PLEXUS Market Comments

Market Comments – January 14, 2021

NY futures continued to push higher this week, with March advancing 139 points to close at 81.15 cents.

A bullish WASDE report, another excellent export sales report and strong soybeans and grain prices kept the cotton market on a firm footing. Since December 21 the March contract has gained 639 points in just 15 sessions and there is still no end to this bull run in sight.

The WASDE beat bullish expectations, as the US crop was lowered by a million bales to just 14.95 million bales. What started out as a potential 20 million bale crop has shrunk by five million bales over the course of the season, as harvested acreage dropped to just 8.7 million acres, down 28% from the 12.09 million acres that were planted. The average yield of 825 pounds/acre was almost identical to the 823 pounds/acre of last season, but it is still 16 pounds/acre below the 10-year average.

The smaller US crop, combined with the record pace of exports, has reduced available supplies considerably, with US ending stocks now estimated at just 4.6 million bales. This compares to 7.25 million last season and 4.85 million bales two years ago. If we consider that around 2.0 million bales will have to come out of existing stocks to satisfy domestic and export needs during the August to October period, then only around 5.0 million bales remain available at this point.

Global numbers showed a widening production gap due to the reduction in the US crop, as global mill use is now expected to outpace production by 2.86 million bales, which compares to a production surplus of 19.53 million bales last season.

Global ending stocks dropped 1.2 million bales from last month to 96.32 million bales, but that number is probably overstated, because we believe that ending stocks in India are considerably lower than the 19.38 million statistical bales (24.80 million local bales) the USDA currently estimates.

Global exports of 43.56 million bales compare to 41.24 million last season. China is the main reason for this increase, as it is now expected to take in 10.50 million bales, up from 7.14 million bales last year. China has also been importing a lot more yarn from places like Vietnam or the Indian Subcontinent, as the Xinjiang ban has forced Chinese textiles and clothing exporters to source more cotton and yarn from abroad.

US export sales amounted to 412,600 running bales of Upland and Pima cotton for both marketing years last week, with 19 markets participating, while shipments of 284,700 RB went to 23 destinations. For the current season commitments have reached 12.8 million statistical bales, of which 6.3 million bales have so far been exported. For the next marketing year there are so far around 0.9 million statistical bales on the books.

The latest CFTC spec/hedge report of January 5 showed that the trade is not backing down yet, as it continued to increase its net short position by 0.83 million to 15.52 million bales, which is the largest exposure since August 2018. Speculators and Index funds increased their net long to 7.72 and 7.80 million bales, respectively.

The unfixed on-call position, which forms a big part of the trade’s net short position, showed not much progress last week. There were still 8.2 million bales in unfixed on-call sales on March, May and July, against just 1.85 million bales in unfixed on-call purchases

Outside markets continued to act in support of higher cotton prices, as soybeans and corn rallied to their highest level since 2014, with March soybeans trading at 14.30 dollars/bushel and March corn at 5.34 dollars/bushel. November soybeans, which are relevant in cotton's fight for acreage this spring, closed today at 12.02 dollars/bushel.

This evening President-elect Biden announced a $ 1.9 trillion relief package, providing more stimulus checks and unemployment benefits for the working class. A second bill is expected for February, which will include funding for infrastructure and combating climate change.

These bills will likely stoke inflation fears and underpin stock and commodity markets over the coming months, as the national debt will take another big jump this year. Since March 15, when the US first went into lockdown, the national debt has increased $ 4.25 trillion, which corresponds to an annual rate of $ 5.1 trillion. The US national debt is currently at $ 27.6 trillion, but by the end of the year it will probably be near $ 33 trillion.

So where do we go from here?

From a technical point of view the primary uptrend is alive and well, but the market has recently accelerated out of its trend channel that has been in force since early April. It would therefore not surprise us if the market were to pull back into this channel over the coming weeks, to somewhere in the high 70s.

The trade continues to buck the trend and has been adding to its net short position on this latest move up. As explained last week, the trade is playing a dangerous game, because sooner or later it will have to buy its way out of this short position, hoping that there is going to be enough spec selling to avoid a squeeze.

With the July/Dec spread nearly 600 points inverted, it offers a great incentive for spec longs to stay in the game, since they can roll their position to a cheaper level, while it becomes prohibitive for trade shorts to roll their position down the calendar. In other words, the trade needs to find a window of opportunity between now and the middle of June to get out of its position.

The fact that US supplies are selling out fast doesn’t make it easier for the trade. Although there is no immediate need for trade shorts to act, we expect the market to remain well supported on dips and believe that prices are headed higher over the coming months.

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