

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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Asset inflation, speculation, and the Fed: back to reality

For hours, we toyed with various other titles — from the provocative (“Exposed!”) to the worn-out (“It’s asset inflation, stupid!”) to the seemingly meaningless (“Fed double-talk”), hoping to whet our readers’ appetites for what was to follow. But, more importantly, we sought to find inspiration for what we were about to say, a subject that many will consider too boring, or even worse, too irrelevant, to dwell on.

Testimony to our lack of imagination is the title we chose. And yet, it says it all: The Fed is directly responsible for one of the most extraordinary financial bubbles in history. The return to reality promises to be extremely painful.

We warned months ago (“Monetary manipulation is not costless,” Sept. 26, 1993) that “the Fed has created a ‘bubble’ and it does not know how to burst it gently. *There is no way to burst it gently.*” Then we went on to explain that mini quarter-point step, the Fed’s most likely course, would be woefully inadequate to produce restraint — anticipating a thesis we developed more fully last month — because “as rates rise, the public begins to shift demand deposits into term deposits *requiring less overall reserves!*”

In “Sell high and buy low” (November 1993) we pointed out that “inflation was never dead in the last 13 years despite the fall in commodity prices. Instead, monetary inflation manifested itself in another class of goods: asset prices. The real estate bubble in the Nordic countries, North America, and the UK, all in the mid ’80s and Japan in the late ’80s were all a manifestation of a monetary system out of control. The stock and bond market bubble of the past six years is, too, just such a manifestation.”

In a separate article in the same issue (“Leaving behind the Magic Kingdom”) we pointed out the “extraordinary difficulties in managing a fiat money system. Rudderless, it (the Fed) must ‘guess’ the appropriate equilibrium rate of interest that will equate supply and demand for genuine savings — and it must further guess the proper timing of each adjustment; in its own words, the issue is when to ‘rein in the stimulus.’

“In our opinion, it is already *much too late*. The Fed has been too easy for too long not to have to pay a steep price.” To prove this contention, we did not resort to measures of money supply or to the rate of inflation in consumer prices, but rather to the yield curve: “Using a ‘Wicksellian rule’ when the level of long-term rates is the best proxy for the ‘natural rate,’ one can estimate *the length and magnitude of the folly* by observing the slope of the yield curve; it has been the most positive and it has lasted for the longest period of time in the post-war period.”

Chart 1 depicts the size and length of the Fed’s manipulative attempts during the post-war period. As is quite *obvious*, the folly reaches its height during the Greenspan Fed. We conclude that the “modern central bank will continue to cause boom and bust, inflation/deflation cycles for as long as it fails to understand the weakness of a managed money system.”

We went on to recommend the sale of March ’94 T-bonds, then trading at 113.12, a position that still remains open and is likely to remain so for quite some time (see T-bonds).

Finally, in “Fiat money: groping in the dark” (see January 1994) we sought to reconcile the obvious paradox: “The behavior 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.

Note: The Hotline Update telephone number will change as of March 7, 1994. See the card enclosed with this issue.

We suggested that extremely low short-term rates encouraged the public to hold larger non-interest bearing deposits for longer periods of time, absorbing in the process a great deal of reserves (given that the Fed imposes a 10% reserve requirement on demand deposits and 0% on time deposits). Despite the massive increase in Federal Reserve Credit and the Monetary Base, commercial banks found themselves unable to aggressively expand their asset portfolios (i.e., bank credit). This led to a very moderate rate of growth of the broader aggregates like M2 and M3.

While inflation in goods and services was well contained, asset inflation — driven by rampant speculation — exploded. The enormous positive carry of long-term securities encouraged dealers, banks, and hedge funds to go on a wild spree. Easy money spawned thousands of mutual funds and other enormous pools of capital that traded anything from Treasuries to European bonds to emerging market securities.

The Fed's decision to raise Fed Funds rates by 1/4 point will aggravate rather than ameliorate future inflationary pressures. For, as we suggested last month, the reverse flow of deposits — from demand to term — will liberate commercial bank reserves, which inevitably will be used to expand bank credit. (The deceleration of the rate of growth of M1 (6.1% at an annual rate) over the past two months, may be the first sign that the demand for non-interest-bearing deposits is decelerating despite the rapid expansion of the Adjusted Monetary Base during this period (17.7%). If so, this should give way to an acceleration in the rate of growth of bank credit and the broader monetary aggregates, with ominous consequences for price inflation).

The only thing the Fed can do is to absorb excess reserves via sales of Treasuries. This would result in a *huge* jump in short-term rates.

The market appears puzzled by the weakness of bonds both here and abroad, in the face of very moderate present and prospective inflation. It shouldn't be. The Fed enlisted the services of large scale speculators — dealers, banks, hedge funds, bond funds — by tempting them with obscene positive "carries." Only rank speculation can rationalize the purchase of 10 to 20-year and 30-year securities on the assumption that inflation rates in the future will remain at today's levels and that, therefore, a buyer of bonds today "enjoys" generous real yields. And only rank speculation can ignore the inexorable rise of debt worldwide relative to income, believing that it will not lead to a massive wave of defaults.

Sensing that the game is up, speculators — leveraged to the hilt — have begun to unwind their positions and are trampling all over each other. Inflation *could* remain at 3% per annum (although it most probably won't) and bond yields could rise toward 10% and beyond.

The longer the yield curve stays so resolutely positive, the higher will interest rates rise. First, because it will encourage continuous speculation, with recurrent waves of liquidation as rates continue their ascent. Second, because it will demonstrate a lack of determination to take the "bull by the horns." Because markets smell weakness, and then pounce on it, the Fed will eventually be forced to leapfrog bond yields.

In sum, the worldwide bear market in bonds has nothing to do with inflation and the economy. It has everything to do with the unwinding of one of the longest running speculative binges in financial history — sponsored and financed by the Federal Reserve Bank.

IMPLICATIONS: *Little-understood events create extraordinary opportunities. Read on.*

Chart 1

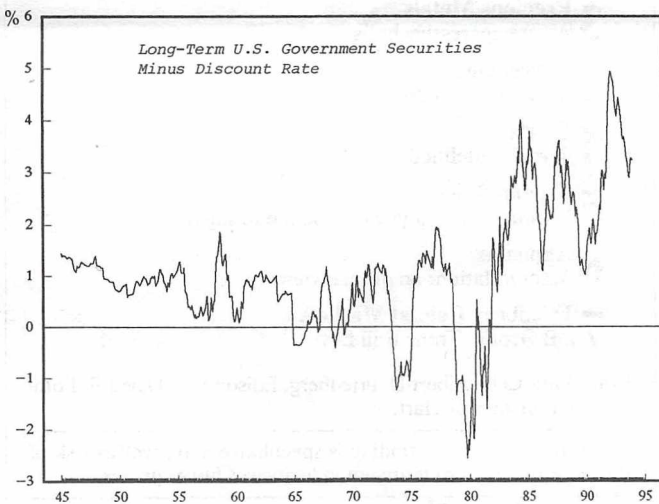
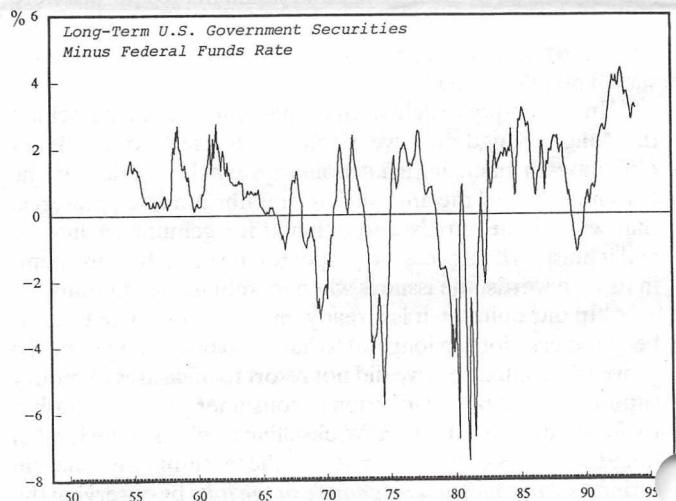


Chart 2



INTEREST RATE FUTURES

Rates heading higher

The implications of our opening comments for the future level of interest rates are rather clear: They are heading higher, substantially so.

