PLEXUS Market Comments

Market Comments – August 01, 2019

NY futures came under renewed pressure this week, as December dropped 182 points to close at 62.37 cents.

The market started the new marketing year on a weak note, as another Trump tweet caused havoc in the financial markets today. Just when traders were hoping for a positive outcome from the latest round of trade negotiations in Shanghai this week, the US president threatened to hit China with a 10% tariff on an additional $300 billion worth of goods, effective September 1.

This caused a major reversal in most markets, with the Dow Jones index dropping 600 points after the news, while crude oil ended the day 4 dollars/barrel, or about 7% lower. Cotton got knocked down as well, as December ended the session 150 points below its session high.

Today's negative news simply helped to complete a short-term topping pattern that had started to form over the last few sessions, after December failed to take out resistance at 64.70 cents on three occasions. The only positive about the market's recent weakness is that there wasn't much volume behind it, as the daily turnover still averaged only 17.5k contracts this week.

The latest CFTC report, which reflected positions as of July 23, showed that speculators continued to expand their net short by 0.03 million bales to a record 4.84 million bales. The trade established a new record as well, as it bought 0.06 million bales to reduce its net short to just 0.65 million bales. Index funds continued to provide the opposing net long position, which dropped by 0.03 million to 5.49 million bales.

The combined open interest in Futures and Options (delta-adjusted) clearly shows how 'empty' the current market is, as it amounts to just 256k contracts, which compares to 444k contracts in June 2018, when prices reached into the mid-90s on heavy spec buying. This low market participation makes the market more erratic, as it doesn't take much effort to move values 100 points up or down, as we have seen this week.

Despite reports of quiet condition in the marketplace, US export sales were once again better than expected at 424,200 running bales of Upland and Pima cotton for all three marketing years combined. Once again it was Vietnam that accounted for more than half of it, but there were still 17 other markets buying as well. Shipments continued to lag at just 297,900 running bales and with just six days of data missing, it is now clear that shipments won't reach the USDA estimate of 14.5 million bales.

For the 2018/19-marketing year commitments have reached 16.7 million statistical bales as of July 25, while shipments amounted to 13.9 million statistical bales. For the new season, which just started today, we already have sales of 5.1 million bales on the books and there will be an estimated 2.5 million bales carried in from last season, which brings total commitments to around 7.6 million statistical bales. That's not quite as much as last season, when we started with 8.7 million bales in commitments on August 1, but it is still the second highest amount on record.

The Federal Reserve lowered interest rates as expected by 25 basis points on Wednesday, which marked the first rate reduction since 2008. Because this move was widely anticipated, markets didn't react to it. However, we believe that this is just the beginning of many rate cuts to come and that within a couple of years US short-term rates will be close to zero again.

There are now over $14 trillion of sovereign debt around the globe that have negative yields and we believe that the US will join this club as well over the coming years. As debt grows a lot faster than GDP these days, cheap interest rates are a necessity if a country wants to be able to service its debt. The US currently pays around $400 billion in interest on its national debt, which is rising by about a trillion dollars a year. On a debt of $22 trillion, a change of one percent in interest amounts to $220 billion a year.

It therefore becomes obvious that interest rates will have to be kept artificially low. The problem this creates is that it forces investors to chase after other assets than these low- or negative-yielding bonds, like stocks and real estate. While commodities seem to be a forgotten asset class these days, we believe that sooner or later this monetary folly of cheap money is going to lift commodities as well.

So where do we go from here?

With an escalating trade war looming, with global cotton production trending towards 127 million bales, with global demand cooling and with the technical picture rolling over, the market is currently facing a lot of headwinds and the path of least resistance continues to be down for now.

Despite all the current negativity, we need to remind ourselves that while the crops are generally looking good at this point, there is still a lot of weather to negotiate over the coming months. Also, looking further down the road we feel that this easy-money regime will eventually lead to inflation, not just of stocks and real estate as has already been the case, but of just about everything else as well. However, timing these events is difficult and for now there is no reason to fight the prevailing downtrend.

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