FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

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Argentina: the great escape

Patience, courage, and the conviction that the market was mistaken have finally borne fruits. In the short span of five weeks Argentina's Brady bonds, as measured by J.P. Morgan, showed a total return of 13.2%, easily outdistancing Mexico (+5%), Brazil (+2.5%), and the non-Latin Index (+1.48%). And this is not the whole story. The total return on the Bocon Pre 1, a *peso* denominated bond, soared 34.1%.

The reappraisal of Argentina's fortunes, which is only in its early stages as we shall endeavour to show, will eventually allow it to escape from its emerging market cage and gain the status of a progressive state, just below the likes of Malaysia, Thailand, Indonesia, and Chile.

The Brazilian/Mexican straightjacket "cost" the country, even after the most recent runup, somewhere around 800 basis points on its dollar debt and somewhere around 1150 basis points on its peso debt. These sums are not trivial, as they represent close to $8 billion per annum of additional cost, an amount equal to 20% of the fiscal budget and 3% of GDP.

We have not ceased to point out that Argentina's fundamentals are far superior to those of Brazil and Mexico. What truly distinguishes Argentina from its two Latin friends are qualitative factors. Compared with Brazil, Argentina has conducted a far more successful privatization and deregulation effort, has a stronger banking system, a higher level of domestic savings (especially now, one year after the introduction of a Chilean-style private social security system), and a much healthier balance of government finances, despite having to undergo an unusually harsh and deep economic recession.

The market has as yet not factored in the fact that Brazil has lost the battle: The Real Plan will come to a tragic end because federal and state finances have exploded out of control.

Compared with Mexico, Argentina's banking system looks like the Rock of Gibraltar, and corruption at all levels of government more like kindergarten. These qualitative differences eventually translate into infinitely more measurable hard numbers, such as rates of inflation, currency depreciation, international reserves, and so on. But by the time the hard numbers reach the headlines, it is too late, as was pathetically demonstrated in the Mexican crisis of 1994.

Not only does Argentina remain trapped in the wrong slot but, in some respects, it shows up at the bottom of the class. We demonstrate this by comparing yields to maturity of the debts of these three countries. In order to obtain meaningful results we compare the stripped yields (i.e. bonds whose collateral has been stripped out leaving a yield that reflects only sovereign risk) of US dollar denominated bonds of similar maturities. Chart 1 compares yield curves as at November 9, 1995, omitting the 0-5 years segment. It can be readily seen that the market's relative assessment of Argentina was far worse than ours. Moving forward to December 7 (Chart 2), the market's perception of Argentina begins to improve although Argentine yields remain above their two comparables for maturities up to 12 years and above Brazilian yields for maturities up to 23 years. This is particularly puzzling — even for those analysts incapable of appreciating qualitative factors — in view of the fact that at the very short end of the yield curve, such as overnight rates, Argentine yields are substantially lower than Brazilian and Mexican yields.

Another component of Argentine yields to look at is the risk premium associated with holding peso-denominated debt. Chart 3 compares peso-denominated debt to US dollar-denominated debt of the same maturities. Such was the market fear in early November that the risk premium on peso

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Contributions by Albert D. Friedberg, Steve H. Hanke, Sholom Sanik, and Peter O'Sullivan.

debt exceeded 1000 basis points (the strange inversion of the yield curve was possibly a reflection of the market's fear of an imminent devaluation). The chart also shows that as of December 7, the spread had narrowed to approximately 500 basis points. As at December 15, the spread had narrowed further and stood at 307 basis points.

Where do we go from here? We have posited that on the basis of qualitative factors, Argentine debt should escape out of the confines of its present high probability-of-default category. Recent economic news such as November's healthy 4.6% month-over-month gain in VAT revenues, the highly successful tax amnesty operation that could bring in as much as $4 billion to treasury coffers, and the 2.8 percentage point drop in unemployment in the greater Buenos Aires area confirm our view.

Argentina is entering a virtuous cycle of economic growth, fiscal solvency, assured convertibility, rising liquidity and falling interest rates. In short order Argentina should be able to achieve spreads over US Treasuries at least as favorable as Poland (450 bp) and the Philippines (340-500 bp depending on duration).

At the same time, the risk premium on peso debt should continue to shrink in view of the fact that Argentina has been able to weather the storm with its convertibility regime intact. In Chart 4 we project prices to March 31, 1996, for the two most widely-traded US dollar denominated debt instruments, the FRB and the BOCON Pre 2, and for the most widely traded peso-denominated bond, the BOCON Pre 1.

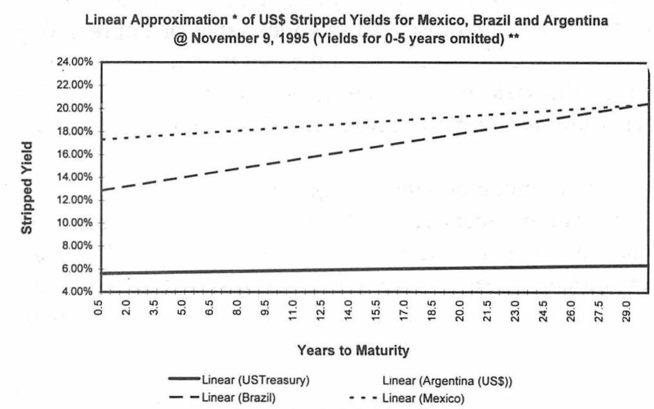
In line with above comments we assumed a spread over LIBOR of 300 basis points for the FRB, a spread over Treasuries of 380 basis points for the BOCON Pre 2, and a 500-basis-point spread over Treasuries for the BOCON Pre 1. Of course, we have assumed that Treasury yields will remain unchanged over the next three months, an unlikely event but a necessarily simplifying assumption that allows us to zero-in exclusively on the rerating gains.

In our opinion the main risk to this forecast lies in the health of President Menem, known to suffer from a weak heart. Only his continuous exercise of power guarantees the Convertibility Plan and the permanence of his extremely able Economy Minister, Domingo Cavallo, against the attack of the more protectionist and less progressive wing of the Peronist party.

STRATEGY: *Our recommendation last month to increase exposure to Argentine peso debt to 30% from 20% was timely. With further prospective gains of 30% to 35%, Argentina remains a strong hold.*

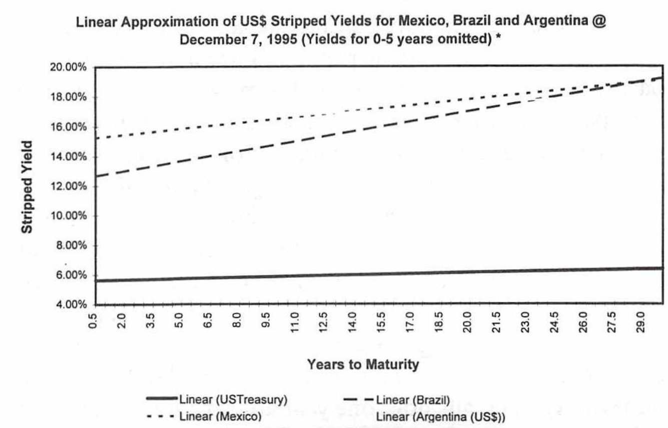
Peter O'Sullivan collaborated in the preparation of this article.

