

25 YEARS

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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Japan on the mend

The sudden and dramatic fall of the \$/yen in recent weeks was all but inevitable given the obviousness of the carry trade. The problem was in knowing when it would happen.

What triggered it was a growing perception that the Japanese economy was still expanding despite the much advertised tightening in fiscal policy that became effective April 1 this year, accompanied by official hints that the time had come to begin raising interest rates. Some initial short covering triggered a minefield of derivatives and options that exploded at close intervals between ¥120 and ¥112, decimating a good number of dealers, hedge funds, and dual-currency bond holders. A reminder that modern markets can react with fulminating speed and violence.

Has the yen experienced more than just a ferocious bear market rally? We think yes. Our *tentative* case is built on the fact that Japan's economy is on the mend, the outlines of a banking resolution are on the horizon, and the deflation is over.

In recent days, economic news indicates that the economy *did* pause in the weeks following the rise in the sales tax. Unemployment climbed to 3.3% in April from 3.2% the month before, as an increased number of companies laid off part time workers. Sales at department stores and supermarkets fell by 8.1% last month from the same period last year, housing starts fell by 9.3% in April (the fourth successive month), and overall construction orders were down by 16.1%. Anecdotal evidence, however, points to a firmer-than-expected pace of business. Economic activity should pick up in coming months, continuing the uneven recovery begun in 1994 (see Chart 1). After all, it is hardly likely that an economy of the size of Japan should contract because of a mere 2 percentage point increase in the sales tax.

More worrisome, at least to the monetary authorities, is the jump in inflation: Consumer prices in Tokyo rose by 1.4% in May compared with the same month last year. This makes 3-month interest rates of 1/2% to 5/8% *negative* in real terms. Has Japan managed to *inflate* out of its banking problem? Will the BOJ countenance this option? Or will the BOJ fight incipient inflationary pressures?

We think the latter is more likely. For one thing, the stock market has reacted favorably to the rise in the yen and indications that interest rates may be going up. For another, Japan's largest commercial banks have whittled down further their bad loans, all along maintaining healthy Basle-based

capital ratios. On the eve of banking deregulation, the monetary authorities and the MOF may have already decided to allow many of the smaller banks to go under or be absorbed while unconditionally supporting the 20 largest banks, and thus allowing depositors of failed institutions to shift deposits into the officially sanctioned list of big banks. This strategy may avoid a full fledged banking crisis if coordinated properly and executed over a *very short* period of time.

The economic recovery has surprised observers, coming in the face of a narrowing current account surplus and the almost complete absence of bank credit to the private sector (see Charts 2, 3). One may perhaps attribute it to the reliquification of the manufacturing sector — the major beneficiary of a more competitive exchange rate — and the household sector. The latter may have benefitted from the sharp acceleration in the rate of growth of M1 begun in the second half of 1994 and attaining its peak momentum at 16% year on year in the first half of 1996. Over the past 12 months, growth has decelerated, but at 9% year-on-year it still remains high. Be that as it may, one can almost certainly say that deflation is

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Contributions by Chris Bradshaw, Albert D. Friedberg, and Sholom Sanik.

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

over. The BOJ, chastised for having allowed an uncontrolled boom in the late '80s, is likely to react quickly to gathering inflationary pressures. Short-term interest futures confirm the view that interest rates are on the rise: September '97 has built in a 35 basis point rise, while December '97 has built in an even steeper 65 bp increase.

Significantly, the mark/yen cross, too, has confirmed a more fundamental change of trend: It has broken below the year-ago lows, leaving behind a huge top formation (see Chart 4).

We now hark back to our January 26 comments, where we found ourselves participating reluctantly in a beauty contest where jurors were asked to choose the least ugly participant from among the US dollar, the deutschemark, and the Japanese yen. While we concluded at the time that of the three contestants, the yen looked the weakest, we suggested

that this was only apparently so. The biggest problem we observed then was continued deflationary pressures on asset values, primarily real estate, which eroded the value of loan collaterals faster than the banks were able to write off these loans. If deflation is truly over, as we believe it is, then the banking crisis is on its way to being resolved. The solution offered earlier on, i.e., to concentrate deposits in the top 20 banks, appears plausible in light of the statement that the 20 largest commercial banks will not be allowed to fail. The economy's firmer undertone may open the way for just such a resolution.

STRATEGY: *We are hesitant to go long yen because of the steep forward cost and the lack of more tangible evidence that indeed a banking crisis has been averted. But our finger is on the trigger. Stay tuned.*

Chart 1

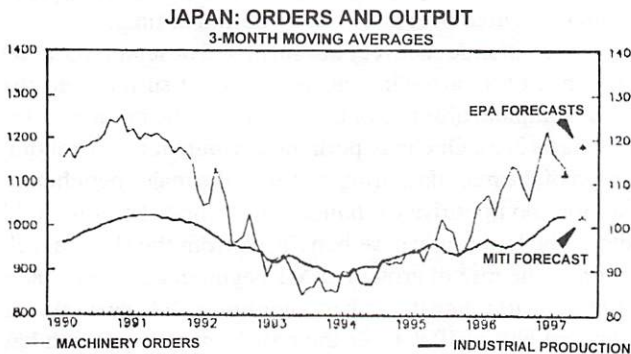


Chart 2

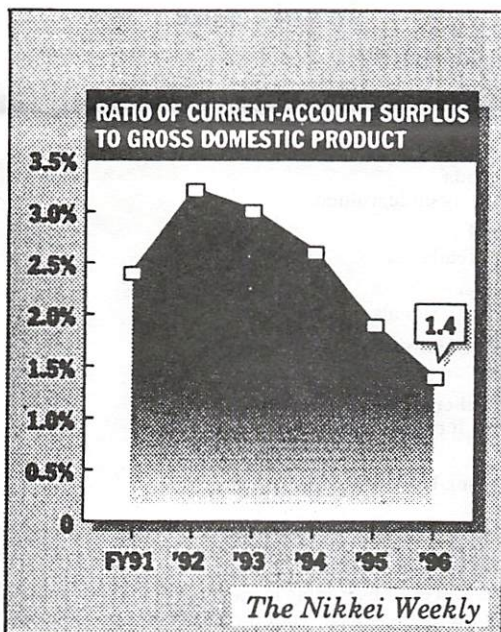
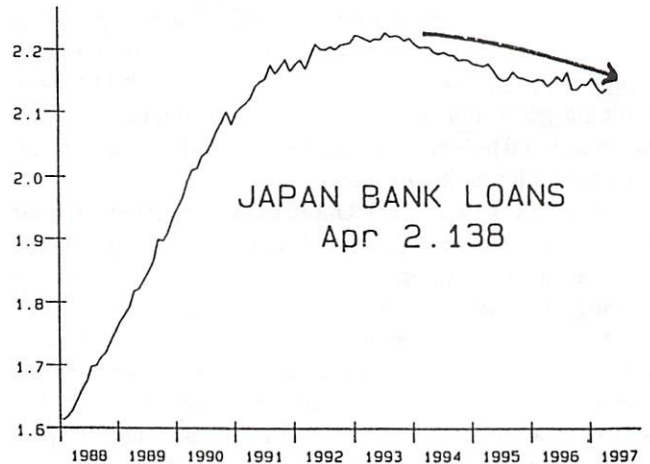


