VIETNAM IS THE CENTER OF THE NEW SUPPLY CHAINS

CAFTA/MEXICO APPAREL INDUSTRY FACES NEW UNREST

PAKISTAN COTTON IMPORT POTENTIAL EXPANDS

ICE COTTON PRICES FIND SUPPORT AMID MACRO VOLATILITY

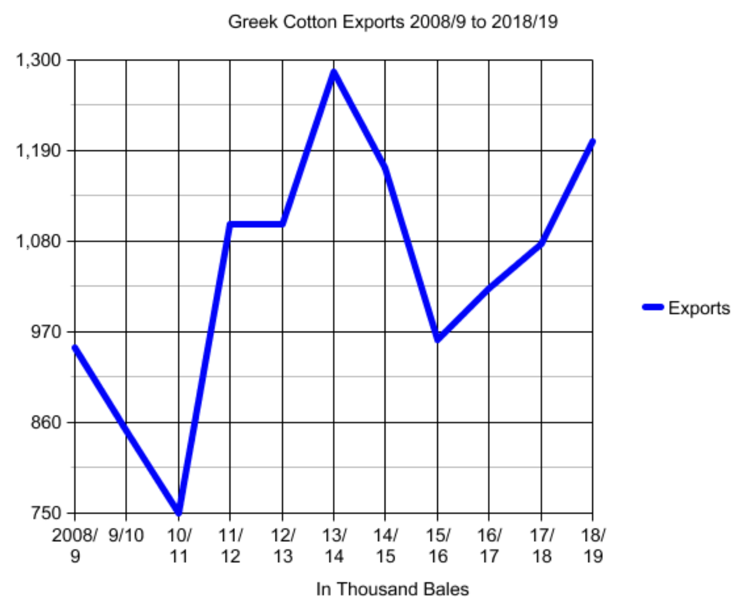
JERNIGAN GLOBAL
KNOWLEDGE IS THE NEW CAPITAL

LACK OF TURKISH IMPORT DEMAND CONTINUES TO HAUNT COTTON MARKET; AGGRESSIVE GREEK OFFERS UNDERMINE US SALES

A lack of finance programs and the movement of the domestic cotton crop have left Turkish mills out of the market for imported cotton at a time when the US and Greek cotton are normally selling in volume. Last year by Oct 19 the US had already sold Turkey 631,900 running bales of upland and 4,500 of Pima. Turkey is an even more important market for Greek cotton when in some seasons up to half of all Greek exports goes to Turkish buyers. In 2018/19 Greece is a major exporter with exports expected to reach 1.2 million bales, which will be the second largest volume on record and only marginally behind the record of 1.285 Million bales set in 2013/14. Greece has improved its quality in recent years offering up to 1 5/32 staple in Strict Middling and below grades. Traditionally rain is always a risk during harvest which means normally the Strict Low Middling color grade makes up a large percentage of the offering. The Greek crop is machine picked and last season it sold at a premium to US styles, sometimes by a wide margin. The crop normally moves heavily the first half of the season.

The disappearance of Turkish mill import demand is causing some merchants who are long the Greek basis to turn very aggressive sellers of Greek cotton. In recent years Turkey has purchased 365,000 to over 587,000 bales from exports of 959,000 to 1.168 Million bales. Indonesia and Egypt have been the other major markets taking nearly 150,000 bales each. China has not been a steady buyer but sporadic in its offtake while Bangladesh and Vietnam have become new buyers in recent years. With exports expected to near a record after a great crop the need to find buyers for an extra 500,000 bales is a challenge. China has appeared a large buyer but not in the lower grade volume needed. Chinese mills are generally unfamiliar with Greek and don't fully know just how much the quality has improved. China has focused its demand on the Strict Middling and Middling. The most difficult and competitive market is the SLM styles.

