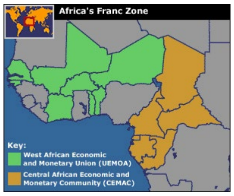
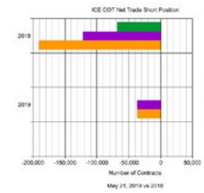


AFRICAN FRANC ZONE BASIS FIRMS AS SUPPLIES TIGHTEN

CHINA'S ELS COTTON PRODUCTION FALLS SHARPLY IN 2019/20

US WEATHER REMAINS A CONCERN



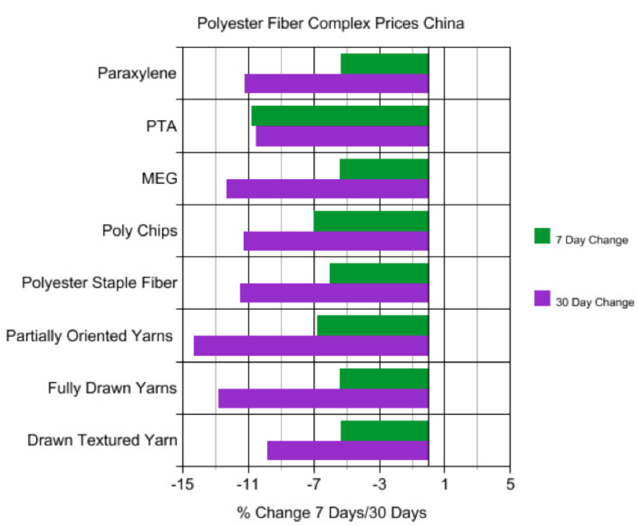
ICE NET SHORT SPEC POSITION REACHES NEW RECORD/TRADE NET SHORT A RECORD LOW

JERNIGAN GLOBAL

KNOWLEDGE IS THE NEW CAPITAL

COLLAPSE IN MAN-MADE FIBER DEMAND IN CHINA AS MORE CAPACITY COMES ONLINE

OVERCAPACITY & PRICE PRESENT A CHALLENGE



Polyester fiber demand in China appears to have collapsed. The weakness is tied to a sharp drop in polyester fabric production and an overcapacity in the entire man-made fiber complex. China's economic model seems to be one of never ending growth in the industrial complex. This model gained additional status after it successfully allowed China to avoid the global financial crisis of 2008/2009. It was hyped as a successful alternative to the West's economic system, capitalism. The model is based, in large part, on the use of heavy subsidies in certain industries to drastically expand capacity, drive down prices, and flood the world with cheap products, with the end game being total control of key industrial sectors in the major markets. This model allowed the "Chinese Price" to capture 90% of many important industries' supply chains. One of the industries chosen for such aggressive subsidies and cheap loans in 2008 was the petrochemical sector. The growth since 2008 has been phenomenal, record breaking, and by 2011 the

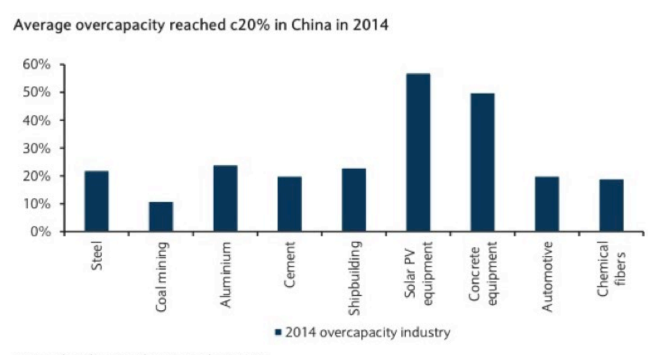
Chinese petrochemical complex was the largest in the world. The growth by 2015 began to slow, but by that time the production capacity in some products, such as PTA, one of the key raw materials for polyester staple fiber, doubled, as did that of polyester staple fiber. The expansion briefly slowed in 2017 due to the government's issuance of strict new environmental standards. However, this appears to have been temporary, with local government's corruption and false data being used to avoid a serious cleanup. When the economy slowed in 2018, many restrictions were eased. The industry that appears to have suffered the greatest reduction in capacity from the environmental policy was not in petrochemicals, but in textile dye production and dyeing.

Hengyi Petrochemical Complex

Hengyi Petrochemical Complex

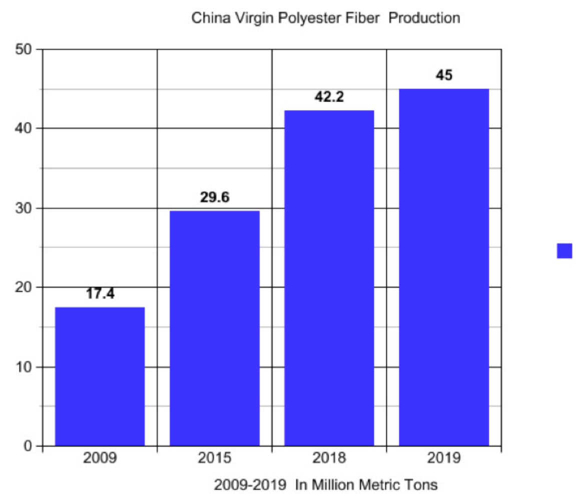
New petrochemical capacity, as well as new PTA, MEG, and polyester staple fiber plants, have begun to once again come online in 2019. In 2019, the petrochemical sector has been impacted by the opening and coming online of the largest refinery and petrochemical complex in China, located on Changxing Island. It is being advertised as a fully integrated "Oil to Cloth" complex. The crude oil is processed all the way to PTA, and then into PET chips. The complex is the Hengli Petrochemical complex, and it processes 20 MMT of crude oil annually. Other new refineries are also adding capacity, including Zhejiang Petrochemical and the Sinopec-Kuwait refining complex, which is expected to add as much as 32 million tons of new refining capacity. Just the Hengli complex opening has ignited a new leg down in the prices of all raw materials of the man-made fiber and the polyester fiber itself. This latest round of expansion appears to be the result of the earlier opening of the sector to non-state-owned companies. The expansion strategy is built on the idea that demand will continue to grow at the same pace of the last ten years, and that the new demand will absorb the additional supply.

