SUPPLY CHAINS MOVEMENT OUT OF CHINA ACCLERATING

CHINESE COTTON YEARN DEMAND EXPECTED TO FALL IN SECOND HALF 2019

INDIAN MONSOON DELAY CAUSING CONCERN IN GUJARAT

GLOBAL TEXTILE/APPAREL CHAIN SUFFERING FROM COLLAPSE OF CONFIDENCE

JERNIGAN GLOBAL

KNOWLEDGE IS THE NEW CAPITAL

TEXTILE AND APPAREL SOURCING FROM CHINA REACHES TIPPING POINT

THE TIPPING POINT – "The critical point in a situation, process, or system beyond which a significant and often unstoppable effect or change takes place"

– MERRIAM-WEBSTER

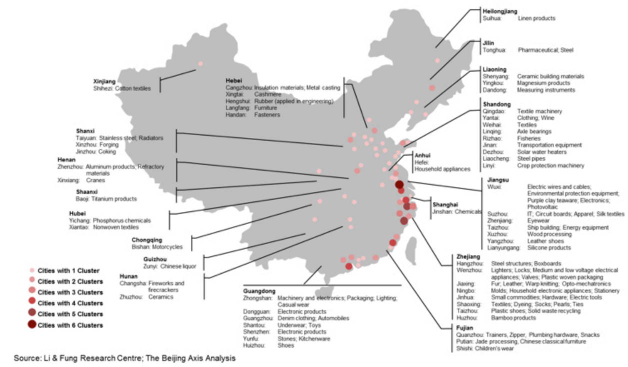
Spencer Fung, CEO, Li & Fung on Bloomberg TV

The term "tipping point" was first known to be used in 1959 and was the title of a popular book by well-known author Malcolm Gladwell in 2000. He expanded on the Webster definition to cite three features of a tipping point - contagiousness, little things cause big effects, and change does not happen gradually, but at one dramatic moment. China, as the factory of the world, appears to meet all the criteria of having reached just such a tipping point. The exact tipping point occurs when a movement or event reaches critical mass. Last week the CEO of Li &Fung, the largest textile and apparel supply change manager in the world with a 100 plus year history managing sourcing from its Hong Kong base, gave an interview on Bloomberg TV. Li & Fung manages sourcing for many of the world's largest retailers and brands, with 80% of its business managed for US-based companies. He was quoted as saying, "Chinese factories are getting desperate as US retailers and brands pull out of China." He went on to say US companies are worried and want out of China ASAP. He said Chinese companies are cutting prices and are desperate for orders. "Nobody is buying or

investing in China." He indicated that by the end of 2019 Li & Fung would be sourcing only 29% of their orders out of China, as compared to 51% in 2018. The tipping point has arrived.

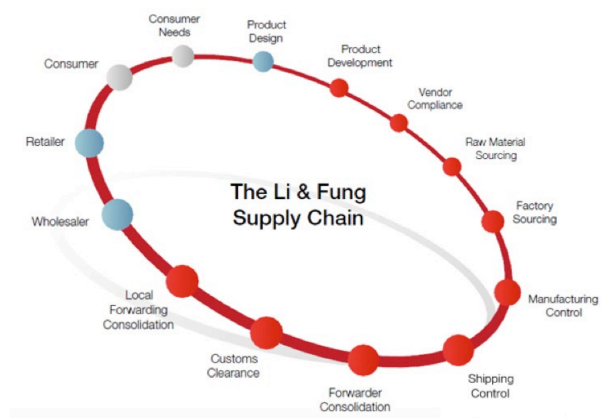
The tipping point appears to have been triggered by the law of unintended consequences, actions which have effects that are unanticipated or unintended. In this case the trigger was China's reaction to the US's demand to address the record trade deficit. At the start of the dispute, all the US demanded was that China address the trade deficit. Actually, 48 hours before the duties were triggered it was believed China had agreed to purchase approximately 200 million USD of US agriculture products, natural gas, Boeing Aircraft, and other US manufacturing products. The *Financial Times* ran a headline stating the deal was agreed to. However, a few hours later the headlines were withdrawn, and China backed out of the agreement. China's reneging may have been influenced by the hardliners. The actions by China opened a Pandora's box of all sorts of problems that would be released over the next year. It provided a major opening for the China hawks and opened the door for a host of grievances to be brought to the surface. It appeared many of these had been suppressed by China, as it used its economic power to silence critics. The expansion of the dispute also exposed for the first time the full extent US companies had concentrated their supply chains in one country, China. It was revealed that 95-100% of some products were sourced in China, and there were no commercial alternatives. Chinese exporters invested in turnkey operations, which made it easy to move to China, and then used the China price to drive out all competition with the aid of government subsidies.

