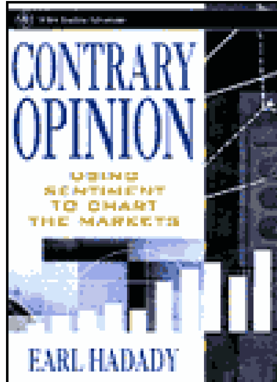

Contrary Opinion: Using Sentiment to Profit in the Futures Markets (2000), R. Earl Hadady

An Elliot Wave Financial Forecast mentioned Hadady's book as an excellent source on how to use futures to mathematically quantify the degree of contrary opinion. Hadady began a stock and commodity advisory service in 1971, and capitalized on the development of financial futures markets in the 1970s, in finding that the actions of the futures markets allowed him to mathematically capture sentiment.

"A futures market is a zero-sum game; that is, the money lost by some speculators and hedgers is exactly equal to the money won by other speculators and hedgers. Note that this statement does not mean there is a trader who wins for every trader who loses." Pg. 3

Since a futures market has a clearinghouse that guarantees the contracts, there is always a short contract balancing out every long contract. Thus, for every losing contract (*not* participant) there is always a winning contract. How this balancing act works day-to-day is what makes market sentiment change over time. Hadady describes this process below:

"How can 80 percent of market participants be bullish when there is a losing contract for every winning contract? There is only one way. The average bull (bullish participant in the market) must hold only a relatively small number of contracts, whereas the average bear must hold a relatively large number. The reverse would have been true had only 20 percent of the market participants been bullish.

Furthermore, the minority in the market, the 20 percent who are bearish in this instance, must be relatively well financed because they hold a large number of contracts. On the other hand, their opposition is lightly financed and is referred to in the jargon of the pit as "weak hands." Consequently, their actions are much more influenced by day-to-day action. A few adverse days will force the "weak hands" to liquidate their positions and retreat to the sidelines. *Grasping this idea is vital in understanding how the markets work*." (Emphasis mine) Pg. 47

In other words, in the above example, the average bear holds four contracts for every one contract held by the average bull. Thus, as extremes in bullish sentiment are approached there are increasingly fewer bulls to buy more and drive the price higher. Also, when the price begins to decline, they will be forced to sell quickly, driving the price down further.

Hadady notes, "The markets' apparent simplicity is very deceptive," and that, "low-risk, high-profit trades occur infrequently." As such, "Patience is a vital characteristic of the long-term successful trader." Lastly, Hadady states, "The big money in the market is typically taking positions contrary to what is breaking in the news; that is, they're the idiots who are selling when the news is bullish…who end up winning and heading to the bank." Pgs. ix, x, 22