

Tracking the big foot

The CFTC's *Commitments of Traders* reports can give you inside information on what the big boys are up to in any market...and it's all legal.

By Steve Brieze

The U.S. government has been quietly providing genuine insider information on a regular basis in the *Commitments of Traders* (COT) report for over two decades, but it is just now becoming common subject matter among market watchers.

And with good reason. Reliability studies conducted by the *Bullish Review* across 36 futures markets from 1983 to 1989 show that extremely long or short positions by commercial hedgers correctly forecasted significant market moves 67% of the time. (For a look at what the COT report is and how to get it, see "A week in the life," below.)

That commercials have shown an uncanny ability to position heavily just before important market turns is only logical. As large cash merchants in the business, commercials maintain their own intelligence-gathering networks and analysts. In fact, in some markets — such as coffee, cocoa and sugar — commer-

cial trade houses are the primary source of fundamental supply and demand statistics available to the trading public. Assuming the statistics are accurately reported, you can be sure they already have been acted on in the market before the data is disseminated to the public. The COT report detects these actual market manipulations.

Besides a decided informational advantage, large commercials by definition trade in sizes large enough to move markets. Given these advantages, their futures trading prowess is not surprising.

Positioning with commercial hedgers — when they become one-sided in their market view — has proved far more profitable than either riding the coattails of large speculators or fading small traders. Large specs were reliable only 46%

of the time, small traders only 45%, in predicting significant market moves in the *Bullish Review* study.

Even so, some market books recommend following the large speculators under the theory that they must be pretty good traders to get that large. While that may have been true 10 years ago, the individual large trader of yesterday has been displaced by commodity funds in the modern data. The growth of these funds can be attributed more to a knack for fund-raising than trading.

Others advise fading small traders to follow the market adage that the public is always wrong. This has not been a successful approach — probably because the COT's "small trader" category includes small commercial hedgers.

Other COT analysts have cen-

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A week in the life

The COT report published by the Commodity Futures Trading Commission (CFTC) breaks down the open interest in futures markets by trader type, providing an insider's survey unavailable anywhere else.

The CFTC has established reporting levels — not to be confused with position limits — for each of the futures markets (see "Living large," at right). Traders holding positions in

Sample from a typical *Commitments of Traders* report

HDR3140100001000107941530 IMM S&P 500 STK INDX 01/04/94

REPORTABLE POSITIONS						TOTAL		NONREPORTABLE POSITIONS	
NON-COMMERCIAL			COMMERCIAL			LONG	SHORT	LONG	SHORT
LONG	SHORT	SPREADING	LONG	SHORT					

(S&P 500 INDEX X \$500.00)

COMMITMENTS

5,824	22,228	1,217	136,901	122,906	143,942	146,351	39,696	37,387
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CHANGES FROM 12/28/93 (CHANGE IN OPEN INTEREST: -1,592)

-26	3,500	350	-3,518	-4,415	-3,194	-565	1,602	-1,027
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PERCENT OF OPEN INTEREST FOR EACH CATEGORY OF TRADERS

3.2	12.1	0.7	74.5	66.9	78.4	79.7	21.6	20.3
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NUMBER OF TRADERS IN EACH CATEGORY (TOTAL TRADERS: 165)

10	24	3	92	77	105	101		
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OPEN INTEREST: 183,636

Source: CFTC

excess of reporting levels must report their actual positions to the CFTC on a daily basis, forming the basis of the COT report. (A sample from the report is shown above.)

The CFTC separates large traders into Commercial and Non-commercial categories. Commercial hedgers are required to qualify with the CFTC

by showing a related cash business for which futures are used as a hedge; they are persuaded to register through lower margin requirements and exemption from position limits.

The Non-commercial category is comprised of large speculators, most notably commodity funds. The balance of the open interest is carried

tered their studies on divergences from seasonal average positions. However, my work has shown there is no statistically reliable seasonality present in the data, even for agricultural markets where one would suspect hedging is a seasonal consideration.

Analyzing net positions So what approach works best when analyzing COT data? Although each report contains many statistics, of primary concern to futures traders are the actual positions (boldfaced in the sample shown in "A week in the life") and the changes from the prior report shown directly below. Some analysts work directly from the raw numbers, but the data is most easily analyzed when graphed as net positions opposite a price chart.

To derive the net position for each trader category, simply subtract the short contracts from the long. A positive result indicates a net long position (more long than short contracts) and a negative difference denotes a net short position (more shorts than longs).

Whether a particular trader group is net long or short is not important to the analysis — net positions relative to historic levels are. For example, commercial traders provided key buy signals with unusually large purchases of both gold and silver contracts at the major bottom last March. Commercially held a net long position in gold (+30,584 contracts) but were net short in silver (-27,657 contracts). Yet both were bullish indications.

How can this be? Each futures market is made up of a unique mix-

ture of traders. In silver, large hedgers are primarily producers who hedge against price declines by selling forward in the futures market. As a result, commercials have never been net long in silver.

