

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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The markets' message

In recent weeks, metals' prices and an increasing number of other commodities have demonstrated a long-forgotten ability to mount and sustain price rises. At the same time, a trade-weighted US dollar index has fallen to its lowest levels in five months, which was not supposed to happen. And finally, long interest rates, having risen *more* than short-term rates, have now touched the highest levels in more than one year.

The message is clear: The Fed has moved too little and too late. This should come as no surprise, because the Fed no longer counts with a specific and reliable anchor. Given financial innovation and the volatility of the demand for money, money supply growth rates no longer bear a close relation to nominal GNP (although they certainly bear a high degree of correlation with inflation *in the long run*).

Targeting nominal interest rates is as absurd as fixing the price of wheat or shoes, while targeting real interest rates presumes that the monetary authorities possess divine-like intelligence to be able to estimate the rate of interest that would equate genuine savings and investments.

Consumer prices and labor costs indexes suffer from informational lags and imprecision. Worst of all, they are backward-looking measures, as they say nothing about future price behavior. Highly sensitive raw commodity prices, too, may merely be reflecting specific supply shortage, such as natural catastrophes, and political or military disruptions, or, conversely, supply increases due to finds or new technological processes.

As argument from *breadth* can be made, however, with respect to raw commodity prices. Presumably, a broad enough advance and/or decline would signal a genuine build-up of inflationary/deflationary pressures. Interestingly, we found breadth to possess good leading characteristics, giving the monetary authorities ample time to act (see Chart 1).

The incipient inflation of the late '80s was fortuitously nipped in the bud, not by a tightening of the Fed but by a severe recession in the industrialized world. In the words of Canada's former Central Bank Governor John Crow, "it should be noted that there were a number of 'surprises' in this period that tended to be favorable from the viewpoint of reducing inflation.

"What economists call supply or price shocks are for the most part thought of as increasing inflation, as were, for example, the shocks of oil prices in the 1970s. However, this need not be the case. It has not been the case for the recent period. In particular, commodity prices have been unusually low, in part as a result of unusually heavy sales of industrial materials from Russia, and in part because world industrial

activity turned out to be weaker than had been expected. Accordingly, the real surprise would have been if inflation had not turned out to be in the lower part of the indicated range."

Next time, the Fed may not be so lucky, and it may well have to pay close heed to the rising breadth curve. Aside from CRB breadth, our three favorite choices are the yield curve, the price of gold, and the differential in the rates of growth between the Adjusted Monetary Base and M1. Past issues have discussed the meaningfulness of these "indicators" at great length.

At this time the yield curve remains historically wide and has even widened somewhat since the Fed's quarter-point hike in its funds rate. Similarly, gold trades dangerously close to its multi-year highs of \$410/oz. and well above its 12-month low of \$325/oz.

Finally, the rates of growth of the Adjusted Monetary Base and M1 have begun to diverge rather significantly in recent months: The former has grown at a 10.6% annual rate in the past six months and 19.2% over the past two months compared with a much more moderate rate of 7.5% and 5.6% respectively for the latter.

The implication is that the Fed is *creating* (via the mone-

In this issue

- 2 Precious Metals**
A compelling case for precious metals
- 3 Currencies**
Long DM/short yen
- 4 Canadian dollar**
Waiting for more rate hikes
- 4 Stock Indexes**
Can stocks weather the storm?
- 4 Interest Rate Futures**
Bullish on rates, bearish on bonds
- 5 Friedberg Capital Markets**
Update on Coeur D'Alene, gold bull/yen bear notes, convertibles' downside risk, Argentina's floating-rate bonds
- 8 US, Canada, Mexico**
Statism, Nafta, and Clinton's health plan

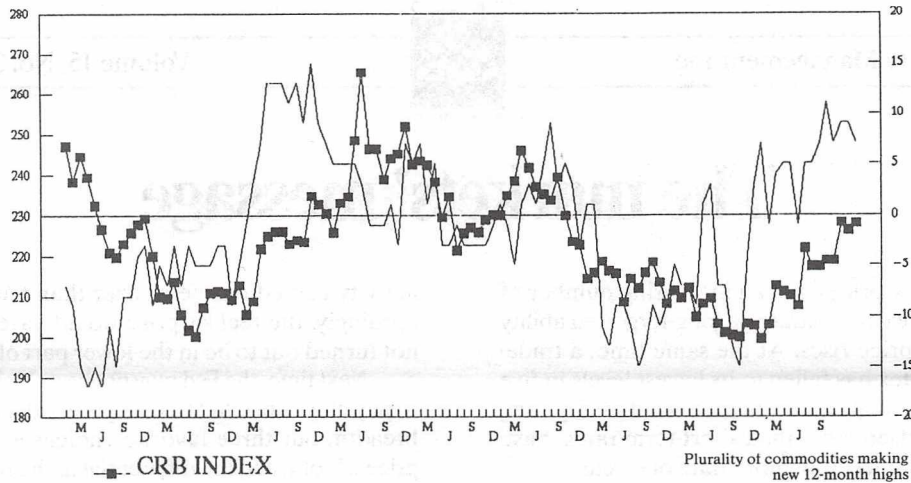
Contributions by Albert D. Friedberg, Edison Lee, Michael D. Hart, Murray N. Rothbard, Llewelyn Rockwell, Jr., and Paul G. Merski.

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tary base) much more money than what is being demanded (public holdings of transaction balances). This is the first

important divergence in at least four years and is confirming what the markets are saying: The Fed has been too easy.

Chart 1 – CRB vs. BREADTH



PRECIOUS METALS

A compelling case for precious metals

We need only list them:

- 1) Rising economic activity in the OECD countries superimposed on years of easy money;
- 2) A boom gone out of control in China, a major buyer of gold;
- 3) Booming economic conditions in India coupled with the important reduction in import tariffs for silver;
- 4) The proliferation of structured bonds (one of which we underwrote recently (see "Gold bull/yen bear notes") and other derivatives, which will allow institutions to participate for the first time in the actual ownership of bullion (indirectly, of course);
- 5) The potential danger of a civil war in South Africa, which presumably will affect gold as well as platinum.

Despite record supplies, coming from record production and an increasing amount of hedge-selling, demand has not been satisfied at present levels, forcing an accelerated drawdown of central bank holdings (see Chart 2).

Canada is an interesting example. Its holdings stood at 20.1 million ounces in 1985, 9.9 million ounces at the end of 1992, and 6.1 million at December 1993. In January, Canada sold another 117,000 ounces. At the 1993 rate of disposal, Canada will be completely out of gold by the third quarter of 1995.

While it is highly unlikely that gold will be completely demonetized by the other large central banks — especially if the price begins to rise — one should consider that total central bank holdings are only 910 million ounces, equal to \$360 billion, or less than one fifth of the assets of all US mutual funds and less than 8.5% of combined mutual funds assets and bank deposits.

