PLEXUS Market Comments

June 18, 2020

NY futures had a mixed performance this week, as July rallied 115 points to close at 61.17 cents, while December was up just 3 points to close at 59.52 cents.

Even though the primary trend is still bullish, the December contract, which is now the lead month, has gone nowhere over the last six weeks. Since May 8 it has settled in a relatively narrow sideways range between 57.32 and 60.98, closing right in the middle of it today.

The July/Dec spread inverted further, closing today at 165 points July over. The remaining July shorts are slow in getting out, as there were still 14,091 contracts open before today's sessions, which is raising fears that some of these procrastinators may get trapped as we approach First Notice Day on June 24, which is next Wednesday.

We believe that the small certified stock of currently 31k bales is already spoken for, as one or two merchants will likely absorb these bales and possibly demand more, with abundant commitments to China justifying their move.

Today's US export sales report showed a familiar picture, with China and Vietnam once again taking most of the 250,900 running bales of Upland and Pima cotton that were sold for both marketing years. China accounted for 114,900 RB, while Vietnam booked 119,300 RB. Shipments were robust at 354,200 RB and beat the 312k pace needed to make the current USDA export estimate.

Total commitments for this season have risen to an impressive 17.85 million statistical bales, of which 12.7 million bales have so far been exported. That compares to last year's 16.2 million in commitments and 11.84 million in shipments. Based on these stellar numbers one would never guess that we are in the midst of a severe global recession.

Since March 12, when the ROW started to lock down due to the pandemic, total Upland sales for the current and next marketing year have increased by 3.36 million running bales, from 16.64 to 20.00 million running bales. China (+1.87 million bales) and Vietnam (+0.68 million bales) accounted for 75 percent of the net increase, while all other markets added just 0.81 running million bales over the last three months.

There has been some confusion in regards to the volume of Chinese purchases, after a news network reported that US Trade Representative Robert Lighthizer stated that China had bought USD 1.0 billion worth of American cotton since February. However, listening to Lighthizer's testimony in Congress it appears that he was referring to the 3.4 million bales that China bought for the entire season so far.

According to Lighthizer China is honoring its promise to buy US Ag products and this helps to explain the strong pace of US export sales. He further stated that he expects China to continue as a strong buyer in the months ahead. Lighthizer gave China credit for doing so despite dealing with a struggling textile industry. This last statement confirms that it isn't strong demand that has led to all the recent buying, but that this is simply a transfer of inventory from the US to China for political reasons.

The bulls continue to get support from the situation in West Texas, where the situation looks dire as far as dryland acreage is concerned. Hot and dry conditions combined with high winds have taken their toll, with only a small amount of dryland making it this year. Even irrigated fields are struggling in some areas. At this point it looks like a below average crop in West Texas and it will likely put a big dent into the USDA's crop estimate of 19.5 million bales.

Financial markets continue to be stoked by the massive money printing effort that is taking place. This week the Fed started to add individual corporate bonds to its buying list, in addition to the exchange-traded funds it has already been purchasing. It is mindboggling to see how much money supply has expanded in the US since this crisis unfolded.

M2 money supply increased by an unprecedented $2.645 trillion to $18.153 trillion over just the last 14 weeks. To put this into perspective, this increase is equivalent to the entire GDP of the United Kingdom!

On a yearly basis M2 has now grown 23.4% and the only reason we are not seeing inflation yet is because the money is not turning over in the economy. The savings rate has been shooting up and some of that money is being invested in the stock market, which is getting more overvalued by the week.

So where do we go from here?

It will be interesting to see what happens when July goes into the delivery period next week. A squeeze is still possible, as shorts are slow to get out of harm's way and there seem to be willing takers. A final push higher in July would probably drag December with it and we could see new crop values trade in the low 60s over the coming week.

However, while the US market has the best fundamentals among all origins and 'risk on' financial markets may continue to rub off on cotton, there is no denying that there is way too much inventory around the globe, which is sooner or later going to put pressure on prices.

We are already seeing basis pressure in several origins and this is only going to get worse unless US prices finally cave in as well. It may take a while, but US new crop values are unlikely to stay in a bubble, even with China buying additional quantities. We would therefore use a move into the low 60s to put on some downside protection, but only via puts or put spreads. The current environment is simply too unpredictable to place outright bets on the market!

https://plexus-cotton.com