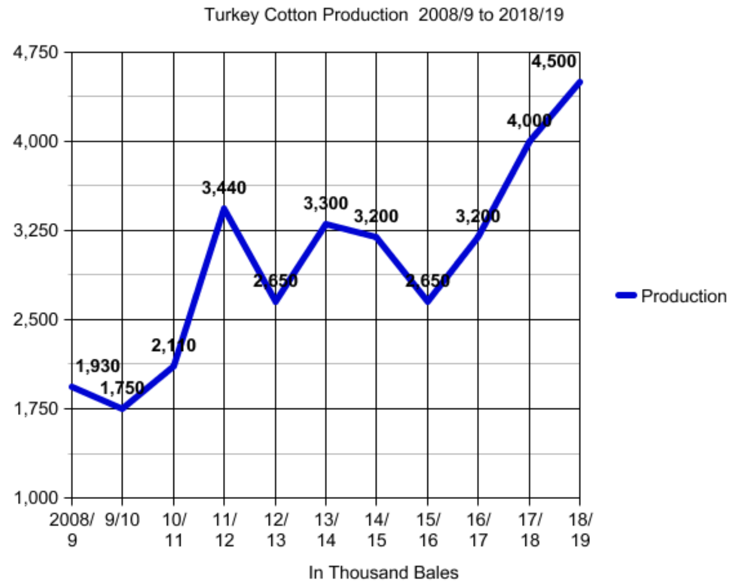
Last year at this time the Greek Middling and Strict Middling 1 5/32 was selling at 1375-1475 points on Dec and a SLM 1 1/8-1/532 was selling at 1275-1325 points on Dec. Offers of the 2018/19 crop started off at similar offers but after the Turkish Lira crisis broke the offering basis dropped just over 200 points. Now, as the Greek harvest is underway and cotton is moving and demand overall has weakened the basis has weakened further, which is especially evident in the SLM offers. Spinners with needs to cover in Middling-SM 1 5/32 styles Greek offers of 1200 points or so reflect real value given the shortage of these color grades out of the US. Middling 1 1/8 offer are very aggressive at 925 points on Dec putting it at a discount to US E/MOT styles which has drawn new sales from traditional buyers of US cotton.

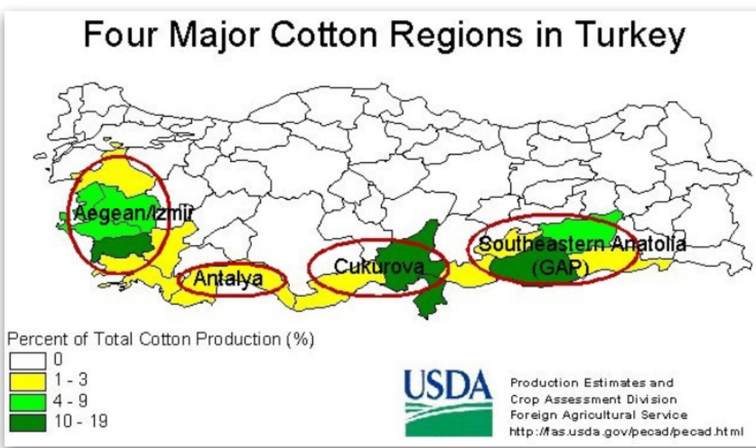


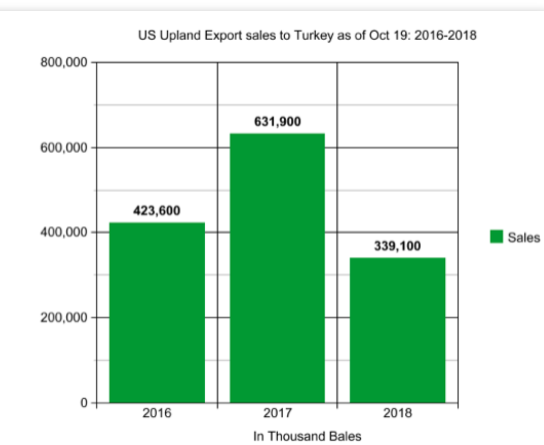
It is in the Strict Low Middling color grades that have experienced the most aggressive competition. Merchants appear to have unsold inventories of 2017/18 US SLM, or 41 color grades, in Memphis/ Eastern and MOT and now they are receiving 2018/19 41 color grades in volume. It was the average color grade in the Memphis Territory the last two weeks. Greece SLM 1 1/8 offers are now occurring at large discounts to US of the similar grades, Greek SLM 1 1/8 has sold at 600-650 points on Dec into Pakistan which has traditionally been a larger buyer of this description. This reflects a big discount to US offers, US E/MOT 41-4-36 offers are at 925 points on Dec, 41-4-37 are at 950 and 4-4-38 are at 975 points on. Memphis Territory offers are bringing a 125-150 point premium. Memphis Territory offers extend to 41-4-40 which is offered at 1100 points on. MT 41-5-38 offers are discounted to 850 points on Dec., in CFR Asia terms. The need by merchants to sell Greek in nontraditional markets is putting major pressure on US offers, especially the lower color grades.

