

FRIEDBERG'S

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Seeing the chasm

The myth of Wall Street's legendary prescience is about to be destroyed. For almost one year, it forecast the end of recession and the beginning of a sluggish recovery accompanied by a dramatic turnaround in corporate fortunes. A normal and expected post-war blip was hailed as the beginning of The Recovery, the subsequent "softness" gave rise to some concern about a double-dip contraction. But never mind, the recovery was "fragile" but "well-based."

Wall Street defied Main Street and common sense, hoping that every quarter would usher in The Reversal. It was not to be. The first, then the second, and finally the third quarter of 1991 revealed a continuing pressure on corporate profit margins (see Chart 1). What seemed like once-and-for-all restructuring accompanied by severe cutbacks was seen only months later to be insufficient surgery; more layoffs have been announced on top of earlier ones, more asset sales, more loss provisions.

Wall Street's optimism was based on historical precedent. Wall Street is not prescient; it merely owns gigantic computers with extensive data banks. It can compare previous cyclical behavior, it can project probable economic activity. And it can do the same with stock market behavior.

The information explosion and the ever larger concentration of investible funds in the hands of "well informed" institutions almost instantaneously discounted the future (Dow Jones Industrials advanced 22.7% in 7½ short weeks — Jan. 14 to March 6 — while it spent 36 weeks advancing a mere additional 2.2% to the recent October highs, 91.1% of the advance in 17.2% of the time).

What is more, those institutions that lacked the fundamental apparatus to make economic projections (or lacked faith in them) were pressured by the extraordinary strength exhibited by the market, a case of the blind leading the blind. Back in February, in a piece entitled "Looking through rose-colored glasses," we commented: "Stock markets have become mere games of baseball. Screens spit out the statistical record of each player as he comes to bat. He's just a number. We find rules such as "two tumbles and a jump" — when the Fed cuts the desired rate twice, the stock market climbs....

"Or even the more esoteric Breadth Stampede (a 2 to 1 ratio of advances to decline on a 10-day moving average basis)....

"The greater the stampede, the more bullish the implica-

tions. The logic eludes us. Are we to believe that *smart money* acts in such haste, buys with such abandon? Is it possible that the revealed truth appears simultaneously to hundreds of institutional investors who for months professed a deep atheism? Or is it — as is more likely — that only one Seer received the Truth, and his blind followers jumped aboard? Should we, then, be impressed by the fanaticism of his followers just because they are rich?"

Ten months after the onset of one of the most spectacular bull moves in history and four discount rate cuts later (rates are now a full 30% lower than at the start of the year), the economy looks sicker than ever.

As we enter an election year, a slight sense of panic and discontent has set in. And so, some economists (although, admittedly, a diminishing group) see a need to further lower interest rates, believing that negative rates will jump-start the economy. Others (mostly, politicians) believe that some tinkering with tax rates (lowering some, raising some), spending and tax incentives (for the purchase of first homes, Amer-

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Contributions by Albert D. Friedberg, Dr. Steve H. Hanke, David B. Rothberg, and Daniel A. Gordon.

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

ican cars, boats, etc.) will do the trick. While others (mostly, the Bush Administration) believe that the recession will go away with some good P.R.

Wall Street sensed this discontent the day Washington floated the idea of legislating a cap on credit cards, presumably to stimulate more consumer buying. If the ensuing stock market selloff was a reaction to this sensing of panic in Washington, it is understandable. And if it was based on concern for the deteriorating banking system's health, it is also justifiable.

What worries us is that neither Wall Street nor Washington understand the *real* problem.

Although they see the chasm — a continuing recession that may turn into a deeper, far deeper affair — they are totally oblivious to the way out.

They are aware of the ongoing process of debt liquidation and want to reverse it. But they fail to see that credit cannot be expended while income and the capacity to service this credit/debt is still falling.

While it is true that for the economy to resume growth, total debt, in absolute terms, must not recede, it is also true that the private sector's (corporation and household) income cannot support its present debt, let alone more debt, on its present income level.

At this stage, the private sector needs more income, not more debt, a point we have been stressing for some months (see for example last month's issue, "Fleeting images of another Great Depression"). But more income cannot be generated unless there is more debt created in much the same way as one cannot lift himself up by his own bootstraps. This Catch-22 situation can only be solved via increased government debt.

As discussed last month, a substantial across-the-board, nondiscriminatory, and permanent tax cut would immediately increase disposable income, thus improving the private sector's debt/income ratio. The increased initial deficit would be financed via more Treasury borrowings.

In effect government debt would take the place of private debt. As government debt "substitutes" private debt, commercial banks' balance sheets are restored: Treasury debt rises as a percentage of total bank assets (or bank credit, as commonly called), and the diminishing proportion of private debt turns more solvent as the private sector's debt servicing capacity improves.

Eventually, this reliquification process comes to an end (it is clearly not as profitable as lending) and lending to the private sector begins a timid recovery. By then, the private sector's debt/income ratios have sufficiently improved to warrant a new lending cycle.

In this respect, it is instructive to observe the leveraging/deleveraging cycle in the US farming sector. Chart 2 shows that debt expansion accompanied the spectacular increases in farm income in the '70s, a period marked by dramatic

increases in food prices. From 1980 onward, as farm incomes collapsed, debt *fell*. Initially, the decline in income was greater than the severe decline in debt, and the debt/income ratio failed to improve (Chart 2). From early 1986 onwards, incomes began to outpace the rise in debt, and the ratio improved. Of course, the farming sector is a relatively small sector in the overall economy; a deleveraging process is possible so long as the overall economy does not collapse — otherwise, incomes never rise.

The farm sector analysis provides a glimpse of the difficulty of achieving similar results in the proportionally much larger manufacturing/service sectors of the US economy. Clearly, it will require a massive effort on the part of a third party, i.e., the government (the external sector in the US is too small to carry the ball, especially when the rest of the world is also in a slump).

It is interesting to note that the shrinkage in the rate of increase of private debt on the past two years (Chart 3) has been partly offset by the increase in net federal debt over the similar period. During this time, real GNP barely changed. This is the automatic stabilizing feature of the budget; if left to its own devices, private sector debt could collapse almost entirely, over an *extended period of time*, while the federal debt, by virtue of ever larger budget deficits, offsets at least partially the impact on GNP.

