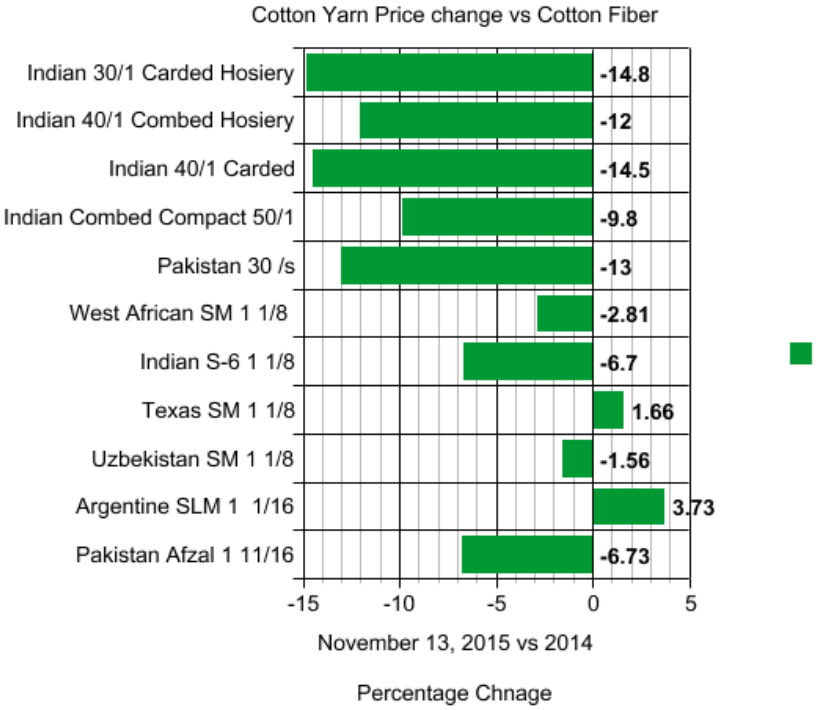
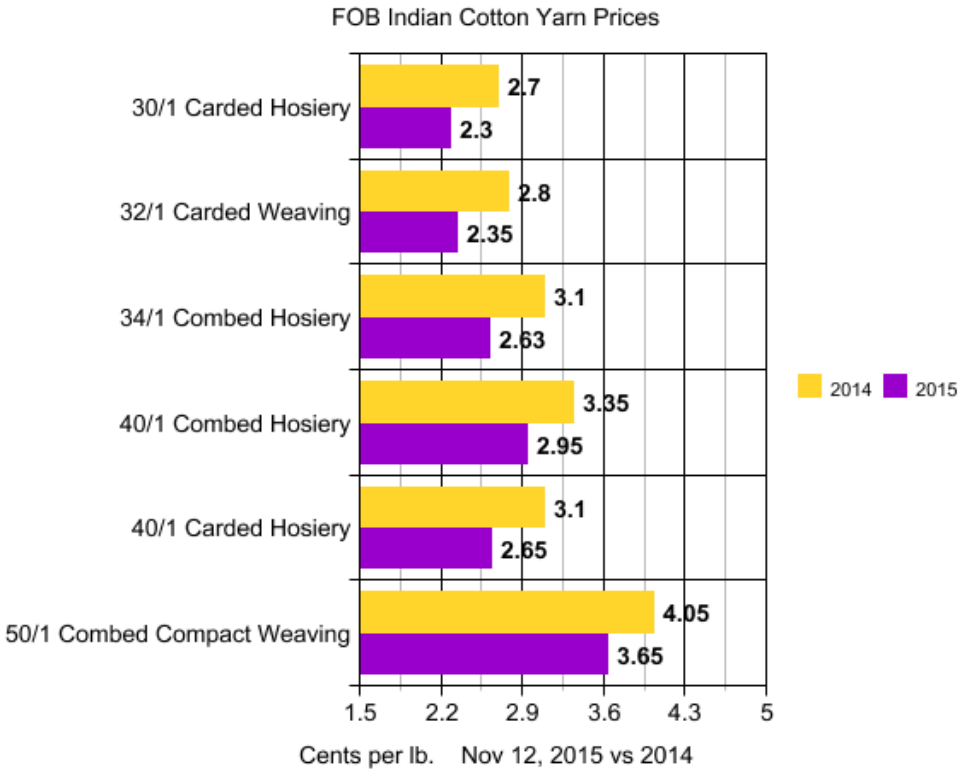
NOVEMBER 16, 2015 **WEEKLY ANALYSIS & RESEARCH**

