PLEXUS Market Comments

Market Comments – October 08, 2020

NY futures rallied to a seven-and-a-half month high this week, as December gained 158 points to close at 67.49 cents.

Hurricane Delta provided the catalyst for the market to break out of its sideways pattern, which saw December being stuck in a 79-point settlement range for 13 sessions before prices started to head north on Tuesday. December reached a high of 68.29 today, before pulling back a bit, while July came within 7 points of the 70 cents level.

It is quite remarkable to see prices back at pre-Covid levels and in the year-on-year comparison the December contract is now 617 points above where its predecessor was on October 8, 2019. How can we explain this higher price level, considering that we are in the midst of a crippling pandemic? There are several factors that have contributed to this phenomenon in our opinion.

From a fundamental perspective, we are dealing with a much smaller US crop than a year ago. Last October the WASDE had the US crop at 21.71 million bales, or about 5 million bales more than private estimates have the current crop. But the most potent driving force has been spec and index fund buying.

Speculators were 3.0 million bales net short a year ago, whereas the latest CFTC report showed them at 4.77 million bales net long now. Likewise index funds expanded their net long from 5.91 to 7.53 million bales over the last twelve months. In other words, these two groups provided 9.39 million bales in net buying, while the trade was on the other side as a scale-up seller, increasing its net short from 2.91 to 12.30 million bales.

The sharply rising ROW stocks, which were a result of the temporary collapse in consumption, have so far failed to stop the market’s advance. This may have to do with the fact that of the 62.54 million bales in ROW beginning stocks, around 63% are in just three origins, namely India (17.86 million bales), Brazil (14.02 million) and the US (7.25 million). India and the US have strong government support behind their inventories, which prevents dumping, while Brazil has logistical constraints that won’t allow it to flood the market with cotton.

Further down the line we have net importers like Pakistan (3.22 million bales), Turkey (2.71 million), Bangladesh (2.42 million) and Vietnam (1.61 million), who together combine for another 9.96 million bales or 16% of ROW beginning stocks. These markets may slow down additional purchases if their stocks are too high, but they won’t dump any cotton onto the world market either.

So nearly 80% of ROW stocks don’t seem to pose a threat of price dumping at the moment, which is why speculators and index funds have been able to dominate the price action. The only place where inventory owners may feel the pinch is West Africa, where 2.53 million bales of the ROW stocks are located. But since they make up just 4% of the total, it doesn’t really pose a threat to global prices.

China has also been an important factor in alleviating global inventory pressure. The Chinese Reserve has been a strong buyer of US and Brazilian cotton, among others. In the case of the US, we currently have commitments of 3.32 million running bales with China, which is nearly double what we had a year ago, when just 1.76 million bales were on the books.

Whether China is buying because of its Phase 1 commitment under the trade agreement or because it wants to convert some of its US treasury holdings into commodities is anyone’s guess, but it doesn’t look like China is done buying yet.

US export sales were nothing spectacular last week, but remained well above the pace needed to make the current US export estimate, as 215,100 running bales of Upland and Pima cotton were added for both marketing years. Shipments slowed to 158,100 running bales, which was probably due to the fact that we are between crops, with old crop inventories running low, while new crop is still a bit behind schedule.

For the current season we now have commitments of 8.7 million statistical bales, of which 2.5 million have so far been exported. That compares to 9.4 million bales sold and 2.0 million shipped a year ago.

Hurricane ‘Delta’ is expected to lose a bit of strength as it heads over cooler than normal waters in the Northern Gulf and it will probably make landfall as a category 1 storm. This is good news since wind speeds won’t be quite as devastating, but the system is still expected to bring 3-6 inches of rain to the Mid-South crops of Louisiana, Mississippi, Arkansas and Tennessee.

These four states combine for about 3.62 million bales of production and if we assumed that 35% is going to see its quality lowered, it would amount to around 1.25 million bales. No disaster, but it adds another piece of support to the bullish puzzle. The US crop continues to disappoint and most private estimates are now in the mid-to-high 16 million bales range. It will be interesting to see what the USDA reports tomorrow!

So where do we go from here?

Tomorrow should make for a lively session, as we have Hurricane Delta's landfall and we get the latest WASDE numbers. Most traders expect a friendly reaction from these events.

Technically the market has been able to distance itself from its uptrend line and its long-term moving averages, which means that spec longs have no reason to sell the market at this point. On the other hand we have some nervous trade shorts, who are starting to feel cornered since time is running out on December fixations.

Unless we get a ‘risk off’ event in the financial markets, cotton will likely remain well supported in the mid-60s and might challenge the 70 cents level if trade shorts are forced to buy their way out of trouble.

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