



Market Weekly

Commodities, Forex, Futures and Options

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HEADLINE OF THE WEEK: "Gustav on the Brink of Explosive Development" (Washington Post, 8/29/2008)

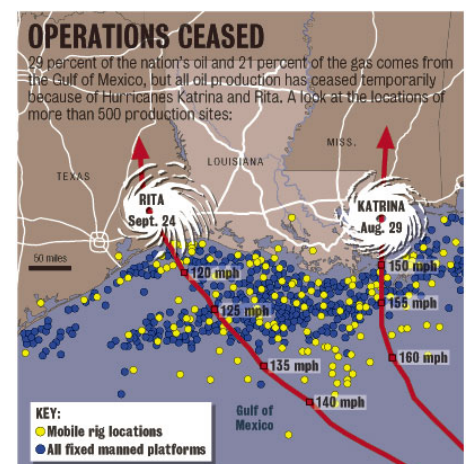
Compiled by Mack Frankfurter, Chief Investment Strategist

WEEKLY RECAP

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Over the past 48 hours Tropical Storm Gustav proved it was a survivor, as it withstood difficult journeys over Haiti and Jamaica. Now it may turn into a monster. Some analysts note that while damage to refineries to the U.S. Gulf Coast may develop due to the storm, the current rate of refinery utilization is still low and refineries in other areas may cover up for lost production, thus tempering any oil rally spawned by storm worries. Meanwhile, a swift business is being done in Gustav-linked derivatives as energy companies and insurers scramble to cover themselves and others speculate the storm will become a major hurricane. Insurance brokerages sell catastrophe, or cat, derivatives to plug gaps in reinsurance capacity that can follow disasters, such as Hurricane Katrina. Of particular interest to energy companies are so-called cat-in-the-box products, which cover a specific geographic area that is home to many offshore oil and gas rigs. Katrina, which made landfall three years ago on Friday, was the costliest storm on record, with insurers paying out some \$50 billion in claims from damage on the Gulf Coast. On Thursday, Gustav was forecast to strengthen into a hurricane in coming days as it neared the Gulf of Mexico, home to a quarter of U.S. crude oil production and 15 percent of its natural gas output.

"Of particular interest to energy companies are so-called cat-in-the-box products..."



Trajectory of Gustav threatens oil rigs located in the Gulf of Mexico, a key area of production in the U.S.

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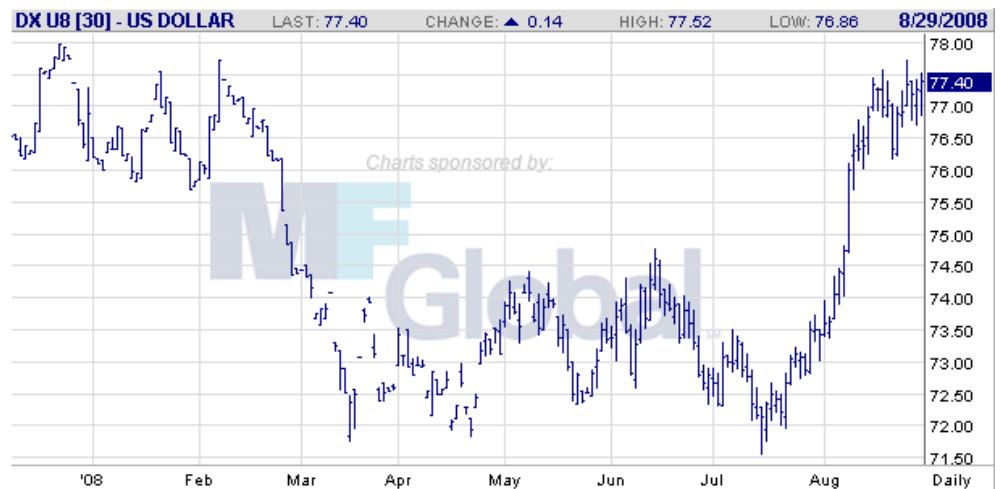
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Headlines from page 1

“Weakening currencies threaten to push up the cost of imports and accelerate inflation...”

