

FRIEDBERG
MERCANTILE
GROUP

**First Quarter
Report
1998**

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Dear Investors,

We have always believed that it is of paramount importance that our investors know the thinking behind the investment decisions we made during the quarter.

As well, we want our investors to understand the modifications and adjustments that have been made in that thinking.

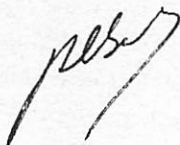
Hence, our policy to be very transparent in these Quarterly Reviews.

In that regard, the 1st Quarter of 1998 has been a challenging one. Overall performance has been less than stellar. Market trends changed and some of the positions we had did not materialize as foreseen.

However, by the end of the quarter we seemed to have regained our balance. We are optimistic about the remainder of the year.

As we have said all along, our mission is to perform well in the long-run - and we are very confident that we will achieve this objective.

Albert D. Friedberg



FOREIGN BONDS

FRIEDBERG FOREIGN BOND FUND

FRIEDBERG TOTAL RETURN FIXED INCOME FUND LTD.

FRIEDBERG TOTAL RETURN FIXED INCOME LP

The quarter presented a very disappointing performance, down approximately 3% on average (slightly more for Canadian-based investors who had to contend with a rise in the Canadian dollar of close to 1%).

Developments in Asia played a particularly prominent role in the poor results. For one thing, the manager believed - until well into the quarter - that the Asian crisis would exert strong deflationary forces on the western economies, aiding generalized perceptions that long-term interest rates would continue to decline. Although we did not buy the whole story ourselves, we believed that the market would. Consequently, long positions in 30-year Treasuries, coupons and strips were reinforced until they represented slightly more than 50% of the portfolio. The dramatic lengthening of maturities was atypical and, we must confess, imprudent. Speculating in interest rates is not part of this bond program's mandate. This is why, in the past, we have rarely strayed beyond the five-year average maturity, probably the best value area in the yield curve for interest rates agnostics. As it was, we exposed the program to substantial capital risk in exchange for minimal yield improvement and the pie-in-the-sky possibility of capital appreciation.

Lack of genuine conviction in the deflationary scenario made us waver at the first signs that inflation was a greater risk than deflation. Vigorous growth in the monetary aggregates, well beyond monitoring ranges set by the Federal Reserve, coupled with inflation in the services sector of better than 3% per annum, was sufficient to force us to make an embarrassing and costly about-face.

This unfortunate operation accounted for almost half of the actual losses for the quarter (aside from the opportunity costs). We exited our long-term position and replaced most of it with a high-quality FRN, which sets its semi-annual coupon at 5.5039%. We then moved to fill in the position with slightly higher-yielding US-dollar-denominated paper but always of a very short-term nature, with maturities not exceeding one year - hence the investment in Argentinian T-bills yielding better than 7% and a sprinkling of some very short-term obligations of a very small number of top South Korean banks. In the fragile and dangerous economic times in which we live, we have come to appreciate the credit and interest rate visibility and comfort provided by short-term notes. We will stay on the look-out for short-term special situations until better opportunities arise in the foreign currency sector.

There was one other way in which developments in Asia affected our performance: their effect on the New Zealand dollar, a sector which constituted anywhere from 25% to 30% of our bond portfolios. This sector incurred the other half of our losses for the quarter. New Zealand's currency, bonds and stocks fell sharply in response to the dramatic decline in economic activity in Japan and the rest of South East Asia, many of which are important trading partners. The decline was aggravated by the unfortunate reaction of the Reserve Bank of New Zealand to these events. Since we discuss this situation in great detail in our latest issue of Friedberg's Commodity and Currency Comments, we do not think it necessary to expand on it at this time (readers are welcome to request a complimentary copy). The upshot of our thinking is that we continue to believe that the New Zealand dollar sector offers outstanding total-return prospects in the medium term (six to 18 months), made up of high current yields (from 9.5% to as high as 19% in a convertible issue), bond and stock appreciation and currency recovery. The country's public and private finances are in exceptionally good shape and the political landscape is tentatively changing for the better; a powerful right wing-libertarian coalition has become a real possibility in next year's election. If sustained, the bullish implications are obvious.

In sum, for the balance of the year we expect reasonable returns, commensurate however with the present level of interest rates. An interesting upside may develop later in the year in the currency exposure, which at this time is still heavily concentrated in US dollars (approximately 70% of the portfolio).

CURRENCY PROGRAM

FRIEDBERG CURRENCY FUND
FRIEDBERG CURRENCY FUND LTD.
FRIEDBERG FOREX LTD.