Chart 1



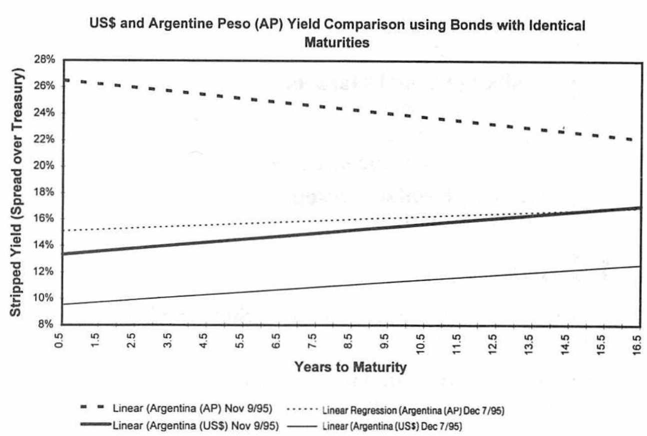
* Linear approximation is a line of best fit between all the data points in a set.
** Brazil and Mexico did not have comparable instruments within 0-5 years.

Chart 2



* Brazil and Mexico did not have comparable instruments within 0-5 years.

Chart 3



US$ Debt - Bocon Pre 2, Bocon Pre 4, Bocon Pro 2
AP Debt - Bocon Pre1, Bocon Pre 3, Bocon Pro 1

Chart 4 – Price Projections

	PRICE			Total
	18-Dec-95	31-Mar-95	% Change	Return
FRB	68.00	88.16	29.65%	31.85%
Bocon Pre 1	82.25	110.27	34.07%	34.07%
Bocon Pre 2	91.95	115.12	25.20%	25.20%

* Assumes constant Libor and Savings Account Rates at current levels.
** FRB @ 300 bps over Libor, Pre 1 @ 500 bps over Treasury, Pre 2 @380 bps over Treasury.
*** The FRB currently pays interest so Total Return is greater than % Change in Price.

	YIELD		
	18-Dec-95	31-Mar-95	% Change
FRB	15.74%	9.06%	-42.44%
Bocon Pre 1	20.40%	10.57%	-48.19%
Bocon Pre 2	16.67%	9.44%	-43.37%

* Assumes constant Libor and Savings Account Rates at current levels.
** FRB @ 300 bps over Libor, Pre 1 @ 500 bps over Treasury, Pre 2 @380 bps over Treasury.

CHART 4

CURRENCIES

Yes, there is a free lunch after all

The now famous carry trade — borrowing yen at 1/2% per annum and investing in 2-year US notes yielding 5½% per annum — explains rather well the absence of the Bank of Japan from the foreign exchange markets. By keeping short-term interest rates down to the floor and by assuring markets that it will not permit the yen to appreciate beyond 100 yen/dollar, the BOJ has been aiding and abetting one of the world's greatest get-rich quick schemes in history while keeping a lid on the yen at no cost to itself.

Since banks, hedge funds, and sophisticated individuals can coin money with practically no investment, one could argue that this operation — equivalent to speculative yen short sales — can go on indefinitely. Or, at least until an accident happens and the two-year note begins to fall. Or, alternatively, until the one-way bet on the yen is no longer a sure thing, as could happen in the unlikely event that the BOJ refuses to accumulate additional dollars. Or where the yen has fallen sufficiently below the ¥100/$ level. On this basis a good case can be made for a further drop in the yen, in spite of the fact that this operation is highly contrived, artificial, and based purely on speculative motives.

While on the subject of easy money, one must bemoan the fact that even the Bundesbank has caved in to the modern inflationist. Adducing slow M3 growth but clearly with an eye on stagnating economic activity and rising unemployment, it cut the discount and the Lombard rates by 50 basis points and rejected out of hand the very reasonable call for adopting longer-term M3 targets.

The asymmetry of present targeting practices is all too obvious: Overshooting is countenanced and undershooting is compensated for by lowering interest rates. A multi-year target would allow for a more equitable and symmetrical response.

Regrettably, this leaves us with no serious guardian of our paper money, at least among the major industrialized countries. Increasingly, investors will have to find refuge among the smaller, independent countries still possessing sound monetary regimes. Switzerland, New Zealand, and Singapore stand out at this time as the most interesting candidates.

