

AFRICAN FRANC ZONE BASIS TURNS WEAKER



AUSTRALIA'S SOUTHERN VALLEY'S EXPERIENCE RAIN



US FORWARD EXPORT DEMAND FOR 2019/2020 TURNS WEAK



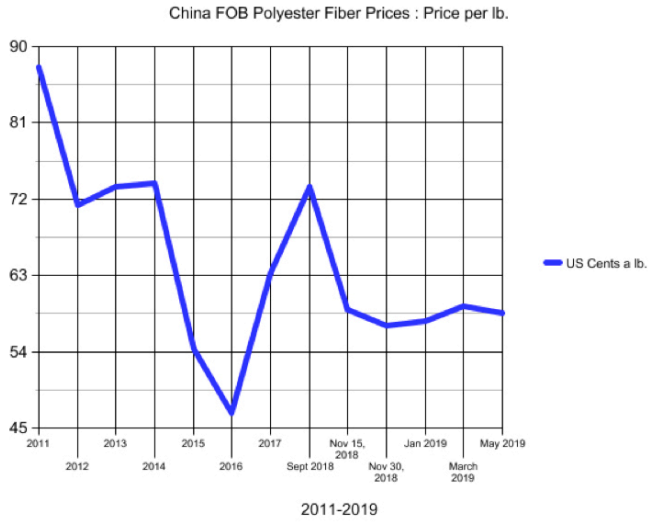
EXCESSIVE RAINS THREATEN US PLANTING WINDOW

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CHINESE POLYESTER PRICES AGAIN UNDER PRESSURE DUE TO OVER CAPACITY CAUSING NEW PRICE ANXIETY FOR COTTON



The arrival of the "China Price" as China joined the WTO marked the destruction of the entire US manufacturing base, as it was unable to meet that price, resulting in US capacity moving to China. This practice gave way to massive deflation in retail prices, as China undercut all other manufactures, and government subsidies and tax rebates reduced cost for the targeted industries. This practice led to overcapacity that provided even lower prices. As time went on, this economic model was repeated over and over again, which provided massive economic growth. The economic stimulus that was unleashed to stop the 2008/2009 global economic crisis from slowing China's growth was one of the largest ever by any government. The stimulus package cost four billion RMB (approximately 586 billion USD), which is greater than the 2017 GDP of Sweden or Poland. At the time, the package was heralded as a great success, as China rebounded quickly followed by other parts of the world.

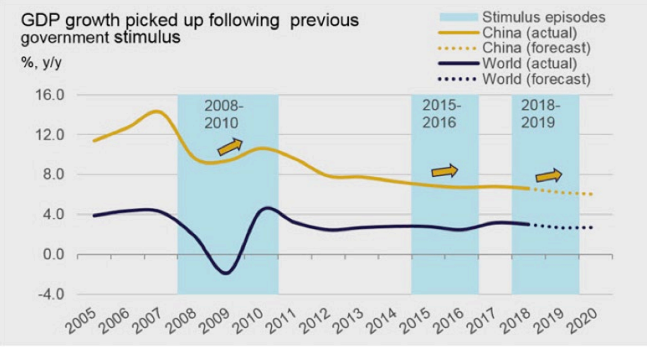


2011-2019

The full ramification of the capacity expansion, which the stimulus unleashed across various industries, was vastly understated. Much of the capacity did not come on line until the 2011/2012 period or later. Now, eleven years later, the world is still feeling the impact of Chinese industries overproducing certain industrial products, despite the fact that, due to the benefit of government subsidies, they are producing these products below the actual cost of production in other countries.

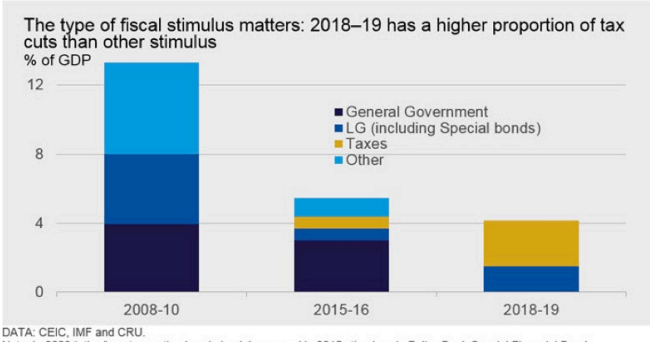
The focus in 2008/2009 was on ten major industries, one of which was the petrochemical sector. As a result, annual polyester and man-made fiber production capacity more than doubled. The industry continued its

expansion at a slower pace until a major environmental clean up effort was launched in 2017. Now, in late 2018 and early 2019, expansion has again occurred, as China moved to create growth by stimulating industrial production. However, instead of new cash expenditures, it suspended environmental clampdowns and allowed polluting plants to come back online, or even expand. It was recently revealed that Shandong Province failed to obey the central government's environmental targets in order to protect local industries and to meet economic targets. Shandong is one of the largest textile and apparel centers in China. The central government had set a four MMT annual target for aluminum production in Shandong, but it had been expanded to 12.6 MMT. Capacity expanded by more than 300%, despite central government restrictions. Curbs on construction were ignored. It appears that this is just an example of how difficult it is to rein in the driver of growth of the last 20 years. The reactivation of polluting plants occurred this past winter all across East China, which greatly increased air quality issues.



DATA: CRU, CEIC and Oxford Economics.

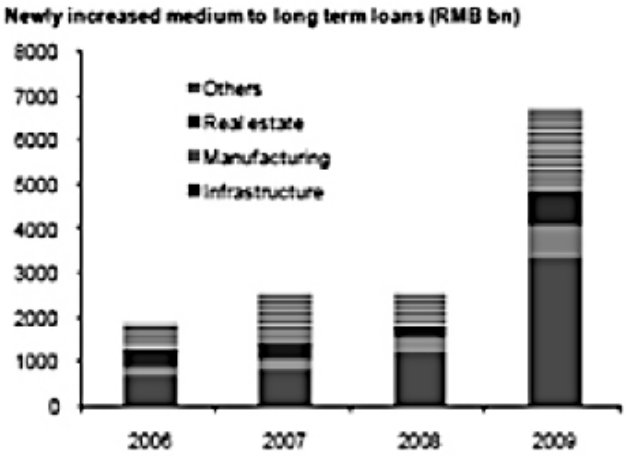
China economic stimulus 2005-2019



DATA: CEIC, IMF and CRU.
Note: In 2008 "other" captures stimulus via bank loans, and in 2015 stimulus via Policy Bank Special Financial Bonds.

