

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

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Monetary manipulation is not costless

Is there a price to pay for "driving" short-term interest rates down to 3%? To hear it from professional and government economists and Wall Street money managers, the answer is a clearly resounding "no." In the naive view, the Fed is a virtuous government agency, dispensing "free" goods in various forms, principally cheap credit and speculative opportunities, with the intent of kick-starting an economic expansion. The cost: nil.

Would that it were that simple. First, a brief history. The Greenspan Fed lowered Fed funds from almost 10% in early 1989 to just over 8% in the first half of 1990, which of course did not stop the recession from coming. It continued to drive interest rates lower through the 1990 recession, and by the spring of 1991, rates had fallen to 6%.

The economy had already begun to recover by then. The Fed — in the interest of aiding the "fragile" economy — continued to lower rates, producing at first a positive yield curve and then, a *monstrously* positive yield curve, without any *appreciable* effect on economic activity. The economy continued to chug along at 1% to 2% rates of growth.

Where there was an appreciable effect was in banks' balance sheets and income statements. With the magnanimity so characteristic of issuers of fiat currency, the Fed engineered the most powerful reliquification process in banking history — an item that we first brought up in our October 29, 1989, issue.

In effect, bank balance sheets destroyed by the reckless lending of the '80s (also a creation of the Fed) were restored back to health in less than four years. Commercial banks' total investments (mostly Treasury holdings) rose a staggering \$300 billion in 3½ years, coming to represent 29.3% of total assets from 22.4% in late 1989.

The effect on bank profits was even more extraordinary as banks availed themselves of cheap deposits to fund their binge on Treasuries. For the first six months of 1993, commercial banks earned \$21.1 billion, an increase of \$5.6 billion over the same period in 1992 and a far cry from the huge losses sustained in the recent past. The average return on assets (ROA) — the basic measurement of bank profitability — was 1.18% and 1.24% during the second and first quarter of this year, the only two quarters in which ROA has averaged more than 1% in 10 years!

The banks' gain was the consumers' loss. Unwilling, initially, to lend long, the consumer passed along the "risk" and the reward to the banks, who thought little of borrowing short to lend long.

Where banks "hedged" their risk, they were able to obtain true rent from consumers lacking the sophistication

and size necessary to deal in derivatives. Where the risks were not hedged, the "cost" to the consumer in the way of future bank bankruptcies and bail-out expenses lies still some years ahead. Either way, the Fed subsidized the banking industry at the expense of the consumer, with some of the cost yet to be paid.

The Fed's manipulation had an appreciable effect on a number of other areas. It subsidized bankrupt entrepreneurs who had been heavy borrowers (such as Trump, Zell, and many others) at the expense of millions of frugal savers. And it succeeded in turning America's financial markets into a huge casino (is there any surprise that the *casino* industry is one of Wall Street's "hottest" performers?) via the efficient intermediation of an exploding mutual fund industry (see the reprint of Henry Kaufman's excellent article, "Age of the risk factor," elsewhere in this issue couched perhaps in a much-too-moderate tone).

The Fed has created a "bubble," and it does not know how to burst it gently. *There is no way to burst it gently.*

While it is easy to anticipate the consequences of this mad adventure, timing remains highly imprecise. Frightened by what it wrought, the Fed may want to *attempt* a soft-

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Contributions by Albert D. Friedberg, Dr. Steve H. Hanke, Henry Kaufman, David B. Rothberg, Edison Lee and Michael D. Hart.

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

lending, i.e., inject a decreasing amount of reserves into the banking system. As Chart 1 shows, to maintain the Fed Funds rate around 3%, the Fed has had to provide reserves over the past five month at a prodigious rate: 21.6% annualized!

Mini quarter-point steps are unlikely to quench the voracious appetite for balances. As rates rise, it will appear that the Fed has succeeded in restraining the growth in reserves. But that will be only an illusion: As rates rise, the public will begin to shift demand deposits into term deposits *requiring less overall reserves*.

Significantly, loan demand has begun to climb in earnest (see Chart 2), much of the growth coming from residential mortgage loans, the new growth industry (thanks to the Basel agreement favoring mortgage loans over business loans). The extraordinary cushion of Treasuries and the ease with which the banking system can re-issue fixed-term deposits that they *have allowed to run off for the past three years have curtailed the Fed's ability to restrain the coming inflationary pressures*.

The Fed has created a financial bubble. All bubbles burst, some being directly punctured by their creators (the Fed in the 1929 episode, the Bank of Japan in 1989-93) and some by simply running out of fuel, with credit demand overwhelming the freshly minted supply of money.

Regardless of the process, the outcome is predictable: higher inflation, which sets in its wake *future deflationary pressures* via much higher interest rates, falling asset prices, and a rising currency.

Following is a more detailed discussion of some of the long-term consequences of the "costless" manipulation of money engineered by the Greenspan Fed over the past four years.

Inflation

Despite repeated and massive fiscal and monetary stimulation, the real economy manages to expand only at a very slow pace. As discussed on earlier occasions, this is attributable to three things: The dead weight of an ever larger, unproductive government sector, the weight of government regulation and bureaucracy on the private sector, and the extremely heavy load of consumer debt.

The interventionist Clinton government is set to aggravate the first two. The Fed in turn, cannot affect these two causes, but by providing cheap credit, it has aggravated the third condition.

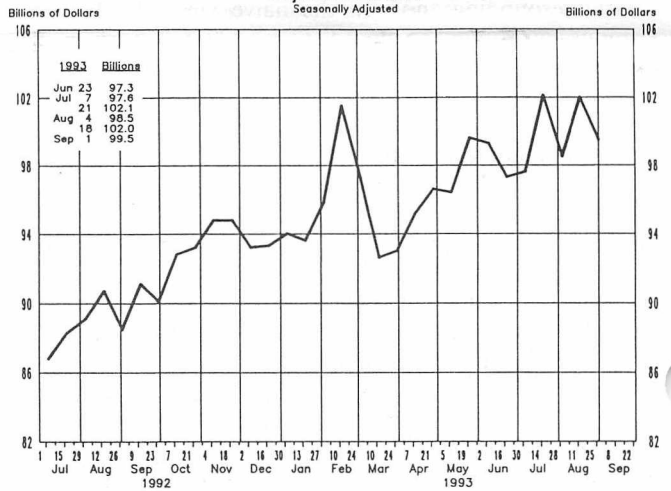
After one of the longest periods of sub-par economic growth in this century, inflation remains stubbornly perched at

around 3% per annum. Rising economic activity accompanied by continued low productivity (on an economy-wide basis) and capacity constraints, well lubricated by cheap money and credit are certain to lift the rate of consumer price inflation to 4%-5% next year and more in the years to come.

The next bout of double-digit inflation, when and if it is allowed to get there, will once again find the Fed fighting the same rear guard action that it has fought over the past 80 years.

Some commodities too will participate in the coming inflation. The likely long term winners: cocoa, coffee, sugar, gold, silver, platinum, grains. And after the former Soviet Union exhausts its stockpile, lead, nickel, and aluminum. David Rothberg, our respected commodity analyst, has been and will be covering these markets.

