

August 3, 2010

### **CTI® Sector Overview for July**

**Energy** – The CTI® was flat the Energy sector for the month of July. The entire sector finished the month nearly unchanged. Slowing economic growth, both domestically and globally, as well as ample stockpiles, kept a lid on prices; however, the recovery in equity prices lent some strength. News of the day was generally the focus, with no major direction or trend in force. We believe economic growth, global demand, stockpile levels, any further developments with North Korea or Iran, the direction of equities and the U.S. Dollar, and any surprises in economic data are the most important factors in the market. The Energy sector remains flat for August.

**Industrial Metals** – The CTI® was short Copper for July. Copper traded quietly for the first half of the month, as some questions about Chinese demand kept funds from jumping in. However, as equities continued to rally and the U.S. Dollar sold off, prices began to rally, finishing July about 10% higher. We believe global economic growth (or a lack of it), any news on Chinese demand, and the state of the U.S. housing market remain the major factors in this market. The sector is now long for August.

**Precious Metals** – The CTI® was long the Precious Metals sector for July. Both Gold and Silver saw a good deal of fund liquidation during the month, with Gold the weaker of the two. The fears of European monetary problems have diminished, and this – along with stronger equity prices – have eliminated some of the safe-haven Gold investments. In addition, the increase in Gold Lease Rates (from negative to positive loan rates) during July placed added pressure on the Gold market. We believe potential conflict in Korea or Iran, the direction of the U.S. Dollar, and any changes in interest rates are the major factors influencing the Precious Metals markets. The sector is now short for August.

**Grains** – The CTI® was short the Grains sector for July. Wheat saw a dramatic rally due to low stockpiles and reduced global output as a result of heavy Canadian rains which damaged their crop and a heat wave in Russia. Corn and Soybeans also rallied for the month, but not nearly as much (Corn, in fact, was only slightly higher). We believe the sector will remain sensitive to any additional acreage or planting news, as well as weather, the direction of the U.S. Dollar and oil, any military conflict, any dramatic move in equity prices, export levels, and global GDP. The sector is now long for August.

**Livestock** – The CTI® was short Livestock for July. Cattle prices finally saw a strong month, with increased demand, seasonal sales, and sizeable fund buying. Hogs were slightly higher, but

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traded in both directions. We believe feed prices, export demand, the direction of the U.S. Dollar, and global economic growth will be the main influences on the sector. The sector is now long for August.

Softs – Soft trading was volatile in July. Sugar was sharply higher, as limited supply kept funds and end-users buying. Some wholesale buyers had not hedged their Sugar needs, and are now being forced to pay up (we were short for July but are now long for August). Coffee saw very strong fund buying, as very low stockpile levels in Columbia more than offset the generally adequate crop this year (we were long for July and remain long for August). Cocoa received a good deal of press because of a major speculator who bought a good deal of Cocoa, but after extremely volatile price swings, it finished July almost unchanged (we were short for July but are now long for August). Cotton saw two-sided action, with fund liquidation during the first half of the month, followed by some buying on the weaker U. S. Dollar during the second half (we were short for July and remain short for August). In summary, we are now long Coffee, Sugar, and Cocoa but short Cotton for August.

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## **News Interpretation and August Outlook**

Coming into July, virtually all the important markets pointed to worse GDP numbers than expected and a slowing world economy. The markets reflected this by being in downtrends, except for Gold, Silver, and U.S. Government Bonds and Notes which are all safe havens and deflation hedges. The U.S. equity markets made a low on July 2<sup>nd</sup>, after confirming a downtrend off the previous important low of June 7th. China has seen its equity market in a bear market for a year, which made an intraday low on July 2<sup>nd</sup> as well. Volume increased on the way down, which is another important bearish indicator.

However, 3 events caused another intermediate rally in virtually all markets:

1. The Equity markets focused on corporate earnings (instead of GDP), which were better than expected for about 70% of the reporting companies in the S&P 500, mostly due to cost cutting.
2. Chinese Equities rallied sharply off the July 2<sup>nd</sup> low, lending support to U.S. equity and commodity markets.
3. Europe climbed down from the ledge – so to speak – as concerns over its sovereign default problems began to subside, and consequently the Euro rallied and the U.S. Dollar sank. This added more fuel to the fire on the commodities rally.

The DTI®, CTI®, and FTI™ all declined for July. The rally in stocks involved about half the volume seen during the decline. GDP came in at 2.4% for the 2<sup>nd</sup> quarter. This was lower than the 1st quarter's 2.7% growth, which has subsequently been adjusted to 3.7% year-over-year due to revising the data from last year downward. This shows the economy slowing, instead of accelerating. Also, the predictions for GDP for the year have been lowered; estimates were in the 3.5% to 4% range, but now the 2<sup>nd</sup> half is estimated to be 1% to 2% by the bears and about 2.8% to 3% by the bulls.

Although Europe's austerity program has not been reflected in the Euro's economy yet, it will eventually. So long term, the Euro should return to its prior downtrend as this policy will not last. Remember, citizens tend to vote out the old leaders in such situations, and instead vote in new leaders who promise changes from austerity.

The forecasting of a slowdown in the economy has been on the mark, yet corporate earnings had easy comparisons to the weak 1<sup>st</sup> & 2<sup>nd</sup> quarters of 2009, and were better than expected. The more difficult comparisons begin with the September 30<sup>th</sup> quarter. We'll maintain our bearish primary views unless the equity markets can move above the June 18th highs across the board in volume.

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Our indexes were set up to be bearish in July, but are now more bullishly set up. The exceptions are energy (where we remain flat), precious metals, and bonds/notes which still suggest weakness. Trading ranges (i.e. the lack of sustained, directional trends in many markets), along with the accompanying whipsaws, are still causing declines in our indexes and hurting performance. The current market and economic environment is unique in the last 50 years. We believe that when the breakout comes (up or down), it will come as a surprise, be powerful, and our indexes will make up their losses quickly. Therefore, we suggest that a 5-10% allocation in strategies based on our indexes should not be sold in losing streaks, but rather added to. *There can be no assurances that the indexes will achieve their objectives or avoid losses.*

Nothing makes money all the time, and an economic environment with interest rates of practically zero and 80 bps CPI increases is a period in which trend-following indexes and strategies tend to have difficulties. There is nothing new about that. The issue is not about the strategy, but rather what the strategy in this environment reflects, as depicted in the outcomes. To repeat what I have said previously, trend-following indexes and strategies tend to benefit and profit from movements up or down, not from trading ranges. We anticipate that this unusual commodities trading range (Crude Oil is at \$78 as I write this, the same as it was over a year ago) will most likely end when least expected.

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