STRATEGY: *Remain sidelined on all major currencies.*

Chart 5

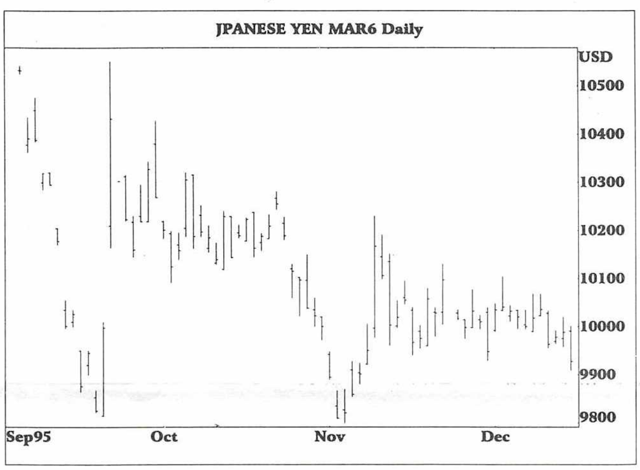


Chart 6

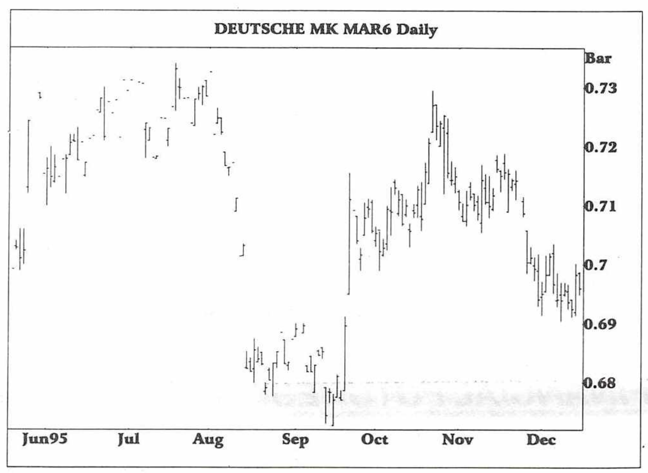
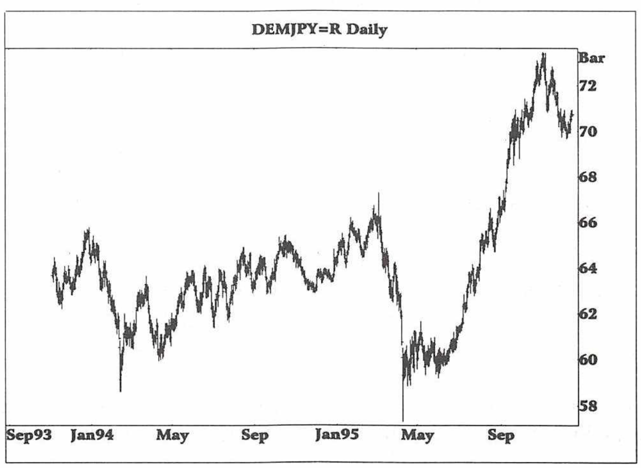


Chart 7



GOLD

Bull in a China shop?

Disappointing price action continues to obscure the real story: Supply tightness is just not going away. While the rare flirtation with backwardation appears to have been (so far) a one-day curiosity, Chart 8 shows that the trend towards a narrowing of the contango persists.

Some market observers believe that the new year will usher in a period of renewed central bank lending and that as a result of it, lease rates will back down once more. This may or may not happen; what is clear is that we are seeing a certain amount of reluctance on the part of central banks to lend gold. This may be due to perceptions of counter-party risks. Or to the fact that central banks are not desirous of tying up bullion for long periods of time. Or to legal restrictions.

What one cannot argue is that central banks have been ignorant of this option; after all, returns of 3% to 5% per annum in gold are competitive with money market rates of some of the harder currencies in the world.

Which brings us to the next point. Why should China, with $72 billion of international reserves, and possibly double this amount, after absorbing Hong Kong in 1997, not consider owning gold, seeing that it no longer is a non-interest bearing asset? Or Singapore with $67 billion? Taiwan with over $90 billion?

Massive reflation and currency manipulation may deter the newly developed Southeast Asian countries from further accumulating US dollars, deutschmarks, or yen (see our article on currencies). We rest our case here, awaiting a market-based confirmation — such as a break above $410/oz. — that a bull market has begun in earnest.

STRATEGY: *Continue to accumulate ridiculously cheap call options.*

Chart 8

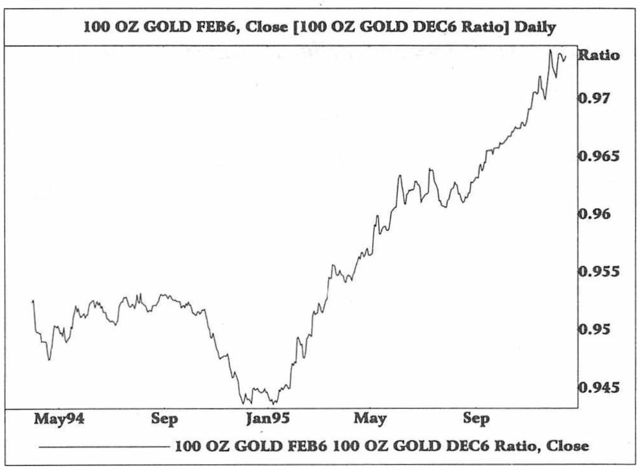
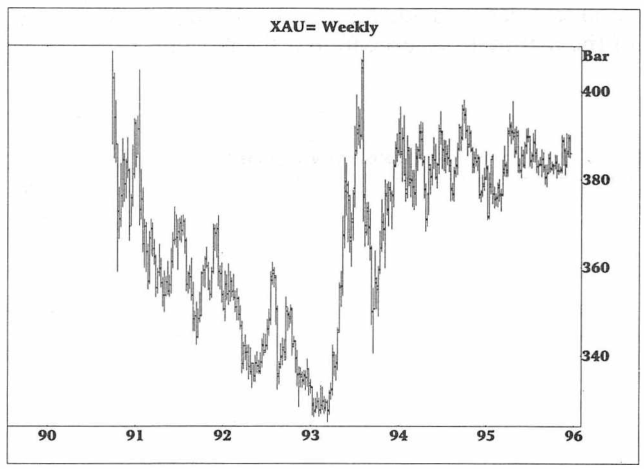


Chart 9



FINANCIAL FUTURES

The party isn't over...yet

Evidence continues to mount that economic growth has come to a near complete halt. From all appearances, this is music to investors' ears. Latest titbits were a soft employment report, higher employment claims, and a further drop in leading indicators.

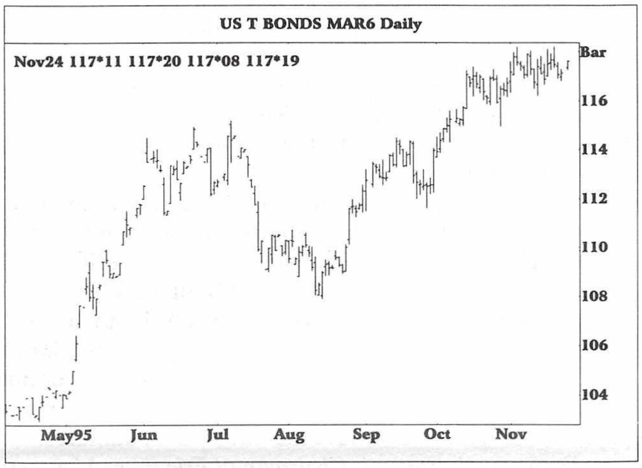
It is quite probable that the Fed, at its meeting this coming Tuesday, will decide to cut the funds rate by anywhere between 1/4% and 1/2%. Markets have already built in a 75 basis point drop by mid-1996. At the same time, economic activity in Western Europe has slowed down significantly, with Great Britain, Germany, and France showing practically no growth for the past three months.

Monetary reflation on all sides of the Atlantic is losing its potency as a way of maintaining or even kickstarting economic growth. Like a drug addiction, dosages must be increased. Assured in their knowledge that inflation is not a problem, central banks in the US, Germany, and Japan may go for this option and step a bit further on the monetary accelerator.

Almost unobserved, commodity prices continue to climb (see Charts 12 and 13): Grain prices, base metal prices and now energy prices are quietly making new one-year or multi-year highs. There is little doubt that they will become, in due course, the party spoilers. For now, however, speculation in the financial futures arena reigns supreme.

