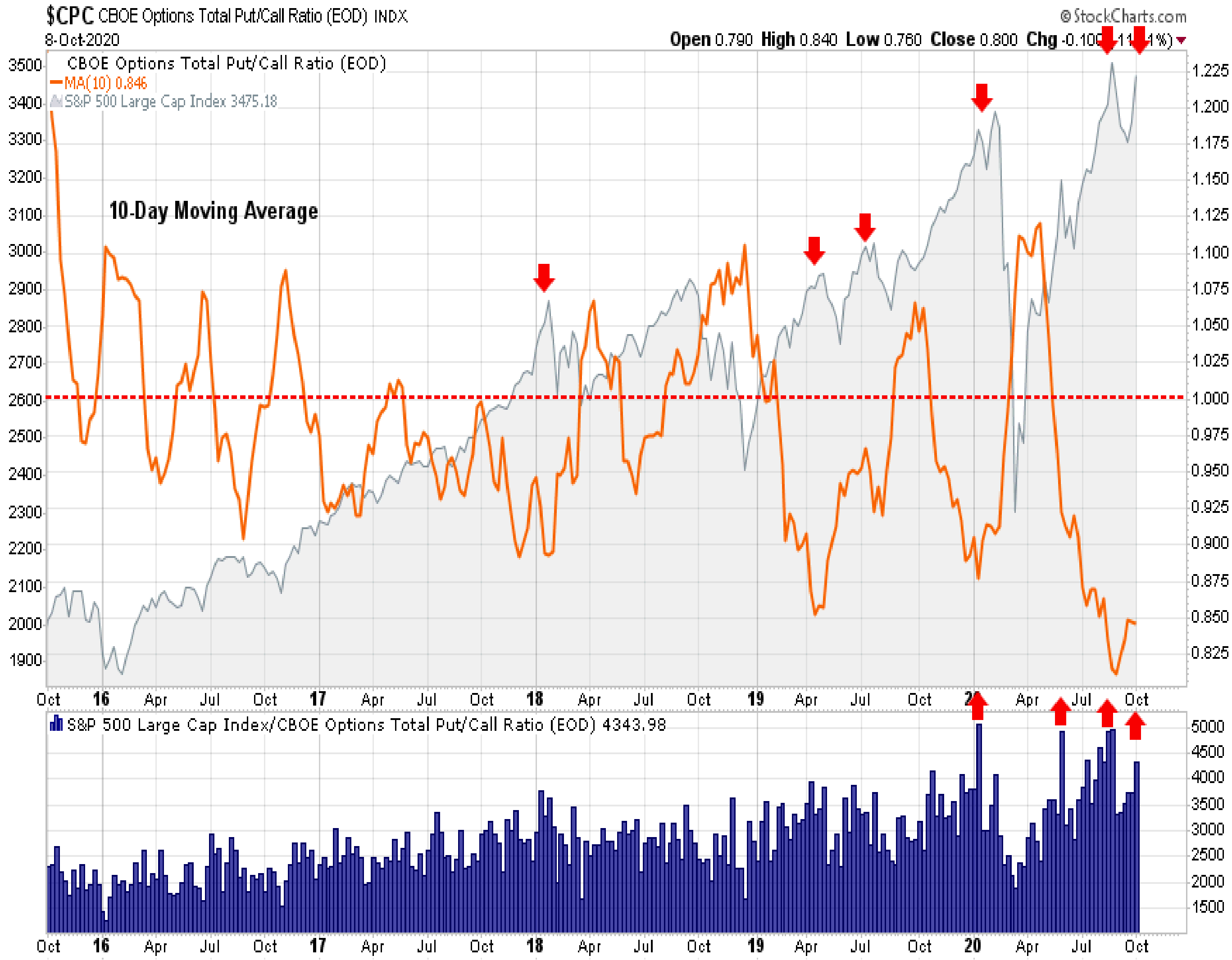
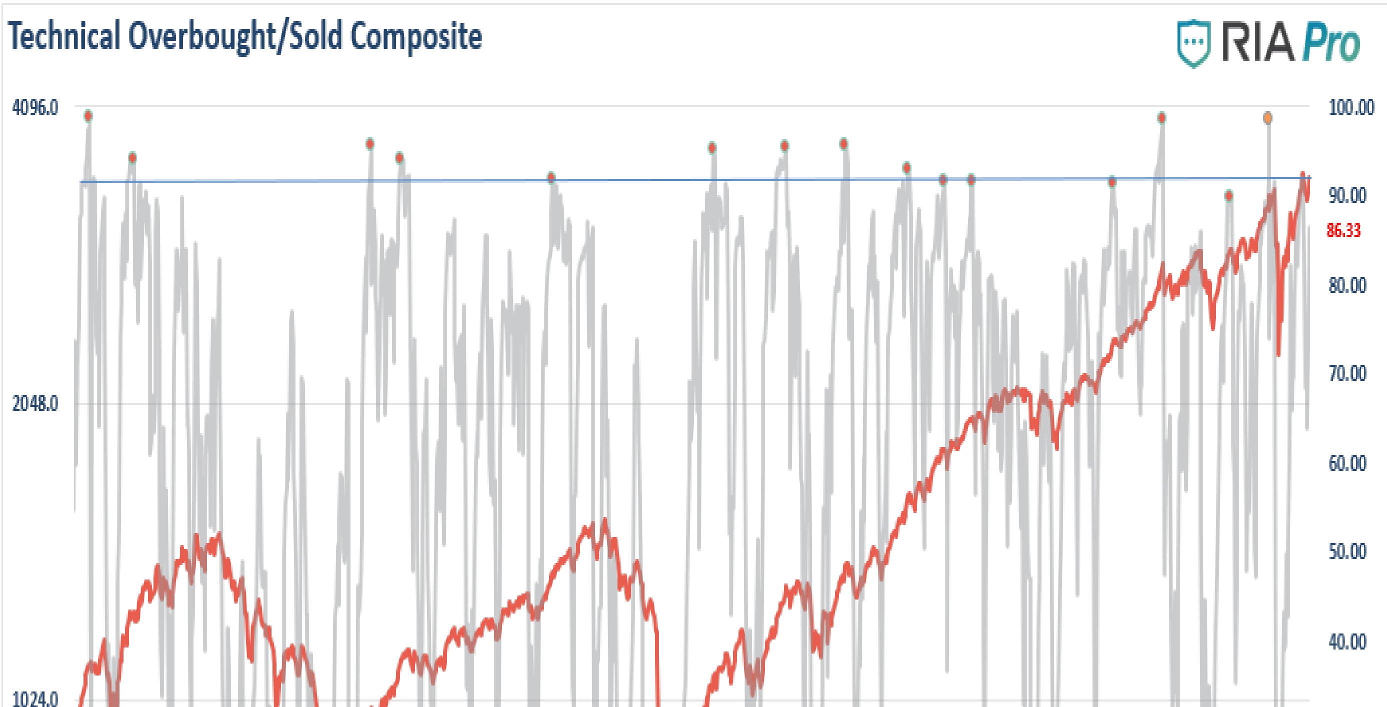
As discussed in [***Hopes Of More Stimulus,***]() the market has rebounded following the September decline. Unfortunately, the market has again gotten quite ahead of the fundamentals as money continues to chase performance. In the Q3-2020 review of the Commitment Of Traders report (COT,) we can see how positioning has moved back towards extremes. Once again, *"everyone's back in the pool."* The market remains in a bullish trend from the March lows but has returned to more extreme overbought conditions on an intermediate-term basis. Despite valuations on a 2-year forward basis at more extreme levels, economic growth recessionary, and a significant risk of a failure to pass more stimulus, investors continue to chase markets.

