PLEXUS Market Comments

Market Comments – May 23, 2019

NY futures ended the week mixed, as July gained 68 points to close at 67.48 cents/lb, while December gave up 26 points to close at 66.83 cents/lb.

After dropping by more than 1000 points in just seven sessions from May 6-14, the market has been able to stop the bleeding and has moved sideways in moderate volume over the last seven sessions.

The latest CFTC report showed us why the market had come under so much pressure, as speculators sold the most ever in a week. In the five sessions between May 8-14 speculators sold a massive 3.43 million bales net, thereby going 2.80 million bales net short overall. Combined with the 1.55 million bales that speculators sold the week before, net sales added up to a two-week total of 4.98 million bales.

Index funds were also net sellers, as they reduced their net long by 0.07 million bales to 6.85 million bales. For the two-week period index funds sold a total of 0.51 million bales net.

On the other side there was the trade as a strong scale down buyer, reducing its net short by 3.50 million bales to just 4.05 million bales. Over two weeks the trade bought a total of 5.48 million bales net and thereby cut its net short position to the lowest level since April 2016.

These big swings in the spec and trade positions are truly amazing. Not only did speculators sell the most ever in such a short amount of time, but they did it from a relatively small net long of less than 3.0 million bales. Typically we see such sizeable spec moves from much larger net long positions of 10-12 million bales.

While the trade may have been able to buy and/or fix some nearby supplies at much cheaper levels than thought possible just a few weeks ago, it has also missed an opportunity to hedge more new crop cotton in the high 70s. Like back in February the trade is once again in an 'underhedged' position and it remains to be seen whether a spec short-covering rally will come to the rescue again.

The trade's 4.05 million bales net short is nowhere near where it needs to be in order to safeguard all the new crop cotton that will be entering the pipeline in about five months from now. By comparison, last season the trade had an 18.9 million bales net short position in mid-May and two years ago it amounted to 17.8 million bales. Back then speculators had large net long positions and we doubt that specs will go net long in the current market environment, apart from maybe a temporary short-squeeze in July.

The drop into the mid-60s has sparked a lot of business as the latest US export sales report shows. Last week net sales of Upland and Pima cotton amounted to an impressive 686,200 running bales for all three marketing years combined, with 21 different markets participating. Shipments of 361,600 RB continued to lag a bit, but that's not a big deal since it will simply shift commitments from one season to the next at the end of July.

Total sales for the current marketing year have reached 15.75 million statistical bales, of which a little over 10.3 million bales have so far been exported. For the coming season there are 3.65 million statistical bales on the books and another 0.1 million bales have already been sold for the 20/21-season. Outstanding sales to China amount to 0.66 million RB for this season and 1.41 million RB for next marketing year.

Texas and the Midsouth continued to experience wet and stormy conditions this week, but apart from crops being a bit later than usual in some areas we are not too concerned. The weather seems to be improving and all this moisture should help to keep abandonment numbers low and yields high.

So where do we go from here?

According to our calculations current crop supplies should be nearly sold out by now, depending on how many new crop sales are going to be shipped from existing inventory. This makes July a dangerous month to be short and we therefore wouldn't rule out a spec short-covering rally over the coming weeks.

December on the other hand faces a lot of overhead resistance, be it from the trade that needs to bolster its massively 'underhedged' new crop position or from specs rolling short their short Julys into December.

Due to these opposite forces we expect the July/Dec spread to invert further. Since May 13 the spread has gone from 95 points carry to a current inversion of 65 points and unless there are some large cancellations showing up over the coming weeks, this inversion is likely to grow.

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