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Commodities Monthly Roundup -- January 2011

Market Highlights for December and 2010: The Thomson Reuters/Jefferies CRB index was up some 10% in December, bringing the total gain for the year to an impressive 17%. (See our chart below). Indeed, commodities as an asset class easily outstripped the 2010 gains seen in global world stocks (up 13%) and that of bonds (up 4.88%). Seventeen of the 19 commodities tracked by the CRB rose last year, led by cotton, which surged 92%, with silver not far behind --up 84% on the year. (Palladium beat both of these advances with a 96% gain, but it is not in the CRB index). Oil was not a group leader in 2010, (up 13% on the year) but it nevertheless had a decent showing on the back of solid Chinese November import data and a noticeable uptick in western oil offtake, particularly during the second half of 2010. On the downside, natural gas lost 21% and cocoa was off by 7.7% in 2010. (See our rankings on the next page).

Once again, it was China that was powering the bulk of the move higher in 2010, although fundamentals also played a part in some complexes, particularly in grains, where crops were ruined by Russia's worst drought in at least a half century, flooding in Canada and Australia, and dry conditions in Europe and South America.

The macro scene was also constructive; major economies of the world were all growing in 2010, reminiscent of 2004-2007, a period that laid the foundation for the 2008 bull market. Out of the US, we did not see a double-dip recession, but perhaps fearful of one possibly setting in, policymakers "doubled down", with the Fed embarking on its QE2 program, while President Obama and the Republicans agreed to maintain the Bush tax cuts, (as well as other spending programs), thus adding another \$900 billion to the deficit over the next two years. Elsewhere, Europe was able to survive a Euro scare twice last year, and although its currency's problems are by no means over, the authorities at least seem to have bought some time for themselves. China also continues to grow very strongly despite the best efforts of the authorities to engineer a soft landing. (More on that later).

Finally, we are seeing no slowdown in the pace at which money is flowing into commodity investments. Latest numbers provided by Barclays shows that fresh inflows into commodities totaled \$6.1 billion over the course of November 2010, taking managed assets to a record \$354 billion. The bank said total new investments in commodities are on track to hit \$60 billion in 2010, down from the record total of \$76 billion hit last year, but still the second highest level ever. Dovetailing this, a host of commodity exchange traded products continue to draw money in, with the gold ETF still retaining its ranking as the most popular vehicle. Base metal ETPs were also among the latest offerings that came out late last year

Outlook for 2011: It seems that all the constructive factors noted above will likely remain in place as we start the New Year, meaning that we could see further gains in commodities going forward.

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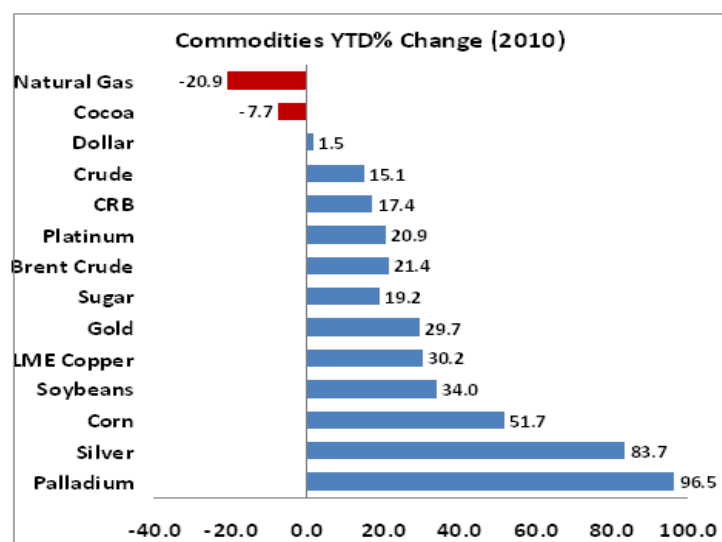
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Having said that, there are certain developments taking shape that argue for some caution as we approach the second half of the year. We discuss these below:

The Dollar - A weak dollar has frequently been cited as a key reason to buy commodities. In fact, it is tempting to trash the dollar given its uninspiring fundamentals, characterized by large federal deficits and a Federal Reserve that has thrown caution to the wind. However, we suspect the dollar could surprise in 2011 if a number of variables fall into place. For one thing, the US economy seems to be gaining strength, although the labor market (along with housing) is the most critical component of the economy that has yet to turn. However, we are seeing signs that labor conditions are improving given the first-ever dip in three years in the weekly initial claims data, the slow but steady increase in private nonfarm payroll growth, and growing signs that companies have maxed out on productivity-induced efficiencies, and may therefore turn to new hiring. In addition, we are seeing commercial loan demand starting to pick up, an indication corporations are more comfortable with regard to the macro outlook. If indeed employment growth revs up, we very well could see the Fed move towards a tighter stance, possibly by the second half of the year. Already, the bond market seems to have prepared itself for such a "repositioning", as 10-year yields have risen by almost 1% from their October lows. It will also be interesting to observe the political dynamic in Washington. Should the Obama administration and the Republicans "come together" and make a serious effort to trim spending or reform entitlements, dollar bullishness will likely increase. In addition, the dollar should benefit from "flight to safety" runs on account of unexpected political tensions or Euro-based funding issues. All this means that the "short dollar/long commodity" trade could be unwound later in 2011, as the headlong rush into hard assets as a hedge against an eroding dollar reverses itself.

China - Asian economies have provided the biggest boost for commodity demand in 2010 and many investors are looking for a repeat going into 2011. However, we are starting to see some headwinds form in this regard. The Chinese, for example, have raised their interest rates and reserve requirements twice in the last two months in an effort to cool off the economy and dent inflation. In fact, the inflation issue was serious enough for the country's president, Hu Jintao, to take to the airwaves in mid-November in an attempt to reassure the public that his government was doing all it could to deal with rising prices, including forcing some companies to freeze prices. On the futures exchanges, authorities were liquidating "speculative" long positions in an effort to bring some relief to end-user prices. We doubt any of these unorthodox measures will work, and the government will likely continue to use the interest rate lever to head off growing inflationary pressures. The Asian macro data thus far shows some weakening, although it is too early to read too much into them at this point. As examples, we had reports this week that China's manufacturing sector grew at its weakest pace in three months in December, while a separate manufacturing index released by HSBC fell for the first time in five months. Out of Australia, manufacturing contracted in December for a fourth straight month, while India's manufacturing growth dipped to a three-month low in December. Should the numbers continue to deteriorate in the weeks and months ahead, markets could be indeed be in for a rude surprise, as much bullishness has already been baked into the high prices we are seeing, as well most forecasts going forward.

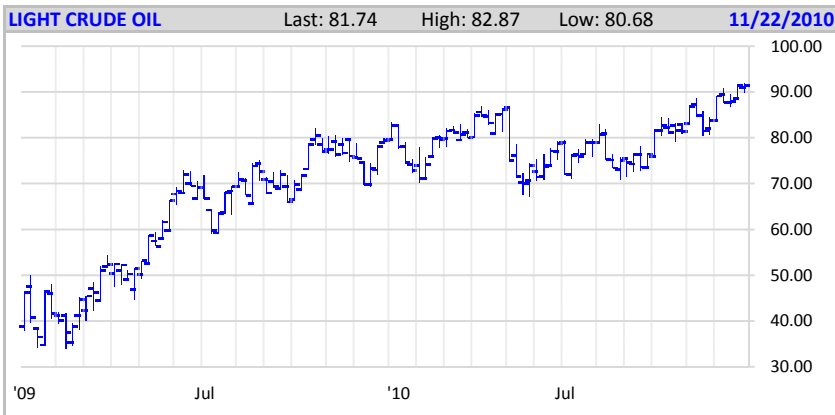
Commodity spirals - We are getting a sense that the current commodity move is eerily similar to what we have seen in 2008, where investors are making easy one-way bets. Frequently divorced from the fundamentals, commodities are being bid higher by increasing amounts of money flowing into increasingly easier-to-understand investment vehicles. All this may be well and good for portfolio managers, but the upward spiral does have real-life consequences. In emerging markets, higher food prices, for example, could translate into civil unrest and riots, as subsidies are scaled back. In base metals, higher prices could lead to demand destruction and metal substitution. Finally, if energy prices get caught up in the frenzy, we will see higher inflation and interest rates, pinched consumer spending, and a possible relapse into recession. On the supply side, we could see expansion plans, where possible, ramped up, thus alleviating tightness in the out-years. So while the current commodity run may be logical on the surface and may very well continue at least for some time to come, we always get very nervous when practically everyone is on the same page.



