

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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The obsession with 'R'

Days away from the July FOMC meeting, the only talk in town is how soon the Fed will lower interest rates. Governors — from the chairman down — don't tire from openly speculating about the health of the economy. That it is merely a slowdown. That it is an inventory adjustment. That it may (or may not) go too far. That one need (or need not) worry about *it*.

Not surprisingly, a firm consensus exists for lowering interest rates where the economy slides into an outright recession. Where a split seems to have been detected, say Fed-watchers, is in determining *when* that crucial moment has come. The conservative camp, probably led by Mr. Greenspan, would like to wait for evidence of a contraction extending beyond the second quarter of the year (already thought to show a negative GDP reading). The liberal faction, led by vice-chairman Alan Blinder, on the other hand would like to pre-empt the possibility of another weak quarter.

Adducing imperfect data, Blinder challenged the conservative camp to take early action, remarking that a "Bunker Hill" wait and see monetary policy strategy "will fail" (Bunker Hill refers to an episode of the American Revolutionary War when the scarcity of ammunition delayed firing "until you see the whites of their — the enemies' — eyes").

The liberal camp is not willing to concede a pause, any pause, in economic growth. Its insistence on an uninterrupted and smooth upward path, however, clashes with the realities of an incredibly complex and dynamic economy, one that is continually striving to achieve new efficiencies, that innovates and even destroys to create anew.

Such progress cannot, by definition, advance in a straight line. The economy must correct poor entrepreneurial decisions. It must pause to recompute and to reformulate new strategies, operating, as it is, under conditions of uncertainty. It must be extremely sensitive to slight changes in competitive conditions vis à vis the rest of the world, to political events, and to economic decisions as far away as China, the FSU, and Patagonia.

It would be a miracle, or just an incredible coincidence, if growth advanced at a steady pace, quarter after quarter, year after year.

The conservative camp is not as far apart from the liberal camp as one might imagine. It believes, with them, that monetary tinkering can fine tune the economy, keeping it on a steady path. It shares with them the idea that real economic decisions such as consumption, investments, and productivity can be influenced by varying the short-term cost

of credit. It subscribes with them to the notion that real economic activity can be kick-started with cheap credit and that it can be arrested with dear credit.

As we have not tired of pointing out, they are committing two errors: For one thing, monetary aggregates, and more particularly bank credit, are the decisive variables, not the cost of credit. And secondly, in the medium to long term, money is neutral, that is to say, it has no effect on real economic activity. Instead, it affects prices. Be that as it may, the Board's current obsession with economic growth at any cost is certain in our opinion to launch us into an inflationary boom.

The US is *already* suffering from too much monetary stimulation. The brief interlude experience towards the end of 1994 — which saw commercial banks liquidate part of their enormous securities holdings — has now come to an end (see Chart 1). Reserve Bank accommodation has been sufficient to allow for soaring loan demand (see Chart 2) without the loss of liquidity. As a result, growth of total bank credit has reached new highs for this cycle (see Chart 3). It is no coincidence that slowdown notwithstanding, commodity prices are a whisker away from breaking out into new highs (see Charts 4 and 5).

We are at a critical juncture. If, as we maintain, the Fed is wrong in worrying about recession, wrong in thinking that

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Contributions by Albert D. Friedberg, David Frum, Edison Lee, and Sholom Sanik.

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

it can save us from a recession by lowering interest rates, and wrong again in overlooking the inflationary consequences of cheap credit, a significant opportunity lies at hand.

The conventional view (embodied in the Fed's current doctrine) is that the slowdown/recession will bring lower interest rates and lower inflation. We are agnostic vis à vis the occurrence of recession (it probably will not occur, although it does not matter for purposes of our speculative investment decision), and we believe that inflation is and always will be a monetary phenomenon. Therefore our view is that inflation is about to accelerate, led by a dramatic rise in commodity

prices, and that long-term interest rates will turn up and make new highs for the cycle.

STRATEGY: Be sure to participate in the coming rise of commodity prices. Our favorites are grains, base and precious metals, sugar, and cocoa. Notwithstanding this blanket bullishness, traders should exercise the normal precautions associated with futures trading, i.e., don't fight the tape, and use good money management techniques to avoid catastrophic losses.

Remain short T-bonds as per Flash Update of June 7, with stops at 117.00, close only.

