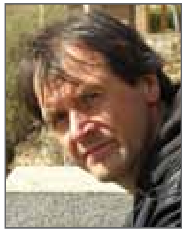


Mike Kock
Mike Kock has been a technical analyst and trader for more than 20 years. He uses quantitive trading methods for commodity, interest rate and currency markets. He is a specialist in the evaluation and application of the Commitments of Traders (CoT)-Report. In 2008 he published "25 Märkte – 100 Chancen", an elementary book about commodities and trading.

Commitment of Traders Report

ON THE TRAIL OF INSIDERS

Those who are seriously concerned with analysing all kinds of markets and the trading done there, sooner or later will encounter the terms "insiders", "smart money", or "speculators". These terms have been around ever since stock markets opened in the US and there have been books galore since then reporting on the successful investment strategies used by such traders. But who is behind these terms? Is it possible to derive any real benefit from them as a private trader if you are familiar with them yourself? Is it really such a smart move to go against the funds, the banks, and all the pros and if so, when does this make sense? This article will give you a clear answer to that. It is based on a report which has been published by a US government agency since the eighties: the CoT (Commitment of Traders) Report. Designed to protect investors, it really serves as a roadmap for being consistently profitable in the stock markets if you can implement and read it properly. How this works, how to evaluate the report properly, and how to implement it successfully using a simple trading system, can be learnt on the following pages.

INTRODUCTION

The traditional CoT Report has existed since 1983. The figures included in it are published by the Commodity Futures Trading Commission (CFTC) in the US based, in Washington. Founded in 1975, the CFTC is an independent US government agency regulating futures and options markets in the United States. It is primarily mandate is to protect trading partners from market manipulation, fraud, and abusive trading practices. To achieve this objective, you first need to know who is active in the markets and what goals they pursue, which is what the CoT Report does. CoT stands for Commitments of Traders. Originally the report categorises investors into two main groups – the Commercials and the Non-Commercials – as well as a third classification, that of Nonreportable Positions.

THE COMMERCIALS

Commercials are not active on the futures markets primarily to make a profit from their activity. Their main interest is in protecting their actual source of profit, which is the production or sale of goods and commodities. About 90 per cent of all the activities engaged in by this group only serve hedging purposes and are not designed to achieve speculative profits.

There are always exceptions, of course. For example, Glencore is often active on the stock markets as a pure speculator. Glencore is one of the largest commodity traders in the world, based in Baar, Switzerland. This company has more than 2000 employees and owns 170 transport ships worldwide. Approximately ten per cent of its staff work in what is called commodity trading. The year 2010 showed that not only were commodities for customers bought there but also speculative profits were sought in specific market situations.

In the summer of that year, Glencore was busy on the futures markets betting on rising prices of wheat and maize. There was a severe drought in Russia and there were many forest fires. According to the Financial Times, the company demanded at the same time that the Russian government impose an export ban on grains. Once that ban was in place, prices exploded enabling Glencore to benefit from all that considerably.

As a rule, though, the Commercials are more interested in protecting their production rather than in speculating. However, to the extent that these companies are getting ever bigger and are controlling more and more of certain commodities, it is safe to assume that this kind of "manipulation" will occur more often in the future.

The Commercials have two advantages – a great deal of capital and their own research staff right there on the plantations, in the fields, in cattle sheds, or in the mines. For example, not only does Glencore have a stake in agriculture, mining and the petroleum industry, but it also holds strong positions on the consumer side, as in the transport sector, for instance. This network is tantamount to pure unadulterated insider knowledge!

Finally, Glencore's response to the article in the Financial Times was as follows: "Glencore's agricultural team early on received word from Russian farms of dramatic planting conditions when the drought began in Russia in the spring and summer of 2010. This enabled Glencore to conclude long contracts on wheat and maize in proprietary trading."

While the profit achieved may well be regarded as speculative gains, it may also compensate for losses suffered as a result of higher purchase prices. It just depends on the eye of the beholder.

The Commercials are the insiders of the markets – at an early stage they recognise situations that are dangerous to their own actual business and respond to that by immediately taking protective measures!

