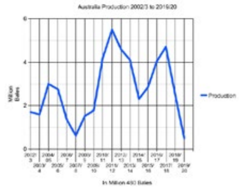
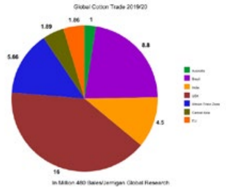


AUSTRALIAN COTTON CROP SET TO FALL BELOW 500,000 BALES



WORLD TRADE FACES MAJOR CHANGES IN 2019/20—2020/21

WITHOUT MAJOR NEW WATER POLICY AUSTRALIAN PRODUCTION IN DOUBT

US COTTON ACREAGE EXPECTED TO FALL IN 2020/21

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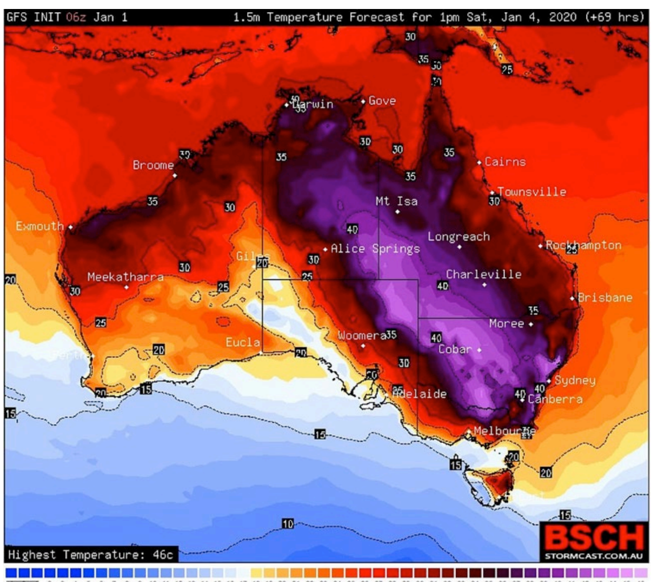
AUSTRALIA IN CRISIS AS BRUSH FIRES THREATEN NATION; COTTON CROP SHRINKS AMID NO WATER POLICY

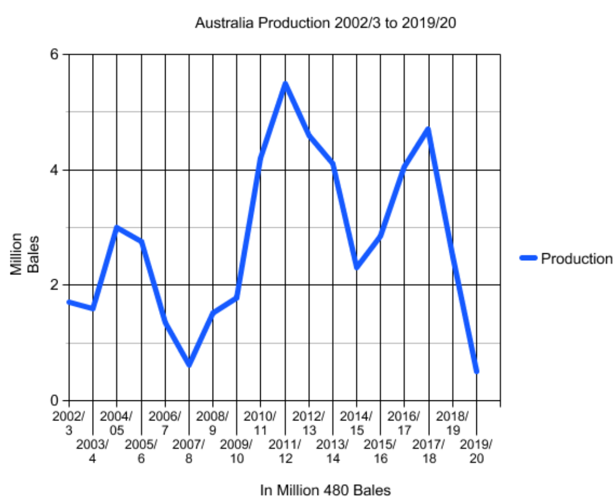


Australia covered with red haze as brush fires continue

Australian brush fires

Australia entered 2020 in crisis as brush fires covered much of the eastern portion of the country, trapping holiday travelers, killing millions of wildlife, destroying property, and making the air difficult to breathe for much of the entire Australian continent. Even the south island of New Zealand was covered by red haze and the smell of smoke on New Years Day. The country is experiencing a humanitarian crisis as homes and businesses are destroyed, people killed and injured, millions of unique native animals are destroyed, water supplies and power are cut off to large areas, and shortages of fuel are trapping additional communities. The fires continue to break out and are almost impossible to control. Adding to the crisis is the fact that the peak of this calamity is occurring at a time when the entire country heads to vacations, which last until mid January for many. This means thousands have been trapped on beaches and other holiday locations. The entire event has the world's attention and is quickly being picked up as being driven by global warming. Australia had its hottest year on record in 2019, and 2020 will see record temperatures for at least the first few days of this year. 2019 was also the driest year on record, with average rainfall of 277.63 mm for the year, which compares to the previous record of 314.46 mm and the mean of 465.2 mm. The average temperature was 2.7 degrees F above the 30-year mean.

The 2020 Australian cotton season started in crisis as water supplies dwindled, record heat increased water needs, and hopes for dryland acreage quickly faded. At first, few appeared to believe the cotton crop could fall to the 800,000-1.0 million-bales level. Now these levels are near impossible, as water requirements have increased and producers have sold water allocations for record prices that generated far greater profits than growing a crop. In some cases, marginal acreage died as the water was sold. In 2018/2019, dryland cotton acreage began at just below 163,000 hectares, and in 2019/2020, approximately 35,000 hectares was planned. However, this acreage, that is located outside the Northern Territory, and northern Queensland have largely failed. We now see the crop near 500,000 bales or less, with over 40,000 bales of the total produced in the northern non-traditional areas. This will have a major impact on world trade, which we will discuss in greater detail. This will be the lowest crop since 1982/1983 when the country only produced 464,000 bales.



