

25 YEARS

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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Scanning the globe for investment opportunities

The takings are meagre. Investment funds scouring the face of the earth have arbitrated away, little by little, the few remaining opportunities. Spreads have been compressed across the entire gamut of investment outlets, risks have gone undifferentiated, and complacency prevails all over the global village.

The great driving force is the US stock market. No sooner does it achieve a new and higher plateau than other investment assets get pulled up in price (Chart 1). As the investing public learns to conquer the heights, the sky is, literally, the limit. From time to time, a small accident happens — witness the Thai stock market crash — but they are few and far between.

The old warriors reminisce nostalgically about the heady days of S&Ls, Tequila, Barings, Sumitomo in the War of the Nineties, the LDC Debt Hangover, and the '87 Crash among the many other glorious landmarks of past wars. Their forefathers survived, and they will too. Pity that things have turned so quiet.

Metaphors aside, the reality is that but with very few exceptions the rewards in today's investment environment do not justify the risks. The exceptions, where they are, belong principally to the category of the poorly understood or the misconceived.

The Argentinean law of convertibility is one such example. A currency board is financially impregnable. Because it is not understood, peso instruments yield as much as 400 basis points more than exactly similar dollar instruments. Those who understand the mechanics of the currency board will still argue that politicians can and will be incentivized to devalue "to get things moving." They fail to understand that devaluations — especially in countries with a long history of currency debauchment — do not offer tangible benefits. Prices catch up and real rates of exchange remain unchanged. Politicians can still do crazy things, but in a semi-rational world, the odds are not high.

While still on the subject, the market fails to take into account these qualitative factors for Argentina:

- A healthy banking system (triple A compared with Brazil and Mexico).
- Dramatically cleansed and improved federal and provincial finances (again triple A versus Brazil and Mexico).

- A practically imagined federal deficit (mostly the result of a very good thing: the privatization of the social security system and the consequent loss of social security contributions) versus a real and quite ominous Brazilian deficit and a meagre 0.1% of GDP fiscal surplus in Mexico, largely due to a windfall (40% higher oil export prices) and the under-execution of a much-needed investment budget.

(The realization that Argentina has a better "thing" going for it has just begun to dawn in officialdom. The IMF forecast that Argentina's GDP would grow by about 2.5% this year after last year's 4.4% drop. Mexico is due to rebound 3.5% this year after a 6.9% contraction in 1995. The IMF further sees Argentina's inflation falling to 0.3% this year from 3.2% in 1995, while Mexico's will likely end around 34%, almost unchanged from last year's 35%.)

These factors were alluded to in previous issues, in particular December '95 and May '96. Not only have the misconceptions remained in place but also they have deepened, with the result that Argentina has fallen further behind Brazil and Mexico (see Charts 2, 3).

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Contributions by Albert D. Friedberg, George Melloan, Peter O'Sullivan and Sholom Sanik.

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

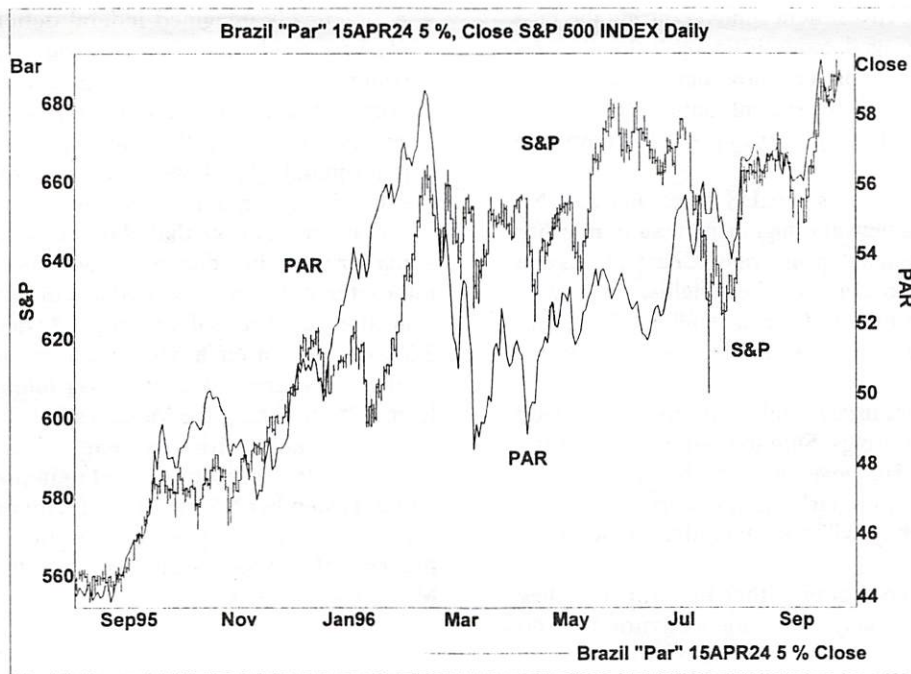
Another interesting misconception has to do with painting reformist countries, i.e., those countries liberalizing and deregulating their economies, with the same brush. And not realizing the great long-term benefits accruing to countries undertaking comprehensive reform.

New Zealand's economic reforms, for example, undertaken in the past decade are staggering and light years ahead of those undertaken in, for example, Australia, Spain, or Brazil. (For a synopsis of New Zealand's remarkable reforms, a recent speech by the governor of the Reserve Bank of New Zealand, Don Brash, to the Institute of Economic Affairs in London is absolutely *must* reading. (Subscribers only should contact Friedberg Mercantile Group at (416) 364-1171 for a free copy).

It is even unfair to express these differences in orders of magnitude. They are a world apart. The reforms are sure to confer many years of prosperity to New Zealand, regardless of the party in power. And yet, price-earnings multiples are anywhere between 20% and 35% lower, and dividend yields are as much as 220% higher, in New Zealand than in those three other countries.

The unexploited opportunities are, as we said earlier, a precious few. As the misconceptions creating them fade, the opportunities too will disappear. The fear is that when the paddy wagon comes, it will take the good girls along with the bad girls. It will then take a great deal of fortitude and patience to see us through. Such is the state of the world today.