TURKISH COTTON IS DISRUPTING MARKETS

The disruption of Greek cotton in the nontraditional markets is one factor and another is a development we discussed several weeks ago which is the result of the Lira crisis and its impact on cash flows and credit which is moving Turkish cotton into export channels. This has continued to occur and the volume will likely exceed all estimates. The situation is due to cash constraints and the lack of credit which has caused a decline in local prices to the point that international merchants see them as very attractive. Turkish cotton is machine picked and the only issue is rains during harvest which reduces color grades to Strict Low Middling and increases leaf content. Rains this season have again occurred with SLM grades now dominating with a shortage of Middling's and above grades occurring. This abundance of 41, or SLM, grades has pushed basis levels to 70.50 to 71.00 US cents FOB gin in the Southeast, approximately 800 point off Dec futures basis for a SLM 1 1/8. To put this in perspective, this compares to an ex gin basis of 200 off for a Memphis Territory 41-5-36 and 450 off in West Texas. Another contributing factor is the location of the largest Turkish cotton producing regions in Adana and in the GAP, or Southeastern region, is near the major export ports. Turkish cotton can currently move cheaply into several markets vs the US E/MOT. This was illustrated in the active Pakistan market last week when the ex gin price and lower shipping cost resulted in sales of a SLM 1 1/8 (a bit leafy) into Pakistan at 78/79 cents which was 100-200 on Dec. US 2017/18 recaps could be found in the same market with a 41-5-37 + offered at 800-850 on Dec. Pakistan mills have limited experience with Greek or Turkish but at these discounts to US recaps they are willing to try these machine picked cottons.

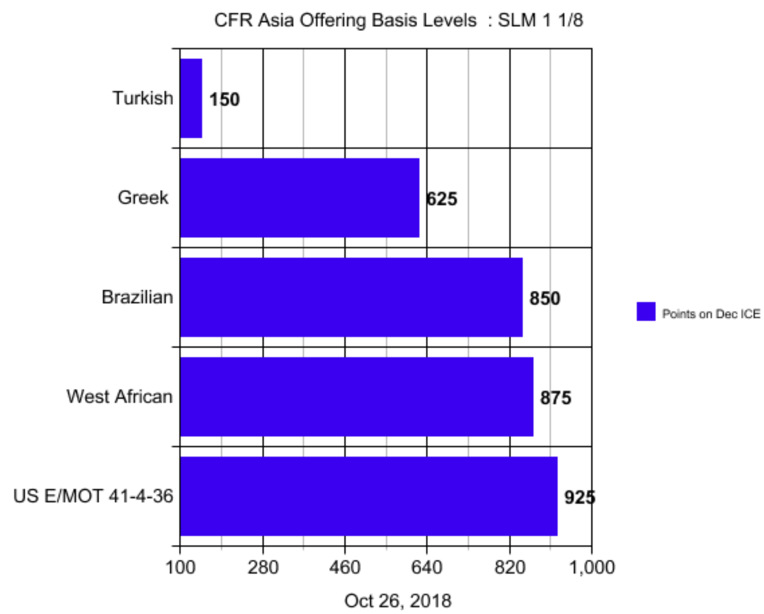






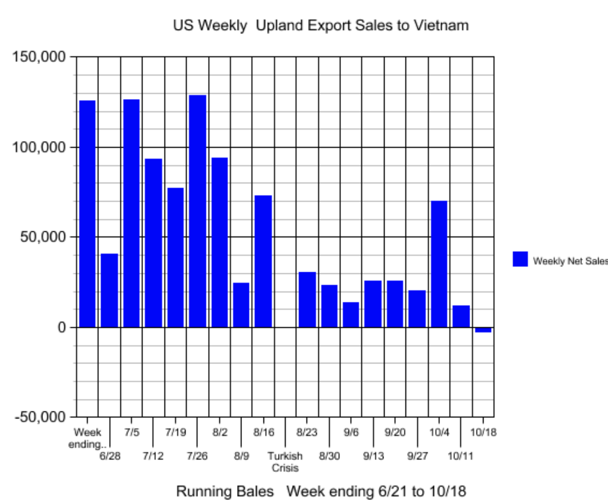
In recent years the booming domestic spinning market has resulted in an increase in Turkish cotton acreage. 2018/19 domestic production is expected to actually reach a record at 4.5 million bales which during the booming domestic consumption markets of 2017/18 the increased production was not an issue. It does reflect, however, a near doubling of production from 2015/16 production of 2.650 million bales. Amid the Lira crisis cash flow and credit are the drivers for all business. The international merchant's access to USD credit makes them the price maker and at such discounts this cotton will move into the export markets, possibly 500,000 - 750,000 bales could move to export. Due to color grade and leaf this cotton does not appear to be attractive to Chinese mills thus it will likely be a disrupter for US cotton in Pakistan, Vietnam and Indonesia. The weekly export sales report for US cotton for the week ending October 18th illustrated this as demand from all these markets were very soft for US cotton.

