Eur's On First

If Abbott & Costello returned as futures traders…

Abbott: Let's see, here in Chicago – We have Eurex on first, Euronext.liffe on second and the Merc on third.
Costello: What do they trade?
Abbott: Euros.
Costello: Euro what?
Abbott: Eurodollars.
Costello: Who does?
Abbott: The Merc.
Costello: I mean the euro guys!
Abbott: Who?
Costello: The guys with "Eur" in their names!
Abbott: Eurex and Euronext?
Costello: Yeah, whadda they trade?
Abbott: One of 'em trades Euribor.
Costello: Who does?
Abbott: Euronext.
Costello: In what?
Abbott: Euros.
Costello: But who trades euros?
Abbott: The Merc.
Costello: In what?
Abbott: Dollars.
Costello: But what do eurodollars trade in?
Abbott: Dollars. Even in Europe.
Costello: Alright, give me some eurodollars!
Abbott: You can't have eurodollars in the U.S. You have to go to Europe.
Costello: Now I'm all confused! What does Eurex trade?
Abbott: Bunds.
Costello: Bonds?
Abbott: No, bunds. European bonds. In euros.
Costello: Who trades bonds in dollars?
Abbott: The Board of Trade.
Costello: On what?
Abbott: Euronext's Liffe Connect.
Costello: Clearing where?
Abbott: The Merc.
Costello: But isn't Eurex going to trade bonds, too?
Abbott: Oh, yeah. They'll clear at The (nee Board of Trade) Clearing Corporation.
Costello: In euros or dollars?
Abbott: Dollars for U.S. accounts. European accounts can clear Deutsche Borse in euros.
Costello: And euros trade on the Merc in dollars?
Abbott: So do eurodollars!
Costello: Why not in euros on Eurex or Euronext?
Abbott: What are you asking me for!?

It is that time of the year once again, when we take a fond look back at 2003. It was a year in which the Federal Reserve saved us both from deflation and a too-close encounter with Mars. In 2003, both the tech stock bubble and commodity prices both started to reflate, and even the homeless got bombarded with offers to refinance their mortgages. So what. We are gathered here today to check on that most reliable of long-term financial indicators, the oats/notes spread, to bestow the Abby Award upon some indifferent honoree and to revisit some key spreads of yesteryear. New ground will be broken in the never-ending search for the ultimate trading system. If you want infinite wealth at zero effort, a ratio only Microsoft software can calculate, you have come to the right place.

A quick administrative note is in order before we begin: As has been the case for each of the past seven Januarys, all of the data presented in these spreads are real. It ends right there, however. Period: Seek not further succor in a vain attempt to trade these yourselves nor risk not thy whole wad.

Your Exchange On Drugs

As our fictional Abbott & Costello may have observed, the real action in the futures industry is not in the pits or even on the screens. It is in the executive suites, even though no one in the futures business has yet to pull down the payday of Richard Grasso, late of the New York Stock Exchange. Lucky Luciano, a real free-markets-for-free-men entrepreneur in 1930s Gotham, once visited the NYSE, tying him with incoming acting chairman John Reed for trips to the corner of Wall and Broad streets before the latter started working there for $1 per year. Luciano obliged the adoring press corps by joking he was in the wrong business. Would anyone laugh today?

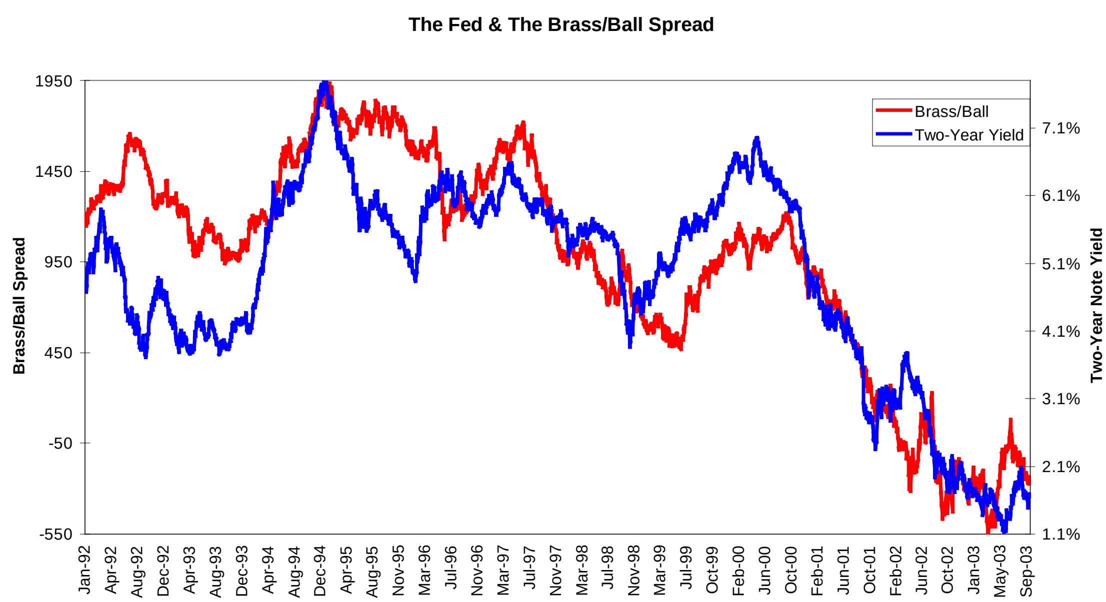
The CME launched an IPO in December 2002, and its stock promptly took off like a scared rabbit. The Merc's stock greatly outpaced that of longtime bull market stalwart Merck. The path of the Merc/Merck spread entered a strong upward channel in May and did not look back until the Merc's stock faltered on the news of a series of management changes in August. But the spread formed a decisive double bottom in September and looks poised to make new highs at the time of this writing. We can be sure, finally, that the 1960s are over now that a futures exchange is outdoing a drug company. As Rush Limbaugh would say, "I can't feel your pain."

