Market Commentary | US
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Commodities Monthly Roundup - July 2011

Highlights for June and Q2: Commodities posted their largest quarterly loss in Q2 since the 2008 financial crisis, with the 19-commodity Reuters-Jefferies CRB index finishing the period 6% lower. June itself was a tale of two different markets (see boxed in area of our chart below). The first half of the month was marked by heavy selling, as investors were spooked by the unraveling situation in Greece and the uncertainty surrounding its potential outcome. The latter part of the month (and heading into the first week of July) saw a much stronger tone set in, as measures taken to stabilize the Greek situation and improving macro readings out of the US and Japan helped draw money back into the long side.

Wheat was the biggest loser in the commodity group, falling 23% over the quarter. Crude oil was down 11%, its worst quarterly showing since 2008, while gold showed signs of stalling around the mid-$1500 mark, but still managed to finish the quarter up by 4.4%. Stock and bonds outperformed commodities, with the S&P 500 down only .5% in the quarter, while US investment grade bonds rose by 2.4%.

Commentary & Outlook (as of July 6th): We think the current bounce we have been seeing in a number of commodity complexes since late June is suspect and could be a "bull trap". We base our cautious view on a number of variables which, in aggregate, do not make the case for being long commodities that compelling. Our thinking is centered around the following variables:

1) For starters, the main reason markets have stabilized and turned higher over the past two weeks is the fact that a €12 billion loan package was finally approved for Greece shortly after the country's parliament formally passed a stringent austerity package. In the meantime, negotiations are continuing on a much larger package, but European authorities want banks and private creditors to participate in a "voluntary" rollover of existing Greek debt by agreeing to purchase additional bonds, while stretching out the maturities of their current holdings. The problem with this approach is that ratings agencies will interpret any "re-engineering" of Greek paper as a form

TABLE OF CONTENTS

Reuters-Jefferies CRB Index

of indirect pressure or aid, and thus may deem the bonds to be in default. Even if some compromise were to be reached, the more important point is that we still do not see how Greece will pay back what it owes. The $40 billion package of tax increases and spending cuts that takes effect through 2015 is equivalent to 12% of Greece's GDP. By way of comparison, a similar package in the US would amount to *$1.75 trillion* over the next four years, considerably higher than anything being considered here. The scale of the numbers suggests that a Greek default is likely, and although we don't know exactly when this will happen, buying commodities (and shorting the dollar) on the back of an apparent Greek "success story" may be premature. Even if Greece fades from the headlines, bond vigilantes will likely next move on to other vulnerable countries, and there are no shortage of candidates here. In fact, Portugal's bonds -- like Greece's -- were downgraded to junk status this week by Moody's, and Italy, Spain, and Ireland have all seen attacks on their paper this past month.

2) Another "austerity package" that has us quite concerned is the one working its way in Washington in equally torturous fashion. Although President Obama is now involved in the budget/debt ceiling negotiations amid signs of compromise surfacing from both sides, we suspect the talks will likely run down to the wire, keeping the markets on edge until August 2, which is when the government technically runs out of money. The president has targeted a July 22nd cut-off date to enable the necessary legislation to be drawn up by August, but it remains to be seen if the two sides will do what it takes to avoid what could potentially be a very destabilizing situation for the markets. Although we think an agreement will *eventually* be reached, sparing the US the embarrassment of defaulting on its debt (ahead of Greece no less) the markets can get quite sloppy in the meantime.

3) Macro numbers have been coming in on the stronger side over the last few weeks, particularly out of the US, where we saw the latest ISM and Chicago purchasing manufacturing numbers exceed estimates. However, based on these limited readings, we may not want to conclude that a second half bounce is setting in just yet. For one thing, the employment picture remains a major drag, and housing also remains depressed despite the slightly better numbers reported of late. Japanese manufacturing numbers and retail sales numbers have also come in on the stronger side over the past month, signaling a potential recovery, but in a major decoupling, numbers out of China and Europe are turning more negative. As examples, factory activity in China expanded at its slowest pace in 11 months in June, with the HSBC "flash" manufacturing purchasing managers' index coming in at 50.1, only a shade higher than the contraction territory that lies below the 50 mark. Out of Europe, the same reading showed that growth in European activity was very tepid this past month, and were it not for the expansion in Germany and France, the overall region would have slipped into contraction.

4) We were cautiously optimistic that the decline in oil prices that took values below the $90 mark at one point in mid-June would reverse some of the inflationary pressures building into system and prompt some of the central banks to hold off on raising rates further. This scenario seems to have fallen by the way side, as crude oil prices are again on the way up, (as are pump prices). Elevated oil prices in our view pose the single greatest threat to growth, since they inevitably unleash inflation and bring out the worst (or best?) of central bankers who will be quick to raise rates. (Chairman Ben Bernanke is the notable exception here). In fact, just today, the People's Bank of China raised its interest rates for a third time this year, and the ECB is expected to follow suit tomorrow. Although the impact of the Chinese rate move was muted, while reaction to a likely ECB move has yet to be gauged, commodity markets should find it increasingly difficult to push higher against such interest rate headwinds.

5) Finally, fund interest in commodities seems to have receded in recent weeks. A, study out by Barclays Capital out last month shows that commodities are now perceived by institutional investors as the least attractive asset class, this according to a survey of 862 investors. In addition, Blackrock reports that investors have apparently pulled over $2.6 billion from commodity exchange traded products (ETPs) in May, the biggest outflow so far this year.

Individual markets: We discuss the individual markets in the pages that follow. Of the group, we think oil and copper and are particularly vulnerable, as they are seen as "China plays" and could experience declines going into the summer months if Chinese macro numbers continue to come in on the softer side. Aluminum is another energy play and may be vulnerable as well, with additional weakness coming from the fact the complex is finally shedding much of the inventory that has been locked up in financing deals. LME steel billet prices have been holding up very well, but there are clear signs of weakening in both the hot-rolled and cold-rolled markets, while further upstream, iron ore prices are also starting to wobble. Freight rates remain subdued.

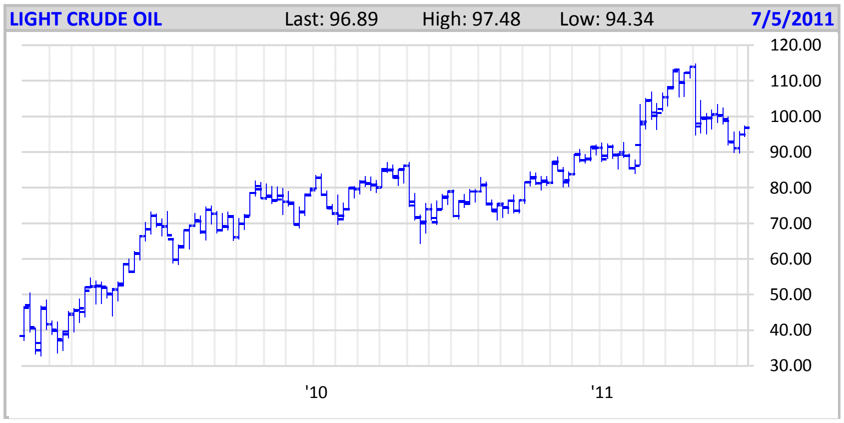
Many of the agricultural complexes have seen sharp selloffs this past quarter and month, as improving crop prospects and waning demand have knocked most of them well off their highs. However, the summer months remain critical for a number of markets, and with inventories quite low, we could see some rather impressive weather-induced snap-backs, at least until stocks are replenished.

On the currency front, it is very difficult to get a clear picture on what the dollar will do over the next several weeks, as there are crosscurrents pulling the currency in different directions. Further upheaval in Europe could see the dollar strengthen, while similarly, a debt deal in Washington could also revive the dollar's fortunes, although we suspect any move will be short-lived. On the other hand, rising rates in other countries will keep the pressure on the greenback as differentials widen. Furthermore, as long as things remain relatively stable, the default preference by investors seems to be to stay short the dollar.

