

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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### Fiat money: groping in the dark

We return this month to one of our favorite themes: The virtual blindness in which central banks around the globe conduct their monetary policy. This rarely-acknowledged fact is the reason why, for most of this century, we have experienced long periods of inflationary booms and equally painful disinflationary busts. It is crucial for our understanding of what's in store for the coming years.

The most ingenuous of the group is the US Federal Reserve. Setting interest rates by fiat, it presumes to know what price will equilibrate the supply of and the demand for money. But is money any different from tomatoes, PCs, or shares?

Even with *excellent* information, a planner would be utterly unable to guesstimate an appropriate equilibrium price, even for one moment in time, let alone over period of weeks and months. Changes in technology, investment opportunities, taxes and politics, among many other things, affect dynamically the supply and demand for money; one need not be a chaos physicist to appreciate how minor changes in one remote part of the world could affect the savings balance in the US.

And yet the Fed prides itself on its interest rate setting abilities, believing that it has found a magical formula for stimulating an overburdened and overindebted economy. It has nearly succeeded in imposing its faulty brand of monetary economics on the rest of the world.

Perhaps alone among its peers, the Bundesbank has refused to play the same game. It has stuck to an explicit (but mild) Monetarist formula (targeting, the quantity of money rather than its price). Something similar may be said, at least for now, about the DM's satellite currencies, particularly the Dutch guilder and Austrian schilling. And about the Swiss National Bank's abiding commitment to monetary base targeting. And finally, in a remote corner of the globe, the Reserve Bank of New Zealand has explicitly targeted inflation, operating via a trade-weighted exchange rate combined — albeit in a very discretionary manner — with some measures of credit and deposit growth.

This is not to say that policies that target monetary aggregates or trade-weighted exchange rates are vastly superior. Unexpected velocity changes offset fluctuations in quantities while operating policies built on trade-weighted exchange rates are only as good as their neighbours' inflation rate. They, are, however, more objective.

Money supply targets or inflation targets cannot be blatantly disregarded; if, historically, a 5% rate of growth for broad money was compatible with stable prices, a prudent central bank would not exceed this target, except under exceptional circumstances. The same can be said for foreign

exchange targets.

Moreover, central bank actions can be measured against some objective criteria: a set rate of growth or a set exchange rate level. Central bank credibility would not suffer grievously if having sustained the stated target, inflation exceeded expectations.

Not so with the Federal Reserve. It gropes in the dark for an interest rate that can balance the supply of and the demand for money and achieve stable prices. The idea that real, not nominal, interest rates are important makes little difference: We are not able to measure accurately *ex ante* real rates nor do we know what effect, if any, positive rates have on the savings balance. Is a real rate of 1% "sufficient"? Is 3% excessive? "Sufficient" for what, "excessive" in what respect?

Can we know *anything* about the stance of US monetary policy in 1993? The behaviour of financial markets leaves little doubt that the Fed is excessively easy. Interest rates have been set so low that savers have been encouraged to transfer funds to the stock and bond markets. From fixed and secure returns to variable and speculative returns.

Interest rates are *intuitively* too low; Federal Reserve credit has grown at double-digit rates, and yet inflation appears to be dormant. Why?

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Contributions by Albert D. Friedberg, Edison Lee, David B. Rothberg and Michael D. Hart.

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

Thanks to a technical quirk of the US monetary system, the demand for holding monetary (transaction) balances has absorbed the Fed's supply of credit, negating, at least temporarily the expansionary effects of the central bank's action.

It works as follows: The lower interest rates move, the easier it is for the public to hold transaction balances, as their opportunity costs are almost nil. But an increase in transaction balances (primarily checking accounts and currency) increases the commercial banks' need for reserves, i.e., required reserves rise, because the Fed imposes differential reserve requirement on various deposits: 10% on demand deposits and 0% on time deposits. The rise in reserve requirements "absorbs" the recently created revenues supplied by the Fed, and supply and demand for money are equated at very high rates of growth.

This "benign" process reverses once interest rates — along with opportunity costs — rise. Here's how: Low interest rates attract borrowers; to accommodate the new lending, the banking system will either liquidate securities (lowering their price and thus raising their yields) or bid for deposits (also raising rates).

The rise in interest rates will raise the opportunity costs of holding transaction balances, forcing households and

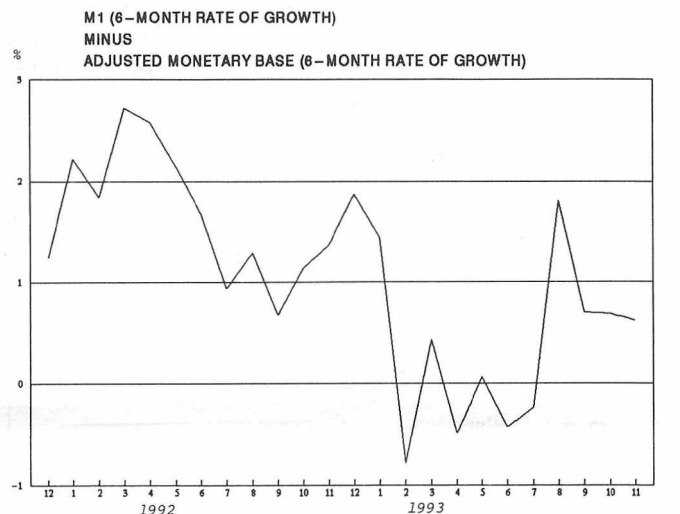
businesses to economize on them. This shift in portfolio preferences (away from demand deposit and into time deposit) releases reserves, as time deposits do not require reserves. At the same time, the Fed is likely to be targeting a slightly higher rate of interest, "leaning against the wind" in their jargon, and thus continuing to supply excessive reserves.

Paradoxically, it is this stage, the stage of rising interest rates, that witnesses the greatest imbalance between Fed-supplied reserves and the public's demand for holding balances. Conversely, the stage in which the Fed pushes interest rates down aggressively, as it had done in 1992-93, witnesses the best monetary balance. This "beneficial" effect is only temporary, of course. Very low interest rates will stimulate credit, which will eventually force interest rates higher.

An interest rate policy is no policy. Setting interest rates by fiat, as we have seen, is a wild guess, with momentous consequences for inflation/deflation and the health of our financial markets.

The bubble in the financial markets should be sufficient notice that interest rates are too low. And but for the existence of reserve requirements on demand deposits, the Fed's interest rate target would have already produced much higher rate of growth in the broader aggregates.

