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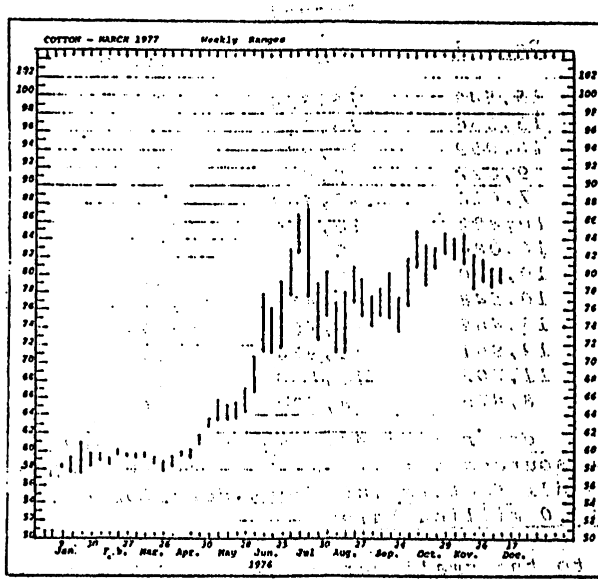
December 16, 1976

"O 'dem cotton fields..."
grow smaller as the demand grows larger.

Since the beginning of the current crop year - August 1st - its been well understood that cotton supplies - both domestic (U.S.), and world, would be tight. Such understanding has been translated into prices which have been averaging approximately 40% above last year. However, over the past few weeks cotton prices have encountered considerable resistance at the 80¢ mark and a certain controversy has blossomed. Have prices reached their peak? Is a downside move imminent? Definitely not.



In our opinion, the current price stabilization reflects a supply/demand ratio that's best described as "a very delicate balance." A slight push in any one direction will upset that balance, tipping the scales just low enough for a herd to jump aboard, thereby pushing those scales even further. We feel that supply has been slightly overestimated, demand slightly underestimated, and that, therefore, that herd will be one of very heavy <u>bulls</u>.

<u>We project a 30%-50% price increase.</u>

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U.S. PRODUCTION

The 1975/76 crop was abnormally small and resulted in a carryover into 1976/77 of only 3.7 million bales.

At the outset of the current crop year the USDA estimated ginning of 10.75 million bales; a 29.5% increase over the previous year. On October 1, that forecast was revised downward to 10.3 million bales. On November 1, bad weather during the month of October force them to further revise; this time to 9.89 million bales. Last Friday - December 10 - their last revision shocked most experts when, for the first time this year, their estimates were altered upward . The most recent USDA forecast for the current year presently stands at 10.26 million bales, with Texas, California, Arkansas, and Mississippi responsible for the largest increases.

We feel 1. The USDA estimate is too high;
2. Their figures contain some important facts that deserve closer scrutiny before an accurate supply picture can be formulated.

1. As the table below demonstrates, the USDA has traditionally been biased in favour of larger than actual harvests.

USDA crop forecasts and acutal cotton crops:

	Dec. 1	Actual Crop	%error
1963	15,548	15,334	1.3
1964	15,356	15,145	1.5
1965	15,059	14,938	.8
1966	9,627	9,557	.7
1967	7,618	7,443	2.2
1968	10,822	10,926	1.0-
1969	10,080	9,990	.9
1970	10,270	10,192	.8
1971	10,548	10,477	1.0
1972	13,469	13,704	1.7-
1973	12,961	12,974	.1-
1974	11,702	11,540	1.4
1975	8,476	8,320	1.8

The average error is 1.4%. However, a random telephone survey of private sources across the U.S. suggests this might be too low. Taking all factors into consideration we are predicting a final yield of 10 million bales.

When added to the small carry over of 3.7 million bales this gives a total supply of 13.7 million bales; the lowest since 1924-25.

2. Below is the latest USDA supply estimate broken down into categories of staple lengths.

Supply by staple lengths

	Shorter than 1 inch		1 inch & 1-1/32 inches		1-1/16 inches and over	
	quant.	% of total	quant.	% of total	quant.	% of total
1971	2,134	15	1,339	9	10,844	76
1972	2,857	18	2,887	18	10,582	64
1973	3,851	23	2,756	17	9,788	60
1974	2,125	14	1,959	13	10,844	73
1975	2,317	17	1,694	13	9,500	70
1976	2,503	19	2,070	15	8,932	66

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A consumption pattern that, last year, was weighted in favour of longer staple lengths resulted in a small carryover of those lengths into this year. This, combined with a production pattern, this year, that is heavily weighted in favour of shorter staple lengths, (esp. in Texas, and Oklahoma), has created a supply picture in which the shorter staple lengths will increase while staple lengths 1-1/16 inches and longer will decrease.

