



Market Weekly

Commodities, Forex, Futures and Options

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HEADLINE OF THE WEEK: "Iceland contagion may spread far and wide" (Telegraph.co.uk, 3/27/2008)

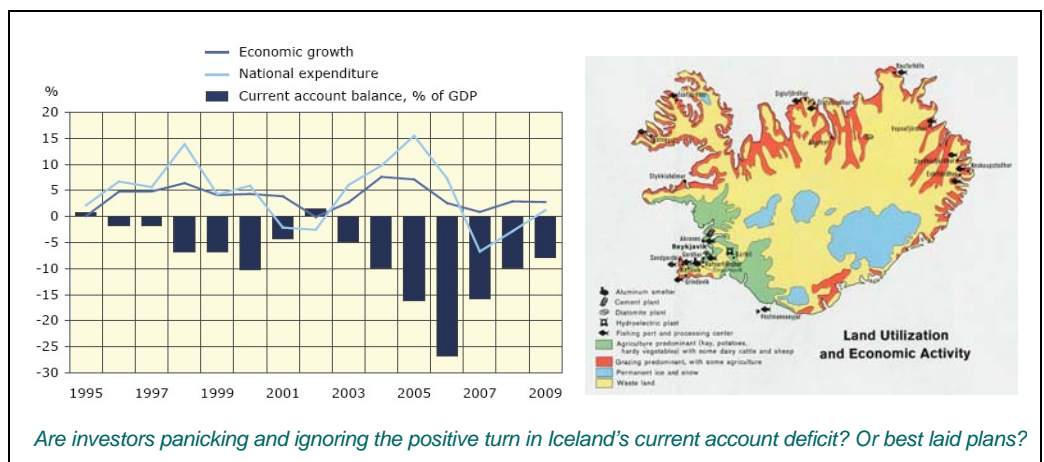
Compiled by Mack Frankfurter, Chief Investment Strategist

In like a lion, out like a lamb? Hardly! March began with hedge fund Carlyle Capital facing a margin call it could not meet. Next followed Bear Stearns, which went belly up in a backroom deal between JP Morgan and the Federal Reserve. This week it is a country that has its back against the wall. With confidence in the krona, Iceland's currency, rapidly weakening because of perceived imbalances in the economy, and fears the banking sector is in danger of collapse, Iceland raised rates to 15% in order to stem the flow of capital. The move was received positively by investors with the krona gaining 6.3 percent against the dollar, while the country's stock index rose 6.2 percent, the most in 15 years. Nevertheless, inflation was 8.7 percent in March and has outpaced the central bank's target of 2.5 percent since 2004. It seems hard to believe that a country of barely 300,000 inhabitants can end up being the potential trigger for a redux of the 1998 Asian crisis. But Iceland is more than just a Nordic hedge fund masquerading as a country. It is also the first of the deficit states to succumb to investor flight, sending an early warning signal of potential troubles across a great swathe of Eastern Europe. In counter defense, it was pointed out that Iceland's current account deficit, the source of concerns, has narrowed from 26 percent

WEEKLY RECAP

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"But Iceland is more than just a Nordic hedge fund masquerading as a country."



Are investors panicking and ignoring the positive turn in Iceland's current account deficit? Or best laid plans?

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Headlines from page 1

of GDP in 2006 to 16 percent in 2007. Yet, as Fitch Ratings noted, countries that run current account deficits above 10 percent of GDP for any length of time almost always come to grief. East Asia's debt crisis in 1997 erupted before any state reached double digits. Iceland's deficit is now 16 percent of GDP, Latvia is at 25 percent, Bulgaria 19%, Georgia 18%, Estonia 16%, Lithuania 14%, Romania 14%, and Serbia is 13 percent. Borrowing in foreign currencies was all the rage in the heady days of the credit bubble. Most mortgages in Hungary over the last two years were in Swiss francs, with the Balkans and Poland not far behind. This is now turning into slow torture, and the region will need \$337 billion in foreign loans this year. At best, these economies face painful adjustments, including higher interest rates to curtail consumer spending, imports and inflation. At worst, foreign investors and local residents lose confidence and abandon their currencies, leading to a debt crisis. As the saga of the 'unwind of the leveraged financial system' continues, we are reminded of a Shakespearean tragedy about ancient Rome. *Caesar*: Who is it in the press that calls on me? *Brutus*: A soothsayer bids you beware the ides of March...

"At best, these economies face painful adjustments, including higher interest rates..."