While price inflation is moderate, unwinding of long speculative positions will return, in the first instance, debt prices to their pre-manipulation levels. This implies a near-term target of 8-8½% for the 30-year T-bond, equivalent to 95-100 for the nearest contract traded on the board.

Beyond that, the Fed will need to demonstrate resolve in containing a speed-up in money supply inflation. In recent testimony Dr. Greenspan referred to a number of indicators as proxies to gauge inflationary pressures as a substitute for targeting the much-discredited money supply. Among these indicators was gold (while one economist has suggested in an

editorial that the Fed may be targeting the Dow Jones Spot Commodity Index).

There is little doubt that the bond market will become extremely sensitive to the Fed's new operating variables. Should gold and commodity prices in general rise as we expect in coming months the Fed will be forced to act. Tepid responses will bring waves of selling.

STRATEGY: *We are short March '94 T-bonds at 113.12 as per our November 1993 issue. Positions should be rolled over and maintained, as we believe that this first phase of the bear market will see a slight widening of the yield curve. Eventually, we will cover our bonds and sell Eurodollar contracts.*

STOCK INDICES

The end of the bull

The bull markets in stocks and bonds of the '80s and '90s are but a reflection of the asset inflation engineered by the Fed's easy money policies. The unwinding of the speculative positions that were the proximate cause of these bull markets need not follow a rational or an orderly path.

While it is true that dividend yields are not that far out of line with prevailing interest rates and therefore stock prices may not appear excessively overpriced, modern money and capital markets have a way of anticipating events with extraordinary speed. This is especially true in a world of derivatives and highly leveraged positions.

Moreover, markets will tend to key off future prices rather than the spot prices. As an example, December '94 Eurodollars trade to yield 4.9% compared with the spot LIBOR rate of 3.75%. At the same time, December '94 Treasury bills trade to yield 4.4% compared with a cash rate of 3.6%. These end-year money market yields compare with a dividend yield of 2.75% for the S&P 500 and 2.62% for the Dow Jones Industrial. Stock prices would have to fall anywhere between

41% and 47% to become competitive with expected money market yields.

Given the general lack of understanding (even among economists) of the process discussed in our opening comments describing what is behind the rise in interest rates, we can certainly make a case that the great 1974-94 bull market has come to an end.

Sentiment considerations support this view: An extraordinary degree of complacency prevails among the ranks of uninformed mutual fund investors. This is in keeping with the maxim that all important distributions (the movement of stocks from strong to weak hands) are conducted on the way down, simply because the public has come to believe in the invincibility and immortality of the bull.

STRATEGY: *One of our two proprietary indicators flashed a sell signal last week, at which point we recommended initiating a short position in the S&P 500 contract. You should be short around 468.80. Maintain stops at 475.40, good anytime.*

PRECIOUS METALS

We are aggressive bulls

Precious metals were pressured during this past week by circulating rumors that the Russian government would make use of its gold reserves to finance its budget deficit. This is a totally irrelevant fear. The government's and central bank's holdings are down to a mere 300 tonnes, the equivalent of 1/10 of the amount of money needed to cover expected deficits for the year. And this is without taking into account

100 tonnes of gold needed to back a gold-backed bond and 50 tonnes of gold needed to satisfy the jewelry trade.

The second "bearish" piece of news pressuring gold prices was the testimony given by US Fed Chairman Greenspan. The Chairman indicated that the Fed may target the price of gold in the exercise of monetary policy. In effect, the Fed has thrown down the gauntlet. As far as we know, mar-

kets love challenges: Taking up the gauntlet, gold should begin to push through 400/oz. in the very near future.

Our very bullish scenario for precious metals is built on four factors:

a) The inadequacy of production to satisfy the strong industrial and fabrication demand, particularly of gold. We have provided abundant details in past issues;

b) The South African situation that may result in a civil war and serious stoppages of production;

c) The smugness of one of the world's largest gold producers who has publicly congratulated himself for having hedged his company's output, stating that "our hedging policy has been working for us brilliantly for the past 10 years; in the past five years alone, it...added a quarter of a billion dollars to our profits." He added "I do not happen to be one of those wild bulls who believes that gold has got to go through the roof and reach \$500...I think it will hang around \$400 and...as you can see, it has some difficulty breaking through that level."

Mr. Peter Munk, Chairman and Chief Executive of

American Barrick Resources Corporation, a company that plans to produce 1.8 million oz. in 1994 and 2 million oz. in 1995 after 1.63 million ounces last year, has for all practical purposes admitted to hedging, not because he is an agnostic but rather because he is an atheist.

If gold producers are not bullish (and Swiss banks are surely not), there are very few souls left in the world who believe in the Second Coming. The element of surprise is strongly in favor of the precious metals bulls.

d) The derivative explosion will facilitate institutional investments in metals, and in particular gold and silver, a situation that was not present in the 1978-80 bull market. Speculative accumulation of gold dressed up in the clothing of a conservative and staid "structured" bond can lend a powerful hand to the coming bull market.

We are aggressive bulls.

STRATEGY: *Stay long silver, platinum, and gold, with stops at 5.10, 370, and 374 respectively, basis nearest contracts, good anytime.*

CURRENCIES

Avoid outright dollar trades

Excessive bearishness on the yen (*Consensus, Bloomberg Poll, Hedge Funds positions*) tipped us off in good time. We exited short yen around 89.85 on January 20th and successfully day traded it on February 4th (see Hotline Update).

Recent threats of a trade war, if carried out, can only be bearish for the yen, as they will reduce Japan's trade surplus. At the same time there is very little that "talking up" the currency could accomplish. In the end fundamentals will prevail, US rhetoric notwithstanding.

Japan needs a cheaper real yen. It can happen in one of two ways: A drop in the nominal rate of exchange to, say, ¥150/\$ and/or a severe domestic deflation *vis à vis* the US. Five-year swaps show a 230 basis point spread in favor of the US, an indication that the markets expect a relative deflation of approximately 12% over five years. Should nominal rates

be impeded from adjusting to more realistic levels, the five-year swap could easily double. This implies a short US/long Japan Treasury note spread.

The US dollar on the other hand has been showing signs of being heavily overbought by the lack of follow through on the release of bullish economic news, particularly against the deutschemark. This weakened technical condition suggests staying away from outright dollar trades.