NON-COMMERCIALS

These are the true speculators. Their interest is clearly in speculative profits. For example, this group includes hedge funds and foreign brokers. This group will only make money if it can make profits on the stock markets. No matter which time window is considered here, it always boils down to a trend-following strategy. The more capital needs to be managed, the harder it becomes to operate "invisibly" on the

T1) THE COMMERCIALS COMPRISE TWO GROUPS

Producers	Consumers
Agriculture	Large Food Companies
Mining	Transport Sector
Petroleum Industry	Construction Industry
Banks	Jewellery Manufacturers
	Financial Sector

T2) OLD VS. NEW COT REPORT

Old CoT Report	New CoT Report	Traders in Financial Futures
Commercials	Producer/Merchant/Processor/User	Dealer Intermediary
	Swap Dealer	Asset Manager
Non-Commercials	Managed Money	Leveraged Funds
	Other reportable Positions	Other Reportable
Nonreportable Positions	Nonreportable Positions	Nonreportable Positions

markets. Consequently, we meet these trend followers predominantly in the most liquid markets such as, for example crude oil, sugar or maize. For us, it is important to know that without this group there cannot be any stable and long term trends in the markets. While only fundamental imbalances in the commodity markets can be indicated by the Commercials at an early stage, the actual price reaction originates from the group of Non-Commercials. There is also a third group, the group of Non-reportable Positions.

NONREPORTABLE POSITIONS

These are the private investors. Their position size is usually too small to be reported, which explains the above term. Surprisingly, this group almost exclusively uses technical analysis for their decisions. While there is no hard and fast evidence of this being a major reason for the high 90 per cent rate of losers, there is certainly a connection.

RELEASE OF DATA

At 3.30 pm EST every Friday, the previous Tuesday's figures are released by the CFTC. The data records the positions of all those markets where 20 or more traders hold positions. However, the positions need to be large enough to require being reported. This causes the number of markets to vary a little, but there may be up to 70 different markets. This concerns:

- Stock Indices
- Interest Rates
- Currencies
- Commodities

You have the option of downloading this data directly from the CFTC website (www.cftc.gov).

Since 2006, the world of the CoT Report has changed a great deal. There are three new reports that have been added:

Supplemental Index Commodity Trader (CIT) Report

This report indicates the commodity index trader positions and refers only to twelve markets.

T3) SUMMARY OF POSITIONS FROM THE TWO COT REPORTS

Old CoT Report				New CoT Report				Differences
	long	short	net		long	short	net	
Commercials	204,961	213,493	-8532	Producer/Merchant/User	32,175	178,756	-146,581	
								-8532
Non-Commercials	124,942	98,847	26,095	Swap Dealer	150,449	12,400	138,049	
				Managed Money	105,723	58,902	46,821	
				Other Reportable	19,219	39,945	-20,726	26,095
Nonreportable	31,291	48,854	-17,563	Nonreportable	31,291	48,854	-17,563	Unchanged!

F1) OLD COT REPORT WHEAT

```
WHEAT - CHICAGO BOARD OF TRADE                                                               Code-001602
Commitments of Traders - Futures Only, July 3, 2012
--------------------------------------------------------------------------------------------------------
      :  Total  :                     Reportable Positions                        :  Nonreportable
      :-------------------------------------------------------------------------:    Positions
      :  Open   :           Non-Commercial        :     Commercial    :      Total      :
      : Interest :  Long   :  Short   : Spreading:  Long   :  Short   :  Long   :  Short  :  Long   :  Short
--------------------------------------------------------------------------------------------------------
      :         : (CONTRACTS OF 5,000 BUSHELS)                                    :
      :         :                                                                 :
All   : 423,551:  124,942    98,847    62,357   204,961   213,493   392,260   374,697:   31,291    48,854
Old   : 371,467:  115,948    85,073    42,152   186,449   195,895   342,549   331,120:   28,918    40,347
Other:  52,084:   16,255    11,035    14,944    18,512    17,598    49,711    43,577:    2,373     8,507
      :         :                                                                 :
      :         :      Changes in Commitments from: June 26, 2012                 :
      :  10,935:    2,251    -3,729    11,146    -3,700     4,754     9,697    12,171:    1,238    -1,236
      :         :                                                                 :
      :         :  Percent of Open Interest Represented by Each Category of Trader :
All   :   100.0:     29.5      23.3      14.7      48.4      50.4      92.6      88.5:      7.4      11.5
Old   :   100.0:     30.7      25.1      11.3      50.2      52.7      92.2      89.1:      7.8      10.9
Other:    100.0:     31.2      21.2      28.7      35.5      33.8      95.4      83.7:      4.6      16.3
      :         :                                                                 :
      :# Traders :          Number of Traders in Each Category                    :
All   :     347:      118       113       102        70       112       254       277:
Old   :     345:      120       115        94        65       111       244       271:
Other:      148:       16        48        14        30        72        58       125:
      :-------------------------------------------------------------------------------------------
      :          Percent of Open Interest Held by the Indicated Number of the Largest Traders
      :                     By Gross Position                        By Net Position
      :            4 or Less Traders     8 or Less Traders     4 or Less Traders     8 or Less Traders
      :              Long:      Short      Long     Short:      Long      Short      Long      Short
      :-------------------------------------------------------------------------------------------
All   :              21.1       18.1       33.4      26.6       20.1      14.8       31.6      22.5
Old   :              23.5       18.2       36.4      27.0       22.5      17.2       34.4      25.9
Other:               58.9       36.3       74.6      45.3       36.9      10.8       45.2      16.5
```

