PLEXUS Market Comments

Market Comments – June 06, 2019

NY futures retreated again this week, as July gave back 75 points to close at 68.59 cents, while December lost 165 points to close at 66.67 cents.

July extended its inversion over December by another 90 points to 192 points this week, but spec short covering in July wasn't enough to pull the rest of the board higher, as trade selling was weighing on December and March.

The CFTC spec/hedge report didn't show any significant changes during the week of May 22-28, as speculators reduced their net short by just 0.17 million bales to 3.94 million bales, whereas the trade sold 0.15 million bales net to go 2.75 million bales net short. Index funds sold the remaining 0.02 million bales to reduce their net long to 6.69 million bales.

The above numbers illustrate why the market hasn't been able to get any upside momentum going. Speculators are still have a near record net short position, while the trade isn't short enough. The trade's 2.75 million bales net short compares to 19.98

million bales last season and 16.39 million bales two years ago. In other words, the trade continues to be significantly underhedged and will therefore have to use any bounce to rectify the situation.

With an expected US crop of 22-23 million bales and with on-call sales outpacing on-call purchases by 3.06 million bales, the trade should probably be at least 10-12 million bales more short at this point in time. However, in order to accomplish that, it requires speculators and/or index funds to provide buy-side liquidity, but at the moment they seem to have no appetite for the long side.

It will take either a major crop problem or an outside event to get speculators to reverse their positions and to go substantially long. The US crop has had a rough start, with weather conditions either being too wet and cool (Texas and Midsouth) or too hot and dry (Southeast), which has led to all sorts of issues. We estimate that planted acreage in these three areas will be down by 7-10%, depending on what happens over the next two weeks. The crop is a very mixed bag and it is going to take some time until we get a better grip on its production potential. At this point we still expect a 22+ million bales crop.

A US/China trade agreement, a weaker US dollar or stronger than expected export offtake are some of the potential triggers that could prompt speculators to reverse their position, but at the moment neither of those seems imminent. Therefore, if speculators refuse to provide buy-side liquidity, then the market will have to move lower in search of buyers.

With the AWP (Adjusted World Price) currently at around 61 cents, there is still a lot of room to the downside before we hit the loan level at 52 cents, at which point the government is going to assume any further downside risk.

US export sales and shipments were not quite what the bulls had hoped for, but considering that current crop is nearly sold out, the numbers were actually quite decent. Combined sales of Upland and Pima cotton for all three marketing years added up to 256,600 running bales, with 18 markets participating. Shipments of 322,700 RB were slower than usual due to the Memorial Day holiday.

Total commitments for the current season have now reached a little over 16.2 million statistical bales, of which 11.1 million have so far been exported. Meanwhile new crop sales are at 3.85 million statistical bales. If we add up all export sales for this season and next (20.05 million bales), plus domestic mill use through October (3.90 million bales), we get total commitments of 23.95 million bales, against which we have an existing supply of around 22.6 million bales.

We realize that not all of the new crop sales are for 3rd quarter shipment, but needless to say that the balance sheet is getting rather tight, especially when we consider that new crop is delayed.

So where do we go from here?

The trade needs to increase its net short in the futures market by a substantial margin, but that requires speculators to go net long again. However, with the chart still in bearish territory and with Trump fighting trade wars on several fronts, speculators seem to be in no hurry to reverse their position.

The hope was that short-covering in July would pull the entire board higher, which would provide the trade with an opportunity to put on more hedges in new crop. However, as we have seen this week, it seems to work the other way around, with new crop futures dragging the board lower, even though the July/Dec spread has been widening.

There is still a possibility that we could see a flash-in-the pan rally in July's final days, but that may not be enough for the trade to get new crop hedged to the degree needed. Therefore, unless some event spooks speculators into buying, we are afraid that the market will have to probe lower in search of willing buyers.

https://plexus-cotton.com