

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



Volume 12, No. 11 December 29, 1991

A prelude to trouble: Debauching the currency

Once again, the politicians are resorting to the printing presses in a desperate attempt to restart the engines of growth. As the accompanying article by Prof. Hanke makes quite clear, the Fed has changed operating procedures and is now totally committed to seeing a much larger expansion of money supply.

You can't blame politicians for failing to understand the differences between reflation and recovery or, for that matter, for failing to properly diagnose the cause of this recession. Professional economists, board members of the Fed, and the winner of a Nobel prize for economics, however, should know better.

The seeds of a bust are planted during a boom: Cheap fiat credit encourages speculative activities and the undertaking of projects that are not otherwise viable. Cheap credit creates the illusion that there are enough savings in the economy to fund almost any project, limited only by the naiveté and greed of lenders and borrowers alike.

Cheap credit creates the illusion that there is no need to rank investment alternatives and undertake only those that exceed society's minimum rate of return; since fiat savings are infinite and bear no relation to genuine savings, worthwhile investment projects are infinite too. With the deceleration of fiat credit growth — constrained by incipient banking failures, competitive business pressures coming from abroad, fear of inflation, etc. — resources begin to idle. Vacancy rates in commercial/industrial real estate soar, unemployment rises (restructuring in effect is the realization that a particular investment project will not produce a minimum rate of return after all).

The counterpart of these excesses is lower quality debt. In effect, the credit boom has built a vast infrastructure of mistaken projects, now for the most part lying idle, and a mountain of debt, used to finance it, that has little prospect of being repaid fully.

Idle resources (borrowing Hutt's felicitous expression) must be put to work so that they do not continue to impede the economy's smooth flow of income: Assets of nil and/or dubious returns must be marked down. At some price, probably far from their original price, they will be employed, thus producing income/jobs. The same is true with idle labor — its price must come down.

At the same time, the concomitant debt must be paid down. If the assets are worth hundreds of billions of dollars less, then the debt counterpart is also worth hundreds of billions of dollars less. Clearly, someone has to take the

losses: sometimes the borrower, sometimes the lender, and sometimes both.

Asset liquidation and debt repayment (debt deflation) processes are the inevitable consequences of credit orgies. If unchecked, this automatic adjustment will restore equilibrium in the asset and labor markets, and a recovery will ensue. Unaided, however, the process may last very long and undermine the resistance of any democratic society. In effect, self-feeding debt deflation and asset liquidations can restore equilibrium to an economy but starting from an extremely low level of activity. Should it be stopped? When? How? The first two questions necessitate a political answer that runs the wide range from "no, never" to "yes, now." The last question is relevant to our investment posture.

In view of the size of the US public sector, a significant proportion of private losses arising from asset liquidation and debt deflation is effectively transferred to the fiscal budget (see Charts 1, 2, and 3). A continuous fall in GNP will automatically enlarge the budget deficit; the deficit will cushion the fall but will not stop the liquidation/deflation process, which may take years to complete.

Alternatively, the Treasury can cut taxes, allowing consumers and businesses to accelerate the debt repayment

In this issue

- 3 The Economy**
Interpreting the Fed's last move
- 4 Cocoa, Coffee, Sugar, Wheat**
Analysis
- 7 Stock Indexes**
Off the edge
- 8 Canadian dollar**
An excellent opportunity
- 9 T-Bonds**
Stand aside
- 10 Friedberg Capital Markets**
- 11 The Exotics**
New Zealand dollar

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

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

process. As private debt shrinks, public debt grows. The banking system's holding of Treasuries rises at the expense of claims on the private sector, a process that is already well underway (see Chart 4), strengthening the balance sheet of lending intermediaries and reducing, hopefully, their urgency to demand repayments (see Chart 5). Only the Treasury's balance sheet deteriorates; its capacity to service its growing debt, however, is now and for the foreseeable future, beyond doubt.

A tax cut may or may not work to bring about a more rapid end to the asset liquidation/debt deflation process. Whether the government enacts a tax cut or not, fiscal debt will explode upwards.

In short, a tax cut or a do-nothing policy will *eventually* see the restoration of better debt/income ratios in the private sector and an orderly liquidation of most of the poor investments undertaken during the '80s.

Not so an expansionary monetary policy. Rapid money growth may *abort* the liquidation/deflation process, postponing once more its final, inevitable resolution. Cheap credit will stave off liquidation by lowering opportunity costs; it will halt debt repayments by extending new debt. Cheap credit, the very cause of the present malady, will once again distort the savings/investment balance and create more uneconomic projects. To avoid a 1989-91 situation will require ever larger doses of cheap credit.

Why not then resort to it? Because, at some point, sooner rather than later, the US dollar will collapse, and price inflation will take on a dynamic of its own. And then the monetary authorities will once again push on the brakes.

Cheap money and credit advocates are unashamedly advocating the debauchment of the US currency. In the

words of Professor James Tobin, winner of the 1981 Nobel prize for economics:

"The efficacy of monetary policy does not depend solely on the response of domestic business and consumers to cheaper and more available credit. An extremely important but insufficiently appreciated effect of lower interest rates is to depreciate the dollar, increasing demand for American exports and import-competing products. Today, exports — particularly of manufactured products — could be the driving force of a vigorous recovery. But that will take a new dose of depreciation, achieved by putting US interest rates well below those in Europe and Japan."

The US dollar is losing value not only against Europe and Japan, but it is also falling steadily in real terms against most Latin American currencies(!), wreaking havoc with *their* monetary policies. In short, the US is exporting inflation in a massive way. In the following pages, our colleague David Rothberg does a fine job of describing some of the early commodity beneficiaries of this reflation. As night follows day, more commodity bull markets will join the parade.

The US appears likely to enter a vicious cycle of currency debauchment, devaluation, and inflation, reminiscent of the early '70s. Only this time, Europe, Japan and Canada(?) may be able to isolate themselves from its effects by floating their currencies upwards.

STRATEGY: Remain long all EMS and EMS-related currencies and the Japanese yen. A US dollar crisis is not too far off. Raise stops to 62.50, basis March '92 DM and 77.50, basis March '92 yen, close only.

