Market
Intelligence
Branch

The Retail Influence

The Global Markets Advisory Committee

The Markets Intelligence Branch ("MIB")
The Division of Market Oversight ("DMO")
March 2021

COMMODITY TRADING COMMISSION
1975

Disclaimer

The views expressed represent those of staff in MIB and do not necessarily reflect the views of the Commodity Futures Trading Commission, any of the Commissioners, the Division of Market Oversight, or other staff at the Commission.

Consistent with Section 8(a) of the CEA, this presentation does not contain data or information that would separately disclose the business transactions or market positions of any person, any trade secrets or names of customers.

COMMODITY TRADING COMMISSION
1975

MIB Mission

The Branch's mission is to monitor the health, performance, and structure of U.S. futures, options, and swaps markets ("derivatives markets"), highlighting and responding to emerging trends, threats, structural and systemic risks.

COMMODITY TRADING COMMISSION
1975

Purpose

MIB has an ongoing research project that analyzes the retail influence on the microstructure of the derivatives markets.

- This interim report is from the research work undertaken thus far. The Branch's work is continuing.
- For this study's purpose, **"Retail"** is defined as a market participant who executes less than or equal to 50 contracts a day.

COMMODITY TRADING COMMISSION
1975

Market
Intelligence
Branch

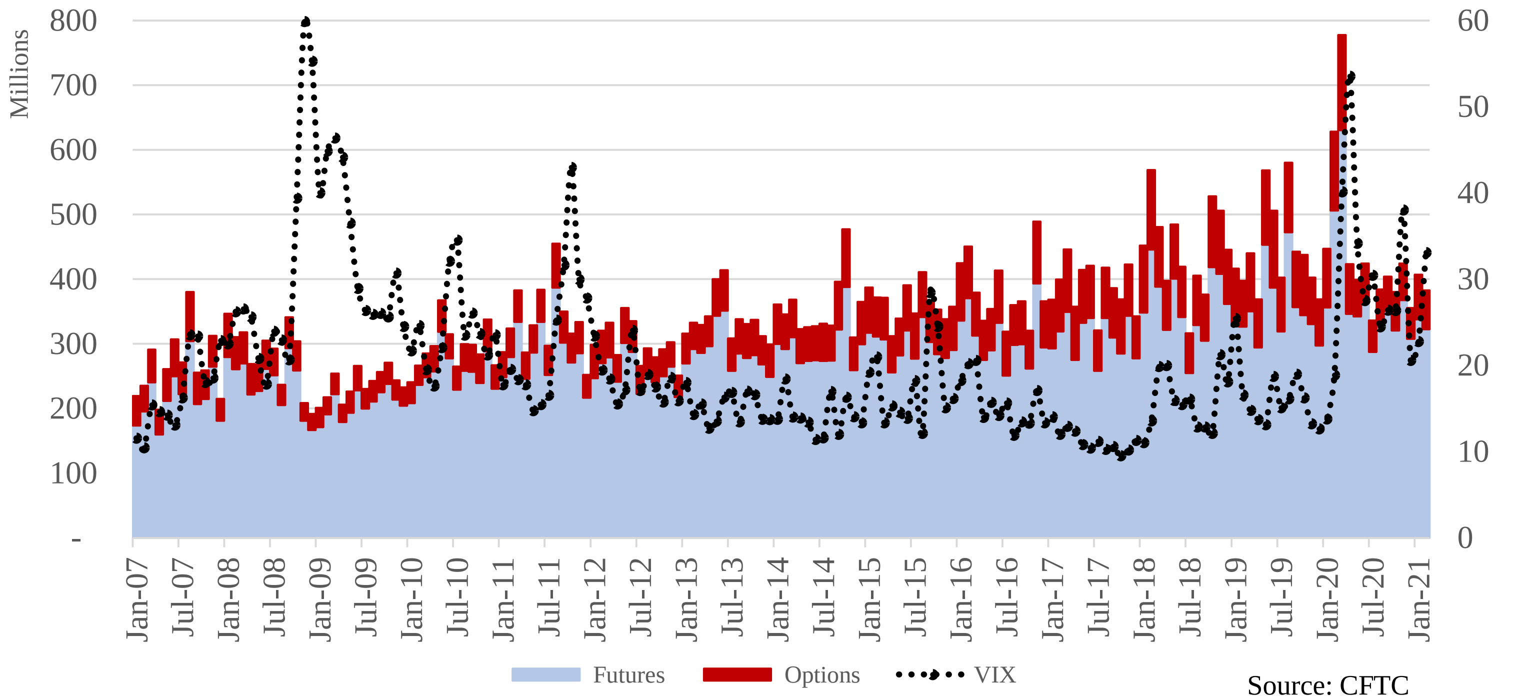
Introduction

Futures and options volume in the U.S. has doubled since 2007.

- Historically, as volatility increased, markets became risk-averse and led to lower volumes. However, in the past ten years, volatility and volumes have risen in tandem.

Daily Transaction Volume & VIX Volatility

All U.S. Futures & Options Markets



Source: CFTC

COMMODITY TRADING COMMISSION 1975

Market
Intelligence
Branch

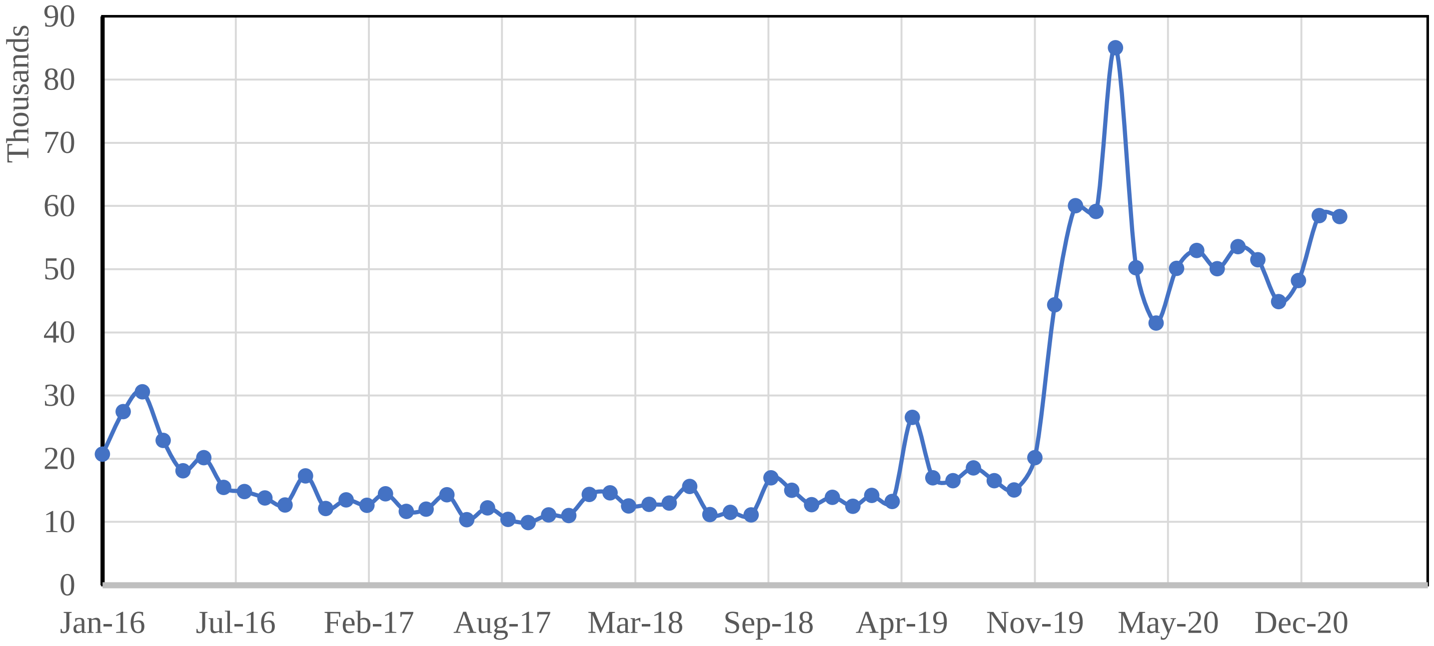
Introduction

Fueled by retail interest, the number of first-time traders reached the highest levels during the early pandemic months.