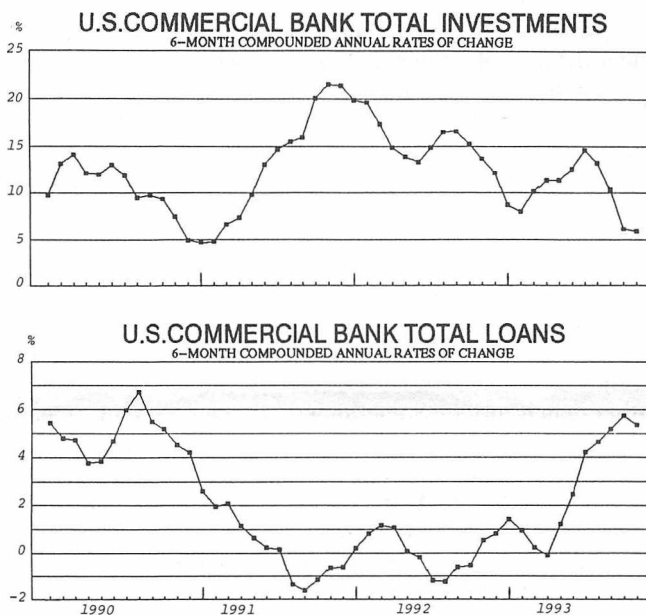
Chart 1



When the growth of M1 exceeds the growth of the Adjusted Monetary Base, demand for money is thought to exceed supply of money.

Note that this has been the case for all of 1992 and most of 1993.

Chart 2



**US DOLLAR**

**Upward impetus could be lost**

We have taken profits on our long US dollar positions.

Increasingly, Germany's "hard" monetary policy is starting to clash with the Fed's easy money stance. The impetus for a higher dollar that came from a better relative economic performance could be lost, at least temporarily, unless the Fed tightens very soon.

**STRATEGY:** We realized handsome profits on our European currency short positions, particularly the DM and the peseta.

**JAPAN**

# Rough times

The Japanese recession deepens. The Finance Ministry reported that corporate pre-tax profits declined sharply during the July/September quarter from the year earlier, stretching the record string of year-on-year declines to 13 quarters. From their peak, Japanese corporate pre-tax profits have declined over 60%.

Sales at the 27 stores in and around the Japanese capital fell by 7.6% in December against the same month last year, the 22nd monthly fall in a row. From their peak, retail sales have declined 15%.

Hosokawa's failure to push through the political reform bill through the Upper House may have dealt a fatal blow to a fiscal package that featured ¥6,000 billion of much-needed tax cuts. The market's initial reaction, bidding up the yen, was highly irrational and clearly stemmed from worries of trade. The market reasoned that if Japan cannot deliver a fiscal package to reflate its economy, the US Treasury might again be tempted to talk the yen higher as a way of narrowing the trade surplus.

American interest in Japan's economic health goes only as far as its concern with its large bilateral trade deficit with Japan. A substantial fiscal package will help; otherwise, it preaches a higher yen. This is a very short-sighted and dangerous philosophy. The US should be concerned with Japan's economic health, not only from a humanitarian perspective aside, but because of its effect on world trade. When the world's second largest economy sneezes, the world could catch a cold...

Expect a rough period ahead. Hosokawa's political necessity to pass some type of reform bill may push him to find a new coalition partner in the LDP. This could translate into a fiscal package that will see tax cuts now financed by increases in consumption taxes in 1995-96. If so, the recession will deepen and the yen will inevitably sink past ¥150. On the other hand, a "good" fiscal package may still emerge.

It is best to wait until the smoke clears.

**STRATEGY:** We covered our very profitable yen short position at around 89.85. We expect to momentarily reenter the short side of the market. Stay in close contact.

Remain short March 1994 Nikkei futures, placing stops at 19,700, basis cash.

Chart 3 – NIKKEI 225 INDEX



**STOCK INDEXES**

# Trading long, but thinking short

Like a staggering marathon runner, the stock market continues to race ahead. Just when it appears that it will fail, it regains some strength and manages to move forward. Poor breadth and poor momentum do not deter the Dow Jones Industrial Average from achieving new all time highs.

The advance has not shown any short term signs of being overbought. In fact, not since January 1992 has *Trendline's* short range oscillator exceeded +5. And yet, a three-year advance with nary an intervening correction of 10% or more must characterize the US stock market as being *grossly overbought*. Signs of excesses abound; listing them would not enlighten anybody. It is itself a sign of a bubble that the best minds on Wall Street can still intellectualize this advance.

We have found two particularly useful indicators (for identifying tops and bottoms), which for the sake of keeping them functional we have decided to withhold from publicizing. Because they are still flashing green, we opted to liquidate our earlier short position and initiate a new long position during the month. (These indicators could turn negative

at a moment's notice.) This is merely a trading position and should in no way reflect a change of opinion regarding the ultimate direction of stock prices.

**STRATEGY:** Maintain long position first initiated at 470.80, basis March 1994; raise stops to 468.00, close only.

Chart 4 – S&P 500 INDEX



**OIL**

## Firming only temporary: remain short

The firmer tone of the past few weeks is accounted for by two developments: the frigid conditions in the Eastern part of the US, which raised the demand for heating oil, and the last minute deal worked out by the creditors of Metallgesellschaft.

It was well known in the trade that the German concern had massive long positions in the nearby crude market and corresponding short position in the deferred contracts; the trading community, long the deferred and short the nearbys, rushed to cover positions once it became known that the creditor banks had worked out a deal to stave off Metallgesellschaft's liquidation.

OPEC has been producing just under 24.7 million barrels per day; no single producer has been willing to step up to the plate and offer to cut back production unilaterally. On the contrary, Saudi Arabia, Kuwait, and Iran have publicly aired their fiscal problems and consequently their inability to show financial strength.

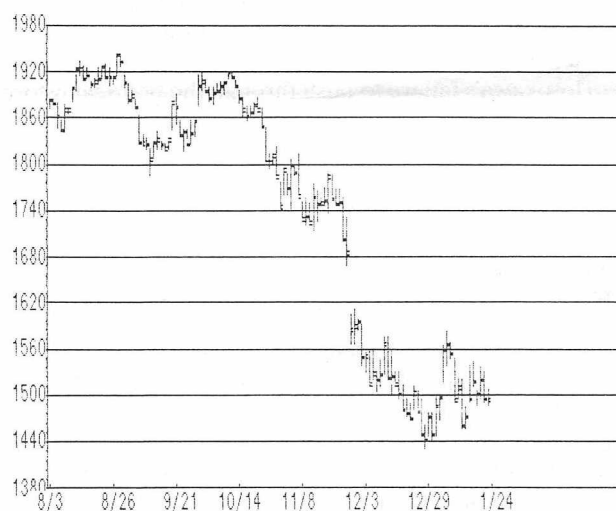
Other producers have continued to pump more oil. Norway's October production jumped 22% over September to 2.4 million barrels per day (mbd), while the UK's production in October surged above 2 mbd day to 2.072 mbd. Arthur Anderson reports that North Sea production is expected to climb steadily into next year.

The twin fallout discussed earlier should work itself out of the market by the end of the month, at which point we shall

be able to judge how much further, but more importantly, how fast will prices drop.

**STRATEGY:** *Remain short.*

Chart 5 – NYME CRUDE LIGHT MAR '94



### **EMERGING MARKETS MANIA: INVESTORS IN SOUTH EAST ASIA TAKE NOTICE!**

## Korea, Clinton's Cuban Missile Crisis

By Karen Elliott House

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As the Clinton administration begins its second year, a group of old men in the world's vestigial communist capitals of Pyongyang and Beijing are about to force the Clintonites to do what came hardest in 1993—make difficult foreign policy decisions.

