PLEXUS COTTON MARKET COMMENTS – JUNE 16, 2022

NY futures gave back some of their recent gains this week, as July lost 298 points to close at 143.51 cents, while December dropped 570 points to 119.23 cents. The July/Dec inversion thus widened by 272 to 2428 points.

December, which is now the lead month, has been moving sideways in a 115-134 cents range for the last ten weeks, as it is still trying to figure out how the supply/demand situation is shaping up in the coming season.

The WASDE report of last Fridays didn't provide much insight, as it showed global production (121.27 million bales) and global mill use (121.54 million bales) at nearly identical levels.

ROW production at 93.77 million bales is projected to be 10.23 million bales larger than ROW mill use at 83.54 million bales, with China expected to import 10.50 million bales, which would leave ROW ending stocks basically unchanged.

However, we believe that the USDA is too optimistic on both sides of the balance sheet, as we expect production to struggle with abandonment and yields this season, while mill use is getting hammered by a global recession. The question is which side will ultimately show a greater decline and at this point our money is on mill use becoming the bigger issue.

Asset markets are in freefall, be it stocks, bonds, cryptos and recently even real estate. This is the first time in decades in which all asset classes are facing declines at the same time. Usually when the stock market crashes, bonds rally, but not this time around. This is a unique situation in which stagflation forces Central Banks to raise rates in a struggling economy in order to reign in runaway inflation.

Generation Z and Millennials, which make up the 10-40 year age range, are the hardest hit, because that's the group that was chasing cryptos, tech and meme stocks higher last year. Some of these assets have been decimated by 70-90%, which has taken a huge bite out of their net worth.

Many of these wannabe traders are now forced to curb their spending habits and considering how expensive essential living expenses have become, there won't be much left to spend on fashion. This negative wealth effect is already being felt throughout the supply chain, as our mill friends can attest to.

Unfortunately this seems to be just the beginning of significant demand destruction, which will likely lead to recession, layoffs and lower asset prices, as well as bankruptcies and defaults. The deflating bubble is a lot bigger than the one we had in 2008 and this time central banks have their hands tied by inflation.

Mills have remained rather complacent in regards to their remaining July on-call fixations, as there were still 1.89 million bales unfixed as of last Friday. As a result we saw an unusually high open interest after option expiry and the GSCI roll, as mills keep pushing their luck towards the notice period.

As of this morning there were still 22k contracts open in July, with First Notice Day on June 24 fast approaching. Most sales contracts call for mills to execute their fixations at least 3 days before FND, which means that by Tuesday most of these fixations will have to be done. As we head into this deadline, we could see more price spikes like today as mills are scrambling out.

Unfortunately mills stick to the same strategy for December as well, as unfixed on-call sales have risen by another 0.46 million to 6.21 million bales. For the entire 2022/23 season there are now 8.88 million bales in unfixed sales between Dec'22 and July'23. This creates a strong layer of support underneath the market that makes it more difficult for prices to decline, which is the exact opposite of what mills are trying to achieve.

US export sales were once again strong at 407,900 running bales of Upland and Pima cotton for both marketing years combined, although 91% of those went to China, which was believed to be Reserve buying. In total there were 14 markets buying, while shipments of 342,500 running bales went to 22 destinations.

For the current season we now have commitments of 16.4 million statistical bales, of which 11.5 million bales have so far been exported. This compares to 17.2 million in sales and 14.2 million statistical bales shipped a year ago.

So where do we go from here? July could still see some volatile moves as mills are getting their remaining fixations squared away, while December is trying to figure out its balance sheet for the coming season.

On the production side we expect to see a setback in West Texas, as most dryland acres won't make it and even some irrigated acreage is struggling, which will lead to significant abandonment numbers and a lower crop estimate than the current 16.5 million for the US.

The slow onset of the Indian monsoon is another development to watch, as the first half of June saw a 32% deficiency. However, rain is picking up now and according to the IMD (Indian Meteorological Department) the deficiency will be gradually compensated and agriculture should therefore not be impacted.

We believe that demand destruction will slowly but surely become the center of attention, as the 121.54 million global mill use number is nothing more than wishful thinking. Or does anyone really believe that mill use is still as strong as a year ago, when it was 121.69 million bales?

For now supply and demand worries still seem to keep each other in check and December in a sideways trend, but over time faltering demand will probably become the more dominant factor in the market.