- Increased order flow through retail FCMs, introducing brokers (offering online account opening, reduced fees, and minimum balance requirements), as well as the growth of smaller retail-friendly contracts at existing and new DCMs contributed to this growth.

New Accounts Opened

All U.S. Designated Contract Markets



Source: CFTC

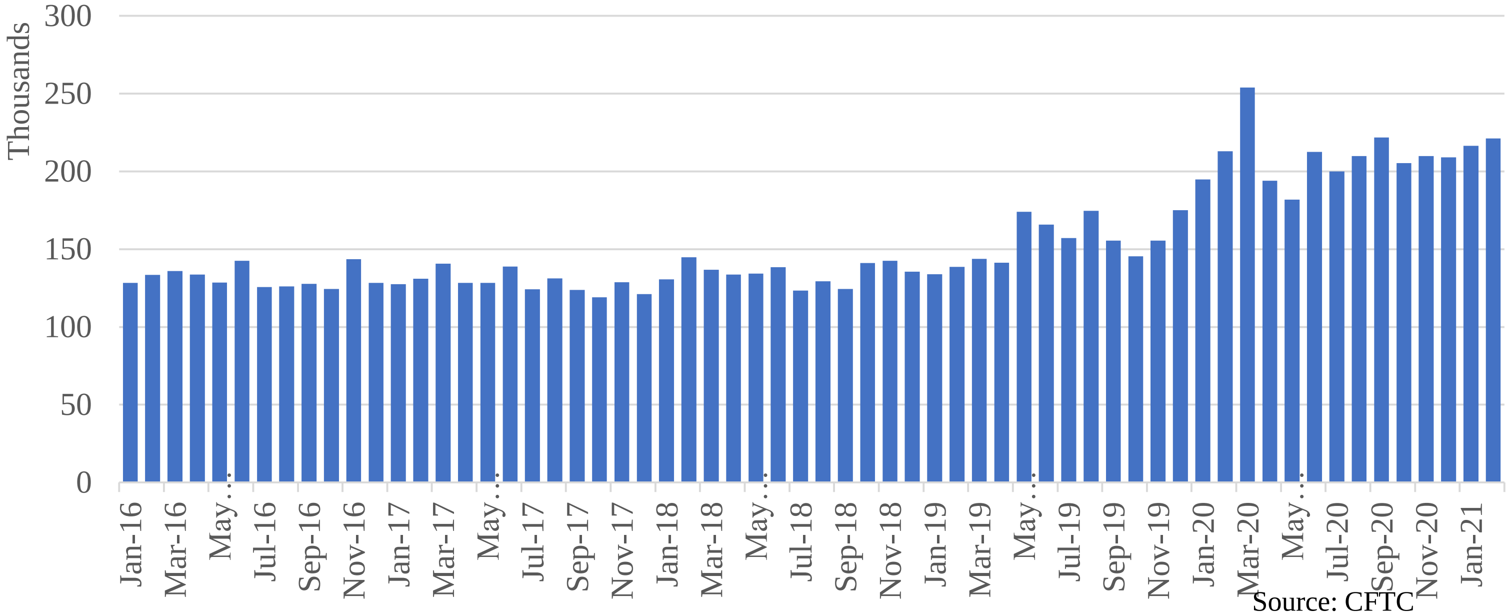
Evolution

Over 750,000 new participants entered the markets since January 2020, and approximately half those accounts traded more than once.

- Allowing for some new account setups to duplicate account references, the growth of over 375,000 accounts is significant.
- The monthly participation rates since 2016 (the number of participants engaged in trading each month) only doubled as most retail accounts sought specific trading opportunities.

