Cotton Compass

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Monday, January 31, 2022

Onward and upward……gulp

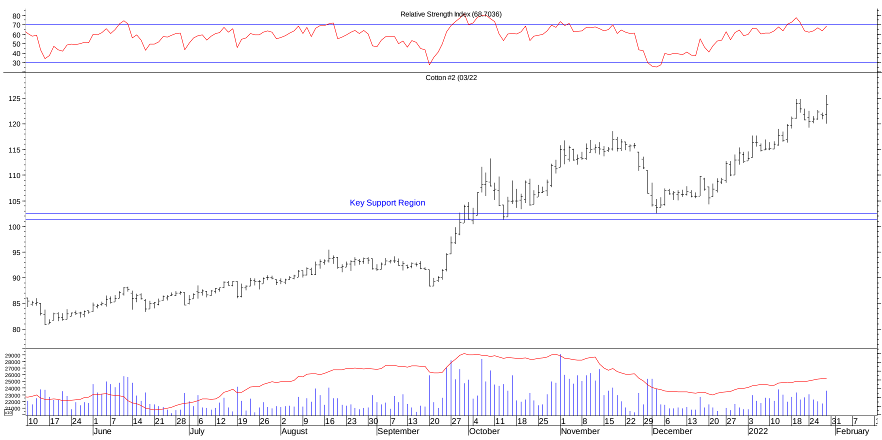
	High	Low	Close	Change (week)	Change (month)
Mar 22	125.60	119.20	123.76	+3.01	+13.71
May 22	122.36	116.72	120.84	+2.86	+12.80

COTTON spent most of last week looking a little indecisive, before a strong push higher on Friday saw life of contract highs across the board, with the December 22 contract touching US$1/lb for the first time….albeit briefly. As we summarised last week, whilst cotton looks expensive from a relative value, historical value and 'statistical' stocks to use perpective, the reality is that the distorting 'exaggerated demand signals' created by unprecedented global logistics bottlenecks means that traditional valuation methods effectively count for nought right now.

The US Export Sales report was impressive on face value, with a solid 394,900 bales of 2021/22 crop (including Pima) and 106,800 bales of 2022/23 sold for the week ending January 20. Shipments, however, were again disappointing at just 202,200 bales (including Pima). We all know the story here…..with just under 3.77 million bales so far shipped from the US (including Pima) and 27 weeks left in the marketing year, the US needs to ship well over 400,000 bales/week in order to meet the USDA's current export target of 15 million bales. With existing unshipped US commitments now sitting at just under 8.3 million bales….(representing almost 18% of global export 21/22 estimates) it's not hard to work out where the global inventory is currently sitting.

On Call: Unsurprisingly, most of these unshipped sales are priced "on call" – meaning the reality is that these shipping delays (not just out of the US, but everywhere) – more than any other factor – are the reason for the increasingly unwieldy mill on call position. Mills will need to fix the price on these on call sales (ie buy futures) prior to shipment – in order to establish a price, open an Letter of Credit and get the cotton shipped. With so much volatility and uncertainty (in all markets), it is understandable that they don't want to fix the price until they know the cotton is on its way…..who knows where values will be in one month, two months or three months time. The mill "on call" position on the March ICE contract currently sits at 43,565 contracts (4.356 million bales worth). There is no way that much cotton will be scheduled for shipment prior to First Notice Day on the March contract (Feb 22)….so it is inevitable we will see some serious buying of March / selling of May as these contracts are rolled over the coming weeks. Looking further forward, the combined March/May/July mill on call position now sits at combined 120,357 contracts (12 million bales worth)…..which suggests we could be facing a very interesting/confronting period if we get to the July/Dec period and these logistis issues and/or the steep invert have not resolved themselves. Being forced to buy July/sell Dec at a huge paper loss – and having that loss absorbed into your basis due to delayed shipments brought about through no fault of your own would not be an inviting prospect, and poses a high risk of significant contract renegotiations ….which would not be painless

Technically, the push to new highs this week leaves the door open for further upside - but as far as an objective goes, the only technical point of reference we currently have is the 2011 period. Back then the only real level of support/resistance we can identify is a rubbery zone in the 140-150 area. Meanwhile, the 38.2% retracement from long term high 219.7 to long term low 28.2% is 146.55 (the 50% is 123.95). Timing wise, however, we continue to feel the cycle is nearing completion. Who knows.