US COTTON DEMAND IN VIETNAM IMPACTED BY GREEK, TURKISH AND INDIA COTTON



Vietnam is at the center of the shift in supply chains as it is under dual influences from China and US. US companies are seeking to quickly expand sourcing in not only apparel but also a host of other products to avoid Chinese tariffs while at the same time Chinese companies want to rapidly increase operations in the country, in many cases by simply shipping the raw materials to Vietnam for assembly. Vietnam has a long, mixed relationship with China, including a very limited war in 1979 which chilled relations until the breakup of the Soviet Union. Their history has made the population very sensitive to the over influence of China. Vietnam shares a 796 mile border with China which has always provided a trade link. The Guangxi province in China is the focal point of that trade with the province launching a major program to stimulate trade. It has announced seven special Cross-Border Zones with Vietnam. The zones are being developed as part of the One Belt, One Road project, with the goal of giving Chinese companies access to two key assets, first, access to much cheaper Vietnamese labor and, secondly, the ability to have products labeled as “Made in Vietnam”. Labor rates in this region of Vietnam are about one third of that paid in the Pearl River Delta region of China. So far these new Cross-Border Zones are progressing slowly and are separate from the earlier announced Special Economic Zones which were agreed to with China and have already triggered protest.

Vietnam will likely be one of the major winners to the US/China trade war as US companies now appear to have adopted a China plus Vietnam plus other markets strategy with Vietnam becoming the first non- Chinese sourcing link. As a result order books are expanding and so is cotton consumption. The Vietnam textile and apparel sector is extremely segmented with limited full service apparel operations. A large portion of the cotton yarn produced is exported to China and then reimported as cotton fabric. The country currently lacks the capacity in fabric production and dyeing and finishing which makes its spinners very price sensitive buyers. Vietnam was a very active weekly buyer of US cotton prior to the Turkish Lira crisis. The Lira crisis reached a peak in early August when the Lira plunged to over 7 per USD and triggered a significant credit crisis for Turkish companies. Vietnam spinners



appear to have been quick to sense the ramifications for global cotton trade and prices.

Vietnam purchased 783,800 running bales of US upland for 2018/19 in the nine week period ending August 16th which equaled an average of 87,089 bales a week. Since the Lira crisis removed Turkey from the market and actually started to move Turkish cotton to export only 220,800 running bales of US upland cotton have been sold to Vietnam in the last nine weeks. Average US weekly export sales to Vietnam has dropped to only 24,333 running bales and in those eight weeks sales have focused on Turkish, Greek, Indian and Brazilian.

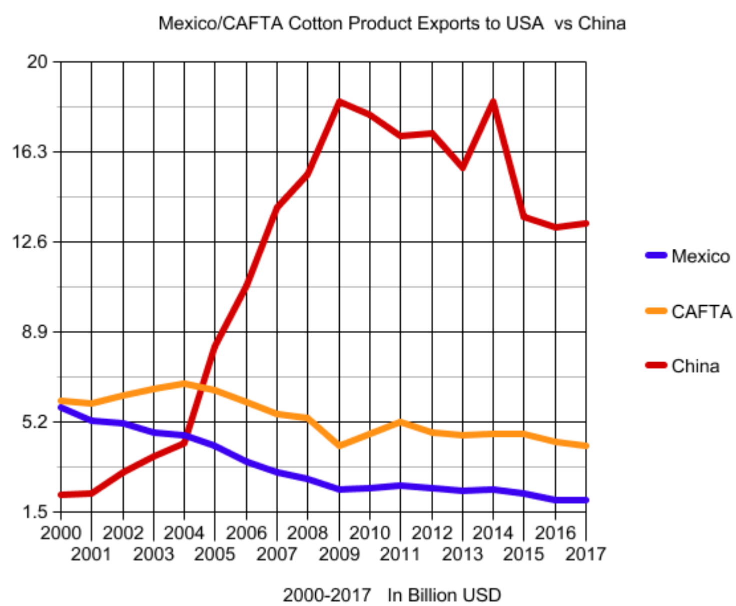
CAFTA SUPPLY CHAIN RISK ACCLERATES AND MEXICAN POTENTIAL LIMITED BY LACK OF STABILITY

Just as companies make strategic decisions to move supply chains out of China in textile and apparel, as well as, many other products, the entire Central America Free Trade Agreement (CAFTA) supply chain and Mexico are showing new instability. Last week we reported on the massive march of illegal migrants assembled in the CAFTA region, it is now being reported they are receiving support, transport, etc. from Leftist groups from the US, Central and South America. Over the past week the caravan grew is size to an estimated 14,000 receiving widespread press coverage from US open border advocates. The mob of immigrants progressed into Mexico where Mexican police were attacked and ineffective in stopping the march northward. The entire episode has undermined confidence in the ability of the CAFTA and Mexican governments to maintain stability and protect the investment of companies in the region. Putting the attack on the sovereignty of the US border aside, the involvement of the Left in this event could have major long-term consequences for the region. In our September 3rd issue we explored in detail the potential for Mexico to expand its textile and apparel industry under the new trade agreement with the US as supply chains moved out of China. However, as we discussed then, one of the key components needed to attract such investments is safety and security. The current episode raises lots of questions, such as are Mexico's borders secure? Can the CAFTA governments be effective partners? What happens to commercial interest when the US restricts all traffic as a means to prevent the invasion of these reoccurring immigration caravans?