Number of Market Participants by Month

All U.S. Designated Contract Markets



Source: CFTC

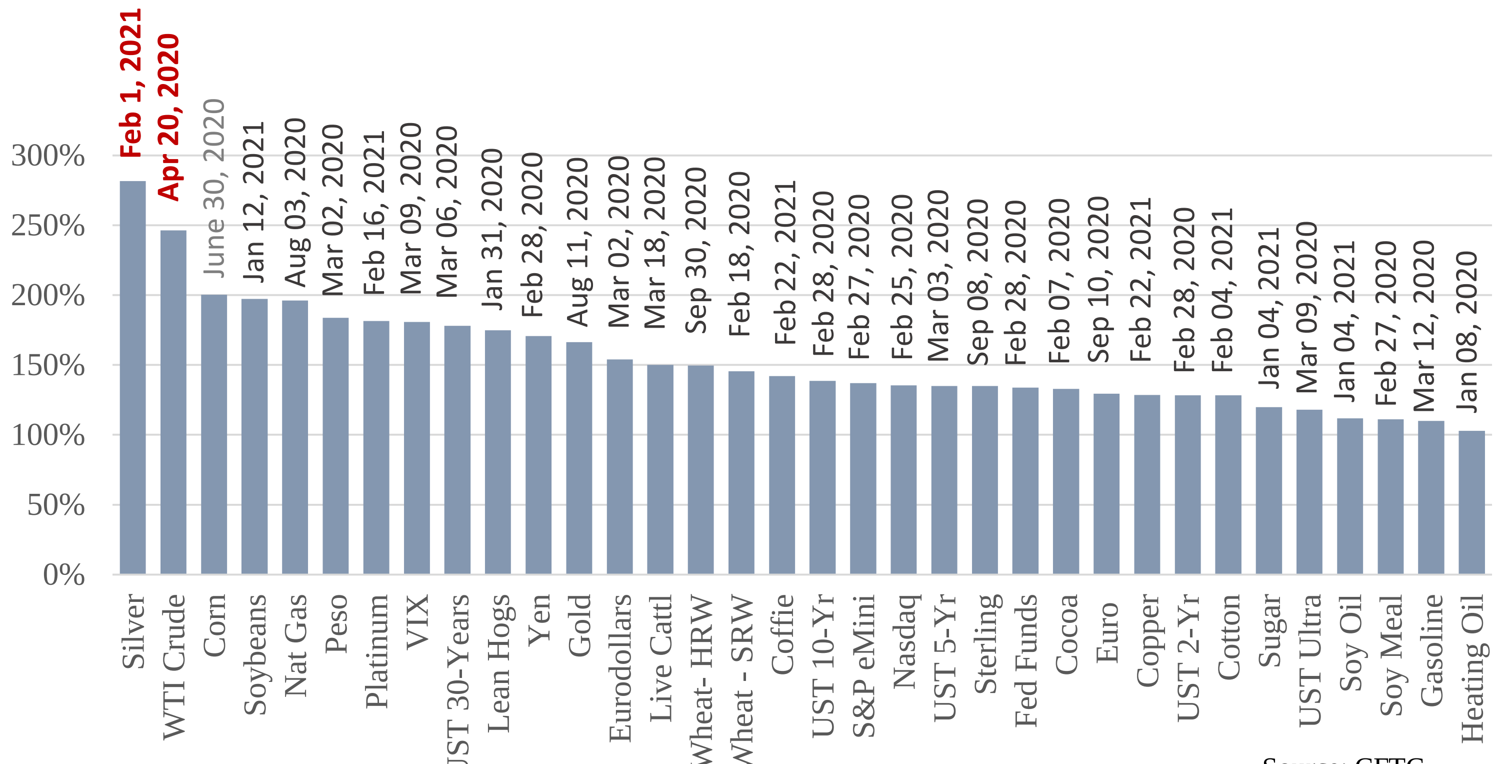
Activity

The most significant retail engagement in futures markets occurred in Silver (February 2021) and in WTI Crude Oil (April 2020).

- Engagement is in short time windows (day-trading to a few days), typically in volatile market conditions.