Chart 3



ISI Group

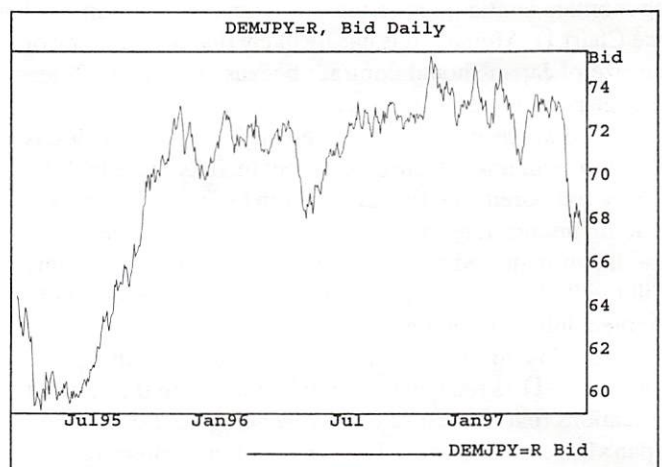


Chart 5

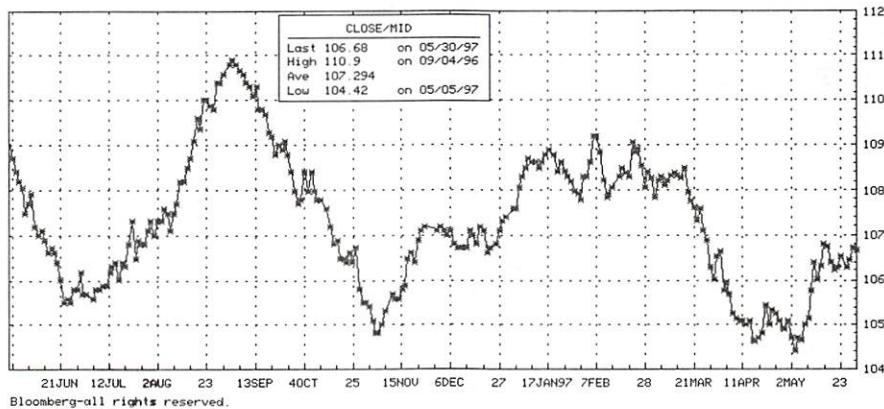
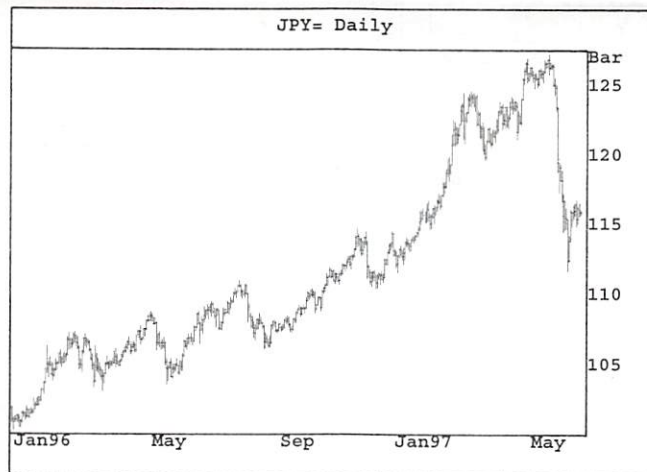


Chart 6



INTEREST RATE FUTURES

The Fed's timidity worries us

An associate of ours (*Global Snapshot*, B.Z.W. Securities Inc., May 15) pointed out that the recent deceleration of inflation in the face of tight labor markets is not unprecedented. Lags between movement and inflation labor market conditions can be substantial. For example, the unemployment rate dropped to 4.9% in January 1973, stayed below 5% for a few more months and did not return to that level until April of this year. Core CPI was unchanged that month, with its year-on-year rate of change falling to 2.5%, a 7-year low. By January 1974, the year-on-year increase in the core CPI was 5.2%. Of course we might add it was not the tight labor market that caused inflation to soar, but rather inflation, i.e., excessive money creation that caused unemployment to fall (although only temporarily in a textbook demonstration of how unexpected inflation can, for as long as it is unexpected, stimulate economic activity) and prices to accelerate.

In fact, commodity prices were already well on their way

to stratospheric heights (see Chart 8). In the words of the 1974 *Commodity Yearbook*, "after 15 years of generally sideways movement, the Commodity Futures Price Index erupted like a volcano and soared to unbelievable highs in 1973-74." In contrast, while commodity prices at this time do not evidence excessive monetary inflation (see article below), asset prices clearly do. This phenomenon was noted by the Chairman of the Fed in his now famous "irrational exuberance" remarks. And yet, the Fed funds rate was left unchanged at the May 20 meeting. As always, this hesitancy will become increasingly more expensive. It is this very "softness" that made us abandon our long T-bond futures position and to liquidate prematurely our June '98 Eurodollar contract.

STRATEGY: Liquidate June '98 Eurodollar at 93.70, or better.