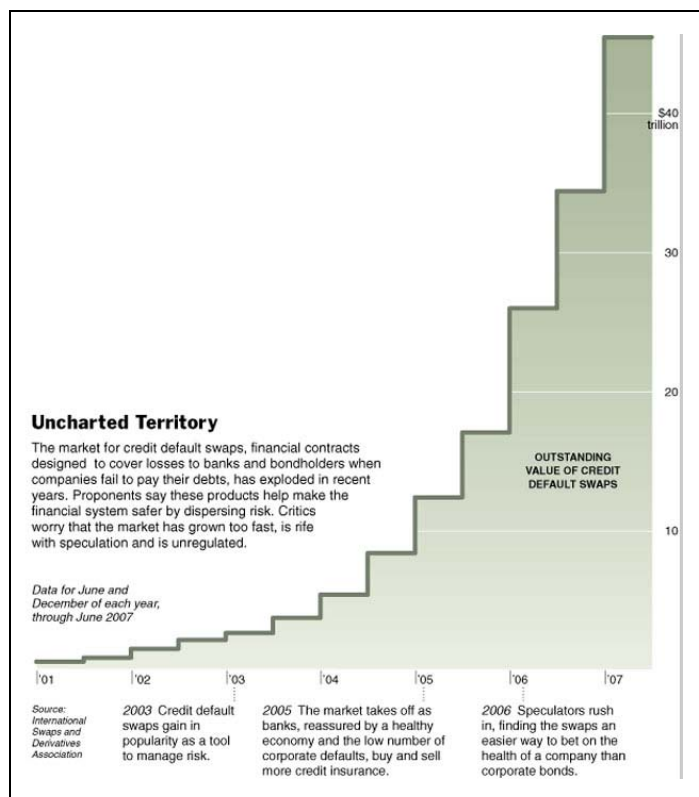
Silver has climbed 24 percent so far this year, but on Friday the May delivery contract fell 3.28 percent.

Notwithstanding concerns about Iceland, a fragile calm descended across global markets this week. Commodity markets staged a rebound after a broad-based sell-off the previous week, with energy, base metals and gold recovering some of their losses. The debate of the influence of speculative buying versus fundamentals in commodity markets continues to generate interest among dealers and analysts. The general chorus from Wall Street is that global demand is strong, and dealers noted that Asia buyers had been quick to step into the market when gold prices dipped last week. Meanwhile, soybeans have found support from ongoing strike action in Argentina that has disrupted shipments from the world's third-largest exporter. Copper rose 7.2 percent over the week as inventories have shrunk to about two days worth of global consumption, while Nickel gained 6.6 percent as strike action continued at the Cerro Matoso mine in Columbia. In currencies, the dollar was back on the defensive at the end of the week, as was the sterling. The mood over the week was tentative and conviction behind the recovery is tenuous.

"The debate of the influence of speculative buying vs. fundamentals in commodity markets continues..."

ECONOMIC REVIEW

Word on Wall Street is that the Federal Reserve has been in unusually close contact with investment banks over the past week, asking for data that is usually within the purview of the Securities Exchange Commission (SEC). This is the first step in a long legislative process that could end up with the Fed relieving the SEC of its regulatory powers over investment banks. But first the Fed will have to deal with the fallout from the surprise decision by JPMorgan to raise their offer on Bear Stearns to \$10 per share. It is rumored that the original \$2-per-share bid was intended to inflict real pain on investors, thus providing a cautionary tale for future banking failures. But now the question of “moral hazard” has been raised yet again in light that the deal is backed by a \$29 billion credit line from the Fed. In defense of Bernanke, it really boils down to a matter of choosing from two bad choices. Arguably, letting Bear Stearns go bankrupt could have resulted in a systemic collapse of the credit default



Next Week's Economic Calendar

All eyes will be on the employment report which is actually two separate reports resulting from two separate surveys.

Date	Time (ET)	Statistic	For	Briefing Forecast	Market Expects	Prior
31-Mar	9:45 AM	Chicago PMI	Mar	46.0	46.7	44.5
1-Apr	12:00 AM	Auto Sales	Mar	5.0M	5.1M	5.0M
1-Apr	12:00 AM	Truck Sales	Mar	6.5M	6.6M	6.6M
1-Apr	10:00 AM	Construction Spending	Feb	-1.0%	-0.9%	-1.7%
1-Apr	10:00 AM	ISM Index	Mar	48.0	48.2	48.3
2-Apr	8:15 AM	ADP Employment	Mar	-	-23K	-23K
2-Apr	10:00 AM	Factory Orders	Feb	-0.5%	0.7%	-2.5%
2-Apr	10:30 AM	Crude Inventories	29-Mar	NA	NA	88K
3-Apr	8:30 AM	Initial Claims	29-Mar	360K	NA	366K
3-Apr	10:00 AM	ISM Services	Mar	49.0	49.2	49.3
4-Apr	8:30 AM	Nonfarm Payrolls	Mar	-70K	-40K	-63K
4-Apr	8:30 AM	Unemployment Rate	Mar	4.9%	5.0%	4.8%
4-Apr	8:30 AM	Hourly Earnings	Mar	0.3%	0.3%	0.3%
4-Apr	8:30 AM	Average Workweek	Mar	33.7	33.7	33.7

