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COMMENT

November 8, 2002

Received CFTC
Records Section
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Ms Jean Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre, 1155 21st, NW
Washington, DC 20581

RE: CME LIVE CATTLE SPECULATIVE LIMIT AMENDMENT

Ms Webb:

The purpose of this letter is to support the recent reduction in speculative spot month trading limits from 600 contracts to 300 contracts effective with the 2002 December live cattle contract as proposed by the Chicago Mercantile Exchange. Such prompt action by the CME is not unprecedented.

Initially, one must be reminded that the development and very existence of agricultural futures contracts is to allow producers a mechanism to shift price risk and to price their production at periods other than seasonal maturity. Speculators do play a necessary and vital role. However, just as producers will limit their use of futures contracts, so too will speculators limit their use if the futures price action fails to appropriately reflect the cash price of the underlying contract. In this concern, the previous expansion of spot month speculative position limits has been a disservice to both hedgers and most speculators.

Basis variability has increased substantially since the advent of increased spot month speculative trading limits in 1998. During the period from January 1999-October 2002, the basis difference from monthly average high to monthly average low averaged \$5.44/cwt. This compares to \$3.54/cwt average variation in the four years preceding 1999. This constitutes an increase in basis variability of 54% following the increase of spot month speculative trading limits. The decreased ability to reliably forecast an expected basis discourages both long and short hedgers from market participation, thus limiting growth of total open interest. The associated risk premium inherent with a weakened and increasingly unpredictable basis structure increases the cost to all producers that comprise the beef industry.

During the period from 1993-2002 (the last ten years), the weakest monthly average basis was recorded six times for any given month since the advent of increased spot month speculative trading limits. This same analysis shows that on three additional occasions the second weakest monthly average basis ever recorded in the 1993-2002 period occurred since the initiation of increased spot month speculative trading limits. In summary, in the last four years of the ten year observation period 50% of the weakest monthly average basis values were recorded. A weak cash/futures price relationship encourages over feeding, adding to existing production, which eventually exerts a downward bias on both cash and futures prices. This year, the increase in average carcass weights will add an additional 750 million pounds to expected beef production. By itself, this additional production from increased carcass weights will lower the annual average fed cattle price this year by approximately \$3.37/cwt. or \$40.54 per head. Additionally, by encouraging overfeeding, a weakening basis trend serves to undermine the delivery weight specifications of the existing contract thereby further limiting the available supply of deliverable type cattle. This enhances the potential for market manipulation during the delivery period limiting and delaying any price convergence. A weak basis is no friend to either the hedger or the speculator, who traditionally is a long trader.

Some individuals have cited the recent October Live Cattle deliveries and subsequent price advance to promote the merits of expanded spot month speculative trading limits. An examination of cash price action since 1999, the first full year of expanded spot month trading limits, provides no such evidence of overall merit. In contrast, weekly cash price analysis comparing the first week of the spot delivery contract to the final full week of cash trade, results in an average price <u>decline</u> of \$.79/cwt. or \$9.51 per head. This analysis is inclusive of the cash price action during the recent delivery period for the 2002 October Live Cattle futures contract. To summarize, while expanded spot month delivery positions may serve to benefit one or several individual speculators, there is no evidence the majority of hedgers or speculators benefit from expanded spot month speculative trading limits.

I would also urge the prompt consideration of the following additional adjustments be made to the live cattle futures contract at the earliest possible time.

1. Increase and expand the weight specifications allowable for delivery to reflect current genetics toward larger carcass size.
2. Expand the delivery period five to seven business days into the month preceding the spot cattle futures contract.
3. Allow heifers to be delivered with appropriate specifications applied.
4. Remove existing bottlenecks within the delivery process.

As a twenty-seven year user of commodity futures and as a broker/analyst representing both hedger and speculator interests, I vigorously urge your <u>support</u> of the CME proposal to reduce spot month speculative trading limits effective with the 2002 December Live Cattle contract. Given the aforementioned reasons, I believe any other conclusion is without merit. Supporting documentation and research for this opinion is available at your request.

Sincerely,

Andrew A. Gottschalk

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