

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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Will they (finally) prick the bubble?

Writing 3½ days before a G-7 meeting is no fun. (By the time the publication is in the mail, the (monetary) landscape, as we know it today, may have changed, and may have changed radically.)

It's difficult enough to guess what politicians will decide in the normal course of events, but it's even more difficult to guess what they will decide when they are *under stress*. And it's even more difficult (impossible?) to guess when they are under stress and clearly do not understand the issues in question.

Add those unknowns to the fact that there are at least three different opinions, among the magnificent seven, of where exchange rates should be and you have discovered the Principle of Uncertainty.

What to do? Instead of attempting to guess what they will do, it is safer to discuss what they ought to be doing. We have posited on a number of occasions that foreign exchange markets are indeterminate (see more particularly FC&CC of April 21, 1991). There is no specific equilibrium point, because there's little or nothing to equalize.

In the first place it was never clear why a nation should buy abroad the same amount as it sells abroad. Secondly, goods and services traders do possess a great deal of flexibility and can adapt easily to relatively large changes in exchange rates.

Finally, trade in goods and services represents only a very minuscule portion of total capital flows. In short, Purchasing Power Parity theorems in a floating and indeterminate foreign exchange regime, which presuppose similar costs and prices across boundaries so that trade in goods and services does not get too far out of line, are irrelevant in a real sense.

When they are used to justify speculative bandwagons, they could become self-fulfilling; but when they run *contrary* to *trends*, they are explained away.

What matters is *anticipating* capital flows. "Favorable" business and political climates are good magnets for capital. Thus economic growth has become synonymous with a strong currency *in spite of the fact that, generally, it is accompanied by unequal and deteriorating external trade.*

But what matters most of all is Central Bank commitment. Commitment to a specific exchange rate level and commitment to a consistent monetary policy. We are, of

course, arguing for a return to a fixed rate of exchange regime, à la EMS.

Detractors of fixed exchange-rate regimes point to many situations where its adherence would have caused undue hardship. Historical examples abound, but they all fall in the category of the undemonstrable. Let's take a fresh example: January 1991. With the US dollar trading at DM1.45, a sudden demand for US dollars would have forced the Fed to sell dollars so as to adhere to the rule of the fixed exchange regime.

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Also: Friedberg Capital Markets, The Exotics, and Forex Rates & Update.

Contributions by Albert D. Friedberg, Dr. Steve H. Hanke, Daniel A. Gordon, and Michael D. Hart. In this issue, we also take great pleasure in welcoming back David B. Rothberg as a regular contributor.

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

IMPORTANT NOTE

Our July/August issue will appear at the beginning of August. There will be no issue in July. Please stay in contact with our Hotline service for up-to-the-minute updates on all our recommendations.

Unsterilized dollar sales would have led to an increase in the US monetary base and a sharp easing of monetary policy with grave inflationary consequences. Clearly, argue the floaters, it would have been inopportune, to say the least, to fight and fix the rate at DM1.45.

There are, however, at least three strong counterarguments. In the first place, the very indeterminacy of the exchange rate may also have been the cause for the dollar to be trading at the then "lowly" (and of course there is no low or high in indeterminate exchange rates) and *oversold* rate. Had it been fixed higher earlier on, there may have never been such a demand for dollars.

Secondly, had the Fed been unconditionally determined to defend the rate, there may never have been a need to sell that many dollars. After all, with increased *credibility*, EMS intervention has become progressively smaller.

Finally, it is surely not a foregone conclusion that (tem-

porarily) easier monetary conditions would have had an aggravating effect on inflation. The very commitment to sound and stable money would have offset the temporary supply bulge via higher demand. In all, fixed rates of exchange would lead to calmer and far less speculative exchange markets, fewer crises, reduced frictions (fewer G-7 meetings), and far more certain planning horizons for business.

The G-7 meeting in London this coming Sunday would be an auspicious setting for a return to (more) fixed rates.

The actual rate is almost irrelevant, although it is, of course, easier to use present levels, say DM1.80 and ¥140. Initially it would be desirable to have wide bands of, say, 6% *on either side*. Eventually, the margin could be reduced to a total of 2% to 2½% as in the EMS.

Floating exchange rates were a sign of the times. The '70s and '80s were loose, undisciplined, and even wild. The sober and more austere '90s deserve better.

CURRENCIES

US dollar

The US dollar continued to move higher, fuelled by generally constructive economic statistics and upbeat official pronouncements to the effect that the recession is over. We continue to have our doubts.

As we said last month, recessions (and expansions, for that matter) do not develop in straight lines; a "pop" does not make a recovery. Furthermore, and far more significantly, none of the basic economic problems (primarily excessive debt) have been resolved: A huge and growing amount of resources is lying idle — impeding the circular flow of income generation — because of greedy and unrealistic pricing; capital spending has just begun to turn down, hit by vulnerable corporate balance sheets and overcapacity; state and municipal taxes are on the rise, delivering a potential death blow to an already overstretched consumer, and so on.

The change in perception may come as early as next month. When it does, it will expose the US dollar run as

merely a speculative plaything. We have repeatedly entered the short side of the US dollar without much success (see details in Hotline Update). We promise, nonetheless, to keep trying, especially as we approach the rarefied DM1.85 level.

STRATEGY: *Temporarily sidelined. Keep in close contact via Hotline Update for reentry suggestions. Retain long DM/short yen spread (now conveniently traded as a cross on the IMM, representing US\$125,000 worth).*

The yen has been gaining relative ground (in parallel with the US currency), a result of a much heavier dollar intervention by the BOJ than by the Bundesbank and a more determined monetary policy (see Chart 3).

Going forward, the BOJ is much more likely to ease in coming weeks (thanks to their collapsing property and stock markets) than the Bundesbank, still faced with a fiscal deficit equal to 5½% of GDP.

Chart 1 – DM/YEN SEPT.

