Market Highlights for February 2011: The Thomson Reuters/Jefferies CRB index was up strongly again in February, rising some 3.25% for its sixth straight monthly increase. (See our chart below). So far, cotton and cocoa are leading the rankings year-to-date, with Brent oil not far behind, up just over 18%. Silver and gold both had stellar months in February; gold notched its biggest monthly gain since August and prices are now back in record territory. Grains had modest setbacks in February, but most have come roaring back. The MSCI All-Country World Index of Equities returned an impressive 3% in February, while corporate and government bonds rose 0.13%. The dollar continued to lose ground over the course of the month, curiously passing up on its traditional "safe-haven" role in time of crisis. Speaking of crises, the one we had this past month was a doozy as another Middle Eastern regime got caught up in the crosshairs of violent protests. Our readers are by now quite familiar with the litany of events leading up to where we are now in Libya, and so we will not rehash the recent history here. Suffice to say, that the near-unraveling of the Qaddafi regime has riled up the markets in a way that Egypt and Tunisia did not. With Libyan oil exports significantly cut back on account of the unrest, oil prices have pushed higher, with Brent getting to a high of $119.79 on Feb 24th, and now close to retesting that level. In the meantime, the rest of the world is watching developments in Libya, and political calculations are being made in both the US and Europe as to whether or not to impose no-fly zones or send troops. So far, there does not seem to be much appetite for either option, but should the Libyan leader pursue a "scorched-earth" policy as he goes down, such scenarios cannot be ruled out.

Things elsewhere in the Middle East are also on the boil. Demonstrations in Oman are gathering pace, but seem to have only recently caught the attention of the energy markets, this despite the fact that the country is a decent exporter in its own right, producing some 800,000 bpd. In Yemen, the opposition rejected an offer of a unity government this week, saying it would not settle for anything less than an end to the 32-year rule of President Saleh. There is an uneasy calm in Bahrain right now, but the Saudis had to deny reports that they were sending tanks in to support the government. Meanwhile, in Iran, two opposition leaders that ran in the last election are now reportedly in custody, triggering widespread protests in the country this week.

In addition to the turmoil that we know about, there is turmoil that has yet to unfold. In this regard, demonstrations are reportedly scheduled for March 11th and 20th in Saudi Arabia, and although we doubt anything much will come out of this event, oil markets will be understandably nervous until then.

We do not expect any of this unrest to be over with so quickly, which means that fund money will likely gravitate into both gold and energy markets in the weeks ahead. A run-up in these complexes could carry the rest of the commodity group higher for a while, but we suspect that a more likely outcome would be for rising energy prices to "decouple" from the rest of the pack, since soaring energy prices will sow the seeds for higher infla-
tion and interest rates, ultimately moderating commodity demand. As recent examples of inflationary pressures, Brazilian prices increased to a little over 6% in the 12 months through mid-February, the fastest rate in more than two years, India’s benchmark wholesale inflation rate averaged 9.4% in the nine months through December, the most in the past decade, while Chinese inflation is running at a two-year high, and increasing. Inflation is running well above target even in developed countries, with increased talk of higher interest rates surfacing in both the Eurozone and in the UK. So far, the US has resisted making any overtures towards tighter money, but we think it will be a matter of time, and likely prior to the end of 2011 that Fed Chairman Bernanke also moves in this direction.

One complex that could be especially vulnerable down the road is the ferrous and nonferrous group, as all bets seem to be on ever-increasing Chinese demand. For their part, the Chinese authorities have been consistently raising reserve requirements and interest rates, but the recent spike in energy prices, if sustained, will likely accelerate their rate-hiking schedule. Already, we are seeing some slowdown that has resulted from previous tightening. In fact, this week’s widely watched manufacturing data shows Chinese manufacturing trending lower this past month, with a key index now at a seven-month low. Markets brushed this report off when it was released, as it came out on the same day that we got extremely strong manufacturing data from other countries. In this respect, India reported its manufacturing grew at the fastest pace in three months, Japan’s manufacturing activity rose at its best clip in eight months, while European manufacturing accelerated to its fastest rate in more than 10 years. Here in the US, the Institute for Supply Management’s most recent monthly survey showed large gains in both employment and production, with the index now at its highest level since May 2004.

