COTTON SWAPFLATION NOW A CONCERN AS PREMIUM TO POLYESTER EXPANDS

LOGISTICS DRIVE COTTON INVERT IN PRICES

VIETNAM COVID OUTBREAK NOW REDUCING COTTON USE

INDIAN COTTON PRICES STALL AS NEW CROP BEGINS TO MOVE

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DEMAND CONCERNS SPREAD; HAS TOO MUCH DEMAND BEEN PULLED FORWARD? IS AN INVENTORY RECESSION POSSIBLE?

Over the last couple of weeks, several troubling discussions have unfolded regarding demand, which caused our optimism to fade. For the cotton and textile and apparel trade, the period has been one of rapidly rising cotton prices and a scramble by spinners for nearby inventory, as well as a sense coverage needed to be extended. Cotton supplies are tight for now, the CFR basis is inverted, and emotional levels are high. At the same time, several major warning signs for future demand at the retail level and for 2022 order books have appeared and are now accelerating. Many of these have been building for a few weeks and now appear to be real headwinds, and new issues are appearing as prices advance. It has become clear in several markets, including China's textile and apparel market, that demand has been pulled forward. It appears that brands and retailers have aggressively placed orders earlier than normal for the remainder of 2021 as the fears of freight chaos and surging prices increase. A survey by the Financial Times reveals that many companies have doubled or tripled orders under the premise that out of all the delays a sufficient volume of merchandise will arrive. This has occurred as inventories have so far been

quite tight and not yet rebuilt. The FT survey asked the question, does anyone have any idea of the actual amount of containers afloat or in route? They answered that question with a no.

In China, the August through October period is traditionally known as the peak season when Christmas and holiday orders are in a rush and factories work 24-hour shifts to complete the orders. It is a time when profits are at their highest and many brands and retailers provide a last-minute rush to the wholesale markets for late orders. For the Yiwu International Wholesale Market, it is a time of robust activity. The market is the largest small commodity wholesale market in the world with over 75,000 booths and more than 200,000 suppliers all set up to meet the needs of the world's small- and medium-sized brands and retailers who need goods, including apparel and textiles. They have always specialized in just in time and meeting the needs of customers. This year, there are no signs of a peak season, and many report that conditions are worse than in normal off-season periods. The reason being cited is that the surging freight rates, delays, and port congestion have disrupted the tempo of export orders and caused many buyers to not be able to afford the new much higher landed cost, especially for the lower priced items. One small Amazon supplier said his freight rate to the US was up nearly 400% and labor coast were up 25%.

The bulk of the normal orders appears to have been pulled forward with the orders placed in February and March, with suppliers now scrambling to ship. In the Yiwu market, this resulted in many of the hot demand items selling out early and sellers no longer being able to even offer. Companies with normal Christmas inventories on hand now report very poor demand and slow sales. In some cases, companies with robust order books which are still open report that even first quarter 2022 through Easter orders were placed much earlier, and they are now working near capacity to fill these. However, new orders are reported as scarce, and it is becoming a concern. China's polyester staple fiber market has been hard hit by these developments while cotton has had supply issues and different order book dynamics, allowing better dynamics. The price of polyester staple fiber has fallen sharply as cotton has rallied during the past 45 days, losing nearly 10% of its value.

This pulling forward of demand is now becoming a concern for first half 2022 order books. What happens when all the double-ordered shipments placed in the panic begin to arrive with many having missed the intended season and sales deadlines? This raises fear that some in the supply chain may attempt to cancel or delay the latest orders as their inventories are rebuilt, which, of course, would cause significant problems for the textile and apparel supply chain. After the devastation of 2020 Covid, many would not be able to bear such an event.

China monthly exports: has demand been pulled forward

Now, a new resurgence of another wave of Covid, the Delta variant, is spreading across many markets and adding to concerns about future demand. If demand prospects falter, there are fears that some brands and retailers faced with surging cost structures might again cancel or delay shipments of the double-booked goods. This fear is spreading as the freight markets are causing further chaos. The world's freight market appears to enter what has to be considered a crescendo of the chaos as new delays, new surcharges, and turmoil unfold. The failsafe for the apparel industry has been the ability to air freight cargo if it appears that the shipment could be delayed for arrival before the prime selling season. We are now in what is considered the prime moment for a decision whether to air freight. It's mid-August and most want the fall and Christmas items on shelves in 30 days.

The Covid control measures have thrown the air freight market into chaos in the world's factory yard, China. We discussed the cancellation of flights last week, and now the availability of workers at the Chinese airports is rapidly shrinking as workers are reported to be resigning. Shanghai Pudong International Airport is the third largest air freight airport in the world, falling behind only Memphis and Hong Kong, and it is now hit by massive congestion and flight cancellations. It appears that over a third of all Chinese air freight capacity of China is shut down, and it is expanding. If the Covid outbreak is brought under control, many airport freight terminals will not be brought back to normal for weeks. When they do, the congestion will be increased and the battle for space accelerating. The cost of the open routes is increasing rapidly on a per-kilogram basis. These conditions, plus the freight, port, and truck delays, mean big problems. This has expanded to Vietnam, a major supplier to the US. Air Freight rates were up 4-10 USD a kilogram last week as capacity was cut by Covid measures. The cost to ship a full cargo plane from Vietnam to Chicago was quoted Friday at 1.1-1.3 million USD or 300% or more higher than a short time ago. For even high-end apparel this is a major hit to margins or will cause losses.

