



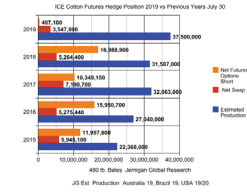
CHINESE TEXTILE INDUSTRY IS OPERATING BELOW 50% OF CAPACITY



HONG KONG UNREST & FINANCIAL FRAUD REDUCE AVAILABILITY OF CAPITAL TO TEXTILE/ APPAREL GROUPS



INDIAN CROP IMPROVES FOLLOWING TIMELY RAINS



UNHEDGED CROPS POISE MAJOR RISK TO ICE FUTURES



JERNIGAN GLOBAL

— KNOWLEDGE IS THE NEW CAPITAL —

THE END OF GLOBALIZATION

COTTON TEXTILE SUPPLY CHAINS FACE MASS DISRUPTIONS

US/CHINA TRADE WAR • COLLAPSE OF CHINESE POLYESTER PRICES • HONG KONG UNREST • AGGRESSIVE CHINESE INTERFERENCE IN AUSTRALIA • SOUTH CHINA SEA DISPUTES • DIVIDE BETWEEN US AND BEIJING SPHERE OF INFLUENCE • EUROPEAN ECONOMIC WEAKNESS



Hong Kong civil servants demonstrations, New York Times, 8/2/19



Beijing supports attacks by Chinese students against HK students: University of Queensland



Massive Corruption in Australia linked to cousin of Xi Jinping

Supply chain disruptions are rapidly increasing, and the China/US trade talks appear headed into uncharted waters, accelerating the “end of globalization” as we know it. Cotton is now facing a significant disruption in the textile and apparel sector of the world’s largest consumer of fibers. The disruption has two separate facets that will have serious implications. First, the collapse of man-made fiber prices, and, second, the dramatic change in cotton trade patterns. Last week “ChinAmerica, a term for the US/China partnership made popular in 2010 when the US rushed to outsource almost complete supply chains, appeared to have come to an end. Up until 2018, many touted the interdependent relationship of the US and China, but that started to change in June 2018 with the beginning of the trade war. US trade talks resumed in Beijing last week, and this time the tone was different. On the US side it was clear the previous week that the Trump administration’s China policy experts Peter Navarro and Robert Lighthizer had advised President Trump that China clearly failed to keep its earlier commitments. China had not lived up to their earlier Argentine commitments to buy a large volume of US agriculture products. They then backtracked on other agreed to commitments, and Xi Jinping failed to stop the flow of fentanyl into the US, which he personally promised Trump over dinner in Argentina. Most recently, China reneged on their pledge to immediately start buying US agriculture products following the G-20 meeting. Over the past week, China’s state media made several comments that Chinese companies had been approved to buy US soybeans, corn, cotton, pork, and sorghum. Following those comments came a statement from the Ministry of Commerce that China would buy US agriculture products based on domestic needs, and the offering of favorable conditions by the US side for the purchases. The statement went on to say that China wanted to see more positive goodwill gestures from the US. President Trump began last week warning China that if he saw no signs it was buying US agriculture products in volume new tariffs were coming, and that he was concerned that China has failed to follow through on its commitments.

The brief meeting in Shanghai between the US and China representatives clearly contained no breakthrough in the negotiations. Even more surprising was the comment from Chinese sources saying China is not backing down or including any

of the earlier concession language in the agreement. The Chinese told the US trade representative the US will just have to trust that China will enforce intellectual property protections. It is truly amazing that the Chinese government would believe such a position is acceptable after multiple violations of every agreement since Xi Jinping came to power. As expected, the US side reacted angrily. The regular weekly US agriculture export sales report contained a few bales of new cotton and soybean sales to China, while there were cancellations of US pork purchases, all of which fueled more disappointment. Tensions with China increased around the world last week, with additional demonstrations and unrest in Hong Kong that brought a direct threat from China that the military could intervene in Hong Kong and send in troops. This was followed by a buildup of Chinese troops on the Hong Kong border. China then endorsed violence by pro-Beijing students in Australia, New Zealand, and Canada against pro-freedom Hong Kong students. A major scandal was revealed in Australia in which Chinese criminals were involved with the country’s largest casino and with Chinese influence peddling. North Korea appeared to follow China, backing out of earlier commitments and firing several missiles off its east coast. These events brought aggressive reaction from the US that resulted in placing an additional 10% import tariff on all remaining Chinese imports into the US. It was also stated that, if needed, these tariffs would be raised to 25% or even higher. The US has also threatened to withdraw China’s special recognition as a developing nation in the WTO. China has a 90-day window to address these WTO issues.



Donald J. Trump @realDonaldTrump · 6h

Our representatives have just returned from China where they had constructive talks having to do with a future Trade Deal. We thought we had a deal with China three months ago, but sadly, China decided to re-negotiate the deal prior to signing. More recently, China agreed to...

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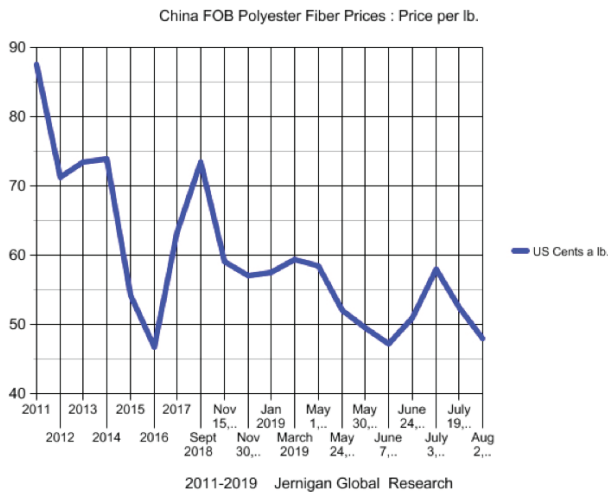
Donald J. Trump @realDonaldTrump

...buy agricultural product from the U.S. in large quantities, but did not do so. Additionally, my friend President Xi said that he would stop the sale of Fentanyl to the United States – this never happened, and many Americans continue to die! Trade talks are continuing, and...