The private sector would undergo a slow and extremely painful process of suffocation, and federal finances would become so suspect that it is doubtful that we would live to see the end of the process — either the government's credit rating sinks as it becomes unable to borrow further unless the Fed monetizes the debt (resulting in hyper-inflation) or the government raises taxes, presumably to close the widening financial gap, eliminating almost entirely the last vestiges of a private sector.

Clearly, the automatic stabilization (or passive debt substitution) process is *unsustainable*. What is needed is an active debt substitution policy on the part of the government, i.e., a planned increase in the deficit.

Unfortunately, the fiscal deficit is rapidly approaching 6% of GNP, a result of slumping government revenues. As opposed to previous recessions (Chart 4), fiscal policy flexibility is being hampered by this enormous budget deficit. It is easy to see why Washington continues to frame its tax cut proposals within a revenue-neutral scheme. But as our foregoing discussion makes clear, there is no quick exit from this persistent contraction short of a massive expansion of government debt to finance a tax-cut-led increase in disposable personal income.

Wall Street and Washington have finally seen the chasm but don't have the faintest notion of how to avoid falling into it. As the sense of panic grows, confidence will be shattered with ominous consequences for the economy, Wall Street, and the dollar.

Chart 1

BIG DECLINES IN MARGINS
S&P Industrials
Trailing 4-Quarter Profit Margin

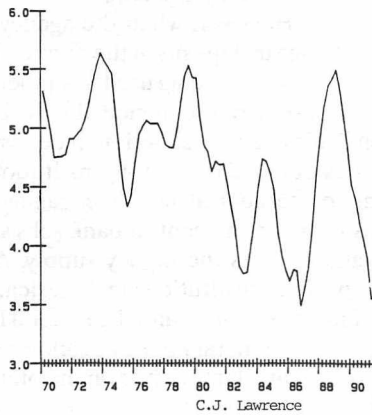


Chart 2

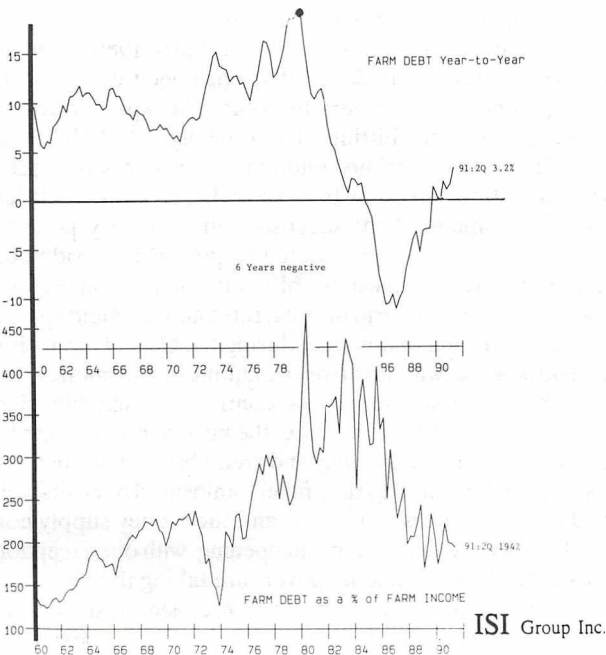


Chart 3

U.S. Non-Financial Total Debt
Year-to-year \$ change

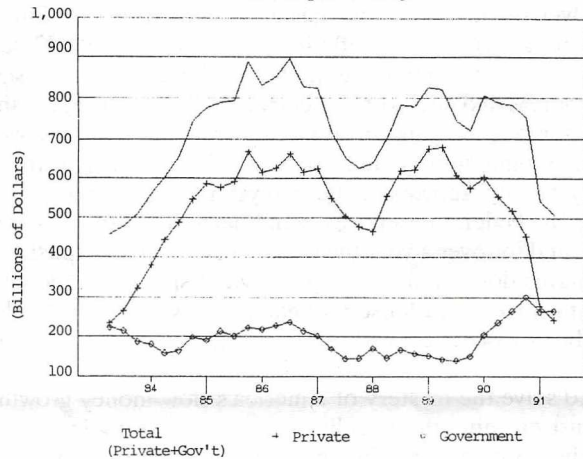
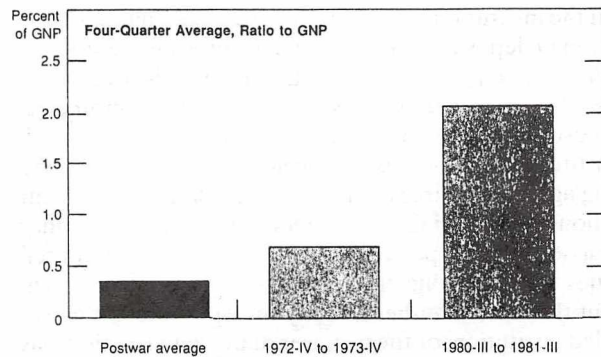


Chart 4

FEDERAL BUDGET DEFICIT PRIOR TO RECESSIONS
relative to GNP.



Note: Federal budget deficit is measured on a National Income and Product Accounts basis.

Federal Reserve Bank
of New York

MONEY SUPPLY

Solving the riddle

The most reliable indicator of economic activity for America has been the relationship between yields on short-term and long-term government securities. When short-term yields exceed long-term yields, the so-called yield spread is negative. In that case, financial institutions find it unprofitable to extend long-term credit because the cost of obtaining short-term funds exceeds long-term lending rates. As a result, the economy tends to slow down. When short-term yields are less than long-term yields, yields spreads are positive, and financial institutions generate profits by obtaining short-term funds and lending them long term. As a result of that credit expansion, the economy tends to grow at an accelerated rate.

Since World War II, the yield spreads have predicted all

turning points in the American economy, including the "double-dip" recession in 1980 and 1981. At present, the yield spread is positive and very large, with the short-term federal funds yield at about 4.5% and 30-year bond yield at about 8.0%. With that positive 3.5% yield spread, the economy should be growing at a rapid rate. Although the third quarter's real GNP growth was 2.4%, that is much below what is normal for the early stage of an economic recovery (5.0% to 6.0% is the norm) and also much below what is predicated by the large positive yield spread.

Why is growth so anemic and uncertain? One factor is the public's lack of confidence in President Bush's economic policies. Another factor is the slow growth in America's

money supply, specifically M2 (currency, demand deposits, small time deposits, and money market funds). That measure of the money supply is important because real M2 is a leading indicator of future economic activity.