The figure shows the CoT Report in its original form with the example of wheat.
Source: www.cftc.gov

Traders in Financial Futures (TFF) Report
The TFF report compiles data from Commercial and Non-Commercial categories from the original CoT Report and puts them in several defined categories. It covers financials only (i.e. the markets that are not included in the disaggregated CoT Report).

Disaggregated CoT Report
This report, which only monitors the commodity markets, subdivides the two most important categories from the traditional CoT Report into four new categories. These are as follows:

1. Commercials, Producers/Merchants/ Processors/Users
2. Swap Dealers
3. Managed Money
4. Other Reportable Positions

The swap dealers were removed from the group of Commercials and added to the group of Non-Commercials.

WHO ARE THE SWAP DEALERS?
In the past 15 years, the futures and commodity markets have experienced an explosion in open interest and volume. Trading volume, for example, has quintupled since 1998. To some extent this is due to the fact that pension funds and capital insurance companies have increased their activities. Historically, pension funds and insurance companies were not allowed full participation in the commodity markets or were even banned from them altogether. They had focused primarily on managing stocks and bonds. Today, they are important players on the commodity markets with billions of dollars invested. Since around 2004, these participants have been investing heavily in the commodities markets, using various indices such as, the Goldman Sachs Commodity Index (GSCI). They do so in a passive way (without leverage) through so-called swap dealers. The swap dealers are the middlemen in these transactions with the investment banks managing these positions from the commodity index. The only important thing to know is that the swap dealers and investment banks are one and the same!

Trading volume has quintupled since 1998.

Regardless of potential profits or losses, the swap dealer does not carry any major risk nor does the investment bank because they only manage the capital. They may even derive some extra benefit from it. The investment banks primarily receive fees associated with managing the positions and for this they can also benefit from the (insider) knowledge of the markets. They know exactly which billions were invested in which commodities and which orders are currently pending.

There is no question that all these changes have serious implications for the markets. Monitoring these activities makes a lot of sense – not just for the CFTC. Let us look at two current CoT Reports on wheat. Here we compare the old CoT Report (Figure 1) to the new disaggregated CoT Report (Figure 2). Please pay attention to the individual numerical values of the various market participants. What we clearly see from Table 2 is that the swap dealers were among the Commercials in the old report. This, of course, causes the meaning of the figures to be changed in a big way. While the Commercials were net short with 8532 contracts before, they are now so with 146,581 contracts (Table 3). In the old report, they were almost bullish, while in the new report, they are far from bullish – at least if we look at only the numerical values.

The only problem is that we cannot really learn anything from these values. It is clear, however, that when the positions of the Commercials are net long, this group will be expecting a bottom to form and prices to rise.