Chart 1

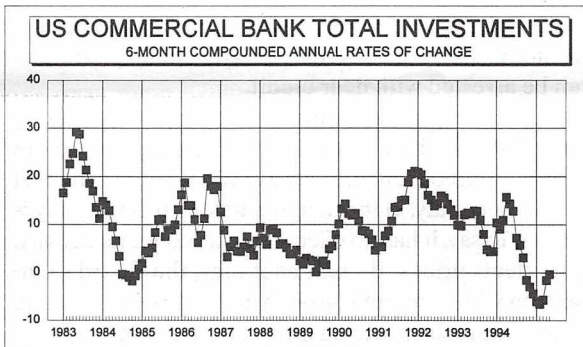


Chart 2

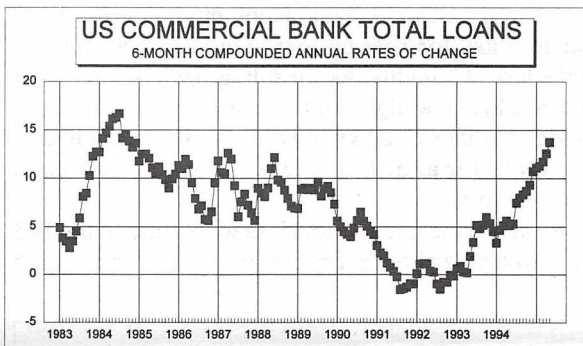


Chart 3

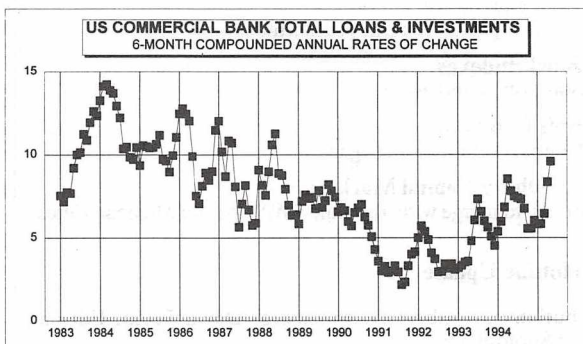


Chart 4

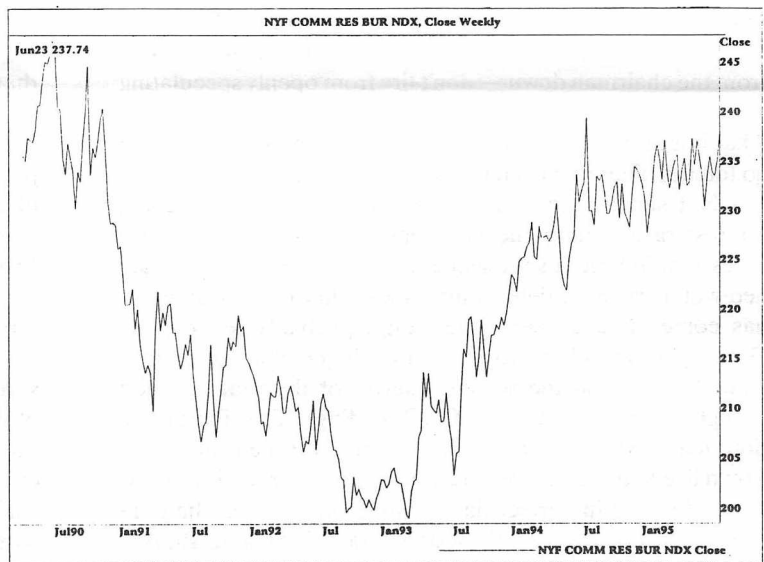
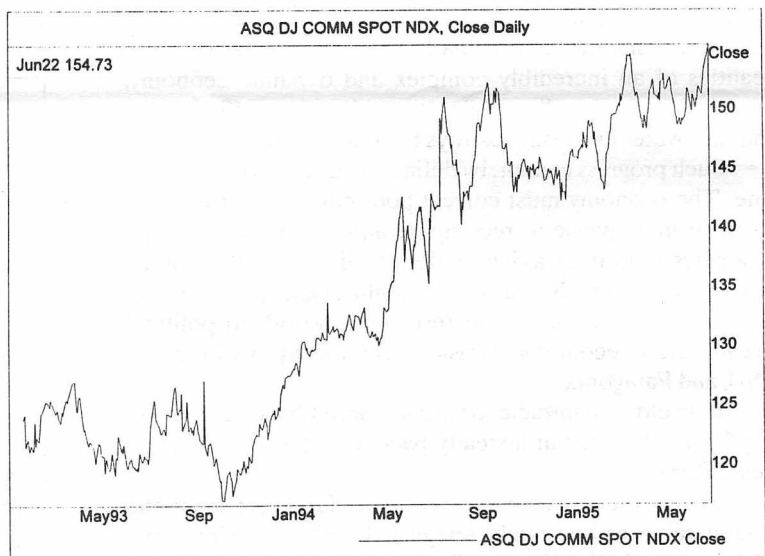


Chart 5



CURRENCIES**DM firm, dollar under pressure, yen weakening**

The massive, concerted, and totally unexpected intervention in defence of the dollar carried out on May 31 did accomplish one objective: It removed the more speculative element from the market. This, the elimination of one-way, destabilizing speculation, is the primary purpose of all interventions, leaving the markets in the hands of genuine players, namely those engaged in international trade of goods and services and long-term and portfolio investors.

Despite the calm and relative stability that has fallen over the major currency markets, the DM et al continued to exhibit a very firm undertone. Increasingly, the dollar is coming under renewed pressure. The causes are not hard to find: first and uppermost is the Fed's almost total neglect of the international role of the dollar in its policy deliberations. As we noted in our opening comments, the Fed's obsession with "Recession" is leading to an easier monetary stance despite already booming conditions in credit growth. Thus, one can find very little constructive to say about the dollar.

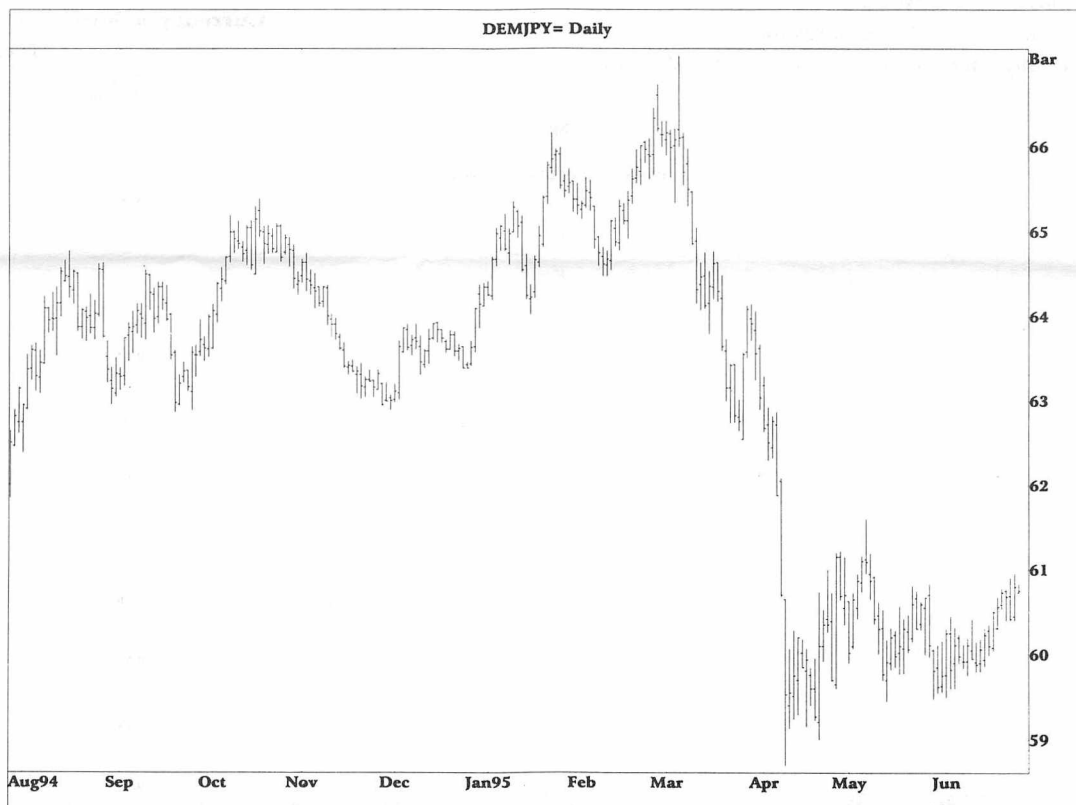
The super-strong yen is playing havoc with the Japanese economy, pushing the country into its first outright deflation since the '30s. The downward rigidity of asset prices, particularly real estate, and the inflexible labor market are making

the adjustment much more difficult than it ought to be. These rigidities, sanctioned and encouraged by government bureaucrats, slow turnover rates and contribute mightily to economic stagnation. Moreover, by braking consumption, they raise the savings rate and produce the perennial current account surplus. This, in turn drives the yen even higher, if only for psychological reasons.

Encouraging and even forcing banks to liquidate assets within the context of an intelligent bailout plan (as most banks are insolvent) coupled with a much more aggressive fiscal deficit (as the world will not permit Japan to climb its way out of the recession via a larger export surplus) should remove some of the yen's upward pressure and should restore some growth to the stagnating economy. Alternatively, the BOJ could engineer a monetary reflation. Either way the yen could begin to lose some strength vis à vis the DM.

STRATEGY: On Wednesday June 21, we recommended switching long yen positions, trading at 120.13 (acquired at 117.15, basis June '95 on May 25) to September '95 DM, then trading at 72.04.