Evidence mounts that North Korea already has nuclear weapons. The Clinton administration can no longer indulge the fantasy that some package of economic and political incentives will induce North Korea to abandon its determination to own and probably export nuclear weapons.

Likewise, in dealing with China—the nation with the most likely leverage on North Korea—the U.S. can no longer indulge the pretense that human rights is the highest American priority when China not only tacitly supports North Korea but itself exports nuclear and missile technology to some of the world's least stable nations, including Iran.

What's at stake for America in North Asia this winter is nothing less than the safety of 37,000 U.S. troops in South Korea, the security of South Korea itself and the stability and

prosperity of Asia.

### **Moment of Decision**

President Clinton isn't the first to face a historic decision in which all choices look grim, but in which the worst choice of all is indecision. For the Kennedy administration, Moscow's attempt to base nuclear missiles in Cuba was such a moment. For President Reagan it was the decision to install Pershing II missiles in Western Europe despite Soviet threats. For George Bush such a moment was deciding to go to war to reverse Iraq's aggression.

For the past year, the components of a Korean crisis have been steadily building. North Korea has refused regular inspections of its Yongbyon reactor, some 50 miles north of Pyongyang, heightening concern it is producing weapons-grade plutonium. A partial inspection convinced experts that North Korea had produced plutonium—some 26 pounds, or enough for several bombs by U.S. estimates. This week brought reports that Pyongyang will allow limited inspections, but this is insufficient to satisfy international experts.

The response of the U.S. and North Korea's neighbors is

a combination of wishful thinking and pass-the-buck. Japan, in range of North Korea's newest missiles, has assumed its normal ostrich stance, pretending the problem will somehow go away. Meanwhile, Tokyo is North Korea's major source of desperately needed hard currency—with remittances of almost \$600 million annually from North Korean immigrants and sympathizers in Japan.

South Korea faces the most direct threat—its capital city is less than 50 miles from the North Korean border. Yet its new “domestic” president, Kim Young Sam, dithers like his counterpart in Washington. In an interview during his November U.S. visit, President Kim carefully avoided any position that would put him out in front of President Clinton. Meanwhile, Mr. Clinton's advisers stress that the U.S. can't confront the North because Washington mustn't be out in front of Japan and South Korea.

If there is a solution to the North Korean problem short of direct and likely military confrontation, it probably lies in Beijing. Without the Soviet Union, China is Pyongyang's only political ally and the major source of the oil that keeps North Korea's industry running. China claims to play a constructive role, but if so, the results don't bear it out.

Here, too, U.S. policy is warped by peripheral vision. There's no visible evidence Washington has seriously sought to induce China's cooperation against North Korea, despite significant U.S. interest and leverage. The pace of China's extraordinary economic momentum depends in no small part on continued access to the U.S. market. American investment, and U.S. technology. China's leaders understand their political survival depends on rapid economic growth. So, while the U.S. can't single-handedly block China's economic development, it can slow growth sufficiently to put at risk China's political stability, the nightmare of Beijing's leaders.

In short, there is a pressure point. Thus a start for a realistic policy is to set America's priorities straight. In an imperfect world, this means choosing between crusading for human rights or stanching nuclear proliferation. Thus far, the president, currying favor with congressional Democrats, has pressed human rights. But what matters most to America's security isn't the fate of Chinese dissidents but the fate of American troops in South Korea and of American allies from South Korea to Saudi Arabia who are within reach of nuclear weapons and missiles being exported by North Korea and China. The point isn't to coddle China, but to get tough on the right issue. Surely Mr. Clinton can make Congress see this.

An essential next step is to drop the delusion that North Korea is just another poor, misunderstood Third World country that can be lured into the community of nations by a combination of economic incentives and political appeasement. North Korea isn't building nuclear weapons because it feels unloved.

Pyongyang builds bombs because it is the very last of totalitarian communist regimes, a slave-system ruled by a delusionary despot and his power-hungry son who cling to the mad dream of ruling the entire Korean peninsula.

They can't be swayed by deft diplomacy or the promise of economic progress for their people. Indeed, a large part of the reason North Koreans have been reduced to one meal a day is that Kim Il Sung and his son have diverted the nation's scarce resources to building a bomb designed to entrench and enhance their power. So the North's nuclear ambitions

can't be blocked by a “coming together” of the international community or the peregrinations of United Nations' officials to Pyongyang.

North Korea's behavior conceivably can be affected by Japan and China if they, in turn, can be prodded to deny Pyongyang funds and fuel. This means putting in place now a total embargo of North Korea, including a naval blockade by U.S. and Japanese warships. China must shut its overland border to North Korea but may be excused from providing naval vessels to confront its old ally. Not so Japan. What reason, after all, is there for Japan to have a powerful navy but for its own defense?

The time to do this is yesterday. Yet the U.S. administration remains divided between doves whose aim is to avoid any confrontation with North Korea and “hawks” who believe that by inching their way toward economic sanctions in concert with the U.N. they can somehow bring China and Japan along. The difference is between appeasement now and failure later.

The reason: Japan can't be counted on to take a stand even when its own interest is at stake; China, by contrast, can be counted on to take a stand only when its own interest is at stake. And China doesn't truly fear a North Korean bomb. For these diverse reasons, both largely ducked engagement in the war against Iraq.

To ensure a different outcome on North Korea, the U.S. must play hardball now with Japan and China. This means forcing Japan to face the grim reality that it now is surrounded by three nuclear nations—Russia, China and North Korea. And, more important, that America's nuclear umbrella will shield Japan only if it acts to protect its own interests. In short, Mr. Clinton had better ask Japan why the U.S. should risk war to protect a nation that appeases North Korea with hard currency.

With China, America should wield both carrot and stick. The carrot: a clear indication that the U.S. will preserve and expand economic ties if China cooperates on nuclear non-proliferation. In short, a new strategic understanding between Beijing and Washington to replace their now defunct anti-Soviet alliance.

At the same time, the U.S. must underscore to China that its tolerance of North Korea's joining the nuclear club risks the addition of a far more powerful member—Japan. While China sees little reason to fear a nuclear North Korea, it has every reason to fear a nuclear Japan.

An embargo of North Korea seems preferable to other options. A direct military strike on Pyongyang's nuclear installations is risky, both because some apparently are hardened to survive air strikes and because a direct hit on stored plutonium risks spreading nuclear contamination across both Koreas. At the other extreme, playing out a policy of incrementalism on a world stage with endless U.N. pleas for restraint raises the risk of a preemptive North Korean strike on U.S. troops in South Korea. The one lesson dictators like Kim Il Sung learned from Iraq's defeat is not to let America choose the hour of confrontation.