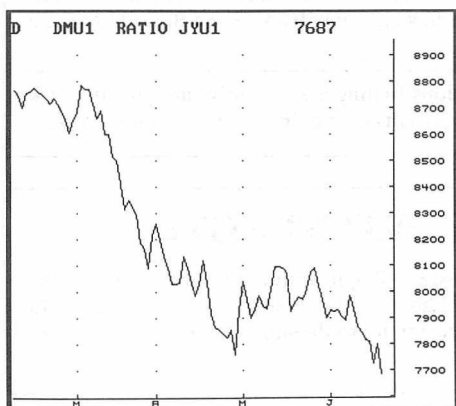


Chart 2 – SEPT. DM

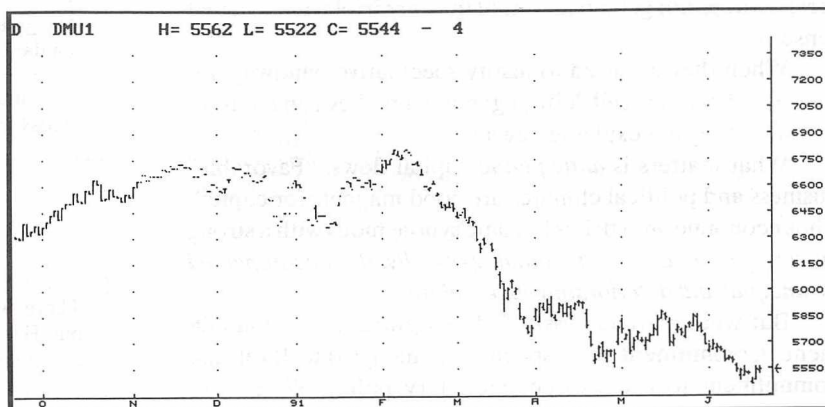
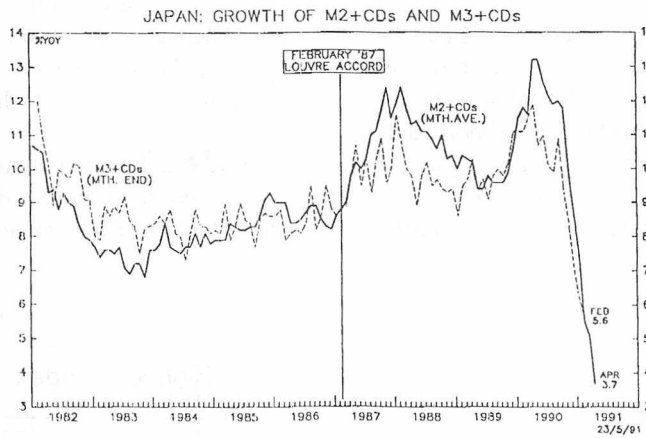


Chart 3



CURRENCIES

Canadian dollar

The monetarists at the Bank of Canada are facing a problem: Year-over-year growth of M2 is climbing back to 9%, having risen quite rapidly over the past three months. Clearly, interest rates have been allowed to drop too fast, and some back-up is in order. Heavy provincial borrowings and a higher monetary policy spell a higher Canadian dollar.

STRATEGY: Remain long futures and call options.

Chart 4
CANADIAN DOLLAR SEPT

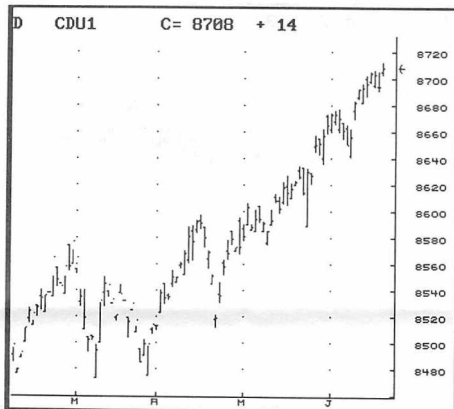
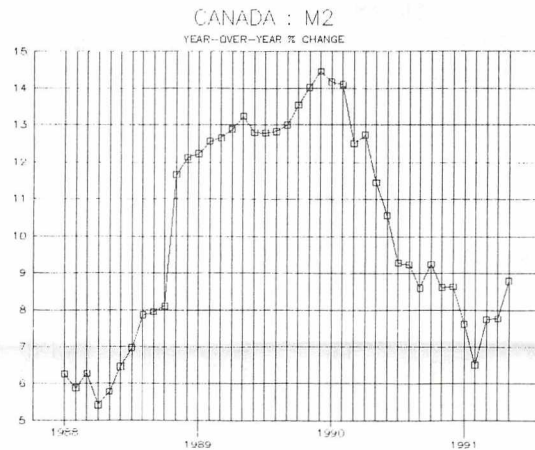


Chart 5



STOCK INDEXES

Bears need patience

The "internal" market action continues to deteriorate. Especially worrisome is the inability of this market to expand the number of stocks making new 52-week highs, be it as a percentage of advancing issues (see Chart 6) or in absolute terms (see Chart 7, an ominous pattern of declining "highs" non-confirming the Average).

There are other worrisome signs: Institutional liquidity

is low and sentiment is euphoric as witnessed by the new-issue craze, as well as the high readings in the odd-lot purchase/sales ratio and investor bullishness. Price-earning ratios are high (17.5 to 19.5 x depending on the index used), even while earnings are still trending lower, dividends are historically low, and the price-book ratio, at an astronomical 3.7 times (using the comprehensive Wilshire Index of 6,000

stocks) exceeds, by a fair margin, the 2.6 ratio prevailing prior to the October 1987 crash.

Admittedly, the high and rising price-book ratio may be almost entirely attributable to LBOs and repurchases of stock at prices in excess of historical "book" but at/or below replacement value, which has the effect of reducing book value. If so, this alarming statistic loses a great deal of its impact.

What's keeping us from turning bearish at once?

For one thing, respect for the beast. Having been bitten

once, we are understandably shy. More to the point, breadth remains relatively healthy and cyclical stocks (like the papers, carmakers, retail stores) despite awful news, are showing unusual vigor (see Chart 8). It's hard to fight a market that shows such disdain for the here-and-now.

STRATEGY: For the moment, we are still long S&P 500 calls (we are too timid for futures). The bears will have their day, but they will need to be patient.

