

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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### The bullish case for the US dollar

Let there be no doubt whatsoever: The US dollar has commenced a sustained cyclical uptrend.

Vague and imprecisely apprehended economic and political forces are propelling the US unit higher. This is as it should be. In the early phases of a trend the "fundamentals" are neither clear nor obvious. Trend maturity is reached as fundamentals come into clearer focus. When nearly everyone understands the argument, the trend has come to an end.

Behind this well-known phenomenon lies the following explication: *Faint changes* are only perceived at the margin. Marginal players initiate the trend, call it an uptrend (the same is true on downtrends). As the changes are better and more widely understood, assets become more efficiently priced. Once enough participants understand the fundamentals behind the trend, prices reach a sort-of equilibrium, as sellers, too, come to understand the dynamics behind the move and insist on fair prices. The persistence of the uptrend convinces the most unsophisticated players — those who do not pay attention to fundamentals — of the continuation of the uptrend: Momentum buyers produce the overshooting effects so common to long trending markets.

What the latter group fails to realize is that *normally* markets are not about trends but about *levels*. Trends exist only for the purpose of reaching "equilibrium" levels in much the same way as a person is unable to get to the corner, if indeed that is where he is heading to, unless he walked there.

Having said that, however, we now make a retraction: The currency markets in particular are an exception to this rule.

They suffer from indeterminacy (see our Comments of April 21, 1991, and August 5, 1991) — that is, they do not enjoy *precise* equilibrium levels, but rather extremely wide ranges. And the reason is simple: Trade in goods and services, which ought to put relatively precise equilibrium levels on currency values (the rationale behind "purchasing power parity" theories), no longer represents the largest (or even a large) component of currency flows between advanced nations. This distinction has passed to *capital flows*, which are insensitive in large measure — and in the near to medium term — to currency levels and which instead respond to returns and anticipated returns.

Well understood, this concept is an extremely powerful trading tool. It says that once begun, currency trends will go on *indefinitely*, pushed to unheard-of and irrational levels, unless... Unless an unexpected event occurs that forces a major reappraisal. Or unless central banks, *concertedly*, indicate that they no longer agree with these levels. It is only then that the trend ends, aided by the fact that emotional latecomers have left the market in an extremely vulnerable overbought

condition, ripe for a substantial counter-reaction. As the back of the speculative bandwagon is broken, fundamentals can begin to re-assert themselves; *the markets move back towards equilibrium*.

The Plaza and Louvre Accords and the concerted central bank intervention in late 1990 and 1992 marked the turning point of successive waves of trend-following speculation. So was the most recent episode of Bank of Japan and Federal Reserve intervention around the ¥100 level.

Even though the "stale" trade surplus story was so well understood — and should not have had a significant impact on the market — the yen continued to rise, accompanied by pronouncements coming from US and European official spokesmen, feeding the momentum players. While fundamentals had changed — the ¥100 to ¥120 level was destroying the export factor, an absurdity in view of the deepening three-year contraction — the bull run did not stop of its own accord. This proved to the Authorities that currency markets lacked determinacy. Thus, the heavy concentrated intervention of mid-August.

That the fundamentals have changed in favor of the dollar there is little question. Economic activity in the US has been gaining momentum, despite the sluggish GDP readings (see Chart 1 constructed by Richard M. Salsman of H.C. Wainwright & Co. who predicates the superiority of the

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Contributions by Albert D. Friedberg, Dr. Steve H. Hanke, David R. Henderson, 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.

Business Week Index of Industrial Output). Loan demand continues to improve (see Chart 2) foreshadowing an almost inevitable rise in interest rates. And while Eurosclerosis (see next article) may yet come to these shores, it remains a longer-term problem.

Europe, on the other hand, continues to be gripped by an industrial slowdown/recession, which in the context of perverse labor policies, produces high unemployment rates and despairing budget deficits. This strong asymmetry in economic activity (to come into much clearer focus over the next 12 to 18 months) coupled with continued political unrest in the former Soviet Union and war in the Balkans guarantees US-bound capital flows.

At the same time, the refusal of the Japanese authorities to revive their economy by way of substantial tax cuts leaves them with only one choice: an externally-led recovery. This will require a cheaper yen, since in real terms Japan's trade surplus is contracting rather dramatically.

The worldwide slowdown in economic activity and the consequent rise in unemployment has fostered a beggar-thy-neighbour attitude. Even the mighty Germans in announcing their surprise cut in the discount rate to 5¼% alluded to the effective revaluation of the deutschemark since the end of July: 2% against its ERM relations, 3.6% against the basket of 20 other important currencies, and 5.5% against the US dollar. Mr. Hans Tietmeyer, the new Central Bank president, noted that this was not helpful to an export-based economy

trying to escape the clutches of recession.

The implications are clear: Europe and Japan, heavily dependent on exports to lift them out of their economic misery, will need to see their currencies depreciate. The US on the other hand, in better economic shape and not nearly as dependent on exports for its health will countenance, at least initially, a rising currency.

This rather vague economic/political fact of life will come into much clearer focus before the end of the year as we approach the final deadline for the Uruguay Round of trade negotiations. In a protectionist world, capital will flee to the most economically independent area. The US fits the bill as the most autarchic state.

In sum, we look for a bull market in the US dollar, of indeterminate duration and magnitude, but one that should see, at the very least, a return past purchasing power parity levels.

**STRATEGY:** We are out of long DM positions as per Hotline Update of October 18, accepting handsome profits, and we are short Japanese yen as of Hotline Update October 18. While we believe that the US dollar will rise significantly against all European currencies and the Japanese yen, clearly the greatest excess has occurred in the dollar/yen and yen/DM areas. Therefore, our preferred speculative position is short yen. Next, we would be short French francs, Belgian francs, and Spanish pesetas. And finally, DM.

Chart 1

Relative Movement of Three Output Measures Since the Recession  
August 1988 - August 1993

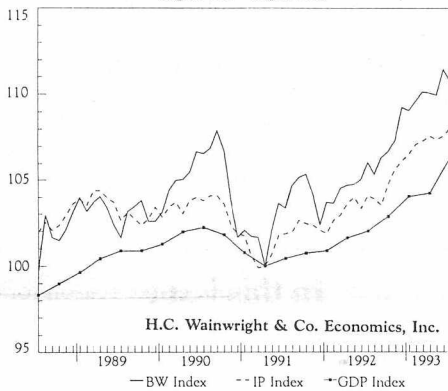


Chart 2

U.S. COMMERCIAL BANK TOTAL LOANS  
6-MONTH COMPOUNDED ANNUAL RATES OF CHANGE

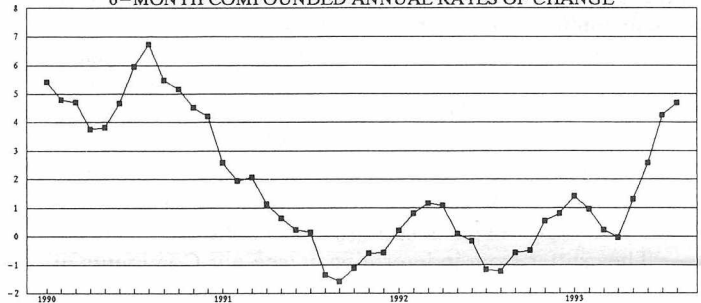


Chart 3 - YEN (NEAREST CONTRACT)