It would appear that none of these companies investing in expansion or the Chinese government did any economic assessment accounting for a period of weaker demand. All the many projections and forecasts by private consultants, the companies involved, and the government, saw uninterrupted growth into 2025. The trade war appears to be the Black Swan event no one was planning for. As we have been discussing, since October 2018 the entire man-made fiber complex has experienced a collapse in prices, and demand sharply contracted. This was followed by a period of stable prices in many products. However, prices over the past 30 days, and again this week, have entered a new decline. Downstream demand has turned quite weak and has spread throughout the entire complex, from naphtha to paraxylene, to PTA, MEG, into the PET chips, PSF, and then to the yarn complex. At the heart of the drop, in addition to the overcapacity due to the coming online of the massive new petrochemical facilities, is weak demand from fabric producers. Man-made fiber producers are reported to be operating at 65%-70% of capacity. The weaker demand appears to be coming from a weakness in apparel exports and much slower retail offtake of man-made fiber apparel in the Chinese domestic market. Again, it appears all companies believed the hype that Chinese domestic demand could only continue to grow. However, the trade war appears to have triggered a new set of dynamics that have already shifted due to the new focus on State Capitalism after Xi Jinping came to power. Overall retail sales in April were okay, showing growth of 7.2%, but retail sales of apparel, textiles, and footwear fell by 1.1% year on year. This marked a dramatic reversal in growth. The reduced spending on apparel and textiles could be linked to a sharp increase in food prices that has taken more of consumers' disposable income. Moreover, wage growth slowed in 2018, and now appears to be flat, which has reduced spending power.



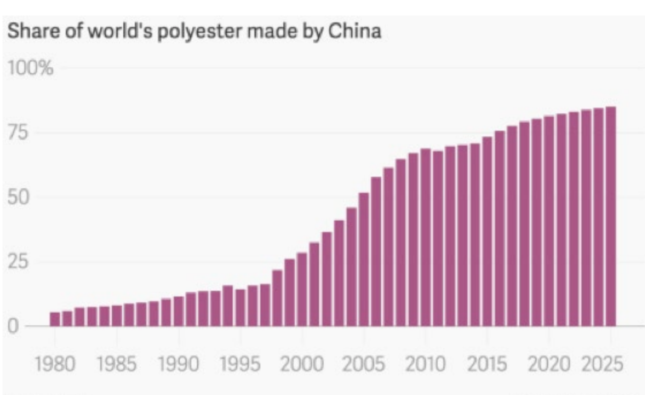
Apparel exports in the first quarter of 2019 have been weak, falling by 24.3%. Part of the decline could be caused by the way shipments have been impacted by the fear of US tariffs, and seasonal factors linked to the New Year's holiday. However, exports to the US fell sharply in March, dropping 15% in volume. The decline was not limited to the US. In volume terms, EU data indicates imports of textile and apparel from China fell 7.73% in January, and by 8.49% in February, with orders being switched to Bangladesh, Turkey, and Cambodia. Combined, the US and EU account for a significant part of all Chinese textile and apparel exports. Again, China's industrial sector is built on aggressive growth. In 2018, apparel exports grew 8.1%. After the performance of the past 20 years, which defied all forecasts, it seems no one in China and outside ever considered that the Chinese economy could contract. Instead, the prevailing forecast was that China's economy would overtake that of the US. The impossible appears to have happened. On Friday, the PBOC announced it was taking over the Baothang Bank, which was reported to have more than 60 billion RMB (near 10 Billion USD) in assets, because of the credit squeeze it was facing. This marked the largest takeover since reform was launched in the 1970s.

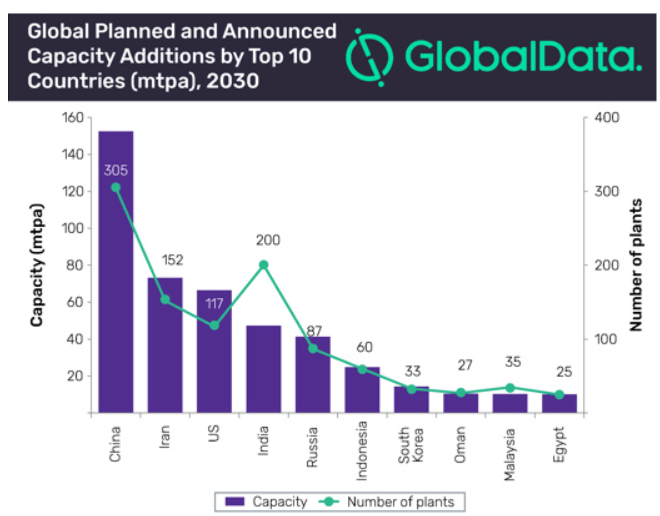
Prices of polyester staple fiber, chips, yarns, and feedstocks have all fallen sharply over the past 30 days, especially the last seven days. Many polyester staple fiber plants have cut production and idled 30% or more of capacity, but so far that has not seemed to stop the price pressure. Stocks at plants of unsold polyester staple fiber are reported to be at a record 80 days of demand, compared to 20 days in January. Beginning with paraxylene, domestic prices have fallen by 5.3% during the last week, and 11.2% over the past 30 days. The two direct raw materials for polyester PET chips, PTA and MEG, are in decline, with PTA prices down nearly 11% last week, and MEG by over 12%. Polyester PET chips used to make polyester fiber and plastic bottles have fallen more than 11% in the past 30 days. PET bottle chip margins are collapsing, and it seems that export demand has dramatically declined, because of new capacity coming online outside of China in Egypt and India. Recycled polyester prices are also under pressure. Adding to the pressure is the new 25% duty on exports to the US. Exports were small but have impacted prices.