**Summing Up**: In the short-term, (and by that we mean over the next 1 to 3 months), the upward commodity spiral seems like it will remain in place on account of the fact that world economies are all growing. However, despite this favorable backdrop, we have trouble extending the upward trend line for most commodities beyond May, as there are several "headwinds" that make the case for a rather sizable correction. The most important is the inflationary spiral now evident in a number of emerging economies, which suggests that we will be seeing interest-rate hikes coming at us at a faster clip. In addition, and as we wrote last month, one consequence of transforming commodities into an easy-to-purchase asset class means that there are eventual bearish side effects to upside price runs. In the case of the grains, harvests cannot be assumed to be terrible on an indefinite basis, and emerging market demand could also start to fade in the wake of soaring prices. Rising base metal prices could lead to demand destruction, metal substitution (in certain applications), as well as a more aggressive supply-side responses. On its own, copper prices, for example, are close to record highs, this despite rising inventories (now at an eight-month high on the LME) and sluggish physical premiums. The most dangerous development of all is the rise in energy prices, which we think has the potential to be a significant game changer, particularly if the unrest in the Middle East engulfs key oil producers like Libya.
WTI NEARBY CONTINUATION

It is difficult to know where crude oil prices will be heading over the next month, as prices will be driven almost entirely by the fast-paced and unpredictable events now unfolding in the Middle East. The Libyan situation is the most pressing in this regard, as 1.2 million barrels of exports were blocked at one point, although it now seems that about the oil is flowing. In addition, the Saudis are replacing barrels from their own production, but their job has not been made easier given the geographical distances separating them from southern European refiners, coupled with the fact that Libyan crude is of the sweeter variety, not the mainstay of their production. Having said that, WTI has not had the explosive advance that Brent has, given the fact that the contract is being weighed down by bulging inventories at Cushing, rapidly being replenished by rising Canadian and US Midwestern production. Technically, the odds favor a further advance, as we are now firmly in breakout territory, with next resistance on the charts around the $110.

BRENT NEARBY CONTINUATION

Of the two main oil contracts, Brent has been far more volatile and responsive to the upside, gaining about $10 a barrel in one session alone last week when it hit an intraday high of $119.75 (from $110) before finishing the day off at $115. The arb has come in slightly from the $20 plus it reached at one point in February to around $15, but given that Brent has been substantially more responsive to the vagaries of geopolitical developments and ongoing crude oil demand then WTI has, we expect to see a substantial Brent premium (i.e., at least $10) last well into the second quarter. In the meantime, our charts clearly indicate that we are in breakout mode. Should we break through key resistance at $120, there is not much more in the way of resistance until $133, but for the moment, it is fundamentals and not technicals, that will have more of an impact on price direction.

RBOB NEARBY CONTINUATION

Gasoline has joined the two crude oil contracts in pushing into breakout territory as well, and charts are showing little in terms of resistance until the $3.00 mark. The spread between gasoline and heating oil has also narrowed substantially this past week, as investors start to rotate out of heating oil and into RBOB. Support is at $2.60, which marked the previous breakout level.

