



## **Commodity Futures Trading Commission**

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# **Testimony**

## **Written Testimony of Jeffrey Harris, Chief Economist and John Fenton, Director of Market Surveillance Before the Subcommittee on General Farm Commodities and Risk Management, Committee on Agriculture**

**United States House of Representatives**

**May 15, 2008**

Thank you, Mr. Chairman and members of the Committee. I am Jeffrey Harris, Chief Economist of the Commodity Futures Trading Commission (CFTC or Commission), testifying along with my colleague John Fenton, Director of Market Surveillance. We appreciate the opportunity to discuss the CFTC's role with respect to the agriculture commodities markets and our view of current trends in the markets as the government regulator charged with overseeing them.

### **CFTC Mission**

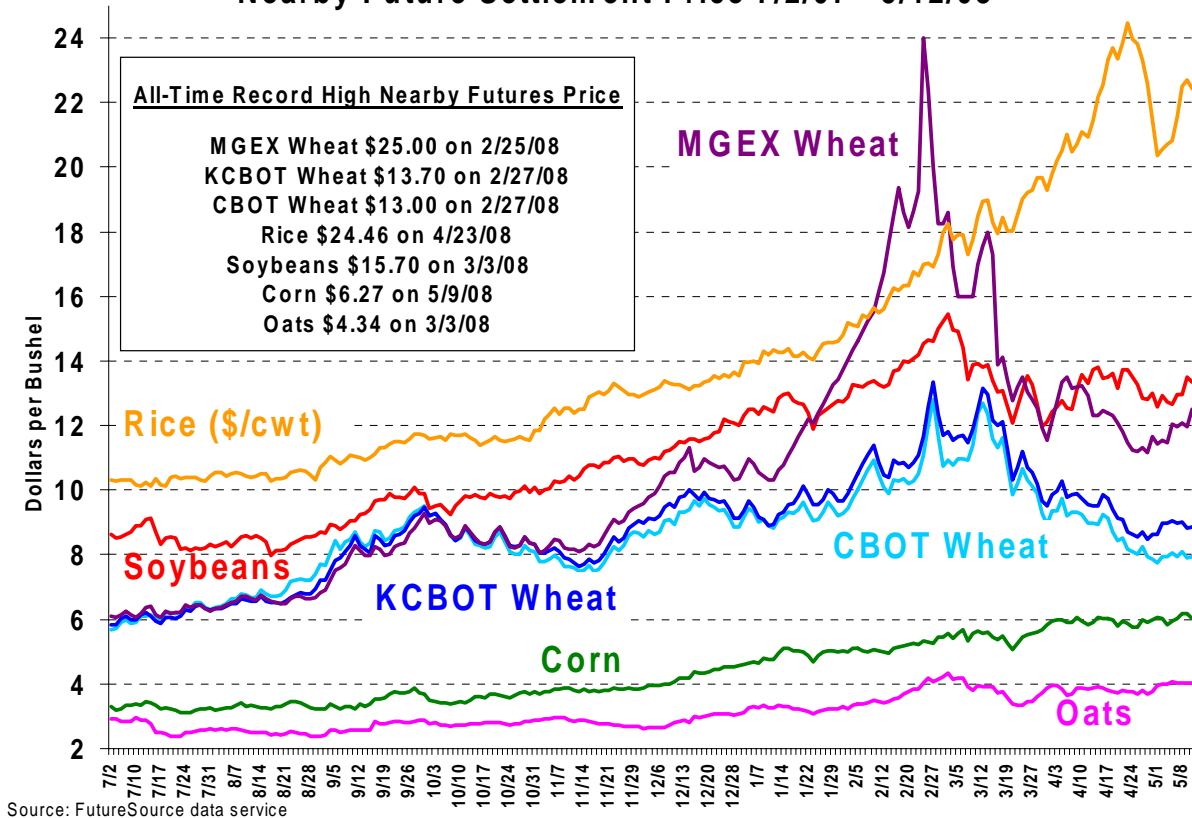
Congress created the CFTC in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States. Broadly stated, the CFTC's mission is two-fold: to protect the public and market users from manipulation, fraud, and abusive practices; and to ensure open, competitive and financially sound markets for commodity futures and options.

These markets play a critical role in the U.S. economy by providing risk management tools that producers, distributors, and commercial users of commodities use to protect themselves from unpredictable price changes. The futures markets are also designed to discover prices that accurately reflect information on supply, demand, and other factors.

### **Overview of Current Trends in the Futures Markets**

These are extraordinary times for our markets: many commodity futures prices have hit unprecedented levels. In the last three months, the agricultural staples of wheat, corn, soybeans, rice and oats have hit all-time highs – as you can see in Chart 1.

## Major U.S. Grain/Soy Futures Prices Nearby Future Settlement Price 7/2/07 - 5/12/08



**Chart 1: Major U.S. Grain and Soy Futures Prices**

We are also witnessing record prices in crude oil, gasoline and other related energy products. Both macro- and micro-economic factors are at work in these prices. Broadly speaking, the weak dollar, strong demand from the emerging world economies, geopolitical tensions in oil-producing regions, supply disruptions, unfavorable weather, and increased production of ethanol have contributed to driving up many commodity futures prices.

Adding to these trends, the emergence of the sub-prime crisis last summer and weak returns in equity and debt markets have led investors increasingly to seek portfolio exposure in commodities as an asset class. As the federal regulator of the futures markets, the CFTC is working to ensure that they are working properly for producers, dealers, processors, consumers and investors. To date, CFTC staff economic analysis indicates that broad-based manipulative forces are not driving the recent higher futures prices in commodities across-the-board. That said, we continue to gather information from the entire marketplace and welcome outside analysis and perspectives so that we can ensure that our view of these markets is complete and accurate. We are continually doing new analysis of our detailed market data, applying new research methods, and building bridges with outside researchers and government experts all to increase our understanding of the futures markets. And separately, our Division of Enforcement investigates any specific instances of potentially manipulative conduct on a case-by-case basis.

In line with these efforts, the agency convened an agriculture forum three weeks ago in which we brought together a diverse group of market participants for a full airing of views and opinions on the driving forces in these markets. For those unable to attend, the agency allowed a two week period after the forum for public comment, which closed last Wednesday. Currently, the Commissioners and staff are reviewing the comments we received, and the Commission plans to announce several initiatives in the near future. We are working closely with market participants to address concerns aired around this forum to ensure the markets are functioning properly.

The CFTC also recently announced the creation of an Energy Markets Advisory Committee and named the public members of the Committee two weeks ago. Our first meeting of that group is scheduled for June 10<sup>th</sup> to look at issues related to the energy markets and the CFTC's role in these markets under the Commodity Exchange Act (CEA). These public forums will enhance our ability to make informed decisions as we strive to improve our oversight of these important markets.

### **Using Data to Oversee the Markets and to Enforce the CEA**

The CFTC receives a tremendous amount of data every day about market fundamentals, futures trading activity, and, most importantly, confidential data about traders participating in the markets. The agency's Large-Trader Reporting System is the cornerstone of our surveillance system. Under that system, clearing members, futures commission merchants (FCMs), foreign brokers, and individual traders file confidential reports with the CFTC each day, reporting positions and identifying each large trader in each designated contract market (DCM). For example, in the NYMEX WTI crude oil futures contract a trader with a position exceeding 350 contracts in any single expiration is "reportable." Large-trader positions reported to the CFTC consistently represent more than 90% of total open interest in the NYMEX WTI contract, with the remaining traders carrying smaller positions.