Asian currencies declined this month, led by South Korea's won, as overseas funds dumped stocks on concern that slowing global growth will damp demand for Asian exports just as central banks grapple with quickening inflation. The won posted its biggest monthly decline since August 1998, Malaysia's ringgit had its worst month since the end of a dollar link in 2005 and Taiwan's dollar posted its biggest loss in seven years. Weakening currencies threaten to push up the cost of imports and accelerate inflation while decreasing demand for exports puts pressure on trade and current-account balances. Meanwhile, the dollar declined against the yen as government reports showed consumer spending slowed and personal income dropped in July. The greenback was headed for its biggest monthly advance against the euro since the European currency began trading in 1999 and its longest gain versus the yen since 2002. The yen appreciated against all of the other major currencies after Japan's government announced plans to spend about 2 trillion yen (\$18 billion) to revive the world's second-largest economy. The greenback rose versus all of the other major currencies this month on speculation the economic slowdown that began in the U.S. is spreading to the rest of the world. The dollar gained 5.9 percent versus the euro, the best performance since the European currency's debut.



The U.S. dollar's month-long advance could lose steam in the upcoming data-packed week.

“The world's farmers will harvest 672 million metric tons in the year ending June 2009, up 10 percent a year earlier.”

Wheat fell, heading for the biggest weekly drop in five months, on expectations that global production will rise after growers planted more in the past year. The world's farmers will harvest 672 million metric tons in the year ending June 2009, up 10 percent from 609 million tons a year earlier, the International Grains Council said today in a report. Russia said production of grains and legumes may rise 16 percent to 95 million tons. Wheat futures have dropped 40 percent from a record \$13.495 a bushel on Feb. 27th. Meanwhile, Soybean oil's premium to palm oil, the widest in more than six years, may halve as output of palm oil peaks in Indonesia and Malaysia and a price plunge attracts buyers. The two vegetable oils, used in cooking and for alternative fuel, are the most consumed in the world. The U.S., Brazil and Argentina are the biggest growers of soybeans, which are crushed to make oil, and Indonesia and Malaysia produce most of the world's palm oil. China and India are the largest users.

ECONOMIC REVIEW

Thursday's dramatic revision to U.S. second quarter growth highlights the extent to which the fortunes of the economy and the outlook for policy depend on growth conditions in other countries. At the same time, it underscores the way in which the U.S. is exporting its economic slowdown through the trade channel to the rest of the world. This comes on top of its export of weakness through global financial markets. A large part of the swing in net exports is due to cyclical conditions, with domestic demand growing more strongly outside the U.S. But the big decline in the dollar until the spring appears to have had a significant impact.

From the perspective of the global economic system, the substantial decline in the U.S. trade deficit in real (price-

adjusted) terms has reduced a long-threatening source of potential economic instability. However, the impact has been mitigated by the sharp increase in the price of oil. For the U.S., the most obvious point is that global conditions matter enormously for growth. Net exports contributed a staggering 3.1 percent to US growth in the second quarter (all figures on an annualized basis). Trade has contributed roughly three-quarters of growth on average over the period of the credit crisis. In doing so it has much more than offset the drag from residential investment, which started much earlier. But foreign growth also impacts on the U.S. economy in other important ways, via its effect on the price of commodities such as oil and the dollar (with exchange rates responding to expected interest rate differentials).

Next Week's Economic Calendar

It's going to be a data-packed week and perhaps a game-changer to current market sentiment, which is bullish...

