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ROSE ON COTTON – COTTON MARKET BREACHES 70.00 ON INCREASED BUSINESS PROSPECTS FROM CHINA, BUT US-CHINA TENSIONS INCREASING

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The ICE Dec cotton contract gained 228 points for the week ending Oct 16 (410 over the fortnight), finishing at 69.92; the Dec – Mar switch strengthened to (64), well below full carry. Last weekend, our proprietary model (timely results provided in our complete weekly report) predicted a finish that would be near unchanged to higher Vs the previous Friday's settlement, which proved to be correct. However, we decided not to trade this bias based on loose S&D balance sheets.

ICE cotton apparently ignored weakness in equity markets and a disappointing US export report, rallying on prospects of increased business with China and US crop quality concerns following Laura and Delta.

The USDA continues to estimate this season's domestic harvest progress as effectively on par with the rolling 5-year average pace. The crop was most recently estimated at 26% harvested. Fortunately for producers, mostly dry conditions are expected across most of The Belt over the coming week, but a depression has formed in the Caribbean and could develop into a tropical storm or hurricane by late next week.

Net export sales were significantly lower Vs the previous assay period while shipments were higher at approximately 120K and 210K RBs, respectively. The US is 60% committed and 18% shipped Vs the USDA's 14.6M bale export projection. Both sales and shipments were off the pace required to realize the USDA's target. With that said, commitments are well ahead of the long-term average pace for this point in the season while shipments significantly lag the longer-term average.

Internationally, China has reportedly ordered spinning mills within its borders to cease buying Australian cotton or face a loss of export quota allotment, which would approximate a 40% tariff on Aussie bales. Continued strained relations over China's handling of the early stages of the coronavirus pandemic and human rights abuses are broadly thought to be behind animosity between the two nations. While this could translate into increased demand for US cotton from China, tensions between the US and China are escalating. China has just announced that it is considering detaining US citizens in China if the US Justice Department does not drop criminal charges against Chinese scientists accused of spying and intellectual property theft while also working at US universities. It goes without saying that this situation is very, very serious.

Elsewhere, some European countries are considering another round of lockdowns amid notable spikes in COVID-19 infections. We believe that such would be detrimental to demand for value added cotton products even as some pundits argue that consumers will transfer some of their disposable income from entertainment and dining to purchases of textiles. We are aware of no data to support such notions, especially during a severe worldwide recession, which is really just a more benign term for depression.

For the week ending Oct 13, the trade increased its futures only net short position against all active contracts to approximately 12.75M bales, which signals that producer selling continues to occur, while large speculators increased their net long to almost 5.8M bales.

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

For next week, the standard weekly technical analysis for the Dec contract remains supportive to bullish, with the market now notably overbought; money flow remains supportive to bullish. Market participants will likely want to see evidence of increased business for US cotton into China if cotton is to maintain its current trend.

For the past several weeks, we have encouraged producers to price 40-60% of their estimated yield at a price of 70 or better. Friday briefly saw that price, and we stand by our advice. Other commentators have advocated a more aggressive pricing strategy, but we believe the possibility of unfavorable harvest weather, election news, and/or developments in COVID treatment or vaccines all have the potential to increase volatility and increase the likelihood of brief rallies to the low-mid 70s.

Additionally, we are seeing a dramatic premium for higher quality recaps. While forward contracts are in the 150-300 off range, we are seeing bids of 250-350 on the spot month for long staple middlings. Given the possibility of quality issues lingering from this season’s storms, we believe producers who have enjoyed good harvest weather would do well to consider selling recaps to the spot market. This also allows the possibility of collecting LDP if we see the market drop below 6800 prior to invoicing. See your local buyer for more details.

This variance in basis also serves as a good example of the advantages of hedging via put options. Mar or May puts at current levels allow a producer to hold what could well be a seasonal high, while still allowing the flexibility to take advantage of fluctuations in the spot basis.

Have a great week!

Report Courtesy: Rose Commodity Group

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