PLEXUS Market Comments

Market Comments – July 22, 2021

NY futures ended a volatile week with small gains, as December added 81 points to close at 89.86 cents.

The market covered a lot of ground this week between Monday’s low of 86.35 and today’s high of 90.59 cents, but December has yet to settle above the 90 cents level.

This week’s price action proved that we are still dealing with solid underlying support and strong overhead resistance, as on the one hand there are 13.5 million bales in unfixed on-call sales waiting for dips, while on the other hand the fast approaching new crops have growers ready to hedge more cotton on rallies.

After failing to take out the 90 cents level last week, we got a ‘wash-out’ of spec longs on Monday, which dropped the market to just over 86 cents, where a lot of fixation buying was waiting. The subsequent rise back to the 90 cents level was still lacking momentum, which made it all the more surprising this morning when December was able to pierce through this key resistance point with relative ease.

This suggests that some of the selling that was waiting above 90 cents has either been pulled or moved to higher levels. But it doesn’t change the fact that as long as major crops continue to perform well, there will be a decent amount of overhead selling waiting.

The most recent CFTC report for the week of July 7-13, during which December traded between 86.30 and 88.50 cents, showed that speculators bought 0.50 million bales to bring their net long back to 6.58 million bales, while index funds added 0.16 million bales to increase their net long to 8.54 million bales. Index funds now own the largest position since November 2018.

The trade on the other hand continued to increase its net short by 0.65 million bales to 15.12 million bales, which matches the high mark of late April. A lot of this sizeable net short is tied to the rising unfixed on-call position, which has reached some worrisome proportions in our opinion.

The latest on-call report as of last Friday, July 16, showed that unfixed on-call sales increased by 0.67 million to 13.53 million bales, whereas unfixed on-call purchases declined by 0.17 to 4.46 million bales.

Not only is the outright number of 13.5 million bales in unfixed sales daunting, but the net amount of 9.07 million bales between sales and purchases represents a tremendous amount of buying power underneath the market. While mills are hoping for dips into the mid-to-low 80s to lower their cost, they may not be aware that they have created a powder keg that could ignite at any time and send this market flying. All that’s needed is a spark, like a weather scare, to set a short-covering rally in motion.

Fortunately, the US crop is doing quite well at the moment, as the latest crop condition reading was the highest in the last five seasons. The cotton belt has received plenty of moisture over the last two months, almost too much in some locations, and farmers are now hoping for some warmer and drier weather.

A lot of cotton from Texas to the Southeast is about a week or two late at this point and more heat units are needed to push this crop along. While the potential for an above average output is still there, the lateness of the crop makes it more susceptible to an early freeze or adverse weather late in the season.

US export sales were a positive surprise this morning, as a total 410,600 running bales of Upland and Pima cotton were sold for all three marketing years combined. Pakistan was responsible for more than half of this volume, leading a pack of 16 markets, while 24 destinations received 256,500 running bales.

Total commitments for the current marketing year are now at 17.5 million statistical bales, of which 15.5 million have so far been exported. With just 2.3 weeks of data left, it looks like shipments won't quite reach the USDA number of 16.4 million bales. However that won't matter much, because the US is for all practical purposes sold out and whether some bales are shipped in late July or early August doesn't make much of a difference.

China's strong domestic market continues to act in support of ROW prices, as the CC-index reached the equivalent of 121 cents this week and some of the better Reserve auction lots fetched as much as 126 cents/lb.

Also, Chinese cotton imports for the 2020/21-season will end up above the USDA estimate of 12.5 million statistical bales, since China has already taken in 12.2 million bales in the first eleven months. The final number will probably be closer to 13.0 million bales. The same observation is true for yarn, as imports for the first six months of 2021 are up by over 30 percent.

So where do we go from here?

This week has shown that the market has a lot of underlying support, as Monday's wash-out was met by ready trade buying. The massive amount of unfixed on-call sales, a strong Chinese market, inflation expectations and still uncertain crop outcomes are discouraging potential short selling.

On the other hand as long as the promise of an 18.0-18.5 million US crop and a 120 million global crop holds, it will be difficult to entice traders to pay up.

To us it still adds up to a rangebound market, with the potential to run away to the upside in case something were to go wrong on the production side.

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