# The poker face of commodities

## With canola trading now subject to U.S. rules, you've got a chance for a glimpse at the other players' cards

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In poker, just like in the markets, it's good to know what the other players around the table might be doing.

With the canola contract recently moving from I C E Futures Canada to the New York Board of Trade (NYBOT) platform on the ICE Futures U.S. exchange on July 30, we will now have some insights into what the various players are doing in the canola market.

Since canola is now part of a U.S. exchange, it is subject to the reporting rules of the Commodity Futures Trading Commission (CFTC). In particular, canola futures and options will now be part of the weekly Commitment of Traders report.

What is the Commitment of Traders report and why is it important? Essentially, it will bring more transparency, disclosure of positions and awareness into what different traders, hedgers and investors are doing in the canola market. It will provide a snapshot of who's long, who's short and what those players have been doing over time.

Futures contracts for agricultural commodities have been traded in the U.S. for more than 150 years and have been under federal regulation since the 1920s. The CFTC, created in 1974, is an independent government agency that regulates futures and option markets.

Its mission is to "foster open, transparent, competitive, and financially sound markets. By working to avoid systemic risk, the commission aims to protect market users and their funds, consumers, and the public from fraud, manipulation, and abusive practices related to derivatives and other products that are subject to the Commodity Exchange Act (CEA)."

The CFTC also publishes the Commitments of Traders (COT) reports to help the public understand market dynamics. It does so by categorizing the long and short positions of different market participants to help market participants understand who is doing what. The COT report contains five categories of traders: 1. Producer/Merchant/ Processor/User 2. Swap Dealers 3. Managed Money 4. Other Report ables (large traders with positions above the CFTC limits) 5. non-Reportable (small traders with positions below the CFTC reporting limits) The CFTC states that 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."

Examples would be elevator companies, commodity trading firms, food processors like General Mills, and producer hedgers.

This category has the largest influence in the market and usually doesn't use futures to speculate or directly make money in the markets. Rather, it hedges their production or demand using futures for selling and delivery purposes, not speculating.

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 is basically an intermediary whose clients or counterparties may be speculative traders, like hedge funds, or traditional commercial clients that are managing risk arising from their dealings in the physical commodity. They could also be dealing on behalf of a large investment fund like a pension plan or a university endowment fund that wants to invest in commodity assets.

A " money manager , " for example a mutual fund or hedge fund, is a registered commodity trading adviser (CTA) or a registered commodity pool operator (CPO). These commodity funds manage futures trading on behalf of clients. They speculate or invest directly in futures and options and are usually the second most dominant figure in the marketplace.

The non-reportable category is made up of small speculators whose positions are small enough that they don't have to be reported to the CFTC. In general, these small speculative traders usually are wrong and don't make money over time.

There is a lot of analysis that can be done to better understanding potential future prices moves based on these COT reports. So let's look at the most important question: What could it all mean for your canola market? Using CFTC reports since the beginning of August, when canola data has been available, we can see that canola is dominated by large commercial entities.

Producers, merchants and processors have represented on average almost 70 per cent of long and 55 per cent of short positions. The summary table shows that large commercial interest is typically not as high in other commodities especially Chicago wheat, feeder cattle and hogs.

This gives a very particular reason to follow canola COT data. I usually look at what these large commercial traders are doing; are they long or short, buying or selling? It doesn't mean they are always right, but they are a large player and can influence the market. If they are significantly long or short, it means that if they reverse their positions, it could potentially push prices one way or another.

Even a rough visual correlation between COT data and commodity prices charts shows that these large commercial trades can move markets. Often they seem to build a large long position when prices have drifted lower and then establish a large short position once prices have peaked and are making their way down again. This is not a rigorous mathematical study or in-depth research but rather some anecdotal evidence I've noticed over the years that can help in your hedging decisions.

Bottom line, with CFTC Commitment of Traders data now available for canola, Prairie producers now have another piece of data to better understand the marketing poker game. However, don't spend too much time on these reports since you don't know exactly what these traders may be doing on the other side in the cash or over-the-counter (OTC) derivatives markets.

Nonetheless, since these figures will change over time, it's still a good idea to at least stay on top of the reports for any changes.

It might tip you off to what some of the other players around the poker table might be doing.

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