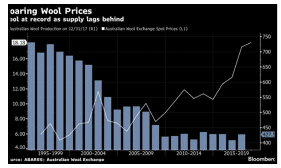
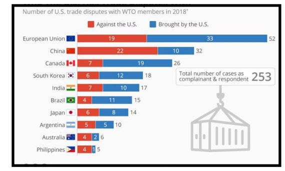
TURKISH DISPUTE VERY IMPORTANT TO COTTON

AUSTRALIAN DROUGHT REDUCES 2019 CROP PROSPECTS



WOOL PRICES HIT A RECORD HIGH



ICE FUTURES PRICE DIRECTION DEPENDS ON TRADE DISPUTES

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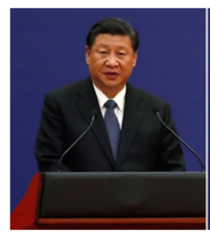
KNOWLEDGE IS THE NEW CAPITAL

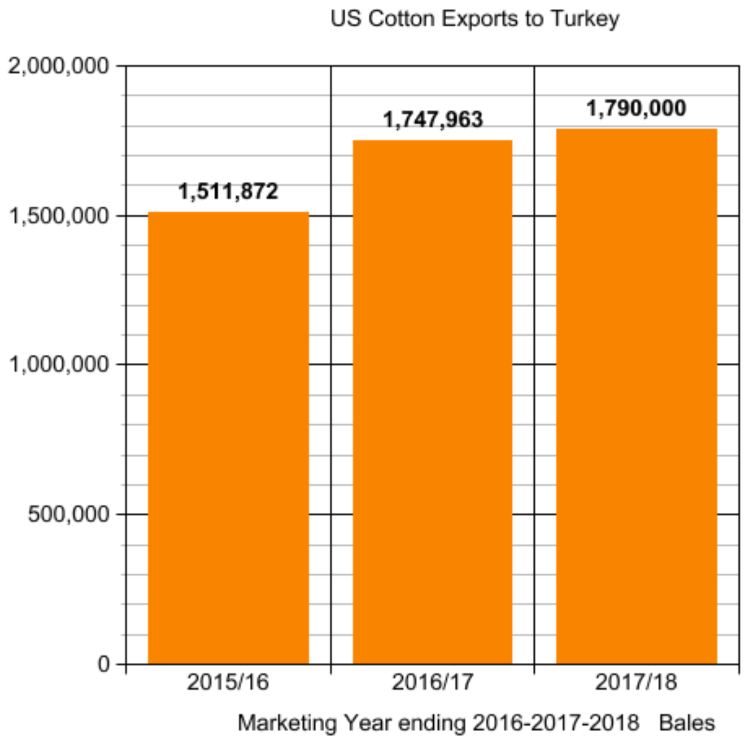
TRADE UNCERTAINTY ROCKS GLOBAL COTTON MARKET



The global cotton market appeared to have the wind at its back in early June and ready to breach the 1.00 mark and higher while for the first time in memory mill demand was aggressive for the next two forward crop seasons. The forward mill demand seemed to be a boost to everyone's confidence. Even as the trade rhetoric was in the background it appeared no one, including Chinese mills themselves, believed that US cotton would be dragged into the fray. After all, the only import quotas up to that point which was issued in a general way were the WTO annual 2018 guaranteed quotas. The marketplace believed these where sacrosanct since it was part of the WTO agreement. At that time and still today apparel imports from China continue to flow into the USA quota free and at the same duty as other countries. Then, Beijing launched a wide ranging set of duties on US agriculture products which included cotton. This resulted in more than a 13 cent correction in the Dec 2018 ICE futures contract. This first blow to spinner's confidence was shaken off to some degree and prices recovered a portion of their losses returning to the upper 80's. Spinners were good buyers on the break but gone was the confidence to first follow prices higher and secondly to expand coverage in the forward seasons. This was followed by confirmation that the US crop was larger than some had expected and more importantly, news of the Turkish crisis.

