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Hedgers, funds, and small speculators in the energy futures markets: an analysis of the CFTC's Commitments of Traders reports

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Abstract

The Commodity Futures Trading Commission (CFTC)'s Commitments of Traders (COT) data are examined for crude oil, unleaded gasoline, heating oil, and natural gas futures contracts. The collection procedures for the COT data are first examined, followed by Granger causality tests to determine if relationships between trader positions and market prices exist. A positive correlation between returns and positions held by noncommercial traders, and a negative correlation between commercial positions and market returns, are found. Furthermore, positive returns result in an increase in noncommercial net positions in the following week, whereas the net long positions held by commercial hedgers decline following price increases. However, traders' net positions do not lead market returns in general.

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In order for prices to continue higher, there must be strong buying support and, according to the latest *Commitments of Traders* report, that may be difficult for at least one segment of the market. According to the CFTC, noncommercial [funds] have increased their net longs. . . to near record levels. ([NGI's Daily Gas Price Index, August 16, 1999](#))

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We're long crude oil. . . I'm making the bet because I can't find a place, in any market, on any chart, where speculator sentiment has been above 90–95% in one direction where betting against their position hasn't been the right thing to do. (Michael Williams, Genesis Trading Group, Barrons, July 20, 1998)

1. Introduction

The Commodity Futures Trading Commission (CFTC) collects data on the composition of open interest for all futures contracts. A subset of this data is released to the public through the CFTC's Commitments of Traders (COT) report. The open interest is divided into *reporting* and *nonreporting* traders, where reporting traders hold positions in excess of CFTC reporting levels. Reporting traders are further categorized as *commercials* or *noncommercials*. Commercials are associated with an underlying cash-related business and they are commonly considered to be hedgers. Noncommercials are not involved in an underlying cash business; thus, they are referred to as speculators. Furthermore, reporting level noncommercial activity is generally considered to be that of managed futures or commodity funds. Overall, the COT data are broadly discussed in terms of hedgers (reporting commercials), funds (reporting noncommercials), and small speculators (non-reporting traders).

As illustrated in the opening quotes, the CFTC's COT report is widely anticipated and closely analyzed by commodity futures traders. In particular, futures traders tend to focus attention on positions held by reporting noncommercials (typically funds). Some analysts suggest that the anticipatory buying of futures contracts in front of the activity of reporting noncommercials can be a profitable strategy. At the same time, other analysts suggest that large fund positions signal market reversals; thus, fund activity can be viewed as a contrary indicator. Still, others argue that following the commercial trade is a profitable strategy (Welling, 1998). Regardless of the supposition, these views are rarely supported by statistical evidence.

The COT data are also used by academics to examine a number of issues including the flow of funds among trader groups (Hieronymus, 1971), the forecasting ability of traders (Hartzmark, 1991; Leuthold et al., 1994; Buchanan et al., 2001), and the existence of risk premia (Chatrath et al., 1997), and is used as a measure of investor sentiment (Wang, 2001, 2002). Yet, the source, reliability, and definitions underlying the data set are rarely scrutinized. Given the widespread use of these data by both academics and industry professionals, it is essential that users have a thorough understanding of how the COT report is compiled and what information it contains.

Given this, the overall objective of this study is to examine the information contained in COT reports, with focus on the COT data specific to the energy futures markets, namely, crude oil, gasoline, heating oil, and natural gas futures. First, the COT data for these futures markets are assessed in terms of collection procedures, trader definitions, and trader categorizations. In doing this, we fully describe the data collection procedures utilized by the CFTC and highlight the strengths and weaknesses of the COT data. It is important that researchers understand these issues, or they risk misinterpreting the results of their studies. Second, the COT data for these markets are evaluated in terms of how

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