### Assume the Worst

In dealing with isolated egomaniacs like Saddam and Kim, it pays to assume the worst—that war isn't anathema to them. Thus, in the mind of Kim Il Sung, his new weaponry

puts him in a win-win situation. He can use the nuclear threat to blackmail South Korea and the U.S., which he already has succeeded in doing by causing both to cancel joint military exercises and unilaterally to declare South Korea a non-nuclear zone. Or, at whatever point the blackmail fails to yield results, he can precipitate a military conflict, including use of his nascent nuclear weapons.

That this would result in devastating human consequences for his own countrymen is irrelevant to him. One need only look at the instructive example of Saddam Hussein to see how cheap human life is to dictators. The fact that nuclear blackmail wasn't an element in the Iraq war was

thanks only to a pre-emptive strike on Saddam's nuclear reactor by Israel a decade before.

Just as despots do not shy from military confrontation, so too must America be willing to face that prospect. The alternative is the certainty of steadily being blackmailed by North Korea now and by prospective nuclear nations like Iran a little later. While these are unpleasant subjects, nuclear weaponry remains the real arbiter of power in a world that still includes zealots and madmen. Thus, Mr. Clinton has to do what President Kennedy did three decades ago: face down nuclear blackmail.

*Ms. House is vice president, international, of Dow Jones.*

## COMMODITIES

### Cocoa

Prices have fallen some \$200 per tonne since last writing. There has been considerable nervousness and confusion over what effects the devaluation of the CFA franc may have on the market. Also, arrivals from the Ivory Coast, the world's largest producer, have been described as "heavier than expected." Finally, following what seemed like a spate of nothing but glowing reports written about cocoa, bullish editorializing has been conspicuously absent recently. (It seemed throughout the fall that the entire commodity newsletter industry had discovered the extremely strong fundamentals underlying the market.)

We believe the strong fundamentals will reassert themselves on prices.

On Jan. 12, following three weeks of intense speculation, the CFA franc was devalued by 50%. Cocoa farmers in the Ivory Coast were immediately awarded payment of 240 new CFA francs per tonne, up from 200 CFA francs before the devaluation. In October, the start of the 1994-95 crop year, the price will rise to 290 CFA francs per tonne. Whether the nominal increase will result in an added or reduced incentive to grow beans will depend upon whether or not growers will feel the increase is enough to compensate for their loss in purchasing power. Certainly fertilizers and pesticides, which are imported, will be more expensive.

Ivory Coast arrivals had been heavy before devaluation, presumably because growers and shippers anticipated it. West African traders who were interviewed following the CFA franc devaluation surmised that even if growers did discover added incentive to sell product, there was probably not much more available left to ship.

The fundamentals of the cocoa market remain strong. Indications are that demand from North America and Eastern Europe may drive world usage higher by more than the 4% average annual growth rate that has prevailed over the past decade. (In North America, according to a recent article in the "Marketing & Media" section of *The Wall Street Journal*, marketings of exotic chocolate beverages have increased cocoa sales by more than 10%.)

This is the third year of what will certainly be a lengthy series of cocoa deficits. Cocoa prices, which are now at the same level they were in the 1960s, will double before the current cycle has run its course. At this point, supplies accumulated during the previous cycle of surpluses may be am-

ple. They become ever less so with every passing day. Any exogenous shock (a weather problem, for example) or any unexpected increase in usage (the emergence of a market in China, for example) will propel prices upward. For the speculator, the best strategy is patience.

**STRATEGY:** *Maintain stops at 900, basis nearest futures contract.*

### Coffee

In 1977 the composite price of green coffee beans landed in the port of New York climbed to the astronomical level of \$2.40 per pound. World stocks at the end of that year totalled 25 mln 60-kilogram bags, or 36% of usage.

Last April the composite price of green coffee beans landed in New York fell to 50¢ per pound. World stocks at the end of the year totalled 36 mln 60-kilogram bags, or 38% of usage.

If the market in 1977 could be described as hysterically optimistic, surely the market of 1993 could be described as hysterically pessimistic. Just as the bull market of 1977 set the stage for the bear market that ultimately ended last year, that bear market has set the stage for the bull market that is beginning now. The cycle has come full circle.

During 1993, the coffee market focused obsessively upon the high level of stocks held in consuming nations. At the end of 1992-93, stocks totalled 20 million (mln) bags *versus* 12 mln bags in a normal year. Half those stocks were held in the US; almost all of the remainder in Western Europe. In response to higher world prices, roasters and importers have chosen to sell off inventory rather than make new purchases. As a result, consumer stocks have declined by about 10%.

It would appear that the burden of holding inventory has merely been transferred from consuming to producing nations. However, if this is so, why have world prices held firm?

The answer lies in the broader statistical picture. Since 1977-78, consumption has increased to about 97 mln bags from about 84 mln bags, or by a little more than 1% per year. In the US over the same period, consumption has actually declined (sales fell from 1,066 mln lbs. in 1978 to 1,004 mln lbs. in 1992, the last year for which figures are available).

Using sales in the US as a proxy for sales in Western Europe and noting that consumption in producing nations

has increased by only 4 mln bags over the period, we can conclude the increase in total world consumption has come about as a result of consumption in new markets.

To conclude, it is quite likely, given that world prices have held firm, that the reduction in stocks held in traditional consuming nations has not merely been transferred to producing nations but rather sold and consumed by non-traditional coffee consuming nations.

Having dispensed with the false notion of a stock overhang, we must turn our attention to the prospects for supply and demand during the 1993-94 crop year.

In its most recent circular (dated December 1993) the US Department of Agriculture (USDA) estimates production at 97.738 mln bags, up 6% over last year, and consumption at 97.049 mln bags, unchanged from last year. We take no issue with the USDA's supply estimate. We would argue however that the department's estimate of usage is understated.

With coffee prices being so cheap in real terms, there seems no reason not to expect world usage to increase by at least the 1% it has averaged since 1978. The question is: Is there any reason to believe usage in the US (and Western Europe) may grow this year, lifting world usage to unexpected levels? There is.

Per capita coffee consumption in the US peaked in 1963 at 3.12 cups per day. With the single exception of 1979 (when consumption rose after the sharp declines that took place in

response to the bull market of 1977-78) per capita consumption fell every single year until 1988 when it bottomed at 1.67 cups per day. For the next three years, per capita consumption hovered at 1.75 cups per day. Last year — no study was conducted in 1992 — per capita consumption rose to 1.87 cups per day, up 12% in the past six years, up 6.8% over the past two years.

A new era appears to be dawning in the coffee market — one characterized by world growth of 3% a year. If so, this could mark the third consecutive deficit year and stocks could be drawn down to 34 mln 60-kilogram bags or to 35% of usage. More significantly, next year will likely be a deficit as well; coffee, like cocoa requires long lead time between planting and harvesting.

We are not calling for an immediate take-off to the hysterical levels of 1977. We would conclude however that coffee will be a stellar performer in the commodity bull markets we expect during the emerging economic cycle.