Turkish mills have long been one of the largest and most reliable customers of US cotton in the world. The US also provided major credit lines for purchases earlier in the industry's development through its GSM programs. The first issues which appeared political involved the anti-dumping charges against US cotton that eventually where established at 3%. Still, the aggressive cheap US basis and quality discounts of 2017/18 resulted in more than 1.79 million bales being sold to Turkey. While cotton has not yet been dragged into the Turkey/US dispute there is little confidence it will not be. The Turkish economy has been severely damaged due to the policies of the Erdogan administration which has put the Lira under pressure against the USD. The policy disruption put the

Lira on a roller coaster ride last week, falling last Monday to a low of 7.2362 per USD, and then recovered before again retreating back to over 6 Lira per USD on Friday. At 7 Lira to the USD and below the consequences for private companies' dealing in foreign exchange becomes very serious. Adding to the seriousness of the fall was the fact that Turkey imports most of its energy needs. The economic crisis appeared to halt all import purchases of cotton and even caused some spinners to consider delaying opening letters of credit. It is unclear what the impact of the crisis is having on the acceptance of L/Cs from all Turkish Banks. Currently 1,500 bales of Pima and 274,100 running bales of upland sales for 2018/19 are open.



US cotton exports to Turkey in 2015/16 reached 1.514 million bales which represented 16.54% of all US exports. In 2016/17 exports increased to 1.747 million bales and 11.71% of all exports while 2017/18 exports were near the same percentage of US exports. Turkmenistan is a major supplier of cotton, cotton yarn and fabric and Turkish companies are the largest investors in its textile operations. Australia, Brazil, Greek and West African are also major suppliers of cotton to Turkey.

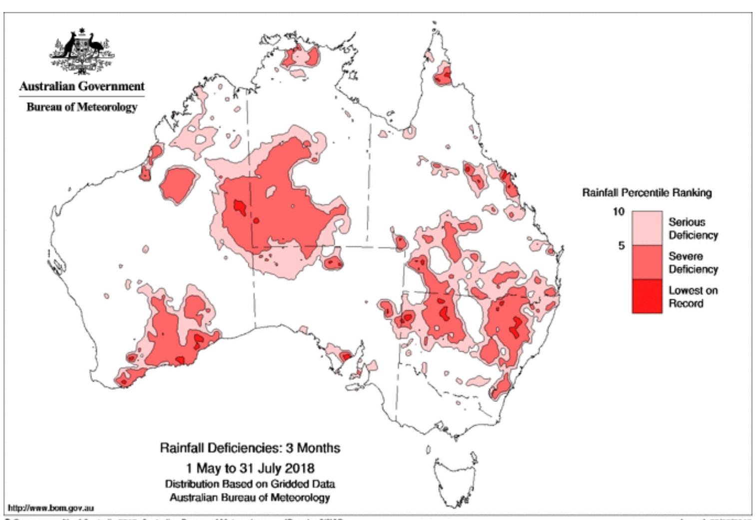
Turkey plays a very important role in global textile and apparel trade. During January - June 2018 Turkey exported nearly 14 billion USD worth of textiles and apparel; as a comparison Vietnam exports over 17 billion USD worth of textiles and apparel in the same period. In addition, it has a domestic economy 2.48 times larger than Honk Kong and more than double that of Norway. The EU is their top export market, over 70%, with France, Netherlands, Spain, Germany, and Italy major markets. Turkey's close proximity to these key markets allows for just in time delivery to many EU retailers. Turkey is also a major high-end apparel mfg. due to its higher yarn count capacity. Turkish mills have been making major investments in new modern equipment and expanding capacity. Apparel is the second largest export group falling only behind autos. The country has several strategic advantages besides it location; including, the fact its fully integrated operations offer turnkey solutions for brands and retailers. As last week ended Turkey had done little to restore confidence, the Lira ended European trade at 6.17 per USD for a loss of 6% for the day.

The situation in Turkey appeared to rattle markets around the world, as did the continued strength in the USD. This added to the anxiety in the cotton market as the currencies of many emerging markets collapsed against the USD which in turn caused a decline in many of their equity markets. The important Indonesian Rupiah fell to a three year low against the USD and approximately 27 billion USD in stock market value was erased. The Indian Rupee hit a new all-time low against the USD and even Hong Kong had to intervene to hold its USD peg. Overall, commodity markets were under significant pressure until Thursday when the announcement of a resumption in Chinese/US trade talks.