Chart 1
Adjusted Reserves
Seasonally Adjusted



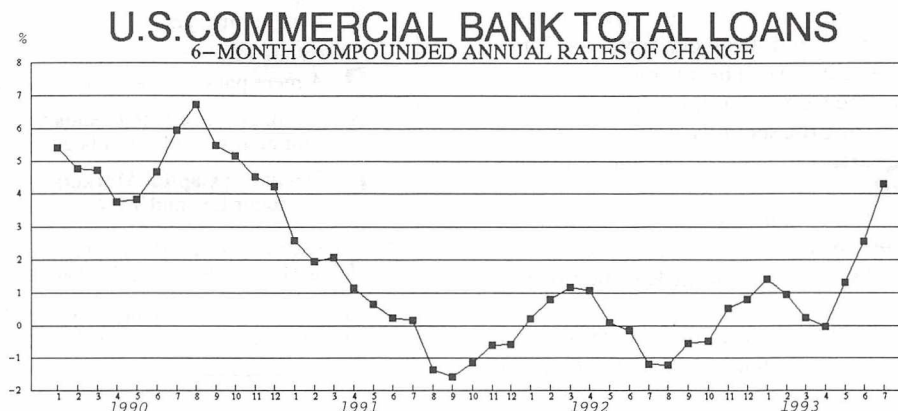
Latest data plotted two weeks ending: September 1, 1993

Adjusted reserves is the difference between adjusted monetary base and currency component of M1.

To the average of two maintenance periods ending:	Compounded annual rates of change, average of two maintenance periods ending:							
periods ending:	9/2/92	11/25/92	2/3/93	3/3/93	3/31/93	4/28/93	5/28/93	7/7/93
2/3/93	14.0							
3/3/93	23.1	19.2						
3/31/93	6.3	-8.0	-12.3					
4/28/93	11.0	2.8	5.6	-20.8				
5/28/93	13.0	6.9	11.8	-6.0	42.5			
7/7/93	10.5	4.7	7.1	-5.4	20.1	9.0		
8/4/93	13.0	8.5	12.2	2.2	25.2	18.1	12.8	
9/1/93	12.5	8.3	11.4	2.8	21.6	15.5	11.0	24.2

Prepared by Federal Reserve Bank of St. Louis

Chart 2



INTEREST RATES

Extraordinary volatility to come

Given the ease with which the banking system can accommodate rising loan demand and consequently the virtual inability of the Fed to restrain it short of dramatic jumps in Fed Funds and/or the discount rate, one can be certain that a) interest rates will rise for a considerable period of time and that b) interest rate volatility will be extraordinary.

STRATEGY: In October '92 we advised purchasing September '93 T-bond put options. They expired worthless; given their cost, the loss was far from catastrophic.

Once again, we advise purchasing puts (cheap in relation to expected increase in volatility). Buy March '94 T-bond puts, 112 striking, for approximately 52/64. Also, buy December '94 Eurodollar puts, 95.25 striking, at approximately 28 points.

US DOLLAR

(Very) near-term lower; longer-term, up

Our trading range thesis of the past few months has been vindicated. We bought DM at one extremity of the range, supported by slightly better relative fundamentals and too much negative sentiment.

The Russian episode has cut short the promising rally and has begun to uncover the soft underbelly of the animal. In effect, recession ravaged Europe continues to wallow in the mud of socialism and nationalism, which give rise to interventionist and protectionist policies guarded by monetary orthodoxy. In words at least, if not in practice.

Adding to these problems is the continued disintegration of the former Soviet Union, the raging war in the former Yugoslavia right at its doorstep, and the revival of some festering communist elements in Eastern Europe.

Long-term foreign exchange rates, being a bet on relative

values no matter how miserable the choice, should begin to favor the US dollar, despite the Clintons and Greenspan. A mediocre expansion, rising inflation, and sharply rising interest rates will suck in capital from Europe and Japan, and should drive the US dollar past 1.90 deutschemarks and 145 yen.

STRATEGY: The bullish US dollar view expressed above is more applicable to the medium and long term. In the meantime, we remain long the DM, hoping to squeeze out a near-term target of DM1.53 to DM1.56. While Yeltsin's dissolution of the Russian parliament may have cut short the promising rally, it may also have had a beneficial side effect: that of shaking out the large technically oriented contingent of DM-bulls.

Mindful of the gathering risks, we have tightened our stops to 59.50, basis December '93, close only.

FINANCIAL MARKETS

Age of the risk taker

by Henry Kaufman

What developments might have the biggest potential impact on financial markets? Experts typically cite innovations such as exotic derivative instruments or asset securitisation or greatly expanded international trading activity. But in the US at least, arguably the most significant development is the enlarged role of the household sector as a financial risk taker.

Millions of people have branched out from passively holding bank deposits and indirectly owning securities through such intermediaries as pension funds to becoming direct participants in financial markets — and thus are exposed to risks beyond those they are accustomed to.

In 1978, American individuals, farmers and small businesses held about 40% of their total assets in deposit form. By the first quarter of 1993, the share of deposits and money funds with no capital risk had dwindled to 24% of total financial assets. In 1978 Americans held only about a third of their total financial assets in instruments directly carrying

market risk: 19% in common stock, 7% in bonds and 6% in miscellaneous assets. Only 1.2% was invested in mutual funds of any kind. Today, assets directly carrying capital risk account for almost 40% of total financial assets. Of that, 16% is in common stocks, 9% in bonds and 7% in miscellaneous assets. Equity and bond mutual funds have surged to 7%.

Mutual funds continue to mushroom — up by an estimated \$22 billion a month so far this year, a third higher than last year's monthly average and four times the \$5 billion monthly average posted as recently as 1990. Mutual funds represent the largest institutional buyer of American equities and of tax-exempt municipal bonds, and they rank high as buyers of taxable bonds.

The other significant shift in household portfolios has been the steady expansion of retirement funds. Back in 1978, a fifth of household total assets was invested through pension plans, mostly defined benefit plans for which the sponsoring

employer bore the ultimate capital risk on investments. At present, pension fund reserves have risen to about a third of total household financial assets. But an increasing share of those funds represents defined contribution plans, where the worker bears the capital risk on the investments not the employer. Defined benefit retirement plans, which tend to be sponsored by the same large corporations now engaged in restructuring, are shrinking. Over time, a shift toward defined contribution pension plans will leave affected retirees with greater financial uncertainty. Retirement income will depend not only on the type of investments in the plan but also on market conditions when retirement takes place, a significant risk to the retiree.

What are the ramifications of these changes? First, the shift away from deposits, like the shift away from defined benefit retirement plans, is a transfer from obligations assuring the nominal capital value of the assets to those whose future values are unknown.

Mutual funds are see-through institutions, taking no risks of their own. Risk and reward are passed on to fund holders. Banks, in contrast, provide stated returns and interpose their own capital to take additional risks. But mutual fund investors may not appreciate all the risks they are taking on. They may act quite unpredictably if a sudden market upheaval dramatically reveals the true risk.

Second, a large increase in money rates will surely induce significant shifts back into deposits and money market funds. This may provoke far greater and quicker declines in the value of equities and of bonds than in prior decades, when longer maturity obligations were largely in institutional portfolios. The economic impact should also be quite abrupt. In this new financial world, changes in stock and bond prices will have a more noticeable wealth effect on individuals. Consequently, personal consumption, which cyclically tends

to be more stable than other components of economic activity, will take on much more of a cyclical hue.