China economic stimulus types

The markets have found encouragement in what appears to have been a recent pick up in economic activity in China, but a deeper look suggests it may be linked to the same economic model that increased industrial product and commodity production. March industrial production output in cement increased 22% from a year ago, steel +11.4%, and new electric vehicles +41.6%. Cloth production increased by 9.2%, but the shocker for us was that total chemical fiber production surged 20.6% to five MMT. These surveys have been plagued in the past by massive statistical issues, such as double counting. Thus, they are not highly accurate in the absolute number, but do provide a reliable indicator of what is occurring. This means China's polyester staple fiber production expanded in March, along with other man-made fibers, despite the lack of profit margins. It also confirms that any environmental controls are not inhibiting growth.



Source: PBOC, World Bank staff estimates.

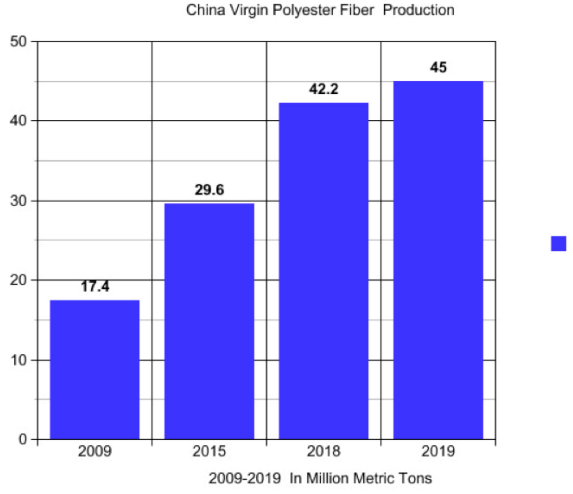
The problem is that the wholesale price of polyester staple fiber and all its sister products is not being driven by cost of production, which has been overshadowed by the installation of capacity, driven by cheap subsided loans, strong local government support, further subsidies, and a continued set of industrial subsidies. First, polyester begins its creation in the crude oil refining process. Then, as the refining is done, a series of raw materials are produced, with each having its own supply demand. Petroleum naphtha is an intermediate hydrocarbon liquid stream derived from the refining of crude oil, and is where it all begins. From here, it moves to paraxylene, which is an aromatic hydrocarbon.

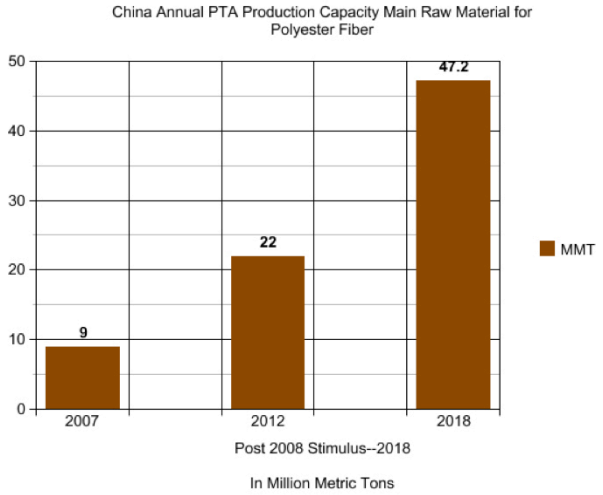
It is one of the three isomers of dimethylbenzene, known collectively as xylenes. Over 98% of paraxylene is consumed in the polyester chain, mainly in the production of fiber, film, and polyethylene terephthalate (PET) bottle resins, via one of two intermediates – purified terephthalic acid (PTA) or

dimethyl terephthalate (DMT). China's rapid expansion of the petrochemical complex has resulted in surging capacity of each of these products. Each of these then experiences its own supply and demand and price movement. The final polyester staple fiber price is then determined by the raw material of PTA and MEG, more than by crude oil.

However, it all starts with crude oil as the raw material. Since posting a December 2018 low of 42.53 USD a barrel for Brent crude, the price has soared recently, hitting a high of 66.30. This represents a 55.9% increase in price. China is the largest importer of crude oil in the world, and it has seen strong demand in 2019. What has petrochemicals done? These prices have been volatile. However, prices are now down for the period, and polyester staple fibers prices in China are now at the same price levels as October 2018. The beginning raw material price is up by more than 50%, but the derivative prices are unchanged. Massive overcapacity, subsidies, and on-going incentives to produce at far below the cost of production are clearly evident.

Last week the average domestic price of a 1.4/38 MM polyester staple fiber fell to 58.51 US cents a lb., which reflects a 2% decline over the last month and a more than 8% drop from year ago levels. In the raw materials market, the price changes in some of the products has been even more dramatic. If we use naphtha as the starting point, the naphtha to paraxylene spread has collapsed by more than 30% during the last 30 days, while paraxylene prices have fallen about 10%. The most direct influence on polyester staple fiber prices occurs from movement in the PTA and MEG price, with PTA accounting for about 60% or more of the cost. MEG prices have fallen near 6% during the past 30 days, while PTA prices have been steady. MEG prices are now down over 40% from a year ago. The fact that the weakness in the earlier raw materials has not yet





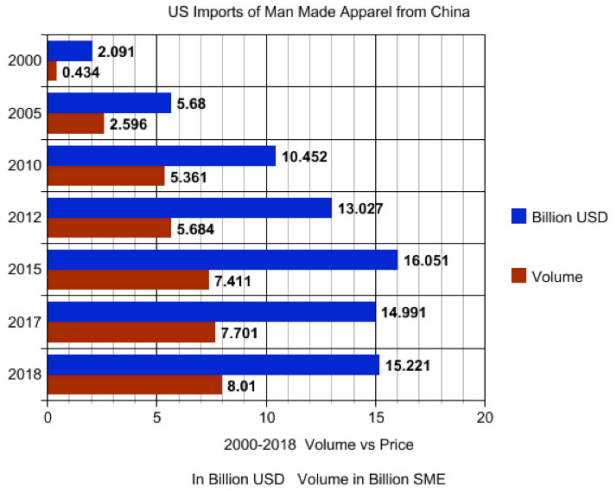
been reflected in PTA prices has helped maintain the polyester staple fiber price. If the strength in PTA gives way, polyester prices will fall several more cents.

