



INDIAN MONSOON ARRIVES LATE/WATER SUPPLIES CRUCIAL



COTTON GAINS MARKET SHARE IN KNIT SHIRTS



US 2019/20 COTTON EXPORTS A MAJOR CONCERN



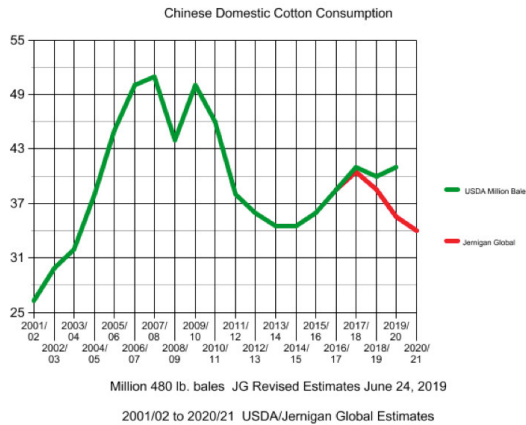
CHINA EXPERIENCES A BLACK SWAIN EVENT



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CONCERN REGARDING CHINESE COTTON DEMAND INCREASES AS SPINNERS REDUCE OPERATIONS

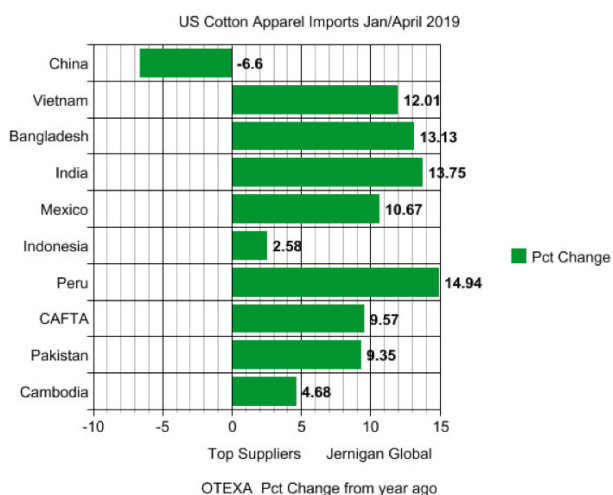


All the evidence suggests that cotton has lost additional market share to polyester, as mills have chosen to increase polyester fiber use following more than a 40% decline in prices from the recent highs. At the same time the spread between domestic and imported cotton and polyester fiber prices has reached 40-50 US cents a lb. in recent weeks. Order books have also experienced a sharp fall for all textile and apparel products, and cotton apparel demand has actually been weaker than that for polyester fiber. Brands and retailers have turned to other suppliers for cotton, while maintaining man-made fiber apparel orders, due to the aggressive prices available. China has 70% of global polyester capacity and the cheapest fiber prices in the world. The record investment in new capacity means the balance of the world does not have the capacity

to immediately replace Chinese orders. Brands and retailers are rapidly turning to other suppliers for cotton apparel with Vietnam, Bangladesh, India, CAFTA, Mexico, and Pakistan specifically benefiting. January-April cotton apparel exports to the US, the largest export market, has experienced a 6.6% drop, while imports from Vietnam are up 12%, Bangladesh +13.13%, and India +13.75%. Chinese exporters have also lost market share in the European market, which also appears heavily concentrated in cotton apparel. Total exports to the EU fell by 10.2% in the first quarter, with orders being switched to Bangladesh and Turkey.

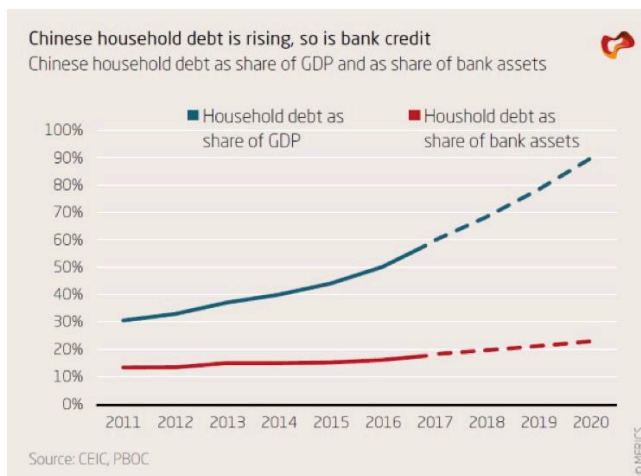
Another factor affecting cotton apparel export orders from all destinations, especially such international brands such as Nike and Adidas, are the orders being

pulled from companies that are using companies in Xinjiang, after press reports exposed the use of forced labor from reeducation/concentration camps in the Xinjiang textile plants. Xinjiang cotton yarn production is expected to be down nearly 30% in the second quarter of 2019. In addition to the export weakness, the domestic market demand has turned soft due to food inflation changing consumers' spending patterns. The Cotlook Textile Purchasing Manager Index for China plunged in May to a record low of 34.19, which reflected a 10.66% decline from April and a record since Cotlook started calculating the PMI in 2016. Any number below 50 indicates a contraction. Prior to the trade war the PMI had exceeded 60.

