FRIEDBERG MERCANTILE GROUP

FOURTH QUARTER REPORT 1998

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Dear Investors,

Nothing can be more satisfying to a manager than a month where (almost) everything goes right. It is a source of intellectual satisfaction for a manager to pit himself against the world's best brains and outwit them. It is a source of emotional satisfaction - to do well for those who have entrusted part of their savings to him.

Of course, one month does not a quarter make, much less a year. And a trying year it has been for those of us who understand that the foundations of our prosperity are as a castle built on sand. The moment of truth for our surrealistic economy has merely been postponed, by months at best. As the bubble becomes bigger and bigger, and the temptation to play grows commensurately, it's important to remember that, when the moment comes, the markets will take no prisoners. Circumventing the various temptations is essential, but is simply not enough. Profits must be generated. And that is truly why December was so satisfying, and why we look forward to the new year.

Albert D. Friedberg



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FOREIGN BOND

FRIEDBERG FOREIGN BOND FUND
FRIEDBERG TOTAL RETURN FIXED INCOME FUND LTD.
FRIEDBERG TOTAL RETURN FIXED INCOME LP
TORONTO SELECTED INTERNATIONAL BONDS TRUST

During the quarter, we experienced marginally negative returns (except for the Canadian dollar based investor). This represented a minor detour on our road to achieving superior returns in comparison with risk-free US dollar denominated Treasuries.

The main culprit was a cross-hedge strategy that backfired. It accounted for between 2.8 % and 4.1% (depending on the fund) of total assets on a gross basis, and somewhat less on a net basis. The action, taken to protect our New Zealand dollar holdings, was of course limited to those holdings, that is, to less than 15% of total assets. Also affecting results was the slight capital loss experienced on our long term inflation-linked Treasuries (more than offset, however, by the coupon) and the reduction in market value experienced by the S&P 500 linked derivative note, a product of the stock market's recovery during November and December. It should be remembered that this note, which at year end was being priced at 100.66, has a minimum redemption of 95% of par value and a current yield of 3.8%. Downside risk, including opportunity cost, can thus be seen to be minimal. On the other hand, the note could pay off big should the US stock market fall by 15% or more by the note's September 27, 1999, maturity date, thanks to a number of embedded put options.

New Zealand convertible bonds continued to represent between a fifth and a quarter of total assets. Current yields of 8.2% and 9.9% (and substantially higher prospective yields to maturity) and a much more stable currency make these bonds attractive holdings. Liquidity considerations, however, keep us from adding to positions.

Major themes for the period ahead are: 1) a gradual weakening of the US dollar; 2) a re-acceleration of inflation, particularly in the US; 3) a sharp widening of credit spreads; and 4) a continued and intensified search for liquidity. As discussed in our September 30 letter, we have restructured our portfolio to take advantage of these major trends. The process continued during the past quarter. For example, we changed our currency mix so that our present portfolios are 30% in yen, 20% to 27% in New Zealand dollars, and the balance in US dollars. The shift to yen was accomplished efficiently and effortlessly. We achieved the least amount of slippage and incurred the lowest transaction costs by selling US dollars forward against yen. In effect, we chose to retain our present bond portfolio with an average yield to maturity of approximately 7% while giving up 4.8% on the purchase of forward yen. Our "synthetic" yen portfolio yields 2.2%, which is consider-

ably more than what a yen bond of comparable duration would yield. This manoeuvre is founded on the premise that yen-based securities will provide total returns well in excess of 7% per annum (for a rationale to our bullish yen stance, see Currency section). This yen exposure can be converted to a euro exposure should we feel that the euro will outperform the dollar and the yen. Alternatively, we may be able to find liquid and creditworthy euro-denominated securities should the occasion arise.