F2) NEW COT REPORT WHEAT

WHEAT - CHICAGO BOARD OF TRADE Code-001602
Disaggregated Commitments of Traders - Futures Only, July 3, 2012

	Open Interest	Producer/Merchant/ Processor/User Long	Producer/Merchant/ Processor/User Short	Swap Dealers Long	Swap Dealers Short	Swap Dealers Spreading	Managed Money Long	Managed Money Short	Managed Money Spreading	Other Reportables Long	Other Reportables Short	Other Reportables Spreading	Nonreportable Positions Long	Nonreportable Positions Short
(CONTRACTS OF 5,000 BUSHELS) Positions														
All	423,551	32,175	178,756	150,449	12,400	22,327	105,723	55,902	45,955	19,219	38,346	12,422	31,281	48,554
Old	371,467	28,574	167,246	141,716	12,490	14,155	95,901	57,566	31,762	20,043	33,727	10,870	28,918	40,347
Other	52,084	3,601	11,510	10,135	1,312	4,776	15,662	5,400	14,329	593	5,639	615	2,373	8,507
Changes in Commitments from: June 26, 2012														
	10,556	-1,455	5,444	1,746	321	-4,011	6,059	-6,459	8,211	-2,403	5,730	1,355	1,235	-1,256
Percent of Open Interest Represented by Each Category of Trader														
All	100.0	7.6	42.2	35.5	2.9	5.3	25.0	13.4	11.0	4.5	9.4	2.9	7.4	11.5
Old	100.0	7.7	45.0	38.2	3.4	3.8	25.3	15.4	8.6	5.4	9.6	2.8	7.8	10.9
Other	100.0	6.9	22.1	19.5	2.5	9.2	30.1	10.4	27.5	1.1	10.8	1.2	4.6	16.3
Number of Traders in Each Category														
All	387	55	91	18	7	21	72	64	47	64	45	55		
Old	383	40	91	18	7	19	72	65	45	58	70	50		
Other	148	13	57	14	4	12	9	10	4	7	28	15		

Percent of Open Interest Held by the Indicated Number of the Largest Traders

	By Gross Position: 4 or Less Traders Long	By Gross Position: 4 or Less Traders Short	By Gross Position: 8 or Less Traders Long	By Gross Position: 8 or Less Traders Short	By Net Position: 4 or Less Traders Long	By Net Position: 4 or Less Traders Short	By Net Position: 8 or Less Traders Long	By Net Position: 8 or Less Traders Short
All	21.1	18.1	33.4	28.6	20.1	14.9	31.6	22.5
Old	23.5	18.2	36.6	27.3	22.5	17.2	34.4	25.8
Other	58.9	54.3	74.6	65.2	58.9	12.8	65.2	18.5

Figure 2 shows the CoT Report in its form as it has been published since 2006. The CFTC continues to publish the original version of the report.
Source: www.cftc.gov

Let us try to illustrate this by way of charts (Figure 3 and 4). You don't really see an awful lot there. However, it is possible to create the first few rules, which look like this:

1. We only look at really extreme positions held by any market participants.
2. Commercials can only indicate potential turning points.
3. The Non-Commercials are always those that drive a trend.
4. The positions held by the Nonreportables serve as counter-indicators.
5. For a bullish setup (for a bearish setup it's the other way round), we need the following extreme values:

   a. Commercials are extremely bullish.
   b. Non-Commercials are extremely bearish.
   c. (Desirable) Nonreportables are extremely bearish.

Figure 5 shows an example of a bullish setup for gold. According to this chart, November 2008 saw a very good situation for a long entry in the gold market. Although the Commercials are mostly net short in the gold market, they are only net short here with -69,496 positions.

This is an extreme point for the insiders. But speculators, too, were able to reach a new record low with only 63,959 net (long) positions.

ANALYSIS AND STRATEGY OF COT REPORTS

There is always the question whether the pace of change on the markets is not constantly increasing. This is indeed the case and it is important to observe the short term changes of the positions in the CoT Report in addition to the long term time frames. This is best done with the CoT Index Indicator.

Four time windows can be used here:
- Three months
- Six months
- Twelve months
- 36 months

This allows us to analyse the activities of all market participants in relation to a defined time frame of observation.

CoT Index Formula:

$$\text{COT Index} = 100 * \frac{\text{Current Net} - \text{Minimum Net}}{\text{Maximum Net} - \text{Minimum Net}}$$

RULES

- The Commercials are bullish when the CoT Index reaches a value higher than 75 and they are extremely bullish when we see values larger than 90 here.
- The Commercials are bearish when the CoT Index reaches a value of less than 25 and they are extremely bearish when we see values of less than ten here.
- The market is bullish when the Non-Commercials have a CoT Index of less than 25 and it is extremely bullish when we see values of less than ten here.