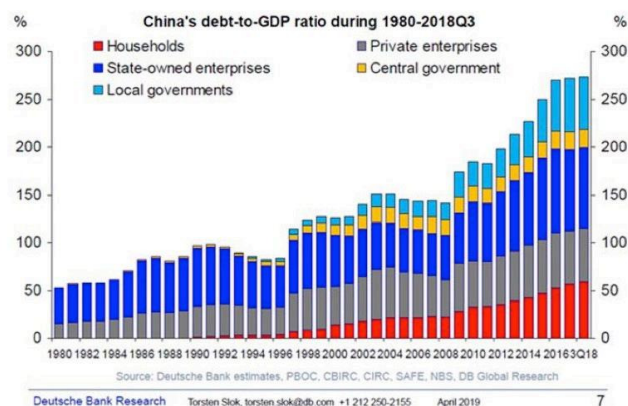


There is also financial strain in the system, with companies facing difficulties in obtaining credit. The collapse of Baoshang Bank, which was called China's "Bear Sterns Moment," has triggered a liquidity crisis for smaller banks. Baoshang's failure was followed by the Central Bank also having to step in to support the Bank of Jinzhou. The situation was serious enough last week for government regulators to call a meeting with the involved parties to discuss the continued provision of credit for smaller banks. In the first quarter of 2019, non-bank borrowing through bank repos and interbank loans surged to a net 74 trillion RMB or 10.7 trillion USD. In the second quarter, a number of banks and firms have been shut out of this market and cannot raise cash. The one-month repo rate moved from 2.9% to 5.2% since the Baoshang bank takeover.

Most of the major Chinese textile and apparel companies have gone to the public equity markets to raise the needed funds, with shares trading in China or Hong Kong. The company that dominates the lower priced apparel markets in the second and third tier cities is La Chapelle, which has 9,625 stores and is traded on the Shanghai exchange. For the year ending



Mercator Institute for Chinese Studies



April 30, 2019, it reported a 94.4% drop in net profits, and its shares have declined from 8.28 RMB a share just prior to the trade war to a low of 3.61 RMD. This company is known as the "Zara of China," and its profits and share price suggest a very weak domestic apparel market. A withdrawal of Chinese buyers from the Australian wool market also reflects weakness in the middle and upper class segment of the market. Wool products have been quite popular with middle and upper class Chinese shopper. The AWEX Eastern Market Indicator for domestic wool prices in Australia, the best global benchmark for global wool prices, fell 3.38% in USD terms last week and is now down 21.4% from the pre-trade war highs.

Weiqao Textile, located in Shandong, was the largest cotton spinner in China at one time and remains a major spinner and importer of cotton. The company was founded by Zhang Shiping, and he was listed on the Forbes Chinese Billionaires list before passing away this year. It is publicly traded in Hong Kong, and its shares are also under pressure, trading today near a 52-week low of 3.45 HK dollars a share, which is down 38% from



La Chapelle Fashion Share price, Shanghai Exchange “China’s Zara”

the recent high and near 50% of its value in 2016.

Heilan Home is the second largest textile and apparel company in China, with a large number of retail stores. It is included in the MSCI Emerging Markets Index, one of the five Chinese companies chosen for the index, which means it is a recipient of foreign funds. Its shares traded at 12.80 RMB a share just before the trade war. Today, however, its shares are at 8.79 RMB, which is up from a 52-week low of 7.44. Texhong Textiles, headquartered in Hong Kong but with operations in China, has seen its shares fall from 13.86 HK dollars a share to a low of 8.16, and is currently trading at 8.90 HKD. Crystal International, also headquartered in Hong Kong and one of the top five largest apparel companies in the world, has seen its shares fall from a 52-week high of 7.06 HKD to a low of 3.05, and are currently at 3.75 HKD a share. Shandong Ruyi Woolen Garments, a parent company that is one of the top five largest textile companies in the world, is headquartered in China and owns several major international brands, including Bally. It trades on the Shanghai Exchange. It too is experiencing a slowdown, as its shares have fallen from a 52-week high of 15.89 RMB a share to 8.22, before recovering to 8.58 RMB a share.

The weakness in these companies’ shares, which represent some of the largest textile and apparel manufacturers and retailers in China, indicates the sector is experiencing a very tough period. The weakest performance was by a company focused on domestic apparel retailing, La Chapelle, and not exporters. Its performance and drop in profits suggest major problems with domestic consumer demand. This company is one of the largest apparel retailers in China and focuses on the low to middle income consumer. This is the most vulnerable consumer and the first to



Heilan Home Share Price

have his shopping habits influenced by the rapidly increasing food inflation and job losses. Data suggest that this demographic accounts for approximately one billion people of the total population of 1.4 Billion.

Retail sales of apparel in May declined for the second month in a row, falling nearly 1% to 104.41 billion RMB or 15.08 billion USD. This represents the weakest retail environment for apparel since the opening of the domestic market. There has been much press given to the rapidly growing middle class and luxury market in China. A much larger part of the market is away from the ultra-modern city of Shanghai, and is focused on the starter consumers and lower-tier buyers. Much of the business is done online and is focused on cheap apparel. Taobao, owned by Alibaba, is the largest online apparel market where manufactures sell direct to the consumer online. This consumer has been hurt economically, and their spending has been impacted. The weakness in domestic demand appears to be just as large a driver in the collapse of textile and apparel demand as the weaker export market.

The weakness in the export market has been more focused on cotton apparel, because companies have begun to rapidly move supply chains out of China, as they have been able to switch to other locations. In many man-made fiber products, other sourcing options are much more difficult to find. The tariffs on man-made fiber apparel have not yet been applied, so the order flow from the US has continued. The only real change has been a slowdown in the growth of shipments and a sharp increase in the volume of man-made fiber apparel from the markets such as Jordan and Ethiopia that depend on Chinese fabric.