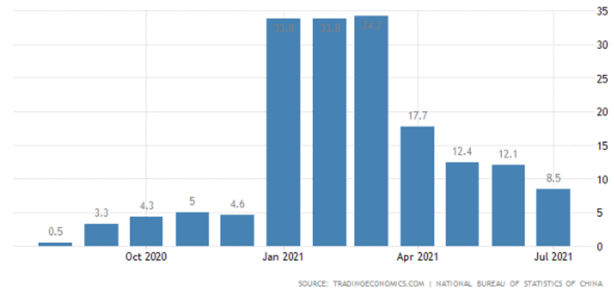
New congestion and problems are surfacing in US logistics, which will impact the fall 2021 season in a significant way. Serious problems are occurring internally in the US following decades of no oversight and protection of the public interest. Dwell times, the time a container spends at a location, are soaring and at a record at the major US ports, rail yards, and warehouses. This comes as a record number of ships wait to berth at Los Angles and Long Beach. July data showed a complete lack of priority for agriculture exports. With the USDA and all departments remaining silent as greed rules, exports from LA port in July fell to the lowest level since February 2005. This explains one of cotton's problems as well as all agriculture products that require a container. At the same time, the number of empty containers shipped back to the Asian exporters increased 20% to 329,999 40-foot containers. Just a small amount of those containers, if required to be allocated to cotton and agriculture products, would allow unlimited cotton export shipments.

US Intermodal Yards Chaos

Then comes the issue of getting the product into or out of the ports. For importers, the situation is causing a lot of economic harm and losses. It is now recorded that the average dwell time for a container has reached 5.3 days at the port terminal, 8.3 days at the warehouse, and 13 days at the intermodal rail yard. This does not include the actual shipping time or all the exceptions with much longer delays. It's been all talk and no action to stop the fees, and after a decade of unlimited consolidation and no attention to the US needs, the railways are adding fees and limiting movement. Shippers have issued a warning that containers could sit at the Port of LA and Long Beach yards for weeks waiting for a train or for a chassis at the intermodal rail yards. Some shipping lines are not allowing inland port terminal shipments into the smaller internal US markets. The railways are placing sizeable fees. Union Pacific announced on August 8th a surcharge of 5,000 USD a container on small shippers and increased spot rates on all California routes. Union Pacific has been allowed over the years to buy more than eight other rail lines, giving them significant pricing power. It is estimated they have over an 18% market share of all US rail freight. Following that move, Union Mason Logistics, which operates 700 containers, added surcharges to its main California routes of 1900 USD a container. This abuse of importers has turned importers to truck, which is adding to new cost, pressure, and problems for all US logistics, including food distribution. The spot rate from Los Angeles and Long Beach ports to Chicago intermodal yards, which is one of the largest truck routes in the US, is now over 8,500 USD a container. The rate to Dallas is 8,100 and to Seattle 8,500. Some simple math suggests a 40,000 USD a container total cost for some small US importers.

These conditions have caused some economists to raise the possibility of an inventory recession coming in the first quarter of 2022. The stockpiling is underway by some companies to build inventory ahead of what they expect to be a record holiday season. In an earnings call, Tapestry, which owns Coach and Kate Spade, reported it was stockpiling inventory to avoid shipping delays. Adding to these worries are signs of waning demand in the US and China. In the US, the Consumer Sentiment Index fell 15.5% in August, the second largest drop ever. In the past, a sharp decline has been followed by a slowdown in spending. This was followed by July

retail sales, which were much worse than expected, as sales fell 1.1% from June and apparel store sales, when adjusted, fell 2.6% from June. The Homebuilders Sentiment Index fell to a 13-month low. There are also concerns over the impact on wages from the chip shortage. Toyota announced it will halt production at 14 plants and cut production by 40%. The foreign policy debacle regarding the US in Afghanistan and the total loss of creditability of the Biden administration by its handling has added to the collapse in sentiment, and the fallout is still unfolding. New anxiety surfaced when, as of August 17th, it was stated that Biden had not talked to one world leader about the situation despite the fact that it was a US and NATO alliance, with many UK, German, French, Danish, and other countries' troop and citizens in the country. Several NATO leaders called into question the entire handling of the US retreat. China taunted Taiwan with new threats about the unreliable nature of the US and then launched a PLA live fire exercise off its coast and sent fighters into Taiwan's airspace. Iran announced new enrichment of uranium. Making conditions worse and reducing confidence is the situation at the Kabul airport, which remains unstable, with thousands of US and other countries' citizens still trapped. Thousands of US citizens and former Afghan workers who are in danger remain outside of Kabul, and the airport and no plans are in place to address this. Amid these conditions, the world has become a much more dangerous place and new risks have surfaced.



