CENTRAL ASIA DROUGHT IMPACTS COTTON CROP

AUSTRALIAN COTTON ASSUMING A LARGER ROLE IN WORLD TRADE

US EXPORT SALES & SHIPMENTS FALL BELOW EXPECTATIONS

SURGING FREIGHT RATES BOOST BRAZIL'S TEXTILE SECTOR

JERNIGAN GLOBAL
KNOWLEDGE IS THE NEW CAPITAL

CURRENT APPAREL SOURCING SUPPLY CHAIN UNDER EXTREME STRESS

"OUR BIGGEST CONCERN RIGHT NOW IS ACTUALLY GETTING INVENTORY, NOT HOW MUCH IT'S GOING TO COST." – statement by CEO of a major US apparel chain retailer during earnings call August 25th

IHS MARKET SURVEY - Vietnam experiencing supply chain disruptions not seen in over ten years

The current sourcing model for apparel is broken, and the coming quarter will test its ability to function. It is quite clear that the economics have dramatically changed and earnings at many firms are going to suffer. Urban Outfitters, the owner of the very successful Anthropologie, Free People, and Urban Outfitters retail stores, held an earnings call on August 25th. What was said in that call is being discussed by the US retailer industry and across Europe. Urban has sales of over 3.5 billion USD and is a very successful retailer with more than 634 stores worldwide and 517 in the USA. It retails apparel, home goods, and other items with apparel accounting for over 61% of sales and with most of that aimed at the young adult. It carries jeans, t-shirts, polos, sweatshirts, dresses, and much more. Cotton apparel plays an important role. In the earnings call, the CEO said, "Lots of products are in Vietnam and we are doing whatever we can to get it in, whenever we can to pad inventory ahead of the holidays." He went on to say that they are now importing their apparel by air cargo to get it here. That means a substantial increase in cost due to air freight out of Vietnam and China in August being hit by Covid, which has reduced capacity and flights by 30% or more. Rates are up nearly 10 USD a kilogram and rising. Reduced crews and quarantines mean it is a struggle to even get products it to the airport and then get it loaded. Then, when it lands in the US, you have delays, shortages of chassis for trucks, and incredible cost to get the product to the distribution centers. Finally, it then must be trucked or sent by rail to the store.

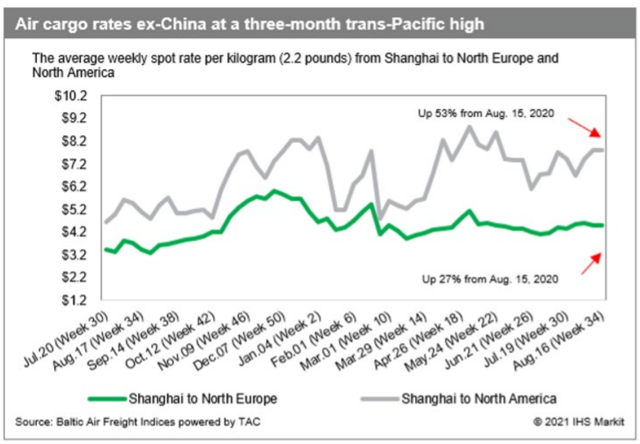
January-June US imports reached 1.3366 trillion USD, and of that record volume 20.8% came from just two countries, China 227.6 billion USD, and Vietnam 47.7 billion USD. Those markets have been thrown into chaos by record import/export logistics, and Covid control measures. Currently the army is in the streets of Ho Chi Min City and the Dong Nai and Binh Duong provinces that make up the Southern Economic Zone, which contributes 22% to the country's GDP. In Ho Chi Min City, only small groups can leave their home and must have a travel pass. Large scale production delays are being reported in the region. Production has stopped in many cases, orders delayed, and export shipments have significantly slowed as the ports are in crisis. One major shipping line says a container shortage will occur through September and October. The air freight scramble is underway. China is not much better where air cargo is a serious issue. Mazada announced Thursday it cannot ship electric car parts out of China because of cargo delays out of Shanghai Pudong Airport. These conditions are destroying the supply chains of US and European companies.

Ho Chi Min, Vietnam

Military on the streets of Ho Chi Min City, Vietnam

The major US transportation hubs are in real turmoil. Chicago, which is a major air freight and rail hub, is the hardest hit. *American Shipper* reported last week that it was so bad in Chicago that they were storing containers in parking lots and that companies had resorted to bribing workers to get access to their shipments and were operating candlestick retrieving missions. All this means significant increases in cost to the bottom lines of retailers. After Urban Outfitters earnings call, their shares lost 10% of their value before recovering. This occurred despite strong sales. This is happening across the retailer industry and will only increase as these sharp increases in cost are disclosed. Abercrombie & Fitch, an iconic American brand, also reported earnings in which sales rose 24% over 2020 and 3% above 2019, with a strong performance in most sectors, including denim. Its shares fell over 13% due to delays in shipments from Vietnam, and that it was being forced to air freight shipments.

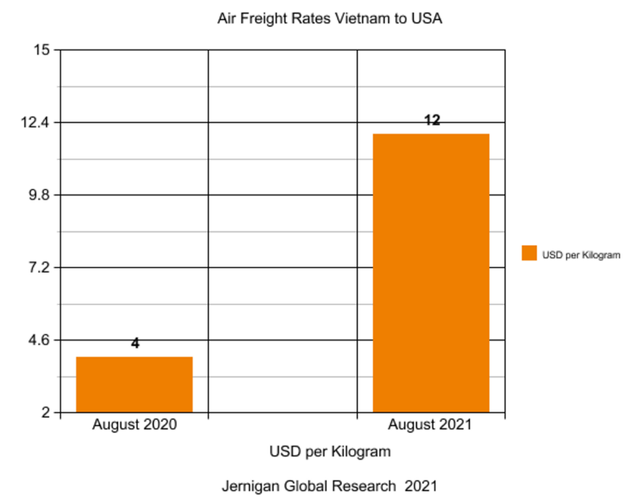
Again, the logistics, no control of supply chains, and lack of investment in manufacturing left net profits subject to a decline. Burlington reported a surge of 118% in second quarter sales, but its cost of product sourcing more than doubled at 149.5 million USD as compared to 72.1 million USD in 2020 and 82.0 million in 2019. It is not just apparel but all products that have been globalized. Peloton reported second quarter sales reached a record 1.06 billion USD compared to 466.3 million a year ago. However, port congestion and soaring freight rates have taken a toll on their bottom line, and customers' shipment of bikes have been delayed by 3-6 months. It announced it will spend 100 million USD or near 10% of sales on expedited shipping costs to get the products in. Much of that will be on air freight. Peloton's shares fell 6% in after-hours trading following the call, and they are being called the posterchild of "Containergeddon".