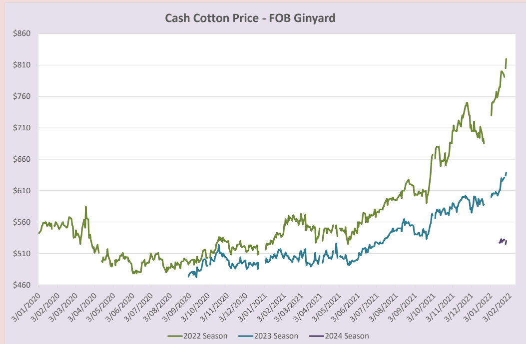


AUSTRALIAN CASH MARKET

	A$/bale Close	High Weekly	Low Weekly	Change this wk
2022	$820	$820	$795	+$20
2023	$639	$639	$630	+$14
2024	$532	$532	$525	N/A

2022 Crop

It was another active week for 2022 crop cotton sales, with more merchants willing to show attractive 'flat pricing' for ginning out to August as their ability to execute workable export sales in deferred months apparently improves (see page 2). We would not be surprised if more than 75,000 bales changed hands over the week – with April-August values peaking on Friday at around A$820-825/bale on Friday (ex Central Valley gins) – with moderate discounts for September. Whilst premiums are still achievable for May/June – with more than 60% of the crop now likely sold from grower hands (and the potential for COVID related hold-ups in delivery and ginning operations) the ability for growers to cover the tail end of the programme with less delivery risk at such attractive levels is more enticing.



Price Outlooks 2022 Crop:

Outlook this week: A$770 - 840/bale

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

2023 & 2024 Crop: 2023 crop was again moderately active, with "intra-day" values trading from A$630 to A$640 and overnight pricing orders executed around A$650/bale at various times through the tail end of the week. Its hard to gauge exactly how much changed hands

Hedging Model: Our "at market" pricing order on Monday would have been executed at $803 April-August (based Central Valleys).

2022 Crop Hedging Model		
Prodn Guess	Sales	Orders
5000 bales – 85% sold @ $635.94 average	500 @ $550 250 @ $575 500 @ $575 1000 @ $595 500 @ $625 500 @ $655 500 @ $720 500 @ $803	
2023 Crop Hedging Model		
5000 bales – 30% sold @ $577	500 @ $550 500 @ $580 500 @ $600	

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EXPORT MARKET SUMMARY

STRONG inquiry has been reported from a range of markets for Australian cotton – including for July/August/September shipment. Vietnam has apparently been particularly active – where some merchants suggest close to 50,000 bales of Aussie may have traded over the last fortnight, with South Korea also a strong buyer and other South East Asian markets picking up smaller volumes. Given the deferred nature of the business, most (if not all) has been conducted "on call" – with reports that transactions are generally settling around 1400 on July for Aussie SM 1-5/32" where Aug/Sep shipment slots are included. As mentioned last week, this is attractive against comparable Brazilian and US offers – and it makes sense that Australian cotton is winning this business.

Note: Chinese New Year celebrations in a range of markets will see muted demand signals next week.

Freight Markets are starting to look interesting. The Baltic Dry Index (BDI) – a measure of bulk shipping rates has been in freefall since early October last year, and is now down below pre-pandemic levels. This is perhaps an indicator of bulk commodity demand and trade flows. By comparison, there has been little relief in container markets – which arguably represent more 'retail' type demand…..and are clearly more important for packaged commodity trade flows, including cotton. Whilst the Freightos Global Container Index is currently back about 12% from its September 2021 high…..it is still about 700% higher than pre-pandemic levels. Whilst not really correlated, we do wonder if the BDI is a canary in the coalmine for the container trade.

***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	+1675 (K) M/J	+1525 (N) A/S/O	+1400(N) J/A/S
Aus M, 37	+1600 (K) M/J	+1450 (N) A/S/O	
US 31-3-36 GC	+1700 (K) A/M	+1750 (K) M/J	
US 31-4 36 GC			
US 41-4 36 GC			
Brazilian M, 36		+1450 (Z) O/N	
Fr W Afr (s), 36	+1575 (K) A/M		
****PSF**	54.75 US c/lb	+1.16 (week)	N/A
Yarn 32Ne-China	4.52 US $/kg	+0.01 (week)	+0.08 (month)
Yarn 40Ne-China	5.11 US$/kg	-0.02 (week)	+0.06 (month)
Yarn 30Ne-India	4.82 US$/kg	+0.04 (week)	+0.47 (month)
Yarn 40Ne-Paki	5.20 US$/kg	+0.14 (week)	+0.15 (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)

AUD/USD…..taking a peek over the edge?

