields 6.73% (131.73 US/JY)				
3 year	7.42%		CBA 14% 1/7/94, yields 12/07% (.689 A/US)					Sweden 9⅜% 14/4/93, yields 11.67% (1.712 US/BP)		Denmark 7⅞% 20/1/94 yields 10.31% (1.257 US/Ecu)
4 year	7.60%								EIB 8¾% 12/7/95, yields 10.17% (5.650 US/ffr)	
6 year	7.84%			Prov. Quebec 6% 1/4/97, yields 8.87% 1.604 US/DM						
7 year	7.96%				Australia 5% 30/10/98, yields 7.24% (1.216 US/SF)					
Spot Exchange Rate	N/A	.5940	.7825	1.5155	1.2746	132.87	5.8225	1.924	5.142	1.3614

*For example, since a US$-based investor would receive 677 basis points (1344-667) by holding the CIBC NZ$ bond, the NZ$ can depreciate to .558 NZ/US from the present spot exchange rate of .5940 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.

Current bond portfolio allocation

In the interest of minimizing transaction costs, we advise current portfolios to remain invested as follows:

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%

Recommended bond portfolio allocation for new portfolios

For new portfolios, we recommend the following investments:

DM fixed-rate bonds	50%
US dollar high-yield and convertible bonds	25%
Danish krone fixed-rate bonds	25%

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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: 1.5000)*
Australian dollar	.7818-.7828	.7736-.7750	.7496-.7526	Neutral	Neutral
Belgian franc	31.08-31.13	31.24-31.35	31.73-31.96	Remain long	Neutral
Danish krone	5.8075-5.8125	5.8490-5.8600	5.9875-6.0150	Remain long	Neutral
Dutch guilder	1.7040-1.7060	1.6953-1.6968	1.6685-1.6725	Remain long	Neutral
Greek drachma	160.60-160.70	166.60-169.70	183.60-193.60	Neutral	Neutral
Hong Kong dollar	7.7962-7.7972	7.7972-7.8012	7.7992-7.8122	Neutral	Neutral
Irish punt	1.7740-1.7760	Not available	Not available	Remain long	Neutral
Italian lira	1134-1135	1148-1150	1188-1195	Remain long	Neutral
Kuwaiti dinar	**We're back!!!**				
Malaysian ringgit	2.7220-2.7240	2.7250-2.7310	2.7400-2.7550	Neutral	Neutral
New Zealand dollar	.5950-.5960	.5884-.5900	.5665-.5695	Neutral	Neutral
Norwegian krone	5.8725-5.8775	5.9275-5.9375	6.0835-6.1035	Remain long	Neutral
Portugese escudo	135.20-135.40	137.25-137.75	145.20-147.10	Neutral	Neutral
Saudi Arabian riyal	3.7475-3.7485	3.7505-3.7445	3.7505-3.7465	Neutral	Neutral
Singapore dollar	1.7440-1.7460	1.7340-1.7385	1.7155-1.7275	Neutral	Neutral
Spanish peseta	94.30-94.40	95.96-96.13	100.68-100.98	Remain long	Neutral
Swedish krona	5.6100-5.6150	5.6895-5.7010	5.9100-5.9320	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

Flash update, Monday, November 19, 9:00 a.m.:
Sell April and forward crude oil at market. This recommendation is in the November issue of the newsletter, presently being mailed.

Tuesday, November 20:
As per our flash update yesterday, we recommended to sell April and forward crude oil contracts at market. This recommendation is in the new market letter, which is in the mail.

Friday, November 23:
One change this week. As per our flash update Monday a.m., we recommended to sell April and forward crude oil contracts at market. This recommendation is in the new market letter, which is in the mail.

Flash update, Tuesday, November 27, 8:30 a.m.:
Sell long December Canadian dollar positions at market, taking profits.

Friday, November 30:
One change as per our flash update of Tuesday, Nov. 27. Sell long December Canadian dollar positions at market, taking profits.

Flash update, Tuesday, December 4, 9:30 a.m.:
Buy March Japanese yen at market, placing initial stops at 7405 close only.

Flash update, Thursday, December 6, 11:15 a.m.:
As recommended December 4 in our flash update, you are long March Japanese yen. Sell long positions at market, accepting profits.

Flash update, Friday, December 7, 11:00 a.m.:
Buy March DM at market. Stops will be announced on the weekly wrapup tonight.