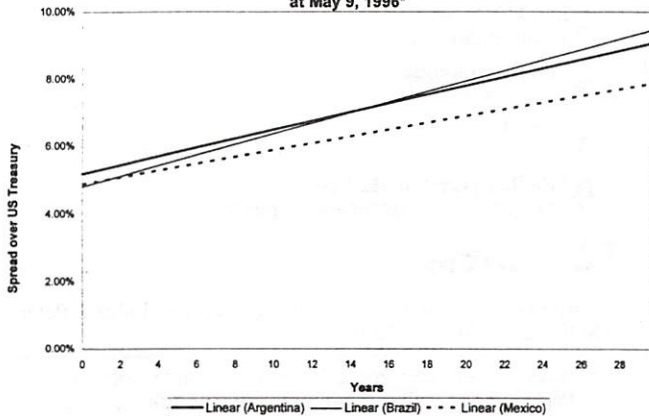
Chart 1



The tide that lifts all boats: Is it easy money, the US stock market, or new era optimism...?

Chart 2

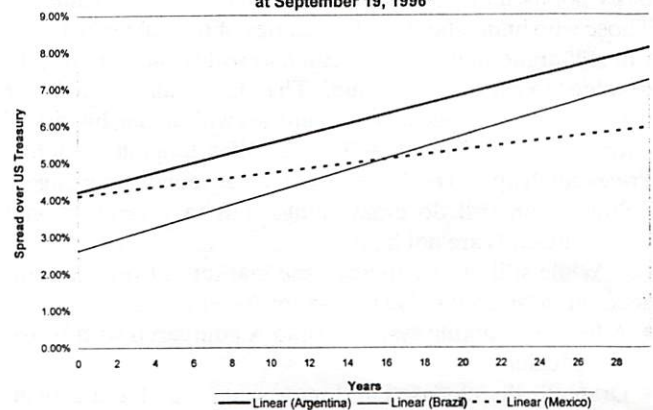
Linear Approximation of Argentina, Brazil & Mexico Yield Curves at May 9, 1996*



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

Chart 3

Linear Approximation of Argentina, Brazil & Mexico Yield Curves at September 19, 1996*



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

CRUDE OIL

Bullish underpinnings

According to Energy Market Consultants, non-OPEC output is running 100,000 to 200,000 barrels per day (b/d) lower than expected in the third quarter, while bad weather in the Black sea has reduced Russian exports significantly. At the same time, European energy demand in August, particularly heating oil, was running 300,000 b/d higher than projected.

Complicating matters, there has been an apparent and unexpected pickup in the rate of underlying oil demand in the Far East (especially China) and also in the US. As a result, total OECD company stocks (2,440 million barrels at the end of August) were almost 90 million b/d below year ago levels, a 60-day supply versus 64 days of last year (see Chart 4).

Given the tight supply/demand equation, prices have become extremely sensitive to the winter weather and to the Mid-East political/military situation. While the former may be difficult to predict, the latter is less so. In the strange topsy-turvy world of Arab politics, Saddam Hussein has become a hero merely for standing up to US "aggression." In the meantime, however, he is wounded, hungry, and trapped. The Iraqi dinar continues to plunge, food and other bare necessities of life soar beyond the means of most middle class people, and a significant portion of the population is near starvation. How long before he unleashes a desperate attack

on his rich neighbours, Kuwait and Saudi Arabia?

According to UNSCOM, Iraq has still not provided evidence of having destroyed many of the missiles and biological weapons in its arsenal. The report points out that Saddam is still trying to import banned items, including chemicals used in rocket fuel and gyroscopes for long-range missiles. A desperate man is capable of desperate actions. Let us not forget that Iraq had produced engines for a new missile with a range long enough to reach much of Western Europe.

While in the short term Iraq may be the greater threat, Iran and the growing number of Arab fundamentalist spread throughout the Middle East remain the obvious long-term danger.

Can the oil trade afford to be inadequately stocked through the critical winter months? We believe not. Trade short-covering should be sufficient to maintain nearest contract prices around \$24-\$25/barrel. (Given the steep back-wardation, this is money in the pocket). Further unsettlement in the Middle East is all an added bonus; if the worst should happen, oil prices could spike well beyond their all-time highs of \$40/barrel.

STRATEGY: Remain long. Raise stops November 1996 crude oil to \$21.75, close only.

Chart 4

MONTHLY WORLD OIL SUPPLY/DEMAND DEVELOPMENTS 1996 EMC mid-September 1996 Estimates/Projections (a)						
GLOBAL BALANCES (mill b/d):						
	Jul 96	Aug 96	Sep 96	Oct 96	Nov 96	Dec 96
DEMAND						
OECD	40.1	40.3	40.9	40.4	41.5	42.5
Non OECD (b)	26.4	26.5	26.6	26.8	26.9	27.0
Total World (b)	66.5	66.8	67.5	67.2	68.4	69.5
Change from year earlier	+5.2%	+2.8%	+3.5%	+3.9%	+2.1%	+2.7%
SUPPLY (a)						
OPEC Crude Oil Output	25.9	25.8	*25.9	*26.0	*26.0	*26.0
Non-OPEC Oil Output (b)	34.8	34.7	34.9	34.7	35.4	35.6
FSU Net Oil Exports	3.0	2.9	2.7	2.7	2.6	2.4
Other Supplies (c)	4.4	4.4	4.4	4.5	4.5	4.5
Total World (b)	68.0	67.6	67.8	67.9	68.5	68.5
TOTAL STOCK CHANGE (d)						
	+1.5	+0.8	+0.3	+0.7	+0.1	-1.0
OECD COMPANY STOCKS ON LAND (e)						
Mill bbls (end month)	2418	2440	2451	2470	2478	2457
Days Supply (f)	60	60	60	59	59	59
Year earlier stocks:						
million barrels	2555	2526	2526	2526	2497	2421
days supply (f)	64	64	62	61	60	57

* Assumed likely level of actual OPEC crude output, defined as wellhead production; EMC is currently assuming that there are no Iraqi oil exports at all during forecast period.

(a) OECD oil consumption projections are based on assumption of milder-than-normal winter weather (measurement of "heating degree-days" at 5% less than "normal", reducing OECD oil consumption by about 200,000 b/d in fourth quarter compared with "normal"; in contrast, colder-than-normal weather in fourth quarter 1995 added about 150,000 b/d on average).

(b) Excluding FSU, for which reliable monthly data for oil consumption do not exist (see EMC estimates for annual oil consumption/output in FSU, plus global annual summary).