Chart 6

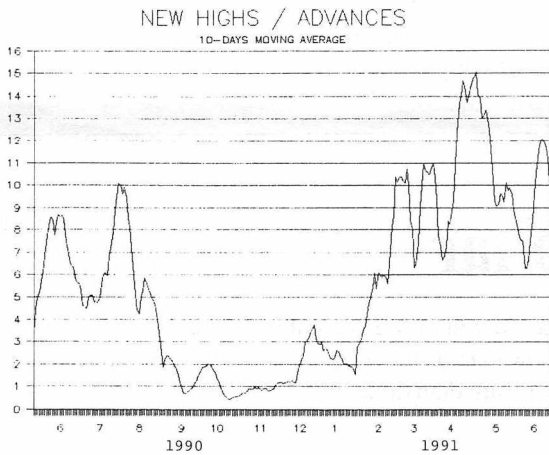
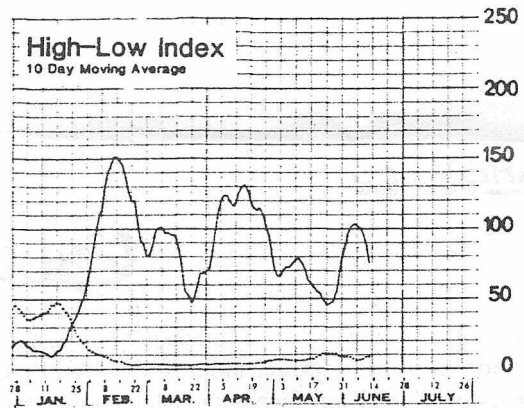


Chart 7



Trendline, Standard & Poor's Corp.

Chart 8

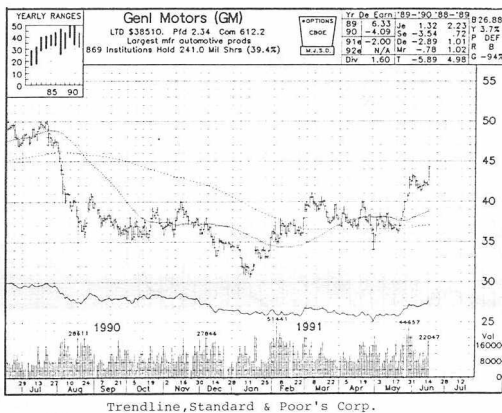
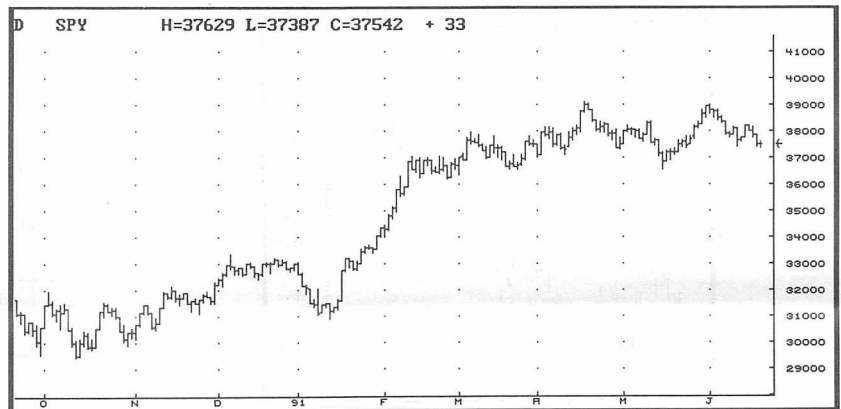


Chart 9 - S&P CASH



GOLD

Still bullish

Official gold stocks fell 35 tonnes in 1990 after a 175-tonne drop the year before, according to Bank for International Settlements (BIS) estimates.

As curious as it may sound, this is actually a *bullish* piece of news. The logic is simple: If central banks are selling, then all gold production, and then some, is being "consumed" or hoarded. For this to happen in the midst of a worldwide

slowdown, it must mean that gold is "cheap." Moreover, forward gold sales (some of the largest producers, like American Barrick, are 100% sold out) also tend to swell spot supplies, at the expense of medium-term supplies. The market has become "oversold," trading below its medium-term equilibrium level — which explains the unusual vigor of demand.

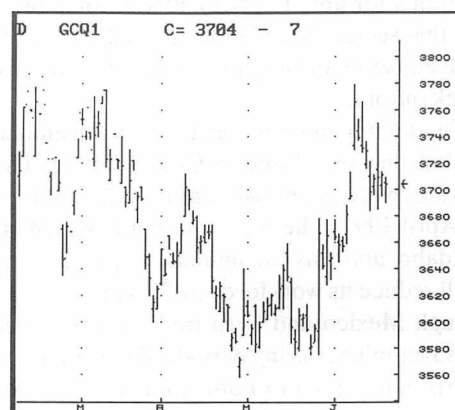
Further proof that the price is too low (caused, no doubt,

by these forward sales operations) is the fact that 10 South African mines, producing 80 tonnes of gold, showed operating losses for 1990 and that the mining industry had cut more than 50,000 jobs over the past two years.

With demand soaring and supplies tapering off, the outlook for the precious metal is good, even without an acceleration of inflation.

STRATEGY: *Remain long futures and (cheap) call options.*

Chart 10 – GOLD AUGUST



SILVER

Happy days are here again

In April, while visiting our friends in the US Senate, we had an opportunity to exchange views with executives from one of North America's largest silver producers. Given the current level of silver prices and the fact that the Senator's guests have been forced to slash their output, we braced ourselves for a standard industry tirade against speculators, government silver sales, etc. Instead, we listened in amazement to a "happy days are here again" scenario.

The executives argued that silver prices had fallen to such low levels that they were starting to turn off supply and turn on demand. In consequence, the executives asserted that we were witnessing the bottom of silver's big bear market.

We were intrigued and began to investigate the plausibility of those assertions. First, we looked at the price action on the July contract. Those price data suggest that bottoming action might, indeed, be in the cards. The weekly lows, during April and May, were locked in a tight range between \$3.90 and \$4.00 per ounce. Then earlier this month, silver made a sharp move to the upside, and has settled in another tight range at about \$4.50 per ounce. Perhaps the mining executives are on to something.

