PLEXUS Market Comments

MARKET COMMENTS – AUGUST 19, 2021

NY futures ended a rollercoaster week slightly lower, as December dropped 56 points to close at 92.76 cents.

December spiked to a high of 96.71 cents on Tuesday, thereby topping the 2018 high of 96.50 cents, as a combination of spec buying and trade short-covering propelled the front month through the 95 and 96 levels with relative ease. However, renewed grower selling and some spec profit taking capped the rally and forced the market to pull back.

Tuesday’s price action formed a “Shooting Star” on the candlestick chart, which serves as a fairly reliable reversal signal. It has been confirmed in the two sessions since, as December continued to retreat, ending today’s session nearly four cents below Tuesday’s high.

As the CFTC Commitment of Traders report has shown, speculators have been the driving force behind the market’s recent push to new contract highs. In the week of August 4-10 speculators added another 0.93 million bales and thereby increased their net long to 8.85 million bales.

The trade has been keeping pace, as its net short grew by another 0.87 million to 17.25 million bales, which is the largest position in three years. Index Funds accounted for the difference, as they trimmed their net long by 0.06 million to 8.40 million bales.

Over the last eleven weeks the spec net long has grown by an impressive 4.0 million bales and tomorrow's CFTC report will likely show a further increase based on the rising open interest in the futures market.

A big part of the trade net short is related to the unfixed on-call sales position, which grew by another 0.43 to 14.67 million bales last week. Since unfixed on-call purchases dropped by 0.13 to 4.12 million bales, the net in favor of unfixed sales is now at 10.55 million bales.

Given the supply chain nightmare we are currently experiencing, we believe that many mills are securing forward deliveries of physical cotton, but are not willing to establish a fixed price yet. This of course is a dangerous gamble, which could hurt buyers in case something were to go wrong with one of the major crops.

Global stocks have been feeling a lot tighter this summer than what the WASDE is telling us, which is why we need to look for potential discrepancies between the statistical and the real world.

We believe that India's ending stocks need to be reexamined, since the USDA shows them at 15.88 million statistical bales (20.33 Indian bales) at the end of last month, while we feel that they are at the most 9.38 million statistical bales (12.0 million Indian bales). Our number is based on several conversation with local sources and it might still be too optimistic. India's 'phantom stocks' have been a topic of discussion for several years now and the strong local market seems to prove the skeptics right.

Therefore, if we assumed a downward adjustment of 6.5 million statistical bales in India, then ROW beginning stocks would drop from 52.64 to 46.14 million bales. If we then were to measure these stocks in ROW mill use of 82.33 million bales plus exports to China of 10.0 million bales, they would theoretically last for six months.

Since this is not a perfect world and remaining stocks don't always match the needs of mills, plus there are shipment delays and mills are trying to build buffer stocks, it is no wonder that it feels like we are about to run out of supplies.

US exports sales amounted to a strong 312,500 running bales of Upland and Pima cotton for both marketing years, with China accounting for about half of the volume. In total there were 14 markets buying, while 20 destinations received shipment of 224,700 running bales. The 'disappointing' shipment number seems to be more a function of low supplies than a lack of willing takers.

Total commitments for the new season are currently at 5.5 million statistical bales, whereof 0.45 million bales have so far been exported. This compares to 7.1 million bales sold and 0.75 million shipped a year ago.

So where do we go from here?

It looks like we are headed for another showdown between spec longs and trade shorts, as their respective positions have been growing to sizeable levels.

The question is whether the outcome is going to be similar to 2011 or 2018? Ten years ago lower than expected Chinese stocks and spec buying fueled a historic short-covering rally. In 2018 we saw speculators bail from a 12.2 million bales net long position, which let the large trade short of around 20 million bales off the hook.

For now this seems to be just a routine correction in a strong primary uptrend, but speculators will be quick to react if their assumptions are proven wrong. In particular we need to keep an eye on economic data, which has been coming in on the soft side against expectations recently, and how the US and other major crops progress over the coming weeks.

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