Wall Street was further shaken by two US retailers that had been on a growth tear opening new stores and increasing market share. Dollar General, which has been rapidly opening stores in rural communities, reported that its net profits were below expectations because of a sharp increase in freight cost. It also stated it expected a greater hit to earnings in the second half of 2021 from shipping cost. Only 4.6% of its sales are apparel, and it is a very low-priced retailer, so surging freight cost would suggest many products may not be able to be offered any longer. Its shares fell 5% Thursday. Its competitor, Dollar Tree, which offers all products at 1 USD, reported that the freight companies will be able to deliver only 60%-65% of the products it ordered in 2021 due to logistical problems. It also reported sharply higher freight cost. The company has the highest number of containers per 100 million USD of sales of any US retailer. It offers only a few apparel or textile items such as socks. Its shares fell 9%.

Most companies have traditionally included freight cost in the cost of goods sold and not broken out that

CATHY PACIFIC CARGO SUSPENDS ALL AIR FREIGHT FLIGHTS ON AUG 20 AS ALL GROUND LOADING CREW FORCED TO SELF ISOLATE FOR 14 DAYS



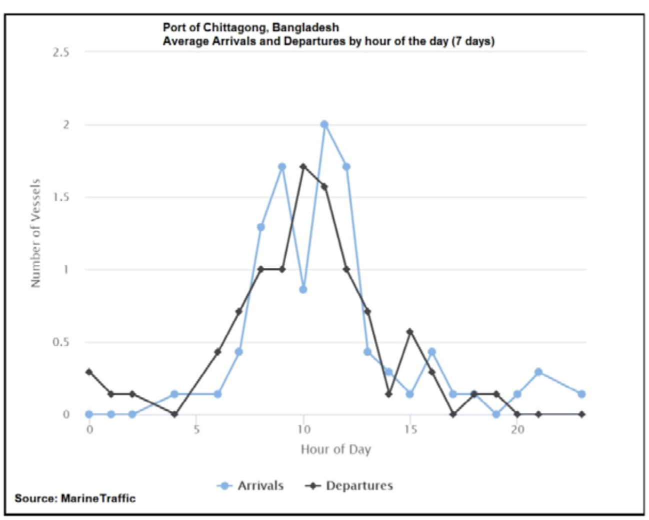
expenditure, so the full impact will not be known for the first quarter of 2022 when these results are announced. When several 100 million USD or more are wiped off a market cap, it gets the attention of everyone.

The problem with the current supply chain model is evident across the US and parts of Europe today. In the US, the major retailers all have large areas of empty shelves or reduced selections. This is even occurring in grocery stores, with one large chain reporting that it receives only 60% of what it ordered in some product areas. It has already changed how the stores procure, manage inventory, and their product offering. As of now, in the consumer goods sector and for sure apparel, the retailers and brands have not yet taken control of their supply chains or logistics or begun to invest in the actual manufacturing of products. Some of the largest have moved to charter their own container ships, which appears to have had limited results and does not seem to have done much more than to make the companies feel like they have acted. One of the largest retailers is reported to have imposed fees on suppliers who are late or short in the orders. This has not worked because the suppliers have no control since the entire supply chain is in chaos.

The "China Fatigue," which we discussed several weeks ago, is increasing, as is the risk of sourcing in China. The US fiasco in Afghanistan, which is ongoing, has added a serious new risk, the invasion of Taiwan. An editorial in the *Sydney Morning Herald* presented the new risk clearly when it wrote the question of Biden's ability to lead the US and the complete failure of his team has invited Beijing to try its luck. The editorial pointed out that Biden's incompetence in Afghanistan played into Xi's vision that the US is the global source of chaos. Amid this crisis of confidence, Beijing may move against Taiwan. Any such invasion would throw South China Sea shipping into total disarray and disrupt a significant portion of the US and European imports. In addition, US actions are feared likely to be more sanctions, duties, etc., rather than military might. The risk to the US, Europe, Japan, and others must now be included in risk analysis. On Friday, the threat of an invasion to Taiwan began to have commercial implications. Taiwan is a major strategic player and manufacturer of advanced semiconductors, and any invasion would have major ramifications for the US. TSMC is the world's largest semiconductor producer and is in Taiwan. Earlier it announced the construction of a plant in the US in Phoenix. Friday, it announced that even during the largest freight congestion on record it was chartering a container ship that would hold more than 5,000 containers to immediately ship its manufacturing equipment from Taiwan to the new Phoenix facility. This was taken by key analysts as a major move for it will require dedicated port space, large numbers of trucks and chassis, and security. It also means that the Taiwan companies now view the threat of an invasion by Xi as real. Japan moved last week to further boost security ties with Taiwan as Chinese planes invaded its airspace once again.