STORM CLOUDS GATHER ACROSS THE SUPPLY CHAIN

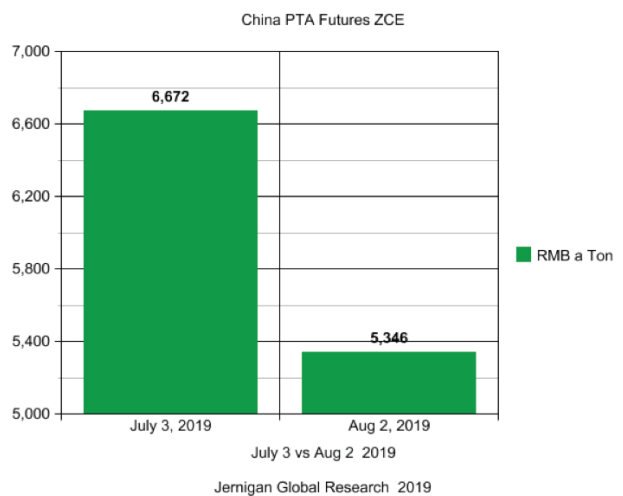
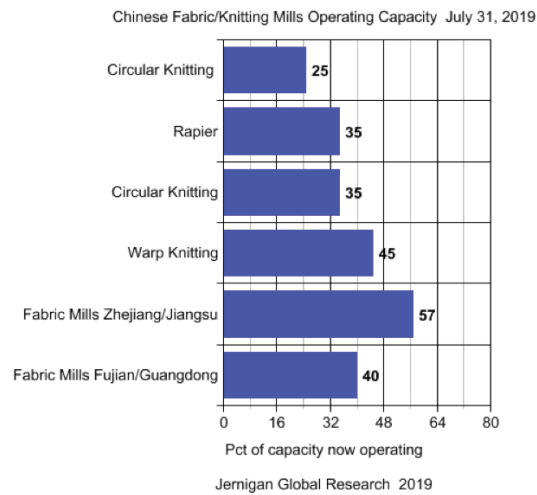
CHINA'S INDUSTRIAL TEXTILE MARKET IS IN PANIC DUE TO OVERCAPACITY AND WEAKER DEMAND

We have discussed many times China's domination of the global man-made fiber industry following the record economic stimulus of 2008. China now controls more than 70% of the global polyester fiber capacity and has continued to their investment in new petrochemical capacity, as forecast after forecast has called for demand to grow an average of 4-8% annually. When that capacity is created by state directives, subsidies, and cheap loans, actual economic demand is not the main driver. There has been a great deal of investment in recent years throughout the supply chain, resulting in massive over capacity in almost all segments of the supply chain. One area in which China has global domination is man-made fiber fabric, with huge production facilities in East China in Zhejiang, Jiangsu, Fujian, and Guangdong. Additional investment has occurred over the past two years, and these production zones have been backed up by polyester staple fiber yarn plants, weaving and knitting, and twisting manufacturing.



East China's fabric mills appear to be operating at close to only 50% or less of capacity on average. The downstream weakness is now causing panic upstream and in the petrochemical feedstocks market. PTA and MEG are the two main raw materials for polyester staple fiber, and PTA – Purified Terephthalate Acid – has experienced extreme volatility during the past 30 days. This is illustrated by the behavior of the ZCE PTA futures contract, which reached a peak of 6,672 RMB a ton on July 3rd, but subsequently closed at 5,346 RMB, for a loss of over 24 % on July 31st. The price is demand-sensitive due to the overcapacity. At the end

of July, downstream polyester staple fiber plants were estimated to be operating at only 70% of capacity, and even then unsold inventories were quite high. Buyers appear to only buy when prices fall, again a result of overcapacity. Polyester staple fiber prices have also collapsed in July, falling by more than 17% since their July highs to end the week at neat 47-48 cents a lb. PET fiber chips and bottle chip prices have been even weaker, and demand has turned very weak for recycled polyester staple fiber. The overcapacity in the PET bottle chip product group is simply incredible. Capacity in June was estimated at 10.16 MMT, while output had collapsed to only 4.5 MMT.



At the same time, the domestic polyester staple fiber market has been weak, with imports from Asia also continuing to flow in. June imports reached 86,986 tons, a 21.1% year-on-year increase, and the main

suppliers were South Korea, Thailand, Vietnam, and Indonesia. The polyester staple fiber plants continue to cut capacity. In Sichuan, plants are reportedly closed, with the recycling sector extremely hard hit. There has been much hype about recycled polyester and the fact that the quality is as good as virgin, and that it could be recycled repeatedly. That is just not true. Significant quality differences are showing up in recycled poly versus virgin, and the quality of the fiber declines after more than one recycling, which is increasing the premium for virgin.

The heart of this downstream weakness lies in the fabric sector. China has the world's largest fabric manufacturing complex, and this is even more true in the man-made and polyester fabrics, with 70-80% concentration of some product lines. This concentration has created unbridled optimism, with companies consolidating, expanding, and taking on more debt in expectation that the growth in demand would continue. Today, the fabric manufacturing centers are in their worst condition in memory. In the fabric plants producing grey fabrics the operating rates at the end of July in the centers of Zhejiang and Jiangsu are estimated at 57%. In the fabric mills in the Fujian and Guangdong clusters, the operating rate at the end of July was down to only 40%. Circular knitting mills are down to an estimated 25-30% capacity, and warp knitting at 45-60% and getting weaker. Twisting plants are estimated to be operating at 65% capacity. The buildup in unsold grey fabric stocks is estimated to be four times higher than normal. Stocks of unsold goods at Wujiang water jet and Haining warp knitting plants are at record high levels.

Several months ago the dyeing and finishing and printing sector was enjoying an upturn in demand that even created some shortages of dyes that resulted in higher prices. This is no longer the case, as operating rates dropped sharply since May. One large operation said early this year that they received more than 50% of their orders from the US, but today it is less than 30%. Sizeable production cuts have been reported at the large dyeing plants in northern Jiangsu. Rayon grey fabric mills are reporting a dramatic slowdown in demand and unsold inventories, now at levels double that of a year ago. Viscose fiber prices have been stable during the last week. However, prices have collapsed from their peak in 2014 and are down by more than 70% from those levels. The slowdown in demand is obviously hurting the profitability of those in the sector.

Cotton textile operations do not appear to be as hard hit, except in Xinjiang where companies are experiencing additional order cancellation due to the forced labor from the camps, which is taking a

toll, as we discussed last week. Unsold cotton fabric inventories are also building and have reached the highest levels of the year.