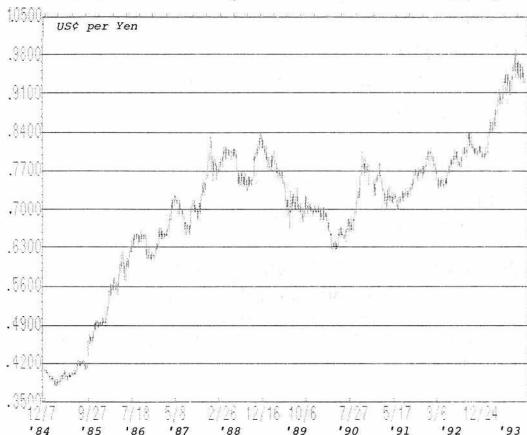
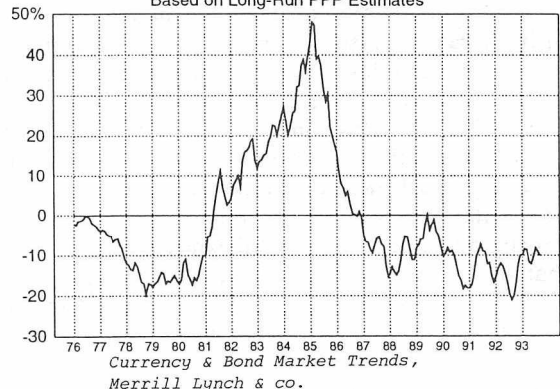


Chart 4

U.S. Dollar Index: Percent Over/Under Valued  
Based on Long-Run PPP Estimates



**LABOR MARKETS**

# Eurosclerosis spreads to our shores

by David R. Henderson

Wouldn't you think that the stellar growth in U.S. jobs in the 1980s, especially compared with Europe, would make our politicians want to avoid the policies that caused Eurosclerosis? Well, think again. Imitating European labor market policies is exactly what President Bush did to some extent, and what President Clinton is doing faster.

Although the U.S. unemployment rate at the end of the 1980s was less than those of the major European Community countries, the scariest difference is between long-term unemployment rates. In 1989, only 1.2% of the U.S. labor force was unemployed for 13 weeks or more. This compares with 8.1% for France, 7.3% for Italy, 6.9% for the Netherlands, 5.2% for Britain, and 4.6% for Germany. The difference is even scarier for very long-term unemployment. More than half of the people in the EC countries who were unemployed were out of work for a year or more, compared with only one in 16 in the U.S.

## Subsidized Unemployment

When a large fraction of the unemployed population is out of work for more than a year, economists tend to suspect government. The reason is simple: Those unemployed people who are just casually looking or who insist on nothing less than the ideal job will stay unemployed long-term only if they are independently wealthy or if the government subsidizes their unemployment. Those who badly want to work will typically find it in much less than a year if the government does not prevent them from finding it. So the culprits to look for to explain high long-term unemployment are government subsidies that discourage people from finding jobs and government regulations that discourage hiring. Both were abundant in the EC economies in the 1980s and much less so in the U.S.

What is the main subsidy for not working? Unemployment insurance. The ratio of unemployment benefits to previous pay is typically higher in the EC countries than in the U.S. In 1988, a single 40-year-old previously employed at the average production worker's wage would get benefits equal to 59% of previous earnings in France, 58% in Germany and 70% in the Netherlands. Compare this with 50% for U.S. workers.

Unemployment benefits in the EC countries also last much longer. In Britain, for example, the maximum duration of benefits is one year. In France, an unemployed person can collect benefits for 2½ years. In the Netherlands, it is three years. Until recently in the U.S., by comparison, the maximum time to collect has been only six months. The greater benefits and longer duration of benefits in the major EC countries are a primary cause of high long-term unemployment.

But European governments are not content to subsidize people not to work. They also actively and intrusively discourage companies from hiring. How? The Italian government makes companies rank job candidates by criteria chosen by the government. There are two main criteria: The larger the candidate's family and the longer the person has been unemployed, the higher is his ranking. Note that the second criterion is likely to be negatively correlated with the person's productivity.

The governments of Austria, Denmark, Finland, Greece, Italy, Spain and Sweden give their own employment agencies a monopoly. For-profit employment agencies are illegal. The governments of Belgium, France, Germany and Norway permit for-profit employment agencies, but only for filling temporary jobs.

Some European governments even regulate the advertising of job vacancies. In Spain, according to the Organization for Economic Cooperation and Development, "It appears to be illegal to advertise a job at all until a contract of employment for it has been submitted to, and approved by, the [government] placement service." All such restrictions discourage hiring.

Nor can a typical employer in Europe just decide to fire someone. In Germany, an employer must give an employee two to three months' notice and must consult the government's Works Council. If the council vetoes the dismissal, the employer must appeal to the Labor Court, all the while keeping the employee on the payroll. The penalty for an "unfair" dismissal: one month of pay for every year of service.

In Italy, the restrictions on firing are even more stringent. The employer must supply proof of the reason for dismissal and the reason must be "just." The employee may demand a meeting with the trade union and the employer, a hearing and an appeal to the courts. The compensation for "unfair" dismissal is not less than five months' pay. As one expert on such laws summed up the Italian law: "Dismissal [is] considered practically impossible except for criminal acts."

But shouldn't restrictions on firing reduce unemployment? No. 'Because employers know that such restrictions make jobs semi-permanent, they are less likely to hire in the first place. The data confirm this semi-permanence. Only 19% of employees in the EC in the late 1970s held their jobs for less than two years, vs. 39% for the U.S. in 1983.

Unfortunately, U.S. government officials — politicians and judges — are increasingly imitating the failed policies of Europe. In the past five years, all three U.S. presidents have helped implement policies that reduce the dynamism of the U.S. labor market. In 1988, President Reagan refused to veto

a law that requires companies employing more than 100 people to give 60 days' notice of any closure or layoff involving 50 or more full-time employees. Though the law is full of exemptions and has not, therefore, had much effect, it is still a significant step in the wrong direction. As in Europe, the long-run effect will be to make employers less likely to hire.

President Bush did his share, too, by signing the Americans With Disabilities Act in 1990. The ADA bans discrimination against disabled people, and defines disability as a mental or physical impairment that "substantially limits" one or more "major life activities," which include walking, talking and breathing. The law explicitly counts as disabled those with a history of alcohol and drug addiction.

The ADA will hurt employment in three ways. First, employers will carefully try to figure out whether a job candidate has disabilities that will cost the employer once the candidate is hired. And second, the law will encourage firms with 15 employees or slightly more to cut employment down to 14. That way, they will be exempt from the law.

After less than a year in office, President Clinton has already done much to discourage employment. In March, he and Congress passed a law that extends unemployment benefits by 20 weeks in states with low unemployment rates and by 26 weeks in high-unemployment states. Mr. Clinton's own chief labor economist, Lawrence Katz (along with his co-author, Northwestern University's Bruce Meyer), showed that an earlier 13-week extension increased the duration of unemployment substantially. And Mr. Meyer estimated in April that such a 13-week extension, if implemented today would cause a 0.4-percentage-point increase in the unemployment rate. Mr. Clinton's two- to 26-week extension will increase

unemployment even more. And if Labor Secretary Robert Reich gets his way, and the minimum wage is raised, the negative effects will be felt by those the administration purports to help — unskilled and inexperienced workers.