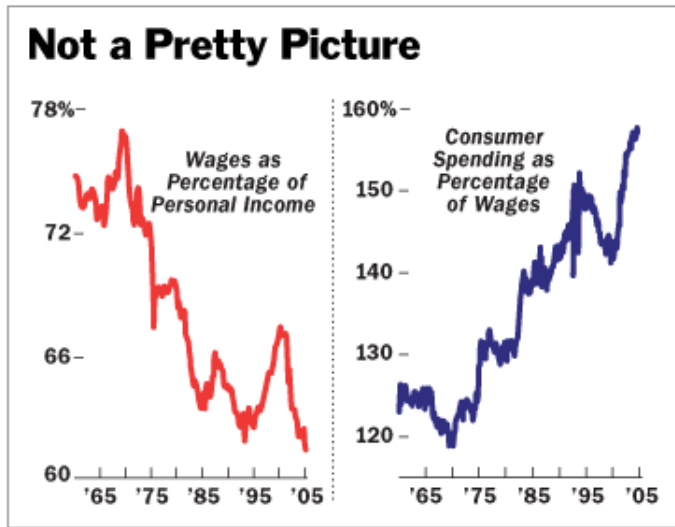
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Economic Review from page 3



Last week, we pointed out that American households have run down savings and cashed in on inflated assets, primarily homes, to keep increasing consumption. Since the 1960s, U.S. consumer spending, which accounts for 70 percent of GDP, has raced ahead of income.

swap market, which relies on a complex web of unregulated over-the-counter deals involving numerous counterparties. In other words a potential disaster was averted—for the time being...

In global economic news, the United Nation’s World Food Program launched an “extraordinary emergency appeal” for governments to donate at least \$500 million in the next four weeks, in order to avoid rationing food aid. This appeal is in response to the spiraling cost of agricultural commodities. Rice prices jumped 30% to a record high Thursday, raising fears of fresh outbreaks of social unrest across Asia where the grain is a staple food from more than 2.5 billion people. It is noted that while the prices of wheat, corn and other foodstuffs have surged since late 2006 and into 2007, price increases for rice gathered steam this year.

~~Op-Ed~~ **MANAGED FUTURES NEWS** Mack Frankfurter, Chief Investment Strategist

For all the bad news, stress on a system can also be a good thing. It makes us step back, re-analyze how things have been done in the past, and impels us to fix that which is broke. Many pundits have long recognized that the financial regulatory system in the United States has become overly complicated and riddled with loopholes. A similar recognition by the United Kingdom resulted in a complete overhaul in 2000, which benefited London finance greatly.

It was therefore with both anticipation and trepidation that I reviewed the most significant news to hit the managed futures industry in some time, that: Treasury Secretary Paulson formerly called for the creation of a new regulatory agency, merging the Securities Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC).

For many years there has been a turf war between the SEC and CFTC, which in turn resulted in non-regulated grey areas including over-the-counter derivatives and hedge funds. These activities have a shared legacy with the futures industry, but during the last decade, have far outpaced managed futures in growth. A large part of this evolution had to do with the fact that the managed futures is regulated and hedge funds are not. Yet, one can also argue that futures regulations provided the means for eventual acceptance of alternative investments, including hedge funds.

The key difference between the SEC and the CFTC is the type of regulatory philosophy employed. Thanks to Felix Frankfurter, who brought together the legislative team that drafted the Securities Act of 1933, the SEC uses a rules-based approach. Meanwhile, the CFTC uses a principles-based approach, which is also used by the Financial Services Authority (FSA) in regulating financial services in Great Britain.

There is no doubt that the SEC is the better known agency. But in my experience, having operated under both the SEC and CFTC, the principles-based approach is far superior. For that reason, I was much relieved to hear that the Treasury endorsed the CFTC’s use of principles-based regulation. Let’s just hope the CFTC doesn’t lose the turf war.

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