PLEXUS Market Comments

MARKET COMMENTS – DECEMBER 9, 2021

NY futures rebounded this week, as March gained 289 points to close at 106.59 cents.

After the market managed to find support near the 50% Fibonacci retracement level at 103.43 cents, we saw some more trade short-covering into spec long liquidation this week, which lifted values by about three cents.

As a result March open interest continued to decline by 8.8k contracts to 128.3k contacts. Total OI was down to 241.1k contracts this morning, which is the lowest level since late July.

The CFTC spec/hedge report confirmed that it was heavy spec long liquidation that forced the market lower during the week of November 24-30, when March fell from a high of 116.24 to a low of 106.41 cents. Speculators sold 1.38 million bales net to reduce their net long to 8.50 million bales, which was their lowest level since September 21, when March was still at around 90 cents.

This spec selling allowed the trade to cover some shorts, as its net short position dropped by 1.52 million to 16.70 million bales. Index funds accounted for the remaining 0.15 million bales, as they reduced their net long to 8.20 million bales.

Today's CFTC on-call report showed that mills have indeed made some headway in reducing their unfixed sales exposure. As of last week March on-call sales were down

0.95 million to 5.92 million bales, while the overall position dropped by 1.22 million to 14.22 million bales. Unfixed on-call purchases were down by 0.25 million to 3.87 million bales, which gives us still a net difference of 10.35 million bales in favor of unfixed sales.

The WASDE report didn't tell the market anything unexpected, as the US crop was raised slightly to 18.28 million bales, while global production (-0.24 million bales) and mill use (+0.17 million bales) were basically unchanged. The seasonal production deficit rose to 2.70 million bales.

Global ending stocks dropped by 1.20 million to 85.73 million bales, which came as the result of the above mentioned supply/demand changes, a further correction in Indian beginning stocks (-0.50 million bales) and a few minor adjustments in other countries.

The most bearish element in this report was the downward revision in Chinese imports to 10.25 million bales, which wouldn't even be enough to absorb the seasonal production surplus in the ROW, which is estimated at 10.55 million bales. Chinese demand has been an integral part of the bullish story and it would be a severe blow to the bulls if Chinese imports were indeed that low. As a reminder, last season China imported 12.86 million bales!

US export sales were once again quite strong last week, as 408,700 running bales of Upland and Pima cotton were sold for both marketing years. There were a total of 17 markets buying, but China, Turkey and Vietnam accounted for 78% of the total.

Shipments of just 123,500 running bales to 21 destinations continued to disappoint and remained considerably below the 363,000 RB weekly average needed to make the USDA export estimate of 15.5 million bales.

Total commitments have risen to 10.35 million statistical bales, of which just 2.7 million bales have so far been exported. These numbers compare to 11.05 million bales in commitments and 4.85 million bales shipped at the same time last year.

According to news reports the backlog of container ships outside Los Angeles/Long Beach seems to be improving. However, this is not accurate, as a new queuing system simply forces container ships to wait farther offshore, which gives the illusion that fewer ships are backlogged.

In fact, last Friday there 96 vessels waiting offshore in addition to 31 ships at terminal berths, for a grand total of 127 ships, which is near a record. We are afraid that it could take a while longer before US cotton is shipped at a faster pace and this is creating a problem down the road as too much cotton is held back at origin.

This 'bird in hand versus two in the bush' situation keeps the market inverted for now, but it artificially suppresses consumption and could lead to supply pressure once the logistics improve. With the July/Dec inversion currently at over 13 cents, mills will try to find ways to stretch their demand into the second half of next year, when December will be the reference month.

We therefore expect this current crop vs. new crop inversion to flatten over the coming months, especially since December looks relatively cheap considering the rising input cost, especially when it comes to fertilizer.

So where do we go from here?

This bull market has been built on four main pillars, namely spec longs, Chinese buying, a large unfixed on-call sales position and inflation expectations.

With speculators currently reducing their net long exposure and with Chinese buying reportedly turning a bit more tepid, the bulls currently rely on support from mill fixations and inflation expectations. As long as no exogenous event accelerates spec selling, we should see a rangebound market, as mill fixations are providing underlying support, while rallies will likely get sold by specs and the trade.

Given all this accumulating supply between slow moving Northern Hemisphere crops and the higher output that’s expected to come on stream from the Southern Hemisphere, we expect the July/Dec inversion to fade over the coming months. Whether new crop will trade up to current crop or whether the two meet somewhere in the middle remains to be seen, but we feel that this 13 cents gap is no longer warranted.

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