Polyester staple fiber prices have fallen by over 6% in the last week, down nearly 12% in the past 30 days, putting them close to record lows, falling to 51-52 cents. POY, FDY, and DTY yarns have also fallen from 10% to 14.3% during the past 30 days. Wood pulp prices are weaker as well, with Viscose fiber down about 4% in the last week, and down sharply over the past three months. Weakness has also been evident in the Viscose fiber yarns and Viscose/poly blend yarn.

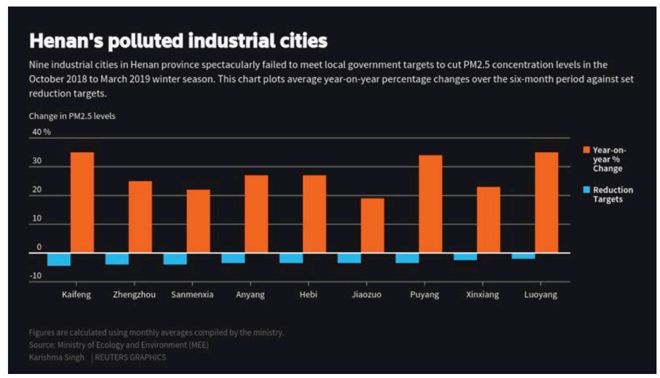
The domestic cotton prices have also been declining, along with international prices and the drop in the man-made fiber complex. The CC Cotton Index of a 3128 has fallen to 99.97 cents, which reflects an almost 6 cents a lb., 5% decline during the past 30 days.





These conditions suggest that Chinese cotton use will decline in 2019/2020. The impact on world cotton trade will be reduced by the need of the Reserve to restock. The greatest threat to the global cotton community is the threat that cheaper and cheaper polyester staple fiber poses to consumption. For the moment, the message of microfiber pollution has been kept in the background, and retailers and brands have actually increased its use, as many new groups entered the performance wear market. US brands and retailers face the prospect of a 25% extra duty on all Chinese apparel imports in about 30 days, unless this is delayed or negotiated away. Even if this duty is applied, it will not stop the flow of the man-made fiber. Chinese exporters have already been found to be dumping yarns by more than 100% below the fair price in the US market. Thus, the Chinese exporter, given the weak state of demand, will absorb much if not all the duty. So far, we have not heard any new solutions to this problem being proposed in the US or other countries. For the moment, the movement to tax man-made fiber for its environmental cost has been stopped by the retail lobby.

CHINA IS HEADED FOR A NEW ENVIRONMENTAL CRISIS: WILL THIS REIN IN EXCESS MAN-MADE FIBER CAPACITY?



The effort by China in 2017 to rein in pollution appears to have failed, with reports from the South China Morning Post indicating the effort has been undermined by fake data, corruption, and the desire to meet economic targets. Inspectors have found fake data, made-up meetings, and even instructions from local officials to companies on how to manage inspections and cover up data. The most widespread fraud in data occurred in the textile and apparel powerhouse provinces of Shandong, Henan, and Sichuan. Shandong is home to the largest textile and apparel company in China, and the largest cotton spinner. In Henan, once the second largest cotton producing province, air pollution has grown horrifically worse over the last year. In the major cities, PM2.5 measurements have increased by 20%-35%. The increase has followed a major government effort to clean up polluting plants and factories. It appears that, even with some large companies installing the needed antipollution equipment, pollution is still an issue. Older plants are continuing to release harmful chemicals. In many areas it appears the largest impact has been on the smaller firms that could not influence officials or afford to install the needed equipment.

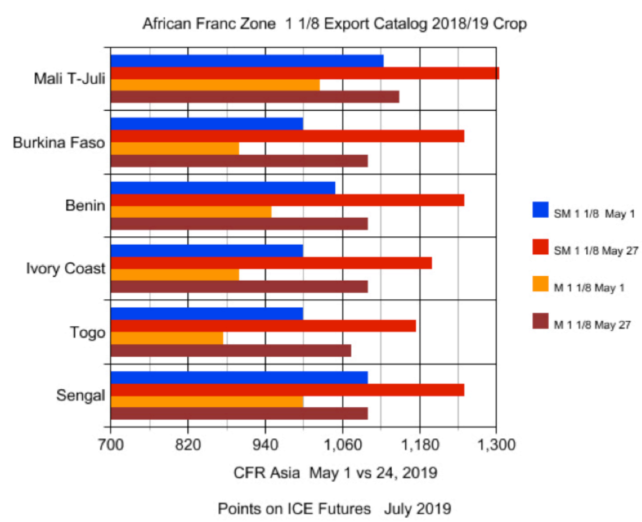
Air pollution crisis - Shandong

A significant study by CUHK in Hong Kong attempted to measure the cost of pollution on the Chinese economy. The study found, first, that pollution costs the country 267 billion RMB (39 billion USD) annually. Secondly, in the agriculture sector, pollution reduced grain production by 20 MMT annually. Thirdly, a million premature babies died annually because of the pollution. Another study by MIT determined that pollution is damaging to health, cognitive performance, labor productivity, and educational outcomes. It also has a broader impact on the social lives and behavior of people. China's inability, or unwillingness, to control the release of a host of toxic chemicals into the environment is having a serious impact. A new report published in Nature traced the source of the ozone-eating trichlorofluoromethane (CFC-11) to eastern China, where Shandong and Henan were the source of the deadly release. China has signed the Paris Climate Accord, but, as you can see, it mattered little to the actual effort on the ground.

