

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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Stagflation ahead: play at your own risk

The sluggish and disappointing pace of economic activity in the US (and abroad) will most likely prompt the monetary authorities to engage in one more round of pump-priming sometime next month.

Successive waves of easy money dosages, aptly applied over the past 14 years, managed to revive the moribund patient, but at a cost of increased speculation. Financial asset inflation took the place of price inflation on goods, services, and wages. As returns on fixed and variable-rate paper plummeted, resources were, perforce, misallocated. In Austrian economic terms, the capital goods sector had been hoodwinked to overexpand (in much the same way that unnaturally low interest rates in Japan in the late '80s caused an overinvestment boom in real estate).

Mega-mergers in the entertainment and banking industries (many if not all of them undertaken with the barest of economic rationales) are the latest consequences of this money tinkering. This misallocation will become apparent only when, inevitably, interest rates are once again set by the supply of, and demand for, genuine savings.

Blissfully unaware of the accelerated process of resource misallocation and, consequently, the looming danger to future economic activity, financial markets float ever higher. Investors have come to formulate the following heads-I-win, tails-you-lose proposition: Vigorous economic activity produces vigorous earnings growth and is, thus, bullish; a slowdown, or better yet, a recession, damages earnings but prompts the Fed to ease money and rates and this too is bullish.

When third-quarter results appeared to come in below estimates (they turned out to be on the whole better than estimated), the broad stock market indexes barely budged. The reason: The market felt that surely the Fed would be alert to the negative implications of an earnings drop. This caused bonds to soar and rates to drop to new 18-month lows. And so it appears that with a little monetary fine-tuning, we have bought permanent prosperity and a permanent bull market.

Wherein lies the danger? Or more to the point, what will spoil the broth?

Indubitably, inflation will. If we understood *exactly* the mechanics of inflation, we would be able to point to a specific date sometime in the future. Unfortunately we don't. But what we do know is that inflation is, and always will be, a monetary phenomenon; that inflation sometimes responds with a relatively long lag to accelerated money growth because of a little-understood phenomenon called velocity; that velocity may be more a function of psychology than economics.

We believe that money growth has been excessive for a number of years, notwithstanding that monetary aggregates

have seemed relatively well behaved. Our opinion is based on the fact that growth in the monetary base (supply of money) has comfortably exceeded the growth of M1 (the demand for money) for the better part of the last six years; that on average, the yield curve since 1982 has been more positive than any time in history; and finally, that commercial banks' portfolios are bulging with liquid Treasury securities, having increased their total holdings by nearly 80% in just the past six years. Thus, monetary conditions have been easy enough to justify a sudden resurgence of inflation.

The missing ingredient — accelerating money velocity — could result from any of a number of events: a collapse in the dollar (which may not be too far off; see our comments elsewhere in this issue), soaring grain prices (also a strong probability), or an upside breakout in the price of precious metals, to cite just a few.

The preconditions for accelerated inflation are in place. When it comes, it will force the Fed to cease creating money out of thin air, which in turn will lay bare the malinvestments of the past decade. A severe and hard-to-cure recession will follow. Only this combination of inflation/recession can doom the financial markets. Play at your own risk.

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Contributions by Albert D. Friedberg, Dr. Steve H. Hanke, and Sholom Sanik.

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

US DOLLAR

A new dollar crisis in the making

Slowly and almost imperceptibly, the US dollar has been slipping, even as the celebrations for the joint G3 interventions continue.

Because most eyes have been riveted on the dollar/yen rate, a parity that has been beaten into staying around ¥100/dollar with gigantic sums of money, most of the real plays have been missed. For example, the deutschemark is within 3.5% of its all-time high, the Swiss franc a mere 1.6%. A new dollar crisis is in the making.

The story is not new, but it simply won't go away: The US dollar accounts for approximately 57% of all foreign exchange reserves (as at the end of 1994; it's somewhat more today), up from a low of 49.1% in 1990. This increase has not been wholly voluntary, witness the fact that the dollar has been under pressure for most of those years and the fact that a very considerable part of this increase was accounted for by industrialized countries, and in particular Japan (clearly a case of involuntary accumulation).

With current account deficits of at least \$170 billion per annum for as far as the eye can see, one must wonder how long central banks will forbear and allow their international reserves to accrue depreciating dollars. Perhaps a more relevant question is how long the Bank of Japan will be willing to finance almost totally the current account deficit. If the answer is, "not much longer," we may be on the verge of a mega-devaluation of the dollar.

The Big Theme is back. As we said in our April 23 issue, "The US dollar 'overhang' could lead to recurring, spasm-like, bouts of central bank liquidations, a process that tends to aggravate the current weakness and is very much reminiscent of the official sterling balances problem of the '50s and '60s.

"The US has gained a great deal from the dollar's status as a reserve currency, being able to run a long string of budget and current account deficits without having to undergo any type of economic adjustment. Unless the US administration is willing to be single-minded about defeating inflation and about stabilizing its debt/GDP ratio, it will be forced to lose this privilege. It may well be that current policies are 'about' right, but this is not good enough. The administration must first learn to say the right things. And if that is not sufficient, it must defend its reserve currency status by being — temporarily at least — too tight."

On a different note, and much to our disappointment, the Japanese government has not produced the much-desired fiscal package, one that would have provided economic stimulation via sizable tax cuts. Neither did they deepen previous deregulatory moves nor did they tell the Japanese public, as we had hoped, that the banking losses are real, they are huge, and they must immediately be corrected via realistic provisions and recapitalizations.

As the depression drags on and the government continues in denial, odds that an accident can trigger a banking meltdown in Japan grow larger by the day. The impact of such a crisis on the yen is not easy to divine. Japanese banking institutions suffering from growing domestic withdrawals may be forced to liquidate foreign assets in preference to illiquid domestic assets, i.e. real estate loans, and repatriate those funds. This would put strong upward pressure on the yen. Or the BOJ may purchase all the dollars offered by the Japanese commercial banks as these funds are being repatriated, thus offsetting upward pressure on its exchange rate.

Alternatively, the Bank of Japan may quickly move as a lender of last resort and provide all the necessary domestic funds to stem a systemic run. In this case, the yen may lose value as the money supply expands.

Finally, the BOJ may decide to come to the rescue of the specific bank or banks under attack, while stabilizing the overall monetary aggregates via open market operations. Not knowing (whether and) how the BOJ will react makes it impossible to guess which way the yen will move under conditions of a banking meltdown. A muddling-through scenario, on the other hand, is almost certain to produce continuous upward pressure on the yen via a stubborn trade and current account surplus.

