INDIAN 2019 MONSOON BREAKS RECORDS

INDONESIA COTTON USE FLAT TO WEAK

US PIMA EXPORTS WEAK AMID NO CHINA DEMAND

US 2019/20 CROP SET FOR EXCELLENT QUALITY

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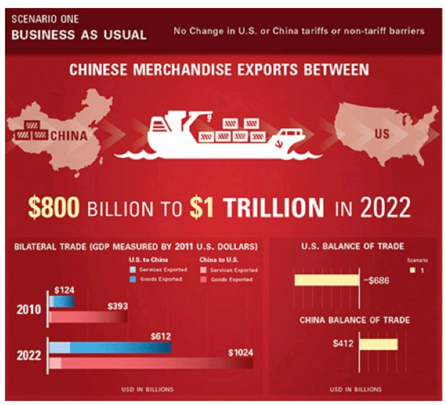
KNOWLEDGE IS THE NEW CAPITAL

CHINA CANCELS US PURCHASES; NO COTTON INCLUDED IN GOODWILL PURCHASES

Source, SCMP



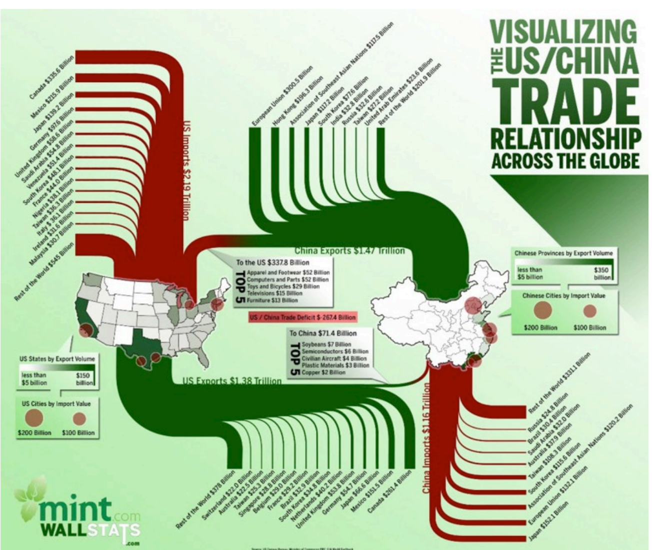
What Could Have Been, Source, ChinaUSFocus

Deng Xiaoping: the father of modern China, the man who sparked hope

The global geopolitical atmosphere was very volatile last week, with the China/US trade drama taking a back seat to attacks on Saudi Arabia's oil fields and the threat of retaliation. The week began with emotions high following a drone attack that damaged Saudi Arabia's main oil facility. The first estimates indicated 5.7 million barrels a day of output or 5% of the worlds supply had been impacted. Crude oil opened sharply higher, with London Brent Crude jumping 11 USD a barrel, and by the close on Monday WTI crude closed 12.38% higher and Brent 12.59% higher. The next day brought a rapid decline in prices, as it appeared the lost oil field output would be restored much sooner than expected. The entire event triggered a liquidity squeeze, with the Quant Funds reportedly caught short by the energy complex going into the event.

As the impact of this Saudi event eased and moved from the headlines, it became clear that the goodwill purchases by China were concentrated only on pork and soybeans, commodities that were in demand and needed, and not part of a wider opening. The weekly US cotton export sales report brought home the reality when China canceled a net 39,300 running bales of upland cotton. Export trade was very dull all last week as spinners resisted the higher prices that had prevailed. China's man-made fiber markets were affected by the surge in crude oil and volatility in the energy complex. On Monday, PTA and MEG futures posted strong gains, and cash polyester prices recovered to over 49 cents FOB. ICE cotton futures slowly gave up last week's gains due to lack of followup buying and the appearance of Trade selling.

