Cotton Compass

Grower subscriptions sponsored by:

Monday, January 24, 2022

Are we there yet??

	High	Low	Close	Change (week)	Change (month)
Mar 22	124.78	119.05	120.75	+1.05	+13.48
May 22	121.17	115.75	117.98	+0.64	+12.75

ANOTHER overall strong performance from ICE in the holiday shortened week was tempered by less than convincing trade on Thursday and Friday. Meanwhile, from a “spread perspective” at its peak, the July/Dec invert blew out to around 19 US c/lb – before settling at 16.59 US c/lb after the front of the board ran out of steam on Friday. Whilst this steep invert suggests the futures market reflects physical fundamentals of tight current ‘destination’ supplies against anticipated balance sheet relief later in the year, it is difficult to gauge a realistic ‘value’ for this market.

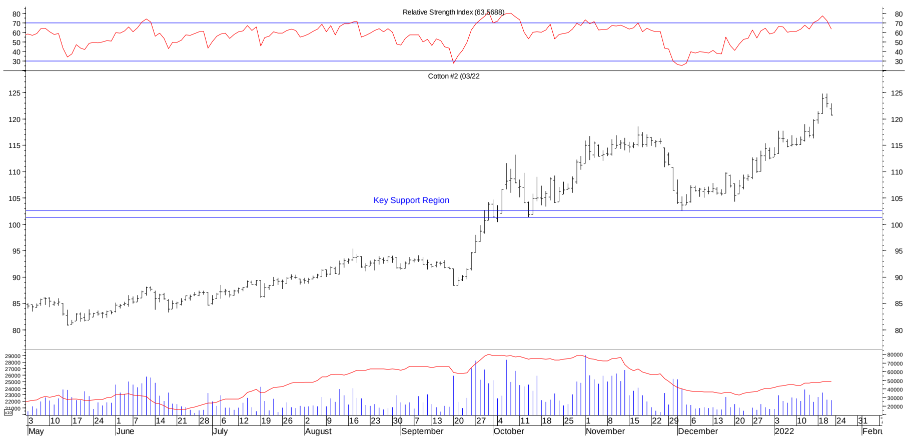
Relative Value is perhaps one measure we can use – simplistically comparing the value of physical cotton to cotton yarn. Our data suggest that, from a ratio perspective, we’ve got Aussie SM 1-5/32” values representing 66% of Chinese 32Ne yarn and 58% of Chinese 40Ne yarn values. That compares to an 11 year average of 58.5% and 48.9% respectively…..and clearly suggests from a ‘conversion to yarn’ perspective, raw cotton prices are high. And whilst ratios as high as they are, certainly not unprecedented, our data suggests they typically don’t last long.

Historical Value is also worth looking at – and on that score, we consider the ‘spot month’ 219.70 March 2011 high and the 28.20 October 2001 low as the key inflection points of modern history. For what it’s worth, the 50% retracement from long term high to long term low is calculated at 123.95…… within spitting distance of last weeks highs on the March contract. Whilst that in itself is technically significant, at this stage it is not necessarily suggestive of a top just yet. If we look at other key Fibonacci levels, the 38.2% retracement would be 146.55 and the 61.8% would sit at 101.35.

Stocks to Use is another measure to consider. The recent USDA numbers suggest an overall 68% global S/U ratio, and a “world minus China” number (adjusted for Chinese imports) of 51%. Whilst these are the tightest numbers for three seasons, they are a far cry from the 39% and 40% respective figures from 2009/10 that preceded the rally in late 2010 and early 2011 to all time highs – and are actually in line with the 20 year average figures of 65% and 48%.

SUMMARY: So…..if cotton prices look high from a relative value, historical value and stocks to use perspective……what is going on? As we’ve mentioned many times in these pages – we believe the main driving factors for the extraordinary rally (over the last 6 months in particular) are the exaggerated demand signals being brought to bare by global logistics bottlenecks – with perhaps as much as 5-10% of global supply held up at origin or in transit rather than at destination. None of us have had experience of anything quite like this…..so while it is occurring, it actually makes sense the traditional ‘valuation methods’ we were taught and rely on count for nought. Eventually, however, things will revert to normal. That said, wild card developments such as the creeping West Texas drought – and perhaps dry conditions and limited snow/glacial ice in the mountains that feed China’s Xinjiang region – need to be monitored.

