

25 YEARS

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

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Fraying at the edges

The global speculative orgy is slowly coming apart, literally fraying at the edges.

The drive to increased safety and liquidity so characteristic of very late stages of a boom (see "The futile search for undervaluation", in our February issue) has been concentrating capital in the great financial centers of the world. In the outer circles — the Periphery, to borrow a Pressbichean/UNCTAD expression — one finds Thailand, South Korea, Singapore, Indonesia, Malaysia, and now Philippines suffering from an agonizing withdrawal of "portfolio" flows. This "running for the hills" phenomenon has already had a devastating impact, with *year-on-year* stock market declines of 49%, 41%, 16%, 11%, 8%, and 5% respectively.

In Malaysia and Philippines the bleeding seems to have just begun as the market contends with the extraordinary excesses of the '90s, especially in property lending. As an example, according to official statistics, office space in and around Kuala Lumpur currently stands at around 38 million square feet, but 93 buildings are at present under construction, which are due to add a further 34.7 million square feet by next year. This compares with an annual take-up rate of less than 3 million square feet.

Let there be no doubt that these excesses were indirectly financed by the millions of investors in the Core, who indiscriminately threw gargantuan amounts of money at the emerging markets, most of them hopeless financial black holes. And further let there be no doubt that they — the millions of investors in the Core — were enticed, encouraged, and financed, in turn, by the Fed, the Bank of Japan, the Bank of England, the Bank of Canada, and the Bundesbank.

As the global tide recedes, more and more bubbles in the Periphery will be punctured: Czech Republic, where a serious economic adjustment has just begun, owing to an unsustainable current account deficit and a hugely overvalued currency; Brazil, where an explosion of the twin deficits, trade and fiscal, are about to tear to shreds the Plano Real; Colombia where a bloody civil war is chasing foreign direct investment — and on its coat-tails, portfolio investment — out of the country; Ecuador, where the same thing is happening thanks to chronic corruption and the government's inability to move ahead with reforms. And last but not least, the Former Soviet Union where massive capital flight is being financed by a measly \$2.2 billion of foreign direct investment (lower than the \$2.9 billion that flowed into Peru last year) and just as massive portfolio inflows, raising the inevitable question: Do these foreign investors know more than the Russian mafias? And if, as is very likely, they don't, how long

will it take for disappointment to set in?

Aiding and abetting the senseless enrichment of the Russian criminal classes? The IMF, which has turned a blind eye to Moscow's statistical falsifications and use of creative accounting to hide the fact that tax revenues for the January-March quarter were running less than 40% of forecast. On First Deputy Prime Minister Anatoly Chubais's own admission, this year the state will run a deficit of close to 20% of what it had committed to spend. After holding up 2 installments of a \$10.2 billion loan, the IMF is likely to make one or more disbursements in April merely on the basis of promises. As Mr. Alexander Livshits, Minister of Finance, said a while back, "The money itself [from the IMF] is not that important to us, we can cover *any* [italics ours] shortfall with a Eurobond issue... the important thing is our respect for the Fund. We know what weight they have in the economy."

Even as the IMF withheld disbursements, the Russian government and a number of corporations were able to exploit this relationship (the loan ordered by the Western governments was never canceled, merely postponed) to issue billions of dollars of debt to yield-hungry Western investors.

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

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

Russia intends to make punctilious repayments on its debt so long as the West continues to advance money, *more money than it needs for repayment*.

The fiscal mess, growing capital flight and now debt service will necessitate ever larger transfer of resources from the West. In the not-too-distant future, this requirement will clash with the receding tide of speculative flows, triggering in its turn a painful chain of default.

Investors' growing preference for safety and liquidity has, as is well known, had a pronounced effect on the performance disparity of large and small caps in the US equity market. Just last week alone, the rally in asset prices was led by the Dow Jones Industrial Average, up a respectable 4.9%, followed by the S&P 500, up 3.9%, the Nasdaq (1.3%), and the Russell 2000 Index, which is the best measure of small stocks (+0.7%).

Somewhere in between, the J.P. Morgan Emerging Market Bond Index was up 1.33%, as increasingly its performance comes to parallel the US equity market (a point we have noted on a number of previous occasions and which is now borne out by quantitative methods).

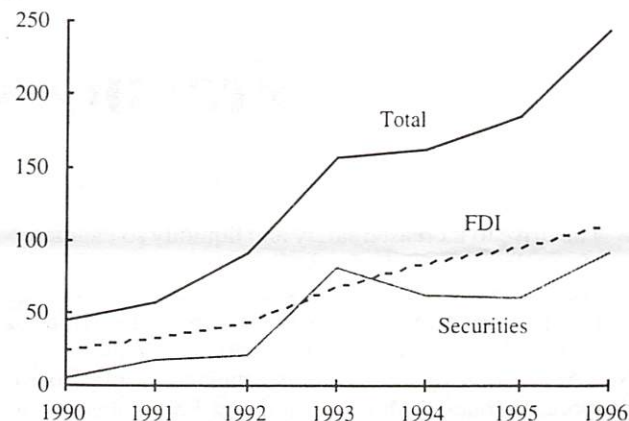
This phenomenon of narrowing breadth, itself the product of increased liquidity and safety preferences, will have an important bearing on funds flowing to the Periphery (see

Chart 1 for a view of the growing magnitudes involved).

The fraying at the edges of the globe is the first sign that more troublesome times lie ahead.

Chart 1

Net private capital flows to emerging economies
\$ billion



Source: World Bank, *Global Development Finance 1997*.

INTEREST RATE FUTURES

Dr. Pangloss, again?

Steve H. Hanke

At its peak in March, the Dow was up 75% over its reading of 2 years ago. By any standard, this qualifies as an asset boom. But is the boom justified, and more important, is it sustainable? Most people answer both questions in the affirmative. Indeed, according to the University of Michigan's survey of consumer confidence, consumers are more confident than they have been in more than 10 years. And that's not all. By the widest margin since 1984, more people expect the expansion to continue uninterrupted over the next five years. Talk about optimism!

There are obvious reasons for these Panglossian sentiments. Indeed, "in this best of all possible worlds" appears to have real meaning today. Consumer inflation, as measured by the CPI, has remained at a fairly steady annual rate of 3% or so since 1992. More remarkable, the price index, excluding volatile food and energy prices, is trending downward, running at an annual rate of 2.5% this year. Furthermore, there are virtually no inflation storm clouds on the horizon, because precious metals prices are lower than they were a year ago.

