

## HUD Commodities Guide

The Heads Up Display (aka: HUD) is our evolving suite of analytical tools we use to separate wheat from chaff, signal from noise, and needles from haystacks... empowering us to make quantitatively supported, positive expected value bets.

We are in the business of [Conditional Edge Stacking](#). Our HUD is the primary tool we use to stack edges upon edges upon edges... you get the point.

The following guide will show you how we use the **HUD's Commodity Tab**.

We'll focus on the actionable steps needed to use these indicators in a trading process. There's a lot of research and theory backing these tools, but we'll cover that in a separate guide.

It's important to note that the HUD Commodities tool is only one input into a full trading process. Our team's process, the [Trifecta Approach](#), involves combining technicals, fundamentals, and sentiment/positioning.

This Commodities tab is a launching off point for that. It quickly tells us where there are extremes, anomalies, tailwinds and headwinds on a sentiment/positioning, technical, and seasonality basis.

Let's walk through a workflow for a recent trade as an example.

To start, here's the top section of the Commodities Tab.



It shows an aggregation of three things:

1. Net Speculator vs Net Commercial positioning on the chart on the left.
2. Net Position Delta which measures the rate of change in both Commercial and Speculator positioning over a 26-week period, in the middle.
3. SQN Market Regime and overbought/sold price vs 20, 50, and 200-day moving average spreads, in the graph to the right

So at a quick glance, this row tells us where the extremes in positioning are. Along with which markets are seeing the biggest changes in that positioning. And what the SQN Market Regimes (which quantifies trend and vol characteristics) are, along with how overbought or oversold each asset is across three different timeframes.

This tool helps us exploit three embedded characteristics of the market:

1. The market tends to move in a way that hurts the most people, most of the time
2. Trend, mean reversion, and momentum are the three key forces behind price moves
3. Regimes matter... Markets top in SQN Bull Volatile Regimes and bottom in Bear Volatile ones

## Step 1: COT Positioning

First off, if you haven't read it, go and pick yourself up a copy of [The Commitments Of Traders Bible](#), by Stephen Brieze. It is the legit bible of CoT trading and is really the only book you need to read on the subject.

Alright, moving on...

The first step is to scan the CoT Positioning chart. Its data comes from the Commitment of Traders Report, which we'll discuss in another guide. But really, you should just read Brieze's book.

Now, we can get into the weeds of best practices for using the new disaggregated report and what should be included in net specs, as well as commercials, etc... But for today's example, we're keeping things basic. So that we can give you a *quick* look at how we use some of these tools.

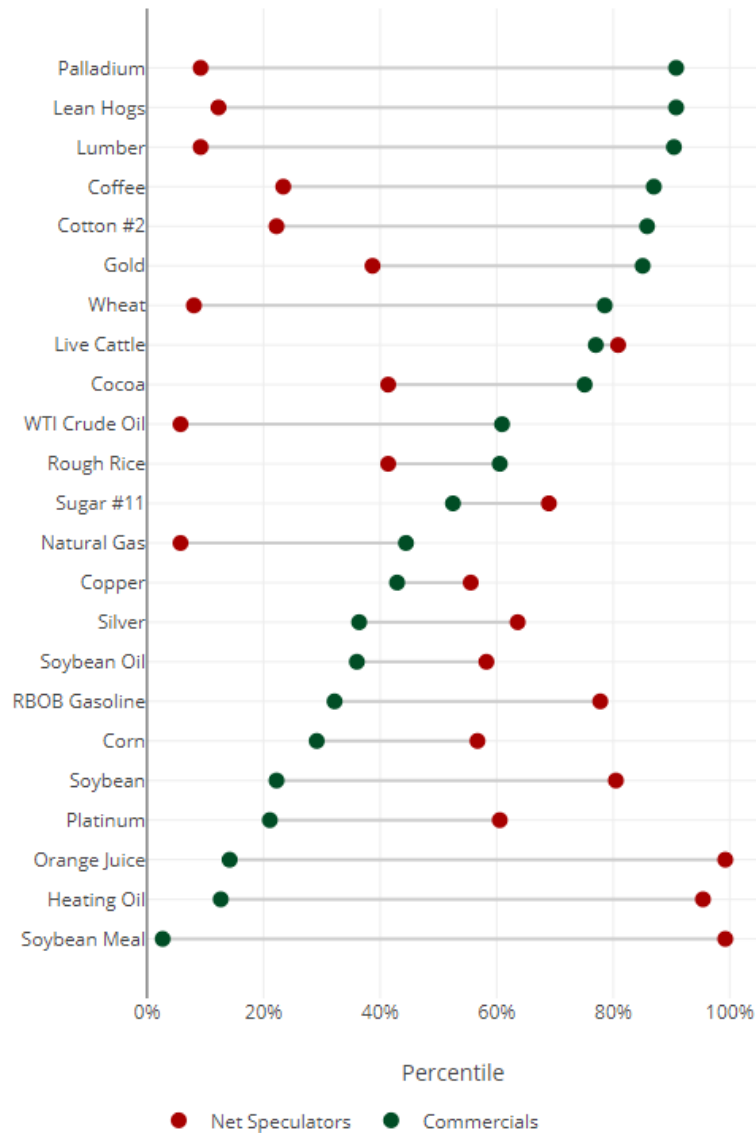
The graph shows the net positioning of both Speculators (red dots) and Commercials (green dots) in the market.

