PLEXUS Market Comments

April 11, 2019

NY futures closed an active week slightly lower, as May dropped 34 points to close at 76.98 cents/lb.

Market action has been fairly two-sided lately, with specs short-covering and/or new longs providing buy-side liquidity, while hedge selling by the trade has been supplying sell-side liquidity. When the two forces are more or less evenly matched, the market can churn a lot of volume in a narrow range, which is what we have been seeing. Despite trading an average daily volume of 61.5k contracts during the GSCI roll this week, the market traded in a band of just over 200 points.

May rallied to an intra-day high of 79.31 cents on Tuesday, but the rebuilding of certified stock combined with a lack of carry seems to have capped the bull run for now. After dropping from 131k bales in early March to just 32k bales at the beginning of this week, the certified stock has since climbed back to 52k bales, while the May/July spread has widened from just 8 points carry on Monday to 76 points today.

US export sales maintained their stellar pace last week, as another 527,700 running bales of Upland and Pima cotton were sold for both marketing years. What added to the bullishness of this report was the fact that China (100,700 RB) and India (78,800 RB) were strong buyers. These two countries account for 54% of global ending stocks, yet they are importing US cotton! Shipments were impressive as well, as another 404,300 running bales left the country.

For the current season we now have total commitments of slightly over 14.2 million statistical bales, whereof 8.15 million bales have so far been exported. For the coming season there are currently 3.0 million statistical bales on the books. When we add up all existing export commitments (17.2 million bales) plus domestic mill use through October (3.9 million bales), we arrive at 21.1 million bales.

Against that we have existing supply of 22.5 million bales (4.3 beginning stocks and 18.2 million crop). We realize that not all of next season's 3.0 million bales in export commitments are for summer shipments and that some new crop will start to trickle in from August onwards, but needless to say the statistical picture is getting rather tight. This means that export sales will probably start to drop off from here on forward, which is simply a function of availability.

With supplies getting tighter, the progress of new crop will be keenly watched by traders. Right now the market expects a much larger crop in the coming season, which is why everyone seems to be quite relaxed and there is a lot of hedging pressure. However, if the US or any other major crop were to run into trouble, we could see a swift reaction by the market.

The WASDE report on Tuesday was another non-event, as it didn't contain any major changes. On balance the report was slightly friendly, since Chinese imports were raised by 0.5 million bales to 8.0 million bales, while ROW ending stocks dropped by 0.4 to 43.32 million.

Speaking of ending stocks, we are still at odds with the USDA when it comes to India. The WASDE showed the Indian crop at 27.0 million statistical bales, which translates to 34.56 million local bales, whereas the Cotton Association of India (CAI) has the crop at just 31.2 million local bales. That's a rather large discrepancy of 3.36 million local bales or 2.62 million statistical bales. Due to the scarcity of water in several states many farmers have decided to uproot their plants instead of waiting for 3rd or 4th pickings, which has led to the lowest crop in a decade.

By extension the USDA is also much too high with its ending stocks of 8.63 million statistical bales or 11.05 million local bales. The CAI has ending stocks at just 1.3 million local bales at the end of September and even if we add two months of domestic mill use back into the equation, we merely get to 6.6 million local bales, or 4.45 million fewer than what the USDA is showing.

So where do we go from here?

For several weeks the action has been dictated by spec buying into trade selling. With the bullish momentum fading, specs will probably take a breather, which would allow the market to ease off some more. However, we don't see the trade chasing the market too far down with their hedge selling.

A tightening balance sheet, strong export offtake and the outlook for a cooler and wetter spring should keep the market well supported in the mid-70s. The upside seems to be equally contained for now, as May has gotten a bit too frisky by making itself more attractive than the cash market, especially given the lack of carry.

We therefore expect May to trade down to a level at which takers become interested again, probably near 7600, and we should see the May/July spread widen further as we head into the notice period. The bull run seem to take a pause for now, but it could be rekindled if export offtake continues to surprise positively and/or if there are some weather issues.

Report Courtesy: The Plexus Group

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