US Agriculture Secretary Sunny Perdue announced on Thursday that the Chinese trade delegation will visit Mid-West agriculture locations, but the exact locations were not disclosed. This suggests a heavy focus on the part of the Chinese on trade. The announcement of these visits has again raised hopes that a limited deal focused specifically on trade is possible, which may include some relief on tariffs. Press reports were in circulation that Chinese companies received notice that US soybeans, pork, and beef were tariff free. However, this is unconfirmed as of now. On Friday, the South China Morning Post carried an interview with Trump advisor Michael Pillsbury in which he stated that if China does not agree to a deal soon the US could increase tariffs 50-100%. Another article suggested that the US and China were preparing for a trade deal, and a Chinese official confirmed the China trade delegation would visit US farms. Then, late Friday, came a statement at a press conference with the visiting Australian President that the US was not interested in a limited trade deal that did not deal with the core issues. Then several hours later, came a short Chinese news announcement that the Chinese trade delegation would not visit the Mid-West farms.



On the surface, the China/US trade talks appear to remain on track, but there are two major situations on the horizon that could disrupt the talks. The first concerns Hong Kong. The US Senate and House hosted meetings with the leaders of the Hong Kong freedom movement, and leaders of both legislative bodies promised swift passage of the Hong Kong Human Rights and Democracy Act. Speaker of the House Nancy Pelosi held a press conference with the group. Hong Kong democracy activist Joshua Wong called on US lawmakers to pass legislation requiring annual reviews of the special status that affords Hong Kong trade and economic privileges. “Beijing should not have it both ways, reaping all the economic benefit of Hong Kong’s standing in the world” amid the “erosion of our freedom,” Wong told a hearing of the Congressional Executive Commission on China.

Meanwhile, the unrest in Hong Kong has continued to take a toll on the economy, as noted by the fact Hong Kong’s USD reserves are reported to have fallen by 16 billion USD in August due to capital flight from the territory. The real estate sector is under significant pressure, with the shares of the second largest real estate group falling to a 16-year low. The Hang Seng Index was under pressure all last week, as funds exited the market; 2.791 trillion USD of Chinese stocks trade in Hong Kong.

The situation in Hong Kong is a balancing act. Hong Kong is important to the Chinese economy, even though its influence has diminished from ten years ago. It has been reported that Chinese banks have 416 global subsidiaries in Hong Kong, and that Hong Kong processes 75% of all global Yuan transactions. At the same time, the unrest is making the southern regions nervous. Videos and news coverage released last week indicate Guangdong ordered 150,000 anti-riot troops to be ready to enter Hong Kong if needed to make sure the National Day celebrations were peaceful.

The second front opening on the trade war is in the capital markets, where US Senator Marco Rubio is pushing hard for passage of the Equitable Act that would give the PCAD board authority to require audited statements from all companies listed on US exchanges. Companies would also be required to disclose all government ownership, and Chinese companies would be required to disclose all Communist Party members on the board. Many of the Chinese companies listed in the US are domiciled in the Cayman Islands or BVI, and three of the companies listed in the US are considered a major security risk to the US – AVI China, Hikvision, and China Mobile. As part of the same initiative, Senator Rubio is pressuring the US Federal Retirement Thrift Investment Board to reverse its decision to allow US funds that track the MSCI All-Country World Index to invest in Mainland Chinese companies. There is discussion of blacklisting any firm with ties to the Chinese Military. Firms such as US Funds manager Blackrock have an estimated 3.3 billion USD invested in Hong Kong ETF's linked to mainland shares. Morgan Stanley, Merrill Lynch, and JP Morgan would also be affected by such an action. These actions would have a significant economic impact on Chinese companies and the country's economy.

The persecution of Christians and all religions in China is once again escalating, with the government's recent orders that churches that are still open must replace copies of the Ten Commandants with quotes of Xi Jinping, and for the churches to post photos of Mao and other Chinese leaders. Three Self Church, a state approved church and one of the largest in China, has now removed the Ten Commandments from its churches. Churches that do not comply are being closed down and members persecuted. The fear of such attacks has now spread to Hong Kong. These efforts are also getting more attention in the US, with the effort also lead by Senator Rubio. Many fear that China is moving toward a North Korea-type worship of the country's leader. It was announced that Chinese journalists will have to take a test on their loyalty to Xi Jinping.

It is becoming increasingly clear that it is dangerous for Americans to visit China. As the week ended, a FedEx pilot had been detained. The pilot was a US Air Force veteran. The incident raised an angry reaction from the US government.