Another interesting perspective is the following: At \$380/oz., the US Treasury owns 2.38¢ in gold backing for each \$1 of the M3 money supply. This is approximately the same gold backing ratio that existed in the early '70s, before

the big rise in gold prices.

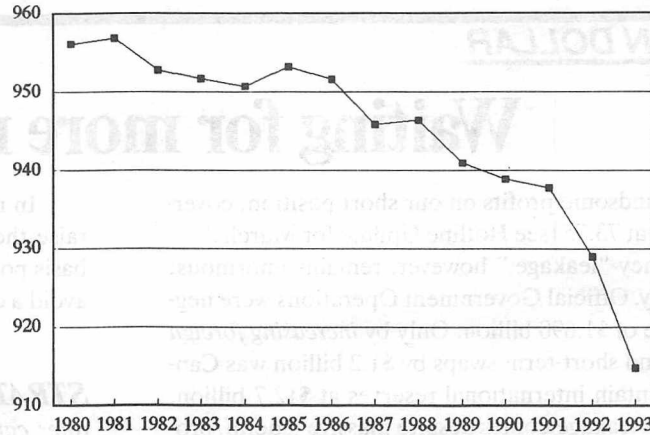
We present these numbers not to suggest that mutual funds will buy gold or that the US Treasury will want to back every M3 dollar with gold but merely to provide a perspective of the "place" of gold in the "global portfolio." Speculative shifts in this global portfolio have an enormous impact on specific assets.

The rising proportion of money and financial assets to total wealth has introduced a highly mobile and destabilizing force into world asset markets, exaggerated by technicians and momentum players who blindly follow trends and prices, irrespective of valuations. As a result, while a demand/supply model for gold based on fabrication and production may yield an equilibrium price of only \$450-\$500/oz., speculative demand driven by technical models can drive prices well beyond this valuation. This is an extremely important consideration in assessing the future price behavior of the three precious metals.

To repeat, there has been an enormous proliferation of technical systems designed to exploit price trends. They bear absolutely no relation to fundamental methods of valuation. At the same time, enormous — relative to wealth — pools of highly liquid assets are available to take advantage of, and to create, portfolio shifts. The combination can produce irrational — and explosive — results.

STRATEGY: *We are long silver and platinum, which have clearly shown better relative strength than gold (see our comments in the Hotline Update of Feb. 1). Maintain stops at 5.10 silver and 370 platinum, basis May '94 and July '94, respectively, close only. Stand by for a new recommendation to time our re-entry into gold.*

Chart 2
Gold Holdings – All IMF Members
(MILLION FINE TROY OUNCES)



CURRENCIES

Long DM/short yen

An irresolute and, worse, a politically influenced central bank is poisonous for a nation's currency – even when real factors should be benefitting it.

A case in point is the US dollar. The currency is cheap (at least on a purchasing power basis), the economy is booming (on both absolute and relative bases), and it continues to maintain a safe haven status, very far away from the troublesome spots of the world: Russia, Yugoslavia, and North Korea. And yet the US dollar has not been able to make any significant upward progress in months. In recent days, the trade-weighted dollar has fallen to five-month lows thanks to the Fed.

The inevitable appreciation of the US dollar will come via a higher rate of inflation rather than an appreciating nominal currency. We made this point on a number of occasions in 1992 and 1993 and see no reason to change our outlook. The trade-off between a currency appreciation and inflation will depend on the Fed's behavior: Continued accommodation will mean more of the latter and less of the former; conversely, a tighter posture will mean higher currency levels and less inflation.

Given the uncertainties surrounding the short-term and medium-term outlook for the US dollar, we strongly favor avoiding outright dollar trades. Instead, we recommend concentrating on the yen/DM cross, now standing around 62.60.

Monetary policies in Japan and Germany are likely to diverge rather significantly over the next 12 months. Japan, caught in the vise of a severe deflation – with bank assets falling by 4.2% year-over-year, money supply growing at a mere 1.6% per annum, and an exchange rate that is bankrupting all but the most efficient exporter – will need to ease significantly.

Germany, on the other hand, is still facing strong inflationary pressures, while M3 is growing well outside the upper part of the band. Since its banking system remains sound, there is little impediment for the Bundesbank to conduct a relatively tight monetary policy. The Bundesbank is extremely conscious of the role of favorable capital market conditions on economic activity and in the strong role of credibility in the formation of these conditions.

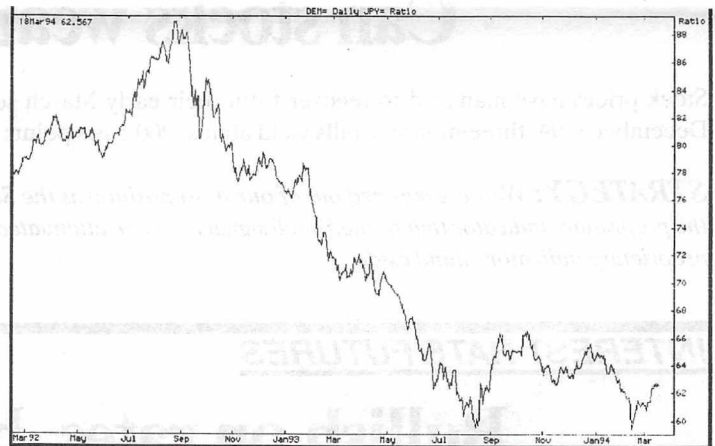
In their February 1994 Overview they state that “nothing could be gained in terms business cycle policy if the reduction in short-term interest rates were accompanied by a significant increase in long term rates.”

The main problem facing Germany is the very high cost of labor. In our opinion, rising unemployment, which by the end of January had reached 2.5 million (some 480,000 higher than the year before) plus some timely changes to the labor code recently introduced by the government should succeed in slowly deflating real wages. This in turn will enable Germany to emerge from its present stagnation.

In sum, while Japan's adjustment has not yet begun, Germany's is well on its way to producing favorable results.

STRATEGY: *The above considerations suggest a long DM/short yen position. This is in effect our position after having purchased June DM at 58.53 (see Hotline Update).*

Chart 3 – YEN/DM cross rate



CANADIAN DOLLAR

Waiting for more rate hikes

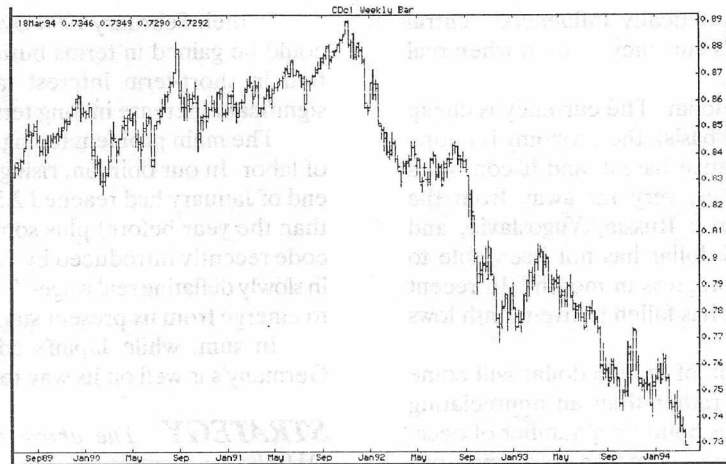
We accepted handsome profits on our short position, covering March 1994 at 73.75 (see Hotline Update for March 3).