Over the past year, M2 has grown only by 2.4%. Since that rate is less than US inflation of about 4%, real M2 has actually been declining. We, therefore, have conflicting signals from two indicators of monetary policy and future growth. Yield spreads indicate loose money and growth, while M2 indicates tight money and recession. The slow growth in money supply appears to be a mystery. To set monetary policy, the Federal Reserve System is using yield spreads as a guide, and for over a year the central bank has been pushing short rates down and allowing the yield spread to become more positive. That loose monetary policy position should have been associated with an expansion in credit and the money supply. But that normal relationship has broken down.

To solve the mystery of America's slow money growth, we must examine the peculiar process of closing insolvent depository institutions (the savings and loan crisis), and how that affects the money supply process. In the simplest case of a failed institution without deposit insurance and any assets, the reduction in deposits (the money supply) is equal to the deposits on the institution's books. In that case, the closing of an institution with \$100 in deposits would reduce deposits by \$100. If the institution has some assets (for example, \$70), the reduction in deposits would be smaller (for example, \$30).

With the deposit insurance, the analysis is a bit more complex, but the results are the same. Under deposit insurance, the depositors suffer no reduction in deposits when an insolvent institution is closed. But deposits *are* reduced when the insuring agency acquires the funds to liquidate the insolvent institution. The insuring agency acquires the funds by either selling assets from its portfolio or having the government sell securities and receiving those proceeds. The agency then pays out those funds either directly to depositors if it closes the failed institution, or the acquirer of the failed institutions if that institution is acquired by another solvent institution. The net result is that deposits in the financial system will fall by an amount equal to the funds disbursed by the deposit insuring agency, regardless of the source of those funds.

Closing failed depository institutions is, therefore, a peculiar case of government spending that impacts deposits in the financial system. To understand that peculiar case, first consider a normal increase in government spending financed by either borrowing or taxing. In that case, deposits are reduced by say \$100 when government finance is raised. However, deposits are increased by \$100 when government spending occurs. Hence, there is no net change in deposits in

the financial system. Now, consider the peculiar case of government spending to close a failed depository institution. Deposits are reduced by say \$100 when the insuring agency acquires funds. However, when the agency disburses funds, there is no change in deposits in the financial system, because the disbursed funds are being used to support \$100 in deposits that already exist. In consequence, the closing of an insolvent institution leads to a net reduction in deposits of \$100.

Closures of failed depository institutions are, therefore, equivalent to the central bank's engaging in open market operations in which the central bank sells securities from its portfolio and reduces the money supply. As a result of the crisis in depository institutions in America, we have an unusual situation. On the one hand the Federal Reserve System is following a loose monetary policy of allowing yield spreads to become positive and large, while on the other hand, the crisis in depository institutions is completely offsetting that loose policy position by imposing an external peculiar tightness on monetary policy.

The magnitude of the tightness imposed by the crisis in the depository institutions is enormous. Since 1986, when the crisis began, more than \$300 billion has been expended by insuring agencies. Moreover, the volume of expenditures has been rising over time, hitting an all-time high of \$19 billion in July 1991. If that were not enough, the process of closing insolvent institutions is far from over. Indeed, the job is less than half complete. That suggests that monetary policy is likely to continue to be subjected to powerful outside contractionary forces, regardless of what the Federal Reserve Bank does with short-term interest rates and the yield spread.

It is interesting to note that during the Great Depression, the yield spread was positive, signalling loose money and growth, but the money supply was contracting, signalling tight money and recession. At the time, the normal relationship between yield spreads and money and credit broke down because banks were failing, and as they failed, uninsured deposits were wiped out, depositors took a hit, and the money supply contracted. Today, the same thing is happening, with one exception: Deposits are insured, and taxpayers are taking the hit.

Given the peculiar economics of closing insolvent depository institutions, America will continue to be locked into a slow monetary growth path. In consequence, it will not realize a strong economic recovery. Indeed, it could slip into a "double-dip" recession. Regardless of what President Bush attempts to do to jump-start the economy, he will fail. Hence, the President will face serious difficulties in the 1992 elections. Indeed, President Bush might very well be only a one-term President.

— Dr. Steve H. Hanke

US DOLLAR

Test of the January lows directly ahead

The US dollar decline is gathering momentum as the convergence theory begins to evaporate. While it is true that Germany and Japan are entering (or have already entered) a recession, there is little doubt that the US decline is proceeding at a much faster rate.

Anticipating capital flows is essential, and here there's little doubt of where they are heading. In the first place, interest rate differentials are still widening and now stand at an historic 425 basis points, basis three-month Euro-DM. Secondly, confusion and panic in Washington are certain to

unnerve foreign investors holding almost \$450 billion of US Federal debt and much more in the way of equities.

Deprived of a clear monetary and fiscal policy, the US dollar stands defenceless, and almost groggy, against the continuing onslaught of currency traders. The destabilizing speculative bandwagon (see our previous discussions in our April and May 1991 issues) has moved into reverse.

STRATEGY: Maintain long positions in Japanese yen, EMS, and EMS-related currencies, particularly the DM. We would consider liquidating these positions, if and only if, the Bush Administration proposed massive tax cuts (as discussed in our opening piece).