Furthermore, as noted in this past weekend's newsletter:

> *"Retail investors have also ramped up speculative bets again, pushing the Put/Call ratio back towards previous highs. There is still room before getting back to previous levels, which suggests a run to all-time highs is possible."*



While this does not mean the market is about to crash, it does suggest *"everyone"* is once again on the long side of the *"risk trade."* The piling back into stocks following the brief September decline has sent our technical composite gauge back towards extreme overbought levels as well. ***[(Get this chart every week at RIAPRO.NET)]()***



What we know is that markets move based on sentiment and positioning. Such makes sense considering that prices are affected by buyer's and sellers' actions at any given time. **Most importantly, when prices, or positioning, become too *"one-sided,"* a reversion always occurs. As [Bob Farrell's Rule #9 states:]()**

> ***"When all experts agree, something else is bound to happen."***

So, how are traders positioning themselves currently?

Positioning Review

The COT *(Commitment Of Traders)* data, which is exceptionally important, is the **sole source of the actual holdings of the three key commodity-trading groups, namely:**

- ***Commercial Traders:*** *this group consists of traders that use futures contracts for hedging purposes and whose positions exceed the reporting levels of the CFTC. These traders are usually involved with the production and/or processing of the underlying commodity.*
- ***Non-Commercial Traders:*** *this group consists of traders that don?t use futures contracts for hedging and whose positions exceed the CFTC reporting levels. They are typically large traders such as clearinghouses, futures commission merchants, foreign brokers, etc.*
- ***Small Traders:*** *the positions of these traders do not exceed the CFTC reporting levels, and as the name implies, these are usually small traders.*

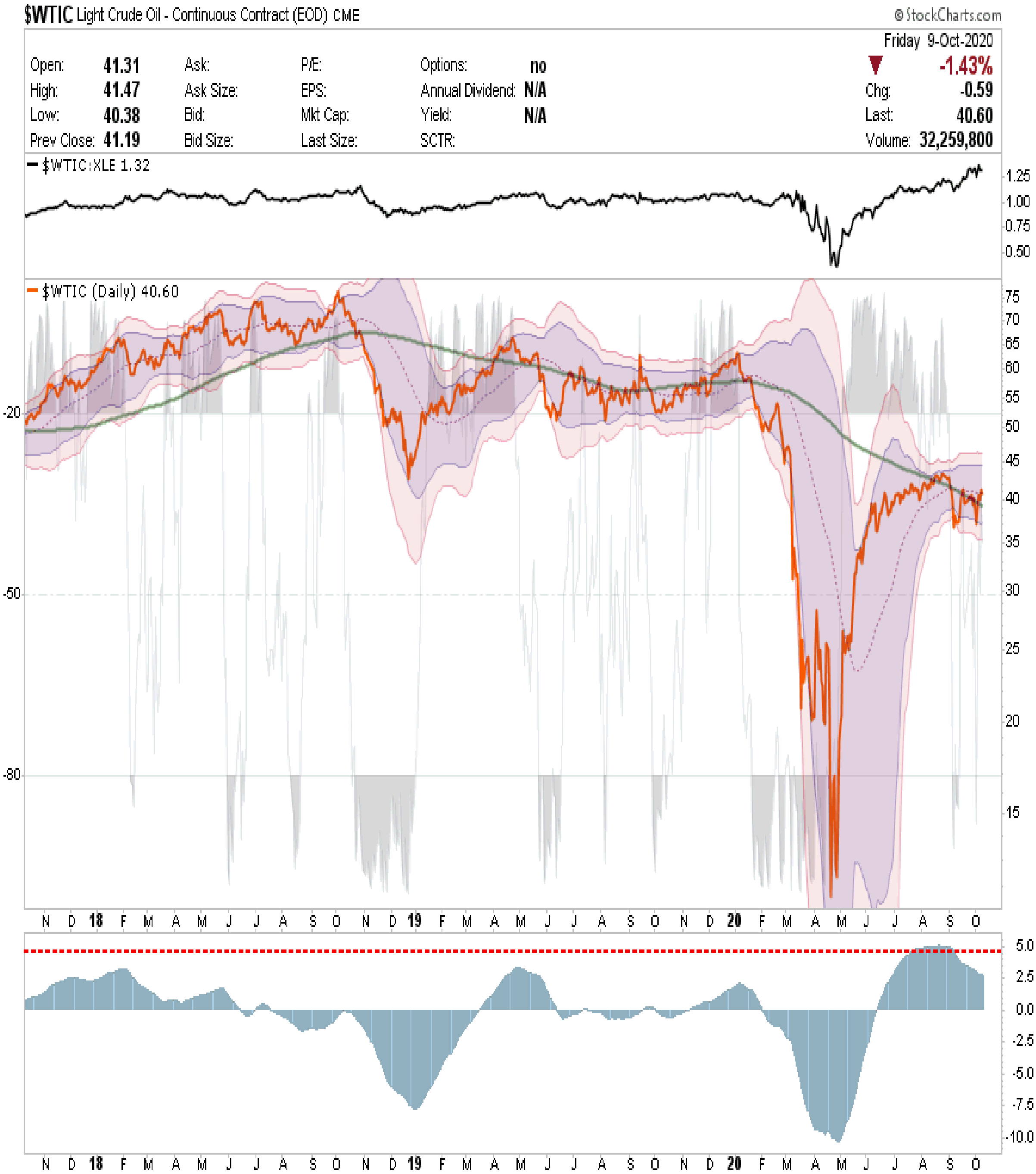
The data we are interested in is the second group of ***Non-Commercial Traders (NCTs.)*** NCT's are the group that speculates on where they believe the market is headed. **While you would expect these individuals to be *?smarter?* than retail investors, we find they are just as subject to *"human fallacy"* and *?herd mentality?* as everyone else.** Therefore, as shown in the charts below, we can look at their current net positioning *(long contracts minus short contracts)* to gauge excessive bullishness or bearishness.