The increasing supply of recycled polyester is also having a negative influence on prices. China halted the import of much of the plastic waste in 2018, which was raw material for the recycled polyester chip production. Now, it appears to be allowing for increased imports of recycled PET chips, with approximately 20-30,000 tons a month reported as being imported. The color index is said to be inferior, but the price discount is making it find buyers. Also, cargos of recycled polyester staple fiber are now arriving from the new capacity plants, which have come online in Southeast Asia and Africa, since China banned the import of most plastic waste at the start of 2018. Imported cargos from Thailand, Vietnam, Malaysia, Indonesia, and Nigeria have arrived, with price discounted below the virgin fiber by as much as 600-800 RMB a ton. This equals a polyester staple fiber price of 54 US cents a lb., or about a four cent discount to domestic virgin polyester. The new capacity and lower prices mean that the cheap recycled polyester staple fiber prices now prevailing across Southeast Asia are also a threat to cotton consumption. This is one reason we have been discussing the fact that when a local market experiences a squeeze in cotton prices, or cotton yarn prices fail to provide the needed margins, spinners take advantage of these discounted recycled polyester staple fiber prices. When China banned the shipments of plastic waste, the wholesale price of the waste collapsed, allowing a large margin for the Southeast Asian producers, and for expansion of capacity. As the plastic pollution problem continues to accelerate, the attraction of installing recycled capacity continues to expand.

The weakness in polyester prices is also being extended to a lesser degree to some of the other man-

made fibers. Chaos is prevailing in the nylon-6 market. Nylon 6 is used in apparel and is a thermoplastic polymer, which means the polymer can be repeatedly melted and hardened, so recycling is also gaining momentum in this product, adding to supply. As part of the petrochemical complex capacity, nylon 6 production also expanded under the 2008 stimulus, and has continued to expand in 2019. New plants are now coming online in Yichen, Fangyuan, Luxi, Jinjiang, and Shenyuan. Overcapacity is reported as a significant problem, with the volume nearing the record over capacity which we saw in 2015, after much of the 2008-motivated new capacity came online. Amid these conditions producers are cutting prices.
Viscose fiber prices have a completely different set of dynamics and are experiencing steady prices at the moment after earlier weakness this year, with the average price near that of cotton on the international market at 83 cents a lb. The exception to the renewed weakness in man-made fiber prices is the continued strength in Chinese dye prices used by much of the world. The great environmental harm caused in the production and use of these dyes has made China the center of output, and also limited the expansion of production into the other textile centers. The 2017 environmental clamp down had a major impact on this industry, closing down old plants and forcing others to install new pollution control equipment. Capacity was closed and has not reopened, and it has caused prices to rally sharply, with many prices presently up 50%, and with disperse dyes leading the strength.

The overcapacity in man-made fiber in China and the expanding capacity outside of China is one of the major challenges for the cotton industry. The difference in China and the balance of the world is that its companies don't have to follow the rules of supply and demand, and can produce and export at prices far below the cost of production in the rest of the world.



Currently, the weakness already has some Japanese companies reducing output, but not in China, where new capacity is still coming online. During the last 12 months, Chinese exporters have been found by the US trade office to have dumped polyester yarns in the US market at prices from 60% to 100% below what was determined to be a fair estimated production cost. In April, two US polyester producers have again sought action against China for dumping polyester yarn into the US market.

What has been missing from any investigations or rulings has been any attempt to halt the economic damage done by the import of underpriced polyester and man-made fiber apparel from China. These are using raw material that is selling far below the true cost of production. The available cheap man-made fiber apparel has undercut remaining manufacturing in the US and in many other countries, such as Brazil. Brazil is being overrun with the cheap man-made fiber apparel that is undercutting the domestic industry, despite attempts to use duties to halt the flow. Then there is the damage done to US cotton producers by the Chinese man-made fiber apparel that continues to take market share from cotton. One reason cotton use in apparel at retail in the US is under serious assault is this "Chinese Price." In recent years, there has been little discussion on launching an investigation, or the possible use of sharply increased duties on man-made fiber apparel imports to address the issue. The lack of action is costing cotton market share. A review of the market value of US MMF Apparel imports from China into the US reveals that, while the total market value of imports fell in 2017 & 2018, the volume of Apparel continued to increase, reaching a new record in 2018 that reflected over a 49% increase since 2010.

For now, the renewed price pressure in the man-made fiber complex means that cotton demand will remain very sensitive to price movements. At 54-58 cents ex-factory/warehouse for polyester fiber, price is a real inhibitor to any move in cotton prices to back near 100 cents. The success for cotton is to fight man-made fiber on price subsidy and environmental grounds. A major effort is underway to ban plastic straws, bags, and other products that are covering the world's oceans and landfills. In Europe, a few investigations have started into Fast Fashion and the issues created by the throwaway apparel. Currently, polyester and man-made fiber have not been taxed or banned, but the link back to same raw material as many plastic products, and especially plastic bottles, is now being increasingly known and discussed. Earlier, an attempt by California to tax man-made fiber apparel was blocked by the Los Angles apparel and retail lobby. This effort reflected the

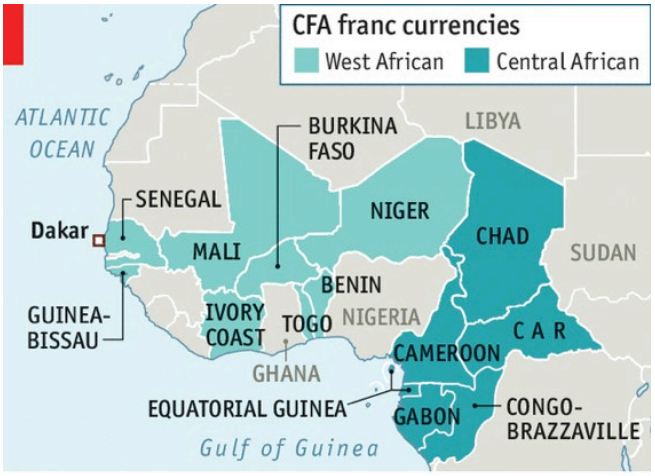
first volley of what is likely to be a long war.

The issue of China's subsidies has been injected into the China/US trade talks. In an interview in the *Financial Times,* Richard Trumka, the head of the AFL-CIO, the largest union in the US, stated, "The Chinese circumvent comparative advantage by underwriting the cost of their uncompetitive industries, or by targeting an industry and subsidizing it. That has to come to a screeching halt. If the agreement doesn't do that and give us a way to enforce it, then it will be an inferior agreement. And it'll be another opportunity, a great opportunity, missed."