STRATEGY: *There is as yet insufficient evidence that the party is over. Remain sidelined with respect to S&P 500 and Treasury bond futures.*

Chart 10



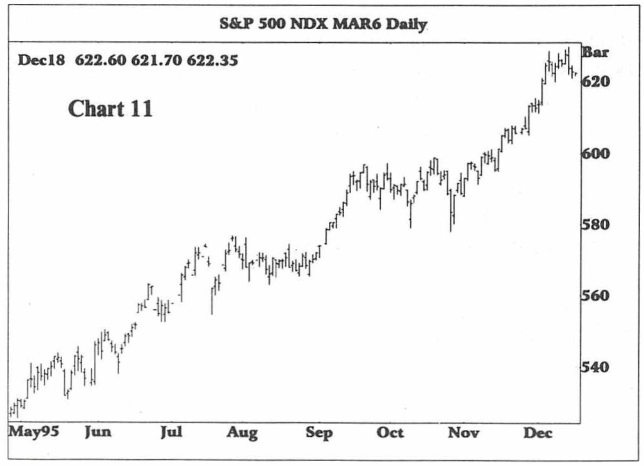


Chart 11

Chart 12 – Goldman Sachs Commodity Index

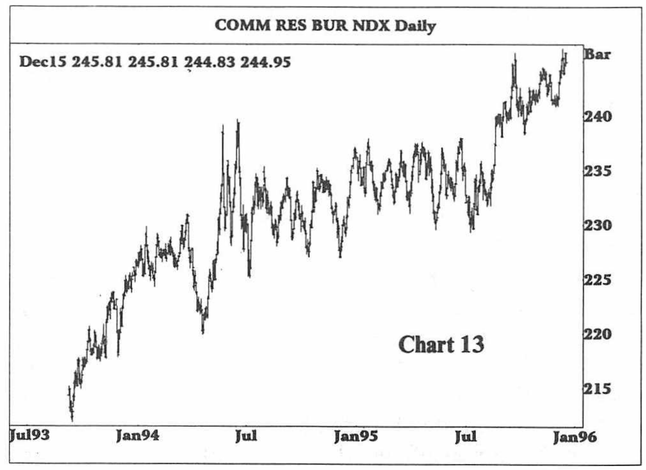


Chart 13

FRIEDBERG CAPITAL MARKETS

The Czech miracle

by Steve H. Hanke

Judged by modern standards, the Czech Republic is unique. Both of its political leaders, President Vaclev Havel and Prime Minister Vaclav Klaus, are first-class thinkers. Consequently, they can and do write their own scripts. Moreover, the playwright and the economist obviously have the "right stuff." Indeed, they have combined their considerable talents to assist the Czechs in pulling off an economic miracle.

Since Havel and Klaus came to power in December 1989, the Czech Republic has witnessed the most successful transformation from socialism to capitalism. The private sector's share of GDP is now 70%, the highest of any of the former communist countries. What is more, this rapid dash to capitalism has taken place with remarkably low adjustment costs. Indeed, October's unemployment rate was only 2.77%, unbelievably low by any standard (Chart 14).

The Czechs have been rewarded for eschewing "shock therapy" and embracing orthodox economic principles. Foreign capital has poured into the Czech Republic and fueled an economic boom (Chart 15). And last month, the Czech Republic joined the OECD, and its bond rating was upgraded to "A" by Standard & Poor's.

On the political front, Klaus' government has been in office since June 1992. This makes it the longest-serving government since the breakup of the Austro-Hungarian Empire in 1918. And looking ahead, odds are that voters will return Klaus' government when they go to the polls in June 1996. In that event, the Czech Republic would be the only East Bloc country to reject political parties of the left.

Just what are the orthodox economic principles embraced by Prime Minister Klaus? There is no mystery here. Vaclav Klaus is a member of the Austrian School of Economics. Consequently, stability is an important objective. Indeed, stability might not be everything, but without stability, everything is nothing. As Professor Carl Menger (1840-1921), founder of the

Austrian School and tutor of Crown Prince Rudolf, put it to the Crown Prince, "It can reasonably be agreed that an uncertain, disorderly currency is a vital deficiency of a state, because it makes itself deeply felt in all economic life and its progress." Klaus clearly agrees with Menger on this point.

Klaus also agrees with Nobelist F.A. Hayek (1899-1992), this century's most notable Austrian economist. Hayek stressed that a free-market economy cannot be engineered or constructed. Rather the general "rules of the game" have to be established and a free market based on those general rules has to be left free to evolve. As Klaus put this at the Cato Institute's luncheon, "you can't introduce the invisible hand with a visible hand."

These Austrian insights have provided Klaus with his strategy. As for tactics, Klaus has relied on flexibility and pragmatism. In short, he has introduced Austrian-motivated policies in an opportunistic manner. The results have been spectacular.

To introduce stability in the Czech Republic, the koruna was devalued in 1990 and pegged to a currency basket (65% DM and 35% US$). The devaluation left the koruna "undervalued." This gave the Czech Republic what Klaus termed a "transformation cushion."

Since the peg was set, it has been maintained, and stability has been achieved. Indeed, inflation is lower than in any other former East Bloc country and has remained on a downward trajectory (see Chart 15). Klaus anticipates that inflation will continue to decline by about 1% to 1.5% per year.

However, there are problems, if I can use that term, on the horizon. With a pegged, but adjustable, exchange rate, the central bank must manage both the exchange rate and domestic liquidity, a difficult task. Indeed, Josef Tosovsky, the able governor of the Czech central bank, has confirmed to me the magnitude of these difficulties.

Led by capital inflows, the overall balance of payments is in surplus. To manage the koruna peg, the central bank must buy foreign exchange and sell koruna at the pegged rate. Consequently, in the past three years the central bank's foreign exchange holdings have exploded from $1 billion to over $12 billion.

In an attempt to sterilize the monetary impact of this increase in reserves and keep from generating inflation, the central bank has had to resort to larger and larger issues of its own paper. This has mopped up some of the liquidity created by capital inflows. But not enough. Inflation is not declining as rapidly as Klaus would like. This spells trouble for the central bank.

The game is coming to an end. Total credit is growing rapidly, with the unsterilized foreign component of that increase accounting for the bulk of the total increase. If the central bank keeps issuing koruna debt to mop up the monetary effects of inflowing foreign exchange, domestic interest rates will rise, luring more hot money into the Czech Republic and fanning inflation.

If these monetary problems weren't enough, the labor market is tight. And not surprisingly, nominal wages have been increasing more rapidly than inflation. More headaches for Messrs Klaus and Tosovsky.

There is only one way to meek Klaus' inflation targets: The koruna will have to be revalued against its mark/dollar basket. This could be accompanied either by adjusting the peg in a one-time move of 5% to 10% or by widening the current exchange rate band from its current 1% to, let us say, 10% or 20%. Under the band-widening option, the koruna would drift up towards the upper end of the band. Over time, either revaluation option will reduce the overall balance-of-payments surplus and remove the inflationary stimulus.