Chart 5 – CME Deutsche Mark Dec 91

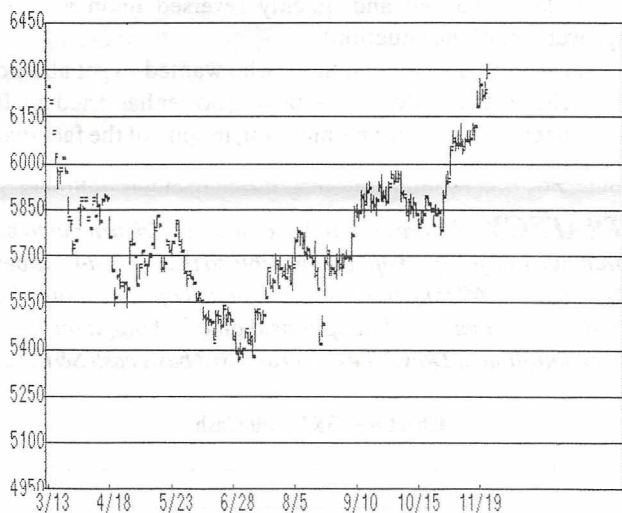
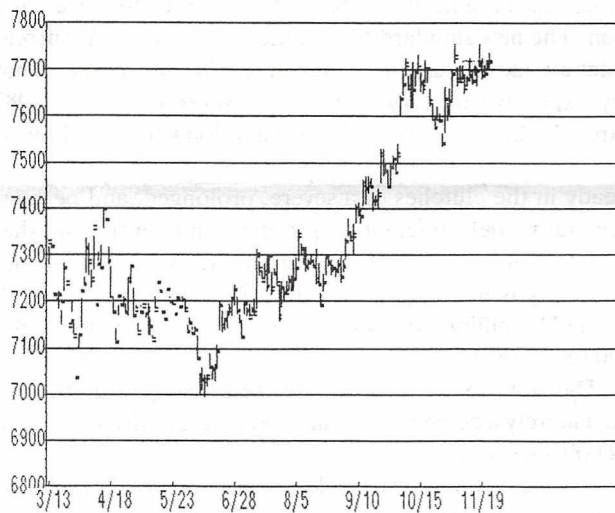


Chart 6 – CME Japanese Yen Dec 91



CANADIAN DOLLAR

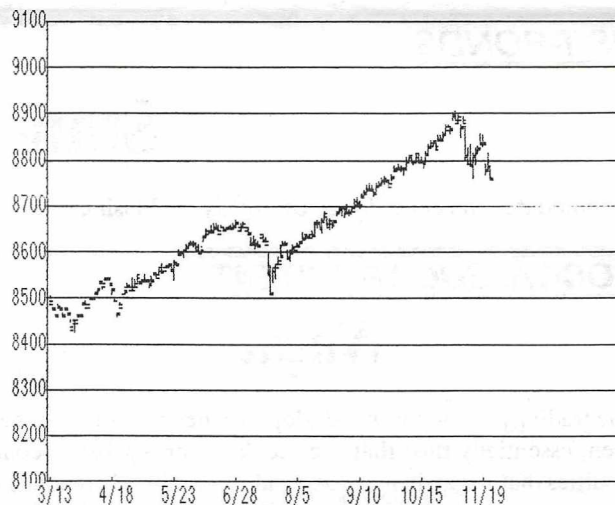
Stay long

Having reentered prematurely the long side of the Canadian dollar on Nov. 19 (per Flash Update), we prefer sitting it out barring an unforeseen development.

Monetary policy remains well focussed and under excellent control, with M2 growing at a 6.2%, year over year. The Bank of Canada *may* find itself slightly ahead of its money supply and inflation targets and *may* use the opportunity to lower rates a bit faster than expected.

Despite erratic monthly figures, the merchandise trade balance continues to fluctuate around a \$10-\$12 billion surplus; thus the currency does not appear to be overvalued in any sense of the word. On the other hand, continued foreign borrowings will underpin the Canadian dollar for the foreseeable future; during the first six month of this year, provinces and their utilities raised a net \$12.4 billion abroad — *double* the level for *all of 1990*. Mismanaged, socialist, provincial governments have become (as explained in the past) a bullish factor in the foreign exchange value of the Canadian unit.

Chart 7 – CME Can. Dollars Dec 91



STRATEGY: Remain long via (cheap) call options.

STOCK INDEXES

Living on the edge

In a desperate attempt to keep the market afloat (and their sensational underwriting profits), Wall Street has resorted to 1987 comparisons to justify present levels: Dividend yields are *not as low*, interest rates are lower, price-earnings ratios (though astronomic at 21x, basis the S&P 500) are lower, and so on. The new standard of valuation is July 1987: If current values are more reasonable than in July '87, the market is not very expensive or very vulnerable. Never mind that 1987 shared the highest degree of overvaluation with that ill-fated year, 1929. Never mind that the economy, unlike 1987, is already in the clutches of a severe, prolonged, and perhaps accelerating debt liquidation process. And never mind that the supply of stock in 1991 has turned into a flood, while net new equity issues were *negative* by \$75.5 billion, \$129.5 billion, \$124.2 billion, and \$63 billion in 1987, 1988, 1989, and 1990 respectively.

Did Nov. 15 mark the first leg of a new bear market, or was it merely a correction in an ongoing blow off? That is the \$64,000 question.

Simple technical yardsticks are flashing extreme danger. We enumerate some of them: 1) New 52-week lows exceeded new 52-week highs every day of this past week, for the first time since Jan. 15, 1991; 2) the market scored new highs in October even as barely 50% to 55% of issues were above their own 30-week moving averages, a serious divergence and loss of momentum from the February/March period when over 90% of issues were above their 30-week moving average; 3) the market itself has fallen below its own 30-week moving average, although this average has a yet to turn down; 4) the extremely low cash position of pension funds and better but nevertheless still low cash reserves of mutual funds; and so on.

What disturbs us most is the *ease* with which the market

fell an astounding 3.9% on that Friday — relatively low volume for such a move (236 million shares) — and the lack of any meaningful bounce in the subsequent days despite lack of substantive news (compare with Soviet coup attempt where the market collapsed and quickly reversed upon a *slight* improvement of the situation).

It appears to us that all those who wanted to get aboard the bull have already done so — buying power has dried up. If so, the decline can gather momentum, in spite of the fact that the market has become slightly oversold.

STRATEGY: *We are at the edge of what could turn out to be a dramatic free fall, perhaps comparable to the August-October 1987 collapse. All long positions and/or call options should be liquidated immediately. Put options should be bought on intra-day penetration of Dow Jones 2860 and 373 basis cash S&P500.*

Chart 8 – S&P 500 Cash

**US T-BONDS**

Standing aside

We liquidated the entire long position as per Flash Update of Nov. 19. Stand aside.

COCOA, SUGAR, WHEAT

Wheat

The trading philosophy we've adopted since mid-summer has been, essentially this: that the secular bear market in commodities that began in mid-1980 had either already reached a bottom or was approaching one; but that the subsequent advance of individual markets would be restrained, at least in

the immediate term, by the recession, which, as we've opined repeatedly over the past 18 months, has been worse than expected.

Against this trading philosophy and with wheat having advanced by 70¢ a bushel, or 25%, Friedberg Mercantile Group has advised selling long positions in wheat at a healthy profit (Flash update of Nov. 15). I respect this view. But I dissent.

