

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

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Journey into the unknown...

The German reunification was perhaps in many respects, but certainly in the monetary sense, a journey into the unknown.

At the core of the problem is the monetary overhang created on July 1, 1990, the date of the currency union between West and East Germany and alluded to in our July 22, 1991, issue. At that time we said that the "6 ostmark (OM) to 1 deutschemark (DM) ratio obtained in the free market in the early part of 1990, although imperfect, was probably the best approximation of the buying power of the OM and the DM. A political decision was made, however, to proceed with a weighted average conversion rate of 1.8 OM to 1 DM.

This conversion of the OM money stock presented the Bundesbank with a potential inflationary problem, one that could be neutralized once the Bundesbank obtained a good "feel for the demand for money of OM holders." In quantitative terms, the conversion caused a one-time increase in M3 of DM180 billion, or 17.2%.

Phrased in relative terms, East Germany ended up with 17.7% of total M3 while contributing, according to the Federal Statistics Office, a GDP equal to 8.3% of the new Federal Republic of Germany. On cursory inspection, the Bundesbank created a monetary overhang of approximately 6.4% (17.7% minus 8.3%). Given the good correlation between long-term monetary growth and price movements (see Chart 1), this one-time increase is likely to lead to a one-time extra price rise of approximately 6%.

Adding fuel to the fire, however, is the now apparent fact that East Germany's GDP was greatly overstated (as was the case with every non-market communist regime), and therefore the rise on reunification in potential GNP for the Federal Republic was *minimal if not actually negative*. This statement is not as surprising as it may seem.

Scores of enterprises that may have been profitable in a Socialist, non-market environment — and therefore may have been considered as generating true income — have been found to be loss-making. And while in some cases, these enterprises could be turned around and made more efficient, in many other cases, they represent dead weight and a real *cost* to the economy. In effect, they add negative value to the inputs they use.

This means that a large portion of East Germany's Net Material Wealth (communist terminology for measuring economic activity) is going up in smoke...and with it potential

GNP. At the risk of exaggerating, one could argue that West Germany acquired a negative asset, i.e., a liability. Thus the DM180 billion increase in M3 may represent not just a 6.4% overhang — but closer to a 14% overhang!

A second complication is the recent pace of the money stock. In January, the annualized growth rate relative to the 1991 fourth-quarter average level was 9%; the three-month annualized rate was an even higher 11%.

Lending to enterprises and individuals was 11.5% up on the year (to November '91); in the most recent past, short-term lending to trade and industry and longer-term loans have been increasing at double digit rates, led by the restructuring and reorganization of ownership which have got under way in the East. In the words of the Bundesbank, "judging by the available information on enterprises bought, investment projects, the deficits incurred by the Treuhand privatisation agency, etc., developments in the East German economy may become even more significant factor in the future. At all

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events, new longer-term lending commitments have remained bullish, suggesting that the credit expansion will stay strong. *There have so far been few signs that the demand for credit is responding to the further rise in short-term interest rates seen last year.*"

As a result of this monetary disorder, inflation has been, by German standards, catastrophic. Consumer prices have been rising at 4.3% to 4.6%, hourly wage costs, which increased by an average 4% a year between 1982 and 1989, jumped 7% in 1990 and 8.2% last year, and unit labor costs for the year to November '91 have risen 6.6%. Coupled with the fact that excessive wage claims and strikes have become a daily occurrence, these statistics reveal that *latent* inflation is a great deal higher than assumed.

Under these circumstances — and despite the well publicized signs of a German economic slowdown/recession — it is virtually certain that the Bundesbank will turn the monetary screws at least once but, more likely, a number of times before inflation is brought back "under control."

If our intuition about the monetary overhang is correct, the Bundesbank is nowhere near the level of interest rates that will ultimately choke off the booming demand for credit. This analysis leads to two intriguing and potentially very profitable trades, which we discuss below.

Chart 1



The Deutsche Bundesbank

YEN/DM CROSS

Back to the cross

In July/August 1989 we recommended a short yen/long deutschemark cross trade that proved to be our best trade for the years 1989 and 1990. While in somewhat dissimilar circumstances, the ingredients are again present for a new cross trade, one that may prove every bit as exciting as the old one.

As analyzed earlier, Germany is caught in a major inflationary episode, the product of a miscalculated monetary reunification. The case for higher interest rates, while still not self-evident to economists who believe in the long run non-neutrality of money, is clear.

Japan, on the other hand, is caught in a (asset) deflationary bust, a still-stubborn but relatively modest consumer price inflation of 2.5%, and a rapidly weakening economy. Witness to the collapse in *domestic* demand is the sharp rise in the current account: In the 3 months to January 1992, it has been running at a surplus of \$93 billion annually compared with 1991's \$72.6 billion surplus.

The collapse in M2 (see Chart 7) is reason enough for the BOJ to relax further and lower the Official Discount Rate by 1/2 percentage point or even 3/4 percentage point.

There are, however, a number of caveats: a) the fast-rising trade surplus is proving a political embarrassment to Japan, one that could be aggravated should the yen fall further; b) a number of economic statistics do not support the view, as yet, that the economy is in a *free fall* (see Charts 2,

3, 4, 5, and 6); the diagnosis may simply be a growth slowdown; and c) the orderly bursting of the bubble, so much an objective of Governor Mieno's policies, has as yet not been completed; the stock market is still valuing industrial shares at an average of 35 to 40 times earnings and bank shares at well over 50 times earnings.

Be that as it may, it is only a matter of a few weeks before the BOJ eases; the deflation will then proceed on two fronts — first, as the yen depreciates, via a growing and even larger trade surplus and second, eventually via a revival of domestic demand.

In sum, Germany and Japan have entered the opposite phases of a credit cycle. The former is attempting to choke off inflationary pressures; the latter is about to alleviate deflationary forces. As a result, the DM is likely to rise *vis à vis* the yen.

