PLEXUS Market Comments

Market Comments – January 07, 2021

NY futures extended their rally this week, with March gaining another 164 points to close at 79.76 cents.

The market started the new year the same way it ended 2020, by trading from one contract high to another. Over the last ten sessions the March contract has gained about 500 points on a closing basis, and there is still no end in sight to this rally, as all the bullish drivers remain in place.

Strong Chinese prices continue to play an important role in the NY futures rally, as the most active month in Zhengzhou, the May contract, advanced another 3.5% this week. May closed today at 15,485 yuan/ton, which equates to around 108.50 cents/lb. In other words, despite the recent rally in international prices, there still remains a considerable price gap to Chinese prices, which continues to attract cotton and yarn imports.

US exports were a bit slower last week, but the 159,300 running bales of Upland and Pima cotton were still ahead of the pace needed to make the current USDA export estimate of 15.0 million bales. Participation was active with 16 markets buying, while shipments of 282,400 RB went to 23 destinations.

For the current season we now have commitments of 12.4 million statistical bales, of which 6.0 million bales have so far been exported. These numbers compare to 12.3 million bales in commitments and 4.4 million bales shipped a year ago. According to EWR data there are currently over 2.23 million RB under shipping order, which should translate into strong shipment numbers over the coming weeks.

Outside markets have remained supportive as well, as soybeans and corn futures continued to advance to new 6-year highs. March soybeans closed today at 13.57 dollars/bushel, while March corn settled at 4.94 dollars/bushel. Cotton has its work cut out to defend its acreage against these strong competitors.

Although it is still a bit early, some analysts believe that planted cotton acreage could be down 6-8% from last season, which has lifted the December contract to 76.35 cents this week. That compares to 71.57 cents a year ago and 74.09 cents two years ago.

The most bullish factor in our opinion is still the large trade net short position, combined with a lack of sell-side liquidity, which keeps feeding the uptrend. The latest CFTC report as of December 29 showed the trade at 14.68 million bales net short, while speculators were 7.18 million bales net long and index funds owned a 7.51 million bale net long position.

Since that report we have seen a 1.6 million bale increase in futures open interest, which suggests that new spec and index fund longs were established, while the trade probably expanded its net short position to over 15 million bales. Members of the trade still don’t seem to understand the danger they are in and would be well-advised to revisit the playbook of early 2008 and the 2010/11-season.

Some speculators apparently understand the current setup and are positioning themselves for a potential market melt up. Yesterday someone bought 1000 call options in the July 105 strike price, paying 83 points or around 415k dollars for the lot. This is a warning sign that sharks are circling in the waters!

Financial markets continue to divorce themselves from reality, which became clear when the US stock market rallied in the face of the events in Washington on Wednesday and Democrats gaining control of the Senate on Tuesday. Political upheaval and the threat of tax increases are apparently no longer a match for the wave of money that is chasing stocks, commodities and real estate.

So where do we go from here?

Short sellers are becoming an endangered species in the financial markets, as they are afraid of getting steamrolled by the trillions of dollars that central bankers have created out of thin air and all the liquidity that is coming out of bonds, where $18 trillion are trading at a negative yield. This is allowing the financial mania to power ahead without much opposition.

Bitcoin closed at just under 40k dollars today and Tesla reached a market cap of $787 billion this afternoon, up over $100 billion in the last four sessions alone, as shorts are being squeezed. With speculative money now chasing commodities as well, short sellers are skating on very thin ice these days.

Trade shorts no longer have control over their fate in New York and depend on speculators to sell them the contracts they need to buy back over the coming months. However, with speculators more likely to add longs than get out of positions, a short squeeze becomes more and more likely, unless we get some kind of a 'risk off' event.

We would therefore advise shorts to cover and to safeguard against a potential selloff via put options only!

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