

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



Volume 13, No. 4 April 12, 1992

### Central banks: a barbaric relic?

Pity those central bankers trying to administer inconvertible paper money regimes.

In 70 years, but more acutely for the past 20, they have tried to manage money with the *overall* intention to preserve its purchasing power. Not only have they not succeeded, but, in the process, they have created some of the most extraordinary bubbles in human economic history — bubbles that are still bursting with, as yet, undetermined consequences for world trade and welfare.

They tried rules based on pure discretion (“leaning against the wind” when price inflation spurted, “accommodating” during recession), which were always too late, the damage having been inflicted, and were always too easily influenced by political pressure.

They tried interest rate targeting, and because they did not (and could not) know precisely the proper level of interest rates that our complex economies required, they variously undershot their targets (producing virulent inflation, as in the '70s) or overshot their targets (causing a vicious deflationary recession, as in 1981-82).

They tried monetarism — that prescription for a steady increase in money supply — although admittedly for too short a time, losing patience when the various Ms, influenced by technological change, began to lose their reliability. Paper money, not being of intrinsic value, could change colors and forms continuously, slipping between the cracks of the rock and leaving no trace.

The next and most recent stage of this bewildering chase for a proper monetary standard, involves an eclectic array of market indicators combined with broad aggregates such as M2 and M3. The Fed (and to a lesser degree, other important central banks, who are perhaps happier targeting the forex value of the US dollar — a case of the blind leading the blind) now pays attention to nominal GNP, the yield curve, the price of gold. Also from time to time it “looks” at unit labor costs, CPI, US and Japanese (?) stock prices, and so on.

A rudderless ship. While the supply of (paper) money can easily be controlled, the demand for money is unpredictable. Monetarists will argue that the demand for money is constant *in the long run* — but in the long run, as Lord Keynes advised, we are all dead.

Since the central bank cannot predict in advance brusque changes in demand, which may be the result of any of a large

number of factors, it will, at times, seem too easy and at times too tight, causing undesired effects on the economy. Related to this problem is the process of credit creation, a key variable in any capitalist society.

Intermediaries in a 100% commodity-backed money standard (and also, for instance, when money supply operates under a competitive note issue as in free banking) can create loans *only* if someone else has saved an equivalent amount; the creation of new purchasing power is accompanied by an equivalent reduction in purchasing power.

Not so in paper, or fiat, money standards managed by central bank; they can create credit at will, irrespective of savings in the economy. Thus, this regime can create too much or too little purchasing power: busts will follow booms, as night follows day.

Is it, then, that difficult to understand why, since the US went off the last vestiges of a gold standard in 1971, we've gone through two major real estate booms (1971-73; 1982-89) and busts (1974 and 1991-92), the most violent commodity price inflation in 100 years (1976-80) and the most spectacular commodity price deflation (1980-82) since 1919, the most

#### In this issue

- 3 Currencies**  
The DM/yen cross Canadian dollar
- 4 Hong Kong/China**  
The sleeping giant awakens
- 6 Stock indexes**  
Topping out
- 7 Cocoa, Sugar**  
The case for cocoa
- 8 Friedberg Capital Markets**  
Argentinean BIC V update
- 10 The Exotics**  
Finnish markkaa — Portuguese escudo
- 12 Hotline 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.

spectacular bull market in stocks since the '20s despite persistent overvaluation, etc.?

In recent months, indicators on which the US Central Bank relies to determine the appropriations of its current policy have emitted such conflicting signals that it has become impossible even for us, who normally interpret most Fed action as inflationary, to pronounce ourselves with any degree of certainty.

Favoring the view that the Fed is *too easy* are the following signals: the steepest yield curve in more than 20 years (Chart 1), negative after-tax interest rates (at the short end of the market: Fed funds, three-month Eurodollar deposits), a booming stock market, the explosive growth in adjusted bank reserves (49.6% annualized over the past 8 weeks!), and M1 (23.9% annualized over the same period).

On the other hand, the weakness in gold prices (Chart 2) and commodities in general (Chart 3), the much faster growth in M1 than in the adjusted monetary base (a sign that the demand for transaction balances may exceed its supply), the *very moderate* rate of growth of M2 (2.7% year over year, 5.8% annualized in the late January to late March span), denote perhaps "excessive" tightness. Finally, the relative stability of the forex value of the US dollar points to neither too much nor too little ease. Which is right?

The Fed, and any other central bank, will never know. They are condemned to act *after* the fact, after price inflation has already broken out and is accelerating, after asset prices have become inflated like bubbles. Unable to predict the consequences of their actions, they are forced to react to these consequences, causing in the process a massive transfer of resources among different sectors in the economy: debtors and creditors, speculators and non-speculators, asset rich and asset poor holders and so on.

The Bank of Japan may or may not be too tight — the

mere fact that stock and property prices are collapsing is not sufficient evidence of tightness as the irrational bubble is still bursting; if they ease too soon, they may once again set in motion a new bubble (although, of course, this time it may not be real estate, stocks, or paintings but may be commodities, Chinese stocks or...tulips?). If they ease too late, they may cause unwanted and irretrievable damage to the economy. *What is tragic is that they have no way to know.*

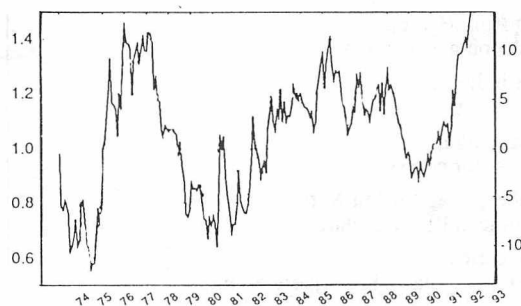
The same is true about the Fed, the Bundesbank, the Bank of Canada (despite the well-intended monetarist policies of the latter two), and all other central banks: They operate blindly, unable to estimate the true imbalance between savings and credit, between supply and the demand for money.

