

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



Volume 13, No. 10 November 22, 1992

### Learning a lesson?

Many speculators have learned a lesson. But, unfortunately, not the same can be said about governments. Capital understands too well the consequences of fiscal incontinence, particularly when deficits become *unsustainable*. Sooner or later the accumulating mountain of debt will overwhelm the nation's capacity to service it. And then there will be only one choice: the confiscation of private wealth.

This confiscating process can come via debt monetization and ultimately hyperinflation or in highly-developed countries via some acceleration of inflation and a substantial increase of taxation. Either way, no good can come to the holders of that nation's currency and debt. Discounting the future, speculators move to liquidate these holdings.

In an attempt to forestall the inevitable, central banks tighten money and raise interest rates so as to compensate holders for this perceived risk. Sometimes they succeed for a time, buying time for a fiscal solution. Most of the time, the manoeuvre is in vain. Higher interest rates, containing a significant risk premium, hobble private sector non-speculative investors and aggravate the fiscal problem by raising its borrowing cost.

Examples in recent months are too numerous: Italy, Sweden, Finland, Norway, Canada, and so on.

Sweden's heroic defence of the krona in September, which saw marginal rates climb to 500%, unravelled a few weeks later when the Bildt government was unable to muster bi-partisan support for a well-meaning package of fiscal reform. The emergency package, put together as the country was experiencing another currency run (\$26.3 billion in six trading days), included a sharp Skr30 billion cut in employers' payroll taxes, equal to 2% of GNP.

The package was to boost the competitiveness of Sweden's industry and was to be financed by cuts in programs ranging from disability payouts to farm subsidies to social security benefits. The pro-growth program was meant to reduce further the state's involvement in the private sector, following closely on the earlier cuts in Sweden's lavish social welfare program.

The successful passing of the emergency package would have "revalued" the market's perception of the future value of the krona. Money market rates would have stayed high (see Chart 1), containing a significant risk premium until such time as the fiscal debt moved from a condition of critical

unsustainability to a path of tolerable relative reduction. It was not to be, and the krona floated downward by 9% *vis à vis* the ECU.

A similar but perhaps more encouraging outcome was experienced by Italy. Forty years of fiscal incontinence and corruption came to a head in September, forcing the government to begin a serious fiscal reform. Future private wealth confiscation was all but inevitable: Interest charges on the public debt were equal to the entire *projected* deficit of L160,000 billion, which in turn, was equal to 10.5% of GDP.

In simple terms, given that real interest rates compounded faster than the growth of GNP, the debt had taken on a life of its own that eventually was sure to overwhelm the revenue capacity of the nation. Hence the panic flight to the exits. Bureaucratic delays made the final devaluation (7%) and subsequent float almost inevitable.

#### In this issue

- 2** **Canada**  
The Canadian debt monster
- 4** **Canadian dollar**  
Freefall
- 5** **Japan**  
Collapsing asset values
- 5** **United Kingdom**  
Equities the place to be
- 6** **S&P 500 Index**  
January blow-off a good bet
- 7** **Interest rates**  
Flattening? Don't know. Rising? Yes
- 8** **US Dollar**  
Overbought and overextended
- 9** **Crude oils**  
The end of OPEC?
- 9** **Commodities**  
Corn
- 10** **Friedberg Capital Markets**

Contributions by Albert D. Friedberg, Neil Reynolds, David B. Rothberg, and Michael D. Hart.

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

Deftly and courageously the Amato government put its house in order and managed to pass thus far 80% of its dramatic program of fiscal reform. The L93 trillion saving, equal to 6% of GDP, was designed to reduce budget deficits from L155 trillion in 1992 to L148 trillion in 1993.

But more importantly the budget included *structural* measures to cut the deficit, which will have a continuing beneficial effect.

The fiscal move was none too soon. The lira had fallen as low as L1000/DM, over 30% below its pre-devaluation parity, while short-term rates shot up to close to 19% and the bond market collapsed (see Chart 2). The successful passage of the budget through Parliament calmed markets, and a substantial recovery has ensued.

Open-ended welfare programs and poor tax collection are two of the most important elements in fiscal disorders. Bank and business bailouts are not structural problems but can become an overwhelming burden to the Treasury. The US Savings and Loan bailout is a case in point, although it has not as yet caused the deficit to move on to an unsustainable

path. In Finland, Norway, and Sweden, however, it almost certainly was the *coup de grace* in an otherwise unstable and grave fiscal situation.

The point of these comments is to demonstrate that it will not suffice to have a disciplined and orthodox central bank when the other arm of the government, its Treasury, is out of control. Once government debt is perceived to be growing exponentially and beyond the nation's capacity to service it, capital will flee. This flight of capital will depreciate the currency, raise interest rates, and decapitalize the economy, further reducing future government revenues. The vicious circle can be broken only by genuine fiscal reform.

Raising taxes today to narrow the prospective deficit will not do: It merely brings forward what the markets had already come to expect. The increased taxes in the present simply equal the present value of the inevitable future confiscation. Genuine fiscal reform means *less government*, not just lower deficits. Unless this lesson is learned, governments will be doomed to impoverish their citizens despite the good intentions of their central banks.

Chart 1

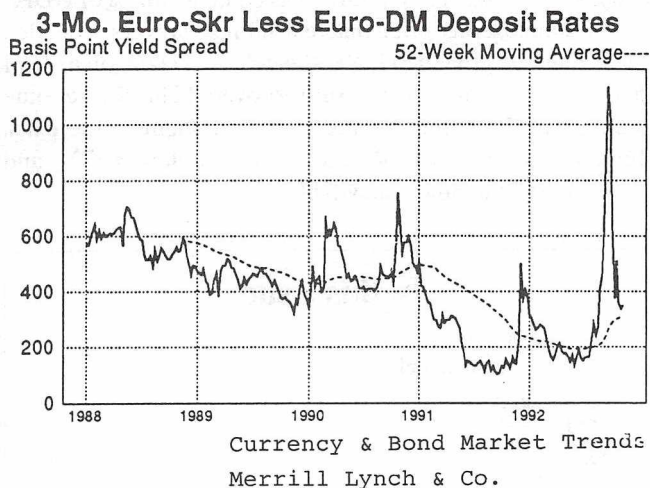
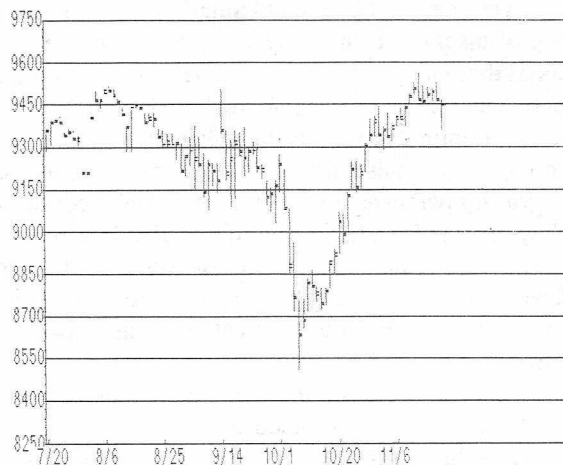


Chart 2 - LIF ITALIAN GB DEC '92



**CANADA**

**The Canadian debt monster**

Four young Toronto men competed last week in a final rugby game of the season, hopped into a car already packed, and headed for Vancouver.

