



# Market Weekly

Commodities, Forex, Futures and Options

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## HEADLINE OF THE WEEK: The End of Oil's Boom? (BusinessWeek, 7/17/2008)

Compiled by Mack Frankfurter, Chief Investment Strategist

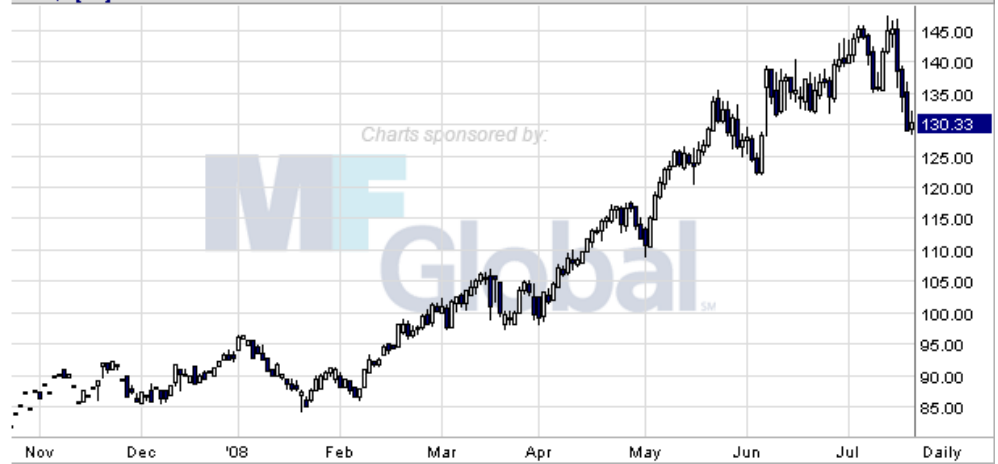
The fall in oil, which last week reached a record high of \$147.27, combined with the rally in bank stocks, brightened what a few days ago looked like an increasingly bleak financial and economic outlook. The slide in the oil price raises the possibility that oil might have peaked. Many oil traders were skeptical, warning that the oil market was highly volatile, trading volumes were thin and prices could swiftly rebound. If sustained, the \$18 decline in oil from its high could improve the prospects for the world economy, easing pressure on incomes and prices. That would reduce the risk of "stagflation," the combination of sustained weak growth and high inflation. At a minimum it would provide extra breathing space for central banks caught between slower economic growth and fast-rising prices pushed up by prior oil and commodity price gains. Analysts say that while oil traders have been betting on surging demand from developing countries such as India and China, reduced demand in the U.S. is now sending bearish signals the markets can't ignore. Moreover, Energy Department data released July 16 showed a 3 million barrel jump in U.S. crude inventories, to 296.9 million barrels—analysts had expected a decline. At the same time, U.S. demand for energy products has fallen 2% from the same period last summer, with a 5% drop in U.S. gasoline demand from the same time a year ago as evidence of a structural shift in the car economy.

### WEEKLY RECAP

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*"...reduced demand in the U.S. is now sending bearish signals the markets can't ignore."*

CL Q8 [30] - LIGHT CRUDE OIL LAST: 130.33 CHANGE: ▲ 1.04 HIGH: 132.04 LOW: 128.54 7/18/2008



The September Dow Jones Industrial Average having entered into bear territory fell below 11000 this week.

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*Headlines* from page 1

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*“...ranchers, facing mounting losses as feed costs rise, are slaughtering their herds... in effect, butchering the bull livestock market.”*

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Even by commodities standards, it seemed like the perfect bull market: a boom in the price of livestock - from bulls and cows to chickens and hogs - as ranchers faced record feeding costs stemming from expensive corn and soybeans. Investors piled into the market this month helping to push live cattle futures at the Chicago Mercantile Exchange, the industry benchmark, to a 22 year high of 104.7 cents per pound, up 16.4% over the past 12 months. The record price levels and bright long-term prospects, as developing countries demand more and more meat, attracted relatively large amounts of money to what is usually one of the smaller and least understood corners of the commodities market. Since the start of the month, however, the price of live cattle has fallen to a one-month low, trading yesterday at 99.0 cents per pound. Traders and analysts say that although investors were right to bet that rising feed costs would support higher meat prices in the long term, they got their timing wrong. The reason is that ranchers, facing mounting losses as feed costs rise, are slaughtering their herds. The increased slaughtering is, in effect, butchering the bull livestock market, prompting investors to exit amid warnings from some Wall Street banks that prices could decline further. Beef cow slaughter for the year to the end of June was up 8.6% compared with a year earlier, according to the US Department of Agriculture.