(c) OPEC output of condensate/NGL/Orimulsion, processing gain, miscellaneous supplies.

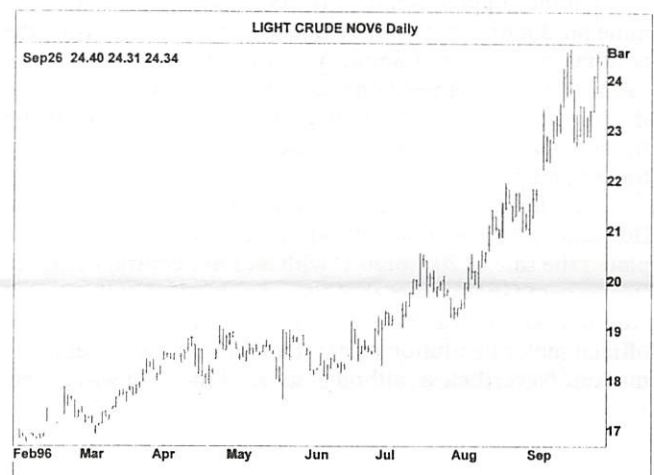
(d) Total oil stocks including strategic stocks, oil afloat, oil in floating storage, etc.

(e) Total OECD company stocks of crude/products on land, excludes strategic stocks, etc.

(f) OECD company stocks measured against OECD oil consumption in next two months.

Source: EMC Energy Market Consultants

Chart 5



GOLD

Short-term bearish, long-term still bullish

Fears that the IMF would vote to sell in the very near future 5 million ounces of gold sent the precious metal down to the lower end of its 2 1/2-year range. Prominent among the sellers were large hedge funds and a number of unidentified mines engaging in a new round of forward selling. Their activity has swelled the Comex open interest, which now stands at a new recent high of 193,000 contracts. Recall that a high-level open interest represents potential buying; it was this phenomenon that caused the sharp end-of-year rally that saw prices hit \$417.00/oz.

The bears argue that consumption is extremely sensitive to prices and that in fact the relatively high prices during the first half of 1996 caused a 50-tonne slump in the demand for jewellery (see Chart 6). In addition, bar hoarding and investments fell by a little more than 260 tonnes. They argue further that price sensitivity has been massively reinforced because jewellery's share of total gold fabrication has risen to more than 85% today from 50% in 1980.

The bullish counter-argument is that jewellery demand has exploded, especially in the developing nations, which now account for two thirds of total offtake against only one third in 1980, and that jewellery's rise in the share of total gold fabrication is simply a consequence of the collapse of speculative bar-hoarding in recent years. Nothing that a good bull market can't change.

On the supply side, the GFMS Report notes that while mine production in Australia and Canada rose, offsetting the continuous decline in South African offtake, official sector sales at 108 tonnes were only around half of what we saw in the first half of 1995. This figure, however, may overestimate the actual amount, because it is the result of gross sales of 201 tonnes and purchases of 93 tonnes.

The largest contribution on the sales side came from Belgium, which announced on March 23 that it had completed the sale of 203 tonnes "with another central bank." In this respect GFMS notes that "it understood" that this meant "the transaction was effected with the assistance of another official sector institution rather than the entire sale being 'off market.' Nevertheless, although most of the gold was proba-

bly sold into the market, some of it appears to have been acquired by another official institution. We also believe that a substantial part of the Belgian sale was effectively made in late 1995 via the forward market."

Producer hedging had little impact during the first half of 1996, because first-quarter forward sales were almost matched by second-quarter repurchases. It should be borne in mind that forward sales can only affect supply negatively when they exceed speculative repurchases and/or maturities. Otherwise they are merely replacing existing hedges.

Since these positions are already quite large, it is difficult to envision net forward sales in future years matching the frenzied activity of the second quarter of 1993 and the fourth quarter of 1995. Moreover, mining companies have already sensed that the stock market prefers unhedged companies, which they believe to have greater share price appreciation in times of rising gold prices.

In our opinion there is only one "wave" left of significant producer selling: South African mining houses, taking advantage of the 20% cheaper Rand and of Rand contango rates of around 14%. Since these circumstances are not likely to persist, we would expect the bulk of their hedging activity to take place between now and the end of this year. From that point on, producer hedging should have little or no detrimental effect on prices. (Eventually, of course, net purchases, when they come, will have a bullish impact).

Short-term bearish factors have gained the upper hand: the advisers' consensus remains too bullish, small speculative long positions are still too heavy, and South African producer selling, as discussed earlier, is expected to unfold imminently. News of an IMF agreement to sell gold could unleash further selling, triggering stops at the important \$380/oz. support level. Long term, the bullish fundamentals remain intact. In fact, they are brighter than ever.

STRATEGY: *Futures traders are sidelined. Long-term call option buyers are long, taking advantage of incredibly low option premiums.*

Chart 6

FIRST HALF GOLD SUPPLY AND DEMAND (tonnes)					
	1996	1995		1996	1995
Supply			Demand		
Mine production	1,120	1,086	Jewellery	1,344	1,395
Official sector sales	108	196	Electronics	100	99
Old gold scrap	338	293	Official coins (sales)	31	46
Gold loans	1		Other fabrication	104	101
Forward sales		198	Bar hoarding	122	180
Option hedging		110	Gold loans		13
			Forward sales	2	
Disinvestment	160		Option hedging	24	
			Investment		50
Total	1,727	1,883	Total	1,727	1,883

Source: GFMS. Totals may not tally because of rounding of constituent figures

STOCK INDEXES

Confounding bull

When we last looked at the stock market, back in late July, we wondered whether the July selloff was merely a correction or whether it was the real thing. While we found the balance to be negative, we cautioned that the climactic July 16 action left enough room for doubt before undertaking an outright bearish posture. *Fortunately*, our strategy was more decisive: we missed establishing new short positions because the September '96 contract did not close again below 629.

Eight weeks later — oh, how things change! — the Dow Jones Industrial Average and the more tradeable S&P 500 Index are making new historic highs, almost every single day. Of course, one can find all kinds of bearish arguments, ranging from overvaluation to frenzied speculation to shrinking profit margins.

