PLEXUS Market Comments

Market Comments – December 19, 2019

NY futures continued to advance, as March added 41 points to close at 67.58 cents/lb.

After the breakout session last Thursday, the market has been flagging sideways for the last four sessions, before finally pushing to a new 5-1/2-month high today. Since posting a low of 56.59 cents in late August, spot futures have gained around eleven cents over the last four months, as speculators have started to buy out of their net short position and fundamentals have turned more supportive, mainly due to losses on the production side.

Back in August the USDA estimated the US crop still at 22.52 million bales vs. 20.21 million now, while global output has been scaled back from 125.61 to 121.11 million bales. Global mill use was also lowered, dropping from 123.07 to 120.27 million bales, but this was already discounted by traders, while production losses weren’t. Ending stocks in the US are now at a more benign 5.50 million bales vs. 7.20 million back in August, while ROW stocks are at 47.08 million bales vs. 48.74 million four months ago.

The latest CFTC report showed that speculators continued to flip-flop their position for a third week. Speculators bought 1.15 million bales net between Dec 4-10 and thereby cut their net short to just 0.98 million bales. Since then they have bought additional quantities and are probably about square by now. By comparison they were 4.87 million bales net short in late August, when the market made its presumed seasonal low

Meanwhile the trade continued to sell into strength, adding 1.19 million bales in net shorts between Dec 4-10, which increased its net short position to 5.84 million bales. There has been more trade selling since then and we estimate the net short to be closer to 7.0 million bales by now.

Other factors contributing to a more supportive sentiment are the technical breakout on the weekly chart, the Fed's about-face to renewed QE, a partial US/China trade deal and a slightly weaker US Dollar.

The so-called "Phase 1" trade deal, in which China commits to buy large amounts of US Ag products, seems to be more of a 'face-saving' exercise, but for cotton it means that China is now going to be there as a buyer on dips, which adds underlying support. However, we don't think that China will chase cotton prices higher anytime soon, because there seems to be plenty of supply this season.

The biggest game changer for financial assets has been the return to an accommodative monetary policy by the Fed, as its balance sheet is up by over USD 300 billion since August and keeps rising by about USD 60 billion a month. This means that we now have all three major central banks – the Fed, ECB and Bank of Japan – aligned to provide monetary stimulus, while fiscal deficits are out of control. This signifies that more money printing is ahead, with an almost zero chance for rate hikes anytime soon. No wonder stock markets have been racing to new highs and even some of the beaten-up commodities are now catching a bid. In such an environment it becomes increasingly dangerous to be short.

US export sales continued at a familiar pace last week, as another 264,800 running bales of Upland and Pima cotton found a home. Buying activity was widespread as 18 markets participated. Total commitments for the current season are now at 11.7 million statistical bales, which is the highest amount at this date since 2010. Sales for the next marketing year are so far at 1.05 million bales.

Shipments of 224,900 running bales were still behind the 375k pace needed to make the USDA estimate, but total shipments of 3.75 million statistical bales are also at an 8-year high.

So where do we go from here?

The market seems to have more bullish arguments at the moment and keeps pushing higher. After flip-flopping for several weeks, speculators seem to be finally transitioning back to a net long position, after the long-term downtrend on the weekly chart has been broken and March has moved above all of its moving averages up to the 200-day.

However, upside potential seems to be limited from a supply/demand point of view, since there is no shortage of cotton. But as mentioned last week, speculators certainly have the power to move cotton futures beyond their perceived ‘fair value’ and we therefore can’t rule out a move into the low 70s over the coming weeks.

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