Date	Time (ET)	Statistic	For Period	Briefing Forecast	Market Expects	Prior
2-Sep	12:00 AM	Auto Sales	Aug	4.8M	NA	4.4M
2-Sep	12:00 AM	Truck Sales	Aug	4.8M	NA	4.6M
2-Sep	10:00 AM	Construction Spending	Jul	-0.3%	-0.4%	-0.4%
2-Sep	10:00 AM	ISM Index	Aug	50.2	49.5	50
3-Sep	12:00 AM	Auto Sales	Aug	4.8M	NA	4.4M
3-Sep	12:00 AM	Truck Sales	Aug	4.8M	NA	4.6M
3-Sep	8:15 AM	ADP Employment	Aug	-	-19K	9K
3-Sep	10:00 AM	Factory Orders	Jul	1.0%	0.4%	1.7%
3-Sep	10:35 AM	Crude Inventories	30-Aug	NA	NA	-177K
3-Sep	2:00 PM	Fed's Beige Book	-	-	-	-
4-Sep	8:15 AM	ADP Employment	Aug	-	-19K	9K
4-Sep	8:30 AM	Initial Claims	30-Aug	415K	NA	425K
4-Sep	8:30 AM	Productivity-Rev.	Q2	NA	2.90%	2.20%
4-Sep	10:00 AM	ISM Services	Aug	50.0	49.0	49.5
4-Sep	10:35 AM	Crude Inventories	30-Aug	NA	NA	-177K
5-Sep	8:30 AM	Average Workweek	Aug	33.7	33.6	33.6
5-Sep	8:30 AM	Hourly Earnings	Aug	0.3%	0.3%	0.3%
5-Sep	8:30 AM	Nonfarm Payrolls	Aug	-60K	-70K	-51K
5-Sep	8:30 AM	Unemployment Rate	Aug	5.7%	5.7%	5.7%

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MANAGED FUTURES NEWS

CME Group completed its acquisition of the New York Mercantile Exchange (NYMEX) this week. The acquisition marked the final act in a dramatic takeover drama that has both captivated and concerned the futures world. The final terms of the acquisition were announced on Thursday. NYMEX shareholders that opted to receive CME Group stock were paid \$7.29 in cash and .2164 CME shares for every NYMEX share. Shareholders that opted for a cash payment received \$81.16 for every NYMEX share. The NYMEX acquisition completes the CME's transformation into the leviathan of the derivatives market. Already a powerful player in the futures realm, the CME's acquisition of the Chicago Board of Trade (CBOT) last year propelled it into a rarefied position in the financial world. The combined CME/CBOT entity (aka CME Group) controls 98% of the U.S. futures market. In the history of the U.S. financial system, few exchanges have approached that level of dominance in a major financial sector. You would have to travel back in time to the early days of the New York Stock Exchange to find something even resembling an analogue. However, even at its height, the NYSE did not have the same market share that CME Group enjoys today. It also participated in a market that was far smaller, and had far less influence, than the modern U.S. futures market.

The Inspector General for the U.S. commodity-futures regulator has officially begun an investigation into an inter-agency report on commodity markets, the Wall Street Journal said citing a person close to the matter. Earlier in the month four U.S. senators had sent a letter to Inspector General Roy Lavik questioning the Commodity Futures Trading Commission's role in an inter-agency task force interim report that said "supply and demand factors" were responsible for the surge in fuel prices. The interim task-force report, which came out just days ahead of a Senate vote on the bill, said skyrocketing energy prices were the result of supply-and-demand fundamentals and not speculation. The senators, including senior members of the Energy and Natural Resources Committee, allege that the CFTC knowingly included "seriously flawed" data and the timing was "suspicious." The Inspector General was taking the issue "very seriously" and was conducting interviews in a number of CFTC offices, the paper said citing a person close to the matter. No one at CFTC was immediately available for comment.

As a record amount of investment dollars pour into commodities, the number of brokerages that specialize in matching and clearing futures contracts is dwindling amid a flurry of mergers. The move to consolidate brokerages began as exchanges developed computerized trading, a shift over the past decade that brought an influx of cash and foreign investors with fiber-optic access to LaSalle Street. Computerized trading also lowered the fees the firms could charge. As a result, their profits depend on boosting trading volumes, which encourages the economies of scale made possible by mergers. Currently, there are 170 futures commission merchants, a 15 percent decrease since 2004, according to the National Futures Association. But those firms are responsible for \$169.3 billion in assets, a 225 percent increase over the same period, according to government reports.

Efforts to overhaul U.S. financial regulation are seen gathering pace early next year, as a new Congress and administration seek to safeguard public money put at risk by recent rescue measures. The Federal Reserve's extension of emergency credit to investment banks, and fears of a deeper slide in home prices, will drive calls for reform in what is expected to be a Democratic-led Congress. Major changes would also allow a new administration, whether the president is Democrat Barack Obama or Republican John McCain, to distance themselves from the current government and the mess left behind by the credit crisis.

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