Next we looked at the supply/demand balance. Our initial foray into that realm proved to be frustrating, since there are only a handful of sources that attempt world silver balances. Moreover, the balances from these sources are all over the map. For example, Handy & Harman (H&H) data show a 3.2 million ounce surplus in 1989, rising to 8.9 million ounces in 1990. Comparable figures produced by another respected silver analyst, the CPM Group, show a surplus of 18.8 million ounces in 1989, falling to a deficit of 17.8 million ounces in 1990.

In an attempt to make sense out of the silver statistics, we contacted Mr. John Bondurant in Memphis, Tennessee. Mr. Bondurant, a self-confessed silver bull, is in our view one

of the best when it comes to understanding the micro-fundamentals of silver. Mr. Bondurant didn't take long to explain why the dispersion of the silver balance numbers was so great. It is because of the low quality of the raw data. Indeed, he indicated that the demand side of the market was an educated guess, at best.

Are prices working?

Given the quality of supply/demand data (and the outright lack of data), we will not engage in a futile attempt to make sense out of the available forecasts. Instead, we employ the following approach: Given current low prices, is there evidence that prices are doing their job? That is, are they depressing supply and stimulating demand?

First, let's look at the supply side. About 60% to 65% of new production comes as a by-product from copper, zinc, and gold mining. Indeed, most of the increase in US silver production since 1985 (an increase to 65 million ounces from 40 million) has come from low-cost, heap leach gold mining. We would expect that this low-cost, by-product production would not be touched by low silver prices. This is true; however, it is not the end of the story about the by-product component of supply.

The heap-leach gold mines are surface operations, and they have rather short lives (about seven years on average). Now, many of these operations in North America are reaching, or have reached, old age. In consequence, we have seen the peak in output from this source. Indeed, supplies from this by-product source will begin to dry up, not because of low prices, but because the heap-leach gold deposits are aging. So, overall by-product production of silver will no longer be a source for a significant increment in new production; rather, its output will be down.

What about supply changes from pure silver mining, which accounts for about 35% to 40% of total new production? It is this sector that should logically be hit by lower prices. Indeed, some of the pure silver mines are closing or cutting back output.

The Candalaria mines in Nevada, with an annual output of 4.4 million ounces, closed in October 1990. The Couer mine in Idaho, with an annual output of 2.1 million ounces, closed in April 1991. The Sunshine mine, which is also located in Idaho and has an annual output of 5.5 million ounces, will reduce its workforce by 75% in June.

Although Mexico and Peru traditionally subsidize un-economic silver mines during periods of low prices, there are some reports coming out of both countries that indicate an intention to close some of the money losers. One exception to the decline from pure silver mines is La Coipa in Chile. That mine came on line in 1990 and will produce an estimated 10.5 million ounces in 1991.

In addition to affecting new production, low prices should affect the secondary recovery of silver, which accounts for 16% of total supply (the remainder coming from new production, both by-product and pure silver mine production). The US Bureau of Mines figures show that supplies from secondary scrap in the US dropped to 13.2 million ounces in 1990 from 23.6 million in 1989. H&H shows only a 4 million ounce reduction in the US for the same period, and no change in the rest of the world. Hence, it appears that increments to supply from secondary sources are falling, even though the magnitude of the declines is in doubt. In short, prices are working in the right direction on the secondary supply sector.

In summary, if we just look at the direction of change on the supply side, it appears that a strong case can be made that the new and secondary production have begun to decline. After piecing together his micro-data, Mr. Bondurant forecasts that the decline from 1990 to 1991 will be about 10 million ounces.

Demand-side black hole

The demand side of the silver market is even more of a statistical black hole than the supply side. However, we can get a handle on 50% of the market that is made up of photographic use. According to *Photofinishing Newsletter*, silver-based film sales are increasing by about 2% to 3% per year.

The other 50% of the market (electronics, jewelry, coins, etc.) is more difficult to get a handle on. However, it is hard to see how, at current prices, that residue could be doing anything but growing. Indeed, Mr. Bondurant estimates that that half of the market is growing in line with the photography side. Hence, he believes that 1991 demand will increase by between 12 million and 20 million ounces.

Market bottoming

On balance, then, it appears that a strong case can be made for a decline in supply and an increase in demand for 1991. In consequence, if we look at Mr. Bondurant's supply/demand balance, it moves from a deficit of 38.6 million ounces in 1990

to a deficit of 63.6 million in 1991, for a swing of minus 25 million.

For the same period, the CPM Group's balance moves from a deficit of 17.8 million ounces to a deficit of 31 million, for a swing of minus 13.2 million. H&H's 1991 forecast is still not available.

However, if either Mr. Bondurant's or the CPM Group's negative 1991 swing is applied to H&H's 1990 surplus of 8.9 million ounces, the implied H&H balance for 1991 will be in deficit. The changes in supply and demand and consequent deficits for 1991 certainly support the assertions made by our mine executives — that we are witnessing the bottoming of the silver market.

The Comex proxy

However, even though at the margin it looks as though silver's supply/demand balance is constructive, we must stress that silver's statistical black hole and market action over the past years have turned speculators off. For them, the only reliable guide for the supply-demand balance is the Comex stocks in New York.

That proxy for supply-demand has been trending upward slightly from January 1990 to the present, and those stocks are at very high levels (about 262.6 million ounces). For those watching this visible proxy for supply-demand changes, the silver balance is still not in deficit, and at the margin demand has not begun to outstrip supply.

