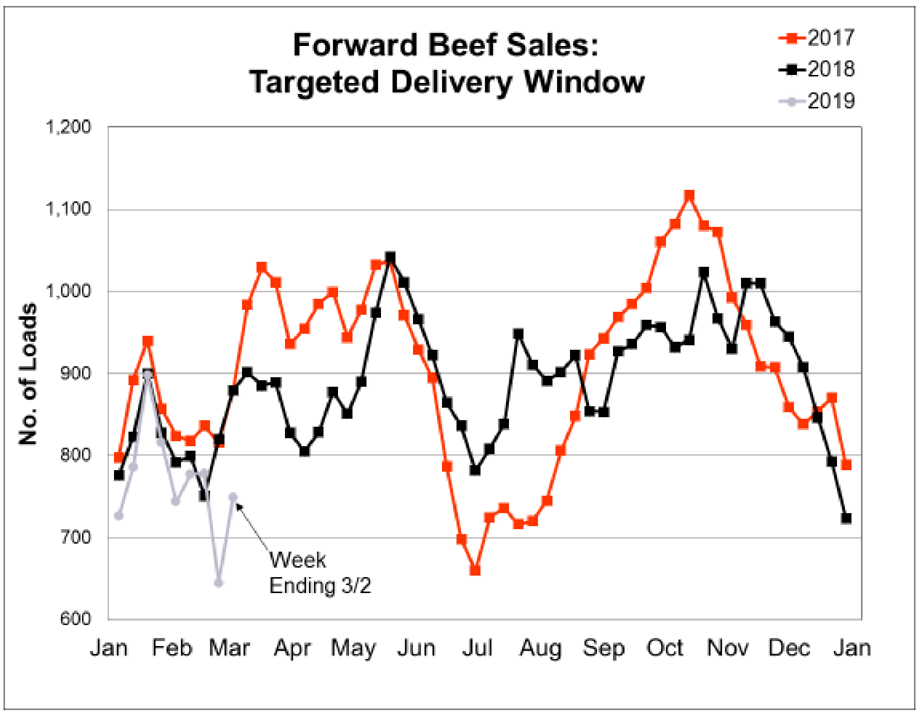
MEAT MARKETS
UNDER A MICROSCOPE

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

January 23, 2019

The prospects of a meaningful recovery in beef cutout values within the next month look pretty slim, based on the continued light volume of product that has been booked for February delivery. I'll begin, then, with a familiar chart:

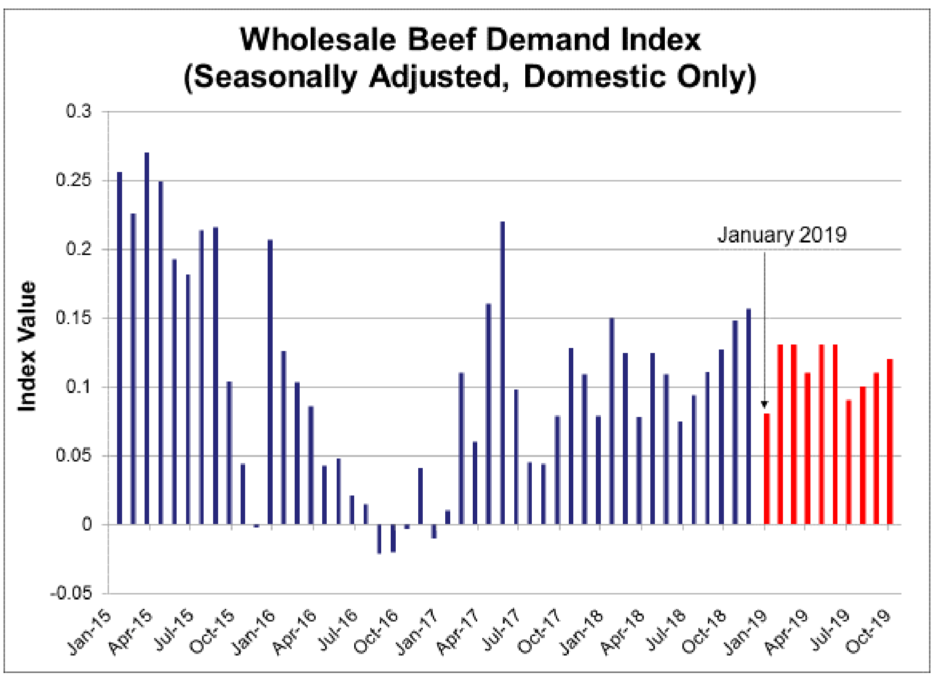


Considering that most of the larger supermarkets are operating six to eight weeks "out front", and given that today is the 22nd of January, advance purchases for February delivery are practically finished. The picture to the left shows that the amount of product lined up for delivery in the first half of February was….well, not terrible, but not very impressive; and the amount secured for the second half of the month was quite a bit smaller than each of the last two years. The picture is similar for other measurements, including that which is destined for export.

Thus, I perceive that the bounce that we're seeing right now is a reaction to production cutbacks and will be short-lived. There is one prominent exception, which is the 50% lean trim. Being meekly priced at $.62 per pound (vs. $.84 on this date a year ago and not far from an eleven-year low for the fourth week of January), and in view of the (presumably) steep drop in carcass weights, this particular market has some room to rally. But apart from a couple of odd items such as ball tips, it's difficult to name anything that else can be expected to move very far from current price levels. My expectation is that four weeks from now, the combined Choice/Select cutout value will be situated near $212 per cwt, $3.50 below yesterday's quote.

Last week I stated that a meaningful rally is likely to develop in March, and my opinion remains the same….but we're not seeing the seeds being planted just yet. The softness in spot prices will bring deferred asking prices down to the point where they attract some interest. Such is the nature of the short-term cyclical swings in demand at the wholesale level. Plus, I notice that in seven of the last nine years, there has been an increase in the combined cutout value averaging 7.1% from January to March. One would think that this pattern is more likely to be repeated this time around, since there has been virtually no January rally. A 7% increase this case would result in a March average of about $228 per cwt.

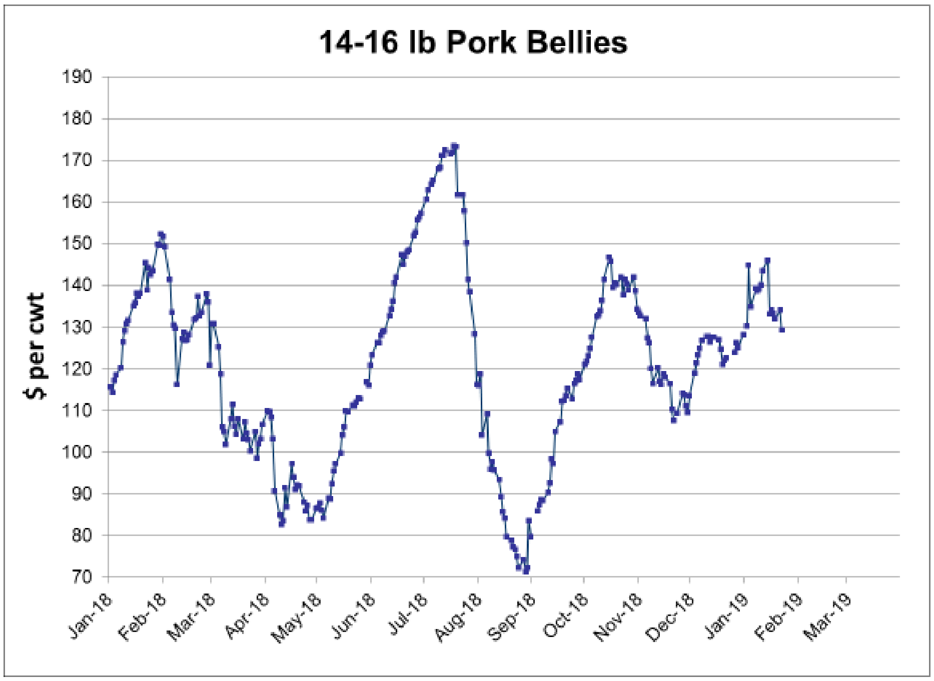
As long as we have the history books open, it worthwhile to take a look at other years in which cutout values have drooped similarly in the first three weeks of January. I like doing this kind of analysis, because it *is* worth knowing….and because it gives me a chance to put my brain on "idle" for a while. OK, so searching through the last 20 years I find only four such occurrences. I think it's safe to say that what the market has done since the holidays is unusual. All I found is that in two of those years (2017 and 2013), the slump continued through the third week of February; in the other two years (2012 and 2001), the market remained weak only through the first week in February before starting upward. In three of those years there was a decent rally into March ($11-14 from the low) and once—in 2017—there was a big rally of $33. In light of the forward booking statistics, I'm guessing that the softness in this year's market will persist beyond the first week of February.