STRATEGY: Clients are long December '95 yen at 101.02 as per Flash Update of Sept. 21, and DM at around .7035 as per Flash Update of Sept. 27. Raise stops to 99.46 and 70.00 respectively, close only.

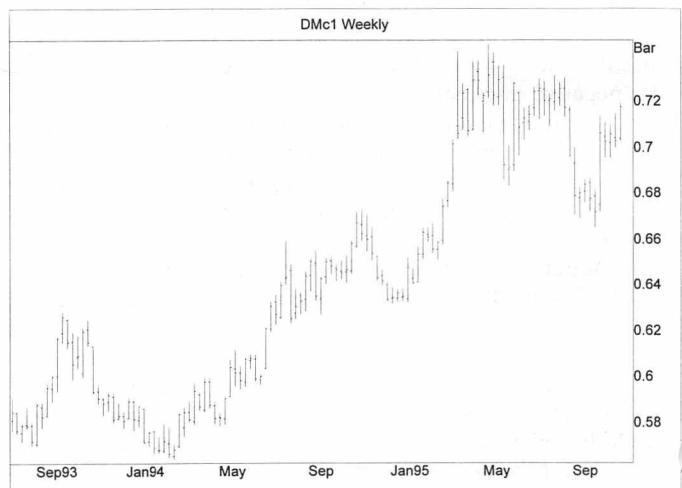
Chart 1 – Deutschemarks

Chart 2 – Japanese Yen

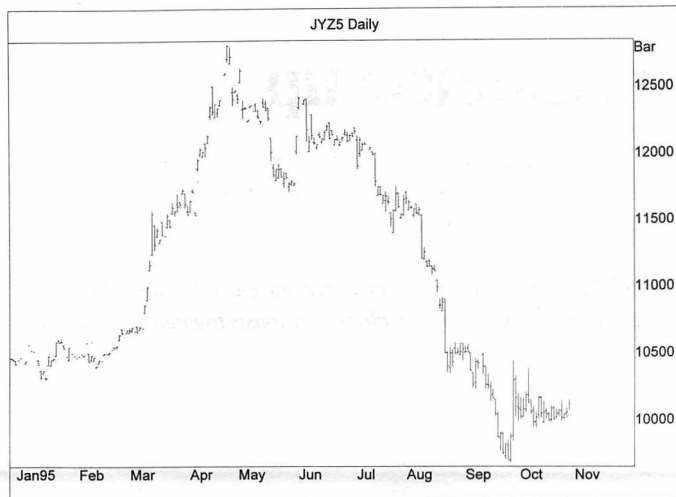


Chart 3 – Deutschemark/ Yen Cross



CANADIAN DOLLAR

‘Oui’ or ‘non,’ we’re bullish

With the outcome of the Quebec referendum on independence too close to call, the Canadian dollar has seen the wind taken out of its sails. Nevertheless the basic uptrend remains intact; the “strain” has been taken in the option market: implied volatilities have soared, tripling in less than a fortnight.

Regardless of the outcome, we remain bullish on the long-term prospects for the Canadian dollar — paradoxically more bullish if a Yes vote leads to an independent Quebec. Here’s why.

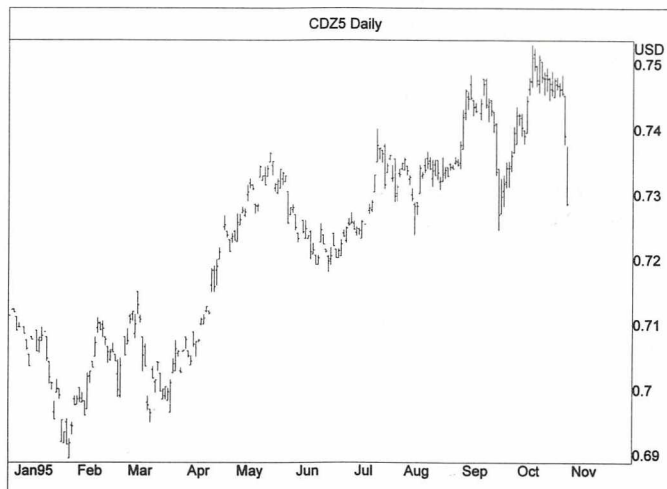
English Canada has for the most part begun a much-needed process of economic retrenchment and deregulation. Quebec has not. Therefore, Canada, ex-Quebec, will be viewed more favorably by foreign investors. In effect, in economic terms one could view separation as a company spinning off a problematic subsidiary; in the stock market of the '90s, this strategy paid off in spades.

As a second reason, one could argue that a narrow victory for the federalists can only serve to encourage the separatists to try again and again; the continuous uncertainty is certain to prove far more damaging in terms of international creditworthiness than the one-time shock of separation.

Finally, separation is likely to focus the federalists’ mind on what is *really* wrong with federalism: too much centralized power and too much bureaucracy.

STRATEGY: *A very weak market following a Yes vote is likely to give us an excellent opportunity to establish long-term positions. On the other hand, a narrow federalist victory may not produce dramatic upside results unless the currency has already dropped below 72¢. Stay in close contact and expect a flash update on the morning of Tuesday, Oct. 31.*

Chart 4 – Canadian Dollar



STOCK INDEXES

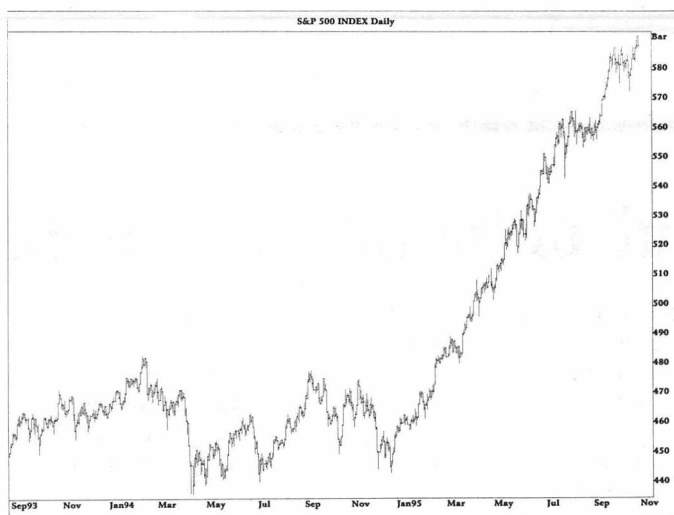
The path of least resistance: up

The devastating selloff in the tech sector has had a remarkably small impact on the overall indexes. Banks, utilities, and defensive issues in general have moved to the forefront of this extraordinary bull market. The ease with which this market takes punishment makes us think that the path of least resistance is still upwards.

