PLEXUS Market Comments

MARKET COMMENTS – OCTOBER 14, 2021

NY futures ended a rollercoaster week lower, as December dropped 451 points to close at 107.10 cents. The Dec/March inversion narrowed from 288 to 215 points.

After posting an intraday high of 116.48 cents on Friday, the December contract fell nearly 13 cents to an intraday low of 103.50 cents on Wednesday, before regaining its footing today.

Even though daily trading volume averaged 46k contracts, we saw only a small drop in open interest. As of this morning total OI still amounted to 284.6k contracts, which was only 4.2k contracts or 1.5% less than a week ago. In other words, spec longs and trade shorts continue to dig in, which promises more volatility in the weeks ahead as this battle continues.

The WASDE report had something for both the bulls and the bears. The US numbers were friendly, as the crop was lowered by 0.5 million to 18.0 million bales, which is probably a fair assessment at this point. However, we still feel there is potential to achieve a bigger number if harvest progresses well.

The world numbers were bearish as presented, as global production was up by 0.69 million to 120.28 million bales, while global mill use was lowered by 0.74 million to 123.40

million bales, which shrank the seasonal production gap to just 3.12 million bales, down from 4.55 million last month.

However, global ending stocks went up by just 0.45 million to 87.13 million bales, as Indian beginning stocks were lowered by 1.1 million bales, with revisions going back five seasons. While this was a step in the right direction, we believe that Indian stocks are still at least 1.5 million bales too high.

ROW stocks actually dropped by 1.06 million to 50.67 million bales, since most of the bearish changes to the world numbers occurred in China, where domestic mill use was lowered by 1.0 million to 40.0 million bales and imports increased by 0.5 million to 10.5 million bales.

We believe that the USDA is too conservative on Chinese imports, since China has been buying up a storm recently and it doesn't make sense to us that China would import less than last season, when it took in 12.87 million bales.

Therefore, if Indian stock were taken down another 1.5 million bales and Chinese imports increased by 2.5 million bales, it would drop ROW stocks by 4.0 million bales to just 46.67 million bales.

This may still sound like plenty of cotton, but we need to consider that around half of these ROW stocks are in India and Brazil, where most of the cotton is already spoken for and logistics can be a limiting factor. In the case of India we doubt that they will be a net exporter of 4.8 million bales (6.14 million local bales) this season, since local mill use is catching up to production, thanks to strong yarn demand from China.

The US has hardly any cotton in its pipeline at the moment, as EWR receipts showed just 1.58 million running bales as of this morning and harvest is delayed. This means that it will take a while until the US supply situation improves to a point where there is excess cotton.

Chinese futures continue to provide cover for US speculators, as the most actively traded January contract closed just marginally lower this week and still settled at a lofty 149 cents today. When NY futures fell precipitously earlier this week, the spread between Chinese and US futures widened to over 46 cents at one point, thereby providing an incentive for arbitraging the two contracts.

This huge price gap may also have lured the Chinese Reserve back into action, at least that's what has been rumored in recent days. It will be interesting to see whether there is any evidence of that in the upcoming US export reports.

The CFTC on-call report showed that mills continued to drag their feet, as there were still 3.58 million bales unfixed as of last Friday, down just 0.38 million bales from the week before. Overall on-call sales still totaled 15.10 million bales, which provides strong underlying support.

On the other side growers only have 1.24 million bales open on December and 3.95 million bales overall, which doesn't amount to much overhead resistance.

So where do we go from here?

After getting close to a 50% retracement of the up move between 88.95 and 116.48 cents, the market has started to turn up again, which might force mills to become more aggressive with their fixations and/or upside protection via options.

Although there may have been some profit taking by speculators during this correction, the nearly unchanged open interest tells us that speculators have staying power and that time is working against the shorts.

While speculators have no time pressure and can simply roll their longs forward at a discount, mills have their backs against the wall, as they need to fix more than three million bales over the next six weeks and then another 4.6 million bales by February.

As long as China continues to provide cover with its high price level and imports, the odds remain in favor of the bulls!

https://plexus-cotton.com