



CHINA COTTON CONSUMPTION PROBLEMS EXPAND



GLOBAL APPAREL INVENTORIES MAY SALE BELOW ZERO



INDIAN CFR EXPORT BASIS NOW AT RECORD DISCOUNTS



BRAZIL GROWERS HOLD BACK SALES AS PRICES FALL



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CHINA PURCHASES CONFIRMED IN US WEEKLY EXPORT SALES CREATE NEW QUESTIONS



中储粮油脂有限公司
SINOGRAIN OILS CORPORATION

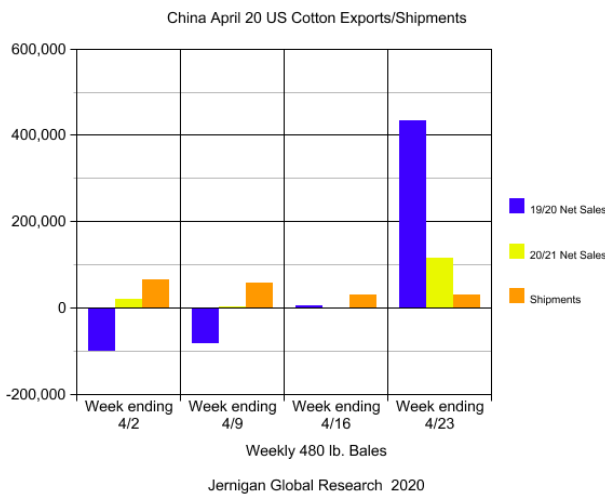


The entire set of conditions surrounding the recently well-publicized press coverage of SINOGRAIN/CNCR's plan to purchase grain and cotton for the National Reserves remains cloaked in mystery. Again, it is very unusual for such discussions to receive press coverage in China and in the international press. As of today, there has been no confirmation that the Reserve/Sinograin has received approval from the National Development Reform Commission (NDRC) for such purchases. The NDRC must approve such purchases and normally is very selective in any press coverage. Many times there is no press coverage until after the event. Adding to the drama of the current event are the rumors that involve the two largest State trading houses for cotton. The most active of these appears to be

playing its largest role in years in such purchases. No sales have been confirmed by the Reserve/Sinograin. Instead, the bulk of the activity appears to be centered on the active inquiry by one state-owned trade house that inquired for US, Brazilian, and African Franc Zone styles. US purchases by this group appear to have shown up in the weekly USDA export sales report, with

sales of 441,700 running bales of upland for 2019/2020 shipment and 115,300 running bales for 2020/2021. It is unclear the number of merchants involved in the sales. Rumors are circulating of other activity, but they are not confirmed.

A review of China's activity in US cotton upland export sales in April suggests ongoing attempts have been underway to adjust for some of the very high-priced sales made earlier, over a year ago. In April, China purchased 439,200 running bales for 2019/2020 and canceled 183,000 bales, leaving net sales at only 256,200, hardly a number to draw much excitement. 2020/2021 purchases have totaled 137,500 running bales. Shipments were a disappointment and showed no signs of the need for the cotton at only 183,000 running bales.

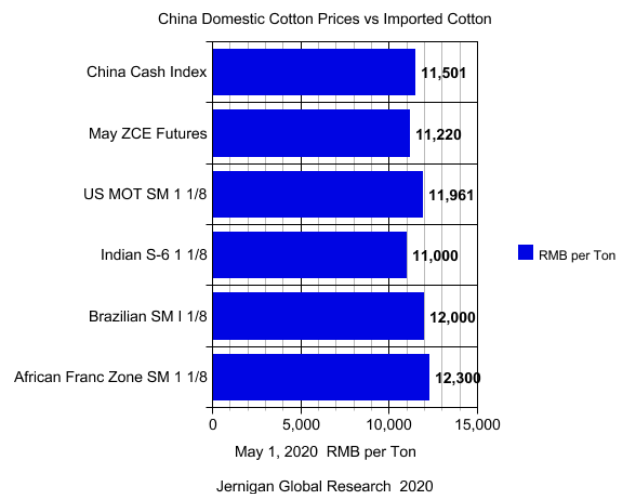


The next question is whether the state-owned companies are buying for their own book, or whether the purchase is intended for the Reserve. The state-owned companies receive special treatment in imports that are not given to the traders and merchants. In the WTO accession agreement, the annual assured import quota of 1% is divided between the private, with an advantage of always having access to imported cotton. In the past, they have taken notable positions from time to time, and US cotton has always been popular. It remains quite unclear why a state-owned trading house would seek to accumulate a large block of US cotton for a trading book amid the current conditions. On call purchases have been used actively in the past.