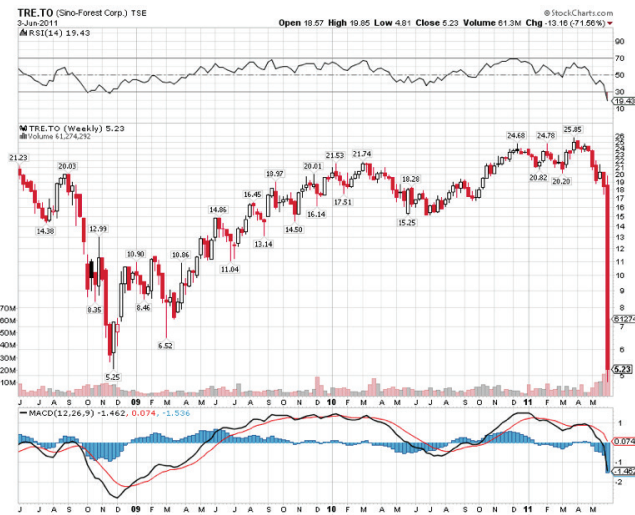
COLLAPSE IN POLYESTER STAPLE FIBER PRICES WILL OFFSET NEW IMPORT TARIFFS FROM USA

The global cotton and natural fibers market has a POLYESTER PROBLEM, and amid all the noise the cotton industry and the rest of the natural fiber sector, has not articulated a strong, clear message. The flood of cheap subsidized polyester and other man-made fiber flowing out of China is causing great environmental damage and continuing to inhibit the ability of cotton to regain market share. Cotton has also fallen behind in innovation. Now, the crisis in the Chinese man-made fiber and textile industry means exporters will aggressively lower prices to move volume. The new 10% tariff on Chinese apparel imports into the US will have little to no impact on the price of polyester apparel moving in from China. First, domestic polyester prices haven't fallen more than that since July 1st and, secondly, the RMB has weakened slightly against the USD, falling by over half a percent on Friday alone. Thus, this move is more symbolic and damaging to confidence than offering a price deterrent.

China's overcapacity and the desperate need for orders and cash flow means exporters will do whatever is possible in an attempt to keep their orders. The new weakness in Chinese polyester prices, collapse in the domestic textile complex, and the concern by spinners over margins means cotton and other natural fibers are in for a battle for market share in the 2019/2020 season. President Trump indicated that, if China does not move forward with negotiations and keep their word on US agriculture purchases, then the 10% tariffs could increase to 25% or more. At this level the tariff would dramatically increase non-Chinese cotton use, with new spinning capacity going in alternative locations, as well as other investments, and would also reduce the flow of cheap polyester apparel. At 25% tariff, a 4.00 USD man-made fiber t-shirt from China would increase to 5.00, which would increase the competitiveness of a cotton product from other locations not subject to the tariff. Such tariffs would also spark the long-term investment in new spinning capacities outside of China. The flow of cheap polyester apparel is also a threat to market share outside of China and will undercut cotton use. In India, the well-intended MSP for cotton, and the lack of BT seeds and irrigation infrastructure has already pushed the domestic price to a sharp premium to imports. The domestic price of Indian cotton has been running approximately 20 cents or more a lb. premium to domestic polyester staple fiber prices. At this level, mills have increased their use of polyester

and other man-made fibers. In Bangladesh, the flow of illegal Chinese fabrics and textiles has undercut local mills. In Brazil, Chinese textiles and apparel are undercutting the local market, and the pressure to move product into non-US markets will only increase this pressure.

CHINESE TEXTILE/APPEL COMPAIES HAVE MASSIVE DEBT LOADS AND FINANCING IS BECOMING A SIGNIFICANT ISSUE



Collapse of Sino-Forest: Chinese financial fraud

Chinese textile and apparel companies have taken on massive debt to capitalize their expansion during the past several years, as have other Chinese companies in other industries, and are now facing major financing issues. This past week, major issues in the Chinese financial markets came to light. Last weekend, the China Construction Bank announced it would provide 29 Trillion RMB (291 Billion USD) in comprehensive financing support to Hunan province. This would appear to be equal to the US bailout of an entire block of states. The bank said the funds would help Hunan strengthen

key enterprises, provide high quality manufacturing loans, and prevent and resolve local government issues with hidden debt. Hunan province is known for being at the center of a massive persecution of Christians, and it appears the government is involved in large-scale corruption and hidden loans. This revelation was followed by the announcement that the top banking regulator in Fujian province was under investigation for graft. Then came news of a massive scandal that is being compared to the downfall of Arthur Anderson accounting in the US following the Enron financial fraud. Ruihua Certified Public Accountants, a major accounting firm which provides audits of many public companies across China, has been accused of falsifying financial data, and the regulator has suspended over 50 pending IPO's of companies for which the firm provided accounting. A couple of firms stand out. Kangdexin Composite Material is accused of inflating profits by 11.9 Billion RMB (1.7 Billion USD). It was reported that it has missing bank deposits amounting to large sums of money. Morgan Stanley has estimated the firm as worthy of being included in the MSCI Emerging Markets Index, which has an estimated trillion USD tied to the index. Morgan Stanley's increased allocation to Chinese companies has been a major source of capital in 2019. Morgan Stanley has now removed the company from the index, and the issue raises further doubt on this allocation and its duration. US Senator Rubio has called on Morgan Stanley to review its allocation of US investor funds to Chinese companies because of the lack of outside accounting. Then there is Sino-Forrest, a Chinese timber company that collapsed following the disclosure that it had also overstated assets.

The Chinese investment bank, CICC, released a research paper that surprised the market with its candor, stating that before the last round of tariffs by the US on Chinese imports, and before the new tariffs announced last week, the trade war had cost China five million jobs in the industrial sector alone between July 2018 and May 2019. Unemployment had been hardest hit in the computer and telecom sector and in plastics and rubber. The Nikkei Asian Review released a report that said over 50 major international companies have announced plans or are already moving production from China. The companies were from the US, Japan, and Taiwan, and they announced plans to move production to India, South Korea, Japan, Thailand, Taiwan, USA, Vietnam, and Mexico. Many of the companies are in tech, which will have long-range impacts on Chinese technology.