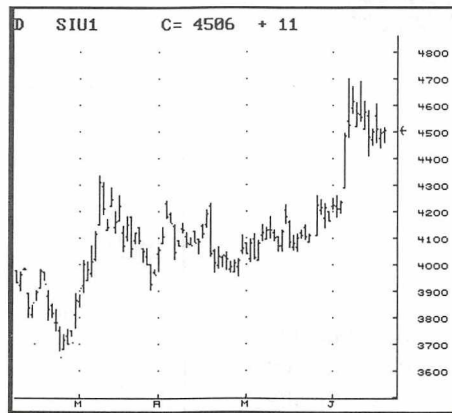
But there is reason to believe that the use of Comex stocks as a proxy for supply-demand balance has some flaws of its own. First, New York tax laws have become more favorable to holding stocks in New York, and this has pulled some silver stocks back from Delaware. Second, the LME silver market was closed in 1989, and some of the LME stocks flowed to New York. Third, speculators have been unloading silver hoardes, and the merchants who purchase it have put it in Comex-approved warehouses. Fourth, there has been a large increase in cash-and-carry business at the Comex (buy cash and hedge forward at a premium to cash). That has been stimulated because those who use this technique have been able to earn returns that exceed those on Treasury bills. Note that while all these factors have caused the visible stocks to increase in New York, they have not altered the total silver balance — rather, they have just shifted stocks to New York from other locations.

On balance, it appears that the four factors mentioned above have run their course and that the stocks in New York are topping out. If our analysis of the supply/demand fundamentals is correct, a deficit in 1991 will translate into decline in the Comex stocks later this year. That will get the attention of the speculators and motivate the silver market. Indeed, the market will stop bouncing along the bottom and begin to move up smartly.

STRATEGY: Purchase September '91 silver at markets risking 4.15/oz., close only.

— Dr. Steve H. Hanke

Chart 11 – SILVER SEPTEMBER



CRUDE OIL

Trading the (profitable) short side

Since last writing, nearby July contracts (which went off the board today) shed 130 points for the benefit of the shorts, of which we are pleased to number ourselves. Let's take a profit.

The decline has been accompanied by a 30,000-contract increase in the combined open commitment of all the oil contracts traded in New York. Considering that consensus of bullish opinion stands currently at only 18%, we've got to conclude the speculative short position represents too many potential buy orders if the market doesn't put another leg down in the next short while.

Fundamentally there's not enough evidence to conclude that it will. Not now anyhow.

The crude market is ruled at present by the following factors. On the bullish side are:

1) **Iraq's inability to export.** The country will be able, technically, to produce about 1.0 mbd (million barrels per day) by the end of this year, and probably in the neighbourhood of 2.5 mbd by the end of next but cannot export anything near these levels of production due to the Bush Administration's current policy of maintaining the trade embargo as long as Saddam Hussein retains power.

2) **Problems in the Soviet Union.** Daniel Yergin, president of US consultant Cambridge Energy Research, projected production in the USSR to slip to 10.4 mbd from 12.7 mbd at the end of 1988. Authorities, not surprisingly, have elected to mete out this near 18% drop against exports. Last week Prime Minister Pavlov announced that Soviet oil exports had declined by 49% in the first five months of the year.

The bearish case is made up of the following:

1) **Kuwait's gradual return to normal production levels.** These are projected at 0.3 mbd by the end of this year, 0.8 mbd by the end of next year, and 1.6 mbd by the end of 1993.

2) **Continued high output from Saudi Arabia,** whose policy in the wake of the gulf war will be to act as a safety valve against price shocks. Currently pumping 8.5 mbd, Saudi Arabia is not expected to reduce output by more than 500,000 barrels.

In the late '70s and early '80s they were pumping 10.0 mbd.

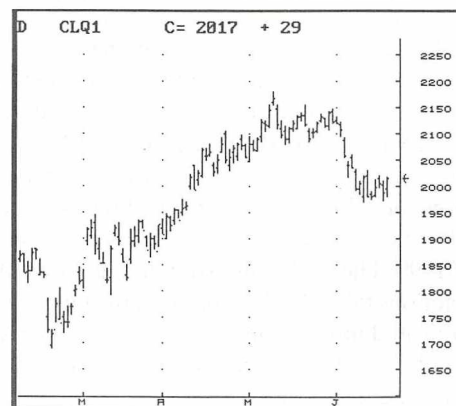
From a trader's perspective, it would be safe to argue that the bearish case is stronger but having a more distant influence on the market than the bullish case has at the present time. Iraq will come to produce and sell more oil, but it is not doing so now, and there is no obvious political development in the offing to suggest it will do in the foreseeable/trading future.

The Soviet Union has enormous incentive to produce and export oil, (the fact that OECD estimates exports have declined by 33% — not 50% as officially reported and attributes the discrepancy to sales made independently by producing regions — testifies to the desire to earn foreign exchange), but the current political crisis and economic chaos is immediate and likely to worsen before it improves. Until it does, exports could conceivably fall even further.

STRATEGY: We are trading the market from the short side. Today we advise liquidating our previously-recommended and profitable short position. Stay posted.

– D.B.R.

Chart 12 – CRUDE OIL AUGUST



FRIEDBERG CAPITAL MARKETS

Alliant Computer

7¼% 15/05/12

Convertible at \$39.75 per share

Recent price: \$23.50

Yield to maturity: 33.45%

For the three months ended April 30, 1991, Alliant failed to cover its interest charges. Furthermore, it showed a significant increase in its inventory/sales ratio, demonstrating difficulty in moving product, and in its accounts receivable/sales ratio.

Following are some relevant corporate statistics and excerpts from the recent quarterly statement for the period ended April 1, 1991.

“Equipment revenues for the first quarter of 1991 decreased to \$6.2 million from \$17.0 million in the first quarter of 1990. The decrease was due to declines in sales of graphics products and the Company’s older FX/40 and FX/80 product line, all of which are being phased out by the Company as it makes the transition to its FX/2800 series. A projected increase in shipments of the company’s FX/2800 system family, which had been expected to offset the aforementioned declines in revenue, did not occur....

“Service revenues increased by 29% to \$4.2 million in the first quarter of 1991 as a result of a larger installed base of systems....

“The increase in equipment gross margins to 56% in the first quarter of 1991 from 55% in the comparable quarter of 1990 was due primarily to a higher volume of relatively lower margin graphics, FX/40 and FX/80 product revenues in the first quarter of 1990....