**STRATEGY:** *We are long calls, but we now prefer futures because the options are too dear. Buy September.*

**SUMMARY:** *Fundamentals of grains and sugar remain very positive. Remain long sugar, corn, soybean meal, and soybean oil. Stay in touch with our Hotline.*

— David B. Rothberg

## FRIEDBERG CAPITAL MARKETS

# Update on our convertibles' downside risk

Chart 7 indicates the latest investment values and downside risk of the convertible bonds in our managed bond accounts.

Compared with two months ago, when we last did the same exercise, yields have come down considerably. For example, for a straight bond comparable to Atari's convertibles, the yield has declined by 88 basis points, from 11.38% to 10.5%.

We believe there are two major reasons for the decline. First, most economic indicators tell us a solid economic recovery is underway, which has led investors to believe that the credit quality of most of these junk issuers will improve quickly. Second, the market's continued search for high yield has pushed up the prices of most junk bonds.

Owing to a general decline in corporate bond yield, the downside risk of our convertibles has been reduced. However, the relative riskiness of these convertibles has not changed, with Coeur D'Alene's convertibles still having the largest downside risk. In addition, Burnup & Sims' convertible is still undervalued, with an estimated investment value of \$110 versus the current price of \$102.

Although Datapoint's convertibles also appear to be undervalued in our analysis, we want to emphasize that there is only one comparable straight bond available, and that particular bond has appreciated by almost 15% in just the last month. Therefore, the estimated investment value of Datapoint's convertibles may not be as reliable.

Chart 7 — Investment Values of Convertibles

Issuer	ATC	BSIM	CDE	DPT	GLYC
Credit rating	CCC2	B3	CCC2	CCC2	CCC2
Recent price (per \$100)	\$73.75	\$102	\$100.5	\$81.25	\$87.75
Yield	10.08%	11.89%	5.92%	12.14%	9.80%
Maturity (mm/dd/yy)	4/29/02	11/15/00	10/6/02	6/1/06	1/1/03
Yield on straight bond	10.5%	9.82%	10.5%	10.5%	10.5%
Investment value	\$72	\$110	\$76	\$89	\$83
Downside risk	2.5%	Nil	24%	NIL	5%

ATC = Atari, BSIM = Burnup & Sims, CDE = Coeur D'Alene, DPT = Datapoint, GLYC = Glycomed

## M/A-Com, Inc.

Stock Symbol: MAI

Exchange: NYSE

Recent price: \$8½

52-week high: \$10¾ (Aug. 12, 1993)

52-week low: \$4.50 (Dec. 30, 1992)

Market cap: \$214 million

M/A-Com, located in Lowell, Massachusetts, designs and manufactures radio frequency and microwave components, devices, and subsystems. It is currently in the transition from

a defense-dependent company to one focused on commercial markets, especially applications in wireless communications.

Its new products are being used in cellular phones, wireless computer networks, and electronic highway systems. Most of these areas have high growth potential. M/A-Com has shrunk its organization to reduce costs by closing defense-related operations. It should resume profitability in 1994 and experience rapid growth in the following three to five years. *The projected fair value of its stock is \$12 versus the current price of \$8½. The stock has the potential of going up to \$20 within two years.*

### Main products

M/A-Com has 40 years' experience in the design and manufacture of devices and components for communications systems used by the defense industry. It has developed expertise in microwave and millimetre wave semiconductor components. Its products are used in radar, navigation, missile guidance, and military surveillance.

With a shrinking defense budget, M/A-Com has restructured its operations to focus on the commercial markets. It sold subsidiaries and closed down facilities that depended solely on the defense market. It took restructuring charges of \$32 million in 1990 and \$29 million in 1993.

Its microwave expertise and technology has a wide range of commercial applications, especially in wireless communications. Its current and future products are focused on three areas:

**Cellular phone and system:** Its current products in this category include power amplifiers and switch matrices for cellular base stations, and voltage-controlled oscillators and RF chip sets for hand-held phones. The demand for cellular base station equipment is expected to grow only slowly, because the cellular network in the US has been almost completely built up, and competition (mainly from Motorola) is very strong.

However, the demand for cellular phones should continue to grow rapidly. The number of US cellular subscribers is expected to increase to 20-25 million by 1997, from 18 million in 1992. Also the number of European subscribers is forecast to double by 1996, reaching approximately 13 million.

Other high-growth regions include Japan, the Far East and Latin America. The rapid growth in worldwide cellular subscribers will translate into strong demand growth for M/A-Com's cellular phone chip sets.

M/A-Com has also designed chip sets for hand-held phones that allow for smaller and lighter phones and clearer signals. These handsets will be used for personal communication systems (PCS) in the future. M/A-Com's chip set was chosen by a major Japanese manufacturer of hand-held phone for its next generation of PCS. M/A-Com expected to ship over 1 million of these chip sets in 1994. Furthermore, M/A-Com was hired by AT&T to design and manufacture the radio transmission system of handsets to be used by AT&T's future PCS. The project was completed and the equipment is under testing at AT&T.

PCS is expected to be an explosive growth area in the personal wireless communications market. By August 1992, the US Federal Communications Commission (FCC) had granted 119 experimental PCS licenses in the US. Arthur D. Little, a prominent consulting firm, projected that there would be 50 to 60 million PCS subscribers in the US by year

2010, and an equal number in the rest of the world. M/A-Com's expertise in this area will give it an advantage to tap the huge potential of this market.

**Equipment for the intelligent vehicle highway system (IVHS).** IVHS is believed to be the future of traffic management in the developed world. IVHS includes electronic vehicle identification, automatic toll collection, traffic signal controls, collision warning and avoidance, onboard tracking and navigation, and roadside communications.

The technology incorporates microwave equipment using frequencies from 5.8 GHz to as high as 60 GHz. IVHS is being given serious consideration at the federal, state, and city levels in the US and other advanced countries. In the Intermodal Surface Transportation Efficiency Act of 1991, the US federal government authorized a total of \$660 million for 1992 through 1997 for the IVHS.

Various modes of the IVHS have been put in place at different sites throughout the nation for trial purpose. A complete IVHS is expected to take 30 years and cost \$350 billion.

M/A-Com's products targeted at this market include sensor components and omnidirectional GPS (Global Positioning System) antennas for automobiles. Automatic toll collection systems utilizing M/A-Com's sensors are in place in London, Dallas, and New York. M/A-Com's semiconductors are part of collision-warning radar systems being installed on 2,400 Greyhound buses. Commercial trucks should be a big market for such systems, and the systems will be available on passenger vehicles in 1995.

M/A-Com's omnidirectional GPS antenna will be a major component product for the IVHS. It will become an option on luxury cars in Japan this year. With the aid of satellite navigation, drivers will be guided to their destination through crowded Japanese cities by dashboard screen displays. These displays will also inform drivers of road hazards, weather conditions, service station availability, and nearby restaurants. Similar systems will be available in the US once mapping of the US is completed.

**Microwave transmission systems.** M/A-Com designs and manufactures components (for example, antennas, integrated circuits, basic semiconductors and complex subsystems) for microwave transmission systems. The largest users of microwave networks are private industries, including the pipeline, railroad and oil exploration companies. The FCC proposed moving the present microwave network users who are in the 2.5 GHz band to the 6 GHz band to accommodate new wireless communications services. The proposed change will create new business for microwave equipment suppliers.

