



Market Weekly

Commodities, Forex, Futures and Options

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HEADLINE OF THE WEEK: "Fed looks at ways to fight asset bubbles" (Financial Times, 5/16/2008)

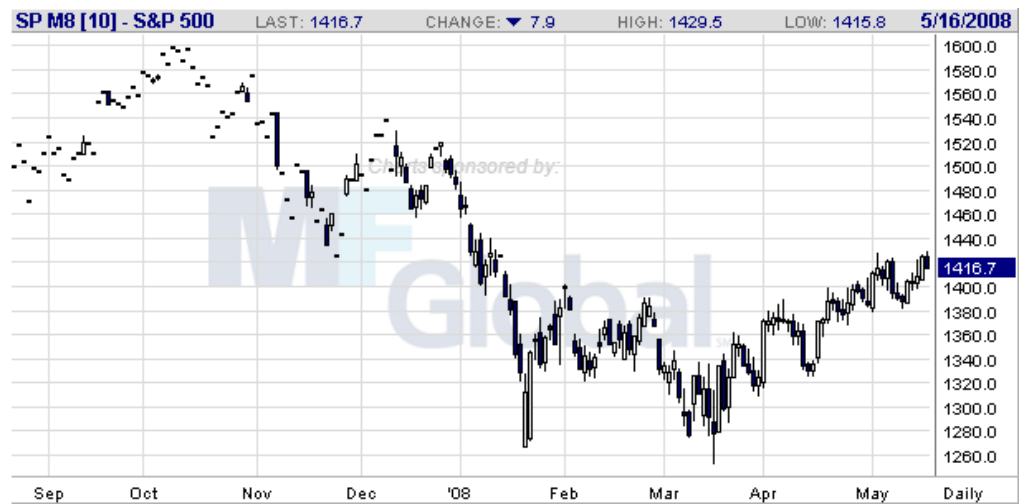
Compiled by Mack Frankfurter, Chief Investment Strategist

WEEKLY RECAP

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It would be a radical and unprecedented step, tackle asset bubbles preemptively rather than mitigating the fallout after they burst. The U.S. Federal Reserve has long stood out among central banks as the least willing to embrace the idea that it should "lean against the wind" when asset prices are rising rapidly. In fact, former chairman Greenspan famously argued that it was in practice impossible to identify bubbles before they burst, and attempts to prick them by raising rates were likely to do more harm than good. Current chairman Ben Bernanke still believes it is hard to know when a bubble is a bubble. But policy looks to shift after the second big and disruptive bubble in a decade. Thinking at the Fed is beginning to shift towards the use of microeconomic regulation to mitigate the risks caused by potential bubbles. Inside the Fed there is interest in using regulatory policy more aggressively. Officials are intrigued by the extra possibilities that could be opened up by proposed new powers set out in a Treasury blueprint for regulatory reform. In the meantime, the S&P 500 has been climbing a wall of worries, having established a double-bottom base in January and March. In the meantime, the VIX has imploded down to around 16. This means option traders are going to have to take more risk to write premium

"Current chairman Ben Bernanke still believes it is hard to know when a bubble is a bubble."



The S&P 500 index is beginning to show a positive construction supported by positive sentiment for the short term.

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Headlines from page 1

“Farmers complain that rising input costs, largely oil and fertilizer, have limited their gains from higher crop prices.”

The leaders of international institutions including the World Bank and World Trade Organization have exhorted governments to use the food crisis to reform policies that distort agricultural production and trade. They argue that fewer subsidies and import tariffs would provide incentives for farmers around the world to increase production and exports. Yet the effect has instead been to entrench farm lobbies in their existing positions, defending ever more fiercely the subsidies and tariff protection that they would now appear not to need. With the farming sector flush with cash, the time would seem ripe for reform. Farmers complain that rising input costs, largely oil and fertilizer, have limited their gains from higher crop prices. But the data also shows a big boost to income and wealth. The U.S. doles out subsidies to its farmers in two ways: price-related payments, which kick in when prices fall, and “direct payments” that are related to overall acreage but not current output. Payments under the first type have dropped rapidly because of stratospheric prices. But farmers are reluctant to see falls locked in by having a lower ceiling imposed on overall payments. To put it bluntly, what goes up can come down. Just look at the wheat chart.



