FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc. Volume 13, No. 1 January 26, 1992

The bull's last, dying gasp?

Driven by an irresistible desire, this writer drifts towards stock market discussions in spite of the fact that for the better part of the past eight years, he's been wrong about where it's headed. And despite the fact that he spends most of the working day trading currencies and commodities, not equities.

I often endure the ridicule of colleagues who will unabashedly take contrary views and turn interesting profits. I admit to being obsessed with the bearish case, but I say in my defence it was not always so.

Why, then, this obsession? On the surface it appears that I am just as comfortable with the long side of markets (as with the great commodity bull markets of the '70s and even the stock market of the mid to late '70s) as with the short side (short the US dollar – or is that long the European currencies? – oil in the early to mid '80s, and so on).

I also find that there have been times in the past when my sentiment has moved contrary to the market, becoming increasingly more obsessive with the passage of time with its refusal to play out my forecast. Many of our clients and subscribers will remember my very early negativism on the Mexican peso and crude oil – the costly two-year to three-year wait before the payoff.

Probing deeper into my subconscious, I discover that my obsession with a particular view on a market is closely correlated with the degree of irrationality shown by the particular market – itself a product of extreme emotional behaviour, deep pessimism, and wild optimism. And because human nature is more often excessively optimistic than excessively pessimistic, I find myself, more often, obsessed with a bearish case than with a bullish case. In short, markets are neither sacred nor prescient; if they represent that 2 + 2 equals 5, they will be proven wrong sooner or later, as surely as night follows day.

While Wall Street types (as well as academics) have become enamored of market signals and values, more commonsensical people have developed a much healthier scepticism. As an example, the Court of Chancery long ago rejected exclusive reliance upon market value in an appraisal action. In *Chicago Corp.* v. *Munds* (Delaware 1934), the court, referring to the 1929 market crash, found: "The experience of recent years is enough to convince the most casual observer that the market in its appraisal of values must have been woefully wrong in its estimate at one time or another within the interval of a space of time so brief that fundamental conditions could not possibly have become so altered as to affect true worth."

These sobering comments are not an invitation to "fight the tape"; for the most part, market trends will reflect reality. New factors are incorporated, assimilated, analyzed, and reflected in a continuum of market levels that never ceases to change. At any one point in time, *most of the time*, markets will reflect *rationally* all known economic data. They will advance or decline anticipating the *probabilities* of certain events.

These probabilities are formulated on a daily basis by market participants who, *however*, enjoy adaptive skills, have relatively short memories, tend to extrapolate linearly, and easily become emotional. These characteristics introduce, some of the time, an element of irrationality to the markets. In effect, the persistence of a trend over relatively long periods of time will breed expectations of its continuing: Adaptive behavior will observe that *corrections* in a bull market have proven to be excellent buying opportunities, while rallies in a long bear market have been excellent selling occasions.

This effect is compounded by the human being's ability (disability?) to think linearly, avoiding the anticipation of discrete changes. If a market has remained static – it is likely to remain locked in a range, so thinks *homo sapiens*. If it has been advancing – it will continue to advance. And, conversely. Short memories block warning signals that flash from the

In this issue

3 The Europeans The Walter Critique

5 Canadian dollar Unfounded jitters

5 Currencies Comfortable with the obvious

6 Wheat, Sugar, Coffee, Cocoa Analysis

8 Friedberg Capital Markets Burnup & Sims

11 LDC Update Argentina

12 Forex Rates & Update

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.

distant past, and euphoria/depression rationalize whatever signals filter through.

A brief digression: Stock markets, unlike other financial assets (such as currencies) and hard assets (such as commodities) but similar to real estate markets, enjoy a very sound, rational basis of valuation: They are a function of returns. If an investor has a choice between earning 10% in fixed-income instruments (for simplicity, ignore inflation) and only 5% in common stocks, he would have to choose fixed-income instruments over common stock *unless* he has good grounds to believe that earnings would skyrocket in the *near* future (the value of $1 to be received 10 years hence is too small and too uncertain to tilt the balance in favor of the currently less attractive alternative).

Now here comes the rub: No one has yet been able to read next month's news today. The future is absolutely uncertain. A bird in hand is better than two flying; therefore, in our example, the fixed-income instrument wins hand down.

Given that stock prices depend on returns and alternative investment opportunities, it is relatively easy to formulate a rational strategy. If stock investors defy rational formulation, it is not because they *know* that earnings will recover dramatically in the next six months but because some element of irrationality has affected their behavior.

While earnings peaked in the first quarter of 1989, stock prices have advanced broadly since that time. Have markets been prescient? Did they really foresee in early 1989 that earnings will continue to rise — sometime in 1992 or 1993? Incredibly, during this period, our switch model, comparing adjusted bond returns to stock returns has often been negative to stocks (see Chart 1), suggesting a strong preference for fixed-income instruments over stocks. And yet stock prices continue to score new highs. What makes investors defy logic?

One could argue that the extraordinary drop in short-term rates made stock prices attractive. But the very positive slope of the yield curve should warn investors that low interest rates are only a transitory phenomenon. Do stock traders know *more* than bond traders and instead expect lower interest rates to be with us for a very long time? Barring institutional constraints, which do not exist, it is impossible for these two markets to be so compartmentalized as to diverge so radically in their interest rate forecast.

We are left, then, with only one explanation: This is one of those times that markets become irrational. The very length of this bull market, 17 years, has fostered a momentum of its own. Adaptive behaviour has encouraged institutions and the public to accept dips as buying opportunities. Short memories preclude investors from searching beyond 1987; standards of overvaluation have, until recently, been dictated by those prevailing in August 1987. Now that they have been surpassed, euphoria has explained away the dangers of historically high price/earnings ratios, price/book value ratios, and historically low dividend yields, by proclaiming that "things have changed."

The nature of the recession is still little understood: Statistics compare the duration and magnitude of previous recessions and come away satisfied that the present cycle is "normal" or even milder than usual. As the recession grinds on, few see the danger of an accelerated contraction — although buildings that have been weakened by explosion or earthquake do tend to look solid until they suddenly cave in.

I now understand my obsession with this market. It is not because it is the stock market, although, as explained, equity markets lend themselves more easily to rational analysis. It is not because I am a bear, although, as I also explained, irrationality crops up more *frequently* alongside excessive optimism than alongside excessive pessimism. It is because this market has behaved *so* irrationally.

Those who ridicule the bears adduce that the deep pessimism reigning on Main Street is the cue for their optimism and that contrarians have always done well. But today's contrarianism is Wall Street's consensus: Every announcement of a writeoff or some massive layoff has been greeted with higher stock prices. The absurdity of the argument is patent to all those of us who still enjoy a modicum of common sense.

When an economic recovery follows a trough in stock prices by anywhere from three to nine months, one can fault oneself for being so short-sighted and ignorant, and join the trend. When an economic recovery fails to take place, despite new highs in stock prices *three years later*, one is witnessing irrational behavior — a bubble, a mania.