While any losses of sales to both China and Turkey could be replaced with new opportunities for Greek, Brazilian, Australian or others the disruption to the US export supply chain is significant. The increased size of the US crop would have likely had only a minor affect on price if pre-June trade conditions still prevailed. The lack of confidence was evident in the US weekly export sales report for the week ending August 9th which indicated only 77,700 bales were sold for 2018/19 and sales for 2019/20 actually fell 11,700 bales. The collapse in forward price confidence is very unwelcome for it will influence grower's confidence in increasing cotton production given the expense in harvest machinery.

REALITY OF 2018 DROUGHT ON AUSTRALIA'S 2019 CROP NEARS

So far each hopeful forecast of rain in both Queensland and New South Wales has failed to bring the big wet. Australia is the land of droughts so the country's farmers are the best water managers in the world, which sometimes makes the world forget the challenges associated with being one of its farmers. Farmers have for the last 20 years or so been battling a city dominated environmental lobby which is constantly demanding it let water flow as it did 2000 years ago instead of allowing it to be used for agriculture. This has inhibited Australia from reaching anywhere near its potential, water is a very controlled commodity from the rivers to wells and every drop is government controlled and monitored. A host of water rights exist and farmers have some of the most advanced catchment systems in the world for the rains that do fall. However, when rain does not fall either in the dam or river catchment areas or on the farms it does not matter, there simply is no water. The current drought is very severe in the central and northern areas of New South Wales. Winter crops appear headed for a disaster in many areas. Homesteads have run out of water to drink, hay supplies are gone and government has passed aid packages that will allow food supplies to continue to flow to the worse areas.

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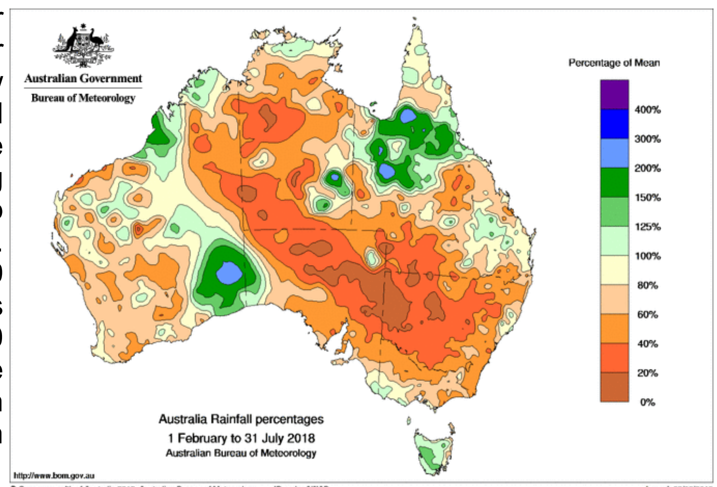
For the Livestock industries the problem is even more acute due to the need to feed and water stock daily. For cotton farmers, after a great 2018 season, it means lost opportunity - a weak Aussie Dollar, strong basis and good ICE futures levels has meant most farmers are at maximum forward sold levels for 2019 as prices have been in the 600-650 AUD a bale, near 95 US cents a lb. FOB gin, for some time. There is no major rain today in the forecast. If no significant rainfall occurs it will mean no dryland crop and a sizeable reduction in the irrigated acreage. Planting in the northern areas of central Queensland has started and the main areas still have 45-60 days to go. Some growers will plant into December if late rains come. The damage from the record drought gets worst with each passing day, in the Southern Valleys where the best water supplies exists water prices are surging as cotton has to compete with very large almond and other nut orchards which have sprung up over the last few years. These orchards have to have water or loose trees and large investments. This has pushed up water prices to 350-380 Australian Dollars per megalitre or 255 to 277 USD. As this price moves to 400 AD and above small growers will likely sell the water and not plant, which a few have already done. If it does not rain then water prices will probably increase further as the orchard companies attempt to save investments.

It is so dry that even the growers with water allocations are worried about how much water it will take to get the crop up given just how dry the soil profile is. As prices have declined some growers have started to wash out some contracts in fear of being oversold. If nothing changes between today and mid-Dec the crop appears poised to fall to 2.0 million bales. This would be the smallest crop since 2008/9 when production totaled 1.775 million bales but above the disaster of 2007/08 of 625,000 bales. A small increase in the new acreage further north in Queensland and in Western Australia is likely but these crops will move in a different time period.



