PLEXUS Market Comments

Market Comments – November 21, 2019

NY futures came under pressure this week, as March dropped 207 points to close at 64.01 cents/lb.

After flagging sideways in a tight range for nearly 4 weeks, March finally broke through its short-term uptrend line dating back to late August, which triggered a decent amount of sell-stops. There have been warning signs that this might happen, as speculators have been net sellers for three weeks in a row.

Speculators are clearly the most potent force in the market. They were largely responsible for crashing prices from a high of 96.50 cents in June 2018 to a low of 56.19 cents in August of this year, as they reversed a 12.24 million bales net long into a 5.36 million bales net short position during that time frame. This 17.6 million bale swing in the net spec position was the biggest ever!

Then in late August specs started to cover and over the following two months they bought 4.59 million bales to reduce their net short to just 0.78 million bales by October 22nd. This has allowed the market to rise to a high of 67.13 cents, basis March. But just when it looked like spec buying was gaining momentum and they might go long, speculators somewhat surprisingly turned into net sellers again.

Whether it was their disappointment about a trade deal that never seems to happen or fears of a slowing economy, speculators ended up selling the market over the last three weeks, with the latest CFTC report showing them 2.38 million bales net short again, which is 1.60 million bales more than they had on October 22nd.

Index Funds absorbed most of what the specs were selling over those three weeks, as they bought 1.30 million bales net to go 7.10 million bales net long as of November 12, which is the latest available data.

The trade didn't do much during those three weeks, as it bought just 0.27 million bales to reduce its net short slightly to 4.72 million bales.

The problem is that if speculators are once again net sellers and the trade should also be selling in order to hedge its large unsold cash position, then who is there left to buy the market? Index funds have provided some support recently, but unless vast amounts of money flow into commodity funds, which doesn't seem to be the case, then this source of buying is going to dry up.

Interestingly, while the technical picture has turned bearish with this selloff, the fundamental side is getting more constructive, as global production has been slipping and US export sales have been quite strong.

Last week the US sold 292,200 running bales of Upland and Pima cotton for both marketing year, with Vietnam's 97,200 bales leading a group of 15 markets. The only fly in the ointment was China's postponement of 39,600 bales from the current into the next marketing year. Also, shipments continued to lag at just 143,800 running bales.

For the current marketing year we now have commitments of 10.7 million statistical bales, of which just under 3.0 million bales have so far been exported. New crop sales are currently at a little over 1.0 million statistical bales.

So where do we go from here?

Until about a month ago the chart looked quite constructive as spec buying was moving the market higher. However, with speculators reversing their stance and with March breaking through trendline support this week, the technical picture has turned bearish. This will likely invite more speculative selling in the days ahead.

This means that the market may have to move lower in search of buyers. Index funds are not going to carry the load for much longer in our opinion, which then leaves only the trade as a potential net buyer. Even though the trade should have a larger net short position by now, the fact that loan support is available several cents below the market may keep producer selling at bay. Producers still own most of the unsold supply at this point.

Merchants are probably basis-short and need to get some cotton out of grower hands, while mills still have to cover a lot of cotton over the remainder of the season. With weekly export sales already at a healthy pace and with the US being one of the cheapest origins, we may indeed see support coming from the trade at these lower levels.

In other words, apart from the deteriorating technical picture there doesn’t seem to be a compelling reason for prices to move much lower. Speculators could weigh on the market for a while longer, but we feel that trade buying will become strong enough in the low 60s to balance things out. We would therefore still buy the market on dips. The upside seems to be equally limited at the moment, unless a trade deal were to be announced. To us it all adds up to a slightly lower trading range of around 62 to 66 cents, basis March.

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