The quarter opened with a roar and ended with a whimper. We managed, however, to end the period on the plus side, in great part thanks to the momentum carried over from the previous quarter. Our largest gain was the short position in the Indonesian rupiah, a position that was initiated in December 1997 and closed out on January 28, at levels more than 49% lower than those prevailing at the end of March. It contributed more than 40% of total gross profits.

The biggest disappointment of the quarter was covering prematurely a short Greek drachma/long Dm position (6 weeks before the 14% drachma devaluation). Adding insult to injury, we lost approximately 2.6% of the account's net worth on this trade! We had been on the right track but simply lost patience at the sight of improvements in the emerging market sector.

The second disappointment was Brazil's valiant and successful defense of the real. Carrying the short position cost us a not-trivial 10.5% of the opening equity. The cost of closing out the position, i.e. the ask on the real for our date, is close enough to the expected value on due date to warrant riding out the position to maturity.

We have often asked ourselves about the advisability of concentrating our trading in the exotic currencies, where inefficiencies and opportunities are more numerous. Intuitively, we have felt that slippage costs are substantial enough to negate much of the benefit. A semi-scientific calculation of trading costs for the past quarter supports this belief: slippage (bid/ask spreads in the spot and forwards) cost approximately 4.8%, without taking into account size effects. As is quite obvious, this is a very substantial handicap to overcome. Clearly, if there was a reason for not trading frivolously earlier, there is all the more reason now. Just standing still can cost you money.

In recent weeks we have run down positions, retaining a profitable spread, long Thai baht/ short Malaysian ringgit and a small unprofitable one, long Kiwi/short Aussie. Like the cheetah in search of prey, we have stilled our muscles and tensed our senses, putting them on full alert: where will the hunt take us?

DIVERSIFIED TRADING PROGRAM

FRIEDBERG DIVERSIFIED FUND

FRIEDBERG DIVERSIFIED POOL

This program was down approximately 12% for the quarter. All the losses were accounted for by trades in four different positions: Silver, Gold, Cocoa and T-bonds.

While our bent on silver was to be long, its extreme volatility stopped us out twice for a net loss of more than 1% of the program's initial equity. Volatility and, more importantly, high slippage may prevent us from reentering this market for the foreseeable future, unless it is with a very small position. We see our mandate, however, to identify profitable opportunities and then to back into them as aggressively as our risk controls will permit, aiming for meaningful profits. This implies leverage ratios well in excess of one to one, a nearly impossible situation for now in the case of silver.

In T-bonds we had the improbable distinction of losing money on both sides of the market, first on the long side and then on the short side, for a total loss of more than 4% of initial equity. This pattern of trading followed closely on the metamorphosis that occurred in our interest rate outlook: we moved from a belief that deflation was about to occur (if only for a very short period of time) to a belief that inflationary forces were gaining the upper hand, driven by an explosion in the monetary aggregates.

We remain of the opinion that the next big move in bonds is down and are attentive to a slight change in its upward momentum on which we could capitalize.

In the meantime, we have established a short position in the 10-year Japanese Government Bond (JGB) contract traded in Japan, which trades at an implied yield of 1.6%. Aggressive easing by the Bank of Japan is sure to stoke inflationary pressures before too long. It is interesting to note that underlying consumer price inflation in Japan is running at a surprising annualized rate of 1.7%, making the JGB yield negative in real terms.

Finally, sensing a change in direction, we liquidated a short position in gold midway through the quarter at around the \$297 level, booking a loss of approximately 4.8% of initial equity. Soon thereafter, we established a long position around the \$295.60 level, a position that we still carry at this writing. The medium-term bullish argument has to do with the herd mentality of mining companies, which have begun to take "profits" on their forward sales. The market is not only being deprived of a regular source of supply (around 300 tonnes, or 7.5% of total supplies, per annum) but is contending with a new source of demand (an indeterminate amount, as we have no way of knowing how much forward gold is being bought back), which may be equally if not more bullish. At some point, of course, mining companies will be tempted to reenter the short side and lock in profitable gold prices. When? Our guess is as good as anyone else's, but \$340-350/oz. basis spot seems reasonable.

The big scores - a reversal in financial futures - still lie ahead. We hope not to disappoint you, or ourselves.

FRIEDBERG GLOBAL OPPORTUNITIES FUND LTD.

The Global Opportunities fund combines the Diversified Trading program with a global securities program. As such, the following remarks should be read along with our earlier comments on the Diversified Trading program.

The salient feature of the quarter was the substantial loss taken on what had been heretofore a spectacularly profitable position: a short position on Japanese bank stocks. The rebound off the lows in mid-January was dramatic and totally unexpected leaving the account down a full 15%, the total extent of the blowout provisions; thankfully, this failsafe mechanism protected the program from a much more serious impairment.

