



HONG KONG SOURCING OFFICES MAY MOVE AS SITUATION BECOMES MORE UNCERTAIN



PRESSURE BUILDS ON BRANDS & RETAILERS TO PULL SOURCING FROM XINJIANG



US UNSHIPED 18/19 EXPORT SALES EXCEED 3 MILLION BALES



US CHINA TRADE TALKS BEGIN AGAIN



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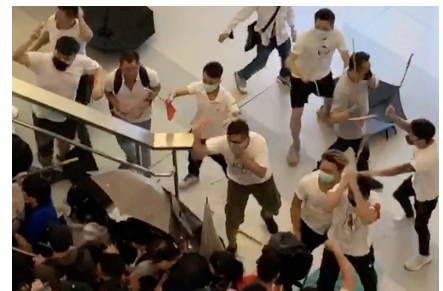
## WILL INTERNATIONAL APPAREL BRANDS PULL OUT OF HONG KONG AS BEIJING BEGINS TO APPLY THUG TACTICS?



Hong Kong arrivals terminal, July 26, 2019,  
Photo: Bloomberg



Hong Kong airport sit-in, July 26, 2019,  
Photo: Bloomberg



Protestors being attacked by Beijing backed triads

Last week began with scenes from Hong Kong were simply unimaginable, another very large march to protest China's rule and heavy-handed management turned quite violent. In the New Territory district that borders China, a Beijing-backed Triad criminal gang wearing white shirts beat and attacked protestors returning home at the Yuen Long station. The entire episode was caught on video with many people injured. The gang appeared to have some official backing, as the police did not arrive until late, failed to pursue the attackers, and made no arrest. The violence sparked outrage from all areas, including Beijing. Beijing also changed strategies and allowed coverage in China where some speculated the Triad gang was backed by China as a means for Beijing to use more force. The event has undermined the confidence in the Hong Kong police force and raised the fear they are now taking orders from Beijing.

In a broader context, the entire event has more importantly undermined confidence in Hong Kong's government. To begin with, the Triad gang attacked people as they got off the train, then entered the train and chased people into all areas. The most brutal beatings occurred against anyone wearing black, which was the color worn by people in the march. The Triad gang beat old people, young people, women, and anyone in their path. Press interviews found clear evidence that China and the Hong Kong government were behind the attacks. Some people who had close contacts to the police were told to not go to the Yuen Long station the day before, and to not wear black. The Hong Kong emergency response number was not working, and police were not to be found. People drove cars to rescue people, and the gang attacked the cars. Later in the night, the police arrived and locals videoed the police chatting with the

Triad members wearing white t-shirts and hard hats that had moved into area neighborhoods. After talking with gang members the police left, and no arrest were made. Locals also posted a video of a member of the Hong Kong legislature talking to gang members. There are calls for investigations into the role of pro-Beijing legislator, Junius Ho, and his role in the attacks. Junius subsequently issued a death threat online in a video against the legislator who made the call for investigations. Junius also went on social media and supported Beijing sending troops into Hong Kong.

All of this was followed by a shocking statement from Hong Kong police on Monday evening in which it told banks and other international companies that the police could not guarantee the safety of employees that lived in the New Territories which border China. The companies allowed workers to go home early. 1400 US companies have offices in Hong Kong, and many of the offices are their Asian headquarters. Some have already announced plans to relocate to Singapore. Singapore press has sighted a new campaign by China to call for loyalty of Singapore's Chinese population, which is causing new concerns.



The New Territory was leased from China in 1898. The Triads have their roots in the New Territory, having begun in China where they had pushed for an overthrow of the Qing Dynasty. The groups fled to Hong Kong when the communists took over. They are involved in a host of criminal activities, such as prostitution, gambling, drugs, etc. Senator Marco Rubio presented many of these facts to the US Senate last week and blamed China for the attacks. At the same time, despite all the video evidence, China blamed the attacks and unrest on US-backed gangs, which was a bit surprising given the clear evidence.

