PLEXUS Market Comments

Market Comments – September 12, 2019

NY futures rallied to a six-week high this week, as December jumped 309 points to close at 62.21 cents.

The market was already in a mini-uptrend over the previous seven sessions when President Trump delayed tariffs on Chinese imports late yesterday. This sparked some buying in the overnight session and when the market crossed above the 60.25 resistance level this morning, sizeable buy stops were triggered, which propelled the market another 200 points higher by the end of the session.

Even the WASDE report - which presented a mixed picture of friendly US numbers and bearish global numbers - was unable to derail the bullish runaway train today, as spec short-covering overpowered scale-up trade selling. Volume was very strong at over 62,000 futures contracts, while options traded nearly 20,000 contracts.

The USDA lowered its US crop estimate by 0.66 million to 21.86 million bales, reflecting the prolonged dryness in the US Southwest this summer. However, after some downward revisions in beginning stocks, mill use and exports, US ending stocks ended up at the same 7.2 million bales as last month, but they are still up considerably from the revised 4.85 million bales at the beginning of the season. US exports are now at a more realistic 16.5 million bales.

Global numbers are still painting a bearish picture overall, as global ending stocks increased by another 1.3 million bales to 83.75 million bales. Global production of 124.90 million bales is expected to outpace mill use of 121.74 million bales by 3.16 million bales this season. And ROW ending stocks are now projected at a record 49.95 million bales, up 1.21 million bales from last month and 4.82 million bales more than at the beginning of the season.

However, when we take a closer look at these stock increases, we notice that it was all due to India, where ending stocks jumped by 2.05 million bales, from 10.33 to 12.38 million bales. That's significant because India operates from a much higher price plateau than other origins due to its MSP (Minimum Support Price). In other words, Indian cotton is currently uncompetitive in the world market.

Therefore, if we analyze the stock situation outside of China and India, which both have higher price levels, we find that stocks elsewhere actually dropped by 0.84 million bales from last month, from 38.41 to 37.57 million bales.

However, ending stocks outside of China and India are still on the rise when compared to previous seasons, as they were at 33.74 million bales in 2017/18 and at 35.10 million bales last season. In other words, there should still be plenty of competitively priced cotton available around the globe.

US export sales slowed considerably last week, as total sales of Upland and Pima cotton amounted to just 78,900 running bales for both marketing years. Sales to China were at a negative 20,700 bales due to cancellations and destination changes. Shipments were also quite slow at just 171,500 bales. For the season we now have total commitments of 8.7 million statistical bales, whereof 1.35 million bales have so far been exported

Today the European Central Bank cut interest rates by another 10 basis points to a negative 0.5% and they also announced that they would start buying USD 22 billion worth of bonds per month, starting in November. By driving rates further into the negative, the ECB and some other central banks are effectively destroying the sovereign bond market, driving investors increasingly into corporate bonds, stocks and real estate.

As mentioned before, we believe that this monetary folly will eventually lead to a paradigm shift towards much higher inflation, which will be bullish for every asset class from a nominal price point of view, including cotton.

So where do we go from here?

Last week we felt that a breakout to the upside was more likely if spec shorts could somehow get triggered into covering. Positive vibes from the trade front combined with technical strength did the trick today and sparked massive spec buying, most of which was short-covering.

The fact that the US crop was lowered by 654k bales may have given the trade pause, as scale up selling was less aggressive than we thought. We would expect some follow-through spec buying in the days ahead, but the higher we go, the more the trade will be willing to add to its net short position.

In other words, we expect to see a handover of shorts from speculators to the trade. US producers were already resigned to the fact that they would not get much more for their cotton than the loan plus a few cents for equities, but now they may get a chance to add 5-7 cents to their bottom line.

We therefore expect trade selling to get quite heavy as we move higher and unless there are further setbacks to the US or any other major crops, or a comprehensive trade deal gets announced, we don't expect this rally to carry on for more than 2-3 cents from here.

https://plexus-cotton.com