*"*Focusing on the Market Participants*"*

By Floyd W. Upperman JR., registered CTA

Floyd's recent article for FutureSource's "**FAST BREAK.**"

Floyd Upperman is fast becoming a recognized worldwide leader in the analysis of the Commitment of Traders (COT) data. His website contains hundreds of unique proprietary studies spanning 45 different markets. His proprietary software combines the COT data with proprietary price derived indicators the results of which are graphed. The market participants are separated by category so independent statistical analysis can be performed on each. The results are monitored using proprietary graphs maintained on the site and updated weekly (with the weekly government release of the COT data). The commercial component is broken down further into its two separate entities as well. These two entities are labeled "commercial producers" and "commercial consumers". Unique studies are performed on each entity as well and the results are graphed and made available on the website. The two separate commercial entities represent unique opposing positions with unique characteristics that correspond with certain price behavior and market plateaus. What is interesting however and very important to note is that while the positions between these two entities will always oppose one another, their views may not!

The general belief is that 90% or more of individual traders focus primarily on price-derived indicators. Floyd has gained an edge in utilizing the relationships between the COT data and price trends. His strategies combine a unique blend of proprietary price indicators with the positioning of the market participants. Floyd calls this unique approach "IMPA". This stands for "Individual Market Participant Analysis". This unique approach combines some of the best conventional price derived indicators with non-conventional proprietary COT derived indicators. Examples of Floyd's research can be found on his website at www.upperman.com

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By tracking and studying the individual market participant activity in the futures markets, a trader can gain certain insights into each market which can be extremely helpful in forecasting significant trend reversals and future bull or bear markets. The U.S. government releases valuable “inside information” to the public identifying the long and short positions held by market participants on a weekly basis! The U.S. government has been providing this information to the public (for free) in its current format since 1983, and in other formats prior to 1983. This data provides a thorough history of commercial and non-commercial activity in each market. By exploring this data, traders can go back in time and see how certain select participants prepared or positioned themselves ahead of significant market turning points and/or in front of bull and bear markets!

For years this data was released only twice a month. Due to the demand by individual traders and some commodity trading advisers, the U.S. government now releases this data on a weekly basis. It is compiled on Tuesday’s and released to the public on Friday’s!

This is true inside information! However, many traders and even some trading advisors do not completely understand all the benefits in tracking and thoroughly analyzing this data! Having some experience with data and knowledge in the markets is necessary to properly interpret this information, thus unlocking its full potential. This is not simple price data. The data is complex and properly disseminating it requires at least some basic knowledge of statistics (more experience is necessary to realize and harness its full value). For those interested however, I’ve already done all the work! The studies are all automated and the graphs and indicators available online via my website! I have setup an easy to use system for tracking this data and disseminating its full value. I look forward (as do members) to every Friday!

Consistency is one of the keys to success in this business in my opinion, whether you use the COT or not. I’ve found this to be extremely important however when using COT derived indicators as part of an overall trading approach. The key is to perform the same study week after week, using the same parameters in order to obtain important knowledge and understanding of the unique behavior by the individual market participant’s. Each market is unique. The same behavior in one market may mean something different when it occurs in another market

By combining certain COT conditions with price behavior and price structure we are able to identify high probability “setup conditions” based on previous similar conditions (which have produced predicted results).

An IMPA setup is a combination of technical requirements (based on price behavior) and specific statistical requirements from the COT. A list of proprietary “criteria”, when satisfied, provides us with a high probability “SETUP” condition.

The raw Commitment of Traders ("COT") report released on Friday's.

This report tracks the positions (longs and shorts) held by all market participants. Any changes in those positions from the previous report are also tracked. My system further breaks down this data and applies proprietary statistical measurements and indicators to identify trading opportunities. We combine these indicators with proprietary price indicators! Everything is graphed.

