Take Commitment Of Traders Data Lightly

Joni Mitchell looked at clouds from both sides, from up and down, and still somehow found it was clouds' illusions she recalled. Would she have been surprised I felt the same way about the weekly Commitment of Traders Data published by the Commodity Futures Trading Commission (motto: If we finish the rules, then what will we do all day?)?

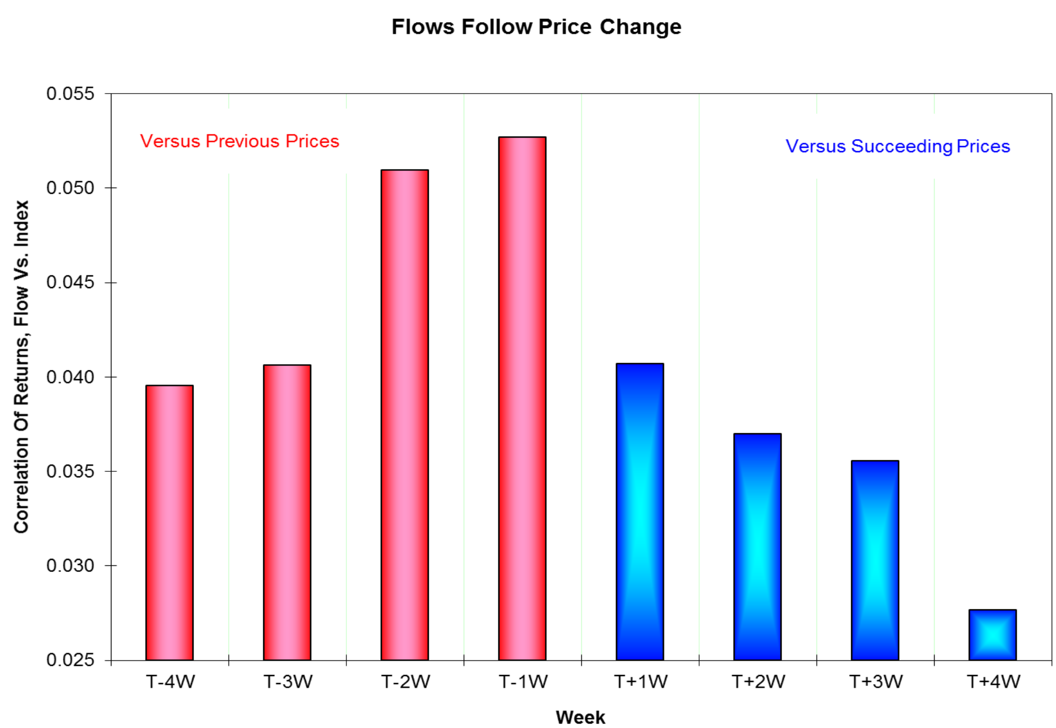
The basic premise can be understood while holding a lit match, depending on how long the match is and your individual tolerance for pain. First, as price is a convergent search process for economic value; this means prices must lag their fundamental market drivers. Second, as most commodity traders are trend-followers in one guise or another, they have to wait for prices to change sufficiently to generate a trading signal. Third, the trend is your friend except for the bend at the end; this means both prices and net speculator positions will overshoot their market-clearing value unless…that underlying economic value shifts over time as both buyers and sellers react to price signals.

The vaunted efficient market hypothesis is silent on the flow of new information into a market. As a result, an apparent price extreme can become even more extreme and the associated net speculative position can do likewise. Let's conclude this little preamble by saying for every anecdotal case of a position extreme leading to a price reversal, there are many more cases where the market keeps chugging along just as it should.

Index-Level Case Study

The net non-commercial positions for the seventeen American-traded components of the Continuous Commodity index (CCI) and the weekly geometric average of that index were used to construct a weekly money-flow series.

This was correlated against CCI price returns over the previous four, three, two and one weeks. All data have been adjusted to account for the gap between the Tuesday reporting period and the Friday release of the Commitments of Traders report. A correlelogram for these flows' weekly returns against CCI price returns over the next one, two, three and four weeks can be constructed. While the causal relationship is not strong, its relative direction is clear: CCI prices determine money-flows by non-commercial traders, not vice-versa.



The sum of these seventeen net non-commercial positions leads the weekly geometric average of the CCI index by seven weeks on average. This implies changes in net trader position have no immediate effect or plausible short-term effect, but rather an almost two month-ahead effect. The r-squared, or percentage of variance explained, of this relationship is 0.79.

Few experienced traders have witnessed this delayed reaction between net non-commercial positions and price and for good reason: The proposition net non-commercial positions lead price remains non-demonstrable. Anyone who wishes to trade commodity futures with a seven-week leading indicator and endure the swings in position equity is welcome to do so.