

CFTC -Commitments of Traders Report Update

April 26, 2012

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Several recent articles and studies have looked at the possible impact speculators and index funds might be having on commodity prices. Some of these reports include data on the aggregate positions each of these categories of participants maintain in individual markets. The source for this data is a weekly report published by the Commodity Futures Trading Commission ("CFTC") called the Commitments of Traders Report ("COT"). The COT report provides a breakdown of open interest in futures and options markets by trader category. However, the data provided by the CFTC can be interpreted in many different ways. This research note will explain how the COT report is generated and provide you with a better understanding of how the data is used by market analysts.

History: The COT report was originally created in 1923 when the U.S. Department of Agriculture's Grain Futures Administration was established to administer the Grain Futures Act. As part of this program the large trader reporting system was implemented to monitor traders that exceeded predetermined position limits. This was followed by the Administration's first annual report in 1924 that included pertinent information on hedging and speculation in designated markets.

Between the years of 1927 and 1933 large trader reporting had been suspended several times due to concerns that required reporting was discouraging market participation. Many believed large trader reporting caused larger and quicker declines in commodity prices during one of the worst economic downturns in the history of the United States. There wasn't much change to the report until mid 1962 when the Commission began publishing the report on a monthly basis. In 1990 the report was published bi-monthly, in 1992 the report was published every two weeks, and finally in 2000 the report was published on a weekly basis.

There have been three material changes to the content in the report since its inception. In 1995, delta adjusted futures-equivalent options were added to the large trader system. The options positions are stated in futures equivalent terms, with the delta factors supplied by the respective exchanges, and are added to the open interest as either a short or long position in their respective

category. Following this in 2007 a new weekly report called the "COT – Supplemental" was added. The supplemental report provides an additional category of the aggregate futures and options positions for index traders. Finally, in September of 2009 the CFTC created a disaggregated report in response to requests for more transparency in the weekly report. This report separates traders into four different categories rather than the original commercial and non-commercial breakdown.

Release Time: The CFTC posts the COT report to its website (www.cftc.gov) every Friday by 4:30 pm Central Time. The data in the report is always as of the previous Tuesday.

Open Interest: Open interest is the number of contracts still open that have not been offset by another transaction. These contracts can be closed by entering the opposite transaction (if long enter a short position or if short enter a long position), delivering or taking delivery of the underlying commodity, by doing an exchange futures for related positions transaction, or in the case of options one could exercise the option. The reported open interest number represents one side of the market as there must be an equal number of long and short positions. When factoring in options positions, the COT report delta adjusts the positions that are reported and then adds the positions to either the long or short futures.

Reporting: All reporting firms must report on a daily basis the entire position of all traders that hold positions above the required reportable level. If a trader is above the reportable limit for a single contract month, he is required to report positions in all contract months for that commodity. Reportable position levels are set by CFTC regulation and vary by product, ranging from 50 contracts to 500 contracts for agricultural products and natural resources. According to the CFTC's website, these positions normally account for 70 to 90 percent of the market, with the remaining positions being designated as non-reportable.

Only commodities that have 20 or more traders reporting at or above the reportable level are included in the weekly reports.

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Formats: Currently there are six different formats available to choose from: futures only (long format/short format), futures and options combined (long format/short format), supplemental commodity index (CIT report) and the disaggregated report.

Futures only reports open interest for futures positions only.

Futures and options combined reports open interest of futures and delta adjusted futures equivalent positions. This shows the theoretical futures open interest if all in the money options were exercised into their respective futures positions.

Short format shows open interest by reportable and non-reportable positions. Reportable positions are then broken down by commercial, non-commercial and spreading positions. This report also details the change for each category from the previous report, the percent of open interest held by each category and the number of traders in each reportable category.

Long format has all of the information included in the short report, but also includes data by crop year and breaks down the concentration of positions held by the largest four and eight traders.

Supplemental format has all of the information included in the short format. However, there is an additional category for index traders. This report is only generated for the following commodities: CBOT: corn, soybeans, soybean oil, wheat; CME: lean hogs, live cattle, feeder cattle; ICE-US: coffee, cotton, cocoa, sugar no. 11; and KCBT wheat.