Another study found that the policy of forcing large heavy industries to move out of the metropolitan areas to rural locations was accelerating the pollution. These areas have failed to implement the new tougher environmental standards, which has increased overall pollution, increased water use and thus water pollution, and actually led to higher air pollution in some cities, as the smog drifts in. The pollution crackdown in 2017 and early 2018 briefly reduced man-made fiber production. However, as the US trade war broke out, the rules were relaxed and new plants are coming online, while controls appear to be much less strict, as economic growth again takes over as the key driver for industrial policy. This has set the stage for a new environmental crisis in the future, as the economic impact increases, and the number of people impacted by cancer and other diseases associated with increased pollution rises. China is also the leader in plastic pollution worldwide.

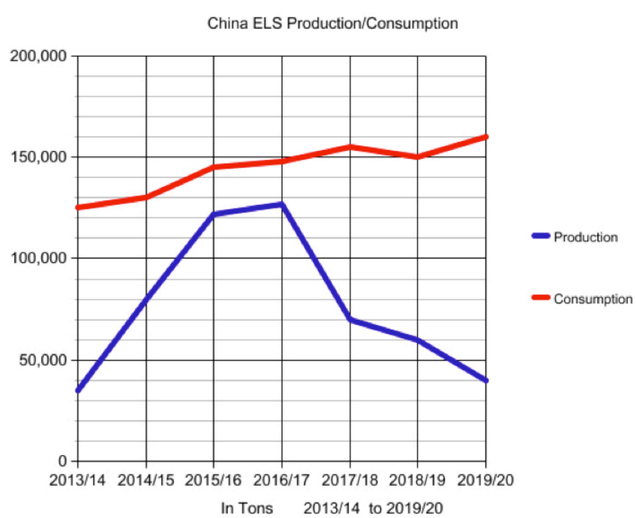
AFRICAN FRANC ZONE HIGH GRADE BASIS FIRMS AS SUPPLIES DIMINISH

The 2018/2019 African Franc Zone is now well sold in the higher grades, Strict Middling 1 1/8, and better. The supply of the medium qualities has also tightened, following brisk offtake over the past 60 days. The reduction in the quality of the 2018/2019 US crop, and a sharply reduced Australian crop, has stimulated increased demand for the higher grade, longer staple, AFZ styles. The 2018/2019 AFZ crop was disappointing in several regions, and, after earlier higher estimates, the total crop has fallen to 5.41 million bales, which is a small reduction from 2017/2018. The tightness in the global supply of high grades is becoming a problem for spinners who need SM 1 1/8 and longer staple cotton. Adding to the anxiety of spinners is the exhaustion in supplies of the Brazilian SM 1 1/8 and 1 5/32 2018 crop. The average CFR Asia basis for the top AFZ SM 1 1/8 style has firmed to near 1300 - 1400 points on ICE, with some merchants withdrawing these offers. The Middling 1 1/8 offers have firmed to 1150-1200 points on, which reflect a 50-100 point firming during the past week. Active offtake has been noted from Indian and Bangladesh. The 2018/2019 African Franc Zone crop appears to be nearing sold out, which might occur over the next 30 days. Bangladesh and Indian mills are facing a very tight supply of Indian cotton, which has rallied. The S-6 1 1/8 has reached 81 - 82 US cents a lb. ex-gin, and the J-34 is at 84-85 cents. At these lofty levels, Indian mills are seeking imports, while Bangladeshi mills are seeking non-Indian styles.



CHINA 2019/2020 ELS PRODUCTION EXPECTED TO FALL SHARPLY

In 2018/2019 China was the fourth largest ELS producer in the world, falling behind US, Egypt, and India, with production reaching near 60,000 tons. China's cotton acreage in 2018/2019 declined to 850,000 from 900,000 Mu (56-60,000 hectares), which was down from expectations of one million Mu (66,666 hectares). 2019 acreage is expected to again fall, dropping to near 600,000 Mu (40,000 hectares). The decline is coming in Awati County, where acreage will decline from 840,000 Mu to 500-600,000 MU. In addition, the 2019 crop has gotten off to a very poor start, with heavy rains and hail causing crop losses and replanting in north Awati County. Planted acreage in the AKSU area is expected to drop by half. The ELS industry is in crisis, as growers turn back to upland cotton. There are several reasons. First of all, the crop has to be hand picked, which is very expensive and has reduced profitability. Currently, there are no ELS seed varieties suitable for machine picking, the gins can not process machine picked ELS without undergoing very expensive upgrades, and the crop has a significant problem with contamination. The contamination problem has prevented domestic ELS cotton from being used in the higher-end products. Short staple is also a problem.



