PLEXUS Market Comments

Market Comments – May 06, 2021

NY futures rallied this week, as July jumped 409 points to close at 90.58 cents, while December gained 288 points to close at 86.72 cents.

On April 27, or just seven sessions ago, the July contract had posted a 91.42 close, but then swiftly corrected to a low of 86.06 cents just two days later. What followed was a low volume consolidation or flag pattern, from which it finally emerged again today.

Today's breakout was probably due to a combination of factors, namely strong US export shipments, buoyant corn and soybean prices, trade short-covering and renewed technical strength. However, the volume of just 25k in futures and a paltry 2k in options was disappointing, considering how big the move was. This suggests that it was probably short-covering rather than new buying that forced values higher, although the latter might now follow.

US export sales amounted to 136,800 running bales of Upland and Pima cotton for all three marketing years. Participation remained active with 18 markets buying, while shipments of 481,300 running bales to 27 destinations reached a marketing year high.

Commitments for the current season have now reached 16.4 million statistical bales, of which 12.2 million bales have so far been exported. The most the US has shipped in a season was 17.67 million bales in 2005/06 and while we won't break that record, the second spot, which is held by the 16.28 million bales in 2017/18, is still within reach.

The most recent CFTC spec/hedge report of April 27 showed that the rally to 91.66 cents last week was sponsored by spec and index fund buying. Speculators bought 0.95 million bales and boosted their net long to 7.25 million bales, while index funds added 0.42 million bales and increased their net long to 7.87 million bales.

The trade was a strong seller into the rally, increasing its net short position by 1.37 million to 15.12 million bales. We don't quite understand the trade's motivation behind carrying such a massive net short position, considering that we are almost sold out of current crop and the fate of new crop is still uncertain. Also, with competing crops rallying and inflation expectations rising, we wonder what trump card these shorts think they have up their sleeves?

This 15.12 million bales net short by the trade is the 3rd largest in the last twelve seasons at the end of April. A year ago the trade net short was down to just 4.44 million bales and two years earlier it was at 9.52 million bales. In both seasons we carried larger inventories than now!

Unfixed on-call sales are certainly part of this net short position and instead of getting out of a hole, merchants and mills keep digging themselves deeper into trouble. Last week total unfixed on-call sales increased by 0.87 million to 10.55 million bales, while total unfixed on-call purchases went up by 0.02 to 4.62 million bales.

Unfixed on-call sales on July were down just 0.02 million to 3.30 million bales, which compares to 0.55 million bales in on-call purchases. Once again mills have missed an opportunity to reduce their exposure and we wonder what they are waiting for with just a little over a month to go?

West Texas received some more rain earlier this week and more is expected tomorrow night and early next week. The area has been on a slightly wetter pattern over the last couple of weeks, but we still need a soaking rain for plantings to expand. While this repeated thunderstorm activity is providing some relief and is buying the bears some time, we are afraid that it won't be enough to get us out of the severe drought the region is in. It will be a tense 4-6 weeks as we approach insurance deadlines.

Competing crop and commodities in general continue on a steep upward trajectory, which makes is nearly impossible for cotton to head in the other direction. With December Corn at 6.35 dollars/bushel and with November Soybeans at 14.20 dollars/bushel at the time of this writing, cotton is still undervalued by comparison and might lose some acreage in the Mid-South and Southeast.

When we see the US stock market valuation at 230% of GDP, which is nearly three standard deviations above the historical trendline, or an 'asset' like Dogecoin is valued at USD 70 billion, we know that markets are no longer in a rational frame of mind.

Dogecoin started as a joke to satirize the growth of alt-coins, by turning an internet meme into a cryptocurrency. It's 'value' is now approaching that of General Motors! We don't know how long this folly is going to continue, but we have a feeling that it won't end well!

So where do we go from here?

The trade is too short for our taste considering how little cotton is left in the US and how uncertain the new crop outlook still is. With financial markets in a state of 'irrational exuberance', speculators are now chasing after commodities and cotton might be next on their list.

In other words, with lumber futures trading 400% higher than a year ago and copper reaching an all-time high today, or with new crop corn and soybeans posting multi-year highs, what stops cotton from moving above a dollar?

Most markets are momentum not value driven these days and unless someone has a really good reason to hang on to a short position, we would advise to get out of harm's way or use options only to operate in this unpredictable and volatile environment!

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