This is especially noteworthy because, since March, 1969 when the New York Cotton Exchange made the 1-1/16 inch staple length the deliverable grade, this length has been in the vanguard of all significant cotton price movements generally. The last time the 1-1/16 inch and longer staple length decreased at the expense of the shorter staple lengths was 1972 and it heralded the greatest bull market in cotton history.

Over the longer term: one might assume that, next year given the relatively high prices, farmers will substitute soybean and sorghums, in favour of cotton, thereby producing a significantly increased yield. Such assumptions are misleading. During the Outlook Conference held recently in Washinton the USDA made known its preliminary thinking on next year's plantings Their projections called for an increase of only 6.8% in planted acreage - 12.5 million acres versus this year's 11.7 million acres. Such an increase seems virtually insignificant considering the extremely tight supply/demand balance both in the U.S. and abroad.

Why? Dr. J. A. Bird of the Agriculture Experiment Station, Texas explains "there has been no significant development in cotton strains in the past fifteen years." As a result, while other crops have generally produced an increased yield per acre over the years; cotton has levelled off. More significantly, in those states in which substitution is a factor the yield per acre of cotton has, on the average, decreased.

% change, (1976 versus 1975) in cotton yield/acre weighted by harvested acres; in those states in which substitution between cotton and soybean and/or sorghum is traditional:

State	%change	acreage	weighted acreage
Arizona	+ 8.1	353	+ 28.6
Arkansas	-35.7	1000	-357.0
California	+ 6.0	1120	+ 67.2
Louisiana	-17.8	545	- 97.1
Mississippi	-13.7	1530	-209.6
Missouri	-28.7	255	- 73.2
New Mexico	+27.5	81	+ 22.3
North Carolina	+ 2.9	68	+ 1.9
Oklahoma	-27.4	335	- 91.8
Texas	+ 9.2	4511	+415.1

Average weighted change in yield: -3%

Some notes are in order here. California and Arizona cannot make a switchover as readily as the eastern states because of the irrigation factor. Texas, the largest producer, had a 9.2% increase in yield per acre this year, but compared with the previous 4 Year average, it showed a decline of 2.4%

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Given that a switch from one crop to another is a costly operation, often involving the purchase of new equipment, etc., and, given that the prices of soybeans, and even sorghum are beginning to show signs of firming somewhat, one can understand a farmer's reluctance to substitute for cotton. The man simply cannot guarantee how much he will be able to get out of the ground.

Over the next five years improvements in technology - an open ended spinning system has been developed that uses all staple lengths with equal ease - and biology - a new strain of cotton has been developed in Texas which, in test situations, has resulted in over 100% increase yields - will radically alter the supply picture. Unfortunately for consumers, these improvements will not be available to help him ease his costs over the next eighteen months.

We conclude that, given presents circumstances, the 1977-78 crop will not exceed 10,650,000 bales. Taking into account this year's very small carryout, its likely that next year's total supply will be even less than this year's.

CONSUMPTION

1. Domestic:

The pause that has afflicted the economic recovery since the first quarter of 1976 is expected to end early in the new year. We are anticipating a real rate of growth for GNP of between 4%-6%. Why? For various reasons, not the least of which is the recent performance of the textile sector. Of all economic indicators, this sector is traditionally in the vanguard of significant change.

Retail Apparel Sales
(seasonally adjusted, in billions of $)

1974 Nov	Dec	1975 Jan	Feb	Mar	Apr	May	Jun
1.996	2.050	2.110	2.117	2.098	2.176	2.214	2.214
Jul	Aug	Sep	Oct	Nov	Dec	1976 Jan	Feb
2.217	2.317	2.249	2.256	2.289	2.337	2.311	2.369
Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
2.371	2.227	2.265	2.324	2.395	2.422	2.395	2.458
Nov							
2.441							

The recovery began around April, 1975 and slowed around May, 76. Note the corresponding figures in the above table. Now note the present trend.