My contention is this: The market is tight. Domestic (US) ending stocks are projected at 18-year lows. World stocks, primarily due to unfavorable growing conditions in Australia, China, and, most importantly, the Soviet wheat producing republics, are similarly tight — at 123 mln. tonnes they will be a resounding 12% less than they were in 1990-91.

With so small a cushion the demand margin is small; it would not take much surprise buying to propel prices into orbit.

Any marginal increase will come from the the republics that previously constituted the USSR or, more specifically, from the West's — i.e., Washington's — willingness to grant supply or the credit to meet that demand.

There is nothing remarkable or unique about this observation. Every grain trader operating within a 10,000 kilometre radius of the Chicago Board of Trade masticates at word of increased credits to Moscow. Yesterday's announcement of \$1.25 bln. in aid in the form of various grains — the allocation amongst wheat, corn, beans, etc. will be made as we go to press — lifted wheat prices a healthy 13¢ to a test of the current bull market highs.

Interestingly, it was wheat that advanced the most amongst the grains although Agriculture Secretary Madigan emphasized that the aid would be directed toward the feed sector. Of greater interest to me has been the fact that farmers have not sold into the rally, and today, the day after the announcement, prices have held.

The Soviet Republicans want wheat because they are hungry. And the farmers and I both suspect it is this ugly basic truth that will motivate the market through to the end of the current crop year. Conventional notions of "repairing the economy," and "creditworthiness" sound absurd when applied to a place — not even a country but a place — in which people are travelling 30 miles to scour garbage heaps for food.

The Soviets want wheat because wheat is food for people to eat today; feed grains are for animals to eat today so people can eat tomorrow. In the Republics the future has become irrelevant. So desperate are they that the only instance we've seen of unity amongst the remaining republics came about the day before the food aid package was announced — a not coincidental event — when the eight of them all agreed to repay what they owed to Western creditors in return for a South America-in-the-eighties-style \$1 billion ADDITIONAL loan plus a one year moratorium on interest repayments, which itself is worth an estimated \$5 billion to \$10 billion dollars.

Does it sound as though the West may be nearly as desperate to feed them as the citizens of the republics are to eat?

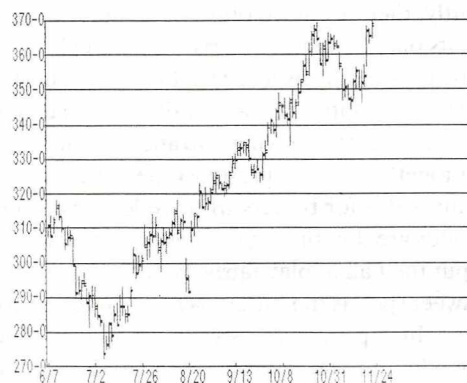
Yes, and with good reason. In Germany, the gateway from the chaotic East to the recession burdened West, even the Ossi, the newly liberated but largely unemployed East German workers, chant "Auslander Raus" (foreigners out), terrifying the pre and post war generations and prompting Helmut Kohl to state that the "increasing flood of asylum-seekers is the most important domestic issue next to monetary stability."

The two issues — asylum-seekers and monetary stability — are not unrelated. The dreadful truth that has thus far been shamed mute is that the last thing the West wants — the last because it simply lacks the economic or social means to accommodate them — is a migration of starving people into Germany. And there is no limit to the amount of aid the West will give to prevent this happening.

It is from this point of view that this author's view of the market may have some originality — a necessary requisite to any successful speculative endeavor. To summarize: The crisis in the republics represents not just an immediate but a potentially RELENTLESS source of demand for food — i.e., wheat. That demand will be limited only by the extent of the crisis. Given the overall tightness of the market, it could propel values to as much as double current ones.

STRATEGY: For readers who have not sold, call options are the only way to play this. If and (hopefully) when they get deep in the money, careful scrutiny of the technical action will provide clues to a top. Bear in mind that one way or the other it will all be over within the next five months. Anyone who wishes to discuss this can call me directly.

Chart 10 – CBT Wheat Dec 91



Sugar

Too true to our market synopsis of last month the March contract rallied to test the 9.00 resistance level, failed to penetrate those highs, then parachuted to 8.20 which is to say it tested the lower level support, it failed to penetrate that level, and has now turned higher.

There's been little fresh statistical information offered since last month. To reiterate: Industry statisticians have informed the market there will be a small production surplus of between 250,000 and 825,000 tonnes and that stocks at the end of the current marketing year will represent slightly more than 30% of consumption. Thirty percent is considered the critical level; anything less leaves the market vulnerable.

Our argument has been that there could be no surplus at all because of i) problems in Soviet growing regions, ii) Cuba having both less incentive and less capability to produce because of the breakdown in the barter agreement for oil that

the beleaguered island nation had with the Soviets, iii) anticipated adverse growing conditions resulting from a change in the weather in the wake of last June's eruption of Mt. Pinitubo.

Having, as I said, little new fundamental information, we are forced to resort to the market's technical aspects for clues as to how accurate our arguments have been. It's an imprecise business to be sure, but it's all we can do.

From the technical point-of-view, then, we must confess, the market doesn't look as robust as it did despite today's impressive run-up. The premium of the nearest contract — March — over the next delivery — May — has narrowed from as much as 30 points 10 weeks ago to virtually nothing. This indicates demand is being satisfied at current prices, that holders of inventory are not inclined to hold back their supplies from the market in anticipation of future price increases.

Market commentaries suggest this has happened because anticipated buying from the Soviets has failed to materialize. Could it be that conditions there are so bad that sugar will take a back seat to other food needs? I don't know.

There still has been no news of which we are aware regarding the Cuban crop. Next week, on the 29th, the USDA is scheduled to release a report on world sugar. Perhaps we will have a better indication then.

Presently, then, we have only the weather argument to hang our hats on. And here, surprisingly enough, conditions appear to be proceeding as forecast. Surface water temperatures in the South Pacific are warmer than average. Sunsets in the tropics are reported glowing a strange redolent ochre.

Taken together, at the present time we are left to conclude this market is for traders who are looking to hit home runs. The odds are that the big sluggers strike out more often than they put the ball in play fairly. But, if we tag it just right — on the sweet spot as the hitters say — “there she goes.”