Much to the bears' chagrin, mania peaks cannot be timed. Fortunately, the existence of optimism has considerably reduced the risk of calling a top, especially in view of their modest implied volatility. Extreme weakness in Tokyo, headed ultimately for the 12,000 to 15,000 level on the Nikkei, contracting volume in New York as the market "consolidates" recent sharp gains, heavy member short-selling in the past few weeks, new-issue madness (and 175 Initial Public Offerings worth $7 billion are currently in registration), the near certain mauling of Bush's State of the Union recommendations, and the public's buying frenzy (witness the ratio of market order to limit orders, Chart 2) all point to a January top, perhaps, *the* top of *the* greatest bull market since the '20s.

If instead this did not turn out to be the top, I can only say, with sincerity, that my obsession will intensify. For if 2 + 2 does not equal 5, it surely does not equal 10.

STRATEGY: *You are short the Nikkei Dow on the IMM, as per our Hotline Flash Update of Jan. 21.*

You are long September and December '92 S&P 500 put options, with strikes varying between 370 and 400.

– A.D.F.

Chart 1

SWITCH MODEL

	E/P	BOND YIELDS	CPI	SIGNAL
89.1	8.47	9.69	5.32	2.01
89.2	7.93	9.48	5.91	2.77
89.3	6.80	8.97	2.81	2.74
89.4	6.45	8.89	3.95	-0.63
90.1	7.00	9.19	7.65	0.47
90.2	6.06	9.40	3.89	3.31
90.3	6.37	9.40	6.88	-0.14
90.4	6.85	9.29	6.95	3.44
91.1	6.02	8.93	3.50	3.04
91.2	5.58	8.91	2.07	-0.83
91.3	5.20	8.79	2.95	-2.52
91.4	4.78	8.45		-1.72

1) POSITIVE NUMBER IS BULLISH FOR STOCKS; NEGATIVE IS BEARISH FOR STOCKS

2) BUY AND/OR SELL SIGNALS FOR STOCKS ARE EFFECTIVE FOR FOLLOWING QUARTER.

Chart 2

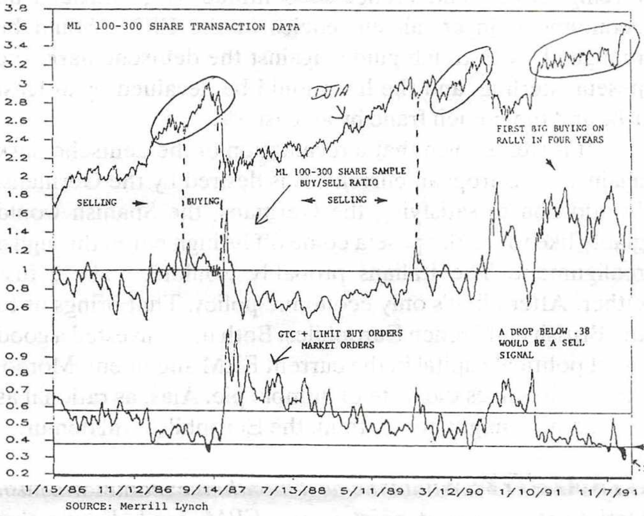


Chart 3

DOW JONES INDUSTRIAL STOCK AVERAGE

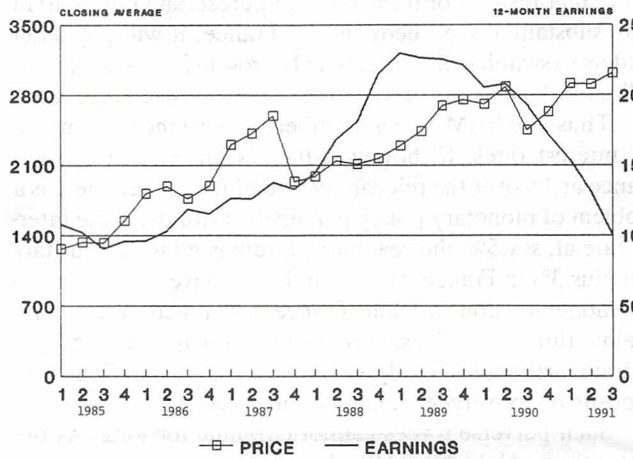


Chart 4 – NIKKEI 25 Index Spot

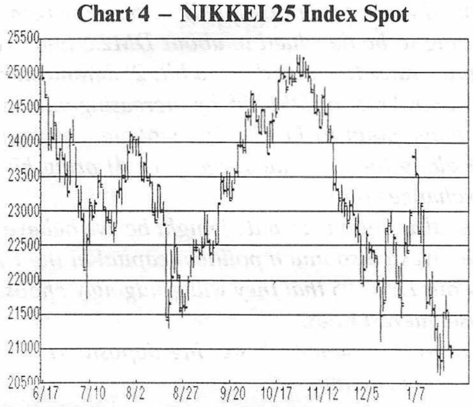
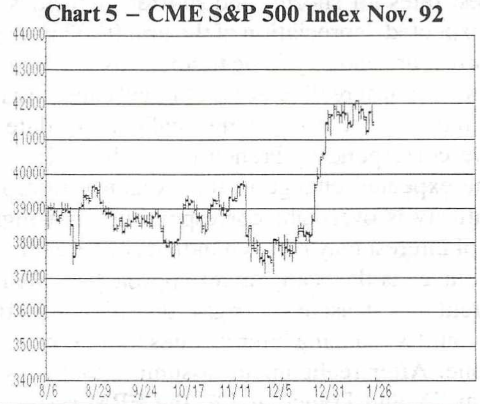


Chart 5 – CME S&P 500 Index Nov. 92



THE EUROPEANS

The Walters Critique

The Treaty of Maastricht marked yet another step by the members of the European Community towards their relinquishment of national sovereignty over monetary matters. Before the ink had dried on the Maastricht treaty, the international chattering classes were celebrating. We, however, eschewed the champagne. Among other things, our reluctance to join the party was motivated by the fact that the Community will have to live with the half-baked Exchange Rate Mechanism (ERM) for at least five more years. Alas, that period could prove to be an eternity for Europe's politicians, particularly in light of the fact that the ERM is suffering from a severe stress disorder.

To understand our diagnosis of that disorder, we must put the ERM into context and present some simple analytics. The ERM is neither an absolutely fixed exchange-rate system, such as that obtained with a currency board system, nor is it a freely floating exchange-rate system. Rather, the ERM is a fudged-rate system in which exchange rates are pseudo-fixed; they wobble in a band and occasionally leap to new levels after a realignment session. Also, the ERM mandates pseudo-monetary policies because exchange rate interventions and coordinated central bank assistance in those operations are required.