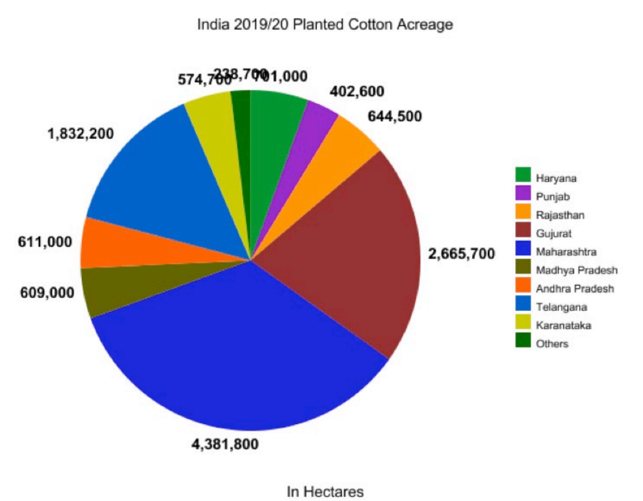
According to the *Financial Times*, the credit crunch in China has triggered the "Great China Corporate Sell-Off." The FT reports that Dealogic estimates that as of September 1st Chinese companies have sold 39.983 billion USD of global assets and only purchased 35.353 billion in new assets, leaving corporate China as a net seller for the first time in several years. In 2016, China purchased a record 217.39 billion USD in global assets, while selling only 15.88 billion. It has also surfaced that local governments are desperate to keep the US and other foreign firms from leaving China. One of these is the Jiangsu government, which invested heavily in the Suzhou Industrial Park that is five times the size of Manhattan. The park is estimated to account for 70% of Jiangsu's exports and imports. For the first half 2019, Jiangsu's exports are down 10%, and imports are down 15% as foreign companies have pulled out. The Jiangsu government is now providing tariff relief on exports to the US.

By Saturday, it appeared that a short-term trade deal focused on the less controversial points was unlikely and that China was not yet ready to really negotiate.

CAN INDIA'S MONSOON PRODUCE TOO MUCH RAIN?

Record Mumbai rains

The 2019 Indian monsoon is setting records for excessive rainfall. Mumbai has now officially received record September rainfall during this monsoon season. From September 1st-18th Mumbai's rainfall amounted to 921.3 mm (36.85 inches), and from June 1st to September 18th they received 3,475 mm (139 inches) of rain, also a record. The monsoon remains active, with almost all cotton areas near an excess. In Gujarat the drought is gone, and the monsoon has produced rains 43% above normal in the important Saurashtra area. Some concern is evident regarding the amount of rain and its impact on cotton. The eventual outcome is not yet known, but the country has planted a record acreage to cotton of 12,660,800 hectares as of September 12th. A rather large portion was planted late, which suggest the continued monsoon rains should benefit the crop. The size of the acreage will make small changes in the average yield very important.



Despite the potential for the crop, the local spot price is being maintained at a large premium to the world market. S-6 1 1/8 ex-gin in Gujarat ended the week near 74-75 cents, while J-34 traded at 70.50. The harvest has begun in the Northern Zone, which has pushed J-34 prices to a discount to Gujarat. It remains to be seen just how prepared and financed the CCI will be this year to procure a large volume of the crop. The MSP is at a large premium to the Cotlook A Index, which suggests spinners will not build inventories at such premiums. The MSP level is also damaging the textile industry and hurting the competitiveness of Indian exporters. This should be a time when Indian apparel companies are experiencing booming business instead of dealing with the impact of the MSP level. Moreover, it has caused some mills to increase their use of polyester fiber, which trades free of the government-initiated support prices.

One feature currently supporting domestic prices is the late active monsoon that has delayed new crop harvest and limited the local supplies. The textile and apparel sector is expected to benefit from Friday's announcement of 20 billion USD in corporate tax cuts. The incentive package cut the basic corporate rate and provided a very low incentive rate for new companies. The new taxes are the lowest on record, resulting in the Indian stock market posting its largest rally on record. The move is expected to provide a significant incentive for business groups to relocate to India. A Free Trade Agreement with the US is expected to be on the agenda when PM Modi meets with President Trump.