The state-owned trading houses have captured global attention with this activity and were mostly the only buyers, as global textile conditions continued to weaken, yarn prices continued to move lower last week, and spinners around the world appeared to have no understanding of what consumption would look

like the rest of the year. A few spinners inquired and purchased cheap 2019/2020 crop recaps where the price was discounted in order to reduce the average cost of inventories before the futures rallied. China's domestic textile market was very weak. Many mills are closing for May Day holiday, and closures will stop the buildup of inventories. This is true for all fibers – polyester, Viscose and cotton. Chinese traders face large losses in positions, with a record 2.76 million bales (and still increasing) of unsold 1-3 year old cotton sitting in bonded warehouses. US and Brazilian cotton make up these stocks, along with Australian and a few other styles. This represents more than one billion USD of unsold inventory held by traders. Then there is the record unsold volume of Xinjiang old crop that the ginners and trade are holding. If the state trade house purchases are intended to be only be used for domestic demand, which has collapsed, then it faces competition from these stocks, which are captive. This means that once a trader moves cotton into these bonded warehouses they will almost have to sell them in China, since shipping them back out to another destination would be very expensive.

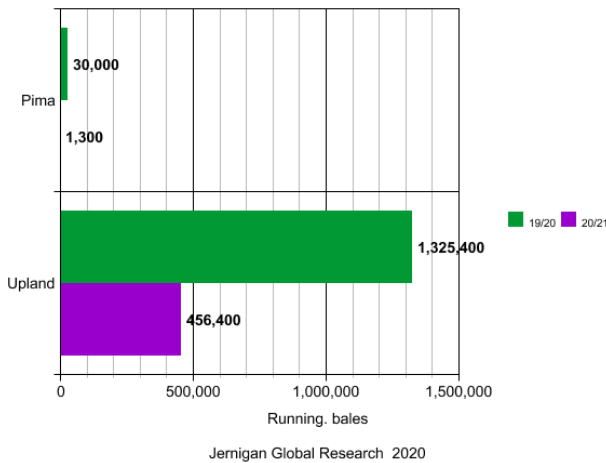
Adding to the unusual nature of the trade house purchases is the fact that there is no competitive price advantage. On April 30th, the Cotlook A Index average price adjusted for the Chinese domestic market, and VAT stood at 11,608 RMB a ton. The Chinese Cash Cotton Index was at 11,501 RMB, and the May ZCE closed at 11,220 RMB. Thus, US cotton landed at a Chinese port is more expensive than domestic cotton by a small margin. No real price advantage exists for imports.



These conditions have made any volume purchases for trading books unusual but not impossible. The behavior of the futures during all this activity also has raised a few questions. Futures began to show support about 30

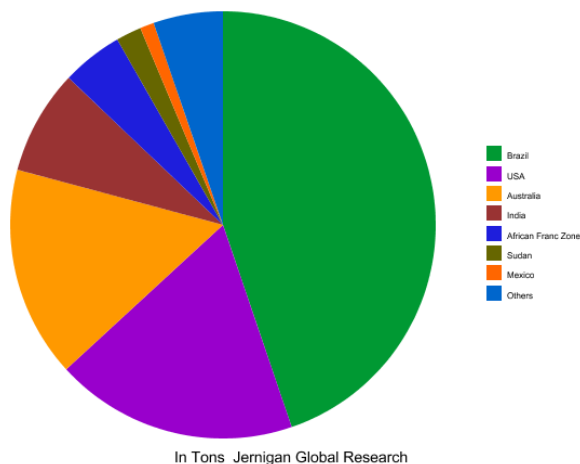
days ago in the 48-50 cent range, and then proceeded to rally almost ten cents before appearing to peak. The May futures found support from one trade group that was also linked to aggressive equity purchases in the US market. Another question being raised is whether the new purchases of US cotton are somehow tied to the over 750,000 bales of outstanding US sales that were made to China more than a year ago at very high prices. Price averaging or links to futures positions are also considerations. Then it may be as simple as the state-owned trading houses acting as agents for the Reserve. However, when a near 1000-point rally in the futures follows such a purchase, it raises a host of questions as to how this is tied to the sales.