The currency "leakage," however, remains enormous: During February, Official Government Operations were negative to the tune of \$1.690 billion. Only by increasing foreign currency debt and short-term swaps by \$1.2 billion was Canada able to maintain international reserves at \$12.7 billion. This continuous leakage comes despite massive federal, provincial, and crown corporation borrowings abroad and the ongoing decline of the floating dollar.

In recent days, the bank of Canada has been forced to raise the interest differential *vis à vis* the US by around 50 basis points. Obviously, more will be needed if Canada is to avoid a complete collapse of the currency.

STRATEGY: Only a quick and dramatic hike in short-term rates can stop the present decline from degenerating into a rout. We are assessing the situation day by day, as we are anxious to reenter the short side of the market.

Chart 4 - Canadian \$ weekly continuation



STOCK INDEXES

Can stocks weather the storm?

Stock prices have managed to recover from their early March sell-off despite continued weakness in the bond markets. Basis December 1994, three-month T-bills yield almost 200 basis points more than the S&P 500. Can stock prices weather the storm?

STRATEGY: We were stopped out of our short position as the S&P 500 managed to close above 470. The bearish connotation of the proprietary indicator that flashed a sell signal has been attenuated, while we have as yet not received confirmation from our second proprietary indicator. Stand aside.

INTEREST RATE FUTURES

Bullish on rates, bearish on bonds

In line with our opening comments, we remain bullish on rates and bearish on bonds.

STRATEGY: Remain short, lower stops at 113, basis June 1994 T-bonds, close only.

FRIEDBERG CAPITAL MARKETS

Update on Coeur D'Alene Mines Corp.

Security: 6% Convertible Subordinated Debentures

Maturity: June 10, 2002

Recent price: \$96

Conversion: \$26 per share

Recent stock price: \$20.50 per share

Coeur D'Alene Mines Corp. is one of the largest silver mining companies in the US. Its major mines include the Rochester Mine, a gold and silver mine in Nevada, the Galena Mine, and the Coeur Mine, both being underground silver mines in Northern Idaho. Coeur D'Alene expanded its gold mining operations in 1993 by acquiring an 80% operating interest in the Golden Cross Mine located near Waihi, New Zealand. The company also has a gold development project in Alaska, and silver and gold exploration activities in Chile.

Coeur D'Alene has suffered from high operating costs in the past few years. Operations at the Galena Mine and Coeur Mine are being suspended owing to low silver prices. The estimated production cost of silver at these two mines is approximately US\$5 per ounce *versus* US\$3.25 at the Rochester Mine. On the other hand, the gold production cost at the Kensington Property in Alaska is approximately \$380 an ounce, which makes its operation unprofitable at the moment.

Owing to the high cost structure, Coeur D'Alene's prospects rely more on future silver and gold prices than output growth. In fact, its stock price correlates highly with the silver price. When silver recovered from its low of US\$3.50 an ounce in early 1993 to its recent level of US\$5.40, Coeur D'Alene's stock also rose to US\$20 per share from its low of US\$10 in the same period. Consequently, we view Coeur D'Alene as a primary play on silver and secondary on gold.

Although we are very bullish on gold and silver, we believe the upside potential of Coeur D'Alene is limited by its high cost structure. Our three-year targets are US\$700 an ounce for gold and US\$8.50 an ounce for silver. At these target prices, which should make all the idle mines of Coeur D'Alene profitable, its projected net earnings in 1997 will be approximately US\$69 million. Using a price/earnings multiple of between 8 and 10, which we believe is appropriate

because of the limited upside on gold and silver prices from the projected high levels, we estimate its market capitalization to be between US\$552 million and US\$690 million.

On a fully diluted basis, the estimated market capitalization will translate into a share price range of US\$26 to US\$33. At US\$33 per share, the 6% convertible debentures will be valued at US\$127, which represents a compounded annual return of 16% including coupon interest.

The downside risk of the debenture is twofold. First, even if gold and silver prices go up as expected, the debentures' potential appreciation may be capped at the face value, because they are callable at par. Second, if gold and silver prices stay only at the present levels or even decline, the debentures will fall back to their investment value, which is currently estimated at US\$75 (see "Update on convertibles' downside risk" in this issue). This represents a 22% potential loss from the recent price level of the debentures.

The above analysis leads to our conclusion that the gold bull/yen bear medium-term notes offer a much better risk/return profile than Coeur D'Alene's debentures. At US\$700 per ounce of gold in 1997, the redemption value of the notes will range from US\$116 (at ¥73.72/US\$) to US\$208 (at ¥200/US\$). If the yen does not depreciate, which is highly unlikely, and stays at the current level of ¥106/US\$, the notes' redemption value will be US\$160, which represents a compounded annual return of 17% before any interest income.

If gold price and the yen/US dollar exchange rate stay at the current levels in 1997, the potential loss on the notes will be only 13% *versus* the 22% on Coeur D'Alene's debentures. Moreover, if gold and silver prices stay at the present levels for the next three years, Coeur d'Alene's earnings will be much lower than projected, and its credit quality may deteriorate. In that case, the debentures' investment value may fall below US\$75.

STRATEGY: *Since the gold bull/yen bear medium-term notes offer a risk/return profile much superior to that of Coeur D'Alene's 6% convertible debentures, we recommend investors swap their positions in Coeur D'Alene's debentures into the Gold/Yen notes.*

Gold bull/yen bear medium-term notes

Issuer: Kingdom of Denmark

Type: Euro-dollar

Maturity date: March 25, 1997

Coupon rate: 6-month LIBOR — 0.55% + 2 x Spread - 5.1%, minimum 0%, reset every 6 months

Spread: US\$ 5-year swap rate — ¥ 5-year swap rate

Issue size: US\$20 million

We believe the gold bull/yen bear notes structured and solely underwritten by Friedberg Mercantile Group are an excellent instrument for risk-conscious, fixed-income investors to capitalize on two trends that we believe are inevitable: the rise in gold price and the depreciation of Japanese yen against

the US dollar.

As explained in our separate product description, the notes' redemption value is based on the gold price and yen/US dollar exchange rate on the maturity date. The higher the gold price and the lower the yen's value, the higher will the redemption value be. Based on our outlook of US\$700 an ounce for gold and ¥140 per US dollar in three years, the redemption value will be 185.61% of face value, which implies a compounded annual return of 22.9% before any interest income.

