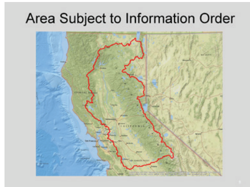
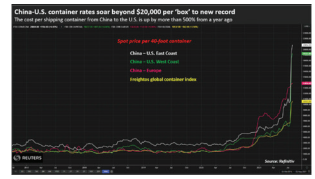
CHINA'S EMBARGO ON AUSTRALIAN COTTON COSTING SPINNERS MILLIONS



CALIFORNIA COTTON INDUSTRY IN CRISIS AS WATER CRISIS EXPANDS AMID NO PLAN

COVID OUTBREAK AGAIN IMPACTS CHINA & VIETNAM



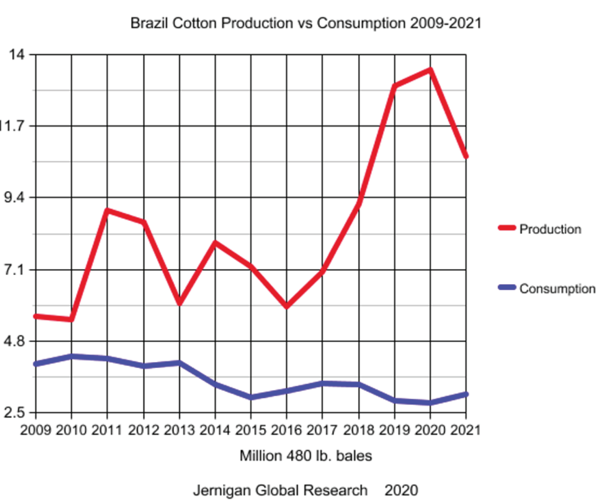
LOGISTICS INHIBIT US COTTON EXPORTS

JERNIGAN GLOBAL
KNOWLEDGE IS THE NEW CAPITAL

2021/2022 COTLOOK A INDEX BEGINS SEASON WITHOUT BRAZIL QUOTE

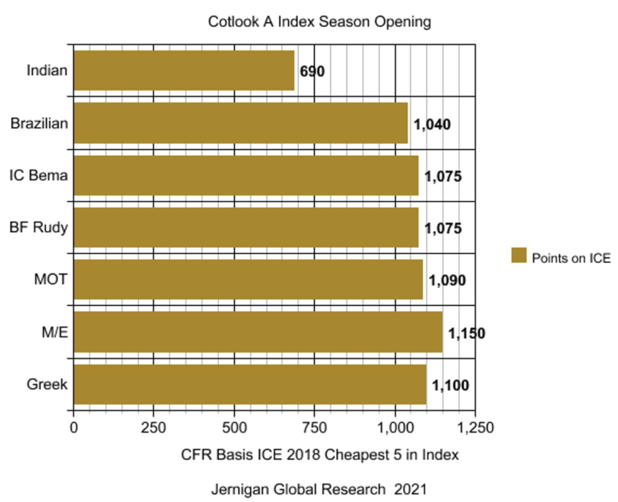
FIRST TIME IN MORE THAN FOUR YEARS

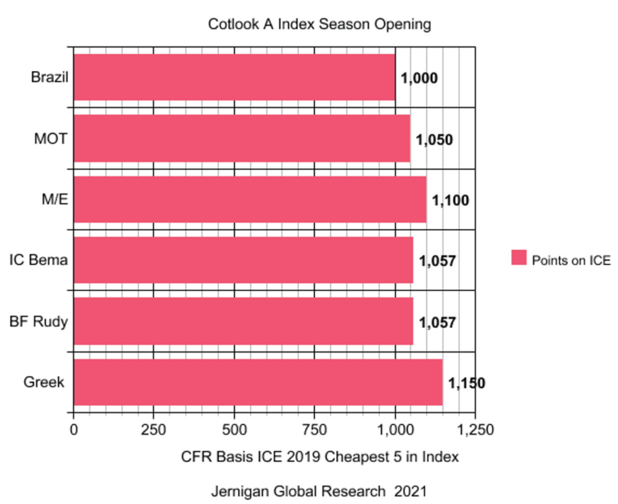
Port of Santos



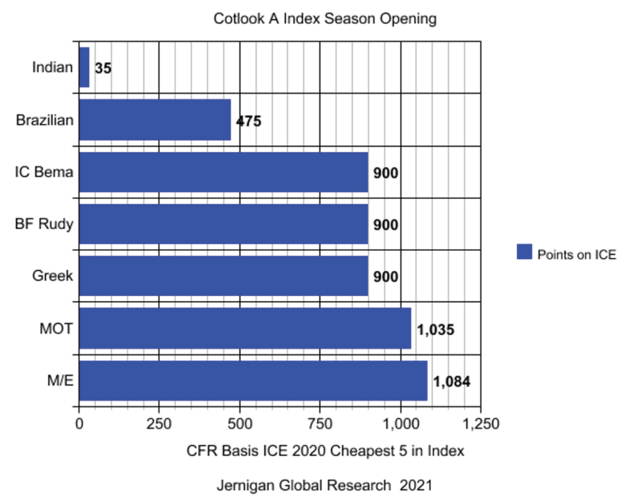
Brazil is the second largest cotton exporter in the world while lacking an adequate cotton warehouse storage system. This combination has made it a major feature of trade for the entire season in recent years and many times the most competitive growth for much of the year. In 2020, when the 2020/2021 season began, Brazilian Middling 1 1/8 was the second most competitive in Cotlook's A Index calculation of the five most competitive growths, with offers beginning the season at an aggressive 475 points On Dec, second only to India at 35 points On. Cheaper basis calculations were actually in circulation. The previous season, 2019/2020, began with Brazilian the cheapest in the index with a CFR basis of 1000 points On Dec. In 2018/2019, it was again the second most

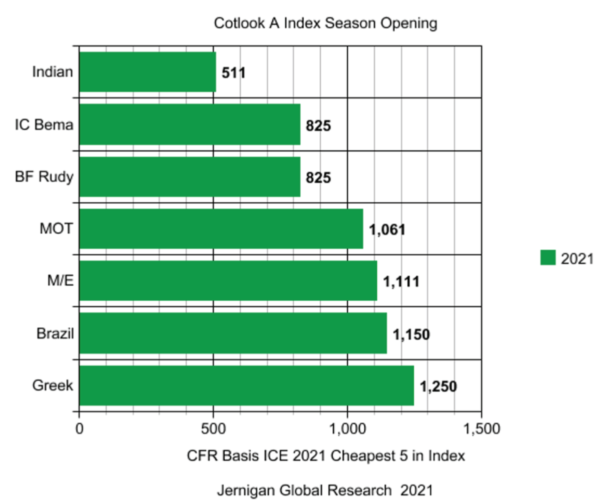
competitive and second only to Indian at 1040 points On Dec. In each year it was at a discount to US E/MOT, M/E and African Franc Zone offers. In 2021/2022 the season has begun with no Brazilian quote in the index. Indian, African Franc Zone, and US E/MOT and M/E make up the index. With a calculation of approximately 1150 On Dec, and most offers higher, it is at a premium to every other growth and even at a premium to Australian Middling 1 1/8 offers for May and June, which are quoted for the first time in years. The Australian for the first time in ten years is at a 75-point discount, a shocking revelation.