The real economy appears to be in good shape, too. The economic expansion of the 1990s, which is entering its seventh year, has averaged 2.6% annually, and is displaying a resilience uncharacteristic of earlier periods of such sustained growth. Indeed, no shortages have appeared in the markets for goods, and there is no speculative bubble in the housing and real estate markets. In fact, the market for housing and real property remains depressed, with prices well below those of the 1989-90 period. There's no sign of the traditional boom-bust cycle here. Even the labor market,

which has registered unemployment rates of 5.5% or less for over a year, has been rather benign. No wonder profits have soared, reaching their highest levels since the 1960s.

The pieces of the jigsaw that explain this glorious state of affairs are to be found on the supply side of the economy. American companies have added capacity at a much faster pace in the 1990s than at any time over the past quarter-century. Also, with the dollar's real exchange-rate at its highest level since 1987 and with plenty of international capacity, imports are relatively cheap. No wonder American enterprises have little pricing power.

What about labor? Here again, the labor supply — the total number of people seeking work — has been growing at a 2% annual rate, almost twice its normal rate. Consequently, until recently, labor has had limited pricing power. But that's starting to change, with average hourly earnings creeping up since their lows of last October, and that's where we find Dr. Pangloss's Achilles' heel.

How will higher wage costs play out? With little pricing power in the markets for goods, we don't anticipate a surge in inflation. The markets for precious metals confirm that story. If the prices for goods don't surge, then where will the wage increases come from? The one place in the economy where there is plenty of wiggle room is profits. As wage pressures slowly build, sky-high profits can't be sustained.

This spells trouble for the stock market, particularly since it has been subject to a classic "overshoot" or at least some "irrational exuberance." Indeed, as I concluded in my Nov. 18, 1996, column in *Forbes* magazine, "Dr. X's Bubble

Detector," it was not a good time to buy a dollar's worth of prospective stock earnings. They were (and still are) too expensive. And now I am raising yet another warning flag: The specter of lower-than-expected earnings flows.

Alas, disappointments in the stock market will not be benign. To understand how a lackluster or a correcting stock market will feed back into the real economy, we must focus on the insights of the Cambridge School of Economics. That school, which was founded by Alfred Marshall (1842-1924), stressed that fluctuations in confidence were the essence of business cycles. Indeed, John Maynard Keynes (1883-1946) devoted an entire chapter of *The General Theory of Employment, Interest and Money* to the subject of confidence and expectations. And Frederick Lavington (1881-1927), who was the most orthodox of the Cambridge economists, went so far as to state that there would be no business cycle if there was not a "tendency for confidence to pass into errors of optimism or pessimism."

Thanks to the boom on Wall Street, the American consumers have witnessed a large increase in their paper wealth. This has resulted in strong consumer spending, and alas, a lot of consumer debt. Indeed, if we look at the surging levels of credit card chargeoffs and personal bankruptcies, we conclude that the consumer is tapped out on debt.

Here's where the disappointments on Wall Street will come into play. As paper wealth heads south, so will consumer confidence. Consequently, later this year, consumers will pull in their horns, and consumption will lag. With that will come a slowdown in the economy.

Precious metals prices do not signal an inflation breakout. Moreover, the lack of pricing power in the goods markets confirms that story. With increasing wage pressure, profit margins will be squeezed, and Wall Street will disappoint.

Without the fuel of ever-increasing paper wealth, the fragility of the consumers' balance sheets will become more evident, and consumer confidence will wane, slowing the growth in consumer expenditures and the economy.

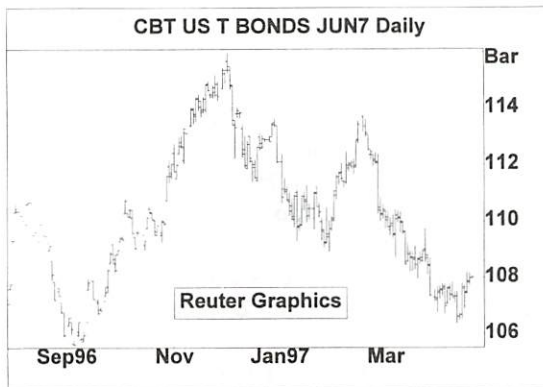
This state of affairs makes for an excellent buying opportunity for bonds, particularly now, when the bonds' bullish consensus is so low.

STRATEGY: Buy June '97 T-bonds at the market, risking 105.00, close only. More risk averse traders may wish to consider purchasing September '97 calls with a 108.00 strike.

On March 20 via flash update, we advised buying June 1998 Eurodollars, then trading at 93.42. Retain stops at 93.00, good anytime.

Steve H. Hanke, Ph.D., is Professor of Applied Economics at Johns Hopkins University, a regular columnist of Forbes magazine, and Chairman of Friedberg Mercantile Group, Inc. in New York.

Chart 2



S&P 500

Technically cautious

Once again positive earning surprises halted a threatening decline. For the first quarter of 1997, average earnings per share gains of 19% year-over-year were reported by 238 companies out of the S&P 500 universe. On a non-weighted basis, average gains were only 5.7%, demonstrating once again that the action is in the big caps. The surprise in earnings comes amidst talk of rising wage cost and lack of pricing power — in short, shrinking profit margins. That this is not so — at least for now — breathes new life into this aging bull market.

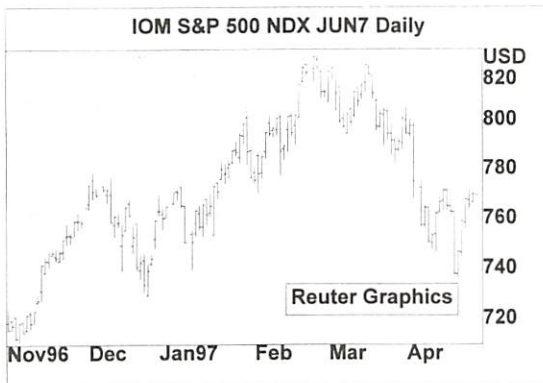
Technical action leaves us uneasy. The low volume decline contrasts rather sharply with previous corrections, especially July 1996, where near panic selling has been an important feature characterizing corrections in this bull market. Furthermore, option activity denotes rising complacency in the face of the sharp decline, a negative technical sign. Finally, breadth continues to narrow as the recovery in the senior indexes is far stronger than the one experienced in Nasdaq or the Russell 2000. The same is true for the advance/decline line and the new high/new lows indicators.

In conclusion, while the recovery looks genuine from a fundamental point of view, technical factors are flashing

caution. We are therefore drawing a line in the sand: 736.70, basis June 1997, the April 14 lows.