Go west, young men, go west — where migrant money is putting migrant muscle to work. Economists reckon that the British Columbia economy will expand by a relatively boomish 4% in 1993; the Ontario economy, in contrast, by perhaps 1.5%. In high-risk environments, people fly (or drive) to quality in the same way that money flies to quality. BC and Alberta are now absorbing a tremendous human migration from depressed and debilitated Ontario, where 12% of the population — more than one million people — now live on welfare.

In fact and in statute, Canada has three “have” provinces (BC, Alberta, and Ontario) and seven “have-not” provinces. Historically, the three “have” provinces have sopped up job-seeking migrants from the “have-not” provinces and have sent back vast sums (transfer payments) to calm down the migratory instincts of the people left behind. Rich as it remains after three years of disastrous recession and stagnation, Ontario has become a good place to leave — an eighth “have-not” province in behavior and in mind-set if not in nominal asset evaluation.

The problem is that in terms of economic destiny, Canada is Ontario. Canada needs a sound-economy Ontario in

precisely the same way that a person needs a beating heart. BC and Alberta aren't substitutes; they are artificial hearts implanted in the country's extremities. Ontario (population: 10 million) cannot expel its economically surplus population onto Alberta (population: 2.5 million) or onto BC (population: 3 million) for very long. Already, 2,000 Ontario migrants a month are ending their westward treks on Alberta's own soaring welfare rolls.

Further, Canada's two remaining "have" provinces confront exceptional political uncertainty and, with it, risk. BC now has a socialist (NDP) government committed to the pro-union legislative agenda that Ontario's socialist (NDP) government has perversely enacted; the difference being that BC still has manufacturing jobs to lose as a result. Although BC Premier Michael Harcourt talks tough on the provincial deficit, he has copied his Ontario colleagues in granting civil servants wage increases far in excess of inflation or common sense.

In Alberta, a discredited Conservative government is choosing a leader to succeed the interventionist Don Getty at precisely the moment that, for the first time, the province has become a net debtor. Conservatives of one kind or another have governed Alberta forever; this record will probably end in the next provincial election. The Liberal opposition talks macho-restraint, but talk is cheap.

Investors will find only scant recognition of the collective risks that confront Canada's three "have" provinces in their respective creditworthiness ratings. The markets have imposed a modest quarter-point penalty on Ontario's soaring, madly-out-of-control debt.

Dominion Bond Rating Service, for example, accords BC and Alberta the highest of its current ratings on provincial debt: AA. Its Ontario rating, AA Low, is excessively generous, and the agency says that this rating is now "under review." DBRS will presumably downgrade Ontario further, probably to the "A Low" rating held by Quebec — whose economic fortunes now appear significantly better than Ontario's. An Ontario downgrade could come within the next few weeks; or it could follow the next Ontario budget in the spring. Whenever it comes, it will be no surprise.

Provincial debt ratings, though, are necessarily an exercise in comparative risk assessment. The magnitude of Ontario's decline skews normal interprovincial comparisons. An analogy can be made to comparative test scores in schools. A pervasive erosion of test standards conceals significant real declines in achievement; an erosion in one jurisdiction competitively induces erosion in another; but students everywhere can still get "A's" on their report cards. By no absolute standard can Ontario be considered an "A" student; for all practical purposes, Ontario has dropped out altogether.

The national implications are necessarily profound. *Sic transit Canada*. It's worst-case scenario time. Consider these warnings from two prominent Canadian economists:

► In an October report, William Robson of the C.D. Howe Institute discusses the risk that lax fiscal policy by the federal and provincial governments will oblige the Bank of Canada

to purchase — "monetize" — federal debt. He calls this "an important and unique danger." The result would be an increase in taxes through inflation.

Robson advances an intriguing, though depressing, calculation. Canadian governments, he says, have imposed tax increases equal to \$26 billion a year merely to pay for the increases in their net interest expenses since 1980. These taxes, he says, probably cost the economy another \$26 billion a year in deadweight costs. This hit is the equivalent, he says, "of an entrenched loss of 4% of GDP — in effect, putting Canada through a recession comparable to 1990-1991, *permanently*."

► In his recent book *The Courcherne Papers*, Queen's University economist Thomas Courcherne discusses "the incredibly bleak prospect of policy-induced stagflation." Courcherne says that Canada has used foreign savings to finance consumptive government spending; that high real interest costs will now ratchet up debt-servicing costs even as the recession further clobbers government revenue and further increases income-support payments.

"The possibility exists," he says, "that the entire Tory deficit-reduction agenda will be overwhelmed. We will be back to 1984, except with a much higher deficit and three-fold level of debt. Moreover, *the tendency will be to monetize the deficit and the debt.*"

Canadian governmental deficit this year will easily exceed \$50 billion, or \$10 billion more than budgeted last spring; indeed, the combined deficits of Ottawa and Ontario alone will approach \$50 billion. As debt loads ratchet upwards, tax revenues inexorably fall. Ontario Treasurer Floyd Laughren's mid-term financial report last week showed revenue shortfalls in every single category of collection. Where's bottom?

Historically, Ontario's combined public sector debt has ranged between 12% and 14% of the province's GDP. In 1992-93, the percentage will rise to 17.5%; by 1994, it will hit 20%; assuming (optimistically) economic growth of 4% a year between now and 1996, it will level off at 21% to 22%. In other words, Ontario's net public-sector debt, as a percentage of GDP, can be expected to rise by more than 60% in the next four years.

Consider now the ratio between government revenues and its annual deficits.

In 1989, at the end of the '80s boom, Ontario's GDP peaked at \$273 billion; its revenues hit \$42 billion; its deficit was a mere \$90 million. Its deficit was aberrational, a mere 0.2% of revenues.