China monthly retail sales

In China, while it is using the US failure for propaganda purposes, there are concerns regarding the weakening Chinese economy following the extensive Covid outbreaks and the damage done by large scale flooding. The July data confirmed the concerns, with total retail sales in July falling 3.3% MOM and grew 8.27% YOY. Textile and apparel retail sales totaled 94.5 billion RMB or 14.605 billion USD which reflected a 20% MOM decline and a 7.5% YOY growth. Year to date retail sales of textiles and apparel grew 29.8% from a year ago at 967.3 billion RMB or 149.50 billion USD. The Beijing Cotlook Textile PMI expanded in July to 54.3, which showed growth as mills reported new orders and increased prices. However, another survey of export mills showed that brands and retailers preplaced orders much earlier than normal in an attempt to get ahead of the surging freight rates and chaos. The preordering was not only for Christmas, but some was through Easter 2022. This caused mills to operate at a much brisker pace and higher capacity. However, as in the FT discussion of a possible coming inventory recession,

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mills are concerned about the next set of orders which have not been placed and the bump in business that just occurred much earlier than the normal period.

Eastern mills also report a shortage of labor in the lowest paying sectors as millions switch to delivery jobs that have tips, better hours, and more flexibility. The booming iron ore sector has also shown weakness, with steel output falling 8% in July, while iron ore prices have fallen sharply by over 27% from their July highs. These losses were before Thursday when prices fell 7.1% in China and 13.5% in Singapore, representing a record drop. Xi's war on the private sector is expanding, with further losses in the key tech stocks last week, 3-7% losses Thursday alone in some Hong Kong shares. This was followed by a major speech by Xi in which he called for new regulation on high income and the redistribution of wealth. He called for common prosperity for all. Interpretations were that that the party will demand more say in all business and more obedience, along with a share of the pie. It appears the attack on Jack Ma and the destruction of China's greatest entrepreneur was just the beginning.

Another worry that is now surfacing is swapflation. Companies faced with higher costs have a few options to deal with it, and one of option is to swap a higher quality or grade product for a lower one. This is occurring in coffee as surging prices have resulted in one major brand swapping the much higher quality Arabica for the lower quality Robusta. In the case of cotton, this appears to be underway in China after the standard-grade Xinjiang and higher-grade cotton has gained nearly 10 % in price since early July. First, greater demand has been evident for the 30s carded and below count yarns versus the 40s combed and above, with the price discount of the 30s carded narrowing. This is also seen in the record demand for the Reserve stocks of aged cotton at higher and higher prices, while the average price paid hit a new high last week. Since the auction started, prices have gained nearly 10% for this mostly 8-year-old, lower-grade cotton. Second, a swap is beginning to occur with polyester, as spinners are now switching some capacity to poly-cotton blends and 100% polyester. The reason is that while cotton prices have gained nearly 10%, polyester staple prices have fallen over 8% for an over 18% swing in favor of poly. Cash cotton prices are currently back to the highs of 2015.

The weakness in polyester staple fiber has also been seen in polyester raw materials along with a small weakness in Viscose fiber. This appears to be the lack of strong new orders during the normal peak period as demand was pulled forward.

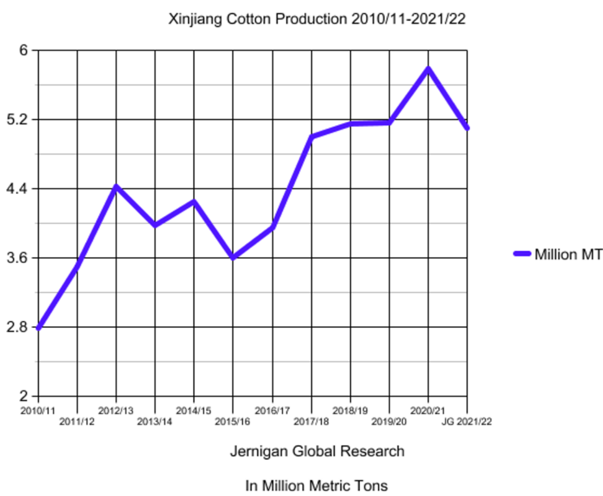
There is also evidence that the recent sharp gains in ZCE cotton prices are due in part to spinners' low inventories of cotton and logistical issues associated with the Covid control measures. All road transport of cotton from Xinjiang or transport of any textile and apparel by truck to the East has stopped. Rail transport is continuing but is slow. This has meant that access to the Xinjiang cotton inventories is limited, and that also applies to the large volume of certificated stocks of cotton held in Xinjiang for delivery against the ZCE contract. In the East, over half of the remaining certificated stocks are held in Jiangsu warehouses, and another 25% of the stocks are held in warehouses in Henan. Transportation in both has been slowed by the flooding and Covid measures and not as easy to access. These conditions have resulted in daily cancelations of certificated stocks for delivery against the ZCE. Just from August 11th-17th, the volume of stocks was reduced by 110,000 bales. Stocks have dropped 937,000 bales or nearly a third since July 8th.