When a reportable trader is identified to the CFTC, the trader is classified either as a "commercial" or "non-commercial" trader. A trader's reported futures position is determined to be commercial if the trader uses futures contracts for the purposes of hedging as defined by CFTC regulations. Specifically, a reportable trader gets classified as commercial by filing a statement with the CFTC (using the CFTC Form 40) that it is commercially "...engaged in business activities hedged by the use of the futures and option markets." However, to ensure that traders are classified consistently and with utmost accuracy, CFTC market surveillance staff reviews the forms and re-classifies the trader if it has further information about the trader's involvement with the markets.

In addition to the breakdown between commercial and non-commercial traders, the large-trader data can be filtered by type of trading activity. For example, on the commercial side, the CFTC can sort the data by more than 20 types of trading entities, ranging from agricultural merchants and livestock feeders to mortgage originators. Traders that are non-commercial include hedge funds, commodity trading advisors, commodity pool operators (managed money traders), and floor brokers and traders.

Using data from the Large Trader Reporting System, the CFTC publishes a weekly breakdown of reportable positions of each Tuesday's open interest. This well-known

public report is called the Commitments of Traders (COT) report. COT reports are published each Friday afternoon for markets in which 20 or more traders hold positions above CFTC-established reporting levels. For reportable positions, the report shows commercial and non-commercial holdings, changes from the previous report, percentage of open interest by category, the concentration of positions held by the largest four and eight traders, and the numbers of traders in each category.

To complement the extensive surveillance program, the CFTC's strong enforcement program has been working hard to punish wrongdoers and to keep manipulators out of the markets. During the last five years, Enforcement has maintained a record level of investigations and prosecutions in nearly all market areas, including attempted manipulation, manipulation, squeezes and corners, false reporting, hedge fund fraud, off-exchange foreign currency fraud, brokerage compliance and supervisory violations, wash trading, trade practice misconduct, and registration issues. Enforcement also routinely assists in related criminal prosecutions by domestic and international law enforcement bodies. Through those efforts, during the past five years (April 2003 – March 2008), the CFTC has assessed more than \$2 billion dollars in monetary sanctions, which include civil monetary penalties and orders to pay restitution and disgorgement.

### **Speculation in the Commodities Markets**

The current market environment raises questions about the role that speculators play in affecting prices in the futures markets. The proper and efficient functioning of the futures markets requires both speculators and hedgers. Overly restrictive limitations on the number of speculative positions held by individuals or entities could impair liquidity. A less liquid market generally drives hedgers out by making hedging more costly and less effective. In the absence of reasonable hedging opportunities, commercial businesses may be forced to increase prices to compensate for unhedged risk. Diminished hedging activity can also impair price discovery in futures markets since commercial hedgers typically are a primary source for new market information. Diminishing the ability of futures markets to serve their hedging and price discovery functions would likely have negative consequences for commerce in commodities and ultimately, for the nation's economy.

Of course, excessive speculation can be detrimental to the markets. Under Section 4a of the CEA, the concept of "excessive speculation" is based on trading that results in "sudden or unreasonable fluctuations or unwarranted changes in the price" of commodities underlying futures transactions. The CEA does not make excessive speculation a *per se* violation of the Act, but rather, requires the Commission to enact regulations to address such trading (for example, through speculative position limits).

The Commission has utilized its authority to set limits on the amount of speculative trading that may occur or speculative positions that may be held in contracts for future delivery in agricultural markets. The speculative position limit is the maximum position, either net long or net short, in one commodity future (or option), or in all futures (or options) of one commodity combined, that may be held or controlled by one person (other than a person eligible for a hedge exemption) as prescribed by a DCM and/or by the Commission.

All agricultural and natural resource futures and options contracts are subject to either Commission or exchange spot-month speculative position limits. With respect to trading outside the spot month, the Commission typically does not require speculative position limits. Under the Commission's guidance, a DCM (which is a regulated futures exchange) may replace position limits with position accountability for contracts on financial instruments, intangible commodities, or certain tangible commodities. If a market has accountability rules, a trader – whether speculating or hedging – is not subject to a specific limit. Once a trader reaches a preset accountability level, however, the trader must provide information about the position upon request by the exchange. In addition, position accountability rules provide an exchange with authority to restrict a trader from increasing his or her position.

Finally, to achieve the purposes of the speculative position limits, the Commission and the exchanges will combine multiple positions in a contract when they are commonly owned or controlled by a single trader. These provisions apply to accounts having a 10 percent or greater financial interest by a single entity.

Violators of speculative limits are subject to disciplinary action. The Commission, or an exchange, may institute these actions depending on the circumstances.

### **Impact of Institutional Investors**

Clearly, the commodity futures markets are experiencing robust growth across commodities, particularly with the recent influx of institutional investors. There is no question that investors and consumers are diversifying their portfolios and seeking exposure to the commodity markets. At the CFTC's recent agricultural forum, managers of pension fund money testified about their increased participation in commodity markets, explaining that commodity exposure substantially reduces portfolio risk when combined with equity and/or debt investments. At the forum, Doug Hepworth of Gresham Investment Management LLC described the benefit as follows: Starting with a portfolio consisting of 40% debt and 60% equities, a five percent commodity exposure was added. The performance of that portfolio was tracked for 196 rolling five-year periods beginning in 1987. On average, portfolio volatility was reduced by 10% by diversifying into commodities.

The arrival of these newer participants has, in some instances, coincided with observed price increases. Perhaps naturally, some have concluded that a portion of the high prices in agricultural and energy futures markets is related to the impact of financial trading in futures markets. Because these allegations come, in many cases, from experienced participants we do take them seriously and are examining this issue very carefully.

There are two basic types of trading activity that tend to be referred to as "funds." Each is identified to some degree of accuracy in our Large Trader Reporting System. The first represents traditional speculative monies that enter the futures markets through various forms of managed money (hedge funds, commodity pools, etc.). Managed money funds can be either long or short in our markets, depending on their speculative beliefs about future prices. The second type—referred to as "index funds or commodity index traders"—has become important in recent years. These funds seek commodities exposure as another asset class (like stocks, bonds, real estate, etc.). Aggregated,

index fund positions are relatively large, predominantly long, and passively positioned—that is, they simply buy exposure to commodities in futures markets and maintain their exposure through pre-specified rolling strategies (before the futures enter delivery months). It is the equivalent to the “buy and hold” strategy common in the stock markets. It is important to understand that dollars placed with index funds are not leveraged. An investor wanting a \$10,000 exposure places that amount with the fund which is invested in futures contracts so as to replicate the dollar return of \$10,000 invested in the indexed commodities. In response to the growing activity by commodity index traders, the Commission has increased transparency in twelve agricultural markets by publishing weekly data on positions held by index traders since January 2007.

Some in the industry believe the combined positions of “funds” are too large, and therefore must be causing or abetting high and/or volatile prices. COT data used by Commission staff show that price changes are largely unrelated to fund trading. In fact, record agriculture prices have occurred in commodities for which there is no futures contract (durum wheat and hay, for example) and in markets with little or no index trading. Specifically, Minneapolis wheat futures (not part of any index fund) have risen higher than and have been more volatile than Chicago or Kansas City wheat futures and Chicago rice (with relatively modest levels of index trading) has recently set new, all-time high prices.

