PLEXUS Market Comments

Market Comments – February 13, 2020

NY futures ended the week basically unchanged, as May edged up just 15 points to close at 68.63 cents.

Neither a bearish WASDE report, bullish US export sales nor uncertainty about the coronavirus were able to move the market this week, as most of the action was confined to rolling remaining March positions forward. The May contract, which is now the lead month, traded in a 175-point range between 67.66 and 69.41 cents, closing today right in the middle of it.

The WASDE report showed a surprisingly big jump in global ending stocks of 2.53 million bales to 82.12 million bales. The changes were evenly split between larger production and lower mill use. Brazil (+0.68 million bales over two seasons) and Pakistan (+0.50 million bales) showed the biggest changes on the production side, while China accounted for a 1.0 million bales drop in mill use due to the coronavirus situation.

The most bearish takeaway from the report is the big jump in ROW stocks, which are now projected at a record 48.38 million bales, up 1.53 million bales from last month. By comparison, last year ROW stocks amounted to 44.32 million bales and two seasons ago they were at 42.84 million bales.

India almost single-handedly accounts for the year-on-year jump in ROW stocks, as its inventory is supposed to increase by 3.70 million bales, from 9.31 to 13.01 million bales. That's actually good news for the market, because the oversupply will end up in the hands of the CCI. So far they have procured around 6.1 million local bales and we wouldn't be surprised if this number were to top ten million bales by April.

CCI prices are slightly higher than the current market level and since they intend to sell their cotton at break-even or better prices, there is no pressure on international values at the moment. At the same time we expect this massive inventory overhang to put a solid cap on the market.

Other than India we also have small year-on-year stock increases in the US (+0.55 million bales) and Brazil (0.43 million bales), but both of these origins are either well committed and/or are somewhat limited by logistics. Since India, the US and Brazil account for a combined 4.68 million bales increase in stocks, it means that inventories in the rest of the ROW are going to be 0.62 million bales lower. This may explain why we aren't seeing much price pressure and why US sales continue to outperform week after week.

US export sales continued to excel last week, as 419,100 running bales of Upland and Pima cotton were added for both marketing years. The number would have been even more impressive if it hadn't been for large cancellations of 152k bales, which stemmed mainly from China. There were 20 markets participating in the buying, with Vietnam leading the way. Shipments of 407,900 running bales were once again above the pace needed to make the US export projection of 16.5 million statistical bales.

Total commitments for the season are now at 14.0 million statistical bales, of which 6.25 million bales have so far been exported. New crop sales are at slightly over 1.2 million statistical bales.

US stock markets continued to post new record highs this week, with the Dow Jones closing in on 30,000 and the Nasdaq approaching 10,000. In just four years the Dow Jones has nearly doubled in value, while the Nasdaq has more than doubled. However, stocks are getting pricey by historical measures, as the Wilshire Total Market Cap has reached $34.2 trillion, which compares to a GDP of $21.7 trillion. This means that the TMC-to-GDP ratio of 157.2 is now at a record level, easily surpassing the previous peak of the 2000 tech bubble.

However, there is no telling if or when this stock market rocket will finally run out of fuel. Valuations clearly don't matter much at the moment and stocks these days are driven by easy monetary policy, stock buybacks, index fund buying, momentum traders and 'safe haven' allocations. Since 1996 the amount of publicly traded companies has been roughly cut in half and with companies hoarding shares through buybacks, the stock market has in a sense become 'commoditized', following laws of supply and demand rather than balance sheets. But we are getting the eerie feeling that this story won't have a happy ending!

So where do we go from here?

Not much has changed from what we stated last week. We still feel that the trade is currently in charge of the market and that over the coming four months it will be a net buyer of March, May and July futures, as open on-call business gets fixed and merchants sell remaining basis-long positions. New net shorts will only be added in new crop as growers are starting to protect their upcoming crop.

As mentioned above, there is not that much extra supply at current prices, as the bulk of unsold cotton will be in the hands of the CCI in India. Unless the CCI changes its pricing policy, we don't expect to see much pressure on the market.

We don't quite know how to handicap the coronavirus situation. So far markets have taken the problem in stride, but China's economy has definitely taken a hit and this will be felt in other parts of the world as well. And if the virus were to spread in the developed world, then a global recession would almost certainly follow. This is a time to play defense and we recommend the use of options only in this uncertain environment!

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