The Brazilian CFR basis has found support, first, from aggressive forward selling from merchants much earlier when crop prospects were larger, and second, from a decline in crop prospects and the yield outlook, and third, from surging freight rates from Santos' port to all the major import destinations. Any merchant who purchased cotton from a grower today at the very firm FOB Santos rate and then sold to China, for example, at the prevailing basis would face very tight margins. Brazil's weaker domestic economy has slowed consumer imports, which has caused shipping lines to divert ships to the hot US West Coast or European markets. Today's quotes to Turkey's main ports have reached 3,000 USD for a 40-foot container before special fees To Karachi it has soared to 4,000 USD, to Bangladesh 5,700 USD, and to North Vietnam the rate hit 4,000 USD.

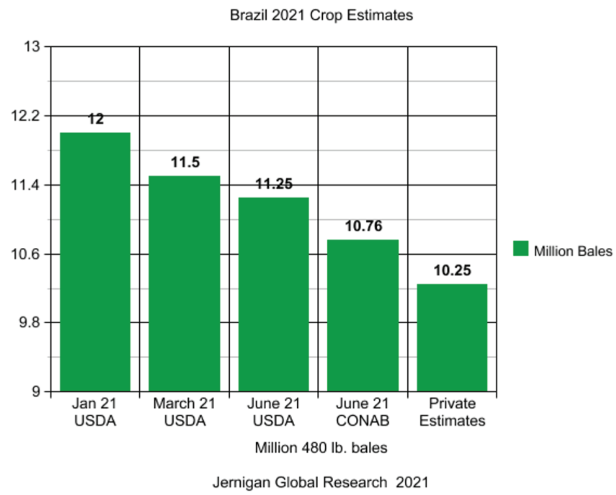




Shipping rates are in total chaos with prices for spot shipment into the US and Europe all over the board, which is causing disruptions from the export markets such as Brazil and Australia as shipping lines switch service and cut services to the lower-volume import markets. One US importer last week said they had to pay 10,000 USD a container premium booking fee in addition to the regular record rate. Moreover, effective this month, new congestion fees were put in place along with cargo discharge fees. It has descended into chaos. For Brazilian cotton exporters, all major routes are now extremely expensive and large premiums to the US. The August through December period promises to be quite challenging as the container lines attempt to cash in on the panic now underway by US importers to get products in before Christmas. Additional capacity switches are likely. Adding to all the chaos is the expanded Covid outbreak impacting the major Vietnamese and Chinese ports. The extreme prevailing freight rates and additional charges suggest that the CFR basis for Brazilian for September-December could move higher on any fresh sales from growers.

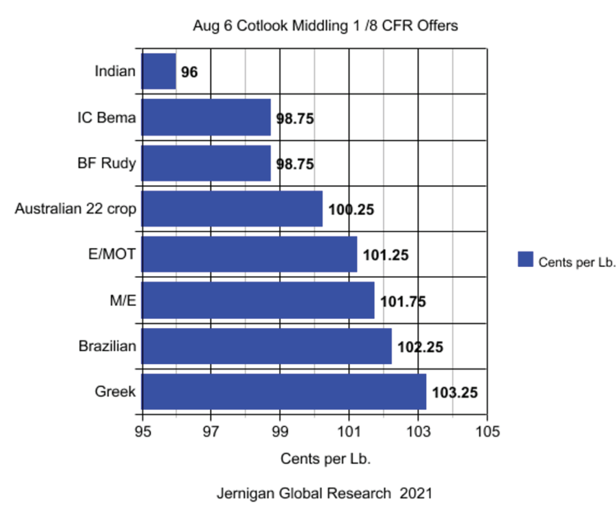
These conditions are far from the aggressive CFR basis levels of a year ago when Brazilian cotton was faced with large old crops stocks and a record new crop all being forced to move at a time when the US had the Chinese market locked under the China/US trade agreement. Brazilian Middling 1 1/8 sold into many markets at a 500–600 point discount to an E/MOT of the same quality, but today the US is at a 100-point discount. The early estimates for the 2020/2021 crop began at 12.0-12.5 million bales and have declined to 10.50-10.75 million bales. With harvest in the crucial Mato Grosso second crop just nearing the 25% stage, no one appears to have confidence in the final yields. There has not been a season in recent memory when the second crop was planted so late and also encountered dry periods and late season cold fronts. Bahia yields have been better than expected. Then you have the level of export shipments in the 2020/2021 international season of 11.1 million bales plus improved domestic use, meaning ending stocks coming into 2021/2022 are tight. Adding to that tightness has been a domestic industry that has been forced to battle for old crop stocks as consumption improved and the crop was delayed. The spot price has been at a large premium to ICE for months, reaching a high of 99.49 US cents a lb. A rather strong Real against the USD has also slowed grower selling at times.

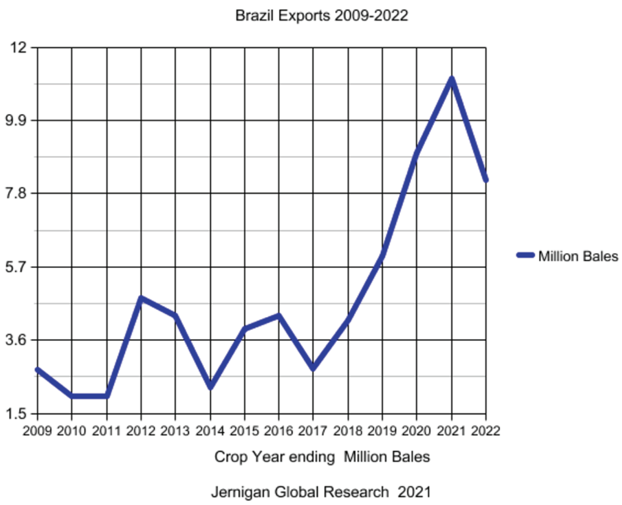
Snow in southern Brazil at end of July



The popularity of Brazilian cotton is illustrated in Turkey where the volume of imports though June reached 257,272 tons, just below that of the US at 259,958 tons. This represents over ten percent of all Brazilian exports. July total export shipments from Brazil slowed to only 61,600 tons as supplies tightened and new crop was delayed. Vietnam was the top export market in July at 18,251 tons followed by Turkey at 12,051 tons.