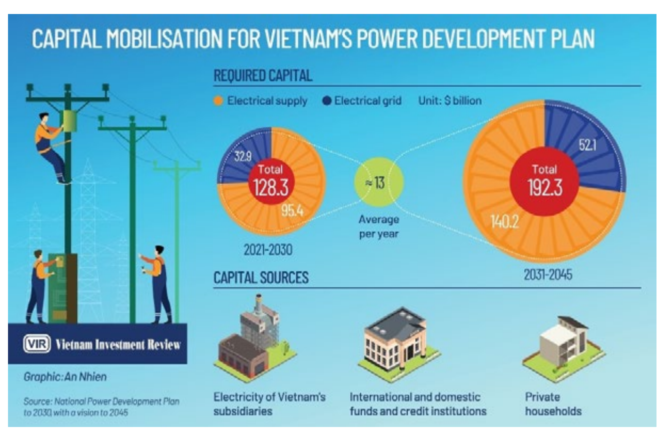
Europe is experiencing issues due to its fixation on sourcing in China. The ocean freight turmoil has turned a record volume of freight to the China-Europe Rail Freight. In the first half of 2021, a record 7,300 trains moved on the route. The cost has surged, and extreme bottlenecks and backlogs are now occurring. The differences in rail gauge require the freight to be transferred between rail networks at Khorgos on the China/ Kazakhstan border and then again on the Poland/ Belarus border. An upgrade in the Malaszewicze Hub in Poland has caused 14 or more-day delays. Other issues have occurred, such as a shortage of railcars in Kazakhstan and overall capacity constraints and delays at the Poland/German border. The cost of the rail freight has increased from 4,000 USD per FEU before Covid to 16,000 to 18,000 USD today. Without delays, the rail takes 18-22 days, while ocean freight has soared from 1,300 USD to over 15,000 USD and takes 35 days or more, plus trucking. The January - May textile and apparel import data for the EU showed that China was the top supplier at 31.2% of all imports, part of which is from Xinjiang exporters and the use of the China/Europe freight network. This has lowered the cost of export from Xinjiang to Europe and opened up new markets. Turkey was the second largest supplier at 15.06% of all imports.

The current chaos however has added yet another new risk to supply chains, the switch to Vietnam and the infrastructure risk now exposed. The US in 2011 imported only 20 billion USD from Vietnam, but in 2020 it exceeded 77 billion USD and will likely post strong growth in 2021. In apparel and footwear, as well as electronics, the reliance has increased even faster. Today, it is the number one supplier of cotton apparel and the second largest supplier of all apparel. For many brands and retailers, the new reliance on Vietnam has shown up already in earnings calls. The switch to Vietnam has generally worked well. The new Covid outbreak and the efforts to contain it and at the same time the record volume of product to export have exposed the main weakness in sourcing in Vietnam, the logistics and its lack of a complete supply chain in some products. Other key sourcing hubs are also having serious problems, one being Bangladesh, a very important apparel provider. The apparel factories have remained open, but a heavy toll on the workers is being reported as Covid infections remain high. The congestion at Chittagong is an ongoing problem, and a projection of the TEU Volume Index

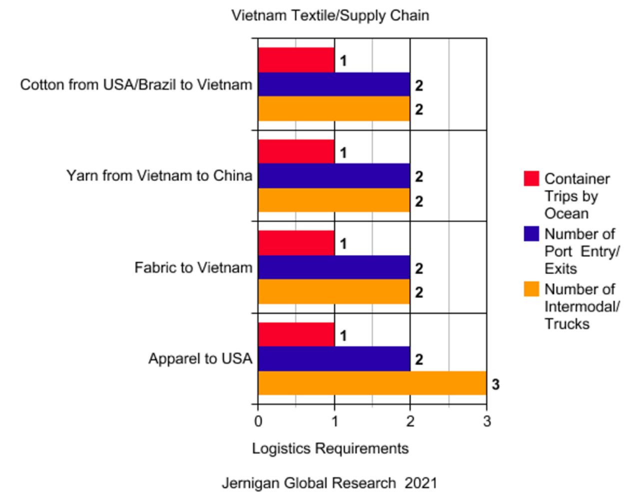


for the period ahead shows a sizeable decline in export volume, which is adding to US importers' woes.

Vietnam announced a 2030 master plan to boost infrastructure that includes 120 billion USD in roads and power, a new deep-sea port, and high-speed rail. For now, a host of infrastructure issues remain, with a shortage of ring roads and expressways. Many of the ports are shadow, which means the largest container ships have to transfer goods to smaller ships at Singapore or other ports. Serious congestion has occurred in the south in the Ho Chi Min City area. The important Cai Mep port, which is deep water and can handle the large ships, must transfer cargo by truck for miles to and from Cai Lai Port. The largest FDI in fabric production, 1.2 billion USD, was done in the Thanh Thanh Cong Industrial Zone in Tay Ninh Province. It is located north of Ho Chi Min city and is 95 kilometers from Cat Lai Port. Thus, progress is being made, but slowly, and hurdles remain. The problem in cotton apparel lies in the long supply chain and the stress it places on all infrastructures. First, the cotton is imported from the US, Brazil, or other locations. It arrives in the port, moves inland to a spinner, and is then spun into yarn. 80% of the time this yarn is placed back into a container and taken back to the port and shipped to Eastern China. From there it enters the congested East China port system, it is transferred to truck or rail and sent to an interior fabric mill where it is made into fabric and then dyed and finished. Then, it is placed into a container and sent by truck back to the port and shipped back to the Vietnam ports where it is offloaded back onto a truck for shipment to an inland cut/sew operation. After being made into the finished apparel, it is repacked into a container and then sent to a deep sea port and loaded for shipment to the US or other regions. In the US, it arrives likely in the Port of Los Angles before moving to a rail and being shipped to the central US. Finally, it goes through an intermodal yard and off by rail or truck to the individual store. For a moment, start adding up the cost of each segment, and then imagine how just a few mistakes along the way can throw it all into turmoil.

