



Market Weekly

Commodities, Forex, Futures and Options

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HEADLINE OF THE WEEK: "Commodities: Who's Behind the Boom?" (Barron's, 3/31/2008)

WEEKLY RECAP

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Compiled by Mack Frankfurter, Chief Investment Strategist

The debate brewing over rising commodity prices as a result of a speculative build-up by commodity-linked index funds and exchange traded funds (ETFs) was thrown into public light on March 31st in an article published by Barron's. This issue has been hinted at on several occasions in Market Weekly, and on March 19th we published a draft of the speech we gave this week in New York City to the IQPC Base Metals Investment Summit (<http://www.safehaven.com/article-9734.htm>). What is not well understood by the general public who chase returns by investing in commodity ETFs, is that for every buyer there is a seller, someone on the other side of the trade. The question is who? Is it a commercial hedger, or is it another speculator who may be "smarter"? As it stands now, it is the commercial players who have record short positions betting that market prices will fall (see the section on Managed Futures News on page 4 for chart). In an analysis by MF Global, they identify the issue as not so much a shortage of cash commodities, but "a shortage of futures for sale amid an index fund business model for carrying long positions for extended periods." We agree with this assessment and think that active management trumps passive management at this stage. For a PDF version of the final presentation, contact a MARI representative.

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First calculated in 1957, the CCI is the oldest commodity index and has long traded as a futures contract.

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Headlines from page 1

“...confidence in the banking system improved after an additional large writedown by UBS..”

As for the first quarter of 2008, it was the worst quarter in more than five years for the stock markets. The losses have seen many equity markets enter “bear territory” by falling 20 percent from recent peaks as a result of increasing fears about a U.S. recession. However, a mood of cautious optimism crept back into the financial markets this week as equities staged a broad rally, credit spreads tightened and the dollar halted its slide. These moves came as confidence in the banking system improved after an additional large writedown by UBS, and capital-raising by Lehman Brothers. Weak employment data was shrugged off as “old hands” in the municipal bond markets were going back to doing what they know how to do—value bonds, work out which municipal borrowers will do better, and get paid a reasonable return rather than watch yields fall to absurdly low levels because of hedge fund leveraged up the sector. Meanwhile, some noted the “dissonance” between what is happening in emerging markets and the “frightening” news coming out of the U.S. and U.K. markets. Business is “good” in South America with businesses planning for growth. However, others pointed to growing economic pressures in Turkey and various eastern European nations.



Thai medium-quality rice, a global benchmark, traded at about \$850 a ton, up from \$760 last week.

“India said it would crack down on hoarding of essential commodities to keep a lid on food prices...”

In other market news, the emissions trading market, which allows companies producing less CO₂ to sell their excess allowances to other companies, is beginning to get off the ground. In the first phase, permits were over-allocated and most companies had a surplus and no incentive to buy permits or cut emissions. When the glut was discovered, the price of permits crashed from more than €30 to less than €10. Phase 2 permits are now trading between €20 and €25. On March 17th, the Nymex launched trading on several versions of emission allowance futures contracts on the CME Globex electronic platform and on the Nymex trading floor. Meanwhile, fears have been growing over rice supplies across Asia as prices rose more than 10 percent to record levels on Friday. India said that it would crack down on hoarding of essential commodities to keep a lid on food prices. But at the same time countries are choking off exports, they are also racing to secure supplies from the handful of exporters still selling the grain in the international market. Rising staple food prices threatens upheaval, and riots have already resulted.

ECONOMIC REVIEW

Eurozone inflation has soared to its highest level for almost 16 years, creating a fresh dilemma for the European Central Bank as it pumps extra overnight funds into money markets. The rise in inflation—from 3.3 percent in February to 3.5 in March—all but rules out any cut in ECB interest rates in the near future, despite slowing economic growth. The central bank aims to keep inflation “below but close” to 2 percent.

Meanwhile, inflation in China hit a 12 year monthly high of 8.7 percent in February after several months of sharply higher food prices. The top ranks of the Beijing government have long been split on the need for the currency to rise more quickly, with objections from the economic planning ministry and the export lobby keeping the pace slow. However, the specter of inflation has now galvanized the Chinese government on allowing the renminbi to appreciate against the dollar at an accelerated pace. A stronger Chinese currency helps reduce the cost of importing products such as soybeans. The currency also helps take the steam out of the swollen trade surplus which has been a political problem in relations with China’s trading partners.

The Senate Banking Committee heard testimony this week focusing on events which led up to the deal that sealed Bear Stearns fate. Testimony shed light on a March 13th conference call with Bear Stearns where the bank notified regulators that without assistance it would file for bankruptcy protection the following morning.

One aspect of the credit crunch that has not been reported here is whether current accounting practices are playing a role. Because risk aversion has increased so sharply that there are no longer liquid markets for the assets that banks hold, a representative index, such as the ABX Index, which tracks mortgage-backed securities, is used to measure the values of these assets. However, in these market conditions, this index does not reflect the fair or true value, and the practice of marking assets to market prices has led to billions in writedowns. Announcements of writedowns cause this index to fall further, which in turn means that other players need to make writedowns, creating a downward spiral. There are those in the accounting side of the industry who think that erratic market prices are damaging the economy, and are calling for alternative ways to report financial assets.

Next Week’s Economic Calendar

FOMC minutes should provide additional fodder for the debate on the Bear Stearns “investment banking bail-out.”