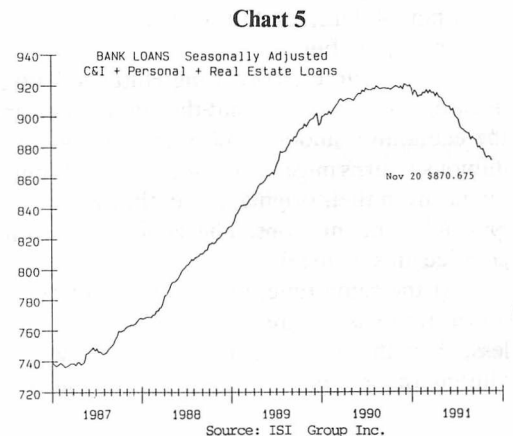
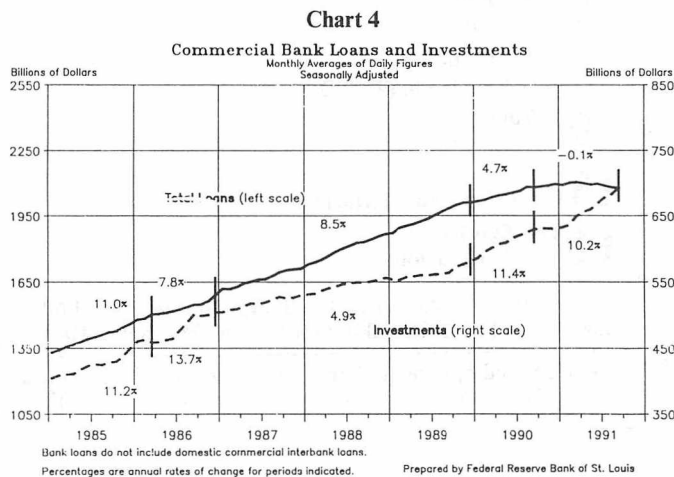
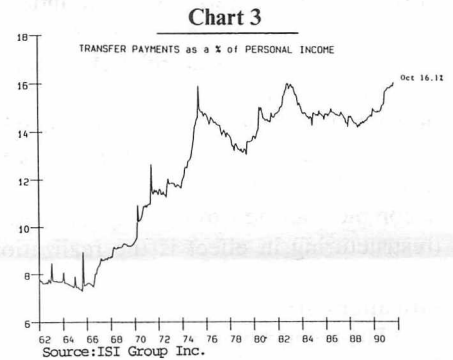
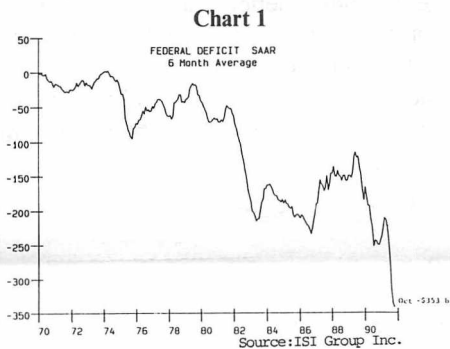


Chart 6 – CME Deutsche Mark Mar '92

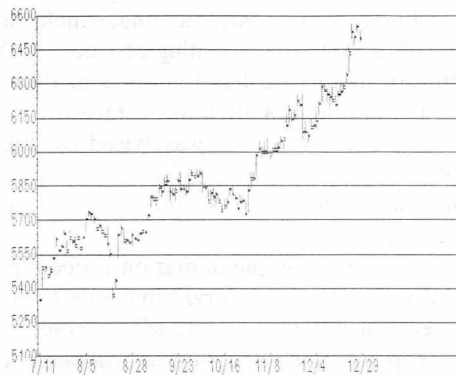
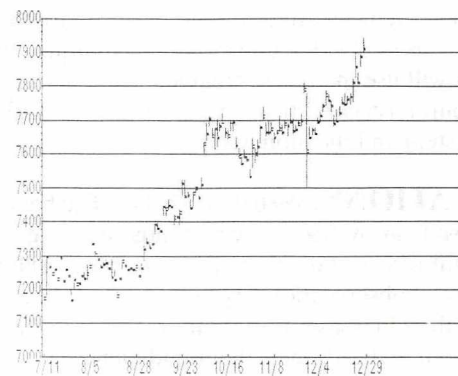


Chart 7 – CME Japanese Yen Mar '92



THE ECONOMY

Interpreting the Fed's last move

Last month we described how the peculiar process of closing insolvent depository institutions was acting to retard the growth in the money supply, specifically M2. The research insights that motivated our analysis were provided for our comments on a privileged basis Nov. 5, 1991, by Messrs. Paul Kasriel of the Northern Trust Company in Chicago and Robert Laurent of the Chicago Federal Reserve Bank. On Dec. 23, 1991, Messrs. Kasriel and Laurent made a sketch of their findings public in *The Wall Street Journal*. Hence, we now acknowledge their important research.

Let's begin this month by upgrading our kindergartner's guide to the mechanics of that process; we now move to a grade-schooler's guide. That advanced level is required so that we can interpret the Fed's last move.

When the government closes a depository institution, the following occurs: The agency that insures deposits acquires funds by either selling assets from its portfolio or by having the government sell securities. Those sales cause deposits in the banking system to be reduced. However, when the insuring agency disburses the funds it receives, there is no change in the deposits in the system. That result is obtained because the funds disbursed by the insuring agency go towards supporting insured deposits that already exist in the system. The net result of the closing is that total deposits in the banking system are reduced. Hence, required reserves in the system are reduced, so excess reserves in the system increase.

Now for the graduation from kindergarten to grade-school: With more excess reserves in the banking system, the federal funds rate, absent Fed intervention, would be pushed down because financial institutions would increase the supply of federal funds they offer. But since 1982 the Fed has become more and more intent on implementing monetary policy by targeting the federal funds rate. With that target and our depository institution closing sequence, the Fed will step in and drain reserves from the system so that the federal funds rate can be kept at the target level. Hence, with the federal funds rate targeting procedure employed by the Fed, the closing of depository institutions acts to retard the growth

in money supply (M2). The key to our grade-schooler's guide is the fact that the Fed is implementing monetary policy by targeting the federal funds rate. That procedure validates contractions in the money supply.