The 2021 registered sales on the BBM are only 416,513 tons or 1,913,877 bales out of a crop estimated at 10.50 to 10.75 MB. In recent years, the major merchants have declined to register sales on the BBM. Private estimates have grower forward sales at near 7.5 million bales, which is over 70% of the expected crop. That, of course, assumes it meets the USDA estimates, which many private traders do not believe it will. The FOB Santos basis is very firm at 700 On Dec, and at that level and with the ongoing surge in freight rates few merchants are in any hurry to make additional purchases and sales. This explains why the CFR basis is firm at 1250 or more On Dec except for a few offers or higher. The Cotlook quote is 1150 points On.





The 2021 cotton harvest overall is approximately 35% complete. The harvest in Mato Grosso is expanding, but yields in the central and southern areas of the state have been disappointing. This region has been impacted by several cold periods that slowed boll opening. Some fields were hit with frost, which was a first for the region. The size of the crop remains a subject of debate. Some estimates place the crop as low as near 10 million bales, which would reduce the unsold surplus by a wide margin. As of August 1st, 581,102 bales had been classed in Bahia, and the quality was excellent. 83.51% was premium mike in a range of 4.2 to 4.9. Only 6.51% had a staple length of 35, 28% had a staple length of 36, 48% had a staple length of 37, and 16.86% was 38 or longer. 81.3% had a leaf content of 3 or lower, and there were no issues with short fiber content. This crop will be in high demand.

The 2021/2022 season began with Indian new crop Middling 1 1/8 as the most competitive at 375point discount to the old crop offers on the last day of the 2020/2021 season. The CFR basis was 500 points On Dec and the Ivory Coast and Burkina Faso Middling 1 1/8 offers were included at a basis of 825 points On March. Those are very competitive levels. One reason is that while services have been cut the freight rate from the main African zone ports, especially Abidjan and Cotonou, are the most competitive in the world into several markets, including Bangladesh and Pakistan. US E/MOT and Memphis/Eastern Middling 1 1/8 rounded out the index at 1050 and 1100 point On Dec for November and December shipments. Australian 2021 crop is ineligible for it is offered for May and June. However, without that restriction it would be in the index at only 1050 Points On May, a shocking discount to US, Greek, and Brazilian offers. The Strict Middling 1 5/32 Australian offer is on par with the Chad Kero 1 5/32 offer, which reflects a record.

The chaos in the freight markets has turned the basis levels upside down and effected trade across all markets. This highlights how much all exporters and importers are at the mercy of a few firms, with three shipping alliances controlling 80% of the markets. No regulation has been put in place requiring minimum service to countries that are small consumer importers, causing severe economic pain. The overcapacity in shipping earlier and low rates have left most national carriers, which were established but seldom used and are in poor shape. The period of extreme low rates and overcapacity in the sector resulted in many exporting regions such as in East Africa enjoying extremely low shipping rates. Santos Port, from which 98% of the cotton is exported, reached record capacity in June. Agriculture exports in 2021 have reached a record and import volume has been strong. Shipment rates from Asia into Brazil have soared as well.

Attention is also on the prospects for the 2021/2022 crop, with expectations that a 13-million bale or larger crop will be produced, assuming weather patterns return to normal. Despite the invert on ICE, growers have been active selling forward to merchants and on the BBM, with 343,527 tons already registered as sold. Mato Grosso corn acreage in 2021/2022 will expand, and this year's second crop harvest was not as bad as feared. Domestic corn prices hit what equaled 8.20 USD a bushel last week. The production cost in Mato Grosso based on this season's average yield was below 2 USD a bushel. Corn is a much lower input cost crop than cotton, which suggests some potential cotton acreage could move to corn. For now, 2021/2022 crop is offered at 1125 points On Dec 22 for a Middling 1 1/8 for October-December shipment and 1075 points On for a SLM 1 1/8. These levels, given the discount, have been attractive to spinners and demand has been steady.

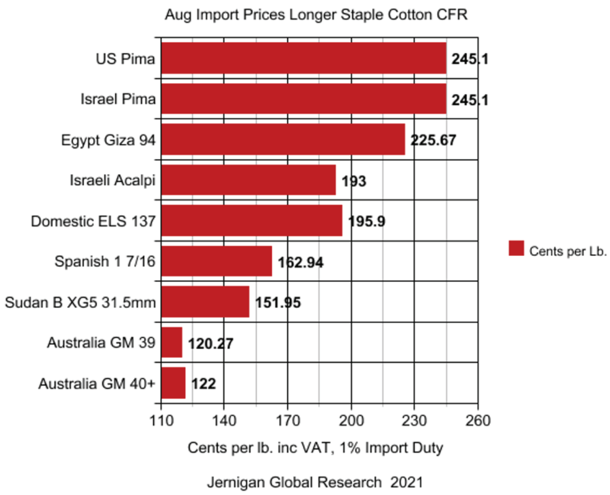
CHINA'S EMBARGO OF AUSTRALIAN COTTON COSTING HIGH COUNT SPINNERS MILLIONS

The Chinese government's attempt to intimidate Australia through words and the embargo of select commodities is costing Chinese high count yarn spinners millions and lowering the quality of products produced. Several years ago, a US brand discovered that it had been buying US Pima branded home textile products from Chinese suppliers that was instead made with the longer staple, high-end Australian cotton. While the move was illegal and was a counterfeit product, it illustrated that the extreme longer staple high-grade Australian could be used in the higher count 60s and above count yarns and also could be used to blend with ELS. This created significant export demand from many markets such as Japan, as the quality of the Australian cotton became known and was responsible for an excellent high quality apparel product. As the spinning features became known, Chinese spinners took up Australian cotton in increasing volume at higher and higher basis levels. Chinese mills visited Australia directly to seek supplies, and a bidding war was created during times of reduced supply. The common discussion among the high-count spinners was that China would take every bale of Australian it could produce. That enthusiasm all came to an end in 2020 when Covid caused a collapse in demand and left one Chinese trade group holding a very expensive long basis position. It was followed by increasing attempts by the Xi government to intimidate Australia into submitting to the will of China. After record investments and a rare trade deficit with the country, Xi viewed that China owned Australia. Despite a Free Trade Agreement that guaranteed access for Australian cotton and other products, China again violated the agreement and simply told the Chinese mills not to buy Australian cotton and that if they did the maximum import duty would be applied. None of this was legal, but no one from the WTO moved to enforce the violation.

Major Chinese trading companies that had established large Australian operations throughout the crisis would pass and established long 2021 crop positions but had to turn and sell back to the market as the ban continued in force. The Chinese market is silent on the subject, as Xi's China allows no debate and his rule by decree demands no comment and complete obedience. The recent curbs on the tech sector saw billions in share values wiped out and yet every individual and company had to submit and not comment. Today, Chinese high count yarn spinners face very difficult conditions, with the available supply of the higher-grade, longer staple upland, domestic ELS cotton or imported ELS very tight. More and more business is moving to India's and Pakistan's ELS spinners. Any buyer of a Chinese-made apparel product that requires these cottons should be suspect and demand testing to prove what cotton was used.