The share prices of the major Chinese textile and apparel companies were under new pressure last week, which is adding to the debt woes. It remains very unclear where all the debt accumulated from the buying spree during the past several years resides. In

some instances, shares have been pledged against bank loans, and, as those shares decline, the banks or the state force an exchange of shares for ownership. Overall, the biggest mystery lies in the financing of the former state-owned firms that have gone public. On August 1st, the share price of the Ruyi Group hit 9.19 RMB, down 2.44%, and compared to a 52-week high of 14.58 RMB per share, which reflects a 37% drop in value. It has announced a spinoff of its Lycra purchase through a public offering on the new NASDAQ-like exchange, Science-Tech Innovation Board. It only recently purchased Lycra for 2.6 billion USD during its

buying spree. The Jihua Group, a textile and apparel group with sales of over 24 Billion RMB (3.47 Billion USD), had a share price of 3.96 RMB on July 30th, compared to a 52-week high reached in March of 5.19, and a 2015 high of 15.15 RMB. This means it now has a market cap less than a third of its 2015 values. Weiqiao, one of the largest cotton spinners in China, saw its Hong Kong shares end July at a 52-week low of .29 US cents a share. The financial constraints of these groups mean a slowing in new expansion and an end to any acquisitions, except for forced mergers and a shrinking of some assets. It is also a serious blow to confidence.

HONG KONG UNREST EXPANDS; CHINA THREATENS TO SEND IN TROOPS



Chinese military parade in Hong Kong

The situation in Hong Kong has now entered a stage where the ability of Chinese companies to raise cash through IPO's and USD bond issues is in doubt. Confidence has eroded over the last ten days following several events and the statements by Beijing. Last weekend, July 26-28, was a weekend of protest in the city. This was followed by a week of scattered protest that ended Friday with a very large protest event organized by the financial sector, which captured global attention. The frequency of the protest and police use of tear gas and other violent methods led to one hotel chain providing guests with a hard hat, gas masks, and maps. This is not a signal that will boost confidence. This was followed by a development that has undermined the confidence of the business sector and set in motion potential events that could have a dramatic impact on the textile and apparel industry, given the central role Hong Kong plays in trading and finance, which we have been discussing over the last couple of weeks.

The China liaison office in Hong Kong held its first press conference since the handover on July 29th. Beijing announced that it backed the current Hong Kong leadership and police and condemned the demonstrations. It then issued a threat that it was prepared to send troops into the city to maintain order if needed and requested. The military chief of the Hong Kong PLA garrison issued a warning that violent clashes would not be tolerated and that the PLA was ready to act to protect China's sovereignty. The statement was followed by the release of a video showing the PLA ready to take to the streets. Later in the week, panic was evident across social media when China gathered troops on the Hong Kong/China border. In Guangzhou, more than 20,000 uniformed police held a large loyalty-to-China ceremony that caused great anxiety.



Hong Kong Stock Exchange performance

As if that wasn't enough, Beijing endorsed and encouraged Chinese students from the mainland attending colleges in Australia, New Zealand, and

Canada to violently attack pro-freedom Hong Kong students attending the same universities during demonstrations. In Australia, education has become a sizeable foreign exchange earner for the country, with the focus on Chinese students. The motivation to entice the Chinese mainland students has resulted in a significant rise in Chinese influence at most major universities. The increased influence includes a Chinese staff from the mainland, donations to the schools, and the ability of the CCP to control press at the schools and basically curtail freedom of the press. Last week it surfaced that a University of NSW computer science professor had co-authored research in Chinese with PLA generals that was used by China's weapons program and provided Chinese military academy students with PHD degrees.

A major clash between mainland and pro-Freedom Hong Kong students at the University of Queensland made global headlines. A group of Beijing-backed students crashed through a gate and attacked the Pro-Freedom students who were holding a peaceful demonstration. The attack was violent, and it was captured on video. Later in the week, the university clamped down on the freedom of speech of the Pro-Freedom Hong Kong students, and removed them any time they attempted to even hold posters illustrating the influence of the CCP at the schools. This was repeated in New Zealand and Canada, where Chinese influence has also become excessive. Even an ice hockey game between a mainland team and a Hong Kong team turned violent, with the video going viral. In every instance, Beijing openly endorsed the violence and the defense of the motherland by the Beijing-backed students, and in far too many cases the universities surrendered under pressure from China.

The financial scandals that have hit the mainland companies listed in China have spread to Hong Kong. It appears China's influence in Hong Kong's financial markets has resulted in less stringent reporting standards.

A major new company listed in Hong Kong was accused of falsifying data last week, and its shares fell 10%. At that point, the company suspended trading to stop the decline in share prices, while it changed auditors and denied the claims. A few of the major Mainland Chinese textile firms listed in Hong Kong have had issues with timely reporting and have been cited by the exchange. This latest scandal has occurred at a bad time when mainland companies have a serious problem regarding their accounting and financial data, which is spilling over into Hong Kong and eroding confidence there. Moreover, several major Chinese companies are planning second listings in Hong Kong. Alibaba is one of those which are planning a secondary listing after raising 25 Billion USD in an IPO in New York.



Chinese flag lowered into the Sea: Hong Kong, 8/3/19, CTV TV

As we closed out this week, Hong Kong was again the scene of additional protests on Saturday night, as the local Hong Kong government and Beijing show no signs of any discussion on a solution. Instead, failed Hong Kong executive Leong Chun Ying offered a one million Hong Kong dollar reward for the arrest of the protester who threw a Chinese flag into the sea on Saturday. Meanwhile, opposition lawmaker Claudia MCMo told the press, "Hong Kong-ers will fight on. We fight for our children."