In gold, however, the commercial mix is more heavily weighted with fabricators who buy long contracts as a hedge against future inventory needs and rising prices. In aggregate, commercials are as often net long as net short in gold. Therefore a simple net position is meaningless; it is imperative to compare the current net position with recent historical levels in the respective market.

A glimpse at a financial and an agricultural market illustrates a better analysis technique. On the chart "Live hogs," above, important market bottoms at points A, B and C were accompanied by commercial buying that moved the commercial net position to above +2,500 contracts. In other words, commercials held 2,500 more long than short contracts ■◆◆

under the Nonreportable classification that includes both small commercial hedgers and speculators.

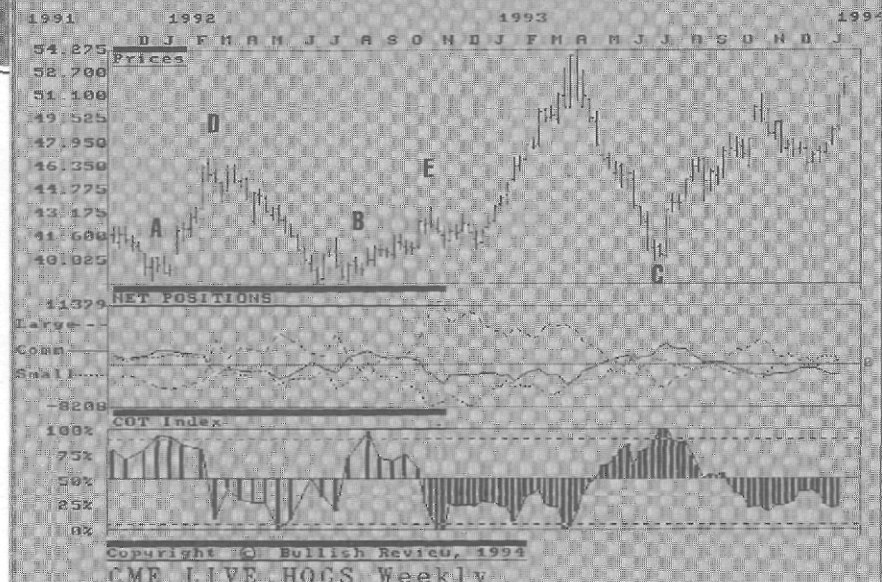
Although it has been published since the 1970s (after being abandoned for the year 1982, the COT data was released on a monthly basis from 1983 to November 1990 and twice monthly until October 1992, when the current bi-weekly reporting schedule was adopted), most traders have ignored the COT report, thinking of it as "old news." Not any longer, as the CFTC has taken steps to increase the frequency and speed of reporting.

The COT report is calculated after the market close each Tuesday. Due

to auditing restraints, two weekly reports are issued on alternate Fridays. Because the report is issued electronically, reported trader positions for the most recent week are three days old.

The report is no longer available by mail subscription, and modem collection from the CFTC is prohibitively expensive, but most of the commodity news wires retransmit the data soon after it is released.

A number of other vendors provide reasonably priced updates by fax, modem or mail and also offer historical data, which is critical for interpreting the data (see "Commitments of Traders data sources," page 40).



Source: The Bullish Review

Living large

CFTC large trader reporting levels
As of Dec. 2, 1992

COMMODITY	QUANTITY
Wheat*	500,000
Corn*	750,000
Soybeans*	500,000
Oats*	300,000
Cotton +	5,000
Soybean oil	175
Soybean meal	175
Live cattle	100
Feeder cattle	50
Hogs	50
Sugar #11	300
Sugar #14	100
Cocoa	50
Coffee	50
Copper	100
Gold	200
Silver bullion	150
Platinum	50
#2 Heating oil	175
Crude oil, sweet	300
Unleaded gasoline	150
Long-term U.S. T-bonds	500
GNMA	100
3-month. (13 week) T-bills	150
Long-term U.S. T-notes	500
Medium-term U.S. T-notes	300
Short-term U.S. T-notes	200
3-month Eurodollar time deposit rates	.850
30-day interest rates	100
1-month LIBOR rates	100
Foreign currencies	200
U.S. dollar index	50
S&P 500 stock price index	300
NYSE composite index	50
AMEX major market IDX-MAXI	100
Nikkei stock index	50
Municipal bonds	100
Value line average index	50
Natural gas	50
All other commodities	25

*in bushels +in bales

The CFTC monitors markets weekly to detect any cornering type activity — a la Hunt — that might impinge on a free and open marketplace. Reporting levels are adjusted to provide at least 10 large traders.