US Outstanding Sales to China as of April 23, 2020



China was also a buyer of US sorghum during the week, with purchases of 318,700 tons, 618,700 tons of soybeans, and 35,100 tons of pork. These purchases suggest they may have started to work on the terms of the Trade Agreement, at least the agriculture part. In March, China imported 209,927 tons of cotton, and Brazil was the largest supplier at 84,389 tons. The US

China Aug/March 19/20 Cotton Imports

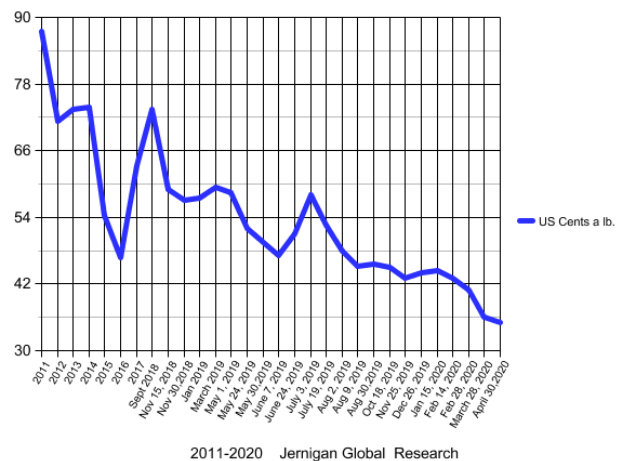


was the second largest supplier at 52,241 tons, followed by India at 33,155 tons. Total Chinese August-March cotton imports reached 1,120,081 tons or 5,146,212 bales. Brazil is the top supplier at 501,422 tons or 2.3 million bales.

March cotton yarn imports were also strong at 190,000 tons. Both of these have added to the unsold inventories. The March imports were purchased before the Wuhan Virus outbreak. The NBS data, which has major statistical issues, showed a sharp decline in textile production in March, with total yarn output declining 16.4% and fabric production falling by 24.9%. WIND, a respected private group, reported total yarn production for January-March fell 27.69%, while another private survey placed yarn inventories up 24.55%.

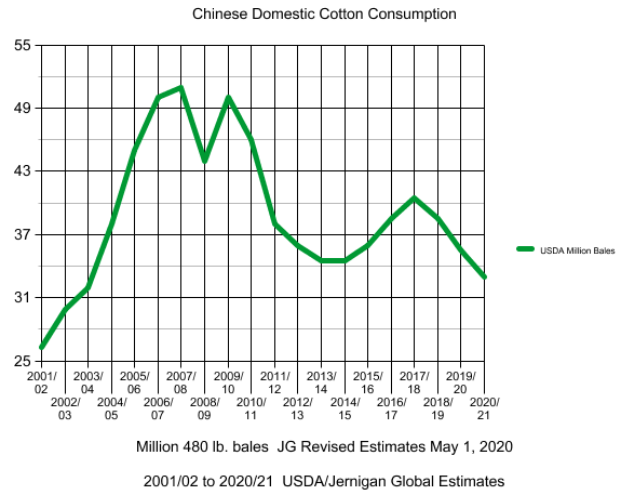
Chinese cotton yarn stocks are rapidly building at the mill level due to declining orders. The price of the benchmark cotton carded 32-count yarn was under pressure all week, falling to 18,800 RMB a ton. This has put it at a discount to Indian and Vietnam imported yarn, which reached near 700 RMB or more by the end of the week. Rayon spinners report very poor conditions, with operating rates falling to 40% and inventories building rapidly. Large discounts can be had on any volume purchases.

China FOB Polyester Fiber Prices : Price per lb.



