PLEXUS Market Comments

Market Comments – January 28, 2021

NY futures pulled back this week, with March dropping 264 points to close at 79.93 cents/lb.

March slipped below the 80 cents level, after speculators and index funds have been pulling back, as recent CFTC data has shown. Meanwhile, the trade still seems to be comfortable with its large net short position, although there are sizeable scale down buy orders waiting to fix open on-call positions.

The latest CFTC spec/hedge report of January 19 showed that speculators and index funds were light net sellers for a second week in a row, as they reduced their net longs by a combined 0.16 million bales, to 7.41 million and 7.72 million bales, respectively.

The trade was once again a light net buyer, reducing its net short by a corresponding 0.16 million bales to 15.13 million bales. Like the week before, this was primarily the result of new trade longs being established, which are believed to be tied to China.

However, based on the drop in March open interest of 11,595 contracts over the last five sessions, trade shorts have since used this dip to reduce their exposure in the front month. Overall open interest was down just 1,942 contracts though, as May and July picked up most of what March relinquished.

Today's CFTC on-call report showed some progress in reducing unfixed sales. Total exposure in current crop dropped by 0.24 million bales to 8.27 million bales, of which 2.22 million are on March. On the other side we saw unfixed on-call purchases in current crop drop by 0.19 million bales to 1.76 million bales, which still leaves 6.51 million bales of net buying power.

US export sales continued to steamroll ahead, as last week another 402,100 running bales of Upland and Pima were added for both marketing years. Once again we saw broad participation with 19 markets buying and 22 destinations receiving shipments of 287,900 running bales.

For the current marketing year we now have commitments of 13.45 million statistical bales, of which 6.95 million bales have so far been exported. Commitments for the coming season are at just under 1.0 million statistical bales.

When we look at the current US balance sheet, we have supply (beginning stock + crop) at 22.2 million bales, of which 13.45 million bales have been committed for export and 2.40 million bales are taken up by domestic mills. In addition to that we need to reserve at least 1.5 million bales for export and domestic use for the August to October period, which leaves only 4.85 million bales for sale. That's not much considering that we are only halfway through the season!

Since this crop has produced a lot of discounted grades, US offers are attractively priced and will likely continue to find ready buyers, especially after this week's drop in futures. When export sales finally do slow down, it will likely be due to limited supplies and not for a lack of buyers!

This week the stock market casino took on a whole new level of absurdity, when basically bankrupt retailers like Gamestop or AMC were bid up by a gang of retail investors, whose goal it was to squeeze short sellers.

Gamestop, a brick-and-mortar retailer who sells games and electronics, posted a USD 470 million loss last year, with hedge funds betting that the stock would eventually go to zero.

However, when retail investors organized themselves on social media to pump up the stock, they set an epic short-covering rally in motion that saw Gamestop shares rally from 20 dollars on January 12 to a high of 483 dollars today, before giving about half of these gains back by the close. Other stocks with a large short interest have become similar targets of this mob.

We mention the above because this can happen to anyone who is short a financial asset. While retail investors are not likely to migrate into futures anytime soon, the current set up in the cotton market nevertheless worries us. Between all these unfixed on-call sales and the US selling out fast, there are a lot of short futures that need to be bought back between now and the middle of June. Hopefully speculators will abandon their longs and thereby provide the sell-side liquidity the trade depends on, but if speculators don't oblige, it might get interesting.

So where do we go from here?

The lack of spec buying over the last couple of weeks has allowed the market to drift back into its long-term trend channel. However, this bull market still has a lot of leeway before it needs to worry, with the 50-day MA sitting at 76.46 and the long-term uptrend line currently running through around 75 cents. The 200-day MA at 67.03 is still a few more levels below that.

Trade scale-down fixations and the selling of basis-long positions should provide enough buying going forward to avoid a deeper selloff. Our best guess is that the market is going to pull back another cent or two to regroup, before resuming its uptrend.

A lot will depend on what happens in the outside markets, which in turn determines the behavior of speculators. Unlike speculators, who can simply roll down the calendar and pick up a roll gain while doing so, trade shorts don’t really have that option, be it because of the roll loss or because current crop shorts are unrelated to new crop.

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