STRATEGY: *For the above reasons, we have entered in long DM/short yen spread. The cross, which currently trades around 61.10, should advance medium-term to the 70 level. Maintain stops, basis the cross, at around 58.00, New York close (3:00 PM Eastern Standard Time).*

CRUDE OIL

Remain sidelined

Better refining margins are pointing the way to stronger crude prices ahead. At the same time substantial inventory drawdowns, weather induced, may afford OPEC some near-term relief.

STRATEGY: *Having covered our short positions, we remain sidelined.*

COMMODITIES**Cocoa**

A \$60 per tonne mid-month rally put an emphatic end to a near-\$300 per tonne price slide that began December 3, 1993. In retrospect it is clear why the market was as vulnerable as it was. Three consecutive years of production deficits and the prospect of at least several subsequent years of the same, had inspired a flurry of bullish editorializing.

The deficits, however, had not made enough of an impact on the availability of actual supplies to cause significant hedge buying. Bear raids were thus aimed against a long position composed of too high a percentage of speculators. When arrivals from the Ivory Coast harvest came in both higher and earlier than expected — arrivals totaled 575,000 tonnes, or nearly 90% of expected total exports by the third week in January — the trade presumably stepped further to the sidelines. There was therefore too small a cushion to the liquidation of the speculative longs.

That's over now. Open interest has fallen 12% from its peak, indicating the liquidation has run its course. More importantly, from a fundamental point-of-view *La Caisse de Stabilisation de Côte D'Ivoire (Caistab)* is rumored not only to have finished its sales for 1993-94 but also to have oversold in its commitments for the year.

These are bullish short-term factors. Long-term fundamentals are, as we have been arguing for some time now, decidedly bullish as well. Consumption, which has averaged growth of nearly 4% annually for the past 17 years, grew 4.4% last year and can be expected to grow by *at least* as much in '94 given improved conditions in OECD countries, increasing stability in the former Soviet states, and the yawning potential for consumption in China and Southeast Asia. A fourth, fifth, and sixth year of deficits loom.

The question of a bull market of major magnitude is not if but when.

STRATEGY: *There is little risk holding long futures positions now, and adding to them if the premium of one-year forward position to the nearest futures contract in New York (currently about 12%) were to shrink to the US T-bill rate plus 2%.*

Coffee

Growing perceptions that the retention scheme developed by Arabica producers will be effectively managed, coupled with indications of reduced availability from Columbia, leave us comfortable maintaining long positions.

Soybeans and soybean meal

Bean carryover stocks of around 150 mln bushels are at bare minimum and the lowest in recent memory. Plantings in 1994 will have to compete with both corn and cotton, both of which are hardly cheap. (Planting intentions will be published March 31). In order to ration the supply of current crop

supplies and to encourage higher plantings of the 1994-95 crop, prices must rise.

Meal prices have been weighed upon by reduced exports. South American crops, which are expected to reach record levels, predict little solace on the export front. On the other hand, domestic usage is running 2% higher than last year and, given the recent rally in hog prices (which improves the profitability of feeding), could prove higher at the final tally.

Taken together, we believe the post-harvest bear trend in beans and meal has run its course and that prices of both will rise by between 10% and 20% from current levels.

Sugar

It is now clear that in general, sugar fundamentals are bullish. Czarnicow, Licht, and Mann, the three major statisticians, predict a deficit in the current crop year (Sept. 1, 1993, to Aug. 31, 1994) of about 1.5 mln tonnes. The resultant drawdown of stocks will be by approximately 3.0 mln tonnes. This brings the stock-to-usage ratio down below 30%, which historically has been the critical level of risk for consumers.

Furthermore, during the 1994-95 crop year, production will have to increase by nearly 5.0 mln tonnes (to roughly 116 mln tonnes) just to equal production (which is expected to grow by another 1.5 mln tonnes) and prevent yet a third consecutive drawdown in year-end stocks.

The reason we, somewhat phlegmatically, describe these fundamentals as bullish "in general" is that there is no guarantee that those countries suffering a shortfall this year will go to the market to augment their supplies.

In the past decade, import requirements of industrialized countries have diminished and now constitute only 53% of the total (versus 65% in the early 1980s). Price and income elasticities in industrialized countries tend to be low. This is not the case in developing countries.

Conditions this year serve to illustrate the point. The production shortfalls have been borne by cane producers, primarily China, India, and Thailand. Speculation has persisted the entire year as to whether or not China and India would make up for their respective deficits through imports. China has reportedly been offered heavily discounted Cuban sugar for some time. The fact it has not purchased any strongly suggests China will simply do with less.

Reuters reports there are strong rumors amongst trade sources that India will bid for sugar and that it will do so soon. If India does enter the market in a significant way, we believe its buying will be enough to spur prices to the next level of between 12¢ and 15¢. Without additional imports from India (or, of course, another nation, perhaps Mexico) the effects of this year's constructive statistical picture will be lost.

STRATEGY: *Don't misunderstand: We are sanguine but with some trepidation. Maintain profitable long positions and stay in close contact.*

— David B. Rothberg

APPENDIX

Asset inflation: an official view

In its World Economic and Financial Surveys, the Research Department of the IMF has been carrying a number of interesting articles that support our thesis of the inadequacy of modern fiat money systems. While they have as yet not admitted that the problems are inherent in a managed paper regime, they have extensively documented the errors committed by a significant number of central banks in recent years.

We quote some excerpts from "‘Boom & Bust’ in Asset Markets in the 1980s: Cause and Consequences," by Garry J. Schinasi and Monica Hargraves, in *Staff Studies for the World Economic Outlook* (IMF World Economic and Financial Surveys, December 1993):

"...more than in other recent inflation episodes, conventional measures of inflation in the 1980s did not accurately reflect the strong price pressures that ultimately led to unsustainable increases in the prices of tangible and financial assets. For example, conventional measures of inflation in Japan were below 2 percent throughout the 1980s, yet money and credit growth were excessive and asset prices soared. In the United States, inflation rose slightly but was relatively stable during this period, while there were large price increases in commercial and residential real estate markets.

"Given the emphasis placed on conventional measures of inflation — which focus on prices of the flow of goods and services — important information contained in asset prices was not given sufficient attention. This is not to suggest that monetary policy should explicitly target asset prices or that policymakers should react to sharp movements in stock prices, for example, whenever they occur. However, it is clear that the indicators of inflation used by policymakers to judge the appropriateness of money and credit policies did not provide a complete and accurate assessment of the inflation pressures that were building during the mid- to late 1980s. Additional transactions-based measures of prices, with broader coverage than the income- or consumption-based measures, might have alerted policymakers earlier to the strong inflation pressures.

"...In a monetary accounting framework, expansion of the money supply in excess of real GDP growth, which can be referred to as "excess money growth," is potentially inflationary. The gap between this excess money growth and actual inflation (in the GDP deflator) is usually interpreted as a change in velocity — that is, a change in the rate of circulation of money relative to nominal GDP. Changes in velocity are often attributed to improvements in transactions technology or to other institutional factors. Policymakers regularly adjust for velocity changes when they deviate significantly from trend movements or when they are known to be associated with special factors.