Overall, there remains no confirmation that the Reserve has received approval to purchase 1 MT of cotton. At this point, it appears the US purchases are trade related involving the state trading houses. A confirmation of Reserve purchases or additional purchases could change all that. The behavior of the ICE futures suggests the purchases were a one-off event and could also be tied to older sales that will later be changed. We also continue to fear that the US/China Trade Agreement is on shaky ground, which makes the rapid shipment of any US sales extremely important. New

reports late last week quoted the US as saying that the trade deal now is secondary to the damage inflicted by China in the spread of the Wuhan Virus to the US. Some press reports suggested new tariffs on imports were possible in order to seek compensation.



COULD RETAILERS' RECORD DISCOUNTS OF APPAREL INVENTORIES BREACH ZERO?



A review of the e-commerce sites of many major apparel retailers in the US indicates that discounts of 40-70% are being offered on spring merchandise. Despite these discounts, Rakuten Intelligence, which tracks electronic online apparel sales, has reported that sales have fallen every week since March 9th. Retailers report that consumers are not rushing to buy despite the discounts. Retailers face a real dilemma in the liquidation of inventory. The traditional discounters have not been willing to submit a bid, since most are still closed and have very limited e-commerce. In addition, imported apparel from China that had drawn extra duty means larger losses. The drama has not yet begun to unfold, because the stores are closed and will only begin to reopen as we move into May. When they reopen and decisions are made on which branches to close, then the real discounting will begin. The question remains, at what point will a retailer begin to entertain bulk, heavily discounted bids? In the past, inventories could be sold to discount chains such as T.J. Maxx, Marshalls, etc., and the price would allow most

costs to be recovered. With that option limited, it is unclear where bids will come from. Will some retailers be willing to pay someone to dispose of the products taking the price below zero? The threat of bankruptcies is now high, with several major chains under threat. This will add to the problems with inventory disposal.

Many retailers have stores full of product, warehouses full of product, and containers sitting at the port that are full and need to be unloaded. The pressure to open space will occur as seasons change. The spring season has been lost for the most part, and the center of attention will soon be on the summer season. The volume of sales lost during the shutdown globally is simply unbelievable. Our estimate is that between 8.4-9.6 million bales of cotton consumption were lost due to the retail shutdown, which on average has had a duration of 7-8 weeks. More than 5 MMT of man-made fiber consumption in apparel has also been lost. This lost consumption of apparel is staggering, with an unknown portion due to the closure of spinners. Then

there is the work in progress or finished and ready to ship. The volume of inventory of apparel in stores, warehouses, in transit, or at the factory waiting to be shipped is mindboggling.

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The key question is where will this apparel move? The first choice will be to the traditional discounters such as T.J. Maxx, Marshalls, Ross Stores, and others. The unknown is how store traffic will return to these stores, since few of these groups have any e-commerce and depend primarily on store traffic. The discounters were also caught with inventories that sit in stores. Storage space is limited. How willing will the group be to store spring 2020 product and then reintroduce in 2021? Retailers and manufacturers are all exploring other options. Manufacturers holding finished apparel are exploring their options. Some are exploring attempting to move products in the domestic markets such as India. Sizing differences is one problem. Others are looking at reworking, upcycling products, with the possibility of improving seasonal relevance. Others are exploring storing unshipped 2020 spring/summer apparel and then using for it for 2021 seasons.

Donations to charities through textile banks are already up sharply, but these will have limited volume potential. Donations to emerging markets will take the apparel to below zero when the cost of shipping is accounted for. Recycling is less of an option due to it not being commercially viable, especially at a time when the entire supply chain is under major economic pressure. For example, virgin polyester is at a discount to recycled. Recycled apparel normally goes into the lower end price products. 20% goes into polishing

and cleaning cloths, and 26% goes into insulation and other industrial products. This means that some of the inventory, especially the low quality man-made fiber products that were designed for the Fast Fashion and mass discounters, will move to a landfill. The average cost of moving product to a landfill is estimated at 45 USD a ton for textile waste. Again, this means this product has moved below zero and has cost to the retailer for disposal of it. The cost could go up as cities face significant budget crises, and recycling has been stopped in many regions to save cost. The next expectation is a fee for large volume of waste disposal, thus the risk of cost increasing sharply or doubling is very high. Man-made fiber apparel never biodegrades, which results in a much higher cost for landfills. It also means this crisis will have created an environmental disaster. The use of landfill for man-made apparel raises a host of concerns.