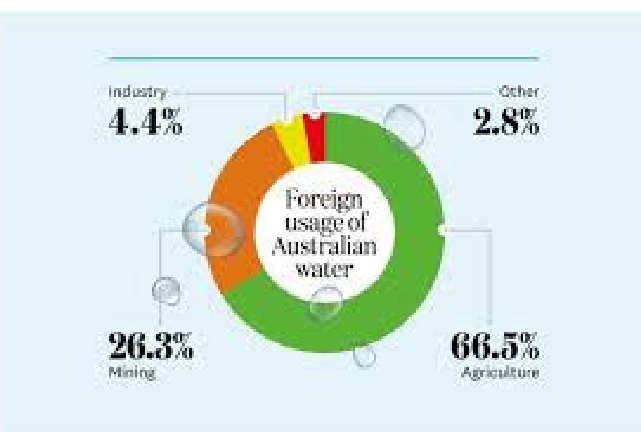
A lack of leadership on water is allowing major rural cities to run out of water. The crisis has the attention of the entire country as brush fires trapped Christmas and New Years holiday travelers on beaches. Smoke endangered the health of millions as orange haze covered large blocks of the nation. US and Canadian firefighters will be joining the effort to stop the spread of the fires. Record heat has occurred this holiday season, with even southern Tasmania reaching 105 degrees F, a new record. Five Melbourne suburbs were evaluated last week as brush fires approached. 260 fires started on Monday alone, and over 207,000 hectares of the east Gippsland area of Victoria has burned. More than 500 million animals have died from the fires including a third of the Koala population. On December 30th, every single state recorded a temp of 105 F or higher. Permanent schemes to address the water issues continue to get delayed amid misinformed greenies and environment and politicians without the guts to stand up for the bold action needed.

Australian brush fires

Families trapped at beach

The most shocking and irresponsible action of the crisis to date was taken by the Southern Downs Regional Council in Southern Queensland. This small, regional, nine-member council appears to have taken national water policy into its hands and sold the region's last remaining water resources to a Chinese company for bottled water. It remains very unclear how this council could have the authority to undermine the needs of the local community. The council granted a lease until 2111 for a Chinese company – one that appears to have no water experience – allowing them to mine 96 million liters of underground water and ship it for bottling water. The council told the press that the state of Queensland had granted the right, and that other companies were drilling water from the aquifer. The water is needed by towns such as Stanthorple, which sit above the aquifer. The town is already running out of water, as are many towns across New South Wales and Queensland. 97.2% of NSW is in drought, and 40 major water storages have less than three months of water left, which means major rural cities will run out of all water. Dubbo, NSW is a major city in the agriculture belt and home to 40,000 people. It is an important agriculture hub, and the town is expected to run out of emergency water supplies in March 2020. The town gets its water from the Burrendong Dam, which also supplies cotton farms. As the towns run out, water is being brought in by tanker trucks from coastal regions.

Stanthorple lies on the New England highway near the NSW border and has a population of 5400 people. The town has a rich history in agriculture and mining. The action of the Southern Downs Council now means that, if the decision holds, a Chinese company will take precedent over the local citizens. This is simply hard to imagine in such a drought. It also brings to light the crisis now prevailing in Australia. The ATO register indicates that Chinese companies now own 10.4% of all tradable Australian water, making it the largest foreign owner of water. The water amount owned is

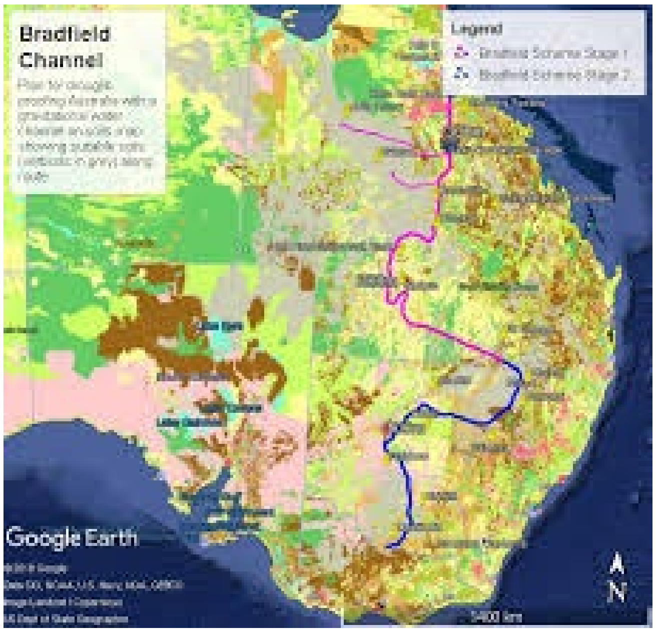


Foreign ownership of water

732 gigalitres, and it is estimated that foreign companies own 1.8 million gigalitres of water allocations from the Murray Darling system.