The fastest-growing area of commercial microwave transmission systems lies in high-frequency (10-23 GHz), short-haul applications, including video distribution, wireless local area computer networks (LANs), and private networks. The use of higher frequencies, together with new digital technology, has dramatically increased the speed of transmission and reduced the cost of microwave systems. M/A-Com's expertise in high-frequency microwave technology will help the company tap this fast-growing market.

### Financial analysis

As previously mentioned, M/A-Com grew up as a defense contractor specializing in search and navigation equipment based on microwave technology. Its peak performance was

in 1981, when its sales and net income reached \$518 million and \$40 million, respectively. With the 1981 EPS at \$1.07, its stock was trading at an all-time high of \$35½, implying a 33x P/E multiple.

Although its revenue continued to grow to \$840 million in 1985, its earnings have never gone back to their previous peak level. Sales declined sharply to \$580 million in 1986 and since then have continued falling to \$339 million in the year ended September 1993. The decrease in sales was mainly due to shrinking defense business and sales of slow-growth business units. By downsizing its operations, M/A-Com has increased its productivity substantially. Its sales per employee had jumped from \$55,860 in 1986 to \$89,200 in 1992.

Despite weak defense business and continued restructuring efforts, M/A-Com has a strong balance sheet. Its current ratio increased to 1.52 in the first nine months of fiscal 1993 from 1.47 in 1992. It generated \$18 million and \$26 million free cash flow in 1991 and 1992, respectively, although it went to a deficit of \$8.4 million in the first three quarters of fiscal 1993, primarily because of \$30 million capital expenditures. Its operating cash flow in fiscal 1992 was four times its interest expense. The total debt to equity ratio has steadily declined from 4.6 in 1989 to 2.2 at the end of June 1993.

We believe M/A-Com is close to restoring its long-term profitability. It took restructuring charges of \$32 million and \$29 million in 1990 and 1993, respectively, to consolidate operations and reduce costs. Its operating margin improved from 2.4% in 1989 to 6% in 1991, but slipped back to 2% in the first three quarters of fiscal 1993. The \$29 million restructuring charge in 1993 should help boost its operating margin to 4.25% in 1994 and 6.5% in 1995. On the other hand, its gross margin increased from 28% in 1990 to 33% in 1991 and has been stable since then.

### Valuation

M/A-Com incurred a net loss of \$21.5 million in fiscal 1993 mainly because of the \$29 million restructuring charge taken in the fourth quarter. Without the restructuring charge, the 1993 EPS would have been approximately 25¢, representing a P/E multiple of 36x based on \$8.50 per share. However, if we consider the projected 1994 EPS of 37¢, the prospective P/E is only 23x. Our projections for its 1995 and 1996 net income are \$17.7 million and \$28.2 million, respectively, which mean EPS of 67¢ and \$1.05. The current price/sales ratio is 0.63x.

Our projections and valuation are based on the following key assumptions:

- Currently 30% of revenue is derived from defense business.
- Defense business will decline 30% to 40% annually for the next three years and then level off.
- Non-defense government business will decline 10% to 20% annually for the next three years and then level off.
- Commercial business (currently 40% of total) will grow at 30% to 40% annually.
- M/A-Com's net margin will return to 6% by 1995, which is approximately the industry average.
- M/A-Com's stock will be trading at a P/E multiple of 20x in 1995, which is equivalent to its long-term earnings growth rate (the IVHS business will not grow rapidly until at least three to five years later).

Based on a projected 1995 EPS of \$1.05 and a conserva-

tive P/E multiple of 20x (i.e., P/E to long-term growth ratio of 1), the stock should be trading at \$21 per share in early 1995, representing a price/sales ratio of 1.25x. At a discount rate of 20%, which is 1,450 basis points above 10-year US Treasury yield, the current fair value of M/A-Com's share should be \$12, versus the current price of \$8.50. It represents a potential appreciation of 33% in the short run.

Chart 8 indicates that M/A-Com's valuation compares favorably with its competitors. Our projected fair value of \$12 per share represents a price/sales ratio of 0.89x, which is still lower than those of the other two major competitors. M/A-Com's share should trade up quickly when the market realizes that the company has successfully transformed from a defense-dependent operation to one that is focused on some high-growth segments of the commercial communications market.

**Chart 8**  
Comparative Valuation – Microwave Companies

Company	Market Cap. (\$ million)	Historical P/E	Prospective P/E	Price to Sales	Price to Cash Flow
Andrew Corp.	\$638	23x	19x	1.66x	14x
Digital Microwave	\$313	Negative	68x	2.80x	25x
M/A-Com	\$214	36x	23x	0.63x	7x

## TWA's bonds rallying

In our TWA update last month, we stated that we were still optimistic about the medium-term viability of the company despite a pullback of the prices of its various securities. And we recommended a strong hold on its new 10% senior secured notes as well as the old 17¼%/16½% bonds. The recent rally in TWA's various securities has vindicated our view.

On Jan. 3, a three-page article on TWA by Jonathan R. Laing was published in *Barron's*. Mr. Laing believed that TWA was having a serious liquidity problem, its operating performance was way below expectation, its cost structure was out of line with its competitors', and a Chapter 7 liquidation could not be ruled out.

The publication of this article sent TWA's 8% new notes, which have been trading on a when-issued basis, down \$5 in the next two days, to \$36 from \$41. TWA's other securities, which are the preferred shares, common shares, and new 10% notes, also dropped slightly in prices right after the article's publication.

Although we disagree with Mr. Laing on his bearish outlook of TWA, we found his analysis to be very thorough and well researched. He presented all the negative aspects of TWA in a detailed and organized fashion. However, we believe that most of the information has already been discounted by the market. In addition, the liquidity problem was not as serious as Mr. Laing thought.

Our pessimistic estimate of TWA's cash drain in the first half of 1994 is in the neighborhood of \$100 million, assuming no top-line or bottom-line improvements at all. Since TWA had estimated cash of \$150 million to \$170 million by the end of 1993, that will be more than adequate to carry it through June 1994, the start of airlines' high season. Moreover, TWA still has some assets that can be sold as a last resort; for example, its 25% interest in the Worldspan reservation system, which may be worth approximately \$50 million.

Nevertheless, one important insight Mr. Laing provided was about the power struggle at TWA's top management. On Jan. 4, just one day after his article was published, William Howard and Glenn Zander announced their resignation as TWA's chairman and vice chairman, respectively, while remaining as consultants with the company. The TWA board then named director Donald Craib as TWA's new chairman and chief executive. Craib was previously the chairman and chief executive of Allstate Insurance Group, and has served on the board of Jet America Airlines, Pillsbury, and Sears.

The resignation of Howard and Zander means the power struggle is over, and TWA's top management can now really concentrate on developing a long-run strategy to return the company to profitability.