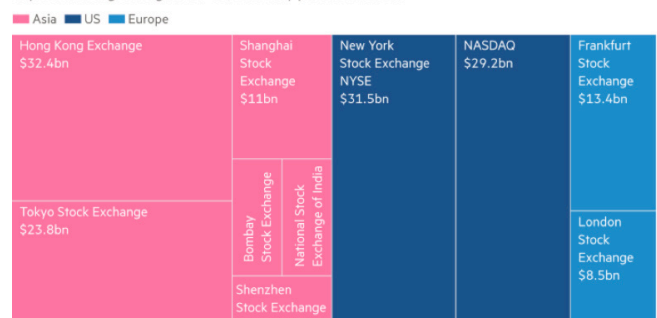
Now the ultimate goal of Beijing has come to light; **China's Ministry of Defense says the People's Liberation Army can legally intervene in Hong Kong if requested by the Territory's government.** The PLA has 6,000 soldiers in Hong Kong in 18 garrisons. Demonstrators on Monday defaced the Chinese government's emblem

with spray paint, which has drawn lots of attention, as a challenge to the Chinese authority. "These acts openly challenged the authority of the central government and touched the bottom line of the 'one country, two systems' principle," the government's Hong Kong and Macao Affairs Office said in a statement Sunday. The appearance of PLA troops in the streets of Hong Kong would likely signal an end to the Hong Kong the world has known. The unrest has taken a toll on retail sales in Hong Kong, which fell 11% year on year in the April-June quarter. June exports fell 9% from a year ago to 39.6 billion USD.

A move by China to send troops into Hong Kong would have significant economic ramifications. Hong Kong was the top global IPO market in 2018, with companies raising a record 36.5 billion USD and going public on the main Hong Kong exchange. Most of the companies were mainland-Chinese companies with the top IPO, China Tower, raising 7.5 billion USD. A total of 64.5 billion USD was raised in Hong Kong capital markets in 2018. 17.6% of the total global equity market value was on the Hong Kong exchange. A move to take troops into Hong Kong streets would endanger all this, resulting in global investors likely pulling back from the Hong Kong market. This would shut off a major source of capital. The Hong Kong market has also been a major source of capital for China's textile and apparel companies. According to the Hong Kong statistics office, 1530 international companies have their Asia regional headquarters in Hong Kong. 290 are US firms, 244 Japan, and 137 United Kingdom. In 2018, 416 firms were engaged in some form of textile manufacturing. 603 firms were involved in apparel manufacturing, and 14,290 firms were involved in textile and apparel import and export-import trade. Most of the major US and European apparel retailers and brands have a buying office in Hong Kong.

**Hong Kong leads global rankings**

Top 10 exchanges for global IPOs, 2018 (by proceeds raised)



Source: Dealogic © FT

**2018's Biggest Chinese Listings in Hong Kong**

Companies	Offer Size (million USD)	Offer Price (USD)	Close on Dec. 24 vs. Offer Price
China Tower Corp. Ltd.	7,492	1.3	20%
Xiaomi Corp.	5,429	17	-22.6%
Meituan Dianping	4,222	69	-36%
Ping An Healthcare and Technology Co. Ltd.	1,118	54.8	-49%
Jiangxi Bank Co. Ltd.	1,096	6.4	5.5%
Haidilao International Holding Ltd.	963	17.8	-2.6%
Bank of Gansu Co. Ltd.	876	2.7	-20%
E-House China Enterprise Holdings Ltd.	597	14.4	-11%
Zhenro Properties Group Ltd.	573	4	24%
Bank of Jiujiang Co. Ltd.	550	10.6	-0.6%

Source: Bloomberg



The Hong Kong firms play a major role in fabric procurement, quality control, logistics, design, and sales and marketing. Moreover, several of the largest apparel groups have also launched their own retail chains that are in HK, Asia, Australia, and China. Hong Kong retail plays a key role in global luxury sales, with Hong Kong sales accounting for 5-10% of global sales of many of the luxury brands and retailers. The demonstrations have caused stores to close and tourist numbers to fall sharply.

One of the largest worries over the handover of Hong Kong to China in 1997 was how the Chinese military would behave. The handover occurred just eight years after the PLA had opened fire on Chinese citizens in Tiananmen Square. The army manages 19 sites in Hong Kong and is headquartered in the previous British army headquarters. The troops move back and forth between Hong Kong and Shenzhen.

By the end of last week the situation appeared to move to a new heightened level, as protestors staged a sit-in at the Hong Kong airport, which is the largest in Asia. The protestors carried signs urging tourists to not trust the Hong Kong police to keep them safe.

Dressed in black, the protestors were in the arrival halls. The protest appeared to have widespread support, with Cathay Pacific Airlines flight attendants' union announcing support for the demonstrations. China is now clearly in the spotlight, as are its next actions. China's Foreign Ministry pointed to the "dark hand" of the US as being behind the movement. This was a ridiculous statement, and further undermined Beijing due to clear video evidence to the contrary which was broadcast across the media. It also became clear that China had mobilized Chinese students across other countries to attack rallies of pro-Hong Kong freedom supporters. Global headlines highlighted an attack by Beijing-supported students at the University of Queensland in Australia, where the Beijing gang broke through gates and attacked the pro-Hong Kong students. This happened as it was made public that China infiltrated many of the Australian universities with professors and money. The education of Chinese students has become a major export of Australia, and China has been increasingly using this to influence the country's higher education. The battles last week moved the issue of Beijing influence at the universities into the spotlight. China made no effort to hide its support of the Chinese students behind the attacks. Bloomberg reported, "The Chinese consulate in Brisbane issued a statement Thursday praising students for staging a voluntary patriotic rally in response to two consecutive anti-China and secessionist protests held at the university campus," according to a website run by the Communist Party's Global Times, a nationalistic tabloid.