STRATEGY: Initiate short positions on any downside penetration of last week's lows.

Chart 3



CURRENCIES

Japan's continuing crisis

Japan's trade balance for the first 20 days of March points to a surplus for a full month of ¥500 billion, up some from February but still well below recent highs (See Chart 4). There are still few signs that the yen's depreciation has had the proper stimulatory effect. At the same time, US authorities have been lobbying rather aggressively against an export-led recovery, perhaps unaware of Japan's fiscal woes.

A more benevolent interpretation is that the US would like Tokyo to offset fiscal tightening with economic deregulation, hoping that the latter would by itself generate domestic demand-led economic growth. Most private sector economists, however, warn that the initial impact of deregulation would be deflationary as prices fall and companies unable to compete in the new environment go out of business. Benefits in terms of economic growth could be delayed for one or two years.

The latest attempts to solve the banks' debt problems were noticeably short on money. Hokkaido Takushoku, the smallest of Japan's commercial banks, which announced that it would merge with Hokkaido Bank, its cross-town rival in Sapporo, received no money.

Nippon Credit Bank, one of Japan's top-20 banks, announced a restructuring, entailing complete withdrawals from overseas operations, the sale of property, including its head office in Tokyo, and staff cuts of more than 20%. To alleviate the bank's alarming bad-loan burden (conservatively estimated at ¥1,000 billion), the BOJ will inject about ¥80 billion and ask (coerce?) a number of financial institutions to buy ¥300 billion of new equity. This strong-arm tactic has

already caused a great deal of resentment and is unlikely to proceed as smoothly as expected. The danger now is that the plan to rescue Nippon Credit will turn into a problem like last year's prolonged stalemate over Japan's 7 failed mortgage companies.

The NCB band-aid is one more indication that despite protestations to the contrary, Japan has not been able to put a system in place to deal with future bank failures. Increasingly, the banking crisis will guide monetary policy and become the most influential short- to medium-term factor in the foreign-exchange market.

German industrial production increased by a seasonally adjusted 1.9% in February, bringing the year-on-year increase to 7.1%. Manufacturing orders advanced again in February; foreign orders (+10.7%) continue to be much stronger in domestic orders (+3.2%). Extraordinary gains in productivity have meant that the upswing continues to bypass the labor market.

Japanese and German officials have indicated that they do not want their currencies to go any lower. The market is likely to continue trading in this range but with a slight upward bias for the US dollar. This is not surprising, given the extraordinary interest rate differential in its favor.

STRATEGY: We advise retaining long positions in Sterling and New Zealand dollars against sales of Japanese yen. Maintain long dollar/yen positions, placing tight, short-term stops at 80.45, basis IMM June '97, good anytime.

Chart 4

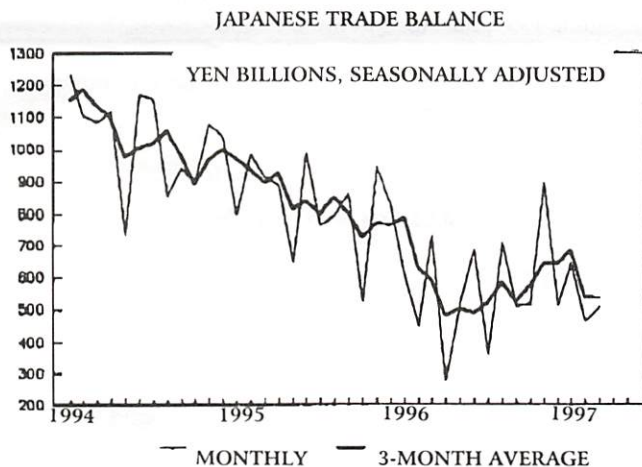
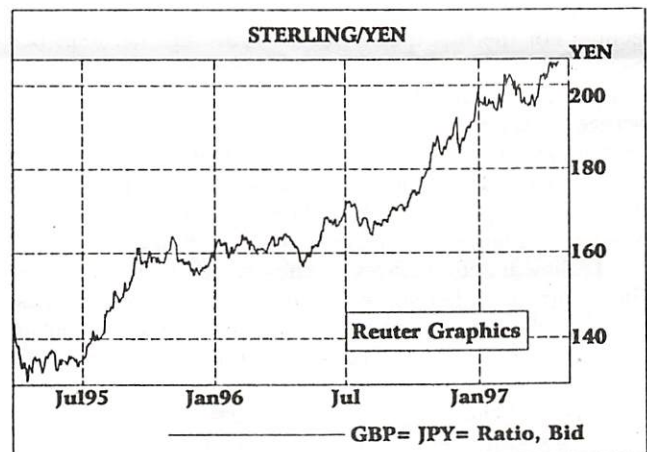


Chart 5



ITALY

The foundering ship of state, the sinking lira

In a continuous exercise in chasing its own tail, Italy's central left government has brought down a new supplementary budget totaling ItL15,500 billion. The government felt the necessity to do so in the face of a worrisome slowdown in receipts and an acceleration in outlays.

The Prodi government has been unable to swing its coalition partners, the Reconstructed Communism (RC), towards pension reform and genuine expenditure cuts. Neither Reconstructive Communism, which refuses to allow cuts in their pensions and welfare system, nor the Party of the Democratic Left, the dominant partner in the government which was reluctant to alienate its electorate ahead of key municipal elections next months, were willing to make significant inroads in the structural nature of public spending. As a result, the fiscal adjustment is merely cosmetic.

At the center of the mini-budget (ItL6,000 billion) is a plan to require employers to deposit funds with the government that the employers now control for the purpose of making lump sum retirement payments. This advance — the government will eventually have to return the funds — is being strongly resisted by Confindustria, the industrialist confederation.

The balance of the mini-budget is made up of revenue enhancements and accounting devices. Some ItL2,600 billion will come from a 6-month freeze on "exit" payments made to public sector employees; ItL400 billion from extending the amnesty period for repaying social security contributions; ItL500 billion from a rise in postal tariffs; ItL1,300 billion from cuts in ministerial budgets; and ItL4,500 billion from banks accelerating payment of the income taxes they handle, alongside a speed-up in inheritance payments.

This trivial attitude towards meeting the Maastricht Treaty public sector deficit target of 3% of GDP is not only ineffective but is also counterproductive. To the extent that it

represents an important contractionary fiscal impulse, it pushes the Italian economy further into recession. (It should be remembered that real GDP fell in the fourth quarter of 1996). In turn, the recession will further depress government revenues and put continued pressure on new emergency measures to stimulate jobs. (Especially in the south where unemployment is 20% already). Moreover, these one-off measures will inevitably rebound with a vengeance in the following fiscal year(s). Finally, the fiscal contraction carries none of the benefits normally accruing to exercises in fiscal discipline by way of improved confidence in the private sector.