Peak Retail Participation vs. Average

Between January 2020 – February 2021 Activity by Contract



Source: CFTC

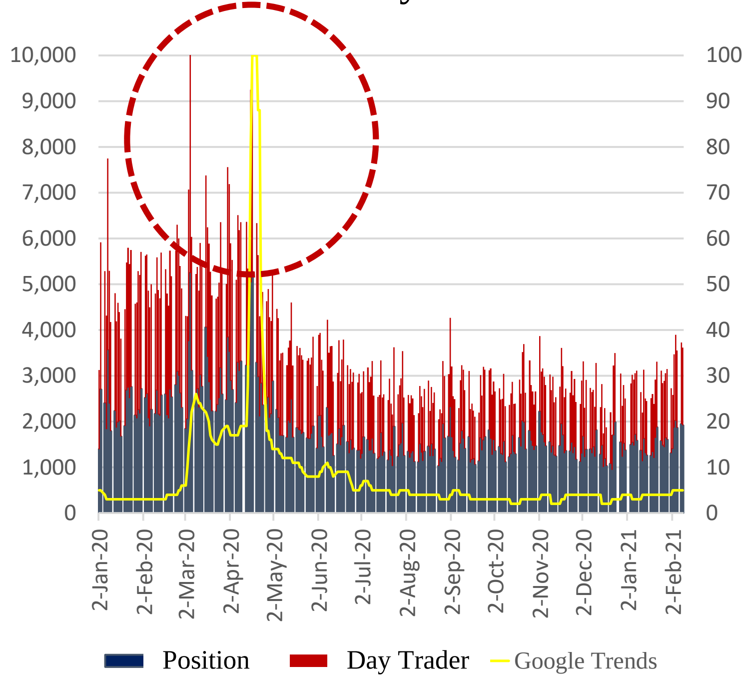
Market
Intelligence
Branch

Social Media

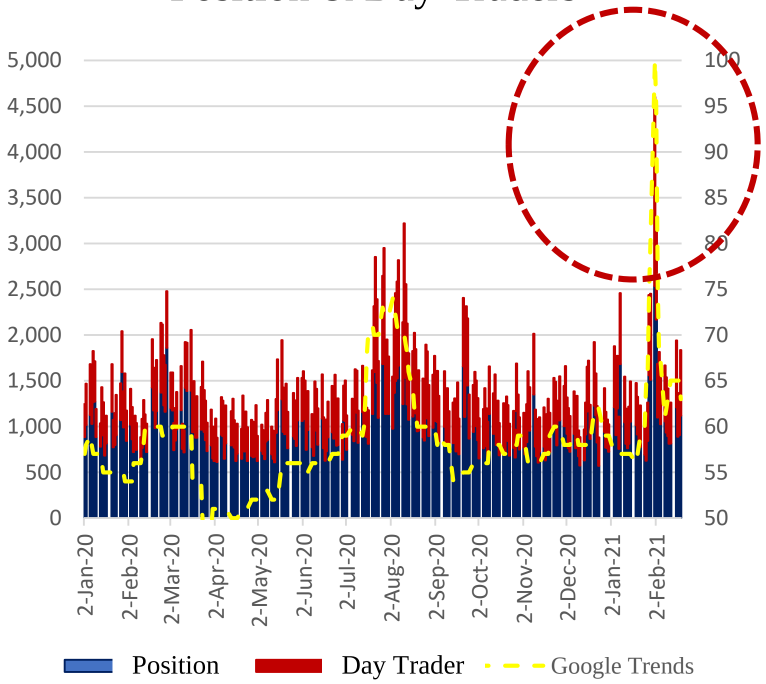
In Silver and Crude Oil (WTI) contracts, the direct retail and day trading in futures aligns well with social media interest.

- Google Trends website analyzes the popularity of top search queries in Google Search. Both February 1, 2021 (Silver) and April 20, 2020 (WTI) recorded scores of 100. In addition, there was over three times the normal activity seen in futures markets by retail accounts.