Given that the process of closing failed depository institutions is only about 50% complete, the Fed faces a major dilemma, particularly if it wants to retain its federal funds rate targeting procedure and at the same time increase the rate of growth in the money supply. What to do? The only way out for the Fed is to alter its method of implementing monetary policy. Specifically, the Fed must shift away from federal funds rate targeting towards total reserve targeting. That is, the Fed must begin to target a level of total reserves that is consistent with a desired level of money (M2) growth.

By implementing monetary policy with a total reserve target, the closure of depository institutions will not act to constrict money supply growth. To explain why, suppose all steps are the same as those described earlier, until we hit the point where the federal funds rate would start to fall. Under federal funds rate targeting, recall that the Fed is obliged to drain reserves from the system to hold the federal funds rate at the target. Now, under total reserve targeting, the Fed would let the funds rate fall, and do nothing because the Fed has already set a total reserve target. Nothing in the depository-closing process would affect that target. Hence, there would be no cause for the Fed to spring into action and drain excess reserves from the system. In consequence of the Fed's ignoring the drop in the federal funds rate, that rate will fall, and financial institutions will, of course, have an incentive to purchase earning assets. When that occurs, deposits in the financial system will increase, excess reserves will decline, and the money supply will increase. By targeting total reserves, rather than the federal funds rate, the Fed's current dilemma will be solved.

In closing, let's review the main points of our grade-schooler's guide to monetary policy implementation. When insolvent financial institutions are closed and deposits are insured, excess reserves are created in the system. Under

federal funds rate targeting, the Fed will drain those reserves, so that the federal funds rate can stay on target. Hence, the closing of insolvent institutions will act to retard growth in the money supply. Under total reserve targeting, financial institutions will use the newly created excess reserves in the system to purchase earning assets. That will increase deposits in the system and the money supply.

IMPLICATIONS: We believe that the Fed has already started to shift away from federal funds rate targeting and towards total reserve targeting. To support our analysis, all we have to do is observe the sharp fall in the federal funds rate and the healthy increase in the total reserves in the system that have been realized since about mid-October.

Also, it is clear from Chairman Greenspan's movements in the days preceding the full-point cut in the Fed's discount rate, which occurred on Dec. 20, 1991, that the Kasriel-

Laurent research played a vital role. On Dec. 18, Mr. Greenspan made a quick flight from Washington to Chicago to attend the Chicago Fed's board meeting, which was held on the evening of Dec. 18 and morning of Dec. 19. When Mr. Greenspan returned to Washington on Dec. 19, he had the Chicago Fed's request for a full-point cut in the discount rate in hand. That request, which was based on the Kasriel-Laurent research, provided Chairman Greenspan with the silver bullet he needed to make the case for the surprise discount rate cut of Dec. 20.

As that shifting in implementation procedures continues, the Fed will allow the federal funds rate to continue to fall. In consequence, the yield curve will continue to retain its unusually steep, positive slope, and we will begin to observe more rapid rates of growth in the money supply (M2).

— Dr. Steve H. Hanke

COCOA, COFFEE, SUGAR, WHEAT

Cocoa

Cocoa has more and more the flavor of a bull market. The news is bullish. And, as is typical of most bull markets, the news leaves lots of latitude for accidents that could only add to the taste.

For example, the crop of the world's largest producer, the Ivory Coast, is reported likely to be "slightly" smaller at between 720,000 and 750,000 tonnes than last year's output of 785,000 tonnes. However, some sources predict total output could fall to as low as 650,000 tonnes and perhaps even to 600,000 tonnes.

In Brazil, which is the world's second largest producer, some traders now fear the main crop, which runs from September to May and was officially (by industry statisticians) estimated down 25% from last year's crop to between just 4.0 mln and 4.4 mln 60 kg bags, will not even reach 4.0 mln bags.

And traders in Malaysia, the world's fourth largest producer, estimate the crop there to be no greater than 165,000 tonnes versus 230,000 tonnes in 1990-91.

Many of the estimates are made by private growers or representatives of growers associations whose biases toward higher prices must be taken into consideration. Still, for manufacturers and other hedgers not to take the potential reductions in output seriously would be a big mistake.

Many of the private traders blame the weather for the poor showings. Heavy rains in Brazil and drought in Borneo, the island on which 60% of the Malaysian crop is grown, could be part of the emerging weather phenomenon inspired by the eruption of Mount Pinitubo in June.

The Pinitubo-inspired weather scenario is one subscribers to our letter are familiar with; we've been discussing it for the past four months. Briefly, the thesis is that the eruption, which was the largest in two decades, can be expected to produce adverse weather of various kinds beginning this current growing season in the southern hemisphere and lasting until early 1994.

A private weather forecaster we subscribe to has pre-

dicted poor growing conditions generally for cocoa. Skeptics — and I confess I was one myself — should note that the same forecaster also predicted a reoccurrence of El Niño, the phenomenon that warms temperatures of currents in the south Pacific. This past month, oceanographers conceded that El Niño, which incidentally has wrought havoc upon crops every other time it has occurred, has in fact appeared.

The other reason cocoa production could quite easily fall to considerably lower levels chocolate manufacturers should fear is the low average price that has persisted for several years now in the wake of the eight years of surpluses.

Again, subscribers will be familiar with the predictions we've made about the effects low prices would tend to have this year. These predictions are best vindicated by Alexander Laubouet, a farmer near the Ivory Coast town of Divo:

"The trees are getting old, the soil needs more nutrients. But we can't afford fertilizer. People aren't hiring so many laborers. There are lots of plots abandoned to the bush."

Given that marketing boards in the Ivory Coast are in arrears of payment for last year's crop and have set a producer price this year that is at a discount to free market prices, it is unlikely a price advance will produce enough of an incentive to increase production.

Persistent inflation in Brazil has served to act as a disincentive to production in that country. And, in Malaysia, 4% of the trees have been ripped up in order to produce palm oil, which has enjoyed a 14% increase in price in the past year.