Technically our initial objective at 121.67 has been exceded – and as mentioned above the 50% long term retracement has been met. Below the market, the first line of immediate support lies at the November high of 118.50….with bulls looking for push beyond last weeks highs. Timing wise….we feel the cycle is nearing completion.

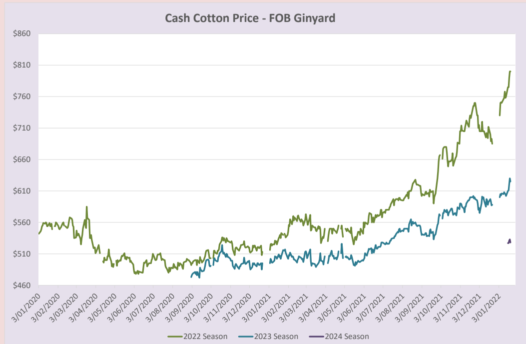


AUSTRALIAN CASH MARKET

	A$/bale Close	High Weekly	Low Weekly	Change this wk
2022	$800	$800	$775	+$40
2023	$625	$630	$610	+$23
2024				

2022 Crop

It was a more active week for 22 crop cash markets – for obvious reasons – with prices cresting $800/bale for pretty much all valleys on Thursday and Friday (at least for a May/June bale). We would expect in the order of 50,000 bales plus sold from grower hands. Although, with irrigators already well sold (for this time of the season), and with dryland producers still looking at plenty of production uncertainty, individual ‘transaction sizes) were likely in the hundreds rather than thousands of bales. And…..given this rally has been so rapid (and prolonged)….maybe there is some complacency and/or ‘fear of missing out’ if it keeps going up. Maybe the pullback in ICE futures over the last couple of days (and a likely lower start to cash pricing this week) sees some more grower engagement.



Price Outlooks 2022 Crop:

Outlook this week: A$750 - 810/bale

Outlook 1-2 months: A$680-780/bale

2023 & 2024 Crop: Growers were reasonably active in the $625-630/bale area for 23 crop – although we suspect volumes would have been much higher if they hadn’t represented a massive $170/bale discount to current crop!

Hedging Model: Whilst we are cautious about overdoing things…..these prices are hard to ignore. Given we feel there is some upside to our production model – we are comfortable enough to chip in with a bit more hear at market – taking us to 85% sold. We will have to sit tight for some time now though.

2022 Crop Hedging Model

Prodn Guess	Sales	Orders
5000 bales – 75% sold @ $614 average	500 @ $550 250 @ $575 500 @ $575 1000 @ $595 500 @ $625 500 @ $655 500 @ $720	500 @ market

2023 Crop Hedging Model

5000 bales – 30% sold @ $577	500 @ $550 500 @ $580 500 @ $600	

January 24, 2022

EXPORT MARKET SUMMARY

WHILST INDIA remains a very strong source of inquiry, merchants are reporting broad based interest from a range of markets – heavily focused on Q1 and Q2 shipment, as well as July/August. Clearly, logistics constraints continue to present challenges for early shipment guarantees – and for Australian cotton it is becoming near impossible to guarantee an April/May/June shipment slot (let alone Q1) given: the almost non existent old crop carry-out; an already heavy 2022 crop forward sales book; and the reality that most gins will not kick into gear until May given the slowish start to the season. Interestingly – and sensibly – we are hearing more and more talk of merchants only agreeing to May/June/July Aussie shipments if they can also sell an August/September portion.

Relative Value: As well as the Indian business reported in recent weeks – given current relative values - it is perhaps not surprising that merchants are reporting consistent inquiry for Australian cotton from a wide range of other markets. Vietnamese and South Korean mills have been behind some of the heavier volume inquiry, and we understand on call sales have been executed at basis levels around 1400 on July (for Jun/Jul/Aug/Sept shipment) – although we do not have specific detail. With US and Brazilian offers at a substantial premium to Aussie (and West African at par) it makes sense that mills are looking at the Australian product.