Dr. Steve H. Hanke is Chairman of Friedberg Mercantile Group, Inc.

STRATEGY: *A synthetic portfolio based on three-year DM and US dollar notes weighted 65/35 (equal to the present koruna peg) yields a mere 4.63%, 559 basis points less than obtainable on triple-A koruna-denominated bonds. This discrepancy can only be explained if one were to expect a devaluation in the near future. Au contraire, as our article points out, a revaluation, not a devaluation, is the more logical outcome.*

We offer the following Czech Koruna Bond:

Issuer: *General Electric Capital* ***Maturity:*** *10/23/98*
Coupon: *10.5%* ***Price:*** *100.60*
Rating: *Triple-A, by both Moody's and S&P* ***YTM:*** *10.22%*

Chart 14

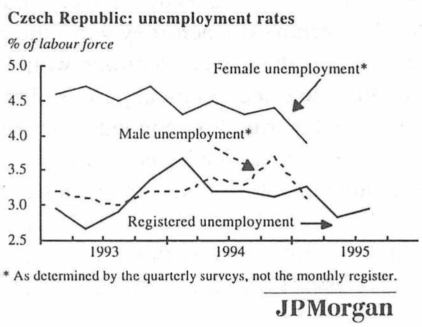


Chart 15

Economic indicators: Czech Republic

	Average 1989-93	1994	1995e	1996f	1997f
Real GDP, % change	-4.3	2.6	4.3	4.9	5.2
Consumption*	-1.4	2.3	3.2	3.5	4.3
Investment*	-1.5	5.6	10.9	6.7	5.5
Net trade*	-1.3	-5.3	-9.8	-5.3	-4.6
Consumer prices, %oya	18.9	10.0	9.2	8.2	6.5
% Dec/Dec	19.4	9.7	8.1	7.5	6.4
Producer prices, %oya	16.6	5.3	7.7	8.7	8.4
Government balance, % of GDP	0.5	1.0	0.0	0.0	0.0
Exchange rate, units/$, eop	25.8	27.9	27.0	25.0	25.3
Merchandise trade balance ($ bil.)	-0.3	-0.9	-3.4	-4.2	-5.2
Exports	7.2	14.1	16.3	19.0	22.0
Imports	7.6	14.9	19.7	23.2	27.3
Current account balance	0.3	0.0	-2.1	-2.3	-2.5
% of GDP	1.1	0.0	-4.6	-4.5	-4.1
International reserves, ($ bil.)	1.8	6.1	12.1	14.7	16.1
Total external debt, ($ bil.)	6.5	11.3	15.9	19.1	22.4
Short term**	2.0	3.6	4.9	6.1	7.6
Total external debt, % of GDP	20	26	30	34	34
Total external debt, % of exports***	60	51	58	64	66
Interest payments, % of exports***	6	4	5	5	4

* Contribution to growth of GDP.
** Debt with original maturity of less than one year
*** Exports of goods, services, and net private transfers.

Source: J. P. Morgan

SOFT COMMODITIES

Soymeal

While the pace of US export commitments for soybean meal has picked up and now stands 1.47 million tonnes, it still lags last year's figure by some 400,000 tonnes. A similar situation exists for the beans themselves. However, upon taking a scan of the global export scene, one finds a different picture. Combined US, Brazilian, and Argentinean exports of both beans and meal are being shipped at historically high levels of 12.2 million tonnes, up 16% from last year's 10.5 million tonnes.

Who's buying? The Chinese, of course. The story of Chinese buying of commodities is well worn. All the same, it's still fascinating, but perhaps nowhere so much as in the case of soybean meal. An article about this topic appears in the December 18 issue of *Forbes,* and we found some of the facts presented in this piece so compelling that they speak for themselves. Keep in mind that we're talking about 1.2 billion people — about a fifth of the world's population.

"In the early 1980s the typical Chinese diet consisted of rice, porridge and cabbage, and maybe a bit of fatty pork once or twice a week. Today most city dwellers eat meat, eggs or fish at least once a day.

"...broilers are becoming an affordable daily food for the masses, thanks to modern industrial-scale chicken-breeding, feeding and raising technology...."

Chickens and hogs eat lots of soybean meal: "Over the last five years Chinese consumption of pork has grown by 11 million metric tons, much more than the entire annual US pork market. With nearly five times the US population, the Chinese, with a hog population of 415 million, now eat four times as much pork as Americans.

"So out go the rice hulls, potato vines, corn husks, water lilies — anything with nutritional value the Chinese have over the centuries fed their pigs, chickens, carp. In come corn, soybeans, and barley."

And lots of room for growth: "Total meat consumption in China is growing 10% a year...Even so, per capita consumption is still only 12% of the level in the US or Hong Kong.

And here is the anecdotal clincher: When the American Soybean Association first opened an office in China in the early 1980's they relate that "...the Chinese didn't know soybean meal could be used for feed. 'They used it as fertilizer'... 'pigs were fed table scraps.'"

Talk about emerging markets.

STRATEGY: *Trail this exploding bull market with generous stops. Raise them to 210, basis March '96, close only.*

Chart 16

Cotton

One of the spectacular commodity bull markets of the decade was seen in cotton. The market more than doubled in price, driven by poor Asian crops and strong demand. As the prices surpassed levels not seen since the American Civil War on a march towards $1.19 per pound, the market was rife with predictions of huge plantings of the fibre by farmers enticed by the out of sight prices. Eventually, bull market dynamics took over, and the soaring prices brought rationing, allowing the market to drop 30% off the highs to settle into a rather steady range either side of 85¢/pound.

Where does this market head from here? Let's examine the supply side by looking at the world's two largest exporters, The United States and Uzbekistan.

The US: On December 11, the USDA reported its estimate for the 1995-96 crop at 18.24 million bales, down 7% from last year's record 19.66 million-bale crop. The street had very optimistic expectations for this crop, but each month's crop report saw the estimates slip. The estimate actually came in below the low end of the range of traders' expectations. As well, exports, although sharply below last year's levels, were expected to be lowered marginally from last month's numbers, but weren't. Clearly these revisions are small and subtle, but have been trending away from what the market has construed as an unfolding bearish picture. The net effect of these seemingly insignificant changes is that the stocks-to-consumption ratio will drop from 20.78% last month to 19.44%. This is not a disastrous carryover by any means, but at the same time it will be the lowest carryover in the US since the 1990-91 season when prices rose by some 25%.

