Testimony of

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before the

Committee on Agriculture
United States House of Representatives

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Mr. Chairman and Members of the Committee, thank you for the invitation to speak to you today. I first began to study the role of institutional investment in the commodities futures markets, back in early 2006, while I was employed by Masters Capital Management. Since I formed my own independent research company I have continued to study this issue in-depth. I have recently added the Air Transport Association as a client but I am not representing them here today.

Instead I want to share the results of my research efforts. I am co-authoring an in-depth research report with Michael Masters that we hope to have completed in the next week or two. My testimony today essentially represents the executive summary of that report. With your permission I would like to submit the full report to your committee when it is complete.[i]

The commodities futures markets are a unique hybrid form of marketplace where two distinctly different categories of market participants transact side by side. Physical Hedgers access the markets to reduce the price risk of their underlying physical commodity businesses, while Speculators trade in the markets to make maximum profits.

When Physical Hedgers are the dominant force in the marketplace then futures prices will accurately reflect the real world supply and demand fundamentals these physical consumers and producers are experiencing directly in their businesses. When Speculators are the dominant force, then futures prices often become un-tethered from supply and demand and can reach irrationally exuberant heights.

In 1936 Congress devised a system whereby speculative position limits would restrict the size of Speculators'positions in order to ensure the dominance of Bona Fide Physical Hedgers and to prevent speculative bubbles from forming.[ii]Congress took this action because they realized that the commodities futures markets were essential to the health of the American economy.

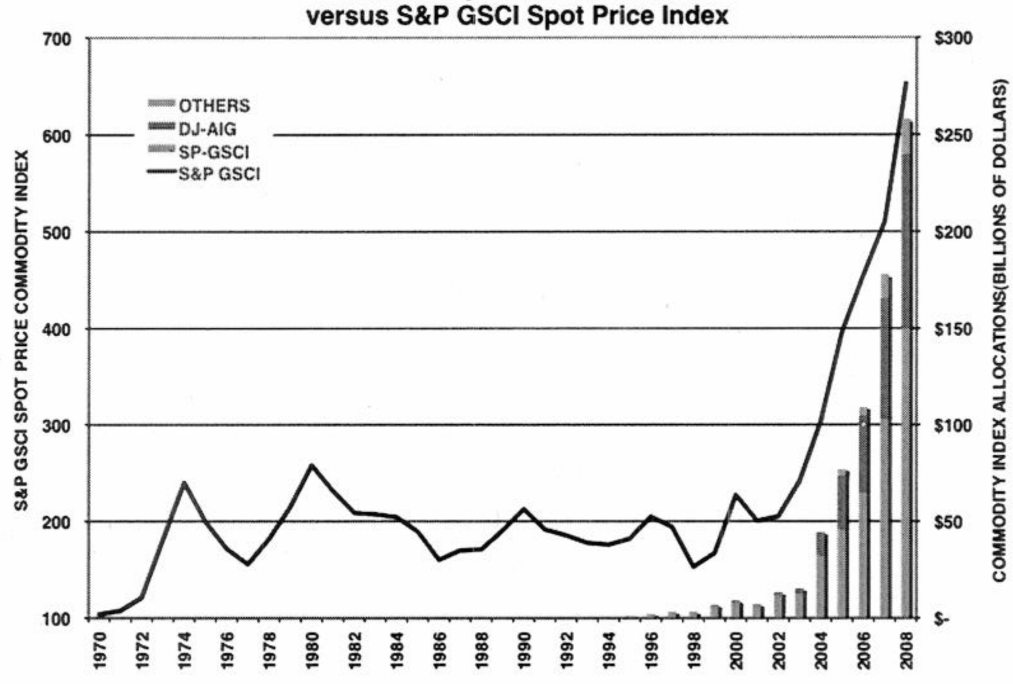
Today the agricultural and energy markets rely on the futures price as their benchmark for the pricing of nearly all their transactions in the real world "spot" markets.[iii] For many commodities, when the nearby futures price rises by $1 dollar, the spot price rises by $1 as well. This is preferred by Physical Hedgers because they can use the futures markets to hedge their price risk on a dollar for dollar basis.