In 1990, the deficit rose to 7% of revenues.

In 1991, it increased to 24%. (Revenues fell to \$41 billion; the deficit rose to \$10.9 billion.)

In 1992, it will probably hit 30%.

What are the implications? Using constant dollar figures, and assuming 4% growth, revenues will need to rise by 50% merely to maintain the present revenue-to-GDP ratio. The province cannot sensibly increase taxes, though. (In 1991, Ontario's provincial and local tax load reached 18% of GDP, the same saturation level that Quebec reached a decade ago.)

The result must inevitably be either drastic spending cuts or super-deficits as far as the eye can see — pushing the debt-to-GDP ratio significantly higher still than the 22% projection.

Federal and provincial governments presumably forgot the reverse dynamic of recessionary revenue collection in a progressive tax structure. The erosion of income tax revenues hasn't slowed; it appears, rather, to be speeding up. But this is the flip side of "bracket creep" and the inflation-driven tax increases of the past generation. In a near-zero inflation environment, decreases in income are producing disproportionate decreases in revenue. If the unravelling doesn't end soon, the revenue implications will become grotesque. (Federal "indexing" means that Ottawa loses revenues automatically when inflation falls below 3%.)

The decline of the dollar makes it difficult for the Bank of Canada to reduce the very high real rate of interest. More than half of Canada's \$400 million federal debt is short-term; a one-point rise increases debt-service costs by \$4 billion a year; \$2 billion of it surfaces within six months. Further, by

normal standards, a 12% decline of the dollar would produce a permanent cost-of-living kick of 3% or 4%. In an economy with 30% or more of its productive capacity idled, we may escape with only a bruise. But the Bank of Canada cannot simultaneously resist *all* of the forces out there that are putting upward pressure on rates.

Courcherne, by the way, observes that by the standard of current-value accounting, Canada's external indebtedness is the highest in the world. And the ratio of Canada's external debt to its GNP — 35% — exceeds Brazil's.

Normally, worst-case scenarios don't happen. Thank goodness. The worst case, though, is a matter of degree, especially in a country used to best-case expectations. It's hard to escape the sense — part of it arising from the statistics, part of it instinctual — that Canada is Latin Americanizing itself. Odd, isn't it, that most of our teachers are still giving us honors-grade marks on our report cards?

— Neil Reynolds

**CANADIAN DOLLAR**

**Freefall**

Our opening comments are highly relevant in this case. Canada is privileged to have a highly regarded, highly disciplined, and highly focused (targeting only inflation) central bank.

On the other hand, Canada presents a sorry fiscal picture (see Neil Reynolds' article for some of the gory details). Not only has the Federal Government's deficit remained at an unacceptably high \$34.6 billion but in the process the federal tax burden in Canadian households has risen \$22 billion since 1984, a year in which the deficit hit a record \$38.5 billion.

While admittedly the federal deficit did decline from 8.7% of GDP in 1984-85 to 5.1% in 1991-92, the total burden on the private sector increased to the equivalent of \$1,900 for the average family. The confiscation of the private sector's wealth, however, did not stop with Ottawa as the accompanying article demonstrates: Ontario's provincial government has become an even greater threat to the only productive element of the economy.

For the past few years, capital flight has burned on a slow fuse: interest rate spreads *vis à vis* the US have been positive at anywhere between 125 and 525 basis points at the short end and 60 and 300 points at the long end. With the continuous widening of the current account deficit, and the worsening political rift with Quebec, the flight has intensified.

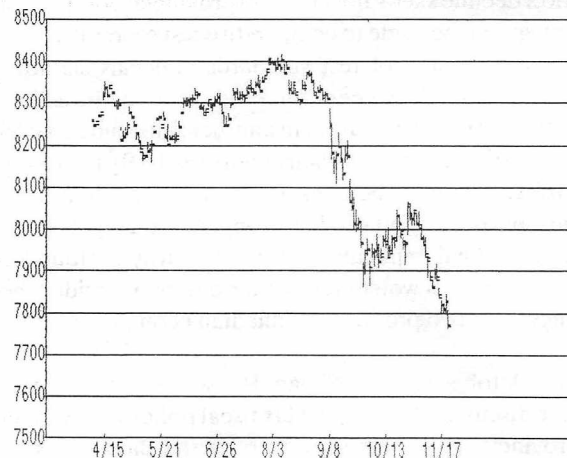
Canada is not experiencing merely an old-fashioned balance of payment problem that can be redressed via belt-tightening measures, reining in domestic spending, and building up savings; instead, sophisticated Canadian investors and foreign investors in Canadian assets have come to the conclusion that they will be expropriated in the not-too-distant future. Market levels exceed their estimate of present value of future flows. Therefore, they can maximize wealth by

"dumping" assets at today's levels.

The rise in interest rates engineered by Bank of Canada in an effort to slow the falling dollar can only buy time — time for the federal and provincial governments to institute genuine fiscal reform. The size of the governments must be severely cut back and a credible, long-term plan must be put in place to rein in the growth of the public sector debt below the rate of growth of the nation's income. Only then will the present value of the currency rise above its market level.

**STRATEGY:** *The Canadian dollar is in a free fall. Only determined fiscal action will end the agony. Stay short as per Hotline Update. Lower stops to 80.60, basis March '93, close only.*

Chart 3 — CME CAN. DOLLARS DEC '92



**JAPAN**

# Collapsing asset values

Japan's economy continues to contract.

During the six months ending September, companies' pre-tax profits plunged by an average of 36%. Manufacturing firms did even worse: Matsushita's fell 66%, Mazda's tumbled 72%, and Nissan lost \$114 million before tax, a first since listing its shares on the Tokyo stock exchange in 1951.

The Ministry of Trade and Industry reported that a survey of 1808 businesses in October found that investments would fall by 3.9% in the financial year till next March, a downward revision from a similar survey in March that forecast a 1.4% fall. Unemployment may begin to rise: Japan's job-to-applicant ratio is likely to be below 1-1 in October, down from 1.01 in September. This means that there were only 100 job offers to every 100 applicants. "In-house unemployment," company employees who have nothing to do because of the slow economy, is spreading.

Collapsing asset values are not only threatening the survival of Japan's banking system but also may force the government to socialize their losses with direct consequences for the currency. Non-performing loans held by the financial sector were officially indicated at \$103 billion as at the end of September. Informed sources believe that the number is

closer to \$500 billion.