STRATEGY: Buy June '92 DM/sell June '92 yen in equal dollar amounts (the yen contract is approximately 25% to 26% bigger than the DM contract). You could also take advantage of the new CME DM/yen cross contract, denominated in yen and representing 125,000 DM, which at the present rate of 79.10 yen to the DM is equal to ¥9,887,500 or approximately US\$74,000.

Chart 2 - Cross DM/YEN

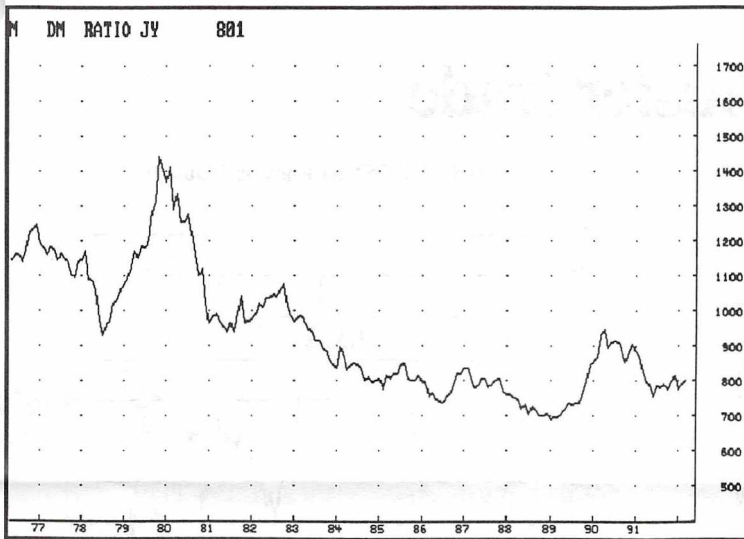


Chart 3



Chart 4

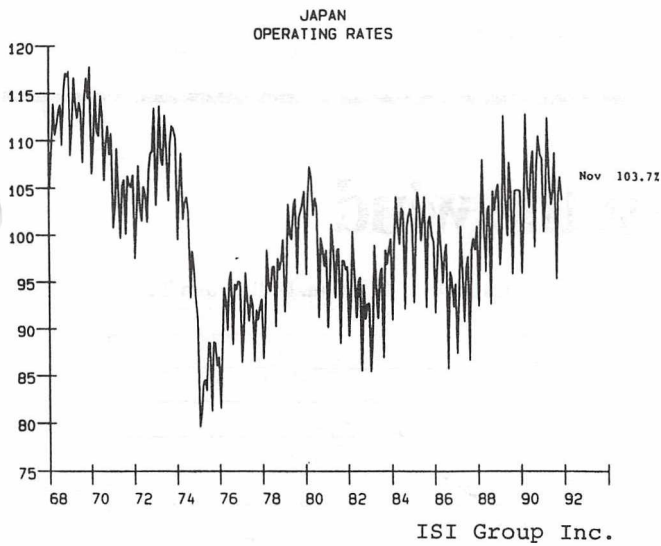


Chart 5

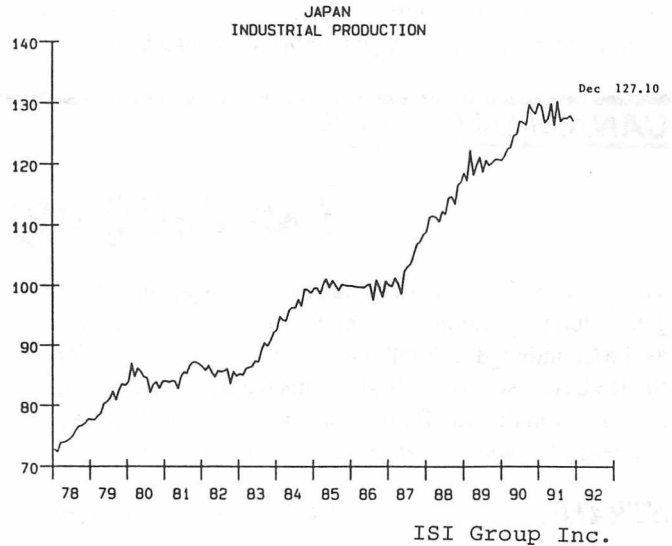
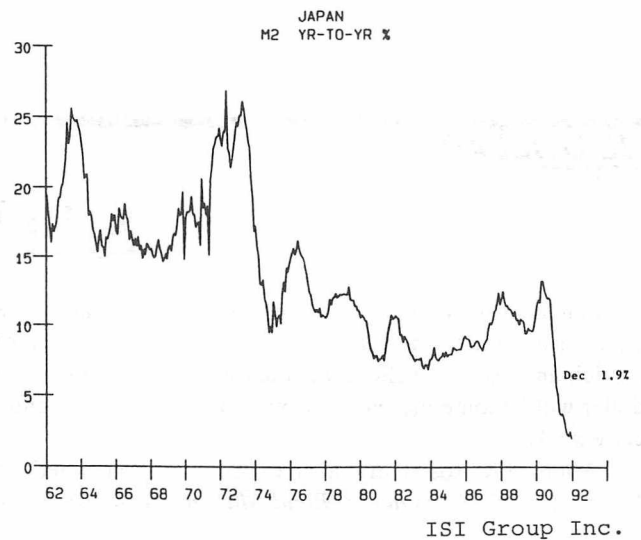


Chart 6



Chart 7



EURO-DM

A blockbuster trade

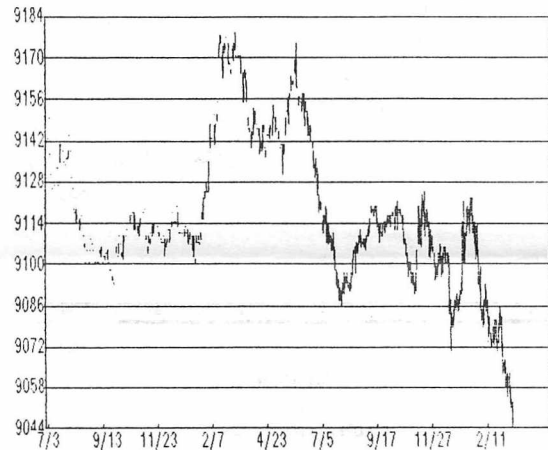
Higher short-term German rates are, in view of our foregoing analysis, inevitable.

