PLEXUS Market Comments

Market Comments – June 13, 2019

NY futures ended the week mixed, as July fell 176 points to close at 66.83 cents, while December was nearly unchanged, dropping just 24 points to close at 66.43 cents.

July gave back most of its inversion to December this week, closing today at just 40 points ‘over’, after it had been at a 192-point premium last Thursday. A large chunk of July’s open interest got cleared away during the GSCI roll that ended today and it will be interesting to see how much is left after tomorrow’s options expiration. We still feel that July could have some life left in it and surprise us to the upside as we approach First Notice Day, which is on June 24.

December has now taken over as the lead month and since falling over a cliff exactly a month ago, it has moved sideways in a 301-point settlement range over the last 23 sessions, closing no lower than 65.46 and no higher than 68.47 cents. After producers had missed their opportunity to hedge in the mid-to-high 70s, they are reluctant to chase the market below 65 cents, but will likely sell into strength in order to increase their downside protection, which is keeping the market range bound for now.

The WASDE report didn’t contain any surprises and the market showed hardly any reaction to it. The two key takeaways are that 1) global production (125.32 million bales) and mill use (125.27 million bales) are basically at the same level next season and 2) ending stocks are seeing a shift from China (-2.88 million bales) to the ROW (+2.60 million bales). Furthermore, these higher ROW stocks are expected to accumulate mainly in the US (+1.75 million bales), which has been putting pressure on US futures, especially since US producers remain considerably under-hedged.

India could provide an interesting twist in regards to who is going to carry the burden of excess ROW stocks next season. An increasing MSP (Minimum Support Price) will all but guarantee that the Indian government would accumulate a large amount of cotton, which it would likely carry until the end of the season.

However, there are some rumors that India might introduce something similar to the US ‘POP payment’, whereby the government would provide payments for the market difference to farmers instead of hoarding stocks. This scenario would be bearish for global prices, because it would lead to fierce competition between the US and India. We should know by early July which way India decides to go.

The US crop, which the USDA still estimates at 22.0 million bales at this point, has struggled with an unusually cool and wet spring in Texas and the Mid-south, while the Southeast has been too hot and dry, although it finally received some widespread rain this week. These irregular conditions have led to a variety of problems, be it acreage that couldn't get planted, plants struggling to make a decent stand, hail storms, sandblasting, weeds or heavy insect flights.

At this point it is nearly impossible to get a good grip on the potential of this very mixed crop and a lot will of course depend on how the weather continues from here, but we believe that the USDA acreage report at the end of this month will show that some of the March intentions were not realized. In light of this struggling and late crop the market deserves a weather premium and this has led to a more cautious approach by traders, which could lead to a short-term momentum shift.

US export sales slowed last week, as just 130,000 running bales of Upland and Pima were sold for all three marketing years combined. Shipments were decent at 379,200 RB, although the pace needed to make the current USDA estimate is at around 415k per week.

Total commitments for the current season are now at 16.3 million statistical bales, of which 11.5 million bales have so far been exported. Sales for August onwards are currently at 3.9 million statistical bales.

Between all export commitments as well as domestic mill use through October we arrive at a total of 24.1 million statistical bales, against which there are existing supplies of 23.0 million statistical bales.

In other words, the supply pipeline could get tight by the third quarter, since more export sales will be added in the meantime and new crop is delayed. For this reason early arrivals demand a premium and this should keep December relatively firm vs. March.

So where do we go from here?

Until we get a better grip on the US crop potential, the trade is probably not going to add too many shorts in the mid-60s, but will likely do so on rallies towards 70 cents. This should keep December range bound in the near future.

Longer-term the market still looks vulnerable to the downside, but only if there are no major crop issues.

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