One major concern is the possible effect of the non-biodegradable microfibers being released into the local water supplies. There is a major concern that the microfibers are moving into the entire food chain. Moreover, the polyester apparel in the landfill releases methane gas. Dyes and chemical treatments are also a large concern, which has raised the possibility that man-made fibers may be banned from landfills in many locations, thus increasing the cost of disposal. A 20-USD polyester retail apparel product that has a cost of 8.00 USD could cost retailers 8.50 or more, including disposal cost. This is expected to shake the supply chain and result in retailers reviewing their product mix. A UBS study of post-virus US consumer spending habits indicated a dramatic drop in expenditures on apparel. The common comment was, "buying apparel and electronics is not important at this time." Amid these prospects, retailers are rethinking seasonal offering and considering a much-reduced product range, which would mean Fast Fashion is headed for major headwinds. Many are reviewing and now considering a much higher quality product offering that has dual-season use and a much longer shelf life. If

true, it would result in a dramatically reduced market share for man-made fiber and a sharp increase in natural fiber use.

We are seeing early data that confirms this change. The changes are occurring in the sales of the 100% cotton products offered by e-commerce during the Wuhan Virus shutdown. In addition, the sales data is showing that US-made products are experiencing a surge in demand. Product safety is a key issue, and the data shows that the CCP Wuhan Virus can survive on surfaces for a length of time. Cotton has been at the forefront of the CDC's approved facemask, and it does not take a great leap for the consumer to realize that a cotton apparel item is much less likely to carry the virus

than a man-made fiber product. Even the failed World Health Organization has recognized this.

We continue to believe cotton's market share of the global fiber market will bottom in 2020 and begin to show significant improvement in 2021. Other natural fibers will also benefit. We expect the development of new technologies that will make cotton perform in a manner that will cause polyester and nylon to see a considerable drop in market share. Against this backdrop, dramatic changes in product offering are expected in the spring of 2021. The liquidation of the excess inventories will dominate the next several months and highlight the crisis at retail now underway across the world.

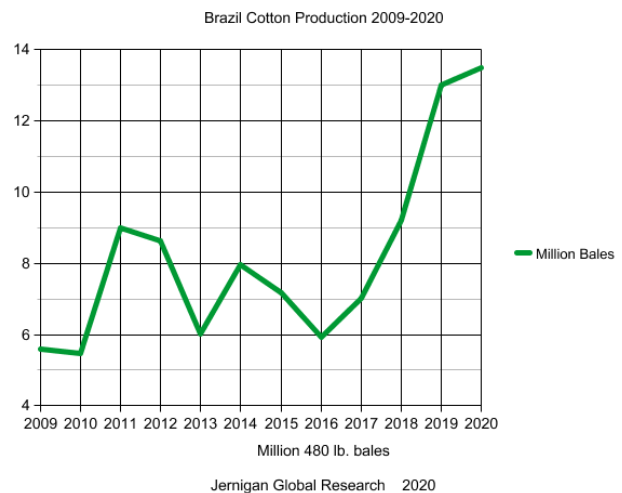
BRAZILIAN GROWERS SLOW TO SELL AT CURRENT PRICES



The 2020 harvest is about 60 days away, and Brazilian growers continue to be reluctant to extend sales during the past 60 days as ICE futures have collapsed and the Brazilian Real/USD exchange rate crashed. On the BBM, growers' sales on March 1st stood at only 687,884 tons, and by April 27th sales had increased to only 715,139 tons. This reflects only a portion of total sales. The expected crop is up to 2.938 MMT or 13.5 million bales. Unlike soybeans and corn, there is no active domestic market for the moment for cotton in Real per lb. Domestic demand is quite weak during the economic downturn created by the CCP Wuhan Virus. The ESQUAL Index of a 42-4-35 landed Sao Paulo hit 47.85 US cents a lb. on April 27th, which is a 715-point off basis from July ICE. Normally, the domestic basis gets very tight as the season nears an end due to the crop being much smaller, and would usually move aggressively to export early in the season, leaving very limited stocks. Domestic spinners always face credit restraints, and are forced to seek stocks as needed. The tightness in the past resulted in a small volume of imports being required. The surge in cotton production has changed all that, and now domestic consumption has turned even weaker. Thus,