Unlike the old gold standard, the ERM is not a self-correcting system. That inability to self-correct is a fundamental, even fatal, flaw. Indeed, in its pure (ideal) form, the ERM will send perverse signals. To appreciate that, we present what has been dubbed the "Walters Critique," after my colleague and collaborator, Sir Alan Walters.

Suppose that capital controls do not exist and that restrictions, which are imposed on domestic financial institutions in order to inhibit the residents from choosing freely the denomination of their assets and debts, are absent. In addition, we assume that exchange rates among participants are fixed for a specified period, and then are realigned. The actual period during which they can be presumed fixed will vary depending on the divergences in inflation rates; the smaller the diversion, the longer the time between realignments. For the purposes of presenting the simple analytics of the ERM, we assume that one year elapses before realignments.

If everyone knows that exchange rates are fixed for a year, then nominal interest rates on financial instruments that originate and mature in that year will be approximately the same for all participants in the ERM. Arbitrage will insure that result. For if the rate of interest (and inflation) in Italy substantially exceeds that in France, it will pay asset holders to switch to lire; that is, to borrow in francs and invest in lira for the period of fixity in the lira-franc exchange rate.

Thus, the ERM forces members to have the same nominal interest rates. If, however, Italy is inflating at 7% and France at 2% over the relevant period of fixity, then there is a problem of monetary policy perversity. With the same interest rate at, say 5%, the real interest rate is minus 2% in Italy and plus 3% in France. Hence, Italy will have an expansionary monetary policy, while France will pursue one of restraint. But this will exacerbate inflation in Italy and yet restrain further the already low inflation in France. This is the opposite of convergence; namely, divergence.

Such perverse forces cannot continue for long. As the date, assumed known and fixed, for realignment approaches, the interest rates for shorter and shorter maturities will reflect the expected depreciation of the lira. It will pay speculators to borrow lire and buy franc financial assets to cash in on their appreciation at realignment. This will cause lira interest rates on maturities that cover the realignment date to rise well above corresponding French rates; the difference will reflect the expected change in the exchange rate. Indeed, when maturity is overnight corresponding to realignment, lira rates of interest may rise to hundreds of percent.

Of course, as the realignment approaches, the interest rate differential is at last in the "right" direction, with the high inflation country realizing interest rates that exceed those in the low one. After realignment, assuming that Italy is still inflating at 7% and France at 2%, the ERM system would revert to the *status quo ante:* With exchange rates fixed for the next year, arbitrage opportunities would reappear, "hot money" flows from France to Italy would occur, insuring that interest rates would be equalized, and of course, the perverse effects on monetary growth would once again be observed.

Although our model of the workings of the ERM is a caricature, it delineates — even exaggerates — the fundamental effects of the system. In reality, to the extent that overt and covert controls on capital movements exist and that the timing of realignments is not known with certitude, those effects are dampened.

However, even with the dampers on the pure ERM system, huge flows of "hot money" still move to high inflation countries within the ERM, so that they can take advantage of relatively high nominal interest rates at virtually no exchange-rate risk. These "hot money" flows, dubbed the "peseta phenomenon," have often motivated realignments, particularly if all the other economic and political stars are "properly" aligned.

At present, with sterling wobbling along just above the lower end of its 6% band, Britain is clearly on the horns of a dilemma. It must face the prospects of raising interest rates in the middle of a nasty slump or devaluing sterling. Politically it is a choice between the hangman's noose or the guillotine.

In this atmosphere of a financial crisis in the ERM, there is only one rational thing to do: realign the ERM. Instead of forcing Britain and France to continue to go through an economic wringer, all currencies in the ERM should be realigned. As a rough guide, against the deutschemark, the peseta, sterling, and the lira should be devalued by at least 10% and the French franc by at least 5%.

It is well known that a revaluation of the deutschemark against the European currencies is desired by the Germans. In addition to satisfying the Germans, the Spanish would gladly like to see the peseta come off its high perch through a realignment. The Italians probably wouldn't make a fuss either. After all, it's only economic policy. That brings us to the British and French Europhiles. Both have invested a good bit of political capital in the current ERM alignment. Moreover, neither likes the taste of humble pie. Alas, as rational as realignment might be, we think the Europhiles will demur.

STRATEGY: *Within the next month, the market will push sterling to its lowest point in the ERM band. Facing that eventuality, there are four possible British policy responses: 1) allow sterling to be devalued to about DM2.5 and eventually allow interest rates to come down a bit; 2) defend sterling and restore a central rate of DM2.95 by increasing interest rates a full percentage point to 11.5%; 3) negotiate a realignment of the ERM along the lines we suggest; or 4) bring back (God forbid) exchange controls.*

Rational as options 1) and 3) might be, we believe that the Brits have invested so much political capital in the ERM and the ridiculous DM2.95 that they will grudgingly choose option 2) and raise interest rates.

Sell March three-month sterling deposits (LIFF). Place stop at 90, good anytime.

— Dr. Steve H. Hanke

Chart 6 – LIF Short Sterling Mar. 92

CANADIAN DOLLAR

Unfounded jitters

With inflation falling to an annual rate of 1.9% for the last half of 1991, the Bank of Canada has achieved early success in its objective of attaining near-zero inflation. Short-term nominal interest rates have correspondingly fallen to new cycle lows, some 175 basis points in the past three months alone. The yield curve has continued to steepen, with three months to over 10 years standing at approximately 180 basis points.

M2 year-over-year money growth has slowed down to just above 6% annually, encouraging market participants to believe that interest rates have room to fall a great deal further. While spreads against short term US interest rates have remained well above 250 basis points in favor of Canada, the Canadian dollar has not taken well the absolute fall in nominal rates. The Bank of Canada has intervened repeatedly in the past few days to maintain more orderly conditions in the market and perhaps to arrest the sharp decline.

We continue to believe that the bank does not have a specific level in mind. Having said that, it is also possible that the most recent 5% depreciation could feed itself back into prices, a development that the bank would have to monitor closely.

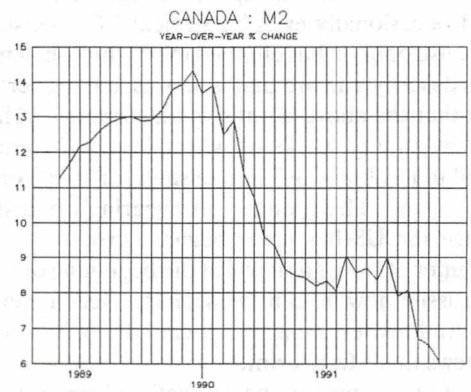
Since trading Canadian dollars implies taking a position in the US dollar, we cannot but reiterate our preference for the Northern unit. It is backed by a single-minded and focused central bank and further supported by the explosive provincial deficits and their large foreign borrowings.

Technically the dollar remains confined to a broad channel that dates back to late 1988 and finds support around 117.50.