HEATING OIL NEARBY CONTINUATION

Similar to gasoline, heating oil is also in breakout territory, and charts suggest that next resistance could lie around $3.20 mark. We see support around $2.80, the top end of the congestion band that was taken out last week. However, heating oil may struggle to do better from here, as increasingly, seasonal considerations will prompt funds to lighten up on the complex, as they start to position themselves more aggressively in gasoline.
EIA/DOE Inventories as of February 18th

Changes in latest week:
EIA Crude: +.822 MB (forecast +1.2 MB) (API: +.16 MB)
EIA Gasoline: -2.798 MB (forecast +.4 MB) (API: -1.6 MB)
EIA Distillates: -1.33 MB (forecast -1.2 MB) (API: -.53 MB)

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*unrevised / **for week prior in bcf

Data Sources: EIA/API; Charts prepared by MF Global©
NATURAL GAS NEARBY CONTINUATION

Natural gas is trading like it is oblivious to everything that has been going on in the Middle-East, and it showed this past month, with prices barely exceeding a $5.50 trading range during the entire period. More recently, prices have poked above the $4 mark, but we suspect things will drift unevenly for the time being, weighed down by large inventories and no discernible reduction in US production. The fact that the net non-commercial short position has ballooned to a record high does not seem to be leading to any kind of short covering.

CRACK SPREADS

Crack spreads have started to come down over the course of February, as the rapid rise in crude oil prices outpaced the gain in product prices, but margins still remain elevated on a historical basis, and are offering refiners, at least in theory, good profits. However, in practice, actual margins are much lower, as non-Cushing grades are trading at sizable premiums to WTI. We expect margins to remain under slight pressure heading into March, as Mid-East jitters will likely manifest itself more in higher crude prices as opposed to an equivalent rise in products.

EMISSIONS

Spot trading on ICE is still frozen, even as registries in several individual countries have reopened in the past few weeks. However, trading in futures is still going on, but volumes are off, with the overall price tone somewhat weaker, as we note from our chart alongside. The EU will now speed up work on protecting the carbon markets from fraud and will also discuss how to handle allowances stolen in computer-hacking attacks. One option on the table is extending the bloc’s financial-markets regulations to include spot trading and reinforcing registry account policies and identity checks. However, excessive regulation runs the risk of rising administrative costs and creating disincentives for participants to use the market.

URANIUM

Uranium prices have dropped slightly in the last week or so, after a fairly brisk rise over much of February. Uranium-oxide concentrate for immediate delivery is now trading in the mid to high $60 range after getting to a high of $72.25 at one point in the month. Denver-based pricing service Trade-Tech said that there was a big seller in the market that was looking to place over 800,000 pounds of uranium oxide, prompting the price slide. There have been also been “numerous reports” of Chinese traders seeking to sell uranium on the spot market. Despite the recent decline, the market’s fundamentals look solid; China continues to be a major buyer, taking out about a third of the world’s uranium supply this year, while India will be close behind. Global production is struggling to catch up; annual production is 47,000 tons, meeting only 60% of demand. The rest is met from utility stockpiles or decommissioned nuclear weapons. Although production will increase over time, it could take 10 years or more until it is sufficient to meet projected demand.
**3-MONTH LME COPPER**

Copper prices sold off by almost $1000/ton to around $9300/ton in mid-February before bouncing back sharply over the last few days. However, the earlier sell-off was not due to any of the reasons cited in our last piece, but rather due to the unraveling Libyan situation, as investors became worried that spiraling energy costs will translate into higher inflation and interest rates, both detrimental to the longer-term demand picture. Once crude oil prices stabilized after the Saudis stepped in, (relatively speaking), copper bounced back. Out of China, January copper imports were quite strong, up by about 6% from December, although, we do expect a slight decline this month given the holiday week. Longer-term, with interest rates moving higher, energy prices volatile, and Chinese growth likely to slow into the second half of the year, we remain cautious on copper at these levels. In addition, rising stocks both on the LME (up some 70,000 since December), coupled with sluggish physical premiums and increased talk of substitution, are all short-term negatives.