“Gross margins on service revenues increased to 42% in the current quarter from 35% in the year ago quarter. The margin improvement is primarily due to the effects of expense reductions resulting from the Company’s cost-cutting actions taken in the second half of 1990....

“Research and development expenditures decreased 28% to 2.0 million in the current quarter from \$2.7 million in the first quarter of 1990. The decrease in expense is primarily attributable to the absence of significant expenditures related to the development of the FX/2800, which was introduced in the first quarter of 1990. As a percentage of sales, research and development expenditures were 19% in the current quarter compared with 13% in the first quarter of 1990....

“Selling, general and administrative expenses totaled \$6.2 million, or 59% of sales, in the first quarter of 1991 compared with \$6.6 million, or 32% of sales, in the first quarter of 1990. The \$0.4 million dollar decrease is due to the effects of actions taken by the Company during the latter part of 1990 and in January 1991 to reduce its cost structure, which included workforce reductions and significant reductions in non-essential costs...”

Chart 13

Interest coverage ('000s)	3 month period ending April '91	3 month period ending March 31 '90
Net income before income taxes	(3521)	1085
(Add back):		
Interest Expense:*	1551	1449
Depreciation/Amortization	1564	1363
Amortization of other intangibles and goodwill:	0	
Total:	(406)	3897
Debt service:*	1551	1449
Coverage Ratio:	N/A	2.68 times

*Interest payment on CV notes plus interest on short term debt.

Chart 14

3 months ended April 1, 1991		3 months ended Dec. 1, 1990	
Inventory	= $\frac{8.9}{10.4} = .86$	Inventory	= $\frac{7.8}{20.3} = .39$
Sales		Sales	
Account receivable	= $\frac{13.79}{10.4} = 1.325$	Account receivable	= $\frac{20.6}{20.3} = 1.02$
Sales		Sales	
Gross oper. profits	= $\frac{5.23}{10.4} = .503$	Gross oper. profits	= $\frac{10.6}{20.3} = .522$
Sales		Sales	
Cash: \$16.3 million		Cash: \$16.5 million	

Pacific Scientific

7¼% of 15/06/03

Convertible at \$38 per share

Current price: 74.50

Yield to maturity: 12.12%

The “quality” of the paper continues to improve. Interest coverage at 3.98 times is ample and liquidity is satisfactory.

Following are some relevant comparative statistics and excerpts from the recent quarterly report for the period ended March 29, 1991.

“Sales for Pacific Scientific Company were \$44.0 million in the first quarter of 1991, down approximately 2% from \$44.7 million in the same period of the prior year. For the quarter, net income was \$766,000 or 13¢ per share. This compares to \$913,000 or 15¢ per share in the first quarter of last year. The 1991 net income reflects increased investment in research and development equal to 9¢ per share....

“While new products are being developed, the Company continues to improve operations. For the first quarter, sales per employee were up 13% from the prior year. Gross margin on sales was up and operating expenses, excluding R&D, were lower than last year. Our balance sheet continues strong with inventories down \$6 million compared to the same period last year, as a result of our world-class manufacturing techniques. Our current ratio has improved to 2.2:1 as a result of careful asset management and cost control....”

Chart 15

Interest coverage ('000s)	3 month period ending March 29/91	3 month period ending March 30/90
Net income before income taxes	1,256	1,427
(Add back):		
Interest Expense:	1,091	1,238
Depreciation/Amortization	1,793	1,582
Amortization of other intangibles and goodwill:	206	265
Total:	4,346	4,512
Debt service:	1,091	1,238
Coverage Ratio:	3.98 times	3.64 times

Chart 16

Total debt = 1.24:1	
Market cap.	
Current ratio = 2.187:1	
3 months ended March 29, 1991	3 months ended March 30, 1990
Inventory = $\frac{34.3}{43.9} = .781$	Inventory = $\frac{37.9}{44.7} = .848$
Account receivable = $\frac{31.2}{43.9} = .7107$	Account receivable = $\frac{31}{44.7} = .6935$
Gross opert. profits = $\frac{13.09}{43.9} = .298$	Gross opert. profits = $\frac{12.87}{44.7} = .288$
Cash: \$7.7 million	Cash: \$6.99 million

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Chart 17 - FOREIGN CURRENCY BONDS

Date: June 18, 1991
We offer the following bonds subject to change without prior notice: Minimum amount US\$5000 (Can.\$7,000)

