PLEXUS Market Comments

Market Comments – Jun 11, 2020

NY futures ended the reporting period basically unchanged, as July gained just 2 points to close at 60.02 cents, while December was down 9 points to close at 59.49 cents.

July pushed to a high of 62.32 cents last Friday in the wake of a somewhat misleading US jobs report, which lured frenzied traders into another rally. However, since then some of the air has started to come out of the bubble and even a constructive US export sales report this morning wasn't able to breathe new life into the spot month.

US export sales amounted to a very strong 618,500 running bales of Upland and Pima cotton for all three marketing years combined. China (372.2k bales) and Vietnam (198.2k bales) accounted for 92% of the net increase in commitments. Shipments remained surprisingly strong at 309,000 running bales, which was on pace with the average needed to reach 15.0 million statistical bales by the end of the season.

Total commitments for the current season are now at 17.75 million statistical bales, of which 12.35 million bales have already been exported. Sales for the next marketing year, which starts in August, are so far at 3.15 million statistical bales.

Today's WASDE report didn't contain any major surprises, as the USDA took steps to correct its overly optimistic consumption numbers. Global mill use for this season was lowered by 2.35 million to 102.65 million bales, while next season's usage was cut by 2.05 million bales to 114.40 million bales.

This brings the USDA more in line with the estimate of the ICAC, which has global consumption at 105.91 million bales for this season and 109.08 million bales for the next marketing year. Since the Covid-19 slowdown is stretching from the current into the next marketing year, it may be easier to look at a 2-year total when making comparisons. The USDA has a 24-month consumption total of 217.05 million bales, while the ICAC is at 214.99 million bales.

While global mill use has been lowered considerably, the USDA maintained global production numbers, as the current season saw a gain of 0.30 million bales to 122.97 million bales, while next season's production was lowered by 0.22 million bales to 118.74 million bales.

As a result of the above changes, plus some adjustments in beginning stocks and trade, the report showed a rather large increase in global ending stocks, with inventories for the current season jumping by 3.40 million to 100.56 million bales, while next year's ending stocks are projected to rise to 104.67 million bales, which is up 5.24 million bales from last month.

The most bearish development is the massive rise in ROW stocks (global inventories outside of China), which are now projected at 63.31 million bales for this season (up 2.39 million from last month) and 69.05 million bales by the end of next marketing year (up 3.74 million from last month). That's over 25 million bales more than what we had at the beginning of August!

Even if we subtracted the projected ending stocks in India (21.11 million bales) and the US (8.0 million bales), which are both countries with strong government support, we would still be left with around 40 million bales that either growers, merchants or mills have to carry. Currently there is hardly any carry on the board, as all 15 futures months between July 2020 and May 2023 closed within a 210-point window today, between 59.29 and 61.39 cents.

While the US is in decent shape in regards to its commitments, which is why the futures market has remained on a firm footing, other origins are not as lucky and are starting to feel the pressure. West Africa has a lot of unshipped and unsold cotton to deal with, Brazil has sold about 70% at origin but merchants are feeling the pinch, while India's CCI will sooner or later have to dispose of its large unsold inventory before new crop arrivals add even more to the burden.

With the market devoid of carrying charges, we are already witnessing substantial basis pressure and this will continue. The short squeeze in July has exacerbated the situation and probably pulled new crop values higher than they should have gone. In this regard it will be interesting to see what will happen when December is left to its own devices two weeks from now.

The CFTC report showed that it was mainly speculators and index funds that were driving the recent rally. In the week leading up to June 2nd, speculators added 0.41 million bales to reduce their net short to just 0.1 million bales, while index funds added 0.32 million bales to boost their net long to 6.26 million bales.

The trade was selling into the advance, adding 0.73 million bales to increase its net short to 6.17 million bales.

The 'risk on', no worry attitude of the US stock market has definitely played a hand in propping up the cotton market. On Wednesday the Nasdaq-100 traded at an all-time high, while the broader S&P500 index was positive for the year.

The army of millennials rushing into the stock market is reminiscent of the dot.com bubble and has pushed valuations to unprecedented levels. The 'Buffet Indicator', which measures the total value of the US stock market as a ratio to GDP, has reached an all-time high this week and is considered “significantly overvalued’. We have a feeling that this bubble, like its predecessors, is going to end in tears as well!

So where do we go from here?

While July may play out its mini-squeeze with the help of China, the market can’t ignore the massive increase in ROW stocks and the much slower than anticipated economic recovery. We are already seeing considerable basis pressure in outside growths and we don’t believe that China will be able to shield US new crop values from that.

The fact that the US is well committed this season and that new crop has some issues with a potential drought in West Texas may keep US values strong relative to other origins, but we feel that ultimately the entire cotton complex will head south under the weight of all these unsold stocks. All this excess cotton is in a game of musical chairs and the music will stop soon, probably once July is off the board.

Markets have recently proven how unpredictable they are, but common sense dictates that prices have a better chance to go down than up from current levels. However, we would only use put options or put spreads to operate in the current environment!

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