China is also the second largest foreign owner of land in Australia at 9.1 million hectares. It also owns the largest thermal coal miner in Australia, with the company taking water from farmers in NSW. KPMG estimates China has invested 150 billion Australian Dollars in Australia over the past ten years. Its investment in water is now raising major concerns. Several years ago, Beijing Enterprises Water Group purchased Trility Australia, which operates water projects and treatment plants in South Australia and Victoria. The company owns such crucial infrastructure as the Adelaide Desalination Plant, which supplies water to Adelaide. It also operates water irrigation systems. Beijing Enterprises is listed on the Hong Kong stock exchange, and it appears to be state-owned and promotes the Chinese Communist Party on its web site. It is also included in the Morgan Stanley International Indexes.

The current economic boom in Australia has been fueled by the selling of natural resources to China, which has allowed the younger generations to become spoiled by enjoying some of the highest living standards in the world, limiting the stress of focusing on social and environmental issues. Most of the population of Australia is focused in just a few cities such as Sydney and Melbourne where desalinization plants protect the population from water woes, allowing the majority of the population to have unrealistic views of the environment and water issues. A third of the country lives just in these two areas. Both are beautiful and free of many of the stresses associated with most such metropolitan areas. The electorate is clearly out of touch with the rural areas and the countryside. This has given way to the development of environmental policies that are not tied to reality and that totally disregard the needs of the rural population. One example is a limit on managed burning of the scrub and underbrush in the many national parks, which has provided fuel for fires in a drought. California has faced the same issues. The resulting record wildfires across the state of NSW have caused air pollution in the cities. This has given rise to the city populace calling out for an effort on global warning. No serious call for a radical new water policy or management of natural habitat has emerged. Also, no comment has emerged on the impact of the natural disaster occurring in China and its impact on Australian weather. The fact that coal still plays such a role in Australian power, when the water schemes proposed would solve the issue, has also fallen on deaf ears. For all the efforts by the green lobby to destroy agriculture, coal is the number one source of power in Australia. Australia has clearly forsaken national security for the easy life, with farmers complaining about the government failing to even maintain adequate fuel reserves in the country and not allowing any oil refining onshore.



Bradfield Channel

Hells Gate Dam near Townsville

The water issue is the pressing concern for the cotton industry and the country as a whole, as the politicians all dance around the issues despite viable projects being proposed. Australia has a major water distribution and water management problem. Northern Queensland, which experiences extreme rains, has tropical rain forest and little water management. The rains cause billion of AD dollars in damages annually due to flooding, with most of the water ultimately flowing out to sea. In January of 2019, rains hit Townsville, Queensland, where 1.4 meters of rain fell in two weeks. This is more rain than rainy London receives in a year. Guess where the BRADFIELD IRRIGATION SCHEME, which has been delayed by inept politicians and misplaced greenies, starts – just near Townsville. The resulting flooding has been declared a catastrophe by the Insurance Council of Australia. Lives were destroyed and billions lost. Still, there's been no action by the Queensland Labor government or the national government. Instead, the focus was on more trivial issues and on the environmental cost of any of the proposed schemes. The environmental disaster caused by the inaction is nothing short of criminal. Millions of animals are dead either by fire or flood, people's homes and businesses have been destroyed, and the agriculture sector suffered a 100+-year disaster.

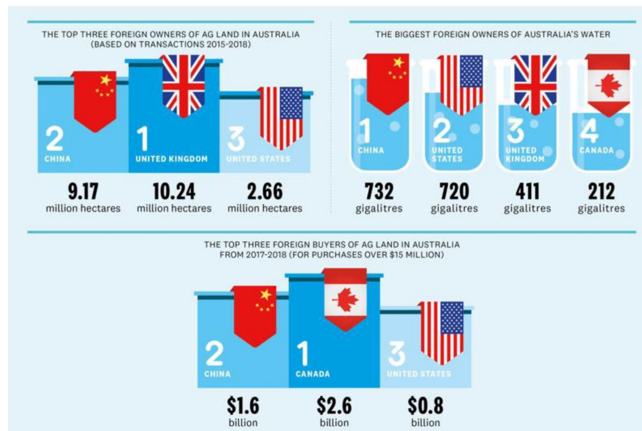
Townsville, Queensland Floods Jan 2019

The Greens and Labor have blocked effort after effort to deal with the issue, and the coalition has failed to take bold action. The problem was identified early, in 1887, when it was proposed that four major northern rivers be dammed. This was followed by the 1938 Bradfield scheme, which proposed a major water management scheme that would have controlled the floods and provided major irrigation supplies for much of the center of the country. Critics have been quick to fault the schemes. However, modern versions of the Bradfield scheme continue to receive funding and study. No action has occurred. Each segment of the scheme is somehow blocked by a green or labor party member or by an environmental group. The same group will sell major assets to China and endorse coal but do nothing for Australian rural areas. Australia's inaction began at the same time the US western areas began to deal with its water issues. The success of these projects gave the engineers of the Bradfield scheme plenty of practical knowledge. During the time of the Australian debate, China transformed Xinjiang through water management.