AFRICAN FRANC ZONE BASIS LEVELS TURN WEAKER AS INDIAN DEMAND IMPROVES



Mali cotton harvest

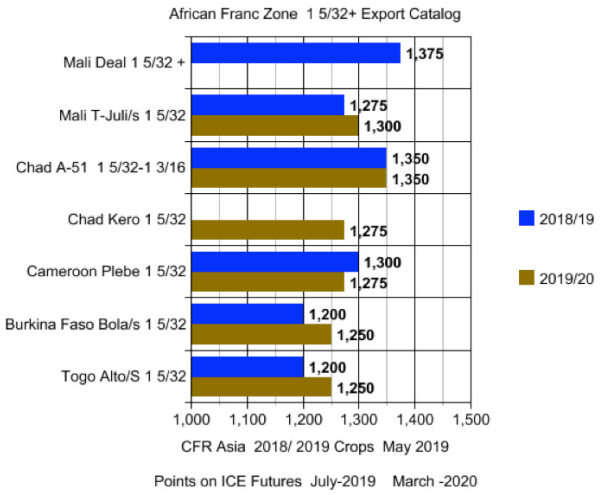


Economist.com

This season's shortage of high-grade (Strict Middling+) longer staple crops in 2018/2019 has increased demand for West African styles across most markets. General basis levels have declined over the last 30 days, as merchants appear ready to sell inventories ahead of another large crop. The region will produce 5.25 to 5.45 million bales, with almost all of it, except for a small volume, going to export. The region has very limited warehouse space, so when the ginners and marketing organizations deliver their sales to merchants, this starts the time clock to get the cotton shipped to one of the regional ports and on a boat. The pressure normally begins to build in April, reaching a peak in May and June. Strong demand has developed on the weaker basis levels from India, Bangladesh, China, and others. The quality of the West African cotton crop has made great strides, along with an improvement in ginning that has occurred as many ginners work hard to assist growers in improving picking procedures. The region, however, is plagued by some of the lowest yields in the world, amid a lack of GMO technology. The quality of the 2018/2019 crop appears to have been excellent, with a wide array of 1 5/32 staple length, and excellent color grades equal to a Strict Middling. This has placed the growth in the spotlight due to the significant quality issues with the US crop.

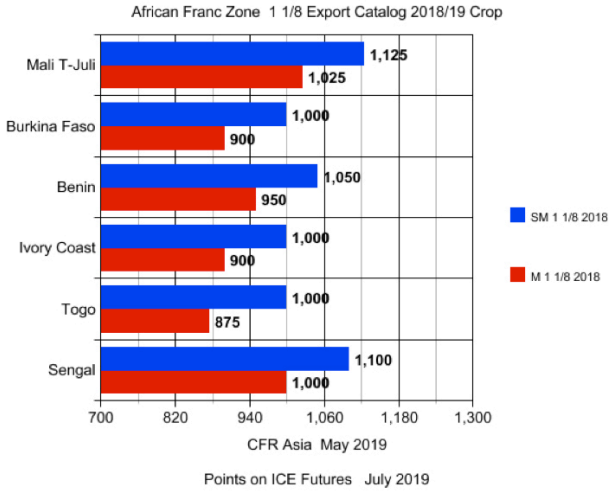


Burkina Faso cotton harvest



CFR Asia offers now reflect this improved quality. The Chad A -51 1 5/32 to 1 3/16, premium mike offers are at 1350-1400 points on July. The quantity of this type is very small, with Chad cotton production collapsing in 2017/2018 and 2018/2019 to 100,000 bales or less. The sector has been beset with a lack of adequate support in inputs. Private sector investment is expected to help revive output in the future. Mali T-Deal 1 5/32 + CFR offers are now in a range of 1350-1400 points on July, and Mali T-Juli/s 1 5/32 is offered in a range of 1250-1300 points on July. The Cameroon Plebe CMIA/BCI 1 5/32 is offered in a range of 1200-1350 points on July. Burkina Faso has had quality issues in 2018/2019, but despite the issues, offers of Bola/s 1 5/32 from the better ginners and merchants are offered in a range of 1200-1300 points on July. The wide range of the African Franc Zone equivalent SM 1 1/8 styles is proving very popular with spinners, with CFR Asia basis levels in a range of 1050 to 1250 points on July ICE futures, depending on origin and ginners and merchants. In the face of the strong level of demand, the basis remains much weaker than last year at the same time, when the general range was 1300-1400 points on July. The most aggressive offers are for Ivory Coast Manbo/s 1 1/8 and Burkina Faso Bola/s 1 1/8, at 1000 to 1150 points on July. In the Ivory Coast, the discount appears tied to quality issues that arose during the civil war, when contamination was a major problem that ginners are now recovering from, and from the near record 2018/2019 crop. The Ivory Coast cotton industry is rapidly expanding, as is the country, which is drawing new investment, especially large investment from China. In Burkina Faso, the 2018/2019 crop was down sharply from early expectations, following poor weather, increased pest infestation, and farmer boycotts. Total seed cotton production was down by nearly 50% from the early targets

Demand for the African Franc Zone styles has increased, as the Cotton Made In Africa program (CMIA) and BCI initiative have grown in the region. The Cotton Made in Africa program has strong support in Europe and Germany, with brands and retailers in particular. The program provides training to small holders to improve environmental practices and increase yields. The CMIA then licenses retailers



and brands to use the logo on the finished apparel, with the fees funding the training. The program also aids local cotton grower communities. In 2017, the program had 1,620,000 hectares of cotton enrolled as CMIA-certificated. 73 textile companies had entered the program, along with 36 trading partners. An estimated 90 million apparel items entered the market with the CMIA logo. This has created demand from the European brands and retailers that are requiring their textile supply chains to use CMIA cotton. This has helped maintain basis levels at times, and helped create a dedicated demand base for the African Franc Zone crops. The program helped stimulate demand for CMIA cotton in Bangladesh, an important supplier to Europe.

The largest inhibitor to production lies in several factors; the lack of GMO seed technology, which has left yields among the lowest in the world, an increase in production cost due to pesticide use, irregular weather patterns, and the renewed outbreak of terrorist groups centered in Mali and Chad.

US/CHINA TRADE DEAL APPEARS HEADED TOWARD A CONCLUSION

As we near the one-year anniversary of the beginning of the Chinese/US trade dispute, it is clear that the dispute began without the US fully prepared for all the consequences associated with actually attempting to address the many longstanding issues that have only accelerated since Xi Jinping came to power. The tough action required to address these complex issues has been avoided by the US, as the results of outsourcing many areas of the entire supply chain of some US industries was moved into the spotlight, and as almost every industrial sector had some impact. Regarding cotton, this has allowed Chinese textiles and apparel to continue to flow into the US, with imports of over 40 billion USD in 2018, as US cotton faced a 25% tariff, even on the cotton imported under the general WTO mandated quota. The textile and apparel imports remained unaffected, because of the cost to US retailers and disruptions to consumers. Instead, almost a year after US agriculture imports were slapped with a 25% duty, the greatest cost related to the trade war has fallen on US farmers and agriculture industries, causing, perhaps, permanent market share loss in some products. Moreover, for cotton, additional damage has been done by China's export of underpriced man-made fiber and apparel. This has raised dumping investigations in polyester yarn, but, so far, not apparel. US imports of man-made fiver textiles and apparel during January and February have already surged 9.1%, with imports from China up 4.32% in volume terms. Agriculture prices rallied briefly after the first hint of a possible agreement last December, but have been on the defensive since that time, when it became clear the US had misunderstood what China had agreed to during the Argentina dinner.

