Thompson on Cotton: Funds, Outside Forces Driving Market

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The hope of a post-holiday market rebound was dashed as the selloff continued last week, highlighted by a limit down move of five cents on Tuesday. Since hitting an intraday trading high of 118.50 three weeks ago, March futures has given up over 14 cents closing the week at 104.20, a decline of almost 15 percent. New crop prices fared somewhat better but still dropped below 90 cents as December 22 futures settled at 87.75.

Even excellent export sales did little to excite traders. Weekly sales totaled 381,330 bales with China purchases doubling their four-week average and Vietnam buying five times their four-week average. Unfortunately, outside noise such as uncertainties surrounding the Omicron variant and the likelihood of interest rate increases served to counter these good numbers.

Cotton, often considered an economic commodity, also had to deal with the pull of the equity markets as they traded in roller coaster fashion with the Dow and the S&P 500 losing, one and 1.2 percent, respectively.

Since the cotton market's rampant rise began some 18 months ago, there have been few selloffs of this magnitude. It's been driven by managed funds who have shied from any significant profit taking to instead accumulate a near historic net long position of over nine million bales.

However, we are beginning to see a change of heart as this has been reduced to 7.7 million bales, which is most likely prompted by outside influences since cotton fundamentals remain strong. The trade, on the other hand, reduced their on-call sales position by only 228,000 bales, an indication mills are holding out for the market to go lower before fixing their price.

Nevertheless, there remains over 6.5 million bales of on call sales-based March that must be fixed between now and the end of February, and the total unfixed on call sales are a sizeable 15.5 million bales. On call sales at a volume nearly double the Funds net long position creates a very bullish scenario.

Where to from here? As you can see, the market's fate rest largely in the hands of the Funds and their reaction to the news around us. History tells us in seven of the past ten years, they have increased their long position between the end of November and March. In two of the three years that they didn't, the market was trading in the 60's because global production exceeded global consumption, which certainly isn't the case at present.

As another positive sign, though some liquidation and profit taking has occurred, the managed funds haven't shorted the market to any significance. So, the question now becomes will they continue their exodus or find renewed interest and put this added cash back to work in cotton.

Last week's market action whereby the Fibonacci 50 percent retracement level of 103 remained in intact gives us hope we are seeing a healthy correction rather than a full-blown price reversal. However, a close below it could trigger further liquidation by the Funds. We remain optimistic that in time the strong demand for U.S. cotton will exert itself driving prices higher as the fear of outside influences subside.