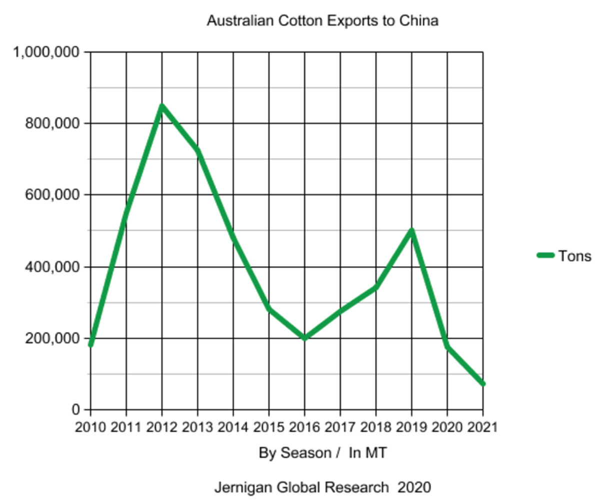
Here are the current economics. First, a domestically produced T137 last week sold for a record 28,000 RMB a ton or 195.90 cents a lb. This cotton is in very restricted supply and the quality is below the US Pima and Egyptian ELS, with a lot of the crop in the last two years falling to Grade 336. Problems with contamination are occurring, and the small size of the crop has reduced the number of seed varieties available and caused a lack of investment in seed research. The number of gins processing ELS have been reduced, which has limited upgrades of the gins. The same has occurred in California Acala, as the crop has fallen to very small levels. Chinese spinners need imported ELS or long staple Australian to blend with domestic ELS or else the product quality falls sharply.

Earlier, the state encouraged some in the industry to make incredible public claims that Xinjiang was producing a large volume of cotton that was equal to Australian and could easily replace the Australian imports. That is simply not true. The Xinjiang cotton industry has become very advanced with technology, large investments in seeds, and machine picking. It has achieved a major accomplishment in yields, with the average Xinjiang yield in 2020 a record, second in the world only to Australia. All of this is impressive and is a real success story. Under the current system and Target Price System prior to 2021, the focus was on yield not improved quality, with growers being rewarded with higher incomes when yields increased. They received little if any bonus for the longer staple, high grades. The Chinese system is focused on buying cotton from growers in seed cotton and not lint. The 2020 crop was a record, but the quality was lower, with the famous "Double 29/30 Staple" quality very rare and only a small percentage. The crop instead was 28 staple and had lower strength and higher mike. This is not surprising considering the US cotton quality had serious issues when the focus was on just producing on yield for the government loan. But no volume of the Xinjiang 29 and above staple, 33 strength, and premium mike can be found, and what was produced moved quickly. The industry has introduced reforms to address the problem, but it will take some time and also require weather much better than prevailed in 2021.



Now, let's review the imported options. US Pima Grade 2 will cost 215 cents, CFR or 245.10 cents with a 1% import quota and higher with a sliding scale quota. This has been the most popular ELS import. There was little Egyptian 94 imported in 2020/2021, and it will cost 225.67 cents with 1% quota, and there is no quality available before new crop. Israel Pima prices appear to be rising daily and are at 245.10 cents with 1% quota. The Acalpi 1 3/8 to 1 7/16 from Israel is at 193 cents after VAT and 1% duty. Then you go to the small quantities of other ELS, such as Spanish Helma 1 7/16 at 163 cents after VAT and 1% quota. The Sudan XG5B 31.55 mm, which can have major honeydew issues, is at 152 Cents. Against these prices, a Good Middling 39 staple, high strength Australian, which would be perfect for the higher counts and blending, under regular VAT and 1% duty would cost 120 cents. It is also available in volume, with a large new crop coming.

Chinese spinners and textile groups have always had our respect due to their ability to manage the whims of Beijing. In the earlier years of a gentler and kinder China, the cotton industry was viewed as essential to the state. At times, spinners were forced to pay much higher prices for domestic cotton than imports as part of their duty to support the rural farmer. This eventually gave way to reform, which brought about the Target Price system and a much more efficient cotton market. Now, however, the economics of Xi are giving the industry a significant economic loss. This comes after Chinese companies have invested billions in the most advanced equipment and some of the most modern mills in the world. China is the largest cotton fabric producer and the go-to source for very high-end cotton fabrics and products as a result. The embargo of Australia cotton will mean a battle to first find an alternative supply. The US is the only volume upland exporter that produces a similar quality, but today it has no supply, and the new crop supply will depend on fall weather and ginners' willingness to focus on quality. Good Middling is hard to find because neither growers nor ginners have been incentivized to focus on it. Thus, China's high count yarn spinners will have to find the needed volume of US Pima, Israel Pima, or Egyptian, which will be difficult, and pay 105 to 125 cents or more a lb. premium over Australian. Even then, the lower US Pima supply and limited increase in Egyptian means that, at any price, supply will be constrained.



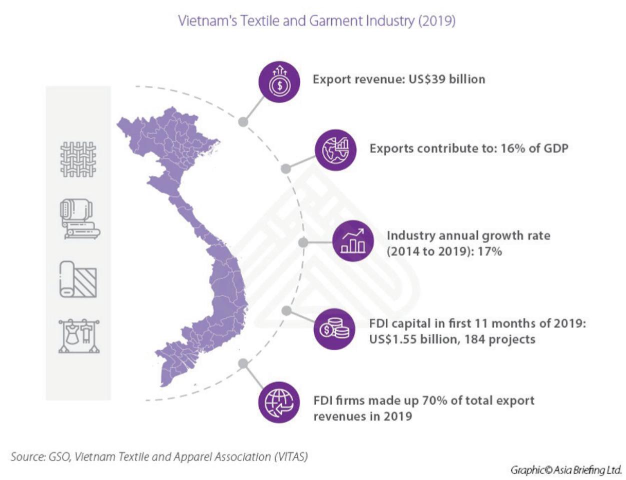
It remains to been seen whether the industry will be able to get the Xi team to quietly lift the embargo or whether it will it be required to see millions lost in investments while the business move to India, Pakistan, and Vietnam, as well as other markets. The XI government just erased an estimated 1 trillion USD from the value of Chinese equities in tech, property, and education companies, with no concern from the CCP. Thus, economics no longer rule China.

