Bullish Review
Of Commodity Insiders

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The Commodity Boom: On Friday, June 27, the US House of Representatives passed H.R. 6377:

> *To direct the Commodity Futures Trading Commission to utilize all its authority, including its emergency powers, to curb immediately the role of excessive speculation in any contract market within the jurisdiction and control of the Commodity Futures Trading Commission, on or through which energy futures or swaps are traded, and to eliminate excessive speculation, price distortion, sudden or unreasonable fluctuations or unwarranted changes in prices, or other unlawful activity that is causing major market disturbances that prevent the market from accurately reflecting the forces of supply and demand for energy commodities.*

Well, hell, it isn't as if the CFTC didn't already have the power, in fact, directive from Congress (in its current form since 1968) under USC Title 7, Chapter 1, Sec. 6a. Excessive Speculation:

> *Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets or derivatives transaction execution facilities causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity. For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility as the Commission finds are necessary to diminish, eliminate, or prevent such burden.*

What makes Congress believe that the CFTC will not continue to abrogated its duties. It has already ignored federal law by eliminating trading limits in all but a handful of agricultural markets. The CFTC made a big deal recently of reaching an agreement to hold London oil traders to the same speculative trading limits as NYMEX traders. What they neglected to mention is that there are no federal limits imposed on NYMEX traders. (The NYMEX imposes a limit, but only during the last three days before contract expiration). Other than this, there is a 20,000 contract advisory level, at which point the exchange may make certain enquiries of the trader. There is no public record of whether or how often even this feeble provision might be invoked.

There are at least a half-dozen proposals in Congress addressing sky-high commodity prices. Most miss the point, which is that Congress already anticipated the current situation and has laws on the books that should have prevented much of this commodity bubble.

One proposal is to ban commodity index traders from investing in commodities. Once again Congress has already decreed that everyone is subject to speculative trading limits except *bona fide hedgers...producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to hedge their legitimate anticipated business needs for that period of time into the future for which an appropriate futures contract is open and available on an exchange.*

How does the CFTC possibly interpret this to include swap dealers such as JP Morgan Chase, Citigroup, Bank of America, Wachovia, or HSBC North America? Absurd.

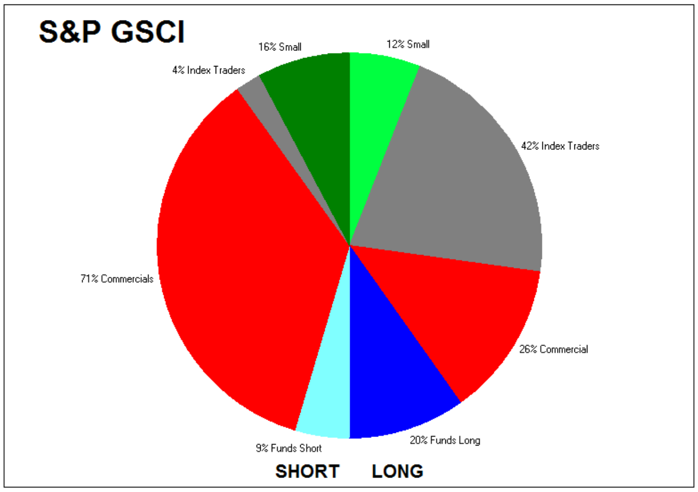
Why am I taking so much space on this? Because the possibility that Congress might try to fix this mess multiplies the risk to commodity traders particularly longs. The table below shows the scale of the problem. Actual CIT positions reported by the CFTC in the *COT-Supplemental* report are shown at upper left. Below left are my extrapolated positions based on the S&P GSCI Index weightings (right hand column). British markets are shaded. While some may quibble about which benchmarks to use or in what proportion, the GSCI is the most popular, and differences between indexes are minimized by separating US markets. We are certainly in the ballpark. All figures have been standardized to current dollar value. The US commodity market total is currently $225 billion.

The pie chart on the next page illustrates that commodity indexers are the largest long player in reported markets, currently holding an astounding 42% of long open interest.

