PLEXUS Market Comments

Market Comments – February 05, 2021

NY futures rallied to new highs this week, with March gaining 435 points to close at 84.28 cents/lb.

The market exploded to the upside today as another strong export sales report sent trade shorts scrambling out of positions ahead of tomorrow's March options expiration. Today's settlement marked the highest for a spot month since August 2018!

Usually the GSCI roll starts several days ahead of options expiration, which provides plenty of liquidity for traders to square away positions. But with March options expiry falling on the first Friday of the month and with the GSCI roll beginning tomorrow only, there was a lack of sell-side liquidity that exacerbated the move to the upside today.

There were nearly 6300 March call options still open between the 80 and 86 strikes, which combined with a slew of other short calls in May and July created a catalyst for prices to move higher, as the sellers of these calls needed to protect their delta exposure. Add to that some last minute March mill fixations and new spec buying coming in as the market pushed through resistance, and we had the perfect set up for a big spike.

US export sales continued strong last week, as another 309,500 running bales of Upland and Pima cotton found a home. Participation was again widespread with 18 markets buying, while shipments of 339,200 RB went to 27 destinations. The EWR report shows that 2.4 million RB are under shipping order, which should ensure a steady stream of exports in the weeks to come.

Commitments for the current marketing year are now at 13.8 million statistical bales, of which 7.3 million bales have so far been exported. The corresponding numbers for last season are 13.6 million and 5.8 million bales, respectively.

The CFTC on-call report showed that as of last Friday there were still 7.84 million bales in unfixed sales in current crop, versus 1.66 million bales in unfixed purchases. While March made some strides reducing its unfixed sales position to 1.69 million bales, it is worrisome to see that there were still 6.16 million open on May and July.

Remember, these unfixed on-call sales represent a market opinion of the past, as buyers were betting on prices to fall, which would have allowed them to lock in a cheaper purchase price. However, as of today all these bets are under water and sooner or later they will have to get squared away.

In order to close out these positions, which exist primarily on the books of shippers, mills need to find willing counterparties. This means speculators, who at this point have no incentive to part with their longs. The primary uptrend is still very much in force and there is currently a 500-point incentive for speculators to roll their positions from July to December.

The promise of another USD 1.9 trillion stimulus package is another reason for speculators to stay invested in commodities. This latest package, which will probably be passed next week, is in addition to a USD 0.9 trillion bill that was passed in December. Unlike in 2008, when it was mostly big business that received a bailout, it is middle and lower class families that benefit from the current stimulus.

Since the money doesn't come from savings or tax receipts - they cover only a fraction of the US budget shortfall these days – it will have to be printed out of thin air, which in turn diminishes the purchasing power of the currency. Think of it as a 'stealth tax' on all citizens, because their dollars will buy less and less over time. The same is happening in other economies, although the US is by far the most aggressive printer.

Some inflation measures are already running ahead of the official CPI, like Manufacturing Prices Paid or the cost of imported goods from China and some other markets. In our opinion it is just a matter of time until we see much stronger CPI readings as well, and with all this new stimulus money we expect inflation to run at 3-4% by the second half of the year.

So where do we go from here?

Although today's breakout was impressive, we don't think that it was the beginning of a big short squeeze yet. As described above, it was caused by a confluence of circumstances in a lack of sell-side liquidity. That will change tomorrow, when the GSCI roll begins, during which index funds and speculators move remaining longs from March into May.

This should put some pressure on the March/May spread in the days ahead and hopefully cool off the market for now. However, we see today as a sneak peek of what might happen down the road, if the trade doesn't manage to bring its exposure down to a more manageable level.

Last week's CFTC spec/hedge report showed speculators at 7.3 million net long, while index funds owned 7.7 million bales. The trade was on the other side with a rather large 15.0 million bale net short position. Since index funds are not likely to sell any of their holdings, the trade is hoping for speculators to part with their position at some point. But 'hope' is not a good risk-management strategy and we are afraid that some of these shorts will get trapped.

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