

TIMELY INFORMATION

Agriculture & Natural Resources

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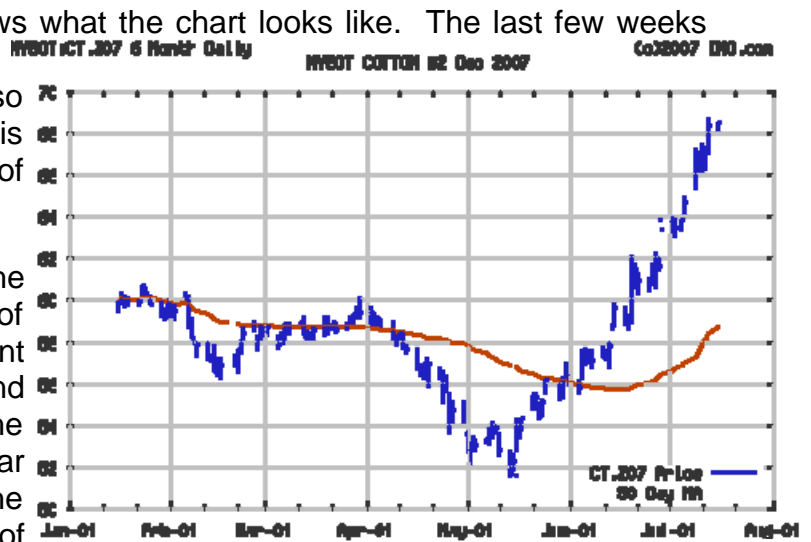
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Which is it: Speculative Bubble or Real Demand

Bob Goodman, Extension Economist

Everyone in the cotton business knows what the chart looks like. The last few weeks have been truly amazing. We have had eight weeks of this bull market so far, and like all runs, it looks from this perspective like it won't stop this side of \$1 per pound. But it probably will.

Everyone seems to agree that the numbers (the USDA numbers, of course) don't really support 70 cent cotton. Although the big Supply and Demand report last week predicted the 07/08 carryout would be at a 13 year low and noted that this would be the sixth straight year of decline, the rest of the numbers were either negative or neutral. Beginning stock estimates were raised, production in China adjusted upwards, that kind of thing. All were minor changes that have in other years made big impacts on cotton markets. But not this year.



It seems to me that there are two choices as to what is driving this market. One is we are seeing a huge speculative bubble that will collapse soon. If this is so, farmers should lock in cotton now. The evidence is the huge non-commercial interest in the market right now. The specs have set a record net-long position in the market. The DTN machine says that the huge interest by funds and other financials who don't usually trade cotton caught the cotton market by surprise. The prices we already have are not supported by market fundamentals.

The other possibility is that the December '07 contract is not driving the market. It is possible that the '08 contract is more important. It is possible that this market is already reflecting the demand for cotton acres next spring. Here is what the futures market is offering on the '08 crop: December corn is at \$4, Beans are \$9.20, and wheat next spring is \$5.70. What kind of price would cotton have to be to get 15 million acres planted? Given the risks and costs involved, I would put that at something like 75 cents without putting too sharp a pencil to it. If this scenario is really the case, higher prices are no doubt on the way. You should wait to price cotton.

But my market advice this week is to take advantage of this rally, whatever its source. I would lock in some cotton right now. Maybe not a lot, but I would be selling cotton into this rally. If you believe the second scenario above maybe you don't sell very much. If you believe the first, maybe you sell a little more. But you got to sell into a rally. If you wait for the high, you will miss it. As for next year's crop, I would hold off, it's just too early. Let's see what they offer when they get real desperate.

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