We take the basic CoT data and adjust it for the average open interest over both a five-year and 6-month period. This gives us a read on positioning levels and changes to those levels over both a long and short time frame.

**100% means specs or commercials are the most bullish they've been over the preceding five year period. A 0% reading means they are the most bearish they've been over five years.**

COT Positioning

260 Weeks



To oversimplify things, commercials are companies that use commodities as inputs into their businesses. Commodities markets function as a place for them to hedge and reduce their spot price exposure.

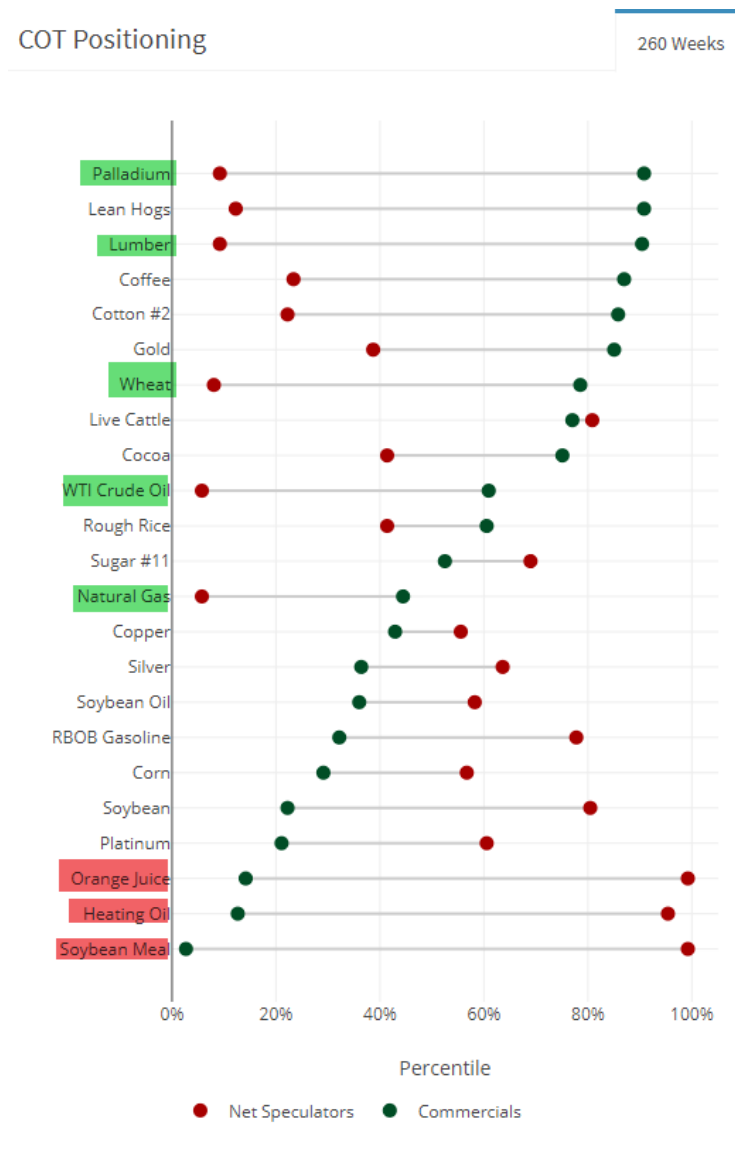
Speculators are, well, speculators like you and me. They degenerate betting on the price changes of various commodities in order to make a buck.