US Senator Marco Rubio discussing Equalization Act, Washington Post

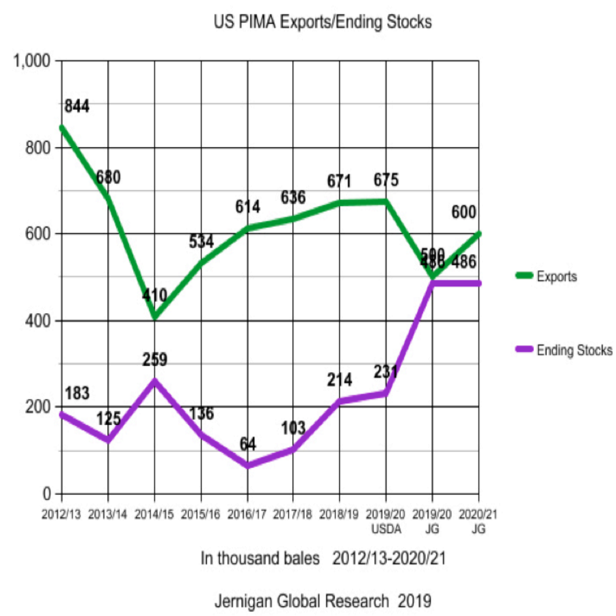
INDONESIAN COTTON SECTOR FAILS TO TAKE ORDERS FROM CHINA

Indonesia has not been a winner in the trade war, as indicated by weak cotton consumption. 2018/2019 cotton imports totaled only 664,227 tons (3,051,492 bales). Cotton consumption is down more than 13% from a year ago, resulting in the lowest imports since 2015/2016. Indonesia is a major supplier to the US but has failed to take advantage of the additional business that has become available due to companies moving production from China. January-July exports to the US of all textiles and apparel are up 2.2%, while cotton apparel imports are only nominally higher, despite the overall growth in the US market. Total exports of textiles and apparel to the US in 2018 totaled 4.7 billion USD. Indonesian cost is higher in the cheaper products, which has caused it to lose business to Vietnam and others. It has also suffered from a drop in cotton yarn exports to China.

The US was the top supplier in 2018/2019, with shipments of 255,198 tons (1,172,507 bales). Indonesia currently has a large volume of high-priced US import contracts open that have not been shipped. Brazil was the second largest supplier, with shipments of 192,195 tons (882,954 bales), followed by Australia, the third largest supplier, even though volume fell sharply with shipments of only 48,637 tons. Imports from India fell sharply and were replaced with imports from Greece, Argentina, Turkey, African Franc Zone, and East Africa. Indonesian cotton use appears set to be flat to weak in 2019/2020, unless it improves shipments to the US. Shipments in July were quite weak. Indonesia is also a large supplier of man-made fiber apparel to the US market.

US PIMA EXPORT DEMAND WEAK DUE TO ABSENCE OF CHINA

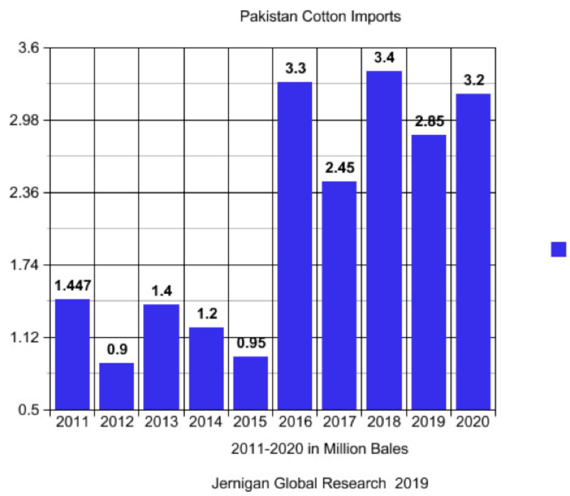
For years, China has been an important market for US Pima, thanks to its exporters' need to meet the demands of major brands and retailers. 2019/2020 export sales presently stand at only 15,700 running bales, and those sales were rolled forward from 2018/2019. Last year at this time, sales stood at 82,200 bales. India has become the top market for US Pima, as Indian exporters appear to be taking business away from the Chinese companies. Pakistan and Vietnam have begun to consume additional supplies of US Pima. The SUPIMA program makes it impossible for Chinese exporters to switch to Egyptian cotton or to replace with domestic ELS supplies. As of September 12th, total US 2019/2020 Pima export sales totaled only 174,200 running bales, compared to sales of 267,400 running bales last year on the same date. India has remained the most active buyer, with sales currently standing at 82,300 running bales or 47.24% of all sales.