It now appears the talks will end this month, either with or without an agreement. Comments emerging late last week were again confusing and unconfirmed by the administration. One such comment was that the US had dropped addressing the cybercrime issues that reduced confidence in a strong, reliable agreement that would provide long-term access for US agriculture exports. This was reported by *Financial Times* and unconfirmed. At the same time, the Trump administration said it was willing to walk away if the agreement did not address the US concerns. Nonetheless, it appears the talks will end in May. For the US agriculture sector, confidence remains low, with soybean and cotton prices on the defensive, as China continues to source from Brazil. Regarding pork, China has approved Argentina as a supplier. For the US cotton and soybean industry, a weak agreement or no agreement means significant trouble for 2019/2020 and beyond exports. The US has likely lost market share regardless, and the news for US cotton is not good, as Chinese spinners have been quite surprised at the dramatic improvement in cotton quality achieved over the past several seasons in Brazil. In addition, the record back-to-back Brazilian cotton crops has left exporters needing to move volume, and offering the cheapest upland CFR Asia basis. Without a 25% extra import duty, this still makes the Brazilian cotton the favorite.

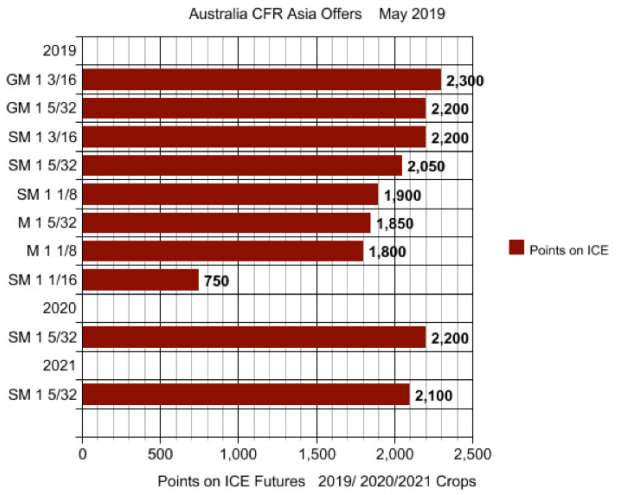
Within the next several weeks, the fate of the China/US trade agreement will be known. It appears that overall trade with China is set for a very volatile period, not just for the US but for other exporters, as China exerts it economic power as the key to the export market. For example, in New Zealand, where China has launched a massive investment and infiltration program, the country is seeking an expansion of its Free Trade Agreement to make it equal to Australia, which is needed for dairy and beef exports. However, China is requiring it to agree to a Belt/Road MOU before allowing the upgrade. Canadian canola imports to China remain blocked, and China is said to be drawing up a list of other products to boycott, unless Canada bows to demands on the release of the Huawei executive. Then, on Thursday, China began to halt imports of Canadian pork. In the Muslim world, silence regarding the Xinjiang camps is the price for continued trade and investment. Egypt just signed a new three billion USD Belt/Road agreement for a new business zone, and China has just announced a 3.4 billion USD investment in two Dubai trading facilities.

AUSTRALIA'S SOUTHERN VALLEY'S HARVEST UNDER THREAT FROM MAJOR RAIN EVENT

Australian growers in New South Wales were racing last week to complete as much of the harvest as possible ahead of a possible major rain event that is expected to impact the NSW cotton belt into Sunday, and eventually impact the Queensland cotton belt as well. An upper level, low pressure system moved up from Antarctica and interacted with tropical moisture to provide the potential for a major rain event. The forecast had the Murray River and Darling River region facing the potential for rains of up to 50 mm in Western and Southern areas, along with high winds and hail. If it occurs, the rain will provide a sizeable boost to water supplies, but such conditions will lower color grades and pull lint from bolls of the open cotton, reducing yields. The threat has already firmed the local FOB basis, and merchants fear that, unlike last season, with a Strict Middling color grade accounted for and 92.3% of all cotton classed this season, Strict and Good Middling color grades could be in very short supply. The fact that dryland cotton accounted for a large block of planted acreage has already provided the 2019 crop with a much larger percentage of short staple lots.

Early rainfall totals show the heaviest rainfall in the Southern Valleys, where approximately 650,000 bales of a 2.2 million-bales crop are expected to be produced. As of May 3rd, the main cotton belt of the south has reported 24 to 40 mm of moisture, with some heavier totals on farm locations. Up to 28 mm has fallen to the west in areas, such as Burke, where no cotton was planted in 2018/2019, due to no water. As the week ended, another wave of rain covered other areas. The Northern belt from Gunnedah north to the Queensland border received from 18-43 MM, and St. George in Queensland reported 20 MM. To the South, Victoria, which has only has a few hectares of cotton near the NSW border, received up to 100 mm.

Australian cotton has made great strides in quality over the last 20 plus years, ascending to the highest quality upland in the world most seasons in its irrigated crop. This season, Australian CFR Asia offers have reached a milestone, as it is being offered near par with the San Joaquin Valley Acala saw ginned styles. For years, Australian traded at a 2000 point discount to SJV, but no longer. The SJV Acala crop last produced a million bales in 2005, when output reached 1,065,000 bales. In 2018/2019, however, the SJV produced only 184,000 bales of Acala, the second lowest crop in modern times. This means the crop is now very much a specialty crop used by only a few mills. The extremely small acreage has reduced advances in seed, and thus the quality of the crop has stalled, with many of its features surpassed by Australian and even some other US uplands during a good season. The SM 1 5/32 Acala is offered at 2050 points on July, which compares to Australian SM 1 5/32 at 2000-2100 points on July. Australia offers currently have higher-grade offers in their catalog than the Acala offers.



In general, CFR Asia basis levels remain very firm, with GM 1 3/16, the top grade offered so far from the 2019 crop, being offered at 2300 points on July futures, a Strict Middling 1 3/16 offered at 2200 points on, and Good Middling 1 5/32 offered at 2200 points on, while a SM 1 5/32 is at 2000-2100 points on July futures. The concern now is that the supply of Good and Strict Middling color grade will drop sharply from cotton exposed to the current rain system.