STRATEGY: *Maintain long call positions.*

Chart 7 – CME Can. Dollars

Chart 8



CURRENCIES

Comfortable with the obvious

As usual, the G7 meeting proved a non-event, although clearly missing was the much-anticipated official benediction for a higher yen rate. This could tend to lend some near-term strength to the US dollar.

While the wide interest rate gap in favor of Germany remains the most obvious supporting factor for the D-mark and its cohorts, it is also true that rapidly falling differentials *vis à vis* Japan (now down to lesss than 75 basis points on the three months) did little to obstruct the rise in the yen, proving that foreign exchange markets are complex and capricious.

In our own model it is not interest rate differentials that are crucial in the determination of exchange rates but economic growth differentials. In this respect Germany and the rest of Europe have clearly entered a slowdown that may easily turn into a recession; the US recession, however, instead of ending, may enter a more dangerous and precipitate downward path. Thus, economic growth differentials between the US and the EC may widen further rather than narrow.

On an unchanged basis the US fiscal position is likely to be a drag on economic growth to the tune of about 1% of GNP. This situation can be changed by President Bush in his upcoming budget message to Congress, although early indications are that the net stimulus via larger deficit to be proposed will be relatively minor, perhaps $15-20 billion per year over the next five years. If so, we believe that the present economic decline will deepen.

STRATEGY: *An enormous leap of faith is required on the convergence of economic activity between the US on one side and the EC and Japan on the other side to overcome the obvious favorable fundamentals of the latter.*

Remain long currencies with a stop at 60.50, close only, basis March DM.

Chart 9 – CME Deutsche Mark Mar. 92

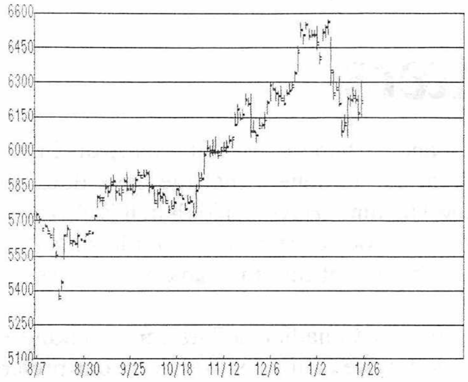
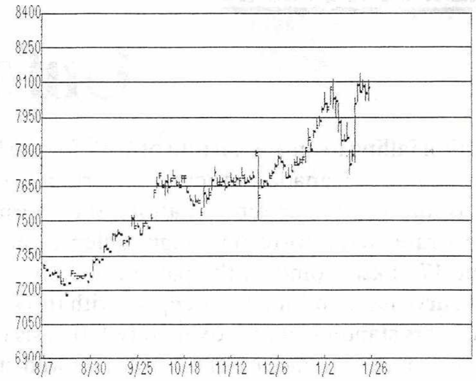


Chart 10 – CME Japanese Yen Mar. 92



WHEAT, SUGAR, COFFEE, COCOA

Wheat

Wheat has taken on many of the characteristics of a market that has entered its final, or "blow-off," stage. Open interest has ballooned to 215,000 from 180,000 contracts. Trading activity on the floor in Chicago has been described as "frantic," and occasionally even "hysterical." Consensus of brokerage house opinion has climbed to 80% bullish. And a chart of prices describes an arc that is now ascending vertically.

Not that the above is entirely unwarranted. The salient fact is that ending stocks of wheat in the US are reliably projected to total only 397 mln bushels, or 15.6% of usage at the end of June. This number is staggeringly bullish. To my knowledge the US has never begun a crop year having so small a buffer of stocks as it will at the beginning of 1992-1993.

The issue now is, can the scenario become even more bullish? And my feeling is that it cannot. We've seen all the bullish news that's fit to print.

The foundation for the market's advance was laid in plantings that were 17% less than in 1990-91. Dry weather in the Midwest reduced yields by 13%. Poor weather in Australia and Argentina reduced the size of crops in those countries so that the entire production of American competitors declined by 12%. The break-up of the Soviet Union fueled a politically-inspired export bonanza; exports rose by 17%, more than compensating for the 9% decrease in domestic usage. At the same time the US chose to fight a subsidy war with the EEP. And to top it all off, the first report predicting winter wheat plantings indicated farmers in the southeast had erred and elected to plant cotton of all crops, which means that aggregate production of winter wheat is actually likely to be less than it was in 1990-91.

It was this last bit of news that seems to have shocked the market into a sudden recognition of just how precarious the supply/demand situation has become.

Where can more positive news come from? There are 2.3 mln acres in North and South Dakota, Minnesota, and Montana that can and, given the obvious incentive, will be given over to Spring wheat. This amount alone will overcompensate by three quarters of a million acres the reduction in winter plantings.

Yields can reasonably be expected to increase in 1991-92 as forecasts call for unusually favorable weather in the Midwest.

Drought-ending rains in Australia have already caused that country's official agency (ABARE) to raise its estimate of the current year's production, and while it's by only a meagre amount (to 9.63 mln tonnes from 9.52 mln tonnes), it is the first upward revision made in 12 months, thus suggesting the forthcoming crop will tend toward normal size.

Germany and Britain have broken ranks with the previously united EEC position on the Dunkel report on GATT, suggesting the subsidy war will be resolved.

As for the former Soviet Union, the CIS, I just cannot see the likelihood of the US providing them with more wheat. For one thing, predictions of widespread food riots have not been borne out. It's probable that what hardship does exist is being borne stoically by a people who are willing to trade in exchange for freedom a reduction in eating standards that were not, as is commonly imagined, low to begin with, but on a par with much of Western Europe.

In addition, all reports from the most recent US mission to the CIS made in early December have a less eleemosynary tone. There seems to be a realistic feeling that the republics have the means to look after themselves. While it is true that in a non-command driven economy, less-productive growing areas will be phased out of production more easily than more-productive areas will be increased in size and efficiency, an appraisal of the grain markets in the republics suggests the major problem is not in production but in distribution and marketing. This is true especially in Russia, the most populous republic and the republic that imports 65% of all the grain imported into the republics as a whole (30.0 mln tonnes in 1987-88, the most recent year for which figures are available).

If the political initiative of the US is to inspire democratic, capitalist regimes in the CIS and the problem with grains is marketing and distributing them, donations of anything but humanitarian grain would tend to inhibit the free-market mechanism, thus frustrating the goal.

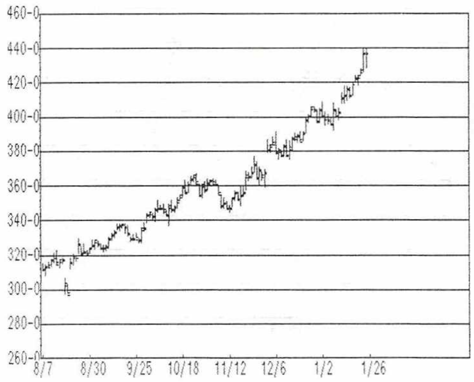
As is typical of bull markets that have entered the "blow-off" stage, the wheat market tends not to regard anything but bullish news as relevent and to interpret equivocal news as bullish.