For central banks, all this will pose unfamiliar challenges. A sharp shift by households out of mutual funds into deposits and money market funds will hurt bond and stock markets, but will increase the growth of money. Will this be interpreted as a symptom of future economic growth or a precursor of contraction?

Indeed, the greater volatility coming from these structural changes may well induce public pressures for greater official intervention in the financial markets. Whipsawed by greater swings in their financial wealth, investors may demand that the government find a way to intervene in segments of the financial markets heretofore considered off-limits for "open market operations," notably the equity market.

This is not going to happen today or tomorrow, but if reports from Tokyo earlier this year are right, the Japanese government purportedly persuaded state pension funds to step into the Japanese equity market to give stock prices a lift. Who is to say that a similar form of intervention could not be devised in, say, the US or UK?

Lately, we have seen the pleasant side of volatility, rising stocks and bond prices with just occasional interruptions. But the dark side of volatility is bound to come again. When it does we may get the answer to what will be the central question — whether economic growth is sustainable if the financial markets are challenged by a rise in interest rates and households are threatened more directly than in the past by a decline in the value of their financial assets.

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EUROPE

France: sans fundamentals

To analyze the course of the French economy, we must, alas, focus once again on the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS). German reunification imposed enormous, and what appear to be never-ending, financing requirements on Germany. To meet those requirements, Germany had to shift from being a large exporter of capital, primarily to other members of the EMS, to being a capital importer. In consequence, Germany had to sell less and purchase more from other countries. That required a significant shift in the relative prices of German exports and imports, with exports becoming relatively more expensive in relation to imports. There are only four possibilities (or combinations) to accomplish the required relative price changes: appreciation of the deutschemark, depreciation of foreign currencies relative to the deutschemark, German inflation, or deflation in other EMS countries.

Members of the EMS have, as a matter of policy, been unwilling to voluntarily change exchange-rate parities within the ERM. Indeed, it has only been after massive speculative attacks that Britain and Italy dropped out of the EMS in

September 1992 and the bands of the ERM were widened to 15% in August 1993. Germany was unwilling to allow inflation to solve the required relative price change problem. That has left only one possibility for adjustment: deflation in other EMS countries. France, in particular, has tried to build its credibility as a strong currency country by voluntarily allowing for the consequences of deflation: a prolonged recession, falling asset prices, the destruction of balance sheets, and a surge in unemployment.

Even though the center-right parties won a massive victory over the socialists in elections earlier this year, they have embraced the socialists' *franc fort* policy with enthusiasm. Furthermore, the new Balladur government, which is cohabitating with socialist President Mitterand, has made it clear that it intends to make no major economic policy changes before the next presidential election in May 1995.

The Balladur government justifies such a policy stance by claiming that the French economy bottomed out last spring, when GDP growth in the second quarter of 1993 was zero after falling the two previous quarters. This justification

is not warranted on economic grounds. Indeed, the OECD's composite leading indicators show that France's indicator has fallen further (-3.8%) than any leading industrial country over the past year.

Furthermore, for reasons that we will spell out, we see nothing but weakness in the French economy through 1994. Indeed, France is *sans* economic fundamentals, and no recovery is in sight. If that weren't enough, the Balladur government's *status quo* strategy will result in a massive erosion of Mr. Balladur's unusually high approval ratings of almost 60%. As in all sporting events, politicians can retain popularity, particularly in the face of a deteriorating economy, only if they are on offense.

* * * * *

Our gloomy view of the French economy is based, in part, on its continued attempt to maintain the franc's parity with the deutschemark. Until such a policy is abandoned, France will continue to reap the fruits of deflation. For example, its money supply growth will continue to be anemic, at best: in July narrow money (M_1) contracted by -0.3%, and broad money increased by only +0.7% relative to a year earlier. Moreover, short-term interest rates will not be allowed to fall too far below long-term rates; at present, three-month Eurocurrency rates exceed long-bond rates by 120 basis points.

In consequence, money growth will not be available to stimulate nominal GDP. Furthermore, the velocity of money circulation will continue to fall (or be weak), because comparatively high short-term interest rates increase the demand for money relative to other assets and GDP, which depresses GDP from what it would be if the yield curve were positively sloped and the velocity of money circulation were increasing (the demand for money was falling).

Even if France is forced to use the monetary independence granted to it by the wider ERM bands and loosen its monetary policy, we must stress that the economy will not bounce back rapidly.

To appreciate this conclusion, we must look no further than the French balance sheets, which have been all but destroyed by the *franc fort* policy. Due to the plunge in asset prices, French banks' balance sheets are weak. Consequently, even if short-term interest rates fall below long-term rates, the banks will borrow short-term funds and purchase high-quality, long-term government bonds. That will allow the banks to reliquify and improve the quality of their balance sheets. Alas, those operations will not increase the supply of credit available to the private sector. The credit crunch will

continue until the banks have sufficiently strengthened their balance sheets.

France's deflationary policy has wreaked havoc on the balance sheets of French businesses, too. Since 1988, businesses have been piling up high-cost debt at an alarming rate. Consequently, interest payments eat up about 11% of French businesses' cash flows. Consequently, if interest rates fall and cash flows improve, corporations will aggressively attempt to repair their balance sheets; they will direct free cash flows towards debt reduction rather than new investments. Consequently, interest rate reductions will not stimulate an investment boom.

Therefore, even though a loosening of monetary policy would allow the healing process — namely, the repair of the banks' and businesses' battered balance sheets — to begin, it will not revive the economy rapidly.

So, the traditional macro-economic fundamentals don't look too bright. Even worse are the micro-economic fundamentals, particularly those centered in the labor market.

Since 1973, France's unemployment record has been the worst of any large OECD country. That's no surprise, since France, in the spirit of the EC's social charter, has adopted more job-destroying laws than any other European country. The surging unemployment rolls, which don't include over a half million workers "employed" in phoney jobs under the *contrats emploi-solidarité*, are well-known. Indeed, current unemployment is 11.7% compared with 10.2% a year ago, and it is rising sharply.

It will take more than a change in monetary policy to fix France's unemployment problem. The labor market for workers will have to be deregulated, the tax system made less discriminatory against work, and the dole made less attractive. These changes will clearly not be made before the next presidential elections.

STRATEGY: *France is sans macro and micro fundamentals. Without policy changes, the economy will continue to deteriorate, and unemployment will mount. Ultimately, the Balladur government will be forced to stop shadowing the deutschemark. Now that the ERM bands have been widened to 15%, France has the freedom to loosen monetary policy and allow the deutschemark/French franc parity to change. It's only a matter of time before higher unemployment and social unrest force the Balladur government to abandon France's destructive deflationary policy. Retain short French franc/long deutschemark positions.*

— Dr. Steve H. Hanke

JAPANESE YEN

Long-term bears

The Bank of Japan finally buckled to the inevitable and cut the discount rate by 75 basis points. The slightly larger than expected cut provided fresh evidence — if any was needed — that the economic situation was becoming desperate. In fact, as we argued in our last issue, Japan needed a double injection: a dose of monetary reflation to fight the ongoing defla-

tion (wholesale prices are down more than 3% year over year) and a dose of genuine fiscal stimulation — via massive tax cuts — to counteract the economic contraction.