The inverted yield curve has made an attractive trade even more so. The reason is this: Cash rates stand at 9.5%, June '92 trades at 90.48, the equivalent of 9.52%, while September '92 trades at 90.86%, the equivalent of 9.14%. In the unlikely case that interest rates remain unchanged between now and the expiration of the September contract, sellers of the latter would show a 36-point profit.

Similarly, put options, costing less than the difference in rates between cash and September '92, are extremely attractive.

STRATEGY: Sell September '92 Euro-DM contracts traded on the LIFFE, placing initial stops at 91.45, close only. Alternatively, buy September '92 puts with a strike of 90.75 or 90.50.

Chart 8 – LIF Short Euromark Jun '92

**CANADIAN DOLLAR**

Leaning against the wind

The Bank of Canada continues to "lean against the wind," gently nudging interest rates higher. In the past seven weeks, as the Canadian dollar fell, interest rate differentials *vis à vis* the US have risen to 330 basis points from 270 basis points — an indication that the Bank views the decline with increasing concern. *A gigantic short squeeze is in the making.*

STRATEGY: We advised adding to our long call positions via the purchase of futures, risking 100 points from entry. Remain long, moving stops to 82.60, basis June '92, close only. Regardless, maintain long calls.

Chart 9 – CME Can. Dollars Jun '92

**US DOLLAR**

Still buoyant

Accompanied by more encouraging statistics, and as anticipated last month, the US dollar has improved. As more participants come to believe that the US recession ended, the dollar will become increasingly overbought — thus, technically weaker.

Michael R. Rosenberg, in an excellent piece penned for Merrill Lynch's *Currency & Bond Market Trends* (Feb. 20,

1992) has made a number of interesting observations:

1. When the G-7 met at the end of 1987, they reaffirmed their commitment to more *stable exchange rates*, and set new confidential *central rates* for the dollar at ¥125/US\$ and DM1.65/US\$.

2. Today's ¥/US\$ and DM/US\$ exchange rates fall well within one standard deviation of their four-year averages.

The DM/US\$ has averaged 1.72 over the past four years, with a standard deviation of 13 pfennigs (i.e., 68% of the time it has fluctuated between 1.59 and 1.88). The average ¥/US\$ rate has been 136 and the standard deviation is ¥9 (68% of the time, the ¥/US\$ rate has traded between 127 and 145).

His conclusions are extremely well thought out and instructive:

"First, in contrast to the dollar's performance between 1973 and 1987, there have not been any sustained large moves in the dollar's direction since 1988. Therefore, trend-following trading rules are now likely to be less successful in the new target-zone regime, because once a new trend is in place and identified, the risk is that the new trend may soon reverse. The result is that under the target-zone regime, exchange rates are likely to exhibit choppier patterns, and therefore trend followers could easily get whipsawed.

If currencies are to be constrained to fluctuate within broad trading bands, investors will fare better by taking long-dollar positions when the dollar trades down to the perceived bottom of its band and to go short dollars when the dollar rises to the perceived top of its band. The only difference between that and the ERM is that in the latter case, the upper and lower bands are clearly defined, while in the former case they can only be estimated...the DM/US\$ 1.50 level and ¥/US\$ 120 level would be approximate floors for

the dollar. Now that the dollar has bounced up strongly from its respective floors versus the yen and deutschemark, there are now greater risks that the dollar may be rising closer to the middle if not the top of its yen and DM bands. Consequently, for most investors with long dollar positions, caution is warranted.

Finally, if the dollar's range of fluctuation will continue to be limited, yield levels will become extremely important in setting asset-allocation strategies. The dollar might make a lot of noise as it bounces from the top to the bottom of its trading range and then back. *If one is not a successful short-run trader, the best strategy when the dollar is in the middle of its band is to overweight the market that offers the highest nominal yield.* The reason for that is that if the middle of the band is the center of gravity, then one would expect the dollar to gravitate to that level in the long run. In that case, the highest-yielding market would offer the highest expected run."

We agree.

STRATEGY: *Shift your attention to the cross trade recommended in this issue. Outright long US dollar positions should be protected with stops at DM1.63/US\$, close only. Act accordingly for all other EMS, EMS related currencies, and the yen. IMM traders should place stops at 60.45, basis June '92, close only.*

UK INTEREST RATES

Stay short

Mr. John Major has finally come to the realization that the UK economy is in a deep slump that shows no signs of abating. Indeed, the *Quarterly Bulletin* of the Bank of England has conceded that the economy is in the "largest recession since 1945." Moreover, the Old Lady has refused to forecast the timing of the recovery. That is a prudent position on the part of the Bank, particularly since things are bad and likely to become even more depressing in the months ahead.

Indeed, our conjecture is that Britain has yet to suffer the depressing effects of the recession now getting under way in Japan and, above all, in Germany, France, and Italy. They show every sign of being sharp downturns. For example, Italy has reported that industrial production fell 2.1% in 1991. And since any recovery in the US will be hesitant and modest at best (see accompanying article), Britain is in for a rough ride. Down we go again.

Realizing this, Mr. Major has called an election. We will have the results by the time our next issue goes to press. Most believe that either a Major victory or a hung parliament are the likely outcomes. The critical issue is how, given either of those outcomes, this politician will respond to the interest-rate/exchange-rate dilemma.

