PLEXUS Market Comments

Market Comments – February 20, 2020

NY futures moved slightly higher this week, as May added 74 points to close at 69.37 cents.

The May contract traded in a 216-point range during this holiday-shortened week, between 68.08 and 70.24 cents, with spreading accounting for most of the action. Tomorrow will be the last trading day before March heads into its notice period and today the March/May spread tightened from 117 to just 62 points.

Considering that this represents only about a third of full carry and with the certified stock at a relatively low 33,349 bales, maybe we are going to see a more lively notice period for a change.

The July/Dec spread, which closed today at July 20 points over, is another indication that that market currently doesn't expect to carry much cotton over the summer. With US cotton still selling at a fast pace and with new crop acreage expected to be 5-9 percent lower next season, some merchants may feel that it would be a good idea to take control of the certified stock.

This week we got the first official guesses on US new crop acreage, first by the National Cotton Council and then by the USDA Chief Economist. The NCC came up with 12.98 million acres, while the USDA was at a more bullish 12.5 million acres. If we take the middle of these two estimates and plug in average abandonment and yield numbers, we come up with a crop of around 19.5 million bales. This is of course still a moving target as weather will be the deciding factor.

However, there seems to be a trend towards slightly lower plantings in the coming season, as the US, Pakistan and China are looking at less acreage than a year ago. This may be enough to give merchants and mills a reason to mop up existing supplies, which is why the market has been holding up so well despite the coronavirus threat.

We feel that financial markets are currently mispricing the risk associated with this epidemic and its economic fallout. While the virus may not be as deadly as initially feared, it is quite contagious and millions of people are changing their behavior because of it, either voluntarily or because authorities force them to. This week there were new clusters in South Korea and Japan, which prompted the CDC to issue a travel warning.

This will almost certainly lead to reduced economic activity, be it because of less travel or because people are avoiding public venues like restaurants, shopping centers and events. Fear is a powerful motivator and if this virus continues to spread, it will at some point get the attention of markets.

So far traders have shown little concern, perhaps in the belief that governments and central banks will come to the rescue as usual. But these entities are not omnipotent and with markets already priced to perfection, it doesn’t take much to turn the tide.

There was some excitement this week about an announcement by China’s Customs Tariff Commission, stating that companies can apply for exemptions from additional tariffs on US imports, including cotton. ZCE futures reacted with a limit-up move and the optimism spilled over into NY futures as well, but the market was unable to hold on to initial gains.

Perhaps traders realized that China has enough supplies for now and that the price gap between the CC-index and the A-index has closed, which means there is currently no great incentive for Chinese buyers to chase after foreign cotton. However, the announcement solidified underlying support, because China will likely be there to buy US cotton on dips.

So where do we go from here?

Even though the market has been channelling higher since the beginning of February, we see no reason for prices to move much higher from current levels.

The latest CFCT report showed that speculators have the lowest exposure in the cotton market since last April and given the uncertainty about the coronavirus, this isn’t likely to change anytime soon.

The trade continues to be a light net buyer of current crop futures, as the latest on-call report still showed 6.05 million in unfixed on-call sales on March, May and July versus 2.39 million in unfixed on-call purchases.

The market looks well supported at 67 cents and unless the virus situation escalates, we see currently no reason for this support to cave in. The upside seems limited by the large amount of unsold cotton in India, which should keep a lid on prices at around 70-71 cents. We therefore see a continuation of the recent sideways trend.

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