Greenspan Passes On Gas

As longtime showman Jimmy Durante was fond of saying, "now everyone's trying to get into the act!" Indeed. Once Alan Greenspan got bored with his successes in monetary policy, he decided to accompany Energy Secretary Spencer Abraham to a Senate Energy And Commerce Committee hearing in June where he warned that high natural gas prices were posing a threat to the economy. Natural gas prices proceeded to drop sharply over the next three months and the economy finally started to show some life, so no major harm was done. Do not bother to look for the Federal Reserve's authority on natural gas prices. You will not find it.

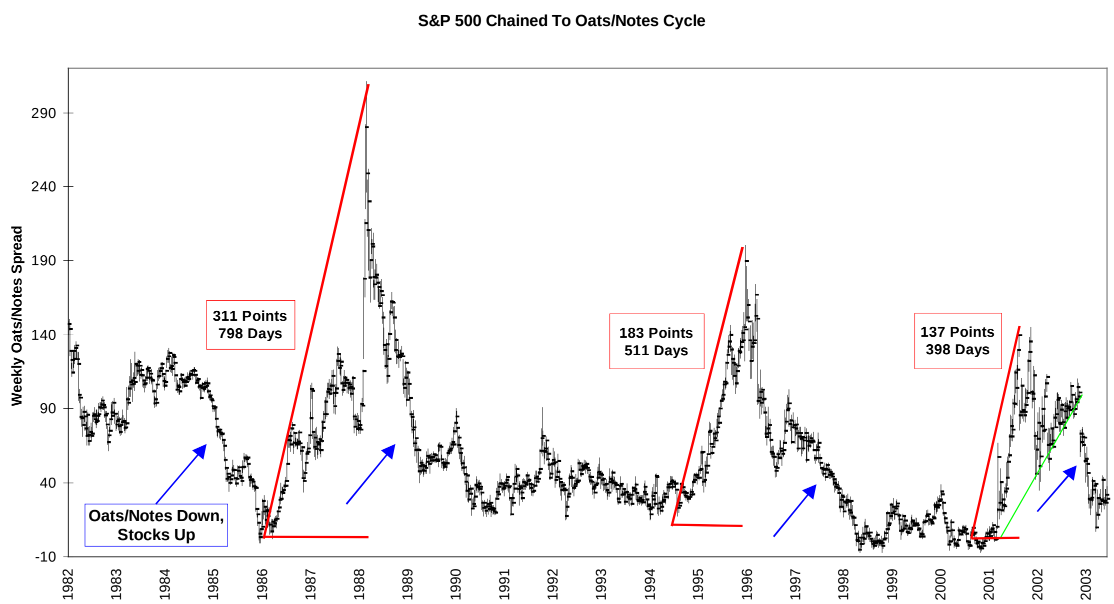
The Brass/Ball Spread

So, if the Fed was chasing around the natural gas market, who was minding the interest rate store? Two-year notes are considered one of the more sensitive barometers of interest rate pressure as they sit at the nexus of money- and capital-market rates. Is there a market that can help you trade these expectation-laden instruments? Last year's entrant in the fixed income forecasting derby, the DXY/CHX spread between the dollar index and Pilgrim's Pride Chicken, certainly kicked off a banner year for homonymous country band and defenders of Texas' good name, The Dixie Chicks. This year it is the brass/ball spread. If we take LME copper and zinc three-month forwards in the same 2:1 ratio used in making brass, and subtract 32 times the price of Ball Corporation stock, we get an indicator that sometimes leads and sometimes lags the yield on the two-year note. Its performance in 2003 in leading the summer jump in rates and their subsequent fall was spectacular. None of the books celebrating the culture of Wall Street bond traders - *Liar's Poker, Bonfire Of The Vanities, F.I.A.S.C.O.* - divulge this deep secret known by all Masters Of The Universe, that it takes brass/balls to trade notes.