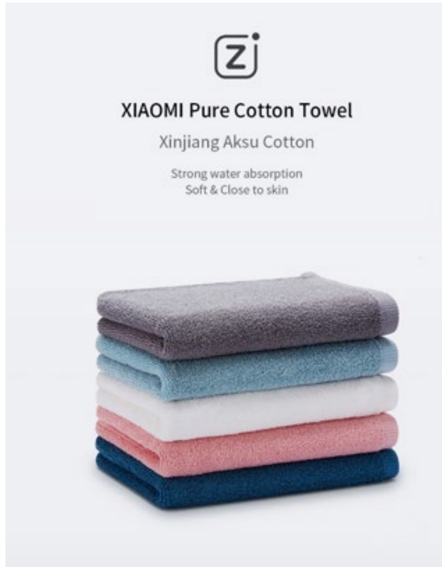
A few ginners are known for low contamination, and their cotton sells at 4,000 to 5,000 RMB a ton, 26-33 US cents a lb., premium to the standard ELS. Domestic T137, the top grade ELS, is selling at a large premium to US Pima at 168 US cents a lb., FOB Xinjiang. The effort to stem the decline in acreage and production has failed. There has been some effort to introduce contract

farming with a couple of domestic textile groups, which are focused on using Chinese ELS. 2019/2020 production is set to be the lowest in many years at near only 40,000 tons or less, around 183,780 bales.

The smaller crop will increase ELS imports in 2019/2020, unless brands and retailers switch from China for their Supima requirements. China is a major market for fine count spinners and consumers of US Supima cotton. Even in 2018/2019, with the 25% tariff, Supima demand has been maintained due to the requirement of brands and retailers. In spite of the application of the 25% duty, before VAT, the price of Supima is still below the domestic ELS T137, and of much better quality, and with the VAT, it is yet more expensive. It is also unclear under which import license SUPIMA is being imported. US cotton imported under the processing quota is exempt, which may mean SUPIMA is not subject to the 25% duty. Mills can also apply for an exemption if the product is not available from other sources. Supima would fit that description.

If no orders are rerouted, China's ELS consumption in 2019/2020 should reach 150-160,000 tons (689,175 to 735,120 bales), while import requirement will reach 450-500,000 bales. As of May 9th, China had already purchased 255,000 bales of US Pima in 2018/2019. Demand should increase in a significant way in 2019/2020, unless China bans all US agriculture imports. China has already issued a notice that companies can apply for an exemption on the duty on US imports if the product is not available anywhere else. China also buys Egyptian and Israeli ELS, but the Supima program requires US Pima. China has purchased around 23,000 bales of Egyptian cotton so far in 2018/2019.

It would appear China's ELS sector is in for a tough period, until the seed companies develop an ELS seed variety that is suitable for machine picking, and the gins invest in new equipment. With domestic prices near 168-170 cents a lb. and still unprofitable due to the hand-picking cost, it would appear ELS production will only be profitable with a lower production cost base and an improvement in quality.



Aksu ELS Towels

US EXPORT SALES SURGE TO 629,500 RB AS PRICES DROP 10 CENTS

The combination of a weak CFR basis and a drop of more than 10 cents in futures triggered aggressive offtake of US and Brazilian cotton. US export sales for the week ending May 16th reached a net 629,500 running bales. 381,400 running bales of upland sold for 2018/2019 shipment, and gross sales totaled 406,300, with cancelations of 24,800 bales. Concern continues over the outstanding China sales and other sales made at much higher prices. The largest buyer for 2018/2019 was India, which purchased 95,500 running bales. The spread between Indian domestic prices and US styles is at near record levels. Despite the weakness in the Lira, Turkey was the second largest buyer at 93,200 running bales. Turkey has now purchased 1,537,000 running bales of upland, and 23,900 bales of Pima. Vietnam purchased 50,900 bales for 2018/2019, bringing US exports to Vietnam in 2018/2019 to a record level. Despite a collapse in the Pakistani Rupee against the USD, Pakistan purchased 31,700 running bales of upland for 2018/2019. Indonesia purchased 24,200 bales, but Pima sales declined 2100 bales, following a switch in sales from 2018/2019 to 2019/2020.

2019/2020 sales totaled 241,500 running bales, led by Vietnam, which purchased 79,000 running bales of upland. El Salvador purchased 65,000 bales, followed by 21,100 bales to Honduras. China appeared to switch 19,800 bales to 2019/2020. India extended coverage, taking 15,000 bales, and Turkey 13,200 bales. Pima sales for 2019/2020 totaled 4,500 bales. The concern remains over the unshipped volume of high priced sales. The US has sold 15,725,507 480-lb. bales. However, shipments have only reached 10,317,726 bales. 577,400 running bales of 2018/2019 sales of upland and 88,400 bales of Pima sales to China remain unshipped. 2019/2020 sales total 1,408,700 running bales of upland.

The US and Brazil have been battling for market share. US 2018 crop E/MOT type offers are the cheapest in the world out of some merchants. One major merchant is offering 2018 crop E/MOT Middling 1 1/8 at 750 points on July, which is sharply below the Cotlook quote, and a 300-400 point discount to African Franc Zone, equivalent to M 1 1/8. This explains why the US is selling record volume, with futures in the current 67 area. Brazilian 2018 crop supplies have also tightened during the past 30 days, which has reduced these offers. The US faces sizeable competition in the 2019 crop, with the most aggressive Brazilian offers undercutting the most aggressive US offers by around 50 points. Some traders will match the Brazilian offers, and this has stimulated offtake. Brazilian styles are also popular in every major export market in which the US competes, with the exception of Latin and Central America and, to a lesser extent, in India.