**3-MONTH LME ALUMINUM**

Aluminum ended the month of February slightly higher than where we started off, with prices now trading just below $2600. The Libyan-induced selloff did knock the market back to an intraday low of $2470, but all in all, we did not see the stomach-churning volatility that was evident in copper. On the fundamental side, the picture has not changed very much—LME stocks continue to rise, and are up some 35,000 tons since the start of the year, this despite the fact that the spreads are not as profitable in terms of cash-and-carry transactions. Stocks in Shanghai are also rising, and Chinese production, while off sharply from the 17.325 million tons produced in June 2010 (annualized), still managed to close the year at 16.131 million tons, up from 12.964 million tons seen in 2009. Moreover, given the ramp-up seen in finished product exports over the second half of the year, (up 50% from 2009 levels) we have to suspect that production is running well ahead of local consumption. All in all, aluminum should be a relative laggard in 2011, and we still would suggest that forward hedge sales be placed between $2500-$2800, (scale up), while buy-side hedgers should stay put for now.

**3-MONTH LME ZINC**

Like aluminum, zinc has not done much over the course of February, closing pretty much unchanged on the month, but prices did manage to spike to $2600 at one point in the month before receding somewhat. Zinc’s fundamentals continue to look sluggish, as LME stocks are increasing, now up by a staggering 100,000 tons since the beginning of the year. Much, but not all, of this metal seems to be tied up in financing deals, and so should act as somewhat of a drag on prices going into 2011. In other developments, the latest numbers provided by the ILZSG project that there was a surplus of 264,000 tons in calendar 2010. Things do not look much brighter for this year, with the Reuters consensus estimate calling for a 185,000 ton surplus to materialize in 2011 given the lengthening list of mine expansions and restarts. These include Horsehead Holding, which said this month that it will have production back up to normal levels at its Monaca, Pennsylvania facility.

**3-MONTH LME LEAD**

Lead got to a monthly intraday high of $2685 at one point in February, but sold off to a low of $2450 at one point in the wake of copper’s sharp decline. In addition, the complex was rattled by news that Ivernia was restarting operations at its Magellan lead mine after a prevention order banning lead shipments was lifted. Out of China, the 100,000 ton-a-year lead smelter in Henan reopened all idle capacity last month after it had cut production by 10% in December and January. In the meantime, the ILZSG reported that global lead market was in surplus by 48,000 tons last year, with the Reuters consensus estimate calling for a much more modest 19,000 ton surplus in 2011. Despite back-to-back surpluses, overall lead stocks are not that high, with the ending stock ratio currently around 4.6, about half what we are seeing in both aluminum and zinc, so the complex is not as bad a shape as the surpluses indicate.
3-MONTH LME NICKEL
Nickel just fell short of getting to the $30,000 mark in February, but we seem to be getting ready for yet another run at this level. Nickel's price rise is taking place against a questionable fundamental backdrop. To wit, Chinese stainless steel output is forecast to decline in 2011, increasing the odds of another surplus this year, which the International Nickel Study Group expects to be around 80,000 tons. (The Reuters average consensus estimates is significantly less, at around 16,000 tons, but there is quite a bit of variation around this number). Slightly more on the positive side, nickel stocks have stopped going up, and are now off by about some 8,000 tons since the beginning of the year. Having said that, quite a bit of production could hit the market later in the year. We see nickel prices possibly getting to a $32,000 intraday high in March, but prices likely have a difficult time pushing significantly beyond $35,000 over the course of 2011.

3-MONTH LME TIN
Tin continued to shine in February, hitting a new high of just under $33,000 a ton over the course of the month, and not giving back much of its gains considering the steep selloffs we saw in some of the other metals (short-lived as they were). Tin stocks have been increasing since the start of the year, but did drop by about 1,000 tons over the course of February. Market participants are still very concerned about lagging production in Indonesia, where the country's full-year exports in 2010 were off nearly 7% from 2009 levels. January output was considerably worse, with exports down a whopping 35% versus December, while first-quarter production will also be down versus last year on account of heavy rains. Consequently, in view of Indonesian supply bottlenecks, we remain friendly towards tin going into 2011 and still look for a $40,000 print at one point over the course of the year.