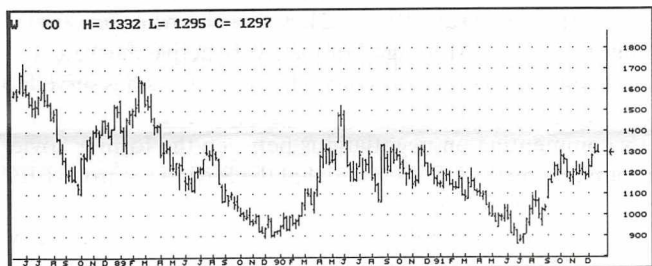
All told, rumors that Gill & Duffus, the cocoa industry's most respected statistical firm, is expected to raise its estimate of the current year's world deficit by 60,000 tonnes surprises us not at all.

Given, furthermore, that we understand the majority of the current year's production is sold or short-hedged — the phenomenon of mass forward protection taken by producers would seem typical of the end of a bear market and the beginning of a bull market — and that all this industry-

specific news is now appearing against the general background of a collapsing dollar, which evokes in us not unpleasant memories of the early 1970's bull market in cocoa — and sugar and wheat and soybeans and coffee and corn and... — yes, we find the cocoa tasty indeed.

Long positions should be maintained and added to on a strong close above 1360, basis March '92. To protect against shakeouts that inevitably will occur as floor brokers and other short-term traders aim at the unsophisticated and undercapitalized, maintain stops at 1250, basis March until further notice. Or keep in contact by phone.

Chart 8 – Cocoa Weekly



Coffee

Just a brief word about coffee. Coffee was the first food I can remember to suffer the censure of health officials. It has also had to endure what is probably the poorest marketing strategies of any food group during the past 30 years.

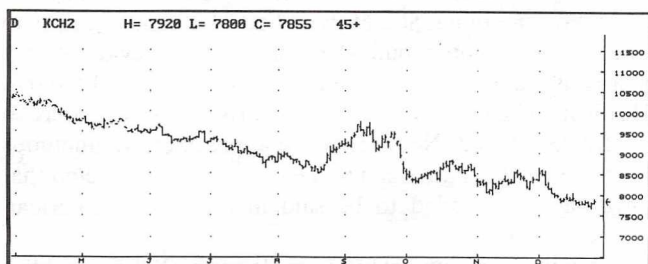
On the supply side, years of surpluses, not unlike those that have weighed on the cocoa market, have leaned heavily on values. Prices currently are near post-war lows in real terms.

But coffee is now the first food I am aware of that has been cleared by health officials of any tumorous or other misdeeds. It has come to be regarded by younger people who have been sold on the virtues of alcohol and drug abstinence as a cheap and cozy drink embodying some cachet. And in Brazil, which is the world's largest producer, it is subject to the same adverse weather conditions that have crippled the cocoa crop.

The size of the 1992 Brazilian crop is still conjectural. Last year the Brazilians produced 26.5 mln 60 kg bags. Production estimates of this year's crop vary between 19 and 22 mln bags. But some estimates call for production of as low as 16 mln bags.

Given that coffee is denominated in (collapsing) dollar terms and that risk of new lows seems negligible, a modest long position via September — which provides the opportunity to capture the effects of a freeze if there is one — is warranted.

Chart 9 – Coffee March



Sugar

The sugar market over the past month has been only slightly more exciting than I imagine it would be to sit and watch beets grow. Still, what action there has been has been good for us bulls.

For one thing, prices have come to describe a slightly rising orientation. Decisive gestures (such as they are) are aimed upward against overhead resistance — at 9¢ on the March contract — as opposed to downward at support levels of 7.80¢. Also, and much more importantly, spreads between March, the nearest delivery month, and May, the next nearest, have slowly but determinedly widened to 0.16¢ in favor of March. This indicates that users are willing to pay a premium for actual supply.

Do these subtle movements imply that the outstanding enigma of Cuban production/(former) Soviet consumption — the market's current main focus — which is due to be resolved within the next month, will be resolved in favor of the bulls? I think it's likely.

Conventional thinking has had it that the former Soviet states would purchase less sugar than it/they did before the economic chaos began, that the Soviets would certainly not, as they have in the past, purchase Cuban sugar by barter for oil at a rate that effectively priced Cuban sugar at four times the world price, and that, finally, the Cuban excess would be dumped on the world market.

Armed only by theory, we have from the outset argued that without Soviet oil and the implicit incentive it provides, Cuba would produce nowhere near its 1990-91 crop of 7.6 mln tonnes. How much the Soviet republics would purchase has been anybody's guess, but given that sugar is earth's lowest cost source of calories (energy), we did not expect the consumption shortfall would be as great as generally expected.

Recent news suggests the following: The republics have been negotiating with Cuba for purchase of 2.0 mln tonnes of sugar — as opposed to the 4.0 mln tonnes they imported last year and the 1.5 mln tonnes I erroneously reported they imported in last month's Comments — at oil-equivalent prices of around 20¢ a pound, or about 225% premium to free market prices.

The fact that the Russians are negotiating at all indicates how important sugar is to them. During the French revolution, during the time of *le maximum*, the absence of sugar caused riots in Paris and nearly broke the back of the revolutionary democrats. It would be unwise to assume the newly democratic republics will stint on sugar in favor of any other commodity save grain.

As for Cuba itself, no authoritative news regarding the size of its crop has been made public. However, Japanese trade houses are reported unable to obtain product contracted for from Cuba, thus suggesting that rumors the crop may be as little as 5.0 mln tonnes may be proven true.

Even if the Cubans chose to produce a crop the size of last year's — dubious in light of the sense they must have had that the Soviets would not be purchasing as much sugar from them according to the old subsidized oil deal — and even if they managed to produce it — an even more dubious opinion given their lack of fertilizer and other inputs — it is unlikely

surpluses will be dumped on the market, because Cuba is essentially a producer of raw sugar, which is much more difficult to offload than already-processed whites.

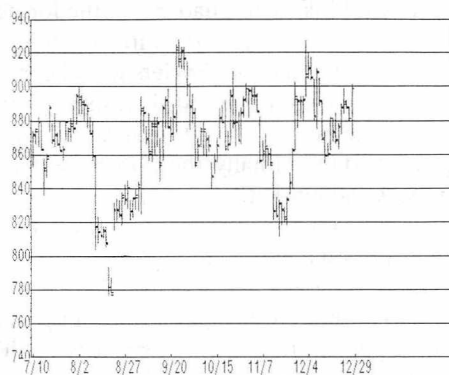
The potential is there for the Cuban/(former) Soviet republic transaction to contribute as much as 2.5 mln tonnes of negative supply to the 1991-92 world sugar balance.