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WTI NEARBY CONTINUATION

We certainly misread the advance that crude staged in December, magnified in some part by the fact that key resistance at \$89.60 was taken out, leading to a technical breakout on the charts. Prices are now at 27-month highs, with reports of periodic refinery outages, coupled with cold weather on both sides of the Atlantic, helping the firmer tone. Strong demand from both the West over the last few months, as well as from China, (where latest monthly imports were up some 14% year-over-year), have also lent offer a measure of support, helping trim inventories in the process. Stocks are now down about 6% so far in December, the largest monthly decline in four years. However, Cushing inventories have not declined as much, and neither have product inventories. Fund data furnished by the CFTC remains shows that near-record long positions are holding in place. This suggests that dips will be well supported, and that prices should support at \$80. On the upside, the \$100 mark seems to be the next logical resistance target.



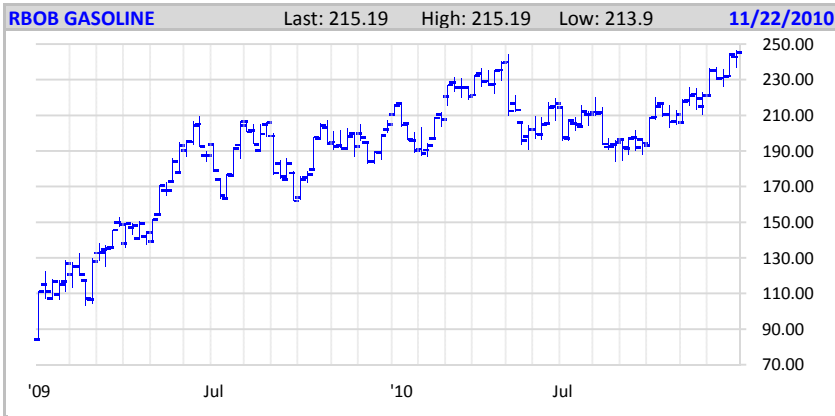
BRENT NEARBY CONTINUATION

Brent gained roughly \$4 a barrel in December, while the Brent premium over WTI also expanded substantially. The complex has been boosted by a number of variables, including a fierce cold snap in Europe during the middle of the month that drew heavily on product inventories, coupled with Nigerian tensions that usually manifest themselves in higher Brent valuations. Of the two oil contracts, we suspect that Brent will likely hit our \$100 resistance target first, as in addition to the constructive arb, its chart pattern looks more constructive. Support is at the \$90 mark, a level that has held for several times over the course of December.



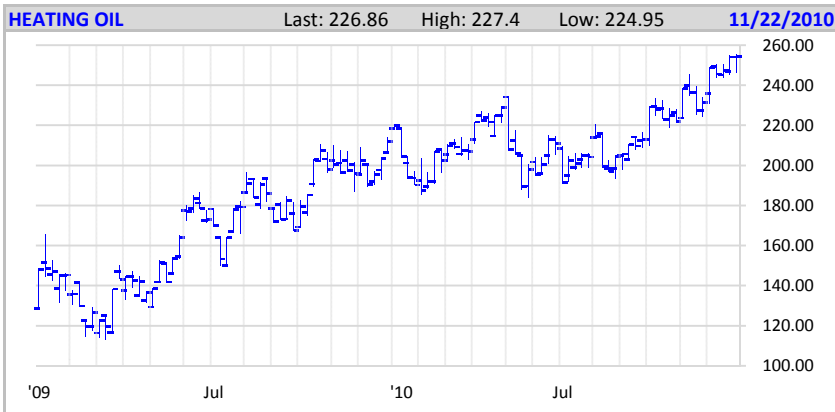
RBOB NEARBY CONTINUATION

In last month's report, we identified \$2.25 as key resistance for gasoline, but this barrier was decisively broken in early December, taking prices to a high of \$2.45 later in the month. This is quite an impressive performance for the complex given that the fourth quarter is traditionally a slow period for the complex. Instead, US December gasoline offtake has been running at its strongest level since December of 2007, which may be the key reason why prices are holding up as well as they have. However, we are not seeing any meaningful reduction in stock levels, with inventories remaining comfortable, and now at five-year highs. All this paints a very mixed picture for the complex, which is why we continue to favor heating oil as a more compelling long play going into the winter months. Chart-wise, we are close to being in breakout territory if we manage to close and pull away from the \$2.45 mark. In such a case, we could see the \$2.60 mark as being next resistance, while on the downside, support is at \$2.25.



HEATING OIL NEARBY CONTINUATION

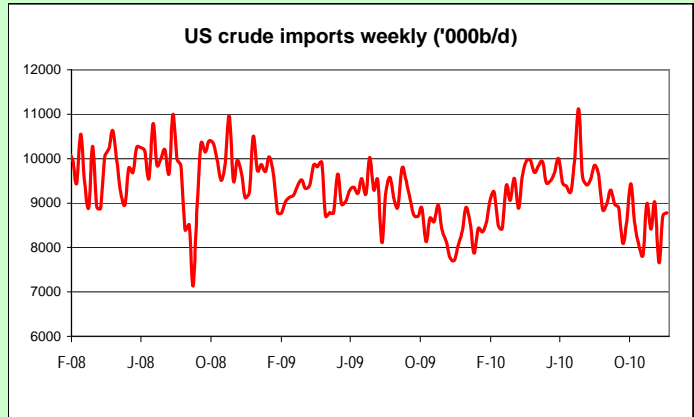
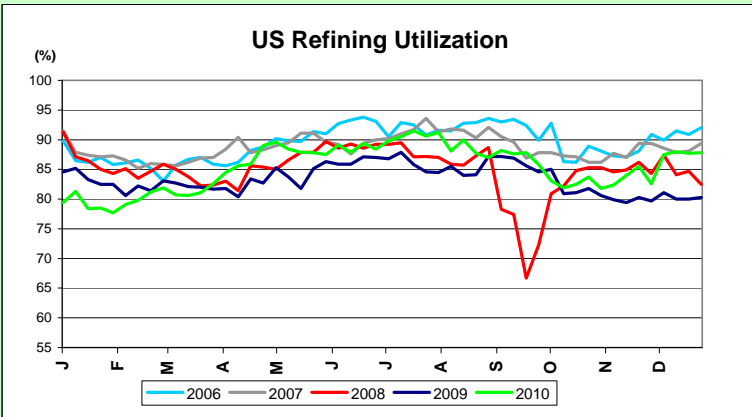
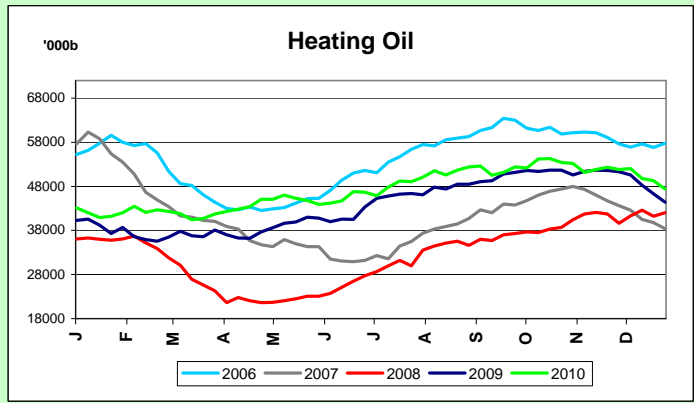
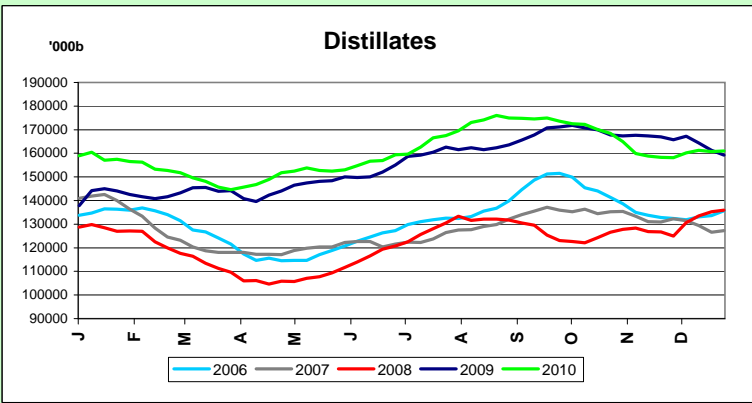
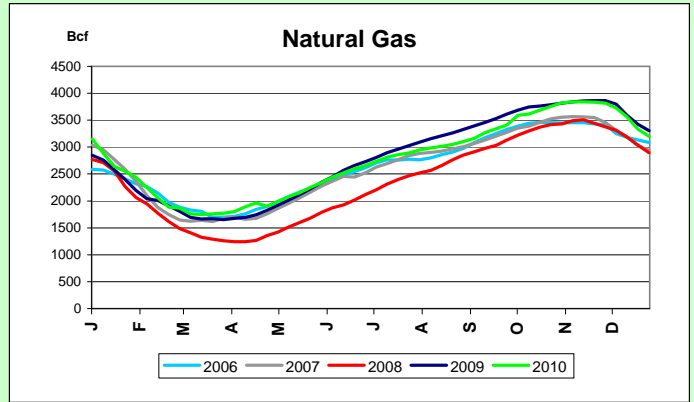
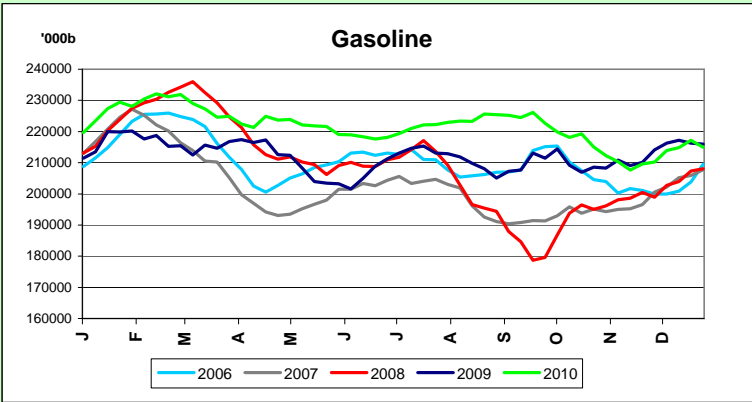
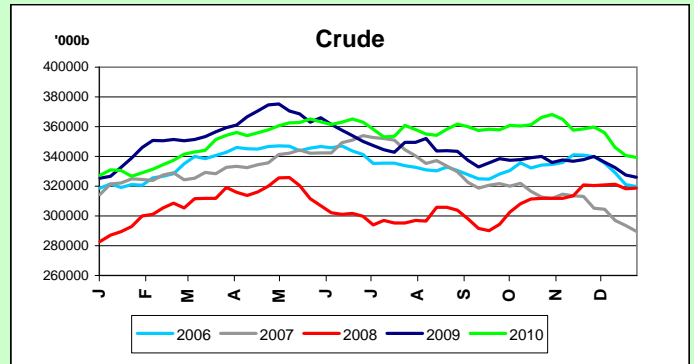
Similar to gasoline, heating oil prices are also in breakout territory, with next resistance around the \$2.66 mark. The complex has advanced by an impressive \$.20/gallon during December, and took out the key upside resistance target of \$2.50 that we identified in last month report. Prices are now in breakout territory, so it is quite difficult to know exactly where the current rally will take us. Much depends on the weather, but given the stormy conditions we have seen thus far (with the winter having just officially started), we may be in store for a particularly harsh winter on both sides of the Atlantic. In addition, out of the US, distillate demand remains quite firm, and should provide a measure of support to the complex. Support is at \$2.50, (previous resistance), with \$2.43 below that.