Utilizing the detailed trader categories in the Large Trader Reporting System, the Office of the Chief Economist (OCE) has been examining daily position changes and price changes to determine whether a cause-effect link can be established between high prices and the trading of various categories of traders—including these funds independently and concurrently. This more general evidence shows that fund positions have not changed in ways that are consistent with causing recent agriculture price increases. CFTC staff has tracked daily price changes and daily position changes in these markets, finding that managed money funds are largely trend followers, buying on the day after price increases, for instance. Increased index fund positions do not lead to price increases either. For example, in the wheat market the data shows that funds were not adding to their positions during the run up in cash and futures prices. In fact, managed money funds were actually decreasing net long futures positions during the recent run up in wheat prices. The absence of a link between fund positions and price changes suggests that global market fundamentals, including restrictions on exports by several major exporters, provide a better explanation for recent price increases. Even with these facts, it is clear that more analysis and research about index trading needs to occur in order to inform this debate and CFTC staff will be studying ways to improve the transparency and efficiency of the markets regarding these types of traders.

In the agriculture commodities, wide basis relationships (cash-futures differentials), where they exist, are largely explained by historically high diesel prices. Since virtually all major modes of grain transportation (truck, rail, and barge) rely on diesel fuel, historically strong bids for grain at the major export facilities get proportionally lower as the grain is located further from those points and incurs higher transportation costs. For example, export terminal cash prices at New Orleans are very strong, but prices up-river along the Mississippi and Illinois are often much weaker due to the cost of barge freight, which is more than twice as high as it was last year and much larger than we have ever

seen at this time of year. Nevertheless, instances of lack of convergence have raised questions about contract design, which the CFTC and the exchanges are closely examining.

CFTC staff has also actively engaged with industry participants to learn more about their concerns regarding trading in our markets. Although staff has confirmed industry complaints that merchants and elevator owners have restricted the amount of fixed-price forward contracting from farmers, we have not seen diminished aggregate short hedging in forward futures months. Analysis of large-trader data currently shows a greater amount of short hedging in wheat, beans, and to a lesser extent, corn, compared to this time last year, by the relevant commercial merchant categories. The CFTC continues to analyze this data and its implications – in hopes of finding ways to encourage more forward contracting by market participants.

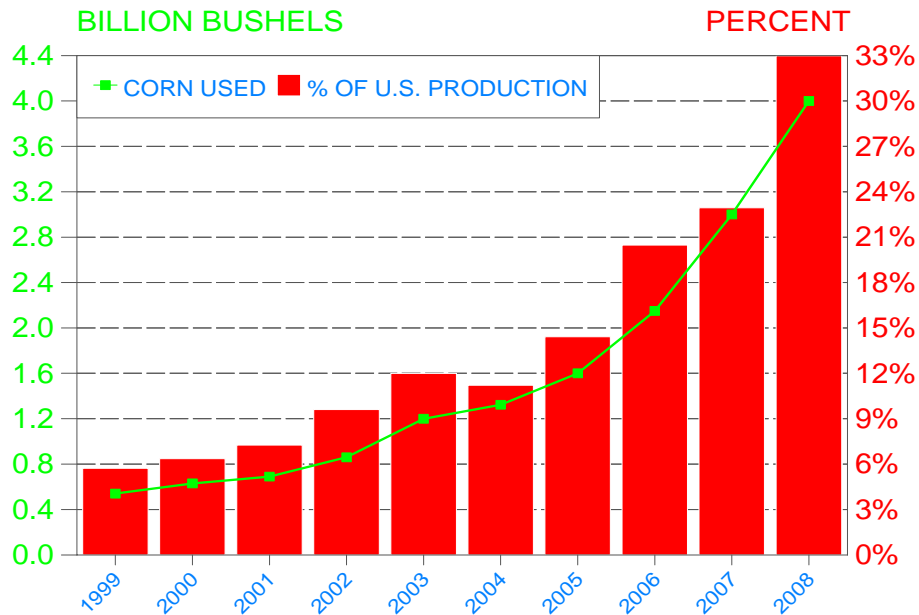
## **Agriculture Commodities Overview**

During the recent increase in agriculture futures prices, Commission staff has been talking with virtually every segment of the agricultural industry—producers, cooperatives, grain elevator owners, merchandisers, exporters, millers, trade associations, and the futures exchanges. Using the Large Trader Reporting data, we are tracking trends in the market and analyzing participation in the markets in an effort to understand what is driving these unprecedented prices.

### **Corn and Soybeans**

Generally, planting intentions are an important factor in agricultural markets, and have become even more important because of shifts of acreage caused by growth in demand for corn for ethanol production. About 4 billion bushels of corn will be used to produce ethanol in 2008 (about one-third of the 2007/2008 crop), as seen in Chart 2.

## U.S. CORN USED FOR ETHANOL



**Chart 2: U.S. Corn Used for Ethanol**

As land has shifted from other crops to corn production to meet this demand, it has had a ripple effect on prices of competing crops. Both corn and soybean prices have been unusually strong—indeed at record levels—despite bountiful harvests of both in 2007. From the most corn acreage planted since 1944, the last corn harvest was a record, exceeding 13 billion bushels. Despite the fact that corn plantings displaced nearly 12 million acres of soybeans, the soybean crop was plentiful (with strong yields from both North and South America). Coupled with a very large carryover from the 2006/2007 crop, we started the 2007/2008 crop year for soybeans with large supplies. Nevertheless, corn and soybean prices have risen since the 2007 harvest to record levels, generally reflecting strong global demand, geopolitical decisions to restrict food exports, weather concerns and projected tight supplies later this year. For example, the ending stocks for soybeans this year are projected to be one of the lowest in the past three decades.

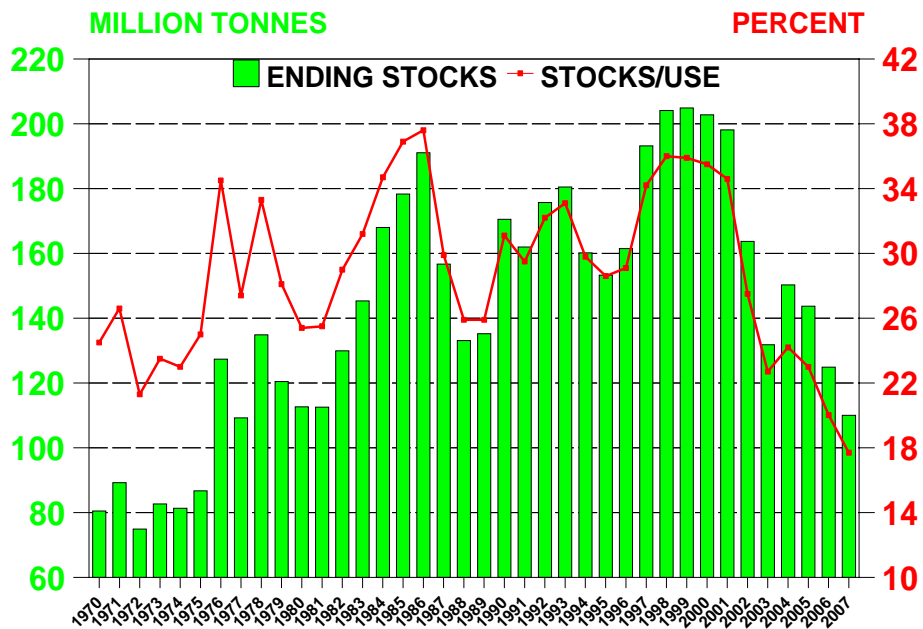
### Wheat

The supply/demand fundamentals for wheat have been very strong. There were poor wheat crops in major growing areas of the world last year, capped off by the second year of drought reduced harvests in Australia (13 million metric tons (MMT) versus a normal 20 MMT). In the U.S., the soft red winter and spring wheat production were of reasonable size historically, but the hard red winter crop was damaged by late frosts, which resulted in poor protein content and lower quality in other categories. The USDA is projecting the lowest carryover of wheat stocks in 30 years and the lowest world



wheat stocks-to-use ratio in recorded history. Chart 3 illustrates that tight world wheat supply situation that has caused high global wheat prices.