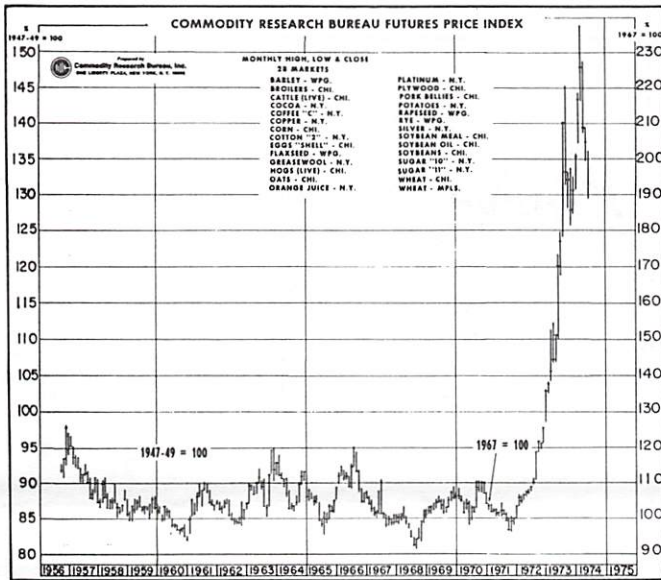
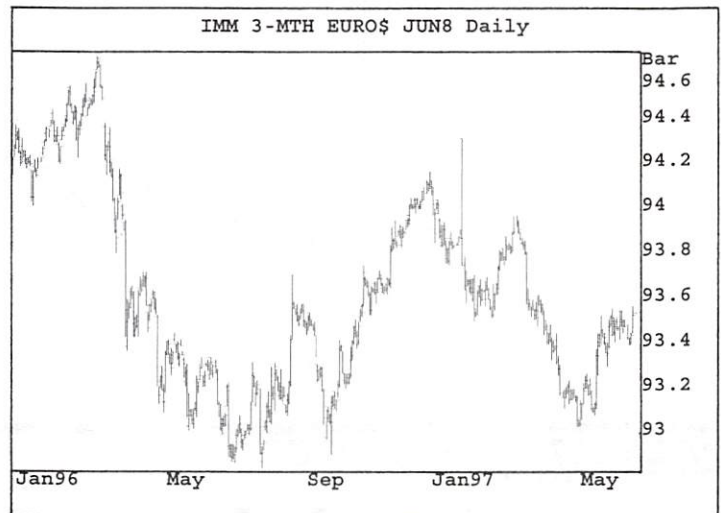


Chart 8

Chart 9



ANALYSIS

A note on commodity price trends

Coffee and palladium speculators have been given a wild joyride, kindling hopes that commodity prices are about to embark on a new bull market à la the '70s.

This may well happen, although not just yet. While the CRB index has recently scored a one-year high, this move was hardly convincing. Dis-aggregating the index by its components, one finds that commodities registering one-year highs barely exceed those that don't, i.e., breadth lags and is quite unimpressive. In the past, this diffusion index has led all major rises and falls in the CRB index (see Chart 10), and there is little reason to suspect that this time it will be different.

A look at other indexes, such as the Journal of Commerce

Industrial Price Index (see Chart 5), confirms this impression: There has been, as yet, no pressure on sensitive commodity prices. This lack of oomph is puzzling for two reasons: The economic recovery is in its sixth year, and even more surprisingly, stock/consumption levels are tighter, on average, than they have been in 20 years. The only reasonable conclusion that we can draw is that market participants, chastised and intimidated by past bouts of boom-bust cycles, have been lulled into living with very low levels of stocks. The sudden and dramatic explosion of coffee prices (see Chart 11), even though rock-bottom stocks have been a fact of life for a number of years, underscore the fragility of such a mind-set and to that extent *may* signal a shift in psychology. We'll see.

Chart 10

CRB vs. Diffusion Index

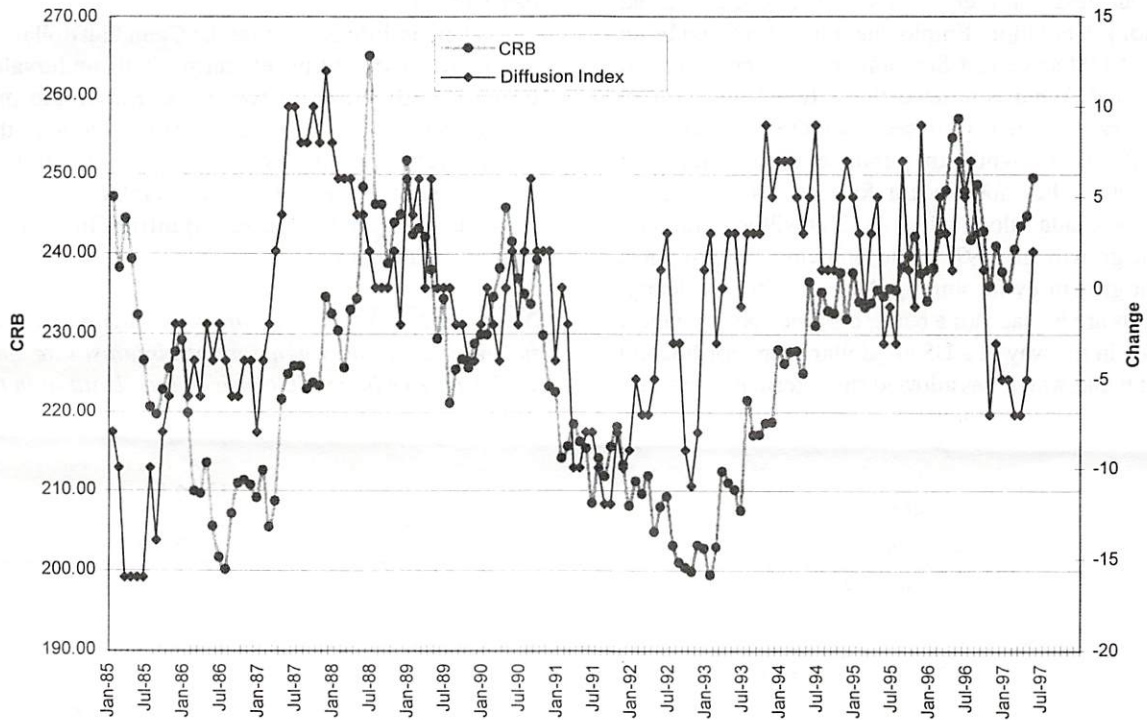
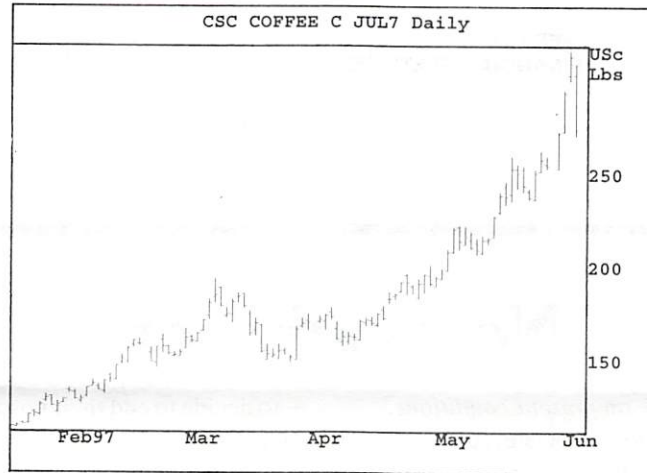


Chart 11



CANADA

Grossly undervalued

If fiscal rectitude was the key to a strong currency, the Canadian dollar would already be trading at US80¢. That is, however, not always the case. What the federal government has accomplished over the past number of years is to bring back its finances from the brink of insolvency: Debt is expected to fall to 73% of GDP this year, more manageable, of course, than the 90% plus of the recent past but still a far cry from a decent 30%-40% range. Specifically, the Federal

deficit in 1996-97 would be no higher than \$19 billion (2.4% of GDP), \$5.3 billion lower than the target of \$24.3 billion (3% of GDP) and \$9.6 billion below last year's.