The concentration fueled China's rise to power and contributed to the hubris that surfaced in recent years following the rise of Xi Jinping. Regarding the companies, it also exposed their total lack of risk management. It was believed that this time it was different. Companies and governments looked the other way as China moved to dominate industries and reasserted the control of the Chinese Communist Party,



China top 100 industrial clusters for sourcing

as Xi Jinping forced every company to have a party official in management. The CCP made the companies, especially the state-owned mega firms, instruments of the state to promote the party line and to use all economic power for that purpose. At the same time, China misjudged several major developments. First, it expected the Trump administration to act as every other previous US administration has since it joined the WTO, and fold at China's demand and ignore China's violation of agreement after agreement. Second, they expected Wall Street interests to use their influence and lobbying on its behalf, but it became clear that the Trump administration would not be swayed by the traditional pressure. Then, as China became more hardline in its approach, and the extent of intellectual property theft, corporate spying, and human rights abuses became known, this support group began to fade away. They also misjudged the support President Trump would receive from the opposition party in Congress, which meant the issues would outlive the first Trump term. It is clear that another miscalculation was the first tariffs being placed on agriculture products in order to weaken Trump's support through the US farm belt. This move failed, but it has continued to wave soybean purchases as its first incentive for talks or a trade deal, which is linked to the economic power of this commodity.



A further confirmation that the tipping point has already occurred is the fact that, even if the US and China reach a truce, the supply chains will continue to move and will not be back. The risk has been exposed, commitments are being made and shareholders are demanding action. A deal increasingly appears unlikely, and even optimists now acknowledge that it could be 2020 before an agreement is completed, if then. Even for companies that are not involved in the tariff war, China has become a much different place in the last two to three years. The *Australian Financial Review* ran a headline feature last week entitled, "How the West Got Xi Jinping Wrong on Business." The article appeared to capture the new mood of the global business community. The root of the tipping point began as Xi Jinping came to power. A few months after the first US tariffs were put in place, and followed by several belligerent actions by China, a blog post shook China's entrepreneur and business sectors, as well as all businesses that operated in or sourced out of China. Wu Xiaoping, an investment banker with China International Capital Corporation, posted a blog that was translated to have said, "It was time to phase out local entrepreneurs and allow state companies to take their place. China's private sector has already done its job in aiding the development of the state economy, and it should now leave the stage."

Prior to this blog post, Xi Jinping's CCP had moved to require all private companies and foreign enterprises to have a party officer with influence. A study in 2016 found that 68% of all private companies and 70% of all foreign enterprises had party officers. Then came the new law requiring all companies to cooperate and share in national intelligence work. The extent to which it has changed is highlighted almost daily. The *Nikkei Asian Review* ran a feature last week, "Xi Doctrine Comes Before Profit for China's State Companies." The feature discussed how state-owned companies were being used to promote the Xi agenda and to spread CCP propaganda. It cited the efforts underway at two state groups, Anhui Conch Concert and KweiChow Moutai, which are listed in the Nikkei Asian 300 Index of the most powerful Asian companies. It was also clear that, even though the companies were listed on an exchange, their first goal was not profit but to promote the goals of the state and CCP. The line between state and party control and the private sector is now blurred to the point where some now say there is no longer a private company in China. It is now apparent that the state can destroy a company at will. The *Australian Financial Review* feature said Xi Jinping in 2017 launched an effort to rein in China's top entrepreneurs, which some believe is behind Jack Ma's, China's most effective business leader, surprise retirement announcement. Just recently, more than two billion USD in market cap were lost by Hong Kong-listed Future Land, a major Chinese land developer, after its chairman was detained by police. He was listed in the Bloomberg's Billionaire Index in 2018. This was followed by the collapse of market cap in another company traded in Hong Kong, after its chairman was detained by police. There is no actual rule of law, only the whim of the CCP, which has undermined confidence in all companies looking to set up operations in China. A recent *South China Morning* Post story carried several quotes from major private company CEOs that praised the CCP and demonstrated the relationship of these groups and the party apparatus. Richard Liu of e-commerce group JD.com predicted communism would be realized in his generation, and all commercial entities would be nationalized. Xu Jiayin of Evergrande Group said that everything the company possessed was given by the party, and he was proud to be the party secretary of his company. Liang Wengen of Sany Heavy Industry said his life belonged to the party.

