



# Market Weekly

Commodities, Forex, Futures and Options

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## HEADLINE OF THE WEEK: "Fears of Stagflation Return As Price Increases Gain Pace" (WSJ, 2/21/2008)

Compiled by Mack Frankfurter, Chief Investment Strategist

Those who have been whispering the word "stagflation" received vindication this week when The Wall Street Journal posted the above headline on page one, raising the specter of a 1970's style economic combo downturn/inflationary scenario. The word "stagflation" was first coined by British Tory MP Iain MacLeod in a 1965 speech to Parliament. "We now have the worst of both worlds—not just inflation on the one side or stagnation on the other. We have a sort of 'stagflation' situation." The dichotomous outlook caught crude oil traders by surprise. Only two weeks ago the West Texas Intermediate futures contract was trading at around \$86 per barrel. At the time, rising concerns of the U.S. economy sinking into a recession, combined with downward revisions to projections for world demand growth, encouraged large speculators to open short positions in an attempt to profit from negative macroeconomic views. Instead a steep short-covering rally ensued, helped by a refinery explosion, fire in Texas, as well as Opec who at its February meeting showed it was prepared to defend higher oil prices by keeping its production quotas unchanged. Now the entire WTI futures curve is trading above \$90 suggesting that the market believes high prices are sustainable.

### WEEKLY RECAP

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*"Instead a steep short-covering rally ensued, helped by a refinery explosion, fire in Texas..."*



Crude oil hit \$101.32 on Wednesday catching investors by surprise given a deteriorating economic outlook.

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*Headlines* from page 1

*“...buying 100 contracts in the cocoa pits on any given day, can move the market a lot...”*

Meanwhile, funds seem to be looking for “undervalued” commodities that hadn’t participated in the rally previously, an approach almost akin to bargain hunting in the stock market. That dynamic has helped cocoa soar more than 22% so far this year, despite a bumper harvest from the Ivory Coast, the world’s largest producer. Also, sugar is up nearly 23% this year, based in large part on the plant’s usage as a fuel source in Brazil, where it is turned into ethanol more efficiently than America’s corn-based product. Funds buying 100 contracts in the cocoa pits on any given day, can move the market a lot, even if it’s not supported by the fundamentals. The latest data on speculative positions from the CFTC shows the net long position—bets on price gains—equal to 33 percent of open interest. This is close to a 14 year high for the contract. Part of the rise in speculative activity is related to political instability and uncertainty over supplies from the Ivory Coast. However, this large bet on even higher prices increases the risk of a sharp correction if funds decide to liquidate some of these positions. Analysts are forecasting a strong rebound in global cocoa production, and with demand growth remaining stable, this should result in a surplus.

CC K8 [30] - COCOA    LAST: 2553    CHANGE: ▲ 88    HIGH: 2575    LOW: 2482    2/25/2008



*Soft commodity markets are small markets and attract speculators, resulting in boom-and bust cycles.*



*“A severe drought in Australia has devastated the wheat crop in three of the past six years.”*

In other commodity market news, Platinum continued its record breaking run from around \$1550 a troy ounce at the beginning of the year to around \$2200 this week. The news fomenting this break-taking rally is continued power supply difficulties in South Africa which have caused widespread disruptions to production. Anglo Platinum, the world’s largest platinum producer, has closed one of its smelters and repairs to electrical equipment will take four to six week’s to complete. For those interested in wheat after the lock limit conditions that took place recently, word is that good rains over the past three months should lead to a healthy crop in 2008/09. A severe drought in Australia has devastated the wheat crop in three of the past six years. Meanwhile, Asian steel-makers have agreed to a 65 percent rise in iron ore prices. This comes at a bad time for the industry, as doubts emerge over steelmakers’ ability to maintain their recent run of hefty increases in both output and profits. A likely beneficiary of the Asian pact will be the London Metals Exchange which just launched a steel contract allowing producers and consumers to hedge their future business commitments.

## ECONOMIC REVIEW

Robust U.S. inflation data and strength in commodity prices was underscored by the Federal Reserve's release of its January meeting minutes, which in a somber tone lowered its growth forecast for the economy and raised its inflation outlook in 2008. Both the headline rate of inflation and the underlying core rate were higher than expected. Policymakers also cut their forecast for growth to between 1.3 percent and 2 percent, half a point less than they predicted in October.

On Friday, The Philadelphia Federal Reserve's index of manufacturing activity came in at minus 24 this month, the lowest level in seven years. If sustained at this level, the headline number of this index is now consistent with a deep recession. There was also disappointing news in the U.S. labor market as the four week moving average of initial jobless claims had risen 10,750 to 360,500. The continued deterioration in this number suggests firms have moved from not hiring to outright firing.

Overseas, China's annual consumer inflation hit an 11-year high of 7.1 percent in January, and producer prices hit a three-year monthly high of 6.1 percent, mainly as a result of winter transport bottlenecks and higher commodity prices. The threat of enduring inflation will add to pressures on Beijing to allow an even faster appreciation of its currency. The renminbi, which has risen by about 13 percent against the U.S. dollar since mid-2005, has been rising more rapidly recently. The Chinese central bank is technically losing billions of dollars a month on foreign exchange reserves it invests in U.S. Treasuries, because it is paying higher rates to its domestic banks than it is getting on U.S. investments. Meanwhile, the Reserve Bank of Australia is bucking the trend in most rest of the developed world by seriously considering a 50 basis point increase at its last meeting. For the time being, however, a 25 basis point rate hike was decided upon, although the central bank indicated that further rate rises could take place soon.

