PLEXUS Market Comments

Market Comments – January 21, 2021

NY futures extended their rally during this holiday-shortened week, with March gaining another 142 points to close at 82.57 cents/lb.

March futures continued to push higher and closed today at the best level for a spot month since September 2018, as fundamental and technical factors keep the cotton market well supported. Even new crop futures kept pace, with December settling just 96 points shy of the 80 cents mark.

China continues to be one of the main drivers behind this rally, as the price gap to the most active Chinese futures contract, which closed today at 107.44 cents, still measures nearly 25 cents. China imported 1.6 million statistical bales of raw cotton in December, which was the highest monthly amount since 2013, and China continues to absorb a lot of cotton yarn from the Indian subcontinent as well.

Cotton and yarn imports by China are estimated to reach around 22 million statistical bales this season, but this number could go up if the Xinjiang issue forces Chinese manufacturers to source more foreign fibers. The Chinese government has recently issued its customary TRQ quota to importers, which is for 4.1 million statistical bales (894k metric tons). This should ensure steady demand from China over the coming weeks.

The CFTC report was a bit of a surprise, because it showed that speculators and index funds were actually light net sellers between Dec 6-12, when the March contract traded between 7865 and 8177. In other words, what was thought to be an influx of new spec and index fund money proved to be new trade longs, possibly linked to China.

Speculators owned a 7.54 million bale net long on December 12, while Index funds had a net long of 7.75 million bales. The trade was on the other side with a 15.29 million bale net short position, which is composed of 4.74 million in outright longs and 20.03 million in outright shorts. It's this massive trade short that worries us as the market is moving higher.

The unfixed on-call sales position in current crop got worse last week, as 0.24 million bales were added to the unfixed March/May/July lot, which grew to 8.50 million bales. Corresponding on-call purchases increased as well, adding 0.10 million to reach 1.95 million bales. The difference between unfixed sales and purchases still amounts to a sizable 6.55 million bales of net buying power.

Strong outside markets contributed to cotton's strength, as the US stock market is still a one-way street into unchartered territory, while other assets like real estate and commodities are also being pursued. The GSCI commodity basket has gained 27% since early November and this strong performance will only draw more investors into commodities.

The world is awash in liquidity and there is more to come as governments are trying to shore up their struggling economies. In the US money supply (M2) increased by $ 3.84 trillion dollars last year, or 25%! At the moment there aren't many options for lending and spending that money, other than chasing financial assets, which has led to the lowest velocity of money on record in the US and in Europe.

But once this pandemic subsides and life starts to return back to normal, velocity is likely going to increase and this could lead to higher inflation. Interestingly, while the US and

Europe are still printing money, the People's Bank of China and the Reserve Bank of India are taking steps to drain excess liquidity. Asian economies seem to be faring better during this pandemic than their Western counterparts!

This could have implications for the US dollar, which after a brief bounce has started to come under pressure again. This week we saw an interesting bifurcation, as the greenback has gained some ground against the Euro, but weakened against commodity currencies like the Australian and Canadian dollar. We still feel that the US dollar is headed lower over the coming months as the extent of the fiscal hole becomes clearer.

So where do we go from here?

As long as China continues to absorb cotton and yarn at the current pace and financial markets remain in a euphoric state, it is difficult to foresee an end to the current bull run.

To the contrary, we still feel that the trade is dangerously exposed with its large net short position, from which it sooner or later needs to escape. Speculators have no intention of quitting their longs at this point, especially since they see a big roll gain ahead if they take their position into the July/Dec rolling period. Likewise, we don't expect to see any outflows from index funds.

In other words, we still don't see any sell-side liquidity on the horizon, which means trade shorts might get trapped. The more the US sells, the more precarious the situation will get for these shorts. So far there is no panic, but this could change in a hurry if the market continues to push higher.

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