IMPORTANT VIETNAM TEXTILE AND APPAREL SUPPLY CHAIN IMPACTED BY COVID

Vietnam has become a major part of the US apparel and footwear supply chain. Regarding cotton apparel, it is now the largest supplier to the US market, with January-May shipments of 2.518 billion USD. From January-July, Vietnam exported nearly 23 billion USD of textiles and apparel. It is a very important market for US cotton exporters as the country is the third largest cotton import market in the world and the US is the top supplier followed by Brazil. For many US companies, it is the lynch pin of their supply chain. Under Armour, which reported second quarter revenue of 1.35 billion USD, sources a third of its footwear and apparel from the country. Their textile and apparel supply chain is on shaky ground due Covid and the chaos in shipping and surging freight rates. Vietnam's textile and apparel industry requires cheap ocean freight, efficient ports and transportation, and covid-free conditions. During the 2020 outbreak, it was spared the worst impact, but this second wave hit the country much harder. Their supply chain is vulnerable due to the lack of investment in fabric production and dyeing and finishing.

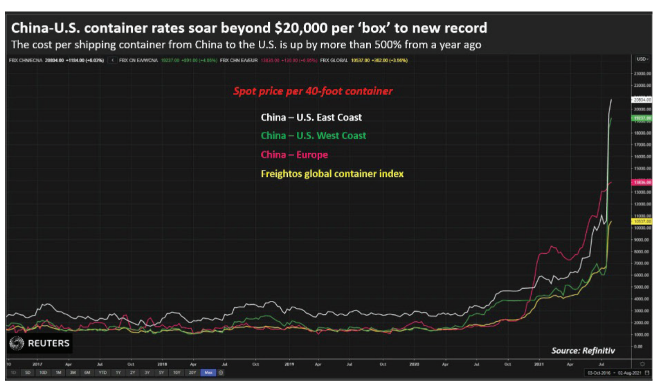
The supply chain for cotton begins with the importation primarily of US and Brazilian, but also other growths, which are shipped by container to the main Vietnam ports. From there, it is transferred by truck to the spinning mills. After it is manufactured into yarn, over 80% of the yarn is then containerized and trucked back to the port, where it is shipped to the main eastern Chinese ports. From these ports it is trucked and sent by rail to the inland fabric mills for production before being sent to be dyed and finished. Once the fabric is finished, it is again packed in a container and sent back to the port where it is shipped back to the Vietnamese ports, then trucked to the cut/sew centers. After being made into the end apparel product it is once more placed in a container and sent back to the port, where it is shipped to the US and other locations. The US is the largest export market. Thus, its textile and apparel industry is one of the most dependent in the world on container freight and the efficient operations of its ports.

The container freight chaos we are experiencing in 2021 changed the economics as rates both to and from Vietnam soared and ports in Vietnam, Southeast Asia, China, and the main transit hubs suffered congestion and delays. A 3-4-day delay in just one of the locations causes havoc in others. The industry is struggling to manage the increasing freight cost, which is squeezing all margins, especially with the repeated shipments. Another event, the Covid outbreak, has caused many supply chains to stop or turn into chaos. VITAS reported a few days ago that 30-35% of all apparel factories had suspended operations, and 90% of the supply chain was broken. A major Covid outbreak has occurred in the southern textile belt. In an attempt to contain the virus, the government is requiring a "three in spot" policy, which requires employees to work, eat, and sleep in place. This put a major financial burden on the companies to house and feed employees at the factory, impossible for smaller and medium sized factories and very expensive for all plants. Some large groups have suspended operations in apparel and even tech. The lockdowns started in some areas only July 14th, and many have now been extended to August 9th or longer. The lockdown in Ho Chi Minh City was extended from August 1st for two weeks, along with 18 other cities in the south.



Hanoi, in the north, is now being impacted and is under lockdown until August 15th. These lockdowns are also affecting trucking of exports to ports and creating additional congestion at the ports. In the south, Cat MEP is a major deep-water port for shipments to and from the US. Congestion at Cat Lai has caused a major backup of containers at Cai MEP. The closure of factories has containers piling up and has created a serious problem for truck movement. In some ports, certain import unloading has been stopped to speed up exports. These conditions are reducing cotton use, causing shipment delays in apparel exports, and causing significant economic damage. The exact impact on the import of cotton, export of yarn, and import of fabric is delays. A lot is at stake. August 2020-June 2021 cotton import arrivals reached 1,444,392 tons or 6.636 million bales. January-June yarn exports reached 1,843,299 tons, of which 1,004,207 tons went to China. Then you also have the record fabric imports. The disruption of this flow has ripples throughout the supply chain. This all comes at a time when Vietnam forward purchases of US cotton are at the lowest level in several years. As of July 29th, Vietnam has only purchased 360,200 running bales of upland for 2021/2022 shipment. This is down sharply from purchases in 2020 at the same time of 627,100 running bales of new crop and 832,700 running bales in 2019 on the same date. The lower US purchases appear to be part of a larger uncovered forward position.

LOGISTICS CONTINUES TO INHIBIT US COTTON EXPORTS



The chaos prevailing across the US logistics from the port, truck, rail, and intermodal continues to inhibit US cotton export shipments. At a time when mills are scrambling to find cotton for nearby shipment, as of July 29th the US had 1,701,153 480-lb. bales that had been sold some time ago and unshipped. While the number is not excessive by historical standards, it is by the pace of demand. In the past, high-priced sales and a host of other reasons always resulted in notable carryover sales, but this year all the major buyers have been seeking cotton ASAP and US logistical delays have caused them problems, as have delays around the world. Only three days remain in the 2020/2021 season, thus shipment will fall 200-300 bales below the USDA target unless the adjustments with the Census data are offset and levels adjusted. Last week's shipments were slow at 229,500 running bales of upland and 8,700 of Pima. The need for immediate shipment was seen in an additional 17,100 running bales of sales for 2020/2021 for upland and 2,500 for Pima.

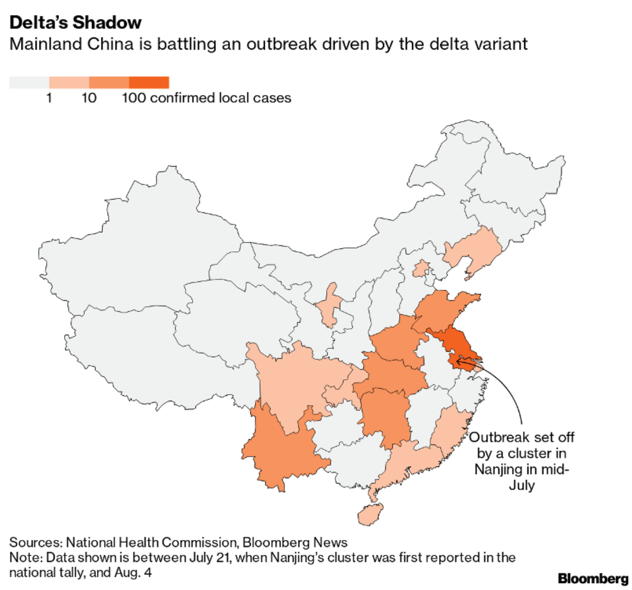
The chaos at the ports continues and is likely to continue well into 2022. The spot rate for a 40-foot container to the US East Coast from China has officially hit over 20,800 USD before surcharges and other fees, and that is up 500% from a year ago. To the West Coast, it neared 20,000 USD. We heard surcharges for premium bookings are an additional 10,000 USD per 40-foot, and individual importers have quoted even higher immediate quotes as it becomes a bidding war with the highest valued products getting the space. Congestion surcharges and discharge fees have also been announced as we begin to enter the peak period. While these rates do not apply for containers headed to China or Asia from the US, these rates are moving up slowly However, at such spot rates container line greed takes over. It is all a mad dash to get an empty container back to a Chinese or Asian port loaded and then back to the US or Europe. The volume of freight has increased the average round turn of Shanghai to LA and back to 73 days instead of the normal 35 days.