## Next Week's Economic Calendar

Will home sales and consumer confidence reveal further economic weakness, and will PPI add to inflationary concerns?

Date	Time (ET)	Statistic	For	Briefing Forecast	Market Expects	Prior
25-Feb	10:00 AM	Existing Home Sales	Jan	4.90M	4.80M	4.89M
26-Feb	8:30 AM	PPI	Jan	0.4%	0.3%	-0.3%
26-Feb	8:30 AM	Core PPI	Jan	0.2%	0.2%	0.2%
26-Feb	10:00 AM	Consumer Confidence	Feb	80.0	82.5	87.9
27-Feb	8:30 AM	Durable Orders	Jan	-5.0%	-4.0%	5.2%
27-Feb	10:00 AM	New Home Sales	Jan	600K	600K	604K
27-Feb	10:30 AM	Crude Inventories	23-Feb	NA	NA	4204K
28-Feb	8:30 AM	GDP-Preliminary	Q4	0.6%	0.8%	0.6%
28-Feb	8:30 AM	Chain Deflator-Preliminary	Q4	2.6%	2.6%	2.6%
28-Feb	8:30 AM	Initial Claims	23-Feb	355K	350K	349K
29-Feb	8:30 AM	Personal Income	Jan	0.4%	0.2%	0.5%
29-Feb	8:30 AM	Personal Spending	Jan	0.3%	0.2%	0.2%
29-Feb	8:30 AM	Core PCE Inflation	Jan	0.2%	0.2%	0.2%
29-Feb	8:30 AM	Core PCE Prices	Jan	NA	0.2%	0.2%
29-Feb	9:45 AM	Chicago PMI	Feb	49.5	50.0	51.5
29-Feb	10:00 AM	Michigan Sentiment	Feb	70.0	70.0	69.6

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

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### MANAGED FUTURES NEWS

Refco Inc.'s former chairman, Phillip Bennett, pleaded guilty to bank fraud, conspiracy, money laundering and 17 other charges in a scheme that cost investors more than \$2.4 billion. Under federal guidelines, Bennett faces life imprisonment with a maximum penalty of 315 years covering all counts as well as forfeiture of \$2.4 billion, prosecutors said. Bennett, whose lawyer says he has \$20 million in assets, is scheduled to be sentenced May 20th. After increasing bail, the judge rejected a request by prosecutors to take Bennett into custody immediately.

Steel, part of the fabric of daily life for hundreds of years, will be for the first time be traded on a derivatives exchange allowing producers and consumers to hedge their future business commitments. The London Metal Exchange, the top platform for non-ferrous metals, will begin trading futures in billets, a steel product commonly used in construction, initially via electronic screens before moving to open outcry floor trading on April 28.

The Dubai Mercantile Exchange (DME) plans to launch two new crude oil derivatives contracts in the second quarter in an attempt to build further trading interest on Wall Street. The new Brent and Oman crude oil futures contracts will be financially-settled. They will allow traders to play the price difference between the high-quality, light-sweet Brent oil and the lower-quality, heavy-sour Oman oil. The exchange launched its Oman crude oil futures in June, but had struggled until recently to build trading activity. Daily trading volumes have recently picked up in 2008 with an average of 2,000 trades for the front-month contract in January.

The New York Mercantile Exchange Inc said Wednesday it will raise margins for its copper and COMEX miNY copper futures contracts, effective at the close of business on Thursday, February 21st. Copper futures margins will increase to \$5,750 from \$5,250 for clearing and non-clearing members and to \$7,763 from \$7,088 for customers.

Germany plans to “tighten the screws” on Europe’s tax havens, the country’s finance minister vowed on Friday, Feb. 22nd, amid a growing global government backlash against financial centers with bank secrecy rule that foster tax evasion. The warning from Peer Steinbrück marks another escalation of the tensions with Liechtenstein that have flared over a mammoth tax investigation into German’s bank accounts held at the principality.

As fears of recession grow, Hilary Clinton has adopted a populist economic message, which included attacking hedge fund managers, describing them as over-paid and under-taxed. The message is blunted by the fact that her daughter Chelsea works for a hedge fund. On her final day of campaigning in Wisconsin, she railed against hedge funds even while Chelsea sat alongside her.

John W. Henry & Co. started the year off on the right foot making gains in five out of its seven programs. Most notably, the firm’s Global Diversified Portfolio rose an estimated 15.16% followed by the Financial & Metals Portfolio, which was up an estimated 14.02%. JWH’s World Commodity Portfolio was the firm’s biggest loser, dropping an estimated 3.19% in January.

The US Commodity Futures Trading Commission (CFTC) has established an advisory committee to provide a public forum examining issues related to the energy markets and the CFTC’s role in them under the Commodity Exchange Act. The commission’s acting chairman, Walter Lukken, will serve as chairman of the new energy markets advisory committee. Other members will be named at a later date, but will include representatives from the industry with knowledge of the energy markets, including exchanges, producers, market users and consumers.

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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).

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