Volatility

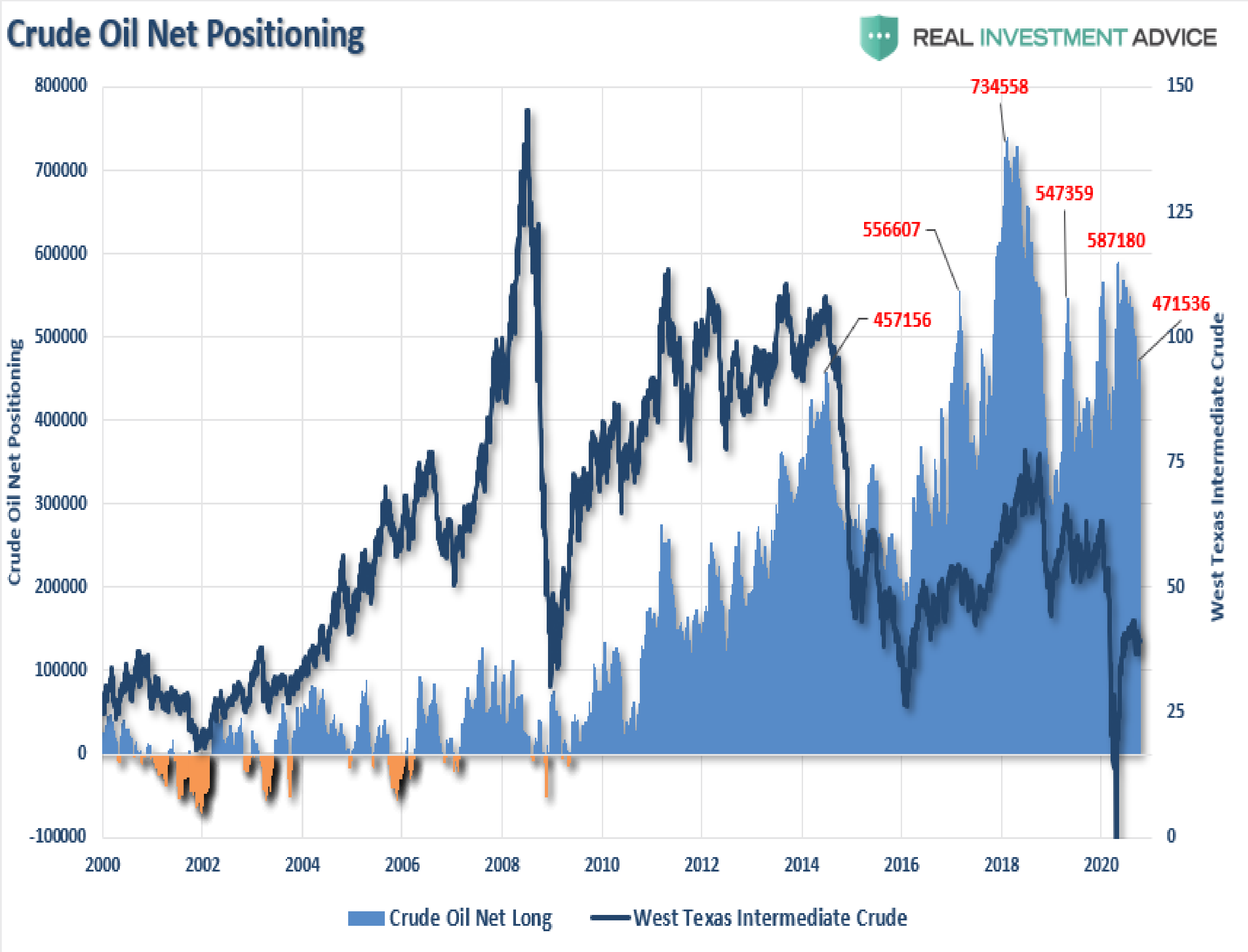
Since 2012, the favorite trade of bullish speculators has been to *"short the VIX."* Shorting the volatility index has been an extremely bullish and profitable trade due to the inherent leverage in options. Of course, as with all things option related, it works great when it works. Just not so much when it doesn't. With the market rally from the March lows, investors have become encouraged to take on risk. Currently, net shorts on the VIX are rising sharply and are back to more extreme levels. While not as severe as seen in 2017 or 2020, the positioning is large enough to fuel a more significant correction. The only question is the catalyst.