Moreover, monetary conditions remain favorable, earnings on balance are still exceeding expectations, and sentiment is *guardedly* optimistic.

STRATEGY: *Remain long as per our Flash Update of Oct. 13. Raise initial stops to 581.00, close only, basis the nearest contract.*

Chart 5 – S&P 500 Index



INTEREST RATES

More rate drops ahead?

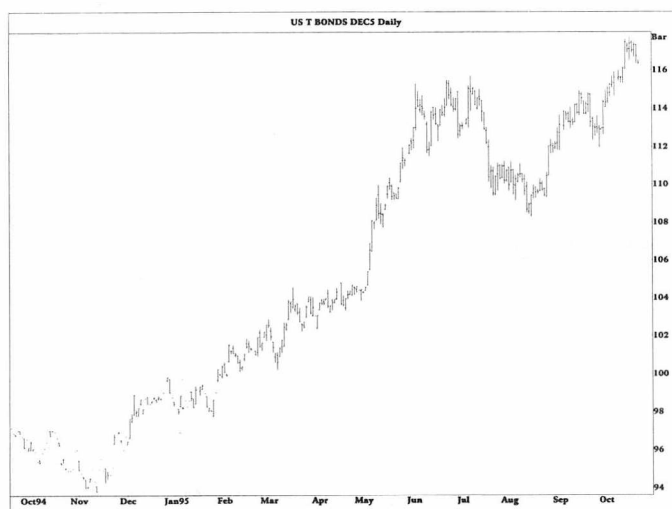
Although Mr. Greenspan intimated this past Friday that interest rates may not be lowered again, evidence is beginning to mount that the economy is a great deal weaker than anticipated. Examining back-to-school sales, our friends at ISI conclude that a weak holiday selling season is in store.

They also report very weak department store sales in early October. Finally, industrial commodities, and in particular copper, aluminum, steel, cotton, and crude oil, are sagging.

If this were not enough, the Fed can worry about the fact that in the past two months, M1 is down 2.6% on an annual basis.

STRATEGY: *Remain long as per our Flash Update of Thursday, Oct. 12, leaving stops at 115.08, good anytime.*

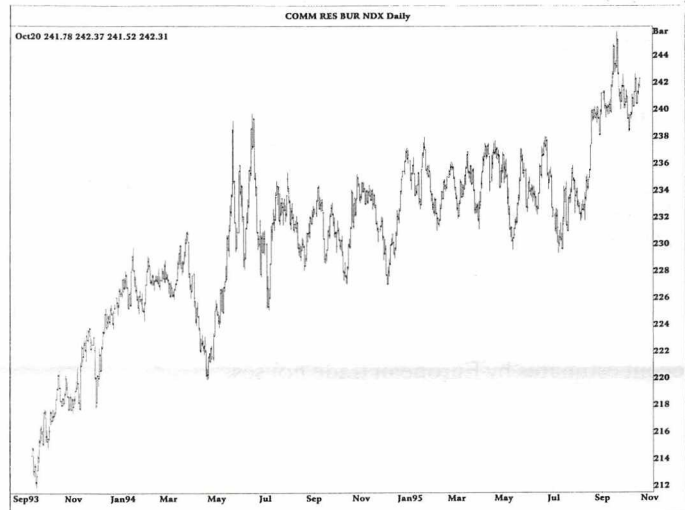
Chart 6 – US T-Bonds



COMMODITIES

Commodity prices have made a significant breakout in recent weeks, as the accompanying chart of the CRB index shows (Chart 7). Admittedly, there are quite a number of divergent trends within the index: Industrial commodities have been weak, precious metals flat, and grain and livestock futures have been making strong advances. Nevertheless, the fact that the index has been able to break out on the upside after a lengthy year-long consolidation against the background of sluggish economic activity may be signalling the beginning of inflationary times. Conscious of this bias, we present below a brief bearish argument for crude oil. And we then turn our attention to the *prima donnas* of the bull market.

Chart 7 – CRB Index



CRUDE OIL

Taking a bet on the smart money

Very mild weather so far during October has reduced total OECD oil consumption by at least 500,000 barrels per day (b/d) compared with normal usage. This has been partly offset by disruptions to Mexican production of at least 300,000 b/d on average during October. All told, heating oil stocks in the Atlantic Basin at end October are likely to be some 15 million barrels higher than otherwise.

What is quite significant is that refiners in the US have been betting quite aggressively on lower oil prices. Total company stocks at the end of September were about 60 million barrels below year-earlier levels, with crude stocks at the lowest level for over 15 years. This de-stocking process has brought substantial downward pressure to oil prices. A mild winter and continuous de-stocking may once again bring OPEC to its knees. A change in the weather, on the other hand, given currently low inventories, could make for sharp rallies.

The major oil companies are anticipating a dramatic change in prices and have positioned their inventories accordingly. The last two times they did so, they were right on the money. In 1985 they de-stocked, and of course late that year prices collapsed. In 1990 the opposite occurred: Major oil companies increased their inventories beyond normal levels and shortly thereafter prices increased dramatically as Iraq invaded Kuwait.

We'll take a bet on smart money.

STRATEGY: On Oct. 2, via Hotline Update, we advised selling December crude oil, then trading around 17.30, with stops at 18.19, good anytime.

Chart 8 – Light Crude



SOFT COMMODITIES

Cocoa

The time-honored tradition of falling victim to the most common of commodity trading pitfalls — being “stopped out at the lows” — did not escape us; we were there. Just two days after the market made its low, the USDA issued its forecast for 1995-96 world production at 2.6 million tonnes, about 40,000 tonnes above recent trade estimates. While its estimate for most of the large producers is roughly in line with other analysts’ projections, its numbers for the Ivory Coast (970,000 tonnes) are at least 60,000 tonnes above the most recent estimates by European trade houses.

We are a bit suspicious of such an optimistic outlook. The market ignored the news and has since rallied \$70 off the lows, owing, in part, to pre-election political unrest in the Ivory Coast. If you’re now thinking to yourself how we can even repeat such superficial analysis, consider this: The leader of the opposition, Laurent Gbagbo, in the world’s most important supplier of this commodity, told a Reuters reporter that he has “...ordered maximum disruption of the elections.” Nice guy; even nicer if he were to win. So we remain skeptical about a 10% increase in production in that country that would actually create a production/consumption surplus.

Unlike a lot of other commodities, information on con-

sumer demand is sketchy. The ICCO uses GDP forecasts by the OECD and the IMF to forecast income growths for each region and bases its consumption figures on this.

