PLEXUS Market Comments

Market Comments – Jun 25, 2020

NY futures were basically unchanged this week, as December edged up just 18 points to close at 59.70 cents.

While July finished its short squeeze by pushing to a high of 63.14 cents this week, the December contract remained flat-lined, as it has ended our last four reports in a tiny range of just 21 points, between 59.49 and 59.70 cents.

The July/Dec inversion widened to 369 points earlier this week, as remaining shorts got punished for overstaying their welcome and were forced to pay their way out of trouble. However, by the time First Notice Day rolled around almost all of the positions had been squared away and the July notice period turned into another dud.

As of this morning there were just 679 contracts (67,900 bales) open in July, whereas the certified stock amounted to roughly 46,000 bales, including bales awaiting review. We assume that after today's session most of the remaining positions have been liquidated and/or will be fulfilled by delivery. Glencore seems to be the lone stopper, while Staplcotn appears to be one of the parties that is delivering.

US export sales were once again a one-trick pony, as China booked 75% of the 174,800 running bales in net new sales of Upland and Pima cotton. Vietnam was a distant second taking 21% of the total, while eight other markets shared the remaining 4%. Shipments continued to impress at

325,700 RB, which was again above the pace needed to make the 15.0 million bale USDA estimate.

For the current season we now have commitments of 17.95 million statistical bales, of which 13.05 million have so far been exported. New crop sales amount to 3.35 million statistical bales, which would grow to 6.30 million bales with a current carry-in of 2.95 million (assuming that 15.0 million bales will be shipped this season).

The latest available CFTC report showed profit-taking by speculators and Index funds between June 10-16, which coincided with the sharp correction in the stock market during that time frame. Speculators sold 0.48 million bales to reduce their net long to just 0.28 million bales, while Index funds sold 0.11 million bales to cut their net long to 6.13 million bales. The trade was a buyer into weakness, reducing its net short by 0.59 million bales to 6.41 million bales.

The exodus of traders has been the most prominent feature in the cotton market in recent weeks. While the US stock market has seen a massive inflow of liquidity from retail investors, similar to what we saw twenty years ago during the dot.com bubble, cotton and several other commodities are experiencing outflows, despite all the concerns about future inflation.

Total open interest amounted to just 158,981 contracts before today's session, which is the lowest level since 2014. That's less than half of the 322k contracts we had two years ago, in June 2018.

What's striking is that large spec long accounts (hedge funds and CTAs) dropped by 16 to just 63 accounts, while large spec short accounts went down by 3 to 56 accounts. This means that several large speculators didn't want to roll their positions into December. There are currently just 119 large spec accounts holding long or short positions, which is the lowest number since September of 2009.

While cotton demand has definitely suffered over the last 3-4 months, there is some hope that we are going to see a significant improvement in the fourth quarter, during the all-important holiday shopping season.

The US savings rate has shot up to over 30%, which means that there is a lot of money on the sidelines that could get deployed. Similar trends are visible in Europe and other parts of the world. Since consumers aren't spending as much money on travel, entertainment and eating out, perhaps they are more likely to splurge during the holidays.

So where do we go from here?

Fundamentals remain bearish, with too much cotton around the globe looking for a home. West Texas received some much needed rain earlier this week, which has improved crop conditions. This leaves China as the main element of support and while the US balance sheet is the best looking among origins, we are not sure that it will be enough to hold prices up if Brazil, WAF and India are cutting theirs.

From a technical point of view December is still in a primary uptrend and has so far held above its 50-day moving average. It is currently forming a flag pattern, which is typically resolved in the direction of the trend, which is up.

However, this bull run has mainly been fuelled by short-covering in the July contract and it will be interesting to see where December is supposed to draw its strength from. In a lasting bull market we need to see strong volume and expanding open interest, which is the opposite of what we have at the moment. The last two sessions saw just about 13k futures traded, the lowest volume in nearly two years, and open interest is contracting.

Therefore, unless new sponsors come in on the long side, we expect the market to grind lower over the coming weeks.

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