The fact of the matter is that the market has continued to confound the majority of experts by smartly rotating from sector to sector and by making tiny — but frightening looking

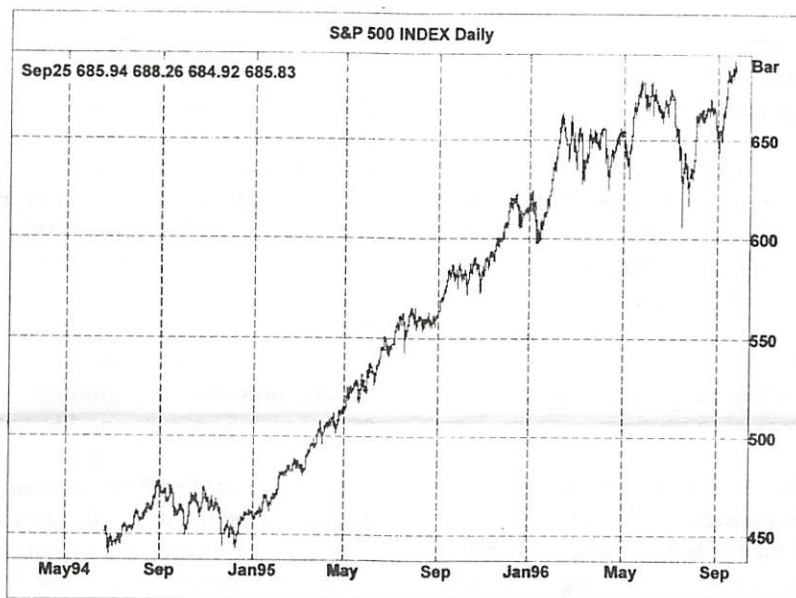
— corrections. A further plus is that the US economy has as yet to show signs of the overheating that is so typical business-cycle peaks, despite the fact that unemployment has fallen to unthinkable low levels, well below the point at which wage inflation should have taken off.

Clearly the stock market is enjoying the best of all worlds: A smooth-sailing economy, low wage and price inflation, a highly accommodative Fed, and a public perception that equities are the ultimate form of investment.

It has also become increasingly clear that the stock market will not turn down for real until there is evidence of price and wage pressures. The longer the Fed persists in its accommodating posture, the greater the odds of an acceleration of inflation taking hold of the US economy.

STRATEGY: *Stand aside.*

Chart 7

**SOFT COMMODITIES**

Corn

Users of corn can breathe a sigh of relief, as the USDA in its September 11 report raised ending stocks to 668 million bushels. This is an increase from last year's panic-stricken 409 million bushel carryover and a healthy uptick from last month's projection for the 1996-97 carryout of 523 million bushels. Can the market indeed relax? We say, hardly.

Growing conditions have been favorable enough for the USDA to raise its September estimate to 8.804 billion bushels from last month's 8.695 billion bushels. Nevertheless, the crop itself is somewhat disappointing in terms of the very early outlook for a 9.3 billion bushel crop.

We consider the call for a 668 million-bushel carryover optimistic. The hike in the domestic consumption guess by

180 million bushels we feel is warranted, whereas the chop of 165 million bushels off exports is short-sighted.

- **Domestic.** Broiler production is expected to grow by up to 6% this coming year. Developing nations, especially Russia, are snapping up cheap, nutritious, and *sanitary* US poultry, because it fits perfectly with their populations' newfound but moderate incomes. The primary market for corn, cattle herds, are expected to grow as well. We read in the Kansas State University's *Cattle Market Update* (August 29): "Given the long-term trend of increasing beef productivity and expectations for continued strength in beef export markets, there is a good chance the liquidation phase of this cattle cycle will be shorter than in previous cycles past. The average liquidation in the past lasted approximately four years. It's possible this liquidation will only last two years.....". Which means that the liquidation of cattle herds triggered by the lack of profitability during the bull market in grains is just about over and herds will be rebuilt.

- **Exports.** Exports in 1995-96 never really made it to the long-touted 58 million tonnes. In fact, by the time the marketing year was over at the end of August, the figure was only 56.21 million tonnes. Caught in the hype, we too were not immune and only a few months ago wrote about a record marketing season of some 60 million tonnes. However, as cash prices flirted with an unheard of and unsustainable \$5.50 a bushel, contracts were cancelled and the market landed with both feet on the ground.

It is not unreasonable to believe that the need and the want is there and has not dissolved, but is merely hiding and waiting to pounce on attractive prices. Export commitments for the new marketing year are running dramatically behind sales of same time last year, as buyers are still recovering from the dizzying heights.

Using the well-worn but vital Chinese argument, their herds are growing and must be fed. They will not be fed with their own corn and substitutes because their capacity for production is limited. They will ultimately turn to the US for corn. Remembering as well, that unlike the Russians who had to stop buying even when they were in need because they ran out of credit, the Chinese are flush with cash, and are simply exercising prudent business practice by waiting until the price is right. With corn now threatening to touch \$3 a bushel, that moment is nearing.

So if we were to equal last year's rather modest export tally, we would have a carryout of only 503 million bushels, putting us right back into danger of needing a perfect crop and harvest.

The contrarian in us noticed some specific predictions in the press the other day: ".....trader sees corn breaking below \$3.00/bushel." It reminds one of the summer of 1994, with corn at \$2.20/bushel and the predictions of large crops pushing corn prices to \$1.70/bushel. From that point the market began its two and a half fold ascent. The real similarity

between the two periods that we look for is in our proprietary open interest monitoring system, which has not confirmed anything yet but, is beginning to show some resemblance.

Another potentially striking likeness is that in the summer of '94 implied volatilities in corn options, a measure of cheapness of options and a gauge of traders' complacency, fell to below 20%. This in a market that measures volatilities as high as 40%. This coincided with the bottom of the market. Implied volatilities are now running below 20% where they were registering numbers as high as 40% only 3 months ago. The market is just as relaxed and complacent.

Imagine just such another opportunity.

STRATEGY: *Stay tuned!*

Soy complex

When we left you in July, the grain markets had encountered a fork in the road. Corn, wheat, and beans were all coming off an exciting season that featured poor crops, complemented by insatiable domestic and foreign demand that just about depleted stockpiles. Forecasts for improved crops in the 1996-97 crop year and a raging demand dampened by soaring prices left the market wondering whether the levels attained could be maintained. A cursory glance at the charts will show that while corn and wheat resolved their dilemma by heading south, the beans took the northbound route. Why?

