PLEXUS Market Comments

Market Comments – March 05, 2020

NY futures ended the week slightly higher, as May gained 85 points to close at 63.35 cents.

After May had dropped over 1000 points in just eight sessions, going from a high of 70.24 on February 19 to a low of 60.18 on February 28, strong trade buying finally stopped the bleeding and stabilized values in the low 60s. The market even made a few attempts to rally, but was rejected on each occasion, as the confidence is simply not there yet to sustain any strength.

Physical business was brisk at these lower levels, as mills fixed existing sales and added a lot of new ones. Today's US export sales report reflected this strong pace of sales, as 457,800 running bales of Upland and Pima cotton were added for both marketing years last week, with 19 markets participating. Shipments of 494,000 running bales were just as impressive!

For the current season we now have commitments of just over 14.9 million statistical bales, which are two million bales more than a year ago, while shipments have reached 7.5 million bales. There is some concern about the sharp drop in container traffic to Asia due to the virus crisis, which could make it difficult for shippers to perform timely deliveries.

The latest available CFTC report, which was for the period of Feb 19-25, during which May traded between 70.24 and 66.15 cents, already showed strong net selling pressure by speculators. Large and small specs sold 0.92 million bales to bring their net long down to just 1.0 million bales, whereas the trade bought 1.10 million bales to reduce its net short to 8.85 million bales. Index funds sold 0.18 million bales and cut their net long to 7.85 million bales.

It will be interesting to see the next CFTC report tomorrow, which will reflect all the changes after the market broke below its 200-day moving average. We expect to see a rather substantial amount of net spec and possibly some index fund selling, while the trade was an aggressive buyer into weakness.

Fortunately, speculators aren't sitting on big positions at the moment, which should mitigate their impact on the market. Index funds hold the majority of longs and it is unlikely that investors will pull vast amounts of money from commodity baskets. In other words, most of the selling pressure may already be behind us, unless the economic situation were to get a lot worse.

Coronavirus concerns continue to dominate the headlines, with infections now present in over a hundred countries. Fear is spreading along with the virus and the global economy is starting to take a hit. Conventions and events are being cancelled and people are increasingly avoiding travel or eating out, which in turn will cause losses to many businesses and lead to layoffs.

This all happens at a time when economies were already starting to slow down. Economic growth has been anaemic before the virus appeared on the scene and there is a high probability that we are already in a recession. The stock market bubble, which was mainly fuelled by ultra-cheap money, stock buybacks and indexing, has masked what was going on in the real economy and lulled many investors into a false sense of security.

The 'Buffet indicator', which compares the Wilshire total market capitalization to US GDP, was at an all-time high of 157% in early February, easily surpassing the dot.com bubble peak of the late 1990s. It is still at 140% today, which is considered 'significantly overvalued'. To bring this ratio back to a fair value reading, the US stock market would have to drop another 35-40% from current levels.

Central bankers and policymakers will do everything in their power to keep asset bubbles from deflating. While traditional tools seem limited, let's not forget that central banks could simply print money to buy stocks and real estate in addition to bonds. Last year the SEC reported that the Swiss National Bank owned nearly 100 billion worth of US stocks, including Apple, Amazon and Microsoft. So far the Federal Reserve has abstained from buying stocks, but the next crisis might change that.

So where do we go from here?

From a fundamental point of view cotton looks attractive at current levels. US cotton is selling out fast and most of it may be committed by mid-year. With India's residual supply priced significantly higher, this could create a vacuum for prices to rise in. However, a lot will depend on how the demand side of the story holds together in view of the economic slowdown.

From a technical point of view the market still looks beaten up and it will take some more repair work to turn things around. The 200-day moving average at around 6600 is now a key resistance level the market is aiming for.

Financial markets are going to play an important part in all this, as they can either instil or kill confidence. The yo-yo stock market shows that investors are currently torn between a deflationary economic outlook and what could be unprecedented monetary and fiscal stimulus down the road. While this selloff may have further to go, the more asset prices fall, the stronger the reaction by the Fed and its cohorts will be. Extreme volatility is here to stay, but the end result is likely going to be higher nominal prices of just about everything.

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