In addition to cutting back the position, we hedged the remainder via Nikkei futures and a sprinkling of sold-out construction stocks that would be obvious beneficiaries in a contemplated reflationary fiscal package. We chose to maintain a reduced level of short positions in a number of weak, medium-sized banks (we have studiously avoided money-centre banks as they are likely to be bailed out, come what may).

We still believe that most of them are insolvent and it is only a matter of time before this fact is recognized.

Our intention is to scale back the long hedges on weakness, leaving us exposed once again to a net short position - admittedly, on a smaller scale. We have been reminded once again that extreme volatility can erupt literally from nowhere, with devastating effects on highly leveraged positions. This is the dilemma confronting every leveraged fund manager: small positions are not meaningful and too large a position can be deadly. Good risk management rules can only control the damage, not avoid it. In the end, deciding on the "right" size of a position is probably a fund manager's most important decision; unfortunately, it is an art, not a science.

And now for a bittersweet observation: even after the significant draw-down for the quarter (-34%), the fund is still up a little over 4% from its inception in June 1997. While the return is far from being good (an annualized 5.3%), it emphasizes a point that we have made repeatedly over the past months and years: when dealing with speculative funds, and provided that you are happy with the manager, buy the down-ticks, not the up-ticks. Anytime a manager is down 20-25%, buy some units (after you have made sure he has not lost his mind). Remember, even the best manager will occasionally have a cold hand. Use it to your advantage.

EQUITY HEDGE PROGRAM

FRIEDBERG EQUITY HEDGE FUND LTD.

FRIEDBERG TORONTO TRUST EQUITY-HEDGE FUND LTD.

It was a disappointing performance for the quarter, down a little over 3%.

In reviewing the trading activity for the period, we found an unusually large number of short positions that did not pan out as expected, testimony perhaps to one of the most powerful and broad-based upward thrusts in market history. That is, of course, not the whole story; a great deal of the underperformance had to do with the aberrant behavior of a number of companies that we had shorted and that advanced in the face of very poor fundamentals and/or extraordinarily high valuations.

Such was the case for Triton Energy (still open), which advanced from 29.188 to 36.75 during the quarter, despite sharply falling oil prices, an extremely hostile environment (guerrilla attacks, sabotage) in its main area of production (Colombia) and continuous failure to generate meaningful cash flows. Or the technology company Xilinx (closed out), which moved from 35.063 to 46.938 despite sporting a fancy price/sales ratio of 5.2 (amid sharply slowing sales) and heavy insider sales. Or, finally, acquisition-hungry casino operator Harrah's Entertainment (also closed out), which advanced to 24.625 from 18.875.

The company operates in a mature industry, suffering from growing overcapacity, and is heavily indebted; yet it commands a growth stock multiple. Carson (still open), a producer and marketer of hair-care products for African-Americans, our worst single short position, moved from 6.688 to 10.063.

As expected in the type of market we experienced over the past few months, the long side proved more rewarding. Sixteen of 24 issues we held at some point during the period showed gains ranging anywhere from 0.16% to 55.2%. The two largest percentage winners were Celtrix Pharmaceutical and Lehman Brothers. The former is an exciting biotechnology outfit developing novel therapeutics for the treatment of seriously debilitating, degenerative conditions primarily associated with severe trauma, chronic disease or aging, which sells at only 83% of 5 year R&D per share (the M ratio, a valuation yardstick conceived by Michael Murphy, author of the California Technology Stock Letter). The latter, an investment banking firm, has shown much improved management in recent years and is still selling at a reasonable price-to-book and price-to-earnings valuation. It is an obvious takeover candidate.

To maintain a market-neutral posture we had to vary (primarily upwards) almost continuously our ratio of long positions to short. Starting from a ratio of 53/47 at the beginning of the period, we ended the quarter with an unusually high 62/38 ratio, a result perhaps of the increased volatility of our short portfolio. Total leverage (longs plus shorts divided by net assets of the fund) at March 31 stood at a healthy 2.36, almost 15% higher than at December 31, 1997.

It is important to keep in mind that a market-neutral fund such as ours does not seek to profit from directional market moves. As such, its proper benchmark is not the S&P 500 but a T-bill rate plus some added measure for volatility-of-returns/risk. The fund does seek to profit from the successful selection of individual stocks, long and short, while trying to maintain at all times a posture that is neutral with regard to market direction.

Shorting overpriced stocks that will decline during a bull market is a difficult exercise that can lead to substantial losses. Doing so while protected by a portfolio of attractively priced long positions is a slightly less dangerous exercise; we need only make sure that the short positions rise less than the longs. Similarly, buying undervalued stocks during a bear market can lead to large losses. Doing so while protected by a portfolio of overpriced shorts is far more comforting; we need only perform relatively better than the market.

