PLEXUS Market Comments

Market Comments – January 09, 2020

NY futures climbed above 70 cents this week, as March added 142 points to close at 70.69 cents.

Spot futures moved back above the psychologically important 70 cents level for the first time since May 10 and the market has now rallied more than 1400 points since posting a low of 56.59 cents on August 26.

Spec buyers and trade sellers were fighting a battle near the 70 cents level for several sessions, as the big increase in open interest bears witness to. In the five sessions from December 31 to January 8, during which March settled in a narrow range between 69.20 and 70.04 cents, open interest increased by 14k contracts, or 1.40 million bales, to 235.9k contracts.

It seemed to be mainly producer selling that was opposing spec buying near the 70 cents level, but today their resistance got weaker, allowing the market to push to a new high.

The latest available CFTC data as of December 31 showed that speculators had extended their net long by 0.20 million bales to 1.42 million bales, while index funds added 0.27 million bales to their net long, which amounted to 7.22 million bales.

The trade was on the other side, adding 0.47 million bales to increase its net short to 8.65 million bales. Considering the big jump in open interest since December 31, we assume that the trade is now around 9.5-10.0 million bales net short. And therein lies a problem, because at this stage of the season we don't expect the trade to add much more to its net short position.

With US export commitments already at 12.1 million statistical bales and domestic mill use accounting for another 3.0 million bales, disappearance is now at over 15 million statistical bales, while supply is probably at no more than 24.6 million bales (beginning stocks of 4.85 and a revised down US crop of 19.75). As the amount of unsold cotton shrinks week after week, the trade has less of a need to hold short futures. Eventually some new crop cotton will get hedged, but most of that will take place in December.

In other words, if speculators continue their buying spree, which so far amounts to around 7.0 million bales net since August, then the trade may not have enough selling left in current crop futures to oppose the bullish momentum.

Speaking of upside momentum, there seems to be plenty of it in the financial markets. After the Iran crisis has been resolved for now, US stocks are back in full 'risk on' mode and posted record highs this week. Knowing that central banks have their back with cheap interest rates and QE, investors are chasing assets to rather lofty levels, for fear of missing out on the rally.

The current euphoria is somewhat reminiscent of the late 90s, when investors disregarded valuations and were chasing tech stocks into the stratosphere. Apple is now the world's most valuable company, with a market cap of USD 1.36 trillion, which is USD 400 billion more than just three months ago. Microsoft is not far behind at a USD 1.24 trillion market cap, up USD 220 billion since October.

And then there is Tesla, who yesterday became the second most valuable car company on the planet, after Toyota. Never mind that they sold less than 400,000 vehicles last year, have USD 13.4 billion in debt and never posted an annual profit. But that doesn't stop investors from valuing Tesla at par with the Volkswagen group or the combined value of GM and Ford.

The above examples illustrate the exuberant mood currently prevailing in the financial world, which is likely to continue as long as central banks promise to do whatever it takes to keep financial bubbles from imploding, be it via cheap rates, money printing or if necessary asset purchases of not only bonds, but potentially other assets like stocks or real estate as well.

What looked like the beginning of a recession a while back has now clearly been postponed thanks to these reflation efforts and the resulting 'wealth effect' may even translate into somewhat better cotton consumption going forward. Retail sales in the US, Europe and parts of Asia have held up better than expected during the holiday season and we might therefore see a slight uptick in mill use.

So where do we go from here?

Speculators remain in control for now and the sanguine mood in the financial markets should keep the buying spree going. Speculators are probably only about 2.0-2.5 million bales net long at this point and they certainly have room to expand their position by several million bales. Let's not forget that it was only 18 months ago when specs were 12.2 million bales net long.

The question is whether the trade still has a need to expand its net short in current crop futures? While we could see some more scale up hedge selling, we don't think it will be enough to stop speculators in their tracks.

Tomorrow's export sales and WASDE report will likely determine the next short-term move. We don't expect to see bearish WASDE numbers, because the US crop is likely going to slip below 20 million bales and demand should have stabilized.

In other words, we currently don't see anything on the horizon that would derail the bullish momentum and therefore feel that the path of least resistance remains higher.

https://plexus-cotton.com