Cotton Moves Lower on Week, Mexico Tariffs Avoided for Time Being

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Cotton Bears were winners on the week with the Dec contract giving up 156 points to finish at 66.51. July lost 249 to settle at 65.59. The July – Dec inversion weakened to nearly flat.

Last weekend, our proprietary model (timely prediction available in our complete weekly report) predicted a settlement that was to be near unchanged to higher Vs the previous Friday's finish, which proved to be incorrect. However, we did not advise trading any bias this week due to a potential trade conflict with Mexico.

ICE cotton had trouble moving higher on the week with potential tariffs bring levied against Mexico (which is now at least temporarily avoided), weakness in CME grains and oilseeds and mostly welcome rains and forecasts thereof across The Belt. An expected increase in 2019/20 domestic carryout to be put forth in the June WASDE report was yet another cautionary factory. Weakening US currency on the prospect of Fed interest rate cuts this year may have offered minor support to the cotton market.

Domestically, sowing remains near an on-par pace this season, but the crop is generally late. Rains and showers have occurred across much of The Belt since Wednesday, and parched areas across southern GA, FL, and southeastern AL received light showers with significant rains expected over the coming week. We are thrilled for our friends in that area.

US export sales and shipments fell short of our expectations. Sales and shipments against 2018/19 were off significantly for the week ending May 30 Vs the previous sales period at approximately 184K and 323K running bales (RBs) respectively. Shipments were off the weekly pace required to meet the USDA's projection of 14.75M 480lb bales. The US is 110% committed and 75% shipped Vs the USDA's projection. Sales against 2019/20 were nearly 52K RBs, with the total now at nearly 3.85M 480lb bales.

There should be no alarm regarding the most recent export data. The assay period included Memorial Day weekend and sales for the previous two periods had been off the charts against a rapidly tightening old crop balance sheet, with shipment levels very strong.

Importers in China have applied for – and have been granted – waivers of US tariffs against some American goods, including pork, but no waivers for cotton or other major US row crops have yet been noted. However, cotton is a very small piece of the US – China trade relationship and, if China begins to re-stock its strategic reserve, waivers could be in the offing for cotton imports from this US. Continued drought across Australia would likely enhance the realization of such a scenario.

Auction sales of cotton from China's strategic reserve slowed noticeably for the week ending June 7. Elsewhere, the USDA's attaché in India continues to enhance his projection of 2019/20 Indian production even as this season's monsoon continues to be delayed, with pre-monsoon rainfall pegged at its lowest level in 65 years.

The USDA will release its June WASDE report on Tuesday, June 11 at noon, ET. The monthly Bloomberg survey of cotton analysts and traders shows little expectation of change in the 2019/20 world balance sheet while also showing an expected increase in domestic carryout of nearly 200K to almost 6.6M bales. The increase in ending stocks is expected to come at the hands of increasing 2018/19 carryout. US production for 2019 was projected at an average of just above 22M bales, while our contribution to the survey was 23M bales.

Our advice for new crop producers changes emphasis this week. While we have long advocated using the option pit to price a portion of early season cotton, the combination of poor crop conditions, uncertain trade and a lukewarm basis look to make 2019 a year to price a substantial percentage of one's crop with puts.

Few producers are eager to price cotton in the mid 60s, and a late crop in less than excellent condition doesn't incentivize producers to make aggressive commitments to forward contracting. Given that one can make an argument for the Dec contract trading to nearly any level between the mid 50s and the low 80s (our personal range is substantially more constrained), put options offer the ability to market for basis later in the year, with substantially reduced risk compared to forward contracting. Should weather and trade conspire to move the Dec contract into the 70s, this advice will see some re-evaluation, but in the meantime, we see little to no downside to a portfolio of out of the money Dec 19 and Mar 20 put options.

For the week ending June 4, the trade modestly increased its aggregate net short futures only position to approximately 3M bales. Specs reduced their aggregate net short position to position to around 3M bales, mostly via short covering.

Much has been said about the trade's large unhedged new crop position, but lower prices could incite some merchants to go long in effort to source cotton from the board.

For this week, the standard weekly technical analysis for and money flow into the July contract remain bearish, with the market also remaining in something of an oversold condition. Traders will continue to closely monitor weekly US export data and crop development estimates, but it will likely be the WASDE report that has the greatest effects on next week's market action.

Have a great week!

Report Courtesy: Rose Commodity Group

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