INDIAN CROP SEES DRAMATIC IMPROVEMENT AS RAINS ARRIVE



Indian monsoon rains—from drought to floods

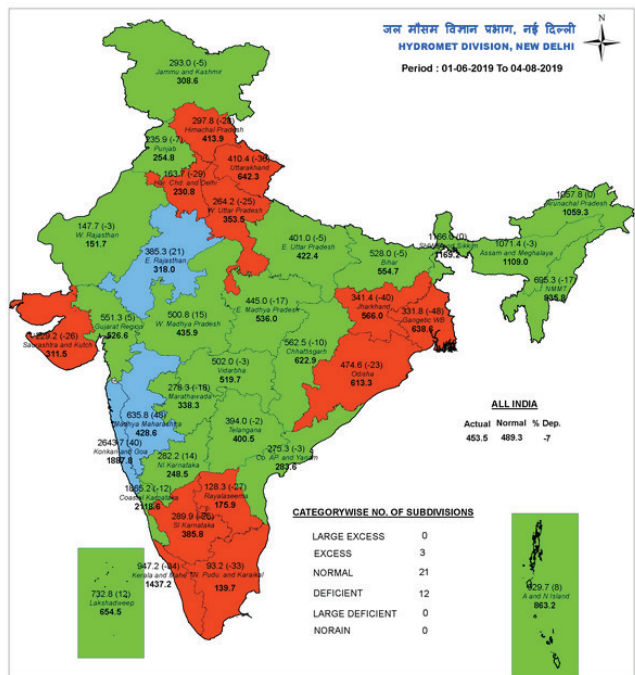
The crucial rains forecast for most of the Indian cotton belt arrived late Sunday night and eased anxiety concerning the crop. The rains may well be remembered as “million bales rains, a term that has become popular in cotton for the sudden arrival of timely rains in the West Texas region. This region has large tracts of dryland cotton that is grown under rather difficult conditions with volatile rainfall. The rains improved moisture in almost all cotton areas and saved several regions from significant yield losses. It allowed the timely development and emergence of a large block of newly planted acreage in Maharashtra. Pockets of dryness remain, including in Saurashtra, but an immediate disaster has been avoided.

The rains were widespread and beneficial in the west, with Rajasthan now near normal. In Gujarat the deficit has been reduced for the season to only 9%, as compared to 41% last week. In the largest cotton districts of Saurashtra and Kutch, the deficit dropped to 29% from 55%. Within this region the deficit in Bhavanagar dropped to 6% from 24%, and Ameli, which has planted over 400,000 hectares, saw its deficit drop to only 13% from 30%. As of July 25th, Maharashtra had planted 4,063,100 hectares, which included 721,200 hectares planted in the previous week. Last week’s rains were very crucial for this large block of dryland cotton that was planted in more marginal areas. Much of this acreage was intended for soybeans, but, because of the delayed rains, growers switched to cotton, which requires less water. The planting was focused in the Vidarbha region of the state, which has very low yields, no irrigation except for a few wells, and poor soils. Cotton acreage in Maharashtra has also expanded, due to the planting of HT BT cotton seed that was not sold officially but purchased anyway. This BT cotton has much lower input cost. The HT BT seed was planted on over 70%

of the acreage in some areas, and heavily planted in Vidarbha. Cotton acreage is up from 30%-100% in a few areas of Maharashtra, as growers planted the BT seed on marginal land. In Chindrapur, 181,166 hectares have been planted, which is up 38% from a year ago. 10,614 hectares was planted for the first time in Gadchiroli, and acreage is up 100% in Nagpur. Last week’s rains were heavy in Vidarbha, reducing the seasonal deficit to only 9% as compared to a 38% deficit the week before. The deficit in Madhya Maharashtra moved to a 37% surplus, as compared to an 8% deficit the previous week. A 35% seasonal deficit in Marathwada is down to 25%.



SUBDIVISION RAINFALL MAP

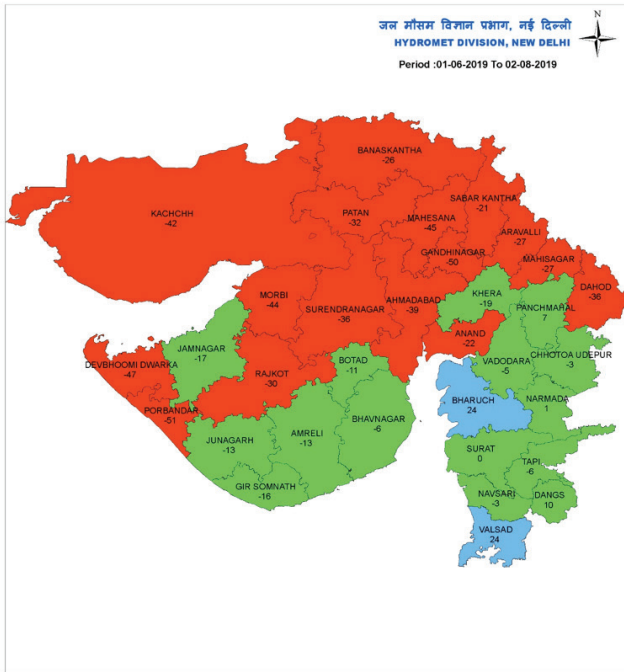


Legend: Large Excess [60% or more] Excess [20% to 59%] Normal [15% to 19%] Deficient [6% to 20%] Large Deficient [69% to 40%] No Data [-100%] No Rain

Planting the previous week was also heavy in Telangana, where 234,500 hectares were planted, bringing the July 25th total to 1,587,700 hectares. Last weeks rains reduced the deficit to 10% for the season, down from 33%. Rainfall is now nearing normal in Andhra Pradesh. West Madhya Pradesh remains a little dry, while the east has been wet. Additional rains are expected over the next few days. These rains have boosted crop prospects and given the late acreage a good chance of reaching a good stand.



DISTRICT RAINFALL DEPARTURE MAP - GUJARAT



Indian domestic prices remain at record premiums to ICE and international values. The spot price of Shankar-6 ex gin ended the week at 79.65, reflecting a more than 20-cent premium to Dec ICE. Even with the improved crop outlook, Indian new crop offers remain very uncompetitive. August-June cotton exports have totaled 750,834 tons, with shipments in June only reaching 10,209 tons, while August-June imports have reached 279,897 tons. Our fear of weakness in cotton yarn exports to China has materialized, with June total cotton yarn exports falling to 59,000 tons compared to near 100,000 tons a few months earlier in the year. Overall, Chinese cotton yarn import demand has fallen sharply, and Indian yarns have been undercut with cheaper yarns from Vietnam and Pakistan.