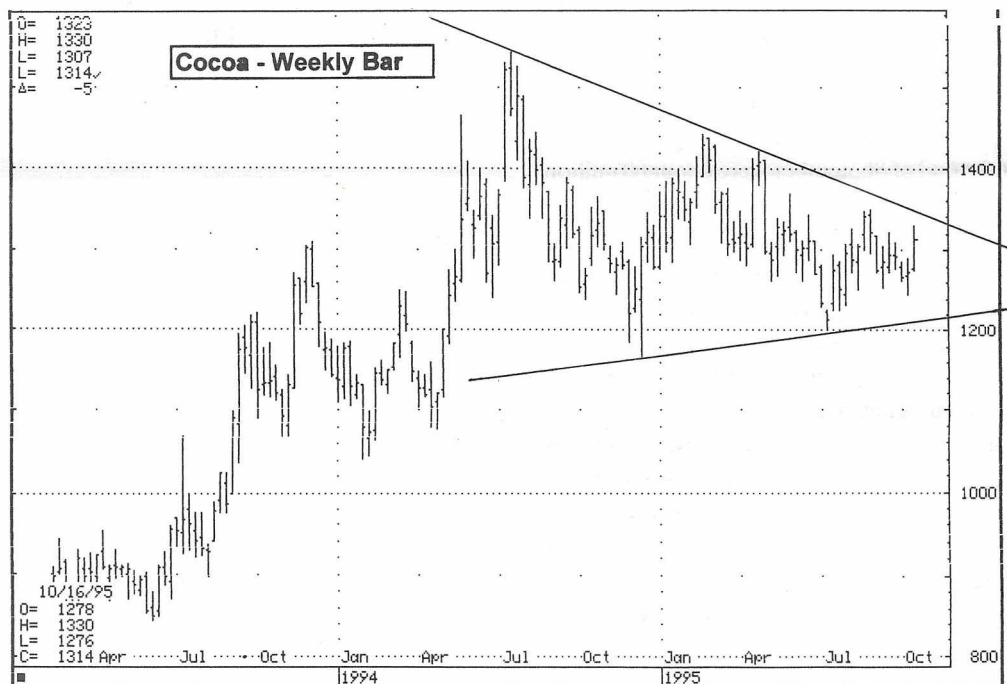
What we do know is that last year, chocolate and confectionary sales at food manufacturer Nestlé were down 4.5%. Imports of beans by grinding European countries were slow all summer and haven’t picked up in earnest.

Industry analysts say that North American manufacturers have completed working off a huge buildup of inventories left over from the recession and are in the market for fresh purchases. In addition sluggish sales figures by Nestlé, Hershey, and other industry giants are more a reflection of buying habits developed in the recession rather than an indication of the current trend. The people we spoke to say that North American factories are having trouble keeping up with demand and are adding production shifts.

The most explosive demand potential lies in the developing countries of Eastern Europe and Asia. With disposable incomes on the rise one can certainly assume that chocolate would be on a list of consumer goods sought by the masses and eagerly supplied by Western companies trying to break into these lucrative markets.

STRATEGY: *Nearby breaks out at 1360 (see Chart 9). Be sure to go long on the breakout.*

Chart 9 – Cocoa - Weekly Bar



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Corn

Historically, 80% of the US corn crop has been consumed domestically. Foreign demand was not an issue. All that changed late last year when it became apparent that China, which had traditionally been a net exporter, would reverse roles and become a net importer.

The export numbers leave no doubt about the transformation. Since the marketing year began in September, US exporters have shipped 7.7 million tonnes of corn abroad compared with 3.8 million tonnes at the same time last year, an increase of more than 100%! In addition last year at this time there were 7.9 million tonnes were sold but not shipped; this year that number stands at 15.7 million tonnes.

The supply side of the equation is not accommodating. After last year's record 10.1 billion bushel crop, a disastrous planting season, and so-so growing season have continuously eroded USDA crop estimates. We started the summer believing in an 8.1 billion bushel crop. The October 11 USDA estimate showed a paltry crop of 7.5 billion bushels. All of which has brought ending stocks down to a shockingly low 685 million bushels.

As the crops are being harvested, disappointing results are being registered. The average yield in the USDA report was seen at 116.6 bushels per acre versus 121.1 in last month's estimate and down from last year's record 138.6 bushels per acre. Much of the corn crop was planted late because of the wet spring, and early indications are that some of that corn is struggling to get to the 100 bushel per acre level.

These facts, hardly a secret, are of course a matter of public record, and prices have responded in kind. As all-time highs can be seen just over the horizon, it can be assumed that at some point these record-breaking statistics will turn into record-breaking prices.

STRATEGY: Market 'feels' overbought. Remain sidelined.

Wheat

On Oct. 18, just after 1:00 p.m., CST, which is shortly before the close of the grain markets in Chicago, US Agriculture Secretary Dan Glickman told reporters that President Bill Clinton's meeting this week with Chinese President Jiang Zemin could lead to more wheat sales. There must have been at least a few traders about who were old enough to remember what mere talk of Russian wheat purchases did to the market 22 years ago. Not that the already fired-up market needed any help at all, but Mr. Glickman's comments spurred a flurry of buying that drove the price of a bushel of wheat over \$5.00 for the first time in almost 15 years.

In last month's comments we wondered if the needy

would get a pullback to buy on the cheap or if they would have to pay up. The market resolved itself on the upside, and the penny wise were turned into pound foolish.

The current situation does not require a bull to scrounge around on the supply side looking for constructive fundamentals, although with uninspired crops and dwindling global stockpiles, they're not too shabby themselves. The real fuel behind a long-running and stubborn bull market, however, is demand. An examination of US exports illustrates a world hungry for wheat.

As of Oct. 12, US wheat already shipped totalled 12 million tonnes compared with 10.1 million tonnes at the same time last year, and this is on top of another 6 million tonnes that have been sold but not shipped.

The Chinese, flush with cash, could become the Russians of the '90s. Buyers are learning from recent mistakes and are jumping on corrections of any size. Egypt, a major importer of US wheat, dove head first into the market last Tuesday on a 7¢ dip and purchased 700,000 tonnes, which was more than the street expected of them. Other African and Asian buyers are said to be waiting for any opportunity to meet their needs.

What would a bull market in wheat be without the Russians? Its total grain harvest, by the planning agency's own admission, is going to be about 15% less than expected. True, they don't have the kind of money the Chinese do, but they're once again trying to talk the market down by denying they have any interest in Western wheat, which may mean that sooner or later they'll be buyers.

STRATEGY: Buy at market (currently 515, basis March '96) but be prepared for substantial volatility. Place initial stops at 470, basis March '96, close only.