China simply dominates the US market in man-made

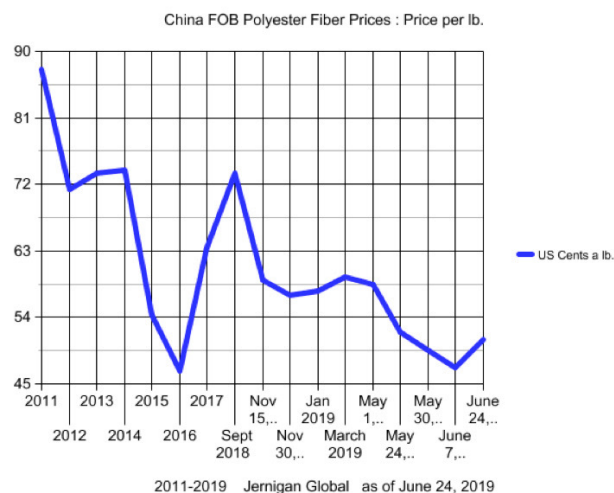
fiber, where it provided 42.75% of all man-made fiber apparel imports in January-April, and imports have reached 6.460 billion USD, up .66%. Imports from countries that rely on Chinese fabrics have soared, with total market share of man-made fiber apparel made from Chinese fabric now exceeding 66% of the US market. Thus, the US is playing a role in helping to accelerate the market share of man-made fiber in China. So far, the environmental message and liabilities have been totally ignored. The final round of tariffs on Chinese imports, if applied, will increase the cost 25% on a wholesale basis. Despite the media hype, this cost will likely be absorbed by the retailer and Chinese exporter. The export market is so weak and the polyester market is extremely soft, so the increase will have limited impact on man-made fiber apparel from China. However, the application of a 25% duty on cotton apparel will lead to these orders being switched to other destinations. If the final Chinese imports into the US have the 25% duty applied, there will be several consequences. First, cotton consumption in China will weaken further as brands and retailers switch to other locations. Cotton yarn import demand will also turn softer. China's heavy domination in the man-made fiber sector provides retailers with very limited sourcing options. The main impact will likely be reduction in China's man-made fiber apparel exports and a further expansion in man-made fiber fabric exports to cut and sew locations. Locations such as Ethiopia, Burma, and Vietnam will experience additional rapid growth in exports to the US, as Chinese fabric is used to cut and sew apparel in these locations. They then receive a local made label, thus avoiding the tariffs.

The comment period on the proposed tariffs got underway last week, and the US Chamber of Commerce and approximately 600 companies came out against the tariffs, while a much smaller number supported the application of these tariffs. The US Chamber, a powerful lobbying group for US business, has become one of the strongest advocates for China, as it continues to protect the need of companies to source from the cheapest locations. This group and Chinese exporters all experienced new hope for a trade deal after it was announced and confirmed by both sides that the US and China would meet at this week's G-20 summit in Japan. Man-made fiber prices and ZCE cotton futures both rallied as a result.

Meanwhile, yarn and fabric mills across China have further reduced operations and are reporting a buildup in unsold inventories. Yarn prices have been quite weak, and yarn importers report that the high-priced yarn import contracts signed in April and early May are being renegotiated. Imported yarn in bonded warehouses has also seen a rise in unsold stocks. In

the Eastern belt, some mills are not shutting down, but only reducing running times for fear of permanently losing workers. Poly/cotton yarn demand is especially weak. Demand for ELS cotton has also turned very weak for both domestic and imported. ELS spinners are reported to be using an increasing amount of long staple Australian high grades when possible. The switch accelerated in May, with increased offtake of Australian at the expense of US Pima. Chinese traders face large losses on unsold inventories of domestic ELS cotton. Unsold stocks of ELS are estimated to be near 42,000 tons, and much of this inventory faces a loss of 1700-2000 RMB a ton, or near 13 cents a lb. or more.

A small number of Chinese mills have returned to the market for a few lots of Brazilian new crop. Stocks at the bonded warehouses are large, and demand is poor. Chinese traders are holding large losses on many of these stocks. Consignment stocks work well when demand is steady and sellers can command a premium for immediate delivery with no delay. However, when demand is slow, the cotton is out of position and very expensive to move. Thus, the seller is at the mercy of the local buyer. Chinese traders last week were aggressively seeking bids, but, unfortunately, buyers' confidence has been shaken.



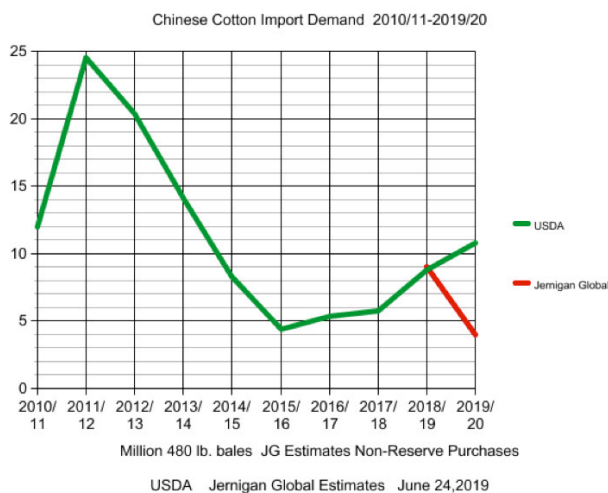
There are fears that import demand will be very soft in the second half of 2019 without a great trade deal. Even then the sourcing patterns for cotton apparel will continue to move out of China, reducing consumption. A larger portion of the cotton use will depend on domestic demand, where it faces heavy competition from polyester in the lower two thirds of the market. Another unknown haunting the market is whether or not the shortage of US dollars in China will influence the Reserve's decisions or allocation of USD. Political pressure is building for the Reserve to purchase unsold old crop cotton inventories, which requires no USD

and only reflects an internal credit cost. The USDA has Chinese cotton imports increasing to 10.5 million bales in 2019/2020, up from 8.750 million bales in 2018/2019. The import level could be half that in 2019/2020 if the trade dispute continues. This, of course, will have a significant impact on world trade and make it extremely difficult for both Brazil and USA to meet export targets.

The only positive news last week from the Chinese market was that man-made fiber prices were steady, with a small increase noted in polyester staple fiber prices. Demand for recycled polyester is weaker than virgin, with the price spread narrowing to 200-300 RMB a ton. In September 2018 it was 2,000 RMB a ton. The weakness is linked to new capacity, the weaker export market, imports, and the very inconsistent quality of recycled polyester versus virgin poly. Overall, polyester staple fiber prices have traded 4-5 cents a lb. off the recent lows, but the rally is fragile. Fears continue regarding the continued overcapacity, with new plants expected to come online in the second half of 2019.