What is certain is that central bank policies, being reactive, swing like pendulums. Every bust will bring in its wake another boom and every boom, a bust. There is no chance under the present monetary regime except *by pure coincidence*, of obtaining steady, non-inflationary, non-deflationary growth.

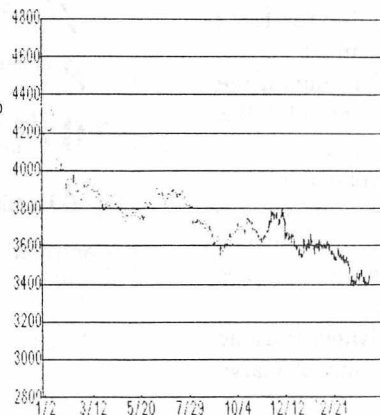
Interestingly, central bank performance has always been measured against the yardstick of *consumer price inflation*. And all monetarist studies have concentrated solely on measuring the impact of fluctuations in money growth over *consumer prices*. Austrian economists on the other hand, have been more concerned with (plain) inflation and (plain) deflation, a state of too much and too little credit, because those deal with booms and busts and not with just *some* of the symptoms such as a rise or a fall in consumer prices.

Twenty years of financial yo-yoing, the Japanese asset debacle, the coming deflation in US stock prices, and the miserable German stagflation should alert intelligent citizens everywhere: Central banks are a barbaric relic in the 21st Century.

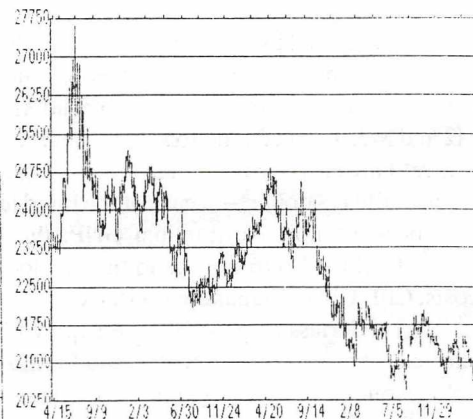
**Chart 1**  
US Yield Curve:  
10-Yr./3-mo. Interest Rates



**Chart 2**  
Gold June '92



**Chart 3**  
CRB Index



**CURRENCIES**

# The dm/yen cross

German monetary growth for February at an annualized 8.5% appears excessive — or at least, it is well above the Bundesbank's target range of 3.5% to 5.5%. Consumer prices for March increased 4.6% year-over-year, not surprising considering the much larger increases in hourly wage costs (8.2%) and the 6.6% increase in unit labor costs in 1991.

The sources of these inflationary pressures can be traced back to the easy money policies of 1987-88 and the very large, one time, increase in M3 resulting from reunification, *absent a corresponding increase* in the supply of goods and services (see last month's issue, "Journey into the unknown...").

Economic activity has slowed down but remains firm, witness the sharp jump in February's industrial production. A planned mid-year tax cut should further stimulate activity. The upcoming change in the composition of the Bundesbank is introducing a political element into its day-to-day operations that may be restraining the "hawkish" tendency of its leading governors.

Be that as it may, the next move in German interest rates, in our opinion, is upwards. The only thing that we are uncertain about is the size of the increase and the number of increases required to bring price inflation under control.

Japan, on the other hand, appears to be at the opposite side of the cycle. Consumption, housing, and business fixed

investment have turned very soft; private domestic demand has fallen from a +9% year-over-year peak in early 1988 to below +2% in late 1991.

While Japanese consumers have enjoyed strong real income growth, they have cut back consumption in the face of falling asset prices. The BOJ has been lowering interest rates reluctantly, in the hope of accomplishing an orderly bursting of the bubble; it has been remarkably successful given the enormity of the collapse. As a result, the yield curve is only slightly negative going out two years, turning positive out to 10 years.

It appears that further easing moves on the part of the BOJ will depend more on the level of economic activity than on the magnitude of the asset collapse. It remains to be seen if the latter can proceed without seriously damaging the former. At any rate, nominal interest rate differentials are certain to widen *vis à vis* Germany, lending support to our long DM/short yen positions.

**STRATEGY:** 1. Remain short September '92 Euro DM futures and long September '92 puts with 90.50 and 90.75 strikes.

2. Remain long DM/short yen, weighted by equal dollar amounts (alternatively, use the DM/yen cross contract on the IMM), place stops at 79.00, basis June '92 contracts.

Chart 4 – DM/YEN Jun '92



Chart 5 – LIF Short Euromark Jun '92



**CURRENCIES**

# Canadian dollar

With better prospects for a breakthrough in the Constitutional talks, pressure has lifted off the currency, bouncing off the psychological \$1.20 level.

Economic activity remains weak; unemployment has risen to multi-year highs of 11.3%. Nevertheless, the Bank of Canada appears committed to a steadfast monetary policy, based on targeting the growth rate of M2 around 5% to 6% per annum. In line with our opening comments, we doubt that

the B of C has found *the* formula for success in achieving noninflationary growth. It remains, however, far more disciplined than the US Federal Reserve. We, therefore, prefer the loonie to the greenback, especially given the positive 285 basis point differential in its favor.