CHINA'S XINJIANG CROP EXPERIENCES HEAVY RAINS, WIND, AND HAIL JUST AS BOLLS OPEN

The 2021 Xinjiang crop is continuing to experience its toughest growing season on record. As we have often mentioned, the region has become a cotton production powerhouse with the second highest upland yields in the world, and, thanks to the aid of the PCC, every technological advance known to man has been applied. What it cannot do is alter the weather patterns in any meaningful way. It has used cloud seeding with some limited success to manage hailstorms. The weather patterns of Xinjiang have been slowly changing, and one

Xinjiang flooding

of the changes has been an increase in moisture and rainfall in the north. In the winter this is great, for it adds to snowpack and increases water supplies, but the problem in 2021 is that it occurred in spring, summer, and now early fall. This year, the storms are violent and full of hail and high winds, resulting in mudslides and serious problems for crops and infrastructure. We have well documented this past spring weather and its problems, which caused 3 or 4 or more replanting, causing a very difficult start. The summer started okay but turned quite violent and experienced massive heat waves that caused shedding of bolls and plant stress. The Chinese press has tried to put a positive spin on crop development, stating it is catching up. However,



early fall weather is bringing no relief with extensive problems likely adding to the woes and reducing the final output and quality. The PCC has applied its technology and involved their extension services; thus all human effort has been made to manage the crop through the weather events.

August, which is about 30-45 days from the full outbreak of harvest, has been an extremely difficult period. The Chinese crop estimates have not yet reflected any of these concerns. The BCO forecast is the best and it has production off 11% from the records of 2020. August began with a continuation of heat waves across northern Xinjiang where half crop is located. Last week brought heavy rains and hailstorms to all of the northern belt and the Aksu region, which is officially in the northern part of southern Xinjiang. A wave of hailstorms hit the Wensu, Awati and Aksu, which caused boll shed and yield estimates to be placed at 100 kilogram per mu in many areas, about 20% or more. The northern belt and Aksu were hit by torrential rains, winds, and hail, with the highest weather alert available issued for the area. In the northern areas in the lli Kazakh prefecture which borders Kazakhstan, 30-40 mm of rain was expected or experienced in a three-hour period. Normal precipitation for the entire month of August is only 16.3 mm. Flooding and mudslides were feared. The entire northern belt experienced similar weather, with up to 60 mm expected in areas. In Kashgar prefecture in southwest Xinjiang in the

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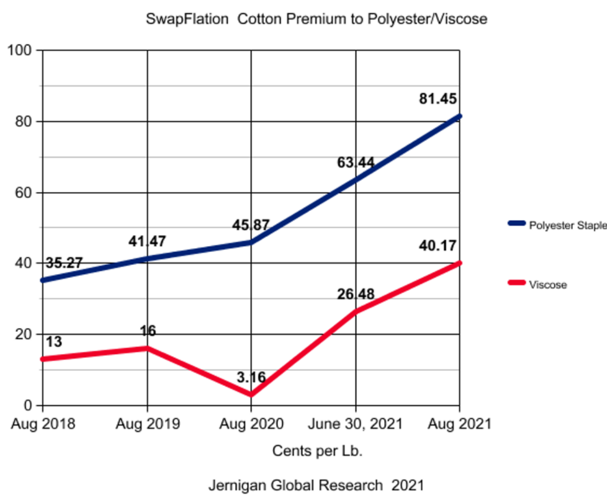
Tarim Basin, similar rains and storms occurred, as well as in Aksu were the ELS crop is located. In areas that missed the hail, flooding, and wind damage, the rain was welcome in the north where water supplies have again been constrained. The cotton and other crop acreage, as we discussed, have expanded past the water capacity.

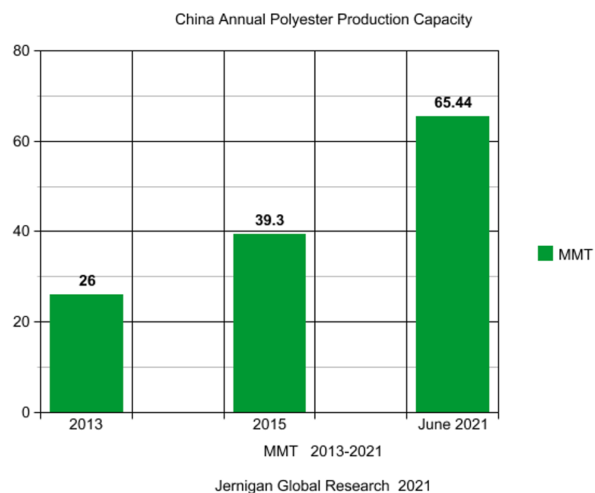
BCO reported that a crop survey of the wider Aksu district showed 476,467 hectares planted to cotton and that plants were taller than a year ago and yield potential was higher. The survey was taken before last week's hailstorms and rain event. While the management of the Xinjiang crop is some of the most diligent in the world, there is now a tendency not to release negative comments or make any statements that would move commodity prices higher. The speculation is already high that with new gins opening in Xinjiang in 2021 the competition for seed cotton will be intense, and early prices suggest possible 7.9-8.0 RMB a kilo. The authorities want to calm this speculation as well. This is the drama of today, but we continue to see the Xinjiang crop 15% or more lower that the 2020 record. The small crop in the East continues to have issues from heavy rains and floods.