My forecast of an average cutout value of $213.50 in February, as pessimistic as it may seem, actually assumes that there will be a substantial recovery in the seasonally adjusted demand index in February. I realize that this might appear to contradict everything I just said about beef demand in February. But I consider the steepness of the plunge in the index reading here in January; it gave back *all* of the preceding five months' worth of gains, and placed it near the bottom of the sideways range in which it has been since October 2017. [And it reminds us that the trend over the last 16 months has indeed been sideways, not upward as press reports would have us believe.] Also, the January-to-February increase in the demand index that I am proposing is quite a bit smaller than that which occurred last year. From this angle, the notion of a $213.50 average cutout value in February might even seem a bit generous.

The pork belly market held basically steady for a full week after its sudden, 13¢ per pound dive last Tuesday….indicating, I *thought*, that last week's slump was simply a one-off adjustment. But that notion seems to have been dashed by another $9.50 per cwt drop in the pork belly composite yesterday. What gives?

Out of ignorance and lack of credentials to the "Pork Belly Club", I have to look at the chart below and concede that $1.20 might be a reasonable target for this "correction".



However, as I pointed out last week, unless there is some deep-seated problem with bacon demand, it will probably require an average belly price of $1.30-$1.35 per pound to bring supply and demand into balance during February. That, by the way, would compare with a February 2018 average of $1.31. I am basing this assessment on the fact that the pork belly demand index equaled that of a year earlier in December; it is matching a year earlier here in January; and if it does the same in February (with weekly hog slaughter running near 2,450,000), then prices should center in the low $1.30's.

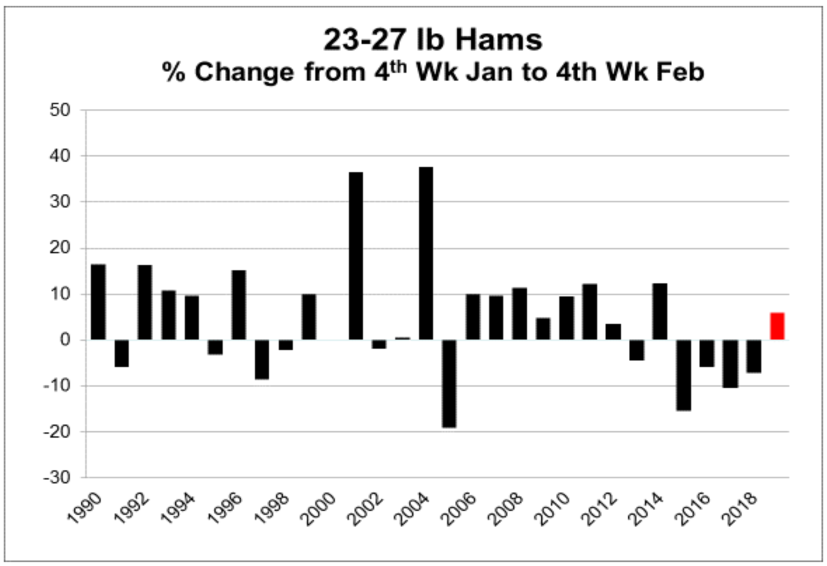
And so it is my guess that even if this market falls to $1.20 first, it will trade higher in February than it stands today.