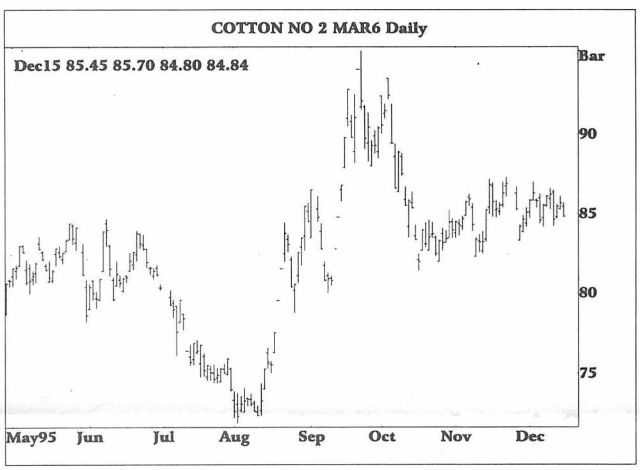
Uzbekistan: The USDA raised its production estimate slightly for this former Soviet Republic to 5.9 million bales. Production in Uzbekistan has been declining in a hurry since the late '80s. In fact it is producing less than half of its 1988-89 output. Uzbekistan consumes very little, so just about the whole crop is available for export, but if its crops continue to shrink, it can't export what it doesn't grow.

On the consumption front, US exports have nosedived from 9.4 million bales last year to 6.8 million bales. This is not a phenomenon that requires much explaining; the soaring prices drove buyers to do without or to use cheaper substitutes. But there was genuine demand that created those 9.4 million bales of foreign demand last year. Although we have no strong evidence, we suspect that this latent demand lurks in the shadows and will reappear as the market makes the psychological adjustment to 85¢/pound cotton.

Then we have foreign exchange-rich and commodity-hungry China. Until now, by and large, China produced what cotton it needed. But as government policies shift crops to food production and an increasing population of nouveau urbanities discover the meaning of a wardrobe, we can expect China to grow less and need more. Also it must be remembered that the textile industry is vital to the Chinese economy and full employment, and it is unlikely that the government would allow this industry to suffer any setbacks by not feeding the mills.

STRATEGY: *We have advised probing the long side, with stops at 81.00, basis March '96, close only.*

Chart 17



Cocoa

As cocoa heads into its fifth consecutive year of production/consumption deficits, one wonders if the long-awaited bull market will ever come. Wary speculators are becoming increasingly fed up with allowing astute hedgers to continuously collect the cost of carry. We speak with the authority of experience. Although the spot price has not strayed far from $1,300/tonne in almost two years, the stubborn bull has contributed generously to the cause. Will the wait be worthwhile?

The trees in most of the producing countries are in the twilight of their productive years. The transition period between the final harvest of the old and the first harvest of the new will bring flat to declining production through the end of the decade. With even just a modest rate of growth in consumption, which is all we really have, production/consumption deficits will grow. The seemingly comfortable 40%-plus carryover stocks-to-consumption ratio will steadily erode.

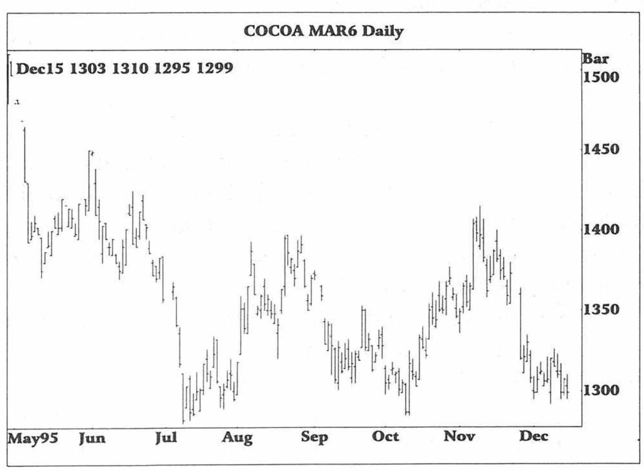
Production for 1995-96 is widely expected to improve considerably, breaking the trend of the last few years. However, a sneak preview at the not-yet-released forecasts of a respected cocoa analyst, which for obvious reasons chooses to remain anonymous, reveals not a global production turnaround but an aberration. Favorable weather conditions should allow the bulk of West Africa growing areas to yield a deceptively good crop. As mentioned earlier, the rate at which old trees are vanishing is much greater than the rate of new trees coming on stream. With clearly defined, multi-year downtrends in production in Brazil and Malaysia, and unsustainable growth in the Ivory Coast, the robust 1995-96 world crop must be viewed as aberration.

The only country that should become an exception is Indonesia, and in a big way. Due to weather and insect problems, this year's crop was smaller than last year's. The long-term trend, however, is definitely up. Indonesia has a huge slew of new trees that are slowly starting to produce. It is said that by the year 2000 Indonesia will produce in excess of 400,000 tonnes, compared with its 1994-95 crop of 250,000 tonnes.

The key issue, though, is consumption. Demand is growing at about 2% a year, and at that rate, only weather accidents will cause the bull to stir. We pointed out last month that growth in developing countries is probably far greater, and as years of production/consumption deficits eat into stocks, it is only a matter of time before this market gets going. Unlike the grain markets, the data on Chinese interest is almost nonexistent. So we'll draw on a titbit of anecdotal evidence: A recent survey conducted by a Western polling firm of corporate name recognition by Chinese adults reveals that 40%, a mere few hundred million people, recognized the name of chocolatier Nestlé.

STRATEGY: *Buy on nearby breaking 1400 on the upside.*

Chart 18



Coffee

Even the wiser and far more powerful great uncle lost the listener's ear when it became obvious that claims of restraint were merely tall tales. OPEC, the elder statesman of cartels, did itself in more than once when members started cheating.

The latter-day version of the coffee persuasion is following the same path. The Association of Coffee Producing Countries (ACPC) is desperately trying to maintain the once highly effective, but currently completely inept, retention program. In its exasperation, it has made noises about holding back supplies completely to stabilize a rapid downward spiral in prices.

In its quarterly review *Commodity Markets and the Developing Countries*, the World Bank accuses the Brazilians, sponsors and promoters of the pact, of exporting 300,000 bags over its quota. In addition, loopholes, not that obvious to the street, do exist. Brazil has exported 500,000 bags of green-coffee-equivalent in quota-free soluble coffee during the third quarter of this year. So despite the fact that we believe that this market carries bullish fundamentals, traders and roasters have thumbed their noses at ACPC and have allowed the market to make 18-month lows.

The USDA's December report will likely lay to rest the long-debated issue of the size of the frost/drought damaged 1995-96 Brazilian crop at 16.8 million bags. This will bring the world crop to 88.2 million bags. Plugging these numbers into the model we used last month will change things a bit, but will still leave us with a friendly stance. The production/consumption deficit will be 8 million bags instead of 10 million bags. The global stockpile number will rise to about 21.5 million bags to leave the season with a stocks-to-consumption ratio of 22 %, still well below the average and clearly very much in bull market territory.

