PLEXUS Market Comments

Market Comments – August 08, 2019

NY futures continued to fall this week, as December dropped another 279 points to close at 59.58 cents.

Escalating trade tensions and jittery financial markets weighed heavily on cotton prices last Friday and Monday, before values finally started to stabilize thanks to support tied to the US loan program.

December collapsed 664 points in just three sessions, from a high of 63.90 cents last Friday to a low of 57.26 cents on Tuesday. Spot cotton hasn't been that low since April 2016. Volume was heavy during this selloff, giving it appearance of a capitulation move.

Since June 2018, when spot futures peaked at 96.50 cents, cotton prices have fallen nearly 40 cents when they reached a low of 57.26 cents this week. This immense price pressure was the result of unprecedented spec selling, since they reversed a near record net long position of 12.24 million bales into a record net short position of currently 4.72 million bales over the last fourteen months, a swing of around 17 million bales.

However, we feel that the market might be “sold out” by now, since speculators are aware of their unusually large net short position and will therefore be hesitant to add more at these low levels, while the trade, which has remained woefully under-hedged on the short side during this entire downtrend, has now suddenly received full price protection thanks to the government loan.

With the AWP now basically at the loan level, growers can park their cotton with the government and then play the ‘loan redemption game’ for nine months. In other words, while producers should have hedged their cotton when prices were in the 60s and 70s, there is no longer any need to do so at 57 cents.

US export sales for the last week of the 2018/19 marketing year came in at negative 7,300 running bales, while shipments amounted to 276,900 running bales. This means that a total of 13.80 million running bales were exported during the season that just ended, which translates into about 14.2 million statistical bales. That’s 0.3 million less than the latest USDA estimate, so US ending stocks will have to be adjusted higher in the upcoming WASDE report.

US export sales for the 2019/20 marketing year, which started on August 1st, were quite decent at 188,300 running bales of Upland and Pima cotton, plus there were an additional 75,800 running bales sold for the following season. Since there were 2.5 million statistical bales carried in from the previous season, we currently have total commitments of around 7.7 million statistical bales, whereof less than 0.1 million bales have so far been exported.

It was interesting to see that China was a net buyer of 54,300 running bales last week, despite the worsening trade dispute. China currently has over 1.8 million running bales outstanding with the US, which present a potential default risk in an escalating trade war.

Last week we talked about the lack of a weather premium in the market, but since recent reports from the field are pointing at some issues, like a lack of rain and insect pressure, we are starting to sense that the market is getting a bit more cautious in regards to the US crop size. Texas in particular has been way too dry lately and unfortunately the two-week forecast calls for more hot and dry conditions, with one weather guy calling it the ‘Texas frying pan’.

So where do we go from here?

We feel that the market has discounted most of the bearish news that’s out there, with perhaps the exception of lower mill use, which we expect to result from a slowing global economy.

Thanks to government support in the US (loan) and India (MSP), a total of 51 million bales, or 40% of global production, will no longer be in a free fall. This should help to build strong support at around 57-58 cents until the crop is in, although speculators do have the power to push prices temporarily below that as we have seen in the past.

However, while the market may have arrived at a strong support level, looking in the other direction we see plenty of overhead resistance, as global production is expected to outpace mill use by a considerable margin, especially if our worries about demand proved to be correct. It would take a major crop issue, a much weaker US dollar or unexpected strength on the demand side to provide the fuel for a lasting rally.

Even if the specs were to tire of their net short position, it would take a tremendous amount of buying to get through all the trade selling that's waiting above the market. We therefore believe that the most likely course of action in the foreseeable future is a transition to a sideways range between 57-62 cents.

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