Commodity Index Traders

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The large inflow of commodity index investment has caused concerns in both academic and policy communities about potential destabilizing effects of index investment on commodity prices. Largely motivated by these concerns, the CFTC is contemplating imposing position limits on financial investments in commodity futures markets, while France, the 2011 host country of the G20, is making coordinating international efforts to regulate commodities markets a top priority of the G20.

Several recent papers have used aggregate position data from the CFTC's weekly commodity index traders (CIT) report to examine the price effect of CIT trading, and find weak or no evidence. However, the CFTC's position data is a black box to the public as the accuracy and reliability of its trader classification are largely unknown to outside researchers. In this paper, we systematically examine daily positions of all reportable traders in US traded commodity futures contracts in the CFTC's large trader reporting system from 2000 to 2010. This proprietary disaggregated dataset underlies the CFTC's CIT report, and allows us to verify the CFTC's CIT classification based on observed trading patterns of all reportable traders.

We focus on several well known characteristics of CITs: first, they tend to invest in multiple commodities as they are mostly portfolio investors; second, they tend to hold largely long positions; third, they follow predetermined rollover schedules dictated by the specific commodity indices they follow; and fourth, their position changes across different commodities are highly correlated. Building on these characteristics, we design our own criterions of CITs. Interestingly, while the CFTC classification is accurate in that the CITs identified by the CFTC mostly satisfy our criterions, the CFTC classification tends to be stale and misses an additional set of traders who change their trading strategies over time. By reclassifying each trader based on his prior year trading pattern, we are able to construct a more accurate measure of CIT positions.

In sharp contrast to the existing studies based on the aggregate CFTC position data, we find significant and positive correlations between CIT position changes and price changes in almost all commodities at both daily and weekly frequencies. We also find that CITs tend to behave like positive feedback traders, which makes them an important channel to spill over volatility and systemic risk from outside markets to commodities markets and across different commodities.