The situation at US ports is adding to the cotton exporter woes, with imported goods delayed for weeks by the congestion. The FT reported that dozens of containers were lost in the Chicago intermodal railyards, some for 78 days or more. Savannah, a major cotton export port in Georgia, moved 20% more volume in the year ending in June. It is all hitting the bottom line of companies. Proctor & Gamble reported a 1.9 billion USD hit to its bottom line from a combined increase in logistics and commodity prices. Again, there is no discussion of a plan to address the real issue of no major US-owned container line or increased focus on reduced outsourcing.

US exporters are now under pressure to begin moving 2021/2022 sales and the backlog of unshipped 2020/2021. The USDA has set an export target of 15.2 million bales, which means an average of 292,308 bales will need to be shipped on average weekly. Since April 1st, the US reached this level or exceeded it in upland shipments in only ten weeks. Since June 17th, it reached it only one time. Last season, US weekly upland export shipments never exceeded 281,948 running bales between August 20th and October 29th. The August to December period will be challenging, which means a greater burden to increase shipments in January-July.

DELTA VARIANT STRAIN OF COVID HITS CHINA

The Delta variant strain of the Covid Virus appeared to be spreading across China last week, leading to a host of new shutdowns, with the usual lack of transparency adding to the concerns. The government reacted swiftly in Xinjiang, halting cotton ginners' preparations for the upcoming new season, which should start in September. The halt to preparations could slow the start of harvest, but the crop is late, which may negate much of the issue. Some ginners have already forward contracted seed cotton, as expectations of higher lint prices have occurred. In addition, the road transport from Xinjiang to the Eastern mills has been halted and rail traffic is quite slow. In July, 261,100 tons were transported from Xinjiang to the Eastern Mills, which was down over 23%. 156,700 tons moved by road and 104,400 by rail. The suspension of road transport will tighten stocks in the East. Jiangsu appears to be one of the hardest hit by the new outbreaks, but cases are showing up across China and affecting travel, freight, warehouse movements, etc. Jiangsu is a very large textile production region, and operations have been impacted. Weather also continues to cause problems.



On August 2-3, additional heavy rain occurred in northern Henan, resulting in the destruction of the Wangzhuang Dam to discharge flood water. The Three Gorges Dam neared the warning level as rains continued, and another tropical cyclone hit southern China with very heavy rains forecast across many areas.

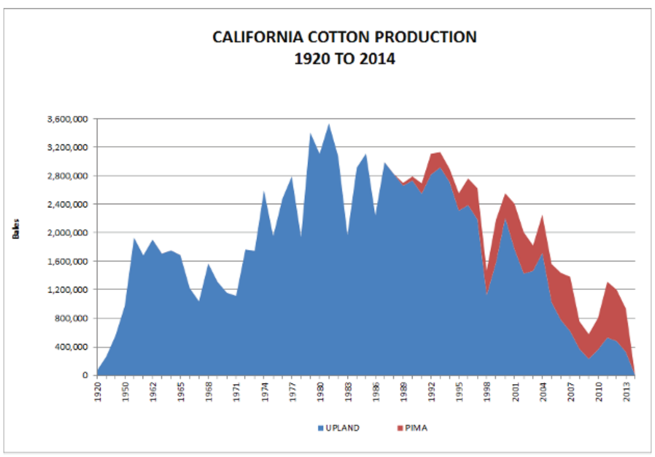
Despite all the effort to halt sourcing from Xinjiang, the Belt/Road train service appears to have helped generate a strong first half performance. January-June apparel exports surged 74% from a year ago at 11.9 billion RMB or 1.842 billion USD, which was a very impressive performance. Textile exports fell 18.6% to 1.59 billion RMB or 246.13 million USD.

Chinese spinners last week remained focused, internally taking up 100% of all cotton offered by the Reserve and buying additional US and Brazilian from the bonded warehouse stocks along with fresh purchases of Xinjiang old crop. ZCE cotton futures traded in a very dull fashion and moved slightly lower. It was as if traders had been instructed to not create any speculative price movement. It was reported that the

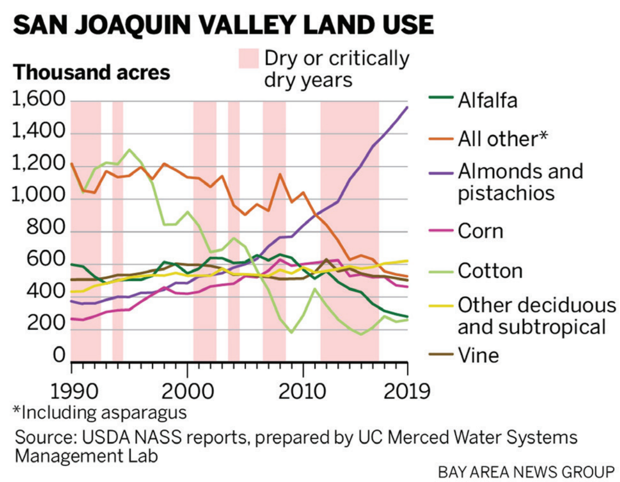
Dalian Exchange had investigated 48 cases of abnormal trading behavior in July. It is clear that the NDRC is serious about curbing higher prices. The government also expanded its actions against private companies and the tech sector, causing additional billions of losses in these equities. They called video games "Spiritual Opium," which caused massive losses in the major gaming companies. They then announced a major new initiative involving the promotion of sports, which sent the shares of the major domestic sports companies soaring. The companies that had previously announced support of Xinjiang cotton use were in the spotlight, with large gains in the share prices of Li Ning, Anta, Topsports, Jiangsu Jinling Sports, Xstep and 361 Degrees. 361 Degrees drew lots of attention earlier with the launch of new cotton apparel products from a fashion show in Xinjiang.

China's cotton prices moved lower last week in direct contrast to international values, with the Cash Cotton Index ending the week at 122.63 cents a lb. for a 2.68 cents loss for the week. The ZCE September cotton futures closed the week at 1.63 cents loss for the period. It was interesting to note that the ZCE cotton yarn futures posted a small 95-RMB-a-ton gain for the week. By Friday, the Covid control measures began to have a wide impact on trade. At the major importing Qingdao port, it was required that all cotton imports undergo disinfection procedures, which delayed movement and added to the cost. Also, trucking activity is being affected, as well as some factory operations.