Last week wheat prices soared on news that the CIS had made an interest payment for credit on grain purchases on time. The market sees this as the opening of the gate to more purchases. The fact is that the republics have interest payments due almost daily on outstanding credit. The likelihood is not only that the US will not provide additional credit but that the repubics will default on payment for grains already shipped and thus deny themselves access to grains they've been extended credit for.

It would not surprise me if it were such a default that broke the back of this market.

In the meantime it is our due to enjoy the ride. The "blow-off" phase is the dessert that ends the meal. In the next month, or for as long as it lasts, prices can rise by more than they have since we first recommended wheat in August at $3.30 a bushel. Do not get out. At the same time, do not expect to sell the top. Stay in close contact with our Hotline and try to stay calm.

Chart 11 – CBT Wheat Mar. 92



Sugar

When I moved to Toronto in the early '70s my first apartment happened to be above a store on Spadina Avenue just south of College Street. The area was a hotbed of gambling. Gangs of guys met daily at noon to head to the track in convoys. All-night poker games spawned within walking distance. Bookmakers preened in front of gaudy cars on summer evenings waiting for bets on baseball games.

There were two old-timers who hung around the Crest Grill, which was located right at the corner and was the epicenter of the gambling universe. They were the doyens of the scene. Their stories were its myths and/or oral history, depending upon your degree of skepticism. One Friday the two of them hooked up in a duel.

They started playing gin in the back of the poolroom that was situated behind the Crest. They spiced that up with bets on as many sports contests as were played that night. When the poolroom closed, they moved into an apartment above it, played all night and all the next morning, and then went to the track to bet against each other in the afternoon.

I saw the two of them lugging themselves out of a cab after the track, looking as though it was they who had run the races. Their match was known to the entire neighbourhood. To me, a newcomer from a small town fresh out of college, it was an epic of titans. I was dying to know who had won.

I built up my courage and self-consciously sauntered up to my favorite of the two, a wonder of a man of 70 who walked like a penguin and went by the moniker of Gaberdene. He looked at me, then over my shoulder out into the sky, which was tending toward the gloomy, turned to his adversary and said:

"Hey! What odds you give me it doesn't rain before 6:00?"

I tell this story for two reasons. One, because I feel that having devoted so much energy in recent months to promote a market that's proven so dull, it behooves me to invest the scenario with drama even if that drama is completely unrelated to the commodity. And two because, as it turns out, we are, after all is said and done, doing nothing more than Gaberdene was doing when he came back from the track that gloomy Saturday: We are betting on the weather.

Their has never been an El Niño year when sugar prices have not staged an advance. With the supply/demand balance being so neutral — the most recent Licht estimate calls for a surplus of about 900,000 tonnes, smaller than the preceeding estimate but hardly enough to impact upon prices one way or the other — the weather, in addition to Cuba and the CIS, which is seemingly omnipresent in commodity forecasting these days, is critical. Would the El Niño wreak the same havoc upon crops this year as it did in 1981 when Southern hemisphere cane production in general was decimated and Indian production in particular was reduced by 5.0 mln tonnes?

Unfortunately for us bulls the answer appears to be no. The volcano that is credited with causing this year's warmer currents in the Pacific blew up in June, too late to arrest the July to December monsoons that provide rain to the Thai and Indian crops. Both growing areas apparently have received adequate moisture.

This leaves us with Cuba and the CIS to hang our horns on. And conditions there are as unknowable as the weather, it seems. Only conjecture about production in the former country and offtake by the latter is forthcoming. We have offered enough of our own in previous issues to render redundant anything we might say here.

Still there is the weather or at least the history of weather-related damage to sugar production. One thing that's come up recently has been mention of the unusually warm weather that's parked itself in the American Midwest and Northwest in the past three weeks. That area is the country's major beet-producer.

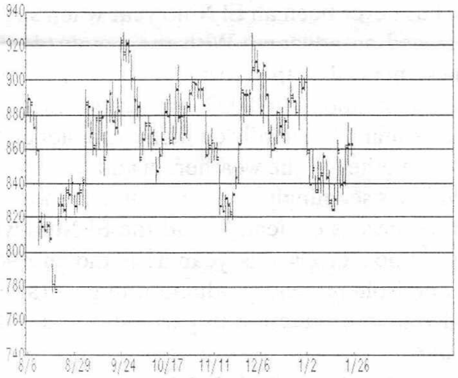
In the US the beet harvest is done all at once. (In Europe the harvest is staggered so as to bring the harvested beets to processing facilities according to the facilities' capacity). The beets are then transported to processing facilities where they are left outdoors, refrigerated by the weather. If it gets too mild, dehydration occurs. Some growers are reporting 50% reductions in post harvest yields. The net effect could be as much as 500,000 tonnes at worst; enough to swing the market to the positive side of its current dull 8¢ to 9¢ trading range.

More importantly, the fact that there would be any concern at all about the previously unworried-about US crop suggests just how trickily insidious an El Niño year can be to sugar, which is grown in all but the coldest parts of the planet.

Anxiety concerning the size of the US crop may explain the unusual increase in the open interest that's built up in the past three weeks. And the indication in the most recent commitment of traders report that commercial hedgers had increased their long position by 6,000 contracts, or 12%.

We are long this market via October 11¢ calls. Being as far out of the money as they are, a decline in price to even 7.5¢ is not likely to do them much damage. Time will not begin to decay their value until June at the earliest. With any unexpected news about the weather — or Cuba and/or the CIS — infinitely more likely to be bullish rather than bearish, I am quite certain Gaberdene, were he still alive, would tell us the odds remain in our favor.

Chart 12 – N.Y. #11 Sugar Mar. 92



Cocoa

We were stopped out of cocoa at 1250, basis the May contract as per last month's advice.

Gill & Duffus, the industry's most respected statistician, raised its estimate of the size ofthe current year's deficit to 170,000 tonnes. It may be raised further yet. It will almost surely be the first year of many for which they will offer deficit forecasts.

The eyes of the cocoa world are on the Ivory Coast, the largest producer. Gill & Duffus is of the opinion production there will total 700,000 tonnes, 9% less than last year's crop.

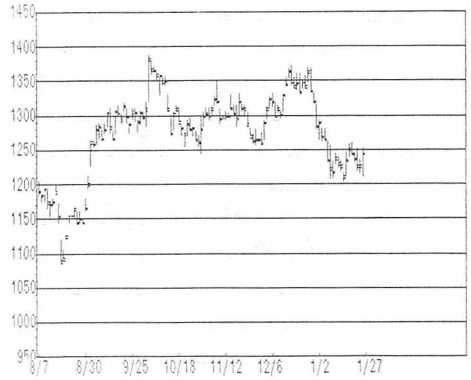
As I mentioned in September's Comments, the Ivory Coast became the world's largest producer by subsidizing producers at prices well above market levels. Years of subsidization of cocoa and other commodities have had a predictably bad effect on the economy of Ivory Coast. The country now not only pays growers less than market prices, it pays them in devalued currency.