The trivialization of the Maastricht Treaty targets has no doubt persuaded the Germans to leave Italy out of the first EMU round. An influential Italian business newspaper reported yesterday that Bonn and Paris were trying to reach an early accord, probably by September, on who would be a founder of EMU and that speculation was mounting that France had taken notice of Germany's intransigent stance towards Spain and Italy.

The coalition government cannot carry through a proper fiscal adjustment, not as long as the RC is part of it. The fiscal measures to date and the ones proposed in the new supplementary budget are downright counter-productive. The economy is contracting and will continue to do so under the weight of the bloated public sector. Not only will Italy miss in 1997 the much sought 3% of GDP public sector deficit target, but many of the problems swept under the rug will come back to haunt it in 1998 and 1999, the critical years for inclusion in a second EMU round. Once EMU euphoria abates, the lira ship will begin making water.

STRATEGY: Last month we advised selling lira against US dollars; remain short.

Chart 8

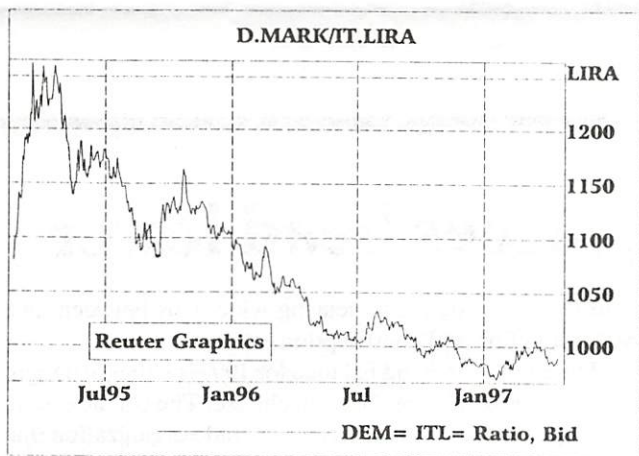
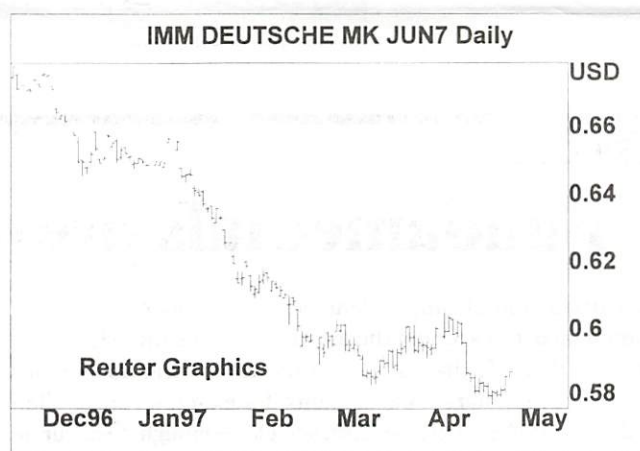


Chart 9



GOLD

The bear trend resumes

The bearish trend has reasserted itself with full force.

The rally from the mid-February lows — more than \$28/oz. from intra-day lows to intra-day highs — was driven by speculative short-covering, which saw open interest on the Comex drop by nearly 30,000 contracts. After reaching heavy overhead resistance in the \$363-\$367/oz. area, prices turned back and began to erode.

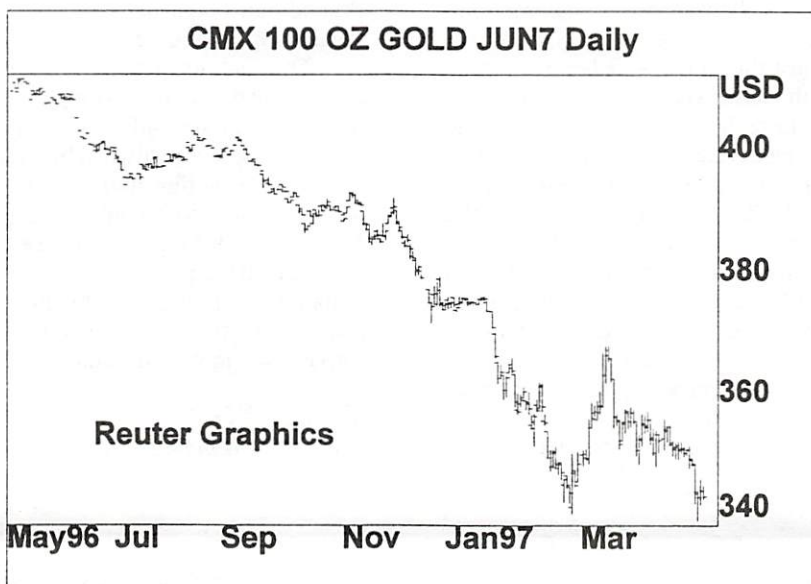
A second phase of short-covering held prices just above \$348/oz. for nearly 4 weeks. Confirming this pattern, open interest continued to fall, this time by an additional 30,000 contracts, taking the outstanding commitment to a multi-year low of 148,000 contracts. At the same time, leasing rates fell to their lowest levels in many months, with 3 months at 1.35% and 12

months at 1.89%, indicating that previously borrowed gold was returning to the market. This fact, coupled with the persistent and less-than-urgent character of the buying, makes us believe that a large producer forward sale was being unwound.

The two short-covering phases have left the market *extremely vulnerable* to a sharp decline. In recent days, as the market challenged the mid-February lows, the open interest began a new expansion phase, indicating that speculative sellers were once again joining the bandwagon. A new downleg has just begun.

STRATEGY: *Remain short; lower stops to \$355/oz., basis June, good anytime.*

Chart 10

**COPPER**

Fundamentals prevail, prices head lower

Any discussion of supply/demand figures related to copper should take into account the erratic reporting infrastructure, or lack thereof, that is the source of information in this market. Grain market participants, for example, are spoiled with the USDA's timely, concise, and close-enough-to-accurate reporting. Agricultural forecasts by independent analysts can vary, but the disputes are orderly. The copper market, on the other hand, lives with sporadic reports whose figures are

contested by participants, leaving wide gaps between analysts' production and consumption estimates.

