

In This Issue

Fundamental Intermarket Relationships That Spell Success 1

Ask Customer Service 4

A Brief Message About Who We Are 5

Holiday Schedule & Product Summary 5

New Customer Service Hours 6

Market Statistics Update & IPOs 6, 7 & 8

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Fundamental Intermarket Relationships That Spell Success

Just about all technical trading methods are vulnerable to unexpected market turns that support, surprise, devastate, and confuse us. Often after we have given up our methods to failure, those same methods suddenly begin turning profits while we stand on the sidelines. Whether a lack of confidence in our methodology or some other outside influence led us to lose out on a great opportunity, we must accept that technical approaches do not always return profits. In fact, some have little (if any) promise for delivering success. Let's turn to common market interrelationships that successful traders depend upon to maintain a positive market focus. This Technical Journal will explore the area of fundamentals, which support just about any trading approach.



We have often made the point that correlated markets get out of step from time to time, and that such divergences represent low risk profit opportunities when one rides them back to their norm. Fundamental analysis involves knowing how one market may affect other markets and how related markets lead or lag one another. This information plays an important role in prediction.

The fundamentalist, with a full complement of external information, acts when the markets are priced lower or higher than expected norms. He simply waits for an opportunity to

appear, then gradually takes on an affordable position that agrees with his research. Research in this context has its roots in the area of supply and demand. It includes studying sympathetic or inversely correlated independent markets which may contribute to an understanding of what the future may hold. By measuring and observing related market forces, the fundamentalist can have confidence that

his trading philosophy will be a success. Knowing how fundamentals can affect your technically based decisions may help bolster your confidence to keep you from overruling your trading plan by taking an early exit.

Technicians, on the other hand, may be accumulating sizeable positions that may move the market well beyond practical fundamental boundaries. The technician often has little or no idea why his current position is turning a profit. He or she is just happy to go along for the ride. If there is a danger in reaping the rewards of a very large profit, it is in thinking you have some extraordinary forecasting powers to repeat the feat again and again. You do not! If you really want to excel in the trading game, try to learn why the markets react the way they do.

In the commodity arena, traders have the luxury of dealing with the building blocks of our world economy.

(continued on Page 2)

Fundamental Intermarket...

(continued from page 1)

“When deciding whether to be long or short any currency, at least half of the focus of your research should be the actions of the U.S. Federal Reserve.”

A broad exposure to vast quantities of market information gives the analyst many dimensions from which to assess value. Markets that technicians avoid are sometimes very responsive to fundamental analysis.

The Corn, Hog and Pork Belly Interrelationships

The pork belly market may be a good candidate for technicians to avoid because it resists following long uninterrupted trends. Pork bellies may, on the other hand, be a good market for the fundamentalist. Their prices oscillate as the lagging cyclical effects of hog breeding and slaughter bear upon future price.

It is important to know more than mechanical facts about a commodity's different delivery months. For example, the August pork belly contract gets the lower grade season-end leftovers and freezer burned stock. Don't forget or ignore the long gap between the August contract and the next and most favored February contract. Pork bellies are often good buys when prices are very low, and good short sales when prices are relatively high.

Knowing something about the hog and corn complex is also helpful because these commodities are each a step deeper in the raw material progression from which pork bellies are produced. (Please see the 4/95 CSI Technical Journal article on the cobweb theorem for more information on the subject of lags in price, slaughter and production for hogs.) It may appear that corn begins the complex process of pricing pork bellies, but actually, the cycle has an earlier origination. The cost of gasoline to fuel the soil-tilling machinery where corn grows and the demand and price of soybeans which may compete for the same acreage are significant factors

the fundamentalist should consider.

Cocoa and Sugar and Earlier Futures Markets

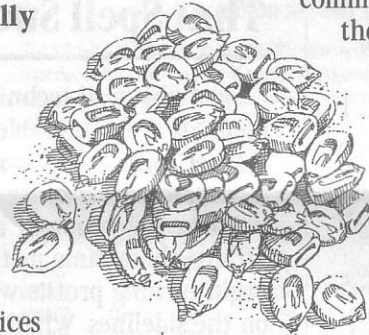
When I first became interested in the opportunities provided by the commodity markets back in the very early '60s, there were only a dozen or so U. S. commodities that traded. Cocoa and sugar were two of them. When my friend at the next desk at General Electric managed to pyramid \$1,000 into \$250,000 trading sugar

during the Bay of Pigs Crisis - circa 1962, he got my attention. During his brief trading experience, sugar moved from below 2 cents per pound to over 13 cents per pound. With no additional capital investment, he added significantly to his position by pyramiding his holdings and exited the market at the top. The only motivation for my friend's original position was that sugar was "too low in price."