### Unequal Treatment

Courts are also placing many burdens on employment. Before the 1970s, U.S. courts subscribed to the "at will" doctrine for employers. Employers were free to terminate employees at will, just as employees are free to quit at will. But since the 1970s, U.S. courts have chipped away at this equal treatment of employers and employees. In April, for example, the California Court of Appeal upheld a \$5.1 million damage award in *Hunio v. Tishman Construction Co.* Mr. Hunio, a construction manager, had walked off a major project because, he said, a customer was "abrasive and abusive." When he came back, he claimed, the company gave him only minor projects, left him idle much of the time and denied him a raise and a Christmas bonus. The jury awarded him \$2 million for "emotional distress" and \$1 million in punitive damages. Such decisions give employers pause about hiring in the first place.

The 1980s showed us that avoiding European-style regulation creates jobs. Yet we are moving in the direction of Europe. We must reverse course now, before a new term is coined, Ameriscclerosis.

*Mr. Henderson is a research fellow at Stanford's Hoover Institution and editor of the Fortune Encyclopedia of Economics. This article is adapted from the fall issue of The Public Interest.*

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## FRENCH FRANC

# The French, too clever by half

For the better part of a year, we have argued that France's economy, as well as its social and political stability, would suffer under the *franc fort* policy (see: "Demise of the Franc Fort," *FC&CC*, December 20, 1992). Since our piece last month ("France: Sans Fundamentals"), evidence has been reported that continues to support our position. For example, the plunge in asset prices has wreaked havoc on French banks. Consequently, their credit ratings have continued to slide: The average French bank is now rated BBB+; in 1985 their rating was AA. Businesses' balance sheets have also been victimized. It's not surprising, therefore, that earlier this month, Dun & Bradstreet Schimmelpfeng estimated that insolvencies in France will increase by 14.4% in 1993 and that France will overtake Britain as Europe's insolvency champion.

\* \* \* \* \*

The political and social consequences of the *franc fort* policy have been even more devastating than the purely economic

ones, however. After the ERM debacle of August 2, the French politicians, in an attempt to save face and salvage the *franc fort* policy, began to fan the flames of nationalism. For example, on August 12, *Financial Times* ran a lead editorial, "An entente that remains elusive." In that leader, *F.T.* concluded that the French and Anglo-Saxon views about currency speculation are in sharp contrast with each other. The French treat speculative activity as immoral, whereas Anglo-Saxon countries consider it a legitimate and integral part of the free-market process.

The ink had not yet dried on your editorial before Mr. Edouard Balladur, France's prime minister, confirmed *F.T.*'s thesis. Indeed, on the evening of August 12 Mr. Balladur castigated speculators and called for reforms to clamp down on them. President François Mitterrand joined the French chorus the next day when he said: "I find it insane and immoral that speculation, using billions of dollars, can have its way against states representing their people's interests and upset the daily life of millions of people."

That French attitude is nothing new. In the good old tradition of the "terror," Mr. Michel Sapin, France's finance minister in the most recent socialist government, reacted to the events of September 1992 with remarks that were destined to gain him a prominent place in the foreign exchange annals. He said: "I will fight, we will fight, France and Germany will fight this speculation, which is based on no economic fundamentals. During the French Revolution such speculators were known as 'agioteurs' and then were beheaded."

Alas, as amusing as those primitive ideas about speculation and concomitant conspiracy theories might be to the Anglo-Saxon readers, they have sparked a dramatic rise in French nationalism. This dangerous trend now appears to be out of control. Indeed, the French, who are very, very clever, appear to be using their wits to outsmart themselves. As the British would say, the French have become "too clever by half."

\* \* \* \* \*

Evidence of the too-clever-by-half syndrome is becoming all too apparent. For example, the government, which subsidizes the French press, has begun a campaign of strong-arming the press. The heavy hand of the government has spiked interviews with Anglo-Saxon economists who are critical of the *franc fort* policy. This is rather ironic since most of the big prizes awarded by the French to their economists go to those so-called economists who snatch ideas from the English literature and translate them into French concepts and French language.

For those who might doubt the government's strong-arm tactics with the press, consider the following, which was reported in the subsidy-free satirical weekly, the *Canard Enchaîné*. After the events of August 2, the respected daily, *Le Figaro*, published several articles that were critical of the ERM and the *franc fort* policy. As a result, Prime Minister Balladur called the newspaper's owner, Mr. Robert Hersant, on the carpet; if the negative press didn't stop, *Le Figaro*'s subsidies would be curtailed.

The popular press has not been the only target of the government's strong-arm tactics. The high civil servants at the French treasury have put the word out that negative reports by independent analysts at financial institutions would not be appreciated. Specifically, two US-based institutions have been told that their French bond business would be jeopardized if they continued to report negatively on the sad state of the French economy.

\* \* \* \* \*

The nationalist flames have spilled over into the labor market, too. Consequently, strikes and labor market unrest are on the rise. Last week, workers at Air France occupied the runways

at Orly and Charles de Gaulle Airports, which both had to be closed. Ironically, Mr. Balladur used a nationalistic appeal in an attempt to defuse the situation, when he told strikers "to think of our country." At the same time, he indicated that he supported Air France's chairman, Mr. Bernard Attali, who is desperately trying to reduce costs at Air France in an attempt to stop the flow of red ink at that carrier. With Air France's costs 40% higher than the privately-held British Airways and Mr. Balladur's support of Mr. Attali's plan to cut 4,000 jobs and reduce bonuses paid for night, weekend and holiday work, it is clear that future confrontations are in the offing. These will, no doubt, spread to other sectors.

\* \* \* \* \*

Not surprisingly, the new burst of French nationalism has spawned a wave of protectionism, too. For example, the French are pushing the European Community not to cut its trade barriers on film and television programs, a snag in the services part of the GATT talks scheduled to conclude in December. Farm trade has also become an explosive issue. The French want to renegotiate the so-called "Blair House" accord on farm trade, because it is too tilted towards free trade. Failure of the Uruguay Round on trade liberalization would not only damage world trade, but more importantly, it would provoke a European political crisis and almost certainly another European monetary crisis.

Given the poor economic fundamentals and potentially explosive nationalistic atmosphere that has developed in France, why have the French been so reluctant to loosen monetary policy and relax the *franc fort*? To defend the franc in August, the Banque de France had to borrow heavily to buy francs. This left it with a huge deficit in its foreign reserves. The Banque has been rebuilding those reserves slowly but it is still in deficit. Consequently, the Banque has a speculative position: it is long francs and short foreign currencies. That will continue to be the case until it eliminates its deficit on its foreign reserve account. Consequently, the Banque will continue to be reluctant to let the franc fall rapidly until the deficit is eliminated. The day of reckoning is approaching, however. When it arrives, the French will again display that they have been too clever by half, and we will see more new lows on the franc.

– Dr. Steve H. Hanke

**STRATEGY:** *Near term, the DM will remain well supported around 3.48-3.49, while DM rallies should be contained in the 3.51-3.52 range. Longer term, as the French cover their reserve deficit, more aggressive central bank easing can be anticipated with further declines for the franc.*

**CANADIAN DOLLAR**

## Short again

The Canadian dollar bulls argue that on a purchasing power parity basis, the currency is cheap. What they do not realize is that Canada needs to generate a huge trade surplus to fund the outflows represented by direct investments abroad, a stubborn current account deficit, and a growing appetite for foreign securities. They do not need a cheap currency. They need a *super-cheap* currency.

Interestingly, the \$50-55 billion combined federal and provincial annual deficits represent Canada's largest source of foreign exchange, as a substantial portion of these financing requirements are funded abroad. This fact has profound consequences.