Finally, US equity markets will soon be getting second quarter earnings reports, with Alcoa kicking thing off on the 11th of this month. We expect a modest retracement in stocks over the next month or so, as some of the earnings will likely coming in light in view of decelerating growth both in the US and abroad. We should remember that roughly half the pickup in US GDP growth over the last 18 months has been attributable to a surge in exports, and so the pace of overseas activity assumes critical importance for US firms. In the bond markets, we think last week's spike in 10-year US bond yields (the sharpest in some two years) has priced in both a "Greek success story" as well as the possibility of a second half bounce in the US economy. Both are "works in progress" in our view, and seen in that context, the sell-off in bonds was likely overdone. We expect rates to likely head lower over the summer months and back below 3% as the US economy remains mired in a slow-growth mode for much of the second half.

WTI NEARBY CONTINUATION

WTI prices gave up quite a bit of ground in June, dropping to a low of $89.82 at one point before recovering about half its losses during the last two weeks. For the second quarter as a whole, WTI's performance was even worse, with the 11% decline being the poorest quarterly performance since 2008. The unexpected release by the IEA of about 60 million barrels of light sweet crude triggered the plunge, but even before the IEA's move, there was concern about high inventories, particularly in the US, and questions about the strength in overall demand. We suspect the bulls were thrown a bit of a lifeline when the Greek debt crisis was "resolved", knocking the dollar in the process and lifting commodities higher. In addition, better macro numbers out of Japan and the US late in June also helped. However, we suspect the higher prices we are seeing are not indicative of a change in the underlying demand trend, and we likely will see lower prices over July and into August. Specifically, prices could drift down for a retest of the $89 low, while on the upside, there is good resistance at $102.

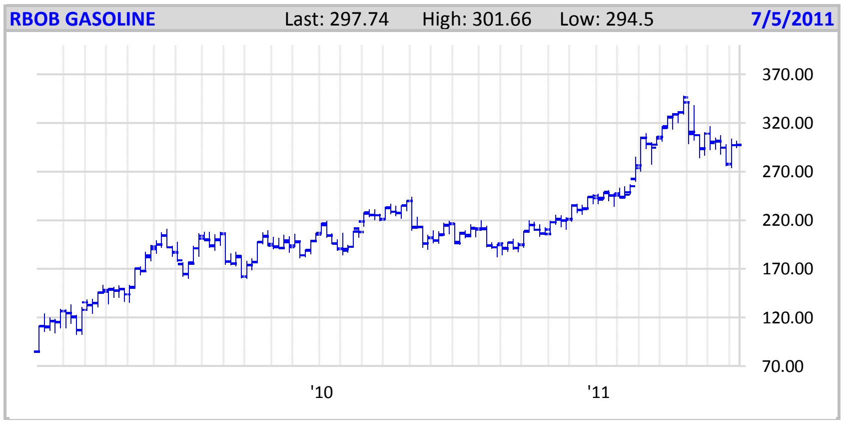


BRENT NEARBY CONTINUATION

Brent lost ground over the course of June, but has recovered more impressively than WTI has over the last two weeks, with the complex recouping about half of its June loss. The arbitrage has come from its record $23 level to currently trade around $17, but still remains at a formidable level. The IEA release was supposed to attack the "sweet" side of the market, but the fact that Brent is holding up well is leading some to suggest that the IEA scheme has failed. It is too early to say, but we suspect that the plan should eventually result in lower prices and as already, we are seeing reduced need for European product cargoes coming into the US. One action that could offset IEA sales is if the Saudis pull some of their oil off the market or tighten their discounts, but even if they do, they still have the problem of weak demand to confront. We look for a downside pullback to $108, while on the upside, we could get to $117, where there is a gap on the charts to be filled.

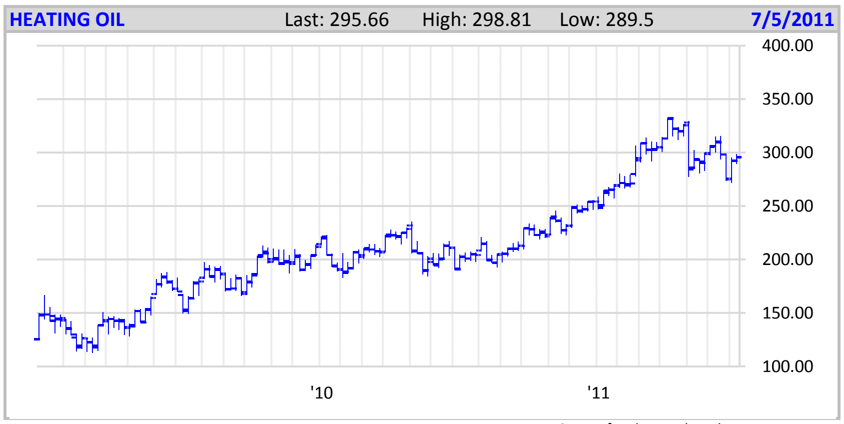
RBOB NEARBY CONTINUATION

Gasoline prices lost quite a bit of ground over the course of June, shedding a whopping $.35/gallon basis the nearby contract at one point before recovering most of its loss during the last week of the month and the first week of July. The IEA release hit the complex hard earlier in the month, as gasoline was already under pressure by weak demand readings, particularly out of the US. In fact, despite the start of the summer driving season, we are hardly seeing any significant improvement in week-to-week offtake. Price-wise, although we do not see prices collapsing to the June lows of $2.67, we do expect a modest pullback to around $2.80-$2.85. Resistance is at $3.00-$3.05 mark, not from current levels



HEATING OIL NEARBY CONTINUATION

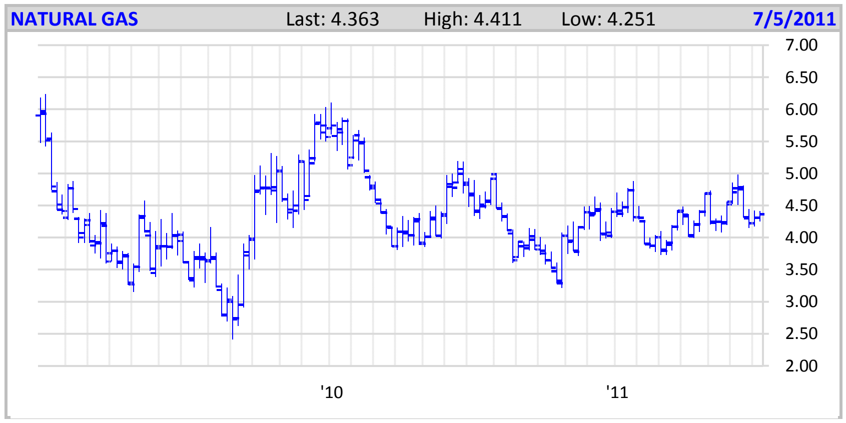
Heating oil peaked at around $3.17 in mid-June, not far from the $3.13 upside target we highlighted in last month's commentary, but like RBOB, it also began a steep release in mid-June, sinking all the way down to $2.74 before snapping back sharply. We don't expect a retest of the old highs anytime soon, as charts still look rather shaky, while we are also seeing some slow-down in overall distillate demand compared to what was evident earlier in the year. Look for a drift down to $2.82, while on the upside, the recent high should figure as rather difficult resistance.



Source for charts: Bloomberg

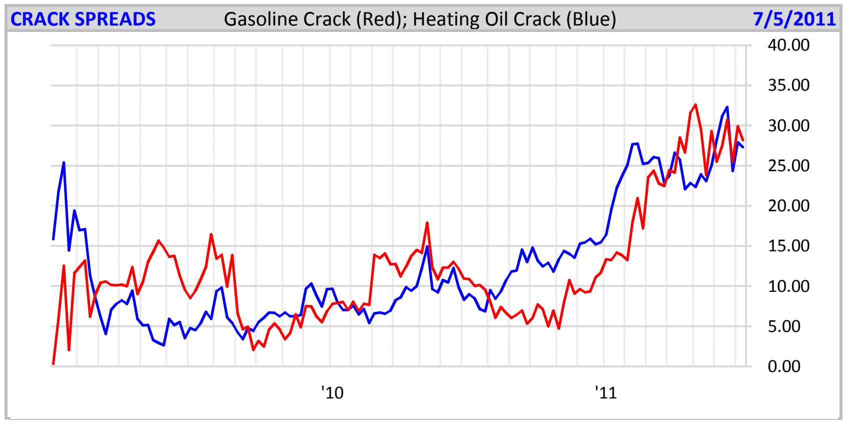
NATURAL GAS NEARBY CONTINUATION

Natural gas prices again failed to take out $4.80-$5.00 resistance band in June, and once again, prices gave way over the course of the month, sinking to a low of $4.1710 at one point. We now are approaching the lower end of the trading band, where there is good support between $3.80-$4.00. We have a shot of getting there, as the expected weakness in the rest of the energy complex could spill over into natural gas. For the time being, we rather stay on the sidelines and look to position ourselves closer to the $4.00 mark, as the risk-reward profile looks somewhat more attractive at those levels.