Source: CFTC

Trading Techniques

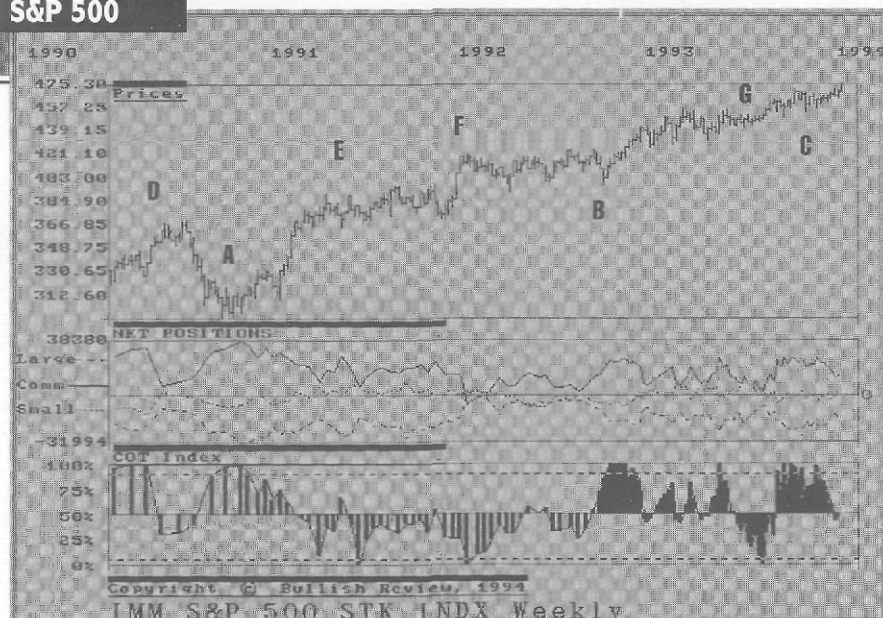
at important lows. At points D and E, commercial selling moved net positions below -2,500 contracts, causing a market drop. (The net positions — long minus short contracts — are graphed below the price chart. They revolve around the zero line at which point long contract holdings are equal to short contracts.)

Pork complex The increased timeliness of the COT report has been especially helpful in the pork complex, which is noted for "V" bottoms and tops; the June low at point C is an example.

The COT report issued June 25 showed commercials had increased their net long position to +3,335 contracts on June 22, an increase of 1,838 contracts in just two weeks. The data was published just three days ahead of an important U.S. Department of Agriculture Hogs & Pigs Report, and live hog prices had been ranging sideways for two weeks as traders awaited the report.

Yet the COT figures were a clear tipoff that commercials were betting heavily on a bullish response to the Hogs & Pigs Report. Traders who positioned long with commercials ahead of the hogs report were rewarded with a limit-up move the day after the report's release and an exciting 3-1/2 month rally. A confirming bullish picture in the pork belly market made the June low a special situation, but only large commercial hedgers were aware of it — unless you were watching their maneuverings through the COT data.

The relative bullishness of the commercial net position is easier to see when shown as an oscillator: The COT Index (plotted underneath net positions in "Live hogs" and the chart "S&P 500," above).



Source: The Bullish Review

The COT Index compares the latest commercial net position to a historical range of net positions using the following formula:

$$100 \times \frac{\text{Current Net} - \text{Minimum Net}}{\text{Maximum Net} - \text{Minimum Net}}$$

where:

Current Net = commercial long position - short position

Minimum Net = lowest net position over the period

Maximum Net = highest net position over the period

(The period can vary between 1.5 to 4 years, depending on the market. Too short a period generates constant signals, too long produces none.)

The scale is 0-100%, zero representing the most bearish net position over the period and 100 the most bullish. We are primarily interested in markets that reach the extremes of the range: Above 90% indicates a one-sided bullish commercial bias, below 5% conveys consensus bearishness.

Moving to financial markets, commercials — generally referred to as

institutional traders including banks, mutual funds and dealers — have proven as astute as their agricultural counterparts in positioning for important market turns. When commercials have held 25,000 more long than short S&P 500 contracts (see chart above), a buying opportunity was signaled (points A, B and C on the chart). Sell signals were generated when the net position dropped below +7,500 contracts (points D, E, F and G).

Point G is of particular interest. The market consolidated in a sideways pattern for most of 1993. In August, as the trading range narrowed, commercials bet heavily on a downside price breakout by selling futures. The breakout was to the upside and commercials quickly reversed positions, buying into the rally — the only COT signal failure on record for the S&P 500.

Of course, you can't discuss stock market indicators without highlighting the October 1987 crash. How did commercials fare? They provided a clear-cut sell signal by moving to a rare net short position on the Aug. 30, 1987, COT report, and held that position through the crash.

Legendary trader Daniel Drew is credited with the adage "Anybody who plays the market without inside information is like a man buying cows in the moonlight." Large commercial hedging firms enjoy an enormous inside informational advantage over other market participants. The COT report levels the playing field by exposing the players behind the trades. Indeed, trading without reference to it might well be likened to "buying cows in the moonlight."

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Commitments of Traders data sources

Source	Phone number	Historical data	Bi-weekly updates
CFTC through Martin Marietta	(301) 306-8000	Not available	Modem \$900 per year minimum billing
Commodity Trend Service	(407) 694-0960	1986 to present Diskette: \$100	Fax or mail \$75 per year
Genesis Data Services	(800) 808-3282	1983 to present Diskette: \$139	Modem \$195 per year
Leidahl Communications	(612) 493-2501	Not available	*Ag markets only Fax or mail \$120 per year
Pinnacle Data Corp.	(716) 872-0845	1986 to present Diskette: \$99	Mailed diskette \$216 per year

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