**STRATEGY:** Remain long, leaving stops at 82.60, basis June '92, close only.

Chart 6 - CME Can. Dollars Jun '92



## HONG KONG/CHINA

# The sleeping giant awakens

As a member of the Austrian School of Economics, it has been clear to me for some time that economic freedom promotes economic growth and wealth creation. Unfortunately, in this day of mass media and uncritical thinking, many have either never learned or have forgotten that first principle of economics.

Hence, we have been forced to reinvent the wheel and prove that first principle again. To accomplish that, Professor Gerald Scully developed an index of economic freedom for more than 100 countries. He then computed economic growth rates for those countries from 1950 to 1985, and conducted a statistical test to see whether economic freedom was related to growth. It was. Higher freedom ratings were positively correlated with growth.

As a rough indicator, consider only two groupings of countries: "free market" and "command." Not surprisingly, the free market group grew, on average, at a 2.8% rate, and the command (even using their totally inadequate and inflated growth statistics) grew at a 1.1% rate. That 1.7 percentage point differential is significant. On average, it will take 25 years for per capita GDP to double in the free market group, while it will take 63 years to double the command group. Contrary to popular folk wisdom, the data also show that the incomes were more evenly distributed in the free market than in the command economies.

In a related study, our friend Mr. John Greenwood of G.T. Management (Asia) confirmed Professor Scully's results. For example, Hong Kong has had the highest degree of economic freedom and the fastest rate of real per capita GDP growth in the world over the period 1965-89, with growth averaging 6.3% per annum. That means real per capita GDP has been doubling every 11 years.

It is worth mentioning that while Hong Kong tops the list for economic freedoms, its political freedoms are abridged. Recall, it is a British Crown Colony, with a colonial administration. Hence, until recently, there were no elected officials

in Hong Kong.

In addition to confirming that the absolute level of economic freedom in various countries is positively correlated to their rates of economic growth, Mr. Greenwood found that the changes in economic freedom in individual countries are positively correlated to changes in rates of growth in those countries.

For example, provided a poor, economically unfree country's first liberalization is above some minimum threshold, such a country's growth rate receives a huge push from that liberalization, because returns on capital, labor, technology, and so on are suddenly made very high relative to its neighbours and trading partners. That explains why China's Guangdong province, which has a relatively low rating for economic freedom, has been the fastest growing region (about 12% per annum) in the world since 1978, when liberalization began there. At 12%, Guangdong's GDP has been doubling every six years.

The implications of that freedom-growth linkage are profound. The value of assets is a function of expected income streams discounted to present value at an appropriate risk-adjusted discount rate. With more economic freedom, expected income streams increase, and the risk associated with those streams declines, because political environments are more stable during economic booms. Hence, the combination of anticipated increases in income streams and reduced risk-adjusted discount rates means that asset values increase dramatically as do the value of claims against those assets.

### Freedom then and now

The primacy of economic freedom has long been realized by clear-thinking men of affairs. For example, Mr. Benjamin Franklin, in his correspondence with Abbé Morellet, wrote in April 1787 that one cannot express it better than you do, when you say that freedom to cultivate, to manufacture, to import and export, freedom which prohibitions and tariffs

hamper, is infinitely more precious than political liberty because the latter affects man rarely, while the former does so every day at all moments, etc.”

In modern times, that truth has been most notably appreciated and applied in Chile, where General Pinochet first established economic freedom. That motivated economic growth, which is necessary for the survival of a stable democracy. Then he reinstated political freedom. That General Pinochet understood perfectly Benjamin Franklin's truth was made clear to me during a private meeting in Santiago that was convened at the General's request on Nov. 14, 1989. As readers know, we of course thought that these were General Pinochet's views long before 1989.

At this point, I must note that I counseled the Pinochet model for Yugoslavia, when I was the Deputy Prime Minister's Personal Economic Advisor (1990 to June 1991).

Unfortunately, the Yugoslavs did not follow that advice. Instead, they accepted the line being fed to them by Western leaders: democracy at all cost. Now Yugoslavia has democracy, and some political freedom, but little economic freedom and almost no economy. Indeed, industrial output has fallen almost 50% in the past two years, and the government in Belgrade has admitted that inflation might hit 100,000% this year.

China's reform-minded leader, Mr. Deng Xiaoping, is no Pinochet, and China's totalitarian political system is not what Chile's transitional authoritarian system was. However, Mr. Deng has been pushing for more economic freedom in Guangdong province on the southeastern coast of China (directly north of Hong Kong) since 1978. Since those liberalizations have been introduced in a region that has had very little economic freedom in the past, the economy of Guangdong, which has a population of 63 million, has exploded.

In addition to the liberalizations, the Chinese have devalued their currency by about 55% in real terms against the US dollar since 1980. The combination has resulted, among other things, in a surge in exports. For example, since 1987, US imports from China have grown at 35% per annum. Moreover, there has been a shift in the composition of those imports. During the first half of the 1980s, food and industrial supplies made up about one half of US imports from China. By 1990, these accounted for only 15% of the total, while 75% was made up of relatively unsophisticated consumer goods.

Contrary to former President Nixon's claims, as well as all the other Western leaders who literally don't know what they are talking about, Guangdong is making the transition from socialism to capitalism without significant foreign aid. (China receives, as did Chile, very little aid on a per capita basis.) Rather, the transformation is being made because private capital is flooding into Guangdong.

From 1979 to 1990, China attracted more than \$20 billion in direct foreign investment, primarily from Asian investors. Most of those funds have gone into new plants that are producing for export. Indeed, now 17% of the total Chinese exports are being produced in foreign-owned plants.

In addition to new plants and equipment (modern tech-

nology), Guangdong has very low labor costs. For example, wages average 20¢ per hour, with wages in the export sector 40¢ per hour. That double whammy, on top of a real exchange rate that has been falling, has made Guangdong super-competitive. In consequence, Guangdong's share of the total exports of manufactured goods from Southeast Asia has risen dramatically in the late 1980s.