Which would put the onus of making up the shortfall squarely on the shoulders of Thailand and Australia, both of them southern hemisphere producers who will have to watch their crops sit in the ground until late spring.

Which leads us again to notions of the effects of Mt. Pinitubo.

In conclusion: Sugar remains a home-run hitter's dream market. While the odds of IT, all of IT, happening are, say, 3:1 against you, the payoff, if IT does happen, can be 20:1 and maybe more. We like the October 11¢ calls and would buy more of them if March crashes through all the current resistance, clogged overhead at around 9¢.

Chart 10 - N.Y. #11 Sugar Mar '92



Wheat

In being long wheat these past several months, we have captured the first bull market of the '90s. Wheat has climbed by \$1.10 per bushel.

With the open position showing little sign of undue speculative interest, the consensus of bullish opinion remaining consistently in the healthy mid-60% range, and a chart that is nothing if not firmly pointed higher, the technical action could hardly be better.

Fundamentals, too, all appear to operate within a singularly bullish context; that being that domestic (US) wheat stocks are now reliably projected to be no larger than 16.7% of usage at the end of the current crop year. This will represent the tightest stock position since at least World War II, tighter even than during the 1973-74 crop year when prices advanced to the record highs of \$6.50 a bushel.

And then, as now, there was a collapsing dollar that, in addition to fundamentals, denominated US wheat more cheaply.

We might be excused if we were to be a bit smug. But not by the market. Let's review the scenario in order to hone a little edge to our thinking.

The current crop year's fundamentals, as noted above, are ultimately dominated by the fact that US wheat stocks —

estimated now at 414 mln bushels — are so very low. There is little relief internationally as both Argentina and Australia have not only suffered reduced crops from last year but, in the past month, have also revised their estimates of those crops downwards.

The former was expected to harvest 9.0 mln tonnes versus 10.8 mln tonnes last year and has now reduced that estimate by 300,000 tonnes due to unusually — Mt. Pinitubo inspired? — wet weather. The latter, which earlier this year admitted its crop would be in the neighbourhood of only 10.0 mln tonnes — versus 15.07 mln. tonnes last year — now believes a harvest of no more than 9.5 mln tonnes is likely due to unusually — Mt. Pinitubo inspired? — dry weather.

Only Canada and the EEC have surplus wheat enough to offer to market. Although both are very active marketers — the heavy export subsidies they offer producers has served to create a buyers' market mentality in importing nations. Traders commenting on negotiations between the former Soviet republics and the USDA noted that the Soviets regarded EEC wheat as being of inferior quality.

The point here is that because US wheat stocks are so low, the USDA may limit further sales from its own competing subsidy program, which is called the EEP (Export Enhancement Program).

The EEP is the division of the department through which majority of export sales to the republics have been made. In doing so they would force foreign buyers to turn to the free market for supply, at which point those buyers would turn to the subsidy programs of other nations because the price would be cheaper. But because of the international tightness and the perception EEC wheat is of inferior quality, the marginal buying of free-market domestic wheat could still be enough to propel futures prices into the stratosphere.

Which leads us to the question: Can there possibly be more demand for wheat than has been accounted for already? For the answer, all eyes turn, as they have for the past three months, to the former Soviet republics.

We have argued for the past three months that the economically-distraught republics would act as a relentless source of demand and that the US, eager to cultivate relations with those republics — especially those with nuclear arsenals — would accommodate the demand at virtually any cost. Our thesis has thus far been vindicated. This is both good and not so good.

It's been good for us that the USDA republic relationship has developed as predicted. It's a bit worrisome that our views are no longer original.

The issue of whether or not the US will provide more wheat to the republics is subject to the following considerations. For one thing, Secretary of State Baker, the man who one senses ultimately pulls the strings, is quite evidently not nearly as enamored of the new leaders as he was of the old. He did not like the way Gorbachev and Shevernadze were so coldly dispatched. Neither did he appreciate the unctuous homages paid to American wishes; he rightly suspected that anything that needed to be said in return for American handouts would be.

Much more importantly, on January 2 the republics

convert to free-market pricing. The Soviet wheat harvest was put at 78.0 mln tonnes. How accurate that figure is and how much of that grain has been hoarded by producers will not be known until the wheat is lured out of hiding by the market forces that begin to act next week. It is possible that not only is there sufficient wheat available but there may actually be enough to cancel some of the credits provided.

On the other hand, the republics have recently caught up on all freight arrears, a gesture certainly suggesting that they expect to ask for more and get it.

The Soviet bread basket is in the Urals, which is part of the Ukraine. The Ukraine is also the principal livestock producing region in the new commonwealth. It is understood that during the economic chaos that has prevailed during the past several months what the Ukrainians have had difficulty obtaining has been corn. The bullish argument then is that a goodly percentage of wheat has been converted to feed. To me, this is the likely scenario.

There is one final point I want to make before I leave off. On January 13 the USDA will issue its first estimate of winter wheat plantings. The current tightness being so severe, this report is a critical one. Obviously the expectation would be that farmers would plant as close to fenceposts as they can. To help facilitate this, the USDA, not surprisingly, reduced the acreage reduction program, ARP, to only 5% versus a 15% reduction for the 1991 crop. (The program is designed to promote price stability).

Given the increased acreage allowed and the incentives to grow, almost every trader assumes seedings will be up; the consensus is anywhere from 3% to 7%. However, the company having the most accurate record of forecasting seedings in the past, Sparks, has actually predicted winter wheat seedings will decrease.