"An alternative interpretation of this gap — one particularly relevant for the 1980s — is that it is a residual that represents potential inflation pressures in markets not captured by national income account measures of output and prices. If there is a shift in the pattern of economic transactions, for example, this residual may not be due to shifts in the demand for money, but may carry important information

about inflation pressures affecting other types of economic transactions. As discussed below, this gap is useful for examining the role that monetary policy may have played in the asset price inflation.

"...For Japan and the United Kingdom, measures of both excess money and credit growth suggested that inflation pressures were building in the mid- to late 1980s. In Japan, growth in the monetary aggregates in the mid- to late 1980s was high — relative to inflation — and variable, yet nominal GDP growth was relatively low and inflation measured by the GDP deflator was steady at its lowest level in decades. This divergence reflected a breakdown in the 1980s of the money-price relationships that had prevailed in the 1970s and was associated with changes in the transmission of money and credit growth to goods prices and asset prices. Excess money and credit growth — that is, money and credit growth in excess of growth in real economic activity — increased and remained high during this period. Moreover, the annual gaps between excess money growth and measured inflation (GDP deflator), and between excess credit growth and inflation, averaged $3\frac{1}{4}$ percentage points and $3\frac{3}{4}$ percentage points, respectively. By construction, these gaps represent either a sharp change in behavior — in the form of a significant change in the demand for money and credit balances — or a substantial shift in the pattern of transactions toward assets and other markets not captured in national income measures of final goods transactions. Viewed in this way, the money and credit gaps represented inflation pressures in the economy that were fully consistent with the inflation asset markets."

For an unusual mention of speculation as being the cause of the asset inflation: "...This suggests that supervisory and oversight systems were not expanded sufficiently to keep pace with deregulation. This institutional inertia may have contributed to an environment that encouraged excessively speculative behavior in asset markets.

"...Because of the decrease in central banks' direct control over the volume of lending, interest rates are likely to become more important indicators of the stance of monetary policies. Because asset prices can convey important information about the supply of liquidity, as they did in the late 1980s, changes in asset prices may be incorporated judgmentally into policy analysis."

Right, but wrong. Interest rates cannot be "properly fine-tuned": They must somehow reflect natural forces or the Wicksellian "natural" rate:

"Although standard price measures will continue to be the main focus of monetary policy, it is important to realize that they may not adequately identify inflation pressures in all parts of the economy. Perhaps the most dramatic example is what occurred in Japan, where, by conventional measures, price stability was maintained throughout the 1980s, even during the dramatic asset price inflation during 1986-90. The flow of goods and services is only a small part of total transactions that occur during any given period and focusing on consumer or producer prices discards much of the informa-

tion available for measuring inflation pressures. Although asset prices are volatile and are determined by many factors other than monetary policy, they should not be ignored when there is reason to believe that excess liquidity is being channeled into asset markets rather than flow markets.

"Another question is whether monetary policy should respond to sharp movements in asset prices. To the extent that asset prices adjust rapidly because of portfolio adjustments or other fundamental changes in the real economy for

example, monetary policy would have little, if any, role except to ensure that these adjustments occur in a stable financial environment. However, to the extent that asset price changes are related to excess liquidity or credit, monetary policy should view them as inflation and respond appropriately. There is nothing unique about asset markets that would suggest that asset prices can permanently absorb overly expansionary monetary policies, without ultimately leading to costly real and financial adjustments."

FRIEDBERG CAPITAL MARKETS

DB Group Ltd.

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

Issuer: DB Group Ltd. (New Zealand company)

Securities: Non-callable subordinated convertible notes

Maturity: June 30, 1996

Principal: NZ\$85¢ per note

Coupon rate: 7% on principal value

Outstanding: NZ\$106 million

Conversion: One common share of the issuer or NZ\$85¢ cash per note on maturity date

Recent price: NZ\$92¢ per note

Stock price: NZ\$84¢ per share

Company overview

DB Group Ltd. (DBG), known as Magnum Corp. Ltd. before December 1992, is a major beer and wine company listed on the New Zealand stock exchange. The company's main businesses are as follows:

- **DB Breweries:** New Zealand's second-largest brewer (40% share), only behind Lion Nathan (55% share). Provided 38% of DBG's sales and 75% of earnings before interest and tax (EBIT).
- **Corbans Wines:** New Zealand's second-largest wine company (38% share), only behind Montana Wine of Corporate Investments Ltd. (40% share). Provided 33% of DBG's EBIT.
- **Allied Liquor:** New Zealand's second-largest wines and spirits distributor.
- **The Liquorland, Robbie Burns, and Green Bottle** retail liquor chains (some are franchised).
- **DB Hotels:** A chain of 53 hotels in New Zealand. Classified as non-core assets and being put up for sale.
- **Travelodge and Parkroyal Hotel:** Classified as non-core assets and being put up for sale.
- **Austotel:** A hotel chain in Australia. 50% owned by DBG. Classified as non-core assets and being put up for sale.

DBG is 50% owned by **Brierley Investments** (BI), a New Zealand investment holding company, and 5% by **Asia Pacific Breweries** (APB) of Japan, which is 80% owned by **Heineken NV** of the Netherlands. In the past few years, DBG has aggressively diversified into the food and hotel business in both New Zealand and Australia through debt-financed acquisitions. However, the performance of these investments has been far from satisfactory, and the prices that DBG paid for these assets are obviously too high.

DBG also faced problems in the domestic market. The per capita beer consumption in New Zealand has been de-

clining since 1989, and worse still, DBG has been slowly losing share to the market leader, Lion Nathan. Furthermore, inadequate cost control at DB Breweries has caused profit margin to erode substantially. Last but not least, DBG's retail chain has suffered from the New Zealand government's deregulation of the liquor distribution system, which allowed other outlets such as supermarkets to sell beer and wine.

The disappointing performance of its key business units together with high interest costs have caused DBG's financial position to deteriorate rapidly. In 1992, DBG embarked on a major restructuring program to re-focus the company on the beer and wine business in New Zealand. All non-core assets would be sold in order to reduce the amount of debt.

Refocusing strategy

Owing to DBG's serious financial problems, both BI and APB have participated in DBG's management more actively. A new CEO, James Strong, was hired in June 1992. He initiated the strategy to restore DBG to a core liquor company in New Zealand by selling all non-core assets. The proceeds from asset sales will be used to pay down DBG's debt. In addition, with the help of APB, several projects that aimed to improve the efficiency and strengthen the market position of DBG's core brewery business are under way.

So far the assets sold include the grocery business, interest in Wilson Neill Ltd. and 37 hotels in New Zealand. A total of \$230 million was raised. All the remaining hotel assets are expected to be sold in 1994 and 1995. DBG will become a pure New-Zealand-based liquor company after all the non-core assets are sold.

In order to be cost-competitive with Lion Nathan, DB Brewery is carrying out a series of cost-reduction initiatives. It decided to spend \$28 million upgrading the Waitemata Brewery, which is DBG's main brewery, to make it one of the world's most technologically advanced breweries. The project should reduce annual production cost by \$2 million to \$3 million and substantially improve the quality of beer produced.

Furthermore, DBG has a 25% interest in a joint venture aluminium can factory in Auckland, New Zealand. Instead of importing from Australia, DBG started obtaining can supplies from the joint venture in September 1992. Lower can and inventory costs should save DBG \$3 million per annum.

