PLEXUS Market Comments

Market Comments – November 12, 2020

NY futures moved slightly lower this week, with March losing 59 points to close at 70.62 cents.

Since March is now the futures contract with the largest open interest, we are henceforth basing our market analysis on it. After a four-week rally that lifted March more than 700 points during October, the market has since cooled off, with March closing the last twelve sessions in a tight sideways range of just 196 points, between 69.72 and 71.68 cents.

The main feature this week was the index fund and spec position roll, which forced the Dec/March spread to widen, as had been anticipated. Since October 26 the spread has increased from a low of 43 points to 214 points today. Meanwhile the certified stock has grown to 86k bales, with another 6.5k awaiting review, which has helped to put pressure on the spread.

Considering that the predominant quality in the certified stock is 41-4s, the December contract still looks a bit pricey when compared to foreign growths. However, if the spread were to widen beyond 280 points, we imagine that there would be takers, regardless of where the market is trading.

The WASDE report failed to move the market, even though it was termed as bearish after the USDA left the US crop basically unchanged at 17.1 million bales. That was way above private estimates, which are in a 15.9-16.5 million bales range. It was definitely a bit strange that the USDA raised the yield in Louisiana by 117 pound/acre after two hurricanes (Delta and Zeta) made landfall in that state in October.

The same is true in the case of Mississippi and Texas, where acreage and yields were left unchanged, despite heavy rains/flooding in the former and an ice storm in the latter. Maybe the government is just waiting for more evidence before making changes, but we expect subsequent reports to show reductions.

India is another place that needs more scrutiny, since the USDA has the crop still at 30.0 million statistical bales, whereas the Cotton Association of India came out with an initial crop estimate of just 27.8m bales at the end of October (35.6 million local bales). Untimely storms and pink bollworm attacks seems to have taken a toll on the crop in some areas.

While global production seems to be lower than 116.11 million bales, the same is true for mill use, which looks too high at 114.05 million bales, given the latest COVID outbreak in Europe and the US.

While demand looked promising until a couple of weeks ago, we are now hearing complaints about softening demand from various prominent markets. Most of the holiday orders have already been placed by now and with the COVID spike possibly affecting forward demand, retailers and mills seem to take a more cautious approach.

The latest available CFTC spec/hedge report showed the expected sharp drop in spec longs during the week of October 28 to November 3, when December corrected from 72.60 to 68.06 cents. Speculators sold 1.01 million bales net and reduced their net long to 6.40 million bales, while the trade bought 0.83 million bales net and lowered its net short to 14.45 million bales. Index funds were also light net buyers, adding 0.18 million bales to increase their net long to 8.05 million bales.

Outside markets had a euphoric reaction on Monday, when news of a potentially effective vaccine sent the Dow to a new all-time high. This gave the cotton market an initial boost as well, but it has been all downhill from there. Even if a vaccine gets approved next week, it will probably take until mid-or-late 2021 before the general population gets inoculated. Until that happens we will likely struggle with slow economic growth, but at least there is a glimmer of hope now.

So where do we go from here?

The roll period is behind us and tomorrow December options will expire. This has provided the market with a sea of liquidity and allowed traders to sort out their positions.

Interestingly, while Dec open interest has dropped from 103k to 55k over the last five sessions (not including what happened today), overall open interest has only lost about 6k so far and was still at 237k as of this morning. This means that the vast majority of longs and shorts have been rolled forward without much outright liquidation taking place.

We will probably see another drop in open interest when options come off tomorrow, but by and large spec longs and trade shorts remain committed to their respective positions. Next week liquidity will dry up again and it will take a trigger to flush spec longs out, while the trade should be in no hurry to cover shorts since December fixations are mostly done.

What might happen is that a continuation of the current sideways move will eventually catch the uptrend line and this could trigger some profit-taking by spec longs, similar to what we saw two months ago. Fortunately specs just migrated their longs to March, which has a lot more leeway to its uptrend line than December. The big question is whether China will be there again to buy big quantities on a dip. Considering that Chinese prices are still at around 97 cents, the answer is probably yes.

For now a continuation of the current sideways move makes the most sense to us, although the odds for a technical break are increasing.

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