PLEXUS Market Comments

Market Comments – July 4, 2019

NY futures moved higher during this holiday-shortened week, as December gained 116 points to close at 67.25 cents.

December continued to meander in a narrow sideways range of 343 points, which had its origin on May 13, or 37 sessions ago. Last week we talked about potential triggers that might inject new life into the market, but despite some positive vibes coming from the G-20 meeting, the market has not been able to produce more than a flash-in-the-pan rally on Monday morning, which quickly fizzled.

The problem, as we have stated repeatedly, is that the trade remains massively underhedged and needs buy-side liquidity from speculators to get something going to the upside. But as the latest CFTC report has shown, speculators have so far not been in a buying mood and instead extended their net short position further.

The CFTC report as of Tuesday, June 25, showed that speculators had sold another 0.62 million bales and thereby went 4.49 million bales net short, which matches the record net short position of March 2016. Outright spec longs were at 4.37 million bales, whereas outright spec shorts amounted to 8.86 million bales. Index funds were also light net sellers, as they cut their net long by 0.05 million to 6.83 million bales.

The trade on the other hand was a strong buyer of 0.67 million bales and reduced its net short to just 2.34 million bales. Only back in January 2015 did the trade own a smaller net short position at 1.98 million bales.

There may be a silver lining in this spec/hedge position, as speculators have sold 1.68 million bales net since the market entered its current sideways trend on May 13, without being able to force prices any lower. In other words, after spot futures dropped around 30 cents since posting a high of 96.50 cents on June 11, 2018, speculators may finally be out of bullets.

This sets the market up for a short-covering rally, as speculators have limited patience with positions that don't perform anymore. We could therefore arrive at a point at which speculators are going to pull the plug on their shorts even without an obvious trigger.

The G-20 meeting brought about the expected result, namely a resumption of trade talks, with further tariffs put on hold for now. However, in regards to Agriculture, President Trump said that China would buy a "tremendous" amount of Ag products.

Shortly before the meeting between the two presidents the USDA announced an order from China for 544k tons of soybeans, which was the largest order since China bought 828k tons in April, just before trade talks broke down. China seems to make an effort to bring the trade imbalance between the two countries down and the import of US Ag products would be a 'win-win' situation in this regard, because China has a production gap in a variety of Ag commodities, including cotton.

The US Planted Acreage report, which showed that 13.72 million acres had been planted, was taken with a grain of salt by traders, since it was not clear how the USDA arrived at that number. We believe that the acreage on which cotton actually made it out of the ground is probably no more than 12.2-12.5 million acres, but it will be a while before we get a better grip on what this crop is made of.

This week India announced the MSP (Minimum Support Price) for various crops, which for cotton meant an increase of nearly 2% over last year's support. Since Indian prices are currently quite a bit above the international level, it is possible that the CCI and NAFED might procure a large amount of cotton from growers, with estimates ranging from 6-10 million local bales.

This means that not only would India not be competitive on the export front at current prices, but it might also absorb a large amount of the excess ROW stocks until later in the season. This would essentially create an umbrella under which US prices are able to rise by several cents.

So where do we go from here?

Since speculators seem to be losing their power to force the market any lower and with growers not willing to chase values below 65 cents at this point in time, it could set the stage for some short-covering rallies. However, the trade is extremely under-hedged at just 2.34 million bales net and it would therefore take a tremendous amount of buying power to push the market through all the scale-up trade resistance.

Only a bullish event that triggered spec short-covering while at the same time moving growers to the sidelines would create enough space for the market to move more than just a few cents higher. At the moment we don't see this happening and therefore expect the market to remain stuck in its sideways trend.

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