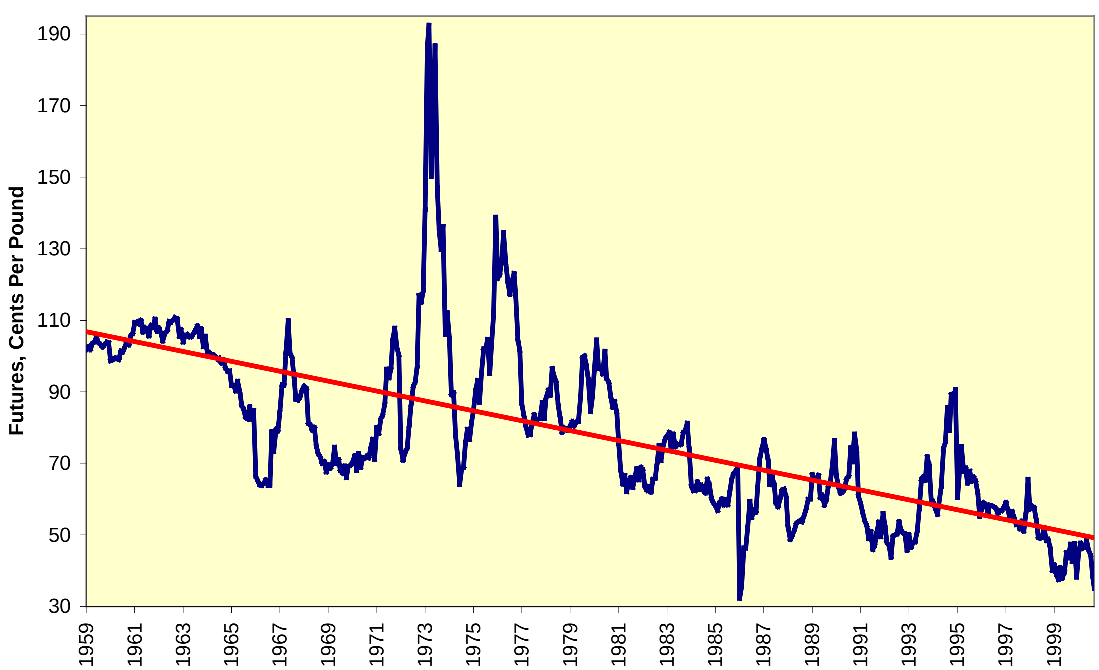
Profits In Textiles, Not Tech Styles

With the prominent exceptions of energy and livestock, commodity markets remain in the grip of a deflationary spiral. For the most part, this is welcome news: Falling prices are evidence of vast increases in economic efficiency. Lower commodity prices should be unwelcome only in the event of a collapse in final demand due to recession.

Cotton always has occupied a special place in the world of commodities. Many early commodity plungers, including Jesse Livermore's fictional alter ego in *Reminiscences Of A Stock Operator*, were cotton speculators. Cotton production has played an important role not only in U.S. economic history, but in that of Egypt, India, China, and Uzbekistan. While it is a crop and thus is tied to all of the vagaries of disease and weather plaguing all production cycles, it is also an industrial commodity tied to overall economic activity. While clothing, towels, and bed sheets may approach the status of necessities, their purchases are both discretionary and postponable.

As we've seen so many times before, the real price of cotton (here deflated by the more appropriate producer price index) has been heading south for a long time, and now is approaching the spike low set in 1986. The real price of cotton has fallen two-thirds since the Eisenhower administration, while the world's population has doubled; only the familiar inflationary spike of the early 1970's mars the trend. The recent downturn in cotton prices, as has been true for so many commodities, began with the Asian financial crisis of 1997-1998: By year-end 1998, China held more than 47% of the world's cotton in inventory.

