PLEXUS Market Comments

March 14, 2019

NY futures continued to trade higher this week, as May added another 119 points to close at 74.30 cents/lb.

The market rallied somewhat unexpectedly this week on what appeared to be light spec short-covering into trade scale-up selling. However, May was unable to take out the January 30 closing high of 74.72 cents, which marks the upper end of a 56-session sideways range. Since December 21st the May contract has settled no lower than 71.11 and no higher than 74.74 cents.

Although overall open interest was up by only 657 lots to 220,996 contracts over the last five sessions, May open interest has dropped by 6,741 lots to 111,926 contracts, while July, and especially December, saw their OI increase by a combined 7,398 lots. This fits our narrative, as we expected to see some spec short-covering in the front, while the trade is using strength to put on additional short hedges in the back.

The latest available CFTC report as of March 5 showed that speculators had bought 0.22 million bales to reduce their net short to 2.25 million bales. However, outright spec shorts remained more or less unchanged at 7.71 million and are still the bulls' biggest hope for providing the fuel for a short-covering rally.

The trade was a light net seller of 0.05 million bales, thereby increasing its net short to 5.12 million bales, while index funds were also net sellers, reducing their net long by 0.17 million to 7.37 million bales.

Since spec short-covering takes place in the spot month, while trade selling is more likely to weigh on back months, particularly December, it can distort spreads. Yesterday the May/Dec spread closed at an inversion of 113 points, while the July/Dec spread was 222 points inverted. Although these inversions have narrowed again today, to have current crop trading above new crop only makes sense if nearly all of the cotton were to be committed by the middle of June.

Since this is probably not going to be the case and we will likely end up with a chunk of unsold cotton that needs to be carried into the third quarter, these inversions should eventually give way to carry. In other words, even if May were to rally because of spec short-covering or some excitement about a trade deal with China, the front month would sooner or later get reined in again, unless December were to move up as well.

Looking at last Friday's WASDE there is no reason to believe that new crop has much upside potential at this juncture. ROW ending stocks look ample at 43.72 million bales, which is 0.60 million bales more than last season and 9.24 million bales more than two years ago. And as we head into the 2019/20-season, early projections are for a substantial increase in production, both in the US and globally, which could add to global inventories unless demand perks up.

Weather could of course derail these high production expectations and the market will therefore be sensitive to news on the weather front as we head into the growing season. There are already some concerns about West Texas, which has received a lot less moisture than normal since November. However, with an El Nino starting to establish itself, the summer outlook for West Texas calls for above normal precipitation and below normal temperatures. El Nino years are typically favorable for US Agriculture!

US export sales for the week ending March 7 were quite decent at 220,100 running bales for both marketing years. Participation was good with 16 markets buying, while shipments of 300,000 running bales were about 25% short of the pace needed to make the USDA export estimate of 15.0 million statistical bales. For the season we now have commitments of just under 13.2 million statistical bales, of which a little over 6.5 million bales have so far been exported. New crop sales are at 2.4 million statistical bales.

So where do we go from here?

What looked like light spec short-covering has pushed the market towards a crucial resistance area on Wednesday, where a 9-month downtrend line, the January high and the 100-day moving average are all clustered together just above 7600. Although the market seems to have failed in its latest attempt, even a sideways move will eventually catch some of these resistance points and this would likely trigger a wave of spec buying.

As we have stated last week, it may take some patience on the part of the bulls, but sooner or later we expect spec short-covering to move the market into the high 70s or low 80s. The trade would probably be a scale-up seller into strength and for reasons mentioned above we don't expect the market to transition into a new bull market anytime soon, but instead move to a slightly higher trading range.

Report Courtesy: The Plexus Group

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