Internal dissension in the Hosaka government, exposing its weak foundation, and the Ministry of Finance's known aversion to tax cuts and deficit financing, killed the country's

only hope for a domestic-led recovery.

The implication of the refusal to cut taxes is that Japan will need to be lifted via the external sector, i.e., an export led recovery. Seemingly, this is inconsistent with the intention of the G-7 who would like to see a shrinkage of the already large trade surplus. What should be borne in mind, however, is that the yen-based trade surplus is actually falling. The yen figure declined 11.6% in August from a year earlier on a seasonally adjusted basis and was down 21.1% from the July 1993 total.

In fact, Japan exports in yen are now at the same level as they were 10 years ago! The well known J-curve effect (a rising yen equals more dollars) is hiding this momentous development; measured in volume terms, while Japanese exports fell 1.7% year over year in August, imports rose 8.5%.

The Japanese economy cannot afford a reduction of the external surplus. *That it can happen in the midst of the nation's worst post-war recession is a clear indication that the yen is grossly overvalued.*

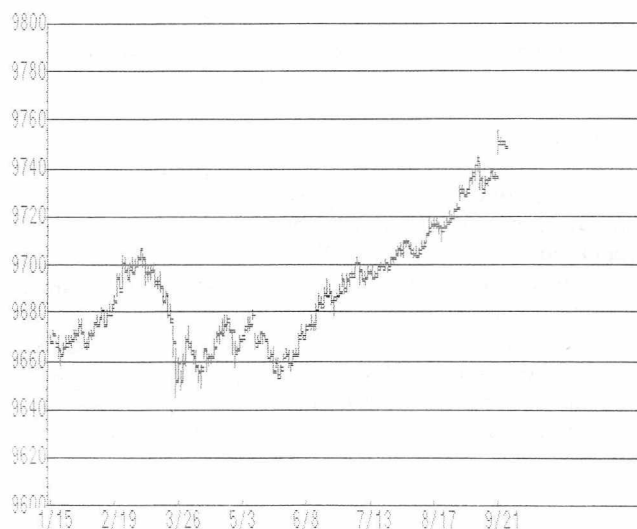
Setting into reverse the J-curve effect one can easily demonstrate that a rising trade surplus in volume terms — something that the economy desperately needs to begin a genuine recovery — will not translate into a larger trade surplus in dollar terms than at the present time. Furthermore, the relocation of many Japanese exporters' production facilities to cheaper countries will blunt future trade surpluses without necessarily blunting the full effects of reinvigorated exporters' margins.

STRATEGY: 1. *We have constructed a long-term bear argument for the yen, one that may see it reach Yen 145-160 in the next 18 months. We are anxious to time our entry at the most propitious moment, i.e., avoid an adverse 3% reaction. Although we are quite sure that the circumstances have been given for the move to begin almost immediately from these levels, we prefer to hold back a little longer until the US dollar is clearly on the rise on all fronts. Remain in close contact.*

2. *As per Hotline Update of September 14, we liquidated very profitably our long Euroyen futures and call option positions, first recommended on November 22, 1992 around 96.60 and again in all subsequent months, adding to them in the June 27, 1993 issue.*

3. *Our previously recommended Amex put options on the Japan Index expired worthless. (Note: the reference to a 21250 stop on Nikkei futures in the August 1st issue was incorrect, as we were no longer short futures having, been stopped out already at 18500 as per Hotline Update of Feb. 26, 1993). We recommend a new purchase of December '93 Amex put options with a 190 striking, trading approximately at 2½.*

Chart 3
SIMEX EUROYEN DEC '93



CRUDE OIL

A mere pause in a long bear market

On September 23 we advised covering all outstanding crude oil short positions and liquidating put options. All showed extraordinary gains.

The market seems to have already accepted the view that OPEC, including Kuwait, will be unable to come up with an overall ceiling of 24.5 million barrels a day, a ceiling that the market believes will arrest the decline. We are more inclined to believe that the deal will be reached but that ultimately will still prove to be excessive in relation to colapsing demand. Thus, near-term there's some optimism.

At the same time, we have been impressed by the ability of the market to absorb product without eroding "crack-margins."

It remains to be seen whether recently refined products can be fully absorbed into the stream of ultimate consumption.

The long term negatives remain unaltered: Rising FSU exports; rising future FSU supplies from deals with AMOCO, Chevron, and other multinationals; the inevitable reentry of Iraq as an exporter of 3.5-4 million barrels per day; the precarious financial position of Saudi Arabia and its inability to revert to being a swing-producer as in 1985.

STRATEGY: *Although we have stepped aside, we continue to monitor this market on a daily basis with the intention to reenter at a more propitious moment. Remain in close contact.*

COCOA, SOYBEAN MEAL, SUGAR**Commodities: Phase II begins**

On August 12, 1992, the Dow Jones Industrial Average closed at 776.92. Eleven years later, almost to the week, the market reached, what until now has been an all-time high of 3681.71. Investors are frequently cautioned to distinguish the forest from the trees. If there was ever a market forest lovers will want to point to it has been the bull market that has taken place in stocks over the past 11 years.

I cannot argue myself out of believing an opportunity similar to the one that the equity market of 1982 represented exists today in commodities. Today the Commodity Research Bureau Index (CRB) stands at 217.42. Ten years from now I cannot see the market at less than 400. Despite myself, I can imagine it even higher.

Here is why I believe the market is about to embark upon its epic journey higher, and why I believe the market is poised to begin that journey now:

The case for monetary exorbitance is made convincingly in the lead article of this month's *Comments*. Suffice it to say here that by having primed the money supply as it has, the Federal Reserve has created the crucial ingredient for an inflationary phase: more cash than available goods and services.

The inflation will not affect the same sectors of the economy that were affected during the inflations of the 1970s and '80s; the inflation of the 1980s was localized primarily in real estate and equities; commodity prices actually fell throughout the entire decade. Commodities are the prime candidates this time around, because they are so cheap.

- They are extremely cheap when measured against other assets; the ratio of US equities to the CRB has widened to unprecedented levels.
- They are cheap such that in the past decade, the rates-of-increase in demand have risen above the demand trends that existed in the early 1980s.
- Finally, many commodities are cheap relative to their own production costs; the extremely low prices that have persisted so doggedly during the past decade have wrecked the morale of producers, causing many to leave production facilities in less than up-to-date states of repair and others to abandon production altogether.

The impetus for the bull market in commodities will come from the increased demand generated by the reinvigorated Western economies. It is our opinion the US is finally emerging from its prolonged slump. Japan and Western Europe should follow. The effect increased demand will have upon commodities is obvious. Less obvious, but no less critical, will be the effect that the first upturn in interest rates will have upon purchasing managers.

For years, users of commodities have been rewarded for waiting to buy. This was so not only because prices were falling due to weak demand, but also because the cost of financing those commodities also fell. When interest rates first begin to rise, what occurs is a simple psychological shift: The perceived reward for holding off inventory purchases is replaced by a perceived penalty as future costs appear higher. As we argue in our introductory article, rates are heading higher

from here. They will drag commodity prices in their wake.

Once the market gets untracked, the current fund mania should insure a steady supply of buying fuel. It is for this reason that, radical though it may sound, I can easily imagine the CRB at above 400 before the bull market cycle runs its course.