Cotton Prices: Deflated By PPI

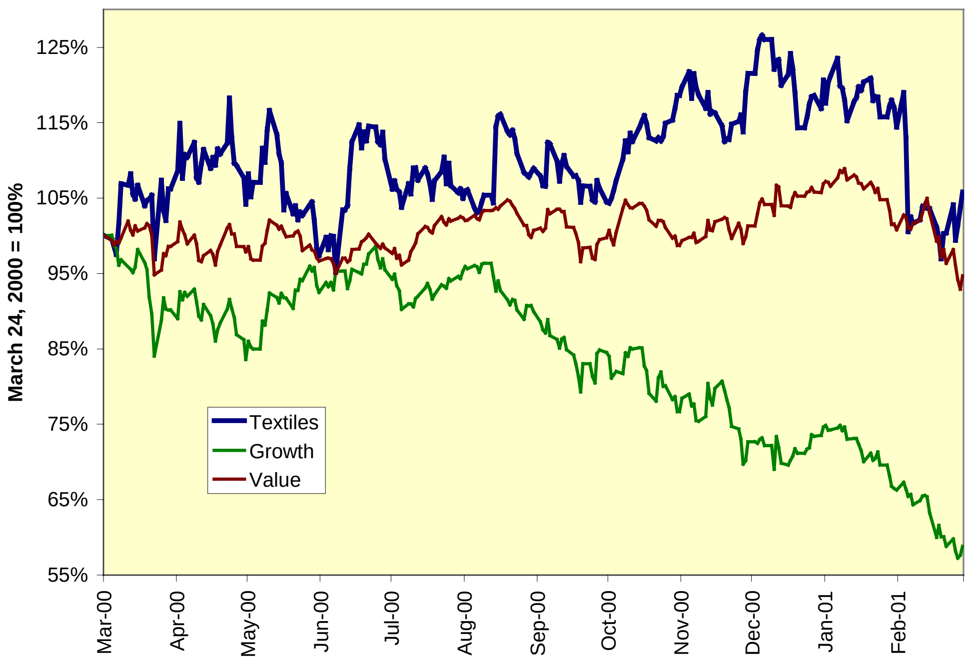


Threading The Needle

Whenever opponents of globalization, a confused and confusing lot on their good days, need some examples of ruthless corporate behavior, the textile industry is usually there to oblige. From the very start of the industrial revolution in England to this day, textile manufacturing seeks the lowest labor costs and regulatory burdens. As a result, global cotton spinning is dominated today by India, Pakistan, and China. The value added in this industry historically has been in design and marketing, not in raw materials or manufacturing. While this is no different today, we can still remain stateside in our analysis and examine the 13-member Bloomberg textile index.

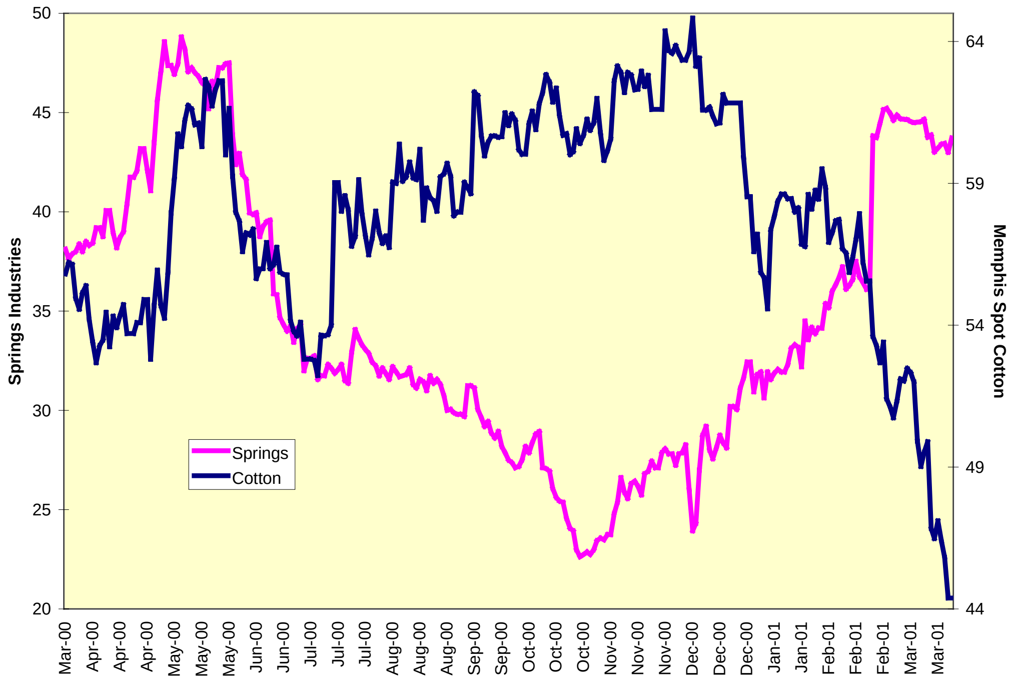
The index, dominated by Cintas Corporation, Mohawk Industries, Westpoint Stevens, Springs Industries, and G&K Services, may not possess the glamour of the tech sector or the political risks of the electric utility sector, but that may be just what the doctor ordered after a trying time in the markets. The index' total return of 7.5% over the past year stacks up well against the S&P 500's loss of 24.5%, the S&P value index' loss of 3.67%, and the NASDAQ's skydive of -61.05%. The performance gap had been even larger by the end of February, but textile issues took a beating in March along with other previously successful defensive issues.

Textiles Outperform Growth And Value



Can we see a connection between textile stocks and the underlying price of cotton? Over the past year, Springs Industries' share price has had both a leading and an inverse relationship to the spot price of cotton at Memphis. This relationship has been most pronounced since the end of October 2000, the time at which the broad market started to crumble. Springs began a rise that saw its share price double from its lows. By early December, cotton began its descent, and has since lost a third of its value.

Springs Industries And Cotton Prices



This equity price rally in anticipation of lower costs is consistent with the patterns we've seen before for commodity buyers; the exact opposite pattern, a rally in anticipation of higher prices, should be expected for commodity producers. This relationship and the relatively strong performance of the textile sector suggest the U.S. textile industry will suffer when cotton prices rebound.

Is such a rebound in the offing? Not if the National Cotton Council's pre-planting estimates are to be believed. Not only has the global economic slowdown stymied demand growth, but inventories remain high and exports to the United States are projected to grow, especially if the dollar remains strong. Moreover, U.S. planting intentions are high, and while weather forecasting is as a dicey business as stock market forecasting, the Council warns growers not to expect a continuation of the poor cotton growing weather seen over the past five years.

Weak cotton prices are symptomatic of the general deflationary pressures facing the world at present; inventory excess and production over-capacity plague more than the tech sector. Cotton, like other agriculturally produced industrial commodities such as rubber and lumber, is a sensitive economic barometer. So long as their prices remain under pressure, the basic industries that consume them – textiles, tires, and housing – should remain relatively firm market performers.