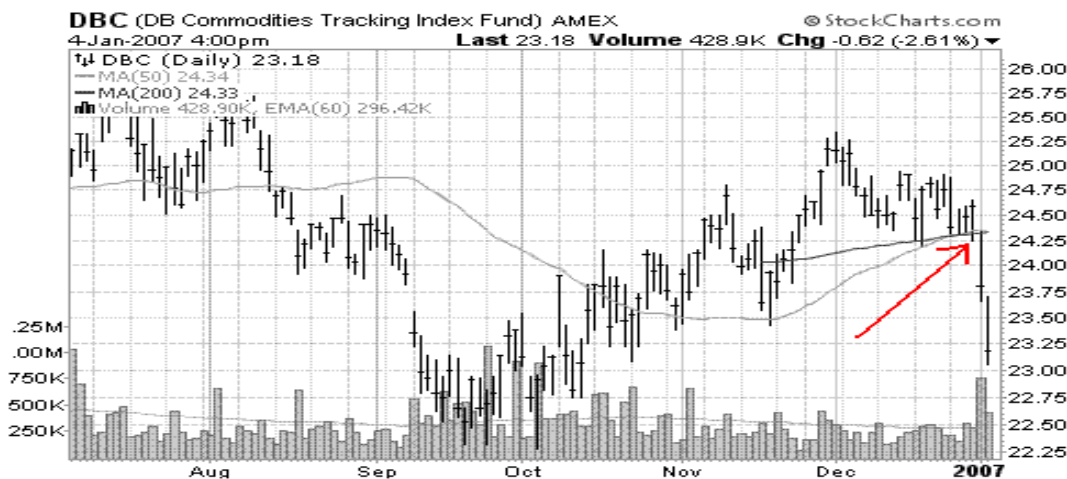


January, 10 2007 – The Broad Decline in Commodity Prices

The broad decline in the commodities market is the story of the 1st week of the 2007. Commodities are a very important part of the economies of emerging market countries that are rich in oil, gold, copper and other products. Rising prices in these areas have had a tremendous impact on the economies of these countries and their respective stock and bond markets. If you look at the DB Commodity Tracking Index*, the high volume drop off in commodities from the start of 2007 is marked with a red arrow.



Most commodities are used in the production of goods for us to purchase. When producers such as GM, Sony and Pulte Homes start demanding fewer raw materials, it becomes noticeable in commodity prices much earlier than in official economic statistics. Copper futures in particular have come down 27% from their December highs. Copper is said to have a “Ph.D. in economics” because in the past it has been a leading indicator of economic growth. Its widespread use includes autos, electronics and the construction trade (plumbing and electrical in our homes and offices). If there is a reduction in demand, it usually means we are using less of it in making cars, buildings and televisions.

If you remember the six stages of the economic business cycle that was discussed in September-November, 2006 newsletters, you will remember that commodities are typically bullish in stage five and turn down in stage six. To review, when the economy is growing too fast, the Fed raises interest rates to slow down growth and contain inflation. Stocks start to fall in anticipation of slowing corporate profits, which leads to reduced demand for commodities and hence declining prices at the beginning of an economic slowdown or recession.

When stocks go up like they did at the end of 2006, the stock market seems to be saying the worst of the economic slowdown is behind us and we have jumped to stage two of the business cycle when the Fed lowers interest rates and stock markets typically do well.

In Martin Pring’s book, “The All-Season Investor”, he writes (pg.160) “It is also very important to remember that some markets occasionally fall out of sequence. When this happens, it occasionally has great significance, although it is not apparent at the time. For instance, commodity prices peaked ahead of equities in 1929. In retrospect, this indicated a very deflationary environment because commodities were unable to maintain their normal strength into the appropriate part of the business cycle.”

Combine the above with the inverted yield curve and the bond and commodity markets seem to be forewarning that we could be headed into recessionary conditions.

*The PowerShares DB Commodity Index Tracking Fund is based on the Optimum Yield™ version of the Deutsche Bank Liquid Commodity Index™ and managed by DB Commodity Services LLC. The Index is composed of futures contracts on six of the most heavily-traded and important physical commodities in the world - crude oil, heating oil, gold, aluminum, corn and wheat.