WILL 2021/2022 BE THE LAST CALIFORNIA ACALA CROP AS WATER ISSUES ARE IGNORED?



California the peak cotton years



California is facing a serious crisis, and there appears to be no leadership at the state or federal level that senses the gravity of the situation. For agriculture, the tech titans have provided the budget for wasteful spending by the state, with little attention paid to the billions of dollars provided by the agriculture sector. The greatest water infrastructure project in the world when designed has seen its supplies forced out to sea for questionable environmental purposes and siphoned off for human use. At the same time, the state has made no plans to increase water supplies to a growing population. Desalination plants have not been increased and the current ones remain underused. This gross mismanagement has coincided with one of the worst droughts since the 1930s, which has pushed agriculture to the brink. Still the state or federal governments have provided no solution or long-term plan to remedy the situation. While the innovation appears to be elsewhere, China appears ready to address water challenges in Xinjiang, and cloud seeding is used to produce rain in the Middle East. California and the federal government do nothing while the state's water supplies run dry. The state is also experiencing wildfires that are destroying family homes and farms. California was a different place in 1990s and 2000 when agriculture had a voice at the table and the state was managed by competent governors and administrators. In 2000, California was the second largest cotton producing state in the US, with production of over 2.4 million bales. The California Acala upland cotton was the highest quality upland cotton produced in the world and drew large premiums from spinners. It was California growers who migrated to Australia to lay the foundation for the great Australian cotton industry.

As water plans failed to be upgraded and environmental groups began to gain control, the intent of the state and federal water projects were betrayed, and precious water was diverted for foolish reasons. This allowed millions of gallons intended for farmland to flow out to sea. Human use began to compete for supplies as the state made no plans to meet its expanding population needs. The very successful almond and nut industries, which are now shrinking and in danger, increased the demand for the declining water supply. Upland cotton lost out by the economics as water cost rose and Australia became an increasing supplier of premium upland. By 2017, only 87,000 acres of upland was planted, and in 2021 just 40,000 acres was estimated to be planted. The question as a new crisis unfolds is will this be the last Acala crop? Pima production also is in crisis as planted acreage fell to only 100,000 acres as water supplies were simply shut off.

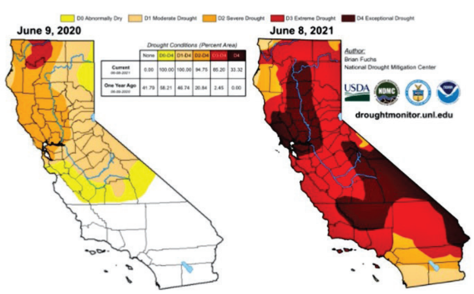


Figure 2. Evolution of drought conditions in California after a second dry year. Source: U.S. Drought Monitor.

2021 Calif Almond Orchards being destroyed because of no water

2021 was the year the state implemented the long-needed regulation of ground water pumping. Prior to this, reduced allocations from the state and federal projects meant farmers drilled deeper and deeper wells and pumped the aquifers dry. Large sinkholes formed, and large blocks of land caved in the aquifers. This disaster gave way to an attempt to regulate pumping and allow for these to be refilled. We will not attempt to explain the details of the regulation due to its complexity and differences by water district. The bottom line is that it sharply reduced farmers' ability to pump, stopped new wells, and charged fees for groundwater allocations. In some districts, the price of ground water surged to levels uneconomical except for the highest value crops or emergency situations.

Now, after almost no allocation from the major water projects for many water rights holders, the state has again acted to further damage agriculture and violate the rights of farmers. The California State Water Resources Board has approved emergency regulation that immediately curtails water allocations for the pre-1914 water rights holders. This stopped the allocation of water to the San Joaquin River Delta and affected the diverting of water from the Sacramento River watershed. This followed a June cutoff of the water rights for junior security water rights holders in several areas. Now, farmers, when notified, must immediately stop using the water, which means some crops will not be harvested or a significant reduction in yields. It can be debated what crops should be grown in such tight conditions, but to cut growers off in the middle of the season is unbelievable.

Lake Oroville Dam, today, Aug 2021

On Friday, it was announced that the Lake Oroville Dam hydroelectric plant was shut down for the first time ever as water levels in the lake fell to a record low of 24% of capacity. At the same time, the local TV network was

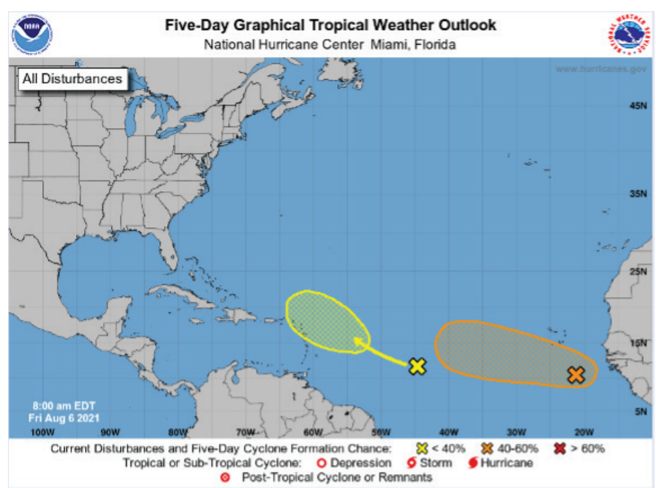
The Supima success endangered by California mismanagement

asking why water had been released, flooding the local Feather River Park. It was gross mismanagement at every level. Another question needs to be asked. Just where did the water go? In 2019, the lake was 97% full. In all likelihood, a large volume was wasted. The Oroville Dam is the tallest in the US and the second largest. When built, it was a tribute to US vision and ingenuity. California also faces a power crisis resulting in blackouts, and hydroelectric power accounts for 15% of all power.