The massive flow of cheap loans and subsidies into the petrochemical and man-made fiber sector since 2008 has now set the stage for a massive shake-up in which only a large scale shutdown of capacity can return the segment to some balance.

Chinese cotton demand remains a major concern for us, as confidence in the entire supply chain has been shaken. For the first time the industry appears to understand that there is not going to be a return to the status quo any time soon. Longer term, the supply chains are moving and will not return, except to produce for the domestic market. The first part of the supply chain, spinners, are idling capacity, and their return online will depend on some stability to trade and for the domestic market to find its confidence again. The Chinese consumer appears nervous, and the lack of access to accurate information appears to be making it worse by allowing rumors and word of mouth to trigger decisions. Increased purchases of gold and foreign exchange are being noted. The problem is also being made worse by the massive overcapacity and the fact that the motto, "build it and demand will come," is no longer working. Small declines of 1-2% in demand have major ramifications and feed on themselves. The reason is that new capacity increased the supply by 10-15%, which gives the illusion that the sky is falling. In much of the world, conditions would stabilize because an open press, widespread blog discussion, or open debate would allow a true picture to emerge. In China, the attempt to muzzle all unapproved comments, even in the financial press, has left consumers with only rumors and street talk as their source of information. Widespread reports surfaced as the week ended of police checking phones at train stations in an attempt to block any viewing of unapproved web sites. This is also shaking confidence and prompting questions on why the government is so insecure.



HONG KONG DRAMA INCREASES AS FURTHER BREACHES OF TRUST OCCUR



Hong Kong Fight for Freedom 2019

June 16th brought the largest protest yet of Hong Kong citizens out in to the streets, as an estimated two million people protested against China's heavy-handed policies in Hong Kong. The protesters called for Carrie Lam, Chief Executive of Hong Kong, to step down. The general level of distrust has increased as it became known that Chinese security personnel were dressed in Hong Kong police uniforms and were participating in crowd control. The soldiers did not understand Cantonese and were believed to be from the PLA garrison stationed in Hong Kong. Then came confirmation that the Hong Kong Hospital Authority had shared injured protestors' information with the police, which facilitated their arrest. These developments did nothing to calm the situation, and new concerns emerged that the situation had already begun to trigger a new exodus of wealth out of Hong Kong.

Hong Kong has 853 citizens, with a net worth of over 100 million USD, compared to 425 in Singapore. The city state is heavily focused on bank assets, with an estimated 900% of its GDP in bank assets and a 300% private credit ratio to GDP. Banking executives reported several large transfers of wealth out of Hong Kong over the past week. The number one location was Singapore. The reason for this was that the companies now fear Chinese encroachment on the rule of law in



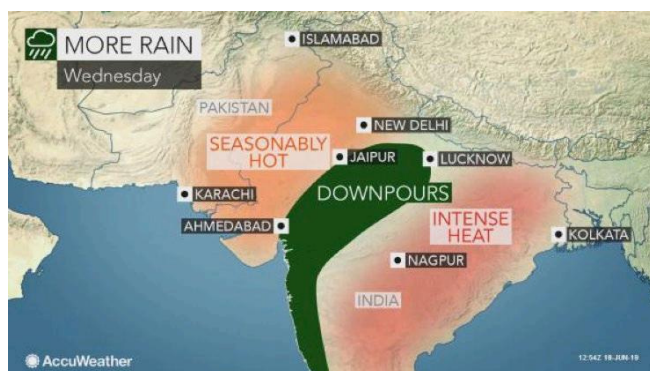
Hong Kong Fight for Freedom 2019

Hong Kong, and the seizure of assets.

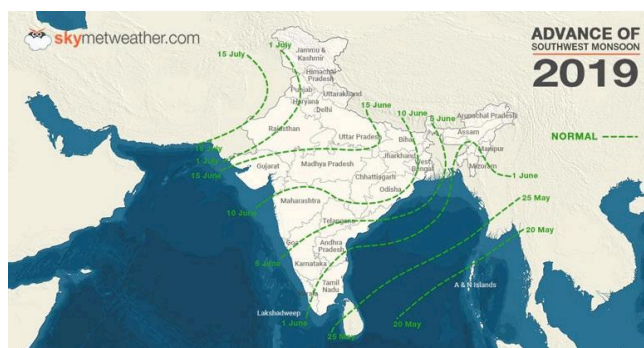
Hong Kong has played a significant role in the financing of China's growth. Since 2012, Chinese companies have raised 156 billion USD from equity floats on the Hong Kong exchange, compared to 143 billion on the mainland exchanges, and 48 billion in the US. Hong Kong has also been used to raise USD from USD bonds.

Another area of concern is the impact of the unrest in Hong Kong on the luxury product market. Bloomberg estimates that eight major luxury brands, which include Burberry, Kering, and LVMH, depend on Hong Kong retail for 6 to 11% of their total sales. As last week drew to a close, the protesters returned to the streets of Hong Kong, as confidence has not been restored and the concern over China's violation of the 1997 handover accords has increased. Making the current situation different from any before is the fact that young Hong Kong citizens realize that the window for the entire agreement is narrowing, and they could face Chinese direct rule later in their lives. A major Communist Party official has been quoted as saying the 1997 handover agreement had little legal meaning and was mainly of historical value. Such comments only confirm many suspicions.