FOB gin basis levels again firmed last week, as ICE futures failed to move higher, and the Australian dollar/USD exchange rate hovered near .7000 cents. 2019 FOB gin levels were 1250 + on July futures, 2020 levels were at 1150 points on May 2020 futures, and the 2021 crop was moving close to 700 points on May 2021. Cash Australian dollar bids were noted for 2022 and 2023 crops at 540-545 AD per bale.

Some hope emerged that a Coalition victory in this month's elections might actually lead to investment in water infrastructure. The Nationals, which are part of the Coalition opposing Labor, announced plans to establish a new government authority to oversee new water infrastructure in rural areas. At the moment, the election remains too close to call.

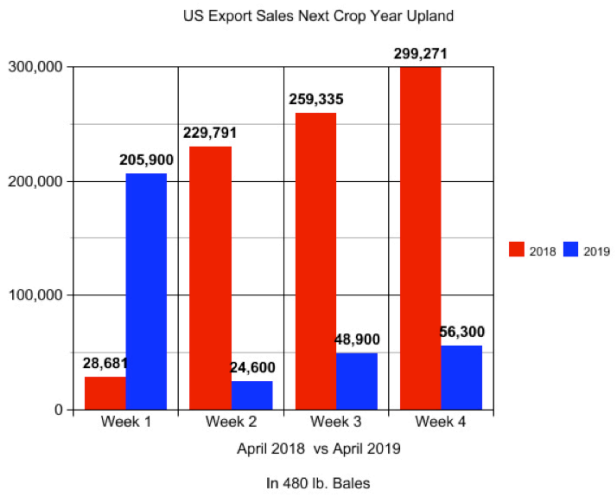
BANGLADESH CONSUMPTION STALLING DUE TO PROBLEMS WITH ILLEGAL IMPORTS

Bangladesh is now one of the largest cotton importers in the world, playing a major role in global apparel trade. The cotton sector has been behind the boom, as cotton has continued to dominate their fiber market. Some weakness in the cotton supply chain has developed, due to unsold yarn inventories and a flow of illegal fabric imports. One estimate suggests the problem is very serious, with customs finding misdeclaring of custom forms in order to avoid duties. Another source of the flow are borderland crossing points. While illegal imports from India are a problem, the big issue is China. Customs seized 455,000 items that were attempting to enter the country illegally. Of that total, 323,432 items came from China, with 19% of that total being textile products. Bangladesh apparel companies face issues selling domestically, as illegal apparel imports are being used to meet a large block of demand.

The Denim sector remains popular, with a new investment in a denim complex that will open in 2020 providing a boost to cotton consumption. The denim sector is experiencing anxiety from the continued rise in dye cost, caused by the import of these chemicals from China. In China, dye prices have rallied 50% or more, and this is being reflected in import prices in Bangladesh.

Despite these woes, apparel exports are expanding, with exporters seeing increased switching from China to Bangladesh by several brands and retailers. US imports of textiles and apparel from Bangladesh in January and February have reached 1.075 billion USD, which reflected strong 10.10% year on year growth. Even more impressive was the fact that 808.3 million USD of those exports to the US were cotton apparel, a growth of 10.84% year on year. Bangladesh is now the third largest supplier of cotton apparel to the USA, and the value of US imports from Bangladesh is now nearing half the volume imported from China. China is the top supplier of cotton apparel to the US, followed by Vietnam and Bangladesh.

US EXPORT DEMAND VERY WEAK FOR 2019/2020 CROP



The weak level of export demand for US styles for 2019/2020 and forward seasons has begun to weigh on overall market sentiment. During the 2018/2019 season, in the period between the week beginning April 5th and ending April 26th, the US sold 816,934 running bales of new crop (2018/2019), reflecting very robust forward demand. This season, export sales of new crop (2019/2020) during the same period were down 59%, at only 335,700 running bales of upland. Last year, weekly export sales of new crop upland were very brisk for the next 13 weeks, with sales averaging well over 200,000 bales. What caused this collapse in forward demand? Several conditions have contributed to the weakness, but the largest influence is the emergence of a near doubling in production in Brazil since the 2015/2016 season. At the same time, domestic cotton consumption in Brazil has fallen by 700,000 bales since 2015/2016. We estimate the 2018/2019 crop at 12.2 million bales against domestic use of only 3.2 million bales, which will leave it with a surplus of nine million bales. The country has never exported more than 4.792 million bales in a season.

We have been discussing in detail what this could mean. In recent years, Brazil has traditionally exported only 2-4 million bales, with that focused in the September-February period. That has all changed, along with the task of moving a surplus of nine million 2019 crop bales before the start of the 2020/2021 season in August 2020. A similar crop will again move to the gin, and the burden begins again. The burden of handling a nine million bales surplus amid the weakness of

domestic mill demand is massive. Brazil has always enjoyed the benefits of a rather active domestic textile industry, which provided an alternative market to exports, and, for a portion of the season, a price higher than export. This gave birth to the "Flex" contract, allowing for growers to deliver to either export or domestic markets. The continued surge in Chinese imports and a lack of reform in regulations has changed that. Then, there is the credit burden associated with a 12 million plus bales crop. Such a crop required a large volume of pre-crop financing, which involves barter. Farmers are provided inputs, and pledge a certain number of bales. When harvest starts, this cotton needs to be turned into cash from the input companies ASAP. The merchants contract the crop, and, as harvest advances, a long basis position becomes a significant capital outlay. Every merchant has credit limits or risk limits, with basis management then an important part of the operation. It's about keeping the crop moving and credit lines reduced and under control. Then finally, as an exporter of traditionally only 2-4 million bales, this has meant that by July, before the start of the next harvest, cotton inventories are depleted, and supplies very tight. Brazil has very limited warehouse space, none of it set up for long-term storage of cotton. Up until now, cotton has been stored on pallets under tarps until export shipment. This works for a few months, but not when it is going to be required to ship 12 months of the year. Exports are forecast at only six million bales. If this is true, it would mean that three million bales would have to be carried into the next season. There will be great pressure to export as much of the surplus as possible.

Brazil now competes with all major upland growths, and has dramatically improved the staple length and quality, which has allowed it to compete in a wide range, extending from the traditional SLM 1 3/32-1/8 up to the Strict Middling 1 5/32. This has resulted in its cotton being able to meet the needs of all major import markets. Other features of the fiber have also improved, so there are no longer problems with short fiber content or stickiness. These improvements, combined with a couple of seasons in which spinners tried Brazilian and were pleased, have resulted in Brazilian competing in every major import market, including those which normally focus on US styles, such as Turkey.