The supply/demand balance for 1997 is either in deficit, surplus, or even balance: You can choose. The classic case in point happened a few months ago. A trade organization that is relied upon for copper statistics revealed that because of some confusion, a previously reported drawdown of stocks of 520,000 tonnes over the 1993-95 period should actually have

been 50,000 tonnes. This error, annualized, represents about 1.5% of consumption. Imagine imposing such an error on the soybean market! Carryover stocks would jump by 37 million bushels, enough to cause an abrupt halt to a bull market.

Although the market has experienced much volatility, and the price of London spot copper is in a gentle downtrend, the "appearance" of all that copper has left the price of copper today at just about the same level it was when the news broke back in November. Whom do you believe?

The point we're getting at is that one cannot rely solely on the statistics published by this industry's analysts, unless there is a semblance of consensus or confirmation by reliable governments. Recently the existence of the additional stocks was confirmed by the Dutch Central Bureau of Statistics.

The most reliable indicator of price direction will thus have to be the market's behavior, which in our opinion, will manifest itself in the market's inversion or its disappearance.

Last month we began to build a bearish case, and the story of the vanishing and reappearing copper, assuming the latest chapter is the truth, is an indication that the tightness represented in the backwardation was in fact a product of manipulation. Since the game can work only when the holders of copper can deliver the physicals they've been "hiding" at inflated spot prices, a breakdown of the backwardation may be a sign that the other side is no longer falling for the deception. Commercial users will sit patiently on the sidelines and allow the price to come to them.

Some subtle, but perhaps meaningful, evidence may be that prices have failed to respond to a recent, persistent drawdown of LME stocks. Typically a significant movement in or out of the warehouses is enough to trigger a plunge in prices or spark a rally, respectively. Had it not been for the budding strike at Escondida, one of Chile's mammoth mines and producer of 800,000 tonnes per annum, this market was well on its way to breaking multi-month lows.

While the strike at Escondida has the attention of the market at the moment, it will go the way of all strikes and end sooner or later, leaving structural supply and demand unchanged. The news that is more significant out of Chile is that production for 1997 is expected to exceed the 3.3 million tonnes we spoke of last month by 100,000 tonnes. The bearish case starts to gather steam as this massive production begins to come to market.

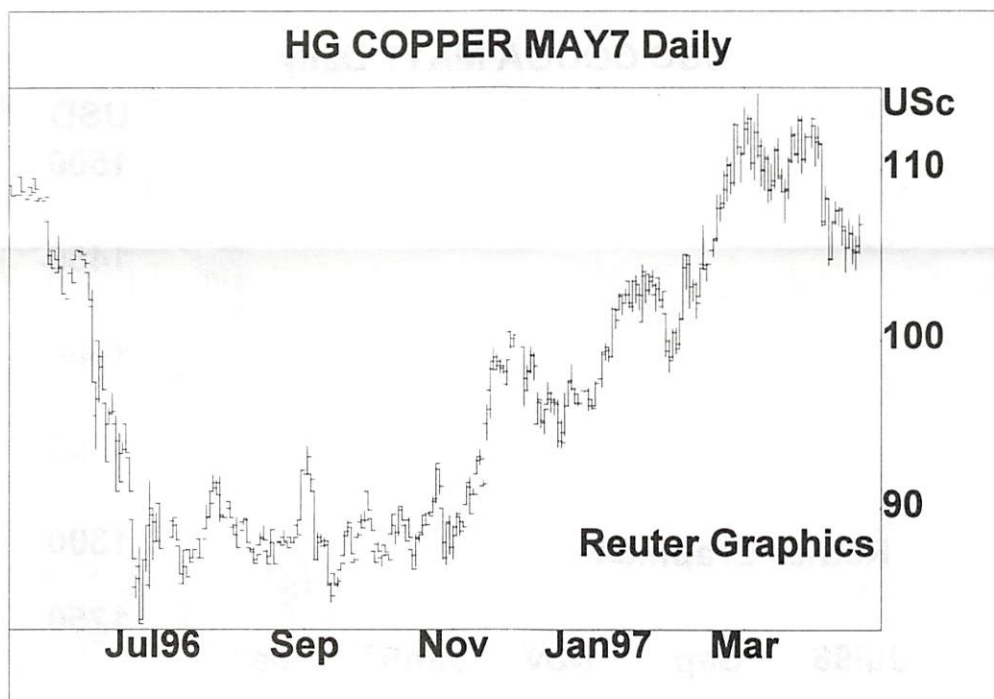
The Chinese will certainly be big, and growing, users of copper, as with other commodities, for years to come. Talk on the street, however, seems to make clear that they've done all their buying for now and their Strategic Reserve Bureau holds, by some accounts, as much as 300,000 tonnes.

We remain bearish.

STRATEGY: Remain short, leaving stops at 114.60, basis May '97, good anytime.

— Sholom Sanik

Chart 11



SOFT COMMODITIES

Cocoa

The other day, an economic forecasting outfit in London reported that their figures for the supply/demand balance for this year will show a deficit that is large enough to bring the key stock-to-consumption ratio down to the mid-30% range. Normally, we, the *very*-long-term bulls, who are shamelessly trading this market from the short side, would have embraced these people and run for cover. So far, we're not running.

For the moment, we choose to view this market as a tale of two markets: London and New York. A cursory glance at charts of July London and July New York would show two markets that are following almost identical patterns. A closer examination reveals that July/December London is £15 in backwardation coming from a £38 contango, or 4.5% of the value of the underlying security. July/December New York has followed in lacklustre pursuit to sit at a \$41 per tonne contango coming from a \$63 per tonne contango, or a mere 1.5% of the contract.

A possible explanation is that there is not enough quality cocoa available to deliver against London, where there is an ample supply of the lower-grade cocoa that can be delivered against New York. Maybe.

