Southern Cotton Growers, Inc.
REPRESENTING COTTON PRODUCERS THROUGHOUT ALABAMA, FLORIDA, GEORGIA, NORTH CAROLINA, SOUTH CAROLINA AND VIRGINIA

COTTON MARKETING NEWS

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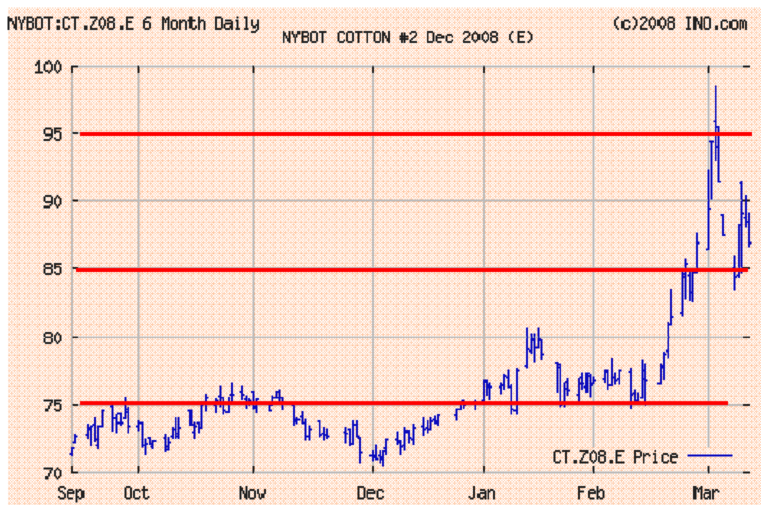
Soaring and Volatile Prices:
Marketing the 2008 Crop Will Require a Plan

My hat is off to anyone who confesses to know what is going on and why and who can accurately predict where we will be in 6 months or 6 weeks or even 6 days from now. Frankly, little about this market seems to make much *economic* sense right now… or maybe it does and I'm just getting too old and/or too slow to see it.

It should be no secret to anyone by now that merchants for the most part are off the market. Time and space here does not allow for a lesson in hedging and a full explanation of why merchants and growers are both in a pickle. Let's just say that until price and/or the basis adjust, everyone appears to be in a mess.

The recent run-up in price to almost $1.00 was purely speculative-driven—i.e. not justified by good ol' supply and demand. Merchants (and maybe even a few producers) with "short" futures positions have lost tons on money on this move up—which *theoretically* wouldn't be a problem *IF* cotton could be sold at the higher price…… but, like I said there's no demand there. Not yet. In fact, the export market has slowed to the point that the old crop is not moving. Currently, merchants are apparently having difficulty finding a home for the '07 crop so they're obviously very cautious about this run in price and are not going to offer to pay 90 cents for new crop. The market is too volatile.



The run in price has been very frustrating for the producer as well. Producers have been saying for months and months that 80 cents or better for cotton is needed to compete with corn and soybeans (and peanuts). Now that prices have finally rallied to a level where that's possible, no contracts are available. I don't know about where you are but I think the verdict could still be out on cotton acreage in Georgia. This run in price could have an impact if producers could lock something down on at least part of the crop.

From the peak at around the 95-cent area, the market (Dec08) has since declined to around 85 cents before gaining back to around the 87 to 88-cent area. Perhaps too simplistically, I see this market as being broken down into 3 or 4 "levels". Given what we think we know about US and World supply/demand outlook for 2008-09, the *still likely* low-price scenario looks to be 75 cents or less.

If I'm a producer, my first objective for right now would be to avoid selling my cotton down there if possible. Shoot for something better if and when you can get it particularly if you have yet to do anything on the '08 crop. On the other hand, I certainly would not want to lock myself out of an opportunity to sell some of my crop at 85 cents or even 95 cents and better should "forces" take us to that level again. Anything seems possible. One thing seems for sure, it may require doing things a little differently and getting outside the comfort zone.

Maybe I'm too much a pessimist, but I am increasingly concerned about the price outlook for the '08 crop. As recently as just a couple of months ago, there was a lot of talk within the industry about 85 to 90-cents to even $1.00 cotton. This recent run has certainly proven that anything is possible, but let's remember this wasn't supply/demand driven. If it were, merchants would not have pulled out of the market.

The weakening dollar makes US exports cheaper. This should help exports and also support higher prices—i.e. 90-cent cotton would not be as "expensive" as it otherwise would if the dollar were stronger. But so far, it doesn't seem that a weaker dollar has helped cotton. Cotton and all commodity prices also seem to be moving with the ups and downs of the stock market and mounting evidence of a recession in the US economy.

In USDA's numbers released this week, the estimate on exports of the '07 crop was dropped from 15.7 to 14.5 million bales. To get the full picture, that estimate was 16.7 million bales as recently as last October. The US crop has gotten bigger and exports have declined. The result is that we will carry about 3 million bales more old crop into the 2008-09 marketing year than previously thought. This means that although acreage will be down in '08, that's still a key component to the price outlook but it's now simply less of a factor than it used to be. With reduced acreage, the market will still be especially sensitive to actual plantings and crop conditions as move into planting season and the summer months. But, the demand side is also going to get more and more attention.

What's a producer to do? I wish there was an easy answer. I tend to avoid discussion of the more complicated strategies because I find most growers would rather try something simpler if it would work.

The easiest and traditional thing to do is simply contract at a fixed price if and when contracts are available. This provides protection from lower prices on the number of bales contracted-- but you also give up any potentially higher price on those bales as well. Nothing wrong with that decision if you're happy living with whatever the consequences might by.

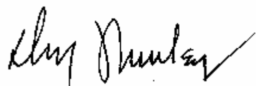
A Call Option could be purchased in addition to the contract. This hopefully would result in a profit on the Call if prices increase. With the market already at such a high level and with Call premiums being so high, this combination seems less feasible than it once was. A contract, if you could get one at even 80 cents, and an "out-of-the-money" December Call (premium around 9 cents) would effectively lock in a floor or minimum net price of around 71 cents. You want to contract at as high a price as possible within the risk you are willing to take but following up with the Call might be more feasible once the market adjust lower.

Alternatively, the producer could purchase a Put Option rather than fix a price with a contract. A Put has the advantage of providing protection from lower prices while also allowing the producer to benefit from higher prices should they occur. Sounds perfect… but Put premiums are also expensive. An "out-of-the-money" December Put at 78 cents, for example, (premium around 4 cents) would lock in a floor of 74 cents *minus basis the December futures*.

Another strategy would be to hedge ("short" or sell) December cotton futures. If prices move lower, profit is earned by buying the futures position back at the lower price. Of course, you would also be selling your cotton at the lower price. If prices increase, you'll be required to put up "margin money" to cover your losses in the futures market but would be selling cotton at the higher price. If prices move lower, hedging will work out better than the Put by the amount of the premium. If prices move higher, however, your losses would be limited to just the Put premium. Taking a "short" futures position right now would be doing something merchants might not be willing to do.

Finally, another decision might be to just sit back and wait. If you could get a contract right now, the basis could be more than double the normal amount. By waiting, if the market drops you could be no worse off if the basis narrows to a normal amount—i.e. selling at 8 cents off when Dec08 is at 88 is the same money as selling at 3 cents off when Dec08 is at 83 cents.

The cotton market and all commodity markets are very volatile. Given this high-risk environment, strategies and decisions should emphasize reducing risk while remaining flexible. The speculative run looks like it may have run its course but it could return. Weather conditions this spring and summer could also push prices higher provided that the demand side improves. Marketing plans should strive to reduce the risk of low prices while allowing the flexibility to obtain higher prices if and when they should occur.



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