In summary: A major bull market in commodities is forthcoming. Prudent investors should look to deploy between 5% and 10% of their investable assets in commodities. (Our Managed Option Account is one vehicle to consider as a means to invest). At this incipient stage we will continue to recommend those commodity assets that have strong long-term fundamental features and our strategy will be long-term in nature.

As of this writing we like cocoa, silver, soybean meal, and sugar.

Cocoa

We first became bullish on cocoa in September 1991. Our reason was simple: A secular increase in demand of about 4% annually had developed in response to 13 years of declining prices. That demand could not possibly be met by production that was beginning to atrophy in the wake of the same low prices. At the time inventories were gargantuan, representing eight months of usage. In May, dismayed by the market's lack of responsiveness to a second consecutive year of production deficits, we updated our 1991 study and concluded that while the deficits were not unlikely to continue — i.e., while we still believed in our initial and now proven thesis — inventories had been drawn down by only two months worth of supply. The drawdown was not — and, at a "deficit-rate" of even 200,000 tonnes a year, would not be — sufficient to cause actual shortages for at least another four years.

In light of recent developments, we must re-revise our views.

The ICCO (International Cocoa Organization) buffer stock of 230,000 tonnes represents about five weeks' supply. This month the ICCO has agreed to sell its inventory. Although specific details are still unknown, it is understood the sale will be conducted in an orderly manner. If orderly means the sale will be conducted over a five-year period at an average rate of 46,000 tonnes per year, then, effectively, an entire month's supply has been removed from the market.

Second, contrary to expectations, Ivory Coast has successfully withheld sales of its mid-crop. The mid crop is estimated at 150,000 tonnes. If no more than half that amount finds its way filtered into the main crop which is scheduled to begin October 1 — itself a sign the Cocoa Marketing Board of Ivory Coast is serious about aborting sales; traders expected the main crop season would begin much earlier because of the hold put on the mid crop — and if next year's main crop should be reduced by as much as is now generally conceded in the wake of disturbingly low pod counts earlier this summer, then anywhere from another month to as much as two months' supply must be subtracted from the inventory data.

In addition, Ivory Coast's marketing board has declared its intention of withholding next year's mid crop from market as well.

Finally, the same low pod counts as were made in Ivory Coast have been made in Ghana and Nigeria.

Taking all events in West Africa together, there now exists the real possibility that inventories may be reduced by an additional two months' supply by the end of the 1993-94 crop year. The year-end inventory would then total three months' supply. Insofar as it would result following three consecutive years of deficit, and with virtually no prospect of anything but yet another production shortfall for 1994-95, represents a hazardously low number to users.

Allowing for a risk of \$2,500 per contract, at least 20% of our commodities portfolio must be invested in cocoa.

P.S. Cadbury Schweppes has opened its first production facility in China. Chinese have heretofore consumed virtually no chocolate products whatsoever.

Soybean meal

Anxieties about the size of the soybean crop receded with the flood waters that plagued the Midwest in the early summer. Meal outdid beans, correcting 83% of the upmove to the July highs. Adding to the bearish sentiment has been the emerging perception that exports will fall by nearly 15% due to increased competition from Argentina, Brazil, and India; and because of reduced meal consumption by the EEC as a result of changes made to the Common Agricultural Policy (CAP) which make meal less competitive.

We like meal because the bearish news is all out. The soybean crop, planted late because of the wet weather, will be in the ground late this year and thus exposed to the risk of early frost. Second, export bookings — a minuscule 117,000 tonnes as of the beginning of the month — should change radically now that prices have stopped falling and foreign purchasing

representatives no longer perceive an advantage in holding off any longer. Third, domestic consumption of meal is scheduled to increase this year as it has for the past five consecutive years.

In other years in which similar fundamentals (i.e., reduced bean supplies, a reduction in new crop meal exports, record high crush indicating strong demand base) were at play, seasonal price patterns show rebounds of no less than 74% of the late summer decline.

We do not expect this year to be an exception. Buy meal with stops at 193.00, basis the December contract, close only.

Sugar

A sugar deficit is now expected in 1993-94 for the second consecutive year. Figures culled from most recent USDA reports and statistician Czarnikow indicate shortfalls of 850,000 tonnes in India, of 410,000 tonnes in Eastern Europe, of 200,000 tonnes in South Africa, of 170,000 tonnes in Argentina, and of 100,000 tonnes in Australia. These shortfalls are expected to be insufficiently compensated for by increases elsewhere. The net result puts production at about 112,000 tonnes. Consumption is estimated at 113,750 tonnes.

The sugar industry has been radically altered by the deterioration of conditions in Cuba, previously the world's largest exporter. While most argue Cuban production is suffering because of the dislocation of its overall trade with the former USSR and that conditions there will right themselves after necessary adjustments are made, we believe it is more likely Cuban production, sadly, will deteriorate even further. Sugar supplies are therefore precious.

We want the right to own some. Maintain long positions with stops at 9.00 basis the nearest futures contract.

— David B. Rothberg

FRIEDBERG CAPITAL MARKETS

Centocor Inc.

Issuer: Centocor Inc. (NASDAQ: CNTO)

Security: convertible notes, due February 1, 2001

Recent price/yield: \$82.25/11.3%

Amount issued: \$106 million

Conversion price: \$27.75 per share

Recent stock price: \$10 per share

Centocor Inc. is one of the fallen angels in the biopharmaceutical industry. Located in Malvern, Pennsylvania, Centocor utilizes monoclonal antibody technology to develop diagnostics and therapeutics that deal with cardiovascular, cancer, and autoimmune diseases.

The company's most promising product was Centoxin, which treats gram negative sepsis and septic shock and could be the world's first human monoclonal antibody pharmaceutical. However, in April last year, the US Food & Drug Administration (FDA) turned down Centocor's new drug application, citing insufficient evidence of efficacy of Centoxin. In June 1992, Centocor initiated a second Phase III trial but finally terminated it because of unsatisfactory interim results. Centocor and its marketing partner Eli Lilly suspended all sales and conducted a recall of Centoxin in Europe and elsewhere where it had been authorized for sale.

Centocor's stock price reacted sharply to the bad news. It fell 20% to \$33 from \$41 per share on Feb. 18, 1992, and it fell another 40% to \$18 from \$31 on April 14, 1992. From the historic high of \$60 in December 1991, it fell to \$5 in April this year.

Based on factors discussed below, we believe the market has undervalued Centocor's stock, which is ready for a rebound. In fact, the stock has already moved up to \$10 per share recently.

Centocor's current and potential products

Diagnostics: Centocor has a basket of diagnostics products that aim at cancer diseases. Its products include *in vitro* assays for ovarian, pancreatic, breast, and gastric cancer. The diagnostics product line has experienced consistent sales and earnings growth. Since 1983, sales have grown steadily, rising to approximately \$45 million last year. Marketed and distributed by collaborative partners, diagnostics has been an important source of cash flow to Centocor.

Centorx: Centorx is an anti-coagulation agent used in coronary angioplasty. Angioplasty is an operation that inserts a balloon to expand a blocked coronary artery. The operation very often irritates the artery's wall and causes platelets to aggregate and form clots, which can be fatal.

Currently, approximately 300,000 angioplasty surgeries are performed annually in the US, and the worldwide market size is estimated at \$275 million.