Unfortunately the price discovery function of the commodities futures markets is breaking down. With the advent of financial futures the important distinctions between commodities futures and financial futures were lost to regulators. The term excessive speculation effectively came to mean manipulation.[iv] Therefore speculative position limits were raised or eliminated because they were not deemed necessary for the prevention of manipulation.[v]

Swaps dealers who trade derivatives in the completely unregulated over the counter markets were given the same virtually unlimited access to the futures markets that Bona Fide Physical Hedgers enjoy.These swaps dealers turned around and convinced institutional investors that commodities futures were an asset class that would deliver "equity-like returns" while reducing overall portfolio risk. These investors were encouraged to make "a broadly diversified, long only passive investment" in commodities futures indices.[vi] And as a result a new and more damaging form of speculator was born – I call them Index Speculators.

As Chart One belowdemonstrates the result has been a titanic wave of speculative money that has flowed into the commodities futures markets and driven up prices dramatically. Assets allocated to commodity index trading strategies have risen from $13 billion at the end of 2003 to $260 billion as of March 2008,[vii] and the prices of the 25 commodities that compose these indices have risen by an average of 183% in those five years![viii]

CHART ONE
Commodity Index Allocations
versus S&P GSCI Spot Price Index

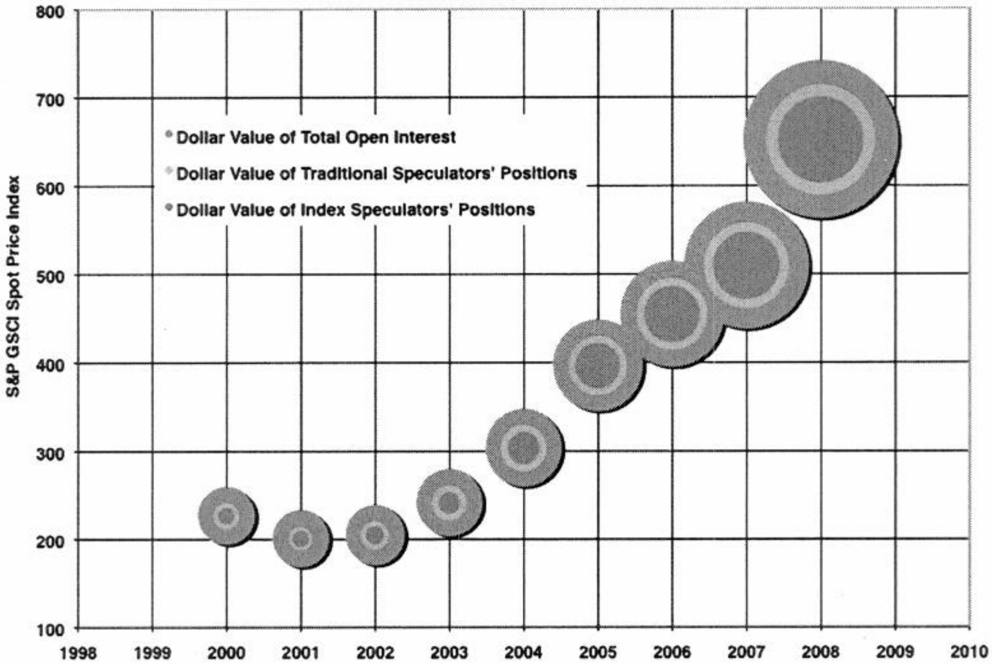


Source: Goldman Sachs, Dow Jones, Bloomberg and estimates derived from the CFTC CIT Supplement
2008 data point represents data through March 12, 2008, final reportwill cover through July 1, 2008

The total open interest of the 25 largest and most important commodities, upon which the indices are based, was $180 billion in 2004.[ix] From the beginning of 2004 to today, Index Speculators poured $167 billion into these 25 commodities.[x] As Chart Two below shows this has caused futures prices to rise dramatically as the commodities futures markets were forced to expand in order to absorb this influx of money.