POOR SPINNERS MARGINS DRIVE DOUBTS IN DEMAND ESTIMATES



The above chart explains why spinners have been buying hand to mouth, while cotton yarn prices for the two largest cotton yarn exporters have fallen from 9.8 to 14.8% from a

year ago cotton fiber prices range from 6.7% lower to 3.73% higher. This squeeze on spinner's margins has turned spinners into to hand to mouth buyers over the past year. The weaker price structure for yarns has prevailed despite the expansion of import demand from China. Cotton fiber prices have been supported by the shrinking supply of cotton outside China. Spinners have been aggressive buyers over the last week taking up US, Brazilian, Indian, Greek and West African for fourth and first quarter needs. Old crop West African supplies are near depletion following recent demand. Pakistan has proven a very active source of business during the fourth quarter taking up approx. 200,000 tons of Brazilian, West African, Indian and US cotton. Turkey has continued active over the past week as has Vietnam.



Indian domestic cotton prices have been the weakest of any origin in comparison to a year ago. The average price of Indian cotton in cents per lb. is about 6.7% from a year ago based on export prices. The Domestic price of a Shankar-6 ex gin currently is 32,150 Rupees per candy; this is down only 1.87% from a year ago when prices stood at 32,750 Rupees per candy. The change in exchange rates however is much more dramatic, a year ago the ex-gin price equaled 68.00 cents, today the price is 62.20 cents or 8.5% lower.

CHINA RETAIL SALES IN OCT HIGHEST OF YEAR AS CONSUMERS TAKE A LARGER ROLE

Wednesday was Chinese Singles day, the online sales event by the Alibaba on line marketplace saw retail sales surge 40% from last year's event to over 13.5 Billion USD. The event was held in Beijing for the first time with cameo appearances by international stars lead by James Bond "Daniel Craig". Alibaba announced it's on line customer base in China is now larger than the entire US population. They cited sales driven by the demand for high quality items, products by Nike and Apple led the sales. Global retailers such as the US firm Macy's which does not have a physical presence in China participated for the first time. In the economic data released Wednesday for October Retail Sales reached their highest level of the year expanding 11%. In contrast urban fixed asset investment in the Jan/Oct period grew 10.2%; this is the slowest since 2000. Industrial Production hit a six year low expanding 5.6%. The real estate glut is clearly a drag on the economy with investment shrinking 2% in Oct. Exports was also weaker in October.

