PLEXUS Market Comments

Market Comments – April 30, 2020

NY futures extended their recent rally, as July added another 96 points to close at 57.33 cents.

The market ended a choppy week about a cent higher, with July closing today at its highest level in six weeks. April has been a stellar month for cotton, since it rallied from an April 1 close of 48.22 to settle at 57.33 cents today, a gain of 911 points!

Cotton joined financial markets in ignoring an overall gloomy macroeconomic picture and instead filtered out a piece of bullish news on which to trade on. The much talked about Chinese buying finally showed up in today’s export sales report, as 537,700 running bales were added to China’s commitments for both marketing years.

Apart from China there were another 46k RB sold to a handful of other buyers, which isn’t too bad considering that most markets are locked down. Shipment of 260,700 RB were still holding up relatively well, although they were about 42k bales below the pace needed to make the current export projection of 15.0 million statistical bales.

For the current season we now have export commitments of 16.5 million statistical bales, of which 10.7 million bales have been shipped. For the coming marketing year we have so far around 2.5 million bales on the books.

Since shipments are likely going to stay below the pace needed to make the USDA export projection, we believe that US ending stocks will rise to around 7.5 million bales. By comparison, over the last ten years US ending stocks were between 2.35 and 4.85 million bales and we have to go all the way back to 2007/08 to find a higher ending stocks number.

The situation does look similar for the ROW (=all countries minus China). The current USDA estimate for ROW ending stocks is at 56.0 million bales, which is a record. By comparison, in the previous 15 seasons ROW ending stocks ranged between 31.9 and 44.6 million bales. In other words, we are looking at an 11.4 million bale jump and this estimate may still be too conservative, because we feel that global mill use won't reach 110.6 million bales.

We therefore need to put this 'bullish' China news into perspective. First of all China isn't buying because its consumption is strong and it needs the cotton, since commercial stocks in China are some of the highest in years and mills are still not running at pre-virus capacity. This is either done out of price considerations or because China feels obligated to do so under the trade deal. But in the grand scheme of things this is simply a transfer of stocks from one place to another.

Considering that ROW stocks are going up by 11-12 million bales or more, half a million or even a million bales of Chinese purchases won't make much of a difference. Sure, it helps to underpin US prices for a while and it may get some speculators excited, but this is not going to flip the switch from bearish to bullish. For that to happen we need to see strong demand return and this isn't in the cards anytime soon.

On the contrary, inelastic global production is going to stay elevated, while demand suffers, which will add even more stocks to the global and ROW balance sheets next season. We wouldn't be surprised to see a global production surplus of 6-8 million bales in the coming season, which would add even more pressure to a saturated market.

The CFTC report of April 21 showed that speculators continued to be net buyers, cutting their net short by 0.24 million to 1.27 million bales. The trade was a net buyer as well, reducing its net short by 0.13 million to 4.07 million bales.

Index funds were the only seller, as they lowered their net long by 0.37 million to 5.34 million bales. That's the smallest index fund net long since early 2015.

So where do we go from here?

Looking at the US stock market one might get the impression that this virus crisis was just a blip in an otherwise healthy bull market. Nothing could be further from the truth, as stocks were already overvalued before we knew the word Covid-19 and they are now even more ridiculously overpriced.

But investors don't seem to care about valuations anymore, as long as central banks and governments keep feeding money into the system, of which a large part ends up chasing stocks. This renewed exuberance seems to have rubbed off on the cotton market, which has rallied nearly 20% from its low in early April.

This happened because some stocks were moved from the US to China, while actual demand suffered as retail stores remain closed and the supply chain is mostly frozen.

However, as we have learned from the crude oil market, commodities are not like the stock market, because they are rooted in reality. The cotton futures market has now become the highest bidder for physical cotton and if this situation prevails, the July delivery will attract a lot of cotton to the board, especially in the absence of carry.

Since we don't believe that physical prices will increase anytime soon, we feel that the futures market will have to back off again and that we will eventually get full carrying charges between July and December.

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