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

COTTON MARKETING NEWS

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Is There An Explanation To This Market?

Prior to USDA's August 11 report, the 2006 US crop was estimated at 20.5 million bales and the World crop 115.6 million bales. Prior to last weeks numbers, the US crop estimate was based on historical average acreage abandonment and yield (16% when adjusted for the developing drought situation in Texas and yield per acre harvested of 770 lbs.

Early on (very early on, based on the March 31 USDA *Planting Intentions* report) believe it or not there was actually discussion by analysts suggesting that the crop could large because, after all, yields averaged 831 lbs in 2005 and a record 855 lbs in 2004 and we were coming off back-to-back 23+ million bale crops with less acreage than expected for 2006. The market dropped about 5 cents during April and May.

Since the high in April and the low in May, the market has produced significant rallies twice—teased us with close to 59 cents in June only to lose about 7 cents and then rally back to almost 58 cents a couple of weeks ago only to then drop 3 cents to where we now find ourselves. For months, analysts (myself included) have dangled the 60-cent carrot out there-- thinking that with the developing and worsening drought situation that surely the 2006 crop will be less than last year and reason to justify the higher prices we've all waited to see. Each time the market rallies, only to sputter out as we approach the magical 60-cent level.

In May, prior to the buildup of drought concerns, the crop was estimated at 20.7 billion bales. And remember, this was considered possibly a low number. In July, acreage was increased 650,000 acres based on the USDA *Acreage* report and last week on August 11, the first official yield estimate was set at 765 lbs/acre and the crop at 20.43 million bales. While we have all been surprised and perplexed by the lack of market strength to date, the increase in the acreage estimate between March and June essentially added another 1 million bales to the US crop and also, when you think about it, 765 is still a darn good yield for a drought year and would be the 3rd highest yield in the last 10 years.

It is hard to believe that 35% of the country's cotton is in poor or very poor condition yet the yield estimate still this high. If the current yield estimate holds, perhaps it adds support to the notion that the higher yields we saw in 2004 and 2005 are a new "plateau", i.e. from now on perhaps even in poor years we may do better than before. But I think the verdict is still out… particularly for Georgia and Texas.

Another thing that has hurt the rally potential has been exports. While the 2006 crop will be down from last year, exports are projected to be down also—1.35 million bales less. In fact, total use (exports and domestic mill use) is expected to be down 1.8 million bales or about 8%. That's fairly significant.

What we see happening is the market playing a game of give and take. Lower production, whether it be in the US or worldwide, can lead to higher prices only if not offset by lower demand as a result of those same higher prices.

We also have to remember that the US is in an export-driven market. Lower production in the US does not automatically lead to high prices (or at least sustained higher prices) if production in competing export countries is good and export supplies adequate.

The Chinese crop looks to be up this year but so is mill use. Their imports are expected to grow only slightly so stocks will be drawn down. Production will be up in India also and their exports up from last year. World stocks are expected to drop 4.2 million bales (8%). The stocks-to-use ratio is forecast to be 40%-- not large but likely not small enough to support an A-Index higher than the 60's.

Another piece of the puzzle is the loss of Step 2. In the absence of Step 2, US cotton will have to be cheaper than before to remain as competitive in the export market.

December closed today at 54.52 cents per pound. The 54-cent level should find support. A drop below 54 would be a bad sign. On the upside, 57 to 58 cents is the barrier for now. If we are ever going to get to 60 cents, the market has to first prove it can bust through 57 to 58. It's been tough so far. If the crop is going to get smaller (less than 20 and closer to 19 million bales), the September report MUST lead the way. I agree with the saying that "small crops get smaller" but eventually it must show itself. If the crop is shorter than currently estimated (and quality may be in question too) then demand/merchant buying should lead the way to higher prices if the market (exports) can support it.

Percentage of 2006 Cotton Rated Poor and Very Poor, Week Ending

	June 11	July 16	August 13
Alabama	20	55	66
Arizona	0	0	1
Arkansas	12	7	8
California	0	0	0
Georgia	16	35	40
Kansas	9	0	10
Louisiana	6	17	12
Mississippi	5	24	32
Missouri	17	6	5
North Carolina	14	8	10
Oklahoma	37	43	56
South Carolina	15	7	18
Tennessee	6	2	5
Texas	37	49	54
Virginia	18	8	3
US	22	31	35

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