



# Market Weekly

Commodities, Forex, Futures and Options

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## HEADLINE OF THE WEEK: "Oil market thumbs its nose as Congress questions price surge" (Los Angeles Times, 5/23/08)

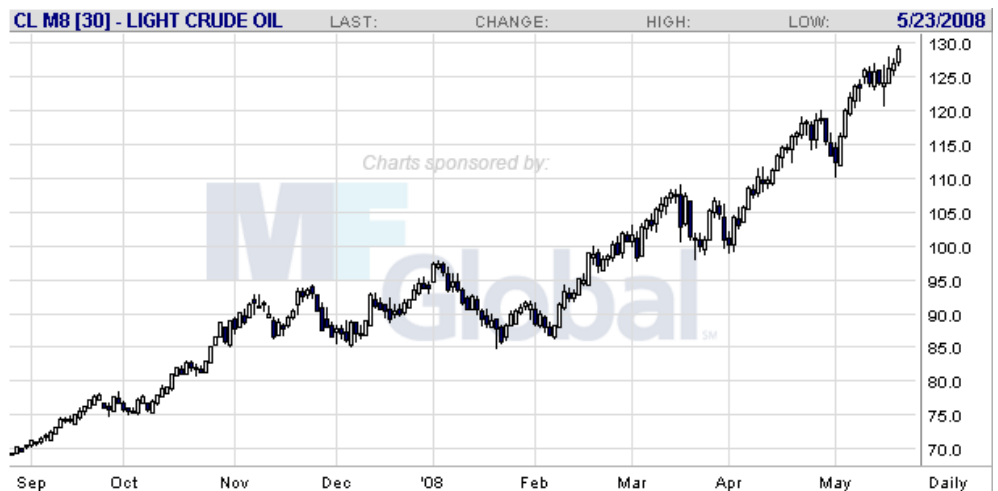
Compiled by Mack Frankfurter, Chief Investment Strategist

### WEEKLY RECAP

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*"No, leave it in the ground, with grace from God, our children need it." King Abdullah*

In 2006, President Bush said in his State of the Union speech that America was "addicted to oil" and often imported from unstable parts of the world, saying he would work to address the issue. This week Saudi Arabia bowed to intense U.S. pressure and said that it would increase its oil production to its highest level in two years after the price surged to a fresh record of almost \$128 a barrel. Yet the announcement did little to ease prices because it failed to reduce concerns over supply: when the kingdom produces more oil, it eats into its cushion of spare supply. This means that President Bush's talks backfired, driving price higher to near \$140—the opposite of what the President, who requested the increased output, had in mind. Going into the meeting, Saudi Arabia was saying that demand forecast did not warrant an expansion. King Abdullah, the country's ruler, put it more bluntly: "I keep no secret from you that, when there were some new finds, I told them, 'No, leave it in the ground, with grace from God, our children need it.'" Investors rushed to buy oil futures contracts as far forward as December 2016, pushing their prices as high as \$139.50 a barrel, up more than \$9.50 on the day. Veteran traders said they had never seen such a jump and said investors were increasingly betting that oil production would soon peak because of geopolitical and geological constraints. "Peak oil views—regardless of whether right or wrong—are seeping into the market and supporting high prices."



*Crude oil's march upwards has been almost relentless... Is it a bubble or is it "peak oil" fundamentals?*

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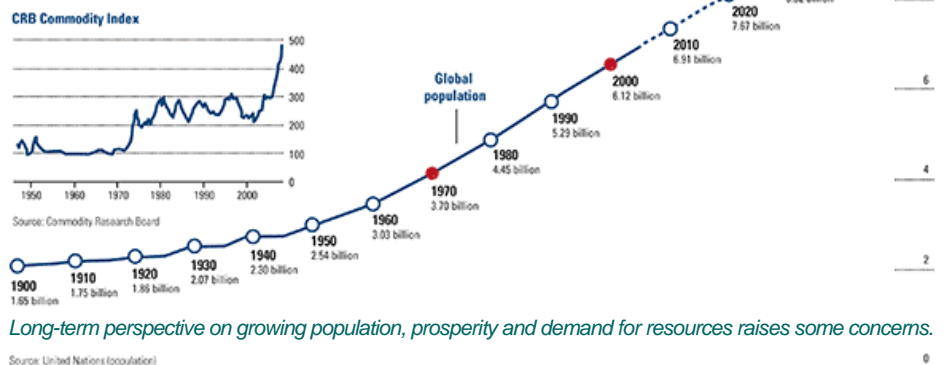
*Headlines* from page 1

*“It was the second successive day that shipping costs hit a record high, and the index closed the week up 11.9 percent.”*