In addition to the above initiatives, DBG will further cut costs by reducing the size of its workforce. It also has started using smaller cans (355 ml instead of 375 ml, the same as Lion Nathan's) to save on excise tax. The estimated total annual

savings from these programs is between \$8 million to \$10 million, with the first full-year effect in 1995.

In the marketing area, DBG introduced its first light full-taste dark beer, Mako, in 1993. While New Zealand's beer consumption is declining, light beer's market share is expected to increase from 1% currently to over 6% in one year, owing to stricter drunk driving legislation (e.g., compulsory breath testing). Although Mako has to compete with Lion Nathan's established brand, its performance has been satisfactory. We believe it will be the major source of earnings growth for DBG.

Another major source of growth is the Corbans Wines operation, which has been the most profitable division of DBG. In fiscal 1993 it contributed only 15% of total revenue but 33% of EBIT. Revenue increased 15% and EBIT rose 17% over 1992. Although domestic demand growth is slow, DBG can improve profitability by increasing export sales and pushing the more profitable bottle products.

The major competitive factor of this division is to maintain an adequate supply of high quality grapes. Currently 45% of grapes were supplied by Corbans' own vineyards (versus 40% of Montana). We believe DBG may have to raise this percentage to over 50% in order to improve the consistency of grape quality and reduce cost in the long run. Our preliminary estimate of the required investment is between \$6 million to \$10 million, which DBG's operating cash flow should be able to finance.

In short, DBG is a major player in a mature industry. Owing to the duopolistic market structure, DBG should concentrate on cost reduction to defend market share. It also should actively identify niches (e.g., light beer) to maintain sales growth. The cash generated from its core business should be used to finance the growth products. It seems that the management of DBG is heading in the right direction: Proceeds from asset sales are being used to pay down debt and reduce interest costs; cash from operations will be used to finance capital expenditures.

In November 1993, BI announced that it would sell its 50% stake in DBG to its joint venture partner APB for \$115 million (\$1.08 per share). BI also made an offer to buy DBG's 50% stake in Austotel for \$76.6 million. We view these steps as very positive for DBG's turnaround efforts. The new majority owner has extensive industry experience, strong brand equity (Heineken), and good local market knowledge (involved with Lion Nathan early on) to help DBG restructure and improve its core business. The sale of Austotel will give DBG the much needed cash to repay its debt. Consequently, these changes have further strengthened our confidence in DBG's long-term prospects.

Financial analysis

Both the sales and EBIT of DBG have declined in the past two years, partly because of lower contributions from DB Breweries and partly divestitures of non-core business. The total revenue in fiscal 1993 was \$761 million and EBIT was \$32 million. However, the bottom line was a net loss of \$23 million, owing to \$37 million restructuring charges and \$16 million net interest expense. In fiscal 1992, DBG's net loss was even larger, at \$233 million, principally because of \$264 million asset writedowns.

With stabilizing beer market share and cost reduction

efforts, we forecast DBG's fiscal 1994 sales to decline to \$742 million but its EBIT to remain flat at \$32.5 million. The forecast fiscal 1995 and 1996 EBITs are \$36 million and \$44 million, respectively. The earnings growth should be mainly driven by margin improvement at DB Breweries and continued growth at Corbans Wines. The profitability of Lion Nathan, DBG's key competitor, has doubled in the past five years, and its EBIT margin currently is almost twice that of DB Breweries. Therefore, we believe there is plenty of room for DB Breweries to improve its margin once they have set it as their top priority.

The net income of DBG depends heavily on two items: net interest expense and asset writedowns. The amount of net interest expense in turn depends on how much debt can be repaid by selling assets. Our projections of asset sales are as follows:

(\$ million)	FY94	FY95
DB Hotels	15.0	14.0
Parkroyal/Travelodge	50.0	0.0
50% of Austotel	76.6	0.0
Total proceeds	141.6	14.0

Together with existing cash and short-term investments of \$122 million, the projected asset sales in fiscal 1994 will generate enough cash to repay \$244 million of term loans. In this scenario, the amount of outstanding debt will be reduced to \$111 million by the end of fiscal 1994. The net interest expense will, therefore, fall to \$9.8 million in fiscal 1994 and further to \$5.4 million in fiscal 1995. DBG's financial position will be markedly improved following these asset sales. Its debt to market capitalization ratio should fall to 0.8 from 1.7; its pretax interest coverage (before restructuring/extraordinary items) should increase to 3.3 from 1.9.

Nevertheless, the pending sale of DBG's interest in Austotel to BI at \$76.6 million will call for an extraordinary writeoff in the area of \$70 million. Austotel is currently being carried on DBG's books at \$150 million (\$110 million purchase cost plus \$40 million advance). However, we believe \$76.6 million is still a fair price as, according to Garlick & Co.'s estimate, the net value of Austotel is approximately \$50 million. We view this expected writeoff as fully discounted in DBG's share price.

As a result of the writeoff, DBG should have a net loss in fiscal 1994. Assuming no major writeoffs for the remaining assets, we forecast its pretax income to be \$30.8 million in fiscal 1995 and \$40.7 million in fiscal 1996.

Valuation of the convertible notes

Trading at 92¢ per dollar, the convertible notes provide a minimum yield to maturity of 3.8% if the holders elect to receive cash of 85¢ at maturity. We believe the stock will very likely trade at \$1 to \$1.1 per share by 1996, which will increase the yield to approximately 14% if the notes are converted. A sensitivity analysis indicates that the yield can go up to 22% if the stock trades at \$1.3 per share.

Our valuation is based on pretax P/E ratio, market capitalization to EBIT ratio and benchmarking against Lion Nathan. The reason for using pretax P/E is to eliminate the effect of tax benefits on earnings, which affect both DBG's

and Lion Nathan's bottom line. The use of market capitalization to EBIT measures how the market values a company's fundamental profitability.

The following set out our projections of DBG's share price in 1996:

	DBG	Lion
Current pretax P/E	Neg	18
Projected 1996 pretax P/E	11	
Projected 1996 pretax EPS*	\$0.1	
Projected 1996 share price	\$1.10	
Current mkt cap to EBIT	8.5	13.2
Projected 1996 mkt cap to EBIT	9.0	
Projected 1996 EBIT per share*	\$0.11	
Projected 1996 share price	\$0.99	

*The 1996 per share figures of DBG are fully diluted, assuming conversion of all the notes.

Our valuation of DBG is very conservative, since the projected pretax P/E and market capitalization to EBIT multiples are substantially below the current levels of Lion Nathan. We believe by 1996 DBG will have considerably closed the profitability gap with Lion Nathan, and therefore, its shares may trade at even higher multiples than we assumed.

Apart from the upside potential, DBG's convertible notes have very strong downside protection. Our estimated asset coverage on a liquidation basis is 2.1X. We believe our estimate is conservative, since we assumed all non-liquor assets could be sold for only \$95 million in a liquidation (versus \$155 million projected above on a going-concern basis). The scheduled debt reductions will significantly improve DBG's financial position and lower interest costs. Hence, we believe the notes' risk of loss is very small.