One part of the scheme, the Hells Gate Dam on the Burdekin River, is being reviewed and should start, but government holdbacks continue to be a problem. The dam will provide irrigation for 50,000 hectares. Other projects have been halted or stopped by Queensland Labor government, which appears strongly anti-agriculture and against its rural areas. In reality, it bears the burden of part of the environmental disaster that has unfolded. For the cotton and agriculture industry, billions are being lost by the inaction of the federal and state governments to address the water issues. The Australian water current scheme is very complex. The Murray River Darling scheme depends on small rivers and allows for water trading. It is this water trading that has driven the price of water to record highs, as the nut farmers are forced to pay any price to save their stands. Again, the strange mix of heavy government control and capital forces has created a disaster. There is no regulation on millions of investments in nut farms by foreign groups that clearly have high water requirements. Then there is the freelance trading of water that allowed these groups to outbid all other farmers for water. Cotton farmers have had to sell water this season because the profit on the water is much greater than any crop. Each state can freelance its policy, which works against the national interest.

Water trading

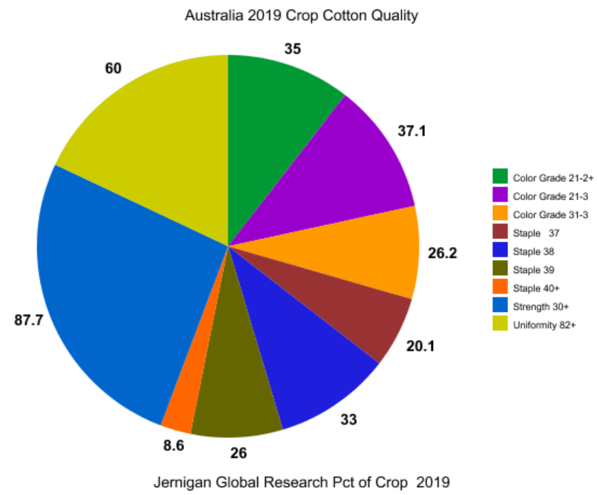
For now, this means the cotton crop will likely fall to 500,000 bales or so, which means many of the cotton towns will simply be out of water by the time the ginning starts. The impact of this on the actual workforce at ginning and harvest is unknown. This will be a season without a dryland crop in the traditional areas, as no window has opened for planting or if it was planted it died. The Indian Ocean Dipole Index plays a major role in the Australian weather, measuring sea surface temperatures in the tropical Indian Ocean. When the index is positive, the pattern of sea surface temperatures across the Indian Ocean restricts the amount of moisture over Australia. The index surged from April 2016 to a peak in October of over Plus 2. The index has begun to fall, which has raised hopes that weather will improve later in 2020. The index change does not mean abrupt changes in weather but is a reliable long-term indicator. This is raising hopes for a change in the outlook for the 2021 crop. Without a major change in weather, the 2021 cotton crop will be concentrated in the nontraditional areas and will fall to below 75,000 bales.



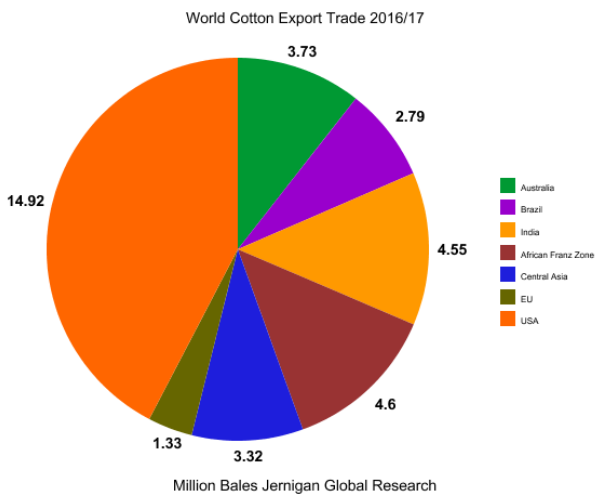
The shrinking crop means that the 2020 crop is oversold by growers. Merchants face issues with maintaining staff and infrastructure for such a small crop. Local prices moved toward 625 AD or higher bid per bale. The Australian dollar has impacted local prices as it recovered to 70 per USD before falling. Chinese demand has fallen sharply, and this has allowed for the stocks in bonded warehouses to meet much of the demand. Outside of China, other buyers appear to be attempting to find the US Memphis Territory high grades as a replacement. Merchants in Indonesia and Vietnam are offering Memphis Territory Green Card 38/39 staple high grades.