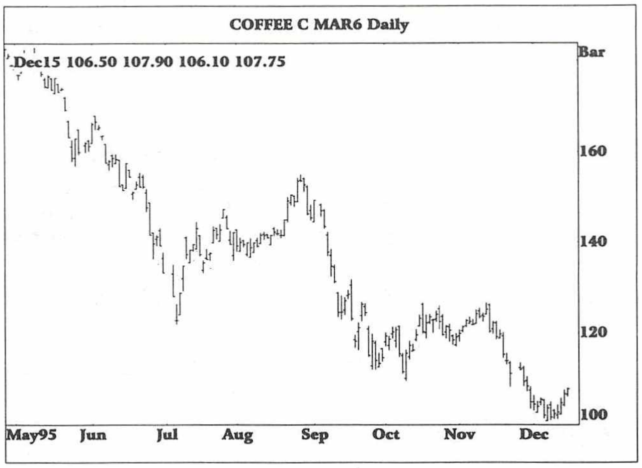
Still, stronger demand is required to fuel this market. Some recent numbers suggest that the effect of high prices can now be seen quite clearly in Western countries like Germany where 1995 consumption is down by 2%.

Backwardation persists in both London and New York, so it can't be argued that the tightness is merely due to the retention scheme, which is primarily being conducted by Central and South American countries whose Arabicas are the deliverable grade at New York.

STRATEGY: *We like the long side but fear that we have as yet not built up a sufficiently large short position to sustain the uptrend. Keep in close contact.*

– Sholom Sanik

Chart 19



FRIEDBERG CAPITAL MARKETS

Update on Atari

Security: 5.25% Convertible Subordinated Debenture
Maturity: April 2002
Recent Price: $46.00
Yield to Maturity: 21.6%
Conversion Price: $16.31
Recent Stock Price: $1.50

During 1995, Atari sales and operating margins continued to suffer due to increased competition from both video game platform providers and PC-based entertainment software. Quarterly sales have declined 50% compared with the previous year, and operating losses continue to mount. The company's flagship product, the Jaguar 64-bit system, which represents over 70% of the company's sales, has been a disappointment. The primary reason for this, according to both the company and industry participants, is the lack of available game titles. Although Atari at one time had the technological edge on its competitors, the lack of game titles and consumer awareness prevented the company from making gains in market share. This opened the door to competition such as Sony, Sega, and Nintendo and nullified any technological advantage of the Jaguar.

In a recent bold marketing move, Atari has reduced the price of the Jaguar to $99 from $159, approximately 33%. This comes only eight days before the end of the holiday shopping season. Reportedly, it is an attempt to increase its share in the interactive home entertainment market; however, the company may not have had any choice, because of lower-than-expected sales during this key retailing season. Whatever the motivation, the move will put further pressure on already strained gross margins. As well, the company continues to increase its library of available games; however, one gets the feeling it may be too little, too late.

From December 1994 to September 1995, the company's cash and near cash balance has declined to $53 million from $80 million ($9 million per quarter on average), because of continuous losses. With a poor performance this holiday season, expect the cash balances to dwindle further. At this time the asset coverage on the convertible debentures is approximately 1.5x. Interest coverage is not meaningful, given that the company is incurring losses and interest is being paid out of existing cash balances. The company remains extremely liquid in the short term with cash and current ratios upwards of 5x and 9x respectively. Continued losses, however, will have a negative effect on one of the few remaining company strengths.

It has been reported that Atari may be considering a strategy that would see the company bow out of the market for video game hardware and concentrate on the development of PC-based software. There is a growing belief that the personal computer will be the system of choice for running video game software in the future. The company is said to be launching a new software division in 1996 dedicated to developing new titles for Windows. If this is the case, it should hope to have better success in developing PC-based software than it did developing software for the Jaguar. Nevertheless, a change of strategy may be just what is necessary to give new life to Atari.

STRATEGY: *The performance of Atari continues to deteriorate, with disappointing sales of Jaguar and declining cash balances. Although there are no short-term liquidity concerns, the long-term viability of the company will depend on its ability to gain significant market share over its competitors in the video game platform market or to successfully pursue a strategy based on PC software development. Both seem like long shots at this time. We recommend that investors remain extremely attentive to further developments.*

– Peter O'Sullivan

Chart 20 – 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 December 15, 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	5.30%		VEB 7% '96 yields 11.12% (DM/US 1.5219)								ESCOM '96 yields 13.93% (SAR/US 0.2520)	NIB '96 yields 10.71% (ITL/US 1.6754)		
2 year	5.36%				World Bk. '96 yields 0.19% (JY/US 92.2354)	Denmark '96 yields 4.53% (DKr/US 5.5025)	Sweden '96 yields 5.91% (US/BP 1.5200)	Cr. Lyon '96 yields 5.37% (FFr/US 4.9625)		R.B.C. '97 yields 5.58% (CDN/US 1.3797)				
3 year	5.40%													
4 year	5.49%		Argentina '98 yields 7.47% (DM/US 1.5536	G.E. '98 yields 2.66% (SF/US 1.0432)										
5 year	5.54%	Tranz Rail '99 yields 8.72% (US/NZ 0.5625)												
6 year	5.58%								UK '01 yields 6.40% (US/ECU 1.2165)				Pre 1:BOCON yields 18.77% (ARG/US 2.0265)	
8 year	5.73%													
9 year	5.77%													
Spot Exchange Rate	–	0.6525	1.4422	1.1631	102	5.5902	1.5359	4.9616	1.2743	1.374	0.2727	1.5935	1.00	4.3382

*For example, since a US$-based investor would receive 318 basis points (872-554) by holding the Tranz Rail NZ$ bond, the NZ/US can depreciate to .5625 from the present spot exchange rate of .6525 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 22 – Recommended current portfolio allocations

1. G.E. Czech Koruna	5%	4. Fletcher NZ$	20%
2. PRE-1	30%	5. Tranz Rail NZ$	5%
3. New Zealand (8%) '98 Gov't	20%	6. World Bk (7¼%) '99 DM	20%