LME STEEL
LME billets have not done very much over the course of February, still hovering around the $550 mark in a very tight trading range. Outside of the billet market, steel prices, in general, have remained firm, propped up mainly by higher input prices, particularly for iron ore and coking coal. Looking ahead into 2011, there are legitimate questions about whether recent price rises could be sustained going into the second half of the year. For one thing, steel demand, which increased by 13% in 2010, may rise no more than 5% in 2011, well below the expected rise in production, according to the World Steel Association. Individual steel mills, like Arcelor Mittall and AK Steel, are looking at much higher demand readings, anywhere from 7-10% for Europe, the US, and China), but really, the big question is what is going to happen with China, and whether the tightening steps now underway will dent prospects going forward, particularly in the overextended construction sector. Moreover, as more steel mills pass on higher steel costs to their customers, we could see demand retrench somewhat further going into the second half of 2011.

IRON ORE
Iron ore prices set new highs of $193/tons in mid-February, but the 5% fall over the past week has raised concerns. There are some bearish elements in the picture, including a drop in Shanghai rebar prices, eroding steelmaker margins, increasing Chinese production, and questions about Chinese growth going forward. In addition, the combination of a spike in coking coal prices and higher scrap availability is pushing output through electric arc furnaces, prompting mills to switch from lower to higher quality iron ore and contributing to wide grade differences. Traditional low-cost suppliers (Australia, Brazil, and India) have not been able to satisfy demand due to production setbacks. Chinese ore production has increased, but it is of low quality and high cost (i.e., greater than $140/t). This is why China is diversifying to places such as Iran (now the 5th largest importing region). In summary, if Chinese steel output is above 5%, and is helped by some recovery in developed economy output, prices should remain high. We should also not forget that quarterly pricing to end February will be used for April contracts, and so there could be some gaming. We see a settlement of $175/t CIF and for spot prices to consolidate. (Contribution by Andrew Gardner in Sydney).

Source for charts: Bloomberg
GOLD COMEX NEARBY CONTINUATION
Gold prices crossed the $1400 mark in late February, posting its if fourth consecutive weekly gain, as the crisis in Libya, coupled with soaring oil prices, stoked inflation worries. On top of that, we are seeing very little progress being made in Washington on the US deficit, while the Fed remains on a very “easy-money” course. However, we suspect the Mid-East will remain the more prominent short-term driver, given that we do not expect to see any kind of quick resolution to the unrest going on in varying degrees across different countries. As a result, gold should continue to do better going into Q2 of this year, and likely make a push towards the $1480 mark sometime late in the quarter. In last month’s commentary, the steep decline in prices and the fairly stronger dollar, made us question the gold’s near-term potential, but certainly the events in the Middle East are a significant game changer. The only “the disconnect” we are seeing is the fact that money flows into physically-backed gold funds are not picking up, with SPDR holdings now at a eight-month low. However, we would expect these outflows to reverse course, particularly if the unrest in the Middle East worsens.

SILVER NEARBY CONTINUATION
Silver is doing somewhat better than gold, and made a fresh high of about $34.50 in late February before experiencing a short-lived selloff. Hedge fund activity has been particularly strong, and at one point, managed-money funds accumulated their largest long-side exposure since October. A brief selloff late in February likely trimmed some of this accumulation, but it was not substantial enough to trigger a wholesale change in the bullish mindset, and in fact, we are again knocking at the recent highs as of this writing. We expect to see in advance to the $38 level sometime in the second quarter, and would not be surprised to see $45-$50 silver later in the year. Unlike the gold ETF, holdings in the iShares Silver Trust have been on an uptick, rising to a six-week high in late February.