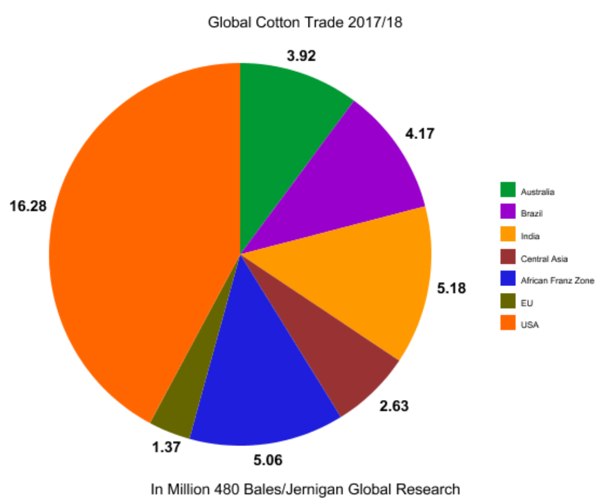
The matrix of global trade will change dramatically from 2018/2019 and past seasons. For the past three seasons, Australia has contributed to 3.63 to 3.92 million bales of world trade that has ranged from 37.90 to 41.38 million bales. In 2019/2020 Australia will contribute less than a million bales, and in 2020/2021, the contribution will drop to a few hundred thousand bales. The Australian crop is the highest quality, longest staple upland crop in the world. The US produces a block of cotton annually that meets the standards of the Australian crop, but it is much more difficult to source and is usually found in mixed lots of such descriptions as E/MOT that includes cotton from almost any US region. During the last four seasons, 2016 to 2019, the Australian crop reached 37 or longer length, with 6%-13.6% reaching 40 or longer. Color grade is normally a Strict Middling and falls in a Middling 3 leaf or higher range. Over 80% is premium mike, and strength is 30 or higher. In 2019, 51.1% of the crop reached 32 or higher, which marks an improvement from several years earlier. In quality terms, such a crop is not easily filled by the other exporters.

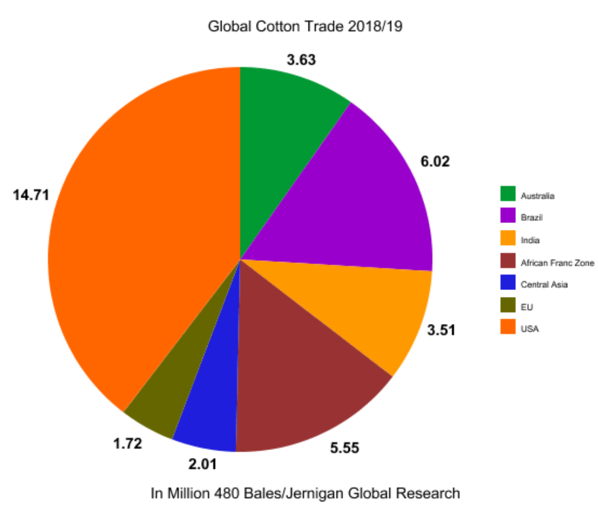
It seems so long ago, but as recent as 2016/2017 Australia exported a larger volume than Brazil at 3.73 MB vs. 2.79 MB. In 2018/2019, things changed. Brazil exported 6.02 million bales and Australia 3.63 million bales. In 2019/2020, Brazilian exports will surge to a new record of 8.80 million bales or more, with Australian shipments falling to a million bales or less. Brazil has improved its quality, but the bulk

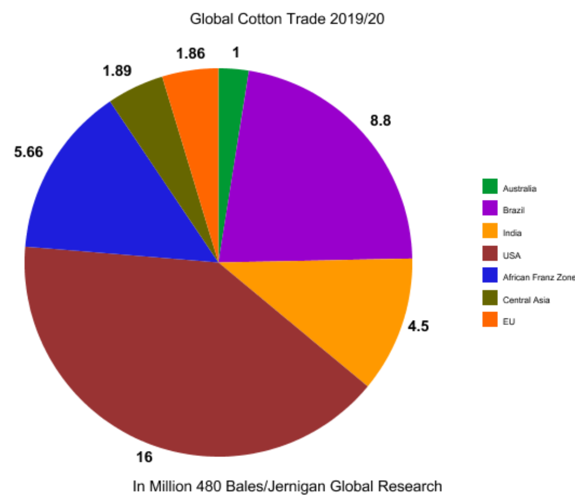


of its crop will be a Middling 1 1/8. Seed quality has improved, and excellent growing seasons have allowed 1 5/32 staple to increase in volume. In both 2018 and 2019, Bahia produced a record quality crop, with a large volume of 1 5/32 and longer staple. Leaf has been higher than Australia, color grade also lower at Middling, and strength is lower than Australia. There is no doubt that Vietnam and Indonesia seemed to have used the Bahian styles to supplement the Australian short fall. Other changes in world trade increased African Franc Zone and Greek exports and a fall in Central Asian exports. The African Franc Zone crop is handpicked and has contamination issues, but the staple length has become longer with a large portion now 1 5/32 and a small volume reaching 38 staple. This growth has replaced the reduced Australian flow in Bangladesh.