Chart 21 – FOREIGN CURRENCY BONDS

DATE: December 15, 1995

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

ISSUER / COUPON / MATURITY DATE		BID	OFFER	YTM	CURR. COUPON	NEXT INTEREST PAYMENT DATE
DEUTSCHE MARK DENOMINATED BONDS						
Bank of Nova Scotia 5 5/8% 7/5/96 RRSP eligible		99.75	100.60	4.03		May-07
World Bank 5 7/8% 4/02/97 RRSP eligible		101.55	-	-		Feb-04
World Bank 7 1/4% 13/10/99 RRSP eligible		108.65	109.50	4.48		Oct-13
World Bank 9% 13/11/00 RRSP eligible		116.75	-	-		Nov-13
Kingdom of Denmark 6 1/8% 15/04/98		103.70	104.55	4.02		Apr-15
Argentina 8% 5/10/98		100.40	-	-		Oct-05
Bk. Foreign Eco. Affairs 7% 29/3/96		97.90	98.75	11.12		Mar-29
Kgdm. of Spain (6 Mo. LIBOR-1/16) 29/6/02 (semi)		99.28	99.58	-	4.5625	Dec-29
CZECH REPUBLIC KORUNA BONDS						
General Electric 10.5% 23/10/98		99.75	100.60	10.22		Oct-23
ITALIAN LIRA DENOMINATED BONDS						
Nordic Inves. Bk 12 3/8% 19/04/96		99.40	100.25	10.71		Apr-19
SWISS FRANC DENOMINATED BONDS						
General Electric 4 3/4% 2/7/98		104.20	-	-		Jul-02
General Electric 4 1/2% 17/12/99		106.20	107.05	2.61		Dec-17
DANISH KRONE DENOMINATED BONDS						
Kgdm. of Denmark 9% 15/11/96		103.00	103.85	4.53		Nov-15
ECU DENOMINATED BONDS						
United Kingdom 9 1/8% 21/02/01		110.80	111.65	6.40		Feb-21
BRITISH POUND DENOMINATED BONDS						
Kdgm. of Sweden 8 3/4% 29/5/96		100.25	-	-		May-29
FRENCH FRANC DENOMINATED BONDS						
Credit Lyonnaise 9 1/2% 23/12/96		103.10	103.95	5.37		Dec-23
JAPANESE YEN DENOMINATED BONDS						
World Bank 5 3/4% 7/8/96 RRSP		102.65	103.50	0.19		Aug-07
CANADIAN DOLLAR DENOMINATED BONDS						
Ontario Hydro 10 7/8% 8/01/96 (semi) RRSP eligible		99.60	100.85	-5.29		Jan-08
Eksportfinans 7 3/4% 5/11/97		101.50	102.75	6.14		Nov-05
Royal Bank of Canada 9 1/8% 7/1/97 RRSP eligible		102.25	-	-		Jan-07
Ontario Province 10 5/8% 15/7/98 RRSP eligible		108.55	-	-		Jul-15
SOUTH AFRICAN RAND DENOMINATED BONDS						
ESCOM 12% 1/5/96 (semi)		98.45	-	-		May-01
ESCOM 11% 1/6/08 (semi)		80.50	81.35	14.24		Jun-01
AUSTRALIAN DOLLAR DENOMINATED BONDS						
Commonwealth Bk. of Australia 9 3/4% 15/5/96		99.90	100.75	7.40		May-15
NEW ZEALAND DOLLAR DENOMINATED BONDS						
World Bank 12.5% 25/7/97 (semi) RRSP eligible		106.75	107.60	7.37		Jan-25
New Zealand Gov't 10% 15/7/97 (semi)		102.65	103.50	7.59		Jan-15
New Zealand Gov't 8% 15/7/98 (semi)		100.25	101.10	7.52		Jan-15
Fletcher Challenge 10.75% 15/12/97 (semi)		102.95	103.80	8.63		Dec-15
Fletcher Challenge 10.15% 30/11/98 (semi)		102.80	-	-		May-30
Tranz Rail Ltd. 10% 15/10/99 (semi)		103.20	104.05	8.72		Apr-15
DB Group 7% 30/6/96 (semi) matures @ 85		88.40	89.25	4.35		Dec-30
Trans Tasman 9% 27/6/99 (semi)		84.85	85.70	14.80		Dec-27
ARGENTINEAN PESO DENOMINATED BONDS	PAR VALUE			IRR		4'th day
Bocon Pre 1: 1/4/2001	132.2187	83.75	85.75	18.77		May-01-97
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS						
Burnup & Sims 12% 15/11/00 CV@16.79 p/sh (semi)		97.25	98.75	12.34		Nov-15
Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh		44.25	45.75	21.74		Apr-29
Coeur D'Alene 6% 10/6/02 CV@ 26.00 p/sh		88.25	89.75	8.08		Jun-10
Glycomed 7 1/2% 1/1/03 CV@14.06 (semi)		75.25	76.75	12.58		Jan-01
California Microwave 5 1/4% 15/12/03 CV@28.44 p/sh (semi)		92.25	93.75	6.26		Dec-15
U.S. DOLLAR DENOMINATED FIXED RATE BONDS						
World Bank 7 1/8% 27/9/99 (semi) RRSP eligible		104.90	105.75	5.42		Mar-27
Farm Credit Corp 7 3/4% 10/06/96 RRSP eligible		100.20	-	-		Jun-10
T.W.A. 12% 3/11/98 (semi)		90.25	91.10	-		N/A
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES						
Kgdm. of Denmark 25/3/97 (Gold call, JY put),(semi)		85.00	86.00	-	8.0865	Mar-25
United Kgdm. 30/9/96 3 mo.LIBID-1/8 (qtly),callable @100		99.82	100.12	-	5.625	Dec-29
Bocon 1/4/01 (30 day LIBOR) starts paying May 1,'97	PAR: 123.4626	92.55	93.40	16.06		May-01-97
Argentina: Series L:FRB 31/3/05, 6 mo. LIBOR+13/16 (semi)		66.75	68.25	15.10	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, November 28, 1995:
Good afternoon for Tuesday, November 28. There are no changes or new recommendations.

Wednesday, November 29, 1995:
Good afternoon for Wednesday, November 29, 10:40 am. This is a flash update. Cover March T-bonds at the market, presently trading at 118.00, cancelling the 118.12 stop, close only.

Friday, December 1, 1995:
Good afternoon for Friday, December 1. There are no changes or new recommendations. We repeat the flash update of Wednesday, November 29, to cover March T-bonds at the market, then trading at 118.00, cancelling the 118.12 stop, close only.

Tuesday, December 5, 1995:
Good afternoon for Tuesday, December 5. There are no changes or new recommendations.

Friday, December 8, 1995:
Good afternoon for Friday, December 8. There are no changes or new recommendations.

Tuesday, December 12, 1995:
Good afternoon for Tuesday, December 12. There are no changes or new recommendations.

Wednesday, December 13, 1995:
Good afternoon for Wednesday, December 13, 5:30 pm. This is a flash update. Buy March cotton at the market, placing stops at 81.00, close only.

Friday, December 15, 1995:
Good afternoon for Friday, December 15. This is a complete summary since our last market letter dated November 26, of all liquidations of open positions and new recommendations that remain outstanding.

- On Wednesday, November 29, via flash update, we advised covering March T-bonds at the market, then trading at 118.00, cancelling the 118.12 stop, close only.
- On Wednesday, December 13, via flash update, we advised buying March cotton at the market, then trading at 85.30, placing stops at 81.00, close only.

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