Thompson on Cotton: When Will the Current Range Break – And in What Direction?

September 20, 2021
By Jeff Thompson, Autauga Quality Cotton

Some things in this world are just difficult to explain such as Einstein's Theory of Relativity, the Fibonacci Sequence, or why a tomato has more genes than a human. Equally as hard to explain is why cotton has traded in a tight range above 90 cents for over a month amid a host of growing negative influences? Some of these include a supposedly larger crop, persistent Covid concerns, a fragile economy, continued supply chain disruptions, and tense U.S. – China relations.

Friday's market settlement at 92.33 marked the 26th consecutive trading session where it closed between 92.30 and 94.90. It seems to resemble a spring that when wound tighter and tighter it's ever closer to breaking. The question now becomes when and in what direction.

The market's opportunistic run to 90 cents has been driven primarily by Spec and Managed Fund monies. In May 2020, at the onset of Covid, NY cotton futures traded at 55 cents while they held a net short position of just over two million bales. Reversing course, in just over a year they have amassed a net long position of 9.1 million bales pushing prices to their current level, a gain of 38 cent.

Their motivation has been improved cotton fundamentals, short supplies, and strengthening demand, as well as a favorable macro environment wherein economic recovery efforts were hastened by government stimulus programs. As these same motivational factors come into question, it’s no surprise their buying spree would slow hence the range bound trading we are currently experiencing. Nevertheless, taking their cue from how these factors play out over time, they will be the catalyst for triggering the spring.

Prices fell to the low end of the trading range last week after hearing the U.S. crop had grown to 18.5 million bales from the previous estimate of 17.2 million. This number has been a moving target all year as evidenced by a swing in the USDA projections over the past three months of two million bales.

In our eyes, an 18 million bale crop is a tall order considering the extreme wet weather in the Midsouth and Southeast and hot dry conditions in the Southwest at a time cotton is most vulnerable. In addition, an early freeze and tropical disturbances pose an even greater threat with such a late crop.

On the economic front, newly released data eased fears the resurgence in Covid had knocked recovery efforts off course. Retail sales rose 0.7 percent in August when expectations were for a decline of 0.8 percent. Contributing to this was an increase in online sales of 5.3 percent while department sales were up 2.4 percent as consumers shopped for back-to-school items. Complementing these figures, jobless claims fell for the fifth consecutive week as more people returned to work.

Seeing potential pent-up demand, retailers have amassed inventories at double digit percentage increases compared to last year and, better yet, exceed 2019 pre-Covid levels. Weekly export sales reflected this. Though down from the prior week's marketing season high, at almost 300,000 bales, exceeds the weekly average needed to meet export estimates with China once again the primary buyer.

Where to from here? In June of 2018 the Funds were long 9.4 million bales and futures were trading at 94 cents, sound similar. Little did we know two black swan events, the U.S. – China trade war and Covid, would soon wreak havoc on the market. That said, even though cotton fundamentals are supportive of current prices, more worrisome is not knowing what lies ahead. For this reason, having a large portion of your crop priced, at least to the degree you feel comfortable, is advised.

Furthermore, fight the urge at harvest to sit and hold unsold cotton. Instead, selling it right away at a competitive basis stops storage and you always have the option of putting it on call if current prices aren't to your liking. Keep in mind pricing cotton in the 90's is a rare opportunity especially at this time of year. At these heights, the upside is much more limited than the downside.