As we pointed out in "The Walters Critique" (FCCC, January 26, 1992), so very much political capital has been staked on the defence of the absurd DM2.95 parity of the

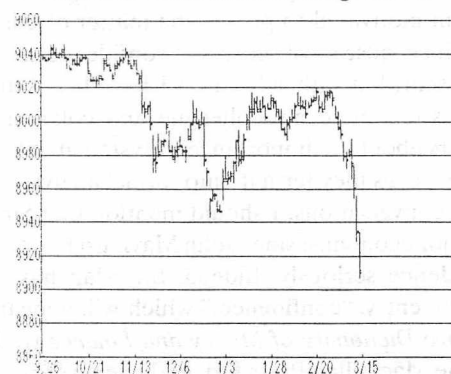
pound that we doubt whether there will be a devaluation. Indeed, it will be asserted that such a devaluation would completely destroy any vestiges of a credible policy.

Hence, the pound, which has come under pressure, as we predicted in January, will be defended with higher short-term rates.

STRATEGY: *Retain profitable short position in three-month sterling deposits (LIFFE). Change stops to 89.75, good anytime, basis June.*

– Dr. Steve H. Hanke

Chart 10 – LIF Short Sterling Jun '92



STOCK INDEX FUTURES

Shakeout expected

As expected, pressure on bond prices has made itself felt on the stock market, causing a slow and spiritless retreat.

The ongoing cyclical recovery is having a disproportionately greater impact on interest rates than on earnings. This means that multiples are being forced to shrink faster than provided for by the increase in the ratio's denominator. The net result is a fall in stock prices. We would note, however, that upward pressure on interest rates should not last more

than a few months (see commentary on T-bond futures).

In sum, we still expect a significant stock market shakeout in the March-June period, which *may* be the prelude to a longer bear market.

STRATEGY: *Maintain long S&P 500 put options. Our advice to be short Nikkei futures (as per Hotline of Jan. 21) remains in effect; entry was around 21,400. Target is below 15,000.*

Chart 11 – CME S&P 500 Index Nov. '92

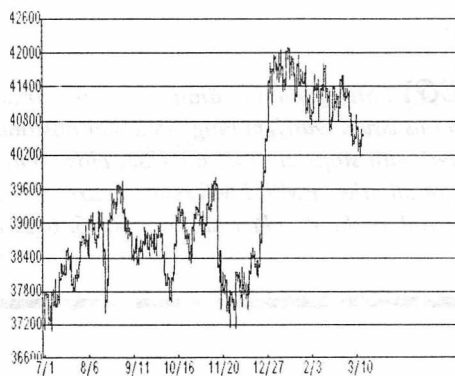


Chart 12 – NIKKEI 225 Index Spot

**MORE ON T-BONDS**

Resiliency lost

Last month's lead article was titled "Bump ahead." It began with the following sentence: "Evidence is mounting that the recession ended in mid-1991." After some analytics and evidence, the article concluded that, "On balance, the economy is poised to show a couple of strong quarters before fading again." Let's pursue the theme introduced in a "Bump ahead": that the US economy has lost its resiliency.

To extend the analysis, I discuss *confidence*. Indeed, I will integrate that concept into the economic analysis presented. I am motivated to pursue the matter of confidence not so much because most surveys of confidence are on their lows at present, but rather because I have benefitted from many discussions with my colleague and collaborator Sir Alan Walters about the importance of systematically including confidence, as they term it, into formal analysis. In addition to our conversations, I should mention that Sir Alan is the first major economist since John Maynard Keynes to deal with confidence seriously. Indeed, Sir Alan has recently authored the entry, "confidence," which will appear in *The New Palgrave Dictionary of Money and Finance* (to be published by the Macmillan Press Ltd. early next year).

To begin, I will examine the unusual nature of the recession that has recently come to an end. By conventional measures, the recession was mild: Between late 1990 and mid-1991, unemployment rose by only half a percentage point; the value of total output, adjusted for inflation, fell by only half as much as it typically does during a recession; and the level of industrial output fell by only 3.7%, which is the smallest decline during any of the postwar recessions. That the recession was mild is not what makes it unusual, however. What is unique about the recession is the fact that the recovery is so weak.

To understand the "dead cat bounce" we are observing and anticipate to continue observing, I recommend an excellent article, "A Bleak Outlook for the US Economy" by David E. Runkle, which appeared in the Fall 1991 issue of the Federal Reserve Bank of Minneapolis' *Quarterly Review*.

Mr. Runkle pinpoints why the recession was unique. He compares the composition of the shortfall of real GNP from its average growth during the most recent recession to those during the average postwar slowdown and during the Great Depression. During the typical recession, most of the GNP

shortfall (about two-thirds) is accounted for by reductions in investment. Reduced consumption, on the other hand, typically accounts for only about 25% of the shortfall, even though consumption is almost two thirds of GNP. In consequence, as short-term rates fall and the yield curve becomes positively sloped towards the end of a typical recession, investment is stimulated, and the economy bounces rapidly back.

During the recent slowdown, the picture has been atypical. For example, the drop in consumption has accounted for 54% of the shortfall of real GNP from its average growth, while the drop in investment has accounted for only 38% of the decline. That picture looks like the one depicting the Great Depression, when the consumption decline accounted for 50%. Hence, I do not think low interest rates and a positively sloped yield curve signal a strong recovery.

To understand the significance of the atypical pattern, Mr. Runkle correctly suggests that we have to look at an insight developed in the late 1950s by Professor Milton Friedman: *the permanent income hypothesis*. That hypothesis states that people make consumption decisions based on the income they expect to receive over their lifetimes (permanent income), rather than on their current or transitory income. In consequence, if people think their income is falling due to a short-term slowdown in the economy, they will not reduce their consumption too much. Instead, they will use their savings or borrow to maintain their consumption, rather than drastically cut back their consumption. However, the permanent income hypothesis states that people will scale back their consumption sharply if they expect the decline in their income or the rate of income growth to be long lasting (permanent).

