MARKET COMMENTS – OCTOBER 7, 2021

NY futures continued to shoot higher, as December gained another 581 points to close at 111.61 cents. The Dec/March inversion expanded from 192 to 288 points.

Since this rally started on September 21, the market has closed 22.59 cents higher over the last thirteen sessions. Total volume has been massive, totaling 602.1k contracts during this advance, which averages around 46.3k contracts per session, while open interest increased by around 25k to 289k contracts.

Surprisingly, open interest has remained unchanged at 289k contracts over the last five sessions, even though we had two locked limit moves and a wide trading range of 1200 points, not counting synthetic values. This suggests that there has been a lot of churning among longs and shorts. While some traders were taking profits or covered shorts, others took their place, with the overall exposure staying about the same.

The CFTC spec/hedge report for the period of September 22-28, during which December traded between 89.95 and 101.55 cents, confirmed that it was massive speculative buying that forced prices higher. Speculators bought 2.81 million bales to boost their net long to 10.54 million bales, while index funds added 0.12 million bales to increase their net long to 8.32 million bales.

The trade was on the other side, adding 2.93 million bales to its net short, which grew to 18.86 million bales, and this position is probably closer to 20 million bales by now. It is quite astonishing that the trade has been sticking with its position and even expanded it during this rally! What will it take to scare these shorts into covering?

The latest CFTC on-call report as of last Friday, when December settled at 104.53 cents, showed that very little progress has been made. Unfixed on-call sales on December

were down just 0.29 million to 3.96 million bales, while unfixed on-call purchases on December were down 0.19 million to 1.25 million bales.

Overall unfixed on-call sales were down just 0.09 million to 15.05 million bales, of which 14.01 million bales are on current crop futures and 1.04 million bales on December '22 and later. With overall on-call purchases at just 3.86 million bales, the net position in favor of sales is still at a bullish 11.19 million bales.

US export sales had another strong showing, as a total of 315,400 running bales of Upland and Pima cotton were added, with China's 214,500 RB accounting for more than two-thirds. In total there were 14 markets buying, while 20 destinations received shipments of 128,800 running bales. The slow pace of shipments is due to the lack of available cotton.

Total commitments are now at 7.9 million bales for the current season, of which 1.75 million have so far been exported. This compares to 8.7 million sold and 2.5 million shipped a year ago.

While cotton futures have seen a big inflow of speculative money in recent weeks, the same cannot be said for other key commodities, where net spec positions have declined quite substantially over the last couple of months. Be it corn, wheat, soybeans, lumber, copper or precious metals, we have seen hedge funds take money off the table, which doesn't jive with the inflation or commodity 'supercycle' narrative.

Could it be that this apparent 'red hot' economy isn't really that great and that demand is actually slowing down? The Atlanta Fed's real GDP estimate for the 3rd quarter shows a dramatic drop from over six percent in August to just above one percent today and anecdotal evidence has it that many small businesses are struggling to survive.

In such an environment we see it difficult for mills to pass this 20% price increase on to the downstream sector. This may explain why the trade has so far refused to get out of its net short position and keeps fighting the speculators. However, while the cash market is rooted in reality, the past has shown that the futures market can take on a life of its own and resemble more a casino than a true price discovery mechanism.

So where do we go from here? With China probably coming back with speculative vigor after its week-long holiday and with the WASDE next Tuesday possibly showing some bullish corrections (Indian stocks and Chinese imports), it is difficult to see this rally coming to an end anytime soon.

So far trade shorts have been defending their positions, but on a 20 million bale net short position every cent costs an additional USD 100 million in margin money and we wonder where the trade's pain threshold lies? Big trade houses with sufficient credit lines might be able to hold on, but smaller entities and traders could get forced out, which in turn would add further fuel to the rally.

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