F3) OLD COT REPORT WHEAT – CHART

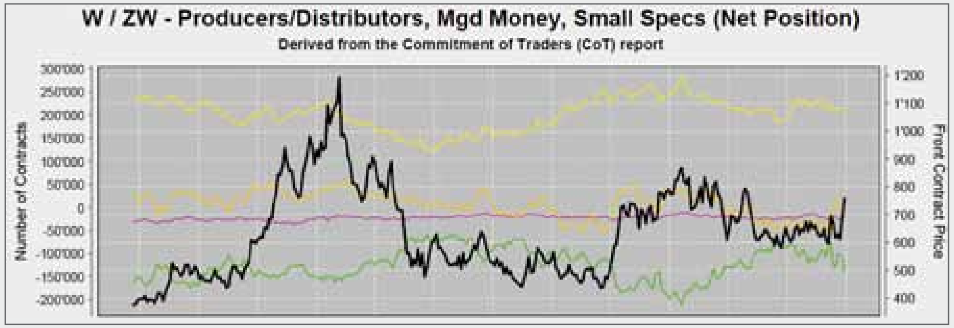


Figure 3 shows the price pattern of wheat (black) as well as the development of net positions of producers/distributors (green), of managed money (dark yellow), of small speculators (pink), and of open interest (yellow). Source: Kock CoT Analyzer

F4) NEW COT REPORT WHEAT – CHART

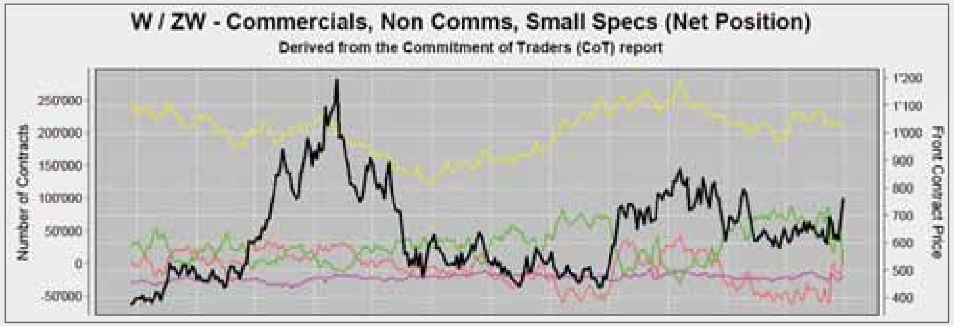


Figure 4 shows the price pattern of wheat (black) as well as the development of net positions of Commercials (green), of Non-Commercials (red line) of small speculators (pink), and of open interest (yellow). Source: Kock CoT Analyzer

- The market is bearish when the Non-Commercials have a CoT Index of more than 75 and it is extremely bearish when we see values of more than 90 here.

Of the five metal markets shown in Figure 6, copper (HG) and silver (SI) are bullish in all four time frames. Gold (GC) and palladium (PA) are only bullish in the later time frames. Platinum, however, is completely neutral. At the back of the table, each group has its own column with the four time frames to be observed. The old CoT Report is indicated in italics. Let us look at this in more detail by studying the gold chart (Figure 7). The blue vertical bars indicate the moments when the Commercials were extremely bullish and the Nonreportables were bearish. These are good opportunities for building long positions in the market. Of course, it would be ideal if we had all four time frames to be observed in the extreme range, but this is not absolutely necessary. In the case of gold, we can certainly use the first three earlier time frames. In conjunction with the bearish positions of private investors, we will achieve good market timing. You may well ask yourself where the positions of the Non-Commercials are. They are not necessary for the initial analysis since we do not yet determine our entry here but only dare to make a market assessment.

We know, however, that the Non-Commercials hold the opposite positions of the Commercials and that they want to continue driving the current trend forward. For a long entry, we need to see a minimum of Commercial short positions. This can be seen clearly in Figure 8. The red line represents the Non-Commercials and the blue line the Commercials.

