PLEXUS Market Comments

Market Comments – February 06, 2020

NY futures continued to trend lower this week, as March dropped 114 points to close at 67.91 cents.

The market slipped below our anticipated trading range of 68-72 cents, as uncertainty about the extent of the coronavirus contagion in China has been weighing on the market.

Although the US stock market doesn’t seem to care and is racing from one record high to another, we wonder whether traders might be underestimating the economic impact of the Chinese situation. With most major cities in lockdown, life in China has basically come to a standstill and at this point it is still anyone’s guess as to when things might get back to normal again.

At the moment many factories aren’t running, consumers are shopping less, tourists stay away and shipments in and out of China are being delayed. It is difficult to quantify this in terms of mill use and end-user consumption of cotton, but there will likely be a cut on both counts. Other markets like Vietnam, Bangladesh and Turkey may pick up some of the slack, which could give nearby demand a boost, but global mill use is likely going to struggle over time.

As discussed last week, speculators had relatively little directional exposure in the cotton market recently and so far they have remained on the sidelines. The latest CFTC report for the week of January 22-28 showed only minor position changes, as speculators sold just 0.07 million bales net to reduce their net long to 2.19 million bales, while the trade sold 0.02 million bales to increase its net short slightly to 10.34 million bales. Index funds were the only buyer, adding 0.09 million bales to lift their net long to 8.15 million bales.

From a technical perspective the March contract broke through its primary uptrend line dating back to early August as well as its 50-day moving average, which is currently at 68.17 cents. The uptrend line and the 50-day MA are almost at the same level and for the last four sessions the market tried to climb back above them, but has so far been rejected.

Fortunately there is still the 200-day MA at 65.85 cents as a line in the sand and as long as this important support level holds, speculators may not get too aggressive on the sell side, considering that they just got out of short positions in recent months.

This leaves the trade in charge for now, as mills have been buying and fixing on dips. Although mills fixed 0.63 million bales on March last week, there are still 6.42 million bales in on-call sales open on March, May and July. The corresponding figure for on-call purchases is just 2.53 million bales, which means there is net support of nearly four million bales.

US export sales continued to impress last week, as net sales of Upland and Pima cotton amounted to 342,600 running bales for both marketing years. There were 17 markets buying, with Turkey accounting for the lion's share at 156,500 RB. Even more impressive were shipments, which at 424,500 running bales finally moved above the pace needed to make the current export projection of 16.5 million statistical bales.

Total commitments for the current season are now at 13.65 million statistical bales, of which 5.80 million bales have so far been exported. This compares to 11.65 million bales sold and 3.85 million bales shipped a year ago. New crop sales of 1.15 million statistical bales on the other hand are only about half of what they were last season.

So where do we go from here?

There is good support in the cash market, but the technical picture has suffered some damage. However, speculators seem to give the market the benefit of the doubt and as long as the 200-day moving average holds, they may stay on the sidelines.

The upside is contained by the uncertainty about China and the fact that there are millions of bales of Indian high grades in the hands of the CCI, waiting to hit the market at slightly higher prices.

The Chinese contagion is difficult to handicap. On the one hand China's GDP will take a hit and other economies are going to feel its effects as well, but perversely traders are 'discounting' all the monetary and fiscal stimulus that will be handed out. China's central bank has already injected USD 229 billion into the system and lowered interest rates, while other central banks are ready to do "whatever it takes" to shore up markets if necessary.

Although commodities are currently taking a hit on demand fears, we expect massive infrastructure spending in China and possibly in the US as well to provide strong support in the long run. In other words, with commodities already so beaten up, the long side looks a lot more interesting to us going forward.

As for cotton, considering the uncertainty about the virus situation, we expect to see a slightly lower trading range of 66-70 cents in the foreseeable future.

https://plexus-cotton.com