Rose Commodity Group

ROSE ON COTTON – COTTON MARKET CRASHES ON RECESSION FEARS

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The May contract crashed last week, giving up 599 points to finish at 78.18, well below the lower end of the long-term trading range. The market finished limit -down on Friday, and the Mar – May spread weakened to (76). Last week, our models predicted a finish on the week that was to be near-unchanged to higher Vs the previous week's finish, which proved to be incorrect. However, we recommended no trading bias on the week due to the release of the Mar WASDE report. The May contract has commenced the new week significantly higher.

The cotton market finished lower on bearish updated USDA balance sheets, continued slow export sales, hawkish statements by Fed Chairman Powell, and on the second largest bank failure in US history. The latter two are blamed for pushing equities and our market much lower on Friday.

In its Mar WASDE report, the USDA's domestic balance sheet was a carbon copy of the one put forth in Feb, despite clear evidence that 2022 production is significantly lower than the currently officially projected 14.68M bales. At the world aggregate level, production was projected significantly higher at 115.1M bales while consumption was lower by 550K bales at 110.1M. Increased beginning stocks pushed carryout 2.07M bales higher, which was a surprise. Consumption for the 2021/22 was reduced 1.07M bales.

Hence, the report was bearish. However, there is little faith in the domestic balance sheet, which carries disproportionate weight as only US bales can be delivered against ICE contracts.

West Texas remains under droughty conditions, and this is seriously raising production concerns for 2023. The majority of the balance of The Belt has no drought issues; in fact, most producers are hoping for dry weather so that pre-planting fieldwork can be accomplished. Airplanes have been spotted across many locales applying burndown herbicide applications.

In other news, Silicon Valley Bank (SVB) – an institution known for venture capital investment – was shuttered by regulators on Friday; on Sunday, Signature Bank – known for its involvement with crypto currencies – was closed by federal bank regulators. The SVB closure was the second largest in US history and brings to mind visions of 2008 and the Great Recession. Consumers know the economy is not in good shape, despite improving labor numbers. Cotton Incorporated's latest consumer survey shows a notable rise in concerns regarding the US economy, and this will almost certainly make itself evident in domestic offtake of textile goods. Fed Chairman Powell did little to build confidence this week when he reversed previous statements and indicated the Fed would likely continue to pursue aggressive interest rate hikes to slow inflation.

For the week ending Feb 2, US export sales were only just above 118K RBs, with sales against the upcoming MY net negative by almost 69K RBs. Shipments were more than 290K RBs, which is above the pace requirement to meet the

USDA’s current export projection. An increase in sales has been noted at the lower end of the current trading range, so new sales could be logged and hedged soon.

Internationally, the Cotton Association of India has again lowered its estimate of 2022/23 production, this time to the equivalent of 23M 480lb bales, which is a decade low. While export competition from India has been abated, their mills cannot import cotton without significant duties. In other news, demand for Brazilian cotton continues to contract, following a strong finish to the recent season. Brazil has potential for a bumper crop this season, which will compete with US bales for export business, particularly into China.

For the week ending Feb 21, the trade trimmed its net short position to approximately 3M bales while large specs flipped their aggregate net long position to a significant net short of around 1.5M bales. This week’s early rally could be spec profit-taking on any remaining shorts.

The standard weekly technical analysis for and money flow into the May contract remains bearish but approaching oversold. Economic news will likely be the main focus for markets this week.

Producers still holding old crop have two arguments in their favor: Continued volatility, which can produce 5-8 cent moves with little fundamental justification, and the likelihood of a pre-plant rally in the next 8 weeks. While we see the potential for a return to the high 80s or low 90s base May based on these two factors, that potential carries a “Best Used By” date, and by late April, we’ll b ready to throw in the towel and focus exclusively on new crop.

We don’t see a reason to get aggressive on new crop forward contracting. The basis is decidedly lukewarm, and we believe that between the anticipated pre-plant rally and the potential for a late summer drought rally, the potential remains to price new crop well into the 90s. We recommend using the option pit to lay a floor under current prices on rallies to or through the mid-80s until the basis or contract prices get to a more attractive level. In the meantime, Soybeans continue to offer the most attractive competition for acres, and that market bears close watching.

Have a great week!

Report Courtesy: Rose Commodity Group

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