Guatemalan intelligence officials confirmed the caravan that originated in the northern Honduran city of San Pedro Sula includes a multitude of people from a host of countries, criminal elements and gang members, as well as, people who have been previously deported from the US in the clamp down on illegal immigration. One block of 600 young men were videoed shouting, "We are coming".

As we go to press US military and Border Patrol are massing on the US border and the US Left is attempting to use this event to pressure the Trump Administration. The sad reality is that these types of events will not stimulate US or international investment in the region. The Trump Administration warned the CAFTA governments to stop the caravan or they would lose US aid, they failed so a cancellation of aid is likely. This reaction is understandable but will only add to the poverty of the region. The instability of the regions governments, all located with access to the southern border of the US, will raise a host of issues since the stability of this region is very important to the US. Also of concern is fact this issue is opening up the potential for China to be involved in the region. The Ortega government in Nicaragua is socialist with ties to China. Recently El Salvador canceled a diplomatic relationship with Taiwan and opened relations with China which drew the rebuke of the US. The incoming Mexican President has been an advocate of more open borders and the ability for easy migration to the US. Regardless of the validity of any of his arguments the way this event has been handled has the potential to derail the US/Mexico relationship as the new president takes office on December 1st. It is also likely to harden the US position, further increase the support for a major US border wall and reduced migration. This outcome will be detrimental to all parties since the shortage of labor in the US provides a significant opportunity for Mexico and CAFTA and the desire for a supply chain in the Americas is on the table. The Mexican peso has been under pressure against the USD since the Caravan began its trek northward.

We are featuring the immigrant march in this week's newsletter because it could perhaps create a very negative situation for US cotton consumption and exports. After the unrest of the past year in CAFTA many companies may stall or postpone new investments while others may pull out all together. The global textile and apparel chain is somewhat fluid and it requires infrastructure and security and security is now a major issue. With 3 million bales of domestic cotton use tied to CAFTA every reduced ton of yarn demand or square meter of cotton fabric demand means another bale of US cotton will have to find another buyer. For the moment the removal of China makes that a major challenge. Another million bales of cotton exports depend on Mexico.



US FIRMS ANNOUNCE PLANS TO MOVE SUPPLY CHAINS OUT OF CHINA AS EARNING SEASONS BEGIN

It is earning season and US companies are finding that shareholders are now focusing on; what is their exposure to China, what percentage of your supply chain is located in China and how will tariffs impact earnings? For tech companies the issue of security has moved to the forefront in their risk assessments and is an important issue. The focus on supply chains and the impact of tariffs is putting significant pressure on US tech companies. On October 23rd the NASDAQ Index fell 4.43% for its worst day in 7 years. The FANG Index (Facebook, Amazon, Netflix, and Google) fell 5.39% and is off sharply from its highs. Semiconductor shares fell sharply as the dislocation of global supply chains which ran through China were changing. Advanced Micro, the firm at the center of the alleged Bloomberg "Big Hack" fell 23%. The tech weakness continued through the end of last week. For companies not in the tech sector analysis focused on what percentage of their supply chain was in China. Every CEO announced percentages of their sourcing in China and plans to move to other locations as infrastructure allows. The market has begun to punish those companies which rely too heavily on China. One example is the US luxury retailer Restoration Hardware, one of the top home furnishing retailers in the US with a heavy focus on furniture. The company is estimated to source 70% of its products in China and because of that the market has punished them with RH shares down by a third since its 52 week high.

For many industries the desire to move supply chains are quite difficult since those industries have moved almost their complete supply chains to China. Press reports last week focused on the “Baseball Cap” industry (the timing could have had something to do with the baseball World Series was being played) and it was disclosed that 89% of all US baseball caps came from China. Such concentration violates all risk management guidelines. Chinese companies invested in the needed infrastructure, the latest technology and made the sourcing process seamless and problem free from product creation to finished product. The US lifestyle brand Yeti went public on October 25th at a much lower price than forecast and then proceeded to fall 6% from its initial offering price due to the focus on what of Yeti’s products are sourced in China. For some companies the question should be what products don’t you source in China, a much shorter list.