The very high potential reward more than compensates for the high odds of potential loss, provided the potential loss is limited in amount. We have been stopped out of outright positions as per Hotline Update of Nov. 15.

Roll call options held on all deliveries through July out to October and beyond. Cheap out-of-the-money striking levels of 11¢ are appropriate for those aiming for the second deck.

Cocoa

After advancing approximately 30% from its July lows, the market has traded sideways for the past seven weeks. The tired, sideways action coupled with the predictably diminished open interest has left it vulnerable to fund selling and other essentially technical maneuvers. As I'm writing this, I'm reading the midday — Friday Nov. 22 — market commentary. It's laden with the classic cliches: “aiming for the stops,” “goosing it up to fill the gap.”

What's needed is a dose of some fundamental medicine to focus these guys on value. This is the first deficit year in the past seven. This is the first deficit year of what may very well be the next seven.

Cocoa is the classic example of a commodity being acted upon by very, very, cheap prices: It enjoys steady 4%-plus annual increases in consumption; it is suffering interruptions in supplies.

Patience is the order of the day. There is still enough cocoa around to satisfy nearly two thirds of a year's worth of consumption needs. The market will not be tight until we've had three deficit years running. And at the present time the market is weighted down by (African) origin sales that have been higher than usual for this time of the year and by a (cocoa) butter market which is extremely depressed due to overcapacity; manufacturers were overly optimistic about the prospects of newly-liberated Eastern Europeans, especially Germans, scoffing up Mars bars just like they do on CNN.

The recent tightening of the spreads — as in sugar, the difference between the nearest and next-to-nearest futures contracts — suggests the beans ground to make the butter may now be in somewhat shorter supply.

Still, this market must be regarded long-term and cautiously. Cocoa is a luxury item. We are in a recession.

In other words, caution AND patience are the or-DERS (sic) of the day. The strategy is to take profits on stop at 1215. If the technical guys do not take us out, we should expect a market that wafts higher — an aroma not a rocket ship. And if they do, we look to re-enter more propitiously.

— David B. Rothberg

Chart 11 — N.Y. #11 Sugar Mar 92

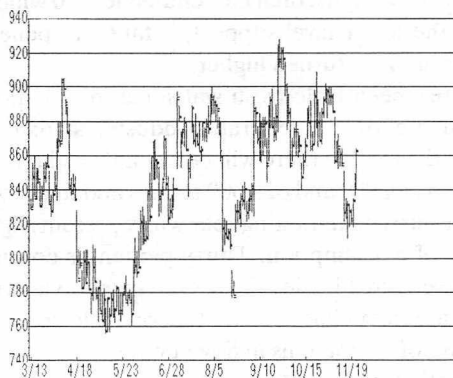
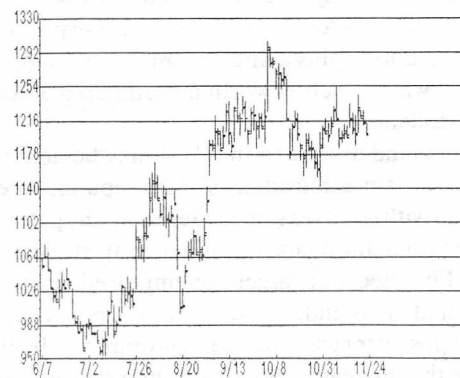


Chart 12 — N.Y. Cocoa Dec 91



FRIEDBERG CAPITAL MARKETS

Diceon Electronics Inc. update

Diceon Electronics Inc. 5½%, due 1/3/2012 convertible debenture

Recent price: \$27½

Yield to maturity: 22.06%

Although the company continues to post sales decreases (23% over the third quarter of 1990) and losses, a result of the prolonged worldwide computer slump, net cash from operating activities increased to \$5.59 million from \$3.99 million for the nine months ended June 29, 1991 compared with the same period last year. Gross margins remain slightly negative, understandable in view of the sharp drop in sales.

The company is a good deal leaner at this time and should be well positioned to take advantage of any economic turnaround. Long-term debt of \$32.5 million is almost exclusively represented by our convertible debentures. Against this, the company has \$28 million of net working capital (of which \$21.6 million is in cash and marketable securities).

In our opinion, despite continued losses and normal uncertainty regarding a future turnaround, the convertibles, now trading at 27% and yielding 22.06% to maturity, represent excellent value.

Risk-oriented portfolios are advised to maintain an accumulation program of these securities.

Chart 13
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, DKr, BP, FFr, ECU, CDN, SAR) or revalue (for JY and SF) before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. **Rates as of November 21, 1991.**

	U.S. \$	NEW ZEALAND \$	AUSTRALIAN \$	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE	BRITISH POUND	FRENCH FRANC	EUROPEAN CURRENCY UNIT	CANADIAN DOLLAR	SOUTH AFRICAN RAND**
1 year	4.82%	CIBC 14%, 92, yields 6.97% (.5557 NZ/US)	Gen. Elect. 14%, 92 yields 7.83% (.7696 A\$/US)				Denmark 9%, yields 8.98% (.6469 Dkr/US)				Canada 10¼%, yields 7.01% (1.1592 US/CD)	
2 year	5.50%	Tourist Hotel 0%, yields 7.29% (.5483 NZ/US)	World Bank 12¾%, yields 7.83% (.7578 A\$/US)	E.I.B. 9½% of 93, yields 7.95% (1.671 US/DM)		Canada 5½%, yields 5.28% (128.96 US/JY)	Denmark 8%, yields 8.91% (6.631 Dkr/US)	Sweden 9¾%, yields 9.70% (1.662 BP/US)				ESCOM 11%, 93 yields 15.72% (.2744 US/SAR)
3 year	5.84%		CBA 14%, 94 yields 8.94% (.7260 A\$/US)									
4 year	6.12%			Sweden 7¼%, yields 8.54% (1.747 US/DM)				EIB 8¾%, 95 yields 8.56% (5.973 FFr/US)				
5 year	6.53%			Bk. of Nova Scotia 5¾%, 96, yields 8.49% (1.738 US/DM)							Ontario Hydro 10¾% yields 8.59% (1.2422 US/CD)	
6 year	6.74%			World Bank 5¾%, yields 8.19% (1.731 US/DM)								
7 year	6.97%				Australia 5%, yields 6.76% (1.3994 US/SF)							
10 year	7.36%									Lik. 9¼% 01 yields 8.77% (1.121 ECU/US)		
Spot Exchange Rate	N/A	.5671	.7917	1.5962	1.419	129.50	6.222	1.797	5.453	1.2771	1.1355	.3302

*For example, since a US\$-based investor would receive 1,022 basis points (1572-550) by holding the ESCOM SAR bond, the SAR can depreciate to .2744 US/SAR from the present spot exchange rate of

.3302 US/SAR over the next 2 years for the SAR investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

**NOTE: These bonds pay interest in commercial rand, which presently trades at a premium to the financial rand used for this table.