In a Phase III trial with 2,099 high-risk angioplasty patients, the use of CentoRx together with standard anticoagulant therapy resulted in a 35% drop in clot-related complications. A Phase III trial of CentoRx in unstable angina patients will start shortly.

Although CentoRx shows strong potential, clinical trials indicated that it has been associated with increased incidence of bleeding. Furthermore, according to David T. Molowa of Bear Stearns & Co. Inc., competing anticoagulants from Biogen and Ciba-Geigy may be available in the near future. As a result, there is doubt whether CentoRx can be a home-run drug. Centocor is prepared to file product license applications for CentoRx in the U.S. and Europe this year. If it receives due regulatory approvals, commercial sales can start in late 1994.

Financial position and business strategy

Despite diagnostics sales, Centocor has suffered losses three years in a row. Before 1990, the payments from associated R & D limited partnerships kept the company profitable. At the end of June 1993, its cumulative deficit was \$602 million.

In anticipation of Centoxin's approval, Centocor started in 1991 to build up inventory and a sales organization to market the product. Therefore, the amount of overhead skyrocketed (226% in 1991). Following the FDA disapproval of Centoxin, the company took an inventory writedown of \$65 million in 1992. Centocor also has taken \$24 million restructuring charges mainly to reduce its workforce. Its goal is to cut its payroll from 1,500 at the beginning of 1992 to 500 by the end of this year.

David Holveck has stepped in as Centocor's CEO since the failure of Centoxin. He has engineered a major strategic change for Centocor's therapeutics business by positioning it as an R & D and manufacturing company.

Centocor entered into a marketing and distribution agreement with Eli Lilly. Under the agreement Lilly has the worldwide marketing rights to CentoRx and will assist Centocor in preparing and submitting worldwide regulatory filing.

Just recently, Centocor formed another partnership with Wellcome Plc, a British pharmaceutical company, to develop and market cancer drugs, which include Panorex. The partnership calls for Wellcome Plc to purchase two million new shares of Centocor at an above-market, but undisclosed, price and make milestone payments.

We believe the new strategy to seek marketing partnerships for its products makes strong sense as Centocor's core competence is in R & D and production rather than distribution.

Owing to the strategic change, Centocor has been able to reduce its overhead considerably and thus conserve cash. One of investors' major concerns about Centocor has been its rapidly deteriorating cash position. However, since David Holveck became CEO, he has reduced the company's quarterly cash burn rate (net cash outflow from operations) from \$50 million in 1992's first quarter to \$30 million in 1992's last quarter. The cash burn rate for the first half of 1993 was further reduced to \$31 million, which exceeded his publicly stated goal of \$35 million. According to Centocor's manage-

ment, their goal is to reduce the quarterly cash burn rate to \$10 million in the third quarter and \$5 million in the fourth quarter of this year.

Although impressed by Centocor's cash burn rate improvement, we believe it will be difficult for them to reduce the quarterly rate to \$5 million per quarter before sales of CentoRx start, which is expected in late 1994.

Following the sale of its St. Louis plant to Chiron Corp. and the Wellcome partnership, Centocor should have approximately \$143 million in cash, \$116 million of which is unrestricted. The capital injection by Wellcome has largely relieved Centocor of a short-term liquidity problem, which we expected to occur in late 1994.

Its current ratio and debt to market capitalization ratio are 3.9 and 0.71, respectively, which are reasonably safe levels.

Valuation of security

We will value the 7¼% convertible notes of Centocor based on an optimistic outlook and a pessimistic scenario to estimate both the upside potential and downside risk.

In the optimistic outlook, CentoRx will gain worldwide approval by the end of 1994 and become a widely acceptable therapeutics product for angioplasty. Its market share will start at 20% and gradually increase to 35%-40% in approximately three years.

On the other hand, Centoxin will be approved based on a very narrow application for pediatric patients (for which trials are being conducted). In this scenario, Centocor will resume profitability in 1996 and will achieve a projected earnings per share of \$1.03 in 1997.

Based on annual sales growth of 30%-35%, the stock may trade at approximately \$31, representing a price-earnings multiple of 30. However, the presence of outstanding stock warrants will have a substantial dilution effect. If the stock trades at \$31 in '97, approximately 8.4 million shares will have to be issued to warrant and option holders, depressing the stock price to \$26. Therefore, appreciation to the conversion price of \$27.75 per share may be delayed to early 1998.

If the 7¼% notes can be converted in March 1998, they will generate an annual yield of approximately 13.3%.

* * * * *

A pessimistic scenario assumes that although CentoRx is duly approved, it can achieve only a limited market acceptance because of the side effect and competitive products.

Because of the limited potential of CentoRx, Centocor may find it difficult to obtain further financing and may have to sell the company to competitors. In the biotech industry, companies are worth much more as a going concern than on a liquidation basis, owing to the intrinsic value of R & D conducted. In the case of Centocor, it has an established diagnostics business; CentoRx (and Panorex, an anti-cancer drug) will command a premium based on the clinical trials and regulatory approval. We believe that some pharmaceutical companies that have gaps in their product lines or have patents expiring soon will be interested in buying new technology from fallen angels such as Centocor.

A conservative estimate of Centocor's value as a sale candidate is based on its diagnostics business, CentoRx and Panorex. The following assumptions are used:

	Diagnostics	CentorRx	Panorex
Annual sales	\$48m	\$41m	\$37m
Net margin	12%	15%	25%
Sales growth	10%-15%	20%-25%	30%-35%
P/E	15	20	20
Timing	1993	1995	2000
Discount rate	0%	25%	25%
Present value	\$87m	\$79m	\$44m

Based on the above assumptions, the estimated total asset value of Centocor is approximately \$210 million. On the other hand, the current book value of Centocor's total debt is approximately \$312 million (\$267 million long-term debt plus \$45 million short-term liabilities). Consequently, the asset coverage is 67¢ per dollar of debt.

Since Centoxin and other products in the pipeline are not included in the valuation, the downside risk of the convertible notes is more likely to be a 10% to 15% loss based on the current price of \$80.

STRATEGY: *Weith an 11.3% yield to maturity Centocor's 7¼% convertible notes offer investors an attractive return and limited downside risk. The convertible notes will realize significant appreciation once the market recognizes that Centocor's stock is undervalued. Henceforth, Friedberg Mercantile Group will be making a continuous market in this security.*

TWA revisited and a new recommendation

Security: 15% Senior Secured Notes

Recent price: \$106.35

Status: In default, to be exchanged for cash and new notes

In our analysis of TransWorld Airline's bonds in June, we recommended the 16% and 17.25% senior unsecured notes as a highly speculative investment with a high potential return. We also stated that the 15% senior secured notes provided too low a yield against the risk.

We now have changed our recommendation to buy on the 15% notes. TWA increased its offer of cash and new five-year notes to the creditors of this class in August in order to ensure approval of its reorganization plan. Under the new offer, each \$1,000 face value of 15% note will be exchanged for approximately \$440 in cash and \$940 face value of new 10%, five-year notes. The previous offer was \$430 cash and \$683 face value of new notes. The new five-year notes will have all interest payments in cash (versus PIKs for the new seven-year notes) and mature on Aug. 1, 1998.