INDIAN MONSOON DELAYS REMAIN A CONCERN; CYCLONE VAYU BRINGS ISOLATED RAINS



Cyclone Vayu Path, June 18-19, 2019



India normal monsoon dates, 2019 monsoon now late

The Indian monsoon remains delayed, with the eastern half of the country continuing to experience a record-breaking heat wave. In an unusual monsoon season, Cyclone Vayu brought moderate rains and cooler temps to eastern Gujarat, east Rajasthan, and western Madhya Pradesh. Vayu brought heavy rains to eastern Rajasthan, with up to 8 inches reported, and with western Madhya Pradesh experiencing up to 4 inches. In Gujarat, up to 4 inches fell, with Saurashtra and Kutch receiving from .40-2.7 inches. These rains were welcome given the extreme drought the region has experienced. As of June 17th, Gujarat had planted 160,914 hectares, which is above last year but less than half the level of the previous year. Rainfall in the Northern Zone, except for eastern Rajasthan, has been very light, with growers spending lots of money on irrigation to keep crops growing until monsoon rains arrive. The monsoon had reached the southern areas in an isolated manner by the end of the week, with light rains reported in coastal Karnataka, Madhya Maharashtra, and interior Karnataka.

The debate over the size of the 2018/2019 crop continues. Arrivals have slowed, with only 30,203,694 bales reported by the CCI. The CAB released a new estimate of supply and demand after a long delay. Beginning stocks were reduced 450,000 bales to 4.291 million bales. The crop was reduced by 2.4 million bales, to 33.70 million bales, consumption was placed at 31.15 MB, and exports at 5 million bales, leaving ending stocks at 4.041 million bales. Other estimates remain below the CAB estimate. The CAI estimate is 31.5 million bales.

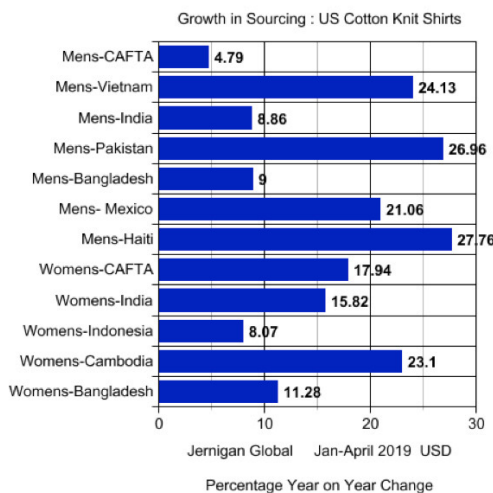
The expectation remains that the MSP for 2019/2020 will be raised for cotton. There are also discussion regarding the

possibility the MSP could include an adjustment to allow spinners to obtain their stocks at global prices. A higher MSP alone will put the textile and apparel sector at a major price disadvantage. The industry continues to face a crisis in yields again in 2019/2020 due to the lack of modern BT seed technology. It is quite ironic that Maharashtra, the state that has the poorest cotton yields in India and some of the poorest farmers, has banned all BT and GM crops. The economics of farming in Maharashtra include some significant hurdles. First, the three major crop districts have no irrigation infrastructure and depend on wells for any water. Second, the farmers are extremely poor, plots are small, and there is little mechanization. Third, farmers are in debt, owing large sums to local money lenders, and this limits any real progress. Cotton is one of the main crops in the state, and at current yields it remains an uneconomical crop that does nothing for farmers' incomes. Average yields in 2018 fell below 300 kg a hectare, or only 268 lbs. per acre. If the ban on BT and GMO crops remains in place in the state, cotton production will continue to lag far below its potential and farmer's income will remain extremely depressed.

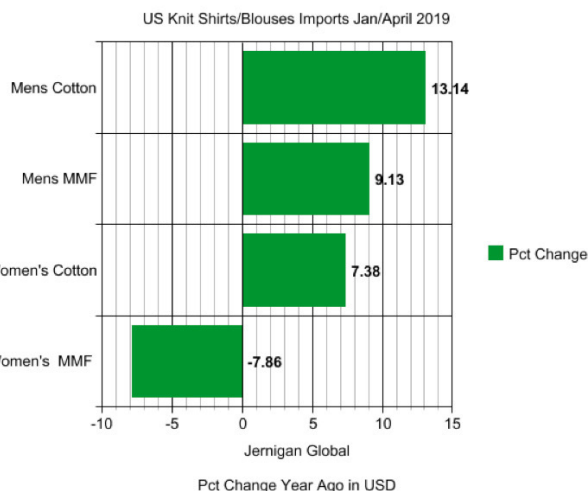
Indian demand for imported cotton has continued, but at a slower pace. There is some concern from cotton yarn exporters due to weaker demand from Chinese buyers. However, the apparel sector is experiencing strong demand as exports have increased as a result of companies switching sourcing from China. Textile and apparel exports in May increased by 5.25% to 3.152 billion USD, and apparel exports alone grew by 14.5%. Local cotton prices continue near 83-84 cents a lb. base a S-6 ex gin in Gujarat, which represents a 1600-2000-point premium to ICE Futures.

AT RETAIL, COTTON IS GAINING MARKET SHARE IN KNIT SHIRTS

Finally, some good news has emerged in regard to cotton's share of the US apparel market. During the January-April 2019 time period, cotton gained share in the important knit shirts category in both men's and women's. The largest segment is men's and boy's knit shirts, where cotton's market share has been 61.63%. At less than one percentage point, the increase is small, but it has come at a time when cotton is under full assault. The category of men's and women's knit shirts and blouses accounts for more than 10.7 billion USD in imports. The January-April imports of men's and boy's knit shirts have increased by 13.14%, to 2.202 billion USD. Man-made fiber imports of the same product have grown 9.13%, to 1.371 billion USD. The top supplier of men's and boy's cotton knit shirts is the CAFTA-DR exporters. Imports from this trade bloc are up 4.79% at 577 million USD, more than double the volume of the second largest supplier, Vietnam. These products are also made from US cotton, fabric, and yarn. Imports from Vietnam are up 24.13%, overtaking China as the second largest supplier. The other major suppliers are China, India, Pakistan, Bangladesh, Mexico, and Haiti. CAFTA-DR exporters are also the largest supplier of man-made fiber men's and boy's knit shirts, with exports to the US up 18.12% in January-April. The other man-made fiber apparel suppliers in the men's and boy's segment are Vietnam, China, Jordan, Mexico, and Haiti. Haiti has emerged as a major location for sourcing a variety of products, due to its special treatment in duty free access to the US market under a series of trade preference acts.