After farmers got short squeezed in February and March, wheat prices came down on increased plantings.

“Corn prices are up nearly 53 percent in the past six months, but wheat prices have fallen by almost 19 percent....”

Speaking of wheat, since last summer, wheat and corn have become synonymous with rising prices as the cost of both crops escalated to record highs. But the bond between both cereals has been broken in recent weeks. Corn prices are up nearly 53 percent in the past six months, but wheat prices have fallen almost 19 percent in the same period. The diverging trend could influence agricultural commodities as well as global food inflation in the following months. The link is the feeding industry: in other words, lower prices for wheat encourage ranchers to purchase the grain for animal feeding, easing the tightness of the corn market. But that extra demand for wheat could, in turn, support its price. Currently, the consensus is for lower wheat prices as the northern hemisphere harvest approaches and, crucially, because the exporting countries that imposed trade restrictions would lift barriers as a higher crop and lower prices prompt them to compete to secure export markets. The U.S. Department of Agriculture forecast that global wheat production would hit a record of 656 million tons in 2008-09 up 8 percent from 2007-08, when extreme weather damaged the crops in key exporters, including Australia. Price risk for corn is still on the upside as the corn acreage already sown at 55 percent of the total is well behind the five-year average of 77 percent for this time of the year.

ECONOMIC REVIEW

U.S. consumer confidence sank to its lowest level in 28 years this month as anxious shoppers grappled with surging food and fuel costs, according to a new survey published on Friday. The Reuters/University of Michigan consumer confidence index plunged from 62.6 to 59.5 in May, the lowest reading since June 1980. Meanwhile, one-year inflation expectations rose to 5.2 percent, the most since February 1982, and up from 4.8 per cent in April. As investors sort through the wreckage of the subprime mortgage debacle that has rocked global securities markets, concerns are growing that similar problems may be lurking in other parts of the huge market for U.S. consumer debt. The question is what the impact the housing turmoil will be on the consumer. Will the consumer be the next to fail? In past downturns the consumer sector has propped up the rest of the economy, but this time may be different.

At the root of investor concerns is that in the six years after the turn of the millennium—years in which economists marveled at the vaunted U.S. consumer's ability to keep on spending—consumer debt more than doubled. Before 2000, total U.S. consumer debt stood at \$6,400 billion. By the end of 2006, it was more than \$13,000 billion. Now, as U.S. consumers are threatened by the multiple pressures of falling house prices, high mortgage debt burdens, slowing employment and rising food and energy costs, investors fear that borrowers will have growing problems repaying their credit cards, auto loans and student debt.

Such debts have been packaged into securities and sold to investors in much the same way that home loans were securitized, prompting investor concerns that more pressure on the U.S. consumer could translate into more trouble for global debt markets. There are growing signs that this feared deterioration may already be underway, but analysts say it remains hard to tell how serious it could be, and whether it will have any broader impact on the securitizations that package consumer debts. Effectively, the markets are at an inflection point between a financial relief rally and deciding whether the U.S. economy is in a mild recession or a deeper, prolonged recession.

In recent months, the rate of new bankruptcy filings had picked up and prompted concerns that the effect of the new more stringent bankruptcy rules are not telling the whole story. It is interesting to note that U.S. consumer bankruptcy filings are up 47.7 percent nationwide in April from the same period a year ago, according to the American Bankruptcy Institute. The new bankruptcy law, combined with the unprecedented headwinds facing the U.S. consumer, could mean that future credit card losses are difficult to forecast, as past performance becomes an unreliable guide to future expectations. The combination of an unprecedented decline in housing prices and rising unemployment, in addition to the ongoing impact of 'normalization' of bankruptcy filings, places the credit card industry in uncharted waters.

Next Week's Economic Calendar

What did I tell you!! Crude oil remains above \$120, but the CPI last week came in lower than market expectations.

