PLEXUS Market Comments

Market Comments – September 24, 2020

NY futures pulled back this week, as December gave up 39 points to close at 65.46 cents.

The cotton market encountered some headwinds from a stronger US dollar and jittery financial markets, but it still performed relatively well and managed to stay above the 6500 level. There was hardly any momentum though, as the average daily trading volume dropped to just 18.6k contracts over the last five sessions, while open interest remained unchanged at 221.4k contracts.

Weather remained the main supporting factor this week, as Tropical Storm 'Beta' popped out of nowhere and dumped a lot of rain on open crops in the Texas Coastal Bend and the Delta, after Hurricane 'Sally' had doused the Southeast last week. We estimate that losses from Sally amount to around 200-250k bales, while Beta was mainly causing quality issues.

After all this rain the forecast now calls for an arctic blast to dip down to the Mid-South and Southeast next week, with afternoon highs topping out in the 60s and overnight lows falling into the low 40s, which is 15 degrees F below normal. This could impact fiber maturity on late planted fields and is yet another reminder that a weather premium is still warranted.

Greece, which is one of the current A-index components, also saw part of its crop damaged by a cyclone this week, with losses estimated at around 100-150k bales. This will likely lift any harvest pressure that might otherwise have been felt.

The latest CFTC report showed renewed spec buying and short covering after the market held crucial support above 6300 during the week of September 9-15. During that week December futures rallied from a low of 6340 to a high of 6693. Speculators bought 0.89 million bales net to increase their net long to 4.72 million bales, with 0.53 million bales coming from short-covering.

On the other side Index funds sold 0.27 million bales and reduced their net long to 7.37 million bales, while the trade was also a net seller, cutting its net short by 0.62 million bales to 12.09 million bales.

In the preceding week speculators had been net sellers after December fell through the 65 cents support level, while the trade (China) was a strong buyer on the dip, and then we saw the reverse action, with spec buying into trade scale up selling. This tells us that the market remains boxed in at the moment, unable to move decisively in either direction.

US export sales did not meet the high expectations, as net new sales of Upland and Pima cotton amounted to 161,800 running bales for both marketing years, with China taking 'only' 45,200 RB. However, participation remained broad-based, with 14 markets buying and shipments of 294,800 RB going to 23 destinations.

Total commitments are now at 8.2 million statistical bales, of which 2.1 million bales have so far been exported. That's 0.4 million bales ahead of last year's pace! In order to reach the current USDA export estimate, sales would have to average around 141k RB per week, while shipments would have to be at 276k RB. These are certainly attainable numbers, especially if China remains in the mix.

The CFTC on-call report showed that mills continue to procrastinate, as even the recent dip to 6340 didn't lead to many fixations. As of last Friday there were still 3.68 million bales open on December, while March, May and July combined for another 5.26 million bales. In total there are currently over 10 million bales in on-call sales still open, while on-call purchases add up to 4.78 million bales.

So where do we go from here?

By being so bearish on the market – justifiably so if we look at the global balance sheet – mills have been holding off on fixations, which paradoxically has created a lot of support for the futures market. In other words, the trade is standing in its own way, making it very difficult for prices to move lower.

In order to provide the sell-side liquidity that the trade needs in order to get out of its shorts, someone else will have to aggressively sell the market. Since we don't expect index funds to withdraw their long exposure to commodities anytime soon, it would require for speculators to turn into net sellers. This might happen if chart support gets broken or an outside event (elections fears?) prompts speculators to close positions.

With the US elections just a little over 5 weeks away, we expect financial markets to become increasingly nervous. Add to that the lack of new stimulus, which these financial bubbles require in order to keep going, and we have the potential for a 'risk off' move and a deeper correction.

It won't take much to get the market into technical trouble, as the primary uptrend line runs through around 6460, while the 50-day MA is at 6400 and the 200-day sits at 62.95. On the other hand, if the market holds steady and no flush out occurs, then trade shorts could find themselves in a bind as the fixation window begins to close. For now the market seems to be happy at around 6500 and it will take some new momentum to move it through strong overhead resistance or scale-down support.

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