Happily a substantial portion of the improvement has come from the spending side: Program spending in 1997-98 and 1998-99 will be lower than was originally planned in the 1996 budget. By 1998-99, program spending will have declined for 6 consecutive years and will be nearly 40% lower

than in 1993-94.

The remarkable fiscal turnaround has had a positive impact on business confidence, private sector output, and private sector job creation. Employment has increased by an estimated 166,000 since last September when employment growth resumed. What is noteworthy is that from January 1995 to January 1997 the private sector created 384,000 jobs, more than offsetting a significant public sector retrenchment of 110,000 jobs. The most recent forecast by the OECD projects that Canada (along with the UK) will lead the G-7 countries in growth in 1997, while enjoying the strongest employment growth by far among these countries. Clearly, the ingredients are in place for a better currency performance.

Standing in the way of a US80¢ dollar is an inordinately easy central bank, which has allowed short-term interest rate differentials to fall below their US counterpart by over 250

basis points. This excessive ease is reflected in the Monetary Conditions Index, which hovers close to its multi-year lows (see Chart 12).

There is little doubt that the Canadian dollar is presently grossly undervalued in real terms. This undervaluation can be corrected in one of two ways: Either the nominal exchange rate rises — an unlikely event so long as the Bank of Canada remains excessively easy — or inflation in Canada accelerates and runs well above the inflation rates prevailing in the rest of the industrialized countries. In this case, the real exchange rate rises.

STRATEGY: We recommend buying Canadian dollar futures only if and when 3-month interest rate spreads vis à vis US narrow below 100 basis points. Until such time, stand aside.

Chart 12

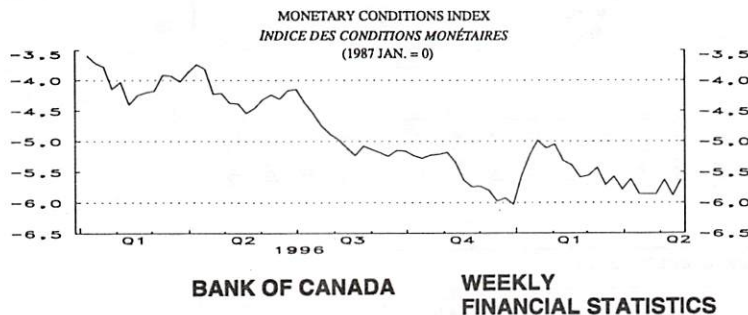
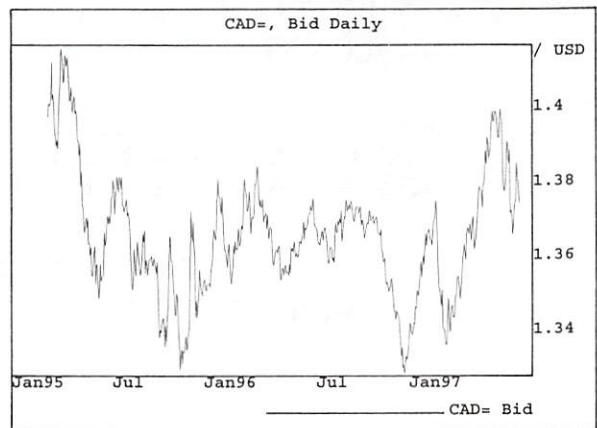


Chart 13



GOLD

Not ready yet

It is hard to conjure up a bullish case on *present conditions*. Financial assets worldwide continue to appreciate, commodity price inflation remains subdued despite the very occasional and inevitable individual run-ups like coffee and palladium, fiscal rectitude is *in*, at least as an attitude, while some governments are able to actually reduce budget deficits. To top it off, large holders of gold have all but indicated that they no longer view gold reserves as a strategic asset and would therefore be willing to “mobilize” these holdings.

The slow demonetization of gold on the part of the more “dovish” central banks (Austria, Belgium, the Netherlands, Portugal, Spain, and the UK) would conceivably add up to supply the equivalent of one year’s mining output. This amount pales in comparison with the approximately 19,000 tonnes of bullion, the equivalent of *nine* years’ worth of mining output that would come to market were the hard-core holders — France, Germany, Italy, Switzerland, and the US

— to decide to end their nostalgic attachment to the precious metal.

While wholesale demonetization is unlikely given the conservative nature of central bankers and the meta-rational attachment to gold held by a large proportion of mankind — and much less over a short span of time — an overhang mentality has begun to grip this market. This “bearishness” will not go away until the overhang perception is resolved. How? It could happen in a number of ways:

- a) Central banks announce that they will not demonetize — unlikely.
- b) Major holders announce an orderly and concerted disposal, perhaps via the BIS, in much the same way the IMF auctioned off gold in the '70s — possible and logical.

- c) China, India, and other dollar-rich Southeast Asian central banks decide to increase their meager gold reserves and absorb, directly or indirectly, the industrialized nations' excess holdings — possible although not very likely, given the present world monetary order.
- d) Commodity prices, fueled by many years of inordinately easy money, stir, financial markets implode, and fears of accelerating inflation and/or massive private sector defaults grip the investing public. Gold begins to rise on these fears, central banks postpone plans to demonetize, stung by criticism that they are no longer reliable guardians of the purchasing power of money and are simultaneously impressed by the prospects of rising prices (they are human too). The overhang perception disappears long enough to spring a massive bear squeeze on the forward sales of complacent gold mining executives, and an explosion of dynamic hedges in the trigger-happy dealer community. Possible. Quite probable. But when?