I cannot see how such disincentive can work except to continue to erode Ivorian production.

Brazilian production too is secularly threatened by years of cocoa surpluses and coincident inflation in that country.

Cocoa at current prices is a value commodity. It is likely to take the baton from wheat and lead the parade of commodities generally into higher ground. Re-enter the long side of the market; buy May '92 cocoa at market. Place stops at 1199, close only.

Chart 13 – N.Y. Cocoa May 92



Coffee

Floor traders gorged themselves on bottom pickers attracted by the sheer cheapness of the brew. We were among them. Still, with retail prices so very low and promotional campaigns increasing in both quantity and quality, it's hard not to imagine a sharp turnaround someday soon. Don't risk more than another penny, literally.

FRIEDBERG CAPITAL MARKETS

Burnup and Sims Inc.

Bond: 12% due Nov. 15, 2000, CV at $16.79 per share
Price: 60.5
Yield to Maturity: 23.7%
Update: Burnup and Sims Inc. was founded in 1929, and together with its subsidiaries currently provides a wide range of cable design, installation, and maintenance services to telephone, CATV, and utility service customers throughout the United States.

In addition, the company is one of the principal manufacturers of power suplies for the CATV industry. Burnup and Sims also operates a motion picture theatre chain in the Southeastern US and also provides commercial printing and graphic art services. A few of the clients using Burnup and Sims services are AT & T , GTE and IBM.

Revenues for the quarter ended Oct. 31, 1991 decreased approximately US$4.6 million, or 10%, when compared with the same quarter in the prior fiscal year. The revenue decline is attributed to a US$4.5 million reduction in sales of cable television and utility services subsidiaries and reduced sales of CATV power supplies.

Earnings for the second quarter were US$730,000, or $8¢ per share compared with US$1.8 million, or 19¢ per share, for the same period the previous year. Operations of the company are somewhat seasonal, and this has historically resulted in reduced net income during the third quarter (November, December, and January) relative to other quarters.

During winter months, inclement weather in certain areas reduces the volume and efficiency of outside service activities. Additionally, certain telephone services customers may reduce expenditures for plant constructions and maintenance during the latter part of their budgetary year, which typically ends in December.

It is important to note that the results for six months ended Oct. 31, 1991, include the US$1.1 million pretax gain from the purchase of the convertible debentures, resulting in the reduction of these debentures by US$3 million to US$27 million in Oct. 31, 1991, from almost US$30 million April 30, 1991.

The company's relatively strong balance sheet combined with the policy of repurchasing their own debt, reassures us that the 12% convertible bond due the Nov. 15, 2000, is an attractive purchase, currently trading at 60.5, to yield 23.75% to maturity.

Burnup & Sims Inc. interest coverage ('000s)

	3 month period ending Oct. 31/91	3 month period ending Oct. 31/90
Net income before income taxes	1,260	2,198
(Add back):		
Interest Expense:	1,222	1,600
Depreciation/Amortization	1,664	2,195
Amortization of other intangibles and goodwill:		
Total:	4,146	5,993
Debt service:	1,222	1,600
Coverage Ratio:	3.39 times	3.75 times

Chart 14

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, ECU, DKr, BP, FFr, ECU, CDN, SAR, ARG) or revalue (for SF and JY) before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. **Rates as of January 23, 1992.**

	U.S. $	NEW ZEALAND $	AUSTRALIAN $	DEUTSCHEMARK	SWISS FRANC	JAPANESE YEN	DANISH KRONE	BRITISH POUND	FRENCH FRANC	EUROPEAN CURRENCY UNIT	CANADIAN DOLLAR	SOUTH AFRICAN RAND**	ARGENTINEAN PESO
1 year	4.10%	CIBC 14%, 92, yields 7.89% (.5214 NZ/US)					Denmark 92, yields 9.17% (6.473 Dkr/US)						
2 year	4.99%	Tourist Hotel '93, yields 8.83% (.5029 NZ/US)	World Bank '93, yields 7.88% (.7032 A$/US)			Canada '93, yields 4.46% (123.11 US/JY)	Denmark '93, yields 8.62% (6.607 Dkr/US)	Sweden '93, yields 10.11% (1.6151 BP/US)			Canada '93, yields 6.58% (1.1938 US/CD)	ESCOM '93, yields 15.27% (.2557 US/SAR)	
3 year	5.37%		CBA 14%, '94 yields 8.59% (.6801 A$/US)										
4 year	5.82%			Sweden '95, yields 8.03% (1.7514 US/DM)					EIB 8¾%, '95 yields 8.29% (6.026 FFr/US)				
5 year	6.28%			Bk. of Nova Scotia '96, yields 8.10% (1.7555 US/DM)							Ontario Hydro '96, yields 8.20% (1.1710 US/CD)		
6 year	6.52%			*World Bank '97, yields 7.61% (1.7139 US/DM)									
7 year	6.77%				Australia '98, yields 6.50% (1.4066 US/SF)								
10 year	7.14%									U.K. 9⅛%, '01 yields 8.20% (1.1475 ECU/US)			Argentina BIC V IRR 25.24% (4.808 $/ARG)
Spot Exchange Rate	N/A	.5404	.7442	1.6125	1.4318	124.37	6.173	1.7765	5.495	1.266	1.1585	.3082	.9905

*For example, since a US$-based investor would receive 109 basis points (761-652) by holding the World Bank '97 DM bond, the US/DM can depreciate to 1.7139 US/DM from the present spot exchange rate of 1.6125 US/DM over the next 6 years for the DM investment to break even with current US$ 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.