Recommended bond portfolio allocation for new portfolios

For new portfolios, we recommend the following investments:

DM and/or ECU fixed-rate bonds	60%
US dollar high-yield convertible bonds	25%
New Zealand dollar bonds	15%

FRIEDBERG'S

**Chart 14
FOREIGN CURRENCY BONDS**

Date: November 21, 1991

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

ISSUER/MATURITY DATE/COUPON	BID	OFFER	CURR.ANN. YLD. TO MTY.	NEXT PAYMENT DATE
<u>SOUTH AFRICAN RAND DENOMINATED BONDS</u>				
ESCOM 11% 31/10/93 (semi)	91.65	92.40	15.72%	Apr. 30
<u>DEUTSCHE MARK DENOMINATED BONDS</u>				
KINGDOM OF SWEDEN 7 1/4% 1/2/95	96	96½	8.54%	Feb. 01
EUROPEAN INV. BANK 5 1/2% 9/8/93	95.45	96.20	7.95%	Aug. 08
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	88.95	89.70	8.49%	May 07
WORLD BANK 5 7/8% 4/2/97 RRSP eligible	89 3/4	90½	8.19%	Feb. 04
QUEBEC HYDRO 5 1/2% 1/5/96 RRSP eligible	87½			May. 01
<u>SWISS FRANC DENOMINATED BONDS</u>				
GOVT. OF AUSTRALIA 5% 30/10/98	88½	90½	6.76%	Oct. 30
<u>DANISH KRONE DENOMINATED BONDS</u>				
KINGDOM OF DENMARK 9% 20/11/92	99¼	100	8.98%	Nov. 20
KINGDOM OF DENMARK 8% 20/08/93	97 3/4	98½	8.91%	Aug. 20
<u>ECU DENOMINATED BONDS</u>				
UNITED KINGDOM 9 1/8% 21/02/01	101 3/8	102 1/8	8.77%	Feb. 21
<u>BRITISH POUND DENOMINATED BONDS</u>				
KGDM of SWEDEN 9/3/8% 14/4/93	98¾	99½	9.70%	Apr. 14
<u>FRENCH FRANC DENOMINATED BONDS</u>				
EUROPEAN INV. BANK 8 3/4% 12/7/95	99 3/4	100½	8.56%	Jul. 12
<u>JAPANESE YEN DENOMINATED BONDS</u>				
GOVT. OF CANADA 23/7/93 5 5/8% RRSP eligible	99 3/4	100½	5.28%	Jul. 23
<u>CANADIAN DOLLAR DENOMINATED BONDS</u>				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	107	107 3/4	8.59%	Jan. 08
GOVERNMENT OF CANADA (semi annual) 05/09/92 10 3/4%	102½	102 3/4	7.01%	Sep. 05
<u>NEW ZEALAND DOLLAR DENOMINATED BONDS</u>				
CDN. IMP. BANK OF COMMERCE 27/07/92 14% RRSP eligible	103½	104½	6.97%	Jul. 27
TOURIST HOTEL 0% 04/06/93	88 7/8	89 7/8	7.29%	4/6/93
<u>AUSTRALIAN DOLLAR DENOMINATED BONDS</u>				
General Electric 11/07/92 14 1/4% (semi)	103.15	103.90	7.83%	Jul. 11
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	110 3/8	111 1/8	8.94%	Jul. 07
WORLD BANK 15/03/93 12 3/4% RRSP eligible	105	105 3/4	7.83%	Mar. 15
<u>U.S. DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS</u>				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03(semi) CV @\$38 p/sh	78	81	10.93%	Dec. 15
ALLIANT COMPUTER 7.25% 15/05/12(semi) CV @\$39.75 p/sh	19	22½	35.07%	May 15
COOPER CO'S. 10 5/8% 01/03/05(semi) CV @\$27.45 p/sh call in 1995 @100	84	85	13.45%	Mar. 01
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @\$39.50 p/sh	24	27½	22.06%	Mar. 01
BURNUP & SIMS 12% 15/11/00 (semi) CV @\$16.79 p/sh	57	59½	24.08%	May 15
<u>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</u>				
REPUBLIC of ARGENTINA 7/10/93 11% (semi) 1 yr. put	101½	102½	9.87%	Apr. 07
SOUTHMARK CORP. 12% 10/8/97	63	66½	7.42%	Jan. 15
<u>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</u>				
UNITED KINGDOM 24/9/96 3 mo. LIBID-1/8 (qtly) *callable @100 09/91	99.77	100.07	5½%	Dec. 31
REPUBLIC OF ITALY 30/4/93 3 mo Limean(qtly)	99.17	99.57	5 7/16%	Jan. 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/MICHNOVS

THE EXOTICS

Finnish markka

Would that we were as timely as we were prescient. On March 24, 1991, we advised selling forward the Finnish markka against the purchase of a high yield EMS currency, and we made the following comment: "Given the inflexibility of wages, and the national aversion to the already high unemployment rate, it would appear that the new political realignment arising out of last week's election would be forced to choose a 10%-20% devaluation coupled with continued austerity."

However, on Sept. 15 we abandoned our bearish position, seduced by the Finnish central bank's fixing of the markka to the ECU around the central rate of 4.9489, with bands on either side of 1.5%.

Of course, the real problem of high labor cost did not go away. Two weeks ago it seemed that the Finnish government had obtained a 7% downward wage adjustment from its trade

unions, thus avoiding the need to devalue. With the rejection of the pact by the metal union, the speculative onslaught forced the central bank to float the currency at first, and later to formalize a 12.3% devaluation. The new central rate is ECU 5.5841, and the intervention points are at ECU 5.39166 and ECU 5.72516.

