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By LESLIE JOSEPHS and ALEXANDRA WEXLER CONNECT

May 4, 2014 6:41 p.m. ET

Cotton is trading at its highest level in over two years as U.S. supplies are expected to hit a 23-year low this summer. The Coley gin in Vienna, Ga. *European Pressphoto Agency*

NEW YORK—Cotton is trading at its highest level in more than two years as skimpy U.S. supplies and a brighter economic picture push up prices.

However, some investors and traders think cotton doesn't have much more room to rise. They say high prices will encourage U.S. farmers to plant a bigger crop for next year, while clothing makers will seek out cheaper substitutes like polyester. Those trends could quickly create a glut in the market.

Cotton for July delivery climbed 0.1% to 94.32 cents a pound Friday on ICE Futures U.S., the highest closing price since February 2012. Prices have risen for three consecutive weeks and are up 11% this year.

Prices are rising on the back of expectations for robust demand this year, driven by strong economic data out of China, the top cotton consumer, and the U.S., the biggest apparel market. A stronger U.S. economy can translate to higher consumer spending on clothing. Increased demand for cotton would stretch supplies, which are expected to hit a 23-year low in the U.S. this summer, according to the U.S. Department of Agriculture.

Consumers may not see higher cotton prices immediately reflected in clothing prices because many manufacturers buy raw materials months before clothing hits the rack.

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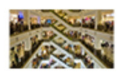
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"Virtually all of our commodity costs are locked in for, I think, 97%, 98% of the year," said Richard A. Noll, chief executive officer for Hanesbrands, Inc., during an investor call in late April.

Still, some traders and analysts see evidence that high prices are starting to crimp demand for the fiber, even with the improving economy. Net export sales of the most commonly grown cotton fell 75% from the previous week in USDA data released Thursday. Apparel makers are shifting to synthetic fibers, which this year could make up a majority of U.S. clothing imports for the first time in two decades.

"It looks to me like demand is easing off," said John Flanagan, president of brokerage Flanagan Trading Corp. He said prices are unlikely to rise above $1 a pound.

Bill Collard, president of New Smyrna Beach, Fla.-based brokerage Futures Management Group, said he placed bearish bets in the July cotton contract on Friday. He said unless China ramps up its purchases of U.S. cotton, there is little reason for prices to be at these levels.

If growers and merchants aren't "locking in prices here, I think they're foolish," he said.

Polyester is cheaper—about 65 cents a pound in China, said Gary Adams, vice president of economics at the National Cotton Council, speaking at an industry conference in Miami.

"That's tough to compete with," Mr. Adams said. He expects China's cotton imports during the 2014-15 season to drop by 50%.

Jordan Lea, co-owner of Eastern Trading Co., a cotton merchant in Greenville, S.C., had an even blunter assessment.

Cotton's market share is "doing more than just shrinking—we're collapsing," he said.

Mr. Lea traces cotton's downfall back to 2011, when prices soared to post-Civil War highs above $2 a pound. Prices are less than half their 2011 peak, but not all textile manufacturers that switched away from cotton have returned.

"We all thought when cotton prices fell. consumption would pick back up again, but it didn't," Mr. Lea said. "What $2 cotton did, it crushed the industry."

Others see a larger U.S. crop leading to lower prices. The National Cotton Council predicted Thursday that U.S. farmers would harvest 15.25 million bales in the 2014-15 season, up about 20% from the current year.

That forecast was cut from the previous outlook in February after dry weather reduced plantings in Texas, the top cotton-growing state. Poor weather could keep prices elevated even if demand slips, analysts say.

Still, the market is unlikely to find itself short of supplies, particularly as China releases cotton from its reserves, said Ashok Hegde, head of Singapore-based Olam International Ltd.'s cotton business.

"Cotton appears slightly overvalued at current levels," Mr. Hegde said. "The pending supply from the China reserve release and the larger U.S. crop has to be reflected in lower prices."

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