STRATEGY: *The subordinated convertible notes of DB Group Ltd. are an attractive investment for aggressive accounts, as they represent a play on the company's turnaround. The minimum yield to maturity is 3.8%, approximately 160 basis points below comparable New Zealand Government bond yield. However, we believe the likely yield will be 14%, based on \$1 per share in 1996, the low side of our estimate. Given a rapidly improving balance sheet, we see only small downside risk in the notes. Henceforth, Friedberg Mercantile Group will be making a continuous market in the security.*

Tranz Rail Ltd.

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

Issuer: Trans Rail Ltd. (New Zealand company)

Security: Non-callable subordinated debentures

Maturity: October 15, 1999

Coupon rate: 10%

Outstanding: \$65 million

Recent price: \$109.05

Yield: 7.97%

Company background

Tranz Rail Ltd. (TRL) is a holding company newly created to purchase New Zealand Railway Ltd. (NZRL) in the latest privatization program of the New Zealand government. NZRL

operates New Zealand's only rail network, providing freight and transportation services. It also runs a joint freight and passenger ferry operation between the South Island and North Island.

TRL is owned by a consortium consisting of the following entities:

Wisconsin Central Transportation Corp. (US rail company)	27.0%
Berkshire Partners (US merchant bank)	27.0%
Fay, Richwhite & Company Ltd. (NZ investment bank)	31.5%
Alex Van Heeren (NZ private investor)	9.0%
David Lloyd Group (owned by the Richwhite family)	4.5%
	100.0%

The privatization of NZRL is characterized by the following chronological events:

- Before 1982, railway operations had been under the control of the New Zealand Government Railways Department.
- Deregulation of the transportation sector started in 1982, when the Railways Department was reorganized as a statutory corporation, the New Zealand Railways Corporation (NZRC).
- Being more commercially oriented, NZRC had extensively restructured its operations by significantly downsizing the company. In January 1990, NZRC defeased debts of \$1.1 billion by agreement with the Crown and wrote down its assets by \$860 million.
- In October 1990, the New Zealand government created NZRL as a wholly owned limited liability company, which bought all the assets of NZRC except those of the road bus services, parcel services and land, at a price of \$185 million.
- The Crown decided in July 1993 to sell NZRL to private investors, and TRL won the bid at \$328.3 million. TRL financed the purchase in the following manner:

Equity	\$105 million
Senior term loan	180 million
Sub. debentures	65 million
Total	\$350 million

NZRL's business

NZRL's major profit centers are the railfreight services and passenger services groups, which accounted for over 90% of its revenue.

Railfreight: Railfreight is the principal business of NZRL. It generated 74% and 69% of the company's total revenue in 1992 and 1993, respectively. Organized into five business units, the railfreight group provides rail transportation to various agricultural and industrial customers. Chart 6 describes the services of railfreight.

Passenger: The passenger services group provides urban and long-distance rail passenger services and markets the Inter Island Line ferry services. In 1993 it accounted for 24.6% of NZRL's total revenue. Passenger services consist of four business segments, which are intercity services (both North Island and South Island), Inter Island Ferry, Cityrail Auckland (urban services) and Cityrail Wellington (urban services).

The Inter Island Ferry is the largest segment, contributing an estimated 52% of total passenger freight revenue. It offers up to six sailings per day in each direction between

Wellington and Picton. The second-largest segment is Cityrail Wellington. With an estimated revenue contribution of 27%, it carried over 10 million passengers in 1992.

Financial analysis

Our analysis is based on NZRL's fiscal 1992 and 1993 financial results, which are the only ones available, since it is not a public company. Its fiscal 1993 revenue declined slightly to \$489 million from \$496 million a year ago, mainly owing to a 8.5% drop in railfreight revenue. However, the passenger services performed strongly, boosting revenue by 22% to \$120 million in fiscal 1993. Operating margin increased to 9.3% from 8%. Because of a \$23 million restructuring charge, its net margin fell to 3.7% from 7.3%.

Since NZRL is the only rail company in New Zealand, we have to compare it with major rail companies in North America to evaluate its financial performance. Chart 7 lists some key financial ratios of TRL and North America's major public rail companies. The comparison indicates that TRL considerably underperformed its North American peers in profitability. Its operating margin and ROE are the second-lowest and its ROA is the third-lowest. In addition, TRL's leverage is also high among its peers. Since all the North American rail companies are privately run, the underperformance shows that there should be plenty of room for TRL to improve NZRL's profitability as a profit-oriented rail operator. An improvement in the profit margin will significantly increase its ROA and reduce its leverage relative to its peers.

TRL's consolidated capital structure is as follows (in \$ million):

Long-term debt:			
Term loan of NZRL	\$	71.7	
Term loan of TRL		180.0	
Sub. Debentures		65.0	\$316.7
Equity:			
Equity of NZRL		265.5	
Equity of TRL		105.0	370.5
Total capital			\$687.2

Currently 46% of TRL's capital is long-term debt, which means a high degree of leverage. The high leverage is a result of TRL financing the purchase of NZRL mainly by debt. As profitability improves and NZRL continues to generate healthy operating cash flow, TRL's leverage should be gradually reduced to become more in line with its North American peers.

NZRL's prospects

NZRL is a monopoly in rail transportation in New Zealand, but it competes with other modes of transportation, which include sea, air, bus, and truck. Rail has its unique advantages over other transports, especially to bulk commodities, owing to its low costs and sometimes convenient locations.

NZRL's business depends heavily on the general economic condition of New Zealand and that of its export markets. Its railfreight services are particularly sensitive to the economic cycle since over 40% of merchandises being transported are raw and processed materials for industrial production.

New Zealand's economy is undergoing a solid recovery. The recovery was driven by prudent fiscal policies, stable prices and healthy export performance. The majority of New

Zealand's exports are primary commodities (e.g., dairy, meat and forest products accounted for over 40% of exports), which often use rail for transportation. Moreover, Australia, Japan and the US, which were the top three export markets and accounted for 46% of New Zealand's exports in 1992, are coming out of the recession. Doyle Paterson and Brown Ltd. forecast that exports would grow 5% in 1994 and 3.5% in 1995.

In summary, an improving economic environment together with a new profit-oriented management team should be able to improve NZRL's operating results substantially.

Valuation of security

TRL's subordinated debentures are currently trading at \$109.05, yielding 7.97%, approximately 220 basis points above comparable New Zealand government bond yield. The debentures are an attractive investment as the spread will certainly narrow when TRL gradually de-leverages with improved operating results. TRL's proforma pretax interest coverage at 2.1 and pretax operating cash flow to interest at 2.5 indicate a low default risk.

Chart 8 provides comparative valuation data of rail bonds on the market.

The data show that high leverage is likely to be the main reason that TRL's debentures provide a much larger spread over domestic government bond yield than other rail bonds. Based on its good interest coverage and healthy operating cash flow, the spread of TRL's debentures should narrow to a maximum of 100 basis points, which implies a yield of 6.3% and a price of \$117.4.

Furthermore, TRL's debentures have strong downside protection. The estimated liquidation value of the company, which is based on an average 40% discount on the assets' book value, can still cover 97% of the debentures' face value after paying off all senior debt. An alternative measure of asset coverage is to estimate TRL's enterprise value instead of its liquidation value, since it can be argued that NZRL is a monopoly and many of its assets are highly specialized. Chart 9 provides benchmark valuation data of TRL's North American peers.