The fundamentalist must beware, however, because you can't always believe what you read about the futures markets. I remember reports and news footage of cocoa producers in Ghana burning small mountains of cocoa beans in the fields to protest low prices. What they didn't tell you was that the "mountains" were foliage covered by a thin veneer of cocoa beans. The ruse of destroying the cocoa crop was simply a ploy to drive up prices.

There is also some measure of a relationship between cocoa and sugar. Demand, or a lack of it for either market, can be interpreted as demand for the other. Chocolate tastes much better when a little sugar is added in.

When taking a technically based position in these commodities, I would urge you to look at the fundamentals. Take a look at storage stocks and



current prices relative to historical pricing. Be aware that both the cocoa and sugar markets are sensitive to carryover stocks. Try also to get some kind of trend confirmation before entering a trade. Low prices can always get lower or the reverse before your golden opportunity presents itself. As we write this journal we see that Cocoa is abnormally low in price and has recently visited historic lows. I can't say when it will happen, but an explosive opportunity will develop in that market that will push prices much higher than current levels.

I remember other examples of unusual events in the now-defunct wool, onion, Maine potato, fresh egg, and frozen egg markets. Could these markets return to the pits in a successful mode in the near future? The exchanges may believe that highly perishable commodities and market scandals go hand in hand. But with the larger supply of speculators in today's markets, such investment vehicles could make a comeback.

Currency Trading

Currency trading in the past was a fairly safe technically based bet because such markets would trend for long uninterrupted periods. In the past few years, currency trends have been much less pronounced in their duration, revealing a more choppy mode. It would be inappropriate to say that these markets could not return to their old norm of long trending behavior. Countries implement policies having to do with controlling their currency that often take months to unfold. In such an event the trending behavior could return.

When deciding whether to be long or short any currency, at least half of the focus of your research should be the actions of the U.S. Federal Reserve. After all, unless you enjoy dual citizenship in at least one other country, you will always be using

dollars to establish a given foreign currency trade. (Please see our two-part series about the U. S. Federal Reserve and how it works in the 6/95 and 7/95 CSI Technical Journals.)

The U.S. Federal Reserve (in particular the Federal Open Market Committee - FOMC) and fiscal policy makers in all countries tend to influence currency market direction. Interest rates are important to the currency markets, but foreign country policy to constantly deflate their currency often undermines the intent to raise foreign investment by offering a high interest rate return.

Despite their unsteady beginnings at the International Monetary Market (IMM) in 1972, currency markets are a popular medium for speculation. When viewing such markets historically, it is easy to project a winning profile. Unfortunately, the proverbial "20-20 hindsight vision" applies here as well as anywhere when offering "proof" that a given trading plan will return profits. Currency trading performance is probably as good a place as any to apply the diversity of technical approach ideas introduced in last month's CSI Technical Journal. Don't forget to add fundamentals!

Stock Index Futures

Stock market prices, as reflected in various indices, are at all-time highs and threatening to move higher. As the markets reach one new plateau after another, Wall Street pundits continually warn of the "likely prospect" that a crash will soon occur. My recently deceased grandfather, a Spanish-American War veteran used to say, "This dollar is only worth fifty cents, and Roosevelt is ruining this country." When I offered to give him 75 cents for every dollar he could produce, he quickly changed his mind, but I knew what he meant. The great curse of inflation is responsible for

(continued on Page 6)

"The great curse of inflation is responsible for much of the growth in stock indices."

Ask Customer Service

Each month on this page our customer service representatives field common questions for the benefit of all our customers. Here they present some common queries about various continuous data series.

Q. *I am interested in using Perpetual Contract® data for long-term analysis, but I am not sure which formula to use. Can you offer some suggestions?*

A. For most applications, we recommend the "code 46" Perpetual Contract series. This formula offers the most recent enhancements to the Perpetual Contract idea. Code 46 applies a time-weighted average to the prices of two contracts that are adjacent to a 90-day forward point in time for the same commodity. The roll-forward date for all contracts involved in this series is the tenth day of the expiration month.

Code 46 was originally developed to remedy the slight inconsistencies that can arise from using the estimated last trading day for the time-weighted average as used in code 39. It tends to perform best on commodities that trade quarterly or more frequently such as the currencies, financial markets and others.

For agricultural commodities that are affected by price disparity between the old crop and the new crop, we suggest using nearest future contracts or raw data. Perpetual Contract data does not provide the best results for these markets.

For markets that trade every month such as the energy products, you might consider code 38, which is a two-month forward Perpetual Contract series.