Date	Time (ET)	Statistic	For	Briefing Forecast	Market Expects	Prior
7-Apr	3:00 PM	Consumer Credit	Feb	\$5.0B	\$6.0B	\$6.9B
8-Apr	10:00 AM	Pending Home Sales	Feb	-	-0.5%	0.0%
8-Apr	2:00 PM	FOMC Minutes	18-Mar	-	-	-
9-Apr	10:00 AM	Wholesale Inventories	Feb	0.7%	0.5%	1.0%
9-Apr	10:30 AM	Crude Inventories	5-Apr	NA	NA	7317K
10-Apr	8:30 AM	Initial Claims	5-Apr	380K	NA	407K
10-Apr	8:30 AM	Trade Balance	Feb	-\$57.6B	-\$57.4B	-\$58.2B
10-Apr	2:00 PM	Treasury Budget	Mar	-\$70.0B	-\$80.0B	-\$96.3B
11-Apr	8:30 AM	Export Prices ex-ag.	Mar	NA	NA	0.5%
11-Apr	8:30 AM	Import Prices ex-oil	Mar	NA	NA	0.6%
11-Apr	10:00 AM	Michigan Sentiment-Prel.	Apr	68.0	69.4	69.5

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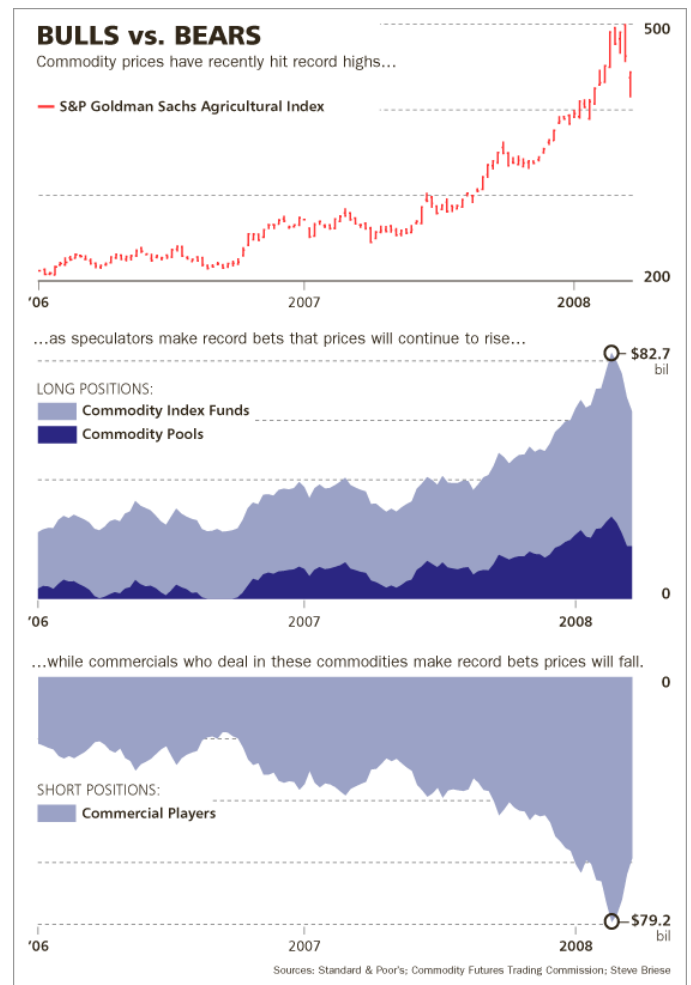
MANAGED FUTURES NEWS

The Commodity Futures Trading Commission, which regulates U.S. futures markets, told the Senate Energy and Natural Resources Committee that speculative investors were not responsible for pushing crude oil prices to record levels. Many lawmakers on the committee disagreed, saying that hedge funds and other speculative investors had taken over futures markets and pushed up oil prices. Two days earlier, oil executives told Congress that speculation might be responsible for half the current cost of oil. Leaders from five top companies agreed that current supply and demand levels should place the price near \$55 a barrel, instead of the roughly \$100 a barrel price. Senator Byron Dorgan, D-North Dakota and others raised the idea of changing the margin investors must pay up front in order to engage in oil speculation. "I think there's an orgy of speculation that we ought to be deciding to do something about," said Sen. Dorgan.

MF Global Ltd. (NYSE:MF) is considering financing alternatives that could include the sale of a minority stake in the company or the issuing of longer-term debt, according to a media reports during the week.

A proposed merger of the Commodity Futures Trading Commission and Securities and Exchange Commission could bring some efficiencies, but it should be weighed against harming the competitive advantage of U.S. futures markets, the head of the CFTC said earlier this week. "Although the creation of a new unified regulator for securities and futures could bring efficiencies, the trade-offs of such a significant undertaking should be weighed carefully given these turbulent economic times and the competitive global advantage currently enjoyed by the U.S. futures industry," CFTC Acting Chairman Walt Lukken said in a statement in response to a government proposal to overhaul regulation of U.S. financial markets.

The Commodity Futures Trading Commission (CFTC) says it will hold a public meeting April 22nd to cover recent issues in the agricultural commodity markets, including the role of speculative and index traders, how traditional participants have been impacted, divergence between futures and cash prices, and the resulting increases in margin requirements. In addition to the CFTC, officials from the USDA and a wide array of participants from the agricultural commodity markets will be on hand.



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