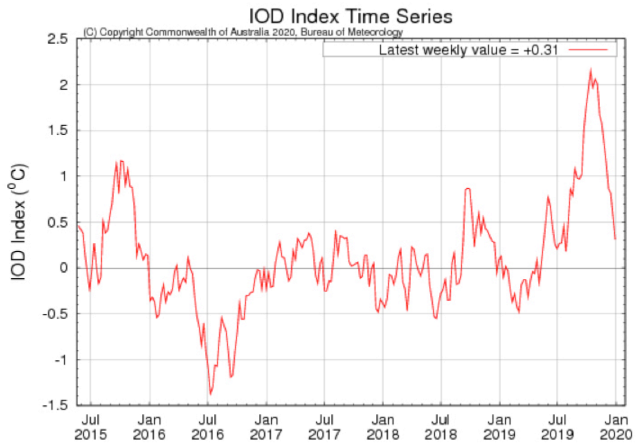
The major export markets for Australian styles over the past four seasons have been China, Vietnam, Bangladesh, India, Thailand, Indonesia, and Turkey. In 2019, the small crop has moved rapidly to China. Australian cotton has been very popular with the high-count spinners of China and for blending with ELS in the 60- and 70-count yarns. Large stocks of the 2018 and 2019 Australian crops have been held in Chinese bonded warehouses. The weaker cotton demand in China will impact how much of the normal Australian volume will need to be replaced.

AUSTRALIA'S TOP COTTON EXPORT MARKETS

2016/17	2017/18	2018/19	2019/20
China	China	China	China
India	Bangladesh	Vietnam	Vietnam
Vietnam	Vietnam	Bangladesh	Bangladesh
Bangladesh	India	India	
Indonesia	Turkey	Thailand	
Thailand	Thailand	Indonesia	
Pakistan	Indonesia		

The only country able to replace the Australian in volume is the US, but spinners face a difficult time sourcing that supply because of the flawed US marketing system we discussed in detail in the December 2nd issue. E/MOT has been a popular sales description for US exporters, as it allows cotton from any state outside California, Arizona, and New Mexico to be sold in a single lot, giving shippers great flexibility. The premise is that the HIV data makes it all equal. For spinners, the wide origin source and the lack of greater details has been damaging, and for growers producing the long staple, high grade, high strength cotton, it has resulted in lost income. It also contributes to the difficulty in sourcing high-grade cotton. Another problem with the lack of regional offers is the need to separate the top grades produced from a region. For example, the Memphis Territory early crop in 2019/2020 produced a large block of cotton on par with Australian, but good luck finding this cotton offered in any homogeneous lots. The root of the issue is the faulted CCC loan rate schedule. The CCC premium and discounts offer only a very nominal premium for a 37 staple, even a smaller premium for a 38 staple, and no premium above that level. That is simply wrong and out of touch, as it obviously penalizes growers producing the higher-grade cotton and hurts commercial trade. And the nominal premiums continue for a Middling. The CCC loan schedule needs a significant overhaul, and it should start with the base grade the industries use. The base grade is out of line and 40 years past its relevance.

The gap in Australian output and the extended time before the pipeline can be refilled does give the US the opportunity to begin to change the marketing feature. From today until at least the middle of 2021, at least the pipeline will be void of Australian supply. If drought relief is not forthcoming for the 2021, Australian crop will fall to nominal levels.



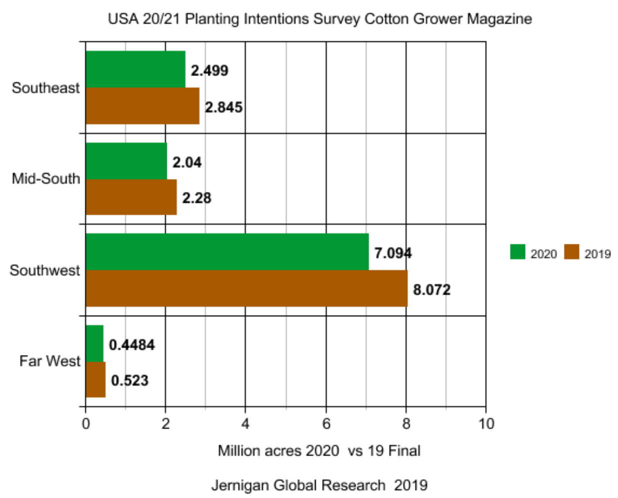
CHINA'S DOMESTIC PRICES RALLY/DEMAND SLOWS