We have continued to maintain a very high-quality portfolio, with an approximate overall credit rating of AA. Liquidity is good to excellent. More than 50% of the portfolio is represented by inflation-linked Canadian and US Treasury securities; less than 5% is in three-month Argentine Treasury bills; 4% is in cash. Finally, modified duration, or the measure by which the portfolio can be affected by interest rates movements, is a low 3 years (assuming an historical beta for the inflation linked securities of .25). Even a substantial rise in rates will barely dent our portfolios.

We have practically bullet-proofed ourselves against a number of unpleasant eventualities that we see coming in the next few months without giving up returns. While we are disappointed that this past quarter did not bear the much hoped for fruits of the ongoing restructuring effort, we firmly believe that the coming quarters will handsomely reward your patience and forbearance.

CURRENCY PROGRAM

FRIEDBERG CURRENCY FUND
FRIEDBERG CURRENCY FUND LTD
FRIEDBERG FOREX LP
TORONTO SPECIALIZED TRUST-CURRENCY FUND

A heartening recovery in December left us with only a modest loss for the year. More important, it seems to have put an end to a cold run that stretched back to the closing days of summer and the unfortunate ruble episode. The failure of that trade had more than a passing effect on the spirit of the manager.

A short position in the Japanese yen caused our single largest loss for the quarter - about 11.5% of the account's equity. Persuaded by the conventional view that a contracting economy necessitated a powerful external stimulus, in other words, a widening trade surplus, to offset faltering domestic demand, and lulled into a comfortable funding position by the extremely low Japanese short-term rates, we fell into the costly trap of running a long dollar/yen position. In the short span of two days the Yen rose 17% and dealt us a near-crippling loss. The experience forced us to reconsider the situation and led us in early November to a diametrically opposite view, which strengthened during December.

Our short dollar/long yen position is predicated on three arguments. The first one hinges on our general view that the US dollar is in the early stages of a decline that will gather momentum throughout the coming year as domestic savings fall and the current account deficit widens correspondingly. This deficit will, at some point in time, become unsustainable and will thus require a lower dollar and/or higher interest rates.

The next two arguments are yen-specific and run as follows: Japan is experiencing deflation simply because the Bank of Japan has been unable to expand broad money supply at the 6% to 8% rate that seems to be more in line historically with a stable (wholesale) price level. All else being equal, deflation is bullish for the currency. Finally, investor perceptions of an economic turnaround could produce a favorable flow of capital even if Japan loosened money supply. In other words, we can make a rational case for neutralizing the potentially bearish implications of a looser money policy. Curiously then we have generated a win-win argument: continuing deflation is bullish; so is the end of deflation. Since the market's verdict, so far, is favorable, I am led to crow that mistakes lead to good and productive ideas, if one could only listen.

Witness to our stubborn conviction, we continued to lose money on the short side of the Brazilian real - accounting for as much as 7.5% of initial equity. The loss, of course, arises from Brazil's high interest rates. To effect the trade, we need to borrow Brazilian currency at rates well in excess of 30% per annum. While the currency does devalue by approximately 7% per annum, financing costs make this an extremely costly speculation. And yet, we persist. With each passing day, the probabilities of a maxi-devaluation (20% to 35%) rise. Brazil's entire stock of domestic debt is now equal to almost 40% of GDP, and it rolls over every six to eight weeks. Clearly, the country (and we) cannot afford such usurious interest rates. (We have commented on this issue at length in our most recent Friedberg's Commodity and Currency Comments; a copy is available upon request if you don't already receive it.)

Suffice it to say that a rational and relatively painless solution is at hand: devalue once and for all (instead of allowing the creeping monthly devaluation) and install a currency board, similar to the ones operating successfully in Hong Kong, Argentina, Estonia, and Bulgaria. Local interest rates would collapse and the budget deficit would disappear almost overnight. The solution is too neat to be ignored. Rising profits permitting, we look to increase our short exposure if and when the immediacy of a devaluation becomes more certain.