INDIAN ARRIVALS CONFIRMING LOWER CROP ESTIMATES AS SPOT PRICES NEAR RECORD PREMIUM

Indian spot cotton prices have again begun to move higher after retreating when ICE futures collapsed. The spot price for a J-34 1 3/32 has reached 84-85 cents ex-gin, which reflects a 17-18 cents premium to ICE July futures, and S-6 1 1/8 ex-gin stands at 81-82 cents a lb. Daily 2018/2019 arrivals have fallen to 15-20,000 bales. As of May 13th, total arrivals stood at only 28.914 million bales, which means the lower crop estimates of near 32 MB is becoming a reality, with an even lower crop possible. The number of gins operating has dropped to only 10% in Gujarat, indicating the season is done. Growers reduced the number of pickings in 2019, and prices are clearly providing a motivation to deliver all available cotton. This means that the 2018/2019 crop could fall to only 30-31 MB, further increasing the import requirements. The lack of supply and local spot prices has accelerated an increase in imports. Available supplies of African Franc Zone are tightening, and basis levels are increasing, which is causing mills to turn to US styles. We continue to expect imports to continue into the arrival of new crop supplies.

Planting of the 2019/2020 crop is well advanced in the Northern Zone, with the crop up and growing. Planting of the irrigated acreage has also started in Gujarat. Indian spinners again focused on imported US, East African, and West African styles last week. Pakistani mills also were in the market, taking up US and Brazilian styles. The Pakistan Rupee/USD exchange rate fell to a record low of 151-152 per USD, while the Indian Rupee was rather firm at 69.50-70.00 per USD.

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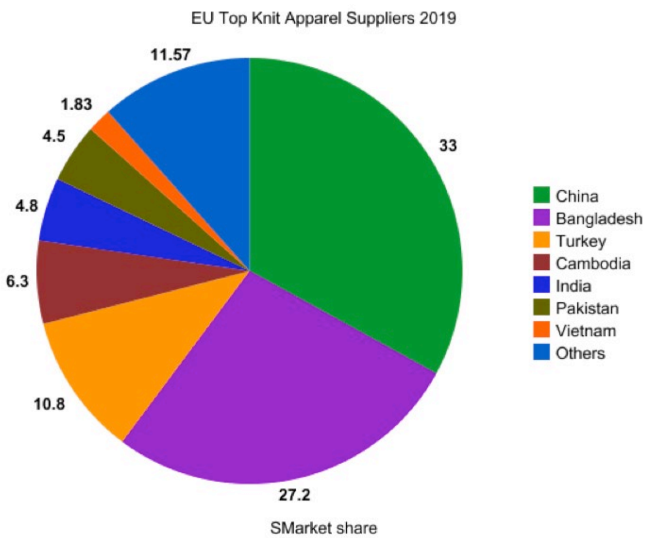
EUROPEAN APPAREL IMPORT DEMAND WEAK; IMPORTERS ALSO MOVE SUPPLY CHAINS OUT OF CHINA



The volume of EU apparel imports declined by 3.5% in February, while imports rose 7.4% in Euro terms. Amid the weaker demand, imports from China fell 8.49%, which followed four straight months of declines. The weakness is tied to a switch to Bangladesh, Turkey, Cambodia, Myanmar, and others. In February, imports from Bangladesh increased 5.31% in volume terms, as compared to the 8.49% decline in Chinese imports. China remains the top supplier, followed by Bangladesh and Turkey. India has become the fifth largest supplier of knit apparel, and sixth largest supplier of woven apparel. The link of China's Xinjiang textile supply chain to the re-education camps that have imprisoned more than a million Urgyers has already resulted in several major European brands pulling out of China.

The combination of weakness in exports to Europe and the USA has impacted a large block of the Chinese textile and apparel exports. The UK Brexit drama has damaged its economy and has affected apparel demand. The UK is a very important market for apparel offtake in the EU.

BRAZIL'S SPOT COTTON PRICES MOVE BACK TO PREMIUM TO ICE

The ESALQ Index of spot cotton prices for a 41-4-35 landed Sao Paulo stood at 70.98 on May 22nd, which reflected a sizeable premium to the ICE July contract. The positive basis followed more than a 10-cent decline in the ICE futures. The beginning of the 2019 harvest is only 30-60 days away on the earliest planted acreage, and merchants remain very aggressive sellers of new crop, while many appear to be near sold out for 2018 crop. The CFR basis for 2019 crop remains very aggressive, with the Middling 1 1/8 offered at 800 points on Dec for October-December shipment, and the same level on March for January-March shipment. The expected acreage increases in the second crop of Mato Grosso acreage for 2020 are in doubt following the sharp rally in corn prices. Corn is the second largest crop in Mato Grosso.

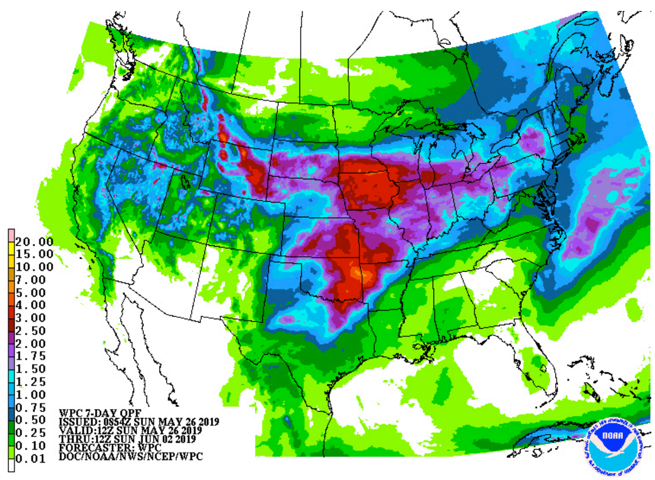
The Brazilian manufacturing sector received a major boost with the announcement by Fiat-Chrysler that it was investing four billion USD in new manufacturing plants in Brazil that will employ 16,000 people. Hopefully, this is a sign of new interest in investing in Brazil's manufacturing sector.