CHART TWO

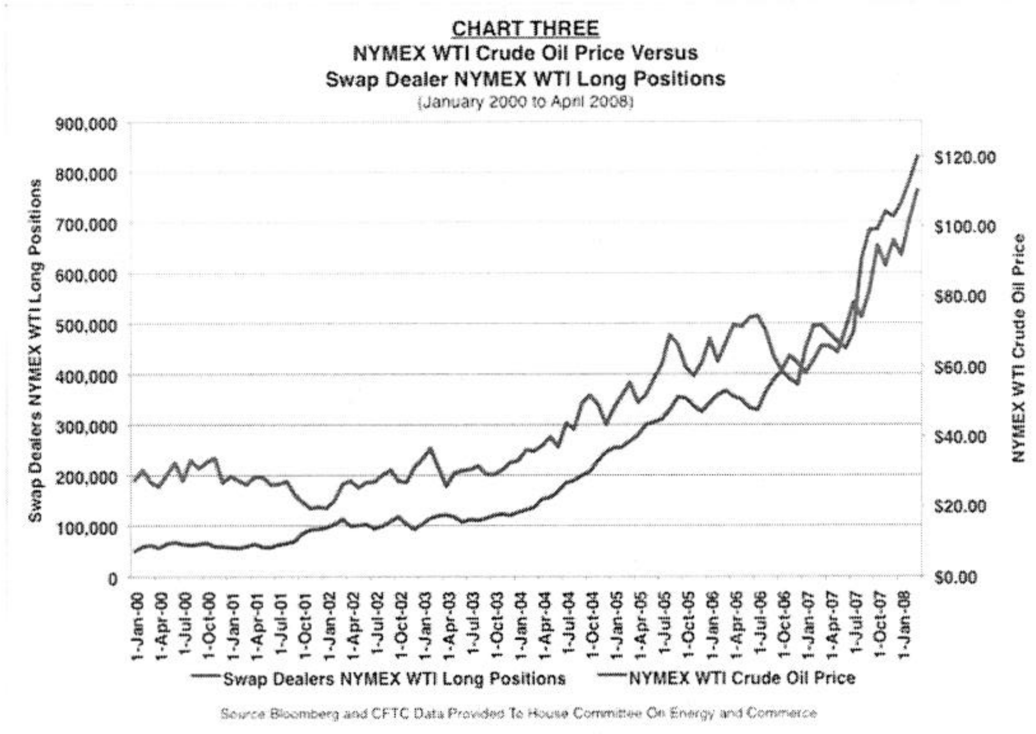
Commodities Futures Markets' Size versus S&P GSCI Spot Price Index



Source: Goldman Sachs, Dow Jones, CFTC Commitmenst of Traders report estimates derived from the CFTC CIT Supplement
2008 data point represents data through March 12, 2008, final report will cover through July 1, 2008.

Index Speculators have bought more commodities futures contracts in the last five years than any other group of market participant.[xi] They are now the single most dominant force in the commodities futures markets.[xii] And worst of all their buying has nothing to do with the supply and demand fundamentals of any single commodity. They pour money into commodities futures to diversify their portfolio, hedge against inflation or bet against the dollar. It is likely that they cannot even name the 25 commodities that exist in the indices.

The four largest commodity swaps dealers: Goldman Sachs, Morgan Stanley, J.P. Morgan and Barclays Bank are reported to control 70% of the commodity index swaps positions.[xiii] That would mean that on average about 1 out of every 4 long positions on the exchanges is controlled by one of these banks.[xiv] Recently released data from the House Energy Committee shows that swaps dealers as a category have grown to become the largest holders of NYMEX WTI crude oil futures contracts.[xv] Chart Three on the next page shows that as their positions have grown in size so has the price of oil.



I am not a legal expert so I cannot comment specifically about each of the proposed pieces of legislation currently pending in the House and the Senate but I believe there are several key elements that need to be part of whatever legislation Congress does adopt.

First there needs to be Federal speculative position limits for all commodities (except precious metals). These limits need to apply in aggregate across all exchanges trading U.S. based futures contracts. I recommend that a panel of Bona Fide Physical Hedgers be convened to determine these position limits since they can be relied upon to set them at levels that truly restrict speculation without restricting necessary liquidity.

