



Market Weekly

Commodities, Forex, Futures and Options

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HEADLINE OF THE WEEK: “Commodities Chaos Has Farmers Crying Foul” (PBS Nightly Business Report, 4/22/2008)

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WEEKLY RECAP

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“...maybe I'm wasting my time, but there are problems, and it's incumbent on us to try and solve them.”

The CFTC this week disputed complaints from farmers and food processors that speculative trading is the root cause of today's high and volatile prices for corn, wheat and other agricultural commodities. That conclusion did not assuage farmers who argued at an all-day hearing that Wall Street players are making it harder for commercial buyers and sellers of ag-commodities to use futures exchanges as a place to limit the risks of price uncertainty. “For those who say everything is all right, I'm sorry, maybe I'm wasting my time, but there are problems, and it's incumbent on us to try and solve them,” said Tom Buis, of the National Farmers Union. The six-member CFTC panel cautioned against new regulations and blaming the situation entirely on speculators, keeping to its position that the agricultural market had been affected by a “number of externalities” including a weak dollar, low crop stockpiles, higher energy, transportation costs and increased global demand from developing countries. One would think that high grain prices would be a boon for farmers, but instead, increased volatility has caused grain elevators to stop buying crops from farmers too far in advance, preventing growers from locking in high prices. At the same time, production costs are squeezing margins.



Wheat falls from historical highs as wet weather improves prospects, and systemic issues come to light (see pg 4).

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Headlines from page 1

You know things have gotten “out-of-whack” when the headline in your local newspaper is reporting that the global run on rice has hit stores in the U.S. Consumers across the country have been cleaning out the shelves on staples such as rice and flour at big-box retailers, including Wal-Mart, Sam’s Club and Costco. Rice prices again hit record prices this week as panicking importers scrambled to secure supplies this week, exacerbating the tightness already provoked by export restrictions in Vietnam, India, Egypt, China and Cambodia. The jump earlier this week came as the Philippines, the largest rice importer, failed for the fourth time to secure as much rice as it wanted. On Thursday, however, rice prices tumbled in Chicago after Thailand and Brazil said they won’t curb exports, and Pakistan announced plans to sell rice, easing concerns about supply shortages. Increasing prices have triggered riots in the past month in countries such as Haiti, Bangladesh and Ivory Coast. Rice is considered the most political agricultural commodity as it is a staple for about 3 billion people in poor countries in Asia and Africa. So are we running out of rice? According to Dr. Mark Welch, an agricultural economist based in Texas, rice supplies are at relatively low levels, but the surge of panic buying and escalating prices is not supported by supply and demand fundamentals. Texas and Louisiana are large producers of rice in the U.S.

“Rice is considered the most political agricultural commodity as it is a staple for about 3 billion people in poor countries...”



Chart for rough rice futures, which trades in Chicago, is tracking Thai medium-quality rice, the global benchmark.

Another puzzle in the commodity story is the continued strength of base metals. Ever since evidence emerged that the U.S. might slide into a recession, debate has raged about the potential fallout on global growth. In a slowing environment, base metals and ores normally decline as such commodities are sensitive to changes in economic activity. However, a spate of supply disruptions for copper, tin, aluminum, coal and iron ore has more than compensated for any consumption weakness, pushing their prices to record levels. The supply disruptions are not a new phenomenon, having already afflicted the industry since 2000. The cost of iron ore and coal has surged between 65 and 240 percent in the last year as demand out of China has confounded pessimists and remained surprisingly robust. But China is only a part of the story. Subcontractors have shut down mines and the copper industry, for example, has produced less than expected for the last six years due to project delays, wage strikes, falling ore grades, breakdowns, power shortages or sulfuric acid shortages. In the Australian coal fields, bad weather has also hit output, while in South Africa, a severe shortage of power has led to problems for miners of platinum and ferro-chrome, resulting in less supply of these metals on the market.

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ECONOMIC REVIEW

According to the World Trade Organization (WTO), world trade growth declined sharply in 2007 and is expected to slow further this year as financial turmoil and rising commodity prices further depress global economic activity. This view is supported by news that surging prices for agricultural commodities, and the fear of shortages at home, have prompted some countries to impose restrictions on exports. Unfortunately these moves threaten to prolong the current global food crisis and even exacerbate it. Various countries have stopped their farmers selling crops abroad or taxed exports heavily in an effort to keep local markets well-supplied and local prices for those crops low. However, the result is that farmers in these countries are not benefiting from record

international prices. At the same time, these same farmers are facing higher input costs in the shape of higher prices for diesel, seed and fertilizers. Soaring food prices is also provoking a rethink of support for biofuels in Europe and the U.S. The U.K. energy minister stated that ethanol targets should be reviewed because of mounting concern that they are contributing to food shortages. Meanwhile, prospects for currency appreciation and interest rate rises across the Pacific Rim increased after countries reported sustained inflation from rising prices for food and fuel. The commodities boom is also driving up the values of arable farm land, and there is even news that Afghan farmers are switching from opium to growing wheat as prices rise.

Next Week's Economic Calendar

The calendar is back to a full slate next week and includes the FOMC policy statement and inflation indicators.