China's ZCE futures rallied sharply last week with cash cotton prices following, and the lead May ZCE contract gained 460 RMB a ton or 2.98 cents a lb. for the week, which far outpaced the ICE futures gains. The May contract closed the regular session Friday at 14,035 RMB a ton or 90.94 cents a lb. China's cash cotton index closed the week at 13,619 RMB a ton or 88.25 and Xinjiang handpicked 3128 ended the week at 14,000 RMB a ton, and Eastern cotton at 13,200-13,500 RMB a ton. Xinjiang ginners continued to add to the certificated stocks as futures rallied. Stocks eligible for delivery ended the week at a record 27,504 units or 5.08 million bales. This marks the first time any cotton futures contract has experienced such volume eligible for delivery in cotton. The spot January contract is trading at more than a 500 RMB a ton discount to the May contract as a result, and its volume is now small and open interest at only a fraction of the stock levels. Chinese mills have not chased the rally and remain cautious. The large stocks indicate that many Xinjiang ginners have used the ZCE contract for hedging for the first time and have short hedges in place with losses. Short covering of some hedges may have contributed to the strength, along with speculative buying. The announced Chinese Central Bank cut in Reserve requirements also contributed to the speculative buying.

The international price, Cotlook A Index adjusted for VAT and 1% import tax, is now at a slight discount to the ZCE price and near par with the cash Index. Some styles, such as the Indian S-6 1 1/8, are now at over a 5-cents discount to the local cash price. Man-made fiber prices remain weak, with polyester prices just off their lows. Many polyester production units are planning 30- 45-day shutdowns beginning January 1st in order to balance supply. Others have delayed bringing online new production units that are ready. The January operating level is expected to be near 50%, while some have delayed the production from new units until the second half of 2020.

2020/2021 FUTURES RALLY FOLLOWING FIRST US NEW CROP PLANTING INTENTIONS SURVEY

US *Cotton Grower Magazine* released its annual US grower planting intentions survey for 2020/2021 last week. It revealed a sharp drop in intentions to 12,081,672 acres, which is down from 13,720,000 acres in 2019/2020, with the decline coming across every region. Texas was forecast to plant 6,346,270 acres, down from 7,167,000 acres in 2019/2020, and the smallest decline was in the Mid-South. 2020/2021 crop ICE futures attracted buying and posted gains of 48 to 108 points. Last season, the cotton grower survey was very close to the final US planting level. Texas will be an area of doubt, as grower finances are poor due to the extremely poor yields of 2019/2020. Using 5% abandonment and an average yield of 900 pounds per acre, the US would produce over 21.5 million bales. Such production would require record exports of 18.5 million bales in order to not to add to the US carryover. If average yields drop to 850 lbs. per acre, then the export burden drops to 17.325 MB.



The US faces a crisis going into 2020/2021, and it is the challenge to increase export shipments. The US cotton infrastructure has never exported the volume needed to meet the larger targets. In 2019/2020, the US has exported over 300,000 running bales of upland in only one week. Now, with just over 31 weeks left in the season, the US needs to ship more than 385,000 running bales of both upland and Pima each week to meet the USDA export target of 16.50 million bales. The odds of the 2019/2020 target being met are falling daily as the volume required to ship increases. How, then, can any higher export target be realistic? No real new investment is in the pipeline to change the situation. If the US produced 21 million bales in 2020/2021 and can export only 16 MB, then two million bales is added to the carryover. Domestic consumption is estimated at 3.0 MB. This lag in export capacity is occurring as Brazil presents a real challenge to the US and is making improvements in its infrastructure. Brazil has more than doubled its cotton export shipment volume in only two seasons.

If the China trade agreement is successful in boosting sales to China, how will the capacity be shipped?