Banks have been able to carry this dead weight thanks to the favorable impact of falling interest rates on their margins. The magnitude of the problem, however, may force the Bank of Japan to lower interest rates to negligible levels so as to enable the banking system to survive. Alternatively, the Treasury may step in to bail out the banks, financing it via higher taxes. (Fortunately, Japan's fiscal situation is relatively healthy.)

Sharply lower interest rates and/or sharply higher taxes are sure to have a negative impact on the yen, possibly offsetting the bullish implications of the huge and widening current account surplus.

**STRATEGY:** *The above scenario suggests three trades: 1) the purchase of short term Euro-yen futures on the Simex, placing stops basis June 1993 at 96.10, close only; 2) the purchase of December '93 yen versus the sale of March 1993 yen on a spread basis, betting that as Japanese interest rates fall, US rates will rise and the differential will widen the spread to perhaps 180-200 points; 3) covering Nikkei futures at the market, accepting extraordinary profits, in the belief that sharply lower interest rates will provide a cushion to collapsing earnings.*

Chart 4 – EURO YEN JUN '93

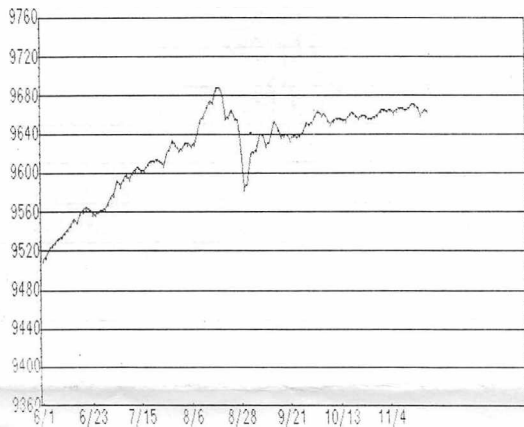
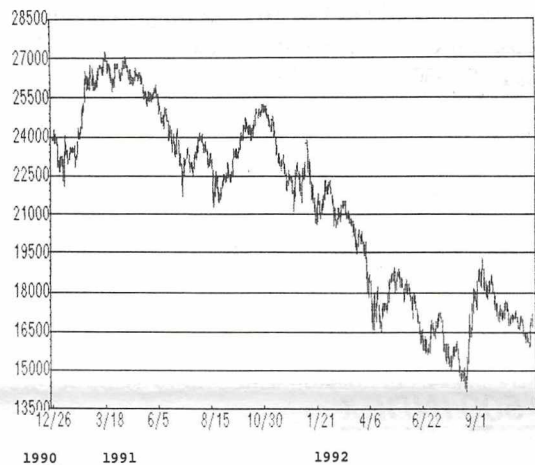


Chart 5 – NIKKEI 225 INDEX SPOT



**UNITED KINGDOM**

# Equities the place to be

Despite the gloomiest headlines in a decade, the FTSE 100 Index raced ahead to within six points of its record close of 2737.8 reached in May. In classic fashion, and as suggested last month, the market is climbing a wall of worry.

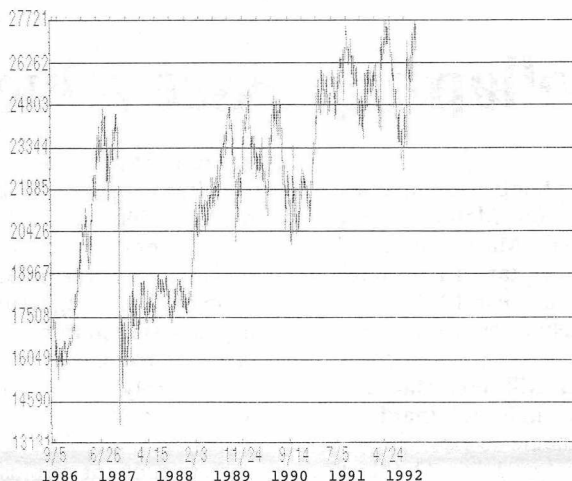
While the ratio of bond yields to equity dividend yields has increased from its previous low of about 1.7 to nearer 1.9, the ratio remains low by recent British history. Interestingly, Sterling's 16% devaluation will benefit significantly about one third of British companies whose earnings are dollar-related. And, of course, economic recovery, if it ever comes,

should further push up earnings.

We continue to believe that in an the UK's inflation-prone economy, equities with earning yields of just slightly under 7% are a much better bet than long-term bonds yielding just under 9%. And they are also superior to index-linked gilts yielding a mere 3.8%.

**STRATEGY:** *In the UK, the place to be is equities. Remain long and raise stops to 2650, close only, basis March 1993.*

Chart 6 - LIF FTSE 100



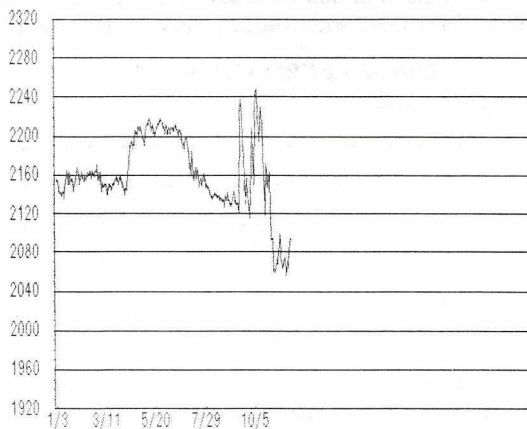
**CURRENCIES**

**An exciting cross trade**

For obvious reasons, we love a long lira/short sterling cross trade. The Italians are on the mend; the British are hopelessly confused. Forward points in our favor are substantial (due to wide interest rate differentials).

Spot is currently at LIT2107/sterling. A six-month forward position can be done at approximately LIT2178. Our target is LIT 1850-1900/sterling.

ITALIAN LIRA PER £



**S&P 500 INDEX**

**January blow-off a good bet**

The resolution of the US-EC trade dispute should serve to catapult stock prices higher over the normally bullish year-end period. Looming on the horizon, however, is President-elect Clinton's fiscal program: Infrastructure spending financed by a wider deficit and an increase in tax rates to the wealthy and the corporate sector.