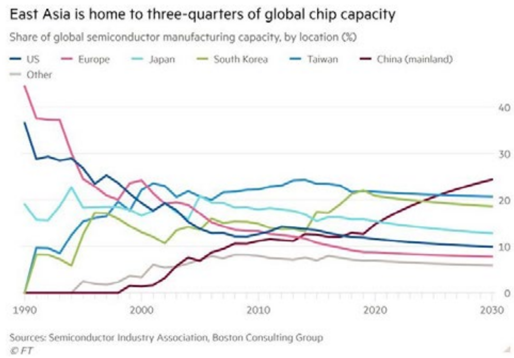


At least a portion of that supply chain originated as a way for Chinese mills to avoid the import duties on cotton. China regulated cotton imports and imposes TRQ quota, then offers a sliding scale that is near 15-16% or more and then can impose a full 40% or more import duty. In contrast, there are no import quotas on cotton yarn. Thus, unlimited imports are allowed. In the case of Vietnam, a trade agreement allows duty-free yarn imports. This provided the stimulus for the continued expansion of cotton yarn exports to China. Then, as Vietnam expanded its cut/sew operations, its fabric demands posted strong growth. Vietnam has limited Chinese company investment in fabric production and dyeing & finishing because of environmental concerns. China is the largest fabric/dye/finish manufacturer in the world. The industry has very weak environmental standards, which has destroyed the water, land, and environment of large areas. Vietnam has attempted to avoid this. Amid the record flow of cheap Chinese Fabric, other companies have been hesitant to make the billions in investment required to put in environmentally approved plants. Chinese fabric imports would undercut them. The question is are surging ocean freight costs, increasing truck and rail costs, and port congestion, both in Vietnam and China, going to end the practices. Most of the brands/retailers sourcing in Vietnam are unlikely to even to have been aware of this complicated supply chain and simply chose the fabric, designed the product, and placed the order. Today, that is changing due to cost and delays.



The Covid outbreak in 2021 could not have come at a worse time for the peak in this movement. Then there is the 500%-600% increase in freight cost. Now, apparel importers must pay hiked up air freight to get their product if they can find the space. We expect the supply chain issues will turn a profitable season into a loss, which will change it all. For Vietnam, the first step will be the needed billions of USD in investments in fabric production and dyeing and finishing. If this is done, a large segment of the freight cost will be eliminated along with the possibility of delays. The question is whether this alone will keep the sourcing in Vietnam and who will make that investment.

In the future, the brands and retailers will be forced to invest more in the supply chain and move away from the asset light model that has been so popular on Wall Street. It has been popular with the investment banks for it funneled all the proceeds to the Investment Funds and away from the workers, suppliers, and communities. The greatest illustration of the failure of this model is found in the auto and electronics industries where it has outsourced components around the world. One of these components is the semiconductor chip that is essential. Instead of making the needed investment, it allowed Taiwan and other Asian locations to dominate supply. Today, it has meant massive production cutbacks, all because no investment was made when needed in the supply chain. That is changing, however. In Germany, the Silicon Saxony Semiconductor Manufacturing Cluster has been born, with Bosch just completing a 1.2 billion USD investment in a new plant in the cluster, the largest investment in the company's history. It specializes in semiconductors for the German auto industry. This microelectronics hub in Germany now has 2300 companies with over 16 billion in earnings. Quite impressive for the old industrial hub of Europe. The UK, which has outsourced at the same pace as the US, reported auto production in July plunged to the lowest level in 65 years due to a shortage of semiconductors and workers.



Semiconductor chip outsourcing: reason behind crisis

Investment in the supply chain, not the asset light model, is the future. The impact of the old model is now clearly illustrated today for the textile and apparel industry in many locations. One that got our attention and created great sadness is the condition in Lesotho, a small landlocked kingdom in southern Africa. Lesotho is very poor, and its residents attempt to make a living in agriculture and in some manufacturing. The kingdom had a strong textile and apparel industry at one time and made a name for itself as a supplier to the once robust South African market and as an exporter to the US under the AGOA trade benefits. It has one yarn and fabric mill that produces mostly denim fabric and consumes 75-80,000 bales a year. Its main focus is knitwear, denim bottoms, and a small amount of industrial workwear. In recent years, the industry, which is very cost driven by the companies, has moved away from cotton apparel to man-made, which has reduced margins. The products offer a duty advantage in the US. The collapse of the South African economy and the influx of cheap imports have destroyed that market for the sector, as well. Denim demand is booming, but it is not helping the sector as its companies recently laid off workers because of the lack of orders. In January-June, it exported 131.49 million

Lesotho textile workers fired-broken supply chain

USD of apparel to the USA, but only 38.167 million USD was cotton apparel and 24.741 million of that was denim apparel.

This year has been the scene of demonstrations, riots, and unrest by textile workers, 80% of which are women. These women demanded a small improvement in wages that were far below that of a living wage. The average wage was 114 USD a month, and they were seeking a 14% raise, which was still below the calculated living wage of only 268 USD a month. Now, workers are laid off, people are hungry, and the unrest in South Africa has spread to the kingdom. The damage done by the recent riots has hurt any chance of new investment and hurt orders. The exports moved through the riot-damaged Durban Port. The question is why the industry was not willing to pay such a small increase in wages to improve the lives of these people by investing in the supply chain and the workers. Instead, billions have been spent on freight cost chasing the lowest wage markets. This model of exploitation of the supply chain is ending, and it could not be soon enough.

CENTRAL ASIAN DROUGHT RAISES DOUBTS ABOUT THE COTTON CROP

Central Asia has experienced one of the most severe droughts on record in 2021, which has reduced water supplies and caused large losses in the grain and fodder crops. Central Asia is a large cotton producing region, but in recent years its role in world trade has fallen sharply as the region became a large domestic consumer. Today, the crop is seldom quoted in trade as most of the small volume of exports is arranged in the region to localized spinners, rarely drawing much attention. The degree the region has fallen out of coverage can be found in the number of times it draws a mention in the international research of Cotlook. The region, however, is currently estimated by the USDA to be expected to produce 5.48 million bales and export 1.46 million. The size of the crop has been falling annually, with 5.86 million produced in 2019/2020 compared to 1988/1989 production of 12.6 million bales, which was just before the collapse of the Soviet Union. The region's crop is 100% irrigated and depends on a water infrastructure set up by the Soviet Union across several republics that collectively provided the shared snow melt, and a river flows through as a system of irrigation canals and aqueducts. The system was set up to be managed by one central authority with the funds for ongoing maintenance and repair provided by the central government. When the Soviet Union established the irrigation scheme to make itself sufficient in cotton, it gave no consideration to the fragile environment of the region in terms of water or to the impact of draining the resources.