Chart 6



CANADIAN DOLLAR

Three-year bear market ends

During the past three years, we continuously harped on the fact that Canada was a relatively inhospitable destination for capital and that as a result, capital flight was pressuring the currency despite its noted cheapness. We argued that a super-cheap dollar was necessary to price assets, goods, and services low enough to fund the exit of capital.

The change in Ottawa to a new government committed to fiscal prudence and more importantly the dramatic Tory win in Ontario (see attached article "Ontario 1uake: tax rates suffer most") have reinstated Canada to the mainstream of the progressive OECD economies.

Canada is no Singapore, Chile, New Zealand, or even Argentina. Or at least not yet. But capital perceives that it is at least as friendly to it as the US, France, and the UK. Moreover, in contrast to the latter three, it enjoys the benefits of an independent central bank, strongly committed, above all else, to price stability.

This guarantees that the recent pickup in inflation (8.9% producer price year-on-year rise compared with 5.7% in calendar 1994, and 2.1% year-on-year consumer price inflation compared with 0.2% in calendar 1994), itself the consequence of the massive devaluation experienced in recent times, will be dealt with firmly and resolutely.

It is at this point that cheapness viewed in the perspective of long-run purchasing power parity estimates (see Chart 8) becomes critical. Most such measures indicate a relative undervaluation of anywhere between 15% and 20%. With the

pall of socialism lifted from most of the land, capital will begin trickling back to take advantage of the "for sale" sign.

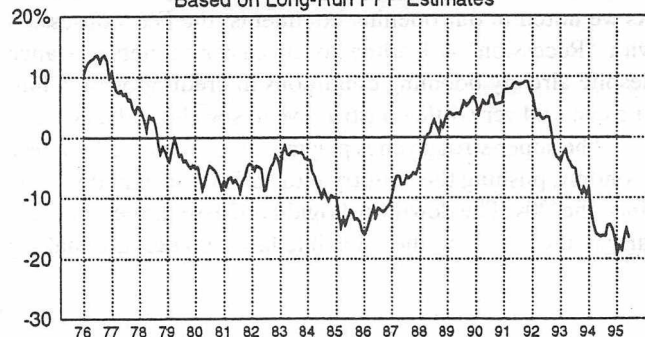
Last but not least, the resource orientation of its economy and the prospective improvement in the country's terms of trade should have a favorable impact on the value of its currency.

We are bullish.

STRATEGY: On Friday June 22, we recommended via Flash Update to buy September Canadian dollars, then trading at 72.70. Remain long and place initial stops at 72.10, close only.

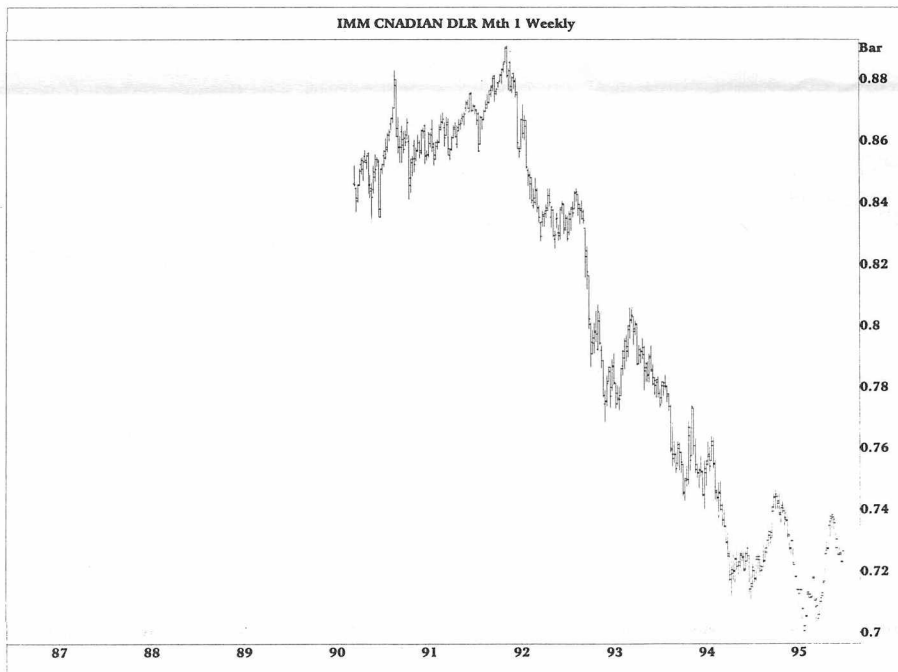
Chart 8

Canadian Dollar: % Over/Under Valued vs. US\$
Based on Long-Run PPP Estimates



Currency & Bond Market Trends,
Merrill Lynch

Chart 7



CANADIAN SCENE

Ontario quake: tax rates suffer most

by David Frum

Toronto — Canadians do after all belong to the same human race that Adam Smith wrote about. Americans have been led to believe that Canada is populated by happy collectivists — English-speaking Scandinavians who cheerfully pay whopping taxes because they delight in government. If that image were ever true, it is true no longer. Canada is adopting the same populist, individualist politics that swept America in November 1994.

Two years ago, Alberta premier Ralph Klein launched a hugely popular campaign of budget cutting. In February, the federal government followed suit. And on Thursday (June 8) Ontario cast its vote for the boldest platform in recent Canadian history: a 30% tax cut, spending cuts to match, workfare, privatization, and repeal of Ontario's pro-union labor code and new affirmative action law. In six weeks of campaigning, Conservative Party leader Mike Harris won a stunning upset victory, taking a party that began 22 points behind in the polls to its biggest win since 1955.

The shock waves will echo far beyond Ontario's borders. Under Canada's loose federal system, provincial governments possess great power: They run most social programs, regulate labor markets and hold responsibility for schools and universities. And the government of Ontario — the province where one-third of Canada's people produce 40% of the country's wealth — is the most powerful of them all. It could reasonably be argued that the premier of Ontario is the most important political figure in the country.

How was Ontario — which has traditionally rewarded bland, centrist politics — persuaded to gamble on Mr. Harris's radical plan? Much of the credit must go to Mr. Harris personally. He unveiled his "Common Sense Revolution" more than a year in advance of the election, and backed it with a pledge to resign if he did not fulfill its terms. And Mr. Harris has stuck by his plan without qualification, even when his party languished month after depressing month at about 30% in the polls, 20 points behind the complacent, content-free Liberals. In other words, Mr. Harris wasn't just offering voters conservative policies; he was offering them accountable politics, a refreshing change from the arrogance and cynicism that have too often disgraced Canada's parties.

* * * * *

But while paying Mr. Harris his due, it should be recognized that a deeper force is at work in Ontario — the same force that has discredited left-of-center politics throughout the Western world: Ontario's public sector has forfeited the public trust.

Out-of-control spending in the 1970s and 1980s pushed Canadian taxes beyond endurance. Ontario's top income tax rate of 53.2% bites at \$49,000 (all figures are in US dollars). And the lower marginal rates are no picnic either. The head of a family of four who earns as little as \$43,000 will pay \$14,000 in federal and provincial income taxes. And that's not counting the 8% provincial sales tax and a 7% federal goods and services tax, plus some of the highest property

taxes in North America.

