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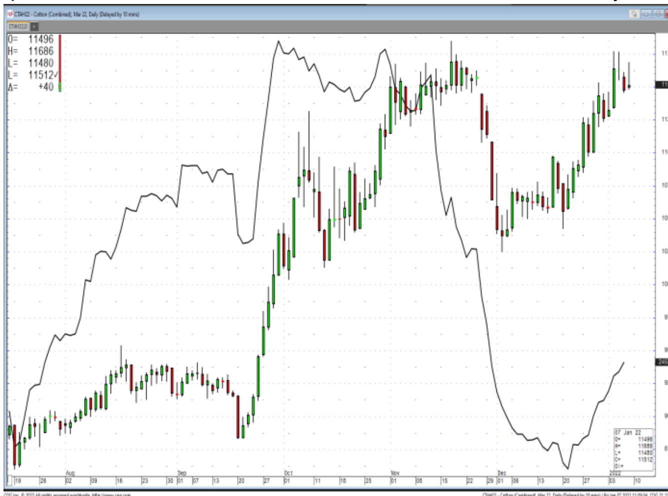
The Plexus Report by Peter Egli

Market comments A/O C.O.B. Jan 6, 2022

NY futures rallied since our last report on December 23, with March gaining 560 points over the last two weeks to close at 114.72 cents. The July/Dec inversion widened from 1359 to 1542 points. (**March Daily Chart & O.I.→**)



Speculators found renewed interest in cotton after they had been net sellers for four consecutive weeks between mid-November and mid-December. Since December 15 open interest has been steadily climbing again, adding 11.5k contacts to 244.0k contracts as of this morning.

The latest CFTC spec/hedge report as of December 28 showed that speculators added 0.50 million bales in new longs in the two weeks since December 14, bringing their net long to 8.39 million bales. They have probably added to that position since, as prices have rallied another four cents.
Index funds were net sellers during the same period, as they got out of 0.36 million bales and reduced their net long to 7.71 million bales, while the trade was only a light seller, increasing its net short by 0.14 million to 16.10 million bales.

The latest CFTC on-call report showed that the trade still has a lot of sales to fix in current crop. As of last Friday, there were 5.09 million bales to fix on March, with a further 2.23 million on May and 4.84 million on July. In total there are still 12.16 million bales to be fixed between now and the middle of June!

By comparison, last year there were just 8.39 million bales in current crop sales open and two years ago it was 7.70 million bales. This massive amount of over twelve million bales represents a tremendous amount of support underneath the market.

US export sales of 191,600 running bales of Upland and Pima cotton for the week of December 24-30 were quite decent considering that we were in a holiday period. There were 16 markets buying, while 19 destinations received shipments of 112,100 running bales.

Total commitments for the current season have risen to 11.25 million statistical bales, whereof just 3.25 million bales have so far been exported. This compares to 12.30 million in sales and 5.90 million bales in shipments a year ago. In order to make the current USDA export estimate of 15.50 million statistical bales, we would have to ship an average of 392k running bales per week over the remaining seven months, which is doubtful.

This slow pace of shipments is starting to turn into a real problem, because it leads to a shortage of cotton at various destinations, while causing a potential inventory overhang at origin down the road. As stated before, the current market inversion is not caused by a supply shortage as such, but by a lack of cotton where it is desperately needed, namely at the mill level.

Readily available cotton in consuming markets is fetching stiff premiums, as mills are scrambling to get their hands on bales to keep their factories operating and to meet downstream sector obligations. This can cause localized price spikes, like we have seen in India, as Bangladesh has recently been bidding up Indian cotton and yarn, since it is not getting its cotton delivered on time from other origins.

The Cotlook A-index illustrates this ‘bird in hand is worth two in the bush’ situation quite well, as Australian cotton is currently the cheapest of the five quotes at 125.00 cents, while India is quoted at 130.00 cents and MOT at 132.00 cents. Australia should be leading the pack because it has the best quality among these origins, but it is offered for June/July shipment, whereas the others are quoted for Feb/March shipment.

These supply chain delays make it difficult to assign a value to future shipments and they are also suppressing mill demand, which we see as a potentially bearish factor going forward. There may be strong demand at the end-user level, but if mills don’t have enough cotton on hand to meet this demand, then mill use will suffer and this in turn will lead to higher ending stocks.

Fortunately, mills are well compensated by the premiums they receive for ready supplies, but they have little visibility when it comes to future deliveries. We have yet to see how this inversion is going to play out over the coming months and what will happen when December takes over as the reference month in mid-June.(**Weekly Continuation Chart Basis March→**)

So where do we go from here? March still looks well supported by the renewed spec interest and the five million bales in unfixed on-call sales that need to be fixed over the next 5-6 weeks.

However, other than on the Indian subcontinent, cash business has turned relatively quiet in most markets, as mills are not prepared to pay these high prices for forward business in view of the looming new crop price cliff.

While we don’t have a firm view on price direction, we believe that the July/Dec inversion of currently over 15 cents is going to fade over the coming months. How this will unfold remains to be seen, but given the rising input costs in the coming season December should be well supported, while July will sooner or later have to face inventory pressure.

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