Retail Activity in Crude Oil WTI
Position & Day-Traders



Retail Activity in Silver
Position & Day-Traders



COMMODITY TRADING COMMISSION 1975

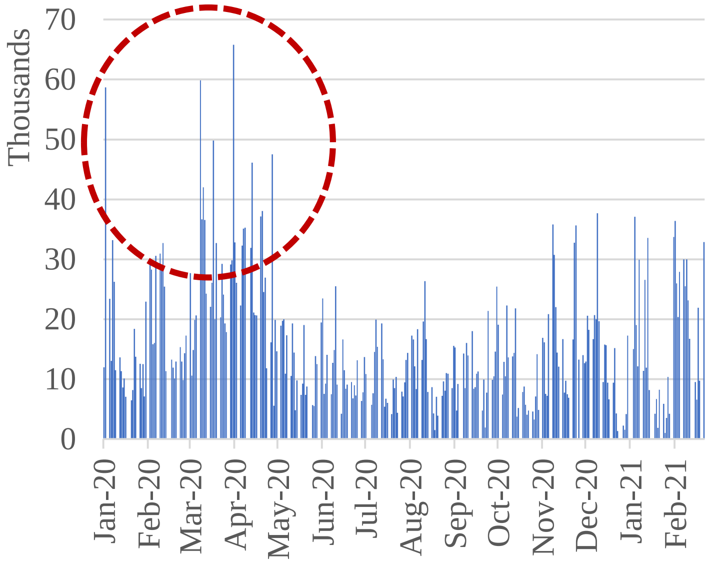
Market
Intelligence
Branch

Market Interconnectivity

ETFs that cater to retail clients may influence futures markets directly, indirectly and tangentially.

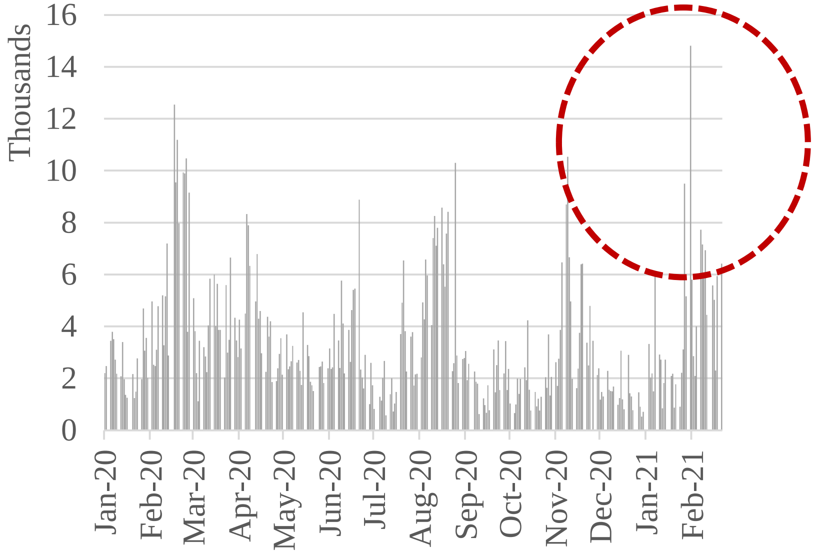
- Commodity ETFs participate directly or via swaps. Physical ETFs (such as Silver) tangentially track to futures markets. In both these markets, the futures contract is considered the benchmark and is the primary price discovery market.

Crude Oil WTI
ETF/ETN Linked Futures



Source: CFTC

Silver
ETF/ETN Linked Futures



Source: CFTC

COMMODITY TRADING COMMISSION 1975

Commodities

Generally, the physical commodity markets are significantly more extensive than small-cap equities. Also, futures have long and short interest that works differently when compared to short-selling securities.

- Unlike in securities, futures have an “active” contract that expires, technically driving non-commercial participants to exit (retail traders are unlikely to take or make delivery).
- Annual global production, according to Barchart, in Copper and Gold is approximately is $180 billion, Silver is $21 billion, Wheat is $183 billion, Corn is $245 billion and Soybeans about $178 billion.
- BP’s worldwide production estimates in Crude Oil is $2.2 trillion/year. Natural Gas is approximately $440 billion/year.
- According to the U.S. Treasury Department, the U.S. debt outstanding on Oct. 1, 2020, surpassed $27 trillion.