Disaggregated format is reported in both the long and short format and has the same information as all of the other COT reports. However, it does break positions down into more defined categories. CFTC Form 40 is used to place each reportable trader in their respective category. This form has some unique guidelines that should be noted. First, any trader or firm that has positions greater than or equal to the reportable levels has to file with the CFTC. Traders or firms are only required to update the form every two years or if the Commission requests an update. Therefore, some traders or

firms may have filed initially as one category but later changed their business structure or strategy leaving them in the wrong category. In addition to this, many firms that report could be placed in multiple categories. In this situation CFTC staff may request additional data from the trader or firm in an effort to clarify which category would be the best fit. Judgment on the appropriate category is made solely by the CFTC at its discretion. One unique part of this reporting is a firm that has different divisions may report them on different forms. This allows the CFTC to properly report positions for firms that use futures and options in different ways depending on their business structure. Currently this report covers over 100 of the major physical commodity markets.

Categories: There are now nine different categories that are reported in the COT reports.

Commercial traders use futures and options to hedge price risk associated with their business. For example, an ethanol plant could be classified as a commercial trader as it uses corn and natural gas for production and then hedges its input price exposure with Corn and Natural Gas futures and hedges its output price exposure with Ethanol futures.

Non-Commercial traders include any trader that is not classified as a commercial trader, but holds positions above reportable levels. This category of trader is generally one that looks to have exposure in a particular commodity, but does not use futures and options to hedge against price exposure in the underlying commodity.

Spreading is when a trader holds a long position and short position in the same commodity, but in different contract months. These positions are combined for non-commercial traders and listed in a separate category. In addition, option spread positions are delta adjusted to futures equivalents and added to the non-commercial spread position as well. Any position net long or net short that remains after they have been combined for spreading are then added to their respective category. This category can be interpreted in many different ways, which causes some confusion on the reports. The COT report assumes that any position held by a non-commercial trader either long or short once

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combined is part of a spreading strategy. However, this may not be the case and can greatly distort the overall size of certain positions.

Non-reportable traders are participants that hold futures and options positions, but do not exceed the reportable limit in any commodity they are trading. This category, which could include commercial, non-commercial and index traders, is calculated by adding up the commercial, non-commercial and index categories and subtracting that total from the total open interest for each commodity.

Supplemental Report

Index traders, as noted above, were first reported separately in January 2007. Prior to that, the positions of these traders were classified as either commercial or non-commercial traders. However, index traders are now reported separately for the twelve agricultural markets that are included in broad-based commodity indices. Some index traders were previously classified as commercial traders because they are using futures and options to hedge their exposure to over-the-counter transactions that are benchmarked to a commodity index. However, the CFTC has elected to separate these positions from those of commercial hedgers as they are not directly in the business of hedging physical commodities. The primary make up of these participants are managed funds, pension funds, institutional investors and swap dealers.

Disaggregated Commitments of Traders Report

Producer/Merchant/Processor/User is the category for any firm that is engaged in a business that uses a particular commodity in its daily operations and accordingly is exposed to price risk. The firm uses futures contracts to offset this price risk by utilizing a hedging strategy to lock in prices prior to actually using the commodity.

Swap Dealer is any participant that uses futures to offset price risk associated with over-the-counter swap transactions. These transactions could be with a traditional commercial hedger, a hedge fund, a commercial bank or any entity that needs a customized instrument to offset price risk exposure. This category contains both bona fide hedge

positions and speculative positions. Due to this, the category can be quite misleading as the true nature of the positions cannot be truly determined.

Money Managers are participants that manage an account on a client's behalf. This includes commodity trading advisors ("CTA"), commodity pool operators ("CPO") or any other unregistered fund that the CFTC has identified to be in this category.

Other Reportables is a category containing traders that are reportable, but do not fit the profile to be listed in one of the other three categories; Producer/Merchant/Processor/User, Swap Dealer or Money Manager categories.

