



# Market Weekly

Commodities, Forex, Futures and Options

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Managed Account Research, Inc. 929 Santa Barbara Street, Santa Barbara, CA 93101  
www.ma-research.com research@ma-research.com 800.308.1495

## HEADLINE OF THE WEEK:

### “Food price fears grow as wheat hits record” (Financial Times, 2/9/2008)

*Compiled by Mack Frankfurter, Chief Investment Strategist*

Demand powers an “epic” run in wheat as U.S. forecast its lowest inventories in 60 years. The CBOT wheat futures for March delivery was stuck against the 30-cent exchange limit for five straight days closing at \$10.93 a bushel. Prices in Kansas rose by their 30-cent daily trading limit to \$11.10 a bushel, while Minneapolis wheat, the variety most suitable for making flour, rose 10.7 percent on the week, extending its price surge since the beginning of the year to 50 percent. As a result, the Minneapolis Grain Exchange will remove the daily price limit on the spot-month hard red spring wheat contract, the first time it has done so. The rally in wheat has accelerated in the past year after weather damaged crops from the world's biggest producers. Rising food consumption in China and increased demand for corn and soybeans used to make alternative fuels also are eroding global crop supplies. Higher costs for commodities and fuel eroded fourth quarter profit reported this week by Kellogg Co., the largest U.S. cereal-maker, while Sara Lee Corp. raised bread prices “to keep pace with historically high wheat costs.”

## WEEKLY RECAP

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*“As a result, the Minneapolis Grain Exchange will remove the daily price limit...”*



*At harvest time, farmers sold wheat when futures were trading around \$5.50 and \$6.00, “an extra good price.”*

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*Headlines* from page 1

Earlier in the week stocks tumbled after the release of extremely weak data on service sector and non-manufacturing activity. The market recovered somewhat by Friday, but not before our runner-up headline of the week, “S&P 500 recorded its worst start to a year in its history,” made its way into the news. In the fixed income market, fears about corporate and commercial property debt reached new heights as investors liquidated leveraged loans in a sign of spreading credit turmoil. Investor worries are shifting from subprime residential mortgages to commercial real estate lending. Investors sought the safety of government bonds, sending the yield on the two-year Treasury to 1.94 percent. Concern of a recession is affecting Europe too, as the Euro endured its worst week in 18 months against the dollar, just seven days after flirting with its record high. Traders seemed to think that much of the bad news about the U.S. economy is already priced in the dollar. In contrast, contagion in the Eurozone from a U.S. downturn has not been fully recognized by the currency market. Weak data coming out of Europe is fuelling talk that the European Central Bank (ECB) would have to scrap its hawkish rates stance. For now, ECB rates were left unchanged at 4 percent.

*“...runner-up headline of the week, ‘S&P 500 recorded its worst start to a year in its history’”*



*The S&P 500 index declined 4.6 percent for the week, closing lower in four of five trading sessions.*

But of all the colorful headlines this past week our personal favorite, for reasons which shall become apparent, was “Flattening oil curve places investors in sticky situation.” After a relentlessly bullish crude oil market last year, prices have been backing off. The weakening of the spot market, however, conceals the strength of forward oil prices, indicating that high energy costs are here to stay. The difference between spot and future oil prices is due to sharply rising long-term production costs, as witnessed in the development of expensive oil-sands projects in Canada, as well as maturing oilfields, difficulty accessing reserves and political risk. The difference between today’s spot crude oil price and futures prices is narrowing and resulting in a flatter futures curve. The shape of the futures curve is said to be key to something called backwardation from which passive commodities indices derive a yield called the roll return. The opposite of backwardation is contango, meaning that investors would lose money if the situation persisted. In any case, such concepts are the subject of a Managed Account Research paper located at: <http://ssrn.com/abstract=1029243>

*“...sharply rising long-term production costs, as witness in the development of expensive oil-sands projects...”*

## ECONOMIC REVIEW

The Group of Seven policy makers met last week and pronounced in a statement that the U.S. economy may slow further, eroding global growth. “Downside risks still persist, which include further deterioration of the U.S. residential housing markets and tighter credit conditions,” the statement said. Risks to growth include heightened inflation expectations. While the statement didn’t propose specific measures, European Central Bank President Jean-Claude Trichet said officials “will do what’s necessary to counter a “significant market correction.”

The group, which consists of the U.S., U.K., Canada, Italy, France, Germany and Japan, also agreed that China should do more to defuse global trade tensions by allowing the yuan to climb against the dollar and other currencies. Meanwhile, U.S. Treasury Secretary Henry Paulson said “we should expect continued volatility” in markets as risk is re-priced. Officials signaled they were willing to take steps to promote growth. Bank of Canada

Governor Mark Carney, whose term began two weeks ago, signaled he will lower interest rates. Luxembourg Prime Minister Jean-Claude Juncker, who represents finance ministers from the 15-nation euro region, said some European countries may have room to cut taxes. However, many economists think the ability of G-7 policy makers to end the crisis is limited.

Meanwhile, Australia bucked the trend in the rest of the world by increasing their benchmark interest rate to 7 percent. Australia’s strong economic growth, driven by commodity exports to China and other fast-growing economies was underlined when the Reserve Bank of Australia pushed rates to their highest level in nearly 12 years in an effort to contain inflation. Australia is now in its 17<sup>th</sup> year of uninterrupted growth spurred by commodity sales and a rebound in agricultural exports. China is now the number one trading partner for Australia.

