Thompson on Cotton: Fundamentals Continue to Gain Strength

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Strike up the band! After months of knocking on the door, the market finally broached 90 cents trading as high as 90.59 before falling back to close the week at 89.66. Nonetheless, the week was not without some nervous moments.

December futures traded in a wide 424-point range including a significant selloff of 322 points on Monday to a low of 86.35. Impressive, however, was the way it rebounded finishing the week strong.

There were two big takeaways from last week's market action. First, cotton follows the equities markets closer than any other traded commodity. Secondly, cotton fundamentals are continuing to gain strength which proved to be a driving force in the market's late week rally.

On Monday, the Dow Jones Index traded down over 900 points before posting losses of 725 points on the day, the worst one-day loss since October 2020. There were fears the resurgence in new Covid cases might work to slow the global economic recovery and bring about business shutdowns.

Following suit, cotton futures fell, though not surprising, since consumer purchases of cotton apparel and home furnishings is discretionary spending and highly tied to economic conditions.

Hoping for a Tuesday Turnaround, we were not disappointed. The cotton market regained a third of the previous day’s losses while the Dow also improved as strong corporate earnings eased previous fears. Thursday brought about additional gains as an excellent weekly export sales report reflected strong demand.

Current and new crop sales combined for an impressive 296,230 bales. Better yet, new crop sales totaled 259,715 bales, a marketing year high. Even at current prices, U.S. cotton is still one of the cheapest growths in the global market. This should further enhance U.S. export sales as global cotton inventories remain tight.

As for fundamentals, a great deal of uncertainty still surrounds this crop. In its most recent conditions report, USDA raised the percentage of the crop rated good to excellent to 60 percent. We find this very hard to believe. A late crop combined with continued inclement weather puts this crop at greater risk with an 18 million bale crop very unlikely.

Where to from here? This week’s market action proved there is solid underlying support but overhead resistance at 90 cents. Even though we have traded above this mark, a close above it is needed to pull technical traders into the market. The spec community should shy from any liquidation in the face of strengthening fundamentals.

Friday’s Commitment of Traders report showed managed funds increased their net long position by 2,670 contracts to 5.9 million bales, a gain of 9.5 percent week over week. Also, there is a significant imbalance in on call sales versus on call purchases currently being held by the trade.

Sales exceed purchases by over nine million bales. This amounts to a great deal of buying power as mills will fix on call sales upon any dips in the market.

Barring any unforeseen macro influences, look for prices to move beyond 90 cents. After which, export sales and crop conditions will play a large role in just how far beyond.