Cleveland on Cotton: Cotton's Tight Price Range Faces Little Pressure to Change

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This week's cotton rally was technical based. Fundamentals have essentially prohibited the market from moving above the 90-cent mark, a resistance level that has withstood four challenges. The resistance line is neither battered nor bruised, but eventually a door that is continually kicked will break.

However, not until either demand improves or the world crop suffers additional weather setbacks is cotton likely to move above the 90-91 cent level. While the U.S. crop is likely smaller than currently reported, world crop production estimates will have to fall by at least another million bales (and the resulting world carryover stocks) for fundamentals to allow the penetration of the 90-cent barrier.

I almost completed an entire paragraph without referencing poor demand. But again, I must reiterate that a bull market cannot exist in the absence of demand. That is not to say the 90-cent barrier cannot be penetrated, rather just to say it will be overwhelmingly difficult to move above 90 cents.

It has been right there, so it can go higher. I just would not expect it.

Either one of three events will have to occur to push prices above 90 cents: (1) At least a million-bale reduction in the world crop, (2) crude moving to the $100 per barrel level, or (3) a real increase in demand is uncovered. The third one is not in the works. Numbers 1 and 2 are in play but are facing weak odds.

Thus, get 90-95% percent of your crop sold up here near 90 cents. Save the rest for the ice cream party should prices go higher.

Cotton's very tight range faces little pressure to change. Thus, the dedicated support at the 83-84 cent level and the 89-90 cent resistance will contain most, if not all, of futures trading into December's first notice day – still more than 30 trading days away. Cotton fundamentals remain very bearish, and cotton technicals remain very bullish.

This dichotomy exists primarily due to cotton's unique trading that allows for reportable On Call sales and On Call purchases which specify a certain set of both the demand for buying futures contract and the demand for selling futures contracts. Thus, at times, the New York ICE cotton exchange is trading based on the demand/supply of raw cotton, but, at times, the trading parameters are more attuned to the On Call sales and On Call purchases ratio.

CFTC reportable On Call positions can have an enormous impact on price activity, regardless of the cotton supply demand situation. This information has been somewhat neutral for the bulk of the 2023-24 marketing year. However, it is likely that a major element of cotton's favorable technical position is based on the On Call sales versus On Call purchases.

Typically, December On Call purchases far outweigh On Call sales, as December is the principal harvest contract for the northern hemisphere. December is the contract month most closely aligned when grower harvest/selling occurs. Mills can take cotton and fix the price when the purchase is made, or they can roll the price fixing to another contract month past December (and continue to delay price fixing month to month out to the July contract).

Currently, On Call sales (cotton sold to mills for which the price must be fixed) is 41,698,000 bales. The price fixing process for mills involves buying futures contracts. On Call purchases (cotton that growers have contracted to sell involves selling future contracts) is 33,240,000 bales. Thus, the ratio of sales to purchases favors more buying of futures than selling – very unusual for the December contract.

While it is too early to make a market judgment relative to the March, May, and July On Call ratios, the stage is set such that the market should be well supported in the 83-85 cent range. That said, it is still early in the marketing season, but this information will be especially important to price activity during the coming months. I am more favorable to the idea of the market trading to 93-95 cents than I am seeing it trade to 82 cents.

Yet, the lack of demand for cotton still hangs over the market. Weekly export sales of upland totaled only 55,300 bales – a pitiful seasonal number. Sales were made to 19 countries, but only two of those countries purchased more than 5,000 bales – Vietnam (15,000) and China (13,300). Most country sales were only about 1,000 bales – an extremely low level. In any other year, sales to 19 countries would imply net upland sales of 400,000 bales or more.

Chinese mills are paying 100% more for cotton than they are paying for polyester. That is not a typo. Polyester in China is half the cost of cotton. Even at that, polyester sales are down. Thus, my broken record to you: cotton sales will not pick up until the second quarter of 2024.

Some are reporting that current increased apparel sales imply better cotton demand, year on year. Be careful. Those comparisons do not mention that current prices are some 10-20% more than year ago prices. Thus, the value of sales cannot be used to measure cotton demand. The comparison suffers from both auto and serial correlation and does not make for a viable comparison.

Speculators will continue to push for higher prices. As long as the ‘specs” continue to hit the market there is hope…and specs are sitting on a bundle. Too, if crude can push even a tiny bit higher, the cotton market can tag along with its cousin.

(Note: Many thanks to my cotton cousins “Lou” and “Rogers” for charging my weak memory banks.)

Give a gift of cotton today.