PLEXUS Market Comments

May 16, 2019

NY futures continued their slide this week, as July gave up another 343 points to close at 66.80 cents/lb.

US/China trade tensions continued to weigh on the market, as July fell to an intra-day low of 64.50 cents on Tuesday before finally rebounding a bit. We have to go all the way back to July 2016 to find a lower print in the market. Between the April 26 high of 78.44 and the May 14 low of 64.50 the market has dropped nearly 14 cents in a matter of just 13 sessions.

The July/Dec spread, which traded at over 100 points carry earlier this week, has since started to reverse again and closed today at just 29 points carry, which could be a sign that the worst of this selloff is over for now.

The latest available CFTC report confirmed that it was heavy spec and index fund selling that caused the damage, as they sold a combined 1.98 million bales between May 1-7, while the trade bought the same amount scale down. Tomorrow’s CFTC report will probably show a similar trend for the May 8-14 period, with specs finding themselves in an overall net short position again.

Last Friday’s WASDE contained no major surprises, as the government was conservative with its initial production estimate. The US crop estimate of 22 million bales certainly has room to grow if the weather cooperates and a 127-128 million global production number seems therefore possible.

The report as presented was actually only mildly bearish due to the anticipated rise in ROW ending stocks, with the US expected to carry most of the burden. In a nutshell, the USDA currently predicts a global production gap of 0.48 million bales, which is neutral. While ending stocks in China are expected to decline by 2.88 million bales, they would rise by 1.75 million bales in the US (bearish) and 0.34 million bales in all other countries (neutral).

However, most traders feel that production numbers could trend higher over the coming months, while mill use may struggle to reach nearly 126 million bales, especially if the trade war were to intensify and the global economy started to cool off.

While the US crop is showing a lot of promise thanks to all the moisture in the ground, it is having a difficult time getting planted. Texas and the Midsouth have been in a wet and cool pattern for many weeks now, with another round of severe storms sweeping through both areas over the weekend and into early next week. We estimate that as of mid-May only about a third of the acres in these two regions have been planted, which will likely make for a later than usual crop.

Meanwhile most of Georgia and the Carolinas had decent planting conditions, but now the forecast calls for dry and potentially very hot weather, with temps reaching 10-12 degrees above normal, which could put some stress on young crops. These conditions are expected to persist over the coming six weeks.

US export sales were surprisingly strong last week, with 424,700 running bales of Upland and Pima finding a home across three marketing years. There were 19 markets buying, including India and even a small amount to China. Shipments of 385,700 RB were about 10k behind the pace needed to make the current USDA estimate of 14.75 million statistical bales.

For the current season we now have commitments of 15.35 million statistical bales, of which just under 10.0 million bales have so far been exported. For the coming marketing year there are currently 3.4 million bales on the books. Outstanding sales to China are at 2.1 million statistical bales of Upland and 0.1 million bales of Pima.

So where do we go from here?

The US/China trade scare combined with a bearish technical picture has collapsed the futures market under the weight of heavy spec and index fund selling. However, this drop into the mid-60s has sparked sizeable export business as mills are filling in remaining needs and even bolster their inventories in some cases.

The market may have overreacted to the trade issue, as so far, neither tariffs on clothing and apparel imports have gone into effect, nor has China banned imports of US cotton. Tariffs on an additional USD 325 billions of Chinese goods are still subject to a public hearing about a month from now, which leaves time to work on a deal.

As far as cotton imports go, let’s not forget that China is already imposing high tariffs on raw cotton, with the exception of the 1% TRQ, some special quotas and mills operating in ‘free trade zones’. We therefore don’t believe that the entire US sales book to China is in jeopardy, even if the trade war were to escalate.

A problem may arise further down the road, if China were to shun US cotton in favor of other origins, which would force the US into the role of residual supplier. But even this would only be a problem if we ended up in a global oversupply situation and there is still a lot of weather to negotiate before we get there.

Therefore, with these low prices allowing remaining current crop stocks to be cleaned out and with the US crop experiencing delays, we feel that the market is low enough for now and that it may retrace into the low 70s.

We felt that July was a dangerous short when it was trading ten cents higher and we certainly feel that’s the case now. Since we expect most of the selling pressure from here on forward to be in new crop, we would not be surprised to see the July/Dec spread to trade at an inversion again.

Report Courtesy: The Plexus Group

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