It also illustrated how the Hong Kong fight for freedom was taking on global significance, and put the spotlight on China's hubris in attempting to trigger violence between freedom and pro-China forces both in Hong Kong and around the world. US Secretary of State Mike Pompeo called on Beijing to do the right thing. The events are all unfolding the week before China and US officials meet in Beijing for the first time since the trade talks broke down. In addition to the fate of the trade talks, a further escalation of the protest and China's reaction will have major ramifications for textile and apparel sourcing and for Asian finance sector.



# PRESSURE TO PULL ALL SOURCING OUT OF CHINA DUE TO XINJIANG CAMPS AND REPORTS OF ORGAN HARVESTING



Aksu produced socks headed for US Market, Source: Global Times



Kashgar airport organ export priority lane 2017

purchase livers for overnight delivery. In the US, it could take months or years for a donor to be found. Another group approached a hospital and asked to purchase organs, especially from Falun Gong members, and the hospitals said they were available. China was widely known to harvest organs from prisoners sentenced to death, but that was

Kashgar, Xinjiang is an oasis town located on the Silk Road, and a major center of Xinjiang's Uyghur population. In 2010, it was named a Special Economic Zone and soon became a major center of textile and apparel investment. The city has a long history of over 2,000 years, and has been the scene of many battles. In 711, it was conquered by Arab Muslims for a brief period. It is also part of the Xinjiang cotton belt. Visiting the Kashgar airport, one will see the above photo of a special priority line. The sign is written in Chinese and Arabic and reads, "Special Passengers, Human Organ Exportation Lane." The lane was to be left open for the speedy transport of newly harvested organs for export. The Chinese government does not appear to fear any international repercussion, and is promoting human organ exports. The Chinese Minister of Health announced that human organ exports are part of the One Belt-One Road. Investigations have found that China's statements that the official reports of voluntary donors are incorrect. Investigation by Human Rights Watch found that China had build a massive organ selling business through its hospitals that one estimate places as worth 10 billion USD. Human Rights Watch found that China has mandated that all Uyghurs, Christians, Tibet Buddhists, and others, such as Falun Gong members, have a medical exam where blood types, DNA, fingerprints, and eye color are put into a data base. This is then used to allow just-in-time harvesting of the needed organs.

ended, according to the Chinese in 2015. The current effort is reported to have its roots in an order from Jiang Zemin to persecute the Falun Gong movement, which began the mass arrest. This was expanded to the Uyghurs, Christians, and Tibet Buddhists.

As inhumane as all this sounds, it has been documented. In a *Wall Street Journal* research piece, it was reported that a journalist and team of researchers traveled to China and posed as buyers of organs. They arranged to

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This organ-harvesting scheme has only now received the press it deserves, as the entire Xinjiang prison camps and forced labor programs have become known. Until now, there has not been any serious effort underway to hide it, as exhibited by the special priority lane at the Kashgar airport. Last week on social media, a campaign began to call for a boycott of Chinese textiles and apparel linked to Xinjiang, citing the forced labor and organ harvesting. The repercussions from the ABC broadcast special have continued to expand, with several major retailers pressured over their sourcing at the factories using forced labor. The investigation identified a major US brand and retailer that was sourcing one of its apparel brands from a Xinjiang-based Chinese company. The Chinese company also had a promotional video in which it said it provided apparel for the group, and Chinese media had covered a story in which it promoted the company as having a re-education center. The ABC investigation caused the promotion video to be taken down. Overall, it appears companies are canceling and pulling out of sourcing from plants that are clearly in Xinjiang. The second debate involves whether a company can be confident that its supply chain is safe from Xinjiang forced labor production, which is extremely difficult due to the lack of transparency and traceability in the supply chains and the use of sub-contractors. Sub-contractors are used widely in the textile and apparel chain, because of its complexity and because it gives everyone deniability. Only a traceable, verified supply chain offers protection. Adding to the anxiety of retailers and brands is the fact that several of the firms which advertise that they were manufacturing for US brands and retailer were in fact not sourcing for these companies and pulled the promotional videos.