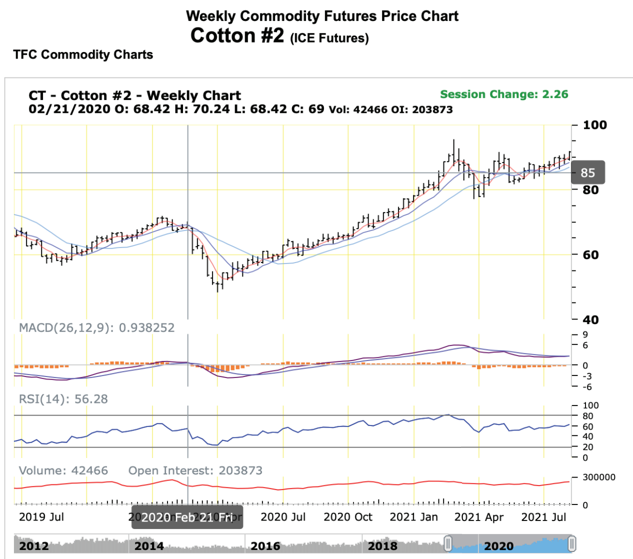
What remains shocking is the lack of a strategy either for agriculture or human needs. For cotton, next season will be a disaster unless a record big wet is in the forecast. An end to the drought is needed to rebuild water supplies since ground water pumping cannot be resumed until the aquifers refill, which will take years. It remains to be seen if Acala production will continue in 2022/2023 given the expected level of Pima prices and water issues. CFR basis levels have declined. The crop size has fallen as a reduced number of spinners have access. In addition, the small crop has given way to reduced seed research and improvement, and the staple length of the top upland styles produced in the other regions, such as Delta Pine, now reaches 39 staple or longer. It is very sad to see this great crop fade away. Pima acreage in 2021/2022 declined to 100,000 acres, and total US Pima production is estimated at 400,000 bales, while demand will exceed that level. The price is at 215 cents and rising. However, that alone will not stimulate acreage expansion in 2022/2023. The issue will be the availability of water and the cost of that water. California is facing a calamity in agriculture production, and today no major plans to address the problem are being discussed.

US EXTENDED WEATHER OUTLOOK RAISES CONCERNS OVER TROPICAL DISTURBANCES

The extended US weather outlook has two unnamed tropical disturbances on track to possibly enter the US Gulf of Mexico or hit the Southeastern US, both areas are of concern. In Texas, the upper Coastal Bend has experienced excessive moisture much of the season and needs a prolonged clear period. The Coastal Bend crop is near opening, and harvest is underway in the RGV. Excessive moisture has been occurring in Southern Georgia, and more rain is likely in the week ahead. A tropical storm is unwelcome, with the same true for the Carolinas. These concerns are happening as many expect the next USDA crop estimate to show a larger crop prospect. The fear is that an active hurricane season, which has been forecast, could change all that. Last week, some US merchants lowered CFR basis levels slightly as confidence grew.



ICE FUTURES MOVE TO NEW HIGHS AS SPECULATIVE BUYING INCREASED

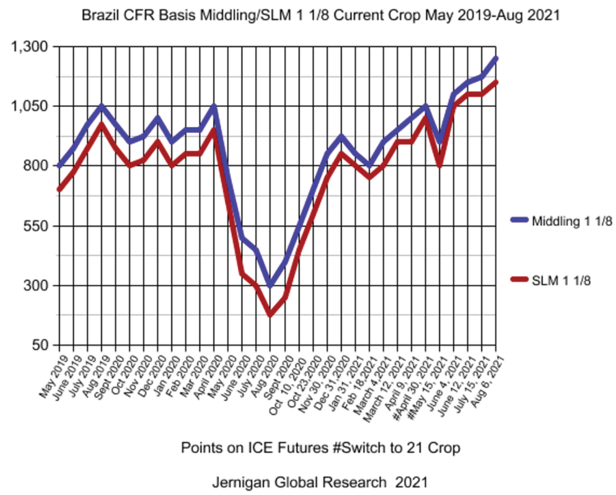


For weeks we have been discussing the continued buildup of Open Interest in ICE, as a new speculative long position built up that came from the traditional Managed Funds, including possible Chinese Hedge Funds via the Other Reportable specs, Swap positions, and Index Funds. Unlike past speculative events, this one has been slow and gradual, with volume most sessions remaining very light. By the end of Thursday's session, Open Interest had again increased in a significant way, reaching a new high of 251,816 contracts to equal the earlier speculative surge in February of this year. It appears another large block of Open Interest from additional speculative buying occurred in Friday's session as prices moved sharply higher amid a new wave of speculative buying. The move to 91.94 in Dec occurred as new Trade selling met the advance and as most spinners moved to the sidelines. At the higher prices at the end of the week fresh export trade had dwindled to a trickle as spinners halted buying. As prices advanced, most buying had been slowing to any discounted lots, such as East African. Chinese buying was absent all week, and the Chinese cotton futures moved lower for the week, losing 1.63 cents a lb. in the lead September contract. The speculative buying appears to be driven by the theme that the turmoil in the freight markets and the large increases this is triggering in prices will make inflation a major issue. The freight market is in total chaos, and with the US having a record trade deficit following centuries of foolish practices, it means almost every product is impacted. Major sellers on Amazon this week were either out of product or announced large price increases, as the record container, port surcharges and truck fees were forced to be passed on.

Through Thursday, the CFR basis levels continued to hold firm except for a slight weakness in some US offers, as export sales remain slow and void of sizeable Chinese offtake. The notable exception was the Australian 2022 crop basis, which remained under pressure, Australian Middling 1 1/8 is now quoted at 1050 points On May. This, plus the May invert or discount to Dec, would place this growth in the A Index if it was eligible, which it is not because of its shipment date of May and June. With a very large 4.5-million-bale-or-larger crop possible, this growth is set to displace US and Brazilian in several major markets. For the moment, freight rate issues are prohibiting sales in some markets, but the discounted basis is beginning to change that. Just as in February earlier this year, this move to new highs on ICE is void of major Trade offtake with continued Trade selling noted. One difference is that, as of today, there is a much firmer CFR basis level. Another notable feature is the lack of Chinese mill or trade house offtake in international markets and instead a focus on internal state Reserve and bonded warehouses stocks. In addition, cotton imports are now subject to disinfection at Qingdao, which is the largest import port, as part of widespread measures to control the renewed Covid outbreak. Major highway transport is halted or slowed, and ginners have halted harvest preparations in Xinjiang.

The US weather outlook is again of some concern as two tropical disturbances have formed that could influence the cotton belt as we enter the prime hurricane season. In India, the monsoon rains continue below normal in the very important state of Gujarat, with season-to-date rainfall at least a third below normal. Total planted acreage in the country also will not expand as many had thought, as planting at this late date still lags slightly behind last year. In Xinjiang, weather continues less than ideal, and we continue to expect a lower crop than forecast.

Dec ICE gained an impressive 2.31 cents for the week, while Cotlook's 2021/2022 index lost 85 points from the 2020/2021 month-end final index level. The strength last week was indeed an ICE event. The COT report for the week before August 3rd revealed limited action, with the large changes occurring since then. It is likely the net speculative long position is now near 75,000, which is not at its peak but extended. The market performed well with gains for five consecutive sessions and ended the week overbought. We have been cautious at 91 cents fearing the impact of 1) China/US relations and the lack of Chinese buying of 2021/22 US new crop, 2) the impact of the shipping problems and its negative effects, and 3) the renewed surge in the Covid variant. All three of those remain a valid concern that is keeping us cautious at these levels.



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