Third Quarter could prove interesting. Whilst there will clearly be a production void in Jul/Aug/Sept for Australian to fill before Brazilian/US new crop hit export channels…..this could also coincide with the period where logistics pipelines finally catch-up and 'in transit inventories' finally arrive at destination…..who really knows?

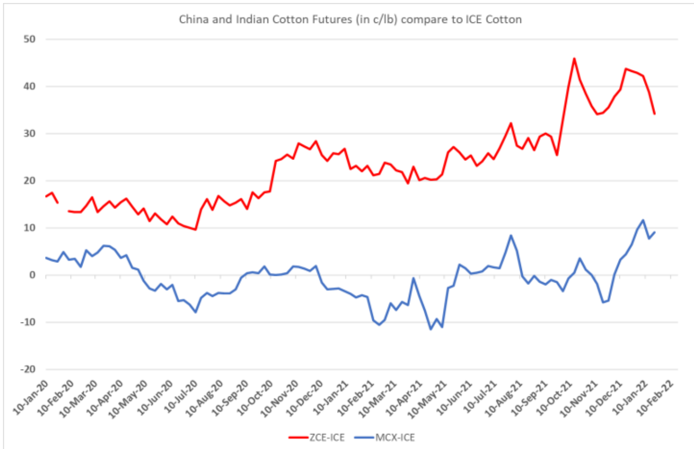
***Estimated offer US c/lb (C&F Main Asian Ports, 1-1/8", 3.5-4.9 NCL)**
Note – add 400-600pts for subcontinent markets

Origin	Offer Nearby	Offer Deferred	Eg Sales
Aus SM, 37		+1525 (N) A/S/O	
Aus M, 37		+1450 (N) A/S/O	
US 31-3-36 GC	+1700 (H) A/M	+1750 (K) M/J	
US 31-4 36 GC			
US 41-4 36 GC	+1585 (H) A/M		
Brazilian M, 36	+1600 (H) F/M	+1450 (Z) O/N	
Fr W Afr (s), 36	+1450 A/M		
****PSF**	53.59 US c/lb	+0.50 (week)	N/A
Yarn 32Ne-China	4.51 US $/kg	+0.01 (week)	+0.05 (month)
Yarn 40Ne-China	5.13 US$/kg	+0.06 (week)	+0.05 (month)
Yarn 30Ne-India	4.78 US$/kg	+0.01 (week)	+0.40 (month)
Yarn 40Ne-Paki	5.06 US$/kg	+0.05 (week)	+0.01 (month)

*Offers estimated based know/est levels Friday Asian business hours adjusted for futures
** PSF = Polyester Staple Fibre (1.4 D / 38mm) ex works China
*** Yarn (India) = 30Ne 100% Cotton Combed, ring spun knitting yarn (ex work)
**** Yarn (China) = 40Ne combed cotton yarn (Qiangqing Market (Zhejiang))
*****Yarn (Pakistan) = 40Ne combed cotton yarn (C&F Main Asian ports)

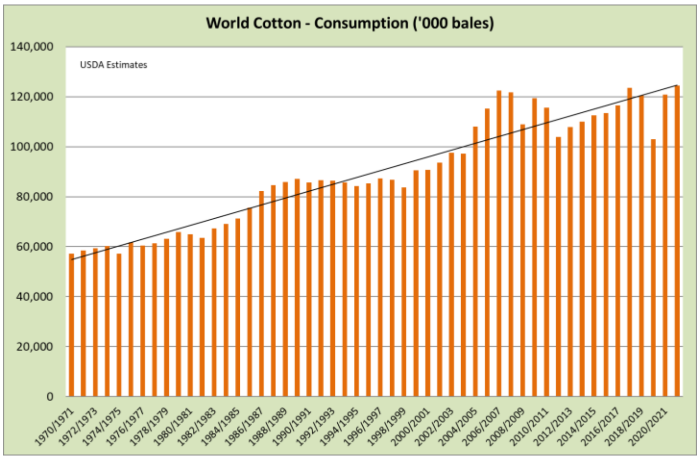
CHINA RELAXING, INDIA IN A QUANDRY

The chart displays China futures (ZCE) in red and Indian futures (MCX) in blue converted into c/lb - from which ICE cotton is then deduced. In other words the premium/discount of each to ICE cotton. Now this is simply a comparison of futures prices and not a comparision of the value of physical cotton of equal quaility at the same location at the same point in time. The comparison is more to highlight the comparative strength (or weakness) between them. The relative strength in ZCE futures has ameliorated recently which potentially reflects the better availability of cotton in China given Reserve Auctions and imports but perhaps also perhaps less demand due to various issues and resources and supply chain issues. The relative rise in Indian values on the other hand is likely suggesting a tightening of physical availability (farmers tight fisted, a smaller crop, slow import arrivals, Bangladeshi demand). India, if we can get the volume of freight, should prove a reasonable destination for Australian cotton – particularly in Q2.