CRACK SPREADS

Crack spreads seem to be moving closer in tandem, unlike what we saw last month. However, the volatility has been quite intense, and we suspect we will see more of the same over the summer months. Of the two, the gasoline crack is likely more inclined to come down, as we think gasoline prices should fall faster than heating oil on disappointing demand readings and a summer driving season that will be muted.

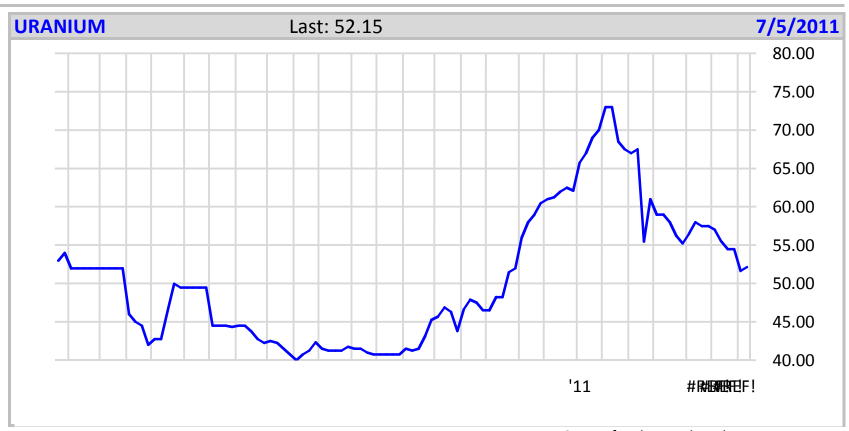


EMISSSIONS

European carbon price permits plummeted to 11.85 Euros a ton, hitting their lowest point since April 2009. The reason for the collapse was due to a European Commission plan whereby an extra 300 million permits will be put on the market to raise funds for green energy projects. The initiative will increase carbon permits substantially, and the market wasted no time bidding prices lower as a result. (See our chart alongside). However, analysts expect carbon permits to recover; a Reuters poll shows EUA permit prices for 2011 projected at 17.0, and 13.17 for CER. Looking forward, the average price expectation for EUA is 20.38 and for CER 15.90 for 2012; all of these are a bit of a stretch at this stage.

URANIUM

Uranium prices were on the weak side this past month, sliding another $3.25 just in the last week. The spot price remains 18% lower from the week prior to the Japanese nuclear disaster, with buyers still unwilling to reenter the market in size. Sales and prices are also still feeling the impact of last month's announcement from Germany's chancellor Angela Merkel that the country may phase out all its nuclear plants as early as 2022. We do not see much to turn the market around in the short-term, with range bound trading along a bottom likely the order of the day.



Source for charts: Bloomberg

LME BASE METALS

We thought copper was on the verge of breaking down last month after being locked in a relatively tight trading range of between $8900-$9280 for most of the period. In addition, most of the numbers we saw coming out were on the bearish side, encouraging our view that the next move would be lower. As examples, while LME stocks fell in June, there were few reports of increased physical activity or rising premiums. In addition, the stock decreases seen in Shanghai were likely exaggerated by the fact that Chinese refined exports have been increasing as well, now at about 144,000 tons year-to-date, or 15% of total refined imports. More importantly, Chinese imports of refined copper dropped 6.9% in May to a 30-month low after falling 16.6% in April. Imports are now off a stunning 47% from May 2010 levels. In view of this backdrop, we believe the current advance to the $9500 area looks very suspect and expect a drift back down to the $9000 over the summer months.

COPPER Last: 9522.25 **7/5/2011**

3-MONTH LME ALUMINUM

Aluminum prices lost about 7% over the course of June, and the tone during the first week of July was hardly any better, as prices continue to hover between $2500-$2550 level. We think part of the reason prices sold off so sharply earlier in the month is that aluminum is perceived to be an “energy play”, and with the recent drop in crude, the selling was more pronounced here than in some of the other metals. In addition, we think investors are becoming slightly nervous about the sharp decline in LME inventories; about 240,000 tons of metal has come out of storage since the beginning of June, possibly due to the fact that metal under financing schemes may be rolling out of storage. Consequently, we expect to see further pressure on flat prices, which could retest support at $2480 over the July/August period, with $2650 being good resistance. Premiums, which are only just starting to ease, may erode further as well. There is not much relief from fundamentals either, as most analysts (including ourselves) are expecting another supply/demand surplus in 2011.

ALUMINUM Last: 2544.25 **7/5/2011**

3-MONTH LME ZINC

Our $2100-$2370 trading range projection for zinc published in last month’s note was not far off the actual trading range, but in light of the recent recovery in metals, charts now suggest that a push to $2450 is possible over the course of July. However, the climb will likely be very much dependent on what the other metals do, as zinc’s fundamentals remain uninspiring on their own. In this regard, the market is expected to be saddled with a large surplus this year. In fact, earlier consensus surplus estimates of between 180,000-200,000 tons now look quite low, since the International Lead and Zinc Study Group itself is showing a surplus of some 178,000 through April. This suggest that the full year surplus could come in somewhere between 400,000-500,000 tons. LME stocks are another problem, now at 855,000, and only marginally lower than the peak of close to 870,000 reached in mid-June. With another surplus expected for next year and ending stock ratios close to 10 weeks, we cannot get too excited about zinc’s prospects going forward.

ZINC Last: 2384.75 **7/5/2011**

3-MONTH LME LEAD

Lead was among one of the better performing metals this month, pushing impressively higher, particularly during the latter part of the month. Investors are concerned that there will be a sharp drop in lead production in China this year as battery makers close plants in response to a rash of lead-poisoning incidents. Although a reduction in lead supply could theoretically result in an increase in imports, domestic lead stocks are quite high, so there will likely not be much upward pressure on free market prices until inventories are first drawn down. Equally problematical is the state of automobile sales, which are expected to come in at anywhere from -10% to +10% (depending on the source one consults). This is a marked deterioration from the +80% gains we were seeing last year, with the decline attributable to the removal of sales incentives and a clampdown on driving licenses. We look for lead prices to remain relatively firm, trading between $2600-$2850 over the course of the next month.

LEAD Last: 2689.75 **7/5/2011**

Source for charts: Bloomberg

3-MONTH LME NICKEL

Nickel prices struggled this past month, hitting a seven-month low of $21,337 in mid-June, not far off the $21,000 downside target we projected in last month's note. A modest recovery set in over the second half of the month, enabling nickel to finish pretty much unchanged over the period. Although nickel inventories on the LME continue to decrease, investors expect another surplus for this year, taking their cue from the International Nickel Study Group estimate, which projects the market to be in a 60,000 tons surplus in 2011. However, more recent numbers put out by the Group sees a deficit by 15,800 tons during the first four months of 2011, which leads us to suggest that the full-year 60,000 ton figure will eventually be revised lower. A downside revision to the surplus could do little to revive the complex's short-term prospects. For one thing, there should be no shortage of supply given that nickel pig-iron is a freely available substitute in many applications. In addition, stainless producers have announced maintenance closures, which could extend well into the third quarter. In the meantime, stainless inventories remain sufficiently high to fulfill any immediate demand needs. We see prices fluctuating between $23,000-$28,000 over the course of the second half of the year.

