PLEXUS Market Comments

October 17, 2019

NY futures rallied sharply this week, as December gained 357 points to close at 64.99 cents/lb.

December closed today at its highest level since July 8, as speculators continued to reverse their net short position, while the trade has not been quite as aggressive in adding new shorts as expected.

The trade's hesitation may have to do with the latest news cycle, which has been more positive due to the promise of a US/China trade deal, the progress on Brexit and a slightly weaker US dollar. With financial markets once again adopting a 'risk on' attitude, potential short sellers seem to give the market some rope.

The latest CFTC report as of October 8, when December was still at 61.32 cents, showed that speculators had a net short position of 3.00 million bales, while the trade was 2.91 million bales net short. Since then speculators have probably bought at least 2.0-2.5 million bales net and they will continue to exit shorts and add new longs. The trade will be on the other side and bolster its net short position, which is still some 8-10 million bales below where it was over the last two seasons.

From a technical point of view the market is still in a primary downtrend, but not by much. The weekly continuation chart shows that the downtrend, which has been in effect since the middle of last year, is currently running just below 68 cents, or less than 300 points from today's close. Since this trendline continues to move lower over time, even a sideways move from here would be enough to catch it in a few weeks. A change of the primary trend would most certainly lead to another onslaught of spec buying!

While the technical picture has been constructive lately, the market is still mired in a bearish mindset from a fundamental perspective. Apparently the mood at last week's ICA Trade Dinner wasn't great and it seems to be only a matter of time until excess stocks will start to pressure values. However, timing is everything and at the moment we still have a fairly empty supply pipeline. It will therefore take a while until nearby basis-short positions have been filled and a surplus builds.

Last week we talked about the fact that not all cotton around the globe is available at the same price level. China, India and Pakistan account for 65.85 million bales this season according to the latest WASDE, which is 53% of global production. The price level in China and India is considerably higher than in other origins and Pakistan is dealing with another disappointing crop, which has forced its mills to resort to more imports.

The most affordable exporters, which are able to offer size, are currently the US, Brazil and West Africa. They account for 30.21 million bales or 70% of all exports, according to the USDA, which is up from 26.32 million bales (64%) last season and 25.51 million bales (62%) two years ago. Australia usually plays a bigger role, but is suffering from drought this season, while India is not competitive at the moment. Central Asia, which used to be among major exporters several years ago, is currently not even considered anymore by most mills.

Since West African cotton isn’t really available until early next year, mills have to rely mainly on US and Brazilian cotton for nearby shipment. However, with many US growers opting for the loan, at least initially, and Brazil having certain limitations in regards to logistics, it is no wonder that there is currently no price pressure discernible. Eventually there will be more than enough cotton available around the globe, but it is going to take some time before it hits the marketplace in greater numbers.

So where do we go from here?

Speculators are currently running the show and the chart has given them a reason to buy out of their shorts and to establish some new longs. The trade has been shorting into the rally, but not yet to the degree needed to stop the advance.

However, once the major crops are in and assuming that they meet expectations, we feel that hedge selling will get strong enough to force values lower again. From what level this will be remains to be seen, as speculators certainly have the power to keep this rally going for another 2-3 cents, and if the long-term downtrend line is broken, we could see an even bigger spike. But at this point we don’t believe that this is a long-term trend reversal, since global demand is still struggling and production should be big enough to keep a lid on the market.

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