Aside from the Brazilian real and a surprisingly cheap speculation on the Saudi ryal, the major theme we foresee for the coming year is the gradual weakening of the US dollar. We alluded to it earlier, in connection with our short dollar/long yen position. It remains to be seen what role, if any, will be played by the euro and perhaps, just as importantly,

the emerging Asian currencies and the terms-of-trade-affected Australian, New Zealand and Canadian dollars.

DIVERSIFIED TRADING PROGRAM

FRIEDBERG DIVERSIFIED FUND
FRIEDBERG DIVERSIFIED POOL
TORONTO SPECIALIZED TRUST-SELECTED COMMODITIES FUND

The Diversified Trading Program was the most successful of all our programs for the past quarter.

The period under review started off on an uninspiring note. First, we stopped ourselves out of a losing stock index short position and were subsequently forced out of a long silver/short gold trade (triggered by risk-control procedures) at a rather inopportune time. In December, the situation brightened considerably. A well-timed speculation on Japanese long-term rates exploded to the plus side in just a few days. We had spent 15% of the account to purchase 18-month 'swaptions' - options to pay 10-year Japanese interest rates swaps - at strike levels of 1.91% (at-the-money forward) and 2.90% (out-of-the-money) when spot rates were approximately 1.45% (the equivalent, at that time, of slightly more than 1% on Japanese Government Bonds, or "JGBs"). Interest rates have since skyrocketed. Ten-year rates for our forward date currently stand at approximately 2.83%.

The decision to choose swaptions over outright sales of JGBs as we have been wont to do was based on our fear that the Bank of Japan would intervene in the bond market at some point in order to expand its own balance sheet (and, with it, the monetary base) and keep down long-term rates. We reasoned that intervention would stir inflation via the open monetary spigots and lead to higher interest rates; no intervention, on the other hand, would overwhelm the government bond market, in the face of a proposed fiscal deficit that was approaching 11% of GDP, and also lead to higher rates. It was another win-win situation (see our yen comments above), resulting from the wildly stimulative fiscal package proposed by the government. We are currently studying ways to reduce unwanted volatility for this trade without diminishing its latent profit potential.

Towards the end of the quarter we reinstated the long silver/ short gold spread. The ongoing process of demonetization should continue to restrain gold prices for some time yet. Silver, meanwhile, should benefit from further increases in demand. Industrial and photographic demand, particularly in the less developed world where digital cameras are not likely to be used anytime soon, is likely to increase. Incipient investment demand is also apparent. Besides Warren Buffet, one or a few

investors continue to draw down silver stocks. At the same time, readily available above-ground supplies amount to no more than $1 billion, and perhaps only half of that - a pittance in today's wildly valued capital markets.

The major themes for the coming year continue to be the insane valuation of stock markets around the globe, the still-too-low interest rate on long-term Japanese securities, and the approaching bottom in commodity prices (thanks to a prospective weaker dollar, monetary reflation across the board, and the struggling recovery in the Asian economies). We look forward to an exciting time.

FRIEDBERG FUTURES FUND

The Futures Fund is equally invested in the Currencies Program and the Diversified Trading Program. Please refer to our earlier comments on these two programs.

FRIEDBERG GLOBAL OPPORTUNITIES LTD.

INTERNATIONAL FUND

Approximately one half of the Global Opportunities Fund is managed in accordance with the Diversified Trading Program (see our comments above). The other half, the Global Securities Program, has now been merged with the International Fund in light of their identical objectives and for ease of management. Comments in this section will therefore relate to the International Fund.

Our continued adherence to the view that global equity markets are overvalued and due for a substantial fall left us poorer by approximately 10% during this past quarter. The overall performance masks some relatively good calls, in particular the successful bearish bet on selected Latin American stocks, namely ICA Controladora (Mexico, -23.4%), Supermercados (Chile, -21.1%), and Telesp (Brazil, -9.67 %). Also, our bullish bet on New Zealand has begun to pay off, contributing almost 6% to net asset value.