COTTON PREMIUM TO POLYESTER AND VISCOSE IN CHINA SURGES TO LEVELS WHERE MARKET SHARE IS IMPACTED



We briefly discussed earlier that a term, swapflation, now being used as commodity inflation, is causing problems for profit margins. In cotton, an age-old problem has existed with the polyester cotton price ratio and how companies switch fibers to maintain margins. The problem has become of much less concern over the last 24 months as the brands and retailers have become more aware of the microfiber pollution and environmental damage done by the lack of biodegradability of polyester and man-made fibers. This has allowed cotton's market share to rebound. It is now up 10-12% off the record lows. Cotton is now in featured lines at all the major US retailers, which is providing a big boost. In China, based on available data, cotton's market share has also rebounded, and cotton use is up, driven by domestic sales and export orders.

This success had us hoping the old cotton polyester price ratio might become a thing of the past. Polyester staple prices are driven by China, and the rules that apply to cotton growers do not apply to the record fixed asset investment driven by the state and subsidies and lack environmental controls. The giant state-owned petrochemical groups under Xi's expansion of the state-owned sector operate under the principal that China's economy will continue to expand, surpass the US, and it will dominate export trade, which means build more plants. With each increase in crude oil use and refining, more petrochemical plants are included for value added. China's polyester capacity expanded to new records in 2021, with 5.2% new capacity coming online through July and capacity is now at 65.4 MMT. This capacity moves into PET chips, polyester staple fiber, and filament. The capacity expansion means demand must follow. This leads to several periods of plant closures and other measures to control losses. Currently the capacity increase has exceeded demand.



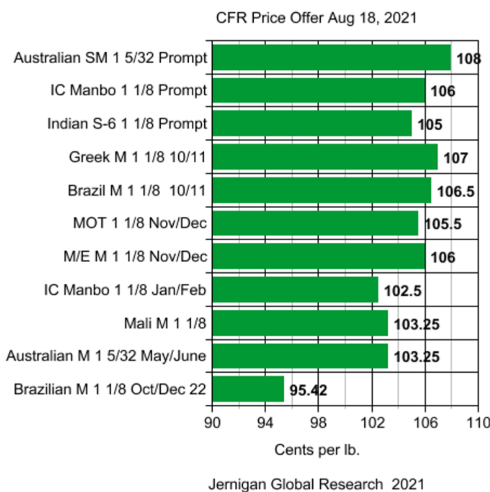
Polyester polymerization rates reached a peak of 94.7% earlier this year as demand was pulled forward as we discussed earlier. Today it is back to 88% as demand has not increased. Inventory at plants is at their highest of the year. The price of polyester staple has fallen from over 52.75 cents a lb. to 48.10 from early July to now. This is up from the Covid lows a year ago and back near 2019 levels and down 27 cents from 2018. Cotton's premium to polyester now stands at 81.45 cents a lb. compared to last year when it was 45.87 on same date, 41.47 cents in 2019 and 35.27 cents in 2018. On June 30th, it was 63.44 cents. Thus, it is not shocking to hear of Chinese spinners seeing a switch to poly/cotton blends as a way to improve margins. Downstream, the fabric mills and apparel groups are not absorbing these premiums. The premium to Viscose is over 40 cents a lb. versus only 3.16 cents a year ago, 16 cents in 2019 and 13 cents in 2018. Viscose has been declining as cotton has rallied.

There has been a small amount of Swap activity in the cash markets. The cash price of 32s carded 100% cotton yarns has slightly outpaced the gains in 32s combed and 40s combed. We have seen this in the surging price of cotton purchased at the state Reserve auction, which is dominated by 2013 cotton. The average price hit a new high last week of 17,993 RMB a ton or 126.14 cents a lb. and was just below the 2020 crop Xinjiang price of 129.72 on the same day. In sales, at the bonded warehouses the Indian cotton has been in demand vs. US because of price.

We fear that the pace of cotton fiber physical prices gains for nearby shipment has deteriorated the margins for many spinners from a profit to a loss. The physical market is inverted, and the price of cotton for prompt in markets such as Bangladesh has reached the point at which spinners are experiencing losses for the first time in months. The rapid rise in cotton prices has caused some yarn sellers to shorten invoice time to the point where weavers and knitters are having trouble getting letters of credit open. Mills buying yarn today for outstanding apparel orders face losses.

These conditions are adding to our concerns regarding 2022 demand. Such developments will not stop cotton's upward trajectory in market share, but they can cause disruptions that will impact several quarters of demand.

LOGISTICS HAVE DISTORTED NEARBY SUPPLIES; CAN CFR BASIS INVERT BE MAINTAINED?



