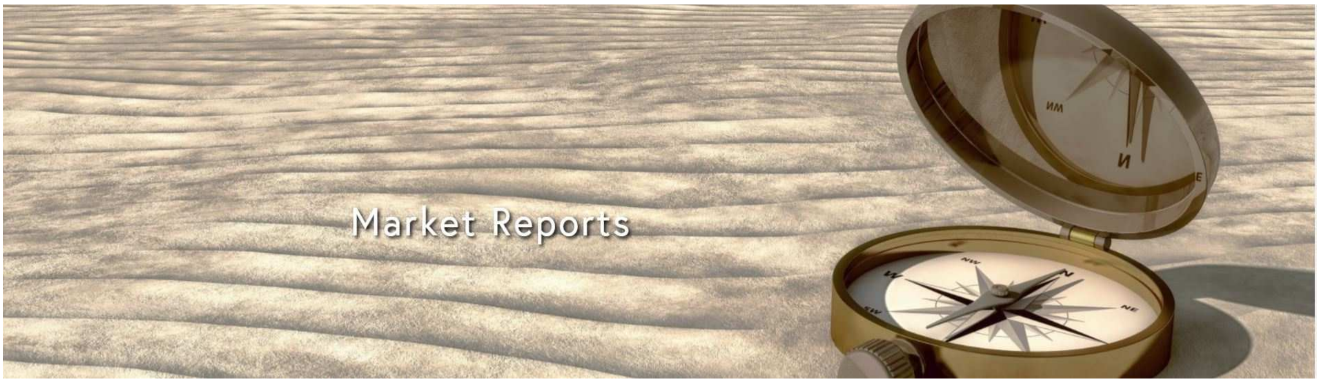


# PLEXUS Market Comments

Market Comments – August 15, 2019

NY futures closed basically unchanged this week, as December inched up just 4 points to close at 59.62 cents.

As expected we are seeing the market transitioning into a sideways trend, since the downside is limited by the US government loan, while the upside is contained by slew of bearish factors. December has now settled the last ten sessions in a tight range of just 148 points, between 58.14 and 59.62 cents, and we believe that the market will remain in a relatively narrow range until the US crop has been harvested.

The latest CFTC report confirmed that it was renewed spec selling that forced the market to new lows in early August. Between July 31 and August 6 speculators expanded their net short position by 0.65 million bales to 5.36 million bales. The trade continued to reduce its net short by 0.64 million to a nearly flat 0.15 million bales net short. The spec and trade positions both represent new records! Index funds were basically unchanged at 5.51 million bales net long.

While this growing spec net short could have bullish implications at some point down the road, Monday’s WASDE report added to the prevailing bearish sentiment. The most damaging factor in the report is the rapid drop in demand, as global mill use was taken down by another 1.2 million bales last month, after it was already lowered by 1.0 million bales the month before. And it may still be too high at 123.1 million bales, considering that in the season that just ended consumption amounted to just 120.6 million bales and that the global economy has started to slow down.

A combination of lower consumption and higher beginning stocks increased global ending stocks by 2.04 million bales to 82.45 million bales. ROW stocks account for most of this increase, as they are expected to go up by 1.31 million bales to a record 47.84 million bales. This compares to 44.68 million last season and 43.01 million bales two years ago.

Looking at the US numbers, which are most relevant to the futures market, we have higher beginning stocks (+0.25 million bales) and a higher crop (+0.5 million bales), which are partly offset by an increase in exports of 0.2 million bales to 17.2 million bales. US ending stocks are thus projected to rise to 7.2 million bales.

However, we believe that this export estimate is pie in the sky, especially with the China situation going on. The USDA simply uses a percentage of supply to determine exports at this point, so this 17.2 million bales number is not rooted in reality. We would be lucky to export 15.5 million bales this season, which would lift ending stocks to 8.9 million bales, the highest in 12 seasons.

Speaking of US exports, the latest weekly report was quite encouraging, as a combined 476,500 running bales of Upland and Pima cotton were added for both marketing years. Participation was broad-based with 17 markets buying. Even China booked 104,500 running bales net, although that was for the 2020/21-marketing year.

For the current season we now have commitments of around 8.15 million statistical bales, of which a little less than 0.4 million bales have been exported. For the 2020/21-season there are so far 0.45 million bales on the books.

The cotton market doesn't seem to be able to catch a break at the moment, as there have been several economic and geopolitical developments lately that make life difficult for commodity bulls. These include the escalating US/China trade war, a sharp drop in German industrial output and exports, the currency collapse in Argentina, the conflict in Kashmir, tensions in Hong Kong and a rising US dollar.

Many of these factors point to a slowdown in the global economy and as a result the US yield curve has inverted for the first time since 2007, which is seen as a troubling sign. The 30-year US treasury bond closed today at a historically low yield of just 1.97 percent. There is no telling when this race towards zero or negative interest rates will finally come to a halt. Adding to the absurdity, in Denmark the third largest bank is now offering negative mortgage rates. Borrowers are able to get a negative 0.5% rate on a 10-year mortgage!

Sooner or later this monetary folly will have dire consequences. As real interest rates get worse, money is increasingly forced to chase all kinds of assets in order to preserve its purchasing power and this will ultimately lead to massive inflation. Take Germany as an example, where a 10-year bond yields minus 0.65% and inflation is at 1.4%, which means that money in the bank loses around 2% of its purchasing power a year.

**So where do we go from here?**

As pointed out last week, we believe that the US government loan is acting as a buyer of last resort, which provides the market with a floor at around 57/58 cents. When financial markets sold off this week, cotton managed to close the day slightly higher, which seems to confirm that there is solid support in the high 50s.

This support should hold at least until the crop has moved into the loan. Thereafter it depends on how fast and in what quantities the loan redemption mechanism flushes cotton into the marketplace.

The upside seems equally contained, at least in the short term, since growers will use rallies to lock in a better price than the loan by selling futures or by buying bearish options strategies. It would take a crop disaster in one of the major crops to alter this outlook.

The longer term view is a lot more uncertain. While a slowing global economy could keep prices depressed for a while, ultra-cheap interest rates and possibly new rounds of QE (quantitative easing) are setting the stage for a massive rally in nominal terms at some point in the future. However, timing such an event is impossible, as it will happen when investors are starting to lose confidence in the current monetary system.

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