*Xinjiang apparel plant, Source: Global Times*

The Chinese press is not reporting on the obvious impact of the reeducation/prison camps on business, but is covering the slow down in orders. The *Global Times* carried a lengthy article on the cancellation of export orders of Xinjiang textile and apparel exporters

due to the US/China trade war. The report was focused on the impact of the trade war on companies operating in the giant Aksu Industrial Textile Park, which has approximately 100 companies operating facilities and is the largest textile industrial park in Xinjiang. The park has attracted massive investment with just little less than one billion USD in subsidy investments by the local Aksu government. The park includes what is referred to as the world's largest colored cotton yarn spinning mill.

The issue is building momentum. At Texworld in New York City last week, panelists were asked about the impact the camps were having on sourcing. The panelists were at first reluctant to talk about the subject for fear of it causing trouble when they returned to China. It is forbidden to talk about it in China. They did say that the issue was beginning to cause havoc in the supply chain and affect orders. The problem stems from the fact that China has high market concentration in several products, with few if any competitors, and Chinese companies produce excellent quality in a highly efficient supply chain. Vietnam is reported to be nearing capacity, and the rapid expansion is now leading to a shortage of workers, which is affecting quality. Wages are rapidly rising due to the number of different industries moving to the country. Ports are also nearing capacity.

For cotton, the challenge is to not let the Xinjiang camps become always associated with cotton textiles and apparel. So far, the cotton industry has been silent, as has much of the textile apparel chain. The fact that one out of five bales produced in the world come from Xinjiang makes this a cotton problem. We estimate that, currently, China's annual cotton consumption in Xinjiang alone has been reduced by two million bales from the dual impact of canceled export orders and weaker domestic demand. The potential is for a much greater impact, as the consequences of the labor/prison camps is felt. Up to now the weakness has been due to switching of orders and weaker demand. One major Xinjiang manufacturer said his order book for deliveries past mid August would drop 70%, while another stated he just received an order cancellation of approximately six million USD for a second-half 2019 shipment. Many of the companies are reported to be willing to cut prices to keep the order, hoping the boycott of Xinjiang textiles and apparel will fizzle.

The situation is not good for anyone. For brands and retailers, Xinjiang cotton is the highest quality in China and the only producer of ELS in China. The Chinese companies offer high quality products at very competitive prices due to the subsidies. For the Chinese companies, the scandal will cost them millions and endanger their order flow and reputations far into



the future. Both the companies and the government have invested billions of USD in the subsidies and infrastructure. Where else in the world could such a modern infrastructure be built in one of the most

remote regions on earth? For the people being imprisoned, history shows such efforts always fail and have a lasting and devastating impact on all.

## US CHINA TRADE TALKS RESUME THIS WEEK IN BEIJING



**ICE** cotton futures recovered last week as hope once again grew that China/US trade talks were making headway and that China's promise to buy a large quantity of US farm products was beginning. China has said that any purchases would be based on actual request and demand from Chinese companies. Last week, a meeting was held with companies that requested exemptions for the importation of US agriculture products. It was believed in trade circles that China granted exemptions for purchase of US Soybeans, Corn, Sorghum, Pork, and Cotton. Since the meeting, China said it has approved exemptions for purchases of 2-4 MMT of US soybeans. There was no official mention of cotton, but the US cotton industry submitted information to make the case for US cotton to get an exemption. US officials during TV interviews on Friday stated the US was expecting large purchases of US agriculture products shortly, which would be much greater than the 2-4 MMT of soybeans. The Chinese cotton trade believes approximately 50,000 tons, or 124,725 bales, of US cotton has been approved for the exemption. It appeared that such purchases are now a requirement to move the talks along. The US side, also through back channels, indicated they were feeling betrayed by the lack of purchases following the Argentina meetings last December, in which China indicated they would immediately start purchases. That, of course, did not happen, but for a few token purchases.

Cotton and soybeans have experienced a small rally

off their lows, but neither market appears to be really putting a lot of faith in major Chinese purchases or a return to the status quo. However, in cotton trade circles it is rumored that some sales occurred last week when prices fell below 62/62 cents, and will show up in future sales reports. No clear indication has surfaced regarding the large volume of 2019/2020 crop sales that were completed at prices 20-25 cents a lb. above today's prices. The weekly export sales report can be managed in such a way that new sales could be made and then old sales canceled much later. Merchants are also working around the clock to resolve and find solutions to the competition of high-priced unshipped export contracts. It is clear by the lack of selling at the current levels that the Trade is banking on some sales and announcements to spark a short covering by the record Funds short position. China's ZCE futures closed with small gains for the week but showed no real excitement over a near-term breakthrough in trade talks. China cotton imports in June were 160,000 tons, which means at a time of weaker than expected domestic cotton demand, the unsold domestic stocks continue to hold at record levels, as preparations for new crop harvest in Xinjiang begin. The entire Chinese industry appears to continue to believe the Reserve will buy the excess old crop before new crop procurement begins, or buy new crop or a combination. The record volume of unsold port stocks remains unresolved. Chinese polyester fiber and viscose fiber prices last week turned lower, with polyester staple fiber prices returning to near 50-51 cents a lb., a 12% decline from