NICKEL Last: 23269 **7/5/2011**

3-MONTH LME TIN

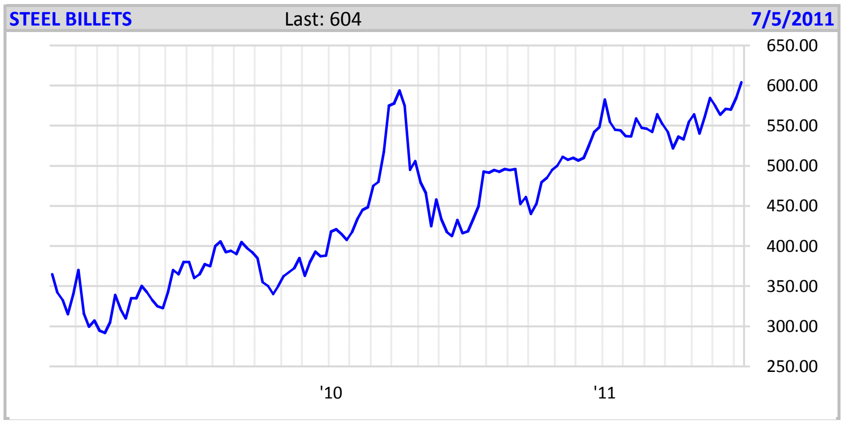
Tin dipped to a seven-month low in June, getting down to $24,510 at one point, not far from the downside target of $24,600 we highlighted in last month's report. Although LME stocks are not decreasing, the rate of accumulation seems to have flattened out, which may explain why prices have started to recover over the last 10 days. We think tin is getting to be attractively priced at current levels, and would consider doing some buying around $25,000, as the fundamentals remain compelling. For one thing, the market is expected to be in deficit this year, while LME stocks as measured by weeks of consumption are not that high compared to other metals. Furthermore, the market is critically dependent on Indonesian, and to a lesser extent, Peruvian and Bolivian exports. Demand remand remains strong, and unlike supply, is well spread out over a number of sectors. We could see tin rally to just under $29,000 over the second half of the year, while on the downside, we don't see prices dropping much below $24,000. For what its worth, PT Timah sees prices between $23,000-$27,000 over the second half of 2011.

TIN Last: 26280 **7/5/2011**

LME STEEL

LME billet prices have bucked the downward trend in June, and have held their ground pretty impressively, with prices now trading close to $600, and well above their early April low of $510. However, we suspect the market will eventually join the weaker tone we are seeing in other pockets of the steel industry; in this regard, *Steel Business Briefing* reports that Chinese exporters are seeing demand for HRC and CRC shrinking drastically since the beginning of May, with prices discounts of about $30-$50/MT readily apparent. Chinese exporters are also worried that further tax rebate cuts could hurt an already weak export market. On the fundamental side, a record amount of steel is expected to come into system this year, about 8% more than last year's record. This increased output could hit the market just as demand starts to weaken even further off, in which case we could see more aggressive price discounting going into the second half of the year.

STEEL BILLETS Last: 604 **7/5/2011**



IRON ORE

We have little to update to our short term outlook from last month, with prices slightly lower in light of some moderate easing in market tightness. Iron ore stockpiles in China have risen to 93 mt, in part due to the beginning of the seasonally slower period for steelmaking, marginal pick up in domestic production, and reports that some customers are deferring large volume orders until credit conditions improve. We expect the softer price conditions to continue until October, iron ore's seasonal low, and with an expectation that conditions in China and Japan will improve into Q4. There have been some interesting developments for the longer term, with a number of major proposed projects due 2014-15 in jeopardy due to capital cost overruns and environmental approvals. (*Contribution by Andrew Gardner in Sydney*).

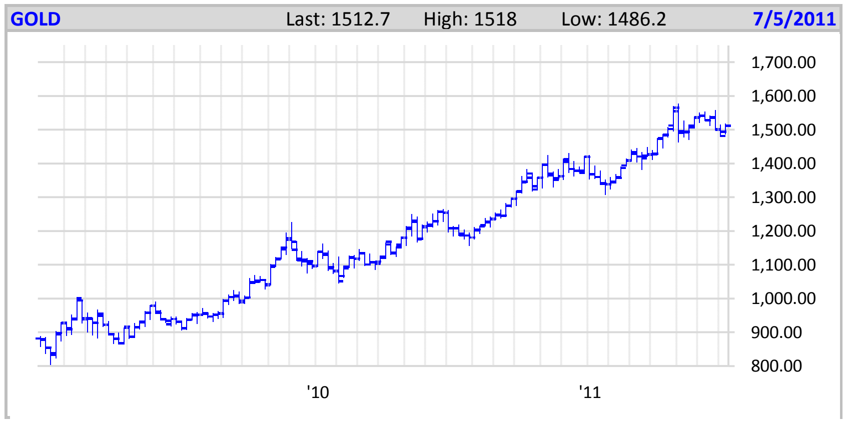
IRON ORE Last: **7/5/2011**

Source for charts: Bloomberg

PRECIOUS METALS

GOLD COMEX NEARBY CONTINUATION

Gold bulls did not have a good June, with prices sinking to a six-week low late in the month. The impact of the Greek crisis has been uneven on gold; early on, investors felt that the Greek crisis was acute enough so that gold was perceived as the logical safe-haven. However, as the crisis receded with both the "troika" and the Greek parliament coalescing around a working solution, gold's lure faded, particularly late in the month where we saw the bulk of the decline take place. In addition, less robust macro data, particularly out China and Europe, eased some of the inflationary pressures that were feeding gold's rise. And finally, the CFTC reports that long side fund interest in gold dipped over the month and was off some 25% just in the last week alone, coinciding with rising doubts over the attraction of commodity investments. We suspect gold will struggle somewhat over the course of July, since we think the ongoing crisis in the Eurozone should benefit the dollar more than the precious metal. In addition, we could see the dollar rally by late-July, which is when we expect a budget resolution to come out of Washington, further increasing pressure on gold. Look for a retest of $1480 support over the July-August time-line, with $1560 being resistance.

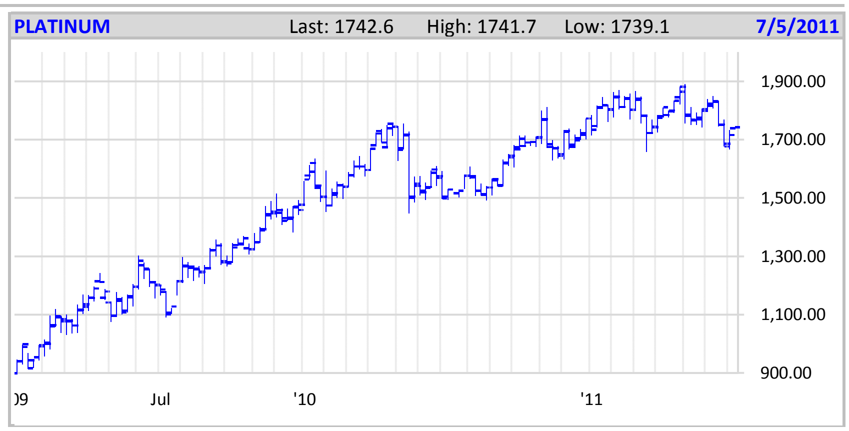


SILVER NEARBY CONTINUATION

Silver has been trending lower over the course of June, and is now hovering around the $35 mark, not far off from the May low of just above $32. Given the sloppiness we expect to see in gold over the next month, we cannot get too excited about what is in store for silver either. In addition, the CFTC reported that speculators decreased their net length in silver by some 33% this past week, which suggests that they need to see a compelling reason to get back in. Technically, should we take out the May lows, which we do not expect to happen just yet, we could see a much sharper break to the downside as stops will be set off. In the meantime, we expect to see a trading range of between $33-$37 for the July period.

