Thompson on Cotton: Strong Fundamentals Driving Market, Expect Increased Volatility

November 01, 2021
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I've always considered chartists akin to those who read tea leaves. If you tilt your head just so and squint your eyes, you can make the charts say whatever you want. Nevertheless, these proponents of flag formations and double bottoms who have been touting a breakout were given credibility after last week's market action.

Following five consecutive days of advances, the December contract posted a new contract high of 114.85 on Friday, gaining over six and half cents on the week. Even more impressive, intraday trading came within 133 points of its October 8 high of 116.48. The March contract, soon to be the cover month, traded similarly gaining five cents on the week to close at 111.22

Despite some lackluster economic news, strong cotton fundamentals were the driving force behind this welcomed move. U.S. cotton continues to be in big demand. Last week's combined current and new crop export sales were a respectable 389,210 bales. China accounted for over half of these sales followed closely by Turkey.

Consequently, with the U.S.-China trade agreement set to expire at the end of the year, renewed negotiations between the two countries were seen as market friendly. Shipments continue to disappoint totaling a paltry 67,412 bales last week, the lowest since November 2015.

The supply chain disruptions are certainly a contributing factor, but we mustn't forget there is a limited supply of cotton to ship with low beginning stocks and a late harvest.

As mentioned, the biggest negative last week came from the economic front. The growth of the GDP, a leading indicator of economic health, slowed to only two percent in the third quarter. This is the slowest pace in the pandemic era recovery. In comparison, first quarter and second quarter gains were 6.8 percent and 6.7 percent, respectively.

Supply chain bottlenecks and a surge in Covid cases were likely the cause. Surprisingly, markets turned a deaf ear as both commodities and equities hit record high levels fueled by strong corporate earnings and a confident consumer ready to spend money heading into the holiday season unfazed by a persistent shortage of goods, delivery delays, and inflated prices.

Where to from here? Next week, the Index Funds begin their roll period prior to first notice day on the December contract, November 24. Thus, we can expect an increase in volatility if that's possible. Nonetheless, there is a tremendous amount of buying pressure in the market with charts flashing buy signals and mills having only a few weeks to fix over three million bales of on call purchases.

Last week's Commitment of Traders Report, our eye on the Managed Funds, showed them reducing their long position for the third week in a row to a net long of 7.7 million bales.

Don’t be alarmed for this report reflects fund activity through last Tuesday.

With 614 points of last week’s total 659-point gain coming after Tuesday, it’s a good bet the Funds were once again buying into this market. Look for December to push beyond its contract high of 116.48 in short order and challenge 120.00. In doing so, the March contract will follow closely behind and, better yet, drag December 22 with them both.