Central Asia cotton belt water infrastructure

Since the collapse of the USSR, the water supplies have fallen, the giant irrigation scheme has fallen into massive disrepair, and water waste has accelerated. The various republics are always in a battle to have the water shared or to provide any of the needed repairs. Attempts to repair the canals have fallen short, and a large portion of the water is wasted before reaching the crops. Attempts to privatize farms still depend on the multiple republic-managed system that brings the region close to war at times. Just this month, tensions were high on the Kyrgyzstan/Tajikistan border over a water dispute. 2021 saw the worst drought to impact the region on record. Along with that has been record setting heat of 45-50 C or 113-122 F at times. The first alert of the damage from the drought came from Kazakhstan, which is a small cotton producer of around 275,000 bales in normal production. However, it is a major wheat exporter, producing 14.26 MMT and exporting 8 MMT. The drought has caused a halt to wheat exports and expectations that production has fallen 70%. This development is what alerted us to the potential issues for cotton.

Overall, the summer of 2021 has seen temperatures across the Central Asian cotton belt running 7-10 degrees C above normal and triggered significant water shortages as water supplies dried up. Little to no comment has emerged regarding the cotton crops, but the grain failure has made the local and regional headlines. We will start with Kyrgyzstan, which shares a long border with Xinjiang and is a small cotton producer but is important in the water distribution. On a good year, it will produce 100,000 bales or so. Kyrgyzstan has experienced a total destruction of crops due to the lack of rain and heat. Its Toktogul Reservoir is on the important Naryn River, which feeds the major source of water for Central Asia, the Syr Darya river. It has seen its capacity drop far below normal, reducing the country's electricity supplies. The reduced flow has impacted Tajikistan and Uzbekistan. Uzbekistan is the region's largest cotton producer, with production expected to reach 3.4 million bales, which may not happen. Uzbekistan has seen reduced water flows and large swings in the weather. Serious water disputes have been reported in several regions. The cotton crops in each region are now under the control of the textile clusters, and these have been fighting to get the water, which has triggered the disputes. No comment has emerged as to the impact on yields and quality caused by the heat and shortage of water.

We suspect the greatest losses have occurred in Turkmenistan, which is one of the most closed societies and most corrupt, with accurate information extremely difficult to find. It has been expected to produce nearly 925,000 bales, but this appears doubtful. The main cotton region is the Mary, Ahal, Dasoguz, and Lebap provinces, which are along the Amu Parya River in a very dry region. Reports have leaked out of the complete failure of cotton crops in the Mary and Lebap provinces. The key water reservoir in the region is said to have fallen into disrepair, with locals having no clue or resources to fix it. Large scale water shortages are reported in the capital Ashghat, and food prices have soared as crops failed. One report leaked out about how the president attended a new water storage that was diverted, but the system had no pumps installed to distribute the water to farms.

Karakum Canal, Turkmenistan

Reforms are being attempted with local business and Turkish firms. In the cotton province of Ahal, a new irrigation system has been launched that is owned by four local enterprises in a joint stock company. It has the grand mission to grow lots of nuts and fruits. It will pull significant water supplies out of the Karakum Canal. Turkmenistan has already decreed the cotton crop must be picked in late September, which is early, and it stated it will not offer any cotton for export via the auctions. The cotton and textile and apparel sector are mostly controlled by Turkish companies that own gins, spinning mills, fabric plants and cut/sew operations. The sector has a large denim mill complex. These companies will feel the impact of any major drop in cotton production. Turkey is the major trading partner of Turkmenistan, and Turkish data suggests imports of Turkmenistan cotton in the 70,000-100,000 bales range, imports of 50,000 - 60,000 tons of cotton yarn, and over 60,000 1,000 SM of most denim cotton fabric.

Cotton production in Tajikistan has also likely been impacted by the drought. A large portion of its production is now controlled by Chinese companies and may have been spared much of the impact. Under normal conditions, it would produce 500,000 bales with China, the key export market for cotton and yarn. Overall, the drought is very likely to have reduced cotton production by a collective 500,000 or more bales from the region. The impact will be felt in smaller exports but likely to a greater impact on reduced yarn production and exports. Uzbekistan is a major exporter of cotton yarn to China where in 2020/2021 it exported 254,437 tons of cotton yarn to China, equivalent to over 1.345 million bales.

AUSTRALIAN COTTON ASSUMING LARGER ROLE IN ASIAN TRADE

The extremely weak CFR basis for 2021 and 2022 crop Australian and its excellent quality is expanding its role in Asian cotton trade. The boycott of Australian cotton by China will affect the margins of the high-end count yarn spinners in China as ELS prices surge. The US sold a large volume of Pima in the latest week despite the average price reaching 225 cents a lb. China's own much lower quality ELS T137 old crop hit a new high of 198 cents or more FOB Eastern warehouse. This compares to a 39 staple, high strength, 33 Good Middling from the 2021 Australian crops landed at a Chinese port at 110.00-110.50 before import duty and VAT. Companies in China are being asked to suffer losses for the sake of the Motherland, and it seems the high-end spinners will do their part. Most other upland cotton, besides a few SJV Acala lots, come near the Australian in terms of quality in most years due to rain events at harvest. The use of US and Israel Pima will cost 115 cents more, and the use of Egyptian will cost 90 cents or more premium. Early indications on seed cotton prices in Xinjiang for upland suggest an ELS lint price of an unknown quality of 210 or more cents. These dynamics are increasing the demand for US Pima in Turkey, Peru, India, Vietnam, and others as orders for the luxury apparel are switched.