If, on the maturity date, gold stays at today's level, which is approximately US\$380 an ounce, and the yen/US dollar rate is unchanged at 106, investors in the notes will have a 13.5% loss of principal. However, the loss may be attenuated

or even more than compensated for by the coupon interest.

The notes have a built-in floor price of US\$200 an ounce for gold and ¥73.70/US\$ so that the redemption value cannot be negative. In other words, investors cannot lose more than what they have invested in the notes.

While there is no need to reiterate why we are bullish on gold and bearish on yen, which can be found in numerous commentaries in past issues, we specifically want to emphasize the following benefits of the notes:

- They provide investors with a cost-effective way to obtain futures positions as well as options on gold and yen. The notes are currently priced at par (no premium) and entail no margin calls for their holders even if gold/yen prices move adversely.
- An important element of the coupon rate, the spread between US\$ 5-year swap rate and ¥ 5-year swap rate, is available only in the wholesale money market (minimum size

US\$20 million). The note effectively enables individual investors to participate in this institutional market.

- The notes, denominated in US dollars, provide a hedge for investors who are concerned about the continuing decline of the Canadian dollar.
- The notes have a floating-rate coupon structure, which will provide a hedge against the expected rise in interest rates. If our outlook on US/Japan relative inflation rates is correct, the notes will provide a premium coupon rate over time. This feature should make the notes an excellent investment for gold bullion investors who want interest income.
- The notes are a high-quality instrument, because the issuer, the Kingdom of Denmark, enjoys a triple-A rating.

Owing to our bullishness on gold and bearishness on yen, and the instrument's additional benefits discussed above, we have made a 15% allocation for our model bond portfolio to the gold bull/yen bear medium-term notes.

Update on convertibles' downside risk

Chart 5 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 increased considerably. For example, for a straight bond comparable to Burnup & Sims' convertibles, the yield has risen by 83 basis points, to 10.65% from 9.82%.

The increase in yields came after the US Federal Reserve increased the Fed Funds rate by 25 basis points on February 4. Both the Dow Jones Industrial Average and Standard & Poor's 500 Index have declined 2.3% since the hike in interest rates. The US 30-year bond yield has shot up to approximately 7% from an all-time low of 5.77%.

The upward trend in interest rates has caused a shakeout in the equity market, which depressed the prices of convertibles. Our outlook for the stock market is generally bearish, since we believe interest rates will go up substantially. Although most economic indicators show only moderate inflation, continued increases in commodity prices will force the Fed to raise rates to a much higher level.

The shakeout in the stock market has depressed the value of the convertibles in our managed bond accounts. Since the price pullback is worse for some convertibles than for their comparable straight bonds, we now have three convertibles that are trading below their investment value: Atari, Burnup & Sims, and Datapoint.

Despite the increase in yields, the relative riskiness of these convertibles has not changed, with Coeur D'Alene's convertibles still having the largest downside risk. Glycomed followed with a 3% downside risk. On the other hand, Atari joined Burnup & Sims and Datapoint to become undervalued.

In fact, based on recent prices, Atari is the most undervalued convertible in our list, trading at 9.5% below its invest-

ment value. Burnup & Sims is the second most undervalued, with a discount on investment value of 6%. We believe Burnup & Sims has the best value among the five convertibles, because the company is on a solid turnaround upon merging with Church and Tower. On the other hand, Atari is a riskier play, because its prospects depend solely on its new multimedia video game, Jaguar (see our review in the December '93 issue).

STRATEGY: *Although we believe Burnup & Sims offers the best value in our convertible list, we will not add to our positions in the managed bond accounts for two reasons. First, the bonds are callable at par, which limits their upside. Second, since only \$32 million of the bonds are outstanding, we want to avoid any liquidity problems by limiting the size of our holdings.*

Chart 5
Investment Values of Convertibles

Issuer	ATC	BSIM	CDE	DPT	GLYC
Credit rating	CCC2	B3	CCC2	CCC2	CCC2
Recent price (per \$100)	\$64.5	\$100.5	\$95.5	\$82.5	\$84.5
Yield	11.92%	11.77%	6.48%	11.55%	10.27%
Maturity (mm/dd/yy)	4/29/02	11/15/00	10/6/02	6/1/06	1/1/03
Yield on straight bond	10.75%	10.65%	10.75%	10.91%	10.75%
Investment value	\$71.2	\$106.3	\$74.9	\$86.4	\$81.8
Downside risk	Nil	Nil	22%	NIL	3%

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

Argentina's floating-rate bonds

Security: Floating-rate bonds
Maturity: March 31, 2005
Coupon rate: LIBOR plus 13/16%, payable semi-annually
Recent price: \$80
Yield: 8.63%

Argentina's floating-rate bonds have seen a price pullback from their all-time high of \$90 in January 1994 to the current level of \$80 — an 11% drop. This softness results from a rise in long-term interest rates in the US.

The US 30-year bond yield rose to 7% last week from an

all-time low of 5.77%. The upward trend in US interest rates adversely affected all emerging market bonds, because some capital has switched back to US government bonds from these high-risk instruments.

However, we believe that the Argentina FRBs represent an excellent investment at \$80. The current price implies a discount margin of 370 basis points over LIBOR. The discount margin measures the effective spread over or under LIBOR of a floating-rate bond, taking into account the premium or discount the bond is trading at. Since a floating-rate bond has only a very small interest rate risk, the discount margin mainly reflects the perceived credit/country risk of the issuer.

Chart 6 compares some of Argentina's key economic indicators with those of Canada and Malaysia, which also have issued US dollar-denominated floating-rate bonds.

Despite the much lower credit rating of Argentina, and thus a higher discount margin over LIBOR, the economic indicators show that Argentina is in better shape than the other two countries. In fact, the economy of Argentina continues to improve. Its inflation has come down to less than 8% per annum, real GDP is estimated to have risen 6% in 1993, and the government budget deficit has turned into a surplus.

Therefore, the only reason Argentina's debt is priced at a discount to Canada's and Malaysia's is that the market still has to be convinced the Argentinian government will continue to carry out the existing economic policies without disruption. Given the political situation there, we are confident that the existing policies will continue.

We believe the fair value of the FRBs is based on a discount margin of approximately 150 basis points over LIBOR, which implies a price of \$94. We also believe Argentina should receive an upgrade on its credit rating if its economy continues to perform well, which will help push up the price of the FRBs.

STRATEGY: At the current price of \$80, Argentina's FRBs are undervalued based on the country's economic fundamentals. Our estimated fair value of the FRBs is approximately \$94. Consequently, we recommend adding positions in the FRBs with a price limit of \$85 for risk-conscious accounts.