billion USD, compared to a 7.86% decline in man-made fiber imports at 1.35 billion USD. In cotton women's and girl's knit shirts, Vietnam has overtaken China as the top supplier. Imports from Vietnam have increased 12.8% to 378.2 million USD, while imports from China, the second largest supplier, have fallen 5.34% to 371.4 million USD. CAFTA-DR exporters are the third largest supplier, with exports growing 18% to 358.23 million USD. The other top suppliers in this category are Indonesia, India, Cambodia, and Bangladesh. The ability of cotton to gain market share in the important knit shirt and blouse segment has had a positive impact on US cotton consumption in Vietnam and Bangladesh, and also on Indian cotton use.



Cotton has gained a larger market share in January-April in women's and girl's knit shirts and blouses. Market share reached 57.44%, and cotton imports are up 7.38% at 1.832

Cotton's share in the non-knit categories has shown further weakness, with cotton non-knit men's and boy's shirts imports up .47% in January-April. Man-made fiber imports rose 15.44%. Cotton, however, still maintains a 70% market share. Cotton's biggest trouble area remains women's and girl's non-knit blouses, where it has only a 34.69% market share. January-April imports declined 9.04% in cotton, but increased 1.16% in man-made fiber. We have noticed a sizeable shift from Chinese to Indian exporters in the cotton segment. India is now the top supplier, with imports up 8.91% as compared to a 32.08% drop in imports from China. This is in contrast to man-made fiber imports, where China remains the top supplier, having increased exports during the period by 7.55%. This illustrates the point we made earlier that brands and retailers have begun to switch cotton apparel sourcing out of China, but it has occurred on a much smaller scale in the man-made fiber segment.

AUSTRALIAN SUPPLIES GROW TIGHTER AND BASIS FIRMER

Australia exported 22,286 tons of cotton in April, which brought August 2018 to April 2019 export shipments to 623,954 tons. This was the largest volume shipped in the same period in several seasons, compared to 440,066 tons in 2017/2018 and 400,219 tons in 2016/2017. China took 434,942 tons or nearly 70% of all exports. Total export shipments from the 2017/2018 season reached 1,035,600 tons. Thus, Australia will have little carryover, as shipments of the 2019 crop got underway in May. ABARES has forecast the 2019 crop at 485,000 tons or 2,228,332 bales. The 2019 crop was of mixed quality, and the only unsold volume left are the shorter staple lots. Good Middling and Strict Middling offers are very scarce. Middling grade dominates all remaining offers in all staple categories. Middling 1 1/16 offers have shown up at 1250 points on Dec, and Middling 1 1/32 at 900 points. Middling 1 5/32 CFR Asia offers are at 2200-2300 points on.

While cold weather has prevailed across the cotton belt, the forecast remains void of any notable rain. The countdown is well underway to one of the smallest crops in thirty years. We expect the unsold carryover stocks of Australian cotton still held in warehouses by the end of the year to be a nominal volume of mostly shorter staple low grades, which will be difficult to

move. The spinners who depend on the excellent quality Australian crop will face a long period of very inadequate supplies. There will be no high grades from January to April 2020 and possibly later, and a supply of 800,000 bales or less from May 2020 until May 2021, with no backup inventory at all. The quality makeup of the 2020 crop will have some uncertainty given the very restricted water supplies.

The heart of the cotton belt, the Gwydir and Namoi valleys, faces the possibility of not a single hectare of cotton for the first time since the growers arrived from California. This illustrates the disaster that growers are facing without a major rain event. It should be noted that, in the past when conditions were the bleakest, a late season major rain event occurred that kept optimism alive. The last such event occurred in November of 2011, when the city of Moree went underwater in many areas. This was followed by another such event in February 2012. These rains set the stage for several years of large crops. The 2011/2012 crop reached 5.5 million bales. The New Coalition government has been slow to come forth with any real water reform or proposals for new water infrastructure. At the moment, a slowdown in economic growth, the slowdown in China's economy, and the expanding US/China trade dispute has it occupied.

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US BUYERS BEGIN TO ROLL UNSHIPPED CONTRACTS TO NEW CROP & CHINESE CANCELLATIONS BEGIN

The US has 4,226,800 bales sold for 2018/2019 that are unshipped, and a large block of those sales was completed at much higher prices, while others were for high grades that simply were not produced. In addition, a large block of unshipped sales to China has been on the books since June 2018. The outstanding volume has been slowly reduced through some shipments, some cancellations, and the rolling of sales to 2019/2020. Shippers have been working hard to get letters of credit open and cotton moving. The pace of export shipments has been disappointing all season, and it has again proven impossible to maintain shipments above 400,000 running bales on a weekly basis. As we near the final 30 days of the season, the open contracts are beginning to be addressed. In the week ending June 13th, US weekly export sales of upland for 2018/2019 were reduced by a net 119,300 running bales, as 180,100 bales were cancelled. China purchased 2,600 bales, cancelled 71,500 bales for 2018/2019, and purchased 49,400 bales for 2019/2020. China still has 332,100 bales of upland purchases and 45,400 of Pima for 2018/2019 that will either be cancelled or shipped. Turkey purchased 12,500 bales for 2018/2019, cancelled 97,100 bales, and purchased 98,200 bales for 2019/2020. Turkey still has 429,500 running bales of upland that must be shipped before the end of the season.