As mentioned above, TRL currently has a lower valuation because of its high leverage. Therefore, we used the lowest figure rather than the averages in each valuation measure to estimate TRL's enterprise value. The results are given in Chart 10. Even the lowest estimate of TRL's enterprise value translated into a coverage of 1.6X, which is higher than in the case of liquidation.

Consequently, regardless of whether the liquidation value or enterprise value is used, the subordinated debentures show a very good asset coverage and thus possess very limited downside risk.

STRATEGY: *We believe the 10% subordinated debentures of Tranz Rail Ltd. are an attractive investment for all accounts, as they provide, at a very low risk, 220 basis points of yield pickup over comparable New Zealand Government bonds. The credit quality of this newly privatized rail operator should steadily improve with better efficiency and New Zealand's solid economic recovery. Henceforth, Friedberg Mercantile Group will be making a continuous market in the security.*

— Edison Lee

Chart 6
NZRL's Railfreight Services

Service	Features	% of Railfreight Revenue*
Bulkflow	Bulk raw and processed materials such as coal, grain, steel, fertilizer and petroleum products. Large volume often needs a dedicated train.	24
Forestry	Raw and processed forest products such as log, pulp and paper. Proximity to mills is important.	18
Cargoflow	Cargo shipment to and from ports and between storage points in New Zealand. Mainly agricultural exports such as meat and dairy products.	26
Distribution	Wholesale service to private freight forwarders. Also handles motor vehicle transportation and storage.	12
Freight Forwarding	Consolidates less than full container lots and transports them to a main center, de-consolidates and delivers them to final destinations.	20

*Estimate

Chart 7
Financial Ratios of Rail Companies

Company	Sales (US\$ million)	Operating Margin (%)	ROA** (%)	ROE*** (%)	Debt/Equity Ratio
TRL*	273	9.3	3.1	4.9	1.6
Burlington Northern	4,699	12.9	4.6	16.1	1.1
Chicago & Northwest	1,043	17.7	1.8	26.8	8.8
Conrail	3,400	16.0	3.9	5.4	0.7
Norfolk Southern	4,548	19.2	5.4	16.0	0.4
Santa Fe Pacific	2,726	3.1	-2.0	17.7	1.6
Illinois Central	565	29.3	6.1	19.0	1.1
Wisconsin Central	137	21.2	4.3	7.5	0.6

*On a consolidated and proforma basis giving effect to the \$65 million debentures sold after the end of fiscal 1993.

**ROA = Return on assets

***ROE = Return on equity

Chart 8
Valuation Statistics of Rail Bonds

Issuer	Coupon	Maturity	Yield	Spread over gov't	Debt/Equity Ratio	Pretax Interest Coverage
TRL (NZ)	10%	10/15/99	7.97%	220 bps	1.6	2.1
Canadian Nat'l (CN)	9.625%	5/14/99	6.95%	64 bps	N.A.	N.A.
CSX (US)	4.5%	7/1/99	5.90%	71 bps	1.2	1.03
Burlington Northern (US)	3.125%	1/1/00	6.29%	66 bps	1.1	3.4

Chart 9
Valuation Statistics of Rail Companies

Company	P/E	Price/Sales	Price/Book
Burlington Northern	21.0	3.11	1.21
Chicago & Northwest	19.1	6.02	1.15
Conrail	25.4	1.91	1.52
Norfolk Southern	19.8	2.21	2.24
Santa Fe Pacific	13.9	3.92	1.72
Illinois Central	17.6	4.64	2.84
Wisconsin Central	34.8	3.68	3.80
Average	21.6	3.64	2.07

Chart 10
Asset Coverage of TRL's Debentures

(\$ million)	P/E at 13.9*	Price/Sales at 1.91	Price/Book at 1.15
Enterprise value	556	932	426
Less: current liabilities & senior debt	324	324	324
Balance	232	608	102
Coverage for the debentures' face value	3.6X	9.4X	1.6X

*Earnings before restructuring charge of \$40 million was used.

Chart 13
FOREIGN CURRENCY BONDS

Date: February 22, '94 We Offer The Following Bonds Subject To Change Without Prior Notice: Minimum US \$4,000 (CDN. \$5,000)

ISSUER/MATURITY DATE/COUPON	BID	OFFER	CURR. ANNUAL YLD. TO MTY.	NEXT PAYMENT INTEREST DATE
DEUTSCHE MARK DENOMINATED				
BANK OF NOVA SCOTIA 5½% 07/05/96 RRSP eligible	99.60	100.45	5.39 %	May 07
WORLD BANK 5½% 4/02/97 RRSP eligible	102 3/4	103.60	4.53 %	Feb. 04
WORLD BANK 9% 13/1/00 RRSP eligible	116.65	117 ½	5.77 %	Nov. 13
KINGDOM OF DENMARK 6¼% 15/04/98	101 ½	102.10	5.54 %	Apr. 15
ARGENTINA 8% 5/10/98	102	102.85	7.23 %	Oct. 05
FINNISH MARKKA DENOMINATED BONDS				
REP. OF FINLAND 11% 15/6/95	106.45	107.30	4.97 %	Jun. 15
ITALIAN LIRA DENOMINATED BONDS				
NORDIC INV. BANK 12¼% 19/04/96	106 ½	107.10	8.56 %	Apr. 19
GENERAL ELECTRIC 11½% 7/02/95	101.65	102 ½	8.54 %	Feb. 07
SWISS FRANC DENOMINATED BONDS				
GENERAL ELECTRIC 4¾% 2/7/98	102 ½	103.35	3.89 %	July 02
DANISH KRONE DENOMINATED BONDS				
KINGDOM OF DENMARK 9% 15/11/94	101 ½	102.35	5.40 %	Nov. 15
ECU DENOMINATED BONDS				
UNITED KINGDOM 9¼% 21/02/01	114.85	115.70	6.28 %	Feb. 21
BRITISH POUND DENOMINATED BONDS				
KGDM OF SWEDEN 8¾% 23/5/96	105 3/4	107	5.34 %	May 29
FRENCH FRANC DENOMINATED BONDS				
CREDIT LYONNAISE 9½% 23/12/96	108.55	109.40	5.77 %	Dec. 23
JAPANESE YEN DENOMINATED BONDS				
WORLD BANK 5¼% 7/8/96 RRSP eligible	106.65	107.60	2.49 %	Aug. 07
CANADIAN DOLLAR DENOMINATED BONDS				
ONTARIO HYDRO 10¼% 08/01/96 (semi annual)	109.35	110.85	4.74 %	Jul. 08
EKSPORTFINANS 7¾% 5/11/97	104.30	-	-	Nov. 05
ROYAL BANK OF CANADA 9¼% 7/1/97	107 3/4	108 3/4	5.70 %	Jan. 07
SOUTH AFRICAN RAND DENOMINATED BONDS				
ESCOM 12% 1/5/96 (semi)	102.10	102.95	10.70 %	May. 01
AUSTRALIAN DOLLAR DENOMINATED BONDS				
COMMONWEALTH BANK OF AUSTRALIA 14% 01/07/94	102.15	103.35	3.51 %	Jul. 01
NEW ZEALAND DOLLAR DENOMINATED BONDS				
NEW ZEALAND GOVT 10% 15/7/97 (semi)	113.85	114.70	5.21 %	Jul. 15
FLETCHER CHALLENGE 10.75% 15/12/97 (semi)	111.05	111.90	7.12 %	Jun. 15
FLETCHER CHALLENGE 10.15% 30/11/98 (semi)	110.20	-	-	May 30
CORPORATE INVESTMENT LTD. 13½% 19/6/95 (semi)	92	-	-	Jun. 19
ARGENTINEAN PESO DENOMINATED BONDS				
ARGENTINA BIC V FIXED/FLOATING 1/05/2001 callable in full on every interest date	95.30	96.30	6.78 %	4th day of mth.
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS				
DATAPOINT CORP. 8¾% 1/6/96	87 3/4	88 3/4	10.80 %	Jun. 01
CV @ \$18.11 p/sh (semi)				
BURNUP & SIMS 12% 15/11/00 (semi)	103 3/4	104 3/4	11.27 %	May 15
CV @ \$16.79 p/sh				
ATARI CORP. 5¼% 29/4/02	69	70	11.00 %	Apr. 29
CV @ \$16.31 p/sh				
COEUR D'ALENE 6% 10/6/02	101	102	5.69 %	Jun. 10
CV @ \$26.00 p/sh				
GLYCOMED 7½% 1/1/03 CV @ \$14.06 p/sh (semi)	85 ½	86 ½	10.11 %	Jul. 01
T.W.A. 10% 3/11/98 (semi)	82.15	83	15.21 %	Feb. 01
T.W.A. 17¼% 15/3/93	41.55	43.55	-	N/A
U.S. DOLLAR DENOMINATED FIXED RATE BONDS				
FARM CREDIT CORP. 7¾% 10/06/96 RRSP eligible	105 3/4	106 5/8	4.60 %	Jun. 10
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES				
UNITED KINGDOM 3/09/96	99.72	100.02	3 1/8 %	Mar. 30
3 mo. LIBID-½ (qly) *callable @ 100				
BOCON 1/4/01 (30 day LIBOR)	94.40	95 ½	6.80 %	May 1/97
starting to accrue May 1, '97				
ARGENTINA: SERIES L: FRB 31/03/05	85 ½	86 ½	6.66 %	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 12