Australian last week continued to move off despite the slowdown in trade with Bangladesh, Vietnam, and Indonesia all mentioned. Indonesian demand for US styles has turned very weak as spinners turn to Australian. Large potential for sales exists in Turkey if basis levels weaken further. The US enjoys a considerable freight rate advantage over many growths in Turkey. The local FOB basis for the 2020 crop held steady last week, but the basis for the 2022 and 2023 crops moved to new lows as ICE strengthened. Adding to the pressure was the invert of Dec and March over May and July and then the 750-points-plus discount of Dec 22 to July 22. The 2022 crop discount is very attractive as merchants remain aggressive for early shipment.

The standard Middling 1 5/32 2021 crop for September and October shipment is offered at 1300 On Dec, which a 2022 Middling 1 5/32 is offered at 1100 On May or July CFR Southeast Asia. US E/MOT 21-2-37 GC are offered at 1700-1800 On Dec, which illustrates the discount of Australian.

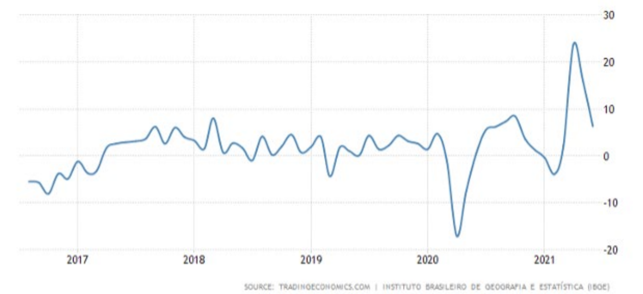
US EXPORT SALES DISAPPOINT AS REGIONAL BUYERS DOMINATE AND SHIPMENTS LAG

The logistical challenges and tight stocks continue to limit the ability of the US to ship much more than 200,000 running bales weekly, which we expected would occur. US inventories are very well committed, and most shipments are now limited to old crop delayed shipments. The tightness of the supply chain and late crop will limit any new crop shipments for several months. Plus, there is the logistics turmoil that is now likely nearing its peak over the next 60 days, which means maximum difficulty in getting cotton to the port and on a ship. Actual shipments in the latest period reached only 209,700 running bales of both upland and Pima. This was about a third below the level needed to meet the USDA target. The US needs to ship at least 290,335 480-lb. bales weekly to meet the USDA target. Every week the US falls short increases the burden for later in the season. In the best of times, the US has limitations on shipments. The fears are that the chaos will continue well into 2022.

Sales are also a problem. For shipments to occur, sales need to be registered. The big gap remains China. Two back-to-back medium-sized purchases created excitement. However, in 2020/2021, China purchased more than five million bales. The US shipped only 26,000 bales in the latest week compared to last year when 502,600 running bales of upland had been shipped at this time vs. 78,000 this season. If US export shipments to China averaged 50,000 bales the rest of the season, which they cannot, US sales would reach just over 2.5 million bales. The issue is logistics, and each passing week means the hurdle to meet targets goes higher. Then, there is the intention of the Reserve regarding restocking, a delay in waiting until October 2022, and the fact that the movement of the Brazil 2022 crop, even at today's prices, offers a ten cent or more a lb. savings.

In the latest week, export sales were soft to most key destinations except for Turkey and the regional markets. 44.3% or 108,600 running bales of 2021/2022 upland sales went to the regional markets led by CAFTA, and 100% of 2022/2023 sales went to these markets. Sales to China fell to a net 7,400 bales, and sales to Vietnam reached only 14,900 running bales. The Covid shutdown has brought most sales to this very important market to a standstill, and imports shipments are delayed by port congestion. Bangladesh demand was light, and Indonesia purchased a very small volume. Port congestion and Covid delays mean Vietnam cotton use will fall and the import volume purchased from the US will struggle to reach the needed levels.

SURGING FREIGHT RATES BOOST BRAZIL'S TEXTILE AND APPAREL INDUSTRY



Brazil monthly retail sales, Pct YOY change

The 500% or more increase in the cost to ship a container of cheap apparel from China has done what tariffs and a weak Real/USD have been unable to accomplish; it has increased Brazilian retailers sourcing of domestic apparel. The Shanghai to Santo 40-foot container rate in June hit a record 9,000 USD and has continued to rise. It was 400 or less at one time. As increased domestic orders have been placed, the cotton spinning sector has been forced to continue to seek cotton for immediate shipment. This improvement has been underway for months and is continuing to expand. For spinners, the lack of inventory is expensive as much of the 2021 crop now being harvested was sold a long time ago for export. Brazil's complicated state tax system makes it very difficult to switch

registered export sales back to the domestic market.

Index of a 41-4-35 landed Sao Paulo

This means exporters move cotton to fulfill export contracts even when domestic prices are much more attractive. This has resulted in the ESALQ Index of a 41-4-35 landed Sao Paulo moving to a large premium to international values. That has again happened. Adding to the difficulty in securing the needed supply has been the late crop and the reduced yields. The ESALQ Index hit a record last week of 104.44 US cents a lb. with 8-day payment, which was near a 9.5 cent premium to Dec ICE. In the past, this might have resulted in a move to import US cotton, but this time there is none available and shipping issues would mean problems and increased cost. Thus, the domestic spinners are bidding for the available lots unsold from farmers.

Demand has remained steady for merchant inventories of 2021 crop unsold, but a shortage of shipping containers at Santos is a real problem. There is also a shortage of refrigerated containers for beef exports, which is causing warehouses at the port to fill up. The containers are said to be almost impossible to find, and export rates are surging. These conditions are keeping the CFR basis for cotton firm and limiting any nearby shipments. Basis levels are inverted and decline as the shipment period reaches January and February. Thus, the most aggressive offers are for February and March, with SLM 5 leaf 1 1/8 offers at 1075 point On March, which has stimulated some offtake in Pakistan and Bangladesh. The 2022 crop continues to draw good demand because of the invert. At 1150-1200 points On Dec 22 for November and December for a Middling 1 1 /8, it is undercutting the 2022 crop Aussie basis because of the Dec discount to July.