**LC Q8 [10] - LIVE CATTLE FULL PRECISION** LAST: 98.125 CHANGE: ▲ 0.725 HIGH: 98.460 LOW: 97.850 7/18/2008



*Investors who betted on increased demand for meat from developing countries, didn't anticipate farmers' reaction.*

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*“Meanwhile, investors are deserting emerging market equities... on fears that surging inflation would hamper domestic demand...”*

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A committee in the shura council, which has an advisory role, will recommend to King Abdullah that the authorities revalue the riyal by up to 30%. The proposal would be put before the Saudi king as early as next week. Last summer a wave of speculation that the riyal peg to the dollar, first adopted in 1986, would be dropped swept through financial markets. However, the chatter has diminished substantially since then, after the central bank ruled out any revaluation. The recommendation was likely to have been stimulated by the impending summer holidays. Wealthy Saudis are likely to feel the weakness of the dollar and of their own currency as they travel abroad. Meanwhile, investors are deserting emerging market equities, leaving them less popular than U.S. shares for the first time in seven years. Fund managers who together oversee \$610 billion have slashed their investments in emerging markets this month on fears that surging inflation would hamper domestic demand and leave economies stagnant. Most investors now assume developed economies will slow rapidly enough to stem wage growth pressure and companies will be forced to absorb increasing input costs rather than pass them on to consumers.



## ECONOMIC REVIEW

Emerging economies must make the fight against inflation their top priority, the International Monetary Fund said this week, as it sharply raised its forecast for price rises in the developing world this year and next. The fund said many emerging markets needed to raise interest rates, cut government deficits and allow currencies to appreciate to contain the inflation risk. The IMF said it expected inflation to hit 9.1% in the emerging world this year and remain high, at 7.4%, next year. The fund also marked up its forecast for inflation in the industrialized world but said price rises there would subside much more quickly, from 3.4% this year to 2.3% next. The warning on inflation came as the IMF nudged up its growth forecast for the U.S. in the light of a better than expected performance in the first half. But it said the U.S. economy was still likely to contract in the second half of this year amid a general slowdown in global growth, including in the eurozone, the UK, Japan and the emerging economies.

China's growth rate slowed in the second quarter of the year because of weaker export markets and restrictions on lending, although the economy is still expanding at more than 10% a year in spite of the global slowdown. The government also announced mixed news on inflation. While consumer price inflation continued to decline—from 7.7% in May to 7.1% last month—factory gate inflation rose again from 8.2% to 8.8%. The batch of economic data underlined the delicate challenge the Chinese authorities are facing in trying to cool the economy in the face of high inflation without prompting a sharp drop in activity and

employment. The authorities have tried to tackle inflation this year by accelerating the rate of currency appreciation and by placing stricter quotas on new bank lending, although they have not increased interest rates. However, the central bank is under growing pressure from parts of the government and industry to relax some of the tightening measures, pressure that is only likely to increase with the latest signs of slowing growth. In particular, the commerce ministry called last week for slower appreciation of the currency.

Meanwhile, Democrats in the House of Representatives introduced a bill intended to toughen the enforcement of U.S. trade laws, including more aggressive provisions targeting imports from "non-market economies" such as China. The move by Charles Rangel, chairman of the ways and means committee, and Sander Levin, who leads the trade subcommittee, marks an attempt to lay the groundwork for broader changes to U.S. trade policy after the presidential election in November. According to the bill, the commerce department's ability to fight back against subsidized goods imported from China with countervailing duties, which it started applying last year, would be written into law. In addition, the White House's powers to block a decision by the International Trade Commission to grant relief for disruptive Chinese imports would be limited. Similar legislation toughening U.S. trade enforcement has been introduced in the Senate too, under the sponsorship of Max Baucus, chairman of the Senate finance committee.

## Next Week's Economic Calendar

The question has been raised a dozen times in the last few years, has housing sales and prices hit a bottom yet?