Taxes have crushed the life out of the economy: Average pre-tax family incomes have been falling since 1990. With their revenues stagnating, Canadian governments have been forced to economize. Unfortunately, the only way gigantic bureaucracies know how to scrimp is by worsening the services they offer to the public. Ontario spends more than any other Canadian province per student — almost \$5,000 — but educational standards are visibly crumbling. The Ministry of Education has been reduced to bragging that 90% of Ontario's students can be considered "adequate."

* * * * *

The failures of the welfare system exceed even those of education. Fully 1.3 million of Ontario's 10 million people subsist on welfare. (Hundreds of thousands more receive benefits from the federal unemployment insurance program and Ontario's own fraud-plagued workers' compensation plan.) That number has risen in every one of the past 20 years, in boom times as well as bust. More people accepted welfare at the top of the 1980s boom than at the trough of the 1981-82 recession. No wonder: A family of three would need an income of some \$20,000 to match the after-tax value of the stipend Ontario will pay them.

But the most shocking evidence of public-sector collapse has accumulated in precisely the corner of the welfare state in which Canadians take the most pride: the state-controlled health system. Between 1992 and 1993, Canada recorded the most startling and unexpected jump in mortality rates since World War II. The infant mortality rate rose for the first time in 31 years. Adult mortality rose even more sharply.

Worried voices were quickly heard blaming AIDS and pollution. But on closer examination, the culprit seems to be less exotic: The queues and shortages of the Canadian health system are killing old people — to be precise, some 2,500 more old people than demographers expected. These people have names, children, spouses, friends. And when Mr. Harris offered voters an alternative to living in one the later chapters of an Ayn Rand novel, they jumped at it.

What occurred on June 8 was no mere political win; it was the latest and biggest victory in a larger cultural struggle. Ideological conservatism, once a timid and humble presence in Canada, is emerging as at least an equal — and arguably even the dominant — intellectual force. Never has the local left manifested less self-confidence; never has the right dared speak so boldly. Canadians are still startled that a politician can triumph on themes like freedom, enterprise and self-reliance. But they're getting used to it. For the first time in decades, hope is whispering in the air.

Mr. Frum is a columnist for the American Spectator and Canada's Financial Post.

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STOCK INDEXES

Standoff, stand aside

Moving rapidly to our objective of 4900 and 570, basis Dow Jones Industrial Index and the Standard & Poor's 500 index, respectively. Since the stock market is likely to peak only after the turn in interest rates, we need not concern ourselves, at this time, with calling a top. In fact, breadth and accumulative

volume add an important time perspective, probably measured in months rather than days, to our numerical targets.

STRATEGY: *Poor fundamentals but still-strong technical factors are giving us a standoff. Stand aside.*

SOFT COMMODITIES

Coffee: ready to perk?

As the market enters the Brazilian frost season, prices have begun to slide. After all, what are the chances of having a devastating frost two years in a row? While from a statistical viewpoint this may be quite true, the market seems to be taking a rather simplistic view: If there's no frost, the price should slide back to \$1.20.

On June 1, F.O. Licht said that 1995-96 world production would be 85 million bags, which creates a production/consumption deficit of 7 million bags. This figure is based on Licht's own estimate of a Brazilian crop of 16 million bags.

Two weeks later the USDA released its latest estimate of the Brazilian crop at 17.6 million bags. While this number is considerably higher and almost at the high end of the range of expectations, it still leaves us with a deficit of 5.4 million bags. This would cause a strain on global stocks, which have already been declining since 1992.

In addition, not only is the quantity of Brazilian stock-

piles an unknown, the quality is questionable as well.

On the matter of consumption, most of the European import figures seem to be registering declines.

We found it difficult to get a handle on the effects of high prices on North American consumption, so we did a bit of our own research. We conducted a poll amongst randomly selected coffee drinkers across North America, some from as far as Texas and Alberta, and found that 91% of the participants did not allow higher coffee prices to affect their consumption at all. (This poll carries a margin of error of plus or minus 8% according to commonly used polling standards, which is actually a bit below generally accepted levels, but we're not really pollsters.)

As well, a coffee shop chain with hundreds of stores across Canada told us that sales, both in dollar and volume terms, are booming. So, while this market has that sinking feeling at the moment, we're watching it closely.

STRATEGY: *Stand aside.*

Cocoa: in strong hands

Maintaining loyalty to a bullish case for cocoa has become a lonely endeavor. The popular sentiment tracking systems show speculator interest at a reading that is lowest amongst all tradeable commodities on the board. From a trend-follower's point of view, who could disagree? The price of cocoa has been in a precipitous decline since the market topped out at \$1,543/tonne in July 1994, and import and grinding news out of Europe has been sloppy.

Holding a long position in cocoa has been a character-builder. We've fought the cost of carry reflecting a market that has had ample short-term supplies, even though we're in the third year of a production/consumption deficit. This picture cannot last forever, though.

As global production shrinks and consumption continues to rise, albeit modestly, existing stockpiles will continue to dwindle. In their May market report E.D. and F. Man says that the ratio of ending stocks to consumption for the 1994-95 season

will shrink to 43.5% from 50.8% at the end of last season. This figure has been declining since the 1991-92 production year.

In addition to the flooding problems we spoke of last month, which cost Indonesia about 50,000 tonnes (some 18%) of its crop, there's something new to worry about. There have been reports of pod borer disease, which in the past has cost Brazil as much as 25% of its crop.

With the open interest having shrunk to about as low as cocoa open interest gets, it's comforting to know that the cocoa being held is in quality hands. The commitment-of-traders data shows the commercials dominating the long side of this market with a net position the size of which they have not held since 1991. It took a few months back then, but when it came, the market doubled in price.

STRATEGY: *Stand aside until spot cocoa breaks above \$1,400/tonne.*

Corn: bulls marching forward

Why is this summer's weather scare in the corn market different from all other weather scares? The answer is simple. We don't need it. This market can stand on fundamentals that actually began to develop last summer when grain traders watched with awe as each USDA estimate for the 1994-95 crop would rise and rise until the final tally showed a record crop of 10.103 billion bushels.

The demand picture, however, quickly ate into this chunky crop. Exports grew by 56%. Domestic use grew by 17%. The crop may have been huge, but the carryover stocks from 1993-94 were tiny by historical standards at 850 million bushels.

The market was complacent because of the size of the crop and ending stocks that would grow to 1.538 billion bushels to be carried forward to the 1995-96 season. Sinking prices (the price was below \$2.20/bushel for the last six months of 1994) discouraged plantings.