The fact that the sleeping giant is waking up has had a significant impact on Hong Kong's economy. Manufacturing has moved from Hong Kong to Guangdong, and Hong Kong has been transformed into a huge service center for China, handling the giant's insurance, banking, shipping, communications, and so forth. In consequence of that restructuring, Hong Kong is well situated to leverage off from and cash in on the transformation of China.

**IMPLICATIONS:** China is following a Pinochet-type transformation from socialism to capitalism. Economic freedom is being introduced first, and political freedom second. China is correctly solving the sequencing problem. In addition, China is focusing on private entrepreneurship and the importation of private capital and new technology, rather than advice from Western bureaucrats and foreign aid, to motivate their economic transformation. In consequence, a successful Chinese transformation is taking place, and growth is exploding. As the new service economy for the awakening giant, Hong Kong is well situated to be a major beneficiary of China's transformation. Indeed, Hong Kong is the key entrepot for China.

That strategic location means that earnings of Hong Kong firms will likely move up from their current annual 15% growth rate to something in the order of 20% to 25% in the coming years. In addition, now that Mr. Deng has made his move for a more accelerated economic liberalization program, which has been endorsed by the National People's Congress, we believe that the risk-adjusted discount rates used to value earnings flows will come down.

Hence, for every dollar in earnings flows, investors will be willing to pay more, and asset prices will rise. In other words, price-earnings ratios (P/Es) will increase. Note that for the past seven to eight years, the willingness to pay for a dollar of earnings from Hong Kong has come down (risk-adjusted discount rates had gone up and P/Es down), because of anxiety of the future of Hong Kong after China assumes control on July 1, 1997. Indeed, the P/Es have fallen from the low 20s to the high single digits. Since 1990, however, they have drifted up to about 13. We anticipate that if the recent course set by Mr. Deng can be maintained, we could see P/Es in the high teens by the end of the year.

Higher earnings and P/Es are the stuff of bull markets. Hence, we anticipate that the Hang Seng index will continue to make new highs this year.

That said, there are two risks: First, China could change its economic liberalization strategy and retreat. That could occur if China's totalitarian political system is not altered in anticipation of a transition to more political freedom. Recall,

economic freedom must eventually collide with a totalitarian system, unless either economic liberties are taken away or the totalitarian system is phased out.

Second, China's broad-money growth, which has been running at 30% per annum could push reported consumer prices from a 4% annual rate to an inflation blow-off level. The latter is a risk, because it would force China to employ its primitive monetary machinery and tighten money growth, which would create a slump. That risk, if it should occur, would not take place until late 1993 or early 1994, however.

**STRATEGY:** Purchase the Hang Seng index at 4425, good anytime with a stop at 4390, close only, which happens to be just below the 1991 uptrend. Each point in the Hang Seng index represent HK\$50.

– Dr. Steve H. Hanke

Chart 7 – Hang Seng Index Spot



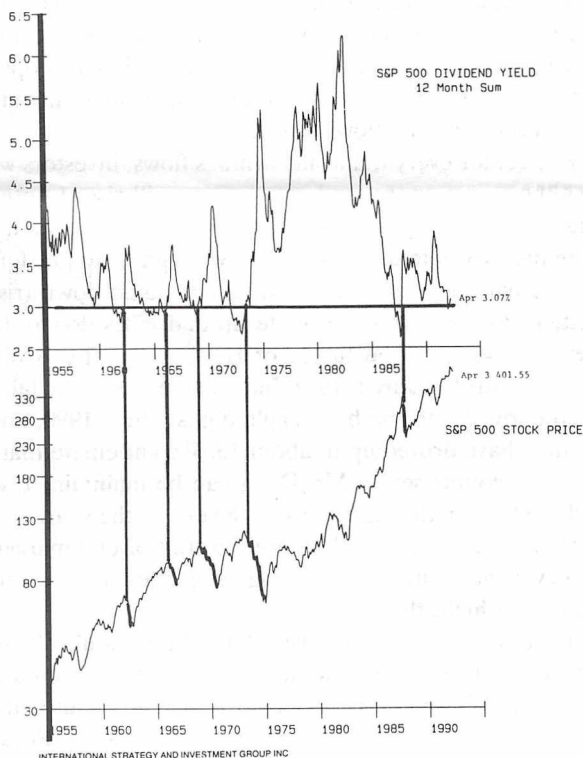
**STOCK INDEXES**

**Topping out**

Deteriorating breadth, more new 52-week lows than highs, and the apparent saturation of the IPO market where last minute cancellations have become more common and after-market premiums are no longer guaranteed, are indications that the market has topped out and is ready for, at least, an intermediate-size correction (10% to 15%).

Dividend yields, at around 3%, remain historically low. Chart 8, Courtesy of International Strategy and Institution Group Inc., is quite revealing. Each time yields have moved above 3%, the market has declined. Will April 1992 be the exception to the rule?

Chart 8



Interestingly, Dow Jones Industrial dividends, at \$92.84, exceed earnings of \$56.48, while S&P 500 dividends represent almost 77% of earnings. A return of dividend pay-out ratios to more normal levels (50% to 60% of earnings), even allowing for earnings to grow by 26.7% (IBES forecast for 1992), would extrapolate yields of 2.7% at current S&P 500 levels, matching the pre-crash record lows of 1973 and 1987.

That the market is not cheap is an understatement.

**STRATEGY:** 1. Maintain long S&P 500 puts. 2. Maintain short positions in NIKKEI futures; place stops at 19,000, basis June '92, close only.