STRATEGY: *The Finnish central bank waited too long: The damage to confidence, reserves, and costs are too high. It will have to regain lost credibility by having to withstand a series of attacks on its currency. Trade the short side of the Finnish markka against the ECU, looking for a move down to the bottom of the band, and a widening of the forwards. Remain long against US dollar; most of the damage has already been done.*

FOREX RATES & UPDATE

<u>Currency</u>	<u>Spot</u>	<u>3-Month</u>	<u>12-Month</u>	<u>Comments vis à vis US\$</u>	<u>Comments vis à vis DM (Spot DM: 1.5870)</u>
Australian dollar	.7925-.7930	.7860-.7870	.7690-.7715	Neutral	Neutral
Belgian franc	36.68-36.72	33.03-33.11	34.01-34.17	Remain long	Neutral
Danish krone	6.1700-6.1750	6.2395-6.2505	6.4300-6.4500	Remain long	Neutral
Dutch guilder	1.7880-1.7890	1.8085-1.8100	1.8643-1.8668	Remain long	Neutral
Finnish markka	4.2870-4.2890	4.3785-4.3835	4.5920-4.6040	See Comments in "The Exotics"	
Greek drachma	180.50-180.80	188.00-191.30	204.50-218.80	Neutral	Neutral
Hong Kong dollar	7.7489-7.7499	7.7339-7.7419	7.7614-7.7874	Neutral	Neutral
Irish punt	1.6790-1.6795	1.6562-1.6587	1.5950-1.6045	Remain long	Neutral
Italian lira	1204-1205	1224-1225	1297-1299	Remain long	Neutral
Malaysian ringgit	2.7360-2.7370	2.7555-2.7675	2.7760-2.8270	Neutral	Neutral
New Zealand dollar	.5677-.5687	.5633-.5648	.5517-.5547	Remain long	Remain long
Norwegian krone	6.2500-6.2550	6.3195-6.3450	6.5535-6.5550	Remain long	Neutral
Portugese escudo	140.15-140.35	142.60-143.00	150.00-151.00	Remain long	Remain long
Saudi Arabian riyal	3.7500-3.7505	3.7500-3.7512	3.7500-3.7525	Neutral	Neutral
Singapore dollar	1.6608-1.6618	1.6558-1.6613	1.6478-1.6608	Remain long	Neutral
Spanish peseta	101.60-101.70	103.55-103.72	109.00-109.25	Remain long	Neutral
Swedish krona	5.8040-5.8090	5.8865-5.8970	6.1140-6.1340	Remain long	Neutral

Explanatory Notes

*New Recommendation.

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 22:**

The market letter is in the mail this afternoon. Please note that our stop on the long Yen position has been triggered as of the close of tonight. Therefore, we advised you liquidate long yen positions at the market. D-mark stops as well as other EMS and EMS-related currencies have been raised to 5795, basis Dec. '91, close only.

Flashupdate, Thursday, October 24, 2:00 p.m.:

Liquidate D-mark long positions at the market, cancelling 5795 stop close. Proceed accordingly with all other EMS and EMS-related currencies, as well as the Portuguese escudo and the Singapore dollars. Present level 1.7040 interbank and 5835 Dec. IMM D-mark.

Friday, October 25:

The following is a recap of this week's recommendations. On Tuesday, October 22, our stop was triggered in the Japanese yen. Therefore, long Japanese yen positions were liquidated. On Thursday, October 24, we advised liquidating long positions in the D-mark, EMS, and EMS-related currencies as well as Singapore dollars and Portuguese escudo at the market. Thank you for calling. Have a great weekend!

Tuesday, October 29:

There are no changes or new recommendations.

Friday, November 1:

Good afternoon. There are no changes or new recommendations. Thank you for calling. Have a nice weekend!

Flash update, Monday November 4:

Reinstate long positions in D-mark, Japanese yen, EMS, and EMS-related currencies. Place initial stops at 5850, basis December D-mark, close only.

Tuesday, November 5:

There are no changes or new recommendations. Thank you for calling.

Friday, November 8:

We are repeating the flash update on Monday November 4: Reinstate long positions in D-mark, Japanese yen, EMS and EMS-related currencies. Place initial stops at 5850, basis December D-mark, close only. There are no further changes or new recommendations.

Flash update, Tuesday, November 12, 8:30 a.m.:

Double-up on long US T-bond positions at the market and/or purchase March call options.

We are repeating this morning's flash update at 8:30 a.m. Double up on long US T-bond positions at the market and/or purchase March call options. There are no other changes or new recommendations.

Flash update, Friday, November 15, 10:55 a.m.:

Liquidate long sugar positions at the market, currently trading at 8.18.

Second flash update, 11:45 a.m.:

Liquidate long positions and/or call options in wheat at the market. December currently trading at 352. Also buy February crude oil at the market. February crude oil is currently trading at 2234. Earlier this morning we flashed a liquidation of all long sugar positions at the market.

Friday, November 15:

This is a recap of recommendations for the week.

On Tuesday November 12, we doubled up on the T-bond positions at the market and/or purchased March call options. For Friday, November 15, we liquidated long sugar positions at the market and also liquidated long wheat positions and/or call options at the market. We established a new long position in crude oil at the market. Thank you for calling. Have a great weekend.

Flash update, Tuesday, November 19:

Liquidate entire long T-bond positions and/or bond call options at the market. We now advise reinstating long Canadian dollar positions; therefore, cover short hedges or purchase March C-dollar at the market.

Good afternoon, this is a repeat of this morning's flash update. We liquidated our entire T-bond positions at around 100.24, basis December. Also we reinstated our long Canadian dollar positions by covering short hedges at around 8840 basis December.

Friday, November 22:

This is a complete summary since our last market letter dated October 20, 1991 of all liquidations of open positions and new recommendations that remain outstanding.

On Tuesday, Oct. 22 we were stopped out of our long Japanese yen positions. On Thursday Oct. 24 we liquidated our long D-mark, EMS and EMS-related positions. On Monday Nov. 4 we advised to reinstate long D-mark, Japanese yen, EMS and EMS-related positions with stops at 5850, basis December D-mark, close only.

On Tuesday Nov. 12, we doubled up our T-bond positions and then on Nov. 19 the entire bond position was liquidated. On Friday Nov. 15, we advised liquidating long sugar and wheat position and purchased February crude oil. And on Tuesday, Nov. 19 we advised the purchase of Canadian dollars.

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