PLEXUS Market Comments

Market Comments – December 03, 2020

NY futures went nowhere since our last report of two weeks ago, as March dropped just 56 points compared to November 19, closing today at 71.11 cents.

March broke above short-term resistance before Thanksgiving, which triggered spec buying and spiked the spot month briefly to a new high of 74.27 cents. However, the breakout attempt was short-lived, as there was no follow-through buying and profit taking reigned values back in over the following sessions.

The loss of upside momentum has deflated the market over the last seven sessions, with today's close sitting more than 300 points below the recent high. However, from a broader perspective we are is still in the middle of a 7-week sideways range, which has seen March settle in a band of just 408 points since October 14, between 69.72 and 73.80 cents.

So far most of the factors that have been supporting the cotton market in recent months are still in place, namely the spec net long position, strong soybean/grain prices, the large price gap between Chinese and international prices, and a weakening US dollar.

What has changed is that mill demand has slowed somewhat in reaction to the renewed shutdowns in Europe and the US, which has prompted buyers to adopt a hand-to-mouth buying strategy, rather than committing to extended coverage. Combined with the supply pressure from Northern Hemisphere crops coming in, we are seeing a bit of a shift towards a buyer's market.

Mills feel no urgency to chase after cotton at the moment, while producers in some parts of the world are getting a bit more antsy. India is a good example, where arrivals have come in fast and furious, reaching around 7 million local bales by November 21. That's about a million bales ahead of the pace seen in the previous two seasons, and daily arrivals are now clocking in at 250-300k bales a day. While the CCI has been procuring about three million bales so far, the fast pace of arrivals is causing a spillover effect, which is starting to weigh on the market.

In the US the situation looks more buoyant, since more than half of the available supply has already been committed. We estimate total supply (beginning stocks + crop) at around 23.0 million bales, which compares to the USDA's latest number of 24.34 million bales, Against that we have so far 10.6 million bales in export sales, plus 2.5 million bales to domestic mills, for total commitments of 13.1 million bales. This would leave less than ten million bales for sale according to our numbers and we are only in early December.

US export sales continued at a healthy pace during Thanksgiving week, as 307,600 running bales of Upland and Pima cotton were sold for both marketing years. Those sales came on top of the 420,100 RB that were sold the week before, bringing the two-week total to 727,700 RB. Participation continued to be widespread, as 21 different markets were buying.

Shipments slowed down a bit during the holiday, as just 208,400 RB were exported last week. However, total shipments of around 4.5 million statistical bales are still 1.2 million bales ahead of last season.

So far about 7.9 million bales of Upland cotton have been classed, with the predominant quality showing 41-3s. Since adverse weather in various parts of the cotton belt has produced plenty of discounted cotton, we should see strong export demand for these attractively priced recaps. Unlike India, we don't expect much crop pressure in the US, at least not anytime soon.

So where do we go from here?

The failed breakout attempt of last week has shown that the market is not quite ready to move higher, since there is plenty of supply in the pipeline at this point.

However, there are also a number of supporting factors, such as a weaker dollar, lofty Chinese prices, strong soybeans and committed spec longs, which should countervail supply pressures.

For the market to move lower we need sell-side liquidity, which only speculators can provide at this juncture, since the trade is more likely to be a net buyer of current crop futures between now and the second quarter.

In order for spec longs to pull the plug on their longs, we need either a 'risk off' event or a technical breach. The most likely trigger is a break below the primary uptrend line, which is currently at around 7050 and moving higher. If the market continued to trend sideways, it would eventually catch the trendline and this could set off some sell stops.

So far the market has managed to stay ahead of its trendline, but the air is getting thinner. However, even if we were to get a washout of some spec longs, there should be plenty of trade buying waiting underneath to cushion the fall. In other words, the result would probably be an extended trading range, somewhere in the high 60s to low 70s.

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