PLEXUS Market Comments

Market Comments – December 17, 2020

NY futures continued to rally this week, as March gained another 293 points to close at 77.19 cents.

The break-out on the weekly chart brought in new spec buying on Monday morning and with the trade being a net buyer as well at this point in the season, the market has been devoid of any significant selling. This has allowed values to spike to their highest level in 20 months, with no end to this rally in sight.

US export sales continued to surpass expectations, as last week another 442,200 running bales of Upland and Pima cotton were added for both marketing years. This brings the two-week total to over 900k bales! Participation was once again widespread with 17 markets buying, although China accounted for over half of the volume. Shipments remained seasonably strong as well, with 274,400 RB going to 21 destinations.

For the current season we now have commitments of around 11.5 million statistical bales, of which 5.15 million bales have so far been exported. This compares to 11.7 million bales in commitments and 3.75 million bales shipped a year ago.

The latest CFTC spec/hedge position showed trade short-covering for the week of December 2-8, during which the March contract traded between 7107 and 7252. The trade bought back 0.92 million bales net and thereby lowered its net short to 13.26 million bales, while speculators sold 0.36 million bales net to reduce their net long to 5.90 million bales. Index funds cut their position by 0.56 million to 7.36 million bales.

The trade obviously used the recent dip towards 71 cents to fix some on-call positions and to sell basis-longs, which is evidenced by the drop in open on-call sales and the strong export commitments in recent weeks.

However, as today's CFTC on-call report shows, there are still a lot of unfixed positions remaining, which has created solid support under the market. As of December 11, there were 4.03 million bales in unfixed on-call sales on March, 1.97 million bales on May and 2.75 million bales on July, for a combined current crop total of 8.75 million bales.

Against that there are only 1.80 million bales in unfixed on-call purchases open, which gives us an imbalance of nearly seven million bales in favor of sales. This represents a significant amount of net buying in the futures market that has to be done over the next six months, irrespective of one's market opinion. These are bearish bets that have been placed in the past, which are now turning into the proverbial 'chickens that have come home to roost'.

Although the cotton market is currently performing well on its own, strong soybeans (12 dollars/bushel), lofty Chinese prices (102 cents/lb), a weaker US dollar (lowest since April 2018) and a euphoric stock market are all adding to the bullish sentiment.

Stocks are currently a one-way street, having added over USD 40 trillion in value globally since the March lows. When we look at the 'Buffet Indicator', which measures the total US stock market cap in relation to the GDP, we are now at around 186%, the highest reading ever. Even the internet bubble of the late 90s has been left behind!

This is a clear indication that the financial casino has detached itself from the real economy, fuelled by cheap money and a lack of investment alternatives, since the bond market is no longer paying positive real returns. At some point the widening wealth gap between the investment class and rest of the citizenry is going to lead to trouble, but for now it is smooth sailings.

With a new US stimulus package about to be passed, and with Janet Yellen taking the helm at the US Treasury Department next year, most traders believe that money creation will go into overdrive. This will eventually lead to higher inflation, which is why more and more investors are chasing tangible assets, be it stocks, real estate or commodities.

So where do we go from here?

The US balance sheet is starting to get tight, which makes it increasingly dangerous for the shorts to fight this bullish trend. Between export sales and domestic mill use we now have commitments of around 14 million bales, against a crop size of 15.9 million bales.

We will also have to reserve at least 1-2 million bales of existing supplies for the August-October 'new crop' period. This means that statistically this crop is just about sold and we are now starting to dig into beginning stocks.

The trade is going to be a net buyer of old crop futures between now and June, and since specs are currently adding to their longs in this bullish trend, the market continues to suffer from a lack of sell-side liquidity, which is why values are pushing higher in search of willing sellers.

The risk is that this becomes a self-reinforcing process, as trade shorts feel trapped and need to buy out, which adds to the bullish momentum and feeds speculation. It will take a bearish outside event to spook speculators into selling, but at the moment financial markets are in full 'risk-on' mode.

How long this euphoric state will last is anyone’s guess, but for now the path of least resistance remains higher, with 80 cents as the next target.

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