At the same time, continued economic recovery is likely to have ended the cycle of easy money, removing from under the market its major prop. Valuation yardsticks are clearly excessive for an economy that is about to complete its second year of recovery. For the S&P 500 the price-earnings multiple stands at 23.6x, the dividend yield at 2.95%, and the multiple

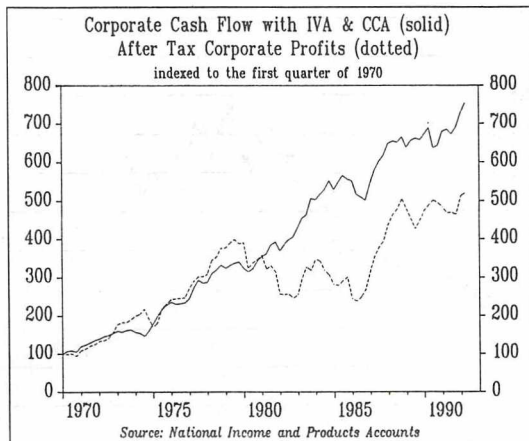
of book value at 2.6x. These also seem to be excessive for an economy where corporate cash flow is booming (see Chart 7).

Sentiment has slowly been improving along with prices. And while it has not as yet reached worrisome levels, speculative juices are flowing more freely: OTC volume has reached 115% of NYSE volume, versus 116% in mid-January, when most of the bull move had already been completed.

The market is still headed higher as suggested in our last two issues. A final blow-off into early January is a good probability.

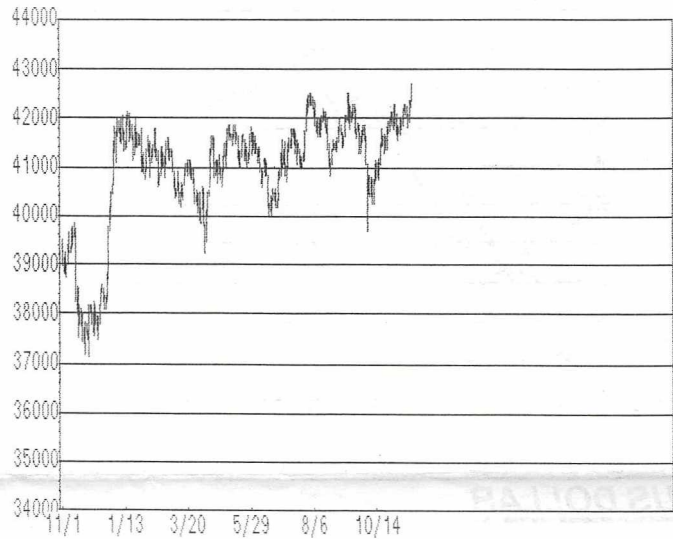
**STRATEGY:** *Remain long futures and/or call options; raise stops to 422, basis December, close only.*

Chart 7



Merrill Lynch & Company  
Global Securities Research & Economics Group  
Investment Strategy Department

Chart 8 - S&P CASH



## INTEREST RATES

# Flattening? Don't know. Rising? Yes

The main feature in the past few weeks has been the narrowing of the yield spreads (see Chart 9). While we fully subscribe to the view that inflation will pick up dramatically in the not-too-distant future (see last month's comments), we are not so sure that the yield curve will have to flatten.

The slope of the yield curve is more a product of central bank manipulation, particularly when it intends to tighten or loosen the reins, than a function of the overall level or direction of interest rates. Were commercial banks to accommodate rising loan demand via liquidation of their huge bond holdings and were the Fed acquiesce in the process, long-term interest rates would rise as much as, if not more than, short-term rates.

It is only when the Fed steps on the brakes and reduces liquidity that short-term rates spike upwards. At the same time, the Fed's actions lead market participants to believe that inflation and credit demands will decelerate in the future, forming an expectation of lower interest rates in the future. Thus, a flat and an inverse yield curve.

Because we do not believe the Fed will react quickly enough to gathering inflationary forces, we take an agnostic view on the yield curve. Having said that, the recent narrowing has left us with a profitable short position in Eurodollars and a stopped out trade on T-bonds.

**STRATEGY:** Remain short March 1993 Eurodollars. Lower stops to 96.30, close only. Remain long deferred months' put options in T-bonds. We were stopped out on our outright short at 103, basis March (see Hotline Update).

Chart 9

Yield Ratio  
30-Year Bond /  
3-month Euro\$

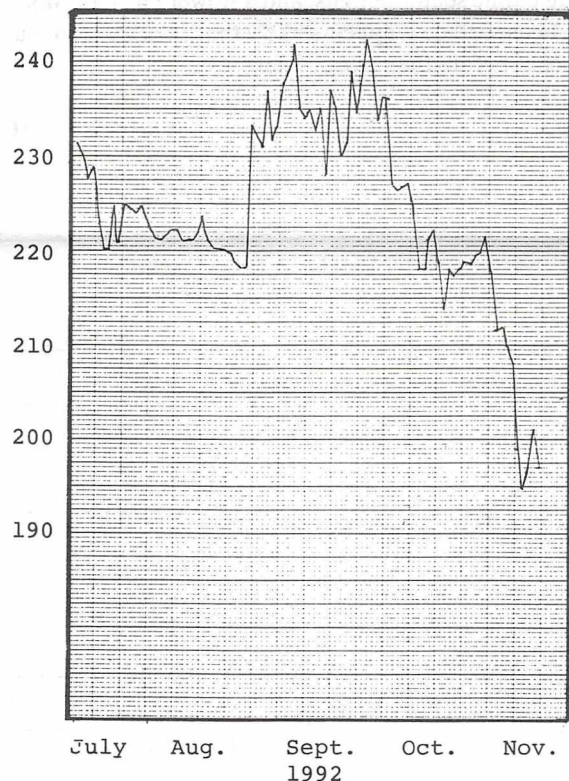


Chart 10 - 3 MTH EURODOLLAR MAR '93

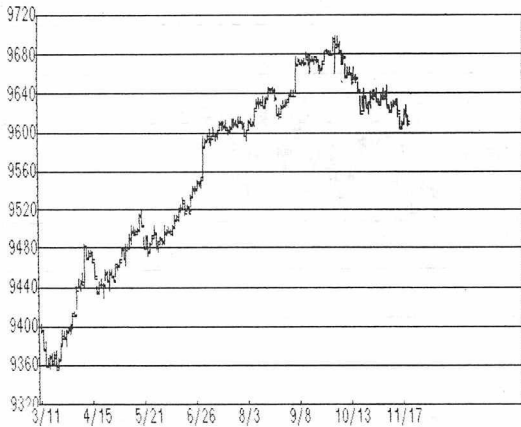
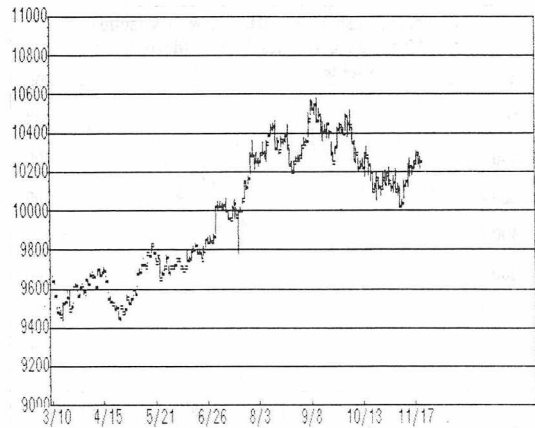


Chart 11 - CBT T-BOND (DAY) MAR '93



**US DOLLAR**

**Overbought and overextended**

There is little fresh fundamental news in the background.