Crude Oil Extreme

Crude oil interesting. The recent attempt by crude oil to get back above the 200-dma coincided with the Fed's initiation of QE-4. Historically, these liquidity programs tend to benefit highly speculative positions like commodities, as liquidity seeks the highest return rate. While prices collapsed along with the economy in March, there has been a sharp reversal of global economic recovery expectations. Interestingly, with the economic recovery showing signs of slowing, crude oil has stalled at its 200-dma.



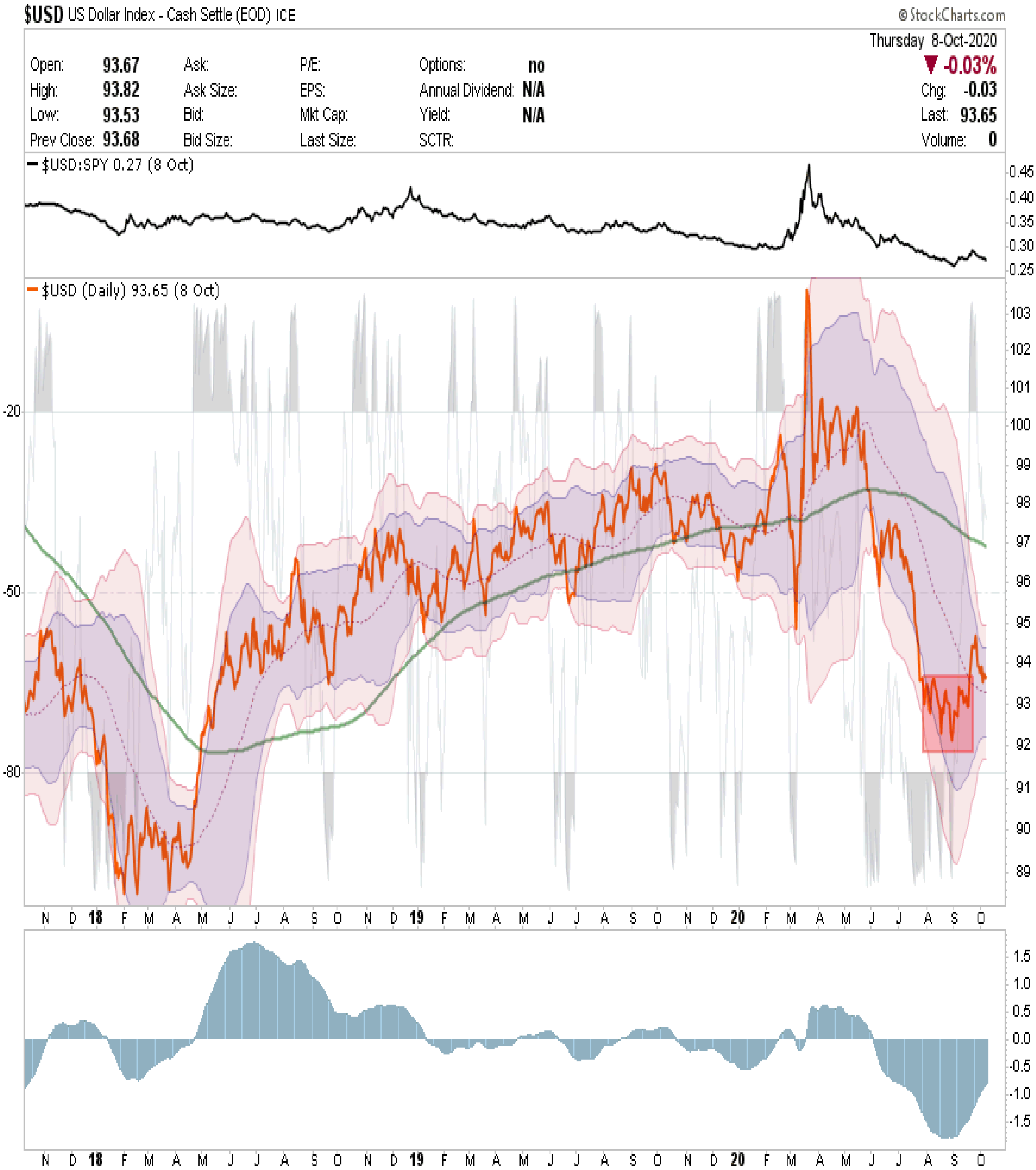
Furthermore, while Oil prices have had a sharp recovery from the March lows, the energy sector has not, and many stocks continue to trade near their previous lows. It is quite a dichotomy between the commodity and the companies that operate in that space. In fact, as noted at the top of the chart, the outperformance of crude oil versus $XLE is at the highest level on record. The speculative long-positioning is driving the dichotomy in crude oil by *NCTs.* While levels have been reduced from previous 2018 highs by a series of oil price crashes, they remain more extreme at 471,536 net-long contracts. While not the highest level on record, it is definitely on the *"extremely bullish"* side.