COMMODITY TRADING COMMISSION
1975

Market
Intelligence
Branch

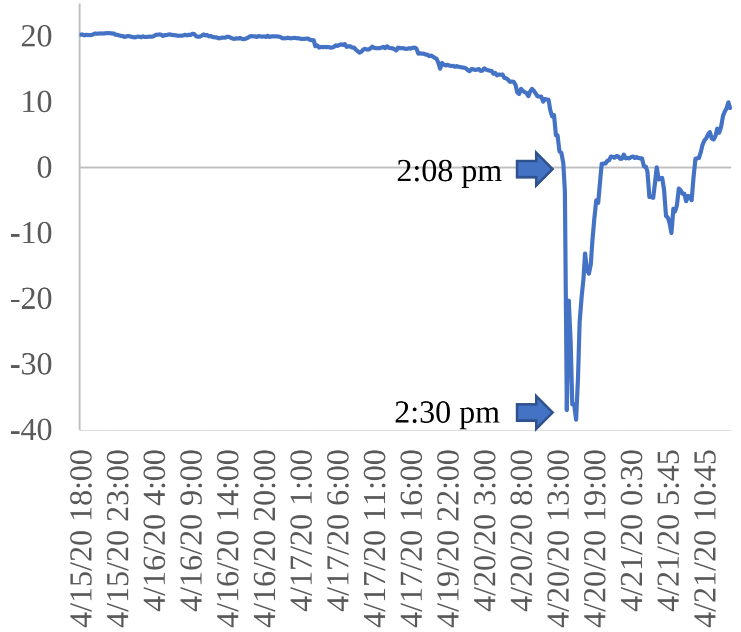
Liquidity

In both Silver and WTI, liquidity (bid-offer, order book depth) was reasonable in the build-up, but fell off during the exit.

- Unlike securities, “active” commodity derivatives are deliverable at expiry which ensures that non-commercial participants exit or roll.
- Retail appeared late for Silver, missing most of the move. In both WTI and Silver, retail left late, losing out in the unwind.

