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Cotton is a Calling

The explosion in cotton prices continued this week as U.S. and offshore funds poured bags of cash into both the New York Cotton Exchange and the Chinese ZCE. The climb to the top continues, wherever that is. The price objective of $1.25 to $1.35 is still in the realm of possibility, although I am a bit dazed by the limit up to limit up trading. Speculators have hit the market hard and heavy as the primary fundamental on which speculators are focusing is the ratio of on-call sales to on-call purchases. That ratio has become more bullish in each of the past two weeks and now exceeds 5 to 1. However, what goes up does come down, but that is no more than a caution. Higher prices will continue if the speculators money lasts. The only demand in the picture is the demand for futures contacts, nothing else, simply the speculative demand to own a long futures position. The technical charts are suggesting the possibility, not the probability of topping action in the market. However, the magic word China has a few more cards to play and that can keep the speculators interested. China will buy more. Yet, demand outside of China has come to a standstill and that must be reconciled in the market sooner or later with lower prices. The trade is out of the picture. Speculators are in control and until they flinch there is no stopping this market. Prices are higher, but a minor correction of 200-300 points is in order before the $1.15 level is hit again and then $1.25-$1.35 level is challenged.

This quandary has created a situation such than most growers no longer sell cotton basis the December futures market. The prevailing contracts are based on the March futures contract. Think about it. No demand, thus the merchant does not need to buy grower cotton.

As suggested last week the market has reached the stage of pure speculation as funds are attempting to squeeze the mills who must buy futures contracts against on-call sales. Mills have somewhat buried their head in the sand, saying so what: Keep bidding the price of cotton higher and higher and we will just forfeit our on-call contracts and leave the merchants holding the bag. There will be some of that. Yet, any mill that defaults will face future shunning by U.S. and all major international cotton merchants. Many merchants encountered this between 2008 and 2012 and were forced to cease business operations, closing their doors for good. The U.S. does not need to lose any mechanizing companies. There are too few now. Competition is good.

The funds will continue to try to push prices higher. However, the funds already hold record long positions. However, the CFTC recently approved a major increase in speculative trading limits. This, coupled with the ICE's failure to increase margin requirements even though the market had advanced 22 cents, gave funds carte blanche to run over any trader and send price volatility to new highs. This should not be implied in any way that speculators are anything other than a major participant. They are very valued. Historically, ICE has increased margin requirements when the cotton market began to act in this fashion. It's failure to do so in the current market has encouraged the massive increase in market volatility to a dangerous level. Therefore, the trading now is by funds on both sides of the market. Consequently, the market has lost it ability to discover or determine a true value for cotton as well as failing to afford any opportunity to hedge or shift risk for mills and growers. Thus, two major market participants have been forced out of any market participation. Few, if any growers can sell their cotton, basis December. The are forced to sell basis March. Granted, they are receiving an excellent price, but they also see that the market has taken some 3 to 5 cents away from them.

Enough of that. The speculators will battle it out and the deepest pockets will win. Cotton prices paid by textile mills will likely make cotton an uncompetitive fiber in the textile market and cotton's of the spinning system will once again decline. It will then take lower prices to rebuild cotton share of the market. The market can handle 95 to 100 cents and maintain its market share. or most of its share.

U.S. exports have cooled considerable as only a net of 246,700 bales of Upland were booked on the week ending 9/30/2121. China, 185,500 bales; Guatemala 33,000; Turkey, 18.200; Vietnam, 15,400 and Bangladesh, 10,300 bales were the largest buyers. Only some 12 countries were represented. China will continue to be a buyer and will likely be in the market for as much as 750-1.0 million bales. Thus, Chinese magic will continue to be on the minds of cotton traders.

The new crop December, red December futures have climbed above 90 cents and are down to 88 cents plus. Growers are encouraged to price as much as 40% of their anticipated production at these levels, or better. Plantings in the U.S. and globally could be up 5 to 7 million acres in 2022. More experience marketers may want to price 100% of their expected production using any combination of puts and calls. Very experienced users of the futures market should look at selling call 4-5 cents above the market and use that money for marketing opportunities as they present themselves.

With prices in the top 1 percent of the historical price range, coupled with the fact that mills cannot profitably spin cotton at current prices one has to question the future strength of the market. Yet, the on-call positions are a feracious "bull in the china shop." Prices are headed higher, but any sell off will hold the market above $1.05.

Gift of Cotton Today