PLEXUS Market Comments

Market Comments – September 10, 2020

NY futures ended the week slightly higher, as December gained 53 points to close at 64.81 cents.

December continued to move sideways, as it has now settled the last 30 sessions, dating back to July 30, in a relatively narrow window of just 362 points, between 62.20 and 65.82 cents. The market has been 'flagging' lower for the last twelve sessions, but managed to hold and bounce off of important support just above 6300, where the long-term uptrend line and the 50- and 200-day moving averages converge.

Futures open interest continues to increase steadily, reaching 216.7k contracts as of this morning, which is 57.7k contracts or 5.77 million bales more than we had on June 24. Specs and Index funds have been adding net longs, while the trade has been expanding its net short position.

The latest CFTC spec/hedge report confirmed this dynamic, as speculators (+0.23 million bales) and index funds (+0.47 million bales) added longs during the week of August 26 – September 1, while the trade sold 0.69 million bales net.

This means that index funds owned around 8.0 million bales and speculators some 5.0 million in net longs, whereas the trade held the corresponding 13.0 million bales on the short side. In order to determine where the market is headed, we need to figure out how these positions might change over the coming months.

Since the current bull run began in early April, index funds have increased their net long by 2.3 million to 8.0 million bales. Since money flows into stock and commodity index funds are likely to continue, we expect this position to gradually increase. In other words, there are no indications that these passive investors will pull their money out anytime soon.

Speculators have been the main buyer over the last five months, as they bought 7.4 million bales net, reversing a 2.4 million bale net short into a 5.0 million bale net long position. First it was short covering that led the charge and recently new longs have taken over.

Speculators are a mix of trend, momentum and fundamental traders and currently there is no reason for them to reverse their position. The trend is still bullish and all the deficit spending and money printing portends higher nominal prices in their view. It would therefore take a big 'risk off' event and/or a break of trend-line support to start flushing these longs out.

The trade has been on the other side of all this buying, with its net short position growing by 9.7 million to around 13.0 million bales since April. Most members of the trade still have a bearish view on the market, but they have so far not been able to stop this tide of spec and index fund buying. The question is how much more will the trade be able to short, considering that we are now transitioning into the phase where shippers start to dispose of basis-long positions.

During the growing season merchants typically accumulate physical positions from producers that are then being hedged with short futures. But once the crops come in and quantities and qualities are known, these basis-long positions are then gradually being reduced.

A fixed price sale to a mill may prompt an immediate buy back of short futures, while an on-call sale will defer the decision until the mills gives fixation orders. However, it is reasonable to assume that the trade is going be a net buyer of futures from November onwards.

Tomorrow's WASDE report will likely determine the market's next move. We expect to see a lower US crop number, somewhere near 17.5 million bales, since it doesn't look like record yields are in the cards anymore.

The global numbers are not expected to change much, although we still feel that mill use is overstated at 113.05 million. If we take 120 million bales as the pre-Covid baseline, then the current USDA estimate represents 94% of normal, which doesn't correspond with what we hear from our clients. We feel that 85% is probably a more realistic assumption at this point and even that may be optimistic!

So where do we go from here?

The market is still devoid of any strong selling, as index funds continue to accumulate longs and the trade is probably going to transition to a net buyer of futures once the crops are in. This leaves only speculators as strong potential sellers.

So far they have no reason to dump their five million bales in net longs, but that could change if financial markets were to sell off and/or we break through support, which is currently just above 6300.

The US stock market looks frothy to us and economic conditions are not matching overly optimistic expectations. Plus in less than eight weeks we have US elections, which has traders quite nervous. In other words, we are entering a very volatile environment in which greed may give way to fear as we move closer to November.

The market lacks any clear direction at the moment and might continue to trade sideways for a while longer, but this could just be the calm before another financial storm and we would therefore advise to use options only for any directional bets.

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