These patterns become clear as we study production and usage. While stock levels of corn and wheat, at least on the surface (see our discussion of corn), seem to be on the mend, there is no relief in sight for bean stocks. As a matter of fact in their Sept. 11 crop report, the USDA's projection for ending stocks for soybeans of 160 million bushels for 1996-97 turns out to be the most ambitious amongst forecasters. At that, it is below last year's level and represents a downward revision from last month's report.

Supply, certainly relative to what can be expected in terms of previous year's production, is not a problem at home or abroad. US production will be up 5.5% on last year at 2.27 billion bushels (63.05 million tonnes) for the second-largest crop on record. The Brazilians and Argentineans, both heavily counted on to provide for the export market, will register record crops. Brazil will produce 26 million tonnes, an increase of 12% over last year, and Argentina will produce 13.5 million tonnes for a gain of 6.8%.

The issue is one of demand. On the export front, the USDA has lowered its forecast for US exports to 815 million bushels from last year's record 840 million bushels. This is in line with a slow start in new sales for the marketing year that commenced on Sept. 1. Commitments at this time last year were running far ahead of where we are now, but then again beans were fetching \$6.50 dollars where they're \$8 a bushel now. The new demand, created primarily by the emerging economies of Asia, has not disappeared, we believe. Unlike corn, soybeans cannot be replaced as is explained later in this article.

It would therefore not be too arrogant and presumptuous at all to assume that US should at the very least meet last year's export totals, which would reduce carryover stocks to 135 million bushels, or 5.8%, of consumption, which is roughly 21 days' of supply.

For further appreciation of how undersupplied this market could become, consider this: While high prices brought increased total feedgrain production to the tune of 21% rise over last year (253.9 million tonnes vs. 209.2 million tonnes), only a small amount of that can serve as a substitute for soymeal's high protein content. Even those substitutes have not been reliable, in that production of virtually every commercially viable protein feed meal has been in decline, including rapemeal, sunmeal, cottonmeal, and fishmeal. Putting further pressure on demand for soymeal is a sharp drop in use of bonemeal, because of the Mad Cow Disease scare, especially in the countries of the European Union.

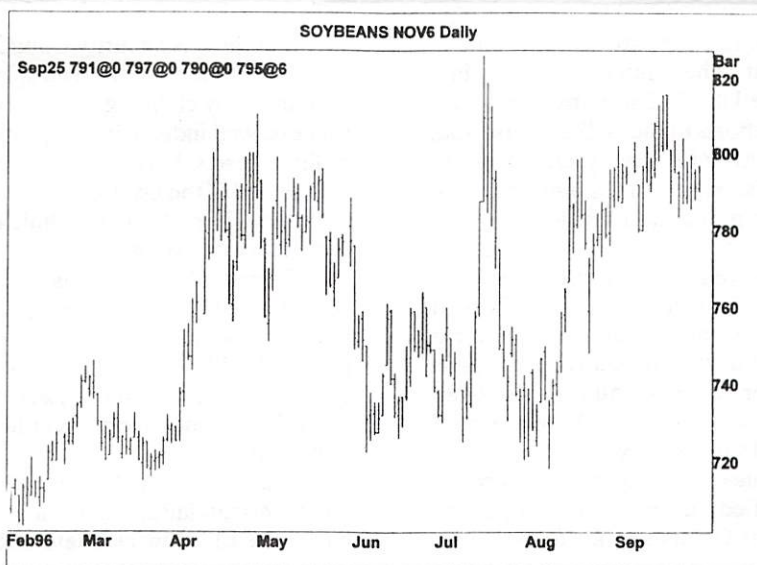
At the same time, usage is expected to boom. Ponder

this somewhat futuristic outlook a friend related to us: Chinese meat production is expected to rise by 5 million tons a year. The ratio of feed to meat needed to feed an animal per annum is 5:1, which would have just Chinese demand alone grow by 25 million tonnes per year! Talk about drawing down stocks. The Chinese could not in the foreseeable future even hope to meet this shortfall by growing it themselves, as production levels have remained stagnant over the past few years, leaving them to look to the overseas markets for imports.

While just about all soybeans are crushed for soymeal, shortages should effect the price of meal more dramatically as users scramble for supplies to feed their animals. Soybean meal remains the favorite horse.

STRATEGY: You are presently long November '96 soybean. Switch this position to December '96 soymeal and place stops at 250, good anytime.

— Sholom Sanik



GLOBAL VIEW

Iraq was another defeat for Alliance politics

by George Melloan

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Brussels — At a small dinner party here Saturday night I asked the Europeans present how Belgians were reacting to events in Iraq. "Iraq?" asked the Belgian hostess. "The only thing Belgians are interested in are the scandals," to which all nodded assent. She was referring to the shocking child murders near Charleroi connected to a pedophile ring now linked, although tenuously, with the murder of a former deputy prime minister, Andre Cools, in 1991.

This downgrading of what foreign policy wonks considered a major event extends far beyond the borders of Belgium. Europeans and Americans alike are more engaged with domestic issues than with what is happening in the distant, dark corners of the world. The French and Germans are preoccupied with economic malaise, wondering if their leaders are serious about reforms. The Italians and Spanish still are taking the measure of new leaders whose parties have never before tasted power. The British are trying to judge the sincerity of Laborite Tony Blair, who could be their next prime minister. Americans, basking in a late summer of full employment and low inflation, seem more concerned with baseball batting averages than with the bad foreign policy won-lost record of their President.

Quite obviously, public perceptions of what is important have shifted in the five years since Boris Yeltsin defied Soviet hard-liners from atop a tank in Moscow, initiating the collapse of the Soviet empire and the end of the Cold War.

In 1991, both Europe and the US were focused on multilateralism, the subordination of purely national goals to broader interests of international unity. The European Community was painting a glowing picture of how it would coalesce, as early as 1992, into a truly unified body and would march on to become the European Union, with a single currency and foreign and defense policy. The US, under George Bush, was skillfully putting together a remarkable European-American-Arab coalition that would force Saddam Hussein's retreat from Kuwait. The United Nations, while lending its imprimatur to the US Gulf initiative, was also gearing up for peacekeeping efforts in the Balkans, Somalia, and Cambodia. The North Atlantic Treaty Organization (NATO) had "won" the Cold War without firing a shot through its staunch solidarity and was preparing itself for a central role in what President Bush foresaw as a "New World Order."