the G-20 highs. Viscose fiber has fallen about a cent a lb., to near 76 cents a lb. over the same time frame.

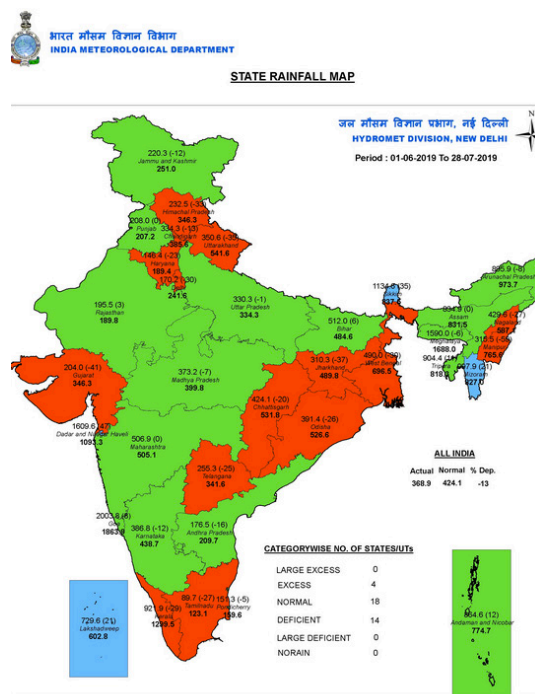
As the trade talks get underway this week, a number of major issues loom that could derail the talks just as they begin or place significant obstacles in their path. First, the rapidly evolving situation in Hong Kong, and second, the Xinjiang labor/prison camps and possible organ harvesting. Third, there is the South China Sea, where China and Vietnam are now in conflict, and fourth, Taiwan, and fifth, Huawei. There were rumors all last week that China had demanded some real export relief concerning Huawei, while the US Congress appeared to fear some kind of concessions by the administration, and was moving to set up road blocks to prevent him from making a deal based on

national security grounds.

This week was yet another week with all the attention on the US/China trade talks. Late Friday, President Trump added to the drama with a White House press briefing in which he said he thought China would wait until after the 2020 US election to complete a trade deal. Any such delay will further hasten the move of supply chain from China and provide the stimulus for new investment elsewhere. For US cotton, it confirms very weak export prospects for the 2019/2020 and 2020/2021 seasons. The US cotton sector is unprepared for such an event, as is most of the global industry. It is clear from every indication that many expect a return to post-June 2018 conditions, which seems impossible.

## INDIA'S MONSOON RAINS AGAIN DISAPPOINT, AND CRISIS EXPANDS IN GUJARAT

The 2019/2020 monsoon has been very disappointing, and the final 45-day period for the monsoon is here, which means only a delay in its withdrawal will save some crop areas. In the state of Gujarat, 2,250,470 hectares of cotton was sown as of July 22nd, with 1,590,200 hectares sown in Saurashtra and 47,800 in Kutch, or nearly 73% of the total acreage. This region is suffering a major drought, and last week there appeared to be a good chance of rain, but only an average of 33.9 mm, 30% below normal, was reported. The season-to-date rainfall is 55% below normal. The balance of Gujarat only received 28.2 mm last week and is 41% below normal for the season. The largest cotton districts in Gujarat are in serious trouble. The Surendranagar district planted 273,100 hectares so far, and rainfall is 46% below normal. Rajkot planted 256,900 hectares, and they are also 46% below normal. The Amreli district planted 402,900 hectares and has received 30% below normal rains, and Bhavanagar planted 233,400 hectares and recorded 24% below normal rains. The small 47,800 hectares in Kutch is likely lost, with rainfall 83% below



normal for the season.

Overall, the monsoon in India has been deficient in 19 of 36 districts, and the cotton belt has been near or below normal for the season. Rainfall in Maharashtra is only 8% below normal, which included the coastal area where little cotton is grown. In the main, three cotton districts Madhya are in the best shape, with rainfall only 8% below normal. However, in the largest cotton area of Marathwada, rainfall is 38% below normal. In Vidarbha, rainfall is 38% below normal, and this is the poorest yielding area with poor soils, so such a deficit has already hurt yields. The very important southern state of Telangana is suffering a

33% drop in rainfall so far for the season.