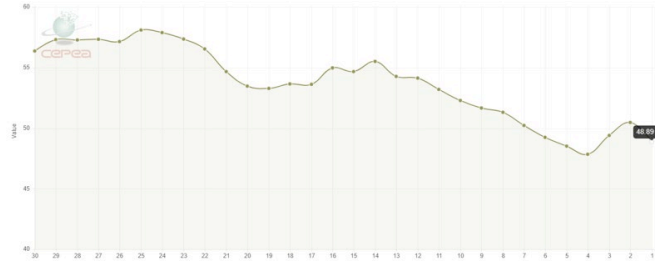
exports are presently the main market, and merchants are bidding 250-300 points on Dec 2020 futures FOB Santos. However, 55-58 cents futures make even these prices, which are sharply higher than domestic bids, also unattractive.

We fear the domestic economy could face another recession as the current government's problems increase and the Real/USD exchange rate remains under pressure. One impact of the Real weakness has been record domestic prices for soybeans. One estimate has the average profit margins on soybeans at 15-25%, depending on land ownership. Even higher margins are offered for the southernmost producers with a closer proximity to the ports. This will result in all emphasis focused on soybeans in 2021, with acreage expanding. Corn is likely to be the second crop, with cotton having now lost much of its luster due to high input cost and poor USD price.



It remains to be seen if growers' plan to withhold sales of 2020 will pay off. It is estimated that over 80% of the soybean crop is sold, which helps with cash flow. The pressure will build once the cotton is ginned and begins to build in the gin yard and storage yards. Growers' cost of production for the 2020 crop was about 10,000 Real per hectare, which equaled approximately 62 cents a lb. based on average yields, the exchange rate at the time when the inputs were purchased. The exchange rate has collapsed since the crop was planted, and 2021 crop expenses are not yet clear. The import of any cotton pickers is not likely at the current exchange rate of 5.4 and higher prevailing today. For growers selling at 58 cents futures and a 300 point on basis FOB Santos means a net loss of 5 cents or more a lb., FOB gin yard. This indicates growers are

unlikely to sell until the pressure mounts after ginning or the price advances. This explains why the CFR basis is not showing any pressure, as merchants are mostly likely flat to short the basis, except for the barter trade.



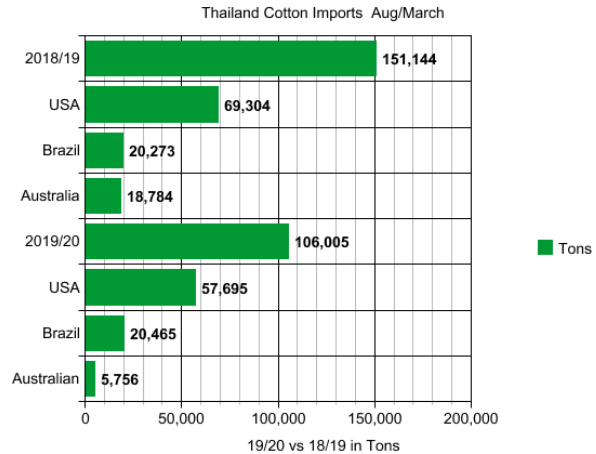
Brazil CEPEA/ESALQ Index

THAILAND COTTON CONSUMPTION VERY WEAK



For all the discussion of moving supply chains, Thailand's textile and apparel sector has not benefited, and cotton use has turned very weak, which is highlighted in the cotton import data. August-March cotton imports have reached only 106,005 tons, a sizeable drop of 30% from a year ago when imports in the same period totaled 151,144 tons. Textile and apparel have not been targets of new investment, and man-made fibers remain quite popular with the apparel companies. Only 35% of Thai apparel exports to the USA are cotton. Thailand has a large domestic man-made fiber industry that produces polyester and other products locally, as compared to the required

importation of cotton. The US is the largest supplier of cotton, providing 57,695 tons in the August-March time period, which is down from 69,304 tons a year ago. Brazil is the second largest supplier, while Australian has lost market share due to the basis levels.