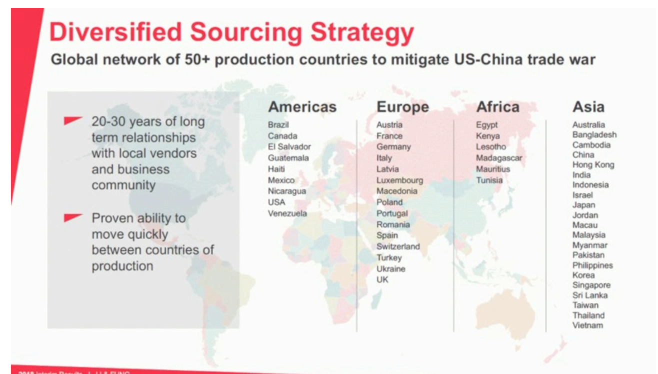
The business atmosphere and conditions are one factor. Another is China's aggressive move to tamp down all domestic dissent and what are perceived to be any domestic opposition groups, including a massive attack on Christians. The most visual issue is the Xinjiang labor camps. Last week, 22 countries issued a statement at the UN asking China to end the mass arrest, close the camps, and allow freedom of religion. The Xinjiang situation has been ignored by countries seeking Belt/Road investment and trade arrangements. However, the US is now being joined by European countries and Japan in calling China to task. A *Wall Street Journal* research story showed Xinjiang labor camps are providing forced labor to many of the massive Xinjiang textile and apparel operations. Brands and retailers are now demanding proof that these factories are not involved in their supply chain or have pulled out of China when possible. The Xinjiang labor camps and imprisonment of over a million Urghurs has endangered one of China's greatest success stories. The engineering and development of a major agriculture production zone and a complete industrial textile and apparel chain in the harsh climate of Xinjiang is a marvel of the world. Record fixed asset investment and subsidies have been provided, which have cost the Chinese state trillions of USD. Investment has also come from many international groups. Now, growth in exports has shrunk, and the sourcing by US and European groups from the region is likely to fall sharply, making operations much more dependent on textile and apparel exports to the Belt/Road regions. The low per capita spending on apparel in these regions makes it

very difficult for any export growth to offset losses to the two largest per capita spending markets, the US and Europe. Xinjiang cotton yarn production has been reduced by at least 30-40% to date by the weakness in orders. An effort is underway to promote textile and apparel exports to Central Asia, where the Belt/Road program has expanded and China is increasing its influence.

Smuggled photo from Xinjiang labor camp

The *South China Morning Post* on Friday ran a story that suggested that China may be considering a change in policy in Xinjiang. The article cited several statements on the success of the labor camp program. It also said a major party conference on Xinjiang would soon be held. The article went on to suggest that the focus may switch from security focus to poverty alleviation and strengthening of the Production and Construction Corps, the state owned group that controls much of northern Xinjiang. There was no discussion regarding the role that the labor camps would play moving forward. The state has invested billions in these facilities. The poverty alleviation effort already appears underway. In the textile hub and a major cotton growing area of Awati county, whose population is dominated by Urghurs, a major textile group has set up satellite factories in local villages in order for employment to be provided and outside income to be achieved. Increased land transfers are also occurring, allowing larger farms to be created.

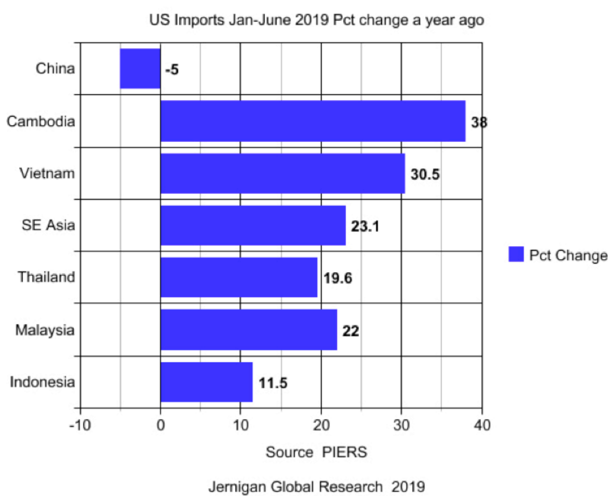
The move of supply chains is occurring across all product lines and, as we discussed in July's *Jernigan Global Monthly*, these conditions and the tariffs are causing entire tech supply chains to move. The volume and value of these supply chains pale in comparison to textiles and apparel. For those looking for signs of the decoupling of global supply chains, the tech sector provides a clear illustration, as revealed in a study by *Nikkei Asian Review* in which major supply chain movement is discussed. HP is the world's largest laptop manufacturer, and it has been quietly moving its laptop production out of China. At this time, it has reduced its output in China by 50% from two years ago, and the movement is still ongoing. The world's third largest laptop maker is Dell, and they are also moving their production out of China to Taiwan, Vietnam, and the Philippines. The smaller producers, such as Lenovo, Acer, and Asustek, have all announced, or are quietly shifting, production to Taiwan, Mexico, and the Czech Republic. The Chinese city of Chongqing has been the global center of laptop production with an estimated 35% of all global capacity, which illustrates just how concentrated the supply chains have become in China.