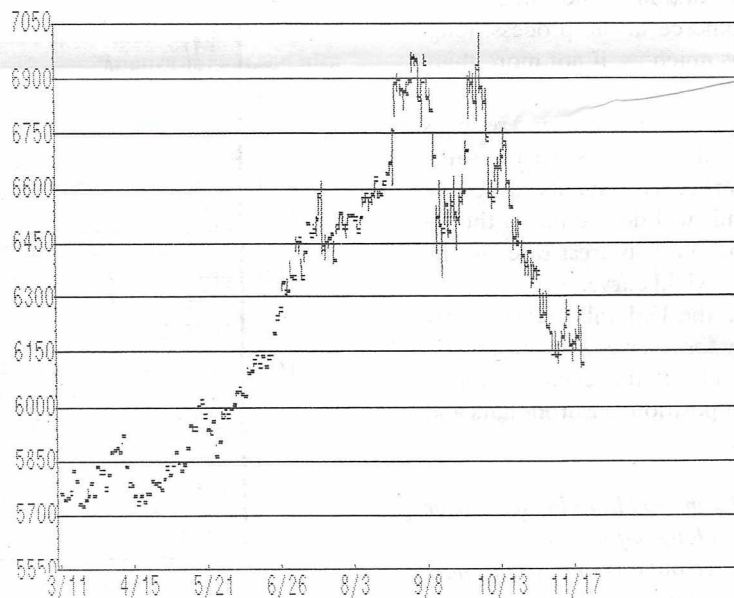
This past Monday, Germany's "five wise men" forecast a zero growth rate for 1993, expecting the economy to shrink in the first half of the year but grow in the second. Pressure continues to mount on the Bundesbank to lower rates and revive the moribund manufacturing sector. The "Bubba," still concerned with the excessive rate of growth in money supply, does not appear overly anxious to acquiesce. What will it take to change their minds? Progress on the wage front, success in cutting public sector deficits, and a slower pace for M3.

On its surface it appears likely that no significant easing will occur before the spring of next year.

In the US all eyes are now focused on President-elect Clinton's State of the Union message. The unspectacular but steady economic recovery is underpinning favorable capital flows; these may be reversed if Clinton makes good on his threat to tax multi-nationals on their world-wide earnings.

**STRATEGY:** We advised (via Hotline Update of Nov. 11) buying March 1993 deutschemarks around 6225 on the belief that the US dollar had become overbought and overextended on present fundamentals. Stops were placed at 6110, close only. If stopped out, stay in close contact.

Chart 12 - CME DEUTSCHE MARK MAR '93



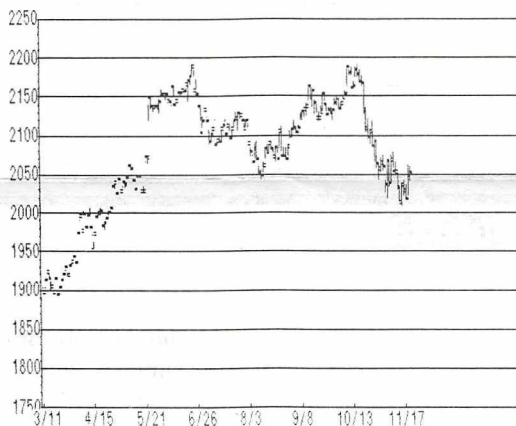
**CRUDE OIL**

# The end of OPEC?

Smuggled oil out of the CIS will do in OPEC.

**STRATEGY:** Retain long-term put options. Lower stops on March 1993 futures to 2080, close only.

Chart 13 – NYME CRUDE LIGHT MAR '93

**COMMODITIES**

## Corn

Last month my colleague Al Friedberg offered the bold thesis that an inflationary phase was forthcoming as a direct result of present money growth in the US. The thesis will govern the writing of this column until sufficient evidence to the contrary appears. For our purposes, we have appended to the thesis a corollary: that a shocking event — like the wheat purchase by the former Soviet Union in 1971 — will begin the inflationary phase in commodities.

Since, by definition a shocking event is unpredictable, what we will do is seek out those commodities having a combination of fundamentals and risk/reward characteristics that would lend to the greatest response to shock, and at the same time allow for at least modest profit should no shock occur. Our strategy is to buy the commodities with a small percentage of the portfolio we allocate to commodities, and to hold them until we can conclude the fundamentals and/or risk/reward characteristics have changed.

Last month we began with cocoa and silver. To them, this month we will add corn.

Corn fundamentals are as follows:

Production in 1992-93 is estimated by the USDA at a record 9.3 mln bushels. Total usage is estimated by the department at 8.3 mln bushels.

Ending stocks as a percentage of consumption is put at 26, nearly twice as large as last year and the highest since

1988-89.

These are hardly statistics to wax excitedly about. Still there are two elements in the fundamental picture that satisfy our criteria and they are sufficient.

First, the cash price, in response to news of the record crop, bounced off a level a full 40% lower than the price achieved six months ago, thereby implying a significant bottom has been formed.

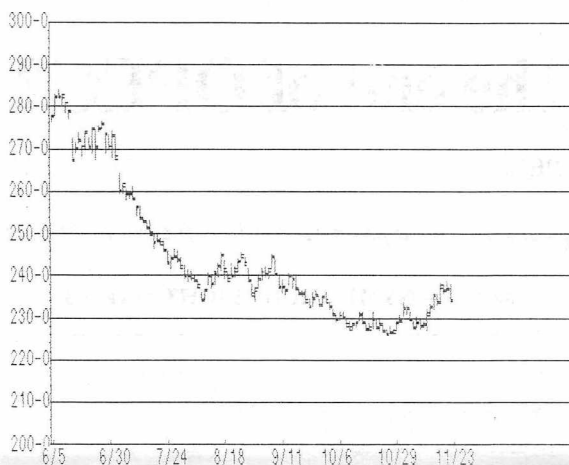
Second, forthcoming revisions to the estimated data are likely to indicate increased usage, especially in the category of exports.