The three key market participant categories are as follows:

1) "**Com**" -- Large Commercial positions (Producer & Consumer hedgers)
2) "**NC**" -- Large Non-Commercial positions (Commodity Investment Funds)
3) "**SM**" -- Non-reportable positions (Small speculators and small hedgers)

Each category represents a particular group of participants. The "Com" category represents the commercial hedgers. The commercials are widely considered the most important group. The commercial hedgers are composed of commercial producers and commercial consumers of a particular commodity. Overall, this group is the most knowledgeable in each market. These two groups of commercial participants have different reasons for being in the market. However, both share the same goal, and that is to reduce their risk in the cash market. For the producer, this may mean locking in a particular price using futures contracts to reduce the risk of being forced to sell their 'produce' at lower prices in the cash market. For instance, a gold mining corporation is a producer of gold. They will sell short gold futures contracts to lock in a price for their gold and thus reduce or contain their exposure to the risk of falling cash prices in the future. A commercial consumer on the other hand, is concerned about the possibility of rising raw commodity prices. They will also use the futures markets to control or contain this risk. An example of a commercial consumer for gold would be a large Jewelry maker. They need to be able to purchase gold to produce their Jewelry. They may buy gold futures contracts to lock in the future price paid for their gold, and by doing so, reduce or contain their exposure to the risk of being forced to pay higher prices in a rising cash market.

By using statistical indicators to monitor the weekly changes in this data and to compare current conditions with historical conditions, one can identify statistically unusual activity as it is occurring. The main group to monitor is the commercial

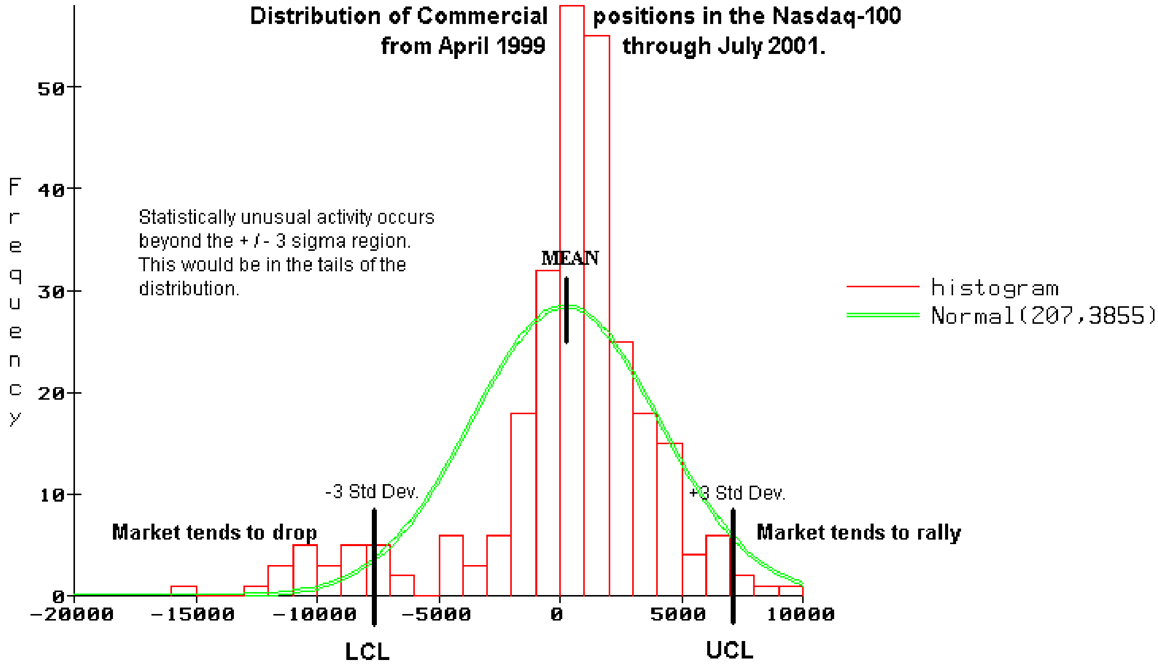

Figure 1

hedgers, as they tend to be the most knowledgeable. They are either producers or direct consumers of the raw commodity, and deal in the cash market regularly. The producers tend to know when production is down just as the consumers tend to be most privy to swings in their customer demand. The bottom line is they are in the best position to be able to foresee changes in demand and/or supply. Furthermore, they depend on the commodity and any price increase or decrease tends to have an impact on their business. As a result, it is in their best interest to understand the supply and demand factors exceptionally well!