The 2021 crop harvest is now estimated at 70% complete, and light rains have moved back into Mato Grosso, which will lower color grades on the remaining cotton, but is very welcome for the upcoming soybean planting. Growers continue to forward contract 2022 crop. The Dec 22 ICE contract has developed resistance at 84 cents because growers can sell 2022 crops at

90 cents FOB Santos near that level, which is a very profitable price. Such prices are assuring cotton acreage will expand even as corn acreage grows. CONAB, in its first 2021/2022 crop outlook, placed cotton acreage at 1.548 million hectares, which was an increase of 13.4% with an average yield of 1,750 kilograms per hectare, or 8.03 bales per hectare, for production of 12.451 million bales. We see the potential for a 13-million bale crop.

DRY WEATHER A CONCERN IN GUJARAT BUT RAINS EXPECTED 30/31

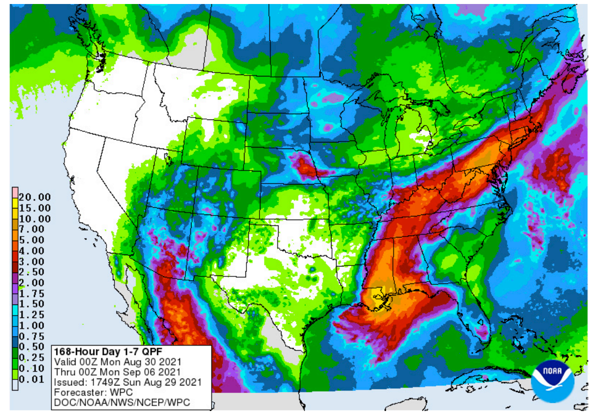
As of August 27, the very important cotton growing state of Gujarat has experienced a very dry August, with the largest cotton producing region of Saurashtra having a deficit of 51% of normal rainfall and the balance of the state a 47% deficit. The dry conditions have, of course, stressed the crop, but the hope is that September rains will restore plants and boost the crop, but yields will likely be below last season. Rainfall has also been below normal in Madhya Pradesh and above normal in Maharashtra and Telangana. The crop in Maharashtra, which has the largest acreage, is in much better shape than in other years and advancing well. Total planted acreage appears headed toward a near 8% decline from last season.

2021 Gujarat cotton crop, Kati Reliance Cotton Photo

Domestic prices held steady last week and showed limited movement in the spot market, but the new crop offers did turn firmer, with Shankar-6 1 1/8 now offered for November and December shipment at 1000 points On Dec, quite a high basis when compared to the same day in 2020 when it was offered at even the Dec futures. These are CFR Asia prices. India's early competitive discount, which reached extremes in 2020/2021, allowed one of the largest volumes in years to be shipped to China, reaching 503,138 tons. A portion of these shipments moved into consignment stocks where they are still offered. India also exported 289,914 tons of cotton yarn to China in 2020/2021.

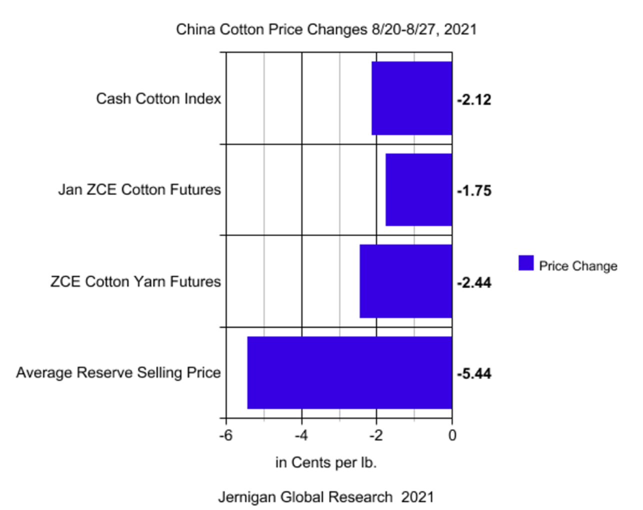
New crop is slowly beginning to move in the Northern Zone at prices above the MSP. At this stage, it is clear the USDA and others have far overestimated Indian stocks, and, as you know, we have been arguing that point for years. Thus, very tight stock levels are now prevailing, and the size of the 2021/2022 crop will be very important to the volume of cotton that will be exported.

WEATHER CONCERNS CONTINUE IN THE US AS A NEW HURRICANE IS EXPECTED TO HIT THE BELT



Hurricane Ida is now forecast to move inland on the Louisiana coast over the weekend and bring heavy rains to Louisiana, Mississippi, Arkansas, and West Tennessee. The rains are not welcome considering the Louisiana crop is now 40% or more open and Mississippi 35%. The storm will also bring heavy rains to the Florida Panhandle and Alabama crops. The storm could impact yield and quality, but it remains to be seen just how heavy the rains and winds will be. Both Mississippi and Louisiana are states that are expected to potentially produce a high grade, long staple crop, but this storm will reduce the supply of top color grades and increase the supply of SLM. Merchant new crop basis levels for 21/31 color grades are already at very firm levels. This storm will accelerate these premiums and increase the offering volume of 41-4-39/38/37 staple, which was already evident Friday. Some aggressive offers had begun to appear for January-March shipments at levels spinners may find attractive. For example, a Memphis Eastern GC41-5-39 was offered at 1150 On March, which is likely to be popular in Pakistan and Turkey. For spinners who need 21/31, the 2021 Australian crop still offers real value. Ida will miss the Texas RGV and Coastal Bend crops, which are open, and harvest is underway. This region will, however, receive some light showers. 84,580 bales have been classed from these two regions and the quality is very good, with 20.7% 11/21 and 65.4% 31 color grades with an average staple of 36.75. The West Texas crop is developing quite well with no new issues.