As we have discussed before, the Indian crop is late, so imports will be required well into crop movement. If the premium to local prices continues, so will imports given the higher MSP. We continue to fear the crop will fall to near 30 million 170-kg bales. As we go to press, the Weather Bureau has forecast that the monsoon will turn active over Gujarat July 29-30, which would be very welcome. Rainfall will be crucial across all

the deficit areas. It will allow additional planting and prevent further crop losses.

India has purchased a record volume of US Pima in 2018/2019, taking 212,300 running bales, which make it the second largest buyer. ELS consumption is booming in India with US and Egyptian styles. US retailers and

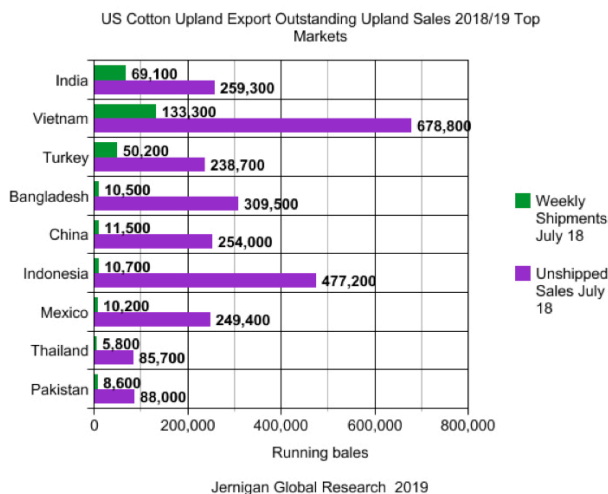
brands are using India for sourcing and incorporating a traceable supply chain. India has also purchased 43,200 running bales of US Pima for 2019/2020 shipment. Total upland cotton purchases continue each week, and purchases now total 1,201,800 running bales, with 942,800 bales already shipped.

## US EXPORTS SHIPMENTS SUGGEST A CRISIS IN UNSHIPPED SALES AS TOTAL NEARS THREE MILLION BALES

US export shipments have been disappointing for months, and now the greatest fear is being realized. The final week of the season is here, and only 1.857 shipping weeks remain to be reported. Total exports appear set to fall about 600-650,000 bales short of the USDA export target. That is one problem that will give the US the largest ending stocks in ten years. The real crisis, however, is the 2,938,100 bales of upland which remain unshipped, a volume which is nearly a third larger than a year ago. When Pima is added, the total swells to 3,102,837 bales. For some time we have been warning that as much as two million bales of cancelations or roll forwards with lower prices is possible. This is now a reality, and the shipment volume in the latest week to many of the markets with the largest outstanding volume was far below the levels, which suggests these sales will never be shipped. We will review each of those markets with sizeable outstanding unshipped sales.

Regarding Pima, 86,600 running bales remain unshipped, which is nearly double that of a year ago. The only likely trouble spot is China, where 19,200 bales remain unshipped, and no bales were shipped during the latest week. India has 36,500 bales unshipped, but we believe this cotton will ship. Upland is where the major trouble lies. Mexico appears to be a trouble spot, likely tied to very high-priced forward sales that have not been resolved. 249,400 running bales remain unshipped to Mexico. The largest volume of unshipped upland sales is to Vietnam, and this is in part due to the record export sales of 2018/2019. As it currently stands, 678,800 running bales remain unshipped, while 133,300 bales were shipped in the latest week. Most of the sales appear to be normal carryover forward sales, with only a small volume likely to be canceled.

Thailand seems to be another problem area, with 85,700 bales unshipped and only 5,800 bales shipped in the last week. Thailand is a small consumption market. Total cotton imports from August-June have



