PLEXUS Market Comments

Market Comments – March 18, 2021

NY futures came under renewed pressure this week, as May dropped 290 points to close at 85.45 cents, while new crop December gave back 230 points to close at 82.59 cents.

Sellers regained control this week, as May fell from a high of 88.49 cents last Friday to a low of 85.35 cents today. It was more a void of buying than any strong selling pressure that led to this decline, because the daily trading volume averaged just under 21,000 contracts over the last five sessions.

Today's decline had traders scratching their heads, because US export sales came in way above expectations this morning. Total sales of Upland and Pima cotton amounted to an astonishing 588,000 running bales for both marketing years. Participation remained broad-based with 16 markets buying and 22 destinations receiving shipments of 362,200 running bales.

Total commitments for the current season are now at 15.4 million statistical bales, of which 9.6 million bales have already been exported. With 20 weeks to go in the marketing year, commitments are just 100k bales shy of the USDA export estimate of 15.5 million bales.

This line has probably been crossed already and it now is just a matter of getting bales on a boat. In order to make the USDA estimate, we would have to ship around 285k running bales a week, which is not a tall order. When we look at the breakdown of outstanding Upland sales, we have five markets that account for over 71 percent, namely Vietnam (21%), China (20%), Pakistan (12%), Turkey (11%) and Indonesia (7%).

Despite last week's price break to 82.87 cents in May, unfixed on-call sales still didn't make much progress. Unfixed sales on May and July dropped by only 0.35 million to 5.29 million bales as last Friday, while unfixed purchases were down 0.13 to 0.92 million bales. This still leaves a difference of 4.37 million bales in favor of sales.

What spoiled the party for the bulls today was a renewed spike in US interest rates, with the 10-year closing at 1.71%, its highest yield since January 2020, while the 30-year settled at 2.46%, which was a 19-month high. Higher interest rates are kryptonite to an overindebted economy, because higher debt service cost can suffocate growth and profitability.

US stocks and commodities got clobbered in today's "risk off" session, with the Nasdaq dropping over 3% and crude oil getting clipped 8%. Soybeans and corn were down about 2%, despite strong export sales to China. Cotton didn't really stand much of a chance in this sea of red.

While we understand the concerns of traders who fear that we might get another 'taper tantrum' like in 2013, we believe that the market is overreacting. At some point higher rates will matter if they stick around, but in the near future the growth forecast looks promising thanks to a massive amount of liquidity that is about to be unleashed as we come out of the pandemic.

Even the Fed this week predicted US GDP growth at 6.5% in 2021, up from its 4.2% estimate in December. And across the pond China's economy seems to be firing on all cylinders. Only Europe is lagging, since it doesn't seem to have a grip on the virus yet, as vaccinations are progressing slower than anticipated.

With stimulus checks just about to be sent out to consumers and with the Fed still buying USD 120 billion of bonds a month, it is difficult to see an asset price collapse anytime soon. We might see some rotation out of tech into cyclical stocks and commodities, which is what a lot of speculators are betting on. Last week the net speculative long position for the 17 commodities reported by the CFTC reached a multi-decade high.

So where do we go from here?

The CFTC spec/hedge report showed that speculators lightened up on their position during the recent selloff, but they still held a 7.10 million bales net long, while index funds carried a 7.72 million bales net long position. Considering the low trading volume and the relatively small change in open interest, we don't think that these positions have materially changed since the last report.

The trade still had a sizeable net short position of 14.82 million bales and based on the price action this week there seems to be no urgency to get out of these shorts. So far this nonchalant attitude seems to be working, but with the US selling out rapidly and with new crop still mired in uncertainty in regards to acreage and weather, we feel that the trade is taking it a bit too easy.

Merchants still have an incentive to get rid of their remaining inventory due to the 400-point inverse to December and these low prices should allow US cotton to find willing buyers.

Technically the market looks vulnerable, but another decent export sales report or renewed worries about the expanding drought in Texas can fix that in a hurry.

A lot will depend on the behavior of speculators. If they continue to exit longs, then it will open up more room to the downside. However, we still feel that this a correction, not a trend change, and that the shorts need to be careful. The US balance sheet is about as tight as we have ever seen it at this point in the season and it won't take much to reignite the bullish trend!

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