### WORLD ALL WHEAT ENDING STOCKS AND STOCKS-TO-USE RATIO 1970/71 THROUGH 2007/08



2007 WORLD ENDING STOCKS ARE THE LOWEST SINCE 1977 AT 110 MMT (4.04 BILLION BUSHEL)  
WORLD STOCKS TO USE IS THE LOWEST ON RECORD AT 17.7%

**Chart 3: Historical Wheat Stocks and Use**

With world stocks of wheat historically low, the market is especially vulnerable to shocks regarding planting intentions for the coming year. Wheat prices in late 2007 were somewhat inflated following the poor October 2007 harvest in Australia and the market expected much larger fall plantings of U.S. winter wheat to follow. However, when the monthly USDA Supply and Demand Report (released on January 11, 2008) revealed that fall plantings were lower than expected, both U.S. and global wheat market prices rose sharply. The response spilled over into the corn and soybean markets as well, since increased wheat prices signaled that additional wheat plantings would likely shift acreage away from corn and soybeans to spring wheat.

Wheat is an essential food staple, and its demand is relatively price inelastic – meaning price changes have little impact on demand. Indeed as we saw this winter, U.S. millers and foreign buyers bid up prices for low physical supplies of wheat, particularly high protein varieties, to extraordinarily high levels. Hard red spring wheat cash prices rose to over \$20/bushel, at one point leaving the limit-locked Minneapolis Grain Exchange (MGEX) futures contract far behind. Durum wheat cash prices rose even more sharply to over \$25/bushel, both in the U.S. and Canada. These examples are notable because MGEX wheat futures have no index trading and durum wheat has no futures contract, leaving supply/demand fundamentals as the likely cause of such run-ups in prices.

Exports are another indicator of abnormally high demand. Despite high prices, U.S. exports to both wealthier countries like Japan and poorer countries like Egypt continue. Overall U.S. wheat exports are up 40 percent over last year, and include exports to North Africa and the Middle East, markets mostly served by Europe and Ukraine for the past few decades.

## **Cotton**

During 2007 and 2008, cotton prices have lagged behind prices for many other crops. Although acreage planted to cotton was down by 29 percent in 2007, record yields resulted in a relatively large crop of 19.2 million bales. Consumption (domestic use and exports) of U.S. cotton for this year will be around 18.8 million bales, so projected season ending stocks will increase by .4 million bales to 9.9 million bales, a relatively large level, equivalent to about 53 percent of annual consumption. Despite the relative abundance of cotton stocks, cotton futures prices also rose sharply beginning in mid-February. Some market commentary attributed the rise in cotton prices to expectations that there would be a further loss of about 12 percent of acreage planted to cotton in 2008, acreage lost to other crops with relatively higher prices. At the recent CFTC agriculture forum, some cotton market participants were less convinced that market fundamentals were the cause of those price moves. CFTC staff continues to closely study the data and circumstances surrounding this time period with these markets to ensure that prices were not artificially inflated.

## **Energy Products Overview**

Similar to the agriculture markets, the energy markets, particularly crude oil, have also experienced a marked increase in futures prices during the past couple of years. The Commission's oversight of oil futures trading focuses on two markets: primarily on the New York Mercantile Exchange (NYMEX) and secondarily on the Intercontinental Exchange Europe (ICE Futures Europe) – the latter because one of its contracts cash settles on the price of the NYMEX WTI Light Sweet Crude futures contract.

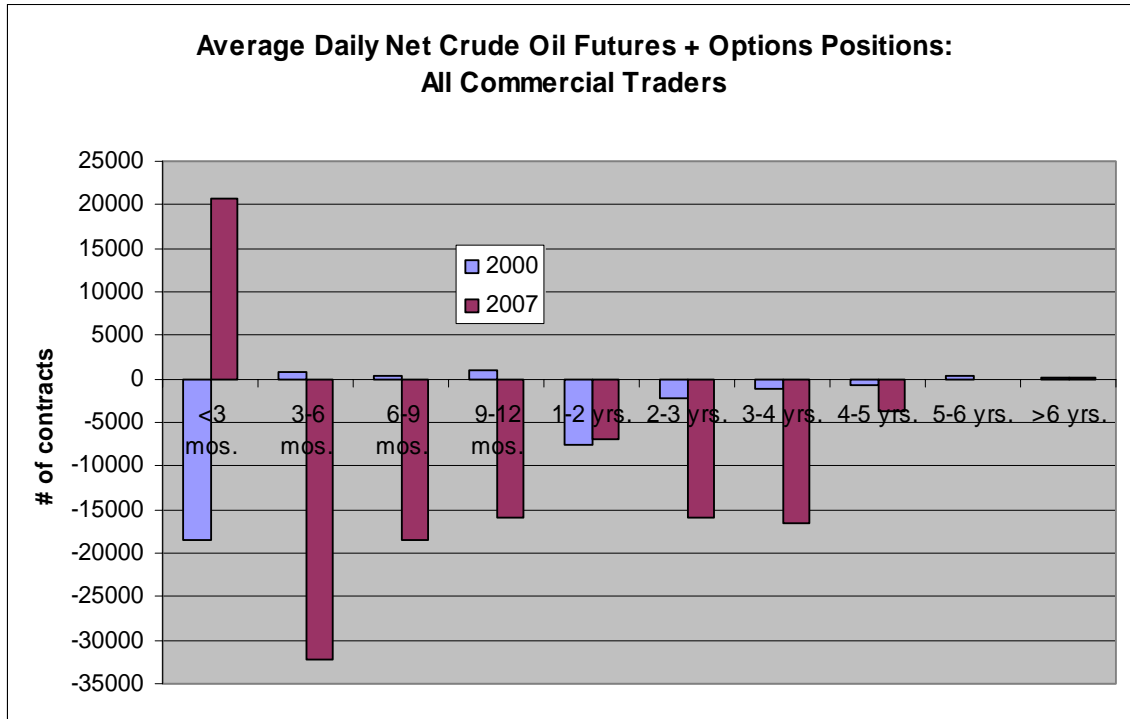
## **Crude Oil**

Crude oil prices have risen significantly during the past few years and are currently above \$120/barrel. Concurrently, open interest in WTI crude oil futures has expanded dramatically, growing from about 1 million futures equivalent contracts in 2004 to about 3 million contracts during the most recent week.