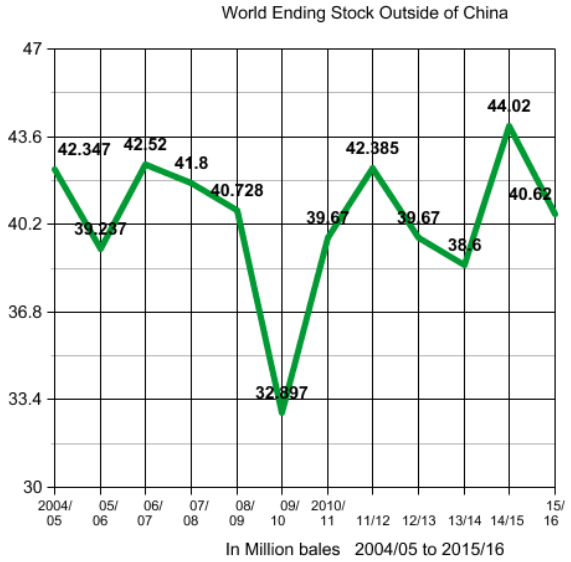
The expansion of retail sales growth at 11% in October was the highest since Dec of 2014 when sales expanded 11.9%. Chinese retail sales of textiles and apparel in Oct reached 122.1 Billion Yuan, this reflected 9.8% YOY growth. Jan/Oct retail sales of textiles and apparel have experienced 10.2% growth reaching 1.059 Trillion Yuan. The Fung Group projects that total retail sales of textile and apparel in China will exceed that of the US in 2017. The growth in the value of the Chinese Domestic apparel market is hard to fathom, in 2009 the total value of sales reached only 462.2 Billion Yuan, between 2009 and 2013 in grew 247% in value terms. Women's wear accounts for 32.7% of the market with children's and sportswear the fastest growing markets. On Line sales is the fastest growing marketing channel.

The growing size of the domestic Chinese market presents one of the greatest challenges for cotton consumption. The importance of the high end market is expanding but much of the sales volume is still driven by price. In 2013 the average urban household expenditure on textiles and apparel was only 306 US Dollars and only 70.60 USD by rural households. The global cotton industry needs to stimulate a program to encourage cotton consumption at the consumer level in China.

PAKISTAN IMPORT DEMAND CONTINUES AS CROP SHRINKS

Pakistan's Cotton Crop Assessment Committee has lowered its production estimate to 11.3 million local bales; this is down from the previous estimate of 13.38 million bales. This equals 8.82 million 480 lb. bales, this compares to the USDA latest estimate of 9.0 million bales. The lower crop and the price level that local cotton is commanding are continuing to drive import demand. Additional offtake of Indian S-6 1 1/8, US 41-4-36, Brazilian SLM, US low grades, Some ELS offtake was noted in US Pima, Turkmenistan and Indian DCH. Total import offtake since the domestic crop began to be revised downward has now reached 200,000 tons or 918,900 480 lb. bales.

USDA WASDE REPORTS LOWER WORLD ENDING STOCKS OUTSIDE OF CHINA

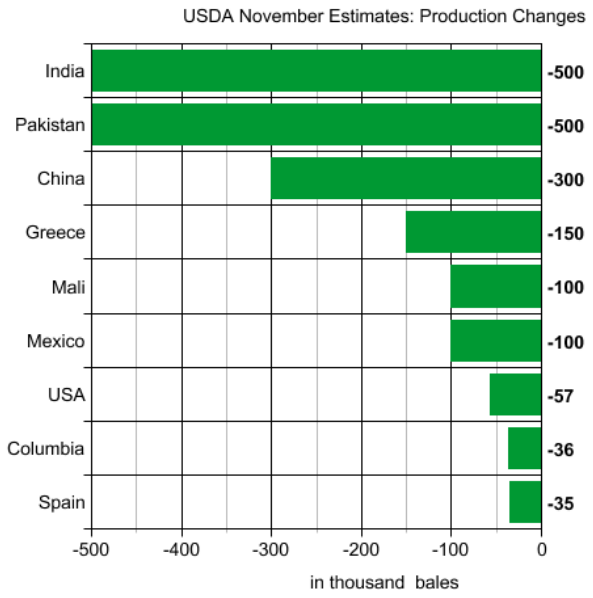


The USDA in its November Supply/Demand estimate further lowered world ending stocks outside of China as it reduced production in 9 countries in a material way. World Ending stocks outside of China are now projected to fall to 40.62 million bales, this is down from 44.02 million bales a year ago, despite this tightening of stocks world prices have shown limited reaction, Indian prices are down 6.7%, West African are down

2.81% and US are up 1.66% from a year ago. This is reflective of just how much the hand to mouth buying strategies of spinners has influenced price movement. World Production was lowered 1.758 million bales to 105.63 million bales; this is down 13.28 million bales from a year ago. This reflects the lowest production level since 103.359 million bales was produced in the 2009/10 time period. We continue to expect total World Production to fall further after US, Indian and Chinese crops adjusted yet lower in future USDA estimates.