Chart 10 – NIKKEI 225 Index Spot



**COCOA, SUGAR**

## The case for cocoa

Back in September we wrote an article headlined "Bull markets" in which we argued cocoa, sugar, and wheat were due for major advances. Wheat prices climbed to levels seen only once before. Sugar prices have tended to waffle indecisively within a relatively narrow trading range. And cocoa prices, after an initial surge, have slid to within range of their previous lows: \$860 per tonne, basis the nearest futures position.

Our bull market thesis for cocoa was essentially that the low prices that have prevailed for the past several years had created huge disincentives for producers to husband existing crops and plant new ones. The same low prices had served to create a demand base that was growing at a steady rate of about 4.5% annually.

We projected that inventories, which stood at a then estimated eight months' supply, would be worked off within four years. However, any shock to production would accelerate the process forcing the market to discount the future to our advantage.

There were two potential shocks that had relatively high degrees of probability of occurring and the potential to significantly affect supply. Extreme dryness resulting from the effects of the Mt. Pinitubo eruption in South America last year threatened both Pacific and African crops. And an unexpected reduction in the size of the Ivorian crop because of a drastic shift in remuneration offered by the government marketing board to local farmers produced dire prophecies of the crop being only 500,000 tonnes versus 800,000 tonnes in 1991.

Neither shock occurred. The world crop generally has come in as forecast by official statisticians. The Ivorian crop in particular now seems likely to decline by only 50,000 tonnes.

What surprises there have been have occurred instead to the benefit of the bears. The huge accumulated surpluses of the past eight years were counted even higher than originally assumed. And worse, consumption was muffled by the combined effects of the world recession and events in Eastern Europe and the former Soviet Union. World offtake is now estimated to register an increase of only 1.6% this year versus our projected average of 4.4% and last year's actual usage of 6.1%.

Does this mean that we were wrong in predicting a bull market in cocoa? I contest that it means only that we were (regrettably) early.

There are three reasons to believe cocoa prices will not make new lows and that they will stage the bull market advance we predicted last September.

1. In this century there have been three major cycles. Major lows in prices occurred in 1965, 1941, and 1920. The length of the cycle corresponds approximately to the yielding life of the cocoa plant. After each bottom was reached, prices climbed, then tested the lows, and then advanced to levels that were at least double the values registered at the lows.

The \$860 per tonne level that was touched last year

occurred according to the cycle schedule. It has all the technical aspects of a major bottom. The current decline to in sight of the lows is in keeping with previous patterns.

2. The current price softness adds only another year of disincentives to producers and incentives to consumers. Last year, growers in Brazil ripped up plants for firewood. This year, the level of inputs, including fertilizers and pesticides which growers provided crops, reached record low levels in Brazil, Ivory Coast, and Malaysia. On the demand side the world in general is emerging out of recession. In addition, economic conditions in Eastern Europe and the CIS, while hardly expected to be such as to provide robust demand, likely reached their nadir last year and, if anything, would tend to improve.

3. The reason the eruption of Mt. Pinitubo had little effect on production last year is that the eruption came in June, too late in the growing season to radically affect weather patterns. Our private forecasting service, *Atlas Forecasts*, anticipates dryness later this season in both Malaysia and West Africa. So, again the potential for a shock to production exists and the probabilities of that shock occurring are greater than they were last year.

In its most recent annual survey, the World Bank offers a forecast of commodity prices. The World Bank survey tends to be conservative. Of the 43 international commodities it surveys, the bank forecasts that only half will actually rise *in real terms*, by the end of the century. Cocoa is predicted to be the commodity that will rise in price by more than any others save sugar and coffee.

We believe cocoa represents excellent investment value at current levels. We recommend buying it, applying low leverage factors to portfolios and risking new lows.

## Sugar

For several months now, we have found ourselves holding out-of-the-money calls on the October delivery having little more than the cheapness of the calls themselves as reason to stay with the position.

Last week's eruption in prices is some vindication for this players' strategy. There has been little cogent explanation for last week's sudden flight to 9.5¢ plus. It could be just a squeeze applied to a complacent market by a Japanese trade house operating through South Africa. Equally plausible, and a definite argument for a sustained advance if proven accurate, is the rumor that Cuban production, the size of which has been shrouded in secrecy throughout the growing season, is in the neighbourhood of only 4.0 million tonnes. Cuban production was 7.5 million tonnes last year.

We advise keeping the calls. If revisions are made to the numbers the market now regards as official, they'll be made to the advantage of the bulls.

— David B. Rothberg

Chart 11 - N.Y Cocoa

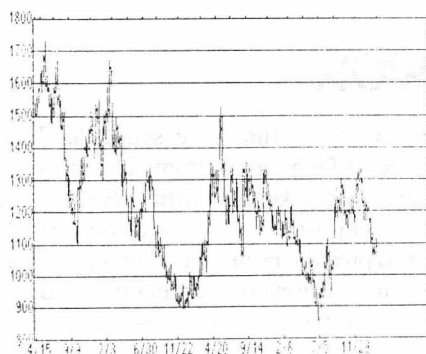
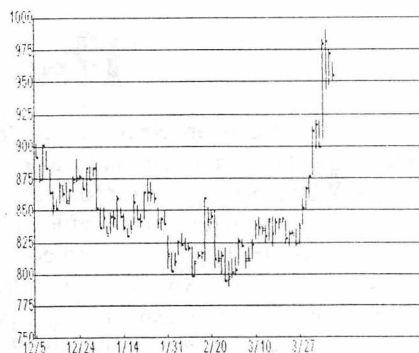


Chart 12 - N.Y. #11 Sugar May '92



**FRIEDBERG CAPITAL MARKETS**

# Argentinean BIC V update

Our favorite Argentina bond, the BIC V has been displaying some weakness in its price. This is to be expected, because the BIC V is amortized and therefore its par value falls by 0.85% per month.

