PLEXUS Market Comments

Market Comments – August 5, 2021

NY futures edged higher this week, with December adding 37 points to close at 90.68 cents.

After dropping to a low of 88.88 last Friday, buyers have once again taken control of the market and lifted December to a new settlement high of 90.68 cents today. We are still lacking momentum though, as the daily trading volume has remained at around 20k contracts all week.

However, open interest continued to expand and is now just shy of 250k contracts. Since the July notice period in late June, open interest has grown by an impressive 42k contracts! For reference, last year we had just 181k contracts open on August 4, while two years ago it was 202k contracts.

The most recent CFTC report confirmed that speculators continued to add longs between July 21-27, as they expanded their net long by 0.87 million to 7.93 million bales. Index funds were also light net buyers, increasing their net long by 0.08 million to 8.42 million bales.

The trade continued to sell into strength, boosting its net short position by 0.96 to 16.35 million bales. That’s the highest trade net short since late February, when it reached 16.84 million bales and the spec net long was at 8.84 million bales.

On February 25, the December contract had reached a high of 89.28 cents, but then it collapsed nearly 1400 points to a low of 75.34 cents over the following four weeks, as speculators liquidated about 2.5 million bales net.

Could we see something similar this time around or do speculators have more staying power? We believe that the latter is the case, since we currently have high inflation expectations, tight inventories and a lot of crop uncertainty as we are headed into the peak hurricane season.

The NOAA Hurricane Center issued a statement this week, according to which it expects the tropics to be more active than previously thought, with 15-21 named storms and 7-10 hurricanes, of which 3-5 are supposed to be major ones. The strongest storm systems on record have occurred in the mid-August to early November period, so the market is likely headed for some excitement.

US export sales were tepid last week, as net new sales of Upland and Pima cotton amounted to just 180,500 running bales for all three marketing years combined. Participation was still widespread with 15 markets buying, while 21 destinations received shipments of 238,200 running bales.

With just two more days of data left in the 2020/21-season, total commitments amounted to 17.5 million statistical bales, of which 16.0 million have been shipped. This means that exports will miss the current USDA projections of 16.4 million bales by around 0.3 million bales.

While this makes the US statistical picture look a little less bullish, it doesn’t change the fact that inventories are extremely tight and that there is no margin for error as far as new crop is concerned. EWR reported total open warehouse receipts at just 1.83 million bales this morning, which compares to 5.06 million last year and 3.21 million bales two years ago.

Unfixed on-call sales showed a further increase of 0.28 million to 13.92 million bales as of July 30, while unfixed on-call purchases dropped by 0.10 million to 4.21 million bales. The net unfixed position therefore grew to a massive 9.71 million bales. Mills continue to make matters worse for themselves by adding more and more of these open-priced contracts!

Their hope is that something is going to trigger speculators into liquidating their net long position, similar to what happened in August 2018, when specs let the trade escape from a 15.65 million bale unfixed on-call position. However, the trade is definitely pushing its luck again and we seem to be just one big scare away from setting off a short-covering rally.

As long as financial markets remain in 'risk on' mode, it is unlikely that speculators will pull the plug on their net long. Today the S&P 500 and the Nasdaq posted yet another record high, although global bond markets continue to send conflicting signals and China has seen some weakness in its market as a result of the government crackdown on speculation.

So where do we go from here?

The chart still looks constructive and spec longs have no reason to exit positions, while trade shorts are getting a bit more nervous as we head into the peak hurricane season.

Therefore, as long as the outcome of the major Northern Hemisphere crops remains in limbo, the market should remain well supported, with the possibility to spike higher in case something were to go wrong on the weather front.

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