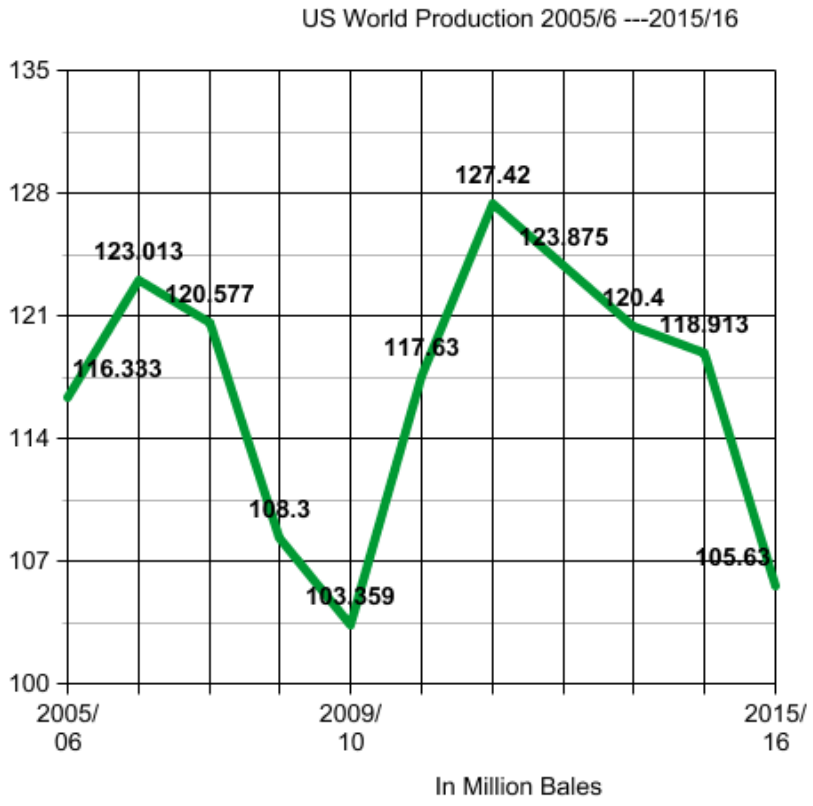
Indian Production was lowered 500,000 bales to 28.50 million bales, we expect production will be lowered an additional 1.5-2.0 million bales. China's production was lowered 300,000 bales to 25.0 million bales. We continue to expect this estimate will be lowered to 23.0 million bales. The respected Chinese estimates are already at this level; Cotlook estimates the crop at 5.01 million tons or 23.018 million bales. Greek production was lowered 150,000 bales to 1.05 million bales. Pakistan production was lowered 500,000 bales to 9 million bales. The US crop was adjusted only slightly, production was reduced 57,000 bales to 13.28 million bales. With harvest near the half way mark the USDA will likely await more ginning data before further adjustments are made. We expect the crop will fall below 13 million bales with further lower adjustments from Texas, Georgia and other regions of the Southeast. Mali's production was adjusted 100,000 bales lower to 1.10 million bales.

Global Consumption was lowered 680,000 bales to 111.59 million bales, World consumption outside of China is estimated to reach 78.59, and this is only 1.26 million bales above last year. We now feel like Domestic Consumption outside of China has been adjusted to reflect the pockets of weakness and will face no further large scale adjustments. The main reduction in the November estimates was in China was consumption was reduced 500,000 bales to 33 million bales which is unchanged from the 14/15 estimate. This could still be adjusted lower; however the reason is the replacement of cotton use with imported cotton yarn use which is boosting non-Chinese consumption. Indonesian consumption was adjusted 150,000 bales lower for 14/15 and 50,000 bales lower for 15/16. Pakistan mill use was adjusted 150,000 bales lower. Consumption in Ethiopia was raised 30,000 bales, Italy was raised 10,000 bales and the Philippines were raised 10,000 bales.