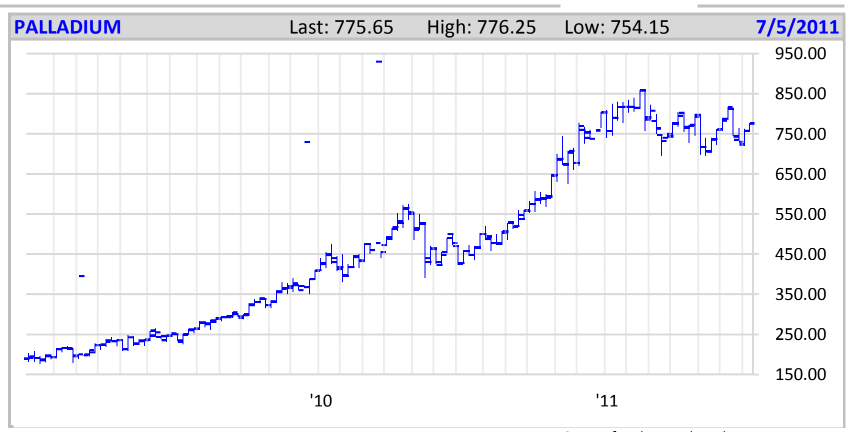
PLATINUM NEARBY CONTINUATION

Platinum lost ground over the course of June, closing the month near 3 ½ month lows, even getting below the $1,700 mark at one point in the month when the dollar spiked. Although there were signs of increased physical demand, this was not enough to offset the overall deterioration in some of the key global macro readings. In this regard, auto sales were looking particularly sluggish, with June US car sales down almost 1% from May levels, as the annual rate of 11.8 million vehicles also missed expectations as well. In Japan, Honda, Nissan, and Toyota all reported lower sales in June as well, with their orders running at about a fifth of year-ago levels due to disruptions from the March earthquake. (As a result, Johnson-Mathey expects Japanese platinum demand to slump some 16% in 2011). South Korean and Brazilian sales are up in double-digits, but French car sales fell for a third straight month. In light of the mixed sales backdrop, we expect platinum to remain range-bound trading between $1670 and $1780 over the next 4 weeks.



PALLADIUM NEARBY CONTINUATION

Palladium closed June near six-week lows, but its performance was not nearly as bad as platinum's (see above). In addition to selling pressures emanating from the stronger dollar and the Greek debt crisis, palladium prices were also pressured by a slew of unfavorable economic data, particularly out of the automobile sector. Chinese auto sales were especially weak, so much so that the government introduced a 'cash for clunkers' program. We expect to see prices maintain their multi-month trading range of $720-$820 basis the nearby contact, and do not expect to see a noticeable breakout from either end for the time being, as the strength in the rest of the precious metals group provides support.

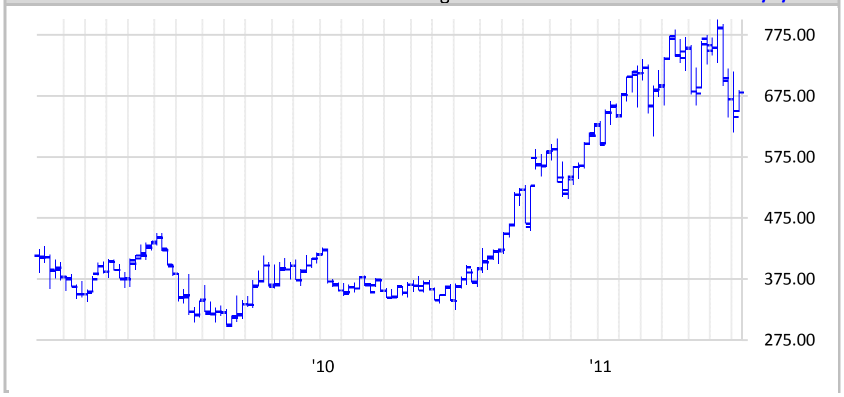


Source for charts: Bloomberg

CORN NEARBY CONTINUATION

It was a volatile month for corn prices, as values neared record highs of close to $8.00 a bushel early on in the month only to collapse to near the 2011 lows by the end. Bad weather in the United States slashed acreage projections early on in the month and pushed prices higher after the USDA reported on June 9th that worldwide stockpiles were expected to come in at 111.89 million tons, down from 129.14 million tons forecast in May. However, prices started to stumble shortly thereafter, taking one of their biggest one-day hits in some seven months on the last trading day of June on the back of the USDA's grain acreage and inventory report. The report showed that US farmers planted 92.282 million acres of corn this year, the second-highest since 1944, while stockpiles came in 12% higher than forecast. Prices were also under pressure as other variables dovetailed the bearish USDA report, including, improving weather in Europe, a more hostile attitude towards ethanol in Congress, and a round of profit-taking as funds bailed out of commodities. We expect further weakness in the month ahead, particularly if the mid-March low of $6.15, gives way on the next go-around. Resistance is at $7.20.

CORN Last: 680.5 High: 684.25 Low: 649 **7/5/2011**



WHEAT NEARBY CONTINUATION

Our call on wheat did not work out that well this past month, as prices plunged to their lowest level since January 2009 by month's end on account of the USDA reporting higher-than-expected acreage and inventories. According to the report, stockpiles of wheat (all varieties) totaled 861 million bushels as of June 1, down 12% from 976 million bushels a year earlier and well above expectations of 823 million. Favorable crop weather in the Midwest and the satisfactory harvest of the winter wheat crop in the US, coupled with a general exodus of fund money out of grains, hurt wheat's prospects somewhat further as well. In addition, the International Grains Council said in late June that it has raised its forecast for the global wheat crop in 2011/12 to 666 million tons from 650 million tons on account of higher revisions for several countries, including China and India, which more than offset lower forecasts for the EU and the US. We expect to see continued weakness over the month ahead for wheat, as the charts look quite poor, and suggest that a further decline to the low $5.00 mark may be in the cards. On the upside, resistance is at $6.75.

WHEAT Last: 613.75 High: 615 Low: 589.25 **7/5/2011**

SOYBEANS NEARBY CONTINUATION

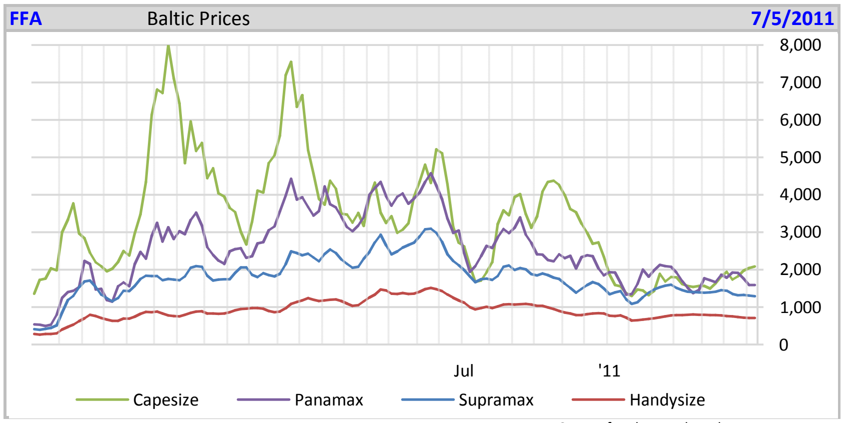
Soybeans confounded our bullish call from last month, as prices tracked the weakness in the other grains, while also being pressured by long liquidation. Twice in June, a surge in the dollar, coupled with a sharp break in energy and equity markets over the mid-month period, drove July soybeans to their lowest level since mid-March. However, prices recouped part of their losses towards the end of the month, as the USDA report on soybeans was not as bearish as was the case with wheat and corn. In this regard, soybean plantings were only 2% less than what traders had expected, offsetting the fact that the size of the overall crop would be the third-largest on record. Going forward, we see good support around the $12.80 level basis the nearby contract, but a break below there will look serious, as there is not much in the way of support until much lower levels.

SOYBEANS Last: 1332.25 High: 1340 Low: 1322 **7/5/2011**

FFA

After hitting a six-week high in May, the Baltic sea-freight index has sagged again, with prices now down to a three-week low after dropping for the last seven days (as of July 4th). The fact that ship-owners are scrapping vessels at a record pace does not seem to be doing much for values. In this regard, shipbroker Clarkson said that forty-eight capesizes have been demolished so far this year through late June compared to a total of 18 in 2010. Although supportive on the surface, the ramp-up in scrapped vessels seems to be more than offset by an ever-increasing supply of new ships. Indeed, 117 new vessels have been launched so far this year and more are on the way in 2012, this according to another UK consultancy. In the meantime, demand seems to be languishing; iron ore imports into China are flat for the moment, while India's monsoons are expected to reduce iron ore exports as rivers rise. In addition, Australia coal producers are still struggling to return to normal after flooding earlier in the year.