RAINS ARRIVE IN CENTRAL INDIA AFTER LONG ABSENCE

After a long absence the Indian monsoon has turned active in central areas of the cotton belt with rain being reported in Gujarat on Friday as the week ended. The rains were welcome across all

Cotton Fields of Telangana 2018 Crop

areas after a prolonged dry period. Good rains were reported in much of Maharashtra which is over 80% dryland, including the Vidarbha area. Reports have surfaced of an outbreak of pink bollworm infestation in fields sown before June 15 with the previous dry weather accelerating the problem. The reports have come from the heavy infested areas of 2017 in Maharashtra and Telangana, however, the recent rains may help to control the spread of the problem.

The CCI is preparing for harvest and announced that in Rajasthan it will buy seed cotton direct from growers in order to increase grower's net income. Haryana and Punjab indicated they will continue their practice of CCI using middlemen. India announced a doubling of import taxes on 328 textile product following a 16% increase in textile and apparel imports in the fiscal year ending in March. Total imports in the year reached 7 billion USD with 3 billion of that total coming from China. China was the main target of the duty increase; imports from Bangladesh are also up sharply but are exempt from the duties due to the free trade agreement. Vietnam and Cambodia will also be exempt because of free trade agreements.

The Indian Rupee/USD exchange rate was under pressure all week falling to a new record low of 70.3980 and ending the week at 70.1575. Due to tight supplies the FX weakness has not increased the competitiveness of Indian cotton for export with most international merchants actually increasing the old crop basis. New crop S-6 1 1/8 offers generally are near par with US EMOT offers, which are very aggressive.

NATURAL FIBER REVIVAL: AUSTRALIAN WOOL PRICES HIT A RECORD 698 US CENTS A POUND.

Wool was the first natural fiber to enjoy a revival with demand surging in 2017, which was one of the first signs indicating to us of the end of the Age of Cheap Polyester had begun. The Wool industry, after a dramatic loss in market share, remade itself with major innovations and promotions which help spur an increase in domestic demand from China. Both developments have continued but new supplies have remained limited. A drought in Australia the largest Merino wool exporter in the world has added to the reduction in supplies. Consumer demand is back and is driving improved consumption in China, Europe and USA. Wool's natural attributes are becoming known to the consumer and its biodegradability is second only to cotton, a feature which is becoming well known in Europe. In the US a wool blend performance t-shirt has become popular because of its natural cooling traits. Most wool fabrics have been found to naturally have a UPF (a rating of UV radiation absorption by fabric) of 30+ and can easily reach a UPF of 50+, depending on the fabric, which has made them popular in the outdoor apparel market.

The new cool image of wool was illustrated in the October 2017 edition of Vogue fashion magazine which had an entire extended feature on the “Women of Wool”, the female sheep shearers in the USA. Wool also has been found to pull moisture vapor away from your skin before it can even become sweat; it can absorb more than 30% of its weight in moisture before it even feels damp.

This week’s wool auctions in Australia saw demand surge with buyers from China, India and Europe active. The competitive buying saw over 98% of all bales offered sold at a record price, the AWEI Eastern Market Indicator (EMI) reached an all-time record of 2,166 Australian cents a kilogram which equaled 698 US cents a lb. Sizeable premiums were paid for the best microns. The weekly gains in Australian Dollar terms were 6.33% and 3.96% in USD while the gain in Chinese RMB was 4.93%. Prices are now up 31% for the year. These gains put the cotton/wool price ratio at a record 8.51.

Wool supplies are down and the drought is impacting wool weights. NSW farmers face a major burden keeping sheep populations with water and feed which are in short supply during the current very rough drought. The Wool forward market is trading at a premium to the current record prices. In the US the latest prices for 18.6-19.5 micron ended the week at 673 cents a lb.