We want to look for extremes in positioning, as it's these extremes in positioning which precede/create large trends and trend reversals.

Let's just use Specs for this example.

**For potential market bottoms, we want to look for readings below 10%. For potential market tops, we want to look for readings above 90%.**

I've highlighted these levels in both green and red, respectively.



Palladium, lumber, wheat, crude, and natty are all markets currently with historically low speculative positioning (<10%). And orange juice, heating oil, and soybean meal show the opposite, with speculators wildly bullish (>90%).

We're going to focus on crude oil for this example, but the positioning extremes in these other names all warrant further investigation.

Moving on... net spec positioning in crude is currently in its 8th percentile relative to its 5yr OI-adjusted average.

This means specs are quite bearish. Which is to be expected, considering an inbound US recession had become a bit of a consensus bet over the last few months.

We at MO are on the other side of that consensus. Our models tell us that a recession is highly unlikely in the first half of the year. We also happen to be wildly bullish oil and oil related equities, for [Capital Cycle](#) reasons. So it's nice to see that this wrong consensus extends to bearish positioning in crude.

## **Step 2: Net Position Delta**

A commonly held but *very* wrong belief is that you want to fade extremes in positioning.

That simply is not true... or at least it's not that simple.

Here's the reality. Yes, extremes in positioning sow the seeds for major tops and bottoms. But... and this is an important *but*... you're very likely to get steamrolled if you just go around fading monster trends because of high or low positioning. You need another input, a timing component.

That component is the Net Position Delta, or the rate of change in the positioning.

So the net delta looks at the change in positioning over a shorter timeframe (we adjust by the 26-week avg OI).

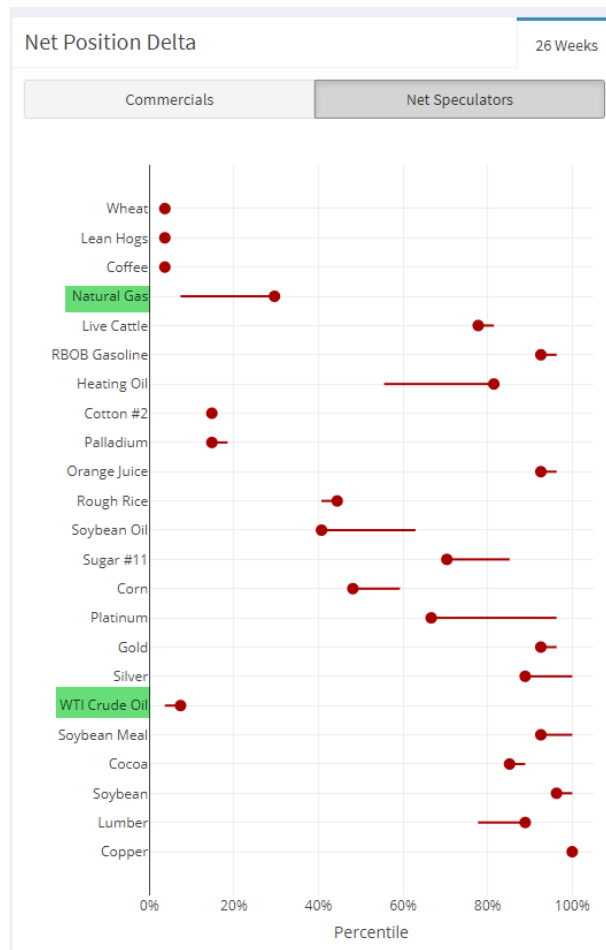
The graph below shows this change in positioning for speculators (you can also view it for commercials).