Second, speculative position limits must apply in the over-the-counter (OTC) commodity swaps market. The commodity swaps market does not need to be regulated per se but if swaps dealers want to access the futures markets then they must report all their counterparties' positions in order to ensure that no one is in violation of speculative position limits. The OTC swaps market is many times bigger than the futures markets so excluding swaps from position limits would allow excessive speculation to continue unabated and render existing limits meaningless.

Third, excessive speculation should be numerically defined as a percentage of open interest. The same panel of bona fide physical hedgers should also determinethis figure. Then the CFTC can establish a system whereby the individual position limits adjust based on the overall level of speculation in the marketplace. This system would prevent the commodities futures markets from ever reaching a level of excessive speculation in the future.

Finally the practice of commodity index replication should be prohibited. Index Speculators damage the price discovery function and lock up large amounts of market liquidity by buying and holding futures positions for the ultra long term. Congress would not allow someone to hoard physical commodities so they should not allow institutional investors to hoard commodities futures either. A way should be found to prevent this damaging practice from continuing.

Speculative position limits worked well for over 50 years and carry no unintended consequences. If Congress takes these actions then the speculative money that flowed into these markets would be forced to flow out and with that the price of commodities futures would come down substantially. Until speculative position limits are restored investor money will continue to flow unimpeded into the commodities futures markets and prices will continue to rise.

ENDNOTES

[i] All of the data in my testimony today is calculated as of March 2008. When I submit the completed report the data will be updated through July 1, 2008.

[ii] "The fundamental purpose of the measure is to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves." Report No. 421, U.S. House of Representatives 74th Congress, Accompanying the Commodity Exchange Act, March 18, 1935.

"It should be our national policy to restrict, as far as possible, the use of these exchanges for purely speculative operations." President Franklin D. Roosevelt message to Congress February 9, 1934

"The bill authorizes the Commission . . .to fix limitations upon purely speculative trades and commitments. Hedging transactions are expressly exempted. That this power of the Commission will be exercised judiciously and for the purposes merely of preventing overspeculation and a type of 'racketeering' by a few large professional traders, may be assumed as a matter of course." Report No. 421, U.S. House of Representatives 74th Congress, Accompanying the Commodity Exchange Act, March 18, 1935.

[iii] "In many physical commodities (especially agricultural commodities), cash market participants base spot and forward prices on the futures prices that are "discovered" in the competitive, open auction market of a futures exchange." "The Economic Purpose of Futures Markets and How They Work - Price Discovery or Price Basing," Commodities Futures Trading Commission Website, http://www.cftc.gov/educationcenter/economicpurpose.html

"In the spot market, therefore, negotiations for physical oils will typically use NYMEX as a reference point, with bids/offers and deals expressed as a differential to the futures price. Using these differentials, Platts makes daily and in some cases intra-day assessments of the price for various physical grades of crude oil, which may be referenced in other spot, term or derivatives deals." "Platts Oil Pricing and Market-on-Close Methodology Explained - A Backgrounder," Platts, A Division of McGraw Hill Companies, July 2007, page 3.
http://www.platts.com/Resources/whitepapers/index.xml

[iv] "Excessive Speculation" (7USC6a) and "Manipulation" (7USC13b) are separate sections of the Commodity Exchange Act. Excessive Speculation is remedied by establishing speculative position limits and is not a violation of the act. Manipulation is a violation and can result in monetary penalties and jail time. Yet on the CFTC website it says "In general, position limits are not needed for markets where the threat of market manipulation is non-existent or very low."
http://www.cftc.gov/industryoversight/marketsurveillance/speculativelimits.html#P8_883

So their stance appears to be that position limits exist to prevent manipulation. Contrast this with the comments of Johnson and Hazen in their book "Derivatives Regulation" where they say "However, Section 4a (7USC6a) is expressly concerned with "excessive speculation" and thus is not specifically an anti(-)manipulation provision. Rather, section 4a focuses upon market disorders attributable to unbridled speculative activity, without regard to whether that speculative frenzy has a manipulative purpose." Section 5.02[1] "Derivatives Regulation," Philip McBride Johnson and Thomas Lee Hazen, Aspen Press, 2004, page 1235.

