PLEXUS Market Comments

Market Comments – April 01, 2021

NY futures closed mixed this week, as May dropped another 49 points to close at 77.95 cents, while December gained 136 points to close at 77.91 cents.

The main feature this week was the erosion of the inversion between current and new crop, as May closed just 4 points above December today, while the July/Dec backwardation narrowed to 136 points. That's quite a change from five weeks ago, when the May/Dec spread had settled at a 603-point inversion on February 24, while the July/Dec was at 667 points.

We currently have a tale of two charts, since May has once again broken below its long-term uptrend line, which originated exactly a year ago, while December is still holding nicely above its primary uptrend. Since speculators play mainly in the front month and the market failed to solidify a rebound this week, today's renewed breach of major support in May led to more long-liquidation and possibly new shorting by specs.

Fundamentally today's big drop doesn't make much sense, because the US cotton balance sheet continues to tighten, West Texas remains too dry, the economy is still rebounding, the S&P500 closed at a new record high and competing crops have been rallying in reaction to the Prospective Plantings report.

USDA planting intentions came in right at the consensus number of around 12.0 million acres, so no big surprise there. But corn and soybean acreage was over two million acres below expectations in both crops, which prompted their respective futures to lock limit up yesterday. Cotton can ill afford to head south while its competitors pile on more gains, since this will attract acres away from cotton as we head into the planting window.

The 12.0 million acreage number has the potential to produce a US crop of 17.0-17.5 million bales if we get a more or less normal growing season. But as this season has shown, harvested acreage can drop dramatically if the weather doesn't cooperate, because we ended up collecting only 8.7 of the 12.1 million acres that were planted.

With West Texas currently experiencing warmer than normal temperatures and high winds, the little moisture the region received from thunderstorms in recent weeks is long gone and unless we get some soaking rain soon, a lot of these intentions will turn into dust.

Texas is by far the biggest state when it comes to cotton plantings with 6.82 million acres or 57% of the total, followed by Georgia as a distant second with 1.2 million acres. Beyond that we have Oklahoma, Mississippi and Arkansas with about half a million acres each.

US export sales were seen as slightly disappointing at 132,700 running bales of Upland and Pima for all marketing years combined. Cancellations of 160.6k spoiled an otherwise decent report, although participation in new sales remained widespread with 15 markets buying. Shipments of 339,000 running bales to 23 destinations were once again above the pace needed to make the current export estimate of 15.5 million statistical bales. For the current season we now have commitments of 15.7 million statistical bales, of which 10.25 million bales have so far been exported.

With only around 2 million bales left for sale according to our calculations, we need to temper our expectations for future export reports, because we can only sell what's there, although at some point we need to see new crop business pick up. But with both sellers (crop uncertainty) and buyers (economic visibility) hesitant to commit, it will probably take until the crop emerges before we see more sales.

Unfixed on-call sales finally made some progress last week, as we saw a drop of 0.9 million bales in unfixed sales on May and July. There were just 1.09 million bales open on May as of last Friday, while July had 2.97 million bales still to fix. On the purchase side we saw a drop of just 0.02 million bales, with 0.87 million bales still open.

Interestingly, despite the 16-cent drop since late February we have seen only relatively small changes in the spec and the trade positions. The latest CFTC spec/hedge report showed speculators at 7.19 million bales net long, down from 8.84 million bales on February 23. Meanwhile the trade net short dropped from 16.84 to 14.85 million bales. Historically we are used to see bigger swings in the net spec position on such a price move, which suggests that there was a lot of churning in and out of positions, while the core long is seemingly still holding on.

So where do we go from here?

The chart and price action still look weak and with program trading making a lot of the decisions these days, we might see further weakness in the front month.

The question is whether current crop will continue to drag the board lower on technical weakness or whether December will eventually step into the leadership role and pull the market out of its hole on constructive fundamentals?

We believe in the latter, since December cannot afford to lose much more ground if it wants to hang on to its projected acreage. The US balance sheet is tight and new crop is still uncertain at this point, as West Texas continues to wait for rain. It may take some patience, but we feel that the market will eventually turn the corner and move higher again.

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