24-Jul-08		Commodity Index Funds		S&P GSCI Index		
		CIT	Percent Allocation	Percent Weighting	Index Weighting	
Corn		$16.0b	25.08%	19.21%	3.30%	CBT-US
Cocoa		$1.0b	1.50%	1.28%	0.22%	ICE-US
Cotton		$4.2b	6.58%	5.24%	0.90%	ICE-US
Feeder Cattle		$0.6b	0.95%	3.14%	0.54%	CBT-US
Coffee		$3.3b	5.17%	4.02%	0.69%	ICE-US
KC Wheat	**Actual**	$1.4b	2.14%	4.60%	0.79%	KCBT-US
Live Cattle		$8.2b	12.86%	15.95%	2.74%	CBT-US
Lean Hogs		$3.6b	5.70%	8.91%	1.53%	CBT-US
Soybeans		$12.6b	19.73%	10.71%	1.84%	CBT-US
Sugar		$5.0b	7.83%	7.16%	1.23%	ICE-US
Wheat(Chicago)		$7.9b	12.46%	19.79%	3.40%	CBT-US
Sub-total		$63.8b	100.00%	100.00%	17.18%	
WTI Crude Oil		$92.3b*			24.85%	NYM-US
WTI Crude Oil		$38.9b*			10.47%	ICE-UK
Brent Crude Oil		$48.4b*			13.04%	ICE-UK
RBOB Gasoline		$16.9b*			4.55%	NYM-US
Heating Oil		$17.4b*			4.68%	NYM-US
Gasoil		$16.9b*			4.55%	ICE-UK
Natural gas		$26.4b*			7.10%	NYM-US
Natural gas		$1.4b*			0.38%	ICE-UK
Aluminum		$13.0b*			3.49%	LME-UK
Copper		$14.9b*			4.01%	LME-UK
Lead		$1.9b*			0.52%	LME-UK
Nickel		$6.1b*			1.64%	LME-UK
Zink		$4.8b*			1.29%	LME-UK
Gold		$7.2b*			1.95%	CMX-US
Silver		$1.1b*			0.29%	CMS-US
Total		$371.3b*			99.99%	
US markets		$225.0b *				
Non US markets		$146.3b *				

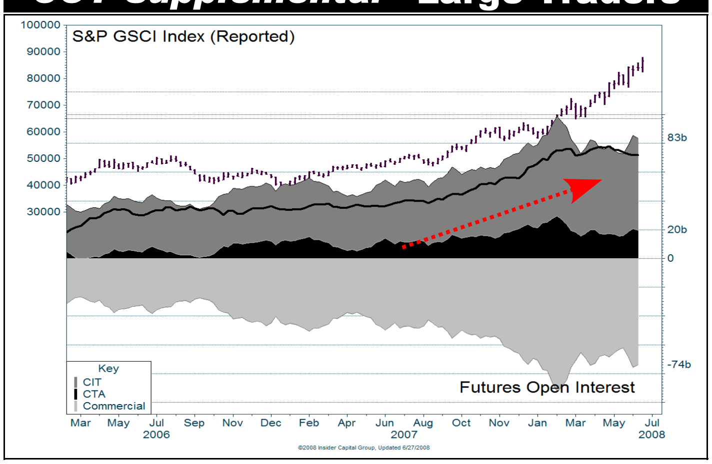
* Estimate

Open Interest in 12 Reported Markets



The chart below shows the large trader net positions reported in the 12 markets included in the *COT-Supplemental* report. Traditional commodity funds are net long by $20 billion, while commercial hedgers are net short $74 billion (difference in totals is due to excluding small traders on this chart).

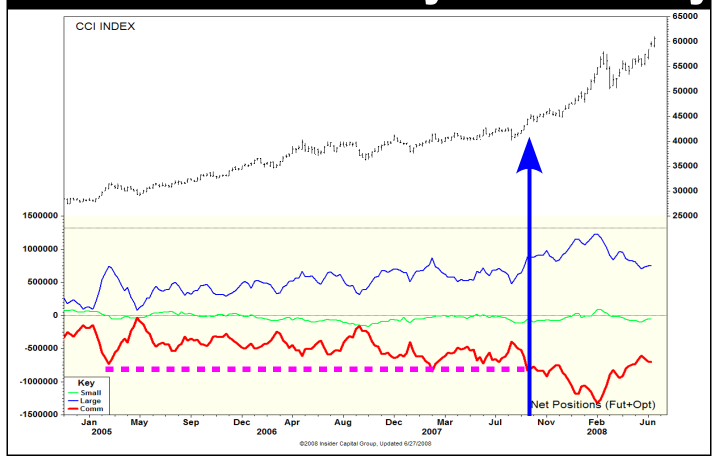
COT-Supplemental - Large Traders



While indexer apologists claim that these positions are static and are just rolled forward, suggesting that any position growth is due to rising prices, the black line shows the CIT positions in contracts; clearly a good deal of the growth is due to indexers adding new long contracts to their positions. There is an obvious positive correlation between CIT positions (black line) and price movement of the GSCI Commodity Index until mid-March. It appears that commercial shortcovering may be responsible for much of the rally over the last three months.

