NOT A DUPLICATE

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Bullish Review
Of Commodity Insiders

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August 21, 2006

Eileen Donovan, Acting Secretary
Commodity Trading Futures Commission
Three Lafayette Center
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Subject: COT reports

In response to your request for comments, am addressing your required format in this letter and have submitted additional comments in a separate enclosure. I am deeply concerned that the CFTC would consider discontinuing such a popular and insightful report. While the report may need modification, the number and size of exemptions to "non-traditional commercials" granted by the Commission would seem to demand more transparency, not less. In general, any modification must avoid discontinuing, suspending, or delaying, the Commitments reporting. And the Commission should take precautions to implement report changes in such a way as to maintain continuity with historical data. Absent historical reference, the report becomes nearly unintelligible. My specific responses to your numbered inquiries are as follows:

1. As an individual trader, I use the COT report to alert me to sudden position changes that would indicate a reversal in sentiment by a particular trader group. I also look at total positions against their historical ranges to identify sentiment extremes among the various trader groups.

   a. The size of the commercial long and short totals, as well as the ratio of these, is useful in discovering extremes or significant changes in sentiment within the "trade." Historically, large one-sided positions among commercial traders has indicated a potential price trend change in the direction of the commercial position. Likewise, resumptions in major trends often follow a large change in commercial buying or selling patterns.

   b. Non-commercial large traders have historically shown a preference for momentum trading strategies and, thus, provided the buying power in bull trends and the selling power in bear trends. I look for a trend to accelerate in the direction of predominant one-sided large speculator trading. I anticipate declining large speculator participation and am alert for potential trend reversals when their positions approach historical long or short extremes.

   c. In uptrends, the extent that large non-commercial traders are willing to bid forward futures prices to a premium over normal carrying charges gives me an indication of the potential strength and longevity of bullish conditions. In downtrends, momentum selling usually results large speculators holding shorts and net short positions near their historical extremes at price bottoms in both futures and cash prices.

2. The Haig working paper on the CFTC website lists 41 related scholarly works, many apparently using COT data, and this is probably not a comprehensive list.

3. Market transparency is the antithesis of manipulative advantage, and the COT report makes US futures the most transparent of any exchange in the world. Do traders change their tactics based on date in the COT report? If they do, those reactions are promptly reported in next week's issue. This self correcting feature is unusual in a potentially market-moving report.

4. The Commission must continue publishing the CoT report.

5. Since the large traders are not identified, only the Commission can judge the need for additional trader categories. It is difficult to understand the distinction the Commission draws between non-commercials and non-traditional commercials. Under the Commission's rules a hedge fund buying futures contracts is listed as a speculator and is subject position limits. However, if the same hedge fund acts through an intermediary swap dealer, it can apparently operate without limits and the futures position is categorized as a Commercial under the guise that the swap dealer is now a "bona fide hedger." If the Commission does not view these as equivalent speculative (non-commercial) positions, than I would prefer to see it listed under a separate category and reserve the commercial category for traditional hedgers.

6. The COT report is not the only source of information regarding the potential size and timing of investment fund rolls. Even if it were, the market would soon arbitrage out any unfair advantage. Transparency is the antithesis of manipulative advantage.

7. a. The COT report is not the sole source of trader information. In fact many of these entities report their positions on SEC reports. For the CFTC to quit disclosing aggregate homogeneous positions would actually tilt the playing field in favor of large players who have the resources to aggregate this information from other sources.
   b. Insiders don't need to "guess" the identity or position totals. They can get actual names from SEC and other (less public) sources and deduce futures position sizes from equity reports and broker contacts. By publishing factual aggregate totals, the Commission only levels the playing field to the disadvantage of potential manipulators who access inside or non-public sources.
      c. The Commission has already increased the threshold number of reportable traders needed to publish Commitments data from 4 to 20. The Commission has to balance this perceived need for privacy of individual trading concerns against the benefits of transparency. It seems to me that a market's susceptibility to manipulation is inversely related to the number of large trader participants. Publishing the aggregate totals in the COT report is the antidote, not the poison.

8. & 9. For simplicity, categories should be consistent for all markets. If the total for a particular category in a particular market is zero, it doesn't take much effort to place it there. This provides flexibility to the Commission in future trader classification. As the Commission points out, the derivatives landscape is constantly changing and new products and non-traditional participants may be just around the corner for any market. And it is conceivable that a future Commission might use a different categorization protocol and categorize positions based on the source of the funds rather than the current practice, which apparently ignores he original source and purpose of the position.