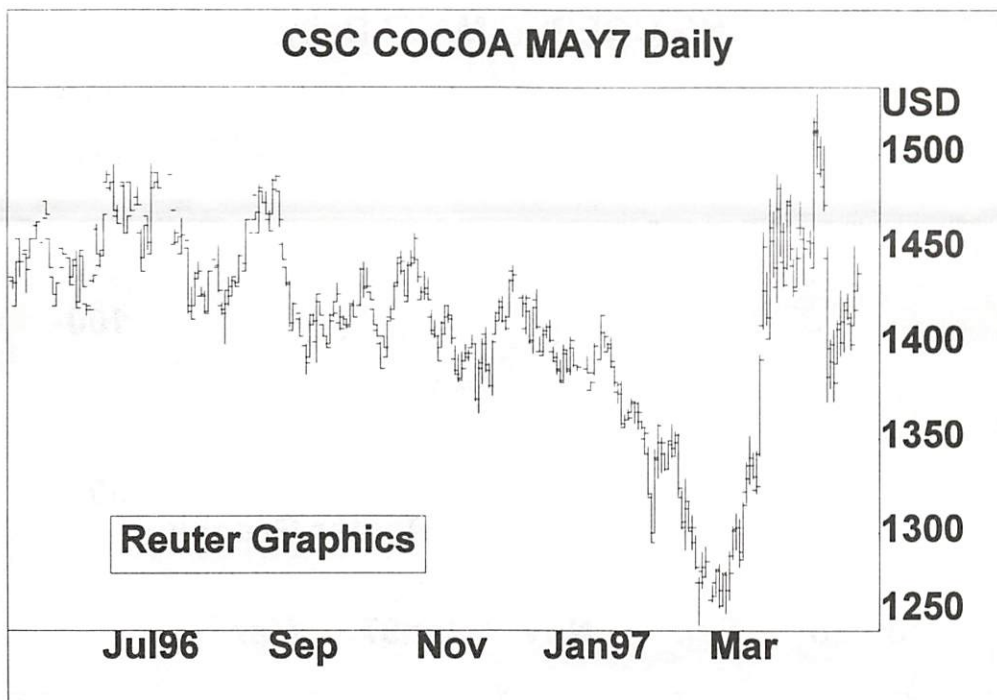
Given that most analysts believe that carryover stocks are still close to 41% of consumption, a supply shortage story of any grade of cocoa is unlikely. The shortage that is showing up in the London spreads is the result, we believe, of a major trading house that is holding, some say, up to 500,000 tonnes off the market, in a bid to stimulate prices and unload when the price is right. It is not as if this is some wild accusation — it has happened before, in this and other markets. Because 500,000 tonnes is almost 20% of consumption, it is not difficult to understand why rallies would take place on either side of the ocean. The tightness, though, appears only where the cocoa might otherwise already have been delivered. New York, as a function of arbitrage, will naturally participate.

Real fundamentals of longer-term significance are the first-quarter grinds that showed mediocre results in Europe but a surprisingly strong showing in the US where grindings were up over 20%.

We still believe that lower prices are needed to eat into the huge stockpiles. The issue of the manipulation will resolve itself sooner or later — we believe to the downside.

STRATEGY: *Remain short, leaving stops at 1562, basis July '97, good anytime.*

Chart 12



Corn

Predicting the course of markets is a tough business at the best of times. This time of year presents a particular challenge for forecasting corn prices. The soy market gets a fresh supply of data to focus on as the South American crops that are being harvested complete the 1996-97 marketing year's picture of supply. The wheat market can watch the harvest of the winter wheat crop as well as plenty of major exporter's crops around the world. Corn stands alone in that the US crop is counted on for some 80% of world trade. Thus, at a time when planting intentions are all we know about the coming crop, it is a no-man's-land. The only concrete item to watch is the supplies from last fall's crop and how current consumption patterns can be used to predict how much of those supplies will be left come September 1.

There are two wild cards in this market: exports and the coming crop. What we can see now is not too positive for prices, but there is no way of knowing how either issue will unfold.

Looking at exports first, the buying binge by foreign importers all but ground to a halt with last year's skyrocketing prices. The marketing year began in September with export commitments that were so limp that a rebuilding of corn stocks back to normal levels was a given. However, as the season progressed, it became clear that price was the issue, and at the right price, large scale purchases would emerge. When the market seemed to have bottomed in early January, the average weekly export commitments jumped about 100,000 tonnes to 708,000 tonnes for that 4-week segment above the previous 4-week segment. The following two 4-week periods saw corn commitments jump to 963,000 and 970,000 tonnes. As price consolidated above \$3.00 per bushel, the buyers became cautious once again as the last 4-week period showed commitments of only 623,000 tonnes. So they are out there; they have just become more selective buyers.

One negative that cannot be ignored is that China may be on its way to self sufficiency. Although massive growth of consumption of commodities in China is an idea that we believe will affect many markets, its production numbers for corn are impressive. The USDA revised the Chinese crop upwards to 122 million tonnes, 4.2% above last month and almost 13% above last year's crop. And it shows. China quickly moved from being a net importer just last year to being a net exporters of 2.5 million tonnes this year.

Moving to the coming US crop, technology in agriculture may cure the wet spring problem that was responsible, in part, for the disastrous crop of the 1994-95 season. As each year goes by, the last planting date keeps moving up as the new generation of seeds requires a shorter growing season, thus allowing for later plantings. We're told that in some corn growing regions, farmers will be able to plant as late as early June. With up to May 10 being the optimum moment, there is still ample time for spring flooding to come and dry out, allowing the farmers to do their work.

The USDA reported earlier this month that planting

intentions for corn are 81.8 million acres, which is more than 2 million acres more than last year and above analysts' expectations. With the decent yields, a crop of close to 10 billion bushels can be harvested.

Given all these bearish angles, one is tempted to make a case for lower prices. There is, however, another perspective. We consider both the exports and new crop to be unknown. What is known is that the USDA ending stocks figure has been dropping every month. Even after slashing exports by 75 million bushels on April 11, domestic use was up enough for them to lower ending stocks by 50 million bushels to 909 million bushels. This is very significant, because at the end of the 1993-94 season ending stocks were 850 million bushels. The following year saw the record crop of over 10 billion bushels, which was not enough to maintain reasonable stock levels to combat the phenomenal export demand that emerged. Hence, the outrageous bull market of 1996 was born. The conclusion is that at these levels of stocks we cannot assume that the bull market is dead. We will continue to monitor exports and the development of the crop to see what the future holds for this market.

STRATEGY: *Remain sidelined.*

Soy Complex

The futures markets were designed to represent commodities at different stages of their production and consumption cycles via an array of contract months that are available for trading and ultimately, delivery. Typically, regardless of whether the market is normal (in contango) or tight (in backwardation), the casual observer might not distinguish one contract from another, because the difference in price is often too subtle. There are situations, however, where the gap between contract months is so stark, one simply can't miss it.

Such are the current conditions in the soy complex. The old crop months, trading either side of \$8.50 per bushel, are still showing prices that reflect the depletion of supplies caused primarily by huge Chinese purchases this past year of both beans and meal. Farmers of the three largest soybean exporters the US, Brazil, and Argentina, responded to the rich prices by planting, or planning to plant, enough to yield what should be record crops. The new crop months are therefore priced accordingly way down below \$7.00 per bushel.