Pima demand at retail appears strong, with Pima featured in the new fall offerings of several major luxury brands. The lack of ELS spindles limits the ability of brands and retailers to move production, which is impacting overall use until China resumes purchases. At the moment, the US is holding the largest potential stocks of Pima it has had since 2012/2013, with a total supply of 931,000 bales that includes a new crop output of 717,000 bales. The burden is to meet the export targets without Chinese purchases. The weakness in exports has pushed the spot price at the farm gate to levels that many California growers find unattractive.

The USDA export estimate of 675,000 bales will not be met without a resumption of Chinese demand due to the issue of lack of spare capacity in ELS spindles. The US itself has a maximum capacity to spin only 25,000 bales of US Pima, which illustrates the lack of investment in cotton textiles in the US.

PAKISTAN IMPORT DEMAND ACTIVE FOR LOW GRADES



Pakistan's spinners were active last week taking up Brazilian low grades, Argentine SLM 1 1/16, other low grades, and US old crop. Prices on these styles were extremely cheap. With Argentine domestic demand weak, exporters are anxious to earn USD at the current exchange rates. New concerns have surfaced regarding the 2019 crop prospects due to the prevailing hot and humid weather that continues to cause problems. September 15 new crop deliveries have reached 1,852,409 bales, down 664,936 bales from last year's deliveries of 2,519,345 bales.

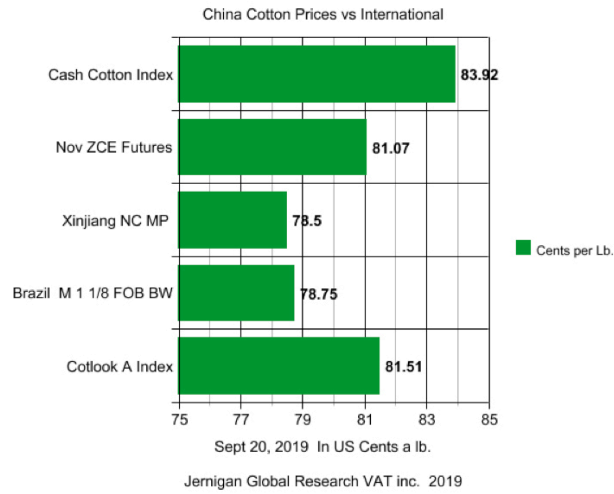
Pakistan apparel exporters have increased shipments to the US. January-July exports of cotton apparel to the US are up 9.11% to 764.493 million USD, making Pakistan now the 9th largest supplier to the US of cotton apparel. Pakistan is the third largest supplier of non-apparel cotton products in 2019, with shipments up 6.18% at 840.375 million USD.

2019/2020 cotton consumption appears set to grow to the 11 million-bales level which will increase import demand to 3.0-3.3 million bales. Some increase in ELS consumption is also being noted.

CHINA COTTON PRICES END THE WEEK WEAK

Picking in Xinjiang is slowly expanding, and some ginners in southern Xinjiang are offering discounts for new crop machine-picked cotton in order to stimulate cash flow. In general, cash cotton prices in China ended the week weak, with the cash cotton index at near 84 cents a lb. This was only a slight premium to the Nov ZCE cotton futures contract, which closed at 81 cents. Southern Xinjiang ginners are offering new crop machine picked 1 3/32 Middling grades at approximately 12,200 RMB a ton, (78.50 cents a lb.), which puts local Chinese prices in line with imported cotton. Brazilian Middling 1 1/8 was offered Friday at 69 cents landed the port, and, after VAT and 1% import tax, the price is approximately 78.73 cents before inland shipment cost. Import demand is weak, with no real price incentive, and the only import interest appears on quality grounds. Merchants with US cotton in bonded warehouses face very difficult conditions.