Sparks has based its forecast on two different surveys and explains the shocking results quite simply: The bull

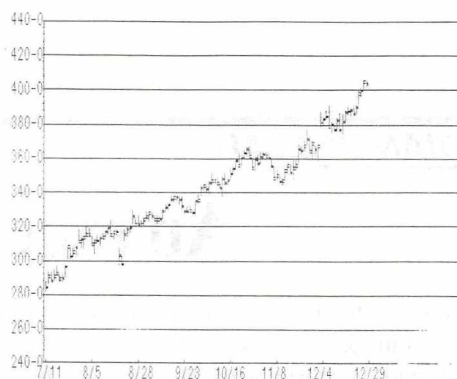
market wasn't far enough along when farmers had to decide what and how much to plant in September.

If winter wheat seedings are down, the very least we can expect is a sharp rally in May and even July futures relative to cash. The most, especially were the news to come in concert with fresh buying from the republics or elsewhere, is.....

The point of this rather long-winded exercise was to find an edge to a bullish posture that, on the surface, appears so perfect as to lull us into a sleep of potential nightmare. I think all factors being considered, the most likely scenario is that wheat prices still have a long way to go. However, given the unknowables, appropriate protective measures are in order. All deep-in-the-money calls should be traded for fresh at-the-money (380) calls on the May delivery. Outright positions are not recommended, given the cheapness of call options.

— David B. Rothberg

Chart 11 – CBT Wheat Mar '92



STOCK INDEXES

Off the edge

Last month we titled our stock market comments "Living on the edge" and surmised that a simultaneous penetration of Dow Jones 2860 and S&P 500 373 would push us into the abyss.

Strangely, the Dow Jones penetration of these lows on Dec. 11 were not confirmed by the S&P 500, which managed to stay well above its previous intra-day lows of 371.36 (recorded Dec. 2) and also above our key 373 level.

Clearly, brand-names consumer goods companies, better represented in the S&P 500, continue to attract institutional interest despite their lofty valuations: Wal-Mart Stores (43x), Merck (31x), Coca-Cola (34x), Bristol Myers Squibb (23x), Johnson & Johnson (28x), Abbott Labs (28x), Pepsico (25x), Pfizer (32x), to name just a few of the most heavily capitalized companies.

The rationale behind today's madness is not growth for growth's sake (as in 1973) but an escape from the miserable

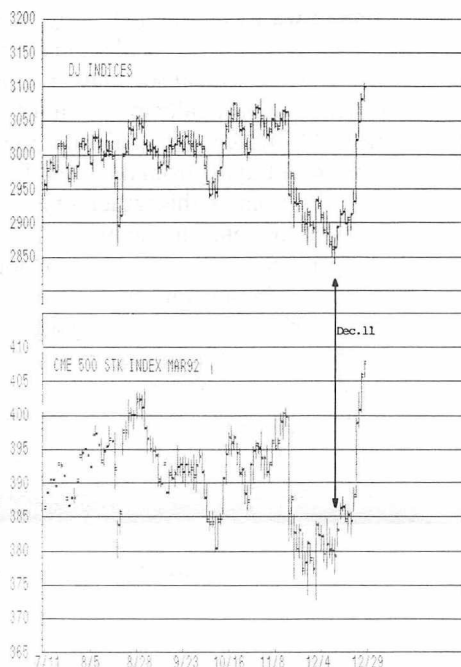
nominal yields obtainable on money market instruments. Even deeper in the subconscious of the institutional manager is the fear of inflation: It is a fact that dear stocks have always done better *in the very long run* than cheap money, in inflation and even in hyperinflation. The crucial phase, however, is "in the very long run."

In the months ahead, the Fed will begin to turn its attention to both the dollar and inflation. When it does, the real world of recession and crumbling earnings will dawn on the equity cultists.

For now, stock market bears would be better advised to either hibernate or shift their sights to stock markets of countries that are not actively debauching their currencies; the likes of UK, France, and Sweden.

STRATEGY: *Neither long nor short.*

Chart 12



CANADIAN DOLLAR

An excellent opportunity

Who said this? "... the fundamental contribution that monetary policy can make to Canada's chances of economic success is to provide a trustworthy money. This is, I believe, becoming increasingly accepted. Given our experience with inflation, the notion that monetary policies designed to generate or tolerate inflation will help the economy to perform better, no longer gets the following it used to. Simply put, inflationary policies have nowhere delivered the goods, or the services, or the jobs."

You guessed it (or maybe you didn't) — John J. Crow, Governor of the Bank of Canada in a speech delivered on December 2. Contrast these words (and deeds, see Chart 13) with what you know about the Fed and its new operating procedures (see our Page 1 article and Prof. Hanke's analysis). And now, whom would you entrust with your money?

Federal fiscal policy remains extremely tight when considering the recession's effects on revenues. Most of the deterioration in the deficit to date occurred in the first quarter of 1991-92. In the first quarter, the deficit was \$5.7 billion higher than that recorded in the same period of 1990-91. In the second quarter of 1991-92 (July-September), the deficit was only \$1.7 billion higher, while in September 1991, the deficit was actually \$0.3 billion lower than in September 1990.

With the transitional costs associated with replacing the federal manufacturer's sales tax (FST) by the goods and services tax (GST) and dramatically lower public debt charges (a result of lower interest rates), the deficit is heading towards meeting the February 1991 forecast of \$30.5 billion.

On the other hand, provincial governments are heading towards a record combined deficit of \$15.4 billion in 1991-92, more than double the previous year's total of \$6.9 billion. As a result, the aggregate federal and provincial fiscal impact on the exchange rate continues to be "bullish," especially in view of the Bank of Canada's tightening grip on money expansion (see Chart 13).

The recent decline represents another excellent opportunity to accumulate long Canadian dollar positions, particularly via cheap call options.

STRATEGY: Add to previously established long call option positions.