In Argentina, rain has again stopped the resumption of harvest in Chaco, while picking has resumed in Santiago Del Estero. Dry weather finally returned to Chaco over the weekend. We expect both quality and yield losses from the extended period of heavy rains. Export trade has been slow, with the standard SLM 1 1/16 currently being offered at 200 points on July for June and July shipment. A new level of uncertainly has entered the market, with the announcement that former President Christina Kirchner is running for Vice President.

HEAVY RAINS WILL CONTINUE TO IMPACT WEST TEXAS

The West Texas region of the US is having a very difficult time, as a series of very violent storms move across the region, each producing hail, periods of heavy rains, tornados, and wind gust of 40-60 MPH. These are not the conditions needed to get the cotton crop planted and up to a stand. In many regions of West Texas, if possible, growers are also switching to corn when the price ratios shift. As Dec corn reaches 4.00 a bushel, and cotton slides below 70 cents, many growers face replanting. Flooding is an issue, as the rains continue. The forecast again calls for very heavy rains across West Texas, Oklahoma, and Kansas over the next 7 days. The rains will end on Monday, with a period of dry weather for several days, which will open up a planting window late next week. The USDA announced its aid package for damage incurred by the China tariffs, and it is a package different from any other program used by the USDA. The aid will be based on the average loss incurred by each county, and the package will also include both specialty crops and all crops that were exported to China.

The crops that fall under the program – alfalfa hay, barley, canola, corn, crambe, dry peas, extra-long staple cotton, flaxseed, lentils, long grain and medium grain rice, mustard seed, dried beans, oats, peanuts, rapeseed, safflower, sesame seed, small and large chickpeas, sorghum, soybeans, sunflower seed, temperate japonica rice, upland cotton, and wheat – will receive a payment based on a single county rate multiplied by a farm's total plantings of those crops in aggregate in 2019. Per acre payments are not dependent on which of those crops are planted in 2019, and therefore will not distort planting decisions. Moreover, total payment-eligible plantings cannot exceed total 2018 plantings. Dairy, tree nut, and hog producers are included under a different payment method.



The payment rate applied to each commodity was not announced, but, for cotton, the NCC had proposed 12 cents a lb. payment. The program was not what was proposed by the various trade groups. One takeaway is that, since it applies to total 2019 acreage, it will reduce the amount of prevented acreage growers of soybeans and cotton are likely to plant past the insurance deadlines to receive the payment. The USDA could yet clarify this, but this is what was assumed from the press release. The disaster relief bill, passed by the Senate but stalled in the House, has added payments for prevented acreage.

In the Mid-South, planting advanced rapidly last week with the arrival of drier weather. In the Southeast, very hot dry conditions are causing stress for the young dryland cotton crops, and there is no rain is in the 7-day forecast. Overall, the 2019 US crop is off to a bit of an unusual start, as weather patterns remain outside the typical patterns.

ICE FUTURES CONTINUE TO FIND SUPPORT NEAR 65 CENTS AS DEMAND REMAINS BRISK

ICE futures found support last week, when prices began to move back toward the 65 area. Demand has been strong since the more than 10-cent break in prices. US cotton remains the most aggressive priced cotton in the world in the type offers (Middling 1 1/8, etc.) and in the lower grades. This has driven demand in every non-Chinese market. For 2019/2020, demand is focused on Brazilian 2019 crop offers, which remain the most aggressive priced style. Demand overall is weaker, due to a slower European and a weaker internal Chinese market. The Chinese domestic market, as we discussed earlier, is quite weak, with almost every textile product under pressure. The weaker behavior has been evident in man-made fibers, Viscose fiber, yarns, fabrics, and in the Chinese domestic cotton price, which has now broken the 100-cents level for the first time in years. ZCE cotton futures have led the decline with major losses. All attention was on the

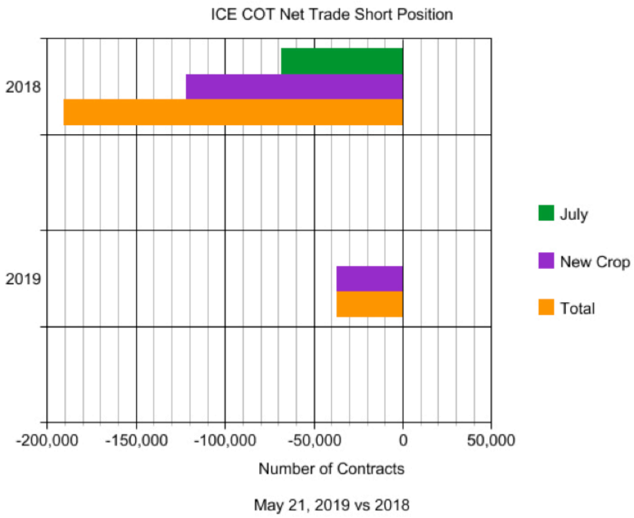
RMB/USD exchange rate last week, which held the 7.0 level. There are fears that it could collapse under the pressure, but, so far, the Chinese Central Bank has held it near 6.9.