Chart 15
Foreign Currency Bonds

Date: January 23, 1992

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
SOUTH AFRICAN RAND DENOMINATED BONDS				
ESCOM 11% 31/10/93 (semi)	92.85	93.60	15.27%	Apr. 30
DEUTSCHE MARK DENOMINATED BONDS				
KINGDOM OF SWEDEN 7 1/4% 1/2/95	97¼	98	8.03%	Feb. 01
EUROPEAN INV. BANK 5 1/2% 9/8/93	96.65	97.40	7.33%	Aug. 08
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	90.55	91.30	8.10%	May 07
WORLD BANK 5 7/8% 4/2/97 RRSP eligible	92¼	93	7.61%	Feb. 04
SWISS FRANC DENOMINATED BONDS				
GOVT.OF AUSTRALIA 5% 30/10/98	90	92	6.50%	Oct. 30
DANISH KRONE DENOMINATED BONDS				
KINGDOM OF DENMARK 9% 20/11/92	99	99 3/4	9.17%	Nov. 20
KINGDOM OF DENMARK 8% 20/08/93	98.30	99.05	8.62%	Aug. 20
ECU DENOMINATED BONDS				
UNITED KINGDOM 9 1/8% 21/02/01	104 3/4	105½	8.20%	Feb. 21
BRITISH POUND DENOMINATED BONDS				
KGDM of SWEDEN 9/3/8% 14/4/93	98 3/8	99 1/8	10.11%	Apr. 14
FRENCH FRANC DENOMINATED BONDS				
EUROPEAN INV.BANK 8 3/4% 12/7/95	100½	101¼	8.29%	Jul. 12
JAPANESE YEN DENOMINATED BONDS				
GOVT.OF CANADA 23/7/93 5 5/8% RRSP eligible	100.85	101.60	4.46%	Jul. 23
CANADIAN DOLLAR DENOMINATED BONDS				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	108.10	108.85	8.20%	Jan. 08
GOVERNMENT OF CANADA (semi annual) 6/12/93 7¼%	99 3/4	100½	6.58%	Jun.06
NEW ZEALAND DOLLAR DENOMINATED BONDS				
CDN.IMP.BANK OF COMMERCE 27/07/92 14% RRSP eligible	101 7/8	102 5/8	7.89%	Jul. 27
TOURIST HOTEL 0% 04/06/93	88½	89¼	8.83%	4/6/93
AUSTRALIAN DOLLAR DENOMINATED BONDS				
General Electric 11/07/92 14 1/4% (semi)	102	102 3/4	7.83%	Jul. 11
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	110½	111¼	8.59%	Jul. 07
WORLD BANK 15/03/93 12 3/4% RRSP eligible	104¼	105	7.88%	Mar. 15
ARGENTINEAN PESO DENOMINATED BONDS				
ARGENTINA BIC V 1/5/2001	.9577	.9652	25.24% I.R.R.	1st of month
U.S.DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03(semi) CV @$38 p/sh	81	83½	10.50%	Dec. 15
ALLIANT COMPUTER 7.25% 15/05/12(semi) CV @$39.75 p/sh	21	24½	32.07%	May 15
COOPER CO'S. 10 5/8% 01/03/05(semi) CV @$27.45 p/sh call in 1995 @100	84½	87½	12.99%	Mar. 01
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @$39.50 p/sh	27½	30½	20.07%	Mar. 01
BURNUP & SIMS 12% 15/11/00 (semi) CV @$16.79 p/sh	57½	60½	23.73%	May 15
U.S.DOLLAR DENOMINATED FIXED RATE BONDS				
FARM CREDIT CORP 7 3/4% 10/6/96 RRSP eligible	103½	104¼	6.58%	Jun. 10
REPUBLIC of ARGENTINA 7/10/93 11% (semi) 1 yr. put	102½	103¼	8.78%	Apr. 07

U.S.DOLLAR DENOMINATED FLOATING RATE NOTES	Bid	Offer	Current Coupon	
UNITED KINGDOM 24/9/96 3 mo.LIBID-1/8 (qtly) *callable @100 09/91	99.80	100.10	5¼%	Dec. 31
REPUBLIC OF ITALY 30/4/93 3 mo Limean(qtly)	99.57	99.97	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

LDC UPDATE

Argentina

Bonos de Inversion y Creciminento (BIC Series V) or Investment Development Bonds. An outstanding opportunity.

Starting in December 1989, and again in January and April 1990, we took constructive notice of the economic revolution taking place in Argentina, caused by the fact that the state, after 40 years of mismanagement, had become unable to obtain or even roll over domestic credit, let alone foreign credit.

At the time, the only government instrument that retained some credibility was the Bonex, which we purchased with annual dollar yields of up to 45% (see our Jan. 28, 1990 issue, "Argentina, Bonex 1982 series: an intriguing speculation yielding 39.9%" and April 22, 1990, "Argentina: stabilization at last").

We liquidated these bonds when their yields to maturity fell to the 20% area, as returns did not justify continuing risks (see Argentina, Oct. 21, 1990). Our total return, capital appreciation plus yield, exceeds 75% on purchases made in January.

At the time, the Menem government had not come to grips with a number of pressing problems: The local currency, the austral, had continued to suffer from indeterminacy in an hyperinflationary economy; the fiscal deficit, fueled by loss-plagued nationalized enterprises and a highly inefficient and unjust tax collection system, was out of control, impeding stabilization and pre-empting whatever was left in local savings through massive borrowings. Our feeling was that Argentina had turned the corner but that it was unable to move forward.

In February 1991, Harvard-educated Domingo Cavallo assumed the direction of the economy. Imposing an extraordinary pace, he began deregulating the economy via Presidential decrees (unable to win congressional approval for a battery of bills), tackling at first the antiquated port system and the labor market, closing down dozens of government agencies, eliminating many of the petty bureaucratic controls on private business activity, forcing a privatization of the telephone monopoly and the state airline, and promising to systematically rid the state of almost all enterprises.

While 47,000 civil servants had already been laid off four months earlier, Mr. Cavallo deepened the cuts and required the 160,000 strong civil service to attend regular training courses designed by Harvard University. Outstanding performance was to be rewarded with higher pay and promotion, and pay differentials were to be increased.

Tax reform was introduced and is about to come into effect, making Argentina one of the lowest and fairest tax countries in the world. Tax collections were improved via computerization and the hiring of young, not-yet corrupt university students. The state achieved an operating surplus in the last six months of 1991.

Coupled with privatization proceeds, Argentina was able to make partial but regular monthly interest payments on the foreign debt and continue amortizing its domestic and Bonex debt. To lend maximum credibility to his plan, Mr. Cavallo adopted a currency board for the austral; fixing it at 10,000 australs to the dollar, an amount that would allow him to retire the entire austral money supply with the "then" meagre dollar holdings, the economy minister promised, via passing a new law, that henceforth the Central Bank would be unable to "print" an austral without the direct backing of a US dollar. In effect, the only manner in which money supply would increase was via capital inflows (now running at an extraordinary rate of US$400 million per month) and/or a current account surplus. A *small* portion of Central Bank holdings could be held in Bonex, priced at current market levels.

With free and assured convertibility, the austral had become as good as the dollar. In the closing months of 1991, Argentina's inflation began to converge on US inflation rates: Consumer prices in December increased at a rate of 0.6% and wholesale prices *fell* 1%. The deflationary muzzle of a fixed regime was alleviated somewhat by a lowering of tariff rates (the lowest in Argentina's history), the elimination of any other trade blockage, and the dramatic productivity improvements from deregulation.

Almost by miracle, the country grew 5% in 1991, unemployment fell to 6% of the labour force despite massive state layoffs, and inflation fell, in the closing months of the year, below double digit numbers.

