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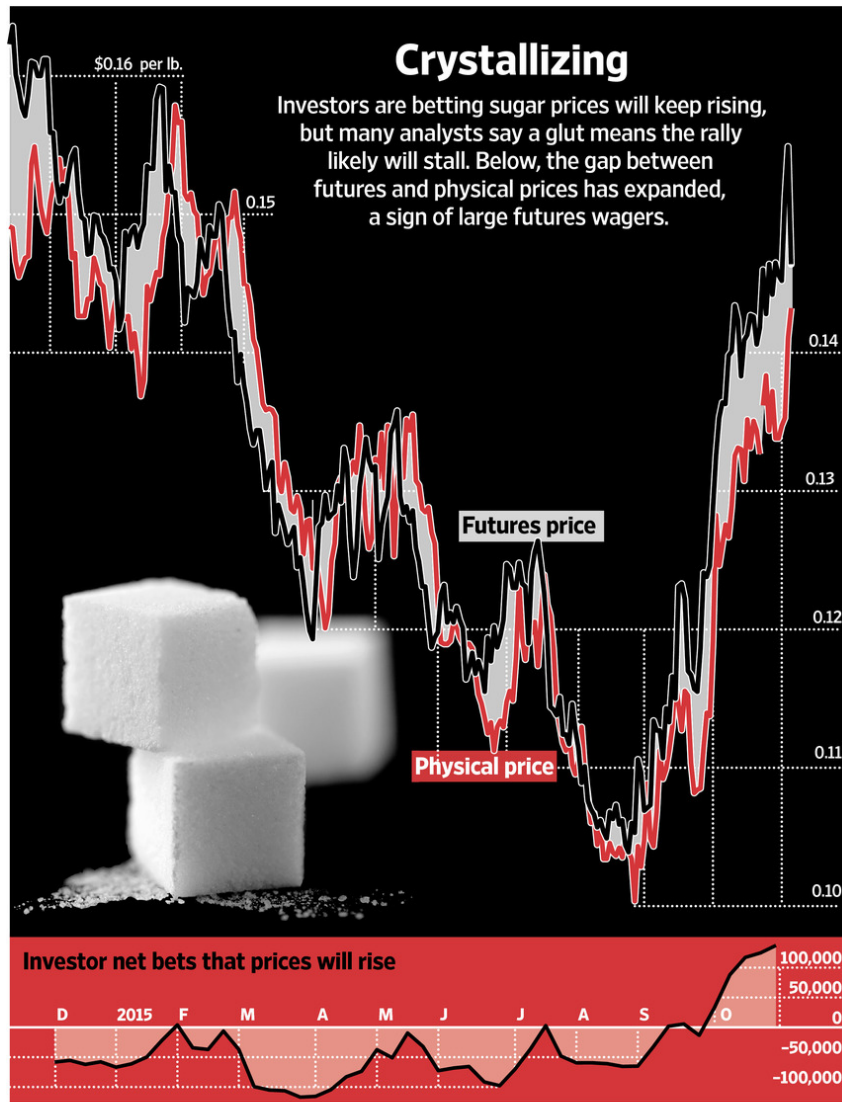
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## MARKETS

# Hedge Funds Load Up on Sugar

Some see signs that futures prices are too high, compared to physical market



Sources: Intercontinental Exchange (futures); Platts Kingsman (sugar price); U.S. Commodity Futures Trading Commission (hedge fund bets)  
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 THE WALL STREET JOURNAL.

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Suddenly, investors again see opportunity in sugar.

Raw-sugar futures prices are up 39% since Aug. 24, the market's largest gain since 2011 and a rare increase amid a deepening commodity bust. Futures-trading volume set a record in September, and bullish bets by money managers this month hit a two-year high, according to Commodity Futures Trading Commission data.

Investment firms Tudor Investment Corp. and D.E. Shaw & Co. are among hedge funds plying the sugar trade, after Wall Street largely gave this \$18 billion market up for dead during a yearslong price decline.