Here's how you read this.

**We want crowded positioning that's beginning to reverse**, as it's this change in positioning — people starting to walk from one crowded side of the boat to the other empty side — that eventually drives a change in trend (top or bottom).

Specs in natural gas are starting to exit their crowded longs. That should help put a floor under natty prices soon.

We can see the same thing in crude, though to a lesser degree. But for a potential fade trade (going long against the consensus spec short) to work, we want to see the net delta continue to shift right, to the higher percentiles, showing that investors are starting to doubt their bearish bias.



Okay, so far, in our look into crude. We know that speculators are very bearish. But, these specs are beginning to question their bearish bias, and so they're starting to lighten up or even reverse some of their positioning.

This is exactly what we want to see when we're thinking about fading the herd. But to prevent us from jumping in front of a stampede, we want to check in on a few more conditions.

### Step 3: Market Regime & Z-Score

The next step is to review the Market Regime and Z-Score of the commodity being analyzed:

Market Regime & Z-Score

Name	Market Regime	Z-Score (20 Day)	Z-Score (50 Day)	Z-Score (200 Day)
Gold	Bull Quiet	-1.57	0.43	1.06
Sugar #11	Bull Quiet	0.59	1.07	1.95
Orange Juice	Bull Quiet	<b>2.07</b>	<b>3.16</b>	<b>2.58</b>
Live Cattle	Bull Quiet	<b>2.25</b>	<b>2.04</b>	1.84
Silver	Neutral	<b>-2.83</b>	-1.08	0.63
Platinum	Neutral	-1.93	-1.76	0.41
Copper	Neutral	-1.67	0.28	0.55
Cocoa	Neutral	-1.02	0.36	1.33
Rough Rice	Neutral	-1.02	0.00	0.93
Soybean Meal	Neutral	0.29	0.95	1.47
Feeder Cattle	Neutral	1.38	1.55	1.24
Heating Oil	Bear Quiet	<b>-2.17</b>	<b>-2.35</b>	<b>-2.20</b>
WTI Crude Oil	Bear Quiet	-1.90	-1.57	-1.45
RBOB Gasoline	Bear Quiet	-1.56	-0.45	-1.09
Corn	Bear Quiet	0.05	0.69	-0.32
Soybean	Bear Quiet	0.18	1.00	-0.14
Oats	Bear Quiet	0.63	0.77	-0.71
Lumber	Bear Quiet	0.63	1.32	-0.44
Wheat	Bear Quiet	0.86	0.20	-0.86
Palladium	Bear Volatile	<b>-2.06</b>	<b>-2.23</b>	<b>-2.35</b>



Our SQN [Market Regime](#) graph gives us a plethora of vital technical information about an asset's trends and characteristics, using a simple quantitative measure.

The SQN indicator can be thought of as a market thermometer. Research by Van Tharp and other prominent figures shows that the market behaves in distinct regimes.

Knowing how to trade in different Market Regimes is just as important, if not more so, than what to trade. So what is a Market Regime?

A Market Regime is a quantified method of organizing the characteristics of different trading environments. We have five:

- **Bull Volatile:** An up trend with increasing volatility. Bull Volatile regimes are preconditions for major tops.
- **Bull Quiet:** An uptrend with low volatility. These are the most profitable regimes to be long in.
- **Neutral:** Sideways range / no trend direction. Over 80% of breakouts from these regimes fail. Mean reversion strategies work well in these.
- **Bear Quiet:** A downward trend with low volatility. These are the most profitable for shorting.
- **Bear Volatile:** A downward trend with increasing volatility. These regimes are preconditions for major bottoms.