Unfortunately, these positions were not large enough to offset losses on our short positions in North American and European equity indices. Towards the end of the quarter, we scaled back some of these positions solely for money management reasons. We continue to believe that North American and European stock prices have been inflated far beyond the canons of rationality. We shall reinstate the full position at a more opportune time.

In the meantime, we have retained a substantial short position in secondary Japanese bank stocks, representing almost 50% of the fund's portfolio. Japan's new regulatory authorities have resolutely put an end to forbearance, with the result that many of these banks will be liquidated or nationalized in the next few months. We expect to cover many of these securities at pennies on the dollar.

During December we pursued a US interest rate spread, long 2-year versus short 30 year Treasuries, anticipating a widening of the spread, currently at 53 basis points. This view is predicated on two assumptions:

1. The Fed is unlikely to raise rates anytime soon, despite the runaway stock market, for fear of destabilizing the extremely fragile financial system. Credit spreads have not as yet narrowed to pre-August levels, Brazil is on the verge of a devaluation, dealers are carrying enormously leveraged securities positions, the US economy is expected to slow down as profit margins shrink, and the trade balance continues to worsen.

2. Long-term rates will begin building in an inflationary premium given the feverish pace of the monetary aggregates and the inevitable bottoming out of commodity prices. Year-over-year changes have already shown an important acceleration.

This yield curve play is a logical corollary to our "macro" view, that is, a gradual weakening of the US dollar, the end of deflation (if it ever existed in the first place), some acceleration of consumer prices, and a gutless Fed.

Major themes for the coming year remain the eventual end to the North American and European stock market mania, the collapse of an important number of Japanese banks and the consequent rationalization of the banking industry, the bottoming out of commodity prices and its positive effect on inflation and the terms of trade of Canada, Australia, New Zealand and Latin America. The major trends should prove to be quite profitable. We will be positioning ourselves accordingly, guided, of course, by prudent money management rules.

EQUITY HEDGE PROGRAM

FRIEDBERG EQUITY HEDGE FUND LTD..
FRIEDBERG EQUITY HEDGE FUND

Unavoidable random differences between the two funds for the quarter under review produced a marginal loss of less than 1% in one fund and a gain of almost 3% in the other. Be that as it may, the performance for the full year remained sub-par, especially in light of our expected return of risk-free rates plus 500 basis points.

Despite some extraordinary individual successes, it is rather obvious hat the overall selection process was not as felicitous as we would have hoped. One can perhaps attribute part of the problem to the almost irrational way the market has been valuing technology issues as well as the extraordinary dichotomy that has developed between large caps and small caps. Normal valuation yardsticks and fundamental security analysis seem to have fallen by the wayside.

As an example, we closed out at significant losses our short positions in Newbridge Networks, Corning Inc. and Micron Technology despite the fact that these stocks were selling at highly inflated multiples of earnings (negative, 33x, and negative, respectively), cash flow (80x, 15.7x, and 56.7x, respectively), and sales (5.1x, 2.9x, 3.6x, respectively). Subsequently, these stocks have all registered significant further advances, validating our disciplined trading approach but leaving us confused as to what may be considered truly overvalued. Increasingly, we have had to rely on momentum analysis analysis and tape behavior to guide us through this irrational market. Avoiding the short side of the Internet craze can be attributed to our dependence on these valuable tools. Irrational valuations, on the other hand, have a positive side, too: when the bubble bursts, there will be many more attractive short candidates.

Our largest gain on the long side was Anne Taylor Stores, up a stunning 94% for the quarter. Our largest gain on the short side was IDT Corp, a telecommunications company, down 33% for the same period. At the close of business on December 31, longs represented 59.2% of the portfolio and shorts 40.8%, a slightly higher long proportion than prevailed in the previous two months. The short portfolio continues to be significantly more volatile than the long side - a puzzling feature. It may well be that bears, mostly the fundamental type, tend to go for similar stocks, creating the conditions for sudden and violent short squeezes. If this thesis proves correct, it would suggest targeting as short candidates unglamorous companies, primarily in basic industries, with low short interest ratios, rather than the extraordinarily overvalued members of the technology group. (We are conducting research into the matter.)