The USDA has estimated domestic disappearance at 6.7 million bales - approximately 10% less than last year. This is too low. The daily rate of usage given for the month of October, by the USDA, was 26,300 bales; down only 3.8% from last year. Based on a 260 (working) day year, this translates into 6.84 million bales.

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Prevailing opinion amongst analysts was that the major factor in the projected 10% decrease in cotton consumption would be the price. Averaging 40% above last year, these analysts felt the fibre would lose its competitiveness with man made fibres.

This has not and will not happen. Precise current data is often hard to come by, but here is an admixture of recent developments and comments. Rayon went up in price during October by 7.5%. The price of polyester staple length is scheduled to rise by 10%, effective January 1. The ratio of cotton stocks to unfilled orders declined, albeit marginally, last month, while, according to Barron's Dec. 6 "...a confidential textile industry study shows a precipitous decline in unfilled orders for products incorporating synthetics." Woman's Wear Daily reports the recently held London exhibition of next spring's ready to wearables was.......'an all cotton show.'

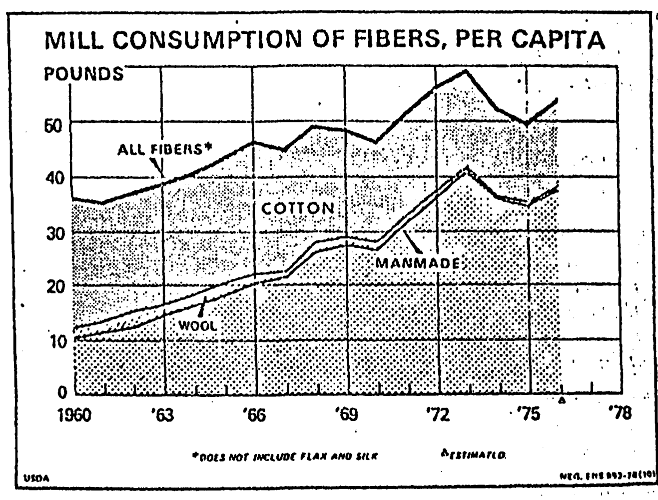

Figure 1

Cotton's share of the textile market stabilized at around 30% in 1974. Just as it is costly for a farmer to switch from one crop to another, so too is it costly for a manufacturer to switch from one blend to another. This is of course true in the short term.

Over the long term there are reasons to suggest, if a switch is to be made, manufacturers will make it in favour of cotton. December 21, OPEC is expected to announce 5%-15% increase in the price of oil. Man made fibres being petroleum based, things do not augur well for the already ailing synthetic market.

We predict domestic consumption will not be less than 6.9 million bales.

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The Salient Fact

The present inventory positions of the mills stood, as of October 31, at 854,000 bales. Every observor has pointed out that figure seem inordinately low. But just how low is it? Up until October 31, consumption had totaled 1.68 million bales, If final consumption reaches 6.9 million bales, there still remains 5.2 million bales left to be used this year. The question is: Do the mill have sufficient inventory to keep up with anticipated usage? The answer is evidently not. A comparison with the previous four years proves the point.

Ratio of Inventory Positions of Consuming Establishments as of October 30, to Mill Consumption, November 1 to the end of Crop Year.

(in 1000's of bales)

Inv. positions of mills, Oct. 30.	854.0	996.8	987.9	1029.0	888.5
Consumption, Nov. 1, to end crop year.	5223[1]	5280[2]	4024	5344	5674
Ratio	.163	.188	.245	.192	.156

[1] Estimated [2] preliminary

Clearly the mills are not keeping up with the present rate of consumption. They will have to be large purchasers in the next, short while, in order to satisfy their own sales. Even assuming that our projection of 6.9 million bales is wrong and the USDA's of 6.67 million is right, the ratio devised above is still the lowest since 1972. And undoubtedly it was heavy mill purchasing in late 1972 that provided the launching pad for the bulls.

Exports

Here is the latest USDA projection of the world situation.

	Beg. Stocks	Prod.	Imp.	Total	Cons.	Exports	End Stocks
1975/76	31.5	55.3	18.8	105.7	63.6	18.4	23.8
1976/77	23.8	60.0	18.5	102.3	63.3	18.0	21.1

for the second year in a row cotton production will outpace world supply.

