ROSE ON COTTON – COTTON MARKET CONTINUES TO TAKE A BEATING, POTENTIAL FOR DEMAND DESTRUCTION ON HORIZON

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It was just another atrocious week for ICE cotton amid the Wuhan virus pandemic. The May contact gave up 681 points on the week to finish at 53.68 while Dec lost 619 at 55.03. The lead month has now traded nearly 2000 points off highs realized earlier this year. The May – July spread strengthened and is effectively flat at (6) which is somewhat encouraging. Last weekend our proprietary model predicted a finish that would be near unchanged to lower Vs the previous Friday's settlement, which proved to be correct. However, we opted to remain long just north of 58.00, which closed the final gap below the market on the continuation chart.

Basically, ICE cotton moved lower with equity and financial markets on increased hysteria regarding the Wuhan virus. Among actions tied to the pandemic were the closures of the Port of Houston and the Vietnam – China border. Further, investors have flocked to US currency as a safe haven, which took the US Dollar Index 4.1% higher on the week to well above par, a bearish development for US export commodities (like cotton). Weakness in crude oil futures, spurred by the

Russia – Saudi Arabia price war (and the pandemic) is also not friendly for cotton futures. The release of another strong round of US export data on Thursday seemingly did little to stem the bleeding of ICE futures as investors anticipate impending evidence of demand destruction at the consumer level, which is a notion that will likely prove well founded.

Regarding the Wuhan pandemic, Goldman Sachs has projected that economic contraction may prove to be, at least in the short-term, as much as 24% with unemployment at 20% or higher. We have already seen initial unemployment claims begin to balloon. These figures are not indicative of an economic recession, but rather of a deep depression. The saving grace is that this situation should be temporary. The arrival of warmer temperatures and more intense sunlight as spring progresses normally severely hinders the transmission of most viruses that affect humans. We're keeping our fingers crossed.

Still, there are some positive elements of such a national crisis. It is proving to be a needed reminder that we are far too dependent on foreign entities (especially China) for many essential goods. While the most prominent item is pharmaceutical ingredients, a strong case can also be made that we are suffering from the lack of a robust domestic textile industry. The current national crisis also seems likely to provide a more concerted focus on the need for border security and regulation.

Further, we have noted the transparency of data and value placed on human life by a democratic system of government, which derives its power from its citizens Vs various other forms of autocratic governments. And this is how it should be. The collective focus and the willingness to help our neighbors that we are witnessing on a national level is also uplifting.

However – and this is not merely our opinion, but a school of thought held by many published economists – we cannot allow fear and hysteria to drive us beyond the economic brink. While this country should do all that it can to protect it citizens through necessary compulsory action in a time of crisis, it must be remembered that an economic depression also results in human casualties.

Domestically, investors are looking toward the Mar 31 annual release of the USDA's Planting Intentions report. While we have constantly thought area committed to cotton would be significantly higher Vs prominent projections, we must now look at projecting planted area significantly lower Vs 2019. The use of cotton in (mostly) discretionary value-added goods and the realization that 2019/20 carryout may be significantly higher than currently projected, coupled with the increased interest in food commodities, could take US planted area south of 12M (or even 11M) acres.

We will be firming up our projection this week.

Further, much of The Belt is again expected to see rainfall over the coming week, with rather heavy rainfall accumulations expected across the Delta and portions of the southeastern states. While field conditions are not yet an acre-curbing concern, most producers will be leery of planting late acreage for cotton at current prices, in the absence of continued subsidies or other price assurance.

US net export sales and shipments against 2019/20 were off significantly for the week ending May 12, but remained quite strong, at around 358K and 385K running bales (RBs), respectively. The US is 96% committed and 51% shipped Vs the USDA's export projection. Sales were again well ahead of the average weekly pace required to meet the USDA's 16.5M bale export target while shipments were just off the pace requirement. Sales against 2020/21 were lower at around 79K RBs; total gross new sales were in excess of 450K RBs (>1.25M of net sales over the last 3 weeks). Sales cancellations were negligible; China was again a net buyer over the period.

We continue to project US exports for 2019/20 at 17.25M bales, but we realize that this projection may have to be downwardly adjusted, depending on the development of the Wuhan virus pandemic. Port and border closures this week and the credible notion of consumer driven demand destruction are other reasons that we are open to lowering our internal projection.

For the week ending Mar 17, the trade reduced its aggregate futures only net short position against all active contracts more than 1M bales to around 4.17M while large speculators notably increased their aggregate net short position to almost 1.5M bales. The latest data either suggests that business for US cotton continues to be accomplished and/or the trade is participating in an aggregate lengthening of their position, either of which is somewhat encouraging. Further, US cotton remains competitively priced Vs competing origins.

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 the Mar contract remains bearish, with the market also remaining in an oversold condition. Overall, we think ICE futures are likely to find strong support below the current market. No doubt, traders will be keen to scrutinize news surrounding the Wuhan virus and US export data this week while also likely adjusting positions ahead of the release of the USDA's annual Planting Intentions report release on Tuesday, Mar 31.

Producers holding old crop cotton have few options in the short run. While we believe the market will recover from the virus-inspired crash, the timeline for such a recovery is far from clear. If economic activity returns to normal within a few weeks, S&D projections would likely support a return to the mid-high 60s, or possibly the low 70s on an overreaction. However, a longer period of social and economic restrictions eats deeper into long term demand. The aforementioned drop in oil prices (cheap polyester) and the fact that much cotton consumption is discretionary could spell a much weaker recovery.

In either case, the option pit does offer an opportunity to offset losses, and we would be far from the first to note that selloffs offer buying opportunities for disciplined buyers. A program of call purchases over time for the next few weeks should pay off well when the eventual recovery occurs.

New crop has a better potential, but successful markers will find both their faith and their discipline tested. Picking bottoms is a fool's game, but it is very likely that Dec 20 or Mar/May/Jul 21 calls bought in the 50s will return a nice premium prior to expiration. In a perfect world, aggressive demand following the resolution of the virus crisis will offer a profit on both the spot and the option side of the equation.

Have a great week, stay safe and try to be mindful of helping prevent the spread of the Wuhan virus!

Report Courtesy: Rose Commodity Group

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