PLEXUS Market Comments

Market Comments – October 22, 2020

NY futures rallied further this week, as December gained another 272 points to close at 71.94 cents.

December continued to push higher on speculative buying, closing today at the highest level for a 'nearby' futures contract in over 17 months. What's surprising to us is that open interest keeps expanding, which means that the trade is still fighting speculators and index funds by adding more shorts.

This was confirmed by the latest CFTC report, which showed that during the week of October 8-13, when December traded between 67.10 and 69.47 cents, speculators added 1.12 million bales net to increase their net long to 6.38 million bales. In the 'large speculators' category the 'long-to-short' ratio is now at nearly 10-to-1.

Index funds were basically unchanged, down just 0.04 million bales to a net long of 7.55 million bales, while the trade was a strong seller, adding 1.07 million bales to boost its net short to 13.93 million bales.

While physical prices were lagging NY futures in the early stages of this bull market, we have recently seen a rebound in basis levels on top of higher futures prices. China, India, Pakistan and Brazil have seen strong demand for their cotton, be it from merchants and/or local mills.

China’s futures market rallied to over 101 cents earlier this week, before cooling off a bit. But the most active January contract still closed above 98 cents today, while the CC-Index was at around 99 cents. Compared to these prices, international offers in the mid-to-high 70s look quite attractive and while China limits the flow of raw cotton imports, cheap yarn made from Indian cotton and other foreign growths will still find its way in.

US export sales maintained a robust pace despite the higher price level, as 278,700 running bales of Upland and Pima cotton were sold for both marketing years. Pakistan led a pack of 18 markets with 97,200 RB, while China added 74,400 RB. Shipments maintained a decent seasonal pace, with 201,500 RB going to 19 destinations.

Total commitments for the current season have now reached 9.1 million statistical bales, of which 2.9 million have so far been exported. That compares to 9.7 million in sales and 2.4 million bales shipped a year ago. Considering that the US crop is about 3 million bales smaller than last season, the pace of export sales is quite supportive!

Even though the trade as a whole is still bearish and believes that sooner or later excess global stocks will weigh the market down, there are currently a number of bullish drivers that are difficult to ignore:

1) the strong technical picture
2) positive money flows into commodities by specs and index funds.
3) smaller than expected crops in the US and India
4) better than expected near-term demand (pent-up demand and restocking)
5) a lack of sell-side liquidity in the futures market (trade shorts are trapped)
6) strong competing crops – grains and soybeans rallying

The trade continues to fight the bullish trend and we have yet to see any short-covering. Today’s on-call sales report showed that mills still had 3.17 million bales open on

December and 3.12 million on March, with the overall unfixed on-call sales position amounting to 10.56 million bales.

There is some hope than an increase in the certified stock (currently just 33.4k bales) might derail spec longs. But speculators won't carry their positions into the notice period and are instead going to roll their longs into March in early November, along with index funds.

Therefore the only way to hurt the specs is forcing the Dec/March spread to widen, which would make it more expensive for longs to switch their positions into March. But whether that would deter speculators from continuing their positions is doubtful as long as the trend remains this powerful.

So where do we go from here?

The bullish trend accelerated this week and the trade has its back to the wall. The trade net short position is probably at over 15.0 million bales by now and we wonder much longer it will be able to fight this trend.

Although the market is clearly 'overbought' and a correction is overdue, the fact that we closed at a 17-month high on the continuation chart provides speculators with more staying power. In other words, instead of booking profits, longs might add to their positions, which would put the trade into a dangerous position.

Time is starting to run out for the December shorts (fixations) and unless we get some sell-side liquidity soon, the odds for a powerful short-covering rally will increase. Maybe the upcoming roll period and the US elections will move some specs to the sidelines, but we wouldn't bet on it.

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