New York Futures

By Hibbie Barrier, The Jernigan Group

As we look at New York futures there are several general observations worth noting. First, volatility has been incredible. Daily price fluctuations of 250 points or more have been quite common in the past two months.

Second, option trading has become an integral part of New York's turnover and price discovery mechanism — probably a result of the increase in volatility. Third, China continues to carry a disproportionate weight on price direction and market focus as their demand continues to grow almost exponentially.

Lastly, the concentration of players and market share of the major merchants. Over the past three or four years there has been a major consolidation of players in the market. In the US for instance, the growth of managed pools and grower co-ops has played a large role in marketing the US crop.

In addition, the deterioration of the US domestic spinning industry has also reduced the number of companies that use futures. What has not been reduced, however, is the number of funds and amount of money held by funds that trade cotton. The combination of these events has and will continue to be a factor in analysing New York's performance.

STRANGE MARKETS

Markets can be strange and hard to understand sometimes. For instance, before prices rallied last (northern) fall, the majority of opinions were bearish or at best skeptical bulls. An increase in Chinese and world production kept the bears in a comfortable position.

Looking back, in September 2003, world stocks were projected at 32.22 million bales and ample levels of US, West African and Brazilian production were on the horizon. Ironically, over the next two months prices rallied nearly 30 cents.

During this period China's crop projection fell from 25.5 to 22.3 milion bales. Chinese consumption increased. At the same time, US production estimates rose from 16.99 to 18.21 million bales. Yet ending stocks fell only modestly to 32.19 million.

This year here we are again. The market is expecting lower prices amid a record world production forecast. In the USDA's September supply and demand estimates, world ending stocks were forecast to rise 810,000 bales to 40.03 million bales. This was the result of increases of 410,000 bales to beginning stocks and a 660,000 bale increase in world production to 107.25 million bales, a new record.

The increase in world production was mainly the result of a 720,000 bale increase in the US production forecast to 20.90 million bales.

World consumption was increased 190,000 bales to 100.85 million bales.

In the US, ending stocks were projected to rise 200,000 bales to 6.10 million. Consumption was raised 200,000 to 6.10 million bales and exports increased 200,000 bales to 12.80 million bales.

WILL ESTIMATES PROVE TRUE?

The big question for the market is will these estimates prove true? The USDA has already cut China's production estimate once. Additional cuts along with steady demand could mean higher world prices.

The forecast rise in world ending stocks has put global demand in a hand to mouth buying pattern. This is the result of the ultra competitive nature of the textile industry and the desire to manage inventories against an extremely volatile physical market.

The combination has left many mills short cotton which has created a continuous stream of prompt demand. This could prove to be a significant factor in New York if new crop arrival and/or new crop movement is slowed. In fact, new crop movement has already proven difficult as growers' price ideas have routinely been above 56 cents — including US and West African cottons.

This begs the question: Which comes first, the chicken or the egg? In cotton's case the chicken is the mill industry. Do they pay up in the face of a perceived excess global supply?

Or, does the egg, in cotton's case, the grower, manage to refrain from selling until prices improve? In both cases last year's fall rally is still fresh in their minds. Mills who paid dearly near the highs are still seething as are growers who are grumbling that they sold too low.

In our last report we suggested the best chance for a rally was the August through October time frame. So far the rebound from the August 12 low at 42.50 to the 56.00 high on September 1 has been on target. Any rally above this level would seem difficult given the expectation of a large world and US crop. Of course this could change if China's production outlook shifts toward a lower number.

As China's cotton balance sheet sits today, they cannot afford much of a decrease in production. Further cuts in production would leave mills at uncomfortably tight levels. Already prices in China are well above world averages. This would encourage imports through next year on the level of the 2003–04 season.

Standing in the way of a bullish market is a largely unsold world crop. Not only is the US crop mostly unsold but so are the West African, Greek and CIS crops. So, without some help from a decline in world production somewhere in the world, prices will be hard pressed to rise much above 60 cents.