OVERVIEW/ANALYSIS

For some time we have been discussing the rapid reduction is supply, this is now beginning to be reflected in the USDA estimates. As the chart above illustrates the drop in production has taken production back to levels last experienced in the global financial crisis. After the further adjustments are made for the US, Indian and Chinese crops the production will be lower than 2009/10. We now believe that World Consumption outside of China has been underestimated, it's simple, China is now likely to import 2.5 million MT of cotton yarn in 2015/16, this equals 12.29 million bales of cotton. This is over 500,000 tons of yarn above the previous season or 2.458 million bales of cotton fiber. The USDA has World Consumption outside of China rising only 1.26 million bales. When this consumption metric is adjusted and production is further adjusted world stocks outside of China will grow much tighter in the second half of 2015/16 and stocks of machine picked cotton will fall to a record low. Today this has not been reflected in the price. The main influence in price instead has been ruled by the removal of China as the center of global trade in fiber and the hand to mouth buying by spinners due to their poorer margins.



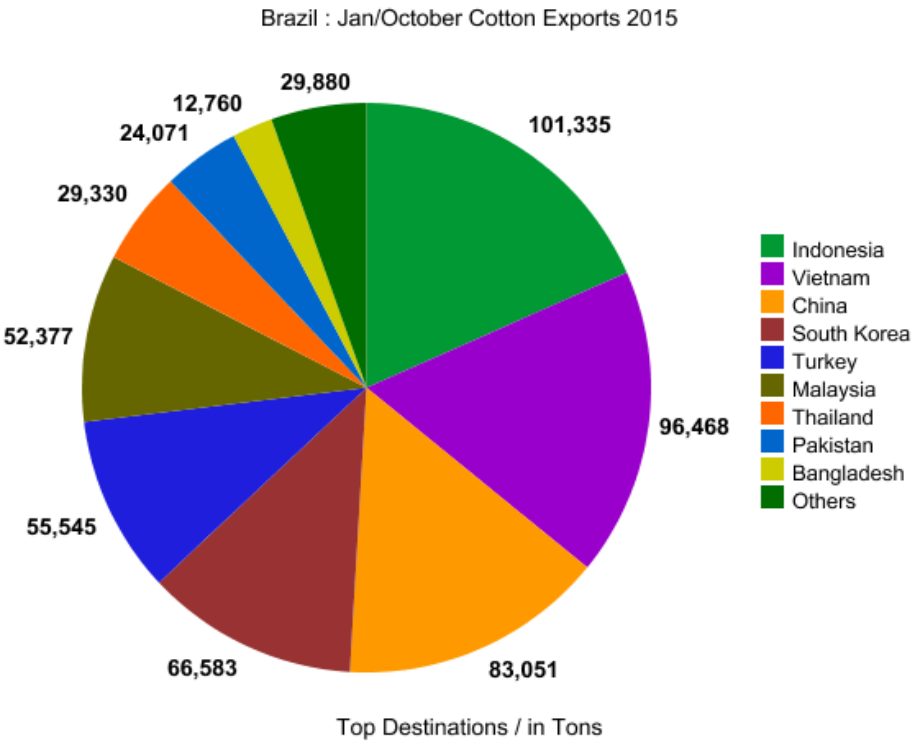
USDA ESTIMATES WEST TEXAS COTTON PRODUCTION AT 4.9 MILLION BALES

The release of the Texas district estimates revealed that the USDA had adjusted upward the estimate for the West Texas region (districts 11, 12, 21, 22) by 75,000 bales to 4.9 million bales. Production in the Northern High Plains (District 11) was lowered 30,000 bales to 610,000 bales; the average yield was lowered from 738 lbs. to 714 lbs. The Southern High Plains production was placed at 3.420 million bales; this reflected a 70,000 bale increase based on an increase in average yields from 643 to 657 lbs. per acre. Production in the Rolling Plains was raised 25,000 bales to 870,000 bales.

