PLEXUS Market Comments

Market Comments – September 03, 2020

NY futures pulled back this week, as December dropped 109 points to close at 64.28 cents.

December rallied to 66.44 cents on Tuesday, which was one point shy of the August 25 high, but it has since given back over 200 points. When we look at the candlestick chart we notice that the three sessions from Monday to Wednesday all had long 'wicks', which tells us that the market was unable to hold on to intraday gains.

Since open interest continued to rise this week, we suspect that new spec and index fund longs initially pushed prices higher, while the trade continued to be a strong scale up seller. When the US dollar started to reverse from Tuesday's 2-year low and financial markets saw some profit-taking, speculators stopped chasing commodities and the void of buying has allowed values to cave in.

The latest CFTC report confirmed that speculators were behind the rally to a 6-month high on August 25. Speculators increased their net long by 1.32 million bales to 4.67 million bales net during the week of August 19-25, while index funds added 0.15 million bales to lift their net long to 7.50 million bales.

The trade was still able and willing to hold against this buying spree and boosted its net short position by a further 1.47 million bales to 12.26 million bales. This represents the trade’s largest net short position since September 2018, when the market was trading at 79 cents.

The market is now at the top of the ‘fixation zone’, which we believe to range from 60-64 cents. The latest ‘on-call’ report showed that there were still 3.76 million bales in unfixed on-call sales on December and 2.54 million bales on March, for a total of 6.30 million bales. If we include all the months beyond March we get a total of 9.56 million bales. These unfixed sales provide a nice layer of scale-down support, although mills might pull or lower their orders if the outlook were to turn more bearish.

US export sales amounted to 148,800 running bales of Upland and Pima cotton, with China and Vietnam once again accounting for the majority of it. Shipments were decent at 286,000 running bales, with China receiving 137,700 RB. For the current marketing year we now have commitments of 7.4 million statistical bales, of which a little over 1.3 million bales have been exported.

China has been the main reason why US futures are where they are today and rumors have it that China will remain a strong importer this season, especially of US cotton. This is great if it materializes, but it also presents a risk to the bullish case if something were to change. We need to remind ourselves that China doesn’t really need all that cotton, but may continue to import for political and strategic reasons.

Another potential threat to the bullish case would be a ‘risk off’ move in financial markets. Today the US stock market suffered its biggest one-day loss since June and this may serve as a wake-up call for all these unsuspecting small investors who have been pouring money into index funds.

The global economy has been on life support since March, with generous government stimulus and central bank asset purchases keeping it going. But we are now entering a period fraught with uncertainty, as many small businesses have used up their savings and further government stimulus has yet to be determined.

Unemployment will likely remain high as a lot of companies won't make it through this pandemic and we expect bankruptcies, evictions and foreclosures to increase as more and more renters and homeowners won't be able to fulfil their obligations.

The wealth gap is going to increase, which will further fuel social unrest. The stock market has been in la-la land, racing from one overvalued close to another, which has created euphoria among the Haves, while the Have Nots have fallen deeper into the hole.

Governments and central bankers will continue to 'paper over' the problem and maybe they will succeed in keeping asset prices inflated, but there will definitely be reality checks along the way. Market uncertainty is only going to increase as we head into the US elections two months from now and many traders and investors will probably take some money off the table, which could weigh on markets.

So where do we go from here?

Spec and index fund buying has been propping the market up, but trade selling has capped the rally near 66 cents and forced a retreat. With outside markets looking shaky at the moment, we don't expect specs to chase cotton prices higher at this point.

Support is most likely going to come from scale-down fixation buying, but this could change if outside markets were to switch into 'risk off' mode.

Technically we broke through initial support at 6500 and the next major support area is near 6300, where the 50-day moving average (63.13), the 200-day moving average (63.08) and the primary uptrend line are converging. It is quite likely that the market is going to test this important support area and then tries to regroup. However, if outside markets remain weak and the 63 level breaks, then a deeper correction would likely follow due to spec long liquidation.

Potential buyers should probably adopt a wait-and-see attitude here and buy the market only on renewed signs of strength, or operate with calls and/or call spreads only.

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