Freight costs for basic commodities such as iron ore, coal and grains surged to an all-time high on Friday, placing new inflation pressures on the countries such as China that import large amounts of natural resources. The Baltic Dry Index, the benchmark for dry bulk commodities’ freight costs, rose to 11,459 points—a 3.5 per cent rise on the day—surpassing its previous peak of 11,039 points last November, boosted by a combination of strong demand for commodities and port traffic jams. It was the second successive day that shipping costs hit a record high and the index closed the week up 11.9 percent. It has jumped tenfold since 2000. Analysts said demand for iron ore and coal was the main factor behind the jump but they also highlighted strong consumption of agricultural commodities. Meanwhile, Argentine farm leaders on Monday indicated they were ready to end a strike that has halted grain exports, boosted international soya prices and delayed wheat planting. Argentina’s farm sector powers the economy and producers have cashed in on soaring commodity prices with surging exports—the country is the world’s leading exporter of soya oil, the third of soybeans and sixth of wheat.

### The Global Resource Squeeze

As the world grows more populous, it also grows more prosperous. Rising living standards in the developing world have boosted demand for resources, lifting prices. CRB Spot Index of prices for 22 commodities, including oil, steel and hogs:



*Long-term perspective on growing population, prosperity and demand for resources raises some concerns.*

Given the combination of the rapid decline of the dollar and the eurozone overtaking the U.S. as the world’s largest economic area, we may be set for another seismic currency shift. It is one in which the euro takes over the baton from the dollar. The story of the decline of sterling mirrors Britain’s slow transformation from the world’s largest creditor to a pariah status as an impoverished debtor. British weakness was driven by declining rates of economic growth and fading competitiveness. The decline was also punctuated by stark political crises. The US currently sucks in something like three-quarters of all net international capital movements. Unlike mid-20th century Britain, which increasingly relied on its imperial possessions for credit in the form of currency reserves held in pounds, the US draws in capital because it is an innovative society that is growing rapidly. The US is also attractive because it seems secure. The safe haven dimension of flows into America explains the often noted paradox that foreigners are willing to accept much lower rates of return on investments in the US than US residents typically receive on their investments abroad. The euro is showing all the signs of strain of being the new international key currency. Manufacturers in Europe complain that its rise is imposing new levels of pain. Politicians in many countries across Europe are pressing to have more influence on monetary policy. For many of their constituents, the euro has become one of the whipping boys of globalization.

*“The safe haven dimension of flows into America explains the often noted paradox that foreigners are willing to accept much lower rates...”*

## ECONOMIC REVIEW

The U.S. is starting to break its “addiction” to foreign oil as high prices, more efficient cars, and the use of ethanol significantly cut the share of its oil imports for the first time since 1977, according to the Department of Energy’s statistical arm. Net imports of the world’s biggest consumer are expected to fall between now and 2030, ending an almost relentless 30-year climb in the use of foreign oil and a fall in domestic production. The U.S. decline in foreign oil dependency is already become more visible, with imports making up 57.9 percent in the first three months of this year, down from 58.2 percent last year.

Increasingly, there has been talk of the “peak oil” theory—the notion based on the 1950s work of Marion King Hubert, a Shell geologist that crude production will soon enter terminal decline. But most of the world’s oil executives, government ministers, analysts and consultants reject this theory, saying it understates remaining reserves, plays down the contribution of technological advances and ignores the role of market forces in shaping future supply. But with oil prices at record highs, fears of the end of the hydrocarbon age

have seeped into the mainstream. Many in the oil industry itself now accept that supply constraints are shaping the price as much as rampant demand.

Meanwhile, the International Monetary Fund warned this month that subsidies were contributing to rising oil prices because they prevented prices from playing “their natural role in moderating demand.” That said, countries across south-east Asia announced plans to cut their expensive fuel subsidies as oil prices jumped this week to above \$135 a barrel. In moves that could damp demand for oil, Taiwan, Malaysia and Indonesia said they planned to cut subsidies or liberalize government-set fuel prices. This could have a noticeable effect given Asia’s position as the engine of global oil demand. The region, in which fuel subsidies are common, will account for about 70 percent of this year’s expected increase in oil consumption. Record prices have already seen falling oil demand in the U.S. and Europe, which are free of subsidies, but demand is still rising in the Middle East and Latin America, where subsidies are also widespread.

## Next Week’s Economic Calendar

It will be an interesting week: consumer confidence, new home sales, durable orders, and personal income numbers.