The chart indicates the development of soybean oil prices. To find a good entry point, it is necessary for us to have a downward trend with falling positions held by speculators and rising positions held by Commercials. This is what we have in the chart six times. But not until the Non-Commercials rebuild their long positions will prices turn upwards, which is what we see in the chart.

For our purposes we will use this insight. Until now we were only able to use the CoT Reports in order to take a closer fundamental look at individual markets. This made it possible to detect trend changes earlier than usual. For a quantitative analysis, this is obviously not ideal. However, to see the real benefit of the evaluation of the CoT Reports, it is necessary to create a system with fixed rules for entry and exit.

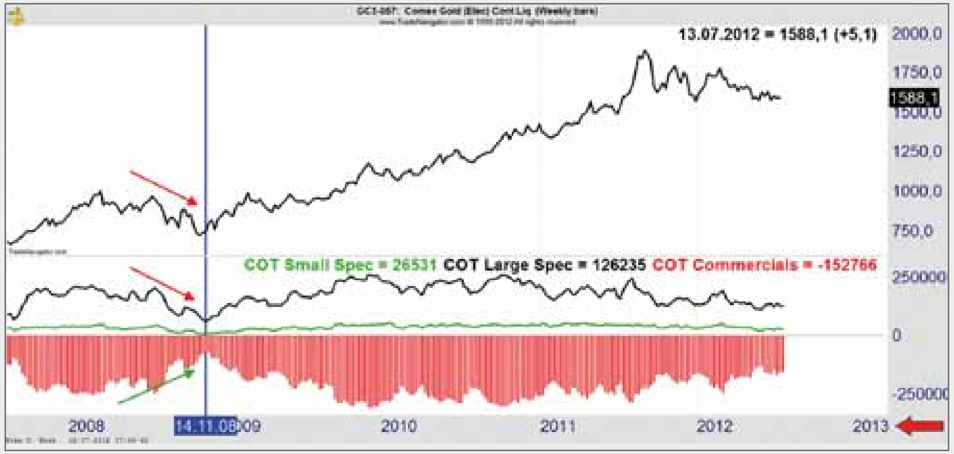
CoT Report on Trading System

The data analysis is based on weekly prices. We use all the four different time frames from the CoT indices of market participants. The entry rules are described below.

Long Entry

At least one of four time slots of the CoT Index is in the extreme range. First and foremost, there are the positions of the Commercials and the Non-Commercials. The Nonreportables only offer support. Once this happens, we will be opening a new long position when the high of the previous week (bar with signal) is broken.

F5) BULLISH SETUP IN GOLD



Here you can see the price pattern of gold (upper black line) as well as the net positions of Commercials (red bars), of Non-Commercials (lower black line) and of Nonreportables (green line).
Source: Tradenavigator

F6) COT REPORT ANALYSIS, WEEK 27/2012 – COT INDEX

	New Report	*Old Report*	Front Price	Open Int. Change	Prod Dist	Swap Deal	*Old Com*	Mgd. Mon	Oth. Rep	*Non Com*	Swap Mgd	Small Spec
GC / QO	▲▲▲	▲▲▲	1598.6	-4^{9}	+++	++++	+++	----	++++	---	++++	----
SI / QI	▲▲▲▲	▲▲▲▲	27.455	3^{7}	++++	++++	++++	----		----	++++	----
PL			1452.1	-1^{5}		+		-	++++		++++	----
PA	▲▲	▲▲▲	582.2	0^{6}	++++	++	+++	--	-	---	++++	----
HG / QC	▲▲▲▲	▲▲▲▲	3.5025	1^{6}	++++		++++	----		----	-	----

Evaluation of the author for the markets gold (GC), silver (SL), platinum (PL), palladium (PA), and copper (HG). Abbreviations: Open Int = Open Interest, Prod Dist = Producer and Distributor, Swap Deal = Swap Dealer, Old Com = Commercials CoT Report old, Mgd. Mon = Managed Money, Oth. Rep. = other Reportable, Non Com = Non-Commercials CoT Report old, Swap Mgd. = Swap Dealer plus Managed Money, Small Spec = Nonreportable = private investors. Source: Kock CoT Analyzer

Short Entry
Here we use the low of the previous week with the signal.

Exit
We hold the position for exactly one week and then close it the following Monday at the open. A stop-loss has to be placed to fit each market.