RAINS INTERRUPT BRAZILIAN HARVEST, COULD IMPACT QUALITY

The last two months have been extremely dry in most of the Brazilian cotton belt with over 700 wild fires reported in the first half of August in the states of Mato Grosso, Para and Amazonas. Early in the week humidity dropped to 10% or lower in many areas of the mid west and reached a record low in Goias. The low humidity can cause problems in ginning that will impact cotton quality. Ginning at such low humidity, without adding moisture, causes broken fibers. At the end of last week this dry weather gave way to the arrivals of the first rains in two months with rainfall reported in northern and central Mato Grosso, Tocantins and western Bahia. The heaviest rains in Mato Grosso are expected in the Campo Novo dos Parecias, Paranatinga and Sinop.

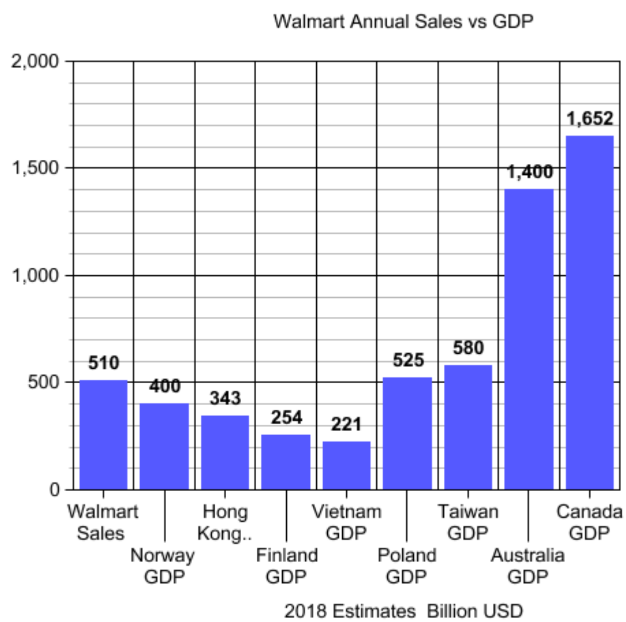
Harvest in Mato Grosso is now near the 50% completion mark. The rains are expected to be scattered but could be heavy enough to increase the volume of Strict low Middling color grades; the first half of the harvest produced excellent color grades. The export offering basis for the 2018 has remained steady from most shippers. A few shippers continue to be more aggressive matching US basis levels with Middling 1 1/8 offers at 1000 points on Dec for October - December and are at a slight premium to the most aggressive US EMOT offers and a discount to Memphis Territory. Forward selling by growers has slowed to small volumes. Cotton export shipments have been slow as the increased freight costs have slowed all movement. Only 1,200 tons was shipped in the second week of August.

The Real/USD exchange rate has remained weak which has influenced the ESALQ Index of a 41-4-35 landed Sao Paulo to decline to 83.04 US cents a lb. on August 16th, this remained at a premium to ICE futures.

US RETAIL SALES AT WALMART SURGE 4.5% YOY; 2018 SALES ON TRACK TO EXCEED 500 BILLION USD

Aggressive pricing and a new internet strategy coupled with the strongest US consumer economy in some time has resulted in the US's largest retailer experiencing their strongest growth in more than a decade with second quarter sales reporting a 4.5% increase in the US and total global sales reaching 128.03 billion USD. Online sales grew by 40% as its new strategy has paid off. Groceries and apparel were the drivers. In 2017 Walmart sold 21.3 billion USD worth of fashion goods. The strong second quarter performance has put the company on tract to post record global sales of near 510 billion USD. The sheer size of Walmart is reflective of the heavy consolidation and concentration which has taken place in the US retail space. Four of the top ten US retailers have a large presence in apparel; the others are Costco (#3), Amazon (#7) and Target (#8). Walmart is now the largest private employer in 22 US states.

To put the volume of Walmart sales in focus, 2018 sales will be larger than the GDP of Norway, Hong Kong, Finland or Vietnam. Sales will nearly equal the GDP of Poland and Taiwan and will equal 60% of the GDP of Turkey with a population of 80 million people. This concentration is truly amazing and indicates just how successful the company's push to close down other US retailers has been. In 2018 the consolidation continues with more and more power in the hands of the mass discount stores. 4,379 retail stores closing have been announced against 2,239 new openings. The closing stores have been the traditional stores while discount stores have led the opening. Dollar General, a miniature version of the Walmart store, has led the growth by taking over the small rural retail store market.



