PLEXUS Market Comments

Market Comments – March 25, 2021

NY futures crashed this week, as May fell 701 points to close at 78.44 cents, while new crop December dropped 604 points to close at 76.55 cents.

Since posting a high of 9560 on February 25, which was just four weeks ago, the market has been in a freefall, losing over 17 cents in the process. While volume has been tepid lately, it accelerated to an estimated 70k contracts today as we broke through major support.

A confluence of technical and fundamental factors combined to create the steep decline this week. Although US export sales continued to make excellent progress, they were overshadowed by worries about the continued lockdown in Europe, China's backlash against European and US retailers over the Xinjiang issue, and a further supply chain disruption due to a large container ship blocking the Suez canal.

Let's start with the one piece of positive news! US export sales continued to surprise, as another 356,400 running bales of Upland and Pima cotton were sold for all marketing years combined, which brings the two-week total to 944.4k running bales. Participation continued to be widespread with 18 markets buying, while shipments of 322,800 running bales went to 24 destinations.

Total commitments for the current crop have now reached around 15.7 million statistical bales, of which around 9.9

million bales have already been exported. For the coming marketing year there are so far 1.55 million statistical bales on the books and we estimate that about 1.2 million of those bales will be supplied from current inventories during the August to October period

The US balance sheet continues to tighten, as supplies of 21.95 million bales (7.25 beginning stocks + 14.70 crop) have been reduced by 18.0 million in offtake (15.7 exports + 2.3 domestic mill use), which leaves just 3.95 million bales. But from that number we need to further reserve around 2.0 million bales for commitments during the August to October time frame (1.2 exports + 0.8 domestic use).

In other words, there are probably no more than two million bales left for sale at this point. Since falling prices and the persisting inversion between July and December are encouraging further sales, it is conceivable that US cotton will for all practical purposes be sold out before new crop arrives.

Now on to the not so good news! It appears that the end of the pandemic is nowhere as near as many of us had hoped, at least in several important regions around the globe. Europe is currently experiencing a third wave of infections and remains firmly locked down until further notice, while Brazil has seen a disastrous explosion in cases and deaths. India and the Philippines are among some of the other countries that have seen a big spike in new cases, which might lead to an economic slowdown.

New, more potent variants of the virus have added more challenges and unless we see the pace of vaccinations speed up considerably, a return to normalcy is being pushed deeper into the future than the market has factored in.

The row between China and western retail brands like H&M, Nike or Adidas, just to name a few, has intensified this week as China is boycotting foreign brands in retaliation for the shunning of Xinjiang cotton by many of these companies. While markets don’t like uncertainty and are trying to assess the fallout from this tussle, we feel that it could end up being a net positive for the market down the road.

First of all, western companies can’t simply ignore the issue, because it is their consumers who decide what products they are willing to buy. And all this escalation has achieved is to put the Xinjiang issue firmly into the limelight. Since China is not likely to give up its garment exports to Europe and the US, it will increasingly be forced to use foreign cotton and yarn to maintain their market share, while at the same time trying to find ways to boost domestic consumption to work down their Xinjiang stockpile.

The running aground of a huge container ship in the Suez canal is currently clogging a vital artery in the global trade network. With global supply chains already stretched thin, this will further add to delays and lost sales. Since clothing is part of this story, the market had a negative reaction to it, although we don’t see this having a long-lasting impact.

So where do we go from here?

Technically the price action looks awful, since today’s limit down pierced through the long-term uptrend line dating back to April 2020. Volume was heavy as specs were stopped out of long positions and new shorts probably entered on negative momentum.

Based on how weak the market went out today we have to anticipate further losses and at this point it is still anyone’s guess as to where this falling knife is finally going to stick.

From a fundamental point of view things don’t look quite as dismal. First of all, the US is almost sold out and instead of rationing demand, these cheap prices are encouraging further offtake. This puts greater emphasis on new crop, which is still very much a moving target in regards to acreage and weather.

With new crop corn and soybeans still hovering near recent highs, cotton is falling further behind in the race for acreage. And while West Texas has received some moisture from thunderstorms, most of the region remains very dry and unless we get soaking rain soon, the headlines will turn to the ongoing drought again.

Also, the sea of liquidity in the global financial system should spark higher consumption and inflation as we emerge from the pandemic, although this may take a while longer than we anticipated.

Other than for a quick momentum trade we don’t like the short side of the market and are more interested in going long - initially via call spreads only.

https://plexus-cotton.com