Using the example of silver (Figure 9), we are now going to go through the individual trades. The first short signal was no entry since the low was not broken. But in the second signal the short entry was made. This is followed by two weeks of long signals and it was only the second signal that managed to make the entry. Silver moves up to the US$50 mark. But six weeks earlier, there were already signs of a trend reversal. The real short entry, though, was only made at the last bar to the low! After that, there were another seven entries, of which three ended up as losers and four as winners.

By now, you should have seen the logic of this simple system and, of course, the opportunities for improvement. What indices do we have in the silver market, having used this system since 1990? The figures are as follows: Hit rate: 78 per cent, profit factor: 2.78, number of trades: 55, number of trades per year: about 2.5, longest losing streak: 2, longest winning streak: 18, average winning trade: 3552 USD, average losing trade: 4041 USD. We will now be testing this system on a portfolio of 39 different futures markets, which – besides commodities – including interest-rate and currency markets. In those 39 markets, the hit rate was highest at 84 per cent in the Swiss franc contract, and lowest at only 25 per cent in the RBOB Gasoline contract. Looking at the entire portfolio, this rough trading approach still achieves a positive value of 54.3 per cent, at a profit factor of 1.7. The average number of trades per year is 61.6. That's not really a lot and means that each and every trade must be carried out. Since 1990, the system has only ended up in the red three times, in 1994, 2001 and 2004. It is interesting to compare the long and short signals. While the long entries have a higher hit rate in all markets, they do have a smaller profit factor. By contrast, the short positions consistently boast a much larger profit. How can this be explained? Downward movements are generally much faster and stronger than upward ones. Since the system is based on weekly prices, more losses are encountered in the short signals than on the long side. There is also the time factor

F7) GOLD CHART

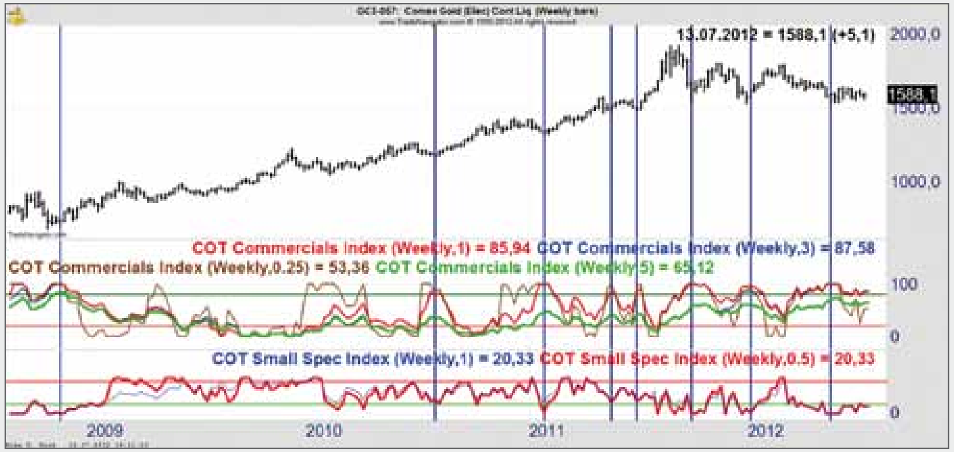
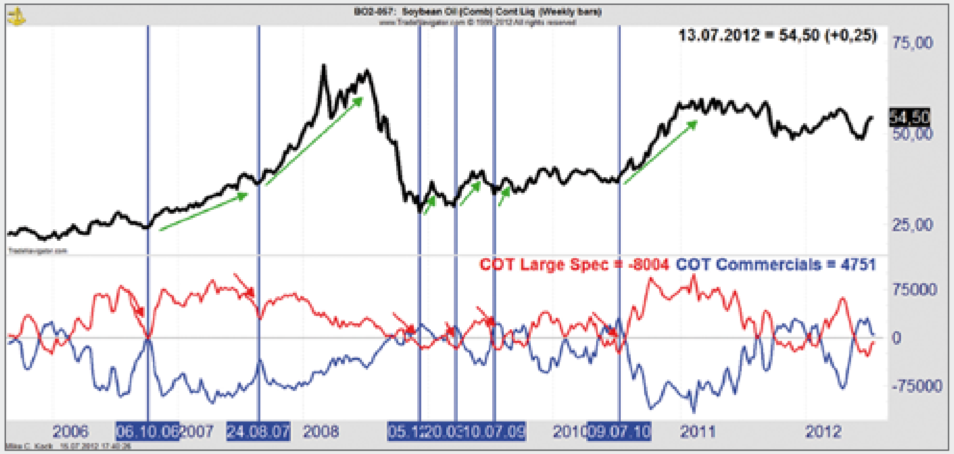