Libya bringing production back online would further exacerbate the oil supply problem. Or, a lack of fiscal stimulus would derail the economic *"reflation"* story. Either event could trigger an unwinding of oil contracts pushing prices lower once again.

U.S. Dollar Extreme

Another catalyst for a decline in commodity prices, equities, and ultimately bond yields **would be a rise in the U.S. dollar.**

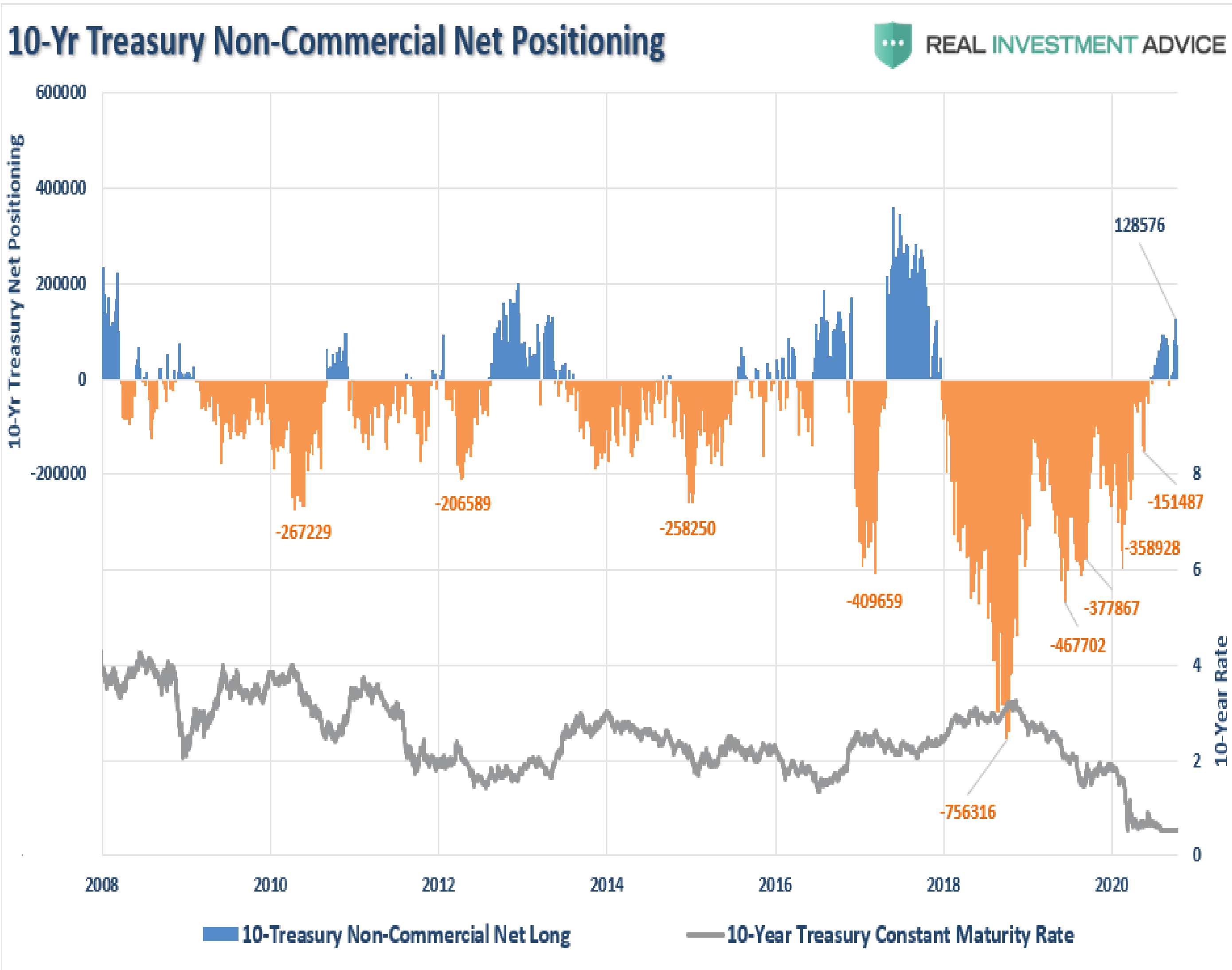


Much of the bulls rallying cry has been based on the dollar weakening with the onset of QE. **Such has also been the tailwind for the rally in International and Emerging Markets.