After the April 4 payment, the bond has a par value of 92.35. Recently the BIC V (trading at 95.21) has fallen to a 3% premium from 8% on fear that the bond would be called.

In most cases positive news will raise the price of a bond and negative news will affect price adversely. This principle works in reverse for the BIC V, because it is callable (only in full) on any interest date. In other words, if news about Argentina continues to be exemplary, Argentina will be able

to refinance at a lower cost, and the bond may be called in order to save Argentina the difference (approximately \$120 million per annum, given potential refinancing cost).

In sum, bondholders find themselves in a situation where unfavorable news is favorable while more favorable news will make for a high likelihood of the bond being called.

**STRATEGY:** Hold tight and continue to receive a high rate daily. Buyers may purchase now and risk the shrunken premium between par value and price.

We offer the Argentina BIC V of 2001 with a current internal rate of return of 18.12%.

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, SAR, Dkr, BP, Ffr, ECU, CDN) or revalue (for SF, JY) before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of April 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	4.09%	Tourist Hotel '93 yields 8.15% (.5234 NZ/US)	World Bank 12 3/4% '93 yields 6.59% (.7453 A/US)	EIB 5 1/2% '93 yields 7.16% (1.6719 US/DM)		Canada 5% '93 yields 4.48% (133.02 US/JY)	Denmark 8% '93 yields 9.42% (6.6205 Dkr/US)	Sweden 9 3/4% '93 yields 10.48% (1.6705 BP/US)				Canada 7% '93 yields 7.57% (1.2288 US/CD)	ESCOM 11% '93 yields 14.82% (1.2611 US/SAR)	
2 year	5.17%		CBA, 14% '94, yields 8.89% (.7120 A\$/US)											
3 year	5.67%			Sweden 7 1/4% '95, yields 8.27% (1.747 US/DM)					EIB 8 3/4% '95, yields 8.63% (5.971 Ffr/US)					
4 year	6.16%			*Bk. of Nova Scotia 5% '96, yields 8.01% (1.7403 US/DM)							Ontario Hydro '96 yields 9.02% (1.322 US/CD)			
5 year	6.66%			World Bank 5 7/8% '97 yields 7.60% (1.697 US/DM)										
6 year	6.86%				Australia 5% '98, yields 6.64% (1.467 US/SF)									
9 year	7.23%									U.K. 9% 2001 yields 8.60% (0000 ECU/US)			Argentina BIC V '01 yields 17.91% (1.4294 \$/ARG)	
Spot Exchange Rate	N/A	.5438	.7632	1.624	1.4915	132.52	6.298	1.773	5.496	1.2611	1.189	.288	.9905	

\*For example, since a US\$-based investor would receive 94 basis points (760-666) by holding the World Bank '97 bond, the DM can depreciate to 1.697 US/DM from the present spot exchange rate of