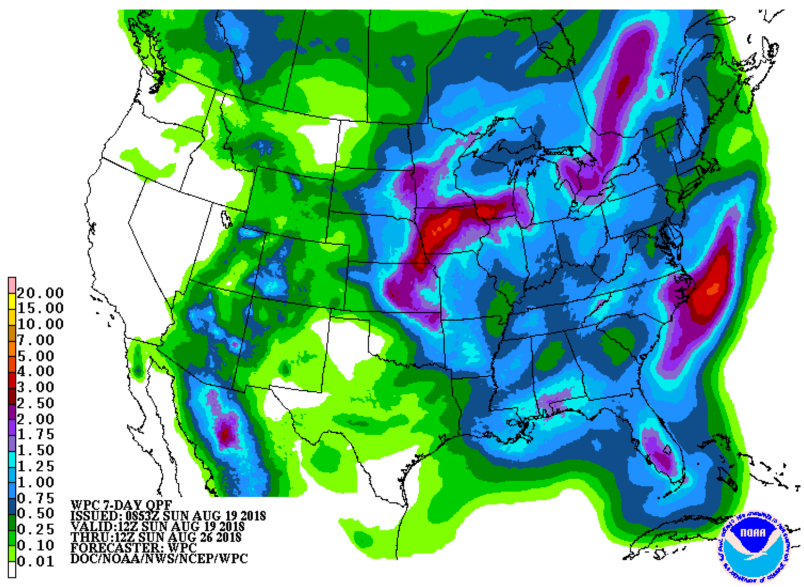
For apparel this development has continued to provide demand for cheap apparel procured from the cheapest labor locations. The rising cost of polyester has not yet slowed the flow of man-made fiber through the discount chains.

SUPPLY CHAINS MAKE PREPARATIONS TO MOVE OUT OF CHINA

In every crisis there is a turning point and that point is normally not noted until after the event has passed. We have been discussing for several weeks (July 23rd issue) our analysis that China acted out of emotion in its quick and rapid response to the trade discussions and that its act to directly attack the US agriculture sector showed that emotion. The move appeared to be part of the new strategy for China to assert itself. This is a major reversal of Deng Xiaoping's thought, "crossing the river by feeling the stones", which was part of a strategy to hide ones true intentions (claws), move quietly, keep a low profile and bide ones time until it's opportune to act. Adding to last week's turmoil was a collapse in the shares of Tencent, a Chinese champion tech company traded in Hong Kong. The company's shares collapsed losing more than 175 billion USD in value at one point following the Chinese Communist Party barring it from releasing one of its major video games. This illustrated the Party willingness to even inflict its will on the Chinese champions which triggered a wave of selling throughout all Chinese tech shares. It also illustrated the fact that all businesses in China now operate at the whim of the Party.

It is clear that in addition to the textile and apparel supply chains attempting to reduce their reliance on China many of the much larger industries are as well. One that got our attention was the electronic giants. Taiwan owned companies have been some of the largest early investors in China, according to one source 15 of the 20 largest Chinese companies exporting to the US are subsidiaries of the six largest Taiwanese owned contract electronic companies that play a crucial role in the global supply chains for I-phones, computers and many of the major consumer electronic products. These six Taiwanese owned companies have sales of 296 billion USD making them larger than Pakistan's GDP. The primary locations for relocating business are Eastern Europe, Mexico, SE Asia and the US. The companies do not appear to be planning a wholesale exit but just developing alternative supply chains in case of a prolonged trade battle with the US and also as a contingency plan for additional Chinese issues. Margins in these products are razor thin and China remains the cheapest for now before any tariff.