The market obviously welcomed the news. All TWA's securities, except the common shares, have been moving up in price every day since the management change was announced. The new 10% notes have risen to \$80 from \$72.50, the new 8% notes to \$44<sup>3</sup>/<sub>8</sub> from \$39.50, and the preferred shares to \$3.50 from \$2.50, while the common shares have stayed between \$4<sup>3</sup>/<sub>4</sub> and \$5. In fact, at \$80 the new 10% notes are at an all-time high (they started trading at \$76 in November 1993 and drifted down to \$72).

We believe the recent rally reflects the fact that the market is increasingly aware of the strong asset coverage of the new 10% notes. Investors also have become more optimistic about TWA's short-term viability. For example, even Mr. Laing mentioned in his *Barron's* article that the collateral of the new 10% notes is worth more than the notes' outstanding

amount. Therefore, the new 10% notes, which have strong downside protection, have appreciated the most, while the common shares, whose value heavily depends on TWA's long-term prospects, have moved only a little in price.

We continue to be optimistic about TWA's medium-term viability for two reasons. First, all recent economic indicators in the US tell us that the economic recovery is solid and on track. Second, the price of oil has fallen by more than 20% in the past six months, and we expect it to drop another 20% to 30% in the coming 12 months. A 25% fall in fuel cost from last year's average will save approximately \$120 million per annum for TWA. Just that factor may lead TWA to break even on an operating basis without any top-line improvement.

Despite the recent rally, we believe the prices of TWA's various securities, particularly the two new notes, still have room to move up. The yields on the 10% and 8% notes, currently at 16.6% and 22.8%, should continue to come down to approximately 13% and 19%, respectively, which implies target prices of \$89 for the 10% notes and \$56 for the 8% notes.

Finally, we expect the 17<sup>1</sup>/<sub>4</sub>% and 16<sup>1</sup>/<sub>2</sub>% old bonds to be converted into various new securities in about a month. Based on the prices of the component securities, these old bonds are currently priced at \$43, up from the low of \$34 in December.

**STRATEGY:** *With respect to TWA's new 10% notes and the 17<sup>1</sup>/<sub>4</sub>%/16<sup>1</sup>/<sub>2</sub>% old bonds, we need only reiterate our previous recommendation: Strong hold!*

— Edison Lee

**Chart 9**  
**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 January 21, 1994.**

	US \$	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	3.35%	C.I.L. '96 yields 12.05% (0.522 NZ/US)											G.E. '95 yields 7.81% (1.772 ITL/US)		Finland '95 yields 4.94% (5.749 FIM/US)	
2 year	4.08%			BNS '96 yields 5.21% (1.7843 US/DM)				Sweden '96 yields 5.18% (1.4647 BP/US)				Ont. Hyd '96 yields 4.25% (1.3152 US/Cdn)	ESCOM '96 yields 10.60% (0.2037 SAR/US)	NIB '96 yields 7.85% (1.824 ITL/US)		
3 year	4.37%	New Zealand '97 yields 4.82% (0.559 NZ/US)					World Bank '96 yields 1.79% (103.08 US/JY)		Credit Lyon '96 yields 5.41% (6.111 Ffr/US)			R.B.C. '97 yields 5.22% (1.343 US/Cdn)				
4 year	4.70%	Fletcher '97 yields 6.78% (0.523 NZ/US)		Denmark '98 yields 5.11% (1.7738 US/DM)	G.E. '98 yields 3.75% (1.4117 US/SF)											
5 year	5.04%			Argentina '98 yields 7.18% (1.9316 US/DM)												
7 year	5.20%									UK '01 yields 5.75% (1.072 ECU/US)				BIC V '01 yields 9.04% (1.2838 US/Arg)		
Spot Exchange Rate	—	.566	.7023	1.7463	1.4641	111.12	6.7794	1.4958	5.932	1.112	1.311	2300	1.699	.9989	5.662	

\*For example, since a US\$-based investor would receive 214 basis points (718-504) by holding the Argentina DM bond, the US/DM can depreciate to 1.9316 US/DM from the present spot exchange rate of

1.7463 US/DM over the next 5 years for the DM investment to break even with current US\$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

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

**Chart 10  
FOREIGN CURRENCY BONDS**

Date: January 20, 1994 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 5½% 07/05/96 RRSP eligible	100	100.85	5.21 %	May 07
WORLD BANK 5¼% 4/02/97 RRSP eligible	103 3/4	104.60	4.22 %	Feb. 04
WORLD BANK 9% 13/11/00 RRSP eligible	119.30	120.15	5.38 %	Nov. 13
KINGDOM OF DENMARK 6½% 15/04/98	102.90	103 3/4	5.11 %	Apr. 15
ARGENTINA 8% 5/10/98	102 ½	103.10	7.18 %	Oct. 05
<b>FINNISH MARKKA DENOMINATED BONDS</b>				
REP. OF FINLAND 11% 15/6/95	107	107.85	4.94 %	Jun. 15
<b>ITALIAN LIRA DENOMINATED BONDS</b>				
NORDIC INV. BANK 12¾% 19/04/96	108	108.85	7.85 %	Apr. 19
GENERAL ELECTRIC 11½% 7/02/95	102.65	103 ½	7.81 %	Feb. 07
<b>SWISS FRANC DENOMINATED BONDS</b>				
GENERAL ELECTRIC 4¾% 2/7/98	103.15	104	3.75 %	July 02
<b>DANISH KRONE DENOMINATED BONDS</b>				
KINGDOM OF DENMARK 9% 15/11/94	101.95	102.80	5.26 %	Nov. 15
<b>ECU DENOMINATED BONDS</b>				
UNITED KINGDOM 9¼% 21/02/01	118.35	119.15	5.75 %	Feb. 21
<b>BRITISH POUND DENOMINATED BONDS</b>				
KGDM OF SWEDEN 8¾% 29/5/96	106 3/8	107 5/8	5.18 %	May 29
<b>FRENCH FRANC DENOMINATED BONDS</b>				
CREDIT LYONNAISE 9½% 23/12/96	109.85	110.70	5.41 %	Dec. 23
<b>JAPANESE YEN DENOMINATED BONDS</b>				
WORLD BANK 5¾% 7/8/96 RRSP eligible	108 3/4	109.70	1.79 %	Aug. 07
<b>CANADIAN DOLLAR DENOMINATED BONDS</b>				
ONTARIO HYDRO 10¾% 08/01/96 (semi annual)	110.85	112.35	4.25 %	Jul. 08
EKSPORTFINANS 7¾% 5/11/97	106.60	-	-	Nov. 05
ROYAL BANK OF CANADA 9¼% 7/1/97	109.40	110.40	5.22 %	Jan. 07
<b>SOUTH AFRICAN RAND DENOMINATED BONDS</b>				
ESCOM 12% 1/5/96 (semi)	102.40	103 ½	10.60 %	May. 01
<b>AUSTRALIAN DOLLAR DENOMINATED BONDS</b>				
COMMONWEALTH BANK OF AUSTRALIA 14% 01/07/94	102 7/8	104 1/8	3.89 %	Jul. 01
<b>NEW ZEALAND DOLLAR DENOMINATED BONDS</b>				
NEW ZEALAND GOV'T 10% 15/7/97 (semi)	115.55	116.40	4.82 %	Jul. 15
FLETCHER CHALLENGE 10.75% 15/12/97 (semi)	112 ½	113.35	6.78 %	Jun. 15
FLETCHER CHALLENGE 10.15% 30/11/98 (semi)	111.95	-	-	May 30
CORPORATE INVESTMENT LTD. 13½% 19/6/95 (semi)	94 ½	96 3/4	12.05 %	Jun. 19
<b>ARGENTINEAN PESO DENOMINATED BONDS</b>				
ARGENTINA BIC V FIXED/FLOATING	98.10	99.10	9.04 %	4th day
1/05/2001 callable in full on every interest date				of mth.
<b>U.S. DOLLAR DENOMINATED FIXED CONV. BONDS</b>				
DATAPoint CORP. 8¾% 1/6/06	80 3/4	81 ½	12.14 %	Jun. 01
CV @ \$18.11 p/sh (semi)				
BURNUP & SIMS 12% 15/11/00 (semi)	99	102	11.89 %	May 15
CV @ \$16.79 p/sh				
ATARI CORP. 5¼% 29/4/02	71	72	10.47 %	Apr. 29
CV @ \$16.31 p/sh				
COEUR D'ALENE 6% 10/6/02	99 7/8	101 7/8	5.71 %	Jun. 10
CV @ \$26.00 p.sh				
GLYCOMED 7½% 1/1/03 CV @ \$14.06 p/sh (semi)	86	87 3/4	9.80 %	Jul. 01
T.W.A. 10% 3/11/98 (semi)	78 3/4	79.60	16.97 %	Feb. 01
T.W.A. 17¼% 15/3/93	41.15	43.15	-	N/A
<b>U.S. DOLLAR DENOMINATED FIXED RATE BONDS</b>				
FARM CREDIT CORP. 7¾% 10/06/96 RRSP eligible	106 ½	107.35	4.40 %	Jun. 10
<b>U.S. DOLLAR DENOMINATED FLOATING RATE NOTES</b>				
UNITED KINGDOM 30/09/96	99.70	100	3 1/8 %	Mar. 30
3 mo. LIBID-½ (qtly) *callable @ 100				
BOCON 1/4/01 (30 day LIBOR)	97.05	97.90	6.10 %	May 1/97
starting to accrue May 1, '97				
ARGENTINA: SERIES L: FRB 31/03/05	87 7/8	88 7/8	6.17 %	Mar. 31
6 mo. LIBOR + 1/16 (semi)				