FFA Baltic Prices **7/5/2011**

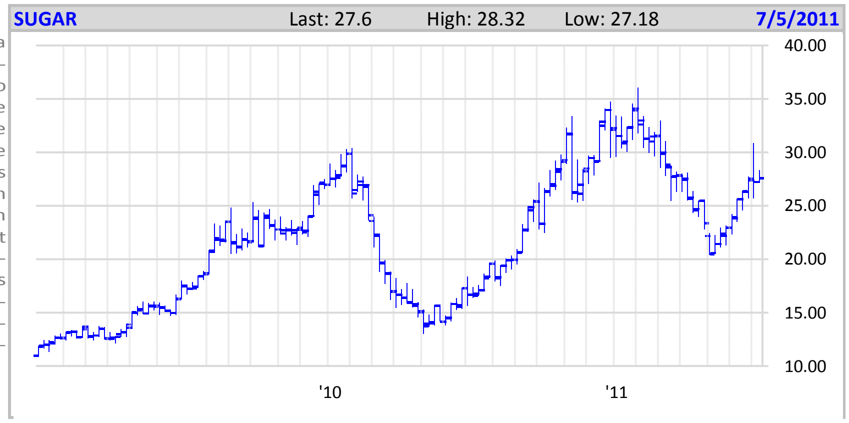


Source for charts: Bloomberg

TROPICALS

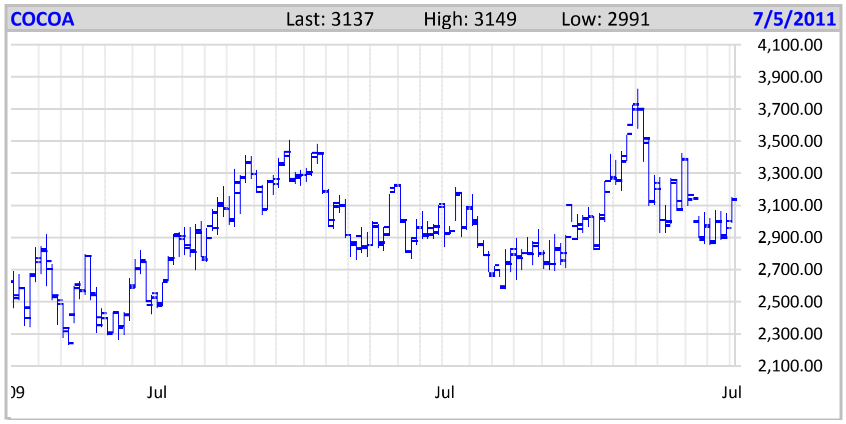
SUGAR NEARBY CONTINUATION

Sugar prices had an explosive June, racing to a four-month high as a number of export delays hit the market. In this regard, Brazil and Thailand were both having difficulty exporting sugar in a timely fashion due to port congestion. Prices also pushed higher on a report from sugar trade organization Unica saying it would revise its estimate for Brazil's cane production, citing a lower-than-expected harvest. Its numbers are due out sometime next week, and the talk is that the figure may be as low as 525 million tons, down from the 586 million tons estimate put out in March. Speculative longs have also been flocking back into sugar, with net long positions hitting three-month highs in late June. The market seems to have shrugged off German research firm's F.O. Licht's projection that output will exceed demand by as much as 9 million metric tons for the year starting in October, up from a surplus of 1 million in the current season. However, numbers like that would make us cautious particularly as we try to push passed the $.30 mark. We think sugar is a bit over-extended here, and are looking for a pullback over the summer months.



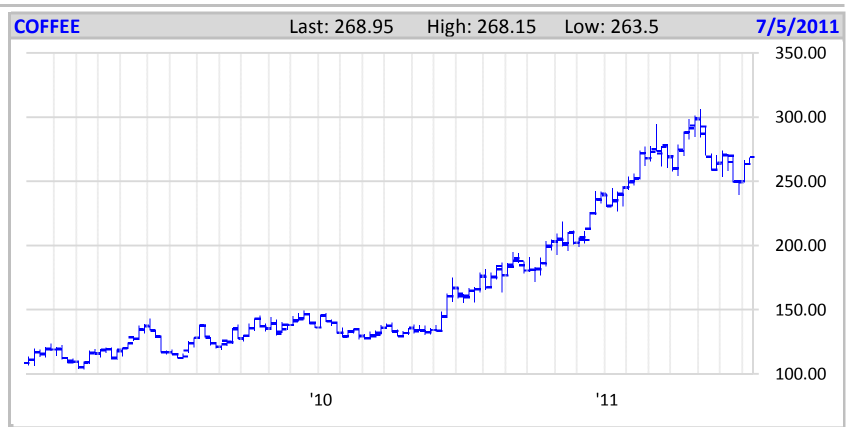
COCOA NEARBY CONTINUATION

Cocoa prices were under intense pressure this month, collapsing to five-month lows on projections calling for a higher global surplus. On June 2, the International Cocoa Organization said that the global surplus in 2010/11 will increase to 187,000 tons, up from 119,000 tons forecast earlier. The excess supply is largely attributable to record-output in a number of African countries; Ghana's crop, for example, is expected to rise by 30% to 825,000 tons, a new record, with the Ivory Coast and Nigeria expected to come in at 1.325 million tons and 240,000 tons, respectively. The surge in Ghanaian production is largely attributable to the continued smuggling that is going on in the Ivory Coast, as pro-Gbagbo militants divert export flows, taking advantage of higher sales prices offered to Ivorian farmers out of Ghana. Ongoing problems with commercial banking and payment procedures are encouraging the smuggling as well. Technically, charts suggest a continued drift low, possibly back to the 2900 sterling mark, as the down channel remains very much intact.



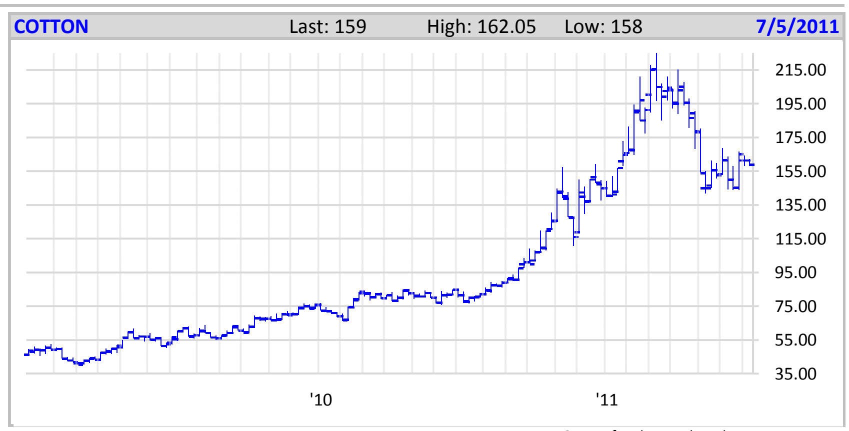
COFFEE NEARBY CONTINUATION

We had a fairly volatile month in the coffee markets this past month, as Arabica prices ended near a five-month low mid-month on a wave of speculative selling and healthier crop prospects, but then rallied sharply over the second half of the month as fears that a winter frost may have damaged a minor portion of Brazil's huge crop took hold. As it turned out, the damage was minimal, slightly increasing the selling pressure on the complex over the first few days of July. However, given that July and August are peak frost periods for Brazil, we are not that keen to get too short the market here, and could see further gains over the next few weeks. Premiums for Robusta continue to remain firm, with Indonesian origins changing hands at $200 above London futures and Vietnamese coffee trading at a $150 premium.



COTTON NEARBY CONTINUATION

After dropping sharply from the March-April highs, cotton seems to have settled into a broad trading range of between $1.40-$1.70 for much of May and June. Its inability to rally from current levels is due in large part to the sharp drop-off in consumption, brought on by the growing supply of cheaper chemical fibers. In addition, low prices for yarn is reducing demand by spinning mills, which are already well stocked anyway. The International Cotton Advisory Committee Secretariat projects consumption falling 3% for the year to 24.5 million tons, while output is expected to grow by 11% to 27.4 million tons. Here in the US, the USDA expects farmers to seed 9.2% more cotton than forecast in March, likely resulting in a bigger crop. The increased supply picture should help replenish stockpiles and keep prices somewhat on the defensive over the short-term.