ISSUER/MATURITY DATE/COUPON	BID	OFFER	Current Yr. Yield to Mkt.	NEXT PAY DATE
DEUTSCHE MARK DENOMINATED BONDS				
KINGDOM OF SWEDEN 7 1/4% 1/2/95	96 1/4	- 97	8.22%	Feb. 1
EUROPEAN INV. BANK 5 1/2% 9/8/93	94 1/4	- 95	8.15%	Aug. 9
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 IRSP eligible	88	- 88 3/4	8.54%	May. 7
WORLD BANK 5 7/8% 4/2/97 IRSP eligible	87.62	- 88.37	8.52%	Feb. 4
QUEBEC HYDRO 5 1/2% 1/5/96 IRSP eligible	86	-		May. 1
SWISS FRANK DENOMINATED BONDS				
GOVT. OF AUSTRALIA 5% 30/10/98	88 1/2	- 91 1/2	6.48%	Oct. 30
DANISH KRONE DENOMINATED BONDS				
KINGDOM OF DENMARK 9% 20/11/92	98.67	- 99.42	9.38%	Nov. 20
ECU DENOMINATED BONDS				
UNITED KINGDOM 9 1/8% 21/02/01	99.55	- 100.30	9.06%	Feb. 21
BRITISH POUND DENOMINATED BONDS				
GOVT. OF SWEDEN 9 3/8% 14/4/93	97	- 97 3/4	10.77%	Apr. 14
FRENCH FRANC DENOMINATED BONDS				
EUROPEAN INV. BANK 6 3/4% 12/1/95	99 1/4	- 100	8.75%	Jul. 12
JAPANESE YEN DENOMINATED BONDS				
GOVT. OF CANADA 23/7/93 5 5/8% IRSP eligible	97	- 97 3/4	6.79%	Jul. 23
CANADIAN DOLLAR DENOMINATED BONDS				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	102	- 102 3/4	10.36%	Jul. 8
GOVERNMENT OF CANADA (semi annual) 01/09/91 9%	99.75	- 100.05	9.18%	Sep. 1
NEW ZEALAND DOLLAR DENOMINATED BONDS				
CIN. IMP. BANK OF COMMERCE 27/07/92 14% IRSP eligible	103 3/4	- 104 1/2	9.41%	Jul. 27
TOURIST HOTEL 0% 04/06/93	82 1/4	- 83	10.07%	matures Jun. 1993
AUSTRALIAN DOLLAR DENOMINATED BONDS				
General Electric 11/01/92 14 1/4% (semi)	103 1/2	- 104 1/4	10.10%	Jul. 11
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	105 1/2	- 106 1/4	11.43%	Jul. 1
WORLD BANK 15/03/93 12 3/4% IRSP eligible	102 5/8	- 103 3/8	10.43%	Mar. 3
U.S. DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03(semi) CV @330 p/sh	73	- 74 1/2	12.12%	Dec. 15
ALLIANT COMPUTER 7.25% 15/05/12(semi) CV @339.75 p/sh	20	- 23 1/2	33.45%	Nov. 15
COOPER CO'S. 10 5/8% 01/03/05(semi) CV @377.45 p/sh call in 1995 @100	74 1/2	- 76	15.29%	Sep. 1
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @339.50 p/sh	30	- 33 1/2	18.28%	Sep. 1
BURNUP & SIMS 12% 15/11/00 (semi) CV @319.25 p/sh	50	- 55 1/2	25.63%	Nov. 15
U.S. DOLLAR DENOMINATED FIXED RATE BONDS				
SOUTHBANK 12% 10/8/97 (semi)	56	- 62 1/2	7.98%	Jan. 15
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES	Bid	Offer	Current Coupon	
UNITED KINGDOM 24/9/96 3 mo LIBID-1/8 (qly) *callable @100 09/91	99.80	- 100.10	6 3/16%	Jun. 30
REPUBLIC OF ITALY 30/4/93 3 mo Limean(qtly)	99.60	- 100	6 1/8%	Jul. 31

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/MICHEM

Chart 18
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\$, DM, SF, DKr, BP, FFr, Cdn, ECU) or revalue (JY) before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of June 19, 1991.

	U.S. \$	NEW ZEALAND \$	AUSTRALIAN \$	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE	BRITISH POUND	FRENCH FRANC	EUROPEAN CURRENCY UNIT	CANADIAN DOLLAR
1 year	6.35%	CIBC 14%, 92, yields 9.41% (.559 NZ/US)	Gen. Elect. 14%, 92 yields 10.10% (.737 A/US)				Denmark 9%, 92, yields 9.38% (7.114 Dkr/US)				
2 year	6.96%	Tourist Hotel 0%, 93 yields 10.07% (.543 NZ/US)	World Bank 12%, 93, yields 10.43% (.7162 A/US)	E.I.B. 5 1/2%, 93 yields 8.15% (1.829 US/DM)		Canada 5%, 93, yields 6.79% (139.61 US/JY)		Sweden 9%, 93 yields 10.77% (1.522 BP/US)			
3 year	7.40%		CBA 14%, 94, yields 11.43% (.683 A\$/US)								
4 year	7.60%			Sweden 7 1/4%, 95, yields 8.22% (1.831 US/DM)				EIB 8%, 95, yields 8.75% (6.354 FFr/US)			
5 year	7.96%			Bk. of Nova Scotia 5%, 96, yields 8.54% (1.838 US/DM)							Ontario Hydro 10%, 96, yields 10.36% (1.275 US/CD)
6 year	8.09%			World Bank 5%, 97 yields 8.52% (1.832 US/DM)							
7 year	8.21%				Australia 5%, 98 yields 6.48% (1.375 US/SF)						
10 year	8.34%									U.K. 9 1/4%, 2001* yields 9.06% (1.004 ECU/US)	
Spot Exchange Rate	N/A	.5751	.7634	1.7895	1.539	140.05	6.9175	1.633	6.0895	1.1453	1.1424

*For example, since a US\$-based investor would receive 72 basis points (906-834) by holding the U.K. ECU bond, the ECU can depreciate to 1.004 ECU/US from the present spot exchange rate of 1.1453

ECU/US over the next 10 years for the ECU investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

THE EXOTICS

Portuguese escudo

The inevitable, eventual entry of the Portuguese escudo into the ERM, has proved to be nothing less than a monetary nightmare.

The vicious circle runs as follows: A high inflation economy (around 13%) running flat out requires a tight monetary policy, which in turn sends interest rates skyward (Eurocurrency deposits 13% per annum; government bonds 20% per annum). This attracts foreign inflows, which bet on high yields and little or no currency depreciation given the escudo's shadowing of the ECU.

These massive inflows are monetized by the bank of Portugal in a desperate effort to hold the upward creep of the escudo. The monetization of course defeats the tightening effort, and the Bank of Portugal finds itself in the position of fighting a no-win battle: Inflation continues to soar, the boom continues, and the escudo's real rate of exchange continues to rise (by 15% over the last two years).

We foresaw this problem some months ago (see our February 24, 1991, issue) and have been able to capitalize handsomely on the results.

Bank of Portugal governor Jose Tavares Moreira has come out feigning, by opening up the possibility of a sudden devaluation. In recent days the escudo has weakened slightly *vis à vis* the DM, but it is doubtful whether the strategy will pay off. A devaluation under present conditions will only

exacerbate an already serious inflationary problem.

On present course the Bank of Portugal runs the risk of finally joining the ERM at too high an exchange rate, being forced eventually to have to endure a severe deflationary bout. Far more sensible would be to adopt a fiscal shock and cut government expenditures so as to lower the boom, lower interest rates, and discourage capital inflows. Of course it would be preferable for the Bank of Portugal to choose a date for entry into the ERM to eliminate uncertainty. In economic matters that is always the correct thing to do.

