PLEXUS Market Comments

Market Comments – October 24, 2019

NY futures managed to consolidate last week's strong gains, as December was down just 34 points at 64.65 cents/lb.

After spiking higher last week, trading action has become much more balanced again, as December settled the last seven sessions in a narrow range of just 62 points, between 64.54 and 65.16 cents. Speculative buying continued to support the market, but trade scale-up selling has intensified, which has helped to cap the market at the 65 cents level for now.

The CFTC report confirmed that it was speculative buying that pushed the market higher. During the week of October 9-15, when the market ranged between 60.98 and 65.85 cents, speculators bought 1.46 million bales net to reduce their net short to 1.53 million bales. We estimate that speculators have since bought another 1.0-1.5 million bales net over the last seven sessions, which would make them basically square by now.

The trade was a net seller of 1.39 million bales, thereby increasing its net short to 4.30 million bales net. However, considering that we are looking at the 3rd largest US crop and the 2nd largest global production ever, it is quite evident that the trade still has a lot of room to increase its hedge position, especially since mills are not that well covered going forward and it will therefore be up to producers and merchants to manage the price risk on all these unsold bales.

Index funds continue to be the only net long in the market for now, as they reduced their position by 0.07 million bales to 5.83 million bales.

While speculative buying vs. trade selling has clearly been the dominant feature in the market, the two forces may not be evenly matched at the moment, because the trade is often using bearish options strategies rather than short futures to hedge its downside risk. Specs on the other hand are primarily buying futures.

Producers or merchants probably don't expect the market to fall by more than 5-7 cents from current levels and may therefore choose a put spread or another bearish options strategy over a short futures contract. Since these strategies have a lower 'delta' than a futures contract, it takes a greater volume of them to match up against spec buying.

US export sales were a bit disappointing last week, especially since traders were hoping that there was

more business done in the wake of the ICA dinner. However, sales of Upland and Pima cotton amounted to just 155,900 running bales for both marketing years, while shipments of 159,700 running bales were still about 180k bales off the pace needed to make the current export projection.

Total commitments for the current season are now at 9.75 million statistical bales, of which just under 2.4 million have so far been exported. Last season we had 9.6 million bales on the books by now, of which 2.0 million bales were shipped. So despite the slow pace of business and the absence of China as a current buyer, US export sales are in decent shape so far.

While there have been some setbacks on the production side lately, primarily in Pakistan and to a smaller degree in China, we are more concerned about consumption and feel that mill use may not live up to the current 121.6 million bales estimate. Last year mills used 120.2 million bales and with the global economy clearly slowing, we don’t expect this number to be topped by 1.4 million bales.

It is a troubling sign that discretionary consumer spending is slowing while revolving credit is trending higher, which tells us that consumers at the lower end are hurting. This is typically seen ahead of recessions and we don’t think it will be different this time.

So where do we go from here?

Spec buying and trade selling seem to be evenly matched at the moment and the market's recent uptrend has been stalling at the 65 cents level.

From a technical point of view the market is still in a short-term uptrend dating back to late August and key resistance points like the long-term downtrend line and the 200-day MA loom just 2-3 cents above. This should keep speculators interested in the long side for now.

From a fundamental point of view we should see increasing hedge pressure going forward as crops are moving in fast and inventories are starting to accumulate. As pointed out above, the trade is massively under-hedged and with current market values still offering a nice premium above the government loan, it makes a lot of sense to put some downside protection in place.

Sellers seem to be somewhat hesitant because of a potential US/China trade deal. While some sort of a trade agreement involving US Ag products is likely next month and this could lead to another price spike, it won't change the current oversupply situation and it also won't turn the slowing global economy around in our opinion. Market psychology may perk up for a while, but the resulting bounce will likely offer a selling opportunity.

We therefore see the market in a mid-60s trading range for now, with a chance to spike into the high 60s on a trade deal announcement, but by the first

quarter we expect prices to be several cents lower than now.

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