VIETNAM/INDONESIA TOP EXPORT DESTINATION FOR BRAZILIAN COTTON

Brazil exported 161,171 tons of Cotton in October; this was up from 148,542 tons a year earlier. Shipments to China increased reaching 36,940 tons; the second largest destination was Vietnam with shipments of 26,687 tons. Indonesia was the third largest at 21,593 tons. Shipments to South Korea reached 17,713 tons and 12,705 tons where shipped to Turkey. During the first six months of 2015 cotton exports from Brazil have

reached 578,500 tons which is up from 537,853 tons shipped during the same period a year earlier. Indonesia has replaced China as the largest export destination; however shipments to Indonesia have reached only 101,335 tons which is down from 121,759 tons shipped a year ago. Shipments to Vietnam have surged and are up over 58% at 96,468 tons. For the full 2015 calendar year Vietnam is likely to be the top export destination for the year, cotton consumption in continuing to expand and will reach a record in 2015/16 and expand further in 2016/17. The expansion in consumption is being driven by increased use of machine picked cotton, quality has been an issue in the Brazilian cotton but the steep discount to US has drawn buyers.



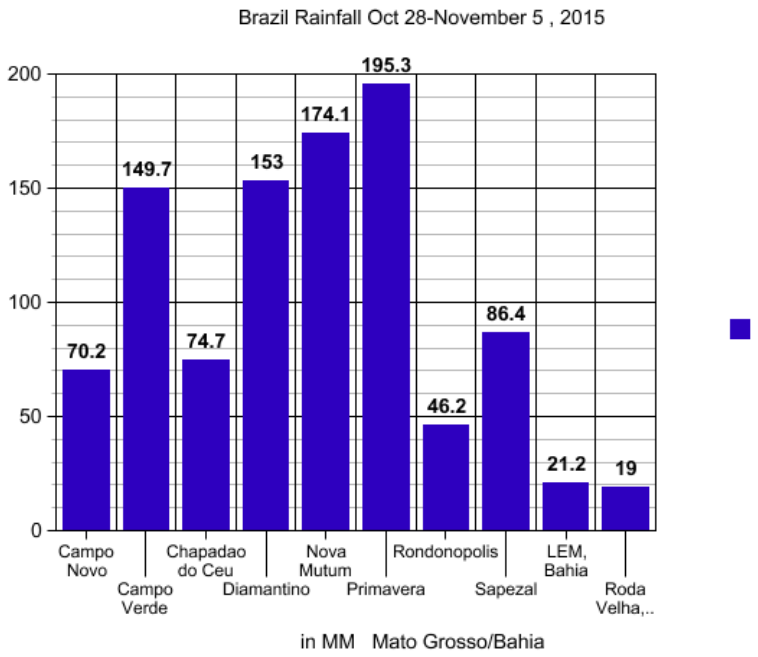
Export shipments to South Korea have been steady at 66,583 tons. Turkey is quickly becoming a very important market; exports are up sharply in 2015 at 55,545 tons which reflects a 64% increase from a year ago. Cotton consumption in Turkey is strong and its mills use a high percentage of machine picked cotton, the heavily discounted Brazilian basis has drawn strong buying interest. Shipments to Malaysia have tripled at 52,377 tons, much of the cotton shipped to Malaysia is for storage in warehouses and will be eventually sold to other destinations, cotton designated for Malaysia is also cotton known as ‘Afloat” which means no final destination is known and that the cotton will be sold before actually being offloaded. Malaysian warehouses are one of the new delivery points for the World cotton contract. The other major export destinations are Thailand, Taiwan, Pakistan and Bangladesh.