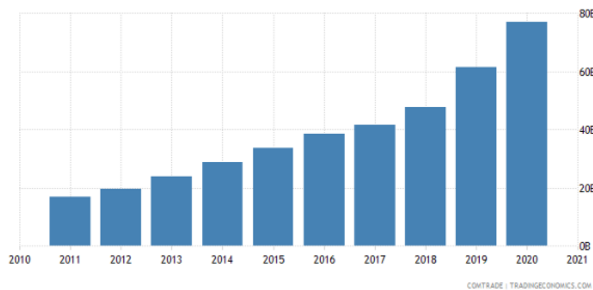
Every origin seller or merchants have significant incentives to ship cotton immediately and sell for prompt nearby delivery as the CFR basis as well as ICE remain at large inverts. Today, the most expensive cotton is for prompt shipment which raises the question, is the reason because the world has ran out of cotton? Using the USDA ending stocks adjusted for China and India (reduced 6 MB) still leaves near 42 million bales, so that is not the case. The answer is logistics. The US has a volume of old crop sold but unshipped, with more than 1.3 million running bales of upland in that position. Some mills complain that shipments are over 60 days behind schedule for all growths. The invert is remarkable; a Brazilian Middling 1 1/8, if a container can be found and can be placed on a ship, would bring 110 cents or so, and that same cotton for January-March is 400 points less. By October 22, it falls to a 15-cent discount. Then you have an Indian S-6 1 5/32 offered for prompt at 900 On Dec, and that declines to 500 On for November. An Ivory Coast Manbo 1 1/8 for prompt would be 1100-1200 points On Dec if you can find the offer, but then for January-March it drops to 850 points On. You have the Australian SM 1 5/32, one of the finest upland cottons in the world, offered at a 200-point discount for May and June to a Brazilian M 1 1/8 for prompt.

Such distortion will impact the margins of traders and make inventory management difficult. Merchants attempting to manage long basis positions face great difficulty. On January 4th, the 2022 crop Australian FOB basis was 565 points On May 22 futures, and on

August 19th it was 300 points Off. In that period, the May futures gained 18.95 cents while the basis lost 865 points or nearly 50% of that gain. The reasons are logistics and the much larger crop prospects, but even then, the logistics are the bigger issue. The China boycott is a key contributor, but so is being shut out of two of the largest cotton import markets in the world, Bangladesh, and Pakistan, and being made less competitive in Turkey. The modern cotton export trade was built on the ability to back fill containers at a low rate after they delivered consumer goods or offered a revenue stream for the returning of containers to Asia. At one point in the collapse in freight rates, Zimbabwe cotton moved into Asia at unbelievable rates just because the empty container space was available from the East African ports return to Asia. In Brazil for years, it was cheaper to move the cotton from Santos to Shanghai than Mato Grosso to Santos. The collective outsourcing by the US and Europe, combined with consolidation of container lines and a collapse in inventories during Covid, changed all that. An illustration of the extremes reached was of a Volvo assembly plant in Ohio that did not manufacture anything but sourced parts from 17 different countries. Amid this chaos, everything has changed. The container line after consolidation has power, and rates today are setting records on the Asia to US and European routes, and shipping lines have shifted capacity. Why would you focus on a Brisbane to Karachi container route when you could get 5-7 times the rate on a Shanghai to LA route? Thus 40-foot container rates from Brisbane to Karachi went up 500% or more if space can be found, and even then, moving an empty container back to a Chinese port and quickly returning to the USA is much more profitable.

These conditions are distorting CFR basis levels and influencing trade and are unsustainable. Up to now, cotton yarn prices have been able to move up with cotton fiber, but last week we saw the first signs of this reversing, and the inter-week decline in raw cotton prices from the highs of 2018/2019 helped alleviate the squeeze. In Bangladesh and Pakistan, cotton yarn prices were unchanged, but in China they registered very small gains with the ZCE cotton yarn futures actually posting losses for the week. This suggests resistance has formed at current yarn price levels. Nearby demand has been strong enough to avoid inventory build, which is helping prices. However, the invert is a negative for nearby, keeping buying hand to mouth while the sharp increase in the gap with polyester and viscose is also being felt.

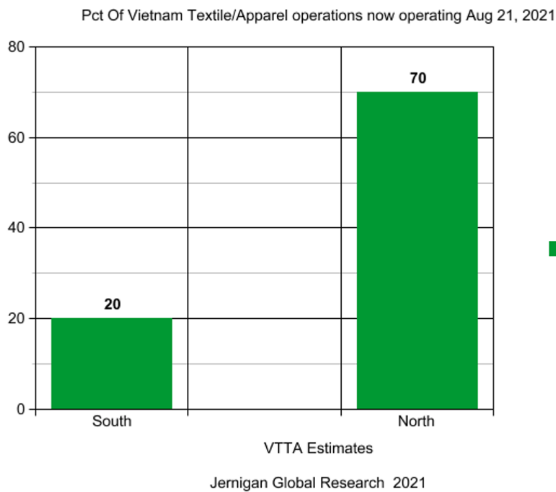
VIETNAMESE COTTON DEMAND WEAKER AS COVID RAGES AND FACTORIES SUSPEND OPERATIONS



Vietnam annual exports to USA

The second round of Covid is causing serious problems in Vietnam. It is impacting cotton demand as ports are congested, transport interrupted, and factories forced to reduce shifts or suspend operations. The government model of asking the factories to have the workers sleep and live at the factory is failing, and companies are suspending operations and asking the government to lift the rules. New Covid cases last week reached records. Cotton imports in July already showed the impact, falling to 140,500 tons, the lowest since February. The flow of export shipments has slowed, and all are concerned about the ability to fill fall 2021 orders. The major US apparel and footwear importers have asked the US government to donate vaccines for textile factory workers. Currently, the country has one of the lowest vaccination rates in the world.

