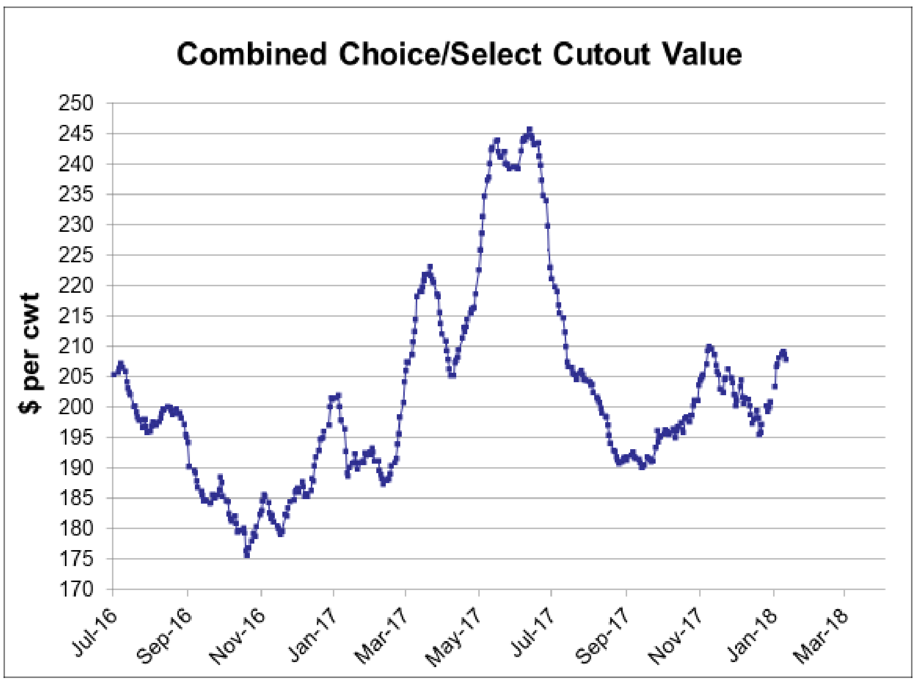
MEAT MARKETS
UNDER A MICROSCOPE

A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

January 12, 2018

There seems to be a consensus that the combined Choice/Select cutout value has made a temporary top, and that the next significant move will be downward. That opinion has some merit; both the time frame and the price level are about "right" for a top.

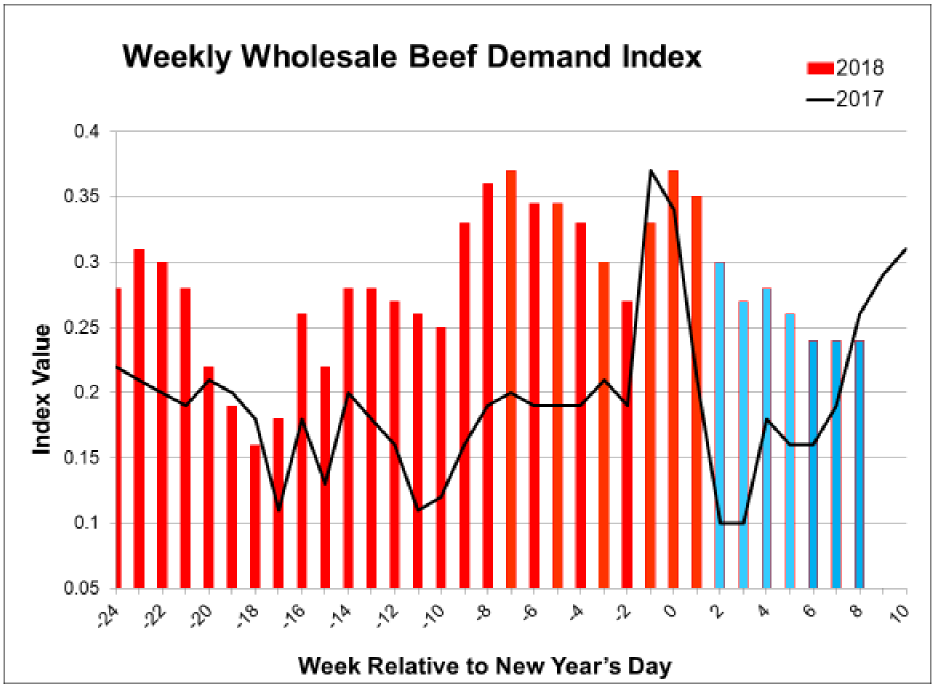


OK, the timing may be a bit premature, as it is rare that the cutout does *not* go up in the second week following New Year's Day (i.e., next week). But last year was one of those exceptions, which somehow makes it seem more possible. [We meat traders are obsessed with what happened a year ago.] But it's almost a moot point. Whether next week or the week after, the next significant move is likely to be downward.