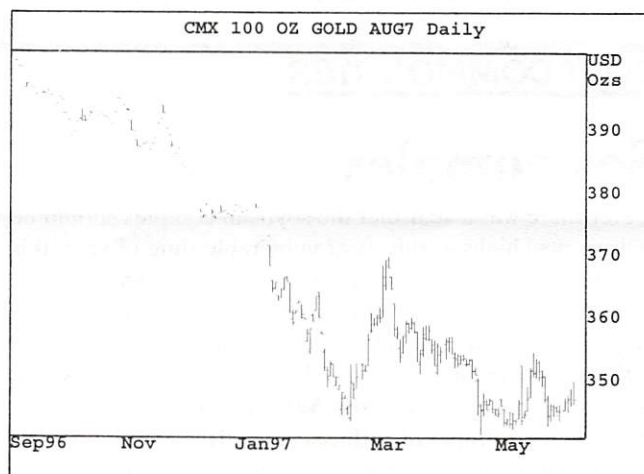
The floating rate regime in operation since 1971 has no place for gold. If the regime can survive the next global crisis, gold will be demonetized. Better, and easier, in a rising market that is oblivious to the ultimate consequences, than at 17-year lows.

It is obvious that the only really bullish scenario, given

the unending supply of excess liquidity, is the one that stirs commodity prices from their multi-year stupor. For now, that is still not in the cards.

STRATEGY: Nimble traders, alert to the goings-on in other commodity pits, should re-establish short position at these levels, risking 355.00, basis August '97, good anytime.

Chart 14



COPPER

Bearish signals

The macro fundamentals by which copper prices are governed and by which traders' sentiments are formed are, certainly on the surface, all bullish.

Down in Chile, the world's largest producer, there are two main issues. First, there is a constant threat of labor disruptions hanging over the industry. The recent strikes at Escondida and Quebrada Blanca mines have ended, but not without the fear of future uprisings. Even though the pipeline of supplies was not affected materially during these strikes, a running premium is attached to the price. The other supply-threatening problem is drought. The nation's mines rely on hydro-electric power. Water levels at reservoirs have been low, and earlier this month some mines lost power for a few hours. Recently, though, there have been good rains, and the threat of power failure has been reduced substantially.

While both problems are real, neither situation has caused more than a ripple in output. They are the kind of stories that surface to keep the market tight. It is a tool used by the forces that reap the benefits of the artificial movements in copper stocks and ultimately prices. Speaking of which, stocks in LME warehouses have nosedived in recent weeks, creating the appearance of runaway demand. The balance of the bullish case is rounded out by the ever-present

possibility of Chinese buying and the economic growth in developed nation's that has lasted longer than most economists expected.

A more sober, longer-term view that doesn't account for traders' sentiment paints a different picture. Back in April when the strike at Escondida kicked off the renewed labor-strike issue, the cash/3-month spread in London quickly reflected the fear of supply shortages as the spread zoomed to \$200 per tonne. The market has had a chance to digest the situation and decide whether a risk premium in the cash *vis-à-vis* forwards has merit. Although prices have moved significantly higher in the past six weeks, the scarcity of supply as measured by the backwardation in London, doesn't seem that dramatic at all as it sits at \$75 per tonne.

More often than not, backwardations and contangos tend to move with the general direction of price. The conclusions that we like to draw from the concepts of normal and inverted markets are invoked all too often; We, too, carry some guilt in this area. The time to consider carefully the widening, narrowing, or as is the case here, sideways movement of the spread is when the spread is not moving with the price. Sophisticated users are buying just enough to meet their needs, while not-so-sophisticated speculators drive prices

higher. The price is pulling away from the spread, creating an aberration that is perhaps telling us that there is no bona fide shortage of supply as suggested by the fundamentals provided by the media.

While it remains dangerous to be short, as the market is quite satisfied with the bullish angle, our long-term outlook calls for supply outstripping demand. The growth of the Chinese economy will definitely keep demand very robust. On the other hand, the efficient market is responding with supply growing at least as fast demand. Using projections for

both supply and demand through the end of 1998, average growth of supply from 1993 will be about 4.5% per annum, while demand will grow by only 4%.

The enormous premium that current prices carry over the cost of production and continued growth of production will combine, one day, to prick the bubble that is this market.

STRATEGY: *Stay tuned.*

— Sholom Sanik

SOFT COMMODITIES

Soy complex

If ever there was a year that the soybean complex should be making new highs at this most vulnerable time of year, this should be it. We are now in soybean-supply no-man's-land. The South American crop is harvested but spoken for. US supplies are, well, ... that's just the point. With 125 million bushels expected as carryover, there isn't much to speak of. Yet, prices have yet to cross \$9.00 per bushel decisively, dampening the hopes of enthusiastic bulls.

In last month's issue we predicted that old-crop beans would trade between \$8.25 and \$8.60 a bushel. Beans traded up to \$9.00, so our numbers were wrong, but the idea that bean prices would not continue to soar was right. The rally that threatened the \$9.00 level, we feel, was facilitated by a new supply side fundamental. Weather problems in South America caused estimates for the Argentinean crop size to dwindle. The USDA confirmed the problems in the May 12 crop report by lowering production to 12.4 million tonnes, a drop of 850,000 tonnes from the previous month. To put this in perspective, the amount lost represents about 25% of all beans that will be left in the US come August 31. The expansion of the trading range by 40¢/bu. was thus warranted.

Viewing the South American story in isolation, the situation becomes even more bullish. The effects of the drought have analysts dropping their estimates for the Argentinean crop even lower, to about 11.5 million tonnes. Brazil's crop, whose estimates crept higher all winter and into the spring, seemed at one point to have the legs to reach 27.5 million tonnes. However, it too was affected by the drought and will now be just over 26 million tonnes.

That is the most bullish development. The other vital components in this market are merely supportive of current old-crop price levels and lead us to believe that a disaster premium is already built in. Export commitments have slowed down from the record-setting clip of earlier this season. They are still on track for the 895 million bushel annual figure predicted by the USDA for the 1996-97 season. However, this has been known for some time, and the slowdown is an indication that the USDA has been right in slowly trimming the annual figure. The most recent commitment data for old-crop beans came in below the low end of analysts'

forecasts at 145,900 tonnes and is significantly below the kind of commitments we've seen this year. Of note, commitments for new crop beans were 345,600 tonnes, a hefty figure. This would indicate that foreign buyers are becoming less desperate and are starting to defer purchases to the much cheaper new crop.

On the domestic side, however, the crush for the week ended May 28 left analysts in the dust, registering 25.462 million bushels, well above the high end of expectations of 23.7 million bushels. This comes after weeks of declining crush figures. Despite the potential of a recovering domestic crush (it is after all only one week's worth of good numbers), there is evidence of rationing of the old crop on both the domestic and export front.

The demand for mighty soybean meal, which has risen by as much as 12.5% against soybean prices in the past year, and is of course the end product that has been responsible for all the frenzy, has suffered a couple of chinks in its armor. This past week's export commitment data showed net cancellations of 11,300 tonnes. Furthermore, hurting the case for old-crop prices in particular, there were commitments of 151,000 tonnes for the new crop, showing clearly, as with the beans themselves that buyers have enough beans to start looking to the more reasonable new-crop prices.