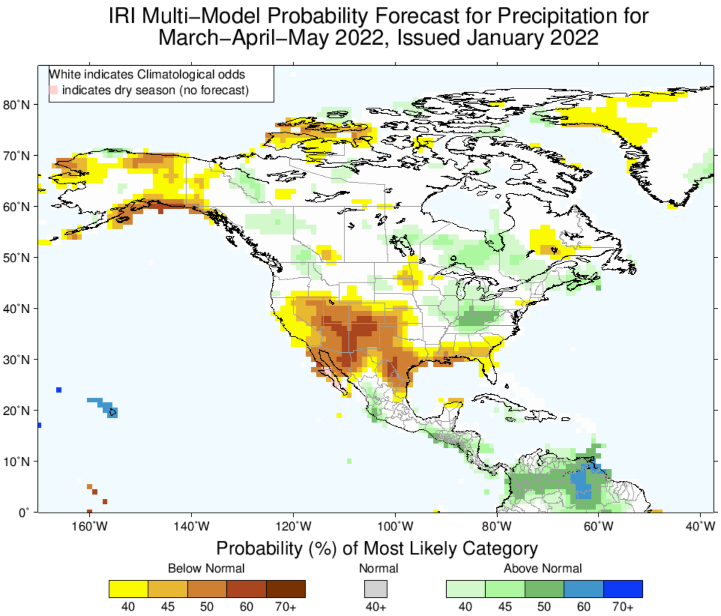
GLOBAL CONSUMPTION

Last week we looked at the progression of USDA monthly estimates for global consumption. This week we include a chart that looks at estimates for each year historically – easier from a perspective point of view. 2021/22 currently represents record global consumption following a sharp recovery in 2020/21. The recovery in 2020/21 is explained through both a post initial COVID recovery and Government stimulus but whether 2021/22 can see global consumption rise again (as is currently forecast) amid Omicron (both Government reactions and individual choice impacting movement), supply chain issues, no additional Government stimulus and inflation starting to eat away at disposable incomes remains to be seen. We admit to remaining wary of current estimates although we can't mount a strong case in the negative currently. Even if global consumption was overstated by 1-2 million bales the impact on the market would probably be somewhat mute. When the market starts to fall….then look for stories about consumption.