The gains are being driven in part by improving sugar-market fundamentals. This year is shaping up as the first in five in which annual production falls below world-wide use, helping to shrink a sugar glut that in August pushed prices to seven-year lows. Aiding the swing: an uptick in emerging-market economic data that has helped drive modest recoveries in the currencies of major producers Brazil and India against the dollar.

But the price swings are also a testament to investors' tendency at a time of easy money and low investment returns to crowd into markets deemed to provide an opportunity for profitable trading. Futures prices rose as much as 12% above those for real-world transactions in the physical sugar market early last week, according to Platts—a sign of froth in the market that suggests futures prices are too high, some traders said.

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“There has been a complete disconnect from the physical market,” said David Martin, managing member of \$75 million hedge fund Martin Fund Management, an active trader in the market who thinks the rally has been overdone.

The moves have already caught the attention of Intercontinental Exchange Inc. which increased margin requirements on sugar futures by 19.5% on Thursday, to raise the cost of making leveraged bets with borrowed money. The gains are already beginning to reverse, with the market dropping 9.7% from its recent peak on Wednesday. Sugar futures closed down 3.3% Monday at 13.99 cents a pound on ICE.

“We’re seeing a new array” of traders entering the sugar market, lured by its growing size and heightened volatility, said Jeff Dobrydney, vice president at Jenkins Sugar Group, a sugar broker in Norwalk, Conn. Investors “are taking advantage of a market that’s actually moving.”

Sugar began to garner attention from traders early this year, as declines in Brazil's currency, the real, sent sugar prices down. Since Brazil accounts for more than 40% of raw sugar for export, a decline in the real tends to prompt producers to boost output, pushing prices down.

Some macro hedge funds, which place trades based on macroeconomic trends, seized on the situation and began selling sugar as a cheaper way to bet against the real, which is expensive to borrow with Brazilian interest rates near 15%, brokers said.

Financial speculators set a record in bearish bets against the market in March, CFTC data show.

The Brazilian currency has since recouped some losses, triggering massive short covering among traders, with some turning around to bet on gains.

At Briarwood Capital Management, a \$30 million New York-based hedge fund, "sugar has been a moneymaker for us," said Fred Schutzman, the firm's chief executive.

Briarwood was short sugar earlier this year but turned to bet on higher sugar prices on Sept. 22 when its trading models showed a buying signal.

There are fundamental reasons to be bullish.

The International Sugar Organization forecast that the sugar market would have the first "statistical deficit" this year, with current production falling short of demand by 3.5 million tons. The London-based sugar-industry group didn't see a shortage of sugar around the world thanks to stockpiles built up from a four-year oversupply since 2011.

"We have seen the longest bear market in sugar for quite some time," said Michael McDougall, director of commodities for Société Générale in New York. "It's like a large ship that takes a lot to turn. But it looks like it's finally beginning to turn."

Sugar mills in Brazil are directing more cane production to ethanol for fuel blending, thanks to government incentives that make prices more attractive compared with sugar.

After a weak domestic crop season, import demand from China has been strong, jumping 55% to 3.75 million tons in the first nine months of the year.

Singapore-based trading house Wilmar International Ltd. took physical delivery of \$1

billion worth of sugar through the financial market so far this year, fanning speculation about increased Asian appetite for the sweetener.

But in a sign that gives some investors pause, sugar producers and processors are placing the largest bets in two years that prices will fall.

“Demand is just not there,” said Bruno Lima, head of sugar and ethanol at brokerage INTL FCStone in Brazil, who found raw sugar offered at a deep discount to the futures prices traded in New York during a recent tour of mills in Santos.

Globally, sugar stocks sat at 85.4 million tons at the end of September, up from 83.2 million a year earlier. The amount left over would be enough to feed the entire world’s sugar demand for six months, according to the ISO.

Briarwood’s Mr. Schutzman said his firm is ready to exit from the trade.

“Right now, our models tell us the odds for sugar prices to rise further are low,” he said.

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