EIA/DOE Inventories as of the latest week

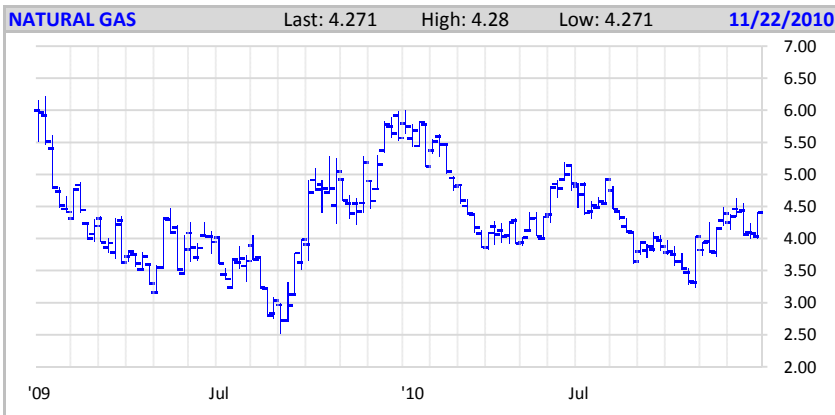
(In MB)	Current week	Previous week	Year ago	Change from last	
				Week	Year*
Crude	339,400	340,700	326,000	(1.3)	13.4
Distillates	161,000	160,700	159,300	0.3	1.7
Gasoline	214,900	217,200	216,000	(2.3)	(1.1)
Heating Oil	47,400	49,300	44,400	(1.9)	3.0
Natural Gas**	3,201	3,337	3,303	(136.0)	(102.0)
Imports	8,780	8,710	8,030	70.0	750.0
Capacity Util (%)	87.8	87.7	80.3	0.1	7.5

*unrevised / **for week prior in bcf



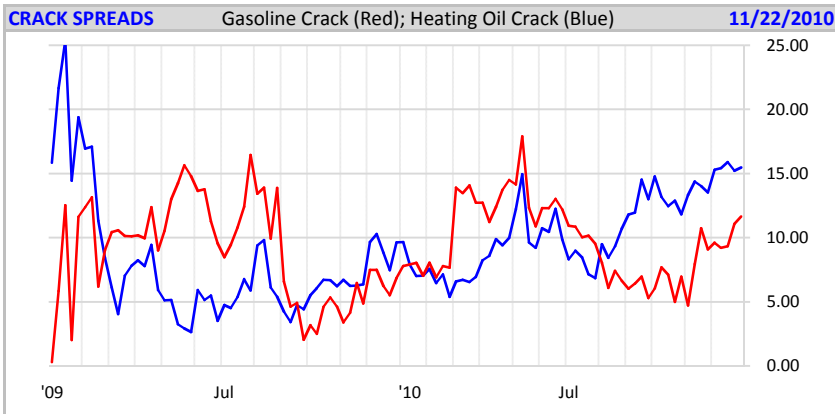
NATURAL GAS NEARBY CONTINUATION

Natural gas prices have been a perennial disappointment for the bulls, with every promising rally fizzling out in rapid fashion. December started off well, with the market rallying to over \$4.60 in what appeared to be a breakout on the charts. However, the upward momentum faltered, with the selloff taking prices back below the \$4 mark. Despite improving demand and colder weather, natural gas cannot shake off the relentless supply increases characterizing its fundamentals, typified by high rig counts and increased production efficiencies. Even the recent draws we have been getting have not done much, in that they are not exceeding estimates by sizable margins, leaving stocks at record highs. It remains to be seen whether the current run we are seeing in prices (now back around \$4.60 once again) will amount to anything, but we suspect that it might, since in addition to colder weather concerns, natural gas should benefit from a degree of index rebalancing given that it was the worst performing commodity in 2010.



CRACK SPREADS

Crack spreads have remained elevated, as product prices have managed to keep up with advancing crude prices. The gasoline crack been particularly impressive, as prices have advanced in what is otherwise a seasonally weak quarter. We think the cracks will continue to remain firm through the first quarter given the pick-up in demand and constructive chart patterns that we are seeing in the flat-price product complex.



EMISSIONS

Emission prices dipped below the €14 euro mark in late December for its lowest reading since July. Late year-end selling in thin conditions likely exaggerated the selloff, as did stories about continued fraud in the permit program. However, most importantly, the Cancun summit, which took place in early December, failed to revive prices, as participants agreed on only modest steps to combat climate change, deferring the tougher decisions on cuts to emissions until next year. Most glaringly, there was no progress on how to extend the Kyoto protocol, set to expire in 2012. A Reuters consensus poll projects that EUA prices could be anywhere between €18.6 and €40 a ton between 2013 to 2020, but this level is deemed to be insufficient to spur new investment in such difficult technologies as carbon capture.