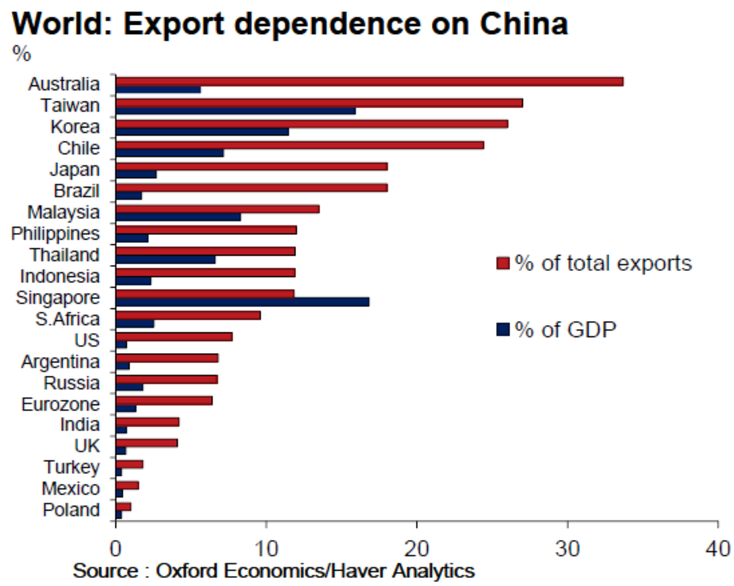
INTENSE RAINS FORECAST FOR US COTTON BELT NEXT SEVEN DAYS



Much of the US cotton belt has been receiving widely scattered showers over the past week and heavy rains will be possible over the next 7 days. These rains will be welcome in some areas but others are rapidly maturing. Over 30% of the crops in Louisiana and Missouri are open and nearly 20% open in Mississippi. West Texas received widely scatted showers last week with the extensive rains not occurring in many areas of the belt. The forecast has heavy rains in the northern Panhandle and light amounts south. 90,043 bales were classed last week in Texas and the color grades became a bit more diverse and staple length improved to average 35.2. High mike remained a feature with an average mike of 4.9 with 45.5% of all classings from South Texas having a mike of 50 or higher. Overall, the US crop remains on track to exceed the USDA August estimate. The next area of focus will be for a return of a dry, clear weather pattern; the wet rainy pattern will need to end soon over the Mid-South and Southeast belts.

ICE FUTURES ENDED THE WEEK NEAR LOWS

ICE futures ended last week near the lows, gone were all the bulls with the market appearing to have few friends. As our regular readers know we turned negative two weeks ago following the loss of confidence by the spinners and our belief that supply chains were beginning to make some confidence rattling changes. Since that time the China/US trade dispute has expanded to include Turkey, a very important market. At the same time, the US Dollar has surged against all emerging market currencies which put pressure on all USD dominated commodity and equity markets. It has also made physical trade more difficult as spinners saw their risk exposure increase. The sheer size of the US Dollar advance has hurt economic growth and made it questionable in several emerging markets. Against this back drop nothing seemed safe. Up until June the world believed the WTO would provide some rules to trade, however, China destroyed that myth openly with its tariff on the WTO guaranteed cotton import quota. From this the dispute has only expanded with zero progress on the key points of contention; forced technology transfer, some rebalancing in the US trade deficit through greater Chinese purchases, real reform of the state owned companies which control the economy, real opening of the economy and a curtailing of the industrial overcapacity in industrial commodities which started the dispute. At the same time that no progress was being made on trade China asserted itself in a very visual way which added to the concerns. The first was to demonstrate that the insertion of the Chinese Communist Party into the business world could be very heavy handed, even for one of its own companies. The CCP bared the Chinese tech giant, Tencent, permission to release a video game which caused record losses in Chinese tech companies, as well as, wiping out 175 Billion USD of the value of Tencent from its record high. This extensive visual illustration of involvement of the Party even in the affairs of private companies ignited new issues and shook confidence.



These conditions appeared to simply keep spinners very nimble on approaching new business while at the same time US exporters have continued to aggressively offer US styles at very cheap CFR basis levels which kept US cotton offered near the same level as Indian despite the fall in the Rupee/USD exchange rate. Amid such offers and the behavior of the futures there was no rush to expand coverage, gone were all the concerns of just 60 days ago. On Friday the Algo/HFT trading systems of ICE appeared to already have shut down for the weekend and showed no reaction to a late announcement of new advances in US/China trade talks. Both China and the US have announced a Chinese delegation will visit the US next week to attempt to end the trade dispute and set the stage for a Trump/Xi Jinping summit in November to end the impasse.

The CFTC data showed what had been clear earlier that the speculative groups were liquidating, through Tuesday Managed Funds had sold 9,688 contracts, Other Reportable 3,638 and the Non-Reportable small spec's 3,045 contracts. All three continued to sell through Friday. The Managed Fund's net long position is now back near 70,000 contracts, this level has maintained longs much of the year but there are no guarantees it is over. The two major overwhelming macro trends; first, the end of the Age of Cheap Polyester is continuing and secondly, the switch to cotton from man-made fibers is underway. These issues continue to provide underlying support but will not be enough to offset the trade headlines.