Date	Time (ET)	Statistic	For Period	Briefing Forecast	Market Expects	Prior
27-May	10:00 AM	Consumer Confidence	May	61.0	61.0	62.3
27-May	10:00 AM	New Home Sales	Apr	515K	520K	526K
28-May	8:30 AM	Durable Orders	Apr	0.5%	-0.7%	-0.3%
28-May	10:30 AM	Crude Inventories	24-May	NA	NA	-5317K
29-May	8:30 AM	Chain Deflator-Prel.	Q1	2.6%	2.6%	2.4%
29-May	8:30 AM	GDP-Prel.	Q1	1.0%	0.9%	0.6%
29-May	8:30 AM	Initial Claims	24-May	370K	NA	365K
29-May	10:30 AM	Crude Inventories	24-May	NA	NA	-5317K
30-May	8:30 AM	Personal Income	Apr	0.2%	0.2%	0.3%
30-May	8:30 AM	Personal Spending	Apr	0.3%	0.2%	0.4%
30-May	8:30 AM	PCE Core Inflation	Apr	0.1%	0.1%	0.2%
30-May	9:45 AM	Chicago PMI	May	49.5	49.0	48.3
30-May	10:00 AM	Mich Sentiment-Rev.	May	60.0	NA	59.5

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

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## MANAGED FUTURES NEWS

### Senate Committee on Homeland Security and Governmental Affairs

Financial Speculation in Commodity Markets: Are Institutional Investors and Hedge Funds Contributing to Food and Energy Price Inflation? HSGA Committee meeting held May 20, 2008, Washington D.C. <http://hsgac.senate.gov/public/>

*The purpose of the Homeland Security and Governmental Affairs Committee Hearing, "Financial Speculation in Commodity Markets," is to examine the role of institutional investors and hedge funds in commodity markets. Questions include: What is the effect of these investors on current food and energy prices? Are financial speculators having a net positive or negative effect on the functioning and long-term stability of the commodity markets? Are food and energy price increases being driven by irrational speculative behavior, a rational response to market fundamentals, or a combination of both? Are rising prices creating an economic incentive for speculators to accumulate and hold stocks of food and energy commodities?*

As grocery and gasoline prices climb, the blame game is in full force in Washington, with a Senate panel listening to testimony Tuesday from a hedge fund manager who says institutional investors are contributing to food and energy inflation. According to Masters, institutional investors such as corporate and government pension funds, sovereign wealth funds and university endowments—relatively new participants in the commodities futures markets—are creating a demand shock. Specifically, he cited index speculators who allocate a portion of their portfolios to commodities investments that track popular indexes such as the Dow Jones-AIG Commodity Index.

The Senate hearing had at least the standard dose of demagoguery. "We may need to limit the opportunity people have to maximize their profits because a lot of the rest of us are paying through the nose, including some who can't afford it," said Sen. Joe Lieberman, (I-Conn.), chairman for HSGAC.

Jeffrey Harris, chief economist for the Commodity Futures Trading Commission, testified for the fundamentalists, presenting a load of charts to support the CFTC's case that you can't blame speculators for what's happened with raw materials prices. "The economic data show that overall commodity price levels, including agriculture commodity and energy futures prices, are being driven by powerful fundamental economic forces and the laws of supply and demand," he said.

"By implication, for better or worse, there is a *crisis of confidence* in regards to the price discovery mechanisms operating in the commodity markets. That said, a debate as to the "rationality" or "irrationality" of commodity pricing is at its essence a philosophical distraction. Rather, I propose that the focus should be on an understanding that supports the economic purpose of the commodity markets, and illuminates the practices and interaction between commercial bona fide hedgers and their counterparty, the speculators... The genie is out of the bottle and it is not going to be put back. There is more than enough blame to go around for high commodity prices, and trying to identify a scapegoat, much less find an answer to the commodity conundrum, is a fruitless exercise that will yield just more of the same old arguments... In conclusion, the futures industry has served as a beacon of a well-regulated marketplace. The principles-based paradigm under which the CFTC and NFA operate has served its constituents and members, as well as protected the public. Unfortunately, it is an easy scapegoat. Blanket allegations are unfair in large part because Congress, the courts and globalization have eroded the futures industry's boundaries..." From letter by MARI's Chief Investment Strategist to Senators Lieberman and Collins at their aides' request.

Meanwhile, the Dubai Gold & Commodities Exchange will launch trading of crude-oil futures on Tuesday, a timely move given the astronomical prices for oil and talk of U.S. regulation of speculators in the commodity markets. The Dubai Gold and Commodities Exchange (DGCX) will launch trading for West Texas Intermediate and Brent crudes under the tickers DWTI and DBRC and they'll trade from 8:30 a.m. to 11:30 p.m. local Dubai time. Regulators should be wary of unnecessary intervention in financial markets, including commodity markets, with increasing competition from financial markets internationally such as Shanghai and Dubai.

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