All of which will contribute to an expected 1995-96 crop of 7.9 billion bushels with a carryover stock of only 748 million bushels. Estimates of total consumption actually show a decline over last year, but are still 6% above the average of the previous

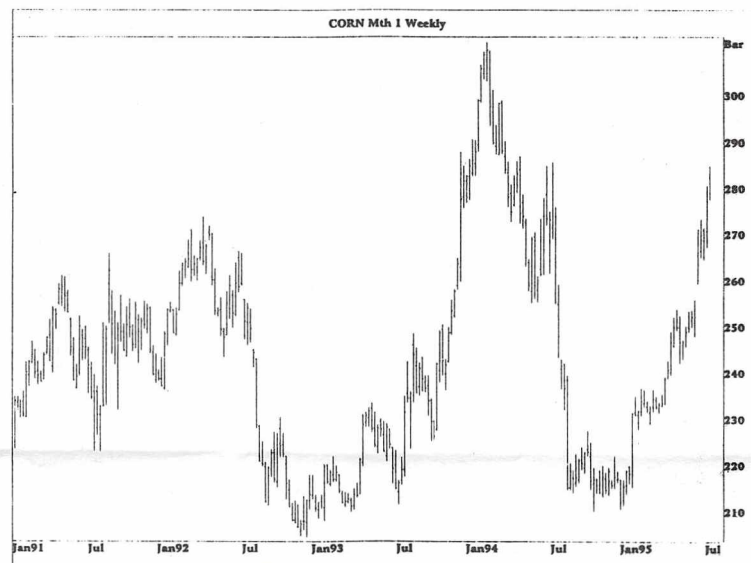
five years, while production is 5% below the five-year average.

Enter the icing on the cake. A very wet spring delayed plantings, bringing the potential yield down to 119.7 bushels/acre — a far cry from the recent trend of 125 bushels/acre. Now that the crops have been planted, the clouds have become stubborn. Even when there has been rain in the forecast, it has encountered skepticism as the market marches forward in a fine, steady bull-market type of action.

The naysayers do have history on their side, as corn traders are terrified of the magical \$3.00 level, which always seems to bring corn farmers to life and gets them planting and ultimately puts selling pressure on the price as they hedge their crops. However, with global stocks dwindling and demand from hungry countries with emerging economies growing, the traditional \$3.00 level should be breached, sending bears scrambling for cover.

STRATEGY: *This could potentially be a huge bull market. On May 21, we advised buying September '95, then trading at 2.87 3/4. Remain long, with stops at 2.73, good anytime.*

Chart 9



Sugar: a sweet bull market scenario

While following the backwardation in the sugar market has thus far fooled many a bull, it should be noted that the July/October spread made highs of 179 points, a spread seen not even by May/July while the market was going up.

In its May market report The International Sugar Organization worries that the market is focusing on short-term factors like the delivery problems at Santos and ignoring the 1994-95 production surplus of 1.8 million tonnes: "Such a

severe backwardation, in our opinion, is not supported by the existing fundamental situation," they conclude.

Although it is difficult to disagree with this assessment, a market that has been fed hand to mouth for such a long time couldn't possibly be in a position to withstand a swing from the optimism expressed in the backwardation to the disappointment of a crop failure or unexpected demand.

* * * * *

Those who live off the excesses of the US Sugar Program should be sweating. In a bill being presented to Congress through the bipartisan efforts of Congressman Dan Miller

(R-FL) and Charles Schumer (D-NY), the program is being attacked. The government provides subsidized loans and creates an artificial shortage by imposing import quotas and marketing controls. The net effect is that the wholesale price of raw sugar for US consumers is fixed at 23¢ a pound, almost double the current world price.

Those with vested interests in keeping the program alive hide behind the disinformation that the program costs the taxpayer nothing in actual net government payments, because the treasury collects an import tariff. While true, this doesn't address the \$1.4 billion dollars a year US consumers pay above the world price.

Even Mark Foley, who represents Florida's 16th district, which contains most of Florida's sugar growing region has conceded: "I expect the program will have to change..."

Demand for sugar in the US has grown by 6% in the past five years, even though the population has grown by only 4% in the same period. This is a fairly interesting statistic in light of the fact that one might have thought that the use of artificial sweeteners by a population increasingly conscious of its health would keep the lid on the growth of sugar consumption.

The market for high fructose corn sweeteners (HFCS) has

grown dramatically over the years as well. America's sweet tooth is firmly in place. In the initial phase of a market without a sugar program, the price of US sugar would fall to the world price, creating a flood of fresh demand. Perhaps, to take the case a bit further, market share might be stolen from HFCS as the price of sugar becomes competitive.

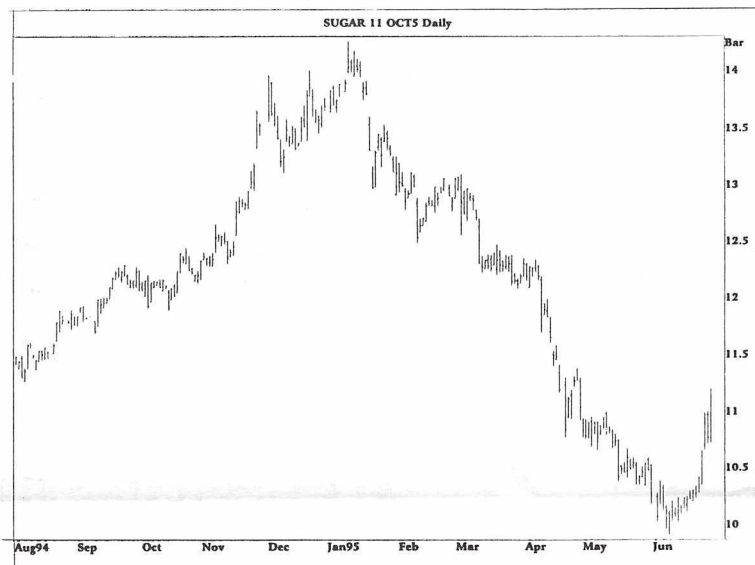
This might be especially true as corn prices have been pushing upwards, because the US is expecting its lowest corn crop in years and the price of HFCS has traditionally been very sensitive to the fluctuations in the price of corn. All this will create demand for sugar.

In the next phase the fat-cat farmers living off the government will find their sugar crops not so profitable, having to sell them at world prices. They'll switch to other crops, causing a real shortage. The demand for sweeteners should remain constant while supplies shrink, the perfect scenario for a bull market, made in the USA.

STRATEGY: Buy October '95 sugar at the market, but be mindful of the potentially large 1995-96 crops. Place tight stops at 10.30, good anytime.

– Sholom Sanik

Chart 10



FRIEDBERG CAPITAL MARKETS

Seabil to Merge with Tasman

(All currency figures are in NZ\$)

Security: 9% convertible capital note

Maturity date: June 27, 1999

Outstanding: \$91.5 million

Recent price: 81.6 cents per dollar

Yield to maturity: 15.89%

Merger Proposal

On June 8, Seabil (NZ) Ltd. announced its intention to merge with Tasman Properties Ltd. by way of a share swap. The

merger will create a property company, to be named Trans Tasman Properties (TTP), with \$1.1 billion in assets and with exposure to both New Zealand and Australia.

The conversion ratio of the share swap will be based on the net tangible asset value (NTAV) of each company. Independent appraisers will conduct a valuation of the two companies' assets and present their findings to the companies as well as shareholders. The results are expected to be available in about three months.

According to the latest public information, Seabil's NTAV was \$1 per share at the end of December 1994. Tasman's NTAV was 3.15¢ per share at the end of March 1995. These

NTAV figures would translate into a conversion ratio of approximately 32 shares of Tasman per Seabil's share. We believe the new NTAV figures will not differ from these significantly.