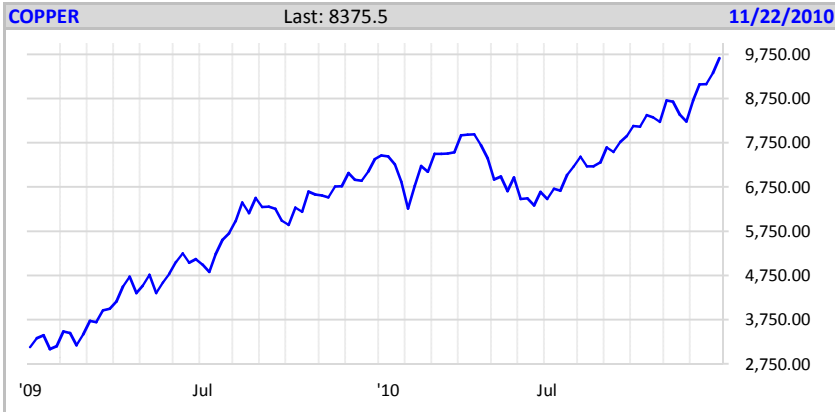
URANIUM

Uranium prices continue to surprise to the upside, and have tacked on another \$4 a pound in gains in December to hit two-year highs. Spot demand remains rather brisk on the back of strong Chinese imports, which shows no signs of letting up. In this regard, China Guangdong, the country's second largest builder of nuclear power plants, was the latest company to enter the market, agreeing to buy 29 million pounds of uranium through 2025 from Canada's Cameco. China and India are both leading the push into nuclear power, with Chinese uranium demand projected to rise to 20,000 tons annually by 2020. According to the World Nuclear Association, this is a little less than half of the total uranium mined globally last year.



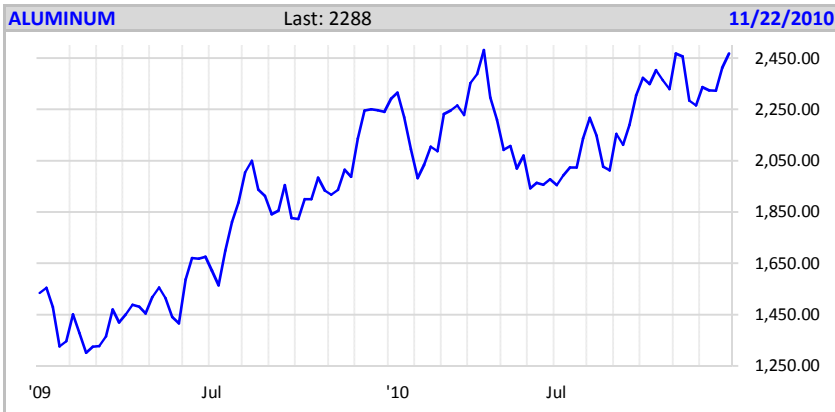
3-MONTH LME COPPER

Copper prices have defied the bears once again, soaring to record highs just as this note was being prepared, and now hovering around \$9700 a ton. At such price levels, there are no technical signposts to guide us as to what lies ahead, but the \$10,000 mark seems to be the next logical upside target. In other developments, we did see the long-awaited copper ETP copper start trading this past month, but by all accounts, the investment vehicle is not matching its pre-launch hype, as only about 1500 tons of copper have been set aside so far to back the unit. But the copper market nevertheless seems to be finding other reasons to go up; investors are clearly worried about the sizable 436,000 ton deficit that has been accumulated for the first nine months of 2010 (this according to the latest ICSG report), and another deficit is expected for next year. The problem for the copper bulls, however, is that should the current price run continue, the market runs the risk of demand destruction or metal substitution (in certain applications), not to mention the possibility of an imminent correction considering the magnitude of the current run.



3-MONTH LME ALUMINUM

Aluminum prices have moved higher over the course of December, but have struggled to replicate the impressive gains seen in copper. This is attributable mainly to the large stock overhang that continues to hover over the complex. Although inventories have been coming down of late, the rate of decline is modest, and also does not take into account the massive amount of stocks that is being held off exchange. Production, while declining, is still not dropping fast enough to make much a significant difference either. Latest IAI data shows that Western November production exceeded last year's levels, while Chinese production was off by some 10% year-over-year, but this was mainly due to government imposed power cuts, whose sustainability is questionable. With a surplus expected for both this year and next, we reiterate our view posted in last month's note, namely, that aluminum will likely remain a laggard going into 2011. Consequently, we would look to put on sale hedges between \$2500-\$2700 basis three months. On the downside, there is short-term support at \$2300 and at \$2250.



3-MONTH LME ZINC

Like aluminum, zinc has also struggled for much of December, trading within a tight \$150 range of between \$2200- \$2350 for much of December. Prices did finally break out late in the month, and the cash-to-three's spread also tightened to a modest back at one point before being crushed by deliveries into New Orleans. Other than that, there has not been any meaningful change in zinc's fundamentals. Stocks continue to climb on both the LME and Shanghai, and are up by some 330,000 tons since the beginning of the year. (Combined, they have grown by a whopping 1 million tons, equivalent to about 8% of refined consumption). The latest ILZSG report has the 2010 zinc surplus (through October) at 211,000 tons. We have not seen any revisions to the ILZSG's full-year surplus projections for 2010 and 2011, which were last at 230,000 and 161,000 tons, respectively, but we suspect these numbers will be revised higher. All this should keep zinc prices in check, at least through the first half of next year, where we anticipate a trading range between \$2000-\$2700.



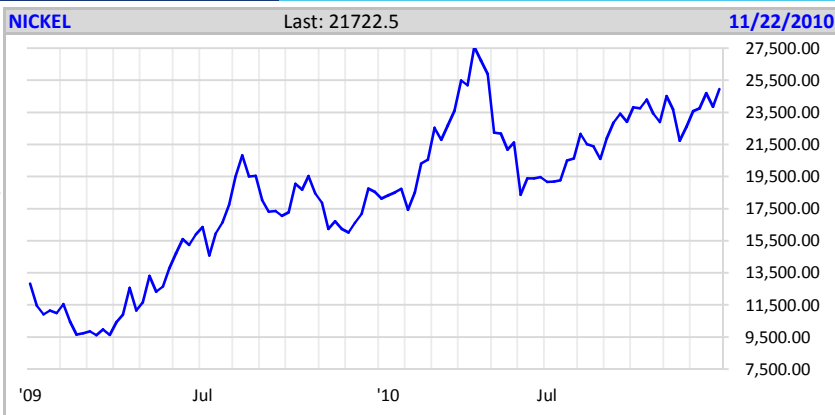
3-MONTH LME LEAD

Similar to zinc, lead has been dogged by excessive production, with LME stocks now at just over 207,000 tons, a 10.5-year high. Although global demand has been fairly brisk, (up 4.5% this year), and has presumably ramped up in recent weeks on account of cold weather gripping both sides of the Atlantic, we still have not seen any noticeable dip in bulging LME inventories. This is because the market has been running at a 51,000 ton surplus through October of this year, and another surplus is expected for next year as well. Having said that, the overall stock level, while high on a gross basis, is still relatively modest when translated into weeks usage. One question hanging over the lead market next year, is how will Chinese car sales fare in light of the fact that the government is ending a tax break for the purchase of small cars. In addition, pollution-choked cities like Beijing have slashed the number of license plates that will be issued for new cars by about 60%.



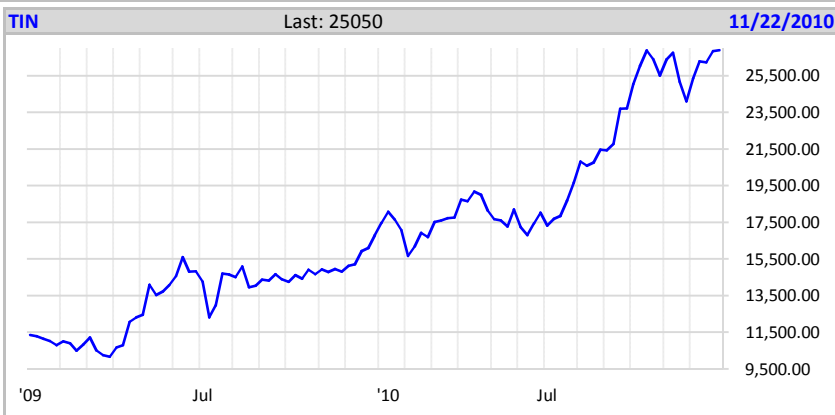
3-MONTH LME NICKEL

Nickel has been a relative laggard in the metals space, up just 4% in the December. LME stocks remain high, and are keeping rallies somewhat in check. In addition, pig iron seems to be making aggressive inroads into the nickel market, and is siphoning off increasing amounts of potential Chinese nickel demand. One study says that Chinese PI usage was up some 78% versus a year ago given that nickel prices are trading well north of \$18,000—an inflection point above which pig iron apparently becomes extremely competitive. In the meantime, Chinese stainless steel output is expected to grow by about 15% in 2010, but is forecast to decline in 2011, possibly pressuring prices further, and increasing the odds off another surplus this year, which the International Nickel Study Group expects to be around 80,000 tons. We see nickel prices trading between \$21,000-\$27,500 during the first quarter of 2011, and suspect that prices will have a difficult time exceeding \$30,000 any time during the year.