PLATINUM NEARBY CONTINUATION
Platinum hit a 33-month high in mid-February, and although it has lost some ground since then, it seems to be recovering as of this writing. Our charts show that the major uptrend line that has been in place since last summer is still intact, and will not be taken out until we get to much lower levels. In the meantime, there is good support at $1760, which has held twice since early January, with resistance at $1870, the recent high. We look for a recovery from here, in line with our upbeat view on the gold and silver. The complex’s fundamentals also are supportive, as a deficit is expected for this year on the back of continued high industrial demand. In this regard, Chinese imports in 2010 were up a staggering 40% from the year prior, and although the China Association of Automobile Manufacturers is forecasting that vehicle sales will increase by a much more modest 10%-15% this year after rising 32% in 2010, demand should still be strong enough to tip the platinum complex into a rough balance.

PALLADIUM NEARBY CONTINUATION
Palladium prices hit a record high of $865/ounce in February, but a late month sell-off knocked roughly $100 an ounce off the metal’s value in a matter of days. We have since recovered somewhat, now hovering around the $785 mark, and suspect that we could work somewhat higher in the weeks ahead. For one thing, production this year will likely remain unchanged from 2010 levels, leading to yet another deficit, estimated to be around 560,000 ounces. Moreover, a number of producers find themselves hard-pressed to significantly increase production. To wit, Norilsk Nickel said a few weeks ago that it expects to produce 2.85 million to 2.87 million ounces of palladium this year, hardly much of an improvement from the 2.86 million ounces produced last year. Technically, the market has priced resistance for us at $865, but should we take that level out, things look wide open until $1070.
CORN NEARBY CONTINUATION
There was quite a bit of volatility in the corn market, as prices raced to a 33-month high in mid February, had a 6% correction over the span of a week, but recovered all of that --and more -- in a matter of days. Although corn plantings are expected to rebound sharply in Europe and North America this year, they are not doing much to relieve the current pressure on prices, since corn inventories are now at a 37 year low. In addition, although the USDA said in late February that US corn plantings will increase by some 3% to 91.281 million acres, strong export demand, particularly to China, and ongoing intake for US ethanol production, continues to keep the upside pressure intact. We likely will see prices climb higher from here going into March.

WHEAT NEARBY CONTINUATION
Wheat had a harrowing fall in late February, dropping almost 20% from its $8.92 three-year high. The decline almost took out the long-term up channel that has been in place since last June, but we seem to have recovered somewhat, and are now back over the $8 mark. Despite the recent wobble, the fundamentals in wheat are still compelling. In this regard, US production of winter wheat is expected to slump 8.8% to 1.355 billion bushels this year, as farmers abandon 22% of acres, up from 15% last year after unusually dry weather damaged yields. In China, drought is also reducing yields, with about 42% of fields in the country’s eight major growing provinces hurt by dryness that may last well into the spring, this according to China’s Minister of Agriculture. Said one US farmer: “I do not think we can see a big enough increase in US acreage to rebuild invento- ries back to a comfortable cushion in one year. It is going to take two years of good weather and good yields. There is absolutely no room for any weather problems anywhere in the world this year.”

SOYBEANS NEARBY CONTINUATION
Soybean prices corrected over the course of February, but not before posting a 33-month high of $14.52. The ensuing correction was roughly in the order of 10%, and took out the short-term up trend line, although the longer-term up channel --in place since last summer-- is very much intact. In addition to the North African unrest and further tightening moves out of China, both of which played a hand in the rather sizable correction, the complex was also buffeted by reports that the Brazilian soybean may come in at 71 million tons, beating last year’s record 68.7 million tons, while exports may rise 13% to an all-time high of 33 million tons. All these figures were substantially better than what was being forecast several weeks ago. Argentinean crop prospects are also better than they were a few weeks ago, as much-needed rain may lift the crop there to 50 million tons, above the 47 million ton estimates out last month. Technically, our charts show that soybeans is somewhat in worse shape than either corn or wheat, and therefore prices may have somewhat further to go on the downside before stabilizing.