Legend
 Large Excess [60% or more] Excess [20% to 59%] Normal [-19% to 19%] Deficient [59% to -20%] Large Deficient [-59% to -60%] No Data [-100%] No Rain

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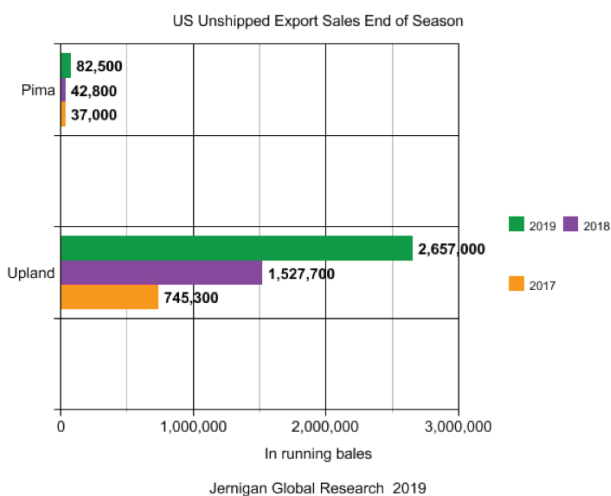
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US UNSHIPPED PROBLEMS CONTINUE AS PRICES FALL FURTHER

The US had 2,810,372 bales left unshipped as of July 25th, leaving one more shipment period in the season. We discussed this in detail last week, and fear that near two million bales or more of this total will be cancelled or rolled into future seasons. However, spinners face huge losses on taking up 90 cents+ contracts. Friday's nearly three cent additional losses only added to the risk on these sales. The record low Trade hedge position suggests that the hedges on these sales were lifted and that no hedge is in place, creating large losses. Quality is also an issue on some sales. The quality of the 2018/2019 US crop was much poorer than normal, and the quality shipped against type sales has disappointed spinners. 2018/2019 type Middling 1 1/8 MOT offers are at a 450 point discount to a Green Card 31-3-36. Export shipments in the last full week were very disappointing at only 291,200 running bales of upland and 6,700 bales of Pima.

New Crop demand was brisk during the week ending July 25th, with upland sales reaching 364,800 bales, followed by 37,800 bales sold for 2020/2021 shipment. Vietnam was the main buyer of 214,000 bales. China purchased 48,400 bales, which may have been part of the rumored 230,000 bales approved good will sale. The future of all outstanding sales to China is again in doubt. First, the trade war is escalating, and second, Chinese domestic prices are collapsing. The bulk of the outstanding 2019/2020 export sales to China of 1,540,000 running bales of upland were made at prices at least 15-20 cents a lb. higher. Unsold port stocks in China remain at a record as 2019/2020 begins. A record amount of unsold domestic stock remains unsold in Trade hands, and demand is collapsing. Conditions suggest these sales are at risk, especially given the trade war. 224,300 running bales of upland and 18,100 of Pima from 2018/2019 remain unshipped as well.



The management of these record unshipped export sales remains a very big negative, overhanging prices when these sales are finally accounted for. With less than a week left to ship in the season, 2,657,100 running bales of upland remains unshipped, which is up sharply from last season's 1,527,700 running bales, and over three times the 2016/2017 carryover sales of only 745,300 running bales. 82,500 running bales of Pima were unshipped for 2018/2019, which is up sharply from 37,800 bales a year ago. No real progress was made last week on shipments to the major trouble spots of Indonesia, Bangladesh, China, and Thailand.

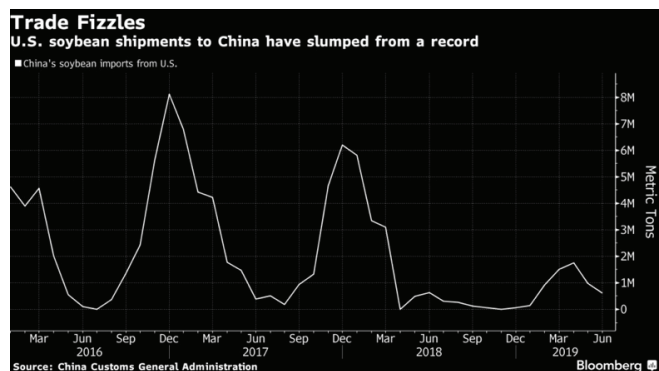
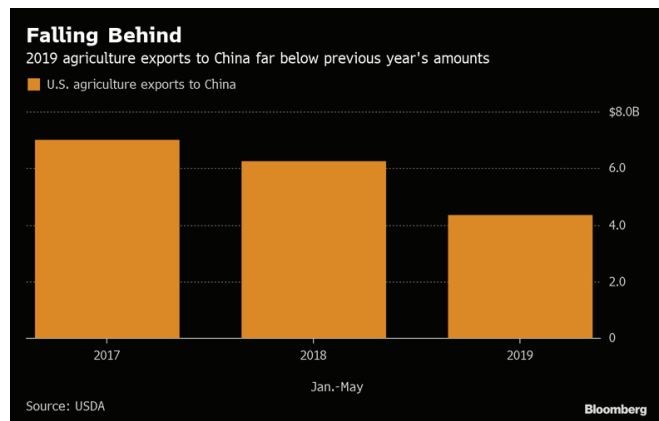
CFR BASIS LEVELS REMAIN WEAK AMID UNCERTAIN DEMAND AND POOR OUTLOOK FOR CHINA

The Cotlook 2019/2020 official index quote for a MOT Middling 1 1/8 is 1066 points on Dec. However, merchants up to Friday were offering a MOT Middling 1 1/8 at a discount of 750 points for prompt shipment. October-December shipment was offered at 950 points on Dec, while a Green Card E/MOT 31-3-36 was offered at 1200 points on Dec for prompt shipment, and 1275 points on for October-December shipment. Brazilian Middling 1 1/8 is officially the cheapest cotton in the A Index, but it is undercut by US 2018/2019 old crop discounted offers. Cotlook is quoting a Brazilian Middling 1 1/8 at 1000 points on, while discounts are noted at 900 points on. Merchants are also offering SM 1 5/32 at premiums. This cotton has moved off to India at 1400 points on, which is at a discount to the few African Franc Zone high grade offers. It remains to be seen if the CFR basis will strengthen following the

collapse in futures Friday. Export trade overall remains dominated by US and Brazilian, with basis levels very close for shipment after October, and Brazil enjoying a discount for 2020 shipment. The domestic FOB basis remains at one of the weakest levels on record for a futures market, which broke the 60-cents level Friday. In the Southeast, the basis for a 41-4-34 was at 225 points off October, 350 off in the Delta, and 600 points off in Texas. At these levels, prices are nearing the CCC loan. The official AWP will drop to 55.05 cents in the week ahead, which means that some of the cotton now in the CCC loan can be redeemed at prices below the full cost of carrying charges and warehouses cost. Growers seeking to forward sell report poor merchant demand. Overall, the Trade has a very large long basis position with poor forward coverage.