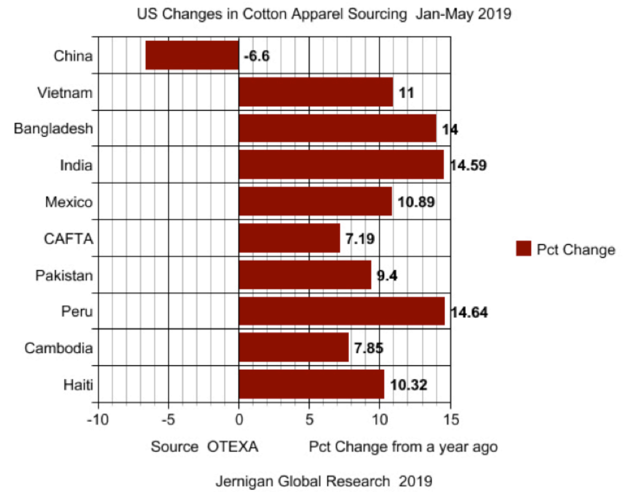


One of the interesting observations of the rush to move textile and apparel sourcing from China is that the US tariffs have not yet been applied to apparel, but only a very few textile items. The first focus of supply chain movement has been in cotton apparel, which had extra capacity in other countries such as Turkey, Vietnam, Bangladesh, Pakistan, India, and others. This movement began several years ago as China moved to support its domestic cotton prices, limit imports, and force consumption of Reserve stocks. Vietnam was one of the first choices and is now thought to be nearing capacity. The movement of the cotton supply chain is now accelerating and will increase before the end of the year as companies rush to meet their reduction in China's sourcing targets. This is causing cotton consumption in China to fall faster than in polyester staple fiber. There are two segments of the

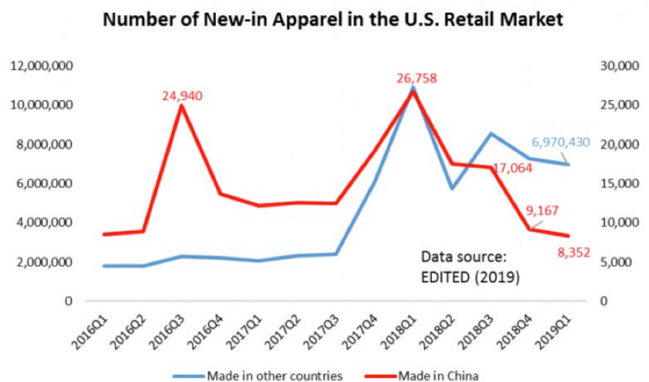
global supply chain that can be moved somewhat rapidly. First, cotton spinning can be easily moved to other regions with excess capacity. There is a limited availability of excess capacity before new investment is needed, but this is occurring in Bangladesh, India and Pakistan.

Second, the easier supply chain to move is the cut and sew operations, and they have been moving. Chinese companies have been investing rapidly in recent years in a number of locations and have accelerated this transition over the last 12 months. This is already showing up in US sourcing, with a surge in imports from Jordan, Cambodia, Egypt's Free Trade Zone, Haiti, and across Africa that all depend heavily on Chinese fabrics. China has put a record amount of fixed asset investment into the fabric production sector along with dyeing and finishing, and they have built up all supporting industries. This investment has caused an environmental disaster due to the lack of environmental controls and enforcement. The investment in man-made fiber and Viscose fabric manufacturing has surpassed any other country in the world by a wide margin. Investment in new fabric production and dyeing and finishing in the new textile hot spots has been slow due to the construction and equipment cost and the coast of environmental compliance. Vietnam, which has taken the lead as the second most favored sourcing location, has halted investment in many provinces by Chinese companies in fabric production and dyeing and finishing because of concern over the environmental cost. New investment has begun to occur over the last year, but progress is slow as new expensive much more environmentally friendly equipment is required.



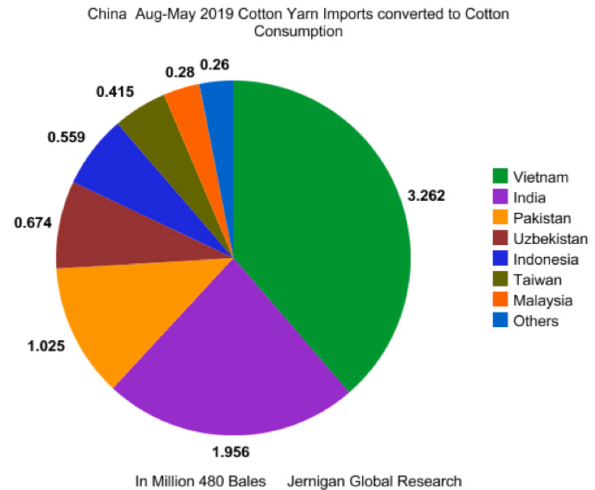


According to the NBS data, China has exported 5.926 billion USD worth of cotton fabric in the January-May period, which illustrates its role in the global cut and sew operations. The exact volume of man-made fiber fabric is not broken down in the NBS data, but Chinese man-made fiber dominates the global cut and sew centers. China produces 70% of the global man-made fiber, which has made it the majority exporter of many man-made fiber fabrics and a dominant force in specialty fabrics. Their overwhelming market share has made it difficult for companies to switch sourcing for many man-made fiber products. In the past we have pointed out examples of their market control in the US regarding several Chinese-produced, man-made fiber apparel products. South Korea and other Asian polyester and man-made fiber producers are expanding man-made fiber fabric production as the changes in Chinese sourcing expand. Indian man-made fiber fabric production is also increasing, a trend which is likely to accelerate over the next 12 months. US imports of both South Korean and Indian fabric have increased in recent months.