- Edison Lee

Chart 6
Comparative Economic Indicators

Country	Discount Margin on US\$ FRBs (bps) (4)	Credit Rating	Govn't Budget Bal to GDP (%)	External Debt to GDP (%)	Govn't Revenue to GDP (%)	Import Coverage of Int'l Reserves
Argentina (1)	370	B1	2	29	25	5.1 months
Canada (2)	-20	AAA	-4.4	54.7	19.2	1.4 months
Malaysia (3)	7	A2	-3	52	26.5	4 months

1. Figures are for 1992 according to J.P. Morgan Securities.
 2. Figures are based on the last four quarters at the end of June 1993, according to International Financial Statistics of the IMF. Provincial governments' revenue and debt are not included in the calculations. The discount margin is for Canada's floating-rate bonds due 2/15/99.
 3. Figures are for 1993 according to J.P. Morgan Securities and International Financial Statistics of the IMF. The discount margin is for Malaysia's floating-rate bonds due 10/19/05.
 4. All discount margins are based on an assumed average Libor of 5% over the life of the FRBs.

Chart 7
FOREIGN CURRENCY BONDS

Date: March 17, 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
DEUTSCHE MARK DENOMINATED				
BANK OF NOVA SCOTIA 5 3/4% 07/05/96 RRSP eligible	99.40	100 1/4	5.49%	May 07
WORLD BANK 5 7/8% 4/02/97 RRSP eligible	103.45	104.05	4.33%	Feb. 04
WORLD BANK 9% 13/11/00 RRSP eligible	114.90	115.75	6.04%	Nov. 13
KINGDOM OF DENMARK 6 1/2% 15/04/98	101.30	102.15	5.51%	Apr. 15
ARGENTINA 8% 5/10/99	101	101.85	7.48%	Oct. 05
BK. FOREIGN ECO. AFFAIRS 7% 29/3/96	82 1/2	83.10	17.68%	Mar. 29
FINNISH MARKKA DENOMINATED BONDS				
REP. OF FINLAND 11% 15/6/95	106.30	107.15	4.80%	Jun. 15
ITALIAN LIRA DENOMINATED BONDS				
NORDIC INV. BANK 12 3/4% 19/04/96	106.90	107 3/4	8.13%	Apr. 19
GENERAL ELECTRIC 11 1/2% 7/02/95	101.90	102 3/4	8.00%	Feb. 07
SWISS FRANC DENOMINATED BONDS				
GENERAL ELECTRIC 4 3/4% 2/7/98	100.90	101 3/4	4.29%	July 02
DANISH KRONE DENOMINATED BONDS				
KINGDOM OF DENMARK 9% 15/11/96	107.05	107.90	5.68%	Nov. 15
ECU DENOMINATED BONDS				
UNITED KINGDOM 9 1/4% 21/02/01	113	133.85	6.56%	Feb. 21
BRITISH POUND DENOMINATED BONDS				
KGDM OF SWEDEN 8 3/4% 29/5/96	104.65	105 1/2	5.97%	May 29
FRENCH FRANC DENOMINATED BONDS				
CREDIT LYONNAISE 9 1/2% 23/12/96	108 3/4	109.60	5.61%	Dec. 23
JAPANESE YEN DENOMINATED BONDS				
WORLD BANK 5 3/4% 7/8/96 RRSP eligible	105.40	106 1/4	2.97%	Aug. 07
CANADIAN DOLLAR DENOMINATED BONDS				
ONTARIO HYDRO 10 7/8% 08/01/96 (semi annual)	107.10	108.60	5.83%	Jul. 08
EXPORTERS 7 3/4% 5/1/97	101 1/2	103	6.77%	Nov. 05
ROYAL BANK OF CANADA 9 1/8% 7/1/97	104 1/2	106	6.68%	Jan. 07
SOUTH AFRICAN RAND DENOMINATED BONDS				
ESCOM 12% 1/5/96 (semi)	102.10	102.95	10.87%	May. 01
AUSTRALIAN DOLLAR DENOMINATED BONDS				
COMMONWEALTH BANK OF AUSTRALIA 9 3/4% 15/05/96	106 1/4	107.10	6.10%	Jul. 01
NEW ZEALAND DOLLAR DENOMINATED BONDS				
NEW ZEALAND GOVT 10% 15/7/97 (semi)	112 1/2	113 1/2	5.49%	Jul. 15
FLETCHER CHALLENGE 10.75% 15/12/97 (semi)	109.85	110.85	7.54%	Jun. 15
FLETCHER CHALLENGE 10.15% 30/11/98 (semi)	109 1/2	110 1/2	7.51%	May 30
CORPORATE INVESTMENT LTD. 13 1/2% 19/6/95 (semi)	94.20	-	-	Jun. 19
TRANZ RAIL LTD. 10% 15/10/99 (semi)	107.05	107.90	8.20%	Apr. 15
DB GROUP 7% 30/6/96 (semi) matures @ 85	90.40	91 1/4	4.38%	Jun. 30
ARGENTINEAN PESO DENOMINATED BONDS				
ARGENTINA BIC V FIXED/FLOATING	88.20	-	-	4th day of mth.
1/05/2001 callable in full on every interest date				
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS				
DATAPoint CORP. 8 3/4% 1/6/96 CV @ \$18.11 p/sh (semi)	81 1/2	83 1/2	11.74%	Jun. 01
BURNUP & SIMS 12% 15/11/00 (semi) CV @ \$16.79 p/sh	101	103	11.64%	May 15
ATARI CORP. 5 1/4% 29/4/02 CV @ \$16.31 p/sh	67 1/2	68 1/2	11.41%	Apr. 29
COEUR D'ALENE 10% 10/6/02 CV @ \$26.00 p/sh	97	98	6.32%	Jun. 10
GLYCOMED 7 1/2% 1/11/03 CV @ \$14.06 p/sh (semi)	84 1/2	85 1/2	10.27%	Jul. 01
T.W.A. 10% 3/11/98 (semi)	78	79 1/2	16.61%	Aug. 01
U.S. DOLLAR DENOMINATED FIXED RATE BONDS				
FARM CREDIT CORP. 7 3/4% 10/06/96 RRSP eligible	105	105.85	4.88%	Jun. 10
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES				
KINGDOM OF DENMARK 25/3/97 (Gold call, JV put), (semi)	-	settling March 25 1994	-	Sep. 25
UNITED KINGDOM 30/03/98	99.72	100.02	3.1/8	Mar. 30
3 mo. LIBID-1/2 (qty) *callable @ 100				
BOCON 1/4/01 (30 day LIBOR) starting to accrue May 1, '97	87.50	88.35	8.52%	May 1/97
ARGENTINA: SERIES L: FRB 31/03/05 6 mo. LIBOR +13/16 (semi)	79 1/2	80.10	8.63%	Mar. 31

GLD (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 8

Recommended portfolio allocations	
1. Gold/Yen Bond	15%
2. New Zealand Gov't	15%
3. Fletcher NZ\$	15%
4. Tranz Rail NZ\$	5%
5. DB Group NZ\$	5%
6. FRB/BIC	15%
7. U.K. FRN	20%
8. TWA 10%	5%
9. Bk for Eco. DM	2 1/2%
10. Argentina DM	2 1/2%

US, CANADA, MEXICO: The rise of statism, a look at Nafta, and President Clinton's health plan

The Nafta myth

Murray N. Rothbard

Americans — or at least the American establishment — may be the most gullible people on earth. When Gorbachev tried to sell his timid reforms as “market socialism,” only the American establishment cheered. The Soviet public immediately spotted the phoniness and would have none of it. When the Polish Stalinist Oskar Lange touted “market socialism” for Poland, only American economists shouted huzzahs. The Polish public knew the score all too well.