When You Are Through Playing Games...
... You turn to the oats/notes spread, the unmodified spread between front month oat and ten-year note futures. The spread subsumes the sum total of financial knowledge within its gaps and squiggles; a conclusion that one day might be confirmed by a score of doctoral theses from university financial programs based on Internet classes.

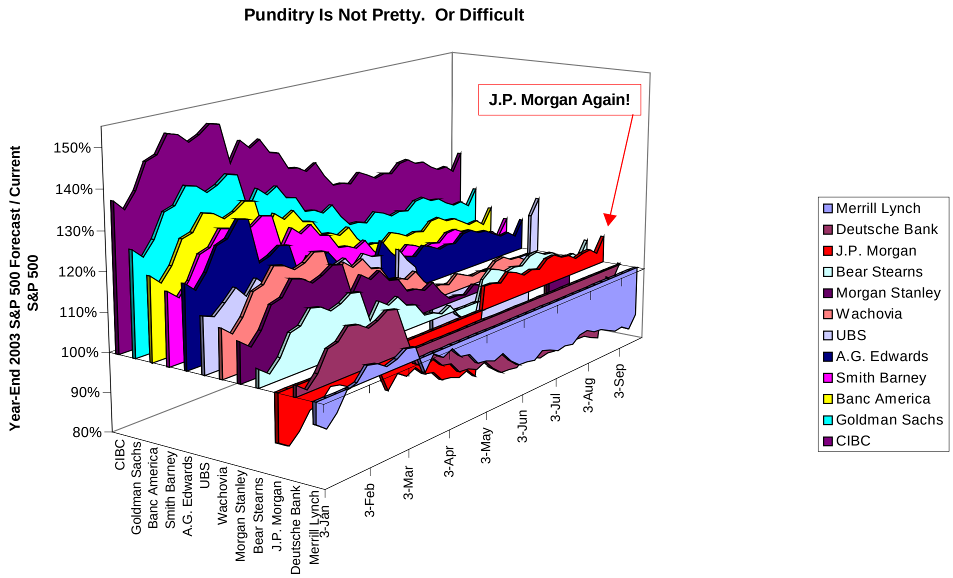
We have more than twenty years of experience now with the oats/notes spread, enough to establish long-term cycles. These cycles have been declining in both amplitude and length over this period; what once ascended 311 points over 798 days between 1986 and 1989 now rose only 137 points over 398 days from between 2000 and 2002. These cycles simply are further evidence of astonishing improvements in American productivity, an absolute necessity lest China grab a dominant share of oats/notes production.



The fate of the U.S. stock market is linked inextricably to the oats/notes spread. The spread has had four different major downturns in its history, and each has been accompanied by a move higher in the S&P 500. The rally in 2003 is no exception; encouragingly, this drop in the oats/notes spread was launched from a breakaway gap lower, the first even seen in the weekly history of the oats/notes spread. Happy days are here again.

Strategize This
If the oats/notes spread is such a reliable indicator, what good are all of those stock market strategists? If you want to win an Abby, the virtual award for fearless forecasting and peerless prognostication inscribed with Druid incantations and festooned with a symbolic broken clock, you actually have to do something right. And that, apparently, is a difficult hurdle to clear in the forecasting game. Last year's winner, Douglas Cliggott then of J.P. Morgan, was the only Wall Street strategist tracked weekly by Bloomberg who even sensed that 2002 might not be such a great time to buy stocks.

The contest is simple. The weekly forecast for the year-end of 2003 was averaged and compared to the S&P 500's actual value at the end of September. The closest ratio to 100% takes the Abby, no questions answered. And that winner, for a second year running, calls J.P. Morgan home. Abhijit Chakrabortti, based in London, joins this author, Ron McEwan, Chris Costakos, Beth Loeb & Darlene Demor and the aforementioned Mr. Cliggott in the select company of Abby Award winners.



Are there lessons to be learned from this year's winning performance? Just two: Do not maintain an off-the-wall forecast number to prove that the market is wrong and you are right, and do not change forecasts frequently to stay close to where the market is at present. In other words, do not trade by hope and do not overtrade. This will be good advice for next year, too.