ICE FUTURES COLLAPSE FOLLOWING A SHARP FALL ACROSS CHINESE INDUSTRIAL FUTURES COMPLEX

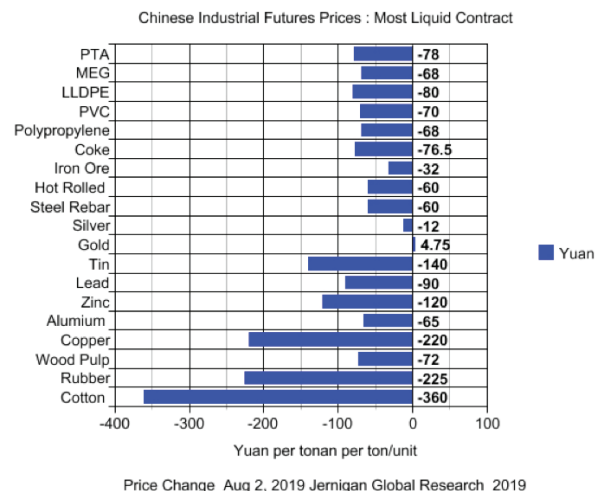
China has the largest industrial futures trading complex of contracts in the world, covering many of the major industrial sectors. Friday, these markets reacted with panic at the breakdown of the US/China trade talks. This suggests a general fear that much weaker conditions lie ahead for demand. This reaction was in direct contrast to the rather emotional statements from Beijing, which doesn't seem to understand the significance of the events unfolding and how the American/China consensus is now gone. With the events of the last ten days, the analysis of many experts is that the theory of US/China convergence that has prevailed for the past 30 years is now totally discredited. In 2018, after turning a blind eye for decades, the US began to turn and has now completed the turn. The announcement of an additional 10% tariff brought complaints from business lobbying groups still attempting to maintain supply chains in China. However, among many of the key opposition members in the US, it brought praise. US Senator Elizabeth Warren issued a very in-depth opposition paper calling for much tougher measures on China than even Trump. Beijing appears to have missed the turn and appears to believe that conditions are the same as prevailed when 2018 began. Such an attitude has been evident in official statements and reactions. It was reported



that the reason US officials stayed such a short time in Beijing for the renewed trade talks was that the Chinese delegation told the US it would not place any of the agreed major policy issues into a written agreement or Chinese law, and the agreements had to be verbal, which meant the US would have to trust the leaders' commitment. That really shocked us, as it is totally out of touch with reality. They obviously believed that the pre-2018 conditions would return.

The US team is greatly influenced by China expert Peter Navarro, who clearly believes the pre-2018 handling of China was a complete failure. He has made his position clear, as has the US trade representative. President Trump reacted with anger at the Chinese stance and announced immediately that, unless they changed positions, a 10% tariff would be placed on all remaining Chinese imports. He also said that, if there is still no improvement, the tariff could soon rise to 25%. He cited the fact that the Chinese had failed to buy the large agriculture purchases that it had promised, first in Argentina and then again at the G-20. He pointed out that Xi Jinping had not kept his commitment to stop the flow of Fentanyl into the US from China and killing thousands of Americans. The facts are clear; China has done neither. The behavior surrounding the purchase of US agriculture products has been bizarre. First there was the delaying and then the holding of meetings meant to suggest that the demand came not from the government giving in to US demands, but from Chinese companies. This behavior occurred despite the US side saying several times that the US expected China would keep its word. After watching this unfold, we cannot help but remember what a member of a Brazilian trade team told us last year before the tariffs were in place. At the time, he was part of an official trade group attempting to increase agriculture exports to Beijing. He stated, first, that the team around Xi Jinping was showing great hubris about China's position and would not tolerate any resistance from any new Brazilian president (the leading candidate at the time had just made a pro-Taiwan statement). Then the Brazilians were pulled aside and told that Beijing had instructed the Chinese buyers to shift sourcing of soybeans, cotton, and other products from the US and to not depend on the US for supplies. The behavior of Beijing since that time and its direct targeting of US Ag imports on the first day of the trade battle backs this up completely. It would certainly appear that the verbal commitments to buy US Agriculture products, first in December 2018 and then again at the recent G-20, were just attempts to buy time, frustrate the US side, weaken the Trump support among farmers, and to have the US side accept whatever Beijing ruled, just as all other US administrations had.

The markets on the Chinese side reacted with panic, due to the industrial sector facing massive over capacity, weaker export and domestic demand, and the loss of access to capital that once flowed freely. Industrial futures suffered sharp losses across all listed industrial markets, except gold and nickel. As we discussed in detail earlier, the Chinese textile market fell sharply last week. On Friday, ZCE cotton futures fell 360 RMB a ton, 2.35 US cents a lb., to close at 12,735 RMB a ton, which was only a few points above the contract low of 12,720 made in June. The ZCE September contract has now fallen 21.5%, or over 23.5 cents a lb., from its April highs. This contract reflects the price of Chinese cotton ex warehouse, and thus is reflective of Chinese cotton demand. The ZCE PTA futures contract, one of the two largest raw materials for polyester, fell sharply Friday. It has fallen 25% in value since July 3rd. MEG, another raw material of polyester, trades on the Dalian exchange, and it declined sharply on Friday as well. Dalian also trades the petrochemical byproducts, LLDPE, PVC and polypropylene, all of which experienced widespread losses. Sharp losses were noted in fuel oil, bitumen, rubber, wood pulp, crude oil, copper, aluminum, zinc, lead, tin, steel rebar, hot rolled coils, iron coke, and iron ore. This was followed by losses across the Chinese and Hong Kong equity markets led by the Hong Kong Hang Seng composite, which fell 2.35%. The Chinese currency, the RMB, fell to a new 2019 low against the USD of 6.9369.



