FYI: 9/10/08 Wall Street Journal: Report Faults Speculators For Volatility in Oil Prices [1]

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Michael Masters

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Report Faults Speculators For Volatility in Oil Prices

By IANTHE JEANNE DUGAN
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As crude-oil prices sink back toward $100 a barrel, dueling reports soon will be released weighing in on whether, and how much, investors are to blame for the gyrations in oil prices.

Washington lawmakers and a money manager, stepping up an attack on commodities investors, will unveil a report Wednesday that they say shows speculators are to blame for this year's rise and fall in oil prices, which have swung by some 50%.
[Michael Masters]

Several Democratic senators intend to use the findings to bolster an energy bill, which includes measures to scale back how institutions can invest in index funds that track commodities markets. These institutions now hold $220 billion in commodities, up from $13 billion in 2003, according to the report, co-authored by hedge-fund manager Michael Masters.

In mid-July, pension funds and other big institutions "began a mass stampede for the exits" of a range of commodities, the report said, partly as a result of several bills that would force a cutback in these investments. In one commodities fund, investors sold futures contracts linked to about 127 million barrels of crude oil.

Prices dropped roughly 20%, or $29 a barrel, according to the report, which is titled "The Accidental Hunt Brothers," after the Texas family that manipulated the silver market nearly three decades ago.

Democrats are promoting the report on the eve of a report from the main futures-market regulator, the Commodity Futures Trading Commission. The report is expected to offer fresh data that help answer questions about the depth of financial speculation in the oil markets.

The CFTC report will provide results from its data sweep, requiring Wall Street dealers who trade on behalf of institutional investors in the commodities markets to reveal much more about the instruments they sell to them to get exposure to commodities prices.

The derivatives that Wall Street "swaps dealers" package for such clients, which allow them to invest in baskets or indexes of a mix of commodities, aren't traded directly on futures exchanges and until now the CFTC's publicly available, weekly trader reports haven't required Wall Street firms to disclose their clients' off-exchange trading activities.

The CFTC report will soon be made final; the agency is expected to either discuss or release the results by Thursday, when its officials are likely to participate in a hearing by the House Agriculture Committee convened to "review dramatic movements in agriculture and energy commodity markets."

Some critics of the agency expect the CFTC to minimize speculators' impact, in order not to contradict its past assertions that financial participants didn't appear to be driving up oil prices.

Bets in the Billions

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At the center of the debate is the impact of tens of billions of dollars that have poured into indexes that track futures contracts. Under futures contracts, investors promise to pay a certain amount in the future for crops, oil and other commodities.

These contracts, traded on markets such as the Chicago Mercantile Exchange, help farmers and others hedge against price fluctuations. Speculators buy futures contracts to make bets on price direction. It is a third group that is at the center of the controversy -- institutions such as pension funds and college endowments, which pour money into indexes that track the futures market.

The reports are part of a battle between Washington and Wall Street over how money is channeled into commodities. The issue took on urgency as food and gas prices soared and after the CFTC in July revealed that more than half of all oil trading came from speculators.

This undermined earlier contentions by the CFTC that speculators weren't influencing oil prices, and prompted lawmakers to ask the CFTC's inspector general to investigate how the agency gathers its numbers.

Wednesday's report said moves by speculative investors have been largely responsible for the oil-price moves of recent months. It will be released by Sen. Byron Dorgan (D., N.D.), Sen. Maria Cantwell (D., Wash.), and Rep. Bart Stupak (D., Mich.), who contend that without controls, these investors could run prices back up. The 50-page report seeks to dispel arguments by some big investors, bankers and economists that oil prices were due to supply and demand.

Crude-oil prices have swung by roughly 50% this year, from about $90 a barrel to more than $145. Tuesday, oil for October delivery settled at $103.26 a barrel, down $3.08, or 2.9%, on the New York Mercantile Exchange.

The recent oil selloff came after several senators proposed laws to curb investments they say drove up the price of gas and food, a notion heralded by Mr. Masters and derided by many economists. Critics said Mr. Masters is trying to buoy his own investing portfolio, which is laden with transportation-related stocks, and lawmakers are trying to show they are addressing high gas prices.

Between January and May, the report said, the price of crude oil rose nearly $33 a barrel, as institutional investors pumped more than $60 billion into commodities through funds that track indexes, the report said.

Meanwhile, the idea that investors are driving up prices is gaining some credence. European Central Bank President Jean-Claude Trichet last week told attendees at a Frankfurt conference that speculation had contributed to the oil-price shock that has hindered global growth. The two presidential nominees, among others, have attacked the trend.

One of the biggest champions of the antispeculation movement is Mr. Masters, 42 years old, who lives in St. Croix and manages Masters Capital Management LLC. The firm reported holdings of about $600 million in a recent regulatory filing, down about half from year end.

Mr. Masters won't comment on the firm's holdings; about 10% are in airlines, autos and other transportation companies that would benefit from lower oil prices. He said profits have been about flat this year.

'Index Speculators'

Mr. Masters stumbled into the spotlight after sending an email to acquaintances earlier this year, complaining that institutions were driving up the price of fuel, food and metals. They are "index speculators," he wrote -- using a term coined by the report's co-author, Adam White, the head of a research and trading firm -- and had to be stopped.

The email found its way to an aide to Sen. Joseph Lieberman (I., Conn.) and ricocheted to other legislators. Mr. Masters soon testified before Congress, and began informally advising legislators.

"You may be the most powerful guy in Washington right now," Sen. Claire McCaskill told Mr. Masters at a June hearing about the impact of investments on oil prices.

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Mr. Masters gained admiration from farmers, crop distributors and others who invited him to speak around the country. But he has drawn ridicule from some economists and others, who question his analysis and say he isn't a commodities expert and is trying to boost his own portfolio.

--Ann Davis contributed to this article.

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