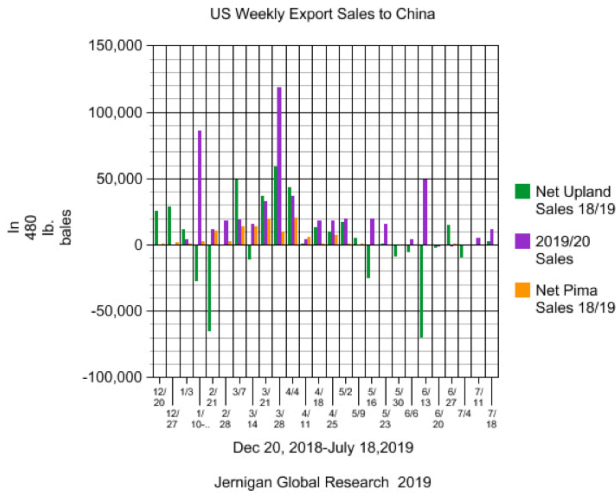
reached only 215,727 tons, which is 6,867 tons below a year ago. Thailand had been expected to consume 1.125 million bales, and imports have reached 991,158 bales with two additional months left in the season. Thailand was an additional buyer of 7,400 running bales of upland in the latest week, which suggests that a large block of the outstanding sales will be canceled because of price. Pakistan has 88,000 bales unshipped, and shipments were light in the latest week, with only 8,200 running bales and new sales of 9,500 noted. This suggests that approximately half the outstanding contract will be honored and shipped and the balance canceled or rolled into new crop with price adjustments.

As we discussed weeks ago, Indonesia is a major trouble area, with a total of 477,200 running bales of upland unshipped and a mere 10,700 running bales shipped during the latest week. This volume of unshipped sales also reflects about 16% of the expected total 2018/2019 consumption. It is likely that most of the sales will be canceled. Bangladesh is another area of concern due to 309,500 running bales of upland remaining unshipped. Recent shipments have been very light, and Bangladesh has been buying very expensive (basis contracts) of African Franc Zone cotton. This



indicates that mills have very limited forward coverage and are not expecting to receive near this volume of US shipments anytime soon. Bangladesh mills have experienced issues with yarn prices that have been influenced by illegal imports of Chinese fabric, which has made it very difficult to fulfill outstanding high-priced contracts. Thus, at least 60% or more of these contracts are likely to be canceled.

weak at 11,500 running bales, leaving 254,000 bales of upland unshipped. It's unclear how any trade discussions would impact these sales. They were all made at very expensive levels, which suggest they will be canceled or rolled forward. India and Turkey also have large blocks of outstanding sales, but these are likely to eventually be shipped. The large outstanding volume of high priced US export sales has created a range of issues. If the spinners simply default, they face ICA default issues, which will affect their abilities to operate normally with ICA members in the future. If a default occurs, the contract will go to arbitration, and if the spinner fails to pay the judgment they are placed on a blacklist. Therefore, all sides will attempt to reach a settlement either through arbitration or in forward sales. Such a large volume is very unusual, and the Trade's net short position in futures and options indicates the sales hedge short was lifted. This means large losses are being dealt with.



As of July 26, 2018, near the time the Chinese tariffs on US cotton began, the US had already sold a very hefty 6,540,800 running bales of 2018/2019 forward new crop sales of upland and 192,300 running bales of Pima. This was one of the largest forward sales on record before the start of the season, and much of the sales were done at CFR prices of near 90-100 cents a lb.