The coming US crop has changed the dynamics of this market. The USDA is calling for a 1997-98 crop of 2.6 billion bushels, 9% higher than last year's crop. The crop looks especially good in light of the fact that as of May 27, 70% of the crop has been planted versus 32% at this time last year, and versus the 5-year average of 45%. Early plantings reduce the chance of frost damage in the fall, as the crops have plenty of time to become fully grown before the first frost.

The market closed out the month of May on a positive note with old-crop prices back to \$8.80 per bushel. Having made the case for an overbought, and at worst a properly priced, market, we concede that if this market once again broke above \$9.00 per bushel, it would be difficult to keep oneself from hopping on for what could be an exhilarating ride.

STRATEGY: *Wait!*

Cocoa

This is certainly a strange bear market. Since cocoa prices broke upwards in February and rallied \$250 a tonne, prices have consolidated and remained suspiciously, for a bear market, close to the highs. Actually, the strongest structural argument for an eventual bull market in cocoa, the ongoing annual consumption/production deficits, has headed in the wrong direction of late, and still the market remains firm.

Every major analyst has lowered forecasted deficit for the 1996-97 season, thereby leaving the 39% stocks-to-consumption ratio largely unchanged. Although the analysts' estimates vary widely, their downward revisions to the deficit were unanimous. The changes came from both the production and consumption sides. Production will still be lower and consumption higher than in the 1995-96 season, but changes were made on both sides.

The new estimates reflect second-quarter grinding statistics, which were not yet published when the major analysts released their previous estimates. The European grindings were quite disappointing, with the US figures being the only bright spot among major grinding countries. On the production side, weather in Western African growing countries has been favorable, accounting for the additional production. This brings shades of last season to mind as a perceived deficit turned into a 160,000 tonne surplus as late season beneficial weather pushed the Ivorian crop to a record yield.

The New York market bears further evidence that grinders are not hot for beans. The September/December spread is slipping deeper into contango. This is probably the best gauge for measuring the relationship between available supply and demand. Some confusion arises, though, when the same spread in London seems to be telling a different story, as it is in backwardation.

We've argued in the past that deliverable grade for cocoa at the London Commodity Exchange is for the higher quality, more sought after, lower bean count per 100 grams. This would make London cocoa more susceptible to tightness. However, there is a more popular story. A large trade house, Phibro, is said to be holding over 30% of the global cocoa supply. Assuming this were true, they could cause a squeeze as they please. They are strong enough to store the cocoa until they get their price. Much of the mysterious strength in this market could well be a result of this manipulation. Ultimately, when this cocoa does come to market and as positions are unwound, prices will collapse, not unlike the Sumitomo affair in the copper market.

Although they should not affect strategies for this year's crop, there are two bullish factors that could affect the new crop and its prices and should be monitored. The quality of a cocoa crop can be forecasted by observing how early the first pods appear on the trees. The early settings, as they are known, are the lowest since 1983. Some analysts have expressed concern that the 1997-98 crops could be affected significantly. The 1983-84 season saw production in the main African producers — Ivory Coast, Ghana, and Nigeria — fall significantly from yields achieved earlier in that decade. The other issue is that there have been reports citing that the Ivory Coast has sold forward as much as 600,000 tonnes of the 1997-98 crop. This eliminates to a great extent the selling pressure that emerges, in this or any commodity, near harvest time.

For the moment, though, the *natural* fundamentals remain bearish. We struggle against the external influences, but a conservative and disciplined approach can keep the patient trader short this market.

STRATEGY: *Remain short with stops at 1507, basis July '97, close only.*

— **Sholom Sanik**

FRIEDBERG CAPITAL MARKETS

Kiwi Income Property Trust (KIP)

A correspondent New Zealand broker has just released the following writeup on the Kiwi Income Property Trust. We concur with his views. In addition we like to note that the macro-economic background remains extremely positive. Inflation should be moving very soon to the lower end of the 0-3% band, measured on the year-over-year basis, which should act as a catalyst to yet lower long-term interest rates. Thus, property trusts would be benefitting from a multiple expansion because of lower interest rates and strong income growth from high absorption rates and disappearing vacancies.

An affiliate of Friedberg Mercantile Group co-manages the Kiwi Income Property Trust.

Recommendation

KIP @ 118 cps: Buy

KIPGA @ 130 cps: Switch to KIP

KIPVB @ 82 cps: Buy if offshore investors

Forecast (Mar Yr.)	95/96A	96/97A	97/98F	98/99F
NPAT (rpt) (\$m)	16.1	21.0	23.8	27.8
EPS (norm.) (c)	6.6	5.7	6.1	7.1
DPS (c)	7.8	8.0	8.4	9.2
PE (x)	17.8	20.7	19.5	16.5
Gross Div. Yield (%)	8.4	8.6	9.1	9.9

Key Ideas

- ◆ KIP has significant exposure to the NZ office property market, which will show strong growth over the next four years.
- ◆ Reported NPAT of \$21.0m was boosted by the acquisition of the Sentry portfolio of buildings in November 1996.
- ◆ KIP is trading at an 8% premium to book NAV of 108cps.
- ◆ KIP ordinary shares offer superior value to KIPGA.
- ◆ KIPVB are preferable for offshore investors.

KIP has announced a NPAT of \$21m for the year ending 31 March 1997, up 30% on 1996. The current result was boosted by acquisition with the first full year's contribution from Sylvia Park, Auckland and Shirley Shopping Centre, Christchurch. The Sentry portfolio acquired in November 1996 also made a contribution. The total dividend for 96/97A was 8.04 cents per unit, equating to a gross dividend of 8.6%, making KIP an attractive income stock.

(A) Office property will provide significant growth

Office property now accounts for 57% of KIP's total property portfolio and will provide the dominant part of earnings growth and capital appreciation over the next four years. KIP's exposure to office property was increased through buying the \$91.5m Sentry portfolio in 1996. The portfolio consisted of two office buildings in Auckland and one each in Wellington and Christchurch. The buildings are generally regarded as of high quality and well located, with good potential for capital appreciation.

The Auckland and Wellington office property markets are poised for a period of significant growth with increasing demand and falling vacancy rates. We expect office rentals to continue to rise from their current \$200-240 per sq. metre (net) to \$350-400 per sq. metre by 2000. Capital values will rise as a result of rising rents. *KIP is well positioned to benefit from the rise in office property values.*

(B) Retail property is currently popular but we remain cautious.

