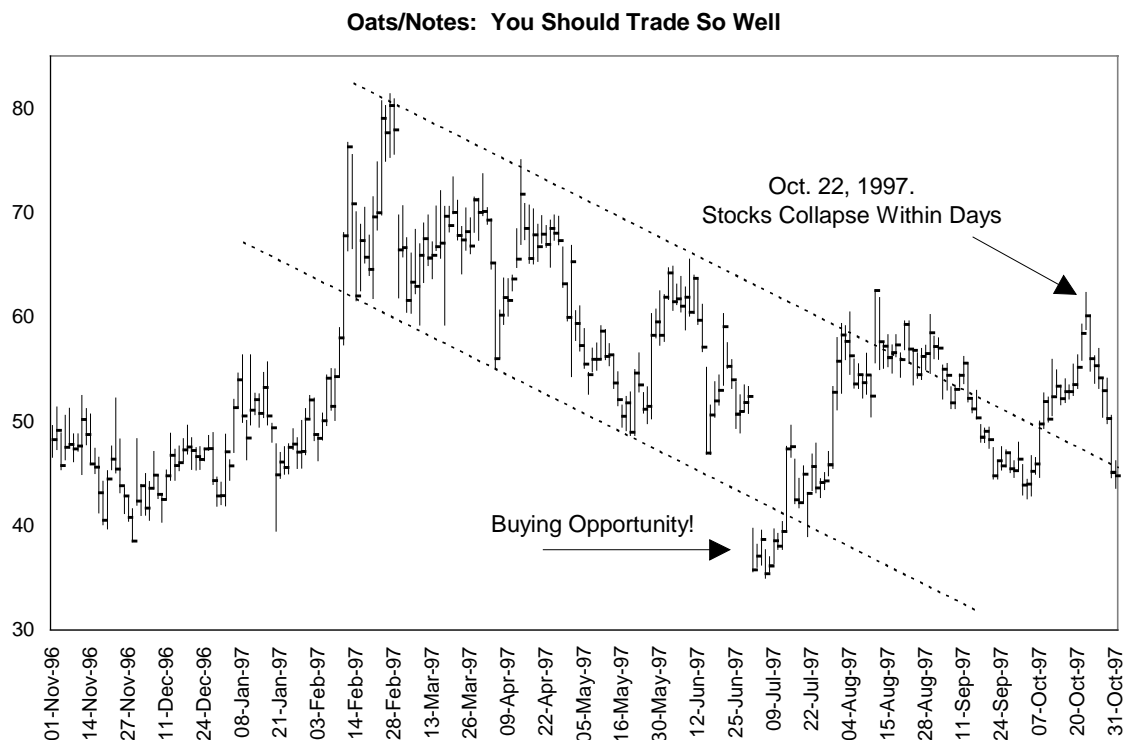


Hedgers Don't Wear Chains

Once upon a time, your correspondent was busy trading palladium for reasons then surely apparent. For what purpose, the executing broker inquired, was palladium used, who else traded it, and most importantly, what did palladium look like? The answers were simple: palladium is used for catalysts and in gold dental work, it is traded almost exclusively by commercial hedgers, and unlike other precious metals worn as jewelry, few people really knew what it looked like since hedgers don't wear chains.

Yet it is often the smaller, less-liquid contracts avoided by large speculators that contain the most useful little nuggets of information. This space last year was devoted to the history of the Oats/Notes spread (see "A Modest Proposal", *Futures*, January 1997). Some may have thought the information in this piece to be of no value, but a cursory examination of this remarkable series (just subtract the spot Ten-Year Notes contract from the spot Oats contract. And, yes, this is actual data) in the year since should silence the skeptics for once and for all.



The Oats/Notes spread continues its remarkable record: it reached a spike top on Wednesday, October 22. The speculative attack on the Hong Kong dollar and stock market began that very night. No other indicator called the impending 554-point drop in the Dow (just a minor boo-boo, according to the NYSE) on Monday, October 27, so well. Armed with Oats/Notes, anyone can be the next Elaine Garzarelli, if that's what they choose.