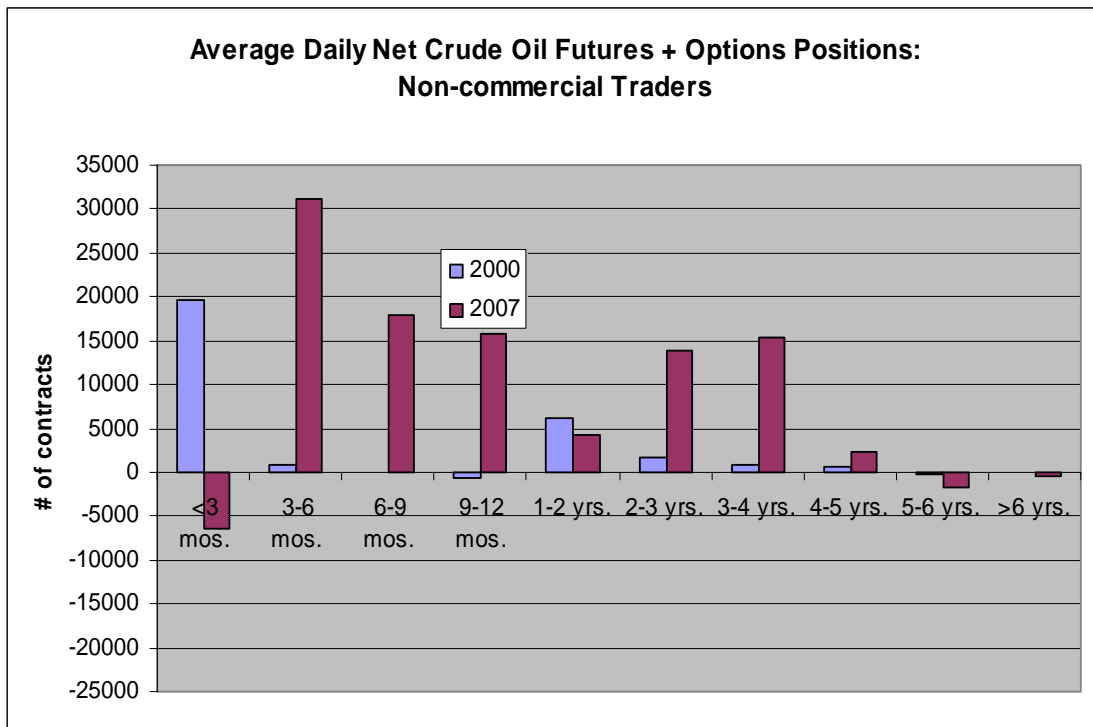
We have studied these markets to better understand the components of this rapid growth and our studies find three major trends in crude oil markets. First, we see large increases in the use of futures contracts by both commercial and non-commercial interests. Commercial participants include those producing, processing, consuming, etc., the underlying commodity or otherwise managing risks related to the underlying commodity. Swap dealers, who use futures to hedge the risk of swaps on their book, are also classified as commercial traders. Non-commercial participants are commonly considered speculators. Growth across these groups has been largely parallel, however, with non-commercial share of total open interest increasing only marginally from 34% to about 36% over the past three years. It is important to understand that the majority of non-commercial positions are in spreads; that is, taking a long position in

one contract month and a short position in another. This is important because any upward pressure on price due to those long positions is almost surely offset by downward pressure from the short side of those spreads.

Second, much of the growth in open interest is concentrated in futures contracts that expire after 12 months. Whereas contracts beyond one year were rare in 2000, we are now seeing significant open interest in contracts with expiries out to five years and beyond. In fact, contracts extending beyond eight years are now available at NYMEX. Charts 4 and 5 below highlight these two trends.



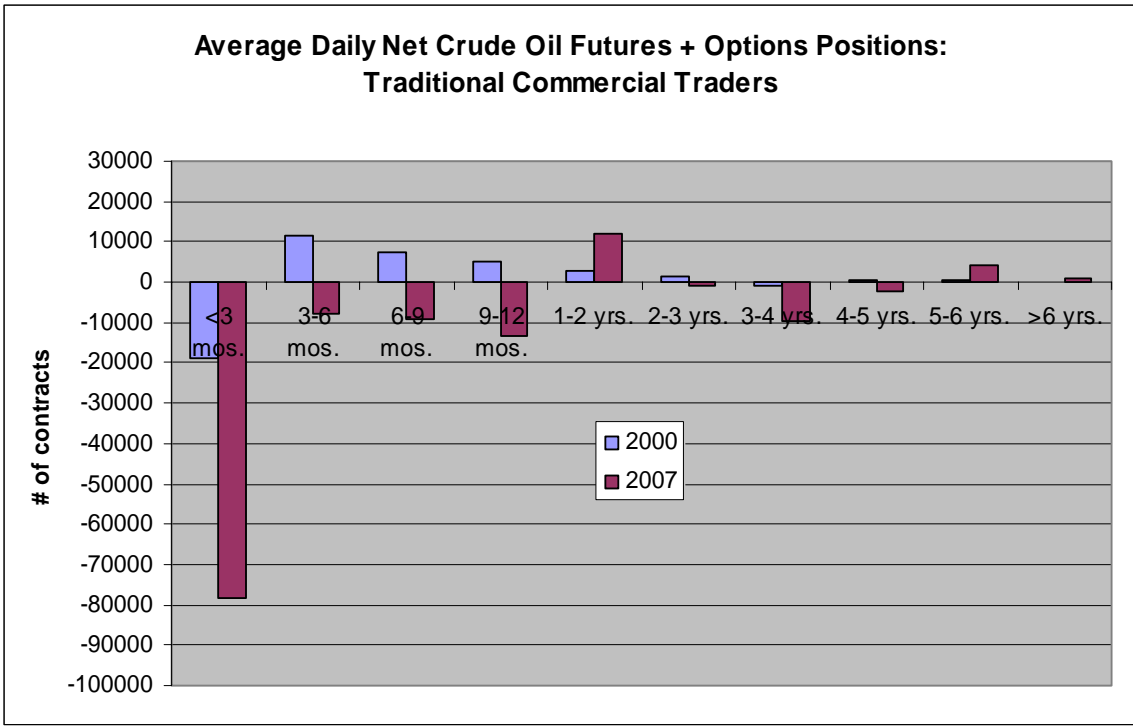
**Chart 4: Trends in Commercial Trader Open Interest**



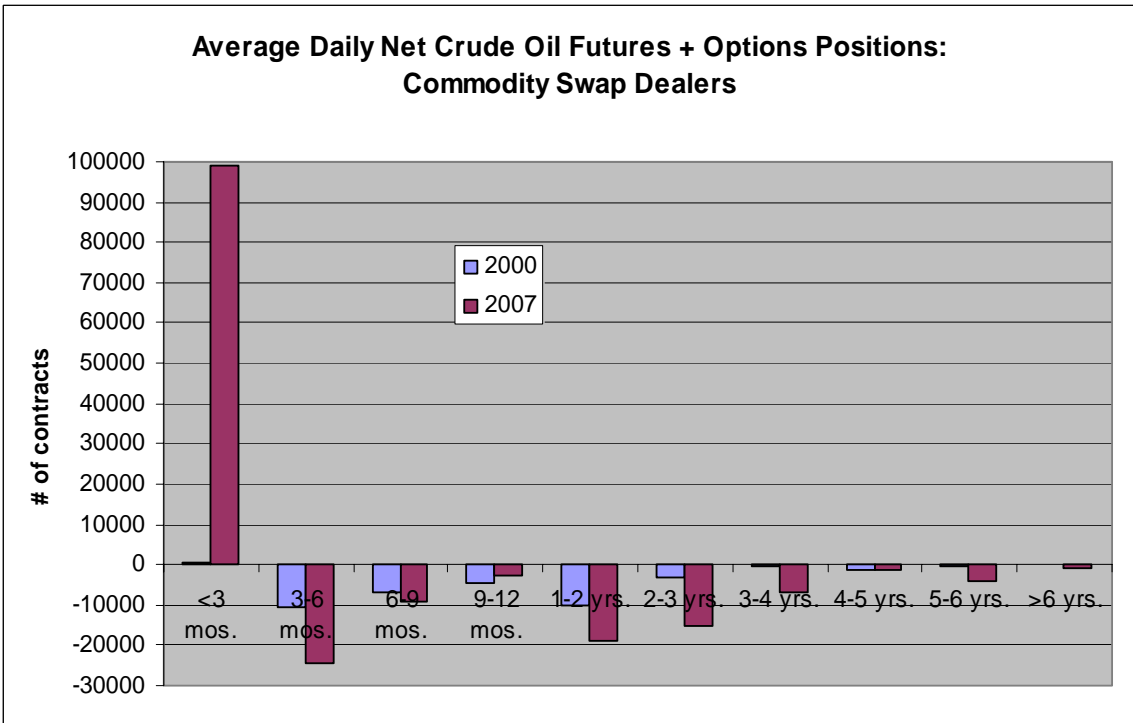
**Chart 5: Trends in Non-Commercial Trader Open Interest**

