Thompson On Cotton: Encouraging

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Encouraging best describes the way cotton prices withstood last week's onslaught of poor economic news. Its underlying strength was found in a shrinking crop. With eighteen percent of the U.S. crop now harvested less than favorable yields are fast becoming a reality. Traders weighing short supplies versus dismal demand are desperately seeking confirmation. Thus, the market traded narrowly in a range of only 161 points for the week, closing Friday all but unchanged at 87.14. Obviously, traders are awaiting Thursday's October supply/demand report.

Crop conditions continue to decline with forty-three percent of the U.S. cotton crop rated poor to very poor. For weeks much of the U.S. crop has been in a drought situation. This has expanded to 76 percent of the Alabama crop and worse yet 97 percent of the Mississippi crop. In these drier areas of the Southeast and Midsouth, early harvest results are reflective of yields nearer a bale to the acre, something rarely seen with the advent of newer seed genetics. It's a year we all feared when the front-end loaded cost risk is realized where Mother Nature doesn't provide.

On a positive note, weekly export sales were the best in months. Surprising given China and other Far East countries were in the middle of a holiday celebration. Sales of 240,000 bales surpassed the 193,000 a week needed to meet current export estimates. China and Viet Nam were primary buyers accounting for over eighty percent of the total volume. It appears most of this business was done when prices dipped to 85 cents. Shipments, however, were still lacking at 150,000 bales, down six percent from the previous week and well below the 236,000 needed each week.

As mentioned earlier, recently released economic data suggests an environment wherein demand will remain weak. The U.S. job market continues to be red hot as Friday's jobs report showed 336,000 new jobs were added in September, doubling expectations of economists. Unfortunately, this is the last jobs report before the Federal Reserve's next interest rate decision on November 1. In addition, an increase in job openings sent bond yields on 10- and 30-year notes to their highest levels in 16 years. Such high borrowing costs will likely exacerbate a downturn in an economy that has up until now been resilient. The increase in long-term rates, along with the resumption of student loan debt, and another possible government shutdown threatens consumer spending.

Where to from here? Don't expect the market to trade as lackadaisical as last week. A host of data traders have been waiting on is scheduled for release. On the economic front is the producer price index and consumer price index, both favored indicators of inflation. In view of a strong job market, the Fed will be concentrating on these two numbers when setting their agenda. Of greatest interest will be Thursday's WASDE report. Will USDA take another big whack at production both here and abroad or instead lower consumption to better balance the books? I've learned the hard way never to second-guess the boys in D.C.

A couple of items of note that offer hope for better prices. Open Interest in the December futures contract increased for the tenth consecutive week and is now at its highest level in eleven months. A tell-tale sign new money is coming into the market. After being net sellers in the previous three weeks, managed funds were net buyers last week accumulating a net long position of 5.4 million bales. Barring any big surprises in the WASDE report, our current trading range should remain intact. That said, with opposing forces creating such a market conundrum, resist the urge to hold cotton while waiting for better prices. A less risky alternative would be to sell at the market and implement an option play or if nothing else sell on call and price later. Either way, get it in someone else’s hands to stop carrying charges.