India remained the largest net buyer, but at a small volume of 15,600 bales. Indian mills would appear to need higher-grade supplies for July-October shipment,

and these are in tight supply from the US. US export shipments are likely to fall short of the USDA's estimates as shipments in the week ending June 13th were only 321,200 running bales of upland and 19,200 of Pima. Besides the rolling forward of 2018/2019 sales, the strongest demand for 2019/2020 US new crop is coming from the CAFTA-DR, Mexico, and Peru spinners that have experienced a big boom in export orders. CAFTA mills are running near full capacity, and cotton apparel exports are expanding. 2019/2020 US export sales to this region have already reached 812,600 running bales of upland, and an additional 115,600 bales of upland for 2020/2021 shipment has also been sold to these spinners.

The 2019/2020 season is the real concern, and we have been saying for some time the main concern is demand. The US and Brazil need large volume export offtake. In the US, the absence of Chinese demand took a major toll on 2018/2019 demand. A world without Chinese offtake, either caused by the 25% tariff or weaker import demand, looks extremely difficult. As of June 13th, the US has sold forward 3,954,100 bales of upland. After these sales are adjusted for China sales of 1,477,900 bales, the US 2019/2020 export sales are less than half the previous forward sales on the same date (2,486,200 bales vs. 5,117,000 bales). The USDA has its target at 17 million bales, but, without a major restoration of Chinese demand, a more realistic target would be 13-14 million bales.

US/BRAZILIAN FOB BASIS LEVELS ARE EXTREMELY WEAK

The precursor to the collapse of the July ICE futures last week has been a very weak FOB basis in both the USA and Brazil. The extreme weakness has illustrated, first, a long basis position held by merchants and coops. Secondly, it has reflected the weakness in near-term demand and a lack of confidence in future demand. A year ago, July futures were over 30 cents a lb. higher, and today, with prices at their lowest levels in three years or more, the US FOB warehouse basis for a 41-4-34 is officially at 675 points off the October contract for West Texas. This basis is prevailing, even with October at a discount to Dec, which explains why the July/December spread has collapsed to close the week at 437 points discounts to Dec. In Brazil, the FOB Santos Port for a 42-4-35 was only bid at 150-200 points on Dec futures, which is down about 50% from the prevailing basis of 300-400 point on Dec. This is due to the fact that merchants are long the basis and do not want to accumulate any more inventory, and export demand is soft,

except at very aggressive CFR Asia basis levels. We have been discussing for months that Brazil faces a logistics crisis, as the record 2019 crop moves. With no warehouse system and no storage room for volume at the ports, the cotton will have to move. Some traders have already loaded cotton "Afloat," meaning without a firm destination and with the hope to sell before reaching Asia. Both FOB basis levels are also reflective of the large, un-hedged trade position that is haunting the market.

BBM sales registration data suggest growers have a large volume of 2019 crop left to market, and also some 2018 crop. BBM registrations of sales for the 2019 crop have reached only 865,932 tons, or just below four million bales. This compares to an expected crop of 12.8 million bales. If one assumes that a larger number of sales have been made and not registered, this still suggests over six million bales remains to be sold from growers.

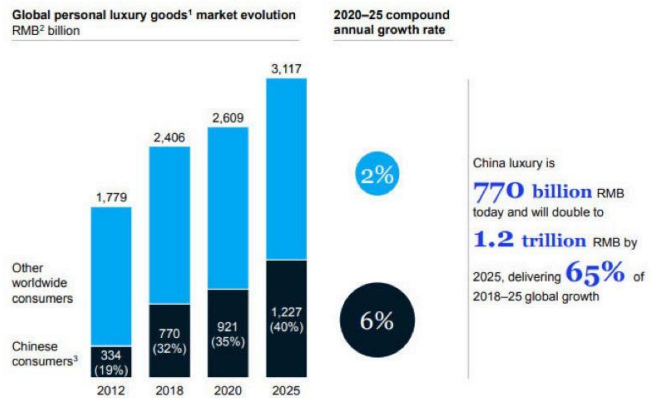
ICE FUTURES COLLAPSE AS THE JULY/DEC SPREAD PLUNGES TO NEAR 500 POINTS

The July ICE contract had few friends last week as the Trade abandoned the contract and weak longs forced the July/Dec spread to 448 points discount July. Two weeks earlier it had traded at a 198-point premium. In the end, the weak domestic FOB and CFR Asia basis levels doomed the spread. The US will have large stocks when the season ends, as unshipped sales remain a serious problem and additional sales cancellations appear likely. As we discussed last week, the record un-hedged trade position remains a major negative on the price outlook. As prices moved lower last week, the Trade, as of the week ending June 18th, sold nearly as many as they purchased – 11,741 contracts vs. buyers of 13,946 contracts. The market ended the week in a very weak technical position, with the weekly charts suggesting a possible move into the 55/60 area.

Unlike other seasons, we do not see a magic price at which the price will solve cotton's problems. The problems are rooted in several areas. The most serious is the situation in China, which we devoted a large portion of this issue to and have been discussing in detail for months as the events unfolded. In our view, China has experienced a significant Black Swan event, and the trade war was only one of the triggers. Since 1990, China has experienced record-breaking economic growth, and the success of their 2008 stimulus program and the ability to avoid a recession when the rest of the world suffered solidified the view that China's economic model was infallible and that economic growth would continue uninterrupted. Under Xi Jinping it appears that the state adjusted the data to show strong 6% plus growth every year when it was in doubt, which added to the hubris of the country, its planners, and politicians. A review of every consultant study from McKinsey on down finds forecasts stating that China's domestic apparel demand would grow 5-6% or more annually through 2025, and would overtake the US in size in 2019. The studies and forecasts also predicted 3-6% CAGR growth for polyester demand. Put in simple terms, not a single study we could find forecast a period of no growth or shrinking demand. This was replicated across many areas of the Chinese economy. Thus, the entire industrial and government complex believed the solution was to "build it and demand would come." The same was true for much of the western business interests that continued to keep nearly 100% of their supply chains in China. The unthinkable has happened, or the Black Swan has occurred. As it relates to the textile and apparel sector, demand has been slowing, and in late 2018 it appeared growth turned flat and then negative in 2019. With capacity expanding, this slowdown has triggered a crisis

with the consumer, the consumer industry sector is in a panic, and there has been a loss in confidence. With no free financial press or open debate, the worst-case scenario is believed.