The challenges of competing with China’s state owned and state backed companies was illustrated in the auto sector where multinational companies have spent billions setting up operations and transferring technology. All that investment would appear to be at risk. It was announced the FAW group, a state owned auto group, had secured a record credit backing from the state owned banks of 1.015 trillion RMB, a breathtaking 145 billion USD. A figure larger than the total GDP of many developing nations. Another way to view this credit line is that it is enough to buy General Motors, Ford and Tesla. The company has a special place within the Chinese Communist Party as it has manufactured the red flag cars which have carried Chinese leaders since the firm was established in 1953, with assistance from the Soviet Union, during the administration of Chairman Mao. It is also the partner of Audi, Toyota and Volkswagen in China. It appears the move is to assure the company will emerge as the top auto firm in the world and also to make sure it is in a very strong position in 2022 when China will allow 100% foreign ownership of auto firms. The world was shocked again when state owned Chinese firms Sinochem and Chem China announced without any notice that the Chairman of Sinochem would serve simultaneously as the head of Chem China, which suggested the two state owned companies would merge. Sinochem is ranked as the 96th largest company in the world by Fortune with revenues of 76.76 billion USD and Chem China is ranked 167 with revenues of nearly 58 billion USD. Chem China shook the global agriculture sector by buying Syngenta and Adama and it also has purchased the famous Pirelli Tire Company. One report last week estimated that 26.5 trillion USD has now been invested by China in state owned companies.

AUSTRALIA'S 2018 CROP NEAR SOLD OUT FOLLOWING STRONG CHINESE DEMAND

You know a crop is nearing a sold out status when high and low mike recaps are selling at a sizeable premium to competing growths. Chinese demand for the 2018 Australian crop has been robust since the outbreak of the US/China trade war with most of the unsold better grades now in bonded warehouses in China. Approximately 250,000 tons of cotton are believed to be in Qingdao port bonded warehouses and is moving off to Chinese mills following the issuance of the sliding scale quotas. Basis levels of the bonded warehouse offers are firm. The small volume offered from Australian warehouses is also firm with SM 1 5/32 3.8-5.0 mike offers at 1700 on Dec while US E/MOT SM 1 5/32 G-5 mike are offered at 1175 points. This is one of the widest discounts on record of US styles. China has deep roots in Australian agriculture with the latest data showing China is close to overtaking the UK as the largest foreign owner of farmland in Australia. China now leases or owns 14.4 million hectares of Australian farmland. Included in the investment are the largest cotton farm, Cubbie Station, and the largest Western Australia wheat farmer, Nicoletti Farms.

Planting of the 2019 crop is continuing to advance with the first flowers reported in Emerald. The extended forecast suggests additional rains are possible in southeastern Queensland from October 30th until November 2nd which will improve the outlook for dryland acreage. At this stage the outlook continues to suggest a crop of near 2.5 million bales.

CONFIDENCE IN PAKISTAN PRODUCTION PROSPECTS FADE; IMPORT BUYING INCREASES

The Pakistan harvest is continuing to expand and with it has come a reduced confidence in the final production prospects. As of October 15th arrivals have reached 6,044,134 local bales which are near the same as last year. Yields in Punjab continue to disappoint. Pakistan mills were extremely active last week taking up Indian S-6 and J-34, US recaps, Turkish SLM 1 1/8, Greek SLM 1 1/8 and Egyptian Giza-94. Private estimates suggest Pakistan will need to import up to 4.4 million local bales or 3.5 million 480 lb. bales in 2018/19. This would be a new record for imports. The big question is how much of that demand will be met from India. India itself faces a much shorter crop and it is not reflected in prices as currency weakness and a credit crisis is driving cotton to export. Greek and Turkish imports are proving quite popular on price considerations.

Pakistan's need for an aid package and its role in the Chinese/Pakistan Economic Corridor (CPEC) remained in the headlines. Pakistan is seeking an IMF aid package and loans from China, Qatar and Saudi Arabia. Saudi Arabia has agreed to a 6 Billion USD package which provided 3 billion in a credit line and 3 billion in deferred oil payments. Under the CPEC the China Road and Bridge Corp and the Khyber Pakhtunkhwa government have announced a new Special Economic Zone.