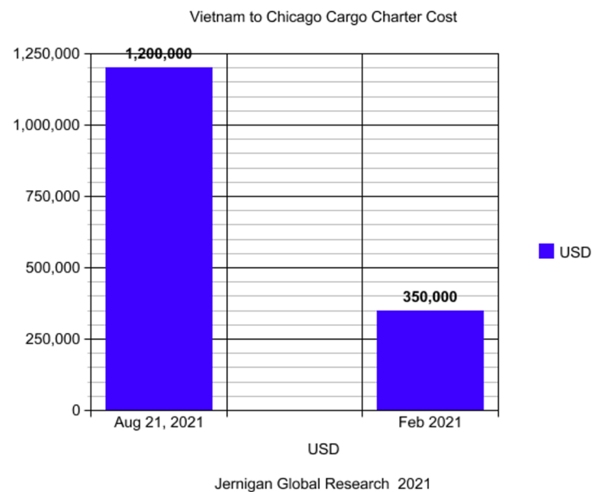
In the week ending August 12th, Vietnam purchased only 12,400 running bales of US upland, which is a very low volume given the expected poor forward coverage. Spinners are worried about the price and the impact on orders of the export issues for the fall of 2021. As of now, Vietnam's purchases of US cotton are down about a third from a year ago at only 604,000 running bales of upland for 2021/2022. It is also increasing purchases of Australian 2021 crop, which is available at more attractive basis levels than US. In June, it was the top export market for Australian shipments, and for 2020/2021 it appears headed to be the largest import market for Australian. Australian shipping rates are competitive, and basis levels very attractive. It also offers Chinese yarn importers a way to obtain Australian cotton.

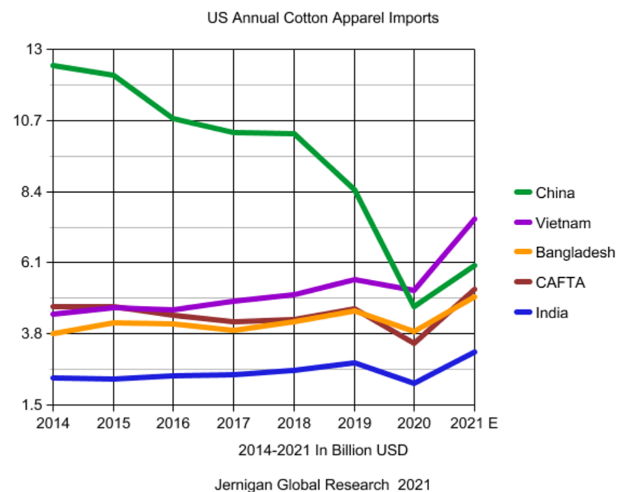


Vietnam is now experiencing a shortage of containers, with 40-foot containers and equipment very difficult to find and with shipping lines saying they may not have enough containers to fill exporters demand for August. This demand is pulling empty containers from other Southeast Asian markets, adding to the woes.

Several weeks ago, we warned and discussed the disruptions to cotton demand being caused by the second Covid wave. Now, the impact is accelerating as infections expand. Conditions are getting worse. Ho Chi Min announced a shelter in place order starting August 23rd. A large logistics group reported Friday that less than 30% of all factories were operating at full capacity, and 19 provinces have some form of lockdown in place. VTAA estimates 80% of the textile and apparel companies in the south have been forced to halt operations altogether, while as of Friday it was 20-30% in the north. It is now evident that large US apparel importers depending on Vietnam are moving to attempt to book air freight shipments of some of the product lines that they depend on from Vietnam. One of these is winter outerwear. The air freight sector is under restraints because of the Covid controls, and ad hoc charter flights have been halted. Air freight rates have gained 4-10 USD a kilogram during the past 20 days. It is now reported that to ship a full cargo plane from Vietnam to Chicago will cost 1.1-1.3 million USD, which is up 300% from earlier. The chaos has spread to Cambodia, another major souring location for apparel.

Cotton consumption in 2021/2022 will need to be reduced, with the size of that reduction depending on how long this disruption lasts and how it permanently affects the supply chain.





INDIAN PRICES HOLD STEADY BELOW 100 CENTS AS NEW CROP STARTS TO MOVE

New crop cotton from the Northern Zone has begun to move in small volume, and the price at the farm gate appears to be 6200-6500 Rupees per quintal, which compares to an MSP for that area of 6,025 and 5,716 Rupees nationwide. Cash prices of Shankar-6 ex warehouse are near 98.50-99.00 cents a lb. Cotton yarn prices were steady to higher. The CAI lowered the 2020/2021 crop by 150,000 bales to 35.545 million 170-kg bales as old crop deliveries have slowed. Consumption was placed at 33 million and exports at

7.7 million, leaving ending stocks at 8.250 million bales. Cotlook reported that the CCI expected Indian stocks lower at 6-7 million bales.

Indian exporters are also dealing with a shortage of containers. The number of empty containers returned to Nehru Port, which is the main gateway for the north, fell to 77,084 in the May-July period, down sharply from 94,633 in the previous period. A shortage of containers is also being reported at the Chennai port. One problem is the fact containers have been diverted to other markets, including Vietnam where a shortage is occurring.