For some people, it seems, all you have to do to convince them of the free enterprise nature of something is to label it “market,” and so we have the spawning of such grotesque creatures as “market socialists” or “market liberals.” The word “freedom,” of course, is also a grabber, and so another way to gain adherents in an age that exalts rhetoric over substance is to call yourself or your proposal “free market” or “free trade.” Labels are often enough to nab the suckers.

And so, among the champions of free trade, the label “North American Free Trade Agreement” (Nafta) is supposed to command unquestioning assent. “But how can you be against free trade?” It’s very easy. The folks who have brought us Nafta and presume to call it “free trade” are the same people who call government spending “investment,” taxes “contributions,” and raising taxes “deficit reduction.” Let us not forget that the Communists, too, used to call their system “freedom.”

In the first place, genuine free trade doesn’t require a treaty (or its deformed cousin, a “trade agreement”); Nafta is called an agreement so it can avoid the constitutional requirement of approval by two thirds of the Senate). If the establishment truly wants free trade, all it has to do is repeal our numerous tariffs, import quotas, anti-“dumping” laws, and other American-imposed restrictions on trade. No foreign policy or foreign maneuvering is needed.

If authentic free trade ever looms on the policy horizon, there’ll be one sure way to tell. The government/media/big-business complex will oppose it tooth and nail. We’ll see a string of op-eds warning us about the imminent return of the 19th century, and media pundits and academics will raise all the old canards against the free market, that it’s exploitative and anarchic without government “coordination,” etc. The establishment would react to the possibility of true free trade about as enthusiastically as it would to repealing the income tax.

In truth, the bipartisan establishment’s trumpeting of “free trade” since World War II fosters the opposite of genuine freedom of exchange. The establishment’s goals and tactics have been consistently those of free trade’s traditional enemy, “mercantilism” — the system imposed by the nation-states of 16th to 18th century Europe. President Bush’s infamous trip to Japan was only one instance; trade policy as a continuing system of maneuverings to try to force other countries to purchase more American exports.

Whereas genuine free traders look at free markets and trade, domestic or international, from the point of view of the consumer (that is, all of us), the mercantilist of the 16th century or today, looks at trade from the point of view of the power elite, big business in league with the government. Genuine free traders consider exports a means of paying for imports, in the same way that goods in general are produced in order to be sold to consumers. But the mercantilists want to privilege the government-business elite at the expense of all consumers, be they domestic or foreign.

In negotiations with Japan, for example, be they conducted by Reagan or Bush or Clinton, the point is to force Japan to buy more American products, for which the American government will graciously if reluctantly permit the Japanese to sell their products to American consumers. Imports are the price government pays to get other nations to accept our exports.

Another crucial feature of post-World War II establishment trade policy in the name of “free trade” is to push heavy subsidies of exports. A favorite method of subsidy has been the much beloved system of foreign aid, which, under the cover of “reconstructing Europe,” “stopping Communism,” or “spreading democracy,” is a racket by which the American taxpayers are forced to subsidize American export firms and industries as well as foreign governments who go along with this system. Nafta represents a continuation of this system.

Yet Nafta is more than just a big-business trade deal. It is part of a very long campaign to integrate and cartelize government in order to entrench the interventionist mixed economy. In Europe, the campaign culminated in the Maastricht Treaty, the attempt to impose a single currency and central bank and force relatively free economies to ratchet up their regulatory and welfare states.

In the United States, it has taken the form of transferring legislative and judicial authority away from the states and localities and to the executive branch of the federal government. Nafta negotiations have pushed the envelope by centralizing government power continent-wide, thus further diminishing the ability of taxpayers to influence the actions of their rulers.

Thus the siren-song of Nafta is the same seductive tune by which the socialistic Eurocrats have tried to get Europeans to surrender to the super-statism of the European Community: wouldn’t it be wonderful to have North America be one vast and mighty “free trade unit” like Europe? The reality is very different: socialistic intervention and planning by super-national Nafta Commission or Brussels bureaucrats accountable to no one. And just as Brussels has forced low-tax European countries to raise their taxes to the Euro-average or to expand their welfare states in the name of “fairness,” a “level playing field,” and “upward harmoniza-

tion," so too Nafta Commissions are to be empowered to "upwardly harmonize," to ride roughshod over labor and other laws of American state governments.

President Clinton's trade representative Mickey Kantor has crowed that, under Nafta, "no country in the agreement can lower its environmental standards — ever." Under Nafta, we will not be able to roll back or repeal the environmental and labor provisions of the welfare state because the treaty will have locked us in — forever.

The worst aspects of Nafta are the Clintonian side agreements, which have converted an unfortunate Bush treaty into a horror of international statism. We have the side agreements to thank for the supra-national Commissions and their coming "upward harmonization." The side agreements also push the foreign aid aspect of the establishment's "free trade" hoax. They provide for the US to pour an estimated \$20 billion into Mexico for an "environmental cleanup" along the US-Mexican border. In addition, the United States has informally agreed to pour billions into Mexican government coffers through the World Bank when and if Nafta is signed.

As with any policy that so heavily benefits government and its connected interests, the establishment has gone all-out in its propaganda efforts. Allied intellectuals have even formed a Nafta network to champion the cause of government centralization. Even if Nafta were a worthy treaty, this outpouring of effort by the government and its friends should raise suspicions.

The public is rightly suspicious that this effort is related to the vast amount of money the Mexican government is spending to lobby for Nafta. That money, so to speak, is the down payment on the \$20 billion that the Mexicans hope to

mulct from the American taxpayers once Nafta passes.

Nafta advocates say we must sacrifice to "save" Mexican President Carlos Salina and his allegedly wonderful "free-market" policies. But surely Americans are justly tired of making eternal "sacrifices," of cutting their own throats, on behalf of cloudy foreign objectives which never seem to benefit them. If Nafta dies, Salinas and his party may fall. But what that means is that Mexico's vicious one-party rule by the PRI (Institutional Revolutionary Party) may at last come to an end after many corrupt decades. What's wrong with that? Why should such a fate cause our champions of "global democracy" to tremble?