Foreign production has been stuck by adverse weather. There's been to little rain in Central America, too much rain and subsequent insect plague in Pakistan. Other than the U.S., only the Soviet Union has enough cotton available for exprt, and even the Soviets now, it seems, will have a less succesful crop then was predicted earlier. The Soviets could have, at most, 4.0 million bales for export.

Foreign demand is high, reflecting continued economic recovery and commensurate tectile activity.

Given the tight supply and high demand abroad, its only logical to assume that U.S. exports would be strong this year. In November the USDA estimated cotton exports would increase 30% to 4.4 million bales. December 12, they revised that figure to 4.5 million bales.

Still, this figure represents only 25% of the total world market of 18.5 million bales. We think this is too low. Over the past weekend India, presumably anticipating the market's bearish response to the USDA's upward revision of production figures, purchased 132,000 bales. On Monday, Indonesia negotiated terms for a loan with the Commodity Credit Corporation to purchase more American cotton as well. Our point is that supplies abroad are so tight that American prices, high as they are, are still competitive. It would not be unwise to suggest that many foreign purchasers are waiting in the wings, like India, and Indonesia, hoping that the right time will present itself to buy. Our feeling is their hopes will go unrequired; necessity, however, will force them to buy.

Also, rumours of a U.S./China cotton agreement have been in the offing now for months. Should such rumours be confirmed... the implications are obvious.

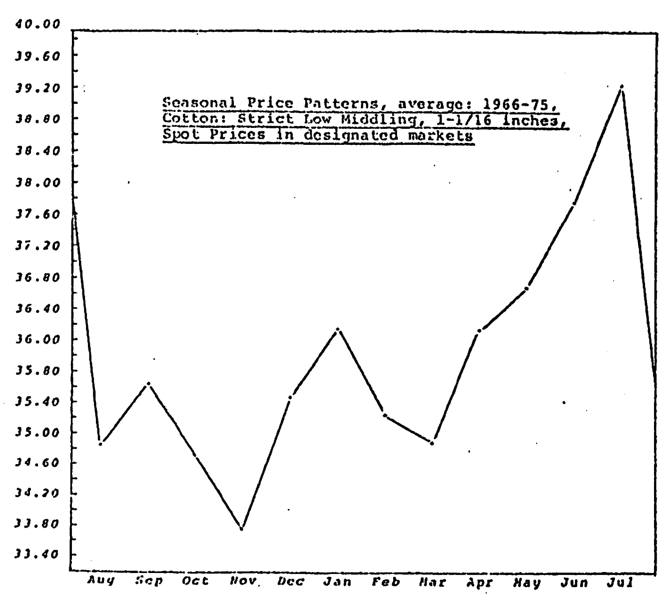
CONCLUSION

Thus, our view of the U.S. supply/demand balance is as follows:

	(in millions of bales) 1976-77	1975-76
Carry-in	3.70	5.70
Production	10.00	8.30
Imports	.70	.92
Total Supply	14.40	14.92
Consumption	7.00	7.25
Exports	4.60	3.30
Total Demand	11.65	10.55
Carry-out	2.80	3.7

Note: figures may not add due to rounding.

A carry-out of 2,8 million bales is the lowest since 1952. 3 million bales is considered the absolute minimum requirement.



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We favour purchase of the July contract at present levels - 76¢-80¢. Our minimum objective is $1.00 by the end of June.

Hedgers should look closely at the October, or even March '78 contracts. Both months are presently trading at significant discounts to July.

To reiterate: we are contemplating a 30%-50% price increase in cotton. This, in the futures market, represents a potential profit of $10-$20 thousand per contract.

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Cotton is traded on The New York Cotton Exchange. The contract consists of 100 bales, or 50,000 pounds of middling-grade 1-1/16 inch cotton, deliverable at ports in New Orleans, Houston, Galveston, and at interior ports in Memphis and Greenville. Price is quoted in cents per pound and the minimum fluctuation is 1/100 cents per pound, or $5.00 per contract. The maximum allowable daily range is 4 cents, and the maximum fluctuation from the preceeding day's settlement price is 2 cents a pound. These limits are suspended from the deliverable contract on the first day of the delivery month. Delivery months are, currently, October, December, March, May, and July.

Margin required: $4,500.00 per contract
Commissions: $75.00, round turn.

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All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.

David Rothberg
Director of Research