The *Commitment of Traders Report* and its usefulness

By Matthew Turner, Commodity Analyst, VM Group

"Speculative fever grips the gold and silver markets" has become a ubiquitous headline, but keeping track of what speculators are doing would be far more difficult than it already is without the weekly Commitment of Traders Report of the Commodities' Futures Trading Commission (CFTC). For decades, this has helped analysts to make some sense of trading dynamics on the Comex futures markets, by splitting the participants up by their reason for trading futures.

As of September this year, the CFTC has enhanced the report to further refine these categories. In theory, this should give us a greater understanding of the market – but does it really?

The Comex division of the Nymex futures exchange remains the most liquid and widely used exchange for trading gold and silver futures. The exchange provides daily information on the amount of futures contracts outstanding, their strike price and date of maturity. This is useful as far as it goes, but as all futures contracts have two sides – a long and short – it tells us little about whether speculators are long or short. This is where the Commitment of Traders (CoT) report is useful because, as of the close of business each Tuesday (although the report itself is released on Friday), it records the long and short positions of three categories of market-user: commercials, non-commercials and non-reportables. Traditionally, as the commercials are seen as entities using the market for hedging business risks (the CFTC describes them as "engaged in business activities hedged by the use of the futures or option markets"), the non-commercials are assumed to represent speculative interest. Most analysts also add in the positions of the 'non-reportables', (which are simply contracts held by users that did not meet the minimum reporting size), as small users of futures markets are more likely to be speculators than hedgers. In gold and perhaps silver this is almost certainly the case, but it is not necessarily so for all commodities. As these entities hold different amounts of long and short positions, one can see whether speculators are collectively net long (own more long contracts than short contracts), and follow the changes on a weekly basis.

The reform of the CoT report has come about because of political concern - largely inspired from within the US - as to the role speculators may have played in pushing up the prices of some agricommodities and energy products, and whether the report was accurately measuring them. So the reform, in a way, has nothing to do with gold or silver; it's more of an attempt to foster greater transparency in those futures markets that are of daily concern to US legislators - crude oil and agricommodities - because last year's soaring prices in the market have attracted the most voter anger.

In particular, it has been argued that the CoT report was understating investment by not accurately recording a relatively new and large user of futures markets, the commodity index funds. This, it is alleged, is because although some commodity index fund buying will be done directly, and so show up in the non-commercial category, much of it is done by swap dealers, who typically are categorised as 'commercials', as they are 'hedging' their exposure to investment funds. So, the theory runs, not only might the report underestimate investment, but if the net long of commercials is rising then, by definition, the net long of non-commercials, what we have called 'speculators', will be falling, which could give a misleading picture of investment trends.

The new report aims to fix this by splitting the two original categories, commercial and non-commercial, into two further segments, making four new categories; commercials thus become the snappily titled "Producer/ Merchant/ Processor/ User" and crucially "swap dealer" categories, while non-commercials become "managed money" and "other reportables". The non-reportables remain the same. The CFTC explains the new categories thus:

Producer/Merchant/Processor/User: A "Producer/Merchant/Processor/User" is an entity that predominantly engages in the production, processing, packing or handling of a physical commodity and uses the futures markets to manage or hedge risks associated with those activities.

Swap Dealer: A "swap dealer" is an entity that deals primarily in swaps for a commodity and uses the futures markets to manage or hedge the risk associated with those swaps transactions. The swap dealer's counter-parties may be speculative traders, like hedge funds, or traditional commercial clients that are managing risk arising from their dealings in the physical commodity.

Money Manager: A "money manager," for the purpose of this report, is a registered commodity-trading advisor (CTA); a registered commodity pool operator (CPO); or an unregistered fund identified by CFTC. These traders are engaged in managing and conducting organised futures' trading on behalf of clients.

Other Reportables: This comprises every other reportable trader that is not placed into one of the other three categories.

The following tables show how the new report compares to the old report for gold and silver as of 29 September, the date of the latest release at time of writing. It is important to remember that the categories 'commercial' and 'non-commercial' are only being disaggregated – they still contain the same number of contracts, and hence the same longs and shorts as before.

