PLEXUS Market Comments

October 31, 2019

NY futures remained trapped in a sideways pattern this week, as December gave up just 21 points to close at 64.44 cents/lb.

Despite some erratic moves over the last couple of sessions, the December contract continues to be stuck in a tight range between 64 and 66 cents. In fact, the front month has now settled the last twelve sessions in a 126-point band, between 64.44 and 65.70 cents.

The current drivers are still speculative buying against trade selling and for now they seem to be evenly matched in the mid-60s. Speculators have sponsored a breakout attempt to the upside yesterday, but trade selling proved too strong near the 6600 level and today the market reversed nearly 200 points lower on disappointing export sales and some negative vibes from the trade and political front.

The latest CFTC report for October 16-22 showed that speculators continued to cut their net short for a 4th consecutive week, as they bought 0.76 million bales to reduce their net short to just 0.78 million bales. Speculators have continued to buy the market since then and we believe that they are either square or slightly net long by now.

Meanwhile the trade continued to add hedges by selling 0.70 million bales to increase its net short to 5.00 million bales. There is still a long way to go until the trade is sufficiently hedged against all the incoming supplies. Index funds sold 0.06 million bales net and reduced their net long to 5.77 million bales.

The speculative position has gone through the biggest move ever since the summer of last year. In June 2018 speculators were 12.23 million bales net long and 14 months later, by early August of this year, they were 5.36 million bales net short. That's a swing of 17.59 million bales, which has forced spot futures to drop from the mid-90s into the high-50s.

By extension the trade gave up its entire net short position on the way down, going from over 20.2 million bales in June of 2018 to basically square at just 0.14 million bales net short in early August. That was the lowest net short position the trade has ever had, at a time when we were expecting to harvest the second largest global cotton crop ever.

Fortunately speculative buying over the last three months has provided the necessary liquidity for the trade to bolster its net short to five million bales, but a lot more is needed to protect all the unsold supply that is coming onstream over the next few months. Since 2006 the average trade net short position has amounted to 10.4 million bales, while the largest net short ever was 23.8 million bales in early 2008.

Hopefully speculators will continue to provide enough buy-side liquidity for the trade to achieve its objective and at the moment it looks like that might be the case, as the technical picture remains favorable and the Federal Reserve is providing assistance.

The market has been in a short-term uptrend dating back to late August and at the moment this trendline runs through around 6300. In other words the market still has some room for a correction without breaking the uptrend.

Meanwhile the Federal Reserve has started to expand its balance sheet again, although it is insisting that it is not 'quantitative easing'. Why don't they just stop using fancy language and call it what it really is, namely 'money printing'!? In addition to providing liquidity to banks, the Fed has also lowered interest rates by another 0.25 basis points this week.

The accommodative stance by central bankers around the globe has definitely gotten the attention of some prominent money managers, who feel that commodities as an undervalued asset class are finally going to wake up from their deep sleep and will start to trend higher. Precious metals have been leading the way and expectations are that other commodities will follow.

US export sales continued to be just so-so as net new sales of Upland and Pima cotton amounted to 201,100 running bales for both marketing years combined. Indonesia rolling 71,300 running bales from the current to next season was disconcerting to traders, because there seem to be quite a few more high priced contracts that buyers would like to postpone. Shipments continued to lag at just 156,500 running bales.

Total commitments for the current season have now reached around 9.9 million statistical bales, of which a little over 2.5 million bales have so far been exported. For the next marketing year there are so far a little over 0.8 million statistical bales on the books.

So where do we go from here?

The chart still looks constructive at this point despite today's mini-reversal and if the market holds the short-term uptrend line, we would expect spec buying to resume.

With harvest gaining momentum the trade will have to get more aggressive with its downside protection, although there is still some uncertainty in regards to the size and quality of the crops in the US and India. An early start to winter in the Texas panhandle and the late withdrawal of the Indian monsoon have caused some concerns and it will still be a while until we know the final outcome of these important crops.

However, unless the cotton balance sheet becomes more supportive over the next month or two, we feel that supply pressure will eventually force values back towards the 60 cents level.

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