PLEXUS Market Comments

Market Comments – January 23, 2020

NY futures closed a volatile week basically unchanged, as March settled just 19 points lower at 70.03 cents.

After gaining nearly 800 points between December 4 and January 13, the market has started to pull back, with the erratic swings of this week signalling that there is some uncertainty and confusion among traders.

We believe there were two factors capping the market this week. First we had an outbreak of a new coronavirus, which originated in Wuhan, China and has since spread to other parts of the world. Markets don't like uncertainty and until we know what the threat potential of this virus is, traders tend to tread more carefully. This is particularly true for the spec sector, which has been the driving force in the market.

The other, more fundamentally relevant reason, was the sharp drop of cotton prices in China and India this week. In the former it was probably a combination of the virus outbreak, abundant local supply and the potential for more imports after the signing of the US/China trade deal that added up to a more negative sentiment.

In India it seemed to be the strong pace of arrivals (over 220k bales daily) and a higher crop estimate that weighed on values. Although the CCI has been supporting prices by absorbing about 4 million bales so far, these bales will eventually find their way back into the market after harvest has been completed, which should keep a lid on values.

With prices in the two largest cotton producing countries under pressure, it has become more difficult for US prices to maintain their upside trajectory. However, the US has already committed about two-thirds of its available supply, possibly more if we include August onward shipments that need to be supplied from existing inventory. This means that sales pressure shouldn't become too strong at this stage. It is now more a question of getting existing commitments shipped in a timely manner.

Also, the need for the trade to sell current crop futures becomes less with every week of additional sales. There are still 7.24 million bales in on-call sales that need to be fixed on March, May and July, whereas corresponding on-call purchases amount to just 2.67 million bales. In other words, we don't expect to see a lot of selling pressure from the trade in current crop futures and believe that speculators remain in control of the market.

Speculators have been strong net buyers since early December and were behind the push from 64 to 72 cents. CFTC data shows that in the six weeks between Dec 3 – Jan 14 speculators bought 4.80 million bales net, while index traders bought 1.28 million bales.

The trade was selling into the rally, adding 6.08 million bales during the same time frame to boost its net short to 10.74 million bales. Again, we don't think that the trade has a lot of room to expand its net short in current crop futures and most of the new selling will occur in December as growers start to hedge new crop.

Speculators were just 2.67 million bales net long last week and they certainly have room to expand that position by several million bales. However, speculators are mostly momentum and trend followers and we just broke through a short-term uptrend line, although the primary uptrend remains in force and we would have to break below 6700 to change that.

Furthermore, the commodity complex has been performing poorly recently, with the GSCI index down nearly 8 percent since January 6, as commodities like crude oil, copper or soybeans have all been under pressure. Against this backdrop it will be difficult for speculators to adopt a bullish stance on cotton.

So where do we go from here?

We feel that neither speculators nor the trade may have a need or desire to add to their respective positions at this point. With the chart starting to look suspect and the commodity complex underperforming, specs will probably take a backseat for now. Spec buying since early December has been mainly short covering anyway and we don't expect new spec longs to be rushing in at the moment.

The trade will probably be a light net buyer in current crop futures over the next four months until July goes off the board and new shorts will likely be put on in December. The US cash market is a bit too expensive compared to its competition, but the pace of sales is well advanced so that there shouldn't be too much downside pressure.

We could therefore see a rangebound market over the coming weeks, somewhere between 68 and 72 cents, with the next impulse probably coming from outside markets or events.

https://plexus-cotton.com