China is winning half of the luxury world.

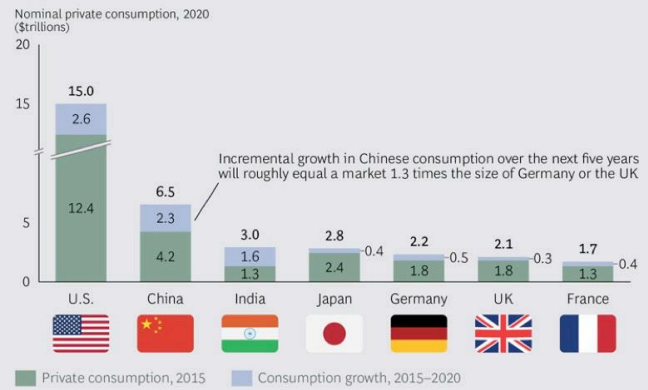


¹Ready to wear, accessories, watches and jewelry, and beauty.
²Fixed exchange rate of €1 = 7.3 RMB.
³Both domestic and overseas spending.

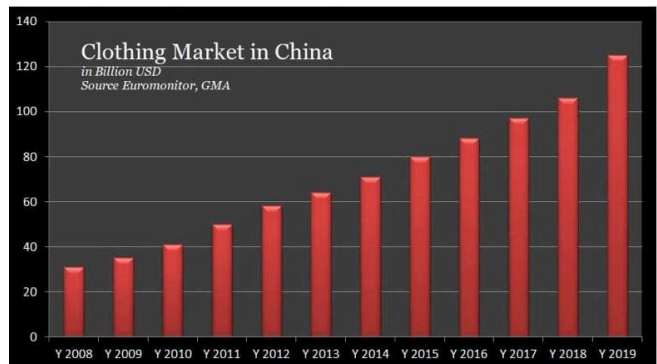
SOURCE: China Luxury Report 2019; China Luxury Report 2017

McKinsey China Luxury Report, 2017

EXHIBIT 1 | By 2020, Chinese Consumption Will Have Grown by \$2.3 Trillion—Even if GDP Growth Slows to 5.5%



Sources: Economist Intelligence Unit; BCG analysis.
 Note: Assumes annual GDP growth rate of 5.5%. Because of rounding, not all numbers add up to the totals shown.



As we discussed several weeks ago, we expect Chinese cotton consumption to be far below the USDA and other private estimates. The US and China are talking again, and President Trump and Xi Jinping will meet this week in Japan. Therefore, a trade deal could be possible, or at least the renewed, in-depth discussion. A trade deal would lift spirits and likely trigger a recovery in prices. However, unlike six months ago, a trade deal alone will not bring a return to the status quo. The supply chains are moving, and this will not be reversed. The US is moving to confront China on the Xinjiang camps, persecution of Christians, protection for Taiwan and Hong Kong, South China Sea militarization, and the encroachment of the Belt/Road on other country's rights. The confrontation is being driven by a Democrat/Republican alliance that actually might be more willing to sacrifice trade than the Trump Administration on these issues. Against this backdrop, can confidence be restored? We are not sure at what price this will occur, or what China/US developments will be required for this to happen. We do appear to be nearing a reflection point. Without some new path forward for a trade agreement, the US will likely place a 25% duty on the remaining Chinese imports. During the past ten days, thousands of companies have petitioned the Administration for a waiver on these duties and argued for them not to be implemented. If the duties are placed, then a new wave of rapid supply chain movement will be likely, and the Chinese consumer and industrial sectors' confidence will be further eroded. An agreement would restore some calm, ease the panic, and allow for some stability to return for at least the short-term.

The issue is time. The US/China trade discussions are now a year old. In diplomatic terms this is but a blink of the eye, but, if you are holding a long cotton inventory at a higher price and un-hedged, or the Trade and growers in the US and Brazil holding 2019 crop unsold in volume, it feels like a century. This means any trade deal needs to provide for new real demand, or the sellers will begin to be forced to move to

complete additional sales. This creates a very nervous condition, and confidence is always hard to regain. US and Brazil growers and Trade all face different degrees of pressure to move the crops regardless of the demand picture. In the US, it is difficult for growers to hold cotton past the CCC loan deadlines. If the Trade has to redeem and hold the inventory in the current expensive storage system, the growers will pay for it in basis, which we are seeing right now at the current FOB basis. The AWP is designed to keep the cotton moving regardless of price, with all the cost going to the US government. At 59.14, the AWP is still far away from the 52-cent loan level. In Brazil, with its lack of a warehouse storage system, limited spaces at gins and warehouses, high interest rates, its need to convert crop finance barter to cash, and growers who will rapidly move to plant soybeans this fall and who will be in no mood to maintain large inventories, pressure will build each day to move cotton. Merchants are already long the basis and want to move the crop. It is crucial that Chinese demand be there to absorb the Brazilian crop, either through the normal import demand or by Reserve purchases. A prolonged period of soft Chinese offtake could have profound ramifications on prices.

Amid these conditions, a trade deal between the US and China might allow prices to rebound, but the duration of any rally will depend on how much offtake occurs. We fear that the adjustments needed in Chinese overcapacity can only be made by the shuttering of capacity, which does not happen easily, especially in the most subsidized industrial system in the world. The strains in the Chinese banking system suggest that the first signs of the economic losses from the last ten years of subsidies, which have produced uneconomical loans and operating losses, are now beginning to be reflected. These conditions could prolong a return to previous growth levels and also usher in a new economic model that is not built on expansion, expansion, expansion. The Global cotton consumption matrix is changing.



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