INDIAN STYLES BEGIN TO MOVE TO EXPORT

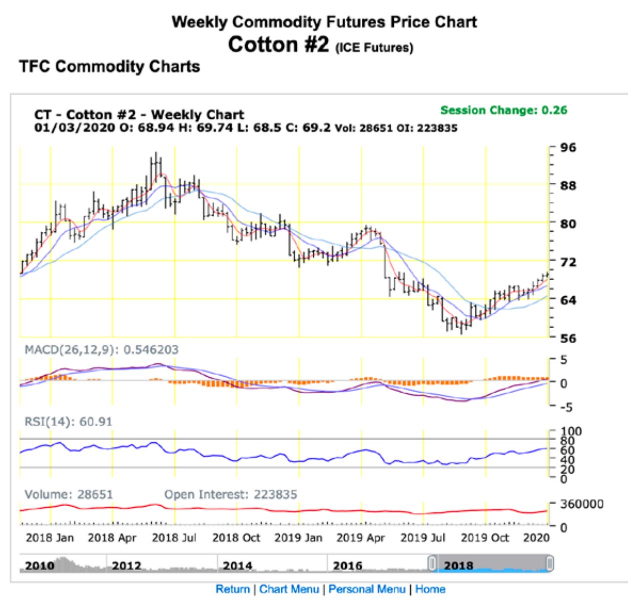
Indian export offers from Indian shippers are now very aggressive, generally a 500 points discounts to US and Brazilian styles. Harvest is in full swing, and daily deliveries are near 250,000 bales a day, which has increased the pressure to export as the ex-gin yard price of a Shankar-6 1 1/8 remains near only 70 cents. The slow CCI procurement and the inefficiencies in the system meant that the high MSP has not supported local cotton prices to the degree many expected. The increased buying by the CCI in December has halted the collapse, and prices have recovered, but as the ex-gin yard price nears 70 cents the pressure returns for exports. Adding to the weakness in USD prices is a weaker Rupee/USD exchange rate driven by the run up in crude oil prices. India is a major crude oil importer, and increases in energy prices have a major effect on the FX rate.

ICE FUTURES STAGNATE AS ZCE PRICES LEAD THE RALLY

President Trump tweeted last week that the US/China trade deal would be signed January 15th in the US, which triggered little reaction in the US but sent most of the Chinese stock and equity markets higher. In addition, the Chinese Central Bank reduced the reserve requirements for banks, which is being called a 115 billion USD stimulus. This appeared to generate a wave of buying on China's ZCE cotton futures, which allowed the May contract to gain 2.98 cents a lb. for the week as compared to a gain of only .28 cents in the lead March contract on ICE, while the Dec 2020 contract gained 1.18 cents. Trade selling capped the nearby contracts on ICE, as active movement of US and some non-US cotton continued from origin. ICE prices continue driven by the buying of the Managed Funds, which are now near 25,000 contracts net long. Demand remains very soft at fixed prices on the price strength. All attention remains on the US/China trade deal, and it certainly appears the Chinese side as well as the US is attempting to avoid any new confrontation. On the Chinese side, it's quiet. It was notable that in Xi Jinping's New Years speech he did not mention Taiwan, which marked the first time Taiwan was not mentioned in the speech since he took office. This comes as Taiwan's president made a statement that it rejected the Two Systems-One Nation policy that failed in Hong Kong. The Chinese action suggests that it clearly needs the US trade deal and hopes it will contribute to economic growth.

No indication of improved cotton demand or textile and apparel demand has been evident in China during the last week, even with the rally in domestic prices. The rally seems heavily speculative based. The situation in Xinjiang suggests mills are running at low capacity and are attempting to keep a low profile amid the concentration camps publicity. An attempt to promote the camps as having released prisoners failed as the *New York Times* was again presented with additional inside documents.

So far, US and Brazilian CFR basis levels are holding on the firmer prices, even as the Indian basis weakens. Brazil's FOB Santos basis has held at 500 points on March futures for a 31-3/4-36, which is only marginally off the peak. This suggests traders are very unsure of a wholesale switch in demand from Brazilian cotton to the US. The 2020 crop FOB Santos basis is also holding at 300 on Dec 2020, which again undermines confidence in Chinese demand being maintained. The African Franc Zone crop basis is weaker but not yet competitive, as a record crop moves. We have been negative on the African Franc Zone basis for some time, which has been overpriced vs. the US and Brazil. The cheapest offers, such as Ivory Coast, are beginning to become more competitive. As most months of futures move back to 70 cents or above, all crops are moving more freely from origin.



On Friday, the global equity and commodity markets were impacted by the US attack on an Iranian terrorist leader at the Bagdad airport. Crude oil rallied sharply. However, it was noted in the US that crude oil production is at record levels, and the rally allowed producers to lock in profitable levels for several years, which will maintain production. The US is now a crude oil exporter. The concern for cotton is the impact these events will have on global demand and economy. ICE futures prices have reached the outer levels of our first discussed upside targets. The further extension of the rally to 72.50 nearby will depend on the speculative enthusiasm and whether any demand follows the rally.

We remain skeptical of the impact of the China/US trade agreement on actual cotton demand. Hong Kong was in the headlines last week, as the Hong Kong police thugs attacked citizens with tear gas and very violent arrest for no reason. 18 countries have now called for an independent panel to review the human rights abuses of the police. The US has been quiet, but now the holidays are over and new attention will return.

Against this backdrop expect resistance to increase if prices attempt to move through the 70 cents area in March. Demand is the key, and there is no shortage of supply.

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