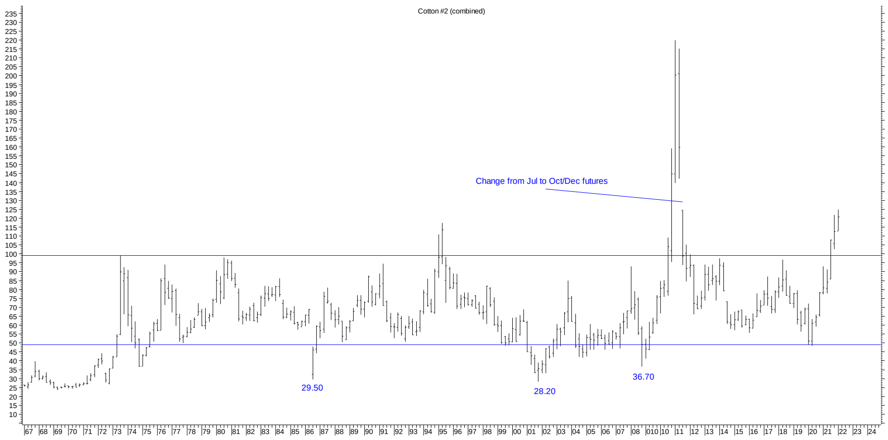
January 24, 2022

La NINA and TEXAS

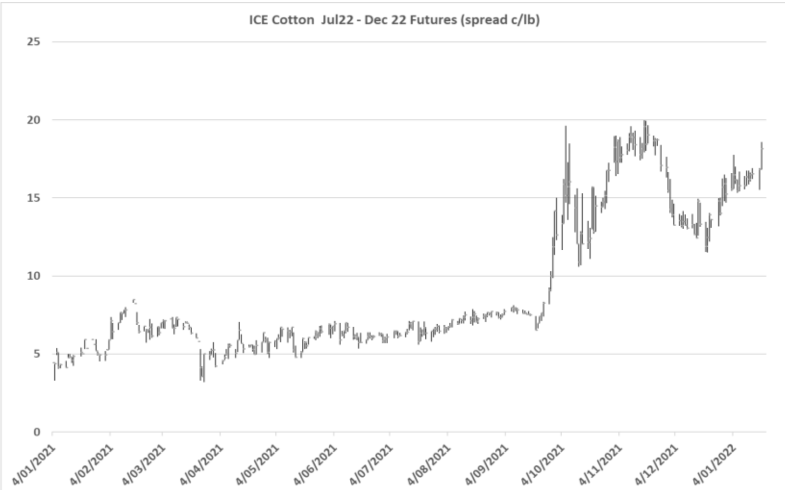


The current US drought monitor map [Current Map | U.S. Drought Monitor (unl.edu)] shows expanding dryness in the US plains and in particular through the plains areas of Texas (western Texas). Unfortunately neither the short term forecasts nor the climate models currently display any improvement – in fact they display a continuing theme of dryness. The latest model work from the IRI suggests a high probability of below normal rainfall right through the first half of 2022 (the model output for M/A/M is shown as this is the key period leading into planting – some half of Texas is planted by end May). We have not completed any analysis on the impact on planted area in La Nina years (we suspect not a lot, but there are many other factors that impact planting decisions including price and insurance rates). What we do know is that abandonment in both Texas and Oklahoma is markedly higher (Texas average 34% abandonment) in La Nina years. In terms of yield the impact is not so clear – after all the poor areas are abandoned early leaving that answer to irrigated fields and weather in J/A/S. The National Cotton Council will put out area survey results in February. From those results, unless the situation improves noticeably, we will be using a high abandonment rate for Texas. Keep in mind Texas upland area in the past decade has represented 50-57% of total US area and some 30-45% of total US production.

HOW HIGH IS HIGH IN THE ICE COTTON MARKET?



The answer is (drum roll) - we do not know. We can ruminate, muse, ponder and even speculate but the reality is we will all be wiser after the fact (which in markets is somewhat useless as the focus is always on “what next?”). In the meantime we need to have some kind of a view or at least some context within which to make pricing decisions (and adjust one’s stance in the market accordingly). From a fundametal point of view it is difficult to justify current price levels. Statistically world cotton stocks are not particularly tight, nor are stocks outside China, nor are stocks with the major exporters. Timing of availability is of course an issue (given statistically stocks are a point in time), however, overall it is difficult to make a fundamental case from current USDA data for prices at current levels. Looking a little deeper there is tightness in India, there is a lift in demand (more of a recovery of inventory post the initial COVID) and there are logistical issues which suggest mills might be overbuying (think buying RAT tests from five difference places hoping that some will turn up – hopefully on time). Trying to narrow all this down to a value is difficult and hence we tend to lean back on our technical analysis. As the chart above displays, prices are in rarified air though there is no sign as yet of a high. We do think a high is close in this market. Our technical targets on the upside currently are 121.67 (already exceeded), circa 130.00 and circa 134.00. Timing of a high? Well for once this might be an easier one to answer. We suspect Feb/Mar is a reasonable bet but highly likely prior end of June. The invert between July futures and December futures (see chart) where December is currently aroound a 17 cent discount to July suggests a major high in this market will be found prior the July contract expiry (purely given once December takes over it is likely to start at a lower value. So our context is



1. the market is still trending higher,
2. we think a high is within 10-14 cents (the rally feels mature),
3. timing of a high probably/maybe Feb/Mar but confident it will be in place by mid-year and
4. once a high is made the downside velocity will be breathtaking.