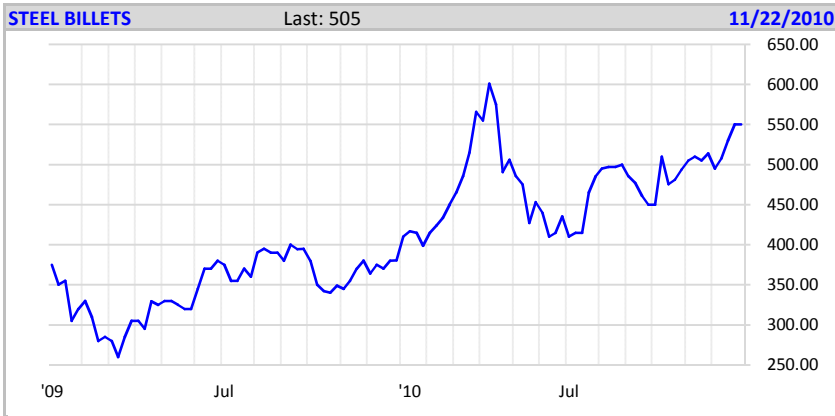
3-MONTH LME TIN

After a rather sloppy November, tin prices took off in December, with the complex having the distinction of being the best performing metal in percentage terms in 2010. Tin's rally was attributable to the fact that LME stocks have stopped rising in December after increasing some 17% in the month before. There also is some question about the marketability of current and future metal in light of growing restrictions having to do with the sale of African "conflict minerals". In fact, the International Tin Research Institute said that US laws pertaining to such minerals may impede the flow of cassiterite, and that some of this production may "no longer be acceptable to the international tin...markets" possibly by April of next year. Given these concerns, coupled with the fact that only a handful of producers are responsible for the bulk of global refined exports, we remain friendly towards the metal going into 2011, and would not be surprised to see a \$35,000-\$40,000 print at one point next year.



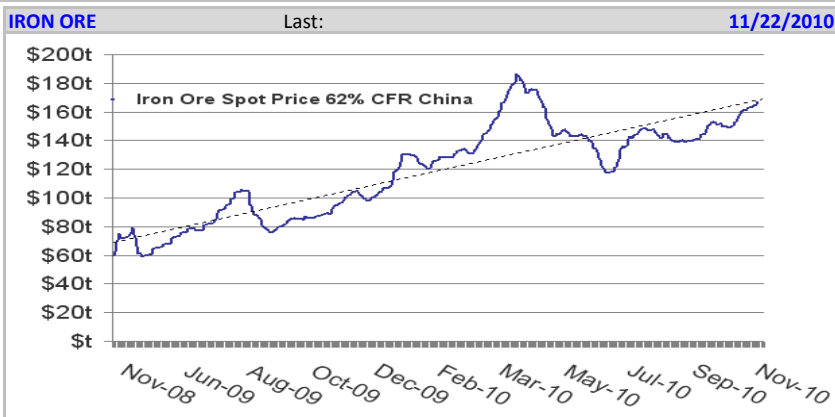
LME STEEL

LME billet prices have been very firm this past month, rising about 8% over the period, and teeing off against surging iron ore and scrap prices. However the increases are taking place against a backdrop of soggy fundamentals. Despite Chinese cutbacks, for example, global production continues to increase, up 16.2% in the January to November period vs. last year, (this according to World Steel Association). Overall output is expected to finish the year at 624 million tons, up 8.2% from 2009 levels. Apparent demand has trailed production, and should leave a substantial surplus in place when the 2010 numbers are all in. More disturbingly for the bulls, Chinese steel demand could be under further pressure in the months ahead, as the government intensifies pressure on the country's real estate sector. Construction already accounts for about half of the country's steel demand, and so any slowdown here would be a significant game changer. In addition, Chinese steel producers could ramp up supply going into the New Year if power restrictions are lifted. As a result, we would be cautious on the sector, particularly for the second half of 2011.



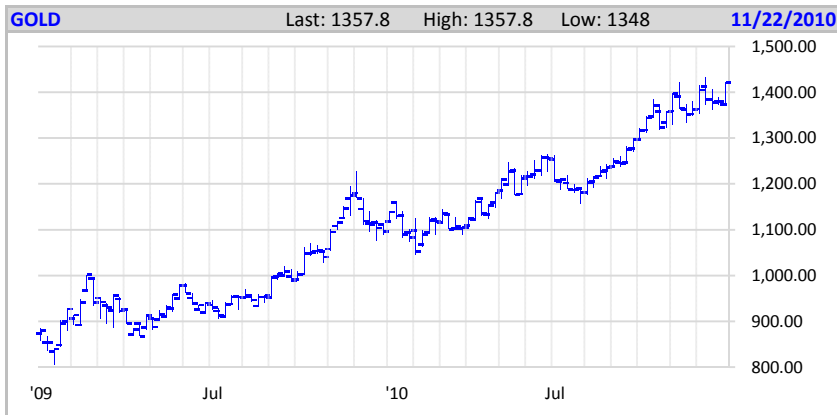
IRON ORE

There will be two major price drivers for iron ore heading into 2011. First, the Indian Supreme Court is expected to give its verdict in late January (already once delayed) on the petitions against Karnataka's State's export restrictions. We do not expect a quick resolution on this matter, as a round of appeals will likely see the situation drag on. Whatever the eventual outcome of this case (originally focused on illegal mining) we expect the trend for Indian exports to be lower given the lobbying of the powerful steel industry and the difficulties in obtaining environmental approvals. A second pricing variable centers on China's iron ore demand in light of a steadily tightening monetary policy currently being pursued by the government. While we see risks forming to end-user demand by the second half of 2011, we expect construction and manufacturing to hold their own for now, and consequently see prices remaining trading between \$160-\$180 at least for the next two months. (Contribution by Andrew Gardner).



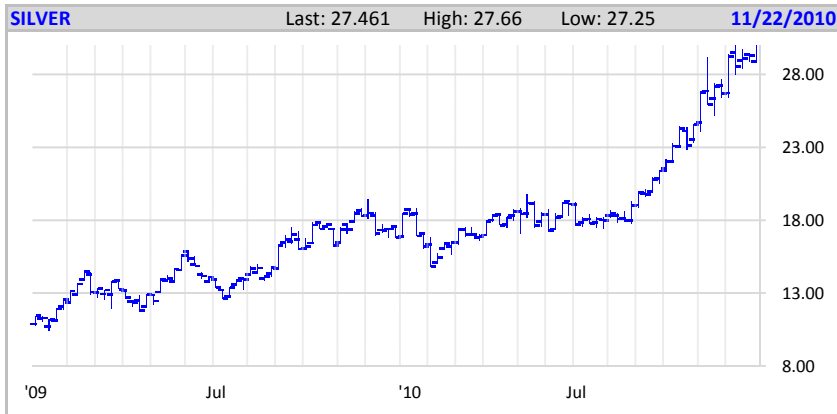
GOLD COMEX NEARBY CONTINUATION

Gold prices had a relatively choppy month in December, losing ground for most of the month after peaking early on, but then picking up steam as we headed into the year-end. The complex is now back over the \$1400 mark, and within sight of its all-time high of \$1431 hit in early December. Given the ongoing issues in Europe, coupled with concern about the Fed's QE2 program and the recent Obama tax compromise, we should see investor demand for gold remaining intact for most of 2011, as confidence in paper currencies continues to erode. Having said that, the complex could see its share of rather sharp setbacks, particularly if various crises force investors to seek the safety of the dollar. For gold to assume its bullish momentum more decisively, we need to see the dollar's downtrend resume. Failing that, gold's climb will be much more gradual, but climb it will. We expect gold to get to \$1550 during the first half of 2011, not entirely an unreasonable scenario, given that gold's inflation-adjusted peak going back to 1980 is somewhere around \$2300. In addition, Chinese demand was very strong in 2010, and is expected to remain that way going into 2011.