Given professor Friedman's insight, it is clear that in typical postwar recessions, people had confidence that the slowdowns were temporary and that things would improve. However, that is not the present picture. Indeed, people have cut back consumption in an unusual way because they have little confidence in the future; they think the current slowdown will have permanence and that the economy has lost its resilience. Is that unusual pessimism justified? I think it is.

As I pointed out in my 1990 monograph, *Social Regulation: A Report Card*, which was published by the US Chamber of Commerce, the Bush Administration and the Congress have reregulated the US economy in a big way. That burden will cut the economy's potential growth significantly. In addition, federal, as well as state and local, taxes, adjusted for inflation, have been increasing at rapid rates. Those tax burdens will also act as major drags on economic growth. Dr. Robert Genetski estimates that those new regulatory and tax burdens will total \$271.7 billion in the 1988-1992 period alone.

It is obvious that people perceive that these regulatory and tax burdens will cut their permanent incomes. Hence, they have cut back hard on current consumption; they correctly have less confidence in the future than at any time since World War II.

Some argue that all this pessimism is unwarranted because fiscal policy will come to the rescue, and that the government will fiscally tune the economy back to a higher

growth path. After all, a standard tenet of macroeconomics is that an increase in the budget deficit is expansionary.

However, Sir Alan Walters has shown in his book, *Britain's Economic Renaissance* (1986), that expansionary fiscal policies will not provide a panacea, particularly when confidence in the consistency and plausibility of government policy is weak. Indeed, Sir Alan's research on fiscal multipliers shows that a loosening of fiscal policy causes nominal GNP to increase. However, the split in that nominal increase between price and real output increases varies, depending on the state of confidence. When confidence is high, most of the increase in nominal GNP caused by a loosening of fiscal policy is real, with little of the nominal GNP change accounted for by price increases. On the other hand, when confidence is low, price increases, not real output increases, account for most of the increases in nominal GNP.

Economic implications: The recent recession has been atypical. The weakness in consumption, accounted for by justified pessimism about future income prospects, explains that uniqueness. New research about fiscal multipliers reveals that when confidence is low, loose fiscal policy will not jump-start the economy; rather, it will lead only to stagflation.

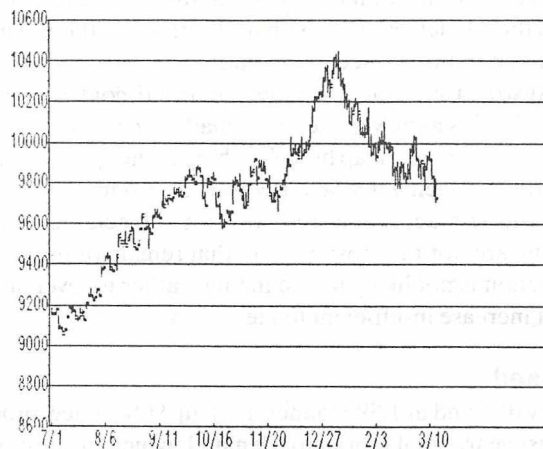
Prospects for the 1990s are not bright. Instead of moving rapidly back to the postwar real (adjusted for inflation) growth trend of about 3% per annum, it looks as though the 1990s will realize something less than a real 2% (average) growth rate. The remainder of nominal growth in the 1990s will unhappily be accounted for by upticks in inflation.

Trading implications: As soon as traders realize that the current recovery is little more than a "dead cat bounce," the bear move in long bonds will end. The bonds will then stage a solid rally. However, that will be cut short as inflation begins to raise its ugly head.

STRATEGY: Retain short position and/or long puts in T-bonds as advised last month, but lower stops (in view of a possible reversal) to 99.21, close only.

— Dr. Steve H. Hanke

Chart 13 – CBT T-Bond (Day) Jun '92



COMMODITIES

The gold market has assumed the aspect of Southwestern Ontario in wintertime; flat and lifeless. Trading has been confined to a range of between \$350 and \$370 an ounce for a full year now. Not surprisingly, commentary on the yellow metal has been as dull as the price; complacently dull it seems to me.

In fact the price equilibrium has mirrored the supply demand equilibrium. A near-perfect balance now exists between what gold is newly-produced and what gold is consumed as a commodity by fabricators.

A tilting of that balance in either direction should serve to break the equilibrium band that has suffocated prices.

We believe there are enough possibilities for catastrophe existent in the international economy to suggest that balance will be tipped into a bullish orientation.

Supply

Gold production totals about 2,000 tonnes annually. That production comes from 27 nations. However 90% of production is concentrated in five countries. They are, in order of production: South Africa; USA; the CIS; Australia; and Canada. Last year these five produced a reliably estimated 1,536 tonnes of the, again reliably estimated, 2,098 tonnes produced worldwide.

In none of them is the gold industry as healthy as it was through the past 11 years.

It is hard not to imagine the curtain descending on the tragedy apartheid has written on South African society. As it does, bankers will become ever less easy about providing financing for relatively costly gold production in that country — gold is mined underground in South Africa. When blacks rule, the industry will be in the hands of a managerial class that has been deliberately undereducated and inundated with the worst kind of sloganizing socialism.

As for the CIS: Mining executives estimate that as much as 75% of the federation's production is uneconomical at current prices. It is further understood that even if Western interests should assume the risk of redevelopment, it would take a minimum of another five years, and perhaps as long as 10, to create efficient industry standards. Last year, production in the CIS fell by 30% compared with 1990. It is not likely to increase in the foreseeable future.

Australia and the USA both enjoyed gold rush years during the '80s as new strikes were made and production was achieved using the cheap heap-leaching technique. Now both countries are facing new and rigorous environmental legislation. And less accessible reserves not subjectable to heap leaching are, for the most part, all that remain of the strikes. Production is not likely to decline but rather to level off at a rate of increase insufficient to meet rising demand.

