Thompson on Cotton: It's Déjà Vu All Over Again

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As Yogi Berra once said, "It's déjà vu all over again." For consecutive weeks cotton prices have dipped precariously below 80 cents before rebounding for significant gains. After falling to a low of 78.56, July futures reversed itself last week, tacking on 310 points to close at 83.90. In a similar fashion, December futures slid to 78.77 before recovering to settle at 83.24, a gain of 214 points for the week. It is obvious, at least for now, mill demand is strengthened when prices weaken. The question is can this support withstand repeated challenges in the face of such ominous headwinds?

The Fed's tenth consecutive interest rate hike came as no surprise to anyone. However, to our dismay, Chairman Powell's post-meeting comments were lukewarm. Though hinting at a possible pause when they meet in June, he remained adamant that two percent inflation remained their target. Until they are assured of a diminishing labor market and shrinking economy, expect them to stay their course. Job numbers released Friday were less than encouraging. In April, 253,000 new jobs were added, far exceeding expectations of 180,000. The unemployment rate now stands at 3.4 percent, matching January's fifty-three year low. In addition, wages grew 4.4 percent over last year. Thus, clearly the labor market is showing no signs of fading. The consumer price index, a key indicator of economic growth, will be released on Wednesday. The Fed will be looking for a decline from the five percent in March as an indication inflation may be cooling.

The fact price weakness is spurring demand was seen in last week's export sales of 255,900 bales which topped the four-week average by 59 percent. More notable, shipments of 439,000 bales were almost twice that needed to meet estimates. It is very likely an increase in U.S. exports will be seen in Friday's WASDE report given such a pace with thirteen weeks remaining in the marketing year.

Where to from here? Holders of old crop cotton, of which there are many, should view this rally as an excellent pricing opportunity. Especially after returning to levels not seen since the May – July roll was made. Though July futures could have another cent or two in it, two factors stand in the way of any significant rally. First is the unusually high volume of old crop cotton still being held by growers. In talking with these individuals, most have lowered their target price to the mid-eighties. Thus, moving beyond 85 to 86 cents will be difficult due to resistance brought on by grower selling. Secondly, those hoping poor conditions in the Southwest might spark a price rally will be disappointed. The worst of conditions are currently being traded thus only if there is a change for the better will there be any market reaction and it will be bearish.

So do not fall prey to the notion of where the market once was, rather see the recent rally for what it is a gift.

Turning to new crop, a lot can happen between now and harvest creating pricing opportunities along the way. We encourage you to manage your market expectations. A return to the lofty prices of last year is not in the cards. Also, do not be fooled into thinking prices have to rally to cover production costs. Frankly, the market does not care what it takes you to produce an acre of cotton. Instead, be prepared to react quickly to opportunities as they present themselves. A marketing strategy where one begins pricing new crop cotton in the 80's is certainly justified given all the geopolitical, economic, and crop uncertainties surrounding today's market.