LETTERS TO THE EDITOR: The big risks of future miscues

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By Alan Rohrbach
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From Mr Alan Rohrbach.

Sir, It is both disconcerting and just plain annoying that seasoned financial market commentators often assert that forward futures prices tell us something about what the future holds ("Getting used to oil at $50", March 11). Knowledgeable participants know that forward futures contracts are nothing more than the clearing house for bull and bear opinions willing to back their view with margin payments. As such, those prices can and do change markedly as the real conditions unfold.

If forward futures were indeed a reliable forecast, the crude oil price would now be at $24 per barrel, where the April 2005 contract was trading in April 2003. In another fairly recent blatant misperception that illustrates this point, in early 2002 the December 2003 Eurodollar (fixed income) future indicated that the Fed would raise rates back up to the 5.5 per cent level (from the then current 1.75 per cent). While this may have seemed reasonable in light of the significant equity market recovery from the post-September 11 debacle, actual economic conditions caused the Fed to cut to 1 per cent instead.

Similar examples abound. I do not disagree with the position that high crude oil prices will most likely continue. Yet that has little to do with forward futures prices being a reliable projection. A useful hedging tool? At times. A bona fide prediction? No way.

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