Source for charts: Bloomberg

EURO

The Euro has not done much over the course of June, starting the month around $1.44 and ending it only slightly higher. The Greek crisis has dominated sentiment throughout the period. In this regard, an initial funding scare hit the currency earlier in June, but a rescue package of $17 billion put together late in the month calmed the market jitters – at least for now. It is important to note, however, that despite this "rescue", Greece is not out of the woods yet, as details of a bigger package have yet to be finalized. Moreover, efforts to make Greek repayments easier by stretching them out over several years are running head-long into rating agency resistance to sign off on the move without viewing any such repackaging of debt flows as a default. Of course, through all this, we still have the possibility of spreading contagion into other countries, with Moody's slashing Portugal's credit rating this past week. The uninspiring backdrop argues for much lower Euro valuations, but investors feel that the issues, the Euro is a legitimate alternative to the dollar. In fact, it may look even more attractive if the ECB raises rates again at its next meeting (on the 7th). We think a 1.41-$1.47 trading range remains in place for July.

EURO Last: 1.4429 High: 1.4578 Low: 1.4397 **7/5/2011**

YEN

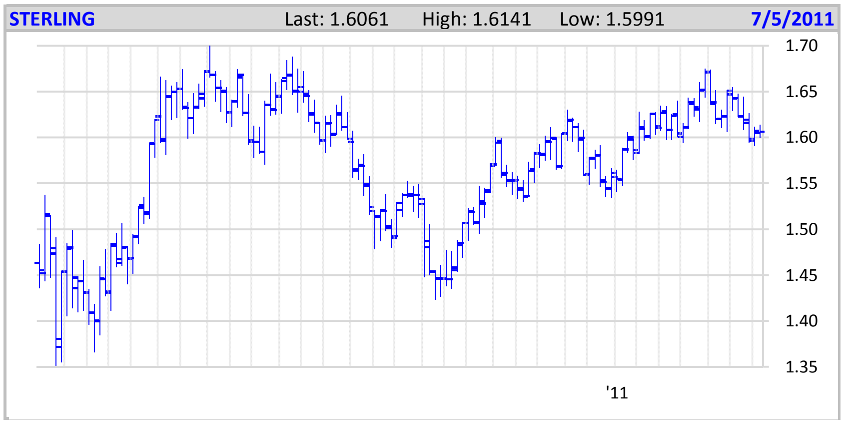
We are seeing an extremely tight trading range in the yen, with the currency hovering between the 80 to 81.50 mark for pretty much all of June. The "resolution" of the Greek crisis has helped the currency, in that money has left the safer confines of the dollar as the crisis receded. In addition, confidence in the yen is returning on growing signs that the Japanese economy is revving up. Both retail sales and manufacturing data came in higher than expected this past month, with the rise in industrial output being especially noteworthy. In this respect, Japanese manufacturers reported a 5.7% increase in May and expect another 5.3% increase in June before things level off to 0.5% in July. In the meantime, the strength in the yen seems completely divorced from the chaotic state of affairs politically. There is ongoing pressure on Prime-Minister Naota Kan to step down, and his reconstruction minister resigned last week.

YEN Last: 8107.013 High: 8118.86 Low: 8054.772 **7/5/2011**

STERLING

Last month, we wrote that we did not see sterling regaining its late April high of $1.6730 over the June/July period, and were looking for a retest of the mid-May low of $1.6050. We not only got there, but also drifted lower still, getting to a five-month low of just over $1.59 before recovering slightly as of this writing. Sterling also fared badly against the Euro, sinking to a sixteen-month low in June. The currency is being hit by weak economic data, complicating the government's efforts to spur a private sector-led recovery to offset the effects of painful spending cuts. The pound may also suffer if a second rescue package for Greece is finalized, as this will raise alarm about potential bail-outs for other nations like Ireland; British banks have lent the equivalent of 6% of UK gross domestic product to Ireland (this according to Morgan Stanley). In the meantime, minutes of the Bank of England's last policy meeting show that some members are considering additional quantitative easing, likely adding further pressure to the currency. We expect a drift lower over the summer months as Euro-zone jitters intensify.

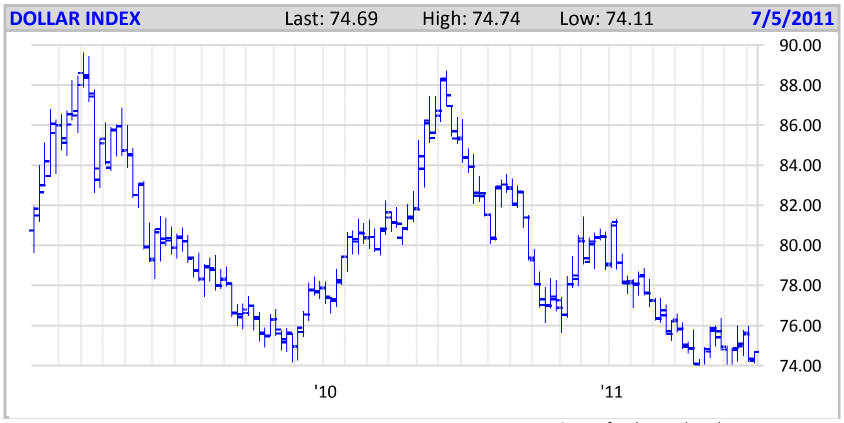
STERLING Last: 1.6061 High: 1.6141 Low: 1.5991 **7/5/2011**



DOLLAR INDEX

The dollar index has not done much over the course of June, finishing slightly lower on the month. However, the rather modest net change belies all that is going on underneath the surface. For one thing, the Greek crisis has alternatively strengthened and weakened the dollar, depending on the severity of the issue on any particular day. We suspect things in Greece (and in Europe) will likely get worse before they get better, and this should be somewhat supportive for the dollar over the short-term. However, pulling the other way, are the widening interest rate differentials, with the Fed is committed to stay on hold, while other central banks get progressively more aggressive. A big unknown is how investors will react to a budget and debt deal now being cobbled together in Washington. We suspect that the dollar should rally once an announcement is made, but if the talks drag on dangerously close to the wire, we could see rather sharp selling set in. For the time being, we would rather favor the sidelines on the index, as these various cross-currents play themselves out.

DOLLAR INDEX Last: 74.69 High: 74.74 Low: 74.11 **7/5/2011**

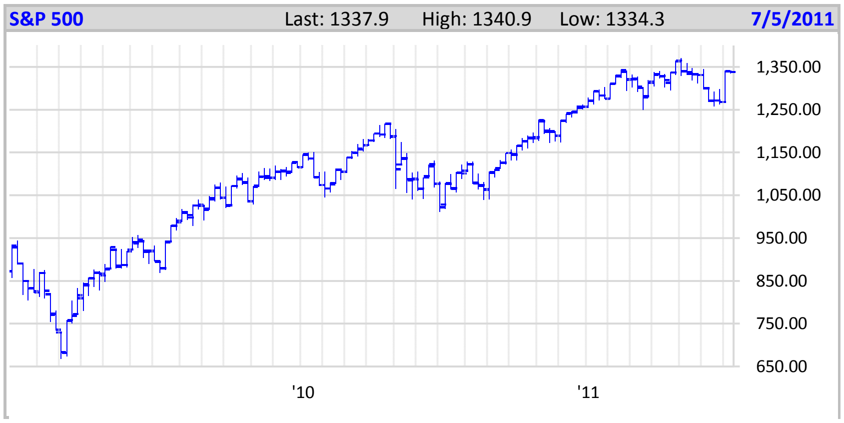


Source for charts: Bloomberg

FINANCIALS

S&P 500

Although the S&P 500 the index did not get down to our downside target of 1240 in June, it did drop to 1260 before staging a very impressive rebound to about 1340. In fact, the last week of June was the best weekly performance in the S&P in about a year, as investors were heartened to see a discernable pick-up in the pace of US economic activity and an easing in the Greek debt crisis. The market will now wait for Q2 earnings to start trickling in on July 11th. So far, the preannouncements have not been that dramatic, as many companies, especially those benefitting from international operations, continue to do well. However, there are headwinds ahead, which prompt us to advise taking some money off the table at this stage. The budget talks could still unnerve the markets as we go into the home-stretch, rates are pushing higher in many emerging markets, while the possibility of another European surprise should not be ruled out. On the corporate front, profit growth could slow during the rest of 2011 as raw material prices rise. In addition, there has been a noticeable stall in employment data of late, and this does not bode well for confidence going forward.