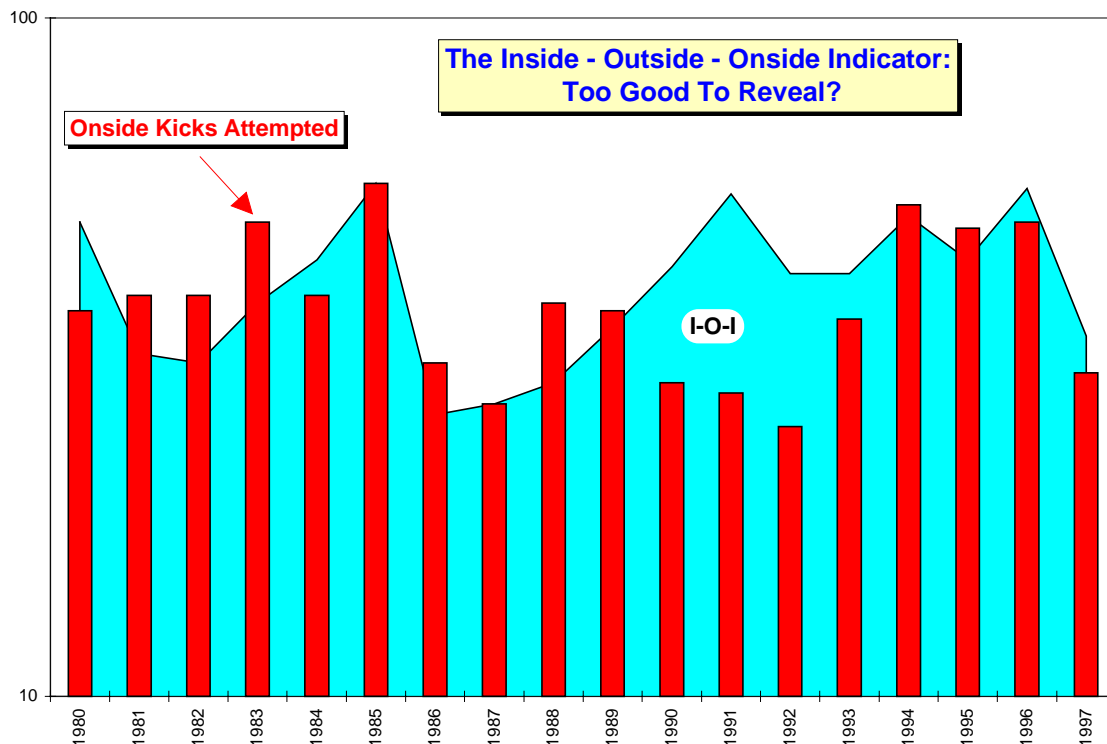
Oats is not the only agricultural contract to exhibit near-magical properties. Take soybean oil, the miracle substance behind mayonnaise. Long overshadowed by its peripatetic progenitor, the soybean (Why don't we have futures contracts on other legumes? All we are saying, is give peas a chance), beanoil is the solution to two problems forever vexing market technicians: what is the real meaning behind "inside" days and "outside" days, (an inside day has a lower high and higher low than its predecessor, while an outside day has both a higher high and a lower low) and if the famous Super Bowl indicator has worked so well, (if a team from the old National Football League

wins the Super Bowl, the Dow Jones Industrial Average will have an up year) are there any other links between football and the markets?