CHINA/US TRADE DISPUTE EXPANDS WITH NO PROGRESS

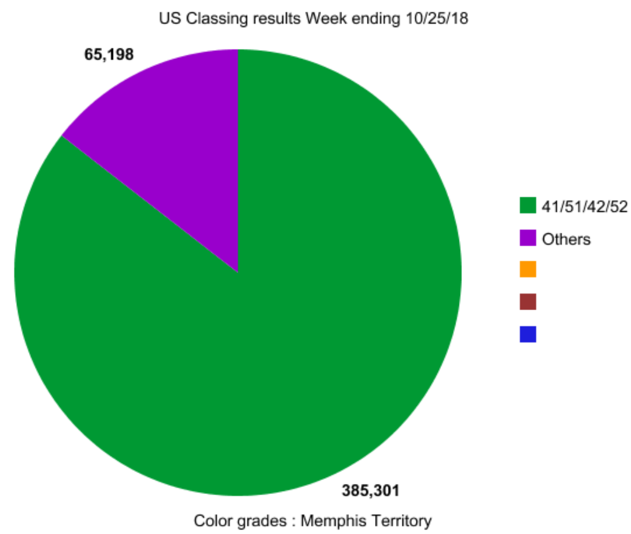
Tariffs have always been a controversial tool used by governments and this time around they are no different as the costs of the tariffs are proving difficult for the US market to absorb. It is clear the US economy and overall structure has enjoyed some expansion from the disinflationary impact of the outsourcing of entire US supply chains to China since China joined the WTO. China's overcapacity in many industrial products, such as steel and aluminum, has supplied the world steel at below the cost of true production for more than 10 years. This has allowed construction industries to expand worldwide and in the US with projects factoring in cost which were not tied to the actual true cost. In other words, construction projects which were profitable when using cheaper steel and other inputs are not currently profitable at a slightly higher prices as buyers, after experiencing nothing but falling prices for 17 years, refuse to accept the higher cost. This phenomenon is showing up in US steel producers as the tariffs have raised the profit margins on a per unit basis for US steel, however, overall construction and MFG demand has stalled as buyers say they cannot accept the higher prices. This has dominated the headlines as complaints of the tariffs.

With reflection this is not surprising, the US consumer and corporate sector has overindulged in cheap prices as a result of the outsourcing of complete supply chains to China and other cheaper locations. These cheaper prices have cost millions of middle class US jobs and allowed consumers to indulge and grow to expect prices that take great tolls on the environment and communities. The reshoring of parts of the US supply chains to the US or to other locations that offer no subsidy scheme is shaking the US and especially equity values where the extreme cheap prices have inflated earning models. While this is painful there was no consideration to the outsourcing that destroyed the US middle class and entire communities. In many products the concentration of supply chains in China has reached 70-80% or more which means these industries face significant cost increase and disruptions. The US, as other countries, has a short attention span and it remains to be seen if the readjustment can be completed.

The pain of the US trade dispute with China is being felt on both sides. Chinese and Hong Kong equities suggest serious damage is occurring there as well. All Chinese equities closed lower last week with values overall down nearly 8% for the month. China's equity markets experience heavy state intervention thus Hong Kong may provide a greater reflection of the economic losses which are occurring. The performance of Hong Kong equities also appears to have begun to indicate weakness in HK property prices which are the most expensive in the world. Hong Kong equities have experienced their worst slump since 1982. This date makes the losses symbolic since that was the year China and the UK began negotiations to hand HK back to China, which occurred on July 1, 1997. The Hang Seng Index is now down nearly 26% from its highs. The weakness has also been tied to the erosion of HK's sovereignty and freedoms. HK has been the world's most robust capitalist capital which has allowed it to flourish.

A simple resolution of the China/US trade dispute is fading with each passing day and the reason is there is more and more concern emerging over a host of issues. The Chinese government has launched its greatest persecution of Christians since the 1966-76 Culture Revolution. Churches have been torn down and pastors arrested. This has occurred at the same time as the reeducation camps have become an international issue in Xinjiang and has drawn the attention of US Senators Charles Grassley, David Perdue and Mario Rubio. A bill has been introduced to condemn these actions and announce America's support of religious freedom. China has an estimated 100 million Christians with Henan actually known as the "Jesus Province". This introduces a very difficult issue into the trade battle as Senator Grassley is a powerful US Senator from Iowa which is the state which was directly targeted by China with its tariffs on soybeans and where the China Daily purchased inserts in the Des Moines Register newspaper attempting to influence US mid-terms. Senator Perdue is from Georgia where the tariffs on soybeans and cotton have taken a significant toll. Senator Rubio is considered a future presidential contender and has been the US Senator leading the effort to counter China's actions. Much attention is now focused on a meeting between Chinese President Xi Jinping and US President Trump at the G-20 meeting in November. US Agriculture Secretary Perdue in a farm meeting last week said no more aid is likely and that farmers should adjust planting intentions to reflect the new trade realities. This was a bit unnerving because it first suggests the trade war could be extended and that the US has no immediate plan for US agriculture to regain the market share it is now losing in China. It is not clear what crops the market is signaling producers to plant in the Mid-South and Southeastern regions.