It was interesting to note that wool traders experienced a small pickup in demand last week when buyers took up the high-quality lots. Chinese companies have a dominant position in the wool market, with brands and retailers having limited alternative sourcing options. Chinese man-made fiber markets were quite volatile last week, rallying early with the gains fading as the week ended. New polyester fiber capacity is expected to come online in October, which has sellers ready to take advantage of price gains when they occur.



US FOB BASIS IMPROVES FOR NEW CROP DUE TO EXCELLENT QUALITY

The US harvest is accelerating in the Mid-South and Southeast amid record dry, hot conditions. Most of the South Texas crop was picked prior to last week's heavy rains that flooded the Upper Coastal Bend. A high-pressure ridge across the Mid-South and Southeast is responsible for record temps of 95-100 degrees daily with little humidity, and for keeping hurricanes or tropical storms from moving on land in the region. The result is a rapid start to harvest and excellent quality. Harvest is now active in Georgia. No major problem with quality has shown up in any location. The early results from the Mid-South suggest that, if the weather holds, it could be the highest quality crop on record. A total of 684,187 bales have been classed so far.

The FOB basis for the base grade has improved to the best levels in a year at 100 on in the Southeast, even in the Mid-South, and 350 off in Texas. The 2018/2019 crop FOB basis was very depressed by the poor quality of the overall crop. Merchants will have to offer discounts to move the remaining 2018/2019 crop inventories, with spinners likely to quickly prefer new crop. The CFR Asia basis for Green Card offers is firm. Spinners are also seeking more regional specifications on the better grades.

ICE FUTURES RETURNS TO THE 60 CENT AREA WHERE SUPPORT RESTS

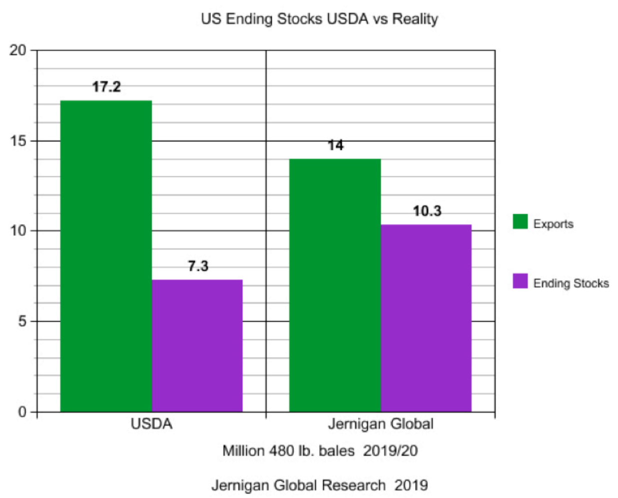
The rally in ICE futures quickly stalled, as Trade selling turned very aggressive and the China good will purchases did not contain any reference to cotton. The Trade selling subsided as prices returned to the 60-cents area, where export trade picked up. The weekly CFTC data confirmed the Trade as aggressive sellers of futures and buyer of swaps, while the Funds covered shorts. So far, no real pressure is evident from either Brazil or the US, as crop movement picks up. Merchants appeared more interested in attempting to fulfill the higher-priced contacts now open than in arranging discount basis levels on new crop. This is allowing the market to hold, as basis levels remain steady. Brazil's ESALQ Index of a 41-4-35 landed Sao Paulo ended the week at a discount to ICE. We still expect market pressure from crop movement, as we move into the October-December period. As of today, the major export crops have experienced no serious issues, and as those crops are ginned, pressure to move volumes will increase. The supply chains remain unsettled.

