Illuminating Data

Commitments of Traders report can disclose promise, perils in the markets

BY STEPHEN E. BRIESE • Around the turn of the century, used-cow salesmen often displayed their livestock after sunset, to ply trade from customers who had become too sophisticated for the pig-in-a-poke ploy. Thus came the adage from a contemporary stock trader that "anybody who plays the market without inside information is like a man buying cows in the moonlight." Inside information is a little harder to come by (legally) today. However, Uncle Sam provides a surprisingly candid biweekly insiders' tally on the New York and Chicago futures markets, called the Commitments of Traders report.

Peter Spacek for Barron's

This report, from the Commodity Futures Trading Commission (CFTC), details purchases and sales of futures contracts. *Barron's* summarizes these figures for 14 major markets (see page 94 of the Market Week section).

The largest traders in each market are required to disclose their positions to the agency on a daily basis and are separated into two groups: "commercial hedgers," firms that operate a cash business in the underlying commodity, and "large traders" (a.k.a. large speculators), primarily commodity and hedge funds.

The reports also show the positions of "small traders," which aren't required to report and whose holdings can be calculated by subtracting the total of contracts held by the reporting groups from all the contracts outstanding. A small trader can be a speculator or a hedger.

The position size that triggers a reporting requirement varies by market. For instance, for Comex gold, it's 200 contracts (20,000 troy ounces); for the S&P 500 index, 300 contracts; for T-bond futures, 500.

Savvy traders use the commitments report to predict important trends, not only in futures prices but also in related primary markets. Bond traders look for signs of imminent changes in the interest-rate environment, and mutual-fund managers use the data to anticipate shifts in the fortunes of stock sectors.

Example: The report issued on Jan. 21 showed that large commercial hedgers had sold an unusually large number of 30-day Treasury-bill futures during the preceding two weeks. In fact, they held 16,545 more short than long contracts when the report was tabulated on Tuesday, Jan. 18. This represented their lowest net position (long contracts minus short contracts) in more than two years. Obviously, the "commercials" had suddenly changed their outlook on short-term rates. This was a clear sell signal to perceptive readers of the report, which was released just five days before the market topped and interest rates spiked.

Example 2: Last year, silver was a hot stock-market sector, as well as one of the brightest commodities. Gold and silver mining shares rallied smartly from a mid-January low of 93 and never looked back. The commitments report published on Jan. 22, 1993, showed that commercial purchasers had pushed their net position to an 18-month high in gold and a three-month high in silver. A second buy signal was apparent in the March 7 report (delayed one week by the World Trade Center bombing), as commercials were aggressive purchasers of both gold and silver contracts. The silver net position reached a 15-month high. Gold and silver futures on the Commodity Exchange bottomed on March 10. Later in the year, unprecedented commercial hedger selling preceded the Aug. 4 market peak. Subsequent rebuying triggered buy signals at the reaction low in August '93 as commercials paid up to re-establish their position. The recent market top was tipped off when record commercial selling (and a new net short record in silver) was noted in the April 1 report.

Not surprisingly, large commercial hedgers have proven to be consistent indicators of important trend changes. (You don't think they invented this game and invited us to play just to lose money, do you? If so, I've got this cow you should see ... after the evening T-bond session.)

Commercials hold a significant informational edge over other traders in terms of fundamental supply-and-demand statistics. (In fact, much of what passes for fundamental news originates from these big trading houses.)

In addition, the heavy hitters aren't subject to the position limits imposed on speculators. When they begin betting in the same direction, their massive trades alone can move markets.

The commitments report can be followed much like SEC insider-transactions numbers to spot special situations. The net positions for commercials can be plotted over time, by subtracting the total short contracts from the total longs to arrive at the net position. Whether commercials are net long or net short isn't relevant in itself. Net position patterns vary from market to market. What is important is to compare current net positions to historical levels.

Commercials are typically value buyers. When their net buying is near its historical top, it's a tip-off that they think bargains are available. When their net position reaches its lower historical boundary, it usually means that they think tulip-mania has gripped a market.

If you followed only one market using these data, the S&P 500 would be a good choice. Commercial hedgers in stock indexes are primarily institutions that use futures as a hedge against their stock inventory or commitments. They have shown an uncanny knack for spotting opportunities in the S&P. Historically, a bearish signal has been generated whenever commercials held more short than long contracts; this is one market in which being net short *is* relevant. This rare phenomenon was in evidence in August 1987, February and August 1989 and January 1992. Any time commercial buying resulted in holdings of 25,000 more long than short contracts, it was time to buy. On the other hand, the bearish report published at the June top in 1990 shouted that it was time to sell.

In sum, the Commitments of Traders report can provide important insights. Analyzing it can be like turning on a light to reveal the sickly cattle . . . or the prize steers. ■

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