Charts 4 and 5 also highlight the fact that commercial traders generally take short positions to hedge and rely on non-commercial traders to take the opposite side of their trades. Thus much of the growth in non-commercial positions appears to be related to meeting the needs of commercial hedgers. Were fewer non-commercial traders willing to take positions opposite to commercial hedgers in distant contracts, hedging might not be feasible. The supply and demand for hedging services intimately ties hedgers and speculators together in futures markets.

The third major trend during the past few years in crude oil markets is that swap dealers now hold significantly larger positions in crude oil futures. These dealers, who sell over-the-counter swaps to their customers (such as pension funds buying commodity index funds or airlines seeking to hedge jet fuel costs), turn around and hedge their price exposures with long futures positions in crude oil and other commodities. This development has expanded the traditional role of commercial traders. Traditional commercial traders predominantly hedge long cash positions using short futures contracts. Conversely, swap dealers (also classified as commercial traders) frequently hedge short swap positions with long futures contracts. Charts 6 and 7 depict these differences.



**Chart 6: Trends in Traditional Commercial Trader Open Interest**

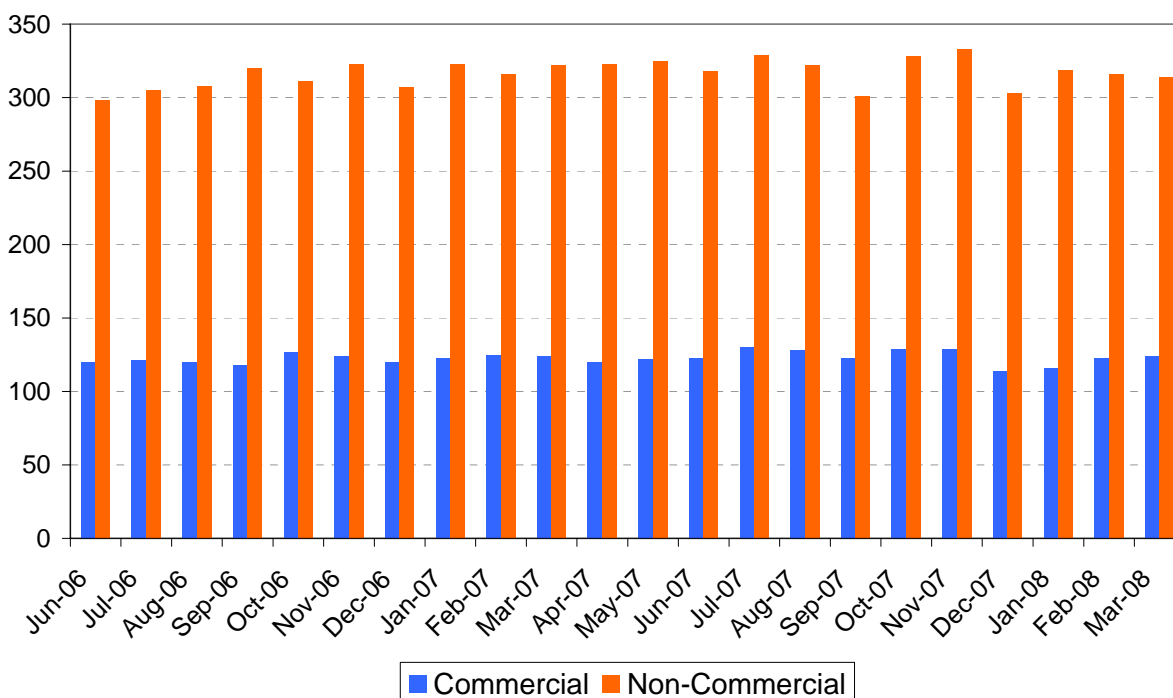


**Chart 7: Trends in Swap Dealer Open Interest**

Chart 7 also demonstrates that the growth in swap dealer trading in the near-term futures contract largely represents flows from commodity index trading.

Given the substantial increase in open interest in crude oil futures markets, OCE utilizes the Commission’s extensive data to examine the role of all market participants and how their positions might affect prices. Although longer-term studies show a slight increase in non-commercial market share in the crude oil futures market, OCE analysis shows that the more recent increase in oil prices to levels above \$120/barrel has not been accompanied by significant changes to the participants in this market. Chart 8 shows that the number of commercial and non-commercial traders has remained nearly constant over the past 22 months, with about 120 commercial and 310 non-commercial participants in the market.

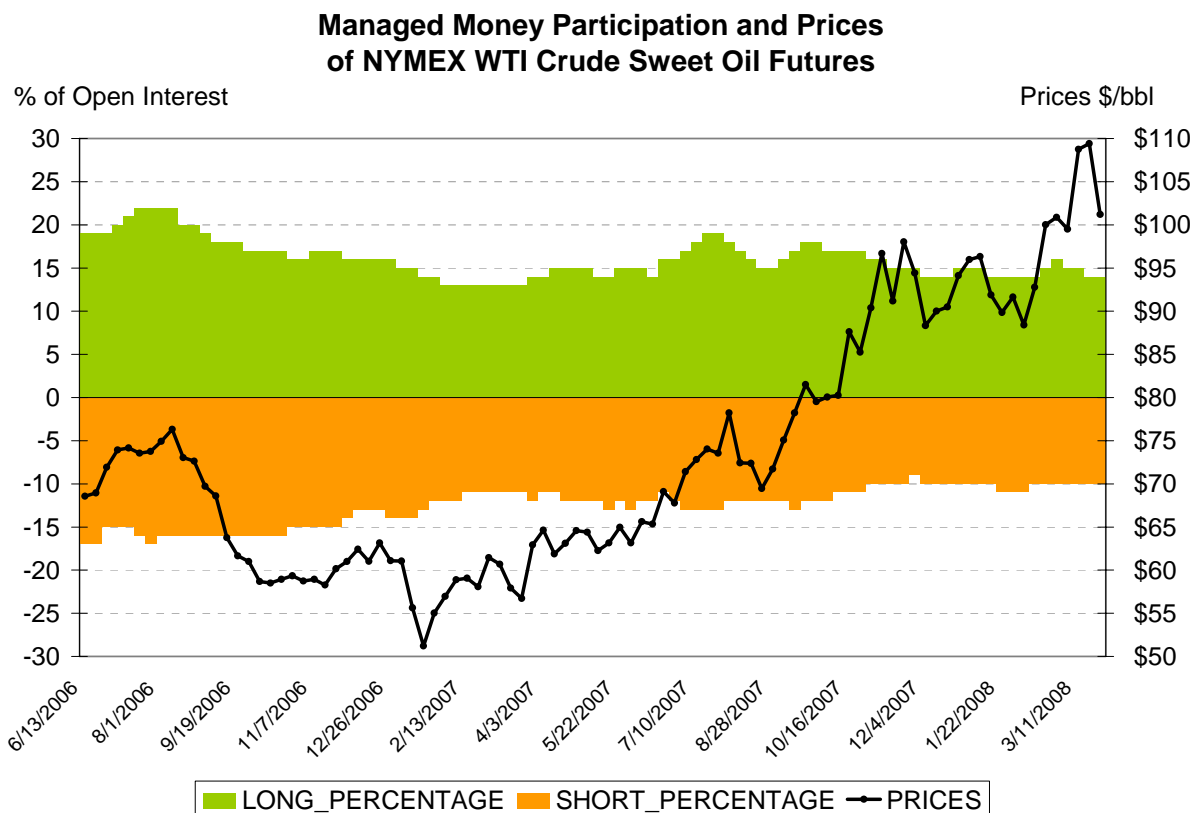
**Number of Market Participants in  
NYMEX WTI Crude Sweet Oil Futures Markets**