Chart 13

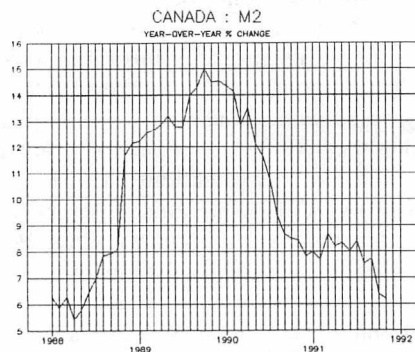
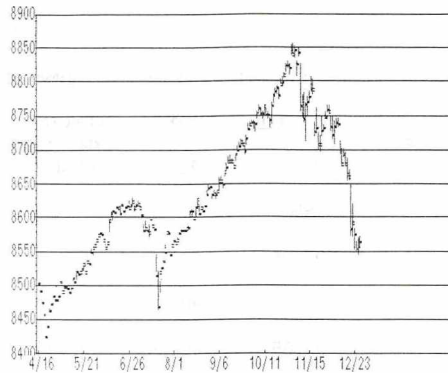


Chart 14 – CME Can. Dollars Mar '92



T-BONDS

Stand aside

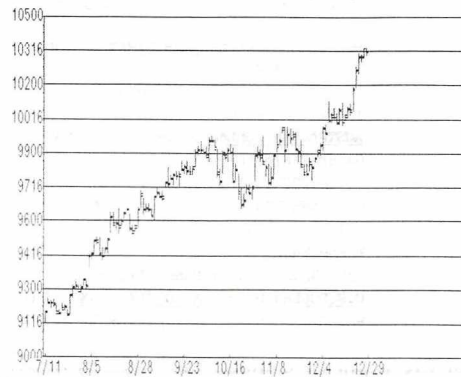
It is not a question of "if" but rather "when" will long-term interest rates in the US begin to climb, spooked by the collapse of its currency's external value.

Long-term 30-year bonds do not offer good value.

STRATEGY: We purchased March '92 T-bond futures on Dec. 2 via the Hotline at 9900. We now advise liquidating this position and nailing down a \$4,500 profit per contract.

Stand aside.

Chart 15 – CBT T-Bond (Day) Mar '92



FRIEDBERG CAPITAL MARKETS

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	20%
Canadian dollar bonds	20%

Chart 16
Foreign Currency Bonds

Date: December 19, 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. Y.I.D. TO MTY.	NEXT PAYMENT DATE
<u>SOUTH AFRICAN RAND DENOMINATED BONDS</u>				
ESCOM 11% 31/10/93 (semi)	92½	93	15.48%	Apr. 30
<u>DEUTSCHE MARK DENOMINATED BONDS</u>				
KINGDOM OF SWEDEN 7 1/4% 1/2/95	96½	97	8.38%	Feb. 01
EUROPEAN INV. BANK 5 1/2% 9/8/93	95.35	96.10	8.13%	Aug. 08
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	89½	90	8.44%	May 07
WORLD BANK 5 7/8% 4/2/97 RRSP eligible	90.05	90.80	8.14%	Feb. 04
QUEBEC HYDRO 5 1/2% 1/5/96 RRSP eligible	87 3/4			May. 01
<u>SWISS FRANC DENOMINATED BONDS</u>				
GOVT. OF AUSTRALIA 5% 30/10/98	89½	91½	6.58%	Oct. 30
<u>DANISH KRONE DENOMINATED BONDS</u>				
KINGDOM OF DENMARK 9% 20/11/92	99	99 3/4	9.21%	Nov. 20
KINGDOM OF DENMARK 8% 20/08/93	97.55	98.30	9.10%	Aug. 20
<u>ECU DENOMINATED BONDS</u>				
UNITED KINGDOM 9 1/8% 21/02/01	102 7/8	103 5/8	8.53%	Feb. 21
<u>BRITISH POUND DENOMINATED BONDS</u>				
KGDM of SWEDEN 9/3/8% 14/4/93	97 7/8	99 5/8	9.62%	Apr. 14
<u>FRENCH FRANC DENOMINATED BONDS</u>				
EUROPEAN INV. BANK 8 3/4% 12/7/95	100½	101¼	8.30%	Jul. 12
<u>JAPANESE YEN DENOMINATED BONDS</u>				
GOVT. OF CANADA 23/7/93 5 5/8% RRSP eligible	100	100 3/4	5.09%	Jul. 23
<u>CANADIAN DOLLAR DENOMINATED BONDS</u>				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	107.35	108.10	8.46%	Jan. 08
GOVERNMENT OF CANADA (semi annual) 05/09/92 10 3/4%	102.20	102.70	6.66%	Sep. 05
<u>NEW ZEALAND DOLLAR DENOMINATED BONDS</u>				
CDN. IMP. BANK OF COMMERCE 27/07/92 14% RRSP eligible	102 5/8	103 3/8	7.54%	Jul. 27
TOURIST HOTEL 0% 04/06/93	88½	89½	8.02%	4/6/93
<u>AUSTRALIAN DOLLAR DENOMINATED BONDS</u>				
General Electric 11/07/92 14 1/4% (semi)	102 7/8	103 5/8	7.42%	Jul. 11
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	110 7/8	111 7/8	8.49%	Jul. 07
WORLD BANK 15/03/93 12 3/4% RRSP eligible	105 3/4	106½	7.15%	Mar. 15
<u>U.S. DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS</u>				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03(semi)	78	80½	11.04%	Dec. 15
CV @\$38 p/sh				
ALLIANT COMPUTER 7.25% 15/05/12(semi)	18	20½	38.60%	May 15
CV @\$39.75 p/sh				
COOPER CO'S. 10 5/8% 01/03/05(semi)	84½	85 3/4	13.31%	Mar. 01
CV @\$27.45 p/sh call in 1995 @100				
DICEON ELECTRONICS 5.5% 1/3/12 (semi)	20	23½	25.62%	Mar. 01
CV @\$39.50 p/sh				
BURNUP & SIMS 12% 15/11/00 (semi)	58	61½	23.25%	May 15
CV @\$16.79 p/sh				
<u>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</u>				
FARM CREDIT CORP 7 3/4% 10/6/96 RRSP eligible	103 3/4	104½	6.54%	Jun. 10
REPUBLIC of ARGENTINA 7/10/93 11% (semi) 1 yr. put	101½	102	9.67%	Apr. 07
SOUTHMARK CORP. 12% 10/8/97	63	68	7.10%	Jan. 15
<u>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</u>				
UNITED KINGDOM 24/9/96	99.79	100.09	5¼%	Dec. 31
3 mo. LIBID-1/8 (qtly) *callable @100 09/91				
REPUBLIC OF ITALY 30/4/93	99.58	99.98	5 7/16%	Jan. 31
3 mo Limean(qtly)				

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/MICHINOV5

THE EXOTICS

New Zealand dollar

New Zealand's contraction is gathering momentum, prompting the government to revise downward its GDP forecasts for the fiscal year that will end in March 1992. On December 16, Reserve Bank economists forecast real GDP would fall 1.7% in the year to March 1992, and rise 1.8% the following year. In the previous forecast in August the bank economists saw GDP rising 1.5% in March 1992 and 2.1% in 1993.

