Thompson on Cotton: Market Direction After Trade Agreement? It Depends

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For nearly two years, we've experienced the highs and lows of the trade war between the U.S. and China. Countless times, they've appeared at the brink of resolve only to have one side or the other flinch thus prolonging the negotiations.

Last week, however, the eagerly anticipated signing of Phase One took place. In an air of pomp, circumstance and political back slapping the White House event was quite a spectacle. Regrettably, very few specific trade provisions within the agreement were disclosed at signing.

We had hoped to gain some insight as to the volume of individual U.S. commodities China agreed to purchase. Not only were these not detailed, Chinese officials further stated their purchase of U.S. agricultural goods would be dependent on their needs and market conditions.

Nonetheless, the cotton market reacted by posting triple-digit gains, with March closing the week at 71.25 followed by new crop December at 72.37. The extended holiday weekend may have provided a reality check for after Tuesday’s trading, the cover month and December slipped to 69.24 and 70.91, respectively.

An Overbought Market

We’ve said repeatedly that the market direction following a trade agreement will depend largely on how much leeway the spec community gives China before they see significant cotton purchases.

Yesterday’s 200-point decline can be looked at as either the beginning of a selloff or simply a minor correction. This should be of great concern to those with old crop cotton still unpriced.

The market certainly finds itself in an overbought situation, gaining 14 cents in a short length of time barely slowing to catch its breath. The market has traded up 14 weeks out of the past 17. This advance has been so rapid that March could fall to 68 cents and still be considered in an uptrend.

Further evidence supporting a correction is continued strong export sales. Last week’s old crop sales of nearly 232,000 bales puts commitments on pace to meet USDA estimates.

Most importantly, the funds continue to add to their long position, which now stands at an equivalent of slightly over three million bales. Since July 30, they have gone long 21 out of the past 26 weeks.

Effects Of China’s Holiday Season

All of these factors are certainly supportive of prices at their current levels. Furthermore, in recent weeks, we have seen a significant volume of buying on every 50- to 60-point break in the market, indicating this correction could be short-lived and a return to the uptrend is promising.

With all of this said, I would refrain from any panic selling. Allow time for corrective measures to play out and gauge China's reaction to the agreement.

However, don't be alarmed if we hear very little out of China over the next three to four weeks. The Chinese New Year celebration begins January 25 and runs until February 8.

As part of their celebration, all manufacturing comes to a halt during this time. Ironically, this is the year of the Rat. Let's hope that doesn't carry a literal connotation.

Until next time.