That category was estimated by the USDA to total only 1.6 mln bushels versus nearly the same amount last year and as much as 2.4 mln bushels in 1989-90. The success of the GATT negotiations, and import demand from the former Soviet Union (FSU) in order to reconstruct a cattle industry all imply increased export trade from the US.

The shock to the market could come from China, the wild card now that it has cultivated an appetite for free markets. Would it not be too reasonable to suggest the Chinese may want American corn to develop a cattle industry?

**STRATEGY:** We are holders of modest positions in the July '93 delivery and would add to them on a retreat to the lows risking a conclusive break of those lows.

Chart 14 - CBT CORN JULY '93



**FRIEDBERG CAPITAL MARKETS**

**Atari Corp.**

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**Coupon: 5 1/4%**  
**Due: April 29, 2002**  
**Convertibility: \$16.31 per common share**  
**Recent quote: \$47.50**  
**Yield: 15.56%**

Atari Corporation of Sunnyvale, California, manufactures and markets personal computers and video games for use in offices, homes, and educational forums worldwide.

The company has had a very difficult year. Sales in the quarter ended June 30/92 were \$23.3 million compared with \$49.2 million for the same quarter in 1991. Sales have been severely affected by intense competition and general economic softness. Because of these adverse conditions, the company found it necessary to reorganize its operations and include a charge of \$34.1 million in operating income (loss).

In spite of the dismal performance in the past quarter, the balance sheet remains robust. At June 30/92 the Company had cash in excess of \$62 million, and resounds with confidence for 1993 sales prospects.

The company has \$43.7 million of 5 1/4% convertible subordinated debentures outstanding. With the common stock trading at \$1.25, the conversion privilege is nearly worthless. Nevertheless, we believe that we are buying these bonds at their investment value and therefore are paying *zero* for the conversion privilege.

We note that the company had repurchased \$31 million face value of these debentures in 1990 and 1991 at between 20 and 25.

Finally, we should point out that default with respect to other indebtedness of Atari Corporation in an aggregate amount exceeding \$5 million would result in an event of

default whereby the outstanding debentures be due and payable immediately.

A worthwhile speculation for aggressive accounts.

**Cooper Cos. update**

Originally recommended in our September '89 issue at a price of 62, the Cooper Companies 10 5/8%, 1/3/05 convertible bond has seen ups and downs.

The Cooper Company bonds were placed on our buy list because cash holdings exceeded the whole CV bond issue. The bond price surged to a high of 93 in June this year just before the company started receiving poor press reports due to the controlling Singer family's alleged shady dealings.

To add injury, on Oct. 30 "the Delaware Chancery Court has ruled that Cooper Company in connection with the sale in 1988 of its plastic and reconstructive surgery business to a subsidiary of Bristol-Myers Squibb Co. assumed responsibility for product liability claims arising from breast implants sold before December 14, 1988."

At this time Cooper says that it is aware of approximately 625 such lawsuits pending or threatened against or involving the company. The company said that it believes that "such liability is likely to be material to Cooper's overall financial conditions" and that it will appeal the court's decision to the Delaware Supreme Court.

To add insult, the Cooper Company and former co-chairman were charged by the SEC with conspiracy and fraud in connection with an alleged junk bond insider trading scheme. Gary Singer, the former co-chairman, is also being charged under RICO, which is indicative of the SEC's desire to rid Cooper Company of Singer's influence.

The indictment marked only the third time that the US attorney has used the RICO law in a financial crime case.

In the meantime, Cooper Company has designated a management committee comprising of three board members not employed by the Company, and not directors at the time detailed in the indictment or the SEC complaint.

The removal of the Singer family from the company would be a highly positive development. The pending breast implant lawsuits, however, are difficult to quantify.

The bonds have retreated from a 1993 high to the low 70s where their yield to maturity is 15.98%.

We advise swapping out of these bonds and into Diceon, Burnup and Sims, or Atari, which yield only 25 to 75 basis points less, pending more information on the materiality of the lawsuits.

**Chart 15**  
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, SF, DKr, BP, FFr, ECU, CD, SAR, ITL, ARG, FIN) or revalue for JY, before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of November 19, 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**	ITALIAN LIRA	ARGENTINEAN PESO	FINNISH MARKKA
1 year	3.67%	Tourist '93 yields 5.16% (.5096 NZ/US)										ESCOM 11% '93 yields 10.85% (.1903 US/SAR)			
2 year	4.52%		CBA 14% '94 yields 6.85% (.653 A\$/US)				Denmark 9% '94 yields 8.91% (6.609 Dkr/US)								
3 year	5.09%			Bk. Nova Scotia '96 yields 7.48% (1.683 US/DM)									NIB '96 yields 12.57% (1481.6 ITL/US)		Finland '95 yields 11.03% (6.115 FIM/US)
4 year	5.53%					World Bk. '96 yields 4.00% (116.49 US/JY)		Sweden 8 3/4% '96 yields 7.39% (1.433 BP/US)	Credit Lyonnais '96 yields 8.38% (5.919 Ffr/US)		RBC '97 yields 8.85% (1.439 US/CD)				
5 year	5.96%										Eksport finans '97 yields 8.38% (1.397 US/CD)				
6 year	6.19%				Australia '98 yields 5.79% (1.389 US/SF)										
8 year	6.50%			World Bk '00 yields 6.88% (1.620 US/DM)						U.K. '01 yields 8.51% (1.073 ECU/US)					
9 year	6.72%													BIC V '01 yields 22.49% (.292 US/ARG)	
Spot Exchange Rate	-	.5169	.6826	1.573	1.4210	123.50	6.0875	1.5369	5.3215	1.2485	1.2718	.2035	1357.0	.9904	5.185

\*For example, since a US\$-based investor would receive 748 basis points (1257-509) by holding the NIB Italian lira bond, the lira can depreciate to 1481 ITL/US from the present spot exchange rate of

1357.0 ITL/US over the next 3 years for the ITL investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

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

**Recommended bond portfolio allocation for new portfolios**

For new portfolios, we recommend the following investments:

Finnish Markka fixed rate bonds	15%	Argentina BICV	22%
Italia Lira fixed rate bonds	25%	US \$ Floating rate Notes	13%
US \$ high yield CV bonds	25%		