On the one hand, if the accretion of government debt continues at this pace, Canada's access to the international capital markets will be severely curtailed, even leading to a Latin American/type debt crisis. This would result in a series of substantial currency devaluations.

On the other hand, if Canadian governments attack their deficits via increased taxation, foreign borrowings would decrease, and private economic activity would slump. The decline in economic activity would deter foreign investors. Here too, the net result would be a depreciating currency.

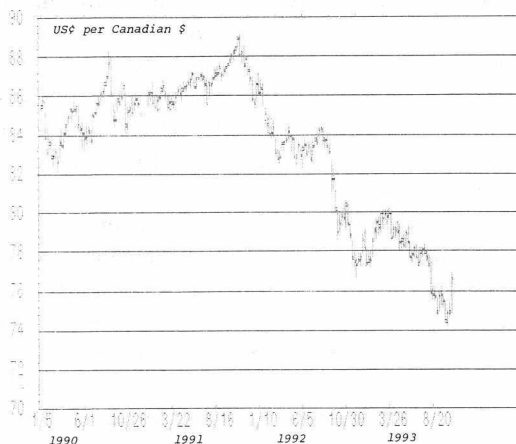
Damned if you do, and damned if you don't. Is there a way out? Is there a way that Canada can avoid a depreciating currency while resolving its fiscal conundrum? Yes. The unthinkable. A substantial cut in nominal public spending, with a promise to lower taxes in the outyears as the debt/GDP ratio begins to fall. The revitalized private sector would act as a powerful magnet to foreign capital, offsetting the decrease in foreign borrowings resulting from the smaller deficits.

Tomorrow's Federal election, which will almost certainly

usher in a left leaning, interventionist Liberal government may paradoxically represent the country's best long-term hope. When coupled with the ruling socialist provincial governments, *one cannot escape the conclusion that a very serious financial and economic crisis lies directly ahead.* And only such a deep and grave crisis can move the Powers That Be to adopt sensible economic policies. For useful historical precedents, refer to Mexico 1982, New Zealand 1984, Argentina 1990.

**STRATEGY:** *We were stopped out of an earlier short position (see Hotline Update of September 29). Reenter short side: Sell March 1994 Canadian dollar at the market placing stops at 78.10, close only.*

Chart 5 – C\$ (NEAREST CONTRACT)

**CRUDE OIL**

## The bear market resumes its course

OPEC's painless agreement of late September did little more than to stimulate a \$1/barrel rally. Output at somewhere between the targeted 24.5 million barrels per day and 24.7 million barrels per day (mbd) produced in September remains excessive.

There are of course those who believe that the fourth quarter call on OPEC oil will be more than 25 mbd implying withdrawals in excess of 500,000 bd. Some trade sources even expect fourth quarter drawdowns of as much as 1.1 mbd. But common sense says that these estimates are way off the mark.

In the first place, oil demand for the year, at 66.8 mbd is 200,000 bd less than the actual consumption in 1992 and it would represent the *first* annual decline in global oil demand since 1983. These International Energy Agency figures should be juxtaposed on Chart 6, which shows a secular uptrend in

global commercial oil inventories.

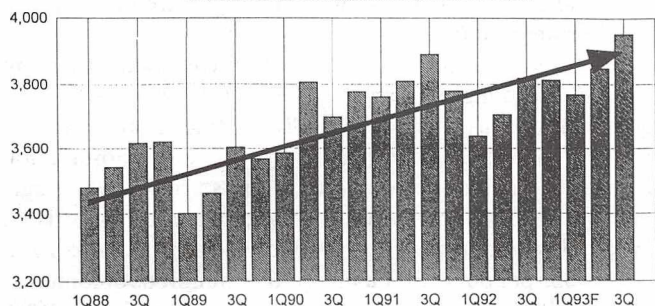
If these inventories are perceived to be excessive in relation to falling demand, the potential exists for them to be drawn down *voluntarily* by hundreds of millions of barrels, with the result that OPEC could find itself producing an unwanted 4-5 mbd. The bear case is further strengthened as we continue to see increases in FSU net oil exports because of plummeting economic activity (an event that we have been anticipating for the past number of years), a further 11% increase in Norway's crude oil production for 1994, and the inevitable resumption of Iraqi exports.

Single digits, in our view, are a foregone conclusion.

**STRATEGY:** *Sell March 1994 crude oil at the market. Buy deferred put options, as they still remain extremely cheap.*

Chart 6

Global Commercial Oil Inventories\*  
(in MM of barrels, by quarter)



\* Excludes the FSU & China, and emergency oil stocks held by Japan, Germany and the US  
Source: US DOE, IEA, Michael Rothman - Merrill Lynch Futures Research

Chart 7 - CRUDE OIL (NEAREST CONTRACT)

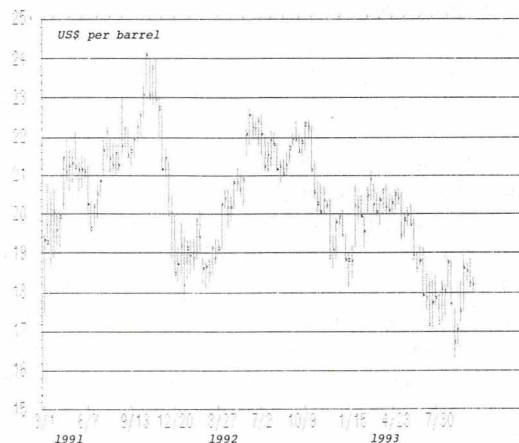
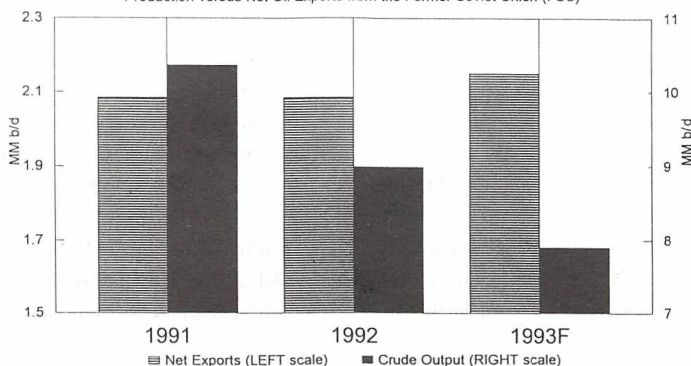


Chart 8

Production versus Net Oil Exports from the Former Soviet Union (FSU)



Source: IEA, Michael Rothman - Merrill Lynch Futures Research

**COMMODITIES**

**Gold: long-term bullish**

In response to the bullish article I wrote last month, several clients have asked how commodities' prices can rise in an environment of low inflation. The answer is that inflation is specific, not general. By that I mean the prices of certain asset sectors can (and will) rise independently of the overall price level (as defined by the Wholesale or Consumer Price Indices). Examples abounded as recently as the 1980s. Throughout that decade, financial assets and real estate rose, while the WPI fell.

In the August issue of his Gloom, Boom and Doom Report, Marc Faber argues that the WPI will remain relatively low through the 1990s, because the trend toward liberalized trade and investment is, in effect, increasing the supply of less expensive, third-world labor. At the same time, Faber agrees commodity prices are scheduled to rise.

In response to the price decline of the 1980s, production of many commodities declined while demand increased. The trends cannot be reversed suddenly. Over the next several years, the only way supply and demand will be rationed into a state of equilibrium will be through price increases.

Last month we focused our thesis upon cocoa, soybean meal (we were stopped out), and sugar. This month we will

examine gold.