SILVER NEARBY CONTINUATION

The silver market was up 84% in 2010, hitting a series of 30-year highs in the process, and was the second-best performing CRB commodity in 2010 after cotton. Prices are rising on the back of strong investor buying and a buoyant gold sector, both of which are outweighing relative oversupply and lackluster industrial demand. The largest silver ETF, the \$10.2 billion I-shares silver trust, has seen \$1.1 billion in net inflows during the first 11 months of this year, and the odds are high that we could see similarly strong buying going into 2011. Not to be outdone, the US Mint reported that it had sold about 4.26 million ounces of silver in November, a monthly record. China has also done its bit to help the rally by eliminating export tax rebates, triggering a 59% decline in exports this year. Despite rising prices, the supply/demand balance is pointing to a surplus this year, but like a host of other commodities, fundamentals are playing a secondary role. We look for prices to peak somewhere around \$35 an ounce in 2011, while good support is at \$28.70, which lies along the major up trendline.



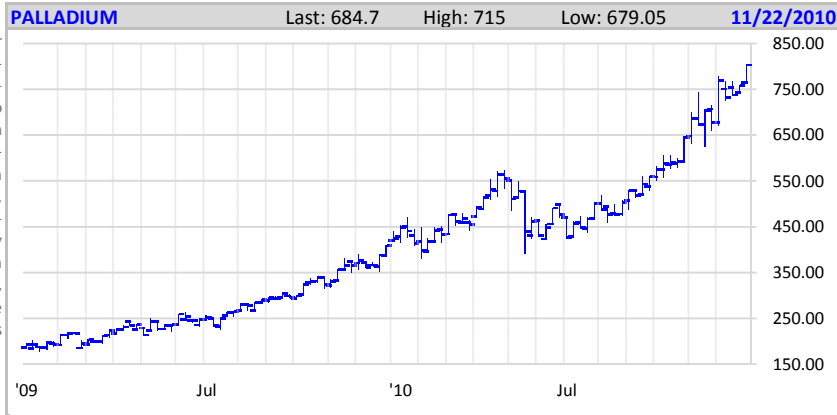
PLATINUM NEARBY CONTINUATION

Platinum had a fairly decent December, bouncing by \$100 an ounce from the lows hit earlier in the month. Nevertheless, the complex has yet to hit its 2008 high, as rising production in South Africa and stagnating demand continue to weigh on prices. On the supply side, South African production is expected to rise slightly this year, its first increase since 2006. In addition, we suspect that platinum is not attracting the kind of fund flow interest that is chasing gold and silver. However, that could change, as an inevitable reallocation of assets sets in. Secondly, jewelry demand could pick up for platinum, especially as gold prices push higher. We see prices pushing above \$1800/ounce during the first quarter of 2011, at which point we could have a breakout on the charts. Support is at \$1630, the bottom end of the trading range.



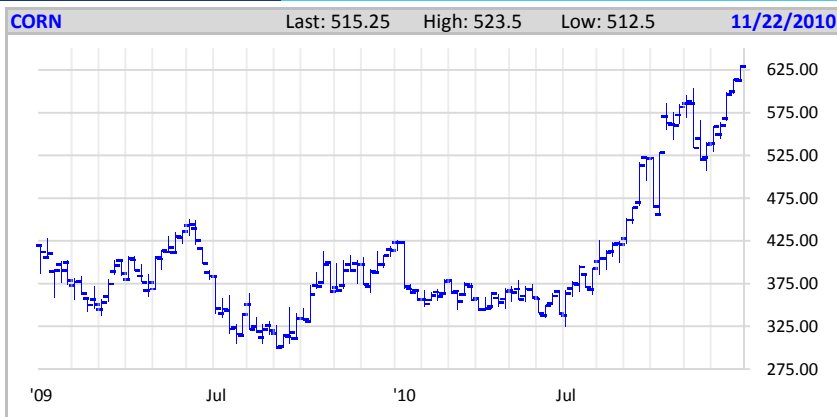
PALLADIUM NEARBY CONTINUATION

Palladium had a stellar 2010, hitting a 10-year high of just under \$800/ounce last week to chalk up a 96% gain on the year, the best performance in the commodity class. (Palladium is not part of the CRB index). We believe the metal should continue to do well as we head into 2011, since production is projected to show no growth this year, and in fact, has basically been flat since 2008. In addition, Russia's state repository (Gokram) is expected to sell insignificant amounts of palladium in 2011 before exiting the markets altogether in 2012. On the demand side, consumption is estimated to have risen by 11% this year from 2009 levels, largely on account of very strong Chinese offtake, and will likely grow at a similar rate next year. Technically, the long-term continuation charts show some resistance around the \$860 level, but above that, things are wide open until the \$1070 mark, which was reached in late 2000. Support is at \$600, which was the point at which palladium prices first broke out during the second half of 2010.



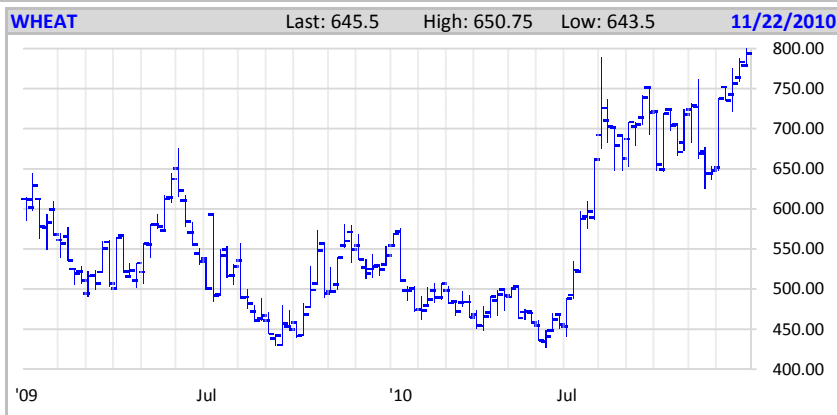
CORN NEARBY CONTINUATION

Concerns that dry weather in Argentina will impact production has pushed corn from \$5.50 to over \$6.24 in December, overshadowing a string of bearish export figures related to China. In this latter regard, it seems that a larger Chinese crop and more comfortable stockpiles have reduced expectations for stepped-up Chinese export demand. Moreover, the Chinese are continuing to sell corn into the domestic market in an attempt to quell inflation. The next major market catalyst will be the January 12th USDA report which will project estimates on final corn and soybean production for the 2010 crop. The trade will also be looking to see if the USDA increases ethanol demand for 2011, as many traders believe the current numbers are too low. Technically, the corn charts look very solid, with prices in breakout territory now that we have cleared the \$6.00 mark. Next resistance at \$6.40, but above that, things look fairly wide opened.



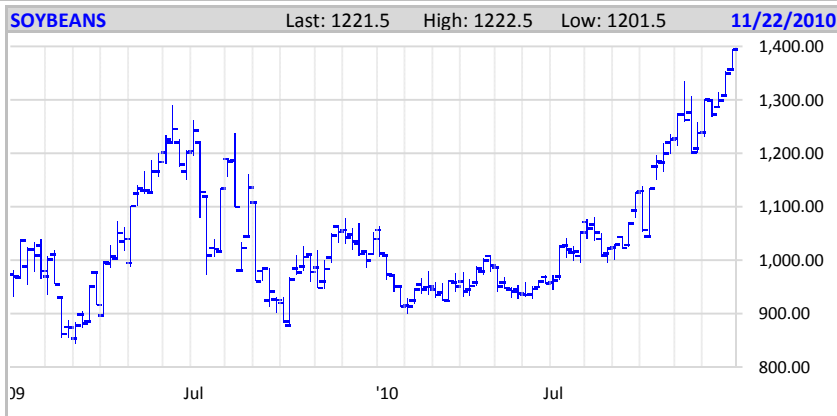
WHEAT NEARBY CONTINUATION

Wheat moved higher along with the other grains this past month, taking out \$7.50 resistance, and moving up to just under \$8.00. Strong U.S. export demand, weather issues in Australia, rumors of potentially large buying from Turkey, and concerns over short supplies of milling wheat, were the main upside drivers in December. Australian crop issues are particularly prominent, as forecasters have lowered estimates for the wheat crop to 24.4mmt from 25.5mmt. Although this seems to be a modest revision, markets remain concerned that much of the crop will be of low quality. This suggests that we could see continued strong export demand for U.S. hard red winter wheat in the months ahead. On the bearish side, wet weather in the U.S. has lowered the risk of damage to the winter wheat crop, but concern about conditions elsewhere will likely keep the complex well bid. Technically, a break above \$8.50 could prove to be extremely constructive, as charts will look quite wide opened after that point.