Each regime is a measurement of the direction of travel of the underlying asset, Bullish, Bearish, or Neutral. And further organized by Volatile or Quiet.

The SQN measures the average % change from close to close to the previous 100 days and then square roots it.

We can write pages on this topic. And this is an incredibly powerful tool when put to its full use. But, no time for that today, and I want to get back to our example.

Suffice it to say, this is a great way to scan for markets that are worth looking into if you want to get long (look at Bull Quiet and Neutral regime assets) and if you want to get short (Bear Quiet).

Okay, back to our example.

Crude is in a Bear Quiet trend. It bottomed in a Bear Volatile back in early December. The June contract that we're interested in buying is in a Neutral regime. This means that it's a good regime to take swing longs at the lower bounds of its trading range (which we just recently did).

The other factor to consider is the Z-Score. **The Z-Score shows the number of standard deviations that price is above or below its moving average.**

- When price is multiple standard deviations above its moving average, it's susceptible to mean reversion lower
- When price is multiple standard deviations below its moving average, it's susceptible to mean reversion higher

This Z-Score chart will automatically highlight any markets where price is 2 standard deviations above or below a moving average.

The idea is to look at price in comparison to its different averages (20, 50, 200 day) to see how it's acting on different timeframes.

Crude is just coming off from being over 2 stdev below its 200-day moving average. That's deeply oversold territory and means we should be on the lookout for some mean reversion higher.

#### **Step 4: Seasonality**

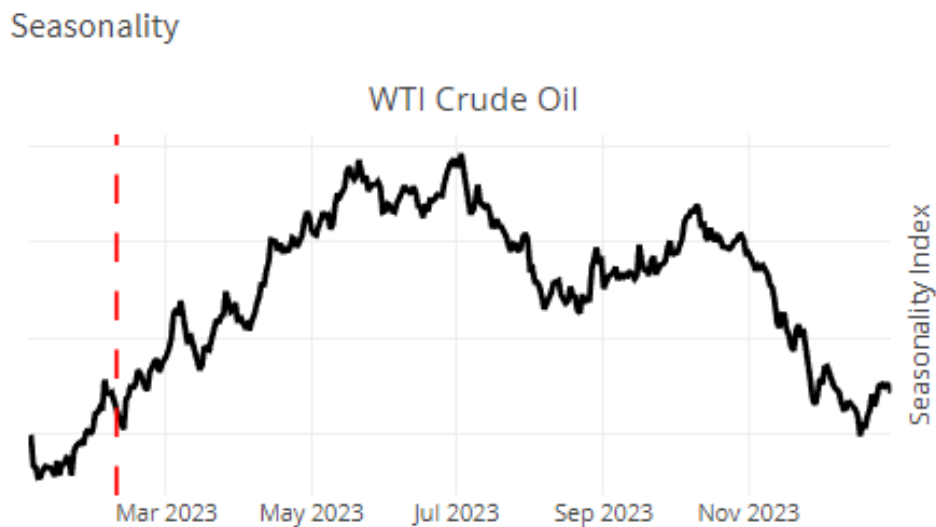
In the mid part of the commodities tab, we have our multi-view section (Futures curve will soon be added to the bottom right corner).



Many of these charts are time series of what we've already talked about above. But one key input, especially when analyzing commodities, is seasonality. That chart is located in the top right corner.

Here's the seasonality of crude. **The vertical red line represents where we are now**, which is smack dab in the early part of crude's strongest period of seasonal tailwinds for the year. This seasonal tailwind continues until May 21st.

That's another conditional edge added to our stack for bullish crude.



## Step 5: Bollinger Bands, Valuation, Open Interest Oscillator



Lastly, we have an Open Interest Oscillator. A proprietary valuation measure, and a measure of Compression and Expansion regimes.