Shipments in the latest week to China were extremely

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## ICE FUTURES CLOSE HIGHER FOR SECOND STRAIGHT WEEK

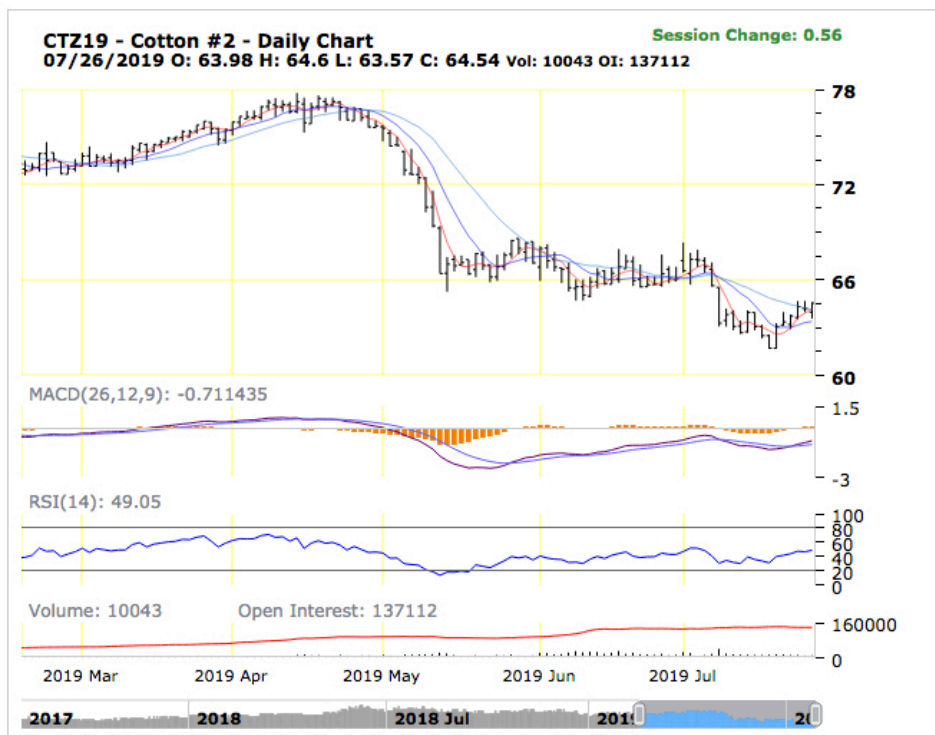
ICE futures and China's ZCE futures both have been buying time for two weeks, followed by a renewal of hope that a US/China trade deal can be achieved. This puts the market in a very nervous position. The Managed Funds added a few additional shorts in the latest period, with the net spec short at a new record of 45,200 contracts. The support during the past two weeks has come from mainly Trade buying associated with new export sales. No notable net Trade selling has occurred, and the net trade short in the latest week fell to another record low of 2,757 contracts in futures and options combined, or only 275,700 bales against a hedgeable universe of more than 30 million bales. The large volume unhedged remains one of the greatest negatives facing the market. It appears that selling interest has been at a standstill at current prices, and the Trade has been willing to wait out the Chinese/US trade negotiations. The negotiations are about to start back. The Trade seems to expect some near-term US cotton purchases as part of a Chinese goodwill move. We will see if this occurs. The hope appears that such purchases will trigger a massive round of Managed Funds short covering, as most of these Funds have trading triggers linked to Algo systems that are set off by certain words in news headlines. This makes any announcement of Chinese cotton purchases through a goodwill effort crucial. As for the trade talks, some success will be critical for the long-term movement of the Funds. This adds a lot of uncertainty to the

outlook. Late Friday, President Trump said the Chinese may wait until after the 2020 US elections to complete a trade agreement. Such a delay would have major long-term ramifications for prices, and also on how the Trade manages the record volume of unhedged 2019/2020 crops. Last week, some West African selling organizations held sales tenders, but the impact was very limited and at high basis levels.

The USDA announced its trade aid package for US growers, and the details indicated the cotton belt areas of the South and Texas received the highest per-county payment rates. The West Texas region received the highest payment rates, which ran up to approximately 14 cents a lb. Generally, cotton growers were pleased with the payment rates compared to the largest soybean and corn counties. The US crop is developing well, and many areas are on track for much higher yields than 2018. Some could be records. Moisture levels are good in almost all areas, and there has been no heat stress, with many areas of the south having much cooler lows, allowing the plant to cool down before warming up. The higher yields plus the higher-than-expected payments suggest farmers may increase selling as the yields are confirmed.

US cotton in the type offers remain the cheapest in the world, and Brazilian are at a small premium, which means these crops are dominating the bulk of trade.

Spinners appear to lack long-term confidence in prices, but an increasing number of spinners are willing to extend coverage for the rest of 2019 at current basis and FOB levels. It looks as though the market is in a period of consolidation, with the next major move depending on sizeable new Chinese goodwill purchases or the lack of them. The Managed Funds appear at a crossroads as they near 50,000 contracts net short. The 50,000- and 100,000-contract levels have been important reversal or staging points in the past. The global markets are clearly in uncharted waters. In Europe, the July PMI for manufacturing was again



weaker, and the ECB said it was ready to loosen further. The negative yields on European debt hit new highs, while the Euro declined against the USD. The US Federal Reserve is expected to cut interest rates, and US growth in the last quarter was below expectations because of manufacturing. All of this is keeping deflation an issue, and the Funds could use these and disappointment in trade issues to move to a 100,000-contract net short.

The trade is clearly looking at the past behavior of the managed funds when they have moved net short. In most instances, the Net fund short was small and short in duration. The Net short has already been extended much larger than ever before. The current technical outlook has improved, with the December

chart forming a possible head-and-shoulders bottom. Therefore, a positive sales announcement, Presidential tweet, etc., could trigger an Algo-induced move into the 65.50 area, which may prompt a wave of Managed Funds buying that could take Dec into the 67.50-68.00 area. It remains to be seen if these developments occur. The Trade will need to sell the rally, and thus the level at which it begins to intensify will determine the degree to which the rally can extend. Cotton has been in a free fall since May, falling nearly 16 cents, with the only rally very brief and mostly in the form of consolidation. The timing seems right for maybe a correction. However, the current environment is unusual, to say the least, and the market's dependence on Chinese demand is a real concern.



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