[v] "In general, position limits are not needed for markets where the threat of market manipulation is non-existent or very low. . . . A contract market may impose for position accountability provisions in lieu of position limits for contracts on . . . certain tangible commodities, which have large open interest, high daily trading volumes, and liquid cash markets."
http://www.cftc.gov/industryoversight/marketsurveillance/speculativelimits.html#P8_883

In 1998 the CFTC allowed the futures exchanges such as the NYMEX to replace "speculative position limits" with "position accountability limits" which do not actually limit the size of positions but simply represent a threshold above which the exchanges look closer at positions to ensure that manipulation is not occurring. The result is that NYMEX WTI crude oil does not have any speculative position limits except in the last 3 days prior to expiration. 63 FR 38525 (July 17, 1998) http://www.cftc.gov/foia/comment98/foi98--028_1.htm

[vi] "Investing and Trading in the GSCI," Goldman, Sachs & Co., June 1, 2005

[vii] "Investing and Trading in the GSCI," Goldman, Sachs & Co., June 1, 2005, CFTC Commitments of Traders Report - CIT Supplement and estimates derived there from.

[viii]

Commodity Futures Prices
March 2003 - March 2008

Agricultural	**Cocoa**	+	34%
	Coffee	+	167%
	Corn	+	134%
	Cotton	+	40%
	Soybean Oil	+	199%
	Soybeans	+	143%
	Sugar	+	69%
	Wheat	+	314%
	Wheat KC	+	276%
Livestock	**Feed Cattle**	+	34%
	Lean Hogs	+	10%
	Live Cattle	+	23%
Energy	**Brent Crude Oil**	+	213%
	WTI Crude Oil	+	191%
	Gasoil	+	192%
	Heating Oil	+	192%
	Gasoline	+	145%
	Natural Gas	+	71%
Base Metals	**Aluminum**	+	120%
	Lead	+	564%
	Nickel	+	282%
	Zinc	+	225%
	Copper	+	413%
Precious Metals	**Gold**	+	183%
	Silver	+	331%

Source: Bloomberg

[ix] Bloomberg did not have open interest data for the base metals in 2004 so I used 2005 figures for 2004. This is conservative since prices were rising during this time frame.

AVERAGE DAILY DOLLAR VALUE OF OPEN INTEREST IN 2004
(millions)

COCOA	$1,569
COFFEE	$2,748
CORN	$8,182
COTTON	$2,645
SOYBEAN OIL	$2,456
SOYBEANS	$9,480
SUGAR	$2,772
WHEAT	$2,647
WHEAT KC	$1,240
FEED CATTLE	$804

LEAN HOGS	$1,873
LIVE CATTLE	$3,556
BRENT CRUDE	$12,620
WTI CRUDE	$33,620
GASOIL	$5,461
HEATING OIL	$8,242
GASOLINE	$7,304
NATURAL GAS	$25,897
ALUMINUM	$12,286
LEAD	$677
NICKEL	$1,986
ZINC	$2,696
COPPER	$11,864
GOLD	$13,221
SILVER	$3,745
TOTAL	$179,590

Source: Bloomberg

[x] There is no publicly available data that shows the total amount of inflows into commodity indexation trading strategies but some approximations can be made. The total amount benchmarked to the S&P-GSCI and DJ-AIG can be estimated and the annual performance of the indices is known. Therefore the amount that the prior year's investment has grown or shrunk can be computed. Then the difference in the yearly change has to come from net inflows. When during the year the inflows occurred is not known, so the assumption is made that all net inflows occurred evenly throughout the year. Changing assumptions on net inflow timing only affects the rate of growth for that year's inflow which never amounts to more than a few billion dollars difference.

ESTIMATED ANNUAL INFLOWS

	S&P-GSCI	DJ-AIG	TOTAL
2004	$16.20	$8.90	$25.10
2005	$4.80	$12.40	$17.20
2006	$28.30	$11.30	$39.60
2007	$14.70	$15.40	$30.10
2008	$35.10	$20.00	$55.10
TOTAL	$99.10	$68.00	$167.10

2008 figures reflect estimated inflows through March 12, 2008, figures will be updated through July 1, 2008 with final report.