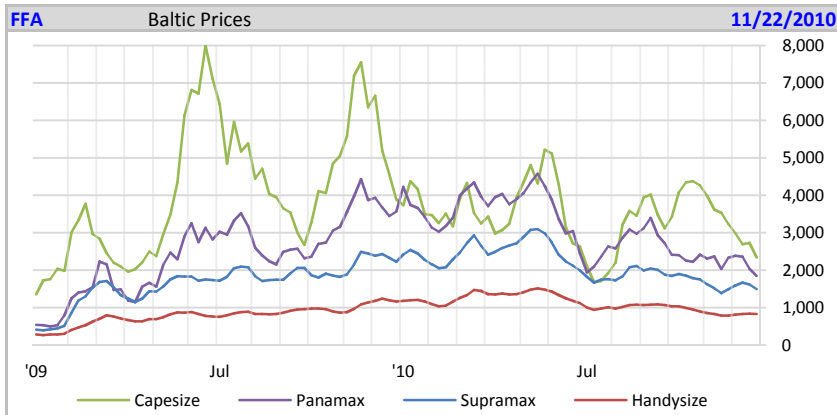
SOYBEANS NEARBY CONTINUATION

Soybeans registered impressive gains in December, taking out the recent \$13.60 high, and finishing at just under \$14, the highest level in more than two-years. Once again, weather concerns are front and center, with South America being a particular problem area. Key growing regions in Argentina have seen only a quarter of their normal rainfall, while excessive moisture in central and northern Brazil have increased the risk of soybean rust. Other bullish news out of the US includes the revival of the \$1 per gallon tax credit for biodiesel subsidies until the end of 2011. On the bearish side, the Chinese government continues to release soybean stocks to curb food inflation, but other than that, we do not see much that will impede the price rise short of a constructive turn in the weather. Charts look very solid, and suggest an eventual move to at least \$15.70, especially now that we are in breakout territory.



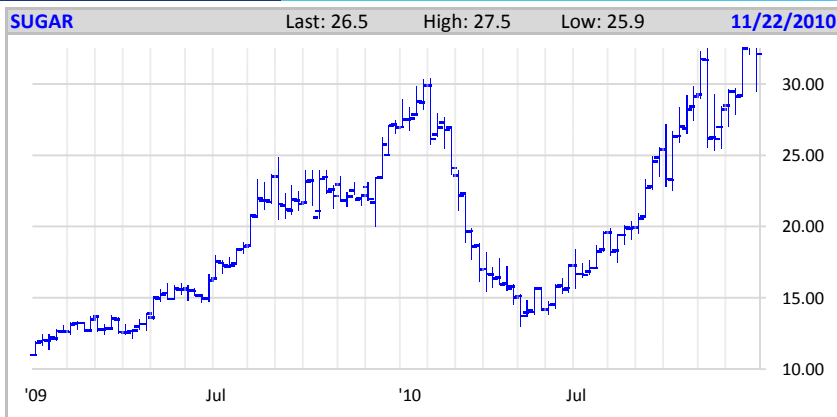
FFA

As our chart alongside shows, major freight indices continue to languish, with the Baltic Exchange's sea freight index hitting a five-month low last week. Given the bubbling commodity markets, this disconnect is quite surprising, and suggests that any demand-side pull on freight prices is being more than offset by increasing vessel supply. Supply-side pressures are particularly apparent for capesize and panamax vessels given weather-related disruptions in the Far East that have hit these categories hard. To wit, Australia declared force majeure last quarter on coal shipments due to torrential flooding, while iron ore cargo activity has been hampered by restrictions on exports from India. We should also remember that ships ordered during the boom years in 2007-2008 are presumably are, or have been, delivered between 2010 and 2012, so vessel supply is likely to weigh on the markets for some time. We do not expect to see much change over the first quarter of 2011, as prices are likely to bump along the bottom for a little while longer.



SUGAR NEARBY CONTINUATION

Sugar staged a strong rally in December, briefly taking out the November highs, and peaking at over 34c/lb. Major bullish factors included the ISO cutting its 2010-11 global sugar surplus estimate to 1.3mmt from the November estimate of 2mmt, Australian production projections being lowered for 2011 due to flooding, and concerns that India could limit export sales in order to quell food inflation, now running at about 12.1% year-over-year. Traders are also concerned that the onset of the Brazilian rainy season will lead to a tight supply situation going into the spring. On the demand side, China is seen as a lurking buyer given a local production deficit of some 2mmt. Despite all this, the market experienced a sharp 10% correction on the last trading day of 2010, an example of how bullish variables inevitably get discounted at some point. Although prices have recovered somewhat, the latest correction has done its share of chart damage, and so we could see a period of consolidation now set in.



COCOA NEARBY CONTINUATION

We completely misread the Ivorian political election at this time last month, thinking that the process was going to end rather peacefully. Instead, a protracted dispute has unfolded, with the current incumbent refusing to accept the outcome, triggering a sharp 10% advance in prices during the first week of December. A call for a general strike from the opposition has also led to concerns over future supplies, as have calls for outside military intervention. So far, the political chaos has only caused minor delays on the ground, as the cocoa crop seems to be moving to the ports unencumbered, and in line with last year. Furthermore, growing conditions throughout Western Africa remain ideal. As a result, prices have come off their earlier highs, but given that the Ivory Coast remains a pivotal producer, we likely will see protracted declines remaining somewhat in check at least until the market gets more visibility on the still-murky political front.



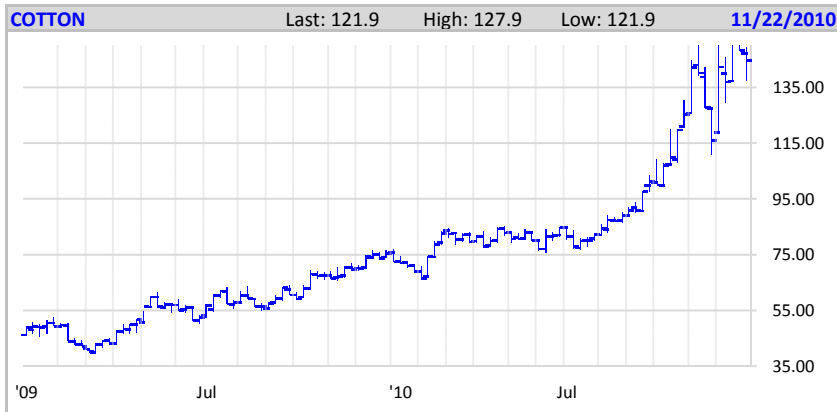
COFFEE NEARBY CONTINUATION

Coffee prices rallied to a new bull market high in December, and have spent the better part of last week consolidating around the \$2.4050 level. The market sparked higher on continued weather concerns for next season's Brazilian and Colombian crops. On the bearish side, harvest issues in Vietnam have been remedied, so supply from that country is expected to flow out normally in the weeks ahead. However, this will not be sufficient to displace the growing concern about the South American crop, and so until these fears are put to rest, we could push even higher. Technically, charts look wide opened, and at this point, it is hard to say where the current rally will take us, but having said that, we are clearly very overbought short-term, with an RSI reading of close to 80.



COTTON NEARBY CONTINUATION

Cotton was the best-performing CRC commodity, up a whopping 92% on the year. Export demand has been strong, with cumulative sales at 90.9% of the USDA forecast versus a 5-year average of 55.1%. Surprisingly, USDA has made no upward adjustments to exports in the last two reports, and seems to be assuming that recent price gains will eventually dent export demand. If it does not, we could see the USDA's 1.9mb ending stock projection get even tighter. Other bullish news over the course of December, includes the USDA lowering U.S. production for 2010, severe Australian flooding, and reports of lower-than-anticipated Indian production for next year. However these concerns have been arguably discounted, while the market has yet to seriously focus on Brazilian plantings that are expected to be up some 40% this year. Technically, the recent retest of the highs has not been that solid, with open interest falling, while fund length seems to be stalling. In addition, the short-term uptrend line seems to have been taken out, so barring any further supply-side shocks, we could work somewhat lower from here over the next several weeks.