Q. *I am considering your "nearest future" contracts and need help deciding between "code 55" which switches contracts on the first day of the expiration month and "code 56" which switches on the last trading day. Which is preferred for analysis?*

A. Like most analysis decisions, this should be a judgement call based on your intended use of the data. It should be a fairly easy call when you stop to consider the following questions:

Ask yourself how long you'll be holding on to your trades. If you typically hold a position after first notice day or at any time during the expiration month, you'll probably want the "code 56" data. This way the last few weeks of trading will be included. Conversely, if you don't trade contracts during the spot month, you'll probably choose code 55.

For pure back-testing, the code 55 is often preferred because of its predictable roll-over date. The code 55 removes the mystery of determining exactly when one contract ends and another begins.

When using nearest-future data for analysis, it is important to remember that synthetic jumps and drops will occur within the data series. These are expected as the time series rolls along from contracts that are expiring to contracts that still hold substantial time value. Any analysis of this data must take these transitions into consideration.

Q. *I recently noticed some unexpected prices in my cash coffee data. They have since returned to normal, but I'm wondering if there was a problem. Please advise.*

A. Between 950919 and 951009 our code 61 cash price for #10 Coffee inadvertently fluctuated between Columbian Coffee (the old standard) and Brazilian Coffee (the new standard). We now quote strictly Brazilian cash prices and have revised our historical data to reflect this change. Please collect the correction file to retrieve the amended prices or call Customer Service for a free replacement if your data base has been affected by this transition. ♦

A Brief Message About Who We Are

I got a call last week from a regular CSI Technical Journal reader who wanted to know what sort of business CSI is in. For those of you who don't know, CSI is an end-of-day market data supplier to a worldwide customer base of many thousands. CSI customers trade the gamut of futures, currencies, securities, options and indices. Subscribers include individual traders, brokerage firms, data banking firms, econometric research firms, universities, etc. Anyone who needs a reliable source of current and historical world market information can depend on CSI. CSI is one of the world's most

comprehensive data sources. Each day thousands of commodity contracts, stocks, options, funds, and indexes are updated, adding to our existing historical data base. For most markets, our coverage starts with the first day of trading - over 50 years in some cases. Accurate data is our hallmark.

This CSI Technical Journal is provided monthly to every data base customer by mail and is available on the Internet. It is also sent to potential customers on our mailing list. A call to CSI Marketing at (800) 274-4727 or (407) 392-8663 will get you full information and a rate schedule. ♦

Holiday Schedule

CSI will be closed for voice contact on Thursday, November 23rd for the Thanksgiving holiday. U.S. exchanges will be closed, but data from other exchanges will be available as usual.

CSI Software Product Summary

Please check all that apply and complete the information box at right.

Mail or fax to CSI, 200 West Palmetto Park Road, Boca Raton, Florida 33432; Fax: (407) 392-7761; E-Mail: COMMSYS@AOL.COM

- QuickTrieve®/QuickManager®** for PC - To retrieve, manage & edit data (includes 1995 Alerts Calendar); New daily user \$59. QuickTrieve/QuickManager version 4.06 upgrade (for current QuickTrieve users only): \$39; shareware demo disk \$5
- 1995 Commodity Alerts Calendar** for use with QuickTrieve \$20; Calendar upgrade for current QT 4.06 users \$10
- QuickPlot®/QuickStudy®** for PC - Charting & analysis software (requires QT/QM) \$89
- Trade Data Manager™** - Macintosh downloader & accounting program \$59; upgrade \$49 or *FREE* with \$100 history order
- Trading System Performance Evaluator™ (TSPE)** for PC - Computes your system's capital requirements \$149
- Trader's Money Manager™** for PC - \$399 (includes TSPE); Demo disk: \$15
- TraDesk™** for PC - Traders' complete accounting system - CSI daily user \$149; Unrestricted use \$299; 30-day trial version \$22
- Seasonal Index Value Pack** for PC - Ten years of history for 33 popular commodities \$315
- Daily Updates** for PC - Starting at \$10.80 per month
- CSI Technical Journal Subscription** - \$35/Yr. - Reprints \$5/each Issues requested: _____
- CSI Mailing List** - \$200/1,000 names (CSI users omitted)
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Fundamental Intermarket...
(continued from page 3)



much of the growth in stock indices. Real growth may be hard to find. Fundamental information that is important to the stock trader is fairly easy to obtain. The level of earnings for a general index of markets in the form of price earnings ratios is a good place to start. Also consider the alternatives of bond investment.