Date	Time (ET)	Statistic	For Period	Briefing Forecast	Market Expects	Prior
29-Apr	10:00 AM	Consumer Confidence	Apr	62.0	62.0	64.5
30-Apr	8:15 AM	ADP Employment	Apr	-	-55K	8K
30-Apr	8:30 AM	GDP-Adv.	Q1	0.7%	0.4%	0.6%
30-Apr	8:30 AM	Chain Deflator-Adv.	Q1	3.0%	3.0%	2.4%
30-Apr	8:30 AM	Employment Cost Index	Q1	0.8%	0.8%	0.8%
30-Apr	9:45 AM	Chicago PMI	Apr	49.0	48.5	48.2
30-Apr	10:30 AM	Crude Inventories	26-Apr	NA	NA	2421K
30-Apr	2:15 PM	FOMC Policy Statement	-	-	-	-
1-May	12:00 AM	Auto Sales	Apr	5.1M	NA	4.9M
1-May	12:00 AM	Truck Sales	Apr	6.3M	NA	6.2M
1-May	8:30 AM	Initial Claims	26-Apr	NA	NA	342K
1-May	8:30 AM	Personal Income	Mar	0.4%	0.4%	0.5%
1-May	8:30 AM	Personal Spending	Mar	0.3%	0.2%	0.1%
1-May	8:30 AM	PCE Core Inflation	Mar	0.2%	0.1%	0.1%
1-May	10:00 AM	Construction Spending	Mar	-1.0%	-0.5%	-0.3%
1-May	10:00 AM	ISM Index	Apr	49.0	48.0	48.6
2-May	8:30 AM	Average Workweek	Apr	33.7	33.7	33.8
2-May	8:30 AM	Hourly Earnings	Apr	0.3%	0.3%	0.3%
2-May	8:30 AM	Nonfarm Payrolls	Apr	-70K	-80K	-80K
2-May	8:30 AM	Unemployment Rate	Apr	5.2%	5.2%	5.1%
2-May	10:00 AM	Factory Orders	Mar	NA	0.4%	-1.3%

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

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MANAGED FUTURES NEWS

The CFTC's April 22nd roundtable on agricultural markets brought out into the open what has been seething in America's farming communities—total frustration. Problem is that facts are complicated. At one point, Robert Greer, product manager for Pimco's Commodity Real Return Strategy Fund, argued that (1) they don't trade commodities on a leveraged basis, and (2) don't take delivery but "roll" the futures contracts. The grain elevators' counterpoint: 'eventually the basis is going to widen to the point that your fund will be forced to take delivery.' Again Greer retorted his well-rehearsed refrains. And again, the reply came back... 'no, you don't understand, at some point your going to be forced to take delivery.' What the farmers were trying to explain to Greer is that the futures price had widen far above what the grain elevators were willing to pay in the spot market as an ongoing business concern. You could hear the virtual world of financial engineering slamming into the brick wall of heartland common sense. So what is the upshot for Greer's long-only commodity fund if the speculative fever in commodities continues? At some point it will have a bad choice on its hands. In order to roll out of the nearby contract into a backdated contract, it will either need to take an unacceptable loss and face the wrath of unhappy investors, or take actual delivery and face the wrath of regulators.

CFTC commissioner Bart Chilton stated this week that the U.K. derivatives industry lacked transparency and that its regulator, the Financial Services Authority (FSA), needs a "strong effort" to pursue market manipulation. The FSA relies too heavily on exchanges to regulate markets and there needs to be "greater oversight and enforcement." The London-based FSA in January said it decided against publishing the holdings of investors such as hedge funds in London's commodity markets, citing costs. The CFTC publishes a weekly "commitment of traders" report showing such holdings in the markets it oversees, although many now complain that this report is misleading. Chilton was in London to discuss the mutual recognition of U.K. and U.S.-registered options and futures so they can be traded in both markets.

With all the news about credit derivatives, one may confuse important differences between over-the-counter (OTC) derivatives versus exchange traded derivatives, such as futures contracts which trade on the CME. In fact, there is a material difference. Processing problems with OTC derivatives are still dogging the industry in spite of a concerted effort since 2005 to end sloppy practices which prevent some trades from being confirmed. According to a new survey, sharp rises in trading volumes in OTC derivatives led to corresponding spikes in unconfirmed trades, data released by Markit Group showed. Regulators are paying close attention to the infrastructure of these markets, but the OTC derivatives industry is determined to face down any threat of increased regulation. Bob Pickel, chief executive of the International Swaps and Derivatives Association (ISDA), recently stated that while the industry may be under heightened regulatory scrutiny, he did not believe more oversight was needed. Separately, an ISDA survey has found that 50 percent of credit portfolio managers are worried that their firms are not sufficiently prepared to deal with another crisis.

Unlike OTC derivatives, futures are regulated, and futures exchanges are promoting the exchange-traded business model as a way to cut unwanted counterparty risks associated with the bilaterally-negotiated OTC derivatives markets. The clearing of derivatives is a lucrative business, which helps explain why there is resistance from the investment banks who act as dealers for these instruments. The ISDA has opposed any centralized clearing in the past but is now mellowing its position.

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