CHINA COTTON PRICES RETREAT AS YARN PRICES CONTINUE TO WEAKEN



Friday's close in Dec ICE just below 95 cents narrowed the premium of China's ZCE cotton futures to one of the tightest levels in some time. Dec ICE gained 1.74 cents a lb. last week, while the January ZCE cotton futures lost 1.75 cents and cash cotton prices declined 2.12 cents. Neither market took much direction from the other last week as China's entire textile and apparel complex was weaker and the NDRC appeared in a mood to further lower commodity prices where they could, as factory gate inflation remained a concern. The Reserve announced that only spinners would be allowed to buy cotton at the state Reserve auctions for the remainder of the 2021 auctions, and spinners would not be able to resell stocks. The move was not at all surprising since, as of August 19th, only

43% of the sales had been to spinners, with the majority to the trade groups. These groups had been speculating they could merchandise these stocks at a profit. The daily auctions continued to sell out the remainder of the week but at much lower prices. The average price paid at the auction on Monday, before the restriction, was 17,797 RMB a ton or 124.58 cents a lb., and prices declined the rest of the week, with Friday's average price down to 17,019 RMB or 119.13 cents a lb.

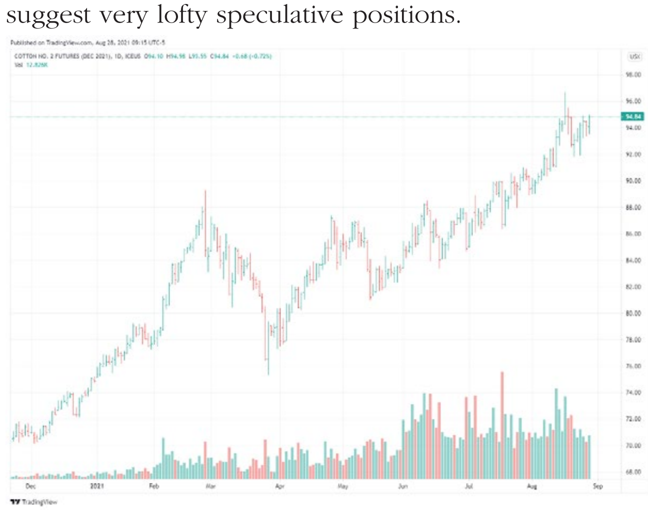
The ZCE prices also moved lower in the distance months, with March and May futures at a slight discount. The January cotton yarn 32s carded futures lost 350 RMB a ton during the week, and the January contract also is at a discount to the average cash price with a 1460 RMB a ton negative basis. Cash prices of cotton yarns declined from 50-150 RMB a ton in most counts. Polyester staple prices were weaker as was the futures. Comments from the yarn sector were that spinners have not been able to pass along higher cotton prices and that downstream the fabric sector was experiencing less offtake. Viscose fiber prices were also weaker as mill stocks remain heavy and demand light. Profitability in Viscose fiber yarns is reported to be very poor.

Chinese spinners inquired for consignment stocks and for new import purchases. However, the price bids were below merchants offering levels. One growth that appears to be drawing interest is Brazilian 2022 crop for October 2022 and forward shipment due to the discount. There is also speculation as to the Reserve's intentions to replenish stocks. The move to stop speculation at the auctions is being taken as a desire to keep cotton prices in check. Thus, any move to buy large volumes from the US or Brazil for 2021/2022 shipment would force prices sharply higher. The growing conjecture is that stocks will be rebuilt when prices offer a better opportunity. New attention is now focused on the possible purchase of Brazilian 2022 crop or the inquiry for it. The invert of ICE and merchant speculation that shipping rates will fall is providing interest at over a ten-cent discount to 2021 crops.

The Xinjiang crop is now opening, and the movement of seed cotton is about 30 days away. Early ideas on seed cotton prices are at a premium to current prices. One ginner purchased a lot forward in order at 8.6 RMB a kilogram, which would be a large premium to cash prices, to test new ginning equipment. A range of 7.8 to 8.0 is expected, which is close to current cash prices in Xinjiang.

ICE FUTURES CLOSE NEAR THE HIGHS OF THE WEEK

International prices have caused limited movement, as demand has underpinned ICE. The price action of August 24th provided the technical support for a larger sell off to be avoided. In that session, the lead Dec contract experienced a decline to a low of 91.91, which was just above the uptrend that has been in place for months. Support appeared on this weakness from very active price fixations of unfixed On Call purchases and fresh export offtake. This export trade provided the support for prices to recover back to levels where HFT and Algo systems provided support. By the end of the day, a large outside range reversal had occurred, with Dec experiencing a range of 91.91 to 94.36 and a close at 94.18. Volume was light, but the range proved to be the major influence for the rest of the week. Friday's close of 94.84 was above that range, which left the market in a very positive technical condition. The COT report for the week ending August 24th confirmed the Trade was a buyer on active price fixations. The Managed Funds and Index Funds were buyers as well, with the Other Reportable and Non-Reportable small spec's the sellers. The Managed Fund's net long position is now 84,057 contracts, which is far below the record set in January 2018 of 108,778 contracts but is at one of the highest levels on record outside that period. The Index Fund's long position reached a record 97,312 contracts and a net 86,880 contracts, both of which suggest very lofty speculative positions.



The main support at the end of the week came from the approaching Hurricane Ida, which will bring unwelcome rain and wind to the US Mid-South, Alabama, and Florida crops. The rains may lower yields and impact quality as cotton is now beginning to open across this region. In the face of such conditions, any additional hedging of the US crop stopped, which allowed the market to ease higher. The storm has triggered memories of previous storms and how they can change direction at the last minute and become locked over an area, such as was the case with Harvey. Thus, emotions are high until the storm arrives on land.

Overall, we continue concerned about the signs of major issues in demand and how the first part of 2022 could experience major weakness. The Covid and supply chain issues in Vietnam are also resulting in a reduction in its 2022/2023 cotton consumption prospects and longer-term ramifications for its supply chain model. These and the other issues we have discussed continue to keep us cautious, and we expect resistance to remain at 95 cents and above. The impact of Hurricane Ida will be important in the short-term, coming into the storm most private work is for a US crop near 18 million bales.

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