So, taking gold, we begin with open interest – the total number of outstanding contracts on Comex – which was 454,585 contracts.[1] As futures have a long and short side, this means that there were also 454,585 longs, which in the old report were split into a non-commercial long of 252,994 contracts, non-commercial spreading (which is where an entity has both long and short contracts) of 49,564 contracts, a commercial long of 84,923 contracts and finally 43,848 of non-reportables. The new report splits the non-commercial long and the non-commercial

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spreading into two further categories, making four in all – 198,175 contracts of managed money longs, 31,419 managed money spreading, 54,819 other reportable longs and 18,145 'other reportable' spreading. Note that the longs and the spreading contracts still each total the same as in the old report, and therefore collectively they equal the total of the old non-commercial category. This means the residual 'non-reportable' long category also remains the same, at 43,848 contracts.

The disaggregation follows a similar pattern for the commercial category, with longs of 84,923 contracts, but there is a slight difference. Whereas, before, there was no spreading category for commercials and there still isn't one for the Producer/Merchant/ Processor/User category (because the spreading category measures the extent of arbitrage trading in the futures markets, and an arbitrage using the futures markets is not a commercial activity), there is one for the other new category, the swap dealer. Thus the commercial long is split into three categories: Producer/Merchant/Processor/User long of 40,629 contracts, a swap dealer long of 34,250 contracts, and a swap dealer spreading of 10,044 contracts. This new spreading category, which by definition has a counterpart on the short side, means that the old report overstated the longs and shorts of the commercial category, although not the net position.

For the short side, exactly the same analysis applies as for the longs, with the same disaggregated categories.

The net position, which is the longs minus the shorts, by definition has no spreading category, as these cancel out, and therefore, it is rather simpler – clearly showing how the two reportable categories in the earlier report are now split into two new categories, with the non-reportables the same.

So have we learnt anything new? On the non-commercial side, not a lot. Where we had non-commercial, we now have 'managed money' and 'other reportables'. Of those, managed money is clearly useful, being obvious speculation/investment demand. Across all 22 commodities in the new report, gold and silver have the highest 'managed money' long, at 44% and 33% of open interest respectively, which intuitively seems right. But of course all of this was previously in the non-commercial category, and as we don't see any reason not to continue adding the category 'other reportables', to get total investment/speculative demand, we in fact still have the non-commercial category as before. In other words, the disaggregation isn't very illuminating – and is unlikely to become so unless as we get more data both in the past (the CFTC has promised to release two years' back data imminently at the time of writing) and, in the future, showing that the two categories reveal very different trends.

But reform of the non-commercial category wasn't the real point of the new report. Instead, it was concern that speculative investment in commodities was being 'hidden' in the commercial category via swap dealers' hedging of index fund investment. The new report separates out swap dealers from those entities that are hedging more obviously commercial activity. Interpreting this category for gold and silver is tricky, as rather than showing a huge undiscovered investment position, in both gold and silver, the swap dealers are net short. In gold, this net short was 92,287 lots as of 29 September (made up of longs, including spreading of 44,294 contracts, and shorts, including spreading of 136,581 contracts), equal to 20% of open interest. For silver, the effect is less pronounced but still there – swap dealers were net short by 2,241 contracts (with longs and spreading of 19,594 contracts offset by shorts and spreading of 21,835 contracts) as of 29 September, about 2% of open interest.

This doesn't tally with what we know about index fund investment in gold and silver, which is that both are substantially net long. The CFTC's Quarterly Investment Report estimates that, at the end of June 2009 (the nearest available date), index fund exposure in gold was 113,000 contracts long and 40,000 contracts short, while in silver it was 38,000 contracts long to 11,000 contracts short. While not all of these will translate into actual futures contracts held on Comex (traders will net off positions held both long and short before using the futures market) we believe most will be.[2]

The CFTC gives two reasons why the net

Open Interest – 454,585

Long – 454,585

OLD	NC long 252,994	NC spreading 49,564			C long 84,923			NR long 67,104
NEW	MM long 198,175	MM spreading 31,419	Other long 54,819	Other spreading 18,145	Producer/merchant long 40,629	Swap dealer long 34,250	Swap dealer spreading 10,044	NR long 67,104

Short – 454,585

OLD	NC short 21,608	NC spreading 49,564			C short 360,157			NR short 23,256
NEW	MM short 3,726	MM spreading 31,419	Other long 54,819	Other spreading 18,145	Producer/merchant short 223,576	Swap dealer short 126,537	Swap dealer spreading 10,044	NR short 23,256