The world looks quite different today. Neither the UN's peacekeeping hopes nor the European Community's bold dream of a historic unity could stand the pressures of even a relatively small war touched off by the break-up of Yugoslavia and the ambitions of the Serbian Communist, Slobodan Milosevic, to fashion a "Greater Serbia" out of every part of the former federation he could successfully put to the sword. America shucked off his conquest as a "European" problem, apparently unaware that a unified Europe existed only in the minds of EC President Jacques Delors and his fellow Euro-

crats in Brussels.

A new American President, Bill Clinton, later displayed little interest in foreign policy, preferring to believe that nasty little problems in that realm could be dumped on United Nations Secretary-General Boutros-Boutros-Ghali. The UN has by now exhausted its credibility and its budget with failed peacekeeping and nation building efforts in Bosnia, Somalia, Cambodia, and Haiti. Its ineptitude has caused serious embarrassments for US and European military forces.

The failures of multilateralism set the stage for the events last week in which Mr. Clinton, in his usual ad hoc way, set about to thwart Saddam Hussein by replicating George Bush's 1991 success at coalition politics. He failed.

At least he failed in substantive terms, although perhaps not in the only context that interests this President, the perceptions of American voters. His formula for a demonstration of "toughness" in an election year was to have US Gulf forces blast Iraqi anti-aircraft batteries with Tomahawk cruise missiles and extend the no-fly zone in southern Iraq to the outskirts of Baghdad. But if the proximate goal of this action was to force Saddam to retreat from the Kurdish territory he had invaded, it failed. Saddam's tanks are still there and his secret police are said to be working actively to bring the Kurdish lands back under Baghdad's control.

More importantly, Mr. Clinton found himself without allies, with the one exception of Britain. Two NATO nations, France and Italy, actively opposed his action, Spain voiced reservations, and Germany had trouble making up its mind, with Foreign Minister Klaus Kinkel voicing only "understanding" and Defense Minister Volker Ruehe later offering stronger support. Turkey and Saudi Arabia, two vital allies in the region, and Jordan, a key player in the Mideast peace process, were openly opposed. Russia and China, taking advantage of Western disarray, on Saturday (Sept. 7) made sure that the UN Security Council lent no support to the US.

Mr. Clinton put his own spin on this major failure of US diplomacy by claiming that his action against Saddam was a success. And indeed, it may prove to be a success in domestic political terms, barring any US casualties. The same may be true as well of the Dayton agreement he concocted for Bosnia, even though the Serbian ethnic cleansers are chortling over the victory it gave them.

These embarrassments to US world leadership may well go unnoticed by most Americans, thanks to a Clinton-friendly press that seems to get special enjoyment from going for a spin with Bill. Foreign policy is not at the top of America's screen in this election year, as best evidenced by the fact that it was hardly mentioned in either the Republican or Democratic conventions.

You can be sure, however, that China and Russia noticed the American failure, that Jacques Chirac of France will not have raised his low estimate of his confrere in Washington,

that Turkey and Saudi Arabia will have seen that it cost them nothing to turn their faces from the West toward fence-mending with their fellow Muslims and that Saddam will be emboldened to try further tests, such as kicking out the UN inspectors who still are searching unsuccessfully for where he is probably hiding chemical, and maybe

nuclear, weapons.

As to the bigger picture, we see the brave 1991 hopes for multilateralism much diminished today. NATO, the UN, and the EU no longer have a clear sense of direction. The world seems to be reverting back to nationalism and even tribalism. So much for that new world order.

FRIEDBERG CAPITAL MARKETS

Foreign stocks: A few more value ideas

In a continuing effort to scan the globe for value, we present to you a number of securities that we believe represent opportunities for above-average yields and capital appreciation. We have been selective in our search and have limited it to three countries: Spain, Finland, and France. The rationale for the former two countries rests in our belief that economic fundamentals warrant our attention, while our interest in French securities involves a special situation that could show interesting results even in the case of a french franc devaluation.

Spain and Finland

Spain has implemented fiscal austerity measures in order to get the budget deficit under control. Last year the deficit stood at 5.8% of GDP¹ while the government has a goal of 3% by 1997. As well, high real interest rates indicate a tight monetary stance on the part of the central bank. Inflation in 1995 was 4.6%, while it is forecast at 3.6% for the current year with further declines expected through the year 2000. Although these measures will involve short-term downside in terms of GDP growth, lower government spending and inflationary control will add to the stability of the currency and make the country a desirable investment destination.

Spanish employment figures point to a decrease in the number of jobless registered at employment offices. The figures released show the 13.5% of the working population were registered as unemployed. Other surveys, however, have this figure closer to 22%. Although these figures differ significantly, their absolute levels indicate that the economy has some distance to go before a cyclical peak — a positive for stock investments. As well, a high but declining unemployment rate, as a lagging indicator, suggests that companies who were able to endure a period of slow growth will have stronger performances going forward.

Finland has also implemented fiscal austerity measures as it contemplates entry into the EMU. The public sector deficit is expected to be 1.5% of GDP next year with total government debt at 61.1% of GDP, slightly above the required criteria. Combined with one of the lowest inflation rates in the European Union (1.0% in 1995 and 1.2% forecasted for 1996), the country is fostering a stable investment environment. The unemployment rate is on a declining trend yet remains high at 17.2%; a situation similar to that in Spain. The reduction of government spending and high unemployment will continue to dampen inflation as it will GDP; how-

ever, the long-term benefits of these measures will enhance the country's stability.

- **Empresa Nacional de Celulosa (ENC)** is a producer and international marketer of cellulose paper pulp. The company is also involved with the environmental protection of forestry as well. ENC is headquartered in Spain and trades on the Madrid exchange. This stock has a P/E (price-to-earnings) ratio of 2.79, a P/B (price-to-book) ratio of 1.11, and a P/S (price-to-sales) ratio of 0.60. These statistics are complemented by a dividend yield of 6.3% (see Chart 8 for relevant index).

The company has made a substantial effort in paying down debt. The absolute amount of debt has declined 50% in the last 3 years and is reflected in the debt-to-total capitalization ratio declining from 43.29% to 19.67% (see Chart 9 for financial ratios). As well, we see increasing margins over the past 3 years, which translates into interest coverage of 9.55 times as measured by the EBIT/Int (EBIT-to-interest) ratio.