Demand

Jewelry demand at 1,890 tonnes, took up 90% of new production last year. Total fabricator demand, which in addition to

jewelry, includes usage by the electronics and other industries, totalled 2,271 ounces, or 1.08 times new production.

The difference between total fabricator demand and production is made up official sector gold sales, scrap, dishoarding, loans, and forward sales. In the last four years the ratio of fabricator demand to production has tended to slip; from 1.16 times in 1989 to the aforementioned 1.08 times last year. However, over the same period, the ratio of fabricator demand to total supply has increased to 87% from 82%.

This is because official sector sales and dishoarding have shrunk to virtually zero. The implication is that at current prices, gold is competitive as a financial asset.

It's an implication having significant consequences. In order for gold prices to enjoy any significant appreciation, the metal must regain some of its tarnished luster as an investment. In this regard gold, which pays neither dividends nor interest, is in competition with a plethora of paper securities that have paid their holders handsome returns over the past 10 years. One might regard the disinclination of portfolios to hold gold as a normal cyclical shift in other periods in history. This period is different.

In recent years financial sophisticates have come to theorize that gold is no longer a financial asset at all. These investment analysts speculate that the metal Keynes once ruefully referred to as "that barbarous relic" is a relic in fact.

The argument goes that in a computer-lubricated age, with no single currency any longer having world reserve status, as was the case, for example, from the end of the Second World War through to, say, the early '80s when the US dollar enjoyed the pre-eminent position, investors have the option of shifting portfolios from denomination to denomination with ease. Made as it is from the safe perspective of generally low and/or declining inflationary environments, environments in which, furthermore, computers have made it possible to hedge against inflation using a variety of interest rate futures positions and other sophisticated gambits, the argument has come to assume some of same dogmatic appeal many financial notions have taken on when freshly propounded, deficit financing by government as a panacea for recessions being one that comes early to mind.

Here are two caveats that have the potential at least to dispel the notion of gold's valuelessness as a financial asset and may serve to explain why dishoarding and official sales have shrunk so much:

1. In order to believe specie can be found that has value, one has to trust that at least one of the governments backing one of the neo-reserve currencies will not debase its specie. One may not trust one single government, not even one's own. But one trusts that at least one government, somebody else's — it doesn't matter — will provide a safe haven to denominate assets.

In other words it's an odds game. By definition, the odds will ultimately work against you.

The three countries today that produce reserve-status specie are the US, Japan, and Germany. The former two carry on complacently under the weights of enormous accumulated budget deficits while the latter is enmeshed in the labyrinthine task of accommodating 10 million new voters who want their share of the Western good life as they see it but have precious little sense of how to go about earning that share.

2. The same computerized lubricants that allow money to be transferred from one country to another with relative ease have created a financial environment in which banks have commingled their assets to an unknowable degree — even by the banks themselves — via their trading activities. Banks are now more dependent upon one another than they have ever been in history.

Would you like to own a CD issued by, for example only, the Dresdener Bank if you knew the Dresdener bank had a trading position with Citicorp that represented 40% of its assets, and Citicorp's loan portfolio was heavily weighted to real-estate developers and retailers in Toronto?

In conclusion, there are time bombs digitally blinking away in the international economy that have the potential to explode gold out of its quaint status of financial relic. The potential alone is enough to inspire investment demand from the insurance-conscious.

The real possibilities of a shock to the financial system creating a spurt in investment demand and the equally real possibilities of a sudden rupture in supplies that are already tight when judged against offtake from fabricators alone, leave gold prices prone to a sudden ascent out of their current complacently flat trading plane.

Call options on the Comex are inexpensive when meas-

ured in terms of implied volatility. Surely, they represent a cheap play on catastrophe.

Short Notes

Cocoa: Cocoa prices appear to have ended their precipitous decline to within range of new lows. The fall came in response to fears Ivory Coast would dump cocoa onto the market in order to fulfill an agreement it has with the IMF and the World Bank to sell at least 75% of its production before the start of the next season. Ivory Coast is the world's largest producer of cocoa, expecting to produce around 700,000 tonnes this year versus 815,000 tonnes last year.

Whatever Ivory Coast sells is now fully discounted, and we expect the market to resume an uptrend in accordance with the underlying bullish fundamentals.

Sugar: The implied volatility of sugar calls has dropped noticeably in the past two months. Writers must believe we are far enough along in the season (which began September 30) to know supplies will be adequate to meet demand. Given that the Cuban harvest was started only in January and that the country has shrouded its production figures in cold-war-type secrecy, and taking into account that we are in the midst of the biggest change in the sugar industry in the past decade at least due to events in Eastern Europe and Cuba, we believe the volatility is too low. Our 11¢ calls on the October delivery are too cheap to sell.

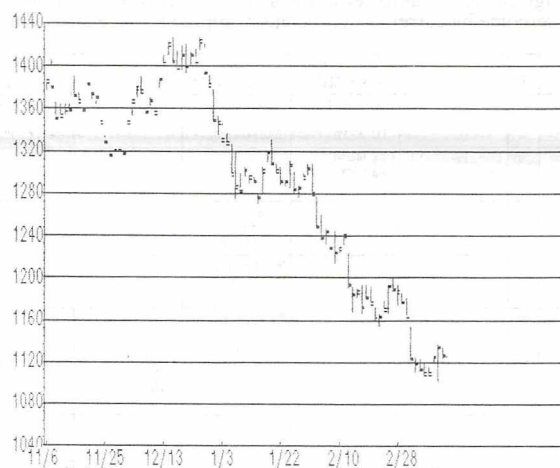
Wheat: We are out of the short side of wheat as per our hotline update of March 6.

