PLEXUS Market Comments

Market Comments – October 29, 2020

NY futures pulled back this week, as December dropped 212 points to close at 69.82 cents.

December posted a 10-month high of 72.60 on Wednesday, before a 'risk-off' move in the stock market spilled over to other asset classes and prompted a long overdue correction. The spot month closed nearly three cents below yesterday's high and if it hadn't been for another excellent export sales report this morning, we would probably have gone even lower.

US export sales amounted to 322,700 running bales of Upland and Pima cotton, with 18 markets participating, while shipments of 244,700 running bales went to 26 destinations. New sales were actually above 433k bales, but they were reduced by cancellations of 111k bales, with Turkey accounting for nearly half of them.

Turkey's economy has been struggling, with the Lira falling to 8.29 vs. the US dollar this week, making imports quite expensive. For reference, in February 2019 the Lira was still at 5.21 to the dollar and ten years ago it was about six times stronger at 1.39.

Total export commitments for the current season are now at 9.4 million statistical bales, of which 3.15 million bales have so far been exported. That's the strongest pace in 16 seasons and shows that mills are keen to receive cotton.

The US crop continues to struggle, as adverse weather in West Texas (ice, sleet and rain) and in parts of the Mid-South and Southeast (storms and heavy rain) has led to harvest delays and reduces quality and yield. We hear of some mike problems in West Texas, which could further cut the availability of tenderable grades. Most private crop estimates are now in the low 16 million range, with some as low as 15.8 million bales.

Our snapshot of the US balance sheet has beginning stocks at 6.5 million and the crop at 16.3 million bales, for a total supply of 22.8 million bales. Against that we have domestic and export commitments of 11.9 million bales so far, which leaves 10.9 million bales for sale. However, with this mixed quality bag it will be a while before shippers know what they have left over for sale and for this reason we don't expect to see much sales pressure over the coming weeks, at least in the cash market.

The futures market may be another story. Speculators have been amassing a relatively sizeable net long position since early April and as of October 20 they were 7.11 million bales net long, while Index Funds owned 7.81 million bales. The last two CFTC reports showed that specs and index funds added 2.06 million bales net. By the same token the trade increased its net short position to a rather substantial 14.92 million bales.

So far we have yet to see any long or short liquidation, as futures open interest continued to rise even during yesterday's selloff, which was a bit of surprise. Futures open interest has risen to 249.5k contracts as of this morning, which is 90k contracts more than at the end of June.

Speculators and the trade continue to dig in and it will be interesting to see which side prevails as we head into the December expiration. One possibility is of course that the can gets kicked down the road and both sides simply roll their respective positions into March.

Outside markets are starting to feel some pressure, as economies around the globe are slowing down again due to rising COVID cases, while governments are slow in providing additional rescue funds. The VIX, which is the 'fear gauge' for US stocks, has risen from 28 to 38 since last Thursday, which is a clear sign that markets are getting increasingly nervous and scared.

The upcoming US elections are adding another element of uncertainty, especially if we were faced with a 'contested' election, which could drag on for weeks. If Democrats were to win the presidency and took control over Congress, then we would likely see initial weakness in financial markets, as fear of rising capital gains taxes in 2021 would spark immediate profit taking.

However, in the long-run the prospect of much higher fiscal deficits would probably lift financial assets to new highs, both as a result of a weaker US dollar and inflation. Market timing is extremely difficult, but we believe that over the coming years we will see higher nominal values of stocks and commodities.

So where do we go from here?

The next two weeks will likely be quite volatile, because we are dealing with the US elections, the index fund roll, December fixations, options expiration and another WASDE report. All that with spec longs and trade shorts sitting on their largest positions in two years.

Technically the market put in an 18-month high on the weekly continuation chart last Friday, while December came within 40 points of its January high on the daily chart yesterday. Since then the market has started to reverse, which could be seen as the beginning of a 'double top' formation. So far this is simply a correction in a long-term uptrend, but if the market continued to weaken, it could trigger a trend reversal.

Trade shorts got a new lease on life after they were pushed to the brink and mills will likely use this weakness to fix some of their remaining 2.7 million bales in December on-call sales. Growers have about half as many contracts open on December. Then there is China, which has so far supported the market on dips. China has been a very strong buyer of commodities this year and there is so far no indication that they are done buying.

Speculators hold the key to the market in our opinion. If they cash in their profits and get out of longs, it would allow for a deeper move to the downside. However, if they stay in their positions and roll to March, then the market will probably challenge the recent highs again after the roll period. The next two weeks could turn into a roller-coaster ride and we would therefore use options only to operate in the current environment!

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