As part of the merger proposal, Seabil's current shareholders are invited to exchange their ordinary shares for mandatory convertible notes (MCNs) on a one-for-one basis. These mandatory convertible notes are currently held by SEA Holdings Ltd., which also holds 60% of Seabil's ordinary shares. The MCNs carry a 9% annual coupon rate, are redeemable only for shares of Seabil (TTP if the merger is approved), and mature on June 27, 1999.

The merger is conditional upon at least 80% of Seabil's shareholders' (excluding shares held by SEA Holdings) agreeing to exchange their shares for MCNs. Other required approvals include both companies' board, creditor banks, shareholders and the New Zealand Stock Exchange.

Implications

Upon approvals, TTP will be a major property company on the New Zealand Stock Exchange and will be included in the NZSE40 index. TTP will have property assets of \$1.1 billion (\$510 million from Seabil and \$570 million from Tasman), with 70% exposure to New Zealand and 30% exposure to Australia.

We believe the merger proposal is fair, because both Seabil's and Tasman's ordinary shares are trading at a similar discount (25% to 26%) to their respective NTAV. In other words, the share swap does not asymmetrically benefit the shareholders of either company. In addition, the exchange of Seabil's ordinary shares for MCNs is an attractive option, because dividend income will become more secured for Seabil's shareholders.

With Seabil's ordinary shares trading at 75 cents, the MCN will provide these shareholders with a current yield of 12% upon exchange. Since Seabil's shareholders should be income-oriented, it is reasonable to assume that all shareholders of Seabil will choose to exchange for the MCNs.

The convertible capital notes (CCNs) that we previously recommended will stay unaffected in this merger proposal. The CCNs will be converted, at the option of the issuer, into cash or shares of TTP at maturity.

The major benefits of the merger are the exposure to a more diversified property portfolio, the opportunity for the combined company to be included in the NZSE40, and the cost savings by eliminating duplicated management. From Seabil's perspective, it can be argued that having exposure to Australian real estate is in fact a negative because of New Zealand's better economic fundamentals. In addition, it is a deviation from the company's initial stated objective to invest solely in New Zealand. Furthermore, the combined company will have a higher financial leverage than Seabil alone has.

Investors in the CCNs should be most concerned about the financial impact of the merger as it affects the underlying credit risk. Owing to the much higher financial leverage of Tasman, the combined company will have a higher debt burden than Seabil alone.

The post-merger debt-to-equity ratio will rise to 1.16 (treating both CCNs and MCNs as equity) from 0.69 of Seabil. However, despite the higher leverage, the CCNs in fact will have better interest and asset coverage after the merger. The

interest coverage ratio will rise to 1.25 (including interest on both CCNs and MCNs) from 1.09, and the tangible asset coverage of all convertible notes will increase to 1.92 from 1.12.

Therefore, although the merger does mean increased financial leverage, the better asset and interest coverage of the CCNs indicates that the credit risk has not deteriorated. Moreover, whether business risk has increased is also controversial. First, despite Australia's weaker economic fundamentals for real estate investments, the fact that Tasman's properties will be acquired at a 25% discount will provide substantial downside protection. Second, we have seen a significant turnaround at Tasman. For the year ended March 31, 1995, it produced operating income of \$3.4 million versus a loss of \$1.6 million a year ago. The recapitalization it went through in March will reduce its interest expense substantially. Consequently, we estimated Tasman could make \$14 million cash earnings in fiscal 1996.

TTP should generate approximately \$18 million in cash earnings annually, after interest expenses on debt, CCNs and MCNs. That should be enough for the company to meet the minimum debt amortization of \$15 million each year for the next two years. Currently, approximately \$170 million of Tasman's debt is on floating rates. We believe the chance of rate hikes in New Zealand is quite small, and interest rates may in fact fall over the next two years when inflationary pressures recede. As a result, it is very likely that the floating-rate structure of Tasman's debt will benefit the company by lowering its interest expense.

STRATEGY: *The 9% convertible capital notes of Seabil have fallen 10% in price following the merger proposal. The notes currently provide a yield to maturity of 15.9%, which represents a spread of 810 basis points over comparable government bond yield. We believe the notes have been oversold as the market focused on the increased leverage of the combined company and ignored the improved asset and interest coverage. It has created a buying opportunity, and we continue to recommend the notes for yield-oriented, fixed-income accounts.*

— Edison Lee, CFA

TWA voting started

The restructuring negotiations between TWA and its various creditors have finally been completed. TWA finalized its S4 filing with the Securities and Exchange Commission in May, and the deadline for voting is June 27, 1995.

The terms of the restructuring with respect to the 10% notes are based on the final agreement that TWA reached with the unofficial committee of the 10% noteholders. Although the terms have appeared in numerous documents, we believe it is worthwhile to summarize them again in the following.

Under the terms of the prepackaged bankruptcy plan, which the unofficial committee supports, each \$1,000 face amount of 10% note would receive the following:

- A) \$754.4892 face amount of new 12% senior secured notes due November 1, 1998.
- B) 10.2078 shares of TWA common stock.
- C) 24.4099 TWA equity rights.
- D) the right to receive conditional consideration of up to
 - 14.646 ten-year warrants or \$48.8199 cash or some combination of the two

- 10.9718 additional shares of TWA common stock
- E) One contingent payment right with a maximum face amount of \$80.1796.

The detailed terms of the above securities are described as follows:

12% Senior Secured Notes. The new 12% senior secured notes due 1998 will have a total of \$170 million face amount outstanding and will be secured by the same collateral that currently secures the 10% notes, except for the second liens on four 767-200 aircraft, which should not have any equity value. The new 12% notes will accrue interest from February 1, 1995. The principal of the new 12% notes will be redeemable for cash only. If, among other things, no default has occurred, the common stock is listed, and the common stock has not traded below \$3 per share during certain specified time periods, TWA has the option to make the first four interest payments in common stock valued at 90% of the average trading value prior to the interest payment date. Furthermore, if the 12% notes trade higher than 93% of their face value during a pricing period following the restructuring and there is no default on the 12% notes, the coupon rate may be reset prospectively to as low as 10%.

Common Stock. The shares of common stock will be transferable. The existing common stock will be reduced in a 46.8722-to-one reverse split.

TWA Equity Rights. The TWA equity rights will allow holders to buy additional shares of TWA common stock during the 21-day period beginning on the 23rd day after the effective date of the prepackaged plan at a 40% discount, subject to a minimum level of \$7.20 per share. However, this minimum may be lowered by TWA. The TWA equity rights are not transferable.

Conditional Consideration. The right to receive conditional consideration is triggered if the value of the equity securities received by the 10% noteholders is less than certain target levels. This right is transferable. If the value of the TWA equity rights received by 10% noteholders does not reach a minimum of \$48.8199 per \$1,000 face amount of 10% note, TWA has to issue up to 14.646 ten-year warrants or up to \$48.8199 in cash per \$1,000 face amount of 10% note, or some combination of the two. In addition, if the aggregate value of the common stock, equity rights, warrants, and/or cash received per \$1,000 face amount of 10% note does not reach \$199.7177 (plus interest at 12% from August 15, 1995, to the 90th day after the effective date of the plan), TWA has to issue up to 19.9718 additional shares of common stock per \$1,000 face amount of 10% note.