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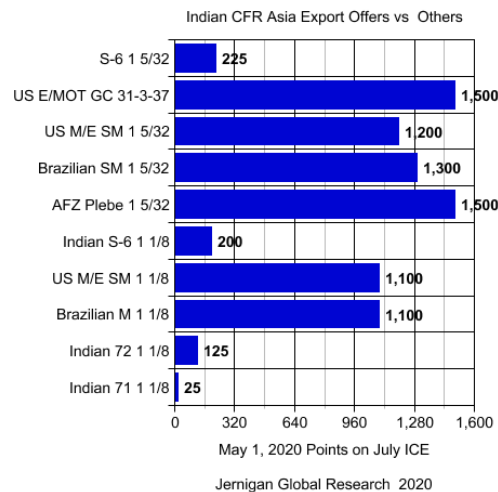
INDIAN COTTON MOVEMENT BEGINS TO INCREASE



Indian cotton is again beginning to move in some volume from growers. The CCI is increasing buying, but prices remain low and have turned weaker in some areas, such as Maharashtra. Domestic mill demand is very weak due to low consumption and high inventories. Spinners have restarted operations except in the worst hit virus areas. Most mills have inventories of 50-60 days, which means they are in no hurry to buy. Despite an appreciation off the lows in the Rupee/USD exchange rate, the spot price for S-6 1 1/8 remains below 58 cents FOB gin. New crop arrivals are building daily, and the CCI is estimated to have purchased more than 1.5 MMT or about 8.823 million 170-K bales.

Indian cotton is now the most competitive of any growth by record margins. On Thursday April 30th, a S-6 1 5/32 was offered at 225 points on July CFR Asia, while a US Memphis/Eastern green card 31-3-37 is offered at 1500 points, a E/MOT SM 1 5/32 is offered at 1200 points on, a Brazilian Middling 1 5/32 is offered at

1200 points on, and an African Franc Zone Cameroon Plebe 1 5/32 is offered at 1500 points on. Yet we have not heard of any volume offtake. Up until now, the China Reserve has not been willing to buy Indian because of storage issues. However, we have never seen such discounts. Indian exporters are also offering a wide range of lower grades at sizeable discounts. A Grade 71 roller ginned 25 mm is offered at 1300 points off July, CFR Asia. Even the top grade MCU-5 30 mm is offered at 400 points on July. The rally in ICE futures is having zero impact, and the pressure is building, with these prices reflecting only small 25,000 bales or so daily arrivals.



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Last week's forecast of rains and a cold front arrived across southern NSW and much of Victoria. The southern portion of NSW received widespread rains and temperatures that fell to a very cool 4-5 degrees C, near 40 degrees F, which brought any cotton growth to a halt. The heaviest rains reached near 50 mm, with good coverage across the southern valleys. The southern valleys are very important to cotton production, and they will account for about 150,000 bales of the 2020 crop. The quality and yields may be impacted by the cool, wet conditions. Harvest in Queensland is advancing under clear skies, and the outlook is for dry conditions over the next seven days.

Export trade appears quiet. However, China/Australia relations appear to have declined to their lowest levels



Central Highlands, Queensland

in years following China threatening retaliation against Australia due to its stance on an open investigation into the source of the CCP Wuhan Virus and also its support for Taiwan to join the WTO. The Chinese Ambassador openly threatened that China could stop purchases of Australian coal, iron ore, beef, and other products. This set off an attempt by some mining executives to make Australia bow to China's demands, which started a heated debate on sovereignty. It remains to be seen if and how these developments will affect cotton trade.

2020 CFR basis levels are maintained at 2300 points on July for a SM 1 5/32 that has so far attracted limited buying interest. The continued rains make the supply of Good/Strict Middling color grades in doubt. Many merchants may already be overcommitted in these color grades.