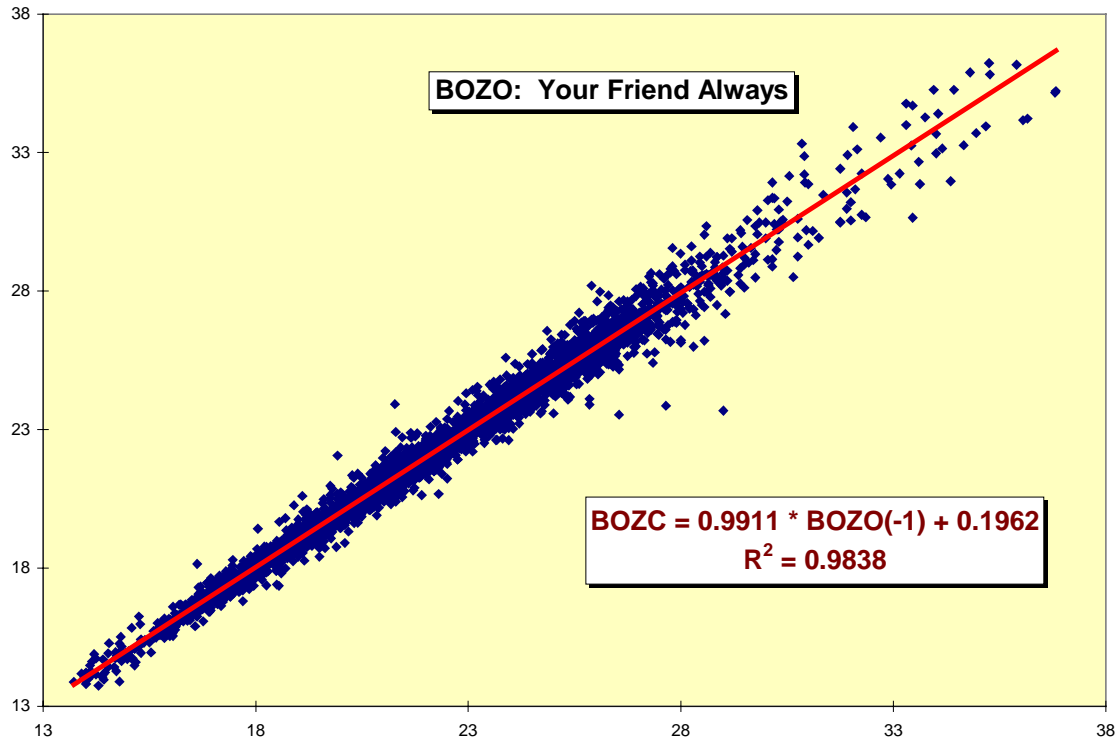
We are proud to introduce the Inside-Outside-Outside Indicator:

$$\ln(\text{OnsideKicks}_{t0}) = f(\ln[\text{Inside}_{t-1} + \text{Outside}_{t-1} + 2 * (\text{InsideOutside}_{t-1} + \text{OutsideInside}_{t-1})])$$

Construction of the indicator is really quite simple. All you need to do is examine the previous year's December beanoil contract between the beginning of January and the start of the football season for the number of inside days and outside days. If either an inside day is followed by an outside day, or an outside day is followed by an inside day, its value is doubled. The logarithm of this sum is an excellent predictor of the logarithm of the number of onside kicks (yes, this data is real; it was provided by the Elias Sports Bureau through the offices of the National Football League) that will be attempted during the current year's football season. The record of this model speaks for itself: the only period of underperformance by this model was 1990-1993, the four-year period when the Buffalo Bills won the AFC title.



The Inside-Outside-Outside indicator makes use of the highs and lows of December beanoil. Is there useful forecasting information in the open (BOZO on most screens) and closes (BOZC) as well? Absolutely. A simple model of the December beanoil markets going back to 1982 shows that today's beanoil opening accounts for 98.38% of the variance in tomorrow's beanoil close. By contrast, today's close will account for 99.07% of the variance in tomorrow's close, and that is after a complete day's trading information.



Many market analysts and technical trading systems designers have expressed frustration over their diminishing returns on effort: Have years of unimaginable computing resources, massive databases, PhD's in physics, assorted financial alchemists and their sponsors, and all of the latest and greatest mathematical techniques arrayed before us in all of their bewildering complexity brought us any closer to understanding the greatest of all cosmic truths – Thou Shalt Buy Low and Sell High? Why the answer is “no” should give us all some food for thought as we enter 1998.