Of course, we're operating in the dark regarding freezer stocks. I bring this up because when the government turns its machines back on, we could be in for a surprise—especially if the next *Cold Storage* report is not released for another month. It was originally scheduled for release today, and I have no idea what the plan may be. Remember, two years ago the January report (which was punctual) shocked the market by revealing a net drawdown in stocks during November and December, sending prices spiraling 50¢ per pound upward in the four weeks following the report. Currently I am assuming that stocks grew by ten million pounds in December, the same as in November; and that the January 1 inventory stood at 47 million pounds vs. 40 million a year ago.

My focus is on the belly market right now because it is the only thing that has kept the pork cutout value from moving higher over the past week.

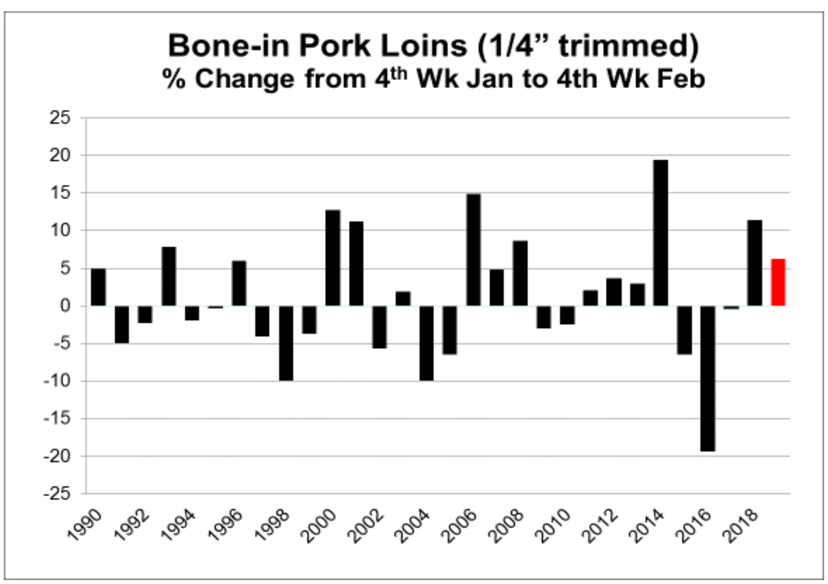
I can't think of a compelling reason why ham prices would not follow a seasonally normal path from now through the end of the Easter buying season. The influence of Mexican tariffs is keeping this market in a lower price tier (I mean, relative to where it would be trading in the absence of the tariff), but why would it affect the near-term price pattern within that lower tier?

Between the fourth week of January and the final week of February, the ham market clearly demonstrates an upward bias, although it is not overwhelming or highly consistent. In each of the last four years, in fact, ham prices have actually lost ground during this time frame. But it seems reasonable that cheap price levels—they are the lowest for this date since 2009 and 18¢ per pound below a year ago—would enhance the probability of *some* sort of appreciation this time around.



The picture to the left shows how a $.54-$.55 market at the end of February would look relative to the historical track record. It seems like a reasonable expectation.

The equivalent picture of bone-in pork loins is shown in the second graph. Bone-in loins are not quite as cheap as hams from an historical perspective; current prices are only slightly below a year ago. The red bar represents what a move from $.80 to $.85 per pound would look like.



If pork loins continue to get a lot of attention in supermarket features—and why would they not?—then this might be a conservative target. About the only thing that cautions me against betting on a sharper increase is the fact that in each of the last three years, this market has ended the month of February in the $.89-$.92 range….

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.