Date	Time (ET)	Statistic	For Period	Briefing Forecast	Market Expects	Prior
21-Jul	10:00 AM	Leading Indicators	Jun	-0.3%	-0.1%	0.1%
23-Jul	10:30 AM	Crude Inventories	19-Jul	NA	NA	NA
23-Jul	10:35 AM	Crude Inventories	19-Jul	NA	NA	2952K
23-Jul	2:00 PM	Fed's Beige Book	-	-	-	-
24-Jul	8:30 AM	Initial Claims	19-Jul	372K	NA	366K
24-Jul	10:00 AM	Existing Home Sales	Jun	4.97M	4.95M	4.99M
25-Jul	8:30 AM	Durable Orders	Jun	0.0%	0.1%	0.0%
25-Jul	10:00 AM	Mich Sentiment-Rev.	Jul	NA	NA	NA
25-Jul	10:00 AM	New Home Sales	Jun	507K	505K	512K

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



### MANAGED FUTURES NEWS

Financial industry executives are mustering on Capitol Hill to head off a Congressional effort to rewrite the rules for the nation's energy markets. The primary focus of Wall Street's concern is a bill entitled the Stop Excessive Energy Speculation Act of 2008, introduced on Tuesday by a group of Democratic senators led by Harry Reid of Nevada, the majority leader. The bill would substantially broaden federal regulators' authority over the vast marketplace for privately negotiated derivatives, called swaps. It also would limit the stakes that speculators and other noncommercial energy traders could take, both in private transactions and in the public futures markets, which allow oil producers and users to hedge their price risks. And it would require regulators to distinguish between "legitimate" and "non-legitimate" hedging transactions and subject the latter to increased scrutiny and tighter market limits. Since the bill's introduction, lobbyists for the futures industry and other institutional interests in the energy markets have significantly bolstered their efforts in Washington. But their concerns are colliding with the determination of lawmakers, who have held more than 40 hearings on "excessive speculation" this year, to take some legislative action to address the economic pain being inflicted on consumers by soaring oil and gas prices.

National Futures Association (NFA) and NYSE Liffe, a wholly owned subsidiary of NYSE Euronext, have entered into an agreement for NFA to provide regulatory services for NYSE Euronext's U.S. futures exchange, NYSE Liffe. NYSE Euronext anticipates that the CFTC will designate NYSE Liffe as a contract market in the third quarter of 2008. Once designation is achieved, the CBOT precious metals complex will be transitioned from CBOT to NYSE Liffe as quickly as possible, and NFA's regulatory services will commence. NYSE Liffe will continue to use the existing trading platform, which is powered by LIFFE CONNECT technology, and CME will continue to provide clearing services for the precious metals complex through the end of the first quarter of 2009. NFA will perform an extensive range of trade practice and market surveillance activities for NYSE Liffe, including processing membership applications, making use of Large Trade Position Reports and other tools to monitor position concentration, and, in consultation with NYSE Liffe's Chief Regulatory Officer, providing a variety of other regulatory services that may be necessary.

The Chicago Board Options Exchange plans to launch a family of volatility indices for commodities, after the introduction this week of a volatility index for oil prices. The move will replicate its widely followed "Wall Street fear gauge" - the S&P 500 VIX index. The new index, known as Oil VIX, measures the market's expectation of the volatility of crude oil prices during the next 30-day period. It comes as oil prices suffer unprecedented swings, which has intraday ups and downs of more than \$10, as traders react nervously to conflicting signals over demand and supply. The CBOE, the largest U.S. options market, said it plans to launch other volatility indices for commodities, including gold, "in coming months." It is also preparing similar indices for currencies to expand into a next generation of indices in non-equity asset classes, it said. Among commodities, natural gas is the most volatile, with gold the least. Traders and analysts said that the new oil index could simplify volatility trading, which now takes place through more complex options trading and variance swaps. The volume of options trading has risen significantly this year, according to data from Nymex and ICE, the two largest energy exchanges. Traders warned that the new volatility index could suffer because it measures the volatility of the United States oil fund, an exchange-traded fund designed to track changes in oil prices, rather than directly measuring the volatility of the Nymex West Texas Intermediate or ICE Brent, the key industry benchmarks for oil prices.

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