Soybean meal

Our choice of soybean meal as the favorite horse in the soy complex was a winning notion. The meal has outperformed both beans and oil handily (see Chart 10). Although commitment-of-trader data indicates that commercials are not very bullish, the level of open interest tells us something else. The open interest is lower now than it was a year ago before we had any idea of the extent of the poor grain crops and strong demand. The commodity funds may be on the long side of the meal, but there is ample buying power left, as this consistently firming market continues to attract the nonbelievers, both speculators and commercials.

Unlike corn and wheat, export commitment numbers of soybean meal are not quite as supportive of the bullish case. US exporters have shipped 106,400 tonnes of soybean meal since the marketing year began this month, which is about 1.5% above the figure for the same time last year. However,

total export commitments of 800,000 tonnes, which includes goods sold but not shipped, is running well behind last year's pace of 1.2 million tonnes. Potential buyers may be scratching their heads, amazed at the nerve of soybean meal prices to be trading over \$190 per tonne without even a brief respite.

While annual export figures have remained relatively flat over the past 10 years, domestic use has grown steadily at about 5% per annum. A 1.4% growth in the protein-consuming animal population, mostly broilers, has contributed to the growing domestic needs.

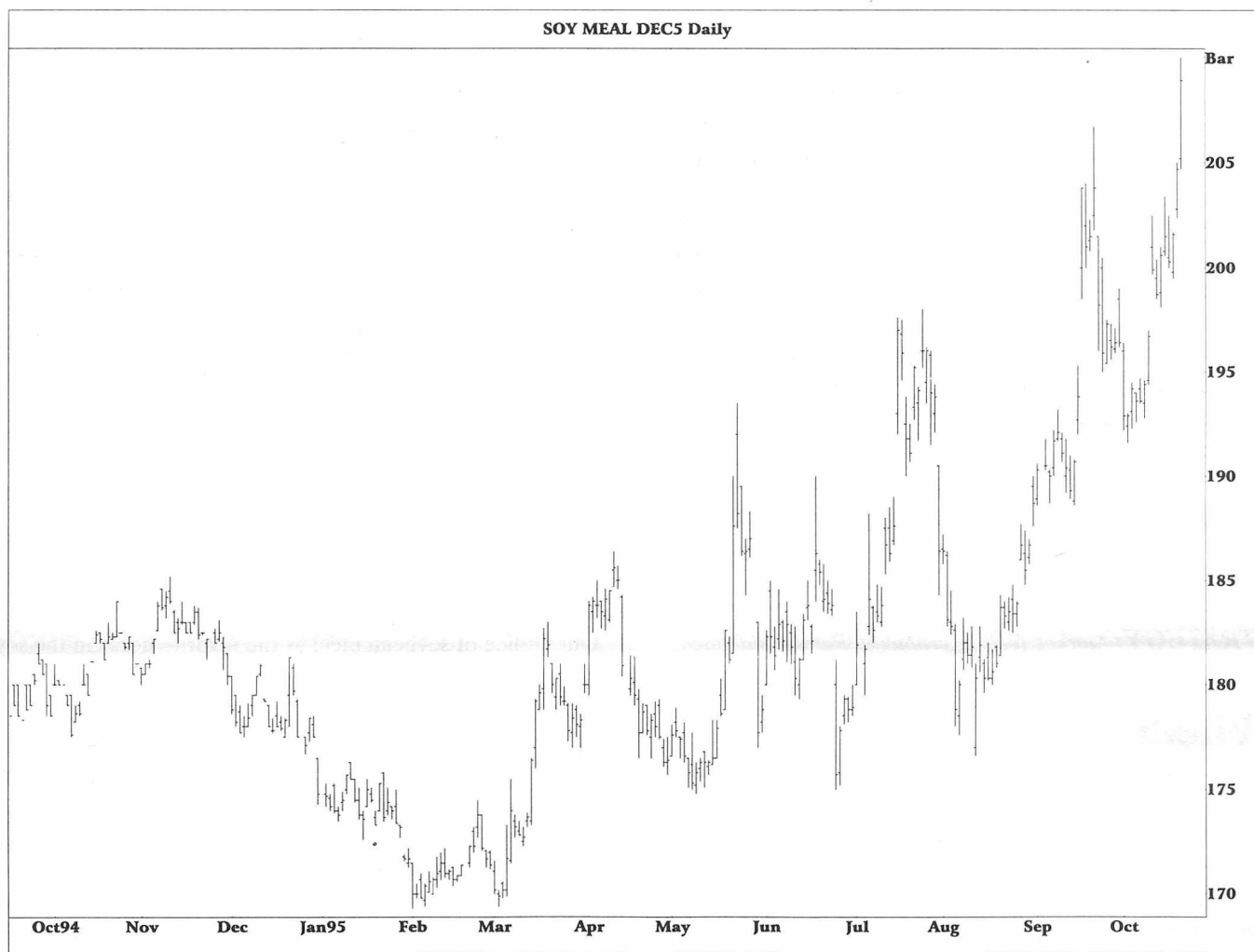
While virtually every grain on the board has been slipping

into contango as prices have been rising, not something we necessarily understand given the export demand numbers, soybean meal has almost completed its journey from contango to backwardation. This further confirms our thoughts that the complacency in this market reflected in minuscule ending stocks is being challenged. The all-time highs recorded in the early 1970s and '80s are nowhere in sight, but we're patient.

STRATEGY: Remain long; raise stops to 195, basis December '95.

– Sholom Sanik

Chart 10 – Soy Meal



EMERGING MARKETS

Arbitrage in Lithuania

by Steve H. Hanke

When opportunities are served up in emerging markets, investors should aggressively pursue them. There's just one caveat: Investors must pay the most careful and anxious attention to the exchange rate regimes employed in emerging markets. Investors can get creamed if they get caught up in a currency devaluation.

Exchange-rate regimes come in three varieties: floating, fixed, and pegged. Under a floating regime, currencies are allowed to seek their own levels in relation to one another. Many of the major currencies float, but not one of the emerging countries allows its currency to float for any length of time.

A handful of emerging countries — most notably Argentina, Estonia, Hong Kong, and Lithuania — use fixed exchange rates. These countries employ currency board-like systems in which their local currencies are backed 100% by a reserve currency and are freely convertible into the reserve currency at a permanently fixed rate. A country operating under this discipline forgoes an independent monetary policy and becomes part of a unified currency area with the country to which its local currency is linked.

As Nobelist Milton Friedman concluded over 30 years ago, fixed and floating regimes appear to be quite different, but in reality they are both free-market mechanisms for international payments.