Finally, we are comfortable being long escudo/short DM and would add to those positions should there be an artificial devaluation.

Note: The May 1991 issue of *International Financial Statistics* published by the IMF revised the 1988 current account to a \$4,421 million deficit from a \$632 million deficit. This revision, which represents 9.5% of GNP, has to our knowledge not been explained. Similarly, 1987 figures were revised from a \$640 million surplus to a \$450 million surplus, while 1989 figures now show a \$155 million surplus instead of \$554 million deficit.

Our advice is for traders to beware: Statistics are difficult enough to understand, but when revised so drastically, they are impossible to use.

Chart 20 – HARD CURRENCY COVER

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

Reserves * + Previous 12-months curren Account *** = 19578
 (Reserves + 12-months C/A) / MI ** = 19578/16508 = 118%
 (Reserves + 12-months C/A) / Broad Money ** = 19578/61180 = 32%

*As at March 1991 ** Feb. 1991 *** 1990

Figures in millions of U.S. Dollars

	MI (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
19 81	8,436	26,901
19 91 (Feb.)	16,508	61,180
% Increase (decrease)	95.6	127.4
Corresponding % increase in the United States	82.01	249.3

Source: IFS

FOREX RATES & UPDATE

Currency	Spot	3-Month	12-Month	Comments vis à vis US\$	Comments vis à vis DM (Spot DM: 1.7900)
Australian dollar	.7641-.7648	.7560-.7571	.7371-.7398	Neutral	Neutral
*Belgian franc	36.81-36.85	37.06-37.16	37.52-37.96	Neutral	Neutral
*Danish krone	6.9000-6.9050	6.9530-6.9650	7.0620-7.0850	Neutral	Neutral
*Dutch guilder	2.0155-2.0165	2.0311-2.0326	2.0599-2.0629	Neutral	Neutral
**Finnish markka	4.2600-4.2650	4.3090-4.3170	4.4345-4.4495	Neutral	Cover
Greek drachma	195.75-195.85	201.35-205.85	219.25-234.25	Neutral	Neutral
Hong Kong dollar	7.7140-7.7160	7.7525-7.7610	7.7890-7.8210	Neutral	Neutral
*Irish punt	1.4850-1.4855	1.4705-1.4720	1.4420-1.4450	Neutral	Neutral
*Italian lira	1332-1333	1348-1350	1391-1395	Neutral	Neutral
Malaysian ringgit	2.7800-2.7810	2.7905-2.7965	2.8100-2.8210	Neutral	Neutral
New Zealand dollar	.5765-.5775	.5714-.5728	.5615-.5645	Remain long	Remain long
*Norwegian krone	6.9900-6.9950	7.0600-7.0710	7.1985-7.2230	Neutral	Neutral
Saudi Arabian riyal	3.7500-3.7510	3.7495-3.7515	3.7515-3.7540	Neutral	Neutral
Singapore dollar	1.7760-1.7780	1.7775-1.7825	1.7770-1.7880	Neutral	Neutral
*Spanish peseta	112.65-112.75	114.26-114.42	117.70-118.00	Neutral	Neutral
*Swedish krona	6.48-6.4850	6.55-6.56	6.72-6.74	Neutral	Neutral

Explanatory Notes

*As per hotline update of June 18, 1991.

**Denotes change in recommendation from last market letter.

Currency expected to firm against both currencies.

Buy Buy

Currency expected to strengthen against US\$ and weaken against DM.

Buy Sell

Currency expected to weaken against both major currencies.

Sell Sell

Currency expected to weaken against US\$, but strengthen against DM.

Sell Buy

Term used to liquidate short position but does not imply a new buy recommendation.

Cover

Term used to indicate sale advice of previous long position, but does not imply a new short sale recommendation.

Liquidate

HOTLINE UPDATE

Tuesday, May 28:

There are no changes or new recommendations. The market letter is in the mail.

Flash update, Friday, May 31, 9:00 a.m.:

Liquidate DM, SF, JY, and other EMS long positions at the market. Stand aside temporarily. Present level 5780 for June.

Friday, May 31:

We repeat the flash update of this morning 9:00 a.m. Liquidate DM, SF, JY and other EMS long positions at the market. Stand aside temporarily. There are no changes or new recommendations.

Flash update, Monday, June 3, 10:25 a.m.:

Reinstate short positions in the US dollar. Our preference remains in June 91 DM. Present levels .5717; interbank at 1.7480.

Tuesday, June 4:

No changes or new recommendations. Keep in close contact for flash updates in our currency positions.

Flash update, Friday, June 7, 1:35 p.m.:

The dollar bulls are once again in command, at least temporarily. Although we remain longer term bearish on the US dollar, we must respect near-term strength. Therefore, we advise selling June'91 DM if it closes today below 56.60 (equating to approximately 176.60 basis interbank spot). The June '91 DM is presently trading at 56.34.

Key off the DM for guide to liquidating other long European EMS and Japanese positions.

Keep in close contact in case we reverse this trade. There are no other changes or new recommendations.

Friday, June 7:

This is a recap of this afternoon's flash update.

4:30 p.m. postscript, given that the June '91 DM closed at 56.41, we have effectively been stopped out.

No other changes or recommendations. Keep in close contact.

Tuesday, June 11:

There are no new changes or new recommendations. Stay in close contact for our next currency recommendation.

Flash update, Thursday, June 13, 8.45 a.m.:

Reinstate short positions in the US dollar. Our preference remains in the DM present levels in the Sept. 5505 interbank level 1.8030 These are nervous trading markets, please keep in close contact for further recommendations.

Friday, June 14:

There are no new changes or recommendations. We will just repeat flash update of Thursday June 13, at 8:45 p.m.

Reinstate short positions in the US dollar, our preference remains in the DM present levels in the September 5505 interbank level 1.8030. These are nervous trading markets; please keep in close contact for further recommendations.

Flash update, Tuesday, June 18, 8:35 a.m.:

Liquidate at market long DM and other European EMS and Japanese positions. Current rate of September DM .5475 and interbank rate 1.8140. Keep in close contact.

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