PLEXUS Market Comments

Market Comments – February 11, 2021

NY futures continued to shoot higher, with May gaining another 238 points to close at 87.87 cents/lb.

The market produced an impressive rally for a second week, with the May contract gaining 674 points or 8.3 percent in the ten sessions since January 28. Since the spot month posted a low of 48.35 cents on April 1 last year, prices have gone up nearly 40 cents or about 83%.

Week after week, stellar US export sales continue to provide a reason for the market to move higher, as we have yet to see any demand rationing due to higher prices. Last week another 455,200 running bales of Upland and Pima cotton were added for both marketing years.

Once again participation remained widespread with 17 markets buying and 21 destinations receiving shipments of 440,700 running bales, a marketing year high. Total commitments for the current season have now reached 14.1 million statistical bales, of which 7.75 million bales have so far been exported. The pace of exports remains about 1.5 million bales ahead of last season!

The WASDE report came in more or less as expected by traders, although on balance we viewed it as slightly friendly. The US crop was left unchanged, pending further classing data, but exports went up by 0.25 to 15.50 million bales, while ending stocks dropped by 0.3 to 4.30 million bales.

The Chinese crop was raised by 1.5 million bales, but that won't have much of an impact, because Xinjiang cotton has fallen out of favor in international markets. Despite the larger crop, China's imports were raised by 0.5 million bales to 11.0 million bales, which is supportive.

India's crop was lowered by 0.5 million bales to 29.0 million bales, while domestic mill use increased by 0.3 million to 24.3 million bales, which combined with some beginning stock revisions dropped Indian ending stocks by 1.3 million bales to 18.1 million bales. However, while this downward adjustment is a step in the right direction, we feel that Indian stocks are still about 2.5 million bales overstated.

ROW ending stocks dropped to 58.46 million bales, which is 3.57 million bales less than last season. Nevertheless, ROW ending stocks are still considerably higher than in the previous three seasons – 2016/17 to 2018/19 – when they ranged from 34.38 to 44.29 million bales. In other words, the world won't run out of cotton anytime soon!

However, while there is enough cotton on a global basis, US stocks are near a 4-season low and could drop even further, if the final crop number were to come in another 0.2-0.3 million bales lower as we believe. This has led to a situation in which US futures prices are forced sharply higher, while physical prices in most origins are no longer keeping pace. This has created a nightmare for holders of basis-long positions and for the many mills who still have cotton to fix on May and July.

Anyone holding cash cotton that is hedged with short futures has no other choice but to get rid of this position as soon as possible. Holding it past June is not an option, because of the 500-point inversion between July and December. The longer traders hold on to their basis-longs, the bigger the risk of a further drop in the basis

This, combined with the 7.81 million bales in unfixed on-call sales on current crop futures, has been adding fuel to an already hot market, at a time when JP Morgan announced that a fifth commodity 'supercycle' may have begun. In other words, we are in a situation in which trade shorts need to cover, while speculators and index funds are quite comfortable holding on to their longs.

The NCC plantings survey came in at 11.5 million acres, which was near the consensus number. This gives us a good starting point for the new crop guesswork, with the NCC putting out an initial crop estimate of 16.7 million bales, which is based on 9.4 million harvested acres and a yield of 855 pounds/acre. Remember, this season we had an unusually high abandonment of 28%, which allowed only 8.7 million acres to be harvested.

So where do we go from here?

Trade shorts are feeling the heat and at the moment we see no easy way out for them. What worries us is that traders are still stubbornly hanging on to their positions, as futures open interest has barely budged over the last five sessions, dropping only slightly from 248.1k to 247.3k contracts. This is quite remarkable considering that we are in the midst of a front month liquidation.

This means that we still have two large contingents of longs and shorts opposing each other, with neither side willing to yield. Considering that US cotton is selling out fast and that speculators currently have no reason to get out of their longs, the shorts seem to hold the short end of the stick.

The tight US balance sheet and the uncertainty regarding new crop plantings, which will be with us for the next 3-4 months, make it unlikely that the market will reverse course anytime soon. While we may get another calm period after the March liquidation, the problem isn't going away and we have a feeling that this is going to end badly for many of these trapped shorts.

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