Retail property accounts for 38% of KIP's property portfolio, and consists of a number of shopping malls. We are cautious on retail property and the magnitude of rental increases that many market commentators are expecting. NZ retail sales are currently depressed, which will constrain any increase in retail property rents in the short term. However, we do acknowledge that shopping malls appear to be gaining sales at the expense of the high street shops.

STL, NZ's largest shopping centre operator, is currently trading at a 40% premium to its NAV of 119cps. However, to remove the effect of gearing, we use enterprise values. *STL's enterprise value is currently at a 26% premium to underlying asset values.*

STL has a superb portfolio of shopping centres with undeniable potential for rental growth and further development. KIP shopping malls are smaller and not quite the "destination shopping centres" that makes STL attractive. *If we ascribed a premium of 20% to KIP's retail properties, which is less than the premium of STL, KIP's NAV would rise to 118cps.*

(C) Property revaluation

KIP revalued its property portfolio at 31 March 1997 by \$12.8m, or 2.5%. This is not a large increase and is less than

the 5.5% average increase in the property portfolio in 95/96A. The small increase isn't surprising, as office rents and therefore capital values have yet to move significantly. We expect the growth in office rents to be spectacular over the next few years, which in turn will lead to higher capital values and asset revaluations.

(D) Ordinary units (KIP) or convertible notes (KIPGA)

In our 21 May 1997 paper entitled "How Should One Value KIP Convertible Notes?" we compared the ordinary shares (KIP) and convertible notes (KIPGA). Using the same methodology (and a KIP share price of 118cps), we come to the following values for

- (1) A domestic investor who can utilise imputation credits, a fair value for KIPGA of 111cps.
- (2) An offshore investor who cannot utilise imputation credits, a fair value for KIPGA at 125cps.

Therefore, both domestic and foreign investors should switch from KIPGA to KIP ordinaries.

(E) Ordinary units (KIP) or Class B units (KIPVB)

Investors in KIPVB receive no dividends prior to September 2001. We value KIPVB relative to KIP using present values of future dividend shares. The values are

- (1) A domestic investor who can utilise imputation credits, a fair value for KIPVB of 84cps.
- (2) An offshore investor who cannot utilise imputation credits, a fair value for KIPVB of 92cps.

A foreign investor should switch from KIP to KIPVB. For a domestic investor, the decision is less clear. KIPVB offer better value than KIP but are also less liquid, which makes them less attractive for some investors.

Conclusion

KIP provides a large exposure to the NZ office property market, which is poised for significant growth. AT 118cps KIP is trading on a small 8% premium to book NAV of 108cps. This premium is well justified given KIP's attractive range of office buildings and the premium the market is currently ascribing to retail property.

Switch from KIPGA to KIP.

Buy KIP and KIPVB for exposure to a rapidly improving office market.

This report was prepared by Chris Bradshaw of Garlick & Co. Ltd., New Zealand Research.

Chart 15 — FOREIGN CURRENCY BONDS

DATE: May 30, 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	106.65	107.50	3.85		Oct-13
World Bank 9% 13/11/00 RRSP eligible	115.75	-	-		Nov-13
Kingdom of Denmark 6 1/8% 15/04/98	101.60	-	-		Apr-15
Argentina 8% 5/10/98	103.30	104.15	4.69		Oct-05
Kgdm. of Spain (6 Mo. LIBOR-1/16) 29/6/02 (semi)	99.81	100.11	-	3.1875	Jun-30
CZECH REPUBLIC KORUNA BONDS					
General Electric Cap. Corp. 10.5% 23/10/98	91.85	-	-		Oct-23
Nordic Inves. Bk 10.625% 10/11/00	91.40	-	-		Nov-10
Intl. Fin. Corp 10% 30/4/98	93.00	-	-		Apr-30
SWISS FRANC DENOMINATED BONDS					
General Electric Cap. Corp. 4 3/4% 2/7/98	102.45	-	-		Jul-02
General Electric Cap. Corp. 4 1/2% 17/12/99	105.70	-	-		Dec-17
DANISH KRONE DENOMINATED BONDS					
Kgdm. of Denmark 9% 15/11/98	106.65	107.50	3.56		Nov-15
ECU DENOMINATED BONDS					
United Kingdom 9 1/8% 21/02/01	113.30	114.15	4.86		Feb-21
BRITISH POUND DENOMINATED BONDS					
European Inv. Bk. 7% 22/12/98	99.90	100.75	6.44		Dec-22
Kgdm. of Denmark FRN 28/8/98 3mo LIBOR-12.5b p. (qtlly)	99.85	-	-	6.44141	Aug-28
JAPANESE YEN DENOMINATED BONDS					
World Bank 4 1/2% 22/12/97 (semi) RRSP eligible	102.05	102.90	-0.75		Jun-22
CANADIAN DOLLAR DENOMINATED BONDS					
Eksportfinans 7 3/4% 5/11/97	101.10	102.35	2.01		Nov-05
Ontario Province 10 5/8% 15/7/98 RRSP eligible	106.00	107.25	3.83		Jul-15
Petromet Resources 6.5% 31/3/04 (semi) CV @ \$9.50 p/sh	87.75	89.25	8.61		Sep-30
SOUTH AFRICAN RAND DENOMINATED BONDS					
ESCOM 11% 1/6/08 (semi)	78.40	79.25	14.89		Jun-01
AUSTRALIAN DOLLAR DENOMINATED BONDS					
Toronto Dominion Bk. Aust. 7.25% 26/2/99 RRSP eligible	102.15	103.00	5.36		Feb-26
NEW ZEALAND DOLLAR DENOMINATED BONDS					
World Bank 12.5% 25/7/97 (semi) RRSP eligible	100.20	101.05	4.82		Jul-25
World Bank 8.25% 30/4/99 RRSP eligible	101.45	102.30	6.91		Apr-30
New Zealand Gov't 10% 15/7/97 (semi)	99.70	-	-		Jul-15
New Zealand Gov't 8% 15/7/98 (semi)	100.50	101.35	6.71		Jul-15
Ontario Province 7.15% 24/11/98 (semi)	99.50	100.35	6.89		May-24
Fletcher Challenge 10.75% 15/12/97 (semi)	100.45	-	-		Jun-15
Fletcher Challenge 10.15% 30/11/98 (semi)	101.30	102.15	8.58		May-30
Tranz Rail Ltd. 10% 15/10/99 (semi)	101.90	-	-		Oct-15
Trans Tasman 9% 27/6/99 (semi)	96.15	97.00	10.93		Jun-27
St. Luke 8.7% 1/4/99 (semi) CV @ 1.00 p/sh	152.30	-	-		Oct-01
Kiwi Income Prop. Trust 9% 30/9/03 (semi)	127.30	129.30	7.36		Sep-30
ARGENTINEAN PESO DENOMINATED BONDS					
Bocon Pre 1: 1/4/2001	PAR VALUE 135.6138	122.55	124.30	IRR 8.55	Jun-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	86.75	88.25	9.01		Jun-10
Sports & Recreation 4 1/4% (semi) 1/11/00 CV @ 25.5 p/sh	71.75	73.25	14.46		Nov-01
The Learning Co. 5 1/2% (semi) 1/11/00 CV @ \$53.00 p/sh	79.75	81.25	12.41		Nov-01
U.S. DOLLAR DENOMINATED FIXED RATE BONDS					
U.S. Treasury 6.25% (semi) 28/2/02	99.00	99.30	6.42		Aug-31
Queensland Tres. (Gold Bull) 2% 4/3/98	92.20	92.70	-		Mar-04
World Bank 7 1/8% 27/9/99 (semi) RRSP eligible	101.55	102.40	5.99		Sep-27
T.W.A. 12% 3/11/98 (semi)	99.40	100.25	-		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	99.74	100.04	-	5.5625	Aug-13
Bocon 1/4/01 (30 day LIBOR) starts paying May 1, '97	PAR: 130.0571 126.00	-	-		Jun-01-97
Argentina: Series L:FRB 31/3/05, 6 mo. LIBOR+13/16 (semi)	PAR: 97 92.65	94.15	8.44	6.75	Sep-30
Venezuela: DCB: 18/12/07, 6 mo. LIBOR+7/8 (semi)	90.50	91.35	9.36	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.