Number of New Made in China apparel skus launched in US market
Source: Sheng Lu, University of Delware

We expect cotton consumption in China to find some stability from the volume of cotton fabric exports and offtake focused on the domestic market. The amount of overcapacity and the new capacity still coming online makes the level of stability difficult to predict, as older capacity is forced to shut down. It will also depend on the Chinese banking system's ability to keep the funding flowing to the weakest groups. The inability of the medium and small sized groups to keep funding lines open with banks is shrinking. The inability to service loans is already causing failures at some banks and bond defaults. The next area of concern is cotton yarn imports, and these yarn imports are an important source of demand for India, Vietnam, Uzbekistan and, to a lesser extent, Pakistan. January-May cotton yarn imports reached 880,000 tons, down 8.1% from last year. This represents approximately 4.528 million bales of cotton use in the countries involved. Private estimates suggest June imports suffered a greater decline, falling to near 150,000 tons. Total 2019 cotton yarn imports could fall 20-25%, which would equal over 2.1 million bales of cotton use in the exporting countries. We would expect India and Pakistan to experience the greatest drops in volume. Many of the Vietnam yarn exporters are owned by Chinese parent companies, and Uzbekistan is tied into the expanded Belt/Road investment and trade.



ENJOY THE GREAT FEEL OF 100% ALL-NATURAL COTTON

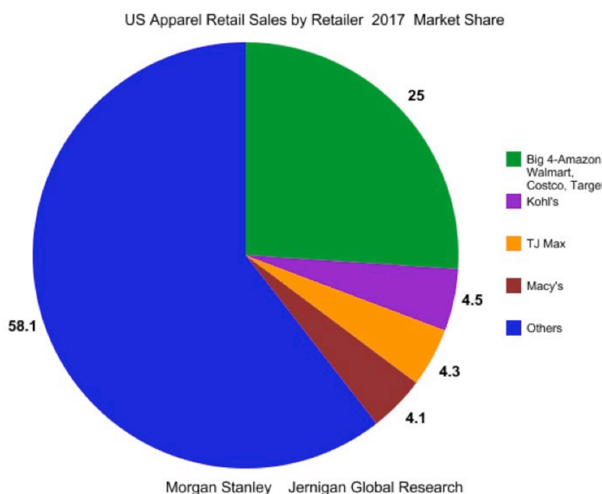
JERNIGAN GLOBAL
KNOWLEDGE IS THE NEW CAPITAL

EXPANDING COTTON CONSUMPTION IN A NEW SUPPLY CHAIN FOR GROWERS

FIELD TO CLOSET™ NASHBROUGH COTTON™

TEXTILE SUPPLY CHAIN BEING SQUEEZED BY US RETAILER BATTLE FOR MARKET SHARE

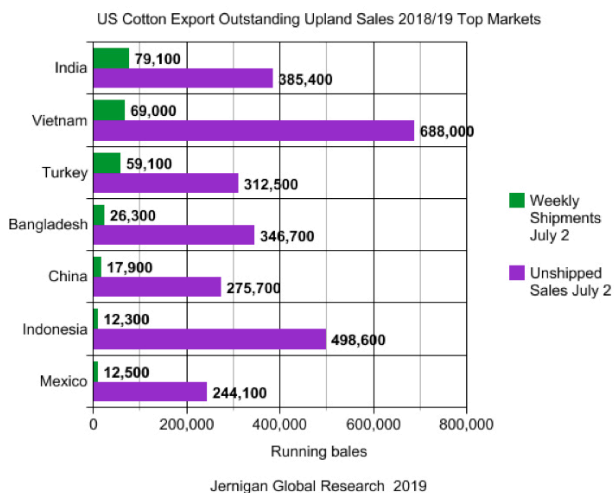
Price pressure is now occurring at the cut and sew level, which is causing a ripple effect all the way back up the supply chain and adding price pressure to even spinners' margins. When research is done regarding the lack of price inflation, retail prices, and in the supply chain, one word comes up – Amazon. The online retailer is now offering almost every product and is willing to deliver it free within two days for Prime members, and at a 25-50% discount to the price offered by the local retailer. It has employed the use of algorithmic systems to compare competitors' prices and then offer slightly below that level. This strategy is now being utilized by its three top competitors, and consumer prices have fallen as a result. Levi's announced their second quarter earnings last week, and the battle at retail played a role in producing results that disappointed analysts, sending their shares down 12%. Four retailers – Amazon, Target, Walmart, and Costco – are now estimated to have a dominant position at retail in the US apparel market, and they're taking market share from everyone else. In 2017, Morgan Stanley research showed these four retailers had a 25% market share of all US apparel sales, and they are believed to have increased market share in 2018 and 2019.