Recommended current portfolio allocations

1. New Zealand Gov't 15%
2. Fletcher NZ\$ 15%
3. Tranz Rail NZ\$ 5%
4. DB Group NZ\$ 5%
5. FRB/BIC 20%
6. U.K. FRN 5%
7. Burnup & Sims 5%
8. Atari 5%
9. Datapoint 5%
10. TWA 10% 5%
11. Coeur D'Alene 5%
12. Glycomed 5%
13. European Currency 5%

HOTLINE UPDATE

Flash update, Monday, January 24, 1:20 pm:

Failure to follow through on the down side prompts us to immediately reinstate long gold positions. Buy April gold at the market, presently trading at 383.20, placing stops at 379, good any time.

Tuesday, January 25:

This is a recap of this week's recommendations. On Monday January, 24, via flash update, we bought April gold at 383.20, placing stops at 379, good anytime. As well, we have one new recommendation: Cover all short crude oil positions and liquidate crude oil puts at the market.

Friday, January 28:

The following is a recap of this week's recommendations. On Monday, January 24, via flash update we bought April gold at 383.20, placing stops at 379, good anytime. On Thursday, January 27, we were stopped out of this position. On Tuesday, January 25 we covered our short December '94 crude position at 16.42 and liquidated 16 crude puts at 93.

We have one new recommendation: Place stops in short Canadian position at 7745, close only basis.

Tuesday, February 1:

There are no new recommendations. We would like to remind you that we liquidated all our puts and covered all our short positions in crude oil as per our flash update on Monday, January 24. The market definitely looks higher.

Flash update, Friday, February 4, 8:20 am:

Having been stopped out, on January 27, of our long gold position but not on our long silver position, demonstrated the obvious relative strength superiority of silver over gold. We like going with strength and therefore advise gold bulls to jump on the silver bandwagon, buying July silver at the market. Platinum would represent an excellent second choice, while gold remains a poor third. Be that as it may, precious metals should explode upwards in coming weeks. Raise March '94 silver stops to 5.10, close only; place stops on any new April platinum and April gold long positions at 370 and 374, good anytime.

A second recommendation: Establish new short position in March '94 Japanese yen at market, placing stops at 94.25, close only.

Flash update, Friday, February 4, 2:05 pm:

This morning before the opening, we flashed the sale of March Japanese yen at the market, which opened at 92.55. Being that we have such a windfall gain, we advise to accept profits. Cover short March Japanese yen positions at the market, presently trading at 91.50.

Friday, February 4:

This is a recap of this week's recommendations. This morning we flashed a recommendation before the opening to sell March Japanese yen at the market, which was executed at 92.50. At 2:05 pm we flashed to cover the March yen to take advantage of the large windfall gain. The buyback was executed at 91.55. Stand aside and wait for new reentry instructions. Our new recommendation for 3:30 pm: Liquidate long March S&P position at 474.00 stop, close only.

We now repeat this morning's message:

Having been stopped out, on January 27, of our long gold position, but not on our long silver position, demonstrated the obvious relative strength superiority of silver over gold. We like going with strength and therefore advise gold bulls to jump on the silver bandwagon, buying July silver at the market. Platinum would represent an excellent second choice, while gold remains a poor third. Be that as it may, precious metals should explode upwards in coming weeks. Raise March '94 silver stops to 5.10, close only; place stops on any new April platinum and April gold long positions at 370 and 374, good anytime.

July Silver opened today at 557.50, April platinum opened at 398.50, April gold opened at 389.80.

Tuesday, February 8:

There are no changes or new recommendations.

Friday, February 11:

There are no changes or new recommendations.

Flash update, Monday, February 14, 8:45 am:

Sell March Japanese yen at market, presently trading at 95.90.

Friday, February 18:

The following is a recap of this week's recommendations. On Monday, February 14, via flash update, we sold March Japanese yen at approximately 95.90.

Friday, February 18:

We have two new recommendations.

1. Buy March deutschemark at the market. This long deutschemark position should leave us with a cross trade of long DM/short Japanese yen, which is presently trading at 61.15, placing stops at 5800, basis the cross, good at the close of business 3:00 pm Eastern Standard Time.

2. Sell March S&P at the market; place initial stops at 475.40 good anytime.

Tuesday, February 22:

There are no new changes or recommendation.

Friday, February 25:

This is a complete summary since our last market letter dated January 23, of all liquidations and all open positions and new recommendations that remain outstanding.

On Friday February 4, we renewed our advice to aggressively add to long silver; as a second choice purchase platinum followed by gold. Stops were placed at 510, basis March silver, close only; 370, basis April platinum; 374, basis April gold, both good anytime.

On Monday, February 14, we advised the sale of March Japanese yen, then trading at 9590.

On Friday, February 18 we advised the purchase of March deutschemark, which left us long the deutschemark/short Japanese yen as a cross trade, then trading at 6115. Stops were placed at 5800, basis the cross, good at the close of business 3:00 pm New York time. We also advised the sale of March S&P at the market.

You should be short March S&P as at the opening on Tuesday, February 22, at 468.80. Stops were placed at 475.40, good anytime.

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