The potential return on the 15% notes depends on how much the market values the new notes. We believe the new notes will be trading to yield between 13% and 17%, which represents a spread of approximately 8% to 12% above US Treasury yield. At a 13% yield, the new five-year notes will be trading at \$89.40 and generate an appreciation of 20% for the 15% noteholders. On the other hand, even at a 17% yield, the potential appreciation is still 10%.

The probability distribution of our yield estimate of the new notes is heavily skewed toward 13%, because all interest payments are in cash rather than PIKs and the collateral is very strong. The new notes are secured, on a first priority lien basis, by TWA's landing slots at various airports (JFK, LaGuardia, and Washington National), and its spare parts inventory.

Based on an appraisal conducted by Avmark Inc. in 1990 (the most updated appraisal is not available), the landing slots carried a market value of approximately \$89 million. While the same appraisal on TWA's spare parts inventory is no longer valid because of the substantial reduction in fleet size, the book value of spare parts inventory as at June 30, 1993 was \$187 million.

We believe the landing slots, which are rights to schedule arrivals or departures within designated hours, have increased in value by at least 10% over the past three years on top of inflation because of rising demand and limited airport capacity. Therefore, the estimated current value of these slots is approximately \$110 million. Furthermore, to be conservative, we assumed a 30% discount on the spare parts inventory in case of a liquidation sale, which brings the market value down to \$133 million. Consequently, the estimated market value of all collateral is about \$243 million. With a projected \$303 million face value of new notes to be issued, the coverage is 80%.

TWA's reorganization plan was declared effective on Sept. 7. We expect the new securities to be issued on Oct. 1. Therefore, the projected appreciation of the 15% notes may be realized in about one month. If an investor holds the new notes to maturity, the projected annual return on the 15% notes will increase to 22% based on a 13% yield. However, we recommend taking profits by selling the new notes shortly upon receipt as the extra 2% return is not worth the default risk.

In addition to this new recommendation on the 15% notes, we maintain our buy recommendation on the 16% and 17.25% senior unsecured notes. These notes are much riskier owing to the more speculative nature of the seven-year notes to be exchanged into, the preferred and common stock components, and weaker collateral. However, the common share component also increases the upside substantially. TWA's new common stock, to be traded on the American Exchange, is currently valued at \$4 to \$5 per share, but our valuation indicates that it can trade up to \$11 per share eventually.

STRATEGY: *The 15% senior secured notes of TWA represent a different play from the 16% and 17.25% senior unsecured notes that we recommended before. The 15% notes offer a 15% to 20% appreciation potential in a relatively short time horizon and are well collateralized. Henceforth, Friedberg Mercantile Group will be making a continuous market in this security.*

— Edison Lee

Chart 4

RECOMMENDED CURRENT PORTFOLIO ALLOCATIONS	
TWA 15%	10%
TWA 17¼%	5%
New Zealand Gov't 10%	8%
Fletcher Challenge (NZ\$)	8%
Selected US\$ CV Bonds	21%
Deutschemark Bonds	26%
Argentina US\$ BOCON	22%

**Chart 5
FOREIGN CURRENCY BONDS**

Date: September 23, '93 We Offer The Following Bonds Subject To Change Without Prior Notice: Minimum US \$4,000 (CDN. \$6,000)

ISSUER/MATURITY DATE/COUPON	BID	OFFER	CURR. ANNUAL YLD. TO MTY.	NEXT PAYMENT INTEREST DATE
DEUTSCHE MARK DENOMINATED				
BANK OF NOVA SCOTIA 5 $\frac{1}{8}$ % 07/05/96 RRSP eligible	99.10	99.95	5.63 %	May 07
WORLD BANK 5 $\frac{7}{8}$ % 4/02/97 RRSP eligible	101 $\frac{1}{2}$	102.35	5.08 %	Feb. 04
WORLD BANK 9% 13/11/00 RRSP eligible	118.20	-	-	Nov. 13
KINGDOM OF DENMARK 6 $\frac{1}{8}$ % 15/04/98	100.30	101.15	5.82 %	Apr. 15
FINNISH MARKKA DENOMINATED BONDS				
REP. OF FINLAND 11% 15/6/95	106.30	107.15	6.45 %	Jun. 15
ITALIAN LIRA DENOMINATED BONDS				
NORDIC INV. BANK 12 $\frac{3}{8}$ % 19/04/96	107.15	108	8.69 %	Apr. 19
GENERAL ELECTRIC 11 $\frac{1}{2}$ % 7/02/95	102.65	103 $\frac{1}{2}$	8.56 %	Feb. 07
SWISS FRANC DENOMINATED BONDS				
GENERAL ELECTRIC 4 $\frac{3}{4}$ % 2/7/98	102.30	103.15	4.01 %	July 02
DANISH KRONE DENOMINATED BONDS				
KINGDOM OF DENMARK 9% 15/11/94	100.30	101.15	7.86 %	Nov. 15
ECU DENOMINATED BONDS				
UNITED KINGDOM 9 $\frac{1}{8}$ % 21/02/01	113.05	113.90	6.67 %	Feb. 21
BRITISH POUND DENOMINATED BONDS				
KGDM OF SWEDEN 8 $\frac{3}{4}$ % 29/5/96	105 $\frac{1}{2}$	106.10	6.17 %	May 29
FRENCH FRANC DENOMINATED BONDS				
CREDIT LYONNAISE 9 $\frac{1}{2}$ % 23/12/96	108.60	109.45	6.17 %	Dec. 23
JAPANESE YEN DENOMINATED BONDS				
WORLD BANK 5 $\frac{3}{4}$ % 7/8/96 RRSP eligible	106.95	107.80	2.86 %	Aug. 07
CANADIAN DOLLAR DENOMINATED BONDS				
ONTARIO HYDRO 10 $\frac{7}{8}$ % 08/01/96 (semi annual)	108.45	109.30	6.50 %	Jan. 08
EKSPORTFINANS 7 $\frac{3}{4}$ % 5/11/97	102.15	103	6.88 %	Nov. 05
ROYAL BANK OF CANADA 9 $\frac{1}{8}$ % 7/1/97	104 $\frac{3}{4}$	105.60	7.12 %	Jan. 07
SOUTH AFRICAN RAND DENOMINATED BONDS				
ESCOM 12% 1/5/96 (semi)	100.90	101 $\frac{3}{4}$	11.50 %	Nov. 1
AUSTRALIAN DOLLAR DENOMINATED BONDS				
COMMONWEALTH BANK OF AUSTRALIA 14% 01/07/94	105 $\frac{1}{2}$	106.10	5.38 %	Jul. 07
NEW ZEALAND DOLLAR DENOMINATED BONDS				
NEW ZEALAND GOV'T 10% 15/7/97 (semi)	113 $\frac{3}{4}$	114.60	5.67 %	Jan. 15
FLETCHER CHALLENGE 10.15% 30/11/98 (semi)	107.30	108.15	7.81 %	May 30
ARGENTINEAN PESO DENOMINATED BONDS				
ARGENTINA BIC V FIXED/FLOATING 1/05/2001 callable in full on every interest date	95.09	95.94	12.86 %	4th day of mth.
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS				
DATAPOINT CORP. 8 $\frac{7}{8}$ % 1/6/06 CV @ \$18.11 p/sh (semi)	81	82	11.96 %	Dec. 01
BURNUP & SIMS 12% 15/11/00 (semi) CV @ \$16.79 p/sh	89 $\frac{1}{2}$	93 $\frac{1}{2}$	13.89 %	Nov. 15
ATARI CORP. 5 $\frac{1}{4}$ % 29/4/02 CV @ \$16.31 p/sh	59	61	13.05 %	Apr. 29
COEUR D'ALENE 6% 10/6/02 CV @ \$26.00 p/sh	102 $\frac{1}{2}$	104	5.41 %	Jun. 10
GLYCOMED 7 $\frac{1}{2}$ % 1/1/03 CV @ \$14.06 p/sh (semi)	86	87	9.89 %	Jan. 1
T.W.A. 15% 31/7/94	105 $\frac{1}{2}$	106.35	-	in default
T.W.A. 17 $\frac{1}{4}$ % 15/3/93 (in Chapter 11 bankruptcy)	32	34 $\frac{1}{2}$	-	in default
U.S. DOLLAR DENOMINATED FIXED RATE BONDS				
FARM CREDIT CORP. 7 $\frac{3}{4}$ % 10/06/96 RRSP eligible	106.90	107 $\frac{3}{4}$	4.61 %	Jun. 10
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES				
UNITED KINGDOM 30/09/96 3 mo. LIBID- $\frac{1}{8}$ (qtlly) *callable @ 100	99.72	100.02	3 $\frac{1}{8}$ %	Sept. 30
BOCON 1/4/01 (30 day LIBOR) starting to accrue May 1, '97	82.15	83	8.99 %	May 1/97
ARGENTINA: SERIES L: FRB 31/03/05 6 mo. LIBOR + $\frac{13}{16}$ (semi)	74	75	11.03 %	

