PLEXUS Market Comments

Market Comments – March 12, 2020

NY futures came under renewed pressure this week, as May lost 365 points to close at 59.70 cents.

Since February 19 the May contract has now lost 995 points and a look at the candlestick chart illustrates that sellers are firmly in control. May closed today at its lowest level since early September and there is still no end in sight to the downtrend.

Considering what is currently happening around the globe, the cotton market didn't really stand a chance this week. The coronavirus continues to spread fear and panic, with economic activity grinding to a halt. The Dow Jones had its worst ever point drop today and its 4th largest percentage decline. Only in 1987 and twice in 1929 did we see greater daily percentage drops, which tells us that we are witnessing a generational event.

Last week we talked about how overvalued the US stock market has been to begin with and sadly it is still considered 'extremely overvalued' today, even after a dropping 28 percent in just 4 weeks. The Wilshire Total Market Cap has lost about USD 9.5 trillion during this decline, but its ratio to GDP is still at an elevated 116%. The long-term average is 84%, so by that measure equities could shed another 27% from current levels.

There are severe dislocations in credit markets, as there is often 'no bid' for riskier securities. Financial institutions are scrambling for liquidity, which has prompted the Fed to inject USD 1.5 trillion in short-term loans to provide a backstop. It is also widely expected that the Fed will take interest rates to zero in the near future. So far these measures have failed to renew confidence, as a reaction rally to the Fed announcement has failed today and the Dow Jones closed near its low of the session.

The Fed will have to resort to bigger guns, like buying exchange traded funds (ETFs) of stocks and corporate bonds, as other central banks have done. The government is also likely to step in with another round of TARP (Troubled Asset Relief Program) and/or similar programs. Since asset bubbles are a lot bigger this time around compared to 2008, it will probably take at least USD 4-5 trillion in Fed money printing and 2-3 trillion in TARP to put the economy back on its feet.

While these measures should eventually succeed in reflating asset bubbles, there will be a high price to pay. The more money the Fed prints and the more the government goes into debt (some of which will ultimately be monetized by the Fed anyway), the bigger the destruction of purchasing power is going to be. We still believe that the most likely long-term outcome will be stagflation or an inflationary depression.

However, in the near-term we have to deal with strong deflationary forces, as global supply and demand shocks are taking a huge toll on global GDP. Many businesses will run into cash-flow issues and some of them will fail, while unemployment is going to rise and consumer confidence is dropping over a cliff. Unlike in 2008 there is no quick fix and at this point it is still anyone's guess as to how long this crisis is going to prevail.

When we look at the cotton market in isolation, we had a record export sales report to brag about this morning, as low prices enticed 21 markets to book 661,900 running bales of Upland and Pima cotton last week. Shipments were great as well at 439,400 running bales. However, when these sales were made, the Dow Jones was still about 5,000 points higher and the US wasn’t in full-blown crisis mode yet. A lot has changed for the worse in just a few days!

For the current marketing year we now have commitments of 15.4 million statistical bales, of which nearly 8.0 million bales have so far been exported. A report by the USDA actually showed a 0.6 million bales higher shipment number by the Census Bureau, which appears to be the more accurate figure. This would mean that exports are already at 8.6 million bales, which is supportive.

Tuesday’s WASDE report turned into a side show with all that’s happening in outside markets. It showed higher global beginning stocks (+0.19 million bales), global production (+0.26 million) and a drop in global mill use (-0.85 million). Global ending stocks were up 1.28 million to 83.40 million bales, while ROW stocks are up 0.52 million to 48.90 million bales. Some of the more important changes were a US production drop to 19.8 million bales (-0.3 million) and a 1.0 million bales drop in Chinese mill use. Chinese imports were also lowered by 0.25 million to 8.25 million bales.

So where do we go from here?

Financial markets are melting down and a lot of paper profits are being destroyed in a very short amount of time. The US stock market alone lost nearly USD 10 trillion in just four weeks! The virus crisis is freezing economic activity and this will take a significant toll on global GDP. The is no telling where this falling knife will finally stick. Most likely it will take massive bailouts by Central Bankers (monetary) and governments (fiscal) to finally halt the slide.

Cotton will have a tough stance in this environment. As stated before, in 2008 global mill use dropped nearly 14 million bales and we expect another significant drop this time around. Consumers are hunkering down, fearing for their health and worrying about jobs and evaporating portfolios. This does not bode well for cotton consumption over the coming months.

This crisis is far from over and will likely deepen over the coming weeks or even months. The world as we know will change for a while and markets will continue to deleverage further. This is a time to play it safe and we would advise to seek

protection via options, even at these seemingly low levels!

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