PLEXUS Market Comments

Market Comments – February 25, 2021

NY futures closed the week with minor losses, as May was down 61 points to close at 89.69 cents, while new crop December gave up 30 points to close at 84.78 cents.

May rallied to an overnight high of 95.60 cents today, extending its February gains to around 1400 points, before crashing nearly 600 points during the day session. What seemed to set this avalanche in motion was a rise in treasury yields, as the 10-year note shot up to 1.6% this morning, which prompted a 'risk off' move in US financial markets.

Commodities as a group held up relatively well, but when soybeans and corn started to reverse down, some spec longs pulled the plug on cotton as well and this caused prices to cascade lower. Cotton had no friends today, as mills were pulling their fixation orders and new spec shorts added to the pressure once May broke through its short-term uptrend line.

Today's price action looks horrible, as it produced the largest 'black candle' on the chart since this uptrend began last April. Volume was heavy, as nearly 63k contracts in futures and 9.9k contracts in options changed hands.

Open interest continued to rise during the week, as there were nearly 250k contracts still open before today's session, of which 180k were in May and July. This means that trade shorts have continued to fight this uptrend all the way and from today's perspective their persistence seems to finally pay off. It will be interesting to see how much has been liquidated during today's monster session.

US export sales continued to surprise positively, as last week 300,400 running bales of Upland and Pima were added for both marketing years, which is remarkable considering that futures were trading near 90 cents. Participation was still widespread with 18 markets buying, while 304,600 RB were shipped to 21 destinations.

Total commitments for the current marketing year have now reached 14.5 million statistical bales, of which 8.4 million bales have so far been exported. Sales for the next season are currently at 1.2 million statistical bales. There are still 23 weeks left in the current marketing year, which means that if sales were to average 100k/week, we would get to 16.8 million bales in commitments, which should be plenty to allow for shipments of 15.5 million bales (current USDA estimate). Weekly exports of 308k statistical bales would get us there.

Unfixed on-call sales were once again only down slightly last week, amounting to 6.94 million bales in current crop, versus 1.29 million in on-call purchases. This still amounts to 5.65 million bales of 'buying pressure'.

The rise in 10-year treasury yields, from 1.13% two weeks ago to a high of 1.61% today, is starting to unsettle the rosy scenario of the stock market. The fear is that higher rates and inflation will start to weigh on equities and corporate debt, unless the Fed intervenes. But the US central bank has so far been rather nonchalant in regards to higher inflation and is apparently letting it 'run hot'.

Between all the stimulus money, the pandemic starting to subside, supply constraints and pent-up consumer demand, it is easy to see why more and more investors feel that inflation might get out of hand. While this is potentially negative for stocks and bonds, it should be positive for commodities, which are seen as an inflation hedge. Therefore, if this inflation narrative prevails, we should see higher commodity prices over time.

So where do we go from here?

Today's price action was outright ugly and we should see some follow through to the downside on Friday. How far down remains to be seen, but unless we get a bounce tomorrow, the weekly chart will paint a bearish 'shooting star', which will invite more selling.

However, when we look at the latest CFTC report, we had specs and index funds at a little over 8 million bales net long each, while the trade carried a 16.4 million net short position. Mills still need to fix and merchants have basis-longs to unload, both of which require futures to be bought back.

Index funds are not really in play, which means that the selling will have to come from spec longs getting out, which happened today. There might even be some new spec shorts established on this break. But we have 8 million bales in spec longs vs. 16 million bales in trade shorts, so unless specs go net short, which we don't anticipate, the trade will eventually catch this falling market. Based on today's momentum we could see a move into the 85-87 cents window.

Whether today's high marked "the" top or "a" top can't be answered at this point, because this was more of an outside driven event, while the bullish drivers in the cotton market haven't really changed. If anything this selloff will help to clear out remaining inventories in the US and give the trade an opportunity to escape their shorts with minimal damage.

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