Friday, December 7:
The US dollar is once again at the edge of the precipice. We would like to take advantage of the situation via a long position in the DM rather than the Japanese yen. Therefore, we bought March '91 DM as per our flash update this morning at approximately 6734. Place stops at 66.00, close only. After having been stopped out of Japanese yen on November 29 at approximately 7490, we bought and sold Japanese yen with more than 65 points profit as per our flash update of Tuesday, December 4 and Thursday, December 6.

Tuesday, December 11:
No changes or new recommendations.

Flash update, Friday, December 14, 10:15 a.m.:
1. Sell Long December Australian dollar positions at market.
2. For short December Eurodollar holders, there are two options. Liquidate shorts and either 1) Roll over to March Eurodollars, into a premium, placing stops at 9280, close only or 2) purchase March 9250 Eurodollar put options to replace short December outright positions.
3. Roll over short December Kansas City Value Line positions. This will replace the regular Friday update if there are no further changes. One important note. There will be no market letter this month, so stay posted.

Flash update, Tuesday, December 18, 11:00 a.m.:
Buy March Canadian dollar. Place initial stops at 8525, close only.

Flash update, Wednesday, December 19, 1:00 p.m.:
Straddle short positions in crude oil by buying February against your existing short positions in the deferred months.

Flash update, Wednesday, December 19, 6:00 p.m.:
One new flash update and repeat of an earlier one today and yesterday's.
1. Straddle long March DM positions by selling March Japanese yen in equal dollar equivalents. In effect we believe that the cross trade will be more profitable than the outright long DM.
2. As of 1:OO p.m. today, we suggested to straddle short positions in crude oil by buying February against existing short positions in the deferred months.
3. As of yesterday's flash update at 11:00 a.m., we recommended long March Canadian dollar positions, placing stops at 85.25, close only.

Friday, December 21:
A wrapup of the week's activities.
1. As per our flash of Tuesday 11:00 a.m., we recommended to buy March Canadian dollar, placing stops at 85.25, close only.
2. As per our flash update Wednesday 1:00 p.m., we recommended straddling short positions in crude oil by buying February against existing short positions in the deferred months.
3. As per our flash update of Wednesday 6:00 p.m., we recommended to straddle long DM positions by selling March Japanese yen in equal dollar equivalents. In fact we believe that the cross trade will be more profitable than the outright long DM.

Friday, December 28:
A wrapup of existent positions and changes since the last letter.
1. As per our flash of November 27, you liquidated profitably long December Canadian dollar positions. As per our flash of December 18, you are long March Canadian dollar with stops at 8525, close only.
2. As per our flash update December 14, you liquidated long December Austrailian dollar positions.
3. As per our flash update of December 14, we recommended to roll over short December KC Value Line positions to March.
4. As per our flash of December 14, we suggested two alternatives for expiring short December Eurodollar positions: 1) Buy March 9250 Euro put options; 2) sell March Eurodollars with stops at 9280, close only. Unfortunately the latter was probably barely stopped out.
5. As per December 14, we recommended straddling short crude oil positions by buying the nearby February against existing short positions in the deferred months.
6. On December 19 we decided to change our currency positions from an outright US dollar short to a cross trade. As a result we advised selling March Japanese yen against outstanding long March DM (instituted as per our flash of December 7) in equal dollar equivalents. That negated the stop on the outright DM as we no longer were trading the dollar/mark position. You are therefore now long DM and short Japanese yen.

Friday, January 4:
We are entering the most vicious phase of the bear market in stocks. In this phase, blue chip stocks will drop faster and further than secondary issues. Therefore, change your short position in Value Line to S&P. In addition, you can enter a new trade: sell 1 March S&P, buy 1 March Value Line on a spread. No stops for the moment.

Tuesday, January 8:
There are no new recommendations. Following is a repetition of Friday's message. (See message of Friday, January 4.)

Friday January 11:
There are no changes. Therefore I will repeat the message of last Friday. (See message of Friday, January 4.)

Tuesday January 15:
No changes or new recommendations.

Flash update, Wednesday, January 16, 5:00 p.m.:
Liquidate long March Canadian dollar positions at 86.23.

Friday, January 18:
Only one suggestion this week, on Wednesday, January 16, to liquidate long March Canadian dollar if it reached 8623. This was not achieved. Therefore cancel this order and await further instructions.

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