During the year, we experienced spurts of good performance. The month of August saw our funds gain slightly more than 3% while the S&P 500 fell 14.6%. The November-December period matched the gain of the S&P 500 even though short positions represented over 40% of the funds' portfolios. This fact, coupled with the program's compounded gain of 20.3% over six years, allows us to remain highly optimistic that long-term returns will exceed risk-free rates by 500 basis points.

NEW ZEALAND

FRIEDBERG NEW ZEALAND FUND LIMITED
NEW ZEALAND EQUITIES FUND
FCMI KIM EQUITIES FUND
TORONTO NZ EQUITY TRUST

The New Zealand market came to life, buoyed by rapidly falling interest rates, a cheap currency, and outstanding valuations.

Even after their recent recovery, New Zealand equities remain woefully undervalued: gross dividend yields for the NZSE 40, at 6.6%, are 160 basis points higher than three-month interest rates and even compare favorably to the yield on 10-year government bonds (5.5%).

We present below our 10 largest holdings, accompanied by some valuation measures:

NZ Cayman Equity Fund
10 Largest Holdings in the Fund

	Price 31-Dec-98	Price /Sales	Price /Earnings	Price /Cashflow	Price /NTA	Gross Dividend Yield
Air NZ	2.98	0.55	15.10	10.55	0.97	4.30%
DB GROUP	2.80	0.44	10.38	5.14	1.23	8.10
FISHER & PAYKEL	6.85	0.95	23.92	13.84	2.04	4.80%
HALL GLASSON	2.45	0.93	15.00	12.32	4.35	11.10%
KIWI INCOME PROPERTY	1.09	N.A.*	14.19	12.59	0.99	9.60%
PDL HOLDINGS	5.30	0.22	17.38	neg	0.95	13.70%
SANFORD	3.60	1.07	14.39	7.03	1.48	6.40%
ST LUKES	1.80	N.A.*	22.98	22.30	1.49	8.10%
TRANS TASMAN PROP.	0.46	N.A.*	17.00	33.09	0.72	10.50%

*N.A. (Not applicable for property trust)

Weighted gross dividend yield	8.69%
NZSE 40	6.60%

The weighted average gross dividend yield of our largest 10 holdings is an extraordinary 8.69%. In some cases, dividends could conceivably be cut in the next few months as earnings do not cover the generous pay-outs. Nevertheless, we remain sufficiently optimistic about the business outlook that we are willing to overlook near-term moves to conserve cash.

Given the present level of interest rates and the anticipated economic recovery (GDP expanded a larger-than-expected 0.7% in the third quarter, officially ending the six-month recession that began early in 1998), we expect price-earnings multiples for the median stock in our tradable universe to rise to 20Xfrom the current 12.6X. This would leave both the ratio of market capitalization to revenues (now at 1.07) and the ratio of price to net tangible assets

(at 1.28) well below comparable ratios in North American and European markets. In sum, short of a devastating global bear market, we believe that New Zealand equities have the potential to rise 50% to 75% over the coming 18 months.

FRIEDBERG ALLOCATION FUND LTD.

The Friedberg Allocation Fund fell 2.35% for the fourth quarter and 6.03% for the year since its inception in June of 1998. This fund reflects the overall asset allocation model of the Friedberg group across a number of asset classes (using our own funds) and thus is a truer reflection of our ongoing view of the world. It is our opinion that asset allocation can play just as important a role in the investment process as the underlying investment itself. Often clients are attracted to a particular investment without fully appreciating the relative risks inherent in individual funds like the Currency Fund or the Global Opportunities Fund. By participating in the Friedberg Allocation Fund, clients are afforded the opportunity to not only invest in the individual funds that we manage, but also to benefit from our guidance on how to balance those risks.

Please note that due to scheduling problems, the 1999 Second Quarter Report will be published in the second half of April.



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