US 2018/19 HARVEST; SHORTAGE OF MIDDLINGS INCREASE



The US classed 907,758 running bales in the week ending October 25th and 450,499 bales of that volume were from the Mid-South, 290,650 from the Southeast and balance from the rest of the belt. One common theme showed up in the data; the highest quality US crop on record was in the field before harvest began. Of the 450,499 bales classed in the Mid-South 85.52% of the total volume fell in four color grades : 41-Strict low middling, 51-Low Middling, 42- Strict Low Middling light spotted and 52-Low Middling light spotted. This comes as the crop is otherwise long staple (large amount 38 and above), strong strength, averaging near 30, near 82% uniformity and premium mike. Texas so far has produced the largest volume of Middling and above color grades, 1,447,853 bales have been classed from Texas and 58.4% of this volume has been color grades Middling and Strict/Good Middling.

So far the Southeastern has enjoyed a higher percentage of Middling and above color grades than the Mid-South but volume is limited and the impact of Hurricanes has not yet been felt. With almost 20% of the US crop harvested and rains continuing then the concern over color grades will soon increase. The majority of the US belt will enjoy a dry period until October 30th when another major front moves through. Classing of the West Texas crop is very small and attention will soon turn to this region for hopes of additional Middling and better color grades.

The US faces several challenges, first, the available volume of Middling and above color grades has likely been overcommitted to export. Secondly, the abundance of high quality Strict Low Middling and Strict Low Middling Light Spotted Color grades. At the moment there is an abundance of SLM color grades available from Brazil, Greece and Turkey. The US will have to wait for sales until these growths are sold out or compete with the heavy discount these growths are offering. The absences of Turkey as a buyer and being forced to compete with Turkish styles are major disruptive factors for US Exports.

ICE FUTURES SHOWS SIGNS OF BOTTOMING

Last week's trade action in ICE futures was dominated by Algo/HFT trading systems whose systems appeared to receive several false signals and then attempted to exploit any outside paper that appeared. These black box systems also appeared to have a macroeconomic component as they took signals from the wild swings in the US equity and currency markets. Before last week cotton has not appeared to be influenced by swings in US and global tech stocks. The market also appeared influenced at times from the swings in the Chinese equity markets. By Thursday afternoon and into Friday prices appeared to find their own way recovering much of the sharp losses of October 24th. One reason for the rather bizarre behavior of prices is that the Trade appears to have no confidence in any argument strong enough to push the position. The speculative large Managed Funds also seem to lack direction as it pertains to cotton with the large volume orders still absent. Much of the week's volume came from the Dec/March spread which experienced heavy volume daily. These conditions have left the market heavily influenced by the new locals, the mindless Artificial Intelligence systems.

Demand, as we have discussed extensively earlier in this issue, has been focused mostly on non US medium grades which are being offered at heavy discounts. This has left US styles lacking robust demand, in addition, the quality issues suggests that merchants face a difficult task matching quality with existing orders. Australian outside the Chinese bonded warehouses is near sold out. Despite the rise in the Brazilian domestic price caused by the strength in the Real merchants are pressing the standard Middling 1 1/8 at weaker basis levels of 950 points on Dec, which reflects a 250 point decline from the average basis in June. The ESALQ Index of a 41-4-35 landed Sao Paulo ended the week at 80.84 cents a lb. Domestic demand is on standby until the results of Sunday's Brazilian presidential election results are known. The Real ended the week at the highest level in years at 3.6538 as polls show a solid Bolsonaro victory. West African basis levels have firmed despite the larger crop. Indian cotton remains very competitive despite the smaller crop as crop movement increases and the currency remains weak against the USD.

Overall, the cotton market continues to suffer a lack of confidence in demand and much of that lack of confidence is due to the disruptions in the traditional flows, as we have discussed in detail this week. We have been of the opinion that cotton prices would likely attempt to bottom in the region below 78 cents and this view continues valid. China's domestic demand is now a concern. We are not sure if the comment was bluster or was real but Chinese officials said it was preparing a tax cut that would be larger than the previous US tax cut. Such a cut could provide a major boost to domestic spending; today 80% of the growth in the Chinese economy came from domestic consumption which compares to 45% in 2010. However, many analysts suggest that a major tax cut will be inhibited by the surging liabilities China faces. This will be an important feature to 2019. Two of the current major exporters could be importers in volume in the first half of 2019; if one assumes some kind of finance package can be worked out Turkish mill import needs will increase for every bales that is exported. Indian consumption is strong, crop is smaller and imports will be required in the second half of 2018/19. The Australian crop window to dramatically increase acreage is closing and a 2.5 million bales crop will go to China. Amid these conditions and the smaller US crop suggests the current very negative tone to physical trade is more about timing and cash flow and less about a real overburden of supply. Against this backdrop we continue to feel prices have limited downside below 78 cents, as measured by ICE futures.

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