Argentina is now in the process of restructuring its external debt held by commercial banks (amounting to $41 billion), being close to reaching a settlement with the creditors that will involve Brady bonds and privatization bonds. Continuous privatizations during 1992 almost guarantee a large influx of dollars.

The downside of this inflow is the inflationary impact in the money supply, which will slowly overvalue the local currency, with the effect of shrinking somewhat last year's trade surplus of $4 billion. Allowing this automatic process would facilitate the long needed recapitalization of the country without upsetting the scheme of free and fixed convertibility. As of Jan. 1, 1992, the austral was changed to a new peso and four zeros were lopped off; one peso is now equal to US$1.

Local peso rates remain higher than dollar rates because of lingering doubts about the new system. We believe that the fear is *absolutely unfounded*, at least through 1992 and perhaps for many more years. As a result, an extremely interesting investment opportunity presents itself: the Investment and Development bonds, BIC V Series.

Borrower: Central Bank of Argentina

Brief overview: There are currently two major series of BIC bonds outstanding: BIC I and BIC V. Other series of BIC have been issued but are held in custody by the Argentine Central Bank. BIC I were issued on Dec. 28, 1989, in the amount equal to 150 million pesos to financial institutions as part of a mandatory exchange for certain bank assets and were later increased by 26.2 million pesos following a voluntary exchange of BIC I for BIC V. The outstanding face amount of BIC I is currently 84.7 million pesos (US$85 million). BIC V series, issued on May 1, 1991, were offered to holders of BIC I in a voluntary exchange on June 29, 1991.

Guarantor: Republic of Argentina

Outstanding: 1,300,000,000 pesos

Type: Bearer bonds

Currency: Argentinean pesos

Maturity date: May 1, 2001

Amortization: 118 monthly instalments, the first 117 of 0.85% each and the final one of 0.55%.

Interest: Average rates on savings accounts and fixed term deposits in pesos corrected by the bank reserve requirements for each deposit (average funding cost) plus a 0.90% monthly interest. This interest is paid out on a monthly basis jointly with the amortization stream of payments.

Payment agent: Central Bank of Argentina

Early redemption: The Central Bank of Argentina has the right to redeem on any interest payment date, at remaining principal plus accrued interest.

Quotation: Quoted on the Argentine Stock Exchange and over-the-counter market.

Tax implications: Principal, interest, and capital gains are exempt of all Argentine taxes.

The bonds are currently trading at 98.40, a small premium over par (par is now 94.90, reduced by the monthly amortizations). For the month of January the average funding cost is 1.20%, which when added to the 0.9% monthly interest produces a running yield of approximately 24.3% per annum. Since interest and amortization are made monthly, a strong compounding is operative.

We strongly recommend this bond for risk conscious accounts.

FOREX RATES & UPDATE

Currency	*Spot*	*3-Month*	*12-Month*	*Comments vis à vis US$*	*Comments vis à vis DM (Spot DM: 1.6030)*
Australian dollar	.7390-.7395	.7327-.7338	.7160-.7185	Neutral	Remain short
Belgian franc	33.16-33.20	33.58-33.64	33.30-33.35	Remain long	Neutral
Danish krone	6.2420-6.2470	6.3270-6.3380	6.5420-6. 5770	Remain long	Neutral
Dutch guilder	1.8135-1.8145	1.8370-1.8385	1.8935-1.8965	Remain long	Neutral
Finnish markka	4.3830-4.3850	4.4660-4.4710	4.6970-4.7080	Remain long	Remain short
Greek drachma	185.80-186.10	191.80-196.60	210.80-226.10	Neutral	Neutral
Hong Kong dollar	7.7570-7.7580	7.7605-7.7665	7.7800-7.8060	Neutral	Remain short
Irish punt	1.6533-1.6538	1.6270-1.6294	1.5623-1.5718	Remain long	Remain long
Italian lira	1212-1213	1234-1234	1294-1298	Remain long	Neutral
Malaysian ringgit	2.6625-2.6655	2.6860-2.7025	2.7565-2.8100	Neutral	Neutral
New Zealand dollar	.5395-.5405	.5350-.5370	.5235-.5270	Neutral	Remain short
Norwegian krone	6.3200-6.3250	6.4150-6.4210	6.6450-6.6750	Remain long	Neutral
Portugese escudo	138.65-138.85	141.85-142.80	148.65-152.45	Remain long	Remain long
Singapore dollar	1.6360-1.6380	1.6335-1.6385	1.6260-1.6380	Remain long	Neutral
Spanish peseta	101.80-101.90	103.88-104.04	109.45-109.75	Remain long	Neutral
Swedish krona	5.8525-5.8575	5.9675-5.9795	6.2525-6.2825	Remain long	Neutral

Explanatory Notes

*Indicates change in recommendation from last issue.

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

Monday, December 30:
This is a complete summary since our last market letter dated November 24, 1991, of all liquidations of open positions and new recommendations that remain outstanding. On Wednesday, Nov. 27, we liquidated long crude oil positions. Monday, Dec. 2, we purchased March T-bond futures and options. Stops were placed at 101.00, close only. On Wednesday, Dec. 4, we advised the purchase of March wheat at the market.

Tuesday, December 31:
There are no changes or new recommendations. The market letter is in the mail.

Friday, January 3:
There are no changes or new recommendations.

Tuesday, January 7:
There are no changes or new recommendations.

Friday, January 10:
There are no changes or new recommendations.

Tuesday, January 14:
There are no changes or new recommendations.

Flash update, Friday, January 17, 8:57 a.m.:
Reinstate long positions in DM, EMS & EMS-related currencies, Japanese yen at the market. Place stops at 6050, basis March DM, close only for any of the above positions. Cash DM rate 1.6190; March DM 6120.

Friday, January 17:
We are repeating this morning's flash update at 8:57 a.m. to reinstate long positions in DM, EMS, EMS-related currencies and Japanese yen at the market. Place stops at 6050, basis March D-mark, close only, for any of the above positions. Cash DM rate 1.6190; March DM 6120.

There are no other changes or recommendations.

Flash update, Monday, January 20, 4:30 p.m.:
Buy September and December S&P 500 put options with a strike in between 370 and 400.

Tuesday, Janaury 21:
I am repeating the flash update for Monday, January 20 at 4:30 p.m. to buy September and December S&P 500 put options with a strike in between 370 and 400, and one new recommendation to sell the March Nikkei Dow futures on the IMM at the market.

Friday, January 24:
There are no changes or new recommendations. The following are all Hotline recommendations of positions that remain outstanding since our last newsletter on December 29, 1991. On Friday Jan. 17, we recommended reinstating long positions in EMS, EMS-related currencies, and Japanese yen, placing stops at 6050, basis DM close only. On Monday, January 20, we recommended the purchase of S&P 500 put options and to short the Nikkei Dow futures on the IMM.

Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published by Friedberg Commodity Management Inc., 347 Bay Street, Toronto, Ontario, M5H 2R7.

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