Apart from the history and the chart, I am placing a lot of weight on the fact that forward bookings for delivery between now and mid-February were/have been rather unimpressive. While recognizing that this is but one indicator, I have to interpret it to mean that supermarket beef features will not be aggressive in the weeks ahead, and that packers will have more product to sell into the spot market than they have had recently. The spot market, of course, it the price that determines daily cutout values.

I am expecting weekly steer and heifer kills to hover in the 490,000 range through the balance of the month, compared with 465,000 over the same period last year. The inventory of cattle on feed 90 days or longer (up 9% from a year ago) is big enough to comfortably accommodate such a rate, and packer margins are starting out the new year in very good shape. It is also worth noting that feedlot conditions have been quite favorable for this time of year. We are almost halfway through January, and dry conditions remain in the forecast.

And so, while supplies should be ample, there is reason to think that wholesale demand will drop off more steeply than usual into February. This is not bullish.



Mind you, wholesale beef demand has been pretty stout in the past three weeks. I can only guess, but it looks like it might be in for the sort of decline that is pictured at left, which would take the seasonally adjusted demand index back down to where it stood in October. [The blue bars represent my humble forecast.] If it unfolds this way, then the next low point in the combined cutout value would be in the neighborhood of $195 per cwt…. a convenient downside target, since this was the most recent low (December 20). From this week's average, that would make for a decline of 5.9%, compared with the 15-year average decline of 2.6% between the second week of January and the second week of February. We *have* seen three declines of greater magnitude, though, within the last nine years. It wouldn't be *that* unusual.

From whence, exactly, should the come the downturn in the cutout value? Based on the seasonal track records, the most likely candidates are listed below. It is a fairly long list:

Change in Price from Second Week of January to Second Week of February

	Years Up (out of 15)	Years Down (out of 15)	Avg Price Change
Shoulder Clods	5	10	-3.5%
Chuck Rolls	4	11	-5.6%
Briskets	2	13	-5.8%
Knuckles	4	11	-3.6%
Inside Rounds	5	10	-3.6%
Bottom Round Flats	5	10	-6.2%
Round Eyes	5	10	-4.8%
CH 0x1 Short Loins	4	11	-3.5%
CH Tenderloins	2	13	-8.1%
50% Lean Trim	3	12	-8.1%
81% Lean Ground Beef	4	11	-7.1%

As long as we're having this much fun, I might as well show the equivalent track records of the major pork cuts, whether good or bad. Before I do that, though, let me ask for your help. In the noble pursuit of subtle clues, every day I scour the news stories using the keyword "beef". This week, the following story popped up:

*"In a freestyle called "Cardi B Truth" over the beat to Offset's **Metro Boomin**-produced "Ric Flair Drip," King Yella claimed to have been with the "Bodak Yellow" rapper before she met her now fiancé."*

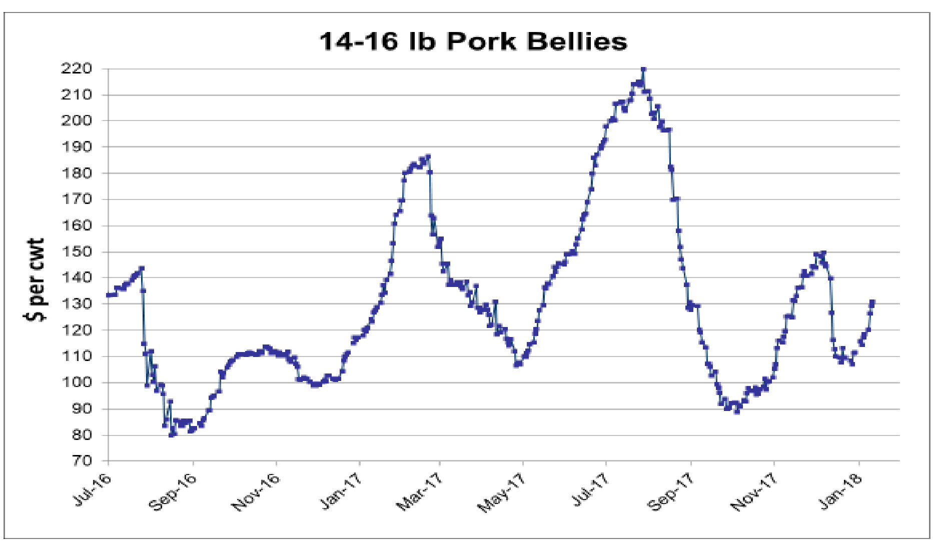
Surely there is some secret to be gleaned from this…. but what is it?

