Thompson On Cotton: Planning Amid Chaos – Possible Approaches

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Cotton Market Commentary

Almost before the ink was dry on my last commentary – where I observed that the low 60s should provide firm support – the trade war between the U.S. and China escalated once again.

President Trump, at China's failure to honor previous trade concessions, imposed an additional 10% tariff on all imported goods from China. In retaliation, China devalued its currency against the dollar, and President Xi announced state-owned companies would purchase no U.S. agricultural products.

This sent shock waves through all markets, financial and commodities alike. Cotton prices have fallen nearly five cents since these announcements were made, now trading below 60 cents.

To illustrate just how crazy and unpredictable this fight has becom, the U.S. stated yesterday that it would delay imposition of these tariffs until mid-December. Seen as encouraging, cotton prices rallied 143 points to close at 59.41.

This simply reinforces the notion to expect the unexpected where these trade talks are concerned and their influence on prices.

Where Are We With Fundamentals?

When looking strictly at cotton fundamentals, the picture isn't all that bad. It's almost as if the down side is being overstated by so many of the market gurus that the market movers have come to accept it as truth.

Those of us more bullish were patiently awaiting the August USDA crop report for confirmation and a corresponding boost in prices. Unfortunately, yesterday's numbers were neutral if not slightly bearish. The market reacted accordingly, giving up 76 points on the day.

First, let me say I know how hard it is to make production estimates, I have a similar responsibility in my job. But pardon me if I take just a moment to vent. It's becoming ever more obvious in these reports that USDA simply tweaks figures so they will add up to some preconceived number that is often far from reality.

Otherwise, why would USDA raise U.S. production by a half a million bales when most of the Cotton Belt is experiencing unfavorable late-season weather. Not to mention, it’s contrary to their own crop conditions report, which shows a decline in the percentage of the crop rated good to excellent.

Export Report: Stranger Things

Furthermore, why would they raise U.S. exports by 200,000 bales when we’ve been told for months demand is shrinking due to the trade war and its effect on the world economy. It’s even stranger that production estimates in every other major cotton producing country went unchanged or declined except for the U.S.

I find it hard to believe weather conditions could be so consistent outside the U.S. that changes in production for other regions of the world weren’t deemed necessary. Though all this seems unimaginable, the sad fact is the market will trade off these numbers for the next few weeks until another report is issued. Sadly, I’ve begun to fear USDA crop reports as much as Presidential tweets.

Angst Abounds

The uncertainty which clouds this market is creating a great deal of angst among all those involved. The spec community has been given no reason to abandon their short position, just the opposite.

Also, as a result, a tremendous amount of unsold cotton is on hand, both here and abroad. In the past, we could always count on China stepping in, once prices reached such a depressed level, and China would buy for either consumption or reserve stocks. China’s absence has everyone looking at downside risk in a different light.

The fact that so much uncommitted cotton is in the hands of producers could work to the advantage of growers. In time, merchants will desperately need this cotton. Often, even when prices are not to the producer's liking, cash flow demands force him to sell, thus supplying the merchants what they want.

This year, growers may not have to succumb to this as the situation is quite different. Over the next few months, growers will receive significant sums of money in the form of Stax payments to those eligible, a sizeable Market Facilitation Payment, and PLC/ARC payments for 2018 crops that qualified.

This would greatly lessen any immediate cash flow needs. In that case, merchants may have to resort to bidding up their basis on new crop cotton. It's very likely that high-quality cotton (31-3-36 grade) could capture an extremely strong basis in early fall.

Marketing Loan Program: Consider Its Benefits

Another tool I would recommend to those with uncommitted cotton is the marketing loan program. The cost of holding cotton can lead to poor pricing decisions. The loan program offers several cost-effective benefits to producers, including:

- **Foremost, cash flow.** Immediately upon putting cotton in the loan, producers receive the loan rate plus or minus grade differences – money for paying down operating loans and other expenses. At 6% interest, two months interest is about ½ cent per pound. Since this is a loan, not a sale, those who normally defer proceeds to January 1 could benefit. As always, I would recommend consulting your accountant, first.

- In the event of an LDP or POP payment, storage and interest charges are forgiven while cotton is in the loan.

Compare this to holding cotton, whereby storage costs are incurred from the day it enters the warehouse until invoiced to a buyer. The interest plus storage can easily be 1 ½ cents per pound.

- **Reduced pressure.** Cash flow provided by the marketing loan and possibly forgiven interest and storage costs can reduce the pressure that forces bad marketing decisions. In addition, allow time for possible basis and market improvement.

- **POP potential.** Having cotton in the loan doesn't exclude a producer from a POP payment. The same money comes to the producer in the form of a marketing loan gain (MLG) or loan deficiency payment (LDP). Loan redemptions are made at the lesser of either the adjusted world price (AWP) or the government loan rate. The difference between the two equates to the POP payment. Since the AWP is recalculated and adjusted weekly the producer has the flexibility to decide when to redeem, thus maximizing this payment.

We at Choice Cotton stand ready to assist anyone with the loan process through our loan servicing agency, USA-LSA. The cost of these services is the same as that at the county FSA office but can be performed in a much timelier manner, often within 48 hours. For more information contact us at 334-365-3369

Until next time.