xi

	2003 LONG OPEN INTEREST		
	PHYSICAL HEDGER	TRADITIONAL SPECULATOR	INDEX SPECULATOR
COCOA	71,300	5,673	2,710
COFFEE	38,378	12,197	5,671
CORN	227,612	54,123	51,139
COTTON	52,529	23,633	9,518
SOYBEAN OIL	76,717	33,449	3,272
SOYBEANS	98,696	58,567	13,733
SUGAR	95,610	31,143	45,931
WHEAT	24,846	25,698	33,960
WHEAT KC	32,759	4,955	10,526
FEEDER CATTLE	3,864	5,238	2,641
LEAN HOGS	5,316	7,377	15,517

LIVE CATTLE	19,820	40,864	20,021
WTI CRUDE OIL	433,028	56,629	108,599
HEATING OIL	69,363	14,063	26,217
GASOLINE	44,252	20,698	25,555
NATURAL GAS	397,488	21,734	29,774
TOTAL	1,691,579	416,042	404,785
	2008 LONG OPEN INTEREST		
	PHYSICAL HEDGER	TRADITIONAL SPECULATO R	INDEX SPECULATO R
COCOA	50,243	72,866	29,527
COFFEE	41,159	56,866	63,133
CORN	505,627	300,017	441,197
COTTON	91,820	77,132	114,804
SOYBEAN OIL	104,064	48,619	72,287
SOYBEANS	141,375	132,849	194,391
SUGAR	359,427	180,670	411,510
WHEAT	58,484	66,958	218,191
WHEAT KC	35,629	31,201	30,299
FEEDER CATTLE	5,117	16,208	9,279
LEAN HOGS	29,366	33,374	105,228
LIVE CATTLE	27,898	51,798	135,451
WTI CRUDE OIL	1,161,063	203,280	606,176
HEATING OIL	65,851	27,972	83,008
GASOLINE	83,826	41,534	78,692
NATURAL GAS	480,964	77,462	214,641
TOTAL	3,241,915	1,418,805	2,807,813
	PURCHASES LAST 5 YEARS		
	PHYSICAL HEDGER	TRADITIONAL SPECULATO R	INDEX SPECULATO R
COCOA	-21,056	67,193	26,817
COFFEE	2,781	44,669	57,463
CORN	278,016	245,894	390,057
COTTON	39,291	53,499	105,286
SOYBEAN OIL	27,348	15,169	69,015
SOYBEANS	42,679	74,282	180,658
SUGAR	263,817	149,527	365,579
WHEAT	33,639	41,260	184,231
WHEAT KC	2,870	26,246	19,773
FEEDER CATTLE	1,253	10,969	6,637
LEAN HOGS	24,049	25,997	89,711
LIVE CATTLE	8,078	10,934	115,429
WTI CRUDE OIL	728,035	146,651	497,577
HEATING OIL	-3,512	13,909	56,791
GASOLINE	39,574	20,836	53,137
NATURAL GAS	83,476	55,728	184,867
TOTAL	1,550,337	1,002,764	2,403,029

Figures derived from data from Goldman Sachs, Dow Jones, Bloomberg, CFTC Commitments of Traders report and the CFTC CIT Supplement. Non-Directional Spreads and Non-Report (Unclassified) Positions are not shown. Traditional Speculators accessing the futures market through the "swaps loophole" are still classified as Physical Hedgers because the CFTC does not distinguish. 2008 figures are as of March 12, 2008 and will be updated to reflect July 1, 2008 in the final report.

Commodities Futures Markets
Percentage Of Open Interest
2008 LONG / DEMAND SIDE

	Physical Hedger	Traditional Speculator	Index Speculator
COCOA	33%	48%	19%
COFFEE	26%	35%	39%
CORN	41%	24%	35%
COTTON	32%	27%	41%
SOYBEAN OIL	46%	22%	32%
SOYBEANS	30%	28%	42%
SUGAR	38%	19%	43%
WHEAT	17%	20%	64%
WHEAT KC	37%	32%	31%
FEED CATTLE	17%	53%	30%
LEAN HOGS	18%	20%	63%
LIVE CATTLE	13%	24%	63%
WTI CRUDE OIL	59%	10%	31%
HEATING OIL	37%	16%	47%
GASOLINE	41%	20%	39%
NATURAL GAS	62%	10%	28%
AVERAGE	34%	26%	40%

