PLEXUS Market Comments

Market Comments – March 04, 2021

NY futures continued to slip this week, as May dropped 255 points to close at 87.14 cents, while new crop December was down 78 points at 84.00 cents.

The May contract continued to retreat for a second week and closed today 846 points below its intra-day contract high of 95.60, which was posted just five sessions ago.

Before last Thursday's downside reversal the open interest in May and July amounted to 179,840 contracts, whereas this morning it stood at 164,211 lots. So we reduced outstanding bets in current crop futures by 15k contracts or about 8% during this volatile correction, which still leaves a lot to be squared away.

Today's session started out promising, with May posting a high of 89.39 cents after a better than expected US export sales report. But prices came under renewed pressure after the 10-year treasury yield climbed back above 1.5% on comments by Fed Chair Powell, stating that there was potential for a temporary jump in inflation. This spooked financial markets into 'risk off' mode again, similar to what we saw last week.

US export sales came in at 220,200 running bales of Upland and Pima for all marketing years combined. This is a strong showing considering that May was trading between 89.57 and 95.60 cents during the reporting period. Participation was still decent with 16 markets buying, while shipments of 386,500 running bales to 24 destinations were excellent.

Total commitments for the current season have now reached 14.65 million statistical bales, which is about the size of the US crop. So far 8.8 million statistical bales have been exported, which is still 1.3 million bales ahead of last season's pace.

Even though Chinese futures prices have come off as well this week, they are nonetheless still elevated at around 111 cents/lb, while the CC-index is above 116 cents/lb. China has been one of the main forces behind the rise in international cotton prices and it continues to absorb a lot of cotton and yarn, particularly from the Indian Subcontinent.

While most analysts credit the Phase 1 trade deal for China's boost in Ag imports, we believe that the Uighur issue plays an equally important role in this. About 85% of the Chinese crop comes from Xinjiang and it is estimated that 1 in 5 garments in the world contains some fiber from this province.

Since products made from Xinjiang have been either banned or are being shunned by the US and Europe, China has to increasingly rely on imported cotton and yarn to feed companies who are engaged in exporting garments and textiles. While cotton imports have jumped from 7.14 million bales last season to an estimated 11.0 million bales in the current marketing year, the increase in yarn imports appears to be even stronger, based on anecdotal evidence from Pakistan and India.

There is no easy fix to this Xinjiang quandary and it is therefore likely that China will remain a strong buyer of foreign cotton and yarn. A strong Yuan has assisted in keeping prices manageable, since the Chinese currency has appreciated from 7.16 to 6.47 yuan against the dollar since the end of May 2020, a gain of almost 10%.

Another supporting factor is the ongoing drought in Texas, which puts a big question market behind any acreage estimate. Many cotton-producing counties in South and West Texas are currently in a moderate to severe drought. Having missed out on winter rains, this means that subsoil moisture levels are inadequate and the region now hopes for rainfall during the planting window to get the crop going and for enough moisture during the summer months to keep it from wilting away.

So where do we go from here?

A look at the candlestick chart shows that sellers have taken control of the market, with five out of the last six sessions being 'black candles'. However, this is still very much a correction in a bull market and until the primary uptrend line, which currently runs through 79 cents, is broken, it would be premature to give up the uptrend.

In the 2011 bull market we had four major corrections on the way up to a 227 cents synthetic peak. The largest one measured almost 40 cents, when the market fell from 151 to 111 cents in November 2010, while the other three amounted to at least 19 cents or more.

A lot will depend on how speculators behave over the coming weeks. While there has been some profit-taking by longs, or damage control by the ones who came late to the party, we believe that the core spec long is not going to abandon its position. If our assumption is correct, then this bull market will sooner or later resume, because trade shorts still need to buy out of a lot of positions tied to fixations and/or basis longs.

It is difficult to say to what level this correction might carry, but the 50-day moving average at 8400 offers a good target. Unless there is panic in the financial markets and we get a stock market debacle, we should see cotton regroup and then launch another rally into the 90s and possibly to new highs before July goes off the board.

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