Just 60-90 days ago it appeared China was headed toward record cotton use, dwindling cotton stocks and a wide gap in its stocks to use which would require a significant return to the import market in late 2018/19 and an even larger return in 2019/20. Now, Chinese mills have resorted to hand to mouth purchases as their confidence has been shaken by the actions of Beijing and

MEET JAMIE LABO, SUPPLY CHAIN MANAGER, JERNIGAN GLOBAL

Jamie has extensive experience in Apparel design and sourcing. Jamie previously was an Apparel &Technical Designer, Product Developer and Sourcing manager with Apparel Simplified. Her previous position was with Li & Fung, of Hong Kong which is the largest textile & apparel supply chain manager in the world. At Li & Fung she managed the Apparel Sourcing for Tractor Supply, the largest farm supply chain in the US.

Please contact Jamie at Jamie.l@jerniganglobal.com to discuss you supply chain requirements.

Washington resulting in most of them concerned about future export orders. Then the moves by China both internally and externally since June has also provided little confidence to the general outlook for the Chinese economy. The exporters know the supply chains are changing and they are worried to the extent that the Commerce Ministry, police and other local agencies have held meetings with exporters to discuss their plans to lay off workers or the shifting of supply chains. At the same time the internet shows the police are conducting random checks of citizen's cell phone content. US retail sales are red hot and apparel retailers are beating estimates but they will soon need to place new orders which bring the fear of tariffs.

Regarding cotton it has long been said that, "when China gets a cold, it is felt around the world". In July we discussed our belief that China had overreacted to the US tariff issue and had let emotion rule its response, which was a very un-Chinese reaction. Since then it appears to have been confirmed by a number of actions but fortunately we are seeing our first signs that Beijing perhaps realizes this and have begun to take steps to correct their course. No more mention of the "Made in 2025" program has been made recently and those saying China has surpassed the US have stopped, some being publicly attacked. The recent economic data, even with its likely inaccuracies, show a weaker economy, the country's equity markets have been especially hit hard, the RMB has weaken against the USD and the Pier to Pier Lending and Vaccine scandals have shaken general confidence.

As the trade talks begin and a US/China summit is planned the emotion will be high on both sides. It might be remembered that earlier in the dispute it appeared there had been a breakthrough with CNBC headlines of a deal, this was followed by a quick rebuttal from China. A group in the US administration is pushing hard for the first major Chinese structural reform since Xi Jing took office and appears unwilling to settle for anything less than its achievement. They also want to continue with additional tariffs regardless of talks until a deal is signed given the tendency of past talks that look like stalling tactics and result in no action. This will likely anger China. From our viewpoint, assured access for US cotton and other agriculture products has to occur. The US has waited for 18 years and allowed unlimited Chinese imports and are still waiting for real access, not quotas or sliding scale but free imports. Without this what has really been accomplished for agriculture when you consider all the market disruption? Nothing but pain. At the same time different industry sectors in the US are just as passionate regarding their points. On the Chinese side a deal will require their internal acknowledgment that conditions have changed and they must give on the required points to keep the export engine and economy going while at the same not appearing to be doing so. They should take some comfort that unlike the previous US administrations this one is economic focused and has not brought up the human rights issues.

The success or failure of the talks regarding cotton will be a market factor daily until resolved. The Turkish situation has been added to the mix and the behavior of both sides is a bit hard to understand given they are both NATO members. The difficulty in seeing how this gets resolved is due to the fact that Erdogan is the first Turkish strongman in recent history and such events have always been prevented by a military which protected the secular state. The US has normally been there to assist Turkey in each of its past economic crisis and these efforts have normally provided a safety net to any crisis. When it involved US cotton credit assistance could normally be counted on to assure cotton kept flowing. Today is quite different, our thoughts and prayers go out to our many Turkish friends and the Turkish people that this will all be resolved before the suffering increases.

For cotton the near term price direction remains tied to how these trade issues are resolved so until the issues are resolved the market continues to have an overhang of Speculative longs which will further reduce positions unless given a reason to stay long.

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