— David B. Rothberg

Chart 14 – Gold (long)



Chart 15 – N.Y. Cocoa Sep '92



FRIEDBERG CAPITAL MARKETS

Cooper Co. update

Convertible bond: 10 $\frac{5}{8}$ %, due 1/3/05

Current price: 90.5

Yield to maturity: 12.46%

Partially due to falling interest rates, partially as a result of the US stock market trading in the stratosphere — whatever the reason — convertible bonds have been stellar performers over the last quarter.

The Cooper convertibles has been rising steadily since our initial recommendation in the October '89 issue, when the bond was trading at 62 $\frac{1}{4}$ to yield in excess of 18%. At that time, the company owed \$200 million face value of these convertible bonds. To Jan. 31, 1992, the company has repurchased \$152 million face value of bonds at discounted market prices.

At present, Cooper's liquidity remains impressive: Net

current assets stand at \$126 million, while long-term debt (primarily the remaining convertibles) has fallen below \$50 million.

The company's debt coverage remains excellent. The convertible bonds continue to be attractive.

Recommended bond portfolio allocation for new portfolios

For new portfolios, we recommend the following investments:

DM and/or ECU fixed-rate bonds	40%
US dollar high-yield convertible bonds	20%
Canadian dollar bonds	25%
Argentina BICV	15%

Chart 16
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, JY, DKr, BP, FFr, ECU, CDN, SAR) or revalue (for SF) before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of March 10, 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	4.67%		World Bank 12 $\frac{3}{4}$ % '93 yields 7.58% (.7339 A/US)	EIB 5 $\frac{1}{2}$ % '93 yields 8.43% (1.7315 US/DM)		Canada 5 $\frac{1}{2}$ % '93 yields 4.97% (134.61 US/Y)	Denmark 8% '93 yields 9.34% (6.7727 Dkr/US)	Sweden 9 $\frac{1}{2}$ % '93 yields 10.77% (1.6153 BP/US)			Canada 7% '93 yields 7.78% (1.2302 US/CD)	ESCOM 11% '93 yields 15.65% (.2355 US/SAR)	
2 year	5.70%	Tourist Hotel 0% '93. yields 8.61% (.5193 NZ/US)	CBA 14% '94. yields 8.97% (.7097 A\$/US)										
3 year	6.18%			Sweden 7 $\frac{1}{4}$ % '95. yields 8.07% (1.7624 US/DM)					EIB 8 $\frac{1}{2}$ % '95. yields 9.08% (6.1550 FFr/US)				
4 year	6.59%			*Bk. of Nova Scotia 5 $\frac{1}{2}$ % '96, yields 8.29% (1.7808 US/DM)							Ontario Hydro 10% yields 9.20% (1.3161 US/CD)		
5 year	7.00%			World Bank 5% yields 7.80% (1.7348 US/DM)									
6 year	7.15%				Australia 5% '98, yields 6.42% (1.3640 US/SF)								
9 year	7.49%									UK 9 $\frac{1}{8}$ % '01 yields 8.46% (1.1285 ECU/US)			Argentina BIC V '01 yields 21.83% (.3279 \$/ARG)
Spot Exchange Rate	N/A	.5483	.7543	1.6715	1.5125	134.23	6.4835	1.7095	5.677	1.2235	1.1947	.2603	.988

*For example, since a US\$-based investor would receive 170 basis points (829-659) by holding the Bk. of Nova Scotia bond, the DM can depreciate to 1.7808 US/DM from the present spot exchange rate of

1.6715 US/DM over the next 4 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 17
Foreign Currency Bonds

Date: March 10/92

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

ISSUER/MATURITY DATE/COUPON <u>SOUTH AFRICAN RAND DENOMINATED BONDS</u>	BID	OFFER	CURR. ANN. YLD. TOMTY.	NEXT PAYMENT DATE
ESCOM 11% 3/10/93 (semi)	92.80	93.55	15.65%	Apr. 30
<u>DEUTSCHE MARK DENOMINATED BONDS</u>				
KINGDOM OF SWEDEN 7 1/4% 1/2/95 call @ 100 1/2% in /93	97.20	97.95	8.07%	Feb. 01
EUROPEAN INV. BANK 5 1/2% 9/8/93	95½	-96½	8.43%	Aug. 08
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	90.20	90.95	8.29%	May 07
WORLD BANK 5 7/8% 4/2/97 RRSP eligible	91.65	92.40	7.80%	Feb. 04
<u>SWISS FRANC DENOMINATED BONDS</u>				
GOVT. OF AUSTRALIA 5% 30/10/98	90½	-92½	6.42%	Oct. 30
<u>DANISH KRONE DENOMINATED BONDS</u>				
KINGDOM OF DENMARK 9% 20/11/92	99	-99 3/4	9.13%	Nov. 20
KINGDOM OF DENMARK 8% 20/08/93	97.45	98.20	9.34%	Aug. 20
<u>ECU DENOMINATED BONDS</u>				
UNITED KINGDOM 9 1/8% 21/02/01	103.30	104.05	8.46%	Feb. 21
<u>BRITISH POUND DENOMINATED BONDS</u>				
KGDM of SWEDEN 9 3/8% 14/4/93	97 7/8	98 5/8	10.77%	Apr. 14
<u>FRENCH FRANC DENOMINATED BONDS</u>				
EUROPEAN INV. BANK 8 3/4% 12/7/95	98½	-99	9.08%	Jul. 12
<u>JAPANESE YEN DENOMINATED BONDS</u>				
GOVT. OF CANADA 23/7/93 5 5/8% RRSP eligible	100.05	100.80	4.97%	Jul. 23
<u>CANADIAN DOLLAR DENOMINATED BONDS</u>				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	104½	-105½	9.20%	Jul. 08
GOVERNMENT OF CANADA (semi annual) 7% 06/12/93	97.80	98½	7.78%	Jun. 06
<u>NEW ZEALAND DOLLAR DENOMINATED BONDS</u>				
CDN. IMP. BANK OF COMMERCE 27/07/92 14% RRSP eligible	101.20	101.95	7.67%	Jul. 27
TOURIST HOTEL 0% 04/06/93	89 3/4	90½	8.61%	4/6/93
<u>AUSTRALIAN DOLLAR DENOMINATED BONDS</u>				
General Electric 11/07/92 14 1/4% (semi)	101½	-102	7.47%	Jul. 11
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	109 1/8	109 7/8	8.97%	Jul. 07
WORLD BANK 15/03/93 12 3/4% RRSP eligible	104	-104 3/4	7.58%	Mar. 15
<u>ARGENTINE PESO DENOMINATED BONDS</u>				
ARGENTINA BIC V 1/5/2001	99.45	100.20	IRR 22.30%	4th day of mth.
<u>U.S. DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS</u>				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03 (semi) CV @ \$38 p/sh	82	-84	10.43%	Jun. 15
ALLIANT COMPUTER 7.25% 15/05/12 (semi) CV @ \$39.75 p/sh	28	-32½	24.20%	Nov. 15
COOPER CO'S. 10 5/8% 01/03/05 (semi) CV @ \$27.45 p/sh call in 1995 @ 100	87½	-90	12.55%	Sep. 01
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @ \$39.50 p/sh	39	-41	15.28%	Mar. 01
BURNUP & SIMS 12% 15/11/00 (semi) CV @ \$16.79 p/sh	75½	-77	17.93%	May 15
<u>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</u>				
FARM CREDIT CORP 7 3/4% 10/6/96	102 3/8	103 1/8	6.86%	Jun. 10
REPUBLIC of ARGENTINA 7/10/93 11% (semi) 1 yr. put	103 5/8	104 3/8	7.82%	Apr. 07
<u>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</u>				
UNITED KINGDOM 24/9/96 3 mo. LIBID-1/8 (qly) *call in bc @ 100 09/91	99.98	- 100.28	4½%	Mar 28
REPUBLIC OF ITALY 30/4/93 3 mo Limean (qly)	99.80	- 100.20	4 3/32%	Apr. 30