**Chart 8: Commercial vs. Non Commercial Participants**

OCE has also studied the impact of speculators as a group in oil markets during the most recent price run-up. Specifically, we have closely examined the relation between futures prices and positions of speculators in crude oil. Our studies consistently find that when new information comes to the market and prices respond, it is the commercial traders (such as oil companies, utilities, airlines) who react first by adjusting their futures positions. When these commercial traders adjust their futures positions, it is speculators who are most often on the other side of the trade. Price changes that prompt hedgers to alter their futures positions attract speculators who change their positions in response. Simply stated, there is no evidence that position changes by speculators precede price changes for crude oil futures contracts. Our tests cover various time frames and intervals from one to five days. When evidence does show that a group of trader positions precedes price changes in these tests, commercial trader group positions are those found to significantly precede crude oil futures price changes.

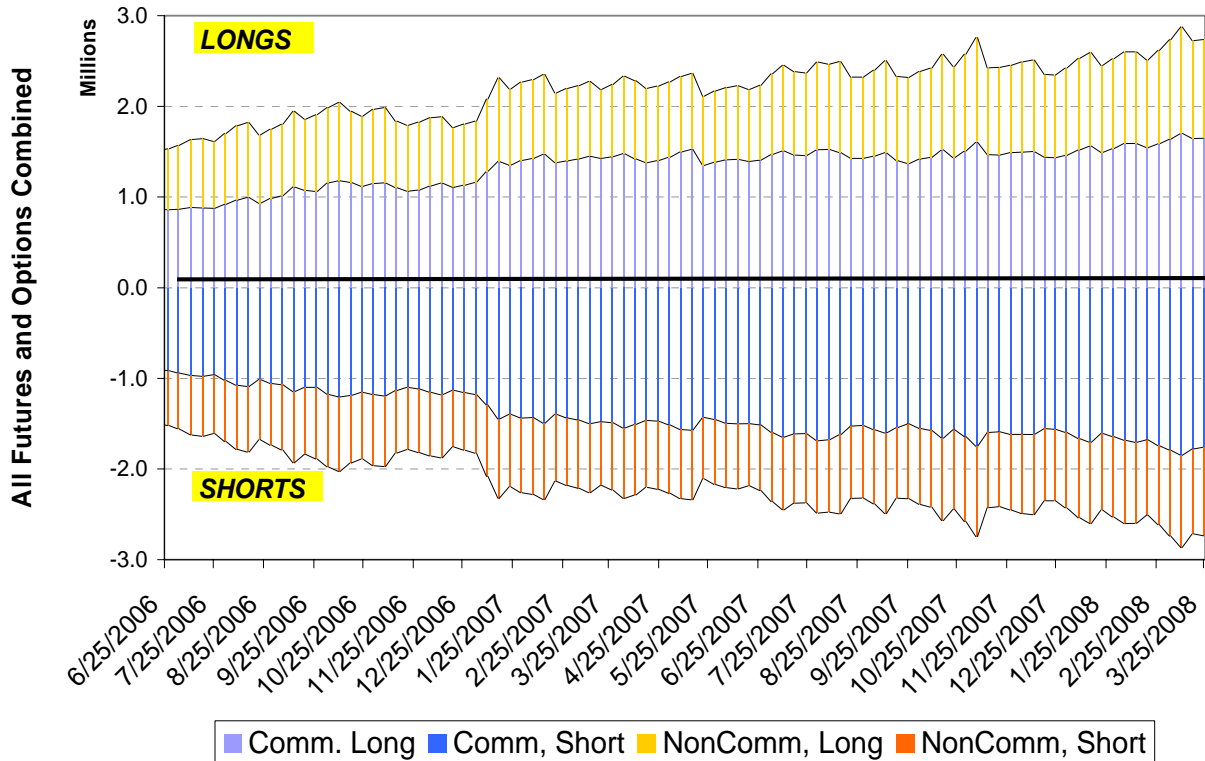
To highlight this fact more clearly, Chart 9 plots the prices and the market share of one group of active speculators (managed money traders) over the past 22 months. Notably, while WTI futures contract prices have more than doubled during the past 14 months, managed money positions, as a fraction of the overall market, have changed very little. Speculative position changes have not amplified crude oil futures price changes. More specifically, the recent crude oil price increases have occurred with no significant change in net speculative positions.



**Chart 9: Managed Money Participation**

OCE has also studied position changes of commercial and non-commercial traders by category, finding similar results. In no case do we find net position changes of any category of non-commercial traders preceding significantly changes in crude oil futures prices. Chart 10 highlights the fact that commercial and non-commercial open interest has grown during the most recent 22 months, but generally remains balanced between long and short positions for each trader group.

