Has There Been Excessive Speculation in the US Oil Futures Markets? An interview with Hilary Till

In this month's interview, Hilary Till, Research Associate with the EDHEC-Risk Institute, discusses the latest EDHEC-Risk position paper on the existence or otherwise of excessive speculation in the US oil futures markets, the transparency of global oil markets, and changes in the commodities markets.

You have just written an EDHEC-Risk Position Paper entitled "Has There Been Excessive Speculation in the US Oil Futures Markets?". This is a follow-up to research that you carried out in 2008, but is based on new data released by the Commodity Futures Trading Commission in the US. Could you tell us about this new data?

Hilary Till: Yes, on October 20th of this year, the CFTC released three years of enhanced market-participant data for 22 commodity futures markets in its new "Disaggregated Commitments of Traders" (DCOT) report. As noted in the new EDHEC-Risk position paper, this is a welcome announcement of additional transparency into the workings of the US futures markets.

This new data is important because we can now evaluate whether the balance of outright position-taking in the U.S. exchange-traded oil derivatives markets has been excessive relative to hedging demand during the past three years.

Using this new data and with some notable caveats, one can conclude that speculative position-taking in the US oil futures markets does not appear excessive when compared to the scale of commercial hedging over the past three years. As noted in the paper, though, we have to be very careful on how strongly we state this conclusion. For example, we do not examine whether there was excessive speculation in the oil markets in other venues besides the US oil futures markets.

Speculators were accused by many as being the source of the oil price spikes in the middle of 2008, but your research does not provide much support for this position. How difficult is it to distinguish between speculative position-taking and regular commercial hedging?
Hilary Till: Yes, this is the key issue. Prior to the release of the DCOT report, it was difficult to disaggregate the position-taking due to true commercial hedgers versus traditionally defined speculators. The existing Commitment of Traders (COT) report had used some categorizations that rendered their meaning ambiguous. Specifically, the meaning of the traditional COT categories became ambiguous when swap dealers, who were providing commodity-index exposure to investors, became classified as "commercials." In a broad sense, when swap dealers hedge the exposure of their swaps with positions in futures markets, this is indeed hedging. But it is not hedging in the traditional sense of the word. Therefore, it became difficult, strictly speaking, to understand the balance between (physical) commercial hedging participation in the futures markets versus participation by those not involved in the handling of the physical commodity.

The new DCOT report largely solves this problem by clearly disaggregating position-taking by those who handle the physical commodity versus those who do not.

This means that we can readily determine the balance of commercial hedging versus speculation, which we do in the new EDHEC-Risk position paper.

Do you feel that there is generally more transparency now in the global oil markets?

Hilary Till: Arguably, no. Many facets of the world oil markets remain too opaque, including future productive capacity estimates from important suppliers, inventory statistics from important non-OECD consumers, and summary position data from over-the-counter (non-exchange-traded) derivatives participants.

You have been a research associate with the EDHEC-Risk for three years now. What are the major changes that have you seen in the commodities markets in that time?

Hilary Till: A significant change in the commodity markets is how closely correlated all commodities seem to be with other risk assets now. I first noticed this in May-June 2006 during a global de-risking that hit all risky assets, whether it was the Nasdaq, Brazilian stock markets, or individual commodity markets.

Another theme has been that up until 2005, one could trade commodities based on US-centric themes. Unfortunately, for those traders and investors who built up a wealth of US-based experience in the commodity markets, many of their strategies became obsolete after 2005, with the predominance of idiosyncratic Chinese factors becoming much more important.

One issue that has become more important over the past year is reconciling the use of commodity-futures positions as a hedge against the potential of further dollar depreciation. The potential demand for this sort of hedge could be greater than the size of the commodity futures markets. And it may be that the best answer is for institutional investors to use the currency forward and futures markets for this hedging goal rather than the much smaller commodity futures markets.

For the past 25 years, one has not had to defend the economic and social usefulness of commodity futures trading. But this has changed in the past year and a half, after the explosive dislocations in both the financial and commodity markets. From a broad historical view, though, this is all to be expected. In a 1970 article by the preeminent economist, Holbrook Working, one can read about how fragile the existence of commodity futures trading has been in the United States since the late nineteenth century.

As noted in the October 2008 EDHEC-Risk position paper, "The Oil Markets: Let the Data Speak for Itself," one hopes that public policy regarding commodity futures markets in the US and in other financial centers will continue to be based on the careful examination of empirical data.

Therefore, for statisticians, economists, and market participants, the CFTC’s launch of more detailed data on oil-market participation is a welcome announcement. The public
release of this detailed market-participant data shows that the CFTC is continuing in its decades-long tradition of providing policy-makers and academics with empirical data that (one hopes) can be used to make sound decisions on the regulation of US futures markets.

About Hilary Till

Hilary Till is a Research Associate at the EDHEC-Risk Institute (Nice, France) and co-editor of the bestselling book, Intelligent Commodity Investing, Risk Books. She is based in Chicago and is the co-founder of the proprietary trading firm, Premia Capital Management, LLC.

Before co-founding Premia Capital, Ms. Till was the Chief of Derivatives Strategies at Putnam Investments and prior to this position was a quantitative analyst at Harvard Management Company.

She has a B.A. with General Honors in Statistics from the University of Chicago and an M.Sc. degree in Statistics from the London School of Economics (LSE). She studied at the LSE under a private fellowship administered by the Fulbright Commission.

Her published work on behalf of EDHEC-Risk has been cited in the Journal of Finance and Journal of Structured Finance as well as by the Bank of Japan, the Banque de France, the European Central Bank, the Bank for International Settlements, the International Monetary Fund, the International Organization of Securities Commissions (IOSCO), the US Senate’s Permanent Subcommittee on Investigations, and by the United Nations Conference on Trade and Development.

In addition, she presented her research on the oil futures markets to the International Energy Agency at the agency’s Paris headquarters in March 2009.

Attachments

EDHEC-Risk Position Paper "Has There Been Excessive Speculation in the US Oil Futures Markets?"  
EDHEC-Risk Position Paper "Oil Prices: the True Role of Speculation"

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