This past June, at the Financial Times Gold Conference held in Istanbul, Frank A.J. Veneroso of Omega Advisors presented an extremely insightful paper focusing on the fundamentals of gold as a commodity. I want to stress the word "commodity."

In our June issue, Al Friedberg argued that despite gold's holding little short or intermediate value as a financial asset, the price of the yellow metal would rise on its own merits. He further reasoned that demand from China would push prices above the \$375-\$425 area of technical resistance, thereby triggering large-scale protective buy stops. The result would be "a sort of crash-in-reverse." Veneroso also discounts gold's role as a financial asset while concluding that gold will appreciate substantially.

Here is a summary of Veneroso's compelling argument.

According to most recent Gold Fields Mineral Survey (GFMS) data, world fabrication demand plus bar hoarding outside Europe and North America exceeds mine and scrap supply by 40% (3,600 tonnes versus 2,600 tonnes, for 1992). The deficit is made up for by liquidations and mobilizations of official and quasi-official gold hoards.

Gold demand has three components: bar hoarding outside Europe and North America, jewelry, and other fabrication demand (i.e., gold bought for use in dental, decorative, electronics, and coinage industries).

Over the past 20 years, two of the three components have tended to be relatively elastic. A 100% rise in the price of gold would translate into a 50% decline in hoarding, while vice versa, a 50% decline in gold prices would stimulate a 100% rise in offtake. For jewelry, the effect has been only slightly less dramatic: When gold prices fall by half, world household income spent on jewelry rises 60% to 70%; when gold prices double, demand falls off, but not quite by half. Fabricated demand, on the other hand, is quite inelastic.

Since jewelry demand composes roughly 80% of overall demand, and bar hoarding and other fabrication demand each compose roughly 10% of overall demand, aggregate demand has a price elasticity approximating that of jewelry.

Now let's turn to supply. As we said, the 40% deficit in mine and scrap production has been made up by mobilizations of official gold hoards, Western disinvestment, and producer forward sales.

Over the past 40 years, official central bank sales have netted out to approximately zero. In recent years official central bank sales have been at near record levels. Odds are official sales will return to zero simply because central bankers tend to be intelligent economists with the mindset of bureaucrats. This is to say that as they become aware of gold's bullish commodity fundamentals, they will prefer standing pat to actively dishoarding as they have been recently.

Contrary to popular opinion, Western investment/disinvestment mobilizations ultimately have an impact approaching zero. They are transitory trends that reverse themselves with the direction of the market. In bull markets Western investment demand increases, especially toward the top. In bear markets Western disinvestment increases, especially toward the bottom. We can safely expect that the liquidation of Western gold hoards will go to zero if it has not already done so.

The final component of non-mine, non-scrap supply has been producer forward sales. Several years ago, producers were largely unhedged. Today they have sold forward (i.e., they have effectively "lent" to the market) approximately half their production. Over the same period, growth in mine supply has been quite slow — less than 2% per year. Ultimately there comes a level at which gold producers conclude that additional hedging is imprudent. (Surely, for example, if a company were to hedge more than 100% of production, then that company would no longer strictly be a producer; rather, it would have become a speculator). Once that level is reached, forward sales will grow at the same rate as mine production and flows from forward sales effectively will go to zero.

What will happen once all three components making up the near 1,000 tonne difference between demand and mine and scrap supply dry up? One thousand tonnes represents slightly more than 30% of the total supplies of 1992. If the average price of gold over the past 18 months or so has been approximately \$350 an ounce, and if demand elasticity is, as we said earlier, approximately 65%, then a price increase of 80% would have to take place simply to ration demand to a

level whereby it could be met by mine and scrap supplies alone. The calculation puts gold's equilibrium price at higher than \$600 an ounce.

The question now is, how will emerging trends affect the equilibrium price?

Let us begin by noting that gold prices today are more than 10 times higher than they were 21 years ago when the gold window was opened. Virtually no other commodity has risen by as much. The standard response to this observation is that gold cannot be compared with its price 21 years ago, because at \$35 per ounce, the gold price was artificially fixed. In fact this is not true. From 1950 to 1966 central banks fixed gold at \$35 per ounce by buying gold — hundreds of tonnes of it. From 1966 central banks sold to speculators. But in 1969, 1970, and 1972 central banks were forced to buy again as speculators sold what they'd bought, because there was no follow-through in the price. In effect, during the late 1960s and early 1970s, the three components of demand we have used in our model equalled mine and scrap supply.

Having shown that \$35 can be used as a base price for purposes of comparison, we return to the issue of why gold prices have increased by more than tenfold. The answer lies in a term called "intensity of use." The term means consumption per unit of world GNP. Unlike other minerals, gold's intensity of use has been increasing. There are two reasons for this:

1. Most commodities are intermediate outputs into economic processes which have tended to become more and more efficient. Gold's primary use is jewelry which is not an intermediate process toward a final good; it is, itself, the final good.
2. Jewelry demand and bar hoarding in the Far East is several times what is in developed countries. Emerging Far Eastern countries have been growing at 9% a year. The geographical shift in demand generates a steady increase in the overall intensity of gold use in the world economy. While the demand we are speaking of has so far originated in Hong Kong, Korea, Taiwan, Thailand, we now expect it will originate in China.

Let's now go back to 1971. In 1971 world demand for gold (excluding Western investment demand, which we have concluded is irrelevant) was roughly 1,700 tonnes. In 1992 it was roughly 3,600 tonnes. If the price of gold had not risen nominally but had, instead, stayed fixed at \$35, and applying the same elasticities we applied earlier to determine gold's equilibrium price, we can calculate that gold consumption would be roughly 5,500 tonnes at an annual rate. The growth rate works out to 6% per year.

Given that world GNP has grown by about 3% per year over the same period, we can calculate that the intensity of use for a constant real price has been growing at the difference, i.e., 3% per year.

Now let's assume that over the next five years, world growth is again 3% per year. Intensity of gold use is then 3%, and demand for gold is, again, 6%. Five years from now, gold demand would be around 5,000 tonnes (3,500 tonnes in 1992 plus 6% six times) if the price stayed where it is. If mine production increased at the 1.7% rate it has averaged over the past two decades, demand would be almost twice supplies provided by mine and scrap production.

Given the view that other sources of supply (official and quasi-official sales and forward sales by producers) would dry up, the nominal price of gold would have to exceed \$700 to ration the supply-demand equation into equilibrium.

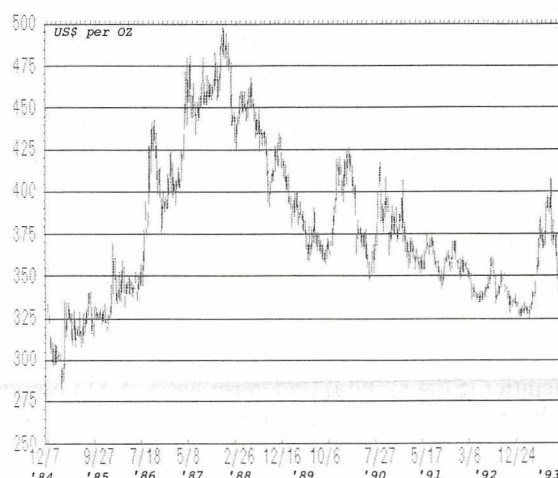
Adding an inflation factor of 3% over the period — not an unreasonable assumption to apply worldwide — we can easily see the 1980 highs of \$850 per ounce being approached.