Amid these conditions, Brazilian exporters are very aggressive with export offers of the 2018, 2019 and 2020 crops, making Brazil the most competitive upland style for most shipment periods. The US's large catalog of very long staple SLM and lower grades has allowed the US to undercut even Brazil in the comparable styles for the May-August shipping period. However, for shipment from October 2019 forward, Brazilian styles are undercutting US offers by 200-300 points in many types. This is allowing it to dominate the limited volume of forward demand for August 2019 through

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August 2020. Each passing week, the US is falling further behind in the pace of forward sales needed to meet a record export target for 2019/2020. More than one third of the current total 2019/2020 export sales have been to China. Total 2019/2020 upland sales total 3.027 million bales, of which 1.369 million bales were sold to China. This, plus the need to sell China 4-5 million additional bales in order to meet needed 2019/2020 export targets, has placed a heavy burden on a successful China/US trade agreement for cotton.

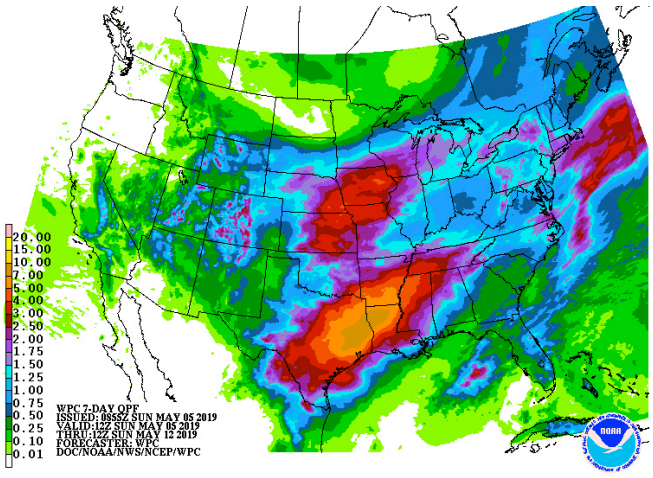
At this stage, the US is unlikely to meet the USDA's export of target of 15 million bales for 2018/2019. The reason is not demand, but the poor performance of the US infrastructure. The US needs to ship 445,547 bales a week the remainder of the season, and shipments must reach this volume for 14 weeks to meet the target. The US has simply never been able to accomplish such an export volume for any extended period of time. 2005/2006 was the last season of the Step 2 subsidy. As the season ended, the US exported over 400,000 running bales of upland in 11 of the last 31 weeks of the season. In the last part of the 2011 bull market, the US exported more than 400,000 running bales of upland in nine weeks during January through March.

We never like to say something is impossible, but against that backdrop the odds would suggest it is a long shot. Shipments, both upland and Pima, last week reached only 302,900 running bales. If the next 14 weeks average shipments reach 325,000 480 lb. bales, then 2018/2019 exports will fall to near 13.4 million bales, which could raise the US carryover to near 6 million bales. Add a 20-21 million-bale crop, and the US surplus grows to over 20 million after domestic consumption and pipeline requirements. A larger crop gets serious quick, while a much smaller crop is required for the burden to be lifted.

The impact of the collapse of the US domestic consumption supply chain after China's WTO entry and its continued slow decline are now bearing its full economic impact on the US cotton industry. At the same time, the US is rapidly facing export competition from the emergence of Brazil, as the second largest, and growing, exporter in the world, with a domestic industry that has also been decimated by Chinese imports, which we have discussed extensively. Both exporting countries are producing machine-picked, high quality upland, resulting in the two exporters now fighting for the same export business 12 months of the year.

EXCESSIVE RAIN THREATENS US PLANTING WINDOW

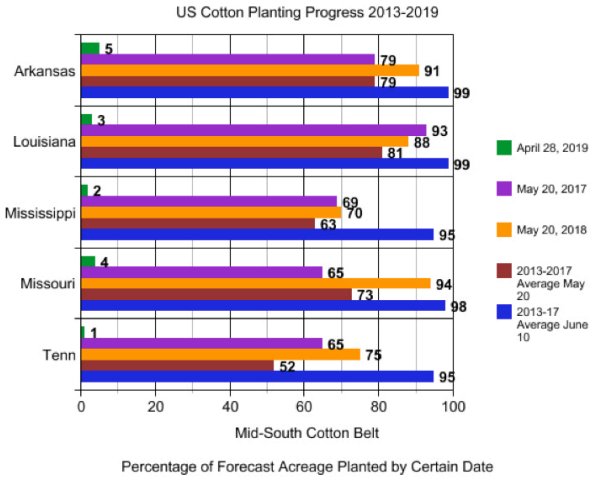
We are fully aware that 'rain makes grain,' but we also all know there are times of excess. For much of the US grain and cotton belt, we appear to in the middle of one of those periods. On social media, one of the most popular posts recently has been of a Nebraska farmer jet skiing through his cornfield, which is under several feet of water. The extended 7-day forecast has almost no extended dry period in the US cotton belt, with the exception of Georgia and the Carolinas. The level of the rain that will cumulatively reach more than five inches will mean more flooding. This will result in some replanting and further delays in planting. For cotton, the delay is still manageable, but is beginning to have some long-term effects. Our first concern is for the Mid-South, where the planting window is now. We know that, if the 7-day forecast is correct, the second half of May planting is expected, at best. A review of US planting history allows a clearer picture to emerge.



MID-SOUTH

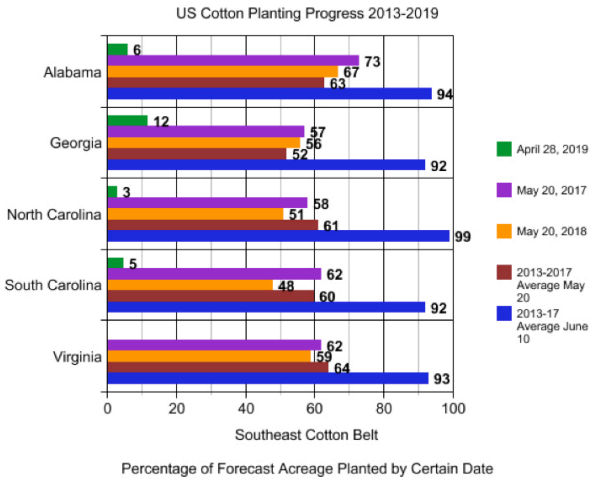
As of today, very little of the Mid-South crop has been planted, which is not unusual. However, the period between May 1st and May 20th is considered very important. Approximately two weeks from today, May 20th, is historically when the Mid-South crop gets planted. Last year, 91% of the Arkansas, 88% of the Louisiana, 70% of the Mississippi, 94% of the Missouri, and 75% of the Tennessee crop was planted on May 20. The 5-year average on that date is Arkansas 99%, Louisiana 81%, Mississippi 63%, Missouri 73%, and Tennessee 52%. By June 10th, on average, all areas are 95-99% planted the last five years. Therefore, the ability for fields to dry out and planters to roll over the next 2-4 weeks will

determine just how much acreage gets planted in the Mid-South, and under what condition.



