PLEXUS Market Comments

Market Comments – December 31, 2020

NY futures continued to move higher over the Christmas holiday, with March adding another 93 points since our last report of two weeks ago, to close at 78.12 cents.

After a brief correction that saw March pull back to a low of 74.28 cents before Christmas, the market has since resumed its uptrend, posting new contract highs this week.

The strong pace of US export sales continues to fuel this bull market, as there were another 318,300 running bales of Upland and Pima cotton added to the tally last week, with 17 markets participating. Shipments remained strong as well, as 290,600 RB went to 21 destinations.

In just the last 4 weeks a total of 1.73 million RB of Upland and Pima cotton have been added, with total commitments for the current marketing year now totalling 12.25 million statistical bales, of which 5.75 million bales have so far been exported. Shipments remain over 1.5 million bales ahead of last year’s pace!

The US statistical picture is getting rather tight, as total supply amounts to just 23.2 million bales according to the latest WASDE, of which 14.75 million bales have so far been committed (12.25 exports + 2.5 domestic). This leaves just 8.45 million bales still available. The corresponding number a year ago was 10.5 million bales.

The EWR (electronic warehouse receipts) data confirms this tight situation, as there were just 11.16 million running bales listed as 'total open', which compares to 14.72 million RB a year ago. The stronger pace of shipments this year makes the remaining inventory look more depleted, but we also get the sense that beginning stocks were overstated and that the crop size might be smaller than the 15.95 million bales the USDA suggests.

The latest available CFTC spec/hedge report of December 21 showed that speculators and index funds were each about 7.5 million bales net long, while the trade was on the other side with a 15 million bales net short position. This massive trade net short, which is to a large degree tied to unfixed 'on-call' sales, has been one of the key drivers behind the market's strength and will continue to force prices higher in our opinion.

There are still a lot of traders and mills who are bearish on the market, believing that sooner or later fundamentals will weigh prices down again. However, when it comes to the futures market, their bearish stance is actually the most bullish fundamental. It is similar to what is happening with Tesla shares, which are experiencing a moon-shot because of repeated short covering episodes. In other words, valuations and fundamentals sometimes take a backseat to money flows.

The NY futures market is a zero-sum game! For every buyer there has to be a seller and that's a problem for trade shorts at the moment. Paradoxically, because the trade as a whole was so bearish in recent months, they have amassed a large net short position, which they now have to cover in a market that's devoid of sell-side liquidity. Index fund longs won't sell and spec longs are currently more inclined to add to their commodity holdings than liquidate them. This means that prices will have to go higher in order to find willing sellers.

Trade shorts can kick the can down the road for a while longer, but rolling their net short position from current crop to new crop is not a realistic scenario, especially with a 400-

point inversion between July and December. Sooner or later most of these current crop shorts will have to be covered!

So where do we go from here?

The market ended the year on a high note, with March closing at a new contract high. We started the year with the spot month at 69.05 cents, then fell to a pandemic reaction low of 48.35 cents, before steadily climbing 30 cents since the beginning of April.

Speculators bought 9.90 million bales net over the last nine months, while index funds added 1.86 million in net longs. The trade fought the trend all the way up and boosted its net short position by 11.76 million bales to just under 15.0 million bales. With little additional cotton left to sell, yet a lot of current crop shorts to unwind, the trade has maneuvered itself into a corner.

As mentioned above, the lack of sell-side liquidity makes it difficult for the trade to get out of its net short position, and unless some outside event triggers sizeable spec selling, the market will likely move higher. Next Tuesday's senatorial election in Georgia, which will decide the balance of power in Washington, has the potential to cause some havoc in financial markets, but beyond that most factors line up in favor of higher prices.

A weaker dollar, rising grains/soybean prices, strong Chinese prices, a bullish chart and a tightening US supply situation are all supporting a rising market and unless we see a change in the current setup that would prompt speculators to sell, trade short-covering will likely move the market above 80 cents.

Happy New Year!

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