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ROSE ON COTTON – COTTON MARKET SOARS AMID DEPRESSED DEMAND, MARKET BEING SQUEEZED?

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ICE July cotton soared for the week ending June 5, with the July and Dec contracts gaining 420 and 350 points to finish at 61.79 and 60.98, respectively, with the July – Dec switch inversion strengthening to 81 points. Last weekend, our proprietary model (timely results provided in our complete weekly report) predicted a finish that would be near unchanged to lower Vs the previous Friday's settlement, which proved to be wrong. Dec is now the de facto lead month by virtue of having the largest open interest.

Most analysts will suggest that ICE cotton moved higher to start the week when a 500K bale exchange for physical (EFP) transaction was made known to market participants, many of whom interpreted this information as a harbinger of increasing demand. Cotton also moved higher on a much lower than expected US unemployment rate (just south of 14%, which is still atrocious), weakening us currency (the US Dollar Index has lost around 3.5% since May 15), spec and mill short covering, and positive sentiment regarding the Wuhan pandemic. Production concerns across the US and abroad also lent support to the cotton market.

While we agree with the analysts touting US currency value, let us remind our readers of one absolute fact: there is currently no demand for cotton – especially for US bales as spot quotes are no longer competitive with those of Brazil, India, West Africa, and other exporting origins, the aforementioned weakening US dollar notwithstanding. Sources tell us that the EFP transaction was between a major international cotton merchant and government entities in China as a settlement against large on-call commitments incurred over the last several weeks. Hence, it seems the transaction did not signal a remarkable revival of demand for US cotton. Our friends on the consumption side have repeatedly queried us (and others we know) regarding the puzzling upward movement of ICE cotton futures as they continue to be saddled with burdensome raw cotton stocks and rising yarn inventories. Why, they wondered, is July inverted over Dec if there is no nearby demand for cotton? Who, they asked, is buying cotton as they themselves have tried to contract merchants to sell their cotton sitting at ports via consignment or other arrangements?

We believe the market is being squeezed – and not via fundamental and/or physical strategy.

Entities with knowledge of mill on-call positions against July (a contract from which mills cannot roll forward) are in position to lengthen their positions via futures and options and wait for mills to capitulate on their hopes of lower prices prior to the first notice day for the July contract and then ride the market higher on the inevitable short-covering associated with mill fixations. They are also privy (at least in a relative manner) as to when the short-covering ammunition runs low and then can not only liquidate their profitable longs (leaving enough length in their positions(s) to take any cert stocks that have accrued off the board), but also sell the market short and ride the retracement (which is often swift) to another quick round of futures profits.

Note that the trade also functions as a speculator. Profits from directional trading are an integral portion of their profit strategy.

This is a nightmare for mills with unfixed on-call commitments. Conversely, it offers producers a tremendous opportunity – if they are wise enough to take this gift and not attempt to milk the current rally. As one of the people in our organization is fond of saying, "this market is gonna drop like a one-egg puddin'". While the balance of our group has never quite grasped the meaning of this phrase, we assume it means "steeply". All things considered such seems likely.

For the week ending May 31, the USDA estimated planting of the 2020 cotton crop at 66% complete, up 13 percentage points Vs the previous week. Planting progress remains on par with the rolling 5-year average pace, despite slow progress across the Mid-south and the southeastern states. The crop was also rated in 44% good or better condition which, historically, is not bad.

We toured the northern delta recently and this is the latest crop we have seen in the area. It is not that a lot of cotton was planted after May 20 – and especially not after May 25. Rather, it is that so much of it was planted late within the planting window. Scott was in the southern portion of the Delta late in the week and reported that most of that crop looked good, with acreage there much closer to alignment with the USDA's Mar 31 projection.

For the coming week, West Texas, southwestern Oklahoma and southern Kansas are expected to continue to have to endure hot and dry conditions while the Mid-south the eastern Gulf Coast are expected to see heavy rains as tropical storm Cristobal makes landfall near the Big Easy. Producers across the southeastern states are also likely to see significant precipitation this week. Given that planting season has closed for these areas, rains will not be overly unwelcome.

USDA will release its June WASDE report on Thursday, June 11 at noon, ET. While we are still working on our estimates and projections, 2019/20 production and projected 2020 planted area will not change Vs May, although yield and abandonment figures could be adjusted significantly. The official estimate of domestic old crop carryout seems likely to increase significantly with a likely reduction to the export estimate. New crop is not off to a great start, but the USDA will likely not kill either the domestic or aggregate world crops just yet.

Net export sales and shipments against 2019/20 were notably lower (sales were net negative) Vs the previous sales period at approximately (10K) and 240K RBs, respectively. The US is 115% committed and 80% shipped Vs the USDA's export projection. Despite being negative, sales remained ahead of the average weekly pace required to meet the USDA's export target while shipments were only 75% of the pace requirement. Sales against 2020/21 were also notably lower at approximately 12K RBs. Sales cancellations were significant at around 34K.

China was not a net purchaser for the period. Further, we think that the latest figures are bearish at current trading levels and show the lack of price competitiveness of US cotton and current levels.

The International Cotton Advisory Committee (ICAC) has modestly increased its projection of 2020/21 world consumption to the equivalent of 109.25M 480K bales, which is far below the USDA's 116M+ bale projection. Further, ICAC projected 2020/21 cash prices (Cotlook A-Index) at a 14-uear low of 58.80.

China imported 125K MTs (573K bales) in April. In both northern India and eastern Africa notable infestations of locusts are threatening this season's crop. Despite earlier forecasts for larger Brazilian acreage in 2020/21, acres are now trending southward of the 2019/20 level.

For the week ending June 2, the trade significantly increased its aggregate futures only net short position against all active contracts to approximately 5.5M bales while large speculators flipped their aggregate net short position to a modest net long of almost 223K bales. The data, combined with open interest figures since the report's effective date, suggest that while there are still spec shorts against July, the net position is likely now approaching flat. This does not suggest further surging of the market – at least not for any meaningful length of time.

For an in-depth analysis of CFCT data see our weekly CFTC analysis and commentary.

For this week, the standard weekly technical analysis for and money flow into both the July and Dec contracts has turned bullish, but the market has also quickly breached overbought levels. Planting progress, weather reports (especially for West Texas), US export sales data and news regarding US – China relations likely each possess market moving potential this week, but the WASDE and export reports likely wield the greatest potential for affecting futures prices, at least from a fundamental perspective. Index fund rolling continues this week, which should apply some drag to the market.

Have a great week!

Report Courtesy: Rose Commodity Group

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