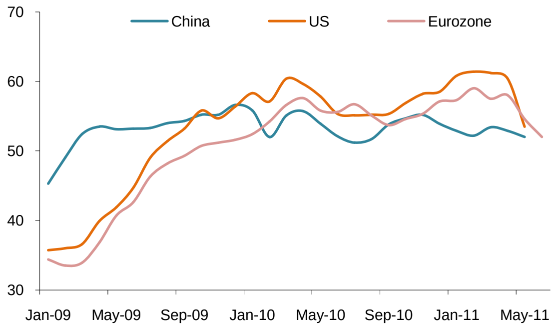


10-YEAR NOTE

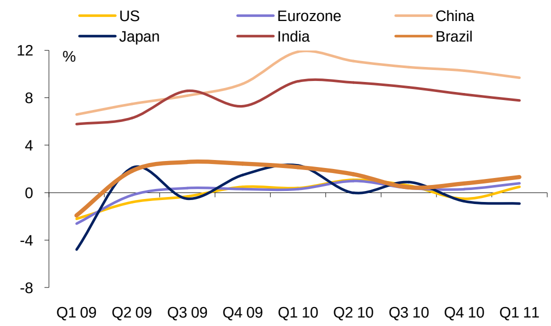
Bond prices moved sharply lower over the course of June, as a noticeable turn for the better in US macro readings encouraged expectations that the US economy may be recovering from its recent slowdown. In addition, easing of fears of an impending bankruptcy in Greece helped the benchmark 10-year Treasury notes stage its biggest jump in yield last week in almost two years, moving from a low of about 2.84% at the start of the week to just over 3.2%. Moving forward, much depends on how the budget talks fare over the course of the next few weeks, coupled with the strength (or weakness) in the upcoming July macro data out of US. We think the sell-off in bonds has perhaps gotten slightly ahead of itself in discounting a strong second half bounce and a "resolution" to the Greek issue, as both are "works in progress". We therefore would likely want to start nibbling at the battered sector here, as we think the market has done too much too quickly.

Source for charts: Bloomberg

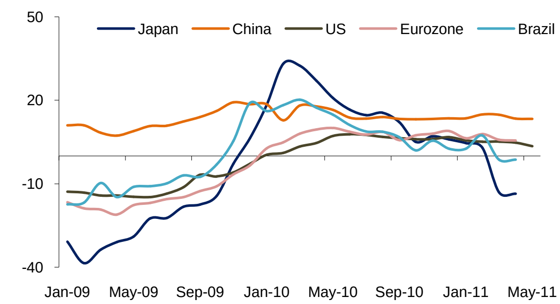
PMI (m-o-m)



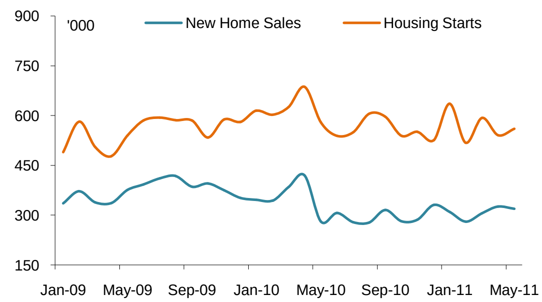
Real GDP (q-o-q)



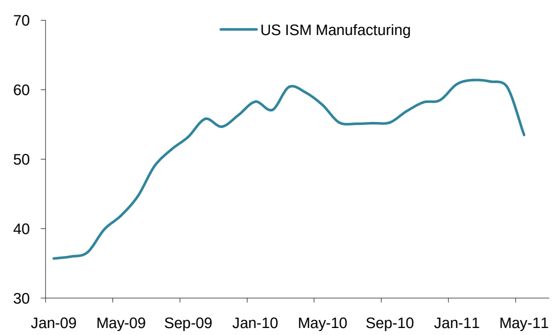
Industrial Production (y-o-y)



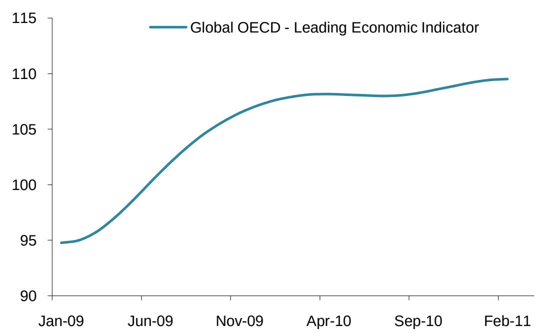
US Housing



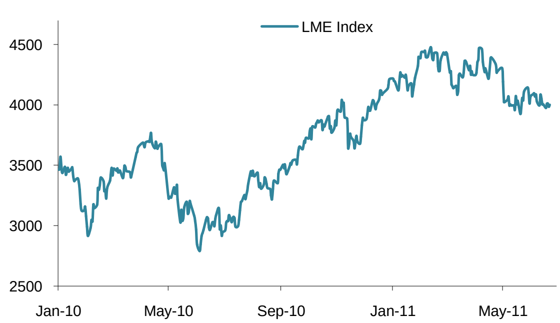
US ISM Manufacturing



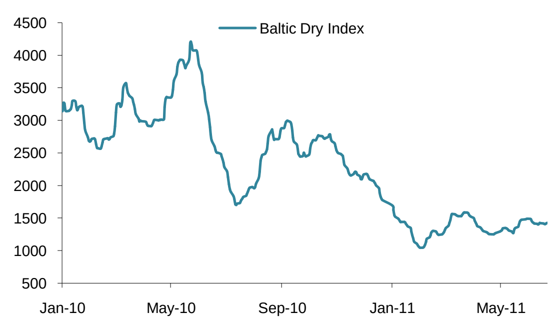
Global OECD - Leading Economic Indicator



LME Index

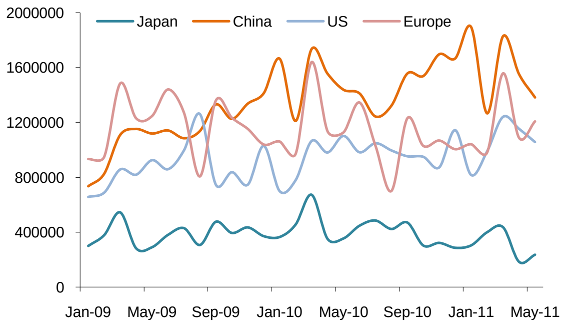


Baltic Dry Index

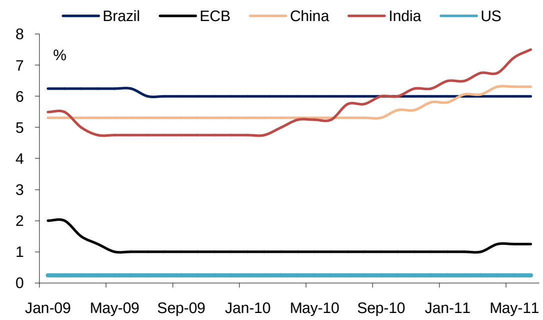


Source for data: Bloomberg

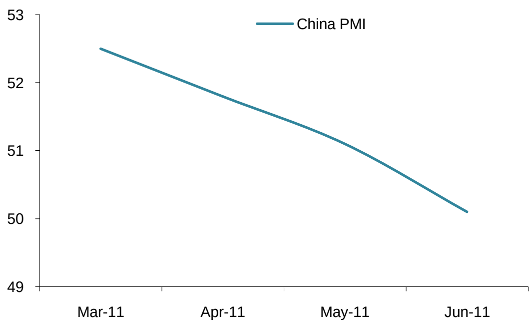
Vehicle Sales



Interest Rates



HSBC Flash China PMI



Consumer Confidence