Thompson on Cotton: Market Resiliency Underscores Strong Fundamentals

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After trading calmly in a narrow range for over a month, last week's market activity was nothing short of a rollercoaster ride. Expecting a breakout of some sort at any time, we were jolted Monday as prices fell over three cents closing below 90 for the first time since August 3.

The impetus was what appeared to be a black swan event, the potential bankruptcy of a major real estate developer in China. This sent shock waves throughout the global financial world with most all markets selling off, commodities included. Fortunately, being more a benign white duckling than a black swan, markets quickly rebounded recouping losses.

Cotton prices were more than resilient. Following Monday's decline, it gained nearly seven cents closing Friday at 95.99 for a new contract high. This recovery speaks volumes for cotton's strong underlying fundamentals, most notably increasing demand. Last week's export sales were the second highest for the marketing season at 368,000 bales.

Almost two thirds were purchased by China, who seem determined to honor their previous commitments or are in desperate need of cotton. These sales figures are prior to Monday's dip in prices which is certain to stimulate additional sales.

Friday's near limit up move is believed to be based on rumors China has confirmed a rather large purchase. Supporting this, in the latest Commitment of Traders Report, the trade is shown increasing their net short futures position by over two million bales. Only nine times since 2006 has a larger one-week move been made.

Currently, there are 4.9 million bales of on call sales based December that will provide additional price support. It is no surprise some of Monday's selloff was the result of Fund liquidation. Their net long position declined from 9.1 million bales to 8.1 million. However, still well shy of their record high long position, we see this as a positive providing them more ammunition to move prices higher as fundamentals strengthen.

Seemingly lost in all this excitement, was favorable news from the Fed meeting last week. Chairman Powell stated though bond buying may taper off before the end of the year, a rise in interest rates was not expected until well into 2022, thus a decline in the Dollar.

Where to from here? The way this market traded last week gives us confidence it has more legs. The bearish negative chart patterns seen at the beginning of the week have reversed. More importantly, this rally was based on cotton fundamentals rather than outside influences.

After finally closing above the elusive 95 cents, mill fixations, a reenergized Spec community, and the possibility of even greater sales to China all add to our bullish sentiment. Of course, with these lofty prices comes talk centered around dollar cotton. Though demand is supportive of current prices, a push through a dollar would require additional Fund buying.