BRAZIL SOYBEAN PLANTING ADVANCES AMID IMPROVED RAINFALL/COUNTDOWN BEGINS FOR SECOND CROP COTTON

Rainfall has varied across Mato Grosso over the past 9 days, some regions have recd moderate to heavy rains while others have recd only light rains. Soybean planting has been delayed this season by the late arrival of the seasonal rains; Mato Grosso is an Agriculture powerhouse with two crops grown over much of the state. The date of planting of the soybean crop is important to cotton for 438,822 hectares of the 576,547 hectares expected to be planted to cotton will be the second crop which will be planted after the soybean harvest which will occur about 110 days or more after planting. Yields and quality have suffered in the past when the second crop was planted into Feb. This of course depends on if the rainy season is extended. Normally March is the wettest month, and the crop is planted to take advantage of that rainfall. As of November 5 61% of the soybean crop had been planted in the state.

In terms of rainfall the pattern has been very scattered, for example the heaviest rainfall in the period occurred in Primavera (important cotton area) with 195.3 mm recorded, just a little over 100 Kilometers to the south at Rondonoplis (another important cotton area) just 46.2mm has fallen. This week much of the state will be dry and hot with only a light scattered shower expected daily mainly in the southern areas.

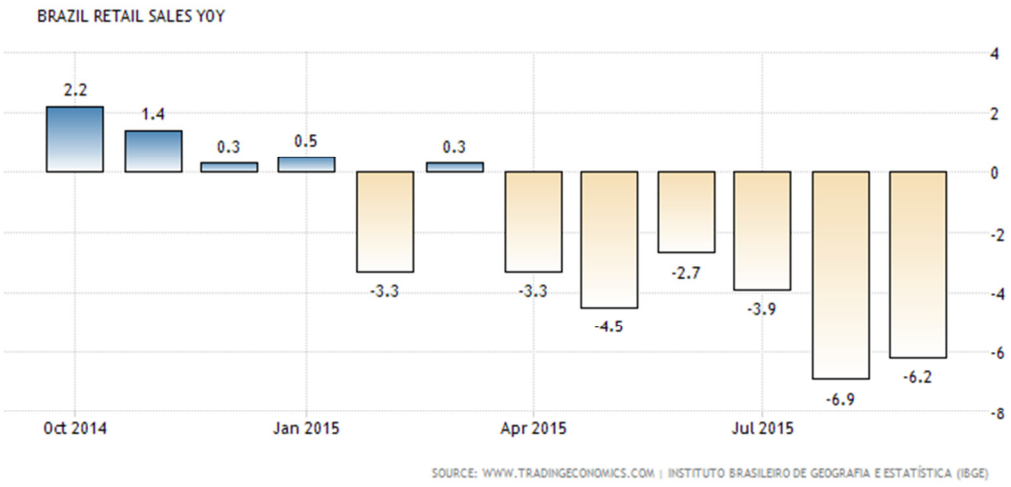
Overall the progress of planting is 5.90% below last year's progress on the same date, it should be noted last year planting was also delayed. The rainy season was extended last season which damaged the full season crop but allowed for record seed cotton yields on the second crop because the rains benefited the late planted second crop cotton. The largest cotton districts are located in the Medium North, West, Central South and South.



In the main cotton districts the areas of concern is in the South were planting has reached 69.7% complete which is 4.80% below last year on the same date, the South will contain nearly 42% of the state's entire cotton crop. In the North Medium region the planting is 8.20% below last year, this area will contain 109,341 hectares of cotton. In the Central South the soybean planting is 3.20% below last years. The greatest delay at this point is in the North West and Northeast East which contain only a small amount of cotton acreage.

Rainfall has been light in Bahia where only 19-21.2 mm has fallen, the region will be hot and dry all this week. The crop is 100% full season in Bahia and planting will not start until December. The current extended forecast has the Bahia cotton region receiving good rains in Dec thru Feb. The forecast for the next 5 days suggest improved rainfall in most regions.

