PLEXUS Market Comments

Market Comments – October 15, 2020

NY futures continued to push higher, as December advanced another 173 points to close at 69.22 cents.

After the December contract had spent about three weeks in a 65-67 sideways range between mid-September and early October, it has since rallied more than 300 points in eight sessions, posting its highest close since February 21 today. The expanding open interest suggests that it was renewed spec buying into trade scale-up selling that sponsored the rally.

The latest CFTC report, which is already a bit dated, confirmed that the initial phase of this advance was led by spec and index fund buying. During the week of Sept 30 to October 6, when the December contract traded between 64.87 and 67.83 cents, speculators bought 0.49 million bales net to bring their net long to 5.27 million bales, which was the highest since September 2018. Over the last two weeks large spec accounts carrying outright long positions increased from 93 to 111 accounts.

Index funds added 0.06 million bales to increase their net long to 7.59 million bales, while the trade continued to be a net seller, expanding its net short by 0.55 million to 12.83 million bales.

Since this bull market started to take off from around 50 cents in early April, it was mainly the futures market that led the charge, with the cash market dragging behind. However, this dynamic seems to have shifted, as strong demand for physical cotton in markets like Pakistan, India, Bangladesh, Vietnam and China has led to an increase in basis levels of various origins, on top of a higher futures market.

The main force has been China, where domestic prices have rallied sharply since the holiday ended last week, with CZCE January futures up over 11 percent in five sessions. The stronger Yuan, which appreciated from 7.16 to 6.71 against the US dollar since May 28, has further added to China's buying power. As a result we have seen keen demand for more attractively priced foreign cotton and yarn

US, Brazilian and Indian cotton have all seen strong support from Chinese buying lately and there is no end in sight. Available port stocks have been eagerly taken up and Chinese merchants also bought about 150k bales of Indian cotton for arrival before the end of the year, which seems to be replacing Australian cotton, after it is no longer eligible to be imported under the favorable 1% TRQ.

With corn, wheat and oilseed prices spiking, it becomes more likely that China will have to commit additional acreage to these crops to ensure food security, at the expense of cotton. Add to that the backlash against Xinjiang cotton and it all adds up to China importing more foreign cotton and yarn over the coming years.

After the US Midsouth suffered a setback from Hurricane Delta last Friday, it was India that experienced adverse weather this week. Telangana, Andhra Pradesh and Karnataka received the heaviest October downpours in 100 years according to local reports, with 24-hour totals reaching up to 11 inches in some locations. Damage assessment is still under way, but these states account for about 28% of the planted acreage in India this season and there will be some quality and yield reduction.

The recent rebound in mill demand has taken a lot of traders by surprise. While most countries around the globe are still struggling with sub-par growth, we seem to have a bifurcated economy, with a service sector that's mired in recession and a goods sector that's doing quite well

People cannot spend money on experiences like travel, events, going to the movies, bars or restaurants, which means that they have a lot more money available to spend on goods, including textiles and apparel. The personal savings rate in the US went as high as 33% in April and still amounted to 14% in August, which is nearly double the long-term average. In other words, people have a lot of money, but fewer things to spend it on. In a strange way, the longer the shutdown lasts, the more money will get diverted to buying goods.

So where do we go from here?

It is no longer just the futures market that is hot, as cash prices have been rallying due to pent-up demand lately. Whether this is just some temporary strength tied to the upcoming Christmas season or something longer-lasting remains to be seen.

But with a friendly technical picture, a struggling US dollar, strong grain and oilseed markets and mills caught on the wrong foot with their sizeable unfixed on-call position, it becomes increasingly difficult to make a bearish case. For the market to reverse course it would take spec long liquidation, but at the moment that doesn't seem likely.

Maybe the upcoming US elections will force some specs to the sidelines. But unless that happens, we will likely see a continuation of this stop-and-go bull market.

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