We should look at the supposed nobility of Carlos Salina in the same way we look at the other ersatz heroes served up to us by the establishment. How many Americans know, for example, that under Annex 602.3 of the Nafta treaty, the "Free-market" Salinas government "reserves to itself" all exploration and use, all investment and provision, all refining and processing, all trade, transportation and distribution, of oil and natural gas? All private investment in and operation of oil and gas in Mexico, in other words, is to be prohibited. This is the government Americans have to sacrifice to preserve?

Most English and German conservatives are fully aware of the dangers of the Brussels-Maastricht Eurocracy. They understand that when the people and institutions devoted to statism suddenly come out for freedom, something is amiss. American free marketers too should understand the equivalent dangers of Nafta.

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NAFTA

Nafta's dangerous side agreements

Llewellyn H. Rockwell, Jr.

The Clinton administration, which can't always get what it wants from Congress, is now trying to smuggle its agenda into law as "free trade." We can know that because of the environmental and labor supplemental agreements to the North American Free Trade Agreement.

Negotiated by US Trade Representative Mickey Kantor, the side agreements are designed to please regulators, union bosses, and environmentalists. In doing so, they prevent future legislators and presidents from enacting free-market reforms.

Within the first few sentences of the environmental agreement, for example, we are told that "sustainable development" will be our policy. As those who follow eco-speak know, this is code for shutting down capitalism.

That's why the agreement establishes a supranational "Commission for Environmental Cooperation," including a "Central Secretariat," to enforce its rules and regulations over the heads of Congress and state legislatures. To do so,

the Commission will have its own budget, court, propaganda office, and bureaucratic army.

Its mission: zealous enforcement of all environmental regulations, including those related to "pollution prevention techniques and strategies," "environmental scientific research and technology development," "conservation and protection for wild flora and fauna and their habitats, and specially protected natural areas," "protection of endangered and threatened species," and even "eco-labelling."

The Commission can even veto American economic projects if they have "significant adverse transboundary effects," i.e., bother foreign governments.

The agreement also obligates the US to "report on the state of the environment," "further environmental scientific research and technological development," and "assess, as appropriate, environmental impacts."

It mandates that the US "effectively enforce its environ-

mental law" through "on-site inspections," "environmental audits," "licenses, permits or authorizations," "search, seizure or detention" of alleged violators, with punishments including "fines, imprisonment, injunctions, the closure of facilities, and the cost of containing or cleaning up pollution."

And if we don't, for example, jail enough businessmen, millions in penalties will be imposed on American taxpayers.

If Congress passes Nafta, all this will go into effect on January 1, 1994. After that, free-market groups can toss out (oops, recycle) their proposed reforms of statist eco-laws, as can Republican legislators. And farmers, hunters, and developers can forget about changing the endangered species act, which covers a host of bugs and weeds. The environmentalists will have a permanent green rope around the neck of the American economy.

Right now land-rights groups can appeal to legislators to change the law. After Nafta, they won't have a prayer, unless they have a friend on the Commission for Environmental Cooperation. Now we can see why our northern neighbor refused to be fully bound by this side agreement. But why should the US sign something that is too much for eco-socialist Canada?

The Clinton administration also tacked a Labour Accord onto Nafta. According to the text, its objective is "to promote compliance with and effective enforcement" of "labour law."

This includes collective bargaining, strikes, minimum wages and overtime pay, anti-discrimination law, and even "equal pay for men and women." The left has been pushing "comparable worth" for a decade. What better way to enact this egalitarian nonsense than to bypass state and federal legislatures and make it continent-wide?

To oversee all of this, the Labour Accord establishes a "Labour Commission" with a "Ministerial Council," and "International Coordinating Secretariat," and a "National Administrative Office." And like the environmental agreement, it sets in concrete some of the worst aspects of the US regulatory state.

Our government is ordered to "promote compliance and provide for effective enforcement" of our "domestic labour law" through "on-site inspections," "mandatory reporting and record-keeping," and "mediation, conciliation or arbitration." And unions are granted advantage over management in disputes over "health and safety," "employment standards," and "industrial relations and migrant workers."

The accord transfers responsibility for labor policy from Americans to the Ministerial Council of Nafta, which is charged with unifying standards on "occupational health and safety," child labour, "human resource development," "work benefits," "social programs for workers and their families," "labour-management relations and collective bargaining procedures." It will also promote "legislation relating to the formation and operations of unions, collective bargaining and the resolution of labour disputes."

Kantor calls these "basic labor rights," but somehow Jefferson forgot to mention them. Such "rights" are currently

driving up the costs of labor and therefore increasing unemployment. Through "child labor" laws, for example, the Department of Labor takes authority away from parents, prevents America's youth from gaining work experience, and maintains tyrannical control over even the smallest details of work schedules. The minimum wage keeps marginal workers permanently unemployed. Health and safety rules freeze the production side of the economy by erecting impenetrable barriers to entry. All these should be repealed, not entrenched and exported.

If there were any doubts, Kantor explained to *The Wall Street Journal* (8-17-93) that "the supplemental agreements will help ensure that the enforcement of domestic environmental laws and workplace standards and requirements will be strengthened" and "that no nation will lower labor or environmental standards, only raise them."

Yet the side agreements are only elaborations on the crucial section 906 of the agreement's main text. The "Parties," it says, must "make compatible their respective standards-related measures" but "without reducing the level" of regulation. Countries "shall...work jointly to enhance the level of safety and of protection of human, animal and plant life and health, the environment and consumers."

In leaving nothing outside the Nafta commission's purview, this one section gives the whole game away. Vague international secretariats are to be empowered to increase the level of coercive control on the entire economy, including people, pigs, and pimento. What the anti-Roosevelt Old Right called "economic regimentation" is being sold as "upward harmonization."

Free trade has a very different message. It says that if American consumers want to buy something from abroad, they should be allowed to. And American businessmen should be allowed to sell their wares abroad. Tariffs and import quotas? Tear them all down. And tear down the litany of foreign aid, guaranteed loans, and political manipulation that harms consumers at home and abroad. Nafta, on the other hand, should go the way of Clinton's "stimulus" package, and on the same grounds.

Former Bush speech writer Tony Snow wrongly calls the free trade argument against Nafta the "Adam Smith Objection." In section 430 of *The Wealth of Nations*, Smith made a tragic concession to the mercantilism that animates Nafta's most dangerous provisions. When "some tax is imposed at home," Smith wrote, it "seems reasonable that an equal tax should be imposed" on imports of the same good from abroad.

Rather than a tax on imports, a consistent free trader would have recommended repealing domestic taxes that cause the problem in the first place. It's safe to say, however, that when Smith recommended tax/tariff parity, he never imagined governments, especially not the new American one, would ever seize 40% of the national income.

Some make protectionist arguments against Nafta, but they need not be our concern. They distract from the essential point that Nafta is not free trade but trade managed so as to solidify government and special-interest control over the economy. The public's suspicion that this is another D.C.

trick is exactly right, even if the public's objections are not as developed as those offered by a trained economist.

