PLEXUS Market Comments

Market Comments – November 14, 2019

NY futures ended the week basically unchanged, as March edged up just 4 points to close at 66.08 cents/lb.

The market remains flatlined as March, which is now the lead month, has settled the last 21 sessions in a tight range of just 162 points, between 65.27 and 66.89 cents. Despite a lot of contracts changing hands this week, the market clearly lacks direction and settled today right in the middle of its 4-week range.

Even last Friday's WASDE report, which provided a set of friendly numbers, was unable to move the market for more than a couple of hours, as traders felt that the USDA missed the mark on mill use. While global production was lowered by 2.83 million bales to 121.9 million bales, the government left mill use basically unchanged at 121.49 million bales, down just 0.12 million bales from last month.

This is clearly too optimistic based on what we see in several of the key markets around the globe. As stated last week, we believe that global mill use is currently at no more than 119.0 million bales, possibly even less.

The USDA has a tendency to be overly optimistic when it comes to demand. Take last season for example, when the government had mill use at 127.94 million in its September

2018 report, but subsequently had to drop it all the way down to 120.29 million bales. This season we started out with an estimate of 125.93 million bales in May, which has already been lowered by 4.44 million to 121.49 million bales, and it has further to go in our opinion.

When it comes to global ending stocks, we notice that they have basically been identical over the last four seasons. Since 2016/17 they have amounted to 80.29, 80.94, 80.55 and 80.80 million bales. During that time frame cotton futures have traded between 57 and 96 cents, so one might assume that ending stocks have no correlation to the price of cotton. Actually they do if we consider where these stocks are located.

Four seasons ago China owned 45.92 million bales of global ending stocks, while the ROW (rest of the world) had only 34.37 million bales. Over the course of the last four seasons destocking in China has brought its stock number down by 13.17 million bales, while ROW stocks have risen by 13.69 million bales. In other words, there has been a change in ownership, whereby China now has only 32.75 million of the total, while the ROW is burdened with a record 48.06 million bales, and possibly more if mill use is weaker as we suspect.

There may be a silver lining in the fact that Chinese stocks are now near a level at which the government no longer needs to destock. Since the 2014/15-season, when the USDA counted Chinese stocks at 67.92 million bales, they have been cut by more than half. Rather than having to get rid of stocks, the Reserve seems to be transitioning into a stocks rotation scheme going forward. In fact, the Chinese Reserve has recently been active in Brazil and this week it announced that it would procure 500k tons (2.3 million statistical bales) from Xinjiang between December and March.

While China seems to have plenty of supply this season, we believe that we are now entering a phase during which Chinese imports will trend higher. This may not matter much as long as global production meets global mill use, but sooner or later there will be a season in which world production runs into trouble and that's when ROW stocks will get drawn down quickly, as China is no longer able to buffer the gap.

Since we are on the subject of China, there has recently been some negative press regarding China's slowing growth rate, as its GDP is apparently growing by 'only' 6 percent a year these days. However, we need to consider that China is now the second largest economy in the world behind the US, with a GDP of USD 14.1 trillion according to the IMF.

Therefore, a 6% growth rate still translates into USD 846 billion, which isn't chump change. To put that into context, that's bigger than Turkey's annual GDP of 744 billion and not far from that of Indonesia, which is a USD 1.11 trillion.

So where do we go from here?

It looks like cotton prices have found a 'sweet spot' in this 65-67 cents zone, basis March. There seems to be a decent amount of volume trading in this range, which means that there is currently no reason for the market to go much higher or lower in order to generate business or to ration supplies.

Technically the market is still in a short-term uptrend dating back to late August and as long as this uptrend holds, speculators shouldn't get too aggressive on the sell side. However, the last two CFTC reports have shown that speculators were net sellers of over 1.4 million bales, which was a bit of a surprise. The trade has stepped in as a buyer and held the market up, but with more supplies coming off the field, the trade should actually be a net seller and increase its short position.

Given speculators' recent behavior there seems to be a greater risk to the downside. But with both the US and global crop getting smaller and with US prices still among the cheapest, traders don't seem to have much of an appetite to go short. We therefore expect a continuation of the sideways range until some new factors come into play.

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