**GOLD** (in ounces, at market prices, can also be held in your bond account)  
Although we monitor these issues specifically, we also can fill any order in any foreign bond.

**Chart 11**

**Recommended current portfolio allocations**

1. TWA	10% of '98	6. Datapoint CV	5%
2. New Zealand Gov't	12½%	7. Coeur D'Alene CV	5%
3. Fletcher NZ\$	17½%	8. Atari CV	5%
4. Argentina FRB/BOCON	30%	9. Deutschemark	10%
5. Burnup & Sims CV	5%		

**HOTLINE UPDATE**

**Flash update, Tuesday, December 21, 12:45 pm:**

Sell long June gold and July silver positions at market, presently trading at 394 and 519 respectively. Cancel stops in gold of 360 and stops in silver of 440, basis nearest contract.

**Tuesday, December 21:**

The following is a recap of this week's recommendations. Today at 12:45 pm, via flash update, we liquidated long June gold and July silver positions at the market, then trading at 394 and 519 respectively, cancelling stops in gold of 360 and silver of 440, basis nearest contract.

**Friday, December 23:**

The following is a recap of this week's recommendations. On Tuesday, December 21, via flash update, we liquidated long June gold and July silver at approximately 394 and 519 respectively, cancelling stops in gold of 360 and in silver of 440, basis nearest contract.

**Tuesday, December 28:**

There are no changes or new recommendations.

**Flash update, Wednesday, December 29, 2:20 pm:**

Reinstate long position in gold. Buy February gold at market, presently trading at 391.60. Place stops at 384.50, good anytime. Stand aside on silver.

**Friday, December 31:**

This is a recap of this week's recommendations. On Wednesday December 29, via flash update, we bought February gold at 391.60. Stops were placed at 384.50, good anytime.

**Tuesday, January 4:**

There are no changes or new recommendations.

**Friday, January 7:**

There are no changes or new recommendations.

**Flash update, Monday, January 10, 9:15 am:**

You were stopped out of the February gold position this morning. We advise you reenter the long side. Buy April gold at the market, currently trading at 386.50. Place stops at 381.50, basis April, good anytime.

We have two additional recommendations.

1. Buy March silver at market, presently trading at 497, placing stops at 484, good anytime.
2. Buy, repeat buy, March S&P at the market, placing initial stops at 465, good anytime.

**Tuesday, January 11:**

The following is a recap of this week's recommendations.

On January 10, via flash update, we bought April gold at 386.50, placing stops at 381.50, basis April, good anytime.

As well, we bought March silver at 497, placing stops at 484, good anytime.

We also bought March S&P at 470.80, placing initial stops at 465, good anytime.

**Friday, January 14:**

The following is a recap of this week's recommendations. On January 10, via flash update we bought April gold at 386.50, placing stops at 381.50, good anytime. As well, we bought March silver at 497, placing stops at 484, good anytime. We also bought March S&P at 470.80, placing initial stops at 465, good anytime.

**Tuesday, January 18:**

There are no new changes or recommendations.

**Flash update, Thursday, January 20, 9:30 am:**

Cover short Japanese yen position at the market, trading at 89.85, cancelling previous stops at 95.00, close only.

**Flash update, Thursday, January 20, 9:45 am:**

Cover short Japanese yen position at the market, currently trading 89.85, cancelling previous stops of 95.00, close only. We also recommend covering short French franc, Belgian franc, Spanish peseta, and DM positions at the market. These positions were recommended in our Oct. 24, newsletter.

**Friday, January 21:**

This is a complete summary since our last market letter dated December 19, 1993, of all liquidations of open positions and new recommendations.

On Tuesday, Dec. 21 we liquidated long June gold at 394 and long July silver at 519, cancelling stops at 360 and 440 respectively.

On Wednesday, Dec. 29, we reinstated long February gold positions at 391.60, placing stops at 384.50, good anytime.

On January 10 we were stopped out of our February gold positions at around of 384.50. Subsequently, we bought April gold at 386.50, placing new stops at 381.50, good anytime.

We bought March silver at 497, placing stops at 484, good anytime.

We also bought March S&P at 470.80, placing initial stops at 465, good anytime.

On January 20, we covered our short March Japanese yen positions at 89.85, cancelling stops at 95.00, close only.

We also covered our short positions in French franc, Belgian franc, Spanish peseta, and DM. The latter was covered at 5725, basis March '94.

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