If this trend continues, the lack of new buying by commodity indexers is likely to result in declining commodity prices. Once prices start to subside, there is a huge speculative (traditional commodity funds and index funds) position to liquidate. In the course of time, this bull market is likely to retrace, as every one before it has. But if Congress forces the CFTC to take steps to reduce speculation, the retreat could quickly escalate to a rout.

Continuous Commodity Index Weekly



The last chart shows net trader positions for the 17 markets underlying the Continuous Commodity Index. At the September 2007 price peak, the commercial net short position was near its historical extremes (dotted line) indicating that they were fully hedged. Commodities were fully priced in September, and the 35% to 60% commodity price hikes since are purely speculative affairs. When all the buyers are in, which they may already be, prices will fall of their own weight. While they are likely to overshoot on the way down, by how much and how suddenly depends on how many longs try to get out at the same time.

Given the real potential for a change in the rules, the risk on the long side of the commodity game now exceeds potential gains. Getting short may not be easy, but it could offer unusual profit potential. We recommend liquidating longs now (ahead of the crowd) and looking for short entry opportunities on signs of a breakdown.

COT INDEXES (Futures + Options)

SYMBOL	COMMERCIAL HEDGER 24. Jun. 2008	CHANGE	LARGE SPECULATOR 24. Jun. 2008	CHANGE	SMALL TRADER 24. Jun. 2008	CHANGE	LAST COMMENT
INDEXES							
CRB	67%	-3	34%	+5	35%	-3	#691
- DowInd	37%	-41	44%	+34	68%	+15	#691
NASDAQ	43%	-16	58%	+17	47%	0	#691
- NIKKEI	51%	-20	36%	+8	91%	+32	#688
S&P500	55%	-15	49%	+16	29%	+9	#691
METAL							
GOLD	33%	+5	63%	-5	34%	-1	#690
COPPER	9%	-12	91%	+8	69%	+18	#690
PLATIN	22%	-18	68%	+12	61%	+17	#674
SILVER	47%	0	50%	-3	44%	+7	#674
CURRENCY							
AUSSI$	27%	-22	79%	+5	47%	+47	#689
POUND	87%	-13	19%	+19	0%	0	#684
+ CANAD$	49%	+1	51%	-2	35%	+4	#691
EUROFX	76%	-13	17%	+14	40%	+8	#690
$INDEX	11%	+2	85%	0	89%	-11	#686
YEN	50%	+9	55%	-12	27%	+10	#678
PESO	7%	-3	98%	-1	61%	+13	#680
SWISS	27%	-13	71%	+16	75%	+5	#679
FINANCIAL							
EUROS	62%	+13	12%	-24	72%	+5	#680
LIBOR	0%	0	0%	-24	0%	+5	#253
5YR-TN	13%	-5	95%	+5	7%	-14	#685
2YR-TN	47%	+1	58%	-8	47%	+16	#666
++ 10Y-TN	93%	-4	12%	+1	14%	+14	#691
T-BOND	78%	-3	31%	-4	24%	+16	#691
GRAIN							
SB-OIL	36%	-2	55%	+3	82%	-2	#674
CORN	44%	+4	57%	+3	56%	-14	#664
KC-WHT	88%	+1	22%	-3	34%	+4	#688
++ MN-WHT	92%	0	4%	-6	58%	+13	#477
OATS	48%	-4	42%	+2	82%	+3	#650
RRICE	62%	-5	34%	+5	47%	+9	#671
BEANS	24%	+7	81%	-4	38%	-11	#690
- S-MEAL	12%	-4	88%	+6	69%	-8	#674
WHEAT	60%	-2	35%	+5	68%	-8	#690
MEAT							
FEEDER	66%	-4	43%	0	56%	+3	#686
-- CATTLE	0%	-3	100%	0	41%	+16	#691
HOGS	33%	-3	48%	+5	83%	-2	#686
FOOD/FIBER							
COCOA	34%	-1	70%	+2	29%	-1	#668
COTTON	35%	-1	66%	0	35%	+7	#674
COFFEE	29%	-11	72%	+7	43%	+25	#672
LUMBER	44%	-2	48%	+4	61%	-3	#681
OJ	74%	0	28%	-3	39%	+8	#648
SUGAR	33%	-7	74%	+5	55%	+7	#675
PETROLEUM							
CRUDE	50%	-2	56%	+9	22%	-21	#674
H-OIL	43%	+1	41%	-1	79%	0	#674
++ NATGAS	100%	0	0%	0	83%	-10	#685
Gasoli	17%	+5	76%	-2	72%	-11	#686

++ = Major buy signal + = Minor buy signal
- - = Major sell signal - = Minor sell signal