The third form of exchange rate is the pegged type. It is widely used in emerging countries, and unlike the other two, it is not a free-market mechanism. A pegged regime is an interventionist system. It requires a central bank to manage simultaneously its currency's exchange rate, the domestic liquidity, and the capital account. This is a tricky, if not impossible, task. Indeed, a pegged rate inevitably results in contradictory policies that invite a speculative attack. When under siege, a peg cannot last unless interest rates are raised to sky-high levels or foreign exchange controls are imposed. Alas, such episodes usually result in a devaluation. Witness the recent Mexican peso fiasco.

Using the above taxonomy of exchange rate regimes, what can we conclude about investments in Lithuania? On April 1, 1994, exactly three years after Argentina installed its currency board-like system, I assisted Prime Minister Adolfo Šleževičius in installing a similar system in Lithuania. Since then, the litas has been fully backed by US dollar reserves and is freely convertible at a 4 to 1 exchange rate with the greenback.

As I demonstrate in *Currency Boards for Developing Countries* (1994), inflation (adjusted for productivity differentials) and interest rates (adjusted for country risk) in the

US and Lithuania must tend to converge through arbitrage, because Lithuania is part of a unified currency area with the US. That process is working with textbook-like precision. Lithuania's monthly inflation rate has fallen from 3.3% in March 1994 to less than 1% per month. And interest rates (3-month duration) have fallen from 90% in March 1994 to about 25%.

Lithuania's interest rates remain higher than those in the US, with litas T-bills yielding about 25%. Comparable US yields are about 5.75%. What's going on here? After all, the Law of One Price tells us that the price of a financial asset quoted in the same currency — and the litas is almost as good as the US dollar — should be the same. This price equivalence won't hold strictly in the Lithuanian case, because that country's risk is higher. Moreover, the costs of obtaining information about and dealing in the Lithuanian paper are higher than for US debt. Both of these costs drive a wedge between Lithuanian and US interest rates. But, the yawning gulf that exists cannot be justified on the basis of these costs alone.

What's the answer? Investors demand a large Lithuanian interest rate premium because they incorrectly believe that Lithuania has a pegged exchange rate. They worry that the exchange rate might be altered or protected by a combination of relatively high litas interest rates and/or foreign exchange controls. Investors also believe Lithuania's relatively small fiscal deficit (about 1.5% of GDP) can be financed by its monetary authorities, causing more inflation. Such worries are misplaced. None of the suspect activities are allowed under Lithuania's currency board-like system.

As long as confusion about Lithuania's exchange rate reigns, near risk-free arbitrage profits will exist. Arbitrageurs should avail themselves of this unique money pump and purchase litas T-bills.

Lithuania has come a long way since the collapse of the Soviet Union. It now has a first-class currency system in which nominal litas returns are real returns for dollar-based investors. In addition, the transformation of its economy has been dramatic, with private sector employment jumping from only 30% of the total in 1991 to over 65%. Not surprisingly, real GDP growth is projected at 5.5% in 1995. Its fiscal affairs are under control. Lithuania's overall balance of payments is positive and projected to keep improving, and foreign reserves are growing. Need I say more?

Dr. Hanke is Vice Chairman of Friedberg Mercantile Group, Inc. He also serves as the State Counselor on Monetary and Financial Issues in Lithuania.

NEW ZEALAND

Wildly bullish

In New Zealand we see an economy that has been growing at 5-1/2% to 6% per year and that will continue to grow at that rate almost indefinitely (after a slight slowdown in late '95/early '96, because of the Reserve Bank's monetary squeeze).

The fiscal surplus for 1995-96 is exceeding expectations. And there will be growing fiscal surpluses for years into the future, allowing for substantial tax cuts (to begin in 1996) as well as significant debt reduction. Receding core inflation (coming in at just under 2% per year) should cause

five-year interest rates to fall to 5-1/2% to 6% from the current 7.10%.

The NZ 40 stock index is currently posting a remarkably modest price-earnings ratio of 11.4.

STRATEGY: Falling interest rates should lift p/e ratios by 25% to 30%, while growth in earnings per share will provide an additional 30% growth over the next 24 to 30 months.

If you're interested in the many ways to capitalize on this situation, call us.

Chart 11 – Breakeven exchange rates for US\$-based investor

This analysis shows a "snapshot" of the relationship between interest rate differentials and rates of exchange. The breakeven rate measures how far the foreign currency has to devalue (for NZ\$, A\$, DM, BP, FFr, CD, SAR, ECU, ITL, and ARG) or revalue for SF, DKr, JY, before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. Rates as of October 20, 1995.

| | U.S. \$ | NEW ZEALAND | DEUTSCHEMARK | SWISS FRANC | JAPANESE YEN | DANISH KRONE | BRITISH POUND | FRENCH FRANC | EUROPEAN CURRENCY UNIT | CANADIAN DOLLAR | SOUTH AFRICAN RAND** | ITALIAN LIRA | ARGENTINEAN PESO | FINNISH MARKKA |
|--------------------|---------|--|---|--------------------------------------|--|--|--|---|-------------------------------------|-----------------|---|---------------------------------------|---|----------------|
| 1 year | 5.62% | | VEB 7% '96 yields 7.89% (DM/US 1.4281) | | | | | | | | ESCOM '96 yields 13.21% (SAR/US 0.2561) | NIB '96 yields 11.63% (ITL/US 1.6947) | | |
| 2 year | 5.71% | | | | World Bk. '96 yields 0.30% (JY/US 89.1393) | Denmark '96 yields 5.51% (DKr/US 5.4164) | Sweden '96 yields 6.51% (US/BP 1.5509) | Cr. Lyon '96 yields 6.83% (FFr/US 5.0182) | | | R.B.C. '97 yields 6.62% (CDN/US 1.3746) | | | |
| 3 year | 5.77% | | | | | | | | | | | | | |
| 4 year | 5.85% | | Argentina '98 yields 7.58% (DM/US 1.4918) | G.E. '98 yields 3.15% (SF/US 1.0294) | | | | | | | | | | |
| 5 year | 5.89% | Tranz Rail '99 yields 8.31% (US/NZ 0.5901) | | | | | | | | | | | | |
| 6 year | 5.93% | | | | | | | | UK '01 yields 7.19% (US/ECU 1.2186) | | | | Pre 1-BOCON yields 26.63% (ARG/US 2.9181) | |
| 8 year | 6.04% | | | | | | | | | | | | | |
| 9 year | 6.08% | | | | | | | | | | | | | |
| Spot Exchange Rate | - | 0.6607 | 1.3981 | 1.1415 | 100.21 | 5.437 | 1.5745 | 4.9135 | 1.3082 | 1.3512 | 0.2745 | 1.6035 | 1.00 | 4.226 |

