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

COTTON MARKETING NEWS

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WHAT TO DO NOW?

Summary. Cotton prices began plummeting on May 10th, the day the USDA May supply/demand numbers were released. Prices (Dec12 futures) have dropped 18%--from just over 83 cents on May 9 to just under 69 cents on Wednesday this week.

Prices have thus far attempted to stop the bleeding twice. The first attempt around 75 cents was unsuccessful. The second attempt is around 70 cents—where we are right now. I shudder to think where prices are headed if the bleeding doesn't stop soon.

Factors. I've talked to no one that saw this coming—let me be more clear, I didn't and no one else saw it coming *quite this soon or of this magnitude*. But this doesn't make growers feel any better so there's little to be gained by dwelling on the past. If we are to understand the near-term and longer term outlook, however, we have to be clear on how we got here and what it will take to pull us out of this ditch.

1-World Stocks. 2011-12 ending World stocks have been building for months. Note that prices were already in a downtrend since February. USDA monthly supply/demand revisions for previous years and carried forward, increased estimated World stocks (there was more cotton out there than previously thought). USDA's May report contained the first projections for the 2012-13 crop marketing year. This report added *another* 7 million bales to projected World stocks by this time next year.

2-Demand. Supply doesn't operate in a vacuum. What's important is supply and demand in relation to each other. Demand has weakened. World demand for the 2011 crop year was once estimated at 120 million bales. That number is now less than 107 million. Weak demand combined with growing stock projections made it increasingly difficult to hold prices where we'd all like to see them. Demand has been rumored to be "improving" and there have been occasional good export reports but apparently too little too late has actually materialized.

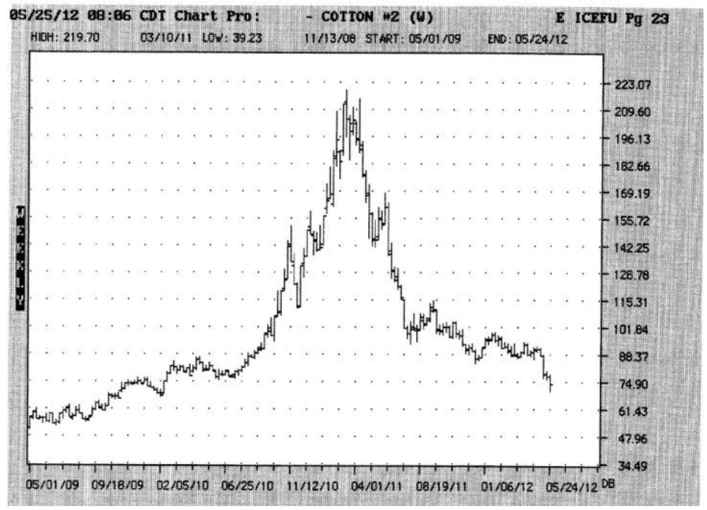
Demand for the 2012 crop year is expected to improve to 110 million bales but production is expected to still outstrip that by 7 million bales—thus the projected increase in 2012-13 stocks.

3-China. It is not exactly earth-shattering news that China has been buying cotton to increase their stocks (reserves). This has been going on for months—and was once viewed as a positive from a demand/export (buying) perspective. Chinese stocks are expected to increase from only 11.6 million bales at the start of the 2011 crop year to a projected 28 million bales by the end of the 2012 crop year. This is due to the huge increase in imports but also expected decline in 2012 crop year demand. This level of stocks (38% of the World) is a large and significant number.

4-US Acreage and Weather/Drought Potential. Regardless of otherwise increasingly bearish supply/demand fundamentals, prices were attempting to remain afloat at least in-part based on the fact that US acreage for 2012 would be down from 2011 and there was continued potential for another drought in 2012. US acreage will be down without question but price support due to weather concerns began to unravel even prior to the USDA May report. Texas and the Southeast both began receiving rain and improved early season moisture and prices had slipped to the 83-cent level even before the disastrous events that started on May 10th. Eased moisture concerns coupled with the bearish 2012-13 numbers finally pushed prices over the cliff.

Price Outlook. I have thought and said all along I thought the "pessimistic outlook" on price was 80 cents. Growers were encouraged to take protection at 90 cents or better on as much of the 2012 crop as they felt comfortable taking. Based on continued weak demand, growing stocks, and now possibly improved drought outlook, the pessimistic scenario has played out—but it's much earlier than anticipated and even more negative on price.

The big questions right now are (1) Where's the bottom? and (2) Is there a chance for improvement and if so how much? The chart to the right is a long-term cotton chart going back 3 years. Some are saying the bottom could eventually be 60 cents but I'm not willing to be that pessimistic yet. It would be hard to argue against an eventual 65-cent level, however. I'm hoping we can settle in at around 70 cents for now and even see some eventual improvement from that level—back to at least the 75 to 78-cent level.



If prices do show improvement, it's likely that the improvement may be limited. With current weak demand World stocks projected to growth to such a burdensome level, the only significant positive driver on price right now is weather. And with supply/demand where it is, there's such a huge potential supply cushion out there (stocks) that the World will be less sensitive to US acreage and weather. Any rally to near 80 may be asking too much.

Marketing and Other Decision-Making. Having said all this, what does a grower do? I think much depends on how much of the 2012 crop the grower already has protected in some form. Let's try to think through a few options.

> <u>Put Options</u>. A Put Option NTM (near the money) right now is going to cost around 5 cents. If the market does go all the way to 60 cents, you make 10 cents and net 5 cents gain for 5 cents invested. If you're that pessimistic and are already contracted to the point of not being comfortable doing any more, then Puts might not be a bad choice for the most pessimistic grower. If you did go the Put route, would it be better to still wait for a rally first?
>
> <u>Loan</u>. But a 70-cent Strike Price minus 5 cents gets you 65 cents floor, basis the cash market. Depending on your basis how far does that place you above the Loan? If your expected basis is 4 cents under, you're at 61 cents compared to 52 cents + Gain or Equity through the Loan. Would you rather take your chances through the Loan and hope for a rally into 2013?
>
> <u>Contract</u>. You could contract more now or wait on a rally before adding to contract sales.

One very important consideration-- with the decline in price and should we stay here or go lower, a grower with Revenue crop insurance at the 70% level or higher is already below the Revenue Guarantee depending on how the APH compares to the farms actual yield potential and what actual yield ends up being. Growers with Revenue protection can take some comfort in knowing they have the Minimum/Preliminary Guarantee.

Parting Thoughts/Comments. If prices remain this low into the 2013 crop year, we'll see a big reduction in cotton acres in 2013 if corn and soybean and peanut prices remain relatively more attractive. We saw this in 2007 through 2010. If prices remain at these levels into 2013, it will also be an interesting first year test of what will be the new farm bill safety net.

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