Regardless of a trade deal, the US/China trade relationship appears set to disconnect. The rhetoric released by the Chinese over the last week included personal attacks on US officials, featuring of Korean war anti-American movies on prime time TV, and Xi Jinping invoking Mao, saying that China was beginning on a new Long March and will have to start over again. State TV called former White House advisor Steve Bannon a “true enemy of the US,” due to his remarks, marking the first time it has every gone after a private citizen. Later in the week, the US Secretary of State was attacked for his remarks. Then, an official of the CCP attacked the election in Australia, which gave a victory to the conservative parties. The pro-Beijing Labor Party was defeated in a major loss. Amid all this, no new dates for renewed trade talks have been announced.

For the 2019/2020 season, the battle will be mainly between three growths; USA, Brazilian, and African Franc Zone. The US will need to export a near-record 17 million bales, Brazil a record 8.5-9.0 million bales, and the African Franc Zone a record six million bales. Combined the total is 32 million bales, which represents 70% of the estimated world trade. For the moment, the competition is between the US and Brazil, with West African at a premium. The AFZ styles have not really experienced heavy basis pressure over the past few seasons, as demand has been strong. First, AFZ styles are very popular in markets such as Bangladesh, due to its quality and the lack of Indian and Central Asian styles. Secondly, until the new crop arrives at the port in February or later, merchants have no pressure to lower the basis. The US Trade has requested the USDA change the transportation differential in the adjusted world price calculation, due to the change in focus from China to other destinations. The cost of shipping to non-Chinese destinations is up to 3 cents a lb. higher than to China. An adjustment to the transportation adjustment could lower the AWP by up to three cents. Today, the AWP is near 59.50 and the AWP becomes important when it drops below the average loan rate of 52 cents. At that time, cotton can be redeemed from the CCC loan at the AWP, which increases the export competitiveness. The Trade is also seeking an increase in the USDA storage credits, which would also increase export competitiveness, especially later in the season. The Trade is arguing that the China tariffs have added to the storage cost, as shipments to China are delayed, which is certainly true for about a million bales of 2018/2019 crop at one point.

The support near 65 cents appears strong for now, but the greatest negative influence still unresolved in the China/US trade dispute is if China moves to ban all US agriculture imports, or Chinese buyers cancel outstanding 2018/2019 sales and possibly 2019/2020 sales. The current pace of 2018/2019 sales is allowing some cushion for the 2018/2019 cancellations. For spinners, supplies for shipment between today and October are getting tighter, with US and Brazilian the main growths remaining, Brazil supplies will increase quickly after July. The tightness is manageable as long as the 2019 Brazilian harvest is without issues. Without a major breakthrough in the Chinese talks, rallies will face trouble near 70 cents in Dec, as spinners are unlikely to follow any rally. The weakness in polyester price is also an issue. If the US follows through with the additional tariffs on all remaining Chinese imports, this will further accelerate supply chain movement and increase investment in alternatives to China. For example, Vietnam Foreign Direct Investment in the year ending April surged 81% to 14.6 billion USD. US overall imports from Vietnam, Taiwan, Bangladesh, and Pakistan have also posted strong growth in the first quarter of 2019, as trade shifted.

A new dynamic has entered the near-term price outlook – the size of the Managed Fund net short position and the size of the net Trade short position. The funds were aggressive sellers in the recent period, and are now short by a record 37,086 contracts. The record short in cotton follows record shorts in corn, wheat, and other agriculture commodities. In the last ten years, the funds have shown a long bias in cotton, and, while they have extended the long positions to near 100,000 contracts, the shorts have been very limited on a net basis. Thus, the current position is unusual, to say the least. Secondly, a closer look indicates that the net short is all positioned in the July contract. That is also odd, as the funds are actually net long New Crop by 203 contracts. This position has occurred as the July contract enters its final period before first notice day. Before any cancelations, the US is also well sold out of old crop. In the current atmosphere, a further build up in the net short to 50,000 contracts cannot be ruled out. However, we are in uncharted waters with the current record short and its total concentration in the July contract. Adding to this dynamic is that the Trade or commercial short position is at a record low, which is very shocking given the larger US and Brazilian crops that are pending. The net trade short is at only 23,490 contracts. Breaking it down further, the trade is net long 14,130 July contracts, and net short 37,620 contracts of New Crop. Compare these conditions to last year at this time. The trade was net short 190,439 contracts. Of that, 68,360 contracts were net short the July contract. Thus, the current state of positions is very much out of the norm. The July futures last year at the same time were near 87 cents, and Dec near 84 cents. Today we are at the lower extremes.



These positions say the Trade has no selling left in July, and that the funds could at the least face a squeeze rolling out of July to Dec, which means major swings in the July/Dec spread. The spec short could also face a price squeeze in the near term, as they exit their July shorts. The trade extreme small net short is yet another matter. The trade war would appear to result in a much-reduced volume of forward selling, which means heavy trade selling awaits on any rally. The record 2019 Brazilian crop and the heavy forward selling by growers and thru the barter trade for inputs in itself would suggest a larger net short, which may mean that the heavy level of Brazil forward sales has reduced the trade short basis positions. Overall, the trade has volume left to hedge. However, if it holds for a rally, the net speculative short could find itself like it did in corn, overextended and forced to cover.

For now, we expect heavy Trade selling to await a rally in the Dec to the 70/72.50 area. The Trade needs to hedge additional US and Brazilian styles, and such a rally would likely stimulate additional new crop-selling tenders out of the African Franc Zone. Support will continue near 65/66, with much of that coming from the July contract. The July contract has the potential to create some anxiety for the speculative short. We believe a new trade matrix is evolving that will be less China-centric for cotton. The dynamic that remains unanswered is whether or not a new consumption base will emerge in the Americas.

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