Source: CFTC Commitments of Traders reports, and estimates derived from CFTC CIT Supplement, does not include Spreads. Data represents an average from January 1, 2008 through March 12, 2008, data in final report will reflect through July 1, 2008

[xiii] "The Global Commodities Boom," Greenwich Associates, Andrew Awad, Woody Canaday, et al., May 2008, page 1. "Commodities: Who's Behind the Boom?," Gene Epstein, Barron's, March 31, 2008. First report identifies the four largest swaps traders and second article references some ISDA data saying four largest swaps traders are 70% of swaps market. Barron's also says and CFTC CIT supplement corroborates that 85%-90% of all index trades are done through swaps.

[xiv] According to calculations Index Speculators average 40% of the long open interest (excluding spreads) in U.S. based commodities (see footnote xii), 85%-90% is done through swaps and 70% of swaps are done with the 4 largest traders. So .7*.875*.4=.245 or 24.5%. I cannot know for sure if this estimate is accurate since I do not have access to this information.

[xv] http://energycommerce.house.gov/Investigations/EnergySpec.shtml

Adam K. White, CFA - Mr. White is currently the Director of Research at White Knight Research and Trading an Independent Research Consulting Firm based in Alpharetta, GA. Prior to his current position Mr. White was a successful research analyst with Masters Capital Management. In his 6 year tenure with Masters Capital he had primary coverage for financial services stocks and was also head of derivatives strategy. Before that he worked for 3 years at The Coca-Cola Company in their treasury department where he was responsible for managing their billion dollar emerging market currency portfolio. He was also head of the "portfolio project" at Coke treasury and built many of the options pricing systems they use today. Coming out of graduate school, Mr. White worked for Swiss Bank Corporation (what was formerly the O'Connor Partnership and later became UBS). He was a Risk Management Advisor responsible for marketing, pricing and hedging interest rate swaps and options. Mr. White holds a B.S. in Accounting from the Fisher School of Accounting at the University of Florida as well as an M.B.A. in Finance and Economics from the Graduate School of Business at the University of Chicago. Mr. White also holds the Chartered Financial Analyst designation. He is married and has one son.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.

Name: ADAM WHITE

Address: 3070 WINDWARD PLAZA, STE F-117; ALPHARETTA GA 30004

Telephone: (404) 557-5859

Organization you represent (if any): N/A

1. **Please list any federal grants or contracts (including subgrants and subcontracts) <u>you</u> have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do <u>NOT</u> require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source: NONE **Amount:** —

Source: NONE **Amount:** —

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) <u>the organization</u> has received since October 1, 2004, as well as the source and the amount of each grant or contract:**

Source: NONE **Amount:** —

Source: NONE **Amount:** —

Please check here if this form is NOT applicable to you: X

Signature:

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.

Committee on Agriculture
U.S. House of Representatives
Information Required From Non-governmental Witnesses

House rules require non-governmental witnesses to provide their resume or biographical sketch prior to testifying. If you do not have a resume or biographical sketch available, please complete this form.

1. **Name:** ADAM K. WHITE

2. **Business Address:** 3070 WINDWARD PLAZA, STE F117
   ALPHARETTA, GA 30004
   (WHITE KNIGHT RESEARCH & TRADING)

3. **Business Phone Number:** (404) 557-5859

4. **Organization you represent:** N/A

5. **Please list any occupational, employment, or work-related experience you have which add to your qualification to provide testimony before the Committee:**

   SWISS BANK CORP. INTEREST RATE SWAPS + DERIVATIVES
   COCA COLA CO. CURRENCY + COMMODITY DERIVATIVES
   MASTERS CAPITAL MGMT EQUITY OPTIONS

6. **Please list any special training, education, or professional experience you have which add to your qualifications to provide testimony before the Committee:**

   B.S. U. OF FLORIDA ACCOUNTING
   M.B.A. U OF CHICAGO FINANCE + ECONOMICS
   CHARTERED FINANCIAL ANALYST DESIGNATION

7. **If you are appearing on behalf of an organization, please list the capacity in which you are representing that organization, including any offices or elected positions you hold:**

   N/A

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