FFA
FFA prices continue to languish as we note from our chart alongside, with prices hitting a two-year low this past month, as a flood of new vessels--likely ordered during the boom two to three years ago -- is likely arriving just now, and exacerbating an already oversupplied market. In fact, some industry analysts are saying that the freight market may not recover until 2014 at the earliest. Others point out that the global dry bulk fleet has already expanded by 12 million deadweight tons in the first six weeks of this year alone and could expand between 11%-13% this year to nearly 600 million tons. This supply increase will be well ahead of demand projections that are forecast to grow by 8% at best, meaning that prices will likely bump along the bottom for most of this year.
COFFEE NEARBY CONTINUATION

Coffee prices have risen more than 36% in early February, but we have been reassessing lower since then, with prices now trading at just over $2.87. The decline may reflect steep corrections seen in a number of other agricultural commodities, but unlike the rest, coffee seems to have had some trouble recovering most of its losses. On the fundamental side, investors are starting to focus on the possibility that we could see a supply/demand surplus for this year, the first of its kind in some four years, as production increases in such key countries as Brazil and India tip the scales. Technically, the chart shows that the long-term uptrend has continued as prices have risen by about 15% since the start of 2011 amid a buying frenzy, and in real terms, are now at their highest level since June 1981. The surge is due in large part to continued strong demand from China, poor cotton crops in Pakistan, and export restrictions in India. Prices are also moving higher for the sake of the fact that coffee prices are up from as much lower prices, forcing coffee buyers to replace supplies in the soaring spot market. For now, there is no sign of a let-up in the global supply squeeze. In this regard, the USDA says that coffee stocks as a proportion of world demand are expected to fall to their lowest in more than 15 years, while global demand for coffee will outstrip production by some 1.3 million bales in the marketing year to July. While the current correction has brought some temporary relief shell-shocked buyers, we suspect prices will resume their uptrend after the current correction plays itself out.

COTTON NEARBY CONTINUATION

Cotton prices had a sharp 15% correction in the second half of February, selling off with most of the US-based agricultural commodities, but not before posting another record high of $2.11 before doing so. Prices have now risen nearly 45% since the start of 2011 amid a buying frenzy, and in real terms, are now at their highest level since June 1981. The surge is due in large part to continued strong demand from China, poor cotton crops in Pakistan, and export restrictions in India. Prices are also moving higher for the sake of the fact that coffee prices are up from as much lower prices, forcing coffee buyers to replace supplies in the soaring spot market. For now, there is no sign of a let-up in the global supply squeeze. In this regard, the USDA says that coffee stocks as a proportion of world demand are expected to fall to their lowest in more than 15 years, while global demand for coffee will outstrip production by some 1.3 million bales in the marketing year to July. While the current correction has brought some temporary relief shell-shocked buyers, we suspect prices will resume their uptrend after the current correction plays itself out.

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EURO
The Euro has been surprisingly steady over the course of February and has not lost much ground against the dollar despite the ongoing turmoil in the Middle East. The Euro’s relative resilience has been attributable to frequent statements put out by ECB officials saying that they may be ready to hike interest rates, or failing that, adopt a more restrictive monetary approach in light of rising price pressures, particularly out of Germany, where inflation rose to 2.2% in February – the highest since October 2008 – and above the ECB’s overall target rate of 2%. Technically, should we take out 1.39, resistance, we do have a shot at testing the 2010 high of 1.43, but anything above that will be difficult to maintain given the funding and sovereign debt issues still plaguing the currency. In addition, although the current tensions in the Middle East have not led to noticeable dollar-buying, we very well could see this happen should the unrest gain in intensity and spread across the region.

YEN
The yen weakened rather dramatically during the first two weeks of February, getting to a three-month low of 84 at one point, but once the unrest in Libya started in earnest, much of these losses were recouped. The dramatic reversal is attributable to perceptions that the yen is a “safe haven” refuge due to its current account surplus, this despite a very uninspiring fiscal and political backdrop. In this regard, the country’s politicians remain deadlocked over a pending budget and a rise in the sales tax, while the country’s prime minister’s approval ratings have sunk to an all-time low. In addition, Moody’s has lowered Japan’s debt rating this past month on concern that the political gridlock will constrain efforts to tackle the country’s monstrous debt, now twice the size of the economy. Nevertheless, these worries have not hurt the yen in the past, and we do not expect them to do so over the next few weeks, as rising global tensions should continue to siphon money away from high-risk currencies and into the relative safety of the yen and the Swiss franc.