Such is the gist of Veneroso's argument. (We have allowed ourselves to change slightly some of the numerical conclusions; nevertheless, the bullish implications are clear regardless of the numbers, giving due consideration to the necessary imprecision in the calculation of the overall elasticities.) If we apply to it our own conclusion of June — i.e., a host of computer-generated buy orders sit above the market poised to cover short positions and generate fresh long positions — the crash-in-reverse we spoke of earlier would indeed be volcanic.

**STRATEGY:** *Our view is long-term and extremely bullish. Buy as many gold futures contracts as you can afford to hold, allowing for swings of as much as \$50 per ounce (\$5,000 per contract).*

— David B. Rothberg

Chart 9 – LONG-TERM COMEX GOLD



## FRIEDBERG CAPITAL MARKETS

### Another look at Burnup & Sims

**Issue:** 12% convertible subordinated debentures, due 2000

**Recent price:** \$98 (12.82% yield)

**Recent stock price:** \$4 per share

**Conversion price:** \$16.79 per share

Since our last update in August, Burnup & Sims (B&S) has announced its negotiations to acquire Church and Tower Inc. (C&T). C&T is a South Florida based private company engaged in telephone master contract work and public work projects. While the price of C & T has not been finalized, B & S will carry out the transaction by a share swap.

The stock of B&S has moved back up to \$4 per share from under \$2 following the announcement. The total debt to market capitalization ratio has fallen to 2.3 from 4, a more comfortable level.

Although full information on the C&T acquisition is not yet available, we believe it is a sensible strategy, because it will increase market share and reduce competition for B&S in the Southeast area of the US. It may even be the start of consolidation of this fragmented and highly competitive industry. Furthermore, the definitive agreement signed for this acquisition calls for an elimination or a reduction to an acceptable level the ownership of B&S by National Beverage Corp. (NBC), which is currently at about 36%. This move will alleviate investors' fear that NBC will unduly influence B&S's financial strategies.

An analysis of B&S's balance sheet indicates that the 12% convertible debentures have an excellent asset coverage ratio of approximately 185%. We consider our estimate very conservative, as discounts were assumed on its various assets, including a 30% discount on accounts receivables and 50% on real estate investments. Although B&S is currently low on cash (\$7 million), it should have sufficient operating cash flow and debt capacity to cope with cash needs at least for the

next two years. Consequently, we believe the default risk of the above convertible debentures is minimal at the moment.

Despite its satisfactory financial position, B&S's operating performance for the first quarter of fiscal 1994 is still weak. Its 14.1% gross margin was up from 9.7% in fiscal 93, but lower than the 15.3% in the same period a year ago. The operating margin stayed approximately the same as a year ago at 1.3%.

As mentioned in our last update, B&S is actively pursuing offshore contracts. Their market coverage includes Venezuela and Hungary, but the present scale of operations is still small. The merger will increase offshore activities of the combined company, because C&T is also actively pursuing international ventures. However, we believe the effect of the C&T acquisition and offshore ventures on B&S's financials will not be seen until at least 12 months later. Therefore, although we are satisfied with B&S's current financial position, whether it will be adversely affected by continued weakness in its operating performance is uncertain.

**STRATEGY:** *We have changed our recommendation to buy from hold on the 12% convertible debentures based on the high yield and strong asset coverage. However, it is still a highly speculative security, because the industry fundamentals are weak. Stay tuned for further updates.*

### Corporate Investments Ltd.

**Issuer:** Corporate Investments Ltd.

**Security:** Convertible notes due June 19, 1995

**Coupon rate:** 13.5% semi-annual payment

**Recent price:** NZ79¢ per dollar

**Amount outstanding:** NZ\$50 million

**Conversion ratio:** Between 1 and 5 shares per dollar

**Recent stock price:** NZ25¢ per share

*(All dollar and cent figures are in NZ currency)*

Corporate Investments Ltd. (CIL) is a diversified New Zealand (NZ) company listed on the New Zealand stock exchange. It has been a holding company with interests in a wide range of industries including food and beverage, forestry, tourism, industrial manufacturing, financial services and real estate.

The diversification has failed to create value added, and many of its subsidiaries have had a dismal financial performance. CIL's stock price has dramatically fallen from its historic high of \$9.50 per share in 1986 to 25¢ per share recently. It reported a net loss of \$119 million for fiscal 1992 mainly owing to writedowns on investments and losses on asset sales. Its debt to equity ratio stood at a high level of 4.5 at the end of June '93 (based on US accounting rules).

CIL last year initiated a massive restructuring program to sell most of its unprofitable businesses. Cash from asset sales was used to pay down debt. It recently has completed negotiations with Westpac Bank to refinance all of its banking facilities (\$104 million) on a term basis. A \$14.6 million subordinated loan was converted into equity at 38¢ per share. These actions have positioned CIL for a healthy rebound.

### Business strategies of CIL

Following the restructuring, CIL has become a food and beverage company with a secondary emphasis on industrial manufacturing. Their main business activities are summarized below:

- **Food and beverage:** CIL's food and beverage interests include Montana Wines Ltd., Waioneke Park/Game Meats Ltd. (deer farming and venison trading), and the Newmans Food group (fruit processing). In fiscal '93, this segment accounted for 47% of CIL's revenue and 98% of its earnings before interest and tax (EBIT). We believe these ratios will go up to 55% and 106%, respectively, in fiscal 1994.
- **Industrial manufacturing:** CIL's industrial interests include Truck Investments Ltd. (a leading heavy commercial vehicle supplier in NZ), Givani Footwear Ltd. (Australasia's largest textile slipper producer), and OHL Corporation (a distributor of optical and sun care products). We believe the industrial segment will experience a low but steady growth in the near future. We projected its EBIT contribution to be approximately 16% in fiscal '94.
- **Real estate:** CIL owns 50% of Corporate Equities (Australia), whose major asset is an office tower in Australia. Management believes that keeping the investment for another five years will give them a better return than liquidating it at a distressed price now.
- **Others:** CIL also has small interests in tourism, stock broking, and cold storage companies. Owing to NZ's steady but slow economic recovery, we believe this segment may not be able to make a positive EBIT contribution until '96.

The crown jewel of CIL is Montana Wines (41% of CIL's revenue in fiscal '93), which is the largest wine maker in NZ. It currently has 43% of the NZ market and is the country's largest wine exporter. Its market dominance has given the business a healthy EBIT margin of 13.5%. Future margin improvement and sales growth will come from increasing the

proportion of high-end wine in the sales mix and exploring export markets more aggressively. Our conservative projections indicate that Montana will contribute \$21.5 million, \$23 million, and \$25 million, respectively, to CIL's EBIT in the next three fiscal years.

CIL reported an EBIT of \$17.7 million and a net income of \$6 million on \$318 million revenue for fiscal '93. We projected the fiscal '94 EBIT to be \$20.2 million and '95 EBIT \$23 million (net income \$10.9 million). At 25¢ per share, CIL's common shares are trading at a price/EBIT multiple of 2.7.

### Financial position of CIL

As mentioned above, CIL is highly leveraged. However, its focus on the food and beverage business will provide it with strong operating cash flow. Projected cash from operations (net of interest on the convertible notes) for fiscal '94 is between \$25-\$30 million. Assuming there are no major capital expenditures, we believe CIL will be able to pay down its debt substantially in the next five years. We projected its debt/equity ratio (based on US accounting rules) would decline to 2.8 in fiscal '94 and further to 1 in fiscal '95. The drastic drop in fiscal '95 is largely due to the conversion of the \$50 million convertible notes into common shares. CIL's current debt to market capitalization ratio is 3.7.