Chart 16 — Friedberg Capital Markets
Recommended current portfolio allocations

1. KIPT 9% cv (NZ\$)	15%	5. The Learning Co. 5.5% cv (US\$)	5%
2. 10 yr. Bunds, hedged (US\$)	15%	6. Sports & Recreation 4.25% cv (US\$)	5%
3. US Treasury 6.25% '02 (US\$)	15%	7. Ontario Province 7.15% '98 (NZ\$)	15%
4. Canada FRN (US\$)	30%		

HOTLINE UPDATE

Tuesday, April 22, 1997:

Good afternoon for Tuesday, April 22. There are no changes or new recommendations.

Friday, April 25, 1997:

Good morning for Friday, April 25, 10:59 a.m. This is a flash update. Buy July soybeans at the market, currently trading at 857.50, placing initial stops at 826.00, good anytime.

Tuesday, April 29, 1997:

Good afternoon for Tuesday, April 29. There are no changes or new recommendations.

Friday, May 2, 1997:

Good afternoon for Friday, May 2. We have two new recommendations: Traders who are short copper should adjust their stop to 113.20, basis July, from 114.60, basis May. And lower stops on June gold to 346.20 from 355.00, good anytime.

Tuesday, May 6, 1997:

Good afternoon for Tuesday, May 6. There are no changes or new recommendations.

Flash Update: Thursday, May 8, 1997:

Good afternoon for Thursday, May 8, 5:00 p.m. This is a flash update. Reinstate short June Japanese yen positions at 81.12 or better. Tonight's close was 81.27.

Friday, May 9, 1997:

Good afternoon for Friday, May 9. We have no new recommendations. The following is a recap of this week's recommendations: On Thursday, May 8, via flash update, we advised to reinstate short June Japanese yen positions at 81.12 or better.

Tuesday, May 13, 1997:

Good afternoon for Tuesday, May 13. We have one new recommendation. Raise stops on long July soybeans to 856.00, good anytime.

Flash Update: Wednesday, May 14, 1997:

Good afternoon for Wednesday, May 14, 2:40 p.m. This is a flash update. Cover short outright June Japanese yen positions at the market, presently trading at 85.60.

Flash Update: Friday, May 16, 1997:

Good morning for Friday, May 16, 11:35 a.m. This is a flash update. Sell August gold at the market, currently trading at 348.00, placing initial stops at 355.00, good anytime.

Tuesday, May 20, 1997:

Good afternoon for Tuesday, May 20. There are no changes or new recommendations.

Friday, May 16, 1997:

Good afternoon for Friday, May 16. We have one new recommendation. Lower stops on short July cocoa to 15.07, close only. We repeat

the flash update of this morning to sell August gold at the market, then trading at 348.00, placing initial stops at 355.00, good anytime.

The following is a recap of this week's recommendations:

- On Tuesday, May 13, we advised to raise stops on long July soybeans to 856.00, good anytime.
- On Wednesday, May 14, via flash update, we advised to cover short outright June Japanese yen positions at the market, then trading at 85.60.

Thursday, May 22, 1997:

Good morning for Thursday, May 22, 11:55 a.m. This is a flash update. Liquidate long June T-bonds at the market, currently trading at 109.04, cancelling the 105.00 stop.

Friday, May 23, 1997:

Good afternoon for Friday, May 23. There are no changes or new recommendations. The following is a recap of this week's recommendations: On Thursday, May 22, via flash update, we advised to liquidate long June T-bonds at the market, then trading at 109.04, cancelling the 105.00 stop.

Tuesday, May 27, 1997:

Good afternoon for Tuesday, May 27. There are no changes or new recommendations.

Flash Update: Friday, May 30, 1997:

Good morning for Friday, May 30, 8:30 a.m. This is a flash update. Cover short August gold positions at the market, presently trading at 350.00, cancelling the previous stop of 355.00.

Flash Update: Friday, May 30, 1997:

Good morning for Friday, May 30, 9:00 a.m. This is our second flash update. Sell June S&P at the market, currently trading at 834.00, placing stops at 845.50, good anytime.

Friday, May 30, 1997:

Good afternoon for Friday, May 30. This is a complete summary since our last market letter dated April 20, of all liquidations of open positions and new recommendations that remain outstanding.

- On Friday, May 2, we recommended to traders who were short copper to adjust their stop to 113.20, basis July from 114.60, basis May, and to lower stops on June gold to 346.20 from 355.00, good anytime.
- On Friday, May 16, via flash update, we advised to sell August gold at the market, then trading at 348.00, placing initial stops at 355.00, good anytime, and we recommended to lower stops on short July cocoa to 15.07, close only.
- On Thursday, May 22, via flash update, we advised to liquidate long June T-bonds at the market, then trading at 109.04, cancelling the 105.00.
- This morning, via flash update, we advised to cover short August gold positions at the market, then trading at 350.00, cancelling the previous stop of 355.00.

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