

MAAP July Review

August 3, 2009

MAAP finished July with a gain. The first part of the month experienced a continuation of the minor correction in commodities that began in early June. However by mid-July a more positive environment resumed. Metals contributed the most to July's gains, followed by currencies and the S&P 500. Small losses occurred in the long positions in energy and grains.

We have maintained for several months that the selloff in commodities in the second half of 2008 was similar to the 1987 crash in equity prices. It was a very severe selloff, but an interruption, rather than a termination, of the secular bull market. Since the commodity markets resumed their bull market advance at the end of February, investors have had to deal with a series of negative economic headlines, anti-speculator government regulatory threats, and the emotional stress of the 2008 financial crisis fresh in their minds. Nonetheless, commodity prices have been climbing a wall of worry, typical of a bull market resumption. Furthermore, the recent five week correction in commodity prices represented an excellent real time test for the leverage management process that we recently instituted. Recent price action increases our confidence in the process. Back tests are useful, but real time experience provides the best information. Our goal is to be able to hold through periodic corrections in an ongoing advance, while avoiding those infrequent major declines. In this regard, markets temporarily experienced some minor deterioration in their uptrends, but never reached critically negative levels before the advance resumed. Having greater confidence in our ability to manage risk will increase our ability to capture and to hold onto future gains.

Evidence continues to accumulate that the global recession is ending. China's infrastructure stimulus clearly provided the jump start that its economy required. In turn, growth in domestic consumer demand in China has resumed. As a result, other nearby Asian neighbors as well as Australia and Brazil have benefited from China's insatiable appetite for raw materials and capital goods. In fact the demand for capital goods from the developing world may prove to be a positive surprise for GDP growth in the developed countries, in turn lifting their growth rates higher than current expectations.

In the U.S. leading indicators increasingly point to an end to the recession and to a resumption of growth. Pessimists continue to forecast either minimal growth or a "W" type recovery, wherein a short recovery is followed by a new downturn before growth resumes. Two factors that put us in the more optimistic camp are the potential for inventory restocking and the potential demand for capital goods exports to the developing world. With the dollar weakness that is unfolding, capital goods and agricultural exports could be two sectors that will see major benefits.

Dollar weakness and developing country economic growth, combined with a continuation of monetary stimulus through 2010, should provide the backdrop for an economic recovery in the U.S. Monetary authorities are likely to maintain an excessively easy stance for fear of a recessionary relapse. Monetary policy, necessary to totally resuscitate the financial sector, will most likely prove excessive for a moderate inflation environment longer term. Expected dollar weakness will create economic tensions, as stronger currency countries will accuse the U.S. of exporting inflation. As occurred in the 1970s, we anticipate that other central banks will be more stimulative than otherwise, as they attempt to offset dollar weakness. The net effect is likely to be higher global inflation in the years ahead.

Inflation will appear first in commodity prices and only later in finished goods and labor rates, as commodities will be the first area to experience shortages with renewed global growth. The next year will prove to be an interesting time as the world begins to grapple with potential upside surprises in demand and the availability, or lack thereof, of idle capacity in key commodities. If investors begin to

sense tightness of supply, explosive price moves could quickly unfold. It is entirely possible that commodity markets could experience a melt up at some point in the next few years. This could result from the lack of sufficient investment in new supplies, the physical limitations in finding new supplies, and the continuing demand growth from the large populations of the developing world. Geopolitical tensions are also likely to increase. Authoritarian countries such as China are seeking long-term country to country supply agreements. The U.S., on the other hand, is dependent on its multinational private companies to provide supplies. This could put us at a severe disadvantage, especially if a weak dollar delegates us to a weaker international role than we have been used to in our life times.

The social implications of accelerating commodity prices will increase the political demagoguery against market participants. Hearings are currently being held with regard to limiting position limits (maximum holdings) by different categories of holders. The misplaced intent being to limit upward price moves. Present position limits would have to be lowered to one quarter to one tenth of current limits, depending upon the market, before our MAAP program would be limited. Speculators are much maligned, but perform a useful function of providing liquidity to other participants in the market. Lack of liquidity leads to inefficient pricing, and ultimately to higher costs of production. We seriously question the logic of those who believe speculators can distort market prices in a major way, unless they have the power to artificially remove supply from the market for an extended time period. Using oil as an example, when a front month contract expires, the holder of that contract must either have rented or owned storage facilities or a refinery in order to take delivery. Lacking those facilities, he must sell to someone who does. Therefore end demand will ultimately determine the price.

Nonetheless, political jockeying will likely increase, as politicians attempt to limit inevitable price increases. Posturing and lobbying will take place and some changes to current market rules may well occur. However in the intermediate term, we do not believe that major changes will occur. Politicians are aware that extreme changes could force markets offshore with its attendant loss of business in the U.S. financial markets. At the same time they are likely to create some new rules or modify existing rules, so that politicians can go to their constituents with evidence that they have reigned in “evil speculators”.

In summary, we believe that the commodity markets have embarked on a new phase of the secular bull market. It will be driven by the commodity oriented demand of growing developing countries as they build out infrastructure and meet demands of their growing middle class. The likelihood of tightening supplies of key commodities will lead to more volatile price moves and increasing geopolitical tensions. While political demagoguery will accompany rising commodity prices, the commodity sectors should provide the best relative investment opportunities during the next global expansion.

Past results are not necessarily indicative of future performance. Actual trading for 3X-6X commenced on 7/8/92 and 2X-4X commenced on 10/15/92. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. For a complete disclosure document of AIS Futures Management LLC's MAAP Program, contact AIS Futures Management LLC, 187 Danbury Rd. Wilton, CT 06897 (203) 563-1180.