Crude Oil WTI

CLK0 – May Contract



Source: CFTC

Silver

SIH1 – Mar Contract

Source: CFTC

COMMODITY TRADING COMMISSION
1975

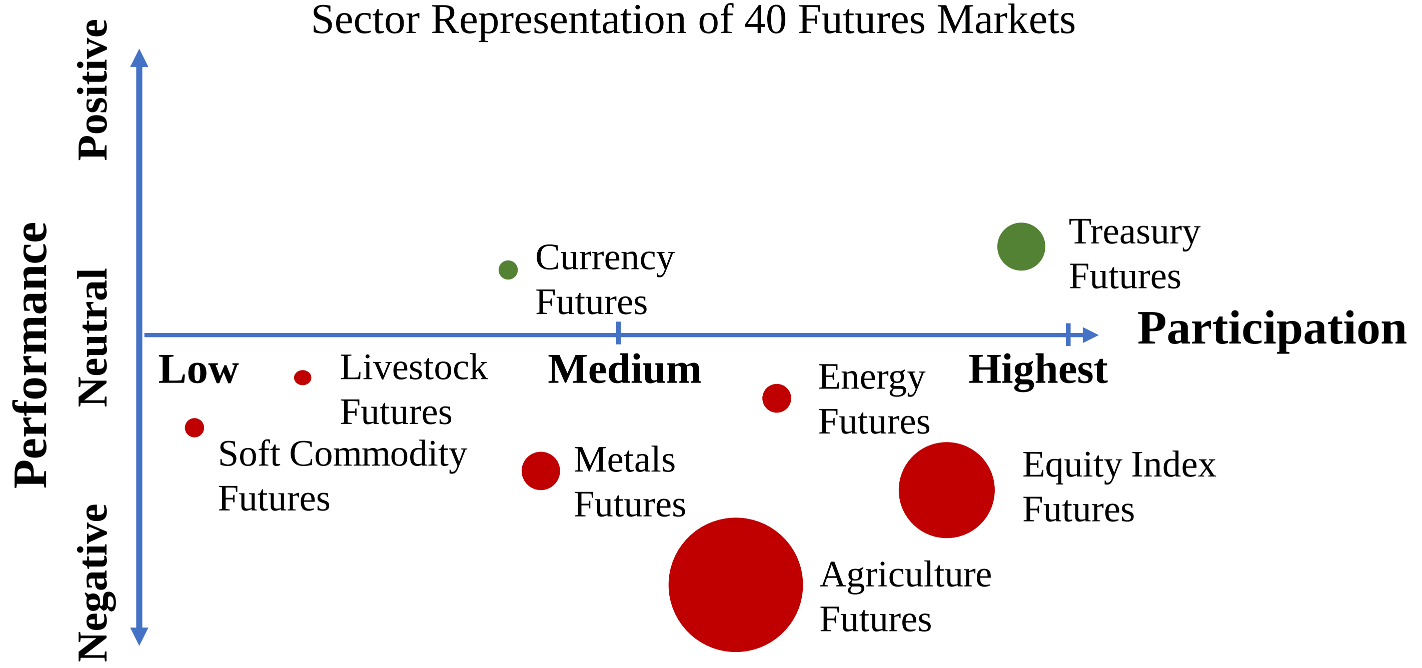
Performance

Overall, retail accounts between January, 2020 and February, 2021 have had significant negative returns.

- All retail participants transactions (outright, spread implied and TAS) including end-of-day positions have been included in the analysis.
- The retail performance is narrowly on the futures markets and excludes other investments that may offset these losses.

Performance and Participation of Retail Accounts

Sector Representation of 40 Futures Markets



Source: CFTC

Summary

There is a visible growth of retail interest fueled by easier market access (directly and indirectly), social media hype, smaller and retail-friendly contracts, and exchanges. The potential commodity supercycle may further incentivize participation.

- Although the number of participants has grown exponentially, the direct trade volumes are approximately 10-15% of total activity. Asset/Money managers offering retail products (i.e., ETFs, ETNs) increase direct, indirect (via swaps), and tangential (cross-market arbitrage) impact.
- Physical commodity markets are much larger than small-cap equities. The futures markets have long and short interest that are dissimilar to equities but they are not immune to short-selling type impacts.
- Retail activity adds to liquidity as almost all transactions are placed as resting or limit orders. Retail participation is also positive for liquidity diversification as retail trading strategies differ from those of the professional traders.

COMMODITY TRADING COMMISSION
1975

Conclusions

The retail participants' growth (both directly or indirectly) adds liquidity and diversification to derivatives markets. However, if this sector is to develop fully, a more even return profile is needed to emerge.

Specifically, two areas where more work may be necessary:

- Investor protections, disclosure requirements, suitability standards, and establishing clear obligations that protect investor interests by all introducing brokers and/or FCMs.
- Evaluate required market structure development and policy considerations such as the predatory type strategies that leverage or target broad retail engagement.

COMMODITY TRADING COMMISSION
1975

Market
Intelligence
Branch

MIB

The staff involved and contributing to this effort include:

Mel Gunewardena – The Chief Market Intelligence Officer
Geoffrey Price – Associate Director, MIB
Eugene Kunda, PhD – Market Analyst, MIB
Jonathan Dye – Market Analyst, MIB
Jay Huhman – Market Analyst, MIB
Michael Nouri – Market Analyst, MIB
Robert Fedinets – Market Analyst, MIB
Wilburn Carlile – Market Analyst, MIB

COMMODITY TRADING COMMISSION
1975

Reference

https://www.wsj.com/articles/everyones-a-day-trader-now-11595649609

https://www.barchart.com/cmdty/resources/crb-yearbook

https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html

COMMODITY TRADING COMMISSION
1975