As the long-awaited South American crops become available, the pressure on old crop supplies lightens somewhat. It has become obvious from recent export data that \$8.50 per bushel beans is a number that starts the rationing process. The average export commitments for the past 4 weeks were 301,850 tonnes. The average of the 4 prior weeks was 443,425 tonnes.

Interestingly enough, comparing the same periods for soy meal shows the opposite happening. The average commitments for the past 4 weeks has been 125,000 tonnes, where

the average of the previous 4 weeks was 52,500 tonnes. The likely explanation is that export demand for US beans has clearly been slipping because of price and availability of South American beans. But because of the slowdown in the shipping process in South America — shipments have been delayed by up to five weeks — European and Asian buyers have been filling their short-term needs with meal purchases. Meal has a very short life; it takes only a few weeks for it to start going bad, indicating that all the meal being purchased is for hand-to-mouth use. Buyers are confident, though, that for their longer-term needs, beans will become more plentiful, and there is no great rush to be paying up at these prices.

The April 11 USDA situation report, however, did nothing to alleviate fears of shortages. It's been such a classic bull market, that even the bad news in this market quickly finds something to compensate for it. Despite lowering the annual export total by 5 million bushels for the second month in a row, ending stocks dropped by 15 million bushels to 125 million bushels, the lowest since the 1976-77 season and forming the lowest stocks-to-consumption ratio since the 1972-73 season. The increased demand came from the domestic side.

The shrinking carryover stocks, however, did not spook the market. After opening 10¢ higher the morning of the report, and drawing yet another wave of the naive, the excitement quickly faded. May beans closed the day off 25¢ and to date have yet to match the level of the close of the night before the report.

The price of new crop November is of course being guided by the planting intentions report released earlier in

the month. At 68.8 million acres the report far exceeded the high end of analysts' predictions of 65 million acres.

All these observations lead us to take a very cautious stance. While the old crop is still very tight, the balance of evidence suggests that the market has, for the moment at least, discounted the insatiable overseas demand. A price tag of \$8.50 for a bushel of soybeans is dear. The likelihood that the market is properly priced is strong, which means that the market will trade in this neighborhood for some time. Although we don't often speak of price targets, in this case we feel quite confident that the market will fluctuate between \$8.25 and \$8.60 until further developments come to light.

The new crop, although the price seems very cheap relative to the old crop, is in reality a very high price for beans — high enough to have enticed soy farmers to plant 68.8 million acres of the stuff. If all these acres are planted and achieve the kind of yields the street is talking about, it would clearly mark the end of the bull market. It is too early, though, to call the size of the crop, because we don't know what the weatherman has in store. In addition, if the lower prices of the new crop brings the foreign buyers back and our predictions of exponential growth of Chinese needs is accurate, the size of the crop could be dwarfed. For the moment we feel the direction is not clear, and no large moves in price, either direction, are imminent.

STRATEGY: *On April 7 we advised liquidating May '97 soybean, then trading at around \$279/tonne. This trade, first put on last October, generated substantial profits.*

— **Sholom Sanik**

**Chart 14 — Friedberg Capital Markets
Recommended current portfolio allocations**

1. KIPT 9% cv (NZ\$)	10%	5. Canada FRN (US\$)	30%
2. 10 yr. Bunds, hedged (US\$)	15%	6. The Learning Co. 5.5% cv (US\$)	5%
3. US Treasury 6.25% '02 (US\$)	15%	7. Sports & Recreation 4.25% cv (US\$)	5%
4. Petromet Resources cv 6.5% (CD\$)	5%	8. New Zealand Gov't 8% (NZ\$)	15%

Chart 13 – FOREIGN CURRENCY BONDS

DATE: April 18, 1997

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 PAYMENT
DEUTSCHE MARK DENOMINATED BONDS					
World Bank 7 1/4% 13/10/99 RRSP eligible	107.15	108.00	3.79		Oct-13
World Bank 9% 13/11/00 RRSP eligible	115.55	-	-		Nov-13
Kingdom of Denmark 6 1/8% 15/04/98	101.95	-	-		Apr-15
Argentina 8% 5/10/98	103.10	103.95	5.07		Oct-05
Kgdm. of Spain (6 Mo. LIBOR-1/16) 29/6/02 (semi)	99.83	100.13	-	3.1875	Jun-30
CZECH REPUBLIC KORUNA BONDS					
General Electric Cap. Corp. 10.5% 23/10/98	98.20	-	-		Oct-23
Nordic Inves. Bk 10.625% 10/11/00	99.40	-	-		Nov-10
Intl. Fin. Corp 10% 30/4/98	97.95	-	-		Apr-30
SWISS FRANC DENOMINATED BONDS					
General Electric Cap. Corp. 4 3/4% 2/7/98	102.25	-	-		Jul-02
General Electric Cap. Corp. 4 1/2% 17/12/99	105.15	-	-		Dec-17
DANISH KRONE DENOMINATED BONDS					
Kgdm. of Denmark 9% 15/11/98	107.05	107.90	3.67		Nov-15
ECU DENOMINATED BONDS					
United Kingdom 9 1/8% 21/02/01	113.35	114.20	4.95		Feb-21
BRITISH POUND DENOMINATED BONDS					
European Inv. Bk. 7% 22/12/98	100.00	100.85	6.41		Dec-22
Kgdm. of Denmark FRN 28/8/98 3mo LIBOR-12.5b.p.(qtlly)	99.84	100.14	-	6.125	May-28
JAPANESE YEN DENOMINATED BONDS					
World Bank 4 1/2% 22/12/97 RRSP	102.45	103.30	-0.44		Dec-22
CANADIAN DOLLAR DENOMINATED BONDS					
Eksportfinans 7 3/4% 5/11/97	101.25	102.50	2.89		Nov-05
Ontario Province 10 5/8% 15/7/98 RRSP eligible	106.10	107.35	4.32		Jul-15
Petromet Resources 6.5% 31/3/04 (semi) CV @ \$9.50 p/sh	89.25	90.75	8.28		Sep-30
SOUTH AFRICAN RAND DENOMINATED BONDS					
ESCOM 11% 1/6/08 (semi)	77.70	78.55	15.04		Jun-01
AUSTRALIAN DOLLAR DENOMINATED BONDS					
Toronto Dominion Bk. Aust. 7.25% 26/2/99 RRSP eligible	100.85	101.70	6.23		Feb-26
NEW ZEALAND DOLLAR DENOMINATED BONDS					
World Bank 12.5% 25/7/97 (semi) RRSP eligible	100.65	101.50	6.49		Jul-25
World Bank 8.25% 30/4/99 RRSP eligible	100.60	101.45	7.45		Apr-30
New Zealand Gov't 10% 15/7/97 (semi)	100.00	-	-		Jul-15
New Zealand Gov't 8% 15/7/98 (semi)	99.85	100.70	7.38		Jul-15
Fletcher Challenge 10.75% 15/12/97 (semi)	100.35	-	-		Jun-15
Fletcher Challenge 10.15% 30/11/98 (semi)	100.45	101.30	9.25		May-30
Tranz Rail Ltd. 10% 15/10/99 (semi)	100.60	-	-		Apr-15
Trans Tasman 9% 27/6/99 (semi)	91.25	-	-		Jun-27
St. Luke 8.7% 1/4/99 (semi) CV @ 1.00 p/sh	139.25	-	-		Oct-01
Kiwi Income Prop. Trust 9% 30/9/03 (semi)	119.40	121.40	8.68		Sep-30
ARGENTINEAN PESO DENOMINATED BONDS					
Bocon Pre 1: 1/4/2001	PAR VALUE 138.4945	123.95	125.70	IRR 9.12	May-01-97
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS					
Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh	57.25	-	-		Apr-29
Coeur D'Alene 6% 10/6/02 CV@ 26.00 p/sh	88.25	89.75	8.54		Jun-10
Sports & Recreation 4 1/4% (semi) 1/11/00 CV @ 25.5 p/sh	71.25	72.75	14.38		May-01
The Learning Co. 5 1/2% 1/11/00 CV @ \$53.00 p/sh	74.25	75.75	14.54		Nov-01
U.S. DOLLAR DENOMINATED FIXED RATE BONDS					
U.S. Treasury 6.25% (semi) 28/2/02	98.05	98.35	6.65		Aug-31
Queensland Tres. (Gold Bull) 2% 4/3/98	91.40	92.90	-		Mar-04
World Bank 7 1/8% 27/9/99 (semi) RRSP eligible	101.25	102.10	6.18		Sep-27
T.W.A. 12% 3/11/98 (semi)	94.40	95.25	-		N/A
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES					
Canada Gov't 10/2/99 3 mo. LIBOR - 1/4 (qtlly), callable @ 100 RRSP eligible	99.73	100.03	-	5.25391	May-13
Bocon 1/4/01 (30 day LIBOR) starts paying May 1, '97	PAR: 132.8198 127.80	-	-		May-01-97
Argentina: Series L:FRB 31/3/05, 6 mo. LIBOR+13/16 (semi)	PAR: 97 88.90	90.40	9.45	6.75	Sep-30
Venezuela: DCB: 18/12/07, 6 mo. LIBOR+7/8 (semi)	85.40	86.25	10.77	6.50	Jun-20