Today, these four also are in a battle for market share and offering even lower prices, the lower prices in apparel are occurring despite the turmoil in moving sourcing out of China. Even in products other than apparel, which have been hit with the tariffs, these companies are reported to be offering prices below a year ago. The four companies are also reporting strong profit margins, which means the price cutting is not coming from their margins but from their suppliers. They are reported to be making suppliers meet their price targets or lose the business. This is true for Chinese suppliers as well, confirming that the US consumer is not paying for many of the tariffs. This price battle is also adding to the anxiety of all members of the supply chain in extending coverage in either product or raw material at a fixed price. Cotton spinners that forward booked cotton in the third and fourth quarter of 2018, and even in the final part of the first quarter of 2019, and that are only receiving delivery now, face a 20-25% loss in the price of the fiber. This is adding to the woes, as it is creating losses with forward yarn and fabric price contracts at the much higher prices being renegotiated.

The battle at US retail is impacting all margins, and it is also aiding in the increase of market share for China's polyester apparel, which is entering the US at prices now being reduced, as illustrated in the recent import data.

US COTTON EXPORT SHIPMENTS SUGGEST US CARRYOUT COULD REACH 5.4 MILLION BALES



US 2018/2019, cotton export shipments continue to disappoint, as shipments in the latest week only reached 333,400 running bales of upland and 10,800 of Pima. These shipment levels, while sizeable, have been far below the level required to meet US export estimates, or at levels that suggest that the large volume of sales still open will be not be shipped. With less than four weeks left in the 2018/2019 season, the US still has 3,551,229 480-lb. bales of cotton sold but unshipped. Based on the recent shipment pace, it appears the US will be able to ship no more that 14.1 million bales, which will raise the US carryover to 5.4 million bales. This begs the question of what happens to the more than 2.2 million bales that will be unshipped. Will these be canceled outright or rolled into new crop with an adjustment in price. Cotton prices have fallen by 20% or more since many of these sales were made.

1,121,000 running bales of upland sales are open to three countries, Indonesia, Bangladesh, and China. 498,600 running bales of upland sales remain unshipped to Indonesia. Recent shipments to Indonesia have been small, and a small volume of new sales continues to occur. This suggests that much of these sales will be canceled or renegotiated for 2019/2020 shipment. Outstanding sales to China stand at 275,700 running bales of upland, and at least 200,000 bales of these sales will likely be canceled or rolled at negotiated prices. 346,700 running bales of upland remain open to Bangladesh, and these sales are suspect given that Bangladesh has continued in the market for prompt shipment. Why would spinners need to book afloat or nearby new shipments if these sales were about to be shipped? Again, much of this volume is likely to be canceled or renegotiated for new crop.

Vietnam has 688,800 running bales of upland sales outstanding, and at least half of these are likely to be shipped before the end of the season, with the balance carried forward. Turkey has 312,500 bales of upland unshipped, most of which are rather recent sales and not carrying large losses. This means they will probably be shipped over the next 60 days. The continued decline in prices has allowed the US to continue to make sales for the next 30 days. Sales in the week ending July 4th reached 53,400 running bales of upland, and additional sales occurred last week as prices collapsed.

Every increasing 2018/2019 carryover and the current crop prospects raise fears that 2019/2020 US carryover could reach an almost unbelievable nine million bales, as conditions today suggest the USDA continues to overestimate 2019/2020 exports by over two million bales.

The US carryover in about 30 days will be the highest in ten years, and the prospect is for it to sharply increase again in 2019/2020. The US warehouse system needs a major overhaul. Monthly storage cost is excessive, and the system does not allow for efficient shipping times. Most warehouses are not located at gins, so the cotton must be shipped to area warehouses after ginning. Many of the merchants have purchased their own warehouses, but these are usually near central shipment points, so if cotton is purchased from a variety of areas the cotton must again be shipped to these warehouses that will then ship for export. Growers do not own the warehouses or the gins. Therefore, growers or traders who do not have cotton in their own warehouse face very expensive monthly storage charges and expensive in/out charges along with delays in moving the cotton. The Amazon efficiency has long been needed in the system. As the 5.4 million bales of carryover reaches CCC loan expiration dates, the growers or holders of the equity must redeem, pay storage costs, and then begin incurring new additional monthly storage cost with no option to forfeit cotton to the CCC if the carrying charges become excessive. This will result in the 5.4 Million bales becoming expensive inventory as it moves out of the CCC loan. It also means the large volume of unsold 2019 crop will face a time clock once it moves into the CCC loan. The industry has requested that the USDA correct the adjusted world price to reflect the greater carrying cost faced by the industry, due to the China trade dispute.

One USDA cotton program that remains in place is the adjusted world price. Cotton can be redeemed at the CCC loan rate plus the storage and interest, or at the AWP, whichever is cheaper. The AWP will be 58.05 through Thursday. This is still far above the CCC loan, but given the storage and interest costs now accumulating on many CCC loans, it will soon be cheaper to redeem at the AWP if it drops further, which it is set to do.