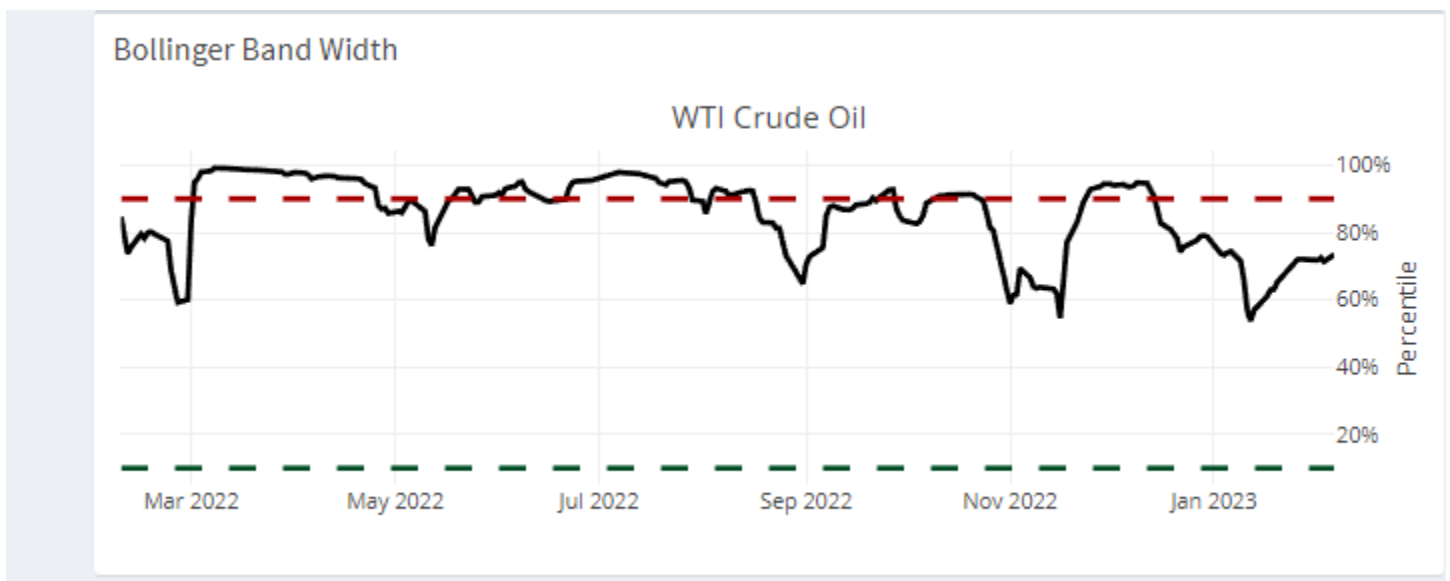
**The Open Interest tool is what the name implies. It's a measure of OI over a 3yr period.** You can think of it as a measure of sentiment. A high reading indicates high speculative interest, and a low reading indicates disinterest. These are the conditions that markets bottom and top in.

Currently, in crude oil, OI is coming off the zero percentile. That means there's been zero speculative interest in this market since July. There's total apathy there.

**A great setup is when we see a very low OI reading (<10%) that coincides with bearish speculative positioning and high commercial interest.** These are the characteristics of major bottoms. And it's what we're seeing in crude right now.

**Bollinger Bands show when a commodity's price is compressed. In markets, compression leads to expansion (ie, Big Trends).** Compression isn't a prerequisite for a big trend, but it is a very valuable signal when you see one. It means there's strong odds a big trend is coming.

Looking at Bollinger Band Width keys us into that:



When price is close to the **green horizontal line**, it's compressed and ready to move.

When price is close to the **red horizontal line**, it's expanded and a big move(s) has already occurred, so the market is susceptible to mean reversion.

This indicator is directionally agnostic. If price is coiled, it can expand higher *or* lower.

In the case of crude, BB width is in neutral reading, so there's no added signal, positive or negative.

To reiterate, all these signals (steps 1 through 5) give us incredibly valuable insight into each commodity market.

With a quick glance, we know immediately how the crowds are positioned, how that positioning is changing, which markets are in which Regimes, how extended their trends are, and how the asset is priced relative to its historical valuation.

These are key pieces of the edge stacking game. The next piece of a profitable trade is matching this data with solid fundamental and technical analysis.