Cleveland on Cotton: Reversal Unlikely a Market Death Blow

February 26, 2021
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It finally happened. After some 14 days of higher highs cotton prices finally bit the dust. The song at week's end was: "You Picked A Fine Time to Leave Me Lucille." Yet, the crop is not in the field. There is scant little old crop in grower hands and the new crop is still in the seed bag.

Better still, the bulls remain in control despite the 400 points (limit down) the May contract gave up on Thursday and the 288 points given up by the new crop December contract. Prices are essentially back to the level they were just a week or ten days ago.

The exceptionally strong position of the December contract continues to beg for acreage.

I have frequently commented that the Chinese market should be monitored. That is where the dam initially broke that began this week's sell off. The Chinese ZCE closed slightly lower Wednesday prior to the New York sell off. ICE was in desperate need of a correction and the ZCE provided the final straw.

The ZCE moved lower again on Thursday and that added to ICE weakness on Friday. We have cautioned that the trend of New York following ZCE has not been as dominant as in the past, but the trend was still evident. After all China is the world's largest/second largest producer of cotton and the largest consumer.

China accounts for more of the world price variability than any other country. Thus, the ZCE's influence on world price is major as New York has a long tendency of following Chinese price activity. Too, the easing of Chinese prices should not be surprising as we previously noted that the Chinese contract was beginning to bump up against long term resistance that had surfaced in 2016.

We noted it had been broken once, but it still loomed as a trouble spot. Nevertheless, both the old crop May and July contracts should find new steam to move higher as will the new crop December contract.

Market technicians pointed to a technical market reversal that occurred in Thursday's trading as a "key reversal," and commented it could spell doom for the market. Yes, it could, but very doubtful. A "key reversal" is the most common of all market reversal signals. The pattern occurs very frequently in the cotton market. As such it is the least reliable reversal signal there is. Key reversals appear all the time.

This is not to say this one will not deliver a death blow. However, the market should prove plenty strong enough to brush aside a common reversal. Let's see how Chinese trading goes over the weekend and in the early days of next week.

U.S. export sales and shipments are on track to sail past the USDA export estimate. The weekly report included net sales of Upland at 247,800 bales and Pima sales of 11,900 bales, considerably above the combined level of some 95,000 bales weekly level required to meet the USDA sales level.

Weekly exports of both Upland and Pima totaled 304,600 bales. Six countries received shipments of more than 10,000 bales each. Shipments need to average only about 275,000 bales a week to reach the current USDA estimate of 15.5 million, a reason to expect USDA to increase its export estimate in its March report.

The weekly Cotton On-call report continues to point to the major problem facing world textile mills. May unfixed call sales total 32,523 versus unfixed call purchases of only 7,047 contracts. Further adding to pressure on the mills, July unfixed call sales contracts total 36,123 versus unfixed call purchases of only 5,815. This is where the real bullishness in the market has surfaced.

No doubt mills fixed prices on unfixed call sales on Thursday and Friday, but the disparity continues to sit firmly on the side of the bulls—especially since trade shorts were at a record level before the selloff. It was this disparity that drove old crop prices to 95 cents and another run to higher levels is expected.

Mills, especially Chinese mills, remain excellent buyers for all quality cotton. Despite mill delivered prices above a dollar per pound Chinese mills continue to bid for quality cotton very aggressively. Spinning margins remain positive and Chinese demand has held strong during the price run-up. The bulls ammunition remains in place.