*For example, since a US\$-based investor would receive 242 basis points (831-589) by holding the Tranz Rail NZ\$ bond, the NZ/US can depreciate to .5901 from the present spot exchange rate of .6607 over

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

Chart 12 – Recommended current portfolio allocations

| | | | |
|-------------------------------|-----|-----------------------------|-----|
| 1. Lithuanian litas T-bills | 5% | 5. Tranz Rail NZ\$ | 10% |
| 2. New Zealand (8%) '98 Gov't | 15% | 6. World Bk (7 1/4%) '99 DM | 30% |
| 3. Fletcher NZ\$ | 10% | 7. Pre-1/BOCON | 20% |
| 4. Seabil NZ\$ | 10% | | |

Chart 13 – FOREIGN CURRENCY BONDS

DATE: October 20, 1995

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

| ISSUER / COUPON / MATURITY DATE | BID | OFFER | YTM | GURR COUPON | NEXT INTEREST PAYMENT DATE |
|---|--------|--------|-----------|--------------------|-------------------------------|
| DEUTSCHE MARK DENOMINATED BONDS | | | | | |
| Bank of Nova Scotia 5 5/8% 7/5/96 RRSP eligible | 99.70 | 100.55 | 4.45 | | May-07 |
| World Bank 5 7/8% 4/02/97 RRSP eligible | 102.40 | - | - | | Feb-04 |
| World Bank 7 1/4% 13/10/99 RRSP eligible | 106.35 | 107.20 | 5.19 | | Oct-13 |
| World Bank 9% 13/11/00 RRSP eligible | 116.60 | 117.45 | 5.00 | | Nov-13 |
| Kingdom of Denmark 6 1/8% 15/04/98 | 102.40 | 103.25 | 4.69 | | Apr-15 |
| Argentina 8% 5/10/98 | 100.20 | - | - | | Oct-05 |
| Bk. Foreign Eco. Affairs 7% 29/3/96 | 98.65 | 99.50 | 7.89 | | Mar-29 |
| Kgdm. of Spain (6 Mo. LIBOR-1/16) 29/6/02 (semi) | 99.34 | 99.64 | - | 4.5625 | Dec-29 |
| ITALIAN LIRA DENOMINATED BONDS | | | | | |
| Nordic Inves. Bk 12 3/8% 19/04/96 | 99.15 | 100.00 | 11.63 | | Apr-19 |
| SWISS FRANC DENOMINATED BONDS | | | | | |
| General Electric 4 3/4% 2/7/98 | 103.20 | 104.05 | 3.15 | | Jul-02 |
| DANISH KRONE DENOMINATED BONDS | | | | | |
| Kgdm. of Denmark 9% 15/11/96 | 102.65 | 103.50 | 5.51 | | Nov-15 |
| ECU DENOMINATED BONDS | | | | | |
| United Kingdom 9 1/8% 21/02/01 | 107.40 | 108.25 | 7.19 | | Feb-21 |
| BRITISH POUND DENOMINATED BONDS | | | | | |
| Kdgm. of Sweden 8 3/4% 29/5/96 | 100.30 | - | - | | May-29 |
| FRENCH FRANC DENOMINATED BONDS | | | | | |
| Credit Lyonnaise 9 1/2% 23/12/96 | 102.00 | 102.85 | 6.83 | | Dec-23 |
| JAPANESE YEN DENOMINATED BONDS | | | | | |
| World Bank 5 3/4% 7/8/96 RRSP | 103.90 | - | - | | Aug-07 |
| CANADIAN DOLLAR DENOMINATED BONDS | | | | | |
| Ontario Hydro 10 7/8% 8/01/96 (semi) RRSP eligible | 99.75 | 101.00 | 5.73 | | Jan-08 |
| Eksportfinans 7 3/4% 5/11/97 | 100.50 | - | - | | Nov-05 |
| Royal Bank of Canada 9 1/8% 7/11/97 RRSP eligible | 101.50 | - | - | | Jan-07 |
| Ontario Province 10 5/8% 15/7/98 RRSP eligible | 107.65 | 108.90 | 6.90 | | Jul-15 |
| SOUTH AFRICAN RAND DENOMINATED BONDS | | | | | |
| ESCOM 12% 1/5/96 (semi) | 98.60 | 99.45 | 13.21 | | Nov-01 |
| AUSTRALIAN DOLLAR DENOMINATED BONDS | | | | | |
| Commonwealth Bk. of Australia 9 3/4% 15/5/96 | 100.80 | 101.65 | 6.40 | | May-15 |
| NEW ZEALAND DOLLAR DENOMINATED BONDS | | | | | |
| World Bank 12.5% 25/7/97 (semi) RRSP eligible | 108.35 | 109.20 | 6.82 | | Jan-25 |
| New Zealand Gov't 10% 15/7/97 (semi) | 103.70 | - | - | | Jan-15 |
| New Zealand Gov't 8% 15/7/98 (semi) | 101.90 | 102.75 | 6.87 | | Jan-15 |
| Fletcher Challenge 10.75% 15/12/97 (semi) | 104.05 | 104.90 | 8.19 | | Dec-15 |
| Fletcher Challenge 10.15% 30/11/98 (semi) | 104.20 | 105.05 | 8.26 | | Nov-30 |
| Tranz Rail Ltd. 10% 15/10/99 (semi) | 104.75 | 105.60 | 8.31 | | Oct-15 |
| DB Group 7% 30/6/96 (semi) matures @ 85 | 87.55 | 88.40 | 6.43 | | Dec-30 |
| Seabil Ltd. 9% 27/6/99 (semi) | 90.10 | 90.95 | 12.47 | | Dec-27 |
| ARGENTINEAN PESO DENOMINATED BONDS | | | | | |
| Bocon Pre 1: 1/4/2001 | 66.00 | 68.00 | IRR 26.63 | PAR VALUE 131.4468 | 4th day May-01-97 |
| U.S. DOLLAR DENOMINATED FIXED CONV. BONDS | | | | | |
| Burnup & Sims 12% 15/11/00 CV@16.79 p/sh (semi) | 98.25 | 99.75 | 12.06 | | Nov-15 |
| Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh | 53.25 | 54.75 | 17.36 | | Apr-29 |
| Coeur D'Alene 6% 10/6/02 CV@ 26.00 p/sh | 91.25 | 92.75 | 7.41 | | Jun-10 |
| Glycomed 7 1/2% 1/1/03 CV@14.06 (semi) | 78.25 | 79.75 | 11.75 | | Jan-01 |
| California Microwave 5 1/4% 15/12/03 CV@28.44 p/sh (semi) | 96.25 | 97.75 | 5.60 | | Dec-15 |
| U.S. DOLLAR DENOMINATED FIXED RATE BONDS | | | | | |
| World Bank 7 1/8% 27/9/99 (semi) RRSP eligible | 103.85 | 104.70 | 5.77 | | Mar-27 |
| Farm Credit Corp 7 3/4% 10/06/96 RRSP eligible | 100.25 | 101.10 | 5.76 | | Jun-10 |
| T.W.A. 10% 3/11/98 (semi) | - | - | - | | N/A |
| U.S. DOLLAR DENOMINATED FLOATING RATE NOTES | | | | | |
| Kgdm. of Denmark 25/3/97 (Gold call, JY put),(semi) | 82.30 | 83.30 | - | 8.0865 | Mar-25 |
| United Kgdm. 30/9/96 3 mo.LIBID-1/8 (qty), callable @100 | 99.82 | 100.12 | - | 5.625 | Dec-29 |
| Bocon 1/4/01 (30 day LIBOR) starts paying May 1,'97 | 82.60 | 83.45 | 19.29 | | May-01-97 |
| Argentina: Series L:FRB 31/3/05, 6 mo. LIBOR+13/16 (semi) | 60.75 | 62.25 | 17.53 | 6.8125 | Mar-29 |