TROPICAL STORM BARRY BRINGS EXCESSIVE RAINS TO US MID-SOUTH REGION

After a hot, humid period, the US Mid-South region was hit with excessive rains over the weekend and into this week. The storm hit the Louisiana shoreline near New Orleans on Saturday and is projected to move across Louisianan, Arkansas, Mississippi, Missouri, and West Tennessee. The excessive rainfall will occur when fields are already saturated, resulting in flooding in many areas. 6-12 inches will be possible, but wind is not a concern. Potential flooding is the only worry. Overall, the US crop is developing normally, with West Texas still experiencing some extremes, such as excessive pockets of rain. The crop potential remains for a 21.5-22.5 million bales crop.

INDIAN MONSOON FOLLOWS VERY ERRATIC PATTERN; SEVERAL MAJOR PROBLEM AREAS CONTINUE

The 2019/2020 Indian crop is going to be late. The question is whether many of the key cotton areas will have a failed crop. The irrigated crop of the Northern Zone is normally high yielding, good quality, and experiences strong demand from the northern mills. However, the irrigated acreage requires supplemental rainfall, as irrigation supplies are not adequate to reach the full potential in yields. The monsoon has been far below average in the region with the heavy rains, falling to the east of the region. Rainfall last week was 36% below normal in Haryana and is 55% below normal for the season, while Punjab was 24% below normal and is 44% below normal for the season. West Rajasthan has received 28% below normal rainfall, while east Rajasthan has received good rains. The primary worry is in the key cotton areas of Saurashtra and Kutch, where little rain has fallen. A large block of acreage planted after the monsoon had a false start. Rainfall in the region was 79% below normal for the week and is 51% below normal for the season.

Beneficial rains fell in Karnataka last week, but rainfall in Andhra Pradesh, Telangana, and the Marathwada district of Maharashtra again experienced below normal rainfall. Rainfall in Andhra Pradesh was 49% below normal for the week and 38% for the season, and Telangana reported 42% below normal rainfall last week and is 73% behind normal for the season. The important Marathwada district of Maharashtra received only 48% of its normal rainfall last week and is 34% below normal for the season.

The normal monsoon begins in June and normally withdraws in September, so the halfway point for a normal monsoon season will arrive in a few weeks. If these rainfall deficits continue, the window for any crop in these areas that get planted will be limited, and yields will be heavily influenced by any delay in the withdrawal of the monsoon. Time is running out quickly for the Northern Zone, which will start its harvest much sooner than any other region. A small amount of new crop has already moved in Pakistan. We continue to believe the 2019/2020 Indian crop will fall short of expectations because of lower acreage and lower yields. These expectations are now growing due to the delayed monsoon rains.

ELS consumption in India is increasing, and spinners appear to benefit from the switching of orders from China. Target, one of the four US retailers winning

the apparel wars, heavily concentrates its sourcing in India, which is benefiting export orders to the US. The main worry regarding consumption is the impact of the lower cotton yarn exports to China expected during the second half of 2019 into 2020. Indian mills continue to increase import purchases, with most business being in US styles with a small volume of African Franc Zone styles. Last week offtake expanded to Brazilian styles. The delay in the crop will increase the demand for imports for later shipment. Domestic prices have fallen but remain at large premiums to international values at 81.45 for a S-6 ex gin.

BRAZIL HARVEST EXPANDS; REAL TURNS MUCH STRONGER AGAINST THE USD

The 2019 cotton harvest is expanding in Brazil, and yields have proven to be a bit below expectations in Bahia. This resulted in a small downward adjustment in the crop by CONAB. Domestic prices remain at a large premium to international market due to the slow arrival of uncommitted cotton and a much stronger Real against the USD. The lower house of the Brazilian congress shocked the world and passed the pension reform package, which will save the government 250 billion USD over the next ten years. The Real ended the week at 3.7375 and has appreciated more than 4% since June 14th. The ESALQ Index of a 41-4-35 landed Sao Paulo closed at 71.64 cents, while at the same time export offers for October-December for a Middling 1 1/8 landed Asia was near the same price at 72.20. CFR basis levels remain steady without much movement. CONAB estimates the crop at 2,665,100 tons (12.198 million bales). Brazil faces a significant hurdle meeting its export targets in light of the weak demand. Additional basis pressure could occur in 2020 if sales fail to improve, as storage becomes a concern.