1.624 US/DM over the next 5 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.

**FRIEDBERG'S**

**Chart 15  
Foreign Currency Bonds**

Date: April 9, 1992

**WE OFFER THE FOLLOWING BONDS SUBJECT TO CHANGE WITHOUT PRIOR NOTICE:  
MINIMUM US\$5,000 (CDN.\$7,000)**

<u>ISSUER/MATURITY DATE/COUPON</u>	<u>BID</u>	<u>OFFER</u>	<u>CURR.ANN. YLD.TO MTY.</u>	<u>NEXT PAYMENT DATE</u>
<b><u>DEUTSCHE MARK DENOMINATED</u></b>				
KINGDOM OF SWEDEN 7 1/4% 1/2/95 call @ 100 1/2 in /93	96 3/4	97 1/2	8.27%	Feb.01
EUROPEAN INV. BANK 5 1/2% 9/08/93	97.20	97.95	7.16%	Aug.08
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	91 1/2	92	8.01%	May 07
WORLD BANK 5 7/8% 4/02/97 RRSP eligible	92 1/2	93 1/2	7.60%	Feb.04
<b><u>SWISS FRANC DENOMINATED BONDS</u></b>				
GOVT. OF AUSTRALIA 5% 30/10/98	89 1/2	91 1/2	6.64%	Oct.30
<b><u>DANISH KRONE DENOMINATED BONDS</u></b>				
KINGDOM OF DENMARK 9% 20/01/92	98.90	99.65	9.28%	Nov.20
KINGDOM OF DENMARK 8% 20/08/93	97.45	98.20	9.42%	Aug.20
<b><u>ECU DENOMINATED BONDS</u></b>				
UNITED KINGDOM 9 1/8% 21/02/01	102 3/8	103 1/8	8.60%	Feb.21
<b><u>BRITISH POUND DENOMINATED BONDS</u></b>				
KGDM OF SWEDEN 9/ 3/8% 14/04/93	98 1/2	99	10.48%	Apr.14
<b><u>FRENCH FRANC DENOMINATED BONDS</u></b>				
EUROPEAN INV.BANK 8 3/4% 12/07/95	99 1/2	100 1/2	8.63%	Jul.12
<b><u>JAPANESE YEN DENOMINATED BONDS</u></b>				
GOVT. OF CANADA 23/7/93 5 5/8% RRSP eligible	100.60	101.35	4.48%	Jul.23
<b><u>CANADIAN DOLLAR DENOMINATED BONDS</u></b>				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	105	105 3/4	9.02%	Jan.08
GOVERNMENT OF CANADA (semi annual) 7% 06/12/93	98.50	99.12	7.57%	Jun.06
<b><u>NEW ZEALAND DOLLAR DENOMINATED BONDS</u></b>				
TOURIST HOTEL 0% 04/06/93	90 1/2	91 1/2	8.15%	4/6/93
<b><u>SOUTH AFRICAN RAND DENOMINATED BONDS</u></b>				
ESCOM 11% 31/10/93 (semi)	94.15	94.90	14.82%	Apr.30
<b><u>AUSTRALIAN DOLLAR DENOMINATED BONDS</u></b>				
COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14%	108 3/4	109 3/4	8.89%	Jul.07
WORLD BANK 15/03/93 12 3/4% RRSP eligible	104 1/2	105 1/2	6.59%	Mar.15
<b><u>ARGENTINEAN PESO DENOMINATED BONDS</u></b>				
ARGENTINA BIC v 1/05/2001 callable in full on any interest date	94.46	95.21	17.91%IRR	4th day of mth.
<b><u>U.S. DOLLAR DENOMINATED FIXED CONV.BONDS</u></b>				
PACIFIC SCIENTIFIC 7 3/4% 15/06/03 (semi) CV @\$38 p/sh	82	84 1/2	10.35%	Jun.15
ALLIANT COMPUTER 7.25% 15/05/12 (semi) CV @\$39.75 p/sh	29 1/2	33 1/2	23.51%	May 15
COOPER CO'S 10 5/8% 01/03/05 (semi) CV @\$27.45 p/sh callable in 1995	91 1/2	93 1/2	11.94%	Sep.01
DICEON ELECTRONICS 5.5% 1/3/12 (semi) CV @\$39.50 p/sh	39	40 1/2	15.46%	Sep.01
BURNUP & SIMS 12% 15/11/00 (semi) CV @\$16.79 p/sh	79 1/2	82 1/2	16.41%	May 15
<b><u>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</u></b>				
FARM CREDIT CORP. 7 3/4% 10/06/96 RRSP eligible	103 3/8	104 1/8	6.58%	Jun.10
REPUBLIC OF ARGENTINA 7/10/93 11% (semi) 1 yr. put	104 1/2	105	7.49%	Apr.07
<b><u>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</u></b>				
UNITED KINGDOM 24/09/96 3 mo.LIBID-1/8 (qtly)*callable @ 100	99.89	100.19	4 1/16%	Jun.30
REPUBLIC OF ITALY 30.04/93 3 mo Limean (qtly)	99.59	99.99	4 3/32%	Apr.30

Although we monitor these issues specifically, we also can fill any order in any foreign bond.

For further information and current prices please call:  
FRIEDBERG CAPITAL MARKETS (416) 364-2700

**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%

**THE EXOTICS**

**Finnish markkaa**

As we predicted in our November 1991 issue, the Finnish markkaa came under renewed attack last week. As pre-weekend speculation mounted, triggered by the finance minister's inept attack on the central bank, and the subsequent resignation of the head of the central bank, Mr. Kuhlberg, the markkaa plunged to Ecu5.94, well below its lowest intervention point of Ecu5.72.

Quick measures adopted over the weekend of April 4, including a proposed cutback in fiscal spending of Fm10 billion (2% of GDP) calmed fraying nerves, and the markkaa returned to the Ecu5.58 level. Reserve losses have been extremely large, and the finance minister's credibility is on the line (as is Ms. Sirkka Hamalainen's, the new central bank governor).

We doubt that fiscal measures will be sufficient to restore competitiveness, especially in view of the enormous loss of business in Soviet trade. While short positions *vis à vis* the DM carry some cost (6-month DM/markkaa cost 2.11% to maintain), we still believe that a new devaluation is inevitable.

**Portuguese escudo**

Portugal has finally joined the EMS in the ERM's 6% fluctuation band at a central rate of 86.93 to the deutschemark.

The small headaches of yesterday are likely to become tomorrow's migraines — as can be attested by the Spanish peseta, which remains persistently at the top of the ERM, despite its stubbornly high inflation rate.

The ERM mechanism is a speculator's delight: High inflation rates call for high nominal interest rates, which in turn attract yield seekers. The large foreign inflows swell the money supply and in turn complicate an inflation problem. This tends to push up the high inflation currencies' real rate of exchange (Chart 16 shows the real appreciation of the peseta in recent years and the still moderate real appreciation of the escudo). No doubt this process will continue for quite some time. The only genuine solution to this economic travesty is a dramatic increase in savings, particularly in the public sector.

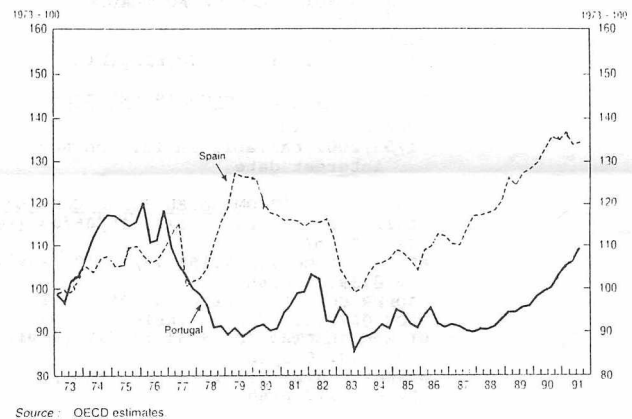
After five years of fiscal consolidation, the general government deficit widened again in both 1990 and 1991. The

OECD has estimated that net lending in 1991 rose to -6.4%. Thanks to privatization proceeds, the general government debt to GDP ratio over the three years ending 1991 fell by 10 percentage points to probably 64%.