** However, over the last couple of months, the long-dollar bias has reverted to a net *"short" positioning.* Historically, these reversals are markers of more important peaks in the market and subsequent corrections **as the dollar begins to rally.**

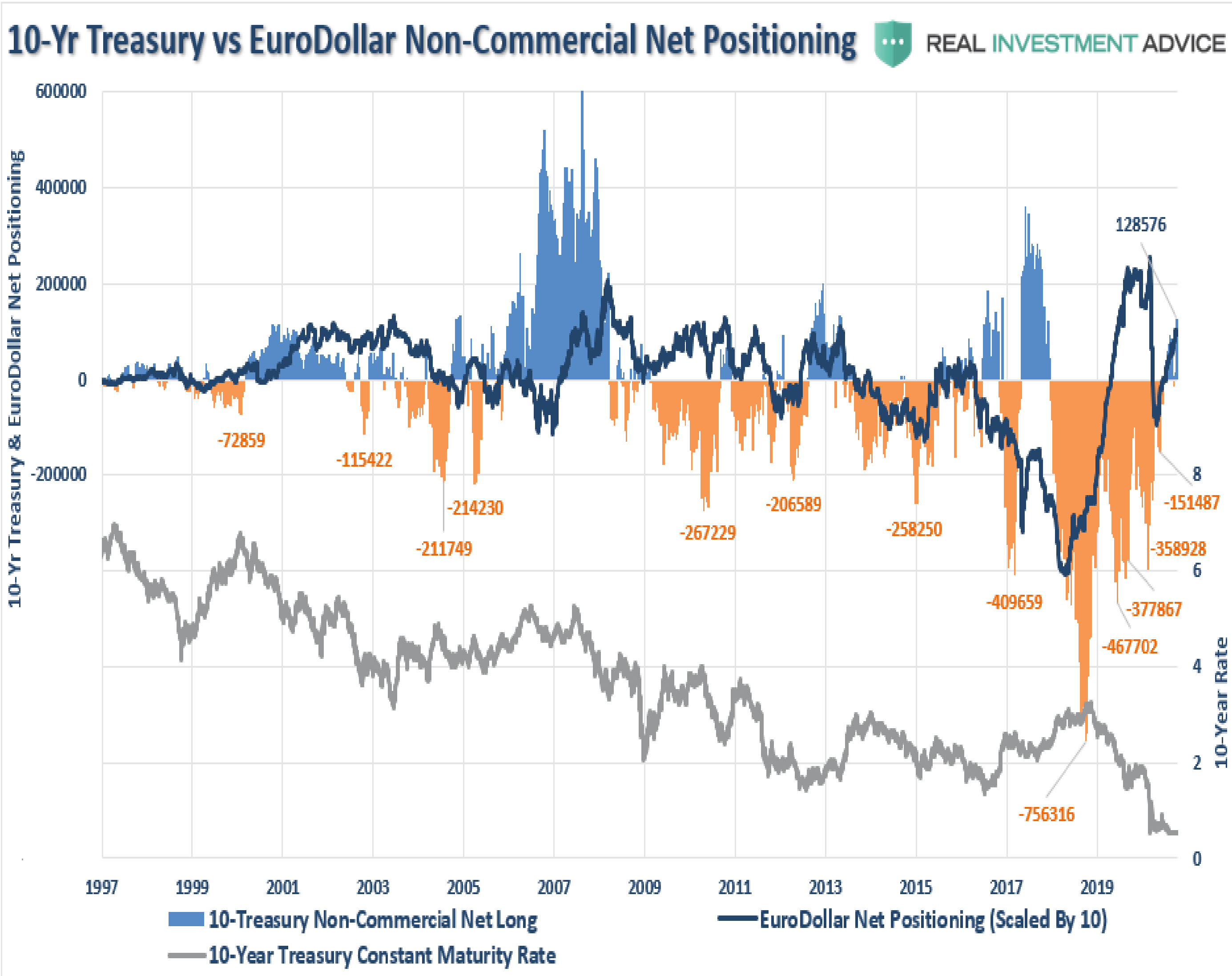
Given the more extreme long-positioning in risk assets and commodities, a decent hedge to reduce portfolio risk appears to be in the contrarian positioning of being long the US Dollar. Such is generally when the media is rampant with stories about the *"demise of the dollar."*

