PLEXUS Market Comments

Market Comments – December 10, 2020

NY futures bounced back this week, with March rallying 315 points to close at 74.26 cents.

Strong outside markets, a weaker US dollar plus bullish WASDE and US export sales reports lifted the cotton market to new highs this week. The market has now rallied about 26 cents since the spot month posted a low of 48.35 on April 1, which was "April Fools Day'. The market has certainly fooled a lot of traders with its strong performance in an economic downturn.

The WASDE report finally showed the much anticipated reduction in the US crop. The 1.14 million bale drop to 15.95 million bales was a bit steeper than the consensus estimate, which was in the low-to-mid 16s. Texas accounted for 900k bales of this reduction, as its crop is now estimated at just 5.25 million bales, which is about 1.1 million bales less than a year ago.

US harvested acreage is at just 9.01 million acres, which means that 26% of the 12.12 million acres that were planted didn't make it due to adverse growing conditions. This is remarkable in an "El Niño" year, which is typically favorable for US agriculture. We started the year with a good moisture profile, but drought, hurricanes and an early ice storm took a large bite out of this crop

US ending stocks dropped by 1.55 million bales to 5.7 million bales, as the USDA not only lowered the crop, but also increased exports by 0.4 million to 15.0 million bales. Given the fast pace of exports, with a mixed quality crop attracting a lot of buyers, we don't expect to see any crop pressure in the US for the remainder of the season.

Global numbers added to the bullish tone, as production was lowered by 2.21 million to 113.90 million bales, while global mill use was raised by 1.58 million to 115.63 million bales. In other words, the USDA is now predicting a seasonal production shortfall of 1.73 million bales, after the November report still showed a production surplus of 2.06 million bales.

Global ending stocks were cut by 3.92 million bales to 97.52 million bales, which is 1.9 million bales less than at the beginning of the season. The US (1.55 million bales less) and India (1.50 million bales less) accounted for the bulk of this reduction in ending stocks. Even though the USDA has reduced Indian stocks to 19.38 million bales, our own number remains a lot lower. We believe that India won't have more than 13 million statistical bales, or 16.65 million local bales, by the end of July.

When we look at global ending stocks minus China and India, who both have governments who are actively absorbing cotton into their stockpiles, we get 41.87 million bales for the current season, which compares to 44.64 million bales last season and 35.30 million bales two years ago. When seen in this context, available global stocks are not as burdensome, especially since China has become a stronger importer of cotton and yarn this season.

US export sales surged last week, as 464,000 running bales of Upland and Pima cotton were added for both marketing years. A total of 23 markets participated in the buying, while 22 destinations received shipments totalling 349,600 running bales.

Current crop commitments have now reached 11.05 million statistical bales, of which 4.85 million bales have so far been exported. The pace of exports is way ahead of normal at this point in the season, with the ten-year average at just 2.65 million bales. Last year there were around 3.5 million bales exported at this date.

While cotton fundamentals are slowly starting to shift out of a bearish narrative, outside forces have been bullish for a while, which is what has swept up commodities along with other financial assets, such as stocks and real estate. Central bankers, led by the Federal Reserve, have all but destroyed the global bond market, forcing investors to try their luck in other assets.

Between money leaving the bond market and massive central bank money printing we now have a sea of liquidity chasing after financial and tangible assets, regardless of valuation or common sense. Bitcoin, Tesla or recent IPOs of companies like DoorDash or Airbnb are just some examples of the casino mentality we are currently in. Tesla is now worth USD 600 billion, as much as its next seven competitors combined, and its price/earnings ratio is at over 1200!

The point we are trying to make here is that if other assets are being bid up to nosebleed levels, why wouldn't commodities follow in their footsteps? Financial assets have become more a function of money flows than valuation, and with governments and central banks continuing to prime the pump, this situation is only going to get worse.

This week Japan announced a USD 700 billion stimulus package, while the US is negotiating a USD 908 billion support bill. In other words, the party is likely to continue, with no end in sight yet!

So where do we go from here?

Although today's WASDE was for the most part 'discounted' by the market, it has shied away any potential sellers and set the market up for another leg to the upside.

The next up move could be triggered by an impending breakout on the weekly chart, which still needs to be confirmed tomorrow. But if the market closes firm, we are likely going to see some new spec longs enter next week.

We still don’t have any meaningful sell-side liquidity and with specs more likely to buy than sell at the moment, trade shorts who need to cover will have to pay up. March has moved about three cents clear of its primary uptrend line, which means that bearish technical triggers are currently not in play.

With financial markets in a euphoric state and with more liquidity being pumped in, shorting any financial assets seems to be dangerous in the current environment. The odds are clearly in favor of a higher market at the moment!

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