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

client eligibility determined at point of sale.

HOTLINE UPDATE

Tuesday, September 19, 1995:

Good afternoon for Tuesday, September 19. There are no changes or new recommendations.

Thursday, September 21, 1995:

Good morning for Thursday, September 21, 8:40 am. This is a flash update. Buy December Japanese yen at the market, presently trading at 101.02.

Friday, September 22, 1995:

Good afternoon for Friday, September 22. We have one new recommendation: Place stops on long December Japanese yen at 97.00, good anytime. We repeat our flash update of Thursday, September 21, 8:40 am, to buy December Japanese yen at the market, then trading at 101.02. The next scheduled update will be Wednesday, September 27. Happy New Year.

Wednesday, September 27, 1995:

Good morning for Wednesday, September 27, 9:55 am. This is a flash update. Buy December deutschemarks at the market, presently trading at .7035, placing initial stops at .6935, close only.

Wednesday, September 27, 1995:

Good afternoon for Wednesday, September 27, 1:15 am. This is a flash update. Liquidate December S&P at the market, presently trading at 582.00, cancelling the stop at 570.00, close only. I repeat the flash update of this morning of 9:55 am, to buy December deutschemarks at the market, then trading at .7035, placing initial stops at .6935, close only.

Friday, September 29, 1995:

Good morning for Friday, September 29, 9:30 am. This is a flash update. Buy December Canadian dollar at the market, presently trading at 7415.

Friday, September 29, 1995:

Good afternoon for Friday, September 29. There are no changes or new recommendations. The following is a recap of this week's recommendations. On Wednesday, September 27, via flash update, we made two recommendations. The first was to buy December deutschemarks at the market, then trading at .7035, placing initial stops at .6935, close only; and secondly, to liquidate December S&P at the market, then trading at 582.00, cancelling the stop at 570.00, close only.

This morning, via flash update, we advised to buy December Canadian dollar at the market, then trading at .7415.

Monday, October 2, 1995:

Good afternoon for Monday, October 2, 5:50 pm. This is a flash update. Sell December crude at the market, placing stops at 18.19, good anytime.

Tuesday, October 3, 1995:

Good afternoon for Tuesday, October 3. There are no changes or new recommendations.

Friday, October 6, 1995:

Good afternoon for Friday, October 6. There are no changes or new recommendations. The following is a recap of this week's recommendations:

On Monday, October 2, via flash update, we advised to sell December crude at the market, placing stops at 18.19, good anytime.

On Tuesday, October 3, December crude opened at 17.30. The next Hotline Update will be Wednesday, October 11.

Thursday, October 12, 1995:

Good afternoon for Thursday, October 12, 5:15 pm. This is a flash update. We have two new recommendations. Buy December bonds at the market, placing stops at 115.08, good anytime, and to raise stops on long March soymeal to 194.00 from 185.00, good anytime.

Friday, October 13, 1995:

Good morning for Friday, October 13, 9:50 am. This is a flash update. Buy December S&P at the market, presently trading at 590.00, placing stops at 575.40, good anytime. We repeat the flash update of last night: We recommended to buy December T-bonds at the market, placing stops at 115.08, good anytime. December bonds opened this morning at 116.11. We also recommended to raise stops on March soymeal to 194.00 from 185.00, good anytime.

Friday, October 13, 1995:

Good afternoon for Friday, October 13. The following is a recap of this week's recommendations.

On Thursday, October 12, via flash update, we recommended to buy December bonds at the market, placing stops at 115.08, good anytime. December bonds opened this morning at 116.11. We also raised stops on long March soymeal to 194.00 from 185.00, good anytime.

This morning, via flash update, we recommended to buy December S&P at the market, then trading at 590.00, placing stops at 575.40, good anytime.

Monday, October 16, 1995:

Good morning for Monday, October 16, 11:45 am. This is a flash update. Liquidate December copper positions at the market, cancelling the stop at 135.00, good anytime.

Friday, October 20, 1995:

Good morning for Friday, October 20, 8:50 am. This is a flash update. Liquidate long December Canadian dollar at the market, presently trading at 74.17.

Friday, October 20, 1995:

Good afternoon for Friday, October 20. This is a complete summary since our last market letter dated September 17, of all liquidations of open positions and new recommendations that remain outstanding.

On Thursday, September 21, via flash update, we recommended to buy December Japanese yen at the market, then trading at 101.02.

On Friday, September 22, we placed stops on the long December Japanese yen at 97.00, good anytime.

On Wednesday, September 27, we had two flash updates: We recommended to buy December deutschemarks at the market, then trading at .7035, placing initial stops at .6935, close only, and to liquidate December S&P at the market, then trading at 582.00, cancelling the stop at 570.00, close only.

On Friday, September 29, via flash update, we recommended to buy December Canadian dollar at the market, then trading at .7415.

On Monday, October 2, via flash update, we recommended to sell December crude at the market, placing stops at 18.19, good anytime.

On Thursday, October 12, we had two flash updates. We recommended to buy December bonds at the market, placing stops at 115.08, good anytime, and to raise stops on long March soymeal to 194.00 from 185.00, good anytime.

On Friday, October 13, via flash update, we recommended to buy December S&P at the market, then trading at 590.00, good anytime.

On Monday, October 16, via flash update, we recommended to cover December copper positions at the market, then trading at 126.50, cancelling the stop at 135.00, good anytime.

Today, October 20, via flash update, we recommended to liquidate December Canadian dollar positions at the market, then trading at 74.17.

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