Change in Price from Second Week of January to Second Week of February

	Years Up (out of 15)	Years Down (out of 15)	Avg Price Change
Bn-in Loins	8	7	+2.8%
Pork Butts	8	7	+3.2%
Spareribs	10	5	+2.9%
23-27 lb Hams	9	6	+5.4%
Pork Bellies	11	3	+8.4%
42% Lean Trim	8	7	+2.3%
72% Lean Trim	8	7	+3.8%
Bnls Picnics	8	7	+0.6%
Pork Cutout Value	11	4	+4.4%

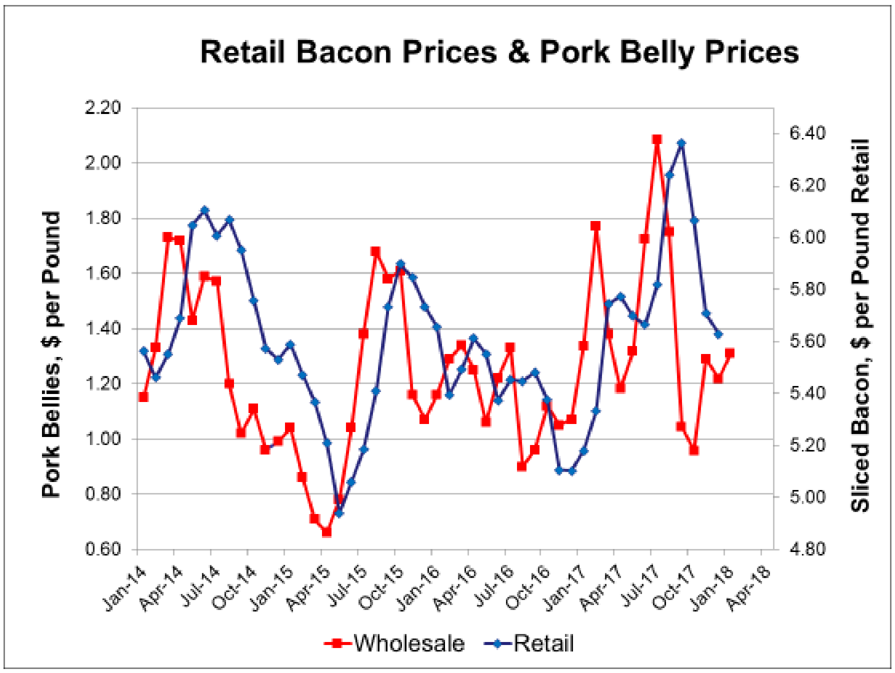
Historically, there has been a distinct, and broad-based, upward bias to the pork cutout value over the upcoming five-week period. Naturally, this has been driven mainly by the seasonal decline in hog slaughter. I cannot come up with a good reason why there would be an exception this time around. If slaughter unfolds in accordance with the summer pig crop estimate, then weekly totals will drop about 70,000 head from now until the February low—a somewhat smaller-than-average decline, but a significant decline nonetheless.

I am more curious about the demand side of the equation, and most curious about the bellies. I am just about convinced that the pork cutout value will not make a substantial move in either direction—not any time soon, anyway—unless the belly market tells it to.



Pork belly prices have gone up roughly 25¢ per pound since December 27. As my Shrink tells me on a regular basis, "this is not normal behavior". Our quest is to figure out how far prices have to go in order to dampen bacon demand from supermarket chains. Remember that since restaurant demand is practically constant in the short term, it is the supermarket sector that is the “swing factor”. I think it’s fair to say that the last time that demand hit such a ceiling was at the end of November, when belly prices reached the mid $1.40’s per pound. The market is rapidly approaching that same price level. And on that subject, I notice that within the last ten years, this market has most commonly appreciated about 10% between now and mid-February. That would carry prices just above $1.40.

And so, a $1.45-$1.50 market sometime in February would seem as good a guess as any of the next price peak. I notice that retail bacon prices fell 12% from September to December, and retail margins have narrowed considerably. In view of the strong rally in wholesale prices of late, the next move in retail prices is probably upward…. which would not be supportive of belly demand.



Currently, belly prices are about even with a year ago. It was about this time last year that they really started to escalate, when it became apparent that nothing had been put away in the freezer—in fact, there was a net drawdown of freezer stocks—during the fourth quarter. Could this have happened again? Anything is possible. But I find it hard to believe that bacon processors would permit such a shortage to develop again this summer. Considering that 3.7 million pounds were added to storage stocks during November; and that prices averaged about 7¢ per pound lower in December than in November; and that they recently spent four weeks at or below $1.20; I have to think that there was a decent accumulation during December—not much by historical standards, but enough to place them above 40 million pounds on January 1, compared with just 18 million a year earlier. My humble conclusion: the resistance at $1.50 will contain the belly market until the spring. That would make for only modest appreciation in the pork cutout value from this point.

Meat Markets Under a Microscope is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523, or visit our website at www.procurementstrategiesinc.com.