- **Enso OY** is an international forestry company that manufactures paper for publications, packaging, and other related products. This international company is located in Helsinki, Finland, and trades on the London International Exchange. The stock has a P/E ratio of 4.97, a P/B ratio of 1.09, and trades at 43% of sales. The current dividend yield is 6.0%.

Although absolute debt levels remain high, there has been a slight but continuous decline over the last three years. More importantly, profit margins have experienced strong growth such that the earnings represent over three times EBIT in interest coverage. Liquidity is adequate with a current ratio of 1.65 times.

- **Energia e Industrias Aragonesas** is a holding company consisting of manufacturers of plastics and insulation. As well, subsidiaries market building materials in Spain and the Netherlands. This Spanish stock has virtually eliminated all its debt through a stock issue. Profit margins have widened dramatically over the last 3 years with the past years' net profit margin at 13.7%. Liquidity and interest coverage have also increased due to increased profits and substantially lower debt service. The stock has a P/E of 3.27, a dividend yield of 12.7%, and trades at 85% of book value, or 45% of sales.

¹Some statistics were cited from The Economist Intelligence Unit.

France

France is experiencing sluggish growth and increasing unemployment. The unemployment rate is currently 12.5% and GDP growth was only 0.4% year-over-year in June 1996. These conditions not only increase the amount of social unrest but put pressure on government finances. This a very precarious position, as it makes the Maastricht criteria difficult to attain.

We believe that if the government is forced to devalue the franc, opportunities exist for companies that produce and export their goods internationally. The diversification would be attractive, because exports from France would increase while domestic costs would remain the same. Repatriated profits from abroad would sustain positive foreign exchange effects, making up for the depreciated currency. Therefore, adjusted for currency effects, these investments will appreciate in value under this scenario due to increased competitiveness as a result of a lower franc.

- **Usinor Sacilor** is a French manufacturer and distributor of steel products with subsidiaries, plants, and distribution centers located internationally. The stock trades on the Paris stock exchange. Geographically, revenues were segmented by approximately 33% in France, 44% in the EEC, 11% in the US, and 12% in other countries. The stock has a P/E of 3.84, a P/B of 0.78, and trades at 22% of sales.

When combined with recent trends and a dividend yield of 7.5%, the stock looks attractive. The company has put a substantial dent in its debt load by paying down approximately 45% of its total debt over the last 4 years. Presently,

the debt-to-total capitalization stands at 38.7%. Other noteworthy trends include a dramatic leap in gross margins, operating margins, and net profit margins.

Combining the debt and profit pictures we see a healthy increase in the company's ability to service its debt. Short-term liquidity has shown an improvement as well and remains at a comfortable level.

STRATEGY: *We believe that these securities are very attractive at their current levels and represent a good investment opportunity for those wishing to allocate a portion of their investments to foreign securities.*

Convertibles update

In our previous issue we recommended two convertible bonds, **Novacare Inc.** and **Sports and Recreation Inc.** Both bonds have appreciated since that time. At current prices (offer), the Novacare convertible is now trading slightly higher than its investment value. As a result, an investor would no longer be receiving a free conversion premium. Consequently, we are recommending that investors not purchase this security at these levels.

Sports and Recreation, however, still trades below its investment value by approximately 100 basis points. Therefore, we continue to recommend this convertible as a yield pick-up opportunity, while obtaining a free call option on the company's equity.

— Peter O'Sullivan

Chart 8

COUNTRY	INDEX	P/E	DIV YIELD
Spain	IBEX 35	20.43	2.67%
Finland	HEX General	15.21	1.76%

Chart 9

Company	Total Debt to Total Cap		Current Ratio		Profit Margin		EBIT/Interest Exp	
	3 Year	Recent	3 Year	Recent	3 Year	Recent	3 Year	Recent
	Average	Annual	Average	Annual	Average	Annual	Average	Annual
Usinor Sacilor	50.17%	38.68%	1.17	1.39	-0.23%	5.65%	2.23	6.06
Emp Nacional de Celulosa	43.29%	19.67%	0.97	1.41	-2.20%	21.42%	3.26	9.55
Enso OY-R SHS	68.47%	62.46%	1.33	1.65	3.90%	8.66%	2.38	3.29
Energia E Ind Aragonesas	35.67%	4.95%	1.32	1.82	1.64%	13.67%	2.93	8.27