Nevertheless, as the OECD survey points out, the public finances remain in urgent need of further consolidation. In view of the difficulty of achieving large savings in the public sector, we believe that the escudo will continue to appreciate in real terms *vis à vis* most other EMS currencies; this means that speculators will enjoy a fun ride for many long months.

**STRATEGY:** *Remain long the escudo vis à vis the DM, first suggested in early 1991. Remain neutral vis à vis the US dollar.*

**Chart 16 – Real Effective Exchange Rate:**



Source: OECD estimates

**Chart 17 – Rates - Portugal**

Spot	1 Month	3 Month	6 Month	12 Month
139.30 - 139.60	140.50 - 141.50	141.80 - 142.60	144.40 - 145.70	148.80 151.10

**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: 1.6340)</i>
Australian dollar	.7635-.7640	.7574-.7583	.7425-.7450	Neutral	Neutral
Belgian franc	33.38-33.42	33.81-33.88	34.90-35.04	Neutral	Neutral
Danish krone	6.2970-6.3070	6.3900-6.4060	6.6220-6.6495	Neutral	Neutral
Dutch guilder	1.8275-1.8285	1.8516-1.8530	1.9125-1.9155	Neutral	Neutral
Finnish markka	4.4270-4.4290	4.5345-4.5465	4.7695-4.7915	Neutral	Remain short
Greek drachma	190.00-190.30	196.50-198.30	217.00-231.80	Neutral	Neutral
Hong Kong dollar	7.7332-7.7342	7.7367-7.7417	7.7582-7.7742	Neutral	Neutral
Irish punt	1.6370-1.6390	1.1600-1.6140	1.5450-1.5570	Neutral	Neutral
Italian lira	1224-1226	1248-1251	1314-1319	Neutral	Neutral
Malaysian ringgit	2.5460-2.5470	2.5670-2.5830	2.6060-2.6670	Neutral	Neutral
New Zealand dollar	.5435-.5445	.5395-.5410	.5290-.5320	Neutral	Neutral
Norwegian krone	6.3680-6.3780	6.4620-6.4670	6.7020-6.7280	Neutral	Neutral
Singapore dollar	1.6500-1.6510	1.6480-1.6515	1.6430-1.6530	Neutral	Neutral
Spanish peseta	102.20-102.30	103.63-107.77	109.75-110.05	Neutral	Remain long
Swedish krona	5.8810-5.8910	5.9955-6.0100	6.2740-6.2990	Neutral	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**

**Wednesday, March 18:**

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

**Friday, March 20:**

There is one new recommendation: Buy July cocoa on the market, placing initial stops at 1055, close only.

**Tuesday, March 24:**

Our recommendations are as follows:

1. Lower buy stops on the short Sterling deposit traded on the LIFFE to 8950, close only, basis June.
2. Lower stops on June '92 D-Mark to 6005, close only. Use this stop to exit all short EMS and EMS-related currencies positions. Do not cover the yen unless June yen closes above 7600. D-Mark/yen cross trades should not be affected by these stops. There are no other changes.

**Friday, March 27:**

There are no changes or new recommendations. This is a review of recommendations for the week. We were stopped out of short D-Mark, EMS, and EMS-related currencies today, when the June D-Mark closed above 6005, as per the hotline recommendation of March 24. On the same hotline of March 24, we advised placing stops on short June J/Yen positions at 7600 close only. Please note that the long D-Mark/short Yen cross trade should not be effected by these stops.

**Tuesday, March 31:**

There are no changes or new recommendations.

**Flash update, Thursday, April 2, 5:30 p.m.:**

We have two new recommendations.

1. Cover short June T-bond positions at the market, cancelling 9921 stop, close only.
2. Buy September 100 T-bond call options at the market.

**Friday, April 3:**

I am repeating the flash update for Thursday April 2, at 5:30 p.m. We covered short June T-bond positions at the opening of this morning at approximately 9911, and we purchased September 100 bond calls at approx 133 as per flash update of Thursday April 2, at 5:30 p.m. There are no other changes or new recommendations.

**Tuesday, April 7:**

There are no changes or new recommendations.

**Flash update, Friday, April 10, 9:50 a.m.:**

Buy July cocoa at the market. Place stops at 937, stop close only, and liquidate long September 100 T-bond call option at the market.

**Friday, April 10:**

This is a complete summary since our last market letter dated March 15, '92 of all liquidations of open positions and new recommendations that remain outstanding:

On Tuesday March 24, we lowered the stop on short Sterling deposit to 8950, close only, basis June and lowered the stop on June D-Mark to 6005, close only.

Also we recommended not to cover the June yen unless it closes above 7600. The D-Mark/yen crosses was not to be affected. On Thursday, April 2, at 5:30 p.m. we flashed to cover short June T-bond positions, cancelling the 9921 stop close only, and we recommended to purchase September 100 T-bond call options that were bought at approximately 133 and liquidated at approx 133 based on our Friday April 10 flash update at 9:50 a.m. Also, on Friday we recommended to purchase July cocoa at the market (trading then at approximately 1022), placing a stop at 937, close only.

Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published by Friedberg Commodity Management Inc., 347 Bay Street, Toronto, Ontario, M5H 2R7. Contents copyright © 1992 by Friedberg Commodity Management Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement.

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

**Trading and Managed Accounts**

All enquiries concerning trading accounts should be directed to:

<b>In Canada</b> Friedberg Mercantile Group 347 Bay Street Toronto, Ontario M5H 2R7 (416) 364-2700	<b>In U.S.</b> Friedberg Mercantile Group Inc. 67 Wall St., Suite 1901 New York, N.Y. 10005 (212) 943-5300
--	--

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