Unusual commercial activity as defined and measured using statistical formulas often precludes major tops or bottoms in a market. I will review how to recognize this phenomena using examples in the Nasdaq and Cotton. First, we will look at a simple distribution of the commercial positions in the Nasdaq-100 (See fig. 1). In this graph, the average net commercial position is in the center of the distribution (bell curve) and the extreme conditions are found in the tails of the distribution. The more rare or extreme the position, the further out in the tails it is found. It is during these times of extreme commercial activity that major tops or bottoms have a tendency to form (* See Figure 2 below).

The large build up of commercial longs shown in the Nasdaq-100 (UCL/LCL) graph above was suddenly and abruptly reversed by the commercials on or about April 4th 2000. This coincided with the top in the Nasdaq-100 futures! At the time, the public was excessively bullish the technology weighted Nasdaq-100 by immense proportions! Based on the above data combined with our price data, we were bearish at the right time! We were successful in exiting out of our longs near the top and established follow up short positions with the IMPA setup as prices began to descend, meeting our last criteria of a short-sell setup!

Sometimes it's very clear, as can been seen in the Nasdaq-100, and in the cotton late in 2000 and early 2001 as well! The data clearly indicated a top in the Nasdaq-100 in April of 2000 and then a top in cotton prices in the fall of 2000.

The movement among the commercial institutions clearly indicated an imbalance was taking place in cotton futures late in 2000. This occurred long before the imbalance manifested itself into sharply lower cotton prices! This is precisely how imbalances are corrected. We observed a similar (but opposite) paper imbalance in OJ in the late summer and fall of 2001 as well. However OJ is not as liquid as the Nasdaq-100 or not even as liquid as cotton. Nonetheless, the imbalance in OJ was on the buy side and sure enough, in the fall of 2001 OJ prices began to rise sharply!

During the early stage of an IMPA commercial imbalance, we don't know for sure if the paper imbalance will resolve itself without a new trend or if the paper imbalance is something that will spill over into the physicals due to some real

