Thompson on Cotton: Signals Remain Bullish Despite 10-Year Highs

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Amid production concerns, transportation restraints, and China's renewed appetite for natural fiber, dollar cotton seemed almost inevitable. Like an elusive brass ring, we've only seen it a handful of times over the course of history. In fact, December cotton futures have closed at dollar or higher only seven percent of the time in the past 16 years.

For that reason, last week's market activity was even more special. After an 18-month climb from a low of 48 cents, cotton prices finally surpassed a dollar in heavy volume, no less. Posting triple digit gains in all but one trading session, December futures closed Friday at 104.35, a ten-year contract high and a gain of over eight cents on the week.

As we've said before, additional Fund and speculative buying would be needed to reach this lofty price level. Last week they did just that driving prices from a recent low of 89 cents to where they are today.

Bullishly, their net long position now stands at 9.4 million bales, the largest volume since 2018. Similarly, the trade increased their net short position to 17.4 million, its highest level since 2018. The resulting increase in Open Interest of 3.9 million bales as the market gained 10 cents is a classic sign of a bull market.

Without sellers standing in the way, the spec's bullishness went unchecked thus pushing prices well beyond a dollar. Still shy of their record long position, the Funds will be watching supply/demand projections and technical charts for direction. With both currently flashing buy signals, don't be surprised to see them further build on their long position.

Cotton harvest is underway in the southeast and midsouth in the earliest planted cotton with the Southwest still a few weeks out. The first picked received the greatest damage from heavy rains, the extent of which we will soon know, while the risk to our late cotton multiplies the longer it remains in the field.

From grower conversations and field observations, it's felt this crop has gone from being an exceptional one, even record setting in places, to one slightly above average.

As for demand, hereto, the outlook appears to be market friendly. Last week's export sales were outstanding at 588,300 bales. This was the largest one week of sales since October 2013. Once again, China was the major purchaser accounting for 420,300 bales. Since current sales are lagging last year and from the five-year average, we wanted to see if this was a product of high prices rationing demand or simply a timing issue.

To do so, we charted the volume of U.S. cotton purchased by China over various marketing years, including 10/11 and 11/12 when prices were like today. In 10/11, their pace of purchases increased considerably from late September to late December while the December 2010 futures contract went from 90 to 150.

Thus, when comparing the 10/11 and 11/12 marketing years to the 21/22 sales to date, one would think we will see a lot more China business over the next 12 weeks.

Where to from here? The crystal ball gets very cloud with prices now above a dollar. As always, much of the market's fate relies on the spec community's view of fundamentals and other market influences. If they see no need to cash out, short covering by the trade as mills fixations are made will be another source of fuel for this market.