Flash report COT Sp500

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"Quantitative approach for asymmetric results"

Who to follow, smart money or dumb money?

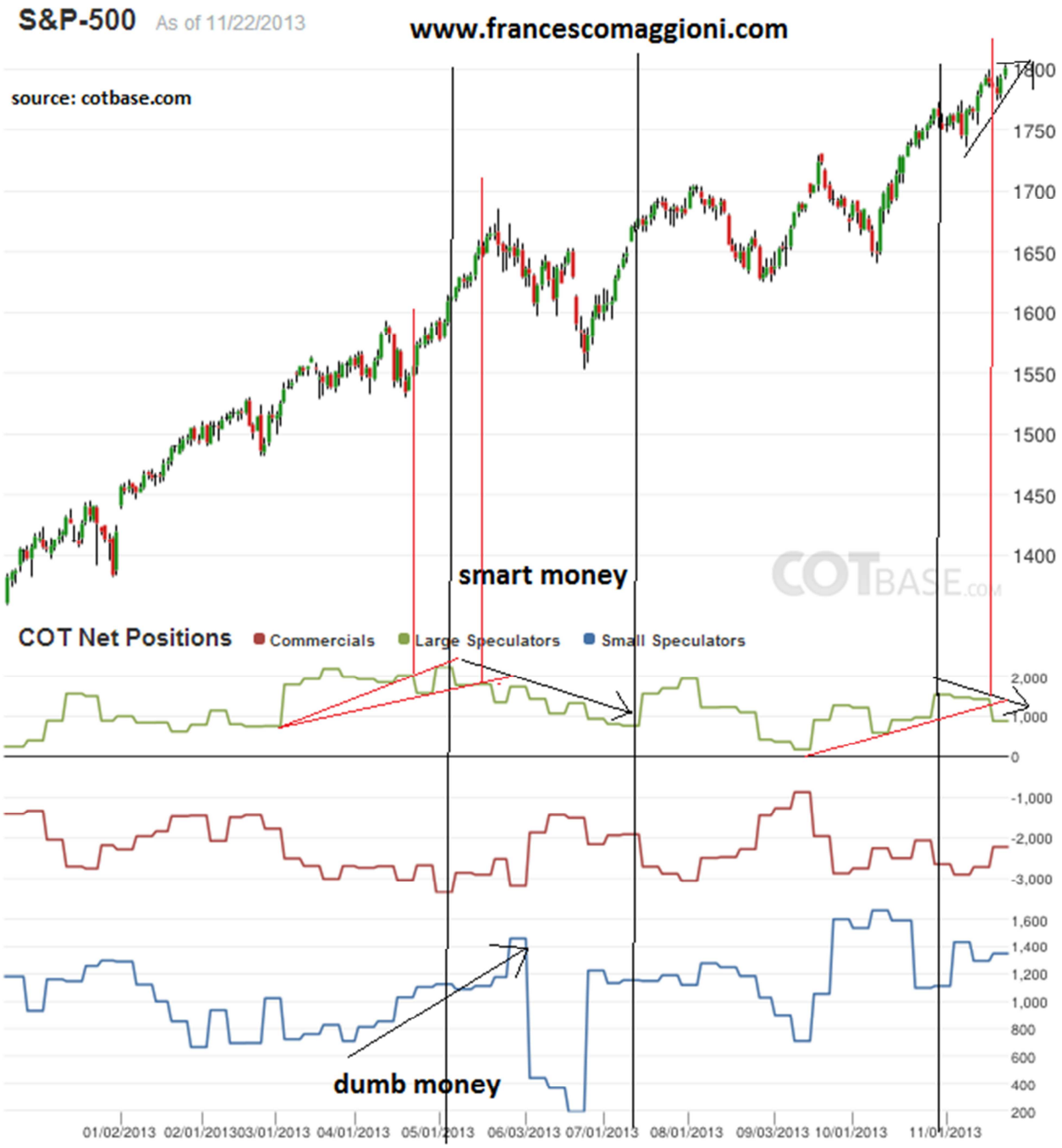


Figure 1: COT analysis

The above image shows the Commitment of Traders for the data up to November 22nd, 2013.

What is important, at least for me is to check the behavior of Large Traders (green line) notably the "smart money" which can be seen that in past retracements (June to July 2013) they decreased their net long exposure way before the retracement started.

On the other hand, the Small Investors (or in a not so polate way, called "dumb money") they had their maximum exposure right up before, or just after the trend inverted, and at that point they decreased their exposure dramatically.

How are those two players behaving right now? Large Trdaders have recently decreased their long exposure with the Sp500 hitting new historical highs. One way of interpreting such divergence situation is that Large Traders do not believe that the Sp500 can go much higher than current levels and/or expect a retracement soon.

Small speculators seem to see or feel the movement done by the Large Traders as they too decreased their net long position. Maybe the general idea in the investment community is that current level of Sp500 seems to be unsustainable and before pushing again on the throttle everybody wants to see the incoming macro data which may, or may not, lead to the tapering.

The one that I tend to see and interpret with higher reliability are still the Large Traders and the message is to be cautious at these levels.

Another way to "trade" the COT is to draw trendlines on the Large Traders' line and see when the line (red in this case) is violated: in the case showed above the violation downward of the LT holdings gives usually a good stop profit tool when long. It can be done in the same way for short positions.

In the next page you will see an historical chart of the COT from 2008 to 2013 with trendlines and marks to show when those trendlines are violated.

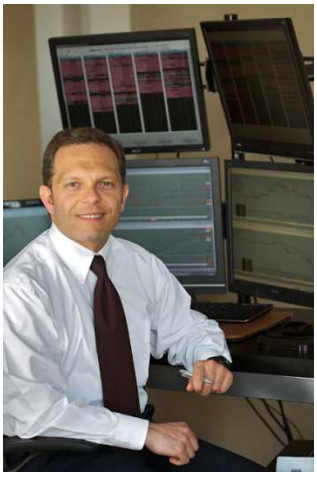
It is important to constant check the COT in the incoming weeks to have a better understanding of future movements of the Sp500, and depending on the Large Traders' position we might be able to clearly define a possible downward movement either a retracement, or trend inversion.

WHAT IF:

The Sp500 will continue its parabolic upward movement? Large Traders will very probably increase their long exposure stating that no trend inversion will happen anytime soon.

An alert should be put above Friday's high as breaking such high will probably trigger this second tier scenario.

Figure 2: Historical COT analysis with trend lines



Mr. Maggioni has been working in the financial markets for the last 11 years covering different roles and working in tier 1 consulting companies and banks worldwide.

In recent years his studies have been focused on the psycho-emotional aspects of trading and how those aspects have an impact on traders' behavior.
Before starting this venture, he was head of a hedge fund desk at HSBC Private Bank in Monaco and before that he was employed at Credit Suisse Asset Management (CSAM) in Zurich covering the in-house single manager hedge funds.

Most of his experience in hedge funds was gained while working in a Swiss family office where he was in charge of the research and analysis as well as due diligence for US and European hedge funds. He also performed quantitative analysis and portfolio construction for several funds advised by the family office.

Prior to that he worked as an external consultant for KPMG Financial Services in the Milan office. In 2002 he has been hired by Ernst & Young LLP, San Francisco as auditor for hedge funds, auditing large single funds and fund of funds. In 2000 he joined Ernst & Young in Milan as an auditor for mid-sized companies.

Mr. Maggioni holds an MBA from IUM and a Portfolio Management degree from the University of Chicago GSB.

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