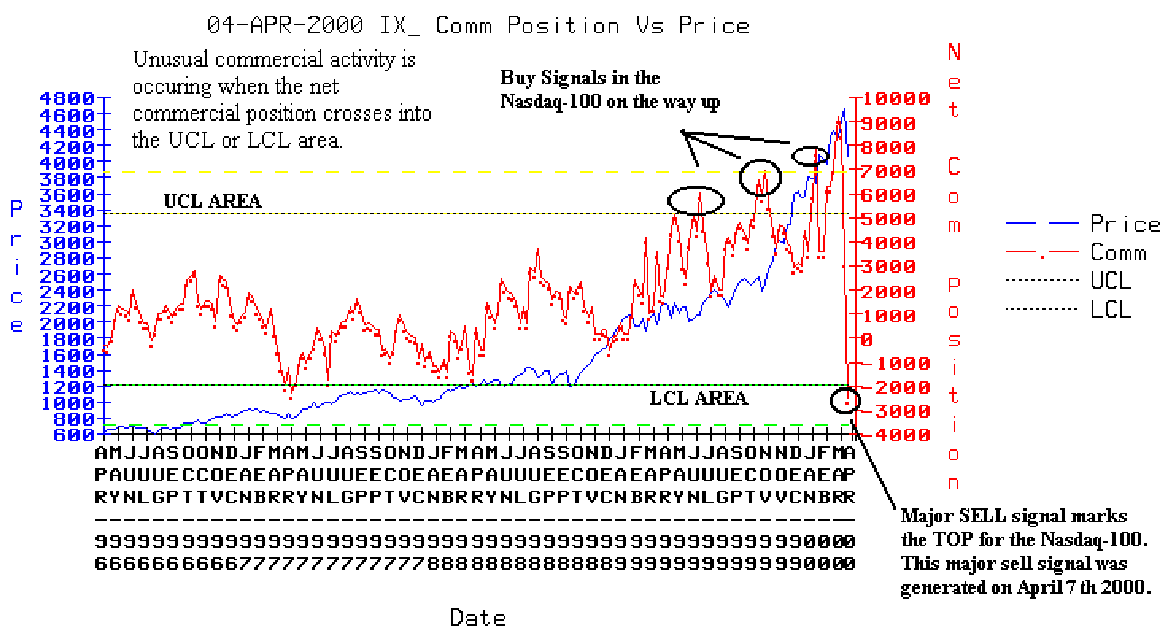

Figure 2

(unknown) underlying issue being anticipated to likely impact the supply and demand. In the case of cotton, unusual positioning of the commercial participants (broken down into their respective counter parts) indicated an imbalance in supply/demand was taking place (on paper) before prices dropped sharply (first in the futures followed by the cash). This is normally what we expect as the IMPA analysis provides more of a leading role, and does not lag the price, as most price-derived indicators tend to do. The actual price structure and changes in price are important in determining the entry of a setup. One of the big advantage of including the IMPA with price derived indicators is that we are always paying attention to the market at the right time, and ignoring the market (technical signals) when no real underlying supply and/or demand issues exist, thus ignoring technical signals that are likely to fizzle or amount to little.

In cotton the imbalance noted in the futures markets via our IMPA analysis and documented in my reports clearly revealed that the imbalance occurring on paper late in 2000 and early in 2001 would result in grossly lower prices for cotton. This particular imbalance remained in affect for a fairly long period of time. Eventually what tends to happen over time is the initial reaction to the imbalance (to much supply and/or to little demand) over-corrects and a new imbalance eventually occurs on the opposite side or in reverse.

Under normal conditions, a market tends to chop sideways (overall). By and large, we do not want to be establishing a long or short position trade under perceived normal conditions. This is where the IMPA comes into play. It helps us understand when we should not be looking at a particular market, and when we should be! We know that under normal conditions, large moves are unlikely (not impossible of course, just unlikely). However, when a disruption between supply and demand begins to unfold, prices adjust accordingly. Using my proprietary statistical indicators for measuring commercial activity on the producer and commercial consumer level, we are able to spot certain trading activity which tends to indicate a perceived future disruption in the supply and or demand! How? Remember, the futures markets are adjusting for perceived price changes in the future. The commercial consumers and producers are at the forefront of supply and demand. They will begin certain hedging programs when they perceive changes in the supply and or demand in the future. Our statistical indicators pick up on any unusual trading activity by the commercial hedgers!

A severe disturbance in the supply and demand causes a severe disturbance in price as well! If supply perceived as being lower than anticipated, prices will go higher. If demand is suddenly perceived to be greater than anticipated, prices may go higher as well. We measure the supply in the commercial producer category and the demand in the commercial consumer category. The trading activity of these two participants is a reflection of the supply and demand. The IMPA identifies unusual trading activity prior to the actual adjustment in price! Thus, this provides us with the opportunity to get long or short in front of a significant price adjustment! My statistical indicators derived from the IMPA or (“COT”) data clearly show us when the conditions are right for a subsequent price trend or reversal to follow! These are the conditions we wait for and profit from! Our one page auto-pilot report provides us with weekly insight on which markets we should be focusing on and which markets may be experiencing unusual commercial producer and / or consumer activity!

In my study of the market participants, I've found that the large moves occur when imbalances in supply and/or demand exist! The current activity in the market (buying and selling) sets the price of a particular commodity out in the future. The markets tend to discount current conditions and adjust for future conditions. It can be anticipated that the large users and producers of the underlying commodities are going to begin making adjustments to offset perceived changes in demands and supply ahead of time. This would be prior to shortages or gluts in supply as well as unusual changes in demand. Often what occurs is the large users and or producers are able to understand or simply identify deteriorating conditions in the physicals before any real deterioration in demand or supply disturbances are noted publicly. The lack of public notification is more or less due to a lack of public interest at the right time. Why? The public tends to be followers rather than leaders. By the time the public finally reacts, on average a good bit of the move has already occurred. The public (by ways of the media and news reporters) tends to focus on current events and not on future perceived conditions. The news is always focused on what is occurring right now while the markets and larger commercial participants are focusing on future perceived conditions. Once in the news, the actual disruption has already occurred and adjustments on paper have likely already taken place. Indeed, those paper adjustments will need to be closed out to fully offset the initial preparation for whatever the current disruption might be. Hence, buying on the rumor selling on the fact. The public is usually there to take the other side of the trade when its time for the initial adjustments on paper to be closed out. This is also why contrarain trading methods often work. Some people actually place trades based on doing the opposite of what is currently being touted publicly.

FYI - When I say "on paper" I simply mean futures contracts not the cash physicals.