Contingent Payment Rights. The contingent payment rights are designed to provide an additional layer of protection if the entire package of securities to be received by 10% noteholders is worth less than certain target levels. The rights are transferable and secured by the collateral backing the new 12% notes. Should the new 12% notes trade at or below 87% of face value during a specified pricing period, TWA would be obligated to pay, per \$1,000 face amount of 10% notes, \$25 on each of February 1, 1996, and August 1, 1996, in cash, together with interest at 12% accruing from February 1, 1995. These two payments are intended to compensate for the

missed coupon payment on February 1, 1995, on the 10% notes.

In addition, after receipt of the conditional considerations, if the aggregate value of the common stock, equity rights, warrants and/or cash received by 10% noteholders does not reach \$199.7177 per \$1,000 face amount of 10% notes, TWA would be obligated to pay up to \$15.0898 (plus interest accruing at 12% from the 90th day after the effective date) on each of February 1, 1997, and August 1, 1997.

Therefore, the total obligations of TWA under the contingent payment rights add up to \$80.1796, plus accrued interest, per \$1,000 face amount of 10% note.

From TWA's perspective, the above restructuring formula would enable it to reduce debt by \$50 million and possibly conserve cash by paying the first four interest payments on the new 12% notes in common stock. On the other hand, from the 10% noteholders' point of view, it provides substantial downside protection due to the conditional considerations and contingent payment rights.

Furthermore, the 10% noteholders are able to preserve all the existing collateral (other than the four aircraft as mentioned above), which is the most valuable assets in a worst-case scenario (i.e., liquidation).

In agreement with other unofficial committee members, we believe the restructuring should be accomplished through a prepackaged bankruptcy rather than through the out-of-court exchange offer. In the prepackaged bankruptcy process, creditors have the option to turn down the plan by appealing to the judge that the company has become non-viable subsequent to the solicitation. This option can be valuable in TWA's case if it continues to perform below expectations during the summer.

Other reasons for supporting the prepackaged plan are mostly legal in nature. The main ones include uncertainty over whether the consents solicited in an out-of-court setting are effective to authorize the trustee to amend the bond indenture and a possible attack on the collateral after it is released from the 10% notes. From TWA's perspective, we believe the prepackaged bankruptcy will be the most effective alternative in achieving debt reduction because dissident bondholders will be cramped down by a majority vote.

STRATEGY: *Hold on to the 10% notes and stay tuned for the outcome of the solicitation as well as TWA's latest operating performance.*

— Edison Lee, CFA

Mexican Treasury bills (CETES)

We advised closing out Cetes positions (first recommended in our March 26 issue).

This was a highly profitable operation, as the currency appreciated approximately 10% vis à vis the US dollar, and investors were able to earn 0.75% to 1.5% *per week* in the short-term 14 day bill. The currency is no longer drastically undervalued, interest rates have fallen well below 50% per annum maintaining only a small margin over inflation, and the political/social climate has worsened as evidenced by the assassination of Polo Uscanga, an important judge.

Chart 11 – FOREIGN CURRENCY BONDS

DATE: June 23, 1995 We offer the following Bonds subject to change without prior notice: Minimum US \$5000 (CDN \$7000)

ISSUER / COUPON / MATURITY DATE	PRICE	OFFER	YIELD	TERM
DEUTSCHE MARK DENOMINATED BONDS				
Bank of Nova Scotia 5 5/8% 7/5/96 RRSP eligible	99.60	-	-	May-07
World Bank 5 7/8% 4/02/97 RRSP eligible	103.15	104.00	3.25	Feb-04
World Bank 7 1/4% 13/10/99 RRSP eligible	104.95	105.80	5.68	Oct-13
World Bank 9% 13/1/00 RRSP eligible	115.35	116.20	5.43	Nov-13
Kingdom of Denmark 6 1/8% 15/04/98	101.05	-	-	Apr-15
Argentina 8% 5/10/98	99.05	99.90	8.07	Oct-05
Bk. Foreign Eco. Affairs 7% 29/3/96	96.50	97.35	10.62	Mar-29
Kgdm. of Spain (6 Mo. LIBOR-1/16) 29/6/02 (semi)	99.19	99.49	-	5.4375 Jun-29
ITALIAN LIRA DENOMINATED BONDS				
Nordic Inves. Bk 12 3/8% 19/04/96	98.90	99.75	12.42	Apr-19
SWISS FRANC DENOMINATED BONDS				
General Electric 4 3/4% 2/7/98	99.70	-	-	Jul-02
DANISH KRONE DENOMINATED BONDS				
Kgdm. of Denmark 9% 15/11/96	102.20	103.05	6.57	Nov-15
ECU DENOMINATED BONDS				
United Kingdom 9 1/8% 21/02/01	106.05	106.90	7.56	Feb-21
BRITISH POUND DENOMINATED BONDS				
Kdgm. of Sweden 8 3/4% 29/5/96	100.40	-	-	May-29
FRENCH FRANC DENOMINATED BONDS				
Credit Lyonnaise 9 1/2% 23/12/96	102.80	103.65	6.78	Dec-23
JAPANESE YEN DENOMINATED BONDS				
World Bank 5 3/4% 7/8/96 RRSP	104.40	105.25	0.96	Aug-07
CANADIAN DOLLAR DENOMINATED BONDS				
Ontario Hydro 10 7/8% 8/01/96 (semi) RRSP eligible	101.50	102.75	5.51	Jul-08
Eksportfinans 7 3/4% 5/11/97	100.80	-	-	Nov-05
Royal Bank of Canada 9 1/8% 7/1/97 RRSP eligible	102.85	-	-	Jan-07
SOUTH AFRICAN RAND DENOMINATED BONDS				
ESCOM 12% 1/5/96 (semi)	97.45	98.30	14.18	Nov-01
AUSTRALIAN DOLLAR DENOMINATED BONDS				
Commonwealth Bk. of Australia 9 3/4% 15/5/96	101.85	102.7	6.44	May-15
NEW ZEALAND DOLLAR DENOMINATED BONDS				
World Bank 12.5% 25/7/97 (semi) RRSP eligible	108.75	109.60	7.42	Jul-25
New Zealand Gov't 10% 15/7/97 (semi)	103.05	-	-	Jul-15
New Zealand Gov't 8% 15/7/98 (semi)	100.25	101.10	7.59	Jul-15
Fletcher Challenge 10.75% 15/12/97 (semi)	102.15	103.00	9.36	Dec-15
Fletcher Challenge 10.15% 30/11/98 (semi)	101.60	102.45	9.29	Nov-30
Tranz Rail Ltd. 10% 15/10/99 (semi)	101.80	102.65	9.23	Oct-15
DB Group 7% 30/6/96 (semi) matures @ 85	88.50	-	-	Jun-30
Seabil Ltd. 9% 2/6/99 (semi)	82.75	83.60	15.08	Jun-27
ARGENTINEAN PESO DENOMINATED BONDS				
BIC V Fixed/Floating 1/5/2001 Callable	56.15	58.15	25.31	IRR PAR VALUE 60.05 4 th day of mth.
Bocon Pre 1: 1/4/2001	59.75	61.75	29.04	129.83 May-01-97
MEXICAN PESO DENOMINATED BONDS				
Government of Mexico "CETES" 22/7/95		available on request		every 4 weeks
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS				
Burnup & Sims 12% 15/11/00 CV@16.79 p/sh (semi)	97.25	98.75	12.32	Nov-15
Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh	47.75	49.25	19.16	Apr-29
Coeur D'Alene 6% 10/6/02 CV@ 26.00 p/sh	89.75	91.25	7.67	Jun-10
Glycomed 7 1/2% 1/1/03 CV@14.06 (semi)	62.25	63.75	15.95	Jun-01
California Microwave 5 1/4% 15/12/03 CV@28.44 p/sh (semi)	125.25	126.75	1.83	Jun-15
U.S. DOLLAR DENOMINATED FIXED RATE BONDS				
World Bank 7 1/8% 2/7/99 (semi) RRSP eligible	104.60	105.45	5.66	Sep-27
Farm Credit Corp 7 3/4% 10/06/96 RRSP eligible	100.90	101.75	5.78	Jun-10
T.W.A. 10% 3/11/98 (semi)	64.25	65.5	24.19	N/A
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES				
Kgdm. of Denmark 25/3/97 (Gold call, JY put),(semi)	69.70	70.70	-	8.45 Sep-25
United Kgdm. 30/9/96 3 mo.LIBID-1/8 (qty), callable @100	99.87	100.17	-	6.00 Jun-30
Bocon 1/4/01 (30 day LIBOR) starts paying May 1,1997	69.40	70.25	24.74	PAR: 119.87 May-01-97
Argentina: Series L:FRB 31/3/05, 6 mo. LIBOR+13/16 (semi)	55.5	57	19.07	7.3125 Sep-29