Figure 7 shows the CoT Commercials Index (blue line – three years, red line – one year, green line – six months, brown line – three months). The blue vertical bars indicate when the commercials were extremely bullish and the Nonreportables were bearish. These are good opportunities for long positions.
Source: Tradenavigator

F8) SOYBEAN OIL



The chart indicates the development of soybean oil futures as well as the according positions of the speculators (red line) and of the producers (blue line).
Source: Trade Navigator

to consider in an exit. The positions are closed again after a bar – in other words, after exactly one week at the opening on Monday. Upward movements need more time though, causing the profit to have been minimised here. It's different with the short signals where the one-week time frame is clearly sufficient. The system needs to have its own stop-loss for each market. Ideally, there is also a profit target there. It makes little sense to use the same risk and money management rules in precious metals, currencies, or interest rates since the average daily and weekly price spreads are far too different.

CONCLUSION

The analysis of the CoT Reports is an efficient way to evaluate the fundamental and technical state of the markets with the Commercials standing for the fundamental side and the Non-Commercials for the technical side. The quantitative study of the past 22 years indicates a steady positive expected value when implementing the CoT data on a portfolio of 39 different markets with buy signals having a higher hit rate than sell signals, but unfortunately a lower profit factor.

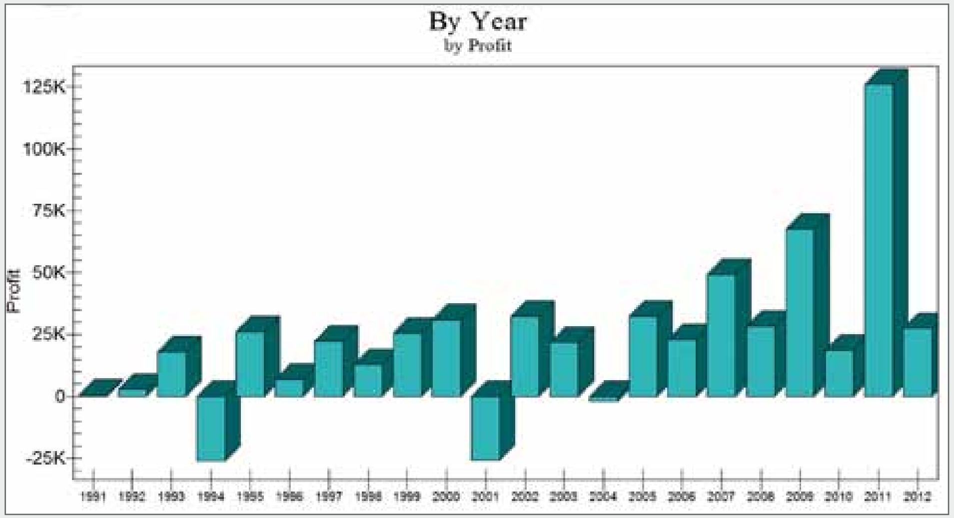
Since the CoT Reports are available from the CFTC free of charge, this provides the opportunity to be even more successful in your trading. Private traders are recommended to implement these signals by using ETFs and ETCs. Trading futures requires more equity since the signals are generated on a weekly basis. As far as institutional investors are concerned, this strategy can easily be implemented on the futures markets.

> The system needs to have its own stop-loss for each market.

F9) SILVER CHART

The red points show extreme short positions, the green and blue points show extreme long positions of the insiders on the weekly chart. The green "G" stands for gold long entry. An entry is made only then when the big speculators adjust their positions in the direction of the extreme positions of the Commercials. Source: Tradenavigator

F10) PERFORMANCE OF COT SYSTEM IN 39 MARKETS



Here you can see the evaluation of trading signals from 1990 until 2012. Source: Tradenavigator