The AUD/USD has come under serious pressure this week, taking a peek below the psychologically (and technically) important 0.7000 level (green line on chart right) for just the second time since February last year. Uncertainty over the pace of US Fiscal tightening has been the key driver for global equity and currency markets this week, with US Federal Reserve president Jerome Powell taking a more hawkish stance than anticipated during his monthly monetary policy announcement, and Minneapolis Fed president Kashkari throwing fuel on the fire on Friday with the statement "we just don't know" if three rate hikes in 2022 are enough. With the RBA still relatively dovish (for now) this is seeing yield chasers shifting cash out of Australia and into the US – thereby putting downward pressure on the local currency. It is also fair to say that uncertainties over the Russia/Ukraine conflict are also generating some 'flight to safety' type trades. Technically, the 38.2% Fibonacci retracement from the Feb 25 2021 high of 0.8007 to the peak COVID low of 0.5510 in March 2020 is 0.7053, with the 50% at 0.6758.

COTTON vs EQUITIES….a casual relationship?

The chart right is a 5 year comparison of cotton (red line) vs the Dow Jones industrial average (blue line). Whilst it would be foolish to try to perform any kind of 'ratio' analysis between the two - the chart does show that in general terms there is a directional relationship (albeit with periods where this relationship completely breaks down for a time – generally to genuine supply/demand imbalances in the cotton market).

The point is that….with growing uncertainty in financial markets (due to inflationary concerns and the potential cessation of Central Bank printing presses and effectively 'free money'….we need to be cautious of the potential impact of a serious equity market correction (if it were to occur) on our market.

Whilst we acknowledge there is genuine supply tightness at the destination end of the textile game, it is our view that this has been created by prolonged logistics bottlenecks, and that the same cannot be said for the rest of the supply chain. So…..there is an imbalance here that could see cotton march to its own drum for a time….but this is an imbalance that will inevitably correct itself. We just don't know when.

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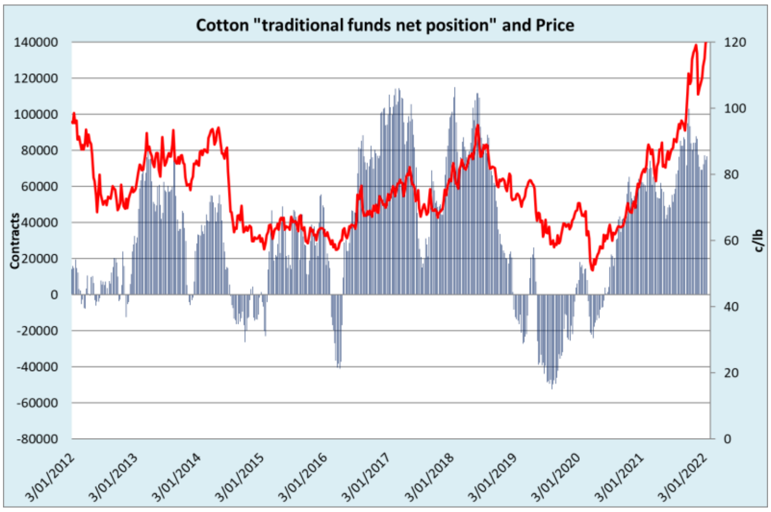
SPECULATIVE POSITIONING



While the current speculative net long position is historically high, it is not above the benchmark 100,000 contracts that in recent history has proved hard to sustain - ie briefly in Sept 2021 and in periods through 2016/17 and 2018.

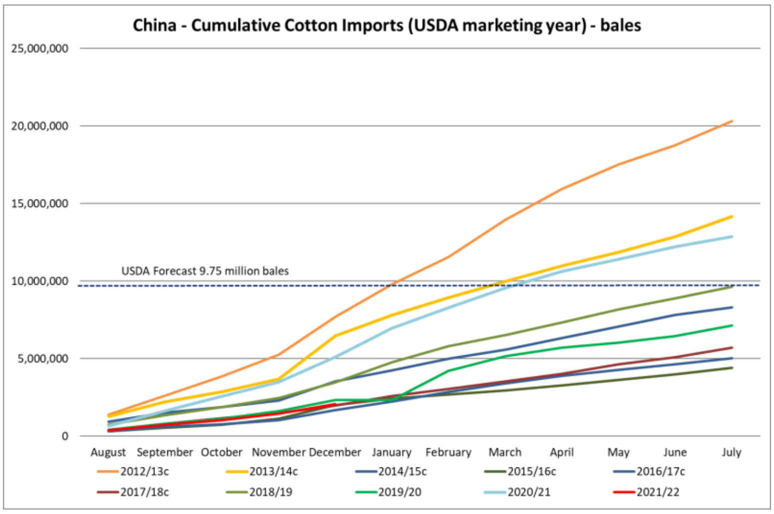
While price is significantly higher, overall participation in the market (open interest) is not currently at peak levels. Perhaps the increased volatility in the market (both from a risk and margin perspective) and the absolute price level is keeping speculators (and other participants) more cautious.