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

HOTLINE UPDATE

Flash update, Friday, July 30, 10:20 am:

Reenter the long side of December gold, presently trading at 406, placing tight stops at 402 good anytime.

Friday, July 30:

This is a complete summary since our last market letter, dated June 27, of all liquidations of open positions and new recommendations that remain outstanding.

On Tuesday, July 13, we advised retaining or adding to the short French franc long/deutschemark position. On Friday, July 30, via flash update, we bought December gold at 406.00, placing initial stops at 402.00, good anytime.

Flash update, Tuesday, August 3, 11:05 am:

The new market letter is in the mail. It recommends the purchase of September deutschemark, currently trading at 58.48, with stops at 57.25, good anytime.

Flash update, Wednesday, August 4:

Sell long December gold position at market, cancelling 402 stop, later changed in market letter placed August 1, to 388, stop close only.

Friday, August 6:

This is a recap of this week's recommendations. On Tuesday, August 3, we recommended purchasing September deutschemark at 58.48; stops were placed at 57.25, good anytime. On Wednesday, August 4, we recommended the sale of December gold at market. Gold opened Thursday, August 5 at 400.70.

Friday, August 13:

There is one new recommendation: Sell September Australian dollar at the market; place initial stops at 69.50, good anytime. As well, the following is a recap of the recommendations for the past two weeks:

On Tuesday, August 3, we recommended purchasing September deutschemark at 58.48; stops were placed at 57.25, good anytime.

On Wednesday, August 4, we recommended the sale of December gold at the market. Gold opened on Thursday, August 5, at 400.70.

Tuesday August 17:

We have two new recommendations.

1. Sell September Canadian dollar at the market; place stops at 76.40, close only.
2. Sell September Australian dollar at the market; place stops at 69.50, close only.

Friday, August 20:

The following is a recap of this week's recommendations. On Tuesday August 17, we made two recommendations.

1. The sale of Canadian dollar at the market, placing stops at 7640, close only. September Canadian dollar opened August 18 at 75.63.
2. The sale of September Australian dollar at the market, placing stops at 6950, close only. September Australian dollar opened on Wednesday, August 18 at 6747.

Flash update, Monday, August 23, 6:10 pm:

There are two new recommendations.

1. Buy December gold at tomorrow's opening, risking 366, good anytime.
2. Buy December silver at tomorrow's opening, risking 4.50, close only.

Tuesday, August 24:

As per our flash update on Monday August 23: On Tuesday morning August 24, we bought December gold at approximately 375.50; stops were placed at 366, good anytime. On Tuesday morning August 24, we bought December silver at approximately 4.80 1/2; stops were placed at 4.50, close only.

Friday, August 27:

The following is a recap of this week's recommendations. On Tuesday, August 24, we bought December gold at approximately 375.50; stops were placed at 366.00, good anytime.

On Tuesday, August 24, we bought December silver at approximately 480 1/2; stops were placed at 4.50, close only.

We have one new recommendation. Place stops on long September deutschemark position to 58.30, close only from 57.25, good anytime.

Tuesday, August 31:

There are no changes or new recommendations.

Friday, September 3:

There are no changes or new recommendations.

Tuesday, September 7:

There is one new recommendation. Raise deutschemark stops to 59.50, basis December from 58.30, basis September, close only.

Flash update, Friday, September 10, 8:27 am:

Cover short September Canadian dollar positions at the market, currently trading at 7607, cancelling 7640 stop, close only.

Flash update, Friday, September 10, 9:08 am:

Sell short December gold at the market, currency at 351, and sell short December silver at the market, currently at 4.20.

Earlier today at 8:27 am we flashed to cover short Canadian dollar at the market, trading then at 76.07, cancelling 76.40 stop, close only.

Friday, September 10:

The following is a recap of all the recommendations given this week.

On Tuesday, September 7, we raised the deutschemark stops to 5950, close only, basis December from 58.30, close only basis September.

Today, Friday, September 10 at 8:27 am, via flash update, we covered short Canadian dollar positions at approximately 76.07, cancelling the 7640 stop, close only.

Also, today at 9:08 am via flash update, we sold short December gold at approximately 351.00 and sold short December silver at approximately 4.20.

Place the following stops: 359.20, close only, for December gold and 4.32, close only, for December silver.

Tuesday, September 14:

We have one new recommendation: Liquidate long Euroyen future positions for call options at market. Weekend wrap-up will be tomorrow, Wednesday 15.

Wednesday, September 15:

This is a recap of this week's recommendations.

On Tuesday, September 14, we recommended liquidating long the Euroyen futures and options positions at the market. December yen opened at approximately 97.33. Next update will be Tuesday, September 21.

Flash update, Monday, September 20:

Cover December gold and December silver short positions on opening at the market, cancelling stops in gold of 359.25, close only and stops in silver of 4.32, close only.

Tuesday, September 21:

There is one new recommendation. Cover short Australian dollar position at market, cancelling 69.50 stop, close only.

As per our flash update last night, we covered our December gold short position at approximately 355.30 and our December short silver position at approximately 413 1/2.

Flash update, Thursday, September 23, 2:45 pm:

Cover all short crude oil positions and liquidate all crude put options at the market. November crude oil is presently trading at 1765.

Friday, September 24:

This is a complete summary since our last market letter, dated August 1, of all liquidations of open positions and new recommendations.

On August 4, via a flash update, we advised liquidating long December gold position at the market, cancelling the 388 stop close only. December gold opened August 5 at 400.70.

On September 14, we advised liquidating all Euroyen future positions and/or call options at the market. December Euroyen opened on September 15, at approximately 97.33.

On September 23, via flash update, we advised the liquidation of all long crude put options and short futures positions. November crude was then trading at 17.65.

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