Date	Time (ET)	Statistic	For Period	Briefing Forecast	Market Expects	Prior
19-May	10:00 AM	Leading Indicators	Apr	-0.1%	0.0%	0.1%
20-May	8:30 AM	Core PPI	Apr	0.1%	0.2%	0.2%
20-May	8:30 AM	PPI	Apr	0.3%	0.4%	1.1%
21-May	10:30 AM	Crude Inventories	17-May	NA	NA	176K
21-May	2:00 PM	FOMC Minutes	30-Apr	-	-	-
22-May	8:30 AM	Initial Claims	17-May	370K	NA	371K
23-May	10:00 AM	Existing Home Sales	Apr	4.85M	4.85M	4.93M

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MANAGED FUTURES NEWS

Trading spaces: CME era ends—Traders bid farewell to Merc floor, host of friendships, rivalries, profits

By David Roeder, Chicago Sun-Times

The Great Migration of Chicago Traders is almost over and that means a new era begins for the Chicago Mercantile Exchange. Today is the final day of trading at the old Merc, its home for nearly 25 years at 20 S. Wacker. It will be left to the meat traders, stalwarts whose business goes back to the exchange's earliest days, to turn out the lights for good.

They will mark the occasion with laughter and lumps in their throat and maybe smuggle in a flask or two to give the place a proper sendoff. As of Monday, their home will move to the Chicago Board of Trade at 141 W. Jackson, where they will join other Merc traders who have relocated in the past few weeks, squeezing in with the Board of Trade crowd.

The amalgamation of the markets is the biggest physical change from last year's acquisition of the Board of Trade by Merc parent CME Group Inc. The two exchanges had four trading floors between them, too much space with the futures markets now mostly electronic. Although the Merc was in the driver's seat, executives agreed the Board of Trade floors were larger and better suited to accommodate everybody.

The Merc will keep some floor space for executive offices. Another part of it is expected to be rented by the oil company BP PLC. So the Merc floors, pan-caked one on top of the other between two high-rises, had to go. The exchange and its members did well there. When trading on the site started after Thanksgiving in 1983, the Merc was still early into its venture of using financial futures as a service to the world economy.

Now, the combination with the Board of Trade makes CME Group the world's largest futures exchange and Chicago's greatest link to financial centers worldwide. For traders in pork belly and livestock futures who will gather the final day, that history will be felt in the heart. They will remember the generations that traded side by side, the friendships and occasional fisticuffs, the crises and the dignitaries. "For my father before me and for me, we made our livelihoods down there," said James Oliff. "I felt it was the best of all possible worlds."

William Salatich Jr., a Merc member since 1975, said that while he looks forward to opportunities in the new space, the Wacker cavern is filled with memories. Salatich remembered visits from the first President Bush, whose security retinue wore long raincoats with firearms glinting underneath, and by his son, who addressed traders in the cattle pit.

The Merc likes to talk about new contracts that became wild successes, but many failed. Salatich laughed over the time the Merc launched a contract on broiler chickens and paid the San Diego Chicken to visit. "I think the San Diego Chicken was the only guy who made money on that contract," he said.

Outsiders have a hard time understanding it, but the trading floor breeds an intense sense of personal loyalties. So any change involving the pits can be wrenching. "The floor is really a little country," said Jack Sandner, former chairman of the Merc. "It's got its own culture, its own life. Your life is intertwined with others and you share their trials and tribulations like you do nowhere else."

But traders, especially those who deal for their own accounts, don't dwell on the past. They've been described as the type who complain about change the loudest but are the quickest to adapt to it. Several Merc traders said the move opens up new opportunities. Meat traders, for example, will be grouped near the grains market. Specialists in the Merc's Eurodollars market have easy access to the Board of Trade business in U.S. Treasuries.

"For the young kids in their 20s and 30s, it's a great move and an opportunity to trade other markets," said Alan Freeman, a pork bellies trader who was at 20 S. Wacker for the start and plans to be there at the end, wearing his signature Marilyn Monroe necktie and a member badge with the name ALF that has been retired at both exchanges the way a baseball player's number is retired.

Like many floor traders, Freeman believes it's a matter of a few years before futures trading goes all-computer. It's about 80 percent there at the Chicago exchanges. But at age 65, he's not ready to surrender to time yet. He'll move over to the Board of Trade, where he started in the business. "Staying at home is not a lot of fun. You get old too fast," he said.

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