India has received very abundant rains, some say too much. However, it also means there is the potential for a larger crop on record acreage. At the moment it remains unclear if the CCI can manage and also finance record procurement of such a large crop. The higher MSP raises lots of questions - will the CCI successfully procure record volume and store the cotton before auctioning at market prices to the mills? Will the Modi government, which appears to be in an economic stimulus mood based on Friday's record tax cuts, adopt an adjusted price for the textile sector with the government paying the difference to farmers? Friday's tax cut and other actions suggest the administration will not want to keep the important textile sector at a disadvantage when India has the opportunity to take business from China. How this is managed will play a crucial role in the global price structure, as well as the ability of supply chains to disengage from China. We do not expect Indian cotton yarn exports to China to rebound, which will put pressure on the Modi government to adapt a pro textile policy while also protecting farmers. India appears to be posturing itself in the US/India axis, which means that earlier hurdles to US/India increasing trade may give way to larger geopolitical interest. An additional opportunity for Indian exporters has possibly surfaced thanks to troubles in Bangladesh, where the textile sector has been unable to stem Chinese fabric imports, while the government has endorsed China's Belt and Road and its imprisonment of over 1.5 million Uyghurs. The latter two actions have hurt an effort in the US to have more favorable trade terms offered.

The ability of the US and China to reach a lasting trade deal still appears a long shot to us. On the US side you have a Congress and leading Democrat candidate that are more hawkish on China than the Trump administration, and legislation regarding Hong Kong and capital markets will hit the president's desk before year's end. On the Chinese side, it is very clear the economy is slowing, but there is no sign of a willingness to reform, as recent actions appear to be more like that of North Korea. One theory is that the lifting of tariffs on US soybeans, pork, and beef are linked to the fact that China drastically needs the products and would like to link US purchases to halting any new tariffs, some roll back of current tariffs, and some reduced pressure on Huawei. This is behind the talk of a visit to the Mid-West, but it must be remembered this type of high-profile visit and purchases have been used for the past 25 years as an attempt to appease the US. Even that appeared off the table as the weekend got underway. Conditions appear much different than prevailed in June 2018. Today, the Congress and Opposition in the US are firmly opposed to a trade deal with China without major reform. They agree that a few purchases of US Ag exports will not be enough. The Chinese leadership does not appear to understand this.

We have been and continue to be of the opinion that, until China has a major change in direction and reform, the US and China are disengaging, and with that will come a much different supply chain for textiles and apparel. Transparency and environmental stewardship are coming, which will give cotton an advantage. The post-2018 conditions will not return, which will change the price dynamics. It will no longer be just a case of another growth replacing US styles in Chinese consumption. It will also be about what level of Chinese consumption can be maintained. The supply chains are being forced to change. In addition, the massive debt of many of the largest textile/ apparel companies in China, and their dependence on accessing USD through Hong Kong capital markets, will no longer be easy. The next phase of the disengagement will be in the Capital Markets.

We see Chinese cotton consumption weaker, no price incentive to import, and large unsold stocks on hand. Many of the big-name brands have now included the percentage they source in China in their earnings calls, and they will not reverse the goal of sourcing US needs elsewhere. This suggests the global supply chain will not see a return to the stability of pre-June 2018, and thus the market still faces the burden to move the large US, Brazilian, and African Franc Zone crops, and faces what may be the final major battle with polyester.



We continue to expect the US to face a major battle to meet any reasonable export target. One issue is the remaining large volume of high priced 2018/2019 sales that were carried forward and will not be shipped. This, plus the large outstanding sales to China for 2019/2020, makes current US export sales over two million bales overstated. Then there is the reduced demand from China or the inability to access that market, which means trouble creating sales. Brazil will face pressure in 2020 to not only sale volumes but also to ship it, which will include the expansion of shipments beyond Santos. Based on these conditions, we expect heavy resistance on rallies into the 62.50-65.00 area in nearby ICE futures, and additional price pressure is likely. Unlike other times of weak prices, the current weakness has no magical price at which demand accelerates. As we discussed in the September Monthly, cotton has lost over 10% market share in the global staple fiber market since 2008. Each 1% recapture results in over five million bales of added consumption. We see natural fibers as being able to recapture a good portion of this lost market share due to the environmental issues that are becoming more serious and highlighted each day. Cotton enjoys the strategic advantage in that recapture. Remember, all other fibers attempt to be like cotton in "hand and feel" but require special processes to reach that status. However, the entire supply chain, from growers to the dyeing and finishing, must understand that performance matters and innovation is required.

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