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

client eligibility determined at point of sale.

HOTLINE UPDATE

Tuesday, March 18, 1997:

Good afternoon for Tuesday, March 18. Our newsletter is in the mail. Please ignore the 1475 stop, close only, we suggested for the short May cocoa position. Instead, we recommend a new stop: 1501, close only, basis May.

Flash Update: Thursday, March 20, 1997:

Good afternoon for Thursday, March 20, 5:15 pm. This is a flash update. Buy June 1998 Eurodollars at the market, placing stops at 93.00, good anytime.

Friday, March 21, 1997:

Good afternoon for Friday, March 21. There are no changes or new recommendations. The following is a recap of this week's recommendations.

- On Tuesday, March 18, we advised to raise stops on short May cocoa to 1501 stop, close only.
- On Thursday, March 20, via flash update, we advised to buy June 1998 Eurodollars at the market, placing stops at 93.00, good anytime.

Flash Update: Tuesday, March 25, 1997:

Good afternoon for Tuesday, March 25, 2:20 pm. This is a flash update. Buy June T-bonds at the market, presently trading at 109.15, placing stops at 107.20, good anytime.

Flash Update: Tuesday, March 25, 1997:

Good afternoon for Tuesday, March 25, 3:15 pm. This is the second flash update of today. Buy June S&P at the market, presently trading at 798.00, placing initial stops at 781.50, good anytime.

Thursday, March 27, 1997:

Good afternoon for Thursday, March 27. We have one new recommendation. Raise stops on May soymeal to 262.00, good anytime.

Tuesday, April 1, 1997:

Good afternoon for Tuesday, April 1. There are no changes or new recommendations.

Friday, April 4, 1997:

Good afternoon for Friday, April 4. We have two new recommendations.

- 1) Initiate a short position in July cocoa at the market, placing initial stops at 1562, good anytime;
- 2) liquidate May soymeal at the market, cancelling the 262.00 stop.

Tuesday, April 8, 1997:

Good afternoon for Tuesday, April 8. There are no changes or new recommendations.

Friday, April 11, 1997:

Good afternoon for Friday, April 11. There are no changes or new recommendations.

Tuesday, April 15, 1997:

Good afternoon for Tuesday, April 15. There are no changes or new recommendations.

Friday, April 18, 1997:

Good afternoon for Friday, April 18. There are no changes or new recommendations. This is a complete summary since our last market letter dated March 16, of all liquidations of open positions and new recommendations that remain outstanding.

- On Tuesday, March 18, we recommended to ignore the 1475 stop, close only that was suggested for the short May cocoa position. We instead recommended a new stop, of 1501, close only, basis May.
- On Thursday, March 20, via flash update, we advised to buy June 1998 Eurodollars at the market, placing stops at 93.00, good anytime.
- On Thursday, March 27, we recommended to raise stops on May soymeal to 262.00, good anytime.
- On Friday April 4 we recommended to liquidate May soymeal at the market, cancelling the 262.00 stop, and we recommended to initiate a short position in July cocoa at the market, placing initial stops at 1562, good anytime. On Monday, April 7, July cocoa opened at 1472 and May soymeal opened at 279.00.

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Subscription Enquiries for
Friedberg's Commodity & Currency Comments
P.O. Box 866, Suite 250
BCE Place, 181 Bay Street
Toronto, Ontario, Canada
M5J 2T3
(416) 364-1171

Trading and Managed Accounts
All enquiries concerning trading accounts should be directed to:
In Canada
Friedberg Mercantile Group
P.O. Box 866, Suite 250,
BCE Place, 181 Bay Street
Toronto, Ontario M5J 2T3
(416) 364-2700
In U.S.
Friedberg Mercantile Group Inc.
67 Wall St., Suite 1901
New York, N.Y. 10005
(212) 943-5300

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