The widespread hatred of Nafta would not have surprised Ludwig von Mises. When law is impartially applied, such as contract law that allows free trade with anybody, anywhere, people understand the rationale. But when governments conspire to create a trade bloc, as Mises wrote in *The Free and Prosperous Commonwealth*, the public is invariably and rightly suspicious of preferential treatment.

Neither would F.A. Hayek have been surprised that Nafta is being sold as free trade. As he wrote, under statism, even language itself becomes corrupted and politicized. These days, it takes the Devil's dictionary to understand Washington-speak. There's only one thing we can count on: the intention and effect of laws are generally the exact opposite of their advance billing. And there's no better example than Nafta.

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US HEALTH CARE

CBO data show Clinton wants \$400 billion tax

Paul G. Merski

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When President Clinton claimed he could finance his massive health care reform plan without broad-based new taxes, few agreed. Now Robert Reischauer, director of the Congressional Budget Office, officially disagrees with the administration as well.

Mr. Reischauer and his CBO staff have imposed some needed truth-in-labelling on Mr. Clinton's plan. Their first move was to "score" — or categorize — the president's mandatory insurance "premiums" as revenues to be recorded on the federal budget books. This represents a move toward budgetary honesty, since the president had relegated those relevant numbers to the off-budget shadows.

The CBO also confirmed through its math that Mr. Clinton's proposed health plan is the largest entitlement program ever — 25% larger than the current Social Security system. By the year 2004, the president's health reform will cost \$100 billion more than Social Security will cost in that year.

By correctly labeling some \$320 billion in employer/employee mandates as new revenues, and by keeping them in the federal budget, Mr. Reischauer exposes the real cost to the taxpaying public of Mr. Clinton's plan. It is these costly new mandates — as well as the additional \$90 billion in tobacco, corporate and other tax increases — that constitute the bulk of the new burden facing taxpayers. In other words, what Mr. Reischauer has done is to quantify for the first time the size of the tax bill that big sections of the health reform represent.

* * * * *

Mr. Reischauer revealed other areas where the Clinton plan doesn't compute. For example, the president's Health and Human Services Secretary Donna Shalala testified in October that the administration was allowing a \$45 billion cushion in case its numbers for health care reform did not add up. Yesterday [Feb 8], though, Mr. Reischauer stated that his office's math showed that there was absolutely no cushion available in the budget. (Indeed, he noted that America was on the "floor" on health care funding. What this means is that, if the administration spends one penny beyond its budget on

health care, the deficit will widen.) In fact, CBO shows the Clinton plan increasing the deficit by \$70 billion rather than decreasing it by \$58 billion, as the administration has claimed.

It is of course no mystery why, after squeaking by the largest tax increase in history, the administration had been pressuring CBO not to count the employer/employee mandates as taxes. The tax increases and tax mandates proposed would easily eclipse the burden imposed under last year's record \$248 billion tax increase.

Fortunately, the CBO's honest labeling of Mr. Clinton's proposed mandates allows taxpayers to better understand the medicine they are being prescribed in an attempt to improve our health care system. It's medicine that shouldn't be taken on an empty stomach.

The side effects of a significant tax increase include: lost jobs, lower wage growth and health care rationing. Despite the president's offer to subsidize small businesses to help them pay for his mandate, even the smallest business, regardless of its income, would be forced to pay at least 3.5% of its payroll to health alliances under the Clinton plan. And that amount is set to be increased over time. Worse yet, the new mandate would only compound the financial burden for many small businesses that are currently absorbing last year's income-tax increases.

According to a new DRI/McGraw Hill econometric study to be released today, the combined impact of Mr. Clinton's demand for universal coverage and the employer mandate would result in hundreds of thousands of lost jobs, a wider deficit and lower GDP growth. The additional taxes proposed to pay for universal coverage (a tobacco tax, corporate assessments, adjustments to flexible spending accounts, and changes in medical-expense deductions) would strengthen unemployment and hurt the income of individuals. They would exacerbate the negative effects of forcing employers to insure their employees (the employer mandate).

* * * * *

The CBO's honest calculations of Mr. Clinton's financing problems confirm the suspicions that most Americans had about the Clinton health reform plan: There is no free lunch. If Americans are legally required by governments to

pay a set amount of money for a government-defined purpose and they don't have any choice about paying that money, it's a tax. Under the president's mandate-financing scheme, government controls more money largely by requiring employers to be the collection agency for Uncle Sam.

Taxes act as the most important price mechanism for people to decide how much or how little government involvement they desire and are willing to pay for. The point did draw serious attention when administration officials testified that the Clinton plan may force 40% of Americans to pay higher out-of-pocket "premiums" than they pay currently.

The CBO is merely an advisory panel. Its job is to advise Congress, in this instance on the financing and budgetary aspects of health care. The Clinton administration and the president's Office of the Management and Budget still have the last word on the financing presented in the federal budget.

But now the Congressional Budget Office's more accurate math and budget recording of the major financing for the president's health care overhaul will make it easier for Americans to decide if they want to take the presidential medicine.

Mr. Merski, an economist, is director of fiscal policy for Citizens for a Sound Economy in Washington.

HOTLINE UPDATE

Flash update, Thursday, March 3:

Liquidate deutschemark position at the market, presently trading at 58.33. Retain short Japanese yen positions.

Flash update, Thursday, March 10, 8:50 am:

Cover short March Canadian dollar positions at the market, currently trading at 73.75.

Friday, March 11:

This is a recap of this week's recommendations:

On Thursday, March 10, via flash update, we covered short March Canadian dollar positions at the market, then trading at 73.75. There is one new recommendation: Lower stops on short S&P to 470, basis June, close only.

Tuesday, March 15:

There are no changes or new recommendations. Next update will be Friday, March 18.

Flash update, Wednesday, March 16, 9:45 am:

Buy June deutschemark at the market, presently trading at 58.83. This long deutschemark position should leave us with a cross trade of long DM short Japanese yen, which is presently trading at 62.55.

Friday, March 18:

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

1. On Thursday, March 3, we advised the liquidations of long March deutschemarks, then trading at 58.33.
2. On Thursday, March 10, we advised the liquidation of short March Canadian dollar, then trading at 73.75.
3. On Wednesday, March 16, we advised the purchase of June deutschemarks, then trading at 58.83, which left us long deutschemarks, short Japanese yen as a cross, then trading at 62.55.

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Friedberg's Commodity & Currency Comments
347 Bay Street, 2nd Floor
Toronto, Ontario, Canada
M5H 2R7
(416) 364-1171

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All enquiries concerning trading accounts should be directed to:
In Canada
Friedberg Mercantile Group
347 Bay Street
Toronto, Ontario M5H 2R7
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Friedberg Mercantile Group Inc.
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