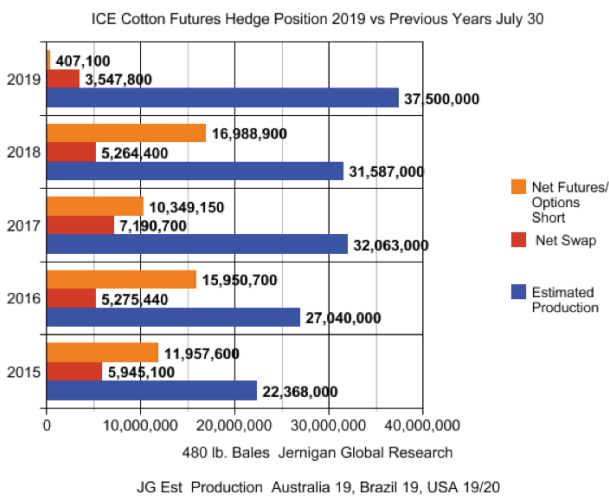
These conditions set the tone for weaker US and European markets. Cotton prices opened lower on ICE and drifted with small losses until new selling sent prices to near limit losses, with the Dec contract closing below 60 cents for the first time at 59.42. This is the lowest close since 2016. The CFTC Commitment of Traders report for the week ending July 31st revealed that the Managed Funds reduced their short slightly by

1,439 contracts through Tuesday. The Trade support, evident the last several weeks, changed to a small net seller. However, the net Trade short position increased by 1,313 contracts to 4,151 contracts. As we have been discussing for several months now, one of our greatest fears for prices was the risk imposed by the lack of hedged positions. The smallest amount of the combined US, Australian, and Brazilian crop on record has been hedged. We have feared that much of this position was being carried unhedged by the Trade, coops, and growers. We have also stated our fear of the risk dangers associated with over three million bales of unshipped US export sales, and the large 2019/2020 sales outstanding to China, all sold at much higher prices and the hedges lifted.

A revised look at, first, the size of the crops that are normally hedged extensively and have strong basis correlations with ICE as compared to the hedged positions, is simply shocking, as we have been discussing. Risk always risks on someone's balance sheet. The futures hedge is designed to transfer and manage that risk off the balance sheet of the producer, trader, coop, or other trade member. Currently, we cannot find where the risk has been transferred. As illustrated in the revised chart, we have included the combined 2019 Australian, 2019 Brazilian, and 2019/2020 US expected crops. Combined, it is the largest it has been in five years, due to the record 2019 Brazilian crop (up 6.88 Million bales/116% since 2016) and the larger US crop (our estimate is 23 million vs. 17.170 million in 2016/17). Even with the much smaller Australian crop, the combined crops that should be hedged or forward sold reaches a revised 37.8 million bales.

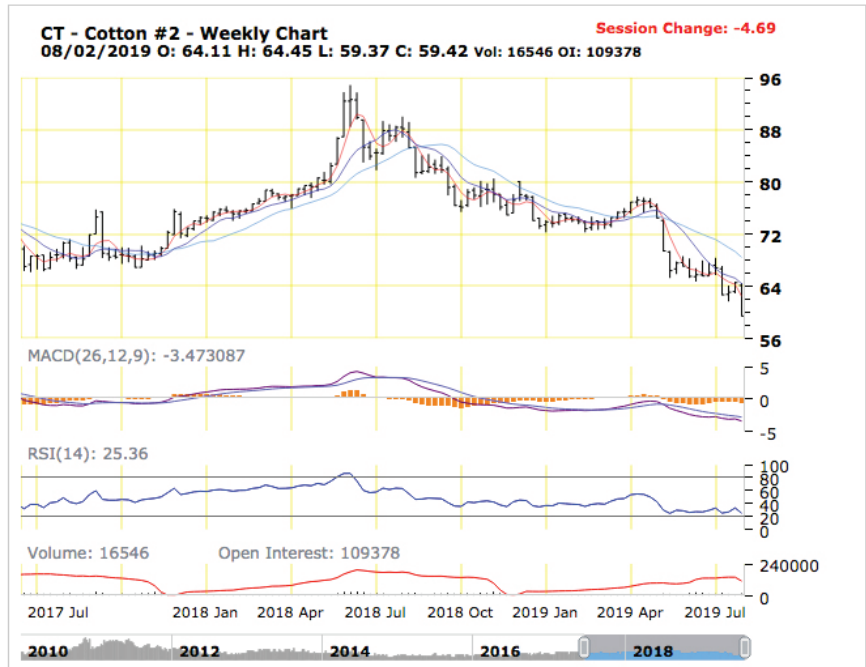
hedged were much smaller. The risk is not found in swap coverage. The swap dealer's hedged position is nearly 33% smaller than a year ago. The risk is not found covered in forward export sales to mills, which is lower than last year. Actually, the large unshipped 2018/2019 US sales and the large percentage of 2019/2020 forward US sales to China make the situation even worse. A further review of these combined crops illustrates the same; in 2015/2016 when these crops only had 22.368 million bales to be hedged, the net trade position on the same date was 11.9576 million bales, and the swap position was slightly larger. We have feared for months that too much optimism was prevailing in the Trade about a US/China trade agreement and that a return to the post June 2018 world would not occur.

The previous week, the market had formed a possible head and shoulders bottom that we discussed, and it appeared the Trade might have a chance to sell into a speculative short covering rally if the market received even a positive tweet on the Chinese/US trade talks, or if China actually completed the good will agriculture purchases that were rumored and actually suggested by China commentary. The market got neither, with the Dec ICE contract reaching only 64.45. The failure to breach the 65-cents level began to disappoint, and prices drifted. Then price action turned to panic when it was announced that no new talks would occur until September. This was followed by the announcement of the additional tariffs on Chinese imports. Volume was very heavy on Friday in both futures and options. It appeared that the selling also contained Trade hedging that had been missing for several months. Overall, the chance for a spec short covering rally seems to have passed. The negative influence of the unshipped US sales, the unhedged crops, and large outstanding commitments to China remain a weight on the market. As we have discussed for months, the situation with China is unfolding rapidly, and the old supply chain is not returning. The new supply chain is yet to formulate itself, and with that comes more uncertainty as to price levels. On Friday, many of the commentaries on the financial networks talked about how the new tariffs would affect the US consumer. That is simply not true. There are lots of moving parts, but the wholesale collapse of the Chinese textile markets has been greater than 10% over the last 10 days, and the RMB has weakened, so it is the Chinese exporters that will be squeezed. The resistance to the tariffs is fading on the US side, and companies are rapidly reducing sourcing in China. The fact that a symbolic 10% tariff is applied and greater tariffs are at risk suggests that the move out of China will accelerate. If Beijing reacts with the same bluster as they did in Hong Kong, the South China Sea, and other issues, the decoupling will accelerate, and



The net short trade position as of July 30, 2019 was 407,100 bales. This compares to 16.9889 million bales last year on the same date when the crops to be

so will the disruptions to the trading patterns of the past 25 years. Cotton is headed for new regional supply chains that are more stable, but the road to that destination could be quite volatile. The greatest challenge for the moment is to stem the flow of cheap polyester apparel that is disrupting every market. As to price levels, as previously discussed, this time it is more about confidence than an absolute price level.



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