Charts: The following charts provide an example of how CME Group uses the data from the supplemental COT. The data is downloaded into spreadsheets to keep a historical record. Once the data is recorded it is used to generate multiple graphs that show historical trends for each category of open interest. The most frequently used chart is the percentage of open interest by category. When calculating these percentages the net long and net short positions for each category are added together and then divided by two times the reported open interest. The reason for doubling the open interest is that the number reported only reflects one side of the market. When adding the net long and net short you are including both sides of the market, therefore you need to factor that into the open interest. In addition to this, spreads are included for the producer/merchant/processor/user, swap dealer, money manager, non-commercial and other reportables percentage of open interest. The spread positions are doubled in the calculation to account for both the long and short positions that make up these spreads. The open interest that is charted in the graph is just reported as one side of the market.

Charts that depict the percentages of open interest held by producers, swap dealers and money managers are based on the COT report-disaggregated. Charts that depict percentages held by commercials, non-commercials and index traders are based on the COT report-supplemental. Lastly, charts depicting only commercial and non-

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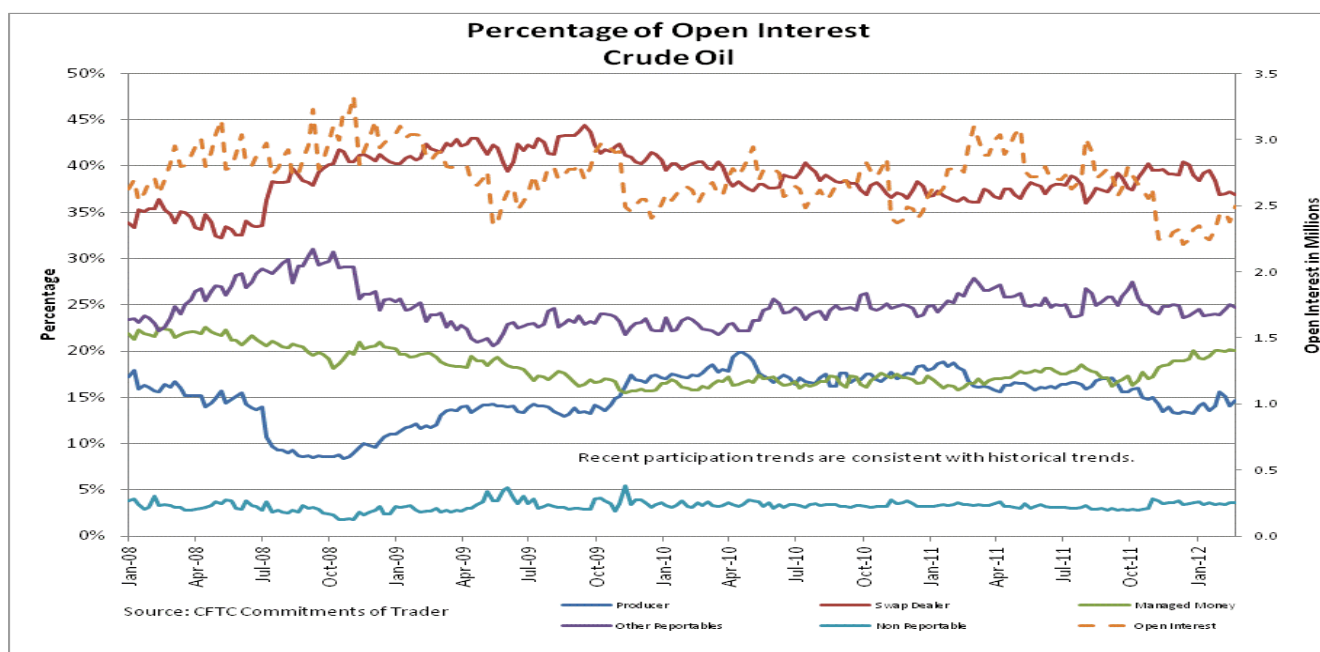
commercial percentages are based on the traditional COT report.

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