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

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FOREX RATES & UPDATE

<i>Currency</i>	<i>Spot</i>	<i>3-Month</i>	<i>12-Month</i>	<i>Comments vis à vis US\$</i>	<i>Comments vis à vis DM (Spot DM: 1.6650)</i>
Australian dollar	.7547-.7552	.7489-.7498	.7357-.7382	Neutral	Neutral
Belgian franc	34.24-34.28	34.67-34.75	35.59-35.73	Remain short**	Neutral
Danish krone	6.4750-6.4800	6.5590-6.5700	6.7500-6.7725	Remain short**	Neutral
Dutch guilder	1.8725-1.8745	1.8973-1.8997	1.9498-1.9538	Remain short**	Neutral
Finnish markka	4.5475-4.5525	4.6350-4.6470	4.8345-4.8595	Remain short**	Remain short
Greek drachma	190.80-191.10	198.50-201.50	219.80-227.10	Neutral	Neutral
Hong Kong dollar	7.7460-7.7470	7.7515-7.7580	7.7760-7.7920	Neutral	Neutral
Irish punt	1.6057-1.6062	1.5807-1.5832	1.5297-1.5392	Remain short**	Neutral
Italian lira	1248-1249	1271-1273	1329-1333	Remain short**	Neutral
Malaysian ringgit	2.5700-2.5720	2.5890-2.6030	2.6200-2.7030	Neutral	Neutral
New Zealand dollar	.5470-.5480	.5429-.5444	.5340-.5360	Neutral	Neutral
Norwegian krone	6.5465-6.5515	6.6435-6.635	6.8580-6.8805	Remain short**	Neutral
Portugese escudo	143.40-143.60	146.40-147.10	153.40-157.60	Remain short**	Remain long
Singapore dollar	1.6680-1.6700	1.6660-1.6705	1.6610-1.6720	Neutral	Neutral
Spanish peseta	105.30-105.40	107.40-107.60	112.50-112.90	Remain short**	Neutral
Swedish krona	6.0450-6.0500	6.1500-6.1600	6.3925-6.4125	Remain short**	Neutral

Explanatory Notes

*Indicates change in recommendation from last issue.

**Cover all short EMS & EMS related currencies vis à vis US\$ if the DM rises above DM 1.63/\$.

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, February 18:

Market letter is in the mail. Please note: We have revised our stops in short D-mark from 63.00 to 62.00 stop, close only. There are no other changes or new recommendations.

Flashupdate, Wednesday, February 19, 4:00 p.m.:

Increase your exposure to CD\$ via the purchase of March contracts at the market, risking 8325, close only.

Friday, February 21:

This is a review of recommendations for the week.

On Wednesday Feb. 19, we flashed to increase exposure in CD\$ via the purchase of March contracts at the market, risking 8325, close only.

There are no other changes or new recommendations.

Tuesday, February 25:

This is a new recommendation: Change the stop in March D-mark to 6116, close only from 6200, anytime.

There are no other changes or new recommendations.

Friday, February 28:

This is a review of recommendations for the week.

On Tuesday, Feb. 25, we advised to cover the stop in March D-mark to 6116, close only from 6200, anytime. There are no other changes or recommendations.

Tuesday, March 3:

There are no changes or new recommendations.

Friday, March 6:

We advise covering all short positions in wheat futures. There are no other changes or new recommendations.

Tuesday, March 10:

There are no changes or new recommendations.

Friday, March 13:

This is a complete summary since our last market letter, dated February 16, of all liquidations of open positions and new recommendations that remain outstanding.

We have revised downward our stop on short DM positions to 6116, close only, and we increased exposure to the Canadian dollar via the purchase of March contracts, risking 8325 close only.

We have assumed that you have rolled over the March contracts to June. Place stops in the June Canadian dollar at 8260, close only.

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