The monsoon rains have returned to the areas lacking, with southern Gujarat wet by Thursday. These rains are welcome. Expectation is for final planted acreage to be down near 5% from last year.

ICE ENCOUNTERS RESISTANCE AT 2018 HIGHS WHILE DEMAND CONCERNS MOUNT

We have been discussing for two weeks the headwinds in demand that were becoming a concern for us. Last week, those accelerated and moved to the forefront. ICE remained under the influence of the Managed Funds and option related traders, surging to a new high of 96.71 in Dec on August 17th, which was quite significant in that it exceeded the 2018 highs by 11 points. The similarities between 2018 and today have been building. In 2018, as today, demand had been robust and On Call unfixed purchases were near today's levels, creating underlying demand, and bullish enthusiasm was high. It was, however, at the start of the Chinese/US trade dispute in which one minute it appeared there was a deal and headlines actually published and then removed after China balked when the deal was presented to Xi. Then came a complete breakdown, and the US imposed tariffs, and China blocked US cotton imports. Prices then began their retreat, which took prices to their Covid lows. Now, we are back at the same levels with demand robust and the CFR basis at a major invert and unfixed On Call purchases have exceeded 2018. However, this time there are several concerns regarding demand and a major change in sentiment caused by the greatest US foreign policy failure in our lifetime causing problems. By Thursday, prices had retreated nearly 400 points off the earlier highs and extended losses on Friday before finding support.

We have discussed our concerns regarding demand in detail in this issue, and these concerns will not be easily solved for they are extremely complex. The new Covid outbreak impacting consumer demand, logistical turmoil, US foreign policy failure and loss of confidence, fears that an inventory recession is coming, and swapflation as cotton/poly price spread nears record. The spike in prices on ICE to the highs appears to have been option related, as market makers were forced to hedge September dated Dec 95 Calls. September options expired Friday and had high deltas. Trade selling awaited the quick advance, which was followed by a retreat. By the end of the week, the once bullish excitement about commodities as an asset class had faded somewhat with a wave of selling across most markets as the Federal Reserve notes showed that it would taper its easy money policy soon. The US Dollar gained rapid ground as the world became a much more dangerous place following the US foreign policy debacle. The collapse in confidence of US governance brought a host of new crises into the spotlight.

China's cotton prices rallied sharply into Wednesday trade and then reversed in late Arb trade and fell further on Thursday and Friday. Chinese equity prices came under new selling as Xi continued his move to cut the influence of the major tech companies and to redistribute wealth. Demand concerns caused a collapse in iron ore prices. As we discussed, much of the sharp gains on the Chinese ZCE cotton futures appeared tied to logistics and a sharp fall in certificated stocks. Concerns also mounted that normal peak season demand had been pulled forward leaving new

orders missing for the normal peak period, which is now underway. China's cotton fiber and yarn markets performed at odds with China Cash Cotton Index, closing Friday at 18,497 RMB a ton or 129.41 for a 4.08 cent gain. However, this was not reflected in the ZCE futures, which in January posted a small loss for the week and closed at 17,815 RMB, which is an extreme discount to the cash index. The spot September contract, which is in delivery, closed the week also at a steep discount at 17,735 RMB, which was a 1.19 cent gain. The average price paid at the Reserve auction on Friday was 17,589 RMB for 2013 crop, which was only at a slight discount to the ZCE Sept contract. Adding to this, the ZCE January cotton yarn contract lost 610 RMB for the week as cash prices gained, suggesting a major change in margins could be ahead. The January yarn contract is at a 500 RMB plus discount to cash prices.

ICE found support during the weakness from fresh export offtake and fixations of open On Call purchases, which continued to increase in the latest period by 434,100 bales. The increase all came in March 22 forward. We have expected unfixed On Call purchases to reach new records as spinners expanded coverage but did not want to lock in the current prices. Such open unfixed purchases will continue to support prices. Our concern is over demand, which we have discussed in detail. Crop developments at this moment are not providing a needed stimulus. The US crop needs heat and a clear fall. At this stage, it still appears very likely the USDA has underestimated the Texas crop by a wide margin.

We have expected resistance in ICE near 95 cents and it appeared. These levels have pushed physical prices for prompt shipment to levels that no longer can be passed along in yarn and fabric prices. The shortage nearby is driven in large part by logistical issues. The current chaos in the US and European supply chains will not end well, and business models will have to be reassessed. Apparel companies cannot have the exposure that the current chaos has provided. The COT report for August 17th confirmed our thoughts, with the Trade adding 13,235 additional new shorts while the Swap Dealers, Managed Funds, Other Reportable Funds, Index Funds, and small Non-Reportable Specs were all buyers. The net Managed Fund's position reached 81,940 contracts net long, and the Index Funds reached 85,678 contract net long. The Index Fund's gross long may be a record.

Amid these conditions, we continue to see heavy resistance in ICE near 95 cents, with the extent of the any additional break depending somewhat on the technical outlook. Any breach of the long-term uptrend near or around 91 in Dec would open the way for a test of the 84/85 area, which we have seen as support for some time. Again, we see a trading range amid the current concerns regarding demand.

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