PLEXUS Market Comments

MARKET COMMENTS – SEPTEMBER 23, 2021

NY futures closed a rollercoaster week basically unchanged, as December gave up just 5 points to close at 92.46 cents. The Dec/March inversion widened from 81 to 96 points.

After December had closed 26 consecutive sessions in a 260-point settlement range between 92.30 and 94.90 cents, it broke through a six-month uptrend line and the 50-day moving average on Monday, dropping to a low of 89.05 cents in heavy volume of 55.4k contracts. Spec long liquidation into scale-down trade short covering erased 9.3k of Dec's open interest in the process.

However, the market quickly regained its footing and recovered all of its losses over the following three sessions, during which December gained a combined 344 points, or 11 points more than it had dropped on Monday. Total volume for these three recovery days amounted to 62.7k contracts, although open interest did not bounce back so far, which tells us that mill fixations were probably doing most of the lifting.

China dictated market action this week, first by spooking financial markets into a selloff with its property crisis, which dragged cotton down with it, and then by showing up as a strong buyer of US cotton, which helped December crawl out of its hole.

US export sales amounted to an impressive 368,900 running bales of Upland and Pima cotton, with China accounting for 221.1k running bales or about 60 percent of the total. Overall there were 18 markets buying, while 22 destinations received shipments of 180,600 running bales.

Total commitments have risen to 7.05 million statistical bales, of which 1.45 million bales have so far been shipped. Sales still lag 1.2 million bales behind last year, while shipments are 0.65 million bales lower.

In the last three export sales reports China has increased its purchases by 668k running bales and probably continued to add more to this tally during this week’s dip. So far China has booked 1.51 million running bales of US cotton this season, which is still less than half of the 3.16 million running bales it had bought last year at this point. But China has once again entered as a stabilizing force and keeps traders guessing as to what its intentions are.

Some fear that China’s crop might be smaller than expected, while others believe that China has to import more foreign cotton because of the Xinjiang issue. From a pricing point of view it makes sense that China’s Reserve would pursue foreign growths, since the CC-index is still calculating at 125 cents/lb, while the January futures contract is at around 120 cents/lb.

From a timing point of view it also makes sense that China would become active now, because there wasn’t much to buy in the US two months ago and if China had been chasing after cotton then, it would have added fuel to an already bullish market. With a sizeable US crop now looking more certain, it should be easier for the market to digest these large sales, although we have yet to find out how hungry China really is.

The US is still on course to make an 18.2-18.5 million bale crop in our opinion. While Texas experienced excellent late summer weather that helped it push over the finish line, the Delta and Southeast were hampered by wet and cool conditions recently, which might have taken some yield off and caused maturity issues in a few areas. Let’s just hope that we will get a warm and dry fall to get this crop off the field without further setbacks!

Although the USDA expects the US crop to be 3.9 million bales larger than last season, total supply of 21.66 million bales would still be the lowest in the last five seasons, when supplies ranged from 21.86 to 24.76 million bales. Since beginning stocks of 3.15 million were quite a bit lower than in previous seasons (last year we started with 7.25 million bales) and the crop is a late, it will take a while until the market is going to feel any supply pressure, if at all. This should keep the December contract on a firm footing vis-à-vis the back months.

The CFTC on-call report showed that as of last Friday there were still 4.91 million bales in unfixed sales on December, versus 1.72 million bales in unfixed purchases. However, this number has been greatly reduced during this week’s selloff and the subsequent rebound, during which a large chunk of these on-call sales were squared away. We therefore believe that no more than 3.5 million bales remain, which would be in the ballpark of recent years.

While China’s real estate problem will likely be contained by the government, it serves as a warning as to how quickly things can change. The entire financial system is overvalued and overleveraged and sooner or later this massive bubble is going to encounter the proverbial needle.

So where do we go from here?

The technical breach on Monday flushed out some spec longs and allowed mills to fix a decent amount of their December commitments. This helped to defuse a potential short-squeeze, although mills are not quite out of the woods yet.

With financial markets quickly reverting to 'risk on', spec liquidation stopped, while mill fixations and possibly China buying lifted the market back into the 92-95 settlement range, where we had been in previous five weeks.

Barring any further macro jitters or last minute crop issues, the market will probably hang around in the low 90s for the time being.

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