The only concern about CIL's financial position is its investment in a high quality office building at Surfers Paradise in Australia. Although CIL has totally written off the investment on the balance sheet, it remains liable for 100% of the interest and 50% of the debt principal on the project. Buttle Wilson Ltd., CIL's investment banker, estimated the net liability of this project to be \$29.4 million. While management believes that they can sell the building at a profit in five years, CIL should be financially able to carry it for a few years until it turns a profit.

### Valuation of security

CIL's convertible notes have two unique features. First, the notes will be paid off with CIL's common shares and will not be redeemed for cash. Second, the conversion intends to give noteholders \$1 worth of stock for each \$1 face value of note, with the maximum conversion ratio at 5 and the minimum at 1. In other words, if the share price in 1995 rises above \$1 per share, each \$1 note will still be issued one share. However, even if the share price falls below 20¢ per share, each \$1 note will be issued only five shares.

Therefore, it is necessary to project the stock price in '95 in order to estimate whether the principal value of the notes can be fully repaid. Based on our estimated '95 EBIT of \$23 million and a multiple of 4, CIL's market capitalization will be approximately \$93 million. With 228 million shares currently outstanding (including the conversion of the \$14.6m subordinated loan at 38¢ per share), the projected per share price will be 41¢. Hence, the conversion ratio will be approximately 2.5 shares per \$1 note.

However, we believe that rational investor expectations will increase the above projected conversion ratio substantially. The reason is that at a conversion ratio of 2.5, investors will expect another 123 million shares to be issued, diluting the share price to 26¢. Therefore, CIL's stock will not trade above 26¢ per share. At 26¢ per share, the conversion ratio will become 3.8. Nevertheless, investors will expect even

more shares to be issued at the conversion ratio of 3.8, thus further depressing the share price.

This process of investor expectations will drive CIL's share price down until it hits the maximum conversion ratio of 5. Our computation indicates that the equilibrium share price is approximately 19¢ per share, which means each \$1 note will be repaid with 97¢ worth of CIL's shares. The projected yield based on this repayment rate is 35%! The yield will still be 21% even if CIL's '95 EBIT is 20% below our estimate (CIL's own estimate is 13% higher than ours). At a 12% discount rate, which represents a 700 basis points' risk premium over the yield on two-year New Zealand government notes, CIL's convertible notes should be trading at its par value.

**STRATEGY:** We believe CIL is a fallen angel that is successfully turning around. Despite its still high debt level, the extraordinarily high projected yield of the convertible notes more than compensates for the risk involved. In addition, we are bullish about the New Zealand economy and its currency for the next two to three years. Buy for aggressive accounts.

## Argentina floating rate bonds

**Issuer:** Republic of Argentina

**Maturity:** March 31, 2005

**Currency:** US Dollar

**Coupon:** 13/16% over 6-month LIBOR

Semi-annual payment

**Amortization:** Principal to be repaid in 19 semi-annual installments commencing on March 31, 1995 as follows:

Year	Amount of each installment (% of principal)
1st - 7th	1
8th	5
9th - 19th	8

**Recent price:** \$81.25

**Approx. yield:** 7.41%

We recommended the above floating rate bonds (FRBs) in our market letter dated March 28, 1993. Since then, their price has increased from \$58 to the current level of \$81.25, which represents a return of over 40% in a six-month period!

The FRBs are part of Argentina's Brady debt restructuring plan to pay off its estimated \$8 billion of interest arrears claims. The FRBs have been trading on a when-issued basis, and the tentative settlement date is now set at October 29, 1993. According to Argentina's plan, the FRBs will be listed on the Luxembourg Stock Exchange after settlement.

The yield to maturity of the FRBs can only be estimated, because of their floating rate coupon structure. The 7.41% yield is based on the assumption that all future coupon payments and principal repayments will be reinvested at the current coupon rate, which is 4.19% (3.375% LIBOR plus 13/16% spread). However, since the current yield curve is upward sloping, it is very likely that the future income stream can be reinvested at a higher rate, thus resulting in a higher yield. Therefore, according to our interest rate outlook, the 7.41% yield should be the minimum that investors can realize.

— Edison Lee

**Chart 10**  
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, DKr, BP, FFr, ECU, CD, SAR, ITL, ARG, FIN) or revalue for SF, JY before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of October 21, 1993.

	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	3.40%		C.B.A. 14% '94 yields 5.32% (.6571 A\$/US)				Denmark 9% '94 yields 7.14% (6.9563 Dkr/US)						G.E. '95 yields 8.17% (1.680 ITL/US)			
2 year	3.87%															Finland '95 yields 6.05% (5.982 FIM/US)
3 year	4.13%					World Bank '96 yields 2.50% (103.10 US/JY)		Sweden '96 yields 5.84% (1.4085 BP/US)	Credit Lyon '96 yields 5.87% (6.1297 Ffr/US)			Escom '96 yields 11.69% (0.1956 US/SAR)	NIB 12 3/4% '96 yields 8.05% (1.7943 ITL/US)			
4 year	4.42%	NZ. 10% '97 yields 5.53% (0.5332 NZ/US)		B.N.S. '96 yields 5.61% (1.7458 US/DM)	G.E. 4 3/4% '98 yields 3.79% (1.4343 US/SF)						Eksportfin '97 yields 6.26% (1.3969 US/CD)					
5 year	4.71%	Fletcher '98 yields 7.59% (0.4857 NZ/US)		Argentina '98 yields 7.87% (1.9359 US/DM)												
7 year	4.90%									UK '01 yields 6.29% (1.0438 ECU/US)						
8 year	4.98%													BIC V '01 yields 11.06% (1.5681 US/ARG)		
Spot Exchange Rate	—	.5562	.6693	1.6685	1.4695	108.10	6.7135	1.479	5.8325	1.1446	1.3027	.2414	1.606	.99945	5.739	

\*For example, since a US\$-based investor would receive 288 basis points (759-471) by holding the Fletcher Challenge NZ bond, the NZ\$ can depreciate to .4857 NZ/US from the present spot exchange rate of

.5562 NZ/US over the next 5 years for the NZ\$ investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