For a market-neutral manager to succeed, then, he must succeed in two areas: proper selection - longs that will rise relatively more than the market and shorts that will decline relatively more than the market; and proper balance between longs and shorts so that the underlying market trend does not dictate results.

In this light we can say that the large number of closed-out short positions and the paucity of relative winners on the short side (only 14 of 22 stocks declined absolutely or rose less than the market) were the primary drivers behind the quarter's poor results.

March's strongly positive results, however, allow us to end the discussion on a hopeful note.

NEW ZEALAND

FRIEDBERG NEW ZEALAND FUND LTD.

NEW ZEALAND EQUITIES FUND

FCMI KIWI EQUITIES INVESTORS

Reflecting a worldwide trend towards large capitalizations, the NZ40 handily outperformed the more junior indices. This situation affected us, in view of the fact that our portfolios have consciously overemphasized the smaller company sector, where we have felt that outstanding values can be acquired.

We present below a table of our 10 largest holdings and some relevant financial statistics to offer you a flavor of the type of investments we have pursued:

9 LARGEST HOLDINGS OF THE PROGRAM

	Price/Sales	Price/Cash Flow	Price/Net Tangible Assets	Gross Dividend Yield
Kiwi Income Property (1)	N/A	10.75	1.03	12.10%
St. Lukes (1)	N/A	5.69	0.92	12.80%
Fisher & Paykel	0.79	11.52	1.64	4.90%
Trans Tasman (1)	N/A	19.16	0.62	12.00%
PDL Holdings	0.32	4.09	1.36	7.90%
Hallensteins	0.57	4.87	2.88	15.80%
DBG Groups	0.41	4.08	1.20	10.10%
Lane Walker Rudkin	0.38	0.00	0.85	18.70%
Air NZ [®] B [®]	0.36	4.67	0.68	11.50%

N/A Not Applicable

(1) Property Trust

These financial ratios compare very favorably with corresponding ratios for similar industries in the North American and European markets. This is true not only for our largest holdings but also for the overall market.

The median values for most of the listed companies on the New Zealand stock exchange are as follows: Price/Sales 1.05; Price-Earnings, 10.29; Price/Cash Flow, 8.2; Price/Net Tangible Assets, 1.18; and Gross Dividend Yield (pre-tax, comparable to a regular dividend yield for North American corporations), 7%. Clearly, company fundamentals are extremely attractive. In fact, in our opinion, they are unmatched anywhere in the globe.

What has held back this market? First, politics; second, the Asian crisis; third, incorrect perceptions.

After the last election, the National party had to join forces with the small, nationalistic and interventionist New Zealand First party to form a ruling coalition, bringing to a halt a promising series of economic measures that would have lifted the country onto a superior growth track. Among the principal casualties was a list of privatizations that were not carried out and a wasteful N.Z. \$ 5 billion increase in government spending which had the further effect of forcing a postponement of a previously planned tax cut. With the change of leadership at the National party, the dramatic fall-out in the polls of New Zealand First and the equally dramatic rise of the libertarian Act party (run by the very same people who brought all the economic reforms in the mid- to late '80s under the banner of the Labor party), the political landscape has begun to change. The May 14 budget may begin to show the changing character of the coalition, while next year's election may bring to power a coalition of forces that will continue the reforms initiated more than a decade ago - reforms that became the envy of the developed world.

Much has already been said about the effect of the Asian crisis on New Zealand. What has not been properly understood is that, unlike the rest of South East Asia, New Zealand is still growing at better than 2% per annum. At the same time, the government continues to run a healthy fiscal surplus (unheard of anywhere in the world) with which it has retired all its foreign indebtedness. While it is true that the country runs a substantial current account deficit (7.7% of GDP), none of the signs of economic disequilibrium normally associated with a deficit of this kind are present. For one thing, the balance of trade is stable. For another, dividend remittances are an important part of the investment income debits - a sign of growth, not weakness. Furthermore, in an economic downturn, dividend remittances are scaled back (unlike fixed-interest payments), reducing the country's need for foreign exchange. Finally, a great deal more needs to be learned about the sources of investment income outflows: is a World Bank obligation denominated in Kiwis and issued so as to take advantage of good retail demand for high-yielding paper the same as a resident obligation? It may be the same for payments purposes, but it is clearly not the same for purposes of measuring economic vulnerability. Certainly, residents have not become overindebted, as was the case in South Korea and Indonesia.

Investors who appreciate value should be adding to their positions.

FRIEDBERG MERCANTILE GROUP

BCE Place, 181 Bay Street, #250

Toronto, Ontario M5J 2T3

Ph: (416) 364-2700 Fax: (416) 364-5385

Address <http://www.friedberg.com>



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