## Traders' Open Interest in NYMEX WTI Crude Sweet Oil Futures



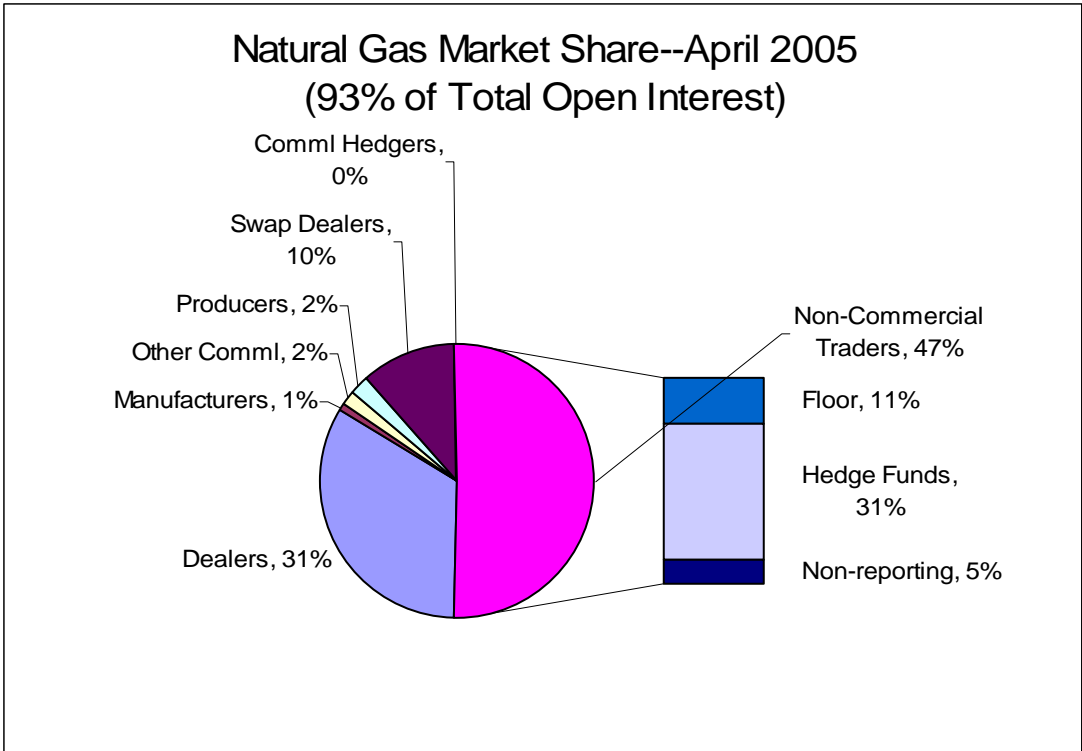
**Chart 10: Commercial vs. Non Commercial Open Interest**

### Natural Gas

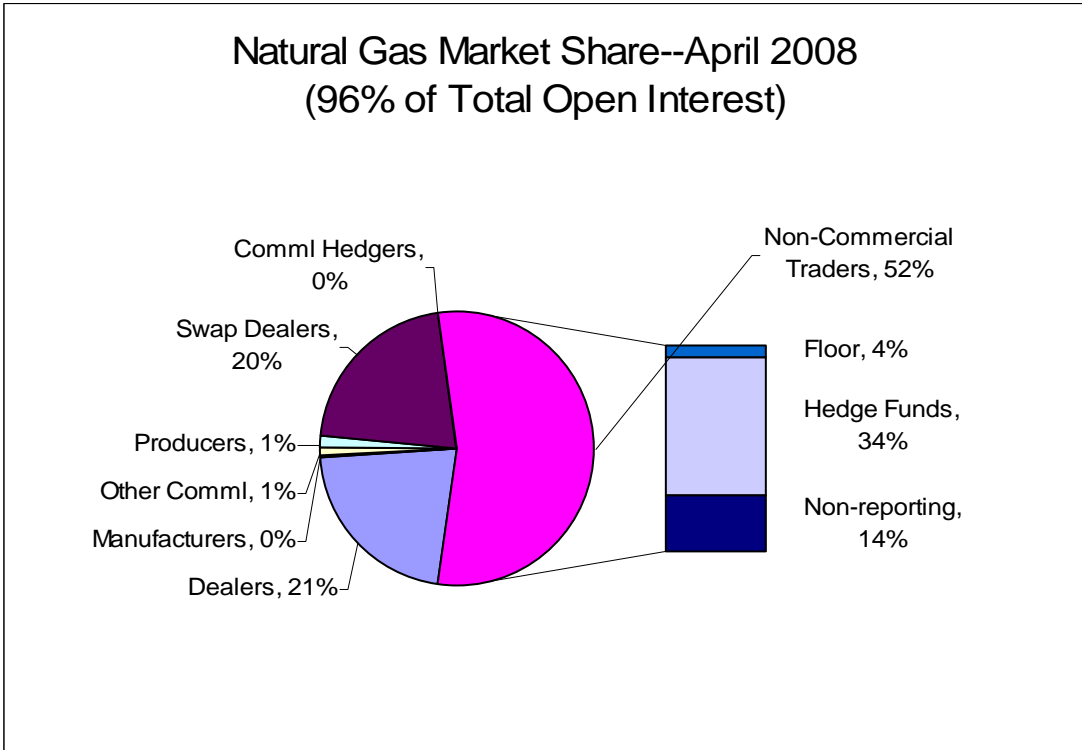
Increasing demand for electrical capacity continues to exert upward pressure on prices for natural gas. Recent NYMEX prices for June deliveries are near \$11.30 per MMBTU (million British Thermal Units), about 73% higher than the corresponding price three years ago.

We compare April 2008 participation in the natural gas contract with participation in April 2005 in Charts 11 and 12. In April 2005, non-commercial participants held 47% of the open futures positions, with hedge funds comprising the majority (31%) of those positions. In April 2008, non-commercial participation increased by a modest 5%, with 3% of this increase coming from hedge funds. These aggregated figures suggest that speculative participation in natural gas futures has not grown substantially while prices have risen more significantly during the past three years. Nevertheless, the Commission's surveillance staff closely follows this market to ensure that all the participants act appropriately and the market is functioning as intended.





**Chart 11: Natural Gas Market Share April 2005**



**Chart 12: Natural Gas Market Share April 2008**

**Conclusion**

Some observers have suggested that higher crude oil and agriculture commodity futures prices are being driven by speculators in the financial markets, and have suggested steps to reduce or limit their actions in the markets. As you can see, the CFTC has been actively engaged with industry participants during this time of extraordinary price increases. In addition, we have utilized our comprehensive data to rigorously analyze the role of investors (both hedgers and speculators) in both energy and agriculture futures markets.

All the data modeling and analysis we have done to date indicates there is little economic evidence to demonstrate that prices are being systematically driven by speculators in these markets. Generally, the data shows that:

- Prices have risen sharply for many commodities that have neither developed futures markets (e.g. durham wheat, steel, iron ore, coal, etc.) nor institutional fund investments (Minneapolis wheat and Chicago rice).
- Markets where index trading is greatest as a percentage of total open interest (live cattle and hog futures) have actually suffered from falling prices during the past year.
- The level of speculation in the agriculture commodity and the crude oil markets has remained relatively constant in percentage terms as prices have risen.
- Our studies in agriculture and crude oil markets have found that speculators tend to follow trends in prices rather than set them.
- Speculators such as managed money traders are both buyers and sellers in these markets. For example, data shows that there are almost as many bearish funds in wheat and crude oil as bullish funds.

Given the widespread impact of the higher futures prices, the CFTC will continue to collect and analyze our data closely, including continuing discussions and work with academic institutions, industry experts and other government experts and economists. In the past few months, the OCE and surveillance staff have conducted dozens of different analyses to examine our markets. We will continue to do that type of work to ensure we're taking a full view of the marketplace. In addition, I encourage others with data and findings different than ours to share that with us.

It is critical to recognize that speculators provide valuable liquidity and information to the futures markets, and this helps reduce the costs of hedging and risk transfer for market participants. Simply put, the economic data shows that overall commodity price levels, including agriculture commodity and energy futures prices, are being driven by powerful fundamental economic forces and the laws of supply and demand. These fundamental economic factors include increased demand from emerging markets; decreased supply due to weather or geopolitical events; and a weakened dollar. Together, these fundamental economic factors have formed a "perfect storm" that is causing significant upward pressure on futures prices across-the-board.

At the Commission, we are devoting, and will continue to devote, an extraordinary amount of resources to ensure that futures markets are responding to fundamentals and are serving the role of hedging and price discovery. Thank you for the opportunity to testify before you today and I look forward to answering any questions.