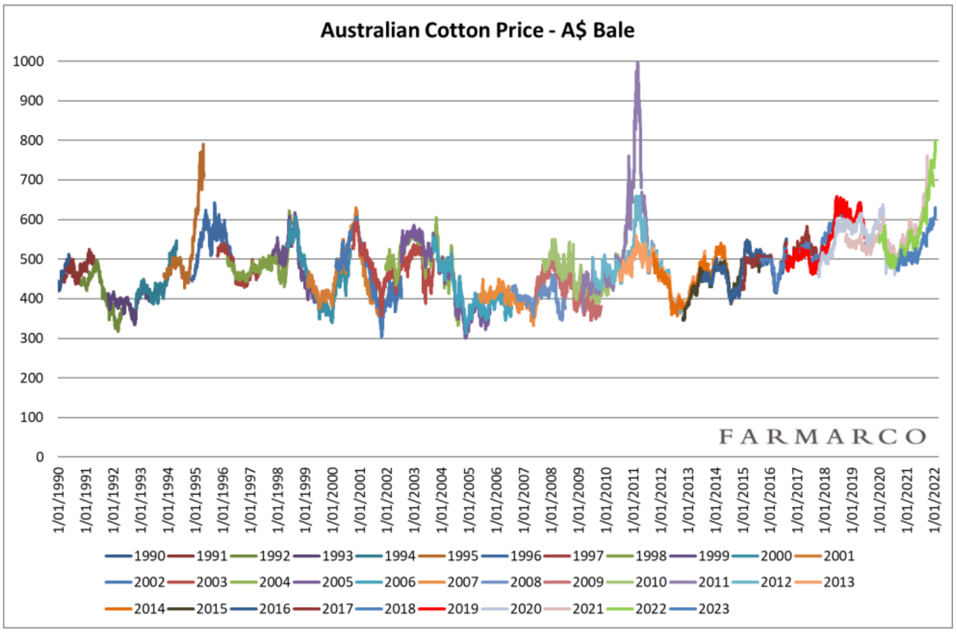
Overall with the market still performing strongly, the specs will hold their position and may even add a little to it - however at some stage the long trade will get stale and then turn sour and the specs will hit the exits and that historically leads to significant pressure on prices.

Much of the spec long position is in the old crop position and will eventually need to be unwound or rolled into the new crop position (Dec futures). This should eventually pressure the Jul/Dec spread and probably the market overall.

CHINA COTTON IMPORTS

For the first five months of the USDA marketing year China has imported some 2.08 million bales (36% Brazil, 34% US, 18% FWA and India combined). Australia, out of interest, is 3.5%. The pace of China's imports is slow. The USDA this month cut 500,000 bales off their China import forecast (9.75 million bales for 21/22) - this does not seem achievable. Seasonally we know imports tend to peak in Dec/Jan and then decline into June. To reach 9.75 million bales China needs to import 7.67 million bales in seven months Jan-Jul or an average of 1.1 million bales (240,000 MT) a month. Now China statistically can easily do this…..but will they? If we use data back to 2007/08 then China on average by the end of December had imported 38% of their final USDA marketing year estimate (range 27- 45%) which would indicate a final number for 2021/22 of 1.2mmt or 5.48 million bales. Even if we use 27% we only come up with a final 7.72 million bales. We are either going to see recent history re-written or over time a serious reduction to the USDA China import estimate. The implication will be a drawdown in Chinese stocks and/or lower mill use.





NOT MUCH TO SAY

Sometimes it is easier to let the picture tell the story.

2022 crop values (currently $800/bale plus depending on delivery period) are historically very high.

2023 crop values in excess of $600 are also up there.

The point for a grower is this – keep perspective of where the market is.

It is easy - as we humans do - to become "used to it", or "desensitised to", or even "take for granted" higher prices…..they don't have to last forever.