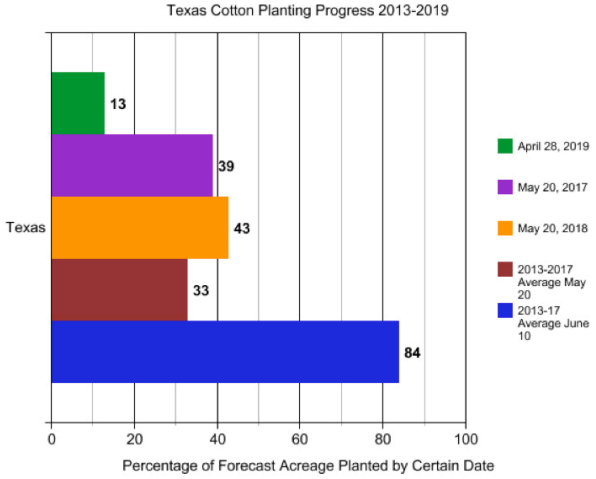
SOUTHEAST

The planting window for this region is more extended. In Georgia, drier weather has allowed planting to advance, reaching 12% by April 28, while normally over 50% of the Georgia crop is planted by May 20th, with the remainder planted between May 20th and June 10th. Overall, much of the region has the same general planting window, with the exception of Alabama, which plants a bit earlier. This region is of much less concern.



TEXAS

Due to the size of the state, the Texas planting window is the longest of any region. Texas planting starts in the Rio Grande Valley, then moves to Coastal Bend, to upper Coastal Bend, to East Texas, and then on to the High and Rolling Plains. At this stage, the crop has been delayed and late planted in the Coastal Bend regions. The planting usually accelerates between May 20th and June 10th, and by June 10th the crop statewide is normally 84% planted. This means today's excessive wet pattern across the High and Rolling Plains can go either way. The soil moisture profile for the planting window will be one of the best ever, and all dryland should be able to emerge, which is very unusual, and suggests there will be little initial failed or prevented acreage. This could set the stage for increased acreage and a record crop. However, if the wet pattern were extended well into June, prevented plantings could occur due to excessive moisture. The next issue would be the late planting and the risk of early frost and cold temperatures that would occur. Only time will tell us which happens.



ICE FUTURES TURN WEAKER AS ASSET PRICES SHOW UNUSUAL BEHAVIOR

At times last week, asset classes across equities and commodities showed very bizarre behavior. In commodities, massive deflation remained an influence on agriculture prices. For example, even though wheat prices recovered slightly at the end of the week, the Bloomberg wheat sub-index total return has collapsed, falling back to levels last seen in the 1960s. CME soybeans are less than half the level of 2012, while coffee has collapsed as well, returning to levels last seen in the early 2000s. This deflation is not being

seen at the retail level, where bread prices have not collapsed, and coffee at Starbucks remains unchanged. Neither is the price collapse occurring in equity prices. On Thursday, Beyond Meats went public. This was the hottest IPO since the 2008 global financial crisis. Its shares nearly tripled from pre-trade price of 25 USD a share. Within the opening minutes, it traded $46, and soon hit a high of $72.95 a share, before closing at $65.74 a share. This gave the company, which lost 29.9 million USD in 2018, a market cap of 3.83 billion USD. To put this into perspective, 3.83 billion USD is very near the market cap of United Bank Shares or Mattel or Goodyear on the same day.

The company produces a plant-based food product it calls meat, or fake meat. This is a significant challenge for agriculture. The launch of a plant-based substance branded as meat that is much more expensive to grow in a lab than a field, and the destruction of the dairy industry by plant-based beverages, illustrate that the Silicon Valley disrupters have discovered the agriculture sector. As we have been discussing, cotton is in the headwinds of this. These conditions certainly suggest that the US and world equity and commodity markets are experiencing some rather unusual movements, which may suggest very volatile conditions ahead. Against this backdrop, the USD, after an earlier retreat, resurged again at the end of the week against some currencies, the Latin American currencies being the standout. The Brazilian real returned to 3.964 per USD, which gives it a 3.7% loss over the past 30 days. The Argentine peso moved back closer to 45, giving it a 6.5% loss over the last 30 days. The Australian dollar moved below 70 cents.

These conditions have ended the Speculative Funds interest in rebuilding a large long position in cotton for now. The pressure on all US dollar-priced export commodities will continue as long as the USD strength remains. So far, the wettest spring on record in the Mid-Western US, parts of the South, and now the very wet pattern prevailing even in parts of Texas, has failed to move prices very much. Corn finally showed some reaction last week, when conditions continued excessively wet and fields flooded. The latest 7-day forecast for the US has excessive rains over all of Texas, Oklahoma, the Mid-South, and the western part of the Southeast, as well as the grain belts. This actually raises the possibility of either late planted or failed acreage from excessive rains. The pattern is very unusual, to say the least, and has us concerned. It is also occurring at a time when the Funds in many of the markets have record shorts.

It will take a very strong Chinese trade agreement with sizeable US procurement requirements, or significant crop problems, to offset the negative aspect to the upside price potential that the renewed weakness in polyester prices and heavy US/Brazil export competition is having. We are also very uncomfortable with so much of the price outlook focused on a successful Chinese/US trade agreement. Past agreements have been weak and then not honored. The perfect example is the Cybercrime agreement signed in the Oval office by US President Obama and Xi Jinping. It was breached immediately, and today the news stories are saying the Chinese believe the agreement has been honored sufficiently to drop demand for new protection. The FT is reporting that the US may go along with that to complete a deal. As soon as an agreement is signed, a host of issues that could hurt relations must be faced – Taiwan, South China Sea, and the list goes on. Then, the real willingness of the US to disrupt the supply chains that continue to flow crucial products from China to the US ahead of an election remains in question. Against this outlook, it is clear that cotton has a very limited voice in Washington.

These conditions suggest that a wide range of possible outcomes could occur. For now, more consolidation is likely in cotton, with spinners reluctant to extend forward coverage, especially with CFR basis levels now aggressively offered through 2020. These levels may stimulate On-Call sales, but fixed prices will likely be focused near-term. Overall, the market feels weak and needs a major China/US trade deal with large procurement, or prices will move lower.

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