PLEXUS Market Comments

Market Comments – January 16, 2020

NY futures closed the week slightly lower, as March gave up 47 points to close at 70.22 cents.

Since December 4 the March contract has rallied nearly 800 points, from a low of 64.05 to a high of 71.96 cents on Monday. This week’s pullback is therefore no surprise, as the market got a bit overextended, both from a technical as well as a fundamental point of view.

Open interest increased considerably during this rally, as overall futures O.I. went up by 5.5 million bales between December 4 and yesterday. When we look at the CFTC data, which includes options as well, we get a similar picture. Over the last five CFTC reports (Dec 3 to Jan 7), overall open interest jumped by 5.1 million bales to 28.0 million bales.

As expected speculators did the heavy lifting, as they were net buyers of 3.82 million bales over these five weeks to give them a 1.69 million bales net long position as of January 7, while index funds added 0.82 million bales to boost their net long to 7.64 million bales. Nearly all of the spec buying has been short-covering and we have yet to see outright spec longs take a more bullish stance. This is needed to keep the upside momentum going, because spec short covering will eventually run its course.

The trade was taking the other side, basically doubling its net short position by adding 4.68 million bales to a total of 9.33 million bales. As remarked last week, we feel that the trade doesn't have much room to add shorts in current crop futures at this stage of the season, which should mitigate downside pressure going forward.

The WASDE report of last Friday didn't move the needle by much, although the numbers were slightly supportive. The US crop was taken down to 20.1 million bales and the final number is likely to slip below 20 million bales. Global production was lowered by another 0.63 million bales to 120.48 million bales, while mill use was basically unchanged, down just 0.05 million to 120.22 million bales. This means that we now have almost identical production and mill use numbers this season.

ROW stocks declined by 0.23 million to 46.85 million bales, but are still considerably higher than the 43.86 million last season and the 42.85 million two years ago. However, when we take India out of the equation as well, then global ending stocks (minus China and India) are very similar to those of the previous two seasons: 34.14 million bales in 2019/20 versus 34.55 last season and 33.62 two years ago.

So the question is if and when Indian stocks might be made available to the global market? Interestingly, the USDA sees Indian exports at only 3.80 million bales this season, vs. 3.51 a year ago and 5.18 two years ago. If that's the case, it would mean that the availability of cotton will be no greater than in previous years. This is quite a departure from earlier in the season, when we felt that the market would be weighed down by excess stocks.

The first phase of the US/China trade deal was finally signed on Wednesday, with China promising to buy an additional

$200 billion in US goods and services over the next two years. Purchases of Ag products would increase by $12.5 billion in year one and $19.5 billion in the second year, compared to 2017 levels. Cotton was mentioned as one of the products, along with soybeans, pork and wheat.

However, the market seemed to have discounted the event and we therefore got a typical ‘buy the rumor - sell the fact’ reaction, with prices coming under pressure over the last two sessions. China will likely buy some US cotton, but probably not at current levels. We therefore see this deal more as a ‘Chinese put’ under the market, rather than an immediate catalyst for higher prices. Interestingly, the USDA lowered Chinese imports by 0.5 million bales, citing ‘lower consumption’.

US export sales continued to advance at a steady pace last week, as 281,700 running bales of Upland and Pima cotton were added for both marketing years. Participation was broad-based with 17 markets appearing on the buyers list. Shipments picked up their pace as well, as 309,400 running bales were exported. Total commitments for the current season are now just shy of 12.6 million statistical bales, of which 4.75 million bales have so far been shipped.

So where do we go from here?

The market needed a break after momentum indicators were ‘overbought’ and US cash prices became expensive relative to other origins.

However, we feel that this is simply a consolidation in an uptrend and not the beginning of a reversal. With the Fed expanding its balance sheet by $400 billion since August, with financial markets still in exuberant mood, with the ‘Phase One’ trade deal promising more Chinese cotton purchases going forward and with US commitments well advanced, we don’t expect to see much pressure on values.

The market may have some more digesting to do near the 70 cents level, but we believe that there is plenty of underlying support and that prices will eventually push higher again.

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