STERLING
Sterling has remained relatively firm over the course of February and is now trading at a five-month high, this despite a report out late in February showing a shocking fourth-quarter-quarter GDP decline of some .5%. Some of the contraction was blamed for the cold weather and snow, but weather alone could not explain the entire decline. (“The wrong kind of snow” quipped the Financial Times). There was weakness in business and financial services output (not prone to bad weather) as well as construction, but industrial production held up. Despite the weak numbers, we see sterling holding the $1.61-$1.65 trading range over the course of the next several weeks, as it is doubtful that the British economy will slip into technical recession this quarter, since subsequent macro numbers are not reflecting severe deterioration. Moreover, the government has to confront rising inflation rates by moving on rates sooner rather than later. In this regard, consumer price inflation readings rose to 4% in January, double the central bank’s target rate.

DOLLAR INDEX
The dollar lost ground against most currencies during the course of February, a somewhat surprising development, given the upheaval sweeping the Middle East. One would have thought that under such circumstances, there would have been a “flight-to-safety”, but instead, investors were likely flocking to gold and the Japanese yen, both of which seemed to assume the dollar’s traditional safe haven role this time around. We also believe that the goings-on in Washington is not doing the dollar any favors; President Obama’s budget hardly made any attempt to get entitlement spending under control, and the Republican-controlled House is not moving forcefully in that direction either, focusing, instead, on the nondiscretionary side of the ledger, something that hardly will make a difference. Moreover, there is no sign that the Fed is even considering rolling back its easy money policy, and its insistence on maintaining low rates is working against the greenback as well, this coming just as other central banks are moving the other way. We look for the weaker tone in the dollar to continue over the course of March, at least until the markets get a fix as to whether or not Washington will get its act together with regard to the upcoming budget.

Source for charts: Bloomberg
The S&P 500 closed at a 32-month high of 1,343 in mid-February, practically doubling since March 2009, as corporate profits increased amid a low interest rate environment. Despite the gains, valuations are now at 16 times reported income, not particularly excessive at this stage of the cycle. More importantly, advances in equity markets from developed countries have handily outpaced those from emerging markets last year, and are ahead again so far this year, as growing geopolitical turmoil and rising interest rates sends money to the US. Moreover, US retail investors are piling into equity mutual funds, while taking money out of bonds. Macro-wise, US growth will continue to face some obstacles going forward, and the sub-par fourth-quarter GDP reading of 2.8% was a reminder that the economy has still not ramped up. However, with a very accommodative Fed, a labor market that is slowly on the mend, and a consumer that is emerging from the foxhole, the backdrop is a favorable one for stocks going forward, and we could see the S&P near 1470 by year-end.

10-YEAR NOTE
Prices for US Treasury 10-year notes fell sharply during the beginning of February, but staged an impressive rebound during the second half of the month, as geopolitical tensions resulted in “safe haven” buying, sending yields to around 3.4%. Outside of treasuries, yields on general baskets of debt securities have been rising for four months in a row, the longest stretch since June 2008, this according to a Bank of America-Merrill Lynch bond index. Bond returns are down 0.14% so far this year, including a 0.22% decline for Treasuries, and a drop of 0.49% for sovereign debt issues. We are hard-pressed to justify purchases of ten-year paper anytime this year; US Federal deficits remain out of control, the Fed is on an accommodative stance and unlikely to pull back anytime soon, the US recovery is picking up steam, inflation readings are bound to push higher given the sharp gains we are seeing in energy prices, while surging US equities continues to draw money away from bonds. None of these variables make a good case for an interest rate decline in the months ahead.

Source for charts: Bloomberg

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