Last but not least, a major index of commodities should be consulted before making stock investments. You can (and probably should) develop your own commodity index because of the flaws in the CRB index. (One flaw is its heavy bias in favor of the grain complex.) A commodity-based index should inversely lead the stock market. As raw materials go down in price, big business, which consumes them, increases its profit margins and returns more value to share prices.

We are working on a generalized market index program which will operate upon any market segment whether it be stock or commodity based. Perhaps when this work is complete we can help point readers in the more appropriate market direction. By turning to market fundamentals, traders can introduce important substance into their decision making.

The search for how and why the market performs as it does should be foremost on every trader's mind. No one knows for sure how the markets will react to certain measured stimulus. To make matters worse, a given set of circumstances will not always produce the same response each time it is encountered. Don't expect the markets to react logically every time, but always try to understand the process, as imperfect as it may be. ♦

Bob Pelletier

Market Statistics Update

NAME, SYMBOL & EXCHANGE CHANGES

5477	ALO	A.L. Pharma Inc - New name: Alpha Inc.
8436	HOLD	American Holdings Inc - New name: Pure World Inc; New symbol: PURW.
12078	CPDN	Apps Dental Inc - New name: Compdent Cp.
4602	ARGS	Argus Pharmaceuticals Inc - New name: Aronex Pharmaceuticals; New symbol: Aronex Pharmaceuticals.
2203	CELX	Celox Cp - New name: Celox Laboratories Inc.
4462	CROM	Chromcraft Revington Inc - New symbol: CRC; New exchange: NYSE.
1868	CTGI	Concept Technologies Group Inc - New symbol: TGSI.
8347	CYGN	Cygnus Therapeutic Systems Inc - New name: Cygnus Inc.
6961	CYTI	Cytocare Inc - New name: Medstone Int'l Inc; New symbol: MEDS.
12411	ECIN	Electronics, Missles & Communications Inc - New name: Emcee Broadcast Products Inc; New symbol: ECIN.
8038	FMSIE	Fidelity Medical Inc - New symbol: FMSIC.
8038	FMSIC	Fidelity Medical Inc - New name: Corniche Group Inc; New symbol: CGIIC.
2774	FDEF	First Federal Savings and Loan (Defiance, OH) - New name: First Defiance Financial Cp (Defiance, OH).
12488	IBKS	Independent Bankshares Inc; New symbol: IBK; New exchange: AMEX.
2978	IFGI	Insignia Financial Group Inc CL A - New symbol: IFS; New exchange: NYSE.
3304	LLF	Lehman Brothers Latin America Growth Fund Inc - New name: Latin America Growth Fund Inc.
12555	MICR	Microterra Inc - New name: Atlantic Group, Inc; New symbol: ATLA.
8883	MTCEF	MTC Electronic Technologies Co - New name: Grandetel Technologies; New symbol: GTTIF.
2812	OLHC	Old Lyme Holding Cp - New name: Kaye Group Inc; New symbol: KAYE.
12623	PELT	Princeton Electronic Products Inc - New name: Princeton America Cp; New symbol: PELT.
1347	TWSTY	Telewest Communications PLC ADR - New name: Telewest PLC ADR.
1898	VEGG	Ventura Entertainment Group Ltd - New name: Insight Entertainment Cp; New symbol: ISTV.
9894	VS	Vista Resources Inc - New name: Fuqua Enterprises; New symbol: FQE.
9857	VWRX	VWR - New name: VWR Scientific Products.
5877	WII	Weatherford Int'l Inc - New name: Weatherford Enterra Inc.
1627	CELL	Wholesale Cellular USA Inc - New name: Brightpoint Inc.

DELETIONS FROM THE STOCK DATA BASE

2015	ACSE	ACS Enterprises Inc
1712	ACUT	Acuity Imaging Inc
8026	ADVC	Advance Circuits Inc
12807	AVTIE	Advent Technologies Inc
8091	ARI	ARI Holdings Inc
2008	AUFN	Autofinance Group Inc
2226	CLIN	Clinicom Inc
12351	CDMD	Command Credit Cp
3677	CVL	CVD Financial Cp
2298	KIDZ	Direct Connect Int'l Inc
4120	ETEX	Eastex Energy Inc
12417	EMRL	Emerald Capital Holdings Inc
7175	EN	Enterra Cp
3219	FC	Ford Motor Co of Canada
12857	GLACV	Glasgal Communications Inc WI
3282	HIL	Hillhaven Cp
13052	HO	Home Oil Co
2385	HTPI	Home Theater Products Int'l Inc
4181	IGLI	IG Laboratories Inc
8949	IFDCA	Industrial Funding Cp CL A