COTTON MARKET COMMENTS

Increased Foreign Production Offsets Small U.S. Crop

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The latest world cotton estimates by USDA for the 2011/12 crop continues to show a sharp increase in production over last year of 8 million bales more than use. Despite the record Texas drought and small crop, foreign production is expected to increase a sizable 10 million bales from last year.

Price moves in the U.S. are tied to growth in foreign mill use outpacing production. This season, foreign production is likely to be only 5 million bales less than use. That is the smallest foreign production deficit gap since 2004/05.

As a result, the export need for U.S. cotton is decreased to mostly rebuilding foreign cotton supplies. Consequently, the 2011/12 U.S. export shipments are projected to decrease over 2 million bales from the 2010/11 season to only 12.0 million or less.

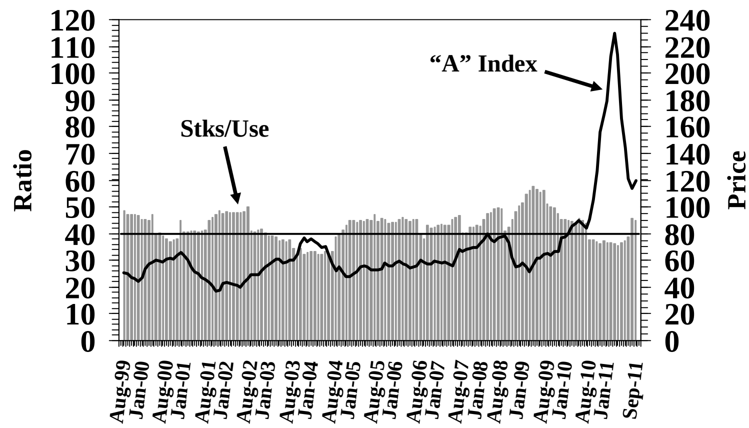
Thus, with an expected 16.6 million bale crop and domestic use of 3.8 (15.8 million offtake), there is an adequate supply of cotton to meet sluggish demand and hold December ’11 futures trading much lower than a year ago. The USDA projected 2011/12 season average farm price remained in the same range of \$0.85 to \$1.05 per pound as last month.

The panic a year ago to trade cotton by nonusers (speculators) has slowed with the threat of large deliveries of cotton on the December ’11 futures contract.

For September 2010 the “A” Index (world price quote) averaged \$1.05 per pound. From there the price skyrocketed to \$2.30 by March 2011. By August 2011 the monthly world price average had dropped in half to \$1.14 per pound.

The spike in cotton price was not based on realistic retail demand for the last year.

Cotton: “A” Index and World Stocks/Use, August 1999 – September 2011



Higher prices do increase production, decrease consumption, and weaken price as it has done many times in the past. However, the longer high prices exist, the more consumption weakens. Therefore, the implication from the record price rally that surfaced in August 2010 points to fairly stable to weak consumption for this season and the next as well as lower price.

The longer the price rally above \$1.00 per pound lasts, the more likely production will outpace consumption, price will move lower, and world carryover stocks increase. The international market responds to a very uncertain complex mix of individual country policy developments, varying economic conditions, uncertain production due to changes in planted acreage and yields, and spurts of speculative and industry trading.

An export-driven market makes for a very unstable market environment. However, in seasons when stocks increase, the market peaks in the first half of the year. Producers need to “fix” their price accordingly.

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