Interest Rate Extreme

One of the biggest conundrums for the financial market *?experts?* is why interest rates fail to rise. In March of last year, I wrote: ***"The Bond Bull Market,"*** which followed up to our earlier call for a sharp drop in rates as the economy slowed. **We based that call on the extreme *"net-short positioning"* in bonds, which suggested a counter-trend rally was likely.** Since then, rates fell to the lowest levels in history as economic growth collapsed. Importantly, while the Federal Reserve turned back on the *"liquidity pumps"* in March, juicing markets back to all-time highs, bonds have continued to attract money for *"safety"* over *"risk."* Such has continued to confound the *"bond bears"* who were sure rates would go screaming higher. Of course, as discussed in the article, they can't go higher when the economy is saddled with debt. Currently, mainstream expectations are for an economic recovery, more stimulus, and a rise in inflationary pressures. However, the number of contracts *"net-long"* the 10-year Treasury, suggests the recent uptick in rates, while barely noticeable, maybe near its peak. **Such suggests the mainstream narrative may not come to pass.**



Importantly, even while the previous *"net-short"* positioning in bonds has reversed, rates failed to rise correspondingly. The reason for this is due to rising levels of **Eurodollar positioning** as foreign banks push reserves into U.S. Treasuries for *"safety"* and *"yield."*



There is a probability interest rates will fall in the months ahead, coinciding with an acceleration of economic weakness.

Conclusion

Despite the *"selloff"* in March, **retail positioning is once again very long-biased. The implementation of QE-4 once again removed all *"fears"* of a correction, recession, or bear market.** Historically, such sentiment excesses from around short-term market peaks, not investable bottoms. Such is an excellent time to remind you of the other famous *"Bob Farrell Rule"* to remember:

> ***"#5 ? The public buys the most at the top and the least at the bottom."***

Investors miss that while a warning doesn?t immediately translate into a negative consequence, such doesn't mean you should ignore it.

> *"There remains an ongoing bullish bias that continues to support the market near-term. Bull markets built on 'momentum' are very hard to kill. Warning signs can last longer than logic would predict. The risk comes when investors begin to 'discount' the warnings and assume they are wrong. It is usually just about then the inevitable correction occurs. Such is the inherent risk of ignoring risk.'"*

The cost of not paying attention to risk can be extraordinarily high.