Thompson On Cotton: Managing Risk Is The Key, And We Have Plenty To Go Around

November 1, 2020
By Jeff Thompson, Autauga Quality Cotton Association

The ghosts and goblins of Halloween came early last week. In just a week's time we experienced:

- A hard freeze in the Southwest.
- Another hurricane in the Southeast.
- An uptick in Covid cases around the globe, and a stock market decline the likes of which not seen since last March.
- Along with the same Presidential campaign noise we've been experiencing the past several months.

With all this occurring, there is little wonder the cotton market reacted the way it did. It's month long climb from 65 cents to above 72 cents came to an abrupt halt. Falling prey to these events, it suffered its worst weekly loss since mid-July, shedding almost two and a half cents to close at 68.92.

The question now becomes is this simply a minor correction or, worse yet, a reversal in the uptrend. Only time will tell, but certainly the angst among traders created by these uncertainties will make for a wild ride over the next few weeks.

It Could Have Been Worse

Further complicating matters, as the December contract nears expiration, the funds will begin their roll period which can make for some huge price swings.

However, all is not doom and gloom for there remains some favorable signs which could lend some price support long term.

There is no doubt that last week’s losses would have been much greater if not for a very encouraging export sales report. Over 322,000 bales were sold to 18 different countries.

Shipments of 244,000 bales keeps us on track to meet export estimates. Currently, 9.4 million bales of export commitments have been made with 3.1 million bales already shipped, the fastest pace in 16 years.

In talking with mill representatives, we are further encouraged that the demand picture is improving. A leading domestic user told us they are now running at 85 percent capacity after falling to nearly 30 percent in the throes of Covid. Abroad, Pakistani textile representatives express a similar rebound in mill production.

Yield And Quality Losses Mount

On the supply side, despite problems all year, never has the crop had to experience such adversity in one week.

The freezing temperatures and ice, which blanketed much of the Southwest, most assuredly will lower yields and fiber quality. Even prior to this, early harvest results had the crop coming in shorter than expected.

In the Southeast, Hurricane Zeta took a similar path to that of Sally a few weeks ago. Though moving faster, rain wasn't near the concern as were the winds. Gusts of nearly 100 mph were reported as far north as central Alabama.

Fortunately, a large portion of the crop had already been harvested in these areas. However, early damage assessment has losses approaching a bale per acre for cotton still in the field.

More disconcerting, with a month remaining in hurricane season, other disturbances can be found in the tropics. One can easily see the U.S. crop falling below 16 million bales as a result of these late season weather woes.

What It Will Take Now

What lies ahead? With 2020 being what it's been, we hate to even venture a guess. As is often the case, our immediate fate lies in the hands of the specs and fund managers.

Open interest in the December contract has fallen by 600,000 bales since October 27, a likely indication of spec liquidation. If they are spooked into taking profits by further liquidating their still sizeable long position, prices will decline.

Conversely, if they have reason to remain friendly to cotton and roll their positions to March, the uptrend in cotton prices should remain intact after the roll period.

What's needed is confirmation of a shorter crop by USDA in their monthly WASDE report scheduled to be released on November 10.

In addition, we need to curtail this second wave of Covid before economic shutdowns are reinstituted and demand is once again crippled. All these outside influences have us very cautious short term.

Over the next few weeks, further price retracement is very possible as these factors play out. Thus, current price levels remain a good pricing opportunity. Keep in mind, successful marketing is all about managing risk.