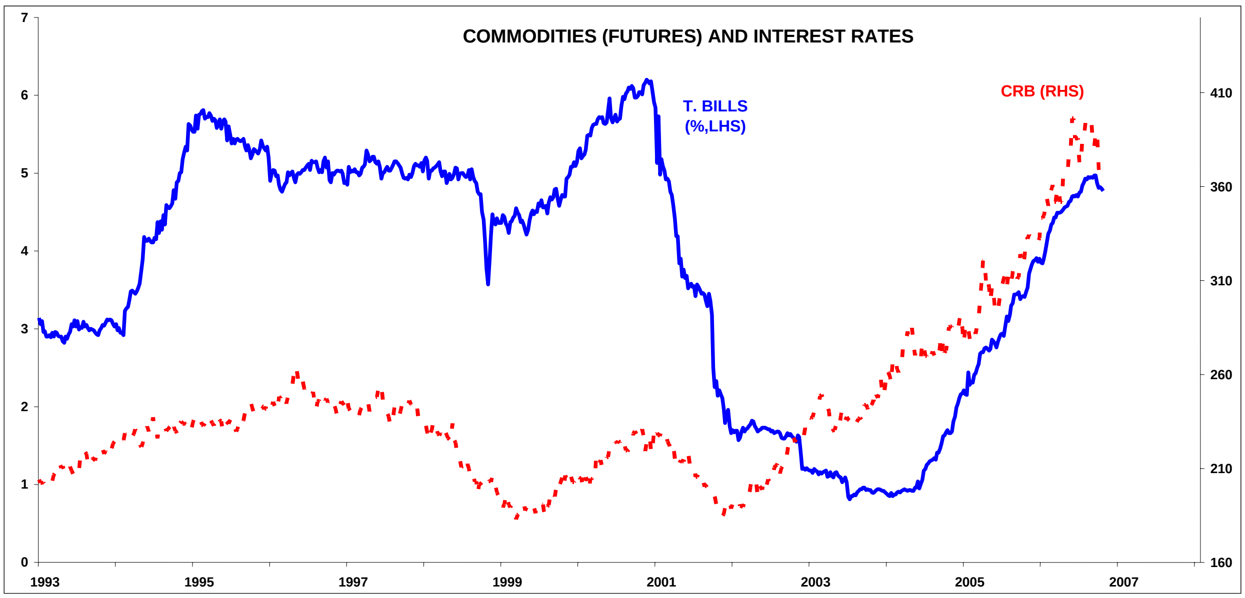
CHART OF THE MONTH: OCTOBER 2006



It is necessary to look at both commodities and short-term interest rates (rate on 13-week Treasury bills) to have an appreciation of the commodity cycle.

Commodities and short-term interest rates have the same cyclical turning points, although commodities tend to move ahead of interest rates.

Their trend is easier to recognize because it is not manipulated by the Fed like that of short-term interest rates. Over the long term, however, the two trends coincide. Both "markets" respond to the growth patterns of the economy, as follows:

a. Eventually, a strengthening economy causes commodities and interest rates to stop declining. As the economy improves, commodities rise decisively. Short-term interest rates may be kept artificially low by the Fed (as in 2003-2004). In the end they will have to join the trend of commodities because both markets respond to the needs of business: buying raw materials to build products and borrowing money to pay for raw materials.

b. The rise in commodities and interest rates has an impact on inflation, consumers' purchasing power, and business profitability. Consumers become more cautious and business starts cutting costs. Both trends cause the economy to slow down. Commodities and interest rates stop rising.

c. The weakness of the economy will continue until the roots of its demise are brought under control. Commodities and interest rates will have to decline quite substantially to have a positive effect on consumers and business.

d. A visible decline in commodities and interest rates convinces consumers and business the worst is over. Consumers start spending again and business increases output to meet demand. The slowdown comes to an end and the economy begins to recover.

e. Go to a.

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