Cotton Marketing Weekly – November 13, 2020
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Cotton is a Calling

Friday the 13th. Cotton is going to be a tough sell in 2021-22 and I desperately hate to write that, much less even think it. Again, I find myself wishing and hoping my analysis will be on the wrong side of history. Yet, for the moment, let's look at the market situation for the remainder of cotton's 2020-21 marketing year. USDA's November supply demand report was expected to shock the market but proved to be a non-market factor. While individual country data saw minor revisions the aggregate data for both the U.S. and the world were left unchanged. Thus, world carryover is still expected to climb above 101 million bales and the stocks to use ratio remains a very bearish 89 percent. U.S. carryover is very burdensome at 7.2 million bales and U.S. domestic use is lagging. The coronavirus, continues to wreak havoc around the globe. As such, while the market is holding within a well-established trading channel, it has fallen to the bottom of the uptrend and is in significant danger of slipping below long-time price support at 67.50-68.00 cents, basis New York December futures. The U.S. and northern hemisphere crops are past peak harvest and while crop size is not fully determined the market has turned most its attention to demand. Another run to 70 cents is possible, but a market close at 67.50 cents would signal lower prices. (One more time—Short Crops have Long Tails.)

My www.agmarketnetwork.com cohosts are holding out for another run to near 73 cents, basis December. For me it is time for me to be done with 2020 crop pricing. If one is still bullish then price the crop in the cash market and buy a July 71 or 72 cent call option. Do not get caught having to pay storage costs. Yet, for those not truly committed to call options they already own, my advice is to sell the calls and pocket what premium value remains, i.e., cut your losses (or take you gains). Yet, if you truly have an inkling that higher prices (over and above storage costs) are in front of us, the call options do provide you the opportunity to profit from higher prices.

Now the big downer, and you can accuse me of fishing at bit. Where do we go with red December prices, or as the New Yorker would say "pink Dec?" The price for the 2021 crop, December 2021 futures is now 69 cents. Most growers must have a 70-cent minimum in mind, need 75 cents, and want at least 80 cents. Given the run-up oilseed and grain prices (with even more expected, it is—historically--expected that cotton prices must also run higher to bid for adequate 2021 planting acreage. Simply stated, that is what markets always do. Yet, the current situation is much different than in past years. The backdrop, the stage, and some differences. The U.S. and world oilseed and grain supply demand situations are very tight—demand is outstripping supply. Not so with either the U.S. or the world cotton situation. The Brazilian soybean crop is facing a significant drought and is as much as two months behind schedule. The U.S. must divert as much as at least 10 million acres of cotton, or hay, and other cropland to meet 2021 oilseeds and grain demand. Most of this acreage must come from land area typically in cotton. Were it not for the "Phase One" trade deal with China cotton would be in even greater excess carryover.   Essentially, China did not need U.S. cotton, but, purchased some 5 million bales simply to meet the trade mandate imposed on it by the Trump Administration. The Trump Administration's policy advanced China to the U.S.'s leading trade partner in cotton. The Trump trade policy is now very much in doubt. For example, China announced this week it will renegotiate the Trump agreement and expects better terms.   However, China did/does need the U.S. grains and oilseeds (and needs more).   However, now that China will not take as much U.S. cotton the market can expect that U.S. carryover will become even a larger burden. Thus, this will have a definite bearish price impact on cotton.   The cotton trade with China will be sorely missed and the U.S. cotton grower will suffer both from the loss of export market share as well as declining prices.

Remember, all of this relates to 2021 cotton plantings and market expectations. Again, most are expecting higher prices for the 2021 cotton crop. Typically, I have often been the only bull, or one of just a couple of bulls. Now, I am left carrying the bear flag, and I do not like it. It does not fit. Market history tells me I should expect higher prices. However, recognizing that the current President was the only U.S. President (Democrat or Republican) to ever require China to honor trade agreements, (repeat THE ONLY), rings louder. Recall, China has just said they want to renegotiate the trade package.

A quick look suggests that Southeastern region acreage will fall some 1.5 million acres in 2021, MidSouth acreage will drop some 1.0 million acres, or maybe as much as 1.25 million. Southwest cotton planting could fall as much as 1.5 million acres. Granted, such a drop in plantings should support prices as the U.S. crop could fall to 15 million bales. However, excess carryover would still be a burden in the absence of U.S. or foreign crop production difficulties.

Granted, we are only playing with numbers right now, but playing is not always fun, especially when you are losing—as some of these estimates imply.

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