ICE FUTURES END THE WEEK AT LOWEST LEVELS SINCE THE TRADE WAR BEGAN, 34% OFF THE JUNE 2018 HIGHS

ICE cotton futures ended the week at the lows of the week and the season. The market remains in turmoil from the impact of the weaker Chinese demand, the changing supply chains, and the need to move a very large US and record Brazilian crop amid weak demand. In our monthly outlook report we explained in detail our projection of lower global cotton use in 2019/2020, caused by a large drop in Chinese consumption and slower demand at the consumer level in Europe. We also discussed in detail the larger issue of the end of globalization and the chance of a global recession. Overall, our estimate of global use for 2019/2020 is 120.27 million bales, which will be the lowest since 2016/2017 and will have an impact on world trade. This would, however, only reflect a 2.4 million bales reduction from 2017/2018. In comparison, during the global financial crisis of 2008/2009, global use fell 13.54 million bales, with seven million bales of that reduction coming from China. World trade is reduced to 39.75 million bales, which will make it impossible for the US, Brazil, and African Franc Zone to reach export targets. US exports are estimated by the USDA at 17 million bales, but we believe this is at least three million bales too high. Brazil and AFZ exports will likely fall, but both regions have no long-term cotton storage facility, which will make it difficult to hold inventories. While these cuts in estimates may appear dramatic, both consumption and world trade will remain above the levels of 2015/2016 when trade fell to 35.44 million bales based on consumption of 113.27 million bales. This suggests that consumption may have additional downside, but it will depend on the continued strength in the US economy and the depth of the slowdown in Europe. We expect the next economic slowdown will have a greater impact on global polyester staple fiber and overall man-made fiber consumption, which will suffer a greater loss. Cotton's market share has already suffered a dramatic drop from the previous global slowdown.

The prospect of a US/China trade deal still appears to be far off, since the first test that something real would occur as the result of the G-20 meeting has failed. President Trump tweeted what we all knew, that China has failed to live up to its pledge to buy large volumes of US agriculture products. We discussed last week that Chinese press reports from Hong Kong suggested these purchases were in doubt. This is the second time China has failed to live up to what the US side said was a firm commitment to buy US agriculture products. The US agriculture sector has been targeted by China since the trade dispute began, and it seems they continue

to try and influence the next election, regardless of what Xi tells Trump at a meeting. Moreover, since the dispute began in June 2018, a lot has changed. The Chinese Swine Flu crisis has expanded, soybean demand has fallen sharply, China's economy has turned much weaker, the textile and apparel industry is contracting, China's financial debt is much larger than earlier indicated, and supply chains are moving and will move regardless of whether there is a short-term truce. Several of these changes mean that China does not have the same need for US farm products it did a year ago, with the exception of pork, and that USD expenditures are certainly higher. A new reality is settling over cotton, and it has lots of uncertainly. The Taiwan arms sales and the US President's stopover, China's new very aggressive moves in the South China Sea, and the human rights abuses along with Hong Kong, all remain ready to disrupt any potential deal at any minute. At the same time, Chinese hardliners appear to be in control, and leadership no longer regards economic performance as the most important factor. Absolute party control and a firm international hand appear to be the drivers.

The entire textile and apparel supply chain is under pressure from the battle by four US retailers to dominate the US market. This has ignited a new wave in price deflation at retail. These conditions, plus the disruptions in the supply chains, have spinners seeking to control risk by limiting forward coverage. This is denying the market the support it needs to stabilize. We have been discussing for six months or more the difficulty the US and Brazil face moving the large 2019 crop, which would stress prices in the best of times and is very painful as global demand contracts. What is a big surprise is the size of the unhedged US, Brazil, and African Franc Zone 2019 crops. The CFTC data for the week ending July 2nd indicated that the Trade covered 11,358 contracts of shorts during that week, reducing its net short position to only 9,121 contracts, while the Managed Funds moved closer to the 50,000 net short position as they added 4,062 new net shorts and increased their position to a new record of 41,727 contracts net short. The other Reportable Specs sold a net 4,804 contracts. We have said for weeks that the record net Trade short and the size of the unhedged 2019 crops are a major negative influence.

Amid these conditions, we continue bearish and see no magical price at which cotton's woes will be remedied. The continued deflation at retail is a very negative feature for the full supply chain and is being maintained by the overcapacity in China.

Jernigan Commodities Global, LLC and its offer of services, whether given orally or in writing or in electronic form, has been prepared for information purposes only. This newsletter may contain statements, opinions, estimates and projections provided in respect of future periods. Such statements, opinions, estimates and projections reflect various assumptions concerning future results, which may or may not prove to be correct. As a result, no representation, warranty or undertaking, expressed or implied, is or will be made or given in relation to the accuracy of any such statement made in this brochure. In particular, but without limitation, no representation or warranty, is given as to the achievement or reasonableness of future projections or the assumptions underlying them, management targets, valuation, opinions, prospects and returns, if any. Consequently the recipient of this newsletter must make their own investigations and must satisfy themselves as to the particular needs of the recipient and seek professional independent advice. Jernigan Commodities Global, LLC disclaims all liability at law and in equity from any and all damages, loss, claims, liability, costs and expenses of whatever nature arising directly or indirectly out of any act, omission or decision made by the recipient in reliance upon this brochure or any statements made by any director, officer, employee or agent of Jernigan Commodities Global, LLC.

Jernigan Global
Knowledge Is The New Capital

@Globalej

@JerniganGlobal

Eddie Jernigan

Register for Research
info@JerniganGlobal.com

ed.j@jernigancg.com

JerniganGlobal.com