Chart 16 - Foreign Currency Bonds

Date: Nov. 19, 1992

WE OFFER THE FOLLOWING BONDS SUBJECT TO CHANGE WITHOUT PRIOR NOTICE:

MINIMUM US\$, 000 (CDN \$7,000) ISSUER/MATURITY DATE/COUPON	BID	OFFER	CURR. ANN. YLD. TO MTY.	NEXT PAYMENT DATE
<b>DEUTSCHE MARK DENOMINATED</b>				
BANK OF NOVA SCOTIA 5 5/8% 07/05/96 RRSP eligible	93 3/4	94 1/2	7.48%	May 07
WORLD BANK 5 7/8% 4/02/97 RRSP eligible	96	96 3/4	6.78%	Feb.04
WORLD BANK 9% 13/11/00 RRSP eligible	111.90	112.65	6.88%	Nov.13
<b>FINNISH MARKKA DENOMINATED BONDS</b>				
REP. OF FINLAND 11% 15/6/95	99.05	99.80	11.03%	Jun.15
<b>ITALIAN LIRA DENOMINATED BONDS</b>				
NORDIC INV. BANK 12 3/8% 19/04/96	98.55	99.30	12.57%	Apr.19
<b>SWISS FRANC DENOMINATED BONDS</b>				
GOVT. OF AUSTRALIA 5% 30/10/98	94 1/8	96 1/8	5.79%	Oct.30
<b>DANISH KRONE DENOMINATED BONDS</b>				
KINGDOM OF DENMARK 8% 20/08/93	98.90	99.65	8.33%	Aug.20
KINGDOM OF DENMARK 9% 15/11/94	99.40	100.15	8.91%	Nov.15
<b>ECU DENOMINATED BONDS</b>				
UNITED KINGDOM 9 1/8% 21/02/01	1023/4	103 1/2	8.51%	Feb.21
<b>BRITISH POUND DENOMINATED BONDS</b>				
KODM OF SWEDEN 8 3/4% 29/5/96	103 1/2	104	7.39%	May 29
<b>FRENCH FRANC DENOMINATED BONDS</b>				
CREDIT LYONNAISE 9 1/2% 23/12/96	102.95	103.70	8.38%	Dec.23
<b>JAPANESE YEN DENOMINATED BONDS</b>				
WORLD BANK 5 3/4% 7/8/96 RRSP eligible	105.15	105.90	4.00%	Aug.07
<b>CANADIAN DOLLAR DENOMINATED BONDS</b>				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	106.85	107.60	8.22%	Jan.08
EKSPOFINANS 7 3/4% 5/11/97	96 3/4	97 1/2	8.38%	Nov.05
ROYAL BANK OF CANADA 9 1/8% 7/1/97	100 1/8	100 7/8	8.85%	Jul.7
<b>NEW ZEALAND DOLLAR DENOMINATED BONDS</b>				
TOURIST HOTEL 0% 04/06/93	96 5/8	97 3/8	5.16%	4/6/93
<b>SOUTH AFRICAN RAND DENOMINATED BONDS</b>				
ESCOM 11% 31/10/93 (semi)	99.60	100.35	10.85%	Apr.30
<b>AUSTRALIAN DOLLAR DENOMINATED BONDS</b>				
COMMONWEALTH BANK OF AUSTRALIA 14% 01/07/94	109 5/8	110 3/8	6.85%	Jul.07
<b>ARGENTINEAN PESO DENOMINATED BONDS</b>				
ARGENTINA BIC V FIXED/FLOATING 1/05/2001 callable in full on any interest date	86.10	87.60	22.49% IRR	4th day of mth.
<b>U.S. DOLLAR DENOMINATED FIXED CONV. BONDS</b>				
DATAPoint CORP. 8 7/8% 1/6/06 CV @ \$18.11 p/sh (semi)	55 1/2	57 1/2	17.71%	Dec.01
DICEON ELECTRONICS 5 1/2% 1/3/12 (semi) CV @ \$39.50 p/sh	37 1/2	40 1/2	15.58%	Mar.01
BURNUP & SIMS 12% 15/11/00 (semi) CV @ \$16.79 p/sh	83 1/2	87 1/2	15.25%	Nov.15
ATARI CORP. 5 1/4% 29/4/02 CV @ \$16.31 p/sh	47 1/2	50 1/2	15.59%	Apr.29
COEUR D'ALENE 6% 10/6/02 CV @ \$37.655 p/sh	83 1/2	86 1/2	8.07%	Jun.10
<b>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</b>				
FARM CREDIT CORP. 7 3/4% 10/06/96 RRSP eligible	108 3/4	109 1/2	4.76%	Jun.10
<b>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</b>				
UNITED KINGDOM 24/09/96 3 mo. LIBID-1/8 (qly) *callable @ 100	99.71	100.01	3%	Sep.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  
Canada & U.S.A. 1-800-461-2700

HOTLINE UPDATE

Tuesday, October 27:

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

Friday, October 30:

There are no changes or new recommendations.

Tuesday, November 3:

There are no changes or new recommendations.

Friday, November 6:

We have one new recommendation: Sell March T-bonds at the market if you have not already done so based on our last market letter suggestion. Place initial stops at 103.00, close only. No other changes or new recommendations.

Tuesday, November 10:

There is one new recommendation: Sell March Canadian dollar at the market. Place initial stops at 8150 stop, close only.

Flash update, Wednesday, November 11:

Buy March D-marks at the market. Place initial stops at 6040, close only.

Friday, November 13:

This is a review of recommendations for the week.

On Tuesday, November 10, we sold March Canadian dollar at approximately 7811, placing initial stops at 8150, close only.

On Wednesday, November 11, via flash update, we bought March D-marks at approximately 6225, and we are raising the stop to 6110, close only.

Tuesday, November 17:

One new recommendation: Buy December 1993, repeat 1993, Simex Euroyen at 9655 or better, and/or June at-the-money or slightly out-of-the-money Euroyen call options.

Friday, November 20:

This is a complete summary since our last market letter, dated October 25, of all liquidations of open positions and new recommendations that remain outstanding.

On Tuesday, November 10 we advised selling March Canadian dollar at the market, then trading at 7811; stops were placed at 8150, close only.

On Wednesday, November 11, we advised the purchase of March D-mark at the market, then trading at 6225; stops were placed at 6110, close only.

On Tuesday, November 17, we advised the purchase of December 1993 Euroyen, then trading at 9649, or alternatively June Euroyen call options.

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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

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