Net – 0

OLD	NC net long 231,386	NC spreading 0			C net long (275,234)			NR net long 43,848
NEW	MM net long 194,449	MM spreading 0	Other net long 36,937	Other spreading 0	Producer/merchant long (182,947)	Swap dealer net long (92,287)	Swap dealer net spreading 0	43,848 67,104

swap dealer position might not match the index position:[3] a) swap dealers also hedge risks that are not index-fund related (which would mean the swap positions being higher than the expected index positions); and b) there are index fund investors who directly buy futures rather than use swap dealers, and so are in the managed money category (which would mean the swap dealer positions being lower than the expected index position). For gold, and to a lesser extent silver, for the longs it seems (b) must be particularly important.

We can use these figures to say what is the maximum amount of investment in both metals that might be hidden in the swap dealer category. For gold as of 29 September there were swap dealer longs of 44,294 contracts, of which 10,044 were spreading, so also short. It is possible that all 44,294 longs were hedging long index fund positions (although swap dealers clearly have other risks that they hedge), which as 10,044 of those were spreading contracts would also imply in that category were 10,044 index short contracts,[4] meaning a net long index position of about 34,000 contracts. If this was the case, then to fully count investment in gold on Comex we could add to our non-commercial net long of 231,386 contracts and our non-reportable net long of 43,848 contracts another 34,000 more net longs for index investment that were hidden in the commercial category. For silver, doing the same calculations, i.e. assuming the entire swap dealer longs are index investment, we could add another 18,000 longs to the non-commercial net long of 47,410 contracts and non-reportable net long of 16,696 contracts. Neither of these two additions is huge, and not something that invalidates using the non-commercial category to gauge investment trends, but they do represent an eighth more gold investment and 28% more silver investment than we would estimate from looking at the non-commercial and non-reportable categories alone.

There is another consequence, if our numbers are correct. If net 34,000 index fund long contracts in gold and 18,000 contracts in silver are hidden in the swap category, this still means that (using the data from the Quarterly Investment Report as a guide) 39,000 net long index fund contracts in gold, and 9,000 net long index fund contracts in silver are in the non-commercial category (and probably in the managed money sub-section). In many ways, these investments are different to 'traditional' speculation, being less volatile and less directly linked to the specific fortunes of gold and silver (rather than commodity and investment trends as a whole). It's hard to be certain about the numbers, but if the non-commercial net long ever falls below something like 34,000 contracts in gold or 9,000 contracts in silver, be aware that the non-index speculative investor might already be net short. ■

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[1] This is the futures-only report – there is also a futures and options report. Normally the wider report is better, but as index funds typically invest in futures only, we will use that report in this article.

[2] Comparison of the 12 agricommodites where the CFTC publishes a weekly index fund report to the Quarterly Investment Report suggests that there are fewer longs and shorts held on the exchanges than notionally would be needed but the net (long/short) position is much the same.

[3] Although for the 12 agricommodities where the CFTC publishes index fund data on a weekly basis the two categories do normally match up reasonably well.

[4] It is possible, because the CFTC classifies entities not trades, that of the swap dealers' 34,250 spreading contracts all 34,250 held long were hedging index fund exposure, but none of the 34,250 held short were not. But it is rather unlikely.

	Open Interest – 128,695							
	Long – 128,695							
OLD	NC long	NC spreading			C long			NR long
	54,966	19,057			26,732			27,940
NEW	MM long	MM spreading	Other long	Other spreading	Producer/merchant long	Swap dealer long	Swap dealer spreading	NR long
	42,374	11,894	12,592	7,163	7,138	17,874	1,720	27,940
	Short – 128,695							
OLD	NC short	NC spreading			C short			NR short
	7,556	19,057			90,838			11,244
NEW	MM short	MM spreading	Other short	Other spreading	Producer/merchant short	Swap dealer short	Swap dealer spreading	NR short
	2,840	11,894	4,716	7,163	69,003	20,115	1,720	11,244
	Net – 0							
OLD	NC net long	NC spreading			C net long			NR net long
	47,410	0	0	0	(64,106)	0	0	16,696
NEW	MM net long	MM spreading	Other net long	Other spreading	Producer/merchant net long	Swap dealer net long	Swap dealer spreading	
	39,534	0	7,876	0	(61,865)	(2,241)	0	16,696