BRAZILIAN COTTON CONSUMPTION REMAINS WEAK



Brazil's Retail Sales in September declined 6.2% from a year ago, this was a lower decline than had been expected boosted by food sales. Retail sales have fallen for the past sixth consecutive months. Unemployment continues to expand with additional companies announcing layoffs. Industrial Production fell sharply in Sept falling 10.9%; this was the largest month on month drop in over 5 years. The Purchasing Managers Index fell sharply in October, falling to 44.10 which was the lowest level in over ten years and compared to 47 in Sept. Any measurement below 50 means contraction.

The weakness in retail sales and Industrial Production has triggered a debate over the actual level of domestic cotton consumption. Spinners continue to report large unsold yarn inventories which continue to limit any improvement in use. Textile and Apparel imports are declining which provides some hope for improvement in 2016 if retail sales stabilize. Jan/Sept cumulative textile and apparel imports have fallen 13% from a year ago, however imports in Sept fell 34%. We expect the volume to continue to decline as the attraction of Chinese imports decline as the Yuan/Real exchange rate is fully reflected. Conab released its November estimate of consumption last week which triggered lots of debate, it estimated consumption at 820,000 tons. This is much higher than all private work. The operating rates at the major spinners suggest a much lower consumption level. ANEA has lowered its estimate of consumption to 700,000 tons. ABIT, the textile association has estimated consumption will fall to 650,000 tons. Our estimate of domestic use is 675,000 tons.

US RETAILERS FACE MAJOR HEADWINDS AS CONSUMER HABITS CHANGE

US Retailer Share prices collapsed last week, the S&P Exchange Traded Fund of US Retailers has fallen almost 9% over the past 8 days, and this is the largest drop since August 2011. The decline was driven by a series of disappointing sales results by the major companies, several of the companies are major US Apparel retailers. US Retail Sales were disappointing as well, total US Retail sales grew only 1.7% from a year ago. Sales at Apparel stores rose 2.3% from a year ago; however Aug/Oct cumulative sales are down .30% from the previous 3 months. The decline was led by the major US Retailer Macy's. The weakness has raised fears over US consumer demand. This concern has not shown up in the actual textile and apparel import data. US imports in Sept rose 4.7% in volume terms; this follows robust imports in August. Imports from Bangladesh, Pakistan and India surged. Imports from Vietnam exceeded a Billion USD and were up over 9% in value terms.

ICE FUTURES: MARCH BECOMES THE LEAD CONTRACT

The December ICE contract is quickly moving to expiration, open interest fell sharply last week as Index funds rolled out of Dec and Dec options neared expiration, by Thursday open interest in December had fallen to only 44,724 contracts while open interest in

March had reached 110,906 contracts. Global Commodity prices fell sharply last week coming under a major wave of selling on Thursday and Friday. WTI Crude Oil moved back to the near the 40 USD a barrel which is down over 22% since its October highs. The Bloomberg Commodity Index of 22 commodities fell to its lowest level since the global financial crisis. The Commodity Research Bureau Commodity Index (this is the oldest commodity index) is now down over 50% from its 2011 highs. The selling pressure in commodities triggered selling in global equities; the US Dollar was also firmer against most currencies lead by weakness in the Euro against the USD. The Euro ended the week near 1.072 which is not far from its March lows of 1.0496. ICE cotton futures turnover was focused largely on spreads and squaring of option positions until Friday when new speculative selling was evident. The market found support throughout the week from brisk export trade. Spinners took up large volumes of US, Brazilian, Indian, West African and Turkmenistan styles covering final fourth quarter and first quarter 2016 requirements.

The overall deflation environment has returned to trigger speculative selling. Outside of this influence the market's largest problem continues to be the trade's lack of confidence in demand. The hand to mouth buying from spinners and the poor level of spinners margins has undermined confidence. The continued contraction in supply should be bullish on prices; the full tightness in supply however will not be felt until the second half of the 2015/16 season. Until this period arrives and consumption is proven the market remains firmly in a trading range.