PLEXUS Market Comments

February 07, 2019

NY futures came under renewed pressure this week, as March gave back 159 points to close at 72.81 cents/lb.

The market continues to meander in a very narrow trading band, caught between strong support near 72 cents and equally tough resistance above 74 cents. As a result March has now closed the last 16 sessions in a tight range of just 164 points, between 72.76 and 74.40 cents.

Today's weakness came in reaction to President Trump's comment that it was 'unlikely' that a meeting with Premier Xi Jinping would take place before the March 1st deadline, which raised fears that tariffs might jump to 25% on March 2nd. This has put pressure on a variety of industrial and agricultural commodities.

We finally got two of the missing CFTC spec/hedge reports this week and they showed that speculators were heavy sellers during the second half of December. Between December 18-31 speculators sold a massive 3.19 million bales net, thereby going 0.84 million bales net short overall. The last time speculators held a net short position was in early 2016, when the market was trading in the mid-50s.

Since May 29 of last year speculators have sold a total of 13.08 million bales net, reversing a 12.24 million bales net long into a 0.84 million bales net short position in a matter of seven months. No wonder the market fell from a high of 96 cents to a low of 71 cents as a result of it. Judging by the rapidly rising open interest we have to assume that speculators continued to add to their net short position. Since December 21 total open interest has jumped from around 211k to currently over 249k bales.

The trade used the price drop in late December to reduce its net short position by a hefty 3.44 million bales to just 7.26 million bales. Index funds sold 0.24 million bales net during the same period and they were the only group that was still long in the market, with an 8.10 million bales net long.

US export sales for the week of December 21-27, which spanned over Christmas, amounted to a respectable 268,700 running bales of Upland and Pima cotton for both marketing years. Shipments were still lagging at 202,300 running bales, but the 3.7 million statistical bales that have been shipped so far are still slightly ahead of last season.

This sales report brings total commitments for the season to around 11.4 million statistical bales as of December 27. We estimate that over the last six weeks this number has grown to around 12.8 million statistical bales. With domestic mills taking 3.3 million bales this season, we would therefore have total sales for the current season of around 16.1 million bales.

But we would also have to reserve at least 2.0 million bales for domestic and export sales for the August to October period, which would bring total commitments to 18.1 million bales. This compares to a total supply of 22.9 million bales for the current season, which means that there would be around 4.8 million bales available for sale if our numbers were correct.

The market is currently trying to figure out whether export offtake will be strong enough over the coming months to keep current crop values inverted over new crop, similar to what we saw last season when the balance sheet was very tight and July traded 2-4 cents above Dec for most of the second quarter. Or will there be plenty of cotton left in June to force carry into the market?

The July/Dec spread was one of the main features this week, as the inversion narrowed from 270 points last Thursday to just 78 points today. This seems to tell us that traders no longer believe that current crop deserves to trade at a big premium over new crop, although we are still a long way from full carry. Six months ago this inversion amounted to nearly 800 points and it has since been steadily shrinking, with today's close marking the smallest difference so far. It will be interesting to see if this trend continues over the coming weeks.

So where do we go from here?

We believe that December is currently at the center of the pricing structure and that the other months are mainly a function of their relationship to December. Given the potential for larger US and global crops next season, we see it as difficult for December to rally anytime soon.

Therefore, if we peg December in the mid-70-s for now, then what does that mean for current crop futures? If US export sales maintain a strong pace and the balance sheet is going to tighten considerably over the coming months, then current crop futures might detach themselves from December and chart their own, more bullish course.

However, if sales remain so-so and we end up with a bunch of cotton that needs to be carried over the summer months, then the market will need carry, which would force current crop futures below December.

The missing export sales reports as well as tomorrow's WASDE should give the market some clues as to which scenario they should bet on. Tomorrow's report will likely show a drop in production and mill use, with the mill use number being the more important one. However, the market has already priced in a substantially lower mill use number and the reaction might therefore be muted.

We therefore feel that the market will remain in a trading range of around 72-77 cents until we get a better read on global mill use and how new crop plantings shape up.