The combination of a gently falling trade-weighted dollar and the readjustment of labor costs resulting from recent moves to decentralize the labor market has impacted New Zealand's external competitiveness in a substantial and favorable way. Thus trade figures for the first five months of the 1991-92 year-end of June 1992 showed a surplus of \$437.7 million compared with a deficit of \$917.8 million for the equivalent period last year. The current account is expected to improve to a deficit of \$1.3 billion total 1991-92 year from \$1.8 billion the year before, and may well be even better than that.

On the fiscal front the government seems to be chasing its own tail. It now expects the fiscal deficit to be around \$2.75 billion for the year ended June 1992, a little over \$1

billion higher than anticipated a few months ago. According to the chief economist of Buttle Wilson Limited, the cyclical component of the deficit is probably no greater than \$1-1.2 billion, while the balance is structural, requiring explicit policy decisions to eliminate it.

In the run-up to the next election and given the low popularity of the ruling National party, this is unlikely to happen. Sooner or later some government will have to tackle the ticking time bomb of superannuations (retirement benefits). Once resolved, New Zealand will have completed its radical reform program begun under the Labor government some seven years ago.

STRATEGY: *Near term the currency is likely to remain under pressure, increasing the possibility of an export-led recovery beginning sometime towards the second half of 1992. We now advise liquidating long positions vis à vis the US dollar and moving towards a fully neutral position. Liquidate also long New Zealand dollars versus deutschemarks, and move towards a slight short position.*

Chart 19 - RATES

Spot	1 Month	3 Month	6 Month	12 Month
.5430-	.5418-	.5383-	.5335-	.5250-
.5440	.5435	.5410	.5375	.5310

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: 1.5150)</u>
*Australian dollar	.7612-.7619	.7552-.7576	.7412-.7469	Neutral	Sell
Belgian franc	31.23-31.28	31.62-31.75	32.73-32.98	Remain long	Neutral
Danish krone	5.9000-5.9100	5.9760-6.0000	6.2150-6.2470	Remain long	Neutral
Dutch guilder	1.7060-1.7080	1.7292-1.7317	1.7927-1.7967	Remain long	Neutral
Finnish markka	4.1550-4.1600	4.2310-4.2390	4.4650-4.4800	Remain long	Remain short
Greek drachma	173.65-173.95	181.85-184.65	203.65-211.45	Neutral	Neutral
*Hong Kong dollar	7.7780-7.7790	7.7720-7.7760	7.8055-7.8165	Neutral	Sell
Irish punt	1.7535-1.7585	1.7256-1.7327	1.6485-1.6625	Remain long	Neutral
Italian lira	1149-1151	1173-1176	1239-1246	Remain long	Neutral
Malaysian ringgit	2.7360-2.7370	2.7560-2.7770	2.8000-2.8500	Neutral	Neutral
Norwegian krone	5.98-5.99	6.07-6.09	6.32-6.36	Remain long	Neutral
Portugese escudo	133.70-134.00	136.30-136.75	143.20-144.50	Remain long	Remain long
Singapore dollar	1.6250-1.6260	1.6205-1.6245	1.6100-1.6260	Remain long	Neutral
Spanish peseta	96.05-96.15	98.05-98.30	103.95-104.35	Remain long	Neutral
Swedish krona	5.5500-5.5600	5.6790-5.6960	5.9700-6.0050	Remain long	Neutral

Explanatory Notes

*Indicates change in recommendation from last issue.

Currency expected to firm against both currencies.

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

Currency expected to weaken against both major currencies.

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

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

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

Buy	Buy
Buy	Sell
Sell	Sell
Sell	Buy

Cover

Liquidate

HOTLINE UPDATE

Tuesday, November 26:

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

Flash update, Wednesday, November 27, 1:35 p.m.

Liquidate long crude oil positions at the market; January currently trading at 2118.

Friday, November 29:

The following is a recap of recommendations for the week. On Wednesday Nov. 27, at 1:35 p.m., we flashed to liquidate long crude oil positions at the market.

There are no other changes or new recommendations.

Flash update, Monday, December 2:

Reenter long side of T-bonds either via March futures or options. Place stops at 9725, close only.

Flash update, Wednesday December 4, 4:55 p.m.:

Buy March wheat at the market for Thursday opening. There are no other changes or new recommendations.

Friday, December 6:

This is a review of recommendations for the week.

On Monday Dec. 2 we bought March T-bonds at 9900 and placed stops at 9725, close only.

On Wednesday after close we recommended to buy March wheat at the trading opening Thursday, at market at 384½.

Tuesday, December 10:

There are no changes or new recommendations.

Friday, December 13:

There are no changes or new recommendations.

Tuesday, December 17:

There are no changes or new recommendations.

Friday, December 20:

There are no changes or new recommendations.

Tuesday, December 24:

Raise stops on March '92 T-bonds to 101.00, close only. There are no other changes or new recommendations.

Friday, December 27:

There are no changes or new recommendations. On Monday morning, we will have a new tape to review all recommendations made since our last market letter.

Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published by Friedberg Commodity Management Inc., 347 Bay Street, Toronto, Ontario, M5H 2R7. Contents copyright © 1991 by Friedberg Commodity Management Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement.

Subscription Enquiries for
Friedberg's Commodity & Currency Comments
347 Bay Street, 2nd Floor
Toronto, Ontario, Canada
M5H 2R7
(416) 364-1171

Trading and Managed Accounts
All enquiries concerning trading accounts should be directed to:
In Canada
Friedberg Mercantile Group
347 Bay Street
Toronto, Ontario M5H 2R7
(416) 364-2700
In U.S.
Friedberg Mercantile Group Inc.
67 Wall St., Suite 1901
New York, N.Y. 10005
(212) 943-5300

All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate. Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.