10. Users of the COT report have benefited with each and every increase in reporting

frequency. Less frequent partial reports create doubt, cloud transparency, and can't help anyone besides inside players.

11. Reportable traders are already required to report speculative positions separate from "bona fide hedges." This is not a hardship, particularly in the case of these large traders, whose reporting is automated.

Finally, I would request that if the Commission should decide to make changes that could negatively affect the continuation, continuity, or promptness of the COT report, that it submit such proposed changes for further specific public comment.

Respectfully,

Stephen E. Briese
Editor

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Subject: COT reports

I began subscribing to the COT reports in 1974 and have published analysis for paid subscribers in Bullish Review since 1988. I have arranged comments in your requested format under a separate letter. The following comment is outside your specific request for comment.

SYNOPSIS

I agree that "non-traditional commercials" such as swap dealers should be separated from true hedgers. BUT I don't necessarily draw a distinction between commodity and financial futures.

There are two distinct types of supply and demand that affect futures prices: economic and financial. The economic component is from firms already at risk, having either an existing inventory or a future inventory requirement to price-protect through hedging: true hedgers. The financial component impacting futures prices is from entities who assume risk in return for a profit opportunity: speculators.

One should not be able to, in effect, launder speculative money through a 3rd party—swap dealers, etc.--to move from one category to the other for reporting purposes (or to circumvent speculative position limits, for that matter). If the source of funds is speculative (investment) for profit, it should be reported as such.

The question should not be whether the entity is "commercial" in nature (this is pure semantics) but rather the motivation behind the position. Futures markets have always pointed to the economic benefit of hedging risk to justify their existence. The Commitments report should be able to separate those hedging risk from those assuming risk for profit.

DISCUSSION

Traditionally, the COT report congregated the large players between the economic (commercial hedgers) and financial (non-commercial) components; and the groups were quite homogeneous. I have found that the differences in motivation between economic players and financial speculators creates a herd-like response to price movement, which is helpful to market analysts and participants alike. The dissemination of this information through the COT report helps level the playing field between the uninformed public and the market insiders who have alternative means of compiling (or at least estimating) this information. When you grant a commercial exemption to firms who are not true hedgers, you destroy the homogeneous factor that makes these groupings useful—to the disadvantage of the public trader.

This is no less true in financial futures.

Long-Term Capital Management (LTCM) is a convenient example. Here, was a hedge fund formed for the sole purpose of financial speculation. If they were to deal directly in futures markets, they would (one would assume) be categorized as non-commercial and be subject to speculative trading limits. (If I am incorrect in this assumption, I have already lost this argument.) But by acting through intermediaries such as swap dealers, LTCM was able to bypass speculative limits and accumulate enormous positions—apparently large enough to threaten the solvency of the financial and banking system. Much of this money undoubtedly ended up in futures markets, placed there by LTCM's counterparties. (If this is not the actual case in this instance, it certainly is the case in many swap deals.)

I believe that protecting futures markets from such speculative risk is a chief purpose of the CFTC, and the COT report a key tool in carrying out this charge. If so, it would seem to me that keeping the Commitments report homogeneous would be to the commission's benefit, and that the granting of exemptions to speculative position limits should be handled as a separate matter to categorization and reporting.

Certainly in this day and age when I can't so much as transfer $10,001 from my bank account to my futures trading account without it being reported to the federal government (at least twice), the source of funds entering the futures markets through 3rd parties such as swap dealers is presumably known and thus could easily be separated between speculative investment or inventory hedging. This also would aid the Commission in barring a LTCM from escaping speculative limits and potentially threatening the stability of futures markets, would it not? The reporting of these positions could scarcely be called a hardship, when my $10,001 transfer is not.

SUMMARY

The thrust of my argument is that the most helpful part of the COT report (from trader/analyst standpoint) is the separation of speculative from true hedging positions. The Commission is correct when it states that this is what most readers of the report believe it to do. It is simple to recognize this distinction in commodity futures, where there is a physical product involved; one is either in the trade and hedging actual operating risk, or it is speculation. In currencies, I would think that it is possible to separate firms who have an exchange rate risk from operations from those assuming risk for profit.

Where it may become more difficult is in equity and bond futures, where the "commodity" itself is a financial product. I will leave it to the Commission to determine whether a distinction can be made here. If it can, it would be very helpful to have it reported so. If this requires a 3rd or 4th category to accomplish, the homogeneity of traders within each group is more important than limiting the number of groups reported.

Respectfully,

Stephen E Briese
Editor