## Next Week’s Economic Calendar

According to Bloomberg.com “The markets need to settle down and hopefully Monday's session will be quiet.”

Date	Time (ET)	Statistic	For	Briefing Forecast	Market Expects	Prior
12-Feb	2:00 PM	Treasury Budget	Jan	\$15.0B	\$30.0B	\$38.2B
13-Feb	8:30 AM	Retail Sales	Jan	0.0%	0.0%	-0.4%
13-Feb	8:30 AM	Retail Sales ex-auto	Jan	0.5%	0.2%	-0.4%
13-Feb	10:00 AM	Business Inventories	Dec	0.8%	0.4%	0.4%
13-Feb	10:30 AM	Crude Inventories	9-Feb	NA	NA	7052K
14-Feb	8:30 AM	Initial Claims	9-Feb	360K	NA	356K
14-Feb	8:30 AM	Trade Balance	Dec	-\$62.0B	-\$61.0B	-\$63.1B
15-Feb	8:30 AM	Export Prices ex-ag.	Jan	NA	NA	0.3%
15-Feb	8:30 AM	Import Prices ex-oil	Jan	NA	NA	0.3%
15-Feb	8:30 AM	NY Empire State Index	Feb	5	7.5	9
15-Feb	9:00 AM	Net Foreign Purchases	Dec	NA	NA	\$90.9B
15-Feb	9:15 AM	Capacity Utilization	Jan	NA	NA	81.4%
15-Feb	9:15 AM	Industrial Production	Jan	0.2%	0.1%	0.0%
15-Feb	9:15 AM	Capacity Utilization	Jan	81.5%	81.4%	81.4%
15-Feb	10:00 AM	Mich. Sentiment-Prel.	Feb	-	78	76.5

*Data is provided for informational purposes only, and is not intended for trading purposes.*

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### MANAGED FUTURES NEWS

The Office of General Counsel of the U.S. Commodity Futures Trading Commission has announced it has issued a no-action letter permitting the offer and sale in the U.S. of eight Eurex futures contracts.

Reform of the way futures contracts are cleared in the U.S. is unlikely to happen for at least five years. The U.S. Treasury distanced itself from a call by the U.S. Department of Justice for reform of the futures clearing system. Treasury comments boosted shares in the CME Group, the world's largest futures exchange, reversing their fall earlier in the week after the DOJ called for clearing to be separated from futures exchanges on antitrust grounds.

The Commodity Futures Trading Commission said it can monitor sovereign wealth funds to make sure they don't manipulate prices. State-owned investment funds around the world control some \$3 trillion in assets, and may be looking at commodities thanks to growing global demand for commodities, such as oil. "They are treated like any other participants in our markets," said acting chairman, Walter Lukken at the Reuters Regulation Summit.

CME Group is considering raising the trading limits on CBOT wheat futures but no decision has been made. "We would like to have all the grain markets in line but we've not made a decision yet," said CME director of corporate communications Allan Schoenberg. The Minneapolis Grain Exchange on Tuesday said it was raising wheat trading limits to 40 cents per bushel from the current 30 cents, effective February 12.

Rochester, Michigan based Altin:Fund returned 4.25% in January (est.) and 9.23% for 2007. The firm runs a managed futures fund of funds for institutional investors. According to earlier reports, the portfolio invests in seven managed futures specialists, including Clarke Capital Management, Fall River Capital and Winton Futures Fund.

The combination of the subprime crisis since last summer and the more recent slashing of interest rates by the Federal Reserve Board is changing the rules of the old carry trade. Two new themes are emerging. The first, already a few months old, is the reverse carry trade. It was triggered by the credit crunch and the reemergence of volatility in the market amid subprime woes. The second theme, which is more recent, is the use of a battered dollar to fund the carry trade. Now that the dollar is a lower-yielding currency, it makes sense to borrow the greenback to fund the purchase of higher-yielding currencies, some currency experts say.

Managed-futures behemoth Campbell & Co. was hurt last year by trades in the currency market, as well as in fixed-income and equities. The firm's \$11 billion Financials, Metals & Energy Large Portfolio was down 13.38% and its 22-year-old \$1.5 billion Global Diversified Large Portfolio lost 11.21%—its first losing year since 1986.

Deutsche Bank has launched a new commodity index, the Deutsche Bank Commodity Harvest Index, to add to its highly successful commodities index product suite. Commodity Harvest is an alpha generating, rule based market neutral strategy that uses the concept of carry in the commodity complex to generate stable returns without direct exposure to commodity spot prices.

Pensioenfonds Zorg en Welzijn (PGGM), Europe's second largest pension fund, has shaken up its commodities investment portfolio. The fund halved its exposure to the agricultural sector and scrapped its gold and silver allocations in spite of recent record prices in both areas. The \$127.8 billion Dutch pension fund simultaneously increased its exposure to industrial metals and livestock, according to officials and bankers familiar with it. The reduction in agriculture investment comes as the sector attracts record inflows amid tight fundamentals and an appetite for hedges against food-driven inflation

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*Market Weekly* is a newsletter publication of Managed Account Research, Inc. Its purpose is to provide weekly commentary on the commodity, forex, futures and options markets, as well as economic news impacting your managed futures investments. To subscribe or unsubscribe, contact us at 800.308.1495 or email: [research@ma-research.com](mailto:research@ma-research.com).

**Managed Account Research, Inc.** 929 Santa Barbara Street, Santa Barbara, CA 93101  
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