PLEXUS Market Comments

MARKET COMMENTS – SEPTEMBER 16, 2021

NY futures pulled back this week, as December dropped 71 points to close at 92.51 cents. The Dec/March inversion decreased slightly from 81 to 71 points.

The stalemate continues, as December has now closed 25 consecutive sessions in a tight 92.30 to 94.90 cents settlement range and is still waiting for a catalyst to inject new momentum.

The WASDE report failed to move the market, as it contained both bullish and bearish elements that kept prices steady. The initial reaction was bearish due to the big jump in the US crop to 18.5 million bales, but while a larger crop estimate is certainly warranted, we feel that the USDA jumped from one extreme to the other by raising the yield from 800 to 895 pounds/acre.

This would be the second highest yield on record, after the 905 pounds/acre in 2017. While that's certainly achievable, we feel that it was a bit premature to plug in such a high estimate at this point.

Global numbers were friendly, as mill use was raised by a combined 1.4 million bales (625k bales in 2020/21 and 810k bales in 2021/22), which was twice the increase in global production. This resulted in a drop in global ending stocks of 542k bales to 86.68 million bales.

ROW ending stocks dropped by 0.66 to 51.73 million bales. Indian stocks were lowered by 550k bales to 13.83 million bales, which is still too high, while Chinese imports of 10.0 million bales were too low in our opinion. So one could argue that ROW stocks are going to be more bullish than presented.

However, we also feel that global mill use of 124.14 million bales is overstated. Tight stocks at origin and the current high prices may have tricked the USDA into concluding that higher mill use is the reason for that. We instead believe that an inventory shift from origins to consuming markets is behind it, as supply chain issues have forced mills to run with higher buffer stocks.

We feel that with the global economy slowing down, we will be lucky to see mill use at 120 million bales. We are not the only ones having a more conservative view on consumption, as the ICAC came out with a 118.83 million bale estimate this week, or 5.31 million bales below the USDA.

The latest available CFTC report for the week of September 1-7, during which December traded between 92.08 and 94.60 cents, showed that speculators added 0.54 million bales and thereby increased their net long to 9.87 million bales.

Index funds sold 0.21 million bales and reduced their net long to 8.65 million bales, while the trade sold 0.33 million bales to boost its net short to 18.52 million bales.

The trade net short position is one of the largest exposures in the last 10 years, which is in part due to the large unfixed on-call position. The latest CFTC on-call report showed that as of last Friday there were still 15.66 million bales in on-call sales open, while on-call purchases were at just 4.20 million bales, for a net difference of 11.46 million bales.

We are now in a very similar position as in August 2018, when unfixed on-call sales were at 15.90 million bales, while on-call purchases amounted to 4.49 million bales and the net difference was at 11.41 million bales. Back then a 'risk-off' environment led to massive spec long liquidation, which allowed mills to escape unscathed from their on-call bets. Whether mills will keep the upper hand again this time around remains to be seen!

US export sales were decent last week, as 294,400 running bales of Upland and Pima cotton were added. Once again it was China that accounted for the bulk of the purchases, leading a pack of 20 buyers, while shipments of 240,600 RB went to 21 destinations.

For the current season we now have commitments of 6.65 million statistical bales, of which just 1.25 million bales have so far been exported. These numbers compare to 8.1 million bales sold and 1.8 million bales shipped a year ago.

The Evergrande debacle in China reminded us this week that markets may have been a bit too nonchalant in regards to the risks that are lurking out there, which could trip up the goldilocks market we have enjoyed since April 2020. Today the Chinese high yield index shot up to nearly 14 percent, its highest level in 18 months and we have yet to see how this situation unfolds over the coming days and weeks.

Some analysts worry that China's woes might be the beginning of a global 'risk off' move that could spark a much overdue correction in global financial assets. We are not just concerned about China, as many emerging markets are not doing too well either and may therefore have some difficulty in servicing their dollar-denominated debt. "Flight to safety" could push the US dollar higher, which in turn would weigh on US assets. We have a feeling that the smooth ride financial markets have enjoyed for so long is starting to get bumpy!

So where do we go from here?

The market can't seem to make its mind up, and neither can we! On the one hand we have this large spec net long position, which has the potential to squeeze mills who still have over 5 million bales to fix on December. If speculators were to hang on to their positions, then a lack of sell-side liquidity could force trade shorts to pay up.

On the other hand we might see a repeat of what happened in late 2018, when a weakening economy and a sell-off in financial markets prompted speculators to cash in their chips and the market fell precipitously. Macro developments need to be watched very closely over the coming weeks!

We believe that sooner or later we will get a sizeable move, because the respective positions are simply too big to remain stuck in a three-cents range.

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