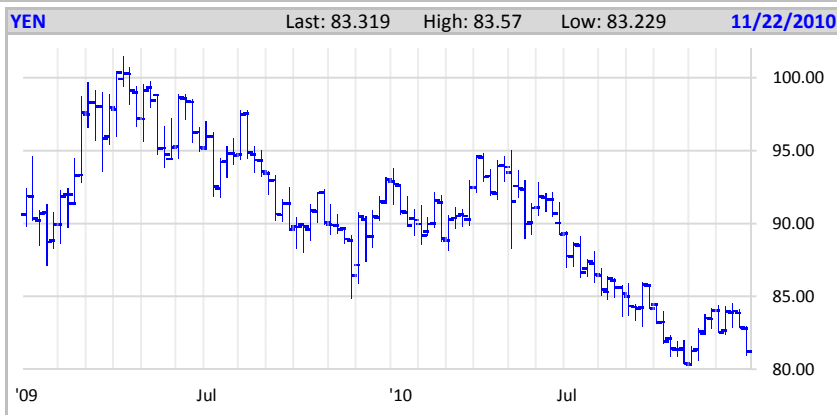
EURO

Things seem to have stabilized for the euro in December after November's sharp selloff, but the currency still had its worst yearly performance against the dollar since 2005 (down 6.9%). More importantly, the fate of the Euro will bedevil the markets well into 2011, as it is entirely possible that other weak links in the chain, namely Portugal, Italy, and Spain, may either individually, or collectively, all need bailouts at some point in the year. Also weighing on the currency, are increasing signs that growth in the US is picking up steam, and this likely could lead to the bond market anticipating a somewhat more tighter monetary policy from the Fed later in 2011. As a result of these variables, we are looking for the Euro to drift down to \$1.25-\$1.27 at some point next year, as US growth picks up, while the periodic funding/bailout issues test the shaky resolve of the European authorities. On the upside, there is a chance of the Euro retesting its 2010 high of \$1.42, but a sustained move above that point looks unlikely in our view.



YEN

The Japanese yen soared during December, erasing practically all its November losses, and now stands at a seven-week high of around 81. The currency picked up steam once it became apparent that the North Koreans decided not to escalate tensions with the South, deciding instead to stand down. The yen also seems to be tracking the Chinese Yuan higher, as markets seem to be figuring that one consequence of the yuan's government-approved appreciation means that Chinese importers retain their competitive pricing power vs. the yen. Charts suggests that a test of the 79.75 mark -- the April 1995 high -- could be the next logical upside target, but we are not sure if the yen will appreciate meaningfully beyond that point given lingering questions about Japanese growth prospects. In addition, the government is very concerned about letting the currency appreciate too much lest it throttles exports altogether, and in this regard, has not ruled out another unilateral intervention in order to blind-side the shorts.



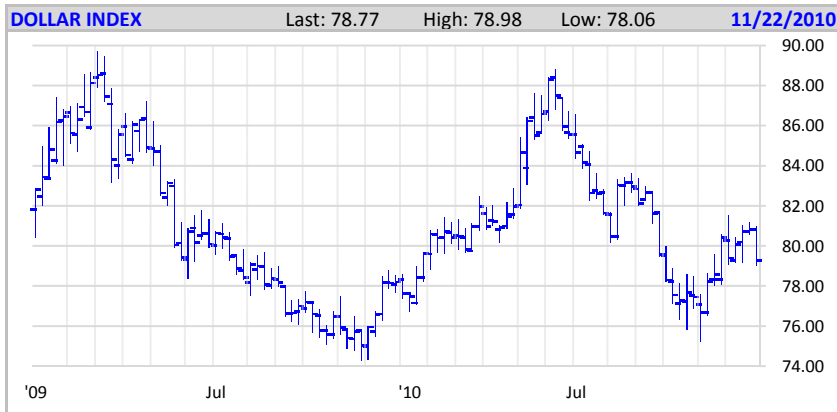
STERLING

Sterling has not done much in December, gaining ground early in the month, but losing it during the second half to end the period practically unchanged. For the year as a whole, the currency was off about 4.1% vs. the dollar. Looking into 2011, government programs to cut spending and increase taxes are now well underway, and do not seem to be getting derailed by either violent protests or fractured political coalitions. The government will also be unable to do much on the interest rate front that could impact the currency. Rates need to remain high enough to stave off inflation, (now running at a six-month high), but not move so high that they would boost the currency, choking off exports in the process. As the government continues to navigate a middle ground, sterling will likely maintain a relatively sideways range as well, with support at \$1.53 and resistance at \$1.63, unchanged from the range identified in last month's report.



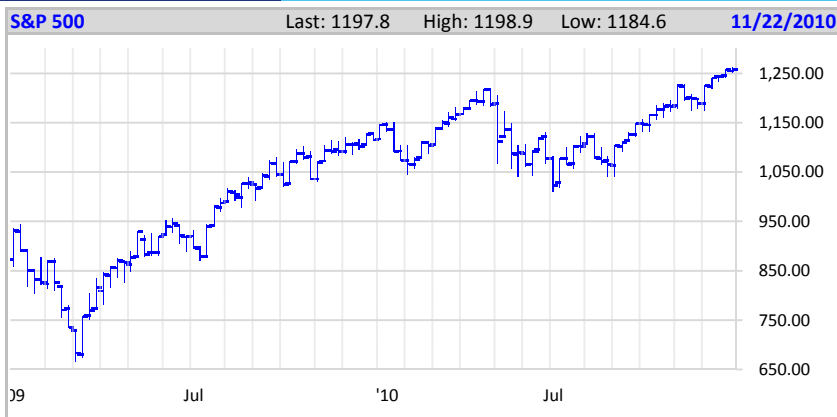
DOLLAR INDEX

The dollar index tried to break out above 81 several times over the course of December, but failed to take this level out. Although the currency has an uninspiring fundamental backdrop, we suspect the greenback could surprise to the upside in 2011. In addition to its safe-haven status that will result in periodic spikes, (such as what we recently saw in the wake of the Korean crisis), the dollar should also benefit from a US recovery that looks like it is gaining steam. The key macro driver in this regard is employment, and leaving aside the disappointing November nonfarm payroll number, most other labor indicators seem to be pointing to a strong December employment rebound. More broadly, although overall GDP growth will likely be modest next year, (likely around 3%), things should improve enough to prompt the currency markets to start discounting the possibility that the Fed could move off its easier stance some time by the second half. We see support for dollar index at 77.5, with resistance at 83.5, and this should hold for the next two to three months.



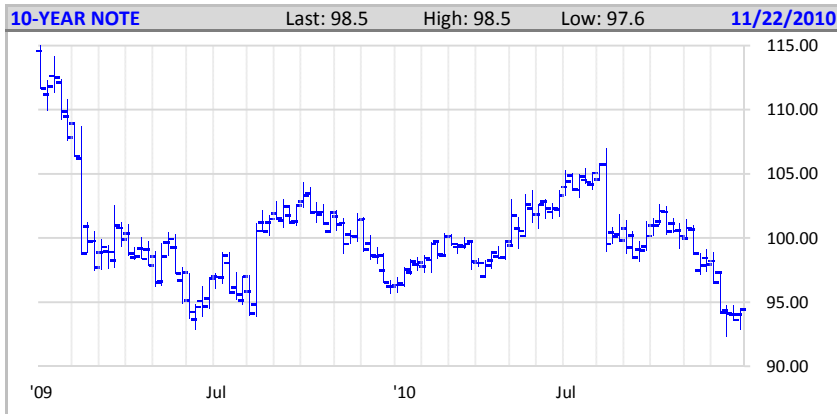
S&P 500

The S&P 500 had its best December in some 19 years, as well as very solid 2010 (up some 135), and we are off to a promising start in 2011 as well. Several factors should help stocks in 2011. For one thing, fourth-quarter earnings will get underway imminently, with another strong year-over-year quarter expected. In addition, money flows going into equity funds accelerated during the fourth quarter, and should continue, as money leaves overstretched bond funds. Third, despite the stronger tone we have been seeing in US macro data in recent weeks, the Fed is expected to keep monetary conditions loose, at least for the first half of the year. Finally, cash on corporate balance sheets remains high, meaning that stock buybacks and acquisitions will be strong for a second year running. If there are any negatives out there, it is the fact that there is a great deal of bullish complacency, coupled with the fact that we have yet to see any meaningful correction set in over the past two months.



10-YEAR NOTE

Treasury note prices continued to deteriorate over the course of December, although the rate of decline moderated somewhat during the second half of the month. Prices have been falling ever since the Fed's QE2 announcement was made in early in November, while the Obama-Republican tax accord did not help matters much either, since the general view holds that the deficit will likely increase by another \$900 billion over the course of the next two years. Against such a backdrop, the rush out of bond funds has been brisk, with money leaving the sector in six of the past seven weeks, the biggest outflow since 2008. Bond investors are also likely discounting the stronger tone we are seeing in US macro readings as well, meaning that many may not wait for the Fed to signal a tighter monetary stance before taking matters into their own hands, and moving into shorter maturities. Current 10-year yields are around 3.3%, and despite the efforts of the Fed, we would not be surprised to see yields push towards the 4.25% mark by the April/May time window.



Source for charts: Bloomberg

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