Chart 10 – FOREIGN CURRENCY BONDS

DATE: September 25, 1996 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					
World Bank 5 7/8% 4/02/97 RRSP eligible	100.15	-	-	-	Feb-04
World Bank 7 1/4% 13/10/99 RRSP eligible	108.05	108.90	4.07	-	Oct-13
World Bank 9% 13/11/00 RRSP eligible	116.90	-	-	-	Nov-13
Kingdom of Denmark 6 1/8% 15/04/98	103.10	-	-	-	Apr-15
Argentina 8% 5/10/98	102.50	-	-	-	Oct-05
Kgdm. of Spain (6 Mo. LIBOR-1/16) 29/6/02 (semi)	99.89	100.19	-	3.34766	Dec-30
CZECH REPUBLIC KORUNA BONDS					
General Electric Cap. Corp. 10.5% 23/10/98	99.40	100.25	10.34	-	Oct-23
Nordic Inves. Bk 10.625% 10/11/00	99.50	-	-	-	Nov-10
Intl. Fin. Corp 10% 30/4/98	98.40	99.25	10.45	-	Apr-30
SWISS FRANC DENOMINATED BONDS					
General Electric Cap. Corp. 4 3/4% 2/7/98	103.40	-	-	-	Jul-02
General Electric Cap. Corp. 4 1/2% 17/12/99	105.00	-	-	-	Dec-17
DANISH KRONE DENOMINATED BONDS					
Kgdm. of Denmark 9% 15/11/96	100.00	100.85	2.04	-	Nov-15
ECU DENOMINATED BONDS					
United Kingdom 9 1/8% 21/02/01	113.30	114.15	5.41	-	Feb-21
BRITISH POUND DENOMINATED BONDS					
European Inv. Bk. 7% 22/12/98	100.55	101.40	6.29	-	Dec-22
JAPANESE YEN DENOMINATED BONDS					
World Bank 4 1/2% 22/12/97 RRSP	104.55	105.40	0.09	-	Dec-22
CANADIAN DOLLAR DENOMINATED BONDS					
Eksportfinans 7 3/4% 5/11/97	102.40	-	-	-	Nov-05
Royal Bank of Canada 9 1/8% 7/1/97 RRSP eligible	100.85	102.10	1.22	-	Jan-07
Ontario Province 10 5/8% 15/7/98 RRSP eligible	108.85	110.10	4.60	-	Jul-15
SOUTH AFRICAN RAND DENOMINATED BONDS					
ESCOM 11% 1/6/08 (semi)	76.95	77.80	15.09	-	Dec-01
AUSTRALIAN DOLLAR DENOMINATED BONDS					
Toronto Dominion Bk. Aust. 7.25% 26/2/99 RRSP eligible	100.45	101.30	6.62	-	Feb-26
NEW ZEALAND DOLLAR DENOMINATED BONDS					
World Bank 12.5% 25/7/97 (semi) RRSP eligible	102.45	-	-	-	Jan-25
World Bank 8.25% 30/4/99 RRSP eligible	101.25	102.10	7.30	-	Apr-30
New Zealand Gov't 10% 15/7/97 (semi)	100.30	-	-	-	Jan-15
New Zealand Gov't 8% 15/7/98 (semi)	99.75	100.60	7.63	-	Jan-15
Fletcher Challenge 10.75% 15/12/97 (semi)	100.40	101.25	9.60	-	Dec-15
Fletcher Challenge 10.15% 30/11/98 (semi)	100.65	101.50	9.36	-	Nov-30
Tranz Rail Ltd. 10% 15/10/99 (semi)	101.90	-	-	-	Oct-15
Trans Tasman 9% 27/6/99 (semi)	87.75	88.60	14.64	-	Dec-27
St. Luke 8.7% 1/4/99 (semi) CV @ 1.00 p/sh	127.75	128.75	11.04	-	Oct-01
ARGENTINEAN PESO DENOMINATED BONDS					
Bocon Pre 1: 1/4/2001		PAR VALUE		IRR	
	108.35	135.7495	110.10	13.04	May-01-97
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS					
Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh	69.75	-	-	-	Apr-29
Coeur D'Alene 6% 10/6/02 CV@ 26.00 p/sh	88.25	-	-	-	Jun-10
Sports & Recreation 4 1/4% (semi) 1/11/00 CV @ 25.5 p/sh	74.75	76.25	11.73	-	Nov-01
Novacare 5 1/2% 15/1/00 CV @ 26.65 p/sh	88.75	90.25	8.98	-	Jan-15
U.S. DOLLAR DENOMINATED FIXED RATE BONDS					
Queensland Tres. (Gold Bull) 2% 4/3/98	92.80	94.80	-	-	Mar-04
World Bank 7 1/8% 27/9/99 (semi) RRSP eligible	102.30	103.15	5.96	-	Sep-27
T.W.A. 12% 3/1/98 (semi)	99.90	100.75	-	-	N/A
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES					
Kgdm. of Denmark 25/3/97 (Gold call, JY put), (semi)	91.75	-	-	7.534	Sep-25
United Kgdm. 30/9/96 3 mo. LIBID-1/8 (qly), callable @100	99.85	100.15	-	5.3750	Sep-30
Canada Gov't 10/2/99 3 mo. LIBOR - 1/4 (qly), callable @ 100 RRSP eligible	99.60	99.90	-	5.28516	Nov-13
Bocon 1/4/01 (30 day LIBOR) starts paying May 1, '97	117.65	118.50	9.41	-	May-01-97
Argentina: Series L:FRB 31/3/05, 6 mo. LIBOR+13/16 (semi)	82.05	83.55	10.47	6.249375	Sep-30
Venezuela: DCB: 18/12/07, 6 mo. LIBOR+7/8 (semi)	81.50	82.35	11.12	6.625	Dec-20

GOLD (in ounces, at market prices, can also be held in your bond account) client eligibility determined at point of sale.

Chart 11
Recommended current portfolio allocations

1. Queensland (Gold Bull)	15%	5. Cash	15%
2. Trans Tasman 9% (NZ\$)	10%	6. New Zealand Gov. (8%)	20%
3. Sports & Recreation	5%	7. PRE-1	25%
4. St. Luke CV	10%		

HOTLINE UPDATE

Tuesday, September 3, 1996:

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

Friday, September 6, 1996:

Good afternoon for Friday, September 6. We have one new recommendation: Those of you long deutschemark, short yen as a cross, should substitute the long deutschemark leg with British pounds in equal dollar amounts.

Tuesday, September 10, 1996:

Good afternoon for Tuesday, September 10. There are no changes or new recommendations.

Flash Update, Thursday, September 12, 1996:

Good morning for Thursday, September 12, 8:30 am. This is a flash update. Sell December copper at the market, presently trading at 86.60, placing stops at 91.50 stop, good anytime.

Friday, September 13, 1996:

Good afternoon for Friday, September 13. There are no changes or new recommendations. The following is a recap of this weeks recommendations. On Thursday, via flash update, we advised to sell December copper at the market, then trading at 86.60, placing stops at 91.50 stop, good anytime.

Tuesday, September 17, 1996:

Good afternoon for Tuesday, September 17. There are no changes or new recommendations.

Friday, September 20, 1996:

Good afternoon for Friday, September 20. There are no changes or new recommendations.

Tuesday, September 25, 1996:

This is a complete summary since our last market letter dated July 22, of all liquidations of open positions and new recommendations that remain outstanding.

- On Wednesday, July 24, via flash update, we advised to liquidate long September T-bonds, then trading at 109.06, cancelling the 107.27 stop, and to cover short September copper positions at the market, then trading at 93.00.
- On Friday, August 23, we advised to move the protective stop on crude oil to 20.75, close only, basis the October contract.
- On Wednesday August 28, via flash update, we advised to buy December wheat at the market, then trading at 4.64, placing stops at 4.49, close only; December corn at the market, then trading at 3.49, placing stops at 3.31, close only; and November soybeans at the market, then trading at 796.50, placing stops at 754.00, close only. Although both the wheat and the corn were stopped out, the position in soybeans remains open.
- On Friday, September 6, we advised that those of you long deutschemark, short yen as a cross should substitute the long deutschemark leg with British pounds in equal dollar amounts.
- On Thursday, September 12, via flash update, we advised to sell December copper at the market, then trading at 86.60, placing stops at 91.50 stop, good anytime.

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