

Santos Notes: In New World, Funds, Specs Here to Stay in Commodities, Says Broker. Commercials could end trailing speculators, fund moves in commodities

By Marvin G. Perez.

Guaruja, Brazil (Coffeenetwork) In a new world of fast communications and deep pockets wielded by investment funds and speculators, commercial participants are likely to stay in uncharted waters when it comes to trading commodities, a taste of which was dished out earlier this year during the swift commodities rally that left many products in record territory, said an industry veteran here.

Eric Nadelberg, Senior Vice President of Investments for Prudential Bache Commodities, LLC in New York said that commercial companies, which used to hold the power of information, have lost their edge in a time when communication is disseminated so fast, other participants can act just as quickly.

Speaking at the 17th International Santos Coffee Seminar, he said that hedge funds and index funds are here to stay in commodities and though perhaps future changes in regulation may shake a bit the current situation in commodities, he sees these participants not going anywhere. In fact, he said there are pools of money being discussed to buy the physical commodities, which could leave commercial participants following the funds and speculators rather than leading them.

“There’s a steep learning curve for the once dominant market sector (the commercials and hedgers),” he said.

“Commercials used to have the information first and act first, and speculators then follow...they had an edge over specs, who were small...but neither of that is true anymore,” he said.

He estimated that in 1992, funds had about \$20 billion in commodity markets, and today that figure is close to \$200 billion, a jump of 1,000%. In the last two years, they have increased their investments in commodities by 30% per year, he said.

“Neither index or hedge funds are going away,” he said, to a stunned audience, many of whom are producers struggling to keep up with rising fertilizer and fuel costs.

He cited the recent forum held by the Washington-based Commodity Futures Trading Commission, where it was concluded that funds are not driving the rallies, but rather joining them, acting like a “herd of animals.” He said that market participants took different positions and interpretations over what discussed at the meeting, where essentially, the CFTC blamed the record prices on soaring demand for raw materials, low global stocks, tight supply and a weaker dollar (in addition to soaring oil prices.)

The subject has been widely discussed here, and many producers, exporters and growers have expressed frustration over the matter.

“It’s no longer about market fundamentals,” said a coffee trader from Brazil. “Now we have to know what’s going with the dollar, oil and the specs.”

Mr. Nadelberg showed charts and tables illustrating the swelling open interest for many commodities that saw record prices and OI in February and March, only to see a sudden selloff.

“This was just a minor prelude to what’s coming,” he said, adding trade needs to prepare for future fund and speculator action, and said that perhaps future regulation may change that a bit. But he warned: “large pools of money are investigating how to invest in physical” commodities.

“Overheating will happen again,” he said, adding that participants need to consider new hedging strategies that involve more options to reduce their vulnerability to market moves and prevent heavy financial pressures from margin calls, as was the case earlier this year.

Mr. Nadelberg is a 28-year veteran of the futures markets where he has concentrated most of his career on working as a proprietary trader and broker for large commercial users of the markets as well as a broker for hedge funds that value his technical trading expertise. Mr. Nadelberg frequently speaks about coffee related issues at international forums