GOLD (in ounces, at market prices, can also be held in your bond account)

client eligibility determined at point of sale.

Chart 12 – Recommended current portfolio allocations

1. New Zealand (8%) '98 Gov't	30%	4. Tranz Rail NZ\$	10%
2. Fletcher NZ\$	10%	5. World Bk 7 1/4% '99 DM	20%
3. Seabil NZ\$	10%	6. Pre-1/Bocon	20%

HOTLINE UPDATE

Tuesday, May 23, 1995:

Good afternoon for Tuesday, May 24. There are no changes or new recommendations. Have a great trading day.

Wednesday, May 24, 1995:

Good afternoon for Wednesday, May 25, 6:00 pm. This is a flash update. We have one new recommendation. Raise stops on long June Canadian dollar to .7280, close only from .7245. Have a great trading day.

Thursday, May 25, 1995:

Good morning for Thursday, May 25, 9:00 am. This is a flash update. Buy June Japanese yen at the market, presently trading at 117.15. Have a great trading day.

Friday, May 26, 1995

Good afternoon for Friday, May 26. There are no changes or new recommendations. The following is a recap of this week's recommendations.

On Wednesday, May 24, via flash update, we advised to raise stops on long June Canadian dollar to .7280, close only. On Thursday, May 25, via flash update, we advised to buy June Japanese yen at the market, then trading at 117.15.

Wednesday, May 31, 1995:

Good afternoon for Wednesday, May 31, 6:00 pm. This is a flash update. Raise stops on long July wheat to 368, good anytime, from 350. Have a great trading day.

Friday, June 2, 1995:

Good afternoon for Friday, June 2. There are no changes or new recommendations. We repeat the flash update of Wednesday, May 31 to raise stops on long July wheat to 368, good anytime, from 350. Have a great trading day.

Tuesday, June 6, 1995:

Good afternoon for Tuesday, June 6. There are no changes or recommendations. Have a great trading day.

Wednesday, June 7, 1995:

Good afternoon for Wednesday, June 7, 5:30 pm. This is a flash update. Sell September T-bonds at the market, placing stops at 117.00, close only. Have a great trading day.

Thursday, June 8, 1995:

Good morning for Thursday, June 8, 10:30 am. This is a flash update. Liquidate long July copper positions, at the market, presently trading at 132.70. We repeat the flash update of yesterday at 5:30 pm to sell September T-bonds at the market, placing stops at 117.00, close only. Have a great trading day.

Friday, June 9, 1995

Good afternoon for Friday, June 9. There are no changes or new recommendations. The following is a recap of this week's recommendations.

On Wednesday, June 8 via flash update, we advised to sell September T-bonds at the market, placing stops at 117.00, close only. On Thurs-

day, September T-bonds opened at 113.28. On Thursday, June 8, via flash update, we advised to liquidate long July copper positions, at the market, which were then trading at 132.70. Have a great trading day.

Tuesday, June 13, 1995:

Good afternoon for Tuesday, June 13. There are no changes or recommendations. Have a great trading day.

Friday, June 16, 1995:

Good afternoon for Friday, June 16. There are no changes or new recommendations. Have a great trading day.

Tuesday, June 20, 1995:

Good afternoon for Tuesday, June 20. We have one new recommendation. At this point in time, we are long the yen, but are leaning more favorably towards the deutschemark. Therefore, liquidate your long yen position and replace it with an equal dollar amount of long deutschemarks. Have a great trading day.

Wednesday, June 21, 1995:

Good afternoon for Wednesday, June 21, 5:00 pm. This is a flash update. Buy September corn at the market, placing stops at 2.73, good anytime. Have a great trading day.

Friday, June 22, 1995:

Good morning for Friday, June 23, 9:00 am. This is a flash update. Buy September Canadian dollar at the market, presently trading at .7270. Have a great trading day.

Friday, June 23, 1995:

Good afternoon for Friday, June 23. There are no changes or new recommendations. This is a complete summary since our last market letter dated May 21, of all liquidations of open positions and new recommendations that remain outstanding.

On Wednesday, May 24, we raised stops on long June Canadian dollar to .7280, close only. This position was stopped out on May 26, when June Canadian dollar closed at .7275.

On Thursday, May 25, we advised to buy June yen at the market, then trading at 117.15. This position was replaced with long September deutschemarks on Wednesday, June 21. The yen opened on Thursday at 120.13, and the deutschemark opened at .7204.

On Wednesday, May 31, we raised stops on July wheat to 368, good anytime. This position was stopped out on June 12, with the wheat trading at 368.

On Wednesday, June 7, we advised to sell September T-bonds at the market, which opened on Thursday at 113.28. Stops were placed at 117, close only.

On Thursday June 8, we advised to liquidate long July copper at the market, then trading at 132.70.

On Wednesday, June 21, we advised to buy September corn at the market. On Thursday, September corn opened at 287.75. Stops were placed at 2.73, good anytime.

On Friday, June 23, via flash update, we advised to buy September Canadian dollar, at the market, then trading at .7270. Have a great trading day.

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