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

**Chart 11  
FOREIGN CURRENCY BONDS**

Date: October 21, 1993 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
<b>DEUTSCHE MARK DENOMINATED</b>				
BANK OF NOVA SCOTIA 5 7/8% 07/05/96 RRSP eligible	99.15	100	5.61 %	May 07
WORLD BANK 5 7/8% 4/02/97 RRSP eligible	103.10	103.95	4.54 %	Feb. 04
WORLD BANK 9% 13/11/00 RRSP eligible	120.15	121	5.34 %	Nov. 13
KINGDOM OF DENMARK 6 1/8% 15/04/98	101.85	102.70	5.43 %	Apr. 15
ARGENTINA 8% 5/10/98	99.65	100 1/2	7.87 %	Oct. 05
<b>FINNISH MARKKA DENOMINATED BONDS</b>				
REP. OF FINLAND 11% 15/6/95	106.55	107.40	6.05 %	Jun. 15
<b>ITALIAN LIRA DENOMINATED BONDS</b>				
NORDIC INV. BANK 12 3/4% 19/04/96	108.40	109 1/2	8.05 %	Apr. 19
GENERAL ELECTRIC 11 1/2% 7/02/95	103	103.85	8.17 %	Feb. 07
<b>SWISS FRANC DENOMINATED BONDS</b>				
GENERAL ELECTRIC 4 3/4% 2/7/98	103.20	104.05	3.79 %	July 02
<b>DANISH KRONE DENOMINATED BONDS</b>				
KINGDOM OF DENMARK 9% 15/11/94	100.95	101.80	7.14 %	Nov. 15
<b>ECU DENOMINATED BONDS</b>				
UNITED KINGDOM 9 1/2% 21/02/01	115.30	116.15	6.29 %	Feb. 21
<b>BRITISH POUND DENOMINATED BONDS</b>				
KGDM OF SWEDEN 8 3/4% 29/5/96	105.90	106 3/4	5.84 %	May 29
<b>FRENCH FRANC DENOMINATED BONDS</b>				
CREDIT LYONNAISE 9 1/2% 23/12/96	109.30	110.15	5.87 %	Dec. 23
<b>JAPANESE YEN DENOMINATED BONDS</b>				
WORLD BANK 5 3/4% 7/8/96 RRSP eligible	107 3/4	108.60	2.50 %	Aug. 07
<b>CANADIAN DOLLAR DENOMINATED BONDS</b>				
ONTARIO HYDRO 10 1/8% 08/01/96 (semi annual)	109.70	110.55	5.77 %	Jan. 08
EKSPORTFINANS 7 3/4% 5/11/97	104.30	105.15	6.26 %	Nov. 05
ROYAL BANK OF CANADA 9 1/8% 7/11/97	108.45	109.30	5.83 %	Jan. 07
<b>SOUTH AFRICAN RAND DENOMINATED BONDS</b>				
ESCOM 12% 1/5/96 (semi)	100 1/2	101.35	11.69 %	Nov. 1
<b>AUSTRALIAN DOLLAR DENOMINATED BONDS</b>				
COMMONWEALTH BANK OF AUSTRALIA 14% 01/07/94	104.65	105 1/2	5.32 %	Jul. 01
<b>NEW ZEALAND DOLLAR DENOMINATED BONDS</b>				
NEW ZEALAND GOV'T 10% 15/7/97 (semi)	114	114.85	5.53 %	Jan. 15
FLETCHER CHALLENGE 10.15% 30/11/98 (semi)	108.90	109 3/4	7.59 %	May 30
<b>ARGENTINEAN PESO DENOMINATED BONDS</b>				
ARGENTINA BIC V FIXED/FLOATING 1/05/2001 callable in full on every interest date	96.74	97.59	11.06 % IRR	4th day of mth.
<b>U.S. DOLLAR DENOMINATED FIXED CONV. BONDS</b>				
DATAPoint CORP. 8 1/8% 1/6/06	86 3/4	87 3/4	10.95 %	Dec. 01
CV @ \$18.11 p/sh (semi)				
BURNUP & SIMS 12% 15/11/00 (semi)	94	96	13.29 %	Nov. 15
CV @ \$16.79 p/sh				
ATARI CORP. 5 1/4% 29/4/02	67 1/2	68 1/2	11.16 %	Apr. 29
CV @ \$16.31 p/sh				
COEUR D'ALENE 6% 10/6/02	103	104 1/2	5.33 %	Jun. 10
CV @ \$26.00 p/sh				
GLYCOMED 7 1/2% 1/1/03	90	91	9.16 %	Jan. 1
CV @ \$14.06 p/sh (semi)				
CENTOCOR 7 1/4% 1/2/01	-	-	-	Feb. 1
CV @ \$27.75 p/sh (semi)				
T.W.A. 15% 31/7/94	110 1/2	111.10	-	in default
T.W.A. 17 1/4% 15/3/93	37	39 1/2	-	in default
<b>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</b>				
FARM CREDIT CORP. 7 3/4% 10/06/96 RRSP eligible	108 1/2	109.10	4.00 %	Jun. 10
<b>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</b>				
UNITED KINGDOM 30/09/96	99.64	99.94	2 15/16 %	Dec. 30
3 mo. LIBID-1/4 (tily) * callable @ 100				
BOCON 1/4/01 (30 day LIBOR) starting to accrue May 1, '97	89 1/2	90.10	7.46 %	May 1/97
ARGENTINA: SERIES L: FRB 31/03/05 6 mo. LIBOR +1 1/2 (semi)	79 7/8	80 7/8	7.48 %	

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

**Chart 12**

**RECOMMENDED CURRENT PORTFOLIO ALLOCATIONS**

New TWA 15%	10%
Old TWA	5%
New Zealand Gov't	8%
Fletcher NZ\$	8%
CIL NZ\$	5%
Burnup & Sims	5%
Datapoint	5%
Coeur D'Alene	5%
Deutschemark	24%
Argentina BOCON	25%

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**HOTLINE UPDATE**

**Tuesday, September 28:**

We have one new recommendation. Buy December gold at market; place initial stop at 349, close only. The market letter is in the mail.

**Flash update, Wednesday, September 29, 9:45 am:**

Sell December Canadian dollar at market, presently trading at 75.20. As well, last night we recommended buying December gold at market. We bought December gold this morning at approximately 356.50 with stops placed at 349, close only. Week-end wrapup will take place this evening, Wednesday, September 29.

**Wednesday, September 29:**

The following recap of all liquidations and new recommendations. On Tuesday, September 28, we recommended purchasing December gold at market, placing initial stops at 349, close only. Gold opened September 29 at approximately 356.50. On Wednesday, September 29 via flash update, we recommended the sale of December Canadian dollar, then trading at 75.20. We now recommend the placing of stops at 7564, close only. Next regular update will be Tuesday October 5.

**Tuesday, October 5:**

There is one new recommendation. Change DM stops to 5995, good anytime. Cancel previous stop of 5950, close only.

**Wednesday, October 6:**

We have one new recommendation: Buy March silver at market, placing stops at 4.04, close only. As well, the following is a recap of the week's recommendations. On Tuesday, October 5, we recommended changing the stops on the December DM position to 59.95, good anytime, cancelling previous stops of 59.50, close only. Next regular update will be Tuesday, October 12.

**Tuesday, October 12:**

There are no changes or new recommendations.

**Friday, October 15:**

There are no changes or new recommendations.

**Flash update, Monday, October 18, 10:00 am:**

Sell December Japanese yen at market, presently trading at 9312.

**Flash update, Monday, October 18, 1:50 pm:**

Sell long December DM positions at market, presently trading at 6082, cancelling 5995 stop, good anytime. We also repeat this morning's Flash Update, advising the sale of December Japanese yen at the market, then trading at 9312.

**Tuesday, October 19:**

The following is a recap of this week's recommendations. On Monday, October 18, we recommended via flash update to sell long December DM position at market, then trading at 60.82, cancelling the 5995, good anytime, stop.

As next on Monday, via flash update, we recommended selling the December Japanese yen, then trading at 9312. We now recommend the placing of initial stops at 96.00, close only.

**Friday, October 22:**

This is a complete summary since our last market letter, dated September 26, 1993, of all liquidations of open positions and new recommendations.

On Wednesday, September 29, we bought December gold at approximately 365.50. Stops were placed at 349, close only.

On Monday, October 6, we bought March silver at approximately 4.40. Stops were placed at 4.04, close only.

On Monday, October 18, we sold short December Japanese yen at approximately 93.12. Initial stops were placed at 96.00 close only.

On Monday October 18, we liquidated long December DM position at approximately 60.82, cancelling the 59.95 stop.

Our next market letter will be mailed October 26.