RALLY IN ICE FUTURES STALLS AFTER CHINESE PURCHASES ARE CONFIRMED

A large block sale to either the Chinese state trading firms or the CNCRC (Reserve) has always carried with it a high degree of drama, ranging from long nights of hospitality centered around toast of Baijiu for the sales team, to the mechanics of the sales and the role of futures in the terms. In addition, security around the exact terms of a sale has always been tight-lipped, and the misinformation is legendary. The current large sale of US cotton has lived up to the past, bringing some excitement to otherwise depressing conditions. The behavior of ICE futures has certainly given the impression that the sales have stimulated a variety of futures activity by those involved, which successfully ignited the buying by some Funds, Algos and HFT. Adding to the ability to move prices is the extremely low level of Open Interest in futures and the fact that daily volume has been very low as much of the cotton trade remained on the sidelines amid very limited trade.

The behavior of ICE last week stirred up memories of the price movement centered around other sales to the Chinese trade houses or Reserve. The excitement came

prior to the confirmation of the sales, which remained clouded in mystery. The rally peaked just shy of 58.00 in July on Thursday, the final trading day of April. July gained 643 points in April, a 12.6% gain. Thursday was a big day for many commodities. WTI crude gained 25%, hogs over 6%, and soybeans posted gains of more



than 17 cents. Despite all the hype, ICE cotton futures volume only reached 23,707 contracts, with spreads and HFT and Algos dominating even that turnover. Friday brought moderate losses, with July closing down 149 points at 55.84. Cotton also benefited in April from the general play on the US economic recovery, as equity markets experienced their best months in years, with the NASDAQ average at one point going positive for the year.

The July/Dec spread showed little movement, and certificated stocks remain at nominal levels. The lack of carry remains one of the great mysteries, as does the lack of certificated stocks given US inventory levels. The CFTC data as of April 28th showed that the Managed Funds were the largest buyer, with the Trade, Swaps, and Other Reportable the best sellers. Overall, futures Open Interest stands at only 174,029 as of April 28th, compared to 212,357 contracts a year ago. A larger options position does balance conditions more closely. However, in both futures and options the net Trade short position remains very small at 43,486 contracts, which compares to a net short of 89,903 contracts a year ago. This position is still far under normal hedged volume given the unsold inventories that must be carried forward.

We continue to view any sales to China as not a savior for prices. First, China has a serious problem with cotton inventories, demand is extremely weak, and supply chains are moving out. Second, US/China trade relations cannot be turned around unless there is a change of leadership in Beijing. As we ended last week, the US was discussing an increase in tariffs and other methods to force China to make reparations for losses resulting from the virus that they unleashed on the world. It now seems a number of countries are following the US's lead, and there are even several individual American states which are also suing. An executive order is forthcoming to ban US pension funds from investing in the Chinese equity markets. Other

measures will be following to stop the flow of credit. Then there is Hong Kong, which is now a failed state where the CCP police abuse people's rights daily and the Hong Kong act will be implemented shortly. There is a move supported by the US and other powers for Taiwan to have a greater role in the world. Considering the consequences of these measures, any outstanding cotton shipments should be shipped ASAP, as any delay will have risk. Therefore, the price structure cannot be built on Chinese sales.

The market outlook depends on the reemergence of demand from retailers and brands. The first stores in the US began to open last week for limited hours and under new conditions. The CEO of Bank of America late Friday did say that their data has shown a pickup in consumer spending last week, which included a small switch from focusing on just necessities. In addition, the government aid funds were flowing and showing up in consumer accounts. We have said for weeks that ICE cotton prices were in a no-man's land due to the state of demand. The drama related to the China trade house purchases provided some excitement but has done nothing to change the outlook. We continue to be fearful that the market faces considerable trouble carrying the record inventories into the next season. The fulfillment of already arranged contracts remains at the forefront of every trader. Credit has tightened after the oil price fiasco caused by the collapse in demand and the excessive speculation that was permitted by the CME and ICE. The magnitude of what was allowed to happen in WTI is shocking and a major turning point. The US and the international public lost billions in the two-day May Casino held by the CME. The Bank of China reported a billion USD loss.

Some CFR basis levels appear to be far out of line with reality as, the premium to Indian breaks all records and the traders face no carry. We continue to see more trouble for prices and basis levels.



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